

HMS Group

Pump powerhouse

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- **Strengthening market leadership position:** HMS Group is the leading provider of flow control solutions to the Russian market and possesses a unique R&D base. The Group's assets include nearly all the major producers of pumps and R&D centres focused on flow solutions that existed in the former Soviet Union. It inherited and is enhancing the largest installed base of pumps in the Russian oil and gas, power generation and water utilities sectors. Utilising its strong balance sheet, HMS Group may pursue M&A opportunities to strengthen its market position. It also benefits from high regulatory barriers to international peers attempting to enter the Russian market – the legacy of Soviet-era isolation.
- **Going with the oil flow:** Russia has faced underinvestment in infrastructure since the early 1990s in the sectors that are currently considered core market segments for HMS Group (oil and gas, power generation and water utilities). With the oil price above \$100/bbl, the willingness of Russian oil companies to expand their exploration and development plans certainly increases, even though potential changes to the future tax regime remain the biggest driver, in our view. Transneft, a key customer of HMS Group, has a solid project pipeline (second phase of East Siberia-Pacific Ocean [ESPO] pipeline, Zapolyarnoe-Purpe and Purpe-Samotlor), largely oriented towards the booming hydrocarbon demand from Asia. The State Programme for Modernisation of Public Utilities 2020, with total capex of \$130bn, is driving demand in the water utilities sector. The main growth driver in the power generation sector is the Russian Energy Strategy till 2030 (Russian Energy Strategy), with estimated capex close to \$300bn.
- **We initiate coverage with a BUY rating and TP of \$12.0/GDR.** Our TP is the mean of the fair values from our DCF and FY11E EV/EBITDA valuations. We apply a 20% discount to the average 2011E EV/EBITDA multiple of HMS Group's international peers of 9.2x. Our DCF valuation targets the best-case scenario for HMS Group and assumes maximum state infrastructure spending, with no delays in major projects. The EV/EBITDA approach on a discount basis to the international peer group reflects the risks related to the actual size of state infrastructure spending and possible oil-price fluctuations, while it downplays country-specific risks.

Report date:

7 April 2011

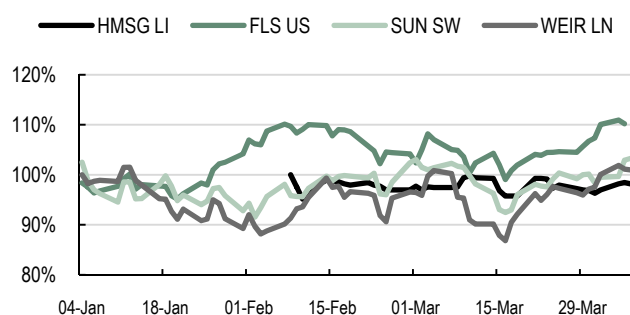
Rating, GDR	BUY
Target price (GDR), \$	12.0
Current price (GDR), \$	8.1
MktCap, \$mn	951
EV, \$mn	1,022
Bloomberg	HMSG LI Equity
ADRs/GDRs since	February 2010
Common shares outstanding, mn	117.2
Web:	www.hms.ru
Free float in \$mn	354
Major shareholder	Vladimir Lukyanenko
with shareholding	21%
Average daily traded volume in \$mn	1.4

Summary valuation and financials, RUBmn

	Revenue	EBITDA	EBITDA margin, %	Net income	Net income margin, %	EPS, RUB/share	DPS, RUB/share	Net debt	EV/sales	Net debt/EBITDA	EV/EBITDA	P/E	P/CE	RoIC/WACC
2009	14,772	1,643	11%	83	1%	-	-	4,518	-	2.7	-	-	-	0.1
2010E	21,949	2,524	11%	826	4%	8.1	3.1	2,730	-	1.1	-	-	-	1.1
2011E	31,214	5,573	18%	3,050	10%	26.0	3.4	2,098	1.0	0.4	5.5	9.4	3.5	4.1
2012E	35,975	5,574	15%	3,068	9%	26.2	3.4	153	0.8	0.0	5.1	9.2	3.0	3.3

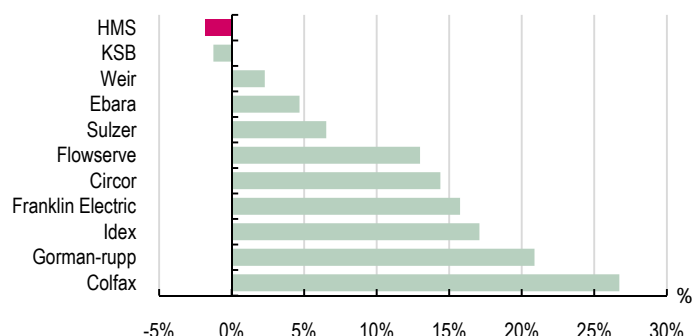
Source: Renaissance Capital estimates

Figure 1: Price performance since IPO



Source: Bloomberg

Figure 2: Sector stock performance – three months



Source: Bloomberg

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Financial summary

Figure 3: HMS financials and key data sheet

Price per share	\$8.1	Rating		BUY		Target price per share	\$12.0	WACC	12.7%		
Bloomberg ticker	HMSG LI	MktCap, \$mn		951		DCF per share	\$12.8	P/DCF	63%		
Dec-YE, \$mn	FY09	FY10E	FY11E	FY12E	FY13E	Revenue by market, RUBmn	FY09	FY10E	FY11E	FY12E	FY13E
Share price (average)	-	-	8.1	8.1	8.1						
MktCap (average)	-	-	951	951	951	Industrial pumps	6,318	8,053	7,643	15,651	17,468
Enterprise value (average)	-	-	1,022	956	883	Modular equipment	4,155	5,416	6,574	8,034	9,228
Income statement, RUBmn	FY09	FY10E	FY11E	FY12E	FY13E	EPC	4,189	4,717	5,507	7,187	9,867
Revenue	14,772	21,949	31,214	35,975	42,181	Other revenue	110	3,762	11,489	5,103	5,618
Cost of sales	(11,164)	(17,281)	(23,200)	(27,401)	(31,706)						
Gross profit	3,608	4,668	8,014	8,574	10,475	Ratio analysis	FY09	FY10E	FY11E	FY12E	FY13E
Gross margin	24.4%	21.3%	25.7%	23.8%	24.8%	Sales growth	5%	49%	42%	15%	17%
SG&A	(2,309)	(2,655)	(3,068)	(3,719)	(4,254)	Cost growth	4%	55%	34%	18%	16%
EBITDA*	1,643	2,524	5,573	5,574	7,016	EBITDA growth	13%	54%	121%	0%	26%
EBITDA margin*	11.1%	11.5%	17.9%	15.5%	16.6%	Earnings growth	-75%	894%	269%	1%	33%
D&A	(344)	(511)	(628)	(720)	(795)	Net debt/EBITDA	2.7	1.1	0.4	0.0	-0.3
EBIT	1,299	2,013	4,945	4,854	6,220	Net debt/equity	2.6	1.2	0.4	0.0	-0.2
NOPLAT	1,087	1,623	3,506	3,406	4,292	RoA	1%	5%	16%	16%	17%
Net interest expense	(807)	(702)	(342)	(195)	(52)	RoE	4%	42%	85%	48%	43%
Income from associates	17	0	0	0	0	Capital employed	6,602	7,241	8,071	9,565	11,768
Other expenses (net)	(215)	(95)	(113)	(143)	(154)	Invested capital	6,206	5,693	5,928	7,403	8,532
Exceptionals/write downs	0	0	0	0	0	RoCE	1%	11%	38%	32%	35%
PBT	295	1,216	4,490	4,516	6,015	RoIC	1%	15%	51%	41%	48%
Tax	(212)	(390)	(1,440)	(1,448)	(1,929)	RoIC/WACC	0.1	1.1	4.1	3.3	3.8
Effective rate	72%	32%	32%	32%	32%						
Net profit	83	826	3,050	3,068	4,086	Ratio analysis	FY09	FY10E	FY11E	FY12E	FY13E
Net margin	0.6%	3.8%	9.8%	8.5%	9.7%						
Shares out, mn	-	103	117	117	117	EV/sales	-	-	1.0	0.8	0.6
EPS, RUB/share	-	8.1	26.0	26.2	34.9	Sales growth	5%	49%	42%	15%	17%
DPS, RUB/share	-	3.12	3.41	3.41	3.41	Cost growth	4%	55%	34%	18%	16%
						EV/EBITDA	-	-	5.5	5.1	3.8
Cash flow, RUBmn	FY09	FY10E	FY11E	FY12E	FY13E	EBITDA growth	13%	54%	121%	0%	26%
CF from operations	(211)	4,999	1,952	3,629	3,822	EV/EBIT	-	-	6.2	5.9	4.3
OPFPS, RUB/share	-	-	16.7	31.0	32.6	PE	-	-	9.4	9.2	7.0
Capex	(212)	(819)	(1,049)	(1,124)	(1,191)	Earnings growth	-75%	894%	269%	1%	33%
Acquisitions	(240)	(2,060)	0	0	0	Dividend yield	-	-	1%	1%	1%
Free CF	(721)	2,121	903	2,345	2,631	P/OPCFPS	-	-	14.6	7.8	7.5
FCFPS, RUB/share	-	-	7.7	20.0	22.5	P/FCFPS	-	-	31.6	12.1	10.8
ST borrowings and financial lease	-	(954)	(894)	670	(714)	Free cash flow yield	-	-	3.2%	8.3%	9.2%
LT borrowings and financial lease	-	926	(4,013)	(1,532)	(372)	Net debt/EBITDA	2.7	1.1	0.4	0.0	-0.3
Dividends paid	-	(320)	(400)	(400)	(400)	Net debt/equity	2.6	1.2	0.4	0.0	-0.2
Equity issues (net)	-	-	3,438	0	0	RoA	1%	5%	16%	16%	17%
Other financing	0	0	0	0	0	RoE	4%	42%	85%	48%	43%
CF from financing	815	(348)	(1,869)	(1,262)	(1,486)	Capital employed (YE)	6,602	7,241	8,071	9,565	11,768
Net change in cash	95	1,773	(966)	1,083	1,145	Invested capital (YE)	6,530	4,855	7,000	7,805	9,259
Cash at YE	758	2,530	1,564	2,647	3,793	RoCE	1%	11%	38%	32%	35%
						RoIC	1%	15%	51%	41%	48%
Balance sheet, RUBmn	FY09	FY10E	FY11E	FY12E	FY13E	RoIC/WACC	0.1	1.1	4.1	3.3	3.8
Current assets	6,907	13,382	8,370	12,313	15,019	P/CE	-	-	3.5	3.0	2.4
Cash and investments	758	2,530	1,564	2,647	3,793	EV/IC	-	-	4.4	3.7	2.9
PP&E	3,955	5,705	6,124	6,764	7,158	Price/book	-	-	5.7	3.7	2.5
Non-current assets	4,904	8,462	8,883	10,006	10,402						
Total assets	11,811	21,844	17,254	22,319	25,421						
Current liabilities	5,696	12,888	6,222	9,588	9,376						
Non-current liabilities	3,740	4,886	4,172	2,647	2,274						
Net debt**	4,518	2,730	2,098	153	(2,078)						
Total liabilities	9,436	17,774	10,395	12,234	11,650						
Shareholders' equity	1,705	2,211	5,000	7,663	11,350						
Minorities	670	1,859	1,859	2,421	2,421						
Total liabilities and sh equity	11,811	21,844	17,254	22,319	25,421						

*EBITDA is calculated on common basis (EBITDA = gross profit - SG&A + D&A)

**Net debt = ST and LT borrowings - cash and cash equivalents

CE, IC, RoA, RoE, RoCE and RoIC calculated on an average basis

Source: Company data, Renaissance Capital estimates

Post-IPO developments

In our view, HMS Group has demonstrated high tolerance to recent negative macro and geopolitical developments across the globe, including escalating social unrest in the Middle East and North Africa and the natural disasters in Japan. We identify several major post-IPO developments and see the following catalysts for the stock.

- Despite the negative developments mentioned above, the oil price remains above \$100/bbl. The oil price is an essential driver for the stock, as HMS Group derives approximately 70-75% of its revenue from the oil sector. We note that Russian oil production is currently close to an all-time high, which is a positive driver for water-injection pump demand. In other words, HMS Group may benefit from a falling dollar and widespread expectations of high oil prices, in our view.
- On 19 March, Russian Prime Minister Vladimir Putin urged oil and gas companies to speed up the development of their East Siberian assets as part of Russia's reaction to the 11 March 2011 earthquake and tsunami in Japan. In response, Transneft announced that it plans to bring the second stage of the ESPO pipeline on stream by YE12 (a year earlier than originally anticipated).
- We are aware of discussions between Transneft and Russian oil majors (TNK-BP, Surgutneftegas and Rosneft) on joint financing for the construction of pipelines to link ESPO with East Siberian deposits. The oil companies may get lower tariffs to access the pipeline, and this approach may accelerate the development of East Siberian oilfields. The Russian government is in active discussions with the oil sector on possible tax-regime changes, which may boost the upstream segment. HMS Group is already involved in the construction of nitrogen-production facilities that are part of the second stage of development of the Vankor oilfield.
- In March, ChelPipe announced that it plans to increase LD-pipe production 35% YoY in FY11. Other local pipe producers are seeing growth in LD- and line-pipe orders from the oil sector. Russian steel majors have also noted increasing demand from pipe-making companies this year. In our view, this proves that Transneft's major projects, including ESPO, are on track. Thus, we expect sustainable demand for pumping equipment in the oil transportation segment. We doubt that Transneft will announce new tenders for ESPO pumping stations this year. However, any announcement – or even market speculation about such an announcement – could be a substantial catalyst for HMS Group, we think. Transneft has yet to sign contracts for 20 ESPO pumping stations (please see Figure 79, a map of the ESPO project, in the *Appendix*). We reiterate our view that HMS Group stands a good chance of obtaining a significant share of this contract pool. In addition, HMS Group's research and engineering subsidiary, Giprotymenneftegas (GTNG), which was consolidated in July 2010, is already involved in preparing pumping-equipment documentation for the Zapolyarnoye-Purpe trunk pipeline (Yamalo-Nenets-Krasnoyarsk Region).
- HMS derives more than 95% of its revenue from Russia, and we initially viewed this focus on the domestic market as one of the key risks for the Group. However, social unrest in the Middle East and North Africa may turn this into an advantage, as HMS's key international peers are exposed to geopolitical risks in unstable regions, while to many investors Russia looks like a safe haven among major commodities suppliers.

- China remains the second-largest oil importer in the world, with approximately 80% of its imports coming from the Middle East. China's Ministry of Industry and Information forecasts that the country will have over 200mn vehicles on the road by 2020. Hydrocarbon demand is growing in China and broader Southeast Asia, and ESPO may facilitate the redirection of up to one-third of Russian oil export volumes to Asia. In our view, geopolitical and oil-demand fundamentals create a favourable environment for HMS Group, and China appears to be a critical market for oil demand this decade.

Figure 4: China – Expected urbanisation developments through 2025

350mn	People will be added to China's urban population by 2025 – more than the population of the US today
1bn	People will live in China's cities by 2030
221	Chinese cities will have a population of 1mn or more; there are 35 cities of this size in Europe today
5bn	Square metres of road will be paved
170	Mass-transit systems could be built
40bn	Square metres of floor space will be built – in 5mn buildings
50,000	Of these buildings could be skyscrapers – the equivalent of constructing up to 10 cities the size of New York
5x	The number by which GDP will have multiplied by 2025

Source: McKinsey report

- The key investor concern currently is associated with the nuclear energy sector, from which HMS derives approximately 15% of its revenue. The Group supplies pumping equipment to Russia's state nuclear agency (Rosatom), which has a solid project pipeline in Russia and abroad (officially comprising 17 projects). The natural disasters in Japan have had a significant impact on the nuclear sector. The market's expectation is that many nuclear power projects will be delayed or cancelled. Despite material risks for the nuclear power industry, we think market concerns may be overdone at this stage. We also note that HMS Group's order backlog in the nuclear power sector includes pumping equipment kits for four domestic projects and only one of Rosatom's overseas projects. We provide two counterarguments in favour of the nuclear sector:
 - Growing energy demand in developing nations.** China has only 13 nuclear reactors, all located on the coast of its most-developed and heavily populated regions, with 28 more under construction. In China, about 80% of electricity is generated from coal, vs only 3-4% from nuclear power. In absolute terms, China would have to build three plants every year for the next 16 years to meet energy demand. Nuclear capacity is expected to quadruple from 10.8 GW currently to around 40 GW by 2015. Taking into account the current economic growth rate, development of the nuclear power sector may be essential for securing an adequate supply of energy. India already faces a transport bottleneck for thermal coal imports, and is also developing its nuclear power sector.
 - Contract termination penalties.** Rosatom currently has 17 overseas projects involving the construction of nuclear power facilities. Its contracts traditionally include significant penalties for cancellation. Turkey has recently confirmed its plans to continue

cooperating with Rosatom, and the Belene project in Bulgaria is still on track.

- Demand for water utilities pumping equipment is sustainable, in our view. It may be well supported by increased government spending prior to next-year's Russian presidential election, coupled with a Brent price above \$110/bbl. Russia's 2011 budget assumes an average FY11 oil price of \$75/bbl. The government faces pressure to increase social spending and to accelerate the construction of key infrastructure projects for the APEC Summit 2012, the 2014 Winter Olympics in Sochi, and the FIFA World Cup in 2018. Water supply solutions are an integral part of all these projects.
- HMS Group may issue FY10 IFRS results at the end of April. We maintain our demand-supply expectations and financial forecasts. By our estimates, FY10 results may come in line with initial expectations during the IPO or beat the estimates. The Group will also provide an update on the order backlog as at 31 December 2011, which may include new projects in the oil and nuclear power segments. Although the effects on society of the disaster in Japan and unrest in the Middle East will undoubtedly be felt for years to come, markets are of course more resilient than people, and investors may look for names that are apparently immune to the negative consequences of these developments.

Investment summary

HMS Group is the leading provider of flow control solutions in the Russian market. Sales are primarily derived from the oil and gas, power and water utilities sectors. The Group operates through three complementary business units – industrial pumps; modular equipment; and engineering, procurement and construction (EPC). The customer base of HMS Group includes major players in the above-mentioned sectors in Russia, including Transneft, Rosneft, LUKOIL, TNK-BP, Rosatom, InterRAO and Mosvodokanal (Moscow's water utility). HMS Group has a solid track record of supplying flow control solutions and services to the CIS (Turkmenistan, Kazakhstan and Tajikistan) and frontier markets (Iraq). The Group has unique R&D and testing facilities in its asset portfolio. According to Frost & Sullivan, the market share of HMS Group's pumps in core segments in Russia amounted to 41% (by revenue) in 2009.

Unique R&D base secures leadership at the beginning of the contract life cycle

HMS Group has the strongest R&D base in Russia and the CIS, including five in-house R&D facilities. Its customised flow solutions and products for major customers, such as Transneft, meet special technical requirements. These requirements are worked out during the pre-tender project preparation stage, which takes up to 24 months. It is worth highlighting that HMS Group traditionally generates product specification and pre-tender project documentation for its major customers, gaining unique market leadership at the start of the contract life cycle. The standards for pumping equipment developed by HMS Group are accepted and adopted by Russian technical supervisory authorities.

- The Group's unique testing facilities are integral to its R&D programme. The testing facilities at the Sumy production site in Ukraine enable HMS Group to test pumps of up to 8 MW in power, with potential enhancement to 14 MW in the near future. These facilities can test the pumping station equipment supplied to Transneft for ESPO.
- HMS Group has replicated its R&D competitive advantage in oil and gas EPC through the acquisition of GTNG in July 2010. Established in 1964, GTNG is the leading R&D facility for oil and gas upstream projects in Russia. The largest Russian oil producers historically outsource all technically complex solutions to GTNG. Thus, HMS Group can get access to project details through GTNG before entering a tender for EPC work. Frost & Sullivan estimates Russia's total oil industry capex at RUB1.55trn (approximately \$50bn) for FY11, with potential growth to \$83bn in FY15E.

In our view, the R&D base secures an essential competitive advantage for HMS Group and enables it to build strong relationships with key customers; we see it as the basis for organic growth. The lack of an R&D base prevents HMS Group's local competitors from creating new pumps and customised solutions, forcing them to rely on outdated technology.

Integrated solutions for major customers

HMS Group is focused on providing integrated solutions to its major customers. The diversified R&D, production and service base enables the Group to offer sophisticated, specialised flow solutions to the market and move into higher-end segments. HMS Group's key customers are looking for suppliers that can provide integrated solutions matching precise specifications and arrange for the timely delivery and installation of equipment. The ability to offer high-quality after-market services also plays a more and more important role in the tender process. It is worth mentioning that foreign competitors taking a shot at entering the flow solutions market in the Russian oil and gas sector face serious difficulties, particularly in the delivery and installation stages of projects. In contrast, HMS Group has the ability to move construction workers and technical specialists on site in a timely manner, despite the remote location of customers' projects – for example, in Eastern Siberia. The development of the EPC unit is an essential step for HMS Group towards gaining absolute leadership in the integrated solutions market, in our view.

Customised products command higher prices and make sales less vulnerable to competition from companies offering standardised equipment, which competes primarily on price. For instance, HMS Group has concluded a number of contracts with Transneft for the construction and delivery of oil-trunk pumping units and spare parts for the oil pipelines Purpe-Samotlor and ESPO. The total budgeted revenue for these contracts as of 30 September 2010 exceeded RUB12bn. According to IFRS audited accounts, for the nine months ended 30 September 2010, HMS Group recognised revenue in respect of these contracts of RUB2.35bn. This amount was included as part of revenue from construction contracts. As of 30 September 2010, payables due to customers (i.e. Transneft prepayment) included the amount of RUB7bn and advances paid to suppliers and subcontractors by HMS Group included the amount of RUB3.2bn related to Transneft contracts. HMS Group remains the preferred supplier of pumping stations for Transneft and may obtain a contract for another 20 pumping stations for the ESPO project, which are necessary to enhance its capacity to 80mn tpa of oil.

We see very limited competition in the Russian integrated solutions segment from foreign players. While alternative suppliers of flow control solutions are acceptable to Russian customers, HMS Group-designed integrated solutions are preferred, we believe. In addition, HMS Group's products and solutions conform to the requirements of Rostekhnadzor (Russia's technical supervisory authority) and the internal regulations and specifications of Russian clients. However, major customers closely monitor the products and solutions of foreign competitors for the purpose of price control over HMS Group.

Inheriting and enhancing the largest installed base of pumps in the post-Soviet space

HMS Group currently benefits from an extensive installed base of pumps in core segments, which require repair, maintenance and upgrades. We note that the current HMS Group asset portfolio is based on the CIS value chain and largely replicates the structure of the flow solutions sector in the former Soviet Union: HMS Group includes nearly all the major producers of pumps and R&D centres focused on flow control solutions that existed in the Soviet Union. Therefore, around 98% of Transneft's trunk oil pipeline pumps were supplied by HMS Group entities. The

installed base also includes over 80% of water-injection pumps currently used by Russian oil and gas companies and 20% of the pumps used in nuclear power stations, including 70% of boiler feed pumps.

After-market business has proven to be resilient for HMS Group. Transneft, Rosneft and other major players in the sector are looking to outsource their service and maintenance, and HMS Group is a preferred provider in this market niche. Appropriate equipment maintenance, particularly for greenfield projects and upgrades, enable customers to avoid accidents and raise the efficiency of their operations, reducing energy consumption. Another competitive advantage of HMS Group is that the Group produces spare parts for after-market service.

Exposure to the after-market services segment gives HMS Group opportunities to cross-sell new products and solutions to its customers. Basically, HMS Group benefits from a continuous cycle in its core segments. The Group provides customised upgrades and new equipment solutions to major customers, which secure HMS Group's market share in future reconstruction, modernisation and replacement capex. HMS Group also benefits from the same approach outside of Russia: the Group completed nearly 100 contracts under the Oil-for-Food programme (established by the United Nations) in Iraq and is currently cooperating with BP on upgrading and maintaining oil-pumping equipment in Iraq installed during the Soviet era.

HMS Group's sales were largely focused on replacement and maintenance before 2009-2010E. Now the Group is getting more orders for new development projects, which are typically more profitable due to the utilisation of integrated solutions. Infrastructure capex will be critical for HMS Group.

Strong infrastructure spending should continue in Russia

Russia has faced structural underinvestment in infrastructure since the early 1990s in all the sectors that are core market segments for HMS Group:

- **Oil and gas:** We believe global oil demand is growing again, with the new demand coming from emerging market economies – including China and India, but also economies across Latin America and the Middle East. Russia has the eighth-largest oil reserves worldwide and is the world's second-largest oil exporter. In our view, exploration and production, refining and oil transport capex in Russia will continue to rise, driven by upgrades of aged infrastructure and the construction of new infrastructure. Prior to the ESPO-1 project, only two relatively small oil pipelines were built over the past 15 years in Russia. We currently identify a number of key oil pipeline projects on the agenda, including the ESPO-1 capacity expansion, ESPO-2, BPS-2 capacity expansion, Zapolyarnoe-Purpe and Purpe-Samotlor. The largest oilfield development projects in Western and Eastern Siberia include Vankor (Rosneft), Priobskoye (Rosneft), Talkanskoye (Surgutneftegas) and Samotlor (TNK BP). The Russian Ministry of Energy forecasts that approximately RUB1.4trn (\$45bn) will be required to modernise the oil-refining sector in the medium term while, taking into account the construction of new capacity, the total investment may amount to RUB2-2.5trn. The key driver behind the upgrade of the oil-refining sector is switching to Euro-4/Euro-5 standard gasoline. Currently HMS Group only

has the technology for cold cycles in the oil-refining segment. Management confirmed that the Group may pursue M&A opportunities to add flow solutions for hot cycles to the product portfolio.

- **Power generation:** Investments in Russia's thermal power generation are driven by the necessity of upgrading aged infrastructure and building new infrastructure, as well as clean power trends. The main growth driver is the Russian Energy Strategy, with estimated capex of close to \$300bn by 2030. The key players in the utilities sector are required to maintain a certain level of capex in power assets, and 121 thermal power stations are currently under reconstruction. Frost & Sullivan forecasts a 2009-2014 CAGR of 28.3% (by revenue) for pumps used for thermal power generation. As for nuclear power generation, the market until recently demonstrated positive dynamics, with Russia and China expected to lead in nuclear power demand in the future. Over the past 15 years, Rosatom has built only one nuclear power station in Russia and three outside Russia. HMS Group is currently producing four kits for nuclear power stations simultaneously. Rosatom has signed state international agreements and MoUs for the construction of 17 nuclear power units outside of Russia (in Slovakia, Bulgaria, India, China, Turkey, Ukraine, Belarus, Armenia and Vietnam).
- **Water utilities and infrastructure:** Russia's water utilities sector has suffered from underinvestment, like other sectors. Upgrading aged infrastructure and building new facilities looks absolutely necessary, and the demand for cleaner water and better handling of runoff is growing. The key driver for flow solutions in the water utilities sectors is the *State Programme for Modernisation of the Public Utilities Sector 2020*, with total capex of RUB4trn (\$130bn). This programme is a top priority for the Russian government, as the respective wear factors for sewage and water pumping stations were 57% and 65% as of 4Q08, according to Mosvodokanal estimates. It is worth mentioning that any significant water utilities accidents in major cities could lead to social instability. The submersible water pumps produced by HMS Group should also benefit from regional 'Clean Water' programmes.

HMS Group's investment case strongly relies on a recovery in infrastructure spending in Russia. Taking into account the historical underinvestment in infrastructure and the visible commitment of the Russian government to rectifying this, we think HMS Group provides well-balanced exposure to the expected upswing in Russia's infrastructure spending over the next 10-15 years. In general, infrastructure projects generate long-cycle business.

High entry barriers to the Russian market

As part of the Soviet Union, Russia was isolated from most of the world for more than 70 years, particularly in the areas of science and technology. While Russia's flow solutions providers, such as HMS Group, did not lag very substantially behind international peers, this situation did create substantial entry barriers for foreign peers and advantages for HMS Group as a local player:

- The standards for pumping equipment development used by local customers must conform to the requirements of Russian technical supervisory authorities and customers' internal regulations. The client-end

technical specifications and project documentation must also be formulated and prepared in accordance with the Russian technical supervisory authorities' requirements. The foreign peers of HMS Group do not have licences for project design in Russia.

- In the nuclear sector, the presence of foreign flow solutions suppliers is even more limited due to the additional technology and documentation requirements of Rosatom.
- In the water utilities sector, the price of imported industrial pumps can be significantly higher than the price of local products. Mosvodokanal (Moscow's water utility) is able to buy more expensive equipment from foreign suppliers, as it is quite rich by the standards of the sector, but the regional utilities cannot afford more expensive foreign products. Even Mosvodokanal still purchases domestically produced pumping equipment. The price difference can be 4-5x for some product groups.
- Delays in supplying spare parts, compatibility issues, greater distance from clients and language barriers reduce the after-market capabilities of foreign peers operating in Russia. The level of after-market service is a critical element, particularly in the case of integrated solutions.
- HMS Group's relationships with number of key customers have existed for over 40 years.
- In general, we have to recognise that it is easier for HMS Group to enter foreign markets than for its foreign peers to enter the Russian/CIS market. There are no global unified engineering standards in overseas markets similar to the Russian/CIS standards.

Primary risks

We identify three major risks to HMS Group's investment case: 1) the price of oil; 2) raw materials inflation, particularly in ferrous metals; and 3) possible delays in major Russian infrastructure projects. We partially attribute HMS Group's strong performance in 2010E to high international oil prices (\$80-90/bbl) and the market's expectation that the oil price in FY11-FY12 will be at the \$100-120/bbl level. The massive investments in oil exploration and production and oil transport infrastructure, particularly in Eastern Siberia, are driven by positive oil price dynamics and growing hydrocarbon demand in the Asia-Pacific region. A prolonged decline in the oil price could hurt HMS Group's order book, as most energy projects in Russia are based on an international oil price of \$60-70/bbl.

We have to accept that export sales of hydrocarbons remain the key source of cash flow for Russia's budget. Russia's 2011 budget is based on an average oil price of \$75/bbl, which is close to the World Bank's forecast but reflects a quite limited financial safety cushion under an adverse economic scenario. If the oil price falls significantly below this level, the Russian government may scale back major infrastructure projects. Thus, the potential delay in major infrastructure and in programmes and projects fully or partially financed by the state poses risks for pump producers.

Raw materials, components and sub-assembly purchases, which together account for roughly 55% of the cost of sales, are HMS Group's largest expenses, as they are for most manufacturing companies. Ferrous metals make a major contribution to

these expenses. Domestic steel prices are linked to dollar-denominated international benchmarks. We currently observe growing concern that the accommodative monetary policy in the US may result in rising prices for basic raw materials (iron ore, coking coal and scrap). In turn, the rising cost curve in the steel sector may push steel prices higher and result in accelerating inflation for steel and other materials. A partially mitigating factor that could shorten the duration of this risk is that the average cycle in the ferrous and carbon sector has shrunk to three-to-six months, and steel prices change direction with approximately this frequency.

An additional risk is that HMS Group relies on a limited number of key customers in the oil sector. The Group's business largely depends on the award and renewal of contracts.

Valuation

Our valuation methodology includes two approaches: the classic DCF valuation method and a multiples analysis, which we view as more appropriate. We initiate coverage of HMS Group with **BUY** rating and TP of \$12.0/GDR, which implies 48% upside potential. Our TP is the mean of the fair values from our DCF and FY11E EV/EBITDA valuations. We used the average 2011E EV/EBITDA multiple of HMS Group's international peers of 9.2x, applying a 20% discount. Our DCF valuation targets the best-case scenario for HMS Group and assumes maximum state infrastructure spending, with no delays in major projects. Our EV/EBITDA approach on a discount basis to the international group reflects the risks related to the actual size of state infrastructure spending and possible oil-price fluctuations, and it somewhat downplays country-specific risks.

Figure 5: Weighted DCF and multiple method valuation

		Value	Weighting
DCF	12.7%	\$12.8	50%
EV EBITDA (x)	9.2	\$11.2	50%
PE (x)			0%
		Target	12.0

Source: Renaissance Capital estimates

We use a conservative bias in valuing HMS Group for the following reasons:

- HMS Group's business focuses on the Russian market (approximately 95% of consolidated sales revenue). Thus, the Group is exposed to the specific country/sovereign risks of Russia. The businesses of HMS Group's major international peers are geographically diversified.
- In our view, HMS Group's financial results may be volatile due to its diversified and sophisticated business model, multi-stage tender/contract processes, the unequal margins derived from different sectors and the uncertain sustainability of the backlog over the long term.
- In our view, HMS Group's upside potential in FY11E EBITDA is largely driven by the large contract with Transneft. The sustainability of cash flow generation and margins in the coming year will largely depend on the relations of HMS Group with two or three major customers, including Transneft, Rosneft and Rosatom.
- We have used a WACC of 12.68%, based on the current pre-tax cost of debt, which is 9.95%, and a cost of equity of 13.55%. We also applied a levered beta of 1.15x and terminal growth rate of 3%.

Please see our WACC calculation and DCF valuation estimates below:

Figure 6: Discount rate calculation

CAPM calculation	
RFR	3.52%
Levered beta for HMS	1.15x
ERP	5.00%
Country risk	1.87%
Size premium	0.50%
Currency risk	1.92%
Alfa factor	0.00%
CAPM	13.55%
WACC calculation	
CAPM	13.55%
Cost of debt (CoD)	9.95%
D / (D + E)	15.65%
E / (D + E)	84.35%
Income tax rate	20.00%
WACC (RUB/nominal)	12.68%

Source: Renaissance Capital estimates

We have used the following macro assumptions in our DCF model:

Figure 7: Macro assumptions

		2010E	2011E	2012E	2013E	2014E
FX rate (annual average)	(RUB/\$)	30.2	30.0	29.8	30.0	29.6
FX rate (EoP)	(RUB/\$)	30.2	29.8	29.9	30.2	29.9
CPI (annual average)	(%)	7%	8%	7%	7%	6%
PPI (annual average)	(%)	15%	11%	8%	7%	7%
Ferrous material prices growth	(%)	36%	9%	4%	4%	4%
Nonferrous metal prices growth	(%)	19%	5%	4%	5%	5%
Rail cargo transport tariff growth	(%)	16%	7%	5%	4%	4%
Electricity/heat tariff growth, %	(%)	20%	18%	11%	10%	10%
Real average wage growth (YoY)	(%)	1%	6%	3%	6%	8%

Source: Renaissance Capital estimates

Figure 8: HMS DCF valuation, RUBmn

	2011E	2012E	2013E	2014E	2015E
EBIT	4,945	4,854	6,220	7,482	8,651
Less taxation	(1,586)	(1,557)	(1,995)	(2,399)	(2,774)
Tax adjusted EBIT	3,360	3,298	4,226	5,083	5,877
Depreciation	628	720	795	872	945
Less capex	(1,049)	(1,284)	(1,191)	(1,242)	(1,284)
Change in working capital	(1,726)	(165)	(1,059)	648	(223)
Unleveraged free cash flow	1,212	2,569	2,771	5,361	5,315
WACC	12.7%				
Discounted cash flow	1,142	2,148	2,056	3,530	3,107
Future cash flow growth rate	3%				
Discounted terminal value	36,270				
PV of 2015E enterprise value	48,253				
Net debt + minorities 2011E	(3,449)				
Fair market capitalisation	44,803				
Number of shares, mn	117				
Fair value, \$	12.8				
Current share price, \$	8.1				
Upside/downside to fair value	58%				

Source: Renaissance Capital estimates

Figure 9 presents HMS Group's international peers. We identify Flowserve and Sulzer as the closest international peers of HMS Group in the flow solutions sector.

- Flowserve, headquartered in the US, sells pumps and integrated flow solutions used for infrastructure projects in the oil and gas, chemicals, power generation and water utilities sectors. In FY09, Flowserve derived

36% of its sales revenue from the oil and gas sector; 20% from power generation, including the nuclear power sector; and 7% from water utilities. Thus, Flowserve's product range and sales revenue breakdown have many features in common with HMS Group's business model. One-third of Flowserve's sales are made in the US and the rest in emerging markets, including China, India and the Middle East.

- Swiss manufacturer Sulzer has been traditionally considered the closest peer of Flowserve in the flow solutions sector. Sulzer is more focused on developed markets, deriving 35% and 31% of consolidated sales revenue from the US and the EU, respectively. In 2009, Sulzer generated 48% of revenue in oil and gas sector and 19% in power generation. In addition, Sulzer supplies integrated solutions for oil product transport, similar to those provided by HMS Group. Sulzer supplied seven pumping stations (28 units) for the ESPO-1 project before Transneft decided to switch to HMS Group as its primary supplier for this equipment. We consider Sulzer to be the closest rival of HMS Group in the EU.

KSB, a diversified flow solutions producer, has more than 30 manufacturing sites and 120 service centres around the world and is not a close peer of HMS Group. The only segment in which the companies have comparable positions is water utilities. KSB's business does not include such high-margin segments as flow solutions for oil and gas and nuclear power generation. KSB's discount to the peer group may be explained by the fact that only the company's preferred shares are traded. Weir Group, another well-known producer of pumping equipment, is also far from being a close peer of HMS Group. Weir's key unit is Weir Minerals, which delivers flow solutions for mining, transport, milling, processing and waste management. This segment generated 59% of Weir's FY09 revenue. In our view, the equipment replacement cycle and many features of flow solutions systems in the mining segment are very different from the oil and gas and power generation sectors.

Figure 9: Global flow control solutions benchmarks

	Ticker	Price, \$	MktCap, \$mn	EV/sales		EV/EBITDA		P/E	
				FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Russia									
HMS Group		8.12	951	1.0x	0.8x	5.5x	5.1x	9.4x	9.2x
Russia weighted average									
International peers									
Flowserve	FLS US Equity	132.2	7,367	1.7x	1.5x	10.0x	8.1x	16.5x	14.1x
Sulzer	SUN SW Equity	156.3	5,356	1.2x	1.1x	8.0x	6.9x	16.9x	14.9x
Weir	WEIR LN Equity	29.3	6,194	2.1x	1.9x	10.1x	9.0x	16.2x	14.7x
Colfax	CFX US Equity	23.2	1,009	1.7x	1.4x	10.4x	8.6x	19.8x	16.3x
Gorman-rupp	GRC US Equity	39.5	663	1.8x	1.7x	10.9x	9.8x	22.6x	19.8x
Ebara	6361 JP Equity	5.0	2,283	0.7x	0.6x	6.4x	5.9x	15.3x	12.2x
KSB	KSB GR Equity	895.8	1,538	0.4x	0.4x	3.7x	3.1x	11.0x	9.3x
Franklin Electric	FELE US Equity	47.3	1,100	1.5x	1.4x	10.5x	10.5x	20.2x	17.2x
Idex	IEX US Equity	45.2	3,723	2.3x	2.1x	10.6x	9.3x	19.2x	16.5x
Circor	CIR US Equity	46.9	806	0.9x	0.9x	9.0x	7.5x	17.6x	13.7x
International weighted average				1.6x	1.4x	9.2x	8.0x	16.9x	14.6x

Source: Renaissance Capital estimates

We apply a 20% discount to the average FY11E EV/EBITDA multiple of HMS Group's international peers to derive our TP. Below we present a sensitivity analysis of the Group's FY11E EV/EBITDA valuation.

Figure 10: HMS Group – EV/EBITDA-based equity valuation (FY11E)

Adjusted net debt FY11E (\$mn)		\$56	\$63	\$70	\$77	\$84
		-20%	-10%	Base	10%	20%
FY11E EBITDA (\$mn)		\$149	\$167	\$186	\$204	\$223
EV/EBITDA	6	\$7.1	\$8.0	\$8.9	\$9.8	\$10.7
	7	\$8.4	\$9.4	\$10.5	\$11.5	\$12.6
	8	\$9.7	\$10.9	\$12.1	\$13.3	\$14.5
	9	\$10.9	\$12.3	\$13.7	\$15.0	\$16.4
	10	\$12.2	\$13.7	\$15.3	\$16.8	\$18.3

*EBITDA is calculated on common basis (EBITDA = Gross Profit - SG&A + D&A)

Source: Renaissance Capital estimates

Sector overview

Oil and gas

Pumps produced by HMS Group are used in three key segments of the oil sector: pipeline transportation, water injection and refining operations. We expect significant growth in spending in all these segments, mainly for the following reasons:

1. **Rising crude output.** As Figure 11 suggests, Russian oil output has increased over 50% during the past decade, yet the throughput capacity of Transneft has been practically flat. This has led to rising concern that emerging bottlenecks in Transneft's pipeline system could hamper the development of new hydrocarbon reserves in the future.

Figure 11: Russian crude output and pipeline capacity, 2000-2010E

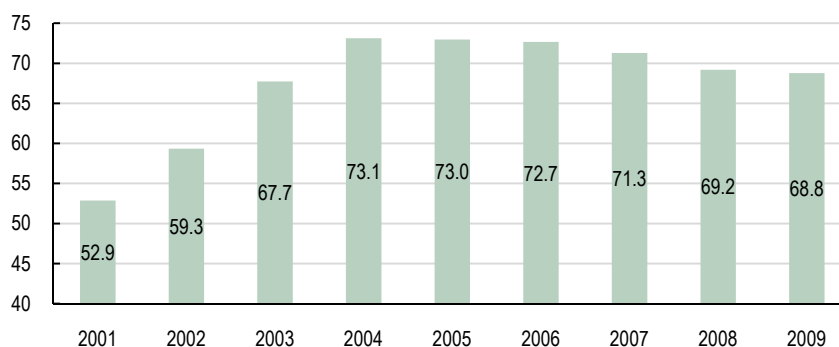
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2000-10E CAGR
Russian crude output, mn tpa	323.2	348.1	379.6	421.3	458.8	470.0	480.5	491.5	488.5	494.2	504.2	4.5%
Pipeline transit, mn tpa	12.1	16.3	18.7	19.8	21.5	23.9	24.1	22.2	22.7	25.4	25.4	7.7%
Load, mn tpa	313	342	373	415	447	452	458	464	457	457	463	4.0%
Russian refineries	161	169	187	207	209	199	203	210	217	216.2	n/a	n/a
FSU refineries	19	27	35	39	41	36	35	34	32	31.8	n/a	n/a
Non-FSU	133	145	151	169	196	213	217	216	206	205.4	n/a	n/a
CPC						4	4	4	2	4	5	n/a
Pipeline length, km	47,900	48,600	48,800	48,052	48,208	47,978	47,866	47,528	48,529	52,973	56,473	1.7%

Source: InfoTEK, Transneft, Renaissance Capital estimates

Part of the solution has been the development of alternative export routes that bypass Transneft, but the core solution lies in Transneft's new pipeline project (ESPO).

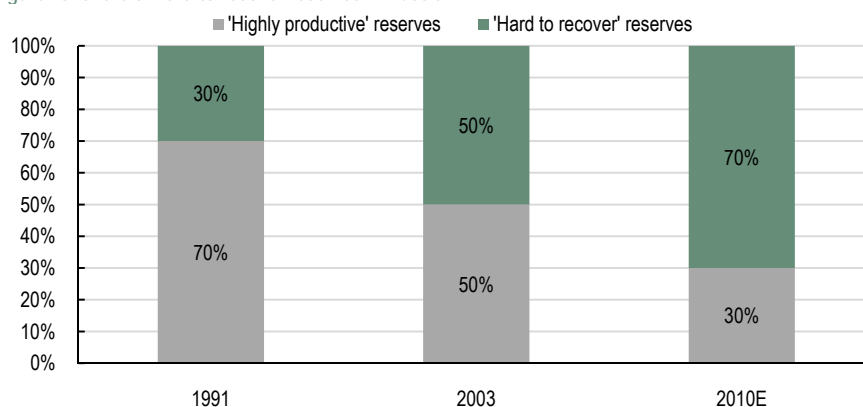
2. **Transneft's obsolete infrastructure, the result of underinvestment during the past two decades.** Most of the pipelines operated by Transneft today are a legacy of the system constructed in the USSR, with no new pipelines having been built over 1993-1999. Based on our estimate of the depreciated replacement cost of Transneft's assets of \$69.1bn as of FY09, and an average useful life of 25 years, just the maintenance annual capex of Transneft should be around \$2.8bn. However, actual maintenance capex averaged only about \$400mn during the past 10 years, on our estimates.
3. **Need to avoid transit states and need for geographical diversification.** Disputes over export prices and transit tariffs with Ukraine and Belarus over the past several years have highlighted the fragility of the Russian export system. The Russian government made a decision to create direct export routes bypassing transit countries in the early 2000s. In addition, tapping the growing Chinese market through direct shipments should not only diversify the export supply, according to the Russian government, but also indirectly improve netbacks for domestic oil producers, we believe.
4. **Depletion of core fields, falling well productivity and the growing complexity of new fields.** Despite encouraging production statistics, core oil fields in Western Siberia are rapidly maturing, leading to more active use of enhanced recovery methods and other techniques aimed at slowing flow-rate declines and increasing recovery factors. According to IHS CERA, the share of hard-to-recover reserves in Russia has increased to about 70% in 2010 from 30% in 1990 (see Figure 13). New fields often require fracturing operations from the beginning due to their low porosity and permeability, or other techniques to achieve economical flow rates.

Figure 12: Average well productivity in Russia, 2001-2009 (bpd)



Source: InfoTEK, Renaissance Capital analysis

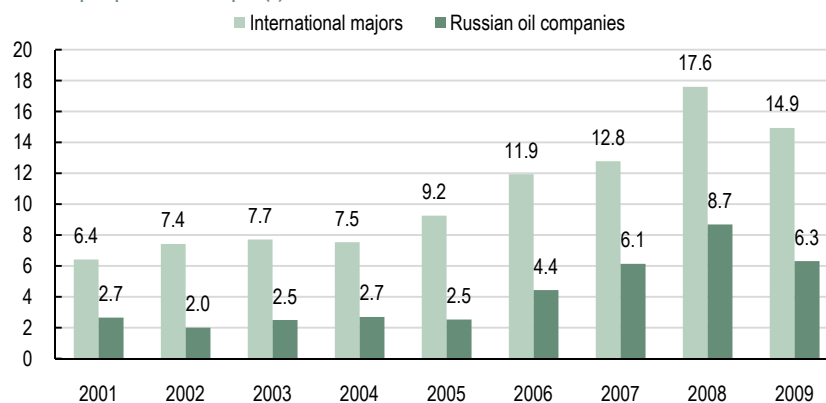
Figure 13: Share of hard-to-recover reserves in Russia



Source: IHS CERA, CATOIL

Falling productivity, combined with the rising share of hard-to-recover reserves, has led to growing capex per barrel of output. According to our analysis, Russian oil companies more than doubled their upstream capex spending per barrel of output from \$2.7/boe in 2001 to \$6.3/boe in 2009. This increase is in line with international majors, who raised their spending over 130% during the same period, reflecting cost inflation and the greater complexity of new fields.

Figure 14: Capex per boe of output (\$)

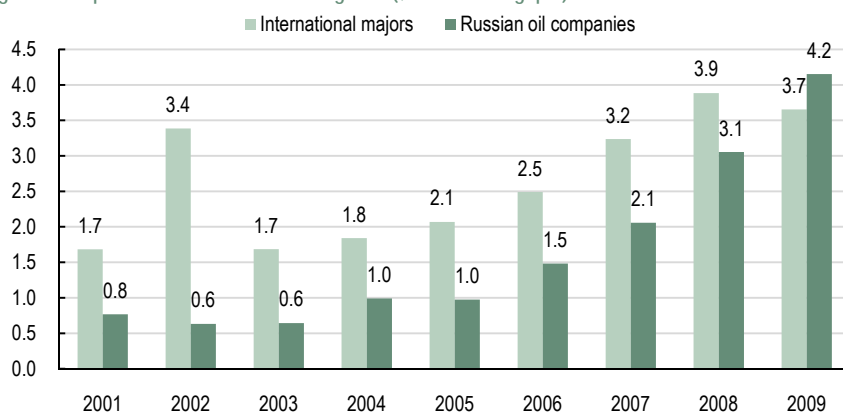


Source: Renaissance Capital estimates

5. **Remote locations of new fields.** Oil companies have to compensate for the natural decline in oilfield production by launching new fields, most of which are located away from existing infrastructure and require new pipeline connections to become operational (such as the recently launched Vankor field). Most new fields are located in northern Western Siberia, in Eastern Siberia and on the Arctic shelves.
6. **New cycle in refining upgrades and capacity expansion.** The Russian government introduced new fuel specifications in December 2008 that will require capex of approximately \$50bn, according to Deputy Prime Minister Igor Sechin, which is about half (\$25.9bn) of our own estimate of capex spending by the six largest oil companies in Russia during 2010-2014E. In addition, most Russian integrated companies are undertaking general upgrades, either to compensate for underinvestment during the 1990s or to increase refining depth and light product yield, as forthcoming changes in downstream taxation will likely increase the taxation of heavy oil products while easing the taxation of light products.

As a result, Russian companies quadrupled their capex spending per boe of throughput during 2001-2009, while international oil companies doubled their spending. Due to the factors described above, we expect above-inflation spending to continue for the next five years.

Figure 15: Capex trends in downstream segment (\$/boe of throughput)



Source: Renaissance Capital estimates

On our estimates, the average Nelson complexity index for the Russian refining sector should increase from 5.0x currently to over 6.0x. We also expect about 34mn tpa of throughput capacity to be added during the next five years (about a 12% increase).

Core segments of HMS Group in the oil and gas sector

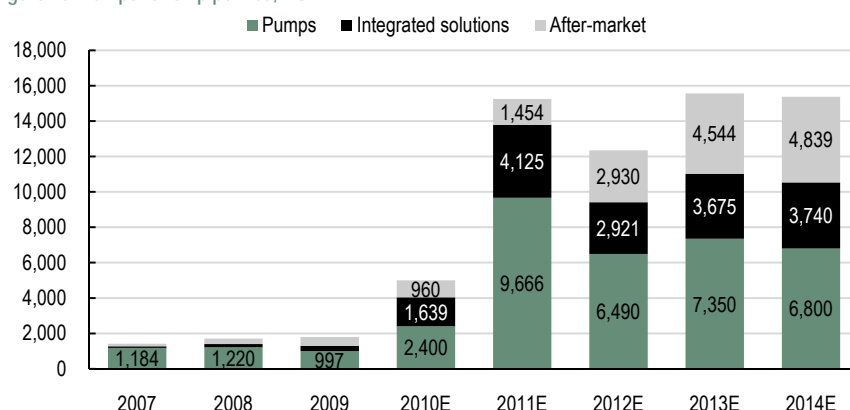
There are three main activities in the oil industry: the extraction of oil-containing fluid from wells, the transport of oil through a pipeline system, and oil processing in a refinery. Because oil is a liquid, pumps are critical for all major and minor auxiliary processes in oil handling. Pumps are also a key element in artificial lifting methods. We will not describe the whole universe of pumps used in the oil and gas sector, but provide key details on core segments in which HMS Group has a significant footprint.

Oil pipeline pumps

After oil is separated, it is transported via a system of inter-field and trunk pipelines. Radial flow and to some extent rotary pumps play key roles in this process. Oil-pumping stations installed along the whole length of a pipeline ensure stable pressures and flow velocities in a pipeline system.

In Russia, Transneft is the single-largest customer for pumps used in oil trunk pipelines, with other oil companies deploying pumping equipment for inter-field oil transport. The market of pumps for oil transport was valued at RUB997mn in 2009 by Frost & Sullivan. It grew at below the industry average rate before the crisis year of 2009, but is expected to rebound swiftly and grow at a CAGR of 46.8% (excluding the after-market and integrated solutions segments) in 2009-2014E according to Frost & Sullivan estimates. Transneft has an urgent need to upgrade existing infrastructure in order to increase pump efficiency (most of the pipeline infrastructure was built before 1985).

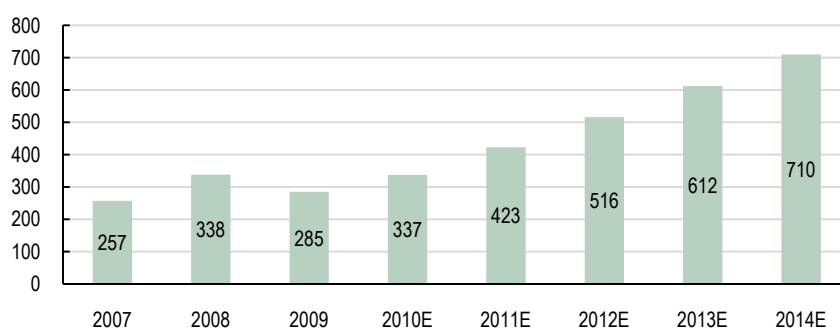
Figure 16: Pumps for oil pipelines, RUBmn



Source: Frost & Sullivan

By our estimates, oil pipeline pump consumption is also driven by large ongoing pipeline projects, including the ESPO-1 extension (due to be completed in 2013), ESPO-2 (2013), the ESPO-2 extension (2015), BPS-2 extension (2012), Purpe-Samotlor (2012), Zapolyarnoe-Purpe (to connect the Yamal fields with the ESPO pipeline) and Haryaga-Yuzhny Khylochuy. We expect significant market growth in 2011E as construction begins at a number of large projects.

Figure 17: Oil pipeline capex, RUBbn



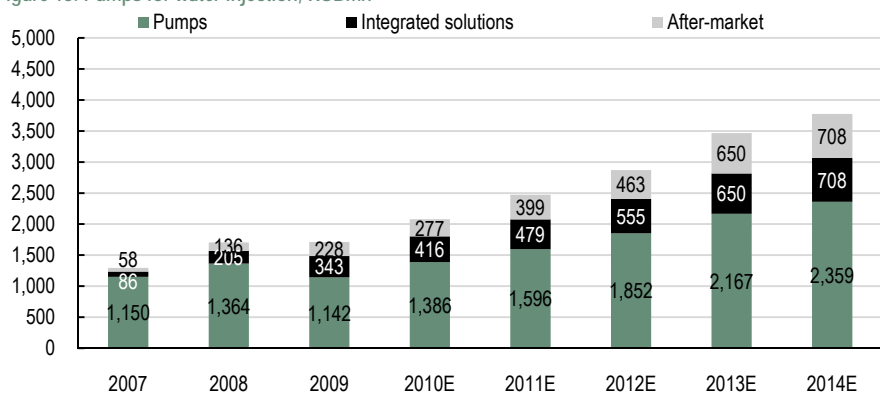
Source: Frost & Sullivan

The nearly 1,000 HMS Group trunk pipeline pumps installed at Transneft facilities provide a major opportunity for after-market services. Spare parts serve as the base for after-market growth, with further growth expected in other after-sale activities in 2011. The large number of pumps to be installed for new projects should boost the market in the medium term. The installed base is expected to grow, enhancing the volume and scope of after-market opportunities.

Water-injection pumps

Extracted well fluid is separated into oil, associated gas and water, and the water is pumped back into the reservoir. The market of pumps for water injection (reservoir pressure maintenance) was valued at RUB1,142mn in 2009 by Frost & Sullivan, with an expected CAGR of 15.6% (excluding the after-market and integrated solutions segments) in 2009-2014E.

Figure 18: Pumps for water injection, RUBmn

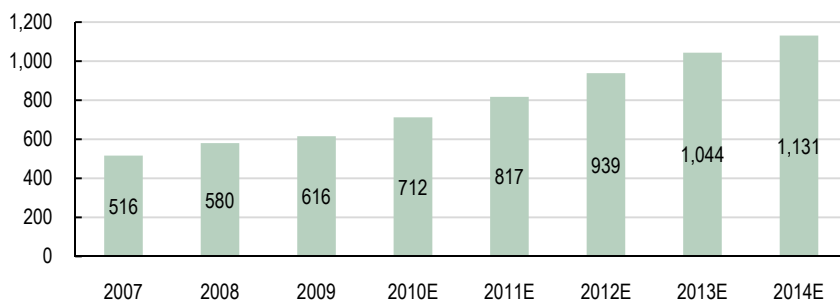


Source: Frost & Sullivan

The key driver is the massive capex of Russia's oil majors in the development of greenfield and brownfield oil projects in Eastern and Western Siberia: the Vankor field (Rosneft), Verkhnechonsk field (TNK-BP), Tyamkinsk field (TNK-BP), Samotlor field (TNK-BP), Talakan field (Surgutneftegas) and Sakhalin (Rosneft, Gazprom).

Another essential driver for water-injection pump demand in Russia is the increasing water cut at mature fields. According to Frost & Sullivan estimates, the average water cut rate of developed oil fields is at 80% presently and is expected to exceed 95% by 2015. Thus, in order to maintain national output at 500mn tpa, more water will need to be pumped in wells, thus driving the water-injection pump market.

Figure 19: Oil exploration and extraction capex, RUBbn



Source: Frost & Sullivan

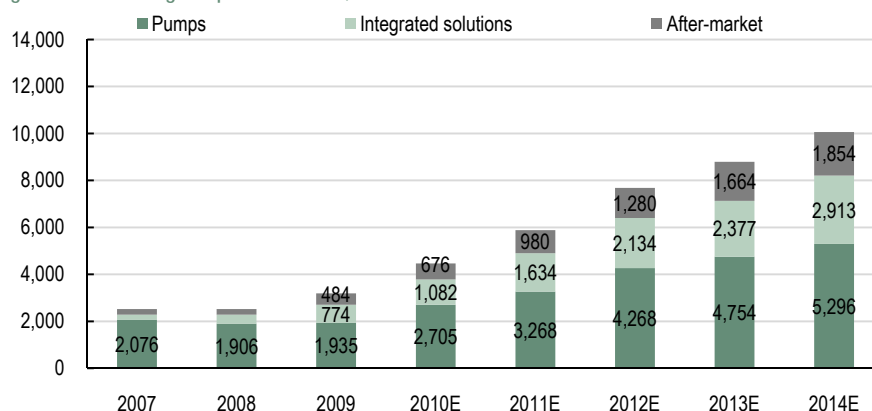
We expect after-market services to migrate away from the supply of relatively cheap spare parts towards the provision of complex services, which are currently performed by the major Russian oil companies' in-house repair shops. TNK-BP, Rosneft and other major players in the sector are looking to outsource their service and maintenance.

Pumps for oil refining and petrochemicals

Once it has been transported to a refinery, oil is processed into various oil products, from high-octane gasoline to bitumen. At all processing stages, oil is moved by pumps.

Frost & Sullivan valued the market of pumps for oil refining and petrochemicals in Russia at RUB1,935mn in 2009, with a CAGR of 22.3% until 2014E.

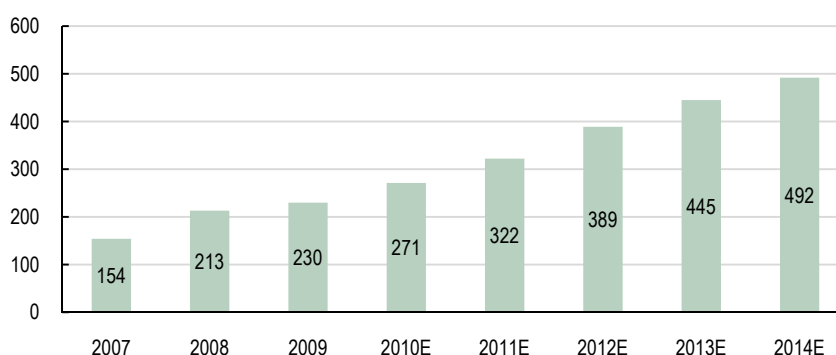
Figure 20: Oil refining and petrochemicals, RUBmn



Source: Frost & Sullivan

The growth of the Russian vehicle fleet and the government-backed switch to Euro-4 and Euro-5 fuel standards are increasing demand for higher-quality fuels and will necessitate an upgrade of current refining capacity. The Russian Ministry of Energy forecasts that RUB1.2-1.4trn is required for the modernisation of the oil-refining sector in the medium term. The total capex may grow to RUB2-2.5trn, on our estimates, taking into account announced greenfield projects: the Nizhnekamsk oil refinery (Tatneft; construction by 2015), Nakhodka oil refinery (Rosneft; construction by 2017) and Mari-El refinery (construction by 2015).

Figure 21: Oil refining and petrochemicals capex, RUBbn



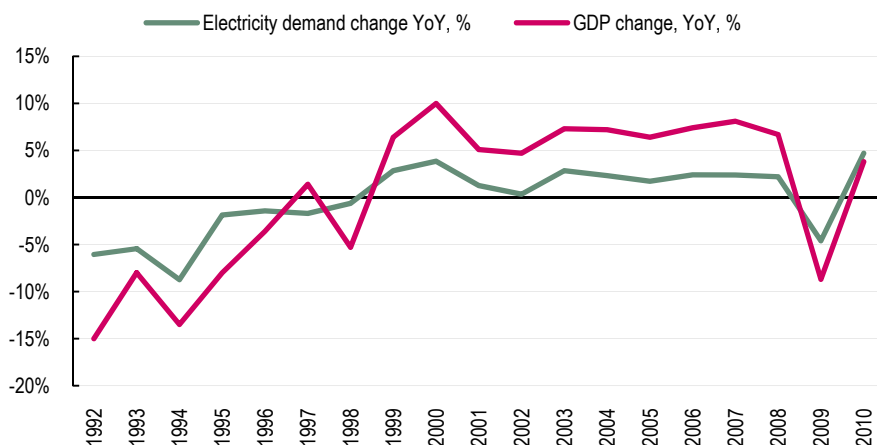
Source: Frost & Sullivan

As for after-market services, we expect the oil-refining pump segment to switch to ever-more-advanced materials, which will increase the price of spare parts. Currently installed pumps will be targeted for upgrades in order to extend their run life.

Power generation

Russia has the world's third-largest power sector, with an overwhelming proportion of the fixed assets having been constructed in the Soviet period – primarily in the 1950s and 1960s. National demand for electricity fell sharply following the demise of the Soviet Union and the wrenching adjustment of Russia's economy to global market forces. For the 20 years following the 1992 partial privatisation of the sector, an excess of capacity meant that very little new capex was required, and tariffs were kept extremely low. However, consistent economic growth over the past decade has now brought electricity demand up to – and in many regions above – peak demand levels during the Soviet era.

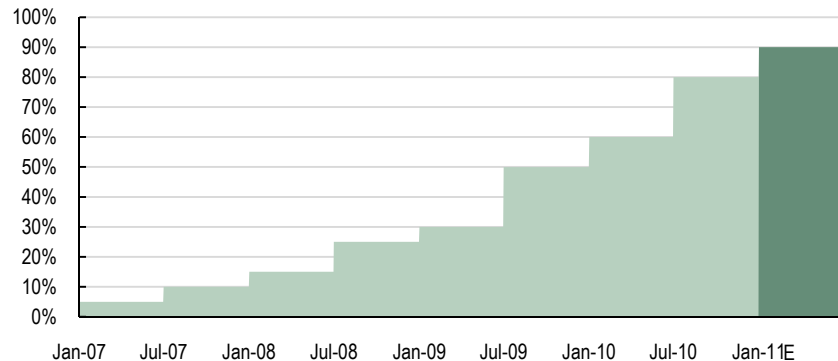
Figure 22: GDP change and electricity demand change



Source: Rosstat, UES, System Operator, Renaissance Capital estimates

Against a background of decaying assets in the power sector and no funds for investment, in 2003 the Russian government adopted a strategy of radical, market-based reform, of which a prime element was the liberalisation of generation markets. The underlying principle was that prices for wholesale generation should be formed by competition and would provide appropriate signals and incentives for investment. Liberalisation is now almost complete, with around 75% of daily output of electrical energy priced by competition.

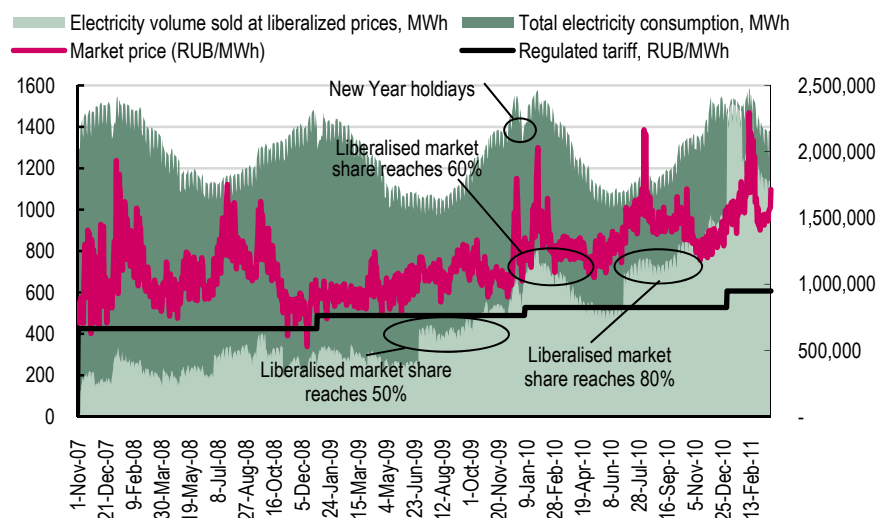
Figure 23: Proportion of wholesale electricity priced by competitive markets



Source: Renaissance Capital estimates

Evidence of huge volatility in market prices and of a series of new, record-high prices in 2010 leads us to the conclusion that, as sector managers have been contending for several years, capacity margins are extremely low.

Figure 24: Production and pricing of electrical energy – European Russia and Urals



Source: Renaissance Capital estimates

To put a stronger focus on tight capacity margins, Russia has implemented separate markets for electricity and capacity, with the latter offering guaranteed financial returns on the construction of new capacity as a back-up to the incentives inherent in the prices on capacity markets. The guaranteed returns are offered in the form of price floors for new capacity, which are calculated on the basis of what we deem to be generous parameters.

In November 2010, the government concluded a series of long-running discussions concerning the obligatory new capex programmes that generation company proprietors had agreed to in principle at the time of generation company privatisations in 2007-2008. For the six Russian wholesale generation companies (OGK), which account for around a quarter of national installed capacity, the programme foresees commissioning 15,000 MW of new capacity by 2015. To give a sense of the change in demand for the manufacture of heavy generation and related

equipment, the quantity of new capacity added by these companies (and their predecessors) over the 20-year period 1989-2008 was zero.

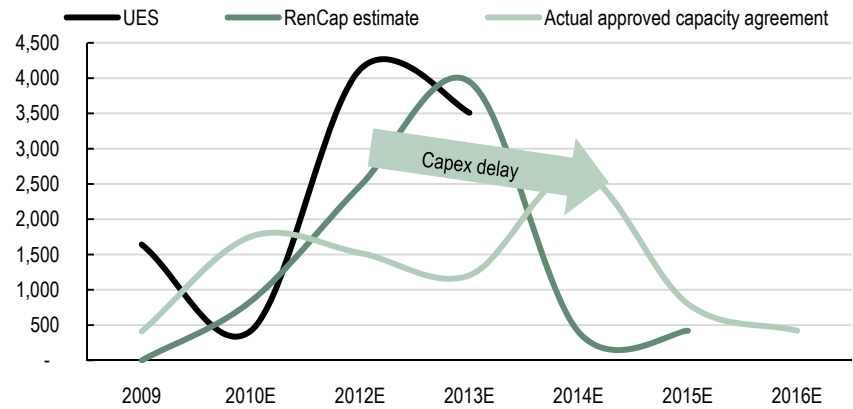
Figure 25: OGK new capex obligations

Power plant	Installed capacity, MW	Original commissioning year planned	Approved commissioning date
OGK1			
GRES-4 (Kashirskaya)	330	2009	31-Dec-09
Nizhnevartovskaya GRES I	800	2011	31 Sep 2013/31 Dec 2015
Nizhnevartovskaya GRES II	800	2013	excluded
Permskaya GRES	400	2012	31-Dec-15
Urengoiyskaya GRES	450	2012	30-Sep-12
Verkhnetagilskaya GRES	330	2012	excluded
Ivanovskie PGU	325	not present	31-Dec-11
Sochinskaya CHP	80	not present	31-Dec-09
OGK2			
Stavropolskaya GRES	420	2010	30-Nov-16
Troitskaya GRES	660	2012	30-Nov-14
Troitskaya GRES	660	2013	Cancelled
Serovskaya GRES	400	2013	Cancelled
Adlerskaya CHP	360	not present	new project - 31 Dec 2012
OGK3			
Cherepetskaya GRES	450	2013	31 Dec 2012/31 Dec 2013
Haranorskaya GRES	225	2011	31-Dec-11
Yuzhno-Uralskaya GRES	1,200	2013	31 Dec 2012/31 Dec 2013/31 Dec 2014
Gusinozerskaya GRES	17	2011	31-Dec-11
New power plant in Sochi region	180	previously not planned	31-Oct-13
OGK4			
Berezhovskaya GRES-1	800	2009	1-Jan-14
Berezhovskaya GRES-1	800	not present	new project - 1 Jan 2011
Berezhovskaya GRES-1	800	not present	new project - 1 Jan 2012
Shaturskaya GRES-5	400	2009	1-Oct-10
Yaivinskaya GRES-16	425	2012	31-Dec-10
Surgutskaya GRES-2	800	2011	1 Aug 2011/1 Sep 2011
OGK5			
Nevinnomysskaya GRES	410	2011	30-Dec-10
Sredneuralskaya GRES	410	2011	30-Dec-10
OGK6			
Cherepovetskaya GRES	330	2012	extended to 420 MW - 30 Nov 2014
GRES-24	110	2009	1-Jun-10
Kirishskaya GRES-19	800	2012	30-Nov-11
Novocherkasskaya GRES-1	330	2012	30-Nov-14
Novocherkasskaya GRES-1	36	not present	12/31/2012 - new project
Ryazanskaya GRES	60	not present	12/31/2014 - new project

Source: Renaissance Capital estimates

As Figure 26 shows, commissioning dates for several projects have been postponed from earlier versions of the plan. This primarily reflects the reluctance of generation company owners to commit to funding new construction projects during 2009, when debt markets were effectively closed and electricity demand was falling.

Figure 26: Postponement of OGC capex obligations

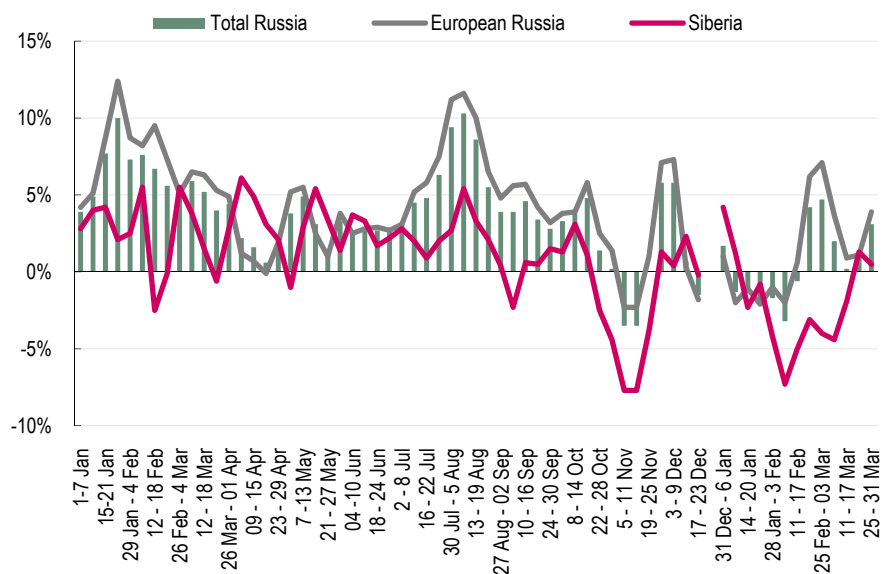


Source: Renaissance Capital estimates

Most recently, in response to calls from generation company owners, the government's senior minister for the energy sector, Deputy Prime Minister Sechin, acknowledged that a guarantee scheme was also required to encourage refurbishment and upgrades of existing capacity. The need is clear to us from the figures. By some estimates (including those of Italian utility Enel), 33% of Russia's fossil fuel generation capacity has exceeded its planned working life and is unreliable and/or in a state of disrepair. A further 18% has six years or less of remaining life. Within 10 years, 60% of capacity will have reached the end of its working life. Neither can hydro capacity fill the gap: here, an estimated 53% of the capacity has been classified as unreliable and/or in a state of disrepair.

Adding to the urgency is the fact that, after a contraction in electricity demand in the wake of the global economic crisis, Russian demand has returned to strong growth.

Figure 27: YoY change in weekly electricity demand – December 2008-March 2011



Source: Renaissance Capital estimates

A cold spell in late February 2010 and unusually hot weather in August 2010 resulted in new records for electricity demand in numerous regions across the country.

Given all this, we judge that while the government may continue to tinker with tariffs, in an effort to avoid price shocks for consumers, the scene is set for a period of intense investment in new generation capacity.

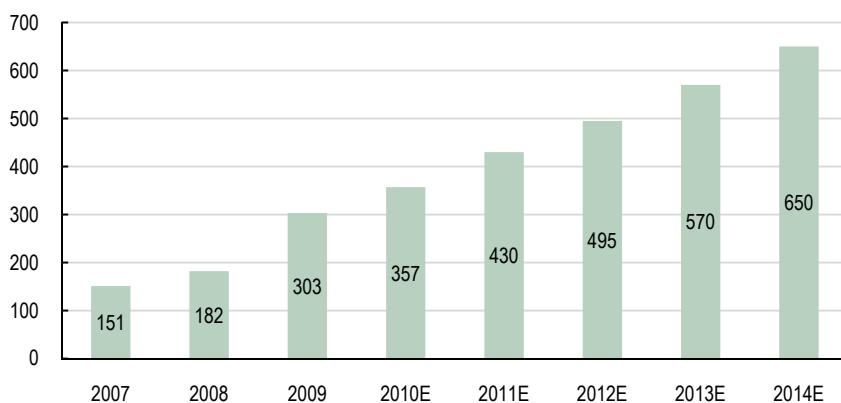
The transformation of thermal water power into kinetic turbine power to generate energy is a key technological process at thermal and nuclear power generation stations. Pump functions include supplying water to reservoirs for heating, pumping liquid into condensers for steam cooling, pumping steam condensate into water reservoirs, and supplying additional water into the closed system to compensate for heat-carrier losses. Since the halt of heat-carrier circulation during any stage of the technological process leads to a stoppage of all the other processes (especially in nuclear energy generation, where this would require a reactor shutdown), rigid requirements are imposed on the pumps' quality and performance.

Nuclear power pumps

The arguments for nuclear energy include increased energy security, decreased reliance on fossil fuels and lower carbon emissions. According to Frost & Sullivan estimates, 50 reactors are under construction worldwide and an additional 130 or more are planned to come online in the next decade. This is a worldwide phenomenon, with Russia and China expected to lead in nuclear power demand in the future.

The Russian Energy Strategy stipulates that generation capacity from nuclear sources must double over the long term. The capex for the nuclear generation segment will be \$100-139bn according to the Ministry of Energy.

Figure 28: Nuclear power generation capex, RUBbn

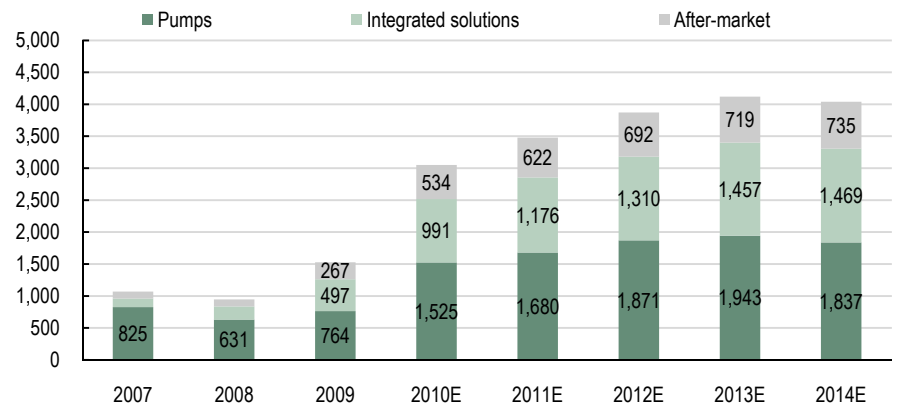


Source: Frost & Sullivan

According to Michael Kruse, a consultant on nuclear systems for Arthur D. Little, China is ready to spend \$511bn to build up to 245 reactors. By Frost & Sullivan estimates, China intends to expand its nuclear generation capacity by at least 50 GW over the next decade. Rosatom, like its Soviet-era predecessors, has a good reputation, in our view, and a strong presence in international markets. A number of projects will be commissioned by Rosatom abroad in the near term, such as the Mokhovtse NPP (Slovakia), Belene NPP (Bulgaria), Tianwan NPP (China) –

Phase 2, Kudankulam NPP (India) – Phase 2, and Akkuyu NPP (Turkey). HMS Group previously supplied pumping equipment to Tianwan Phase 1 and Kudankulam Phase 1. Frost & Sullivan values the market of pumps for nuclear power generation (secondary circuit) at RUB764mn in 2009, with a CAGR of 19.2% until 2014.

Figure 29: Nuclear power generation (excluding MCP), RUBmn



Source: Frost & Sullivan

In terms of after-market services, the critical character of the application, extensive technological know-how and safety regulations have created a large after-sale market for the nuclear non-main circulation pump (non-MCP) segment. Manufacturers are involved in pump maintenance for the duration of a pump's run life and it serves as an additional stream of revenue for them.

Aftermath of the 11 March 2011 earthquake and tsunami in Japan

In recent days, the mass media have been writing obituaries for the nuclear power industry. However, electricity generation is a long-term business and we judge it helpful to consider the issues in this context.

By common consent, one of the most critical challenges facing the human race today is the need to satisfy global demand for energy without destroying the Earth's ecosystem. This could be achieved by limiting demand, reducing the current overwhelming reliance on fossil fuels, or a combination of both.

To date, progress has fallen far short of what is required. The most promising initiatives to move away from fossil fuel generation continue to run into obstacles. For example:

- Hitherto, Spain has been a world leader in the development and use of solar power. In response to Spain's dire financial imbalances, the country's government has slashed the system of subsidies previously paid to solar generation. Without this support, solar operators claim their businesses are not viable.
- Plans for the construction of wind power and of biomass plants are facing fierce opposition from some environmentalists. For example, in the UK, one of the most promising locations for wind-generation, the Minister for Climate Change has complained of more than 200 well-organised groups lobbying against the construction of wind farms. In Europe, plans for new

biomass generation plants are being opposed by environmental lobbies on the grounds that the material (e.g. wood chips) consumed by these plants is sourced from South America, where forest habitats are threatened with destruction.

In response to unfolding events in Japan, governments around the world – many of which have only recently and reluctantly come round to the prospect of rapid expansion of nuclear generation – have initiated nuclear risk assessments to consider what went wrong at Japan's Fukushima plant. What are likely to be the conclusions of these studies?

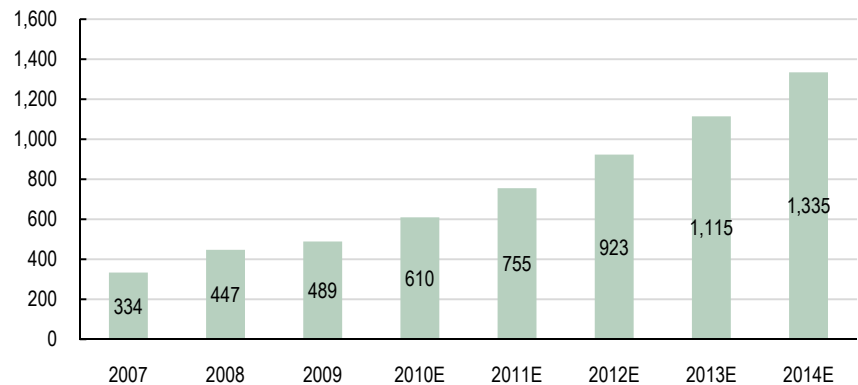
1. The earthquake that affected the Fukushima plant was one of the most powerful ever recorded – at 9.0 on the Richter scale. At the time of writing, there have been three non-nuclear explosions at the plant and leakage of some radioactive material.
2. The measurable human cost so far is four injured workers and a further two workers admitted to hospital for overexposure to radiation. Two workers were killed directly by the tsunami. In the absence of any significant worsening of the situation, it could be argued in economic terms that Fukushima – with a capacity of 4,700 MW, one of the world's largest power plants, one which has been producing electricity since 1971 – has suffered the worst-conceivable natural disaster at an acceptable human cost. To compare, in China 77% of electricity is generated from coal, with an average of 3,000 accidental deaths per annum reported by coal mines.
3. Seismic risk maps show that Fukushima is located in an area judged to be at high or very high risk of earthquake activity. Meanwhile, the overwhelming majority of the Earth's economic activity (and hence of demand for electric power) is located in regions judged to be at low or very low risk.

From this perspective, we contend that once the situation at Fukushima is under full control and fears of a major radiation catastrophe have fallen from the headlines, governments around the world will revert to the conclusion that an expansion of nuclear power is the least-bad solution to one of the global community's most pressing problems.

Thermal power pumps

The main growth driver for Russia's thermal power generation sector is the Russian Energy Strategy, which estimates capex at \$200-290bn. It is worth mentioning that the privatisation of the Russian utilities sector was coupled with mandatory investment requirements for new investors.

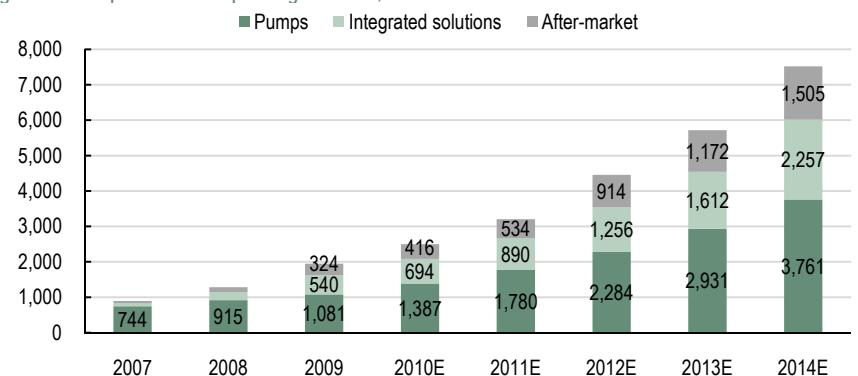
Figure 30: Thermal power generation capex, RUBbn



Source: Frost & Sullivan

Thermal power generation is one of the most attractive segments for suppliers of pumping equipment. By Frost & Sullivan estimates, the market is expected to increase five-fold by 2014. Additionally, the industry's requirements for pump suppliers are tightening to include customised specifications (in-house R&D required), the supply of integrated solutions and after-sales service.

Figure 31: Pumps for thermal power generation, RUBmn



Source: Frost & Sullivan

Due to efficiency issues and the cost of new pumps, after-market services – including upgrades and the supply of spare parts – are of great importance. This is backed by a trend to outsource the maintenance of rotating equipment.

Water utilities and infrastructure

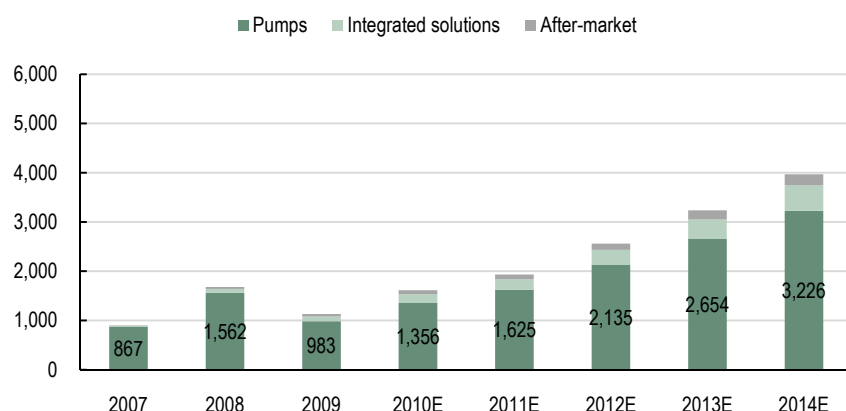
After water is extracted from natural sources, such as water wells and reservoirs, it needs to be distributed via pipeline networks to end-users (the public, industry and agriculture) for utilisation. Later, industrial and household effluents are transported into sewage treatment plants. Pumps are at the core of each and every stage of water recovery, transport and disposal. Any disruptions in water supply can lead to equipment failure and economic losses. Thus, the quality of pumps and their uninterrupted functioning is vital for water supply and disposal processes.

Pumps for municipal water supply and disposal are technically complex products, so manufacturers need to have a strong research and design capacity, which is feasible only for large producers.

Water utilities pumps (clean water supply and dry-pit sewage)

Frost & Sullivan valued the market of pumps for water utilities (clean water supply and dry-pit sewage) at RUB983mn in 2009, with a CAGR of 26.8% for 2009-2014E.

Figure 32: Water utilities pumps, RUBmn



Source: Frost & Sullivan

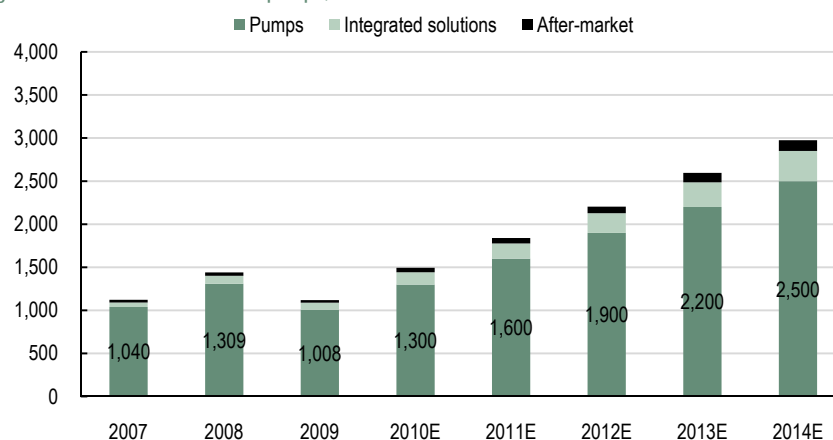
Modernisation of the water sector has been identified by the Russian government as a key priority for economic development. A key driver for growth is the *State Programme for Modernisation of the Public Utilities Sector*. The programme envisages over RUB4trn of financing until 2020, with RUB422bn coming from the federal budget. In addition, demand for the replacement of pumps is expected to grow due to the high wear ratio in the sector: by Mosvodokanal's estimates, the wear ratio as of 4Q08 was 57% for sewage-pumping stations and 65% for water-pumping stations.

Pumps used in the public water supply transport cleaner water and are made to last, so the wear is low, and in most cases it is more economical to replace a complete pump rather than to repair it with spare parts. Maintenance is performed by in-house waterworks services. Hence, the after-market services segment for pump suppliers is relatively small and is not expected to develop significantly.

Submersible water well pumps

The market for submersible water well pumps was valued at RUB1,008mn in 2009 by Frost & Sullivan, which expects a CAGR for 2009-2014E of 19.9% (excluding the after-market and integrated solutions segments).

Figure 33: Submersible water well pumps, RUBmn



Source: Frost & Sullivan

Regional 'Clean Water' programmes are a key driver for the sector, as they target increasing the proportion of water supplied from wells and raising the efficiency of equipment. A number of these programmes are already under way (e.g. in the Volga district and in St Petersburg). The sector has suffered from structural underinvestment over the past 20 years, in our view. Residential housing construction and agricultural sector growth are also driving demand for submersible water well pumps.

In terms of after-market services, relatively low pump prices make it uneconomical to repair pumps. The only products for the after-sale market are pump parts for bigger units.

Strategic positioning

Advanced R&D capabilities

HMS Group has an advanced R&D base in Russia, with five in-house R&D facilities in Russia and Ukraine. The role of R&D becomes increasingly important along the value chain of HMS Group's products and services, from industrial pumps to integrated flow solutions, including modular equipment and EPC. The customised design of equipment, particularly for integrated solutions, makes the unique testing facilities of HMS Group very attractive for key customers. The testing facilities have become an integral part of HMS Group's business model.

HMS Group's R&D centres work closely with clients' R&D divisions in developing pre-tender documentation and helping clients to adopt new design solutions and technical specifications. The R&D base gives HMS Group an essential competitive advantage, in our view, and enables the Group to build strong relationships with key customers. In fact, clients rely on HMS Group's services and expertise during the development of pre-tender documentation, including technical policies and standards. In our view, strong R&D provides the basis for organic growth at HMS Group. The lack of an R&D base prevents HMS Group's local competitors from creating new pumps and customised solutions and forces them to rely on outdated technology.

Industrial pumps

Products and their distribution

HMS Group supplies pumps to customers in the oil and gas, power and water utilities sectors, including a broad range of industrial pumps with various applications in flow solutions systems. The production time and price of HMS Group's industrial pumps largely depends on the application, engineering and design complexity as well as the unique specifications of the product, if a customised solution is required.

Figure 34: Industrial pumps

Product/service	Core market segments	Price	Production time
Customised pumps	▪ Nuclear and thermal power generation pumps	RUB1-30mn	6-12 months
	▪ Trunk oil pipeline pumps		
	▪ Oil field pipeline and water-injection pumps		
	▪ Water supply and waste water pumps		
	▪ Submersible water well pumps		
	▪ Oil-refining and petrochemical pumps		
Standard pumps	▪ Water supply and waste water pumps	Less than RUB1mn	Less than 3 months
	▪ General industrial pumps		
	▪ Household vibration pumps		

Source: HMS Group

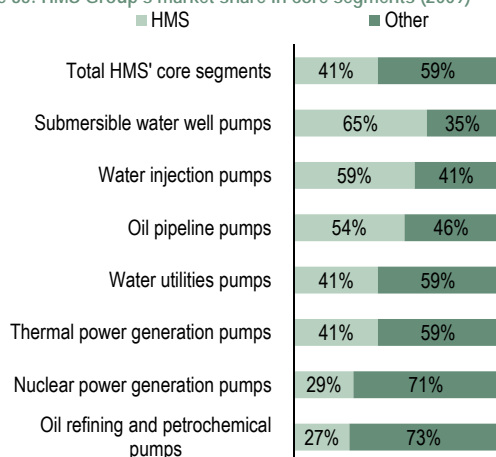
HMS Group's customer base includes major players in the above-mentioned sectors in Russia, including Transneft, Rosneft, LUKOIL, TNK-BP, Rosatom, InterRAO and Mosvodokanal. HMS Group has a solid track record of supplying its flow control solutions and services in the CIS (Turkmenistan, Kazakhstan and Tajikistan) and frontier markets (Iraq).

Orders for pumping stations for the ESPO pipeline are currently a key driver of HMS Group's performance. We note that the ESPO contracts are classified by HMS Group under non-modular integrated solutions, and will be accounted for in the "industrial pumps" reporting segment in audited IFRS accounts. HMS Group has concluded a number of contracts with Transneft for the construction and delivery of oil trunk pumping units and spare parts for the oil pipelines Purpe-Samotlor and ESPO. Total budgeted revenue for these contracts as of 30 September 2010 exceeds RUB12bn. According to IFRS audited accounts for the nine months ended 30 September 2010, HMS Group recognised revenue in respect of these contracts of RUB2.35bn. As of 30 September 2010, payables due to customers (i.e. Transneft prepayment) include the amount of RUB7bn. The Group has historically been able to earn higher margins on integrated solutions than on bare pumps. Assuming it can maintain high EBITDA performance, we expect that the contracts with Transneft will generate a substantially higher EBITDA margin than that usually seen for bare pumps. HMS Group remains the preferred supplier of pumping stations for trunk pipelines and may obtain a contract for another 20 pumping stations for the ESPO project, which would be needed to enhance the pipeline's capacity to 80mn tpa of oil.

Competition and potential M&A opportunities in the industrial pump segment

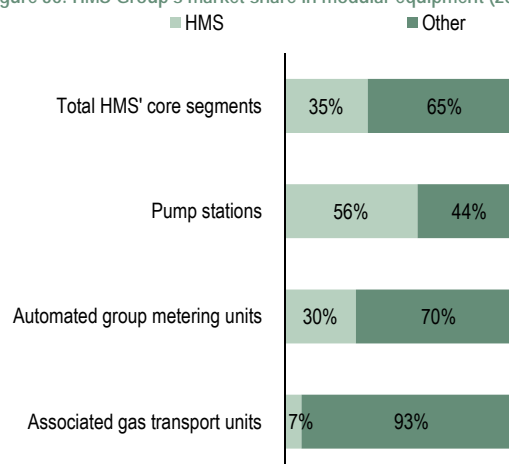
In the industrial pump market, HMS Group mostly faces competition from relatively small local niche players, as the Russian industrial pump market is highly fragmented. However, the lack of an R&D base prevents HMS Group's local competitors from creating new pumps and customised solutions, forcing them to use outdated technology.

Figure 35: HMS Group's market share in core segments (2009)



Source: Frost & Sullivan

Figure 36: HMS Group's market share in modular equipment (2009)



Source: Frost & Sullivan

In the oil pump segment in Russia, most of the larger pumps conform to custom standards developed during the design stage of oil and gas industrial facilities. Thus, the production of these pumps requires strong production, design and engineering capabilities. For many competitors (e.g. Volgogradneftemash and Votkinsky Plant), oil pumps are not a core business, and their R&D activities are not focused on pumping equipment. Thus, we think these players may eventually abandon the oil pump market and shift their focus to core businesses. We do not exclude the possibility of accelerating M&A activity in the oil pump segment in coming years.

If we consider the power generation sector, industrial pumps are supplied by no more than five or six large companies with very strong manufacturing, engineering and design capabilities. On top of that, nuclear power plants are classified as high-risk facilities, with stringent requirements for the equipment used. In the nuclear power segment, NPO Frunze (38% market share in FY09) and HMS Group (29% market share in FY09) are the leading players; however, both offer largely complementary rather than competitive products. Competition from local producers is very limited in the power generation segment.

In the water utilities segment, pumps for municipal water supply and disposal are technically complex products, requiring manufacturers to have strong research and design capabilities, which is feasible only for large producers. The closest competitor of HMS Group in this segment is the Kherson plant (KEMZ, based in Ukraine), with 11% market share in 2009 by Frost & Sullivan estimates, which offers cheaper products to the market.

Figure 37: Domestic vs international manufacturers' shares in HMS Group's core segments

Oil production	Near-monopoly of Russian manufacturers (incl. JV and foreign ownership) – 95%
Surface oil pumps (drilling, water injection, oil refining)	Dominance of Russian manufacturers – 80%
Oil transport	Dominance of Russian manufacturers – over 90%
Thermal power generation	Dominance of Russian manufacturers – 70-75%
Nuclear power generation	Near-100% monopoly of Russian manufacturers
Water utilities	Clean water supply and dry-pit sewage – 100% domestic
	Wet pit and waste water treatment – 100% imports
	Water well – 65% domestic
Household pumps	Dominance of Russian manufacturers – 70-75%

Source: Frost & Sullivan

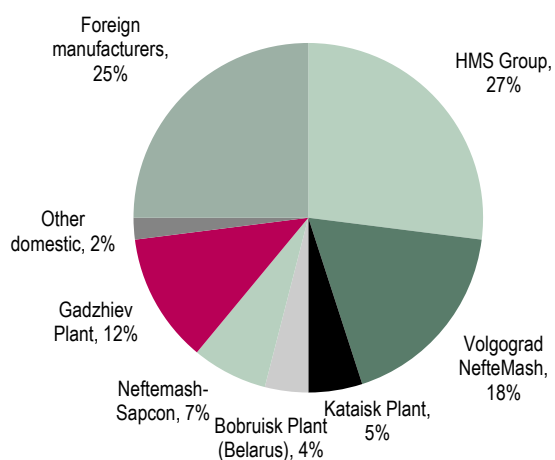
Foreign competition in the Russian industrial pumps segment is very limited, particularly in the oil and gas sector. The market is protected by high entry barriers for foreign peers, which are described in detail in the *Investment summary* section of this report. It is worth mentioning that foreign competitors trying to enter the flow solutions market in the Russian oil and gas sector have faced major problems, particularly in the delivery and installation stage of projects. HMS Group faces some competition from foreign peers in thermal power generation and the water utilities segment. KSB is particularly strong, and Sulzer is becoming ever more active in the thermal power segment. However, we do not expect foreign manufacturers to increase their market presence because of higher prices for foreign-made products, the increasing quality of domestically produced pumps and the technical incompatibility of foreign-made pumps with Russian thermal power generation capacity. In the water utilities segment, the presence of foreign peers – including KSB, Grundfos and Italian producers – is quite significant, but their products are more expensive and have limited or no direct competition with HMS Group's products. For example, the regional utilities cannot afford more expensive foreign products. The price difference can be 4-5x for some product groups.

Taking into account the strength of HMS Group's financial position, we do not exclude the possibility that the Group will use the proceeds from its recent IPO to pursue M&A opportunities on the Russian/CIS market. HMS Group still lacks a number of products in its industrial pumps portfolio, while we see a high level of fragmentation in some segments of the market. We identify the following possible acquisition targets in the industrial pump sector that would complement the Group's asset/product portfolio:

- A local manufacturer of pumps for oil refining.

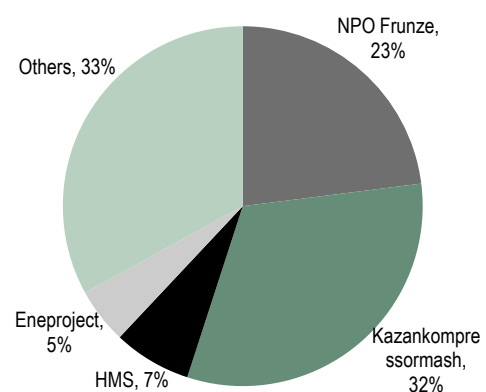
- A local manufacturer of dosing pumps for oil and gas, chemical and petrochemical applications.
- A local manufacturer of pumps for water utilities, nuclear and thermal power generation.
- A local manufacturer of pumps for wet-pit sewage applications.

Figure 38: Pumps – Oil industry: Oil refining and Petrochemicals, 2009



Source: Frost and Sullivan

Figure 39: Modular equipment – Associated gas processing and transport unit supplier market shares, 2009



Source: Frost and Sullivan

Modular equipment

Products and their distribution

HMS Group is focused on providing integrated solutions for its major customers. The diversified R&D, production and service base enables the Group to offer sophisticated and specialised flow solutions to the market and move into higher-end segments. HMS Group's key customers are looking for suppliers that can provide integrated solutions matching precise specifications and arrange for the timely delivery and installation of equipment. These integrated systems – often containing multiple pumps, valves, pipes and controls – create value by giving customers the ability to install fully assembled packages on-site, at the same time minimising labour costs. Pump companies are moving in this direction because customers are demanding this level of service. Additionally, the higher-value-added nature of the solutions in the modular equipment segment and the lucrative after-market sales and service opportunities are attractive for many industry participants.

The modular equipment market is primarily exposed to the oil and gas sector and may be subdivided into two major groups of flow solutions (see Figure 40 below).

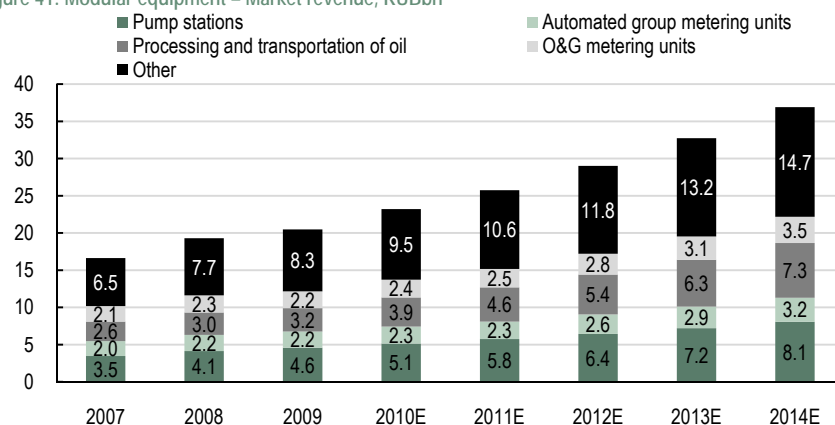
Figure 40: Modular equipment products – Production time, price, application

Product/service	Core market segments	Price	Production time
Pumping stations	<ul style="list-style-type: none"> Oil and water pumping stations. Pumping stations for water injection and oilfield transport. 	RUB20-50mn	6-9 months
Measuring and other modular equipment	<ul style="list-style-type: none"> Automated group metering devices. Chemical dosing facilities. Fire stations. 	RUB5-15mn	3-9 months
Service and repair	Repair and maintenance services.	RUB2-5mn	na

Source: HMS Group

Frost & Sullivan valued the Russian modular equipment market at RUB20.5bn in 2009, with a CAGR of 12.5% for 2009-2014E.

Figure 41: Modular equipment – Market revenue, RUBbn

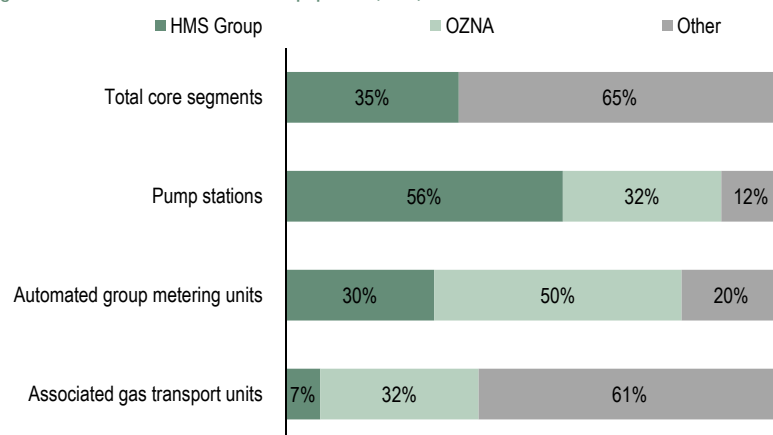


Source: Frost & Sullivan

Competition and potential M&A opportunities in the modular equipment segment

In HMS Group's core segments in the modular equipment market (pumping stations, automated group metering units [AGMU] and associated gas processing and transport units), its market share has increased steadily over the past three years.

Figure 42: Market share in modular equipment (2009)



Source: Frost & Sullivan

The Russian market for modular equipment is currently at a mature stage and is controlled by several major players. In general, HMS Group does not face significant competition from foreign peers due to high entry barriers – including, first of all, substantial differences in equipment standards.

In the pump stations segment, the two major players (HMS Group and OZNA) control approximately 90% of the market, on Frost & Sullivan estimates. According to Frost & Sullivan estimates, HMS Group's share of the pump stations segment rose to 56% in 2009 from 43% in 2008, while OZNA's share dropped to 32% from 43% over the same period. These dynamics may be explained by the leading position of HMS Group in the development of the Vankor oilfield. OZNA is a well-known player in Russia that is involved in oil and gas project design. It provides the full spectrum of EPC services and produces a wide range of oilfield and gas field equipment (measuring units, reservoir pressure maintenance systems, manifold units, pumping stations and boiler equipment), as well as offering oil and gas equipment after-sales services.

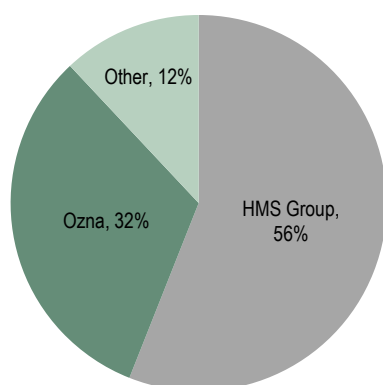
The AGMU segment is still dominated by OZNA, with a 50% market share in 2009 on Frost & Sullivan estimates. HMS Group's market share reached 30% in 2009. Associated gas transport units are a relatively new segment for HMS Group. The compressor producers (NPO Frunze and Kazancompressormash) have the biggest market shares in this segment.

We also do not exclude the possibility of M&A activity in the modular equipment sector. The Group may target assets in the oil and gas and water utilities sectors:

- A local manufacturer of flow control solutions in oil and gas.
- A local manufacturer of modular equipment for wastewater treatment.

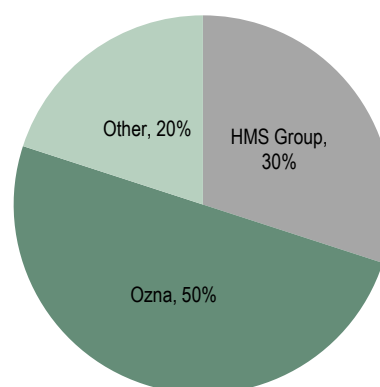
Another driver for potential M&A activity may be the acquisition of companies supplying components for HMS Group's integrated solutions. For example, we are aware that Kazancompressormash sells compressors for HMS Group's modular equipment. Looking at HMS Group's business model, we think Kazancompressormash could be a valuable addition to the Group's asset portfolio. We doubt that OZNA would be a target for acquisition by HMS Group, as we think such an acquisition might raise the concerns of oil and gas sector representatives and draw the attention of Russia's antimonopoly watchdog.

Figure 43: Pump station supplier market shares, 2009



Source: Frost & Sullivan

Figure 44: AGMU supplier market shares, 2009



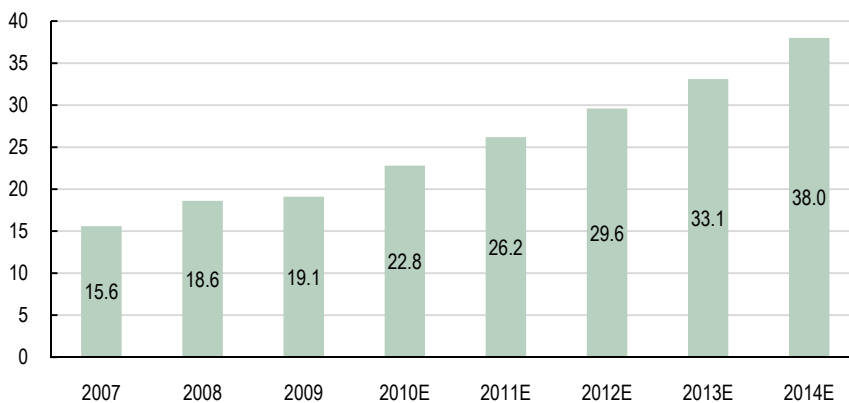
Source: Frost & Sullivan

EPC

Products and their distribution

The EPC segment is primarily exposed to the oil and gas and water utilities sectors. HMS Group's EPC unit is focused on the oil industry, providing design, oilfield infrastructure construction and crude oil transport construction services. Project design and management are among the most important and complex stages of an EPC project in the upstream oil sector. The availability of a dedicated in-house research and design centre is a significant competitive advantage for an EPC contractor. We note that the companies involved in the EPC sector derive their highest margins from the design/engineering stage of the project life cycle.

Figure 45: Engineering, research and design services for the upstream oil sector, RUBbn



Source: Frost & Sullivan

HMS Group acquired GTNG in July 2010. Established in 1964, GTNG is the leading R&D facility for oil and gas upstream projects in Russia. The largest Russian oil producers have historically outsourced technically complex solutions to GTNG. GTNG's major projects include the Priobskoe oilfield, Novo-Urengoykskoe gas condensate field, Vostochno-Urengoykskoe gas condensate field, Zapadno-Salymyskoe oilfield, the gas pipeline at the Nakhodka field, and Compressor Station 2 at the Yamburgskoe gas field. Frost & Sullivan estimates Russia's total oil sector capex at RUB1.55trn (approximately \$50bn) for FY11, with potential growth to \$83bn in FY15. HMS Group paid RUB2.5bn for 51% of GTNG in July 2010, while the design institute had a net cash position of RUB1bn. The deal's EV of RUB4bn brings the EV/EBITDA to approximately 6.5x on FY08 EBITDA, making the deal attractive from an economic viewpoint, in our view.

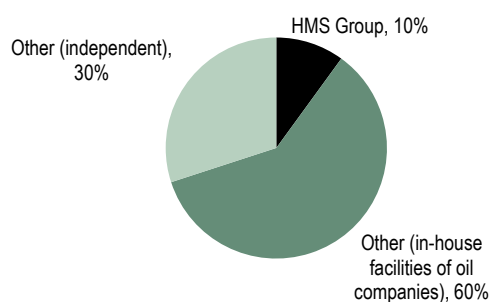
HMS Group also has exposure to the water utilities sector in the EPC segment. In 2008, the Group signed an agreement with the Ministry of Water Industry of Turkmenistan for the turnkey design and construction of a pumping station for pumping water from the Amu Darya river to the Yilgynagyzsky channel. HMS Group designed a new customised pump (3.5 m³/s capacity) with three changeable rotors adjusted for operating in desert conditions. The pumping station was commissioned in December 2010. In addition, HMS Group has actively taken part in the restoration of the water utilities system in Grozny, Chechen Republic.

Competition and potential M&A opportunities in the EPC segment

The EPC market is highly fragmented. HMS Group primarily faces competition from domestic peers (Sibtruboprovodstroy, Neftegasmontazhservice, Globalstroyengineering, Stroytransgaz and Sibkomplektmontazh), as the involvement of foreign companies is very limited, particularly in the oil sector. Globalstroyengineering has been the market leader for the past three years.

The competitive landscape of research and design services within EPC is also very fragmented, with no single player holding a dominant position. The major oil and gas companies, such as Rosneft and Surgutneftegas, have their own in-house centres. HMS Group (GTNG), Globalstroyengineering and Stroytransgaz have internal design expertise, providing design services in the sector. Crude oil transportation is dominated by three leading companies, each holding less than a quarter of the total market: Globalstroyengineering, Stroytransgaz and Mezhrayon Truboprovodstroy. In its core segments in the EPC market, HMS Group's market share has been stable over past three years.

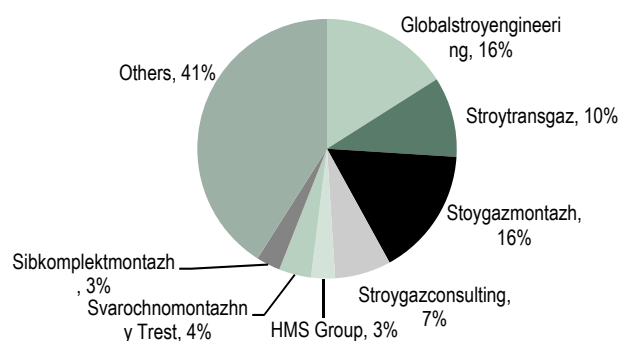
Figure 46: Market share in projects and design EPC services



Source: Frost & Sullivan

In the EPC division, we would not expect HMS Group to gain a leading position or become one of the major players. However, some M&A opportunities may help HMS Group to expand its market share, for example in oilfield infrastructure construction. According to Frost & Sullivan, Sibkomplektmontazh had a 3% market share in Russia's oilfield construction segment in 2009. In our view, the acquisition of Sibkomplektmontazh would benefit HMS Group and double its market share in the oilfield infrastructure market.

Figure 47: Oilfield infrastructure construction, FY09 (revenue-wise)



Source: Frost & Sullivan

Primary sales growth opportunities

We believe HMS Group's sales are driven by three major factors:

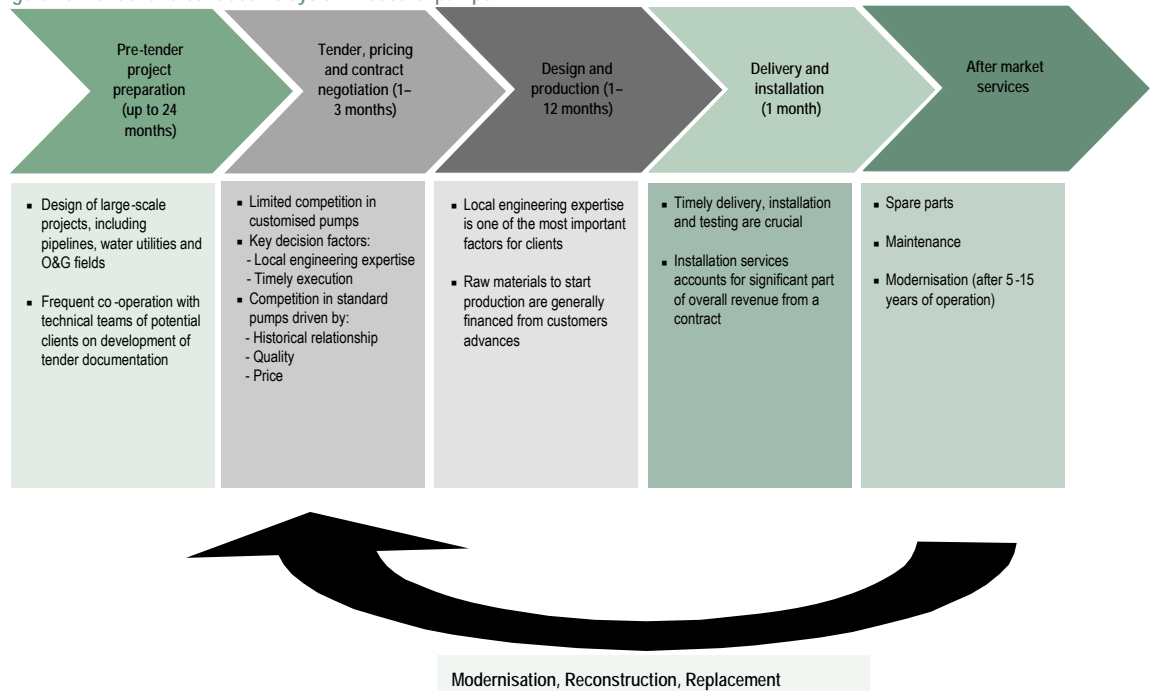
Boost in infrastructure spending: Sales growth opportunities are primarily driven by the ambitious infrastructure capex plans of Russia's government and the corporates in HMS Group's core market segments (oil and gas, power generation and water utilities). We observe a structural shift from replacement capex to growth capex in the state infrastructure investment policy. Frost & Sullivan provides the following capex estimates for the oil and gas, power generation and water utilities segments till 2015 in Russia (a detailed breakdown of capex projects for each segment is presented in the *Appendix*, in Figures 72-77):

- Capex forecast for oil exploration and production: RUB5,869bn (\$189bn).
- Capex forecast for refining: RUB2,459bn (\$79bn).
- Capex forecast for oil pipelines: RUB3,408bn (\$110bn).
- Capex forecast for nuclear power generation (including Rosatom's overseas projects): RUB3,244bn (\$104bn).
- Capex forecast for thermal power generation: RUB1,961bn (\$63bn).
- Capex forecast for water utilities: RUB4,041bn (\$130bn).

Thus, the total infrastructure spending in HMS Group's core segments may be estimated at \$675bn. In our view, HMS Group is well positioned to gain a significant share of the huge infrastructure spending expected during the next five years in Russia. We believe the planned investments in Russia's oil and gas, power generation and water utilities sectors are vital for the development of the national economy and for society. Taking into account its solid installed base of pumping equipment, HMS Group should be able to exploit the structural shift from replacement capex to growth capex in infrastructure spending by its major customers. We see opportunities for HMS Group to cross-sell new products and integrated solutions to its customers as they launch ambitious and technically sophisticated projects.

HMS Group benefits from a continuous cycle in its business model. We note that its customised flow solutions and products match the special technical requirements developed by customers and approved by the state technical authorities. These requirements are worked out during the pre-tender project preparation stage, which takes up to 24 months. It is worth highlighting that HMS Group traditionally generates product specification and pre-tender project documentation for its major customers, gaining market leadership through its unique R&D base at the start of the contract life cycle. As we mentioned above, HMS Group's foreign peers do not have licences for project design in Russia, and their equipment does not have local certification.

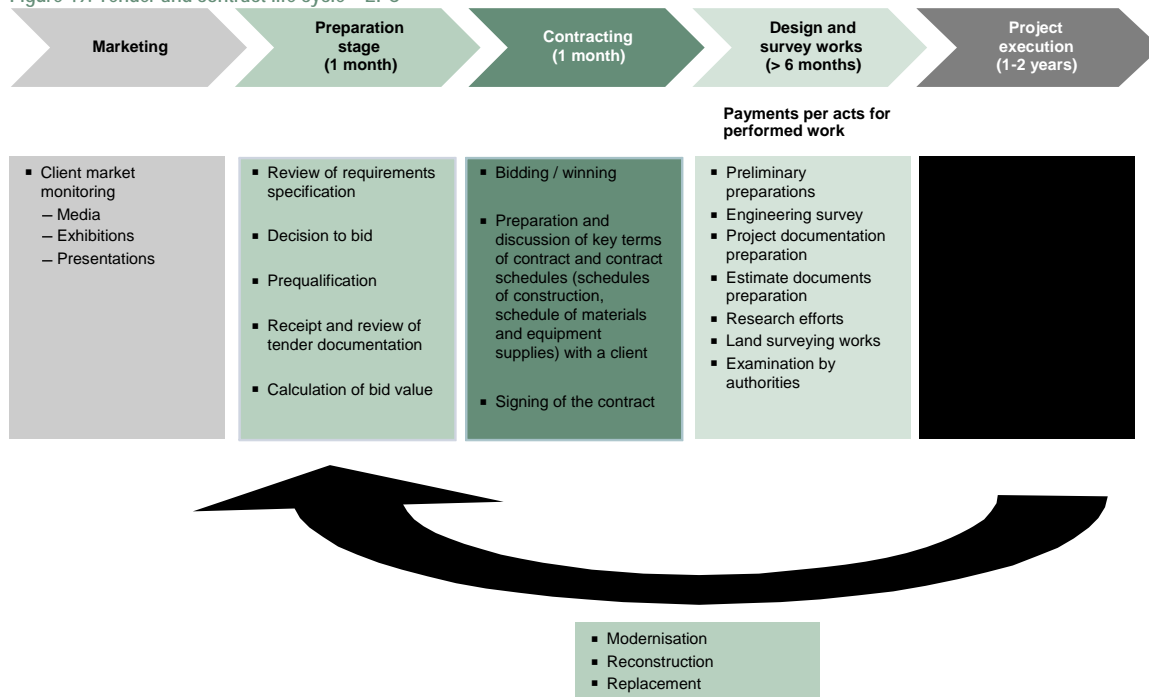
Figure 48: Tender and contract life cycle – Industrial pumps



Source: Frost & Sullivan

Growth in demand for integrated solutions: HMS Group has replicated its R&D competitive advantage in the integrated solutions segment and particularly strengthened its position in the oil and gas EPC market through the acquisition of GTNG in July 2010. If we consider the tender and contract life cycle, HMS Group can get access to project details through its R&D units before participating in tenders for EPC work. However, new development projects in all of HMS Group's core segments are characterised by high specifications and complexity. Thus, HMS Group's R&D base looks like an even more powerful competitive advantage to us in the integrated solutions segment.

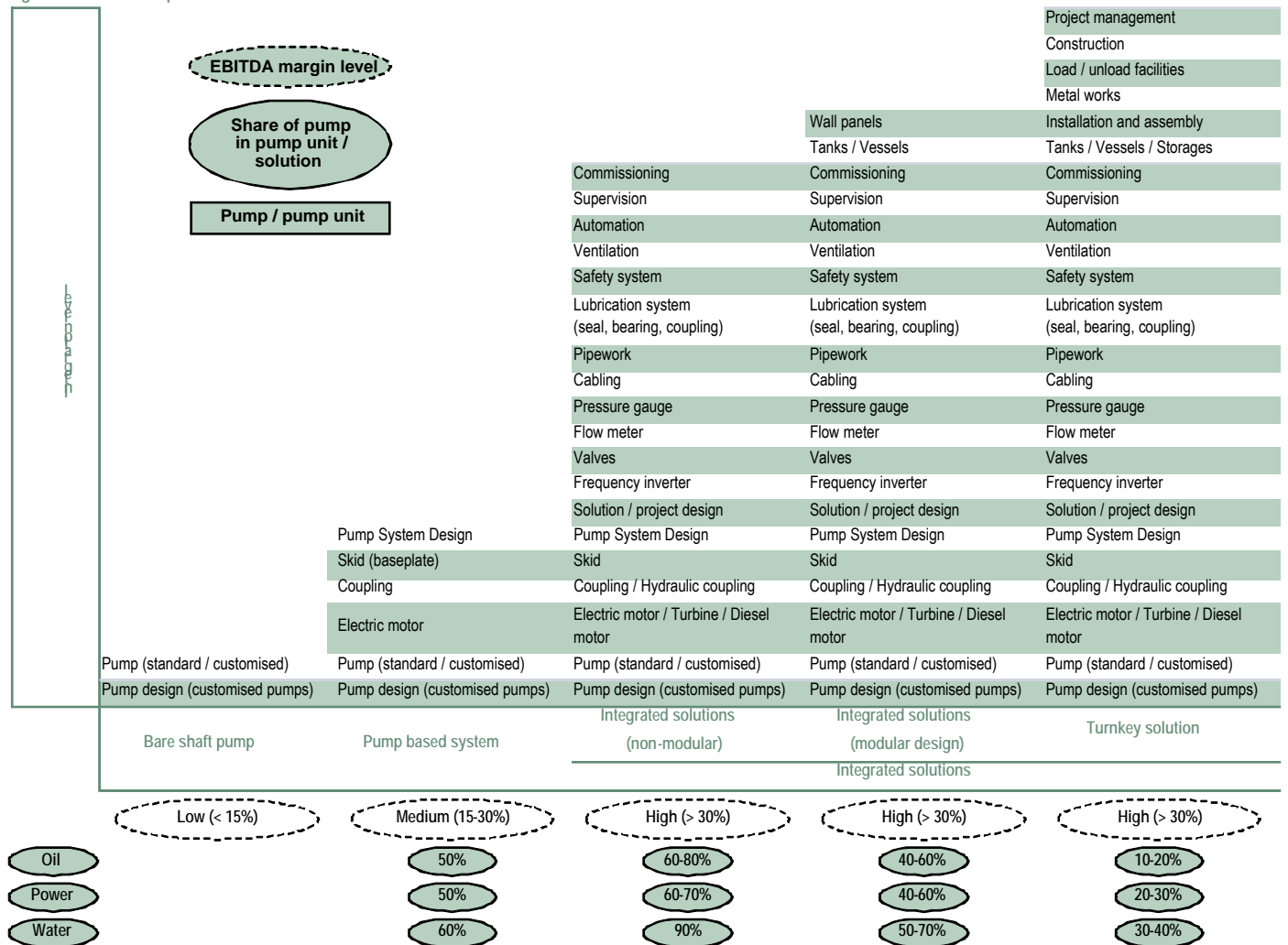
Figure 49: Tender and contract life cycle – EPC



Source: Frost & Sullivan

HMS Group's integrated solutions may be subdivided into three major categories: pure pump-based integrated solutions, pump-based integrated solutions with modular design, and pump-based turnkey solutions. The table below reflects the dynamics of margins along the value chain from the industrial pipe business on a stand-alone basis to integrated solutions, including turnkey solutions.

Figure 50: HMS Group business model



Source: Frost & Sullivan

The oil production and transport segments have suffered from massive underinvestment over the past 20 years, and HMS Group's integrated solutions unit has room to expand in this segment. The total capital investment needed to upgrade existing Russian oil and gas infrastructure has been estimated at \$600bn by the Russian government, according to Frost & Sullivan. If this investment were evenly distributed over 20 years, it would generate yearly investments of \$30bn. Greenfield oil projects and infrastructure improvements will be required to sustain supply levels in line with demand. At the same time, Russia's oil pipeline network is in dire need of investment for the refurbishment of infrastructure. Additional drivers are the development of oil pipelines from new fields and the construction of new export-oriented trunk pipelines.

Taking into current trends in the oil and gas sector, we identify a number of specific sales-growth opportunities for HMS Group in the modular equipment segment:

- Pumping stations: Demand growth is driven by the increasing water cut in the extracted well fluid in exhausted fields (close to 80%) and the development of new fields.
- AGMU: The Russian government has agreed to the concept of a state system for the measurement and control of production and movement of oil and oil products (State System Neftecontrol). The system will tighten control over the quality and properties of oil products.
- Associated gas transport units: The possible tightening of associated gas utilisation requirements (to up to 95% by 2012) is a key growth driver for this segment of modular equipment.

Another very important step for the strengthening HMS Group's position in the integrated solutions segment was the acquisition of GTNG in July 2010. GTNG secures a bridge between the two highest-margin businesses of HMS Group – pumping equipment and oilfield design. We note that the ESPO project run by Transneft is not the sole driver of growth and margins for HMS Group. We see a number of projects, particularly in the upstream oil sector, that we think could be great sales opportunities for HMS Group. The development of the Vankor field by Rosneft and the upgrade of the Samotlor field by TNK-BP may be substantial sources of cash flow for HMS Group, while the ability to supply high-quality, customised, integrated solutions is absolutely necessary for participating in the key growth capex projects of the oil majors.

Construction in the EPC segment generates relatively low margins (5-7%). However, taking into account the huge size of the market for oilfield infrastructure construction (above RUB100bn for FY11 by Frost & Sullivan estimates), even a relatively small share of the sector could make a material contribution to consolidated cash flow. At the same time, the EPC segment also plays a significant role in sustaining HMS Group's margins, as the average margin for the design stage in the oil and gas sector may be estimated at 20-25%. Taking into account the general integration of HMS Group into the real sector, the Group may further strengthen its positions in engineering, research and design services.

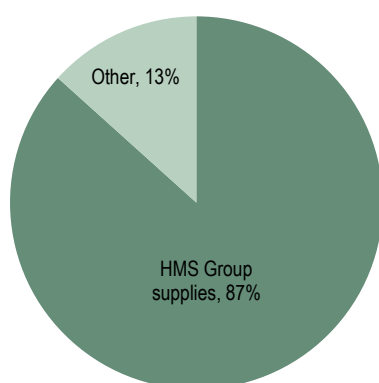
We also see more and more opportunities for integrated solutions and particularly the EPC division of HMS Group in the water utilities sector. Major infrastructure projects in Russia include, first of all, the 2014 Winter Olympics in Sochi, the APEC Summit 2012 in Russia's Far East and the 2018 FIFA World Cup. All these projects require significant new construction and upgrades of existing water utilities. According to Frost & Sullivan estimates, the EPC market for the water supply will more than double over the next five years in Russia.

Finally, we should stress the strength of HMS Group's sales force and general sales competence, as the Group was for more than 10 years in pure sales mode before shifting to the real sector in 2003.

Rising role of after-market services: HMS Group currently benefits from an extensive installed base of pumps in its core segments, which require repair, maintenance and upgrades. We note that HMS Group's current asset portfolio, based on the CIS value chain, largely replicates the structure of the flow solutions sector in the Soviet Union. HMS Group includes nearly all the major producers of

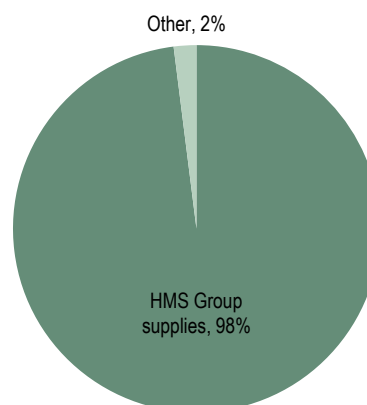
pumps and R&D centres focused on flow solutions that existed in the former Soviet Union. Below (Figures 51-53) we show Frost & Sullivan estimates of the installed base of HMS Group's pumps in core segments.

Figure 51: Water-injection pumps – Installed base



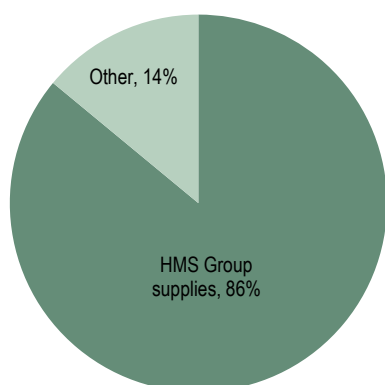
Source: Frost & Sullivan

Figure 52: Oil trunk pipeline pumps – Installed base



Source: Frost & Sullivan

Figure 53: Submersible water-well pumps – Installed base



Source: Frost & Sullivan

For instance, HMS Group has recently upgraded 100 water-injection pumps at TNK-BP sites. The Group was able to raise the pumps' energy efficiency 15% after the upgrade, and TNK-BP recovered the upgrade expenses in one year. Building on its success, HMS Group secured another contract with TNK-BP (in autumn 2010) for the integrated servicing of 36 facilities for oil processing and pumping and 44 facilities for reservoir pressure maintenance. It is worth mentioning that an upgrade costs the customer half as much as a new pump, according to HMS Group. The installed base of HMS Group in Western Siberia comprises 4,000 water-injection pumps.

After-market services currently contribute approximately 10-12% to HMS Group's consolidated revenue line. However, we think growth of the Group's installed base

of pumps and a growing focus by major customers on the efficient outsourcing of maintenance work may increase the share of after-market services to 30%+ of HMS Group's revenues over the longer term. We believe the continuous-cycle nature of HMS Group's business model may secure sustainable cash flow in long term as after-market services become more and more important.

Export markets

HMS Group is exposed to a number of export sales opportunities. Although we do not assume any export sales in our forecasts, we believe they might provide significant upside potential to our investment case. We highlight several key export opportunities below:

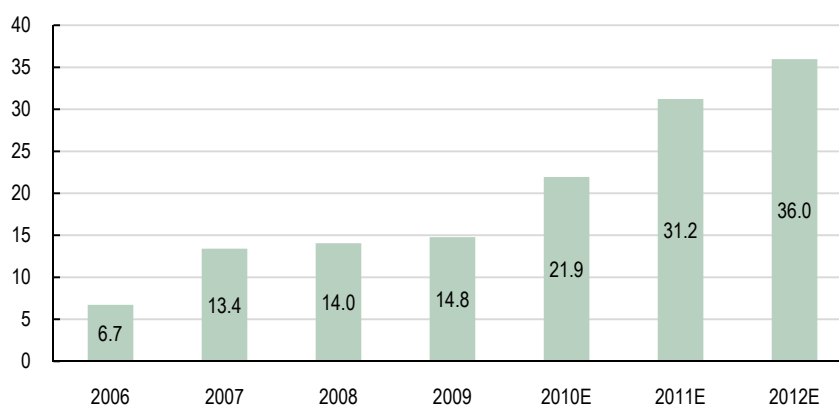
- HMS Group has an office in Baghdad, Iraq and is currently cooperating with BP on an upgrade of the Rumaila oilfield. BP's project includes the modernisation of the field, including drilling new wells, renovating old ones, adjusting the level of pumps, and investing in and optimising the massive water-injection programmes needed to maintain pressure and boost production. Due to the historically close relations between the former Soviet Union and Iraq, there is a significant installed base of HMS pumps from Soviet and post-Soviet projects in the country. We do not exclude the possibility of future cooperation between HMS Group and global oil majors in Iraq beyond the scope of upgrade and maintenance work. It is worth mentioning that the presence of HMS Group's foreign peers in Iraq is quite limited, reflecting the challenging post-war environment.
- Kazakhstan is another attractive export market for HMS Group's pumping equipment for the oil sector. Demand there has grown steadily, particularly for HMS Group's modular equipment. Russia and Kazakhstan have shared a very similar engineering and technical background since the Soviet era, which is a starting point for cooperation in development.
- There is a strong demand for turnkey solutions in the water utilities segment in Central Asian markets, including Turkmenistan, Uzbekistan, Kyrgyzstan and Tajikistan. HMS Group has offices in Turkmenistan and Uzbekistan. The Group recently completed a turnkey construction project for a pumping station on the Amu Darya river in Turkmenistan. Another project in HMS Group's pipeline is a pumping station at the Arnasi water-storage basin in Uzbekistan. Given the challenging water-supply environment in Central Asia, all the countries of this region are very interested in making visible progress towards water security.
- HMS Group has a long history of cooperation with Rosatom in nearly all of Rosatom's major international projects. Above we described the key drivers of demand for pumping equipment and integrated solutions in the nuclear power sector. Rosatom has signed state international agreements and MoUs for the construction of 17 nuclear power units outside of Russia (in Slovakia, Bulgaria, India, China, Turkey, Ukraine, Belarus, Armenia and Vietnam). We think HMS Group is likely to participate in all of these projects, while Rosatom remains one of the most competitive players in the global nuclear power sector.

Financial analysis

Backlog, sales and bookings

HMS Group's revenue demonstrated positive dynamics through 2006-2010E, reflecting CAGR of 26.7% by our estimates.

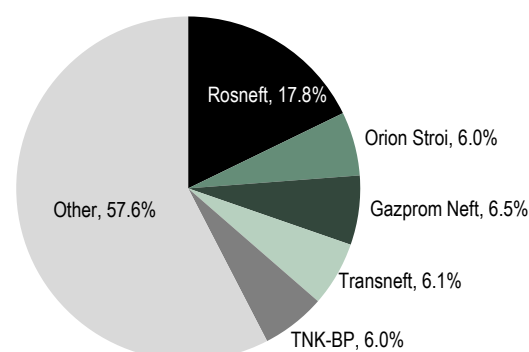
Figure 54: Revenue growth 2006-2010, RUBbn



Source: HMS Group for 2006-2009, Renaissance Capital estimates

HMS Group has a well-established and diversified customer base that includes most of the major names in the Russian oil and gas sector.

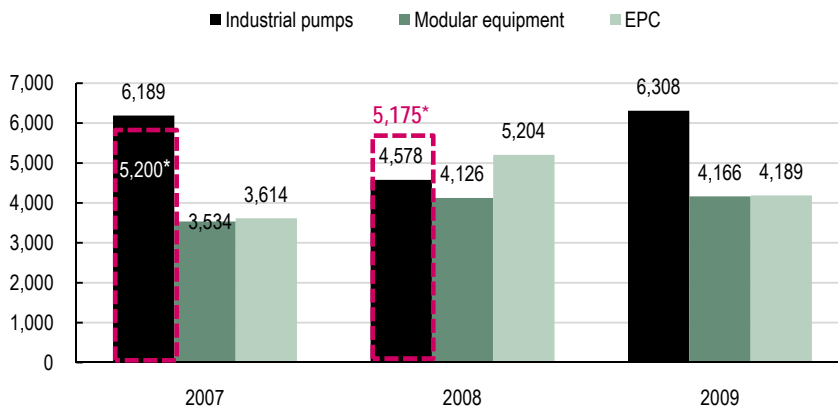
Figure 55: Sales breakdown by clients (2007-9M10)



Source: HMS Group

The positive dynamics of revenue in the industrial pumps and modular equipment segments were largely driven by a growing number of large-scale projects with major customers, including Transneft, Rosneft and Rosatom. The 20% YoY decline in the EPC segment's revenue in 2009 may be explained by its exposure to the construction sector in the post-crisis environment. However, we note that HMS Group's core business units demonstrated a high tolerance to the fallout from the crisis. We identify HMS Group's exposure to the upswing in Russia's infrastructure spending as one of the key drivers for the Group. In general, infrastructure projects are a long-cycle source of business.

Figure 56: Revenue breakdown by segment, RUBmn



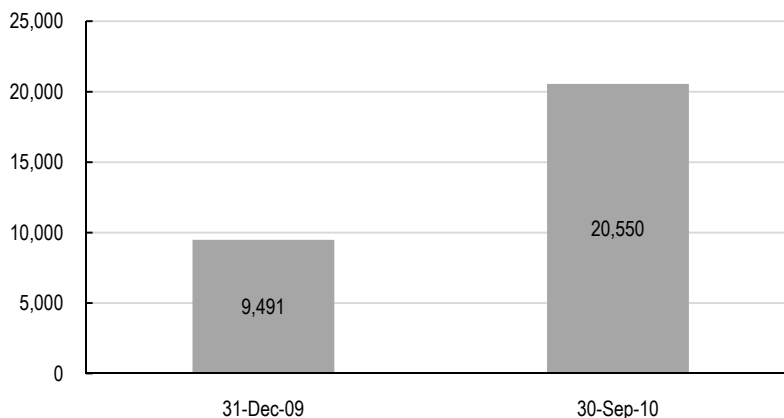
* Excluding effects of hydraulic equipment sales contract in Iraq

Source: HMS Group audited IFRS accounts

The dynamics of HMS Group's backlog in 2010 are shown below. The backlog grew approximately 117% from RUB9.5bn at the end of 2009 to RUB20.6bn on 30 September 2010. The backlog does not, however, include standard pump sales, which have a typical contract cycle of three months. We forecast 42% YoY growth in HMS Group's sales revenue in FY11. The significant backlog growth is driven by the following key projects:

- HMS Group has concluded a number of contracts with Transneft for construction and delivery of oil trunk pumping units and spare parts for the oil pipelines Purpe-Samotlor and ESPO. Total budgeted revenue for these contracts as of 30 September 2010 exceeds RUB12bn. According to IFRS audited accounts for the nine months ended 30 September 2010, payables due to customers (i.e. Transneft prepayment) include the amount of RUB7bn.
- HMS Group increased its exposure to the EPC business at the design stage after the acquisition of GTNG.
- HMS Group has seen a growing number of high-margin orders from the nuclear power sector, backed by Rosatom's plan to build 35 nuclear power blocks. The volume of orders from Rosatom is increasing.

Figure 57: Evolution of backlog, RUBmn

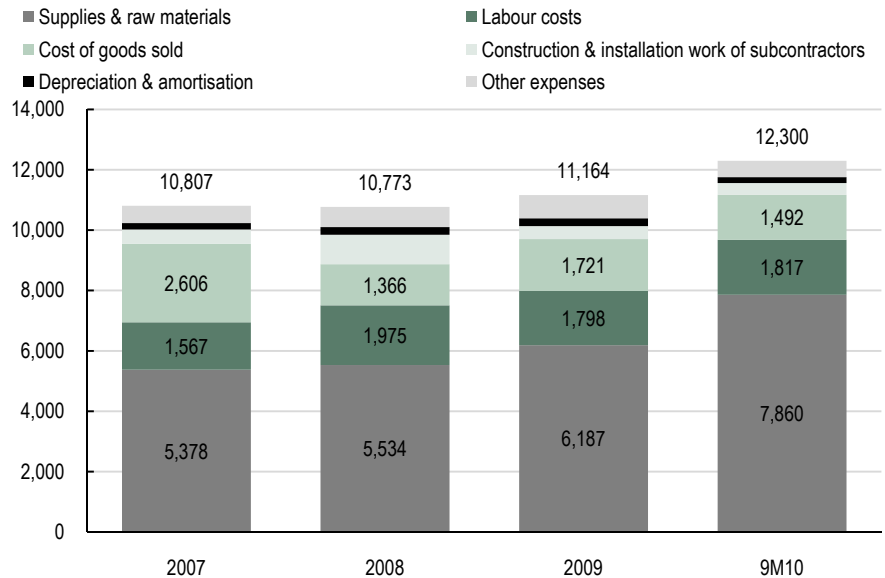


Source: HMS Group

Costs

Approximately 60-65% of HMS Group's cost of sales is for supplies and raw materials. This is the largest expense item for the Group. Ferrous metals account for most of the raw materials cost.

Figure 58: Cost of sales breakdown, RUBmn



Source: HMS Group audited IFRS accounts for 2007-09', IFRS reviewed accounts for 9M10

HMS Group buys some supplies outside Russia. For instance, the Group obtains stainless castings for the pumps it provides to Rosatom from South Korea. It has a number of stainless casting suppliers in South Korea and buys \$10-15mn worth of castings there annually, reflecting approximately 20% of HMS Group's total cost for the pumps it produces for the nuclear power sector. HMS Group arranges for the certification of its casting suppliers according to Russian standards. South Korea has an oversupply in this niche sector, and HMS Group can allocate very big orders to local producers if necessary.

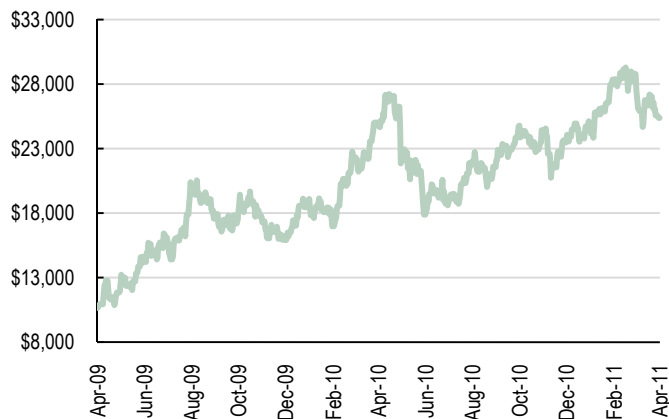
As shown in Figures 59 and 60 below, the prices of ferrous and non-ferrous metals have remained volatile over the past two years. HMS Group is not immune to rising raw materials costs, which are a risk for the business model. However, we think significant hikes in stainless steel prices are unlikely unless the nickel price rises significantly, and nickel appears to us to be oversupplied currently. Even though the global steel price used as a benchmark for Russian domestic steel prices has demonstrated upward dynamics, the YoY increase in steel prices may be limited to 5-10% in FY11, by our estimates. In any case, taking into account HMS Group's market position and the customised nature of its products and flow solutions, it has the ability to transfer raw materials cost pressure to end-consumers, in our view.

Figure 59: World HRC price, \$/tonne



Source: Bloomberg

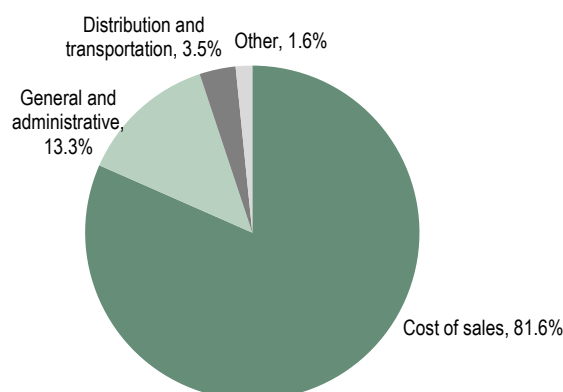
Figure 60: Nickel LME spot price, \$/tonne



Source: Bloomberg

SG&A costs contributed approximately 17% of HMS Group's total operating costs in FY09, which is an average level for the sector.

Figure 61: Total operating cost split, FY09

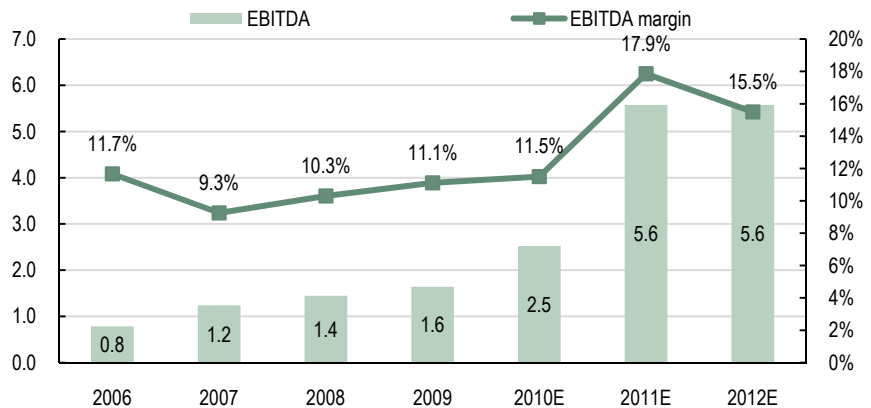


Source: HMS Group

Margins

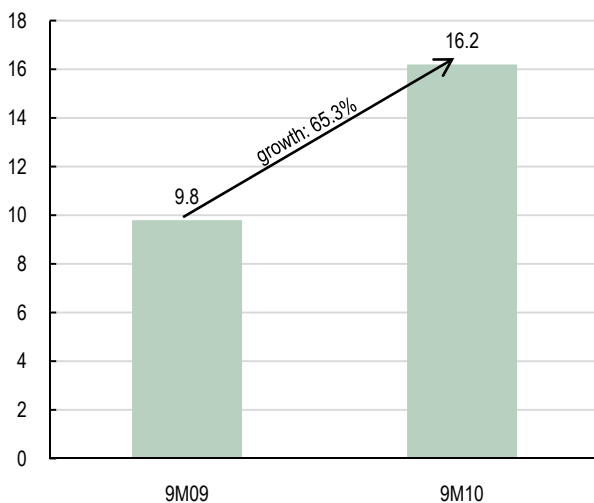
We understand that management is targeting close to a 20% EBITDA margin in FY11, although it has not formally stated a time frame. HMS Group's EBITDA margin has ranged between 9% and 12% over the past five years. We note that the EBITDA numbers in Figure 62 are calculated on a common basis ($EBITDA = \text{Gross Profit} - \text{SG\&A} + \text{D\&A}$), while all other charts in the *Financial analysis* and *Valuation* sections reflect HMS Group's internal method of EBITDA calculation, unless otherwise stated.

Figure 62: HMS Group – EBITDA dynamics, RUBbn



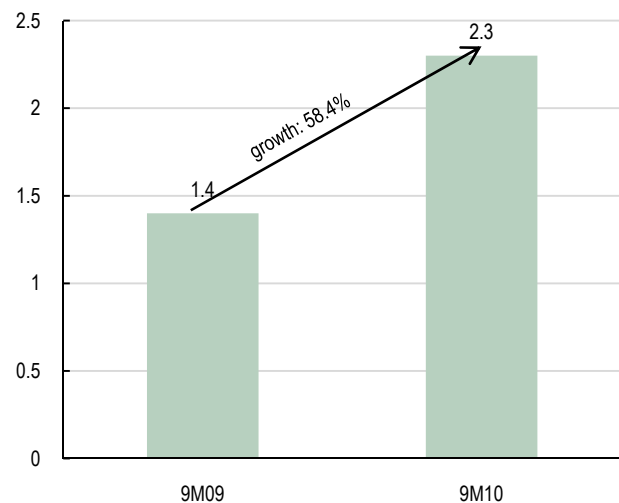
Source: Renaissance Capital analysis

Figure 63: HMS Group – Sales revenue dynamics for 9M10, RUBmn



Source: HMS Group

Figure 64: HMS Group – EBITDA dynamics 9M10, RUBmn



Source: HMS Group

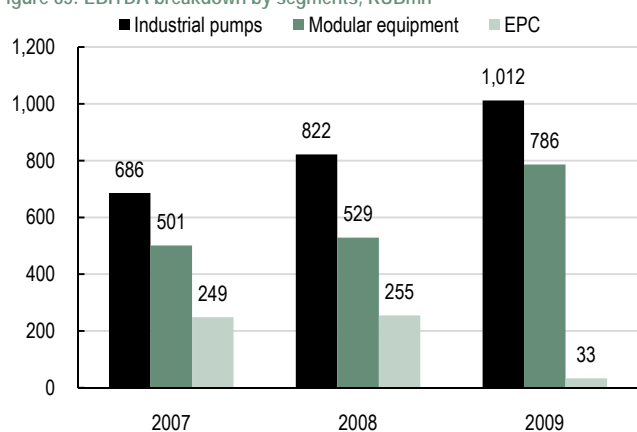
HMS Group has concluded a number of contracts with Transneft for construction and delivery of oil trunk pumping units and spare parts for the oil pipelines Purpe-Samotlor and ESPO. Total budgeted revenue for these contracts as of 30 September 2010 exceeds RUB12bn. According to IFRS audited accounts for the nine months ended 30 September 2010, HMS Group recognised revenue in respect of these contracts of RUB2.35bn. This amount was included as part of the revenue from construction contracts. As of 30 September 2010, payables due to customers (i.e. Transneft prepayment) include the amount of RUB7bn, and advances paid to suppliers and subcontractors by HMS Group include the amount of RUB3.2bn related to Transneft contracts. The Group has historically been able to earn higher margins on its integrated solutions than for bare pumps. Assuming it can maintain high EBITDA performance, we expect that the contracts with Transneft will generate a substantially higher EBITDA margin than is usually derived from sales of bare pumps.

As shown in Figure 66 below, HMS Group's modular equipment segment achieved a 19% EBITDA margin in FY09. The growing share of integrated solutions in HMS

Group's sales mix as well as the share of highly customised pumps implies further upside potential for operating margins in coming years, in our view.

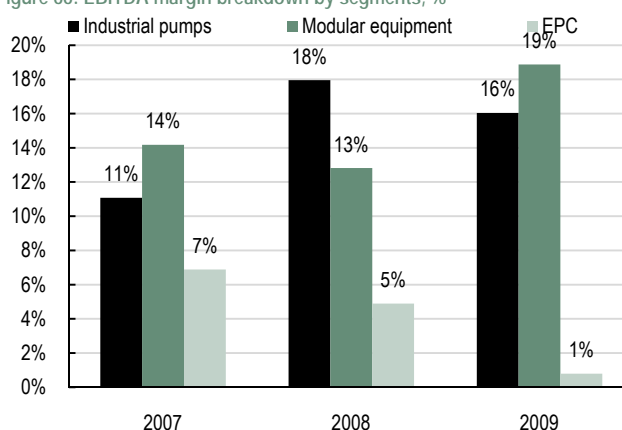
We note that the sustainability of HMS Group's high margins in coming years is not solely driven by contracts with Transneft. The EPC business unit – despite its unimpressive dynamics in 2008-2009 – may also make a solid contribution to HMS Group's results in coming years. The Group may derive approximately RUB5bn of revenue from EPC construction and RUB2.5bn from EPC design in FY11, on our estimates. The margins in the EPC construction segment on a stand-alone basis may rebound to 5-7% this year. In the EPC design segment, we think margins look sustainable at the 20-25% level. The acquisition of GTNG, along with the development of an integrated solutions segment, creates a solid base for HMS Group's higher-margin businesses, in our view. In addition, the EPC unit may strengthen its position in the nuclear power sector, with Rosatom planning the construction of 35 nuclear energy blocks. It is worth mentioning that HMS Group has taken part in nearly all of Rosatom's projects in the post-Soviet period. Overall, HMS Group's margin looks sustainable to us over the medium term, taking into account the transformation of the Group's business model and its exposure to infrastructure spending in the most dynamic and underinvested sectors in Russia.

Figure 65: EBITDA breakdown by segments, RUBmn



Source: HMS Group

Figure 66: EBITDA margin breakdown by segments, %



Source: HMS Group

2011 estimates

We expect sales to increase 42% in 2011. We estimate that the EBITDA margin will increase to 17.9%, with approximately 70% of the proceeds from the trunk oil pumping station contract to be included on the FY11E revenue line. We expect the cost dynamics to be in line with in-house estimates of key economic indicators and the general dynamics of ferrous and non-ferrous metals on the international market.

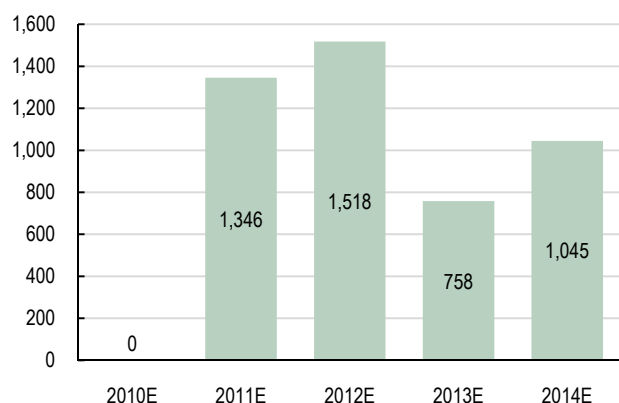
Balance sheet analysis and debt levels

HMS Group has a strong financial position, with gross debt of RUB5.1bn, and cash and cash equivalents of RUB1.9bn as at 30 September 2010. The Group has an internal maximum net debt/EBITDA covenant of 2.5x. In our view, HMS Group's operating cash flow will allow it to meet the stated debt repayment schedule. The Group has the ability to raise debt capital for financing potential M&A transactions

and organic growth in the future. HMS Group also benefits from declining interest rates rolling down the yield curve on its debt obligations. The interest rate in 4Q10E could fall below 10%, compared with 10.2% in 3Q10.

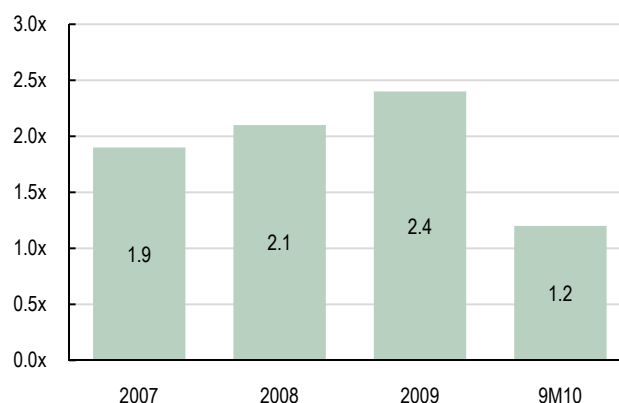
We note that the strong financial position of HMS Group permits a well-balanced use of debt and equity for future M&A and organic growth initiatives.

Figure 67: Debt repayment schedule, RUBmn



Source: HMS Group

Figure 68: Net debt/EBITDA dynamics



Source: HMS Group

We also identify an increase in working capital requirements due to general business enhancement, while the working capital/revenue ratio falls to 5.6% in 9M10 from 19% in FY09. These dynamics may be explained by HMS Group's obtaining large-scale contracts with advance payments of up to 70% – for example, the ESPO contract. We believe HMS Group's moderate working capital requirements give it high tolerance to potential financial market turmoil or even to a liquidity crisis similar to that in 4Q08-1Q09.

Figure 69: Working capital dynamics of HMS Group

	2007	2008	2009	9M10 LTM
Working capital (RUBmn)	1,973	2,222	2,800	1,332
Inventories	1,853	2,433	3,180	3,259
Trade and other receivables	3,869	3,028	2,876	11,007
Trade and other payables	3,749	3,239	3,255	12,934
Change %	21.0%	12.6%	26.0%	-52.4%
Working capital/total assets	0.2x	0.2x	0.2x	0.05x
Working capital/revenue, %	14.7%	15.8%	19.0%	5.6%

Source: HMS Group

Capex and dividends

Substantial investment in production capacity will not be required to meet sales targets.

No dividends are expected in FY10. The Group has also provided guidance for dividends for the year ended 31 December 2011. HMS Group plans to keep the payout ratio at 25% of consolidated net profit in the future. However, the actual size of dividend payments will depend on HMS Group's financial position and performance.

Pre-IPO and post-IPO shareholder structure

Figure 70: Pre-IPO and post-IPO shareholder structure

Shareholder	Total pre-IPO		Total sold		Total post-IPO	
	Number of shares	%	Number of shares	%	Number of shares	%
Vladimir Lukyanenko	37,542,546	36.6%	12,882,790	29.5%	24,659,756	21.0%
German Tsoy (Chairman of the Board)	27,308,499	26.6%	6,516,074	14.9%	20,792,425	17.7%
Artem Molchanov (CEO)	9,250,899	9.0%	2,207,355	5.1%	7,043,545	6.0%
Nikolay Yamburenko (Head of Pumps Division)	8,063,153	7.9%	1,923,947	4.4%	6,139,207	5.2%
Vladimir Yamburenko (Head of NasosEnrgoMash)	6,228,423	6.1%	1,486,162	3.4%	4,742,261	4.0%
Yuri Skrynnik (Head of Strategy)	4,174,009	4.1%	1,431,586	3.3%	2,742,424	2.3%
Kirill Molchanov (1st Deputy CEO)	2,896,942	2.8%	691,238	1.6%	2,205,704	1.9%
Vasiliy Khromov	1,467,783	1.4%	350,227	0.8%	1,117,556	1.0%
A. Frolov	1,264,998	1.2%	301,841	0.7%	963,157	0.8%
A. Borovko	1,187,746	1.2%	283,408	0.6%	904,338	0.8%
Others	3,215,001	3.1%	1,001,946	2.3%	2,213,055	1.9%
Principal and selling shareholders	102,600,000	100.0%	29,076,573	66.6%	73,523,427	62.8%
Primary shares			14,563,427	33.4%	14,563,427	12.4%
Secondary shares			29,076,573	66.6%	29,076,573	24.8%
Free float			43,640,000		43,640,000	37.2%
	102,600,000			100.0%	117,163,427	100.0%

Source: Company data

Financial summary

Figure 71: HMS Group – Financial summary

	FY08	FY09	FY10E	FY11E	FY12E	FY13E	FY14E
Income statement (RUBmn)							
Revenue	14,046	14,772	21,949	31,214	35,975	42,181	48,732
Cost of sales	(10,773)	(11,164)	(17,281)	(23,200)	(27,401)	(31,706)	(36,397)
Gross profit	3,274	3,608	4,668	8,014	8,574	10,475	12,335
Gross margin	23.3%	24.4%	21.3%	25.7%	23.8%	24.8%	25.3%
SG&A	(2,171)	(2,309)	(2,655)	(3,068)	(3,719)	(4,254)	(4,853)
EBITDA*	1,451	1,643	2,524	5,573	5,574	7,016	8,354
EBITDA margin*	10.3%	11.1%	11.5%	17.9%	15.5%	16.6%	17.1%
D&A	(348)	(344)	(511)	(628)	(720)	(795)	(872)
EBIT	1,103	1,299	2,013	4,945	4,854	6,220	7,482
NOPLAT	898	1,087	1,623	3,506	3,406	4,292	5,104
Net interest expense	(462)	(807)	(702)	(342)	(195)	(52)	97
Income from associates	49	17	0	0	0	0	0
Other expenses (net)	(190)	(215)	(95)	(113)	(143)	(154)	(163)
Exceptionals/write downs	34	0	0	0	0	0	0
PBT	534	295	1,216	4,490	4,516	6,015	7,416
Tax	(204)	(212)	(390)	(1,440)	(1,448)	(1,929)	(2,378)
Effective rate	38%	72%	32%	32%	32%	32%	32%
Net profit	330	83	826	3,050	3,068	4,086	5,038
Net margin	2.3%	0.6%	3.8%	9.8%	8.5%	9.7%	10.3%
Cash flow (RUBmn)							
CF from operations	733	(211)	4,999	1,952	3,629	3,822	6,558
Capex	(661)	(212)	(819)	(1,049)	(1,124)	(1,191)	(1,242)
Acquisitions	(261)	(240)	(2,060)	0	0	0	0
Free CF	(393)	(721)	2,121	903	2,345	2,631	5,316
Borrowings and financial lease (net)	978	1,184	(28)	(4,907)	(862)	(1,086)	(1,226)
CF from financing	695	815	(348)	(1,869)	(1,262)	(1,486)	(1,626)
Net change in cash	302	95	1,773	(966)	1,083	1,145	3,690
Cash at YE	669	758	2,530	1,564	2,647	3,793	7,482
Balance sheet (RUBmn)							
Current assets	6,203	6,907	13,382	8,370	12,313	15,019	19,533
Cash and investments	669	758	2,530	1,564	2,647	3,793	7,482
PP&E	3,928	3,955	5,705	6,124	6,764	7,158	7,527
Non-current assets	4,797	4,904	8,462	8,883	10,006	10,402	10,772
Total assets	11,000	11,811	21,844	17,254	22,319	25,421	30,306
Current liabilities	7,900	5,696	12,888	6,222	9,588	9,376	10,848
Non-current liabilities	375	3,740	4,886	4,172	2,647	2,274	1,048
Net debt**	3,413	4,518	2,730	2,098	153	(2,078)	(6,994)
Total liabilities	8,275	9,436	17,774	10,395	12,234	11,650	11,897
Shareholders' equity	2,077	1,705	2,211	5,000	7,663	11,350	15,988
Minorities	648	670	1,859	1,859	2,421	2,421	2,421
Total liabs and SH equity	11,000	11,811	21,844	17,254	22,319	25,421	30,306
Ratio analysis							
Sales growth	5%	5%	49%	42%	15%	17%	16%
Cost growth	0%	4%	55%	34%	18%	16%	15%
EBITDA growth	17%	13%	54%	121%	0%	26%	19%
Earnings growth	-33%	-75%	894%	269%	1%	33%	23%
Net debt/EBITDA	2.4	2.7	1.1	0.4	0.0	-0.3	-0.8
Net debt/equity	1.6	2.6	1.2	0.4	0.0	-0.2	-0.4
RoA	3%	1%	5%	16%	16%	17%	18%
RoE	17%	4%	42%	85%	48%	43%	37%
Capital employed (YE)	5,487	6,602	7,241	8,071	9,565	11,768	14,774
Invested capital (YE)	5,285	6,206	5,693	5,928	7,403	8,532	9,119
RoCE	6%	1%	11%	38%	32%	35%	34%
RoIC	6%	1%	15%	51%	41%	48%	55%
ROIC/WACC	0.5	0.1	1.1	4.1	3.3	3.8	4.4

*EBITDA is calculated on a common basis (EBITDA = Gross Profit - SG&A + D&A)

**Net Debt = ST and LT borrowings - Cash and cash equivalents

Source: HMS Group for 2008-09, Renaissance Capital estimates

Management

Board of directors

German A. Tsoy has been chairman and a non-executive member of the board of directors in HMS Group since 2010. Tsoy is one of the founders of HMS Group. Since the establishment of the group in 1993, Tsoy has held different executive positions. In July 2008 he became a member of the board of directors. Prior to that, from 2005, he was president of HMS Group. Prior to a career with HMS Group, from 1987 until 1990, Tsoy worked at the Osh United Air Group of the Kyrgyzstan Agency of Civil Aviation, in various roles. Tsoy graduated from the Fergana Polytechnic Institute, where he studied the power supply of industrial enterprises, and from the Buguruslan Flying School of Civil Aviation.

Vladimir V. Lukiyanenko has been a non-executive member of the board of directors of HMS Group since 2010. Lukiyanenko has more than 15 years of management experience. Currently, he is also the general director of OOO Gidromashinvest. Previously, until 2008, he was vice president of OOO Hydraulic Machines. His earlier work experience included the role of chairman of the supervisory board of OAO Sumy Frunze NPO from 2003 until 2007 and executive positions at OAO Sumy Frunze NPO (Ukraine). Lukiyanenko studied cryogenic technology at the Moscow Institute of Chemical Machinery (currently Moscow State University of Engineering Ecology).

Artem V. Molchanov is CEO of HMS Group and a member of the board of directors. He was one of the co-founders of the Group (in 1993) and has more than 17 years of management experience at HMS Group. He became president in 2008. From 2005 Molchanov was CEO of OOO HMS Management Company. Prior to that, from 1993 until 2005, he was deputy general director of OOO Hydromashservice Trading Company. Molchanov studied the economics of manufacturing enterprises at the Plekhanov Russian Academy of Economics (currently Plekhanov Russian University of Economics), from which he graduated with a degree in the economics of manufacturing facilities.

Kirill V. Molchanov has been first deputy CEO of HMS Group since 2006. He also serves as an executive member of the board of directors, appointed in 2010. He is currently responsible for finance, IT and HR. Molchanov was deputy general director on the Group until 2005. As one of the co-founders of the Group (in 1993), he has held various executive positions since its establishment, for a total of 17 years of management experience at HMS Group. He studied electronic computing machines at Bauman Moscow State Technical University, graduating with a degree in mechanical engineering. He is currently enrolled in an executive MBA programme at Cambridge Judge Business School.

Philippe Delpal was appointed as an independent non-executive member of the board of directors of HMS Group in 2010 and is the head of the Audit Committee. Previously, in the period from 2007 to 2010, Delpal was president of BNP Paribas Vostok in Russia. Prior to that, Delpal founded Cetelem Russia in 2006 and served as its CEO from 2006 until 2010. He served as the chairman of the board of directors at Rusfinance Bank from 2004 until 2006. Delpal held various managerial positions at Société Générale from 1996 until 2004 and served as an IT specialist at CERN, the European Organisation for Nuclear Research, from 1994 until 1996. He graduated from the Telecom Paris University with a degree in IT, economics and management. Delpal was appointed to the French Foreign Trade Advisory by the French government.

Andreas S. Petrou has been a non-executive member of the board of directors of HMS Group since 2010. Prior to that, in 1989-1998, he was a member of the board of The Cyprus Tourism Development Public Company Ltd, where he represented the interests of the Government of the Republic of Cyprus. In 1987-1990, Petrou was the general secretary of the Cyprus Dairy Organisation. Petrou has been a member of the Cyprus Bar Association since 1985. He founded his own law office in 1985. Petrou is an honours graduate of the Law School of Democritus University of Thrace.

Yury N. Skrynnik has been a non-executive member of the board of directors of HMS Group since 2010. He has been responsible for strategic marketing since 2008. Skrynnik has more than 15 years of science and management experience. In 1999-2007, he was the chief representative of OAO Sumy Frunze NPO (Ukraine) in the Russian Federation. Before that, in 1992-1999, Skrynnik worked as the director of the innovative technical subdivision of OOO Machines, Equipment, Technologies, Products and Services. Earlier, in 1986-1992, he was a scientific research officer at the Moscow Institute of Chemical Machinery (currently Moscow State University of Engineering Ecology). Skrynnik studied machines and chemical industry technology at the Sumy branch of Kharkiv Polytechnic Institute. He has a PhD in engineering science and is the author of more than fifty scientific publications.

Nikolai N. Yamburenko has been an executive member of the board of directors of HMS Group since 2010. Yamburenko has 32 years of industry experience, including seven years at HMS Group, which he joined in 2003. He has been head of the industrial pumps business unit at OOO HMS Management Company, responsible for the pump division. Since 2004, he has held executive positions at Hydromashservice and OOO HMS Management Company. In 1998-2005, he was CEO of OAO Livgidromash, a subsidiary of SMR Group. Yamburenko studied construction and the production of radio equipment at the Moscow Aviation Institute, from which he graduated with a degree in radio electronics.

Management

Andrey V. Nasledyshev is the CEO of OOO HMS Management Company. Nasledyshev is responsible for company strategy, M&A activity, marketing and legal issues. Nasledyshev has 11 years of industry experience, including six years at HMS Group (since 2004). Prior to that, he held senior management positions at OAO Siberian Aluminum Group (Basic Element). Before that, he held similar roles at OAO RusPromAuto. Nasledyshev has seven years of experience in the execution of M&A deals in the oil and gas and machine-building industries. He graduated from the Plekhanov Institute, with a degree in economic cybernetics, and the Higher School of Economics (Prague, Czech Republic). He also holds an executive MBA degree from the University of Antwerp Management School.

Mikhail Y. Kuzmenko is the CFO of HMS Group. Kuzmenko has more than 10 years of experience in finance. Kuzmenko held a similar position at State Unitary Enterprise Gamma Chemical Plant from 1997. Kuzmenko graduated from Moscow Technical Forest Institute (currently Moscow State Forest University) with a degree in economics and the organisation of wood processing and the pulp and paper industry. Kuzmenko holds a PhD in economics.

Vladimir Moiseyenko has been head of the EPC business unit since 2005, when he joined HMS Group. Moiseyenko has 32 years of industry experience, including his time at HMS Group. Before joining HMS Group, he held executive positions at

Yukos Exploration and Production Company and worked at other Russian oil and gas companies. Moiseyenko is a graduate of the Tyumen Industrial Institute.

Anatoly V. Nazarov has been the head of the oil and gas equipment business unit of SMR Group since he joined the Group in 2006. He has 33 years of industry experience, including four at SMR Group. Prior to that, Nazarov worked as CEO of ZAO Yukos Refining and Marketing (Yearx-Yearx). From 1993 Nazarov held executive positions at OAO Yukos Oil Company. Nazarov is a Volgograd Polytechnic Institute graduate with a degree in automobile transport and has a PhD in economics. He is also an Honourable Oilman of the Tyumen region.

Andrey E. Novikov is the head of the oil and gas equipment business unit at HMS Group. He is in charge of sales in this unit. Novikov has 12 years of experience in the pump and oil and gas industry, including 10 years at HMS Group, which he joined in 1998 in the role of deputy head of the sales department. In 2001-2002, he served as general director of ZAO Elteco, and in 1998-2000, he was deputy head of the commercial department at OOO Hydromashservice. Novikov is a graduate of Moscow State Institute of Electronics and Mathematics (Technical University), with a degree in engineering and mechanics.

Igor B. Tverdokhle has been the director of R&D at HMS Group since 2006. Tverdokhle has 24 years of experience in the industry, including 10 years in R&D in the oil and gas sector and his six years at HMS Group (since 2004). He was the engineering director at OOO HMS Management Company in 2005, and prior to that worked as deputy chief engineer at OAO Sumy Frunze NPO (Ukraine). Earlier, from 2001 until 2004, he was the chairman of the management board at VNIIAEN – the largest R&D centre for pump development in the CIS. Tverdokhle graduated from the Sumy branch of the Kharkiv Polytechnic Institute with a degree in chemical engineering and mechanics. He also holds a PhD in engineering science.

Appendix

Capex programs

Figure 72: Capex forecast for oil exploration and production

Oilfield	Operator	Reserves, mnt	Project timeline	Total capex, RUBbn	Capex, 2010-2015, RUBbn	2010E	2011E	2012E	2013E	2014E	2015E
Vankor	Rosneft	524	2009-2017	369	316						
Verkhnechonsk	TNK-BP	202	2009-2015	138	120						
Tyamkinsk (Uvat region)	TNK-BP	75	2010-2012	85	85						
Samotlor	TNK-BP	400	2009-2014	166	138						
Russkoye	TNK-BP	306	2009-2015	135	115						
Talakan and Alinsk	Surgutneftegas	135	2010-2014	231	231						
Prirazlomnoye	Sevmorneftegaz	46	2009-2011	70	47						
Priobskoe	Rosneft	694	2008-2013	130	87						
Sakhalin offshore	Rosneft, Gazprom	394	2006-2030	6,300	1,512						
Other projects (Yurobcheno-Tokhomskoe, Korchaginsk, East-Messoyakhsk group, Sakhalin 1 and 2, Novoport, YANAO-North of Krasnoyarsk Krai, Titov and Trebs, Salym, Pyakyahinskoe, Verkhnekolik-Yeganskoe, Kamennoe, Moskovtsova, Labaganskoe, Osoveyskoe, Koltogorskoe, Ozernoe, Lyaminskoe, Rogonizhnikovskoe, Vysotnoe, Taas-Yuryakch, etc.)					1,990						
Replacements and upgrades					1,226						
Total capex					5,869						
Total investments on pump systems for exploration (pumps for water injection, oil production, drilling)					280						
Total investments on pump systems incl. integrated solutions for exploration					340						

Source: Frost & Sullivan

Figure 73: Capex forecast for refining

Investment project	Project	Project timeline	Total capex, RUBbn	Total capex till 2015, RUBbn	2010E	2011E	2012E	2013E	2014E	2015E
Komsomol'sk refinery	Reconstruction and upgrade	2010-2012	24	24						
Tuapse refinery	Upgrade	2010-2014	4	4						
Kuybyshev refinery	Reconstruction and upgrade	2010-2015	7	7						
Syzran' refinery	Reconstruction and upgrade	2010-2015	25	25						
Novokuybyshevsk refinery	Reconstruction and upgrade	2010-2015	24	24						
Achinsk refinery	Reconstruction and upgrade	2010-2014	13	13						
Angarsk refinery	Reconstruction and upgrade	2010-2014	12	12						
Nakhodka refinery	Construction of a plant	2009-2017	270	180						
Grozny refinery	Construction of a plant	2011-2014	12	12						
Saratov refinery	Reconstruction and upgrade	2011-2012	9	9						
Volgograd refinery	Reconstruction and upgrade	2011	11	11						
Nizhny Novgorod refinery	Reconstruction and upgrade	2011-2015	30	30						
Kirishi refinery	Reconstruction and upgrade	2011-2020	198	175						
Yaroslavl refinery	Reconstruction and upgrade	2011	4	4						
Moscow refinery	Reconstruction and upgrade	2011-2020	33	15						
Omsk refinery	Reconstruction and upgrade	2010-2017	7	5						
Ufa refinery	Reconstruction and upgrade	2011-2014	9	9						
Ufaorgsintez	Reconstruction and upgrade	2011-2014	4	4						
Salavatorgsintez	Reconstruction and upgrade	2011	55	5						
Orskneftegazsintez	Reconstruction and upgrade	2010-2012	9	9						
Khabarovsk refinery	Reconstruction and upgrade	2009-2012	40	40						
Mariy refinery	Reconstruction and upgrade	2011-2015	60	60						
TANECO Oil Refining and Petrochemical Complex	Upgrade and construction of a plant	2009-2015	220	220						
Verkhoturksk refinery	Construction of a plant	2011-2014	72	72						
Tomsk refinery	Construction of a plant	2011-2015	45	45						
Yaisk refinery	Construction of a plant	2008-2014	22	15						
Other projects, including mini refinery plant construction										
Upgrading and replacement										
Total capex										
Total capex on pumping systems for refining										
Total capex on pumping systems including complex solutions for refining										

Source: Frost & Sullivan

Figure 74: Capex forecast for thermal power generation

Investment project	Generation capacity, MW	Project timeline	Investment, RUBmn		Project timeline					
			Total capex	Capex, 2010-15	2010E	2011E	2012E	2013E	2014E	2015E
TGK1	1,520	2006-2015	115,874	72,514						
TGK2	1,410	2006-2015	31,502	27,950						
TGK3 Mosenergo	1,992	2006-2014	87,895	39,487						
TGK4 Kvadra	1,040	2006-2015	30,254	20,616						
TGK5	710	2007-2014	22,068	14,074						
TGK6	750	2007-2014	22,000	16,192						
TGK7 Volga	470	2006-2012	19,834	10,641						
TGK8	890	2006-2013	38,916	17,642						
TGK9	1,409	2006-2017	54,395	27,930						
TGK10 Fortum	2,359	2006-2015	57,619	46,762						
TGK11	302	2007-2015	32,889	26,119						
TGK12 Kuzbassenergo	428	2006-2013	30,546	21,199						
TGK13 Yenisei	320	2006-2013	15,177	10,317						
TGK14	27	2006-2010	9,569	7,687						
OGK1	2,130	2006-2015	83,636	42,222						
OGK2	1,860	2006-2016	53,220	36,870						
OGK3	2,042	2006-2014	62,757	45,776						
OGK4	2,509	2006-2014	104,364	76,225						
OGK5	1,600	2007-2013	61,976	31,716						
OGK6	1,821	2007-2014	252,017	233,710						
Other projects (including public utilities and industrial enterprises)	1,510	2010-2015	785,100	785,100						
Investments of modernisation and repairs		2010-2015	350,000	350,000						
Thermal power generation investment				1,960,750						
Pumping equipment investment				17,000						
Pumping equipment with integrated solutions investment				26,500						

Source: Frost & Sullivan

Figure 75: Capex forecast for nuclear power generation

Investment project	Generation capacity, MW	Project timeline	Investment, RUBmn		Project timeline					
			Total capex	Capex, 2010-15	2010E	2011E	2012E	2013E	2014E	2015E
Rostov NPP: Reactor No 2	1,000	2005-2011	30,120	1,000						
Reactor No 3	1,100	2009-2015	64,860	47,637						
Reactor No 4	1,100	2011-2017	67,550	67,550						
Kalininsk NPP: Reactor No 4	1,000	2006-2012	48,832	12,698						
Beloyarsk NPP: Reactor No 4	800	2007-2013	65,578	33,721						
Novovoronezh NPP-2: Reactor No 1	1,100	2007-2013	66,025	31,715						
Reactor No 2	1,100	2008-2014	64,894	46,769						
Leningrad NPP-2: Reactor No 1	1,100	2008-2014	69,024	49,712						
Reactor No 2	1,100	2009-2015	67,735	61,745						
Reactor No 3	1,100	2010-2016	67,276	67,276						
Reactor No 4	1,100	2011-2017	67,550	67,550						
Kursk NPP-2: Reactor No 1	1,100	2010-2016	67,276	67,276						
Reactor No 2	1,100	2012-2018	67,735	59,141						
Reactor No 3	1,100	2013-2019	67,735	39,080						
Reactor No 4	1,100	2014-2020	67,735	20,707						
Smolensk NPP-2: Reactor No 1	1,100	2012-2018	67,735	55,741						
Reactor No 2	1,100	2013-2019	67,735	39,080						
Reactor No 3	1,100	2014-2020	67,735	20,707						
Reactor No 4	1,100	2015-2021	67,735	7,727						
Kolsk NPP-2: Reactor No 1	1,100	2015-2021	67,735	7,727						
NPP Mochovce (Slovakia): Reactors 3, 4	440	2010-2013	53,458	53,458						
NPP Belene (Bulgaria): Reactor No 1	1,000	2011-2015	128,000	128,000						
NPP Kudankulam (India): Reactors 3, 4	1,000	2012-2017	108,000	64,800						
NPP Tianwan (China): Reactors 3, 4	1,000	2011-2016	108,000	86,400						
NPP Akkuyu (Turkey): Reactors 1-4	1,200	2014-2019	204,000	27,100						
Investments in other projects: Ukraine (2 reactors), Belarus (2 reactors), Armenia (1 reactor), Vietnam (1 reactor) etc.	1,200	2012-2019	2,500,000	1,580,530						
Repair, maintenance and useful life prolongation costs		2010-2015	500,000	500,000						
Nuclear power generation investment				3,244,848						
Pumping equipment investment (incl. MCP)				27,000						
Pumping equipment (incl. MCP) with integrated solutions investment				41,000						

Source: Frost & Sullivan

Figure 76: Capex forecast for oil pipelines

Project	Pipeline length, km	Rate of flow, mn tpa	Project timeline	Total capex, RUBbn	Capex, 2010-2015 RUBbn	2010E	2011E	2012E	2013E	2014E	2015E
ESPO 1	2,694	20	2006-2011	450	50						
ESPO 1 extension	n/a	30	2010-2013	200	200						
ESPO 2	2,046	30	2009-2013	283	230						
ESPO 2 extension	300	17	2012-2015	172	172						
BTS-2	1,000	50	2009-2012	120	100						
Zapolyarnoe-Purpe	536	45	2011-2015	120	120						
Purpe-Samotlor	430	25	2010-2012	45	45						
Project Yug (South)	1,465	9	2011-2013	81	81						
Haryaga-Yuzhny Khylochuy	160	8	2010-2012	90	90						
KTK -2	1,510	35	2012-2014	88	88						
Yurobcheno-Tokhomskoe-Taishet	600	18	2012-2013	63	63						
Tikhoretsk-Tuapse 2	295	12	2011-2012	20	20						
Komsomolsky NPZ-Port De-Kastry (oil products pipeline)	313	9	2012-2014	50	50						
Komsomolsky NPZ-Port De-Kastry (oil pipeline)	300	na	2012-2014	45	45						
Other projects (crude oil flow expansion for pipelines: Purpe-Kholmogory, Usa-Ukhta-Yaroslavl, pipeline from <i>Northern Caspian</i> oil region, Kirishi-Primorsk, etc.)					1,204						
Replacements and upgrades					850						
Total capex					3,408						
Total investments on pump systems for pipeline					40						
Total investments on pump systems incl. integrated solutions for pipelines					60						

Source: Frost & Sullivan

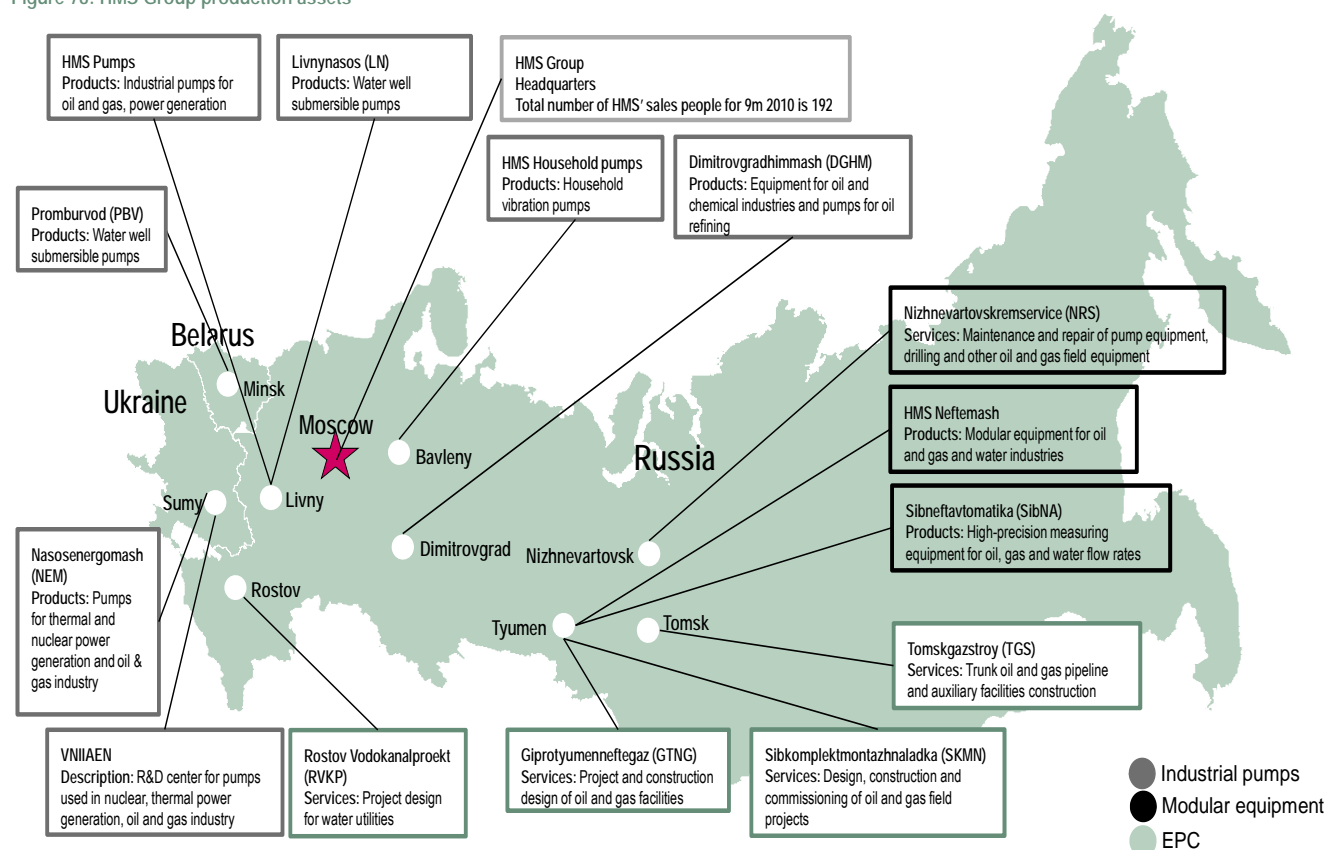
Figure 77: Capex forecast for water utilities
Private-sector programmes

Company		Project timeline	Total capex, RUBmn	Capex, 2010-2015, RUBmn	2010E	2011E	2012E	2013E	2014E	2015E
JSC Evraziysky	Water supply in Rostov-on-Don and the southwest Rostov region	2009-2026	21,903	7,300						
	Investment project Clean Don	2009-2019	3,306	1,802						
	Water supply and sewage systems in Azov and the Black Sea region	2009-2013	4,300	3,440						
JSC RKS	Modernisation of the water supply system in Perm	2009-2011	474	316						
	Construction and modernisation of water supply system in Petrozavodsk	2009-2012	394	296						
	Development of heat supply system in Vladimir and the Vladimir region	2009-2012	362	272						
	Modernisation of biological water-treatment facilities	2009-2011	360	240						
	Water supply systems in Kirov (Federal programme Zhilische)	2009-2011	132	66						
JSC Rosvodokanal	Barnaul	2009-2011	6,932	4,772						
	Kaluga	2009-2011	3,319	2,116						
	Krasnodar	2009-2011	1,890	1,260						
	Omsk	2009-2010	1,587	794						
	Orenburg	2009-2011	946	630						
	Tver	2009-2015	2,525	2,165						
	Tyumen	2009-2011	2,700	1,800						
State programmes										
St Petersburg Water Utilities Development Programme		2010-2025	274,200	102,825						
Grozvodokanal		2010-2011	105,127	105,130						
Russian Federal Target Investment Programme	Economic and social development in the Far East and Transbaikalia	2010-2013	100	100						
	FGUP Capital construction division # 900 under the Federal Agency for Special Construction, Moscow	2010-2013	1,018	1,018						
	Water utilities and environmental protection	2010	7,251	7,251						
Regional "Clean Water" programmes (unconfirmed budget)		2011-2017	1,500,000	500,000						
Water Strategy of Russian Federation until 2020 (excl. "Clean Water")	Public and industrial water supply	2009-2020	184,145	92,073						
	Protection and reconstruction of water objects	2009-2020	186,109	93,055						
	Protection from unfavourable impacts of water	2009-2020	326,182	163,090						
Federal programme Zhilische (public housing) 2011-2015		2011-2015	620,000	620,000						
Sub-programme: Modernisation of municipal infrastructure objects		2011-2012	6,696	6,696						
Investments in other projects				1,743,065						
Replacement and amortisation				580,000						
Total investments in water utilities				4,041,570						
Total investments on pump equipment in water utilities				93,987						
Total investments on pump equipment with complex solution in water utilities				120,000						

Source: Frost & Sullivan

Portfolio of assets

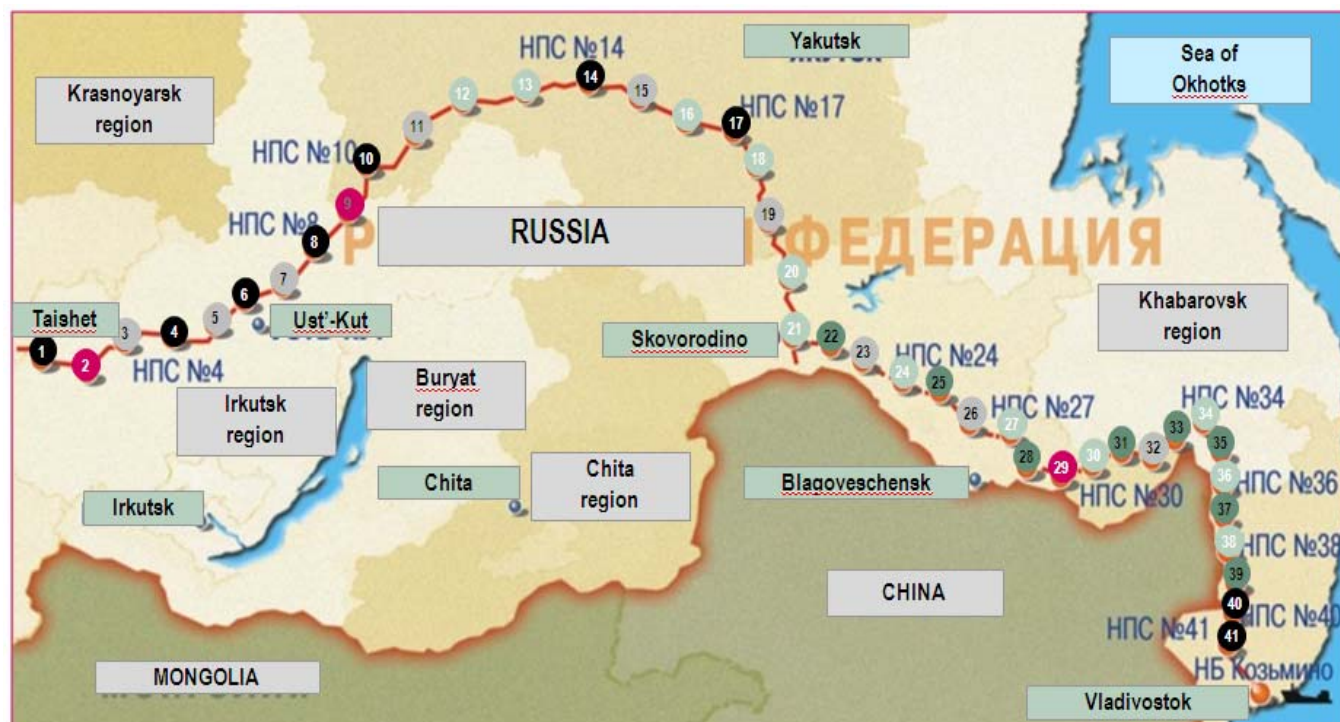
Figure 78: HMS Group production assets



Source: HMS Group

Transneft's East Siberia – Pacific Ocean (the ESPO) project

Figure 79: East Siberia – Pacific Ocean pipeline



Total number of pumping stations	41
● Pumping stations under construction by HMS	12
● Pumping stations constructed by Sulzer and Turbonasos	9
● Pumping stations to be constructed	20

Purposes of new pumping stations – increasing capacity	20
● For Komsomolsk and Khabarovsk refineries	9
● For Primorsk refinery	4
● Not information the present time. Supposedly – for increasing of capacity after launching new branches from oilfields	7

Source Company data, Transneft.

Peer analysis

Figure 80: Description of major peers

Company		Principal products	\$mn	By segment	Sales (2009)		By end-market	EBITDA margin (2009)	CAGR 2010-12E	
					By geography				For sales	For EBITDA
Ebara	- Engineered pumps	Fluid machinery & systems: 60% Environmental engineering: 29% Precision machinery: 11%	5,102		Japan: 81% North America: 12% Other: 7%	na	3.1%	-0.2%	14.0%	
	- Standard pumps									
	- Turbo-compressors, blowers, and fans									
	- Steam and gas turbines									
	- Waterworks and sewage systems									
	- Industrial water/wastewater treatment plants									
	- CMP and plating systems									
	- Bevel polishing equipment									
- Dry vacuum pumps										
KSB	- Centrifugal pumps	Pump division: 61%	2,639	na	Europe: 68% Americas: 14% Asia / Pacific: 14% Middle East / Africa: 4%	Industry and building services: 47% Energy and mining: 32% Water and waste water: 20%	12.3%	6.0%	13.6%	
	- Shut-off valves									
	- Control and monitoring systems									
	- Package units with pumps and valves									
Flowserve	- Engineered pumps	Flow control division: 27% Flow solutions division: 12%	4,365		North America: 32% Europe: 25% Asia Pacific: 19% Middle East and Africa: 15% Latin America: 9%	Oil and gas: 36% Power generation: 20% General industries: 19% Chemical: 18% Water management: 7%	16.2%	8.1%	13.3%	
	- Industrial pumps									
	- Engineered and industrial valves									
	- Control valves									
	- Actuators and controls									
	- Precision mechanical seals									
	- Single stage pumps									
- Two stage pumps										
Sulzer	- Barrel pumps	Pump division: 55% Chemtech division: 19% Metco division: 17% Turbo services division: 9%	3,095		Americas: 35% Europe: 31% Asia, Middle East, Australia: 27% Africa: 7%	Oil and gas: 48% Power generation: 19% Automotive industry: 5% Pulp and paper: 4% Aviation: 4% Other: 20%	14.1%	8.6%	9.3%	
	- Ring section pumps									
	- Axial split pumps									
	- Vertical pumps									
	- Agitators									
	- Pumping systems for pulp and paper industry									
	- Pumps for mining industry									
	- Hydro cyclones									
Weir	- Valves	Minerals: 59% Oil and gas: 22% Power and industrial: 17% Other: 2%	2,178		North and South America: 32% Middle East and Africa: 16% Asia: 15% Europe and FSU: 12% Canada: 9% Australia: 9% UK: 7%	Mining: 42% Oil and gas: 28% Power generation: 16% Infrastructure: 8% Other: 6%	16.6%	9.6%	8.8%	
	- De-watering equipment									
	- Wear-resistant linings									
	- High-pressure well service pumps									
	- Flow control equipment									
	- Pressure control and rotating equipment									
	- Centrifugal pumps									
	- Two-screw pumps									
Colfax	- Three-screw pumps	na	525		Europe: 44% US: 24% Asia and Australia: 18% Middle East and Africa: 7% Central and South America: 5% Canada: 2%	General industrial: 34% Commercial marine: 26% Oil and gas: 17% Power generation: 14% Global navy: 9%	15.5%	8.1%	16.6%	
	- Progressive cavity pumps									
	- Propeller pumps									
	- Gear pumps									

Figure 80: Description of major peers

Company		Principal products	Sales (2009)				EBITDA margin (2009)	CAGR 2010-12E	
			\$mn	By segment	By geography	By end-market		For sales	For EBITDA
Gorman-rupp	- Self-priming pumps	266	na	US: 64% Other: 36%	Water: 70% Power generation: 8% Mining: 7% Oil and gas: 6% Defence: 5% Other: 4%	13.3%	15.4%	12.6%	
	- Packaged pumping systems and lift stations								
	- Standard centrifugal pumps								
	- Priming-assisted pumps								
	- Submersible pumps								
	- Rotary gear pumps								
Kirloskar BL	- Monoblock pumps	537	Pumps: 91% Other: 9%	India: 79% Other: 21%	Irrigation: 50% Power generation: 27% Water: 16% Other: 7%	7.4%	16.0%	7.4%	
	- Openwell and borewell submersible pumps								
	- Vertical and horizontal multistage pumps								
	- End suction bare shaft pumps								
	- Engineered pumps								
	- Valves								
- Turbines	Franklin Electric	626	Water systems: 80% Fuelling systems: 20%	US: 45% Other: 55%	na (mainly infrastructure)	12.7%	8.1%	17.3%	
- Submersible fuel and water pumps									
- Motors									
- Electronic controls									
- Air motors and compressors									
- Industrial pumps									
Idex	- Engineering clamping systems	1,330	Fluid and metering technologies: 48% Health and science technologies: 23% Fire and safety/diversified products: 20% Dispensing equipment: 9%	US: 53% Europe: 27% Other: 20%	Medical: 20% Oil and gas: 12% Infrastructure: 12% Machine building: 12% Chemical: 10% Other: 34%	19.0%	8.0%	10.6%	
	- Dispensing equipment								
	- Fire suppression equipment								
	- Flow meters								
	- Micro pumps								
	- Rescue tools								
- Sanitary	Circor	643	Energy: 46% Flow technologies: 37% Aerospace: 18%	US: 42% Europe: 20% Canada: 3% UAE: 2% Other: 33%	Oil and gas: 51% Power generation: 20% Aerospace: 16% Other: 13%	11.4%	11.2%	24.5%	
- Process valves and controls									
- Generic valves for heating and cooling									
- Steam catapult valves									
- Cryogenic valves									
- Tube and pipe fittings									

Source: Bloomberg, Renaissance Capital estimates

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