November: Russian Equities: Fair Value or Foul?

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Theme: Kalina: It's a Beautiful Play

- **October turned out to be every bit as volatile and dangerous as had been expected. Nervousness over the inflationary effect of high oil, and how that might affect global growth prospects, hurt equity sentiment in general and that translated into a sharp correction in global emerging markets. Russian equities are particularly highly geared both on the upside and the downside given the lack of diversity in the local investor base and the almost complete dominance of those investors in day-to-day trade movements. Between the high and low points in October the correction on the RTS was 20% at worst, while over the month the drop was 10%.**

- **Given the lingering concerns over the international environment, and the negative effect that these could yet have on global liquidity flows, any push beyond our DCF-based fair value of 975 is not justified, while the risk of a retracement to below 900 remains a possibility. The specific positives for the Russia story this month should include further progress on removing Gazprom's ring-fence and the MSCI re-adjustment at the end of the month. This will be positive for MTS and Sistema, while the $35 bln bid by Telefonica for mobile operator O2 highlights the sector's growth potential.**

Portfolio Selections*

Gazprom – locals	Fair value under review. Further progress in ring-fence expected against an improving trading backdrop.
Kalina	18% upside to fair value after our recent fair value. Well placed consumer stock.
MGTS	15% upside. Bucking the negative trend in the regional telecom sector because of Moscow regional restructuring.
MTS/VimpelCom	29-30% upside. Bid for O2 highlights cheap valuations plus MSCI re-adjustment at end of month.
Sistema	19% upside. Partly with the MTS story, the Moscow industry restructuring and its emergence as a technology proxy.
Sberbank	32% upside. Important beneficiary of economic growth and expansion. Scarcity value as only quoted major bank.
Severstal	18% upside. A good way to play the recovery in the oversold metals sector.

*Note: * based on a 3-6 month time horizon*

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Strategy

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October turned out to be every bit as volatile and dangerous as had been expected. Nervousness over the inflationary effect of high oil, and how that might affect global growth prospects, hurt equity sentiment in general and that translated into a sharp correction in global emerging markets. Russian equities are particularly highly geared both on the upside and the downside given the lack of diversity in the local investor base and the almost complete dominance of those investors in day-to-day trade movements. Over the month, while the Dow Jones Industrial index fell 1.6% (NASDAQ fell 2.9%), the RTS ended 9.6% lower. Between the high and low points intra-month the correction was 20%.

As the month ended, it seems as if the mood amongst global investors is a bit more optimistic, and that should support an extension to the recent recovery, perhaps back towards the DCF-based fair value level of 975 for the RTS. Given the lingering concerns over the international environment, and the negative effect that these could yet have on global liquidity flows, any push beyond the 975 level is not justified while the risk of a retracement to below 900 remains a possibility. The specific positives for the Russia story this month should include further progress on removing Gazprom's ring-fence and the MSCI re-adjustment at the end of the month. This will be positive for MTS and Sistema, while the $35 bln bid by Telefonica for mobile operator O2 highlights the sector's growth potential.

Recent US economic data has allowed for global equity stability that could support a year-end rally in Russia

The better than expected US GDP growth data, reflecting very difficult months in that economy, has at least temporarily encouraged global investors to become more optimistic about a year-end rally. While that would probably suck cash out of global equity and emerging market funds (the main beneficiaries this year of the sustained exodus from US and EU equities), the net boost to investor confidence would translate into a strong year-end rally in the local markets. Our message continues to be that the recent low seen in the RTS was close enough to the bottom for investors to start buying, and the resilience seen when the RTS dips below 900 adds to confidence in that view. However, emerging market investors are not out of the woods just yet, and while the domestic story remains very strong there are still some risks of an external shock to pull prices lower.

That said, Russia is among the select group of oil-exporting EM countries (along with Nigeria, Mexico *et al)* that is relatively shielded from the slowing effect of high energy prices on the global economy. Its increasingly prominent role in exporting crude oil, products and especially natural gas as we head into the winter heating season makes Russia an attractive defensive play for dedicated EM and EMEA investors.

Prices have now corrected by 13% from the high, but had fallen as much as 20%

Based on closing prices as of October 30 the RTS had corrected by 13% from the closing record high of October 4. Based on the intraday high of October 4 and the recent intraday low, the correction was actually closer to 20%. That is very consistent with the pattern in previous corrections after a strong run in prices such as we have seen since mid-May (see Figure 1). Given that there is no negative change in the base assumptions supporting the positive investment case, then despite the risk of a further small dip (e.g. on external events and concerns) the current level is close enough to the bottom to stop selling and look to buy selectively.

Dangerous to be short when the RTS is below 900

The bounce in prices from recent lows prompted by the better than expected economic data in the US, the recovery in global equity markets they occasioned, and confirmation that legislation to enable the share ownership limits in Gazprom to be restructured showed just how difficult it can be to close short positions or buy stocks when investor sentiment changes.

Most attractive stocks on valuation and recent price fall

The following – in alphabetical order – are the most attractive shares based on the price fall since October 4 (Figure 3) and upside to DCF-based fair value (Figure 4). The list excludes shares with specific problems, such as most of the regional telecoms (on Svyazinvest delays) and Norilsk Nickel (on the weak price of nickel).

Chelyabinsk Pipe

Gazprom – locals and ADS

Golden Telecom

Irkut

Kalina

Mechel

MGTS

MTS

Sberbank

Sistema

VimpelCom

Gazprom

Legislation to remove the foreign ownership restrictions on Gazprom local shares is expected to be introduced imminently, opening the possibility of removal of those restrictions around year's end or, at a minimum, confirmation of the removal schedule.

Mobile stocks and Sistema should also attract good support

MTS (and VimpelCom) should continue to see price recovery that is partly in response to the recent bid by Telefonica for the UK mobile phone operator O2 (at a higher valuation than the industry average) and also the fact that MSCI has said it will likely upgrade the weighting of MTS in its Russia, EMEA and GEM indices at the end of this month. This should also provide strong support for Sistema.

Figure 1. RTS Rallies and Dips

02-07-'03 to 17-07-'03	-18.0%		2 weeks
17-07-'03 to 20-10-'03		51.5%	13 weeks
20-10-'03 to 19-11-'03	-25.3%		4 weeks
19-11-'04 to 12-04-'04		62.6%	21 weeks
12-04-'04 to 16-06-'04	-31.8%		8 weeks
28-07-'04 to 08-10-'04		33.3%	10 weeks
08-10-'04 to 20-12-'04	-20.5%		10 weeks
21-12-'04 to 10-03-'05		21.1%	11 weeks
11-03-'05 to 15-05-'05	-11.5%		9 weeks
17-05-'05 to 04-10-'05		63.9%	19 weeks
04-10-'05 to date	-13.0%		4 weeks

Source: RTS, Alfa Bank estimates

RTS trading has followed a broadly familiar pattern

One clear view from the table above is the fact that, with the exception of the period of the "YUKOS case", the trading characteristic of the market is that while rallies are usually extended over several months, the correction when it comes is usually very quick. The reason for that is the nature of the investor mix in Russia, or rather the fact that there is very *little* mix. The domestic market is heavily dominated by traders and investors with a short- to medium-term performance objective. Because of the slow pace of financial reforms, Russia does not yet have a significant mix of investor types. In particular, there is an absence of major mutual funds or pension funds. In a normal circumstance, any sharp correction would be cushioned by buying on the part of investors with a longer-term performance objective. In Russia this is mainly absent, hence the market tends to be heavily biased in one direction at any one time.

Local traders now completely dominate price movements

This can be seen in the build-up of dominance of local trading liquidity in the daily turnover of Russian stocks, such that currently local investors account for roughly 70% of total daily activity.

Figure 2. Trend in Trading Liquidity

	2002		2003		2004		2005		Last Week*	
	$ mln	%	$ mln	%	$ mln	%	$ mln	%	$ mln	%
Local Bourses	182	50	230	55	527	55	256	54	1,049	68
Foreign trade	181	50	188	45	429	45	221	46	498	32
Average Daily	363		418		956		477		1,547	

**Source: based on the first week of October*

Domestic investment case still intact

The reasons supporting the domestic investment case remain intact:

Urals price looks safe above $50 p/bbl

Oil

The year-to-date average price for Urals is $50.0 p/bbl, and with a current price of around $55 p/bbl we remain comfortable with our annual average of $51.5 p/bbl. This level supports the current valuations for oil stocks and will allow for the continued strong trend in the economy, including incremental growth in fiscal health and debt reduction.

Our price assumption for 2006 is for $45 p/bbl Brent and $41.5 p/bbl for Urals. The Federal Budget for 2006 is based on a price assumption of $40 p/bbl Urals, and at that level it runs a surplus.

Oil price is now back at the level when the RTS peaked

Although the oil price had corrected by about 5% since the October 4 peak but is now actually trading slightly higher than the price on that date, the slight – and temporary – weakness is one of the key reasons that spooked traders and triggered the 15% market correction. It is unlikely that the price will dip much lower, as the US and IEA will soon exhaust the planned release of strategic reserve oil while winter demand is building. In particular, this winter will expose a very significant shortage of product in the US and, to a lesser extent, in Europe. Meanwhile, rising tensions in the Middle East (Syria and Iran) will generally keep traders cautious.

Plenty of local liquidity

Liquidity

The availability of liquidity in the domestic market continues to grow on the back of oil, gas and other commodity exports, and that is one of the key drivers of local trading activity. Year to date the amount of cash in circulation is up over 20%, and the total volume of credit is rising even faster. The average oil price assumption used in our earnings and macro forecast models for 2006 is well ahead of the average Urals price of the past three ($35.6 p/bbl) and five ($30.8 p/bbl) years and should be more than enough to keep local liquidity rising.

Process to remove the ring-fence is now well under-way

Ring-fence

The removal of the Gazprom ring-fence is one of the major stock market events anticipated by investors. Economy Minister German Gref has confirmed that all negotiations with interested state agencies on the terms for removing the ring-fence have been completed and that legislation to enable the changes has/is about to be introduced to the Cabinet and the parliament. If that is the case, then the ring-fence should be gone, or at least the firm timetable known, by the end of the year at the latest. Given President Putin's open support for removing the restrictions (it is reported that he commented recently "I hope they won't make us wait long"), it is possible that we could see the plan within weeks. In that case, and given a close deadline, it is possible that MSCI could start to upgrade Gazprom's weighting in the Russia, EMEA and GEM indices as early as December 1, but it is still more likely that this will happen in the end May 2006 review. While Russia-dedicated funds will have to accommodate an increased Gazprom weighting by selling other stock positions, EMEA and GEM funds will have to raise their total Russia weighting and, given the relative size of the funds invested in each category, that latter effect should compensate for any negative Russia-dedicated fund re-balancing.

Moody's rating upgrade reflects the strength of the economy

Moody's

Moody's upgraded Russia's credit rating from Baa3 to Baa2 as a reflection of the continued improving fiscal health in the economy. The agency cited the continued rise in financial reserves, the early debt repayment and continued prudent use of oil revenues as the basis for the upgrade. Many investors had hoped for a two-notch upgrade to A- based on Moody's criteria of default risk, but Moody's highlighted ineffective government and the slow pace of reforms as the reason for continued caution. Russia's deteriorated placing on Transparency International's ranking of countries by corruption index obviously did not help.

Domestic stability is a big positive factor for price growth

Stability

Since President Putin met with senior business leaders last April and promised to bring an end to such issues as "tax terrorism" and to enact legislation and guidelines to control the activities of state agencies and officials, there have been no "accidents" or other events that have upset investors or business leaders. Quite the opposite in fact. The difference in the way that the state recently acquired ownership of Sibneft is at complete variance to the aggressive and contentious way it took ownership of Yuganskneftegaz last December. This shows a completely different attitude to the "investment case" and, hopefully, an understanding of the damage that actions like those against YUKOS do to the country's investment attractiveness.

Still below the GEM peer group average

Valuation

On average, Russian equities are now again trading at about a 25% discount to their peer groups in emerging markets using 2005 earnings multiples (EV/EBITDA).

Fair value for the RTS is 975

Using discounted cash flow (DCF) analysis is a better long-term measure, as it allows us to differentiate risk in different sectors and to reflect some continuing macro concerns (e.g. such as that of increased corruption costs and the very slow pace of reforms that affects some industries more than others). On this basis we can calculate an average fair value for equities equivalent to 975 on the RTS. The recent strong rally did extend prices to a premium of 7% beyond that fair value, while today's closing level is at a 1% discount to that level.

Vested interest in avoiding problems to mid 2006 at least

International

The government clearly wants to have a better international image and, in particular, to have a successful G-8 summit in St. Petersburg in June 2006 and be admitted to the WTO around that time. That is a powerful driver of discipline at least over that period, and that can only be good for the domestic investment case.

Internationalization continues

Russian companies are also becoming much more active internationally. Apart from Gazprom's increasing role in global energy, LUKoil has just completed the largest external investment of any Russian company ($2 bln), and both LUKoil and TNK-BP are negotiating with Lithuania to buy either a controlling stake or full ownership of that country's major refinery. This trend is expected to continue, and that will also help with valuations and perceptions.

Major risks – mainly external

Threat is a reversal of liquidity

The major risk to the domestic market is still external, i.e. that investors will start to reverse liquidity flows from international equity and GEM funds in response to the fear of rising inflation, the impact on global growth and the prospect of increased interest rates.

Likely to prevent RTS from reaching high

That threat has been a background factor to equities for most of this year, and while now hurting the pricing of some international commodities (e.g. nickel), the recent evidence suggests that, so far, the actual impact is minimal. Nevertheless, this is likely to remain a threat and a factor holding back equities to year-end and, therefore, something that will also curtail any quick return to the optimism that drove the RTS beyond the fair value.

What to buy?

Figure 3 below shows the most liquid shares ranked by the smallest correction in their share price since the October 4th closing record high.

Figure 3. Shares Ranked by Least Correction since October 4th

Megionneftegaz	4.0%
MGTS	3.6%
Saratovneftegaz	3.1%
Sibneft	1.4%
Kalina	0.7%
NTMK	-2.9%
YUKOS	-3.4%
Mosenergo	-3.8%
Wimm-Bill-Dann	-4.0%
Bashneft	-4.1%
Pharmacy Chain 36.6	-4.2%
Irkut	-4.7%
Center Telecom	-6.0%
Ufaneftekhim	-6.2%
Golden Telecom	-6.8%
NLMK	-6.8%
South Telecom	-6.9%
Gazprom local	-8.1%
Severstal	-8.9%
Ufa Refinery	-8.9%
Pyaterochka	-9.0%
Transneft pref	-9.1%
VimpelCom	-9.2%
Udmurtneft	-10.7%
LUKoil	-10.9%
Sberbank	-11.4%
MTS local	-11.7%
Uralsvyazinform	-12.5%
Volga Telecom	-12.6%
RTS	***-13.0%***
MTS	-13.1%
Norilsk Nickel	-13.4%
Tatneft	-13.6%
Siberia Telecom	-14.3%
Gazprom ADS	-14.4%
Purneftegaz	-15.1%
UES	-16.0%
Surgutneftegaz	-18.0%
Sistema	-18.3%
Rostelecom	-19.9%
YaroslavlNOS	-21.2%

Source: RTS, DataStream

The table below is a ranking of shares based on highest upside to DCF based Fair Value.

Figure 4. Stocks Ranked by Upside to Fair Value

Company	Market Cap	Price	Fair Value	Upside to Fair Value
	$ mln	*$ p/s*	*$ p/s*	*%*
Chelyabinsk Pipe	373	0.79	1.10	39.2
Irkut	554	0.63	0.87	38.1
Sberbank	16,207	853.00	1,170.00	37.2
Uralsvyazinform	1,130	0.04	0.05	34.3
MTS	14,591	36.60	48.00	31.1
VimpelCom	8,159	39.78	52.00	30.7
Wimm-Bill-Dann	774	17.60	22.50	27.8
Golden Telecom	1,059	29.11	37.00	27.1
Sistema	10,547	21.86	27.00	23.5
Volga Telecom	885	3.60	4.43	23.1
Norilsk Nickel	15,187	71.00	87.00	22.5
Severstal	4,851	8.79	10.54	19.9
Baltika	3,410	27.80	33.00	18.7
Mechel	4,066	29.30	34.50	17.7
Kalina	332	34.00	40.00	17.6
Seventh Continent	1,367	21.20	24.50	15.6
MGTS	1,381	17.30	19.80	14.5
Siberia Telecom	721	0.06	0.07	13.3
Pharmacy Chain 36.6	199	24.90	27.90	12.0
ZSMK	1,667	125.00	140.00	12.0
MMK	4,518	0.45	0.50	11.1
NTMK	2,162	1.65	1.80	9.1
RTS		***911***	***975***	***7.1***
Surgutneftegaz	32,511	0.91	0.96	5.5
Center Telecom	615	0.39	0.41	5.1
Northwest Telecom	726	0.69	0.71	2.9
Vyksa Metallurgical	847	450.00	460.00	2.2
VSMPO	1,894	158.30	160.00	1.1
Rostelecom	1,516	2.08	2.07	-0.5
LUKoil	44969.1	52.9	49.3	-6.8
OMZ	184	5.20	4.80	-7.7
Sibneft	17,069	3.60	3.27	-9.2
Far East Telecom	228	2.06	1.80	-12.6
Pyaterochka	2,927	19.1	15.5	-18.8
South Telecom	320	0.11	0.08	-29.6
Gazprom	121,682	5.1	***U/R***	***U/R***
Tatneft	7,124	3.27	***U/R***	***U/R***

*Source: RTS, Alfa Bank estimates; Note: * using closing market data of October 30, 2005*

Second-tier stocks

Second tier outperformed the blue chips as spreads widened

In October the second-tier universe of Russian stocks as measured by the RTS-2 Index fell 5.0% as part of the broad-based correction in the market. The drop in the Index was less than that seen in the benchmark RTS Index, which recorded a fall of 9.6% m-o-m. While some stocks were hard-hit, their relative lack of liquidity actually helped prevent more serious declines. Instead, what we observed was a widening of bid-ask spreads and a fall-off in recorded turnover, which actually prevented many investors from losing their nerve and selling into the sharp correction.

More generally, the selling was driven by the desire to take impressive YTD profits, and in the great majority of cases did not reflect deterioration of corporate fundamentals. Since many of these stocks have had great runs this year, we were unsurprised by the magnitude of the monthly falls. 33 stocks recorded declines of greater than 15% last month, while only 22 stocks gained more than 10% compared to September (see Figures 5 and 6 below).

Should stage a comeback as part of an anticipated year-end rally

If recent market history is any guide, many if not most of these names are likely to return to at least mid-year form during the anticipated year-end rally starting towards the end of November and into December. Looking ahead, many of these stocks, particularly the prefs, look increasingly attractive as dividend season approaches in February-March. We suggest looking at the list of worst RTS performers (see Figure 6) and trying to identify the stocks that fell the furthest but which also have an underlying corporate story.

Our top picks again lie in the oil & gas sector on strong prices and IPO news

Our top picks in the second tier for November include the downstream **Bashkir stocks** (on publication of 3Q05 results expected at mid-month) as well gas companies **Novatek** and **RITEK** (oil & gas again looks very attractive as we head into the winter heating season, which should support the uptrend in prices). **Sakhalinmorneftegaz** and **Purneftegaz** – both commons and prefs – are currently the focus of attention as the market considers the dimensions of Rosneft's IPO likely scheduled for the second half of next year.

Figure 5. Top RTS Performers, October 2005

Stock	RTS ticker	% change
Nizhnekamsk Tire	NKSH	51.3
Voronezhenergo	VZEN	46.2
VASO	vaso	38.5
Slavneft	slav	36.4
Bogoslovsky Mining	brad	30.5
Motovilikhinsky Factory	motz	28.6
Perm Azot	azop	26.0
Saratov Refinery	KRKN	19.2
Gaisky GOK	ggok	18.9
TsUM	TZUM	17.2
Ryazan Refinery	rnpz	16.7
Sakhalinmorneftegaz	SKGZ	15.5
Orsk Refinery pref	orfep	15.0
Sovincenter pref	sovip	14.9
Stavropolneftegaz	STNG	14.7
Megionneftegaz	MFGS	14.3
Komsomolsk Refinery pref	knprp	13.7
Tupolev	tupl	13.6
Soda	sodd	13.5
Novorossiisk Shipping	nmtp	12.0
Votkinsk GES pref	votgp	10.9
Krasnogorsk Coal	rakr	10.1

Source: RTS

Figure 6. Worst RTS Performers, October 2005

Stock	RTS ticker	% change
Yaroslavlnefteproduct pref	slnep	-51.4
Yaroslavlnefteproduct	slne	-29.6
Murmansk Shipping	mush	-29.0
NizhegorodNOS pref	ngnsp	-25.1
Novoil	nunz	-23.7
Kolomensk Factory pref	klmzp	-22.8
Kamchatskenergo pref	kchep	-22.5
Nizhegorodnefteorgsintez	ngns	-22.4
Varyeganneftegaz	VJGZ	-21.6
Tulachermet	tymt	-21.3
Uralelectromed	uelm	-20.5
Borsk Glass Factory	borg	-20.3
Chelyabinsk Pipe	CHEP	-20.2
Ufaneftekhim pref	UFNCP	-20.0
Cherepetsk Machinery	cherp	-20.0
Vysokogorsky GOK	VGOK	-20.0
Dorogobuzh	dgbz	-19.2
Novoil pref	nunzp	-19.2
Novorossiisk Shipping pref	nompp	-18.3
Middle Urals Metals	sumz	-18.6
Seversky Pipe	svtz	-17.5
UralSib Bank	USBN	-17.4
Ufa Motors	UFMO	-17.3
Saratovneftegaz	snfg	-17.1
Ufaorgsintez pref	UFOSP	-16.7
Rostelecom	RTKM	-16.5
Nizhnekamskneftekhim	NKNC	-16.2
Komsomolsk Refinery	knpr	-16.0
Rostelecom pref	RTKMP	-15.8
Apatit	apat	-15.8
Votkinsk GES	VOTG	-15.7
Ufa Refinery pref	unpzp	-15.6
Khimprom	vhim	-15.0

Source: RTS

Theme: Kalina: It's a Beautiful Play

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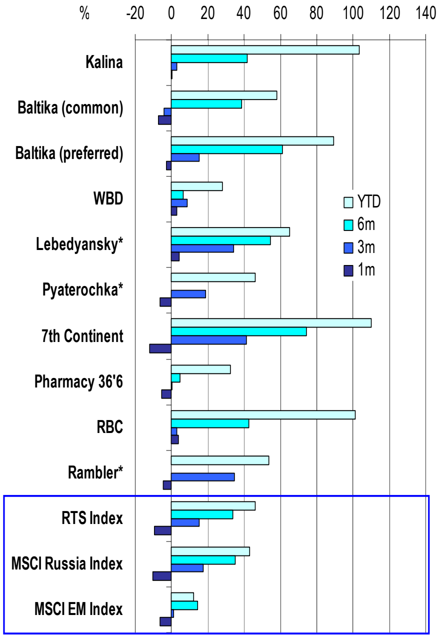
- Kalina is a leading domestic producer of cosmetics with $224 mln in 2005E sales. Kalina enjoys strong brands and impressive market shares in its core segments: 38% in facial skin care, 30% in skin care and 11% in oral care.
- Earlier this year Kalina acquired 58.4% of German cosmetics producer Dr. Scheller Cosmetics AG with $99 mln in 2004 sales and two major brands: *Manhattan* and *Apotheker Scheller*. Dr. Scheller was acquired at 2005E EV/EBITDA of 9.4 and EV/Sales of 0.8 vs. Kalina's respective multiples of 8.3 and 1.5 on a stand-alone basis. The acquisition should boost Kalina's 2005E revenues by 84% to $336 mln.
- At current valuations Kalina is the cheapest stock in Russia's consumer sector as well as vs. global peers: It trades at 2006E EV/EBITDA of 5.7x and 2006 P/E of 9.5x. This implies 45-50% discounts on 2006E EV/EBITDA and 40-45% discounts on 2006E P/E to international peers (notwithstanding higher growth rates) as well as 54% and 66% respective discounts to the Russian consumer goods averages.
- We believe that Kalina is a prime acquisition target for global majors (attractive valuation, growing market, strong brand and room for cost cutting) and deserves a premium to its current valuation. The company's acquisition would be a catalyst for the share price.

40-70% discounts to Russian and global peers

Key issue for Kalina stock is low liquidity

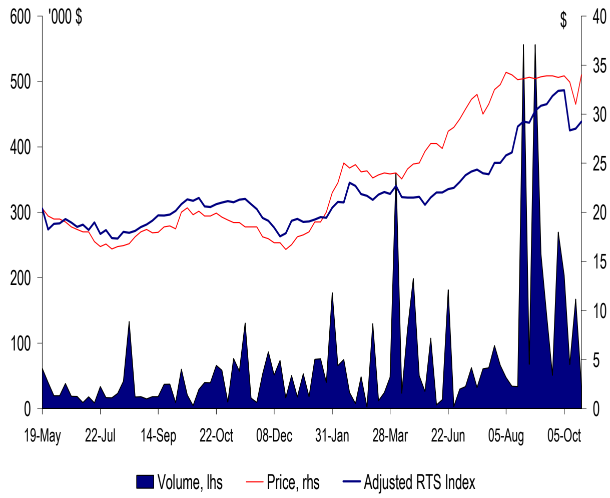
Kalina has been outperforming the RTS Index YTD and is up 103% vs. the 46% increase of the Index. Nevertheless, it remains one of the cheapest stocks among peers, as described below. The main issue involving Kalina stock is its low liquidity: We estimate free-float at about 40%, which implies market cap of free-float of about $130 mln. The average daily trading volumes are rather modest at about $70,000 per day, though the stock is not traded each day.

Figure 7. Relative Share Price Performance



Source: Bloomberg

Figure 8. Kalina – Post-IPO Share Price Performance



Source: Bloomberg, Alfa Bank estimates

Kalina trades at 40-66% discounts to peers

Despite its share price rally in 1H05, Kalina (pro-forma, including Dr. Scheller) looks very attractive compared with both Russian consumer companies and global cosmetics peers. The stock is traded at 2006E EV/EBITDA of 5.7x and 2006 P/E of 9.5x. This implies 45-50% discounts on 2006E EV/EBITDA and 40-45% discounts on 2006E P/E to international peers (notwithstanding higher growth rates) as well as 54% and 66% respective discounts to the Russian consumer goods averages.

Figure 9. Kalina – Comparative Valuation

	EV/Sales			EV/EBITDA			P/E			Revenues CAGR	EBITDA CAGR	EBITDA margin		
	2005E	2006E	2007E	2005E	2006E	2007E	2005E	2006E	2007E	2005-07E	2005-07E	2005E	2006E	2007E
Russia														
Kalina (pro-forma)	1.0	0.9	0.8	7.0	5.7	4.8	11.7	9.5	8.0	15%	20%	15%	16%	16%
Developed Markets														
Procter & Gamble	2.7	2.5	2.4	11.8	11.2	10.5	18.8	18.2	16.8	6%	6%	23%	23%	23%
L'Oreal	2.7	2.5	2.4	14.3	13.1	12.1	23.3	21.0	19.6	6%	9%	19%	19%	20%
Colgate- Palmolive	2.7	2.6	2.4	11.7	10.8	10.1	18.7	17.0	16.1	5%	7%	23%	24%	24%
Avon Products	1.4	1.3	1.3	8.5	7.8	7.5	12.5	12.7	12.2	6%	7%	17%	17%	17%
Beiersdorf	1.6	1.5	1.4	10.7	10.0	9.4	22.4	19.9	18.7	5%	7%	15%	15%	15%
Revlon	1.7	1.6	1.5	11.7	9.4	7.9	ng	ng	32.1	5%	22%	14%	17%	19%
Oriflame Cosmetics SA	1.8	1.7	1.6	11.8	10.5	9.6	15.4	14.5	13.2	8%	11%	15%	16%	16%
DM Average	***2.1***	***2.0***	***1.9***	***11.5***	***10.4***	***9.6***	***18.5***	***17.2***	***18.4***	***6%***	***10%***	***18%***	***19%***	***19%***
Emerging Markets														
Colgate-Palmolive (India)	3.2	3.0	2.9	17.3	15.5	13.7	27.5	21.1	18.9	6%	12%	19%	19%	21%
Dabur (India)	3.1	2.5	2.3	23.6	17.2	14.6	30.7	21.9	17.9	16%	27%	13%	15%	16%
Natura Cosmeticos (Brazil)	3.4	2.8	2.4	13.7	11.3	9.6	18.9	15.6	13.3	19%	20%	24%	24%	25%
Sarantis SA	1.4	1.3	1.2	8.3	8.1	7.7	13.0	11.8	10.6	7%	4%	16%	16%	15%
Eng Kah (Malaysia)	2.3	1.8	1.5	7.8	6.3	5.2	12.1	10.0	8.2	23%	23%	29%	29%	29%
EM Average	***2.7***	***2.3***	***2.0***	***14.1***	***11.7***	***10.1***	***20.4***	***16.1***	***13.8***	***14%***	***17%***	***20%***	***21%***	***21%***
RU Consumer goods average	***3.0***	***2.1***	***1.6***	***18.8***	***12.3***	***9.2***	***35.0***	***27.6***	***18.1***	***31%***	***32%***	***16%***	***17%***	***17%***
Kalina premium/discount to DM	-50%	-54%	-58%	-39%	-45%	-50%	-37%	-45%	-56%					
Kalina premium/discount to EM	-61%	-61%	-61%	-51%	-51%	-53%	-43%	-41%	-42%					
Kalina premium/discount to RU Consumer sector	-66%	-58%	-51%	-63%	-54%	-48%	-66%	-66%	-56%					

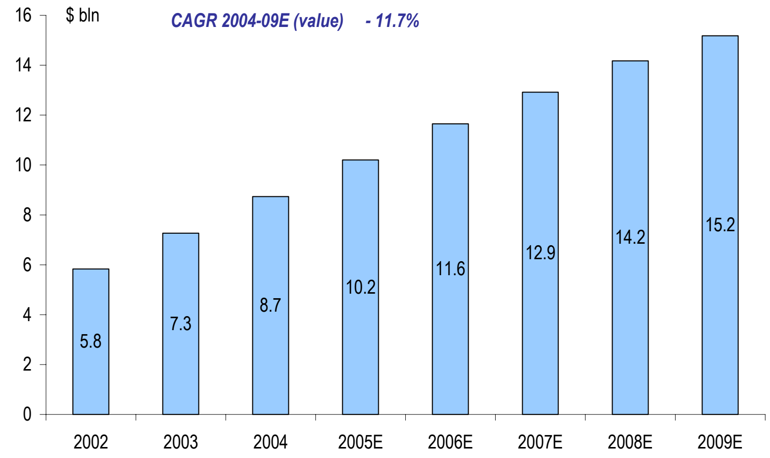
Source: Bloomberg, Alfa Bank estimates

Russian HPC: $10 bln market with 2004-09 CAGR of 12%

We forecast Russia's HPC market at $10 bln in 2005 (+17% y-o-y)

Russia's market for household and personal care (HPC) is valued at $10.2 bln in 2005 (+17% y-o-y). The market grew 22% in 2002-2004 to $8.7 bln and is expected to expand to almost $16 bln in 2010 (with 2004-2010 CAGR of 11%), driven mostly by rising real consumer incomes.

Figure 10. Russian HPC Market, 2002-2010E

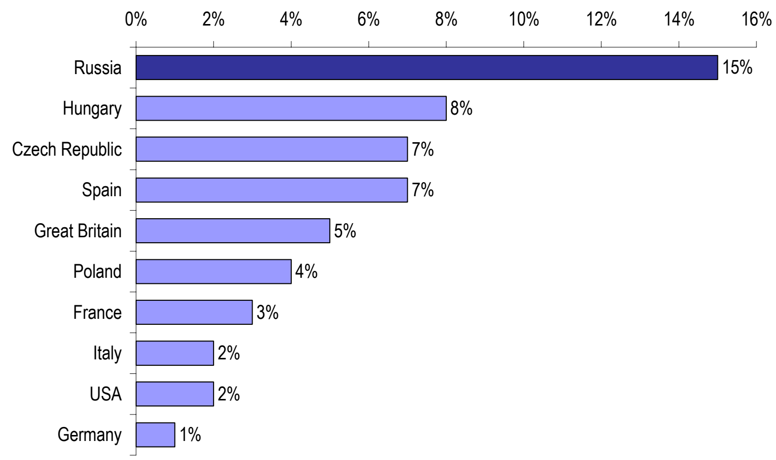


Source: Alfa Bank estimates

Russia's cosmetics market grew 15% in 2004 to $6.4 bln

Cosmetics and toiletries accounted for 73% of Russia's HPC market in 2004 (+15% y-o-y to $6.4 bln), making it the sixth-largest market in Europe after Germany, France, Great Britain, Italy and Spain. It is expanding quickly and is expected to become one of the leading markets in Europe. It still has good potential since annual per capita spending on cosmetics and toiletries in Europe was around $160 in 2004, while Russia's respective figure was nearly four times lower at $44 (almost equal to the average per capita cosmetics spending in Eastern Europe and Latin America). In 2005 we expect average per capita cosmetics spending in Russia to reach $51 (+16% y-o-y).

Figure 11. Cosmetics and Toiletry Market Growth by Country, 2004, y-o-y



Source: Colipa Statistics

The largest segment in Russia's market is decorative cosmetics

The breakdown of Russia's cosmetics and toiletry market by category differs from the global breakdown. The largest segment in Russia is decorative cosmetics (21% vs. 13% in the world market), albeit this is unsurprising taking into account that Russian women spend around 12% of their income on cosmetics (i.e. very high by Western standards). Hair care, the largest segment in the global market (26%), ranks second in Russia with a 19% share. Skin care, the second largest segment in the global market (19%), ranks only sixth in Russia with a share of 8%. This can be explained by the fact that leading positions in this segment are occupied by Russian producers whose products are relatively cheap. Bath care takes third place in both the Russian and global markets.

Local producers strengthened their positions thanks to the 1998 crisis

Local cosmetics manufacturers have increased their market shares in recent years, particularly in the mass-market and middle-market product segments. Russian cosmetics producers held only 20-25% of the market before the 1998 financial crisis, but as a result of ruble devaluation local manufacturers were able to strengthen their positions and now almost half of the market (48%) is controlled by local brands.

A number of new and several old Russian cosmetics companies enjoy good positions in the cheap cosmetics segment. These companies use old technologies and do not direct much spending to R&D and marketing, which allows them to maintain low prices for their products.

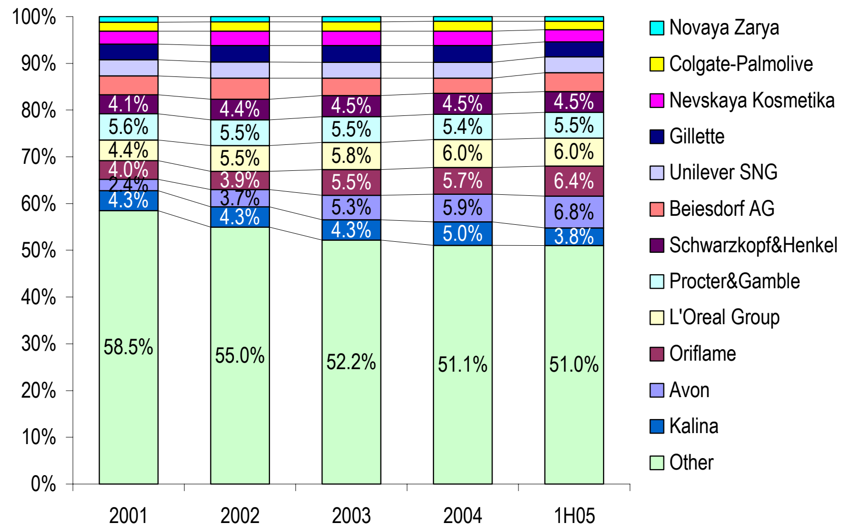
Share of counterfeit products down significantly in recent years

A few years ago the market was beset by a large (up to 50%) share of counterfeit products, but this figure eventually declined to 10-20% in 2004, according to various estimates.

Foreign producers have increased their market share

As of the end of 1H05, the top ten producers (only two of which are Russian) controlled 46% of the market. In 1H05 many foreign producers managed to increase their market shares in value terms (Procter & Gamble, Beiersdorf, Oriflame and Avon), while most local manufacturers lost some market share. This can be explained by a number of factors. First, prices in dollar terms for local products increased while prices for many international brands decreased, which led many customers to switch to foreign cosmetics. Second, foreign manufacturers continue to pursue an aggressive marketing policy (including BTL advertising). Third, distribution became more developed thanks to fast growth in retail networks and direct sales. These forms of distribution traditionally benefit international producers more than local ones. And finally, the impressive growth of Russia's cosmetics market (compared to only 3-7% per year in European countries) encouraged multinational companies to invest in local industry and launch local production.

Figure 12. Key Players in Russia's Cosmetics Market in Value Terms, 2001-1H05



Source: Company data

A number of international producers set up production facilities in Russia

Avon recently opened a 250,000 sq.ft factory in Narofominsk (70 km south of Moscow) with investment totaling $40 mln. The plant's capacities are around 180 mln units, but they will be increased to 265 mln units in 2007. The plant produces hair and skin care products.

Oriflame is building a factory not far from Moscow at a cost of €30 mln ($36 mln) and which is expected to be opened next year. In 1992 Unilever acquired the Soviet perfume company Severnoye Siyaniye, which produces skin and hair care products under the *Sunsilk*, *Timotei* and *Dove* brands.

P&G invested over $200 mln in its business in Russia

Procter & Gamble's facility in Novomoskovsk produces about half of its products sold in Russia. The company has invested over $200 mln in its Russian business.

Henkel operates four factories in Russia manufacturing household products (200,000 tons of detergents). The company has invested over $60 mln in its Russian operations. Over half of Henkel's personal care products sold in Russia are produced at third-party factories, while the balance is imported from Henkel's foreign factories.

The main recent trends in the Russian market are:

- growing share of retail networks and direct sales in distribution;
- declining share of local producers;
- faster growth in prices for local products than for foreign products;
- more aggressive marketing policy;
- synergy between cosmetics and medical products (parapharmaceuticals development); and
- construction of production facilities in Russia by foreign producers to reduce COGS expenses.

Customers switch to higher quality products

Further development of the cosmetics market will be marked by intensifying competition among existing players as well as the switching of customers to higher quality products, i.e. branded goods.

Russia's leading cosmetics producer

We forecast Kalina's sales at $224 mln in 2005

Kalina is the leading domestic producer of cosmetics in Russia with 2005E sales forecast at $224 mln (stand-alone). The company was founded in 1942 on the base of Novaya Zarya factory, which was evacuated from Moscow during World War II to Yekaterinburg.

Kalina is expanding through acquisitions

The company is implementing an expansion strategy of acquiring smaller companies in the industry. Kalina has acquired Omsk synthetic detergents plant (1998), Nikolaev perfume and cosmetics industrial complex "Aliye Parusa" (1999), Almalyk household chemical goods plant (2000) and "Lola Atir Upa" perfume and cosmetics factory (2001). In February 2005 Kalina acquired a 58.4% stake in the German cosmetics company Dr. Scheller Cosmetics AG.

Kalina boasts very strong brands

Kalina enjoys very strong brands *Cherny Zhemchug* (Black Pearl), *Chistaya Linia* (Clear Line), *Mia* and *32* (oral care). Its balanced portfolio of strong brands remains one of the company's key competitive advantages.

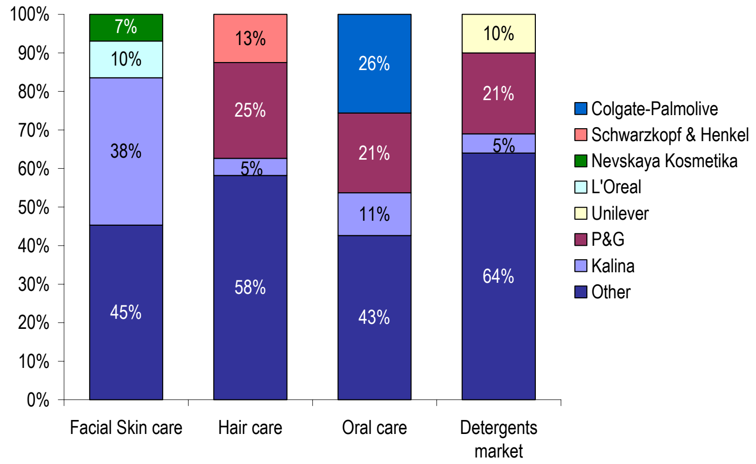
19% of Kalina's revenues are derived abroad

Kalina sells its products in Russia (81% of sales), the CIS and Baltic countries as well as some others. Almost all non-Russian sales take place in CIS countries, the key markets of which are Ukraine, Uzbekistan and Kazakhstan (65% of all non-Russia sales).

Kalina is a market leader in facial skin care with a 38% share

According to AC Nielsen, Kalina held a 38.25% market share in Russia in volume terms in the segment of facial skin care in March-April 2005. The company's largest competitors are L'Oreal (9.53%), Nevskaya Kosmetika (6.94%) and Svoboda (6.38%). Kalina holds a 30.4% share in the skin care market, followed by Nevskaya Kosmetika (14.0%), Svoboda (9.7%) and Beiesdorf (6.6%).

Figure 13. Cosmetics Market Volume, March-April 2005



Source: AC Nielsen

Kalina holds 11% of oral care market

In the hair care segment, Kalina has a mere 4.5% share, while P&G controls 24.84% and Schwarzkopf/Henkel – 12.5%. Kalina also enjoys an 11.1% market share in the oral care segment, where the largest players are Colgate-Palmolive (25.6%) and Procter & Gamble (20.7%). Kalina holds 5% of the detergents market, where P&G controls 21.0% and Unilever – 10.0%.

Kalina has the largest cosmetics distribution network in Russia

Kalina has the largest distribution network among all cosmetics retailers in Russia, with a total of 192 dealers in Russia, Ukraine and CIS countries. Their share in Kalina's distribution network is increasing each year. Kalina products are sold in Russia through nearly 81,000 outlets in over 200 cities in Russia and the CIS.

Kalina is continually increasing the share of branded products

A steady increase in the share of branded product in the company's portfolio (72% of turnover last year, up from 61% in 2003) has led to a 50% increase in margins in recent years. Management plans to increase the share of branded products to 100% by 2008.

Skin care products account for over half of Kalina's revenues

Skin care represents almost half of sales (48.5%) by value, followed by oral care (12.8%), detergents and household chemicals (10.9%), and hair care (10.5%).

Acquisition of Dr. Scheller strengthens position in makeup market

Kalina acquired stake in Dr. Scheller at 47% discount to own valuation on 2005E EV/S

Earlier this year Kalina acquired a 58.4% stake in Dr. Scheller Cosmetics, AG, a German personal care company with $99 mln in 2004 turnover and two major brands: *Manhattan* and *Apotheker Scheller*. Dr. Sheller was acquired at 2005E EV/EBITDA of 9.4 and 2005E EV/Sales of 0.8 vs. Kalina's respective multiples of 8.3 and 1.5.

On December 24, 2004 Kalina decided to make a voluntary takeover bid to the shareholders of Dr. Scheller. The acceptance period was initially limited to March 4, 2005 and then extended to March 18, 2005.

On March 18, 2005 Kalina announced that its takeover bid had been accepted for a total of 1,380,384 shares, which is equivalent to around 21.2% of the share capital of Dr. Scheller. Furthermore, Kalina announced in writing the exercising of the call option it had concluded with Dr. Hans-Ulrich Scheller for a further 9% of the shares. This means that the shareholding of Kalina amounted to at least 30.2% by the end of the extended acceptance deadline. On April 15 Kalina announced that it had increased its stake in Dr. Scheller to 58.396%. Kalina acquired in total 6.5 mln shares of Dr. Scheller at a price of €4.2 per share.

Dr. Scheller's brands are very popular in Germany

Dr. Scheller has four strong brands, *Manhattan Cosmetics* (Decorative cosmetics); *Manhattan Clearface* and *Apotheker Scheller* (skincare); and *Durodont* (oral care). All of these brands are among the top three in their respective segments in Germany. *Manhattan* has the strongest position with a 15.4% share in Germany according to AC Nielsen (ranking second in the category).

Dr. Scheller's net margin was only 1.1% in 1H05 vs. Kalina's 11.0%

Kalina paid $20.8 mln and assumed $28.6 mln in debt for its 58% stake. Management intends to focus on increasing Dr. Scheller's profitability (in 1H05 its EBITDA margin was 7.9% vs. Kalina's 18.4%, while the net margin stood at 1.1% vs. our forecast for Kalina of 11.0%).

Cost reduction program allowed Dr. Scheller to increase profitability

Following the decline in sales and negative earnings reported for 2003 (net loss stood at $2.5 mln), Dr. Scheller Cosmetics managed to achieve a positive turnaround in 2004 due to a cost reduction program. Net earnings became positive to stand at $0.03 mln.

Dr. Scheller's sales grew 11% in 1H05

These positive developments continued on into 1H05. The company's total sales grew by 10.7% to around $52.7 mln, mainly driven by foreign markets. Net income grew to $0.5 mln from a loss of $1.1 mln in 1H04.

Attractive target for strategic majors

Kalina is attractive for strategic investors:

Kalina appears quite attractive based on fundamentals and valuation, not only to portfolio investors as discussed previously but also for global majors, who we believe are currently considering opportunities to enter the sector.

We base our view on the following factors:

Intensification of M&A in FMCG sector

Intensification of M&A in the FMCG sector

This year we have seen intensification of consolidation activity in FMCG and Retail. The best example occurred in the beer sector, where there were five large acquisitions by global majors (Heineken and InBev).

In 2005 Coca-Cola acquired Russia's second-largest juice producer Multon for $0.5 bln assuming debt. Heinz acquired a local ketchup producer, while Norway's Orcla gained exposure to the confectionary market. There have been more IPOs and strategic acquisitions in Russia's consumer goods sector in 2005 than any other year to date.

By contrast, the latest acquisition in the HPC sector took place quite a while ago, when Unilever acquired Severnoe Siyanie in 1992.

Attractive valuation and relatively small market cap

Attractive valuation and relatively small market cap

As discussed previously, Kalina is traded at 40-50% discounts to global peers, notwithstanding the higher growth rates of both the company and the industry. Russia's HPC market is increasing with 2004-09E CAGR of 12%, which is well ahead of the global market's 3.7% growth rate. In monetary terms, the size of the HPC market is expected to increase from $10.2 bln at present to $15 bln within five years.

Kalina is not only attractively valued, it also has a relatively small market capitalization of $330 mln, making it quite 'affordable' for major global cosmetics producers.

Strong brands are key strength

Strong brands are key strength

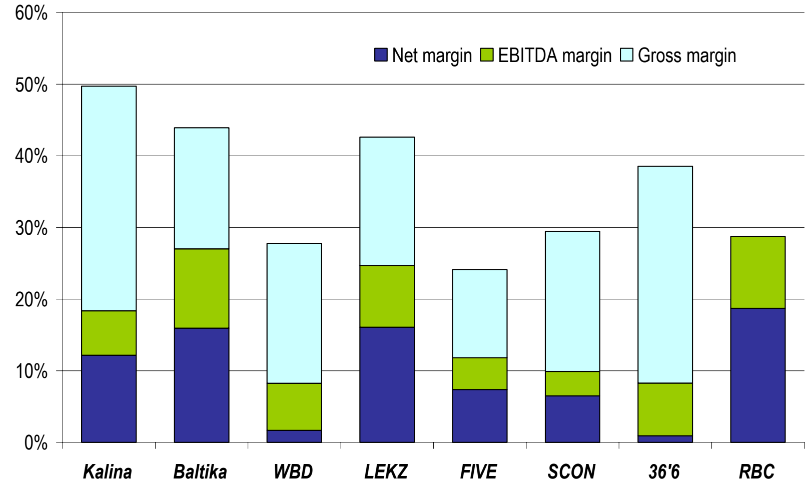
Kalina's key competitive advantage is strong brand recognition: In its core facial care market the company enjoys a 38% market share, while three key brands (*Black Pearl*, *Clean Line* and *MIA*) occupy about 20% of the market. The company outperforms both L'Oreal and Nivea in this segment. Kalina also enjoys a strong position in oral care (11%) and controls about 5% of the market in volume terms in the hair care and detergent segments.

Profitability can be increased through economy of scale

Profitability could be increased through economy of scale

Kalina directs about 33% of revenues to SG&A expenses, while advertising alone (excluding Dr. Scheller) takes up about 11% of revenues. The main reason is that despite its smaller size, Kalina must advertise on par with global majors. Thus we believe that in case of Kalina's acquisition by a global major, Kalina could benefit immediately through cost savings in both SG&A expenses (common advertising and distribution) and cost of goods sold (though global joint procurement and outsourcing).

Figure 14. Russian Consumer Company Margins, 2005E



Source: Alfa Bank estimates

We believe that Kalina may be an interesting acquisition target for companies such as Procter & Gamble (low presence in the facial care segment), Johnson & Johnson (low presence on the Russian market) or another, including Unilever and Schwarzkopf & Henkel.

Acquisition of Kalina with a premium would benefit minorities

Considering the above factors, we believe that Kalina deserves a premium for its growth rate, strong brands and exposure to the lucrative Russian market. In case of acquisition with a premium, this could set a new valuation benchmark for the stock, which would benefit minority shareholders.

Stock Performance and Valuations

Figure 15. ADR Performance, MTD, as of November 2, 2005

Company	Type of ADR	Ratio	% as ADRs	Price $	Change last month %	YTD $	Last 52 weeks High $	Low $
Oil and Gas								
Gazprom ADS	114A, REG S	10 in 1	1.4	61.0	-9.0	71.8	70.0	29.5
LUKoil	Level 1	4 in 1	31.0	55.8	-4.0	81.3	69.0	5.1
Sibneft	Level 1	5 in 1	4.0	17.7	0.6	18.0	20.0	12.9
Surgutneftegaz	Level 1	50 in 1	19.0	49.0	-8.8	31.8	72.4	31.0
Tatneft	Level 2	20 in 1	25.0	62.4	-3.0	115.2	74.0	26.8
YUKOS	Level 1	4 in 1	20.0	4.7	-2.1	34.3	13.6	1.5
Utilities								
Irkutskenergo	Level 1	50 in 1	N/A	19.8	6.7	96.0	24.0	9.5
Lenenergo	REG S	80 in 1	6.2	54.0	0.0	12.5	54.0	39.6
Mosenergo	Level 1	100 in 1	20.0	11.3	4.7	-25.0	16.9	7.0
UES	Level 1	100 in 1	22.0	35.2	-9.3	26.7	42.8	25.1
Telecoms								
Golden Telecom	Level 3	1 in 1	14.0	29.5	-6.5	11.7	32.0	25.0
MTS	Level 3	20 in 1	22.0	37.0	-9.2	6.7	42.2	29.3
Sistema	Level 4	50 in 1	23.0	23.0	-6.1	N/A	27.2	15.0
VimpelCom	Level 3	1 in 4	40.0	40.2	-9.5	11.3	46.2	25.0
MGTS	Level 1	1 in 1	N/A	15.6	0.0	36.8	13.5	8.5
Volga Telecom	Level 1	2 in 1	8.5	7.1	-9.2	29.7	7.0	4.3
Rostelecom	Level 2	6 in 1	19.7	12.7	-15.0	16.4	16.2	10.0
South Telecom	Level 1	1 in 2	N/A	5.3	2.3	69.2	4.7	2.5
Uralsvyazinform	Level 1	200 in 1	N/A	7.1	-11.0	13.5	6.9	4.8
Other sectors								
GMK Norilsk Nickel	Level 1	1 in 1	17.0	75.1	-9.8	36.5	87.0	43.5
OMZ	144A, REG S	1 in 1	16.6	5.0	-9.8	59.6	4.8	2.2
Wimm-Bill-Dann	Level 1	2 in 1	32.2	18.1	-5.9	26.2	20.4	11.9

Note: N/A – not available
Sources: Reuters, Bloomberg

Figure 16. Blue Chip Performance and Valuation vs. International Peers, MTD, as of November 2, 2005

Company	Price $	Change MTD %	Change YTD %	Last 52 weeks High $	Last 52 weeks Low $	ADV $ mln	MCap $ mln	P/E 2004	P/E 2005E	EV/EBITDA 2004	EV/EBITDA 2005E	Target price $	Upside %	Recommendation
Oil and Gas														
Gazprom	5.0	-3	88	5.3	2.4	255.5	119,179	8.6	13.9	7.4	7.9	U/R	N/A	**U/R**
LUKoil	56.0	-3	85	61.8	26.2	11.0	47,632	7.6	9.2	5.1	5.9	49.27	-10.3	**HOLD**
Sibneft	3.6	3	20	4.1	2.6	0.8	17,069	6.3	9.5	4.9	7.0	3.27	-9.2	**HOLD**
Surgutneftegaz	1.0	-8	33	1.1	0.6	1.5	35,655	14.1	16.1	6.7	7.1	0.96	0.3	**HOLD**
Tatneft	3.3	2	128	4.0	1.4	0.3	7,124	8.1	9.7	4.5	5.1	U/R	N/A	**U/R**
YUKOS	1.2	1	77	3.6	0.4	0.1	2,573	0.9	1.1	0.5	0.7	Suspended	N/A	**SUSPENDED**
Petrobras	*48.7*	*4*	*10*	*49.4*	*25.6*	*8.7*	*50,883*	*7.2*	*5.8*	*4.0*	*3.2*			
PetroChina	*0.6*	*6*	*20*	*0.7*	*0.4*	*50.9*	*112,959*	*9.0*	*7.6*	*5.3*	*4.3*			
Sinopec	*0.4*	*-7*	*-13*	*0.5*	*0.4*	*42.8*	*34,031*	*7.0*	*6.4*	*4.3*	*4.2*			
Average for peers								***7.7***	***8.8***	***4.7***	***5.0***			
Utilities														
Irkutskenergo	0.3	-11	61	0.4	0.2	0.1	1.287	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Lenenergo	0.6	2	12	1.0	0.6	0.0	765	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Mosenergo	0.1	6	-14	0.2	0.1	0.0	2.473	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
UES	0.4	-7	27	0.4	0.3	7.5	14.734	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
CEZ	*27.2*	*-9*	*97*	*759.0*	*278.2*	*1157.8*	*2.031*	*N/A*	*N/A*	*N/A*	*N/A*			
Copel	*6.2*	*2*	*41*	*14.7*	*8.3*	*0.6*	*832*	*N/A*	*N/A*	*N/A*	*N/A*			
Eletrobras	*17.9*	*-11*	*4*	*49.5*	*28.1*	*10.8*	*4.310*	*N/A*	*N/A*	*N/A*	*N/A*			
Average for peers														
Telecoms														
MGTS	13.0	0	37	13.5	8.5	0.0	1,038	10.5	9.1	5.9	5.2	19.8	14.8	**BUY**
TeleSP	*14.8*	*2*	*-28*	*21.8*	*14.1*	*0.6*	*8,901*	*8.2*	*7.8*	*3.5*	*3.4*			
Tele Norte Leste	*24.0*	*10*	*23*	*25.0*	*15.3*	*6.5*	*7,851*	*14.8*	*11.4*	*5.8*	*5.5*			
Average for peers								***11.2***	***9.4***	***5.1***	***4.7***			
Rostelecom	2.2	-14	18	2.7	1.7	1.0	2,099	37.2	26.9	5.5	5.5	2.07	-2.4	**HOLD**
Indosat	*0.5*	*-6*	*-13*	*0.6*	*0.4*	*6.2*	*2,646*	*15.1*	*11.6*	*4.4*	*3.7*			
Embratel	*2.1*	*5*	*-29*	*4.8*	*1.7*	*0.1*	*1,729*	*ng*	*7.9*	*3.6*	*3.2*			
Average for peers								***26.2***	***15.5***	***4.5***	***4.1***			
Golden Telecom	29.5	-7	12	32.0	25.0	2.3	1,071	11.1	8.6	4.5	3.6	37	25.4	**BUY**
Netia	*2.1*	*1*	*4*	*2.2*	*1.6*	*3.3*	*552*	*ng*	*16.8*	*4.4*	*4.2*			
MTS	37.0	-9	7	42.2	29.3	49.8	14,731	12.1	9.4	6.6	5.4	48	29.9	**BUY**
Sistema	23.0	-6	3	27.2	15.0	10.2	11,098	16.7	14.8	3.8	3.4	27	17.4	**BUY**
VimpelCom	40.2	-9	11	46.2	25.0	32.7	8,254	14.2	10.8	6.3	5.0	52	29.2	**BUY**
Stet Hellas	*19.5*	*1*	*4*	*22.2*	*14.9*	*20.1*	*1,632*	*16.5*	*16.0*	*6.1*	*5.8*			
Mobinil	*48.1*	*-5*	*51*	*54.5*	*29.4*	*N/A*	*4,963*	*21.3*	*16.5*	*10.0*	*8.2*			
Average for peers								***15.3***	***13.3***	***5.9***	***5.1***			
Metals														
GMK Norilsk Nickel	75.5	-5	39	82.8	43.2	3.3	15.206	10.9	14.3	5.6	6.8	87	17.6	**BUY**
Amplats	*59.5*	*2*	*91*	*63.7*	*28.8*	*1633.1*	*12965,8*	*36.1*	*24.3*	*16.0*	*13.7*			
Inco	*40.0*	*2*	*7*	*47.3*	*33.3*	*83.1*	*7567,8*	*12.4*	*10.2*	*5.4*	*5.6*			
Implats	*113.9*	*3*	*58*	*116.3*	*68.9*	*2991.9*	*7585,3*	*17.2*	*9.6*	*11.1*	*11.4*			
Average for peers								***19.1***	***14.6***	***9.5***	***9.4***			
Severstal	8.9	-9	38	10.3	6.4	0.3	4.912	4.2	5.1	2.6	3.0	10.5	18.0	**BUY**
Mechel	30.0	-18	34	37.0	13.6	4.7	4.167	8.1	9.0	4.2	4.5	34.5	14.9	**HOLD**
Evraz	17.3	-4	N/A	18.3	13.5	0.1	6.143	5.2	4.8	3.2	3.1	19	9.8	**HOLD**
China Steel	*0.8*	*5*	*-19*	*1.1*	*0.8*	*29.4*	*8698,2*	*5.5*	*5.5*	*3.5*	*3.6*			
POSCO	*210.8*	*4*	*17*	*233.8*	*159.4*	*63.3*	*18376,7*	*4.7*	*4.2*	*2.7*	*2.5*			
Average for peers								***5.5***	***5.7***	***3.3***	***3.3***			
Food														
Lebedyansky	57.0	-3	N/A	65.0	37.2	0.1	1,163	14.6	12.2	9.5	8.1	62.4	9.5	**HOLD**
Wimm-Bill-Dann	16.8	-1	29	18.0	13.0	0.0	739	31.7	24.5	9.0	7.4	22.5	33.9	**BUY**
Cadbury Schweppes (UK)	*985.3*	*0.6*	*26.6*	*1058*	*786.2*	*0.0*	*2,0479*	*26.9*	*17.3*	*11.9*	*11.9*			
Coca Cola Company (USA)	*42.7*	*-0.3*	*2.4*	*45.3*	*39.2*	*0.0*	*10,1471*	*20.9*	*20.0*	*14.4*	*14.4*			
Average for peers								***23.5***	***18.5***	***11.2***	***10.4***			
Retail														
Pyaterochka	19.6	-4	N/A	21.5	11.9	0.0	3,003	25.1	18.0	16.5	11.8	15.5	-20.9	**SELL**
Seventh Continent	22.3	-8	121	25.3	9.3	0.0	1,439	28.0	17.9	19.0	11.8	24.5	15.6	**HOLD**
Robinson & Co	*3.4*	*0*	*-3*	*4,0*	*3,4*	*0,1*	*296*	*13.8*	*15.1*	*11.2*	*10.6*			
Tesco PLC	*524.4*	*-2*	*-14*	*593.3*	*509.0*	*2105*	*41,137*	*17.1*	*16.2*	*9.9*	*9.3*			
Average for peers								***21.0***	***16.8***	***14.2***	***10.9***			
Engineering														
OMZ	5.2	-7	60	5.7	3.2	0.0	149	41.6	11.6	7.1	6.6	4.8	-8	**HOLD**
Hyundai Heavy	69.5	6	110	79.4	28.3	26.2	5278	44.7	neg.	22.9	23.4			
Average for peers								***42.2***	***11.6***	***14.8***	***14.9***			

Notes: N/A – not available, N/M – not meaningful; U/R – under review

Sources: RTS, Bloomberg, Alfa Bank estimates

Figure 17. Second-tier Stocks Performance and Valuation, MTD, as of November 2, 2005

Company	Price	Change		Last 52 weeks		ADV	MCap	P/E		EV/EBITDA		Target	Upside	Recommendation
		MTD	YTD	High	Low			2004E	2005E	2004E	2005E	price		
	$	%	%	$	$	$ '000	$ mln					$	%	
Oil and Gas														
Megionneftegaz	42.90	1	47	27.95	18.50	90	4,359	9.9	N/A	7.1	N/A	U/R	N/A	**U/R**
Bashneft	10.90	12	42	6.60	3.68	143	1,859	9.1	N/A	4.1	4.7	U/R	N/A	**U/R**
RITEK	6.02	6	12	5.00	3.16	426	585	5.1	N/A	3.2	N/A	U/R	N/A	**U/R**
Utilities														
Bashkirenergo	0.52	1	6	0.36	0.29	103	412	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Chelyabenergo	0.03	0	-16	0.04	0.01	27,000	125	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Krasnoyarskenergo	0.49	9	9	0.62	0.44	24,067	292	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Kubanenergo	15.00		85	7.30	7.30	0	268	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Kuzbassenergo	0.73	-4	-1	0.74	0.62	26,149	442	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Novosibirskenergo	23.50	0	26	19.50	13.00	29,250	318	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Permenergo	5.40		4	5.40	4.00	0	196	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Rostovenergo	0.05		43	0.05	0.05	0	156	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Samaraenergo	0.11	0	-8	0.13	0.10	33,410	396	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Sverdlovenergo	0.42		0	0.43	0.42	0	217	N/A	N/A	N/A	N/A	N/A	N/A	**RESTRICTED**
Telecoms														
Far East Telecom	2.05	6	35	1.50	0.89	31,441	226	7.5	21.5	9.7	6.6	1.80	-12	**HOLD**
Center Telecom	0.40	4	35	0.42	0.26	43,665	777	217.1	118.4	6.4	5.2	0.41	3	**HOLD**
Volga Telecom	3.67	7	9	4.20	2.47	148,967	1,214	14.5	12.0	6.7	5.3	4.43	20	**BUY**
Northwest Telecom	0.70	6	27	0.67	0.44	77,854	798	33.8	17.5	7.8	5.5	0.71	2	**HOLD**
Siberia Telecom	0.06	2	-3	0.07	0.04	127,673	924	15.5	12.0	6.0	4.9	0.068	9	**HOLD**
South Telecom	0.11	6	28	0.12	0.07	39,364	359	-34.3	-39.4	8.2	6.2	0.075	-31	**SELL**
Uralsvyazinform	0.03	1	-6	0.04	0.03	369,764	1,221	25.4	14.3	7.1	5.2	0.047	34	**BUY**
Other Sectors														
AvtoVAZ	24.20		-11	30.00	22.10	0	766	9.5	3.7	2.6	1.9	32.60	34	**BUY**
Chelyabinsk Pipe	0.85	49	178	0.80	0.21	230,126	508	280.6	38.3	20.4	10.9	1.10	29	**BUY**
Vyksa Pipe	450.00	9	111	425.00	177.00	53,800	838	11.9	8.7	6.7	4.7	460.00	2	**HOLD**
NTMK	1.68	5	28	1.30	0.60	104,772	1,886	4.9	3.9	3.2	2.2	1.80	7	**HOLD**
Sberbank	890.00	16	53	805.00	369.50	1,922,649	17,813	N/A	N/A	N/A	N/A	1170.0	31	**BUY**
Irkut	0.63	6	8	0.67	0.49	44,475	577,5	8.9	7.0	7.1	6.6	0.87	38	**BUY**
Kalina	34.00	12	89	33.00	16.50	55,269	327,7	14.7	10.9	8.0	7.1	40.00	18	**BUY**

Sources: RTS, Alfa Bank estimates

Figure 18. Preferred Stock Performance and Valuation, MTD, as of November 2, 2005

Company	Price	Change		Last 52 weeks		ADV	Pref. to Com. discount	Dividends 2004E	Dividend yield	Target price	Upside	Recommendation
		MTD	YTD	High	Low							
	$	%	%	$	$	'000 $	%	$	%		%	
Oil and Gas												
Transneft pref.	1630	43	18	1058	750			10.77	0.01	U/R	N/A	**U/R**
Surgutneftegaz pref.	0.76	15	22	0.6825	0.403		22	0.0203	0.03	0.77	1	**HOLD**
Tatneft pref.	1.84	24	60	1.295	0.545		36	0.0335	0.02	U/R	N/A	**U/R**
Utilities												
UES pref.	0.3	11	19	0.3007	0.213		10	0	2	N/R	N/R	**N/R**
Telecoms												
Rostelecom pref.	1.57	18	13	1.72	1.31		24	0.1320	0.07	1.6	2	**HOLD**

Source: RTS, Alfa Bank estimates

Upcoming Events

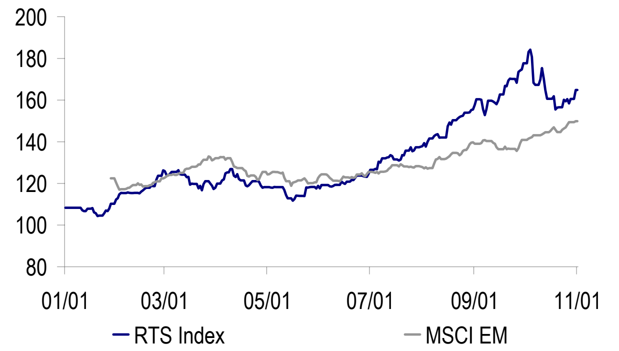
Figure 19. Calendar of Upcoming Corporate Events

Date	Company	Event
November 1	Lenenergo	State registration of new transmission company
November 1-10	Seventh Continent	3Q05 RAS results
November 5	Corporate Service Systems	State registration of shares of new supply and generating companies
November 1-10	Baltika	3Q05 RAS results
November 1-10	Far East Shipping Company	3Q05 RAS results
November 1-10	GAZ	3Q05 RAS results
November 1-10	GUM	3Q05 RAS results
November 1-10	KAMAZ	3Q05 RAS results
November 1-10	Neftekamski Plant	3Q05 RAS results
November 1-10	PAZ	3Q05 RAS results
November 1-10	PRISCO	3Q05 RAS results
November 1-10	SeverstalAvto	3Q05 RAS results
November 1-10	UAZ	3Q05 RAS results
November 1-10	Wimm-Bill-Dann	3Q05 RAS results
November 1-10	Zavolzhsky Motors	3Q05 RAS results
November 15	UES	1H05 IAS Results
November 15	UES	3Q05 RAS results
November 17	Kurganenergo	Approval of restructuring plan by AO-energos AGM
November 17	Orelenergo	State registration of shares of new transmission company
November 17	Permenergo	State registration of shares of new transmission company
November 17	Sverdlovenergo	State registration of shares of new transmission company
November 20	Kabbalkenergo	Establishment of new generating company
November 21	Kolenergo	State registration of shares of all companies spun off from AO-energo
November 21	Lenenergo	State registration of shares of all companies spun off from AO-energo (except for transmission)
November 21	Volgogdaenergo	State registration of shares of all companies spun off from AO-energo
November 21	Pharmacy Chain 36.6	9M05 IAS Results
November 22	Baltika	Baltika bond: 3rd coupon payment
November 22	Kostromskaya GRES	EGM on merger with GenCo-3
November	MTS	3Q05 results
November	VimpelCom	3Q05 results
November	Wimm-Bill-Dann	9M05 GAAP results
November	Hersonsky Naftopererobniy Combinat	Completion of modernization plan by ABB Lummus Global
November	Nizhny Tagil Steel	1H05 IAS results
November	Uralkali	9M05 results
November	Zakhidenergo	Completion of Burshtynska TES reconstruction
November	ZapSib Steel	1H05 IAS results
November	Acron	9M05 RAS results
November	Power Machines	Approval of acquisition of 22.48% in Power Machines by UES
November	SUN Interbrew	9M05 GAAP results

Sources: Company reports, Alfa Bank estimates

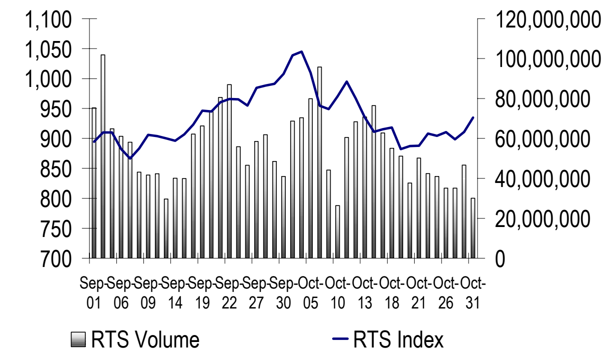
Chartbook

Figure 20. RTS vs. MSCI EM, YTD



Sources: RTS, Reuters

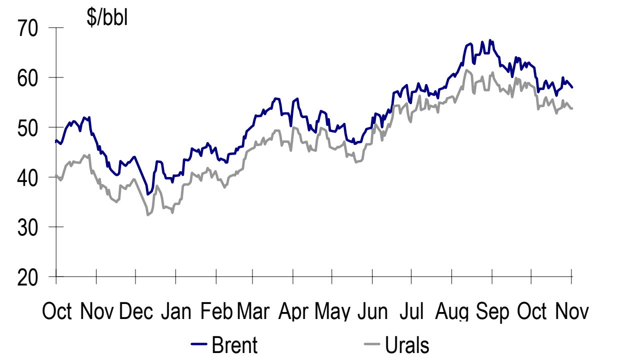
Figure 21. RTS Performance, MTD



Source: RTS

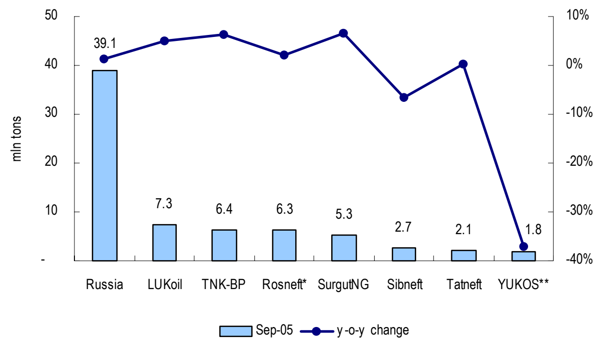
- RTS saw a sharp correction in response to external factors after reaching an all-time high of 1,052
- Combined exchange-traded volumes were generally strong in October as the RTS corrected downward

Figure 22. Oil Price: Brent vs. Urals, past 12 months



Source: Bloomberg

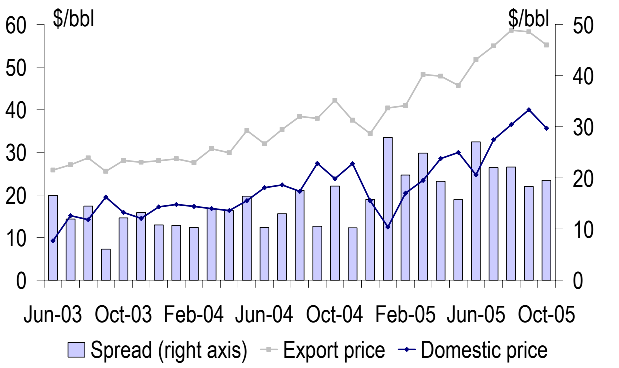
Figure 23. Oil Output by Company, monthly (mln tons)



Source: Ministry of Energy

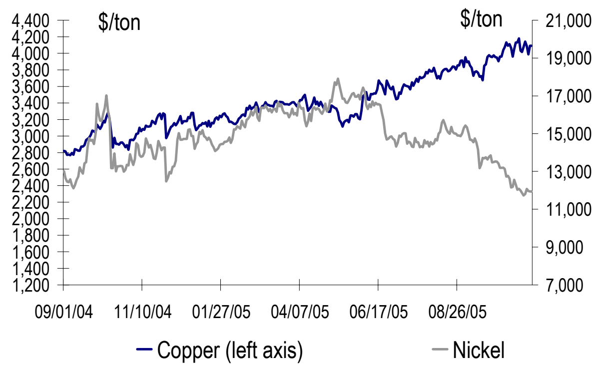
- Oil output growth in Russia continued to slow in September, leading us to revise downwards our full-year forecast to 2.8% in daily production terms

Figure 24. Oil Export Price vs. Domestic Price



Source: Ministry of Energy

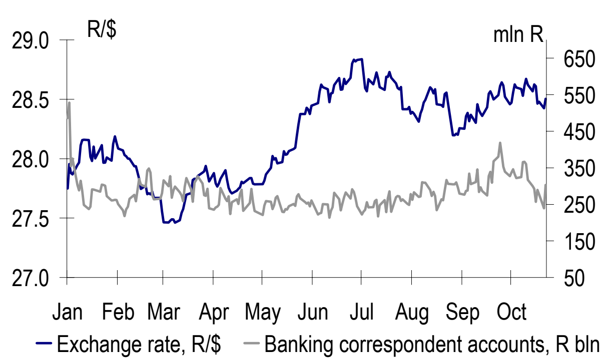
Figure 25. Copper vs. Nickel Price, Past 12 Months



Source: Bloomberg

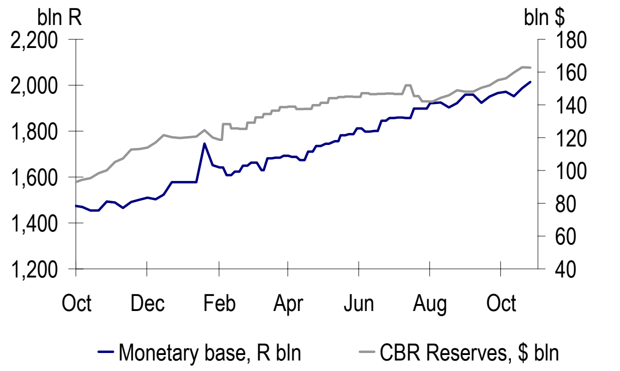
- Following the 5% correction in the export price in October, domestic crude price saw a larger drop (-11%)

Figure 26. Exchange Rate vs. Bank Liquidity



Source: CBR

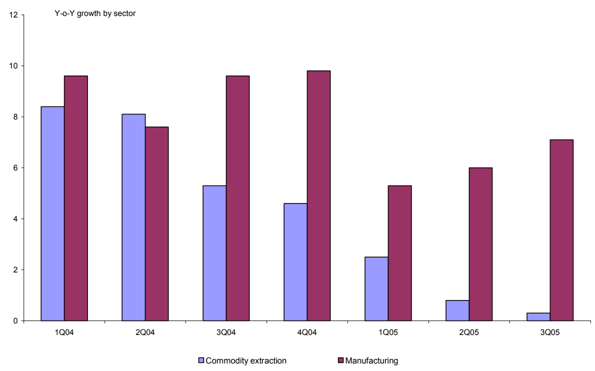
Figure 27. Monetary Base vs. CBR Reserves



Source: CBR

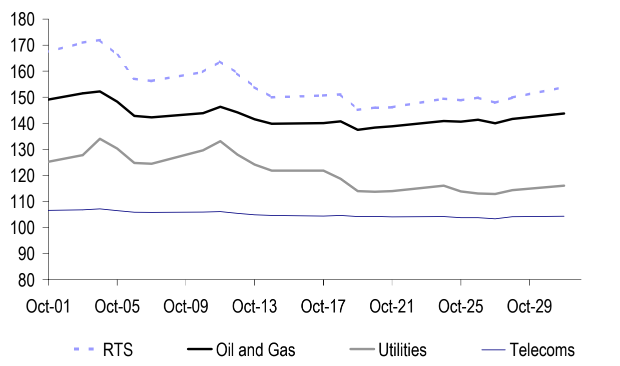
- Higher fiscal spending will support banking liquidity at the end of this year
- CBR reserves will increase substantially in November-December reflecting $5 bln to be borrowed by Gazprom for the Sibneft deal

Figure 28. Manufacturing sector performance



Source: Rosstat

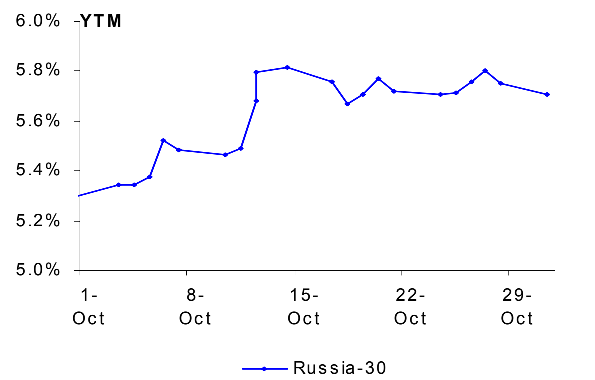
Figure 29. Sector Performance, MTD



Source: Alfa Bank estimates

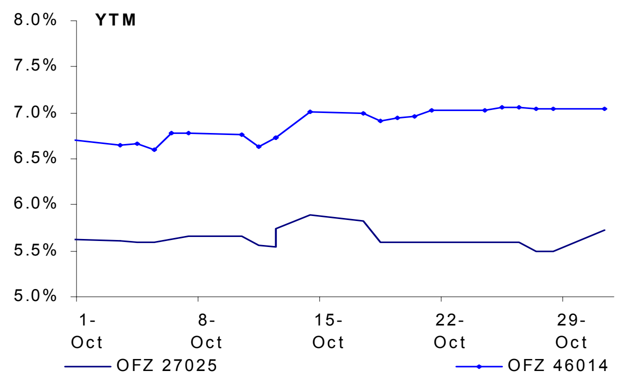
- Manufacturing sector growth remains strong, while commodity extraction volumes are stagnating

Figure 30. Russia-30 Performance, YTM



Source: Reuters

Figure 31. OFZ 27025 – OFZ 46014 Performance, YTM



Source: Reuters

- The period of growth in emerging market debt came to an end in October due to inflationary fears and the oil price decline
- Deep correction on the external debt market alongside a deficit of liquidity put pressure on the OFZ market and led to growth in yields

Macroeconomics

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Economic figures suggest growth acceleration

Economic data released in October suggest some recovery of growth thanks to the services sector. The 5.9% GDP growth for 9M05 and the 4.0% industrial growth for the same period allowed us to upgrade our GDP forecast from 5.5% to 6.0% for this year. However, the growth model remains focused on oil, as around 70% of the GDP increase was linked to crude production. The only change involved the mechanism; whereas before growth was mainly derived from the commodities sectors, additional oil revenues are now being redistributed by the budget to the machine-building segment through higher investment by state companies. Thus, we were unsurprised that the commodity extraction sector expanded just 1.0% y-o-y in 9M05, while manufacturing grew at a rate of 6.1% y-o-y.

While corporate foreign debt at 10.6% of GDP is similar to peers' figures, local debt could increase

Corporate borrowing by Russian companies was another focus in October. The country's corporate debt totaled just 35% of GDP at the end of 2004, or nearly half the emerging markets average of 65%. Meantime, foreign corporate debt is expected to reach 10.6% of GDP by the end of 2005, similar to Poland's 11.1%, Brazil's 9.4% and Mexico's 7.6%. This suggests that the continuing rise in corporate borrowing is likely to be financed by a faster increase in bank lending. The modest 12% YTD growth in corporate lending (vs. 48% y-o-y in 2004) alongside flat interest rates suggests that banks lack financial resources to satisfy demand. Growth in local corporate debt will thus proceed in line with greater borrowing by Russian banks abroad as well as the arrival of foreign banks to the Russian market.

Figure 32. Russia's Corporate Debt, $ bln and % of GDP

	1998	1999	2000	2001	2002	2003	2004	2005F
Foreign debt, $ bln	19.6	21.1	21.8	24	33.6	55.1	77	115
Domestic debt, $ bln	15.6	16.5	28.1	42.5	54.6	91.8	129	150
Share of GDP	12.9%	20.7%	19.8%	22.0%	26.1%	33.9%	35.3%	35.8%

Sources: CBR, Alfa Bank estimates

Debt/EBITDA in Russia averages around 1.0, could rise by 2-3 times

The low debt burden of the main Russian blue-chip companies is another reason to expect continued growth in corporate debt. Of the top 32 companies in Russia's oil, telecoms, metals and retail segments, only half have a Debt/EBITDA ratio above 1.0 and only six above 2.0. According to S&P methodology, a "BBB" rating (i.e. Russia's sovereign level) corresponds to a Debt/EBITDA ratio of around 2.4. In Russia, the current average is around 1.0.

Figure 33. S&P Ranges for Corporate Ratings

	AAA	AA	A	BBB	BB	B	CCC
Debt/EBITDA	0.2	1.1	1.7	2.4	3.8	5.6	7.4
DEBT/equity	6.2	34.8	39.8	45.6	57.2	74.2	101.2

Source: S&P

Market Regulation

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Figure 34. Key Events

October 19	**FSFM to propose amendments to Civil Code defining futures contracts** At an investment conference Monday, the head of the Federal Service for Financial Markets (FSFM) Oleg Vyugin said that the FSFM had drawn up amendments to the Civil Code that would clearly define what constitutes a futures contract. Current law effectively treats futures contracts as wagers (i.e. gambling), which means that they are unenforceable in a court of law. This legal ambiguity gained widespread attention in the aftermath of the 1998 financial crisis, during which Western institutions were left holding millions of dollars in worthless ruble-dollar forward contracts. Although this helped keep many local banks stay afloat, it also helped destroy trust in the Russian banking sector on the part of foreign investors. Only recently has the futures market (in bonds, equities and currency) begun to revive with meaningful traded volumes. That said, the segment it is still under-developed and limited to a few market-makers such as the RTS. Adoption of the amendments would boost the development of Russia's financial market, as it would allow a greater number of players to diversify risk through hedging while attracting a greater number of foreign participants. The amendments have yet to be submitted to the Duma for approval, though Vyugin hopes they will be before year's end. Meanwhile, *Kommersant* reports that the FSFM continues to work on legislative proposals concerning bankruptcy of companies and credit organizations, though no dates were mentioned as to when they might be ready.
October 20	**FSFM reportedly to propose limiting ADR listings to amount of local free-float** The Federal Service for Financial Markets (FSFM) continues to wage its campaign against "equity flight". *Vedomosti* cites FSFM head Oleg Vyugin as saying that the FSFM is elaborating a legislative proposal limiting the amount of depository receipts (ADRs, GDRs and ADSs) that can be issued by Russian companies to the size of local free-float. At present, a maximum of 40% of an issuer's stock can be listed overseas, although such shares must first be listed locally. Vyugin added that his agency plans to regulate non-sponsored ADRs programs (i.e. those operating without the participation or approval from the issuer) and that the Justice Ministry was currently examining the FSFM's proposals. Although limiting ADR issues represents a non-market means of stemming equity flight, we feel it is a necessary measure given the goal of protecting and developing the local equity market. Ultimately, of course, the aim should be to improve the intrinsic attractiveness of the local market, and along these lines we expect the FSFM to elaborate further measures. These might include an insider-trading law and tighter rules on reporting according to international accounting standards.

Source: Corporate and Industry News

Corporate and Industry News

Oil and Gas

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Ring-fence liberalization on time?

October was full of talk about progress on the Gazprom ring-fence liberalization front, with reassurance from top echelons of power, including President Putin and Gazprom CEO Miller, that the year-end deadline would be met. However, we have yet to see concrete progress. The draft amendments are currently being reviewed by the Economy Ministry, with accompanying commentary expected in November. To liberalize the market in Gazprom's shares, the government needs to remove the clause from the federal Law on gas supplies in Russia restricting foreign investment in Gazprom to 20% of its share capital. Secondly, the government must legalize the shares acquired by foreigners prior to 1997, which we consider a formal step. Finally, the government needs to remove restrictions calling for Gazprom's shares to be traded only on certain stock exchanges.

Last week, Chairman of the Duma Energy, Transport and Communications Committee Valery Yazev announced that he has prepared amendments to the Law on Gas Supplies that lifts the 20% cap on foreign ownership in Gazprom shares. We take this as good news for Gazprom. Although this is only the initial step in the process (the new draft law needs to be approved by the Duma, the Federation Council and signed by President Putin), it clearly demonstrates the government's commitment to resolving the issue.

It remains a question as to whether the government will manage to meet the year-end deadline for ring-fence liberalization, and we would not be surprised to see further delays. The necessary documents may be ready by year's end, but that would not mean their immediate enforcement.

Recently, the MEDT's Kirill Androsov reportedly said that the government may need to wait for a new law defining strategic sectors of the economy before it can start dealing with the ring-fence issue.

Although this sounds like a done deal, in fact it is not. We would not be surprised to see further delays and are skeptical as to the year-end deadline being met. To augment concerns, the Economy Ministry's Kirill Androsov was quoted as saying that the government may need to wait for the new law defining strategic sectors of the economy to be passed before it can start dealing with the ring-fence issue.

Sibneft acquisition completed speedily

Gazprom's acquisition of Sibneft closed smoothly without complications, unlike the previous failures by both sides on the M&A front (both Gazprom's acquisition of Rosneft and the YUKOS/Sibneft merger have fallen through in the past). The latest transaction is inherently different in terms of the interests involved. The deal has been swiftly approved by Gazprom's board of directors, despite Economy Minister and board member German Gref's concerns over the fairness of the price paid and the expediency of the deal for Gazprom altogether. At Gazprom's request, Deutsche Bank conducted a valuation of Sibneft and concluded that the $13.1 bln paid for a 72.7% stake was fair. The deal also swiftly received a green light from the Federal Anti-monopoly Service, with certain conditions regarding Sibneft's oil product retail markets, in line with Russian legislation. The deal closed on October 21. Immediately upon acquisition, Gazprom appointed its Deputy CEO, Alexander Ryazanov, as the new head of Sibneft. The latter did not wait to announce Gazprom's plans with regard to Sibneft's operations – export revenues of the oil company may be consolidated within Gazprom's export arm Gazexport. We would not be surprised with such a course of events, with Gazprom ending up diverting some of Sibneft's export proceeds to finance some of Gazprom's own projects.

Meanwhile, Sibneft disappoints with production decline statement…

As far as Gazprom's plans regarding its oil business are concerned, the company intends to consolidate its existing oil assets on the basis of Sibneft. Gazprom remains optimistic about Sibneft's prospects, despite the latter's announcement of an expected decline in this year's oil production. Sibneft first scared the market with a 5% expected decline, only to then correct it upwards to a 2.8% reduction in terms of total annual oil output. This still compares poorly with the 2.7% growth we expect for Russia's oil sector as a whole.

…but Gazprom pleasantly surprises on the financials side

On a positive note, Gazprom released a strong set of 1Q05 IAS results, which beat both our and the market's estimates. Revenues surpassed our forecast by 4.0% and the consensus estimate by 1.5%. EBITDA was 10.5% and 7.5% stronger than our and the consensus forecasts, respectively, and net income was 12% higher than we and the market had expected. Balance sheet data provided another positive surprise, with a $2.4 bln decrease in Gazprom's net debt to $14.0 bln, mainly thanks to the improvement in the company's working capital position and higher cash flow generation on the back of a favorable oil and gas price environment.

LUKoil acquires 66% of Nelson, awaits decision on remaining 34%…

Following its announcement in September, LUKoil purchased 66% of Nelson Resources, a Kazakhstan-based oil producer listed in Canada. The offer extends for 100% of Nelson shares, which is scheduled for shareholder approval at an EGM on December 2. Certain of its success, LUKoil has reportedly already raised $2 bln (i.e. the price offered for the whole of Nelson) in the form of a 6-month unsecured loan from Citigroup at a very attractive rate of LIBOR + 0.5%.

…but fails to buy Petrokazakhstan, to our content

LUKoil's dispute with Petrokazakhstan (PKZ), another Canada-listed oil producer in Kazakhstan, over the parties' 50/50 JV Turgai Petroleum is in full swing. Following CNPC's offer to buy out 100% of PKZ for $4.18 bln, LUKoil has been fighting with its JV partner for its pre-emptive rights to the partner's 50% stake in the JV. LUKoil filed a claim with a Stockholm arbitration court and subsequently requested a Canadian court to halt CNPC's acquisition of PKZ until the Turgai issue is resolved. LUKoil did not waste any time, and in a rather extravagant move offered to buy out 100% of PKZ at the same price as CNPC ($4.18 bln). The Canadian court, however, approved CNPC's purchase of PKZ, and the former hurried to close the deal. LUKoil's JV issue remains outstanding, but we welcome the company's failure to purchase PKZ. The buyout would have been a costly investment for LUKoil, and we would rather see the company invest in its upstream expansion within Russia and continue downstream expansion in Eastern Europe.

Economy Ministry's new proposals on oil sector taxation

The government seems to be making progress in terms of revising its position regarding taxation of the oil sector. The Economy Ministry plans to compose a new draft piece of legislation concerning the mineral extraction tax (MET) by November 7. The new proposals include: (a) amendment of the MET formula with Urals at $40 p/bbl as a basis. This is expected to come into effect from 2006; (b) the introduction of a 7-year MET tax holiday, or exemption from MET until production from the field reaches 2 mln tons p.a. (40 mbpd) on the exploration of certain new fields in 'frontier' regions, including Eastern and Western Siberia and possibly Russia's Arctic shelf; and (c) to stimulate the development of fields with high sulfur-content oil via the introduction of a 5-year tax benefit of up to $10 p/ton (or $1.4 p/bbl). The government plans to implement changes to the oil sector taxation over 2006-2007, which we would certainly welcome.

Looking ahead, more news on the ring-fence and oil sector taxation front

In the month ahead, we continue to focus our attention on any progress in Gazprom's share market liberalization, as well as concrete proposals for reduction of oil sector taxation.

Gazprom

Figure 35. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	33,916	42,926	44,111	44,178
EBITDA, $ mln	13,128	18,368	17,213	16,858
Net profit, $ mln	7,142	8,553	8,580	8,919
P/E	15.9	13.2	13.2	12.7
EV/EBITDA	10.3	7.4	7.9	8.0
Market Cap, $ mln	119,533			
Enterprise Value, $ mln	135,301			
Production, boe	3,464			
Reserves, boe	105,816			
Shares Outstanding, mln	23,674			

Sources: Company reports, Alfa Bank estimates

Figure 36. Company Snapshot

Strengths

- Monopoly over domestic gas market
- Large portion of revenues (65-70%) derived from exports
- Strong position on the European gas market

Weaknesses

- Low domestic gas prices
- Slow progress in improving operating efficiency
- Dual market for company's share trading

Opportunities

- Ring-fence removal appears imminent in the near term
- Potential for cheap asset acquisitions
- Potential JVs with international majors; Gazprom would benefit from foreign management expertise
- New export-pipeline projects
- Gradual rise in domestic gas prices

Threats

- Risk of growing inefficiency of operations as new assets are added to the company's structure
- Risk of squandering cash proceeds expected from the government in exchange for the 10.7% stake

Sources: Company reports, Alfa Bank estimates

Figure 37. Key Events

October 6

Putin, Gref comment on Gazprom

Speaking at the Russia-EU summit in London yesterday, President Vladimir Putin was quoted as assuring investors that Gazprom's share market liberalization should be finalized by the end of the year. The market's reaction to this was, however, lukewarm at best, with local shares closing down 3% in line with the market and ADSs under-performing – down 8.5%.

In turn, Minister of Economic Development and Trade German Gref continued his criticism of Gazprom's strategy. He was quoted by Interfax yesterday as questioning the expediency and fairness of the price that Gazprom paid Millhouse for 72.7% of Sibneft. It appears, though, that the minister's opinion does not have strong backing among other prominent government officials. The head of the Federal Anti-monopoly Service (FAS) was quoted as saying that his agency should be ready to approve the deal within two weeks, while another FAS official reportedly suggested that the approval might be extended as early as this week.

October 7

Gazprom to release 1Q05 IAS results soon

Gazprom is due to release its 1Q05 IAS results either today or early next week. We expect a strong set of numbers on the back of high international oil and gas prices and stronger domestic gas prices. We expect a 31% increase in revenues to $11.7 bln vs. the consensus estimate of $12.0 bln. EBITDA should rise by 28% to $5.0 bln vs. the consensus of $5.1 bln, while net income should grow 26% to $2.9 bln, under both our and the consensus estimates.

Our focus will be on Gazprom's operating expenses, the situation involving net debt (which amounted to $16.3 bln as of end-2004), operating cash flow generation and capex efficiency.

All in all, we do not expect the results to have a significant impact on Gazprom's share price. The stock is being driven instead by developments on the expansion side (JVs with international majors, meaningful acquisitions of core assets, etc) as well as concrete steps toward ring-fence liberalization.

October 18

Gazprom board as expected approves Sibneft acquisition

Gazprom's acquisition of Sibneft is steaming ahead. As expected, the gas company's board of directors yesterday approved the purchase by the company of 72.7% and 3.0% stakes in Sibneft. The deal was backed even by Minister of Economic Development and Trade German Gref, who previously openly questioned the expediency of the deal for Gazprom and the fairness of the price offered.

Gazprom intends to transfer the $13.1 bln lent by a consortium of Western banks for the 72.7% stake in Sibneft over the next few days, *Vedomosti* quoted banking sources as saying.

October 19

Gazprom appoints head of Sibneft from its ranks

Acting quickly after its board's approval of the Sibneft acquisition, Gazprom has hurried to change leadership at the newly acquired asset. Yesterday, CEO Alexey Miller announced the appointment of his deputy, Alexander Ryazanov, to head Sibneft, replacing the existing CEO Yevgeny Shvidler. The appointment must now be approved by Sibneft's board of directors, which we expect to happen shortly.

The appointment does not come as a surprise. The motivation of Gazprom to install its own people at the helm of Sibneft is logical, and Ryazanov represents a suitable candidacy. He joined Gazprom as Deputy CEO in November 2001, at the invitation of Miller himself, according to *Vedomosti*. Over his time at the gas monopoly, Ryazanov achieved success in returning under Gazprom's control some of its lost assets, such as the petrochemicals company Sibur, as well as suggesting schemes for interaction with independent gas producers. He has also been actively involved in negotiations with regard to new projects, such as Shtokman and Kovykta, and has fought for gas price increases on the domestic market, for example through the launch of a gas exchange.

In his interview with *Vedomosti*, Ryazanov stated Gazprom's plan to consolidate its oil assets on the basis of Sibneft. He also emphasized that Gazprom has no intentions to sell Sibneft, either in block or in small installments. Regarding the question of future control over Sibneft's export proceeds, Ryazanov replied that centralization of flows within Gazexport, Gazprom's export arm, seems logical, though it remains subject to discussion. We would not be surprised if Gazexport does indeed consolidate Sibneft's export proceeds, with a view to divert some of the funds to finance its own projects.

October 20	**FAS gives green light to Gazprom's acquisition of Sibneft** As we expected, the Federal Antimonopoly Service (FAS) yesterday announced that it approved of Gazprom's acquisition of a 75.7% stake in Sibneft. As it commonly does, the FAS stated a number of conditions that Gazprom must meet concerning oil production in Russia. For instance, Gazprom must ensure non-discriminatory access to Sibneft's Omsk refinery for third-party crude suppliers. It must also allow for fair competition among petroleum product suppliers in markets where Sibneft holds a dominating position. Finally, Gazprom will not be allowed to shut its refinery on non-technical grounds. The FAS imposed no demands with regard to the gas market, given that Sibneft holds no gas assets.
October 21	**Gazprom 1Q05 IAS results stronger than expected** Yesterday Gazprom released its long-awaited first-quarter 2005 IAS results, which were stronger than expected. Revenues increased 36% y-o-y to $12.2 bln, surpassing our estimate by nearly 4% and the consensus forecast by 1.5%. This growth in revenues was primarily driven by stronger-than-expected realized gas sales prices (net of excise tax and customs duties) by 37% to $125/mcm. Traditionally, operating costs grew more moderately, and we expect acceleration in this growth over the remainder of the year. Total operating costs reported by Gazprom for 1Q05 increased 8%, resulting in a sizeable 41% increase in EBITDA to $5.5 bln, or 10% and 8% above our estimates and the consensus figures, respectively. Operating profit rose 52% to $4.3 bln, thanks to a modest 13% rise in DD&A. Going forward, we again expect acceleration in DD&A expenses, resulting in lower margins. The bottom line saw a 43% rise to $3.3 bln, versus our estimate and the consensus of $2.9 bln. The company paid an effective income tax rate of 26%, in line with the 1Q04 result and below the 28% rate witnessed in 2004 as a whole. On a more encouraging note, Gazprom managed to reduce its net debt position by as much as $2.4 bln, to $14.0 bln as of March 31, 2005. This was helped primarily by the company's operating cashflow generation ($4.6 bln in 1Q05 versus just $2.4 bln in 1Q04). This, in turn, was helped by improved income generation, as well as a smaller increase in working capital ($305 mln in 1Q05 versus $775 mln in 1Q04). Overall, we view the results as positive for Gazprom, but do not see this as a driver for the company's share price. We reiterate our view that the catalysts for the stock remain developments on the expansion side (JVs with international majors, meaningful acquisitions of core assets, etc), as well as concrete steps toward ring-fence liberalization.
October 27	**Deutsche Bank concludes that Gazprom paid fair price for Sibneft** In a press release issued yesterday, Gazprom announced Deutsche Bank's report on the valuation of Gazprom's acquisition of Sibneft. The bank concluded that Gazprom's $13.1 bln bid for 72.7% of Sibneft was indeed priced fairly. Deutsche Bank employed a variety of valuation methodologies, including analyses of Sibneft's financial standing, comparable companies and comparable transactions, and accounted for Gazprom's super-majority control over Sibneft (over 75%, given the 3% interest acquired for Gazprom by Gazprombank). Deutsche Bank's valuation summary comes in the wake of serious criticism of the deal by Minister of Economic Development and Trade (and Gazprom board member) German Gref. However, he eventually voted in favor of the deal, and the acquisition was approved unilaterally by Gazprom's board. This news comes as no surprise to us whatsoever, and therefore we consider it neutral for Gazprom's share price.
October 28	**Government moving closer to Gazprom ring-fence liberalization** There has been some further progress on the Gazprom ring-fence liberalization front. This morning, *Interfax* quotes Valery Yazev, Chairman of the Duma Energy, Transport and Communications Committee, as saying that it has prepared and signed off on amendments to the Law on gas supplies in Russia, which lift the 20% cap on foreign ownership in Gazprom shares. We treat this as good news for Gazprom. Although this is only the initial step in the process (the new draft law needs to be approved by the Duma, the Federation Council and signed off by President Putin), it clearly demonstrates the government's commitment to resolving the issue. It remains questionable as to whether the government will manage to meet its year-end deadline for ring-fence liberalization, but today's news should nevertheless provide support Gazprom's share price, in our view.

Source: Alfa Bank research

LUKoil

Figure 38. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	34,058	36,096	32,880	31,586
EBITDA, $ mln	7,109	9,724	8,449	7,927
Net profit, $ mln	4,248	4,376	4,034	4,394
P/E	11.0	10.7	11.6	10.6
EV/EBITDA	7.0	5.1	5.9	6.3
Market Cap, $ mln	46,738			
Enterprise Value, $ mln	49,555			
Production, mln boe	664			
Reserves, mln boe	20,072			
Shares Outstanding, mln*	851			

*Note: * Excluding 25 mln treasury shares*
Sources: Company reports, Alfa Bank estimates

Figure 39. Company Snapshot

Strengths
- Large proved reserves totalling 20.1 bln boe
- Diversified asset base
- Independent oil export routes from Timan-Pechora and Caspian region (20 mln ton capacity)

Weaknesses
- Slow progress in improving operating efficiency
- High and rising unit capex

Opportunities
- Advantages of strategic partnership with ConocoPhillips
- Increasing production growth
- Rationalization of asset portfolio
- Restructuring program to boost capex and opex efficiency
- Development of gas business segment
- Revival of contract in Iraq

Threats
- Large capex may not yield the desired rate of return
- Dependence on the domestic market

Sources: Company reports, Alfa Bank estimates

Figure 40. Key Events

October 3	**LUKoil offers to pay $2 bln for 100% of Nelson Resources – marginally positive** Nelson resources, a Toronto-listed oil and gas company with all of its asset base in Kazakhstan, and LUKoil each issued a press release on Friday announcing the Russian oil company's offer to buy out 100% of Nelson for a total of $2 bln. LUKoil also stated that it has reached a definitive buyout agreement with holders of 65% of Nelson. The offer translates into $2.21 per share, representing a 13% discount to Nelson's market price. The offer price values Nelson at $180.07/boe of 2004 production and $12.63/boe of proved reserves versus LUKoil's own valuations of $76.87/boe and $2.45/boe based on production and proved reserves, respectively. However, LUKoil's valuation of Nelson is largely in line with CNPC's valuation of PetroKazakhstan ($10.70/boe of proved reserves), another foreign-listed company with an asset base in Kazakhstan. We view LUKoil's offer, if taken up, as favorable for LUKoil. Nelson holds quality assets, with its crude selling at near Brent prices. A more benign taxation regime in Kazakhstan than in Russia also helps. With the 2% addition to LUKoil's production, LUKoil estimates 5 ppt additional growth in its net income from Nelson's contribution. The deal would be in line with LUKoil's diversification strategy. In the future, LUKoil plans to increase the share of its international upstream projects in its total production from 4% currently to over 8% by 2007 and over 15% by 2014. LUKoil aims to fully control Nelson, as opposed to its participation in the Azeri-Chirag-Guneshli project in Azerbaijan, in which it was only a minority shareholder and chose to dispose of its stake back in 2003. LUKoil and Nelson have agreed to negotiate definitive agreements on the buyout by October 12.
October 4	**ConocoPhillips raises its stake in LUKoil to 14.8%** ConocoPhillips announced that it had increased its stake in LUKoil to 14.8% as of the end of the third quarter from 12.6% at the end of the second quarter. As part of the two companies' strategic agreement signed in September 2004, Conoco is allowed to bring its stake in LUKoil up to 20%, which is what we believe the US company intends to do. This should support LUKoil's share price, in our view.
October 14	**LUKoil approaches endgame in Nelson acquisition** LUKoil is drawing closer to completing its deal with Nelson Resources. The oil major bid $2 bln for 100% of Nelson on September 30, by which point it had already reached a definitive agreement with holders of 65% of Nelson's shares. This number rose to 66.3% by October 3. Yesterday, LUKoil signed an agreement with Nelson's board of directors whereby the board will recommend that company shareholders accept LUKoil's offer at the AGM scheduled for late November. Should LUKoil secure acceptance from at least 75% of Nelson's shareholders, it will be allowed to purchase the entire company according to Bermudan law. This development is marginally positive for LUKoil. Although the acquisition would barely impact the scale of LUKoil's business (Nelson would account for just 2% of LUKoil's hydrocarbon production), and the bid price values Nelson at a 140% premium to LUKoil's valuations (based on production), Nelson's assets in Kazakhstan are of superior quality. Moreover, Nelson enjoys Kazakhstan's benign tax regime (at any rate, more benign than Russia's). LUKoil announced yesterday that it has reached an agreement with Citigroup to raise $2 bln for the transaction at LIBOR + 0.5% p.a. for a six-month period. LUKoil plans to refinance the loan with a subsequent 3-5 year syndicated loan.
October 20	**LUKoil posts 9-month operating data; better than preliminary** Yesterday LUKoil issued a press release on its 9M05 operating data. Consolidated crude production was up 4.3% to 66.9 mln tons in January-September 2005 (+4.7% up in barrel-per-day terms to 1.80 mln bpd). This is better than the preliminary data provided by the Customs Committee a few weeks ago, which announced that LUKoil's 9-month average crude output was up just 2.1% at 1.75 bpd). LUKoil's total hydrocarbon output in January-September averaged 1.91 mln bpd, or 5.5% higher y-o-y, thanks to the impressive 18.5% growth in daily gas output. Overall, we found the data encouraging and marginally positive for LUKoil.
October 26	**LUKoil offers counter bid for Petrokazakhstan** In a new twist to LUKoil's Kazakhstan ventures, the company yesterday announced its readiness to make an offer to Petrokazakhstan (PKZ) shareholders to buy out 100% of the company on terms equal to those proposed by China's CNPC (which bid $4.18 bln). In so doing, the company aims to resolve its dispute with PKZ over the parties' JV in Kazakhstan, Turgai Petroleum. LUKoil claims it has pre-emptive rights to buy out PKZ's 50% stake in the JV following CNPC's offer to acquire PKZ. On October 18, Canada's Alberta Province Court postponed approval of CNPC's offer until October 26, giving the Russian major a chance to settle the dispute. LUKoil now claims that it will acquire PKZ should the Canadian court decline to approve the CNPC deal. In our view, the $4.18 bln bid is quite a bit more than PKZ is actually worth. That price tag values PKZ at $76/boe of output versus LUKoil's own $71/boe and the Russian industry average of $53/boe. Additionally, should PKZ's shareholders choose LUKoil over CNPC, the Kazakh company would have to pay a $125 mln penalty to CNPC, which we believe LUKoil would end up offering to pay. It should be noted, however, that the offer is more reasonable than LUKoil's bid for Nelson Resources, which values Nelson at around $180/boe of output. We believe that CNPC will now reconsider negotiating with LUKoil over the Turgai issue rather than lose the battle for PKZ altogether. Should LUKoil succeed in purchasing PKZ at $4.18 bln, it would represent another expensive but solid acquisition. We consider this news to be neutral for LUKoil's share price at this stage.
October 28	**LUKoil looks to expand into Kazakh downstream** During his meeting with Kazakhstan's Prime Minister Danial Akhmetov and Oil Minister Vladimir Shkolnik in Moscow yesterday, LUKoil CEO Vagit Alekperov announced the company's plans to build, in partnership with the Kazakh government, a large natural gas processing and chemicals plant in Kazakhstan over the next few years. The plant would potentially process 8.5 bcm of gas per year to be sold as heating and industrial oil, and another 5.5 bcm to be used in plastics production. The project cost is estimated at between $3.6 bln and $3.8 bln. LUKoil plans to complete a feasibility study next year and would be able to commence construction in 2007. The plant may potentially be put into operation as soon as 2010. We welcome the development, as it is in line with the company's expansion downstream. The plant would allow LUKoil to process gas from fields in the Caspian region, including its $1 bln Khvalynskoye project. It is too early to estimate any concrete impact of the proposed project on LUKoil's financials due to its very early stages and as no indication on funding of the project has been provided.
October 31	**CNPC responds to LUKoil in Kazakhstan** It's now CNPC's turn to claim pre-emptive rights over a Kazakh JV. On Friday the Chinese company informed Nelson Resources – a UK-listed company with an asset base in Kazakhstan – of its intention to exercise its pre-emptive rights over the North Buzachi Joint Operating Agreement to acquire Nelson's 50% interest in the North Buzachi field. CNPC's move follows the acquisition of a controlling stake (over 65%) in Nelson by LUKoil. Nelson claims that the agreement does not stipulate such pre-emptive rights. CNPC's move echoes LUKoil's own fight for its rights to acquire 50% of Turgai Petroleum, its JV with Petrokazakhstan (PKZ) in Kazakhstan. PKZ was last week purchased by the Chinese company. LUKoil has filed suit in a Stockholm arbitration court with a view to defending its pre-emptive right over Turgai Petroleum.

We view Friday's development as fairly neutral for LUKoil. Even if CNPC does secure its pre-emptive rights over North Buzachi field, which looks doubtful given Nelson's assertiveness on the non-existence of any pre-emptive rights over the field, the impact would be immaterial for LUKoil given the field's size. North Buzachi produced 9.3 mbpd of oil in 2004 (10.7 mbpd in 2Q05), which accounts for a mere 0.5% of LUKoil's own production.

Source: Alfa Bank Research

Sibneft

Figure 41. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	9,265	10,637	9,695	9,264
EBITDA, $ mln	3,242	3,475	2,457	2,415
Net profit, $ mln	2,046	2,197	1,820	1,747
P/E	8.3	7.8	9.4	9.8
EV/EBITDA	5.4	5.0	7.1	7.2
Market Cap, $ mln	17,069			
Enterprise Value, $ mln	17,377			
Production, mln boe	260			
Reserves, mln boe	4,827			
Shares Outstanding, mln	4,741			

Sources: Company reports, Alfa Bank estimates

Figure 42. Company Snapshot

Strengths

- High operating efficiency
- Owns Russia's most advanced refinery with 82% refining depth
- Access to Moscow fuel market via 38% stake in Moscow refinery

Weaknesses

- Low (8%) free-float
- Having been one of most aggressive tax minimizers, the company is at risk of back tax penalties

Opportunities

- Sale of stake in the company to a strategic investor
- Boost in operating efficiency of Sibneft's 50% subsidiary (Slavneft)

Threats

- Fate of the 20% stake in Sibneft currently held by Yukos
- Potential further downward revisions to already decelerating production growth

Sources: Company reports, Alfa Bank estimates

Figure 43. Key Events

October 5 **Sibneft's 1H05 US GAAP results surprise on the upside**

Sibneft released a strong set of first-half 2005 US GAAP results. Revenues increased 43% y-o-y to $5.73 bln versus the *Bloomberg* consensus of $5.57 bln. This was driven solely by strength in oil prices (Urals up 46% in 1H05 to $45.54/bbl), as the company's production stagnated.

The effect of operating costs on EBITDA was mixed. On the positive side, the company managed to keep its operating expenses and SG&A under control – up just 31% to $1.22 bln, and 22% to $0.72 bln, respectively. On the other hand, Sibneft saw a 91% jump in taxes other than income tax to $1.80 bln on the back of strong international oil prices (both export duties and mineral extraction tax, which account for a lion's share of the company's taxes other than income tax, are linked to the Urals oil price). As a combined result of these effects, EBITDA was up 29% to $1.94 bln, strongly ahead of the consensus of $1.83 bln.

Below the operating line, the 41% rise in pre-tax income to $1.88 bln was helped by a 165% jump in interest received (to $11 mln) resulting from the company's significant cash position – nearly $1.2 bln as of the end of 2004. Another contributing factor was the 83% drop in Sibneft's other non-operating expenses to $17 mln as a result of the cut in the company's social expenses related to Chukotka region from the beginning of 2005.

The 44% rise in net income to $1.42 bln (versus consensus of $1.34 bln) was helped by the smaller rise in income tax (up just 32% to $0.46 bln). The company's effective income tax rate dropped to the statutory 24% from 26% in 1H04 and from as much as 39% in 2004 overall. In our comment on Sibneft's full-year 2004 US GAAP results, we noted that the high effective income tax rate was attributable to the accounting for back taxes.

Overall, Sibneft has been able to maintain its profitability margins at healthy levels.

On a disappointing note, Sibneft demonstrated a $219 mln increase in working capital, which hampered growth in cash flow generation from operating activities.

As far as capex is concerned, Sibneft registered a 70% increase in its unit E&P capex to $1.68/bbl due to its efforts to ramp up stagnating production. However, the number is still low compared to the industry average. We stress that the company has been under-investing due to its former core shareholders' choices to cash in on hefty dividends.

October 17 **Sibneft expects decline in 2005 production**

Sibneft continues to prove disappointing in terms of production. On Friday, vice president Alexander Korsik announced that the company expects to produce around 5% (or 1.7 mln tons) less crude this year than in 2004. According to reports, the company partly blames this decline on the disruptive YUKOS merger process, which interfered with the development of Sibneft's Priobskoye oil field. Korsik was also quoted as saying that the company overestimated its field development plans.

The reported annual reduction in output translates into a 1.9% decline in terms of barrels per day, from 0.68 mln to 0.67 mln bpd. This is disappointing – worse than the expectations of an already pessimistic market, and also under-performing our own estimates for 2005 output. We had predicted growth of 2% y-o-y in terms of bpd. Sibneft's new figure compares even more poorly with our forecast for Russia's oil industry average output growth of 3.0% in 2005; we now revise this industry-wide forecast downward to 2.8% in terms of bpd, based solely on Sibneft's new expectations.

Sibneft's negative production growth implies that the company will reduce output by around 1% m-o-m in the remaining three months of the year, in contrast to an average increase of 0.6% m-o-m for the sector as a whole.

The news is therefore seriously disenchanting, and we anticipate further declines in Sibneft's share price.

Source: Alfa Bank research

Surgutneftegaz

Figure 44. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Net Revenue, $ mln	12,841	16,148	14,892	14,174
EBITDA, $ mln	4,057	4,243	4,006	3,839
Net profit, $ mln	2,503	2,406	2,211	2,197
P/E	13.8	15.5	16.9	17.0
EV/EBITDA	4.5	4.3	4.6	4.8
Market Cap, $ mln	41,183			
Enterprise Value*, $ mln	18,385			
Production, mln boe	522			
Reserves, mln boe	8,750			
Shares Outstanding, mln	43,428			

*Note: * Excludes value of own stock held through company's subsidiary*
Sources: Company reports, Alfa Bank estimates

Figure 45. Company Snapshot

Strengths
- Politically safe stock
- Refinery near St. Petersburg is well located for domestic deliveries and export

Weaknesses
- Low dividend payout ratio (3-4%)
- Refinery is one of Russia's most obsolete (54% refining depth)
- Very poor financial transparency, capital efficiency and shareholder relations

Opportunities
- Development of new reserves in Eastern Siberia
- $800 mln modernization of Kinef refinery by 2008
- Change in corporate governance practices

Threats
- Company's non-transparent ownership structure facilitates manipulation of large 47% block of "treasury shares"
- Large unused cash pile which does not add value

Sources: Company reports, Alfa Bank estimates

YUKOS

Figure 46. Key Events

October 4 **Slovakia eyeing YUKOS' stake in Transpetrol?**
Following in the Lithuanian government's footsteps, Slovakia is keen to get back hold of YUKOS' assets located on its territory. *Vedomosti* quoted a Slovak Economy Ministry official as saying that the government had approached YUKOS' president Steven Theede with a proposal to sell YUKOS' 49% interest in the pipeline company Transpetrol back to them by the end of the year. According to the business daily's sources close to YUKOS, the company has not yet decided on the terms of a potential sale. During his visit to Slovakia earlier this year, President Putin noted that Tatneft might be interested in taking up YUKOS' stake in Transpetrol, though Tatneft has not commented.

October 5 **Court upholds $3.5 bln tax claim for 2000 against YUKOS**
Pressure continues to be relentlessly applied to YUKOS. Yesterday, the Supreme Arbitration Court confirmed the Tax Ministry's R99.4 bln ($3.5 bln) claim against the company in back taxes for 2000, *Interfax* reported.

October 12 **Bailiffs raise court orders against YUKOS**
YUKOS was dealt another blow yesterday, this time from foreign creditors who provided the company with a $1 bln loan back in 2003. Late last month, the Moscow Arbitration Court upheld a June ruling by the London Supreme Court and urged YUKOS to pay the creditors the outstanding amount totaling $475 mln. Yesterday, the Moscow court ruling was followed by the city's bailiff service, which initiated 14 cases against YUKOS based on the number of creditors involved. The bailiffs will now check the availability of cash in YUKOS' accounts, and in case of a deficit, initiate bankruptcy proceedings and the sale of YUKOS' remaining assets.
The most likely candidates, according to a YUKOS official, include the company's 20% stake in Sibneft still frozen by court order and Yuganskneftegaz preferred shares (around 23.2% of YuganskNG's share capital). The list may also extend to include YUKOS' interest in Mazeikiu Nafta refinery in Lithuania, in our view.
Whichever the assets chosen to pay off YUKOS' loan, we believe that the company's stock will come under pressure after their stellar performance in recent days.

Source: Alfa Bank research

Telecoms

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For this monthly report we shift a bit from the traditional overview of upcoming events to a more ‘global’ subject – VAS (value-added services) and their dynamics in Russia. Our aim is to introduce current trends in Russia’s mobile VAS market and then go into greater detail in future reports.

We expect 22-23% Russian ARPU erosion in 2005, 9-12% in 2006

VAS has already become an important component in helping mobile operators support their falling ARPU. We expect 22-23% Russian ARPU erosion in 2005 and 9-12% in 2006, which will bring the country’s ARPU level to among the lowest in Europe.

77% mobile penetration raises question of sources for future growth

Also, 77% mobile penetration reached in Russia by the end of 3Q05 already raises questions regarding how the market will grow going forward. We believe this should be the main topic on corporate agendas and in analyst reports starting from 2006. In fact, mobile ARPU has already stopped falling in a number of East European countries, and VAS is one of the vehicles driving this trend.

Russian mobile VAS market has already exceeded $1 bln

Nevertheless, we are already talking about some sizeable contributions from VAS to Russian telecoms revenues. The VAS market exceeded $1 bln last year, and in 2005 should be approximately 20% larger (see Figure 47 below).

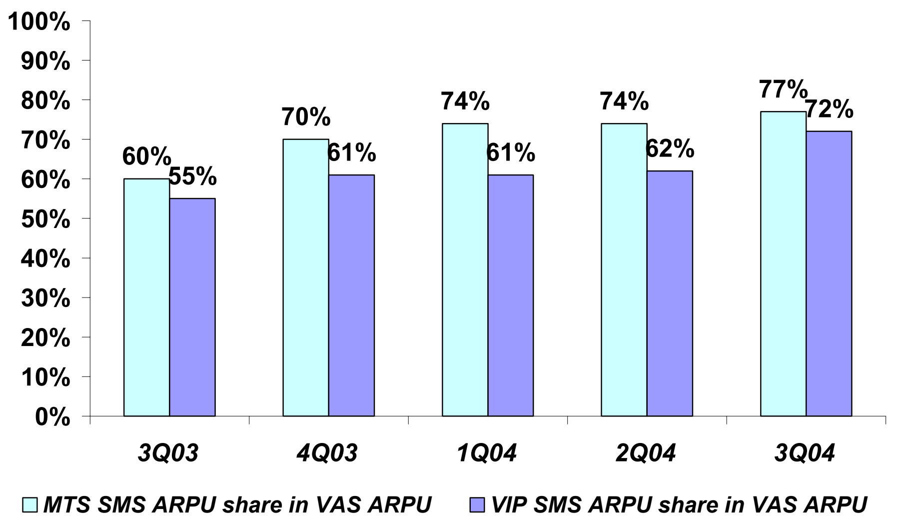
Figure 47. VAS – Russia

	Services	Revenues 1H'05 $ mln	Revenues 2004 $ mln	Share of VAS, 1H'05 %	Share of VAS, 2004 %
1	Basic services	84	164	14%	16%
2	SMS\MMS	283	462	47%	45%
3	Data transmission	102	102	17%	10%
4	Content	133	297	22%	29%
	Total:	602	1025		

SMS services account for more than 50% of VAS revenues

SMS services account for approximately half of all VAS industry revenues, and even more for mobile operators, which account such revenues in full (not deducting payments to content providers, as they are accounted in operating costs). See Figure 48 on the following page.

Figure 48. SMS Share in VAS ARPU



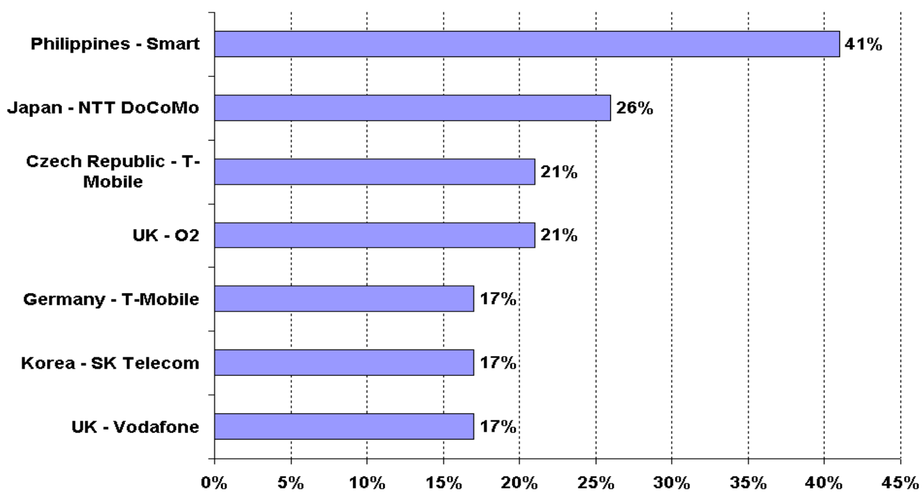
Little correlation between a country's wealth and mobile data usage

However, the global trend favors a growing share of data transfer services in total VAS revenues. What is encouraging is that there is no direct correlation between a country's wealth and subscriber usage of mobile data revenues. For example, the biggest share of data transfer services in total revenues is shown by the Philippines' Smart – 41%, which is even higher than the usual benchmark (NTT DoCoMo – 26%).

Data revenues in Russia are only 12-14% of ARPU

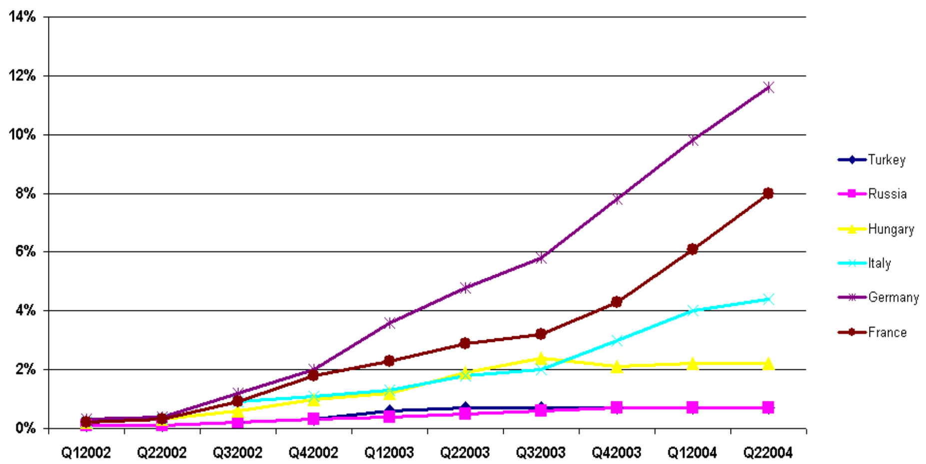
In fact, there is a general view that data revenues have a total revenues ceiling of around 25%. NTT DoCoMo, for example, has not topped 26-27% even after having run its very successful I-mode service for six years. In Russia, this figure is thus far only 12-14% (and from low ARPU) and falling. As of 1H05 it was $1.1 compared with $1.5 in 2004. In fact, this is one of the lowest figures among global mobile operators offering data services. Only a few operators in Latin America and Asia have a data ARPU figure as low as $1.

Figure 49. Data Transfer Service, % of Revenues



Thus far, Russia remains far behind in terms of mobile data usage (see Figure 50 below).

Figure 50. Mobile Data Usage, Subscribers



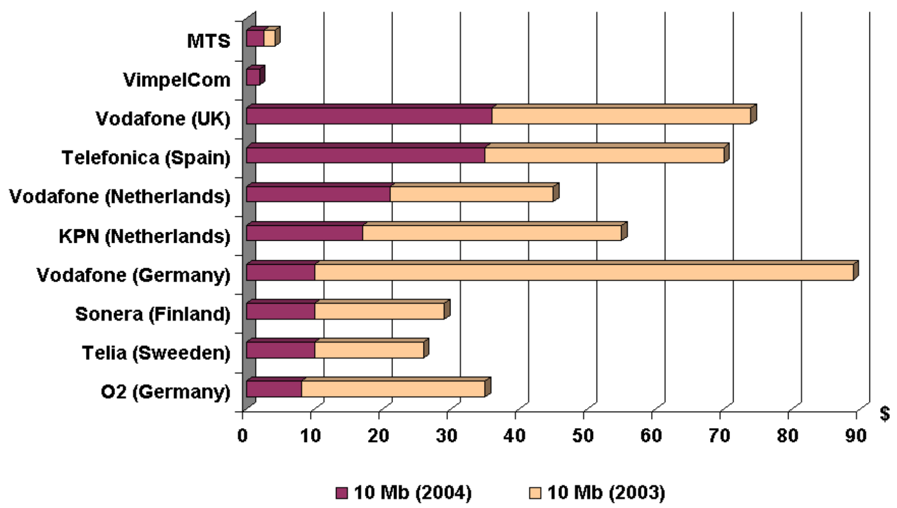
Lack of quality content is the main reason for poor mobile data performance

The main reason for the poor development of mobile data usage in Russia is the lack of quality content, in our view. In fact, content service is the only VAS component with revenues in a downtrend (see Figure 50 above). Content service revenues for 1H05 were only 45% of the 2004 figure, which is part of the reason why, for example, MTS is expecting only $3-4 ARPU from each of its I-mode subscribers (currently numbering 10,000) compared with $20 in Japan. Again, content is key – MTS is currently offering only 120 I-mode sites compared to 4,600 in Japan.

I-mode as a service has proved that content is driving usage and revenues. For example, France's Bouygues Telecom revealed that its I-mode subscribers spend $12-18 more per month than its GPRS subscribers, capitalizing on wider availability of I-mode content. For comparison, in Russia WAP portals (numbering more than 600) are the primary source of data revenues. However, only 6.2% of total Russian subscribers use GPRS services even though the share of GPRS handsets in total handsets reached 45%.

Poor Russian data usage is not a function of a fat price for data transmission. In fact, data is much cheaper than in the main European markets (see Figure 51 below).

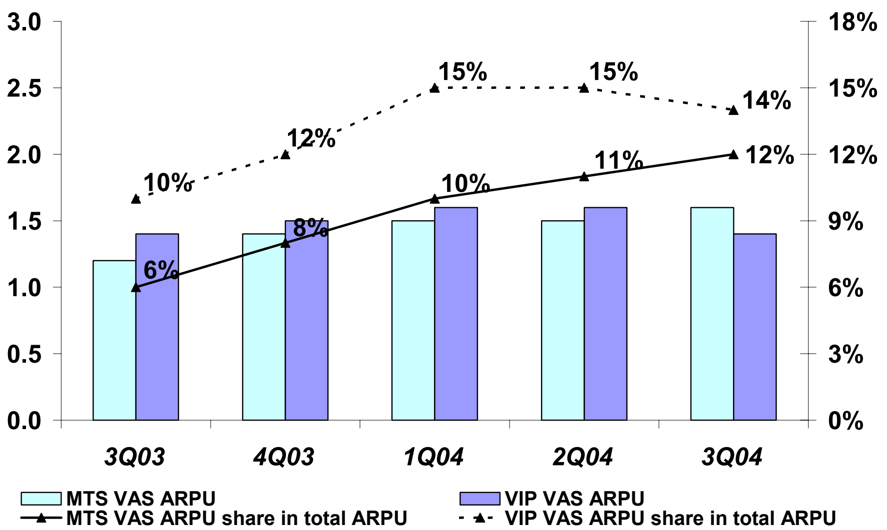
Figure 51. Cost for 10 Mb of GPRS Data



MTS has started to outperform recently in terms of contribution from VAS

As far as the relative performance of MTS and VimpelCom is concerned, VimpelCom has historically been more dynamic in VAS, although recently MTS began to outperform both on dynamics (proportion of VAS in ARPU) and in absolute terms (from 3Q05). Its recent introduction of I-mode could help it going forward, and we eagerly await VimpelCom's offering to customers.

Figure 52. Non-Voice ARPU – MTS vs. VimpelCom



MOBILES

MTS

Figure 53. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	3,887	5,107	5,996	6,269
EBITDA, $ mln	2,095	2,627	3,196	3,383
Net profit, $ mln	1,023	1,214	1,567	1,660
P/E	14.4	12.1	9.4	8.9
EV/EBITDA	8.3	6.6	5.4	5.1
Market Cap, $ mln	14,731			
Enterprise Value, $ mln	17,296			
Subscribers, '000 sub.	34			
ADRs Outstanding, mln	399			

Sources: Company reports, Alfa Bank estimates

Figure 54. Company Snapshot

Strengths
- Very strong financial position
- Nationwide license coverage in 87 of 89 regions

Weaknesses
- Relatively low free-float
- Potential share overhang on DT selling its stake in MTS

Opportunities
- Expansion to CIS market at reasonable multiples
- Inclusion to the MSCI Index
- Synergy with other Sistema companies

Threats
- Introduction of Universal Services Fund
- Price wars in the market

Sources: Company reports, Alfa Bank estimates

Figure 55. Key Events

October 11 **MTS wins race for mobile net additions in September**

Russian mobile penetration once again showed 3% monthly growth. The number of subscribers (with valid SIM cards) reached 111.7 mln in September, which translates into 77% penetration, or monthly growth of 3.1% (vs. 3.4% in August). Some decline in new additions compared to the previous month was due to very active subscriptions at the end of August due to preparation for the school year and inflation of prices of mobile handsets after mobile dealers encountered problems with the tax police. MTS is reversing the trend and signed more subs than VimpelCom and other competitors in Moscow, St. Petersburg and the regions overall. However, in our judgment this does not suggest a serious shift in the trend. This has occurred a few times previously, when one operator led the race for new subscriptions for some time, only to see the situation then reverse for no particular reason. It has yet to be seen whether MTS can sustain its leadership going forward; it currently operates in one more region than VimpelCom (79 vs. 78). We expect October's numbers to be strong on the back of some new promotions scheduled for this month.

October 18 **Vneshtorgbank hires MTS CFO to run its financial operations, supporting VTB's IPO plans**

The senior vice president of Vneshtorgbank (VTB) Vassily Titov told *Reuters* that VTB has offered MTS CFO Nikolai Zhekhomsky the post of senior vice president responsible for a financial unit within the bank. Zhekhomsky has worked with MTS since 2002 and was directly responsible for the change in company policy with regard to the number of Eurobond issues. We believe that VTB is particularly interested in his knowledge of Eurobonds, especially because the bank indicated IPO plans earlier this year. In our view, Zhekhomsky's arrival is a further indication that the IPO will proceed as planned. Meanwhile, MTS appointed Zhekhomsky's deputy Ulf Backmeyer to the post of acting CFO. We await news of Zhekhomsky's permanent replacement and its impact on MTS's business.

October 19 **MTS to change tariff plans**

MTS announced changes to its tariff plans. The company, sources said, intends to eliminate the "Jeans" tariff family and introduce five new 'straightforward' tariff plans with new names. Importantly, the average tariff per minute (TPM) will not change, supporting our prediction of a slowdown in TPM erosion in the market (current TPM averages $0.07-0.08). We also expect ARPU erosion to slow to 9-12% in 2006 (vs. 22-23% in 2005). For some reason, MTS decided against transitioning to denomination of its tariffs in rubles instead of dollars at this stage. We are confident that eventually all operators will be forced to convert their tariffs from dollars to rubles – currently, only MegaFon quotes its tariffs in rubles. Regarding MTS stock, we again stress that the current weakness in its share price is unjustified, and we view this as an excellent buying opportunity before the revision of MTS's weighting in the MSCI Russia index on November 1. We reiterate our BUY rating for MTS ADRs and local shares, with target prices of $48 and $9.6, respectively.

Source: Alfa Bank estimates

VimpelCom

Figure 56. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	2,147	3,243	3,802	4,176
EBITDA, $ mln	1,023	1,512	1,895	2,061
Net profit, $ mln	350	580	766	829
P/E	23.6	14.2	10.8	10.0
EV/EBITDA	9.3	6.3	5.0	4.6
Market Cap, $ mln	8,254			
Enterprise Value, $ mln	9,530			
Subscribers, '000 sub.	27			
ADRs Outstanding, mln	205			

Sources: Company reports, Alfa Bank estimates

Figure 57. Company Snapshot

Strengths
- Telenor and Alfa Group as co-investors

Weaknesses
- Lowest ARPU among 'Big Three' operators
- Lack of decent exposure to the Far East

Opportunities
- CIS expansion at fair multiples, Far East license
- Further margin and ARPU convergence with MTS
- Inclusion in MSCI Russia Index

Threats
- Introduction of Universal Services Fund
- Unfair treatment by regulators
- Price wars in the market

Sources: Company reports, Alfa Bank estimates

Figure 58. Key Events

October 13 **1800 MHz spectrum frequencies found in Far East; VimpelCom should be the best candidate**
The Federal Communications Agency (Rossvyaz) has found some available frequencies in the 1800 MHz spectrum in the Far East, despite previous statements by the State Frequencies Commission (SFC) about a lack of available frequencies in the region. The newly found frequencies will be auctioned in November. VimpelCom, for which Far East is the only region where it lacks a full presence (it only operates in Amur, Khabarovsk, Kamchatka and Sakhalin regions), has asked the SFC to find available frequencies 36 times, but without much success. The latest request to the SFC came from NTK (Novaya Telefonnaya Kompaniya), an operator with 430,000 subscribers, 12% market share in the region and 70% owned by Korea Telekom, to find available frequencies in the 1800 MHz band. Without speculating too much, we believe that VimpelCom should be better positioned to win the auction for the frequencies given its already significant presence in the region (27% market share) and its numerous requests in the past.

Source: Alfa Bank estimates

Alternative Operators

Golden Telecom

Figure 59. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	584	761	948	1.131
EBITDA, $ mln	171	229	288	345
Net profit, $ mln	65	96	125	150
P/E	16.5	11.1	8.6	7.1
EV/EBITDA	6.0	4.5	3.6	3.0
Market Cap, $ mln	1,071			
Enterprise Value, $ mln	1,021			
Shares Outstanding, mln	36			

Sources: Company reports, Alfa Bank estimates

Figure 60. Company Snapshot

Strengths
- Largest CLEC in Russia
- Vast regional and Ukrainian exposure

Weaknesses
- Relatively low liquidity
- Limited transport infrastructure

Opportunities
- Further regional and CIS expansion
- Becoming national LD operator
- Rebound in margins due to efficient management

Threats
- Intensifying competition and decreasing margins in carrier business
- Large payments to the Universal Services Fund

Sources: Alfa Bank estimates

Traditional Operators

Svyazinvest

Figure 61. Key Events

October 28	**Svyazinvest privatization possibly delayed until end of 2006** In an interview with Echo Moskvy radio, AFK Sistema president Vladimir Yevtushenkov said he doubts that Svyazinvest will be privatized before the end of 2006. He emphasized that privatization was inevitable, but that it could be delayed given mixed attitudes toward the process. In our view, the Syvazinvest privatization may be postponed as far as 2007, the year before a major round of elections. We therefore continue to prefer the mobile telecom stocks to wireline names.

Source: Alfa Bank estimates

MGTS

Figure 62. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	481	562	638	707
EBITDA, $ mln	168	202	229	257
Net profit, $ mln	75	99	114	131
P/E	22.0	16.6	14.5	12.6
EV/EBITDA	10.4	8.6	7.6	6.7
Market Cap, $ mln	1,574			
Enterprise Value, $ mln	1,735			
Lines in Use, '000	4,196			
Shares Outstanding, mln	96			

Sources: Company reports, Alfa Bank estimates

Figure 63. Company Snapshot

Strengths
- Ownership of the bulk residential 'last mile' in Moscow

Weaknesses
- Has one of the most outdated networks among regional telecoms
- Small revenue from LD business
- Lack of control over Sistema's CLEC business

Opportunities
- Review of settlements with Rostelecom for LD traffic

Threats
- Loss of SME/SOHO segment to CLECs
- Large costs of network digitalization
- Failure of new CEO to deliver

Sources: Company reports, Alfa Bank estimates

Center Telecom

Figure 64. Key Events

October 18	**Center Telecom's improved profitability in 1H05 unsustainable for FY2005** Center Telecom released its unaudited 1H05 IFSR financial statements. Its performance resembles that observed at Siberia Telecom and Far East Telecom (which released results earlier this month): growth in profitability accompanied by an increase in net debt. Revenues in 1H05 were $486 mln, which is 45% of our FY2005 forecast. However, we expect revenues growth to accelerate in 2H05 due to an increase in local tariffs. EBITDA reached $132 mln or 54% of FY2005E, which implies that the EBITDA margin increased to 27% in 1H05 from 20% in FY2004 (outpacing our 2005 forecast of 23%). Center Telecom demonstrated a positive albeit marginal bottom line of $1 mln – still better than our expectation of a net loss of $3 mln for 2005. Net debt of $781 mln in 1H05 is already close to our FY2005 expectations. The company indicated capex in 1H05 at $143 mln or 82% of the FY2005 forecast, which is alarming since climate conditions typically make the second half of the year capex-heavy for telecom companies. On balance, we view the results as neutral for the share price performance. We believe that the trends in the audited FY2005 statements might be slightly different, i.e. improvement in the EBITDA margin may not be so significant (closer to our estimate of 23%) and the company may still incur a net loss this year.

Source: Alfa Bank estimates

Far East Telecom

Figure 65. Key Events

October 13	**Far East Telecom's 1H05 IFSR EBITDA margin grows to 20% from 17% in 2004** Far East Telecom also released 1H05 results according to IFRS. The trends shown were close to those of Siberia Telecom. 1H05 revenues of $177 mln were about 47% of our 2005E forecast. However, since we expect acceleration of revenue growth in 2004 due to increased local tariffs in 2H05, the risk to our forecast is on the upside. The EBITDA margin improved to 20% from 17% in 2004, which is above our forecast for full-year 2004 of 19%. Net debt in 1H05 of $131 mln has already approached our forecast for 2005E of $142 mln. The company failed to disclose the level of capital expenditures, which may be alarming. On balance, we believe the results are neutral for share price performance, and thus reiterate our HOLD recommendation and $1.80 target price.

Source: Alfa Bank estimates

Siberia Telecom

Figure 66. Key Events

October 13	**Siberia Telecom's improved 1H05 IFSR EBITDA margin offset by growth of net debt** Siberia Telecom released non-audited 1H05 results according to IFSR. We do not maintain models on a half-year basis, and suggest analyzing the results for reference purposes only. The results were mixed. 1H05 revenues of $455 mln were about 49% of our 2005E forecast. However, since we expect acceleration of revenue growth in 2004 due to increased local tariffs in 2H05, the risk to our forecast is on the upside. The EBITDA margin improved to 29% from 27% in 2004, but is still below our forecast for full-year 2004 of 30%. Net debt in 1H05 of $433 mln already exceeded our forecast for 2005E of $390 mln. Capital expenditures of $84 mln were about 44% of our full-year expectation. On balance, we believe the results are neutral for share price performance, and thus reiterate our HOLD recommendation and $0.068 target price.

Source: Alfa Bank estimates

Uralsvyazinform

Figure 67. Key Events

October 25	**Uralsvyazinform released disappointing IFSR results for 1H05** Uralsvyazinform released 1H05 IFRS results that unfortunately demonstrate a number of disappointing trends. The EBITDA margin decreased 3 ppts since 2004 to 27% in 1H05, despite the fact that peers' EBITDA margins were growing. Regardless of its corporate guidelines of 29-30%, the actual EBITDA margin is well below our FY2005 forecast of 33%. As with other regional telcos, net debt continued to grow to $740 mln and exceeded our FY2005 forecast. We treat the results as unsatisfactory, but nevertheless believe they will be neutral for stock performance since the company trades almost exclusively on extra-financial factors, i.e. expectations surrounding Svyazinvest's privatization.

Source: Alfa Bank estimates

Volga Telecom

Figure 68. Key Events

October 18	**Volga Telecom's margins slide and net debt grows in 1H05; neutral** Volga Telecom released its unaudited 1H05 IFSR financial statements. Revenues in 1H05 were $405 mln, which is 46% of our FY2005 forecast. However, we expect revenues growth to accelerate in 2H05 due to an increase in local tariffs. EBITDA grew slower than revenues and reached $131 mln, or 43% of FY2005E, which implies that the EBITDA margin declined to 32% in 1H05 from 33% in FY2004 (under-performing our FY2005 forecast of 34%). The net margin also declined to 10% ($39 mln) from 12% in 2004. Net debt of $345 mln in 1H05 already exceeds our FY2005 forecast. The company reported 1H05 capex of $87 mln, or 49% of the FY2005 forecast. On balance, despite negative trends in margins and net debt, we treat the results as neutral for share price performance. We also believe that the trends in audited FY2005 statements may differ from unaudited interim results.

Source: Alfa Bank estimates

HOLDINGS

Sistema

Figure 69. Key Events

October 6	**AFK Sistema moves forward towards IPO of Comstar UTS in 2006** MGTS will receive 20.7% of the post-transaction Comstar UTS and Sistema will own 79.3% directly and via its subsidiaries. There is still the issue of how MGTS minorities will be treated during the transaction into Comstar UTS. Although the proposed valuation of MGTS is below the current market price, we view the proposed swap ratios as a 'calculation tool' for defining Comstar UTS' post-transaction structure rather than an indication of what MGTS minorities will get in cash as a result of the transaction. In case of a swap, the merger of MGTS and Comstar could be beneficial for MGTS shareholders, as they would finally get access to cash flows that are currently bypassing the company (e.g. MTU-Inform provides services and receives payment for ADSL services that are based on MGTS' last-mile access). We also believe that the IPO might be positive for MGTS since it would allow the company to access investment resources required to upgrade its outdated (only about 20% digitalization) network in Moscow and strengthen its competitive position. The Comstar IPO would also be positive for Sistema, as it would allow the company to unlock some of the value hidden in its non-public assets.
October 10	**AFK Sistema's 1H05 results show rapid growth in non-telecom segment** AFK Sistema released 1H05 financial results Friday. Almost all lines of business showed healthy growth, and the recent trend of Sistema no longer being just a telecom company was even more pronounced – the telecommunications segment represented 80% of the Group's revenues for 1H05 compared with almost 87% during 1H04. The same trend, though, weighed on the EBITDA margin, which declined to 42% on the back of growth in lower-margin segments in total consolidated revenues. For example, the share of the technology segment in total revenues increased to 12.7% from just 3.4% during the same period last year, and we expect the proportion to grow further. In the short term, this will continue to pressure margins on the consolidated level. Sistema confirmed plans to move forward with an IPO for various businesses in its portfolio, among which the first will most likely be insurance and technology.
October 14	**R50 bln claim against Sistema has no future, in our view** ASVT has brought a lawsuit against AFK Sistema alleging damages of almost R50 bln ($1.75 bln). The suit alleges that Sistema improperly compensated ASVT for a 19% equity stake in MTS that ASVT owned and transferred to Sistema back in 1995. ASVT currently owns a 1.5% stake in Sistema. By our understanding, the R50 bln claim (approximately 12.5% of MTS as of yesterday) represents the value of ASVT's original stake

	(had it not been transferred to Sistema) recalculated using MTS' current market value. This legal position is very difficult to justify, in our view. We believe the likelihood that Sistema will either be forced to pay R50 bln or surrender a major part of its MTS equity to ASVT is minimal, and suggest that investors exploit yesterday's decline in Sistema's share price to augment positions. We reiterate our BUY recommendation for Sistema shares with a target price of $27 per GDR.
October 14	**Rahimov denies negotiating sale of additional Bashkir energy assets to Sistema** According to *Kommersant*, Bashkir President Murthaza Rahimov supports Sistema's intention to invest in Bashkir energy assets, but has had no involvement in negotiations for the sale of additional assets to Sistema. The holding has shown open interest in further investment in Bashkortsotan. Rahimov's statement may be a positive signal for Bashkir assets in the event that Sistema decides to continue buying stakes on the open market.
October 24	**AFK Sistema searches for acquisition opportunities** According to *Gazeta.ru*, AFK Sistema is currently in negotiations to acquire a stake in Intracom, a Greek producer of telecoms equipment and provider of IT services. Intracom sells its services to 60 countries worldwide, and Sistema may therefore view it as an ideal launchpad for expanding its own IT solutions and telecoms equipment businesses. Intracom's 2004 revenues were €620 mln, with net profit of €43 mln. Its current market cap is more than $800 mln. More than 35% of Intracom's equity belongs to two private Greek shareholders. Gazeta.ru writes that Sistema hopes to close the deal by the end of 2005. However, the deputy CEO of Concern Scientific Center (part of the Sistema holding) Elena Sanarova has asserted that Sistema is only negotiating for a cooperative business venture with Intracom – not for the purchase of a stake. Additionally, *Vedomosti* reports that AFK Sistema hopes to buy a 51% stake in Russian smart cards producer Rosan for $5-10 mln with the aim of issuing banking smart cards and potentially SIM cards for MTS.
October 26	**AFK Sistema loses first court case to ASVT regarding MTS stake; neutral** The Moscow Arbitration Court ruled in favor of ASVT's argument that its re-registration was invalid since the forms were filed by one of its shareholders rather than the company itself. To remind, ASVT owns 50% of VAST, which in turn owns 3% of MTS (implying that ASVT is potentially the beneficial owner of 1.5% of MTS). What is surprising is that now MGTS claims to be VAST's second-largest shareholder rather than Sistema. The Court resolution means that either (i) VAST, which now has a non-valid organizational form, must be liquidated (i.e. both Sistema and ASVT would each get direct ownership of 1.5% of MTS), or (ii) VAST must be re-registered by its management (i.e. maintaining the status quo by which Sistema and ASVT would each still beneficially own 1.5% of MTS through VAST). In our view, the potential implications for both Sistema and MTS are neutral. We doubt that Sistema will lose its controlling stake in MTS, and in the worst case believe that it might be forced to make some extra payments to settle the dispute. However, the amount of compromising material regarding Sistema's historical transactions once again raise questions about corporate governance and treatment of minority shareholders by both Sistema and MTS.

Source: Alfa Bank estimates

Metals

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Mittal Steel won auction of Kryvorizhstal valuing it at 2005E EV/EBITDA of 5.4

In October the successful sale of Ukraine's Krivorizhstal was the key event on the Russian metals market. Mittal Steel won the auction for a 93% stake in the Ukrainian steel maker with a bid of UAH 24.2 bln ($4.8 bln), or more than double the starting price of $1.98 bln. This deal valued the company's equity at $5.2 bln, implying 2005E EV/S and EV/EBITDA of 2.3 and 5.4, respectively (for Russian steel companies, the averages were 0.9 and 3.0; for EM peers, 1.1 and 3.6).

Notably, earlier in October Turkey's largest producer of flat steel, Erdemir, was sold via government auction at a price implying 2005E EV/EBITDA and EV/S of 9.0 and 1.9, respectively.

Both auctions were important in that they gave the market new benchmarks showing that attractive EM companies are still in high demand. The sale of Krivorizhstal via the auction was especially valuable for the Russian market, as it gave a high benchmark for a CIS company. Major Russian steel companies increased in price following the sale (especially NLMK).

Meanwhile, in October Russian steel majors released 1H05 IFRS-GAAP results that, excluding SG Mechel, were strong.

Severstal's IFRS revenue up 52% y-o-y to $4.1 bln in 1H05

Mainly thanks to price growth alongside higher output, Severstal's revenue jumped 52% y-o-y to $4.1 bln in 1H05. COGS rose 57% and gross profit grew 44% to $1.5 bln.

Effective SG&A and control over other operating expenses led to an impressive 53% rise in operating profit to $1.07 bln in 1H05. EBITDA reached $1.2 bln, while the EBITDA margin remained almost flat on a y-o-y basis at 29%. The bottom line grew 37% y-o-y to $742 mln.

Figure 70. Severstal Income Statement 1H04-1H05

	1H04	1H05	1H05/1H04
	$ mln	*$ mln*	*%*
Revenue	2,718	4,125	52
COGS	1,676	2,624	57
Gross profit	1,042	1,501	44
SG&A and other operating expenses	341	427	25
Operating profit	701	1,074	53
Other expenses (other income)	-10	105	n/m
Pre-tax profit	710	968	36
Tax	163	227	40
Minority	6	-2	n/m
Net profit	542	742	37
Depreciation	116	130	12
EBITDA	817	1,204	47
Margins			
EBITDA	*30*	*29*	*-3*
Operating	*26*	*26*	*1*
Net	*20*	*18*	*-10*

Source: Company reports, Alfa Bank estimates

Evraz's 1H05 EBITDA margin down 3 ppts to 31% in 1H05

Evraz Group's revenue increased 27% y-o-y to $3.6 bln in 1H05. Operating income grew 13.4% to $1.0 bln, while EBTDA increased 15.5% y-o-y to $1.1 bln. The EBITDA margin decreased from 34% in 1H04 to 31% in 1H05. The bottom line grew 10% y-o-y to $729 mln.

Figure 71. Evraz Group – 1H04-1H05 IFRS Results

	1H04	1H05	1H05/1H04
	$ mln	*$ mln*	*%*
Revenue	2,856	3,632	27.2
Operating profit	887	1,005	13.4
EBITDA	968	1,119	15.5
Net profit	661	729	10.3
Operating margin	*31.0*	*27.7*	*-10.8*
EBITDA margin	*33.9*	*30.8*	*-9.1*
Net margin	*23.1*	*20.1*	*-13.2*

Source: Company reports, Alfa Bank estimates

Mechel's 1H05 EBITDA margin down 6 ppts y-o-y to 20%

Mechel's revenue rose 33% y-o-y to $2.143 bln, mainly on the back of strong markets in 1H05. However, COGS grew 39% y-o-y, and other costs also grew significantly. Despite the healthy revenue growth, EBITDA remained almost flat y-o-y at $423 mln, pulling down the EBITDA margin from 26% in 1H04 to only 20% in 1H05. This significant deterioration in profitability was disappointing. Due to high raw materials prices, EBITDA in the steel segment declined 50% y-o-y to only $103 mln, whereas that in the mining segment increased 50% y-o-y to $320 mln. The mining segment accounted for 76% of EBITDA. The bottom line decreased 4% y-o-y to $244 mln in 1H05.

Figure 72. Mechel – Income Statement, US GAAP, 1H04-1H05

	1H04	1H05	1H05/1H04
	$ mln	*$ mln*	*%*
Revenues	1,609	2,143	33.2
Expenses	963	1,343	39.4
Gross profit	646	800	24.0
SG&A and other operating expenses	291	438	50.6
Operating profit	355	362	2.1
Other expense (income)	13	42	231.2
- Interest on debt	30	28	-7.0
- Other expenses, net	-17	15	N/M
Pre-tax profit	342	320	-6.4
Taxes	74	74	-0.7
Minority interest	8	3	-66.2
Income from continuing operations	260	244	-6.3
Adjustments	6	0	N/M
Net income	254	244	-4.3
EBITDA	421	423	0.5
Gross margin	*40.1%*	*37.3%*	
Operating margin	*22.1%*	*16.9%*	
Pre-tax margin	*21.3%*	*14.9%*	
Net margin	*15.8%*	*11.4%*	
EBITDA margin	*26.1%*	*19.7%*	

Source: Company reports, Alfa Bank estimates

We are reviewing our steel price forecasts and incorporating 1H05 IFRS-GAAP results into our DCF models. Meantime we keep our recommendations unchanged.

Norilsk Nickel's 1H05 EBITDA margin grew 5 ppts y-o-y to 50%

In October GMK Norilsk Nickel released 1H05 IFRS financials that were very close to our expectations and neutral for our valuation (see details in Figure 73). Norilsk Nickel remains among our top picks, and we reiterate our BUY rating with a target price of $87.

Figure 73. Norilsk Nickel 1H05-1H05E

	1H04	1H05	1H05/1H04	1H05E	1H05/1H05E
	$ mln	*$ mln*	*%*	*$ mln*	*%*
Revenues	3,286	3,442	5	3,440	0
Costs	-1,568	-1,501	-4	-1,536	-2
Gross profit	1,718	1,941	13	1,905	2
SG&A	-525	-504	-4	-502	0
Operating profit	1,193	1,437	20	1,402	2
Other expenses	-27	-55	104	-39	41
Pre-tax profit	1,166	1,382	19	1,363	1
Tax	-293	-408	39	-367	11
Net profit	889	979	10	996	-2
EBITDA	1,477	1,737	18	1,699	2
Margins, %					
Gross margin	*52*	*56*	*8*	*55*	*2*
Operating margin	*36*	*42*	*15*	*41*	*2*
Pre-tax margin	*35*	*40*	*13*	*40*	*1*
Net margin	*27*	*28*	*5*	*29*	*-2*
EBITDA margin	*45*	*50*	*12*	*49*	*2*

Source: Company reports, Alfa Bank estimates

In October more than 70% of VSMPO-AVISMA stock was frozen

In October more than 70% of VSMPO-AVISMA stock (the stakes of the company's key managers Vyacheslav Bresht and Vladislav Tetyukhin) were frozen after Renova filed a suit claiming violation of the terms of the "Russian roulette" agreement.

As a reminder, in May Renova offered its stake (13%) for $96 per common share of VSMPO, $96 per preferred share of AVISMA and $192 per common share of AVISMA. At that time the market prices of VSMPO common, AVISMA common and AVISMA preferred shares were about $106, $204 and $102, respectively.

Bresht and Tetyukhin acquired Renova's stake, and the deal was closed in August. Renova subsequently confirmed that it had received payment for its stake ($149 mln). But even then, Renova representative Andrey Shtorkh said that Renova intended to examine the legality of the payment: One of the terms of the deal prohibited using the stake as collateral, and the possible breach of this condition raised questions.

Dispute between Renova and VSMPO's key shareholders is negative for VSMPO and may at least postpone the long-awaited IPO

We doubt that the payment will be cancelled, but the ongoing dispute and suit are negative for VSMPO and may at least postpone the company's long-awaited IPO. We will continue to closely monitor the situation, and meanwhile reiterate our recommendation to HOLD VSMPO stock.

RTS and MICEX suspended trading in VSMPO shares in response to the court decision. Sverdlovsk Regional Arbitration Court will consider the case on November 22.

GMK Norilsk Nickel

Figure 74. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	7,033	6,058	5,490	4,917
EBITDA, $ mln	3,375	2,673	2,231	1,880
Net profit, $ mln	1,832	1,399	1,064	765
P/E	8.1	10.7	14.0	19.5
EV/EBITDA	4.4	5.5	6.6	7.9
Market Cap, $ mln	14,904			
Enterprise Value, $ mln	14,767			
Shares Outstanding, mln	201.4			

Sources: Company reports, Alfa Bank estimates

Figure 75. Company Snapshot

Strengths
- Diverse export revenue base, exports generate 90% of revenues
- High liquidity relative to other companies in the sector

Weaknesses
- Low technological level compared to western peers
- High social expenditures - more than $100 mln per year

Opportunities
- Implementation of revised capex program
- Development of new metals projects (gold, etc.)

Threats
- Revision of privatization and Group's restructuring results
- Increase in tax burden

Sources: Company reports, Alfa Bank estimates

Figure 76. Key Events

October 7 **Norilsk Nickel's 1H05 EBITDA margin grew 5 ppts y-o-y to 50%**

Yesterday GMK Norilsk Nickel released 1H05 IFRS financials that were very close to our expectations. As we forecast, the top line increased 5% y-o-y to $3.4 bln. Nickel and copper sales volumes decreased 1-2% y-o-y (to 119 kt for nickel and 189 kt for copper). Gold sales volumes decreased 17% y-o-y to 440 koz (note however that the 1H04 output figures of Lenzoloto and Matrosov Mine were provided as of April 6, 2004). The decrease in gold sales volume was attributed to the initiation of export sales (up to 17.4 koz were on the way to customers) and lower grades in the processed ore, although the decline was partly offset by 7% y-o-y growth in the gold price in 1H05. According to the company the decrease should be compensated in 2H05.

Moving to further increase corporate transparency, PGM sales volume data were released for the parent company, but due to prior secrecy the comparative figures for 1H04 were not provided (we estimate Norilsk sold similar volumes of platinum and palladium in 1H04). The parent company sold 1.469 mln oz of palladium and 0.327 mln oz of platinum in 1H05. Norilsk Nickel's daughter SWC increased PGM sales volumes by about 30-40% y-o-y.

The cost of metals sales decreased 4% y-o-y in 1H05 (cash operating costs increased 2% y-o-y). Further control over effective SG&A costs led to a 20% y-o-y increase in operating profit to $1.437 bln in 1H05, while EBITDA grew a strong 18% y-o-y to $1.737 bln (only 2% above our forecast). The EBITDA margin grew 5 ppts y-o-y and was in line with our expectation.

Strong performance on the operating level boosted the bottom line 10% y-o-y to $979 mln (bottom line growth was slower than that on the operating level due to a higher effective tax rate of 30% in 1H05 vs. 25% in 1H04).

To sum up, the results were unsurprising and are neutral for our valuation.

October 24 **Norilsk raises 2005 output plans by 4% for platinum, 3% for palladium; neutral**

Norilsk Nickel has announced preliminary 3Q05 production figures for its Polar Division and Kola MMC: 61 kt of nickel and 113 kt of copper. Total production volumes in 9M05 reached 181 kt of nickel and 338 kt of copper.

Norilsk also produced 840 koz of palladium and 198 koz of platinum in 3Q05 (excluding SWC). Accordingly, 9M05 palladium and platinum output amounted to 2,323 koz and 553 koz, respectively.

Deputy General Director Tav Morgan expects nickel and copper production to remain unchanged for FY2005, implying total output of 240-245 kt of nickel and 440-450 kt of copper. The company has increased its FY2004 forecasts for palladium production from 3 mln oz to 3.08 mln oz, and for platinum production from 700 koz to 730 koz.

These recalculations of the company's PGM output plans only marginally impact our 2005E forecasts (i.e., net revenue for the revised output plans would increase by less than 1%), and thus we consider the news to be neutral.

Source: Alfa Bank estimates

Severstal

Figure 77. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	6,648	6,861	6,763	6,536
EBITDA, $ mln	2,124	1,921	1,688	1,461
Net profit, $ mln	1,401	1,162	969	786
P/E	3.5	4.2	5.1	6.2
EV/EBITDA	2.4	2.6	3.0	3.5
Market Cap, $ mln	4,912			
Enterprise Value, $ mln	5,068			
Shares Outstanding, mln	552			

Sources: Company reports, Alfa Bank estimates

Figure 78. Company Snapshot

Strengths

- Healthy financial performance
- Professional management team

Weaknesses

- Long-term contract sales hinder pricing flexibility in the environment of rising prices
- High dependence on performance of world steel markets

Opportunities

- Acquisition of foreign assets could increase Severstal's capacities and strengthen its position on foreign markets
- Entrance to large-diameter pipe market

Threats

- Low liquidity, estimated 8% free-float

Sources: Company reports, Alfa Bank estimates

Figure 79. Key Events

October 10 **Severstal's IFRS revenue up 52% y-o-y to $4.1 bln in 1H05; positive**

On Friday Severstal released non-audited 1H05 IFRS financial results. Mainly thanks to price growth alongside higher output, revenue jumped 52% y-o-y to $4.1 bln. COGS rose 57% and gross profit grew 44% to $1.5 bln.

Effective SG&A and control over other operating expenses (costs increased only 25% y-o-y) led to an impressive 53% rise in operating profit to $1.07 bln in 1H05. EBITDA reached $1.2 bln, while the EBITDA margin remained almost flat on a y-o-y basis at 29% (down only 1 ppt y-o-y).

Non-operating expenses were $105 mln vs. non-operating income of $10 mln in 1H04 (due to increased net financing expenses and lower negative goodwill), and as a result the bottom line grew 37% y-o-y to $742 mln. To sum up, the results are strong and we are revising our model.

October 24 **Severstal to pay 3Q05 dividend of $0.10 p/s; we expect $0.53 p/s for 2005**

On Friday Severstal's board of directors recommended to pay an interim dividend of R3.0 ($0.10) per share for 3Q05. Total dividends for 3Q05 thus amount to R1.7 bln ($58 mln). The cut-off date was set for October 19, and the EGM was scheduled for December 6.

The company's interim dividends for 2Q05 and 1Q05 totaled R3.9 ($0.14) and R4.0 ($0.15) per share, and total dividends for 9M05 will probably amount to R10.9 ($0.39) per share, or $214 mln in total.

We believe that the company's FY2005 net income will be about $1.16 bln. Based on a 25% payout ratio, we estimate that total dividend payments for 2005 will be $291 mln ($0.53 per share).

After considering the interim payments, we keep our prior forecast for full-year dividends unchanged and forecast dividend payments of $0.14 per share in 4Q05. We reiterate our BUY rating on Severstal stock with a target price of $10.5.

Source: Alfa Bank estimates

Evraz

Figure 80. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	5,925	6,190	6,385	5,958
EBITDA, $ mln	2,004	2,075	2,209	1,861
Net profit, $ mln	1,084	1,183	1,269	1,046
P/E	4.7	4.3	4.0	4.8
EV/EBITDA	2.8	2.7	2.6	3.0
Market Cap, $ mln	5042			
Enterprise Value, $ mln	5642			
Shares Outstanding, mln	350			

Source: Alfa Bank estimates

Figure 81. Company Snapshot

Strengths

- Company controls 85% of its iron ore and 100% of coking coal supplies
- The largest steel group in terms of output in Russia (21% of local steel output)

Weaknesses

- Relatively unfavorable geographic position increases transportation costs
- Low technological level of steel-making capacities (open hearth – 26%; ingot casting – 66%)

Opportunities

- $1.2 bln investment program in 2004-07 to modernize equipment, especially NTMK
- Expansion of mining business through acquisitions and brownfield projects

Threats

- Imposition of new export barriers in the US and EU

Source: Alfa Bank estimates

Figure 82. Key Events

October 13 **Evraz's 1H05 EBITDA margin down 3 ppts to 31% in 1H05; results in line with consensus**

Evraz Group this morning published its consolidated IFRS figures. Mainly due to a strong market and output growth (+4.9% y-o-y), the Group's revenue increased 27% y-o-y to $3.6 bln in 1H05. Operating income grew 13.4% to $1.0 bln, while EBTDA increased 15.5% y-o-y to $1.1 bln. The EBITDA margin decreased from 34% in 1H04 to 31% in 1H05. The bottom line increased 10% y-o-y to $729 mln.

The results were in line with the consensus estimates and therefore neutral for Evraz GDRs.

Source: Alfa Bank estimates

SG Mechel

Figure 83. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	3,636	4,055	4,177	4,339
EBITDA, $ mln	908	887	828	760
Net profit, $ mln	543	512	464	413
P/E	6.5	6.9	7.6	8.6
EV/EBITDA	3.4	3.5	3.7	4.0
Market Cap, $ mln	3536			
Enterprise Value, $ mln	3076			
Shares Outstanding, mln	139			

Source: Alfa Bank estimates

Figure 84. Company Snapshot

Strengths
- Company controls 90% of its iron ore and 100% of coking coal supplies
- Diversified product range and strong expertise in the production of special steel

Weaknesses
- Relatively low profitability (25% EBITDA margin in 2004, US GAAP)
- Low technological level of steel-making capacities (ingot casting – 82%)

Opportunities
- $900 mln capex program planned for 2005-2009
- Expansion of raw steel and rolled steel capacities to 8.2 mln tons and 7.1 mln tons in 2007E

Threats
- Imposition of new export barriers in the US and EU

Source: Alfa Bank estimates

Figure 85. Key Events

October 18 **Mechel's 1H05 EBITDA margin down 6 ppts y-o-y to 20%**
Yesterday Mechel published its 1H04-1H05 US GAAP results. Revenue rose 33% y-o-y to $2.143 bln, mainly on the back of strong markets in 1H05. However, COGS grew 39% y-o-y, and other costs also grew significantly. Despite the healthy revenue growth, EBITDA remained almost flat y-o-y at $423 mln, pulling down the EBITDA margin from 26% in 1H04 to only 20% in 1H05. This significant deterioration in profitability is disappointing.
Due to high raw materials prices, EBITDA in the steel segment declined 50% y-o-y to only $103 mln, whereas that in the mining segment increased 50%
y-o-y to $320 mln in 1H05. The mining segment accounted for 76% of EBITDA.
The bottom line decreased 4% y-o-y to $244 mln in 1H05.

Source: Alfa Bank estimates

Consumer Goods

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Razgulyai and Cherkizovsky are mulling IPO in 1H06

Two companies in the consumer goods sector are mulling IPOs during 1H06 – Razgulyai and Cherkizovsky. At this point in time, both are more known to debt investors than equity investors. In this monthly comment we present brief snapshots of both.

Razgulyai: From agriculture to manufacturing, the largest vertically integrated holding

Sugar and grain are key areas for Razgulyai

Razgulyai Group is an agricultural holding consisting of the managing company OAO Razgulyai and two industrial holdings – Sugar Holding and Grain Holding. The company was founded in 1992 as an agricultural trader, and from 1995 it began to invest in manufacturing of agricultural goods. Over the next ten years it was transformed into the largest vertically integrated agricultural holding in Russia. The companies and plants of the Group are actively working in the Northwest and Central-Black Earth areas of Russia, the Northern and Middle Volga regions, the Northern Caucasus, the Southern Urals and Western Siberia.

10% market share in grain, 12% in sugar and 16% in groats

Razgulyai currently operates 24 production and storage facilities and enjoys sizeable market shares in the highly fragmented agricultural market: 10% in grain trading, 16% in groats production, 12% in sugar and 3% in flour.

Figure 86. Razgulyai – Key Markets

	Number of companies	Capacity	Market share 2004/2005E	Competition
Grain Holding	24			
- Grain trading	14 (13 line elevators, 1 port elevator)	1.9 mln tons/year	11%/10% of interregional commercial turnover	Highly fragmented market; Glencore; OGO, Louis Dreyfus; Yug Rossii; Nastyusha
- Flour production	5	0.58 mln tons/year	1.6%/3.2%	Makfa (0.42 mln tons); Stoilenskaya Niva (0.34 mln); Lenstro (0.32 mln); Nastyusha (0.30 mln); Roszerno (0.29 mln)
- Groats production	4 The Company launched the Rise project, a 50/50 JV with the Krasnodar region administration	0.33 mln tons/year	9.1%/15.8%	
Sugar Holding	14	Sugar-beet: 4.3 mln tons/year Raw sugar: 1.5 mln tons/year	12.1%/ 11.8% (the decrease in production in 2004 was due to reduced manufacturing of low margin sugar from raw sugar)	High concentration of capital: out of 96 factories in the industry, the five largest are responsible for more than 50% of sugar production Prodimpex (17%), Rusagro (12%), Zolotoj Kolos (10%), OPK (8%), Dominant (8%)

Source: Company data

The company does not disclose its beneficial shareholders, and 100% of equity is owned by offshore companies. We expect Razgulyai to disclose its end-owners prior to the IPO scheduled for 1H06.

Figure 87. Razgulyai – Shareholder Structure

Globalko Holding Aktiengeselschaft (Liechtenstein)	50%
Tulino Trading Limited (Cyprus)	15%
Ways Island Investments Limited (Cyprus)	15%
Seperlino Trading Limited (Cyprus)	10%
Balkontore Investments Limited (Cyprus)	10%

Source: Company data

Revenues decreased from $741 mln in 2003 to $728 mln in 2004 due to re-focus on manufacturing

During 2000-2003 the company specialized in grain and sugar trading. However, in 2H02 it reviewed its strategy in order to concentrate on production rather than trading sugar. In the grain business Razgulyai focused on the acquisition of elevators and flour milling as well as groats productions. The new strategy resulted in slowing of growth rates and a decrease in revenues from $741 mln in 2003 to $728 mln in 2004. The EBITDA margin increased slightly to 10.6%. The decrease in sugar production was due to a reduction in manufacturing of low margin sugar from raw sugar in favor of sugar beet production. Unfortunately, the company failed to elaborate explicitly on the reasons for the expected decrease in revenues and significant increase of net debt in 2005E.

Figure 88. Razgulyai – Major Lines of Business

	2003	2004	2005E	2003	2004	2005E	Market size, 2004
	Turnover			% of total turnover			
Grain							
$ mln	253	270	222.5	36%	37%	32%	2,500
'000 tons	2,374	1,760	1,920	72%	64%	62%	20,100
Groats							
$ mln	16.4	46.1	79	2%	6%	11%	500
'000 tons	65	112	192	2%	4%	6%	1,119
Flour							
$ mln	14.1	46.9	73.9	2%	6%	10%	2,300
'000 tons	73	192	340	2%	7%	11%	11,200
Sugar							
$ mln	422	365	330	60%	50%	47%	3,000
'000 tons	802	697	630	24%	25%	20%	6,000
Total							
$ mln	706	728	705	100%	100%	100%	
'000 tons	3,314	2,761	3,082	100%	100%	100%	

Source: Company data

Figure 89. Razgulyai – Financial Highlights

	2003 *$ mln*	2004 *$ mln*	2005E *$ mln*
Revenues	**741**	**728**	**705**
Gross income	100	103	N/A
Operating income	50	53	N/A
EBITDA	**74**	**77**	**78**
Net income	**42**	**47**	**40**
Net debt	107	90	185
Total assets	379	399	N/A
Gross margin	*13.5%*	*14.1%*	*N/A*
Operating margin	*6.7%*	*7.3%*	*N/A*
EBITDA margin	***10.0%***	***10.6%***	***11.1%***
Net margin	*5.7%*	*6.5%*	*5.7%*
Net debt/EBITDA	**1.4**	**1.2**	**2.4**
ROA	11.1%	11.8%	N/A

Source: Company data

Razgulyai has two major investment projects:

(i) The joint program by Krasnodar region and Razgulyai Group to administer rice production in 2005. The overall objective of the program is to increase rice production from 430,000 tons in 2004 to 580,000 tons in 2006.

(i) Promotion of sugar, flour and groats under the company's umbrella brand name *Divnitsa*. The main goal is to stabilize financial streams and increase added value.

$100 mln in investments over the next 2.5 years

Overall, the company plans to invest about $100 mln in modernization of production facilities over the next 2.5 years, about $5 mln in production plants that are currently working close to full capacity, and about $60 mln in twelve elevators. Razgulyai also plans to acquire a groats plant in Krasnodar region. The funds are expected to be raised at an IPO in 1H06.

Company may place its stock at 2005E EV/EBITDA of 7.7x

Overall, Razgulyai expects to raise at least $100 mln for 25% of equity, and assuming 2005E net debt of $185 mln this translates into estimated EV of $600 mln, or 2005E EV/EBITDA of 7.7x. The company said it expects $1.0 bln in revenues by 2007, which implies 19% revenues CAGR in 2005-07E, but we believe that the risk to growth rates might be on the downside.

There is no direct benchmark for the company in Russia, while neither the timing of the IPO nor its parameters are clear. Nevertheless, we present a comparative valuation with the Russian consumer sector (see Figure 90). The valuation looks cheaper than the consumer average (2005E EV/EBITDA of 12.3x), but it is also under-performing in terms of growth rates (average revenues CAGR in 2005-07E of 27%).

Figure 90. Razgulyai – Comparative Valuation

	2005E EV/EBITDA	Revenues CAGR 2005-07E
Razgulyai	**7.7**	**19%**
Kalina	7.1	15%
Baltika	8.9	18%
WBD	9.6	13%
Lebedyansky	9.7	17%
Pyaterochka	16.2	38%
Seventh Continent	18.1	42%
Pharmacy Chain 36.6	9.0	36%
RBC	19.8	34%

Source: Company data, Alfa Bank estimates

Cherkizovsky – A pricey 'pig in a poke'

Cherkizovsky specializes in meat processing as well as poultry and pork breeding with $730 mln in 2004 sales

Cherkozovsky has been mulling an IPO since 1998, but there is significantly less information available on the company than on Razgulyai. Cherkizovsky Group consists of APK Cherkizovsky (eight meat processing factories) and APK Mikhailovsky (seven poultry plants and six pork complexes). Revenues of APK Cherkizovsky in 2004 were $600 mln, while those of APK Mikhailovsky amounted to $130 mln.

Group is beneficially owned by Igor Babaev and his family

The Group is beneficially owned by Igor Babaev and his family, but beneficial ownership is not yet fully disclosed.

Figure 91. Cherkizovsky Group OJSC – Shareholder Structure

Cherkizovsky Group Ltd.	91.403%
APK Ptitseprod	2.854%
Sociedad Anonima "PACIFIC AGRO LTD. CORP."	0.798%
Morgan Stanley Bank Aktiengesellschaft	0.7%
Igor Babaev	1.69%
Sergei Mikhailov	0.543
Lidia Mikhailova	0.28%
Evgeni Mikhailov	0.141%

Source: Company data

Company's estimated EV of $1.2 bln might make it pricey

The company said it expects to list about 25% of its shares, perhaps on the London Stock Exchange. Igor Babaev estimated the equity value of the holding at $1.2 bln. We believe the Group carries a large amount of debt that could be as high as $250-350 mln (although no official data are available), and thus the enterprise value might be significantly higher at about $1.5 bln, which would make the stock pricey. However, no audited financials are available, and thus we await the IPO details in order to estimate the company's value.

Wimm-Bill-Dann

Figure 92. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	1,189	1,382	1,569	1,764
EBITDA, $ mln	97	114	139	167
Net profit, $ mln	23	23	30	41
P/E	35.4	34.9	27.0	19.8
EV/EBITDA	11.3	9.6	7.9	6.4
Market Cap, $ mln	813			
Enterprise Value, $ mln	1,097			
Shares Outstanding, mln	44			

Sources: Company reports, Alfa Bank estimates

Figure 93. Company Snapshot

Strengths

- Leading Russian milk and juice producer with national brands
- Developed distribution network, share of direct dairy distribution is 25%

Weaknesses

- Low capacity utilization rates at a number of regional dairies
- Low profit margins
- Acquired plants require significant upgrades to comply with WBD standards

Opportunities

- Entry to new segments (water, cheese) will boost sales
- Cooperation with domestic milk producers to ensure delivery of milk

Threats

- Shortage of domestic raw materials
- Increasing competition from foreign and domestic peers

Sources: Company reports, Alfa Bank estimates

Figure 94. Key Events

October 24 **WBD to raise $105 mln through bond issue; neutral**

Wimm-Bill-Dann's board of directors yesterday approved the issue of R3 bln ($105 mln) in 5-year bonds. Previously WBD planned to place two bond issues totaling R7 bln ($245 mln), but the company reconsidered its plans. The bonds will be guaranteed by WBD's subsidiary, Siberian Dairy Plant. Earlier, its AGM confirmed that the plant would guarantee two of WBD's bond issues pending approval by the latter's board.

The raised funds will be directed to refinance WBD's current debt and for future capex. WBD placed R1.5 bln ($52.5 mln) in bonds in 2003 with maturation in April 2006. We expect capex to total $90 mln this year and $95 mln next year, while operating cash flows are forecast at $64 mln in 2005 and $83 mln in 2006. $105 mln will be just enough to cover part of the capex and refinance existing debt. It appears that previously the company planned to finance some large acquisitions via an additional bond issue totaling R4 bln ($140 mln), but later abandoned those plans.

October 19 **Danone increases its stake in WBD by 1.2 ppts to 9.5% of equity; positive**

Danone increased its stake in Wimm-Bill-Dann from 8.3% to 9.5% and said it may continue to do so in the future. The company spent $8.7 mln on the purchases, and most of the shares were acquired on the open market during October 13-14 and October 17 at an average price of $18.25-18.5. Danone became a WBD shareholder in 2002 by acquiring a 4% stake that soon increased to 7.2%. Later, Danone made an offer to WBD shareholders to acquire a controlling stake in the company, but the offer was declined. It thus seems clear that Danone sees good potential in WBD.

We believe the news should have a positive impact on WBD's share price performance, and reiterate our BUY recommendation with a target price of $22.5.

October 17 **WBD acquires Essentuki, boosting company's bottled water capacity; neutral**

WBD acquired a 100% stake in Essentuki mineral water plant (located in Stavropol region in the Southern federal district) for an undisclosed sum. The plant produces Novoessentukskaya and Essentuki mineral waters, which are sold in Moscow supermarkets. The plant's production capacity is about 8,000 units of 1.5 liter bottles per hour. It is very difficult to estimate the market share of both Essentuki brand and this producer due to (i) high fragmentation of the market and (ii) the fact that Essentuki brand is not exclusive and its copyright is reserved only by location; there are still over 30 other producers that use Essentuki brand. In 2003 WBD reached a co-packing agreement with Essentuki plant for the bottling of certain types of Essentuki mineral water (e.g. Essentuki No. 17). WBD has been producing Essentuki mineral water since then at two production facilities. However, WBD was operating at full capacity in this segment, and thus the acquisition of the plant seems logical. Another rationale for the acquisition is that WBD's advertising of Essentuki contributes to the promotion of all existing Essentuki brands. Following the acquisition, WBD will increase its production of Essentuki in plastic bottles and add Novoessentukskaya brand to its mineral water portfolio.

The new plant will provide support to WBD's bottled water business, which was less than 1% of company revenues in 2004. The water market is still quite fragmented (the five largest producers control around 45%), and therefore WBD, which still lacks a significant share of the market, has every chance to achieve a leading position in this fast-growing sector. Notwithstanding the above, and considering the very small share of the water business in WBD's revenues, the news should be neutral for share price performance.

Source: Alfa Bank estimates

Seventh Continent

Figure 95. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	496	791	1,285	1,598
EBITDA, $ mln	44	78	126	151
Net profit, $ mln	27	51	80	95
P/E	50.0	26.6	17.0	14.5
EV/EBITDA	32.3	18.1	11.3	9.4
Market Cap, $ mln	1,368			
Enterprise Value, $ mln	1,423			
Shares Outstanding, mln	65			

Source: Alfa Bank estimates

Figure 96. Company Snapshot

Strengths
- The fifth-largest supermarket chain in Russia
- Good reputation and strong brand
- Diverse store formats

Weaknesses
- Presence only in Moscow
- Low profit margins

Opportunities
- Regional expansion
- Improve profitability

Threats
- Increasing competition on the market
- Growth of lease rates

Source: Alfa Bank estimates

Figure 97. Key Events

October 18 **Seventh Continent to open Our Hypermarket in Krasnoyarsk; positive**
Seventh Continent concluded a provisional agreement with STROINROS Investment Company LLC, which is building a trade and entertainment center in Krasnoyarsk. According to the agreement, Seventh Continent will own 10,000 sq.m of the center's floor space totaling 53,000 sq.m. The company expects to use this space to open its Our Hypermarket store. We expect Seventh Continent to open hypermarkets in Kaliningrad, Ryazan, St. Petersburg, Reutov and Chelyabinsk in 2006.

October 17 **Seventh Continent is entering the Tomsk market; positive**
Seventh Continent will open a trade and entertainment center with 37,000 sq.m of floor space in Tomsk. Total investment is expected to reach $10 mln. It is assumed that Seventh Continent will open another three similar centers in Tomsk by 2010. The total sum of investment is estimated at $100 mln.

October 10 **Seventh Continent to cooperate with Detsky Mir; positive**
Seventh Continent and Detsky Mir signed a memorandum on cooperation. The chains agreed to cooperate in the field of development and construction of trade and entertainment centers. The cooperation mainly implies joint investments in construction. Seventh Continent will purchase real estate in the centers built by Detsky Mir. In addition, the companies agreed to exchange information on the availability of real estate objects in which both parties are interested.

Source: Alfa Bank estimates

Baltika

Figure 98. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	994	1,443	1,688	2,008
EBITDA, $ mln	253	390	458	539
Net profit, $ mln	132	230	277	333
P/E	27.3	15.7	11.8	14.1
EV/EBITDA	14.4	9.3	7.9	6.7
Market Cap, $ mln	3,609			
Enterprise Value, $ mln	3,632			
Production, mln hl	26			
Shares Outstanding, mln	131			

Sources: Company reports, Alfa Bank estimates

Figure 99. Company Snapshot

Strengths
- Leading Russian brewer with a national brand
- Strategic investor is a major shareholder
- One of the most profitable emerging-market brewers

Weaknesses
- Absence of fully-integrated distribution network
- Low liquidity and free-float

Opportunities
- Intention and ability to increase its market share

Threats
- Decrease in profitability due to increased competition

Sources: Company reports, Alfa Bank estimates

Figure 100. Key Events

October 20 **BBH completes merger of Yarpivo and Voronezh brewery; positive**
Two BBH assets, Yarpivo brewery and Pivzavod Voronezhsky, completed their merger despite the objections of some minority shareholders. The merger is in line with BBH's strategy to consolidate all of its Russian beer assets with Baltika as a core.
A number of Baltika minority shareholders claimed that the acquisition prices in the consolidation process were unfair. Nevertheless, BBH managed to complete the merger successfully, and we also expect the company to consolidate Pikra and Vena breweries with Baltika, which will strengthen the latter's position on the market.

Source: Alfa Bank estimates

Pyaterochka

Figure 101. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	1,106	1,616	2,364	3,063
EBITDA, $ mln	111	191	267	320
Net profit, $ mln	74	119	167	195
P/E	40.4	25.1	18.0	15.4
EV/EBITDA	28.2	16.5	11.7	9.7
Market Cap, $ mln	3,003			
Enterprise Value, $ mln	3,144			
Shares Outstanding, mln	153			

Source: Alfa Bank estimates

Figure 102. Company Snapshot

Strengths
- Russia's leading grocery retailer
- High profit margins
- Large amount of stores and their good location
- Strong brand

Weaknesses
- Two controlling individual shareholders (67% stake)

Opportunities
- Further geographical expansion
- Improve profitability per sq.m

Threats
- Increasing competition on the market
- Shareholders' hypermarket project may have a negative impact

Source: Alfa Bank estimates

Figure 103. Key Events

October 27 **Pyaterochka opened 61 new stores in 9M05; positive**

Pyaterochka Holding NV announced its 9M05 operating highlights. The company increased the total number of its outlets by 46% to 645, of which 349 are franchise stores. Pyaterochka opened 61 own stores in Moscow and St. Petersburg (+25% since the end of 2004) in 9M05. Only 28 stores were opened during the first six months of the year, while in the third quarter alone the company added 33 stores. We believe that the company will be able to reach the 99-store forecast contained in our DCF model for 2005. As of October 1, 2005 Pyaterochka was operating 152 stores in St. Petersburg and 144 stores in Moscow and Moscow region. Pyaterochka's franchise network grew much faster, delivering 69% YTD growth in 9M05. Pyaterochka franchisees opened 142 stores during this period, 57 of which were opened in the third quarter.

We are pleased by Pyaterochka's operating highlights, but they are still in line with our DCF forecasts (99 new stores should increase Pyaterochka's 2005E sales by 46% to $1.6 bln). Although we may see short-term strength in the share price based on the above-mentioned news, we nevertheless reiterate our SELL recommendation with a target price of $15.5.

October 10 **Pyaterochka's CEO announces development strategy**

Pyaterochka's CEO Oleg Vysotsky said the company was considering the acquisition of a number of Moscow retail chains, one of which may be Kopeika. Vysotsky also said that intensifying competition on the market would probably reduce the company's gross and EBITDA margins by 1% in 2006, and we agree with his estimates. Further acquisitions may boost Pyaterochka's sales, and we welcome such a strategy, although the financial effects of the deals will depend on their prices. Recently Pyaterochka also announced that it would invest $220 mln in its business this year and $180 mln next year. The retailer plans to open 70 stores this year and 90 in 2006, focusing on Moscow and St. Petersburg.

Source: Alfa Bank estimates

Lebedyansky

Figure 104. Key Events

October 11 **Lebedyansky to expand baby food range; positive**

Lebedyansky plans to expand its baby food range to include meat purees, according to *Vedomosti*. The new products will appear under the *Fruto-Nyanya* brand at the beginning of November. Baby food accounted for 10% of Lebedyansky's first-half revenue, and the company is aiming to increase this figure to 15%.

Source: Alfa Bank estimates

PHARMACEUTICALS

Pharmacy Chain 36.6

Figure 105. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Revenue, $ mln	211	333	476	619
EBITDA, $ mln	19	28	35	42
Net profit, $ mln	1	3	6	11
P/E	285.8	67.7	32.3	18.4
EV/EBITDA	15.5	9.6	7.4	5.6
Market Cap, $ mln	199			
Enterprise Value, $ mln	265			
Shares Outstanding, mln	8			

Source: Alfa Bank estimates

Figure 106. Company Snapshot

Strengths
- Leading pharmacy chain in Russia
- Strong position in Moscow, excellent regional presence
- Very strong brand – "36.6"

Weaknesses
- Negative cash flow until 2006
- Dependence on imports
- Low liquidity

Opportunities
- Expansion into regions via acquisitions
- Private labels development

Threats
- Competition will eat into margins
- Fast growth may be hampered by inadequate financing

Source: Alfa Bank estimates

Figure 107. Key Events

October 26	**Pharmacy Chain 36.6 sells real estate; neutral** A local real estate fund yesterday announced that it had acquired a property on Strastnoi Boulevard from Pharmacy Chain 36.6. According to the announcement, this property will immediately be leased back to 36.6 for a 14-year period. This deal is in line with 36.6's strategy to sell off its real estate assets in order to focus on retail development. As of June 30, 2005, 36.6 owned 100 pharmacies (15 in Moscow) out of its 287 outlets. The book value of the company's real estate is $35 mln, while its market value reaches $45 mln. The news is positive for the chain, but should have no significant impact on share price performance due to the small sum of the transaction, which we estimate at $0.5 mln.
October 24	**Pharmacy Chain 36.6 to sign agreement with Boots; positive** According to *Vedomosti*, Pharmacy Chain 36.6 this month will sign an exclusive agreement to sell the main brands of Boots (Botanics, Natural Collection, Mediterranean and No. 7) in its stores. This is very positive news for 36.6 and should allow the company to increase sales considerably thanks to Boots' strong brands (Boots' sales are expected to reach around $10 bln in 2005). Since no details were provided regarding the agreement, we cannot evaluate the financial impact of the news, although it should be significant. For example, cosmetics (or parapharmaceuticals) generate 52% of 36.6's total pharmacy revenues in Moscow.

Source: Alfa Bank estimates

MEDIA

RBC

Figure 108. Key Events

October 26	**RBC acquires two IT companies with 2006E revenue of $50 mln; neutral** Pyaterochka's CEO Oleg Vysotsky said the company was considering the acquisition of a number of Moscow retail chains, one of which may be Kopeika. Vysotsky also said that intensifying competition on the market would probably reduce the company's gross and EBITDA margins by 1% in 2006, and we agree with his estimates. Further acquisitions may boost Pyaterochka's sales, and we welcome such a strategy, although the financial effects of the deals will depend on their prices. Recently Pyaterochka also announced that it would invest $220 mln in its business this year and $180 mln next year. The retailer plans to open 70 stores this year and 90 in 2006, focusing on Moscow and St. Petersburg.

Source: Alfa Bank estimates

Banking

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Banks attracted $2.8 bln in subordinated loans last year, but are not yet active on the IPO market

October was full of news in the banking sector, some of which suggests upcoming changes in the banking shares market. The latest data for subordinated loans attracted by Russian banks shows that they nearly tripled in 7M05 compared to the same period in 2004, from $1.7 bln to $4.5 bln. Paradoxically, of the total amount of $4.5 bln, $2.2 bln was received by the three largest state-owned banks – Sberbank, Vneshtorgbank and Gazprombank. As subordinated loans represent a cheaper way to increase capital compared to directly increasing capital, and given the small amount of subordinated loans used by private banks, we believe that private banks are unlikely to hold IPOs before 2007-2008. Continuing strict regulation by the CBR should then push banks to enter the equity market.

City of Moscow reduces its direct presence in Bank of Moscow to less than controlling

In terms of corporate news at the beginning of October, the Bank of Moscow, Russia's fourth-largest bank in terms of assets, announced that its main shareholder the City of Moscow had reduced its direct control from 55.5% to 48.7%. The 6.8% stake was sold to Moscow Insurance Company, in which the bank holds 49% interest with the remaining 51% belonging to the City. This sale of direct ownership to an affiliated company will facilitate consolidation of the bank's capital in the hands of management. While the City of Moscow and its entities still control 62.2% of the bank, *de facto* its transfer to private hands is a done deal.

VTB plans to consolidate PSB via transfer to single share

Vneshtorgbank (VTB), Russia's second-largest bank, is in the process of consolidating new business entities. According to VTB president Andrei Kostin, after buying a 76% stake in Promstroibank St. Petersburg (PSB), the bank will then be merged via transfer to a single share in 2006. We treat this news as confirmation of VTB's upcoming IPO. Another interesting fact is that VTB's central office will soon be moved to St. Petersburg, which means that PSB's position will be reinforced in the North region. It also suggests that the City of Moscow will face a decline in fiscal revenues.

Sberbank

Figure 109. Key Financial Indicators

FY Ending December	2004	2005E	2006E	2007E
Assets, $ mln	50,170	67,453	75,983	84,870
Net profit, $ mln	473	767	824	929
P/E	35.8	22.0	20.5	18.2
Market Cap, $ mln	17,623			
Ordinary shares, mln	19			
Common share price, $	890			

Sources: Company reports, Alfa Bank estimates

Figure 110. Company Snapshot

Strengths
- 75% monopoly on the retail deposit market
- State participation eliminates the risk of a run on deposits

Weaknesses
- Greater lending threatens to increase bad loans
- Inefficient and costly network of 1,329 branches
- State participation reduces incentives to increase Mcap

Opportunities
- Large branch network will aid in development of mortgage market
- Expenditures (equal to 40% of income) could be cut by 25%

Threats
- Pension reform
- Deposit insurance may increase the cost of deposits by 10%

Sources: Company reports, Alfa Bank estimates

Figure 111. Key Events

October 10	**Subordinated loans of Russian banks triple in 7M05 y-o-y; banking IPOs seen in 2-3 years** The total volume of subordinated loans, which are used to increase banks' capital, jumped from $1.7 bln in July 2004 to $4.5 bln in July 2005. This instrument remains more attractive for Russian banks compared to IPOs. Stronger monitoring by the CBR as well as fast growth in the retail segment has increased banks' appetite for additional capital. Subordinated loans, the receipts of which are used to recalculate the capital adequacy ratio, have became a very popular instrument, with 377 banks using them to increase capital as of mid-2005. Of the total amount of $4.5 bln, $2.2 bln was lent by three largest state-owned banks – Sberbank, Vneshtorgbank and Gazprombank. As subordinated loans represent a cheaper way to increase capital compared to a direct increase in capital, and given the small amount of subordinated loans used by private banks, we believe that private banks are unlikely to hold IPOs before 2007-2008. The continuing strict regulation by the CBR should then push banks to enter the equity market.
October 28	**Sberbank unveils preliminary 9M05 RAS results; we predict $2 bln net profit in FY2005** According to its RAS results, Sberbank posted a $1.7 bln profit in 9M05. We view this as positive, and predict net profit of $2 bln for the full year. Note that the forecast for IAS net profit is somewhat more modest, at $1.3 bln for FY2005. A more detailed analysis of Sberbank's performance can be made after the release of full P&L figures, expected around November 10. However, we conclude from our recent meetings with bank management that Sberbank will likely show solid growth in fees income in 2005. This year, the bank began charging fees for pension transfers as well as a number of other social payments, which could potentially yield some $200-300 mln in additional revenues. In addition, some $200 mln may be saved due to a substantial cut in the payrolls tax rate from 36% to 26%. Given these prospects for revenue growth, we reiterate our target price of $1,170 per common share, implying upside potential of almost 40% and a BUY rating.

Source: Alfa Bank estimates

Fixed Income

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Date	Event, Commentary
Oct-5	**Venezuela transferred $20 bln of reserves into euros.** The anti-Bush rhetoric of Hugo Chavez did not affect the exchange rate significantly.
Oct-6	**European Central Bank kept its key rate unchanged at 2% p.a.** However, ECB President Trichet expressed concern about high inflation and confirmed the need for a rate hike in the future.
	Indonesia placed its first tranche of Eurobonds soon after the terrorist attacks in Bali. Demand exceeded supply by four times, and the government managed to increase the issue of 10- and 30-year bonds to $1.5 bln.
Oct-11	**Bank of Turkey reduced the key rate by 25 bpts.** The rate was set at a level of 14%.
Oct-14	**Moody`s upgraded the sovereign rating of Brazil.** Low inflation allowed the Bank of Brazil to begin loosening. The decision was welcomed by the market and led to the rating upgrade.
Oct-16	**US markets closed in observance of Columbus Day.**
Oct-17-18	**President of Brazil visited Russia.** Vladimir Putin and Lula da Silva signed a technological alliance to promote cooperation in energy, aviation and aerospace. The presidents announced their intention to promote friendship and cooperation.
Oct-20	**Bank of Brazil reduced the key SELIC rate by 50 bpts.** The previous time the rate was reduced by 25 bpts, and the positive effect on economic growth and the sovereign rating persuaded the Central Bank of the efficacy of this policy.
	EC began considering the memberships of Turkey and Croatia. A decision is expected before Christmas.
Oct-24	**US President Bush nominated Ben Bernanke to succeed Alan Greenspan as Fed chairman.** Bernanke is known as an experienced central banker. He is expected to continue policies championed by Greenspan with an even greater focus on targeting inflation.
Oct-25	**Moody`s upgraded Russia`s sovereign rating by one notch to Baa2** Slow and ineffective structural reforms prevented a two-notch upgrade. Ratings of quasi-sovereign companies and banks were upgraded to the sovereign ceiling, while the long-term debt ratings of VTB and Sberbank were raised to A3.

Emerging markets: The higher you fly, the farther you fall

Nine months of profits for emerging market bulls suddenly came to an end in October. Most experts, including US Fed Chairman Greenspan and Russian Finance Minister Kudrin, warned investors of a “bubble” inflating on the market, but this could not stop the chain reaction of purchases. At the end of September the market was already highly outbid, and when spreads reached unjustified lows, with UST yields continuing to grow, even a relatively minor event was enough to burst the bubble. As it turned out, that reason was a downward correction on the oil market.

As we expected, the chain reaction continued, but then turned downwards, affecting major stock indices, oil prices and fixed income instruments alike. Even the long-awaited sovereign rating upgrades of Russia and Brazil, in keeping with the start of talks on Turkey’s membership in the EU, could not help the market recover. Russian Eurobond prices soon reached summer levels observed before the rally in oil prices began.

Another rate hike is expected in the US

Inflationary fears and expectations of further rate hikes triggered selling on the US Treasury market. Players believe that price stability is the Fed’s main objective, as confirmed by Greenspan and other Fed members. Mark Olson, the only member to vote against an interest rate hike in September, confessed that his decision was due to a lack of data. With oil prices remaining at high levels even after the deep correction, inflationary pressure is now a headache for the global economy.

The nomination of Ben Bernanke to succeed Greenspan as Fed chairman convinced investors that the Fed will continue tightening even in 2006, as Bernanke is known as a supporter of targeting inflation and a follower of Greenspan`s policies.

Forecast for November calls for stagnation

Since mid-October, sentiment in emerging markets has been mixed. Prices seem relatively attractive for purchases, but investors were shaken by the steep decline in prices that followed the August-September rally.

Future trends will be developed by the Fed’s decision on the key rate on November 1, as well as comments from Fed members. The next key yield level of the 10-year UST is 4.63% p.a., which was not surpassed in the spring.

US Treasuries are likely to continue pressuring global bond markets in response to:

- high inflation figures;
- steady economic growth (according to the latest GDP estimates); and
- Bernanke's reputation as an advocate of Greenspan's policies and a supporter of targeting inflation.

With Russian Eurobonds being less volatile, they may show resistance to bearish sentiment surrounding US Treasuries, which should lead to a narrowing of spreads in November.

RTS Index: Three-wave Correction

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Figure 112. RTS Index – Technical Analysis Focus

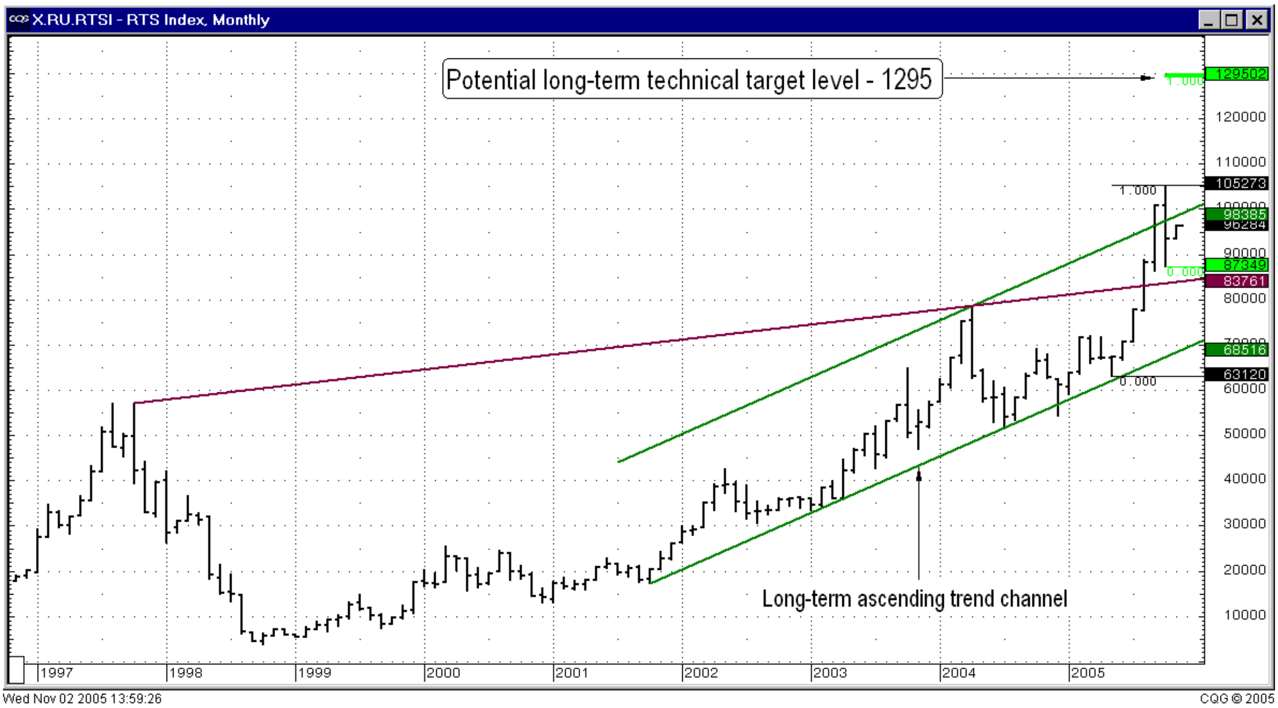
Share	Recommendation	Trend performance: Short-term	Trend performance: Long-term	Resistance Level			Support Level			Monthly Range (October 1-31)	
RTSI	HOLD CASH	Neutral	Bullish	R4	1295.00	Major	S1	942.11	7-week MA	OP	1007.76
				R3	1052.73	All-time high	S2	812.63	26-week MA	HI	1052.73
				R2	983.85	Trend channel	S3	758.67	200-day MA	LO	873.49
				R1	963.11	50.0% FiboR	S4	685.16	Major	CL	934.99

Source: Alfa Bank estimates

Investment Summary

- **The short-term trend on the RTS became neutral, while the long-term tendency remains bullish.**
- **The discrepancy between the current level of the RTS Index and the 200-day MA narrowed but remains too great, which implies significant residual downside potential.**
- **We believe that a three-wave correction is currently in progress, which suggests a decline to below 874 on the RTS.**
- **However, there is a small chance that the three-wave correction may be "flat". In this case, after its completion the RTS Index should penetrate through the historical high and then climb toward our new long-term technical target of 1,295.**
- **We therefore recommend that investors TEMPORARILY HOLD CASH and SEEK NEW ENTRY POINTS to the market.**

Figure 113. RTS Index – Monthly Technical Performance as of November 2, 2005



Sources: RTS, CQG, Alfa Bank estimates

Classic Technical Analysis

The RTS Index does not so bad from a technical standpoint

The Russian equity market currently does not look so bad from a technical standpoint. In line with our optimistic scenario, the RTS Index nearly reached our technical target level of 850 and then began to rebound. As a result, the short-term trend on the RTS has again become neutral. Meanwhile, the long-term tendency remains bullish. At the same time, the discrepancy between the present level of the RTS Index and the current 200-day MA narrowed but remains too great. This implies significant residual downside potential.

In accordance with Elliot Wave Theory, the RTS Index is currently at the beginning of the corrective wave "C", which suggests a drop to below 874

It is interesting to examine the technical wave pattern on the RTS from the standpoint of Elliot Wave Theory, which was originally applied to the major stock market averages, particularly the Dow Jones Industrial Average. In its most basic form, this theory says that the stock market follows a repetitive rhythm of a five-wave advance followed by a three-wave decline. According to Elliot, one complete cycle has eight waves – five up and three down. In the advancing portion of the cycle, each of the five waves is numbered. Waves 1, 3, and 5 – called *impulse* waves – are rising waves, while waves 2 and 4 move against the upward trend. Waves 2 and 4 are called *corrective* waves because they correct waves 1 and 3.

After the five-wave numbered advance has been completed, a three-wave correction begins. The three corrective waves are identified by the letters "A", "B" and "C". For the time being, the corrective wave "B" is still in progress but is approaching a very strong resistance level, as seen in Figure 114. For this reason, we believe that the RTS Index is currently at the beginning of corrective wave "C", which should be completed below point "A", in line with the basic technical corrective "zig-zag" model. This suggests that the RTS Index should fall below 874. However, there is a small chance that a so-called "flat three-wave correction" will form on the RTS. In this case, wave "C" would start from significantly higher levels. In this case, the RTS Index may form a "double top" trend reversal technical pattern before the resumption of weakness.

Figure 114. RTS Index, Daily – Illustration of Elliot's Three-wave Correction, as of November 2, 2005

Sources: CQG, Alfa Bank estimates

Wave B usually represents the last chance to exit long positions gracefully and a second chance to initiate new short sales

Wave "B", the bounce in the new downtrend, usually occurs on light volume and represents the last chance to exit long positions gracefully as well as a second chance to initiate new short sales. Wave "C" leaves little doubt that the upward trend has ended. Depending on the type of correction in progress, wave C will often decline well below the bottom of wave "A", registering all kinds of traditional technical sell signals. In fact, by drawing a trend line under the bottom of wave 4 and wave "A", the familiar head and shoulders top sometimes appears.

The presence of fifth-wave extensions of wave "A" confirms our thesis that the Russian stock market is in a three-wave correction mode

Corrective wave "A" is rarely recognized correctly. This wave is often interpreted as a simple dip in the upward trend. A more reliable signal that the price change was genuine is when the corrective wave "A" has an elongated form, which is apparent after breaking it down into five additional waves. Figure 114 indeed shows a fifth-wave extension of wave "A", which confirms our thesis that the Russian stock market is in a three-wave correction mode. It also indicates that a "zig-zag" or "double zig-zag" model is more likely as compared to a "flat" corrective model.

Short-term Trend and Cycles

Figure 115. RTS Index – Daily Trend and Cycles Performance, as of November 2, 2005

Source: Alfa Bank estimates

Short-term trend on the RTS became neutral

The slow adaptive trend line (ATL) in the upper part of Figure 114 is forming a local bottom under the slow adaptive moving average (AMA), implying that the short-term trend on the RTS has become neutral. However, the fast ATL is still rising, which implies a consolidation phase on the RTS.

Slow momentum is forming a plateau in negative territory

The slow momentum study (see Figure 114) is forming a plateau in negative territory, which confirms that the acceleration phase of the short-term bearish trend has ended. Meanwhile, the fast momentum study continues to advance in positive territory, which should be viewed as an additional sign of short-term consolidation on the RTS.

Short-term CWC reached moderately overbought territory

Having passed a new trough in strongly oversold territory, the short-term composite wave cycle (CWC) in the lower part of Figure 114 is still advancing. For the time being, the short-term CWC has just reached overbought territory between the "plus sigma" and the "plus two-sigma" level. In our view, the rising short-term CWC is now a major driver of growth on the RTS. We expect the resumption of weakness on the RTS after the cycle passes its new crest.

Long-term Trend and Cycles

Figure 5. RTS Index – Weekly Trend and Cycles Performance as of November 2, 2005

Source: Alfa Bank estimates

Long-term trend on the RTS is still bullish

The slow ATL in the upper part of Figure 115 continues to rise over the slow AMA, indicating that the long-term trend on the RTS is currently bullish. Meanwhile, the fast ATL has just passed its local bottom and begun to move upwards in tandem with the slow ATL, which should be considered a medium-term bullish precondition.

Slow and fast weekly momentum indicators look bullish

The slow momentum study in the middle of Figure 115 is currently shaping a plateau, which indicates the end of the accelerating phase of the long-term bullish trend. Meanwhile, the fast ATL has begun to rise. Such a combination of technical indicators suggests a possible resumption of growth on the Russian equity market in the medium term.

Long-term CWC formed its new trough

The long-term CWC formed its new trough in strongly overbought territory near the “minus two-sigma” level. At the same time, the volatility of the long-term CWC is now small, which limits the upside potential stemming from this cycle.

Support and Resistance Levels

First strong resistance is now located near 963

The near-term support and resistance levels on the RTS are illustrated in Figure 112 and Figure 113. The first strong resistance level is now located near 963. The next strong resistance level is the same as the upper boundary of the long-term ascending trend channel at around 985. Major support is near a level of 685.

Upside and Downside Potential

With regard to the state of the equity market, we conclude the following:

Future performance of the RTS Index will depend on what type of three-wave correction is now occurring, i.e. zig-zag or flat

1. The short-term trend on the RTS has become neutral, while the long-term tendency remains bullish.
2. The discrepancy between the present level of the RTS Index and the current 200-day MA narrowed but remains too great, which implies significant residual downside potential.
3. We believe that a three-wave correction is currently in progress, which suggests a decline to below 874 on the RTS in line with wave “C” of the “zig-zag” A-B-C technical pattern.
4. However, there is a small chance that the three-wave correction may be “flat”. In this case, after its completion the RTS Index should penetrate through its historical high and then climb toward our new long-term technical target of 1,295.

We therefore recommend that investors TEMPORARILY HOLD CASH and SEEK NEW ENTRY POINTS to the market.

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Alfa Bank calculates BUY, SELL and HOLD recommendations based on the difference between the current market price of a stock and the calculated target price. Depending on the indicated percentage difference between the current market price and the target price, the share is then classified into one of three rating categories.

BUY	15% or higher indicated upside to target price
HOLD	Less than 10% downside and less than 15% upside to target price
SELL	10% or greater downside to target price

15% is the long-term "average" return for equities and is now widely used as the threshold in determining a BUY recommendation.

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