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Russian Property

2010 strategy: Stay Overweight

Julia Gordeyeva, CFAResearch Analyst
(+7) 495 933-9229
julia.gordeyeva@db.com

We continue to be positive on the sector going into 2010

We upgrade our target prices across the sector and raise LSR Group and Sistema-Hals from Hold to Buy. Our top picks are AFI Development, PIK, and LSR Group.

First signs of pickup in physical real estate market emerge in 4Q09

4Q09 saw initial signs of a pickup in the physical real estate sector, particularly in the residential market. Developers reported more than a doubling of sales volumes in 3Q09 compared to trough spring levels, while December looks set to post the highest sales yet in '09. Prices have stabilized and even edged upwards in Moscow. There has been commercial market activity as well: the take up of both office and quality shopping center space has improved in 2H09 and a number of developers have announced re-launches of frozen projects. However, the office market still remains highly oversupplied, keeping rents under pressure. While overall, market activity still remains below pre-crisis levels, we can cautiously argue that the market seems to have found a bottom.

Stocks trade ex-'solvency risk'; declining risk premiums priced-in

The Russian real estate sector was one of the best performing sectors last year, 497% on average (although still down 80% in the last 2 yrs), as companies froze projects, scrambled for clients, and re-financed debt, while stocks returning from distressed valuations looked ahead to anticipated economic recovery. As insolvency risks dissipated following debt re-structuring, change of control, and asset sales, Russian developers now trade ex-'solvency risk.' Declining risk premiums also seem to be largely priced-in. Where does upside come from?

Valuation upside remains on further re-valuation of land banks

We continue to see momentum in the sector and remain Overweight as we still see valuation upside potential in most of companies under coverage. We argue that the stocks will continue to price-in the re-valuation of land banks, which are still heavily discounted by the market. Our new target prices still incorporate 60-82% discounts on land banks as uncertainties surrounding the nature and timing of development persist. However, as developers re-launch frozen projects and start new developments (we anticipate the process to start this year), the discounts are likely to narrow, driving share price performance. We estimate that each 10ppt reduction in the currently applied discount would translate into meaningful upside in share price from current levels. AFI Development and Open Investments appear to have the deepest markdown on their land banks, while Sistema-Hals and PIK offer the most upside potential on a narrowing discount.

Still prefer residential, quality retail, and construction materials exposure

We have revised our earnings forecasts and raise our SOTP-based target prices across the sector. At the same time, we have rolled over our target NAVs to YE10, introduce new economic forecasts, incorporate the FY09 worse-than-expected performance of the construction materials sector, selectively bring forward sales of residential housing, lower RoEs, and make other company-specific changes. Top picks in the sector are AFI Development, PIK, and LSR Group. Apart from the specific risks detailed in the company sections, industry risks include a slower-than-forecast recovery in GDP, consumption growth and demand for real estate, a greater-than-anticipated price decline, as well as a lack of credit from banks (p. 8).

Deutsche Bank AG/London

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Forecast Change

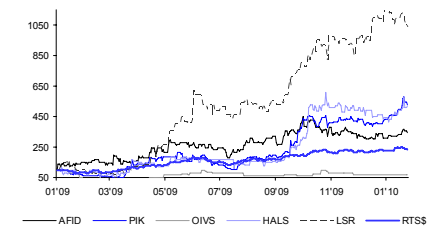
Top picks

AFI Development (AFIDLq.L),USD2.05	Buy
LSR (LSRGq.L),USD7.80	Buy
PIK (PKGPq.L),USD4.87	Buy

Companies featured

AFI Development (AFIDLq.L),USD2.05		Buy	
	2008A	2009E	2010E
DB EPS (USD)	-0.21	0.40	0.08
P/E (x)	-	4.7	23.3
EV/EBITA (x)	110.9	46.7	29.3
LSR (LSRGq.L),USD7.80			Buy
	2008A	2009E	2010E
DB EPS (USD)	-0.68	0.23	0.27
P/E (x)	-	33.8	28.7
EV/EBITA (x)	11.8	11.5	14.2
Open Investments (OIVS.RTS),USD43.00		Hold	
	2008A	2009E	2010E
DB EPS (USD)	-5.34	-14.80	6.86
P/E (x)	-	-	6.3
EV/EBITA (x)	84.1	11.9	6.5
PIK (PKGPq.L),USD4.87			Buy
	2008A	2009E	2010E
DB EPS (USD)	-2.30	-0.09	-0.02
P/E (x)	-	-	-
EV/EBITA (x)	130.3	36.7	19.7
Sistema-Hals (HALSq.L),USD1.60		Buy	
	2008A	2009E	2010E
DB EPS (USD)	-1.81	-1.24	-0.66
P/E (x)	-	-	-
EV/EBITA (x)	-	-	205.1

Relative performance



Summary of New TPs

	Old TP	New TP	% ch
AFI Development	2.5	3.4	+36%
LSR Group	6.3	10.3	+63%
Open Investments	44.0	47.0	+4%
PIK	3.9	7.5	+92%
Sistema-Hals	0.5	2.0	+285%

Upcoming events

	Date
PIK 4Q09 operating highlights	
Location	1H February
Sistema-Hals FY09 results	
Location	March
AFI Development FY09 results	
	2H March
LSR FY09 results	
	2H April