

Russia Equities

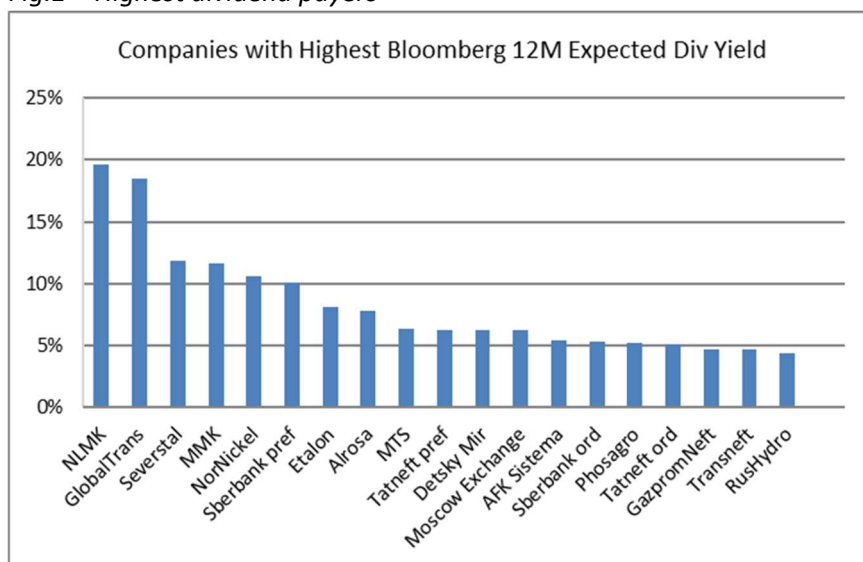
PORTFOLIO (2020 RECAP -2021 OUTLOOK)

In 2020 winners were the metal & mining stocks, retailers, and Internet companies, while oil & gas stocks, utilities and banks were the losers. All through 2020 we were underweighting oil & gas (32.2% vs 43.6% in the MSCI Russia as of 31 Dec 2020), retail (3.4% vs 4.6%), Internet (6.4% vs 10.2%) and financial (15.2% vs 19.2%) sectors. We were overweight in the utilities (4.6% vs 1.1%), telecom (3.3% vs 1.7%), metal & mining (21.3% vs 19.6%), real estate (6.0% vs zero) and transportation (2.6% vs zero) sectors.

In 2020 we kept a quite balanced approach between growth and value stocks. Value stocks have deleveraged and completed their large capex programs, their cash flows remain supported by low ruble costs, so they can pay generous dividends (Fig.1), while growth stocks are now exposed both to the ongoing digitalization process and to the stimulation of consumer demand on lower inflation and credit expansion.

In our portfolio, as of 31 Dec 2020, value stocks accounted for 68% (66% in our benchmark) vs 32% for growth stocks (34% in the MSCI Russia).

Fig.1 – Highest dividend payers



Source: Bloomberg

Oil & Gas (32% of the portfolio allocation, underweight)

Global oil demand dropped by 10 mln bpd yoy in 2020 (with a dip of -20 mln bpd yoy in April) and it is expected to rebound by 6 mln bpd in 2021E (IEA estimates of +5.8 mln bpd, OPEC +6.2 mln bpd).

Oil prices have regained 50% since the end of October amid hopes that the Covid vaccine rollout will increase demand for fuel while supply remains constrained by OPEC+. But with many economies back in full lockdown, demand for oil is expected to remain weak over the next few months while higher prices could encourage some producers to pump more than agreed. With oil prices above \$50, US producers shall also be adding capacity later in 2021 and through 2022. Iranian barrels (potentially 1.5-2.0 mln bpd additional supply) coming back to the market is a downside risk to the market, would Biden lift sanctions on Iran. We do not expect it will happen anytime soon, though (not before the end of 2021), as long as

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Iran continues to develop its nuclear program. In Russia, crude output decreased by 9.3% yoy in 2020, to 478 mln tons, and it is expected to rebound only slightly in 2021.

These observations drive us to remain conservative and align on the consensus of oil prices (Brent) in a \$50-60 /bbl range in 2021.

The outlook for natural gas is more resilient than for oil, underpinned by the role of natural gas in supporting fast growing developing economies as they decarbonize and reduce their reliance on coal, and as a source of near-zero carbon energy when combined with carbon capture use and storage. Entering into 2021, prices in Asia reached record levels and European TTF prices are at their highest since Jan 2019, while storage utilization in Europe falls to seasonal historical average.

The collapse in oil demand and drop in oil prices, crude output cuts, and domestic market contraction, made this year the worst ever for Russian oils. The crisis forced the government to find additional sources of budget funding, and it has cancelled tax breaks on highly depleted and highly viscous oil reserves, in addition to changes to the EPT regime starting from 1 Jan 2021. The strain on EBITDA will likely be moderated by the provision of additional tax breaks, as usual, but could amount to 130 blnR in 2021E, and 650 blnR over the 2021-25E period. Lukoil and Rosneft shall be less affected (up to 5% of their 2021E EBITDA) than Tatneft (over 10% of its 2021E EBITDA).

Besides, oil stocks globally suffer from disaffection on the back of the fight against green house gases and global warming. We though believe that Russian stocks have a capacity to decouple from the global negative trend thanks to their specific profile as low-cost producers having relatively lower emissions. They also do not yet pay for CO2 emissions and do not plan, as global majors do, to cut their core oil business nor to invest massively into reinventing their business models.

In 2021, with our assumption of Brent prices fluctuating in a \$50-60 range this year, we expect oil & gas stocks to provide average returns relative to the Russian market, at around 7% dividend yield.

Russian oil & gas stocks remain at a 70% discount to global majors on 2021E P/E (9.0x vs 31.0x) while paying higher dividends (7% DY in average vs 6%).

Gazprom (-31%, underweight)

In 2020 Gazprom lost market share in Europe and transit through Ukraine fell to record low. The stock underperformed the oil & gas sector, but we assume it will catch up in 2021, supported by higher gas demand in Europe and a better pricing environment. Gazprom is considerably leveraged to export prices, given the majority of the company's opex is quasi-fixed, and the new spot gas prices in Europe (which serve as a benchmark for some 2/3 of Gazprom's gas contracts in the region) is a direct addition to the company's EBITDA and earnings. Gazprom raised its gas selling price for Europe by 35% yoy to \$170 per thousand cubic meter in 2021. It plans to pay 40% of 2020E adjusted net income and up to 50% on 2021E earnings. Moreover, the management board approved a 2021E investment program at 902 blnR which is 18% lower than the originally approved program for 2020 and one of the lowest levels of investments for Gazprom in the past decade. Therefore, while the dividend yield on 2020E earnings shall be around 4% only, we assume Gazprom will increase its payout to no less than 50% of adjusted net income on 2021E earnings, which would raise the dividend yield to 8%. Longer term, we see potential new contracts with China as an important catalyst for the stock. According its Chairman Alexey Miller, Gazprom may soon increase its exports to China to over 130 bcm pa, to compare with the 38 bcm pa provided for in its existing 30Y contract.

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Nord Stream 2 Sanctions Included in US Defense Bill has long weighed on the stock price, but we consider that now it has already been discounted by investors.

Gazprom trades on 2021E P/E of 6.5x, EV/EBITDA of 6x and 4% DY.

Lukoil (-30%, underweight)

Strong financial position (Net Debt/EBITDA at 0.4x as of 3Q20) and relatively modest capex guidance for 2021E of 450 blnR following 460-480 blnR in 2020 supports solid FCF and dividend yield expectations in 2021E (12% and 9%, respectively).

Lukoil now trades on a 2021E P/E of 8.5x, EV/EBITDA of 4.0x and DY of 9%.

Rosneft (-1%, overweight)

Despite having a higher leverage (Net debt/EBITDA at 3.0x as of 3Q20), therefore a higher beta to oil prices, than its peers, Rosneft outperformed the sector in 2020 thanks to its buyback program. In 2020 it spent about 20% (400 mln\$) of the allocated amount, and the program was extended into 2021. We see the Vostok Oil project as the main catalyst for the group. It has approved the sale of a 10% stake to Trafigura in November and we expect more deals in 2021. For 2021 we see the FCF yield at 12% and the DY at 7.5%.

Its dividend policy targets 50% payout on IFRS net income.

Rosneft now trades on a 2021E P/E of 7.5x, EV/EBITDA of 6.0x and 7.5% DY.

Surgutneftegas (-40% common, -8% preferred, overweight)

The dividend yield on preferred shares could reach 14% based on the revaluation of the company's cash pile (46 bln\$ as of 2Q20) due to the 16% rouble depreciation YTD, which materially impacts the net income (from which prefs dividends are extracted).

Surgut trades on a 2021E P/E of 4.0x.

Tatneft (-44% common, -46% preferred, underweight)

Tatneft's oil output decreased by 13% in 2020 (vs -9.3% for total Russian crude output). It guides for 1% yoy output growth in 2021.

Tatneft was the worst performer among Russian oil & gas companies, as it shall be the most affected by the new taxation regime. High viscosity oil was up 23% yoy and accounted for 13% of its production in 2020 and accounts for a large part of the ambitious production growth planned in its Strategy 2030 agenda. However, under the new tax regime, the development of these reserves is not economically viable anymore. Instead, Tatneft will reallocate funds (c12 blnR pa for 3 years) to comply with all environmental and industrial safety standards at its existing fields. Therefore, despite its generous

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dividend policy allocating 100% of its disposable FCF (same dividend for ords and prefs), Tatneft has lost its status of best dividend payer in the sector.

Tatneft trades on 2021E P/E of 7.5x, EV/EBITDA of 6.5x and dividend yield of 6.5%.

Novatek (-18%, underweight)

In contrast to Gazprom, the run-up in gas prices shall have only limited impact on Novatek cashflows, because the majority of Yamal LNG's sales are made under contracts, which are mostly linked to oil, rather than gas, prices. The main positive effect on shareholder value is the decision by Novatek, last December, to raise its dividend payout from 35% to 50% of adjusted net income. We also expect a higher dividend payout based on 2020E earnings as Yamal LNG's non-financial guarantees have been lifted (2-3% yield based on 40-50% NI payout estimated).

Novatek has reiterated its long-term growth plans (57-70 mln tons of LNG production by 2027-30) and its expected timeline for Arctic LNG-2 (project completion estimated at 29%). At the same time, Novatek will delay Obsskiy LNG plant and commissioning by at least one year vs the earlier expected launch in 2023. We assume gas demand will outpace pre-crisis levels as soon as in 2021 and benchmark prices will be 30-50% above the 2020 average. We expect far stronger market fundamentals starting from 2022, when demand growth offsets the existing production glut. Specific catalysts in 2021 are the commissioning of the fourth train of Yamal LNG, the reception of cash flows from Yamal LNG (in the form of dividend and interest payments), as well as securing financing for Arctic LNG-2.

Novatek trades on 2021E P/E of 19.0x and EV/EBITDA of 17.0x and 2.5% DY.

Electricity generation (4.6% of portfolio allocation, overweight)

Russian utilities saw major growth at the beginning of the year (with rouble strength, stable profits, increased dividends and hefty FCF) and were facing nice inflows, as we had foreseen in our last year's outlook. But then, the outbreak of coronavirus, as well as rouble depreciation and subsequent market turbulence, led to an extensive correction in their share prices, not only in US dollars but in roubles as well. However, once the currency started to stabilize, the utilities sector turned to defensive mode, while dividend announcements created strong support.

After demand (-2.4% yoy) and prices (-4.0% yoy) collapsed during the pandemic, we expect utilities to enjoy a rebound in 2021. However, gencos are set to spend more on investments including DPM2, Arctic, renewables, ESG, Far East, new turbines as the second investment cycle kicks in. DPM1 contract expiry will also continue to weigh on profitability. Therefore, we expect the average dividend yield will be now remain in line with the MSCI Russia benchmark at around 7%.

ESG requirements have been adding pressure onto Russian electricity stocks over the few past years, particularly from Scandinavian investors, having historically a significant interest in Russian utility stocks. Russia is to launch a green certificates system and Russian corporates in general are driving for cleaner energy as a tool to mitigate the risks associated with the looming EU carbon border tax. While all Russian utility names still fail to screen well (partly justifying their 50% discount to international peers), given their non-compliance with the maximum coal-fired capacity share and lack of carbon footprint reduction

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commitments, some companies like Enel Russia, TGK1 or InterRAO are closing the gap aggressively while other names are yet to wake up to carbon risks.

Unipro (-15%, overweight)

Electricity output decreased by 8% in 2020. Unipro completed the oxygen cleaning procedure of its Unit 3 at Berezovskaya GRES and enters the final stage of the project - testing launches, which significantly raises chances to deliver on its promise to launch the unit in 1Q21 and to produce 15-20% of additional electricity output yoy in 2021. This shall inflate 2021E EBITDA by 15-20% and profits by 25-30% and bodes well for a robust dividend payment on 2021E cash flows.

9M20 revenues and EBITDA grew by 5% and 21% yoy, respectively, which is very strong, but Unipro 3Q20 conference call did not reduce uncertainty about the amount of future dividends.

While the company confirmed its intention to pay dividends in 2021-2022, the uncertainty over the actual size of 2021 dividends persists. We continue to consider Unipro as a solid value story with potential DY in 2021-2024 in excess of 10%.

Unipro trades on 2021E P/E of 10.0x, EV/EBITDA of 6.0x, EV/IC of \$220 /kW and DY of 11.0%.

Enel Russia (-19%, overweight)

Electricity output decreased by 44% in 2020. Enel Russia is leading the green push in Russia with its wind projects, almost fully financed from debt, and capex keeps growing. Expiry of the DPM1 payments in 2021 will send the company's bottom line to below the 1-blnR threshold (vs the 3-blnR dividend commitment), but dividend payments are protected by the 3-year preset dividend level.

Enel Russia trades on 2021E P/E of 80x, EV/EBITDA of 9.0x, EV/IC of \$120 /kW and DY of 9.0%.

IRAO (-12%, overweight)

Our 2020 pick InterRAO looks like the most undervalued company in the sector. If InterRAO closes the deal for the acquisition of Kaliningrad CHPs, it shall add 15-20% in EBITDA and net income in 2021E. The stock's dividend yield continues to be the weakest point of its investment case, with a 4% yield but we bet on an upgraded dividend policy and large-scale M&A (think of Unipro and Enel Russia) to turn around the story in line with the management's rhetoric on the use of the company's large cash pile (net cash position is 1.1x 2021E EBITDA and it has 30% of treasury shares).

IRAO management expects electricity export to rebound in 2021 but stop short of 2019 levels. Cross-border trading at its normalized state delivers 10-12 blnR of annual EBITDA, or 6-8% of total.

IRAO trades on 2021E P/E of 4.0x, EV/EBITDA of 2.0x, EV/IV of \$110 /kW and DY of 4%.

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Telecom (3.3%, overweight)

While core mobile services still represent the highest share of companies' revenues (57% of the telecom market in 2019), the contribution of digital services (Cloud value added services, fintech, smart homes, streaming, and content), which is rising and delivering outstanding growth rates (+62% yoy for Rostelecom in 3Q20), is becoming an important driver for the telecom companies. The return of roaming revenues will become another driver, as will enhanced network coverage quality.

The government has approved a target of 2024 for the development of 5G, which reduces short-term capex risks. By 2024 the authorities plan to deploy 5G networks using domestic equipment in at least ten cities. The volume of capital investments in the construction of 5G in Russia should amount of 152 blnR (2 bln\$) by 2024 and 231 blnR (3 bln\$) by 2030. The question of spectrum (along with many other details) is yet to be decided. Meanwhile, 4G penetration in Russia is still <50%.

Companies will not have to deploy high capex to roll out the network in 2021, suggesting better visibility for dividends and FCF. We largely expect dividends to remain attractive, ranging from 6% for Rostelecom to 9% for MTS.

Russia mobile service revenue was preserved in 2020 growth on the back of improving subscriber mix although roaming remained a material drag due to the lockdowns throughout the country. After Vimpelcom started raising prices in some regions, we assume competitors will also raise prices in 2021.

Very similar to the electricity sector with its generous dividend yields and forecastable cash flows, the Russian telecom sector will continue to attract investors chasing yields in the falling rate environment.

Sistema (+55%, overweight)

AFK Sistema offers a good proxy for the 2021 upturn, providing exposure to the underlying MTS (44% holding) and Ozon (31% holding) performance. Ozon's successful IPO became a great driver for Sistema's stellar stock performance in 2020 on the back of Russian e-commerce prospects (2019-25E CAGR of 30%), although Sistema's valuation still has not reflected all the run in Ozon shares, and now trades at 45% discount to NAV.

IPOs of Segezha (wood pulp) and Medsi (clinics), as well as further debt reduction and a shrinking holding discount may support the stock's performance in 2021. This month, Sistema has announced that it was preparing Segezha for a potential IPO in 2021, subject to market conditions.

Because the current level of the net debt (170 blnR) still exceeds the target earlier stated by the company (140-150 blnR), the dividend yield shall remain at a only 1% on 2020 earnings.

Sistema trades on 2021E P/E of 14.5x, EV/EBITDA of 5.0x and DY of 1%.

MTS (-13%, underweight)

MTS remains our favorite in the telecom sector with its superior network, advanced digital transformation, and fintech verticals. Its core business has performed sustainably (+3% yoy in Russia mobile revenue for 3Q20, +5.4% in Russia fixed line excluding telephony). However, MTS's main growth drivers are media, fintech and cloud services (contributing more than half to top line growth in 3Q20).

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B2B/G cloud revenue soared 80% yoy in 3Q20, while MTS Bank's interest income climbed 37% in 9M20. MTS will further pursue digitalization trends, while maintaining its core mobile business leadership (32% share of the mobile market in 2019). MTS also delivers generous dividends with a committed minimum 2021 payout of R 28 ps (DY of 8.5%). Mobile revenues account for 66% of total revenues vs 33% for MTS Bank. We assume MTS will raise prices in 2021.

MTS kept buying back its shares in 2020, opening a new purchase program, and may continue to do so in 2021.

MTS trades on 2021E P/E of 9.0x, EV/EBITDA of 5.0x and 8.5% DY.

Rostelecom Prefs (+2%, overweight)

The mobile segment continues to deliver double-digit growth (+14% yoy in 3Q20) with Tele2's market share soaring to 16% as of 2019. Apart from the successful core business performance, the digital segment is gaining momentum with 14% of total revenues in 3Q20 (vs 10% a year ago) and 62% yoy growth. Rostelecom's data center leadership was enhanced by the acquisition of DataLine (combined market share of 26%). Rostelecom is also the sole executor and key beneficiary of the 2021-22 e-government infrastructure development. Government-led digitalization efforts are an additional important driver for Rostelecom's digital expansion in the long run.

We look forward at any initiative the company would take to reduce its capex in order to increase its dividend payments. Rostelecom announced in December that it had attracted VTB Bank as a strategic partner to jointly develop its data centers and cloud assets - RTK-DC. VTB Bank will invest 35 blnR for a 44.8% stake in RTK-DC with a transaction multiple of 7.8x EV/EBITDA 2020F vs Rostelecom's trading multiple of 4.0x. The transaction is also an important step towards crystallization of Rostelecom's sum-of-the-parts value. Rostelecom expects RTK-DC to deliver double-digit growth over the next two years and eyes an IPO of the asset within the next three years. RTK-DC generated c10 blnR of EBITDA in 2020, corresponding to c5% of Rostelecom 2020E EBITDA. Other digital businesses that deserve a higher multiple vs its trading multiple include Smart City and cyber security.

Rostelecom trades on 2021E P/E of 8.5x, EV/EBITDA of 4.0x and DY of 7%

Metals & Mining (21.3% of portfolio allocation, overweight)

The mood remained upbeat across the metals complex in 2020 and so far, entering into 2021. Tailwinds from a softer dollar and negative US real yields overshadowed concerns about rising Covid-19 infections and stricter lockdowns in major economies. But the main driver on the metal markets remains China's demand, which is roughly 50% of global demand of any metal commodity. The 5-year Chinese program to urbanize another 500 mln people is metal-intensive. So are the infrastructure programs to be funded by money printing in Europe and the US to stimulate their economies. ESG is a growing factor in this industry too, which bears both risks and opportunities for Russian companies, as we could see with Norilsk, both hit by the oil spill that happened in 2020, and blessed by the growing demand for nickel, palladium and platinum in depollution units and electric vehicles.

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Norilsk (+1%, underweight)

Our 2021 outlook on nickel prices is neutral given the 100-150,000 tons surplus built up in 2020. Last year, demand fell 6-7% due to the pandemic, while the rapid expansion of NPI in Indonesia meant essentially unchanged supply: the country is set to enhance its annual output by around 200,000 tons this year. In the long run, the outlook for nickel is still good, on an anticipated rising share of electric or hybrid vehicles, and the evolution of batteries to a higher nickel load in cathodes.

Copper prices are traditionally strongly associated with the economy's overall health due to copper's versatile application in heavy industry, transport and communication. Its price rallied from \$4500 /ton (under the marginal cost of \$5000 /ton) in May to above \$8000 /ton on China's economic recovery, while coronavirus restrictions affected the supply side in South America. Copper is another ESG winner, thanks to its use in windmills, and Biden's program to build 500,000 windmill stations to recharge electric cars in the US is a strong support.

Palladium reached an all-time high of \$2866 /oz at the beginning of 2020 due to the limited availability of the metal and high physical demand in China, driven by the new China-6 emission standards. The coronavirus outbreak led to shutdowns both in the automotive industry and catalyst production and, eventually, softer demand, while the supply side was affected by South Africa's national lockdown. We are positive on the fundamentals of palladium in the long term, while the supply and demand balance in 2021 will be subject to the recovery of automotive sales.

After a tumultuous year of disruptions for both platinum supply and demand, the net effect is that the market is expected to see another deficit over 2021. Platinum prices have almost recovered pre-virus levels of above \$900 /oz, but in the longer run fundamentals remain fragile as diesel car sales continue to underperform their gasoline and EV alternatives globally. Palladium's substitution with platinum is a potential strong catalyst in the future but remains challenged by the technological complexity of the process in modern engines, as well as overly high geographical concentration of production in South Africa.

Norilsk trade at only 5.0x EV/EBITDA, below its 5Y average of 6.2x. We believe it will rerate once it has met its environmental obligations. It offers a unique exposure to the developing electric vehicle industry, boasts a very low-cost reserves base, and a unique commodity basket (nickel, copper, platinum and palladium). Due to its low cost base, its profitability is strongly leveraged on commodity prices. Each additional \$1000 /ton of Ni adds 200 mln \$ to Norilsk's EBITDA.

Norilsk's leverage remains subdued with 2020E net debt at \$4.9bn, or just 0.5x ND/EBITDA. The dividend policy is to pay 60% of EBITDA out as dividends, if ND/EBITDA is below 1.8x.

Norilsk trades on 2021E P/E of 8.0x, EV/EBITDA of 5.0x and 7% dividend yield.

Polyus (+79%, underweight)

Polyus boasts one of the largest reserves globally, 100% open-pit, and one of the world's lowest cash costs (TCC guided at \$375-425 /oz for 2020). In 2020, the company expanded its reserves base and expected production volumes at Sukhoi Log (from 1.6 to 2.3 mln oz), as well as reducing the TCC guidance. At the end of December, Polyus also announced throughput capacity and gold production of the new mill at Blagodatnoye that are substantially higher than the company's previous guidance, while estimated TCC and capex, released for the first time, are moderate.

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Gold remains a defensive asset in case of any new global shock, and the persistence of low real yields and weak USD keeps supporting gold demand.

Polyus trades on 2021E P/E of 11.0x, EV/EBITDA of 6.0x and DY of 3.5%.

Alrosa (-2%, overweight)

Starting from August, Alrosa's monthly rough diamond sales returned to normal territory of 200-300 mln\$, as retail demand in the US and China supported manufacturers' appetite for rough stones. This ended the April-July lull when sales were only 20-30 mln\$ due to Covid-related restrictions. We expect a continuation of recovery in the diamond market in 2021.

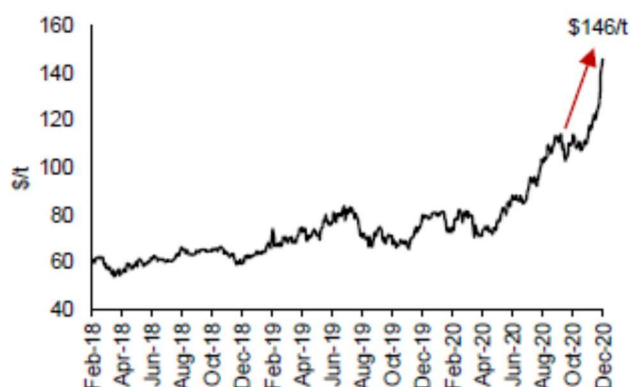
Alrosa trades on 2021E P/E of 11.5x, EV/EBITDA of 7.0x, 20% FCF yield and over 10% DY.

Steel mills (7.1% of portfolio allocation, overweight)

Global steel production in 2020 decreased by 0.9% to 1829 mln tons. It increased, though, in Russia, by 2.6% yoy, to 73.4 mln tons (4% of global output), and also in China, by 5.2% yoy, to 1053 mln tons (58% of global output). For the first time in 11 years, China became a net importer of steel in 2020, which created a positive base for the steel market to recover in the rest of the world. As a result, prices rallied when construction activity picked up again in Europe and China. FOB Black Sea HRC prices rallied from \$350 /ton in May to \$700 /ton in December. Steels are also perfect candidates for stock rotation into cyclical.

A solid cost-push across the steel curve is the rise in the prices of iron ore (Fig.2), which contributes 40% plus to the cash cost per ton of steel for non-integrated steel-mills. Iron ore futures in Singapore reached \$150 /ton last December (c\$45 below the 2010 all-time high) as supply from Australia declined, and Vale SA trimmed 2021 production guidance. Appreciation of the yuan is another support, given the share of China in global iron ore demand. The supply squeeze may ease after additional capacities restart in 1H21, though.

Fig. 2 – Iron Ore 62%Fe futures, SGX exchange (in USD per tonne)



Source Bloomberg

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Russian steels currently trade on 25% FCFY and with steel prices still rising, the rally may have further to go. In December, high demand for rolled metal on the global market brought prices to multiyear highs. In all key markets, including in Russia, demand for rolled metal exceeded the supply. Metallurgists in Russia significantly increased their price lists for the rolled metal set for sale in January, aiming to reflect in their price lists the December increase in global prices for raw materials and rolled metal.

In Russia, 70% of steel demand comes from the construction sector, which benefits from the declining interest rates. Russian steelmakers are also to be the major beneficiaries of the country's impending infrastructure boom driven by the state's National Projects. MMK is exposed at 80-90% to its local market while Severstal and NLMK are efficient exporters.

NLMK (+20%, overweight)

When iron ore prices rise, NLMK, which is 100% integrated in iron ore, outperforms.

NLMK's main positives remain its strong balance sheet, strong cash flow generation, with no pick-up in capex in view.

NLMK trades on 2021E P/E of 9.0x, EV/EBITDA of 6.0x and >10% DY.

MMK (+10%, overweight)

Magnitogorsk is the most exposed to the domestic market among Russian steels (80-90% domestic share).

The company guided for a 1-bl\$ EBITDA increase through 2025. MMK is on track to further increase its capacity by 1 mln ton of steel and 400,000 tons of pig iron in 2023-2025 through a BOF capacity upgrade and a new blast furnace.

The company's economics remain healthy (MMK was net cash positive as of end 2020), which is a prerequisite for stable dividend payout. Its new dividend policy stipulates payment of $\geq 100\%$ of FCFE if net debt/EBITDA is below 1.0x and $\geq 50\%$ of FCFE if ND/EBITDA $> 1.0x$. We assume 15% DY for 2020E at domestic HRC price of \$540/t and 12% at domestic HRC of \$480/t.

Despite its recent rally MMK remains cheap at 3.5x consensus 2021E EV/EBITDA and given that the major negative catalyst (MSCI exclusion) is already priced-in, we believe that the stock may rerate when iron ore prices start to reverse.

MMK trades on 2021E EV/EBITDA of 3.5x, P/E of 9.0x and >10% DY.

Chemicals (3.3% of the portfolio allocation, overweight)

Prices for phosphate-based fertilizers rebounded in 2020, supported by robust demand from India and Brazil with the DAP Baltic spot price reaching \$360 /ton vs only \$295 /ton in May. After the 2019 glut, the phosphate market is expected to record a 1.1-1.2-mln ton deficit in 2020. We see global demand rising 1.2% in 2020 to 47.2 mln tons as India and Brazil are set to add 1.2-1.3 mln tons of new import demand on local production suspensions as well as increased crop acreage. The supply side was supported by

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softer exports of DAP and MAP from China, as well as by supply disruptions at Ma'aden. Nevertheless, the 3Q20 data shows a slowdown of consumption growth in India and higher yoy exports from China. Therefore, we expect the phosphate fertilizer market to be balanced next year.

Phosagro (+9%, overweight)

The company has engaged in a 2.8-bl\$ capex program over 2019-25 (1.1 bl\$ in new projects vs 1.7 bl\$ maintenance) to increase fertilizer production by ~30% by 2025 compared to 2018, from 9 mln tons to 11.7 mln tons (and +22% to 11 mln tons by 2022). It will also grow production of feedstocks to be 100% self-sufficient in phosphate ore, 80% in ammonia and 91% in sulfuric acid by 2025.

ESG risk may weigh on the stock price in the future, but at today's levels (DAP price above \$360 /ton vs Phosagro cash cost \$180 /ton) the company generates significant cash flows and pays good dividends (as confirmed in 3Q20). Material rouble depreciation boosted Phosagro's top line and shall offset the implied 3.5x MET increase in 2021.

The dividend policy approved at end of Sep 2019 allocates >75% of FCF for dividends, with a net debt/EBITDA ratio of less than 1.0x, 50-75% of FCF with net debt/EBITDA of 1.0x-1.5x and less than 50% of FCF with a net debt ratio of more than 1.5x.

Phosagro trades on 2021E P/E of 7.5x, EV/EBITDA of 5.5x, and 7% DY.

Transportation (2.6% of portfolio allocation, overweight)

Although freight turnover (transportation of goods) declined by 5.4% yoy in 11M20, this year saw the successful IPO of Sovkomflot, Russia's leading shipping operator, on the Moscow Exchange, raising 500 mln\$ in its primary placement. The placement timing was good as the shipping market was quite resilient, and tank and freight rates remained high in 2020.

Russia's railway traffic was caught up in the global quarantine crisis. In 10M20 Russian Railways cargo turnover declined 3.2% yoy, with the main contraction happening in 1H20 (-5.3%), followed by a modest recovery in 2H20. Transportation of coal (-6.5% yoy), oil/oil products (-9.8%) and metals (-10.2%) sagged substantially, resulting in a surplus of gondola and tank cars on the railway network. Spot tariffs on gondolas and tank cars dropped to R 700-800 per railcar per day compared to R 2000 just a year and a half ago. Though railway operators' long-term tariffs have a weak correlation with spot prices and are not overly volatile, their EBITDA and net incomes declined by an estimated 30-40% yoy in 2020. In 2021 we expect to see some improvement both in pricing and volumes, as the global economy is generally expected to grow and rising exports from Russia should boost demand for railcars.

Globaltrans (-33%, overweight)

Globaltrans semi-annually pays an over 10-12% DY. It has underperformed the market in 2020 due to the tough market conditions. Railway tariffs collapsed and the company's EBITDA will dip 35% in 2020. Considering the relatively young fleet in operation, Globaltrans can compensate pressure on rates on a very competitive market by lower capex to preserve high cash flows and remain one of the best dividend opportunities on the Russian stock market. It has reiterated its commitment to pay 5 blnR dividends for

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2H20 assuming no shocks to the economy, and also its intention to maintain solid dividends in the future. We assume the company and the sector are at the lowest stage of the business cycle, but with the economic backdrop supposed to improve in 2021, we shall see rising demand and pricing on the railway market.

The company recently listed on the Moscow Exchange.

Globaltrans trades on 2021E P/E of 5.5x, EV/EBITDA of 4.5x and >10% DY.

Retailers (3.4% of portfolio allocation, underweight)

After underperforming for many years, retailers reversed the trend in 2020 as Covid forced consumers to change their behaviors, implying traffic contraction offset by an enlarged basket. In 2021 we shall see the reverse with basket normalization offsetting the rebound in traffic. The cancellation of travel restrictions and a complete rebound of the HORECA industry will also likely reallocate part of the consumers' budgets from groceries to eating out in 2021. Meanwhile, real wage kept contracting in 2020 and dragged retail sales down.

Reacting to enhanced demand for online shopping during lockdown, retailers heightened their focus on digitalization, and the e-grocery market more than tripled in size in 2020 to reach an estimate 145 blnR, with X5 being the market leader with a share of 6%. It is forecasted to grow to 605 blnR by 2023 while increasing its contribution to total food retail from less than 1% to 3% (vs 3.5% across developed markets).

We favor specialized retailers exposed to lesser competition such as Detsky Mir over food retailers.

X5 (+6%, underweight)

X5 remains the market leader with a 13% share in 2020. Revenue grew by 14.3% on the back of a 5.5% growth in LFL sales and an 8.3% increase in the trading area. On-line revenue surged by 362% to 20.1 blnR. Although this still represents only 1% of consolidated revenues (targets a 5% share by 2023), X5 also leads in the e-grocery business with a 6% market share and an ambitious target of 20-23% by 2023. The launch of its Okolo delivery service is an important move that may help X5 to compete with Internet giants Yandex.Eda or Sberbank's Delivery Club in the future. X5 contemplates an IPO of its online business in the next 2-3 years.

We have a balanced outlook for 2021 (9% sales growth, 7.0% EBITDA margin, 6.6% dividend yield), while the company guides for 10%+ top line growth in the 2021-23 period (vs 13% in 2019 and 14% in 2020). In 2021, it plans to open about 1,400-1,500 new stores, including in the eastern part of Russia.

X5 Retail introduced semi-annual dividends. They recommended 20 blnR for 9M20 for 2.7% yield, but dividend payments in 2021 will be increased 1.7x yoy to 50 blnR (6.0% DY).

X5 trades on 2021E P/E of 15.5x, EV/EBITDA of 6.0x, 6% DY.

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Detsky Mir (+13%, overweight)

The main event in 2020 was the purchase of 25% of the company's capital by PE fund Artus, which is willing to increase to 29.9%. In December, Onexim also doubled its share from 5.35% to 10.67%.

2020 revenue increased by 11% yoy to 143 blnR. Total openings for 2020 came broadly in line with the company's guidance. The company guides on improved EBITDA margin in 2020 (10.7% in 2019 under IAS17).

New initiatives in smaller formats, the pet segment and the marketplace represent upside risks. Detsky Mir completed the roll-out of its marketplace in October and management has discussed an opportunity to spin-off and IPO its online business. Detsky Mir's online business contributed 23% to its Russia sales (22% to total sales) as of 9M20 (and 29.8% in 4Q20). The company's strategy targets a 45% share of online sales in the medium-term, which implies 40-45% online sales growth p.a. (vs 13% total sales CAGR). According to the company, the online store generates 10%+ EBITDA margin, in line with its blended EBITDA margin. We believe that secures better positioning than other e-commerce players, which are not yet at a breakeven. If we value Detsky Mir's online part at OZON's multiples at IPO and current levels, respectively (3-4.4x EV/Sales 2021E), we calculate that Detsky Mir might be worth 2-2.5x its current market cap.

Comfortable leverage (1.1-1.2x net debt / EBITDA) and limited capex requirements (4-5 blnR p.a. in 2021-23F) secure the sustainability of solid dividend payouts for the coming years.

The stock trades at 2021F EV/EBITDA of 6.0x and 10% DY.

Real Estate Developers (6.0% of the portfolio allocation, overweight)

In 2020, investor sentiment warmed to the sector and even allowed for the IPO of a newcomer - Samolet Development. Housing entered a boom phase that has seen sales volumes rocket (residential primary sales were up 22% yoy in 2020 in Moscow to a record high of 1.3 tlnR) and a 20% yoy increase in prices thanks to mortgage loan rates that have fallen to historical lows (7.36% at the end of 2020 from 9.00% in December 2019). This was driven by the CBR 200-bps rate cut to 4.25% and the government's subsidized interest rate mortgage program for new apartments until the end of 1H21 to support demand and the economy. As a result, despite falling disposable income the number of people able to afford to buy an apartment more than doubled. Whereas it makes a good contribution to overall GDP growth, it may or may not be extended at least until end-2021, but the base demand for mortgages will remain driven by the maternity capital available for families with children, and investors' optimism shall continue at least within 2021. Given that mortgages are likely to come at 8% of GDP only this year, we do not see the risk of a sudden stop in this market.

Unsatisfied demand for quality housing in Russia remains huge. With many people still living in old houses that were build over 50 years ago, and the average living area per person significantly smaller than in Europe. In some of the largest cities like Moscow and Saint Petersburg, demand exceeds supply. As a result, average prices in both cities have increased by 20-25% yoy in 2020 and they may rise another 10% or more in 2021 while mortgage interest rates remain at the current low level. Construction costs are growing very slowly (approximately in line with CPI), which means price growth will broadly mean higher developer margins and cash flow, which in turn shall boost dividends.

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LSR (-10%, overweight)

LSR Group's new contract sales rose 7% yoy to 590,000 sqm for 9M20. In value terms, this is a 16% uptick to 66 blnR, with an average price of 130,000 /sqm (+13% yoy). Sales for 3Q20 were especially good, climbing 33% yoy in terms of volume and +48% in value terms, driven by falling mortgage rates. As a result, the company reiterated its initial FY20 guidance to sell 870,000 sqm (+6% yoy) of 96 blnR (+13% yoy) in value terms. For the past few years, the company margins have been under pressure, mainly due to investments in its Moscow flagship project ZilART. However, we expect to see a material turnaround in its margins and earnings, as it has raised its average prices by 20-50% in Moscow and St Petersburg, and ZilART is now producing positive cash flow. In the long run LSR is looking to expand its presence in the Moscow region, which will require meaningful investments in the land bank. In contrast, in St Petersburg, the company profitability may be under pressure as the share of luxury high margin projects is falling, as is its low-cost land bank.

LSR trades on 2021E P/NAV of 0.5x, P/E of 6.0x and 9% DY.

Etalon (-8%, overweight)

In 2020 Etalon residential housing sales rose 3% yoy in value, to 79.9 blnR, or 9.5% above the company optimistic forecasts. In volume terms, sales fell 15% yoy, to 538,194 sq.m.

Etalon's portfolio comprises a variety of segments from comfort to business in Moscow and St Petersburg. By 2024 the company plans to expand its land bank to over 6 mln sqm from the current 3.3 mln sqm, 40/50% of which will be in St Petersburg/Moscow and another 10% for regional expansion. Etalon targets doubling its construction volumes and growing its minimum gross margin to 35% by 2024 and we hope to see the beginning of margin growth as soon as 2021 considering the 20% average increase in pricing.

The key to Etalon's investment case is the strategy and further asset integration by key shareholder Sistema (25% stake). The company listed on MOEX in 2020. Etalon has a solid dividend policy suggesting a minimum dividend of R 12 ps, which translates into an almost 10% DY, the highest in the sector.

Etalon trades on 2021E P/NAV of 0.2x, P/E of 9.0x and 10% DY.

Internet (6.4%, underweight)

Advertising was under pressure in 2020, but as the economy accelerates and the effects of Covid diminish in 2021, we expect the ad market to rebound (Mail.ru estimates 17% CAGR in 2020-22E), while digitalization trends should support the growth of Internet businesses such as online education (22% CAGR) and ride-hailing (19% CAGR). Moreover, thanks to Covid restrictions, consumers have started to spend much more time online, boosting the gaming, food delivery, and communication segments.

With rapidly evolving Internet ecosystems, competition is now strong between ecosystems that expand their verticals to capture the full consumer lifecycle.

The law on pre-installing Russian software on electronic devices favors Yandex (search, web browser, navigation, cloud services) and Mail.ru Group (email, messenger, news aggregator, streaming, voice

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assistant, social networks). Ozon placement in November quickly boosted the stock to a capitalization close to Mail.ru.

Mail (+17%, overweight)

In 2020 we placed our bet on Mail rather than Yandex. Apart from its core advertising business (41% of revenues in 9M20, 16% of Russia's digital ad market), the company has exposure to the gaming segment (33% of 9M20 revenues), taxi, and food tech, as well as e-commerce and other budding segments. It has a broad user base with total MAU representing 93% of Russia's Internet users. VK maintains its leadership among domestic social networks. Gaming is another important driver to the group's performance: MYGAMES is still reflecting qoq growth in registered users, and over 75% of the company's revenues are now from foreign markets. The pandemic has given a strong boost to the gaming segment, and while 2021 will likely see respective momentum moderate, structurally higher growth rates will likely persist in the long run and we expect double-digit growth in the segment again in 2021.

CEO Boris Dobrodeev mentioned that Mail.ru Group is considering an IPO of its educational projects and commented on the prospects for development of the company's EdTech business. Mail.ru Group probably occupies more than 10% of the online education market in Russia.

Mail trades on 2021E P/E of 33x and EV/EBITDA of 14x.

Yandex (+58%, underweight)

Ad revenues represented 60% of Yandex's top line in 9M20, and a rebound of the ad market in 2021 will drive a faster earnings acceleration next year (we assume 17% yoy growth in 2021). At the same time, the ride-hailing and food-tech businesses continue to show strong top line momentum of 52% yoy in 9M20, and improving profitability, despite the taxi business being adversely affected by the pandemic. Yandex's growth will continue to be anchored by the ad market rebound and the development of new verticals: we see food tech and e-commerce growing healthily. We also anticipate that Yandex will enter new verticals, such as fin tech, which will likely become a priority after the JV with Sberbank was dissolved. It is among the most promising verticals that can be rolled out to the more than 70 mln person Yandex user base.

Yandex trades on 2021E P/E of 55x and EV/EBITDA of 30x.

Banks (15.2%, underweight)

It would be excessive to say that Russian banks benefited from the Covid crisis, but at least they came out pretty unharmed with 1.6 tlnR of profits, which is only 6% less than in 2019. Compared with the previous year, the ROE of Russian banks lost 3 pps to 16%. Falling rates drive an acceleration of corporate (+10% in 2020) and retail lending, particularly mortgages (up 25% in 2020), which eventually will drive earnings growth and lower NPLs. According to the CBR, the share of overdue loans in the corporate sector has risen just 30 bps in 11M20 to 8.1%, and 40 bps to 4.8% in the retail segment. Based on 3Q20 figures, Russian banks' CoR levels have returned to pre-Covid figures. As Russia's economic resumes growth in 2021, Russian banks shall avoid building up additional provision charges, and likely reverse some of the provisions created in 2020. On the other end, lower interest rates imply lower net interest margins, and banks are encouraged to expand their lending activities. We see both corporate and consumer lending

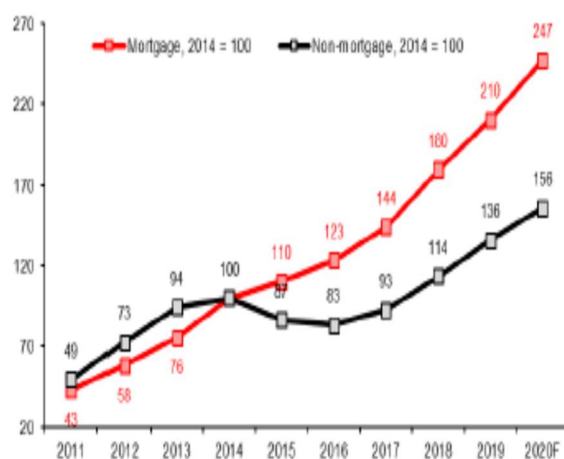
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growing by 10-15% in 2021, including mortgages, which will remain subsidized by the government in 1H21.

According to CBR estimates, around 50% of households in Russia have no savings, including the 8% households which fully spent their saving since the beginning of the year. Those households may be willing to increase their loan exposure. Some 42 mln Russians now have loans, including 36 mln people, with loans to banks and 8 mln people with mortgages (6% of the Russian population). The mortgage market will remain supported in 2021 by the low interest rates as well as by the increase in the maternity capital program, which is expected to reach 520 blnR in 2021 and 600 blnR in 2022.

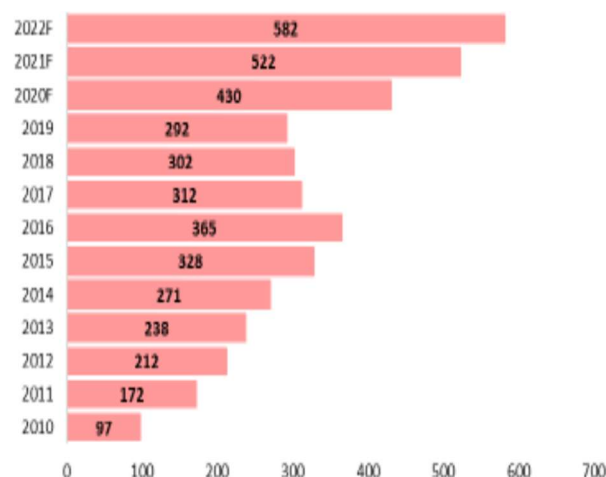
In 2020, Russian banks extended 4.3 tlnR of mortgage credits to the population, up 51% yoy. The average mortgage amount is 2.5 mlnR and the average interest rate decreased to 7.36% at the end of 2020 from 9.00% in December 2019. The total amount of outstanding mortgage credit at the end of 2020 rose by 21% to 9.9 tlnR (still less than 10% of GDP), of which 0.85% only were overdue. We thus expect this segment to remain a strong driver of credit expansion in the coming years.

Fig.3 – Russia's mortgage / non-mortgage market



Source: CBR

Fig.4 – Russia's maternity capital (in bln RUB)



Source: State Pension Fund of Russia

Despite the measures taken by the CBR to cool down credit expansion, we see falling rates drive an acceleration of corporate and retail lending, particularly mortgages, which eventually will drive earnings growth and lower NPLs. There is no credit bubble in Russia. Russian households remain creditors to the banking system and the share of overdue loans is c7% in the corporate sector and less than 5% in the retail segment.

Sberbank (-10%, underweight)

As described in its 2023 strategy presentation, Sberbank has largely completed its digital transformation and will invest an additional 4% of equity (200 blnR) to leverage its 100-mln customer base and become a top 3-5 player in e-commerce. Its "Sber" ecosystem concept is built around an integrated client offering based on three concepts. (i) Non-financial services (Okko, SberZvuk, SberMarket) drive traffic and engagement, (ii) open marketplaces (Goods.ru, DomClick, SberAuto) plus the 3P e-commerce marketplace drive financial product sales, held together by (iii) Sber ID, SberPay, SberPrime (subscription) and Spasibo (loyalty). By YE23, Sber plans positive EBITDA for its main non-banking assets.

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2020 RAS net income decreased by 8% yoy to 782 blnR, with 16.5% ROE and 5.5% NIM. Assets grew 20% yoy to 33.1 tlnR, total loans +16% to 23.9 tlnR. The loan-to-deposit ratio is 95% and cost-to-income ratio is 30%. In 2021 it targets ROE >17%, 13-15% retail loan growth and 7-9% corporate loan growth, NIM -50 bps. It assumes the share of non-banking revenues shall reach 5% in 2023 (vs. 1% in 2020) and DPR of 50%.

The stock is trading on 2021F P/BV of 1.1x, P/E of 6.5x and DY of 7.0% (ords) and 7.5% (prefs).

VTB (-32%, equal weight)

VTB earnings net income reached 70 blnR in 11M20 with 4.5% ROE and shall reach 75 blnR for 2020. VTB is more leveraged than its Russian peers to the economic turnaround expected in 2021. Its earnings have fallen by over 70% yoy in 11M20 on climbing provisioning and asset impairments, but in 2021 it shall enjoy the reversal of this trend and return to its initial net income target of 220-230 blnR.

In December VTB's supervisory board approved a development programme through to 2023 focusing on housing and transport infrastructure, green finance, and digital transformation. VTB aims to earn 300 blnR net income in 2022 and 330 blnR in 2023, with a 15% ROE target in 2022 and 2023 (up from 12% in 2019). It has announced a 35 blnR investment for a 44.8% stake in RTK-DC, Rostelecom's data centres and cloud business. This confirms VTB is looking to expand its non-financial services ecosystem, with cloud and data services one of the big areas of focus.

In April 2019 VTB committed to pay out 50% of net income in dividends starting from 2020. We may also see investor appetite resume for VTB after the bank's comments on its preferred equity buyout.

VTB trades on 2021E P/E of 4.0x, P/BV of 0.5x and 4% DY.

TCS (+53%, overweight)

Tinkoff Credit Services Group is both a bank and a fintech company, which 100% online business model helped sail through the Covid crisis quite unscathed. Following its strong November financial report, taking YTD asset growth to 40% and 11M20 net income +14 yoy to 30.5 blnR, it upgraded its YE20 guidance – net income > 42 blnR, CoR around 10-11%, funding costs around 4%, around 10% net loan growth. It guided 20% yoy net income growth to 42 blnR and growth shall remain strong in 2021 (we assume another 20% yoy to over 50 blnR), driven by its the development of the loan portfolio as well as the brokerage and insurance segments. Client base now totals 12 mln, adding 2.5-3 mln clients per annum, with a midterm target of 20 mln pursued through an aggressive marketing strategy.

Founder Oleg Tinkov has announced it was converting his supervoting Class B shares (each share has 10 votes) to single vote Class A, effective today. This will mean his voting stake drops to 35% from 84%, in line with his economic stake. We expect the stock to be included in the MSCI Russia Index in February.

It paid 3Q20 dividend is \$0.25 DPS, implying about 30% payout ratio, bringing dividends for 9M20 to \$0.59 ps, c2.7% annualised DY.

TCS trades at 10.0x 2021E P/E and 3.0x 2021F P/BV vs. 30% ROE.

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MOEX (+23%, overweight)

Moscow Exchange is a cash cow generating stable fee revenues in any economic conditions, but it benefits from the increased inflows into the Russian stock market as domestic investors reallocate savings out of low-redeeming bank deposits. Over the past 5Y its commission income has grown by an average 11% pa, while the share of interest income is gradually decreasing. The company actually targets a ratio of 70/30 commission/interest income.

MOEX trades on 2021E 15x P/E, and 6.0% DY.