

Research  
May 27, 2009

Telecommunications  
Russia

## Dalsvyaz

Recommendation: CS – BUY  
PS – BUY

*Low debt provides for growth*

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### Bullet moments

☎ Late May Dalsvyaz output its annual consolidated report by IAS. For now almost all IRCs have reported already. At the background of the other companies, Dalsvyaz looks strong, but not without negative of course.

☎ As a strong moment we outline the most significant sales growth. The main input of the given estimate's upping was provided by the increase of subscribers of broadband access (BBA) services – within a year their number upped by 74% to 309 thousand. Nevertheless, by OIBDA margin estimate the company occupies poor positions.

☎ Also we should call the comfortable debt load a very positive feature of the company. By Debt/SE (0.49) and Debt/OIBDA (1.16) coefficients the company occupies not the first place though, but those figures are lower than the branch average. Also we should mention that Dalsvyaz has no currency debts. Meaning that the company has no loss (no profit also) from currency exchange, which appear when ruble versus dollar or euro rates change, and that excludes "paper" affects on the net profit. Besides, the company has liabilities in the currency, in which it gains almost all the income.

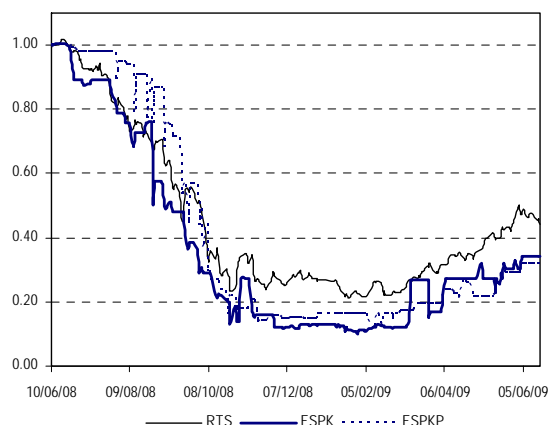
☎ Note that Dalsvyaz, unlike the other IRCs, reduced its plans on investment program insignificantly, which is a consequence of a more stable financial situation. That means the company will not lower the development rates and will keep its confident position at the market, first of all in BBA segment.

☎ Nevertheless, despite all the values of Dalsvyaz, there are serious risks for the company's share market that are related to the possible restructuring of Svazinvest and the company joining Rostelecom.

☎ We revised our model of Dalsvyaz and our estimation of its shares. Our new estimates form 3.4860 USD per common and 2.6145 USD per preferred share (former estimates – 2.3992 USD and 1.7994 USD respectively). Considering the current market quotes, the company's shares obtain significant growth potential and we confirm our recommendation BUY for both share types. However, we make a reservation that the given estimation does not consider any possible changes in the structure of Svazinvest and has been formed only including the fundamental estimates of the company.

### Principal estimates

Company's shares vs. the RTS index



#### Information about Dalsvyaz

Ticker RTS	ESPK / ESPKP
Market price (cs), USD	1.6000
Market price (ps), USD	1.0750
Min / max price during last year (cs), USD	0.4750 / 4.6600
Min / max price during last year (ps), USD	0.4000 / 3.3500
gair price at year end (cs), USD	3.4860
gair price at year end (ps), USD	2.6145
Upside (downside) (cs), %	117.9
Upside (downside) (ps), %	143.2
MC, mn USD	186
EV, mn USD	361

Financial values (IAS)	2008	2009 (F)	2010 (F)
Sales, mn USD	648	541	517
OIBDA, mn USD	216	188	170
Net income, mn USD	69	60	44
OIBDA margin, %	33.4	34.7	32.9
Net income margin, %	10.7	11.2	8.5

Financial coefficients	2008	2009 (F)	2010 (F)
$EV / S$	0.56	0.67	0.70
$EV / OIBDA$	1.67	1.92	2.12
$P / E$	2.21	2.53	3.46
ROIC, %	19.6	21.1	14.8
ROE, %	23.2	18.6	13.6

## Financial model

### Income statements of Dalsvyaz, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)
Sales	378	402	587	648	541	517	521	535	577	623
Costs	(294)	(295)	(404)	(417)	(353)	(347)	(361)	(374)	(400)	(431)
Non-recurrent items	0	(30)	(15)	14	0	0	0	0	0	0
<b>OIBDA<sup>1</sup></b>	<b>85</b>	<b>137</b>	<b>197</b>	<b>216</b>	<b>188</b>	<b>170</b>	<b>160</b>	<b>161</b>	<b>177</b>	<b>193</b>
<b>OIBDA margin, %</b>	<b>22.4</b>	<b>34.1</b>	<b>33.6</b>	<b>33.4</b>	<b>34.7</b>	<b>32.9</b>	<b>30.7</b>	<b>30.1</b>	<b>30.6</b>	<b>30.9</b>
Amortization	(37)	(67)	(82)	(89)	(72)	(74)	(78)	(81)	(87)	(91)
<b>EBIT</b>	<b>48</b>	<b>70</b>	<b>115</b>	<b>128</b>	<b>116</b>	<b>96</b>	<b>82</b>	<b>79</b>	<b>90</b>	<b>102</b>
<b>EBIT margin, %</b>	<b>12.6</b>	<b>17.4</b>	<b>19.7</b>	<b>19.7</b>	<b>21.4</b>	<b>18.6</b>	<b>15.8</b>	<b>14.9</b>	<b>15.7</b>	<b>16.3</b>
Interest expenses	(17)	(24)	(28)	(25)	(33)	(39)	(33)	(16)	(0)	0
Non-operating income (losses)	8	2	6	4	0	4	4	4	0	2
<b>EBT</b>	<b>39</b>	<b>49</b>	<b>93</b>	<b>107</b>	<b>83</b>	<b>61</b>	<b>53</b>	<b>68</b>	<b>91</b>	<b>104</b>
<b>EBT margin, %</b>	<b>10.3</b>	<b>12.2</b>	<b>15.9</b>	<b>16.5</b>	<b>15.4</b>	<b>11.7</b>	<b>10.1</b>	<b>12.7</b>	<b>15.7</b>	<b>16.7</b>
Income tax	(17)	(15)	(26)	(30)	(17)	(12)	(11)	(14)	(18)	(21)
Minority interest	0	(0)	(3)	(8)	(6)	(4)	(4)	(5)	(6)	(7)
<b>Net income</b>	<b>22</b>	<b>34</b>	<b>64</b>	<b>69</b>	<b>60</b>	<b>44</b>	<b>38</b>	<b>50</b>	<b>66</b>	<b>76</b>
<b>Net income margin, %</b>	<b>5.7</b>	<b>8.4</b>	<b>11.0</b>	<b>10.7</b>	<b>11.2</b>	<b>8.5</b>	<b>7.4</b>	<b>9.3</b>	<b>11.5</b>	<b>12.2</b>

<sup>1</sup> Excluding non-recurrent items

Source: company's data, Estimation: Veles Capital

### Balance sheets of Dalsvyaz, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)
<b>ASSETS</b>										
<b>Non-current assets</b>										
PPE and intangible assets	412	427	647	581	511	498	464	454	438	420
Other non-current assets	12	99	13	23	20	19	18	18	18	18
<b>Total non-current assets</b>	<b>424</b>	<b>525</b>	<b>660</b>	<b>604</b>	<b>531</b>	<b>516</b>	<b>482</b>	<b>472</b>	<b>456</b>	<b>437</b>
<b>Current assets</b>										
Current assets	62	66	87	83	75	76	76	80	87	94
Short-term investments	0	0	32	5	118	119	144	0	76	162
Cash and equivalents	6	7	14	19	17	17	17	17	20	21
<b>Total current assets</b>	<b>67</b>	<b>73</b>	<b>133</b>	<b>107</b>	<b>210</b>	<b>212</b>	<b>237</b>	<b>98</b>	<b>182</b>	<b>277</b>
<b>Total assets</b>	<b>491</b>	<b>599</b>	<b>793</b>	<b>711</b>	<b>741</b>	<b>728</b>	<b>719</b>	<b>569</b>	<b>638</b>	<b>714</b>
<b>LIABILITIES</b>										
<b>Shareholder's equity</b>										
Authorised capital	152	166	178	149	125	118	110	109	108	107
Retained earnings	86	59	109	155	174	197	212	252	305	364
<b>Total shareholder's equity</b>	<b>238</b>	<b>225</b>	<b>287</b>	<b>304</b>	<b>299</b>	<b>315</b>	<b>322</b>	<b>360</b>	<b>413</b>	<b>471</b>
Minority interest	0	1	57	53	50	51	51	56	61	68
<b>Non-current liabilities</b>										
Long-term borrowings	128	175	281	194	248	216	201	0	0	0
Other non-current liabilities	47	43	74	61	51	48	45	45	44	44
<b>Total non-current liabilities</b>	<b>174</b>	<b>217</b>	<b>355</b>	<b>254</b>	<b>299</b>	<b>265</b>	<b>246</b>	<b>45</b>	<b>44</b>	<b>44</b>
<b>Current liabilities</b>										
Current liabilities	67	79	94	99	93	97	100	108	120	132
Short-term borrowings	12	77	0	0	0	0	0	0	0	0
<b>Total current liabilities</b>	<b>78</b>	<b>156</b>	<b>94</b>	<b>99</b>	<b>93</b>	<b>97</b>	<b>100</b>	<b>108</b>	<b>120</b>	<b>132</b>
<b>Total liabilities</b>	<b>491</b>	<b>599</b>	<b>793</b>	<b>711</b>	<b>741</b>	<b>728</b>	<b>719</b>	<b>569</b>	<b>638</b>	<b>714</b>

Source: company's data, Estimation: Veles Capital

**Statements of cash flow of Dalsvyaz, mn USD**

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)
<b>Cash flows from operating activities</b>										
Net income	39	19	79	121	83	61	53	68	91	104
Amortization	37	67	82	89	72	74	78	81	87	91
Changes in working capital	15	(25)	(3)	3	1	1	1	1	1	1
Interest expenses	(8)	(15)	(9)	(24)	(33)	(39)	(33)	(16)	(0)	0
Income tax	(10)	(17)	(33)	(35)	(17)	(12)	(11)	(14)	(18)	(21)
Other	9	56	13	11	45	47	42	21	7	2
<b>Net cash provided by operating activities</b>	<b>82</b>	<b>84</b>	<b>128</b>	<b>164</b>	<b>152</b>	<b>131</b>	<b>129</b>	<b>141</b>	<b>167</b>	<b>178</b>
<b>Cash flows from investing activities</b>										
CapEx	(78)	(95)	(98)	(143)	(107)	(96)	(87)	(81)	(78)	(77)
Other	(1)	(71)	(17)	41	(123)	(3)	(32)	148	(76)	(85)
<b>Net cash provided by investing activities</b>	<b>(80)</b>	<b>(166)</b>	<b>(115)</b>	<b>(102)</b>	<b>(231)</b>	<b>(99)</b>	<b>(119)</b>	<b>66</b>	<b>(154)</b>	<b>(162)</b>
<b>Cash flows from financing activities</b>										
Proceeds from borrowings	62	218	157	41	208	0	0	0	0	0
Repayments of borrowings	(56)	(130)	(159)	(87)	(115)	(20)	(0)	(200)	(0)	0
Other	(7)	(6)	(5)	(7)	(13)	(11)	(9)	(8)	(10)	(14)
<b>Net cash provided by financial activities</b>	<b>(1)</b>	<b>83</b>	<b>(7)</b>	<b>(54)</b>	<b>80</b>	<b>(31)</b>	<b>(9)</b>	<b>(207)</b>	<b>(10)</b>	<b>(14)</b>
Currency rates corrections	1	(4)	(3)	(1)	(1)	(0)	(0)	(0)	(0)	(0)
<b>Net change of cash</b>	<b>1</b>	<b>1</b>	<b>7</b>	<b>5</b>	<b>(2)</b>	<b>0</b>	<b>(0)</b>	<b>(0)</b>	<b>3</b>	<b>2</b>
<b>Cash at the beginning of period</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>14</b>	<b>19</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>20</b>
<b>Cash at the end of period</b>	<b>6</b>	<b>7</b>	<b>14</b>	<b>19</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>17</b>	<b>20</b>	<b>21</b>

Source: company's data, Estimation: Veles Capital

## Price estimation

### Discount rate (WACC) of Dalsvyaz, %

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Cost of equity (<math>k_e</math>)</b>	<b>15.86</b>	<b>15.02</b>	<b>18.61</b>	<b>17.82</b>	<b>16.75</b>	<b>17.54</b>	<b>16.98</b>	<b>16.75</b>	<b>14.27</b>	<b>14.27</b>
Risk-free rate	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Stock market risk	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Coefficient $\beta$	1.2	1.1	1.7	1.6	1.4	1.5	1.4	1.4	1.0	1.0
Corporate risk	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Share of equity, %	66.9	63.1	47.3	55.1	64.9	58.4	62.9	65.0	99.9	100.0
<b>Cost of debt (<math>k_d</math>)</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>	<b>18.41</b>
Risk-free rate	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Debt premium	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Tax rate	44.4	77.8	32.5	24.6	20.4	20.3	20.2	20.1	20.0	20.0
Share of debt, %	33.1	36.9	52.7	44.9	35.1	41.6	37.1	35.0	0.1	0.0
<b>WACC</b>	<b>14.00</b>	<b>10.99</b>	<b>15.35</b>	<b>16.05</b>	<b>16.01</b>	<b>16.34</b>	<b>16.13</b>	<b>16.03</b>	<b>14.27</b>	<b>14.27</b>

Estimation: Veles Capital

### Cash flows of Dalsvyaz, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)
<b>Net income (corr.)</b>	<b>36</b>	<b>24</b>	<b>78</b>	<b>109</b>	<b>77</b>	<b>53</b>	<b>46</b>	<b>53</b>	<b>67</b>	<b>77</b>
Depreciation and amortization	37	67	82	89	72	74	78	81	87	91
CapEx	(78)	(95)	(98)	(143)	(107)	(96)	(87)	(81)	(78)	(77)
Changes in working capital	15	(25)	(3)	3	1	1	1	1	1	1
<b>Free cash flow</b>	<b>9</b>	<b>(29)</b>	<b>58</b>	<b>58</b>	<b>43</b>	<b>32</b>	<b>37</b>	<b>54</b>	<b>76</b>	<b>92</b>
Discount rate, %					16.0	16.3	16.1	16.0	14.3	14.3
Discount coefficient					1.00	0.86	0.74	0.64	0.56	0.49
<b>Discounted cash flow</b>					<b>43</b>	<b>28</b>	<b>27</b>	<b>34</b>	<b>43</b>	<b>45</b>

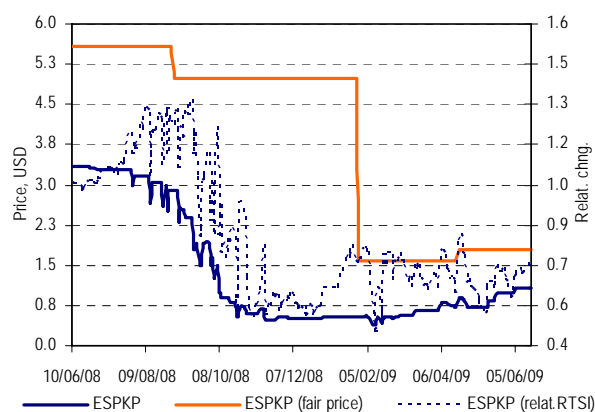
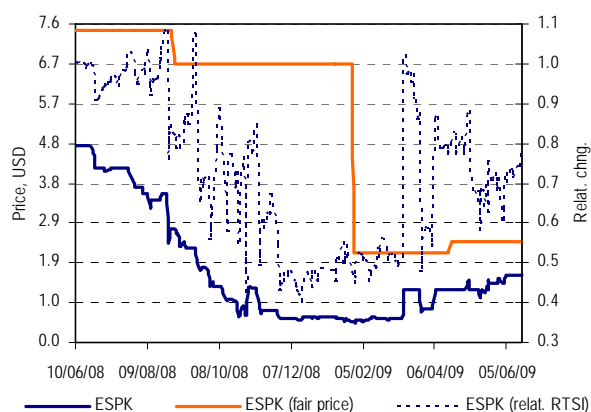
Source: company's data, Estimation: Veles Capital

### Dalsvyaz's stocks valuation

TGR, %	3.0
Sum of cash flows, mn USD	298
Terminal value, mn USD	913
Discounted terminal value, mn USD	299
Enterprise value, mn USD	597
Net debt, mn USD	113
Shareholder's equity (incl. minority interest), mn USD	484
Minority interest, mn USD	69
Shareholder's equity, mn USD	415
Number of shares, mn units	96
<b>Fair value of common stock at the year end, USD</b>	<b>3.4860</b>
Discount preferred stocks to common stock, %	25.0
<b>Fair value of preferred stock at the year end, USD</b>	<b>2.6145</b>
Upside (downside) of common stock, %	117.9
Upside (downside) of preferred stock, %	143.2

Source: company's data, Estimation: Veles Capital

## Dalsvyaz' fair price history



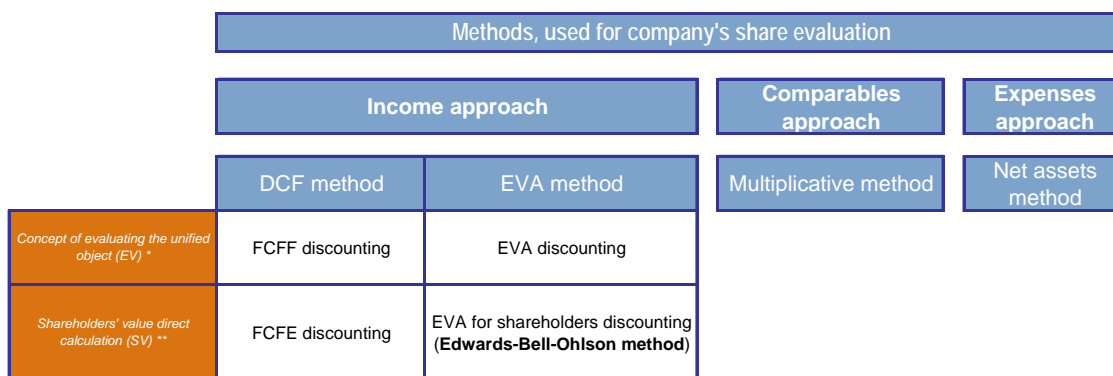
Source: RTS, Estimates: Veles Capital

## Sector coverage

Share	Tiker	Current price, USD	Target for year end, USD	Current growth potential, %	Recommendation	Date of recommendation revision	Investment idea
<b>Traditional telephony</b>							
Volgatelecom, cs	NNSI	1.2500	2.5993	107.9	BUY	4/20/2009	
Volgatelecom, ps	NNSIP	0.9200	1.9495	111.9	BUY	4/20/2009	
Dalsvyaz, cs	ESPK	1.5400	3.4860	126.4	BUY	6/18/2009	
Dalsvyaz, ps	ESPKP	1.0000	2.6145	161.4	BUY	6/18/2009	
NWT, cs	SPTL	0.2920	0.3008	3.0	BUY	4/20/2009	
NWT, ps	SPTLP	0.3350	0.2256	-32.7	HOLD	4/20/2009	Rapidly fall quotes last year intends considerable potential of growth despite of negative moments
Sibirtelecom, cs	ENCO	0.0235	0.0392	66.8	BUY	4/20/2009	
Sibirtelecom, ps	ENCOP	0.0223	0.0294	32.2	BUY	4/20/2009	
Uralsvyazinform, cs	URSI	0.0146	0.0295	102.3	BUY	4/20/2009	
Uralsvyazinform, ps	URSIP	0.0088	0.0221	151.7	BUY	4/20/2009	
Centrtelecom, cs	ESMO	0.2300	0.3083	34.0	BUY	4/20/2009	
Centrtelecom, ps	ESMOP	0.1500	0.2312	54.2	BUY	4/20/2009	
STC, cs	KUBN	0.0335	0.0191	-43.0	REDUCE	4/20/2009	High debt level carries highly risks of investments in this shares
STC, ps	KUBNP	0.0220	0.0143	-34.9	SELL	4/20/2009	
<b>Alternative telephony</b>							
Comstar-UTS	CMST	4.1000	5.6700	38.3	BUY	5/27/2009	Company has all chances to live out crisis with minimum losses
<b>Long-distance communication</b>							
Rostelecom, cs	RTKM	6.3000	3.4406	-45.4	SELL	6/22/2009	An extremely high market price, resulted from buyup of shares, yet unsupported by fundamental factors
Rostelecom, ps	RTKMP	1.5000	2.5805	72.0	BUY	6/22/2009	
<b>Cellular communication</b>							
Vimpelcom	VIMP	11.30	10.59	-6.3	SELL	5/29/2009	High debts cuts up development
MTS	MTSS	5.53	10.29	86.1	BUY	5/25/2009	Fundamental underestimation of shares
<b>Media</b>							
CTC Media	CTCM	10.59	11.06	4.4	BUY	5/8/2009	Rapidly fall quotes last year intends considerable potential of growth

Estimation: Veles Capital

## Brief investor's guide



\*

Debt cost is calculated separately and then subtracted from the sum total cost of business (target EV), formed considering the cash flows/ economic profits of firm.

\*\*

Debt is accounted integrated -via annual coverage. So the fair cost of shareholders' value (target SV) is formed directly - considering the cash flow / economic profits for holders.

Note:

DCF methods differ from the methods of economic profit by the way of investments calculation. The methods of unified object evaluation concept differ from these methods of direct calculation of shareholders' value costs - by the way of accounting cost and maintenance of debt liabilities.

### Cost calculation within the frames of income approach:

	Business cost calculation (EV) within the frames of united object cost evaluation	Shareholders' capital value calculation (SV)
DCF method (FCFF)	$EV = \sum_{i=1}^n \frac{FCFF_i}{(1+WACC_c)^i} + \frac{TV}{(1+WACC_c)^n} + NA$	$SV = EV - D$
DCF method (FCFE)		$SV = \sum_{i=1}^n \frac{FCFE_i}{(1+k_{S_i})^i} + \frac{TV}{(1+k_{S_i})^n} + \text{Cash} + NA$
EVA method	$EV = IC_1 + \sum_{i=1}^n \frac{EVA_i}{(1+WACC_c)^i} + \frac{TV}{(1+WACC_c)^n} + NA$	$SV = EV - D$
EBO method		$SV = BV_1 + \sum_{i=1}^n \frac{SVA_i}{(1+k_{S_i})^i} + \frac{TV}{(1+k_{S_i})^n} + \text{Cash} + NA$

### Signs:

EV	- Enterprise Value
SV	- Shareholders Value
TV	- Terminal Value
Cagr	- development rates within the target period
BV, E	- Balance Value, Equity
EBIT	- operational profit from selling, profit before payments of credit interest and income tax
EBITDA	- operational profit before payment of credit interest, income tax and amortization
EBT	- Earnings Before Tax
EAT	- Earnings After Tax
EPS	- Earnings Per Share
NOPAT	- net operational profit, free from effects of debt financing <b>NOPAT = EBIT * (1 - income tax effective rate)</b>
FCFF	- Free Cash Flow to Firm <b>FCFF = gross cash flow - gross investments</b> <b>Gross cash flow = NOPAT + amortization</b>
FCFE	- Free Cash Flow to Equity <b>FCFE = gross shareholders' cash flow - gross investments</b> <b>Gross shareholders' cash flow = EAT of operational profit (including interest payoffs) - annual debt coverage + attracted borrowed assets + amortization</b>
EVA	- Economic Value Added <b>EVA = economic profit spread * IC = (ROIC - WACC) * IC</b>
SVA	- Shareholders Value Added <b>SVA = spread * E = (ROE - k<sub>s</sub>) * E</b>
WACC	- Weighted Average Cost of Capital
k <sub>s</sub>	- required shareholders' yield
D	- fair (market) cost of net debt
Cash	- cash assets, along with market securities on thee balance
NA	- non-operational assets
IC	- Invested Capital
ROIC	- Return on Invested Capital <b>ROIC = NOPAT / IC</b>
ROE	- Return on Equity
ROA	- Return on Assets

## Information disclosure

### The statement of an analyst and confirmation of the responsibility withdrawal

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The investment recommendations are given based on the evaluation of the company's share yield. The basis for the calculation of the expected company's cost is the evaluation by the discounted cash flows method (DCF). In some estimations the method of comparable coefficients, and also the mixed estimation (by DCF method and by comparable coefficients method) are applied. All recommendations are assigned based on the determined by us the fair cost of the shares within the nearest 12 months.

At the present moment the investment scale of the Investment Company Veles Capital is the following:

**BUY** – corresponds to the growth potential of the shares within the nearest 12 months by 15% or more.

**ACCUMULATE** – corresponds to the growth potential of the shares within the nearest 12 months for 5-15%.

**HOLD** – corresponds to the growth (reduction) potential of the shares within the nearest 12 months from -5% to 5%.

**REDUCE** – corresponds to the reduction potential of the shares within the nearest 12 months from 15% to 5%.

**SELL** – corresponds to the reduction potential of the shares within the nearest 12 months by 15% or more.

In some cases the deviations from the evaluation scale given above, based on which the recommendations are assigned, are possible. That fact relates to the high volatility of some securities in particular, and market in the whole, and also to the individual characteristics of one or another issuer.

In order to get additional information and specifications please contact the Research Department of the Investment Company Veles Capital.

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