Market recovery, but value stagnation

Russian real estate

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Martyn graduated in economics from Cambridge University in 1983 and began his career in commodity and financial futures broking. After four years he moved into equity fund management and enjoyed considerable success with funds at MGM Assurance, Lloyds Investment Managers, and finally Kleinwort Benson which became RCM under the ownership of Allianz of Germany. For 12 years before joining Edison he was focused on company research within the European financial sector with RCM as a senior analyst and director. He has been a non-executive director of Independent Minds Research.

Jonathan Goslin

Jonathan started his career at Russell Investments as a portfolio analyst. After three years, and having completed all of his CFA exams, he left to work at the investment bank Altium Securities as a consumer sector analyst. Jonathan has a first class honour's degree in finance and econometrics from the University of Canterbury (NZ).

Mark Cartlich

Mark joined Baring Securities in 1993 to cover construction and infrastructure across global emerging markets, after graduating in international relations from Cambridge University. After the takeover by ING he covered a range of basic materials sectors across the Latin American and EMEA regions, including steel, pulp and paper, building materials and construction. From 2005 he built up a top-rated real estate team in the EMEA region. During three years at Nomura and Religare he broadened his geographical and sectoral coverage to cover the wider property and infrastructure sectors across global emerging markets.

Roger Leboff

Roger has covered the real estate industry in various capacities since the early 1980s. Over the last few years he has covered the UK's leading real estate companies, niche investors and a number of specialist funds in the UK, Asia, Eastern Europe and India. An initial career in property lending was followed by periods as an investment analyst at Hoare Govett and James Capel, and as a financial journalist.

Matthew Read

Matthew graduated in economics from the University of York in 1995 and, following a period working in the Insurance broking industry, gained his MSc in Finance from Cass Business school in 2000. Matthew's career as a closed end fund analyst began 12 years ago when he then joined Teather & Greenwood, subsequently moving to Hardman and Co. before joining Edison in 2008.

Mark Thomas

Mark started his career with 10 years in NatWest, where his appointments included branch lending, balance sheet management, PA to the group finance director, trading risk and investor relations. This was followed by 12 years as a highly rated stockbroking analyst covering banks and financial institutions in the UK and across Europe. This record combines experience from the inside of how financial companies work, with identifying and communicating what is important to investors.

James Carthew

James started his career with M&G Investments in 1984. He completed the ACCA exams in 1992, the IIMR exams in 1994 and from 1995 to 2000, managed a number of UK equity funds as well as the M&G Fund of Investment Trusts. In 2001 he joined Progressive Asset Management and was responsible for the investment management of a number of funds, including Advance UK Trust, an activist fund of closed-end funds with a global remit. He left Progressive after managing the liquidation of Advance UK in 2010 and established an independent research company, Sapient Research. He is a director of Greenwich Loan Income Fund Limited, a judge on the Investment Trust of the Year Awards and writes a weekly column on investment companies for Citywire.

Sector research

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Companies in this report
AFI Development
MirLand Development
PIK Group
Raven Russia
RGI International

Priced as at 7 September 2012

Russian real estate values have rebounded strongly from the lows in 2009, supported by positive fundamentals; however, quoted real estate valuations are still a fraction of their peaks, which we believe looks too punitive, given financial and operational improvements.

Market recovery looks set to continue

The recovery of Russian real estate from the financial crisis continues, with strong demand, tight supply, falling vacancy levels, rising rental rates, improving prices and falling yields across most segments. With the economy forecast to grow steadily, supported by strong commodity prices, we anticipate continued market recovery, which should improve yields and valuations in the sector further.

Asset recovery not reflected in valuations

While asset valuations for commercial developments are now 65% of their previous heights, quoted stock market valuations are just 8% of the 2006 peaks, leaving sector multiples at a fraction of their former highs. This is a function of a number of factors, including general market weakness, investor risk aversion and mid-cap stocks being out of favour. Corporate governance has historically been viewed as weak by investors, but recently there has been much improvement.

Retail and warehouse are our preferred segments

We believe the most attractive segments of the sector in Russia, especially Moscow, are retail and warehouses, based on the supply and demand dynamics, occupancy levels and improving rental rates. Generally, we prefer companies that have a diversified portfolio, blending residential with commercial, to spread the risk profile. Generally, delivery times are shorter for residential, cash flow is more immediate, reducing the need for external finance and planning regulations are less onerous. The commercial segments can benefit from the long-term cash flows provided by good quality tenants, the ability to finance projects without recourse to the parent, and an institutional market for potential secondary sales.

Raven is our preferred, RGI and MLD also offer upside

Raven Russia has been rewarded for leading the way in its segmentally-focused strategy, cash returns to investors and corporate governance efforts. It thus provides the model for others to emulate if they want to reach the same level of valuation. We still see some upside for Raven, but see more for the likes of RGI International and MirLand Development, which should benefit from project progress and other catalysts. AFI Development (AFID) continues to suffer from uncertainty about some of its Moscow projects but looks relatively undervalued, while PIK looks fairly valued at current levels.

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Investor concerns appear overdone

An improving sector backdrop has translated into a steady improvement in asset values, but this has not yet been reflected in the market valuations of the listed companies, due to risk aversion in respect of the Russian market and the sector in the wake of the European sovereign debt crisis. We believe that investor concerns have been overdone:

- The macro outlook remains positive.
- Each real estate segment is seeing tightening supply, falling vacancies, rising rental rates and falling yields, as investment volumes recover.
- Corporate governance issues have largely been addressed.
- Financing concerns have eased.

This report analyses the macro backdrop and key drivers for each of the main property sectors: commercial, retail, warehouse and residential. We believe the most attractive segments of the sector in Moscow/Russia are retail and warehouses, but generally we prefer companies that have a diversified portfolio, with a mixture of two or more segments to spread the risk profile.

Key recommendations

We would not apply a blanket target multiple to the sector, but from a stock point of view we regard some current valuations as overly cautious. Our preference would be for Raven Russia as a pure play on warehouse, the most attractive segment in the sector, plus MirLand and RGI, as they are mixed developers and both have a major residential project that will drive growth over the next few years.

Exhibit 1: Russian comparative valuations

	Price (local)	Market cap (£m)	FV local	P/NAV (x) 2011	P/NAV (x) 2012e	Yield (%) 2011
AFI Development	$0.39	257	$0.55	0.20	0.22	0.0
MirLand	102p	106	160p	0.50	0.49	0.0
Raven Russia	65.8p	385	73.5p	0.91	0.94	4.5
RGI International	$1.60	157	$2.40	0.55	0.54	0.0
PIK Group	$2.20	692	$2.16	0.84	0.84	0.0
Average/total		1,598		0.59	0.60	

Source: Company data, Edison Investment Research, Bloomberg. Note: AFID, PIK and RGI are quoted in US$.

AFI Development: AFID is the largest of the London-listed developers, with large-scale commercial (office and retail) and residential projects in Moscow and the regions, although its segmental and geographical diversification has not prevented it suffering from project revisions and impairments

MirLand: Diversified exposure to office, retail and residential in Moscow and the regions.

PIK Group: One of the largest residential developers in Russia, with a huge portfolio and strong national brand, but still rebuilding its balance sheet after the financial crisis.

Raven Russia: A pure play on our preferred property segment and the quality stock in the sector.

RGI International: Niche residential and retail developer, now shifting towards the mid-market segment from its previous focus on high-end projects.

Investment thesis: Asset recovery not yet in valuations

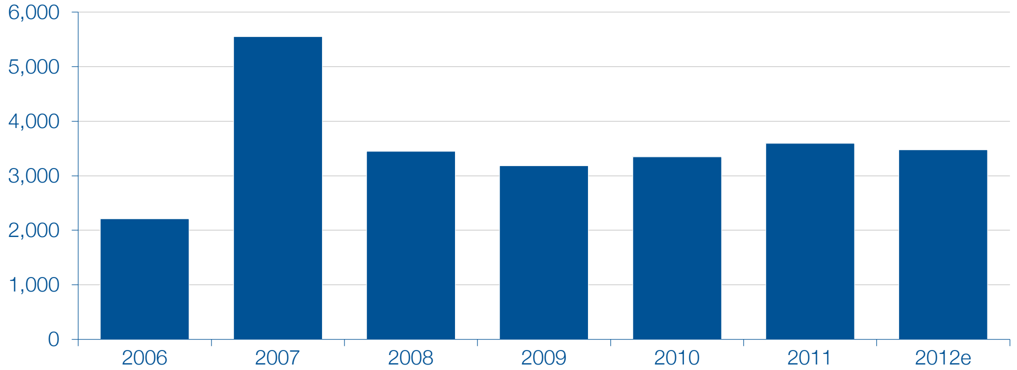
Sector recovery increasingly evident

The Russian real estate sector has seen a significant and widespread rebound from the crisis induced lows of 2009. This is true to varying degrees across all market segments. From office to retail, industrial and residential, the overriding picture is of strong demand, tightening supply, falling vacancies, rising rents and/or prices and falling investment yields. This theme is most evident in Moscow, the dominant market, but is also becoming as true in other regional markets, including St Petersburg.

This has been reflected in rising asset values…

The improving sector backdrop has been translated into consistent improvement in asset values since 2009, as prices have risen and yields have fallen. Since the low of US$3.2bn in 2009, the aggregate NAV for the four main commercial developers has rebounded by 13% and is back to 65% of its 2007 peak level. This is a recovery that we expect to continue for the foreseeable future, as the strength of the market feeds through into appraisal values.

Exhibit 2: Aggregate sector NAV (US$m)

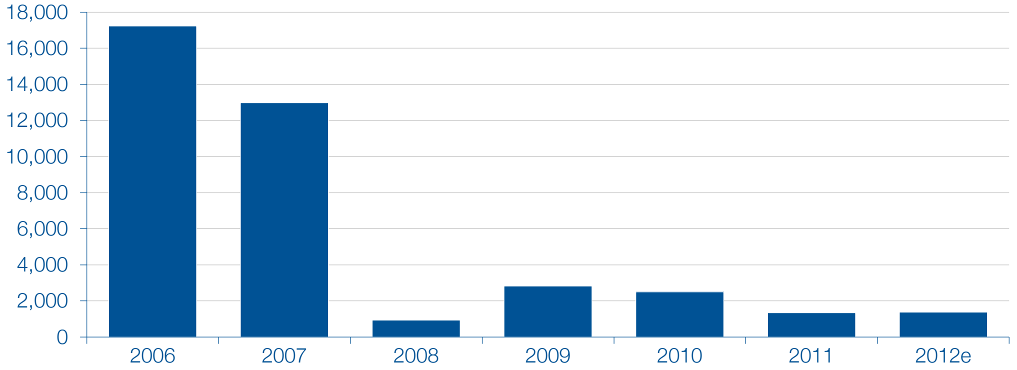


Source: Company data, Edison Investment Research

…but not yet in market valuations

However, this has not yet been reflected in the market valuations of the listed companies. The main four commercial developers are currently valued at just 8% of their peak 2006 market capitalisation, even though share prices have bounced approximately 40% from the 2008 lows. There was a significant rebound during 2009 for most developers, but this faltered in 2010-11 and market valuations have since more than halved again, in spite of the continued improvement in asset values, as investors have become more risk averse about the Russian market and the sector, in the wake of the European sovereign debt crisis.

Exhibit 3: Aggregate market valuation (US$m)

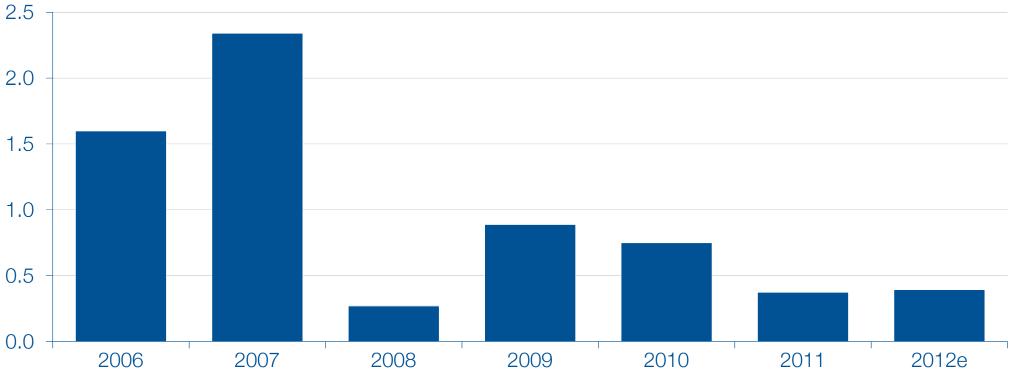


Source: Bloomberg

This is evident from the market multiples

With asset values picking up and market valuations slumping recently, market multiples have dropped sharply, from more than 2x NAV in 2007 and c 0.9x NAV at the close of 2009, to 0.38x at year end 2011 and slightly lower again currently. This is a reflection of investors' risk perceptions, which have deteriorated since the hope of improving economic conditions induced a market recovery in 2009. While we would not expect market multiples to return to the inflated levels of over 2x NAV that we saw in 2007, P/NAVs of lower than 0.2x in one case are clearly sending a message that investors are not comfortable with the risks of the sector.

Exhibit 4: Sector P/NAV (x)



Source: Bloomberg, company data

We believe that investor concerns have been overdone. The macro outlook remains positive, corporate governance issues have largely been addressed and financing concerns have eased. We would not apply a blanket target multiple to the sector, but from a stock point of view we regard some current valuations as overly cautious.

Macro outlook remains positive

The macro outlook suggests that the asset recovery in the sector should continue. Oil and metals prices recovered very strongly from the lows of 2008-9, which has enabled the Russian economy to rebound sharply in 2010 and 2011. Steady c 4% growth is expected to continue for the next few years according to consensus forecasts, given the continued strength of commodity prices and improving domestic fundamentals, including falling inflation and unemployment.

In this context we believe the most attractive segments of the sector in Moscow/Russia are retail and warehouses, given the supply and demand dynamics, occupancy levels and improving rental rates. Generally, we prefer companies that have a diversified portfolio, with a mixture of two or more segments to spread the risk profile.

Corporate governance issues have largely been addressed

Good corporate governance is largely an issue of perception and it is difficult to link share price performance directly to good practice. Nevertheless, we have tried to compile a checklist of investors' requirements and useful indicators in Exhibit 5. For example, it is generally better received to be listed on the Main board of the LSE than on AIM. A larger free float and smaller stake held by a controlling shareholder would often imply more protection for minority shareholders and compliance with the UK Combined Code of corporate governance, and having a majority of independent directors and all the requisite committees in place would normally be regarded as positives. In most cases, the main corporate governance issues have been addressed by the companies featured in this report, but in some cases they may still be hindered by having a dominant controlling shareholder, or a less favourable listing.

Exhibit 5: Corporate governance checklist

	AFID	MirLand	PIK	Raven	RGI
Listing	GDR (A)	AIM	GDR	LSE	AIM
	LSE Premium (B)				
Free float	36%	19%	62%	92%	60%
Controlling shareholder	64%	81%	38%	8%	40%
Disclosure of shareholdings	3%	3%	N/A	3%	3%
UK Combined Code	Compliant	Compliant	Compliant	Compliant	Compliant
UK Takeover Code	?	No	No	Yes	No
Independent directors	5/8	5/9	3/9	4/8	6/11
Audit committee	Yes	Yes	Yes	Yes	Yes
Remuneration committee	Yes	Yes	Yes	Yes	Yes
Nominations committee	Yes	Yes	N/A	Yes	Yes
Dedicated IR executive	Yes	No	Yes	Yes	Yes
Country of registration	Cyprus	Cyprus	Cyprus	Guernsey	Guernsey

Source: Company data

Financing concerns have eased

While it would be an exaggeration to say that financing is straightforward in Russia, there is no doubt the backdrop has improved significantly from 2008-9. There are a number of large state-owned lenders, such as Sberbank and VTB, who have substantial lending capacity and have been increasing their loan books recently. Commercial property, especially investment-grade space in Moscow or St Petersburg, which is rented out to top-quality tenants, is generally regarded as attractive collateral for the banks. Land sites are generally acquired with equity and residential development tends to be financed via pre-sales, so it is commercial construction financing that is the most challenging, but even then financing does not tend to be the brake on a project that could take at least two years to achieve all the required approvals and be ready to break ground.

Exhibit 6: Debt structure

2011 data	AFID (US$m)	MLD (US$m)	PIK (US$m)	Raven (US$m)	RGI (US$m)
ST debt	99	132	607	96	57
LT debt	528	218	857	466	0
Pref stock				218	
Total debt	**627**	**351**	**1,465**	**779**	**57**
Cash	85	34	89	182	41
Net debt	**542**	**317**	**1,375**	**598**	**16**
Net gearing	29%	91%	N/A	89%	4%
LTV	**23%**	**52%**	**55%**	**63%**	**10%**
Average debt cost	9%	6%	12%	7%	10%
EBITDA cover	0.4	0.3	0.9	1.0	(22.0)
Main lenders	VTB/Sber	Sber/EBRD	Sber/Nomos	Unicredit/IFC	Sberbank

Source: Company data

Generally, the companies in this report are not particularly highly geared. The average net debt/equity ratio is 85%, which may sound high, but the average LTV (loan-to-value) – the more useful ratio, especially for commercial developers, is 44%. The only exception is PIK, which not only has net debt of US$1.38bn but also had its equity base wiped out during the crisis, so the gearing ratio is meaningless. However, even PIK's average LTV is 55%, which is not the highest in the sample. More importantly perhaps, the average debt costs have fallen significantly, to below 10% on average (for all but PIK) and should be covered by EBITDA on average this year.

The market rewards focus and yield

Two factors that appear to have an observable impact on valuations are a clearly-articulated business model, with exposure to a particular segment of the market, and a clear intention to return cash to shareholders. Raven Russia, for example, has been rewarded for its single-minded focus on the warehouse segment, dividend pay-out and good corporate governance record, with a premium rating. While the warehouse segment is perhaps the most attractive within the sector, we believe it is the combination of this and the visibility of returns from the stock's yield that has produced the premium rating.

Combining business models not being rewarded

In the past, company valuations benefited from developing a range of flagship projects and producing high-development margins. The market preference now seems to have shifted towards maximising the return from existing assets and focusing on a core segment. Raven Russia has focused on letting out its existing space, adding capacity through bolt-on acquisitions at attractive valuations and only developing new schemes where it has clear tenant demand.

Exhibit 7: Companies' sector exposure

	AFI	MirLand	PIK	Raven	RGI
Office	\	\			
Hotel	\				
Residential	\	\	\		\
Retail	\	\			\
Warehouse				\	

Source: Company data

Most of the other companies do not have this luxury, so continue to develop a number of large projects. Only two of the companies, Raven and PIK, are specialists. All the others are multi-segment, using the up-front cash flows, faster paybacks and easier financing of their residential projects to offset the longer-term development risks of their commercial portfolios. This strategy has not been rewarded by the market, as evidenced by the relative valuation disparity between Raven and its peers (see Exhibit 1 on page 2).

Valuations appear to compensate for the risks

We would not be comfortable applying a blanket target multiple to the sector, but from a stock point of view we would regard some current valuations as excessively cautious. Nobody expects former inflated multiples to be repeated any time soon, but by the same token there seems little reason for excessive discounts to become the 'new normal'.

For AFID to trade at less than 0.2x NAV for this year, while its peers, which have similar levels of risk, trade on ratings of at least double, seems to penalise the stock unduly, despite the recent profit warning. Raven trades on a discount to NAV of just 6% for this year, but deserves its premium rating in our view. With its steady dividend yield of 5%, we see further upside to our fair value.

MirLand and RGI have significant discounts to NAV (51% and 46% respectively for 2012e), which may well be justified, but we do see some upside for both from current levels, as project progress assists the former and the resolution of the shareholder dispute with Synergy benefits the latter. As a pure residential developer, we value PIK differently from the rest of the sector (we look at the group's profit per m^2 rather than NAV), but we do not see any upside from current valuations.

Exhibit 8: Russian comparative valuations

	Price (local)	Mkt cap (£m)	FV (local)	P/NAV (x) 2011	P/NAV (x) 2012e	Yield (%) 2011
AFI Development	$0.39	257	$0.55	0.20	0.22	0.0
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Average/total		**1,598**		**0.59**	**0.60**	

Source: Company data, Edison Investment Research, Bloomberg. Note: AFID, PIK and RGI are quoted in US$.

Economic and political risks

The sector is exposed to a number of economic and political risks, on top of the country risks in relation to the macro backdrop and its effect on the supply and demand of real estate. The availability and affordability of financing is a key risk, which, as discussed above, we believe is largely mitigated by the companies in this report. We believe the political process remains stable, despite the developing protest movement recently. However, political interference by local government is another risk, because of the need for planning and permitting approvals, which has had an impact on Moscow-based developers after the change of mayor last year.

Foreign exchange movements usually offset by valuation changes

As far as currency is concerned, the companies tend to match their assets and income to their liabilities, so PIK has 90% of its debt in RUB, whereas Raven has all its debt in US$ to match its rental income. Given that their currency of operation is RUB and they all report in US$, they are prone to foreign exchange gains and losses from movements in asset valuation, which are at least partially offset by the valuation movement on the balance sheet.

Industry analysis: Continued recovery?

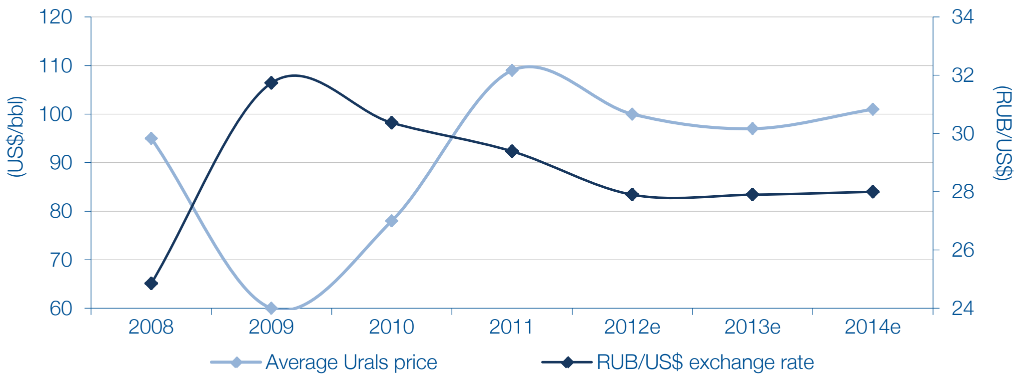
There is a clear theme dominating the Russian real estate sector: strong demand and tight supply producing higher rents across all segments. The commercial office segment still has further recovery to come, especially in rentals, as vacancies fall further. Retail space is expected to be so tight in Moscow that rentals are likely to be squeezed further, as developers focus more on the regions, where the regulations are less onerous. Warehouse rents may not rise that much more, especially as development of new space increases, but yields look set to fall further. With residential demand recovering even more quickly than for commercial schemes and pricing back to pre-crisis levels, the attractions for developers are clear.

The recovery in real estate asset values so far looks to be justified and more is likely, as yields continue to compress, especially in the warehouse segment. At some point, this should be reflected in share prices, when investors are more convinced of the validity of the companies' strategies.

Macro forecasts: Steady growth expected

As Russia is a resource-based economy, it tends to grow strongly when commodity prices are high. Oil and metals prices have recovered very strongly from the lows of 2008-9, which, together with the problems in the banking sector, brought about the crisis in Russia. This enabled the economy to rebound sharply in 2010 and show consistent GDP growth subsequently. This steady c 4% growth is expected (by Rosstat and market forecasts) to be maintained for the next few years, given the continued strength of commodity prices and improving domestic fundamentals, including falling inflation and unemployment. Russian economic performance is so tightly correlated to the oil price that the strength of the Ruble over the past three years closely tracks the recovery of the Urals oil price, as the inverse correlation in Exhibit 9 shows. The Ruble's recent appreciation (a downward move in the chart) suggests continuing strength in the economy.

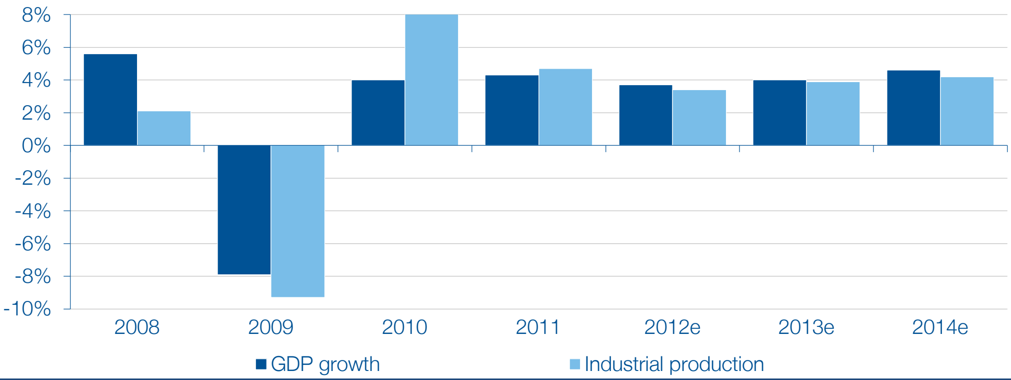
Exhibit 9: Correlation of oil price and exchange rate



Source: Bloomberg

With the oil price at approximately US$110/bbl, the government is generating revenues in excess of its budget estimate, which explains why GDP forecasts of c 4% have not been revised down for 2012-14, despite the weakness in the EU and the slower growth in industrial production since the 2010 recovery. This growth has continued into 2012, with GDP and industrial production growing 4.1% and 5% respectively in Q112. This was in part due to the extreme cold in the first few months of the year, which produced significant demand for energy resources and was the main driver of industrial production growth.

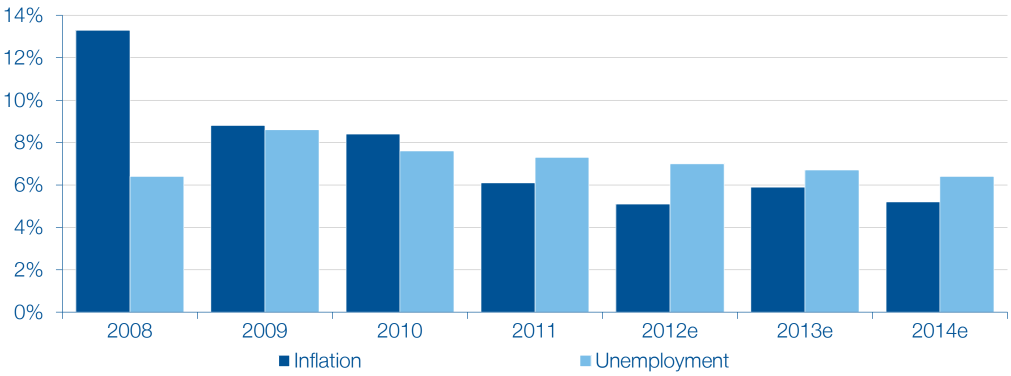
Exhibit 10: Macro forecasts



Source: Rosstat, Ministry for Economic Development

One macro indicator that had not seen much improvement until recently is inflation, mainly owing to weather-related factors. Nevertheless, it has been falling consistently since 2009 and was just 1.5% y-o-y in Q112, although this was partly distorted by delayed increases in utility prices. The forecast is for inflation to fall to 5% in 2012 and to settle in the 5-6% range in 2012-14. As a result, the refinancing rate has fallen from 13% at the end of 2008 to about 6% in the past year, while debt markets have become more accessible, mainly due to the activity of the leading local banks. Unemployment is also expected to continue its downward trajectory in the wake of the growth in GDP, falling to 7% in 2012 and below in 2013-14. All of which is positive for both demand and funding across all segments of the property sector.

Exhibit 11: Inflation and unemployment

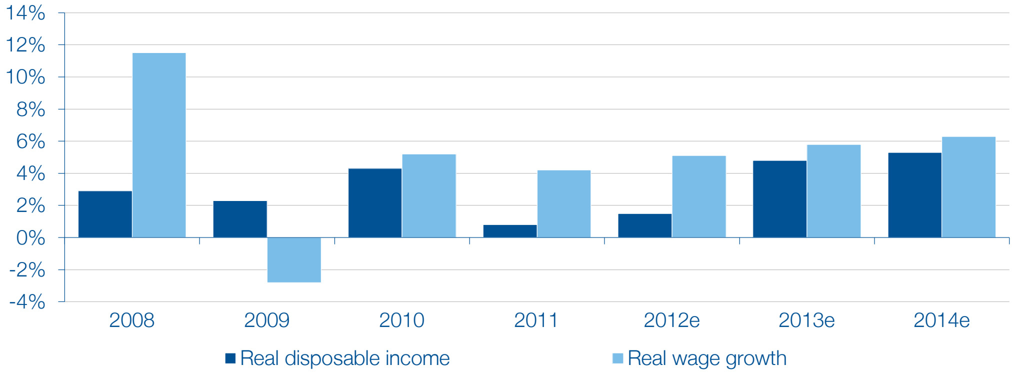


Source: Rosstat, Ministry for Economic Development

Falling inflation and unemployment, combined with growing consumer lending, rising wage growth and disposable income has fed through into growth in consumer spending. Real wages increased by nearly 12% in January and February 2012 and disposable income grew by close to 3%. As a result of this, and a preference for spending over saving among Russian citizens, retail trade turnover grew by 7.3% in the first two months of 2012, after a more than 5% rise in 2011.

With growth of 5-6% in real wages forecast in 2012-14 and c 5% in disposable income in 2013-14, the retail sector is expected to continue its recent strong performance, which should help to sustain investment in retail real estate.

Exhibit 12: Real wage and disposable income growth



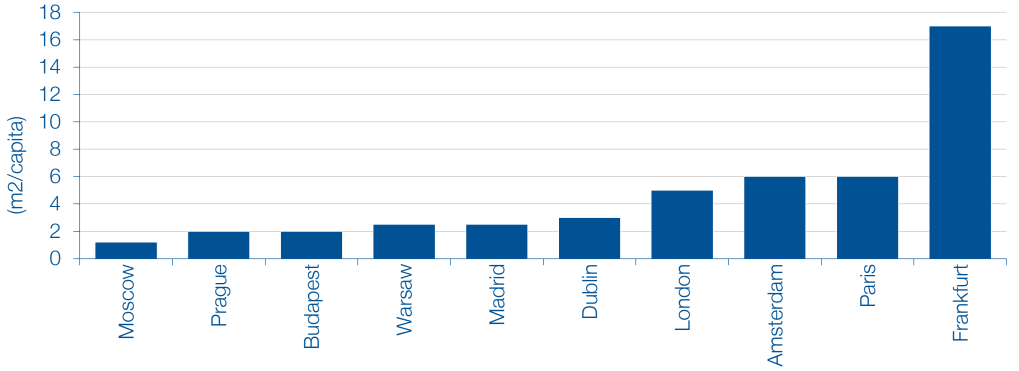
Source: Rosstat, Ministry for Economic Development

Commercial segment: Falling vacancies to boost rental rates

Commercial supply remains limited, especially in the wake of tighter planning restrictions brought in by the new Mayor of Moscow in the last year, and demand has recovered well to drive down vacancy levels, but this has not yet been fully reflected in office rental rates and investment volumes, despite a fall in initial yields.

Moscow has among the lowest level of office stock per capita relative to other European capitals, with just 1.2m^2 per head, compared with 5m^2 in London, 6m^2 in Paris and as high as 17m^2 in Frankfurt (see Exhibit 13 below).

Exhibit 13: Office stock per capita (m^2)



Source: JLL

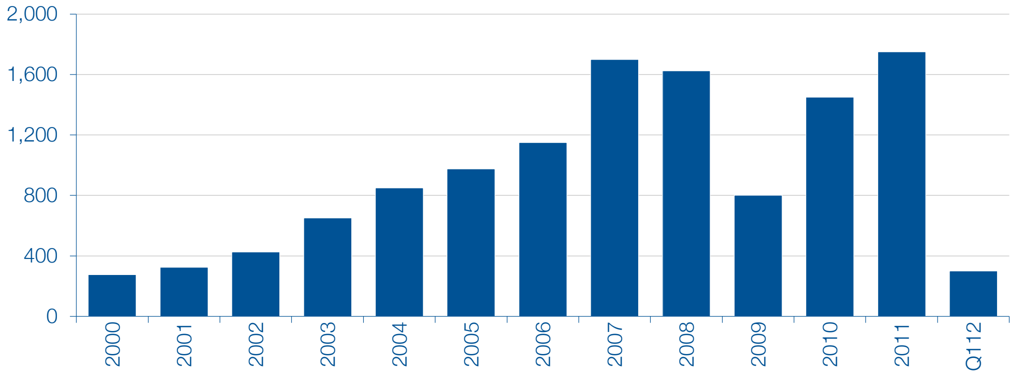
Total office stock in Moscow is approximately 12.3m m^2, with another 350,000m^2 expected to be delivered this year, taking the total to 12.65m m^2. The trend of new delivery has been downward, with Cushman & Wakefield (C&W) estimating that 600,000m^2 was completed in 2011, compared with 914,000m^2 during 2010. A class property (the highest-quality investment grade space) represents only about 22% of the total stock, and much of this is not centrally located. Despite new restrictions brought in by the new mayor on large-scale commercial projects, especially in the central administrative district, there is still a pipeline of almost 2.2m m^2 of new space for delivery over the next three years, but in reality this is likely to be delivered over a longer timescale.

Exhibit 14: Moscow office stock (million m2)

Source: C&W, MirLand

The improvement in the macroeconomic backdrop has led to a marked recovery in business confidence and hence the demand for commercial space. After halving in 2009, demand rebounded sharply in 2010 to nearly 1.5m m^2. Jones Lang LaSalle (JLL) estimates there was a further improvement in 2011 to 1.75m m^2, with only 0.6m m^2 added to supply last year. In Q112, office take-up reached 300,000m^2. Although this was less than 20% of total demand in 2011, Q1 is generally the quietest quarter seasonally, suggesting the year has started well.

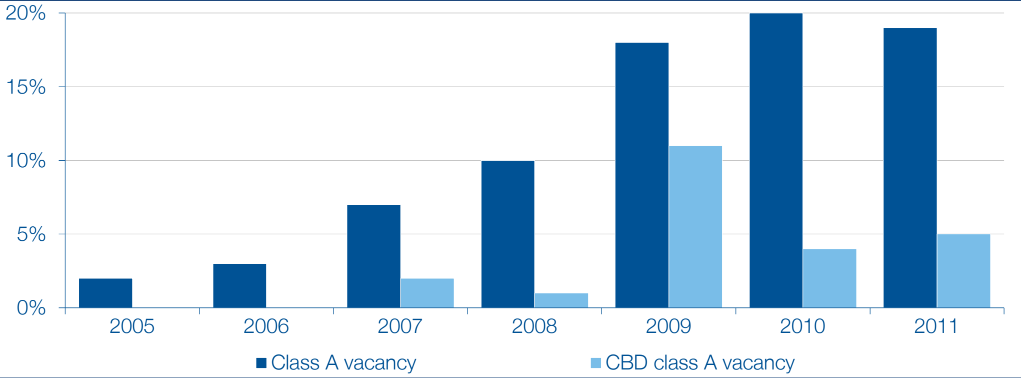
Exhibit 15: Moscow office take-up (000's m^2)



Source: Jones Lang LaSalle

With demand almost back to the peak levels of 2007-8, the average vacancy rate for Class A space overall has only fallen slightly from over 20% at the start of last year to 18% by year end, owing to the amount of supply under construction when the crisis struck. However, the rate for Class A space in the central business district fell to just 5% in 2011 from 11% in 2009. While this is still above the lows of 2005-8, it underlines the added attraction of the best quality space in the centre of the capital.

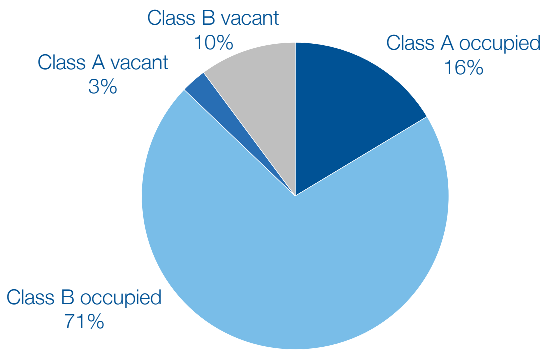
Exhibit 16: Moscow office vacancy



Source: JLL, AFID, C&W

According to Cushman & Wakefield, there is only 0.4m m^2 of the 2.8m^2 of A class space currently vacant, so if total market demand in 2012 reaches the same level as last year (1.75m m^2) and only 0.35m m^2 of new A class space is added, then vacancy rates should fall quickly and a shortage could even emerge in the next year. Even the total vacant space of 1.86m m^2 would be significantly reduced if demand reached the same level as last year, given the lack of new supply expected this year.

Exhibit 17: Moscow office supply split (million m^2) 2012e



Source: MirLand, C&W

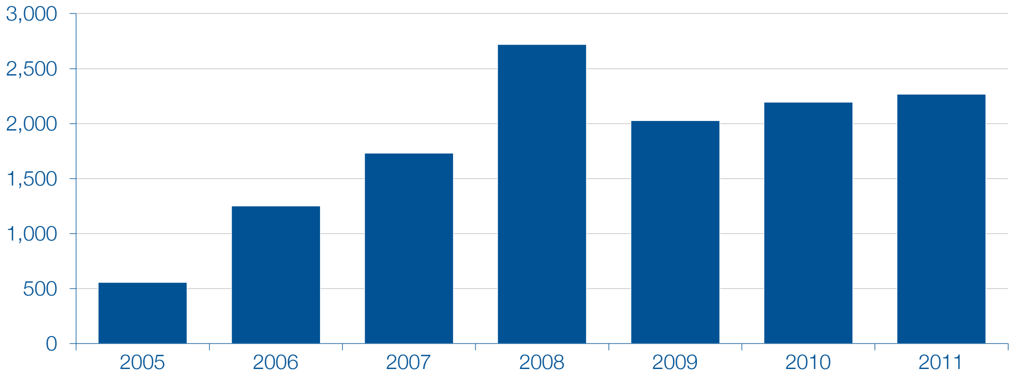
After slumping sharply in 2009, A Class rental rates have recovered well, rising 11% in 2010 and another 10% in 2011. Although rents are still only just over half the former peak, they rose as much in Q1 as most forecasters were expecting for the whole year. With prime rents in the Central Business District now back at US$1,000/$m^2$ per year, excluding operating expenses and VAT, the spread over the average rates for A class properties has narrowed to US$200/$m^2$. Class B rental rates have recovered much less, because demand is lower and vacancy levels are higher.

Exhibit 18: Moscow office rental rates (US$/$m^2$ per year)

Source: JLL, C&W, AFID

After peaking at 13% in 2009, prime yields for commercial buildings are currently as low as 9%, having fallen by a further 200bps during 2011. This decline is a direct consequence of the recovery in investment volumes over the past two years; from a trough of US$2bn in 2009, secondary market investment picked up to just under US$2.3bn last year.

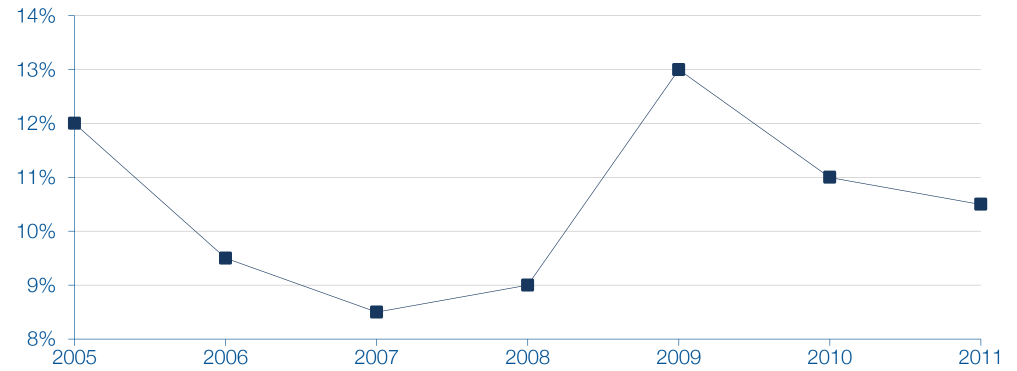
Exhibit 19: Moscow office transaction volumes (000's m^2)



Source: JLL, C&W, AFID

Therefore, although supply remains tight and demand has recovered well to drive down vacancy levels for the best-quality space, this has not been fully reflected in rental rates, which have further room to improve. Nevertheless, yields have still fallen as investment volumes have recovered.

Exhibit 20: Moscow prime office yields



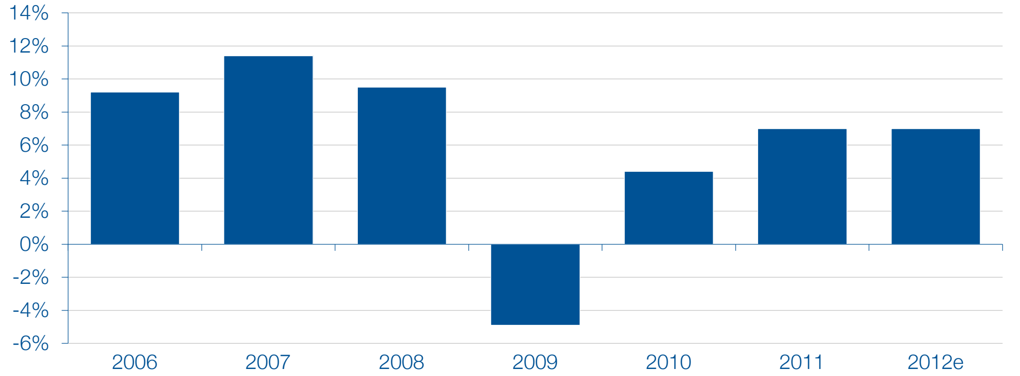
Source: JLL, AFID, C&W

Retail segment: Expanding consumption

With continued growth in retail turnover attracting more international and domestic retailers to expand their presence in the country, pressure on retail space should continue. Rental rates are thus likely to be squeezed higher, owing to a lack of new supply to meet the demand, especially in Moscow. Current development activity is focused more on the regions, where planning requirements are less onerous than in Moscow. Yields in Moscow may therefore fall further as investment volumes recover.

The Russian retail market is now the largest in Europe, with US$468bn of retail sales in 2011, compared with US$410bn in France and US$408bn in Germany. As an indication of the improving consumer demand and confidence in the Russia economy, Russian retail turnover increased by 4.4% in 2010 and 7% in 2011, after a fall of 5% in 2009. Rosstat expects that recovery to continue, with growth of 7% in 2012.

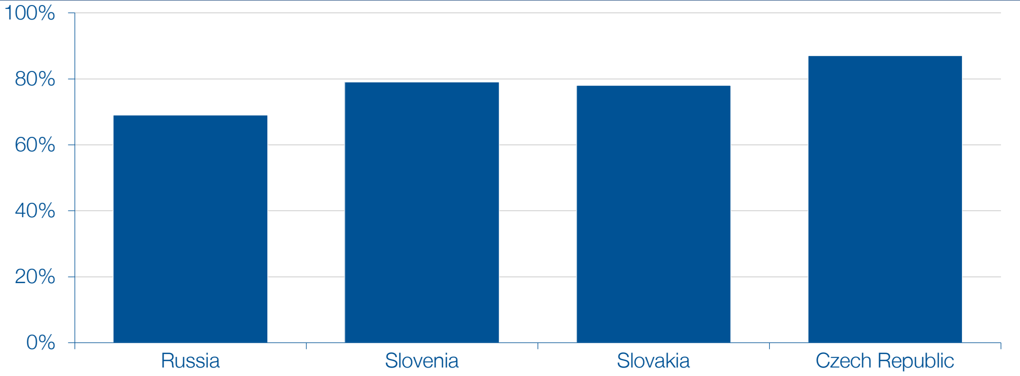
Exhibit 21: Retail turnover growth



Source: C&W, Rosstat

JLL estimates that 69% of households in Russia are now regarded as middle class, by having an annual income of over US$15,000 per year, which is the fourth highest in the CEE/CIS region (only lower than the Czech Republic, Slovakia and Slovenia). Indeed, over 50% of households in Moscow are now earning over US$30,000 a year and in St Petersburg the figure is just under 40%. In addition, Moscow residents are estimated to spend 77% of their incomes on consumption, partly due to low residential costs, but also reflecting a low savings rate and the rapid growth of consumer financing.

Exhibit 22: CEE middle class (households with annual income of over US$15,000)

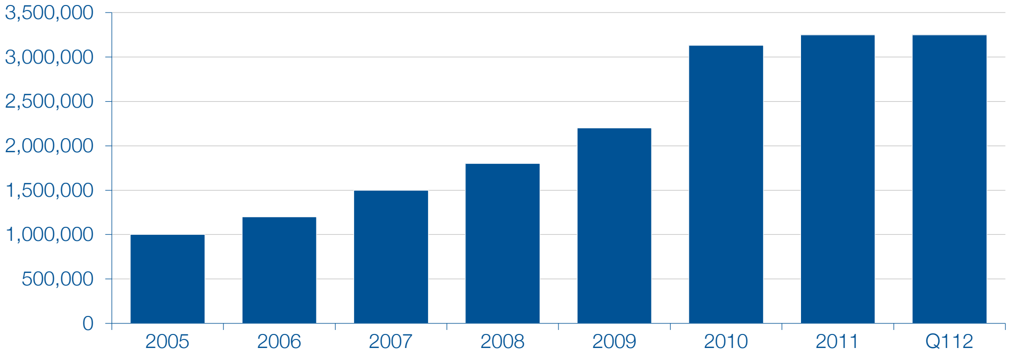


Source: JLL

Retail supply

There is currently 10.4m m^2 of shopping centre space nationally, with a project pipeline of 3m m^2, although just 0.12m m^2 of new supply was added in Moscow in 2011. New construction in the capital has become increasingly difficult under new guidelines introduced by the mayor in the past year, which require more focus on parking, forcing developers to revise their concepts and decrease the intensity of the retail component, which has further reduced the retail vacancy rate.

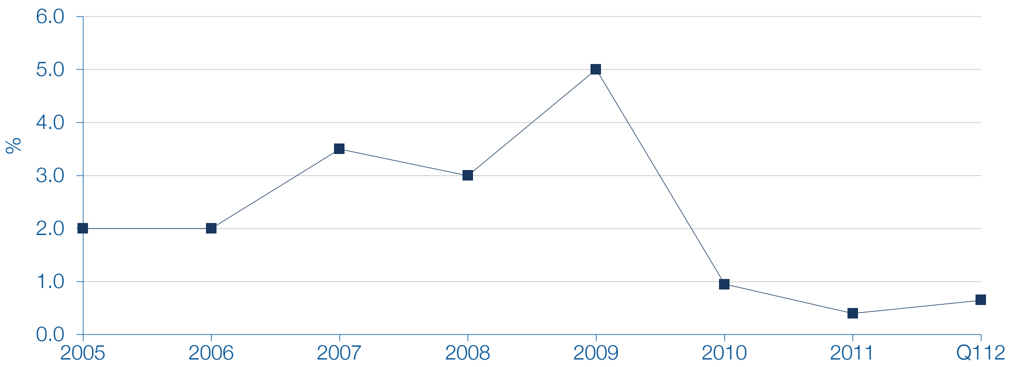
Exhibit 23: Moscow retail supply (m^2)



Source: JLL, AFID, C&W

Virtually no new construction has been started in the last two years and some projects have even been cancelled, leaving a Moscow pipeline of just 468,000m^2. This has also encouraged developers to focus on St Petersburg and the other regions. As a result, the vacancy rate in Moscow has been below 1% for the past year. In other Russian cities, 27 new quality shopping centres were completed in 2010 and their vacancy rates improved from 15-20% on opening to 5-10% last year, proving that the strength of demand for space extends beyond Moscow and St Petersburg.

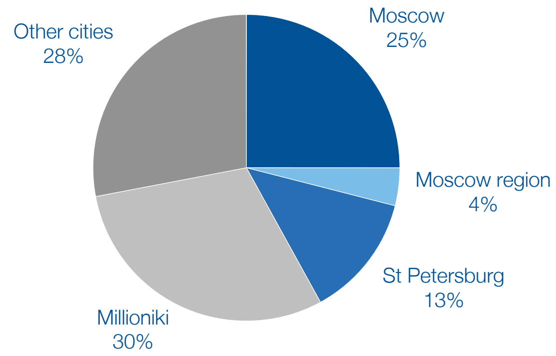
Exhibit 24: Moscow retail vacancy rate (%)



Source: JLL, AFID, C&W

Prime retail centres are more widely spread across Russia than prime office as Exhibit 25 illustrates. Only 42% of total shopping centre space is located in the Moscow and St Petersburg areas, with 30% in the Millioniki cities (those with over 1m people) and 28% elsewhere. Demand for space is driven by both local and international retailers. There are reports that companies such as Hamleys, Juicy Couture, GNC, Banana Republic, American Eagle and Victoria's Secret are planning to open stores in Russia. Others, including Jimmy Choo and Jaeger, are expanding their franchise relationships through local partnerships. Other established players like Stockmann, Stefanel and Mango are planning to extend their networks, as well as local electronics stores such as M.Video and Technosila, hypermarkets such as Auchan and grocers such as X5 and Dixy.

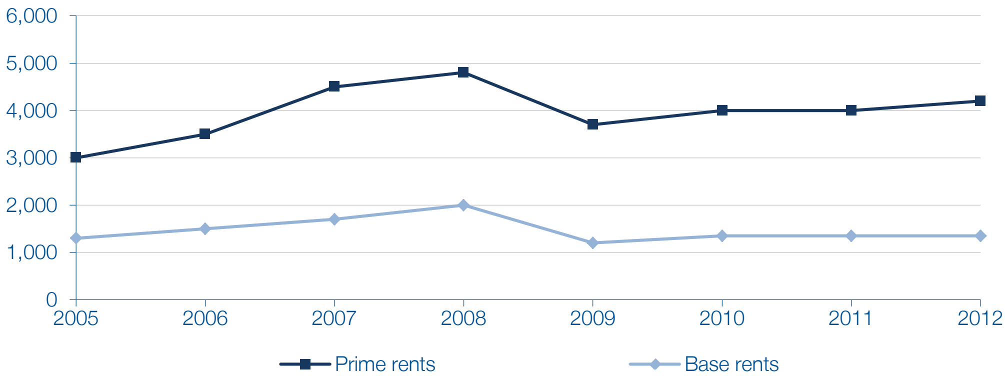
Exhibit 25: Shopping centre distribution



Source: JLL

Retail rents proved more resilient than the commercial segment in the 2008/9 downturn and so have rebounded less over the past two years. Nevertheless, Moscow rental rates rose by 10-15% in 2010, were flat in 2011 and have increased by another 5% in Q112, in line with market forecasts for a 6-7% rise for the full year. Despite already being among the highest in Europe, this increase results from tight supply and continued strong demand. Rental rates are now 12.5% off the 2008 peak, with prime rates of US$2,700-4,000/$m^2$ and average rates of US$500-1,350/$m^2$.

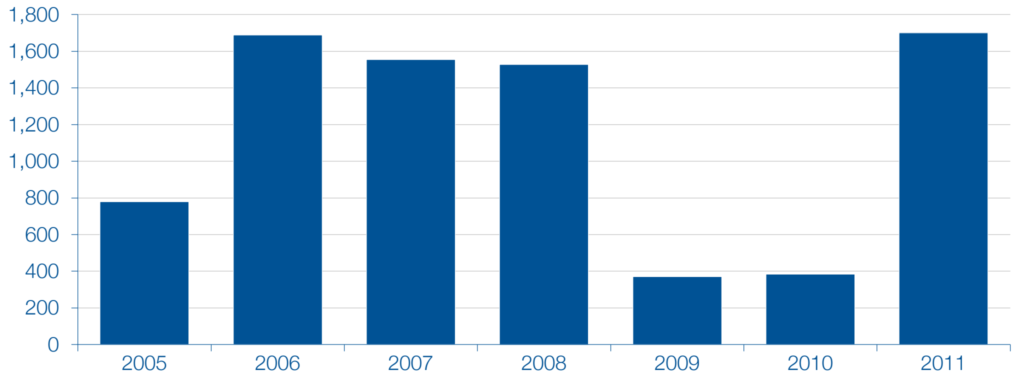
Exhibit 26: Moscow retail rates (US$/$m^2$ per year)



Source: JLL, AFID, C&W

The level of secondary transactions in the retail segment in Moscow collapsed from US$1.5bn in 2008 to just US$370-380m in 2009-10 and even zero in Q111. However, for the full year 2011 there was a startling recovery to US$1.7bn, as investors responded to the pick-up in the market and once again began to appreciate the apparently attractive long-term fundamentals.

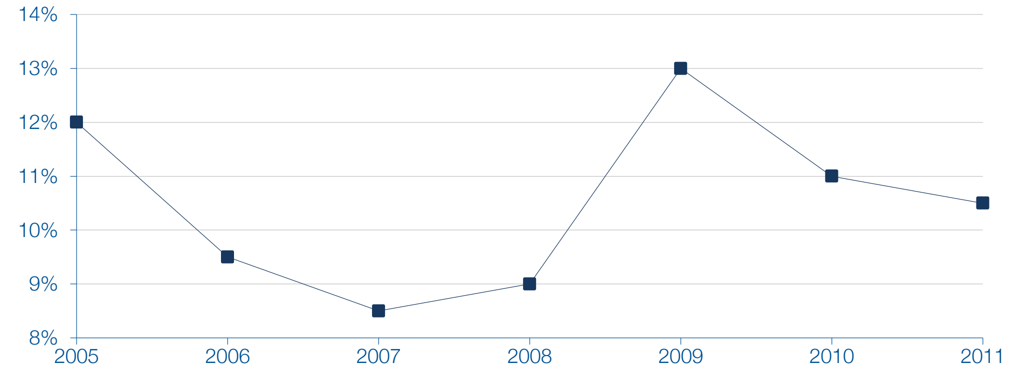
Exhibit 27: Secondary investment in retail assets (US$m)



Source: JLL, AFID, C&W

It is, therefore, less clear what drove the yield compression in 2010 to 11%, given the lack of transactions, but the lack of space available for sale and a few one-off deals are likely to have driven up sales values. Market yields have since declined to 10.5% and look likely to fall further if the level of transactions is maintained this year.

Exhibit 28: Retail prime yields



Source: JLL, AFID, C&W

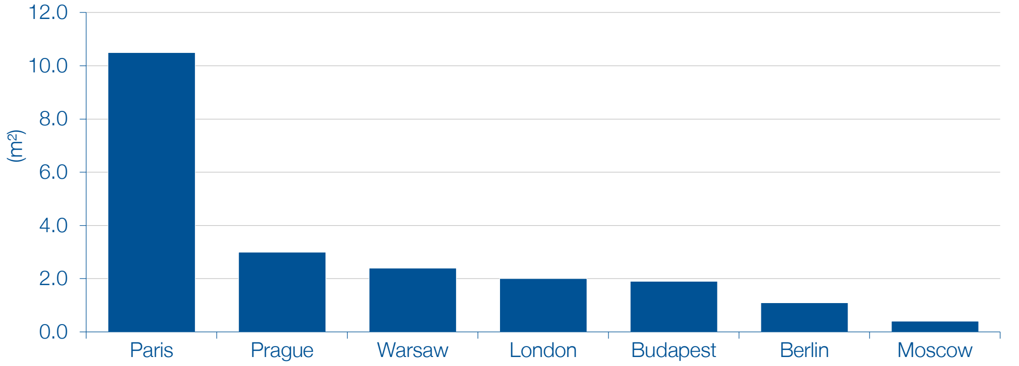
We conclude that regional shopping centres will continue to be a priority for developers and that new supply in Moscow is likely to remain limited, partly due to tight planning restrictions. Even if all the currently planned projects in Moscow are completed this year, supply would only reach 294m^2 per 1,000 inhabitants, up from 276m^2 currently, still lower than many other smaller Russian cities. This is likely to maintain pressure on vacancy levels and drive up rental rates in the 2013-14 period.

Warehouse segment: Back to peak levels already

Further recovery in warehouse rental rates looks likely, with vacancy rates already so low in Moscow, a lack of new construction and the strength of demand. This should result in a further fall in yields, but for these to reach the former lows, a recovery in investment volumes may well be required. There are currently too few transactions available to establish a meaningful market level.

Russia's lack of supply in the industrial segment is startling. In the capital city there is currently 7m m^2 of A and B class warehouse space, but Moscow still has among the lowest level of modern warehouse space per capita in Europe, as Exhibit 29 shows.

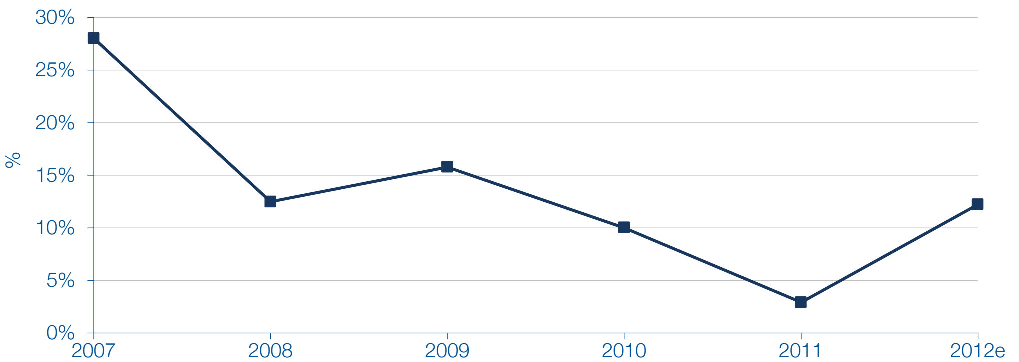
Exhibit 29: Modern warehouse stock per capita (m^2)



Source: Raven Russia

New supply fell to just over 400,000m^2 in 2010 and dropped to just 150,000m^2 in 2011, 76,000m^2 of which was delivered in Q111. New construction volumes have fallen so much that a shortage of supply of high-quality warehouse space that is ready for tenants to occupy, is expected this year. The majority of the current stock was built speculatively, as the level of vacancy meant that pre-lets were relatively rare, but now that it has fallen developers are expecting a growing demand for pre-lets and projects that are built to suit.

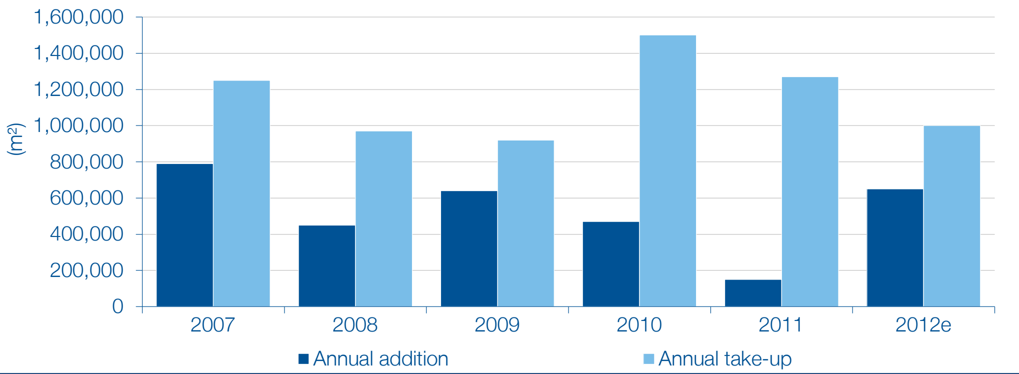
Exhibit 30: Annual change in A class supply



Source: Colliers, Raven Russia

Although supply additions are expected to pick up this year to over 600,000m^2, take up is forecast to reach 1m m^2 and will therefore exceed new supply by over 300,000m^2, so the market situation is anticipated to become even tighter. Tenant demand is still dominated by retail and distribution companies, but the share of manufacturing tenants has also increased recently.

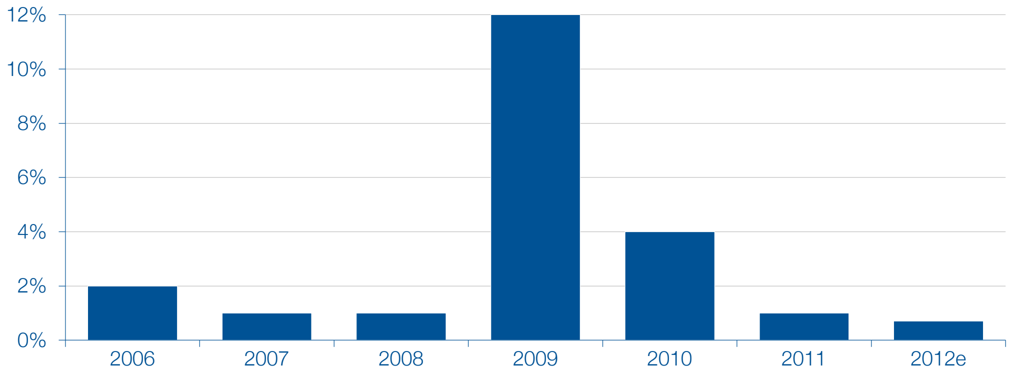
Exhibit 31: Warehouse supply and demand (m^2)



Source: Colliers, Raven Russia

In the year 2009-10 alone, the Moscow vacancy rate fell from 18% to 7% on the back of strong demand and modest construction volumes. Indeed, after a record quarter in Q410, with take-up of 0.5m m^2, demand remained high going into 2011. As a result, the vacancy rate fell further to 3.7% in Q111 and as demand continues to improve, the remaining net space is expected to be absorbed in 2012.

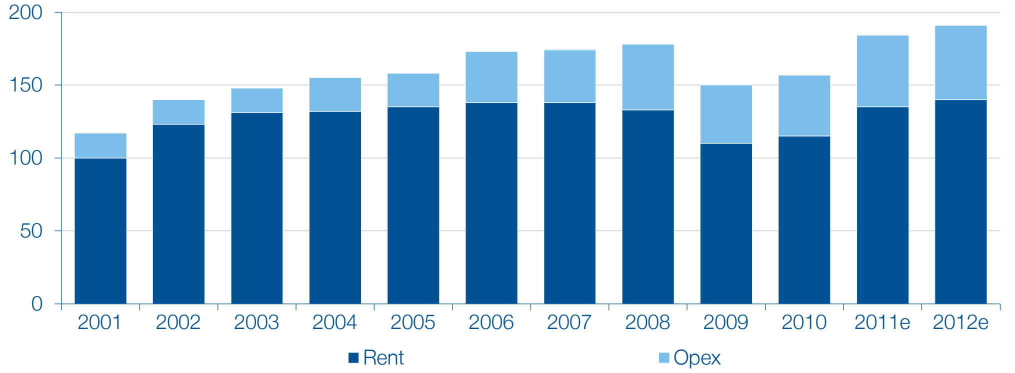
Exhibit 32: Moscow class A vacancy rate



Source: Colliers, Raven Russia

Rental rates for Class A space suffered from oversupply and lower occupancy rates in 2009, but recovered in 2010-11 to approximately US$125-135/$m^2$/year, plus operating expenses of c US$40/$m^2$. Rents for B class property are US$15-20/$m^2$ lower at US$110-115/$m^2$, while prime rents are even higher. Despite the expectation of tight supply and demand, Moscow already has the second highest rents in Europe, so is unlikely to see significant further rises from current levels.

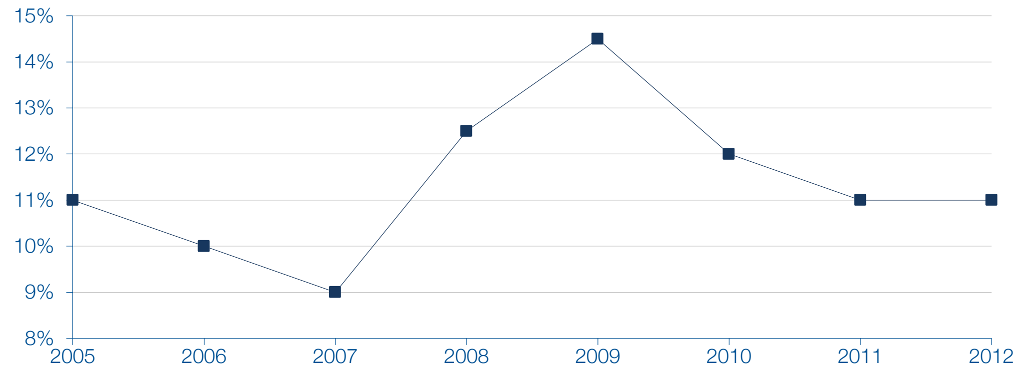
Exhibit 33: Warehouse rents and opex (US$ m^2 per year)



Source: JLL, Raven Russia

Yields have come down from their financial crisis induced peaks of 14-15% in 2009, but are still some 20% above their nine-year lows, at levels of 11-12%. However, to reach the former troughs of 9-10%, investment volumes may need to recover more strongly.

Exhibit 34: Moscow prime industrial yields



Source: C&W

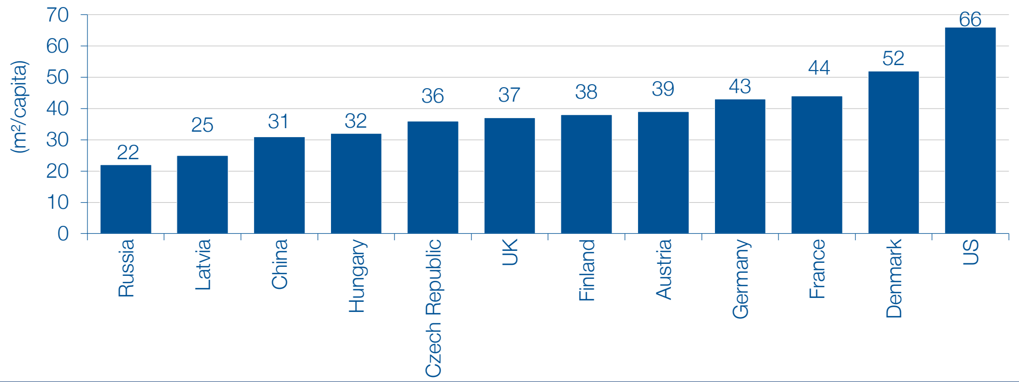
We conclude that market yields and therefore asset valuations still have some way to go to reach former peaks, in spite of the tight market fundamentals and the rebound in rental rates. Unless there is a significant increase in new supply in the next year, the market backdrop in this segment is probably the most favourable within the overall real estate space and supports those companies with exposure, explaining the premium rating Raven Russia currently commands.

Residential segment: Fundamentals remain in favour

Residential projects are less restricted in terms of financing and planning approvals, and benefit from attractive long-term fundamentals. Many commercial developers have diversified into residential projects, because this can provide more immediate cash flows and a faster payback on land sites. This is especially so in Moscow and the surrounding area, due to a simpler regulatory and planning regime. With demand recovering even more quickly than for commercial schemes and pricing back to pre-crisis levels, the attractions for developers are obvious.

Russia suffers from an acute lack of quality housing stock, with just $22m^2$ per capita on a national basis, compared with $66m^2$ in the US; even in China the level is 50% higher, at $31m^2$. The situation is not helped by the lack of mortgage penetration in Russia, with housing debt to GDP at just 3% last year, compared with 86% in the UK and 13% in China.

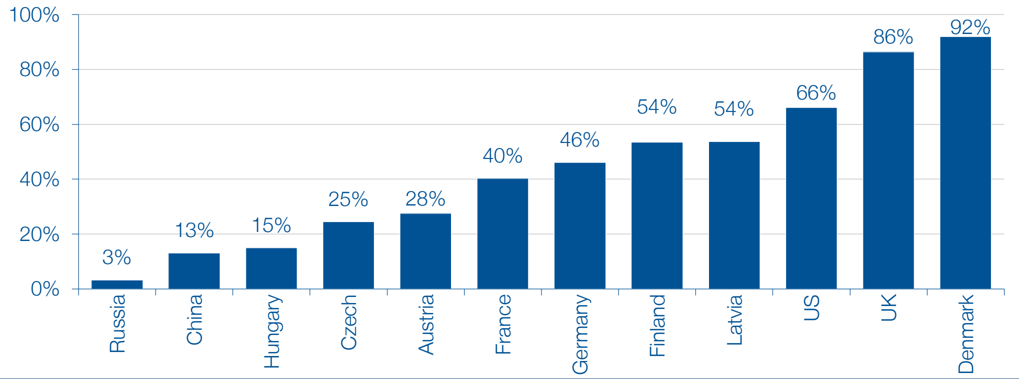
Exhibit 35: Housing stock per capita (m^2)



Source: Rosstat, Euromonitor, UNECE

Mortgage lending rallied sharply throughout 2010 and 2011, growing at over 100% per quarter, but remains approximately 40% below the 2008 peak. Despite the growth of mortgage lending over the past two years, it started from such a low base that, with GDP also rebounding, its share of GDP remains the lowest of any comparable country.

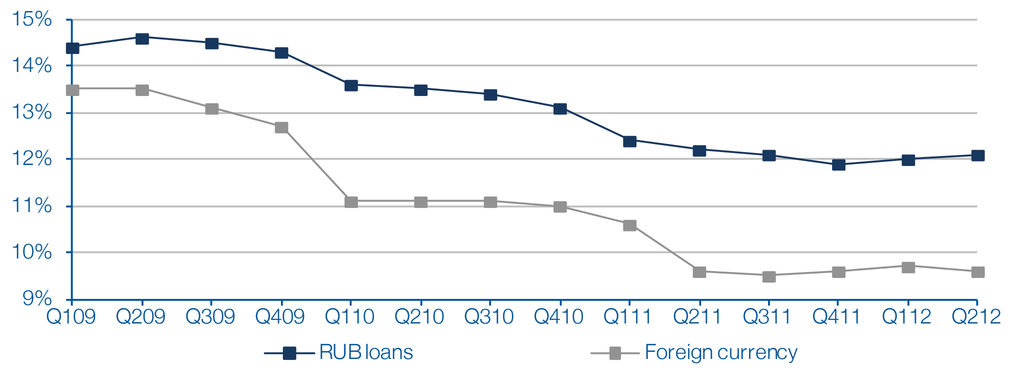
Exhibit 36: Housing debt to GDP



Source: Rosstat, Euromonitor, UNECE

The growth of mortgage lending since the trough in the financial crisis, whether measured by the number or value of loans, has a lot to do with the steady fall in mortgage rates over the last two years, both in local and foreign currency terms, which has substantially increased mortgage affordability for ordinary people.

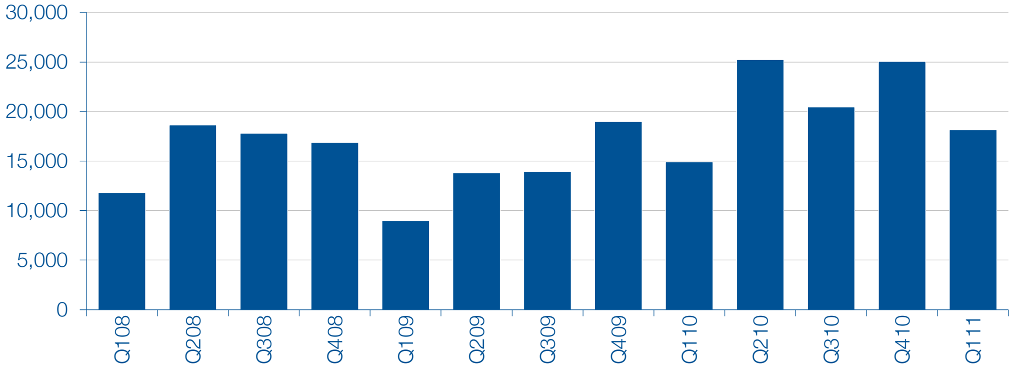
Exhibit 37: Average mortgage rates



Source: LSR Group

This has in turn fed through into secondary transactions (Exhibit 38), which in Moscow picked up sharply in 2010, rising at an average quarterly rate of 56% after turning positive in Q409. Looking at y-o-y comparisons, transactions were ahead of the previous two years in each quarter to Q111 (the latest for which data is available).

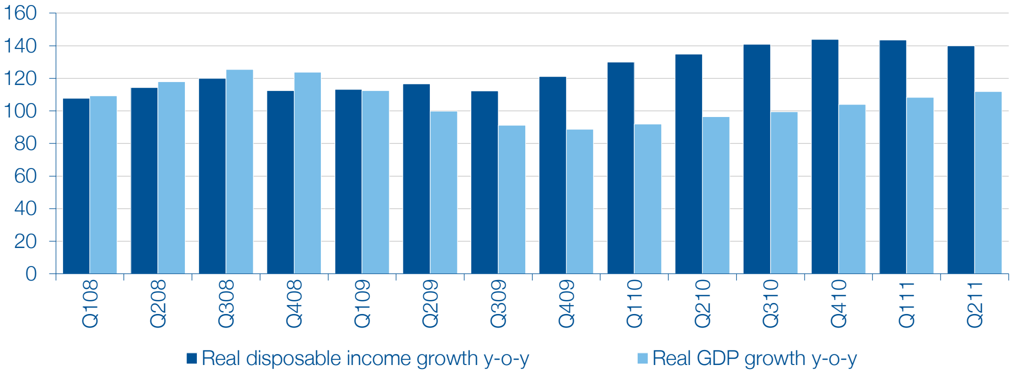
Exhibit 38: Secondary market transactions in Moscow (units)



Source: PIK Group

Another key driver of residential demand has been the growth in disposable income, which has rebounded very strongly from the low in mid-2009. As the chart below shows, real disposable income growth has significantly outpaced GDP growth in the past two years and this has been a significant factor in the ability as well as the desire of people to invest in residential property. This has reinforced the impacts of falling mortgage rates and other demographic factors, including household creation.

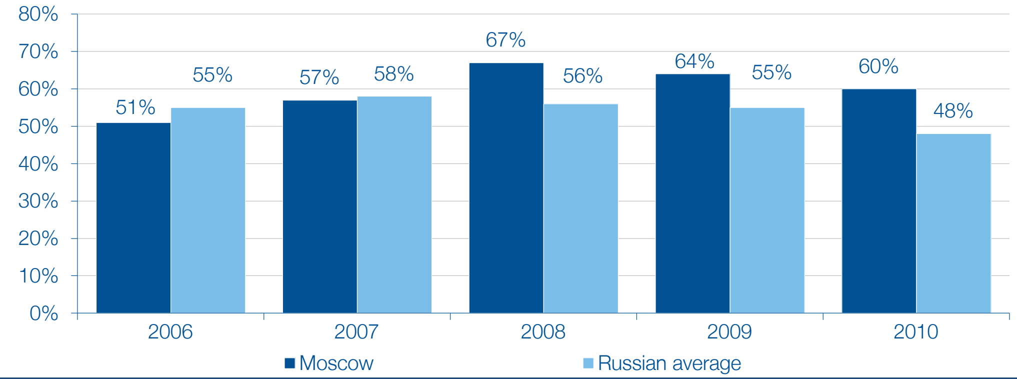
Exhibit 39: Disposable income growth (Q107=100)



Source: Rosstat, EIU

Affordability in Russia has improved significantly, as a result of falling mortgage rates and rising incomes and by 2010 was at the best level since before the crisis. We believe the trend has continued. Although Moscow remains more expensive on this measure, it is now less so than it was in 2008.

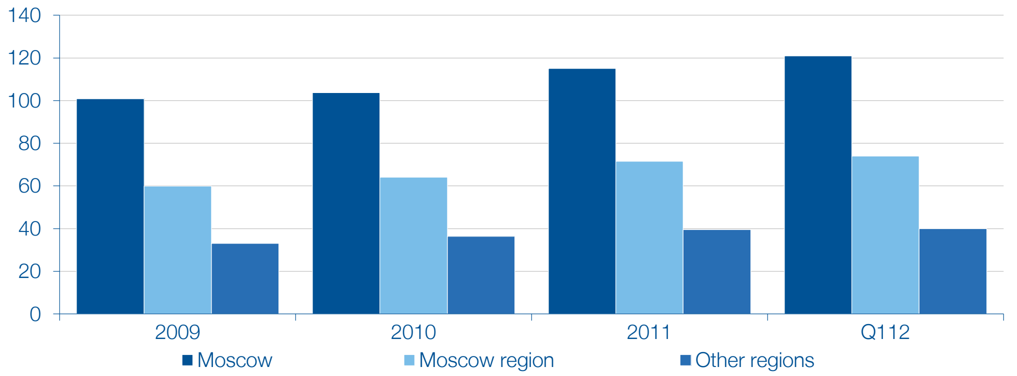
Exhibit 40: Affordability (% of average income spent on mortgage financing)



Source: Rosstat, EIU

Affordability has improved, despite the fact that residential prices have rallied since the mid-crisis trough. As an example, PIK's realised prices were up 10% on average across Russia in both 2010 and 2011, with gains of over 11% in Moscow and the Moscow region being partially offset by lower gains elsewhere. This recovery continued in Q112, as PIK saw prices rise another 5% in Moscow and 3% on average across Russia in local terms. Prices are now on average 20% above the 2009 low in Moscow and 21% higher on average across Russia.

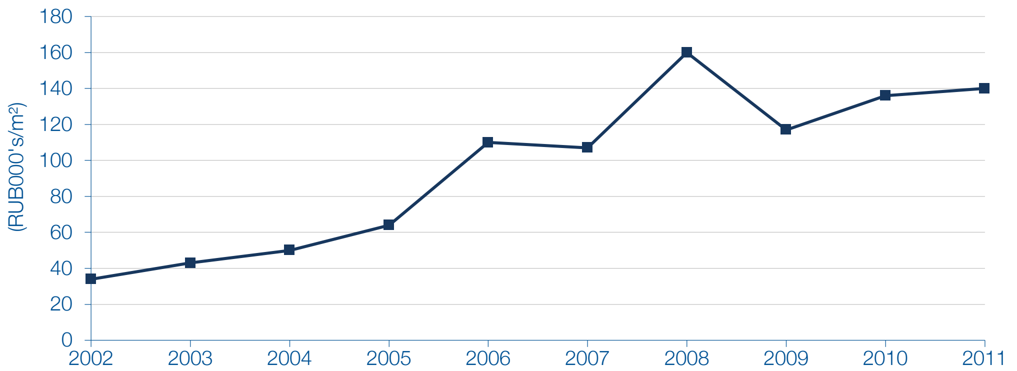
Exhibit 41: Average realised prices (RUB000's/m^2)



Source: PIK

Indeed, the index of average Moscow residential prices was just 12% below the 2008 peak in local terms by the end of 2011, after an increase of 20% during 2010-11 to RUB140,000/m^2 (US$5,000) offset the sharp 27% drop during the market slump in 2009.

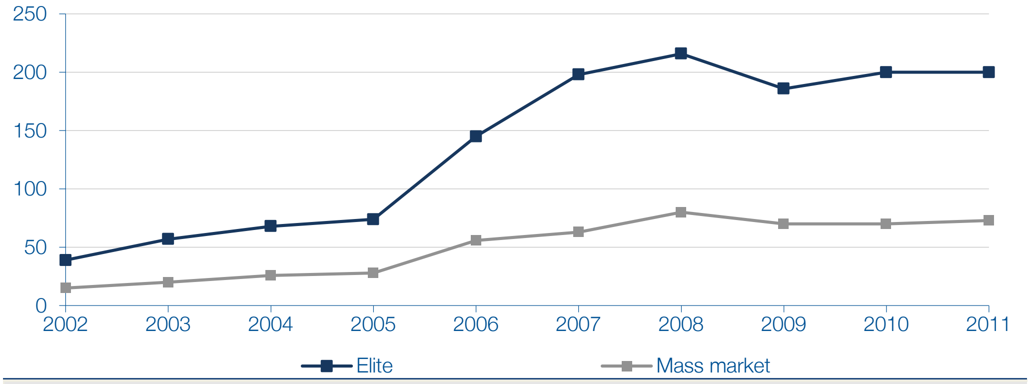
Exhibit 42: Moscow average residential prices



Source: IRN index

Beyond Moscow the correction in residential prices after the 2008/9 crisis was less severe. Even so, prices in St Petersburg have picked up a little, gaining 7% in the elite market from the low in 2009. However, prices in the mass market segment have recovered only marginally, rising approximately 2% to RUB73,000/m^2 (US$2,600).

Exhibit 43: St Petersburg residential prices (RUB000's/m^2)



Source: SPb Realty

Overall, commercial space is clearly more attractive to foreign institutional investors than residential property, given its stable, high-quality tenants, greater access to financing, better transparency, superior market statistics and more widely-available forecasts. This is especially the case in a market like Moscow, where international investors are attempting to reduce risk and volatility.

However, the residential segment has huge attractions for developers too, as a result of the ability to self-finance projects, less restrictive planning policies, lack of supply, stable demand dynamics and prices that were quick to rebound in the prime segment and generally held up well in the economy and business segments. As a result, developers are often keen to combine the two segments within their portfolios, even if they are not currently being rewarded for the diversification strategy by investors, as residential business models seem less well understood than commercial and have shown more volatility in the past.

Company profiles

AFI Development

Year end	Revenue (US$m)	Adj NP (US$m)	Adj EPS (US$)	NAV (US$)	DPS (US$)	P/NAV (x)
12/10	75.0	(50.3)	(0.05)	1.73	0.0	0.23
12/11	133.9	(16.1)	(0.02)	1.92	0.0	0.20
12/12e	189.8	5.9	0.01	1.81	0.0	0.22
12/13e	267.1	(20.6)	(0.02)	1.95	0.0	0.20

Note: Adjusted EPS and NP exclude revaluation gains, impairments and other one-off adjustments.

Investment summary: Growth offset by risks

AFID has the most diverse portfolio of the Russian developers, both segmentally in hotels, commercial and residential property and regionally across Russia. As well as eight completed commercial and hotel properties, AFID has a large residential project under construction, which should generate cash from pre-sales during construction and boost profitability on completion. Investors have been reluctant to give AFID credit for its project delivery and improved corporate governance, but this could change if we have seen the last impairments and we start to see increased profitability and NAV growth.

Completions expected to double in three years

AFID has 215,000m^2 of finished commercial space, after four major completions in the past year: AFI Mall and Paveletskaya in 2011, Ozerkovskaya III and the Kalinina hotel this year. The total completed portfolio is expected to double by 2014 with three further phases at the Plaza site. The residential portfolio has c 500,000m^2 of sellable area (and 40,000m^2 completed) to be sold over the next five to six years, while the operating hotel portfolio is expected to double to 100,000m^2 by 2014.

Profitability improvement delayed again

Profitability, and by extension NAV growth, should improve as AFID takes advantage of improving occupancy, rental rates and sales prices to generate increasing cash flows from its commercial and residential projects. However, the recent announcement of valuation losses on some of its Moscow projects will offset any gains this year. Despite further project completions in 2012-14 and residential sales increasing from 2013, we forecast three-year compound NAV growth of just 5%. Net debt is not forecast to fall until 2014 either, so there is little prospect of dividends or buybacks in the short term.

Valuations seem overly depressed

AFID is currently trading on discounts of 78% for 2012e and 80% for 2013e on our NAV forecasts. The discounts are substantial to its peers, partly because of the uncertainty over approvals for some of its Moscow projects, which has not been entirely resolved by recent impairments. Our valuation of just US$574m implies significant upside and would still be a 70% discount to our 2012 NAV. With management changes, including the CEO, Mark Groysman and CFO, Natalia Pirogova, who developed their careers outside the AFI group, improved disclosure after the full LSE listing last year and further project completions, investor perceptions should also start to improve.

Price*	$0.39
Market cap	$435m

*As at 7 September 2012

Share price graph

Share details

Code	AFRB
Listing	LSE
Sector	Property
Shares in issue	1,048m
Free float	36%

Price

	High	Low
52 week	US$0.67	US$0.34

Balance sheet as at 31 March 2012

Net Debt/Equity (%)	32.0
NAV per share (US$)	1.78
Net debt (US$m)	618

Business

AFI Development is the biggest of the London-listed Russian developers, with large-scale commercial and residential real estate projects in Moscow, the Russian regions, Ukraine and the CIS. It is controlled by AFI the Israeli conglomerate, but managed locally.

Major shareholders

Africa Israel Investments	64%
Blackrock	4%
SEB	4%
Cohen & Steers	1%

Analysts

Mark Cartlich +44 (0)20 3077 5700
Martyn King +44 (0)20 3077 5745
property@edisoninvestmentresearch.co.uk

Potential portfolio of over two million m^2

AFID has completed 12 commercial and residential projects in Russia and has 215,000m^2 of commercial space, with over 90% occupancy, after four completions in the past year. It has a potential pipeline of more than 20 projects, with in excess of two million m^2 of potential space, which is expected to be completed over the next five to seven years. The residential portfolio is dominated by the 478,000m^2 Odintsovo/Otradnoye project, which is now in the construction and pre-sales phase. AFID is majority owned by Africa Israel Group, an Israeli conglomerate with real estate, construction and infrastructure operations globally.

Limited NAV growth expected after the Q212 impairment losses

Jones Lang Lasalle valued AFID's property assets at US$2.4bn as at June 2012, a decrease of 14% since December, but still 4% up YoY, as the AFI Mall completion in H111 was offset by impairments. There have been two completions this year totaling 60,000m^2, so we expect to see further value uplift from these projects, although this will be offset by the US$240m of valuation and impairment losses that were pre-announced for Q212, mainly resulting from changes to the Moscow government's master planning and development policies. Therefore, we forecast NAV to grow at a three-year compound rate of 5%, starting with a 4% fall this year.

Portfolio gearing remains low

AFID had total debt of US$701m and cash and equivalents of US$128m as at H112, so net debt was only US$573m and net gearing was just 35%. The group has sufficient secured debt financing to complete the short-term commercial pipeline, using only financing secured against the individual projects, without recourse to the group. Most projects also have low loan to value ratios. Indeed the current LTV of the portfolio has increased just 3% in a year to 30%.

Now trading at a substantial discount to NAV

We estimate a valuation of US$1.6bn for the portfolio, approximately 33% below the JLL figure, incorporating only completed projects. Completed investment property is valued at US$1.5bn, on yields of 10.5-11%, excluding projects under development, or in the land bank with no defined start dates. The residential projects are valued at just US$22m, despite the completion value of US$1.3bn, because of their long timelines (three to five years). With US$84m of completed hotels, we reach a fair value of US$574m (still a 70% discount to our 2012 NAV). The stock is currently trading at discounts of 78% and 80% to 2012e and 2013e NAVs.

Corporate governance concerns addressed, but risks remain

Corporate governance is often cited as a reason for negative investor perceptions around AFID. This is largely a hangover from the poorly-handled IPO, especially the over-inflated valuations and the poor share price performance subsequently, which was partly attributable to the financial crisis. With a full listing on the LSE, a new CEO and CFO, compliance with the UK corporate governance code, a board with a majority of independent directors and all the required committees, the company has gone a long way to meeting investor concerns. Further details on the board are available on the company's website.

However, with a free float of just 36%, there are always likely to be concerns over the protection of minorities. The main risk, other than sector development and funding issues, is revisions to the Moscow government's planning policies. Catalysts include further improving investor perceptions of the group, which seem not to have changed despite the LSE move. Some form of compensation for the city's takeover of the Tverskaya Zastava project is also expected.

Exhibit 44: Valuation (US$m)

SOTP valuation	GLA (m^2)	Rental income	Yield	Completion date	Discount rate	Project (NPV)
Four Winds Plaza Office	22,043	16.4	10.5%		12.8%	153.6
Ozerkovskaya IV	1,545	0.5	11.0%		12.8%	4.6
H2O	8,996	2.5	11.0%		12.8%	21.9
AFI Mall City	107,080	130.0	10.5%		12.8%	1,217.6
Paveletskaya	14,035	4.2	11.0%		12.8%	37.6
Berezhkovskaya	10,259	4.7	11.0%		12.8%	30.7
Plaza II	35,030	29.8	11.0%	2013-14		
Plaza IIa	4,321	3.8	11.0%	Jun 12		
Plaza IV	80,397	68.5	11.0%	2013-14		
Ozerkovskaya Phase III	46,394	18.6	11.0%	Mar 12		
Investment properties	**366,403**	**335**				**1,466**
Total Hotels	134,599	50.7				85.8
Residential portfolio	**GSA (m^2)**	**Sales income**	**Profit**	**Completion date**	**Discount rate**	**Project (NPV)**
Otradnoye	477,980	1,371	584	Dec 17		
Botanic Garden	67,181	423	208	N/A		
Plaza I Residential	51,256	666	476	Dec 14		
Ozerkovskaya III Residential	5,108	15	12	Mar 12		
Properties under development	**601,525**	**2,475**	**1,280**			
Four Winds Residential	18,272	12	11	Dec 08	12.8%	3.7
Ozerkovskaya Phase II	16,711	30	27	Dec 08	12.8%	18.5
Completed properties	**34,983**	**43**	**38**			**22.2**
Portfolio total	**1,137,510**					**1,574**
Net current assets						116
Net debt & minorities						(1,074)
Other liabilities						(72)
Adjusted NAV						**544**
Mid-year adjustment						1.05
Fair value at year end						**574**
Fair value per share (US$)						**0.55**

Source: Company data, Edison Investment Research

Exhibit 45: Corporate governance checklist

Listing	GDR (A shares)
	Premium (B shares)
Free float	36%
Controlling shareholder	64%
Disclosure of shareholdings	3%
UK Corporate Governance Code	Compliant
Independent directors	5/8
Audit committee	Yes
Remuneration committee	Yes
Nomination committee	Yes
Registration	Cyprus

Source: Company data

For further information see the corporate governance page on the company's website.

Exhibit 46: Financial summary

US$m	2008	2009	2010	2011	2012e	2013e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	113	63	75	134	190	267
Cost of Sales	(73)	(29)	(39)	(82)	(76)	(122)
Gross Profit	40	34	36	51	114	145
EBITDA	26	26	15	20	79	105
Operating Profit (before amort. and except.)	26	26	15	20	79	105
Intangible Amortisation	0	0	0	1	0	0
Revaluations	(155)	23	76	269	(116)	168
Other	0	(0)	(18)	(1)	0	0
Operating Profit	(129)	49	73	288	(37)	273
Net Interest	3	(4)	(3)	(41)	(71)	(133)
Profit Before Tax (IFRS)	(126)	45	70	248	(108)	141
Tax	18	(47)	(44)	(75)	26	(34)
Minority interests	(1)	(1)	(0)	(1)	0	(0)
Net income (Adj NP)	46	(27)	(50)	(16)	6	(21)
Net income (IFRS)	(109)	(4)	26	172	(82)	106
Average Number of Shares Outstanding (m)	1,047.7	1,047.7	1,047.7	1,047.7	1,047.7	1,047.7
EPS - adjusted (US$)	0.04	(0.03)	(0.05)	(0.02)	0.01	(0.02)
EPS - adjusted and fully diluted (US$)	0.04	(0.03)	(0.05)	(0.02)	0.01	(0.02)
EPS - (IFRS) (US$)	(0.10)	(0.00)	0.02	0.16	(0.08)	0.10
Dividend (US$)	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	35.2	54.7	48.2	38.4	60.1	54.3
EBITDA Margin (%)	22.9	41.6	20.4	14.6	41.6	39.5
Operating Margin (before GW and except.) (%)	22.9	41.6	20.4	14.6	41.6	39.5
BALANCE SHEET						
Fixed Assets	1,429	1,606	1,965	2,485	2,589	3,457
Intangible Assets	0	0	0	0	0	0
Tangible Assets	1,401	1,533	1,956	2,479	2,583	3,452
Investments	28	73	9	5	5	5
Current Assets	772	741	464	400	663	675
Stocks	271	214	197	208	451	571
Debtors	228	127	137	107	190	107
Cash	272	211	130	85	21	(3)
Other	1	190	1	1	1	1
Current Liabilities	(307)	(275)	(182)	(276)	(381)	(460)
Creditors	(167)	(181)	(148)	(177)	(189)	(104)
Short term borrowings	(140)	(94)	(34)	(99)	(192)	(356)
Long Term Liabilities	(165)	(367)	(516)	(742)	(1,085)	(1,782)
Long term borrowings	(159)	(322)	(434)	(528)	(899)	(1,556)
Other long term liabilities	(6)	(45)	(81)	(214)	(186)	(226)
Net Assets	1,729	1,706	1,732	1,867	1,786	1,892
CASH FLOW						
Operating Cash Flow	27	(15)	23	41	(237)	(10)
Net Interest	(31)	(40)	(50)	(59)	(71)	(133)
Tax	0	0	0	(13)	0	0
Capex	(250)	(123)	(159)	(190)	(220)	(701)
Acquisitions/disposals	13	41	11	10	0	0
Financing	0	0	0	0	0	0
Dividends	(200)	0	0	0	0	(0)
Net Cash Flow	(440)	(136)	(175)	(212)	(528)	(844)
Opening net debt/(cash)	(480)	26	205	338	542	1,070
Other	(67)	(43)	42	8	0	0
Closing net debt/(cash)	26	205	338	542	1,070	1,915

Source: Company data, Edison Investment Research. Note: Adjusted EPS and net income exclude revaluation gains, impairments and other one-off adjustments.

MirLand Development

Edison investment research

Year end	Revenue (US$m)	Adj NP (US$m)	Adj EPS (US$)	DPS (US$)	NAV (US$)	P/NAV (x)
12/10	21.6	(6.5)	(0.06)	0.0	3.4	0.49
12/11	47.5	(4.0)	(0.04)	0.0	3.4	0.50
12/12e	58.6	(6.4)	(0.06)	0.0	3.4	0.49
12/13e	134.4	18.5	0.18	0.0	4.1	0.41

Note: Adjusted NP and EPS exclude revaluations, impairments and other one-offs.

Investment summary: Focus shifts to residential

MirLand's focus is shifting from being a pure play commercial developer with a small yielding portfolio and a huge land bank of projects, to becoming a medium-sized commercial investor with a substantial residential development, the pre-sales from which should provide a steady stream of cash flows for years to come. Not only should this boost earnings and NAV from 2013, as the first phase is delivered, increasing the NAV discount to nearly 60% next year, it could also enable the group to start paying dividends, once debt levels have been further reduced.

Business focus has shifted to development

MirLand has a mixture of commercial, retail and residential projects in Moscow, St Petersburg and across Russia. With c 130,000m^2 of yielding commercial space, the development of the 630,000m^2 Triumph Park residential project in St Petersburg is now starting to be sold in phases. Although further commercial projects will continue to be delivered, it is clear that residential development has become more important.

Both commercial & residential to support NAV growth

The company currently has six completed income-producing commercial properties, with potential annual rental income of US$47m. Completed commercial space is expected to grow nearly fivefold by 2017 (CAGR 24%). It also has a potential 696,000m^2 of residential gross sellable area, currently under development in phases over the next seven years, on which sales have already started.

Trading at a large discount after recent sell off

The shares performed poorly in the wake of the market correction over the past year and after a recent recovery now trade at a 51% discount to this year's NAV and a 59% discount to 2013. We estimate a fair value of US$273m (160p) using a sum-of-the-parts model, which heavily discounts the entire portfolio, (for example the Triumph Park residential project is valued at half the JLL appraisal value), but would imply significant upside from current levels. With residential sales starting to drive the growth in profitability and NAV, we would expect to see this being reflected in the share price.

Price*	102p
Market cap	£106m

As at 7 September 2012

Share price graph

Share details

Code	MLD
Listing	AIM
Sector	Property
Shares in issue	103.6m
Free float	12%

Price

52 week	High	Low
	220p	212.5p

Balance sheet as at 31 December 2011

Net Debt/Equity (%)	91.0
NAV per share (US$)	3.4
Net borrowings (US$m)	317

Business

MirLand is an internally-managed real estate developer, operating in Russia since 2004. It is controlled by the Israeli developer Fishman Group with over 30 years' experience in real estate development internationally.

Major shareholders

Industrial Buildings Corp	40%
Jerusalem Eco. Corp	31%
Darban Investments	14%
Clal Ins Ent Holdings	4%
Capital Venture W'wide	3%

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A 1.4m m^2 portfolio across Russia

MirLand Development Corporation is an internally-managed, Cypriot-domiciled real estate developer, which is controlled by the Fishman Group, the Israeli developer with over 30 years' experience in real estate development internationally. MirLand has a portfolio of 14 projects on 175 hectares of land across Russia, with potential completed space of 1.4m m^2. Management is a mixture of international Israeli executives with domestic experience and local directors

Commercial space to grow at a compound rate of 24%

The company currently has six completed income-producing commercial properties, with approximately 130,000m^2 of space and potential annual rental income of US$47m. Completed commercial space is expected to grow nearly fivefold by 2017 (CAGR 33%), starting with the completion of the Triumph House in Kazan next year. It also has a potential 696,000m^2 of residential gross sellable area under development, on which sales have already started this year.

No longer reliant on parental support

Current project debt is just US$71m, although total debt was US$351m at year end 2011 and net debt was US$317m. Net debt/equity was 91% at year end, but the LTV on balance sheet valuations, which were below Cushman's appraisal values, was just 52%. Although MirLand should still be able to draw on Fishman support, the reliance on parental guarantees has fallen from 77% of the total in 2006 and 43% last year to zero in 2011.

NAV growth expected to resume in 2012

MirLand calculates an adjusted NAV, using the group's share of the market value of its assets of US$5.2 per share. We are forecasting NAV growth on a sector-consistent basis of 1% in 2012 and 23% 2013 and a three-year CAGR of 26% with no forecast revaluation gains other than on project completions. This year's growth is likely to be held back by higher debt costs, offsetting the revaluation gains, but residential profits should start to drive growth from next year onwards.

No longer trading at a premium to peers

The shares halved in value in the wake of the market correction in the past year and are currently trading at a discount of 51% to our sector-consistent 2012 forecast NAV and 59% for 2013. This valuation has slumped from a slight premium to the rest of the sector, which we do not believe is justified given the NAV growth profile. We calculate a sum of the parts valuation of US$273m, equating to a fair value of 160p, which implies significant upside from current levels.

Corporate governance could be improved by a full LSE listing

The shares have been hit more by market weakness than by stock-specific factors, but there are still corporate governance improvements that could be made. The shares are still listed on AIM, which does not help investors' perceptions, although a change will not be possible while the free float remains under 20% (the threshold for the LSE is 25%). Management is local and the board is a mixture of local, international and Fishman group directors; please see their website for further information.

MirLand has all the required committees, complies with the Corporate Governance Code and has a majority of independent directors, but does not have a dedicated IR executive like most of its peers. Other than the usual macro-related and sector risks, the main risk is securing financing for development. Although project debt is low and parental support is likely to be forthcoming, there is a refinancing requirement of US$40-45m per year over the next few years.

Exhibit 47: Portfolio

SOTP Valuation (US$m)	GLA/GSA (m^2)	Annual rental income	Assumed yield	Completion date	Project NPV
MAG	19,228	7.3	11.0%		64.2
Hydromashservice	16,896	7.0	11.0%		61.9
Century Buildings	21,056	8.4	11.0%		38.5
Triumph Mall	27,325	10.5	10.5%		97.5
Vernissage Mall	34,056	9.0	10.5%		42.7
Tamiz	12,971	5.1	11.0%	Jul/11	43.5
Total investment property	**131,532**	**47.4**			**348.3**
Triumph Park Trade Centre	117,775	37.8	12.0%	May/17	18.3
Big Box Complex	55,245	9.5	13.0%	May/14	8.3
Skyscraper	92,000	59.6	11.0%	Aug/15	86.3
Triumph House	26,277	7.7	13.0%	Aug/13	13.7
Penza Shopping Center	18,024	5.8	13.0%	Aug/14	8.5
Saratov Logistics	104,000	17.3	13.0%	Jan/15	19.7
Novosibirsk Land	180,000	30.0	13.0%	Dec/15	27.8
Property under development	**593,321**	**167.7**			**182.5**
		Sales	**Profit**		
Western Residence - Perkushkovo	65,330	181.9	84.1	Dec/15	14.3
Triumph Park - St Petersburg	630,900	2,079.5	630.9	Dec/19	143.1
Total residential	**696,230**	**2,261.4**	**715.0**		**157.5**

Source: Company data, Thomson consensus estimates

Exhibit 48: Fair value calculations

Fair value calculations	US$m
Investment properties under development	182
Investment properties	348
Residential	157
Trading properties in stock	0
Other non-current assets (liabilities)	7
Net current assets (liabilities)	(16)
Enterprise value	**680**
Less net debt	419
Adjusted Y/E NAV	**273**
Number of shares (m)	103.6
Fair Value per share (US$)	2.63
Fair Value per share (£)	**1.60**

Source: Edison Investment Research

Exhibit 49: Corporate governance checklist

Corporate governance checklist	MirLand
Listing	AIM
Free float	19%
Controlling shareholders	85%
Disclosure of shareholdings	3%
UK combined Corporate Governance Code	Compliant
UK Takeover Code	No
Independent directors	5/9
Audit committee	Yes
Remuneration committee	Yes
Nominations committee	Yes
Registration	Cyprus

Source: Company data, Edison Investment Research

For further information see the corporate governance page on the company's website.

Exhibit 50: Financial summary

Dec	US$m	2008 IFRS	2009 IFRS	2010 IFRS	2011 IFRS	2012e IFRS	2013e IFRS
PROFIT & LOSS							
Revenue		20	17	22	48	59	134
Cost of Sales		(7)	(7)	(12)	(27)	(26)	(60)
Gross Profit		13	10	10	20	33	75
EBITDA		(10)	(4)	(3)	5	14	55
Operating Profit (before amort. and except.)		(10)	(4)	(3)	5	14	55
Intangible Amortisation		0	0	0	1	1	1
Revaluation of investment properties		(59)	(16)	30	33	14	49
Other		0	0	(1)	(6)	0	0
Operating Profit		(69)	(21)	25	33	29	105
Net Interest		(35)	3	0	(16)	(23)	(31)
Profit before tax (IFRS)		(104)	(18)	25	17	6	73
Tax		(1)	(5)	(2)	12	(1)	(18)
Minority interests		0	0	0	0	0	0
Net income (Adj NP)		(46)	(7)	(6)	(4)	(6)	19
Net income (IFRS)		(105)	(23)	23	30	4	56
Average Number of Shares Outstanding (m)		103.6	103.6	103.6	103.6	103.6	103.6
EPS - adjusted (US$)		(0.44)	(0.06)	(0.06)	(0.04)	(0.06)	0.18
EPS - adjusted and fully diluted (US$)		(0.44)	(0.06)	(0.06)	(0.04)	(0.06)	0.18
EPS - (IFRS) (US$)		(1.01)	(0.22)	0.22	0.29	0.04	0.54
Dividend per share (p)		0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		64.2	56.8	45.7	42.8	55.8	55.5
EBITDA Margin (%)		-50.2	-25.8	-15.5	10.5	23.7	40.6
Operating Margin (before GW and except.) (%)		-50.2	-25.8	-15.5	10.5	23.7	40.6
BALANCE SHEET							
Fixed Assets		368	445	484	533	621	861
Intangible Assets		0	0	0	0	0	0
Tangible Assets		286	396	460	515	602	842
Investments		82	50	25	18	18	18
Current Assets		162	171	224	207	246	254
Stocks		144	140	178	158	193	166
Debtors		1	3	4	7	6	9
Cash		10	21	11	34	40	71
Other		6	6	31	7	7	7
Current Liabilities		(82)	(126)	(158)	(164)	(198)	(248)
Creditors		(20)	(42)	(70)	(32)	(44)	(61)
Short term borrowings		(62)	(84)	(88)	(132)	(154)	(186)
Long Term Liabilities		(106)	(171)	(210)	(228)	(318)	(460)
Long term borrowings		(80)	(126)	(185)	(218)	(305)	(435)
Other long term liabilities		(26)	(44)	(25)	(10)	(13)	(25)
Net Assets		342	319	341	347	352	407
CASH FLOW							
Operating Cash Flow		(70)	(33)	(29)	8	(7)	90
Net Interest		(5)	(8)	(12)	(23)	(23)	(31)
Tax		0	0	0	(1)	0	0
Capex		(78)	(52)	(40)	(15)	(73)	(190)
Acquisitions/disposals		38	1	22	7	0	0
Financing		0	0	0	0	0	0
Dividends		2	3	4	5	6	7
Other		6	31	(4)	(37)	0	0
Net Cash Flow		(107)	(58)	(59)	(57)	(96)	(124)
Opening net debt/(cash)		(35)	132	190	262	317	419
Other		(73)	0	(12)	3	(6)	(7)
Other cash adjustments		13	(1)	(2)	(2)	(0)	0
Closing net debt/(cash)		132	190	262	317	419	550

Source: Company data, Edison Investment Research. Note: Adjusted EPS and net income exclude revaluations, impairments and other one-off items.

PIK Group

Year end	Revenue (US$m)	Adj NP (US$m)	Adj EPS (US$)	NAV (US$)	DPS (US$)	P/E (x)
12/10	1,258	(172.2)	(0.34)	2.17	0.0	N/A
12/11	1,564	(10.1)	(0.02)	2.29	0.0	N/A
12/12e	1,752	8.6	0.02	2.31	0.0	126.8
12/13e	1,951	36.7	0.07	2.38	0.0	29.5

Note: Adjusted NP and EPS exclude revaluation gains, impairments and other exceptional items. PIK's actual reporting currency is RUB.

Investment summary: Returning to profitability

PIK Group is emerging from nearly four years of balance sheet reconstruction, write-downs and losses in the wake of the financial crisis, assisted by the recovery in the residential market, especially in Moscow. The group's gearing remains high as the equity base has yet to be rebuilt, but the LTV was 55% at year-end, while debt costs have been reduced and should be covered by EBITDA this year. Nevertheless, the stock's risks remain and in our view there is not much upside at current levels.

A leading residential developer in Russia

PIK is one of the leading residential real estate developers in Russia, with a strategic focus on the Moscow Metropolitan Area (MMA). The main business is the development, construction, sale and management of mass-market residential properties. As at year-end 2011, PIK had a portfolio of 6.9m m^2 of unsold net sellable area across Russia valued at US$2.7bn by CBRE, 88% of which is in the MMA.

Earnings remain weak, but returns are improving

Earnings before exceptionals are expected to recover steadily from this year and PIK is starting to generate a decent return on capital now (13-15% in 2012-13), partly because of the low equity base. However, there are still risks in the level of gearing and the extent of debt service costs, although they should be covered by basic EBITDA this year – for the first time since 2007.

Valuation based on potential profit per m^2

As PIK is a residential developer and it currently has such a low book value, we have valued it differently to the other stocks in this report. Although PIK is trading at a small discount to NAV, this is less relevant for a residential developer and so is the premium P/E ratio, which is a function of high debt interest costs and depressed earnings. We use a three-year average after tax profit per m^2 to reach a valuation of US$1.1bn, which is equivalent to US$2.2 per share, similar to current trading levels.

Price*	US$2.2
Market cap	$1.1bn

**As at 7 September 2012*

Share price graph

Share details

Code	PIK LI
Listing	GDR
Sector	Property
Shares in issue	493.1m
Free float	62%

Price

	High	Low
52 week	US$3.6	US$3.64

Balance sheet as at 31 December 2011

Loan to value (%)	55.3
NAV per share (US$)	2.29
Net debt (US$m)	1,375

Business

One of the leading residential real estate developers in Russia, with a strategic focus on developing and selling mass-market residential properties in the Moscow Area.

Major shareholders

Holborner Services	20%
Brigantia Ltd	17%
VTB	9%
Artertesia Consulting	7%
Lacero Trading	2%

Analysts

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2011 showed market recovery feeding through

The 2011 results showed further evidence of the market recovery feeding through into the numbers, with all the profit lines turning positive for the first time since the downturn. PIK's realised prices were up 10% on average across Russia in 2011, with a gain of 11% in Moscow partially offset by lower gains in other regions. Moscow residential prices are now only marginally below the 2008 peak in local terms. Basic EBITDA (normalised operating profit plus depreciation) went from a negative US$42m in 2010 to US$172m last year, cash collections were up 31% and new sales contracts increased 30% to exceed 500,000m^2 for the first time since 2007.

Demand recovery has continued in H112

The recovery has continued in 2012, with net cash collections up 26% y-o-y in H112 and cash collections from the sale of apartments to individuals increasing 53% on the back of higher volumes and a rise in prices. PIK launched 20 new projects in H112, 16 of which were in the MMA and new sales contracts to customers improved 18% to 270,000m^2, of which 87% were to retail customers, a gain of 50%. The average realised price saw a rise of 16% y-o-y, which also helped to drive the rise in cash collections.

Debt refinancing process now largely completed

While PIK still has significant debt outstanding, it has managed to shift the majority to long term, restructure the more expensive facilities, cancel all fines and penalties for late payment and diversify its sources of finance. Average debt costs are 12.2%, interest cover is now positive and the trend is downward for the loan-to-value and net debt/EBITDA ratios. PIK had been planning a secondary offering of approximately US$350-400m to complete the refinancing. This is now off the agenda, removing the potential overhang for the stock.

Housing statistics point to long-term growth trends

Russia still suffers from an acute lack of quality housing stock, with just 22m^2 per capita on a national basis, compared with 66m^2 in the US. This is not helped by the lack of mortgage penetration in Russia, with housing debt to GDP at just 3% last year. However, mortgage lending rebounded sharply in 2010, growing at over 100% per quarter as lending rates fell, a trend that has continued, with developers teaming up with lenders.

Valuations look fair at these levels

On our estimates for 2012 and 2013, the stock is currently trading on ratios of 12.7x and 10x EV/EBITDA and 1.5x and 1.3x sales respectively. Although P/NAV is less relevant for a residential developer like PIK, the stock is trading at discounts of 16% this year and 19% for 2013. The P/BV is irrelevant, as PIK's equity was wiped out by impairment losses in 2008-10. We reach our valuation from the potential profitability of the existing portfolio over three years and our fair value of US$2.2 is in line with where the shares are currently trading.

Corporate governance, catalysts and stock risks

PIK ticks most of the corporate governance boxes. Its directors are a mix of local and foreign, but the board includes directors from the major shareholders, including the bank VTB. It is the only company to report in RUB, but this reflects its business. The main catalysts are further operational and pricing recovery, potential land acquisitions or project sales and debt refinancing. The main non-operational risk is the balance sheet, which remains undercapitalised, so the need to raise capital to bolster the equity base remains.

Exhibit 51: Portfolio

PIK Portfolio	2006	2007	2008	2009	2010	2011
Portfolio value (US$m)	8,802	12,324	2,900	2,500	2,405	2,676
Unsold land bank NSA (m m^2)	8.8	14.2	14.9	11.6	10.6	6.9
Portfolio value (US$/$m^2$)	1,000	867	195	216	227	387

Source: PIK Group

Exhibit 52: Valuation

Profit/m^2 valuation	2011	2012e	2013e	2014e		Ave 2012-14
Profit/m^2	336	392	451	512		452
Post tax	255	298	343	389		343
Unsold land bank NSA m m^2	6.9	6.8	6.6	6.4		6.9
EV	**1,768**	**2,017**	**2,262**	**2,497**		**2,376**

Source: Edison Investment Research

Exhibit 53: Fair value calculations

Fair value calculations	US$m
Trading Properties Under Development	2,376
Enterprise value	**2,376**
Less net debt	1,375
Less minority interest	16
Adjusted NAV	**985**
Mid-year adjustment	1.08
Fair value at year end	**1,071**
Number of shares (m)	493.1
NAV per share (US$)	**2.2**

Source: Edison Investment Research

Exhibit 54: Corporate governance checklist

Corporate governance checklist	PIK
Listing	GDR
Free float	62%
Directors & Employee Trust	38%
Disclosure of shareholdings	N/A
UK combined Corporate Governance code	Compliant
UK Takeover Code	No
Independent directors	3/9
Audit committee	Yes
Remuneration committee	Yes
Nominations committee	Yes
Registration	Cyprus

Source: Company data, Edison Investment Research

For further information on the board of directors and corporate governance see the company's website.

Exhibit 55: Financial summary

US$m	2008	2009	2010	2011	2012e	2013e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	1,248	1,298	1,258	1,564	1,752	1,951
Cost of Sales	(936)	(1,047)	(1,175)	(1,244)	(1,379)	(1,522)
Gross Profit	312	251	82	320	372	429
EBITDA	93	127	(42)	172	211	256
Operating Profit (before amort. and except.)	71	113	(45)	156	196	242
Other operating income (expenses)	(11)	(12)	(12)	55	0	0
Impairment losses and reversals	(890)	(147)	(37)	98	0	0
Other	(211)	(129)	10	78	0	0
Operating Profit	(1,042)	(176)	(84)	387	196	242
Net Interest	(84)	(197)	(185)	(169)	(185)	(194)
Profit Before Tax	(1,126)	(372)	(269)	218	11	47
Tax	50	(27)	68	(55)	(3)	(12)
Minority interests	8	12	(1)	(5)	0	1
Discontinued operations (net of income tax)	3	38	0	0	0	0
Net income (Adj NP)	(120)	(116)	(172)	(10)	9	37
Net income (IFRS)	(1,065)	(350)	(202)	158	9	37
Average Number of Shares Outstanding (m)	490.2	490.8	503.9	493.1	493.1	493.1
EPS - adjusted (US$)	(0.25)	(0.24)	(0.34)	(0.02)	0.02	0.07
EPS - adjusted and fully diluted (US$)	(0.25)	(0.24)	(0.34)	(0.02)	0.02	0.07
EPS - (IFRS) (US$)	(2.17)	(0.71)	(0.40)	0.32	0.02	0.07
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	25.0	19.3	6.5	20.4	21.3	22.0
EBITDA Margin (%)	7.5	9.8	-3.3	11.0	12.1	13.1
Operating Margin (before GW and except.) (%)	5.7	8.7	-3.6	9.9	11.2	12.4
BALANCE SHEET						
Fixed Assets	1,498	1,232	1,069	1,144	1,129	1,115
Intangible Assets	934	735	748	835	835	835
Tangible Assets	562	494	310	281	266	252
Investments	3	3	11	28	28	28
Current Assets	3,342	2,741	2,932	2,863	3,149	3,123
Stocks	2,593	2,242	2,215	2,366	2,615	2,551
Debtors	480	353	389	365	374	377
Cash	107	114	142	89	117	152
Other	161	32	186	43	43	43
Current Liabilities	(3,614)	(2,723)	(3,836)	(3,086)	(3,099)	(3,085)
Creditors	(2,535)	(2,185)	(2,556)	(2,479)	(2,491)	(2,477)
Short term borrowings	(1,080)	(538)	(1,279)	(607)	(607)	(607)
Long Term Liabilities	(548)	(969)	(230)	(914)	(1,164)	(1,100)
Long term borrowings	(285)	(737)	(161)	(857)	(1,107)	(1,043)
Other long term liabilities	(262)	(233)	(69)	(57)	(57)	(57)
Net Assets	679	281	(65)	7	16	54
CASH FLOW						
Operating Cash Flow	471	170	12	(21)	(37)	292
Net Interest	(134)	(126)	(135)	(200)	(185)	(194)
Tax	(34)	(7)	(36)	(52)	0	0
Capex	(733)	(56)	44	55	0	0
Acquisitions/disposals	(79)	34	3	16	0	0
Financing	(79)	(7)	0	0	0	1
Dividends	0	0	0	0	0	0
Net Cash Flow	(587)	8	(112)	(203)	(222)	99
Opening net debt/(cash)	715	1,258	1,161	1,298	1,375	1,597
Other	45	90	(23)	128	0	0
FX adjustments	(1)	(2)	(2)	(3)	0	0
Closing net debt/(cash)	1,258	1,161	1,298	1,375	1,597	1,499

Source: PIK Group, Edison Investment Research. Note: income statement translated at average US$/RUB rates of: 27 for 2008, 31.7 for 2009, 30.3 for 2010 and 29.4 for 2011. Forecasts use the current exchange rate of US$1=RUB 31.9.

Raven Russia

Year end	NOI (US$m)	Adj NP (US$m)	Adj EPS (US$)	DPS (US$)	P/NAV (x)	Yield (%)
12/10	61.1	(17.5)	(0.04)	0.03	1.03	6.5
12/11	91.7	(10.1)	(0.02)	0.05	0.91	4.5
12/12e	131.5	13.2	0.02	0.05	0.94	4.5
12/13e	148.7	23.4	0.04	0.05	0.94	4.5

Note: Adjusted NP and EPS exclude revaluation gains, impairments and other one-offs. NOI is net operating income from property assets.

Investment summary: The quality sector play

Raven Russia has proved successful in improving transparency and maximising returns recently, via internalising management, moving all three classes of stock from AIM to the main board of the LSE, consistently paying dividends and buying back shares. With secure funding, limited refinancing needs, a good shareholder base, low tax structure, customer-led development plans and a wide margin between property yields and debt costs, the company is well placed to benefit from continued market recovery.

Potential portfolio of over 3m m^2 across Russia and the CIS

Raven is an internationally-managed commercial property investment company, with over 1.2m m^2 of completed space, predominantly warehouses, at 12 projects in Russia, with a potential 2m m^2 in the project pipeline. Moscow accounts for 67% of the completed space, while 70% of the land bank is in the regions and 16% in the rest of the CIS. With limited plans to develop the land bank, management remains focused on increasing occupancy (currently 94%) and maximising rental rates.

A simple business model

Raven has a different business model to its peers in Russia in that it has been deliberately set up to develop into a REIT-like entity, using the tax benefits of its Guernsey registration to pay out all excess cash, over administration and finance costs, to shareholders. The turbulence of the past few years has delayed the achievement of that objective, but it is now in sight. Management would rather deliver a 10-11% yield on its income-producing portfolio every year, than a 20-25% one-off development margin every few years, as it enables a consistent payout ratio to be maintained.

Valuation still offers upside

The shares trade at a justifiably small discount to our forecast NAV of just 6% for 2012 and 2013, given the strength of the warehouse segment in Russia, Raven's leading position in it, the recent success of management's vacancy-reduction strategy, its ability to add bolt-on acquisitions at reasonable yields and raise capital at attractive rates, as well as the potential growth in the portfolio and the dividend yield. Our fair value of US$693m suggests approximately 11% upside, which would leave the shares trading at a small premium to NAV.

Price*	65.8p
Market cap	£385m

**As at 7 September 2012*

Share price graph

Share details

Code	RUS
Listing	LSE
Sector	Property
Shares in issue	586.4m
Free float	92%

Price

	High	Low
52 week	67.5p	48.75p

Balance sheet as at 31 December 2011

Net Debt/Equity (%)	89.4
NAV per share (US$)	1.19
Net borrowings (US$m)	598

Business

Raven Russia was founded in 2005 to invest in class A warehouse complexes in Russia to be leased to Russian and international tenants. International management combines with an in-house team of Russian professionals.

Major shareholders

Invesco Perpetual	29%
Schroder Investment	14%
Mackenzie Cundill Inv.	10%
F&C Asset Management	5%
Directors	4%

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The largest warehouse developer in Russia

After the recent Pushkino acquisition (for US$215m cash) the group's portfolio is now over 1.2m m^2 across Russia, with another 2m m^2 in the pipeline, to be developed as the warehouse sector, which is already the most attractive market segment in Russia, continues its recovery. Management has pursued both selective organic growth and acquisitions over the past year, taking advantage of both tight supply and strong market demand, as well as the travails of some over-indebted competitors, to pick up new assets at reasonable prices.

Raven's strategy now looks to be bearing fruit

The strategy has been clear since the financial crisis erupted. Firstly, to let out the remaining space in the existing warehouses and take advantage of rising rental rates where possible. Secondly, to stabilise the capital structure and reduce debt costs. Thirdly, to sell down the residential portfolio to raise cash and finally, to look for earnings-enhancing acquisitions in the warehouse sector in Russia, especially in Moscow. With the Moscow warehouses fully let, rental rates increasing, occupancy averaging over 90%, two acquisitions this year and a further issue of preference shares, the strategy is clearly paying dividends.

Latest acquisitions to add >US$30m to NOI

The acquisition of the 213,000m^2 Pushkino site was completed in June, adding US$25m to NOI. Raven has also announced the acquisition of a 45,000m^2 Class A warehouse at Sholokhovo, to the north of Moscow, for US$49.8m with two tenants generating c US$6m, at an initial yield on the deal of 11.75%. The group is also acquiring 38 hectares of land, with zoning at Padikovo, to the north-west of Moscow, at a cost of US$23m.

Debt costs should be covered for the first time this year

At year end the group had gross debt of US$779m, including US$218m of irredeemable preference stock and net debt of US$598m, which has since been increased by the US$101m preference share issue (used to part-fund Pushkino). We forecast it reaching US$893m by year end. The remaining debt is mainly bank loans and supra-national finance (EBRD, IFC) at the project level, with an LTV of 63% in 2011. Raven has two unencumbered assets, limited refinancing needs until 2013 and pays an average rate of just 7%. Even so, on our forecasts, this year will be the first time interest costs have been covered by NOI.

Valuation enhanced by payout on ordinary and preference shares

The shares trade at a discount of just 6% to our 2012 forecast NAV and 11% to our fair value of the completed space, which in our view reflects the strength of both the company and its market segment. This is a premium to its peers, which we believe is justified by a simple strategy that is being delivered by a sound management team, which communicates regularly and openly with its investors. On top of the valuation discount is the yield on both the ordinaries and the 194m outstanding preference shares. The ordinary shares yield 4.5%, while the preference stock has a fixed cumulative payout of 12% and is currently yielding over 9%.

Stock catalysts, risks and corporate governance

The main short-term catalysts are likely to be continued improvements in occupancy rates, additional acquisition opportunities, further increases in rental rates and in appraisal values as results are released. The main risks we see are macro rather than micro orientated, relating to demand for warehouse space in Russia, the availability and cost of financing and any big change in the warehouse supply backdrop. Raven ticks all the corporate governance boxes on our checklist below and has a good mix of local and international management. Further information on the board of directors can be read on the company's website.

Exhibit 56: Portfolio

City	Project	Land (hectares)	Gross lettable area (m^2)
Moscow	Southern	2	14,000
Moscow	Krekshino	22	118,000
St Petersburg	Constanta	1	16,000
Moscow	Istra phases 1-5	33	199,000
St Petersburg	Shushary 1-4	26	142,000
Moscow	Noginsk 1	22	123,000
St Petersburg	Pulkovo 1	5	36,000
Moscow	EG Lobnya	10	53,000
Moscow	Klimovsk 1	9	54,000
Moscow	Klimovsk 2	9	54,000
Moscow	Pushkino	0	213,000
Moscow	Sholokhovo	0	45,000
Rostov on Don	Rostov 1	19	100,000
Novosibirsk	Novosibirsk	18	120,000
Completed space		175	1,287,000
St Petersburg	Pulkovo 2	10	67,400
Moscow	Noginsk 2	40	180,300
Moscow	Padikovo	38	200,000
Rostov on Don	Rostov 2	27	126,500
Khabarovsk	Khabarovsk	27	140,000
Chelyabinsk	Chelyabinsk	59	295,000
Omsk	Omsk	19	230,000
Omsk	Omsk 2	9	45,000
Saratov	Saratov	29	159,000
Ufa	Ufa	48	240,000
Nizhniy Novgorod	Nizhniy Novgorod	44	220,000
Minsk	Minsk	45	225,000
Development projects		403	2,182,200
Total projects		578	3,469,200

Source: Company data

Exhibit 57: Fair value calculations

Fair value calculations	US$m
Completed properties	1,295
Land and expansion sites	102
LT inventory	40
Roslogistics	13
Warrant conversion/deferred tax	70
Enterprise value	1,521
Less net debt and minorities	(893)
NAV	629
12-month adjustment	1.10
Adjusted NAV	693
Number of shares (millions)	579.2
Adjusted NAV per share (US$)	1.20
Fair value (p)	73

Source: Edison Investment Research

Exhibit 58: Corporate governance checklist

Corporate governance checklist	Raven
Listing	LSE
Free float	92%
Directors & Employee Trust	8%
Disclosure of shareholdings	3%
UK combined Corporate Governance Code	Compliant
UK Takeover Code	Compliant
Independent directors	4/8
Audit committee	Yes
Remuneration committee	Yes
Nominations committee	Yes
Registration	Guernsey

Source: Company data, Edison Investment Research

For further information see the corporate governance page on the company's website.

Exhibit 59: Financial summary

US$m	2008	2009	2010	2011	2012e	2013e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	71	112	131	163	203	225
Cost of Sales	(32)	(62)	(70)	(71)	(72)	(76)
Net Operating Income (Gross Profit)	40	50	61	92	132	149
EBITDA	9	16	42	63	100	118
Operating Profit (before amort. and except.)	9	16	42	63	100	118
Revaluation of investment properties	(39)	(58)	63	133	0	0
Exceptionals	(31)	(51)	16	11	0	0
Stock Expense/Other	(68)	0	(6)	(6)	(6)	(6)
Operating Profit	(129)	(92)	115	201	94	112
Net Interest	(61)	(56)	(59)	(72)	(80)	(86)
Profit Before Tax	(189)	(148)	56	129	15	26
Tax	19	9	(14)	(41)	(1)	(3)
Minority interests	0	0	0	0	0	0
Net income (Adj NP)	(39)	(37)	(18)	(10)	13	23
Net income (IFRS)	(170)	(139)	41	88	13	23
Average Number of Shares Outstanding (m)	439.2	488.9	493.1	528.2	567.2	567.2
EPS - adjusted (USD)	(0.09)	(0.08)	(0.04)	(0.02)	0.02	0.04
EPS - adjusted and fully diluted (USD)	(0.09)	(0.08)	(0.03)	(0.02)	0.02	0.04
EPS - (IFRS) (USD)	(0.39)	(0.28)	0.08	0.17	0.02	0.04
Dividend (USD)	0.05	0.02	0.03	0.05	0.05	0.05
Gross Margin (%)	55.4	44.9	46.8	56.3	64.8	66.2
EBITDA Margin (%)	13.2	14.7	32.1	38.9	49.5	52.4
Operating Margin (before GW and except.) (%)	13.2	14.7	32.1	38.9	49.5	52.4
BALANCE SHEET						
Fixed Assets	1,090	1,081	1,147	1,339	1,579	1,579
Intangible Assets	0	13	13	13	13	13
Tangible Assets	902	988	1,056	1,253	1,470	1,470
Investments	188	80	77	72	95	95
Current Assets	191	310	199	277	213	211
Stocks	0	61	56	51	40	32
Debtors	83	69	35	44	56	63
Cash	108	128	108	182	117	116
Other	0	52	0	0	0	0
Current Liabilities	(133)	(213)	(139)	(166)	(171)	(173)
Creditors	(53)	(115)	(50)	(71)	(49)	(51)
Short term borrowings	(80)	(98)	(90)	(96)	(121)	(121)
Long Term Liabilities	(413)	(632)	(626)	(781)	(985)	(985)
Long term borrowings	(357)	(567)	(560)	(684)	(888)	(888)
Other long term liabilities	(56)	(65)	(66)	(97)	(97)	(97)
Net Assets	735	546	580	669	637	633
CASH FLOW						
Operating Cash Flow	22	15	36	84	47	113
Net Interest	1	2	(29)	(38)	(80)	(86)
Tax	(4)	(1)	(3)	(3)	0	0
Capex	(465)	(139)	(36)	(80)	(217)	0
Acquisitions/disposals	(92)	74	68	10	0	0
Financing	0	88	(33)	(31)	(17)	0
Dividends	(51)	(4)	(4)	(16)	(28)	(28)
Net Cash Flow	(589)	35	(1)	(73)	(295)	(1)
Opening net debt/(cash)	(377)	329	537	542	598	893
Other	(138)	(252)	(3)	27	0	0
FX adjustments	20	9	(2)	(10)	0	(0)
Closing net debt/(cash)	329	537	542	598	893	893

Source: Company data, Edison Investment Research. Note: Adjusted net income and EPS exclude revaluation gains, impairments and other one-offs.

Edison investment research

RGI International

Year end	Revenue (US$m)	Adj NP (US$m)	Adj EPS (US$)	NAV (US$)	DPS (US$)	P/NAV (x)
12/10	3.1	(19.7)	(0.14)	3.29	0.0	0.52
12/11	1.5	(48.3)	(0.30)	3.11	0.0	0.55
12/12e	0.0	(13.5)	(0.08)	3.07	0.0	0.52
12/13e	81.9	5.0	0.03	3.30	0.0	0.49

Note: Adjusted NP and EPS exclude revaluation gains, impairments and other one-off items.

Investment summary: Synergy resolution

RGI is currently trading at a 46% discount to our forecast 2012 NAV, but more than 50% to 2013 when residential profits start to feed through and boost NAV growth. It has been perceived as riskier than its peers, as it is less diversified, both geographically and sectorally, but also because it is developing fewer projects and as the main one is residential, the cash flows will not recur. Now that the dispute with Synergy, its second largest shareholder, is resolved, further project progress could change that perception.

Moscow-based retail and residential developer

RGI currently has six developments with potential gross lettable/sellable area of close to 1.2m m^2, but two projects dominate. The Tsvetnoy project, which was completed last year, is now growing revenues very strongly, but may be sold during the next year and the biggest residential project, V Lesu (1.3m m^2), is under construction, with 36% of the first phase already sold. RGI's assets are appraised semi-annually by DTZ and at year-end 2011 RGI's share of the assets in the portfolio was valued at US$686m.

NAV growth set to recover

We expect reported NAV growth to accelerate as residential projects start to generate cash in 2012-13. We see our sector-consistent NAV calculation increasing from US$528m last year to US$613m in 2013 and NAVPS from US$3.11 to US$3.47, with potentially a four-year CAGR of 18% to 2015, as other commercial and residential projects reach the delivery phase.

Discount may narrow now that Synergy dispute resolved

With the stock trading at a 48% discount to NAV for 2012e and 51% for 2013e, after the poor performance over the past year, the shares appear undervalued, especially now that the year-long dispute with Synergy, its second largest shareholder, has ended. The board has a majority of independent directors, with significant international experience, which helped it to defend itself in the dispute. The end of attempts by Synergy to control the board and direct strategy could be the positive catalyst the stock has been looking for, with significant potential upside to our sum-of-the-parts fair value of US$394m.

Price*	US$1.6
Market cap	$259m

*As at 7 September 2012

Share price graph

Share details

Code	RGI
Listing	AIM
Sector	Property
Shares in issue	161.8m
Free float	60%

Price

	High	Low
52 week	US$2.07	US$0.93

Balance sheet as at 31 December 2011

Net Debt/Equity (%)	3.6
NAV per share (US$)	3.11
Net borrowings (US$m)	16.4

Business

RGI is a property development and management company focusing on high-end residential developments and retail properties within Moscow and mid-class residential in the surrounding areas.

Major shareholders

DES (Boris Kuzinets)	40%
Synergy and Petr Shura	24%
Sigrun	20%
Rencap	4%
Prosperity	4%

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The portfolio is dominated by two projects

Of RGI's six developments with a potential gross building area of nearly 1.6m m^2, Tsvetnoy, (now revenue generating) and V Lesu, a 1.3m m^2 project now under construction, comprise 84% of the portfolio value. Most projects are 100% owned, the exceptions being V Lesu, which is 82% controlled and Khilkov, in which RGI has a 50% stake. RGI is controlled and managed by Boris Kuzinets, who owns an approximately 40% stake through his company DES Holding.

Q2 trading update showed encouraging residential sales

RGI recently announced that cash collections in Q212 were 35% higher than in Q1, owing to positive sales momentum at the V Lesu residential development, where 36% of Phase 1 has now been sold, generating over US$90m. The Tsvetnoy Central market also performed well, with sales up 82% y-o-y to over US$18m. Sales of over US$37m in H112 were more than double the H111 when it opened. Management confirmed it is in discussions with a number of parties over the potential sale of the asset, although no agreement has been agreed.

NAV growth to be driven by residential delivery

We expect NAV growth to recover as residential projects (V Lesu and Khilkov) start to generate cash in 2013-14. We calculate a sector consistent NAV, that we use for all the companies. On this basis, we see a four-year compound growth rate of 18% and NAVPS increasing from US$3.11 last year to over US$6.0 in 2015.

Funding strategy is very conservative

RGI's financial strategy is conservative, both in terms of funding and valuations. Management has committed to keeping the balance sheet liquid, with a debt-to-equity ratio of no higher than 50%, compared with the current level of 13%. The company also had cash of US$41m at year end. The Synergy capital (US$97m) can now be treated as equity and part funding the residential business with pre-sales means that debt needs are generally lower.

Synergy dispute is now resolved

In July RGI finally reached agreement with its 24% shareholder Synergy Classic and another shareholder, Synergy director Petr Shura, after their claims against the company were dismissed by London and Guernsey courts in December, ending their attempts to control the board and direct strategy. The non-monetary settlement states that all remaining claims between RGI and its directors and Synergy/Petr Shura will be withdrawn, as will claims between DES Commercial Holdings (RGI's main shareholder) and Synergy. The parties also agreed not to make any future allegations relating to these claims.

Valuation looks attractive

With the stock trading at a 51% discount to 2013e NAV after the weak performance over the past year, the shares appear undervalued, now that the Synergy dispute is resolved. Although RGI is more dependent on fewer projects than its peers, it has a fraction of their debt levels, so it is not necessarily more risky. We estimate fair value at US$394m, using a sum-of-the-parts model, which suggests significant upside from current levels.

The main risk was the long term presence of an unsettled shareholder calling EGMs and bidding for RGI's assets. The main catalyst was also a resolution with Synergy, so now that the dispute has been resolved, the main drivers are likely to be project progress at V Lesu and Khilkov, as well as the potential sale of Tsvetnoy.

Exhibit 60: Portfolio

Project portfolio	Asset type	GBA (m^2)	GLA/GSA (m^2)	Ownership	Completion	Development costs (US$m)
Tsvetnoy	Retail	36,527	15,097	100%	completed	106
V Lesu (Kingston)	Residential	1,325,607	1,054,401	82%	2012-2017	1,512
Khilkov	Residential	27,258	14,470	50%	2013	129
Victory Park	Residential/hotel	25,000	18,991	100%	2013	37
Chelsea	Mixed use	7,600	5,908	100%	2014	34
Ostozhenka	Residential	1,000	1,000	100%	2013	6
New Site near Kingston	Mixed use	150,000	63,000	100%		
		1,570,865	**1,172,867**			**1,816**

Source: Company data

Exhibit 61: SOTP valuation

	GLA m^2	Rental income (US$m)	Development costs (US$m)	End yield	Completion	Project NPV
Tsvetnoy	15,097	23.4	106.3	N/A	Dec 10	247
Chelsea	3,805	3.5	16.3	10.2%	Dec 14	22
Victory Park Hotel	8,600	7.6	37.0	12.0%	Dec 13	17
Commercial portfolio	**27,502**	**34.5**	**159.6**			**286**
Residential	**GSA**	**Sales income**	**Cost of Sales**	**Margin**	**Completion**	**Project NPV**
V Lesu (Kingston)	1,054,401	2,232	1,512	32%	Dec 17	208
Ostozhenka	1,000	25	6	75%	Dec 13	9
Khilkov	14,470	321	129	60%	Dec 13	41
Victory Park Residential	8,000	87	27	69%	Dec 13	29
Victory Park parking	2,391	13		100%	Dec 13	13
Chelsea Residential	2,103	36	9	75%	Dec 14	13
Residential portfolio	**1,082,365**	**2,714**	**1,684**			**313**
Total portfolio	**1,109,867**		**1,843**			**598**
Net current assets						(173)
Net debt						(19)
Minorities						(33)
Adjusted NAV						**373**
Mid-year adjustment						1.06
Fair value at year end						**394**
FV per share (US$)						**2.40**

Source: Company data, Edison Investment Research

Exhibit 62: Corporate governance checklist

Free float	60%
Controlling shareholder	40%
Disclosure of shareholdings	3%
UK combined Corporate Governance Code	Compliant
UK Takeover Code	No
Independent directors	6/11
Audit committee	Yes
Remuneration committee	Yes
Nomination committee	Yes
Registration	Guernsey

Source: Company data, Edison Investment Research

For further information about the directors see the company's website.

Exhibit 63: Financial summary

US$m	2008	2009	2010	2011	2012e	2013e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	1	85	3	2	0	82
Cost of Sales	(7)	(24)	0	(2)	0	(56)
Gross Profit	(5)	62	3	(1)	0	26
EBITDA	(16)	99	(6)	(16)	(16)	11
Operating Profit (before amort. and except.)	(16)	99	(6)	(16)	(16)	11
Intangible Amortisation	0	0	0	1	1	8
Revaluation of investment properties	(900)	(177)	46	(32)	6	33
Other	0	22	7	(29)	0	0
Operating Profit	(915)	(55)	46	(76)	(8)	52
Net Interest	(17)	2	(10)	12	(3)	(12)
Profit before tax (IFRS)	(932)	(54)	36	(65)	(11)	39
Associated company	(16)	(6)	(1)	(20)	0	0
Tax	233	26	(6)	7	3	(9)
Minority interests	86	9	(4)	(0)	(0)	0
Net income (Adj NP)	271	152	(20)	(48)	(13)	5
Net income (IFRS)	(629)	(25)	26	(78)	(9)	30
Average Number of Shares Outstanding (m)	125.8	125.8	142.6	161.8	161.8	161.8
EPS - adjusted (US$)	2.16	1.21	(0.14)	(0.30)	(0.08)	0.03
EPS - adjusted and fully diluted (US$)	2.16	1.21	(0.14)	(0.30)	(0.08)	0.03
EPS - (IFRS) (US$)	(5.00)	(0.20)	0.18	(0.48)	(0.05)	0.19
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	72.5	100.0	N/A	N/A	32.3
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A	12.9
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	N/A	12.9
BALANCE SHEET						
Fixed Assets	736	568	435	158	179	243
Intangible Assets	0	0	0	0	0	0
Tangible Assets	664	494	368	108	130	193
Investments	72	74	67	50	50	50
Current Assets	63	46	320	589	560	755
Stock & Assets held for sale	37	15	245	531	525	712
Debtors	2	3	1	17	0	14
Cash	22	27	55	41	35	28
Other	2	0	19	0	0	0
Current Liabilities	(95)	(9)	(20)	(244)	(237)	(290)
Creditors	(95)	(9)	(8)	(186)	(177)	(189)
Short term borrowings	0	0	(12)	(57)	(59)	(101)
Long Term Liabilities	(189)	(174)	(278)	(51)	(60)	(236)
Long term borrowings	(70)	(107)	(106)	0	(7)	(175)
Other long term liabilities	(120)	(67)	(172)	(51)	(53)	(61)
Net Assets	514	431	457	452	443	473
CASH FLOW						
Operating Cash Flow	(9)	(15)	(21)	(40)	2	(181)
Net Interest	(0)	(8)	(10)	0	(3)	(12)
Tax	0	0	0	(19)	0	0
Capex	(118)	(35)	(69)	(46)	(15)	(22)
Acquisitions/disposals	(27)	27	28	(18)	0	0
Financing	0	(1)	89	51	0	(0)
Dividends	2	3	4	5	6	7
Net Cash Flow	(152)	(29)	20	(68)	(9)	(209)
Opening net debt/(cash)	(130)	48	79	63	16	31
Other	(55)	(3)	(3)	133	(6)	(7)
Other cash adjustments (FX & discontinued operations)	28	0	(1)	(18)	0	0
Closing net debt/(cash)	48	79	63	16	31	247

Source: Company data, Edison Investment Research forecasts. Note: Adjusted net income and EPS exclude revaluation gains, impairments and other exceptional items.

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