LSR:

MAKING THE MOST OF THE CONSTRUCTION BOOM

LSR Group is offering its third rouble-denominated four-year bond issue worth RUR3 bln (about $117 mln) at face value, which will initially trade to put as a straight two-year bond.

LSR Group is the biggest construction holding in Russia's North West. The companies of the group are the key suppliers of building materials, aggregates and construction panels in the region.

LSR's diversified and vertically integrated business comprising production of a wide range of building materials and aggregates, construction and provision of construction services as well as property development, secures the company a unique competitive position in the construction market of Russia's North West, further supported by the high entry barriers in the industry.

Highly transparent by industry standards, the group has a rating of B1 from Moody's Investor Service, the highest among companies operating in Russia's construction sector.

We estimate the fair yield of LSR-3 '11 in the range of 8.9%– 9.13% to a two-year put.

- **We highlight the benefits of stability that company enjoys thanks to diversification, which not only provides protection against price volatility in the real estate market but also enhances cost control in its development and construction segments**
- **LSR's revenue amounted to $777 mln in 2006, rising an impressive 61% YoY in rouble terms. Cost control secured an increase in margins, in particular EBITDA margin went up 3 percentage points to 17.8% in 2006**
- **We believe LSR will benefit from the strategy combining orientation to market momentum with a longer-term focus. The company's capex is primarily aimed at capacity expansion and modernization of the construction materials segment, which will enable LSR to make the most of the recent construction boom and provide a safe haven of relatively low but stable margins after the boom subsides**
- **The massive land bank (5.5 mln sq. m) supports future development projects and also provides a source of liquidity, as land plots for construction have a market value of their own**
- **Leverage as measured by the debt-to-EBITDA ratio is moderate by industry standards. Liquidity is enhanced by about $370 mln of credit lines extended to the company (still unused)**
- **High transparency by industry standards. The group has presented its audited IFRS financials for two years, 2005 and 2006, and was recently assigned a rating of B1 with stable outlook by Moody's**
- **The new placement will lead to only a small increase in LSR's leverage, as most of the proceeds (75%) will be used to refinance the company's short-term debt**

LSR-3 '11	
Sector	Construction
Bloomberg	LSRGRP
Placement date	19 July 2007
Issuer	LSR Group
Issue amount	Rub 3b (~USD 117m)
Coupon	semi-annual
Put option	2 years at 100%
Tenor	4 years
Lead-manager	Uralsib, ABN AMRO
Fair value	YTP 8,9%-9,13%

$ mln	2005*	2006*
Revenue	463	777
Gross profit	131	269
EBITDA	68	138
Net profit**	9	40
Assets	765	1 471
Equity	105	195
Debt	248	550
Gross margin	28,4%	34,6%
EBITDA margin	14,8%	17,8%
Net margin	2,0%	5,2%
Debt / Revenue	0,5	0,7
Debt / EBITDA	3,7	3,9
Net debt / EBITDA	3,3	3,4
EBITDA / Interest	2,5	3,5
Debt / Equity	2,37	2,82
Debt / Assets	0,32	0,37
Current assets / Assets	0,61	0,65
ST debt	79%	40%
Current ratio	0,80	1,06

* ratios based on balance sheet and P&L data were calculated in rouble terms
** in 2005 before a loss from discontinued operations ($5.3 mln)

Source: LSR IFRS financial statements, Uralsib estimates

Fixed Income Research
Kiti Pantskhava PantskhavaKS@uralsib.ru
Phone number +7 (095) 788 0888 x3655
Bloomberg USIB

13.07.2007

Issue parameters

Size – RUR3 bln, semiannual coupons, term to maturity – 4 years, put option – 2 years at par. LSR-3 will initially be traded to put as a straight 2-year bond.

Purpose of the new issue

The proceeds from the placement (RUR3 bln, or about $117 mln) will be split on a 25/75 basis between funding the Group's investment programme and refinancing short-term loans, resulting in only a small increase in net debt.

Ratings

LSR is rated B1 with a stable outlook by Moody's.

Our view on LSR's credit

Strengths:

- LSR is the biggest construction holding in Russia's North West. The companies of the group are the key suppliers of building materials, aggregates and construction panels in the region
- We believe LSR will benefit from the strategy combining orientation to market momentum with a longer-term focus. The construction boom has emerged only relatively recently and will likely continue in years to come, bringing out the benefits of the Group's business model. As margins in the construction industry are currently high, the company is investing massively in the development of the construction materials segment. This will both help the group meet high demand for construction materials in the next several years and provide a safe haven of relatively low but stable margins after the construction boom subsides. It was also wise of the company to enter the commercial real estate business, which will become a source of cash flow once the construction boom peters out
- The group's competitive position in the North West is secured by both high barriers to entry and the name it has made for itself over 14 years in the construction business
- Diversified business with about 60% of revenue provided by the construction materials segment, implying lower sensitivity to price fluctuations in the real estate market
- The massive land bank (5.5 mln sq. m) supports future development projects and also provides a source of liquidity, as land plots for construction have a market value of their own
- Leverage as measured by the debt-to-EBITDA ratio is moderate by industry standards. Liquidity is enhanced by about $370 mln of credit lines extended to the company (still unused)
- High transparency by industry standards. The group has presented its audited IFRS financials for two years, 2005 and 2006, and was recently assigned a rating of B1 with stable outlook by Moody's

Challenges:

- If financed with debt, the planned capex will negatively affect both the capital structure and leverage
- High leverage as measured by Debt/Equity and Debt/Total assets along with the planned capital expenditure calls for raising capital

through either a private placement or an IPO in order to maintain financial stability

Issuer profile

LSR Group is a diversified vertically integrated construction company with a focus on the production of building materials, construction, construction services and real estate development. Founded in 1993, the group has become a leader in the construction industry of Russia's North Western region.

Most of the group's revenue comes from the four business divisions:

- Real estate development
- Building materials
- Aggregates (crushed rock production, sand and sea sand quarrying)
- Construction and construction services

The building materials and aggregates segments secure the bulk of revenue, contributing 59% to the top line in 2006.

Construction and construction services were the second largest source of revenue in 2006 with a combined contribution of 26%, while real estate development accounted for just 14% of sales.

The group's diversified operations provide an important safeguard against the volatility of the housing market, while vertical integration, in particular, the strong construction materials segment, allows effective cost management.

LSR Group's sales totaled $777 mln in 2006, a 61% increase in rouble terms from $463 mln in 2005, mainly on the back of the building materials and aggregates segments' expansion, which accounted for over 60% of revenue growth.

As a developer, the company is ranked number one in St. Petersburg's luxury housing segment. The group's real estate development activities are equally spread between highly profitable elite real estate and economy-class housing. Such distribution of projects gives LSR Group protection against a possible downturn in the housing market. Demand for luxury apartments is relatively stable and is only liable to moderate volatility, while the economy-class housing is the segment sensitive to a slightest economic downturn.

In the construction segment, LSR is a leading producer of large precast panels used in mass-market housing developments.

To sum up, high margins and low volatility of demand in the luxury real estate segment provide a safety cushion against possible losses in the economy class segment.

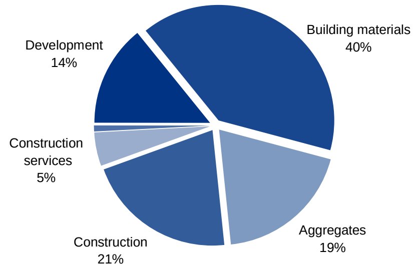
The massive land bank (5.5 mln sq. m) not only supports future development projects, but also provides a source of liquidity, as land plots for construction have a market value of their own.

Ownership structure

Andrei Molchanov, the founder of LSR, holds a majority stake (81.5%) in the group, with the rest (18.5%) controlled by directors and their family members.

Thanks to its shareholders and directors the company enjoys the benefit of a strong relationship with the St Petersburg government and administrative authorities and has a strong track record of successfully obtaining permits and developing projects in the region.

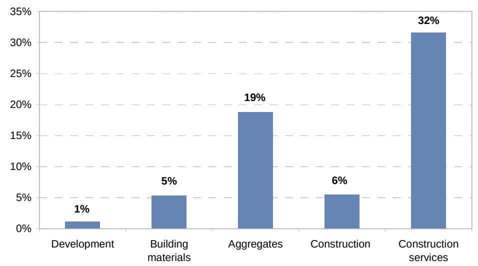
Figure 1: LSR's revenue* structure



*before elimination of inter-segment operations

Source: LSR IFRS financial statements

Figure 2: Inter-segment revenue as percentage of total segment revenue



Source: LSR IFRS financial statements

LSR Group

BUILDING MATERIALS
- OAO Pobeda LSR (99,87%)
- OAO Ob'edinenie 45 (97,03%)
- OOO Obiedinenie 45-M (100%)
- OAO PO Barrikada (95,5%)
- OAO ZHBI-6 (57,7%)
- ZAO Vertical (100%)
- ZAO Skanex (100%)
- Nordwest Baustoff Beteiligungs GMBH (50%)

CONSTRUCTION SERVICES
- OAO GATP №1 (99,8%)
- OAO UM-260 (97,11%)

CONSTRUCTION
- ZAO Gatchinskiy DSK (99,13%)
- ZAO DSK block (100%)
- ZAO Stroitrest №28 (50%)

DEVELOPMENT
- JSC Construction Corporation Revival of St. Petersburg (97,78%)
- OOO Gatchinskiy DSK (100%)
- OOO Osobnyak (100%)
- ZAO Mosstroirekonstruksia (100%)
- LSR-Europe GMBH (100%)

COMMERCIAL REAL ESTATE
- ZAO A Polus Estate (100%)

AGGREGATES
- OAO Granit-Kuznechnoye (95,09%)
- OAO Rudas (99,9%)
- OAO Lenrechport (100%)

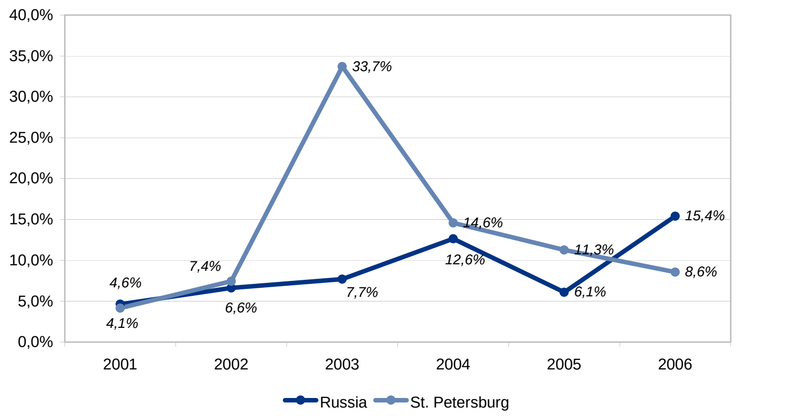
OTHER
- OOO BaltStroiKomplekt (100%)
- OOO Kvartira Lux Service (100%)
- OOO "PSG LSR " (100%)
- ZAO Promishlenniy Leasing (100%)
- Mayer-Melnhof Russland Beteiligung GMBH (30%)
- OOO LSR-Invest (100%)

Industry overview

The output of the construction and construction materials industries dropped drastically after the collapse of the Soviet Union, with annual housing output decreasing from 61.7 mln sq. m in 1990 to 30.6 mln sq. m in 2000.

The recovery of the Russian economy after the 1998 default brought about

Figure 3: LSR's share of construction service market in Russia's North West



Source: Rosstat, Petrostat

acceleration in real GDP and disposable income growth. This and the timely adoption of laws regulating real estate development have led construction activity to expand. By 2006, Russia's residential construction output reached 50.2 mln sq. m, rising 64% in six years.

St Petersburg is Russia's third largest real estate market after Moscow and the Moscow region and is among the fastest growing construction markets. In 2000–2006, the CAGR growth of housing space completed in St Petersburg reached 13%, outpacing that in Russia by 4.1 percentage points.

Several factors supported dramatic expansion of the housing construction market:

- First and foremost, solid economic growth and rising disposable personal income boosted demand for new housing
- Russia's per capita housing space of 20.4 sq. m is far below that in Europe – 35 sq. m per capita
- Poor quality of the existing housing stock, a significant proportion of which thus requires replacement in years to come
- Emergence of mortgage lending further supports households' purchasing power, thus increasing demand for housing

As demand exceeds supply in the market, housing prices have soared across Russia, with Moscow being the most expensive city as measured by the price per sq. m.

A year after the 1998 default, the price of one sq. m of housing collapsed by 40%, from $500 to $300, in St Petersburg, rebounding only after 2000. Prices increased an estimated average 25–30% per year in the primary residential property market in 2001–2002. Growth slowed in 2005, when prices saw a modest 1.5% increase due to oversupply in the market, only to accelerate the following year. In 2006, prices for new housing jumped 110–119%, depending on the segment.

Increasing property prices are fuelling growth in the earnings of construction companies and producers of building materials. At the same time, the long-lasting steady rise in prices and their high absolute level pose a risk of correction, which is already taking place in the Moscow market and is likely to have a negative effect on developers' revenue and margins.

We believe that any moderate price decline will in the first place affect developers, while the top line and margins of building materials producers will remain immune to changes, as long as these are not so drastic as to force a downturn in new construction.

The construction industry benefits from the high entry barriers that make it very difficult for new players to launch full-scale operations in a market that has a recognized well-established group of leaders. The most significant entry barriers include:

- *High cost of entry,* which includes both the cost of land and high capital requirements of construction materials manufacturing. Small building plots are scarce in St Petersburg. Most of the sites available for development projects are so-called "brownfields" that may require significant investment in the construction of roads, utility lines and so on, before housing construction starts. In the construction materials sector, startup expenses are not limited to the cost of land but include investment in the purchase and installation of equipment, which may require initial cash outlays of several hundred million dollars
- *Scarcity of mineral resources as well as licensing requirements*. Manufacturing of construction materials, such as brick and crashed rock, and quarrying of sand, require access to clay, granite and sand deposits which are very few in the St. Petersburg area. Moreover, extraction is subject to licensing by government authorities

- *A strong brand recognition and a well-established client base* of local players are significant factors favouring them over newcomers
- *A long-standing relationship* with St. Petersburg authorities is an important competitive advantage of local players and LSR in particular

Market share

The group is a market leader in North Western Russia. Its top position in the rankings is protected by high entry barriers resulting from massive capital requirements and the company's well-established business relations with customers that can buy a variety of building materials and aggregates from a single supplier – LSR Group. Moreover, LSR is a leading provider of construction services in the region.

As a developer, the company focuses on the elite and economy-class housing segments. The revenue secured by the development business is not high, but 5.5 mln sq. m of land provides a solid basis for future growth.

Below are a brief description of the group's major products and services and an estimate of LSR's market share in St Petersburg as of the autumn of 2006.

Real estate development and construction

LSR is a recognized developer of elite residential real estate in St Petersburg. As of the autumn of 2006, the group led the rankings with 26% of the local market. LSR also develops economy-class housing in the St Petersburg area and business-class residential projects in the Moscow region.

LSR is a leading producer and assembler of large precast panels in mass market housing developments with an estimated share of 70% in the St Petersburg market (the autumn of 2006). The construction division's contribution to the group's top line stood at $170 mln in 2006.

LSR' land bank exceeds 5.5 mln sq m, including over 400 thousand sq. m of useful space in prime locations in central St Petersburg.

Construction services

The construction services segment provides tower cranes and truck shipping services to construction companies in the St Petersburg area.

Tower cranes

LSR is the leading provider of mechanized construction services in St Petersburg. The group rents out tower cranes and hoisting machinery and provides the crews. LSR's cranes are currently in use in St Petersburg, the Leningrad region and Sochi.

Building materials, aggregates and construction services

The building materials, aggregates and construction services segments secured 64% of the group's revenue in 2006. The production of construction materials and aggregates is highly concentrated in the group's home market, with 3–4 biggest producers securing 60–70% of supplies. LSR is a major player in Russia's North West, leading the ranking of suppliers for a wide range of building materials and aggregates.

Sand

LSR is a leader in the market for construction sand in the St Petersburg area and the only supplier of sea sand. The group controlled 69% (the autumn of 2006) of the St Petersburg market, which is off limits to imports from other regions because of high transportation costs.

Figure 4: LSR's share of brick market in Russia's North West

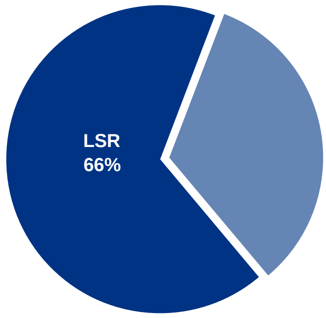


Figure 5: LSR's share of sand market in Russia's North West

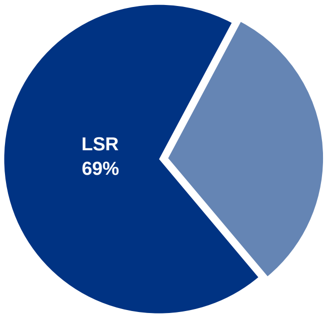


Figure 6: LSR's share of reinforced concrete market in Russia's North West

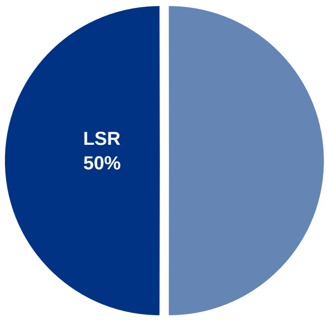
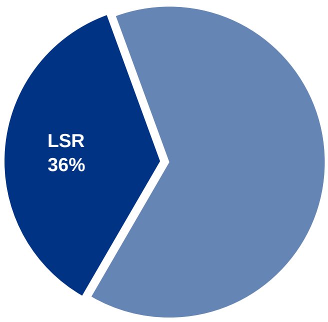


Figure 7: LSR's share of ready-mix concrete market in Russia's North West



Crushed rock

LSR is the largest producer of high quality granite stone in the North West of Russia. Access to quarries is crucial in crushed rock production. LSR controls three granite stone quarries located in the Priozersk district of the Leningrad region.

The market is highly concentrated, with four biggest players controlling 80% of supplies.

In the autumn of 2006, LSR's market share stood at 35% in St Petersburg.

Bricks

LSR is the largest brick producer in Russia. The group holds mining licenses for two major high quality clay deposits, Krasny Bor and Nikolskoye, with a reserve life of 100 years based on current production levels.

The brick market is highly concentrated, with three biggest producers controlling about 80% of it.

LSR had a market share of 66% in the autumn of 2006.

Ready-mix concrete

LSR has created the largest network of mortar mix and ready-mix concrete production facilities in St Petersburg. The ready-mix concrete market is local because the material loses its properties when transported long distances. The high quality of the mix is guaranteed if transportation time is no longer than 45 min.

The concentration of the St Petersburg concrete market is high and is further increasing. In 2005, seven biggest producers supplied 80% of the material.

LSR controlled 35% of the market in the autumn of 2006.

Prefabricated reinforced concrete items

LSR is the largest producer of prefabricated reinforced concrete in its local market. LSR's prefabricated reinforced concrete products were used in about 70% of all buildings under construction in St Petersburg as of the autumn of 2006.

Aerated concrete

LSR is the largest producer of aerated concrete in Russia and Northern Europe, its production facilities are located in Russia, Estonia and Latvia.

The group's share of the St Petersburg aerated concrete market was 55% as of the autumn of 2006.

Figure 8: LSR's share of crushed rock market in Russia's North West

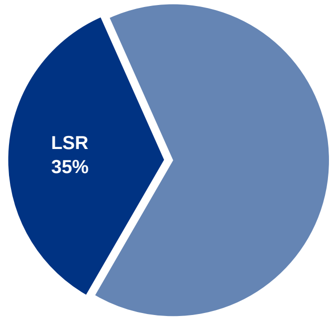


Figure 9: LSR's share of aerated concrete market in Russia's North West

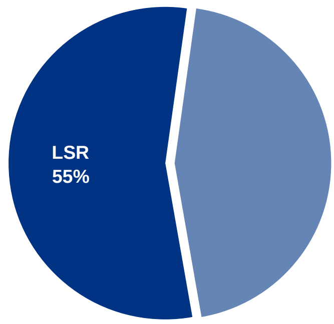


Figure 10: LSR's share of construction (panels) market Russia's North West

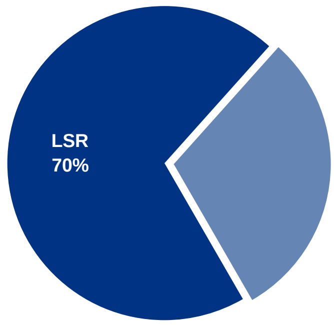
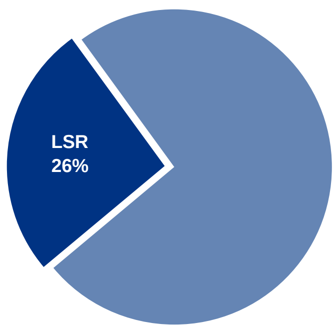


Figure 11: LSR's share of elite real estate development market in Russia's North West



Financials

We are basing our analysis on consolidated IFRS financials audited by KPMG for two consecutive years – 2005 and 2006.

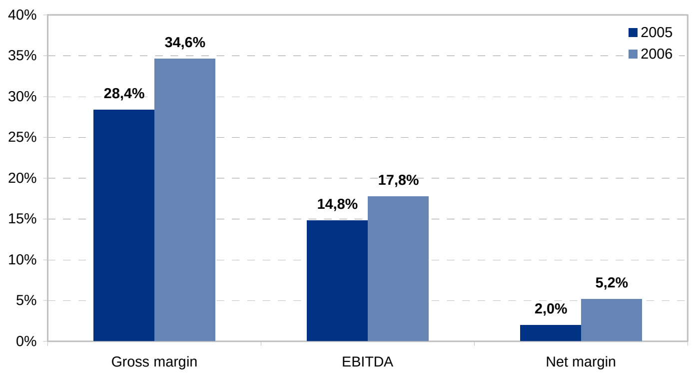
P&L

LSR's revenue amounted to $777 mln in 2006, rising an impressive 61% YoY in rouble terms. The main contribution to improvement in the group's performance came from three business segments – building materials, aggregates and construction, which, taken together, accounted for about 90% of the increase in 2006. Their individual shares in the consolidated revenue growth equaled 47%, 25% and 17% respectively, with the development segment securing a mere 10%.

EBITDA almost doubled to $138 mln over the year, with EBITDA margin rising 3 percentage points from 14.8% in 2005 to 17.8% in 2006.

Net profit was the best performing P&L item, rising from $9 mln to $40 mln in 2006. Supporting the striking profitability increase were the faster growth of revenue than that of costs and additional income from the revaluation of investment property, foreign exchange gain and dividends.

Figure 13: Margins 2005 2006



Source: LSR IFRS financial statements

Assets

Total assets stood at $1,471 mln in 2006, up 92% from 2005. Independent appraisal of property, plant and equipment performed by American Appraisal in 2005 was used in the revaluation carried out on January, 1 2006.

Figure 12: Summary financials of LSR

$ mln	2005*	2006*
Revenue	463	777
Gross profit	131	269
EBITDA	68	138
Net profit**	9	40
Assets	765	1 471
Equity	105	195
Debt	248	550
Gross margin	28,4%	34,6%
EBITDA margin	14,8%	17,8%
Net margin	2,0%	5,2%
Debt / Revenue	0,5	0,7
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Debt / Equity	2,37	2,82
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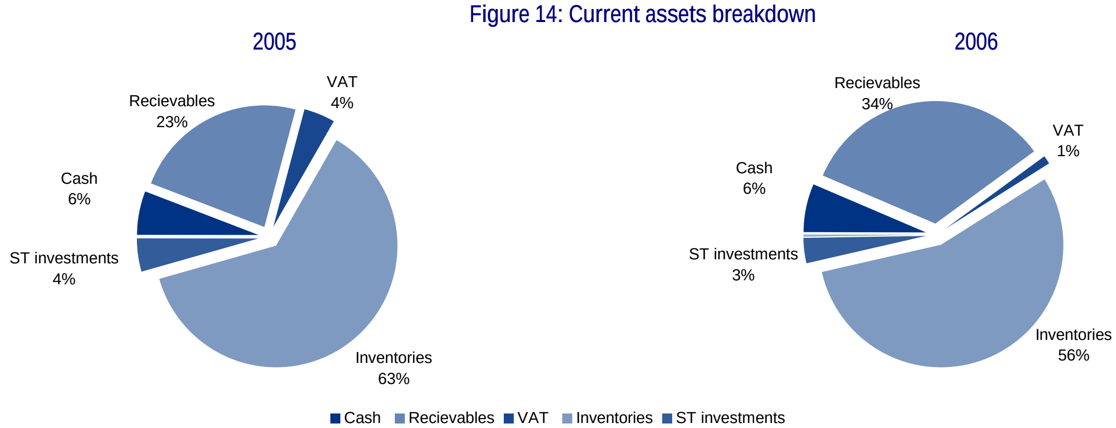
Current assets / Assets	0,61	0,65
ST debt	79%	40%
Current ratio	0,80	1,06

* ratios based on balance sheet and P&L data were calculated in rouble terms
** in 2005 before a loss from discontinued operations ($5.3 mln)

Source: LSR IFRS financial statements, Uralsib estimates

Figure 14: Current assets breakdown

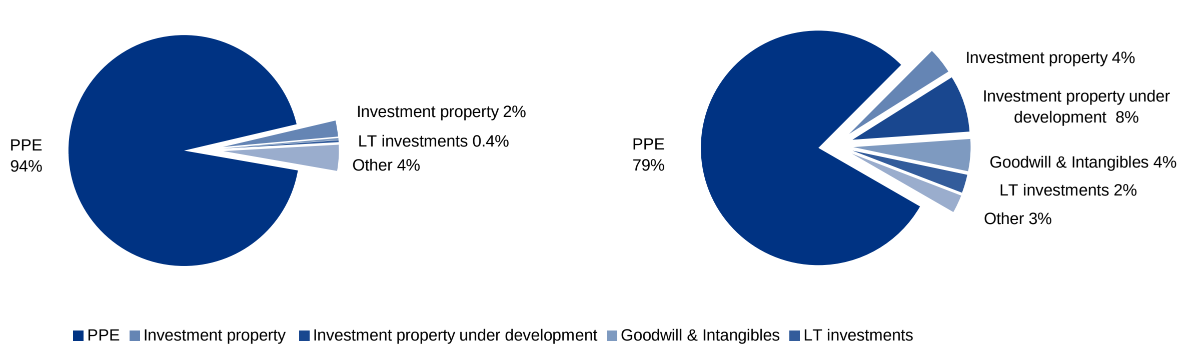


Source: LSR IFRS financial statements

The expansion in total assets came from an increase in inventories, receivables and PPE. Most of the gain in inventories was owed to the construction work in progress and completed construction, reflecting growth in real estate development operations. Prepayments for apartments played the major role in the receivables growth. Focus on the development of the construction materials segment, including efficiency improvement, capacity expansion and investment in new plants resulted in intensive capital investment during 2006, boosting PPE. The expansion in PPE was also driven by acquisitions and business combinations in 2006.

The overall asset structure included 65% of current and 35% of non-current assets, a minor change from 61% and 39% respectively in 2005.

Figure 15: Non-current assets breakdown



Source: LSR IFRS financial statements

Bank loans were collateralized by fixed assets with the carrying value of approx. $137 mln, inventories worth US$0.55 mln and shares in subsidiaries, including four guarantors of the third bond issue – 61% of ZAO Gatchinsky DSK, 100% of OAO Lenrechport, 90% of OAO Granit-Kuznechnoe and 81% of OAO Pobeda LSR.

Debt and liquidity

Financial debt equaled $550 mln in 2006, up 122% from 2005.

Debt before obligations under financial leases, which accounted for 8.5% of borrowed funds in 2006 increased to $594.2 mln by 1 May 2007.

Debt/Total-assets slightly increased from 32% in 2005 to 37% in 2006.

Debt/EBITDA rose from 3.7x to 3.9x, while the interest coverage ratio improved from 2.5x to 3.5x in 2006, reflecting both the improved margins and lower interest expense.

About 63% of the group's debt was denominated in roubles, with the effective rate of interest on rouble-denominated debt averaging 10.1%, euro-denominated – 8.35% and dollar-denominated– 9.48%. The effective borrowing rates declined for loans in all of the three currencies.

The maturity profile shifted towards longer-term loans with the ST debt ratio falling from 79% in 2005 to 40% in 2006. The bulk of the loans mature in the period starting after one year and before three years.

Figure 16: Debt breakdown by currency

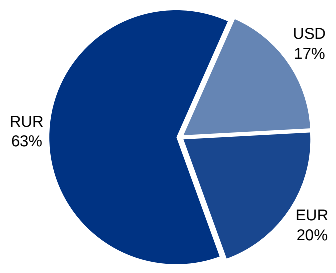
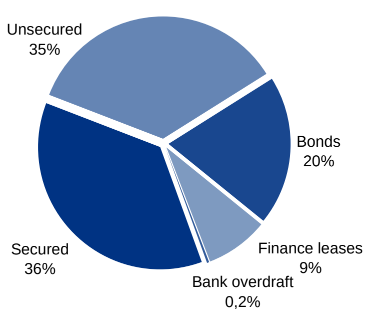


Figure 17: Debt breakdown by form



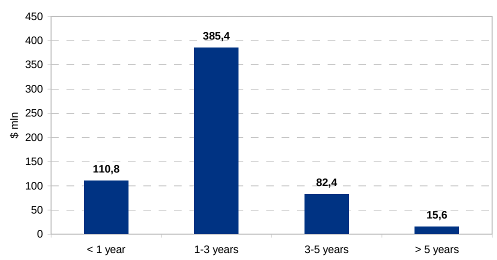
Source: LSR IFRS financial statements

Figure 19: Creditors as of 1 May 2007

$ mln	
Bonds	107,1
Sberbank	134,3
PSB	109,7
Bank of St Petersburg	0,7
Deutsche Bank	194,1
EUROHYPO AG/ Hypo-Alpe-Adria-Bank	20,9
Other	27,4
Total	594,2

Source: LSR

Figure 18: Debt maturity profile as of 1 May 2007



Source: LSR

The company has a very safe liquidity profile as evidenced by current ratio improvement from 0.8x in 2005 to 1.1 in 2006 and the EBITDA interest coverage ratio as well as timely access to bank loans. Credit lines extended but not yet used by the group amounted to $369.4 mln.

Capex

The group's investment programme is primarily focused on its construction materials and aggregates segments. In 2007–2010, the company is planning to invest $1.2 bln–$1.6 bln

The construction boom has emerged only relatively recently and will likely continue in years to come, bringing out the benefits of the Group's business model. As margins in the construction industry are currently high, the company is investing massively in the development of the construction materials segment. This will both help the group meet high demand for construction materials in the next several years and provide a safe haven of relatively low but stable margins after the construction boom subsides. It was also wise of the company to enter the commercial real estate business, which will become a source of cash flow once the construction boom peters out.

Although we are positive on the group's business model and strategy that can be inferred from the structure of its investment programme, the size of investment seems to be excessive. There is a possibility of serious deterioration in the company's credit quality if it chooses to finance capex only from its cash flow and with debt, especially in the early stages of investment programme implementation, which makes a private placement or an IPO a very realistic source of raising much needed capital.

Figure 20: LSR's investment programme

Business segment	Investment purpose	Tentative schedule
Cement production	· Construction of 1.95-mln-ton cement factory to meet company's own needs	2010
Brick production	· Construction of new factory with annual capacity of 220 mln bricks and lower operating costs	2009
Operation of construction machinery fleet	· Purchase of new cranes, hoists, truck cranes and other vehicles and machinery	2007-2010
Concrete production	· Production capacity expansion · Production efficiency improvement · Product quality improvement	2007-2010
Crushed granite production	· Installation of new production machinery to expand production by up to 600 thousand sq. m of crushed granite annually · Development of Zabolotnye deposit	2007-2010
Sand quarrying	· Introduction of new sand quarrying technologies · Launching of new quarries, land purchase · Modernization and replacement of machinery and vehicles · Establishment of relevant infrastructure	2007-2010
Areated concrete production	· Construction of new factories in Ukraine (capacity of 400 thousand m^3) and Lithuania (350 thousand m^3) · Modernization of factory in Latvia	2008–2009 2007
Production of prefabricated concrete items	· Production capacity expansion · Product quality improvement	2007-2010
Panel production	· Equipment modernization	2007-2010
Transportation services	· Garage space expansion · Purchase of new vehicles · Construction of maintenance centre	2007-2010

Source: LSR

Public track record

LSR Group has two outstanding bond issues in the domestic debt market:

- LSR-1: RUR 1 bln (about $39 mln) maturing on 20 March 2008, coupon – 10%
- LSR-2: RUB 2 bln (about $78 mln) maturing on 8 December 2009, put option on 3 June 2008, coupon – 10.7%

Market peers

The construction industry is widely represented in the domestic bond market. There are two distinctive groups of companies in terms of yields of their bond issues trading in the secondary market. One is made up of construction industry leaders based on either scale of their operations or quality of financial statements, corporate governance and transparency. The other comprises fairly small regional companies showing slow growth, high leverage, lack of audited consolidated financials or any combination of these.

This segmentation of the construction industry risk is supported by the premiums over the OFZ curve. The leaders' premiums are in the range of 300–450 bp, corresponding to a yield range of 8.5%–10%, while those in the rear-guard trade at 600 bp over the OFZ curve and higher, yielding more than 12%.

The leaders include GlavMosStroy, PIK and SU-155 – the biggest construction groups with an output of over 1 bn sq. m of housing per year. Despite their huge operations, these three companies have a very complicated corporate structure with cross ownership, lack consolidated IFRS financial statements and transparency. Although the PIK group has recently floated its shares in the public market, its IFRS financials are not available to investors at large.

LSR, Mirax and LenSpetsSMU have ratings from international rating agencies and produce audited consolidated IFRS accounts. While their construction volumes are far below those of GlavMosstroy PIK and SU-155, they benefit from their higher transparency and the rating agencies' independent appraisal of their credit.

Russian accounting standards (RAS) envisage no revenue recognition under the percentage of completion method. Moreover, there is no single method of accounting under the completed contract method, nor are there any sound consolidation standards. Because of the drawbacks of RAS, as well as the complicated corporate and legal structure of Russian developers, where most holdings comprise dozens of companies, IFRS financials are not comparable with RAS statements.

We believe the relative credit quality can be best estimated by looking at a peer group with similar characteristics. Companies that are the most suitable for comparison with LSR are Mirax and LenSpetsSMU.

Mirax is a developer operating in the Moscow market. The company is rated B2 by Moody's and B by Fitch. Mirax Group is among the leaders in business-class commercial and residential real estate. Between 2000 and August of 2006, Mirax completed a total of 378.7 thousand sq. m of both commercial and residential property. Under construction at the end of the period were 2,079.9 thousand sq. m, including the Federation Complex in Moscow's most ambitious City project.

As of February 2007 the group had a sizeable land bank of 5 mln sq. m.

Mirax was initially established as a branch of St Petersburg-based construction company Stroimontazh, which was incorporated more than 10 years ago by Sergei Kirilenko and Artur Polonsky. The latter headed the Moscow branch in 2000 and after its rebranding in 2004 became a majority shareholder in Mirax Group.

Mirax reports its financials under US GAAP. The latest available audited (KPMG) data is for 2005.

Unfortunately, the company has not yet released its audited consolidated financials for 2006.

LenSpetsSMU is among the leading developers in Russia's North Western region. The company is rated B by S&P. Having operated for almost 19 years, the group claims to control 15.8% of the St Petersburg market. The group's corporate and legal structure is relatively transparent compared with its Russian peers. There are 26 companies making up the group, with two of them controlling most of the assets and cash flow. The company is owned by five individuals and focuses mainly on the mass and business class segments of the market.

One should bear in mind that although we consider Mirax and LenSpetsSMU to be close peers of LSR Group, direct comparison of these companies is limited by the following factors:

- Unlike its chosen peers, LSR Group is not a pure developer. The bulk of its revenue and EBITDA comes from the construction materials and aggregates segments
- Another weak point of our comparison is reporting standards. LSR Group reports under IFRS, while Mirax Group produces US GAAP financials, which may lead to discrepancies as balance sheet and P&L items are calculated. Moreover, Mirax Group has yet to present its audited consolidated financials for 2006

LSR vs LenSpetsSMU:

Pros:

- LSR is a leading vertically integrated construction company in Russia's North West. The companies of the group are the key suppliers of building materials, aggregates and construction panels in the region
- LSR is significantly larger in scale (sales of $777 mln compared with LenSpetsSMU's $284 mln)
- LSR's EBITDA margin was above that of LenSpetsSMU – 17.8% vs. 9.5%

Contras

- LenSpetsSMU is a construction leader in St Petersburg, focusing on property development
- LenSpetsSMU has a stonger capital stucture with Debt/Total assets at 19% against 37% for LSR Group

Overall, we believe LSR is superior to LenSpetsSMU. Having operated in the same regional market for over a decade, the companies have achieved quite different results. LSR Group has built a diversified vertically integrated construction holding that earns almost triple the revenue of LenSpetsSMU while managing to keep under control its leverage – it is roughly equal to that of LenSpetsSMU as measured by Debt/EBITDA and Debt/Equity. The comparison of LSR with LenSpetsSMU brings out the strengths of LSR's diversified business model.

As implied by a rating of B1 from Moody's Investors Service – one notch above Mirax's B2, the credit quality and business model of LSR Group are more stable than those of Mirax Group. The difference in the ratings is in line with our view on the companies' credit and business models.

Based on the 2005 financials, the LSR credit was roughly on a par with that of Mirax. LSR's weaker margins were offset by the factor of scale and the business model that provides for diversified sources of revenue and control of the cost of inputs due to vertical integration. In the absence of Mirax Group's audited financials for 2006, Moody's ratings are the latest indications of LSR Group's current slight superiority in credit quality.

Figure 21: LSR relative to its peers, USDm

$ mln	LSR 2006	LenSpetsSMU 2006
Revenue	777	284
Gross profit	269	35
EBITDA	138	27
Net profit	40	16
Assets	1 471	501
Equity	195	39
Debt	550	96
Gross margin	34,6%	12,3%
EBITDA margin	17,8%	9,5%
Net margin	5,2%	5,6%
Debt / Revenue	0,7	0,34
Debt / EBITDA	3,9	3,6
Net debt / EBITDA	3,4	3,5
EBITDA / Interest	3,54	6,29
Debt / Equity	2,82	2,44
Debt / Assets	0,37	0,19
Current assets / Assets	0,65	0,91
ST debt	40%	10%
Current ratio	1,06	1,78

Source: Companies, Uralsib estimates

Valuation

We believe LSR's debt should trade at a discount to that of LenSpetsSMU and at roughly the same spread over the OFZ curve as Mirax Group or even tighter.

LSR's yield curve is also useful for estimating the fair range of the upcoming LSR-3 placement. The market prices the LSR-2 credit at 360 bp over the OFZ curve, implying a yield to put of 9.3% for the LSR-3 bond.

Mirax's spread over OFZ is about 335 bp, corresponding to a two-year yield of 9.05%.

LenspetsSMU is trading at 400 bp over OFZ, or 9.7% if the debt had a two year tenor.

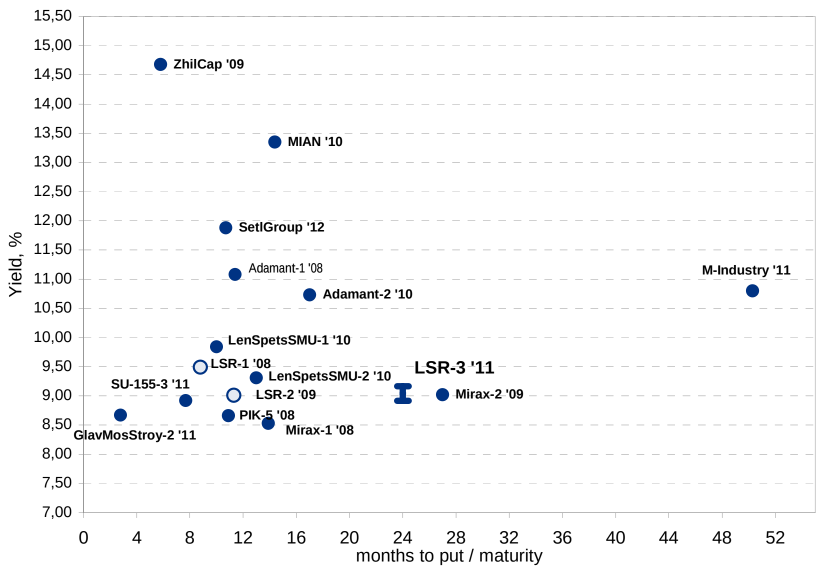
We believe the credit quality differential between LSR and LenSpetsSMU is worth at least 50 bp. At the same time, there are few, if any, factors to justify a premium of the LSR credit over that of Mirax.

To sum up, there are three possible points on the yield curve where the LSR-3 bond may trade. The first estimate, derived from the group's own yield curve, is 9.3%, the second comes from an estimate of LenSpetsSMU's two-year yield of 9.7% less a 50-bp premium, resulting in the 9.2% level. The third is justified by both our view on the LSR credit relative to Mirax and the former's higher rating, suggesting a zero spread or even a discount of LSR to Mirax. An assumption of a mere 10-bp discount to Mirax Group spread, justified by the rating differential, produces a yield estimate of 8.9% for LSR-3.

In our view, the average of the three approaches (9.13%) sets the higher bound of the LSR-3 fair yield to put, while 8.9% is an estimate of the lower bound for the issue. The fair yield is therefore in the range of 8.9%–9.13%.

The following chart shows the current market positions of the construction sector's outstanding bonds.

Figure 22: Market picture



Source: Micex, Cbonds

Fixed Income

Head of Fixed Income
Alexander Pugach, apugach@uralsib.ru

Sales and Trading

Head of Sales and Trading
Eduard Koluzanov, Koluzanovea@uralsib.ru

Sales
Sergey Shemardov, Head of Sales, she_sa@uralsib.ru
Elena Dovgan, vice-president, dov_en@uralsib.ru
Anna Karpova, vice-president, kar_am@uralsib.ru
Dmitry Kuznetsov, sales-manager, kuznetsovde@uralsib.ru
Dmitry Popov, sales-manager, popovdv@uralsib.ru

Editorial
Evgeny Grinkrug, editor/translator, grinkruges@uralsib.ru

Trading
Andrey Borisov, senior trader, bor_av@uralsib.ru
Vyacheslav Chalov, trader, chalovvg@uralsib.ru
Konstantin Makarov, repo-trader, makarovkv@uralsib.ru

Fixed Income Research
Kiti Pantskhava, senior analyst, pantskhavaks@uralsib.ru
Nadezhda Myrsikova, analyst, myr_nv@uralsib.ru

Debt Capital Markets

Head of Debt Capital Markets
Dmitry Shklovsky, Shklovskyda@uralsib.ru

Issuer Support Services
Guzel Timoshkina, Head of Support, tim_gg@uralsib.ru
Natalia Grishenkova, senior associate, grischenkovane@uralsib.ru
Galina Gudyma, senior associate, gud_gi@uralsib.ru
Olga Stepanenko, senior associate, stepanenkooa@uralsib.ru

Victor Orekhov, vice-president, ore_vv@uralsib.ru
Evgeny Kochemazov, vice-president, kochemazov@uralsib.ru
Olga Krasnoperova, associate, krasnoperovaoy@uralsib.ru

Equity Research

Co-Heads of Equity Research
Konstantin Chernyshev, che_kb@uralsib.ru
Kim S Iskyan, iskyanks@uralsib.ru

Strategy
Anton Tabakh, CFA, tabakhav@uralsib.ru
Leonid Slipchenko, slipchenkola@uralsib.ru

Politics & Economics
Vladimir Tikhomirov, PhD, tih_vi@uralsib.ru

Banking
Anton Tabakh, CFA, tabakhav@uralsib.ru
Leonid Slipchenko, slipchenkola@uralsib.ru

Utilities
Caius R. Rapanu, rap_ca@uralsib.ru
Matvey Taits, tai_ma@uralsib.ru
Pavel Popikov, popikovpn@uralsib.ru

Metals & Mining
Michael Kavanagh, kavanaghms@uralsib.ru
Kirill Chuiko, chu_ks@uralsib.ru
Dmitry Smolin, smolindv@uralsib.ru

Oil & Gas
Caius R. Rapanu, rap_ca@uralsib.ru
Evgeniya Dyshlyuk, dyshlyukem@uralsib.ru

Telecommunications, IT & Media
Konstantin Chernyshev, PhD, che_kb@uralsib.ru
Konstantin Belov, belovka@uralsib.ru

Consumer Goods & Retail
Andrei Nikitin, nikitinai@uralsib.ru
Maria Startseva, startsevamv@uralsib.ru