



Iskander Lutsko, chief investment strategist
Stanislav Yudin, senior equity research analyst
Olga Nikolaeva, senior fixed income analyst
Elizaveta Herne, analyst

What is happening on Russian capital markets?!

FALSE MARKET MOVEMENT

The Russian equity market stands on fragile footing subject to geopolitical risks. In fact, since resumption of equity trading on the Moscow Exchange on March 24, we have seen market making false movement based on unjustified expectations. After reaching a local peak on April 4 (+8% since March 24), the stock market has been declining and has already fell 18,5% to the levels of February 25, falling 9,3% short of the low of February 24 (start of the military conflict in Ukraine), or the local low of August 2018.

Since the trading resumed, key losers included the oil and gas sector and banks (the most liquid securities were sold, partly due to delisting), top gainers were retail (Magnit, Fix Price) and communications companies (VK).

The average volume of trading on the Moscow Exchange last week was ₺27 bln per day, compared with ₺50 bln per day immediately after the reopening. After systemically important credit institutions (SICI)/banks (following the Central Bank's move to ease terms of fixing book value) bought shares worth ₺46 bln in March, household investors have been driving the bulk of trading. This is the reason behind a drop in trading and performance of shares, which are traded in the absence of clear market direction. According to the Moscow Exchange, the number of unique accounts has increased to 19 mln (26.3% of the active population and 13% of the total population of Russia). In the US, individuals directly invest in 40% of the equity market and through institutional funds in the remaining 60%. At the same time, local and international funds have traditionally accounted for the bulk of trading in the Russian market. **Local funds, including managing companies and NPFs, have a negative view of the stock market.**

The main reason for the negative view of the equity market is the short planning period, the high risks of reduced operating flows of export-oriented companies, and the uncertainty with the rouble exchange rate, which significantly increases the risks of investing in companies with a focus on the local market. A potential equity overhang following GDR conversion into shares adds to the downside. The overhang from sales of Russian companies' receipts by residents after delisting and local shares by non-residents (should the ban be lifted) could exceed \$60 bln (₺4,500 bln), or 14% of current market capitalisation.

Criteria	Estimate, ₺ bln
Market capitalisation of MoEx	35 790
Free-float	14 010
Receipt holders	9 246
Non-residents	5 540

Source: ITI Capital, Bloomberg

Meanwhile, the bond market is moving in an opposite direction following a sharp cut of the key rate (on April 8). **The rouble is strengthening against the dollar, despite easing of capital flow restrictions due to low demand for the hard currency and its limited supply in the banking system.**

Other important reasons behind the market decline

1. Delisting of Russian shares/equity sales by residents. Delisting legislation will come into force on April 27 - Russian companies have until 5 May 2022 to terminate the contracts under which they offered securities under foreign law and close the depositary receipt programmes. We estimate that, based on the equity share of the receipts, their value after conversion into local securities will amount to ₺9,245 bln, or 27% of the Moscow Exchange's capitalisation. We estimate that a third of these holders are residents and around 10% of them could sell their receipts for ₺920 bln. Selling such number of receipts in the market would require much time, as the trading volume now stands at ₺25-30 bln per day. After the February sanctions, **the value of the Russian equity portfolio of foreign funds, including local securities and receipts, fell to \$47 bln (₺3 666 bln). Before the sanctions, the share of non-residents was \$200 bln, while the market capitalisation exceeded \$800 bln.** Based on the current market capitalisation, the share of non-residents, including individuals, could amount to ₺5,539 bln at best. (\$71 bln). Non-residents will not be able to sell Russian securities until transactions between NSD and Euroclear are resumed.

2. Sanctions rhetoric intensifies. Europe is working on hey another package of sanctions against Russia, the sixth in less than two months. Over the past two weeks, the West has imposed sanctions on Russia's banking sector, including Sberbank and Alfa Bank, triggering a reallocation of bank assets and forced selloffs, including of local stocks and bonds.

The speculations about an embargo on oil and gas imports from Russia to Europe (which accounts for 70% of Russian energy exports) have intensified. For the time being there is a ban on coal imports to Europe from Russia (Russia accounted for 4% of Europe's coal imports in 2021). Energy supplies, including oil and gas, account for 59% of total Russian exports.

3. Lack of corporate motivation. Dividend payments have so far been suspended by steel companies (NLMK, Severstal, Evraz, MMK and others), retailers (X5, Cherkizovo and others), as well as LSR, Veon, the Moscow Exchange, Rusagro and Enel Russia. The state-owned exporting companies are highly likely to make dividend payments to

increase federal budget revenues from government stakes in companies. **So far, officially announced dividends have amounted to ₺293 bln, compared with an expected ₺ 4.7 trln for 2021 before the sanctions.** Abandoning or suspending dividend payments and dropping plans to publish its financial results are a response to the operational sanctions imposed and the inability to pay dividends to their major shareholders. **Some companies rule out dividend payments due to the low predictability of operating cash flows and limited options for attracting new funds. Moreover, The Russian central bank told lenders to consider postponing dividends.**

4. Global volatility. The S&P 500 is down more than 5% since early April and the Nasdaq fell more than 9% after rebounding in March. We highlight three main risks which are not yet fully priced in. The first is the Fed's more hawkish monetary policy stance, the second is recession/geopolitical risks and the third is a lockdown in China due to the coronavirus.

5. Inevitable technical default. Six major companies (Russian Railways, Severstal, SUEK, Eurochem, Chelpipe and Nordgold) have faced technical default on their external debt, the grace period for these bonds has already expired, the grace period for the Russian sovereign bonds expires on May 4.

6. Not cheap enough. The capitalisation of Moscow Exchange has fallen by 45%, from an all-time high (October 2021) of ₺62 trln to ₺36 trln. Sberbank and VTB's losses on state programmes could exceed ₺600 bln for 2022, compared to a profit of ₺1.6 trln last year. The market share of exporters has grown to 78% and their future depends on the oil and gas embargo. Retailers are the most exposed to rising inflation, while the ability of IT companies to implement import substitution is highly questionable. In addition, growth stocks are under pressure from soaring foreign currency rates.

WHAT IS HAPPENING IN THE BOND MARKET?

The "dovish" statements of the regulator in recent days have strongly encouraged OFZ market participants. The yields of "classic" sovereign bond issues fell sharply against the backdrop of higher trading volumes; therefore, almost the entire curve is approaching the 10% yield (the only exceptions are securities maturing within the next year).

We should also highlight the sharply reduced negative slope of the sovereign curve, largely driven by investors' reassessment of interest rates in the medium term. Since the resumption of trading in the third decade of March, the government bond price index RGBI has recovered from its December 2014 low and has returned to 125.5 p.p. (+28% from its low).

We assume that yields on government bonds with a constant coupon have long since reached an equilibrium given our baseline forecast for the key rate by the end of the year. The current prices seem overbought, so we do not see much interest in taking long positions in "classic" OFZs now, unlike high-yield corporate bonds. Moreover,

given expectations of higher annual inflation in the coming months, real yields will increasingly move into negative zone, thereby losing appeal for investors. Therefore, we continue to favour high-quality corporate rouble bonds of first- and second-tier borrowers. As far as the public sector is concerned, inflation-linked bonds might be of more interest, even if their prices have also materially increased in recent weeks.

WHAT IS HAPPENING ON THE CURRENCY MARKET?

The rouble has been the best gainer of all Russian assets, after an April 8 to April 13 pause the Russian currency continued to pick up, gaining 35% from its peak on March 9. The growth was driven by currency sales by exporters on the background of an all-time high inflow of export revenues. Imports fell due to limited consumer demand amid the cap on currency cash withdrawal and reduction of its share in the banking system due to sanctions.

In March, exporters were only able to sell hard currency in the equivalent of ₴865 bln (i.e. \$10 bln per month, or \$0.5 bln per day), which does not exceed 33% of the actual hard currency revenues (we estimate that hard currency exports revenues amount to \$500 bln per year, of which \$400 bln are subject to mandatory conversion into roubles under the 80% sales rule, equivalent to \$1.6 bln sold per trading day).

Hence, exporters actually sell 2.5 times less currency than the mandatory amount due to organically low trading volumes on the exchange market which dropped to \$0.8-1 bln a day compared to \$1.4 bln of export revenues per day of which 80% should have been sold on the exchange.

The latest measures by the authorities that imply extension of the term of mandatory conversion of exports revenues from 3 to 60 days and reduction in the share of export revenues sales from the current 80% will have little impact on the exchange rate.

WE ARE LIKELY TO SEE THE ROUBLE STRENGTHENING TO ₴70/\$, GIVEN THAT APRIL TRADITIONALLY SEES RECORD QUARTERLY TAX PAYMENTS.

\$ bln	Mar-22	*Estimate of export revenue
Export revenues	10.8	33.3
Proceeds each trading day	0.5	1.6
Ratio to valuation		32.4%
Ratio to trade volume, %	47%	198.4%
Average volume of USD/RUB traded on MoEx, \$ bln	1.1	0.8

Source: ITI Capital, Bloomberg

* Export sales based on estimated \$500 bln a year in total revenues, of which \$400 bln are subject to mandatory sales

WHAT TO EXPECT NEXT? / WHAT TO DO?

The positive scenario assumes a 50% probability that there will be no embargo on oil, gas and metals and that the special operation will be over by mid-May. It implies lifting the "toughest" sanctions, in particular "unfreezing" of foreign currency reserves and resumption of transactions between Euroclear and NSD, a partial withdrawal of non-residents from Russian assets followed by ₺1 trln worth stock market interventions by the Central Bank and corporate buy-backs worth ₺650 bln, which would fuel a market recovery.

This positive scenario implies a high probability that non-residents will not sell all of the Russian assets they own. The other scenario is no changes in the current environment with no growth prospects and the threat of new sanctions. The base case scenario assumes further gradual sales and the market decline to the level of February 24, when the military conflict broke out in Ukraine.

Company	Nearest dividend per share	Period	Yield of the nearest dividend	Record date	Interim payments ₺, mln	Payment date	Conversion date	Capitalisation, ₺ mln
Announced								
Beluga Group	47.24	4Q21	2.1%	17-Jun-22	746	1-Jul-22	8-Jul-22	36 356
Inter RAO	0.2365838	4Q21	9.8%	10-Jun-22	24 699	24-Jun-22	1-Jul-22	252 074
Krasnoyarskenergosbyt	0.846632826	4Q21	10.3%	2-Jun-22	505	16-Jun-22	23-Jun-22	4 888
Segezha	0.64	4Q21	7.3%	2-Jun-22	10 042	16-Jun-22	23-Jun-22	137 884
Levenguc	0.244616547	4Q21	1.8%	1-Jun-22	13	15-Jun-22	22-Jun-22	726
AKB Primorye	1310	4Q21	3.3%	30-May-22	328	13-Jun-22	20-Jun-22	9 950
Fix Price	6.8	4Q21	1.8%	27-May-22	5 780	10-Jun-22	17-Jun-22	322 150
KuibyshevAzot	17.4	4Q21	4.1%	23-May-22	4 074	6-Jun-22	13-Jun-22	100 262
Permenergosbyt	14	4Q21	10.1%	23-May-22	507	6-Jun-22	13-Jun-22	5 044
Tattelecom	0.04285	4Q21	7.5%	18-May-22	893	1-Jun-22	8-Jun-22	11 850
Positive Technologies	14.4	4Q21	1.6%	8-May-22	864	22-May-22	29-May-22	54 456
Polymetal	40.6536	4Q21	4.8%	6-May-22	19 255	20-May-22	27-May-22	397 846
Novatek	43.77	4Q21	4.3%	5-May-22	132 899	19-May-22	26-May-22	3 069 705
Phosagro	390	4Q21	5.6%		50 505	14-Jan-00	21-Jan-00	899 896
Polyus	315.1057	4Q21	2.3%		42 876	14-Jan-00	21-Jan-00	1 857 347
					293 986			
Scrapped divs payments								
NLMK	12.18	4Q21	8.2%		72 998			893 950
Severstal	109.81	4Q21	10.9%		91 990			840 567
LSR		4Q21	0.0%					
Cherkizovo	130.27	4Q21	4.4%		5 500			124 344
MMK	3.55	4Q21	0.1%					
Veon		4Q21						
Evráz		4Q21						
Mother and Child		4Q21						
Enel Russia		4Q21						
Rusago		4Q21						
X5								
MoEx								
High payout probability								
Alrosa								
Gazprom								
Rosneft								
Lukoil								
Tatneft								
Gazprom neft								
MTS								

CONTACT LIST

Trading

Mikhail Durov | Fixed Income Trader | Mikhail.Durov@iticapital.com

Sales

Aleksandr Panfilov | Head of Fixed Income Sales | Aleksandr.Panfilov@iticapital.com

Research

Iskander Lutsko | Head of Research, Chief Investment Strategist | Iskander.Lutsko@iticapital.com

Olga Nikolaeva | Senior Fixed Income Research Analyst | Olga.Nikolaeva@iticapital.com

Stanislav Yudin | Senior analyst, Equity Research | Stanislav.Yudin@iticapital.com

Elizaveta Herne | Research Analyst | Elizaveta.Herne@iticapital.com

Oleg Makarov | Chief Editor | Oleg.Makarov@iticapital.ru

CONTACT DETAILS:

ITI Capital Limited
Level 33 Tower 42,
25 Old Broad Street,
London EC2N 1HQ,
United Kingdom

PHONE:

+44 (0) 20 3889 8333
+44 (0) 20 3889 8331

WEB:

iticapital.com

ITI Capital Ltd. (hereinafter, the "Company") is not responsible for and does not give any warranties in connection with the transfer of marketing materials. This marketing document is for information purposes only. Any information in this document is based on data obtained from sources believed by the Company to be reliable, but no representations, guarantees or warranties are made by the Company with regard to the accuracy, completeness or suitability of the data. The information contained herein does not constitute the provision of investment advice. It is not intended to be nor should it be construed as an offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or offer.

Neither the Company, nor its affiliates, principals, directors, employees or agents accept any liability for any direct or consequential loss arising from any use of this marketing document and any accompanying materials. Investors should make their own investment decisions using their own independent advisors, as they believe necessary and based upon their specific financial situations and investment objectives when investing. This material is not intended for the use of Private Customers as that term is defined under the Financial Services and Markets Act 2000 in the United Kingdom. This material has been approved for publication in the United Kingdom and European Union by ITI Capital Limited, authorised and regulated by the Financial Services Authority and a member firm of the London Stock Exchange.