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Russian Stocks Cheapest Globally

By The Moscow Times

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A woman battling St. Petersburg’s first big snowfall of the season Thursday. **Dmitry Lovetsky**

LONDON — Russian stocks, the cheapest worldwide, are getting cheaper after the nation's companies posted record profits that topped analysts' estimates by the widest margin in emerging markets.

MICEX Index companies reported combined earnings of 178 rubles a share ($5.70) during the past year, the most since at least 2003 and 29 percent above the average of about 400 analyst estimates compiled by Bloomberg. The MICEX is valued at 6.8 times profit forecasts for the next 12 months, the lowest level among 59 world stock indexes tracked by Bloomberg and about half the global average of 12 times.

While the MICEX advanced 13 percent in the past year, its valuation tumbled 31 percent because Russian shares failed to keep pace with a surge in earnings estimates spurred by oil's rally above $80 a barrel.

Equity mutual funds in the world's largest energy exporter attracted less money in the past six months than funds in the other BRICs — Brazil, India and China — as investors favored more expensive shares in faster-growing economies, EPFR Global data show.

"Russia really stands out as being cheap and attractive," said Maarten-Jan Bakkum, an emerging market equity strategist in The Hague at ING Investment Management, which oversees about $100 billion in developing nations.

"Investors will increasingly be looking for emerging economies that can still improve," he said. "For Russia, there should be some room for improvement."

Russia's economic expansion will probably accelerate to 4.3 percent next year from 4 percent in 2010, according to October estimates from the International Monetary Fund.

China's growth will slow to 9.6 percent from 10.5 percent, while the pace in India will drop to 8.4 percent from 9.7 percent, and Brazil's expansion will decelerate to 4.1 percent from 7.5 percent, IMF forecasts show.

Russia has lagged behind the other BRIC nations in luring investors. Chinese equity mutual funds attracted about $3.3 billion in the past six months, while Indian funds received $1.3 billion and Brazil got $1.9 billion, data compiled by EPFR Global show. Russian funds took in $637 million, the data show.

"Russia remains relatively out of favor in an emerging markets context," said Lewis Kaufman, a money manager at Thornburg Investment Management, which oversees about $65 billion in Santa Fe, New Mexico. "If we can sustain oil prices of $80 to $100, Russian equities offer a unique combination of cyclical and structural recovery potential."

Gazprom, the country's largest listed company, trades at 4.3 times 2011 profit estimates, compared with 10 times for PetroChina, the biggest Chinese energy company, according to data compiled by Bloomberg. The discount on the gas export monopoly to PetroChina has widened to 58 percent from 50 percent at the start of 2010, the data show.

Sberbank trades at a 60 percent discount to India's ICICI Bank, compared with 38 percent at the end of 2009, according to price-earnings ratios compiled by Bloomberg.

"I find, opportunistically, Russia pretty interesting," said Jim O'Neill, who helps oversee about $820 billion as chairman of Goldman Sachs Asset Management and coined the term BRICs in 2001 to describe the four biggest emerging markets.

"It is structurally the weakest of the four, but it's not all as gloomy as people seem to be talking about," he said. "If I look at the forward PE, for Russia it's really cheap," he said in an interview in London.

While MICEX companies beat analysts' estimates by 29 percent, earnings in the MSCI Emerging Markets Index surpassed forecasts by 5.7 percent, data compiled by Bloomberg show. Companies in the Hang Seng China Enterprises Index trailed projections by 2.4 percent, profits in India's Bombay Stock Exchange Sensitive Index topped estimates by 7.7 percent and Brazil's Bovespa Index exceeded expectations by 1.5 percent.

Analysts may be too optimistic in their outlook for Russian energy company profits because

Prime Minister Vladimir Putin's government is likely to raise taxes on the industry to help pay for increased spending ahead of the 2012 presidential election, Alex Kantarovich, a strategist at New York-based JPMorgan Chase & Co., wrote in a report Monday.

Energy companies account for about half of the MICEX Index's capitalization, according to Bloomberg data. The sector's low equity valuations are the main reason Russian shares appear cheap relative to the rest of emerging markets, said ING's Bakkum.

Russian profits may be overstated because companies have been slow to write off the value of aging machinery and factories, Kingsmill Bond, the London-based chief strategist for Troika Dialog, wrote in a report e-mailed Nov. 3.

Stock valuations for some Russian companies already reflect the "lack of transparency" in the country's financial disclosures, said Kaufman, whose Thornburg Developing World Fund has beat 97 percent of peers this year with a 25 percent gain.

The MICEX Index's valuation discount of about 42 percent to the MSCI All-Country World Index of global shares compares with a 24 percent average gap since January 2006, according to price-earnings ratios compiled by Bloomberg.

Thornburg owns shares of Sberbank because of "massive" consumer deposits that make its funding stable and the potential for better-than-estimated loan growth, Kaufman said.

Sberbank's deposits amount to 77 percent of assets, compared with the 55 percent average for global peers, according to Bloomberg data. The lender's per-share earnings will probably surge 87 percent next year, four times the average gain for emerging market financial companies, analysts' estimates compiled by Bloomberg show.

Magnit, a Krasnodar-based food retailer, is another Thornburg holding, Kaufman said. While the stock is more expensive than the Russian equity market at 25 times analysts' 2011 earnings estimates, it's cheaper than Beijing-based supermarket operator Wumart Stores, which trades at 30 times profit estimates.

Magnit will increase earnings by 91 percent during the next two years, almost double the 51 percent growth projected for Wumart, Bloomberg data show.

Gazprom shares are poised to rally 34 percent in the next 12 months, according to an average of 10 analysts' share-price estimates. The stock has retreated 7.8 percent this year, compared with a 2.3 percent gain for PetroChina.

Russia has the cheapest stocks among major developing nations, based on 10-year reported earnings, a valuation measure designed to adjust for economic cycles, Jonathan Garner, the chief Asia and emerging markets strategist at Morgan Stanley in Hong Kong, wrote in a Nov. 8 report.

"It's probably the cheapest market among global emerging nations," said ING's Bakkum, who recommends an "overweight" position in Russia. "A lot people are prepared to buy Russian assets."