



Tera Capital Fund

Investor Newsletter

March 2012

Altima
asset management

Tera Capital Fund is the only fund of funds in the world which pays no fees other than a success fee

Based on Tera Capital Fund's performance and innovation, in February 2012 the Global Banking & Finance Review announced that Tera had won its second award as the most innovative fund of funds in Europe for 2011

According to EurekaHedge, Tera Capital Fund was the No. 4 performing fund of funds in the world YTD through Q1 2012

Fund Performance (net of fees)

Returns	Tera* (%)	RTS, MSCI & ROS Avg** (%)	AAM Russia Fund Index ¹ (%)
Monthly	(3.57)	(6.53)	(2.96)
Year-to-date	19.44	17.73	13.22
Trailing 12 months	(15.23)	(23.68)	(19.86)
Since Fund inception (Apr 05)	188.43	172.16	166.98
Anlzd mnthly rtn (since Fund inception)	12.88	11.33	8.61
Annualized Stand. Dev. (since inception)	25.58	38.67	30.92
Sharpe Ratio ²	0.41	0.33	0.20
Trailing 12 m Sharpe	(0.41)	(0.54)	(0.83)

*Weight averaged, all series (currently 9) combined

**RTS: -5.61%, MSCI: -8.17%, ROS (Crédit Suisse): -5.80%

Investment Advisor's Assessment

Russia

➤ In its **World Economic Outlook for 2012**, the IMF predicted that **Russia's economy will grow by 4.0% in 2012**, up from a 3.3% projection in January, as the world's biggest energy exporter benefits from higher prices for commodities.

The **forecast for 2013** was essentially the same as for 2012, at **3.9%**, mainly because the IMF feels that oil prices will probably decrease slightly.

In a related announcement, the **Russian Finance Minister, Anton Siluanov**, stated that **Russia's budget deficit would be 0.3% or less of GDP in 2012**, again mainly because of higher-than-planned oil prices. The prior forecast was for a deficit 1.5%. Siluanov added that "What is important is that we are not going to spend any of the oil revenue".

The relationship between the Russian economy and oil prices is much discussed. Some say that the Russian economy is a proxy for oil prices; others argue that the Russian economy is rapidly diversifying away from the oil and gas industry.

The reality is that, while diversification is certainly taking place on a massive scale, about half of the Russian economy (compared to almost 75% 10 years ago) is still dependent on the oil and gas industry.

Thus, it is worthwhile to look at how Russian equity markets have been functioning recently relative to oil prices. A recent paper from **Katsuya Ito** from **Fukuoka University in Japan**, "**The Impact of Oil Price Volatility on Macroeconomic Activity in Russia**" is very informative in this regard. Mr. Ito looked at the period between Q1 1994 and Q3 2009 and found that "a 1% increase (decrease) in oil prices contributes to the depreciation (appreciation) of the exchange rate by

0.17% in the long run, whereas it leads to a 0.46% GDP growth (decline)."

Thus, the recovery in oil prices after the 2008-09 economic crisis should have led to a comparable recovery in equity prices to reflect a growing Russian economy.

However, this has not occurred to the extent that the historical relationship between oil prices and the Russian economy would indicate.

One sell-side analyst recently note that, based on the 15-year trailing correlation between Brent oil prices and the RTS index, the current Brent price would indicate a RTS Index **65% higher** than current levels. While we are not predicting an immediately 65% rally on Russian markets any time soon, at some point the gap between the high oil price and low stock prices becomes too wide for investors to ignore. **This analysis is strongly supported by the IMF's conclusions.**

The strong potential growth can also be seen in the indices. The MSCI Russia Index is 59.8% weighted in energy and 10.5% weighed in raw materials. It is currently valued at a **forward P/E of 5.8 with a par valuation to book**. Meanwhile, the **MSCI Emerging Markets Index has a forward P/E of 10.4 and a price/book ratio of 1.8**. The Russian market is the most exposed to natural resources of any BRIC market, and for that it has paid the price of having the most depressed valuation.

However, the valuation discount has reached record new lows in some cases. Russia's largest company by market capitalization is **Gazprom**, which holds the largest undeveloped reserves of hydrocarbons in the world of any publicly traded energy company. For that, investors pay a **trailing P/E of 3.5 and a forward P/E of 2.8** (and, no, 2.8 is not a typographical error). The multiple to book value is 0.59.

Whether from the Putin discount or Europe fears, depressed valuations pervade the Russian market. For instance, **Lukoil** trades at a slightly higher **forward P/E of 4.2** and a smaller discount to book value of 0.70 than Gazprom; nevertheless, it is still well below the MSCI Russia Index. The company is the **third-largest non-state publicly traded oil company in the world** by proven reserves of hydrocarbons (**1% of world total**) and is the sixth-largest non-state publicly traded oil company worldwide in production of hydrocarbons (**2.2% of global oil production**).

As you will see the forthcoming white paper comparing Russia to other BRIC and major EM countries, IMF figures show clearly that the price of Russia equities is undeservedly low.

➤ **PricewaterhouseCoopers** expects the **Russian automobile market** to increase this year by 4% in comparison with last year to 2.6 M units. Sales of Russian cars are expected to decrease 11% to 550,000

¹ Altima Asset Management created this index of 21 Russia-focused equity funds created on or before May 2005 to provide an appropriate benchmark.

² Risk free rate: 2.5%

units while foreign car sales (produced or assembled in Russia) should go up 11% to 1.15 M units.

"Q1 continued the positive trend of 2011," PricewaterhouseCoopers analysts wrote. "Total sales of cars went up 21%. We expect a slight slowdown in growth rates in the future and presume that total sales of cars in 2012 should come to about 2.6 M units excluding light commercial vehicles."

The **market for new cars in Russia increased 51% in monetary terms** and 21% in volume in January-March to \$15 B, or 580,000 cars. This figure includes Russian cars, which held steady at the same level as Q1 2011 at \$1.3 B. **Foreign cars produced in Russia increased 90%** to \$7 B from \$3.7 B in the same period of 2011.

Imports of new cars increased 37% to \$6.7 B from \$4.9 B in Q1 2012. Imports of cars will increase 7% to 900,000 units.

➤ **Volkswagen's business boom in Russia, where sales climbed 77% to 66,000 vehicles,** helped it beat market expectations for its Q1 2012 profits as net profit rose to €3.19 B from €1.71 B in the same period in 2011.

➤ **Russia's dollar eurobonds** climbed on their first trading day after investors bid for \$24 B of the notes. The yield on the longest-maturity bond, due in 2042, fell to 5.67%. The bond was priced to yield 5.79%. Institutional investors, including pension funds, bought more than 70% of the new debt. Russia sold **\$3 B of the 2042 bonds** and \$2 B each of the shorter-maturity notes. Investors bid for \$11.5 B of the 30-year paper, \$6 B of the 10-year and \$6.5 B of the government's five-year notes.

The **Russian government covered its full-year foreign borrowing target.** It has no plans to revise its foreign-debt ceiling for this year after selling the maximum amount allowed.

➤ **Russia's international currency and gold reserves rose \$5.4 B to \$510.8 B** at the end of March, slightly under its all time record reached in 2008.

➤ **Russian oil output was 10.36 M barrels per day** in March, unchanged from a post-Soviet monthly high in February. Oil production was 43.8 M tons in March. **Russia is expected to increase output by 1% in 2012** over last year's average of 10.27 M barrels per day.

Daily gas production declined slightly after a bump in production to help meet elevated demand in early February. It totaled **62.19 B cubic meters** in March, or 2.00 bcm per day. Russia's daily gas production was 2.07 bcm in February.

➤ **Saudi Arabia's crude production rose to close to a 31-year high** in January, matching Russia's for the first time since February 2006. It **increased output by 0.6% to 9.87 M barrels** a day, the second-highest monthly level since at least 1980.

➤ **Domestic electronic payment transactions increased 80%** in 2011 to \$4.2 B. About 90% of physical goods bought on the Web are paid in cash.

Company News

➤ **Gazprom earned nearly \$45 B in 2011, up 35%** due to rising production and prices. Its **2011 net income attributable to shareholders rose to \$44.68 B** from \$33.05 B. **Sales increased to \$158 B** from \$123 B in 2010.

Net debt rose to \$35 B as of Dec. 31 2011 from \$30 B in 2010 as it increased borrowings for new projects,

including its **expansion on the Yamal Peninsula** and the **second stage of Nord Stream subsea pipeline** to Germany.

Gazprom is seeking to develop deposits in Yamal, north of its traditional production regions where reserves are gradually being depleted, to achieve its long-term goal of **increasing market share in Europe to a third from about one fourth now.**

This summer, Gazprom will launch the Bovanenkovskoye field, the largest on Yamal, with **reserves of 4.9 T cubic meters, enough to supply global demand for over a year.**

Prices under Gazprom's long-term contracts, the backbone of its deals with European buyers, are tied to those of oil and oil products, which rose sharply last year. ➤ **Income from VTB's foreign retail business quadrupled** in 2011 and included a substantial jump in the **amount deposited by French and German citizens.** **French pensioners** seem particularly interested in the bank.

Though its presence outside Russia is still largely confined to the countries of the former Soviet Union, VTB, like its main Russian rival Sberbank, has been expanding its international presence in recent years.

German and French clients deposited \$712 M with VTB's retail operations in those countries in 2011, 38% of the total deposits made with VTB 24's foreign operations in 2011.

In Germany alone, more than 40,000 accounts were opened with VTB Directbank and €400 M (\$529 M) was deposited in 2011. However, by the end of March 2012, **deposits had almost tripled to more than €1 B (\$1.3 B).**

French media has portrayed VTB's arrival as "**honest people [finally] offering an honest rate ... our fat cats don't want to work, but the Russians can,**" **first deputy president** at VTB 24 **Dmitry Rudenko** said. "It was completely unreal!"

VTB's attractiveness is based on the **high rates of return it offers on deposits.** In France, the deposit rate was 3.5%. The lender intends to grow its total foreign credit portfolio by 28% in 2012 and the total deposits made by clients by 10%.

➤ **Steel giant Severstal posted a net profit of \$2.04 B** in 2011, up from \$575 M loss in 2010, after it sold loss-making plants in the United States and demand for steel in its key markets remained strong. **Revenue surged 23.3% to \$15.8 B,** while **EBITDA reached \$3.6 B,** up 25.1% from 2010.

Severstal saw demand in Russia and the United States increase 13.8% and 11.5%, respectively in 2011.

Severstal sold three underperforming mills in Ohio, Maryland and West Virginia in 2011, which had a positive effect on Severstal's results. It still owns mills in Dearborn, Michigan and Columbus, Ohio.

➤ **Polymetal said rising gold prices drove 2011 net profit up 21% over 2010 to \$290 M.** Its average realized gold price in 2011 increased 26%. The company's adjusted **EBITDA in 2011 grew 47%** to \$624 M, while **sales reached \$1.33 B, also up 47%.** Its maiden dividend was set at \$0.20 a share.

Q1 2012 revenue jumped 64% over the same period in 2010 and the company is on



track to achieve its full-year target for 2012.

Q1 2012 sales reached \$377 M prices and output increased. **Gold production grew 24%** to 101,000 troy ounces, while silver output climbed 74% to 5.7 M ounces. Total output was 203,000 gold-equivalent ounces.

➤ **Polyus Gold International**, Russia's largest gold mining company, posted a **57% increase in annual net profit in 2011**, boosted by strong sales and high gold prices and that **Q1 2012 sales jumped 52%** as output and prices advanced.

Polyus' **profit reached \$558 M** in 2011, with **gold sales jumping 37% to a record high \$2.3 B**. EBITDA reached \$1.1 B in 2011, up 55% year on year, while its total cash costs rose 19% to \$661 per troy ounce.

Revenue climbed to \$587 M from \$385 M in 2010. **Sales volumes increased 24%** to 345,000 troy ounces of gold as output rose 27% to 328,000 ounces.

Polyus produced 1.5 million ounces of gold last year, 8% more than in 2010. It is boosting production following gains in prices for the precious metal. Gold climbed 11% on the London Metal Exchange in 2011 after adding 29% in 2010 as investors sought a haven from Europe's sovereign-debt crisis. Polyus said its weight-average selling price increased 23% to an estimated \$1,702 an ounce in Q1.

The company plans capital expenditures of \$600 M this year to expand. It's on schedule to commission a plant at the untapped **Natalka deposit** in December 2013, where it will process as much as 10 million tons of ore a year.

Polyus expects **Natalka to produce about 18 tons of gold in 2014 or 2015**, raising the company's current output by about 30%.

➤ Gold miner **Petropavlovsk** is likely to increase its 2012 production target. The company, which operates open-pit mines in the Russian Far East, is forecasting a 680,000-ounce production figure in 2012, about 8% higher than last year. The company reported a **52% increase in the amount of gold** it sold in 2011, which along with higher gold prices helped deliver a **tenfold increase in full-year net profit to \$240.5 M**.

The company said **revenue more than doubled to \$1.3 B**, and increased its full-year dividend by 20% to 12 pence (\$0.19) a share. Earnings per share reached \$1.24, more than **10 times the 2010 figure**, reflecting improved operational management.

➤ **O'Key**, Russia's fourth-largest food retailer, posted a **20.7% rise in net profits** for 2011 and said it planned rapid expansion of its network of hypermarkets.

The company, which had 71 stores at the end of 2011, said **full-year profit rose to \$108.3 M**.

"We aim to expand our hypermarket network organically at an annual rate of 30%, and we are also expanding our land bank to ensure we complete our planned store openings over the next two years," said **chief executive Patrick Longuet**. **EBITDA increased 5.4% to \$250 M on revenue of \$3.1 B**. **Revenue was up 12.7%** while like-for-like sales increased 5.3%.

➤ The increased popularity of **Mail.Ru Group's** online games, social networks, applications and advertising **pushed up revenue 45% in Q1**, while **revenue for 2011 increased nearly 60%**.

Q1 2012 was \$160.3 M compared with \$110.6 M in 2011, while 2011 revenue was \$515.4 M compared with 2010 revenue of \$324.7 M, a 59% increase.

The company, which is traded on the London Stock Exchange, reported **net income of \$208.6 M** in 2011 versus \$80.8 M in 2010.

Mail.Ru had a 41% increase in the number of daily visitors to its **Odnoklassniki** social-networking site and a 21% increase to its Mail.Ru web portal in March of this year versus March 2011.

Mail.Ru also owns the **Moi Mir** social-networking site and instant messaging applications **ICQ** and **Mail.Ru Agent**. It holds about a 40% stake in **Vkontakte**, the Russian equivalent of **Facebook**, and about 21% of electronic-payments company **Qiwi**.

Russia has the largest number of Internet users in Europe, or 51 M users, but that is just 36% of the population, meaning there is significant growth potential.

➤ US doughnut group **Krispy Kreme** announced that it had signed a franchise deal with restaurateur **Arkady Novikov** to open **40 Moscow outlets** as it seeks to expand into the growing Russian consumer space. The company currently sells its products in 21 countries.

It joins **Burger King**, **Wendy's/Arby's** and **Chilli's**, which have all opened in Russia during the past three years, as has rival **Dunkin' Donuts**. Western restaurant chains have flocked to Russia in recent years as **rising incomes and consumer spending have increased growth prospects** in the emerging market. (In a related development, **McDonald's** announced that it would **franchise out Russian restaurants** for the first time in its 22-year history in the country.)

➤ Private freight operator **Globaltrans** said that its **annual profit increased 40% in 2011 to \$317.2 M** and



that its outlook for 2012 is optimistic after a strong start to the year. Globaltrans, which is seen as a barometer for the Russian economy since it transports the natural resources and metals that are its lifeblood, also said it

had lowered net debt by 32% to \$258.4 M.

The debt position frees the company up for potential acquisitions after ruling itself out of the auction for state firm Freight One late last year.

The company also announced that it had agreed to buy nearly **10,000 new railcars** for delivery in 2012, its target for the year. The purchases will be funded from borrowings and its own cash reserves.

Overall Russian freight turnover, measured in tons per kilometer, increased 8% in Q1 2012 on strong demand for products.

➤ **Uralkali** said **profit rose 64% last year** on higher prices and its merger with **Silvinit**. **Net income climbed to \$1.53 B** from \$929 M, as **revenue rose 41% to \$4.2 B**. Adjusted EBITDA jumped 75% to \$2.46 B.

Uralkali, which increased output by 6.4% last year to 10.83 M tons, further reduced its sales target for this year because of global stockpiles. Sales this year may reach 10.2 M tons to 10.5 M tons.

➤ **MegaFon**, Russia's second-largest mobile-phone operator, will pay owners **TeliaSonera AB**, **AF Telecom** and **Altimo \$5.15 B in dividends** and pursue an IPO in London, ending a governance dispute. AF Telecom will get majority control of MegaFon, buying part of TeliaSonera's stake and Altimo's entire shareholding. The shareholders have agreed to sell as much as 20% of MegaFon in an IPO on the London stock exchange where MegaFon's share sale **may raise as much as \$4 B in the world's biggest IPO since July**.

MegaFon had 61.6 M subscribers in Russia at the end of 2011, as well as units in Tajikistan, Abkhazia and Ossetia. The company reported **net income of \$1.5 B on sales of \$8.1 B in 2011**.

➤ **Sberbank** announced that it intends to **reduce the number of state representatives on its board of directors** and recommended that dividends for 2011 be paid at 15.3%, a post-Soviet record. The moves came as repeated media reports affirmed that Russia's largest bank was planning to go ahead with its **\$5.5 B privatization** in April.

The **Russian Central Bank**, which owns a controlling stake in Sberbank, has said it will sell 7.6% of its holding when the bank's share price climbs beyond 100 rubles (\$3.40); that threshold was crossed on Feb. 28.

Speaking after the end of a board of directors' meeting, **President German Gref** said a **"sharp increase" in the number of independent directors** was a **positive step for Sberbank**. "Independent directors are more

meticulous and more critical," he said. "That will help us." The board of directors recommended that the company use 15.3% of its 2011 profit to pay dividends, up from 12.1% in 2010. **Net income in 2011 rose 79% to \$103 B**.

Fund Awards



**Most Innovative Funds of Funds
(for innovation and performance)**



No. 4 ranked fund of funds in the world, YTD 2012



No 8 ranked fund of funds in the world for 2009



Most Innovative Funds of Funds (for innovation and performance)



No. 2 ranked fund of funds in the world for 2010



No 1 ranked fund of funds in the world for 2005

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