

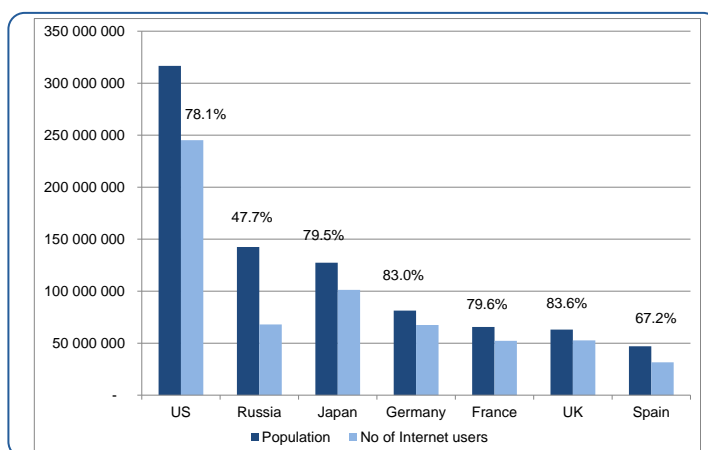
Mail.ru - Nostrovial*

Investment summary:

- Mail.ru is a leading Internet company in the high-growth Russian-speaking Internet markets. According to *comScore*, Russia (with a population of c. 143mn) is Europe's largest Internet market measured by number of users and is currently only at a 48% Internet penetration level compared with the US' 78.1%.
- It completed an IPO in the form of Global depository receipts (GDRs) on the London Stock Exchange (LSE) in 2010 and over the past year sold minority stakes in Groupon and Zynga, as well as most of its stake in Facebook (it still owns 0.6%), The company returned this money to shareholders through dividends.
- Increased prosperity and Internet access of an emerging Russian middle class, the popularity of social networks, Internet growth in the Russian-speaking Commonwealth of Independent States (CIS [Russia, Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Turkmenistan, Tajikistan, Ukraine and Uzbekistan]), a robust gaming market and a diverse portfolio are just some of Mail.ru's growth drivers.
- We believe the company can also grow through acquisitions in its main market of Russia and especially through a controlling stake in social network VKontakte (it already owns 40%). The Russian Internet market still offers significant upside potential with Internet use growing by leaps and bounds, buoyed by a booming mobile Internet user base.
- *Bloomberg* consensus forecasts expect earnings growth to increase 18% in FY13 from FY12. FY14 and FY15 is also expected to see double-digit earnings growth. We believe these EPS numbers are on the conservative side. After the bumper special dividends paid in FY12, *Bloomberg* consensus expect a 9.3% FY13 DY. Although this seems high it likely includes the expectation that Mail.ru will have the scope to return more cash to shareholders after it sells its remaining c. \$500mn Facebook stake (possibly through another special dividend). Thereafter consensus forecasts show the company offering a steady FY14 and FY15 DY of 2.2% and 1.9%, respectively. The group has also had stable positive cash flows and we believe Mail.ru is a great addition to any portfolio. However, at

a FY13E P/E of nearly 22x the stock is not cheap and we would recommend investors look for share price weakness to accumulate.

Population and Internet penetration comparison (2012):



Source: CIA World Factbook, Internet World Stats, Anchor Capital

*Note percentages in chart above signify Internet penetration



Global Ideas is a newsletter published four times a week (Monday, Wednesday-Friday) and available only to clients of Investor Campus and Anchor Capital. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watchlist, which is continually reviewed and updated.



*Nostrovial is a frequently used Western mispronunciation of the Russian word Na Zdorovie a toast which means to good health or simply Cheers.

Contacts

Anchor Capital reception 011 591 0677
Investment/ Sales mnyoung@anchorcapital.co.za
Brokerage/ Trading fswart@anchorcapital.co.za

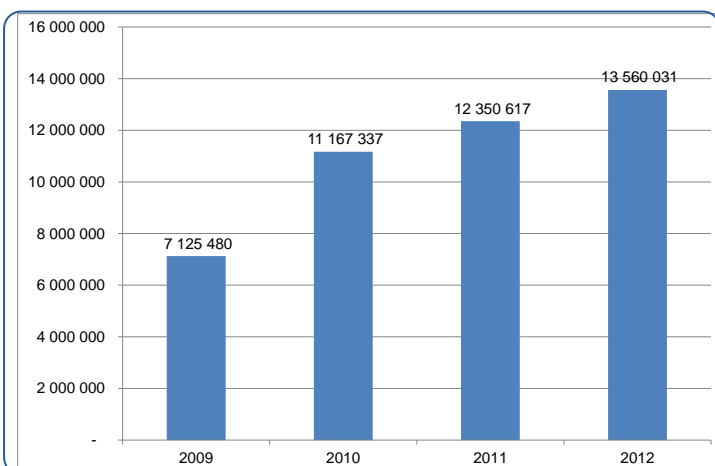
Trading Desk 012 665 3461
General Enquiries info@anchorcapital.co.za
Newsletter Enquiries newsletters@anchorcapital.co.za

Growth drivers:

The following are what we believe to be the key growth drivers for the company:

- Increased prosperity of the emerging Russian middle class:** We expect the emerging middle class in Russia to drive growth for Mail.ru as more tablets, PCs and smartphones are sold. Russia's middle class is 55% of its population, higher than any other BRICS (Brazil, Russia, India, China, South Africa) country and, similar to other emerging markets, Russia's population (the most prosperous of the BRICS) adopted consumer technologies later than many developed economies. In recent years Russia (along with countries like Brazil, India and China) has been moving up the ranks, leapfrogging long-time PC market leaders such as the US, Japan and Germany. Russia has 143mn consumers and according to a February *Sberbank CIB* report its consumer market will be the largest in Europe and the fourth-largest in the world by 2020. Research firm *IDC* estimates Russia is already the fourth-largest PC market globally while a *PR Newswire* report notes the country has emerged as one of the most promising tablet markets for due to growing demand and increasing consumer disposable income. Living standards and incomes in Russia have improved significantly over the past decade and prices of PCs, tablets etc. have come down significantly, resulting in computer literacy and Internet access across Russia rocketing. Average salaries in Russia climbed from an equivalent of \$80/month in 2000 to \$750/month at the end of 2010. Similarly the average costs of a PC was \$1,500 while the average salary was \$200/month, which meant that someone needed seven to eight months' salary to buy a computer. Now the average salary is \$500/month and a computer costs c. \$400. Thus accessing the Internet is cheaper and far more within reach of the average Russian family.

Russia PC shipments (2009-2012):

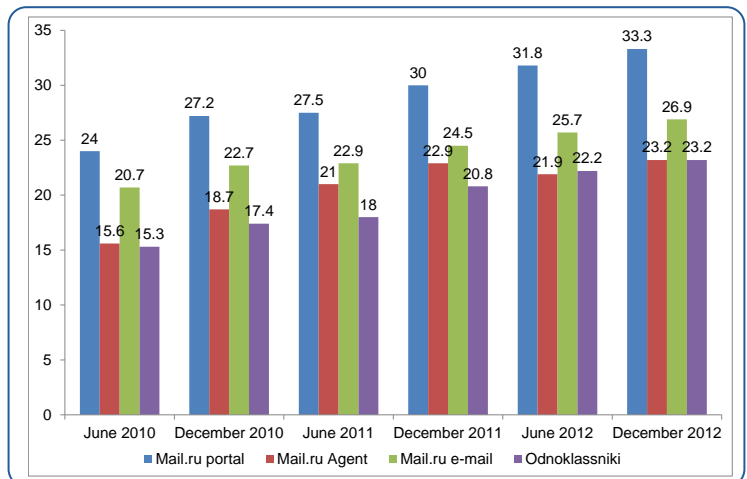


Source: Company data, Anchor Capital

- Increased Internet access/use in Russia -** Mail.ru CEO Dmitry Grishin said in a 2010 interview that there are very few countries with the potential for the internet that exists in Russia and China. Russian is the fifth

most-spoken language globally by total number of speakers and Mail.ru aims to serve these 250–300mn Russian speakers worldwide. Of this target market c. 143mn live in Russia and the remainder in the former Soviet Union. Currently Russia has c. 68mn Internet users and the *Public Opinion Foundation* expects the figure to grow c. 20% (to 80mn users) by the end of 2014. Mail.ru is perfectly positioned to benefit from this huge potential for Internet growth. Although Internet penetration currently may be far greater in the US and western Europe than in Russia, Internet use in those countries is nearing saturation and can't provide the same level of growth. Despite Mail.ru's sites already reaching c. 86% of current Russian-speaking Internet users monthly and the company being one of the five largest Internet sites based on number of total pages viewed (*comScore*, March 2013) there is still significant upside potential to increase its customer base using its diverse portfolio of products.

Mail.ru active users (mn):



Source: IDC, Anchor Capital

- Growing Internet use in CIS:** With a combined population of c. 100mn-plus CIS countries form the biggest part of the wider Russian-speaking market and these countries currently have even lower internet penetration rates than Russia (Uzbekistan 30.2%, Ukraine 34%, Kyrgyzstan 39.9%, Kazakhstan 45%, Belarus 46%,). Although Mail.ru already has over 40% of its users outside Russia, the size of these markets offer it the opportunity to further expand its presence.
- Social networks** are extremely popular in Russia with *Intel* saying that Russian consumers spend more time on social networks than anyone else in the world. Here Mail.ru is in the enviable position of controlling Odnoklassniki (meaning 'classmates'), Russia's second-largest social network, and also owning a 40% stake in its bigger competitor and the largest social network VKontakte. Added to that it also owns the My World social network and ICQ instant messaging (IM), and runs Russia's largest e-mailing service. While Facebook is a strong player globally it is not as strong in Russia - local social networks are much bigger than Facebook, and are adding more users. According to *comScore* data, Odnoklassniki had 39.4mn visitors in Russia in May 2013, up 27% YoY, while Facebook visitors dropped 23% to 10.8mn.

- Community Internet value-added services (IVAS) :** Mail.ru has been reducing its reliance on advertising revenue and plans to expand by enticing mobile users with a combination of online communication and entertainment (communitainment). IVAS, which includes massively multiplayer online games (MMO) was Mail.ru's key source of income In FY12 and its fastest-growing segment. In gaming the company follows a free-to-play model where the user plays for free (see *point below*), but can purchase extra features in the game or app. Revenue from IVAS including the sale of virtual gifts on social networks and extra features in games surged 51% to \$369mn in FY12. Mobile users often have phone accounts linked to their credit cards making it easy to pay for applications and this ease of use further encourages spending. For Mail.ru IVAS is a far more stable revenue stream than online advertising (which is dependent on economic swings) and its CEO notes that IVAS is very sticky and when a holiday or birthday comes up Russians buy virtual gifts in a similar manner to the way people spend money offline. Mail.ru has said that it expects community IVAS and MMO gaming to be its key revenue streams going forward and it is already uniquely positioned to take advantage of this segment's revenue-generating ability.
- A surging Russia gaming market:** Following on the above, according to *Electronic Arts (EA)* projections, the Russian gaming market will nearly double from 2012-2015 (from \$850mn to over \$1.5bn). Although Russia is already the biggest video game market in Central and Eastern Europe, it is still far behind the US (the current global leader), where the *NPD Group* estimates video game market turnover reached \$21.6bn in 2011 (global turnover was \$74bn). *EA* believes the Russian video game market will expand mainly by virtue of free-to-play games – exactly the type of applications Mail.ru is so good at and where the company can make money from players buying various bonuses, artifacts etc. to move their characters through a game faster. Social networking games are also expected to provide a major source of growth with *PriceWaterhouseCoopers (PwC)* naming Russia's video game market the biggest in Central and Eastern Europe in 2011, with sales reaching \$1bn and expected to reach \$1.7bn by 2015. *PwC* also forecasts that growth will be primarily driven by online games, as sales in this segment are estimated at no less than \$1.1bn over the next two years. As Russia's leading provider of online games Mail.ru will directly benefit .
- Mobile advertising:** The company's communitainment strategy works well for mobile devices as people interact with each other and play games on these devices. For many Internet companies it's a problem that people don't use their products on a mobile platform but in the case of Mail.ru its social networks and online gaming options are perfectly positioned for the mobile environment. With consulting firm *J'son & Partners* expecting mobile advertising in Russia to grow to c. \$216mn in 2015 from c. \$61mn in 2012, Mail.ru is uniquely positioned to benefit as traditional Internet advertising wanes. In this regard *ZenithOptimedia* forecasts growth in total Russia Internet advertising to slow to a

compound annual rate of 26% in 2013-2015, down from 45% in the past three years. Mail.ru's diversified asset base means its revenue is derived from both of these advertising avenues and it can thus make up for any drop in its traditional Internet advertising from its mobile advertising platform.

- Search engine expansion:** Mail.ru's search engine was expanded to handle queries from all of its almost 40mn users worldwide and it recently dropped Google's search engine. With only c. 5% of the Russian population estimated to speak English, the majority will not be inclined to use foreign portals and search engines to access information, while foreign companies also seem to fail to respond to distinct interests of the Russian population. This is where Mail.ru comes in. Its search is currently the third-most popular and its online recruitment business, Headhunter is the largest in the Russian-speaking world.
- A diverse portfolio:** Mail.ru has a diverse asset portfolio and although it sees communication and entertainment services as the core of its expertise, the fact that it has such a diverse portfolio means it has a very wide net in which to catch potential customers. In addition, its web-mail service and portal as well as other group companies have no serious competitors. Moreover, Mail.ru could acquire small or middle-sized players so as to increase its value and absorb strong teams.

Background:

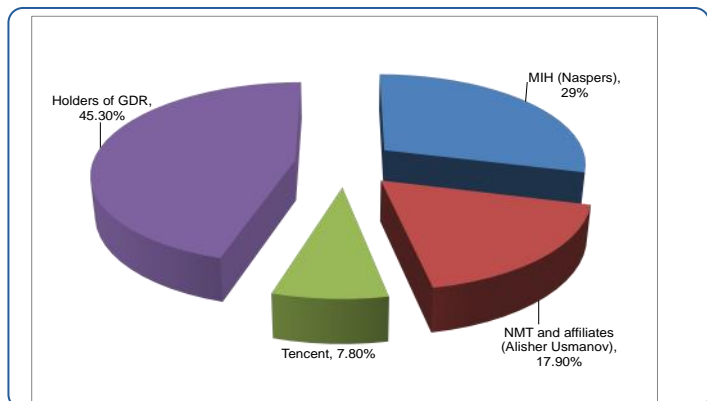
Mail.ru Group (LSE:MAIL) was originally owned by Port.ru, a company founded in 1998. It received an initial investment of \$1mn after which its business expanded rapidly. However, attempts to fund expansion in 2000-2001 were derailed by the collapse of the technology bubble and it was forced to seek merger partners. In 2001, Yuri Milner, who was managing a company called NetBridge, which owned other Internet brands, persuaded the entrepreneur Igor Linshits to back a merger with the Mail.ru business. Linshits took an active role in the development of the business and following the merger, Milner became CEO. The company started operating under the Mail.ru name in October 2001. In 2006, Linshits sold his stake to Tiger Fund and Milner's Digital Sky Technologies (DST) for more than \$100mn. In 2010, DST changed its name to Mail.ru Group and Dmitry Grishin became one of the Mail.ru

What it does

Mail.ru Group offers Internet access services in Russia and operates social networking websites (two of the three largest Russian-language online social networking sites Odnoklassniki and Moi Mir [My World]), IM (Mail.Ru Agent and ICQ), an email service (it offered the first free e-mail service in Russia) and Russia's largest online games platform. It completed an IPO in the form of GDRs on the LSE in 2010. *ComScore* estimates that Mail.ru's sites reach c. 84% of Russian Internet users on a monthly basis and that it is among the top-five largest Internet businesses based on number of total pages viewed. The company is controlled by Russian billionaire Alisher Usmanov, who sold 7.4% of Mail.ru for \$532mn in February but retains an 18% stake and voting control in the company.

Naspers owns a 29% stake and Tencent, China's largest Internet operator, owns 7.8%. Mail.ru's charter bans foreign shareholders from owning more than 45% of voting rights.

Mail.ru shareholding structure:



Source: Company data, Anchor Capital

Business segments:

Mail.ru is made up of the following units:

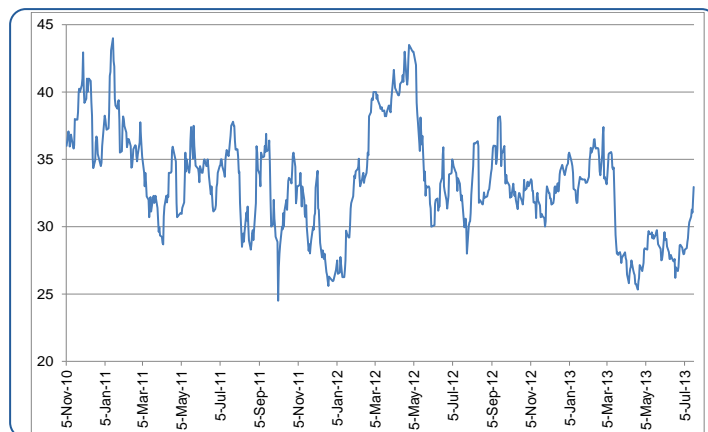
- **Email and portal** - Mail.ru is the leading email service in Russia. Revenue is generated through display and context advertising.
- **Social networks** - Odnoklassniki and My World are two of Russia's biggest social networks while it also holds a 40% stake in Vkontakte, which means 'in touch' and is Russia's largest social networking site.
- **IM** - Mail.ru Agent and ICQ (acquired from AOL in 2010) are two IM services popular in Russia and the CIS.
- **Online games** - the company is Russia's leading online game provider.
- **Search and e-commerce** - The Mail.ru search engine is currently the third-most popular and Headhunter is the largest online recruitment business in the Russian-speaking Internet market.

The company also has an investment in Russian electronic payment service, Qiwi (21.35%). Mail.ru sold part of its Facebook stake last year and it now holds only a 0.6% interest. It also owns stakes in a number of Russian and Ukrainian Internet companies.

Share price performance:

Mail.Ru's share price has dropped c. 11.9% since February. First it recorded its biggest decline in six months on 28 February (down 10.2%) after Usmanov's USM Holdings sold 15.5mn Mail.ru GDRs and then it dropped further in March when the second special dividend was paid. The first payout to shareholders in the company's history occurred in August 2012 (when it paid out a special dividend of \$795mn or \$3.80/share). However, since the company's November 2010 IPO, when it raised about \$1bn, Mail.ru shares have advanced 19%. The share price has been performing well over the past week and is now down only 4.5% YTD (YoY its up 9.6%).

Mail.ru share-price performance since listing (\$):



Source: Bloomberg, Anchor Capital

Mail.ru's metrics are as follows:

| | |
|------------------|--------|
| Spot (\$) | 32.95 |
| Mkt Cap \$bn | 6.9 |
| 12M trailing P/E | 5.57 |
| 12M Fwd P/E | 21.68 |
| P/Book ratio | 2.33 |
| FYE | 31-Dec |
| 12M trailing DY | 24.7 |
| 12M fwd DY | 9.36 |

Source: Company data, Anchor Capital

Mail.ru's forecasts are as follows:

| Mail.ru | 2012* | 2013F | 2014F | 2015F |
|-----------------|-------|-------|-------|-------|
| December y/e | | | | |
| EPS (\$) | 1.30 | 1.53 | 1.81 | 2.10 |
| % growth | | 18% | 18% | 16% |
| DPS (\$) | 8.10 | 3.08 | 0.71 | 0.62 |
| P/E | 25.3x | 21.5x | 18.2x | 15.7x |
| DY | | 9.3% | 2.2% | 1.9% |
| Share price, \$ | 32.95 | | | |
| 12M Fwd P/E | 21.68 | | | |

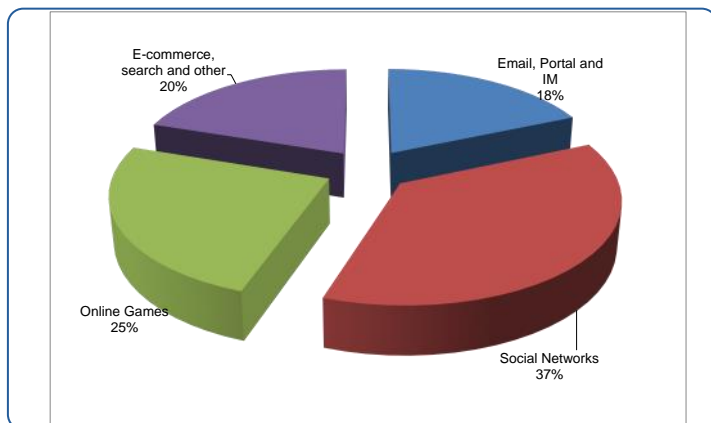
Source: Bloomberg, Anchor Capital

Note in FY12 the company paid two special dividends of \$3.80/ share and \$4.30/share.

Full-year results:

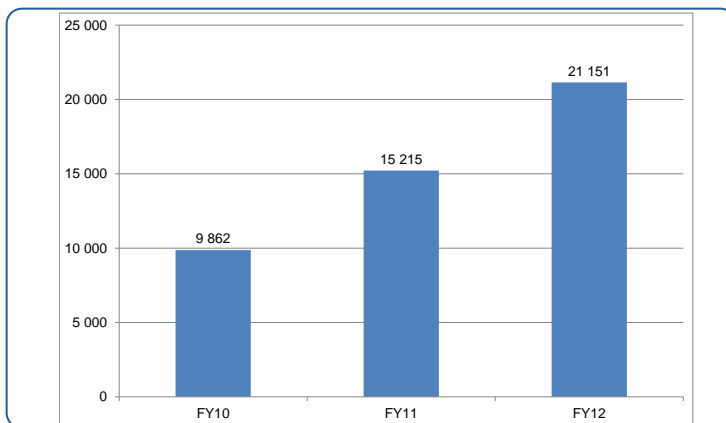
In March Mail.ru released its FY12 results which showed revenue increased 39% (\$700mn), EBITDA by 38% (\$400mn) and net profit 36% (\$250mn). Revenue from media advertising grew 14.9%, with a 44.3% growth in content. The company also announced a record dividend payment of about \$900mn or \$4.3/GDR. It had already paid a special dividend in August 2012, when shareholders received \$795mn (\$3.80/GDR). As mentioned this increased dividend comes mostly from the sale of its Facebook shares. The company's EBITDA margin increased to 46.0% in FY12 (FY11: 41.5%) as a result of operating expenses growing at a slower pace than revenues, and due to a more than seventeen-fold increase in net gain on venture capital investments and associated derivative financial assets and liabilities.

FY12 operating segments contribution to revenue, %



Source: Company data, Anchor Capital

Mail.ru revenue growth (RUBmn):

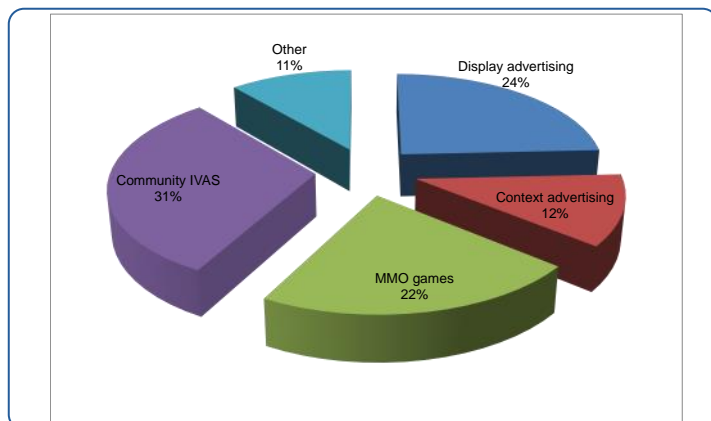


Source: Company data, Anchor Capital

Mail.ru's Community IVAS, which includes MMOs, was its main income source and the fastest-growing segment (up 78.7%). This revenue is driven by payments for features and virtual items (including virtual gifts, revenue-sharing with developers through its Application Programming Interface [API], revenue from its own social games and from dating services sold primarily on its social networks). A large portion of payments are made by SMS, and revenue is recognised net of commission paid to distributors or SMS operators. MMO games contribute 40% of revenue here. Total advertising income increased 23.1%, and contextual advertising (revenue earned through partnerships with third parties) showed a growth rate of 44.3%.

Display advertising (from banners and similar ads on its websites) recorded a 14.1% growth rate (the slowest segment) on the back of a growth slowdown in display revenue in 2H12 which was driven by a combination of a planned reduction in advertising inventory on some of its properties, a ban on alcohol advertising and inventory adjustments for TV. Its gaming division saw 24% YoY growth. Other revenue is generated through subscriptions to its online recruitment site, Headhunter, and the 40.6% increase in Other revenue was primarily driven by the overall macroeconomic environment and Headhunter's leadership position in the online jobs market. The company provided FY13 guidance of 25-28% YoY revenue growth and EBITDA margins in the low 50% (vs 46% in FY12).

FY12 revenue by product



Source: Company data, Anchor Capital

Yandex:

Yandex and Mail.ru are not in direct competition, the two groups are quite different, having their strongest positions in different segments of the market. Yandex holds dominance in search in Russia with a market share estimated at c. 64%, while this core service is supplemented by other services including maps, an online payment service and a social network for professionals. On the other hand Mail.ru is the leader in social networking by operating IM ICQ, MoyMir, Odnoklassniki and holding a minority stake in VKontakte. In terms of how revenue is generated Yandex relies almost exclusively on its advertising business, while Mail.ru has a more diversified base which generates revenue from its Internet services, portal and games. Although still relatively high, Mail.ru has a lower 12M fwd P/E (21.7x) compared with Yandex (29.1x) and Tencent (32.0x). It is also trading at an impressive 9.7% 12M fwd DY vs 0.6% and 0.4% for Yandex and Tencent, respectively. Key for Mail.ru to increase its profitability is how significantly it can grow its Russian-speaking customer base, not only in Russia but also in the CIS. In our view, looking at the growth of Internet users and the amount of time spent on the Internet in Russia, the market can look forward to a robust performance from the company on this front.

Mail.ru vs peer group

| | Market cap \$bn | 12M trailing P/E | 12M fwd P/E | 12M fwd DY |
|---------|-----------------|------------------|-------------|------------|
| Mail.ru | 6.7 | 5.4 | 21.7 | 9.7 |
| Yandex | 10.5 | 37.6 | 29.1 | 0.6 |
| Tencent | 78.1 | 38.1 | 32.0 | 0.4 |

Source: Bloomberg, Anchor Capital

Risks:

Below we highlight possible risk factors facing Mail.ru:

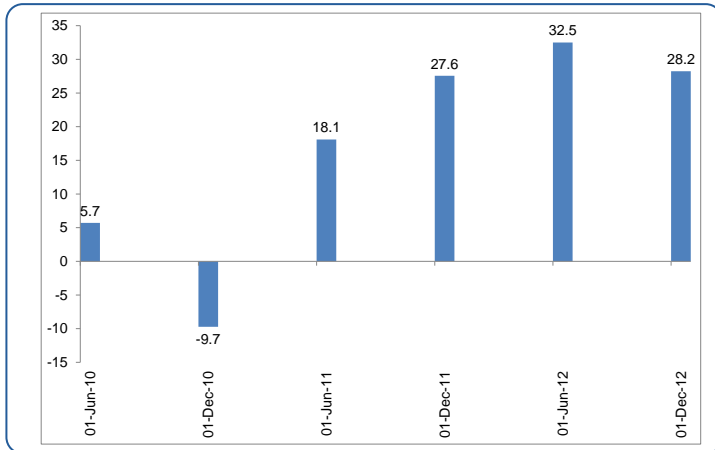
- **The global economic environment:** Challenging economic conditions or another global financial crisis will curb spending on luxury items such as PCs, tablets, mobile phones and Internet access, impacting Mail.ru's potential for growth.
- **Google** is looking to step-up its effort in Russia and analysts suggest a better way to infiltrate the Russian market would be to grow a more local operation that can better tackle the market there. Currently Yandex is Russia's most-used search engine by far, with 62% market share compared with Google's 26%, giving it an overwhelming advantage in attracting advertisers and generating profit. Mail.ru comes in third with less than 9% of search queries. If Google increases its market share in Russia its more likely to impact Mail.ru than Yandex.
- **Facebook gains market share in Russia.** Facebook has thus far been unsuccessful in penetrating the Russian market and according to *comScore*, Vkontakte and Odnoklassniki have 40mn and 31.5mn unique users in Russia, respectively, compared with Facebook's 11.9mn unique users. However, it is not impossible to imagine that Facebook could make bigger inroads in the Russian market in the future. Facebook's biggest markets are peaking and where better to look for growth than the huge Russian market where users are spending the longest amount of time online. Also as the younger generation in Russia becomes more westernised it is a distinct possibility that they would prefer to use the more globally well-known (western) social network.
- **Aging game titles:** According to Mail.ru's 2012 annual report the leading games in their stable were Perfect World, Allods Online and Legend. All of these games have been running for over 4 years, while the typical lifetime of an MMO game is 5-7 years. This means these three games will soon have to be replaced, posing some risk to revenue as Mail.ru's top-3 games generate nearly two-thirds of its total MMO revenue.
- **MMO games:** Mail.ru generated 22% of its revenue from MMO games in FY12. Most of these games are free-to-play, which means the player is only charged when making in-game purchases. This business model leads to double or triple the number of active users compared with a subscription-based model, but on the negative side only a fraction of these active players are actually willing to pay for these in-game enhancements. Mail.ru has been fortunate thus far with its model but its not unimaginable that the willingness of players to make in-app purchases could peter out.
- **Piracy and the consequences of Draconian legislation in Russia:** Illegal content is freely available online in Russia with Mail.ru's CEO Dmitry Grishin saying that media groups will have a hard time charging for online content because of rampant piracy. He noted in an interview that Russian Internet users were not inclined to pay up front for high-priced content but free-to-play games that charge a small fee for virtual goods have been successful. Ironically the group has been sued

several times in recent years over piracy claims, mostly due to its partial ownership of Vkontakte.ru, one of the largest piracy hubs in Russian digital space. To combat the rampant piracy Russia has, over the past nine months, passed two bills regulating domestic Internet use, including an extrajudicial blacklist for websites and a radical anti-piracy law. This new Draconian legislation is aimed at curbing film piracy, but places much of the responsibility on middlemen rather than on the pirates themselves. It allows bans and/or lawsuits to be initiated against almost any website, including online media and search engines. The law basically says that copyright owners do not need to contact the uploader, but instead they can go directly to court, which will then order the contested content be removed – without ruling on its legality. If the host does not get the uploader to comply within 24 hours, a state watchdog can block the offending webpage or website by IP address (which is often shared by a number of unrelated websites, all of which will effectively fall under the ban). The bill also allows copyright holders to target any “informational intermediaries” involved in disseminating contested content which means a search engine, blog or news website can face bans because a user posted a link to a pirated movie in its comments section.

Conclusion:

In a relatively short space of time Mail.ru has grown into a formidable online entertainment and communication service for Russian-speakers globally. That Mail.ru (also Yandex and RuTube [Russian YouTube]) has done this with very little, if any, innovation is a testament to the resourcefulness of the company as well as the demand for those products they provide. Mail.ru has in effect simply branded existing technologies to reach Russian-speaking users. It was able to market the Internet to Russians at the right time and we believe it will continue reaping the rewards from the largest growing internet segment in Europe. Mail.ru, as a diversified consumer Internet conglomerate, has also been the leading e-mail service in Russia for the past decade and it owns the second- and third-largest social networks in the country with a 40% stake in the biggest one.

There are those analysts who are of the view that the company may have peaked. Its share price on the LSE hit an all-time high of \$44.00 in January 2011 and it is currently down 25% from this level. However, we like the company due to its dominant position in the Russia Internet and gaming space. At the same time its structural drivers remain strong as stable community IVAS and MMO gaming continues to be its main revenue streams while Mail.ru also expects display advertising growth to recover in FY13 from the lower FY12 levels. The company's operating margins at c. 30% have also remained robust (and stable since 2011) and we expect this to continue. We also think the company has exceptional growth prospects for portability to the mobile environment which will become increasingly important globally as a booming mobile Internet user base effectively drives overall Internet user growth.

Mail.ru operating margin (%):

Source: Bloomberg, Anchor Capital

The amount of time Russian users spend online continues to grow (over the past year the average number of hours spent online per user per month in Russia have increased from 15 to 22.5) and the ways through which the Internet penetrates into users' daily lives keeps increasing. In Russia the web is all about communication: email, IM and social networks are extremely popular and Mail.ru has all of these communication tools covered - it is also where most of Mail.ru's audience is concentrated. According to the company when people communicate over the internet in Russia they want to share information and they want to be entertained. In the entertainment aspect Mail.ru also excels with its gaming division.

The fact that the company paid out two large special dividends over the past year could signify that Mail.ru is not looking to make any big future acquisitions and it also shows a company willing to return cash to shareholders when it is available. Although it still owns c. 0.6% of Facebook, it has repeatedly stated that it wants to get rid of all international assets and instead focus on the Russian-speaking market. At its results conference call the company said it views non-core assets as financial assets and not strategic ones and would not sit on excess cash over the long term. This could indicate that further shareholder remuneration is on the cards once it sells its remaining stake in Facebook (worth c. \$500mn). The company's focus on the Russian-speaking market will be through the creation of startups and by optimising the integration of these startups into the existing company structure. Key for Mail.ru to increase its profitability is also how significantly it can grow its Russian-speaking customer base (not only in Russia but also in the CIS - a region which is far from saturation point and like Russia offers momentous growth opportunities for the company).

Social networks are extremely popular in Russia and measured by time spent online and page views, users of Russian social network sites are above global averages. In our view, looking at this and the growth (and still growing) of Internet use, we can expect a robust performance from the company. The possibility of Mail.ru buying a controlling stake of VKontakte (it already owns 40%), which has 100mn active users, has been bandied about in the media

for some time now, but Mail.ru has balked at this as it believes the share price is too high. However if it does acquire a majority stake in the company this would cement Mail.ru's leadership position in the Russian social networking space and will help the company derail the expansion of Facebook as well as drive its future growth. As mentioned above some of Mail.ru's most popular games are already older than four years and it would also be sensible for the company to use its cash flow to fund deals for smaller gaming companies, thereby allowing it to recruit the game designers within these companies. Ad revenue is cyclical, but Mail.ru gets half of its revenue from the more stable gaming services it offers. With the display market expected to recover this year, and community VAS and MMO gaming expected to remain strong, the group has forecast revenue growth of 25-28% in 2013, while the EBITDA margin is expected to stay in the low 50s.

We consider Mail.ru to be a strategic asset and a great addition to any portfolio. Its broad revenue model gives the investor a valuable and diversified doorway into the high-growth Russian (and Russian-speaking) Internet market/s. On a 12M trailing and fwd P/E basis Mail.ru (at 5.6x and c. 21x, respectively) is much cheaper than its counterparts in the Internet space (Yandex, Tencent) which are trading at 12M fwd P/Es of 29.1x and 32.0x and 12M trailing P/Es of 37.6x and 38.1x, respectively. Nevertheless, at a 12M fwd P/E of around 21x the stock is currently not cheap and we would recommend investors look for any share price weakness to accumulate.

Mail.ru will release its 2Q13 results on 5 September.

Marco de Matos



The business of money: Global asset management and stockbroking



The business of knowledge: Financial education, information and valuation services

Disclaimer

This report and its contents are confidential, privileged and only for the information of the intended recipient. Anchor Capital (Pty) Ltd and Ripple Effect 4 (Pty) Ltd make no representations or warranties in respect of this report or its content and will not be liable for any loss or damage of any nature arising from this report, the content thereof, your reliance thereon its unauthorised use or any electronic viruses associated therewith. This report is proprietary to Anchor Capital (Pty) Ltd and Ripple Effect 4 (Pty) and you may not copy or distribute the report without the prior written consent of the authors.