

# Rambler Media

## COMPANY NOTE

**BUY**

**Upside: 42%**  
**Target Price: \$68.24**

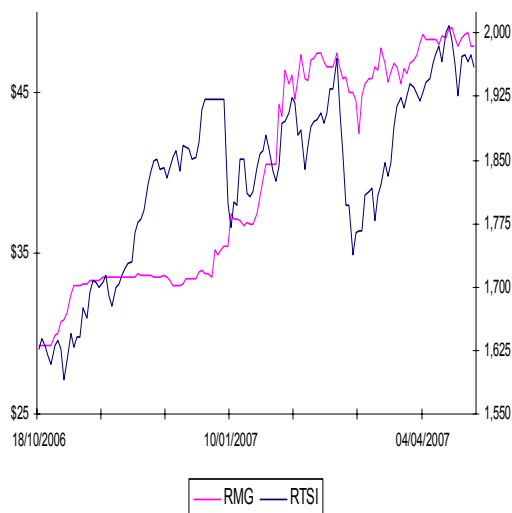
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Stock data			
Ticker	RMG LN	M.Cap \$ mn	713.3
Shares Ords	15,017,000	Free Float, %	26%
Shares Pref	-	Free Float, \$ mn	185.5
Bid Ords, \$	47.5	Offer Ords, \$	48.5

Market performance			
Absolute	Ords	1 month	6 months
Relative to RTSI	Ords	7.6%	102%
Price range, \$		-2%	79%
High	Ords	48.6	48.6
Low		42.5	23

Financials, 2007E			
Revenue, \$ mn	77.8	P/S	9.2
EBITDA, \$ mn	35	EV/EBITDA	21.9
Net Income, \$ mn	23.65	P/E	30.2

### Market performance



Source: RTS, Sovlink Securities

## An option on value

- The Rambler Media group of companies was founded in 1996. Originally, Rambler was founded as a Russian internet search engine. Nowadays the company positions itself as a web-portal. At the moment its major shareholder is Prof-Media – with a stake of 55% – a large media holding belonging to Vladimir Potanin (Norilsk Nickel). Approximately 26% of Rambler's shares are traded in London on AIM. Prof-Media acquired a controlling stake in Rambler in the autumn of 2006.

- Internet advertisement in Russia has been growing at a high rate for a number of years. The most dynamic segment of this market is pay per click (PPC) advertising. At the moment Begun and Yandex.Direct share 80-90% of the PPC market in Russia. Rambler has held a 25% stake in Begun since 2005. Rambler stated in its press release issued in September 2006 that it is going to exercise its option (included in its original purchase contract) to acquire the remaining 75% in the near future.

- At the moment Begun lacks transparency and does not reveal its real financial statement figures. This is mainly due to the fact that Begun is a cash cow for its current majority shareholder – Finam (which holds a significant portion of the outstanding 75% stake). We expect Begun's cash flow to improve significantly after Rambler exercises its option to purchase the remaining 75% stake.

- On March 15, Rambler Media announced that Mark Opzoomer had been appointed as its CEO and Arthur Akopyan as the CFO. In our opinion these changes (as well as the appointment of other directors) are an indication of Prof-Media's intention to increase Rambler's capitalisation. The newly appointed top managers have strong track records as senior executives in the media and technology sectors. In their previous roles they had been instrumental in improving the transparency and profitability of the companies in which they worked. We take their appointment as a sign that Prof-Media is now moving towards improving the financial results of the companies it has acquired.

- Nevertheless, in our opinion the main revenue driver for Rambler's shares lies in Begun's consolidation. We strongly believe that the new management was hired to increase Rambler's value to its shareholders. Management sees the takeover of Begun and the consolidation of its true financial figures in Rambler's statements as the quickest way to achieve this.

- Taking into consideration our DCF results and the planned takeover of Begun, we issue a **BUY** recommendation on Rambler, and estimate the fair value of the company's shares at \$68.24 per share, which gives upside potential of 42%. However, we stress that our target price is based on the assumption that Rambler will exercise its option to acquire the remaining 75% stake in Begun in the near future.

## Industry outlook

### *Internet advertising in Russia*

Internet advertising in Russia has been growing at a continuously fast rate for a number of years. According to Mindshare Interaction, in 2006, internet advertising in Russia amounted to \$187 mn – a y-o-y increase of 87% – whilst PPC advertising doubled to \$102 mn. The ZenithOptimedia agency forecasts Russian internet market revenues to increase to \$360 mn between 2007-09.

At the moment Yandex, Mail.ru, RBC, and Rambler are the leading players in the Russian internet industry (ru-net). Whilst Yandex and Begun are the market leaders in the PPC market, Mail.ru and Rambler are media advertising providers (based on banner advertising) – with PPC advertising making up 30% of the total advertising appearing on their pages, while 70% consists of banner advertising. (Google has only a minimal presence on the Russian market, earning no more than \$3 mn from the Russian internet market in 2006.)

Despite the dramatic growth of the PPC market in Russia, Begun has managed to significantly outperform the Russian market. According to Rambler, which holds a 25% stake in Begun, Begun's sales tripled in 2006.

### *Company Review*

The Rambler Media group of companies, was founded in 1996. At the moment, the major shareholder is Prof-Media – which owns a stake of 55% – a large media holding belonging to Vladimir Potanin (Norilsk Nickel). Approximately 26% of Rambler's shares are traded in London on AIM. Prof-Media acquired a controlling stake in Rambler in the autumn of 2006.

Prof-Media is a strategic investor, which is building its assets in a vertically-integrated holding, and is interested in increasing the capitalisation of the assets it has acquired. It is possible that Prof-Media intends to list its shares on an international exchange in the next few years. As a result of the acquisition, Rambler will benefit from synergies with Prof-Media assets such as Afisha.ru, other online sites, and its offline publications.

Earlier this year, Rambler sold its unprofitable TV division to Prof-Media for \$23 mn and announced that it will spend the proceeds on new internet acquisitions. We think that Rambler is accumulating cash to acquire Begun (the second largest PPC advertiser on the Russian internet).

On March 15, 2007 Rambler Media announced that it had appointed Mark Opzoomer as its CEO. Opzoomer has 24 years of corporate management experience: he was the managing director and regional vice-president of Yahoo! Europe (2001-2003); prior to that he served as deputy chief executive of Hodder Headline Plc, an LSE-listed book publishing company, as commercial and finance director of Sega Europe Ltd., and as commercial director of Virgin Communications Ltd. Opzoomer replaces Irina Gofman, who will remain with Rambler as a non-executive director. In addition, Arthur Akopyan who was appointed Rambler's CFO, – previously he had been the CFO at the Synterra Group, a leading internet service provider – is very experienced in consolidating new acquisitions, business restructuring and preparing IFRS statements.

In our opinion, these (and other) new appointments are an indication of Prof-Media's intention to increase the financial results of the assets it has acquired. The newly appointed top managers have strong track records as senior executives in the media and technology sectors, and we expect their efforts to add momentum to Rambler's development.

## The PPC market in Russia

According to a report published jointly by Begun, Rambler, and Yandex, PPC advertising revenues in Russia almost tripled from \$40 mn in 2005 to \$110 mn in 2006.

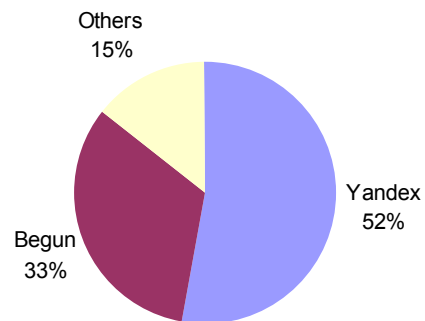
According to AKAR Media, internet banner advertising revenues in Russia amounted to \$100 mn in 2006 (an increase of 60% from 2005). This is the first time that Russian internet PPC advertising overcame media (banner) advertising not only in terms of growth, but also in absolute value. In total the Russian advertising market's revenues amounted to \$210 mn.

**Russian PPC market structure, \$ mn**

Yandex	58
Begun	36
Others	16

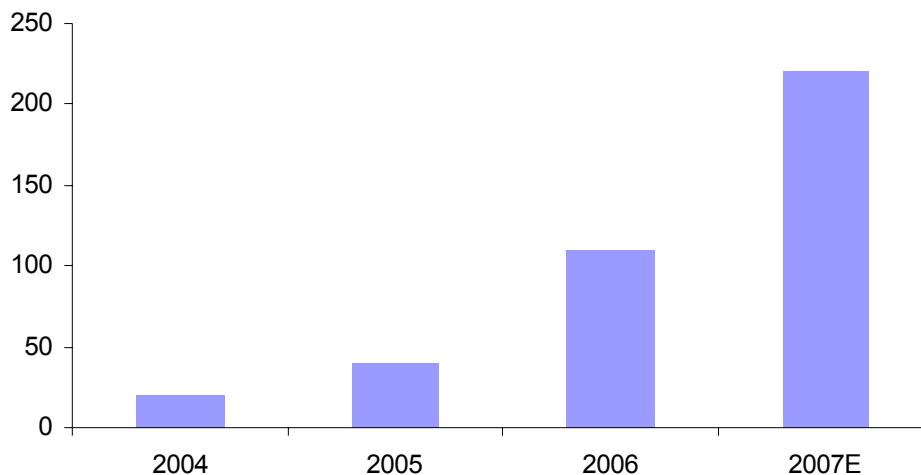
Source: Yandex, Ashmanov & Partners, Sovlink estimates

**Russian PPC market structure, %**



Source: Yandex, Sovlink estimates

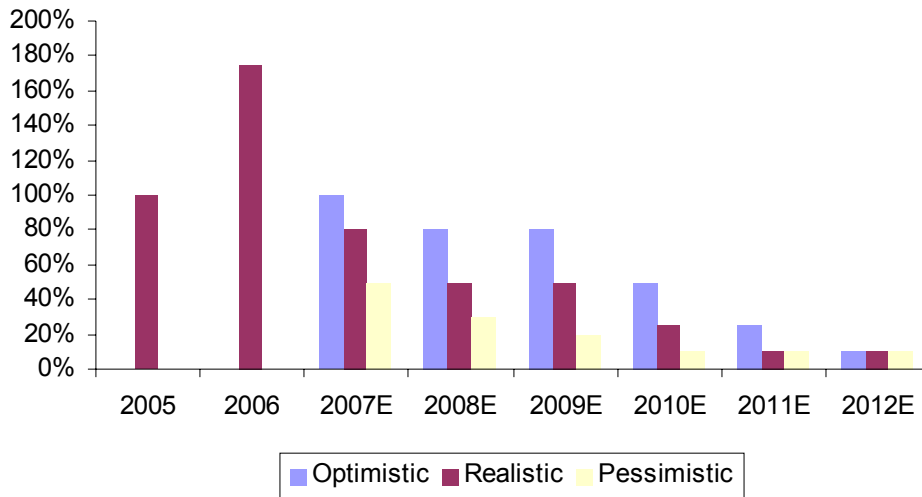
*Paid search advertising growth in Russia 2004-2007, \$ mn*



Source: Begun, Rambler, Yandex

At the moment, Begun and Yandex.Direct share 80-90% of the Russian PPC market. Other market players include Google, Link.ru (combined media and PPC advertising services), and Rorer.ru (PPC banners).

*Paid search advertising growth, 2005-12*



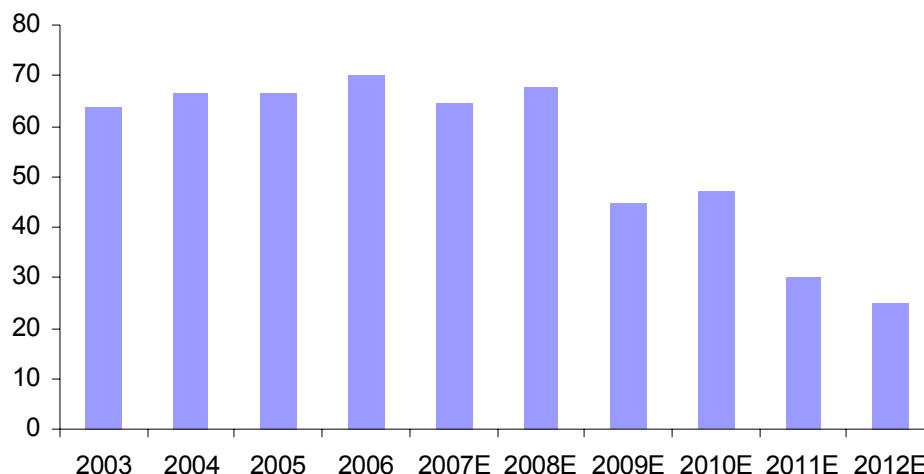
Source: Begun, Rambler, Yandex, Sovlink estimates

## Valuation

In order to forecast Rambler’s revenues we used the growth rates of advertising budgets in Russia. We also took into consideration the fact that historically, Rambler has grown 50% faster than the rest of the market, according to AKAR. However, we do not expect Rambler’s 2006 results to be impressive. This is because, at the moment, Begun does not present its results in a transparent manner and does not reveal its real financial figures. This is mainly due to the fact that Begun is a cash cow for its current majority shareholder – Finam (which holds a significant portion of the outstanding 75% stake). We expect Begun’s cash flow to improve significantly after Rambler exercises its option to purchase the remaining 75% stake.

Nevertheless, in our opinion the main revenue driver for Rambler’s shares depends on Begun’s consolidation. We strongly believe that the new management team was hired in order to increase Rambler’s value for its shareholders. Management sees the takeover of Begun and the subsequent consolidation of its true financial results in Rambler’s statements as the shortest way to achieve this.

*The growth of internet advertising budgets in Russia, % changes y-o-y*



Source: AKAR, Sovlink estimates

We have forecast revenues for Rambler up to 2012, based on the market's historical revenue growth rates, which are 60%-70% lower than Rambler's historical growth rates. We have deliberately chosen a conservative scenario. In our worst case prediction, Rambler would perform on par with the market. We believe that Rambler is unlikely to perform worse than the whole internet market, as historically it always outperformed the market.

*Rambler's revenues from internet services*

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E
Revenue \$, mn	14.8	29.2	48.1	80.8	116.8	171.9	223.4	279.3
Revenue growth	111.2%	97.1%	64.7%	67.9%	44.7%	47.1%	30.0%	25.0%
Industry	66.7%	70.0%	64.7%	67.9%	44.7%	47.1%	30.0%	25.0%
Rambler's outperformance	44.5%	27.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: AKAR, Sovlink estimates

We believe that Rambler may exceed our forecasts and outperform the average industry growth rates through 2007–12. However, we have based our DCF model on a conservative scenario, which assumes that Rambler will develop at the same rate as the rest of the Russian internet advertising industry.

Begun has consistently developed at a fast pace over a number of years, outperforming the PPC sector growth rates, and gaining market share. We have also used a conservative scenario for our sales forecast for Begun, in which we assume that Begun's market share does not increase but stays constant. We note that this is a very conservative assumption, as Begun has historically grown 3-4 times faster on an annual basis than the market as a whole.

*Begun revenue forecast, \$ mn*

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Optimistic estimation		66	118.8	213.8	320.8	401.0	441.0
Realistic estimation	36	59.4	89.1	133.7	167.1	183.8	202.1
Pessimistic estimation		49.5	64.4	77.2	84.9	93.4	102.8
% of PPC advertising market	32.7%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%

Source: Sovlink estimates

We based our revenue forecast for Begun on the PPC industry's turnover forecasts. [For 2007, Begun, Rambler, and Yandex jointly forecast the market's turnover at \$220 mn.] We consider this forecast as optimistic.

*PPC advertising turnover in Russia, \$ mn*

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Optimistic estimation				220	396	713	1,069	1,337	1,470
Realistic estimation	20	40	110	198	297	446	557	613	674
Pessimistic estimation				165	215	257	283	311	343

Source: Begun, Rambler, Yandex, Sovlink estimates

The optimistic scenario assumes that growth would continue at a high rate during 2007-2009. The realistic scenario is based on the assumption that growth will slow down to 50% in 2008-2009. The pessimistic scenario assumes that the growth rate will decline sharply between 2010-12 to 10%.

*Russian PPC ad growth rates*

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Optimistic			100%	80%	80%	50%	25%	10%
Realistic	100%	175%	80%	50%	50%	25%	10%	10%
Pessimistic			50%	30%	20%	10%	10%	10%

Source: Begun, Rambler, Yandex, Sovlink estimates

In our model we assume internet revenue only, and exclude the Company's Mobile VAS division. As the Mobile VAS division does not have positive cash flow, and we expect it to be sold in the near future. Moreover, this division has a minimal effect on the considered cash flows.

We believe that Rambler is going to acquire Begun in May-June 2007. Therefore, we have combined the revenues of Rambler and Begun, in order to obtain the total expected revenue for Rambler. We presume that Begun's results will be consolidated in Rambler's financial statements in 2H07, and have included this assumption in our DCF model.

**DCF Summary, \$ mn**

	<b>2007E</b>	<b>2008E</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>
Revenues	77.79	169.85	250.49	338.94	407.20	481.44
EBITDA	35.01	76.43	112.72	152.52	183.24	216.65
Amortization & Depreciation	2.02	4.42	6.26	8.47	10.18	11.55
EBIT	32.98	72.02	106.46	144.05	173.06	205.09
Tax adjustment	-9.34	-20.38	-30.06	-40.67	-48.86	-57.77
Net profit	23.65	51.63	76.40	103.38	124.20	147.32
Net profit margin, %	30%	30%	31%	31%	31%	31%
NI	23.65	51.63	76.40	103.38	124.20	147.32
Amortization & Depreciation	2.02	4.42	6.26	8.47	10.18	11.55
Capex	-3.38	-3.86	-4.21	-4.39	-4.60	-4.93
Change in working capital	-2.20	-2.29	-1.62	-1.55	-1.64	-1.32
FCFF	20.09	49.90	76.83	105.91	128.14	152.63
FCFF discounted	17.94	39.78	54.69	67.31	72.71	77.32

Source: Sovlink estimates

WACC	15%
Terminal growth rate	4%
<b>NPV of forecasted years, \$ mn</b>	329.75
<b>NPV of Terminal Value, \$ mn</b>	731.07
Fair EV, \$ mn	1,060.82
Net Debt, \$ mn	36
Fair M.Cap, \$ mn	1,024.82
Number of shares	15,017,000
<b>Target price, \$</b>	<b>68.24</b>

Our results are based on the assumption that Begun's results will be consolidated with a takeover P/S ratio of 3x under the realistic scenario given above. We have outlined below different transaction scenarios and the resultant share price of Rambler's shares for each scenario.

**Begun's acquisition**

We have evaluated the future benefits for Rambler as a result of Begun's consolidation. Two years ago Rambler bought a 25% stake in Begun for \$750,000 and simultaneously received an option to buyback the remaining 75% - 1 share. According to the contract, this option expires in the summer of 2007.

At the moment, Begun does not present its accounts in a transparent manner and does not reveal its real financial statement figures. This is mainly due to the fact that Begun is a cash cow for its current majority shareholder – Finam (which holds a significant portion of the outstanding 75% stake). We expect Begun's cash flow to improve significantly after Rambler exercises its option to purchase the remaining 75% stake.

In our calculations we assume that the transaction will take place with a P/S ratio of 3x. Such a coefficient is suitable for a private, non-transparent company like Begun. (In the table below, we have also provided scenarios with P/S ratios of 6x and 8x for information purposes.)

*Rambler's share price dependence on the acquisition of Begun*

P/S 2006E		1.5	3.0	6.0	8.0
Begun deal value, \$ mn		40.5	81.0	162.0	216.0
Debt for deal financing, \$ mn		0	36	117	171
Rambler share price forecast, \$	optimistic	105.44	102.74	97.35	93.75
	realistic	70.94	68.24	62.85	59.25
	pessimistic	55.69	52.99	47.60	44
WACC		15%	15%	15%	15%
Terminal growth rate		4%	4%	4%	4%

Source: Sovlink estimates

Taking into consideration the DCF results and comparative valuation, we issue a **BUY** recommendation on Rambler, and estimate the fair value of the company's shares at \$68.24 per share.

**Comparative valuation**

Company	Current M.Cap, \$ mn	P/E		EV/EBITDA		Country
		2007F	2008F	2007F	2008F	
Yahoo! Inc	42,608.9	53.5	44.0	15.6	12.9	USA
Trizetto Group Inc	853.5	35.2	26.8	8.6	7.0	USA
Google Inc-Cl A	144,996.2	33.3	26.0	19.2	14.3	USA
Average		<b>40.7</b>	<b>32.3</b>	<b>14.5</b>	<b>11.4</b>	
Iomart Group Plc	102.4	N.A.	N.A.	9.2	7.1	Britain
Dada Spa	375.3	23.4	21.0	11.6	9.0	Italy
United Internet Ag-Reg Share	4,682.0	22.9	18.6	9.5	8.1	Germany
Average		<b>23.1</b>	<b>19.8</b>	<b>10.1</b>	<b>8.0</b>	
So-Net Entertainment Corp	680.9	40.1	N.A.	11.6	9.8	Japan
Gmo Internet Inc	556.4	52.6	N.A.	9.0	7.7	Japan
Yahoo! Japan Corp	20,273.4	39.8	N.A.	23.6	20.2	Japan
Lg Dacom Corp	2,072.8	11.5	9.4	6.3	6.3	South Korea
Neowiz Corporation	533.3	21.3	14.7	8.9	8.6	South Korea
Nhn Corp	7,623.1	25.7	22.6	13.0	10.4	South Korea
Gigamedia Limited	727.0	N.A.	N.A.	11.0	8.0	Taiwan
Average		<b>31.8</b>	<b>15.6</b>	<b>11.9</b>	<b>10.1</b>	
Sohu.Com Inc	861.0	N.A.	N.A.	17.5	12.9	China
Sina Corp	1,873.9	N.A.	N.A.	20.1	15.0	China
Baidu.Com - Spon Adr	3,339.7	N.A.	N.A.	35.4	21.9	China
Sify Ltd-Sponsored Adr	405.7	N.A.	N.A.	21.1	16.6	India
Average				<b>23.5</b>	<b>16.6</b>	
Rambler		30.9	14.1	21.9	10.0	
Discount to Chinese companies				7.0%	39.7%	
Discount to Google		7.3%	45.6%	-13.8%	29.8%	

Source: Bloomberg, Sovlink estimates

As can be seen in the table above, Rambler's multiples for 2007–08 appear quite modest in comparison to Google or Yahoo shares. Rambler's multiples are also at a discount of 20-30% to Chinese companies, so the company does not seem to be an overpriced internet stock. Moreover, we believe that Rambler will be able to improve on these figures.

*P/S comparisons for different countries*

<b>Company</b>	<b>Sales</b>	<b>P/S Ratio</b>	<b>Country</b>
Yahoo! Inc	6,425.7	6.87	USA
Google Inc-CI A	10,604.9	13.27	USA
Sohu.Com Inc	134.2	6.38	China
Netease.Com Inc -Adr	199.8	8.20	China
Sina Corp	212.9	8.67	China
Baidu.Com - Spon Adr	107.4	31.36	China
Yahoo! Japan Corp	1,311.0	13.46	Japan

Source: Bloomberg, Sovlink estimates

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## STOCK RATING POLICY

<b>STRONG BUY:</b>	Target price offers upside of over 100%; confidence level – high
<b>STRONG BUY (SPEC):</b>	Target price offers upside of over 100%; confidence level – low
<b>BUY:</b>	Target price offers upside of between 25% and 100%; confidence level – high
<b>BUY (SPEC):</b>	Target price offers upside of between 25% and 100%; confidence level – low
<b>HOLD:</b>	Target price offers upside of less than 25%
<b>SELL:</b>	Target price at or below current price levels

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