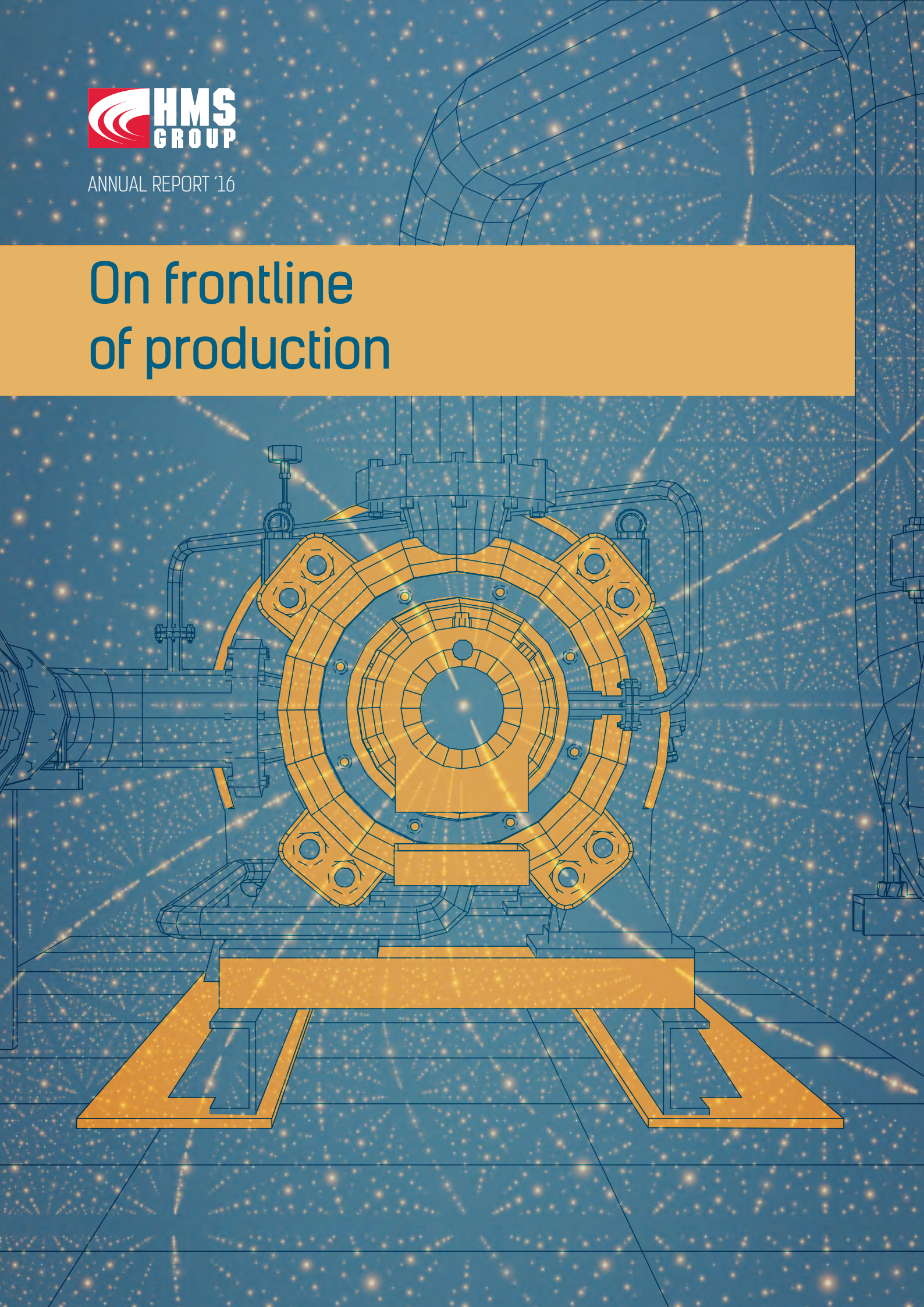
HMS GROUP

ANNUAL REPORT '16

# On frontline of production



# HMS GROUP IN 2016

HMS Group is a major pump and compressor equipment producer and provider of flow control solutions and related services for oil and gas, nuclear and thermal power generation, utilities and water supply in Russia and CIS countries as well as one of the leading manufacturers of skid mounted modular oilfield equipment. We are a dynamic engineering company with successful practice in design, installation and construction and the commissioning of complex oil and gas production and water facilities.

You can find more information on our web site:
**www.grouphms.com**

# OVERVIEW



# MARKETS



# PERFORMANCE



# GOVERNANCE



# ADDITIONAL INFORMATION

# WHO WE ARE



HMS Group is a large producer of industrial machinery, and the leading manufacturer of industrial pumps and compressors in Russia and in CIS countries, as well as one of the leading manufacturers of skid mounted modular oilfield equipment. We are a dynamic engineering company with successful practice in the design, installation, construction and commissioning of complex oil & gas production and water facilities.

**HMS Group is a vertically integrated holding company with a modern corporate management system wherein the functions of the manufacturing companies' shareholders and that of its business administration are traditionally separated.**

HMS' parent holding company is HMS HYDRAULIC MACHINES & SYSTEMS GROUP PLC (the Republic of Cyprus), which issued securities in the form of Global Depositary Receipts at the London Stock Exchange in February 2011.

HMS consists of 12 manufacturing facilities in Russia, CIS countries and Germany, plus 7 Research & Development centres and Institutes, including one of the largest pump-testing facilities in Europe, and employs 15 thousand people.

The company operates via four divisions:

## Industrial Pumps

REVENUE

**16,724 RUB MN**

EBITDA MARGIN

**16%**

**Description**

The industrial pumps business segment is our oldest division, responsible for designing, engineering, manufacturing and supplying a diverse range of pumps and pump-based integrated solutions to customers in the oil and gas, power generation and water utilities sectors in Russia, CIS countries as well as across the globe. It also provides aftermarket maintenance, repair services and other support for its products.

**Core products and services:**

- Oil transport
- Oil refineries
- Nuclear and Thermal power
- Water utilities
- Water injection
- Trunk pipelines
- General industrial pumps

## Oil & Gas Equipment

REVENUE

**15,144 RUB MN**

EBITDA MARGIN

**20%**

**Description**

The oil & gas equipment business segment manufactures, installs and commissions modular pumping stations, automated metering equipment, oil, gas and water processing and preparation units, as well as other equipment and systems, that are primarily used for the extraction and transportation of oil.

**Core products and services:**

- Oil pumping stations and pump stations for water injection
- Oil & gas and water processing units
- High-precision and automated metering units
- Tanks, reservoirs and vessels
- Oil development equipment

## Compressors

REVENUE

**8,700 RUB MN**

EBITDA MARGIN

**7%**

**Description**

The compressor business segment was established after the acquisition of the leading Russian compressor producer, Kazankompressormash (KKM), in July 2012. In 2013, this segment was bolstered by the acquisition of NIITK, a research & design institute providing compressor technologies. The division is responsible for the design, engineering, manufacture, and supply of a diverse range of compressors and compressor-based solutions to customers in the oil and gas, metals and mining and other core industries in Russia.

**Core products and services:**

- Oil & gas production
- Oil & gas transportation
- Gas processing
- Oil refineries
- Oil & gas chemistry
- Refrigeration applications for various industries

## Engineering, procurement and construction (EPC)

REVENUE

**2,297 RUB MN**

EBITDA MARGIN

**–3%**

**Description**

The engineering, procurement and construction (EPC) business segment provides design and engineering services, project management and project construction work for customers in the sectors of oil upstream and midstream, gas upstream and water utilities.

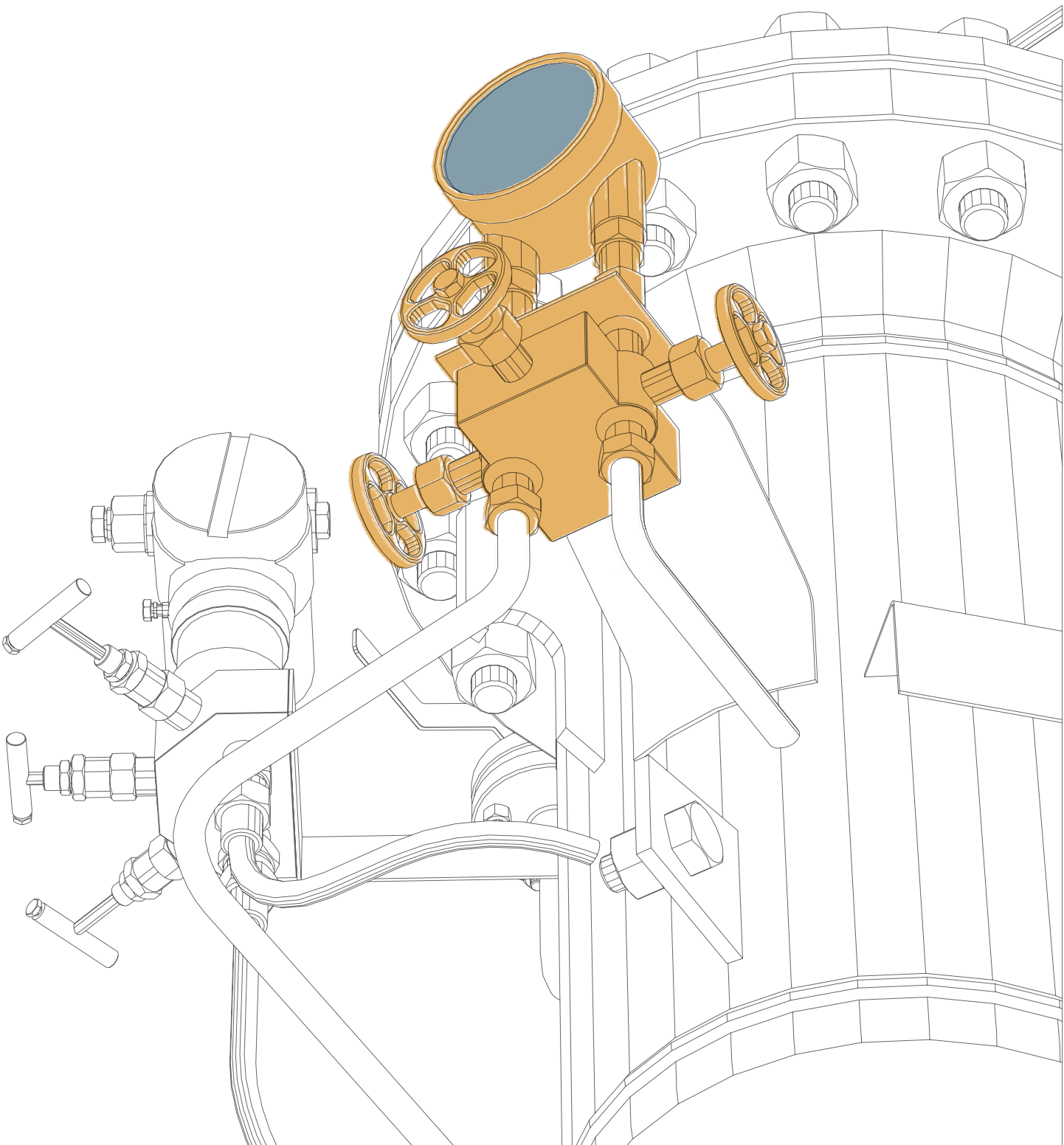
**Core products and services:**

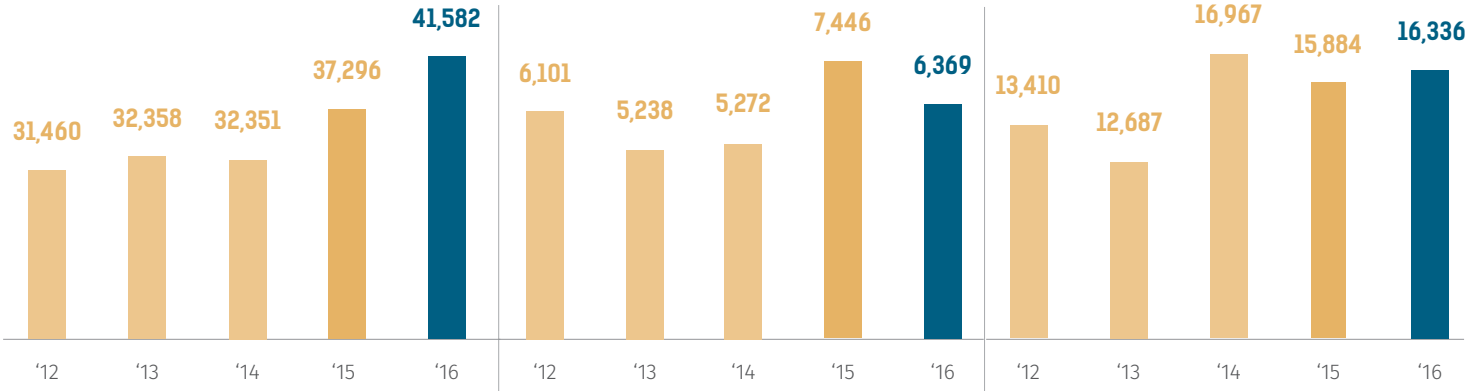
- Oil & gas projects focused on design and planning
- Oilfield surface infrastructure and pipeline construction

# HIGHLIGHTS



HMS Group is a dynamically growing diverse corporation that combines leading machine-building (pumps, compressors, oil & gas equipment), engineering and construction companies. Our markets are oil & gas, nuclear and thermal power generation, water supply & utilities, metallurgy, etc.






## REVENUE

**41,582 RUB MN**

▲11%




## EBITDA

**6,369 RUB MN**

▼14%

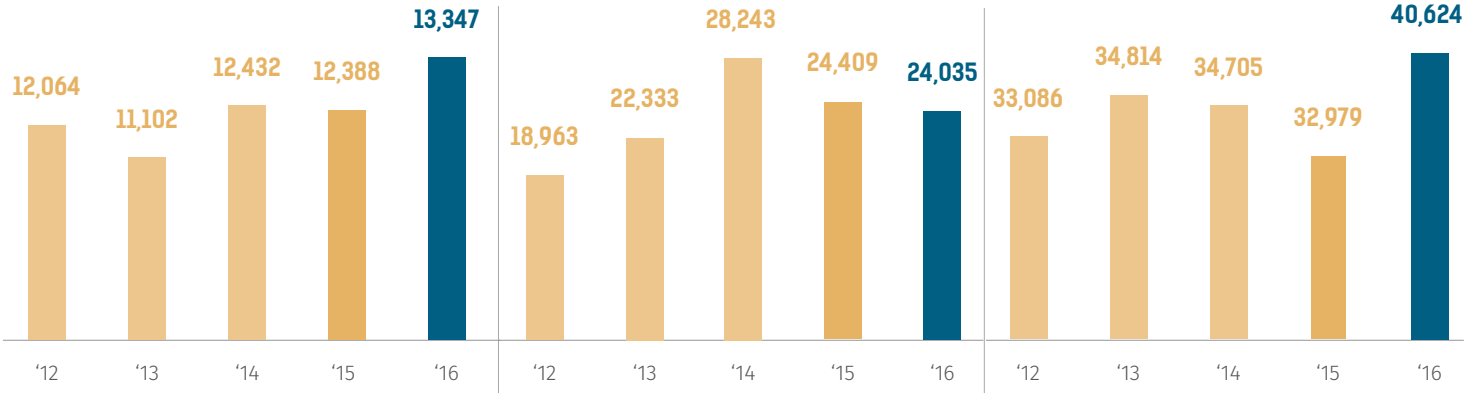



## TOTAL DEBT

**16,336 RUB MN**

▲3%

| Name | UNIT | Change yoy | 2016 FY | 2015 FY | 2014 FY | 2013 FY | 2012 FY |
|---|---|---|---|---|---|---|---|
| Backlog | Rub mn | **-2%** | 24,035 | 24,409 | 28,243 | 22,333 | 18,963 |
| Order intake | Rub mn | **23%** | 40,624 | 32,979 | 34,705 | 34,814 | 33,086 |
| Revenue | Rub mn | **11%** | 41,582 | 37,296 | 32,351 | 32,358 | 31,46 |
| EBITDA, adj. | Rub mn | **-14%** | 6,369 | 7,446 | 5,272 | 5,238 | 6,101 |
| Net debt | Rub mn | **8%** | 13,347 | 12,388 | 12,432 | 11,102 | 12,064 |
| EPS | Rub | **–** | 10.53 | 16.34 | -13.83 | 16.79 | 17.98 |
| Dividend per share* | Rub | **2%** | 8.53 | 8.37 | - | 3.41 | 6.82 |
| ROCE | % | **-174bps** | 14.0% | 16.9% | 11.1% | 13.9% | 18.7% |




## NET DEBT

**13,347 RUB MN**

▲8%




## BACKLOG

**24,035 RUB MN**

▼2%




## ORDER INTAKE

**40,624 RUB MN**

▲23%

*If payment of final dividend of Rub 5.12 per ordinary share in respect of 2016 FY will be approved at the AGM on June 20, 2017. If not, 2016 FY total dividend equals Rub 3.41 per ordinary share, paid already on January 26, 2017.

# CHAIRMAN STATEMENT

Chairman of HMS Group,
**Nikolay Yamburenko**

*2016 was difficult due to tough market conditions, however the company has managed to maintain its growth.*

# Dear Shareholders,

**In 2016, we had mixed financial performance, in comparison to the very successful year in 2015:** revenue increased by 11 percent and EBITDA decreased by 14 percent.

It is worth mentioning that, generally speaking, the last few years for Russian oil and gas machine building industries have not been very successful. Many of our competitors are in a state of bankruptcy or pre-bankruptcy, either because of the weak market or due to financial mismanagement. Large clients are continuing to put pressure on pricing, which inevitably affects profitability.

**Amidst such conditions, HMS Group has once again confirmed its status as the market leader, by further developing the business through capturing the market share of its competitors, among other things.**

However, in the mid-term perspective, **the main source of growth is planned to be a result of the new development strategy approved by the Board of Directors in 2016**. It involves an increase in market capitalization due to both the growth of the business and a new shareholding policy.

The initial results of the strategy have already been reflected in the financial results of 2016, in both the current portfolio of orders and in the growth of HMS' market capitalization.

Recently, we have successfully completed the preparation of our company for explosive growth:

- Executed many large projects for Russia's oil and gas majors, proving ourselves as a reliable supplier and one that is able to deliver technically sophisticated projects;
- Certified our production in accordance with international standards and created a professional export sales team;
- By the end of 2017, we expect to complete the localization of production of foreign high-tech pumps for the transport of oil and oil products, oil processing and petrochemistry (in compliance with API standards), as well as for thermal and nuclear power generation, and water utilities;
- Assured full access to capital markets, both on the public debt market and the bank facilities market, including the possibility of receiving large bank guarantees for the execution of large contracts.

Today, **we are planning to grow as a result of increased export and large contracts, while maintaining a steady growth of business with our standard products.**

In 2016, the company moved to a new policy of profit distribution among shareholders. We reduced the cost of HMS' GDRs ownership through negotiation with a depositary bank, made a decision to pay dividends twice a year (interim and final), and approved a new dividend policy to pay out total dividends in the region of 50 percent of the "Profit attributable to Shareholders of the Company" for the year, as set out in the IFRS Consolidated Financial Statements. However, the size of the dividends will be subject to the necessity of balancing the interests of all capital consumers: financing of capital expenditures and working capital, maintaining of the Net Debt-to-EBITDA ratio in a comfortable range, and payment of dividends.

Nevertheless, on the whole, given the remaining low liquidity of our GDRs, we want to have a stable base of shareholders who will enjoy a good dividend yield.

Naturally, we are **eager to further strengthen our activity in the field of investor relations**, which, along with our new dividend policy, has already resulted in the growth of market capitalization, and which we believe will drive it further.

Yours faithfully,
**Nikolay Yamburenko**

# CEO STATEMENT

CEO of HMS Group,
**Artem Molchanov**

*There are great opportunities available on the market, and we are confident that we possess the power and abilities to seize them.*

# Dear Shareholders,

Next year, we will celebrate the anniversary of HMS Group, which will be turning 25 years old. In terms of human age, the company is reaching adulthood. Since its establishment in 1993, we have come a long way, growing from a small trade company to one of **the largest private machine-building companies in Russia**. In the Forbes list for 2016, HMS Group is honored to be ranked 9th place. It is also important to point out that in this list we are the only producer of oil & gas equipment, in addition to being the only company listed on the London Stock Exchange.

Over the last few years, we have **completed the optimization and integration of acquired assets**, in particular by KKM, that in turn illustrated successful integration of KKM into HMS Group.

Furthermore, we have **accumulated vast experience in the realization of large projects, involving complex technological solutions,** with such large Russian and international companies as Transneft, Rosneft, Gazprom, Gazprom Neft, BP, ENI, and others. We have **gained a reputation as a reliable supplier** and have **received references** that allow us to further strengthen our presence on the extremely competitive and high-tech market of solutions based around pumps, compressors and oil & gas equipment, both within Russia and abroad.

HMS Group expects to complete its localization project for Ukrainian and German pumps at the base of HMS Livgidromash, located in the Orlov region, by the end of 2017. The main emphasis of this localization is on high-tech pumps for transportation of oil and oil products, oil processing and petro-chemistry (in accordance with API standards), as well as for thermal and nuclear power generation and water utilities.

The company has improved its access to capital, both on the public debt market and on the market of bank facilities. At the end of 2016, Fitch assigned the company a B+ credit rating. In February 2017, we successfully returned to the bond market. In 2017, the key priority of HMS' debt policy will be the optimization of interest rates, along with the prolongation of the debt portfolio's duration.

In 2016, the Board of Directors approved a new development strategy based on the following:

- **Export: organic growth via entry into global markets** and the reengineering of HMS' products to comply with the standards of these markets;
- **Large contracts: the further development of technological engineering**;
- **Shareholder policy: the distribution of a substantial part of the profit among shareholders** in the form of dividends, and the increase of IR activity.

The initial results of this strategy were reflected in the financial results of 2016, in the order intake portfolio for 2017, and in the growth of HMS' market capitalization.

In the context of all its business components, including production, finance, sales, and the agreed policy of the shareholders, **HMS Group has prepared a basis for further development by signing new large contracts with Russian companies, as well as by increasing export activity**. There are great opportunities available on the market, and we are confident that we possess the power and abilities to seize them.

Not everything depends on us – a significant amount also depends on our clients and when they start to implement the realization of certain projects.

Given the existing possibilities and with a little luck, we believe in the continual growth of HMS Group's business.

Yours faithfully,
**Artem Molchanov**

# MAP OF OPERATIONS


**HMS Livgidromash**
(before 26.08.2010 Livgidromash)
Location: **Livny, Orel region, Russia**
Founded in 1947
A member of HMS Group since 2003
**Products:** pumps for oil processing, petrochemical, shipbuilding, power generation, water, utilities and environment, agriculture
http://www.hms-pumps.com
**Business unit:** Pumps

**Livnynasos**
Location: **Livny, Orel region, Russia**
Founded in 1970
A member of HMS Group since 2006
**Products:** submersible centrifugal ECV-type pumps for municipal, industrial, rural and household water supply as well as for irrigation and groundwater control
http://www.livnasos.ru
**Business unit:** Pumps

**Nasosenergomash (NEM)**
Location: **Sumy, Ukraine**
Founded in 1949
A member of HMS Group since 2004
**Products:** pumps for oil and gas: midstream, upstream; thermal and nuclear power, water supply and utilities.
http://nempump.com
**Business unit:** Pumps

**Promburvod (PBV)**
Location: **Minsk, Belarus**
Founded in 1927
A member of HMS Group since 2007
**Products:** electric driven submersible pumps for water supply, utilities and environment.
http://www.promburvod.com
**Business unit:** Pumps

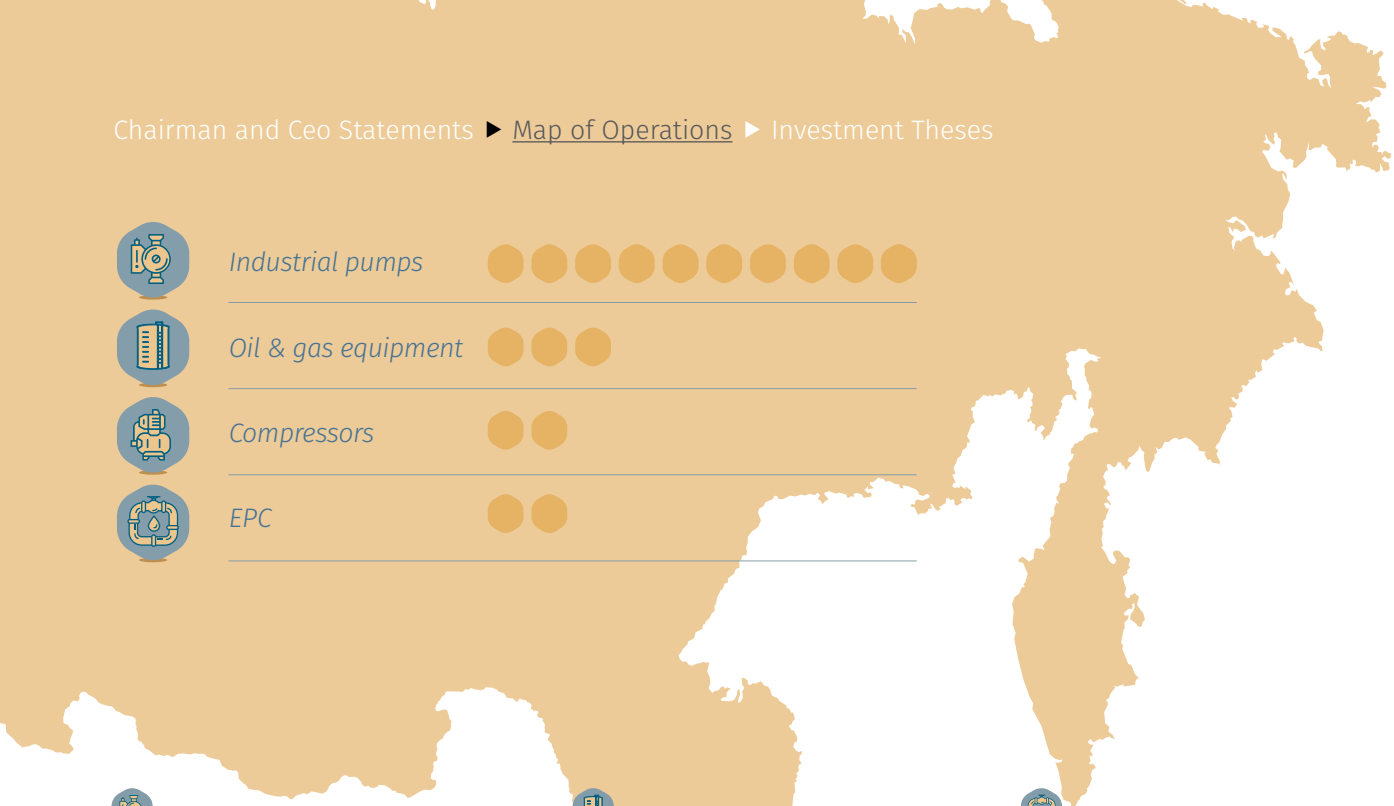
**Bobruisk Machine Building Plant (BMBP)**
Location: **Bobruisk, Belarus**
Founded in 1898
A member of HMS Group since 2011
**Products:** pumps for oil refining, petrochemical, steel and mining, power, pulp and paper, construction, as well as for water and water waste and sewage in municipal, agricultural and industrial water supply systems.
http://www.bmbpump.by
**Business unit:** Pumps

**HYDROMASHSERVICE**
Location: **Moscow, Russia**
Founded in 1993
The associated trading company of HMS Group
**Products:** pumps and units, compressors and units, oilfield, measuring and modular equipment
**Services:** commissions, installation supervising, repair, service maintenance and equipment upgrade
http://www.hms.biz
**Business unit:** Pumps

**Dimitrovgradkhimmash (DGHM)**
Location: **Dimitrovgrad, Ulyanovsk region, Russia**
Founded in 1931
A member of HMS Group since 2011
**Products:** pumps for chemical processing and oil and gas, vessel equipment, chemical equipment, spare parts for gas pumping stations
http://www.himmash.net
**Business unit:** Pumps

**Apollo Goessnitz GmbH (Apollo)**
Location: **Goessnitz, Germany**
Founded in 1863
A member of HMS Group since 2012
**Products:** process and standard pumps and systems, system engineering — projecting, design and manufacture of plants for liquid fuels, process plants, plants for water supply, automation systems and electrical Apollo is certified according to ISO 9001 by Lloyd's Register Quality Assurance
http://www.apollo-goessnitz.de
**Business unit:** Pumps

**Nizhnevartovskremservice (NRS)**
Location: **Nizhnevartovsk, Russia**
Founded in 1998
A member of HMS Group since 2006
**Services:** pumping, drilling and other oilfield equipment repair, maintenance and upgrade.
http://www.nv-rs.ru
**Business unit:** Pumps




**Institute Rostovskiy Vodokanalproekt (RVKP)**
Location: **Rostov-on-Don, Russia**
Founded in 1932
A member of HMS Group since 2008
**Description:** institute with focus on water supply and waste water and sewage systems and related hydro-technical facilities design.
http://rvkp.ru
**Business unit:** Pumps

**HMS Neftemash**
Location: **Tyumen, Russia**
Founded in 1965
A member of HMS Group since 2004
**Products:** modular equipment for oil & gas, including cluster pumping stations and equipment for water injection systems; group automatic measuring units for oil well gauging metering; stations for hydraulic drives of submersible well pumps and underground oil extraction equipment; oil pumping stations, etc.
http://www.hms-neftemash.ru/en
**Business unit:** Oil & gas equipment

**Sibneftemash**
Location: **Tyumen, Russia**
Founded in 1976
A member of HMS Group since 2011
**Description:** special oilfield equipment development, design and manufacture for oil exploration intensification and efficiency; current and work over repairs, isolation works and fracturing.
http://www.sibneftemash.ru/en
**Business unit:** Oil & gas equipment

**Sibnefteavtomatika (SIbna)**
Location: **Tyumen, Russia**
Founded in 1986
A member of HMS Group since 2009
**Products:** controlling devices and systems development and manufacture for oil and gas, power generation, water, heat and gas supply.
http://sibna.ru/eng/main
**Business unit:** Oil & gas equipment

**Kazankompressormash (KKM)**
Location: **Kazan, Russia**
Founded in 1951
A member of HMS Group since 2012
**Products:** centrifugal, screw compressors and systems for air and various gases; compressor stations; refrigerators.
http://www.compressormash.ru/en
**Business unit:** Compressors

**NIITURBOKOMPRESSOR n.a. V.B.Shneppa (NIITK)**
(before 26.08.1985 – ICBS – Special Design Bureau compressor engineering)
Location: **Kazan, Russia**
Founded in 1957
A member of HMS Group since 2013
**Description:** a major scientific and research and production center in Russia to develop centrifugal, screw, rotary and scroll compressors.
http://www.niitk-kazan.ru/eng
**Business unit:** Compressors

**Tomskgazstroy (TGS)**
Location: **Tomsk, Tomsk region, Russia**
Founded in 1968
A member of HMS Group since 2006
**Products:** linear objects construction, reconstruction and overhaul such as oil pipelines, gas pipelines, product pipelines, water pipelines, condensate pipelines and power transmission lines.
http://www.tgs.tomsk.ru
**Business unit:** EPC

**Giprotyumenneftegaz (GTNG)**
Location: **Tyumen, Russia**
Founded in 1964
A member of HMS Group since 2010
**Description:** the leading Russian R&D center with integrated oilfield designing for oil and gas.
http://www.gtng.ru/en
**Business unit:** EPC

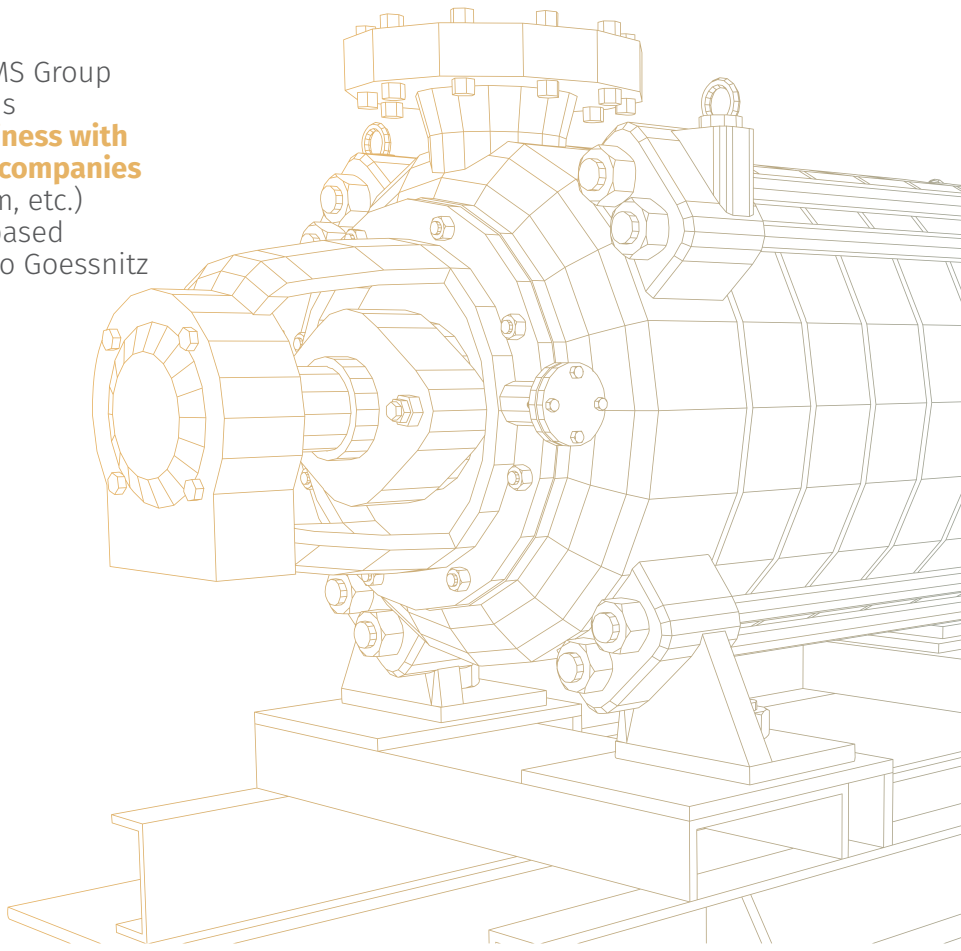
**VNIIAEN**
Location: **Sumi, Ukraine**
Founded in 1951
Associate of HMS Group (47%) since 2007
**Description:** development of pumping equipment for large complexes of atomic and thermal power engineering; on projects of oil, chemical, sugar and food industries, oil pipeline transportation and maintenance of pressure in oil pools, water supply and irrigation; at civil engineering and mining works, in underground systems, agglomerate-and-ironmaking and steel industries, sewerage system and cattle-breeding complexes, municipal and public utilities etc.
http://www.vniiaen.sumy.ua/en
**Business unit:** Subordinate enterprise

# INVESTMENT THESIS

Business platform and core expertise are established and provide strong base for future growth

## 1 MATURE BUSINESS PLATFORM

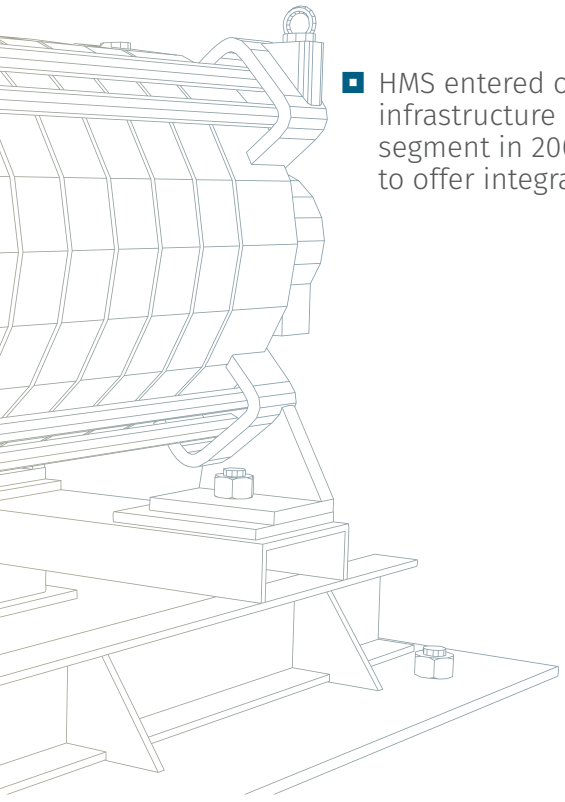
- HMS Group business is based on **the mature and established business platform** with a focus on products where the Company has unmatched R&D expertise and production capabilities
- Business is to be further developed organically, i.e. currently there are **no plans for M&A**
- The company has **stable recurring business** with confirmed order backlog for the next year
- Further development will be held with **low CAPEX** at ca. 1.5x of D&A level
- **EU presence:** HMS Group has access and is **conducting business with EU engineering companies** (Siemens, Alstom, etc.) through its EU-based subsidiary Apollo Goessnitz



## 2 ENTERING NEW MARKETS

- Further development of business with **Gazprom & other majors in oil & gas industry by executing large customized projects** in all key segments of HMS Group
- **Return to the market of oil transportation** on the back of localization of trunk line pumps in Russia
- Customers in new markets are already a part of the client base and offer strong future opportunities
- **Oil & gas refining and petrochemicals represents another growth area** with expanded strong references, incl. international engineering majors

## 3 OPTIMIZATION OF THE BUSINESS PORTFOLIO



- HMS entered oil & gas infrastructure construction segment in 2007 with a view to offer integrated solutions
- Following the financial crises, this segment saw a sharp decrease in profitability
- HMS Group decided to exit the segment and continues to **develop Engineering and Procurement ("EP") business**, based on HMS products and engineering competences

# STRATEGY

## VISION

HMS Group is an international machinery and engineering company – producer of industrial pumps, compressors, technological units and state-of-the-art integrated solutions for key industries: oil & gas, petrochemicals, power generation, mining & metals and water utilities.

## STRATEGIC GOALS AND PRIORITIES

### 1 Revenue Growth

The consistent increase of revenue is one of our main targets.

### 2 Increasing Profitability

While continuing to expand our business, we are also concentrated on increasing our EBITDA margins.

### 3 Building a Platform for Further International Development

Our international growth targets require the Company's sustainable development across all functions and processes.

### Corporate Responsibility

We view the **expansion and diversification of our business** as key factors of our business growth. HMS Group maintains solid positions in Russia and CIS countries, and as such, our primary focus is to sustain and grow our client base and our share in these core markets. We also have significant experience in providing supplies to customers in the Middle East, Asia, as well as in Western and Eastern Europe, taking active steps to increase our presence in the international marketplace.

Our **product portfolio** is regularly expanded and upgraded by our R&D function, which develops state-of-the-art products and solutions that allow us to stay ahead of our competitors. New products and the expansion of existing product lines helps us to enter new segments and niches across various industries and uses, providing tangible benefits to our clients.

**Sales channels optimization** helps us not only to increase market coverage, but also to maintain an individual and personalised approach to our different client groups. Customer experience is one of our highest priorities: we sell customised products and solutions via various channels in order to make our products available to a wide range of customers.

We have efficiently integrated our recently acquired assets and have started to benefit from multiple synergies in R&D, procurement, production and sales. We are in constant pursuit of **cost control and value creation management** across the entire production cycle.

Our deep technical expertise and experience in supplying integrated solutions allows us to **focus on high-margin projects** and increase their share in our contract portfolio. We have participated in multiple strategic infrastructure projects in the oil and gas and energy sectors, which has helped us to build and strengthen reliable partnerships with industry leaders.

We see **joint ventures** and other forms of cooperation with industrial companies, both in Russia and abroad, to be one of the ways **we can offer more sophisticated products and solutions** and enter new markets and product groups.

In the face of the rapidly changing international environment and emerging challenges, we are consistently working on the development of a **highly effective management system and corporate structure**. We are also strengthening our competences in international marketing and sales, as well as in project and risk management.

HMS Group covers the full cycle of the machinery business, which allows us to maintain a leading position in the industry. We follow the **best practices and international standards** in product development, manufacturing and quality management in order to meet the high requirements of our international customers.

Over the past few years, we have managed to gather a team of highly devoted professionals in all functions. We are dedicated to **the development of our personnel**: HMS Group has a strong system of **training** its employees, and our management team is also regularly improving their qualifications to meet challenges and achieve strategic goals. We are now focusing on the **culture of innovations and change** by developing motivational incentives to ensure that each employee contributes to the Company's success.

HMS Group strictly complies with health and safety standards, following a code of ethics in respect to all of its stakeholders. We also aim to lower the environmental impact of our operations.

We carry out charity work in the regions of our presence, and offer support to charitable foundations for children and the disabled. The year 2016 was marked by the continuous support we provided to a number of charity funds, schools and civic organizations.

We also support sporting developments in the regions of our presence, including for our employees and their families. HMS Group became a general partner of the European Judo Championship in Kazan in April 2016.

# HISTORY



## 1993

German Tsoy, Artem Molchanov and Kirill Molchanov **founded the original pump trading and servicing company**.

The Company expanded its operations and client base to become a **leading distributor of pumps and pumping equipment in Russia and the CIS**.

## 1995

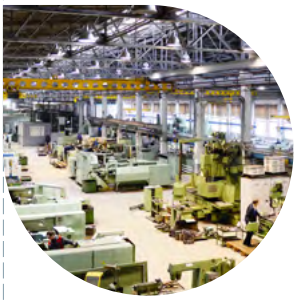
HMS Group launched a **pump skid assembly business** in Russia and CIS countries.

**Hydromashservice** became one of the **leading enterprises** specializing in the delivery of pumping equipment for oil and gas complexes, power and water industry and housing utilities.

## 2003

HMS Group **began to manufacture pumps after the acquisition of Livgidromash** (currently — HMS Livgidromash), one of the largest manufacturers of industrial pumps in the CIS.

## 2004



**HMS Group enhanced its oil and gas equipment offerings through the acquisition of Neftemash**, one of the largest Russian producers of modular flow control equipment for surface oilfield sites.

## 2005

HMS Group became a **leading manufacturer of high capacity customized pumps through the acquisition of Nasosenergomash** (NEM), located in Ukraine, one of the major companies in the nuclear and thermal power generation industries and trunk oil pipelines in the CIS.

## 2006

HMS Group became **a leading manufacturer of submersible borehole pumps for water through the acquisition of Livnynasos**, one of the largest producers of submersible electric water pumps in the CIS.

The company also acquired operational control over **Tomskgazstroy, a provider of construction services for oil and gas pipelines**, and expanded its **maintenance and repair business through the acquisition of Nizhnevartovskremservice**.

## 2007

**HMS Group entered the EPC market** through the acquisition of Sibkomplektmontazhnaladka (SKMN), a provider of integrated EPC services for the development and construction of oilfield infrastructure.

The company also **acquired a minority stake in Dimitrovgradhimmash (DGHM), a manufacturer of pumps and vessel equipment**, with an option to purchase a controlling stake in 2012, and **increased its R&D capabilities through the acquisition of a 49%** stake in VNIIAEN, an R&D centre and the only one of its kind in the CIS, which specializes in pumping equipment for the nuclear power generation and oil transportation industries.

# HISTORY (CONTINUE)



## 2008

HMS Group **increased its presence in the water utility, power generation and modular equipment sectors** through the acquisitions of Promburvod, the largest producer of electric submersible water pumps in Belarus, and NPO Hydromash, a manufacturer of pumps for the thermal power generation and oil and gas industries that has subsequently been joined to NEM and Rostov Vodokanalproekt (RVKP), a leading project and design facility for the water utility sector.

## 2009

HMS Group continued **to enhance its position in the water utility, power generation and oil and gas sectors** through the acquisition of Sibnefteavtomatika, a manufacturer of high-precision measuring equipment for the oil and gas, power generation and water utility sectors.

The company **participated in the flagship project** of the Vankor oilfield development and the Baltic Pipeline System construction project.

## 2010

HMS Group **enhanced its design and R&D capabilities and its position in the EPC market** through the acquisition of 51% of the voting shares of Giprotyumenneftegas, a leading independent Russian R&D centre focused on the design of the surface infrastructure of oil and gas fields.

The Group **participated in the ESPO-1 pipeline expansion project and the construction of the ESPO-2 pipeline (Transneft)**, and commenced a large-scale production of pumps for use in nuclear power generation.

## 2011

**HMS Group went public in February 2011, placing 37.2 percent of its stock on the London Stock Exchange via GDRs.**

**As a key consolidator in the domestic pumping industry**, HMS completed 3 acquisitions (Sibneftemash, Bobruisk Machine Building Plant and exercised the option to acquire its next stake in DGHM), seeking opportunities to increase its presence in existing and adjacent markets.

## 2012

HMS Group **entered the promising new gas projects market** with the acquisition of the leading Russian industrial compressor producer Kazankompressormash.

Pursuing the enhancement of its pumps product portfolio, the Group **completed the acquisition of the German manufacturer of high-end specialized pumps, Apollo Goessnitz GmbH**, which strengthened its market position in industries with a need for technologically-demanding integrated solutions.

## 2013

HMS Group made a disposal of SKMN **to make the Group's business model more effective, release resources, involved in the EPC business**, and use them for the active development of the core business.

The company received its **first large compressor contract to deliver a complete gas compression system** based on a centrifugal compressor with a gas turbine drive to Stavrolen (Lukoil).

## 2015

**The best year for HMS Group in terms of EBITDA ever.**

EBITDA

**7,446 RUB MN**

▲41%

## 2016

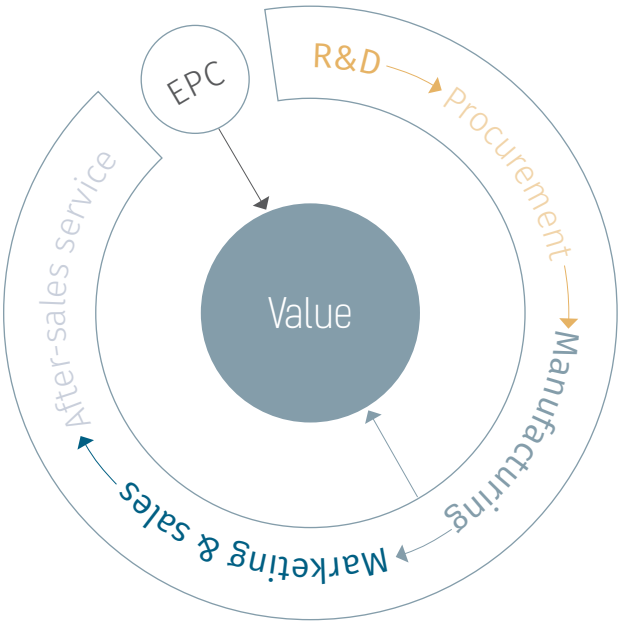
**HMS Group** established its business platform and core expertise, which provide the **strong base for future growth**.

# BUSINESS MODEL

HMS Group's business model comprises all major elements of the value chain: research & development, manufacturing, procurement, marketing & sales, across all of its manufacturing business units (industrial pumps, industrial compressors and oil & gas equipment), supplemented by engineering and after-sales service, as well as EPC business with its own aspects.

**HMS Group's business consists of recurring operations (the manufacture of standard and customized equipment and sales across all target segments) and of large-scale projects that cover the full business cycle (from engineering and manufacturing to construction and commissioning).**

HMS' customers are mainly medium and large sized industrial companies. We also approach small businesses though our dealers and specialized independent trading companies. Participation in mega-projects allows us to maintain and strengthen partnership relations with the largest oil & gas and energy generation companies, as well as with leaders in other industries.




## 1 RESEARCH & DEVELOPMENT

Our core business competence is Research & Development, which allows us to develop new products and provide state-of-the-art solutions. The development of new products is focused on innovations and efficiency in order to meet the growing requirements of our clients.

Our R&D capabilities include 3 leading R&D centers in Russia (Moscow, Kazan and Livny), 1 center in Ukraine (Sumy) and 1 in Germany (Goessnitz), as well as 2 leading Russian project and design institutes (Tyumen and Rostov-on-Don). We actively benefit from synergies between our R&D and engineering centers in terms of product development and project implementation.

## 2 MANUFACTURING

Our manufacturing assets consist of 12 plants in Russia, Ukraine, Belarus and Germany. In manufacturing, we also benefit from cooperation with our production facilities, which work as one large manufacturing complex, enabling us to optimize production costs and reduce lead-time. HMS plants can perform joint supplies for large-scale projects and can relocate orders, using all available capacities.

We are also continuing to implement our large-scale capital expenditures program to increase our production capacities and achieve the highest technological level of production, in order to meet the growing demand and requirements of our clients. In 2016, the first stage of the localization project at HMS Livgidromash (the assembly, mounting and testing of the shop for the production of large industrial pumps) was completed. The second phase (the mechanical processing shop) is planned for completion in December 2017, and HMS Livgidromash will become the largest and most advanced pump manufacturing plant in Russia. We have also significantly expanded our manufacturing capacities at Kazankompressormash (with new capacities in the blanking and welding shop and the installation of new milling equipment).

## 3 MARKETING & SALES

In 2016, HMS' overall sales volumes reached Rub 41.6 billion (+11% yoy) and our client list amounted to over 6,000 names in Russia and abroad (+20% yoy). We increased sales to many client groups, especially in the industries of oil & gas upstream, conventional power generation and mining. Our compressor business showed impressive results due to the increased sales of gas compression systems (6 systems shipped to our clients in 2016). We are continuing to develop our sales channels, with sales volumes in 2016 via dealers and independent trading companies doubling compared to 2015.

Outside of Russia, HMS' sales offices are currently located in Germany, Italy, the UAE and Iraq, as well as in Belarus, Kazakhstan, Ukraine, Uzbekistan and Turkmenistan. We are also growing our presence in new markets. In 2016, we entered the prospective Iranian market, with significant contracts for API process pumps.

Our marketing function strengthens our brand in both conventional and new markets. As part of our market strategy, we regularly familiarize our customers with our latest products and solutions at leading trade fairs all around the globe.

# 2016 IN CONTEXT



## January

- Quality management systems (QMS) of Kazankompressormash and NIITK were certified in line with STO Gazprom 9001-2012 requirements in the fields of design, production, delivery, installation and the maintenance of compressors, refrigerating systems and turbo expanders. This certification has confirmed the efficiency of the QMS, which ensures maximum compliance of manufactured compressor equipment with the quality, safety and reliability requirements of Gazprom and other oil and gas companies.

- Kazankompressormash manufactured and delivered compressor systems for Tatneftegazpererabotka (TATNEFT). This equipment was produced under the reconstruction project for the crude gas compressor system at the Minnibaevo gas processing plant (GPP) and was delivered as prefabricated units.

## February

- HMS updated the ratio of the Company's depositary receipts program: for every five receipts held by depositary receipt holders, they received 1 "new" receipt in return. The issued number of ordinary shares and their nominal value stayed unchanged. Also, according to the terms of the amended deposit agreement with BNY Mellon, the annual depositary fee is equivalent to US$ 0.01 for every "new" DR, instead of the previous US$ 0.03 for every "old" DR, implying a fifteen-fold decrease in such fees.

- Kazankompressormash signed a contract for the delivery and installation of a boosting compressor station worth Rub 2.8 billion. In accordance with the contract, the compressor station is to be delivered to the customer's site. The station is based on three centrifugal-type compressor units with gas-turbine engines and is intended for the compression of low-pressure associated gas.

- Sibneftemash's QMS was certified by Gazprom (STO Gazprom 9001-2012). The Certificate received confirms the management's high quality and effectiveness in the fields of design, production and delivery of equipment for the development of field infrastructure.

- HMS Group supplied ten high-pressure pumps for the project of Yargeo (NOVATEK), which were put into operation at the oil and gas condensate pumping stations on the Yarudeyskoye field. The high-pressure pumping units are based on a retrofitted special application CNSp pump series, with a rated capacity of 180 $m^3/h$ and a pressure head of 1050 m. Due to their unique design, the supplied pumps surpass hermetic pumps, occasionally applicable for the transfer of high-pressure oil and gas condensate by a number of parameters. In 2015, the Group supplied a batch of state-of-the-art compressor systems for stripped associated petroleum gas to Yargeo for construction projects at the Yarudeyskoye field.

## March

- HMS Neftemash signed contracts with a total worth of Rub 3.1 billion for the delivery and installation of complex integrated solutions for the pumping of natural gas liquids, oil, wash-down water and rust preventive chemical. These contracts are a follow-up to another project that has been successfully completed recently.

- HMS Group completed the construction of the largest and most high-tech multiphase metrological test flow facility in Russia, which will allow the testing and metrological calibration of up-to-date multiphase metering units. The Federal Agency on Technical Regulating and Metrology of the Russian Federation (Rosstandard) certified the facility and approved it in accordance with the working standard of flow rate unit of liquid-gas mixtures. Representatives from the world's largest metering unit s producers – Siemens, ABB, Honeywell, Schneider Electric, Weatherford and Emerson – took part in a formal opening ceremony, which was held on March 24, 2016.

- Kazankompressormash signed a contract for the delivery and installation of modular screw compressor units for the Novoportovskoe oil & gas condensate field for the next stage of the central production facility (Gazprom Neft). Three highly productive compressor units TAKAT, intended for the compression of natural gas, are to be produced.

- Kazankompressormash manufactured and delivered two AEROCOM compressor systems for NLMK. Nitrogen six-stage integrally geared centrifugal compressors of the AEROCOM series have a capacity of 18,000 Nm³/h and 30 bar discharge pressure per unit, and are equipped with a 3,150 kW electric motor. They are intended for the process compressor equipment retrofit project at the oxygen and nitrogen compression area of oxygen shop. Similar compressor systems along with the custom designed, highly efficient 43GC1-210/31 centrifugal oxygen compressor, had been previously delivered to NLMK by Kazancompressormash.

- The compressor system manufactured by Kazankompressormash was put into operation at the advanced oil-refining complex at LUKOIL-Permnefteorgsintez. The 5GC1-300/2-12.5 centrifugal compressor system, with a capacity of 26,000 Nm³/h an 11.3 bar discharge pressure and a 6.25 compression ratio, is intended for the compression of unstripped gas as a part of the newly delayed coking processing line. Earlier in 2014-2015, three complete gas compression systems for the compression of dry stripped gas, as well as the centrifugal compressor system for the compression of dry hydrocarbon gas, were successfully put into operation at LUKOIL-Permnefteorgsintez.

## April

- Kazankompressormash put a high-tech gas compression system into operation at Stavrolen's boosting compressor station, designated to compress dry stripped gas (LUKOIL). The gas compression system is driven by a gas turbine engine on the basis of a 5GC2-287/15-57 compressor, with a rated power of 25 MW by means of a gearbox. The gas compression system was completed by a steam recovery boiler (with the ability to generate steam up to 310°C and a pressure of 39 bar), plus gas separators, air-cooling units, a fuel gas treatment unit, water treatment units and other processing equipment. The complete gas compression system was manufactured and supplied as part of the project of Stavrolen for the construction of the first phase of the gas processing plant (GPP-1) with a capacity of 2 billion m3/year, designed for the processing of associated petroleum gas supplied from the fields named after Yu. Korchagin and V. Filanovsky.

## May

- HMS signed an agreement with UniCredit Bank to open a 3-year non-revolving credit line in the amount of Rub 1.2 billion, which matures in May 2019. The credit facility was utilized for general corporate needs.

- HMS Group took part in the 2016 Iran Oil Show International Exhibition in Tehran, Iran. A wide range of pumping equipment, manufactured in accordance with the API 610 standard, was presented at HMS Group's booth. These state-of-the-art pumps are intended for the oil, gas and gas condensate extraction process, as well as for oil refining and petroleum chemistry applications.

- NIITK designed and manufactured an integrally geared centrifugal compressor system for the Joint Institute for Nuclear Research (located in Dubna, Moscow Region). The AEROCOM 2-179/18 centrifugal compressor system, with a capacity of 10,600 Nm³/h and a 17.6 bar discharge pressure, is equipped with a 1,600 kW electrical drive and an up-to-date microprocessor automation system and is intended for the compression of nitrogen. The compressor system is a part of the processing unit at the NICA accelerator complex, currently under construction in the Veksler and Baldin Laboratory of High Energy Physics (located in Dubna, Moscow Region). This project became one more example of successful cooperation between the institutes. NIITurbokompressor has already manufactured and supplied rotary screw compressor systems for helium to the Joint Institute for Nuclear Research.

## June

- HMS Neftemash signed a contract worth Rub 2.1 billion for the delivery and installation of a formation-fluid and low-temperature separation unit. The company will deliver this integrated solution to the customer's site. The unit, made up of inlet formation-fluid separators, heavy condensate separators, heavy condensate degassers, low-temperature separators, heat exchangers and others, will be installed at an oil and gas condensate deposit located in West Siberia in 2017.

- HMS Group signed a contract to retrofit of a batch of water injection pumps that were manufactured by HMS Group and operated at the Vankor oil & gas condensate field. The contract assumed the procurement of complete refurbishment kits, in-depth retrofit works, acceptance tests, installation supervision and the commissioning of CNS 500-1900 and NCN-E-800b-1 pumps operating at modular cluster pumping station №2 in the free-water knockout unit FWKU-South. Hydraulic and performance tests of a single CNS 500-1900 pump were carried out at the premises of Nizhnevartovskremservice, while rest of the pumps were retrofitted on site.

- Kazankompressormash put two high-performance Soitaab (Italy) water jet cutters into operation: new WATERLINE 2060-1H-50HP machines with a 2,000x6,000 mm working area and an ability to cut virtually all types of materials without causing mechanical and thermal deformation to the work pieces. One of the machines is equipped with a 3D head for cutting work pieces up to 60-degree angle, providing complex cutting with chamfering. The implementation of this new technology is being carried out under the long-term investment program for the modernization of Kazankompressormash's manufacturing facilities, which is aimed at increasing the production volume of state-of-the-art and reliable compressor equipment. As a part of the program, the latest generation NC machining centers made by the leading global manufacturers have already been purchased and installed, resulting in a significant increase in the accuracy of machining and a reduction in the lead-time.

## July

- NIITK designed and manufactured an integrally geared centrifugal compressor system for the Bashkir Soda Company that is aimed at the compression of circulation gas in the vinyl chloride production system.

- Kazankompressormash manufactured a complete gas compression system for the project of reconstructing the Yuzhno-Balykskiy Gas Processing Plant (SiburTyumenGaz). This compressor system wascompleted with dry gas seals, redundant air-cooled oil coolers and a bypass valve located within the housing of the compressor system.

## August

- HMS Livgidromash was certified in line with STO Gazprom's 9001-2012 requirements. The audit was carried out by experts from one of Russia's leading certification associations – the Russian Register – and notified by an organization authorized by Gazprom. This certificate confirms that HMS Livgidromash's quality management system in the engineering, design, manufacture, installation and maintenance of pumps and pumping units fully complies with Gazprom's requirements and provides a supply of equipment and servicing that meets the customer's requirements in the areas of performance, reliability and safety.

- HMS delivered new generation pumping units to the Southern water treatment plant of Vodokanal of St. Petersburg. This project was implemented under a strategic partnership agreement between HYDROMASHSERVICE and Vodokanal of St. Petersburg in order to provide an increase in energy efficiency for the objects at Vodokanal of St. Petersburg and to enable the citizens of St. Petersburg and the Leningrad Region to have accessible and high quality service of water supply, sewage disposal and waste treatment.

## September

- Kazankompressormash put two compressor systems into operation at the Yugo-Zapadnaya CHPP Phase 2 that are based on GCM3-107/7-31 integrally geared centrifugal turbochargers with a capacity of 45,996 $Nm^3/h$. The discharge pressure (30 bar) and 3,150 kW electric motor are manufactured with all the necessary accessory equipment, including an automatic control system, a nitrogen station, a compressed air station, and a methane-nitrogen mixture extraction unit. Compressor systems are designed to compress and supply natural gas to the gas turbine of a PGU300 power unit, according to the API 617 standard requirements.

## October

- Forbes ranked HMS among the Top 200 Largest Private Companies in Russia and among the Top 10 Largest Machine-Building Companies in Russia in 2016. Moreover, Forbes has ranked HMS Group No. 9 in the ranking for Russia's largest private machine-building company. Companies are ranked by their total revenue for 2015, which totaled Rub 667 billion, down by 19 percent yoy from Rub 825 billion in 2014. Unlike most of the other participants, HMS was one of the few with a revenue growth.

- HMS Group signed a Special Investment Contract (SIC) with the Russian Federation (the Ministry of Industry and Trade and the Government of the Orel region) as part of the XV International Investment Forum "Sochi-2016." The special investment contract is a new tool whose aim is to support import substitution in the form of an agreement between an investor and the Russian Federation. The signed SIC provides HMS Group with a package of state support measures for the realization of the second stage of the company's localization project, which is aimed at developing manufacturing competences for high-capacity oil refining, oil transport and nuclear pumps in Livny, in the Orel region. The key advantage gained from the conclusion of the contract is the admission of state customers to procure manufactured products based on a SIC without having to hold a tendering process, as long as the product supplier is included in the register of single suppliers.

- On October 7, Gazprom's Deputy Chairman of the Board, V. Markelov, and the President of HMS Group, A. Molchanov, signed a long-term contract for the manufacture and supply of import-substituting products manufactured by Kazankompressormash. According to the contract, Kazankompressormash will provide the serial production, delivery and after-market services of MKU TAKAT (modular compressor systems) based on rotary screw compressors. This new generation of state-of-the-art MKU TAKAT are intended for application as stripper wells and provide a solution for the extraction of low-pressure gas. These systems meet the requirements of the API 619 standard. The compressor systems fully comply with Gazprom's requirements and demonstrate the best technical performance for this type of equipment.

- Kazankompressormash manufactured 5 complete gas compression systems for the project of infrastructure development of additional wells in the East section of the Orenburg oil & gas condensate field (Gazpromneft-Orenburg). The supplied systems are based on high-performance compressors, which are designed in accordance with the API 617 standard and have "back-to-back" type impellers made of titanium alloy that provides a significant reduction in dynamic rotor loads. Energy-efficient NK-16-18ST gas turbine units manufactured by KMPO are applied as compressor drives.

- HMS Group signed a contract to supply a modular pumping station at the Novoportovskoe oil & gas condensate field under the project of its infrastructure development. The station is intended for the injection of a working agent into a formation for pressure maintenance.

## November

- The Group signed a number of credit agreements with Raiffeisenbank, totaling Rub 2.9 billion. HMS has refinanced its previously signed credit lines of Rub 1.8 billion at lower interest rates, which will reach maturity in 2019. Furthermore, the Bank and the company have signed a new 5-year uncommitted loan facility with 3-year tranches in the amount of Rub 1.1 billion rubles, which will reach maturity in 2021. The credit line was utilized for general corporate needs.

- HMS supplied a large batch of pumping units for the modernization project at the Gazprom Neft Moscow Refinery. The pumping units will operate as part of the sulfuric-alkaline waste and process condensate treatment system under construction. Single-stage and multistage high-pressure process pumps will feed the system with raw material and will pump out petroleum products and working liquids. The pumps have high-efficiency hydraulics of a flow path and are made of highly resistant stainless steel. The equipment is characterized by its low vibration and ability to operate smoothly. As a result, the refinery will significantly improve its technical and ecological manufacturing features. The fluid catalytic cracking unit will be retrofitted in the beginning of 2017. After the retrofit, the capacity of the unit will rise by 20 percent. In addition, the refining depth and the yield of light petroleum products will increase. The quality and ecological features of the products, as well their energy efficiency, will be improved.

- The company signed a contract to supply pumping units the Kola Nuclear Power Plant. AS-1D pumping units for the reactor planned after cooling system and the process water system, as well as the AS-H pumping units for auxiliary systems, will be supplied under the ongoing power generator life extension program at the Kola Nuclear Power Plant. In addition, HMS Group is currently implementing a contract for the batch supply of high and low pressure pumping units for an emergency cooling system of the core section at the Kola Nuclear Power Plant.

## December

- Fitch Ratings assigned the JSC HMS Group (legal entity, the holder of HMS Group's assets, located in Russia) a first time Foreign and Local Currency Issuer Default Rating (IDR) of "B+", with a "stable" outlook.

- Two centrifugal compressor units were manufactured by Kazankompressormash after having been successfully tested and put into operation at the booster compressor station of NOVATEK-Yurkharovneftegaz. The 53GC2-188/10-87 compressor units, with a unit capacity of 2.822 mn $Nm^3/d$ and a discharge pressure of 87 bar, were designed to be operated as a part of GPA-16 NK-03H Ural's gas compression systems for the compression of associated petroleum gas. The most advanced and effective technical solutions were used in the development and manufacture of these compressors. The compressors were designed with the ability to operate using one or two compression stages, which ensures the reliable operation of the compressor system in all specified operational cases. The application of dry gas seals eliminates any possibility for leaks of the working gas. The operating mode of compressor units makes it possible to use of a parallel arrangement of casings and an application of three-shaft speed-increasing gears with two output shafts. The advantages of this arrangement are its small size, the flexible operation scheme of compressor units (one compressor casing is operating over the first few years, and in the following years may involve sequential operation of two compressor casings), as well as the system's high-energy efficiency.

# Export Activities in Short

Despite the fluctuations of world's hydrocarbon prices in 2016, which led to the suspension of many major international oil & gas projects, the export sales revenue of HMS Group still managed to reach about US$ 30 million. At the same time, the export backlog for 2017 increased by 30 percent, equaling US$ 40 million.

In 2016, HMS Group and its manufacturing facilities were prequalified for and enrolled into the list of approved vendors for such significant international customers as Exxon Mobil (the West Qurna-I project), Linde AG, ENEC, MAADEN, the Ministry of Petroleum of Iran, NIGC, ICOFC, and others. Furthermore, the Group continued its extensive cooperation with strategic customers such as BP, ENI, Petrofac, DAELIM, Technip, Tecnimont, Doosan and many others.

In 2016, apart from the above, after the lifting of sanctions, HMS Group re-entered the Iranian market and signed contracts worth around Euro 7.9 million for the supply of API process pumps to Iran's petrochemical industries.

# MACROECONOMIC DEVELOPMENT

**In 2016, the global economic growth rate was equal to 3.1 percent**, with advanced economies showing a decline, standing at 1.6 percent compared to 2.1 percent in 2015, and emerging markets and developing economies performing slightly better than the year before, standing at 4.2 percent compared to 4.0 percent in 2015. Among the main economic developments made in 2016, the following deserve most attention:

- Prices for oil, metals and other commodities demonstrated growth by the end of the year. The price of Brent oil recovered from US$ 31 per barrel in January 2016 to US$ 53 per barrel in December, following OPEC's agreement to limit crude oil production;
- The growth of the Chinese economy remained above 6 percent, which was supported by a targeted government stimulus of consumption and real estate market recovery;
- The US economic growth rate slowed down to 1.6 percent; bolstered by low inflation, the Federal Reserve decided to raise the interest rate to 0.75 percent in December 2016;
- The European economy started to slowly recover in 2016, with its GDP growth rate increasing from 1.2 percent in 2015 to 1.5 percent, with Germany contributing 1.7 percent of the GDP growth rate in 2016.

**Supported by recovering oil prices, Russia's economic decline began to slow down**, with its decline in the GDP decreasing **from -2.8 percent in 2015** (reviewed) to **-0.2 percent in 2016**. Under continuing international sanctions, additional support for the economy came from the localisation of production, which resulted in a 0.4 percent growth index for the output products and services, with industrial production (+1.1%) and agriculture (+4.8%) being the main contributing factors.

**By the end of the year, the Russian Ruble had strengthened by 17 percent against the US dollar, and by 20 percent against the Euro** (RUB/USD: from 72.92 to 60.66; RUB/EUR: from 79.63 to 63.81), and as such, its volatility became significantly lower than the year before.

**The current account of national balance of payments showed a decline** from US$ 69.0 billion (revised) in 2015 **to US$ 22.2 billion in 2016**, mainly due to a decrease in exports (from US$ 342 billion in 2015 to US$ 280 billion in 2016), although, balanced by a decrease in capital outflow (from US$ 57.5 billion to US$ 15.4 billion). Foreign bank liabilities lowered by 54 percent to the level of US$ 27.4 billion in 2016.

As in the first half of the year, when the pressure on Russian Ruble was easing and inflation (the consumer price index) was declining, **the Bank of Russia decreased the interest rate from 11.00 percent** to 10.50 percent in June and **to 10.00 percent** in September, which should encourage the corporate and private financing. This is now much lower than 17.25 percent interest rate observed at the end of 2014, but still has a potential to decrease even further.

**The total sum of outstanding credits issued to the non-finance sector decreased by 6.9 percent** (from Rub 44.0 trillion at the end of 2015 to Rub 40.9 trillion at the end of 2016), and **outstanding credits to corporate borrowers decreased by 9.5 percent** (from Rub 33.3 trillion to Rub 30.1 trillion respectively). The volume of the corporate overdue debt was lower by 8.9 percent in 2016 compared to 2015.

**In accordance with improvements in the real economy, the Russian stock market started to recover**: RTS index (based on market capitalisation in USD) grew from 755 points in January to 1,152 points in December (+53 percent with a total capitalisation of US$ 171.5 billion), the MICEX index grew from 1,761 points to 2,233 points (+27 percent with a total capitalisation of Rub 10.5 trillion).

**Real domestic consumption** in Russia **decreased by 3.8 percent** in 2016 (compared to an 8.1 percent reduction of the previous year). **Investment in fixed assets lowered by 0.9 percent** in 2016.

**The industrial production index increased by 1.1 percent**, supported by growth in the raw materials extraction sector by 2.5 percent, and in the energy, gas and water production sectors by 1.5 percent. Manufacturing showed minor positive dynamics with a 0.1 percent increase. The main growth in manufacturing came from chemical production (+5.3%), wood processing (+2.8%), paper production (+0.8%), the textile industry (+5.3%), leather goods production (+5.1%) and food production (+2.4%). **The machinery and equipment production index amounted to 3.8 percent yoy**; in 2015, it showed double-digit decline of 11.1 percent. Other manufacturing sectors continued to decline with the manufacture of other non-metallic mineral products decreasing by 6.6 percent.

**Inflation (the Consumer Price Index) in Russia reached 5.4 percent** in 2016, in comparison to 12.9 percent the year before. The main cause of the slowdown in inflation was a significant drop in consumer demand, with trade turnover decreasing by 5.2 percent in 2016. **The Industrial Producers Price Index was 7.4 percent** in 2016, versus 10.7 percent in the previous year, following overall economic stabilisation.

**The average unemployment rate in 2016 stood at 5.5 percent**, which is 0.1 percent lower than in 2015. **Real wages grew by 0.6 percent**, yet real disposable income fell by 5.9 percent – the most significant decrease since the year 1999.

**The Russian Federal Budget showed a deficit** of Rub 2.97 trillion, which comprised 3.5 percent of the GDP – budget revenues decreased by 1.5 percent, while spending grew by 5.2 percent. The decrease of oil and gas earnings amounted to 17.6 percent when compared to 2015, thus the government succeeded to increase its non-oil and gas revenues by 10.7 percent compared to 2015. The main contributing factors of which came from public property, including the sale of Rosneft's oil company shares in the amount of Rub 710.8 billion.

In 2016, **the Russian Federation increased its external debt** by 2.6 percent to the level of US$51.2 billion. Russia's total debt grew by 1.6 percent to Rub 11.1 trillion (or 12.9 percent of the GDP).

# MARKET TRENDS
## OIL INDUSTRY



### Upstream

Russia has the largest oil & gas reserves in the world, in addition to being the world's second largest oil producer, with a 13 percent share of the world's total oil output. In December 2016, Russia ranked first place in the world for oil production. The upstream oil industry is still the backbone of the economy and one of its main sources of investment resources, which affects Russia's international payments and exchange rate.

In 2016, oil output in Russia reached 547.5 million tonnes (+2.5% yoy), according to Russia's Ministry of Energy. This increase was maintained by the development of new oil production centres in Eastern Siberia and the growth of crude oil exports to Asia, primarily to China, where demand for Russian oil is increasing.

RUSSIA'S SHARE OF THE WORLD'S TOTAL OIL OUTPUT

**13%**

### Midstream

Russia has the largest oil pipeline system in the world – more than 72 thousand kilometres of oil pipeline and around 500 installed pump stations. The existing trunk pipeline system transports over 90 percent of the crude oil produced in Russia.

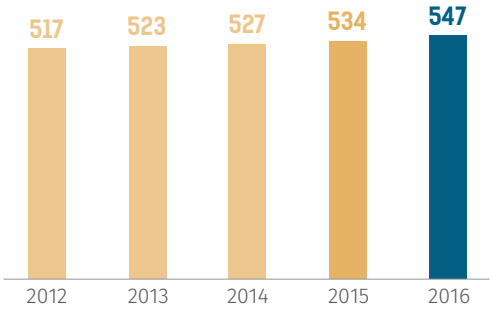
Transneft, the only oil pipeline operator in Russia, increased its oil exports by 2.7 percent yoy to 235.8 million tonnes in 2016.

The existing pipeline system is currently being expanded through the following projects:

1. The Kuyumba-Taishet main pipeline
2. Expansion of the ESPO (East Siberia-Pacific Ocean) pipeline system
3. The North pipeline
4. The South pipeline

Transneft's total capital expenditure for 2016 is estimated at Rub 337.5 billion rubles.

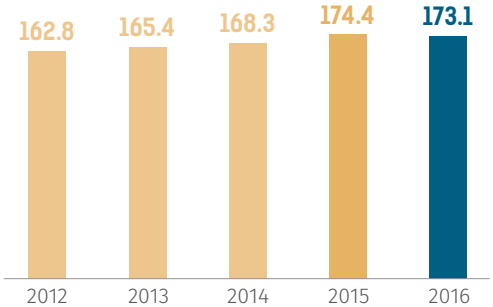
**Oil Production in Russia,** *millions of tonnes* ▲2.5% yoy




547

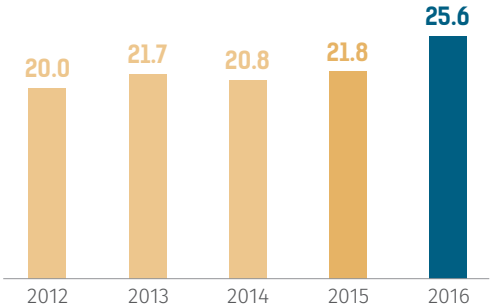
The Zapolyarye-Purpe main pipeline

**Russian Well Stock,** *units* ▼0.8% yoy




173.1

**Production Drilling Rate,** *thousands of km* ▲17.4% yoy




25.6

## Downstream

There are 40 oil refineries in Russia with a total crude oil distillation capacity of 5.5 million barrels per day. Rosneft, the leading Russian oil company, is the largest refinery operator and owns 9 major refineries in Russia. LUKOIL, with 4 major refineries, is the second-largest refinery operator in Russia.

In Russia, a lot of refineries are out-dated and are not able manufacture their main products – light oil products with a high level of refining depth, i.e. petrol and diesel – at a high quality level. Previous changes in taxes have encouraged companies with modest success to invest in the modernisation of refineries to produce more high quality products, such as diesel and petrol. Tax changes introduced in 2015 and the low global crude oil price will continue to stimulate refineries to modernise their production facilities more intensively. Growth in the oil refinery industry is likely to be driven by several new projects:

*Isomerisation process units:*
- Kuybyshevsky Refinery (Rosneft)
- Ryazan Oil Refinery Company (Rosneft)
- Gazpromneftekhim Salavat (Gazprom)

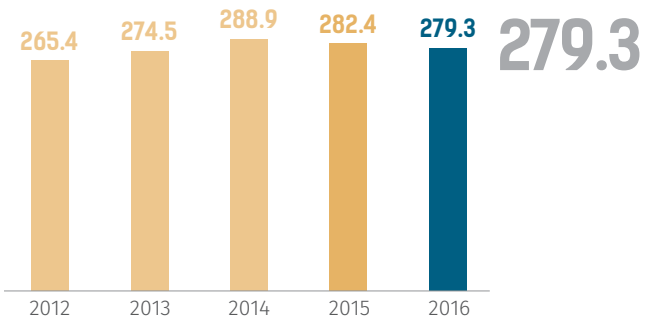
*Alkylation process units:*
- NizhegorodNOS (LUKOIL)
- Angarsk Petrochemical company (Rosneft)

*Diesel hydro-treating process units:*
- PermNOS (LUKOIL)
- Antipinsk Refinery (Rosneft)

*Reforming process units:*
- Kuybyshevsky Refinery (Rosneft)
- Novokuybyshevsky Refinery (Rosneft)
- Syzran Refinery (Rosneft)

*Cat-cracked petrol hydro-treating process units:*
- NizhegorodNOS (LUKOIL)

**Crude Oil Processing by Domestic Refineries,** *millions of tonnes* ▼1.1% yoy




## Gas Pipeline Projects

Gazprom is virtually the sole owner of all natural gas pipelines in Russia.

In 2016, the Russian natural gas transportation system included more than 170 thousand kilometres of high-pressure pipelines with 250 compressor stations (3,825 gas-pumping units) and 26 underground natural gas storage facilities. The majority of Russia's natural gas pipelines were constructed during the Soviet era and around 75 percent of the system is more than 20 years old.

Since the late 2000s, Gazprom has built major new pipelines for the transportation of natural gas from new gas fields, including fields in Yamal and Eastern Siberia, as well as for new export routes, including exports to China and pipelines to Europe in order to avoid Ukraine.

The Unified Gas Supply (UGS) system includes domestic pipelines and the domestic part of export pipelines in Western Russia; however, it does not include pipelines in Eastern Russia. In 2007, the Russian government delegated Gazprom with the task of establish the Eastern Gas Programme (EGP) to expand gas infrastructure in Eastern Siberia and the Russian Far East. The backbone of the EGP is the "Power of Siberia" pipeline, which is currently under construction.

The "Power of Siberia" pipeline will run nearly 4,000 kilometres through 5 Russian regions: the Irkutsk region, the Republic of Sakha (Yakutia), the Amur region, the Jewish Autonomous region and the Khabarovsk territory, and will have an annual capacity of 38 billion cubic metres of gas.

Gazprom approved a Rub 911 billion investment programme for 2017.

| Pipeline | Volume bcm | Length km | Compressors MW | Construction |
|---|---|---|---|---|
| Ukhta-Torhzok, first and second lines | 90.0 | 2,343 | 1,430 | 2014-2019 |
| Power of Siberia | 61.0 | 3,056 | 1,330 | 2015-2020 |

# MARKET TRENDS
## POWER GENERATION



**Russia still remains one of the largest electricity producers in the world, behind China, the USA, Japan and India. The relatively low energy efficiency of its national industries drives strong electricity demand. As a result, this strong demand is linked to challenges affecting the limited and ageing energy production capacity, and explains the need for the massive investment programmes of power generating companies and the ever-increasing growth of tariffs.**

In 2016, electricity output in Russia increased by 1.2 percent yoy, reaching 1,071 billion kW/h.

Russia's power complex consists of approximately 600 power plants, each with an individual capacity of over 5 MW. In 2016, the total capacity of Russia's power plants amounted to 257.1 GW, exceeding the 2015 level by 3.8 GW. This growth was driven by the construction of new power facilities and modernisation of the existing infrastructure.

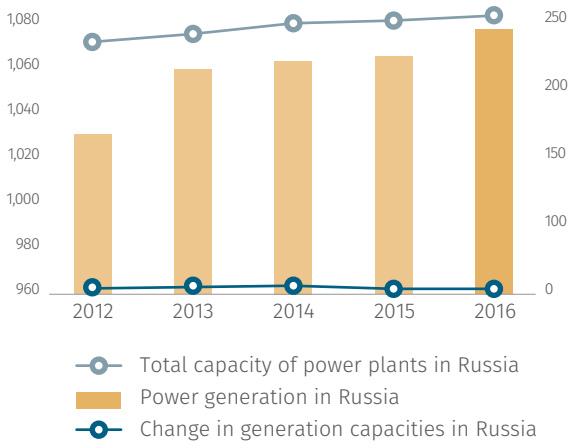
The power industry is composed of the following capacity components: thermal (68%), hydraulic (21%) and nuclear (11%) plants. The long-term outlook of the Russian power industry has been determined in the plan entitled "The General Scheme of Energy Development for the Period up to 2020".

### ELECTRICITY OUTPUT IN 2016

**196.4 BN KW/H**

▲0.6% yoy

**Power generation in Russia,**
*bn kW/h, GW*




## Thermal Power Plants

In 2016, Russia's overall installed thermal power plant capacity amounted to 175GW, an increase of 1.5 percent yoy. The infrastructure in the thermal power sector is quite outdated, with almost 55 percent of the installed capacities being more than 30 years old. Russia's main thermal power stations use organic fuels such as gas or coal.

Russian power plants have an efficiency ratio of 37 percent, compared to 41 percent for developed economies. This difference dictates the need for equipment upgrades at all major-power generating companies in Russia. This is also the reason why the technical modernisation and reconstruction of existing power stations is the primary goal for the Russian thermal power sector, in addition to the start-up of additional modern generating capacities.

In total, investments grew by 3 percent yoy and reached Rub 390 billion.

## Nuclear Power Plants

Russia possesses full-cycle technology for the nuclear power industry, from the extraction of uranium ore to electric power generation. Currently, Rosenergoatom operates 34 nuclear power units with an overall installed capacity of 27.1 GW. They account for 18.3 percent of domestic electricity generation. The share of nuclear power generation of total energy in the European part of Russia is 30 percent, and 37 percent in the Northwest respectively.

Currently, a number of large-scale nuclear power plants are being constructed in Russia. The following construction projects are currently underway: Novovoronezhskaya NPP Phase II, Leningradskaya NPP Phase II, Baltic NPP, and the world's first floating nuclear co-generation plant named "Akademik Lomonosov." In addition to Russia, Rosenergoatom is constructing nuclear power plants abroad, namely Kudankulam in India, Bushehr in Iran, Ostrovets in Belarus, Ninh Thuan NPP -1 in Vietnam, as well as a nuclear power station in Jordan, a nuclear power station in Armenia, Tianwan Second Stage in China, and Hanhikivi-1 NPP in Finland.

The majority of the 34 nuclear operating reactors in Russia are in the ageing process: 80 percent of their capacity has a 20-40 year maturity. This has led to the development of a large-scale investment programme by the state operator Rosatom.

In 2016, electricity output grew by 0.6 percent yoy and reached 196.4 billion kW/h.

The estimated investments in nuclear power increased by 9 percent yoy and reached Rub 350 billion.

# WATER

**Water consumption in Russia is showing stable and positive dynamics, along with the steady growth of tariffs and an inflow of private investments into the sector.**

Development of the water management complex programme of the Russian Federation in 2012-2020, which aims to increase the coverage of water and wastewater services in Russia's regions, with the goal of reaching 95 percent safe water supply coverage and 87 percent wastewater collection and treatment by 2020.

According to the Programme, 48 reservoirs and hydroelectric facilities are to be constructed and reconstructed at existing multi-purpose water reservoirs. The construction and rehabilitation of infrastructure will contribute to creating new opportunities for equipment suppliers, engineering firms and construction companies. Emerging interest in advanced solutions, such as membrane systems, ultraviolet and ozone treatment, has created good development prospects for the market's participants.

A large number of water supply systems are in need of modernisation due to the low capacity of centralised water supply systems, which impedes the development of localities. The share of out-dated pipes exceeds 60 percent in some cities.

Capital expenditure on water and wastewater infrastructure is forecasted to grow from US$ 2.5 billion in 2016 to US$ 2.7 billion in 2020.

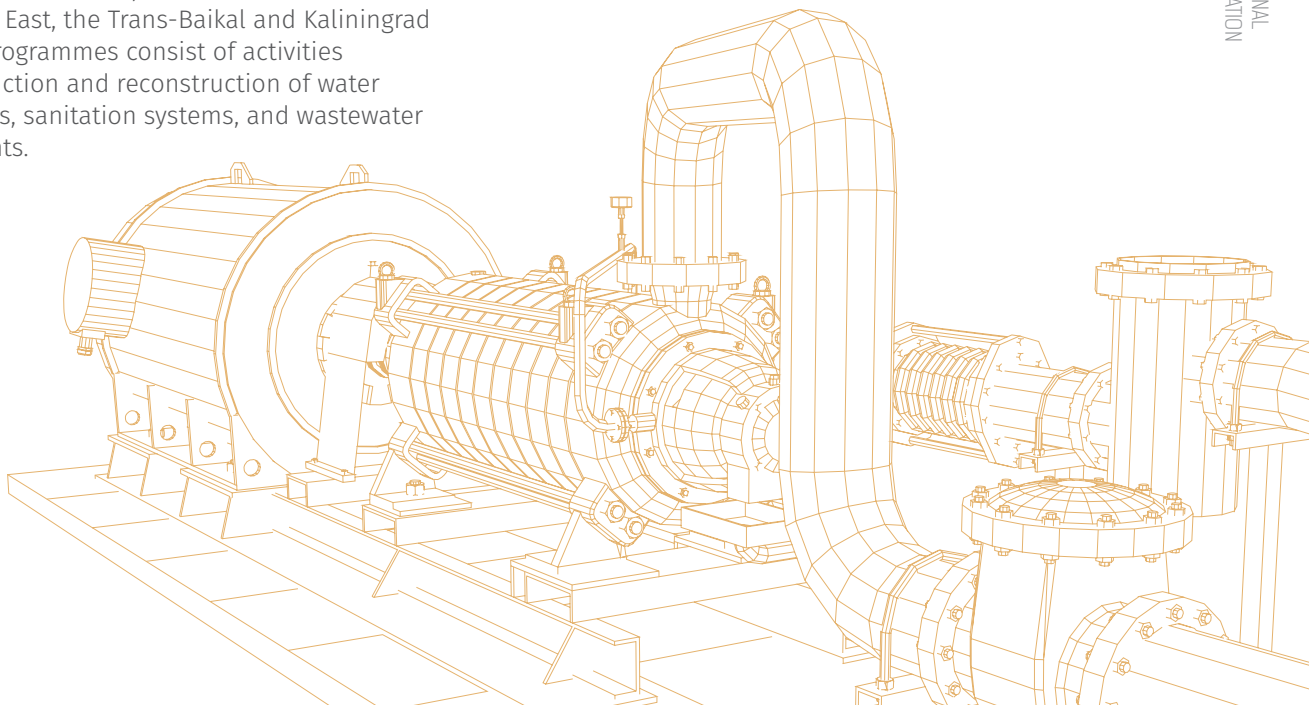
Today, the problems of water supply and wastewater treatment are addressed within the framework of the Special Purpose Federal Housing Programme, a series of special purpose federal programmes for territorial development, and programmes for the development of the republics in the south of Russia, the Far East, the Trans-Baikal and Kaliningrad regions. The programmes consist of activities for the construction and reconstruction of water supply facilities, sanitation systems, and wastewater treatment plants.

**48 RESERVOIRS**

AND HYDROELECTRIC FACILITIES ARE TO BE CONSTRUCTED AND RECONSTRUCTED

CAPITAL EXPENDITURE ON WATER AND WASTEWATER INFRASTRUCTURE IN 2016

**2.5 US$ BN**



# OPERATING PERFORMANCE



## Backlog & Order Intake

The Group built its backlog at Rub 24,035 million, down 2 percent yoy due to the decline in the compressors business segment.

| Backlog, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Industrial pumps | 10,318 | 10,075 | 2% |
| Oil & Gas equipment | 8,512 | 5,716 | 49% |
| Compressors | 3,476 | 6,915 | -50% |
| EPC | 1,730 | 1,702 | 2% |
| Construction | 719 | 581 | 24% |
| Project and design | 1,011 | 1,121 | -10% |
| **Total** | **24,035** | **24,409** | **-2%** |

In the pumps business segment, the backlog increased 2 percent yoy to Rub 10,318 million because of inflow of contracts for recurring products. In the oil & gas equipment business segment, the backlog increased by 49 percent yoy to Rub 8,512 million due to the increase in the number of signed contracts for recurring products. The compressors' backlog declined to Rub 3,476 million because of revenue recognition of two large contracts signed in 3Q 2015 and 1Q 2016 and fewer contracts signed for recurring products. The EPC backlog increased by a minor 2 percent to Rub 1,730 million due to better performance of the construction sub-segment.

| Order intake, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Industrial pumps | 15,999 | 15,399 | 4% |
| Oil & gas equipment | 17,125 | 7,919 | 116% |
| Compressors | 5,172 | 8,145 | -36% |
| EPC | 2,328 | 1,517 | 53% |
| Construction | 771 | -181 | n/a |
| Project and design | 1,557 | 1,698 | -8% |
| **Total** | **40,624** | **32,979** | **23%** |

Order intake[1] grew by 23 percent and equalled Rub 40,624 million based on growth of all segments except the compressors. Order intake for industrial pumps increased by 4 percent because of more orders for recurring products. The oil & gas equipment grew by 116 percent not only because of large contracts signed but also due to 72 percent growth of recurring business.

In 2016, HMS Group signed three large contracts: two contracts worth almost Rub 5.6 billion in the oil & gas business segment, and a Rub 2.8 billion contract – in the compressors segment.

Order intake for compressors decreased by 36 percent because the large contract signed in the reporting period (Rub 2.8 bn) was smaller than the large one signed in the comparative period (Rub 3.7 bn) combined with fewer recurring contracts signed. The latter was less because Kazankompressormash slowed down its activity in the area of recurring business to keep its productive capacity free as there were several large contracts under discussion. One of these discussed contracts was signed in 1Q 2017, adding Rub 3.9 billion to the compressors' order intake and backlog.

In the EPC segment, TGS (the construction sub-segment) signed a number of new contracts.

[1] According to management accounts

# FINANCIAL PERFORMANCE

## Group Performance

Group revenue was up by 11 percent yoy and reached a new high of Rub 41,582 million, growing for the third year in a row.

In terms of revenue mix, this growth was supported the most by recurring products. In 2016, recurring business increased by 15 percent and as a share of revenue amounted to 75 percent vs. 73 percent last year. Here, machine-building recurring products[2] grew by 18 percent yoy. Revenue from large contracts also grew, but at a slower pace, by only 3 percent yoy.

In terms of segments, the compressors business segment was the driver of the revenue increase because of large contracts.

| Financial highlights, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Revenue | 41,582 | 37,296 | **11%** |
| EBITDA | 6,369 | 7,446 | **-14%** |
| EBITDA margin | 15.3% | 20.0% | |

EBITDA margin decreased to 15.3 percent from 20.0 percent in the comparative period due to two main factors:
- A decrease in the profitability of the pumps business segment because of the revenue mix with a larger share of recurring business, which has lower margins compared to large projects;
- An increase in the share of large contracts in the compressors segment, that still have low margins.

EBITDA declined by 14 percent yoy to Rub 6,369 million mainly because of the decline in the pumps business segment due to smaller share of large contracts, especially in 1Q 2016. The pumps' EBITDA was almost completely generated by recurring business. In the oil & gas business segment, EBITDA generated by large contracts declined, and recurring business, in contrast, grew significantly, due to a higher profitability of innovative projects, among other things. Also, there was a high basis of comparison for the oil & gas equipment segment last year. The compressors segment increased its share in the company's EBITDA as well as in the large contracts' portfolio.

Cost of sales increased by 19 percent yoy to Rub 30,799 million compared with Rub 25,783 million. This growth outpaced revenue (+11% yoy) and was driven by materials and components (+22% yoy). The main reason was a change in the prevailing type of contracts, which became more material-intensive in particular because of a specific nature of KKM's contracts. Labour costs stayed unchanged, and as a share of revenue even decreased to 11 percent from 12 percent.

| Cost of sales, Rub mn | 2016 FY | 2015 FY | Change yoy | Share of revenue 2016 FY | Share of revenue 2015 FY |
|---|---|---|---|---|---|
| **Cost of sales** | **30,799** | **25,783** | **19%** | **74.1%** | **69.1%** |
| Materials and components | 20,172 | 16,520 | **22%** | 48.5% | 44.3% |
| Labour costs | 4,627 | 4,607 | **0%** | 11.1% | 12.4% |
| Construction & design and engineering services of subcontractors | 2,173 | 1,135 | **91%** | 5.2% | 3.0% |
| Depreciation and amortization | 1,340 | 1,281 | **5%** | 3.2% | 3.4% |
| Others | 2,487 | 2,239 | **11%** | 6.0% | 6.0% |

**Operating expenses excl. Cost of sales** grew by 3 percent yoy to Rub 6,771 million, whilst as a percentage of revenue decreased to 16.3 percent.

Distribution and transportation expenses increased by 23 percent yoy and amounted to Rub 1,700 million. As a percentage of revenue, they also grew, to 4.1 percent from 3.7 percent. Major contribution to the increase was made by transportation expenses and other expenses related to contracts' execution. Here, transportation expenses grew due to a growth of the number of heavy and oversized products dispatched as well as more deliveries to remote northern regions of Russia.

[2] Machine-building products include standard pumps, oil & gas equipment, and compressors, and exclude EPC (GTNG and TGS)

# FINANCIAL PERFORMANCE (CONTINUE)

General and administrative expenses declined by 2 percent to Rub 4,523 million.

SG&A expenses[3] grew by 4 percent yoy to Rub 6,223 million, with lower share in revenue (15% in 2016 vs 16% in 2015). The growth of SG&A expenses was mainly because of an increase in transportation costs.

| Expenses other than Cost of sales, Rub mn | 2016 FY | 2015 FY | Change yoy | Share of revenue 2016 FY | Share of revenue 2015 FY |
|---|---|---|---|---|---|
| Distribution and transportation | 1,700 | 1,378 | **23%** | 4.1% | 3.7% |
| General and administrative | 4,523 | 4,603 | **-2%** | 10.9% | 12.3% |
| Other operating expenses | 548 | 624 | **-12%** | 1.3% | 1.7% |
| **Operating expenses ex. Cost of sales** | **6,771** | **6,605** | **3%** | **16.3%** | **17.7%** |
| Finance costs | 1,905 | 2,087 | **-9%** | 4.6% | 5.6% |

Operating profit declined by 20 percent to Rub 3,624 million compared with Rub 4,525 million because of the lower EBITDA. Operating margin decreased to 8.7 percent (2015: 12.1%).

Finance costs declined by 9 percent yoy to Rub 1,905 million. Foreign exchange revaluation gain more than compensated for the growth of interest expenses of 11 percent yoy.

As of January 1, 2017, average interest rate grew to 12.2 percent (01.01.2016: 11.4 percent), where Ruble-denominated only, in contrast, decreased to 12.4 percent (01.01.2016: 12.5 percent). Within a year, interest rate increased during the first 9 months. The reasons for the growth were the same as in the previous reporting period: a Euro-denominated loan was refinanced with a Ruble-denominated one, "old" before-the-crisis loans at low interest rates were replaced with more expensive ones. But since 4Q 2016, the average interest rate began to decrease.

Profit for the year decreased by 32 percent yoy to Rub 1,198 million from Rub 1,764 million, due to the lower operating profit. And profit for the year adj. equaled to Rub 1,587 million, down 26 percent from Rub 2,148 million.

## Segment Performance

The reportable operating segments derive their revenue primarily from the manufacture and sale of industrial pumps, oil and gas equipment, compressors, oil and gas construction and other products and services. From 2015 onwards, HMS Group reports a total segment's revenue, which includes external revenue and intersegment revenue, for more consistent demonstration of the performance of each segment.

### Industrial pumps Business Segment[a]

The industrial pumps business segment's revenue declined by 7 percent yoy to Rub 16,724 million. EBITDA decreased by 33 percent yoy to Rub 2,755 million. As a result, EBITDA margin decreased to 16.5 percent.

The main reason for the lower financials was a decline in the share of large high-margin contracts in revenue and EBITDA. Here, EBITDA was almost completely generated by recurring business with lower margin.

| Industrial pumps, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Revenue | 16,724 | 17,925 | **-7%** |
| EBITDA | 2,755 | 4,098 | **-33%** |
| EBITDA margin | 16.5% | 22.9% | |

[3] SG&A expenses = Selling, General and Administrative Expenses = Distribution and transportation + General and administrative

[a] The industrial pumps business segment designs, engineers, manufactures and supplies a diverse range of pumps and pump-based integrated solutions to customers in the oil and gas, power generation and water utilities sectors in Russia, the CIS and internationally. The business segment's principal products include customized pumps and integrated solutions as well as pumps built to ordinary specifications; it also provides aftermarket maintenance and repair services and other support for its products.

## Oil & Gas equipment Business Segment[b]

Revenue stayed almost flat at Rub 15,144 million and EBITDA was down by 7 percent yoy to Rub 3,032 million. From the perspective of recurring business, the oil & gas equipment segment continued to deliver strong results.

There was a twofold decrease in revenue from large contracts in the oil & gas business segment, but recurring business almost substituted them. EBITDA generated by large contracts declined. Recurring business, in contrast, showed significant growth in EBITDA terms. Also, the oil & gas equipment segment last year demonstrated a high basis of comparison.

EBITDA margin declined to 20.0 percent because of a larger share of recurring business. But, margins for recurring oil & gas equipment are higher than in the previous periods due to a higher level of innovation and added value of new equipment put into operation.

| Oil & Gas equipment, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Revenue | 15,144 | 15,218 | **0%** |
| EBITDA | 3,032 | 3,246 | **-7%** |
| EBITDA margin | 20.0% | 21.3% | |

## Compressors Business Segment[c]

Revenue grew by 108 percent to Rub 8,700 million, and EBITDA increased to Rub 619 million mainly due to growing portfolio of large contracts. EBITDA margin was almost the same 7.1 percent vs. 7.5 percent in the compared period.

| Compressors, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Revenue | 8,700 | 4,183 | **108%** |
| EBITDA | 619 | 315 | **96%** |
| EBITDA margin | 7.1% | 7.5% | |

## Engineering, Procurement and Construction (EPC) Business Segment[d]

The EPC business segment continued its negative dynamics. Revenue was down to Rub 2,297 million from Rub 2,617million. EBITDA dropped to minus Rub 75 million from plus Rub 180 million due to poor performance of the both sub-segments: project & design and construction. These weak results are a direct consequence of the shrinking contracts portfolio because of tougher pricing of oil & gas majors and stronger competition in the stagnating market for a small number of orders. As a result, EBITDA margin turned negative 3.2 percent from positive 6.9 percent last year.

| EPC, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Revenue EPC | 2,297 | 2,617 | **-12%** |
| EBITDA EPC | -75 | 180 | **-142%** |
| EBITDA margin EPC | -3.2% | 6.9% | |

[b] The oil & gas equipment business segment manufactures, installs and commissions modular pumping stations, automated metering equipment, oil, gas and water processing and preparation units and other equipment and systems for use primarily in oil extraction and transportation. The segment's core products are equipment packages and systems installed inside a self-contained, free-standing structure which can be transported on trailers and delivered to and installed on the customer's site as a modular but fully integrated part of the customer's technological process.

[c] The compressors business segment designs, engineers, manufactures and supplies a diverse range of compressors and compressor-based solutions, including compressor units and compressor stations, to customers in the oil and gas, metals and mining and other basic industries in Russia. The business segment's principal products include customized compressors, series-produced compressors built to ordinary specifications, and compressor-based integrated solutions.

[d] The engineering, procurement and construction (EPC) business segment provides design and engineering services, project management and construction works for projects for customers in the oil upstream and midstream, gas upstream and water utilities sectors.

## Cash Flow Performance, Debt and Liquidity Position

Working capital[4] increased by 13 percent yoy to Rub 9,962 million because of the continuing execution of large contracts. But as a share of revenue it stayed stable at 24 percent.

| Working capital, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Working capital | 9,962 | 8,813 | **13%** |
| Working capital / Revenue LTM | 24% | 24% | |
| Capital expenditures | 1,701 | 1,457 | **17%** |

Despite the increase in working capital, HMS Group generated net operating cash inflow of Rub 1,808 million.

HMS' capex grew 17 percent. This growth affected Net cash used in investing activities, the net outflow of which increased to Rub 1.8 billion (2015: Rub 1.4 billion).

The company continues execution of its Localization project[5] where it invested Rub 665 million during 2016 year. Excluding these capital expenditures, HMS raised its maintenance capex by 26 percent yoy to Rub 1.0 billion. In 2014-2015, the company reduced its capital expenditures due to the economic crisis in Russia and imposed sanctions, and today is increasing them to a "normal" level required for further development.

Increased investment activities decreased free cash flow[6], which amounted to Rub 20 million.

| Cash flow performance, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Net cash (used in)/from operating activities | 1,808 | 1,881 | **-4%** |
| Net cash used in investing activities | -1,788 | -1,431 | **25%** |
| **Free cash flow (FCF)** | **20** | **451** | **-95%** |
| Net cash (used in)/from financing activities | -394 | -1,594 | **-75%** |
| Cash & cash equivalents | 2,990 | 3,496 | **-14%** |

Cash & cash equivalents were down to Rub 3.0 billion vs. Rub 3.5 billion last year.

Net cash (used in)/from financing activities increased by Rub 1.2 billion.

Total debt increased by 3 percent yoy to Rub 16,336 million. Net debt grew by 8 percent yoy to Rub 13,347 million because financing cash flows (buy back of issued shares, dividends paid and purchase of a stake of Apollo), that totaled almost Rub 1.1 billion, weren't covered by free cash flow of Rub 20 million. Larger Net debt and lower EBITDA resulted in the higher 2.10x Net debt-to-EBITDA LTM ratio.

In December 2015, the Group exercised its right under the option agreement to acquire the remaining 25% share in Apollo Goessnitz GmbH. Share purchase transaction was legally completed in February 2016, and, as a result of this transaction, the Group increased its ownership interest in Apollo Goessnitz GmbH from 75% to 100%.

| Debt & Liquidity, Rub mn | 2016 FY | 2015 FY | Change yoy |
|---|---|---|---|
| Total debt | 16,336 | 15,884 | **3%** |
| Long-term debt | 12,770 | 11,218 | **14%** |
| Short-term debt | 3,566 | 4,667 | **-24%** |
| Net debt | 13,347 | 12,388 | **8%** |
| Net debt / EBITDA LTM | 2.10 | 1.66 | |

[3] Working capital is calculated as Inventories + Trade and other receivables (excluding Short-term loans issued, Bank deposits and Promissory notes receivable) + Current income tax receivable - Trade and other payables - Short-term provisions for liabilities and charges - Current income tax payable - Other taxes payable - Dividends payable (Rub 393 mn) which emerged because of dividends announcement in Dec 2016 and their payment in Jan 2017

### Credit rating

Fitch Ratings assigns JSC "HMS Group" (legal entity, the holder of HMS Group's assets, located in Russia) a first time Foreign and Local Currency Issuer Default Rating (IDR) of "B+", the outlook "Stable".

## Significant Events & Financial Management After the Reporting Date

In March 2017, HMS Group signed two large contracts: Rub 3.9 billion for delivery of compressor equipment and Rub 10.2 billion for delivery of oil & gas equipment.

### Financial management

In February 2017, HMS Group successfully placed a Rub 3.0 billion exchange bonds issue of JSC "Hydromashservice", one of the main operational subsidiary of the Group. The company came back to the public debt capital markets with Rub 3 billion 10.75 per cent coupon bonds with a 3-year put option and 10-year maturity. It was the first HMS Group debt issuance since 2013.

The same month, HMS signed a credit agreement with UniCredit Bank totaling Rub 800 million. The 3-year loan facility with maturity in 2020 was utilized for general corporate needs, including refinancing at lower interest rates its previously signed credit lines.

As of mid-April, 2017, average interest rate of Ruble-denominated loans decreased to 11.2 percent and to 11.0 percent for all loans, including FX-denominated.

In April 2017, HMS did the following, among other things:
- Lowered the interest rates of one credit line without its refinancing, and
- Refinanced Rub 1.86 billion at a lower interest rate.

### Change in Business segments and reporting structure

Due to the change in the internal management and reporting structure effective 1 January 2017, the results of the Group's subsidiaries Giprotyumenneftegaz PJSC and Institute Rostovskiy Vodokanalproekt OJSC since 1 January 2017 will be presented within "Oil and gas equipment" segment, whereas previously these entities were included in "Engineering, procurement and construction" and "Industrial pumps" segments, respectively. Additionally, starting from 1 January 2017, "Engineering, procurement and construction" segment will be renamed "Construction" segment, and "Oil and gas equipment" segment will be renamed "Oil and gas equipment and projects" segment. Because such changes occurred after the period end, they have not been reflected in the segment information herein, but will be reflected for the first time in the reporting period for 2017.

## HMS GDRs

During the period from December 1, 2016 up to and including April 26, 2017, HMS Group repurchased 37,693 of its global depositary receipts ("GDRs"). The share repurchases are part of the Company's buy-back program. In total, HMS Group purchased 903,562 GDRs (3.86 percent of its issued share capital).

[5] Development of manufacture competences for high capacity oil transport pumps and nuclear pumps in Russia, Orlov region (Livny) at HMS Livgidromash

[6] Free cash flow (FCF) = Net cash (used in) / from operating activities (operating cash flow) + Net cash used in investing activities (investing cash flow), represents the cash that a company is able to generate after laying out the money required to maintain or expand its assets base.

# KEY PROJECTS AT HMS

Centrifugal compressor 4GC2-75/30-83 GTU with gas-turbine engine

Major Siberian gas field

## Completed Projects

In 2016, HMS Group completed the delivery of oil & gas equipment to a major Russian oil & gas company under the so-called “Liquid Hydrocarbon Project,” signed in 2Q 2014. The total size of the contract, including additionally signed specifications, amounted to 7 billion rubles.

## Projects on Track

In December 2013, the company signed a 5.7 billion rubles contract to supply an integrated solution to a major Siberian gas field. According to the contract, HMS will design, manufacture, deliver, supervise and test the complex technological facility, including compressors, pumps, tanks, vessels, filters, coolers and other components. The project is planned for completion in the near future.

In 2016, the company signed several follow-up contracts as a result of the successful execution of recently completed large-scale projects:

- Contracts for the production of a boosting compressor station. The station, based on 3centrifugal-type compressor units with gas-turbine engines intended for the compression of low-pressure associated gas, will be manufactured by Kazankompressormash and installed on an oil and gas condensate deposit, located in Western Siberia;
- A contract for the delivery and installation of technologically integrated solutions for two Siberian gas fields. HMS Neftemash will deliver complex integrated solutions for the pumping of natural gas liquids and the pumping of oil, wash-down water and rust preventive chemicals.

SUCCESSFUL COMPLETION OF THE LH PROJECT WITH ONE OF THE RUSSIAN OIL & GAS MAJORS RESULTED IN FOLLOW-UP CONTRACTS

**7 RUB BN**

DEVELOPMENT OF DESIGN DOCUMENTATION, MANUFACTURING, DELIVERY, SUPERVISION AND TESTING OF COMPLEX TECHNOLOGICAL FACILITY, INCLUDING COMPRESSORS, PUMPS, TANKS, VESSELS, FILTERS, COOLERS AND OTHER COMPONENTS FOR PROVIDING COMPLEX INTEGRATED SYSTEMS

**5.7 RUB BN**

API 610 oil-refining pumps

Inter-stage compressor stations based on turbo-compressor units

## New Projects

In the autumn, HMS Group signed a 9 million Euro contract to deliver oil-refining pumps in line with the API 610 international standard. This project is managed by a top international engineering company, which serves as a customer engineer under its EPS (Engineering and Procurement Services) contract with the Russian customer. HMS will produce and deliver more than 50 centrifugal API pumps of different designs for an atmospheric crude distillation unit/vacuum distillation unit, to be installed at one of Russia's largest high-tech oil refining plantlocated in Western Siberia.

In addition, several contracts with a total worth of 7 million US dollars were signed to deliver 8 turbine feed pumps and other pumping equipment to the third and the fourth power plant units in 2017 and 2018 respectively. These contracts are a follow-up to the contracts executed in 2004-2006 for the delivery of main pumping equipment to the first and the second units of this nuclear power plant.

## New Projects after the Reporting Date

In March 2017, HMS Group signed a 10.2 billion rubles contract for the delivery of a range of technologically integrated solutions, including helium concentrate membrane recovery units (skids 1st and 2nd stage), as well as inter-stage compressor stations based on turbo-compressor units and gas booster stations, to be completed in the first quarter of 2018.

Later, the company signed a contract for the delivery of major and accessory processing equipment worth 3.9 billion rubles, for the reconstruction of gas booster stations at the customer's oil & gas condensate field.

HMS ENTERED THE MARKET FOR PROJECTS OF INTERNATIONAL ENGINEERING CONTRACTORS IN RUSSIA, WITH SIGNING OF THE CONTRACT TO DELIVER API 610 OIL-REFINING PUMPS

**9 EUR MN**

THERE ARE VERY FEW SIMILAR PROJECTS REALIZED IN THE WORLD, AND IT IS THE FIRST PROJECT OF THIS KIND IN RUSSIA. HMS GROUP WILL DESIGN AND MANUFACTURE EQUIPMENT TO OPERATE UNDER ADVERSE CLIMATIC CONDITIONS

**10 RUB BN**

# RESEARCH AND DEVELOPMENT

HMS Group is continuously strengthening its research and development capabilities, with the Company`s strategy being aimed at establishing the best Research & Development in Russia and CIS countries.
Our investments are dedicated to strengthening our core competencies in industrial pumps, oil and gas equipment and compressor technologies, as well as in developing solutions for the oil and gas industry and water utilities.

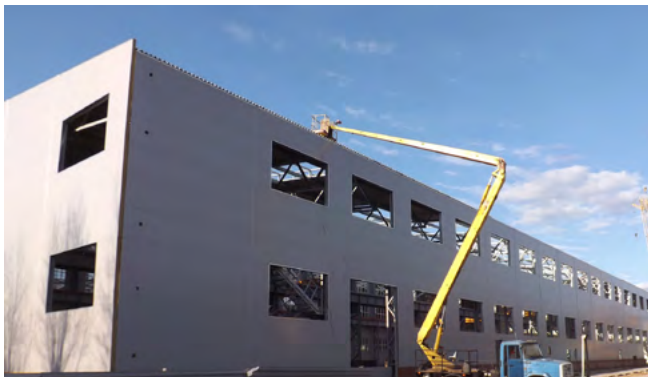
## Pumps

### Localisation Project

In 2016, HMS deepened the process of localising heavy pumps and pumping equipment, extending the lines of pumps produced at HMS Livgidromash. The company completed the first stage in Q1 2016. Within the framework of this project, HMS constructed a new production unit and a new transformer substation. The newly built test complex has become the only one of its kind in Russia, enabling testing of pumping units installed at the oil pipelines of Transneft and Rosatom's nuclear power plants. It consists of all the main and support systems needed to conduct operational testing of heavy centrifugal pumping units.

Within the second stage of the project, a manufacturing building is to be constructed, which will be equipped with modern high-performance equipment. Additional manufacturing capacities and the multifunctional test complex will maintain HMS Group's leading position and will cover customer requirements for high-tech pumps in the long term.

The project is being supported by the Ministry of Industry and Trade of the Russian Federation, the Government of the Orlov region and the Fund of Industry Development of the Russian Federation. HMS Group plans to complete the project by the end of 2017.

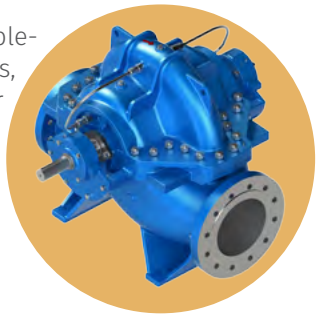


Nasosenergomash continues the differentiation of foundry materials created that are used for pump production. Manufacturing with post-heat treatment was development for the following alloy steels: 1.1138 SEW 685, 1.4107 EN 10213, 1.4317 EN 10213, and others. New steel grades have high rates of resistance to corrosion and cavitation and are thus intended for operation in aggressive environments.

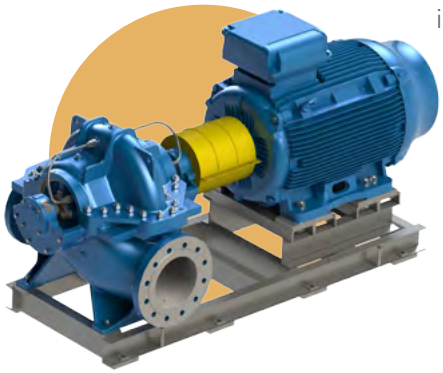
In 2016, we continued to expand our pump products lines with new API pump models. We started to introduce to the market a new line of overhung water pumps (Kordis), launched a new family of pumps for oil refining (2NK, 2NPS), developed and started production of advanced pumps for oil transport (upgraded main line NM and new vertical NMV pumps). We also significantly upgraded our lines of pumps for power generation (PE feed pump and KsV condensate removal pumps) and launched an advanced model of slurry pumps for mining industry (HDP).

2NK series API 610 OH2 pumps are the main processing pumps in petrochemicals and gas refining. They are also widely used in heavy duty industries like petroleum, petrochemical, energy, etc. The new pump line is available in a wide spectrum of construction and numerous design alternatives to meet all demand. It took more than 3 years of intensive work to develop and set up the production.

New D series pumping units based on double-suction centrifugal pumps are characterized by improved service reliability and easy maintenance. Pumps are completed with ADCHR series induction motors made by RUSELPROM.



A new generation of the double-suction pumps, DeLium series, are developed with computer modelling and meet up-to-date requirements for high efficiency, long service life and reliability. Extensive model range and using at least two interchangeable impellers for one casing allows the selection of the most suitable pump within 80-3500 m3/h capacity range and 5-180 m head range. In addition, the impellers could be manufactured in accordance with specific customer requirements. Pump's curves are adopted for parallel operation and operation with variable speed drives. Various versions of pumps are available for operation in the regions within -60 to +60°C temperature range.



# RESEARCH AND DEVELOPMENT (CONTINUE)



## Oil & Gas Equipment

### Binary Mixtures

In 2016, Sibneftemash begun the realisation of a project aimed at developing a technology and equipment complex for thermo-chemical, oil-and-gas-bearing formation treatment with the aim of increasing hydrocarbon production and restoring the ecological environment on oil & gas fields, instead of using the foreign technology of proppant-gel fracturing.

The project is being carried out in cooperation with Tyumen State University and the Institute of Biochemical Physics of the Russian Academy of Sciences. Currently, the composition of binary mixtures' components, stabilizers, initiators and the degradation of binary mixture activators in reservoirs, as well as their energy characteristics and mixture preparation procedure, have been optimised. The Company has produced prototypes of units for the preparation, mixing and injection of mixtures into reservoirs. HMS has applied for two patents: one for a mixing pump and one for a unit for the production and injection of binary mixture in reservoirs.

### Nitrogen Generator

HMS produced a prototype for a membrane nitrogen generator and completed its element-by-element set up (the heater, the pneumatic valve, the flow controller, and the gas analyser).

### Plate Heat Exchangers

In 2016, HMS Neftemash began the realisation of a project for the development and production of plate heat exchangers for Russia's petrochemical facilities. Under this project, HMS set up production of gasketed plate exchangers for oil and gas, in cooperation with G.A.M. Heat (Germany) and Euro Heat (Serbia).

# Compressors

**Centrifugal Compressor Units**

HMS Group has developed and produced a centrifugal compressor unit with a parallel arrangement of pressure cases that is unrivalled throughout the world. The 53GTs2-188/10-87 GTU unit will be put into operation at a boosting compressor station of NOVATEK's Yurkharovskoe field. The realised plan, with parallel cases of low- and high- pressure, enables the effective transportation and processing of natural oil and gas within a wide range of gas composition, flow rate and pressure.

**Modular Compressor Unit TAKAT 78.2-7 M3a HL1**

HMS developed a modular compressor unit (MCU) based on an oil-flooded screw compressor in order to operate in a technology of distributed compression on GAZPROM's Yamburgskoe oil & gas condensate field. MCU TAKAT is composed of domestic components and consists of two container modules (compressor and separation) with an electrical module, a control module and a reserve generator that serves as a back-up system.

The Group's current operating portfolio includes 246 patents, 46 registered trademarks and 26 registered computer programmes, reflecting our commitment to research & development.

# Legal Protection of Intellectual Property

In 2016, the HMS Group continues the complex protection of exclusive rights to its products and the individualisation of produced goods and services that are provided with the purpose to acquire the right of exclusive use in the market. The company has received exclusive rights on 20 intellectual property assets: 16 invention and utility model patents, 1 registration of application software, and 3 trademark registrations.

These patented technologies are intended to enhance the work of:

- Centrifugal pumps and compressors, and their separate units and parts,
- Gas separators,
- Compressor oil preheating systems,

as well as the improvement of the conditioning process of an oil-gas-water blend for transport, and the design of new products for thermo-chemical, oil-and-gas-bearing formation treatment.

The stable annual dynamics for the registration of exclusive rights are related to HMS' policy of discovery and the necessary provision of legal protection to the high-tech results of its intellectual activity.

# SOCIAL RESPONSIBILITY

HMS Group fully recognises its responsibility to all of its stakeholders and makes an effort to communicate with them on a regular basis. The Group maintains an enduring and solid record of commitment to its people, contributing to social development and improvements in the quality of life across the local communities in the regions of its operation.

## People

As an employer of over 15,000 people and being one of the major job creators across cities where the facilities are located, we carry enormous responsibilities for the people affected by our operations. We believe that employees are one of the core assets of HMS Group, and therefore, we can only be successful and sustainable through the attraction and retention of the best people, and by encouraging and developing them to achieve their full potential.

In 2016, we continued our staff training and education, focusing mainly on the areas of accounting and functional education, including the development of managerial competencies for the company's officers (with MBA/EMBA programs), as well as English language instruction.

HMS conducts systematic actions that address accident prevention and the creation of healthy and safe working conditions. Safety is one of our top priorities and the company is improving its health and safety standards on a regular basis.

This includes courses and trainings on occupational safety, fire and the environment, which are held at all production sites throughout the year. We also hold regular, routine medical check-ups for employees working in hazardous production areas.

HMS' branches issue free personal protective equipment, including work clothes, safety shoes and other personal safety apparel. The company analyses the given personal safety apparel on a regular basis, as well as examining novelty products.

We promote and encourage a healthy lifestyle, not only because it helps to maintain a productive and positive workplace, but also because it is the right thing to do.

In February 2017, one of HMS' employees, Nikolai Kuzovlev, successfully participated in the 2016-2017 Ice Climbing season, winning 8 medals. The last one was the bronze medal in the 2017 Ice Climbing World Championship.

## The Environment

The efficient use of natural resources is one of HMS Group's main priorities. The Group systematically implements environmental and energy-saving technologies at its production sites, in spite of the fact that the environmental impact of HMS Group's subsidiaries is generally low.

Not only do we continue to work on developing and selling an energy-efficient product and service solutions, but we also focus all of our businesses on the efficient consumption of fuel, paper, water, electricity and heating.

The HMS Group conducts activities on a regular basis to offset its impact on the environment, including waste management, the analysis and control of water quality on industrial sites, compliance with environmental emissions, and the monitoring of the industrial environment.

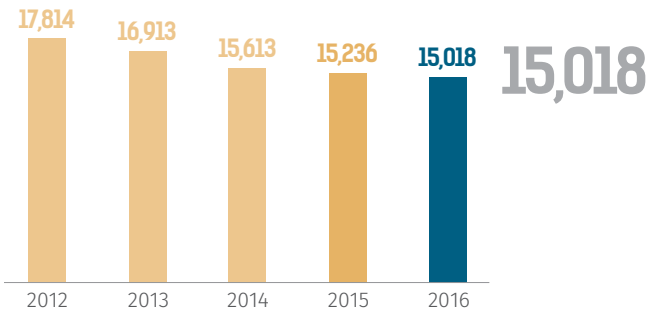
## Charity

HMS' charity initiatives are aimed at improving the social climate in regions where the company operates. The creation of jobs and business opportunities also strengthen local economies and provide support for the development of community projects.

HMS Group focuses at helping children who are in need of medical treatment, as well as children in need of social and professional assistance, of which these projects are realised through:

- Social support and protection of citizens, including improvement of the financial position of the indigenous peoples, social assistance to the unemployed, the disabled and other disadvantaged groups who, due to their specific physical or intellectual condition or other circumstances, are unable to implement their legitimate rights and interests by themselves;
- Promoting the prestige and the role of the family in society;
- Promoting the protection of motherhood, fatherhood and childhood.

**Average Headcount**
*as of 31 December 2016*




The average headcount decreased mainly because of restructuring in the EPC Business Unit.

# BOARD OF DIRECTORS

HMS Group's corporate governance practices are designed to ensure that the interests of all its stakeholders are given due consideration.

The corporate affairs are governed by the memorandum and articles of association of the Company and the provisions of applicable Cyprus law. Although the Company is not subject to any mandatory corporate governance code in its home jurisdiction of Cyprus, nor required to observe the UK Corporate Governance Code, it has implemented various corporate governance measures. These include the appointment of two independent non-executive Directors to its Board of Directors and the establishment of an Audit Committee and a Remuneration Committee.

Each of these Committees of the Board of Directors is chaired by an independent, non-executive Director. Under the Cyprus Companies Law, the directors have to declare the nature of their interest (either direct or indirect) in transactions at a meeting of the directors of the company. Under the articles of association of the Company, directors have no right to vote on a matter in which they have an interest even if the director has disclosed any interests in the transaction. HMS Group continues to review its corporate governance policies in line with international best practice.

## The Board of Directors and Performance

### General Overview

The Board of Directors consists of eight (8) members, three (3) of whom are Executive Directors. During the year Mr. Vladimir V. Lukyanenko was appointed as a Director of the Company by the Board of Directors.

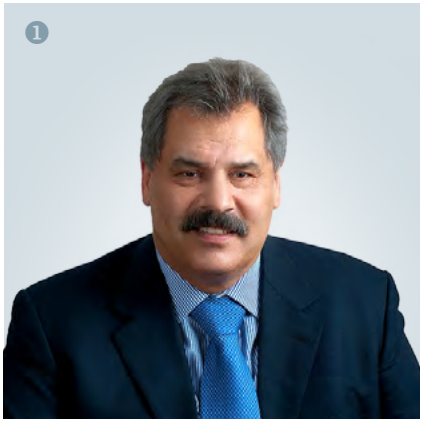
THE BOARD OF DIRECTORS CONSISTS OF

**8 MEMBERS**

### 1 Mr. Nikolay N. Yamburenko

Chairman of the Board of Directors
Non-Executive Director
Chair of the Strategy and Investments Committee

Mr. Yamburenko was appointed as a member of the Board of Directors in October 2010. He has been a non-executive member of the Board of Directors since 10 July 2014, when he was appointed Chair of the Board of Directors. Mr. Yamburenko previously held the position of Head of the Industrial Pumps Business Unit from 2005. Prior to joining the Group, Mr. Yamburenko was the CEO of Livhydromash (HMS Pumps), which is now part of the Group. Mr. Yamburenko has more than 30 years of industry experience. He graduated from the faculty of radio electronics of the Moscow Aviation Institute named after S. Ordzhonikidze, where he gained a degree in radio electronics.



### ❶ Mr. Nikolay N. Yamburenko

Chairman of the Board of Directors
Non-Executive Director

### ❷ Mr. Artem V. Molchanov

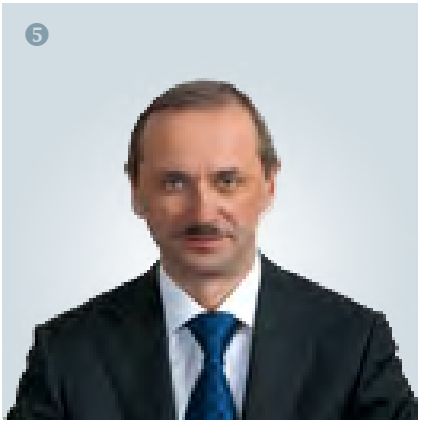
Member of the Board of Directors
Managing Director (CEO)

### ❸ Mr. Kirill V. Molchanov

Member of the Board of Directors

### ❹ Mr. Vladimir V. Lukyanenko

Member of the Board of Directors
Non-Executive Director



### ❺ Mr. Yury N. Skrynnik

Member of the Board of Directors

### ❻ Mr. Philippe Delpal

Member of the Board of Directors
Chair of the Audit Committee
Independent Director

### ❼ Mr. Gary S. Yamamoto

Member of the Board of Directors
Chair of the Remuneration Committee
Independent Director

### ❽ Mr. Andreas S. Petrou

Member of the Board of Directors
Non-Executive Director

# EXECUTIVE DIRECTORS

## ❷ Mr. Artem V. Molchanov

Member of the Board of Directors
Managing Director (CEO)

As one of the founders of the Group, Mr. Molchanov has held various executive positions within HMS Group since its establishment in 1993. Mr. Molchanov became the President of HMS Group in 2008 and was appointed as an executive member of the Board of Directors in October 2010. Mr. Molchanov has more than 20 years of industry experience. He graduated from the Plekhanov Russian Academy of Economics (currently Plekhanov Russian University of Economics), where he gained a degree in industrial economics.

## ❸ Mr. Kirill V. Molchanov

Member of the Board of Directors

As one of the founders of the Group, Mr. Molchanov has held various executive positions within HMS Group since its establishment in 1993. Mr. Molchanov was appointed as an executive member of the Board of Directors in October 2010 and has served as Vice President of HMS Group since 2008. Mr. Molchanov has 20 years of industry experience. He graduated from the Bauman Moscow Higher Technical School (currently the Bauman Moscow State Technical University) with a degree in electromechanical engineering. He graduated from the Judge Business School, University of Cambridge with an executive MBA degree.

## ❺ Mr. Yury N. Skrynnik

Member of the Board of Directors

Mr. Skrynnik was appointed as an executive member of the Board of Directors in October 2010. He is currently the Head of the Compressor Business Unit, a position he has held since its establishment in 2012. Previously, Mr. Skrynnik held the position of Director for Strategic Marketing. Prior to joining HMS Group, he served as the Chief Representative of JSC “Sumy Frunze NPO” (Ukraine) in Russia from 1999 to 2008. Mr. Skrynnik worked as Director of the Innovative Technical Subdivision of “Machines, Equipment, Technologies, Products and Services” Ltd. from 1992 to 1999. He served as a scientific research officer at the Moscow Institute of Chemical Machinery (currently the Moscow State University of Environmental Engineering) from 1986 to 1988. Mr. Skrynnik has more than 20 years of science and management experience. He graduated from the Sumy branch of the Kharkiv Polytechnic Institute with a degree in mechanical engineering in 1983. He was awarded a PhD in engineering science from the Moscow Institute of Chemical Machinery (currently the Moscow State University of Environmental Engineering) in 1988. Mr. Skrynnik is the author of more than 50 scientific publications and creator of 20 inventions.

# NON-EXECUTIVE DIRECTORS

## ❹ Mr. Vladimir V. Lukyanenko

Member of the Board of Directors
Non-Executive Director

Mr. Lukyanenko was appointed as a non-executive member of the Board of Directors in July 2016. He is also the member of the Remuneration Committee, the Audit Committee and the Strategy and Investments Committee. Currently he is the Director General of PROFITPROM LLC. From 2006 to 2008 Mr. Lukyanenko was the Vice-President of Hydraulic Machines LLC. From 2006 to 2008 Mr. Lukyanenko was the Vice-President of HMS Group. He has served as the Chairman of the Supervisory Board of Sumy Frunze NPO PJSC (Ukraine) from 2003 until 2007. He graduated from Moscow Chemical Engineering Institute (currently - Moscow State University of Engineering Ecology) with a degree in machine building in 1991. Mr. Lukyanenko has over 18 years of experience in the industry.

## ❻ Mr. Philippe Delpal

Member of the Board of Directors
Chair of the Audit Committee
Independent Director

Mr. Delpal was appointed as an independent non-executive member of the Board of Directors in December 2010 and is Chair of the Audit Committee. Mr. Delpal has had a career in banking, most recently as Chair of BNP Paribas Vostok in Moscow. He is now an Operational Partner for Financial Services in Baring Vostok Capital Partners, one of the largest private equity firms in Russia. He is also currently serving as a non-executive Director for Tinkoff Credit System Holding (LSE listed), Orient Express Bank OJSC (Russia), Blackrock Emerging Europe PlC (London, LSE listed investment trust), and Komercijalna Banka AD (Serbia). Prior to that, Mr. Delpal founded Cetelem Russia in 2006 and served as its CEO from 2006 until 2010. Mr. Delpal was CEO of Rusfinance Bank (Société Générale Group) from 2004 to 2006. In addition, Mr. Delpal has over eight years of experience as an auditor at Société Générale. He graduated from the Telecom Paris Tech with a degree in IT, Telecoms and Economics. He has been living in Russia since 2004.

## ❼ Mr. Gary S. Yamamoto

Member of the Board of Directors
Chair of the Remuneration Committee
Independent Director

Mr. Yamamoto was appointed as an independent non-executive member of the Board of Directors and Chair of the Remuneration Committee in December 2010. Prior to joining the Group, he served as Chief Executive Officer at Borets International in 2009. Mr. Yamamoto has served as the President of Yamamoto Consulting since 2008. He served as a member of the Board of Directors at Radius Servis from 2007 to 2008. Prior to this, Mr. Yamamoto enjoyed a 20-year career with Schlumberger Limited and served as Vice President of Schlumberger Russia from 2003 to 2008. Mr. Yamamoto has more than 20 years of management experience. He graduated from the University of California, Berkeley, with a degree in engineering in 1988. Mr. Yamamoto is a member of the Society of Petroleum Engineers and the Independent Directors Association.

## ❽ Mr. Andreas S. Petrou

Member of the Board of Directors
Non-Executive Director

Mr. Petrou was appointed as a non-executive member of the Board of Directors in June 2010. From 1989 to 1998, Mr. Petrou served as a member of the Board of The Cyprus Tourism Development Public Company Ltd, representing the interests of the Government of the Republic of Cyprus. From 1987 to 1990, Mr. Petrou served as the General Secretary of Cyprus Dairy Organisation. In 1986, Mr. Petrou established his own law firm. He is an honours graduate of the Law School of Democrious University of Thrace. Mr. Petrou has been a member of the Cyprus Bar Association since 1985.

## Principal Activities of the Board of Directors in 2016

The Board of Directors held six meetings in 2016, all of which occurred in Cyprus. During the course of the year, the Board of Directors continued working on the development of the Company's mid-term and long-term financial and business strategy, including investment plans, M&A activities, budgeting, long-term incentive program for the management of the Company and general corporate development. In addition, the Board of Directors appointed Mr. Vladimir V. Lukyanenko as a non-executive director of the Company to serve until the next General Meeting. Mr. Vladimir V. Lukyanenko was also elected as a member of the Remuneration Committee, the Audit Committee and the Strategy and Investments Committee. In December 2016, the Board of Directors approved the payment of an interim dividend to the shareholders of the Company.

At its meetings, the Board of Directors also reviewed other issues connected with the activities of the Company that are within its remit, including the approval of corporate reports.

## The Board of Directors Committees

There are three Committees of the Board of Directors: the Audit Committee, the Remuneration Committee, and the Strategy and Investments Committee. Each Committee has its own internal terms of reference which set forth its duties and responsibilities, as well as qualifications for Committee membership, procedures for Committee member appointment and removal, Committee structure and operations and reporting lines to the Board of Directors. A brief description of the main activities of these Committees in 2016 is set out below.

### AUDIT COMMITTEE

#### General Overview

The Audit Committee comprises three independent Directors and is expected to meet three to four times per year. Currently, the Audit Committee is chaired by Mr. Philippe Delpal; its other members are Mr. Gary S. Yamamoto and Mr. Vladimir V. Lukyanenko.

The Audit Committee is responsible for considering, amongst other matters: (i) the integrity of the Group's financial statements, including its annual and interim financial statements; (ii) the effectiveness of the Group's internal controls and risk management systems; (iii) auditors' reports on the Group; and (iv) the terms of appointment and remuneration of the auditors of the Group.

The Audit Committee supervises, monitors, and advises the Board of Directors on risk management, control systems, and the implementation of codes of conduct. The Audit Committee also supervises the Group's submission of financial information and a number of other audit-related issues, and assesses the efficiency of the work of the Chair of the Board of Directors.

#### Activities in 2016

Three meetings of the Audit Committee were held in 2016. The main issues that the Audit Committee oversaw during the year were the preliminary review of IFRS financial statements and internal control and risk management (including the audit plan).

The Audit Committee also supervised the internal and external audit procedures, and the implementation of the annual tax strategy within the course of the year. The Audit Committee also made recommendations to the Board of Directors with regards to internal control efficiency and interim dividend distribution.

### REMUNERATION COMMITTEE

#### General Overview

The Remuneration Committee comprises four Directors and is expected to meet at least once per year. Currently, the Remuneration Committee is chaired by Mr. Gary S. Yamamoto; its other members are Mr. Nikolay N. Yamburenko, Mr. Philippe Delpal and Mr. Vladimir V. Lukyanenko. The Remuneration Committee is responsible for, amongst other matters, determining and reviewing the Group's remuneration policies. The remuneration of independent Directors is a matter for the Chair of the Board of Directors and the Executive Directors. No Director or manager may be involved in any decisions regarding their own remuneration.

#### Activities in 2016

Two meetings of the Remuneration Committee were held in 2016. The main matter reviewed by the Remuneration Committee was the Group's Long-Term Incentive Program. Ernst & Young were engaged in developing the Long-Term Incentive Program.

The Remuneration Committee adopted decisions and made recommendations to the Board of Directors regarding the Long-Term Incentive Program, in accordance with international best practice.

## EXTERNAL AUDIT OF FINANCIAL STATEMENTS

Every year the Company/Group appoints an external auditor who is responsible for the auditing and inspection of the consolidated financial statements of the Company/Group in compliance with IFRS. The external auditor also prepares reviews of the consolidated interim financial information of the Company/Group in compliance with IFRS requirements. The external auditor of the Company/Group is selected from leading audit firms after a thorough review of their respective proposals. Following the review, the Audit Committee gives its recommendations to the Board of Directors regarding the candidacy of the external auditor and the level of the auditor's compensation and advises the Board of Directors on other terms and conditions of the contract with the auditor. In 2016, based on the recommendation of the Audit Committee, the Board of Directors selected Deloitte (Cyprus) to conduct the audit of the financial statements of the Company/Group for the year ending 31 December 2015. Deloitte remains appointed for the 2016 audit.

## STRATEGY AND INVESTMENTS COMMITTEE

### General Overview

The Strategy and Investments Committee comprises four directors, one of whom is independent. The Committee is expected to meet at least once each year. Currently, the Strategy and Investments Committee is chaired by Mr. Nikolay N. Yamburenko and the other members are Mr. Gary S. Yamamoto, Mr. Yury N. Skrynnik and Mr. Vladimir V. Lukyanenko.

The Strategy and Investments Committee is responsible for considering, amongst other matters: (i) strategic business combinations; (ii) acquisitions, mergers, disposals and similar strategic transactions involving the Company; and (iii) fundamental investments of the Company.

### Activities in 2016

Two meetings of the Strategy and Investments Committee were held in 2016. The main matter reviewed by the Committee was the Group Strategy up to 2022.

## DIRECTORS' COMPENSATION

The total compensation of the Chairman of the Board was Euro 270,115 for the year ended 31 December 2016.

The total compensation of the independent Directors, as set out in the Group's consolidated statement of profit or loss and other comprehensive income, was Euro 235,000 for the year ended 31 December 2016.

## Litigations involving the Company

*Grigorishin Litigation*. In February 2014, the Company was served in Cyprus with an interim order of the District Court of Nicosia (the "Order"). The Order was obtained by Konstantin Grigorishin and certain other plaintiffs against a number of defendants, including the Company, certain of its shareholders and directors, and Bank of New York (Nominees) Limited. Among other things, the Order froze property of most of the defendants, including the Company, but excluding Bank of New York (Nominees) Limited and two other defendants, for an amount up to EUR 400 million.

In April 2014, following prior written and oral submissions against the Order by the Company and several other defendants, the District Court of Nicosia discharged the Order in full, including in respect of the Company and its shareholders and directors. As far as the Company is aware, since then the plaintiffs have taken no substantive steps to proceed with their action against the Company or its directors.

The Company strongly rejects the plaintiffs' claims and allegations against the Company as groundless. The Company will continue to defend vigorously its position in these pending legal proceedings.

*Tsoy Litigation*. In late June 2014, the Company's shareholder, German Tsoy, and his holding company, Acura Global Limited (BVI), launched an action in the District Court of Nicosia against a number of defendants, including certain other shareholders and certain directors of the Company. The plaintiffs have initiated this litigation purportedly as a derivative action seeking damages "for the benefit of" of the Company "and/or" its majority shareholder, H.M.S. Technologies Limited. As such, no claims have been asserted directly against the Company by the plaintiffs.

The Company's non-defendant directors, who made up the majority of the Company's Board of Directors, carefully considered the plaintiffs' claims and allegations, obtained legal advice from the Company's lawyers, and unanimously concluded that the plaintiffs' allegations were entirely meritless.

In June 2016, the plaintiffs completely and unreservedly withdrew their action and made a declaration that they have no claim against any of the defendants to the above action. This withdrawal was not a result of any settlement agreement, and the Company was not required to pay anything to the plaintiffs in connection with this withdrawal of claims.

# RISK MANAGEMENT AND INTERNAL CONTROL

## Overview

The Group is exposed to various risks and uncertainties that may have undesirable financial or reputational implications. In order to minimize the negative impact of such risks and to benefit from available opportunities, a risk management and internal control system has been integrated into the Group's operations.

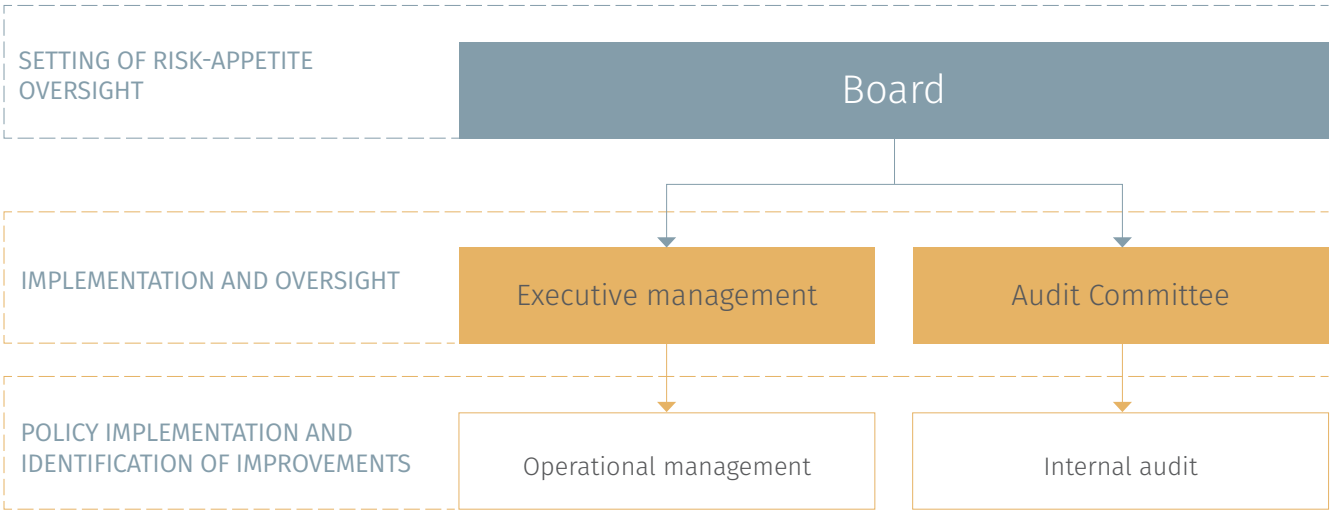
The overall objective of this system is to obtain reasonable assurance that the Group's goals and objectives will be achieved.

The main principle in the design and maintenance of such systems is that the expected benefits should outweigh the associated costs.

## Key features of the Group's internal control system over financial reporting

The Group uses a formal risk management program across its companies; there is an ongoing process for identifying, evaluating and managing the significant risks faced by the company. Risks are classified according to their likelihood and significance; different strategies are used to manage identified risks. This process is regularly reviewed by the Board in accordance with applicable guidance.

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. This system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.




Internal control and risk management monitoring is performed through internal and external assurance providers, which include:

- Financial statement audits performed by external auditors. Discussion by the Audit Committee of the results of the audit, including a review of the financial performance, any changes to disclosure, a subsequent events review, important accounting matters and other internal control matters
- Review and formal approval of the financial results by the CEO, CFO, Audit Committee and the Board
- Board and sub-committee approval and monitoring of operating, financial and other plans
- Consolidation and verification of correct identification and proper assessment of critical business risks. The Audit Committee reviews changes to the risk profiles together with progress on actions for key risks on a regular basis
- Internal audit function. The Head of Internal Audit functionally reports to the Audit Committee and administratively to the First Deputy CEO. The internal audit department performs its activities in accordance with an audit plan and incorporates review of material controls, including financial, compliance and operational controls. The results of each audit are discussed in detail with the companies and business units concerned and action plans are agreed upon.

## Continuous improvement

HMS Group's goal is to continuously improve its governance and risk management sub-systems. We assess the findings of audits and internal investigations and use them to adjust our internal processes and procedures.

The key features of the risk management process include:

- The gathering and analysis of information related to internal and external factors which can negatively impact the achievement of the Group's objectives
- The identification of the possible level of negative impact of various events on operational and financial results in accordance with applicable risk-assessment methods
- Setting appropriate risk-tolerance levels
- Ranking risks according to their significance and probability
- Making appropriate decisions to manage identified risks
- Actively monitoring the steps taken to control the most significant risks.

## Principal risks and uncertainties

The relationship between the main categories of the risks we encounter and how they affect our strategy is shown in the table below.

| Risk\Strategy | Enhancing margins | Driving growth | Generating cash | Maximising returns | Securing customers | Securing longterm suppliers |
|---|---|---|---|---|---|---|
| Global politician and economic risks | ▪ | ▪ | ▪ | ▪ | | |
| Sales | ▪ | ▪ | ▪ | ▪ | | |
| Project execution risks | ▪ | ▪ | ▪ | ▪ | ▪ | ▪ |
| Human Capital | ▪ | ▪ | ▪ | ▪ | | |
| Acquisitions and disposals | ▪ | ▪ | ▪ | ▪ | | |
| Fraud and corruption risks | ▪ | ▪ | ▪ | ▪ | ▪ | ▪ |
| Technology | | ▪ | | | | |
| Legislation and regulations | ▪ | ▪ | ▪ | ▪ | | |
| Product liability and litigation | ▪ | ▪ | ▪ | | ▪ | ▪ |
| Financial risks | ▪ | ▪ | ▪ | ▪ | | |

# RISK MANAGEMENT AND INTERNAL CONTROL (CONTINUE)



Below is a summary of the principal risks facing the Group's business. The Group also faces other risks both known and unknown; some of them apply to similar companies operating in both the Russian and international markets.

## Global political and economic risks

The Group may be exposed to various political, economic and other risks not only in the countries where it has primary production facilities (Russia, Ukraine, Belarus, Germany) but also in jurisdictions where the Group has other interests (e.g. EPC projects in the Middle East and Central Asia). The Group has not to date been significantly affected by the recent developments in Ukraine but, in the event of a deterioration of that country's situation, the Group's operations in Ukraine (including export of production to Russia which is significant part of the Group's integrated solutions), as well as its financial position, could be affected, and the extent of this impact is difficult to predict.

The introduction of new regulations or the imposition of trade barriers or international sanctions could disrupt the Group's business activities or impact on the Group's customers, suppliers or other parties with which it does business. In some instances, this could have an adverse, material effect on the Group's financial position and prospects.

## Sales

The Group's business depends on the levels of capital investment and maintenance expenditures by the Group's customers, which in turn are affected by numerous factors, including the state of the Russian economy and those of other nations, fluctuations in the price of oil, taxation of the Russian oil and gas industry, availability and cost of financing, and state investment and other support for the Group's customers or in state-sponsored infrastructure projects.

The Group's business depends on the award of contracts and renewals and extensions of existing contracts; moreover, the Group relies on a limited number of key customers and contracts and may incur losses due to unfavourable terms of contracts with certain large customers.

## Project execution risks

Since the Group's contracts are typically on a fixed-price basis, there are risks associated with cost overruns (especially in the EPC segment). The Group seeks to mitigate these risks through its efforts to improve profitability and cost control, in part relying on volume growth and an increasing share of high-margin integrated solutions services.

## Human Capital

The ability to achieve the Group's strategic goals highly depends on our most important asset — our people. We develop and remunerate our employees using leading HR practices. In line with Group's growth strategy, we aim to attract talented employees from the market and continuously improve our recruitment methods.

The success of the Group's businesses depends heavily on the continued service of its key senior managers. These individuals possess industry-specific skills in the areas of sales and marketing, engineering and manufacturing that are critical to the growth and operation of the Group's businesses. While the Group has entered into employment contracts with its senior managers, the retention of their services cannot be guaranteed. The Group is not insured against damages that may be incurred in the case of loss or dismissal of its key specialists or managers. Moreover, the Group may be unable to attract and retain qualified personnel to succeed such managers. If the Group suffers anxextended interruption in its services due to the loss of one or more such managers, its business, financial condition, results of operations, prospects may be adversely and materially affected.

## Acquisitions

The Group cannot be certain that the anticipated cash flows, synergies and cost savings from acquisitions or other transactions will materialize or reach expected levels. Inefficient integration of the newly acquired businesses poses a risk to the Group's operations. Any failure to integrate the operations of the Group's companies successfully could adversely affect the Group's business and financial condition and the results of operations.

Since its formation in 1993, the Group has completed a number of acquisitions involving the purchase of industrial pumps, modular equipment manufacturing and EPC services companies and the Group expects to make additional acquisitions in the future. The integration of these and future acquisitions into the Group's operations poses significant management, administrative and financial challenges.

The integration process may result in unforeseen difficulties and could require significant time and attention from management that would otherwise be directed at developing the Group's existing business.

## Fraud and corruption risks

Fraud and corruption are pervasive and inherent risks of all business operations. There is always some potential for fraud and other dishonest activity at all levels of a business, from that of a factory worker to senior management. Efficient operations and optimal use of resources depends on our ability to prevent occurrences of fraud and corruption at all levels within the Group.

HMS Group promotes ethical behaviour among its employees and maintains dedicated violation reporting channels to raise concerns within the Group through an ethics hotline available 24/7. The Group's internal audit and/or security department perform investigations into alleged fraud and misconduct cases. If necessary, the results of such investigations are provided to the CEO, the Board, the management and Audit Committee, as necessary.

As the Group operates in a number of jurisdictions around the world, the Board and senior management also put a strong emphasis on corporate compliance with applicable regulation, including anti-bribery and anti-corruption legislation, such as the UK Bribery Act.

The Group has implemented procedures to ensure that all employees are aware of the requirements of the Group's anticorruption policies, with a particular focus on those roles most exposed to the risk of breach.

## Legislation and regulations

Recent Russian government initiatives included significant amendments to tax law governing operations with entities incorporated in offshore jurisdictions. As a company with a majority of its operating assets located in Russia, HMS Group recognizes that these developments may have significant implications for its business and development plans. HMS Group continues to monitor these developments.

# HMS GDR

As of December 31, 2016, HMS Hydraulic Machines & Systems Group Plc had an issued share capital of Euro 1,171,634.27 divided into 117,163,427 ordinary shares with par value of Euro 0.01 per share, and these shares are not traded.

In February 2011, the company signed a depositary agreement with The Bank of New York Mellon (BNY Mellon), under which the issue of Global Depositary receipts (GDRs) for HMS Group shares was initiated.

As of December 31, 2016, the total number of GDRs issued in exchange for shares of HMS Group amounted to 9,600,800 GDRs or approximately 41% of the Company's issued share capital.

Since February 8, 2016, the ratio of the company's GDRs program was changed:

- **Old ratio:** 1 GDR equals 1 Ordinary share
- **New ratio:** 1 GDR equals 5 Ordinary shares

For every 5 GDRs held by holders, they received 1 "new" GDR in return. The issued number of ordinary shares and their nominal value remained unchanged. And currently, there are 9,600,800 depositary receipts outstanding in the GDR program.

According to the terms of the amended deposit agreement with BNY Mellon, the annual depositary fee will equal US$ 0.01 per "new" GDR instead of the current US$ 0.03 per "old" GDR, implying a fifteen-fold decrease in such fees.

| HMS Group Plc GDR Details | |
|---|---|
| Ticker | HMSG |
| CUSIP | RegS: 40425X407<br>144A: 40425X308 |
| Exchange | London Stock Exchange |
| ISIN | RegS: US40425X4079<br>144A: US40425X3089 |
| Ratio, GDR : common shares | 1:15 |
| Effective Date | Feb 11, 2011 |
| Underlying ISIN | CY0104230913 |
| Depositary bank | BNY Melon |

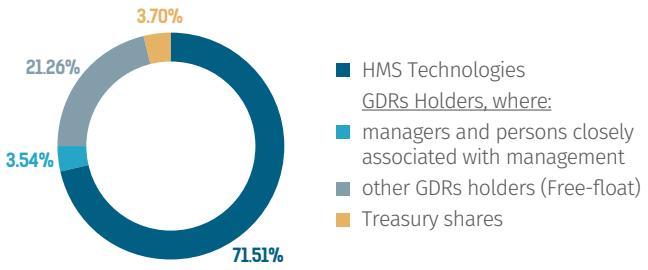
**Information on HMS Group Plc GDRs**
$

Price of HMS Group's GDRs (rebased to 1:5 ratio)

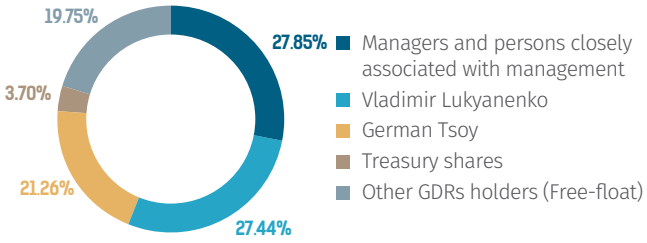
| | Min | Max | At the end of the period |
|---|---|---|---|
| 2011 | 19.90 | 41.21 | 22.05 |
| 2012 | 19.50 | 29.90 | 21.10 |
| 2013 | 10.50 | 21.15 | 12.50 |
| 2014 | 1.30 | 12.50 | 1.30 |
| 2015 | 1.30 | 4.50 | 2.76 |
| **2016** | | | |
| 1Q 2016 | 2.05 | 2.85 | 2.85 |
| 2Q 2016 | 2.85 | 5.00 | 4.05 |
| 3Q 2016 | 4.05 | 5.60 | 5.49 |
| 4Q 2016 | 5.60 | 8.01 | 7.46 |

# Major shareholders of HMS Group as of December 31, 2016

**Shareholding structure by legal entities,** %




**Shareholding structure by holders (effective share),** %



# SHAREHOLDER'S INFO & DISCLAIMER

| Information | |
|---|---|
| Company Name | HMS Hydraulic Machines & Systems Group Plc |
| Company Type | Public |
| Fiscal Year-End | December 31 |
| Disclosure | LSE |
| Managing Director (CEO) | Artem Molchanov |
| First Deputy CEO (CFO) | Kirill Molchanov |

## GDRS HOLDERS' CONTACTS

**Contacts for inquiries regarding:**

- advise of a change of name and/or address;
- report lost/stolen GDR share certificates or the non-receipt of a dividend check;
- request an election form for the scrip dividend program;
- request forms to transfer GDRs;
- report the death of a registered holder of GDR shares;
- request a duplicate account statement;
- have dividends electronically deposited to your bank account;
- consolidate similar account registrations;
- request general information about your shareholder
- account, etc

The Bank of New York Mellon
BNY Mellon Shareowner Services
PO Box 358516
Address: Pittsburgh, PA 15252-8516, USA
Tel: +1 888 737 2377 (USA only)
Tel: +1 201 680 6825 (International)
Email: shrrelations@bnymellon.com
Website: www.bnymellon.com

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Fax: +7 495 730 6602
Email: ir@hms.ru
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# Disclaimer

This document contains forward-looking statements that reflect management's current views with respect to future events. Such statements are subject to risks and uncertainties that are beyond HMS Group's ability to control or estimate precisely, such as future market and economic conditions, the behavior of other market participants, the ability to successfully integrate acquired businesses and achieve anticipated synergies and the actions of government regulators. If any of these or other risks and uncertainties occur, or if the assumptions underlying any of these statements prove incorrect, then actual results may be materially different from those expressed or implied by such statements. HMS Group does not intend or assume any obligation to update any forward-looking statements to reflect events or circumstances after the date of these materials.

This annual report does not constitute an invitation to invest in HMS Group GDRs. Any decisions you make in reliance on this information are solely your responsibility. The information is given as of the dates specified, and we undertake no obligation to update it save as required by applicable law. HMS Group accepts no responsibility for any information on other websites that may be accessed from the company's website by hyperlinks