

# 'RYE, MAN & GOR Securities'

## Russian Market Weekly Report # 118 February 28th, 1997

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### Political News

On February 21 **Russian President Boris Yeltsin met with U.S. Secretary of State Madeleine Albright** in the Kremlin. According to Albright, the meeting mostly concerned economic, arms control and strategic issues, as well as the issue of NATO eastward expansion. U.S. Secretary of State described the talks as a "serious and constructive exchange" contributing to development of a NATO-Russia agreement on the alliance enlargement.

On February 24 **Boris Yeltsin** met with the new chairman of the Constitutional Court Marat Baglai. During the meeting, briefly shown on television, the president announced he would not authorise any **amendments to the Constitution**, as "society is not ready for it".

During the meeting with Prime Minister Victor Chernomyrdin, nationally televised, **Boris Yeltsin**

publicly expressed his **disappointment with the work of his top officials**, and accused Chernomyrdin of failing to settle problems in the public sector, such as wage arrears. In addition, the president asked **Victor Chernomyrdin to re-organise the cabinet**. On February 25 Chernomyrdin confirmed that his cabinet would be re-arranged, and promised the changes would be more than "cosmetic". The above caused speculations in the Russian media that the first candidates to be dismissed are the Premier Minister himself and the Defence Minister Igor Rodionov, whom Boris Yeltsin publicly accused of "whining" over the situation in the armed forces. According to the president's press-secretary Sergei Yastrzhembsky, there was no mention of the Prime Minister's dismissal during the meeting. Anatoly Chubais, current chief of staff, is believed to be Chernomyrdin's most likely successor.

### Economic News

On February, 26 **Boris Yeltsin signed into law the 1997 federal budget**. The budget foresees a **deficit** of 95.4 trillion rubbles ( \$17 billion) or 3.5% of GDP on **revenues** of 434.3 trillion rubbles (\$77 billion) equal to 15.9% of GDP, and **spending** of 529.8 trillion rubbles (\$94 billion) or 19.4% of GDP. **Annual inflation** is 12% per year, down from the previous year's 22%, while **GDP growth** is projected at 1%. The budget was earlier passed by the State Duma on January 24, and by the Federation Council on February 12. The 1997 federal budget will come into effect after has been officially published.

On February 21 an **IMF mission left Moscow**. No decision, concerning the release of the January instalments of the \$10 billion loan was made. According to IMF Moscow representative Martin Gilman, quoted by Reuters, the Fund mission "is not yet in a position to recommend the release of the latest tranche". According to Finance Ministry officials, the decision will mostly depend on January figures. Another important point here is the difference between 1997 projected revenues offered by Russian government, and those proposed by the IMF. Figures provided by the 1997 federal budget are considered unrealistic, and the decision on the loan is likely to depend on whether the IMF will agree to more realistic figures, offered by the government. So far the IMF representatives found January revenues and tax collection performance rather poor, and the

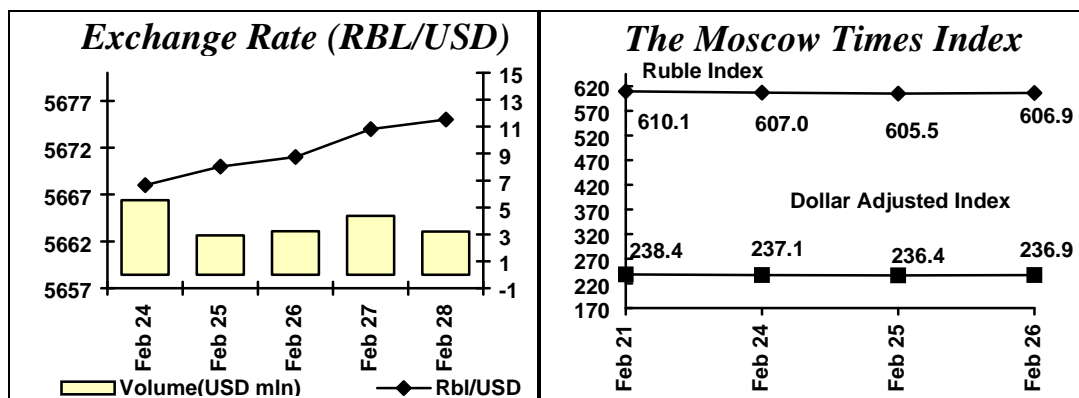
assessments necessary for disbursement of a \$320 million tranche of the loan are not yet finished. Interfax reported Martin Gilman as saying that Russia and the IMF will be able to complete a **1997 financial and economic program for the 3-year Extended Fund Facility** "within 7 to 10 days of the 1997 budget coming into effect".

According to **Russian State Tax Service**, tax revenues within the first 20 days of February totalled 5.2 trillion rubbles, which is 45% above January figures, but still below targets, set by the IMF. As of February 1, 1997 The Russian **government** was **owed a total of 33.4 trillion rubbles (\$5.9 billion)** in taxes by 90 companies. The biggest tax debtors were: **Avtovaz** (2.8 trillion rubbles), **Yuganskneftegaz** (1.9 trillion rubbles), and **Noyabrskneftegaz** (1.5 trillion rubbles).

On February 21 the State Duma approved in the first reading a **package of amendments to the existing law on foreign investments**, which will limit foreign investments in basic sectors such as telecommunications and power production. Before becoming a law, the amendments must be passed in two more readings by the Duma, then adopted by the Federation Council, and then signed by President Boris Yeltsin.

The Central Bank's current policy on the government securities market is to issue stable securities with longer maturities, rather than speculative short-term T-bills. Thus, at a primary auction, held on February 19, tranches of 4-month and

8-month T-Bills were auctioned. Annual yields were 30.13% and 30.71% respectively. At Treasury-bills primary auction, held on February 26, annual yields on the 2nd tranche of 1-year T-bills were 31.01%, and yields on 3-month T-bills were 28.99%.



### Company news

On February 21, **Regent Gaz Investment Company** announced it would stop proceeding with its mutual fund backed by Gazprom domestic shares following statements, issued by Gazprom on the previous week. According to a statement made by Sophia Shaw, director of the Regent Gaz Investment Company and Regent Fund Management Ltd., the scheme itself was "appropriate and legal", but it was "inadvisable" to invest in the company because of "the stated position of Gazprom". Shareholders in the Fund will be able to redeem their holdings. In an interview with the "Wall Street Journal" Gazprom president Rem Vyakhirev said the company violated Gazprom's "procedure for the sale of shares and accordingly decreased the value of the company". On the other hand in the same interview he admitted that according to the company's Charter, amended in June, 1997, Russia registered subsidiaries of foreign companies have the right to buy its domestic shares, but shares can be traded only in Russian, and only profits from the purchase can be transferred to outside investors, but not the shares.

On February 27, **Gazprom** announced it is trying to acquire 25% plus one share of **RAO Unified Energy Systems**, currently held by the government. The above stake is enough for seats on the board of directors and control changes to the company's corporate Charter. According to the Gazprom's president Rem Vyakhirev, the scheme aims to "force restructuring of the company" and thus restructuring of the power industry, as UES now accounts for four-fifths of Russian's electricity. Moreover, UES is one of Gazprom's major debtors. Its current debt to Gazprom reportedly totals 20 trillion rubbles (\$3.5 billion), while the UES's regional "energo" utilities owe creditors

some 50 trillion rubbles. On the other hand, according to Vyakhirev, interviewed by the "Wall Street Journal", Gazprom's accounts receivable amount to \$11 billion, and its debt to the government is about \$2.65 billion. The 25% stake would enable Gazprom to force UES to re-pay its debts. In response to Gazprom's announcement UES officials said the purchase of a 25% stake contradicts Russian anti-monopoly legislation. But a very important point here is that Gazprom is rather closely linked with the government. (The present Prime Minister Victor Chernomyrdin is its former director, while the current energy minister is another former executive). Moreover, the company's president told the "Wall Street Journal" that he has the power to turn off gas supply to the former Soviet republics without consulting the government. Gazprom controls a 8.5% stake in UES, auctioned in January, 1996, and acquired by a consortium of Russian banks, headed by the National Reserves Bank, the company's domestic bank. Currently Gazprom controls one-third of the world's known gas reserves.

On February 25 a **40.12% stake in Surgutneftegaz Oil Company**, put up for an investment tender, was acquired by a "dark horse" **Surgutfondinvest**. The stake was bought for 415 billion rubbles (\$73.5 million), which is only 5 billion rubbles above the initial price. Under the terms of the tender, Surgutfondinvest will have to invest in the company another 1.2 trillion rubbles more, as well as to transfer a 5% stake in Surgutneftegas, JSC, Surgutneftegas Holding's subsidiary, to the Surgutneftegas Oil Company. Surgutfondinvest is a pension fund manager, that is believed to be related to Surgutneftegas.

According to the results of a reserves audit, carried out by U.S. engineers **Miller & Lents**, **LUKoil** total

**proven oil and gas reserves in Russia** amount to 10.7 billion barrels of oil, as compared with 10.5 billion barrels in 1996. As of January 1, 1997 oil reserves of LUKoil's subsidiaries LUKoil-Permneft, LUKoil-Nyzhnevzhskneft, LUKoil-Kaliningradmorneft, and LUKoil-Astrakhanneft, located in the European part of Russia, totalled 3180.2 million barrels with proven oil reserves totalling 2850 million barrels (90% of the entire amount) and gas reserves of 1087.8 billion cubic pounds. Based on the company's 1996 annual production rate of some 58 million metric tons, LUKoil total reserves stand at 26 years-worth of output.

**U**nder the **privatisation scheme for the oil company Rosneft**, approved by the Russian State Property Committee, the government will retain a 51% stake in the company for 3 years. 25% of Rosneft shares will be offered to employees. However, under Russian legislation, an employee can buy shares in a privatised company worth only 20 minimal wages, meaning that some 800 employees will be able to acquire only about 2% of Rosneft shares.

**T**he **joint management of the Menatep holding company and Yukos** will be **headed by Rosprom, president Mikhail Khodorkovsky**. Rosprom is Menatep's industrial holding. Yukos Vice President Leonid Nevzlin has been appointed as first deputy chief executive, while Yukos first vice-presidents Victor Ivanenko and Victor Kazakov will serve as deputy chief executives. Rosprom consultant at Yukos Andrei Rappoport will be appointed as Rosprom first vice-president, according to Rosprom officials cited by Interfax.

**C**hernogorneft reported **financial figures for 1996**. The company's net profits totalled 215.9 billion rubbles (\$42.2 million). Pre-tax profits amounted to 311.8 billion rubbles (\$60.9 million), while operating profits were 366.5 billion rubbles (\$71.6 million).

**S**lavneft-Megionneftegaz extracted 12.47 million tons of oil in 1996, as compared with the previous year's 12.84 million tons of oil. 1997 production volume is projected to decline to 11.95 million tons. The company's board of directors declared results for 1996 were satisfactory.

**L**UKoil-Permneft extracted in January, 1997 some 25 thousand tons of oil, 8% above the projected level.

**A**ccording to preliminary data, **Kirovenergo net profits in 1996** will total 30 billion rubbles, while the company needs some 100 billion rubbles per year to finance its investment projects, the company's representatives reported.

**U**ralsvyazinform, located in the Perm region, reported **financial results for 1996**. The company's gross profits totalled 595 billion rubles, while pre-tax profits were 148 billion rubles. Both figures are slightly below the targets. The company announced that it is going to issue its 1-level ADRs in March 1997. Underlying shares for the issue will include 2% of the company's Charter Capital, acquired from employees. Uralsvyazinform Charter Capital totals 912,097 million rubles. In 1996 the company installed 56.5 thousand access lines. The amount of cellular subscribers increased by 6.1 thousand, while that of paging subscribers went up by 1.73 thousand. In total, the company spent 135.5 billion rubles on the development of its communication network.

**E**lectrosvyaz, located in Rostov region, announced **preliminary figures for 1996**. The company's pre-tax profits totalled 65 billion rubles, down from 77 billion rubles in 1995. Sales proceeds amounted to 540 billion rubles, as compared with the previous year's 331 billion rubles.

**D**ue to an appeal by **Rosgosstrakh** depositors and policyholders, **privatisation of the company will be delayed** for one month. In early February a union of the company's investors appealed to the court to hold the privatisation on the grounds that some 18 trillion rubbles (\$3.1 billion) in savings were lost due to inflation. The deal will be considered by the court on March, 25. According to Rosgosstrakh press-secretary Irina Aristova, depreciation of savings is an internal federal debt not related to the company. According to Rosgosstrakh officials, the postponement will not affect the entire process of privatisation, that will be resumed in September, 1997. (For information on privatisation terms see RMG Weekly #116.)

### *Analytical section*

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## ***Russia's Unified Energy System - Still a force to be reckoned with***

**R**ussia's national power company UES came into the media spotlight once more this week, when Rem Vyakhirev, the chairman of gas monopolist Gazprom, said his company is mounting a bid for a 25.1% stake in the giant utility. But the announced bid

is unlikely to have a negative effect on UES, since the power utility is in a position to either defeat the challenge or cut a favourable deal with Gazprom that already controls up to 8.5% of UES stock through its National Reserve Bank. UES shot back

immediately on Thursday, after Vyakhirev had announced his intentions, ruling out a transfer of part of the government's controlling stake to Gazprom and "inviting" the gas giant to buy the shares on the market.

That would certainly be an expensive affair for Gazprom - UES's market capitalisation tripled from \$3.5 to \$10 billion between December and February - and a large-scale buying spree on the part of Gazprom would obviously drive the value of the shares further up. Moreover, it is highly unlikely that this could be carried out in practice given the actual distribution of the shares.

AUES official told RMG this week that foreign investors now hold 27% of UES stock, while the government retains some 52%. The remaining shares are held by Russian individuals and legal entities - including Gazprom itself.

There are good reasons to assume that UES can successfully keep Gazprom at bay, at least in the short-term. It seems to have fought off - or delayed - another challenge, from the country's Economics Ministry that called for a separation of UES's Central Dispatch Department (CDD) from the mother company. The CDD operates Russia's wholesale electricity market, but is hardly a major profit grosser for UES: it accounts for some 11% of UES consolidated revenues, but its profit margin is below that of UES.

Still, the Gazprom bid points to UES's main achilles heel - its huge debts. UES has an estimated 20 trillion rubbles (\$3.5 billion) in debts to Gazprom. The total outstanding debts of regional energos - in which UES holds controlling or near-controlling stakes - run as high as 50 trillion rubbles (\$8.8 billion). UES for its part is also a major victim of

the country's non-payments crisis. Currently it is receiving less than 10% of consumer payments in cash, with the rest in barter or different types of securities.

On its own the cash-strapped company will find it next to impossible to raise the \$4-6 billion in annual investments needed to upgrade Russia's power stations and electricity grid. UES is planning investments of 8.5 trillion rubbles (\$1.5 billion) drawn from its own resources this year, but it is also eyeing the international capital markets. No go-ahead has yet been given to its long-awaited ADR program, but the company is currently involved in talks with international credit rating agencies concerning a rating that could pave the way for a Eurobond later this year.

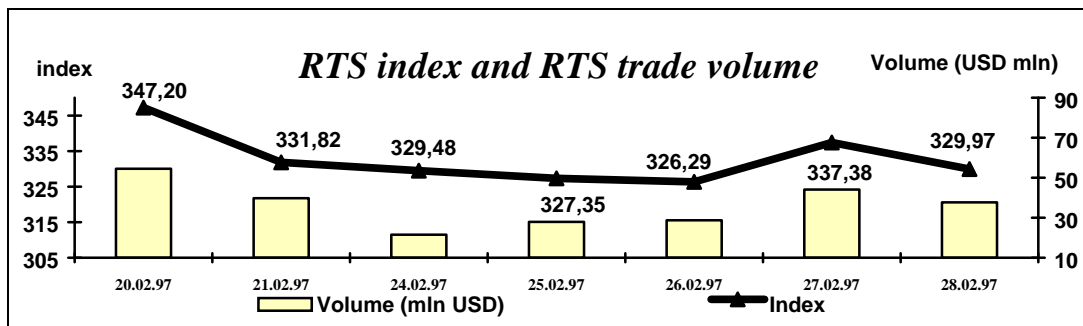
Although we doubt the acquisition will take place, Gazprom control over a major stake in UES need not be bad news for shareholders. A lasting settlement of the issue of its energy debts would help ease UES's cash flow problems and allow it to plough ahead with restructuring of the power industry.

It is clear that UES needs strong political backing to pull off a number of measures to broaden its revenue base - including a re-structuring of the system of Russian electricity tariffs - also in this respect Gazprom could prove helpful.

Despite the political uncertainty surrounding UES and its serious non-payments problems we believe that it remains a company with considerable potential in both the short- and medium- to long-term.

Rye, Man & Gor Securities will release an updated report on UES on March 4.

RMG Research



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## Equities

February, 28

COMPANY	BID (USD)	OFFER (USD)	One Day Change* %	Market Cap (USD)**	P/E Ratio	Dividend yield
<i>Oil and Gas</i>						
<i>Chernogoneft</i>	12,25	13,50	0,00	344 682 033	11,12	
<i>Komineft</i>	2,60	3,35	3,48	129 766 180	neg.	
<i>Kondpetroleum</i>	1,70	2,24	6,49	74 627 520	neg.	
<i>LUKoil Holding</i>	14,81	15,00	-1,68	10 456 829 961	20,77	0,266
<i>LUKoil Holding (preferred shares)</i>	11,85	12,00	-2,05			0,832
<i>Megionneftegas</i>	6,36	6,45	-2,21	792 833 367	6,00	
<i>Megionneftegas (preferred shares)</i>	4,52	4,90	-2,38			2,541
<i>Nizhnevartovskneftegas</i>	7,20	8,90	2,55	109 981 483		
<i>Noyabrskneftegas</i>	9,60	10,55	6,61	718 195 844	23,64	
<i>Noyabrskneftegas (preferred shares)</i>	6,20	6,50	5,39			2,033
<i>Orenburgneft</i>	5,90	6,30	0,00	402 969 813	5,51	0,134
<i>Purneftenegas</i>	4,14	4,35	-0,82	435 162 751	8,14	
<i>Purneftenegas (preferred shares)</i>	2,80	2,99	-0,52	****		5,831
<i>Tatneft</i>	73,00	77,00	1,49	1 308 487 050	3,70	1,378
<i>Sakhalinmorneftegas</i>	2,60	2,95	-0,89	169 857 994	9,93	
<i>Surgutneftegas</i>	0,821	0,832	2,99	4 155 564 864	10,56	0,835
<i>Surgutneftegas (preferred shares)</i>	0,580	0,588	1,04			4,418
<i>Tomskneft</i>	7,25	7,89	3,70	315 337 364	21,04	
<i>Tomskneft (preferred shares)</i>	5,10	5,50	1,92			2,045
<i>Varieganneftegas</i>	3,60	5,00	-9,47	77 791 773	neg.	
<i>Yuganskneftegas</i>	14,12	14,40	0,11	694 170 472	6,13	
<i>Yuganskneftegas (preferred shares)</i>	9,05	9,45	0,54			2,721
<i>Metals</i>						
<i>Seversky Tube Works</i>	1,70	2,30	0,00	96 258 000	2,89	0,965
<i>Norilsk Nickel</i>	6,95	6,98	-0,50	811 281 957	1,82	
<i>Norilsk Nickel (preferred shares)</i>	4,82	4,90	-4,61			1,761
<i>Nizhnetagilsky Metallurgic Works</i>	0,070	0,080	0,00	77 491 057	0,43	2,133
<i>Energy</i>						
<i>Chelyabenergo</i>	0,44	0,499	0,64	198 789 488	2,92	
<i>Irkutskenergo</i>	0,266	0,272	-0,19	1 282 271 271	9,79	0,335
<i>Krasnoyarskenergo</i>	0,470	0,495	-3,60	282 522 863	n.a.	0,207
<i>Lenenergo</i>	0,865	0,950	-1,89	774 630 210	90,87	0,066
<i>Lenenergo (preferred shares)</i>	0,590	0,620	0,83			1,008
<i>Mosenergo</i>	1,393	1,395	-1,88	3 568 000 000	6,77	0,732
<i>Novosibirskenergo</i>	5,800	7,500	3,10	75 184 661	1,60	1,519
<i>Permenergo</i>	34,000	37,500	4,38	215 756 970	1,47	2,769
<i>RAO UES</i>	0,227	0,229	-2,17	9 748 685 567	3,29	0,439
<i>RAO UES (preferred shares)</i>	0,187	0,190	-3,46			0,531
<i>Samaraenergo</i>	0,450	0,590	0,00	260 509 621	3,81	0,769
<i>Sverdlovskenergo</i>	0,760	0,820	-1,86	413 200 176	3,28	0,253
<i>Shipping</i>						
<i>Primoskoye Sea Shipping</i>	1,75	2,80	0,00	50 327 550	18,64	2,062
<i>North-West River Shipping</i>	2,60	3,20	7,81	27 908 834		
<i>Automobile Manufacturers</i>						
<i>GAZ</i>	23,00	27,00	0,00	111 075 000	0,50	2,432
<i>KamAZ</i>	1,32	1,38	0,75	72 948 222	neg.	
<i>Telecommunications</i>						
<i>Rostelekom</i>	3,96	4,02	0,13	3 479 387 428	12,47	
<i>Rostelekom (preferred shares)</i>	2,93	2,94	0,69			3,012
<i>Moscow Telecom</i>	1300,00	1600,00	0,00	1 389 321 751	43,29	0,047
<i>Moscow Telecom (preferred shares)</i>	905,00	938,00	-0,75			1,101
<i>S.-Petersburg Telecom</i>	1,55	1,65	-1,54	710 580 630	20,91	
<i>S.-Petersburg Telecom (preferred shares)</i>	1,15	1,20	-2,49			2,247
<i>Trading Companies</i>						
<i>GUM</i>	27,50	29,50	0,09	171 000 000	9,00	0,711
<i>TZUM</i>	0,65	0,93	-0,63	70 829 425	24,42	0,481
<i>Banks</i>						
<i>Sberbank</i>	140,50	146,00	0,35	1 289 250 000	1,84	4,938

\*Average prices for BID and OFFER are used to count the daily CHANGE. In absence of BID or OFFER, available figures are used to count the CHANGE.

\*\* The calculation of MARKET CAPITALIZATION is based on RTS quotation of common and preferred shares. If the preferred shares are not traded on the market than only the common shares are taking in consideration.

\*\*\*Dividends in USD calculated on the basis of RUB/USD exchange rate as for day of shareholders meeting. with one exception - Purneftenegas(\*\*\*\*) paid dividends twice a year so the average. exchange rate is used.

\*\*\*\* PE ratio is calculated on the basis of companies' financial performance in 1995.

