

VIEWPOINT

"WILL THE OWNER OF THIS ECONOMY PLEASE STAND UP..."

The current rumpus over purchase of the lion's share of the Russian aluminium sector by Boris Berezovsky (represented by the LogoVAZ trading company and the vague concept of "Sibneft shareholders") illustrates the fluid and potentially explosive situation regarding off-shore ownership of major Russian industrial assets.

Despite Berezovsky's confirmation that the deal has happened, the head of Sibirsky Aluminy, which will be his only serious rival in the sector, suggests that it is a mere canard similar to the "merger" of Yukos and Sibneft which was trumpeted and then forgotten at the start of 1998. However, Sibirsky Aluminy has taken the news sufficiently seriously to ask the Antimonopoly Ministry to carry out an investigation. The Minister says that it will probably be unable to prove anything if the deal was carried out through offshore entities. "A game of hide and seek" and "a big question mark" is how he described the situation.

Anonymous ownership of a third of the world's aluminium capacity is certainly bizarre, but a similar state of affairs already exists in another of Russia's key sectors. Gazprom, which is renowned for its xenophobia, is busily selling off Russian gas fields to an upstart US company, Itera, which expects to be able to raise its annual output from Russian fields to 80 billion cubic metres in the next few years - that is

nearly a sixth of Gazprom production. Most observers agree that Itera is a vehicle set up by Gazprom management to put valuable assets out of the reach of the government.

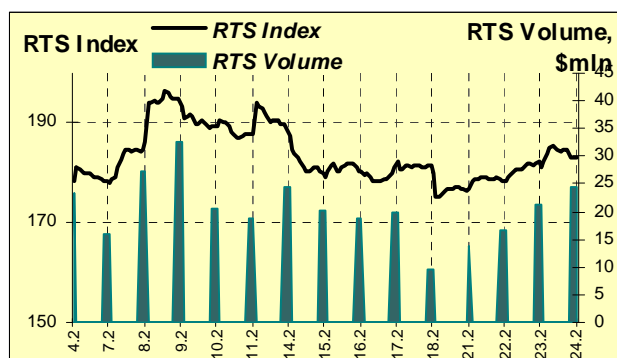
The boss of Itera refused to admit any ownership link with Gazprom in an interview published this week: "our shareholders do not include representatives of Gazprom management or members of their families or their distant relatives". But of course Gazprom's huge power base makes it easy to find reliable placemen with no formal link to the company.

Gazprom management had the unqualified support of the last Communist dominated Duma, for which the company was a counter-weight to the government. The Communists were happy not to notice transfer of Russia's hydrocarbon crown jewels to unaccountable offshore owners even as they battled to prevent direct investment in Russia by reputable foreign companies.

The new Duma is much less antagonistic to the government, but that in no way lessens the risk of un-transparent offshore ownership. Gazprom boss Rem Vyakhirev has just pledged allegiance to President in waiting, Vladimir Putin, and Berezovsky is reputed to be a patron, whom Putin cannot do without. The offshore question will be a major test of the new President's independence

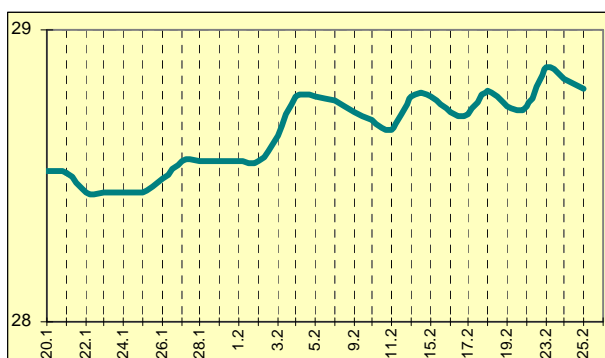
MARKET INDICATORS

LAST 3 WEEKS INDEX & VOLUMES IN RTS-1



Source: RTS Statistics, Central Bank

THE CENTRAL BANK RUB/USD EXCHANGE RATE

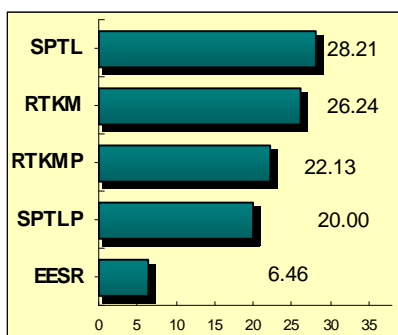


SHARE MARKET

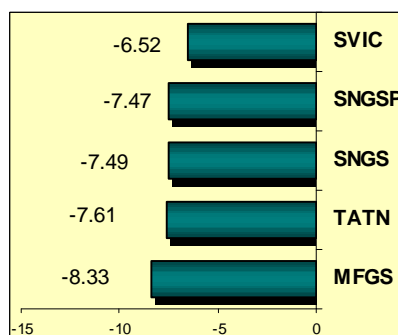
The RTS index gained less than 1% on the week from Thursday to Thursday, starting at 182.26 and finishing at 182.88. The pre-election lull was not helped by President's Day in the US and lacklustre performances of leading world stock indexes. UES almost stood still and oil stocks languished with both Lukoil and Surgut losing a few percent. Rostelecom was the surprise star, gaining around 20% over the week. Explanations included the general enthusiasm for telecom and inter-

net stocks worldwide. But rumors and possible insider information concerning the likely merger of Svyazinvest with Rostelecom could well be the main reason for the growth, which market participants put down to a few big orders from western investors. The merger is expected to be beneficial for Rostelecom. RTS volumes were weak, but seemed to be recovering by Thursday when the market showed a respectable \$24.3m of trade.

THIS WEEK TOP GAINERS, %



THIS WEEK MAJOR LOSERS, %



Source: RTS, RMG estimates

THIS WEEK IN RUSSIA

POLITICS

The Central Electoral Commission cleared a total 11 candidates for participation in the March 26 presidential elections. Ballot papers will offer two and a half serious candidates (Vladimir Putin, Gennady Zyuganov, and Grigory Yavlinsky), along with Samara governor, Konstantin Titov, framed prosecutor general, Yury Skuratov, and Chechen businessman, Umar Dzhibrailov, who is suspected of involvement in the 1996 murder of US businessman, Paul Tatum. Vladimir Zhirinovskiy was disqualified due to an omission in his son's tax declaration to the Electoral Commission.

FINANCE

Mikhail Kasyanov approved a final plan for foreign borrowing this year, which foresees \$4.41bn in untied credits and \$1.5bn in tied credits (for purchases of specific foreign goods and equipment). However, if the IMF pays out just one credit tranche instead of four, the untied money will be about \$2bn less. The Duma deputy and former finance minister, Mikhail Zadornov, predicted that the government will have to borrow \$500-700m from the Central Bank to meet heavy foreign debt obligations in March and about the same amount in the second quarter. He predicted \$2.5bn as the highest possible amount of untied credits for the whole year.

A large part of the first post-crisis issue of GKO (short couponless instruments, as opposed to longer coupon-bearing OFZs) were successfully placed by the Finance Ministry on February 23. The Ministry sold R1.3bn of 6-month GKO with nearly zero yield to non-residents for money frozen in rubles since the 1998 default - the carrot for the buyers is permission to repatriate the money at redemption. Separately, over R2.2bn of ordinary GKO (out of an R2.5bn issue) were placed at a yield of 20.1% compared with expected 22-25%. However, this achievement looks less significant based on reports that R1.6bn of the ordinary placement was taken by Sberbank, which is owned by the CB.

The placements were easily cancelled out by a payout of R10bn on February 23 to redeem maturing OFZs. This will not help the situation on the foreign exchange market. (Konstantin Korishchenko, head of open market operations at the CB, pointed out that placement of more GKO and OFZs would do nothing to soak up excess ruble liquidity in any case, since the Finance Ministry sends the money it raises straight back into the economy).

In 1999 the Finance Ministry placed R257bn of domestic debt and paid and paid R215bn to redeem maturing paper. About 80% of the new debt was sold to state institutions, mainly the Central Bank. Total domestic debt as of January 1, 2000, was R583.6bn (\$20.8bn), including a reviving GKO-OFZ market worth R522bn (\$18.6bn). By comparison the GKO-OFZ market, which collapsed in August 1998 was worth over \$40bn and a much larger portion of it belonged to private investors.

LEGAL AND DUMA

The government is preparing draft amendments to the law on privatisation for submission to the Duma. The new law would allow direct sale of a share stake to a strategic investor without competition if there is only one applicant for the stake, and transfer of illiquid stakes almost for free provided that investment conditions are observed. It would also allow issue of derivative instruments on state-owned shares for placement on international markets. (Farit Gazizullin, the state property minister, said in an interview that sales of government stakes in Gazprom, Lukoil and Onako will be "the biggest privatisation projects" this year).

Sergei Shatalov, the tax specialist who was recently appointed deputy finance minister, said in an interview that the Ministry is on track to present the second (more substantial) part of the new comprehensive tax code to the Duma at the end of March. Shatalov opposes reduction of VAT from its current 20% level, but is in favour of lower and simpler income tax rates.

The SPS (Union of Right-wing Forces) has succeeded in setting up a commission in the Duma for protection of investor rights. There is likely to be strong competition for the role of investors' defender between the new commission, headed by SPS deputy and ex-small business minister, Irina Khakimada, and the committee for banks and financial markets, headed by Alexander Shokhin.

The ex-premier, Viktor Chernomyrdin, will head a new interfactional fuel and energy grouping in the Duma, to be called "Russian Energy". The grouping includes well-known deputies representing interests of various parts of the oil and gas industry. They include Sergei Generalov, the former fuel and energy minister, and several former top oil and gas managers. The commission will joust with the Duma committee on fuel and energy, which is controlled by deputies who are completely loyal to the government.

The Duma has passed amendments to the 1997 bankruptcy law in the third and final reading. The amendments make it harder to bankrupt a company. A creditor will only be able to start proceedings if he is owed more than 5000 times the monthly minimum wage (\$15,000) instead of the current level of 500 minimum wages (\$1500), and the maximum period of external management, when the decision on bankruptcy is put on hold, will be extended from 18 to 30 months.

SECTORS

Telecom minister, Leonid Reiman, said in an interview that his Ministry and the Anti-monopoly ministry will raise tariffs gradually in line with inflation to

bring regional companies to a cost-covering level. He also said that the Ministry is pushing hard to win changes in customs tariffs, which favor foreign telecom equipment suppliers over domestic producers. Reiman, said that Russia will opt for conformity with Europe and not America in choosing mobile standards. The D-AMPS standard, which had big success in Russia in the early 1990s' and is still used by Vimpelcom, "will disappear of its own accord", according to Reiman. He also said that the Ministry wants to see two competing mobile providers in each Russian region, both provided with licenses for the two GSM standards (900 and DCS-1800), which are now overtaking D-AMPS. In Moscow Vimpelcom and MTS both have GSM 900 and 1800 licenses, and issue of a third license is expected.

The government will raise export tariffs on crude oil from 15 to 20 euros per tonne and on diesel from 10 to 15 euros per tonne due to further rises in world oil prices. However, the increases will only come into effect on April 15, due to legal delays. Deputy premier, Viktor Khristenko, said that the government is working on a new scheme, which would enable export tariffs to reflect oil price changes more rapidly and accurately. The newspaper Vremya this week published figures from a leaked government document, which estimates that slow government reaction to price rises deprived the budget of extra revenue. According to the document, oil companies earned extra profits of R117bn due to the rise, while total budget revenue from oil export tariffs was only R14.3bn.

COMPANY NEWS

OIL AND GAS

GAZPROM will hold its AGM on June 30. The record date has been set at May 5.

SIBNEFT is spoiling its image among Western banks due to a debt evasion, which involves the oil trader and Sibneft shareholder, Runicom. Following the August 1998 crisis, the EBRD agreed to accept a \$58m credit to Runicom by collapsed bank, SBS-Agro, as security for a loan provided to SBS under the EBRD's program of lending to Russian small businesses via Russian banks. SBS told the EBRD that the security was reliable because it was guaranteed by Sibneft. Runicom then claimed that it had already settled the debt and denied the obligation. The EBRD will be hard pressed to recover any of the money from the plundered carcass of SBS. Alexander Smolensky, who headed SBS and now stands behind the new banking formation, OVK, which has syphoned many of SBS's assets, is thought to be closely associated with the Berezovsky-Abramovich alliance, which controls Runicom and Sibneft.

ENERGOS

UES is under attack from the Communist leader, Gennady Zyuganov, who claims that company CEO, Anatoly Chubais is ruining the Russian power sector and selling off prime chunks of it to foreigners. The Communists are the biggest faction in the Duma. Zyuganov wants a state pledge to keep UES intact, and dismissal of Chubais

UES and Gazprom will agree terms for gas supplies to power stations every quarter instead of once a year under an agreement signed by Anatoly Chubais and Rem Vyakhirev. The quota for January-March represents almost a tenth of total Gazprom production last year. UES must ensure timely payment and increase the share of cash payment from the current level of 40%. Gazprom has recently put strong pressure on UES to settle its huge gas debt.

IRKUTSKENERGO if being drawn into a battle with the Irkutsk governor, Boris Govorin, who does not want the company to come under the control of UES. Irkutskenergo management is now reconciled to UES control as a way of resisting pressure by local industry

RYE, MAN & GOR SECURITIES

Sources: Information agencies Reuters, Skate, Interfax, AK&M, Russian mass media, RMG estimates

and the administration to keep tariffs artificially low (tariffs in the region are the lowest in Russia at 9 kopeks (30 cents) per kWh). Govorin has transferred half of the 40% stake, which is controlled by the administration to a friendly private company in order to make it harder to the State Property Ministry and USE to contest vague agreements made several years ago on joint federal-local management of the stake.

NOVSIBIRSKENERGO has won the green light for a tariff increases averaging 34% for heat and 22% for power, effective from March 1. Permission was given by the regional energy commission

TELECOMS

ROSTELECOM could face competition for long-distance traffic from Transtelecom, the Railways Ministry subsidiary, later this year after the telecoms minister, Leonid Reiman, said that criteria for issue of a second national long-distance license could be ready as early as April. Transtelecom says it will start to offer internet access services in March, first in European Russia, but also as far as Vladivostok by the end of 2000. Transtelecom's nationwide fibre-optic network will enable to avoid renting lines for internet access from Rostelecom.

ROSTELECOM has agreed with Merrill Lynch on extending repayment of a \$100m credit, due this month, over a period of 4-6 years.

MGTS preliminary data for 1999 show a pre-tax profit of R92.67mn (\$3.22m). The company expects to do much better this year.

VIMPELCOM could lose its gamble to win customers by slashing prices after the company's main rival, MTS, this week announced two new price packages that undercut Vimpelcom. The cheapest MTC package makes it possible to talk for 100 minutes per month (mostly at peak hours) and pay just \$37 including VAT and the subscriber tariff. Further bad news for Vimpelcom is an upcoming tender for a third GSM license in Moscow, announced by the deputy

minister for telecoms. It is rumoured that the tender will be won by Finnish company, Sonera. Vimpelcom and MTS respectively had 43% and 48% of the Moscow mobile market at the start of February.

SVYAZINVEST privatisation is being promoted by the State Property Ministry. The minister, Farit Gazizullin, said in a newspaper interview published Tuesday that a contract to carry out preparations for sale of a second 25% stake minus one share would be signed with Arthur Andersen "within a week". A first 25% stake plus one share was sold to private investors in 1997. However, both Svyazinvest and the Ministry have said that they do not want to sell the second stake until they can be sure of attracting a sum at least equal to the \$1.8bn, which was paid in 1997. It is not clear how Svyazinvest privatisation plans will mesh with a merger between Svyazinvest and Rostelecom, which has also been looking more likely in recent months. The merger deal will probably involve absorption of Svyazinvest by Rostelecom.

OTHER

GAZ faces delays with launch of its new improved version of the Volga sedan due to inability to repay the first R250m instalment of a R1bn Sberbank loan, agreed last July (the total facility was worth \$40m at the time). Provision of the remaining R750m is also being held up by failure of GAZ to reach agreement with the EBRD on restructuring of an earlier loan worth \$65m. The economics director of GAZ said that the company will have to raise the prices of its cars due to rises in the price of steel.

ALFA BANK plans to issue eurobonds worth \$150-200m and raise a syndicated loan of \$50m later this year. Managing director, Alex Knaster, said that repayment of \$175m of eurobonds, due in July, will not be a problem for the bank. The eurobond issue is the first such by a Russian entity since the 1998 crisis and shows the financial robustness of Alfa compared with other Russian banking institutions.

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