

Market Wrap

The RTS closed on Friday, January 10, at 357.94 points, nearly unchanged from December 27 after two weeks of disruption due to New Year and Russian Christmas holidays. There were seven trading days in the period, but RTS volume was just \$50m. There were significant winners and losers despite the index stability. The oil price spike could not prevent sector market cap falling 1.7% as investors foresaw an OPEC decision to increase output (made this weekend). Expected downward price pressure due to the decision outweighed recent price peaks due to thickening Iraq war clouds and the Venezuela strike, which has reduced US oil inventories to 30-year lows.

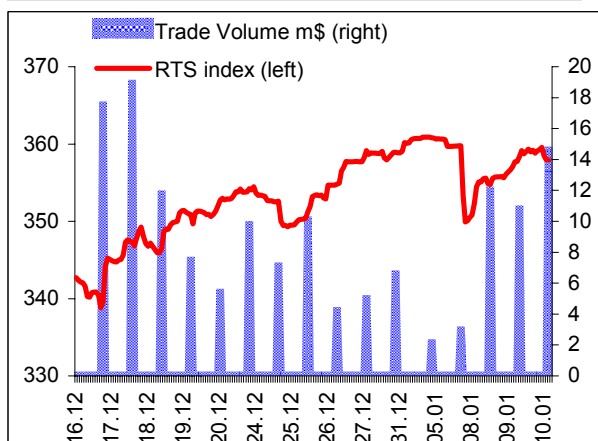
Lukoil was under extra pressure due to the BP decision to let investors convert bonds into Lukoil ADRs (see Oil in this RMG Weekly). The stock lost over 5% at the opening on January 8, when trading restarted after Russian Christmas, and was down 1.5% from December 27 to January 10 with biggest volumes on the system. Yukos lost 1.5% and Surgut fell 1%. But Surgut prefs rose 5.2% on volumes over \$3m (more than commons) as investors bought into recent legal changes that will end dividend dodging by the company. Sibneft was the biggest oil loser, shedding 5.4% on profit taking after its success at the Slavneft auction.

UES rose 2.4%, suggesting optimism that the sector reform package will go through the Duma this month. Mosenergo did even better with a 3% rise.

Norilsk was the most exciting stock, rising 8.7% and forcing UES into third place by trading volumes. Investors found the company attractive due to its recent expansion in gold mining, as the global search for safe-haven assets sends gold prices to new highs.

Telecoms were also interesting, with major 4.7% advance by Rostelecom and 5.8% strengthening by Ural Svyazinform. Telecom sector market cap rose 5.6% in the last two weeks, representing more than half of its total y-o-y growth (10%). The effect was due to better results and prospects for Rostelecom and completion of sector mergers.

The market should be helped this week by growing confidence in the US, where the plan to cancel dividend tax has given over 5% growth by the Dow and S&P indices since January 1. Good 4Q results from top US companies are expected this week, as well as good news on consumer sentiment and the economy.

RTS Index & Volume

Key Figures

RTS Index	357.94	-0.34%
RTS Volume (\$m)	48.94	35.77%
Ruble / Dollar	31.88	

Weekly data Fri-Fri.

Inflation (December)	1.5%
Int'l Reserves (Dec 27)	\$47.8b

Winners

Kolenergo com	+20.4%
Uralkalii com	+17.8%
Norilsk Nickel com	+8.7%
Rostelecom pref	+7.7%
Rostovenergo com	+6.7%
Severstal com	+6.4%

Top Volumes (\$m)

Lukoil com	10.5	20.4%
Norilsk Nickel com	9.5	18.5%
RAO UES com	9.3	18.0%
Surgutneftegaz com	4.7	9.2%
Rostelecom com	3.8	7.3%
Surgutneftegaz pref.	3.2	6.3%
Yukos com	2.5	4.9%
Total (Top 7)	43.5	84.5%

Losers

Chelyabinsk pipe plant com	-6.7%
Sibneft com	-5.4%
Tatneft com	-3.2%
Sakhalinmorneftegaz pref	-1.8%
Lukoil com	-1.5%
Yukos com	-1.3%

Sector Statistics

Sector Name	Volume \$	MC\$'000	% of MC	Change -week	Change -month	Change -year
Oil & Gas	24 139 203	62 978 229	67.85%	-1.74%	2.55%	35.40%
Power Utilities	10 135 138	9 252 399	9.97%	1.53%	-0.23%	-15.80%
Metals	9 724 107	6 294 526	6.78%	7.96%	14.61%	9.20%
Telecom	5 614 888	5 169 570	5.57%	n/m	n/m	n/m
Other	893 345	2 720 209	2.93%	n/m	n/m	n/m
Banks	417 430	3 794 375	4.09%	2.41%	-2.45%	157.31%
Chemicals	341 366	381 388	0.41%	9.65%	10.18%	13.62%
Engineering	178 634	1 546 780	1.67%	-3.05%	-7.81%	3.14%
Transportation	2 211	522 161	0.56%	0.17%	2.81%	0.48%
Retail	n/m	162 393	0.17%	n/m	-22.63%	-16.60%
Total	51 446 322	92 822 030	100.00%	-0.12%	2.82%	26.59%

VIEWPOINT: INVESTORS SHRUG OFF RENATIONALIZATION THREAT

It became known just before the weekend that the St.Petersburg administration has submitted three petitions to the city arbitration court calling for review of privatization of Lenenergo, the regional power utility, in the early 1990s. The petitions claim that inclusion of distribution networks in Lenenergo was illegal (they should belong to the city) and that permission of various bodies for privatization was required but not obtained.

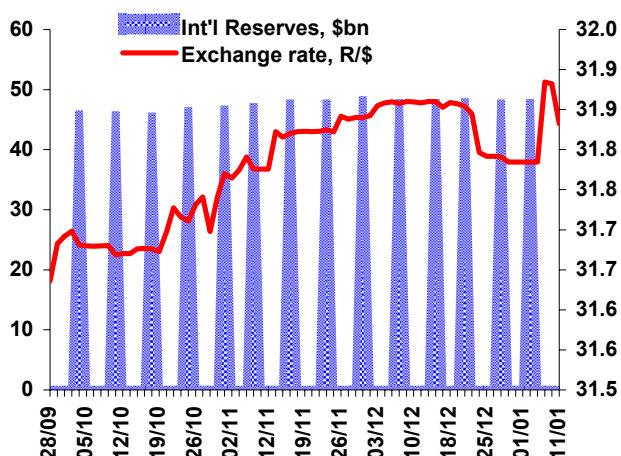
Neither UES, Lenenergo, or independent observers believe that the move by Petersburg mayor, Vladimir Yakovlev, is really motivated by concern about legality of Lenenergo privatization. Byzantine Russian legislation and the nature of privatization in the early 1990s would make it possible to challenge most (perhaps all) privatizations in the country.

Best guesses are that Yakovlev wants to pressure UES to give the administration a share of receipts for power export contracts, or that the petitions are an attempt to exploit recent power and heat breakdowns, due to extreme low temperatures, for populist purposes (Yakovlev faces elections a year from now).

What is most interesting is that the Lenenergo share price felt no noticeable effect from the news. Investors, therefore, do not take the renationalization threat seriously. They might become more worried if the Petersburg court upholds the application from the administration (possible in view of dependence of courts on the executive, particularly in the regions). But even then, we think that investors would find it hard to be worried. Renationalization is not a credible threat in Russia any more, unless it is part of a game plan, by which an oligarch uses links with government to take assets from another oligarch (that was recently seen when the Deripaska-Abramovich business empire grabbed major pulp and paper assets via their “renationalization” and quick resale).

It is reassuring that renationalization of companies with wide ownership is no longer credible in Russia. but disappointing that the government of Russia's second biggest city is using such a threat, particularly when legality is not its real concern.

Economic Indicators

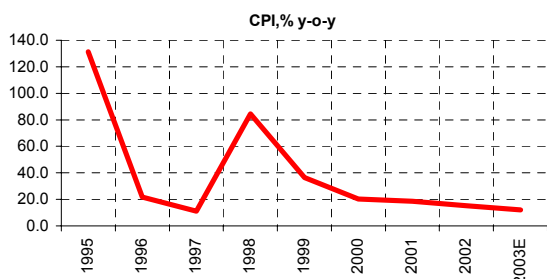


Key Macro Figures

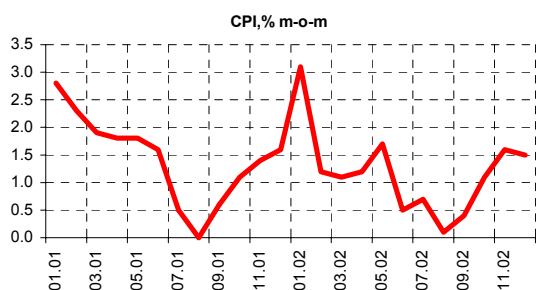
CBR refinancing rate, %	21	
M2, Rbn	1 930.0	1/12/02
M0, Rbn	690.5	1/12/02
CPI, %	15.1	2002
Inter'l Reserves, \$bn	47.8	3/01/03
One-day MIACR, %	3.1	9/01/03
Exchange rate R/\$	31.83	11/01/03
Exchange rate R/euro	33.43	11/01/03
OFZ yields, % p.a.	11.55	10/01/03
GKO-OFZ duration, days	475.95	10/01/03
Eurobonds Russia 03 YTM	3.53%	13/01/03

Inflation in 2002 was 15.1%

Goskomstat announced that inflation in 2002 was 15.1%, the lowest level since 1998. The lowest-ever Russian CPI growth (11%) was in 1997. Inflation in December was 1.5% in line with our expectations.



Food prices rose by 11% in 2002 (17.1% in 2001), non-food prices grew by 10.9% (12.7% in 2001), and tariffs for services rose by 36.2% against 36.9% in 2001. In Moscow inflation in 2002 was 17.2% and 14.7% in St Petersburg. In December m-o-m inflation was 1% in Moscow and 1.2% in St Petersburg. The government forecast for 2003 is 12%. Based on this forecast and the seasonality factor, inflation in January should not be more than 1.9%, and that should be the highest level of the year.



Household saving up 27% in 11M 2002

Household saving in bank accounts, securities and cash increased by 27.4% in 11M 2002 to R1323.2bn (\$42bn) from R1039.0bn (\$33bn), according to Goskomstat. In November 2002 saving rose by 2.5%.

Saving by Russian households (Rbn)

	01.01.2002	01.12.2002	11M02, %
Total	1039.0	1323.2	27.40%
Bank deposits	444.9	617.7	38.80%
Cash	400.5	464.9	16.10%
Securities	193.6	240.6	24.30%

Source: Goskomstat

Total saving in the national currency increased by 35.4% from December 2001 to December 2002. The share of securities in saving grew by 27.8%.

Share of consumer spending on goods and services falls

The share of household incomes spent on goods and services fell in 11M 2002 to 73.6% of the total from 75.3% in 11M 2001, according to Goskomstat. In November 2002 householders spent 73.7% of their incomes on goods and services. The increased saving rate is good news for the economy.

Household incomes and expenditures

	11M01	11M02
Money revenues, Rbn	4666.5	5924.1
Money expenditures, Rbn	4602.2	5859.6
Goods	60.10%	58.20%
Services	15.20%	15.40%
Compulsory payments	8.70%	9.20%
Saving	8.90%	10.50%
Foreign currency purchases	5.70%	5.60%
Cash	1.40%	1.10%

Source: Goskomstat

Deposits of householders in rubles and foreign currency on November 1 totaled R982.5bn, and rose by 39.9% from the beginning of the year. The share of Sberbank in total ruble and foreign currency saving was 68.2% on November 1, 2002 against 71.4% on January 1, 2002. Savings on Sberbank ruble accounts were R488.2bn and on Sberbank foreign currency accounts the equivalent of R181.9bn as of November 1, 2002. Pension accounts are 62.8% of total saving in Sberbank.

Volume of gold in Russian state reserves up by 100kg

Largest gold reserves

	Tonnes	% of international reserves
USA	8149	56.7
Germany	3446	38.9
IMF	3217	
France	3025	51.3
Italy	2452	50.2
Swiss	1957	35.1
Netherlands	873.6	47.3
European Central Bank	766.9	
Japan	765.2	1.7
Portugal	606.8	37.6
Spain	523.4	14.4
China	500.8	2.0
Taiwan	421.8	3.3
Russia	386.9	8.8
India	357.8	6.0

Source: World Gold Reserve

The volume of gold reserves of Russia rose by 100kg to 386.9 tonnes in November 2002, according to the World Gold Council. The share of gold in total Russian gold and currency reserves was 8.8% in

November. Russia ranks fourteenth in the world by the size of its gold reserves:

The total volume in state reserves of 114 countries in November 2002 was 28 933 tonnes. Financial institutions have 4181 tonnes of gold.

Consolidated budget results in January-October 2002

The Finance Ministry and Goskomstat published budget execution results for January-October. The consolidated budget surplus was R241.2bn and the federal budget surplus was R214.9bn.

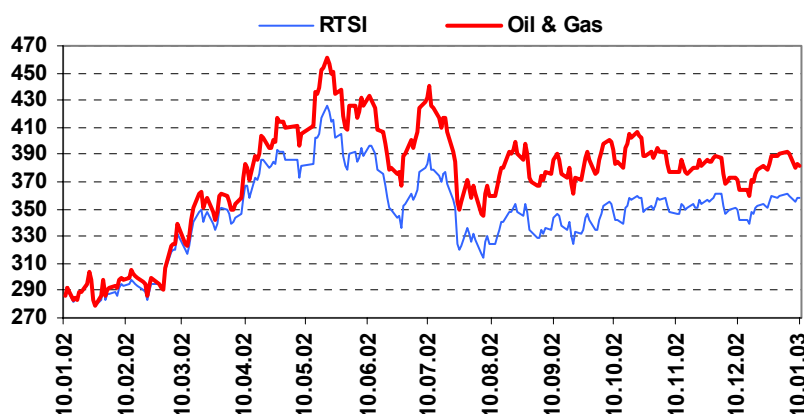
Budget execution (Jan-Oct 2002, Rbn)

	Consolidated budget	Federal budget
Surplus	241.2	214.9
Revenues	2858.0	1803.4
Tax revenues	2269.9	1383.2
- Profit tax	397.7	149.5
- Value-added tax	616.2	615.9
- Excises	216.1	176.4
Expenditures	2616.8	1589.5
- Social and cultural	1076.2	488.8
- Defense	218.2	218.2
- Debt servicing	205.0	193.9
- Law-enforcement and state security	166.9	129.0
Social tax	278.2	278.2

Source: Goskomstat

Interest payments in January-October 2002 fell by 12.2% as a share of federal budget expenditures (from 20.6% of total expenditures in 10M 2001). The surplus was spent on internal debt payment of R47.7bn and external debt payment of R166.2bn.

Oil & Gas Index vs. RTS Index



Oil & Gas Key Figures

Indicator	Value	Wk Change
Urals (\$/b)	29.67	-4.0%
Brent (\$/b)	29.51	-2.2%
OIX (CBOE oil index)	259.21	1.1%
Dow Jones Energy Index	199.39	0.2%
US crude inventory change (EIA data) m bbl	278.7	-3.0%
US gasoline inventory change (EIA data) m bbl	209.8	2.1%
Tatneft ADR	15.3	-1.6%
Lukoil ADR	60.8	-1.7%
Surgutneftegaz ADR	15.56	2.0%
Yukos ADR	139	-1.8%
Sibneft ADR	20.89	-5.7%

Sector Wrap

- Russian Minister of Energy Igor Yusufov visited oil ministers of OPEC countries on the threshold of their meeting this weekend.
- Russian oil production may be raised in the near future. It is estimated that oil production in Russia in 2003 could grow by 8-9% and exports by 5% despite Transneft capacity constraints.
- Consortium British Petroleum (BP) announced the redemption of bonds issued in February 2001, which are convertible into Lukoil ADRs.
- Russia has reached a 10-year record in oil production. The volume of oil and gas condensate production was 379.63m tones in 2002, which is 9% higher than in 2001. The biggest oil producers in 2002 were Lukoil, Yukos, Surgutneftegaz, TNK and Sibneft.
- Export duties on crude oil will be reduced to \$26 per tonne from February 1, 2003.

Sector Statistics

Issue	Issue RTS Code	Mid Market Price, \$	Weekly Change, %	Weekly Volume, \$mln	Market Cap, \$mln	52 week Low, \$	52 week High, \$	P/S 01	P/E 01
LUKoil com	LKOH	15.225	-1.5	10.498	13 013.62	12.050	18.620	1.01	4.97
Megionneftegaz com	MFGS	8.766	0.4	0.018	993.04	4.400	10.500	1.57	9.75
Megionneftegaz pref	MFGSP	3.900	2.4	0.027		1.800	4.800		
Sakhalinmorneftegaz com	SKGZ	2.176	-4.8		148.35	1.930	3.400	0.68	3.05
Sakhalinmorneftegaz pref	SKGZP	1.426	-1.8	0.087		1.000	2.000		
Sibneft com	SIBN	2.097	-5.4	2.024	9 861.90	0.823	2.235	2.24	8.22
Surgutneftegaz com	SNGS	0.313	-1.0	4.710	12 993.47	0.286	0.475	2.30	7.34
Surgutneftegaz pref	SNGSP	0.233	5.2	3.218		0.183	0.260		
Tatneft com	TATN	0.764	-3.2	0.805	1 723.66	0.495	0.863	0.38	2.02
Tatneft pref	TATNP	0.454	1.1	0.068		0.370	0.615		
Udmurtneft com	UDMN	90.000	9.1		278.73	65.000	100.000	0.30	2.78
Udmurtneft pref	UDMNP	78.500	-9.2	0.004		44.500	121.000		
Yukos com	YUKO	9.295	-1.3	2.512	20 804.02	5.740	11.420	2.22	5.61

Russia discusses quota plans with OPEC

The Russian energy minister Igor Yusufov visited oil ministers of OPEC countries in the run-up to Sunday's OPEC meeting, which canceled production cuts planned in December. In talks with the Saudi oil minister Yusufov discussed possible oil production increase (by 1.5m bpd) to avert a world deficit and reduce oil prices to \$25/bbl from levels above \$28m, which had lasted for two weeks. Yusufov also negotiated with ministers of Kuwait, Iran and Qatar ministers. Russia is not a member of OPEC, and the Organization has previously criticized Russia for over-production.

Last month OPEC decided to reduce oil production to 23m bbl per day from January 1, but oil prices then grew to 29-33 \$/bbl due to the strike in Venezuela and tension around Iraq. Venezuelan production has fallen from 3m bbl to 600-700 000 bbl per day. The country, which supplies 9% of US consumption and exports 2.4m bbl per day, now plans to restore oil production in two thirds of the previous level till the end of January, but the political crisis in Venezuela is not yet resolved and there are plans to restructure the national oil company "Petroleos de Venezuela". The report on Iraq by UN inspectors last week also pushed oil prices, since it looks like a pretext for war.

According to OPEC regulations if the price of the OPEC basket exceeds the \$22-28/bbl band during 20 trading days, OPEC should increase oil production. The increase will be 6.5% or 1.52m bbl per day to 24.5m bbl per day from February 1, 2003.

Russia could increase oil production in 2003

Current high demand for oil on the world market increases likelihood of Russian output increase in 2003 and highlights plans for new export routes. Exports are currently capped by capacity limits of the Transneft pipeline system. Oil production in Russia could grow by 8-9% and exports by 5% in 2003 in accordance with the Russian government however we believe those numbers are overoptimistic (see [RMG weekly #406](#)).

In the longer term exports could be boosted by construction of a new pipeline from Eastern Siberia. There are two alternative routes: from Angarsk in Russia to Datsin in China (proposed by Yukos) and from Angarsk to the Russian Pacific port of Nakhodka. Japan has stated willingness to buy 1m bbl per day from Russia and to assist in building an oil pipeline to Nakhodka. Japan currently buys 90% of its oil from the Middle East. The biggest Japanese refinery, Nippon Oil Corp. recently bought a first consignment of Russian oil (2m bbl).

Further US officials have noted that a proposed pipeline from Western Siberia to Murmansk could make Russian oil an alternative to Middle East

supplies for US consumers. Murmansk port is ice-free and oil delivery through Murmansk could attract American and other investors. Lukoil, Yukos, Sibneft and TNK signed a memorandum on construction of such a pipeline with capacity of 80m tonnes last November. Total value of the project is between \$3.4bn and \$4.5bn, with payback in eight years at a transport tariff of \$19.7-24.1 per tonne.

BP plans to call a bond convertible into Lukoil ADRs

British Petroleum (BP) announced the redemption of bonds issued in February 2001 with maturity in 2006 in volume \$420m, which is convertible into Lukoil ADRs. The bonds have par value of \$1000 and correspond to 20 Lukoil ADRs (one ADR represents four shares). The bond will be redeemable at par value. For investors the conversion of bonds into shares will translate into the price of \$12.5 for one Lukoil share compared with current \$15.25 on the market. Hence we expect the majority of bond holders to convert their bonds into Lukoil ADRs before the call date of February 10 2003. This indicates that the free float of Lukoil will increase by maximum 4% putting a short-term pressure on its shares.

BP became a shareholder of Lukoil in 2000 after merger with ARCO, which owned 7% of Lukoil. BP sold off a 3% stake in 2000. The placing \$420m of five-year bonds on the other 4% was in 2001 with a 3% semi-annual coupon. BP could call bonds from February 10, 2003 by par value while investors have a right to convert bonds till this date. BP retained the right to pre-empt such conversion by redeeming the bonds for cash until February 2003. BP has now waived that right, suggesting negative assessment of near-term Lukoil share price performance. Lukoil shares lost value on the market as a result.. From the conversion BP intends to receive \$66m.

Separately, holders of Lukoil bonds issued in November 2002 for \$350m can exchange them into GDRs increasing the free float by another 1%.

Russian oil production rose by 9% y-o-y in 2002

The volume of oil and gas condensate production in 2002 was 379.63m tonnes, 9% higher than in 2001 and in line with our expectations. The biggest oil producers in 2002 were Lukoil, Yukos, Surgutneftegaz, TNK and Sibneft (in that order).

Export of Russian oil through Transneft pipelines rose by 4.5% to 151.73m tonnes in 2002 and 4.859m tonnes was exported outside the Transneft system. The biggest Russian oil exporters are Lukoil (25.85m tonnes), Yukos (25.62m), Surgutneftegaz (17.45m), TNK (14.75m), and Sibneft (10.49m).

Production and MC/Production in 2002

	Production in 2002, million tonnes	MCap, m\$	MC/Prod., \$/bbl
Lukoil	75.5	12 906	23.4
Yukos	69.9	20 771	40.7
Surgutneftegaz	49.2	13 117	36.5
TNK	37.5	4 270	15.6
Sibneft	26.3	10 066	52.4

Source: Ministry of Energy, RMG estimates

The volume of gas production rose by 2.4% y-o-y in 2002 to 595.3bn cm. The share of Gazprom in total volume of gas production was 523.79bn cm.

Export duties on oil will be reduced to \$26 per tonne

Export duties on crude oil will be reduced to \$26 per tonne from February 1, 2003, following a decision by the government commission on protective measures in foreign trade. The export duty on crude oil is currently \$29.8 per tonne. Export duties on oil products will be unified at \$23.5 per tonne. The current export duty on light oil products is \$35 per tonne and \$20 for heavy products.

Sibneft (HOLD) increased oil production by 27.4% y-o-y in 11M 2002

Sibneft increased oil production in 11M 2002 by 27.4% y-o-y to 23.774m tonnes. In November 2002 the company produced 2.351m tonnes against 1.871m in November 2001. Company exports in 11M 2002 were 9.713m tonnes including 0.99m in November. Export of oil products grew by 1.7 times y-o-y to 3.539m tonnes. Total refining grew as shown in the table.

Sibneft oil refining in 11M 2002 (million tonnes)

	11M02	11M01
Total refined products, of which:	14.6	12.2
Omsk refinery	12.2	
Moscow refinery	2.4	
Of which gasoline:	3.6	3.0
Omsk refinery	3.1	
Moscow refinery	0.5	

Source: Ministry of Energy, RMG estimates

Tatneft (SELL) production in 2002

Tatneft produced 24.612m tonnes of crude in 2002 or 1800 tonnes more than in 2001. In December 2002 the company produced 2.084m tonnes, as in December 2001. Total oil production in Tatarstan in 2002 was 28.672m tonnes.

Tatneft 2002 production and MC/Production

Production, million tonnes	MC/Prod., \$/t	MC/Prod., \$/bbl
24.6	70.7	9.7

Source: Company data, RMG estimates

Surgut (BUY) oil and gas production in 2002, forecast for 2003

Surgutneftegaz increased oil production by 11.8% y-o-y to 49.2m tonnes and gas production by 20% y-o-y to 13.3bn cm in 2002. Company CEO Vladimir Bogdanov said that the company launched three new oilfields last year and processed 16.2m tonnes of crude oil. Recoverable reserves grew by 30m tonnes and the company launched 911 new oil wells against 843 in 2001. The company saved R160m (\$5m) in costs thanks to construction of its own power generating facilities at fields.

The company is targeting production of 52.9m tonnes of oil and 13.6m cm of gas in 2003 according to Bogdanov with launch of three new oilfields. Investments in equipment will total \$300m.

Surgut will start work in 2003 on the third section of its main gas processing plant at cost of \$250-300m. Launch will be in 2004 and the payback period is three years.

Tax costs of Surgut in 2002 were R86bn (\$2.74bn), down from R91bn in 2001. The company spent R2bn (\$64m) on social programs.

Lukoil (BUY) wins tender for oil product supplies to Sri Lanka

Lukoil Asia Pacific Pte, a Lukoil subsidiary, has won a tender to supply fuel oil and kerosene to Ceylon Petroleum Corp. Lukoil APP will deliver 21 000 tonnes of fuel oil and 3000 tonnes of kerosene.

Blue Stream commissioned

Gazprom announced that the Blue Stream pipeline to Turkey has been put into commission and pipeline pressure will be built up over 15 days. Capacity is 16bn cm per year. In 2003 Gazprom plans to supply 2bn cm of gas to Turkey through Blue Stream, rising to 4bn cm in 2004.

Ecologist claims would raise costs of Sakhalin-1 and Sakhalin-2

Russian and international ecology organizations have requested Exxon Neftegaz Ltd., Sakhalin Energy and other operators of the Sakhalin-1 and Sakhalin-2 projects not to build underground pipelines in the seismically risky Sakhalin region. Instead ecologists propose special overground pipelines, as in Alaska, which could prevent damage in case of seismic

activity. Ecologists also want bridge passage across all rivers and streams where salmon spawn.

Major participants of Sakhalin-1 are Exxon Neftegaz (30%), Rosneft (20%), Indian company ONGC (20%) and SODECO (30%). The participants of Sakhalin-2 are RD/Shell (55%), Mitsui (25%) and Mitsubishi (20%).

Russian oil producers ask for protection of their interests in Transneft

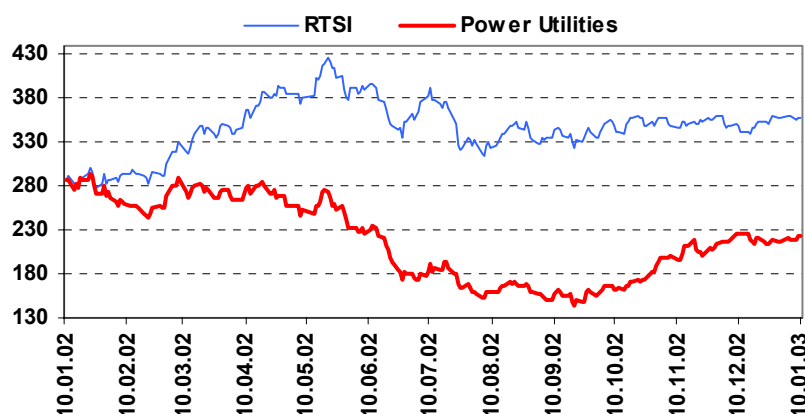
Russian oil companies are lobbying the government to prevent increased transportation of Kazakh oil through the Transneft system. Total 17.5m tonnes of Kazakh oil was transported in 2002, and this will rise

to 19.5m tonnes this year. The Russian energy minister Igor Yusufov supports the companies, which estimate that sales of Russian producers reduce by \$2.48bn if 15m tonnes of Kazakh oil is transported and that the budget loses \$1.059bn.

Domestic gasoline prices rise

Amendments to the Tax Code that came into force from January 1, 2003, raise excises on gasoline by 45%. The tax will be paid by filling stations. The excise increase will lead to 10% price growth nationwide, but price growth could be 50% in some regions.

Power Utilities Index vs. RTS Index



Power Utilities Key Figures

Sector indicators: median	Russia	Discount to emerging markets
MC / Net sales	0.35	55%
MC / Owned inst. capacity	42.93	78%
MC / Retail supplies of elec.	6.81	82%

ADRs of Russian power utilities	Last sale	Wk change
RAO UES	13.350	6.8%
Mosenergo	3.250	6.6%
Irkutskenergo	2.500	0.0%

Sector Wrap

- The Senate approved amendments to the law on tariff regulation, by which maximum tariff changes for the next year must be written into the budget draft and cannot be changed without changing the budget.
- Many Duma deputies have made enactment of the tariff setting amendments into a pre-condition for approving the power bills package in a second reading. Duma deputies may return to the second reading of the power bills package on January 22. UES officials are optimistic about approval.
- The Russian Accounts Chamber reported that preliminary review of the Falcon deal had not revealed any violations. This is reassuring for UES, which was the main participant in that deal.
- UES plans to complete a deal for sharing its exports with Rosenergoatom in the first quarter of 2003. Company financials will not be significantly harmed.
- Tariffs were increased from New Year for some energos, following growth in prices for fuel and purchased electricity, but the outlook for the tariffs-costs balance in 2003 still gives cause for concern.
- Mosenergo is not expecting new loans in 2003 because the Moscow REC refuses to include loan coverage in tariffs.
- Nizhnovenergo expects competition from a sales company established by local authorities and Rosenergoatom. The new company is holding negotiations with potential customers and may start operations in the first quarter of 2003.

Sector Statistics

Issue	Issue RTS Code	Mid Market Price, \$	Weekly Change, %	Weekly Volume, \$mln	Market Cap, \$mln	52 week Low, \$	52 week High, \$	P/S 01	P/E 01
Bashkirenergo com	BEGY	0.133	2.9	0.001	142.08	0.105	0.184	0.26	2.66
Irkutskenergo com	IRGZ	0.080	3.2	0.008	381.34	0.058	0.087	1.09	13.55
Lenenergo com	LSNG	0.282	-0.2	0.001	238.68	0.237	0.508	0.37	6.20
Lenenergo pref	LSNGP	0.209	0.0			0.157	0.299		
Mosenergo com	MSNG	0.033	3.0	0.374	932.83	0.023	0.055	0.63	13.13
Permenergo com	PMNG	2.050	7.6	0.024	100.63	1.420	2.200	0.20	6.22
Permenergo pref	PMNGP	1.850	10.8	0.037		1.350	1.910		
UES com	EESR	0.133	2.4	9.261	5 646.45	0.075	0.176	0.43	7.57
UES pref	EESRP	0.108	0.0	0.115		0.065	0.138		
Samaraenergo com	SAGO	0.034	7.9		111.39	0.026	0.044	0.27	8.86
Samaraenergo pref	SAGOP	0.019	1.1			0.015	0.025		
Sverdlovennergo com	SVER	0.163	0.1		101.16	0.103	0.172	0.13	16.55
Sverdlovennergo pref	SVERP	0.106	-1.9			0.065	0.120		

Senate approves amendments to law on tariff regulation

The Russian Senate approved changes to the law on tariff regulation at the end of December. The changes require regulated tariffs of natural monopolies to be set once a year before adoption of the state budget in its first reading by Duma. Maximum tariff growth for gas, power utilities and railroads must be set in this way and revision is only possible through amendments to the state budget. At the regional level regulated tariffs must be set in a similar way with respect to regional budgets.

Adoption of these law amendments was required by the Duma in December as one of the conditions for approval of the power bills package. The Duma already tried to carry the amendments earlier last year, but found no support in the Senate.

There was no official response to passage of the amendments from the President, whose signature is needed to make them law, but signature may come when deputies commit firmly to passing the power bills package (see also next article).

Power bills package may be discussed by Duma in late January

A second reading of the power bills package in the Duma may be held on January 22. The date was proposed by the Duma energy committee. Confirmation or rejection of the date will occur when the Duma reconvenes on January 15. Approval of changes to the law on tariff regulation by the Senate make successful passage of the power package more probable (see previous story).

UES officials say that the power bills are sure to be approved in the first quarter of this year since UES has reached agreement with Duma deputies on outstanding issues, although details of this understanding have not been revealed. We are also optimistic about passage of the power bills in the first months of 2003, although indefinite postponement still cannot be ruled out.

Accounts Chamber finds no violations in Falcon deal

The Russian Accounts Chamber says that preliminary results of its review of settlement of Russia's sovereign debt to the Czech republic, in which UES was involved, have found no violations. The deal was arranged in October 2001 and involved transfer of a part of Russia's Czech liabilities to UES in exchange for clearing of UES debts to the state budget, Gazprom and Rosenergoatom (the deal is known as the "Falcon" deal, since Czech company Falcon Capital acted as intermediary). UES gained about \$550m from the deal. Final results of the Accounts Chamber review are expected later in January.

UES (BUY) to share exports in first quarter of 2003

A UES BoD meeting at the end of December decided that a joint export operator should be set up with nuclear power company, Rosenergoatom, in the first quarter this year. The move represents a compromise, ending conflict between the two companies over rights to exports. Exports are currently viewed as a monopoly function of UES, but Rosenergoatom has protested that it delivers up to 40% of electricity to the wholesale power market and therefore has a right to share exports.

The Antimonopoly Committee helped Rosenergoatom to press its claim and it was decided that UES will share exports with Rosenergoatom in the same proportion as supplies to the domestic power market. This will be done via sale to Rosenergoatom of a stake in the export entity Inter RAO UES, which is currently a wholly-owned UES subsidiary.

Since UES exports account for only 2% of the holding revenues the change should not affect company finances dramatically, but it may impact UES non-consolidated net profit, which is the basis for dividends. By our estimates the potential loss may be 5%, although this is also short of catastrophic.

Tariffs raised for regional energos

Some energos reported tariff increases from the beginning of 2003. Regional governments, which are ultimately responsible for energo tariff setting, may be reacting to December passage in both chambers of the Russian parliament of changes to the law on tariff regulation (see story above). But there are also objective economic justifications for higher tariffs: gas tariffs, the wholesale electricity tariff and the UES transmission fee rose at the start of January.

The average energo tariff increases at New Year are 10-15%, which is in line with expected inflation in 2003 and may indicate no further tariff revisions this year (even then, tariffs in 2003 will be more than 10-15% higher than the average in 2002, since many of the 2002 rises occurred in the course of the year and not at its beginning).

It is noticeable that regional utilities are tackling the problem of cross-subsidization by industry of households, raising household tariffs and keeping industry tariffs unchanged. The utilities are being forced to this by threat of defection by industrial customers to the wholesale market.

However, tariffs of most energos are likely to be inadequate in 2003 (like in 2002), as growth of fuel and purchased electricity prices continue to outpace tariff growth. Cost-cutting programs are urgently required but it is not clear whether they are feasible. We see the financial situation in the power sector in 2003 as remaining difficult.

Mosenergo (BUY) plans no new loans

Mosenergo financial director, Vladislav Nazin, said that the company is unlikely to take new loans in 2003 because of the position of the regional energy commission, which opposes inclusion of loan coverage in tariffs. The most recent loan by Mosenergo was \$70m from the EBRD, which was used to settle Eurobonds in October 2002 and for capital construction. The company has not yet reported tariff revision, which should follow increase in fuel prices at New Year. We believe that such revision will come in the first quarter, as tariff changes in the second half of 2003 will be harder to obtain due to Duma elections.

Nizhnovenergo (BUY) faces competition

At the end of December the Nizhny Novgorod regional energy commission set tariffs for Nizhnovatomenergoby, a sales intermediary founded in early 2002 by the city administration and Russian nuclear power holding, Rosenergoatom. The company has the right to resell electricity from the

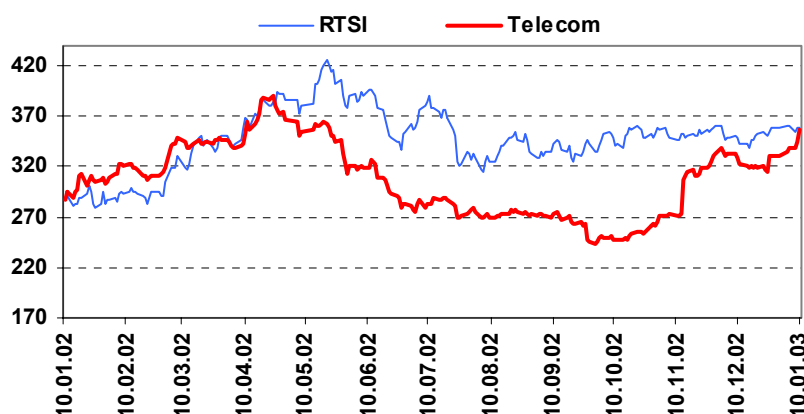
wholesale power market to regional customers and may begin operations in the first quarter of 2003. It is currently holding negotiations with potential customers.

The newly established company could become a serious rival to the existing monopoly, Nizhnovenergo, by undercutting its tariffs.

Energos continue buying their land

We noted in the previous RMG weekly that energos have started buying land, on which their facilities are situated. Since then it has been reported that Novosibirskenergo and Mosenergo have taken steps to do this. Novosibirskenergo began first payments for land at the end of December, transferring \$3m. Mosenergo estimates that it will need to spend \$360m for land purchases. That represents about 20% of annual revenues, which will seriously damage financial figures. Payouts to buy land will be common throughout the power sector for the next 1-2 years, intensifying pressure on utility finances.

Telecom Index vs. RTS Index



Telecoms Key Figures

Sector indicators: median	Value	Wk change
MC / Net profit	13.93	
EV / EBITDA	4.75	
EV / Net sales	1.29	
EV / Access lines	0.12	
EV / Employees	9.99	

ADRs of Russian telecoms	Value	Wk change
Rostelecom	7.44	3.33%
MTS	39.89	3.18%
Vimpelcom	35.62	9.26%

Sector Wrap

- Siberia Telecom and Center Telecom announced EGMs to complete the merger process with fixed telecoms in their respective federal zones. Both companies have reasonable growth potential.
- Ural Svyazinform released preliminary 2002 financial results in line with our estimates, showing growth in all segments. Production multiples also improved, but proposed 2002 dividends do not represent attractive yield.
- Siberia Telecom plans to issue bonds worth \$40m to finance acquisition of two mobile operators and other company projects. The stakes to be acquired are currently owned by RTDH Corporation, which is affiliated with Siberia Telecom through Svyazinvest.
- A similar deal is being examined by Volga Telecom. The company plans to acquire more shares in mobile operator NSS to raise its stake to 100%. A \$30m bond issue is planned for possible financing of this acquisition.
- December and full-year figures for the Russian mobile market are impressive. Total subscriber numbers grew 9.2% from November and 121% from the end of 2001. The two leaders, MTS and Vimpelcom, showed almost identical growth rates during the year. Further 70% growth in total subscriber numbers is expected in 2003.

Sector Statistics

Issue	Issue RTS Code	Mid Market Price, \$	Weekly Change, %	Weekly Volume, \$mln	Market Cap, \$mln	52 week Low, \$	52 week High, \$	P/S 01	P/E 01
Center Telecom com	ESMO	0.273	0.7	0.123	152.03	0.191	0.390	1.18	13.99
Center Telecom pref	ESMOP	0.170	1.5	0.057		0.100	0.188		
Dalsvyaz com	ESPK	0.736	-0.9	0.071	29.64	0.525	0.800	0.59	10.57
Dalsvyaz pref	ESPKP	0.483	2.7	0.017		0.360	0.600		
Moscow City Telephone com	MGTS	6.225	-1.2	0.012	541.24	5.950	7.500	2.03	43.95
Moscow City Telephone pref	MGTS	3.450	0.7			2.350	3.770		
North West Telecom com	SPTL	0.371	0.6	0.025	322.58	0.345	0.570	1.15	13.13
North West Telecom pref	SPTLP	0.212	6.1	0.024		0.170	0.300		
Rostelecom com	RTKM	1.259	4.5	3.758	1 119.10	0.948	1.670	1.70	14.60
Rostelecom pref	RTKMP	0.825	7.7	0.240		0.496	0.850		
Siberia Telecom com	ENCO	0.025	0.4	0.117	82.71	0.017	0.032	1.12	11.84
Siberia Telecom pref	ENCOP	0.016	6.8	0.020		0.009	0.017		
South Telecom com	KUBN	0.075	4.9	0.099	269.65	0.054	0.098	0.97	8.17
South Telecom pref	KUBNP	0.052	6.2	0.020		0.041	0.055		
Ural Svyazinform com	URSI	0.014	5.8	0.966	509.88	0.009	0.015	1.26	19.73
Ural Svyazinform pref	URSIP	0.009	5.5	0.080		0.008	0.009		
Volga Telecom com	NNSI	1.261	1.0	0.038	134.03	0.810	1.450	1.33	16.87
Volga Telecom pref	NNSIP	0.883	12.4	0.024		0.480	0.970		

Siberia Telecom (BUY) announces EGM

Siberia Telecom will hold an EGM on March 4, 2003 to complete merger with 10 other telecoms in the Siberian federal zone. Main issues on the agenda will be elections to the board, appointment of the CEO, and changes in charter capital. The cut-off date was December 29. The company carried out share conversion on November 30, increasing its charter capital by 4.46 times. The merger increases company telephony capacity by 5.72 times and these two figures imply potential for growth in the stock price.

Center Telecom (BUY) announces EGM

Another EGM will be held by another merger company, Center Telecom, which merged companies in the Russian central federal zone. The EGM date is February 20 and the cut-off date was December 17. Company charter capital increased 3.4 times due to the merger, while access line numbers rose by 4.1 times, implying growth potential.

Ural Svyazinform (BUY) gives preliminary 2002 results, dividend estimate

Latest estimates by Ural Svyazinform for 2002 results of the enlarged company are quite close to our estimates, although the EBITDA figure differs significantly due to different estimates of D&A expenses. The company will definitely show major financial progress in absolute terms, though margins may stay close to those in 2002.

Ural Svyazinform FY 2002 results (RAS)

	FY02 (company), \$m	FY02 (RMG), \$m	FY01 (RMG), \$m
Net sales	462	471	365
EBITDA	171	141	118
- EBITDA margin	37%	30%	32%
Operating profit	123	127	68
- Operating margin	27%	27%	19%
Net profit	32	30	23
- Net margin	7%	6%	6%

Source: Company estimates, RMG estimates

Ural Svyazinform also reported growth in production parameters for the enlarged entity. The number of fixed access lines in use totaled 3m at the end of 2002, up 4% from 2001. Mobile subscriber numbers totaled 445 087, up by impressive 740% from the end of 2001.

CEO Vladimir Rybakin stated that common and preferred shareholders will receive 20% of net profit as dividends for 2002. Before the merger Ural Svyazinform had no preferred shares on its balance, but following merger with other telecoms they total 20% of charter capital. The December EGM decided that dividends per preferred share would be 10% of net profit divided by the number of preferred shares

equal to 25% of charter capital (a principle often used in Russia). This will mean that the preferred shareholders payout will be about 8% of net profit. We believe that the common share payout will total 10% of net profit, as consolidated payout on common shares of all merged companies in 2001 was exactly 10% of their consolidated net profit.

Based on these estimates the Ural Svyazinform common dividend could total 0.009 cents and the preferred dividend could be 0.028 cents, representing 1% and 3% dividend yields respectively, which has little attraction.

Siberia Telecom (BUY) to finance acquisitions via bonds issue

Siberia Telecom plans to issue up to \$40m of bonds in the first half of 2003, part of which should be spent on purchase of 49% stakes in two mobile operators, Yeniseitelecom and Baikalvestcom. The company announced an EGM to be held in February on acquisition of these companies via purchase of missing stakes from their current owner, RTDH Corporation. Total costs on these purchases are likely to be \$21.3m. Both Siberia Telecom and RTDH are affiliates of the Russian telecommunication holding Svyazinvest so the deal will be internal.

Volga Telecom (BUY) to consolidate ownership in NSS, plans bonds issue

Volga Telecom is carrying out an operation similar to that at Siberia Telecom, and plans to hold an EGM on acquisition of 50% in mobile operator Nizhny Novgorod Cellular Communications (NSS) via purchase of this stake from RTDH Corporation. Volga Telecom already owns 50% of NSS, and the operation is clearly a policy step by Svyazinvest, following the pattern at Siberia Telecom. The EGM is scheduled for February 12. Volga Telecom also plans bond issue of about \$30m, possibly to finance purchase of the missing stake (price of the deal has not been specified).

Apart from NSS Volga Telecom has 20-100% stakes in 15 other cellular operators, acquired after merger completion in the Volga federal zone. Increase of stakes in these companies would require considerable financial resources.

Mobile figures update - 2002 results

The telecom consultancy J'son & Partners reported preliminary Russian mobile market statistics for the end of December 2002. Total subscriber numbers reached 17.8m, up by 9.2% from November and by impressive 121% from the end of 2001. The Russian market has thus again beaten predictions, exceeding 2002 forecasts of 17m. The December change was higher than in November (5.8%) due to a pre-holiday

boom in sales and attractive market strategies of operators. Sales in November are traditionally stagnant.

Mobile subscribers in December 2002 (millions)

	MTS	Vimpel-com	Mega-Fon	Other operators
Moscow	2.98	3.71	0.32	0.19
Other regions	3.43	1.37	2.63	3.17
Total # of subscribers	6.41	5.08	2.95	3.36
<i>Dec/Nov 2002 change, %</i>	<i>5.7%</i>	<i>10.7%</i>	<i>10.3%</i>	<i>5.7%</i>

Source: J'son & Partners, RMG estimates

MTS still leads the two other biggest operators by total number of subscribers, but the company has shown slower growth rates compared with its rivals in recent months. Vimpelcom is already ahead of MTS in the Moscow license area (MLA) and achieved 36% subscriber growth in other regions in December thanks to strong marketing and acquisition of Extel, the Kaliningrad-based operator with over 100 000 customers. MegaFon's subscriber base in the MLA rose 28% in December (25% in November) mainly thanks to aggressive sales strategy and low tariffs, although this involves losses, which cannot be sustained indefinitely.

Changes from the start of the year show approximately equal growth in the subscriber base of MTS and Vimpelcom (142% and 141% respectively). Penetration rate in the MLA has now reached almost 50% and further development is now focused on other regions, where penetration is substantially lower. The trend is clear from fall in the MLA share of

total customer base from 51% at the beginning of the year to 40% at the end. It is important to note that Vimpelcom is trailing MTS and MegaFon in most regions except the MLA, and Vimpelcom may need to increase investments and adjust its strategy to regain the initiative.

In 2002 MegaFon impressed with a 223% increase in its customer base, especially in non-MLA regions, but such growth is explained but a comparatively low initial base. MTS and Vimpelcom both did better in terms of net additions.

The average penetration rate at the end of 2002 was 12.4%, a major increase from 5.6% at the end of 2001, but there is still large growth potential in 2003. J'son & Partners forecasts 30m mobile subscribers by December 2003, which would be a 70% rise year-on-year.

Penetration rate in December 2002 - top 10 regions

Moscow license area	48%
St Petersburg	33%
Krasnodar	20%
Kaliningrad	19%
Samara	16%
Tatarstan	15%
Novosibirsk	14%
Yaroslavl	11%
Tomsk	11%
Stavropol	11%
Russia average	12%

Source: J'son & Partners

Magnitogorsk announces figures as Putin visits

President Vladimir Putin visited Magnitogorsk and met with the CEO of steel maker Magnitogorsk Steel (MMK), Viktor Rashnikov. According to Rashnikov, investment in company development last year totaled \$100m, most of which was directed to capacity modernization, allowing the company to increase output of steel and make production more profitable. Rashnikov reported that average wages at MMK are R9000 (\$284) and will rise to R11 000 (\$340) in 2003. Output has risen by 65% over the last six years and MMK has become the first Russian company to produce galvanized steel for the auto industry.

According to Rashnikov, the company's main problem is delayed VAT refunds on export operations. The average time for VAT refund is three months, diverting \$40m of current assets on average.

Rashnikov said that US and EU recognition of Russia as a market economy has helped MMK on these markets, but the US customs barrier of 30% is a problem. MMK's biggest trade partner is China (the company supplied 1m tonnes of production to China in 2002). All Russian steel producers currently supply about 50% to export and 50% to the domestic market.

We expect sales in 2002 to be \$1785m and net profit about \$93m. The company has good prospects for 2003 and integration with Novolipetsk could be the major event in Russian metallurgy in 2003-2004.

Severstal (BUY) starts metal auctions

Severstal carried out a first steel auction, at which about 100 buyers bought 20 000 tonnes of production. The company plans monthly auctions as a way of increasing its client base and tracking its structure. Severstal increased output by 4.9% to 7.78m tonnes in 11M 2002.

We expect sales of around \$1750m in 2002, but net profit may halve y-o-y to \$80m due to higher interest payments, sales expenses and other operating expenses. The cost spike is partly due to company restructuring and we expect profitability to improve in 2004.

Nizhny Tagil (HOLD) increased rolled metal output by 4.7% in 2002

The Nizhny Tagil steel plant increased output of rolled metal by 4.7% y-o-y to 4.66m tones in 2002. The company increased cast iron production by 1.5% to 4.7m tones, and steel production by 1.9% to 5.29m tones.

According to company officials and based on financial results in 9M 2002, sales in 2002 may be

\$760m and net profit \$68m. Company shares seem cheap at the current price of \$0.09 per share, but there is risk of asset use by Eurasia Holding, the main shareholder of the company, that will be harmful to minorities.

Russian government cuts duty on galvanized rolled metal imports from Ukraine and Kazakhstan

The Russian commission on protective measures in foreign trade decided to reduce import duties for galvanized rolled metal imports from 31.8% to 24.3% from Ukraine and from 36.9% to 13.6% from Kazakhstan. The high duties were instituted to resist dumping by Ukrainian and Kazakhstan producers, whose prices undercut domestic producers by up to \$100 per tonne. Production of galvanized rolled metal in Russia fell by 9% in 1998-2000 to 899 000 tonnes in 2000.

The commission also decided to cancel export duties on polyvinylchloride and on nitric fertilizer and permitted temporary duty-free import of trucks with Euro-3 engines to help Russian logistic firms become competitive in Europe.

Pipe producers cut output

Taganrog Steel decreased pipe production by 18.7% y-o-y to 414 370 tonnes, including 214 300 tonnes of oil pipes and 108 900 pipe casings. Another leading pipe plant, Pervouralsky Pipes, reduced its output by 3.4% to 615 470 tonnes in 2002. Pervouralsky sales increased by 10% y-o-y in 2002 to R3012m (\$96m). Oil pipes are 8-10% of production and main customers are engineering companies.

Norilsk Nickel (BUY) restructures its mining units to raise production efficiency

Norilsk Nickel integrated three mines - Komsomolsky, Mayak and Skalisty into a mining group with its concentrating plant Talnalakhskeye, implementing the strategy stated in the development program till 2015. The group makes part of the company Polar subsidiary, which also includes Oktyabrsky, Taymyursky, Zapolyarny subterranean mines, Medvezhiy ruchey open-cast mine, the concentrating plant Norilskaya, sintering mill, three metal plants Nিকেlevy, Medny and Nadezhdinsky, workshop on platinum metal concentrates, geological enterprises, Dudinsky port and other units.

Enterprises of polar subsidiary produce 85% of nickel and cobalt, 70% of copper and 95% of PMG within Norilsk Nickel group. We think that this is a positive development as it reflects Norilsk Nickel management' dedication to raise production and administration efficiency and keep our short term BUY recommendation.

GAZ (HOLD) increases production in 2002

GAZ announced increase of production in 2002 by 3.5% y-o-y to 198 135 vehicles. The company increased production of trucks and minibuses and reduced production of passenger cars.

GAZ production figures

	2001	2002	% y-o-y
Total	191 435	198 135	3.5%
Passenger cars	80 692	65 648	-23.0%
Trucks	110 868	132 487	19.5%
inc. minibuses	21 601	32 229	49.2%

Source: Company data

GAZ intends to begin production of restyled "Sobol" trucks after production is resumed on January 8.

AvtoVAZ (SELL) increased export and cuts output in 2002

AvtoVAZ increased export of cars by 13.1% y-o-y in 2002 to 96 707 from 85 525. Most exports are of the company's most recent model, the 2110.

AvtoVAZ production figures

	2001	2002	% y-o-y
Total	767 313	702 966	-8.4%
Export	85 525	96 707	13.1%

Source: Company data

Production decline of 8.4% y-o-y was due to reduced domestic demand. Output was suspended before New Year to clear backlogs of unsold cars, and was due to resume on January 8. AvtoVAZ plans to build 690 000 cars in 2003.

In March AvtoVAZ and General Motors may decide to extend their cooperation, recently begun with the new Niva model. Joint production of engines for Opel (incorporated in GM) is a possible future project.

Russia builds fewer agricultural machines

Russian output of combine harvesters fell by 14.4% y-o-y in 11M 2002 to 7245 from 8459 in the same period of 2001. In 11M 2002 Russian producers built 393 feed harvesters against 553 in 11M 2001, 4236 seeding-machines against 5507 in 11M 2001, 4684 cultivators against 4131, and 5439 harrows against 5620.

Russian combine harvester production

	11M 2001	11M 2002
Rostselmash	5347	4541
Krasnoyarsky plant	2893	2521
Taganrogsky plant	174	178
Tulsky plant	28	2
Total	8459	7245

Source: ASM-Holding

ZiL plans to increase truck output by 62% in 2003

The Moscow truck maker ZiL plans to increase output by 62% y-o-y in 2003, based on a business plan approved by the supervisory board. The company plans to produce 20 245 trucks against 12 500 in 2002. The sales target is R7294m (\$225m).

Baltika (BUY) to launch new beer plant in Samara

Baltika plans to launch a beer plant in Samara on January 21. The investment totals \$55m and capacity is 150m liters per year. Construction started in October 2001. Baltika now has plants in St Petersburg, Tula and Rostov. The company was targeting 165m dl of beer production in 2002.

Baltika plans to launch a new plant in Khabarovsk in April 2003 with planned capacity of 10m dl per year, investing \$50m. The plant will produce beer for China and other Asian countries. Construction began at the end of 2001.

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