

Market Wrap

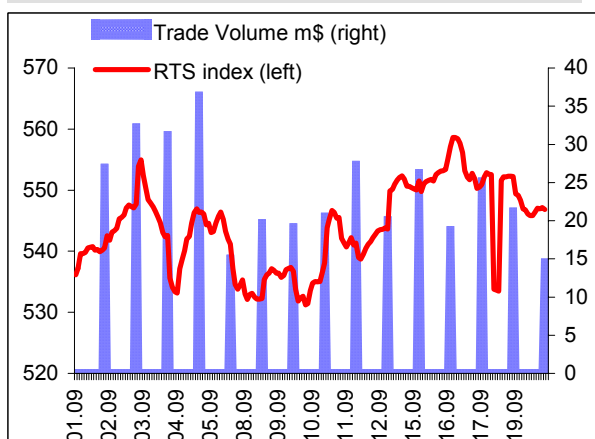
Mixed signals sent the RTS index up toward its historical maximum of 571 points and then back down to a Friday close at 546.86 points last week. Lower oil prices took a toll on some, but not all oil stocks, UES came under pressure from reform uncertainties, and speculators found some interesting stories among second-tiers.

A climb towards 560 points on Monday and Tuesday was due to rumors of a western buyer for YukosSibneft, and expectations of a relevant announcement at the Bush-Putin summit starting on September 21. But the market lost direction by mid-week as oil prices continued to slip, doubts grew over Yukos interim dividends, and concerns appeared over government and Kremlin plans to make generating company shares available for cash, threatening demand for UES shares.

A UES decline of 3% determined overall market performance. Yukos was down 1.9% for the week, keeping company with Lukoil, which was the main whipping boy for lower oil prices and lost 3.3%. Surgut and Tatneft both gained (2.86% and 2.38%), mostly as a correction after losses of previous weeks.

Norilsk was the most successful blue chip, adding 11% thanks to its purchase of yet another gold producer. But Nizhny Tagil was the best stock on the market, adding 50% on 15 recorded trades (\$0.5m). The outstanding performance was due to a eurobond road show by Nizhny Tagil owner, EvrazHolding. Sberbank lost 5% after the CBR predicted major decline of its retail market share (see [Viewpoint](#) in this RMG Weekly).

Regional telecoms seemed unaffected by announced delays of Svyazinvest privatization and ADR issues. Ural Svyazinform and South Telecom both gained 1-2% on healthy volumes.

RTS Index & Volume

Key Figures

RTS Index	546.86	0.6%
RTS Volume (\$m)	105.95	-0.79%
Ruble / Dollar	30.59	
Int'l Reserves (Sep 12)	\$62.1b	

Weekly data Fri-Fri.

Winners

Nizhny Tagil Metal com	+54.1%
Chelyabinsk Metals com	+25.4%
Chelyabenergo pref	+23.0%
Orenburgneft com	+14.0%
KamAZ com	+13.2%
GMK Norilsk Nickel com	+9.2%

Top Volumes (\$m)

RAO UES com	39.9	37.6%
Yukos com	22.4	21.1%
Lukoil com	12.0	11.3%
Surgutneftegaz com	8.4	7.9%
Norilsk Nickel com	5.3	5.0%
Sberbank com	2.9	2.7%
Rostelecom com	2.1	2.0%
Total (Top 7)	92.9	87.7%

Losers

RAO UES pref	-4.1%
Sberbank com	-4.0%
RAO UES com	-3.5%
Lukoil com	-3.1%
Aeroflot com	-2.0%
Tatneft pref.	-1.5%

Sector Statistics

Sector Name	Volume \$	MC\$'000	% of MC	Change -week	Change -month	Change -year
Oil & Gas	46,411,193	88,071,969	61.46%	-0.03%	0.71%	48.04%
Power Utilities	42,527,974	20,630,467	14.40%	-0.86%	6.74%	232.66%
Metals	6,233,400	13,519,079	9.43%	9.54%	19.91%	157.53%
Telecom	5,610,394	8,644,238	6.03%	0.14%	3.87%	97.18%
Banks	2,884,050	5,104,437	3.56%	-2.58%	2.44%	72.08%
Engineering	1,707,816	2,545,652	1.78%	3.17%	14.08%	32.07%
Transportation	307,950	785,452	0.55%	-0.53%	24.25%	75.45%
Others	145,190	3,189,915	2.23%	n/m	0.33%	9.29%
Chemicals	120,645	639,681	0.45%	3.45%	13.71%	75.95%
Retail	n/m	175,525	0.12%	n/m	-2.30%	12.71%
Total	105,948,611	143,306,414	100.00%	0.66%	3.74%	70.39%

VIEWPOINT: DEPOSIT GUARANTEE LAW WILL BOOST BANK SECTOR AND INVESTMENT

A draft law on bank deposit guarantees went through the Duma last week. It was supported by left, right and center, and the government is probably not being over-optimistic when it predicts that the measure could be ready for implementation by New Year.

This looks like very good news, since deposit guarantees have been viewed as a vital ingredient for growth of the Russian banking sector. Retail deposits are the main source of funds in the bank sector worldwide, and the potential in Russia is particularly large, since households have been enriched by three years of economic growth and keep a lot of that money at home, mindful of losses suffered in 1998 bank collapses.

The law has been repeatedly discussed and delayed over the last 10 years. Strong Duma support at the end of 2003 is probably conditioned by approach of elections (“deposit guarantees” has a pleasant ring to the ears of most voters).

A CBR statement last week that the Sberbank share of retail deposits could fall below 50% by 2007 was obviously based on introduction of the insurance scheme, which is expected to tempt depositors away from Sberbank to higher interest rates at younger, private banks. Sberbank, which already has an implicit government guarantee for deposits, and honored all retail obligations in 1998, will come into the new insurance scheme on equal terms with other banks by 2007.

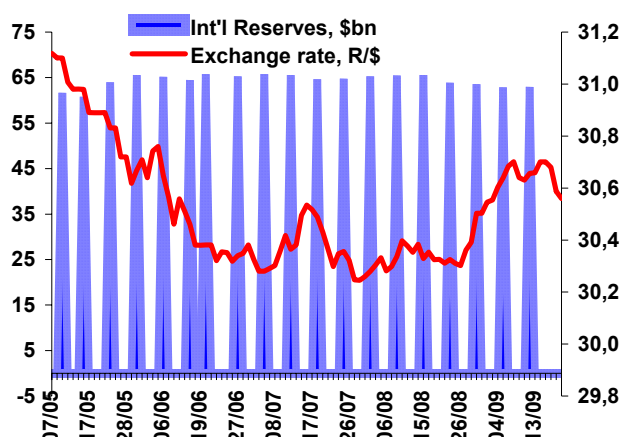
Such a broadening and strengthening of the non-Sberbank banking industry would be welcome. However, Russian households, which are extremely

canny as regards outplacement of their cash (a skill acquired through bitter experience), may not buy the story. First, after watching virtuoso responsibility-dodging performances, such as that by Alexander Smolensky of SBS-Agro in 1998 and after, they will guess that bank owners will use the guarantee mechanism to take wild risks with retail deposit money. Second, they will make the simple observation that more guarantees mean lower interest on deposits, making it not worthwhile to quit Sberbank.

The new guarantee mechanism is actually less generous than the guarantees, which Sberbank now offers, Sberbank interest rates are currently negative in view of inflation, but the institution attracts cash due to the full confidence of deposit safety, which it inspires. By contrast, the new measures will give just 75% of a \$3000 deposit and no guarantee for larger sums.

Nevertheless, if every Russian put (fully refundable) \$500 in a bank as a result of the deposit guarantee measure, that would be \$70b for investment in the economy, which is a very significant sum. That is unrealistic, of course. But placement of personal cash on accounts at several banks, in order to spread risk, was widely practiced by relatively affluent Russians before 1998. And if one in 20 people each put \$1000 in each of 10 different banks, that would give the same effect.

Economic Indicators



Source: CBR

Industrial production rose by 6.6% y-o-y in January-August

Goskomstat reported growth of industrial production in January-August 2003 by 6.6% y-o-y. That compared with growth of 3.8% in the same period of 2002. Industrial growth in August 2003 was 5.5% y-o-y against 7.1% in July. The largest growth in January-August 2003 was in the fuel industry (9.7% y-o-y), ferrous metallurgy (9.4% y-o-y) the medical industry (7.9% y-o-y), and machine engineering (7.8% y-o-y). There were declines in light industry (-3% y-o-y), the printing industry (-7.1%) and microbiology (-22.9%).

Industrial production in January-August 2003

	% y-o-y
Power energy	4.5
Fuel industry	9.7
Ferrous metallurgy	9.4
Non-ferrous metallurgy	4.8
Chemical & petrochemical	4.1
Machine engineering	7.8
Timber, wood, pulp and paper industry	0.8
Building materials	5.3
Light industry	-3.0
Food industry	4.6

Source: Goskomstat

Output of main products in the energy sector rose in January-August: power energy production was 595bkWh (up by 4.5% y-o-y), oil production was 275mt (11.2% growth y-o-y), oil processing rose by 3.1% to 126mt, gasoline production rose by 2.7% to 19.3mt, and gas production rose by 4.2% to 405bcm. However, production of passenger cars fell by 7.3% to 646 000.

Key Macro Figures

CBR refinancing rate, %	16	21/02/03
M2, Rbn	2625.4	1/08/03
M0, Rbn	940.9	1/08/03
CPI, %	-0.4	08/03
Inter'l Reserves, \$bn	62.1	12/09/03
One-day MIACR, %	4.11	18/09/03
Exchange rate R/\$	30.56	20/09/03
Exchange rate R/euro	34.40	20/09/03
OFZ yields, % p.a.	7.33	19/09/03
GKO-OFZ duration, days	866.97	19/09/03
Eurobonds Russia 05 YTM	2.9%	19/09/03

Monetary base fell by 0.7% in August

The monetary base (broad definition) fell by 0.66% in August to R1500.8b from R1510.8b. The volume of currency issued, including cash in vaults of credit institutions, rose from R992.0b to R1020.6b or by 2.88%. Required reserves, held by banks at the Central Bank, rose by 2.26% from R243.6b to R249.1b. Amounts on correspondent account balances of credit institutions with the CBR fell by 9.4% from R144b to R130.4b. The volume of other accounts of banks at the CBR fell by 55.85% from R57.3b to R25.3b. CBR obligations to buy back securities rose from R73.8b to R75.3b.

Duma passes bill on deposit insurance in first reading

The Duma last week passed the first reading of the bill on bank deposit insurance, which will provide for return of deposits to clients in case of bank insolvency. The upper limit for refunds to a single depositor at a bank is R95 000 (\$3065). Deposits under R20 000 will be 100% refundable and deposits over R20 000 will be 75% refundable, and these limits may be increased in the future. Sberbank deposits will be subject to a separate state guarantee until 2007, when Sberbank will join the scheme created by the new law.

The volume of insurance payments will not exceed 0.15% of balances on deposit accounts, and the Agency for Restructuring of Credit Organizations will determine insurance payment amounts as well as providing an initial deposit insurance fund of R3b (\$97m). The law also sets out procedures for accessing and leaving the deposit guarantee system. The law should receive final approval in November, according to government plans.

Biggest Russian producers increased sales by 28.7% in January-July

The largest Russian companies generated sales revenues of R3505b (\$113b) in January-July 2003, up by 28.7% y-o-y, according to Goskomstat. In July 2003 their volume of paid production was R564.6b, which is 6.5% higher than in June.

The share of cash in total payments to these companies rose to 86% from 84.4%. The share of payments by bills was 4.5%, while barter was down to 0.7% of total settlements in July.

Payments for production of biggest Russian producers in July 2003

	Rm
UES	56 747
Gazprom	135 789
Railway Ministry	47 843

Source: Goskomstat

Shadow economy estimates

According to an estimate by Russia's Security Council, the shadow economy accounts for 20-25% of GDP or about R2000-2500b (\$65-81b), and about 9m people are employed in the shadow economy. The criminal sector is estimated to account for 5% of GDP. The volume of illegal outflows from Russia was \$12b in the first half of the year, according to the Security Council.

IMF revises its forecasts

The International Monetary Fund revised estimates for growth of the world economy and the Russian economy. According to new forecasts by IMF experts, the US economy will grow by 2.6% in 2003 and 3.9% in 2004. The IMF sees expansion of the US budget deficit and trade deficit as the main obstacles to US growth. Growth in the eurozone will be slower at 0.5% in 2003, according to the IMF, due to subsidies for new EU members. The fastest growing region will be Asia.

IMF growth rates forecast, %

	2003	2004
World economy	3.2	4.1
USA	2.6	3.9
Eurozone	0.5	1.9
Germany	0.0	1.5
France	0.5	2.0
Italy	0.4	1.7
Japan	2.0	1.4
UK	1.7	2.4
China	7.5	7.5
Russia	6.0	5.0

Source: IMF

The Russian economy will grow by 6% in 2003, according to the IMF, which has upped its earlier forecast of 4% Russian growth. The IMF forecast for GDP growth in Russia in 2004 is 5% due to reduction of the inflow of oil dollars.

Industrial producer prices rose by 1.4% in August

Industrial producer prices rose by 1.4% in August and by 9% in January-August 2003, according to Goskomstat. In July the growth of prices was 2.2% and in June it was 0.7%. The producer price index rose by 12.4% y-o-y in January-August 2002.

Industrial producer price growth in Jan-Aug 03

	August, % m-o-m	January-August, %
Power energy	0.4	13.8
Fuel industry	5.5	1.2
Ferrous metallurgy	1.0	24.1
Non-ferrous metallurgy	-1.5	11.8
Chemical & petrochemical	1.6	9.3
Machine engineering	0.8	8.0
Timber, wood, pulp and paper industry	0.2	5.4
Building materials	1.6	14.3
Light industry	0.9	7.9
Food industry	1.0	7.4

Source: Goskomstat

GDP rose by 7% in 1H 2003

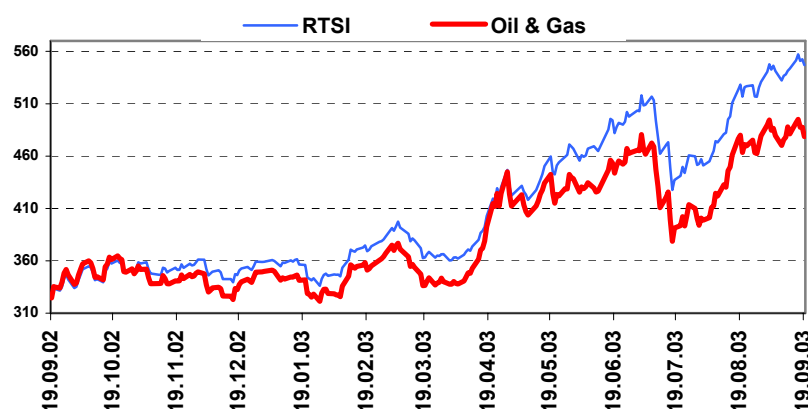
According to Goskomstat, Russian GDP rose by 7% y-o-y in 1H 2003 to R6033.8b (\$195b). Index-deflator GDP in 1H 2003 was 117.1% y-o-y. In 2Q 2003 GDP was R3110.7b, up by 7.2% y-o-y. In 1Q 2003 GDP was R2898.1b.

The share of goods production in GDP was 32.3%, the share of services was 55.5%, and the share of net taxes was 12.2%.

Production of five base sectors rose by 6.6%

Output by the five base sectors (industry, building, agriculture, transport, retail) was 6.6% higher y-o-y in January-August 2003. Growth of output in the same period of 2002 was 2.8%. Industrial output growth in January-August 2003 was 6.6% (R5426b), investments in fixed capital rose by 12%, the volume of agricultural production fell by 6.1%, transport turnover rose by 7.2%, and retail turnover increased by 8.4%.

Foreign trade turnover in January-July 2003 rose by 26.1% y-o-y, exports rose by 28.1% and imports rose by 22.5%. Real disposable income rose by 13.4% in January-August 2003. The nominal wage rose by 24.7% and real wages rose by 9.2%.

Oil & Gas Index vs. RTS Index

Oil & Gas Key Figures

Indicator	Value	Wk Change
Urals (\$/b)	23,9	-4,8%
Brent (\$/b)	25,3	-5,4%
OIX (CBOE oil index)	277,7	-0,7%
Dow Jones Energy Index	217,1	-0,7%
US crude inventory change (EIA data) m bbl	279	1,1%
US gasoline inventory change (EIA data) m bbl	195	1,4%
Tatneft ADR	21,35	-0,7%
Lukoil ADR	74,10	-3,6%
Surgutneftegaz ADR	21,75	2,8%
Yukos ADR	58,50	-0,5%
Sibneft ADR	27,60	0,5%

Sector Wrap

- The Yukos BoD will consider interim dividends for nine months of 2003 at its meeting on September 25, 2003. We expect dividends of \$0.6 per common share.
- Shareholders of Sibneft approved interim dividends of R30.534b (\$1006m) at an EGM held on September 15, 2003.
- We calculated fair prices of major TNK-BP subsidiaries based on average level of comparative multiples for all subsidiaries of the holding. We recommend to BUY shares of the Ryazan Refinery, Saratovneftegaz and Udmurtneft and to HOLD other TNK-BP subsidiaries.
- Gazprom has placed 1b euros of medium-term euronotes.
- Gazprom will raise its capex budget by R10.38b (\$335m) in 2003, using its own cash. The Gazprom executive committee will develop a strategy of long-term debt management by November 2003.
- The government has given Gazprom the green light to push for higher prices for gas supplies to Belarus at negotiations starting in October.

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 02	P/E 02
LUKoil com	LKOH	18,650	-3,1	11,983	15 881,23	13,610	20,600	1,19	8,42
Megionneftegaz com	MFGS	14,525	3,4	0,526	1 647,23	5,050	14,700		
Megionneftegaz pref	MFGSP	7,425	11,6	0,251		2,400	7,250		
Sakhalinmorneftegaz com	SKGZ	4,050	11,7		239,76	1,930	2,750		
Sakhalinmorneftegaz pref	SKGZP	2,051	1,0			1,300	1,700		
Sibneft com	SIBN	2,770	0,4	0,085	12 943,75	1,740	2,815	2,68	12,33
Surgutneftegaz com	SNGS	0,436	3,1	8,355	17 640,99	0,286	0,560		
Surgutneftegaz pref	SNGSP	0,272	1,4	0,555		0,203	0,320		
Tatneft com	TATN	1,078	2,1	0,820	2 423,22	0,721	1,220	0,70	6,86
Tatneft pref	TATNP	0,565	-1,5	0,311		0,434	0,575		
Udmurtneft com	UDMN	165,050	-2,9		530,12	81,000	160,000		
Udmurtneft pref	UDMNP	162,500	15,7	0,029		74,500	127,000		
Yukos com	YUKO	14,495	-1,0	22,379	32 257,03	8,360	15,170	3,03	10,83

Yukos (HOLD) interim dividend to be decided

A decision on nine-month interim dividends is on the agenda for the Yukos (RTS: YUKO) BoD meeting on September 25. In case of a positive decision, interim dividends will be paid to shareholders of record on the meeting date. A record date for ADR holders will be separately established by Deutsche Bank, the depository bank for the Yukos ADR program.

We expect interim dividends of \$0.6 per common share or \$1.3b for all shares. Sibneft shareholders will not receive any payments since they will not yet officially be Yukos shareholders. We keep our HOLD recommendation for Yukos shares.

Yukos acquires 34% interest in Geoilbent

Yukos (RTS: YUKO) has signed an agreement to acquire 34% interest in Geoilbent from Harvest Natural Resources (Houston, USA). Geoilbent holds licenses for oil and gas properties in the Yamalo-Nenets region (Severo-Gubkinsky, Urabor Yakhinsky, Vansko Namysky, Uzhno Tarasovsky and Prisklonovy). The purchase price is \$75m including Geoilbent debts of \$5.5m owed to Harvest Natural Resources.

Acquisition of an interest in Geoilbent will significantly expand the Yukos asset base in Yamalo-Nenets. Geoilbent produced 891 000 tons of oil in 2002, up by 9.7% y-o-y. Geoilbent's balance sheet liabilities about \$30m. Closing of the transaction is expected by the end of the year subject to consent from the Russian Ministry for Antimonopoly Policy and the EBRD.

Sibneft (HOLD) shareholders approve \$1006m dividends

Shareholders of Sibneft (RTS: SIBN) approved interim dividend payments of R30.534b (\$1006m) at an EGM held on September 15, 2003. The dividend per share will be R6.44 (\$0.21). Total dividend payments for full-year 2002 were \$1.09b. We keep our HOLD recommendation for Sibneft shares, while awaiting exchange conditions to Yukos shares for minority shareholders. The average price for the last half of the year was \$2.43 per common share, and we expect that the price offered by Yukos to Sibneft minority shareholders will be about \$2.67, which is 10% higher than the current six-month average share price.

Gazprom (local shares BUY) raises 2003 capex by \$335m, commits to debt strategy

The BoD of Gazprom (SPBEX: GSPBEX) approved several decisions on capital expenditures for 2003 and volume of borrowings.

Gazprom has decided to increase the volume of capex in 2003 by R10.38b (\$335m), using its own cash. Priority capex projects include gas field

construction, reconstruction and technical re-equipment of gas fields, drilling, launch of gas pipelines and development of the Pestsovoye, En-Yakhinskoye and Zapolyarnoye gas condensate fields. Spending of R3.52b (\$113.5m) is planned for improving gas supply infrastructure in various Russian regions.

Gazprom's original capex budget for 2003 was R179.8b (\$5.8b). Capex in 2004 should rise to R237b (\$7.4b), but that figure may be cut back to R200-230b (\$6.25-7.2b).

The Gazprom executive committee is also due to present a long-term debt management strategy by November 2003, setting out main principles of debt management and a schedule of debt servicing. In January-August 2003 the company borrowed \$3.31b, which is about 75% of the total planned volume of borrowing for 2003. Borrowed resources were used for restructuring of short-term debt, investment program financing and financing of current activities. None of this borrowing was secured. The average interest rate for the Gazprom borrowing in 2003 was 8.9%, lower than in 2002. In 2002 the rates for foreign currency borrowings varied from 3.4% to 13.3%. Eurobonds placed in 2002 with maturity in 2007 and 2009 had interest rate 9.125% and 10.5% respectively. The BoD postponed approval of a \$300m loan from a syndicate of banks, led by Commerzbank AG, despite its approval by the company's executive committee on July 31, 2003. This loan would be guaranteed by export sales.

The BoD also approved collaboration with Eural Trans Gas (ETG), which is the operator for gas supplies from Turkmenistan to Ukraine. Gazprom will ensure transit of 34bcm of gas from Turkmenistan across Russian territory to Ukraine.

We are closely following Gazprom's efforts to define a debt strategy, and are pleased to see that the company is aware of its importance. We keep our BUY recommendation for local market shares.

Gazprom could increase the price of gas for Belarus

Prime minister Mikhail Kasyanov has canceled the government's recommendation to Gazprom to set a price of around \$30 per 1000cm for supplies to Belarus. Gazprom will begin negotiations with Belarus in October on a new gas price, and we expect that the company will press for a level of \$35-40 per 1000cm.

Itera has contracted to supply about 6.3-7.5bcm of gas to Belarus at a price of \$46.68 in 2004 (Itera is due to supply about 6.3 bcm to Belarus in 2003). Gazprom will supply 10.2bcm to Belarus this year and Transnafta is to supply 1.5bcm. TNK has

negotiated a contract for supplying 250mcm to Belarus by the end of 2003 at a price of \$37 per 1000cm.

China sets gas prices for West-East pipeline

According to the Chinese government, the average price for gas transported through the planned West-East pipeline in China will be about \$153.4 per 1000cm, of which \$58 will represent the field price of gas and \$95.4 will represent transportation. Prices in specific cases will depend on the region, where gas is bought, and on the category of consumer. The highest gas prices will be set for municipal gas systems (\$140.1-176.4 per 1000cm). Enterprises will pay lower prices (\$135.3-157.1 per 1000cm), and the lowest price will be for power stations (\$132.9-145 per 1000cm). Uncertainty over gas prices has been a major obstacle in negotiations between PetroChina and a consortium including Royal Dutch/Shell, ExxonMobil and Gazprom.

Gazprom placed euronotes

Gazprom (SPBEX: GSPBEX) placed 1b euros of medium-term euronotes last week. Lead-managers of the issue were Deutsche Bank and UBS, and the issue was carried out through Gazprom subsidiary Gaz Capital SA. The largest portion of the placement (33%) was purchased by UK investors, 10% was taken by Russian investors, 11% was taken by investors from the USA and the same amount by Swiss investors, 7% was sold to German investors, 6% to Italian investors, 3% to Austrian investors, and Asian investors bought 5% of the issue. The interest rate was 7.8% and duration of the notes is seven years. The issue was placed at nominal price.

Average export price for gas rose by \$14 per 1000cm in 1H 2003

According to Gazprom, the average export price for gas in 1H 2003 was \$129 per 1000cm, which is higher than expected \$115 and will have a significant

effect on net profit of the company. We expect that full-year EBIT will be \$6.7b, if export prices hold up.

The Gazprom BoD also announced that reduction of costs in 1H 2003 was R29b (\$935m). Non-consolidated net profit of Gazprom rose by 6.9 times y-o-y in 1H 2003 to \$3563m. Sales in 1H 2003 were \$13 031m.

TNK-BP to determine priorities

TNK and BP gave an update on their Russian merger, which has created TNK-BP. On the TNK side the merger includes TNK itself, as well as Onako, Sidanko, Rusia-Petroleum and a network of filling stations. A part of Slavneft assets could also be joined to the merged company after division of Slavneft by Sibneft and TNK.

Minority shareholders currently own 3.9% in TNK (RTS: TNKO), 1.2% in Onako (RTS: ONAK), and 2% in Sidanko (RTS: SDNK) and also shares in subsidiaries of these three (Orenburgneft, the Ryazan Refinery, Udmurtneft, Varieganneftegaz and others). According to Vedomosti newspaper, exchange rates will be announced by the end of this year.

We calculated fair prices of major TNK-BP subsidiaries based on the average level of comparative multiples for all subsidiaries of the holding. It is not yet clear whether minorities will be offered exchange of their shares to TNK shares or a buy-out procedure, but valuation of all subsidiaries should be carried out by the same method in either case, so we assume that the best policy is to buy less expensive subsidiaries. We see upside 31% for the Ryazan Refinery, 66% for Saratovneftegaz and 32% for Udmurtneft.

We therefore recommend to BUY Ryazan Refinery shares as well as shares in Saratovneftegaz and Udmurtneft. We recommend to HOLD other TNK-BP subsidiaries.

TNK-BP subsidiaries

	Ticker	Sales 2002, \$m	Net profit 2002, \$m	MC/ Production	P/S	P/E	MC/ Reserves	Target price com, \$	Target price pref, \$
Orenburgneft	ORNB	483	-25	19.6	2.8	-54.6	12.2	14.6	7.4
Ryazan refinery	RNPZ	91	-22	0.4	0.4	-1.6	0.0	26.2	10.5
Orsknefteorgsintez	ORFE	329	1	7.7	0.6	395.6	0.0	34.0	15.3
Saratovneftegaz	SNFG	138	21	12.7	1.0	6.8	41.4	74.9	61.6
Udmurtneft	UDMN	451	58	16.0	1.3	10.1	202.2	223.6	197.3
Varieganneftegaz	VJGZ	259	53	29.9	2.2	10.8	40.0	18.6	14.9

Source: Company data, RMG estimates

TNK-BP has stated that the maximum possible valuation of all minority stakes is \$800m. The market could maintain a high price for subsidiaries, in expectation of an offer from TNK-BP.

Dudly gave initial indications of TNK-BP's operating strategy, saying that most investments will be directed to West Siberia. The company will announce its strategy in more detail in November. Operations in

West Siberia will be focused on production increase using new technologies. The company plans to increase profitability of production by 3-5%.

Lukoil (BUY) to launch terminal in Astrakhan

Lukoil (RTS: LKOH) will launch an oil terminal in Astrakhan on October 1, 2003. The terminal will have capacity of 2mt per year. It will be supplied by rail, and will allow loading of oil onto tankers for transportation across the Caspian Sea.

In separate Lukoil transportation news, Lukoil-Komi spent \$150m to increase capacity of the 150km Kharyaga-Usa pipeline from 7mt to 12mt. The pipeline will transport oil from Komi fields to the Transneft system at Usa.

Sakhalinmorneftegaz (SELL) increased oil production by 1.6% in January-August

Sakhalinmorneftegaz (RTS: SKGZ, SKGZP) increased oil production in January-August 2003 by 1.6% y-o-y to 1.082mt and reduced gas production by 1.5% y-o-y to 1.25bcm. In 2003 the company plans to produce 1.73mt of oil, up by 3% y-o-y, and 1.672bcm of gas, down by 3.3% y-o-y.

Megionneftegaz (HOLD) reduces net loss in 1H 2003

The Slavneft subsidiary, Megionneftegaz (RTS: MFGS, MFGSP), reduced its net loss by 59.1% y-o-y in 1H 2003.

Megionneftegaz 1H 2003 results (RAS)

	1H03, \$m	1H02, \$m	Change, %
Net sales	417.4	277.9	50%
CGM	416.6	295.2	41%
Gross profit	0.7	-17.4	
Operating profit	-7.4	-26.4	
- Operating margin	-2%	-10%	
Pre-tax profit	-16.8	-36.7	
- Pretax margin	-4%	-13%	
Net loss	-16.8	-41.3	

Source: Company data, RMG estimates

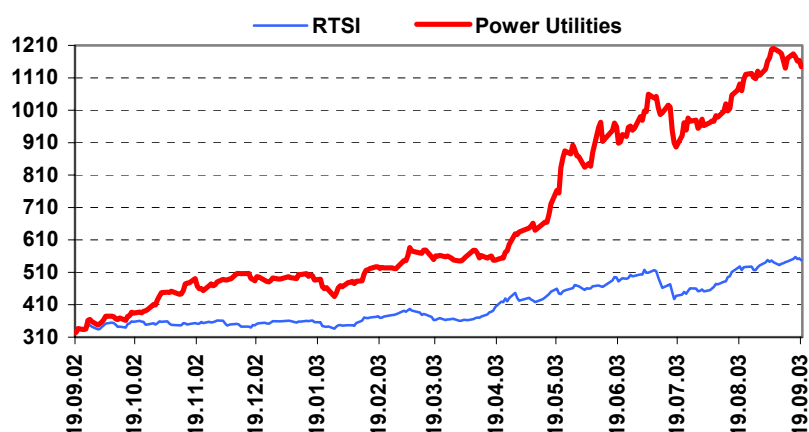
Accounts receivable stood at \$102.6m by the end of 1H 2003 and accounts payable were \$116.3m.

Vostok Nafta, a minority shareholder of Megionneftegaz, has challenged Slavneft's decision to pay interim dividends for 1H 2003 despite the Megionneftegaz losses. Slavneft is 99% controlled by TNK and Sibneft. The Slavneft interim dividends could be as high as R2.24 or \$0.07 per share. We keep our HOLD recommendation for Slavneft in expectation of a decision on division of the company.

Tatneft (SELL) expects higher profits in 2003

Tatneft (RTS: TATN, TATNP) may raise its forecast of profits before tax from R11b (\$355m) to R18b (\$581m), according to a company official. Income tax paid by Tatneft is the major revenue item in the Tatarstan budget and we suspect that the company may be under political pressure to give rosier profit forecasts. In view of this, and continued corporate governance concerns, we keep our SELL recommendation.

Power Utilities Index vs. RTS Index



Power Utilities Key Figures

Sector indicators: median	Russia	Discount to emerging markets
MC / Net sales	0,62	41%
EV / EBITDA	3,46	24%
MC / Owned inst. capacity	88,87	66%
MC / Retail supplies of elec.	12,05	78%

ADRs of Russian power utilities	Last sale	Wk change
RAO UES	31,850	-4,0%
Mosenergo	6,550	2,3%
Irkutskenergo	4,750	5,6%

Sector Wrap

- State officials are supporting use of cash in auctions for Wholesale Generating Companies. The news may undermine demand for UES shares.
- The MEDT and the Federal Energy Commission worked out guidelines for power tariffs in the next three years, based on growth rates below inflation.
- The Federal Energy Commission prepared legal provisions, allowing cross-subsidization to remain in the power sector until full market liberalization.
- UES announced impressive plans on power markets of former Soviet republics.
- Mosenergo and Moscow officials signed an agreement, by which the city will increase its stakes in distribution companies to be detached from Mosenergo.
- A Russo-German engineering consortium stated plans for huge investments in the Russian municipal sector.

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 02	P/E 02
Bashkirenergo com	BEGY	0,310	13,8	0,284	325,32	0,112	0,252	0,63	17,62
Irkutskenergo com	IRGZ	0,101	-1,4		462,38	0,064	0,112	1,19	72,47
Lenenergo com	LSNG	0,563	1,6	0,022	465,59	0,237	0,520	0,65	11,41
Lenenergo pref	LSNGP	0,313	-4,6	0,007		0,159	0,330		
Mosenergo com	MSNG	0,066	-1,5	0,624	1 857,19	0,028	0,085	1,08	90,15
Permenergo com	PMNG	3,600	10,8	0,013	148,45	1,500	4,250	0,33	17,22
Permenergo pref	PMNGP	2,925	17,0			1,350	3,000		
UES com	EESR	0,319	-3,5	39,873	13 747,47	0,075	0,346	0,91	12,99
UES pref	EESRP	0,284	-4,1	0,524		0,073	0,313		
Samaraenergo com	SAGO	0,064	13,9	0,018	226,60	0,033	0,059	0,48	60,43
Samaraenergo pref	SAGOP	0,033	14,8	0,046		0,019	0,032		
Sverdlovennergo com	SVER	0,345	8,7		176,26	0,144	0,270	0,22	21,52
Sverdlovennergo pref	SVERP	0,160	0,3			0,092	0,130		

Gref proposes cash as entrance ticket to WGCs

The Minister for Economic Development and Trade (MEDT) German Gref proposed last week that shares in future Wholesale Generating Companies (WGCs) should be available for cash as well as UES shares.

WGCs are to be set up through mergers of stand-alone power generating stations and a few stations detached from energos, and the government recently approved their exact composition. The UES (RTS: EESR, EESRP) "5+5" strategic plan envisages creation of WGCs as 100% UES subsidiaries in the form of holdings in a first stage and their subsequent transfer to single shares. According to the original plan, WGC shares would be obtained in return for shares of merging power stations, and power station shareholders, who prefer not to participate in WGCs, could trade their shares at auctions for shares of UES.

The MEDT justified its alternative proposal by stressing that sale of WGCs for shares only may lead to creation of oligopolies in the power sector, since it will facilitate acquisition of control by strategic shareholders of UES and power stations. The MEDT sees that as harmful for the economy and as tending to undermine any competitive market in the power sector. By contrast a cash-for-shares system would widen the circle of potential buyers. In particular, it may attract interest from foreign buyers to WGCs.

We find Gref's proposal very reasonable and expect it to be approved by government. Such approval would lead to reduction of demand for shares in UES, stand-alone power stations and possibly energos from strategic buyers. Commenting on Gref's proposal the head of the presidential administration, Alexander Voloshin, who also heads the UES BOD, said that cash may indeed be authorized as a means of payment for WGCs, but that the basic principles of power sector restructuring will not be changed.

MEDT and FEC propose three-year targets for power tariffs

The Ministry for Economic Development and Trade (MEDT) and the Federal Energy Commission (FEC) have prepared a draft resolution on development of tariffs in the power sector for the next three years. Officials have not released details, but say that, according to the proposals, tariff growth up to 2006 will not exceed compound inflation. The document will not bind power tariffs but will be used by regulatory authorities as a guideline for setting of tariffs. MEDT representatives said that their model takes account of fuel price forecasts and water levels in hydro reservoirs as well as inflation.

Elimination of cross-subsidization delayed

According to Vedomosti newspaper, the Federal Energy Commission (FEC) has prepared amendments to the government decree on canceling of cross-subsidization in the power sector (mainly undercharging of households and overcharging of industrial consumers). The decree was signed in 1997 and envisaged ending of cross-subsidization by 2000. However, that objective has still not been achieved by any energo. The amended document prescribes ending of cross-subsidization before the end of the transitional period of power sector reform. Specifically, it supposes that cross-subsidization will exist until power market liberalization, which is expected not earlier than 2006-2007.

The news is negative for industrial consumers, which hoped to transfer to the wholesale power market instead of being supplied by energos. Energos will gain from the delay, since they will have more time to rebalance tariffs between customers. In the long term energos, which are largely reliant on big industrial customers, will lose value in their distribution and sales business as higher residential tariffs will not fully compensate lower industrial tariffs and some industrial customers will switch to the wholesale market.

UES (BUY) starts expansion in former Soviet republics

UES (RTS: EESR, EESRP) announced grand plans for participation on power markets of former Soviet republics. UES CEO Anatoly Chubais stated last week that the company is targeting acquisitions in Armenia, Belarus, Ukraine, Moldavia, Tajikistan and Kyrgyzstan. In the longer term, UES is looking at purchases of power facilities in Latvia and Lithuania, and also Bulgaria and Slovakia.

UES has already begun expansion beyond Russia: earlier this year UES acquired power generating and distribution facilities in Georgia, which gave it control over 20% of local generation and 35% of distribution, while in Armenia UES has received control over several power stations as payment of debts to Russia and has also obtained a five-year management contract for an Armenian nuclear power station.

Chubais said that UES plans to participate in privatization of Moldavskaya GRES in Moldavia for exports of electricity to Romania and Bulgaria, and is also interested in the electricity distribution grid in Ukraine, and in renting the Berezovskaya GRES in Belarus for exports of electricity to Poland. In Tajikistan and Kyrgyzstan UES would arrange imports of cheap power to Russia. In particular, UES wants to participate in completion of a hydropower

station in Tajikistan. Chubais said that there is a favorable climate for buying power assets in these countries at present.

The plans look positive for UES, though it is hard to see how they fit with the principles of UES restructuring and its ultimate break-up, after which generating assets will be mainly privatized while the government should take control over distribution, possibly preserving the UES brand name. Strategically, it would make sense for UES to be interested in distribution assets in adjacent states, since import-export operations are bound to be profitable.

Mosenergo (BUY) signs agreement with Moscow authorities

Mosenergo (RTS: MSNG) and Moscow government officials signed an agreement on participation of the latter in future distribution companies, which are to be detached from Mosenergo. Mosenergo and UES representatives earlier confirmed existence of such an agreement in verbal form. According to the official agreement, the Moscow authorities will receive support from UES and Mosenergo management for joining their electricity and heat grid infrastructure to infrastructure detached from Mosenergo, and will increase their stakes in these businesses proportionally. At present the Moscow government directly owns 3% of Mosenergo and has another 5% stake through the Bank of Moscow.

Amalgamation with Mosenergo distribution facilities should lead to increased share of the city authorities in share capital of future heat and power distribution companies in Moscow. However, the Moscow government says that it wants control over these companies, and that may not be possible unless the city authorities increase their share in Mosenergo before its break-up.

Russian-German consortium plans major investments in the housing sector

Mikhail Vilkovsky, a member of the executive board of Russian Municipal Systems (RKS), recently set up by major Russian corporations including UES for reconstruction of the Russian municipal sector, said that a Russian-German consortium of industrial enterprises plans \$300b investments in this sector in the next 20 years. Participants of the consortium on the German side are DaimlerChrysler Services, BASF, Henkel, DAW, Phoenix, Hydrometer, Techem, Viessmann, and Veka. Vilkovsky said that launch of a \$4m pilot project is expected in the town of Korolev (near Moscow), but will depend on a special agreement with Gazprom. Commenting the consortium's investment plans, Vilkovsky said that \$300b is a target sum, which is unlikely to be

accumulated and used in the stated period, but that such a sum reflects sector investment needs.

Power utilities continue reporting 1H 2003 financials

Novosibirskenergo (RTS: NVNG, NVNGP) announced attractive half-year RAS results with operating profit growth of 254% mainly due to tariff rises. Operating margin increased from 5% in 1H 2002 to 14% in 1H 2003. Payables & debt deteriorated a little but that could be due to seasonal factors.

Novosibirskenergo 1H 2003 results (RAS)

	1H03, \$m	1H02, \$m	Change, %
Net sales	173.3	127.5	36%
CGM	149.5	120.8	24%
Operating profit	23.8	6.7	254%
- Operating margin	14%	5%	161%
Pre-tax profit	10.7	-4.8	n/a
Profit tax	9.2	1.0	845%
- Effective tax rate	86%	n/a	n/a
Net profit	1.5	-5.7	n/a
- Net margin	1%	neg	n/a
	1H03, \$m	FY02, \$m	Change, %
Receivables	56.3	56.4	0%
Payables and debt	132.5	125.2	6%

Source: Company data, RMG estimates

Sayano-Shushenskaya GES (RTS: SSHG, SSHGP) showed much improved figures for 1H 2003 under RAS. The company's average tariff for electricity doubled in 1H 2003 compared with 1H 2002, so that negative effect of a 5% fall in output was barely noticeable. Revenues increased by 77% while operating costs fell by 2%. As a result Sayano-Shushenskaya GES reported 31% operating margin compared with a negative figure in the same period of 2002. Net margin was also high at 15%. Payables & debt declined by 25% while receivables stayed almost unchanged.

Sayano-Shushenskaya GES 1H 2003 res. (RAS)

	1H03, \$m	1H02, \$m	Change, %
Net sales	20.8	11.7	77%
CGM	12.5	12.8	-2%
Operating profit	6.5	-1.3	n/a
- Operating margin	31%	neg	n/a
Pre-tax profit	5.3	-2.8	n/a
Profit tax	2.3	0.0	>1000%
- Effective tax rate	43%	n/a	n/a
Net profit	3.0	-2.8	n/a
- Net margin	15%	neg	n/a
	1H03, \$m	FY02, \$m	Change, %
Receivables	25.0	25.0	0%
Payables and debt	8.8	11.7	-25%

Source: Company data, RMG estimates

Kirovenergo (RTS: KIRE, KIREP) revenue growth of 26% in 1H 2003 under RAS was nearly matched by cost growth. Operating profit rose by 22%, but operating margin stayed nearly unchanged. Net profit almost doubled due to lower non-operating charges. Receivables rose by 19% but their share in revenues remained rather low.

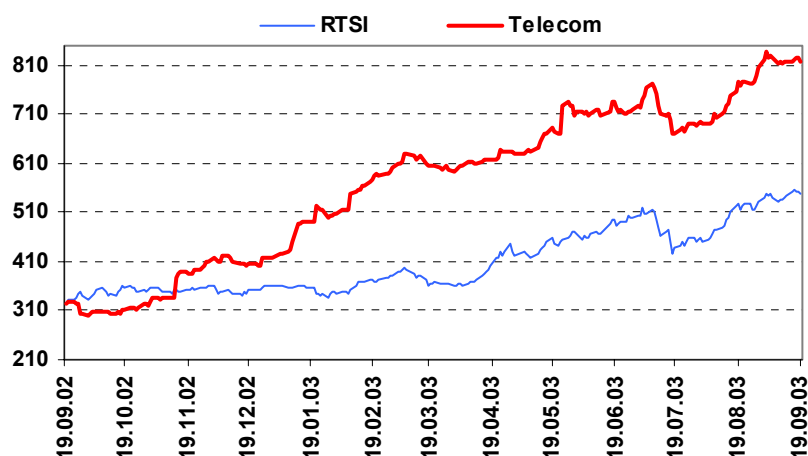
Kirovenergo 1H 2003 results (RAS)

	1H03, \$m	1H02, \$m	Change, %
Net sales	101.6	80.4	26%
CGM	89.8	70.8	27%
Operating profit	11.8	9.6	22%
- Operating margin	12%	12%	-3%
Pre-tax profit	9.4	3.6	162%
Profit tax	3.3	0.2	>1000%
- Effective tax rate	35%	6%	441%
Net profit	6.2	3.4	83%
- Net margin	6%	4%	45%

	1H03, \$m	FY02, \$m	Change, %
Receivables	69.4	58.3	19%
Payables and debt	56.5	56.8	-1%

Source: Company data, RMG estimates

Telecom Index vs. RTS Index



Telecoms Key Figures

Sector indicators: median	Russia	Discount to emerging markets
EV / EBITDA	4,2	10%
EV / Net sales	1,5	27%
EV / Access lines	134	86%
EBITDA / Access lines	32	87%

ADRs of Russian telecoms	Last sale	Wk change
Rostelecom	10,150	-3,3%
MTS	71,910	1,2%
Vimpelcom	58,980	6,6%

Sector Wrap

- The telecommunications sector showed very rapid growth in 8M 2003.
- Svyazinvest privatization has been put on hold again, at least until 2005, and Svyazinvest reported deferment of IPOs of the regional telecom companies.
- The Antimonopoly Ministry set strict limits to tariff increases by Svyazinvest and RTOs.
- Rostelecom announced plans to introduce per minute billing for outgoing international calls.
- Ural Svyazinform reported 2002 IAS financials, showing the highest share of cellular business in results among RTOs.
- Ural Svyazinform and Volga Telecom acquired control over Tatincom-T.
- Center Telecom and South Telecom successfully placed domestic bonds last week.
- MegaFon faces a new round of battles between its shareholders after the Antimonopoly Ministry refused permission for merger between Vimpelcom and MegaFon.

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 02	P/E 02
Center Telecom com	ESMO	0,332	-0,2	0,100	644,35	0,191	0,333	1,23	18,63
Center Telecom pref	ESMOP	0,241	0,0			0,110	0,225		
Dalsvyaz com	ESPK	0,985	2,9	0,049	113,60	0,525	0,950	0,67	18,03
Dalsvyaz pref	ESPKP	0,710	-7,8	0,010		0,400	0,750		
Moscow City Telephone com	MGTS	10,775	0,5	0,034	943,58	5,950	11,400	2,93	26,17
Moscow City Telephone pref	MGTSP	6,625	4,3	0,058		3,000	6,700		
North West Telecom com	SPTL	0,408	0,7	0,092	348,15	0,345	0,450	1,04	31,65
North West Telecom pref	SPTLP	0,254	3,1	0,050		0,170	0,235		
Rostelecom com	RTKM	1,660	-0,7	2,080	1 484,04	0,977	1,990	1,83	1,51
Rostelecom pref	RTKMP	1,150	-0,5	0,071		0,590	1,220		
Siberia Telecom com	ENCO	0,030	0,5	0,404	440,46	0,017	0,031	1,13	29,15
Siberia Telecom pref	ENCOP	0,021	-0,7			0,009	0,021		
South Telecom com	KUBN	0,091	0,1	0,473	332,09	0,054	0,096	0,99	6,67
South Telecom pref	KUBNP	0,068	3,0	0,023		0,042	0,067		
Ural Svyazinform com	URSI	0,027	1,1	1,620	1 011,66	0,010	0,027	2,14	34,33
Ural Svyazinform pref	URSIP	0,021	6,3	0,310		0,008	0,021		
Volga Telecom com	NNSI	2,145	1,9	0,077	639,10	0,810	2,200	1,83	13,47
Volga Telecom pref	NNSIP	1,458	1,2	0,056		0,663	1,410		

Telecom sector growing rapidly

The first deputy telecom minister Boris Antonyuk said that the telecom market expanded by 45% y-o-y in the first eight months of 2003. He expects market volume to exceed \$12b for the whole of 2003, representing over 2% of GDP.

Rapid introduction of new capacities and tariff increases are driving revenues in traditional fixed telephony. In alternative segments cellular business is developing fastest, particularly in the regions, where it has had low presence (except in the Moscow license area and St Petersburg), though other businesses are also developing quickly. The most optimistic estimates point to sector turnover of \$13b in 2003 and up to 3% share of GDP.

Svyazinvest privatization on hold again

The head of the Ministry for Economic Development and Trade, German Gref, said that privatization of the state's stake in Svyazinvest will not occur in either 2003 or 2004. This was decided at a joint meeting of interested ministries, including the Telecommunications Ministry and State Property Ministry. Gref said that sale of a 25% stake minus two shares (out of a total 75% government stake), which had been planned, is less attractive for a buyer and for the state, suggesting that the government plans to sell the whole of its stake. However, the government needs more time to prepare a mechanism for keeping some control over Svyazinvest after the sale.

A probable price of \$500m for 25% minus two shares, which was estimated by the government's financial advisors, is clearly insufficient to justify sale at present (a blocking stake of 25% plus one share in Svyazinvest was sold to Soros funds for \$1.9b in 1997).

Gref noted that privatization of shares in regional operators owned directly by the government (not via Svyazinvest) is still planned for 2004. The government plans to sell 0.092% of South Telecom, 7.2% of Center Telecom, 0.6% of Volga Telecom and 4.367% of Ural Svyazinform.

Svyazinvest defers IPOs of regional telecoms

According to the deputy CEO of Svyazinvest, Georgy Romsky, IPOs through placement of Level-3 ADRs are not on the agenda for regional telecom operators in the near future. It was stated earlier that RTOs would start IPO programs soon after their mergers, which were completed at the beginning of 2003. Romsky said that RTOs are currently able to finance their capex internally and using domestic borrowing. Combined with cancellation of the Svyazinvest privatization, the news of IPO delays may further

undermine the share price rally of RTOs. We estimate that shares of most regional telecoms have already reached or exceeded their fair values. The three stocks, which still seem to have growth potential are Ural Svyazinform commons (RTS: URSI, target price \$0.031), Siberia Telecom commons (RTS: ENCO, target price \$0.035) and Siberia Telecom prefs (RTS: ENCOP, target price \$0.024).

Antimonopoly Ministry reins telecom tariff increase

The Antimonopoly Minister Ilya Yuzhanov said last Wednesday that tariffs for fixed-line operators will not be raised until summer next year, although some RTOs will be allowed to raise tariffs in January 2004 if increases, permitted earlier, have been delayed.

Commenting Svyazinvest predictions that fixed tariffs for local services will double and reach \$10 per month in the next few years, Yuzhanov noted that, according to a government resolution, the Antimonopoly Ministry should assure that tariff levels cover the cost of service provision, as well as reducing cross-subsidization between subscribers, but he said that doubling of tariffs is unlikely.

The overall impression is that local tariffs will grow more slowly than many had anticipated. In our forecasts we used inflation forecasts as a basis for future tariff growth rates, which now looks justified.

Rostelecom (HOLD) to introduce per-minute payments for international traffic

Rostelecom (RTS: RTKM, RTKMP) announced plans to change the current system of settlement with regional telecoms (RTOs) for international traffic and to transfer to per-minute billing for these settlements. At present Rostelecom fully accumulates payments for termination of incoming international traffic and receives half of revenues of RTOs for outgoing international traffic (RTOs first receive these payments from customers and then transfer half of them to Rostelecom). However, incoming traffic has been stagnating in recent years while outgoing traffic is steadily growing, leading to lower international revenues for Rostelecom.

Change seems to be supported by regulatory officials and the new system may be introduced in 2004. Receipts for international traffic account for only 10% of total RTO revenues, so damage from introduction of the new scheme should not be too serious for them. Rostelecom's revenues from RTOs for outgoing international traffic are estimated at 18% of its total revenues and will rise following the change. A 50% rise of these receipts will result in a 9% rise of total Rostelecom revenues.

Ural Svyazinform (BUY) gives 2002 IAS statements

Ural Svyazinform (RTS: URSI, URSIP) 2002 results under IAS showed a high share of cellular business, as was expected. Revenues were 18% higher than under RAS mainly due to consolidation of mobile subsidiaries (RAS results are non-consolidated). Mobile gave 21% of total IAS revenues, the highest level among regional telecom operators, and we expect further increase to 25% by 2007. However, operating income and EBITDA were lower under IAS than under RAS in 2002. It looks that this was due to different approaches to estimating depreciation charges (significantly lower under RAS). IAS net income was 25% higher than the RAS result.

Ural Svyazinform FY 2002 financials

	Under IAS, \$m	Under RAS, \$m	Deviation, %
Revenues	556.8	471.7	18%
Operating expenses	465.6	339.3	37%
Operating income	91.2	132.4	-31%
EBITDA	166.7	169.8	-2%
EBITDA margin, %	30%	36%	-17%
Income before tax and minority interest	63.9	n/a	n/a
Net income	36.5	29.5	24%
Net margin, %	7%	6%	5%

Source: Company data, RMG estimates

Ural Svyazinform held a conference call after publication of IAS results, during which company representatives said that local tariffs are expected to grow by 15% in ruble terms next year, coinciding with our estimate of rises in line with inflation. Mobile APRU is currently \$25, but the high level is due the northern part of the company's service area and stands at a lower level of \$18 in the Urals (in line with our prediction).

Ural Svyazinform aims to acquire all cross-zone networks in its macro region from Rostelecom in the next two years, and the relevant agreement has already been reached.

Revenues breakdown under IAS

Local fixed fee	18%
Local per-minute	3%
DLD	30%
ILD	7%
Connection	5%
Cellular	21%
Data	1%
Other (incl. internet)	13%
Total	100%

Source: Company data, RMG estimates

In the next few years company capex will total \$200m on average, which also coincides with our forecasts. We reiterate target prices at \$0.031 for common share and \$0.021 for preferred shares.

Ural Svyazinform (BUY) and Volga Telecom (HOLD) acquire Tatincom-T

On Tuesday the oil company Tatneft reported sale of a 83.4% stake in the Kazan-based cellular operator Tatincom-T to Volga Telecom (RTS: NNSI, NNSIP) and Ural Svyazinform (RTS, URSI, URSIP). According to Vedomosti newspaper, the total sale price was \$25m. Volga Telecom bought 50% for \$14.98m and Ural Svyazinform bought the remaining 33.4% for \$10.02m. The two regional telecoms also took on company debt of \$15m.

Tatincom-T is one of the largest cellular networks in the Republic of Tatarstan with about 120 000 customers. It operates in the old-fashioned D-AMPS standard, but ownership of a GSM-1800 license for the whole region makes it attractive. Tatneft earlier announced plans to sell Tatincom-T in line with its strategy of selling non-core assets.

The price paid by Volga Telecom and Ural Svyazinform represents \$380 per subscriber, which looks in line with earlier sector deals. According to Vedomosti, only Svyazinvest representatives on the Volga Telecom board supported the acquisition, while other board members stressed that the company has no clear strategy of developing cellular business, and that the price is excessive.

Volga Telecom and Ural Svyazinform both have significant cellular subsidiaries in the Volga and Urals federal districts. By our estimates Volga Telecom held 12% of the its regional cellular market as of the end of 1H 2003 and Ural Svyazinform controlled 42% of mobile business in its serviced area. Acquisition of Tatincom-T, which serves a territory between the Volga and Urals macro regions, should be a key step in planned unification of cellular assets of the two Svyazinvest subsidiaries.

Center Telecom (SELL) places bonds

Center Telecom (RTS: ESMO, ESMOP) carried out placement of three-year domestic bonds totaling R2b (\$65m) last Tuesday and Wednesday. The placement was fairly successful with YTM of 12.73%, which is lower than similar issues by other telecoms. This was the first bond issue by Center Telecom after its merger with other telecoms in Central Russia. Earlier the company made two other issues, each worth R600m (\$20m), one of which matures in November this year, and the other in April 2005.

South Telecom (HOLD) places bonds

South Telecom (RTS: KUBN, KUBNP) successfully placed the whole of its bond issue on the MICEX last Thursday. The three-year issue of R1.5b (\$50m) attracted R2.3b demand and was placed at YTM of 14.75%. The half-year coupon rate was set at 7.12%.

Advertising the issue South Telecom deputy CEO Andrei Litvinov said that the company expects increase of revenues to \$700m in 2006 (our estimate is \$640m) and EBITDA margin of 40% (we estimate 35%). Litvinov also noted that the company plans no sale of its stake in Astrakhan-Mobile and Volgograd-Mobile. These are D-AMPS operators, which are currently introducing networks in GSM-1800 standard with financial support from South Telecom.

North-West Telecom (SELL) holds internet conference

North-West Telecom (RTS: SPTL, SPTLP) held an internet conference last week, in which it detailed plans to place four-year R1.5b (\$50m) domestic bonds on October 8. The company wants to avoid repayment of the whole principal sum at once and aims to do that by breaking the maturity terms into three periods: 30% to be repaid in three years time, another 30% half a year later, and the remainder after a further six months.

Management predicted 2003 dividends of R0.16 (0.5 cents) per common share and R0.34 per preferred share (1.1 cents) based on estimated RAS net profit of R800m (\$26m). This payout would represent an increase of 2.5 times from 2002. The dividend yield at current prices is 1% and 4% for commons and prefs, which is fairly low, and supports our SELL recommendation.

North-West Telecom is continuing work on annexation of three fixed-line operators, which were not attached to the company during recent mergers in the telecom sector. These companies are Lensvyaz, Komisvyaz and Pskov GTS, all located in the North-West macro region. The merger with Lensvyaz is first on the agenda: a Lensvyaz EGM to vote on merger is due at the end of 2003 and merger as such may be completed by the end of 1H 2004.

Introduction of universal service delayed

Introduction of a planned universal service fund may not happen before 2005, according to draft documents prepared by the Telecommunications Ministry in connection with launch of the new telecommunications law. The fund will be sponsored by telecom operators (including alternative operators) to subsidize construction of telecom infrastructure in remote regions and for low-budget customers, and the delay in its implementation is due to the need for

a contest to choose companies, which will provide universal services. Most operators were against creation of the fund, but the government insisted on its inclusion in the new law. Total annual allocations to the fund are estimated at \$350m

MAP blocks Vimpelcom (BUY) - MegaFon merger

The Antimonopoly Ministry (MAP) refused permission for merger of Vimpelcom (NYSE: VIP) and MegaFon, which was widely rumored after Alfa-Eko, the largest shareholder of Vimpelcom, bought a blocking stake in MegaFon. The MAP decision contradicted an earlier statement by the Minister for Telecommunications, Leonid Reiman, who said that amalgamation of the two companies was possible. Commenting the decision the MAP's head, Ilya Yuzhanov, said that any merger between the three national cellular operators (MTS, Vimpelcom and MegaFon) is impossible at the present time, since it would be damaging for the market.

Battle for MegaFon continues

The battle between MegaFon shareholders hotted up last week. Alfa-Eko, which bought a blocking stake in MegaFon from LV-Finance in August, and which failed to force an EGM to re-elect the company BoD on September 10, stated last week that MegaFon has significant financial problems, which cannot be resolved without Alfa-Eko participation. Alfa-Eko vice president Igor Baranovsky told Kommersant newspaper that MegaFon has a critical cash flow situation. This statement is strange in view of recent MegaFon half-year results, which showed strong development and high operating margins. Baranovsky refused to give more detailed comments on MegaFon financials. One interpretation of his statement is as a veiled threat to create financial problems for MegaFon by aggressive use of Alfa-Eko's blocking stake.

Meanwhile, one of MegaFon shareholders, IPOC International Growth Fund, which holds a 6.5% stake in MegaFon, announced on Thursday that it has challenged the legitimacy of the deal between Alfa-Eko and LV-Finance in courts in Switzerland, the Bahamas and the British Virgin Islands. The shareholder reported that it had prior agreements with LV-Finance on buying the stake and already transferred part of the relevant sums. The court in the British Virgin Islands already sanctioned arrest of a 25.1% stake in MegaFon. However, representatives of LV-Finance and Alfa-Eko insist that their deal is legally correct and the IPOC challenge will be unsuccessful.

S&P confirms MTS (BUY) rating

S&P rating agency took MTS (NYSE: MBT) off the "governance watch" list, where it was placed after summer changes in the MTS executive board. At the end of July MTS president Mikhail Smirnov was transferred to the post of CEO of MGTS, while Vasily Sidorov, the deputy CEO of Sistema Telecom, was nominated to head MTS. Both MTS and MGTS have AFK Sistema as a major shareholder, which made S&P see violation of the rights of other shareholders of MTS due to the deal. However, S&P subsequently found that the reshuffles were discussed with other major shareholders of MTS and were approved by the parties. S&P also confirmed the MTS corporate governance rating at 7.4, which is above average for Russian companies.

MTS acquires remaining stake in Kuban-GSM

MTS announced purchase of 100% of Kubtelesot, which holds 47.3% of Kuban-GSM. Before the deal MTS already owned 52.7% of Kuban-GSM. MTS paid \$107m for Kubtelesot acquisition.

MTS bought a 51% stake in Kuban-GSM from South Telecom in April 2002 for \$71.4m, and acquired the additional issue of Kuban-GSM in October 2002 for \$4.9m, raising its stake to 52.7%. The Kuban-GSM subscriber base has more than doubled since then, which explains higher price of the latest deal.

Moscow fixed-line operators face new rival

The Telecommunications Ministry granted 100 000 telephone numbers in Moscow to Petersburg Transit

Telecom (PTT), an alternative fixed-line operator based in St Petersburg. PTT will use a Moscow code beginning with 6 (the so called 6th million, 6XXXXXX). Earlier Moscow telephone numbers with this prefix were reserved for future employment by MGTS and could not be used by other operators. The move looks like a privilege given to a structure, which is close to Telecommunication Ministry officials, since PTT is fully owned by Telecominvest, and Telecominvest was set up by people who now occupy key posts in the Telecom Ministry.

The Moscow fixed-line market is mainly controlled by MGTS, but alternative operators have strong presence in the business sector and internet. MTU-Inform and Golden Telecom are the biggest Moscow alternatives with total 300 000 numbers, followed by Globus Telecom (100 000), Central Telegraph (100 000), Comstar (70 000) and Telmos (60 000). With 100 000 numbers, PTT will be on a par with the biggest Moscow altnets. PTT will follow the same strategy in Moscow as in St Petersburg, acting as operator for operators (renting its lines to smaller companies). The increased competition may cause a new wave of consolidations among altnets.

MGTS deputy CEO Semen Rabovsky said that the problem of number shortage in Moscow has been solved by the 6th zone. MGTS earlier reported preparatory work to divide Moscow fixed-line numbers into two zones (095 and 499) to address capacity shortages. But one million new numbers in the 6th zone will cover demand, which is estimated at 500 000 up to 2007.

Norilsk Nickel (HOLD) acquires gold mining company

Norilsk Nickel (RTS: GMKN) won an auction for 44.9% of Lenzoloto, a Russian gold mining concern. Norilsk will pay \$152m for the stake (five times more than the auction starting price), raising its ownership level to 65.8% of Lenzoloto shares. Lenzoloto consists of eleven gold mining companies in Irkutsk region and has total gold deposits estimated at 200 tons. Last year Lenzoloto extracted 9.4 tons of gold, the third largest result in Russia after Norilsk Nickel (29 tons) and Omolon ZRK (12.5 tons), which is controlled by Canadian Kinross. According to Vedomosti newspaper, Lenzoloto generated net sales of \$85m in 2002.

Norilsk Nickel also owns 100% and 50.6% respectively of gold mining companies Polus and Matrosov. Norilsk is pursuing a strategy of diversification, including increase of gold production. Earlier the company said that it plans to produce 100 tons of gold per year by 2007.

We view the latest acquisition positively, particularly in view of Norilsk's plan to buy Sukhoy Log, the biggest Russian gold deposit (over 1029 tons of reserves), which is located near to Lenzoloto's deposits, since this will allow cost savings.

EvrzHolding carries out road show

EvrzHolding, the Russian biggest steel holding, started a road show for three-year eurobonds. The total placement sum will reportedly be about \$150-200m, but the company is withholding details under an agreement with ING Bank, the lead-manager for the issue. EvrazSecurities S.A, an offshore subsidiary of EvrazHolding, is the issuer of the bonds and Zapsib (West Siberian Steel), a key production facility of the holding, is the placement guarantor.

Severstal (HOLD) posts consolidated results under IFRS

Severstal (RTS: CHMF) published 2002 consolidated financials under International Financing Reporting Standards (IFRS), showing 13% growth of net sales from \$2b to \$2.3b. Comparing consolidated and unconsolidated P&L revenues, we found a 15.6% revenue difference in favour of the consolidated statement (\$2.3b compared with \$1.9b), which confirmed our assumption that most of turnover came from the parent company.

COGS and SG&A of the parent company were lower y-o-y, as we indicated earlier ([RMG Weekly # 440](#)), and we assume that growth of these items in consolidated statements was due to affiliated companies.

The consolidated statement showed 234% growth of operating profit from \$91m to \$305m in 2002, mainly due to the parent company, which showed \$290m operating profit. Net profit of \$191m was 7.4% higher than a \$178m non-consolidated result.

Severstal consolidated 2002 financials under IFRS

	FY02, \$m	FY01, \$m	Change, y-o-y
Net sales	2 271	2 009	13.0%
COGS	1 509	1 485	1.6%
Gross profit	762	525	45.2%
-gross margin	33.5%	26.1%	
SG&A	95.5	95.5	n/m
Distribution expenses	278.1	223.8	24.3%
Indirect taxes & contributions	37.6	36.8	2.2%
Operating profit	305.1	91.4	233.8%
-operating margin	13.4%	15.2%	
EBIT	274.2	24.6	1014.6%
EBIT margin	8.4%	-0.6%	
Net profit	191.0	-11.4	n/m
- net margin	8.4%	neg	

Source: Company data, RMG estimates

Mechel (HOLD) gives 1H 2003 results under RAS

The steel maker Mechel (RTS: MECH) posted strong 1H 2003 financials under RAS, showing 55% y-o-y growth of net sales from \$260m to \$401m, helped by the positive market situation in the steel sector. Mechel increased steel output by 11% from 1.8m to 2.1m tons. COGS and SG&A were kept under control, allowing the company to show 172% y-o-y growth of operating profit from \$15m to \$34m. A company official said that Mechel has reviewed its price policy to take full advantage of the current positive state of the market, enabling increase of operating margin from 5.8% to 8.5%. Net profit of \$17.2 represents a 457% improvement from 1H 2002.

Mechel 1H 2003 financials (RAS)

	1H03, \$m	1H02, \$m	Change, y-o-y
Net sales	401.2	259.6	55%
COGS	346.8	229.3	51%
Gross profit	54.4	30.3	79%
-gross margin	13.6%	11.7%	
SG&A	20.4	15.4	33%
Operating profit	33.9	15.0	127%
- operating margin	8.5%	5.8%	
EBT	25.2	1.4	1747%
EBT margin	6.3%	0.5%	
Net profit	17.2	3.1	457%
- net margin	4.3%	1.2%	

Source: Company data, RMG estimates

TMK to buy a Romanian plant

Tube Metallurgical Company (TMK), the Russian biggest pipe holding (owns the Sinarsky, Volgogradsky, Seversky, and Taganrog pipe plants) will take part in an auction to buy the Romanian steel maker, Combinatul Siderurgic Resita SA (CSR), which makes steel for the pipe industry. Earlier the Romanian government bought back a controlling stake in the company from American Noble Ventures, which failed to meet its commitments under privatisation conditions.

GAZ (HOLD) plans bond issue

The Russian automaker GAZ (RTS: GAZA, GAZAP) intends to issue \$30m of five-year ruble bonds subject to BoD approval. The company wants to start the placement at the end of 2003.

Aeroflot (HOLD) borrows \$60m

Aeroflot (RTS: AFLT) took a one-year \$60m credit to finance current activities at interest rate of LIBOR+3%. The lenders are an alliance of domestic and international banks, led by Vneshtorgbank and Citibank. The head of Vneshtorgbank, Andrew Kostin, said that the bank is also interested in plans to build a new terminal at Sheremetevo (Moscow's main airport), but the bank has received no offers to take part in this project so far.

In separate news, the BoD of Aeroflot called an EGM on November 22. The main initiator is National Reserve Bank (NRB), a major shareholder of Aeroflot. The president of the bank, Alexander Lebedev wants to change the BoD of the carrier with inclusion of three or four representatives from NRB, and says that this will help to improve company performance.

In separate news, Aeroflot plans to invest \$10m to create a new company image, and has already carried out a tender, which was won by Media Arts FCB. The project should enable the company to offer a new brand to customers over the coming 18 months.

Templeton buys into Amtel

Amtel, the Russian largest tire holding, intends to sell about 4% of its stock to Templeton Strategic Emerging Markets Fund via a new issue. According to Amtel's CFO, the total value of this deal is estimated at \$10m and the fund has an option to buy a further 2% of the placement during the next six months.

Amtel is a 100% subsidiary of Amtel Holdings Holland B.V. The Russian holding owns several domestic tire plants: Kirov, Voronezh and Amtel-Siberia (Krasnoyarsk), which together produced 5.9m tires in 2002.

Amtel seems to be acting on earlier promises that it will intensify activity on capital markets. An official of the company confirmed plans to make an IPO on a western stock exchange, and said that that the Templeton deal is a preparation for such a placement.

In related news, the president of Templeton, Mark Mobius, said that his fund is considering opportunities to increase its share in Wimm-Bill-Dann, the Russian dairy and juice company. The fund currently has a 1.18% stake in WBD and views the company's prospects positively.

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