

Market Wrap

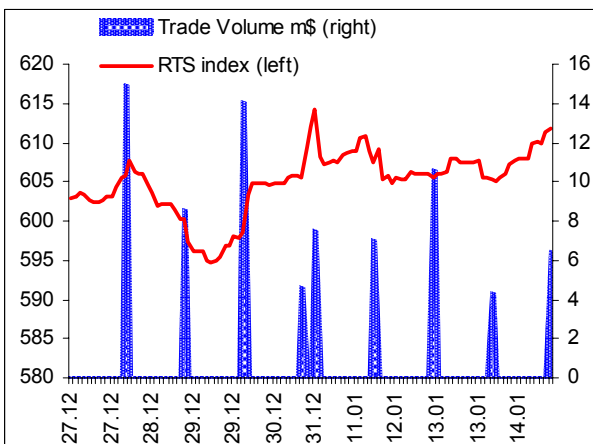
The RTS index was mostly flat and very quiet from (western) Christmas until mid-January, with the peak and trough both coming before New Year: the index rose to 614 points on December 31 after sinking to 595 on December 29. Daily trading was mainly under \$10m last week (the RTS started work on Tuesday) and the index closed at 611.74 on January 14.

The apathy reflected lack of news over the long New Year holiday and lack of ideas about what 2005 might bring. Over half of trading last week was in UES and Lukoil, with the remainder spread evenly over other blue chips. Both UES and Lukoil were losers, falling by 4.1% and 1.2% respectively.

Surgut lost only 0.2%, regaining ground on news that minority shareholders are going to court to contest the treasury share arrangement, which ensures management control over the company. Norilsk dropped by 3.7% as its offer to buy shares on the market expired.

The main interest last week was in TNK-BP subsidiaries, particularly Orenburgneft, whose commons and prefs rose by 11.6% and 11.1% after the holding presented an attractive share exchange plan.

Gazprom share prices were steady at the start of the year, despite a statement by a senior state property official that removal of limits on foreign ownership is not yet certain. We see the statement as an expression of caution rather than a sign that the limits will really stay in place.

RTS Index & Volume

Key Figures

RTS Index	611.74	-0.39%
RTS Volume (\$m)	27.68	-43.18%
Ruble / Dollar	27.87	
Int'l Reserves (Jan 7)	\$124.6b	

Weekly data Fri-Fri.
Winners

GUM com	+24.9%
Udmurtneft com	+16.5%
Varieganeftegaz	+13.4%
Orenburgneft com	+11.6%
Orenburgneft pref.	+11.1%
Kazan Orgsintez com	+8.8%

Top Volumes (\$m)

Lukoil com	8.7	31.5%
RAO UES com	6.9	24.8%
Sberbank com	1.9	6.7%
Transneft pref	1.7	6.1%
Surgutneftegaz pref.	1.0	3.5%
Rostelecom com	0.9	3.3%
Surgutneftegaz com	0.9	3.2%
Total (Top 7)	21.9	79.1%

Losers

Ryazanenergo com	-25.4%
Yarenergo pref	-13.8%
Stavropolenergo com	-11.9%
Kolenergo com	-11.7%
Udmurtenergo pref	-10.7%
Ufaneftekhim com	-8.2%

Sector Statistics

Sector Name	Volume \$	MC\$'000	% of MC	Change -week	Change -month	Change -year
Oil & Gas	13,558,192	87,639,735	49.72%	0.13%	9.65%	-11.25%
Power Utilities	7,789,069	24,181,866	13.72%	-4.10%	2.49%	16.96%
Banks	2,014,942	9,827,645	5.58%	1.97%	12.27%	67.66%
Telecom	1,833,604	12,311,351	6.98%	-4.81%	4.09%	4.76%
Metals	1,670,956	21,949,772	12.45%	19.75%	38.21%	13.38%
Engineering	307,880	3,101,055	1.76%	0.39%	5.95%	16.36%
Others	278,769	12,753,141	7.24%	84.87%	190.75%	353.07%
Chemicals	195,442	2,478,992	1.41%	-1.04%	0.77%	66.72%
Retail	22,662	155,758	0.09%	14.31%	16.88%	-1.11%
Transportation	6,400	1,856,402	1.05%	-7.90%	10.00%	61.02%
Total	27,677,914	176,255,718	100.00%	4.74%	16.28%	7.04%

VIEWPOINT: EVERYTHING STILL TO PLAY FOR IN 2005

Official New Year holidays were extended to record size this year: most Russians were off work for the first two weeks of January. It has been suggested that the long holidays, at a time of year when healthy outdoor leisure pursuits are limited, will make the country's alcohol problem more acute. At any rate, the long break, approved by the Duma last year, has the scent of populism, and lost work time, with or without alcohol damage, is unlikely to do much for Putin's target of doubling GDP in 10 years.

That said, Russian business and the political class needed time to recuperate and collect their thoughts after the Yukos climax in December. An interview with economy minister German Gref, published immediately after the holidays in Kommersant newspaper, suggests that, post-Yukos, the liberal wing in government is down but not out. The interview touches a large number of key issues very concisely, indicating that it was carefully prepared.

The minister is respectfully skeptical about Putin's 10-year plan, and he states unequivocally that Gazprom needs full reform of its business (not just its share market) based on competitive principles to end chronic inefficiency, saying that independent gas companies should be encouraged to expand, "instead of which they are being systematically swallowed by Gazprom". Gref also dares to say: "Rosneft and Yuganskneftegaz (if it becomes state-owned) should be privatized".

Yugansk has in fact become state-owned after Rosneft paid R10 000 to buy the shelf-company, which bought the Yukos crown jewels in December. What is more, Rosneft has paid outstanding \$7.65b for the asset, apparently borrowing the money from state-controlled banks, which in turn seem to have borrowed it abroad. In a bizarre twist this large one-off cash inflow to Russia was the main factor limiting net capital leakage from the Russian economy last year, which threatened to shoot back to 1990s levels due to sharply increased political uncertainty.

That can hardly be treated as a macroeconomic achievement and, as the New Year begins, there is little room for optimism elsewhere on the macro front, where the pro-Kremlin Duma majority is using popular discontent as an excuse to force the government to review its program for abolishing payment exemptions as the basis of the social security system. Russia's benefit system (free transport, lower housing payments, etc., for vulnerable groups) is notoriously widely and thinly

spread, and changeover from payment exemptions to cash subsidies for needy groups was meant as a way of focusing it to get more effect from less resources.

We fully sympathize with the skepticism of people in real need about the outcome of any state-organized reform process that affects their vital interest. But that does not reduce the need for such reform. Meanwhile, after the Duma pressure, Russia is now headed for a worse-of-both-worlds compromise, where a large part of the budget surplus, intended for early settlement of foreign debt, will be used instead to fund badly targeted social support with real cash instead of the previous, less economically damaging, exemptions.

Little cause for cheer on the macroeconomic front, then. Nevertheless, we do feel, emerging into 2005, that there a strategic void at the heart of the anti-market camp, which had the upper hand in the Kremlin last year, and that the New Year break has given new heart to real reformers, just by giving them time to assess the situation and see that void.

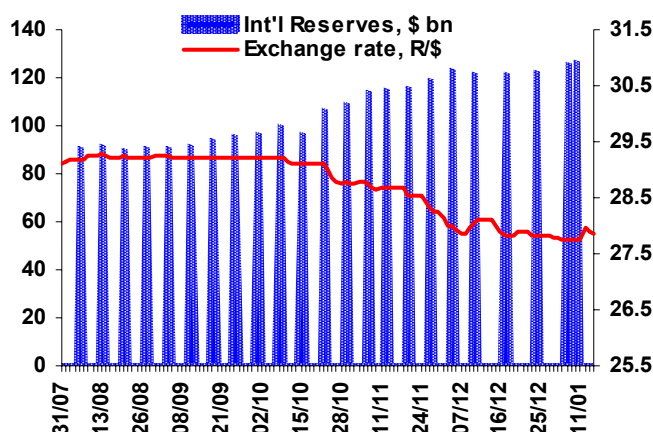
The social security impasse and the promise of more clumsiness and infighting over the Gazprom-Rosneft merger (the Rosneft purchase of Yugansk puts new questions marks over the merger, and may be opposed by Gazprom top brass and their Kremlin backers) point to ultimate failure of the powers of reaction. And Yukos' lingering death in 2003-2004 was most probably due to unwillingness of anyone to take responsibility for the death blow. This cowardice and indecision look to us like a slow replay of the 1991 "Putsch", which tried to reinstate the USSR, and we all know how that ended.

So, for a New Year "envoi", here are some heartening words from Economy and Trade Minister:

"We like to say 'I am for a strong state' . But what does that mean? If it is the expression of some one who does everything he can for development of his country, than I agree. If, though, it is the expression of someone who does not believe in his own citizens, who wants to take away their rights and freedoms, confiscate their property for the state and take all decisions on their behalf , then that is someone who should be kept away from any position of responsibility in government."

Who could he be talking about?

Economic Indicators



Source: CBR

Key Macro Figures

CBR refinancing rate, %	13	15/06/04
M2, Rbn	3939.9	01/12/04
M0, Rbn	1332.7	01/12/04
CPI, %	1.1	12/2004
Inter'l Reserves, \$bn	124.541	01/01/05
One-day MIACR, %	0.69	14/01/05
Exchange rate R/\$	27.9469	14/01/05
Exchange rate R/euro	37.6971	14/01/05
OFZ yields, % p.a.	5.57	14/01/05
GKO-OFZ duration, days	1745.05	14/01/05
Eurobonds Russia 03 YTM	3.69	14/01/05

Preliminary data 2004 budget show surplus of 4.2% to GDP

The Ministry of Finance released preliminary data on 2004 budget execution. The budget surplus was 4.2% to GDP, significantly higher than earlier forecasts, due to higher-than-anticipated budget revenues. 2004 GDP is estimated at R16 550.1b, or \$574.7b.

The main 2004 budget results

	Rb	\$b	% to plan	%GDP
Revenues	3422.3	118.8	104.5	20.7
Expenditures	2724.8	94.6	98.8	16.5
Surplus	697.5	24.2	-	4.2

Source: Interfax, RMG estimates

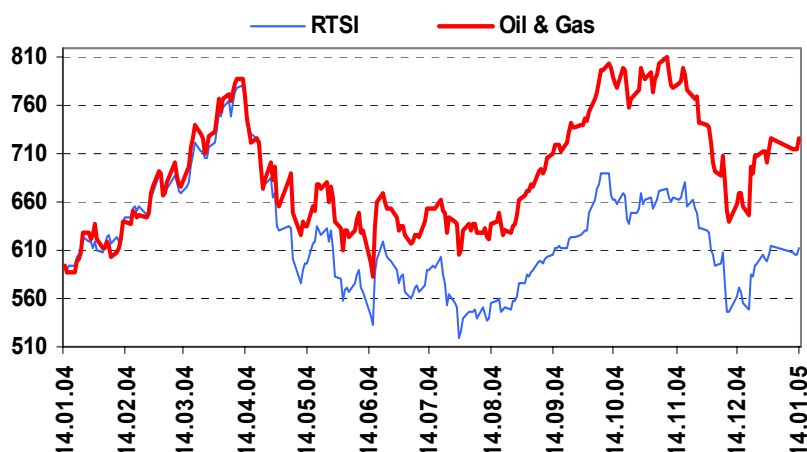
The surplus allowed the Ministry of Finance to consolidate R522.3b in the Stabilization Fund as of January 1, 2005, and rules for Fund use allow the government to spend sums exceeding the R500b threshold. Finance minister Alexei Kudrin confirmed that Russia intends to use the fund to repay its debt to foreign countries, primarily members of the Paris Club, ahead of the agreed schedule.

Inflation exceeds government forecast

CPI inflation in 2004 not only exceeded the 10% target stipulated by the 2004 budget law, but was actually higher than the government's more pessimistic estimate of 11.5%. The final result was 11.7% y-o-y. The main price growth factors were expected domestic fuel price hikes (by 31% in 2004 vs.2003) and unexpected rise of food prices (20-24% annual growth). Government targets for CPI growth in the current year are 7.5-8.5%, probably again overoptimistic.

CBR estimates net capital flight in 2004 at \$7.8b

According to the Central Bank, net capital outflow from Russia surged more than four times last year, to \$7.8b in 2004 vs. \$1.9b in 2003. The official figure is enough to cause concern, and most independent economists believe that the actual figure was much higher – in the range of \$15-17b.

Oil & Gas Index vs. RTS Index

Oil & Gas Key Figures

Indicator	Value	Wk Change
Urals (\$/b)	41.77	13.0%
Brent (\$/b)	45.21	11.1%
OIX (CBOE oil index)	402	0.0%
Dow Jones Energy Index	319.97	-0.7%
US crude inventory (EIA data) m bbl	288.8	-2.4%
US gasoline inventory (EIA data) m bbl	215.3	1.8%
Tatneft ADR	27.45	-5.3%
Lukoil ADR	118.5	0.6%
Surgutneftegaz ADR	36.8	2.8%
Yukos ADR	2.66	-24.0%
Sibneft ADR	30.45	3.2%

Sector Wrap

- TNK-BP presents final version of consolidation plan. Three core subsidiaries, TNK, Onako and Sidanco, call EGMs on March 1, 2005, to vote on their merger into the overall holding. Shareholders of the three sub-holdings who vote for accession to TNK-BP Holding (or who abstain) will have their shares converted into shares of the latter. Shareholders who vote against accession will be able to sell their shares to the sub-holdings for cash. Deloitte which was hired as appraiser, valued TNK-BP at \$18.53b. A single share of TNK-BP Holding is valued at \$1.24. Buyout prices for TNKO, ONAK and SDNK are \$3.31, \$2.35 and \$29.19 respectively. TNK-BP also gave valuation figures for 14 selected operating subsidiaries of the sub-holdings. These are not official prices but investors should think of them that way as only technical approval is required. TNK-BP is carrying out the consolidation earlier than expected. In most cases investors will get the shares of TNK-BP Holding by the end of the year.

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 04E	P/E 04E
LUKoil com	LKOH	30.025	-1.2	8.729	25 410.58	23.850	33.490	0.85	5.29
Megionneftegaz com	MFGS	18.950	-4.7		2 222.09	12.980	21.750	0.88	7.23
Megionneftegaz pref	MFGSP	11.350	-3.0	0.046		6.050	11.800		
Sakhalinmorneftegaz com	SKGZ	5.850	-3.3		422.57	4.450	7.250	1.70	19.86
Sakhalinmorneftegaz pref	SKGZP	4.300	8.9			2.600	5.000		
Sibneft com	SIBN	3.110	3.7	0.465	14 698.03	2.330	3.840	1.84	7.74
Surgutneftegaz com	SNGS	0.755	0.7	0.882	30 627.74	0.560	0.838	3.16	11.12
Surgutneftegaz pref	SNGSP	0.551	-0.2	0.961		0.370	0.590		
Tatneft com	TATN	1.413	-6.8	0.022	3 146.95	1.065	1.860	0.64	3.55
Tatneft pref	TATNP	0.758	-7.2			0.545	0.900		
Udmurtneft com	UDMN	317.500	16.5	0.069	961.76	190.000	300.000	2.36	31.44
Udmurtneft pref	UDMNP	222.500	26.4			125.000	185.000		

TNK-BP (not traded) presents consolidation plan

On December 30, 2004, BoDs of holding companies TNK (RTS: TNKO, HOLD), Onako (RTS: ONAK) and Sidanco (RTS: SDNK), which are the main components of TNK-BP, scheduled EGMs for March 1, 2005, to vote on their merger into the overall holding. At the end of last week TNK financial officials presented investors with details of the consolidation, including conversion rates and buyout prices defined by an independent appraisal agent.

TNK-BP Holding was incorporated as a public company in November, 2004, in the town of Uvat (Tyumen region, Russia). It has charter capital of R15b divided into 14.55b common shares and 0.45b preferred shares with face value of R1.0. This capital is fully paid and TNK-BP Holding is currently 100% owned by the Cyprus firm, Novy Investments, which is a full subsidiary of TNK International Ltd., registered in the British Virgin Islands. TNK-BP Holding owns (directly and via cross-holding) 96% of TNK, 98% of Onako and 98% of Sidanco.

Shareholders of the three sub-holdings who vote for accession to TNK-BP Holding (or who abstain) will have their shares converted into shares of the latter. Shareholders who vote against accession will be able to sell their shares to the sub-holdings for cash.

TNK-BP hired White & Case, PricewaterhouseCoopers and Morgan Stanley to act as advisers during the consolidation process. Deloitte was engaged as independent appraiser to value the group's companies. DeGolyer and MacNaughton have provided production and cost profiles based on TNK-BP's end-2003 reserves audit.

Deloitte valued TNK-BP at R517.8b, or \$18.53b, 94.2% of which is represented by value of the sub-holdings (the rest is equity value of stakes in operating companies that are directly owned by the parent company, such as Orenburggeologia, in which TNK-BP Holding has an 87% stake). Thus, a single share of TNK-BP Holding is valued at \$1.24.

Values of TNK-BP sub-holdings and swap ratios

Company	Equity value, \$b	Share in TNK-BP	Conversion ratio *	Buyout price, \$
TNK-BP Holding	18.53	100%	1	-
TNK	10.47	56.49%	2.66	3.31
Onako	1.26	6.78%	1.89	2.35
Sidanco	5.73	30.92%	23.49	29.19
Total sub-holdings	17.45	94.19%	-	-

Source: TNK-BP official offer

* TNK-BP's shares per 1 share of sub-holding

A presentation by TNK-BP CFO Kent Potter also gave valuation figures for 14 selected operating subsidiaries of the sub-holdings. These are not

official buyout prices but only numbers calculated by the appraiser. To become buyout prices they will need to be approved by BoD of the operating subsidiary. But the figures are almost certain to be acceptable to minorities, and only a few of the 14 have strong minorities in any case (including a 38% stake in Ryazan Petrochemicals Plant – not to be confused with Ryazan Refinery – owned by the Russian Federal Property Fund). So investors should think of these rates as buyout figures.

Swap ratios for 14 TNK-BP operating companies

Company	Equity value, \$m	Share in TNK-BP	Conversion ratio *	Buyout price, \$
Orenburgneft	2 519	13.59%	24.28	29.99
Udmurtneft	1 152	6.22%	273.93	338.36
Varyeganneftegaz	800	4.32%	28.22	34.86
Saratovneftegaz	320	1.73%	81.95	101.22
Orenburggeologia	145	0.78%	1.64	2.03
Neftemaslozavod	80	0.43%	939.25	1160.16
Orenburgnefteprodukt	76	0.41%	92.24	113.93
Saratovnefteprodukt	70	0.38%	22.06	27.25
Ryazannefteprodukt	65	0.35%	1.17	1.45
Saratov Refinery	47	0.26%	40.32	49.80
Kaluganefteprodukt	12	0.06%	97.40	120.31
Tulanefteprodukt	5	0.03%	33.62	41.53
Rostovnefteprodukt	6	0.03%	2.53	3.13
Ryazan Petrochemicals Plant	2	0.01%	259.73	320.82
Total	5 298	28.6%	-	-

Source: TNK-BP official offer

* TNK-BP's shares per 1 share of sub-holding

We note that the Ryazan Refinery (RTS: RNPZ), which is a popular speculative idea in TNK-BP's downstream universe, is not one of the 14 as well as less speculative Orsk Refinery (RTS: ORFE). Certain joint ventures, in which TNK-BP has interest – a 50% stake in Slavneft (RTS: SLAV, BUY), RUSIA Petroleum, STBP Holdings (BP-branded Moscow retail) and Ukrainian business, – will not be part of TNK-BP Holding.

We find the proposed swap conditions very fair and note that TNK-BP seems to have selected the most favorable figures for investors from those presented by the appraiser. Overall valuation figures for the holding are \$17 per thousand barrels of production and \$2.4 per barrel of proved reserves. The figures for sub-holdings vary from \$14 to \$17 and from \$2.0 to \$3.1 respectively. These levels look more than satisfactory compared with, for example, the \$1.46 per barrel of proved reserves used for Lukoil (RTS: LKOH, BUY) in its recent deal with ConocoPhillips and TNK-BP's own figure of \$1.85 at the moment of its creation. The valuations mean that both selling to the core shareholder and swapping into TNK-BP Holding will deliver profit to investors.

We see the consolidation plan as a sign that TNK-BP has given up ambitions of an IPO that would include

Slavneft, RUSIA Petroleum and other smaller assets. Concentration on a Russian-domiciled holding seems aimed to placate the insular mood in the Kremlin, which wants national oil assets to stay within its reach and is keen to encourage development of the domestic equity market. An offshore profit-center could be dangerous in the current political climate.

TNK-BP Holding shares are not listed or traded as yet, but we expect the stock to become a successful blue chip and to trade on equal terms with the two other politically safe oil & gas benchmarks – Lukoil and Gazprom (RTS:GSPBEX, BUY). The appraiser did not make its DCF assumptions public, and our own DCF model gives fair value of \$24.81b, representing 34% upside to the appraisal value. We see better opportunities in TNK-BP as the market gradually unlocks value of the holding, due to a relatively higher level of transparency and overall efficiency compared with Lukoil and Gazprom. We recommend investors to vote for the exchange and become shareholders in TNK-BP.

TNK-BP is carrying out the consolidation earlier than expected. Investors previously assumed that the process would last about 18 months (until the middle of 2006) but it now looks as if the voluntary exchange offer to the 14 named subsidiaries (and, we think, to most other subsidiaries) will be made in the third quarter of 2005. So, in most cases, investors will get new assets (shares of TNK-BP Holding) by the end of the current year.

Lukoil (BUY) summarizes 2004 preliminary results...

The BoD of Lukoil (RTS: LKOH, BUY) summed up operational results of the company in 2004. According to preliminary estimates, consolidated net profit of Lukoil after taxes is \$4b, 60% higher than in 2003 (not including sale of the company's share in the Azeri-Chirag-Guneshli project).

Geological prospecting led to a hydrocarbon reserve increment of about 120mt of oil equivalent, including 71mt of oil and gas condensate and 49bcm of gas. The increment in reserves is 1.3 times the amount of oil and gas extracted. This a good reserve replacement ratio compared to other (surviving) main Russian oil players: it is well above Surgut, Sibneft and Tatneft, and close to TNK-BP and Rosneft.

Aggregate Lukoil production including equity companies and international projects totaled 86.3mt, of which 82.8mt in Russia and 3.5 million tons internationally. Lukoil continues to step up its foreign business and international production already exceeds 4% of total production, higher than for any other Russian major.

Average daily well production increased to 10.7 tons and the average water cut stabilized at 76.5%. These

figures are significant because Lukoil's well restructuring program included mothballing of low-flow wells (below 10 tons a day), and the average figure close to 10 tons shows that some of the low-flow wells are still on stream, which is disappointing.

Overall gas production rose by 8.9% to over 6.2bcm, and throughput at secondary gas processing plants was around 2.2bcm. According to preliminary estimates, throughput at Lukoil refineries was 43.8mt of crude, representing an increase of almost 1.5mt from 2003.

The company's Russian-based refineries processed over 35.3mt of crude, an increase of 3.0%, while its international facilities processed over 8.4mt, up by 6.2%. Refining depth at Russian refineries was increased from 73.5% to 75.3%. Refining depth at international refineries was increased from 66.6% to 69.8%. Lukoil's petrochemical plants produced 1.86mt, 4.9% more than in 2003. Retail sales through Lukoil filling stations rose by 17% to 2.8mt.

Lukoil reported investment spending of \$4.1b (the estimate is unaudited, but collected in compliance with the company's own investment control rules).

...posts record figures in 3Q04 US GAAP...

Lukoil (RTS: LKOH, BUY) showed very strong 3Q04 US GAAP consolidated results, exceeding market estimates. EBITDA and net income consensus were 7% and 16% lower than the actual figures. The key grow factors are standard for the sector in Russia – record high oil and product prices during the quarter, increase in sales volumes and greater output. These factors combined to give record quarterly sales of \$9.8b.

General performance of the company did not change significantly. In particular, transportation costs remained the same (in per barrel terms) as did administrative costs. There was some reduction of lifting costs but the effect was offset by ruble appreciation, so dollar figures only stabilized.

The figures create concern about future development of ruble related costs. Our estimates show faster strengthening of the national currency in fall 2004 (more than 8.9% y-o-y), particularly in Q4, and in 2005. Lukoil's cost-cutting efforts may therefore be stymied by macroeconomic factors.

Lukoil key P&L figures, 3Q04 (\$m)

	3Q03	3Q04	y-o-y change
Sales	6 041	9 822	63%
EBITDA	1 262	2 271	80%
EBITDA margin	21%	23%	-
Net income	701	1 399	100%
Net margin	12%	14%	-

Source: Lukoil, RMG estimates

... and increases stake in Burgas Refinery

On January 13, 2005 the Bulgarian Stock Exchange announced results of a tender offer by Lukoil Europe Holdings B.V., a 100% subsidiary of Lukoil (RTS: LKOH, BUY), to purchase shares owned by minority shareholders of Lukoil's Burgas Refinery. The offer to buy 28.89% shares was announced in December 2004. According to the tender results, owners of 2 987 394 shares (22.05%) of the refinery accepted the tender offer, increasing the stake of Lukoil Europe Holdings B.V. in Burgas to 93.16%.

Russian government may keep limits on foreign ownership of Gazprom (BUY)

The Russian government may keep restrictions on foreigners buying shares in Gazprom (RTS: GSPBEX, BUY), according to Vedomosti newspaper, citing a statement by Valery Nazarov, director of the Federal Property Management Agency. Nazarov said that the government does not plan to lift quotas on participation by foreigners in Gazprom capital. Foreign investors are currently allowed to hold a maximum combined total of 20% in Gazprom, according to a presidential decree from 1997. However, the newspaper also cited an unnamed Gazprom official, who said that permitted foreign participation in Gazprom may be raised to 25% in the near future.

Nazarov added that Gazprom share liberalization (ring fence removal and combining of domestic and ADS markets) will start in March-May, as soon as the merger between Gazprom and Rosneft is completed. But we think that the government will need one or two months more to prepare the process.

Natfa-Moskva acquires 2% of Gazprom (BUY).

Vedomosti newspaper cited an unnamed representative of GMK Nafta-Moskva, who said that the company has acquired about 2% of Gazprom's shares. If true, that would make Nafta-Moskva one of the biggest known stakeholders in Gazprom (RTS: GSPBEX, BUY). ADS and free float in domestic shares account for 35.8% of the gas giant's capital. The rest belongs to the Russian government, Gazprom's construction and building partner, Stroitransgaz, German Ruhrgaz (a part of E.ON), or represents treasury shares.

Vedomosti stated that the following investors are known to own significant stakes in Gazprom: UFG, Hermitage Capital Management, Vostok Nafta, MDM-Bank and a few more, which together have up to 15% of Gazprom stock. We would add Interfin trade Group, with about 1% of Gazprom's capital, and a number of new Gazprom-oriented offshore funds launched last year, such as Novy Neft-I and Novy

Neft-II managed by Charlemagne Capital (each with about 0.25% of Gazprom's shares). Together with Nafta-Moskva this suggests overall institutional holdings in Gazprom at about 20%. This points to the increasingly mature character of Gazprom's share market.

EBRD and International Financial Corporation (IFC) will each buy 1% in Novatek (not traded).

The EBRD and IFC officially said that they are prepared to spend \$40m each to buy a minority stake in Novatek from its shareholders. It was previously rumored on the market that shareholders of Novatek plan to sell up to 3% of company shares to institutional investors. The Cyprus-based fund SWGI was believed to be the potential seller. In late December several brokers held private face-to-face presentations of this private placement for about a dozen large and medium-size investment and hedge funds.

Our interpretation of these developments is based on various clues that have surfaced in past months. Insiders recently gave signs that SWGI fund is quitting Novatek's capital and is selling its 27.78% stake to strategics and others. In particular, 25% is to be sold to Total for \$0.85-1b and the remainder appears to be the 3%, which is available to portfolio investors: 1% for the IFC, 1% for the EBRD and what is left for investment funds. The company never named a beneficiary of SWGI and assiduously refuted any links between SWGI and the vice-governor of Yamalo-Nenetsk region, Josef Levinzon, whom SWGI was believed to represent.

We rate the news as positive and think that IFC and EBRD participation will help Novatek to maintain and even improve its level of corporate governance.

Yukos (SPEC. BUY) to claim \$20b in damages from Russia, but faces opposition from Western banks

Yukos (RTS: YUKO, SPEC. BUY) is planning to launch a \$20b claim for damages by mid-February against the Russian government and others involved in the YNG auction. The auction went ahead despite a US court injunction blocking the move, and Yukos plans to launch its action for damages ahead of a key court hearing in Houston, currently scheduled for February 16. This will rule on both the validity of Yukos' bankruptcy filing and the court's jurisdiction over the case, following a challenge from Deutsche Bank, the leader of a consortium of lenders, which initially planned to fund a bid for YNG by Gazpromneft.

Deutsche Bank argued in its filing that the US risked becoming a jurisdiction of convenience since Yukos

had few assets in the country. According to the Financial Times, other banks in the Gazpromneft syndicate which included BNP Paribas, JP Morgan, ABN Amro, Dresdner Kleinwort Wasserstein and Calyon also suggested on that they may file motions to dismiss the Yukos bankruptcy claim.

Nevzlin becomes trustee of 60% in Group Menatep.

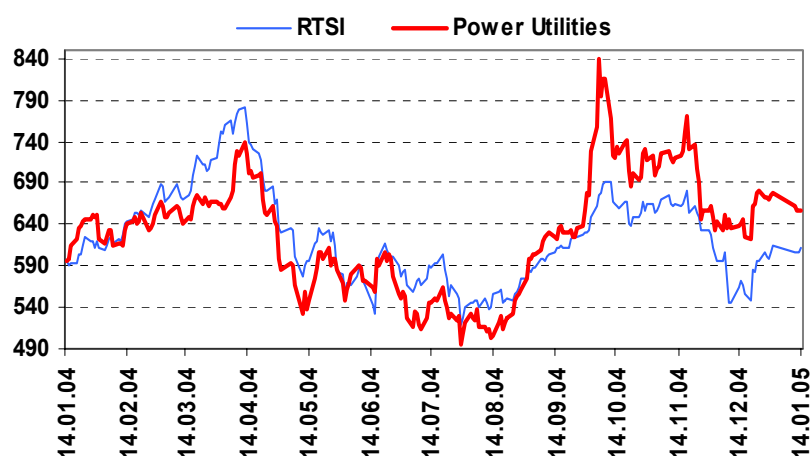
Mikhail Khodorkovsky, the jailed former CEO of Yukos (RTS: YUKO, SPEC. BUY), has confirmed transfer of 60% shares in Group Menatep to Leonid Nevzlin, the second biggest Yukos shareholder, according to statements by Khodorkovsky's lawyer to news agencies last week. Menatep representatives

have repeatedly said that trustee management of 50% of Group Menatep changes hands automatically in case of "force majeure" circumstances such as death, arrest (if it makes a person incapable of voting) or loss of a significant asset. So the procedure had to happen after sale of YNG.

Yukos (SPEC. BUY) de-listed from RTS.

Yukos (RTS: YUKO, SPEC. BUY) shares have ceased to trade on the A1 list of the RTS. Exchange officials said that the stock was shifted to non-listed status as of January 14.

Power Utilities Index vs. RTS Index



Power Utilities Key Figures

Sector indicators: median	Russia	Discount to emerging markets
MC / Net sales	0.75	53%
EV / EBITDA	6.54	39%
MC / Owned inst. capacity	145.09	75%
MC / Retail supplies of elec.	27.65	62%

ADRs of Russian power utilities	Last sale	Wk change
RAO UES	27.150	-5.1%
Mosenergo	14.350	-2.1%
Irkutskenergo	10.100	4.1%

Sector Wrap

- Sixteen more energos completed state registration of divesting companies in the beginning of 2005. Now these energo formally represent only distribution business, but we still leave their valuation as before reorganization.
- In the end of 2004 the government approved several documents connected with the power sector reform.
- Trade System Administrator has become operator of the whole national wholesale trades, including regulated and unregulated.
- UES plans changes to common dividend computation methodology.
- UES reported preliminary production figures for 2004.
- Mosenergo raised tariffs from January 1, the Moscow developer Dekra acquired almost 5% in the power utility.
- Siberian Coal Energy Company received approval from Federal Antimonopoly Service for consolidation of its stakes in several energos.
- More power utilities reported EGM results on payment of interim dividends.

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 04E	P/E 04E
Bashkirenergo com	BEGY	0.315	0.0	0.040	338.85	0.299	0.400	0.49	20.24
Irkutskenergo com	IRGZ	0.207	-4.7	0.010	989.11	0.131	0.245	1.58	50.06
Lenenergo com	LSNG	0.860	-5.1		669.97	0.595	0.920	0.75	65.00
Lenenergo pref	LSNGP	0.458	-1.6			0.350	0.645		
Mosenergo com	MSNG	0.146	-2.2	0.438	4 056.42	0.068	0.310	1.42	42.98
Permenergo com	PMNG	5.275	-2.8		227.25	3.580	5.350	0.39	5.11
Permenergo pref	PMNGP	4.075	0.0			2.950	4.750		
UES com	EESR	0.273	-4.1	6.876	11 724.45	0.228	0.358	0.50	9.35
UES pref	EESRP	0.249	-6.0			0.210	0.339		
Samaraenergo com	SAGO	0.124	-1.6		459.93	0.073	0.127	0.66	27.91
Samaraenergo pref	SAGOP	0.072	-2.7			0.057	0.085		
Sverdlovennergo com	SVER	0.404	-0.6		242.78	0.340	0.500	0.25	16.58
Sverdlovennergo pref	SVERP	0.219	-2.3	0.011		0.190	0.315		

More energos register new companies

UES (RTS: EESR, EESRP, BUY) reported last week that 16 more energos completed state registration of new companies, which are being divested from them. Chuvashenergo (NR), Ivenergo (RTS: IVEN, IVENP, HOLD), Karelenergo (NR), Kostromaenergo (RTS: KOSG, KOSGP, HOLD), Marienergo (RTS: MIEN, MIENP, BUY), Penzaenergo (RTS: PNZE, PNZEP, BUY), Udmurtenergo (RTS: UDME, UDMEP, BUY), Vladimirenergo (RTS: VLEN, BUY) and Volgogradenergo (RTS: VGEN, VGENP, BUY) carried out the registrations on January 1, and Astrakhanenergo (RTS: ASRE, ASREP, BUY), Lipetskenergo (RTS: LIEN, BUY), Rostovenergo (RTS: RTSE, RTSEP, HOLD), Ryazanenergo (RTS: RZEN, BUY), Tambovenergo (RTS: TAEN, TAENP, BUY), Tverenergo (RTS: TVRE, TVREP, BUY) and Yarenergo (RTS: YARE, YAREP, HOLD) did so on January 11. Kalugaenergo (RTS: KLEN, BUY), Pskovenergo (RTS: PSEN, BUY), Belgorodenergo (RTS: BENR, BENRP, HOLD), Bryanskenergo (RTS: BREN, BRENP, BUY) and Voronezhenergo (RTS:

VZEN, VZENP, BUY) officially split up their businesses last year.

All the above-mentioned energos were reorganized following the basic UES plan, by which medium- and low-voltage distribution assets were left in energo ownership, while electricity generating assets, high-voltage transmission lines, and sales and management businesses were allocated to separate entities. In most cases heat generating and distribution have been annexed to new generating companies. Share capitals of the new companies are paid using additional share capital of the reorganizing energos. Shareholders of energos receive the same number of shares in each new divested company as they have in the energo. Par value of shares in the new companies differ from those of shares of the original energo, reflecting proportions between fair values of the energo parts after division of businesses, as assessed by the appraiser. This situation is illustrated in the table below for three energos.

Division of energo value after break-up, based on par values (example)

	Generating company	Energo (low-, medium-voltage distribution assets)	High-voltage distribution company	Sales company	Management company	Other	Total
Voronezhenergo							
- par value of shares (R)	16.0000	51.3161 *	3.5000	0.4000	0.0050		71.2211
- share of energo assets	22.5%	72.1%	4.9%	0.6%	0.0%		100.0%
Kalugaenergo							
- par value of shares (R)	1.0000	29.8706 *	1.0000	0.2000	0.0040		32.0746
- share of energo assets	3.1%	93.1%	3.1%	0.6%	0.0%		100.0%
Ryazanenergo							
- par value of shares (R)	2.8600	22.8056 *	0.5600	0.0500	0.0100		26.2856
- share of energo assets	10.9%	86.8%	2.1%	0.2%	0.0%		100.0%

* share par value plus undistributed additional share capital recalculated into per share value

Source: Company reports, RMG estimates

Note that we made significant corrections (marked with asterisks) to this table compared with the version published in our report "[Energos: Still Attractive Despite Reorganization Risks](#)" issued on October 15, 2004. Figures in the energo column of the table now represent the sum of energo par value and undistributed additional share capital (i.e. share capital remaining after share capitals of divesting companies have been financed), adjusted to per share value. For example, for Voronezhenergo the actual par value of shares is R10 and R41.3161 represents undistributed additional share capital per share.

The key point for investors is that reorganized energos contain mainly distribution business, so their market value should be different from what it was before reorganization (when they combined businesses that have been divested). We should also

note that in estimating energo fair value (the value before reorganization) we only considered values of electricity generating and distribution, and did not count value of heat generating and distribution, high-voltage transmission or sales and management businesses. We so have calculated the fair value of reorganized energos, which consist only of electricity distribution business, and results are shown in the following table (recalculated per share).

Fair value of energos before and after reorganization (for commons only)

	Current price, \$	Target price, \$	Up / down (ask-based), %	Fair value for distribution only, \$
Astrakhanenergo	0.065	0.107	64%	0.055
Belgorodenergo	37.500	42.335	13%	39.400
Bryanskenergo	2.290	3.321	45%	3.096
Ivenergo	0.065	0.088	35%	0.041
Kalugaenergo	0.480	0.755	57%	0.742
Kostromaenergo	0.067	0.084	26%	0.050
Lipetskenergo	0.350	0.640	83%	0.292
Marienergo	0.235	0.326	39%	0.171
Penzaenergo	0.280	0.408	46%	0.212
Pskovenergo	0.155	0.228	47%	0.220
Rostovenergo	0.056	0.065	18%	0.043
Ryazanenergo	0.168	0.283	69%	0.236
Tambovenergo	0.021	0.035	66%	0.021
Tverenergo	0.100	0.153	53%	0.107
Udmurtenergo	0.470	0.760	62%	0.413
Vladimirenergo	1.900	3.351	76%	1.966
Volgogradenergo	0.345	0.520	51%	0.201
Voronezhenergo	0.550	1.255	128%	1.134
Yarenergo	20.000	6.200	-69%	3.010

Note: prices as of 14.01.05

Source: RTS, RMG estimates

Logically, market prices of reorganized energos should only reflect distribution business, but this is not necessarily happening. Some reorganized stocks, particularly those traded on the RTS-Board, are still priced as if they had all their old assets. We assume that brokers may agree to use the old company as a proxy until shares of divested companies start being traded. Not all of the divested companies will return to the stock exchange, though: generating companies are sure to receive stock exchange listing, but high-voltage transmission companies will merge with the UES-controlled Federal Grid Company (FGC) and other (small) divested companies are unlikely to be of interest to investors.

Until now we have used the “ask” price to calculate upside/downside potential for energo shares. Recent utility performances on the RTS suggest that “ask” prices for divested energos still reflect the value of the former pre-divestment entity, while “bid” prices are generally for sole distribution companies. We continue to calculate upside/downside based on “ask” prices, and our target prices are still for the full basket of assets, although some of them are at least temporarily absent from the entities being traded on the stock market.

We plan to issue a separate note in the near future offering more detailed analysis of the situation with energo reorganization. UES and the RTS have scheduled a round table this Wednesday concerning liquidity of reorganizing energos, and we hope that it will bring more clarity.

Government stamps changes in power regulation

The government approved several documents connected with power sector reform in the last week of 2004. PM Mikhail Fradkov signed a resolution on non-discriminatory access of power market participants to monopoly services (power transmission and dispatching). The government also approved dispatching rules and drew up a list of isolated energy systems, including those in Kamchatka, Magadan, Sakhalin, Chukotka and Taimyr, as well as western and central regions of Yakutia (all these systems are located in the Russian Far East).

In addition Vladimir Putin signed changes to the law, which is supposed to govern the power sector during the transitional period. In particular, the changes concern combination of natural monopoly and competitive businesses in the power sector between January 1, 2005 and April 1, 2006. The previous reading supposed ceasing of such combination by market participants (mainly energos) starting from January 1, 2005, but the date has been put off due to un readiness of most power companies for break-up of businesses.

TSA takes functions of single market operator

The Trading System Administrator (TSA), which controls electricity trades in the deregulated section of the power market, has also become operator in the regulated section as from January 1, 2005. According to the TSA, this will allow unification of the system of contracts and settlements between market participants, and provide smooth transition to the fully deregulated power market in 2006. The TSA emphasized that it has become the world’s largest electricity trading operator in volume terms.

UES (BUY) to change dividend calculations

The UES (RTS: EESR, EESRP) BoD is planning to discuss changes to its way of calculating common dividends at a meeting on January 28. The current system is based on calculation of two multiples: (1) EBITDA corrected by a special coefficient determined by UES BoD and characterizing financial performance of UES in the dividend period; and (2) net profit corrected by obligatory allocations to the reserve fund and preferred dividend payments. The lowest of these two figures is used as the basis for dividend payout on common shares. UES wants changes to the second multiple, which currently takes account of revaluation of financial investments (gains are subtracted from and losses are added to net profit). The changes will have no effect on preferred dividend payments.

We estimated UES common dividends for 2004 at R0.047 (0.17 cents) and preferred dividends at R0.228 (0.82 cents). But the common dividend may be even lower after the change. In any case, current common dividend yield at 0.6% (based on 2004E dividend) is negligible.

UES (BUY) estimates electricity production and consumption in 2004

According to UES (RTS: EESR, EESRP) preliminary estimates, production by controlled companies was 652b kWh in 2004 vs. 635.8b kWh in 2003 (2.5% growth). Hydro stations produced 130.6b kWh in 2004, up 13.3% from 115.2b kWh in 2003, thanks to higher water levels in reservoirs last year. Electricity production by controlled fuel-fired generators was practically unchanged last year (521.4b kWh vs. 520.6b kWh in 2003). According to UES, total Russian consumption of electric power was 908.8b kWh last year, up by 2.3% from 2003. The difference between overall Russian demand and UES production was met by non-controlled generators (nuclear, public, municipal, etc.).

Real estate developer acquires 5% in Mosenergo (SELL)

Vedomosti newspaper reported just before New Year that one of the largest real-estate developers in Moscow, Dekra, acquired a 4.6% stake in Mosenergo (RTS: MSNG). The newspaper quoted company BoD chairman, Sergei Denisov, who said that Dekra bought its shares on foreign exchanges in spring-summer 2004. Price of Mosenergo shares on the domestic market grew rapidly starting from mid-summer, mainly due to purchases by Gazprom, which built a blocking stake in the power utility by the end of 2004.

Dekra does not disclose its shareholder structure and may well be affiliated with the Moscow government, which wants control over electricity and heat distribution companies that are to be divested from Mosenergo. There have been market rumors that the Moscow government acquired shares during the last rally. In any case, Dekra said that it wants to exchange its Mosenergo shares for stakes owned by the city government in several Moscow business complexes. The Moscow government directly holds a 3% stake in Mosenergo, a 5% stake was controlled by Bank of Moscow (affiliated with the city government) until spring 2004, after which it was reportedly sold.

A Mosenergo EGM on divestment of businesses is scheduled for February 28.

Mosenergo (SELL) raises tariffs

Average tariffs for electricity in Moscow city and Moscow region were raised by 12.55% and 12.23% as from January 1, Mosenergo (RTS: MSNG) reported. This is a smaller rise than the 15% predicted by the company a month ago, but more than the average growth ceiling set by the Federal Tariff Service for 2005. The biggest increases, of about 25%, apply to households, while tariffs for industrial users were increased by less than 10%. Inequality of the tariff rises is meant to reduce cross-subsidization, by which industrial customers subsidize households. Mosenergo did not report heat tariff changes, but information on its web-site suggests that tariffs for heat rose by 25-50%.

SUEK consolidates energo stakes

At the end of December Siberian Coal Energy Company (SUEK in the Russian abbreviation) announced acquisition of stakes in three power utilities: a 32% stake in Dalenergo (RTS: DALE, DALEP, HOLD), a 33% stake in Khabarovskenergo (RTS: HBEN, HBENP, HOLD) and a 20% stake in Yakutskenergo (RTS: YAEN, YAENP, SELL), all located in the Far East federal zone. The Federal Antimonopoly Service (FAS) had already approved consolidation of stakes in several power utilities, including these ones, on the SUEK balance sheet. The stakes were factually controlled by SUEK via intermediary companies before their formal acquisition.

Recent statements by SUEK suggest that it wants to consolidate its stakes in power utilities and coal companies to create a vertically integrated company, which will be more comprehensible for investors. SUEK currently controls major stakes in eight energos, either directly or through affiliates. These are Altaienergo (RTS: ALTE, ALTEP, HOLD) (a 45% stake), Amurenergo (RTS: AMEN, AMENP, BUY) (47%), Buryatenergo (RTS: BUEN, BUY) (47%), Chitaenergo (RTS: CHIE, CHIEP, BUY) (45%), Dalenergo (47%), Khabarovskenergo (46%), Kuzbassenergo (RTS: KZBE, BUY) (47%) and Omskenergo (RTS: OMNG, OMNGP, BUY) (48%). All of them mainly burn coal and are located close to coal mining companies controlled by SUEK. SUEK also has a large stake (46%) in Luchegorsk Fuel-Energy Complex (LuTEK). Smaller stakes in a few other energos (reportedly Chelyabenergo (RTS: CHNG, CHNGP, HOLD), Orelenergo (RTS: OREN, OREN, HOLD), Kirovenergo (RTS: KIRE, KIREP, BUY), Krasnoyarskenergo (RTS: KRNG, KRNGP, HOLD), Novgorodenergo (RTS: NGNR, NGNR, BUY), Tulenergo (RTS: TLEN, BUY)) have not been slated for consolidation by SUEK, and seem to be portfolio investments.

UES (RTS: EESR, EESRP, BUY) will remain the largest shareholder in all these companies, in which SUEK has stakes, until completion of power sector reorganization.

We see SUEK's integration moves as positive for the power utilities concerned, and for minority shareholders in these utilities. The process suggests an eventual public offering of shares in the united company, and fuel-power integration should boost bottom-line results.

More utilities approve interim dividends

There have been more EGMs at power utilities to approve payment of 9M 2004 dividends, as arranged by UES (RTS: EESR, EESRP, BUY) to ensure that dividend payment is not interrupted by sector restructuring (the relevant utilities will have different asset structures by the time of their 2005 AGMs, and would be unable to pay out full 2004 dividends). Practically all stand-alone fuel-fired power stations (GRESs) and hydro stations (GESs), and about 30 energos are included in the scheme. Dividends for the fourth quarter of 2004, which these utilities will pay later, will likely be 1/3 of 9M 2004 dividends.

The EGM of Volzhskaya GES (RTS: VOLG: SELL, VOLGP: HOLD) on December 27 approved payment of interim dividends for 9M 2004 at R0.06945 (0.25

cents) per common and preferred shares. The cut-off date was on November 30.

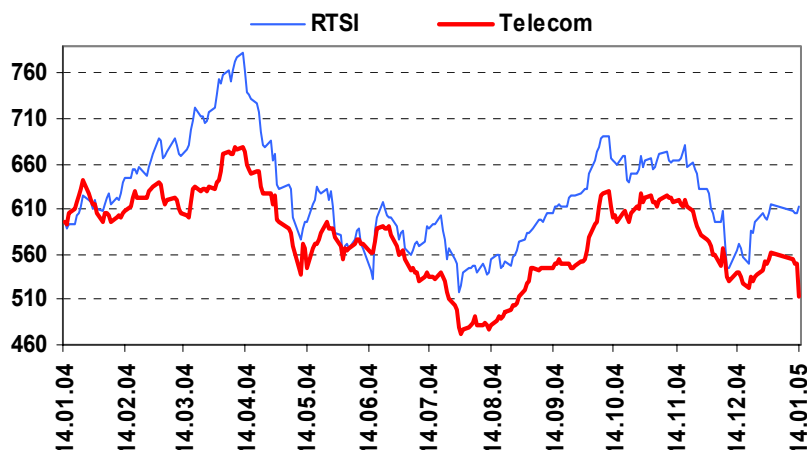
The same day shareholders of Votkinskaya GES (RTS: VOTG: SELL, VOTGP: BUY) approved payment of 9M 2004 dividends at R0.0242 (0.09 cents) per common share and R0.13327 (0.48 cents) per preferred share. The cut-off date was also on November 30.

Orelenergo (RTS: OREN, OREN, HOLD) reported that its EGM decided to pay interim dividends for 9M 2004 at R0.0827 (0.30 cents) per preferred share, and no dividends on common shares. The cut-off date was on November 10.

Chelyabenergo (RTS: CHNG, CHNGP, HOLD) shareholders approved payment of 9M 2004 dividends at R0.0377 (0.13 cents) per common share and R0.09 (0.32 cents) per preferred share at the EGM on December 31. The cut-off date was on November 16.

An EGM of Stavropolskaya GRES (RTS: STGS, HOLD) on December 31 approved payment of 9M 2004 dividends at R5.42 (19.4 cents) per common share. The cut-off date was on November 16.

Telecom Index vs. RTS Index



Telecoms Key Figures

Sector indicators: median	Russia	Discount to emerging markets
EV / EBITDA	3.9	17%
EV / Net sales	1.2	40%
EV / Access lines	271	83%
EBITDA / Access lines	69	73%

ADRs of Russian telecoms	Last sale	Wk change
Rostelecom	10.630	0.3%
MTS	34.020	1.9%
Vimpelcom	35.200	11.7%

Sector Wrap

- Russian taxmen delivered the final tax claims to Vimpelcom for 2001 which were much less than previously reported preliminary claims. It, as well as preliminary additional tax claims for 2002, means that the company will not be a star in Yukos-2.
- AC&M Consulting reported mobile market estimates for December 2004 which exceeded the most overbold expectations on net additions. The reason was active marketing of mobile operators which desired to show the stock market rapid subscriber base dynamics.
- AFK Sistema reported 9M04 financials under US GAAP. It is the indirect sign of coming IPO of the holding

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 04E	P/E 04E
Dalsvyaz com	ESPK	1.075	-0.9		128.68	0.890	1.390	0.51	5.14
Dalsvyaz pref	ESPKP	1.085	-1.8			0.760	1.200		
Moscow City Telephone com	MGTS	12.000	-0.2	0.018	1 118.67	11.350	13.500	1.97	13.35
Moscow City Telephone pref	MGTSP	9.800	-4.2	0.020		8.200	12.400		
North West Telecom com	SPTL	0.518	-1.4	0.026	547.26	0.438	0.680	0.88	37.39
North West Telecom pref	SPTLP	0.377	-4.4			0.280	0.467		
Rostelecom com	RTKM	1.800	-0.8	0.903	1 645.55	1.655	2.660	1.26	8.54
Rostelecom pref	RTKMP	1.385	-6.1			1.250	1.800		
Siberia Telecom com	ENCO	0.057	-2.5	0.105	807.19	0.039	0.064	1.12	9.88
Siberia Telecom pref	ENCOP	0.038	-1.2	0.042		0.031	0.045		
South Telecom com	KUBN	0.074	-1.3	0.007	269.61	0.073	0.121	0.45	neg
South Telecom pref	KUBNP	0.056	0.5			0.054	0.095		
Ural Svyazinform com	URSI	0.035	-4.1	0.410	1 332.03	0.029	0.046	1.35	10.48
Ural Svyazinform pref	URSIP	0.024	-5.7	0.080		0.021	0.028		
Volga Telecom com	NNSI	3.285	-0.9	0.158	984.68	2.400	3.450	1.34	33.97
Volga Telecom pref	NNSIP	2.205	-2.5	0.055		1.650	2.490		

Taxmen are gentle with Vimpelcom (BUY)

Vimpelcom (NYSE: VIP, RTS: VIMP) reported before the New Year holidays that tax inspectors delivered preliminary results of a review of the company's 2002 tax filing. According to taxmen, Vimpelcom owes R408.5 million (\$14.7m) in tax plus R172.1m (\$6.2m) in fines and penalties for 2002. This is much less than initially rumored R9b (\$323m). The figures, which the mobile company has received for 2002, do not represent a final tax claim or demand for payment by the inspectorate.

Vimpelcom told us that the tax inspectors' calculations refer only to VAT and do not challenge deductibility of expenses incurred by Vimpelcom in connection with the agency relationship between Vimpelcom and its wholly owned subsidiary, KB-Impuls, which holds the GSM license used by Vimpelcom for its operations in the city of Moscow and Moscow region.

Moreover, the mobile operator received final claims for 2001 stating that the company should pay only R284.9m (\$10.2m) in extra taxes plus R205m (\$7.4m) in fines and penalties. This is much less than \$158m extra tax claims for 2001 (fines and penalties included), which were initially reported.

As we expected, the company has been successful in contesting preliminary claims by the tax services, particularly profit tax claims relating to specifics of the arrangement between Vimpelcom and KB-Impuls. The success may be due to ineptitude of the claims or to pressure by foreign shareholders of Vimpelcom.

Vimpelcom CEO Alexander Izosimov said that the company will pay most of the 2001 claims plus fines and penalties, resolving the issue, thanks to "constructive dialogue" with the Russian tax service.

It now looks as if the overall total back-tax bill (with fees and penalties), including any claims for 2003, will not exceed \$70-80m, which is much less than initially feared \$700m. Vimpelcom can pay that much without serious threat to its financial and operating activity: company net income for 2004 is expected to be \$464m, and EBITDA is predicted to be over \$1b.

Investors and creditors of Vimpelcom, who feared that the company was about to star in Yukos-2, can now be optimistic. Tax inspectors seem ready to call off tax challenges to the agency relationship with KB-Impuls. A final, modest extra tax bill will allow the company to put this episode behind it and raise new credits, which it needs to pursue massive expansion.

We saw company shares as attractive even when a much bigger tax bill looked likely. The latest signs that state officials are not out for Vimpelcom blood encourage us to confirm our BUY recommendation with \$47.2 ADR fair price.

AC&M Consulting gives mobile estimates for December 2004

AC&M Consulting gave estimates for mobile market development in December 2004. Russian mobile operators seem to have gone into marketing overdrive in the last month of the year, increasing the Russian-wide subscriber base by 12.6% from 65.59m to 73.85m subscribers. Net additions of 8.3m are almost two times more than in November 2004 and three times more than in December 2003. We expected that subscriber numbers would top 70m by the end of 2004, but the scale of the December surge is surprising. According to the figures, Russian-wide penetration now exceeds 50%, so every second Russian uses a mobile phone.

Mobile subscribers in November 2004 (million)

	MTS	Vimpel-com	Mega-Fon	Other operators
Moscow	7.47	7.48	1.82	0.09
Other regions	19.00	18.22	11.78	8.00
Total # of subscribers	26.47	25.69	13.60	8.09
<i>Dec'04 / Nov'04 change, %</i>	<i>15.4%</i>	<i>14.6%</i>	<i>6.9%</i>	<i>7.7%</i>

Source: AC&M Consulting, RMG estimates

AC&M expressed caution about the quality of subscriber base growth. In particular, the agency noted that the penetration in the Moscow License Area is close to 100%, which is unrealistic and suggests some discrepancy between treatment of subscriber base by the operators and real numbers of active subscribers. MTS (NYSE: MBT, MICEX: MTSI, BUY) disconnects subscribers after their account has been inactive for six months, while Vimpelcom (NYSE: VIP, RTS: VIMP, BUY) sometimes allows one year of inactivity before disconnection. Operators stimulate connection through special offers (e.g. free call time), which increases demand for connection, but only a portion of the bought sets are used for any significant period of time, which causes misleading subscriber base figures. It is true that inactive subscribers are irrelevant for operator revenues, but attracting new subscribers costs money (to pay dealers, to put money on the account, etc.) and entails losses, when there is little or no resulting use. The scale of marketing activity will become clear when companies disclose their financials for 2004.

MTS was the leader by net additions in December 2004 both in Moscow and in other regions thanks to a special effort on the marketing front, offering extra connection sets on special terms. The MTS subscriber base climbed by 15.4%, while Vimpelcom's was 14.6% higher. MegaFon had little by way of special offers in December, and its subscriber base grew by 6.9%.

Growth of the subscriber base is bound to slowdown at the beginning 2005, and investors should not be

concerned by such a slowdown. Financials of the mobile companies will continue strong in any case.

AFK Sistema gives 9M04 results under US GAAP

AFK Sistema offered results for nine months of 2004 under US GAAP. The holding is one of the leaders in the Russian telecommunication sector, with controlling stakes in MTS (NYSE: MBT, RTS: MTSI, BUY), MGTS (RTS: MGTS, MGTSP, BUY) and Comstar-United Telesystems, but also owns companies outside the telecom sector (notably ROSNO insurance company).

AFK Sistema 9M 2004 results (US GAAP)

	9M04, \$m	9M03, \$m	Change, %
Net sales	4 135.9	2 608.6	59%
CGM	2 829.4	1 847.2	53%
EBITDA	1 847.2	1 115.7	66%
- EBITDA margin	45%	43%	
Operating profit	1 306.5	761.4	72%
- Operating margin	32%	29%	
Net profit	372.2	143.9	159%
- Net margin	9%	6%	

	9M04, \$m	FY03, \$m	Change, %
Receivables	293.0	182.3	61%
Payables and debt	331.8	234.9	41%

Source: Company data, RMG estimates

Sales improved by 59% due to fast revenue growth by the Russian mobile leader, MTS, which provides as much as 70% of holding revenues. Profitability of Sistema is lower than profitability of MTS because other holding subsidiaries are less profitable than the mobile operator.

Sistema is improving its investor relations in preparation for a promised IPO in London. The Russian Federal Service for Financial Markets has registered a new issue by Sistema, for purposes of the upcoming IPO, on 19% of current outstanding shares of the holding (or 16% of the new amount of shares).

New rumors over Svyazinvest privatization

A Telecom Ministry official reported last week that plans for privatization of state-owned Svyazinvest holding may be revisited. It was reported earlier that tough negotiations are underway concerning the privatization between the Russian Telecommunication Ministry and the Ministry for Economic Development and Trade, on one hand, and Russian defense officials, on the other hand. Defense officials, particularly in the FSB, are unwilling to let a non-state company carry their traffic.

News agencies reported a possibility that the government will privatize only 25% minus 2 shares in the company, so that 50% plus one share will remain in state ownership. A 75% stake in Svyazinvest has been valued at about \$2.9b, but it is difficult to imagine that the government could obtain more than \$650-750m for 25% minus 2 shares, which is less than a blocking stake.

The Russian telecom minister said after consultations with President Putin that the company should be sold in its current form (without removal of Rostelecom) and that the government should sell the whole of its stake (75% minus one share) to avoid dramatic value collapse.

We believe that the holding will be sold as desired by the Telecom and Economic Development Ministries.

Officials buttress monopoly of Rostelecom (BUY)

The Telecommunication Supervision Service has ordered some alternative operators to stop violating legislation, which requires all telecom providers to transmit LD traffic through the network of Rostelecom (RTS: RTKM, RTKMP). It is generally known that several mobile providers have been transmitting their LD traffic through networks of alternative operators – TransTelecom (TTC) and Interregional TransitTelecom (ITT). Rostelecom has reported that its share of the LD traffic market was about 60-65%, but it should be 100% under the Telecommunications Law. The action by the Supervision Service should revive Rostelecom financials, increasing company revenues.

However, we still think that its monopoly position (and cross-subsidization) are more of a hindrance than a help to Rostelecom. The company has huge excess transmission capacity (reportedly only 40% is used), but sector regulation prevents the company from raising the load factor by lowering its prices. The general expectation is that Rostelecom will lose market share after deregulation, which is scheduled for 1H05, but it is important to remember that Rostelecom is the only company with excess transmission capacities, so that competitors will have to borrow capacity from the ex-monopolist in order to expand their business.

Ural Svyazinform (BUY) plans to invest \$300m in mobile business

Ural Svyazinform (RTS: URSI, URSIP) reported plans to invest \$300m in mobile business development in 2005-2009. The company BoD will approve big investments in mobile business to make it a key cash generator.

We have previously said that development on the highly competitive mobile market is hardly the best

strategy for RTOs, as margins will erode and the Big Three will use effects of scale to make life increasingly hard for small operators. However, Ural Svyazinform has a fair chance of being the exception to this rule, since it is the fourth largest Russian mobile operator and plans to sell mobile services in a package with fixed-line and new services.

RBC (HOLD) confirms ADR program

RBC information Systems (RTS: RBCI) confirmed plans for an ADR program, saying that RBC shares are in demand among international investors and that management will continue efforts to make the company more attractive for them.

We have reservations about the stock, believing that it is traded at fair value and that foreign investors are unlikely to be too excited about a firm with \$300m capitalization and \$95m predicted 2005 sales. Also the ADR program will require additional spending by the company, and could even destroy shareholder value.

RBC says that it does not plan to issue new shares for the ADR program, suggesting that owner-managers will make a partial exit. The program may thus be more valuable for core shareholders than for other investors. We confirm our HOLD recommendation for company shares.

Dalsvyaz (HOLD) approves dividend policy

Dalsvyaz (RTS: ESPK, ESPKP) approved a dividend policy last week. The company promises to pay out at least 10% of company net income as dividends on preferred share and a further 10% on common shares. The amount paid per common share cannot exceed dividends per preferred share.

The dividend policy announcement is very important because 2004 profits at Dalsvyaz will be large, following sale of its stake in mobile company Primtelefon to MTS. We expect that dividends will be generous, offering income of 14% on both prefs and commons.

Magnitogorsk Steel (HOLD) management pays for government stake

U.F.G.I.S. Structured Holdings, which won the auction for a 17.84% government stake in Magnitogorsk Steel (MMK) acting in the interest of managers of MMK management, had made payment to the Russian Federal Property Fund for the stake. Vedomosti newspaper, citing an MMK representative, reported that MMK funds were not used, and the winner of the action raised foreign banks credits on security of MMK shares in order to pay for the stake. The government shares were sold for \$790m, and management also spent \$870m to buy a 16% stake in MMK owned by Mechel Steel Group (RTS: SGML).

MMK management now controls more than 90% of the company, and we guess that the owners will move to solve MMK's main problem, which is lack of its own raw material sources. We also think that the company may soon place its shares, which are currently traded only OTC, on the stock exchange.

In other news, MMK increased sales by 60% y-o-y to R133.3b (\$4.63b) under RAS in 2004. The company explains the growth by rising metal prices and change of its sales structure in favor of more expensive products. We predict that the company will show \$4.22b sales under IAS in 2004.

Russian steel giants will participate in auction for Yakutugol stake

An auction for 25% plus one share of the East Siberian coal company, Yakutugol, will be held on January 24, 2005 with starting price of R3.62b (\$130m). Yakutugol is a large coal producer, mining about 9 million tons of coal annually, most of which is coking coal, used in metallurgy. The company is currently fully owned by the Property Ministry of the Republic of Yakutia.

According to Vedomosti newspaper, Magnitogorsk Steel (MMK), Novolipetsk Steel (RTS: NLMK), Severstal (RTS: CHMF), EvrazHolding, Mechel Steel Group (RTS: SGML), Base Element and Sumitomo (Japan), have all expressed interest in the stake. So there is a strong chance that the starting price will be significantly exceeded.

We think that Yakutugol is a very attractive asset for steel companies. It has a good location, close to Vostochny Port in the Russian Far East, and most of its production is already exported to Japan, South Korea and Taiwan under the long-term contracts. We guess that the keenest Russian bidders will be NLMK and MMK, which both lack their own coking coal facilities. NLMK uses 40 000-50 000 tons of Yakutugol coal each month. Other companies may

be interested in the stake in order to expand their raw material base, but also as an investment, since prices for coking coal are rising.

EvrazHolding wants to buy assets in Georgia

The Georgian government wants to privatize 80% of Chiatumarganets, a large producer of manganese ore, and 100% of Vartsikhsk GES (hydro power station) as a single lot. EvrazHolding (the Russian steel producer), DCM (a Austrian-Ukrainian JV), and Interpipe (a Ukrainian company), have all said that they are ready to bid more than \$100m for the assets.

Manganese ore produced by Chiatumarganets is used in production of ferroalloys. The plant has one million tons of installed capacity, but now only produces about 180 000 tons annually and its main customer is the Zestavonsky Ferroalloys Plant (Georgia), of which 51% is owned by DCM DECOMetal. The main users of power from Vartsikhsk GES are Chiatumarganets and Zestavonsky.

Ivanishvili sells metallurgy business

Boris Ivanishvili, the Russian businessman who owns Mikhailovsky GOK (RTS: MGOK, MGOKP) via the company Unikor, sold 97% of the GOK for \$1.65b to the businessmen Alisher Usmanov and Vasily Anisimov. In October 2004 Usmanov, Ivanishvili and Anisimov signed a preliminary agreement to unite their steel businesses. Unikor, the main owner of which is Ivanishvili, would sell 47% of Mikhailovsky GOK to Usmanov and Anisimov structures, while Usmanov would sell 50% of Ural Steel to Mikhailovsky GOK, and Ural Steel would buy 30% of Tulachermet, the leading Russian pig iron producer, from Unikor.

The first stage of the deal was closed on December 28, 2004, when Mikhailovsky GOK bought 43% of Ural Steel, Usmanov and Anisimov bought 47% of the GOK, and Ural Steel bought 30% of Tulachermet for \$100m. Now Usmanov and Anisimov have confirmed acquisition of 97% of the GOK, which will be owned on a parity basis, as will Ural Steel.

Novolipetsk Steel (BUY) gets RTS listing

Shares of Novolipetsk Steel (RTS: NLMK) were included in the RTS "B" list as of January 14. They were previously traded only OTC. We assume that the placement is a stepping stone to placement on foreign stock exchanges, which we expect to be successful. We also expect NLMK to increase its free float, which we now estimate at about 4%. We keep our BUY recommendation for NLMK shares.

VSMPO-Avisma (BUY) merger may wait till 2Q05

The Federal Antimonopoly Service (FAS) has still not given VSMPO (RTS: VSMO), the world's largest titanium producer, permission to absorb Avisma (RTS: AVSM, AVSMP), the company which supplies raw materials to VSMPO. A FAS official said that the service has sent VSMPO a request to reveal VSMPO beneficiaries. Vyacheslav Bresht, head of VSMPO BoD, said that this is the only factor delaying merger approval. He also said that the company will comply with the FAS demand and he expects that permission for merger will be given by the end of January 2005. But Avisma liquidation will only be formalized on March 31, 2005, due to the end of the tax period.

The companies decided to merge in March 2004 and terms of the merger were approved at EGMs in September 2004. The companies planned to complete the merger by the end of 2004. VSMPO and Avisma shareholders approved transfer to a single share on December 28, 2004.

We think that the merger and subsequent IPO by VSMPO will go ahead. We keep our BUY recommendation for VSMPO-Avisma shares.

AvtoVAZ (BUY) increases car output

AvtoVAZ (RTS: AVAZ, AVAZP), the leading Russian auto producer, produced more 717 981 vehicles (up 2.6% y-o-y) in 2004, exceeding our estimate of 712 000 vehicles. In 2003 the company produced 699 889 cars. The company exported 92 966 cars in 2004 and plans to export the same number in 2005. AvtoVAZ also said that it will produce about 18 000 of its new Lada Kalina cars in 2005, rising to 220 000 by 2007.

In other news, GM-AvtoVAZ, the JV between AvtoVAZ and GM, which produces Chevrolet Niva and Chevrolet Viva jeeps, increased car output to 55 150 units in 2004 compared with 25 235 in 2003. The company sold 57 943 cars in 2004.

GAZ (BUY) increased vehicle output by 8.4% y-o-y in 2004

According to preliminary data, GAZ (RTS: GAZA, GAZAP) produced 231 336 vehicles and car kits (up 8.4% y-o-y) in 2004. The company made 65 686 cars (up 15.7% y-o-y), 117 043 trucks (up 8.1% y-o-y) and 31 522 mini buses (down 13.2% y-o-y) last year.

Chelyabinsk Pipe Works (HOLD) acquires 57.2% of Pervouralsky

Chelyabinsk Pipe Works (RTS:CHEP), the Russian pipe producer with the largest installed capacity (13.5% of the Russian pipe market in 2003), acquired

57.2% of Pervouralsky Pipe Works (RTS:PNTZ) (11.3% of the Russian market) in a move to create the second largest Russian holding after TMK (42% of the market), which has output of 1.5m tons and sales over \$1b.

This is the second alliance between Chelyabinsk and another large player on the Russian pipe market. Chelyabinsk coordinated its business with OMK for 18 months until October 2002, but the companies went their separate ways after failing to agree merger terms. The alliance with PNTZ could be more fruitful as the companies make a complementary range of pipes, thanks to which the partners expect to increase their market share by five percentage points to around 30%. The merger process is expected to take about 1.5-2 years.

The price of the deal was not disclosed and the only indication is a \$190m loan from the EBRD, which, according to an EBRD source quoted by Vedomosti newspaper, was entirely spent to finance the purchase. If that was the full cost, it implies \$332m market capitalization of PNTZ, which is five times higher than the current market capitalization of \$65.7m, suggesting that CHEP significantly overpaid for the stake, particularly in view of PNTZ's dependence on external supplies of steel.

The companies plan to overcome this steel dependence by launch of electric steelmaking with one million tons capacity soon after the merger is complete. The new facilities, which will fully meet the partners' steel needs, will cost \$200m and have a 5-8 year payback period. In an interview to Vedomosti, Andrei Komorov, the chairman of CHEP's BoD, said that his company may seek further integration with other metal producers. Ural Steel (former Nosta) (RTS:NOST), which is now completing consolidation with Mikhailovsky GOK (RTS:MGOK) and Tulachermet to create a single metallurgy holding, is already cooperating with Chelyabinsk and may strengthen its ties with the pipe maker.

Still treating Chelyabinsk as a stand-alone plant, we keep our HOLD recommendation with fair price at \$0.275 per share. However, we may review our valuation when more details of its merger with Pervouralsky become available.

Russian pipe output fell 1.2% in 11M 2004

Growth of Russian pipe output slowed towards the end of 2004 and turned negative in 11M, showing 1.2% decline y-o-y. Total pipe output in the period was 5.55m tons, including 2.44m tons of higher value-added seamless pipes (+3.3% y-o-y) and 2.95m tons of electric-welded pipes (-4.6%). Most of the seven biggest pipe producers increased their output in 11M: Vyksa (RTS:VSMZ) by 2.2%,

Pervouralsky (RTS:PNTZ) by 1.6%, Taganrog (RTS:TAMZ) by 7.3%, Volzhsky (RTS:VLTZ) by 6.6%, and Sinarsky (RTS:SNTZ) by 0.9%. However, Chelyabinsk Pipe Works (RTS:CHEP) and Seversky (RTS: SVTZ) reduced output by 8.5% and 6.6% respectively.

Kalina (BUY) buys 30% of German Dr.Scheller and says that ADRs are imminent

The BoD of Kalina (RTS:KLNA) approved purchase of up to 30% of German Dr.Scheller Cosmetics, offering 4.2 euros per share, representing 20% premium to their current market price of 3.5 euros. Kalina, which is the largest Russian manufacturer of personal and home-care products, hopes that cooperation with the Western producer, whose brand has strong recognition, should help sales of Kalina's premium products. The purchase is being financed by recent IPO proceeds and is expected to be completed by the end of 1Q05. We view the step positively in general, but more information is needed before we can assess the benefits.

Separately, Kalina says that it will issue Level-1 ADRs in the immediate future (early this year) after receiving approval from the Federal Service for Financial Markets to make an ADR issue on up to 19.99% of its common shares on December 23 (see Weekly#507).

We keep our BUY recommendations on Kalina stock with fair price of \$20.8 for the end of 2004.

Capital Group sold its 5.9% stake in Wimm-Bill-Dann (HOLD)

Vedomosti newspaper reported that Capital Group sold its 5.9% stake in WBD (RTS: WBDF), the largest Russian dairy company, in August-September 2004, explaining a fall in the share price at that time. The fund, which normally invests in companies on a long-term basis, was the second largest western

investor in WBD (after Danone) and did not explain why it decided to fix losses that are estimated at about \$5m. Possible reasons are disappointment over WBD's development prospects or review of country risk. Loss of the large institutional investor is negative for WBD liquidity, but we are optimistic that the blow will be softened by Danone's recent statements that it wants to increase its stake in the company.

InBev acquires Alfa-Eko's stake in SUN Interbrew (SELL) for 259.7m euros (\$341m)

Belgian InBev (formerly Interbrew) announced after New Year that it is buying Alfa-Eko's 21.8% of B shares (voting shares) and 1.9% of A shares (non-voting shares) in Sun Interbrew (Lux: SUNB5-LX) for 204.7m euros and an additional 55m euro payment to waive claims between the parties and secure an assurance from Alfa that it will not repeat its bid for a strategic stake in Sun Interbrew. The price offered by InBev is approximately three times higher than what Alfa paid when it was buying company shares in summer last year and represents 240% premium to the current market price.

The offer seems to represent success of green-mail by Alfa, which likely instigated a private court claim challenging the sale of a stake in Sun Interbrew by Indian SUN to InBev. Alfa had said that it was interested buying SUN's stake.

Alfa expects completion of the transaction before the end of January, after which Sun Interbrew shares will become highly illiquid as InBev will own 97.3% of voting shares and 98.8% of non-voting shares.

We keep our SELL recommendation for SUN Interbrew shares, particularly in view of inflated valuation, implied by the InBev offer, and shrinkage of the free float.

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