

UFG leading the way on IPOs



Ilya Sherbovich, President and Head of Investment Banking, United Financial Group, describes why interest in strategic investment in Russia is at record high levels

UFG and Deutsche Bank are consultants to Gazprom on its planned merger with Rosneft, which is in turn very much associated with the Yukos affair. What has been the impact of the Yukos case on UFG's overall business?

The Yukos affair created an atmosphere of caution and doubt about doing business in Russia, certainly, but among the numerous companies we work with – both foreign and Russian – we see the interest in strategic investment in Russia at a record high level. Moreover, we seem to have turned a very definite corner with President Putin's pledge to lower the Civil Code's statute of limitations on privatisations, and promises earlier in the year to revise the tax code. Both these announcements bolstered investor confidence, as they appear to be backed by concrete legislation in the pipeline to protect property rights and minimise the likelihood of a repeat of Yukos-type cases.

If the interest of strategic investors is at an all-time high, what needs to be done to successfully meet this demand?

This demand hinges on the readiness of owners to sell and much depends upon the price. Valuations for Russian companies are reaching attractive levels for current owners, but still offer enough upside for foreign strategic investors. We have

seen a significant amount of foreign participation in the 'new business' areas like telecoms, consumer goods, banks and financial services. The natural resources companies, where the majority of investor interest understandably lies, are more tightly regulated by the Government. In such cases, the State has shown itself to be rather cautious or its position is unclear. So, first and foremost, there is a great need for a clear and official State policy towards foreign strategic investment. Once this is clear, it is my belief the rest will follow.

Previously, you have described the policy of the government as to develop "national champions" in the natural resources sector. In the light of this, what role do you believe the government is willing to give to strategic foreign investors in the development of Russia's economic policy?

Our forecasts suggest that we will eventually see a "national champion" emerge in each sector: a company in which the government has a controlling stake, or owned solely by Russian shareholders. Such "champions" would become the holding tanks for consolidation of both domestic and foreign assets, and might be, in the case of industrial giants, crucial tools in Russia's foreign policy. This model actually makes a great deal of sense for Russia, but it is not stated government policy and thus

is surrounded with a degree of uncertainty. So, once again, the root of the problem lies in the lack of a clear State policy. We can only go by what happens in the market, and from this, we can clearly see the State giving nods of approval to deals where a foreign major acquires a significant – but not controlling – stake in a Russian company. The Conoco-Phillips acquisition of a LuKoil stake is a good example of this kind of deal. This situation is unlikely to change in the foreseeable future, but this is not necessarily a bad thing because these kinds of deals do benefit Russian companies, in that foreign companies bring access to additional capital and technology. Foreign investment also acts as a major stimulant to domestic competition, which in turn improves domestic efficiency.

The merger of Gazprom and Rosneft has been approved and Yuganskneftegaz will be run by a state-controlled company. Given that since the fall of the Soviet Union, privately-owned oil & gas companies have proved more efficient than the state-controlled companies, what fears do you have for the industry?

As it stands today, the private oil sector is large enough to create real and sustainable competition on the market. I see no signs of an imminent "nationalisation" of the oil industry; rather we are seeing an

increase in state participation through acquisition of a 51% stake in Gazprom and control over Yuganskneftgaz. The market responds well to a healthy mix of state and private businesses in the sector, providing the regulatory environment treats them equally.

UFG have advised Gazprom to buy oil assets. Do you envisage Gazprom expanding both domestically and abroad in the coming years?

Gazprom's goal is to become a leading global energy company, and we foresee that they will pursue this goal, deploying a number of strategies, including domestic and international acquisitions. The obvious targets are in countries where Gazprom already has a strategic interest: Eastern and Western Europe and possibly Asia, and we do not rule out the US in the future.

Foreign investors continue to regard the liberalisation of the Gazprom share market as the Holy Grail. What progress, if any, has been made and what form will this liberalisation take?

Market participants expect some progress on this issue by the end of the year. Most observers directly link the success of Rosneft acquisition to share liberalisation which should be the next step after the merger is completed. I do not think these two processes should be necessarily interdependent. The key issue is model of liberalisation, ie whether the liberalisation will be a partial or total lifting of restrictions for foreign ownership of Gazprom local shares. Once the government secures its 51% stake in Gazprom, the possibility of a group of foreign investors amassing an influential interest in Gazprom is ruled out. Still, there is a very real possibility that a quota will be put in place, so the question is what the size of the quota would be and whether it will satisfy the existing foreign demand.

How would you characterise the current level of IPO activity by Russian companies?

We are seeing what can only be described as an explosion of capital markets activity among Russian companies, both in terms of IPOs and secondary placements, in a number of key sectors. We have piloted a number of these, together with our partners at Deutsche Bank under the



Ilya Sherbovich (centre) with members of the UFG Corporate Finance Team

joint brand 'DeutscheUFG'. The market is coming into its own, and finally fulfilling its primary function: providing capital to facilitate corporate expansion, and/or enabling private owners to decrease their participation in the business. The retail sector is particularly active at the moment, but we see encouraging signs in the consumer goods, metals & mining, financial services and telecoms sectors as well. We were very happy to see very healthy demand from both domestic and international investors for the deals that DeutscheUFG recently placed for Seventh Continent (one of the largest Russian food retail chains) and Lebedyansky (the largest juice producer in Russia).

There is a perception that the Russian Securities Market is moving to New York or London. How should the challenge of "keeping the Russian stock market in Russia" be successfully addressed?

We reject this notion of artificial barriers for capital movement. Companies should be allowed and we try to raise funds in the place that makes the most sense for them and which delivers maximum convenience and cost effectiveness. The domestic Russian market today provides a very viable alternative to the traditional venues of New York and London. So, while I agree with you that this perception does exist, it is clear to us that it is erroneous and concern is misplaced. The Russian market is very strong with real liquidity, which is why we are seeing more and more IPOs

with local listings on the RTS and MICEX. That being said, a foreign listing can be the right choice for many companies. At DeutscheUFG our goal when we work with companies gearing up for an IPO is to determine which kind of listing will yield the maximum benefits for the company in the long-term. We are well positioned to do transactions with both local and international listings.

Deutsche Bank owns 40% of UFG and you cooperate on a variety of levels. How is that partnership progressing and what does the future hold in terms of Deutsche Bank purchasing the remaining 60%?

This 60-40 model is unique in the Russian market and we believe it is the right structure to provide clients with the best of both worlds – Deutsche Bank's global reach and UFG's in-depth local expertise. We spent much of last year consolidating the relationship and building up the teams who work together on corporate finance deals and in equity products, as well as those in the business support units and we're very pleased with the results. We lead the market in M&A and capital markets advisory, which is due in large part to our ability to offer this blend of expertise to our clients. On the equity side, the shared trading platform has won UFG the largest share of the London Stock Exchange's Russian trading volumes. We see definite benefits in the synergistic relationship we have created. We are not in any active discussion about changing this model. **rir**