

Expert opinion on privatisation in Russia

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“There comes a tide in the affairs of men which, taken at the flood, leads on to fortune”. Russia as it emerges from the crisis years of 2008 and 2009 has a unique opportunity to take the flood tide and by doing so to sail away from the planned economic stagnation and crony capitalism that have been the hallmarks of its recent economic history. There is recognition at the highest levels of the benefits and indeed the imperative need of modernisation and diversification, away from reliance on natural resources and commodities that leave Russia over-exposed to changes in demand in other countries. The theory of “de-coupling” talked so much about in the period before the crisis is discredited and we now only wonder how any of us could have believed for a moment that an economy so reliant on the export of natural resources could ever isolate itself from turmoil in the markets that buy those resources. It was a fool’s dream. But it is a wise goal. It will take time. It will take money. But above all it will take courage.

The government has announced a list of companies and assets to be privatised which includes some 450 enterprises. In addition, the crisis has driven many other companies and assets into the ownership of the state banks with Sberbank, VEB and VTB now controlling significant sectors of the Russian economy. These assets are not core to their banking business and will need to be spun off into asset management companies and sold to new owners. Market prices for companies have fallen world wide and Russia is no exception and no-one should expect a significant recovery anytime soon so these assets, if sold, will fetch only current market prices not the historic valuations of 2007 or early 2008.

And this is, for me, where courage is relevant. Why? Because the challenge for the owners of these assets, whether it is the state directly or the state owned banks, is to sell them in a way never before done in Russia (ok, perhaps never is overstating the case, but there is hardly a great track record here to build upon).

If you want to find out the market price of a business or business asset you need to find out what people are prepared to pay for it. You can run any number of calculations based on discounted cash flow, compare multiples paid in other deals in this market or other markets, assess asset value independently etc etc but you will only ever receive what someone will agree to pay you. And no-one ever wants to pay more for something than they have to. So to get the best price you need to have a pool of interested buyers competing with each other; you need an auction. Sounds simple? It is anything but. You need people who know how to organise the process, to tempt the buyers, to whet their appetites and to keep them engaged in a bidding war for as long as possible. Potential buyers need information about what is for sale; good, reliable information with more than a degree of objectivity. And they need to believe they have a chance of winning; that the process will treat all bidders fairly and that it is fully transparent.

This is the challenge for Russia. If we are serious about modernisation, about investment, about broadening the economic then this process has to be carried out in a way appropriate for a modern economy and a modern government. Another “controlled” auction such as that of Yukos, or God-forbid, a

handout of assets to loyal servants such as the loans for shares debacle, will do serious damage to Russia's image but more importantly to Russia's mid-term economic prospects. The final decision on who gets to buy these companies must be a decision made by the market not by the politicians.

There is real expertise in the world on how to run auctions professionally to realise maximum value and that expertise is easily bought. Investment banks, audit firms, lawyers and other advisors with international reputations should be employed by the government and the state banks to prepare these companies for privatisation and to run the sale process. These advisors should also be chosen through "beauty parades" so that they demonstrate their skills and experience, the commitment of their teams, particularly their Russia based teams, and to create competition on price. Running a well organised, professional privatisation process will raise confidence not only in the privatisation process as such but will start to change perceptions of Russia in the international market. Russia needs to be seen as an environment that understands the advantages of competition and the policies required to attract and retain investment. And if you think Russia has already made sufficient progress in this regard, then I suggest you take a look at the risk factors set out in the prospectus for the Rusal IPO or the RZhD Eurobond. There is plenty more to do but what an opportunity this is to take that flood tide and to define the economic future of this great country.