

# Georgian troops enter Tshkinvali after ceasefire collapses

bne

Heavy fighting has broken out in Tshkinvali as the South Ossetian army battles to stop Georgian troops taking the city. Tbilisi says that most of South Ossetia is now under Georgian control.

Georgia launched an all out attack on South Ossetia last night, just hours after a ceasefire had been agreed. President Mikhail Saakashvili has now announced a general mobilization.

Reintegration Minister Temir Yakobashvili says that Georgia wants to recover control of the breakaway republic as quickly as possible. "The cynical answer is - at the first opportunity, the actual answer is: This will hopefully occur very soon," Iakobashvili told Interfax this morning.

An emergency sitting of the UN Security Council convened yesterday evening at Russia's request failed to reach agreement on a response to the situation. Russia's President Dimitry Medvedev is meeting with the Russian Security Council this morning. State Duma Speaker Boris Gryzlov said that Russia would make "every effort" to defend its citizens in South Ossetia.

More than 15 people were killed last night, and many others wounded, according to the South Ossetian authorities. The South Ossetian parliament building has been burnt down, government offices have been damaged and many other buildings in Tshkinvali are on fire, a statement from South Ossetia's Committee for Information and Media published early this morning said. Georgian



SU-25 warplanes have bombed Tshkinvali and the highway connecting South with North Ossetia.

Speaking in Moscow this morning, South Ossetia's envoy to Russia Dimitry Medoyev said the Georgian army had completely wiped out five South Ossetian villages.

"Tbilisi has adopted scorched earth tactics, five settlements in South Ossetia, that were on the border with Georgia, have been wiped off the face of the Earth. They are currently being flattened by tanks," Medoyev said.

Several Russian peacekeepers have been killed and others injured after an artillery attack on peacekeeping headquarters in Tshkinvali. **See page 14**

## Azerbaijan banks burn bright

Heiner Klemm

in Baku

Azerbaijan's banking sector is on fire. Banks across emerging Europe have recorded phenomenal growth in recent years,

but none are growing stronger than in Azerbaijan. The growth is starting to attract international attention and the first foreign banks have moved into Baku with rep offices, while others are on the prowl for take over targets.

Banking sector assets and liabilities have increased by some three and a half times over the last three years, according to Rufat Aslanly, member of the management board

of Azerbaijan's Central Bank, the National Bank of Azerbaijan. In terms of capitalization, the banking sector recently surpassed the AZN1bn mark (\$831m), having grown 5-times from AZN200m three years ago.

Aslanly points out that, despite booming credit portfolios, banking prudential indicators are on par with the best in the world: over-due loans decreased from 3.5% to 3.1% over the last three years, **See page 15**

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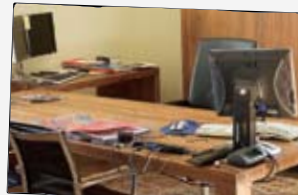
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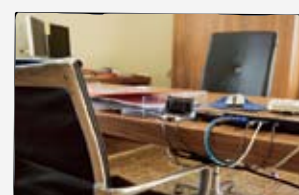
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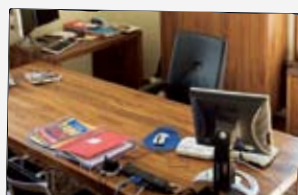
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## RUSSIA

**Mechel: Zyuzin opens dialog with authorities, too soon to call conflict over**  
Unicredit, Russia

Topic: Mechel's main shareholder, Igor Zyuzin, has started a dialog with government officials and other steel companies, Kommersant writes. In his meetings he explained that as a NYSE-listed company, Mechel provides very detailed financial reporting and a separate audit of its income taxes, and denied transfer pricing. The market reacted positively to the news, rising 9% to \$24.1 yesterday.

Our view: Although we are encouraged that lines of communication are open, we believe it is too early to call the conflict over, and believe the market's strong positive reaction is overdone, as the final outcome of story remains far from clear, in our opinion.

**RTS panic sets in, locals call the bottom** Ben Aris

Equity investors into Russia are panicking as the leading RTS index tanked to dip below 1800 on Wednesday August 6 having given

TRUTH & BEAUTY:

## Madness in Moscow! Try not to panic

**Eric Kraus**

of the Nikitsky Russia Fund

T&B is frankly bewildered! When we began drafting the current issue, the Russian market was in the process of finally catching up with some of its global peers - alas, to the downside. This sell-off looked like nothing more than the typical exacerbated volatility of a market which is largely the appanage of traders rather than long-term investors. Nothing unusual there.

### Then the bottom fell out of the bucket!

Efficient-markets nonsense aside, real-life financial markets can be irrational, at least in the short-term. That said, before accusing them of a momentary departure from reality, one had best check to see whether there is something seriously amiss. We dove down for a closer look, but came up empty-handed:

- The macros are excellent - even inflation is trending down.
- Our macro assessment is confirmed by the fact that the rouble is strengthening, the banking sector is growing, while Russian fixed income goes from strength to strength, despite the global flight from risk.
- Corporate profitability remains well above the emerging markets average.
- There is no visible domestic political turbulence.
- Commodity prices are coming off, but nowhere near enough to justify the carnage.
- Oil prices have given up 3 months of gains, but remain in a long-term uptrend.



- The Global situation is pretty dreadful, but again, Russia has decorrelated -- in the wrong direction.

Therefore, we are left with Mr. Putin's unkind remarks about one metals and mining oligarch (who clearly had it coming), as well as attempts by the formerly-toothless Anti-monopoly Commission to start cracking down on certain abuses of dominant market positions, especially in the commodities sector, where aggressive pricing is damaging Russian attempts to move up the value chain. In most other countries, investigations for price-fixing are seen by the markets as matters of law enforcement, not as a fundamental shift in the economic regime...

In short, either T&B has totally lost the plot - or the market has. The amount of sheer nonsense we have heard in the last 48 hours sets our hair on end. In particular, five years after, a surprising number of investors still have not understood what the Yukos debacle was all about. Despite there having been something like 30 false-Yukos scares, people continue to trot out this particular scarecrow at regular intervals.

The Mechel affaire has no more to do with Yukos than with the War of the Spanish Succession! It is the result of a plea from the steel majors for the government to do something about price gouging by the miners. With Russia embarking on a massive project to rebuild its dilapidated infrastructure, we expect to see further measures to favour domestic steel pro-



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up all the gains it made this year and a good chunk of those it made in 2006 too.

But by Thursday analysts in Moscow were saying enough is enough and screwing up their courage to call the bottom of the sell off, saying Russian equities are almost certainly oversold at this point. If they are right this is one of Russia's regular big buying opportunities.

### War breaks out in South Ossetia

bne:flash

Georgian troops crossed the border into the breakaway republic of South Ossetia this morning, Friday August 8, the day the Olympics open in Beijing.

As of 10am Georgian President Mikheil Saakashvili said in an address to the Georgian nation on Friday that Georgian troops took control of most of South Ossetia overnight.

"We've fully liberated the Znauri and Tsinagari districts, some villages and fighting is now taking place in the center of Tskhinvali. Its outskirts are under our full control," Interfax reports.

### UC Rusal accuses Interros of violating minority shareholders' rights, opposes Strzhalkovsky as CEO

Unicredit, Russia

Topic: UC Rusal issued a press release yesterday saying it believes the results of the voting at Norilsk Nickel's recent AGM suggest that Interros controlled more than 30% of Norilsk Nickel. If true, this could mean that Interros failed to meet its statutory obligation to announce a buyout offer for minorities, and UC Rusal has asked the Federal Service on Financial Markets to investigate Norilsk Nickel's shareholder structure. UC Rusal also asked Interros and Vladimir Potanin to clarify the situation around the irrevocable offer to acquire of 16.66% in Norilsk Nickel made to Onexim in April 2008 and the potential buyout of minorities' shares.

ducers, including limitations on the export of scrap, along with a sharp restriction in the use of transfer pricing (which favours export of Russian minerals at the expense of the domestic steel producers).

We hereby offer a bet to all comers that, in six months time, this affair will be totally forgotten. Mechel will, at worst, pay a fine amounting to one percent of its annual sales, and life will go on much as before.

### Black spot of inflation

As inflation has been THE black-spot on an otherwise extraordinary economic performance, the fact that the Anti-Monopoly Commission is finally showing some teeth should be welcomed. If something is amiss, it is the chronic inability of the Russian government to properly communicate its intentions and the motives behind its actions. A quick look at your Bloomberg "Ni Russia Mechel" will show that there have been any number of reassuring statements, but they have gotten lost in the general cacophony. It would be refreshing if the government would appoint one public spokesman on economic policy, with everyone else requested to shut up. That said, one would have thought that, by now, investors would have grown accustomed to this habitual clumsiness, and would heavily discount the occasional inflammatory statement. Apparently not.

In any event, the irrationality of the market reaction is clearly demonstrated by the fact that the mineral extractors (e.g. Mechel, RASP - who will presumably have to lower their domestic prices) have been affected no worse than have some of their customers (e.g. MMK, NLMK - who will obviously benefit!).

Investing in Russia still takes solid nerves. Regular readers will know that, given the global context, we have been bearish for some months. We now think that prices are so far below any reasonable value that the market has only one way to go, and - holding our breath - we would now recommend investors begin to cautiously reposition into the equity market.

As we go to press - the market has managed to frighten its own (very limited) wits out with the fear that "they" were "going after" the oil companies. This is truly insane. You cannot complain about monopoly behaviour in Russia, then panic when the government tries to do something about it! The market is now several percent cheaper than this morning - great! We are not usually this affirmative, but this is a buying opportunity, at least near-term. There is blood in the streets...

Happy Trading

COMMENT:

## Corporate raiders hit Hermitage Capital

### Hermitage Capital

in London

*ED: what follows is the content of a letter circulated by William Browder's fund Hermitage Capital detailing how the tax payments from several of the fund's assets were stolen by raiders. This text is unedited and has not been verified by bne.*

We are writing to keep you updated on the administrative harassment we have been experiencing in Russia over the last year. We recently learned a number of new things that fully explain what was behind the issues we have been facing. Sometimes the truth is stranger than fiction and the story we tell below will probably be as shocking to you as it was to us.

As you may recall from our last letter on April 3rd, an unsuccessful attempt was made to steal assets from our three Russian investment vehicles through a sophisticated "corporate identity theft." The whole story began in June 2007 when our offices (and those of our lawyers) were raided by the Moscow Interior Ministry, who seized all the original corporate documents of our Russian investment holding companies. This was done under the guise of a tax investigation into withholding tax payments from a managed account belonging

to one of our clients. Even though it was confirmed by the Russian Tax Ministry that there were no taxes owed, the Moscow Interior Ministry used the spurious tax case as a cover to go on a wideranging search for assets held in Russia by these three Hermitage investment vehicles.

Simultaneous to the asset search, HSBC (as trustee for the Hermitage Fund) was fraudulently wiped off the share registry of our three vehicles and was replaced with a new and unknown company called Pluton from Tatarstan. When we investigated who was behind Pluton, we discovered it was 100%-owned by a man named Victor Markelov, who further investigations revealed is a 41-year-old convicted murderer from Saratov, Russia. In order to change ownership of a Russian company, one needs to have the original charter, corporate seal and certificate of registration of that company. All of these documents and seals had been taken by the Moscow Interior Ministry during the raid on our lawyers' offices and were in the Interior Ministry's possession when this fraudulent ownership transfer and identity theft took place.

## UKRAINE

**NERC increases gas distribution tariffs by 46.2%, supply tariffs by 28.75% on average**  
Concorde Capital

At its meeting yesterday, the National Electricity Regulatory Commission (NERC) approved increase in tariffs for gas distribution and supply. The average tariff for gas distribution was raised by 46.2% to UAH 81.3/thr cm (USD 16.8/thr cm). The average tariff for gas supply was upgraded by 28.7% yoy to UAH 34/thr cm (USD 7.0/thr cm). New tariffs will come in force since September 1, 2008. According to NERC, new tariffs will allow fully covering operating costs of GasCos.

**AMCU allows RTS to establish stock exchange in Ukraine**  
Concorde Capital

The Antimonopoly Committee of Ukraine announced yesterday it gave permission to Russian RTS Stock Exchange and 22 Ukrainian companies, including leading Ukrainian investment banks, to establish Ukrainian Exchange. The reason for creation of a new stock exchange in Ukraine is that Ukrainian investment banks are unsatisfied with the quality of the PFTS' services. The PFTS is the biggest Ukrainian stock exchange with ~90% share in total trading volumes.

**Ukraine to increase household gas prices from 1 Sep**  
Renaissance Capital

Event: Yesterday (7 Aug) Ukraine's National Commission for Electricity Regulation (NERC) decided to increase gas retail tariffs for households, as well as gas distribution and supply fees from 1 Sep 2008. We calculate that households' average retail tariff will grow 13.6% to UAH394/mcm (\$81.2/mcm, all figures in this article exclude VAT). Distribution and supply fees will increase 46.2% to UAH81.3/mcm (\$20.9/mcm) and 28.7% to UAH34.5/mcm (\$7.1/mcm),

At the same time, a number of lawsuits were filed by a tiny shell company called Logos Plus in St. Petersburg using forged contracts, which appeared to have been created using the same documents that were in the hands of the Moscow Interior Ministry. The perpetrators then sent lawyers that we didn't appoint and never heard of to the St. Petersburg court to "defend" our companies, but instead of defending them, they "fully admitted liability and accepted all the claims." As a result, the judges in St. Petersburg awarded Logos Plus \$376 million of damages against our three stolen vehicles.

At first, the perpetrators' plan appeared to be to get bogus court judgments and then use these judgments to seize any assets they found. Their hope was that the asset searches at HSBC, Citigroup, ING and Credit Suisse between June and August 2007 would yield a jackpot of assets for the perpetrators to seize. Unfortunately for them, all our assets had been moved out of Russia into safe and lawful jurisdictions a long time before and the perpetrators got from us. After we learned about the whole scheme, we filed a number of criminal complaints, and went to court with the proof of the fraudulent claims and were ultimately successful in invalidating the St. Petersburg court decisions.

That seemed like it should have been the end of our troubles in Russia, but it wasn't. In early April we discovered that two new cases identical to those in St. Petersburg had been filed against our vehicles late last year in Moscow and Kazan for an additional \$903 million.

Again, lawyers who we had never appointed and never heard of showed up to "defend" our companies, and again they admitted full liability and the courts awarded the plaintiffs \$903 million. What was particularly disturbing about this new discovery were the dates when the cases were filed. They had been filed on October 19th, 2007 in Moscow and October 22nd, 2007 in Kazan. This was more than a month after the asset search had yielded no results. It seemed strange and worrying that the perpetrators would continue to be so active filing fake cases against our companies when it was clear at this point that they would not be able to seize any assets since these companies were empty. We did further investigations to try to understand what their motivation was.

The whole story started to make sense in June this year when we requested information on our three stolen companies from the Russian company registration database. We learned that the perpetrators had opened new bank accounts for the three companies in December 2007.

Two of the vehicles set up accounts at the Universal Savings Bank ("USB"), and the third vehicle opened an account at Intercommerz Bank. Both banks were tiny

by any measure. USB had total capital of \$1.5 million, and Intercommerz had capital of \$12 million. Looking more closely at the banks' disclosure statements on the Russian Central Bank's website, we learned that the aggregate customer deposits increased by 623% at USB and 273% at Intercommerz shortly after our stolen companies had opened their accounts. What was truly chilling were the amounts by which the banks' deposits had increased. USB's deposits had grown by \$97 million and Intercommerz's by \$143 million - roughly the same amounts that our vehicles paid in capital gains tax to the Russian government in 2006.

In light of this disturbing coincidence, we dug deeper to see if there was any more detailed information about the spike in deposits at the two banks. Under Russian regulations, all banks have to report their top ten borrowers and depositors to the Central Bank on a monthly basis, and this information is widely available in Moscow. We were able to see the reports for the two banks and learned that two of our stolen investment vehicles were the largest and second largest depositors at USB with a combined \$91 million in their accounts, and our other stolen vehicle was the largest depositor at Intercommerz with \$139 million in its account. The size of each of our stolen vehicles' deposits was exactly equal to the amount of tax it had paid in 2006 to the Russian budget.

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respectively. This should result in a 3% increase in gas retail prices for industrial users to about UAH1,291/mcm (\$266/mcm), according to our estimates.

**Action:** We view the announcement as positive for Ukrnafta.

**Rationale:** Naftogas of Ukraine currently forces Ukrnafta to sell its gas at the below-production-cost price of UAH199/mcm (\$41/mcm), in order to provide gas supplies to Ukrainian households at fixed low tariffs. The tariffs have not changed since late 2006. The increase in households' gas tariffs should improve Naftogas's financial standing and make it more willing to reach a compromise with Ukrnafta on a higher gas purchase price, in our view.

## Government approves Ukrtelecom's financial plan for 2008

Foyil Securities

Yesterday the government approved updated Ukrtelecom's financial plan with a net profit target of UAH 8.7m, instead of the UAH 1.5bn net loss included in the plan earlier this summer. The government also announced an increase of the tax payments to UAH 1.5bn, which is 20% more than the Company paid last year (Source: Interfax).

**Our view:** We see the news as positive for Ukrtelecom, because an increase of government control could result in an improvement of the Company's profitability. However, we see the possibility for Ukrtelecom's management to fail with the target and report a net loss, as for 1H 2008, and then resign by a directive of the Ministry of Transport. Meanwhile, privatization prospects remain gloomy, which creates a threat to our current HOLD recommendation.

## Inflation and money supply in Ukraine in July 2008

Renaissance Capital

According to the State Statistics Committee of Ukraine, in July 2008

The whole story now fell into place. In short, after the straightforward asset seizure failed because our vehicles were empty, the perpetrators set out to steal the taxes that Hermitage vehicles had paid in 2006. How did they do this? They filed bogus court claims that were exactly equal to the 2006 profits of each of the Hermitage vehicles. Our three companies had combined profits of \$972 million that year, and the fake court claims from Moscow, Kazan and St. Petersburg totaled \$972 million. By burdening our vehicles with these new "claims," we believe the perpetrators went back to the tax authorities and filed amended tax returns with additional "losses" that reduced the companies' profits to zero. On the basis of the restated results, the perpetrators appear to have filed for a refund of all the taxes that the Hermitage Fund paid in 2006 (\$230 million) and directed it to the newly opened accounts in these tiny banks. With the refund money deposited in the banks, the perpetrators could wire it wherever needed, complete the fraud and then cover their tracks. Indeed, as of the time of writing of this letter, USB has filed a liquidation request with the Russian Central Bank and once the waiting period is over, it will cease to exist.

So the two-pronged scam worked in one area and failed in another. The perpetrators weren't able to steal the assets from us based on the fake court claims, but they were able to steal \$230 million from the Russian government by filing amended tax returns on behalf of our stolen companies. What makes this story even more shocking is that we filed six 255-page criminal complaints with the Russian authorities in December last year, one month before the tax fraud took place, and they did nothing to stop it. Two complaints were sent to the Russian General Prosecutor, two to the Russian State Investigative Committee and two to the Internal Affairs Department of the Interior Ministry. There was enough information to prevent the fraud and indict a number of people behind it if the government had acted.

Instead of doing anything to save the Russian state from this highly sophisticated and organized looting, two of our complaints were thrown out immediately; two were returned to the same Interior Ministry official we were complaining about (essentially, he was being asked to "investigate himself"); and one was thrown out for "lack of any crime committed."

Only one complaint was taken seriously. It was taken up by the Russian State Investigative Committee in early February, but before it could get any traction, the case was lowered to the South region of the Moscow district of the State Investigative Committee (the lowest level of the Committee) and by June, another senior Interior Ministry official whom we had named in our complaint had joined the "investigation" team (again, to "investigate himself"). To this day there has been no serious response by the Russian authorities to this massive fraud against the Russian state.

As we described in our April letter, the problem of corporate "raiding" is now so endemic in Russia that President Medvedev speaks about it as one of the biggest problems faced by Russian businesses. In this case, raiders have taken this problem to a new and absurd extreme by "raiding" the Russian state itself and so far getting away with it. Together with HSBC, we will shortly be filing new criminal complaints with the Russian General Prosecutor and Russian State Investigative Committee as well as with many law enforcement authorities outside of Russia. It is hard to predict what will happen next in this unfolding and unbelievable saga, but as always we will keep you updated on any further developments as they arise. **bne**

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the country recorded deflation, the first time since Apr 2006. Prices for the month decreased 0.5% MoM, though prices have increased 14.9% YtD.

At the beginning of July, the government corrected its inflation forecast for 2008, increasing it to 15.9% from 9.6%. PPI in July amounted to 3.6% MoM and 46.4% YoY. In 7M08 it amounted to 34.1% YtD. According to Reuters, on 1 Aug, Ukraine's money supply (M3) amounted to UAH467.547bn (\$96.6bn), increasing 3.8% MoM and 54.3% YoY. The monetary base increased UAH163.682bn (\$33.82bn) from UAH154.224bn (\$ 3186bn), 6.1% MoM and 41.6% YoY.

#### **Tymoshenko says NERC will increase GasCos' tariffs today** Concorde Capital

According to Prime Minister of Ukraine Yulia Tymoshenko, the National Electricity Regulatory Commission (NERC) at its meeting today will approve increase in tariffs for gas distribution and supply. Tymoshenko assured higher tariffs will allow gas distribution companies (GasCos) to increase financing of grid maintenance and raise salaries to prevent workforce turnover. NERC was postponing tariff increase over the last couple of weeks, as exact numbers were not approved by regulatory bodies. Yesterday GasCos' trade unions started picketing of the Cabinet of Ministers, demanding urgent increase of GasCos' tariffs.

Alexander Paraschiy: Last time gas distribution and supply tariffs were revised in July 2007. In October 2007 the NERC and the Cabinet of Ministers promised to raise tariffs for gas distribution in January 2008, to account for increase of operating costs and possibility of financing gas network upgrade. The process was postponed, so that majority of GasCos reported losses over the early quarters of 2008. We expect today tariffs will be upgraded by 25-40%, which will allow most of GasCos report profits in 2H08.

## Russia's second tier investment banks are in a league of their own

**Graham Stack**

in Moscow

While Russia's top tier investment banks are making headlines with Chelski-esque recruitment and multi-million salaries, second tier setups quietly play their own game.

Moscow's investment banks have separated into two very different leagues that however peacefully coexist. There is an upper bracket comprising global brands such as UBS, Deutsche Bank and Unicredit, alongside their Russian competitors such as Renaissance Capital and Troika.

Then there are the rest: investment banks often run by their founder-owners, such as Veles Capital, IFK Metropol, Brokerkreditservis, Otkrytie, Trust Investment, that are growing rapidly, but not sufficiently to narrow the gap.

"They're definitely not catching up with the big guys," says Evgeny Tarzimanov of Standard & Poor's, "and the gap is probably widening."

Investment banks' business is often difficult to compare, but the clearest indication of the gulf between first and second class is on the labour market.

Russian and Western media have recently been full of stories about the soaring salaries paid by Moscow's investment banks, numerated in millions of dollars.

"Young people under 30 are arriving without any real experience and starting on \$2m a year," a VTB insider commented to business daily Vedomosti in July.

VTB's own recruitment policy made headlines in April when the newly launched investment bank division of Russia's second biggest bank wielded a blank cheque-book to 'steal' a large part of Deutsche Bank's staff.

This is where the second tier banks opt out.

#### **Small is beautiful**

"There are two different leagues on the labour market," says Troika Bank's Olga Veselova. "Top tier investment banks pay at least twofold compared to second tier."

Top tier banks are either owned by globally-active banks such as Deutsche Bank or UBS, or, in the case of Russia's homebred Renaissance Capital and Troika, they compete directly with them - and recruit internationally. The top tier is part of the global banking market.

"Top tier banks recruit from other top tier banks or from abroad, not from second and third tier banks," says Veselova.

Renaissance Capital and Troika are currently extremely aggressive on the labour market, "paying crazy dollars for the people they want," says Tarzimanov. "The second tier banks are far more cost conscious."

"We are not trying to recruit 'stars'," admits Marina Mironova, human resources head of second tier Veles Capital. "Our priority is not the publicity a candidate brings, but real experience, willingness to take responsibility, his achievements."

While the stars stick firmly to the first tier firmament, questions are already being asked about whether their mouthwatering wage deals are justified: both in the case of the Russian banks trying to compete with global giants such as UBS and Deutsche Bank despite limited resources, and the global names exposed to the credit crisis.

The other drawback to the big investment banks' Chelski-esque recruitment is high personnel turnover creating instability, such as in the case of Deutsche Bank.

Second tier banks, on the other hand, says Tarzimanov, "boast stable teams, often with owner management, low personnel turnover and long track records."

Renaissance Capital head Aleksandr Pertsovsky explained to Vedomosti July 10 the chasm opening between first and second tiers as a result of the rapid growth of the Russian market was combined with its inefficiency.

"It doesn't necessarily mean that number one automatically takes ten times more than number two, but an inefficient market means that distribution of revenue is skewed," said Pertsovsky. "I don't want to assess the competition, but look at the top ten according to Thomson, Bloomberg or Dealogic - only the global banks and Renaissance."

In this context, it is not surprising that the second tier banks pursue very different business models.

For a start, according to Tarzimanov, much of their trading is proprietary trading with their own positions. Three quarters of Renaissance Capital business, on the other hand, is client-driven.

## Tymoshenko initiates postponing of loan repayments for agri companies

Concorde Capital

Premier Minister of Ukraine Yulia Tymoshenko said yesterday she will request from banks to postpone loan repayments for domestic agricultural companies by September 1, 2009, through flood damages in Western Ukraine.

## ArcelorMittal Kryviy Rih's net income doubles, to invest \$400m

Combined sources

ArcelorMittal Kryviy Rih's (KSTL: BUY) net income surged 2x yoy in 1H08, the Head of the Plant's Production Department, Volodymyr Sheremet, said yesterday. He did not specify the numbers (the company's 1H07 net profit totalled USD 380 mln).

In addition, says Troika's Veselova, 2nd tier investment banks serve predominantly Russian clients, whereas around 50% of clients of first tier banks are foreign."

Second tier banks make a virtue out of being small by offering customised services. "They are more flexible: can go for smaller deals that big banks wont do, for a fee, for instance, of \$1m," says Tarzimanov.

"When the client enters our company," says Veles Capital's CEO Alexey Gnedovsky, "he will be met by a top manager, not the client manager. And this is not only a psychological advantage. A top manager can offer products or special conditions tailored for each client. We are in a position to develop and offer individual investment strategies."

Flexibility means that smaller setups explore second and third tier stocks and even non-listed stocks. "There are many successful companies in Russia with sales over than \$15m that are not traded yet. It is possible to buy these shares with 50-90% discount to fair value," says Andrey Lee, head of Veles strategic investment department. Tarzimanov names real estate as a particularly attractive sector to smaller investment banks.

### Seeking niches

And second tier banks also seek out niches. Mikhail Slipenchuk's IFK Metropol, for instance, burst through to lead the M&A market by a number of deals in 2007, as a result of working closely with the new companies spinning off from electricity monopoly RAO EES. Veles,

on the other hand, has never conducted an IPO, but is a leader on the Russian promissory note market.

However, such specialization brings with it increased risk. "Second tier banks are threatened by weak risk management, lack of diversification, coupled with low shareholder equity," argues Tarzimanov. The larger the share of proprietary trading, the greater the exposure to the volatility of the Russian stock market.

Troika's Veselova also points to increased competition within the second tier, as banks such as Bank of Moscow, Nomos and Gazprombank spin off their treasury arms as brokerage and investment operations, often with bank customers as client base. KIT Finance is thought to be planning the same move.

Despite increased competition, no one expects much of a wave of M&A in the second tier soon, in contrast to the entry of global majors to Russia's first tier. Merrill Lynch's acquisition of 10% of Trust Investment Bank in November 2007 "was an exception rather than a rule," says Veselova. Rumours, however, are swirling that Mikhail Slipenchuk, 100% owner and head of IFK Metropol, is looking to sell a stake, but the bank has said nothing official.

According to Tarzimanov, the majority of owner-managers still characteristic of second tier setups are simply not interested in selling: "They see huge growth potential ahead in Russia, and they love their businesses." **bn**



### Adam Smith Conferences' Inaugural Ukrainian Energy Forum

7th – 9th October 2008, Premier Palace Hotel, Kyiv

### Adam Smith Conferences' Inaugural Ukrainian Pharmaceutical Forum

14th – 15th October 2008, Premier Palace Hotel, Kyiv

### Adam Smith Conferences' 3rd Annual Ukrainian Banking Forum

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Minister of Transport & Communications Rudkovskiy outlines the Ministry's key investment priorities at the Ukrainian Investment Summit 2007



An impressive opening panel for the Energy Day at Ukrainian Investment Summit 2007 – I-r A Bazarov, C Mandil, A Konoplyanik, I Voronin, R Shetler-Jones

For any queries please contact Adam Smith Conferences:

## Prague Stock Exchange confirms sale bne

The Prague Stock Exchange has confirmed it is to begin the process of selling a controlling stake in the bourse.

Potential buyers reportedly include the Vienna Stock Exchange, the Warsaw Stock Exchange, German stock exchange operator Deutsche Boerse, and the OMX Nordic Exchange.

"The offers for a strategic partnership have been coming from the most renowned world stock exchanges," said Petr Kobic, director general of the exchange. "It is a logical step by our shareholders."

## Austria's OMV to keep MOL stake for time being Wood & Co

Now that OMV has withdrawn its HUF 32,000 offer for MOL because regulatory hurdles were too high, a key question now is what will happen to the stakes that both companies have acquired, and what is the overhang risk. OMV's management says it has no plans to sell its 20.2% stake in the near term. OMV expects further consolidation in the sector, citing Lukoil and Gazprom as potential buyers. It will likely keep its stake in MOL until then as an entry-ticket to talks when buyers come in, hoping for a more profitable exit.

## Latvian central bank chief calls for more foreign workers bne

Latvia's head of monetary policy department of the Bank of Latvia Karlis Bauze, has called for his country to gradually start attracting a qualified foreign workforce, wires report.

Bauze reasons this should be done in order to balance the labour market and bridge the gap between high wage growth and low productivity.

# Aizkraukle – small town name, big city bank

**Mike Collier**

in Riga

The town of Aizkraukle lies an hour's drive from Riga and is wholly unremarkable. Apart from a tenuous claim to be an important location in the fictional Latvian epic tale Lacplesis, it's the sort of place to drive through without stopping. But if the town isn't worth a second look, the bank that rather unexpectedly bears its name certainly is.

The contrast couldn't be more striking. Where Aizkraukle is a bit run down, boring and grey, Aizkraukles Banka (AB), founded in 1993, is efficient, energetic and bright yellow - or at least its eye-catching logo is. It also happens to be one of the most profitable banks in the region and unusual in that it is completely independent of foreign parent companies. At the end of June 2008 it had total assets of €1.5bn, around €5.7m under trust management and last year recorded a €38m profit with return on equity (ROE) of 34.9% and return on assets (ROA) of 2.85%.

"We have two main goals. First is the development of the Latvian economy. The second is the development of Riga as a regional financial sector," says deputy chairman Olegs Fils, who along with co-founder and chairman Ernests Bernis still owns over 90% of AB's shares.

Evidence of the former goal came recently when AB set up a special lending programme for small and medium sized enterprises, working in partnership with state-owned Hipoteku Banka. Evidence of the second goal will arrive in more spectacular fashion in around three years with the construction of a new corporate headquarters at the heart of a gleaming financial district in Riga called New Hanza City. The ultramodern glass edifice will be the sort of thing they can only dream about back in Aizkraukle.

According to Fils, New Hanza City will simply be a physical reflection of a straightforward fact: "This confirms that Riga is becoming the regional financial sector for this part of Europe. It's good for Latvia because we have a lot of multinational investors here - not only banks from Sweden, but investors from Germany, Denmark, Norway, Finland and of course Russia."

There is no shortage of banks claiming to act as a bridge between East and West, but AB has a bet-



ter claim than most. Instead of just holding the door open to western investors wanting to take their money east, it also works in the opposite direction, providing western standards of accountability and efficiency to well-heeled individuals and institutions in Russia and the CIS with offices in St Petersburg, Minsk, Kiev, Almaty, Moscow, Baku and Odessa.

This two-way flow is in marked contrast to many of AB's competitors in its home market, says Fils. "The Latvian experience is that foreign banks use the Latvian market to step forward to the Russian market and the Ukrainian market. For instance SEB bank came here and is now stepping into Ukraine and Swedbank's next step is into Russia."

Talk of Russian money flowing west via little-known regional banks inevitably prompts raised eyebrows and whispers from cynics, but AB is candid about tackling the issue of "funny money."

"The banking industry is a part of our lives. Our business standards are exactly the same as in other spheres of human activity. We speak openly with our clients, employees, and with society; we keep our promises and do not take part in morally or legally shady deals," says Fils.

The main drivers of AB's rise from regional obscurity have been "organic" growth and efficient staff, says Uldis Eglitis, AB's head of financial institutions.

## Reinvested profits

"Profits have always been reinvested into capital thanks to the shareholder structure, which is quite simple. The bank is owned more than 90% by two individuals and therefore the bank can grow all the time. It is highly profitable and if you compare us with banks of the same size or larger, there is a lot of efficiency in what we do."

Eglitis recalls a recent press report revealing that AB's staff are some of the best paid in Latvia's highly competitive financial services sector in which 25 banks currently operate (as against more than 60 when AB was founded!) "We employ around 600 people in the bank. The fact that there is a very well

## **Austria's OMV withdraws MOL offer** Wood & Co

OMV is withdrawing its HUF 32,000 offer for MOL from last September. The European Commission indicated it would not accept OMV's proposal to combine the Schwechat and Slovnaft refineries into a single tolling refinery and offer a third party access to part of the combines capacity.

OMV posted a 2Q08 net profit of EUR 684 mil, 14% better than the consensus of EUR 599 mil. Clean EBIT was EUR 1,083 mil (+17% versus consensus). Earnings from the refining segment surprised on the upside, the best result since 2005. Key points are:

OMV (in EUR mil) 2Q07 2Q08 yoy  
1H07 1H08 yoy  
Clean EBIT 584 1,083 85% 1,064 1,734 63%  
EBIT 562 951 69% 1,074 1,746 63%  
- E&P 442 752 70% 863 1,431 66%  
- R&M 94 200 113% 123 243 98%  
- Gas 42 27 -36% 121 115 -5%  
Net 411 684 66% 743 1,130 52%

## **Prague Stock Exchange could be for sale** KB

Czech TV reported yesterday it got information that the Prague Stock Exchange is for sale. Patria confirmed it is ready to discuss selling its share of almost 25%. An unnamed source added that several other shareholders may also intend to sell their stakes which would bring the share for sale to a total of 50.28%. The CEO Kobic declined to comment on the issue yesterday but promised a statement later. Daily HN reported that regional bourses like those of Vienna or Warsaw expressed their interest to acquire the PSE

## **S&P affirms Riga city rating at 'BBB', entrepreneurs still wary** bne

Rating agency Standard & Poor's has affirmed the long-term credit

focused bonus structure, which has improved over the years, is maybe why we are rated so highly. But at the same time what wasn't mentioned in the article was that the profit per employee is correspondingly among the best in the industry."

Eglitis has also been part of recent moves to diversify the services AB offers its customers by establishing daughter companies AB.LV Asset Management and AB.LV Capital Markets in 2006, running five investment funds as well as individual asset management.

AB.LV Capital Markets carries out buying and selling of financial instruments at the customer's request, servicing of financial instruments' accounts, and

provides informative support. The custody of financial instruments is provided by the bank but purchased financial instruments belong directly to the customer. They are not entered on the balance sheets of AB.LV Capital Markets or Aizkraukles Banka, and are held in separate customer accounts.

"The funds are defined according to the profile of our customers, which are more risk-taking than the average European investor and looking for a higher yield," says Eglitis. "We use the knowledge the bank has obtained managing its own portfolio, which has been successful over the years, and we expect that the business will grow and show nice profits." **bne**

COMMENT:

## **Hard or soft landing for CEE? The jury is still out**

### **Deutsche Bank Research**

In Kazakhstan and the Baltic countries the macro-economic adjustment is under way. While Kazakhstan and Lithuania seem to be experiencing an orderly slowdown after years of a credit boom, the intensity of the downturn in Estonia and Latvia is now calling into question the potential for a soft landing.

In Romania, Bulgaria, Ukraine and Russia the economic cycle shows no sign of a turnaround. Accelerating inflation, high real wage growth, still rapid real credit growth and strong growth of imports are common features of all four countries. Despite recent central bank tightening, further measures are required to secure a soft landing.

The global financial crisis and deteriorating asset quality could be a challenging combination. In a worst-case scenario, tougher external financing conditions and deteriorating asset quality in Eastern Europe might put a question mark over the strategic commitment of mother banks from Western Europe.

A financial crisis could prove costly. In this scenario the public debt ratio would shoot up dramatically in Estonia, Kazakhstan, Latvia and Ukraine. But it would still remain below Hungary's current debt level.



### **Macroeconomic adjustment is under way in the Baltics and Kazakhstan**

In the March issue of our Credit Monitor, we commented on tentative signs (i.e. slowing credit, retail sales and real GDP growth) of a soft landing in the Baltics and Kazakhstan. This orderly slowdown scenario has further materialised in Kazakhstan and Lithuania although slower domestic demand has yet to feed through to the inflation and external debt dynamics (and the current account deficit in Lithuania). In Estonia and Latvia, however, the severity of the macroeconomic adjustment over the last few months (see chart) is calling the potential for a soft landing in those two countries into question. We have slashed our baseline full-year GDP forecast to 2% for Latvia and 0.5% for Estonia. Although we now attach a 30-40% probability to a recession scenario, the probability of a crisis scenario (i.e. banking sector distress and sharp currency depreciation over the next 12 months) still remains low in our view.

### **Romania, Bulgaria, Ukraine, Russia remain in overheating camp**

Accelerating inflation, double-digit real wage growth, still rapid real credit growth and strong import growth are common features of all four countries

rating of Latvian capital Riga at 'BBB', short-term rating at A-3, outlook Stable.

S&P attributed the affirmation to Riga's stable financial situation, which is based on strong economic potential and balanced budget planning and execution.

#### **Czech president: Czechs should not set excessive goals as EU head** bne

The Czech Republic should not set excessive goals for its upcoming EU presidency, warns the country's Euro-skeptic President Vaclav Klaus.

Klaus, a member of the centre-right ODS party, was backed up by Senate chairman Premysl Sobotka, also from ODS.

"We both have the feeling of certain sobriety," Klaus said, explaining their approach to the EU presidency, scheduled for the first half of 2009.

that remain in the overheating camp, namely Romania, Bulgaria, Russia and Ukraine. In order to cool the economies the central banks - in addition to raising key interest rates - have taken the following recent measures: The Central Bank of Romania proposed a regulation which limits the income taken into account by financial institutions to a maximum of 20% over the income declared in the tax bill of the previous year. The Central Bank of Russia increased the obligatory reserve ratio for credit organisations and raised its refinancing rate to 11% in July. The Central Bank of Ukraine envisages a rise in the provisioning rates for consumer and FX loans to borrowers without stable FX income streams. But in our view, given the strongly negative real interest rates in several countries (see chart), further gradual monetary, regulatory and fiscal tightening measures by the authorities are necessary in order to avoid a sharp economic slowdown à la Estonia and Latvia.

#### **Credit crisis, deteriorating asset quality could prove challenging**

Much of the recent credit boom has been financed externally driving up banks' aggregate external liabilities to above 40% of total liabilities in the Baltic countries and Kazakhstan. As we have argued previously, strong foreign ownership in the Baltic countries should mean easier and cheaper access to funding for local Eastern European banks, as long as mother banks do not come under pressure as well, which is currently not the case. But deteriorating

asset quality in the local Eastern European banks and thus declining profits coupled with tougher financing conditions for the mother banks remains a low-probability risk scenario, in which Western European mother banks' strategic commitment might be questioned. In Kazakhstan, external financing conditions for banks remain tough and are expected to lead to a further consolidation of the banking system. Although reported ratios of NPLs in Kazakhstan are still in the range of 2 to 4%, the actual percentage of loans under stress is estimated to be as high as 15-20% of total loans since banks restructure problem loans and extend grace periods.

#### **A financial crisis could be costly**

Alongside increased financial intermediation levels and growing bank balance sheets in the Eastern European countries, the potential cost of bank bailouts for the sovereign in the event of a financial crisis has risen as well. Based on S&P's estimates of gross problematic assets in a reasonable worst-case scenario, we calculated the potential public debt-to-GDP levels for all Eastern European countries in the event of a financial crisis based on 2008 GDP data. The above chart shows that if the sovereign takes over the estimated problem loans, public debt levels in Estonia, Kazakhstan, Latvia and Ukraine would rise sharply, increasing at least fourfold in a financial crises scenario. But overall, they would still remain below current Hungarian debt levels. bne



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**Bulgaria's largest steelmaker Kremikovtzi declared bankrupt**  
bne

Bulgaria's debt-ridden steelmaker Kremikovtzi has been declared insolvent by Sofia's City Court, which has opened a procedure for the firm's bankruptcy, the court's press office announced.

It is expected that the bankruptcy of Kremikovtzi will lead to a sale of a 71 per cent stake in Bulgaria's largest steel mill, which is owned by Indian businessman Pramod Mittal. The debts of the plant are currently estimated at around lev 1.6 billion (€800 million), excluding Kremikovtzi's €325 million bond.

**US may suspend \$50m of aid to Serbia over Kovacevic case**  
bne

Speculation is rising that the United States will withhold \$50m of aid earmarked for Serbia in response to the failure of the Serb authorities to extradite student fugitive Miladin Kovacevic.

Twenty one year old Kovacevic was studying in the US when he got into a fight with fellow student Bryan Steinhauer in a college bar at Binghamton University in New York state. Kovacevic is accused of attacking Steinhauer, who is currently in a coma.

Despite having his passport confiscated by the US, Kovacevic was able to obtain a new passport from the Serb consul in New York after being released on bail and return to Serbia where he remains today.

**Turkey's ad market grows 13% on year in first half of 2008**  
ATA Invest

Mr. Yalcindag, the head of International Advertising Agency's Turkey branch (also the CEO of Dogan Media Group) stated that the size of the ad market reached YTL 1.8 bn in 1H08, implying 13% growth

## Romanian stocks hit for six as credit crunch spreads across region

**Dominic Swire**

in Bucharest

Stock markets across Central and Eastern Europe have been reeling as economic worries drive foreign investors into dropping assets in emerging countries. One of the worst affected has been Romania, with the recovery prospects for the Bucharest bourse looking grim for the rest of the year. However, long term, analysts believe the country is developing at such a pace it's just a matter of time before market confidence returns.

Stock markets in Southeast Europe registered a terrible first half of the year. The Bulgarian market closed the first half of 2008 with losses that erased last year's gains. The SOFIX was down 34.7% and the BG 40 dropped 40.8%. The Belgrade BELEX 15 index of most liquid shares recorded a drop in value of 23.1% during the same period, while Slovenia's SBI20 dropped 30.7% and Croatia's CROBEX fell 31.5%. But the most affected market in the region has been Romania. In just two days, July 15-16, over €2.1bn was written off the Bucharest Stock Market, with the value of listed companies falling 50% over 12 months to €16.9bn. Many analysts worry the losses will continue throughout the year.

One of the main reasons the Romanian stock market has been hit so hard is because of the disproportionate number of foreigners investing in it, argues Oleg Galbur of Raiffeisen Capital & Investment in Bucharest. During the current global crisis, many investors have been consolidating assets and selling riskier investments in emerging markets. "Foreign investors were net sellers in the whole region, including Romania. However, the Romanian capital market lacks strong local institutional investors that could offset the sharp fall," Galbur says.

One reason for this has been the relatively small number of IPOs in the Romanian market that usually attract more long-term investors, as well as insufficient liquidity and doubts about Romania's macroeconomic stability. "In our opinion, foreign investors overreacted to the widening of current account deficit, depreciation of domestic currency and growing inflationary pressure, which otherwise is something common for a fast-growing economy," says Galbur, who believes foreign investors will be attracted back once the international context improves. "The economic growth of at least 6-6.5% in 2008 coupled with decreasing inflation and a contracting current account deficit should motivate investors to pay higher attention to domestic-listed entities," Galbur says.

It is highly unlikely, he argues, that Romania will climb out of its current mess until at least the end of

the year. Nevertheless, such concerns seem trivial when put in the wider perspective of the country's rapid development over the last few years. A recent report by the Organisation for Economic Cooperation and Development (OECD) on the economic performance and social policies of countries in the Black Sea region praises Romania on many levels.

**Silver lining**

The OECD report entitled, "Black Sea and Central Asia: Work and Wellbeing," highlights Romania's rapid economic growth and "drastic" reduction of inflation, which was 34.5% in 2001, compared with an estimated 4.3% in 2007. In 2006, the report points out that Romania attracted an impressive \$11bn of foreign direct investment compared with just over \$5bn each for Bulgaria and Greece.

Evidence of this fast economic development can be seen in the growing number of Romania's Diaspora

The image is a promotional poster for the EA@BS Cannes IX-th Eurasian Business Summit. At the top, it features the EA@BS logo and the event title 'CANNES IX-th EURASIAN BUSINESS SUMMIT' in large, bold letters. Below the title is a globe icon. The dates '5 - 11 OCTOBER 2008' and the location 'CANNES, FRANCE' are prominently displayed. The text describes the summit as an annual platform for international dialogue between public authorities, the business community, and politicians within the Eurasian space, Europe, and North America. It lists various topics of discussion such as energy, oil, metallurgical, complex financial and investment, transport, telecommunications, construction and real estate, trade, agro, chemistry, and mechanical engineering. At the bottom, there is a list of logos for participating organizations and sponsors, including bne, PHILIPIC, NORDICUM, and others. Contact information for registration, sponsorship, and speaker opportunities is provided, along with the website www.lvauk.com/summit.html.

over 1H07. Ata estimate was slightly lower at YTL 1.75 bn. Yalcindag also said that 84% of the total ad spending was materialized through TV channels and print media, while internet, cinema and outdoor ad spending improved their shares. We maintain our forecast for FY08 ad market size at YTL 3,629 mn with expected 11.4% growth compared to a year ago.

### Iran ready to talk gas with Bucharest, Turkey bne

Iran may become a safe energy source for Europe and for Romania, according to Iran's Ambassador to Hungary HE Hamid Reza Arshadi, local media reports.

In a recent interview with newspaper Gardianul Arshadi says Romania could have a key role in attracting Iran into the proposed Nabucco gas pipeline, thus reducing the EU's reliance on Russia.

that are returning to the country as new opportunities are being created and the standard of living rises. In 1990, Romania's net external migration figure was 96,900 people. The latest figures from the OECD show that this figure dropped to 7,200 in 2005, two years before joining the EU. Since then, the report says the country's economy has been one of the fastest growing in the 27-member bloc, benefiting from structural reforms and sound macroeconomic policies.

"Romania's getting to the top of the scale where Romanians are thinking about coming back. The economy is expanding and jobs are being created at all levels," Colm Foy, Head of Publications and Media Relations at OECD Development Centre, told bne in Bucharest.

### A new Ireland

Standing under a hotel parasol on a hot Bucharest afternoon Rainer Münz, Head of Research at Austria's Erste Bank, carefully rescues an earwig from a neighbouring table before waxing lyrical about how vital EU membership is for Romania.

"Think back to where Ireland or Spain were twenty years ago," Münz tells bne. "They were seen as, how do you say, semi-poor countries on the fringes of Europe. Look where they are today. This is exactly what we are expecting from this part of world... We think we see an Ireland economy ahead of us."

Romania has certainly attracted some big name investment over recent months, namely Nokia's €55m new plant in central Transilvania; Renault's €146m gear box plant in southern Romania; not to mention Erste Bank themselves putting their money where their mouth is and stumping up €3.75bn for a majority stake in Romania's biggest bank BCR at the end of 2005. Yet despite the investment Münz says it could be a generation before the country approaches anything close to a western standard of living. But the catch-up period is likely to be highly lucrative for the companies that stick around.

"The firms that remain here during this time will be rewarded with a very business-friendly environment," says Münz. "The markets here are not saturated yet." **bne**

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### BP diverting oil whilst BTC burns Visor Capital

The operators of the Azeri-Chirag-Gunashli group of fields announced that they have begun diverting crude deliveries whilst the BTC pipeline remains shut. This could cause short-term problems for exports from Kazakhstan, although no significant share impact is expected.

Following the explosion earlier this week, the BTC pipeline remains shut, and is still burning. It is now expected the fire will be put out within 1-2 days, but that the pipeline will remain shut for 1-2 weeks. The explosion has been claimed by the Kurdish separatist group the PKK.

Meanwhile, BP and its partners, who operate the Azeri-Chirag-Gunashli group of fields, that supply the BTC, were actively looking at alternative export routes. Some of the one million barrels per day currently transported by the BTC have already been re-routed via

## Georgian troops enter Tshkinvali after ceasefire collapses

Georgia claims the attack against South Ossetia was launched in response to the shelling of several Georgian villages by South Ossetian forces late last night. A statement on the Georgian Ministry of Foreign Affairs' website, published at 00.45 this morning, says that "separatist rebels" attacked the villages of Prisi and Tamarasheni, leaving several dead.

"To protect peaceful civilian populations and to prevent further military attacks, the Government of Georgia has been forced to take adequate measures," the statement said.

Speaking to journalists this morning, Georgia's Prime Minister Lado Gurgenedze said that dialogue between the two sides could only be resumed once peace has been restored in Georgia and separatist activity halted.

"Until such a time, the operation to ensure the safety of the local civilian population will continue. If an operation to halt separatist action in Tshkinvali or another settlement is needed in order to achieve this, then these actions will be carried out," Gurgenedze said. Meanwhile, Tbilisi appears to be preparing for a

larger war. According to Georgian press reports - as yet unconfirmed by the Defence Ministry - a mobilization of reserves started this morning, with reservists gathering at Tbilisi's Lokomotiv stadium.

South Ossetia's President Eduard Kokoity has appealed to Russia for help. The republic's allies in the region are also mobilizing. Several hundred volunteers from North Ossetia arrived in Tshkinvali earlier this week after clashes between Georgian and South Ossetian forces on August 1.

North Ossetia's President Teimuraz Mamsurov is on his way to Tshkinvali to meet with Kokoity. "I will reach Tshkinvali by all means," he told Interfax. "Georgia has demonstrated its barbaric, fascist essence. We cannot remain on the sidelines and out of the effort to protect our brothers and citizens."

Abkhazia is also mobilizing its army. Armoured vehicles, artillery and infantry units started moving towards the Georgian border at the Inguri river this morning. The chief of the Don Cossacks has called on all Cossacks aged under 40 to volunteer to help South Ossetia.

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Supsa. It is also likely production on Azeri fields will be reduced until the pipeline reopens.

### Heavy fighting in South Ossetia raises war fears

bne

Heavy fighting last night in the Georgia-South Ossetia conflict zone left up to 20 people injured. The Georgian side is being accused of gearing up for war by moving a convoy of troops into the region, while Georgia's President Mikhail Saakashvili, in an attempt to deflate the situation, called for Russia and Georgia to work together to find a peaceful solution, reported Interfax August 7.

Officials from Georgia, South Ossetia and Russia are due to meet in Tshkinvali today to try and find a way to stop the escalating conflict. After a week when six people were killed and many injured in shellings and sniper attacks in the Tshkinvali area, there is a growing danger than these incidents could lead to full scale war between the two sides.

Interfax reports that a large group of Georgian troops is moving from Kutaisi in the direction of South Ossetia. The group reportedly consists of twenty trucks full of soldiers, three armoured personnel carriers, three missile systems and three artillery weapons.

### Kazakhstan to supply oil to Mongolia

bne

Kazakhstan is to supply over 1 million tons of oil and 30,000 tons of wheat to Mongolia. The deal was agreed yesterday August 6 during Kazakh President Nursultan Nazarbayev's visit to Ulan Bataar.

"The President of Kazakhstan accepted our proposal on delivery of 1 - 1.5 million tons of crude oil to Mongolia from Kazakhstan. In connection to this, the governments of both countries will commence talks on incorporation of these deliveries

Yesterday it appeared that war would be averted. After a day of heavy fighting, Georgian President Mikhail Saakashvili offered an immediate ceasefire and peace talks to South Ossetia.

In a televised address yesterday, Saakashvili said that Georgia would give amnesty to illegal armed groups in South Ossetia if they agreed a ceasefire. "We offer total amnesty to the separatists if they cease fire," he said.

## Azerbaijan banks burn bright

and non-performing loans at under 5%. Return on equity stands at above 35%, while return on assets is above 3.7%.

Three main factors account for the strong growth says Aslanly: economic growth running over 30% a year; Azerbaijan's banks started to borrow from the foreign markets in 2006; and, probably most importantly, restructuring of the banking sector.

Over the last four years the Central Bank has been working to standardize the legal basis for banking activity, implement corporate governance standards, restructure the private banking sector and develop financial infrastructures including payment systems and implementation of IFRS.

"As result, in 2004, we adopted a new central banking law which is in full compliance with Basel Core Principles on effective banking supervision," says Aslanly, "We drafted this law with assistance from international financial institutions and followed up with a special financial sector assessment project from the World Bank and the IMF. Consequently, all banking activities in Azerbaijan now have a solid legislative basis."

### Squeezing the sector into shape

The Central Bank has successfully slashed the number of banks in Azerbaijan from some 250 about eight years ago, to the current number of 46. But an attempt to cut the number further by hiking the minimum capital requirements and thus pressure smaller banks to merge or be bought failed. Banks are growing so fast that no one was ready to sell and to the annoyance of the central bank all the banks in the sector managed to meet the new requirements. With total banking sector assets still only equal to about 20% of GDP, compared with

"We ask them to immediately cease fire, not to test the Georgian people's patience and to stop the violence."

The offer came after the South Ossetian government refused to meet with Reintegration Minister Temir Yakobashvili and Russia's Ambassador to Georgia Yuri Popov in Tshkinvali, since no representative from North Ossetia was present. **bne**



values of over 100% in the West, the banks expect plenty more growth.

Jahangir Hajiyev, chairman of the state-owned International Bank of Azerbaijan (IBA), by far the largest bank in the country, believes that even the IBA, with AZN100m in shareholder equity as of the end of 2007, is under capitalized, but ultimately the country needs no more than 15 banks. The IBA, however, is not likely to fall foul of capital adequacy requirements.

"We are achieving record earnings - profits were at AZN70,404,000 in 2007, up 92% on the previous year - so we are sticking these back in and have no problems growing the bank," says Hajiyev.

The smaller private banks are frequently seeing their profits boom by several hundred percent, year on year, and Aslanly concludes that, for now, upping the minimum capital requirement above AZN10m would be unproductive. "Capital adequacy is at 12% and the top 15 banks have healthy capital adequacy ratios of around 14% to 16%," comments Aslanly.

The Central Bank is having more success in cutting down on the number of banks by way of regulatory reforms. At the start of 2008, after several years of discussion, a deposit insurance scheme was introduced. Currently, nine banks have not joined the scheme and Aslanly says: "these nine banks have limited banking licenses - they cannot collect deposits from the general public. Ultimately they have two options: merge or transfer to become non-bank financial institutions."

Public trust in the banking sector has been growing in leaps and bounds and even ahead of the insurance scheme, deposits were rocketing, up by 67% in 2006 compared with the previous year, and increasing by a

into the planned accounts of next year," Mongolian President Nambaryn Enkhbayar told journalists after his meeting with Nazarbayev.

#### **The purchase of Kazphosphat is under consideration by Russian "Eurochem" Visor Capital**

We expect the production rate to increase due to planned investments. Companies operating in the same industry may be affected by higher competition.

Russian company "Eurochem" is currently negotiating the purchase of a 50% share of Kazphosphat for US\$400m.

#### **Georgia: Volunteers arrive in South Ossetia** bne

Militants from the North Caucasus are "uncontrollably" flooding into South Ossetia, Georgia's peacekeeping commander has said. Tbilisi has accused Russia of allowing militants from the North Caucasus to infiltrate the region.

"To prevent illegal armed groups from infiltrating into the conflict zone in the Tskhinvali region is the direct responsibility of Russian peacekeepers. However, it not being fulfilled, and militants are uncontrollably heading into South Ossetia," peacekeeping commander Mamuka Kurashvili said yesterday August 5.

South Ossetian President Eduard Kokoity had previously announced on August 2 that 300 volunteers from the North Caucasus had arrived in Tskhinvali.

#### **Sinopec launches bid for Imperial Oil** Visor Capital

Imperial Oil yesterday confirmed that it had received a second offer, rumoured to be from Sinopec. The first offer of Gbp1,260 per share

further 102% in 2007. Aslanly believes that public trust is mainly based on the improving quality of banking services and trust in the government's regulatory authority.

"In 2004, we revoked the license of one bank. The Central Bank led the liquidation process and within three months had repaid all the deposits. This gave a crucial boost in confidence to the public," says Aslanly.

Local depositors are not the only ones that are gradually being won over. Vladimir Myashin, an analyst at GlobalRating, in February wrote: "Active banking reforms in Azerbaijan have started showing results."

#### **Catching up with the giant**

Until recently the IBA entirely dominated the banking sector, but over the last few years it has lost virtually half its share of the market to private banks.

"Five years ago, IBA's market share was around 75% and it collected over 80% of deposits, while by the end of 2007, IBA's market share had dropped to under 38% and the top 15 private banks alone accounted for more than 65% of deposits," comments Aslanly.

Faig Huseynov, chairman of the privately-owned UniBank, Azerbaijan's third largest bank, comments: "a few years ago IBA dominated the market, but now the picture is changing as the other banks move ahead rapidly. IBA is still the giant of Azerbaijani banks, but I wouldn't say that it monopolizes the sector or that we suffer because of any advantages that they might have. In the same way, the small banks should not, and do not, suffer from us being bigger. Everyone focuses on slightly different businesses and success is dependent on each bank's personal strategy."

UniBank, which was set up in October 2002, as a result of the merger of the two small private banks MBank and PromTekhBank, appears to have its strategy fine-tuned to perfection. The bank focuses on financing private companies in the non-oil and gas sector, including SMEs and financing of nascent businesses via micro-lending. In a little over five years, the bank has grown its assets by a staggering 45-times, from some \$10m to \$450m.

The EBRD and Germany's DEG joined the success story, respectively acquired stakes of 20% and 8.33% in 2003 and 2005. Having two well-known institutional shareholders has also helped UniBank to attract international funding by way of bilateral and syndicated loans to local companies and Huseynov comments that the bank is doing significant business with a host of foreign banks including Deutsche bank, Citi Group, JP Morgan, Morgan Stanley, Standard Bank and VTB.

UniBank recently started to sharply expand its retail business and now retail deposits account for nearly half of its \$300m portfolio. Huseynov explains that: "Overall public wealth is growing, which raises retail banking to a new level of importance."

The bank is seeing increasing demand for car loans, credit cards, and mortgages. Last year the government set up a state mortgage fund, which gives the public access, via selected banks, to funding at extremely favourable rates. UniBank, as is the case with many other private banks, has launched its own mortgages and is currently signing agreements with foreign financial institutions to attract between \$15m and \$30m for 10 to 15 years, specifically for mortgage purposes. The establishment of mortgage financing is described by Myashin as one of the main recent accomplishments of Azerbaijan's financial sector.

As with most of the banking sector, UniBank's presence is still nearly exclusively limited to Baku with only two of its 13 branches located outside the capital. This year UniBank plans to expand strongly into the regions, adding as many as 10 branches outside Baku and increasing its overall number of branches to 30. Huseynov confirms that the government's efforts to develop infrastructure throughout the country are paying off: "The regions are developing very fast. More small to medium plants and workshops, and private companies are opening up. There is business in the regions and it has become strategically important to expand beyond Baku."

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is thought to have been made by India's ONGC. The news is good for Imperial stock, and for the wider oil sector in the FSU. The shares finished up 8%.

Imperial Energy (IEC LN) announced yesterday that it had received a second offer for the firm. Although the firm did not name the bidder formally, it is believed to be Sinopec, following an article in the Guardian newspaper over the weekend.

No amount was given for the second bid, although it is likely to at least match an earlier offer of GBP1,290 per share. The first bidder was not named, although it has been widely reported to be ONGC.

#### Kazakhstan seeks Chinese investor for Beineu-Samsonovka pipeline **bne**

The Kazakh government aims to attract a Chinese co-investor for the planned Beineu-Samsonovka gas pipeline.

"It was decided to fund this project 50/50: one half will be allocated from the budget and the other by an investor. Under an inter-governmental agreement with China, the Energy Ministry has offered Chinese investors to take part in this project, and there are normal prospects for this cooperation," Deputy Prime Minister Umirzak Shukeyev told a government meeting yesterday August 4.

Failing this, 50% of the project will be funded either by a foreign investor or by KazMunaiGaz, Interfax reported Shukeyev as saying.

#### Georgia: Tshkinvali evacuates children as fear of war increases **bne**

The South Ossetian authorities started a mass evacuation of children from the region yesterday August 3, after clashes between

#### From off the map to off the scale

For leading international banks, Azerbaijan has suddenly gone from being a blank zone on the map to the place to be. While local banks are filling in their coverage of the regions, foreign banks are queuing up to establish their first presence in the capital.

Germany's Commerzbank, which was operating in Russia long before the Wall came down and in the 1990s was quick to launch rep offices everywhere from Ukraine to Kazakhstan, and Belarus to Uzbekistan, left it until the end of 2007, to arrive in Baku.

"There was only one blank area where we had no presence at all and that was the Caucasus. In the 1990s, we developed some relationships with the main banks in the region but dealt with business from Frankfurt because things were not moving ahead. The countries of the Caucasus were very underdeveloped and didn't keep pace with their neighbours such as Kazakhstan," comments Dr Marco Graff, head of Commerzbank's rep office in Baku.

"All that changed with the completion of TBC. The Azerbaijani businessman, loaded with oil dollars, started looking around for where to spend the money and the market started to develop so quickly that we felt we had to be here to keep our figure on the pulse and develop more complex banking solutions," says Dr Graff.

Commerzbank joined France's Societe Generale and Latvia's Parex Group, which have had rep offices in Baku since 1998 and 2005, respectively, and will soon be joined by the Turkish division of US banking giant Citibank, which was granted permission to open a rep office by the Central Bank in February. According to Aslanly, Citibank plans to switch from a rep office to opening a subsidiary bank within a year or two.

Commerzbank is in no such hurry. Dr Graff plans to watch developments closely and before making any plans to switch to full banking activities.

"Trade is picking up quickly between Azerbaijan and Germany. Siemens and Lufthansa have been here for ages. The utility RWE just opened a rep office and the road construction company Wirtgen Group is looking to set up operations in Azerbaijan. So there is plenty of business for us but the banking sector still has some catching-up to do. The content of the financial instruments being used are often much more developed than the know-how of the market," comments Dr Graff.

Hajiyev welcomes the arrival of the foreigners, commenting: "Foreign banks bring know-how, new technologies and new services. Its good for developing the banking sector and it also helps to create a more competitive environment."

The number of banks with foreign capital has recently increased to 21, and while six of these are already majority owned by foreigners, the media and local

bankers alike are talking about the imminent purchase of a local bank by Russia's second largest bank VTB as the first major acquisition by a foreigner.

VTB is rumoured to be purchasing AF-Bank, reportedly the 35th largest bank in the country, and while sources say that the deal has already been closed, Aslanly says that the Central Bank is still considering the issue.

Several US and European banks, including ABN Amro, have reportedly approached the Central Bank regarding buying a local bank. Kazakhstan's Halyk Bank has also been named in the media, while the Bank of Georgia and IsBank, respectively, the leading banks in Georgia and Turkey, are also reportedly taking a closer look at the country.

"We won't know for sure until we see a huge VTB sign on top of one of banks in Baku," comments Huseynov. As for how it will change the local landscape, Huseynov says:

"Hopefully we'll see something fresh. But again it really depends on the bank's strategy. If they just come to serve existing clients then it wouldn't change much, but if a major foreign bank moves in with big plans to provide the full spectrum of banking services to local, foreign, new and old clients then we'll see competition really heat up." **bne**

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Georgian and Ossetian forces on Friday night left six dead.

Buses carrying around 1,000 South Ossetian children set off from Tskhinvali for Russia yesterday, as fears of war breaking out between Georgia and South Ossetia increase.

On the night of August 1, three South Ossetian soldiers were killed by Georgian sniper fire. Shelling of the capital Tskhinvali which lasted for several hours later that evening left three civilians dead, the South Ossetian authorities say. Fire was returned by South Ossetian forces, Interfax reports.

On August 2, the Georgian village of Dvani in the Znaura district of Tskhinvali region came under fire from South Ossetian positions. Troops at the Georgian peacekeeping position in the village which was targeted in the attack returned fire. Although no one was injured in the attack, buildings in the village were damaged.

The commander of the joint peacekeeping force has set up a temporary observation post in the conflict zone, Itar Tass reports. "In connection with increased facts of violation of the ceasefire agreement by the sides, the peacekeeping troops of the Russian motor rifle battalion have set up a temporary observation post between the Ossetian village of Andisi and the Georgian Tseri," the force's deputy commander Vladimir Ivanov said.

On Saturday, the South Ossetian leader Eduard Kokoity said his forces would respond to attacks on Tskhinvali.

"Those who are firing on the city and those who are sending those units there will get a feel of the power of the South Ossetian armed forces," Kokoity said. "It is a base practice on the part of Georgian generals to shoot civilians in the back and fire on Tskhinvali and other populated areas in South Ossetia. We will put an end to it because we reserve the right to retaliatory strikes. We have resources to hit back at them and to inflict serious losses on the enemy."

## Georgia and South Ossetia: War appears to have begun

### Renaissance Capital

Full-scale military action began last night (7 Aug) in Georgia's breakaway region

- So far there has been limited evidence of direct military support by Russia of the Russia-backed rebels
- The UN Security Council has failed to reach an agreement on issuing a statement
- The Russian Security Council has convened
- Russia has promised to take action in response to what Prime Minister Vladimir Putin called "aggressive Georgian action"
- Georgian President Mikheil Saakashvili has ordered the full mobilisation of troops in response to what he calls "largescale military operations by Russia"
- We expect Russia to get involved, but the scale of direct military involvement remains unclear
- We expect a further deterioration of the situation in the region
- We expect Russian assets to continue to suffer. We particularly expect a decline in the rouble and widening of CDS spreads, which is likely to apply pressure to Russian stocks and bonds
- However, we think that, with fundamentals remaining solid, any sell-off is likely to be reversed in a matter of days and weeks, with the timing dependent on the scale of Russian involvement

According to Reuters, today (Aug 8), the UN Security Council failed to reach an agreement regarding a Russian statement that would have called on Georgia and separatists in its South Ossetia region to immediately stop any bloodshed. Security Council members began meeting late Thursday (7 Aug) and remained behind closed doors for two hours until early Friday morning to discuss the three-sentence statement.

However, council diplomats said one phrase was unacceptable to the Georgians; this was backed by the US and Europe. That wording called on all sides in the conflict "to renounce the use of force," according to a draft of the text. After failing to agree, the council decided not to take any action on the issue, the diplomats said.

However, they agreed to hear statements from Russia and other individual council members and Georgia.

On Thursday, Georgia and South Ossetia accused each other of aggressive actions.

According to Georgian authorities, South Ossetian forces attacked Georgian villages and injured two Georgian peacekeepers while South Ossetian authorities reported several casualties and six civilians wounded. After visiting the injured peacekeepers in hospital, Saakashvili said that Georgia wanted to resolve the crisis in a peaceful manner and called on South Ossetia to cease fire. The Georgian Minister of Reintegration Temur Yakobashvili called the incident an attempt to drag Georgia into war. Georgia denied Russian peacekeepers' reports that Georgian SU-25 fighters and surveillance aircrafts were flying over South Ossetian territory and that a Georgian brigade was being positioned on the Georgia-South Ossetia border. The US urged all parties to negotiate an end to the conflict immediately.

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### Kazakh railway traffic expected to double by 2020

Visor Capital

The president of Temir Zholy approved a new investment programme for 2008-2012. Capacity is expected to double by 2020, but investment costs may cause higher tariffs costs. No direct share impact is expected.

According to the president of JSC "Kazakhstan Temir Zholy", Kazakhstan's state railway operator, the volume of loaded goods increased by 9% (119.3m tons) and by 8% for transportation level (Tons 134.9m). Goods turnover increased by 12.4%.

As the president of the company, Askar Mamin said that the company had identified demand for railway services would double over the next 10 years. Hence, they had introduced a KTZ development Strategy 2020 and a 5 year Reform program of railway transport. The company approved an investment program for 2008-2012, with Government support. This program incorporates a major repair of railways, the purchase of new carriages and the development of a new Dostyk station.

The overall level of investment will be US\$7.4bn, and the tariff for railway services will rise by 15%.

Georgian troops, backed by warplanes, pounded separatist forces near the South Ossetian capital.

This week, Russia's Ministry for Foreign Affairs said it would not remain neutral if the situation in Ossetia and Abkhazia became more acute. The ministry's ambassador, Yuri Popov, is already in the region and has called for a two-party meeting between South Ossetia and Georgia, in which South Ossetia has refused to take part.

Georgia has refused Russia's other offer of a four-party meeting between Russia, Georgia, South Ossetia and North Ossetia, claiming it would be ineffective. Russian authorities say they hope the matter will be settled before a war breaks out.

Interfax reported that, this morning, Georgian troops entered Tskhinvali, the capital of the breakaway region of South Ossetia, after battling separatist forces overnight.

Interfax quoted its correspondent as saying a heavy battle was raging in the southern part of the town. He said Georgian forces had not yet entered Tskhinvali, but were engaged in a battle with two convoys of

trucks that had entered South Ossetia from Russia and were trying to reach the breakaway capital.

Putin said in Beijing that Georgian troops were leading fire from three positions, backed by tanks. He also announced that three Russian peacekeepers were wounded and their headquarters damaged during the Georgian shelling of Tskhinvali. In addition, Popov said that Georgia "initiated war in South Ossetia".

Konstantin Kosachev, the chairman of parliament's Foreign Affairs Committee, said that Georgia's actions ultimately contradicted its commitment not to use armed forces in the region. Russian President Dmitry Medvedev is said to have discussed pressing measures, based on a mandate to protect local civilians, national interests and restore peace. He has called a Russian Security Council meeting on South Ossetia.

The crisis has fuelled fears of a full-blown war in the region, which is likely to undermine Russia's position as a peacekeeper and the guarantee of stability in the region. **bne**

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March 3, 2008

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#### NEW NEWS

1. GIC Pk deal marks shift towards project-level financing
2. Cifir of Shemenyevs-3 increases by 39%
3. Derzhavka sells his half of Moscow-City developer
4. Large increases in the price of office space in Moscow in 2007
5. Moscow City project to be completed in 2012
6. Moscow, St Petersburg and Prague top list of retailer destinations
7. Real estate report: Value distractions
8. Additional details of the draft law on retail trade
9. Aushan takes over 18 Remonte's hypermarkets
10. Cifir: New Head of Project Management
11. CIBR: MIRLAND DEVELOPMENT APPOINTS CIBR/SAR AS EXCLUSIVE AGENT
12. CIBR: retail flagship
13. Cifir: Office flagship
14. ENKA completes Naberezhnaya Tower Complex at Kronopromskaya Naberezhnaya
15. Housing construction up 19.4% in 2007
16. LBR's Malchukov not running for election to the Board
17. Rosatom to get \$1.2bn HQ in Moscow
18. Rosatom/Indar sees to call red tape in inspections
19. 4 km signs pre-lease agreements: positive
20. Russian, Dubai joint venture to build residential district in Moscow
21. Sistema-HALS makes strategic appointment
22. St Petersburg shopping
23. Stockholm lacked in battle over store
24. USC to sell HQ for \$175m

#### NEW INVESTORS

25. Alfa wants to buy Rosneftekhim; waits for FAS approval
26. GIC: Real Estatebuys 25% stake in the Mytachi project from Pk for \$233m in cash
27. LBR Group: 2007 trading update: In line with expectations

## bne:deal

businessneweurope

### China's Sinopec reportedly to rival India's ONGC for acquisition of Imperial Energy

UralSib

Olympic record is very possible. Yesterday The Sunday Telegraph reported (without disclosing the sources of its information) that Sinopec has started due diligence on Imperial Energy. The report came three weeks after The Times of India reported that ONGC is buying Imperial and the company disclosing a cash offer of 1,290 pence per share (within the market range), without identifying the bidder. We believe Sinopec could pay a record high premium

to the market assuming a similar premium to that paid by Sinopec for Udmurtneft (currently operated jointly by Sinopec and Rosneft) of double the current market price of 1,074 pence, which would bring the market cap to \$4 bln.

Another expensive expansion in Russia possible. In 2006 Sinopec paid \$3.6 bln for 96.86% of Udmurtneft, or an implied EV/2P SPE reserves ratio of 6.6, vs. the peer group average of 2.5. Imperial Energy's current EV/2P reserves ratio is approximately 2.2. We believe Sinopec could double the original bid, likely placed by ONGC. In June 2007, another Chinese oil and gas company, CNPC, acquired two license blocks with 80 mln tons of prospective resources (the equivalent of 5 mln bbl of 2P reserves, according to our estimates) in the Irkutsk region (via a JV with Rosneft) for approximately \$50 mln, which would be the equivalent to an EV/2P multiple of 10.

Good if sold, good if it remains a standalone. Imperial has built an excellent upstream reserve base via M&A activities and buying licenses at auctions. The company's

2P reserves now stand at 802.6 mln bbl, all located in the Tomsk region. The three core fields - Maiskoye, Snezhnoye and Kiev-Eganskoye - are already connected to the Transneft pipeline system. We believe Imperial will substantially improve its margins once the ESPO (Eastern Siberia Pacific Ocean) pipeline is operational, as the company will be able export 100% of its oil. We believe Imperial Energy provides an excellent opportunity to buy into an independent Russian producer both from an M&A standpoint and as an ongoing standalone business.

Victor Mishnyakov

**bne comment:** Visor Capital wrote in a note to investors August 5:

"The news is likely to prove positive news for Imperial, which saw its stock surge by 70% on the initial offer. In demonstrating the valuation for energy stocks, is likely to be positive for all stocks in the region. The shares finished at GBp1,160 up 8% on the day."

## bne:stocks

businessneweurope

### Equity risk premium in Russia is 5.5% not 4%

David Aserkoff, Rencap

• In our view, the declines the market is presently experiencing are not driven by changes in the earnings outlook; nor have sovereign-bond yields changed materially. What has changed is the equity risk premium (ERP). This report introduces our estimate of the ERP at 5.5%.

• We also lower our year-end target for the RTSI from 3,000 to 2,350. This still leaves some 20% potential upside to our estimate of fair value and would put the market on around 9.3x our 2009E market earnings forecast, which is based on sub-consensus oil prices. Our 2,350 target is also below the average of our bottom-up price targets for our analysts.

• The most likely positive catalyst that we can imagine is progress on oil taxation, but even that is far from certain. We believe the most probable scenario is that the market trades in a narrow range to the end of the quarter.

• The other risk to the market is commodity prices, either a rebound or a further de-

cline. Looking at oil, we will be focusing both on the demand destruction in the slumping OECD economies as well as Gulf of Mexico hurricane forecasts and the potential for political turmoil in Nigeria and Iran.

• We believe the higher ERP has a 0-10% impact on most stocks, but a much bigger effect on the consumer and retail sector. We lower our ratings on X5 and Magnit from Buy to HOLD. This report includes our changes in target prices on all our big caps under coverage which result from the changes in ERP.

## bne:banker

businessneweurope

### Russian government draws up plans for International Financial Centre

bne

The Russian government's plans to create an international financial centre in Moscow are based on a competitive taxation system

and simplified registration and permission procedures for issuers and investors, RBC Daily reports.

RCB, which has obtained a copy of the government's plans, says the core principles for creation of the International Financial Centre are easy access, with minimum registration and permission procedures for investors, issues and financial institutions. It will also require a competitive tax system to be introduced.

The government will also address issues relating to the protection of property rights, risk management and the prevention of manipulative practices and the use of insider information. New courts will be set up to

deal with disputes between members of the International Financial Centre.

Several new laws will have to be introduced, including a law on stock exchanges and trading, a law on clearing and a law enabling direct access to Russian exchanges for foreign stocks.

The success of the project will depend on a combination of strong investment demand from investors and investment proposals by issuers.

## bne:investor

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### FAS attacks the oils no risk in FAS concern over rising oil product prices

URALSIB Securities Ltd

FAS slams oil for not reacting to the claim. The Federal Antimonopoly Service (FAS) today announced that five of six Russian oil companies had not responded to its request to provide documents in relation to its investigation into oil product prices. The FAS threatened punitive action against the managers of LUKOIL, Gazprom Neft, TNK-BP and Rosneft for failing to provide the information in time (a deadline of 4-5 August, according to the FAS). The FAS said that only Surgutneftegas had submitted the

requisite documents in time. We believe the market has overreacted to the news against that negative backdrop provided by the Mechel situation, with selling pressure emerging after the FAS announcement. We do not believe the authorities are embarking on a similar move against the oil companies as they have against Mechel, as product prices have eased during the past month and the entire peer group is being probed.

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