

An Un-Russian affair

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When a Russian telecoms company lists in New York without ever having gone to the local stock exchange, you know it is determined to shed the weight of the country's past and become a high-tech, post-Soviet, globalisation-age phenomenon. When it returns for more equity and debt, while Russia's largest companies are still holding back, you know it is succeeding.

The company is Vimpelcom, the cellular phone operator. On 25 July it raised \$68 million from a convertible bond offering in New York, and another \$75 million from a simultaneous issue of Level 3 ADRs – the first time since the 1998 financial crash that a Russian company has raised debt finance on the international markets. The bond matures in July 2005 for a final redemption price of 135.41%, giving an 11% yield to maturity. Vimpelcom first issued Level 3 ADRs in November 1996, and remains the only Russian company to have done so.

It is not only Vimpelcom's financial structure that makes it very un-Russian. There is the market it works in, which has growth opportunities not open to the natural resources giants. And there is its management structure – as Norwegian, or American, as it is Russian – led by former Soviet –star wars? scientific adviser Dmitry Zimin, and with Jo Lunders, from strategic partner Telenor of Norway, as chief executive officer. Vimpelcom has issued IAS accounts since its foundation in 1994 and has none of the transparency headaches of other Russian corporates.

In other respects, though, Vimpelcom is Russian enough – for example its revenue per user fell to \$43 in March 2000 from a monthly average of \$215 in 1998 and \$99 in 1999, as the company expanded its lower-margin prepaid business. Another very Russian indicator is Vimpelcom's credit rating, which Standard & Poors raised to BB- on 28 July, but continues to reflect Russia's poor standing as a sovereign borrower.

Valery Goldin, head of international relations at Vimpelcom, says: 'The general economic situation in Russia, and the country's debt rating, are obviously important factors when we choose financing instruments. The situation after the crisis was horrible, but now it's improving. Next year, once the Paris club talks are tied up and the sovereign debt restructured, we will see many more Russian companies coming to the market.'

Vimpelcom, however, did not have to wait until next year. Goldin says: 'The convertible bond was good for us, because we need this money for cap-ex purposes, and good for bondholders, who have a safeguard against any fall in share prices.' Aleksandr Kabanovsky, telecoms analyst at Brunswick Warburg, says: 'An issue of this kind, that appeals to debt-side investors as well as those buying shares, is a relatively attractive way of coming back into the market. If Russian economic reform continues, there will be significantly higher cap-ex needs in Russian industry all round, and the telecom market will be one of the fastest growing. There are possibilities for cellular phones, cable TV and 'new economy' areas.'

Vimpelcom expects to invest \$400 million over three years in an expansion programme to make it Russia's leading telecoms provider. As well as debt offerings, it is likely to look for cash from strategic partners, chiefly Telenor. Telenor exercised an option to maintain its 25% stake in the New York offer, as did the European Bank for Reconstruction and

Development.

Bank loans (Vimpelcom has recently had a \$80 million credit line from state-owned Sberbank, the largest Russian bank, and has a good relationship with Citibank and others) and vendor financing are also likely sources of funds.

Goldin says: "Vendor finance from suppliers of equipment has been important for us. Their terms are better than those we could get from western banks. Contracts for equipment delivery may be arranged on leasing terms with an option to buy out these terms." Vimpelcom has outstanding \$74.4 million (including \$11.4 million interest) on a lease agreement with LM Ericsson, used to purchase equipment for its D-AMPS network in Moscow. It also has a \$98.7 million equipment finance obligation with Alcatel for GSM 900/1800 equipment for its Moscow network.

The Moscow cellular market is Vimpelcom's key area of operations. Goldin says the company sees its main growth opportunities in selling new services and upgrades to its customers in the capital; market penetration of mobile services outside the capital is only about 3% and no-one in the industry is counting on it growing rapidly. Vimpelcom's main competitor in the Moscow cellular market is MTS, a joint venture owned 51% by Sistema of Russia and 49% by Deutsche Telekom, which made an initial public offering of ADRs in June, raising a net \$305 million for 15.4 % of its stock. MTS works closely with Motorola, and last month they launched Russia's first GPRS service together.

Another joint venture, Sonic Duo, has just been awarded the city's third GSM licence, and announced on 21 September that Ericsson had won a \$100 million contract to build its GSM network. Sonic Duo is 65% owned by Central Telegraph, a subsidiary of Russian state-controlled national telecoms player Svyazinvest, and 35% owned by Sonera of Finland.

A shadow was thrown across the Moscow cellular market on 13 September when the Ministry of Communications withdrew approval for Vimpelcom and MTS to use some 900MHz channels for GSM phones, presumably in order to hand them to Sonic Duo. Shares in Vimpelcom and MTS fell rapidly on the news; both companies stated that they would vigorously contest the order. On 15 September communications minister Leonid Reiman suspended the seizure of the channels "and analysts agreed that, although this ended the immediate problem for the companies, the apparently arbitrary and opaque character of the initial decision was worrying." "The main damage is to the attitude of foreign investors to Russia", says Tom Adshead, analyst at Troika Dialog.

Beyond Moscow, the telecoms industry's problems, and financing needs, bear a little more resemblance to those of the Russian economy in general. There are 89 small regional operators, which, it is hoped, will be restructured into between eight and ten larger entities over the next three years.

President Vladimir Putin's appointment of Reiman as communications minister and of former PTS general director Valery Yashin as head of Svyazinvest, the state-controlled telecoms holding company, is seen as a clear indication that, for the first time, there is the political will to carry through reforms. Both men have a background in the St Petersburg telecoms industry, and are seen by industry sources as a counterweight to other strong interest groups in the industry such as that around the state-controlled companies Rostelecom and Svyazinvest, and that around Sistema, the Moscow financial-industrial group whose owners are close to the city's mayor, Yuri Luzhkov.

Other factors that will assist growth are tariff reforms, including elimination of cross-subsidisation and introducing time billing for local services; possibilities of growth in the domestic long-distance market and a hoped-for internet boom. Industry sources say the industry's cap-ex requirements are potentially \$1,000 million a year.

Alongside equipment supplier financing, of which Vimpelcom's arrangements with Ericsson and Alcatel are the best, but not the only, example, foreign strategic investors will play a key role. Apart from Sonera's involvement in Sonic Duo and Telenor's in Vimpelcom, Telia has earlier this year announced that it has purchased 15.05% of Telecominvest, the value-added services holding based in St Petersburg for \$81 million.

Kabanovsky of Brunswick Warburg says: 'There is an abundance of financing scavenging around Russia for any and all opportunities for direct investment in telecoms. Scandinavian operators are likely to continue to expand their presence in Russia, since the country lies at the heart of their global expansion strategies.' A large international cellular operator is almost certainly on the way in, he added.

Many observers are convinced that the real joker in the pack of the Russian economy is the internet. Brunswick Warburg estimates that the new technology sector generated revenues of nearly \$2.5 billion in 1999. IT and internet analyst Alexander Andreev said value will migrate rapidly from hardware and access to software, services and online business. He forecasts internet penetration increasing to 10.5%, or 15.1 million users, by 2003, with e-commerce turnover of \$5.2 billion and advertising revenues of \$59 million by that time.

Andreev said: 'There is private venture capital everywhere, and about \$100 million has already been invested into the 'new economy'. But things are at an early stage. It is as yet unclear whether the internet will develop along US lines, with start-ups modelled on Yahoo! and Amazon, or on the European model, with existing media companies taking a predominant role. And there is no cash flow yet: debt financing will only come after that.'

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