

Desknote

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Truth and Beauty... (and Russian Finance)

Rosneft-Olma: Wounded Goliath Demands Damages!

First they came for the Jews, but we said nothing, because we were not Jewish. Then they came for the Socialists, but again, we said nothing, because we were not Socialist. Now, they are coming for us, and there is no one left to say anything...

Frankfurt, 1937

My, what a healthy appetite our local vampires have! We have just learnt from a *Vedomosti* article that Rosneft has increased its estimate of damages in the lawsuit it has filed against Russian brokerage Olma to an incredible \$26.8M.

Truth and Beauty first discussed this issue on October 10, and having heard nothing more about it, assumed that the troglodytic oil major had gone back to quietly "squeezing value" from its majority stakes in publicly-traded companies. Not at all! Rosneft, the last remaining state-owned Russian oil major with, among other things, an 81% stake in Purneftegaz, 63% of Sakhalinmorneftegaz, and large pieces of several fairly dodgy smaller deals, is seeking to bankrupt niche player Olma for the crime of having posted a \$1.253bn estimate of Rosneft's valuation on its website. Apparently, Rosneft thinks it is worth much more, and that its value plunged solely due to Olma's unfavorable posting...

But wait, it gets better! Rosneft managed to find a Russian assessor, EkonInvestOtsenka, who estimated damages not on the basis of company fundamentals, but rather, by extrapolating the upward trend in Rosneft daughter company Purneftegaz for an undetermined period, which was then applied to the share price between April 4 (the day their research went online) and May 15, when Rosneft President Bogdanchikov sat down with Vladimir Putin. The defendant replied that, using the same approach and continuing the extrapolation until the present, Rosneft's value should be nearing **\$1 trillion**, rich even by current market standards!

Indeed, although Sakhalin has been going nowhere since 1999, there was recently a substantial rally in Purneftegaz: while of course, we have no proof, market rumor has it that this rally was driven by buying by corporate insiders...if this is true, then they shouldn't be suing Olma, they should pay them a commission!¹

The absurdity of it all! Rosneft is nothing if not controversial. Its relations with its daughter companies are widely seen as being frankly "incestuous;" investors in some of these subsidiaries frequently express anger and dismay at finding themselves on the receiving end of some very unwelcome thrusts by Daddy. Purneftegaz is believed to have suffered from unfavorable transfer pricing in its oil sales, while Sakhalinmorneftegaz gets paid a fair price for oil, but has seen some of its best assets transferred to Rosneft, then leased back to it. What, exactly, Sakhalin owns is open to discussion. Thus, over the past few years, despite the fact that Sakhalin sits atop very rich reserves, its share price has declined, underperforming the market by 53% since January 2000 (RTS +88.3%, Sakhalin Ords -12%). Sakhalin Ords (but, uniquely, not its Prefs) have been excluded from the calculation of the RTS Index; we currently rate Sakhalin Prefs "a buy" given their rich dividend yield; the Ords are NWBP², until such time as there is a change in management strategy.

If Rosneft actually gave a tinker's damn about either its reputation or its market cap, it could start by explaining its relations with its subsidiaries, pricing and ownership structures, etc. This, not a website posting by a small brokerage, is what has been holding its price down. Taking Rosneft's logic a bit further, we note that, two years ago, T&B wrote some very unflattering things about valuation of the European mobile telephone sector, the valuation of which subsequently plunged by over \$250 bn. We await the first lawsuits with trepidation.

Journalists following the suit inform us that the court does not appear to understand the issues of equity valuation, and the judge's objectivity should not be taken for granted; a very dangerous precedent may be about to be established. Estimating the value of Russian companies almost invariably requires the analyst make a series of subjective assumptions: quality of corporate governance, transparency, utilization of treasury stock, dividend payout, insider interest, etc. etc. Change any one of the assumptions and one gets massive swings in value. No one seems to know how to value UES, while Surgut has been variously valued at between \$20bn and zero! How much more so than the subsidiaries of a state-controlled oil company managed by the former president of one of these same subsidiaries (and whom, by the way, is widely believed to still own a controlling interest in the said subsidiary).

T&B is certainly not given to talking up our competition, indeed, we derive endless pleasure in picking holes in the wonderfully clueless scribbings of a few of our peers. The Olma-Rosneft story is, however, of vital importance to the entire community, and everyone (sell-side analysts, journalists – and, yes, you, Mr. Investor) had damn well better feel concerned!

The local analysts have proved a fairly rambunctious bunch, and tilting at dragons has become something of a local sport. Although some years back we ourselves ran into a spot of difficulty after bating one major oil company, their management confined itself to phoning ours – no one thought to sue! If Rosneft prevails in court, analysts will suddenly live in fear of bringing down hugely expensive lawsuits upon their firms whenever they have something unflattering to say! Coverage will be reminiscent of Wall Street telecoms "research" of the boom years, leaving analysts the option of rating Russian companies on a scale of "*Strong Buy*", "*Screaming Buy*" or "*Your Grandchildren will bless you!*" Meanwhile, we strategists shall regale our readers with tales of Abramovich's selfless beneficence as Chukotka governor, Potanin's major contribution to the world of high culture as a Guggenheim board member (!), and yes, Bogdanov's commitment to maximizing Surgut shareholder value! "Lies and Ugly", anyone?

P.S. For anyone wishing to gain a first-hand look at the workings of Russian justice, the hearing will take place before the Moscow Arbitrage Court, Novaya Basmanaya 10, Krasnaya Vorota Metro Station, starting Wednesday 19 February at 15:00.

¹ An alternative version, perhaps not mutually exclusive, is that Purneftegaz is being bought in front of an upcoming Rosneft privatization
² Not With a Barge Pole!