



NK Alliance, RAZGULAY, UNIMILK, MOESK

NK Alliance

Placement date

Wednesday, 20 September, 2006

Issue parameters

Size – RBL3bn, semi-annual coupons, term to bullet maturity – five years, 3-year put option. Overall, initially NK Alliance will be priced as a three-year bond.

Profile

NK Alliance is an oil products trader operating mainly in Russia's Far East and in Ukraine. Basically, the company buys oil from major oil producers, refines it at its refineries and then sells the products both wholesale and through its own chain of gas stations. Approximately 40% of NK Alliance's products go for export, while the rest is sold domestically.

The main assets of NK Alliance are Khabarovsk (located in Russia, 57% stake) and Kherson (Ukraine, 28% stake) oil refineries, out of which Khabarovsk refinery is currently working, while Kherson plant is shut down until 2010 for complete reconstruction. Therefore, currently Alliance's business in Ukraine is pure gasoline retail trade.

The main problem of NK Alliance is the effectiveness of its refineries, which were built deeply in the Soviet era, so the degree of oil processing at them is quite low even by the Russian standards (Nelson complexity index of around 1.5 compared to Russian average 4.3). This means that the products of both refineries include a large portion of low fractions (mazut), which are in excess domestically and have to be exported with relatively small added value.

As a result, the main strategic goal of NK Alliance is to perform a reconstruction of both of its refineries in order to significantly increase the share of gasoline and diesel oil (high fractions) in their product. The works at Khabarovsk refinery are being conducted with the plant working, while Kherson refinery was, as mentioned above, shut down in August 2005.

The market share of Khabarovsk refinery in the total Russian oil refining is 1.5%.

Besides refining and trade, NK Alliance owns licenses for oil extraction at three relatively small oilfields located in Tatarstan and Kazakhstan. In the end of 2005, own oil production provided 5% of all oil refined at Alliance's refineries.

Net revenue of NK Alliance totaled USD1.6b in 2005.

Ownership structure

The end beneficiaries of NK Alliance are several individuals, almost all of them – members of the well-known Bazhaev family.

Main oil suppliers

The main raw oil supplier to Alliance is Surgutneftegaz, accounting for more than 50% of total Alliance's external purchases. Following are Vanieganneft (19% share), TNK-BP (7%), Lukoil (6%).

The oil is transported via Transneft pipelines to the local station Meget, from where it reaches Khabarovsk by rail.

Purpose of the new issue

The funds from the new bond (~USD110m) will be used to refinance existing bridge loans obtained from Raiffeisen and Gazprombank before the placement. The bridge funds were raised by NK Alliance to finance its capital expenditures.

Financials

NK Alliance reports its consolidated financials according to IFRS, audited by Deloitte&Touche. The latest available report is for the year 2005.

NK Alliance '11	
Placement date	20 Sep 2006
Issuer	OAO NK Alliance
Guarantors	OAO Khabarovsky Neft. Zavod
Issue Amount	Rub 3b (~USD 112m)
Coupon	semi-annual
Put option	3 years at 100%
Maturity	5 years
Lead-manager	Gazprombank, Raiffeisen Bank


Income statement

Net sales USD1.6b (+33.9% to 2004).

EBITDA USD126.3m (up 82.7% from 2004). EBITDA margin 7.9% compared to 5.8% in 2004.

The margins of NK Alliance are highly correlated with the differential between the petrol price and the domestic price of raw oil. In 2004 Transneft significantly increased the capacity of its export pipelines, which allowed Russian oil majors to export more oil and thus created raw oil deficit domestically, driving the local price of oil up. As a result, EBITDA margin of NK Alliance was relatively low in 2004. For 2006-2008 the company is forecasting that its margin will stabilize at around 8-9%.

Net margin: 3.8% in 2005 and 2.7% in 2004.

Key financials of NK Alliance

Reported items (USDm)	2004	2005	Ratios (x)	2004	2005
Sales	1195.2	1598.9	Gross Mgn	11.8%	14.0%
GP	141.2	223.9	EBITDA Mgn	5.8%	7.9%
EBITDA	69.2	126.3	EBIT Mgn	4.2%	6.2%
EBIT	50.8	99.7	Net Mgn	2.7%	3.8%
NI	32.2	60.2			
			Debt/EBITDA	2.18	2.04
Assets	661.2	874.9	Debt/EBIT	2.96	2.59
Fixed Assets	304.0	438.0			
			NetDebt/EBITDA	1.91	1.59
ST Debt	150.5	207.1	NetDebt/EBIT	2.60	2.01
LT Debt	0.0	51.0			
			EBITDA/Interest	4.0	6.5
Debt	150.5	258.1	EBIT/Interest	2.9	5.2
Equity	264.9	325.1			
			Debt/Capital	0.36	0.44
CFO	6.0	66.5	Debt/Assets	0.23	0.29
CFI	-38.5	-127.5			
CFF	25.7	100.7	ST Debt/Debt	100.0%	80.3%
CapEx	40.9	137.2	ROC	12.2%	16.0%
Depreciation	18.4	26.6	ROA	4.9%	6.9%
			ROE	12.2%	18.5%
FCFE	-32.6	-61.0			
FCFF	-20.2	-46.7	Current Ratio	1.28	1.21
			Quick Ratio	0.28	0.37

Source: Company

Cash flows

NK Alliance was free cash-flow negative both in 2004 (USD-32.6m) and 2005 (USD-61m). We believe that the company is very likely to remain cash-flow negative in 2006-2008 due to high investments required for the reconstruction of its refineries.

Assets

Total book value of assets USD875m in 2005 (up 32.3% to 2004). Fixed assets constitute around 50% of total assets. USD57m was held as cash in the end of 2005.

Debt

Total borrowings – USD258m, up 107.6m from 2004.

Debt/EBITDA ratio 2.04, down from 2.18 in 2004 due to significant EBITDA growth in 2005. Debt/Assets 29% (23% in 2004).

The borrowings of NK Alliance are currently entirely bank loans from large banks, like Gazprombank, Raiffeisen, Sberbank, BNP Paribas, Alfa-Bank, Rosbank. The loans are usually collateralized with fixed assets or oil reserves of the company.



Liquidity

Short-term debt occupied 80.3% of total debt in 2005. Such a large reliance on short-term financing can be logically explained by the nature of the company business: bank loans are mainly required to finance prepayments for raw oil, and these transactions are always short-term.

On the other hand, now the investment programme of NK Alliance demands long-term resources, so the current 5-year bond directly suits this purpose.

Current ratio in 2005 – 1.21 compared to 1.28 in 2004.

Overall, we believe that the liquidity situation of NK Alliance is adequate to the company's business and does not raise any specific concerns.

Plans for the future

The works at two main refineries will cost NK Alliance about USD1b in capital expenditures spread over the years 2006-2010. This programme will be financed using approximately USD200m of new debt (excluding the bond), retained earnings and IPO funds.

The IPO of NK Alliance is likely to take place in the end of 2006 – beginning of 2007, and its parameters will entirely depend on the precise calculation of the investments required for the reconstruction of Kherson refinery.

USD200m of debt is planned to be raised in a form of a syndicated loan from banks. The 2/8 ratio between debt and equity financing appears to be quite healthy, as currently the Debt/Equity ratio of NK Alliance is close to 0.8.

Regarding own oil extraction, the company is planning to gradually increase the oil production at its oilfields in order for them to be able to provide about 50% of raw oil for Alliance's refineries in 2008.

Market peers

The most natural peer of NK Alliance on the rouble bond market is Russneft, which placed its debut bond in December 2005.

Russneft is larger in scale than NK Alliance (sales in 2005 – about USD2.5b), but has a significantly larger leverage (Debt/EBIT ratio of 7.1 in 2005 compared to 2.6 of Alliance). Having relatively large oil production, Russneft is more profitable than NK Alliance, and based on the high financial leverage – more dynamically growing.

Our view for the credit of NK Alliance

Positive features:

- Oil sector
- Low leverage by the standards of the Russian economy
- Audited IFRS reporting
- Clear and transparent business model, no side businesses
- Expected IPO likely to attract additional investors' interest and make the company even more responsible
- Proximity of Khabarovsk refinery to China with its almost unlimited future demand for petrol

Negative features:

- The company is investing in the stopped Kherson refinery (likely to resume operations in 2010)
- Impressive investment programme requires about USD1b of resources – the future leverage will depend significantly on the timing and success of the planned IPO
- The most capital-intensive project (Kherson refinery – USD600m) is located in Ukraine with its internal political risks, plus NK Alliance does not have a controlling stake in the plant
- A very small share of own oil production (expected to be amended by 2009)
- No ratings from rating agencies.

Overall, NK Alliance appears to be a transparent company with a clear business model, currently running a relatively low leverage. The large investment programme questions the low leverage in the future, but IPO plans are likely to help settle this problem.



Pricing NK Alliance

Russneft is currently trading at 8.8% to put in 28 months, 285bp above the OFZ curve.

We believe that in spite of the lower leverage, NK Alliance will not be able to place its bond at a discount to Russneft. A premium is necessary for the debut nature of the issue and for the primary placement. As a result, we would regard credit spread 300-315 to be fair for NK Alliance at the upcoming auction.

3-yea OFZs are currently located at 6.10, so the fair YTP value of NK Alliance should lie in the range of 9.1-9.25%.

Summary

We believe that the upcoming placement is a very rare opportunity for investors to obtain credit exposure in the oil sector with a 9%-figure yield, approx. 300bp above Lukoil and Gazprom.

NK Alliance has relatively little debt, reports its results according to IFRS, so with the planned IPO the YTP of the paper should be expected to notably decline, probably to the level of 8.5% (provided the long-term interest rate base remains unchanged), bringing investors significant speculative profit.

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Razgulay

Expected auction date

Friday, 22 September, 2006

Issue parameters

Size – RBL2b, semi-annual coupons, term to bullet maturity – five years. Initially the bond will be trading to 18-24 put option.

Ratings

The issuer is unrated by international rating agencies.

General description

Razgulay, established in 1992, is one of the largest integrated agroindustrial holdings in Russia and top 5 globally. It rates number one in grain and rice production and is a top 3 in sugar with 11% Russian market share. Since 2003 when government program for support for the national agriculture industry emerged, Razgulay started consolidation of production facilities for grain and sugar processing. Within grain division Razgulay is expanding it's own rice harvesting to take advantage of the deficits of supply in the market. Acquisition of Slavyansky KHP in 2006 will boost company's market share to 70% from 38%. Due to low capacity utilisation of both sugar and grain production facilities Razgulay has significant potential to increase output at low cost. Company plans to increase export via brand new Azov sea port elevator launched in 2004 with annual capacity of 1.5 m tons to achieve 10% share of total Russian export. Expansion of own sugarbeet harvesting is also driven by government support of the sector which makes margins on beet sugar processing highly attractive. Razgulay operates a strong asset base including 14 grain elevators, 5 groats facilities, 13 sugar processing plants and 6 flour mills. Obviously, company's focus is on higher margin segments and efficiency.

Government support

Government support for the national producers include subsidies to compensate for the interest paid on debt, protection from foreign goods through imposition of import tariffs, corporate income tax benefits and government interventions on

Razgulay '11	
Placement date	22 Sep 2006
Issuer	OOO Razgulay-Finance
Guarantors	ZAO Zernovaya Kompaniya Razgulay, ZAO Sakharnaya Kompaniya Razgulay
Issue Amount	Rub 2b (~USD 74m)
Coupon	semi-annual
Put option	1,5 or 2 years
Maturity	5 years
Lead-manager	Bank of Moscow



the wheat market to eliminate price volatility. As a number one participant in the government interventions program, Razgulay benefits during periods of low prices, as the spare elevator capacity is used to store government wheat reserve.

Import tariffs on raw sugar allow to sustain 30% EBITDA margin on the beet sugar production.

Upcoming WTO membership is likely to force the Government to cease to protect national producers. Management feels confident there will be a gradual transition and if the industry experiences significant pricing pressure antidumping actions will be taken.

Ownership structure

Razgulay is a public company with 28.3% free float, including 6.24% Deutsche Bank stake with the rest 71.7% controlled by the president of the Group Mr. Potapenko.

Financials

Razgulay has 6 year reporting history in accordance with International Accounting Standards.

2005 was a big year for acquisitions. Together with revaluation of plant, property and equipment it increased total assets from US\$386 to US\$703 up 82%.

Income statement

Razgulay is subject to seasonality with about 2/3 of Sales coming in the 2nd half of the year.

Net sales in 2005 amounted to US\$687m up 8% compared to 2004, with US\$388m attributable to grain and US\$299 – to sugar division.

Grain and sugar divisions contributed 2/3 and 1/3 of EBITDA respectively with margin at 13.1% up from 9.7% in 2004. Most profitable were groats and beet sugar production yielding 22% and 21% respectively. Protective import tariffs result in raw sugar processing and trading margins just above breakeven level. Razgulay's strategy is to gradually decrease raw while increasing beet sugar production, which can earn as much as 30% EBITDA margin.

Net income margin – 7% in 2005.

Debt

Borrowings – US\$177m as of 1H 2005 (+108% to 2004).

60% of borrowings are short-term. Current ratio – 1.42.

Debt/Assets – 25% (22% in 2004).

Debt/EBITDA – 1.97 as of 2005, up from 1.37 in 2004.

EBITDA/Interest – 3.5 down from 8.56 in 2004.

CAPEX

Capital expenditure over the next 3 to 5 years is likely to be significant. Razgulay needs both to finance expansion in own harvesting of rice and sugarbeet which may require up to US\$120 and US\$200-250 respectively as estimated by the management and renovations of its numerous processing facilities. Management doesn't have precise understanding about the scale of renovation expenses.



Purpose of the new issue

The proceeds from the bond placement (US\$75m) will be used in full to refinance existing debt.

Market peers

Quite a few agroindustrial companies have issued bonds on the rouble market. The closest peer of Razgulay is RusAgro trading at 11.90 to 6 month put. Though Rusagro reported slightly higher margins and lower debt in 2004 which is the latest reporting period available, we prefer Razgulay with 6 years of audited IAS reporting, successful IPO earlier this year and strong financials, that is worth 50 to 70 bp discount to Rusagro bonds.

Pricing Razgulay

Razgulay is no stranger to both the rouble and Eurobond market. Rouble issue Razgulay-2 is trading to 5 month put at 11.38%. We consider that 11.8-12.1% to put is a good compensation for the risk associated with the new Razgulay bond, with the company borrowing appetite unclear to the management itself, as they state they feel comfortable with Debt/EBITDA surging to 3.5 or even 5.

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Unimilk

Placement date

Tuesday, 12 September, 2006

Issue parameters

Size – RBL2bn, semi-annual coupons, term to bullet maturity – five years. Initially the bond will be traded to 3-year put option.

Profile

Unimilk is the second largest (after WBD) milk and dairy products manufacturer in Russia and Ukraine, with market shares of 8% and 12% correspondingly. The total milk products sold by Unimilk in 2005 amounted to 629 thousands ton. Since 2006 Unimilk unites 25 companies, operating in Russia and Ukraine. Net sales amounted to USD458m in 2005.

Main products

- Milk and sour milk products
- Sour cream
- Cream
- Yoghurt-dessert group

Ownership structure

The only shareholder – Unimilk Enterprises Limited – 100%. The actual owner of the shares is Unimilk management.

Ratings

Unimilk is unrated by international rating agencies.

Purpose of the new issue

The funds from the new bond (~USD75m) will be used for the short-term debt refinancing (40%), the other part (60%) – used for capex financing.

Financials

Unimilk prepares financials according IFRS. Last audited (KPMG) financials available – 2005, IFRS financials for 6M2006 are being currently audited by KPMG.

Unimilk '11	
Placement date	12 Sep 2006
Issuer	OOO UNIMILK-Finance
Guarantors	OAO UNIMILK Company
Issue Amount	Rub 2b (~USD 74m)
Coupon	semi-annual
Put option	3 years at 100%
Maturity	5 years
Lead-manager	Raiffeisen Bank



2005 IFRS financials include consolidated results of 12 companies. 6M2006 IFRS draft financials include operations of 25 companies which is due to new companies bought by Unimilk in 2006.

(IFRS)	6M2005	2005	6M2006
Revenue	200	458	386
EBIT	6.3	7.7	10.0
EBITDA	14.4	27.7	25.6
Assets	298	329	641
Equity	66	40	202
Debt	176	211	317
EBIT Margin	3.2%	1.7%	2.6%
EBITDA Margin	7.2%	5.9%	6.6%
Current ratio	1.0	1.0	0.7
STDebt/Debt	38.9%	46.7%	60.0%
Debt/Capital	72.6%	78.3%	61.1%
Debt/Assets	59.0%	64.0%	49.5%
Debt/EBITDA	5.9	7.7	6.1
Debt/EBIT	13.5	27.4	15.7
EBITDA/Interest	1.5	1.6	3.3
EBIT/Interest	0.7	0.5	1.3

Source: Company

USDm	Unimilk (IFRS)	WBD (IFRS)	Apteki 36.6 (IFRS)	Cherkizovo (US GAAP)
Revenue	458	1 399	305	546
EBIT	7.7	87.5	13.3	42.0
EBITDA	27.7	140.9	21.7	62.5
Assets	329	921	245	424
Equity	40	412	63	77
Debt	211	279	110	232
EBIT Margin	1.7%	6.3%	4.3%	7.7%
EBITDA Margin	5.9%	10.1%	7.1%	11.4%
Current ratio	1.0	2.0	1.3	0.8
STDebt/Debt	46.7%	8.4%	25.3%	39.5%
Debt/Capital	78.3%	40.4%	63.5%	75.0%
Debt/Assets	64.0%	30.4%	44.9%	54.7%
Debt/EBITDA	7.7	2.0	5.1	3.7
Debt/EBIT	27.4	3.2	8.3	5.5
EBITDA/Interest	1.6	6.2	1.4	4.0
EBIT/Interest	0.5	3.8	0.9	2.7

Source: Companies

Income statement

Net sales totaled USD458m in 2005 and USD386 in 6M2006 – almost a two-fold increase vs. 6M2005 figure. Rapid sales growth is related to the purchase of new companies and bears immediate impact on the Unimilk output.

EBITDA for 6M2006 amounted USD26m and nearly reached 2005 level. The substantial increase of EBITDA in 6M2006 is caused by revenue growth of existing Unimilk companies due to rise in prices for the company products.

Constant net loss, demonstrated by Unimilk over last years, eventually turned into net income and amounted to USD0.33m in 6M2006. EBITDA margin was 6.6% in 6M2006 up from 5.9% in 2005 and lower than 7.2% in 6M2005.

Unimilk margins are almost twice lower as compared to the leader of the dairy market – WBD and inferior to the average level by the consumer goods sector.

Assets

Unimilk demonstrated significant growth of assets for the last 6 months, thanks to big acquisitions in 2006. According to the company, the assets of purchased companies are already included into Unimilk draft financials for 6M2006.

USD641m of total assets in 6M2006 (+191% to 2005), USD10m in cash.

Borrowings

Total borrowings: USD317m in 6M2006 compared to USD211m in 2005. According to Unimilk, 2006 is going to be the peak of leverage, the company plans considerable debt reduction next year. Nevertheless, according to our estimates, the Debt/EBITDA ratio is unlikely to sink below 6.0X-7.0X by the end of the year.

Debt/EBITDA ratio – 6.1X in 6M2006, down from 7.7X in 2005, but still at the extremely high level. Debt/Assets – 49.5% (lowest level since 2004). As a negative feature we note the growing part of short-term debt in total borrowings.

Liquidity

Current ratio – 0.75 in 6M2006 compared to 0.98 in 2005, reflecting growing short-term liabilities. The funds from the placement will help Unimilk solve liquidity problems.

Cash flows

Unimilk CFO in 6M2006 (USD22m) surpassed 2005 value (USD15m), at the same time Free Cash Flow remains negative: investments, including assets and affiliated companies acquisition totaled USD163m in 6M2006, bringing negative FCF up – from USD-9m in 2005 to USD-18m in 6M2006.

Such a dramatic increase in negative FCF is connected with the wide investment program, focused on acquisitions this year. We expect a gradual reduction of negative FOCF in the future.



Company plans

Unimilk has very ambitious plans for the future, including significant increase of the market share, margins and Debt/EBITDA improvement. Long-term goal of Unimilk is to become #1 company on the Russian dairy market.

Although catching up with WBD looks unrealistic, acquisitions of new companies in 2006 have already boosted Unimilk revenue and may strengthen company position on the market by the end of 2006.

Company credit

Positive features:

- Stable revenue growth, positive dynamics of EBITDA and reduction of Debt/EBITDA ratio
- Prospects of substantial market growth due to large acquisitions

Negative features:

- High dependence on the raw milk prices
- Extremely high leverage and low EBITDA margin
- Negative FCF

In our view, Unimilk is currently standing at the crossroads and awaiting for the results from recent developments. There is a clear positive trend, concerning growing net revenue and EBITDA, however, the leverage of Unimilk remains steep and is unlikely to decline in the nearest future.

Pricing Unimilk

The lead managers of the issue are marketing Unimilk with a YTP for 3 years at the level 9.99%. This point gives almost 200bp premium to the corresponding point of WBD issue, trading at YTM 8.21% for 52 months. We believe that such premium is justified because of considerably weaker credit profile of Unimilk in comparison to WBD and required premium for debut placement of Unimilk bond.

Another close pier on the ruble market is Apteki36.6'09, the ruble issue of the largest Russian drugstore chain, currently trading at 10.16 for 22 months. According to the audited 2006 IFRS financials 36.6 had slightly better EBITDA margin and Debt/EBITDA ratio than Unimilk, however, the Apteki financials for 6M2006 show weaker results in comparison to Unimilk. Besides, unlike Unimilk, Apteki has demonstrated downtrend in the credit quality up to now.

Cherkizovo, possessing much stronger credit quality in comparison to Unimilk, offers 9.05% for 27 months. We believe that Unimilk must be placed with premium of at least 100bp to Cherkizovo implying Unimilk YTP 10.05%.

We estimate the fair level of Unimilk to be in the range 10.0%-10.2% and believe that rapid EBITDA growth will help the company to decrease leverage in the future and bring Unimilk margins higher. Still, as the current Unimilk results demand substantial premium to WBD and Cherkizovo issues, we don't see immediate upside if the issue is placed below 10%.

Our view for the placement – neutral

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MOESK

Placement date

Tuesday, 12 September, 2006

Issue parameters

Size – RBL6.0bn, semi-annual coupons, term to bullet maturity – five years.

Profile

AO MOESK (Moscow Regional Power Grid Company) – is the largest Russian regional electric power company. MOESK was established in Apr 2005 on the basis of Mosenergo subsidiaries, located in Moscow and Moscow Region. Net revenue of MOESK in 2005 amounts to US\$666m.

The company core business lines are electric power transmission and connection of new customers. MOESK provides approximately 92% of the energy distributed in Moscow region. The company is a natural state-controlled monopoly and that's why the tariffs for services for electrical transmission are subject to state regulation.

Main assets of MOESK:

MOESK '11	
Placement date	12 Sep 2006
Issuer	AO MOESK
Guarantors	OOO Promtekhnik
Issue Amount	Rub 6b (~USD 222m)
Coupon	semi-annual
Maturity	5 years
Lead-manager	Vneshtorgbank, Alfa-Bank



- 14 power grid companies, transmitting electric energy and providing services for medium voltage systems, cable buses, transformer and distribution substations
- 3 maintenance & service companies

Ownership structure

50.9% of MOESK stock belongs to state-owned RAO UES, 30% owned by Gazprombank, 7.5% – Moscow Government.

Ratings

MOESK is unrated by international rating agencies.

Purpose of the new issue

The bond funds (~USD224.3m) will be used solely for investment program financing.

Available financials

MOESK prepares only unaudited financials according RAS. Available financials are for 2005 and 6M2006. As the company was founded in Apr 2005, the results for 2005 contain MOESK operations for 9 months.

Income statement

Net revenue totaled US\$419m in 6M2006, almost surpassing 2005 level. As the company doesn't prepare IFRS financials and doesn't provide depreciation figures, we cannot calculate EBITDA value and use only EBIT instead.

MOESK Key Financial Figures, USDm			
(RAS)	2005	3M2006	6M2006
Revenue	433	231	419
EBIT	68.5	83.1	134.7
EBITDA	-	-	-
Assets	1 124	1 218	1 374
Equity	943	1 038	1 075
Debt	57	47	132
EBIT Margin	15.8%	36.0%	32.2%
EBITDA Margin	-	-	-
Current ratio	0.9	1.2	1.1
STDebt/Debt	91.7%	89.2%	96.2%
Debt/Capital	5.7%	4.3%	10.9%
Debt/Assets	5.1%	3.9%	9.6%
Debt/EBITDA	-	-	-
Debt/EBIT	0.8	0.1	0.5
EBITDA/Interest	-	-	-
EBIT/Interest	22.5	88.4	45.5

Source: Company

MOESK Relative to its Peers in 2005		
USDm	MOESK (RAS)	FSK UES (IFRS)
Revenue	433	1 088
EBIT	68.5	360.1
EBITDA	-	619.7
Assets	1 124	5 945
Equity	943	4 795
Debt	57	705
EBIT Margin	15.8%	33.1%
EBITDA Margin	-	56.9%
Current ratio	0.9	1.5
STDebt/Debt	91.7%	4.2%
Debt/Capital	5.7%	12.8%
Debt/Assets	5.1%	11.9%
Debt/EBITDA	-	1.2
Debt/EBIT	0.8	2.0
EBITDA/Interest	-	23.1
EBIT/Interest	22.5	13.4

Source: Companies

The company generated US\$135m of EBIT in 6M2006 vs. USD65m in 2005, which was due to seasonal growth of demand for energy and the absence of repair works. As a result, EBIT margin was higher in 6M2006 – 32.2% vs. 15.8% in 2005.

Assets

Total assets increased from US\$1.1bn in 2005 to US\$1.3bn in 6M2006.

Borrowings

Total company debt increased from just USD57m in 2005 to USD132m in 6M2006 but is still at the very low level – with Debt/Assets ratio at mere 9.6%. Debt/EBITDA ratio fell from 0.85X in 2005 to 0.48X in 6M2006. We note MOESK leverage as the lowest in the energy industry.

Liquidity

The current ratio in 6M2006 was up to 1.09 vs. 0.89 in 2005, the bond placement will generate cash inflows for the company and will improve MOESK liquidity.

**Plans for the future**

As the most assets of MOESK are close to the critical age, replacement of the obsolete equipment is a key point in the company investment program, which also includes construction of new facilities. The total capex for 2006-2009 is planned at the level USD5.4bn. According to MOESK, investment program will be financed mostly via own funds, however the company is planning further borrowing on the ruble bond market (USD1bn).

Our view for the credit

Positive credit factors:

- State-controlled monopoly
- Very low leverage
- Excellent credit profile

Negative factors:

- Inability to influence tariffs due to state regulation
- Wide investment program means higher leverage in the future and consequently worse Debt/EBITDA ratio
- Absence of IFRS financials

Market peers

The only company, operating in the same area and present on the ruble bond market is FGC UES (Federal Grid Company). FGC UES is rated B+ by S&P and Baa2(P) by Moody's. According to FGC audited IFRS financials net sales totaled USD1.088bn in 2005. The company operations bear significantly higher margins with EBIT and EBITDA margin at 33.1% and 56.9% correspondingly. The only distinct disadvantage of FGC is higher leverage in comparison to MOESK. Debt/EBTDA amounted to 1.16 and, as the FGC has huge investment plans for the next years, we expect further substantial growth of FGC leverage.

Summarizing all these factors we can estimate MOESK credit quality as inferior to FGC UES.

Pricing

The fair level of MOESK YTM for 5 years should be higher than that of the currently outstanding FGC UES-2. The premium, in our view, should equal 70bp and compensate for:

- absence of credit rating and audited IFRS financials
- premium for debut ruble bond issue
- weaker margins of MOESK

We estimate MOESK fair yield to be in the range 7.90%-8.10% and find the issue quite attractive at this level and higher. Moreover, unlike FGC UES case, the demand for the paper will be limited due to poorer information disclosure and, thus, investors can count on sufficient premium during the primary placement.

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