



Analyst's Notebook

Ukraine / Electricity
 September 14, 2006

A New Round of Energy Privatization?

The State Property Fund has prepared a draft decree on partial privatization of Ukrainian energy companies (generators and distributors) in order to meet the planned contribution from privatization to the 2006 budget. The draft plan, which requires approval from the Cabinet, involves selling state stakes in state-controlled energy companies down to 60%, and some minority state stakes in energy companies down to 40% or 25%. The plan would allow the state to retain to preserve control, or in some cases to preserve its current level of influence as a minority shareholder, while also potentially significantly increasing the liquidity of energy stocks.

Stakes for sale: Generation Companies

Company	State's stake	Proposed stake for sale	State's stake to be left after sale
CEEN	78.29%	18.29%	60.0%
DNEN	76.04%	16.04%	60.0%
DOEN	85.77%	25.77%	60.0%
ZAEN	70.10%	10.10%	60.0%

Stakes for sale: Distribution Companies

Company	State's stake	Proposed stake for sale	State's stake to be left after sale
CHEN	70.00%	10.00%	60.0%
CHON	46.00%	6.00%	40.0%
DNON	75.00%	15.00%	60.0%
DOON	65.06%	5.06%	60.0%
HAON	65.00%	5.00%	60.0%
HMON	70.01%	10.01%	60.0%
KREN	70.00%	10.00%	60.0%
LOEN	60.06%	0.06%	60.0%
LVON	26.98%	1.98%	25.0%
MYON	70.00%	10.00%	60.0%
ODEN	25.01%	0.01%	25.0%
PREN	25.02%	0.02%	25.0%
TOEN	61.00%	1.00%	60.0%
VIEN	75.00%	15.00%	60.0%
VOEN	75.00%	15.00%	60.0%
ZAON	60.25%	0.25%	60.0%
ZOEN	75.00%	15.00%	60.0%

Privatization, Socialist Style

By decreasing state stakes in companies to some key threshold value (either 60%, which ensures the ability to hold shareholders meetings and approve most important decisions; or 40%, which ensures the ability to block shareholders meetings; or 25%+1 share, which ensures the ability to veto the most crucial decisions such as share issues). In this way, SPF chairwoman Valentina Semenyuk, who is also one of the leaders of the Socialist Party, has found a way to compromise between the seemingly opposite agendas of her two positions.

More Liquidity, or a Crony Asset Grab?

A new wave of energy sector privatization would be an important test of the new government's transparency. Clearly, System Capital Management, which has placed its former managers in all the key positions controlling the sector, would be tempted to buy most of the offered energy assets for its energy holding DFEC. If the tender rules are fair and transparent, with no preferences to particular business groups, it would demonstrate that the new government is ready to work transparently with potential investors.

How Much Can the State Earn?

The total par value of the proposed shares is USD 45.8 mln, according to the SPF. We estimate the total fair value of the proposed stakes, based on the value of companies for minority shareholders, at USD 70 mln for Oblenergos and USD 230 mln for GenCos. If the government and SPF manage to sell these stakes in 2006, they could almost fill the USD 390 mln gap between the 2006 privatization plan and 7m06 privatization results.

Is it the Right Time to Sell?

Selling down the state stakes sounds good in principle, as the companies need large investments to upgrade their generation capacities. Selling small stakes in these companies could be considered as a step preparing them for full privatization.

However, we do not think this is the best time to sell energy distribution companies from the standpoint of maximizing the state's income. The current regulatory environment and risks related to high indebtedness decrease the values of Oblenergos from the point of view of international investors, and give an advantage to groups, especially SCM, who have a better idea how the regulations will change in the near future. We expect changes in tariff policy and the resolution of debts by mid 2007 to significantly increase Oblenergos' value.

If the SPF wanted to maximize revenues, there are other ways it could do that such as by selling blocking stakes (25% to 27%) in five companies where two main private shareholder groups are in conflict. By our estimates (see our Oblenergo report of Dec. 15, 2005), such sales could bring in twice as much revenues as selling small stakes in Oblenergos as proposed by the SPF.

Will Energy Stock Prices Increase?

Ukrainian energy stocks have been increasing in value since the start of this year, due to the gas price hike and the growing importance of electricity in Ukraine's energy balance. If the SPF's plan is implemented and the sales are conducted fairly and transparently, more energy companies will become liquid enough to attract interest and we will see a second wave of growth in energy stock prices.

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