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Placement of Russian Energy Companies' IPO on NYSE Euronext and NASDAQ Opens Up New Opportunities

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By Anna Brown

During the past three years a number of major Russian market players moved to list their shares on the foreign stock exchanges. According to RosBusinessConsulting's statistics, in 2007, Russian public companies raised more capital than the companies of any other European country. The Russian IPO boom had a tremendous influence on the world's economy and greatly improved Russia's business climate. For those Russian IPO pioneers, the decision to go public became an important strategic tool to attract investment and to find new business partners while the process of preparing for IPO improved business reputation and guided the transition to the new level of corporate governance.

Raising capital is the main reason to go public

The initial public offering means offering shares of stock for public trading for the first time. The stock is listed on a public stock exchange so that private investors can freely buy and sell it. The funds generated from the initial sales go directly to the company instead of passing between the investors, as it happens with already established public companies. Thus, the issuer raises capital for expansion of its operations without incurring any debt or expending resources on seeking individual investors and business partners. There is no strict obligation on the company to reimburse the new shareholders with guaranteed distributions. The new shareholders only have a right to receive future profits. The company may also issue additional shares at some later point but any further listings would constitute secondary placements, not an IPO.

Another way of going public is a reverse merger. The process begins with finding a shell company, which is already registered on the target foreign exchange. The foreign shell company then acquires all outstanding shares of the domestic private operating company. In anticipation of the merger, the shares of the shell company escalate in price bringing the necessary funding to the acquired private company. After the merger, the new company also issues additional stock to the public in order to raise more capital. If the name of the private company is well known in its industry and may itself serve as an attraction to the investors, the shell company then changes its name to the names of the former private company. Reverse mergers are less expensive than IPOs but require a more extensive legal review and preparation.

In 2006 and 2007, Russian companies conducted nearly 50 initial and secondary placements, with an estimated volume of \$63 billion.¹ In July of 2006, Rosneft conducted one of the largest and the most successful IPOs in global financial history after placing nearly 15 percent of its shares on stock exchanges in Moscow and London. The company raised approximately \$10.6 billion in Moscow and London becoming the fifth largest IPO ever in the world and the largest ever among global oil and gas companies.² Following Rosneft's IPO, TMK, Chelyabinsk Zinc Plant, and Severstal listed their shares on the Russian and foreign stock exchanges. Another example of a simultaneous IPO in Russia and abroad is the IPO of Uralkaliy. In October of 2007, the company moved to list its shares in London and Moscow. The IPO allowed the company to raise approximately \$947 million trading for up to \$3.5 per each share and up to \$17.5 per a global depositary receipt.³

2008 brought a successful IPO on the foreign stock exchange of Globaltrans Investment Limited, the owner of New Transportation Company and Sevtekhnotrans. Globaltrans specializes in the railway transportation of oil, coal, cement and metals. The capitalization of Globaltrans amounted to \$1.5 billion while the company itself raised \$449.5 million placing 29 percent of shares on the London Stock Exchange.⁴ UK RusAl, the largest producer of aluminium and alumina, and Metalloinvest, one of the largest and fastest growing mining and metallurgical holdings in Russia, are also expected to conduct their IPO with estimated volume of \$7.5 billion and \$3 billion respectively.

Public offerings are primarily sold to institutional investors, with a marginal number of shares allocated to the retail investors. For instance, almost a half of Rosneft's IPO was bought by four investors and three of them are: Malaysian Petronas, British Petroleum and Chinese CNPC. European Bank for Reconstruction and Development became the largest buyer of Globaltrans stocks. Large IPOs essentially target institutional investors who attract larger volumes of capital.

The U.S. stock exchanges are opening to Russian IPOs

While the most popular of all foreign stock exchanges to Russian issuers historically remained London Stock Exchange (LSE), New York Stock Exchange Euronext (NYSE Euronext) and NASDAQ are now moving to attract Russian IPOs with the main focus on the oil, gas and mining companies as well as major energy producers. In order to ease the process for the Russian

issuers, NASDAQ created a separate department specializing exclusively in providing aid to companies from Russia and the CIS. In addition, it adopted new rules that significantly relax its corporate governance requirements for non-U.S. companies. The changes allow foreign companies traded on NASDAQ to follow only their home country rules instead of the more rigid ones that NASDAQ imposes on U.S. companies. In April of 2008, NYSE Euronext also announced that it had launched a special program to persuade Chinese, Indian and Russian companies planning initial public offerings to list in the US. The goal is to create an alternative to the London Stock Exchange's in drawing big foreign IPOs.

NYSE Euronext is considered to be the most prestigious stock exchange in the United States and, perhaps, in the world. The exchange is a holding company, which was created by the merger of the New York Stock Exchange and Euronext N.V., a European exchange comprised of the local exchanges of Amsterdam, Brussels and Paris, London-based derivatives market (LIFFE) and the Portuguese exchange. On April 4, 2007, following the merger, NYSE Euronext commenced trading as one market. Each listed company has to meet strict requirements, as the NYSE Euronext strives to keep its reputation for trading strong, high-quality securities. NASDAQ originally specialized in trading shares of technology and telecommunications companies. Nowadays, it is the largest U.S. electronic exchange listing companies in all areas of business including energy, mining, retail, financial services, transportation, media and biotechnology. It lists more companies and, on average, trades more shares per day than any other U.S. market.

Some legal aspects of foreign listing

A corporation seeking to come out on the national and on one or more foreign stock exchanges usually engages multiple investment banks to take care of the IPO's financial planning and a multinational law firm to deal with differing legal requirements in both the Russian domestic securities market and the foreign stock exchanges. For example, following the Russian Federal Law "On Securities Trading", #39 of April 22, 1996 (as amended and updated) and the rules issued by the Russian Federal Commission on Financial Markets, prior to the approval of the share trading by the Russian registered corporation outside the Russian Federation, the issuer must provide an opportunity to investors to purchase its shares inside the Russian Federation. A Russian registered company may not trade more than 70 percent of its shares on a foreign stock exchange (see Order of Russian Federal Commission on Financial Markets, #06-42 of April 18, 2006 "On Changes in the Regulations on Procedure of Issuing Permits to List Shares of Russian Issuers Outside the Russian Federation, adopted by the FCFM Order #06-5 of January 12, 2006."

The Western exchanges also impose the variety of legal and accounting requirements. Any company seeking to list on the foreign stock exchange must first show that it qualifies for listing according to standards set forth for non-resident companies by the exchange itself. For example, both NASDAQ and NYSE Euronext have specific requirements on amount of income in the latest three years and the aggregate market values of publicly held shares. All new registrants must fully comply with the Generally Accepted Accounting Principles (GAAP), which are more stringent than other international accounting standards. Then the company must register with the local securities exchange commission and obtain a transfer agent. The process of registration with the securities exchange commission is sometimes the most difficult step in the overall procedure.

The United States Securities and Exchange Commission requires issuers to complete the registration and to electronically file the disclosure statements. The SEC online system enables immediate public access to every document filed. Most Russian businesses are not used to granting free access to their financial and corporate information. All companies listed on the NYSE Euronext and NASDAQ are subject to corporate governance standards under the modifications to the listing rules prompted by the Federal Sarbanes-Oxley Act and related SEC rulemaking. Foreign issuers are subject to the independent audit committee requirements and the disclosure provisions. All of these hurdles may be overcome by engaging a highly qualified group of professionals.

Conclusion

In light of the declining share values of many major U.S. corporations, the crash of real estate market and related credit crisis, more and more American investors are considering the options to invest in the booming Russian economy. With constantly rising fuel prices, the stock of the Russian oil and gas companies is an attractive investment in the eyes of foreigners. For Russian oil and gas corporations, listing on the US stock exchanges is a unique opportunity to raise capital for expansion. The benefits of an IPO far exceed the amount of the capital raised. During the process of preparing for an IPO on the foreign exchanges, Russian corporations are forced to bring their accounting in compliance with the international standards and improve their corporate governance in accordance with Western requirements. Such changes in the internal structure and procedures allow corporate Russia to better integrate into the global economy. Considering the efforts that the U.S. stock exchanges are making to attract Russian oil, gas and mining companies, it would not be surprising if NYSE Euronext and NASDAQ become the new grounds for the future Russian IPOs.

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