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FGC's consolidation: minority shareholders vs the state?

Trunk grid company shareholders were required to vote on merging the grid companies into FGC (the Federal Grid Company) by December 17 – the results of the vote have not yet been announced. In case shareholders approve the merger, the grid companies will cease to exist in the middle of 2008, and their shareholders will receive shares in a larger structure – FGC – which owns high-voltage lines across the country.

Simultaneously with FGC's consolidation, shareholders in UES – which is expected to be restructured and liquidated on the same date – will also receive a stake in FGC. The state will be amongst the new shareholders in FGC, and will need to build up its stake in FGC to at least 75% + 1 share. Since grid company shareholders and UES shareholders will be receiving stakes in FGC via separate transactions, we have studied the swap terms that these two different shareholder groups were offered.

The assets of the grid companies, FGC, as well as the heat energy WGCs and TGCs were valued on the same date – April 1, 2007. This is also the date on which assets on UES' balance sheet were separated to reflect the restructuring. The value of one share in FGC – based on the temporary transfer of UES' assets to be spun off to the State Holding, which is then merged into FGC – was valued at about RUR 0.59. This figure was used by investment banks to calculate the swap ratio that will be applied to grid company shares for conversion into FGC shares.

The number of FGC shares that the State Holding will receive, corresponds proportionally to the state's 52.7% stake in UES, and amounts to about 46% of FGC's current share capital. In order to increase its stake, the state will also transfer its stakes in the heat energy WGCs and TGCs to the State Holding. These stakes were also valued as of April 1, and at the same time, the list of heat energy WGCs and TGCs to be transferred to the State Holding was approved by UES' Board of Directors.

Hence, in order to acquire its stake in FGC (as required by law), the state will contribute its assets on the date set at a fixed price. Over time, even though the market value of these assets could vary, these changes in the value of the state's contribution will not affect the state's stake in FGC. In the table below, we have compared the value of the State Holding's stake with the market price of the assets that it contributed.

	Value of the state's stake, RUR mn	Share price, RUR	Number of shares belonging to State Holding	Valuation of State Holding's assets, RUR mn	RTS quote, \$	Value of State Holding's assets on RTS, RUR mn	Difference
OGK-1	67,893.89	3.14	18,015,639,455	56,525.21	0.12	52,965.98	16.19%
OGK-3	42,268.45	4.54	2,403,129,109	10,910.82	0.1465	8,625.43	-1.97%
OGK-4	66,173.09	2.84	19,749,723,309	56,154.72	0.1345	65,080.28	43.71%
OGK-6	50,409.10	3.82	3,098,020,532	11,821.01	0.131	9,943.10	4.30%
TGK-1	29,439.19	0.03	1,104,735,971,816	37,755.93	0.00126	34,103.20	12.00%
TGK-2	9,518.50	0.03	372,338,966,983	12,207.53	0.00103	9,395.97	-4.56%
TGK-3	45,822.76	6.03	9,749,771,368	58,767.95	0.25	59,717.35	26.00%
TGK-4	8,300.65	0.02	448,073,145,367	10,645.63	0.00126	13,832.02	61.11%
TGK-6	9,407.15	0.03	439,217,262,097	12,064.72	0.00106	11,406.47	17.23%
TGK-7	22,757.02	3.03	9,645,676,890	29,186.01	0.1105	26,113.26	10.95%
TGK-9	10,874.68	0.01	1,933,621,188,037	13,946.84	0.00032	15,159.59	34.78%
TGK-10	16,008.72	80.37	255,455,754	20,531.27	4.15	25,973.46	56.87%
TGK-11*	5,709.63	0.04	148,226,781,050	6,185.17	0.0017	6,173.65	23.77%
TGK-12	14,307.40	91.11	133,768,659	12,187.87	2.79	9,143.76	-6.97%
TGK-14	2,031.71	0.01	259,701,823,454	2,605.68	0.0004	2,545.08	21.12%
Total	400,921.9			351,496.35		350,178.59	-0.37%

*As TGC-11's shares have been trading for a few days only, we have used the valuation price



The table shows that the overall market value of the assets contributed by the state to FGC has remained almost the same – as the value of some generating companies has declined, whilst other companies have risen in value, leaving the aggregate value almost unchanged.

According to preliminary estimates, FGC will have a total of 1,155 bn shares outstanding after the consolidation and restructuring of UES. After UES' shareholders' meeting on restructuring, Anatoly Chubais confirmed that the state will acquire a stake of over 75% in FGC. Therefore, we have estimated the price of one FGC share, based on the value of the assets contributed by the state in exchange for its future stake in FGC and the number of shares they receive in FGC. In our estimate, we also took into account the value of 167.3 bn shares of FGC, which are to be transferred to the State Holding by the state during UES' restructuring, as well as the over RUR 40 bn that are scheduled to be assigned to FGC from the federal budget in 2007-08.

Similarly, we tried to calculate the price of one share in FGC for the grid companies' minority shareholders. For this, we added the values of minority shareholders' stakes in the grid companies (except those that are 100% subsidiaries of UES (such as the Orenburg trunk grid company) or of the Far Eastern energy company (such as the Amur and the Khabarovsk trunk grid companies). According to our preliminary estimates, the grid companies' minority shareholders will receive about 39 bn shares in FGC.

Calculations for each of the options stated above are given below:

RUR mn	State	Minority shareholders in the trunk grid companies
Valuation of assets on April 1, 2007	451,332.63	22,941.18
Valuation of FGC shares	99,836.28	0
Budgetary funds to be contributed in 2008	21,700	0
Other assets	9,220.9	0
Shares owned post share issue in 2007	44,955,946,665	0
Stake in new charter capital*	Over 75%	3.4%
Number of shares	863,000,000,000	39,095,000,000
The price of 1 share in FGC is based on the valuation carried out on April, 1, RUR	0.59	0.59
Market value of assets on RTS on December** The price of 1 FGC share based on its market value on the RTS, RUR	450,014.87	32,537.9
	0.59	0.83

*UES' minority shareholders will receive the remaining shares in FGC

**In order to calculate the market value of the blocks of shares in the WGCs and TGCs, we used the bid price on RTS; for less liquid grid companies with a wide bid-ask spread, we used the mid-market price

Thus, with respect to current market prices the grid companies' minority shareholders will (proportionately) contribute more than the state in order to become shareholders in FGC.

Yet, it should be kept in mind that according to UES' Board of Directors', the state's stakes in the heat energy WGCs and TGCs might be sold before the restructuring is completed. In this case, proceeds from the sale of these assets will be assigned to the company, which should have obtained these stakes in the heat energy WGCs or TGCs – as specified in UES' balance sheet, prepared for the separation of its assets. Here this would be the State Holding, which will then be merged into FGC. The sale of the state's stakes coincides with the SPOs of the WGCs and TGCs, which will enable UES to receive a premium for control (or a stake close to a controlling majority) from the new shareholders.



Thus, the state's future stake in FGC is based on the value of the assets it contributed as of April 1, whilst the sales price of the state's stake to investors might be higher. In the table below, we have compared the sale proceeds or projected sale proceeds with restructuring estimates:

	Offer price of the state's stake, RUR	Number of shares sold	Amount due to FGC, RUR mn	Estimated price, RUR mn	Difference
OGK-3	4.54	2,403,129,109	10,910.2	10,910.8	0.0%
OGK-4	3.3503	23,273,201,587	77,972.2	56,154.7	38.9%
TGK-1	0.035	1,095,446,795,119	38,340.6	37,438.5	2.4%
TGK-3*	6.5	9,749,771,368	63,373.5	58,767.9	7.8%
TGK-9*	0.00801	1,933,621,188,037	15,488.3	13,946.8	11.1%
TGK-12*	75	133,768,659	10,032.6	12,187.9	-17.7%
TGK-14*	0.01	259,701,823,454	2,605.7	2,605.7	0.0%

Companies have not completed their offering yet*

Consequently, it is possible that the current conditions may, in the end, turn out to favour the grid companies' minority shareholders. We think that the consolidation process will be advantageous for minority shareholders of grid companies.

In our opinion, the common shares of the Bryanskaya and Tverskaya grid companies, and the preferred shares of the Voronezhskaya and Permskaya grid companies offer the best return to investors interested in acquiring a stake in FGC.



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BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
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