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Meeting with IES' General Director

Mikhail Slobodin, IES' (Integrated Energy Systems) General Director held a press conference with journalists and analysts, during which he discussed the company's future strategy regarding its energy assets.

IES is one of the key players in the energy industry, and, pursues an aggressive acquisitions policy. We think that other companies may follow IES' strategy with respect to its acquired energy assets – which is why we have prepared a brief note on the meeting.

So far, IES has acquired an (almost controlling) stake in TGC-5, a 75% stake in TGC-9 and approximately 25% stakes in TGC-6 and TGC-7, as well as a 100% stake in Orenburgenergosbyt and an approximately 80% stake in Sverdlovenergosbyt. In addition, IES holds a 75% stake in Rossiskiye Kommunalnye Sistemy (RKS), the largest private business operator in the utility sector, as well as blocks of shares in more than 10 gas-distribution companies in Russia and Ukraine.

Next, IES plans to optimize the management of its acquired assets:

- In order to improve the management of its acquired assets, the company will establish a number of divisions, with the Urals Generation division managing energy generation assets such as TGC-5 and TGC-9. A trading division will monitor the procurement of all fuel resources at IES' enterprises, commercial dispatches and trading on the wholesale energy market. A retail sales division will run the acquired energy supply companies, gas-distribution companies, and conduct heat energy sales. Newly acquired generation assets such as TGC-7 and TGC-6 will form a new division called Generation Volga. IES plans to complete the creation of the new structure in April-May. CJSC IES will be renamed as IES Management and will retain the functions of a management company.
- Regarding the TGCs, IES will concentrate on building up its heat grid assets. Over the next 1.5 years, the TGCs will buy out heat grids in the Udmurtia, Kirov and Sverdlov regions from RKS, as well as heat supplying companies. As part of the plan, the TGCs will form 5-year agreements (with an option to extend the term) for the purchase of coal. Furthermore, IES has not ruled out the potential purchase of minor gas fields, whose effective production rate will increase as domestic gas prices grow.
- IES also intends to centralize its customer services, having delegated the sales of energy power, heat and gas to the sales companies acquired from UES. At the same time, according to Mr. Slobodin, the business will not be transferred free of charge – the TGCs should obtain adequate compensation from the sales companies.
- IES estimates the economic benefit of its planned changes at \$300-400 mn over 5 years. However, over the next two years, the market will not be able to find out whether this is true or not. According to Mr. Slobodin, IES is not interested in increasing the capitalization of its assets, which is why the TGCs controlled by it will not publish IFRS reports and will only reveal information as required by FFMS. Investors will find out about the companies' performance from IES' consolidated reports, which the company will prepare in time for its IPO scheduled for 2009-10.
- Slobodin also added that IES may sell some of its TGC assets in order to increase its interest in TGC-5 and TGC-9, as well as in TGC-6 and TGC-7. These enterprises operate in Povolzhie, and previously IES feared that the Federal Antimonopoly Service (FAS) would not allow it to buy all these enterprises. However, as preliminary negotiations with the antimonopoly agency demonstrated, according to Slobodin, IES will probably obtain FAS' permission, provided it sells some of its assets. Mr. Slobodin considers industrial enterprises consuming energy from such thermal power plants as potential buyers. Furthermore, he did not rule out the possible establishment of a joint venture with the participation of external investors.



- Slobodin stated that IES has not made a final decision on whether it will buy out any of the remaining sales companies, since the company will have to make heavy investments for the TGC acquisition. Nevertheless, he admitted that the acquisition of, for example, Samaraenergo, fits in with IES' strategy.

In conclusion, IES will take the measures required to enhance the performance of its assets; however, Mr. Slobodin did not deny that portfolio investors will find it difficult to earn profits while these plans are being implemented. The last chance for them, according to Slobodin, is to accept the company's mandatory offer to buy out the outstanding stakes in the acquired companies. The offer period for TGC-5's stock has already passed, for TGC-9 the offer period will begin in the near future, while it is almost impossible to predict whether IES will buy a controlling stake in Tgc-6 and TGC-7 or not. However, we think that minority investors in TGC-5 will have another opportunity to profit.

Second potential buyout offer for TGC-5

IES only bought a 46% stake in TGC-5 during its IPO and via subsequent buyout offers. IES intends to increase its stake in TGC-5 to a controlling one. According to Mr. Slobodin's previous statements, the company was negotiating with Gazprom to acquire its 5% stake in TGC-5. In case this happens, IES' stake in TGC-5 will exceed 50%, which means that IES will again have to make an offer to buy out minority share holders. We believe that Mr. Slobodin's reluctance to indicate in detail IES' interest in TGC-5 and his intention to strictly follow FFMS' rules and instructions indicate that the offer will be announced soon.

Under the law on joint-stock companies, the price of a buy out offer for public companies is the greater of the weighted average price of shares for the previous 6 months and the price at which the investor purchased its shares during the same period. Today, the weighted average price of TGC-5 shares for the past 6 months is 20% higher than its current value. Yet, we do not expect Gazprom to sell its 5% stake at market prices, which are at 2006 levels, when TGC-5 entered the market. In any case, TGC-5 shares are now trading lower than its peers in terms of EV/IC multiples, whilst its advantage over its peers lies in the fact that it has already been spun-off from UES, which means that it has already undergone the massive exit of UES shareholders that were not interested in holding shares in smaller companies – a process, which UES' other companies still need to go through.



STOCK RATING POLICY

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
SELL:	Target price at or below current price levels

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