

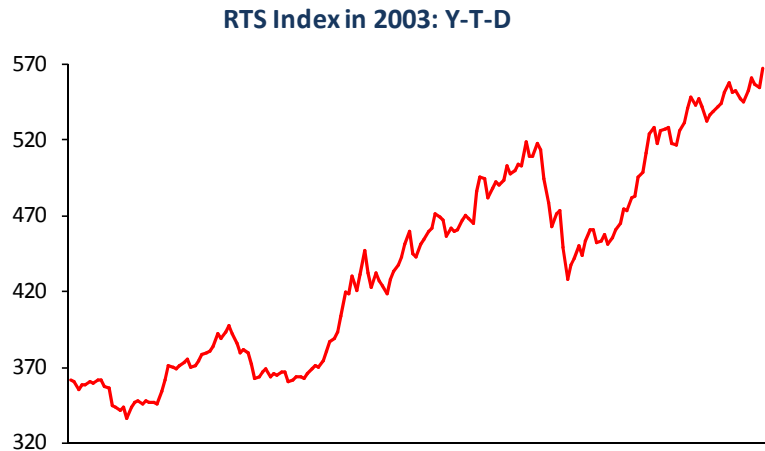
**Russia: Up or Down? Investors Speak!**  
Global Investor Survey, Conducted at LJ Consultants, Inc.  
October 2003

**By Lev Janashvili**

**Introduction**

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As an investment prospect, Russia seems to radiate a decidedly positive glow these days. The country has crafted an economic recovery that seems increasingly convincing, as another batch of reports over the past two weeks revealed impressive GDP growth and stabilizing inflation – all this, against the backdrop of sputtering Eurozone economies. The benchmark RTS index has shown remarkable momentum. Having risen 57 percent so far this year, the index has eclipsed corresponding gains of 12 percent in the DJIA and 37 percent in the NASDAQ.



And the blossoming friendship between presidents Bush and Putin has not only added to Russia’s positive aura, but it has also arguably eased concerns over thorny geopolitical issues.

Still, this is not the first time Russia finds itself in the midst of broad based excitement. As such periods in the past, the current bull market has spawned not only legions of satisfied investors, but also a set of nagging questions. Is this a sustainable recovery? Or is this a continuation of the cycles of boom and bust characteristic of Russia’s past? How can the country’s government further encourage foreign investment? In what ways do corporate practices need to change to inspire greater investor trust? How can Russian corporations attract long-term fundamental investors, instead of speculative in-and-out traders? Have the recent corporate and NYSE scandals – or the arguably onerous regulations such as Sarbanes Oxley - convinced Russian companies to look for capital outside the U.S.?

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These are some of the questions we tackled in this study, based on responses from 58 members of the financial community in the U.S., Western Europe, Russia and Latin America. Thirty-nine of the survey participants were institutional investors (Buyside); they collectively represent 13.4 percent of the total institutional investments in Russia.<sup>1</sup> Fourteen respondents were research analysts from leading Russian and Western brokerage firms (Sellside). The responses were compiled between August 13, 2003 and September 25, 2003.

#### Disclaimer

Because of the size and composition of the respondent sample, we consider the findings of this survey suggestive, but not conclusive. Although the survey reflects the views of some of the top buy-side and sell-side participants in Russia's capital markets, the sample is too narrow to warrant definitive conclusions about the global investment community's perceptions of Russia's investment merit. We believe that the findings of this survey may have been different had we received a higher number of responses, especially from institutions that never invested in Russia or have liquidated their positions in the country's equity and debt markets.

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<sup>1</sup> Source: Thomson Financial

## Key Findings

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**Encouraged in part by the strength of Russia's economic recovery and positive trends in the oil market, most respondents feel guardedly optimistic about the performance of Russian capital markets over the next year, the equity market in particular.** Sixty percent of the respondents expect the RTS to deliver above-average performance, compared to other emerging markets. Nine percent expect the benchmark index to rank as one of the best emerging markets. Importantly, this generally positive outlook comes on the heels of a dramatic, albeit volatile, bull market in the RTS, which rose some 69 percent from the lows of 2003 (57 percent year-to-date) and about 1300 percent since the financial crisis in 1998.

Expectations are more optimistic for the equity market compared with Russia's debt market. Fifty-eight percent of the respondents rate the equity market BUY, compared with 33 percent for the debt market. Thirty-five percent assigned a HOLD rating to the equity market, compared with 57 percent for the debt market. Ten percent rated the debt market SELL.

Over the next 12 to 18 months, expectations are most optimistic for the fundamental performance of wireless, metals, oil and gas industries. Seventy-three percent of the respondents assigned "One of the best" or "Above average" ratings to the wireless industry, compared with 69 percent for the metals industry, and 64 percent for oil and gas. Financial services received the lowest ratings, with 31 percent of respondents rating the industry "Below Average" or "One of the Worst".

**Corporate corruption, inadequate protection of investor rights top the list of investment risks.** Fifty-eight percent of the respondents said they do not feel confident about the effectiveness of securities regulation in Russia. The uneasy relationship between the country's business and government interests also emerged as an important risk factor. Despite President Putin's strident assertions to the contrary, the recent crackdown on Yukos initially fueled speculation that this particular controversy may serve as a prelude to a wholesale review of Russia's privatization of state assets in the 1990s.

**Corporate governance practices and levels of transparency dominate investment decisions in Russia.** Ninety-one percent of respondents rated corporate governance as "extremely important" or "very important". Eighty-nine percent assigned the same ratings to transparency. By contrast, several factors traditionally viewed as key selling points for investing in Russia received lower ratings. Only 59 percent of respondents, for example, rated the size of the Russian market and its growth prospects as extremely or very important.

The eclipse of economic growth by the emphasis on governance and transparency seems particularly noteworthy against the backdrop of positive recent announcements on Russia's economic performance. In Q203, the country's GDP grew by 7.5 percent, compared to Q103, and by 23 percent compared to Q202. The International Monetary Fund (IMF) has raised its outlook for Russia's GDP growth to 6 percent from 4 percent for 2003, and from 3.5 percent to 5 percent for 2004. At the same time, the IMF lowered its outlook for GDP growth in the Euro zone, from 1.1 percent to 0.5 percent in 2003 and from 2.3 percent to 1.9 percent in 2004.

Arguably, some observers may have discounted the good economic news in Russia because of skepticism about the way the State Committee on Statistics compiles and analyzes socio-economic data. On the other hand, transparency and governance practices represent undeniable investment risks, respondents argued.

**Respondents agreed that the credibility of Russian corporations has improved since the late 1990's, but apparently not enough. The corporate sector still gets poor or mediocre marks on management credibility, accounting, governance and disclosure practices.** For example, 51 percent of the respondents rated the quality of information issued by Russian corporations as “poor” or “very poor,” and 54 percent assigned the same ratings to the timeliness of information.

However, respondents were quick to point out that Russia's progressive business elite – companies such as Yukos, WimmBillDann, Norilsk, to name a few – represent positive exceptions to the generally lackluster performance of Russian corporations. Further, the respondents are overwhelmingly optimistic; 92 percent expect corporate practices to improve “dramatically” or “somewhat” over the next few years.

**The recent corporate and NYSE scandals will not do much to diminish the allure of U.S. capital markets for Russian companies, according to 71 percent of the respondents.** “A U.S. listing is about access to more funds only, not ‘prestige’ or ‘respectability’”, a sell-side respondent argued. A buy-side respondent echoed this viewpoint: “Scandals are a matter of course in the rest of the world, and this is something others have learned to live with.”

A more compelling threat to the cachet of a U.S. listing could come from other markets, particularly the London Stock Exchange, which has recently intensified its efforts to attract Russian listings. “It's liquidity that's important, and London can provide that as well,” noted a buy-side respondent.

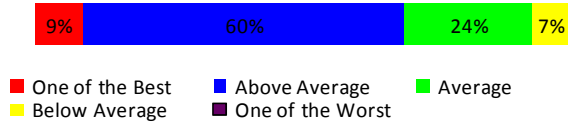
**Respondents disagreed on how the Sarbanes-Oxley Act would affect the appetite of Russian companies for a U.S. listing.** Only 14 percent of U.S.-based respondents expect adverse consequences; 57 percent of this subgroup don't. By contrast, 43 percent of Russian respondents say the Act will dampen the interest of Russian companies in the U.S. capital markets. Russian respondents were also twice as likely as their U.S. counterparts to support an exemption for non-U.S. issuers from the requirements of Sarbanes Oxley. Twenty-nine percent of the Russian respondents supported the exemption, compared with 14 percent of U.S. respondents. In general, many respondents – Europeans (ex. Russia), in particular -- are simply not sure about Sarbanes Oxley's impact.

**ADRs: Preferred But Not Indispensable.** Hardly anyone denied the importance of ADR programs and US listings in attracting Western investors. In fact, 98 percent of respondents attach some degree of importance to ADRs and listings – ranging from “important” to “very important.” It came as a bit of a surprise to us that 60 percent of European respondents consider ADRs and listings “very important,” compared to 43 percent of U.S. and Russian respondents.

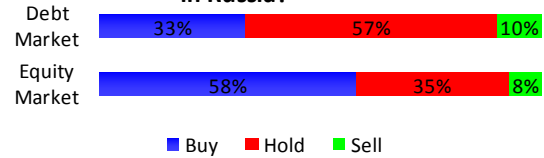
At the same time, 77 percent of the buy-side respondents said they would invest in the local shares of a Russian company that does not have an ADR program. Not surprisingly, Russian investors are most willing (100 percent) to invest in local Russian shares, followed by European institutions (82 percent), and then U.S. respondents (67 percent).

## By the Numbers: Outlook

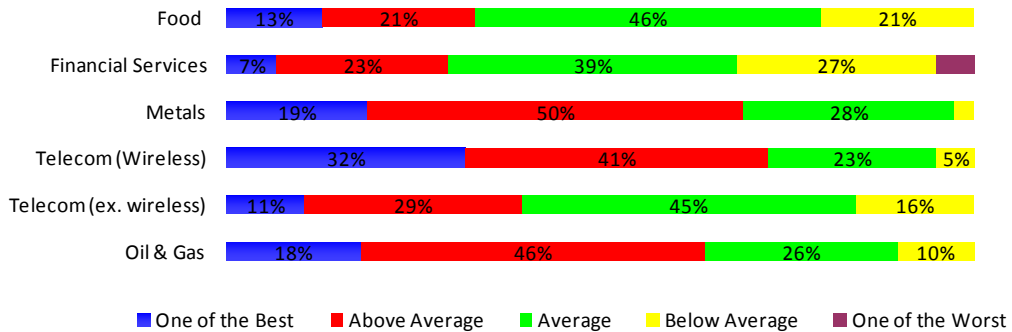
Over the next year, what is your outlook on the performance of the Russian stock market (RTS) compared to other emerging markets?



Over the next year, what is your outlook on the performance of equity and debt markets in Russia?



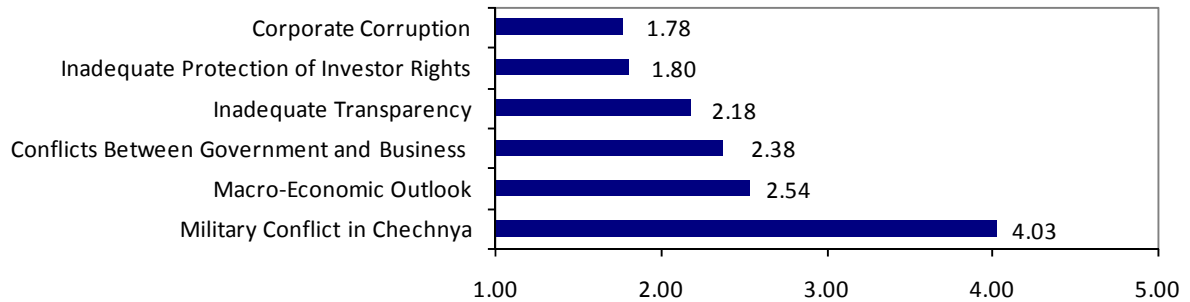
What is your outlook on the fundamental performance of the following industries in Russia over the next 12 to 18 months?



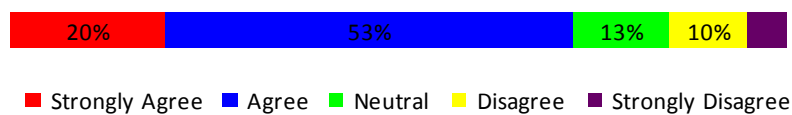
## By the Numbers: Risk Factors

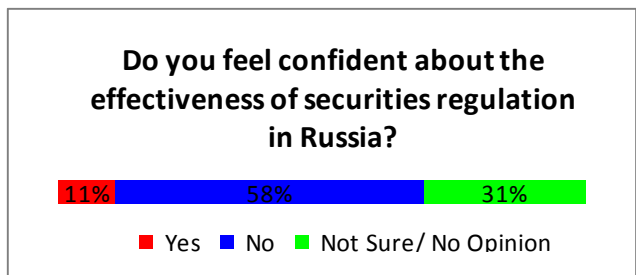
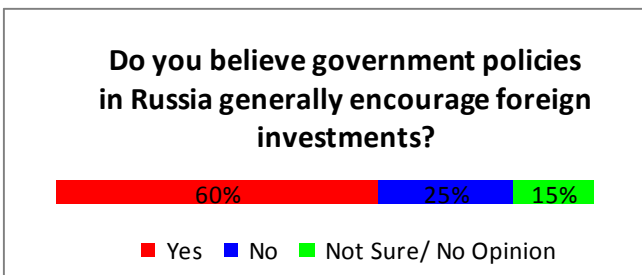
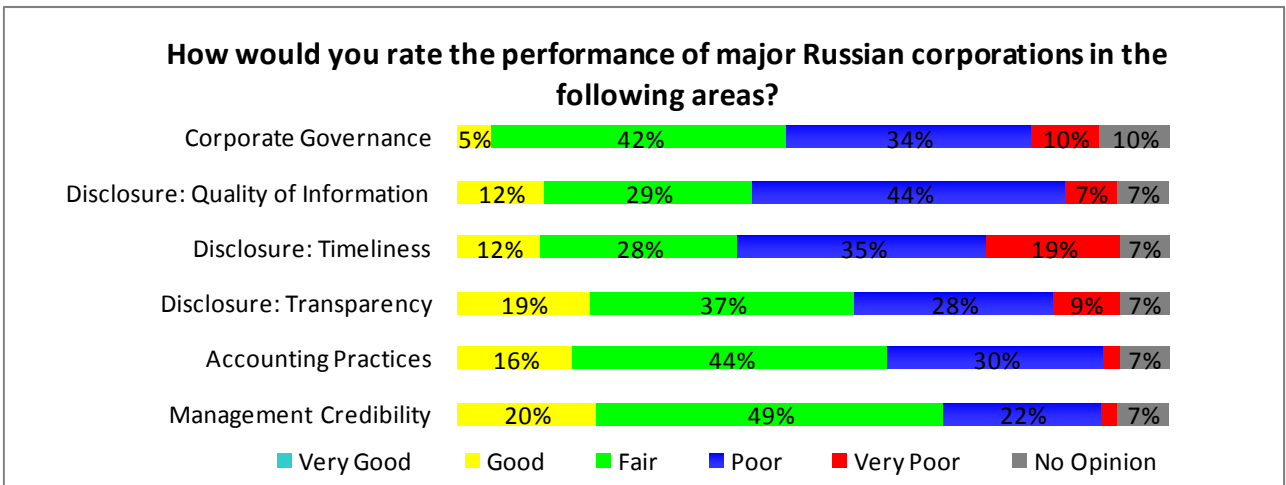
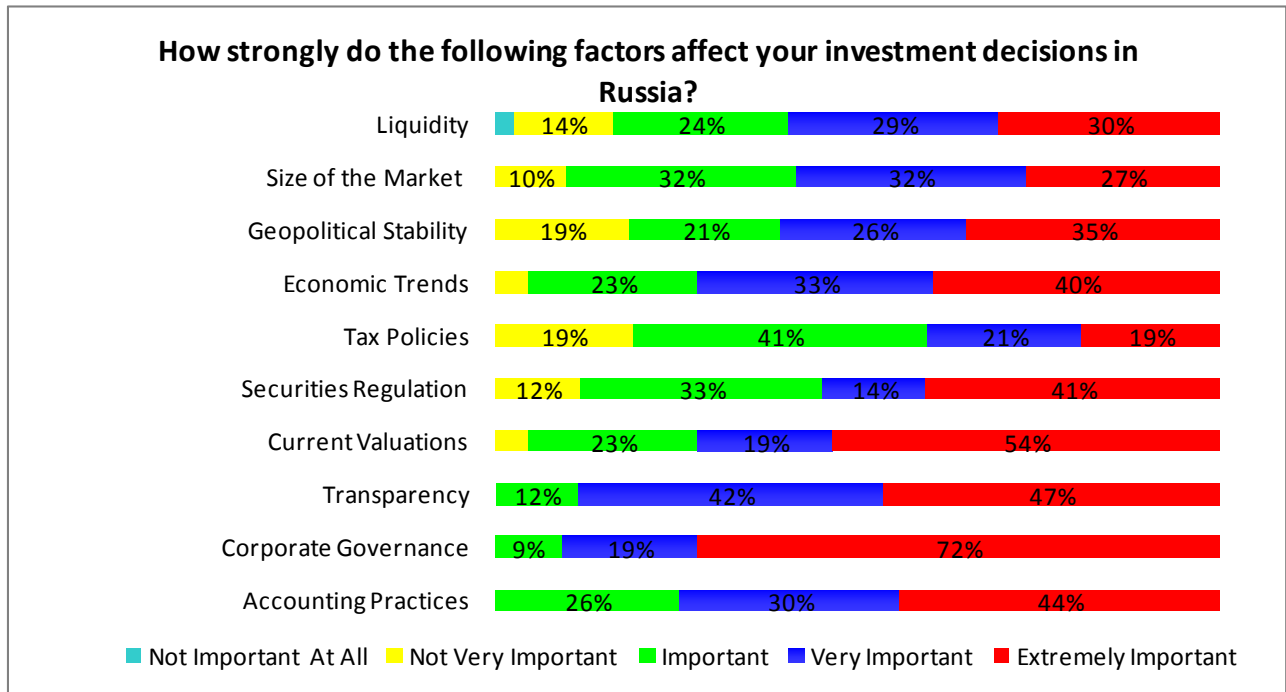
How strongly, if at all, do the following factors undermine the investment merit of the Russian market?

1 - Extremely Important Risk Factor, 5 - Not an Important Risk Factor At All

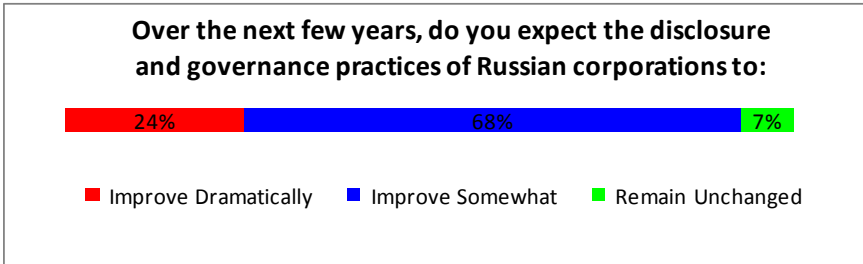
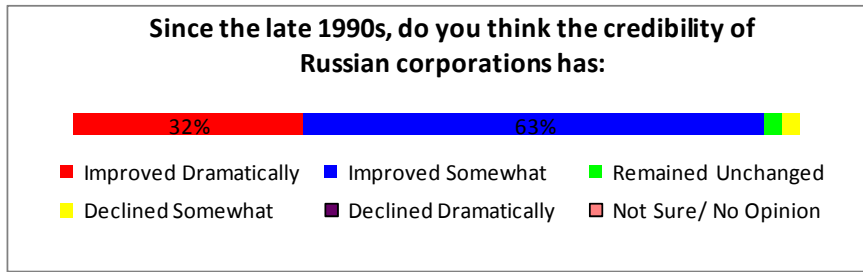


"The risks of investing in the Russian market justify discounted valuations for Russian stocks compared to their peers in more developed countries."

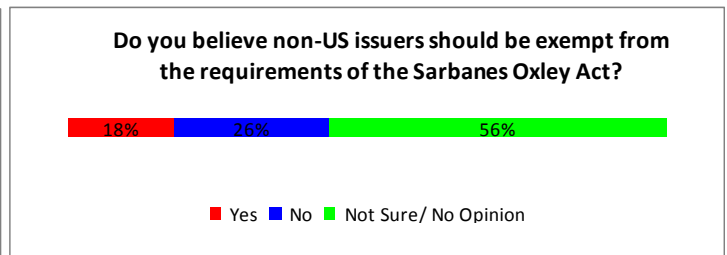
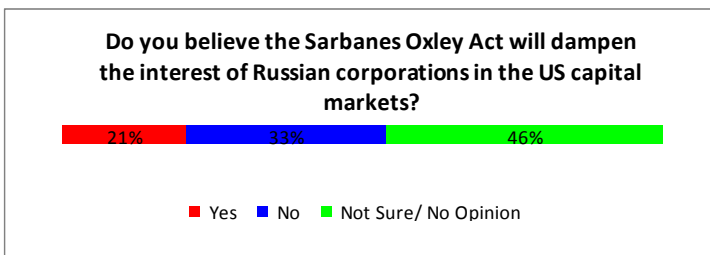
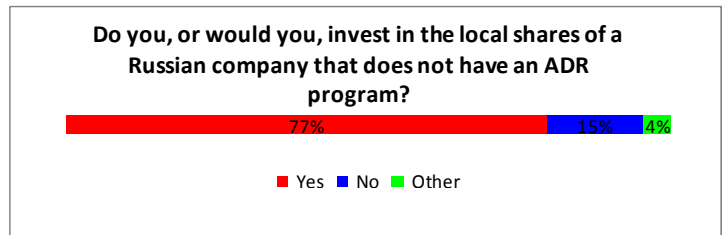




## By the Numbers: Corporate Credibility



## By the Numbers: US Market, ADR Programs



## About the Author

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### LJ Consultants

LJ Consultants, Inc. (LJC) is an independent, specialized management consulting firm helping clients identify, interpret and address some of their most complex and pressing business challenges. The firm's services include management consulting, investor relations and public relations. For more information, please visit the LJC web site at [www.LJConsultants.com](http://www.LJConsultants.com).

*Lev Janashvili, President* -- Lev has extensive experience (consulting and corporate) in long-term positioning strategies, crisis communications, M&A, public offerings, turnarounds and repositioning programs. He has advised clients on public offerings with an aggregate value of more than \$50 billion and M&A transactions worth more than \$20 billion. Lev has experience in most major financial and media centers worldwide, with clients from more than 20 countries. His clients – past and present – include industry leaders such as Deutsche Telekom, Novartis, Reuters and BP, as well as emerging leaders in technology and healthcare. Lev is fluent in Russian and Georgian. He holds a B.A. Magna Cum Laude from Yeshiva University. He is currently pursuing a M.A. in Organizational Psychology from Columbia University.