

"Banks have to adapt quickly"

Alexey Kornya, CFO of Russian telecommunications provider MTS talks about financial turmoil and a twisted perception of risk. That is why he confidently calls for a reassessment of rating rationales.

By Armin Haerberle

>> Mr Kornya, how concerned are you about the current turmoil in financial markets?

<< The volatility and liquidity situation around the globe is getting worse. This will clearly have an effect on the Russian market as well. But we believe that in Russia, at least, the government can cushion the slowdown with its currency reserves by supporting liquidity and credit provision through this second wave of the crisis.

>> Are you not afraid of inflation picking up from increased government spending?

<< No, at least not for Russia. For much of the developed world, however, I think this would indeed be the only viable option in the long run. Right now all developed economies, and their governments in particular, are over leveraged. The only way out of this, in my understanding, is higher inflation.

>> Would that make financial markets in, say, Russia even more attractive?

<< I would not say that Russia is benefiting from the current situation. We are very much dependent on global economic growth and the price of commodities. I am not so sure that the ruble would benefit

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from a global slowdown. However, I am sure that developed markets will be growing much slower over the next decade compared to the emerging markets.

>> But are in particular the political and social tensions in these countries not a reason for concern?

<< This risk, I believe, is largely overestimated. Right now, risk is generally assessed improperly around the world. What we see is that strong companies in emerging markets with strong cash flows and balance sheets, low debt and good growth rates receive lower ratings than many companies in, say, the United States, which is over leveraged, has neither stable cash flows nor sustainable business models and is indeed very dependent on promises of the future. The United States has better ratings just because of a twisted perception of political risk. This needs to change soon because, as we have already learned very painfully, investing in developed markets' companies, even investing in western banks, is no less risky than investing in emerging markets.

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>> MTS is not investment grade-rated and so from what you are saying now, do you also have the feeling that you cannot do much about it?



<< I think that the major reason for us not having an investment grade rating is attributable to country risks and questionable rating methodology. For example, I don't think that our risks are any higher than the risks of some operators in eastern Europe just because their home countries are part of the European Union. As globalisation and economic integration progresses, there should be ever less differentiation between countries in terms of their governmental risks anyway. MTS, for example, has been listed on the NYSE for more than 10 years now – so why are we treated as if we were just a local Russian company?

>> But does that even affect your local financing?

<< That is the irony of it. Emerging markets generate major surpluses, but because their financial institutions and markets are still underdeveloped, they invest this money in Western markets, which are hard to access and where the returns are lower. But I think that financial systems in the emerging markets are ad-

■ The CFO ...

Alexey Kornya has worked at Mobile TeleSystems (MTS) since 2004. He was promoted to vice president and CFO in June 2010, having served as acting vice president and CFO since 2008 and as chief financial controller from 2007 until 2008. Before his time at MTS, Kornya worked at PricewaterhouseCoopers, OJSC North-West Telecom and AIG-Brunswick Capital Management. In 1998 he graduated from St. Petersburg University of Economics and Finance.

vancing rapidly and soon less money from these regions will be pouring into Western economies.

>> In Russia, the government has pushed the development of a stronger financial market very actively. Has this been successful?

<< The government did actually do quite a lot to develop Russia's financial system. Of course, there still is a lot of work to be done in the future before Moscow can consider itself a financial centre. But I think that we are moving in the right direction.

>> In what ways is that change manifesting itself?

<< For example, we are now trading more with institutional investors. Two years ago, our local shares traded at a 25-per-cent discount to our ADRs in New York. International investors can give you a whole list of reasons why they do not feel comfortable about trading in Moscow. We need to improve clearing and requirements for brokers, to name but two areas. At the moment, there are even rumours that the limit of how much of your share capital can be traded abroad might be abolished. We >>

■ ... and the company

Mobile TeleSystems OJSC (MTS) is among the leading telecommunication groups in Russia, eastern Europe and central Asia, providing mobile and landline as well as broadband and pay-TV services. The group has roughly 100 million mobile subscribers and owns GSM licenses in Russia, Ukraine, Uzbekistan, Turkmenistan, Armenia and Belarus. In 2010, MTS achieved an operative income before depreciation and amortisation (OIBDA) of USD 4.8 billion from its sales of USD 11 billion, which approximates a margin of 43 per cent. Since June 2000, the telecommunications provider is listed at the New York Stock Exchange (NYSE) via Level-3-ADRs.

will see whether this will really happen, but the discussions are pointing in the right direction.

And this is not only happening in Russia. Over the next decade, there will be a lot of developments in the financial systems of emerging markets all over the world. I'm pretty sure China is moving in a similar direction. They are talking already about having a fully-convertible yuan in a couple of years. This will have a major impact on the global financial system.

>> Do you consider having GDR's listed in Hong Kong or raising yuan bonds?

<< We thought about raising yuan debt to pay for our equipment from Huawei, a Chinese technology company. But it still involved certain risks, the value of the assets was too small and I still prefer having US-dollar debt rather than yuan-denominated debt because I think the yuan will continue to appreciate.

>> Your EBITDA leverage is around 1.2. Why do you keep it so low?

<< It is indeed quite low. But before the crisis, our net debt to EBITDA ratio was as low as 0.4x. During the crisis, low leverage enabled us to make strategic investments, like developing our retail presence because we could buy up a number of small regional and distressed retailers. We also bought a fixed-line business, Comstar, at a price that was very attractive for us.

>> So you are done for the time being?

<< No. Right now, we are buying smaller broadband operators throughout Russia. I don't believe very much in the big-scale deals we would have to do outside of the CIS. But the low leverage gives us flexibility to further consolidate the local market

and to invest in 3G mobile-phone-networks.

>> Can you give me a figure?

<< This year we have a guidance of close to USD 3 billion of investments.

>> Pushing 3G networks must be very complex in a vast country like Russia.

<< Yes, but that is also an opportunity. You are not necessarily getting the quickest returns on investment in the highly urbanised areas such as Moscow, because penetration is already high there. But in more distant regions, they often don't have

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fixed-broadband yet and mobile services are actually giving people their first access to the internet.

>> In the last half year, your share price suffered quite a bit. Why is that?

<< I think there are a few factors. The first one is the retreat of investors out of emerging markets as soon as global uncertainty rises. The second one is the negative sentiments towards the telecom industry. "Voice" is becoming "data" thanks to players such as Skype. The industry is now investing a lot in data infrastructure, but data is still priced very cheaply compared to voice. Data earnings can thus cannibalise your more profitable voice earnings, which still constitute about 70 to 80 per cent of revenues. And there is a

negative sentiment towards intensification of competition in the Russian market, but I think that the disruptive effect of this is grossly overstated.

>> We talked about bond markets, but how have your bank relationships developed?

<< We did a few syndicated loans in spring 2009. But as the ruble debt market opened and we got access to ruble funding on debt capital markets, we basically stopped working with international banks on international, dollar-based financing. They are regularly asking whether we want to do business with them, tackling the bond market or syndicating a loan, but we are not interested in that type of funding.

>> Why not?

<< Because it is always in hard currency and swapping hard currencies back into rubles is just not attractive. If we were an export company or had hard currency cash flows, we could benefit from

borrowing in rubles and swapping them back in US dollars. That would get us much cheaper financing these days than borrowing in dollars directly. But our costs and cash flows are almost exclusively in rubles. The essential problem is that international banks, even though they want to work with us, do not have ruble funding themselves. For them, the business model of pushing US-dollar- or euro-funds into Russia without a local funding base might have worked well before the crisis, but that is no longer the case. This is another area where I think emerging markets will see a major change in the next few years. Funding will become much more of a local business, and banks will need to adapt to that quickly. ||

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