While many emerging market countries saw their bonds savaged by volatility and damaged by economic slowdown, Russia had an impressive 2001. Timely repayments and an increasingly well-regarded government persuaded banks and investors that the time was right to return for the first time since the crisis of 1998. The City of Moscow led the way, with Rosneft taking the prize as the first corporate to return. 2002 is set to be just as exciting, with the sovereign due back after a four year absence. **Laurence Knight** reports.

Moscow heads up Russian revival

For many, 2001 was the year when the Russian phoenix at last arose from the ashes of 1998. In the primary markets, Russian issuance finally kicked off again in the fourth quarter. In the secondary markets, the Russian Federation was the strongest performer of all the major emerging markets sovereigns. The steeply inclined Russian curve rallied throughout the year, and its component of the EMBI+ outperformed the index by 20%, to yield less than 750bp over Treasuries by December.

In anticipation of this formidable performance, origination bankers in London were jetting over to Moscow with ever greater frequency in search of the biggest prize — the first Russian issue since the meltdown of 1998.

The Russian Federation itself made clear early on that it had no intention of returning to the Euromarkets until at least 2002, despite concerns about how it would handle its notorious 2003 debt repayment spike of $19.2bn.

"Russia continued to rally all the way through the problems in Argentina and Turkey," says Dennis Holtzapffel, head of emerging markets syndicate at UBS Warburg in London. "If anything, it benefited as a diversification play with obvious potential spread compression. Besides Turkey, Russia is the one country in EMEA with a truly global investor base."

Chris Tuffey, Credit Suisse First Boston's London emerging markets syndicate chief, suggests that Russian Eurobonds benefited from the lack of supply and the gradual retirement of the existing debt stock. "At the same time," he adds, "demand for Russia has gone up and up, as investors believe more and more in the Putin administration and in the economic turnaround story, even with the low oil price."

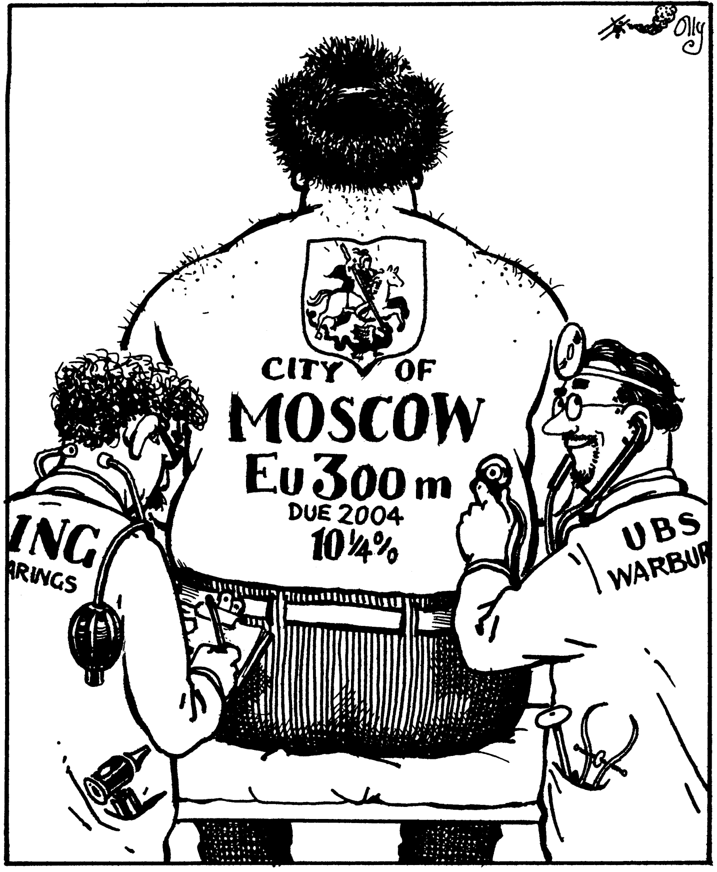
Russia also finally resolved all of its outstanding debt disputes. The government caved in to demands from the Paris Club, above all from Germany, to pay its debts in full, once it became clear that oil receipts gave Russia the capacity to do so.

The last blemish, bar around $1bn of Comecon bank claims, was cleared up at the end of the year, as the government was finalising a restructuring of Soviet era foreign trade obligations into $2bn of 30 year Eurobonds.

The one thing the federation pointedly chose not to do in 2001 was to launch an entirely new Eurobond.

In the sovereign's absence, London bankers entered into a bruising competition to reopen the market with a lesser credit.

An emerging markets health check.



Moscow's back with a new issue.

Technically, the race was already decided in June by a small trade finance type deal, when UBS Warburg arranged a $100m two year FRN for state owned Moscow Narodny Bank.

But Moscow Narodny sold its deal mainly to relationship banks in London, and is regulated by the UK's FSA, making the credit, as one buyer put it, "only Russia light, for investors who don't want to inhale".

So the prize of bringing the first true Russian credit was still to be won, and for most of the year, two big names vied for contention.

In January, Gazprom mandated CSFB and Citigroup for its debut issue, expected to be at least a benchmark Eu500m in size.

"Gazprom is the best corporate credit in Russia," says Citigroup's global emerging markets debt syndicate head, Aidan Freyne. "It is the biggest gas company in the world, it has huge export earnings, it is of vital strategic importance to the Russian government."

So confident were the leads of the company's attractiveness, that they proposed bringing a bond unrated, unstructured and unguaranteed.

But all this was not to be. In May the Russian government ousted the company chairman and oligarch Rem Vyakhirev, sending a junior minister, Alexei Miller, to the company in his stead.

Although the new management eventually confirmed the Eurobond mandate, it became clear as the year wore on that the Russian government would not permit the bond before the market was ready, or before the government had decided its own issuance plans.

Moscow the winner

In the end it was the City of Moscow that headed up a late flurry of issuance from Russian borrowers in the last quarter of the year.

Barring a calamity, the city was the one issuer bound to return in 2001. Under draconian post-1998 Russian legislation, Moscow had until December 31 to refinance its Eu750m redemptions in 2001, or lose the funding option. But things did not go to the carefully laid plans of the laconic Moscow funding chief, Sergey Pakhomov. "We planned early in the year to issue three bonds," he says. "We expected to place the first in June, but the market made this impossible, and in the end it didn't happen until late autumn."

While UBS Warburg and ING Barings safely saw off the first deal, a Eu250m three year retail targeted offering in October, the other two deals were bundled together for a late rush to the market in November. The second Eu400m four year and five month issue scarcely gave European retail enough time to digest the first one.

"Undeniably, the two deals were a bit too close to each other," adds Pakhomov. "But we came within an 11% yield on the second bond, when a week earlier this looked pretty ambitious."

The 75bp pick-up over the previous bond, partly caused by the steepness of the sovereign curve, helped bookrunners JP Morgan and BNP Paribas to target a more institutional-type audience, and cleanly execute what could easily have become a trying deal.

"Funds looking for sovereign paper bought into this bond as a good proxy for the federation," says Luc Cardyn, head of emerging markets syndicate at BNP Paribas in London. "As a result, we could price this bond flat to the Russian dollar curve on a swapped basis."

Following Moscow's lead, issuers from further down the credit curve emerged during the rest of the year, but with mixed success.

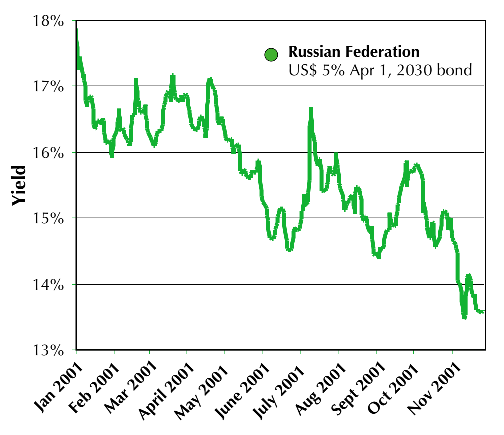
The first corporate was a name few bankers had even heard of at the beginning of the year — Rosneft. The oil company eked out a $150m five year 144A listed deal via ABN Amro and Dresdner Kleinwort Wasserstein in November, but only by offering a chunky 12.75% coupon, and only after swallowing ambitions of issuing up to $300m.

"It was a tough market that we launched into," says Dermot Mayes, head of emerging markets syndicate at Dresdner Kleinwort Wasserstein. "The Russian sovereign curve was particularly volatile, making pricing difficult.

"We also launched the deal just as the market decoupled from Argentina. This meant investors were looking at huge returns on much more familiar credits, including the Russian Federation. A new and complicated corporate credit like Rosneft was no longer the focus of their attention."

Many bankers say the company was not the best credit to kick the market open again, anyway. Only the eighth largest oil company in the federation, Rosneft was state owned — with an uninspiring bureaucratic management to boot — but not state guaranteed, and was one of the few pipeline corporates not to be rated through the sovereign ceiling by Moody's.

Performance of Russia's 30 year benchmark



Source: JP Morgan

Putin: his administration has attracted overseas admirers — and investment

Sibneft, in contrast, was seen as one of the strongest Russian oil credits, and was next in line to issue. But its European roadshow was followed by a week of hesitation, and then company president Eugene Shvidler postponed the transaction until 2002.

"I cannot understand why Sibneft would want to issue," said one banker during the roadshow. "It is cash rich and does not need to come to the market for a year yet. It can get cheaper terms in the loan market. And if it waits, the Russian curve should rally some more."

On top of this, the whole economic and political environment was rapidly turning against oil issuers, as the only thing that seemed likely to halt the slide in the oil price below $20/barrel was an undertaking by president Putin to Opec to constrain oil exports.

This hardly boded well for other pipeline oil credits with expansion plans — Tyumen Oil Company, Tatneft and above all Transneft, the state owned oil pipeline company.

Despite the misfortunes of the oil sector, the London banks were keen to jump on the end of year market rebound and cram in last minute roadshows for other Russian credits.

In the last week of November, Deutsche Bank hosted presentations across Europe for Gazprombank, the gas company's house bank. ING Barings and Dresdner Kleinwort Wasserstein followed up the next week with US and Europe roadshows for leading mobile operator MTS. The week after that, Deutsche was back, this time with steel company Magnitogorsk Metallurgical Kombinat.

"Although the Russian corporate sector got off to an awkward start, it was always going to be a question of time," says Mayes at Dresdner Kleinwort Wasserstein. "Once there are enough corporate issues out there, the sector will reach a critical mass. Investors and banks will start dedicating manpower and credit work to it, and we will see more secondary liquidity and more money available for new issues."

"It is widely anticipated that 2002 will be the year when the market's appetite for analysed risk expands," says Andrew Dell, global head of syndicate at ING Barings in London. "There should be an upsurge in deals for Russian corporates, and repeat deals for several east European issuers that debuted in 2001."

Half marks for Kazakhstan

A similar argument might be made for Kazakhstan, which like Russia saw a big pipeline of corporate issuers in 2001, but no sovereign issuance. Also like Russia, disappointingly few mandates were converted into actual deals.

The first deal from the country was the only one not connected to the burgeoning oil industry, a $100m three year fixed rate bond in June for the number two bank, Bank TuranAlem, via Dresdner Kleinwort Wasserstein. "This was a safe haven transaction for investors weary of Argentina," says Dresdner Kleinwort Wasserstein's Mayes. "The yield on Kazakh debt is pretty stable, thanks to a backstop bid from domestic banks and pension funds."

That domestic bid also delivers unusually tight secondary pricing of Kazakh sovereign bonds for a double-B credit. However, TuranAlem's bond was sold at a yield of over 12%, partly due to regulatory limits on the Kazakh pension funds' ability to buy non-sovereign credits.

London banks were keen to jump on the end of year market rebound and cram in last minute roadshows for Russian credits

One week later, state owned oil pipeline company KazTransOil sold an unguaranteed $150m five year bond via JP Morgan to US and European investors, on the back of the same story of diversification plus the domestic bid.

It achieved a yield of 8.9%, well inside TuranAlem, but only to see that widen out on secondary markets. After September 11, yields peaked around 12%, forcing JP Morgan to issue an explanatory note in one of its daily research reports, in which it blamed heavy selling by one or two major holders of the bond.

The limits on Kazakh pension funds, and the slow pace of growth of their liabilities, slowed down further issuance, and in the fourth quarter Kazakh corporates with debut issues were suffering the same problems as their Russian counterparts.

A bond for the state rail company, Kazakh Temir Zholy (KTZ), was roadshowed by Morgan Stanley in October, but then disappeared off the radar screen.

"They are trying to arrange a joint listing in Kazakhstan for this bond," said a banker following the deal. "This way they can guarantee that when an international account wants to sell, it will be able to find a buyer in Almaty [the Kazakh capital]."

Likewise, a debut bond from state oil producer Kazakhoil via ABN Amro dropped off the 2001 calendar, as according to the lead manager, it will await successful completion of the KTZ deal first.