

# The ALROSA-2014 Eurobond:

*The spread of the Alrosa Eurobond over the Gazprom yield curve is too wide as the Russian government implements its plan to obtain a controlling stake in Alrosa*

**Recommendation:**

**BUY**

**Fair yield**

**Gazprom-2013 + (25-50 bp)**

At the Alrosa AGM on June 25, 2005, Russian Minister of Finance Alexey Kudrin (also Chairman of the Alrosa Supervisory Council) said that the State was taking steps to enhance its control over the company. In particular, *the charter capital of Alrosa is to be increased, and the Russian government will receive a controlling stake through buying out the additional shares issued.* Currently, the government of Russia controls 37% of Alrosa, the government of the Republic of Yakutia – 32%, local self-government institutions of Yakutia – 8%, and company employees – 23%.

The Russian government has been expressing its intention to obtain a controlling stake in Alrosa for about a year, and now these plans seem to be entering their final implementation stage. The government of Russia has gained control over Gazprom recently, and Alrosa is facing a similar future. *This means that Alrosa is of strategic importance for the State and should drive the credit premium of the company's debt liabilities further down.* Once the Russian government has gained a controlling stake, it is going to create a national mining company on the basis of Alrosa. In addition to mining diamonds, this company will implement the policy of the State in mining other natural resources on the Russian territory and abroad.

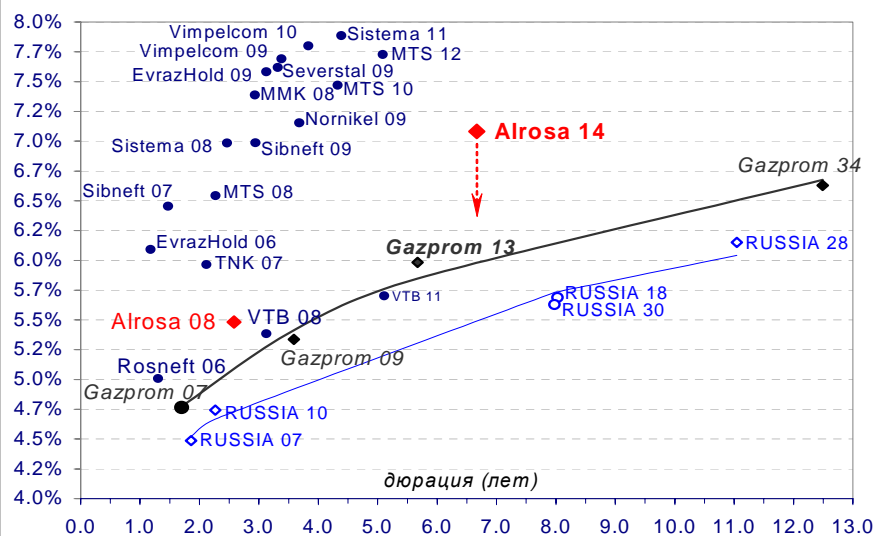
Accordingly, Alrosa credit ratings, upgraded recently by Moody's from "B2" to "Ba3" (which does not reflect more government influence yet), have considerable upside potential upon the Russian government's receipt of a controlling stake. Moody's may upgrade Alrosa to the Sovereign level after the government of Russia has received a controlling stake. *Moreover, the Company has begun recently to reduce debt for the first time over the last few years. Although net debt had increased to a record high \$1.4 bn by mid-2004, it fell to \$1.3 bn by the end of 2004. At the AGM, the Alrosa management announced its plans to reduce the company's net debt to \$985 mn by the end of 2005.*

## Trade Recommendation

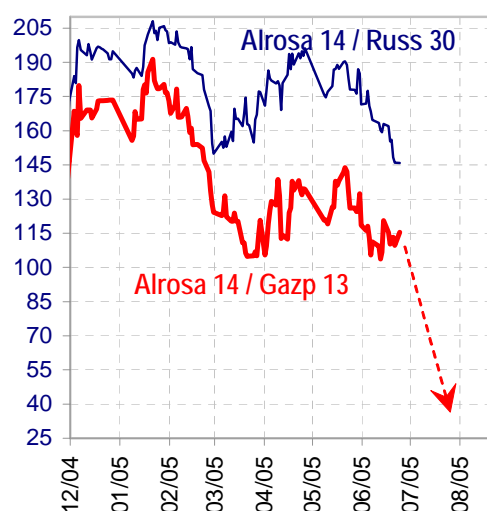
Considering its actual quasi-Sovereign status, the Alrosa-14 Eurobond still carries an unfairly high yield premium over the Gazprom Eurobond curve. *We do not see any considerable difference between the credit risks of Gazprom and Alrosa for investors, as both companies have a similar debt burden and may count upon governmental help in case of need. Alrosa credit risks are to diminish in the course of successful implementation by the government of its plans to obtain a controlling stake in the company (success is no doubt, taking into consideration a similar experience with Gazprom and the government's tough policy aimed at gaining control over governmental companies). Thus, the Alrosa-14 spread over the Gazprom curve and the Sovereign curve is too wide.*

*We expect the Alrosa-14 yield spread over the Gazprom-13 to narrow by 60-90 bp (a 5% price upside potential), as we estimate the Alrosa-14 fair yield spread over the Gazprom-13 to be not more than 25-50 bp.*

**THE RUSSIAN EUROBOND YIELD CURVE AS OF JUNE 28, 2005.**



**THE ALROSA-2014 YIELD SPREAD, BP**



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