

## Equity Markets

\$0.0015

O/W

IRAO RU

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### Utilities



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## Inter RAO: Aggressive Expansion Play

Investors have completely ignored Inter RAO's aggressive plans to grow through acquisitions on the local market. However, the attractively low prices of the target assets coupled with state financing make these plans extremely attractive for minorities. We initiate coverage of Inter RAO with an O/W rating and 12-month TP of \$0.0015/share.

**Aggressive growth via acquisitions creates attractive investment case...**: The company is now heavily involved in M&A in keeping with its strategic goal of expanding on the local power market. This should raise its capacity to 30 GW from the current 7.2 GW by 2015. Since these acquisitions are intended to be financed using government funds, and the current prices of local generating assets are well below their pre-crisis levels, we think this aggressive growth creates an extremely attractive story for Inter RAO's minorities.

**...but the market completely ignores this opportunity:** Based on our sum-of-parts valuation, Inter RAO is now trading 21% below the value of its existing businesses. However, the market ignores the value inherent in two acquisitions we consider to be done deals: OGK-1 and TGK-11. These add \$709 mln of additional value to the company, bringing the total upside we see in the stock to 81%. In addition, other potential takeovers offer a large upside opportunity, as the company's ongoing acquisition strategy could create significant value.

**High-quality assets give superior exposure to liberalization:** As part of UES's breakup, the company obtained the newest thermal-generation assets in Russian, all of which were commissioned in the past decade and are therefore much more efficient than the older assets of OGKs and TGKs. This means that Inter RAO's local generating business is much better placed to benefit from electricity market liberalization than those of its OGK and TGK peers.

**Import/export monopoly benefits from ruble depreciation:** As it sells over half of its exported electricity in euros, Inter RAO benefits significantly from the ruble depreciation of late 2008/early 2009, which has been only modestly eroded by recent currency strength.

**One of the most liquid names in the sector:** Following UES's breakup, Inter RAO is now one of the most liquid names in the Russian power sector alongside RusHydro and FGC. Inter RAO's trading volume over the last year has averaged some \$1.7 mln per day vs. \$6.9 mln for FGC and \$9.6 mln for RusHydro. However, over the last month its volumes have spiked to over \$9 mln/day.

### Share data

Bloomberg ticker	IRAO RU
Reuters ticker	IRAO.RTS
Closing Price	\$0.00083
Average Daily Volume	\$1.7 mln
Free Float	20%
52 Week Range	\$0.00015-0.00085
Shares outstanding, mln	2,274,114
Market Cap, mln	\$1,888
12 M Target Price	\$0.0015
Upside	81%
Recommendation	O/W

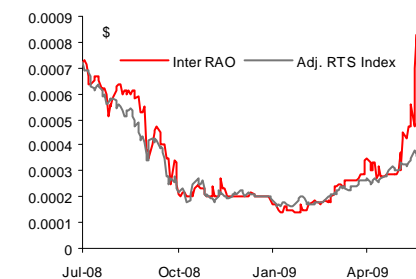
Source: Bloomberg, Alfa Research

### Inter RAO valuation

Type of business/assets	Equity value \$ mln
Trading (export-import) business	1,299
Local generating assets	279
Local retail business	2
Foreign generating assets	582
Foreign electricity distribution assets	124
<b>Total value of the existing business</b>	<b>2,286</b>
<b>The value of newly-acquired assets</b>	<b>709</b>
- OGK-1	698
- TGK-11	11
- value of future acquisitions	\$\$\$?
<b>Total equity value</b>	<b>2,995</b>
Shares outsd, mln	2,274,114
Fair value per share	\$0.0013168
12M target price	\$0.0014993
Current share price	\$0.0008300
Upside	81%

Source: Bloomberg, Alfa Research

### Share price performance



Source: Bloomberg, Alfa Research

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The contents of this document have been prepared by Alexander Kornilov of OJSC Alfa Bank ("Alfa Bank") as Investment Research within the meaning of Article 24 of Commission Directive 2006/73/EC implementing the Markets in Financial Instruments Directive (2004/39/EC). Please refer to the further important information in relation to this Document located on the last page. Note that the recommendation contained in this document in relation to Inter RAO differs materially from recommendations issued by Alfa Bank and distributed by Alfa Capital Markets in the 12 months preceding the publication of this document.

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## Investment Case and Valuation

### Investment case: Six reasons to buy Inter RAO

**We initiate with O/W rating and 12M TP of \$0.0015/share**

We initiate coverage of Inter RAO UES with an Overweight rating and a 12-month target price of \$0.00105/share. We think the company offers an attractive combination: a value story from its existing business and a growth story from its policy of expanding aggressively on the local market through acquisitions of generating assets. In spite of the recent spike in its share price, the market is still undervaluing Inter RAO's existing business while completely ignoring the value that could be added by new acquisitions mainly carried out using government funding. We therefore believe that Inter RAO offers one of the most attractive investment cases among Russian power stocks.

**Aggressive growth through acquisitions creates an attractive investment case**

**1) Aggressive growth:** Inter RAO is now pursuing its goal of aggressively expanding on the local power market via acquisitions of various generating assets located in Russia. With a current capacity of only 7.2 GW (excluding assets under management), the company is looking to increase its capacity to 30 GW by 2015 through acquisitions. We think these will provide attractive value opportunities for minority shareholders, as they are intended to be financed using government cash, while current market conditions mean that assets can be snapped up at bargain-basement prices.

Although the plan for future acquisitions has not yet been specified, the company already has two targets in the pipeline: OGK-1 and TGK-11. Both acquisitions look like done deals, as Inter RAO is expected to raise the cash to acquire OGK-1 via its new share issue and is now negotiating with two of TGK-11's current shareholders, Rosneft and SUEK, on obtaining their stakes.

In addition, Gazprom management recently said that the company is negotiating with Inter RAO about potential asset swaps. These could also increase Inter RAO's generating capacity in Russia, though details have yet to be discussed.

**Growth through acquisitions is ignored by the market**

**2) Growth ignored by market:** In spite of the strong recent performance of Inter RAO's share price, we think the market is still ignoring the huge upside offered by its aggressive expansion policy. Moreover, the market even undervalues the company's existing business: the stock is now trading at \$0.00083/share, 21% below our valuation (\$0.00101/share), most of which comes from its trading, local generating and foreign businesses. We think that once the market gets wind of the value implied by the acquisition opportunities, it will also correct this mispricing of existing assets.

**Import/export monopoly benefits from weaker ruble**

**3) Benefits from weaker ruble:** Accounting for more than 90% of Russia's electricity import/export market, Inter RAO has a unique opportunity to benefit significantly from ruble depreciation, as more than half of its exports are sold in euros. As a result, we expect its trading business to post exceptionally strong results in 2008 and 2009, and we doubt the current share price reflects these expectations.

**Exposure to several national power markets with no alternative investment instruments**

**4) Broad geographical exposure:** With its extensive foreign business, Inter RAO offers investors exposure to several economies in general and their local electricity markets in particular. Several of these are CIS countries for which there are no alternative investment instruments, making Inter RAO shares the only way to gain exposure. Inter RAO currently operates assets in Kazakhstan, Moldova, Georgia, Armenia, Tajikistan, Kyrgyzstan, Lithuania and Finland.

**The highest-quality thermal-generation assets in Russia**

**One of the most liquid names in the Russian power sector**

**DCF is not applicable; we prefer an SoP, multiples-based valuation**

**5) High-quality assets:** As part of UES's breakup, the company obtained the newest thermal-generation assets in Russian. All of these power plants were commissioned in the past decade and are therefore much more efficient than the older assets of OGKs and TGKs. This means that Inter RAO's local generating business is much better placed to benefit from electricity market liberalization than those of its OGK and TGK peers.

**6) Liquidity:** Inter RAO is now one of the most liquid names in the Russian power sector alongside RusHydro and Federal Grid Company. As the sector has had few highly liquid names since UES's breakup, Inter RAO offers a good opportunity for liquidity-constrained investors. Its daily trading volume over the last year has averaged some \$1.7 mln vs. \$6.9 mln for FGC and \$9.6 mln for RusHydro. However, over the last month volumes have spiked to over \$9 mln/day.

### Valuation

Although the company reports IFRS financials, its FY08 results are not expected to be released until August. In addition, after its massive restructuring last year, even its latest RAS accounts are not indicative because they do not consolidate all the company's business activities and so cannot serve as a reliable basis for cash-flow forecasting. We have therefore ignored sophisticated cash-flow-based valuation techniques, preferring instead a more simplistic approach involving a sum-of-parts (SoP) valuation of the company using different multiples, mainly asset-based ones. We intend to support our analysis with a more comprehensive study after the company provides its consolidated IFRS numbers.

Given the lack of consolidated financials and thus reliable balance-sheet data, we opted to perform an equity-based calculation of the company's SoP value. We did so as a simple sum of the interests it holds in its various constituents.

Our SoP valuation of Inter RAO is summarized below:

**Figure 1: Inter RAO valuation**

Type of business/assets	Equity value \$ mln	Per share \$	% of total	Valuation metrics
Trading (import/export) business	1,299	\$0.00057	57%*	8.0x EV/EBITDA discounted @ 30%
Local generating assets	279	\$0.00012	12%*	P/kW for Russian thermal GenCo peers
Local retail business	2	\$0.00000	0%*	P/MWh for Russian retail electricity companies
Foreign generating assets	582	\$0.00026	25%*	P/kW for Russian peers at discount
Foreign electricity distribution assets	124	\$0.00005	5%*	Combination of P/Length of Lines and P/MWh for Russian peers @ 30% discount
<b>Total value of existing business</b>	<b>2,286</b>	<b>\$0.00101</b>	<b>76%</b>	
<b>Value of newly acquired assets</b>	<b>709</b>	<b>\$0.00031</b>	<b>24%</b>	
OGK-1	698	\$0.00031	98%	
TGK-11	11	\$0.00000	2%	
<b>Total equity value</b>	<b>2,995</b>	<b>\$0.00132</b>		
Cost of equity		13.9%		
<b>12M target price</b>		<b>\$0.00150</b>		
Current share price		\$0.00083		
Upside		81%		

Source: Bloomberg, Alfa Research

\* As a percentage of the subtotal value of the existing business

As can be seen, our 12-month target price based on the valuation of both existing and newly acquired assets assumes an 81% upside from the current share price.

Looking at the valuation breakdown, it is clear that the market undervalues even the company's existing business, which we value at \$0.00101/share vs. the current price of \$0.00083/share. On top of that, the market completely ignores the company's strategy of aggressively expanding on the local power market, which is made doubly attractive by the low prices of the assets to be acquired and the fact that these acquisitions will be financed using state money only available to a state-owned company like Inter RAO. Although our valuation reflects the planned acquisitions of OGG-1 and TGG-11, we believe other potential takeovers create additional upside risk, as the company's ongoing acquisition strategy may create much greater value for minorities.

**We have left out the company's asset-management business and global investment prospects**

A lack of information compels us to leave two important pieces of Inter RAO's business out of our valuation: the management of various power assets in CIS countries (e.g. the Armenian NPP and Khrami HPPs in Georgia) and future projects that mainly reflect Russia's geopolitical interests. As regards the first, we do not have enough information to value the asset-management business. As for the second, although we acknowledge that some of Inter RAO's foreign investment projects might not be in the best interests of minorities, almost all of them are now only at the R&D stage, which makes it very difficult for us to evaluate their potential impact on the company.

**We value the trading business at \$1.3 bln**

We value the company's trading business, which primarily involves its electricity import/export operations, at \$1.3 bln. We arrived at this figure by applying an EV/EBITDA multiple of 8.0x to the management's estimated 2008 trading EBITDA. This multiple is the current mean of foreign integrated electricity peers in emerging markets. We then applied a 30% discount to reflect the fact that Inter RAO's trading business is typically highly volatile (see Figure 11 in the next section, showing the company's historical trading EBITDA), and we are not confident that the 2008E EBITDA will be sustainable in the future.

**Figure 2: Valuation of trading business**

2008E trading EBITDA	\$ mln	265
Assigned EV/EBITDA multiple		8.0x
Implied value of the segment, EV	\$ mln	2,120
Assumed discount	%	30%
EV of the segment after discount	\$ mln	1,484
Less: Net debt, RAS, 2008	\$ mln	185
<b>Implied equity value of the segment</b>	<b>\$ mln</b>	<b>1,299</b>

Source: Company data, Alfa Research

**Local generation was valued using Russian peers' P/kW multiple**

Following our equity-based SoP approach, we valued the company's local generating assets by applying the average P/kW for Russian thermal-generating companies (both OGGs and TGGs).

**Figure 3: Valuation of local generating assets**

Asset	Ownership	Installed electric capacity	Equity value
			\$ mln
	%	MW	
Severo-Zapadnaya TPP	100%	900	135
Kaliningradskaya CHP-2	100%	450	67
Sochinskaya TPP	100%	78	12
Ivanovskie CCGTs	100%	435	65
<b>Total value attributed to Inter RAO</b>			<b>279</b>
Average P/kW for Russian thermal GenCo peers		\$150/kW	

Source: Company data, Alfa Research

**We discount the foreign generating assets value to Russian peers**

While we also valued the company's foreign generating assets using the average P/kW multiple for Russian GenCo peers, we then applied discounts

of 30% to thermal and 50% to hydropower peer multiples to reflect the regulatory risks of the respective countries as well as the unclear future of electricity market liberalization in most of the countries where Inter RAO now operates. We used a higher discount for the hydropower multiple because the latter comes from RusHydro, which has higher liquidity, greater exposure to electricity-price liberalization, better corporate governance practices and lower valuation risks than Inter RAO's hydropower assets in CIS countries.

Needless to say, we value only those assets owned by Inter RAO, not those it has under management.

**Figure 4: Valuation of foreign generating assets**

Asset	Ownership	Installed electric capacity	Equity value
	%	MW	\$ mln
Moldavskaya TPP	100%	2,520	264
Mtkvari TPP	100%	600	63
Cascade of Sevano-Razdan HPPs	90%	560	107
Ekibastuzskaya TES-2	50%	1,000	52
Sangtudinskaya HPP	67%	670	96
<b>Total value attributed to Inter RAO</b>			<b>582</b>
Average P/kW for Russian thermal GenCo peers		\$150/kW	
Average P/kW for RusHydro		\$426/kW	
Discount to Russian thermal peers		30%	
Discount to RusHydro		50%	

Source: Company data, Alfa Research

In our valuation, we used Inter RAO's target stake in the Sangtudinskaya HPP, which it will obtain after placing new shares in favor of Rosatom.

**We apply asset-based multiples of Russian MRSKs to value Inter RAO's two DisCos**

Based on information provided by Inter RAO, we have applied two asset-based multiples of Russian MRSKs to value Electric Networks of Armenia and Telasi, its distribution companies. The results are summarized below:

**Figure 5: Valuation of foreign distribution assets**

Asset	Ownership	Electricity throughput	Length of lines	P/km-based valuation	P/MWh-based valuation	Average value
	%	GWh	km	\$ mln	\$ mln	\$ mln
Electric Networks of Armenia	100%	4,900	29,600	133	78	106
Telasi	75%	1,500	5,568	19	18	18
<b>Total</b>				<b>152</b>	<b>96</b>	<b>124</b>
Average P/km for Russian DisCos		\$6,000/km	'000 \$/km			
Average P/Throughput for Russian DisCos		\$23/MWh	\$/MWh			
Discount to Russian peers		30%				

Source: Company data, Alfa Research

As in the case of the foreign generating assets, we also discounted the Russian price multiples at 30% to reflect the high regulatory risks associated with both countries (Armenia and Georgia).

**Target acquisitions are valued at market price**

Inter RAO's current acquisition targets, OGK-1 and TGK-11, are no less important to its value than its existing assets. Although the company has said it is considering other potential M&A deals in Russian generation, it has not specified its acquisition targets, which prevents us from recognizing the value of other potential acquisitions.

We have valued Inter RAO's future interests in OGK-1 and TGK-11 at their current market price. In the case of OGK-1, the Inter RAO stake is simply the

amount of cash to be paid for the GenCo's new share issue, which is R21.3 bln. Based on OGK-1's current share price, this figure assumes that Inter RAO will obtain a 41% post-money stake, although the precise share will depend on the placement price. Also, we do not rule out that Inter RAO could acquire FGC's and RusHydro's current stakes in OGK-1.

Although the press reports that Inter RAO has agreed with SUEK to obtain its stake in TGK-11 (see the next section for more details on the deal), it is unclear what specific source of funding Inter RAO will use to acquire the needed stake in Kuzbassenergo from FGC, and the deal has not yet been confirmed by the company. Therefore, in estimating Inter RAO's value attributed to TGK-11, we assume only its 7% ownership resulting from the deal agreed with Rosneft.

### **Risk factors**

Below we provide the risk factors we think are inherent to Inter RAO shares:

#### **State's interests might prevail over minorities'**

**State control:** The company is now state-controlled, with Rosatom owning 57.3% of its shares, and the government is set to increase its stake through an upcoming placement of additional shares. Given Inter RAO's high level of involvement in various geopolitical issues important to Russia, the interests of the government as majority shareholder may not always coincide with the interests of minorities.

#### **More than 60% of revenue comes from trading business**

**Volatile trading business:** Around 63% of Inter RAO's revenue comes from its trading business, especially import/export operations, which tend to be extremely volatile and hard to predict. This makes the company's business and valuation highly vulnerable to fluctuations in the volumes and margins of its trading activity. However, the company plans to gradually lower the share of trading in its overall business through the acquisition of local generating assets, thus shifting its focus from trading to electricity and heat generation.

#### **Regulatory risks of countries where Inter RAO operates**

**Foreign regulations:** Since Inter RAO operates in several countries of the CIS and Baltic regions, minorities bear the risks associated with these countries' regulatory frameworks for their electricity sectors. Therefore, any adverse changes to these frameworks could considerably undermine the company's businesses in these countries.

## Company Overview

### The company at a glance

Inter RAO UES is now a vertically-integrated power company, incorporating various sections of the electricity business. The company was spun off from UES on July 1, 2008. The once former-UES subsidiary – jointly owned by Rosenergoatom – was spun off from UES on July 1, 2008, and its shares are now listed on Russian exchanges. Inter RAO's total installed capacity for its generating assets is around 18,000 MW. This includes directly owned assets as well as those under fiduciary management, the largest of which is OGK-1. Inter RAO also has a monopoly on Russia's electricity import/export trading, accounting for more than 90% of the market. Total export volumes in 2008 were 20.6 TWh vs. just over 3.0 TWh in total imports over the same period.

Inter RAO was established in 1997 by RAO UES and has been selling electricity on the Russian wholesale power market since 2000. In 2003, Rosenergoatom (Russia's nuclear power monopoly) became a 40% shareholder in the company. At the same time, Inter RAO was conferred the status of unified import/export operator to meet the needs of both RAO UES and Rosenergoatom, and began exporting electricity to 12 foreign countries.

Along with import/export operations, the company has been active on the M&A market, acquiring various electricity assets, mainly from former Soviet republics. UES financed all these acquisition and brought them under Inter RAO's umbrella. Most notably, Inter RAO acquired thermal power plants and a local electricity distribution networking company in Georgia followed by the acquisition of hydropower assets in Armenia. In 2005, the company acquired a 50% stake in Ekibastuzskaya GRES-2 in Kazakhstan. This list of acquisitions extended considerably over the next three years.

In 2008, as part of the restructuring of UES, the company obtained four standalone power plants which had not been included into the respective OGKs and TGKs, with total installed capacity of 1.9 GW. These power plants are the most recent ones commissioned by UES, mostly since 2000.

### The state now controls 57.3% via Rosatom

The government is the main shareholder, and currently controls 57.3% of the company's equity via Rosatom, the state company responsible for the country's nuclear industry, including nuclear power production. The company is set to approve a new share issue at its AGM scheduled for June 25, with Vnesheconombank (VEB), Rosatom and the government as the main beneficiaries. The main purpose of the share issue is to raise around R26 bln in cash for its various ongoing projects (see below for details).

### Inter RAO's key business segments

Given the company's abovementioned conglomerate structure, we have split its business operations into the following key areas:

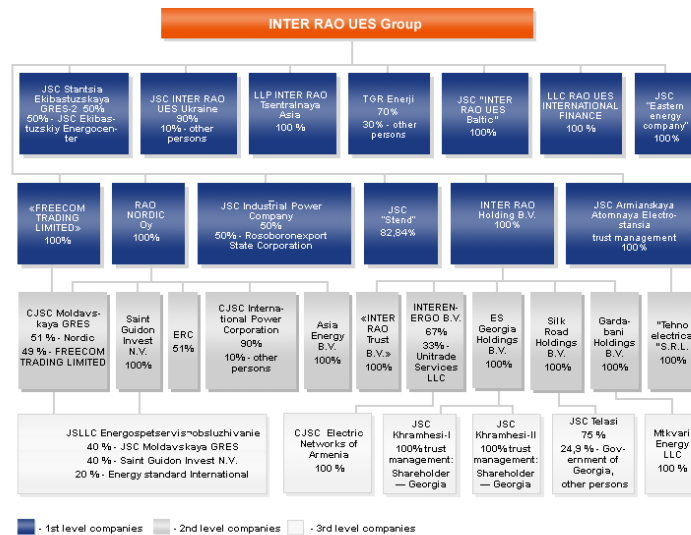
- **Trading**, which mainly consists of electricity import/export operations, including trading abroad. Its trading activity also includes a small retail branch that operates in the Orel region and provides around 28% of the region's electricity consumption;
- **Local electricity generation**, coming from the four most recently built power plants in Russia, located in various parts of the country;
- **Foreign assets**, including generating power plants and low-voltage distribution networks in Armenia and Georgia;
- **Fiduciary management of assets**. This covers relatively old deals involving the company's Armenian assets (the fiduciary management

of a local nuclear power plant since 2003) and Georgian assets (two local hydropower plants) as well as the recently approved deal that will see Inter RAO managing the shares in OGC-1 owned by the Federal Grid Company and RusHydro (61.9% of voting shares);

- **Investment activity**, which is currently the least transparent section of the company's business. It mainly involves plans to renew existing assets (both local and foreign) as well as plans for joint participation in investments in the core electricity businesses of various countries around the world (from South America to Europe to the Middle East).

Below is the current organization structure of Inter RAO and all its subsidiaries:

**Figure 6: Inter RAO UES structure**



Source: Company data

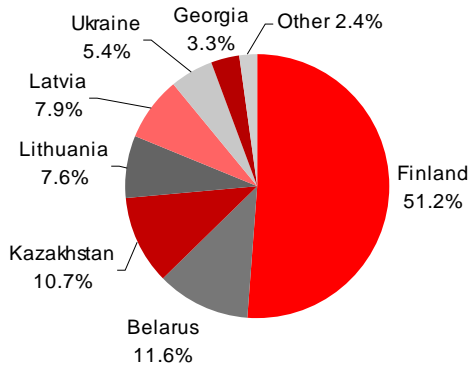
Since the first three business areas make up our valuation of the company, we will go through them in more detail.

### Electricity-trading business

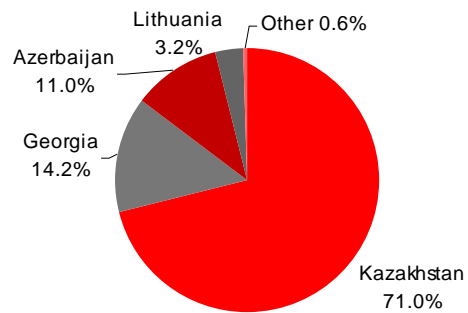
Inter RAO is a local import/export monopoly, controlling more than 90% of the market, meaning that more than 90% of import/export flows in electricity have to go through Inter RAO as the mandatory intermediary. Therefore, the company is able to catch all the profits resulting from the difference between local and foreign electricity prices. The largest share of Russia's exported electricity goes to Finland, Kazakhstan, Belarus and Baltic countries. The main import markets include Kazakhstan and some counties in the Caucasus, chiefly Georgia and Azerbaijan.

Inter RAO's import/export trading structure is summarized in the charts below (in volume terms):

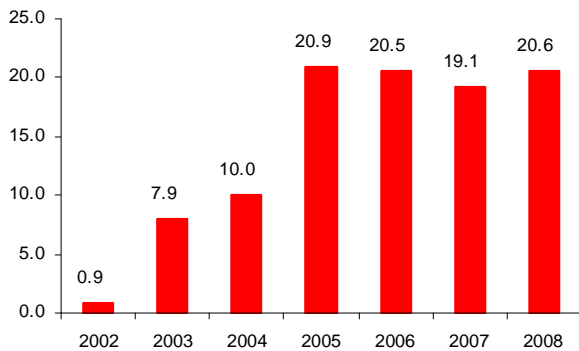
**Russia's import/export monopoly, accounting for 90% of the market**

**Figure 7: Electricity export make-up, 2008**


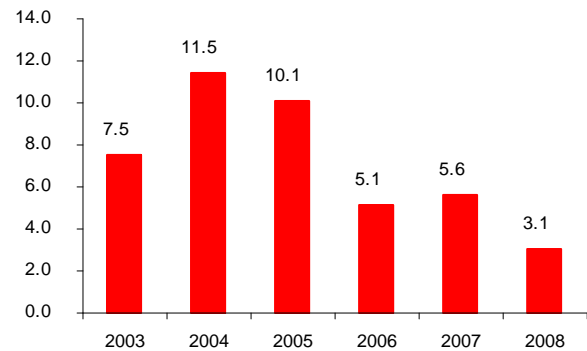
Source: Company data

**Figure 8: Electricity import make-up, 2008**


Source: Company data

**Figure 9: Export performance, bln kWh**


Source: Company data

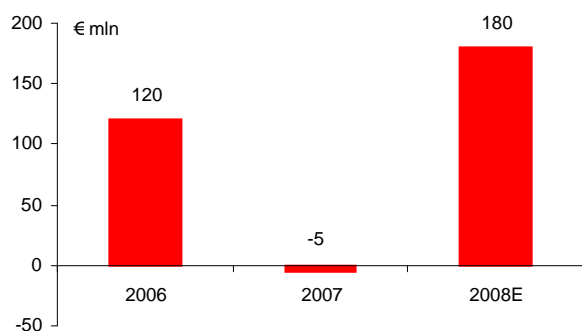
**Figure 10: Import performance, bln kWh**


Source: Company data

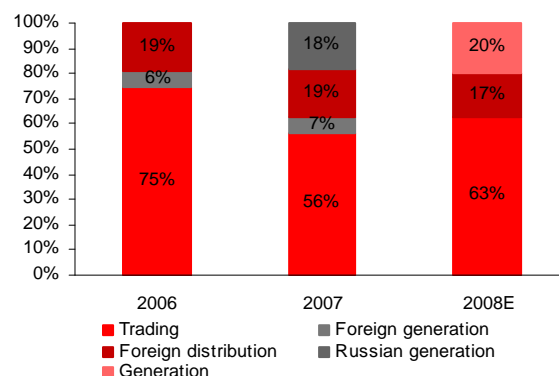
**Trading EBITDA reached €180 mln in 2008, management guides for an 8-10% profit margin**

On the financial performance side, the company expects trading EBITDA to reach €180 mln (\$265 mln) in 2008. Consolidated 2008 IFRS numbers are due to be released in August. Vyacheslav Artamonov, Head of Trading at Inter RAO, said earlier that the company expects to see an 8-10% profit margin from its trading operations in the foreseeable future.

The revenue breakdown and trading EBITDA performance are shown below:

**Figure 11: Trading EBITDA, € mln**


Source: Company data

**Figure 12: Revenue breakdown**


Source: Company data

The charts above show that trading EBITDA rose considerably in 2008 compared with the unspectacular previous year, which saw negative EBITDA. We think there were two major factors behind this: 1) European electricity prices were higher in 2008 than in 2007 when the price in euros dropped 43% vs. 2006, and; 2) The ruble depreciated at the end of 2008.

The company's share in trading fell following the company's restructuring and involvement in local power generation. Management now considers the acquisition of generating assets on the local power market as one of its major strategic goals, which will enable the company to reduce its exposure to the highly volatile trading business while at the same time considerably expand its asset base.

### Local power-generating business

In 2008, the company took control of four stand-alone power plants as part of the UES restructuring deal. As a result, the company now owns Severo-Zapadnaya CHP, Sochinskaya TES, Kaliningradskaya CHP-2 and Ivanovskie CCGTs. These power plants are the newest in the country, and were commissioned by UES after 2000, and therefore have the best technical parameters and the highest efficiency vs. their older peers. In particular, the fuel consumption rate of Inter RAO's local generating assets is only 260-270 gce/kWh compared with the Russian average of 330-350 gce/kWh.

The key parameters of the four power plants are summarized below:

**Figure 13: Inter RAO local power generation assets**

Asset	Location	Ownership %	Inst. electric capacity MW	Fuel type	2008 electricity output	
					2008 electricity output GWh	2008 load factor %
Severo-Zapadnaya TPP	Leningrad region (near St. Petersburg)	100%	900	Gas	4,366	55%
Kaliningrad CHP-2	Kaliningrad region	100%	450	Gas	2,689	68%
Sochi TPP	Krasnodar region, Sochi	100%	78	Gas	434	63%
Ivanovo CCGTs	Ivanovo region	100%	435	Gas	653	17%
<b>Total</b>			<b>1,863</b>		<b>8,142</b>	<b>50%</b>

Source: Company data

The company currently wants to expand onto local power markets by acquiring local generating assets. In particular, the company is expected to gain control of OGK-1, the largest wholesale generating company in Russia in terms of installed capacity. Inter RAO also has its sights on TKG-11 as an acquisition target.

**Four most recently built power plants make up the company's local generation assets so far**

**Power plants have high exposure to electricity exports**

Three of these power plants are located very close to the Russian border, which will help the company’s export business, as the plants have a high exposure to potential power exports. The location of the power plants is shown below:

**Figure 14: Location of Inter RAO’s local generating assets**



Source: Alfa Research

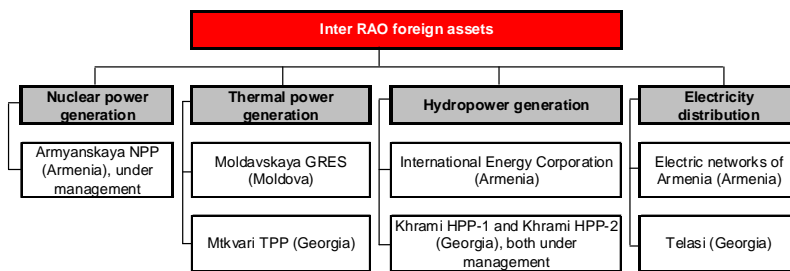
As can be seen from the map above, Severo-Zapadnaya CHP, Kaliningradskaya CHP-2 and Sochinskaya TPP are the best placed to gain exposure to the electricity export market.

**Foreign assets: Generation and distribution**

Inter RAO’s foreign assets are both generating and distributing businesses.

The structure of Inter RAO’s foreign assets, including those under fiduciary management (not owned) is summarized below:

**Figure 15: Inter RAO foreign assets**



Source: Company data

**Inter RAO’s foreign generation assets have 5.4 GW of capacity**

The company’s total foreign generating assets have installed capacity of 5.4 GW, 2.8x more than its local electric power plants. This figure does not include the assets under fiduciary management, which usually add just over 1 GW of capacity (Armyanskaya NPP (815 MW) and two Georgian hydropower plants: Khrami-1 and Khrami-2 (220 MW in total).

The key characteristics of Inter RAO’s own generating capacities are presented below:

**Figure 16: Inter RAO-owned generating assets outside of Russia**

Asset	Location	Ownership %	Inst. electric capacity MW	Fuel type	2008 electricity	2008 load
					output GWh	factor %
Moldavskaya TPP	Moldova	100%	2,520	Gas, coal, fuel oil	2,631	12%
Mtkvari TPP	Georgia	100%	600	Gas	503	10%
Cascade of Sevano-Razdan HPPs*	Armenia	90%	560	Hydropower	577	12%
Ekibastuzskaya GRES-2	Kazakhstan	50%	1,000	Coal	6,199	71%
Sangtudinskaya HPP	Tajikistan	67%**	670	Hydropower	1,142	19%
<b>Total</b>			<b>5,350</b>		<b>11,052</b>	<b>24%</b>

Source: Company data

\* Owned by the International Energy Corporation, 90% owned by Inter RAO

\*\* This stake will be obtained after Inter RAO's additional share placement, the current stake is only 2.18%

- **Moldavskaya TPP.** One of the largest thermal power plants in Eastern Europe, with huge export potential to the UCTE zone. The station has the capability to export electricity to neighboring Romania, Belarus, Ukraine and Bulgaria, and it has the added advantage of being able to use gas, local coal and fuel oil.
- **Mtkvari TPP.** One of the most cost-efficient gas-fired thermal power plants in Georgia. The power plant sells its electricity through Telasi, a local distribution company, also owned by Inter RAO.
- **Cascade of Sevano-Razdan HPPs.** Located in Armenia, these hydropower plants produce 10-12% of the country's total electricity. All the hydropower plants are now fully operational.
- **Ekibastuzskaya GRES-2.** One of the largest power plants in Kazakhstan, producing around 8% of the country's electricity output. The power plant uses cheap local coal from Ekibastuz's mines and exports some electricity to Russia.
- **Sangtudinskaya HPP-1.** A newly-built hydropower plant located on the Vakhsh River in Tajikistan. Its first unit was commissioned in 2007 and a further two in 2008, with the participation of Inter RAO UES. The plant is expected to be completed this year and its total installed capacity should reach 670 MW. Currently, Rosatom has a 64.45% stake in Sangtudinskaya HPP-1 while Inter RAO owns only 2.18% of the plant. However, Inter RAO is expected to gain control of the asset soon, following a new share placement. This is set to be approved at its forthcoming AGM, scheduled for June 25.

### Distribution business includes two companies in Armenia and Georgia

As well as generation, the company is also involved in electricity distribution (the so-called "last mile") via the ownership of two companies: Electric Networks of Armenia and Telasi. The main parameters of both companies are summarized below:

**Figure 17: Inter RAO foreign distribution assets**

Asset	Location	Ownership %	Electricity throughput	Length of lines
			GWh	km
Armenian Distribution Networks	Armenia	100%	4,900	29,600
Telasi	Georgia	75%	1,500	5,568
<b>Total</b>			<b>6,400</b>	<b>35,168</b>

Source: Company data

The networking company in Armenia benefits from favorable RAB-based tariff regulations – now being introduced in Russia – which have a 17% rate of return vs. the proposed 12% rate in Russia.

### **Expansion into local power market a key strategic priority**

The company now has the following set of strategic goals:

- To significantly extend its generation asset base to 30 GW by 2015;
- To increase the market value of the company to \$14 bln by 2015;
- To increase the value of its power assets in order to carry out attractive future asset swaps with strategic investors in the global power sector;
- To create vertically-integrated sub-holdings in target markets;
- To diversify engineering capabilities and implement energy-efficiency and energy-savings projects in Russia and abroad.

#### **OGK-1 and TGK-11 deals are already in the pipeline**

To fulfill its first goal, the company is now going through an aggressive M&A phase, expanding onto the local electricity market through the acquisition of local generating assets. Currently, the company has two generating companies in its pipeline: OGK-1 and TGK-11, which have both come under its fiduciary management. Both companies are Inter RAO acquisition targets on the local market, and the company has already taken steps to gain control of them.

#### **OGK-1: Done deal with state money**

Gaining control of OGK-1 looks like it will be a fairly simple process involving two stages. First, Inter RAO will issue additional shares in favor of VEB paid for with R21.3 bln in cash. Then, Inter RAO will transfer this cash to OGK-1 to finance its Urengoiskaya CCGT project via OGK-1's new share issue in favor of Inter RAO. OGK-1's placement price is currently unknown and therefore we do not know the exact post-money stake of Inter RAO. However, it has to be close to the controlling stake based on the current market value of the company.

Recently, RusHydro's acting CEO Vasily Zubakin said that his company is considering selling its 23% stake in OGK-1 to Inter RAO. Inter RAO's response is still unknown, but we do not rule out the possibility that this will happen, along with the acquisition of FGC's 43% stake.

#### **First stage in TGK-11 acquisition will involve Rosneft and SUEK**

Inter RAO will likely obtain Rosneft's and SUEK's stakes in TGK-11 in the first stage of its acquisition. Rosneft has agreed to transfer its shares in TGK-11 to Inter RAO, which will result in the latter ending up with around 7% in TGK-11.

*Kommersant*, citing an unnamed source close to the deal, reported that Inter RAO has agreed with SUEK to obtain its 26% stake in TGK-11. Inter RAO will purchase 18.6% of Kuzbassenergo from the Federal Grid Company and then exchange this stake for SUEK's share in TGK-11. The deal with Inter RAO involves a pure-share swap and does not involve any cash settlements.

Therefore, along with Rosneft's shares, the company is set to end up with a 33% stake. *Kommersant* also reported that Inter RAO is now negotiating with the E4 Group, which acquired 28.9% in TGK-11 in 2008, and is currently paying the FGC for this stake in installments.

#### **Share issue plans**

The company is set to hold an additional share placement, with a maximum of 1,600,000,000 shares. This issue is on the agenda of the company's AGM scheduled for June 25.

The new share issue will involve the following parties and payment methods:

- Vnesheconombank (VEB) will transfer R21.278 bln to the company to finance an OGK-1 project;
- Russia's Federal Property Agency (via VEB). R4.5 bln in cash will be injected to finance the construction of the Kambaratinskies HPPs in Kyrgyzstan;
- Rosatom will transfer its 64.45% stake in Sangtudinskaya HPP-1 to Inter RAO's and/or cash.

### **Corporate governance**

#### **Board of directors**

The company's board of directors is presented below:

Igor Sechin, Chairman of the Board, Deputy Prime Minister of Russia

Nikolai Anoshko, CEO of Russische Kommerzial Bank AG

Evgeny Dod, Chairman of the Management Board at Inter RAO UES

Sergei Kirienko, CEO of State Corporation Rosatom

Vyatcheslav Kravchenko, CEO at Rosneft-Energo

Grigory Kurtser, Head of Resource Management Service at VTB

Alexander Lokshin, Deputy CEO of State Corporation Rosatom

Sergei Maslov, President of the St. Petersburg International Commodity Exchange

Yuri Petrov, Head of the Federal Property Agency

Kirill Seleznev, Member of Gazprom's Management Board, Head of Gazprom's Marketing Department and Gas and Liquid Hydrocarbon Processing

Sergei Shmatko, Russia's Minister of Energy

#### **Management board**

The management board of Inter RAO is listed below:

Evgeny Dod, Chairman of the Management Board at Inter RAO UES

Vyatcheslav Artamonov, Deputy Chairman of the Management Board, Head of Trading

Timur Ivanov, Deputy Chairman of the Management Board, Head of Business Development Direction at Inter RAO

Mikhail Mantrov, Deputy Chairman of the Management Board, Head of the Corporate Center of Inter RAO

Dangiras Mikalayunas, Head of the European Geographic Division

Alexander Nikitin, Head of the Financial Division, CFO

George Rizhinashvili, Head of Strategy and Investments Division

Sergei Rummyantsev, Head of the Investment Programs Division

Sergei Tolstoguzov, Head of the Asset Management Division

Yuri Sharov, Head of the Central Asia and Far East Geographic Division

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## IMPORTANT INFORMATION

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