LOCAL PLAYERS VIE FOR POSITION

As Russian capital markets activity revives, second-tier investment banking groups have ambitious plans to share a larger slice of the business. But competition is tough.

WRITER
Philip Alexander

For Russia's investment banks, the financial crisis was a story of survivals, rescues and resurrections. The bailout of KIT Finance by Gazprom pension fund manager Lider Asset Management, and later Russian Railways, was the harbinger of the crisis in Russia. Sharp falls in stock market values hit any investment banks or brokerages that had relied on margin lending, with shares as collateral, to fund themselves or their clients.

The established market leaders remain Renaissance Capital, in which cash-rich Mikhail Prokhorov took a 50% stake at the height of the crisis, and Troika Dialog, which sold a 33% stake to South Africa's highly liquid Standard Bank. State-owned VTB Capital has also burst onto the scene, with its status as the investment banking arm of Russia's influential second-largest bank helping to win mandates for the Rusal initial public offering (IPO) of January 2010 and the sovereign bond in April.

Beneath this top tier, however, smaller players are battling for a share of a rebounding market. Among the survivors, Metropol Investment Financial Company was the only institution that did not sell a stake to a government or other liquid investor. It was a close shave, recalls Metropol's founder and CEO, Mikhail Slipenchuk. One of the country's largest banks closed a credit line for $80m without warning, and within weeks only Metropol's private banking subsidiary, Obibank, was keeping lines open.

"Normally, only a loan of $2m or more would go to the board to decide. In the winter of 2008/09, the board was discussing paying just $50,000 for diesel to heat our offices in the freezing weather," says Mr Slipenchuk.

But the bank avoided default, and its traders continued to make money on the markets. After putting any activities that could not show a weekly return on hold for most of 2009, the bank began to invest again in December. Its equity capital markets (ECM) business is already developed, and Mr Slipenchuk wants to build capacity in debt capital markets (DCM) and mergers and acquisitions advisory. He has set an ambitious target of quintupling the overall market share of the investment bank.

Meanwhile, Metropol's brokerage activities have also received a potentially significant injection this April, when the group sold a 50% stake in Obibank to Japan's SBI Group, which runs one of the largest online trading platforms in Japan. The two companies are also creating a $100m joint venture fund to invest in Russian shares and real estate.

"SBI wanted a partner to help it establish a presence in the fast-growing Russian private banking market, and for us it can bring the highest standards of technology for internet banking, including trading, payments and risk management," says Mr Slipenchuk.

COMMERCIAL BACKBONE

Another survivor is Uralsib Capital, which has a rather different business model. It is the investment banking arm of one of Russia's largest privately owned commercial banks, ensuring that it had access to liquidity through the Central Bank of Russia repo window.

John Parker, a managing director and head of international equity sales at Uralsib, acknowledges that the bank will not yet overtake the likes of Renaissance as the top player on investors' broker list, but says it has a unique position. The commercial bank is present in 46 regions of Russia, with 2.7 million clients, weighted towards the corporate banking segment. This gives its institutional investor base the potential to access expertise on non-oil and domestic-oriented sectors of the economy.

"Outside the likes of Gazprom, Russian companies must be careful to understand who can invest in their stock. It is about promoting themselves properly to the right investors, who are not necessarily the top investors in the world. That is what will take their stock price to the highest sustainable level," says Mr Parker.

According to research by Uralsib, international investors are slowly moving beyond the traditional top 10 blue-chip stocks in Russia, into the second tier. The top 10 accounted for 87% of foreign investor holdings in December 2008, but this had dropped to just 69% by January 2010. In addition, the listing of Rusal in Hong Kong in January has encouraged Russian companies to look more closely at the vast funds available in Asia, especially Chinese investors who may be restricted from investing outside their home exchanges.

Mr Parker brought one Chinese Qualified Domestic Institutional Investor (QDII – permitted to invest externally by the Chinese authorities) to Russia, which came with a team of 11 staff and made significant profits during the market rebound in the second half of 2009. But he notes that this model is still relatively rare among QDIIs and other Asian investors.

"The overwhelming theme for Asian investors in Russia is its role as a resource supplier to China, which is something they understand sitting in Hong Kong or Singapore – they know how much oil, metals or fertiliser China

Mikhail Slipenchuk, founder and CEO, Metropol

Roman Lokhov, head of global markets and investment banking, Otkritie

Andrey Shemetov, CEO, Aton Capital

needs, and want to invest in those companies. But I don't think we are yet seeing many Asian investors asking what the domestic themes in Russia are," says Mr Parker.

MOSCOW CONVERGES

Otkritie Financial Corporation is also following the combined corporate and investment banking model, on a similar path to Uralsib's consolidation of several commercial banks in 2005. Helped by VTB Capital's purchase of a 20% stake in March 2009, the corporation has now bought and consolidated two corporate banks, Russian Development Bank and Petrovsky Bank. The plan now is to build out a full-service investment bank across ECM, DCM, foreign exchange and advisory. While this will draw on its corporate client base, Otkritie is also positioning itself as a prime brokerage provider.

"The prime brokerage segment is not well developed in Russia, but the demand is there, both from Russian clients and especially from the algo and proprietary trading houses in western Europe. They want to get quotes in dollars or to hedge every trade," says Roman Lokhov, head of global markets and investment banking at Otkritie.

Its London arm, Otkritie Securities, has UK Financial Services Authority (FSA) registration, and was the first Russian brokerage to offer direct market access (DMA) to the two Moscow equities exchanges, RTS and MICEX, providing more transparent pricing to investors. Mr Lokhov is targeting a $30m to $40m DMA business in 2010, to double in 2011. He believes Otkritie can best gain market share by switching its revenue model from charging clients spreads, to charging commission fees and offering associated services, as Russian markets converge to western European standards. Moscow stock markets still settle on a cash-upfront (T+0) basis, but Mr Lokhov sees the move to Western-style T+3 trading settlement as inevitable.

"The government and the exchanges want to build up a financial centre in Moscow, so the exchanges are moving to international standards, trading in dollars and so on. In three years, there will not be much difference between Russian and western European stock markets, so international investors will expect us to allow them to play by their own rules, FSA regulated," says Mr Lokhov.

At the same time, the bank aims to use its $3bn to $4bn balance sheet and top five Russian brokerage network to create a strong investment banking platform, with a view to launching an IPO of its own shares within three years. The advisory team advised extensively on the unbundling of power giant RAO UES in 2008, and the bank won its first IPO mandate in April 2010, for satellite navigation and tracking manufacturer Russian Navigation Technologies.

TOUGH COMPETITION

The survivors have a head start as the market revives, but they face competition from several resurrected firms. Russian Railways merged the remnant KIT Finance with the investment banking operations of its affiliated bank, TransCredit, to form TKB Capital in April 2010. The bank is still restructuring, but would clearly have the edge if Russian Railways decided – as is widely expected – to begin an unbundling and privatisation process similar to that undertaken by RAO UES in 2008.

And then there is Aton Capital, whose owner Evgeny Yuriev sold its investment banking business to UniCredit in 2006. He retained the retail brokerage side of the business, and signed a non-compete agreement that ran until 2009, by chance sidestepping the worst of the financial crisis.

According to Aton's CEO, Andrey Shemetov, wealth management, investment banking and institutional brokerage lines have all been fully rebuilt in the past year, and have already acquired their first mandates. The bank is targeting yearly profits of $120m by 2015, before exploring a possible IPO.

"The presence of aligned relationships with a wide range of Russian and international investors allows us to work equally effectively with blue-chip issuers, as well as with companies in the second and third echelons. Now we are orienting ourselves to deal with medium-sized companies outside the commodity sector," says Mr Shemetov.

The competition from foreign investment banks also shows no signs of abating, and poaching of quality staff is accelerating again. However, it is not clear whether access to the largest international institutional investors is such a significant advantage for Russian companies outside the blue-chip segment.

The recent secondary share offering by real estate developer LSR is a case in point. The company turned to Goldman Sachs and JPMorgan after smaller Russian firms had suggested its desired asking price of $11 per global depository receipt (GDR) was too high. In the end, the US banks had to cut the guidance price, and the GDRs were only sold at $8.50 – in line with what Russian investment banks had originally proposed. TB