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Yandex Warns of Risk Ahead of IPO

By The Moscow Times

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Russia is a topsy-turvy place. Take initial public offerings: In the West, the game is to convince investors that you have the coolest product on the market and the sharpest management team if you want people to buy your stock. In Russia, it seems that the more dirt on yourself that you can squeeze into your prospectus, the more investors will be attracted to your company.

It worked for Wimm-Bill-Dann. When the company floated at the start of 2002, it admitted in its prospectus that the company's largest shareholder, Gavril Yushvayev, had served nine years in a Soviet labor camp after being convicted of a violent crime. The company also admitted that Yushvayev and another shareholder, David Yakobashvili, also owned Trinity Motors, which was one of the first companies to import American-made cars and was rumored to have ties to organized crime. (Trinity used the main hall in Detsky Mir as a showroom in the very early '90s.) All these admissions were taken as a sign that the company was serious about transparency, and investors didn't seem to care about whatever wrongdoing stood behind them.

Wimm-Bill-Dann co-owner Yakobashvili told me at the time that the board had debated the decision to come clean long and hard. "At the end of the day, if we didn't admit it then someone would have eventually dug all this stuff up and that would have caused a lot more damage." It was a fine judgement, but he was right. Everyone ran the Soviet labor camp story, but four days later the story was dead and hardly anyone still remembers it. Indeed, PepsiCo had no qualms about talking to this former convict when negotiating its $3.8 billion takeover in December 2010.

Now Yandex, Russia's "Google," is going down the same road. The biggest selling point the company highlighted in its IPO prospectus is that it is a really, really dangerous investment.

Russia's most popular search engine filed with the U.S. Securities and Exchange Commission to list 52.2 million shares at between $20 and $22 each on May 9 ahead of its IPO on Nasdaq, which would value the company at $6.7 billion at the top of the range and would make it Europe's biggest online company, according to analysts with investment bank UralSib.

The investment story is obvious: The company has wiped the floor with Google on RuNet — Yandex says it accounts for 64 percent of all search traffic in Russia compared with Google's 22 percent — and online advertising revenues will likely triple in the next five years. Indeed, online ad spend was the only advertising segment to grow in the last couple of years, and this also fits neatly into a global trend that recently saw online ad spend in Britain overtake television ad spending. If you are interested in Russia online, then the Yandex IPO is a no-brainer.

However, the company went out of its way to highlight the political and corporate risks in its pitch to investors. "High-profile businesses in Russia, such as ours, can be particularly vulnerable to politically motivated actions," Yandex said in the prospectus. "Other parties" may perceive Yandex's news service "as reflecting a political viewpoint or agenda, which could subject us to politically motivated actions," the document said.

Nice. We at bne have also heard a persistent rumor that the company was being leaned on by government officials who blocked the IPO in the hope of extracting a 25 percent stake for unnamed individuals — wait, they successfully blocked it? When? We can't substantiate this rumor, but the company has taken three years to get to this point after it first announced it wanted to float.

Still, the company is being punished on price. The indicative price range the company just released is low compared with Yandex's peers in other emerging markets due to the high risks of investing in such a public and attractive company. Yandex will offer a 2011 price-earnings ratio of 30-34 times, while Chinese portals such as Baidu (56 times) and Sina (69 times) demand much higher prices.

Why is Yandex selling for half of what it could get if it was in China? The fault is surely not just its run with the FSB, which at the start of May demanded data from its online payment service Yandex.Dengi — data which was promptly leaked and used to bosh anti-corruption blogger Alexei Navalny, who is also being investigated by the Investigative Committee.

The majority of the discount is simply "Russia risk." This is pretty much the same thing as the risks that Yandex highlighted in its prospectus. The point is not that these things will happen to Yandex, but that they could happen to anyone with an attractive business in Russia. Yandex's owners are in no more danger of losing their company than anyone else. But the risk means that like everyone else, they have to spend a considerable amount of time and effort cultivating a *krysha* (literally, a roof) in government to protect themselves from attack. This is a colossal waste of resources and remains a drag on growth.

But investors don't really care about this either as the margins are fat, and more importantly this IPO shows that owners have woken up to the fact that if they want to float they have to leave something on the table for their shareholders. In the past, nearly all of Russia's IPOs were priced for very strong growth that never appeared and almost all have underperformed the index in the last 10 years. This ability to sell stock at very expensive valuations has been killed by the crisis. One fund manager, who asked to remain anonymous, said: "Russia risk is always there, so most are used to it. As long as the pricing and strategy are right, then appetite should remain."

The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.