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Swedish Telecoms Poised for Russia's 4G Wireless Wave

By Peter Spinella

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Fourth-generation ultra-broadband wireless is hitting Russia's major cities, and Sweden's top two cellular providers, TeliaSonera and Tele2, are ready to cash in.

A recent change to the shareholding structure of TeliaSonera's Russian interest, securing an annual payout to the Swedish provider, has better-positioned the firm to benefit from the 4G roll-out.

Tele2 is committed to winning regional licensing tenders throughout Russia. It faces a tough battle with the three majors, though, for 4G bandwidth rights.

The Swedes' Russian experience spans more than a decade. Tele2 has grown its local wireless telephony business into Russia's fourth-largest. TeliaSonera, on the other hand, was only in April able to secure a substantial return on its nearly 18-year investment in the nation's No. 2 provider, MegaFon.

Exponential Growth, Big Payouts

Tele2 entered Russia in 2001 by acquiring 12 regional operators. It now covers 37 regions and more than 20 million subscribers in the nation. The firm's exponential growth is, to a large extent, by virtue of its pricing strategy: undercut the competition.

Tele2 prides itself on compelling Russia's big three players to bring down prices. "Cellular expenses of Krasnodar region residents were among the highest in Russia in 2008 before Tele2 launched its network in November of that year. In 2009 they were among the lowest," the firm said on its website.

Tele2's average regional market share in Russia exceeds 30 percent, it said.

"This fact is a good demonstration of what could happen if we have an all-Russia license," Tele2 spokesman Alexander Bakhorin said by e-mail. "We provide to our customers the best deal: reasonable price for high level of service."

Globally, across all of its areas of presence, Tele2 has 34 million subscribers, about half the population of those areas. Russia is Tele2's largest market by customer base.

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Sweden's largely state-owned telephony leader, TeliaSonera, has been involved with MegaFon since that firm's inception in 1994. TeliaSonera's attempt to prize control of the Russian provider was thwarted in 2010 by a court ruling that the state-controlled foreign investor could not acquire the "strategic" firm.

Only recently, on April 24, was TeliaSonera able to reap a substantial profit from its investment in MegaFon. For the first time in the Russian provider's history a dividend deal was clinched.

Pursuant to the agreement, TeliaSonera would get a onetime payment of $3.25 billion, 18 times its initial investment, plus an annual dividend. It would also eventually lower its stake to 25 percent plus one share, yielding majority ownership to AF Telecom, controlled by Russia's wealthiest man, Alisher Usmanov.

Within days of that agreement, Usmanov moved to unite his MegaFon stake with 100 percent of Scartel, operator of Russian broadband wireless provider Yota, by creating a joint telecom holding. The move would essentially bring both companies under his wing.

Yota has been a pioneer of wireless Internet in Russia. But whether its indirect merger with MegaFon translates into revenue for TeliaSonera has yet to be seen.

Pulling Up Stakes

VTB Capital analyst Viktor Klimovich told Vedomosti on April 26 that as long as Scartel's networks are not overloaded, it would be more profitable for the firm to remain independent and rent out bandwidth to MegaFon and other mobile operators.

But Klimovich also noted that thanks to its common shareholders, MegaFon could completely usurp Scartel's entire network, which would give MegaFon more than twice as many LTE frequencies as its big three competitors. LTE, which stands for "long-term evolution," is a high-speed wireless communication standard and a precursor to the 4G standard.

TeliaSonera's diminished stake in MegaFon would still preserve its ability to block big mergers and acquisitions.

"It would be in TeliaSonera's interest to keep a stake above 25 percent in order to maintain blocking minority rights in MegaFon," said Iouli Matevossov, senior analyst of telecoms and media at Alfa Bank. He noted that he was not speaking on behalf of Alfa Group's telecom investment arm, Altimo, which owns a stake in MegaFon that it is selling as part of the dividend deal.

MegaFon plans to float 20 percent of its shares, including a portion of TeliaSonera's stake, in an initial public offering on the London Stock Exchange slated for July. The sale is expected to gross $4 billion.

Earlier in April, TeliaSonera's CEO had told The Wall Street Journal that his firm was looking to raise the liquidity of its investments in foreign holdings where it was unable to increase ownership.

"By increasing the liquidity of its shares, TeliaSonera gains increased flexibility and lessens risk," Alfa Bank's Matevossov said.

The recent MegaFon agreement sees Altimo shedding its 25.1 percent stake in that firm for $5.2 billion. Altimo owns 44 percent of voting shares in VimpelCom, which runs Russia's third-largest cellular provider, Beeline. It determined that possessing interests in two directly competing firms was disadvantageous. Altimo might use proceeds from the MegaFon deal to gain 6 percent more voting shares in VimpelCom, Altimo's chief executive, Alexei Reznikovich, told the Financial Times in late April.

Conflict Resolution

TeliaSonera and Altimo are both suing Turkey's largest mobile operator, Turkcell Iletisim Hizmetleri AS. The conflict is now TeliaSonera's most pronounced.

In 2005, Turkish businessman Mehmet Karamehmet agreed to sell a 14 percent stake in Turkcell to TeliaSonera, which currently owns a 38 percent stake in the mobile operator, but instead used the shares to collateralize a loan provided by Altimo, also a shareholder in Turkcell. Karamehmet's firm, Cukurova, then reportedly defaulted on the loan but refused to give up the stake. The firm was subsequently hit with litigation from both Altimo and TeliaSonera.

"As Altimo exits MegaFon, we will continue our partnership with intensified focus on resolving the ownership disputes and establishing a good governance structure in Turkcell," TeliaSonera's CEO, Lars Nyberg, said in a statement April 24. "Once this has been achieved the board can focus entirely on developing Turkcell's potential by growing the business, both in Turkey and abroad."

Meanwhile, Tele2 is facing off with MegaFon and others for 4G frequency rights across Russia.

"Tele2 will participate in competition for nationwide licensing of LTE 4G. If we win, we'll extend Tele2's presence to all Russian regions," said Bakhorin, the Tele2 spokesman.

But the competition for 4G bandwidth rights will likely be tough for Tele2. Interfax reported in December that the terms of an LTE tender proposed by a consortium comprising the big three operators — MegaFon, Beeline and Mobile TeleSystems (MTS) — and leading long-distance provider Rostelecom would "practically guarantee" that those firms win.

Nonetheless, Tele2 has petitioned for "technological neutrality," the ability to use any technology on the frequencies for which it already has licenses. That would mean it could utilize next-generation technologies to offer high-speed wireless on its current frequencies without requiring new licenses. The firm is awaiting approval by the communications ministry.

MegaFon, meanwhile, is already well-positioned to introduce 4G because of the compatibility of its 4G technologies with existing 3G and 2G networks that crisscross Russia, market watcher Wireless Federation said on its website.

"It means that the owners of 4G mobile devices will be automatically reconnected to 3G/2G networks if they are out of 4G coverage. Therefore, they will not lose mobile Internet connection during the switch," it said.

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