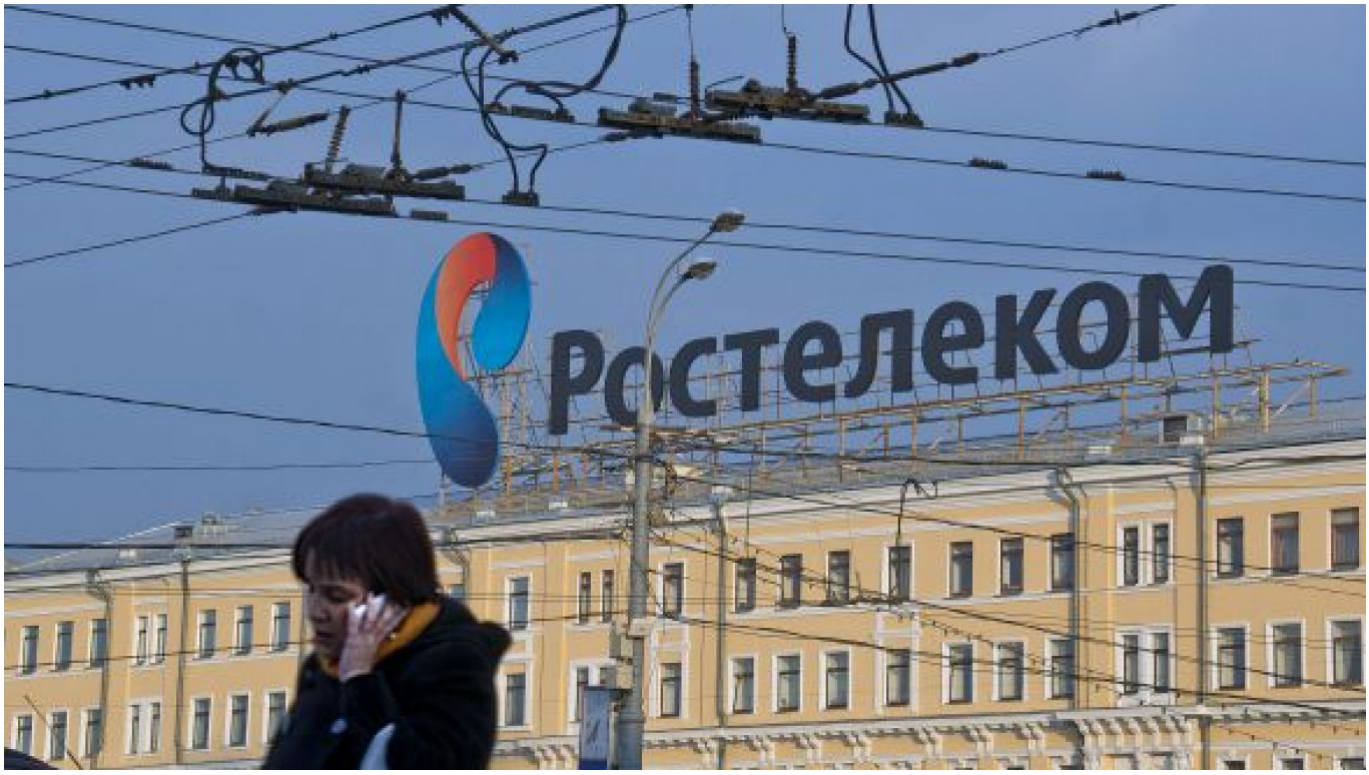
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As Rostelecom-Tele2 Merger Looms, State Frets Over Control

By Guennadi Moukine

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Analysts see merger between the national operator's mobile assets and Tele2's as a winning combination. **Vladimir Filonov**

State-controlled telecoms giant Rostelecom plans to place its market-lagging mobile operation under the same roof as regional budget cellular provider Tele2 and send the two on the offensive to win 25 percent of the Russian mobile market by 2018.

Rostelecoms's five-year strategic development plan, which was leaked to the media on the eve of the company's announcement of the third-quarter financial results Wednesday, prescribes separation of the its mobile network assets into a stand-alone subsidiary RT-Mobile and allows it to merge with T2 Rus Holding, which controls Tele2 Russia.

Rostelecom has not denied the veracity of the plan.

T2 Rus Holding is currently owned in equal shares by VTB Group and billionaire Yury

Kovalchuk — reported to be a personal acquaintance of President Vladimir Putin — who bought his 50 percent stake last month through Bank Rossia, where he is a major shareholder.

When combined, Rostelecom and Tele2's mobile operations would create a new player with 16 percent market share, putting it in fourth place after the big three dominant players MTS, MegaFon and VimpelCom.

A business model that forms a part of the strategic plan forecasts an average 15 percent annual growth and expects the venture's turnover to reach 212 billion rubles ($6.5 billion) and increase its subscriber base to 65 million people — giving it about 23 percent of the market, which is nearly double its current share.

Question of Control

But in the proposed scenario Rostelecom would only get a 45 percent stake in the deal, which is not enough to be in control of the joint venture and is causing concern with the operator's state overseers.

Olga Dergunova, head of the Federal Property Management Agency, sent a letter to Deputy Prime Minister Arkady Dvorkovich on Monday, a day before the board meeting which was expected to adopt the plan, complaining about the potential lack of control over the mobile venture, Kommersant reported.

Though the federal government owns a 51 percent stake through the property management agency and state development bank VEB, only two of 11 board members represent the state's interest, which is not proportional, the letter said.

Dergunova called for the government to take greater control of Rostelecom's board.
The effects of this letter, however, will not be known until the board of directors gathers for a meeting now scheduled for Wednesday evening.

Future Options

Rostelecom, meanwhile, has been doing its best to keep its options open to gain control over the whole enterprise in the future by negotiating the right of first refusal for VTB's stake if the state-owned lender ever decides to sell it, Vedomosti reported Tuesday.

The right of first refusal is the key element of this deal, iKS-Consulting mobile analyst Maxim Savvatin said. "It gives the company an opportunity in the future to return to the wireless communications market."

Rostelecom has 13.8 million and Tele2 has 23.2 million mobile subscribers in Russia, said Timur Nigmatullin, an analyst from Investcafe, which makes getting 45 percent of the company and bringing only 13.8 million subscribers to the table look like a good deal.

However, Rostelecom also brings licenses and mobile frequencies, the absence of which handicapped Tele2 in the past and caused its Swedish owner to sell its Russian arm.

Financially, the deal is fair, said Anna Lepetukhina, an analyst at Sberbank CIB. If Tele2's 55 percent is valued at $2.4 billion, which is the amount VTB paid for it in March this year,

Rostelecom's 45 percent in mobile assets would be about $2 billion, which is about 22 percent of its entire market value.

Whether the new company will be able to complete against the "big three" is another question.

Some analysts say that because of the extended network coverage that the new company will have and Tele2's reasonably low churn out rage of 6.75 percent — which is half the rate of the "big three"— there is expected to be some customer movement towards the new company, Nigmatullin said.

Mobile number portability, or MNP, due to go into effect on Dec. 1, is going to help lure customers to the new provider, said Denis Kuskov, head of the information analysis agency Telecomdaily.

The fact that the operators do not have much 3G coverage may not be a problem, said AC&M's managing partner Michael Alexeyev. Already there are signs in the U.S. and Scandinavian countries that operators focus entirely on 2G and 4G. As far as 4G goes, Rostelecom and Tele2 are not that far from the "big three."

Rostelecom has the license and frequencies, and Tele2 has the experience and know how to be competitive. Together, they will be a serious player against the "big three," Kuskov said.

Other analysts, however, are more cautious. "While theoretically possible, competing on the mobile voice market will be difficult," Savvatin said, "because the market is already distributed between the big operators."

"Most likely, the new company will focus on 4G mobile data plans. With a quality network and attractive plans, the new company may be able to take a good position and even overtake some of the big three," Savvatin added.

In its third-quarter financial results announced Wednesday, Rostelecom reported flat operating income before depreciation and amortization at 29.4 billion rubles ($894 million) and net profit increase of 12 percent to 10.5 billion rubles.

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