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INDEPENDENT NEWS FROM RUSSIA

Coronavirus Pandemic Rebalances Russia's Corporate Landscape

Earnings season shows tech companies setting record-high share prices, and closing the gap on Russia's energy giants.

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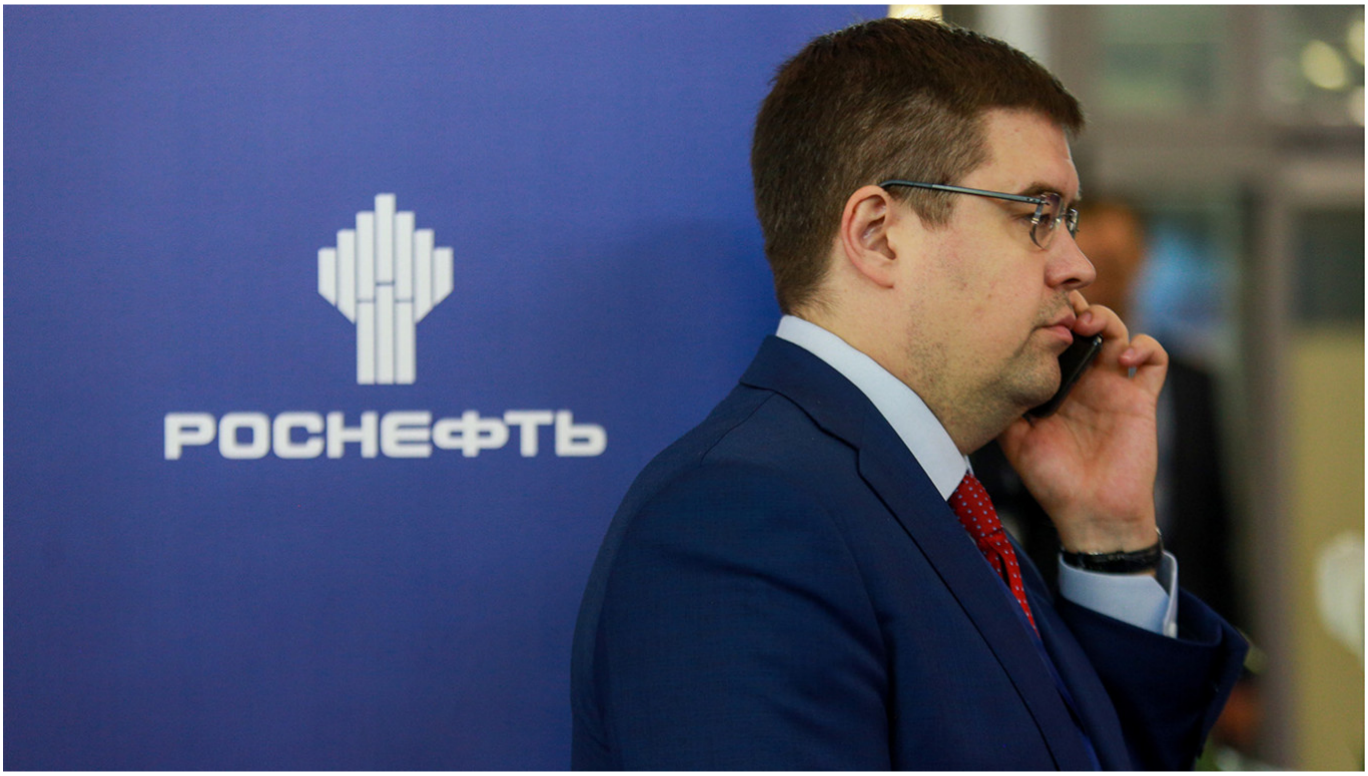

Rosneft returned to profit in the second quarter, but still suffered heavy losses in the first six months of the year. **Maxim Slutsky / TASS**

Russia's younger technology companies have weathered the coronavirus pandemic significantly better than the country's heavyweight energy and commodities giants, corporate results released during the summer earnings season has shown.

While tech empires like Yandex have seen their share prices soar to record highs and credited the global lockdown with boosting future business lines, traditional names on Russia's corporate scene, such as Rosneft and Aeroflot have posted eye-watering losses and multi-billion dollar falls in earnings during the first half of 2020.

Nevertheless, despite some bright spots, Russia's bruised energy, mining and commodities titans weigh heavily on the business landscape, meaning Russia has not benefited from the kind of technology-fuelled surge in the stock market that the U.S. has seen, with the stock market still down 16% in dollar terms.

The ugly

Russia's biggest corporate losers from the pandemic have been the oil and gas giants which traditionally sit atop Russia's corporate pyramid as the most valuable and profitable firms in the country.

"The oil and gas sector suffered the heaviest losses. It's been the weakest among all industries since the beginning of the year," said Vasily Karpunin, head of analytics at BCS Broker.

The energy giants have typically seen a fifth of their share prices wiped out since the start of the pandemic, as oil prices are yet to fully recover from their sharp fall in March and Moscow agreed to significant production cuts as part of a revised emergency OPEC+ deal.

The fortunes of Rosneft, the state-backed oil giant headed up by Igor Sechin, are indicative. The firm which controls around 40% of Russia's oil output is expected to forego dividends after chalking up losses of around $1.7 billion during the first half of the year, VTB Capital energy analyst Dmitry Loukashov said. Moreover, the headline figures obscured "large swings" in separate budget lines, Loukashov added, such as a $1.5 billion gain due to foreign currency movements.

However, the firm did post a profit in the second quarter — a sign of potential recovery in the sector, with oil prices now stabilized above $40 a barrel and the OPEC+ production cuts easing. Nevertheless, expectations for earnings in the traditionally lucrative industry in the foreseeable future have been slashed, as even Russia's government forecasters do not expect oil prices to return to the $60-a-barrel floor which had characterized the market in recent years.

The bad

Russia's financial sector — whose fortunes are closely tied to the health of the wider economy — has also been one of the worst-affected by the pandemic.

Record low interest rates eat into banks' margins — the difference between the interest they pay on deposits and what they earn from loans — while a jump in unemployment and fall in salaries has also triggered regulatory requirements for lenders to increase their capital reserves. The more money banks have to keep on their balance sheet to account for non-performing loans, the less they are able to dish out as credit and earn a return on.

All this has "negatively affected their net profits," said Karpunin. The most visible impact has been on share prices, and the largest banks' decisions to postpone 2019 dividend payments and review bonuses for top managers.

Sberbank's share price is down around 8% since the start of the year in rubles, even as the wider MOEX Index has largely recovered. The country's biggest lender and still its most valuable company posted second quarter profits of 167 billion rubles ($2.2 billion) — down a third on last year. Nevertheless, that was still surprisingly positive, analysts said, and far ahead of the worst-case scenarios forecast in March and April.

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"The rapid recovery of business and lending activity came well above our expectations," said Mikhail Shlemov, banking analyst at VTB Capital. "However, we see downside risks for the net interest margin, as the cuts in deposit rates are to bring a diminishing effect in the coming quarters."

VTB — Russia's second-largest bank and also state-owned — posted a less rosy update. Profits dropped 93% in the second quarter, coming in at just 2.1 billion rubles ($28 million). The lender said its provisions for losses on loans over the first half jumped by more than 150% to $1.3 billion. As many corporates have done throughout the pandemic, it refrained from issuing guidance on where it expects profits to come in over the rest of the year.

As in the energy industry, Russia's banking sector also looks set to be under pressure well beyond the pandemic. Some estimates have Russia's economy not returning to pre-coronavirus levels until 2024, and markets are not expecting the Central Bank to increase interest rates until at least 2022. New loans were still down by a third in July compared to last year, and emergency government stimulus measures, including moratoriums on bankruptcy and tax holidays, will start to be removed later this year.

The good

As old school sectors have floundered amid unprecedented economic turmoil, it has been a different story for Russia's few technology companies, which have captured a short-term boost and look well-positioned to continue accelerating in the coming years, analysts say.

"Investors are optimistic about Russian IT companies — which in some ways have benefited from the forced self-isolation and greater digitalization within society," said Karpunin.

Shares in Yandex have set a new record high, with the market value of Russia's largest technology company passing the $20 billion mark. Yandex's market capitalization has now passed a number of oil majors including Tatneft and Gazprom Neft, and the tech giant is worth more than one third of the value of Gazprom and Rosneft — Russia's number two and three publicly listed companies.

Russia's other leading tech company Mail.Ru has seen its value more than double since the market crash in March, with its share price up almost a third since the start of the year.

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The firm, which is listed in London, posted a particularly robust set of earnings for the second quarter, with advertising revenues holding up significantly better than its rivals — including Yandex — and worldwide quarantine proving a boon to the firm's money-spinning online and mobile games department. While analysts doubt the boost in gaming profits can be repeated, VTB Capital's technology analyst Vladimir Bespalov believes the company is on the cusp of a "strong profitability turnaround, after years of flattish earnings." He forecasts that profits will jump by a third next year to around $470 million.

Index provider MSCI's recent reweighting of its Russia stock market index — the MSCI Russia 10/40 Index — demonstrates the gulf in performance between Russia's two preeminent tech firms and the country's traditional corporate heavyweights in recent months. The influential ranking placed Yandex in fourth place, overtaking embattled metals giant Nornickel, which is trying to negotiate a discount on a $2.1 billion fine for its Arctic oil spill.

The reassessment hands Yandex maximum weighting in the index — an instrument used by investment managers around the world to build share portfolios. Mail.Ru is also set to enter with a significant weighting later this year, following the launch of its secondary listing on the Moscow Exchange.

The rest

Despite some bright spots and a pandemic which has so far helped Russia's technology companies close the gap with the country's dominant energy players, Russia's business world has been dealt a painful blow from the pandemic.

Beyond the top tier of publicly listed companies, more than a third of Russia's businesses posted losses between March and May, consulting firm Finexpertiza found. Combined, corporate profits crashed by two-thirds compared to the same period last year — the sharpest fall in at least 16 years since the firm has collected such data.

Karpunin is hopeful the second quarter will prove to be the nadir.

"The consequences of the coronavirus pandemic have not yet been fully overcome, however, it is safe to say that the worst is over. Stimulating monetary policy, an increase in global demand for raw materials and goods, as well as the removal of restrictions will allow the affected sectors to continue to recover gradually."

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