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Future of Energy Sector Liberalization Uncertain

By The Moscow Times

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Russia is showing signs that it may curb power sector liberalization ahead of the 2012 presidential elections, hitting shares, cutting profits and drying up vital investment from foreign and domestic players.

The uncertainty created marks a setback for the country, which has almost entirely privatized its power sector over the past decade, attracting Germany's E.On, Italy's Enel and other heavyweight European utilities with the promise of big returns.

Recent ambiguous government statements on tariff caps — which may restrict the amount grid companies can charge for distributing electricity — have sent jitters through the industry and investment community alike.

''The government needs to decide if it wants to continue with market liberalization or not,'' said Derek Weaving, power analyst at Renaissance Capital. ''In the wake of recent talk of imposing tariff ceilings, financial planning in the sector is in disarray and urgently needed [capital expenditure] is being cut back."

There has also been a dramatic impact on the fortunes of power company shares.

Grid company MRSK is down 28.2 percent over the past three months, yet last year's gains mean that it is still 136 percent up on this time last year.

Enel-controlled OGK-5 has dropped 8 percent in the past month, and E.On's OGK-4 is down 5.6 percent — having both recorded massive gains in 2009.

Senior industry executives at a recent conference showed little optimism for profit growth in the sector until at least 2013, after Russia's presidential election.

Mikhail Abyzov, chairman of power engineering firm E4 Group, told the conference that he did not see positive conditions for a return to 2008 profitability until at least 2013 and attacked the government's "market illiteracy" and "social irresponsibility" that held the sector back.

Under a complex liberalization scheme with specific deadlines to reassure investors, grid tariffs were due to rise by up to 40 percent in some regions this year.

But Economic Development Minister Elvira Nabiullina said last month that the government may cap tariff growth for the Federal Grid Company and local grids at 15 percent in 2011 — leading to immediate downgrades of the Federal Grid Company by Citi to "hold" and Morgan Stanley to "underweight."

Analysts speculate the state wants to be seen as favoring the consumer ahead of presidential elections in 2012, with Dmitry Medvedev's United Russia party hoping to stay in power.

"They are doing this because of the 2012 elections. ... There are a lot of poor people in Russia. These people are very sensitive to tariff hikes, and growth will affect them very badly," says Vladimir Samodorov, an analyst at the broker RMG.

Others say the move would be short-termist and affect plans for much needed investment in the sector. Russia has been struck by numerous infrastructure calamities in recent years, including the collapse of a Siberian hydroelectric dam last August that killed 75 workers.

Prime Minister Vladimir Putin angrily denounced some of the nation's most powerful businessmen, including Mikhail Prokhorov and Vladimir Potanin, for failing to invest in power at the reopening of the dam in February. Accountant KPMG estimates that a colossal $550 billion is required to modernize dangerously outdated equipment over the next 10 years, vastly more than Kremlin forecasts.

Analysts estimate that the Soviet-designed national grid is 69 percent obsolete and leaks 8.7 percent a year.

"For 20 years, Russia has lived off the fat of the power sector infrastructure inherited from the Soviet Union. The fat has now been consumed, and the time has arrived for Russian consumers to pay proper market prices for electricity," said Renaissance's Weaving.

"If the Russian government ducks the reality, the country will end up an electricity supply industry that is neither reliable nor safe," he said.

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