Micex IPO is an FX plan

5 February 2013

By Ben Aris

http://blogs.ft.com/beyond-brics/2013/02/05/micex-ipo-is-an-fx-plan/#ixzz2KhKtNBnW

The management of Russia's MICEX exchange arrived in London on Tuesday on a roadshow ahead of its IPO on February 15. What they are selling is not just a stock exchange but a diversified business that is in many ways unique.

Widely seen as Russia's leading stock exchange, MICEX is actually a unusually diversified business for an exchange, which means it has managed to earn steadily increasing profits that have been largely unaffected by the 2008 crisis, let alone the notorious volatility that plagues portfolio investors into Russian stocks.

Trading stocks and bonds made up only 34 per cent of MICEX's operating income in the first nine months of 2012. The biggest single business on the exchange is foreign currency trading (FX) that accounts for 80 per cent of the aggregated trading volumes by value and, at just under a third, was the single biggest contributor to the operating income in same period.

It's all in the name: MICEX stands for "Moscow Interbank Currency Exchange". The exchange was set up in 1992 as the money market platform for the banking sector and also for Central Bank of Russia (CBR) interventions on the currency market, used to control the exchange rate and provide support to the banking sector in times of crisis. Neither of these jobs are typical for an exchange and 20 years later its FX business still provides MICEX with a steady stream of income.

It only took on trading stocks in the second half of the 1990s and came into its own when the government ruled domestic Gazprom shares could only be traded on MICEX after it removed the so-called ring fence – special rules that prevented foreigners buying locally listed shares in what at the time was Russia's most valuable company.

In all the exchange trades five asset classes: in addition to stocks, bonds and currency it is also a platform for repo deals with fixed income instruments and also the burgeoning derivatives business.

And as well as handling issuance and trading, the exchange also unusually offers all the post-trade services of settlement, clearing and depository services as a single unified operation – more steady revenues for the exchange irrespective of what else is happening in the country, which together make up 16 per cent of its total income.

The advantage of having such a diversified business is the exchange's income has risen pretty consistently over the last six years, despite the huge swings on its trading floor, even during the worst of the 2008 meltdown, when the value of stocks traded on the exchange plummeted by about 75 per cent.

"MICEX keeps making money no matter what is happening on the exchange itself," says one banker close to the business who didn't want to be named. "When share prices tank then derivatives spike. And the volumes of FX trading continue to grow no matter what else is going on in the country."

FX trading remains the exchange's cash cow with volumes rising by a consolidated annual rate of growth of 24 per cent since 2009 to top in Rb295.5tn in 2012. And currency-trading volumes will only increase once restrictions on foreign investors buying bonds directly on the MICEX floor from their trading desks around the world are removed this month.

However, the fast growing business line is derivatives trading. Following the 1998 financial crisis the Central Bank ruled that derivatives were regulated by the same rules as casinos, as Russian banks attempted to wiggle out of some $40bn worth of forward contracts obligations signed with foreign investors to protect themselves from the very devaluation that actually happened.

Things have got better since then. A new law on investment was passed in 2002 that created the foundation of a real derivatives market and another covering futures trading was introduced in 2006. (All the casinos in Moscow have also since been closed and banished to remote regions in Russia's interior.)

The derivatives business is booming. Because of a lack of domestic institutional investors, investors in Russian stocks have become increasingly keen to hedge against perennial volatility and part of the goal of merging MICEX with the RTS in 2012 was to further deepen the derivatives business, which now makes 18 per cent of the exchange's income.

The exchange still quotes both the RTS and MICEX indices, which are now identical in terms of the basket of stocks and their weighting, except the RTS is denominated in dollars and used as a basis of hedging while the MICEX index is denominated in rubles. Last year, 43 per cent of all the derivate contracts written were against the RTS index value and worth a total of $3.8bn, making this derivative amongst the top six biggest derivative products in the world.

All in all MICEX reported revenues of Rb15.9bn ($530m) for the first nine months of 2012, a 36.7 per cent increase on the same period a year earlier, with net profits up by just under a quarter to Rb6.4bn ($213m). Going forward the exchange is travelling through Europe, America and the Russian regions (as this will be a Russian IPO on a Russian exchange after all) telling investors that the future looks even brighter.

The Kremlin is pushing to create an international financial centre in Moscow, but the ultimate goal is to win back Russia's equity business from London, the preferred destination for most of Russia's biggest IPOs.

Russian companies already account for 18 per cent of the London Stock Exchange's total capitalization, according to President Vladimir Putin, but the president said last month that from this year he wants all the IPOs planned as part of the privatization drive to be held on the Moscow, not London, exchange. A few days later Andrei Kostin, CEO of VTB Bank, dutifully announced that VTB would sell its next tranche of a reported 10 per cent on MICEX, not the LSE. More will follow.

It will take a long time before MICEX can seriously threaten the LSE appeal for big Russian companies wanting to float. But the listing of MICEX and the new drive to promote domestic listings is another step along the road to creating a fully-fledged Russian capital market that can serve both pensioners and Russian companies looking to raise capital. It should also provide MICEX'S shareholders some nice and steady dividend payments in the process.

Source: [Financial Times]