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RTS and Micex: the long road to modernising Russia's financial markets

By Ben Aris in Moscow

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Oleg Jelezko just made a packet from the biggest private equity deal in Russia to date. Da Vinci Capital Management, of which Jelezko is managing partner, can partly cash out of its 20 per cent stake in Russia's RTS after the exchange announced it would merge with its larger rival Micex on Wednesday, June 30.

The merger is a significant step in the Kremlin's much-vaunted plans to turn Moscow into an International Financial Centre (IFC) and build up the domestic capital market so it can better serve Russia's growing investment needs. The Russian pension system is also in desperate need of reform – a quarter of the current state deficit goes toward topping up the state's pension obligations – and a more efficient and better capitalised exchange is a first step in the pension reforms widely excepted next year.

Da Vinci is one of the five major shareholders in the RTS, along with leading Russian investment banks Renaissance Capital, Aton Capital, Alfa Bank and Troika Dialog. Under the terms of the merger, each of these banks can take a 35 per cent of their stake out as cash and will get shares in the combined entity at a ratio of three RTS shares to one merged Micex/RTS share for the rest.

All of the investors are going to take out some cash as the merger is a validation of their investment, but we still see a lot of upside in the coming years and will remain investors and involved in the exchanges.

Says Jelezko, who cut his teeth at Renaissance Capital and help build Russia's derivatives market in partnership with the RTS a few years ago.

Jelezko draws a parallel with Brazil:

Brazil is comparable with Russia: it has the same level of technology, the same economic size and a similar economic profile. The Brazilian stock exchange is listed with a market capitalisation of between $15bn and $16bn. The combined Micex and RTS has a valuation of about $4.5bn, so we believe this will rise three-fold in the next five years or so.

There are already plans to IPO the combined exchange by 2013 or earlier and raise at least $300m Micex President Ruben Aganbegyan told journalists at a press conference on Wednesday.

The merger will be finalised in the autumn, as it still needs to be approved by the regulator and also the anti-monopolies service (FAS). But given there are about 50 licenced exchanges in Russia (of which about six are functioning), participants don't see any problems with completing the paperwork.

The creation of a single stock exchange really only marks the beginnings of the IFC project. Despite the provocative moniker, the main point of the reforms is to create the financial infrastructure the market needs to integrate itself with the international capital markets, rather any attempt to somehow replace the likes of London and New York as the dominant global exchanges.

"Really all we are doing it trying to make a giant plug that we can plug into the global markets," says Jelezko.

The next big challenge will be to create a central securities depository (CSD), something that has been under discussion for more than a decade. But that is likely to be as difficult as getting the two exchanges merged. Currently, there are two main depositories, DCC and NDC, that worked with the RTS and Micex respectively. Neither of these depositories are keen to merge and the situation is made more complicated by the fact that much of Russian equity trading is cleared and settled through the company registrars. Many of these are owned by oligarchs and used as a last line of defence to protect their companies from corporate raiders, who also don't want to see any more mergers.

However, the government is clearly committed to forcing through change in the sector. Jelezko is also a member of "Group #1″ of a task force dealing with financial infrastructure, headed by Alexander Voloshin, former chief of Boris Yeltsin's presidential staff and widely regarded as the 'éminence grise' in the Kremlin in the 1990s.

And the stock exchange merger is a positive sign that political will exists to implement financial reform, despite the two bourses' rivalry and the global economic crisis.

In the meantime Da Vinci is putting its money where its mouth is and hopes to follow through on the success of its first fund that invested in the RTS with a second one to launch this autumn targeting financial services in general.