

CASE Belarus' POLICY BRIEF

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State-Owned Companies in Belarus: How Much are They Worth and Will They Be Privatized any Time Soon?

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Executive Summary

The paper assesses possible privatization of the twenty largest Belarusian state-owned companies from the perspective of their market values. In my view, even based on pre-COVID financial indicators of Belarusian state-owned companies, a large-scale privatization would at best bring \$5 billion to the state - barely enough to cover the budget deficit and external debt repayments in 2021.

Therefore, it is not surprising that there have been no attempts to sell any of the largest state assets recently; for the Belarusian authorities the cons of ceding control over shrinking, but still significant, parts of the economy by far outweigh the pros of temporarily easing the financial pressure. Looking ahead, the benefits of a prospective privatization for Belarus will be long-term and not confined to an immediate financial gain for government finances, but

rather come in form of reduced strain on public finances, more efficient economy and increased growth of private sector as a result of a better allocation of capital.

Background and Motivation

Upon the fall of the Soviet Union in 1991, the newly independent Republic of Belarus inherited a significant state-owned (largely manufacturing) sector, which has largely not been privatized yet. Keeping the largest state-owned enterprises (SOEs) under state control has been one of the key pillars of Alaksandr Lukashenka's policies since he came to power in 1994. This policy helped him achieve several important goals including low unemployment, preventing social unrest, as well as maintaining leverage over large swaths of the population by requiring workers to be politically loyal in return for keeping their jobs.

In the late 90s and 2000s, this policy worked quite well, to a large extent due to significant subsidies from Russia, amounting to 10-20% of Belarusian GDP [1]. This enabled the government to keep state-owned enterprises afloat and employing a significant fraction of Belarusian population. However, from the late 2000s-early 2010s Russian subsidies began to decrease. The decrease in subsidies (coupled with the financial crisis) forced Lukashenka to (albeit reluctantly) agree to the sale of Beltransgaz, the operator of natural gas transit pipelines, to Russian gas company Gazprom for \$5 billion. To date, this deal remains by far the largest privatization deal in the Belarusian history [2]. In the first half of the 2010s the privatization of large SOEs was considered, but no deals materialized due to repeatedly setting unrealistically high asking prices [3].

As the Russian subsidies went down, Belarusian economic growth slowed significantly (the average real GDP growth decreased from 7.2% in 2000s to 1.8% in 2010s [4]). Moreover, in absence of a large scale privatization, the Belarusian government was not able to arrest the gradual but steady decline of the state-owned enterprises. For instance, the number of people employed at SOEs decreased from 1.7 million in 2012 to 1.3 million in 2019 with the difference mostly absorbed by the private sector [5]. Although the Belarusian economy was hit by both economic and political crises in 2020, the topic of privatization of the largest SOEs was not even on the table. At least for now, Lukashenka seems to be even more reluctant to entertain any privatization offers, repeatedly claiming that «national heritage» is not for sale.

Nevertheless, Belarus is now faced with dwindling foreign currency reserves, widening budget deficit, little and expensive possibility of refinancing external debt on international financial markets and the unwillingness of Russia to provide funds beyond the refinancing of existing debt. This paper is an attempt to answer the question which is often raised in current Belarusian political and economic discourse – how likely is it that Lukashenka (however reluctantly) agrees to privatization of the largest SOEs (most likely by Russia) after all other financing sources are extinguished?

In order to answer this question, I will conduct a high-level valuation of the «portfolio» of the

largest Belarusian state-owned companies, which will allow to estimate a rough level of proceeds that could be received by Belarusian government as a result of a privatization.

Data and Limitations

I collected data on revenue and net income of the 20 largest state-owned corporates and 4 state-owned banks for the 2019 fiscal year. Unfortunately, the list is not exhaustive as some of the large Belarusian SOEs such as Belorusneft (petroleum company) as well as state owned electric utilities companies (like Minskenergo) do not make their accounts publicly available. Another limitation of the study is the fact that only around half of state-owned corporates publish their accounts in accordance with the International Financial Reporting Standards (IFRS). In the remaining cases I had to rely on the accounts made in accordance with the Belarusian accounting standards, which often do not accurately reflect the true underlying profitability of the entity [6].

Overview of the financials of the largest Belarusian state-owned companies

The total revenue of the 20 state-owned corporates and 4 state-owned banks stood at \$20.7 billion in 2019. If they were one company, it would be placed at around 150-160th in the Fortune 500 list of the largest US companies, being comparable in size to companies like McDonald's and Marriott [7]. Notably, only 3 companies, two largest oil refineries (Mozyr Oil Refinery and Naftan) and Belaruskali (one of the largest producers of potash fertilizers in the world), account for around half of all the revenue. At the same time, the net income of all profitable companies on the list stood at only \$1.1 billion, with Belaruskali accounting for 40%. Furthermore, four companies (Belaruskali, two oil refineries and Belarusbank, the largest state-owned bank) accounted for more than 80% of all net income. The well-known Belarusian machine building industry (producing, among others, agricultural and mining machinery, tractors as well as heavy-load and dump trucks), which is often used as an image of the Belarusian state sector, is either barely profitable or loss-making (for detailed data for each of the companies see Appendix).

Valuation Approach

In order to get a rough estimate of the market value of the largest Belarusian SOEs portfolio, I have used a simplified version of comparable companies' approach. This approach consists of (1) finding the current ratio of the market capitalization to earnings («price-to-earnings multiple» or «P/E») of a comparable company that is publicly traded, and (2) applying this ratio to the net income of the company that is being valued. In the case of a portfolio of Belarusian companies, the most natural ratio to apply is the P/E multiple of the Russian stock market ^[8], which currently stands at around 8 (based on one-year projected earnings) ^[9]. Applying the multiple of 8 to the total net income of the largest and profitable Belarusian SOEs (and by consequence assuming their return to pre-crisis profitability in 2021) gives us a rough estimate of the total market value of the largest Belarusian SOEs at around \$9 billion.

In the context of a possible sale, it must be noted, however, that it is extremely unlikely that the government would entertain a sale of the majority stake in the very largest and most profitable companies on the list (Mozyr Oil Refinery, Naftan, Belaruskali and Belarusbank). Furthermore, around 40% stake in Mozyr Oil Refinery already belongs to a Russian company (Slavneft). As noted previously, these companies account for 80% of all the net income of the largest Belarusian SOEs. Therefore, the realistic proceeds in the case of privatization should be reduced by at least 40% - which leads us to an estimate of the privatization proceeds of around \$5 billion.

Of course, this approach is very simplified and does not take into account a number of factors that would certainly influence the valuation of largest Belarusian SOEs in case of their sale. Some of the key factors that are likely to push the valuation further down are:

1. Perception of investing in Belarus being more risky than investing in Russia ^[10].
2. Significant foreign currency debt load of the Belarusian SOEs.
3. Heightened risk of nationalization or government meddling even in an already privatized enterprise as a consequence of the unresolved political crisis ^[11].
4. Further deepening of the economic crisis and the inability of Belarusian SOEs to return to pre-crisis profitability.

On the other hand, especially in case of a sale of some of the most profitable companies to Russian counterparts, the political factors as well as synergy effects (for instance, from a renewed alliance of two of the largest global potash producers – Belaruskali and Uralkali) could push the valuation up somewhat. However, in my view, the factors that would push valuation down far outweigh the factors that would push the valuation up. Therefore, I consider \$5 billion to likely be a ceiling to the amount of possible sale proceeds, even in case of a large-scale privatization.

Conclusion

Even if for some reason (e.g. a desperate need for funds) the Belarusian government agrees to a mass privatization of the largest state-owned enterprises, the proceeds will likely be under \$5 billion. This amount would be sufficient for the government to cover the projected budget deficit of around \$2 billion ^[12] and meet the payments on external debt of ca. \$3 billion ^[13] without drawing down foreign currency reserves or attracting additional funding. This would, of course, significantly reduce the immediate strain on public finances. However, the relief would not last more than a couple of years. In my view, this would not be enough for the government to consider any sort of a large-scale privatization (beyond a few isolated deals as it was the case in 2000s and 2010s). The political and ideological importance of controlling the largest SOEs would likely outweigh any short- or medium-term monetary benefits from their sale. What is more, the government would have to face an unpleasant psychological consequence of the fact that the asking prices previously quoted by Lukashenka would turn out to be many times (and sometimes even orders of magnitude) too high.

To sum up, any significant privatization would likely come only after change in the political decision-making in Belarus. The benefits of privatizing the state assets for Belarusian economy would mostly come not from the immediate financial gain from their sale, but rather from a significantly reduced strain on government finances, more efficient management of formerly state-owned companies and higher economic growth as a result of a more efficient allocation of capital across the economy.

References

1. According to the IMF estimates
2. An Overview of top 10 privatisations deal in the Belarusian history (in Russian) <https://news.tut.by/economics/678398.html>
3. For instance, the asking price for the potassium producer Belaruskali was set at around \$30 billion and for the steel producer Belarusian Steel Works at \$8 billion, both being multiple times higher than market value at the time
4. According to the World Bank
5. BEROC. Transformation of SOE Sector in Belarus (in Russian) http://www.beroc.by/en/publications/policy_papers/transformation-of-soe-sector/
6. For instance, companies are often allowed to spread foreign exchange currency losses incurred in a given year (which commonly arise as a result of a devaluation of Belarusian ruble and significant foreign currency indebtedness) over several years.
7. <https://fortune.com/fortune500/2020/search/>
8. Other argument in favor of using the multiple of the Russian market is the fact that Russian companies would be the likeliest buyers of Belarusian asset in current political situation; the multiple of the buyer company often serves as a reference or a ceiling to the multiple that is paid for the target company, in order to avoid dilution.
9. <https://www.msci.com/documents/10199/3b75a8ba-8690-41c4-9e0e-fe34f80ef808>
10. See, for example, OECD risk classification ,where on a scale from 1 (least risky) to 7 (most risky) Russia has a score of 4 and Belarus has a score of 6.
11. For instance, in June 2020 Belarusian government imposed a temporary administration on Belgazprombank (which was formerly led by one of the would-be presidential candidates), despite it being almost 100% owned by Russian companies Gazprom and Gazprombank
12. <https://bsblog.info/economic-security-of-belarus-february-2021/>
13. <https://bdg.by/news/finance/v-2021-godu-belarusi-predstoit-vyplatit-po-dolgam-8-mlrd-rublej>

Appendix

THE LARGEST 20 CORPORATES (MAJORITY OWNED BY THE BELARUSIAN GOVERNMENT)

#	Company	Industry	Revenue in 2019 (USDm)	Net Income in 2019 (USDm)
1	Mozyr Oil Refinery	Oil Refinery	4.044	165
2	Naftan	Oil Refinery	3.714	109
3	Belaruskali	Potash fertilizers	2.294	448
4	Belarusian Steel Works	Metallurgy	1.676	-74
5	Belarusian Railway	Railway transportation	1.659	-15
6	Grodno Azot	Nitrogen Fertilizers	805	48
7	Minsk Tractor Works	Agricultural machinery	773	48
8	Minsk Automobile Plant	Heavy-load trucks	741	-22
9	BelAZ	Large dump trucks	487	15
10	Beltelecom	Telecommunications	477	82
11	Mahilioŭ chemical fibers plant	Chemicals	445	-6
12	Belavia	Air Transportation	422	33
13	Belshina	Tire Production	352	-34
14	Slutsk Cheese-Making Plant	Dairy products	331	24
15	Belgosstrakh	Insurance	328	12
16	Hrodna Tobacco Factory	Tobacco	280	89
17	Gomel Chemical Plant	Phosphate fertilizers	280	32
18	Babushkina krynka	Dairy products	241	2
19	Gomselmash	Agricultural machinery	236	-2
20	Atlant	Manufacture of Refrigerators	234	-15
TOTAL			19.818	938

BANKS (MAJORITY OWNED BY THE BELARUSIAN GOVERNMENT)

#	Bank	Revenue in 2019 (USDm)	Net Income in 2019 (USDm)
1	Belarusbank	538	149
2	Belagroprombank	220	31
3	Belinvestbank	99	18
4	Bank Dabrabyt	43	14
TOTAL		900	212

Sources: companies' websites, common portal of the financial market (<https://portal.gov.by/>).