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The PB Newsletter

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Reporting on privatization in the enlarged Europe

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What is the PB Newsletter?

The PB Newsletter is a semi-annual report on privatization activity in the enlarged European Union. It aims at monitoring the most recent trends, at analyzing aggregate data on revenues and transactions, and at providing updated statistics at the country and sector level.

The PB Newsletter highlights the most important deals, which are regularly commented on by privatization guru William L. Megginson. It also hosts contributed articles by top international scholars, who will make accessible to the reader the most recent results of professional research.

The Newsletter will also report on the PB indices, a series of indicators which will follow the performance of equity investment in privatized companies in the EU.

Rigorous, updated, easily accessible and freely distributed on the web, the PB Newsletter is an authoritative source of information and a vehicle for a more informed discussion on the choices and consequences of privatization.

Italian Version

Il processo di dismissioni europeo ha fatto grandi passi in avanti nel 2005, certamente un anno che ha segnato alcuni record nella storia recente delle privatizzazioni. A livello globale, gli introiti annuali hanno superato per la prima volta dopo la fine del secolo la soglia dei 100 miliardi di dollari. L'Europa, partita lentamente nei primi trimestri, ha accelerato vertiginosamente le vendite nel secondo semestre per chiudere il bilancio con 75 operazioni per un controvalore di 67.7 miliardi di euro, solo di poco inferiore al record storico realizzato nel 2000.

Questi risultati straordinari sono in larga parte riconducibili alla performance di un singolo paese, la Francia, che nel corso dell'anno ha battuto i partner europei in tutte le categorie. Nel 2005, la Francia ha infatti realizzato quasi la metà degli introiti complessivi, la maggiore offerta pubblica iniziale (Electricité de France, la maggiore IPO europea degli ultimi cinque anni), la maggiore offerta secondaria accelerata (France Telecom) e tre delle quattro più importanti vendite dirette nell'ambito della dismissione completa del settore autostradale. Indubbiamente, il nuovo governo de Villepin ha saputo mostrare la serietà del proprio impegno a riformare alcuni settori chiave, a partire dalle infrastrutture.

Il tema del coinvolgimento del settore privato nella proprietà/gestione delle infrastrutture sta animando il dibattito europeo. Ma come possono i governi progredire nelle privatizzazioni delle industrie di rete senza temere che gli ex monopoli pubblici diventino privati? Gli economisti rispondono che la regolazione attenta di queste industrie è altrettanto importante della proprietà privata per generare miglioramenti di efficienza. In questa newsletter, Carlo Michelini di Morgan Stanley ci offre il punto di vista del banchiere, sottolineando l'estrema rilevanza della regolazione nelle decisioni di investimento nei settori dell'industria di rete recentemente privatizzati. Michelini evidenzia che gli investitori istituzionali apprezzano i titoli delle società che operano nei settori regolati per le loro caratteristiche difensive in termini di prevedibilità degli utili e loro stabilità nel ciclo economico. La regolamentazione dovrebbe quindi risultare "sostenibile" piuttosto che offrire elevati rendimenti di breve periodo. Inoltre, dovrebbe essere percepita come indipendente e quindi non soggetta a interventi discrezionali da parte del governo, tipicamente percepiti dagli investitori come una fonte fondamentale di rischio. Un esempio tratto dalla recente storia dell'Enel ci mostra che revisioni inattese del regime regolatorio causano un incremento della volatilità specialmente se percepite come incoerenti rispetto agli obiettivi di lungo termine del regolatore.

Identificare le fonti di valore nelle società privatizzate è certamente importante, ma ugualmente importante è misurare il loro valore e stimare quanto i governi abbiano ancora da vendere. L'articolo di Luca Farinola e Bill Megginson, due ricercatori del Privatization Barometer, ci fornisce il quadro completo sul valore del portafoglio titoli dei governi dell'Unione Europea. Dall'analisi risulta che i governi detengono partecipazioni dirette e indirette in 123 imprese quotate e fanno ampio ricorso a strutture piramidali complesse per incrementare il potere di controllo, in particolare in Germania, Francia e Italia. La principale conclusione dello studio è la seguente: a fine 2005 il valore complessivo di questo portafoglio è uguale a 295 miliardi di euro. Il governo francese giganteggia gli altri partner europei con un portafoglio che vale oltre 93 miliardi e che comprende 18 società a grande capitalizzazione. Il governo italiano segue con partecipazioni in solo 7 imprese che però valgono 31,6 miliardi di euro (la sola partecipazione in Eni vale 26,4 miliardi). I portafogli più ricchi nei paesi del primo allargamento sono quelli della Polonia e della Repubblica Ceca, con 11,81 e 10,37 miliardi di euro rispettivamente. La rilevanza di questi numeri suggerisce che in futuro le privatizzazioni non saranno certo limitate dalla disponibilità di assets, ma piuttosto dalla riluttanza a cedere il controllo.

Se si getta uno sguardo al di fuori dei confini europei, anche un osservatore casuale non può non notare i mutamenti straordinari che stanno avvenendo in Turchia. Nilgün Gökgür, un'economista del Boston Institute for Developing Economies e uno dei più accreditati consulenti sulle privatizzazioni, ci descrive le evoluzioni più recenti del processo turco in una nuova sezione della Newsletter che ospita studi dedicati a paesi o aree non ancora coperti dal Privatization Barometer.

Negli ultimi tre anni, l'economia turca è cresciuta a tassi superiori al 6 percento mentre la borsa di Istanbul è salita a ritmi vertiginosi guadagnando oltre il 50 percento all'anno. Indubbiamente la forte accelerazione impressa alle dismissioni dal nuovo governo dopo la vittoria elettorale del 2002 ha contribuito al mutato contesto economico. Annunciate venti anni fa e attuate a rilento nel corso degli anni 90, il nuovo governo sostenuto dal partito islamico AK ha lanciato le privatizzazioni quale elemento qualificante di un programma ambizioso di riforma strutturale in vista dell'ingresso nell'Unione Europea. L'Agenzia delle Privatizzazioni è riuscita a compiere operazioni rilevanti, quali ad esempio Türk Telekom, affiancando alle vendite processi di ristrutturazione delle imprese pubbliche. Di conseguenza, l'intera performance del settore delle partecipazioni statali è migliorata, con effetti positivi in termini di maggiori dividendi e minori sussidi dal Tesoro. Molti fattori spiegano questi buoni risultati: una maggiore stabilità sul piano macroeconomico, una revisione del quadro legale e regolatorio, e – non da ultimo – un generoso prestito della Banca Mondiale per alleggerire il peso economico e sociale del taglio degli esuberi. Rimangono naturalmente ostacoli e ulteriori sfide. Il governo turco sarà presto chiamato ad affrontare le privatizzazioni più difficili, riguardanti cioè le società più indebitate e operanti in perdita quali le società di generazione e distribuzione elettrica, le ferrovie, i porti e non da ultimo le banche pubbliche. Nonostante ciò, la determinazione da parte del governo turco ad affrontare anche queste sfide difficili non sembra vacillare.

Come d'abitudine, la Newsletter offre un breve resoconto sulla performance degli Indici PB, basati sui titoli delle società privatizzate quotate in tutti i mercati dell'Europa allargata. Nel 2005 gli indici PB non hanno brillato come negli anni precedenti: il PB Composite ha riportato infatti una performance leggermente inferiore ai *benchmarks* europei sebbene tutti gli indici PB settoriali – con la sola eccezione del PB Utilities – restino in territorio positivo. Ma quando i rendimenti in eccesso vengono corretti per il rischio, gli indici PB confermano il loro *appeal*. Dall'analisi CAPM condotta su un periodo di 36 mesi, il PB Composite emerge di 5,5 punti percentuali di rendimento in eccesso rispetto a un portafoglio ben diversificato. Questo risultato conferma che i prezzi dei titoli delle privatizzate sono probabilmente influenzati da fattori di rischio idiosincratici, con implicazioni interessanti per l'industria del risparmio gestito.

Anticipare le tendenze future nei processi di privatizzazione è un compito difficile che PB sembra svolgere con qualche successo. Concludiamo quindi anche questa newsletter con le nostre previsioni per il 2006. Di certo sarà difficile replicare i risultati straordinari di quest'anno: riteniamo comunque che il controvalore complessivo delle operazioni non sarà inferiore ai 40 miliardi di euro. La Francia difficilmente resisterà alla tentazione di ritornare sul mercato con un'operazione su Edf o Gaz de France e la Germania, che ha vissuto quest'anno una battuta d'arresto, riaprirà – seppur con difficoltà – il proprio dossier privatizzazioni probabilmente coinvolgendo il KfW. I governi della Nuova Europa hanno poi a disposizione un'abbondante riserva di società privatizzabili, che potranno risultare prede di quella rinnovata attività di M&A che ha caratterizzato gli ultimi mesi. Miglioramenti sul fronte del ciclo economico potranno poi contribuire a scrivere un altro capitolo di una storia che certamente non è ancora finita.

English Version

Privatization in Europe made a big leap forward in 2005, certainly a record year in recent privatization history. At the global level, privatization volume exceeded $100 billion for the first time after the turn of the century. European divestitures started slowly but accelerated briskly during the second semester, and closed with a balance of 75 major privatizations worth €67.7 billion, just short of the all-time record reported in year 2000.

This record is largely attributable to the exceptional results of a single country, France, that in 2005 dwarfed most of its European partners in all dimensions of privatization activity. France alone raised almost half of total proceeds, implemented the largest IPO (Electricité de France, the largest European IPO for almost five years), the largest secondary accelerated sale (France Telecom), and three out the four largest private sales via the complete divestiture of the highway sector. Undoubtedly, the young administration of Prime Minister Dominique de Villepin has shown its credible commitment to launch (finally) privatization in strategic sectors, and especially in infrastructure.

Indeed, private sector involvement in infrastructure is certainly a key topic in the European privatization agenda. But how can governments pursue divestiture in these sectors without fearing that public monopolies turn private? Economists provide a natural answer to this question, suggesting that careful regulation is at least as important as private ownership to boost the efficiency of firms. In this newsletter, Carlo Michelini from Morgan Stanley provides the investment banker's point of view on the issue, claiming that the quality of the regulatory regime for privatization represents the single most important variable in the investment decisions of prospective buyers in network industries. Indeed, the assessment of the regulatory regime can cause significant differences in the valuation levels investors ascribe to these stocks. Particularly, given that investors use regulated stocks as defensive instruments, the regulatory regime should be sustainable rather than offer short-term high returns and growth. Furthermore, the regulatory regime must be clearly viewed as independent and not subject to undue government intervention, which is typically perceived by investors as a fundamental source of risk. Unexpected reviews to the regulatory regime can cause severe volatility to regulated stocks, especially if such changes are perceived as irrational or not consistent with the long term objectives of the regulator.

Identifying the sources of value in privatized firms is certainly important. Equally important is trying to measure how valuable are governments' stakes in these firms. The article by two PB researchers, Luca Farinola and Bill Megginson, draws the full picture on the holdings of 25 European Union central governments in companies listed in European stock exchanges. They document that EU central governments hold direct and indirect stakes in 123 listed firms. Interestingly, the study documents the widespread use of complex pyramidal structures as control enhancing devices especially in Germany, France and Italy. The bottomline of the study is the following: at the end of 2005, European governments' ultimate ownership is worth €295 billions. The French government dwarfs all other European partners with a portfolio value exceeding €93 billion, comprised of 18 large-capitalization firms. The Italian government follows with stakes in only seven listed firms, but worth €31.6 billion of value, the stake held in the oil company Eni being worth €26.4 billion. The most valuable stakes held by governments of New Europe are those of Poland (worth €11.81 billion), the Czech Republic (worth €10.37 billion). These numbers are striking and suggest that future privatization will not be constrained by any inventory of assets any time soon, but rather by the reluctance to relinquish control given the advanced stage of the process in several core EU countries.

If we take a look on what is going on at the borders of Europe, even the casual observer may notice the spectacular changes taking place in Turkey. Nilgün Gökgür, a development Economist from the Boston Institute for Developing Economies and a leading privatization consultant, describes the most recent evolution of the Turkish process in a new section of the PB Newsletter featuring country reports on areas not (yet) covered by the Privatization Barometer.

In the last three years, the Turkish economy boasted growth rates of 6 percent or more, with a stock market gaining more than 50 percent yearly. Undoubtedly, the dramatic acceleration of the privatization process after the electoral victory of the new Islamist-based Justice and Development (AK) Party in 2002 contributed to this new economic environment.

Announced twenty years ago, and progressing very slowly in the 90s, the new government launched privatization as part of a structural reform package aimed at creating a competitive economy for a prospective EU membership. The Privatization Administration has successfully privatized important enterprises, Türk Telekom among them, raising substantial revenues. Privatization was also accompanied with enterprise reforms and labor restructuring for the SOEs. As a result, the performance of the remaining SOEs has significantly improved generating higher dividends and other income while reducing the need for budgetary transfers from the Treasury. Several factors contributed to this positive results: the enhanced macro-economic stability, a revised legal and pro-competitive regulatory framework, and the generous World Bank loans to ease the burden of labor restructuring on displaced workers. Obstacles and challenges remain. Next in line for privatization are the more difficult and financially important cases, that is loss-making and heavily indebted SOEs (electric generation and distribution companies, railways, and ports) together with the state-owned banks. Nonetheless, the present Turkish government's resolve to transform the Turkish economy appears unwavering.

As customary, the newsletter reports on the PB Indices, tracking the performance of shares of privatized companies that are listed for trading in domestic stock markets of the enlarged European Union. In 2005, PB indexes did not boast the bright over-performance that we were accustomed to comment in our previous analyses: the PB Composite performed slightly less than European benchmarks, although all our sector indices - with the only exception of the PB Utilities – remain in positive territory. But when excess returns are adjusted for risk, PB indices confirm their appeal. Using a CAPM approach over the 36-month period, the PB Composite still gains 5.5 percent excess returns over a broadly diversified portfolio. This result indicates that the idiosyncratic risk factors seem to affect the pricing of privatized stocks, with interesting implications for the asset management industry.

Anticipating future privatization trends is a difficult game that the PB Newsletter has proved to play quite successfully in the previous issues. We therefore conclude by stating our forecast for 2006. We will not see a repeat of the extraordinary volume of privatizations implemented this year but we expect that total transaction value will not fall below €40 billion. France will hardly resist the temptation to come back to the market with a secondary issue on EdF or Gaz de France, and laggard Germany will resume, with difficulty, its stalled privatization agenda, especially involving the KfW. A significant inventory of saleable assets is still available in several countries of New Europe, and many of them may become attractive targets of global M&A activity, which surged recently. An improved business cycle may also contribute to a story which is certainly far from its end.

Bernardo Bortolotti

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Privatization Trends in Europe

Privatization volume close to all time hit...

Signs of economic recovery are emerging in Europe. Consumer confidence is raising, employment is picking up, and the business mood is lightening. During 2H2005, governments took advantage of this new environment on the macroeconomic front to reopen the privatization agenda, with significant success. The 75 major privatizations implemented in 19 countries of the enlarged Europe in 2005 have raised €67.7 billion in revenues, marking the highest value since the turn of the century. Total transaction values increased by 25 percent versus 2004, being just short of the historical record of €73 billion reported in year 2000 (see Figure 1).

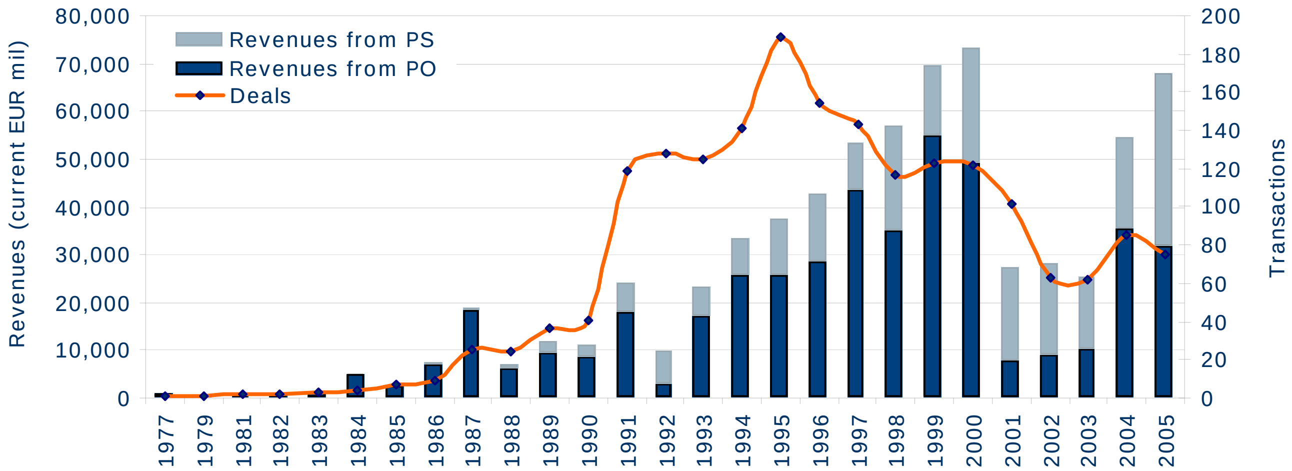
…but Germany lagged behind

An important guest did not join the party: Germany. The monumental (and unexpected) defeat of Schroeder's incumbent party in state elections during May triggered a political crisis which brought the country to elections and produced a hung parliament. The uncertainty surrounding the elections and the political fragmentation induced by forming a grand coalition turned the planned large scale privatizations into a daunting task for the new government. Because of this, Germany, has privatized only a single company, Fraport, since the change of government. Overall, with the exception of Germany, the 2005 balance is quite in line with expectations, confirming consolidation of the increasing trend we forecasted in our previous newsletter.

Salient features of 2005 privatizations are…

The most interesting facts that we document for 2005 are (i) the dramatic acceleration of the French process; (ii) the relevance of private equity placements and leveraged buy-outs; and (iii) the continuing preference given to accelerated transactions in seasoned equity offerings (SEO).

Figure 1. Privatization in the Enlarged Europe: Total Revenues and Transactions 1977-2005



Source: *Privatization Barometer*

French privatizations (vivement...)

Indeed, France dwarfed most of its European partners during 2005 in all dimensions of privatization activity: it alone raised almost half of total proceeds, it has implemented the largest IPO (Electricité de France), the largest secondary accelerated sale (France Telecom), and three out the four largest asset sales via the complete divestiture of the highway sector. In particular, the two giant IPOs in the energy sector (Gaz de France and especially EdF, the largest for almost five years) made France the largest market for IPOs by volume in 2005. Undoubtedly, the young administration of Prime Minister Dominique de Villepin has been able to show its credible commitment to modernize and privatize some strategic sectors, even amid strong social resistance.

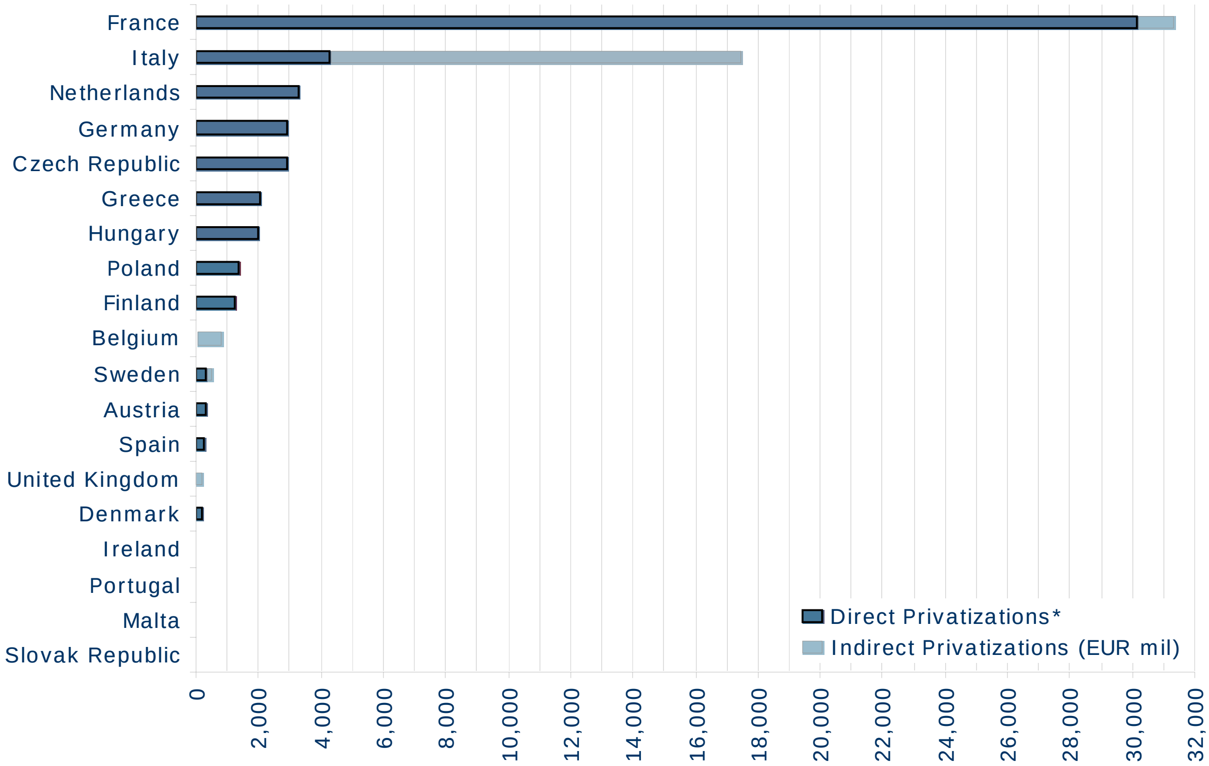
Behemoth private sales...

Despite positive market conditions (with European equity markets gaining 22 percent over the year), governments demonstrated a strong preference for asset sales, which yielded 56 percent of total revenues. Again, France had a strong impact on this recent trend. With well designed and sequenced sales, the French government auctioned off the three main operators of the highway system to strategic operators, who bid almost €15 billion for these assets. However, the most important equity placement of the year was the €12 billion leveraged buy-out of Wind, the Italian telecom mobile operator of the electricity giant Enel, by the Egyptian entrepreneur Sawiris. The size of this deal demonstrates the importance of the wave of capital flows into telecoms, Europe's star M&A performing sector in 2005.

...and the enduring preference towards accelerated transactions as block trades or ABOs

The year 2005 also marked a definite decline in conventional, fully marketed follow-on (secondary) privatizations and a spreading of accelerated underwritings such as block trades and accelerated bookbuilt offerings (ABO) to institutional investors. Approximately two thirds of total SEO volume was raised by this innovative underwriting method, which has increasingly gained global market shares recently. While conventional fully marketed methods are typically

Figure 2. Distribution of Privatization Revenues by Country, 2005



* Direct Privatizations refer to the sale of government's direct stakes. Indirect Privatizations include spin-offs and transfer of shares from government owned companies.
Source: *Privatization Barometer*

used in IPOs, the consolidation of this trend documents an epochal decline in the involvement of retail markets in SEOs.

France and Italy get the lion's share...

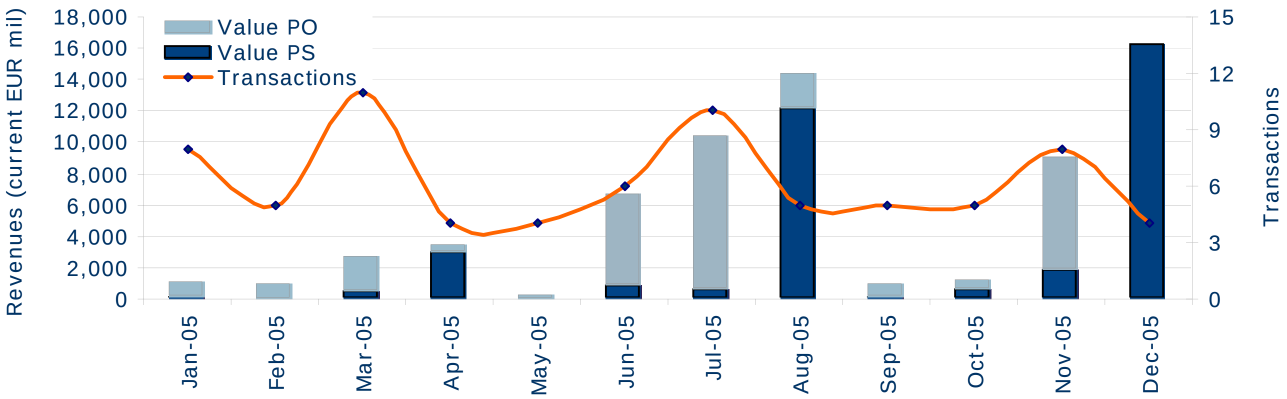
The distribution by country of privatization activity appears widely skewed. In 2005, France and Italy alone implemented almost 30 percent of transactions and raised 70 percent of total proceeds. Italy boasts a total of €17 billion largely thanks to three important transactions involving Enel, definitely a key driver of privatization in Europe. These are the €4 billion fourth tranche, the secondary issue of Terna, the grid operator, and the above mentioned spin-off of its TLC mobile operator, Wind. Negligible revenues (€13 million) mask the relevance of the privatization of Alitalia, the flagship carrier. Through a complex deal that also involved a capital increase—cleared by the European Commission—and a deep restructuring that caused trouble with unions, the Italian government is no longer the majority shareholder of the company. This is expected to allow Alitalia to recover from a long standing financial crisis. Nevertheless, these privatization efforts did not substantially curb Italy's towering government debt, which after a decade-long decline is now reversing and is expected to rise toward 108.5 percent in 2005.

The remaining privatization activity in Old Europe is quite evenly split among three countries: the Netherlands, Germany, and Greece. Noteworthy operations in this group are some accelerated transactions, such as the sale of Deutsche Post by the Federal Government, the two issues by the Dutch TLC operator KPN, and Greece's OTE.

...while accession countries follow the 10 percent rule.

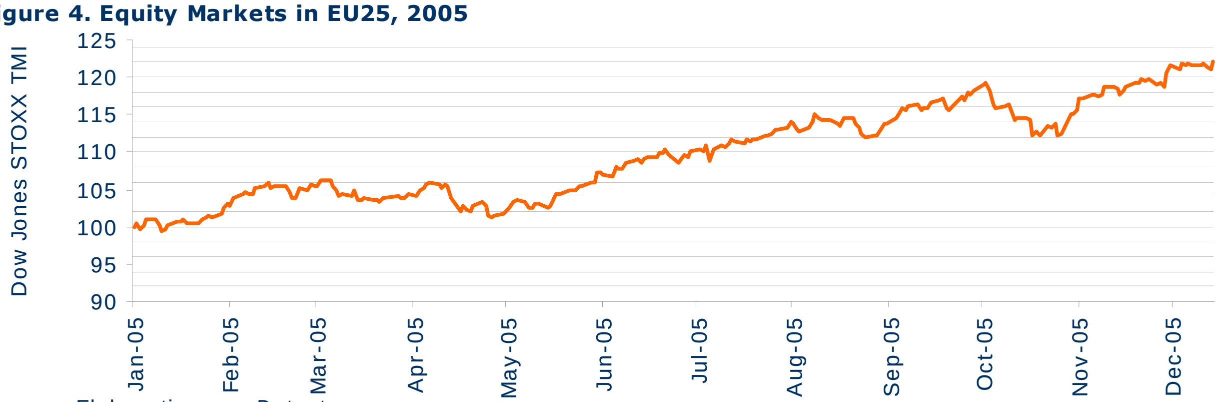
Privatization in the accession countries seems to follow a rule of thumb. Generally, New Europe raises around 10 percent of total revenues, and the balance for 2005 confirms this rule. The 10 new EU countries implemented 18 deals worth about €6.5 billion. We document a definite resumption of the

Figure 3. Total Privatization Revenues and Transactions in EU25, 2005



Source: *Privatization Barometer*

Figure 4. Equity Markets in EU25, 2005



Source: Elaborations on *Datastream*

process within the Czech Republic, which raised almost a half of total revenues of the region with a follow-on privatization of Cesky Telecom. Hungary also made important steps in its infrastructure privatization program, with the private sale of Budapest Airport. Privatization activity slowed in Poland with respect to 2004, largely due to political uncertainty during the electoral year. Other countries lag behind.

The surge of direct privatizations witnesses the general incumbency of squaring public finances

The need to square public finances is witnessed by the preference divesting governments gave to direct privatizations rather than indirect operations. In direct privatizations revenues flow directly to the state's coffers, and can be allocated to curb public debt or to finance the budget. In indirect privatizations, the revenues accrue pro rata to the government only if the divesting company decides to distribute them as extraordinary dividends. In 2005 direct privatization accounts for the overwhelming part (almost three-fourths) of total revenues, and with volumes concentrated in financially distressed countries such as France, Germany, and the Netherlands.

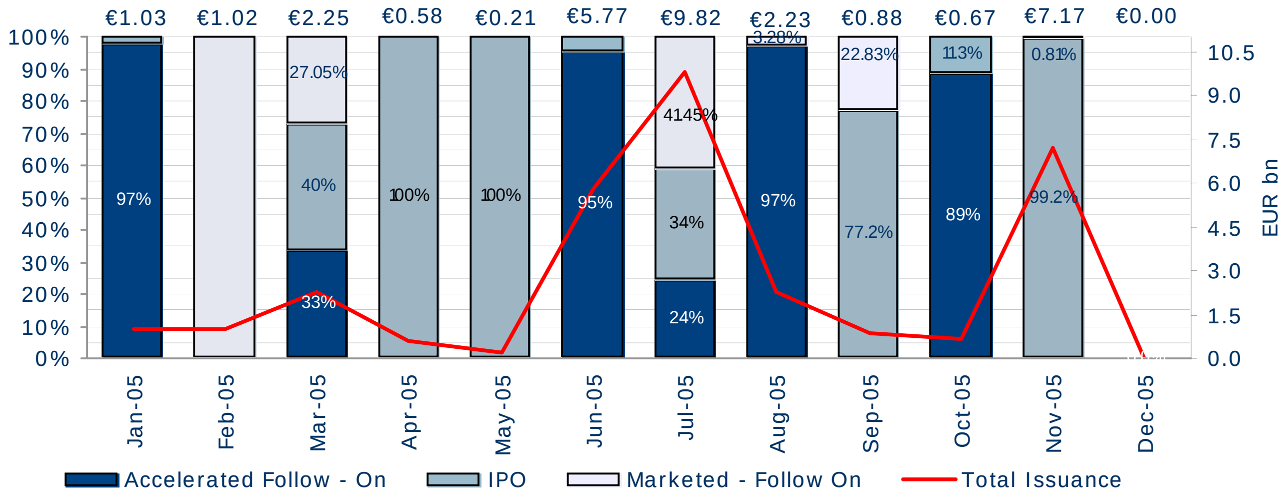
Privatization rallied in 2H2005

As Figure 3 clearly shows, 2H2005 marks a definite upward shift in most recent privatization trends. The amount raised in Europe during this semester (€52.3 billion) accounted for 77 percent of the year's total revenues. The size of the deals is also impressive: the average transaction is worth almost €1.5 billion, dwarfing the corresponding figure for 1H2005 (€394 million). Given the strong bearing of the second semester over the year, the general comments stated for 2005 refer particularly to this sub-period.

2006 will probably not be as hot, however the story is far from its end.

We conclude with the PB's usual forecast of future privatization trends. Given the record marked in 2005, next year is not likely to see a repeat of the extraordinary volume of privatizations implemented this year. This expectation does not simply hinge upon a simple statistical reversion to the mean. 2006 will be an election year in heavy privatizing countries such as Italy, Austria, and in some accession countries, notably Hungary. In Germany, political fragmentation will likely challenge the implementation of structural reforms. Both factors will hinder large scale privatization in EU countries. Nevertheless, we expect that total transaction value will not fall below €40 billion. The colossal IPOs in the energy sector gave a €70 billion increase to the value of the French government's portfolio. Thus France will hardly resist the temptation to come back to the market with a secondary issue on EdF or Gaz de France. We also

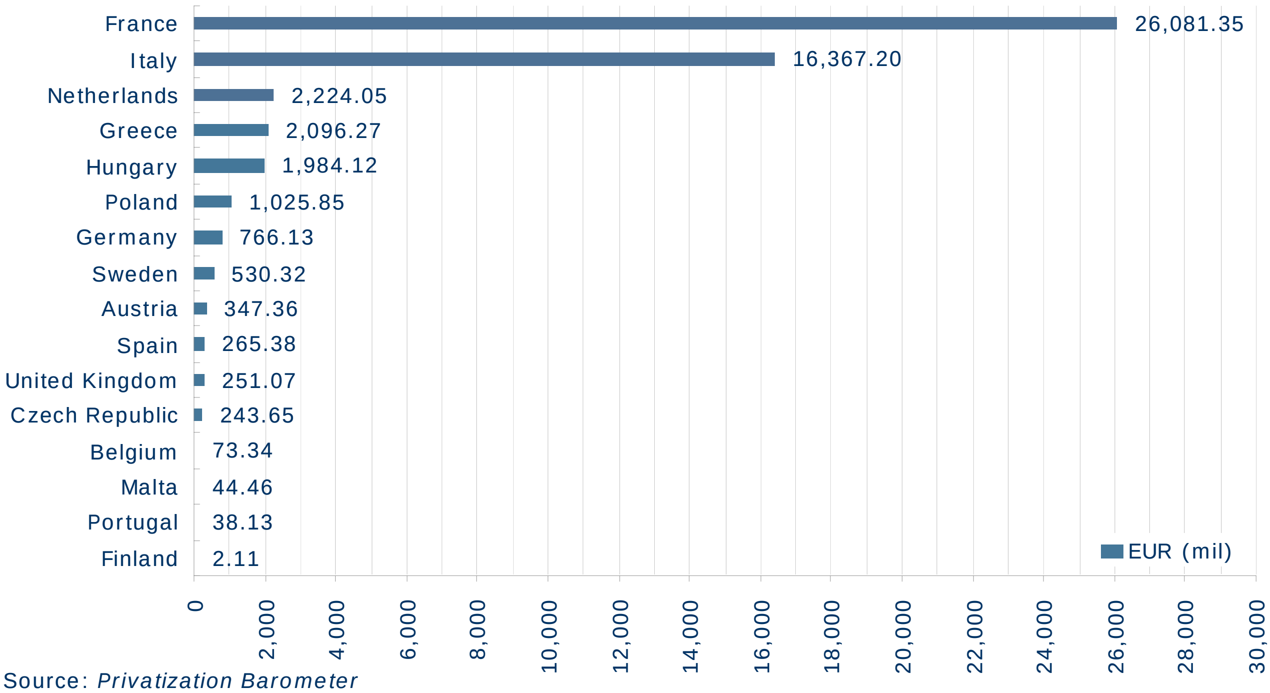
Figure 5. Share Issue Privatization in the Enlarged Europe, 2005



Source: *Privatization Barometer*

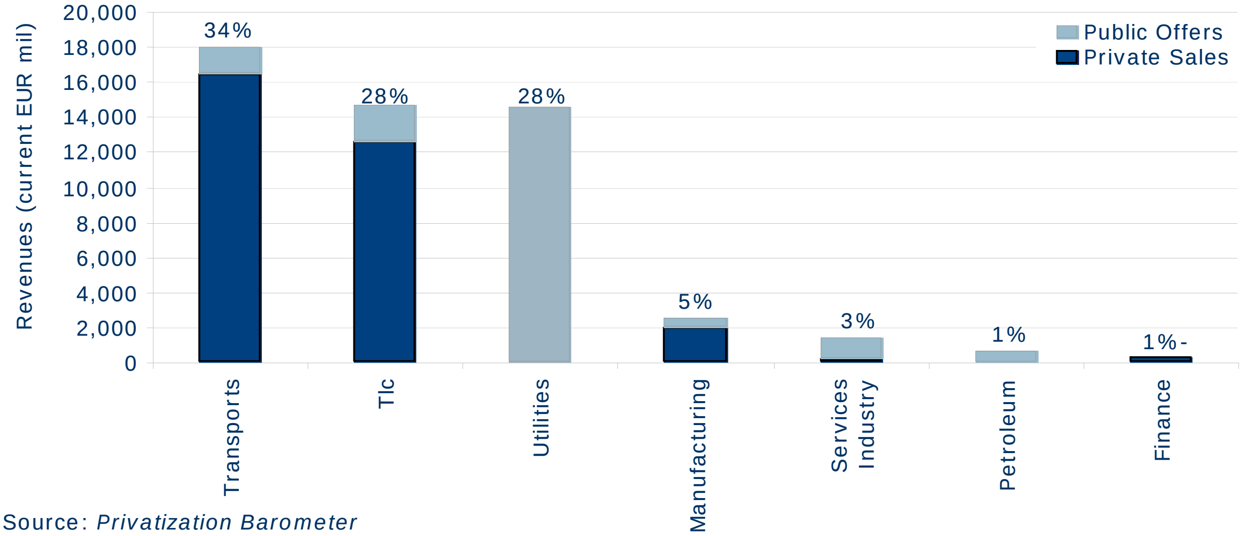
expect the 2005 laggard Germany to resume, with difficulty, its stalled privatization agenda, especially involving the KfW. A significant inventory of saleable assets is still available in several countries of New Europe, and many of them may become attractive targets of global M&A activity, which surged recently. An improved business cycle may also contribute to a story which is certainly far from its end.

Figure 6. Distribution of Privatization Revenues by Country, 2H2005



Source: *Privatization Barometer*

Figure 7. Distribution of Privatization Revenues by Sector, 2H2005



Source: *Privatization Barometer*

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Major Deals of 2H2005

In 2005, privatization activity resumed peaking the high volumes reached n the late -1990s

For the world's privatizing governments, it must have seemed that the late-1990s had returned during the second half of 2005, as this semester witnessed global privatization proceeds exceeding $100 billion for the first time in half a decade. European governments executed 15 public share offerings and 22 private sales, worth €52.34 billion ($63.35 billion), during the July-December period, while governments in the Middle East and, especially, Asia raised an additional €35.45 billion ($42.90 billion) with eleven large and several smaller sales. These sales, combined with a strong first half of 2005, brought the full-year 2005 global value of privatizations to over €118 billion ($142 billion), the third highest dollar total on record.

Continuing a trend that has been emerging since 2001, four out of seven European privatizations during 2H2005 involved a private sale rather than a public offering, though public share issues continued to account for the lion's share of sale proceeds. Outside of Europe, share issue privatizations still dominate, both in terms of number of sales and total proceeds.

Especially during 2H2005, revenues boasted thanks to some imposing deals

The second half of 2005 also witnessed the return of block-buster share issues, with no fewer than 13 offerings (seven in Europe) raising at least $4 billion each. The semester's largest sale was the Italian utility Enel's €12.1 billion ($15.0 billion) sale of its **Wind** telecom subsidiary to Weather Investment, which closed during August after an extended struggle between competing bidders. The largest share issue privatization of 2H2005—the €7.6 billion ($9.20 billion) initial public offering of **China Construction Bank**— came from outside Europe, but the €7.1 billion ($8.4 billion) **Electricité de France** IPO was almost as large.

France is the world's largest single privatizer during 2H2005, Italy is right after...

... and, amazingly, Turkey ranks in third position, giving a boost to a heretofore struggling and slow privatization program.

As has frequently been the case recently, the French government was the world's largest single privatizer during 2H2005, raising over €26 billion ($31.2 billion) by selling its entire holdings in four companies and partial stakes in two others. Unsurprisingly, Italy was second—raising €16.4 billion ($20.2 billion) in five sales—but the fact that Turkey ranked as the world's third largest privatizer during 2H2005,with three sales raising €10.3 billion ($12.4 billion), marked a real coming of age for that country's heretofore struggling privatization program. The two largest Turkish divestitures were private sales, including a €5.4 billion ($6.6 billion) sale of the state's remaining shares in **Turk Telecom**, while the third was a public offering. Rounding out the list of the world's top privatizing governments during 2H2005 are China, with two large share offerings raising €9.6 billion ($11.6 billion); Japan, with two public offerings raising €7.5 billion ($9.1 billion); and Taiwan, with one private sale and one public offering raising €3.4 billion ($4.2 billion), collectively.

The sale of Italian Enel's telecom subsidiary Wind is the largest privatization of the semester.

Sales in Old Europe during 2H2005

As noted above, Old Europe's largest privatization of 2H2005—indeed the largest all year—was the sale, by Italy's Enel, of its **Wind** telecoms subsidiary to the consortium Weather Investments for a total consideration of €12.1 billion in cash, assumption of debt, and an equity stake in the consortium. Weather is a vehicle company established by the Egyptian entrepreneur Naguib Sawiris, which includes Mr. Sawiris' controlling shareholdings in Orascom, the quoted mobile phone operator. Enel had been trying to sell Wind for many years, and was finally able to dispose of this non-core subsidiary for a much higher than expected price, since Weather had been competing for several months with a five-member consortium of mostly U.S.-based private equity companies. In the first part of a two-stage deal, Enel received a net cash payment of about €3 billion and offloaded €7.4 billion of Wind's net financial liabilities. In the second stage, Enel received a 26 percent stake in Weather Investments. Although the Italian government did not receive any proceeds from Wind's disposal, this sale counts as a privatization because it did eliminate the state's indirect ownership in the telecom company.

The second and seventh largest privatization sales of 2H2005 together represent a fundamental change in French national utility policy. The €3.39 billion ($4.05 billion) initial public offering of a 17.47 percent stake in **Gaz de France** in July and the €7.11 billion ($8.40 billion) IPO of 12.70 percent of **Electricité de France** in late November were the first large divestment of energy utility assets

Table 1. Deals, 2H2005

Date	Company Name	Nation	Sector	Percentage for Sale	Value of Transactions (€ mil)	Direct/ Indirect Priva.*	Method of Sale
08/11/05	Wind (Enel)	Italy	Telecommunications	62.75	12,100.01	I	Private Sale
11/21/05	Electricité de France	France	Utilities	12.70	7,112.01	D	Initial Public Offering (IPO)
12/14/05	ASF	France	Transportation Industry	50.00	5,690.52	D	Private Sale
12/14/05	SAPRR	France	Transportation Industry	70.20	4,792.01	D	Private Sale
07/02/05	Enel	Italy	Utilities	9.30	4,070.49	D	Public Offering
12/14/05	SANEF	France	Transportation Industry	76.00	4,023.30	D	Private Sale
07/07/05	Gaz de France	France	Utilities	17.47	3,387.56	D	Initial Public Offering (IPO)
12/14/05	Budapest Airport	Hungary	Transportation Industry	75.00	1,788.69	D	Private Sale
08/12/05	Koninklijke KPN NV	Netherlands	Telecommunications	6.40	1,322.12	D	Accelerated Transaction (AT)
07/18/05	Opap	Greece	Services Industry	16.40	1,257.83	D	Accelerated Transaction (AT)
11/03/05	Framatome Connectors International (Areva)	France	Manufacturing	100.00	1,075.95	I	Private Sale
07/12/05	Koninklijke TPG NV	Netherlands	Transportation Industry	9.00	901.93	D	Accelerated Transaction (AT)
08/09/05	OTE	Greece	Telecommunications	10.00	838.44	D	Accelerated Transaction (AT)
09/13/05	PGNiG	Poland	Petroleum Industry	15.25	682.80	D	Initial Public Offering (IPO)
10/26/05	Fraport AG	Germany	Transportation Industry	11.60	597.06	D	Accelerated Transaction (AT)
11/15/05	AssiDoman AB	Sweden	Manufacturing	100.00	380.46	D	Private Sale
10/12/05	Polmos Bialystok	Poland	Manufacturing	61.00	260.04	D	Private Sale
07/31/05	BBC Broadcast Ltd	UK	Telecommunications	100.00	251.07	I	Private Sale
11/15/05	Vitkovice Steel	Czech Rep.	Manufacturing	98.96	243.65	D	Private Sale
07/07/05	Altadis	Spain	Manufacturing	2.02	203.10	D	Accelerated Transaction (AT)
09/19/05	Voestalpine AG	Austria	Manufacturing	7.60	201.99	D	Public Offering
07/21/05	Antenna Hungaria Rt.	Hungary	Telecommunications	75.00	195.43	D	Private Sale
10/03/05	Torri dell EUR Building Complex	Italy	Finance & Real Estate	50.00	174.37	D	Private Sale
10/28/05	Fraport AG	Germany	Transportation Industry	4.95	169.06	D	Private Sale
11/02/05	Infracity AB (Vasakronan AB)	Sweden	Finance & Real Estate	100.00	149.86	I	Private Sale
07/15/05	VA Technologie AG	Austria	Services Industry	14.70	145.37	D	Private Sale
10/12/05	Polish Chemical Co Pulawy	Poland	Manufacturing	29.00	76.28	D	Initial Public Offering (IPO)
08/25/05	Arcelor	Belgium	Manufacturing	0.80	73.34	D	Public Offering
11/27/05	Malta International Airport	Malta	Transportation Industry	20.00	44.46	D	Public Offering
07/12/05	Portucel Tejo-Empresa de Celulose do Tejo	Portugal	Manufacturing	95.00	38.13	I	Private Sale
09/30/05	Clinisa E Inisas SA	Spain	Services Industry	100.00	36.28	D	Private Sale
09/09/05	Inspeccion Tecnica de Vehiculos de la Comunidad de Madrid SA	Spain	Transportation Industry	100.00	25.99	I	Private Sale
11/17/05	ALITALIA	Italy	Transportation Industry	12.10	13.30	D	Public Offering
08/30/05	Terme di Rimini SpA	Italy	Finance & Real Estate	94.13	9.03	I	Private Sale
07/11/05	Totolotek ToTo-Mix SA	Poland	Services Industry	100.00	3.42	D	Private Sale
09/22/05	PW Atex Sp zoo	Poland	Utilities	56.02	3.31	D	Private Sale
11/01/05	Kiinteisto Oy Lintulankulma	Finland	Finance & Real Estate	100.00	2.11	D	Private Sale
Total	**37 Transactions**				**€ 52.340,78 mil**		

* Direct Privatizations refer to the sale of government's direct stakes. Indirect Privatizations include spin-offs and transfer of shares from government owned companies. Parenteses report the Parent/Seller Company name.
Source : Privatization Barometer

The two IPOs of French utilities GdF and EdF are both financially successful

by the French government, which has a long (and remarkably successful) tradition of state directed infrastructure development. Both were extremely controversial politically, but successful financially. The government reserved half of the Gaz de France (GdF) offering for domestic retail investors—in addition to a 15 percent tranche reserved for employees—and priced these at €23.20/share, slightly below the €23.40/share price charged to institutional investors. Retail investors were also offered one bonus share for every ten purchased, if they retain the shares for 18 months. In the end, GdF was enthusiastically received. The institutional tranche was over-subscribed 27 times, and the stock soared 23 percent during the first day's trading. The offering attracted 3.3 million new shareholders.

The EdF offering was less riotously successful than GdF, but this largest European IPO in five years was completed in record time—largely to finesse political opposition. Seven-eights of the stock on offer were primary shares, raising investment capital for EdF, while the remaining shares were a secondary offering of government holdings. EdF stock did not jump in value after trading began; in fact the institutional buyers suffered a 3 percent first day loss (retail investors broke even). Nonetheless, the offering did attract a record 4.8 million private buyers. Soon after the issue was placed, the French government reneged on a pre-offering promise to allow EdF tariffs to rise along with costs and, unsurprisingly, the shares slumped in response.

The French government also completely divested the three toll-road companies ASF, SAPR and SANEF

France also accounted for Old Europe's third, fourth and six largest privatizations of 2H2005, with the direct sales of three roadway companies in December that collectively raised €14.5 billion ($17.4 billion) for the national government. The French construction company Vinci purchased the remaining shares of **Autoroutes du Sud de la France** (ASF) that it did not already own for €5.7 billion ($6.8 billion), and saw its shares rise 3 percent on the news it had won the auction. The French services group Eiffage, in partnership with Australia's hyper-acquisitive Macquarie Bank, paid €4.8 billion ($5.8 billion) for 70.2 percent of **Autoroutes Paris-Rhin-Rhone** (SAPRR), while Spain's Albertis purchased 76.0 percent of **Autoroutes du Nord et de l'Est de la France** (SANEF) for €4.0 billion ($4.8 billion). Unlike Vinci, however, Albertis' stock price fell by over 2 percent on the announcement of its winning bid.

Italy's Enel public offering , in July, reduced the government's stake in the utility to 21.4 percent

With the July public offering of a 9.3 percent stake in **Enel** for €4.1 billion ($4.9 billion), Italy finally broke France's monopoly over the largest privatizations of 2H2005. The Enel offering was the semester's fifth largest sale in Old Europe, and reduced the Italian government's stake in the electric utility to 21.4 percent. Retail investors were offered shares at €7.07 each, while institutions were charged €7.18 per share. Even though both prices were discounts from the previous day's closing price, and the offer was three times subscribed, Enel shares fell by 0.6 percent on the first post-placement trading day.

The Netherlands advanced in Koninklijke KPN privatization and canceled its golden share

Old Europe's eighth largest privatization of 2H2005 was the Dutch government's December offering of a 6.4 percent stake (half its remaining ownership) in **Koninklijke KPN**, which raised €1.3 billion ($1.6 billion). These shares were sold through an accelerated bookbuilt offering targeted exclusively at institutional investors. The Dutch government simultaneously announced plans to sell its remaining stake in KPN, and cancel its golden share, within a year. Interestingly, while stock market investors responded favorably to news of KPN's share sale and the attendant policy announcements, bondholders reacted very negatively. Credit default spreads, a form of default insurance, on KPN debt rose more than 30 percent on the news, since investors inferred a much higher likelihood that the company would be acquired—and subsequently levered up—once the government's takeover protection was withdrawn.

Greece successfully sold a stake in OPAP

Finally, the ninth largest privatization in Old Europe during 2H2005 was Greece's public offering of a 16.4 percent stake in **OPAP**, which raised €1.26 billion ($1.5 billion) in July. This sale was also structured as an accelerated bookbuilt offering. The market responded surprisingly favorably to the sale, driving OPAP's share price up by 3.3 percent the day offering details were announced. The issue itself was subscribed 4.2 times, mostly by foreign investors—who were allocated 60.5 percent of the shares versus 32 percent for local retail investors and 7.5 percent for Greek institutions. The offering was placed at €24.44 per share, very close to the contemporary market price.

Sales in New Europe during 2H2005

Poland launched an IPO on its gas monopoly PGNiG

There were only two large privatizations in New Europe during 2H2005. The first was the highly controversial IPO of Poland's gas monopoly, **PGNiG**, which raised €683 million ($838 million). This offering was politically charged, since it was launched two days before a late-September general election, and because there was fundamental disagreement between the government and the opposition—as well as between the main parties in the governing coalition—regarding whether PGNiG should retain its gas distribution monopoly and whether the company should retain ownership if its pipeline assets. The final plan involved the company selling 900 million shares to current and former employees, Polish retail and institutional investors, and foreign institutions, with the proceeds earmarked to support PGNiG's ambitious capital investment program. In spite of the controversy, the IPO was hugely over-subscribed (16 times by domestic investors, 29 times by foreigners), allowing PGNiG to raise 80 percent more than expected from the offering, and the shares closed the first day's trading 33 percent above the 2.98 Zloty offering price.

Hungary sold a majority stake of Budapest Airport

The second large New Europe privatization of 2H2005 was the December direct sale of 75 percent minus one share stake in Hungary's **Budapest Airport**. This hotly contested auction pitted BAA, the British airports group against two German companies, the construction and infrastructure group Hochtief and the airport group Fraport. In the end, BAA prevailed with a €1.8 billion ($2.2 billion) bid, and was awarded a 75-year operating contract. Interestingly, an 11.6 percent stake in **Fraport** itself had been sold by the German government through an accelerated bookbuilt offering that raised €597 million ($720 million).

Sales outside of Europe during 2H2005

Outside Europe, Turkey is the biggest surprise

Although, as usual, Europe accounted for the majority of privatization sales during 2H2005, governments in the Middle East and Asia executed eight large and several smaller sales. The semester's biggest surprise was the strong performance of Turkey, which executed two large asset sales and one major public offering. In November, the government raised a surprising $6.6 billion (€5.6 billion) by auctioning its 55 stake in **Turk Telecom**. The winning bid was submitted by a group led by Saudi Arabia's Oger Telecom, which trumped the bid of a Russian consortium with a long and troubled history of joint ownership of Turk Telecom. One month later, Britain's Vodafone won the auction for **Telsim**, Turkey's second largest telecom operator, with a bid of $4.6 billion (€3.8 billion), beating out Orascom Telecom and several other regional operators. The final large Turkish sale was the November IPO of **Vakifbank**, which expanded the bank's capital by about 25 percent and raised $1.27 billion (€1.1 billion) for the company.

Also China executed multiple large sales during 2H2005

As has been true for much of this decade, China executed multiple large sales during 2H2005. In fact, November's $9.20 billion (€7.6 billion) IPO of **China Construction Bank** was 2005's largest share issue privatization and the largest ever privatization of a Chinese company. This issue was over-subscribed 10 times by institutional buyers and 42 times by retail investors, though the share price closed unchanged after the first day's trading. CCB also attracted two large strategic investors prior to the offering. Bank of America purchased a 9 percent stake in CCB for $3.0 billion (€2.5 billion), while Singapore's Temasek Holdings purchased a 5.1 percent stake in CCB for $1.4 billion (€1.2 billion). The second large Chinese share issue privatization of 2H2005 occurred two months before CCB, when **PetroChina** sold shares equal to about 22 percent of its existing capital and raised $2.24 billion (€1.86 billion). Some 55 percent of this offering involved newly issued shares.

Japan finalized the privatization of NTT and sold a stake in the Central Japan Railway Company

Japan also executed two large share issue privatizations during the second half of 2005. The largest was the sixth and final offering of a 7.09 percent stake in **Nippon Telegraph and Telephone** (NTT), which raised $4.8 billion (€4.0 billion). This sale, in September, brought the Japanese government's holdings in NTT to the legal minimum of 33.7 percent, and the government allocated proceeds from the offering to the retirement of public debt. In July, the government sold a 27 percent stake in **Central Japan Railway Co**., better known as **JR Tokai**, for $4.3 billion (€3.6 billion), bringing its holdings down to 17 percent. The government also announced plans to fully divest itself of JR Tokai shares early in 2006. These two share offerings brought the cumulative total proceeds from Japan's 20-year privatization program to ¥31 trillion, worth $269 billion (€222 billion) at current exchange rates.

Taiwan privatized TLC and banking sector

After many years of often futile attempts, the Taiwanese government finally privatized **Chunghwa Telecom** in August 2005. The public offering (mostly in the form of ADRs) of a 17 percent stake in Chunghwa raised $3.0 billion (€2.5 billion), and reduced state holdings to 48 percent. The sale was executed despite the usual intense attacks by Chunghwa's unions and opposition political parties. Also in August, the Taiwanese government successfully auctioned off a 22 percent stake in **Changhwa Bank**, for $1.14 billion (€930 million), to the island's most profitable financial group, Taishin. This followed several failed attempts to restructure and privatize Taiwan's notoriously unprofitable state-owned banking sector.

Ukraine...

The final two large privatizations of 2H2005 were remarkable in many respects. In October, the Ukrainian government raised $4.8 billion (€4.0 billion) —far more than expected—by auctioning off its holdings in the **Kryvorizhstal** mill to Mittal Steel, the world's largest steel producer. This surprisingly successful outcome capped a tortured history for private ownership of Kryvorizhstal, which the former Ukrainian president, Leonid Kuchma, had sold one year previously for a mere $800 million to a local consortium that included the president's son-in-law. The new, democratically elected Ukrainian government renationalized

Kryvorizhstal, in order to privatize it “fairly,” an objective that was accomplished with the October 2005 auction.

…and Egypt

Finally, the Egyptian government executed its largest ever privatization in December, with the initial public offering of a 20 percent stake in Telecom Egypt. This secondary offering raised $782 million (€650 million) and was heavily oversubscribed, partly because employees and domestic retail investors were offered shares at E£11.84 and E£14.80, respectively, far less than the E£15.56 price institutions were charged.

Carlo Michelini

Managing Director, Morgan Stanley

Regulation and Value: Capital Market Approach to Regulated Assets

Privatization is regulation in network industries…

Privatization and regulation have often been two aspects of the same process, as governments have transformed public sector utilities into private companies operating under defined regulatory systems and capable of being listed and traded on the international capital markets. Regulated assets are today an important part of the asset allocation process performed by investors. In an environment of falling interest rates, regulated assets have provided a high yielding investment option and have performed strongly since the 2001 market collapse.

… and certainly in the case of electric utilities

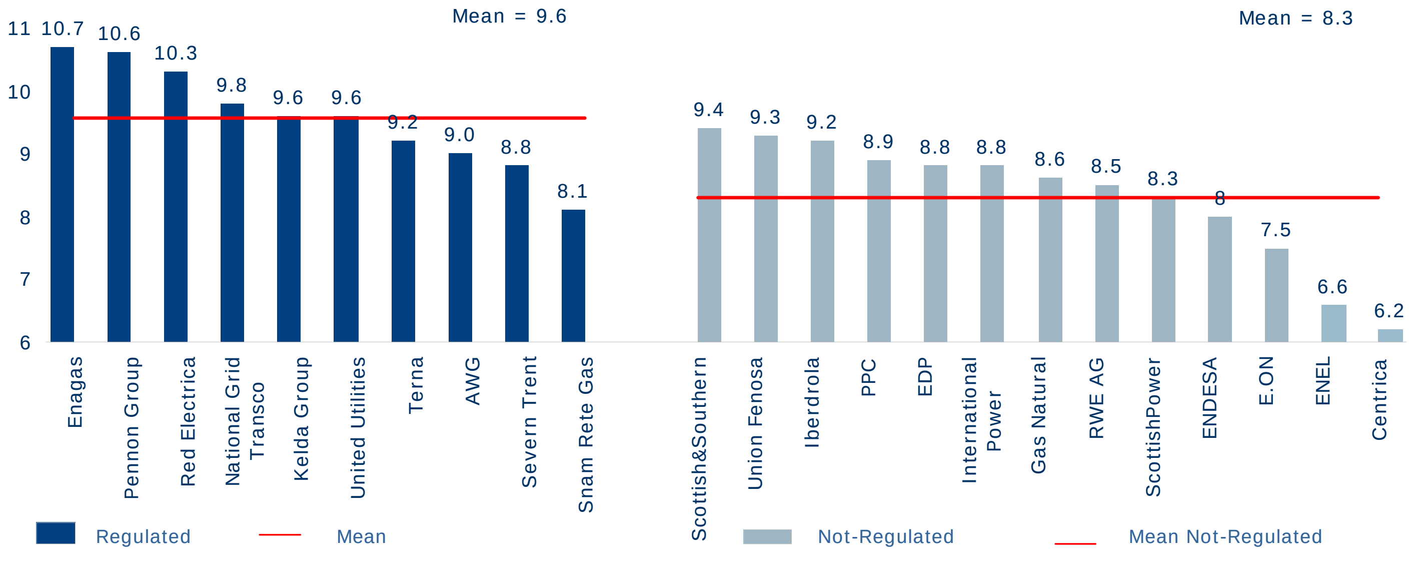
In this article we discuss the result of a recent survey carried out by Morgan Stanley with a group of international institutional investors aimed at identifying the main features of capital markets' approach towards regulated assets. We have focused on utilities, with particular reference to listed companies that operate transmission and distribution activities for electricity and gas under a regulated tariff regime. Because of the impossibility to replicate the network operated by these companies, they operate under a condition of "natural monopoly".

Regulation in natural monopolies

A clear and transparent regulation is key for the liberalization of the market

In this sector, privatization and liberalization imply regulation: a clear and transparent regulation of the networks is a pre-condition of the liberalization of the services offered over such networks. The regulator is expected to set the rules so as to guarantee equal and fair access, in order to promote the development and

Figure 1. - EV/2005E EBITDA



Source: Morgan Stanley Research

Tariffs as a fundamental regulatory instrument for third party access

the quality of the networks and foster efficiency gains. The main regulatory instrument available to the regulator is the tariff regime. Tariffs for access need to generate an adequate return in the short term, but also must offer predictability over the long term, considering the very long useful life of transmission assets (up to 40 years) and the corresponding long-term nature of the investment cycle.

Regulation and value

Regulated assets outperformed broader utilities with also non-regulated assets

The visibility and predictability provided by the regulatory environment in a natural monopoly is one of the main sources of value creation. In the last three years, European stocks representing activities carried out over networks and entirely or predominantly regulated have outperformed the broader utilities assets that are also exposed to competition. These stocks trade today at a significant premium to the other European utilities stocks, as show by a comparison of EBITDA multiples of regulated stocks versus utilities that comprise also competitive activities (Figure 1).

International investors' attitude towards regulation

The institutional investor's view on regulated assets

The table on the previous page shows that regulated stocks in different regimes attract different valuation levels: the ratio of Enterprise Value to expected 2005 EBITDA range from 10.7x to 8.1x.. Financial theory provides various explanations to this variance. Instead of a theoretical approach, we have attempted to identify the sources of difference in value for regulated assets by canvassing the views of a group on international institutional investors, comprised mostly of European pension funds and hedge funds.

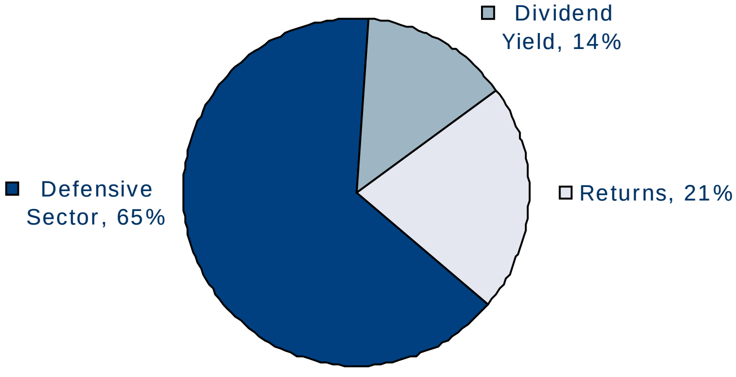
Stocks of regulated assets have defensive characteristics

First, we have asked what the main attractions of regulated assets as an investment alternative are. As expected, investors pointed to the defensive characteristics of these stocks as the main reason for investing. For "defensive characteristics" it is meant predictability of cash flows, earnings and dividends, as well as stability of these measures through the economic cycle. The absolute levels of expected dividend yield and returns are important but secondary considerations.

The importance of sustainable regulation

We have also asked the key requirements that a regulatory regime must satisfy to result into an attractive investment proposition. Interestingly, and consistently with the search for a defensive investment, the survey has shown that investors attach greater importance to the long term sustainability and the clarity of the

Figure 2. Main Attractions of Regulated Assets



Source : Morgan Stanley Research

regime as opposed to high returns and growth prospects. A regulatory regime is deemed to be sustainable when analysts believe that the parameters for tariff settings are: (i) rational; (ii) consistent with the long-term cost structure of the regulated companies; and (iii) unlikely to generate returns that the regulator may judge over time as excessive (or excessively low). A sustainable regulatory regime is therefore not expected to change significantly over time.

The primary risk factor affecting regulated assets is political interference, followed by interest rate and re-investment risk

When asked about the key uncertainties and sources of risk perceived for regulated stocks, investors have again attached a high importance to the transparency of the regulatory regime, by pointing to the risk of government intervention as the main source of risk for these stocks. Investors perceive a risk that the government may retain ultimate intervention or suasion power over the regulator, and that the interests of the government and the regulator may not necessarily be aligned (for example protection of employment vs. efficiency gains). Government intervention over regulatory matters or over decisions of economic policy is perceived as a possible source of irrational or not sustainable regulation. Other risks mentioned, albeit as less important, are interest rate risk (given the stable nature of the expected dividend flows from regulated assets, increases in interest rates have a direct impact on valuations as they are typically not counterbalanced by higher growth as can be the case for cyclical stocks) and re-investment risk (the risk that a regulated company may decide to re-invest cash flows in riskier or low-return activities as opposed to distributing dividends).

RAB as the most preferred valuation metric

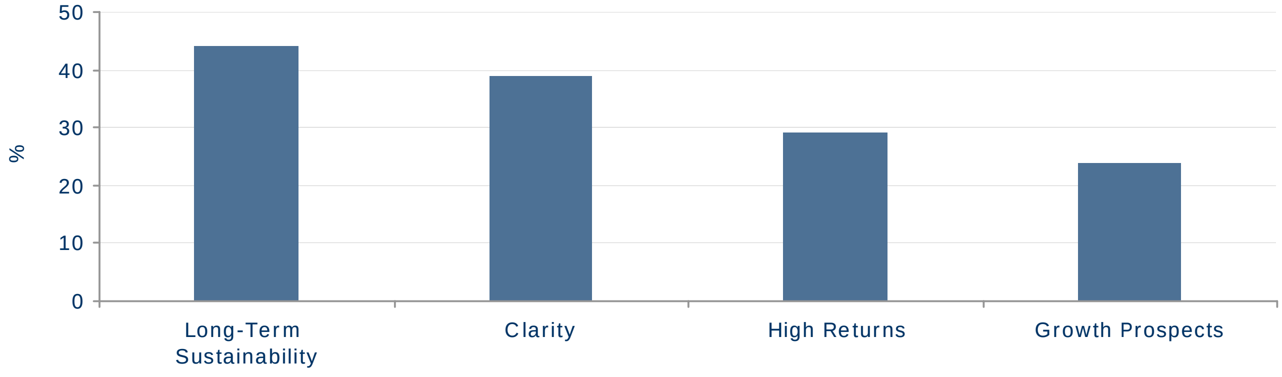
Finally, and as further proof of the overwhelming importance of the regulatory regime, investors have indicated a preference for valuation metrics that make specific reference to the "regulated asset base" ("RAB"), i.e. the notional value that the regulator applies to the regulated assets to determine allowed returns, as opposed to more common valuation metrics such as price earnings and enterprise value to EBITDA ratios.

Perception of lack of regulatory clarity and impact on stock valuation: one example

Unexpected and non rational regulatory reviews affect stock volatility and valuation

The survey highlights the extreme importance investors attach to the predictability and clarity of the regulatory environment. There have been various cases where unexpected changes to the regulation or stances by the regulator interpreted as not rational by the capital markets have caused high volatility in the stocks involved and even a fundamental change in valuation levels.

Figure 3. Key Requirements of the Regulatory Regime



Note: investors were allowed to provide multiple answers
Source: Morgan Stanley Research

The story of Enel tells us that…

One example relates to the publication in late November 2003 of a consultation paper by the Italian energy regulator. The consultation paper was focused on electricity transmission and distribution tariffs. The proposed parameters (returns and efficiency factors) were in line with expectations. However, the document outlined a new methodology for the valuation of RAB of the distribution activities. The market had been expecting an extension of assets life that would have caused an increase in RAB of ENEL's distribution activities to approximately € 20 billion. The document, instead, provided indications pointing to a RAB value in the region of € 16 - 17 billion.

Some analysts pointed out that the proposed new approach would not alter tariffs in the short term, and therefore would not require a change in expectations for earnings estimates and dividend distributions for at least another three years.

...regulatory risk matters, even keeping earnings expectations constant

However, as shown by our survey, capital markets attach greater importance to the visibility of the regulatory regime than short term financial expectations. The regulator's paper caught the market by surprise. The extension of the asset life had been widely anticipated as a more logical, rational approach and many analysts had already incorporated a higher RAB in their model. Some analysts argued that the new definition of RAB for ENEL's distribution activities was not sustainable in the medium to long term (sustainability being another theme highlighted by our survey). Furthermore, our survey also showed that RAB was used by many analysts as a direct proxy for the value of regulated companies.

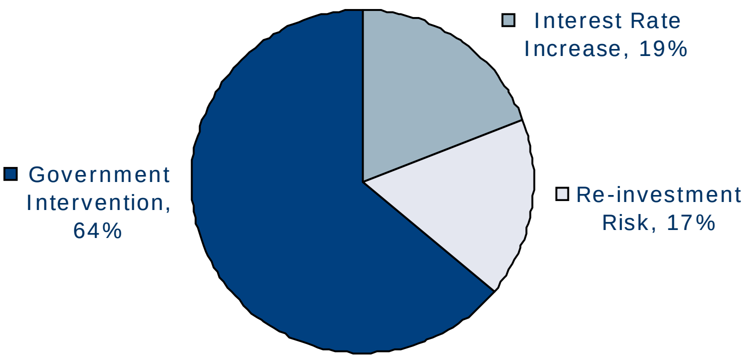
Even though ENEL's activities are not entirely regulated, ENEL's distribution assets represent a sufficiently large portion of the company's enterprise value for the shares to be exposed to regulatory risk. The result of the unexpected action by the regulator was in fact great volatility on ENEL shares in the days following the publication of the document: ENEL share price dropped by 3.68 per cent in two days (3 per cent in relative terms), causing a market capitalization reduction of €1.2 billion, notwithstanding the fact that the change in RAB would not necessarily cause lower financial results in the short term.

Conclusions

Regulated assets represent an important privatization opportunity and the capital market approach could be useful for divesting governments

Regulated assets constitute an extremely appealing asset class to investors, based on their strong cash flow generation and ability to pay significant dividends. Therefore, regulated assets have represented and will continue to represent an important privatization opportunity to governments worldwide. For these assets, privatization needs to be accompanied by regulation. The quality of the regulatory regime for privatization candidates comes under severe scrutiny by investors and probably represents the single most important variable in the

Figure 4. Key Risks Related to Regulated Stocks

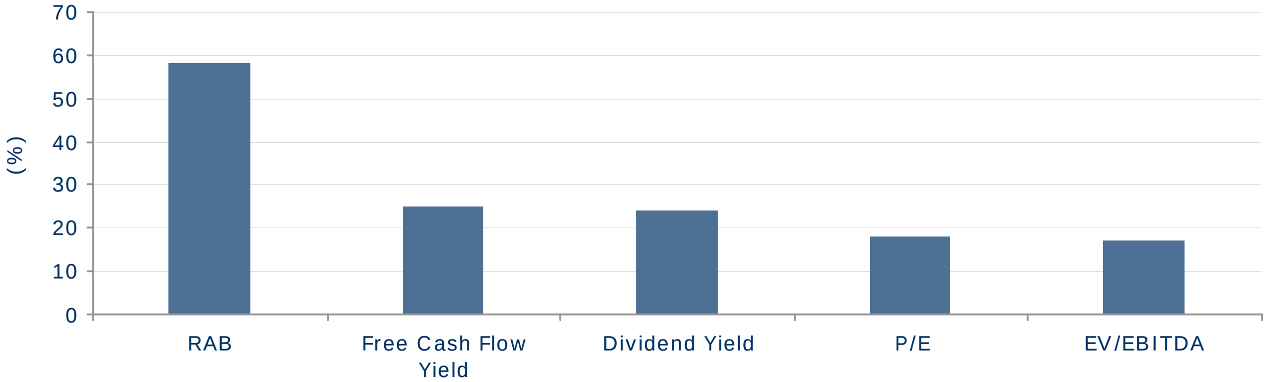


Source : Morgan Stanley Research

investment decisions of prospective buyers of these privatizations. The assessment of the regulatory regime can cause significant differences in the valuation levels investors ascribe to these stocks. The key features of capital markets' approach to evaluating regulated stocks are:

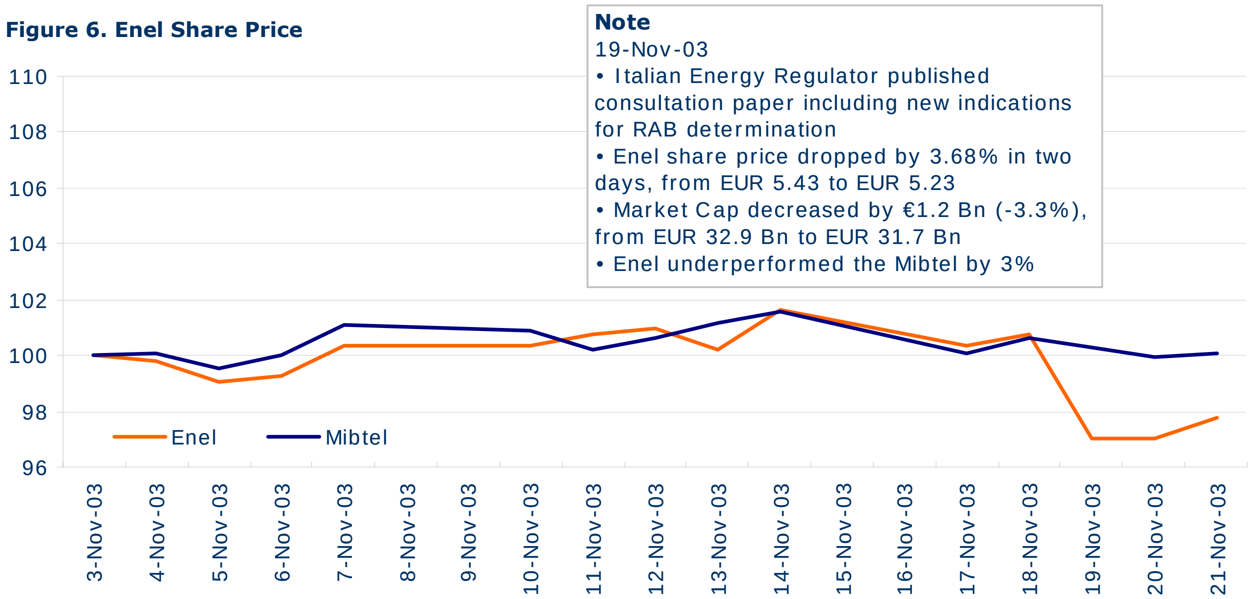
- Investors use regulated stocks as a *defensive* instrument in their asset allocation: defensive means predictable and non-cyclical;
- For the stocks to be valid defensive instruments, it is more important that the regulatory regime be *sustainable* rather than offer short-term high returns and growth;
- The regulatory regime must be clearly viewed as *independent* and not subject to undue government intervention, which is typically perceived by investors as a source of risk for regulated stocks;
- Unexpected changes to the regulatory regime can cause severe volatility to regulated stocks, especially if such changes are perceived as irrational or not consistent with the long term objectives of the regulator.

Figure 5. Valuation Parameters Preferred by Investors



Note : investors were allowed to provide multiple answers
Source : Morgan Stanley Research

Figure 6. Enel Share Price



Source: FactSet

Luca Farinola [§] and William L. Megginson [†]

[§] FEEM [†] University of Oklahoma

Leviathan as Shareholder: the Value of Governments' Stakes

Given that since late 1970s European governments have been selling large chunks of public assets…

Since 1977, European governments have executed almost 1,900 cash sales of state assets, and have raised approximately €700 billion. Roughly 2/3 of these revenues have been raised through share issue privatizations (SIPs), with the remaining 1/3 coming from private sales, and these collectively have cut the role of state enterprises in Europe's economies roughly in half. SIPs have immeasurably increased the size, efficiency and liquidity of the continent's stock markets, and listed privatized firms are among the largest and most actively traded stocks on every exchange. After a slow start in the 1980s, European privatizations surged throughout the 1990s, before dropping sharply from 2001 to 2003, and recovering briskly since early 2004, pushed by the positive outlook in global equity markets.

…what remains to sell today?

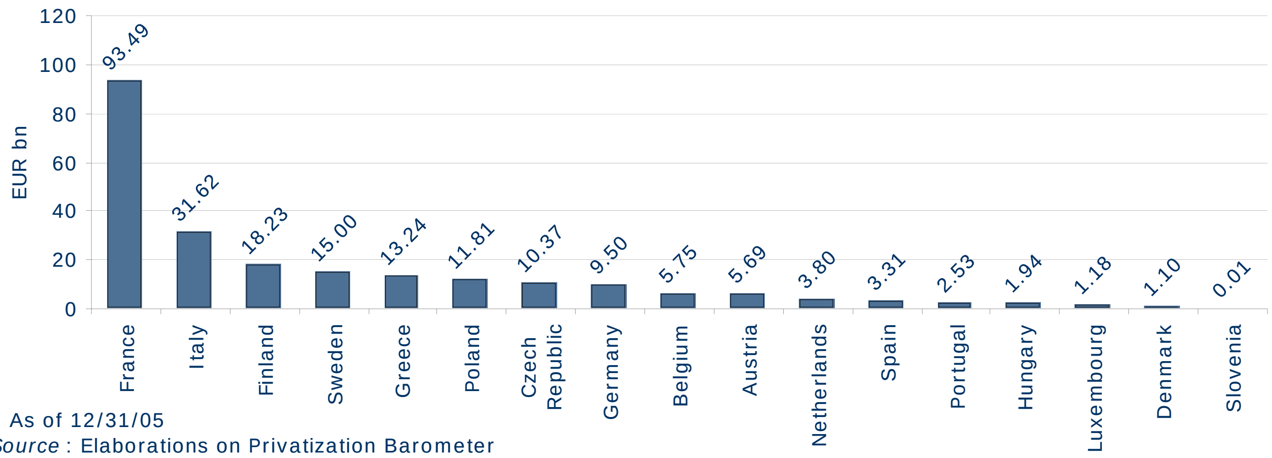
Given that so much has been sold over the past three decades, a natural question to ask is: Do EU governments have any assets left to sell? More specifically, what is the market value of the residual stakes that EU governments hold in partially privatized, listed companies?

Some answers are provided in a research study carried out by the Privatization Barometer, screening the holdings of 25 European Union central governments in companies listed in European stock exchanges. We summarize these findings below.

Direct stakes ready to sell

The first step in determining how much EU governments have left to sell is to compute the value of stakes that European governments retain directly in partially privatized, listed companies. It is important to clarify what directly held

Figure 1. Central Government Direct Portfolio Value*



* As of 12/31/05

Source : Elaborations on Privatization Barometer

means in our valuation. Along with the stakes held by governments – typically through ministries – we treate as direct any stakes held by entities institutionally devoted to act as holdings of the state. Examples of such entities are the Austrian OIAG, the Spanish SEPI, the Portuguese Parpublica, and the National Property Funds and the Privatization Agencies holding stakes in Eastern European countries. Their holdings are consolidated with the shares held directly by the government essentially because of their nature.

A conservative valuation excluding local governments holdings, unlisted firms and assets.

It also bears mentioning what our valuation does not include. As the analysis is limited to listed companies, it does not include wholly-owned state enterprises and we do not assign a value to those infrastructures and assets that in some countries have not even been corporatized—such as electricity networks, roads, ports and airports, railways, and many others. Moreover, as we consider central government holdings only, the stakes held by local governments are also not included. In the case of Germany (and to a smaller extent also Belgium, Italy and Sweden), the involvement of local governments - such as cities and the Lander - in the ownership of publicly traded firms is particularly important, therefore the inclusion of their holdings would increase considerably the total portfolio value. In other words, our portfolio evaluation is a very conservative one.

European governments still have direct stakes in 100 listed companies worth almost one quarter trillion

We document that EU central governments hold direct stakes in 100 listed firms worth €230 billion at the end of 2005. As shown in Figure 1, twenty-three of the twenty-five EU countries retain such stakes, the exceptions being Ireland and the United Kingdom.

The French government dwarfs other European partners with a portfolio value exceeding €93 billion, comprised of 18 large-capitalization firms. The French data are net of the important transactions completed in 3Q2005. The Italian government follows with stakes in only seven listed firms, but worth €31.6 billion of value, the stake held in the oil company Eni being worth €24.6 billion. The most valuable stakes held by governments of New Europe are those of Poland (worth €11.81 billion), the Czech Republic (worth €10.37 billion), and Hungary (worth €1.94 billion).

Taking cash flow rights seriously: indirect stakes

Direct vs indirect stakes: the government as a ultimate owner

But this is not the whole story. Although important, direct stakes represent only a part of the full public portfolio for many of the European countries. To give a weight – in terms of value - to the state as shareholder, the analysis should be extended to the value of indirect ownership retained by governments in listed companies through a variety of forms and intermediate actors, often with complex ownership structures. To do so, we investigated the ownership structure of partially privatized, listed firms accounting for the ultimate ownership of the state in Europe.

We briefly describe the screening criteria of direct and indirect ownership. We treat as indirect all stakes retained by the State as ultimate owner through any intermediary other than the government (through its ministries) and the entities devoted to act as shareholders, as already mentioned above. Examples of indirect holdings are the stakes held through financial institutions such as the German KfW, the French *Caisse Depots et Consignations* (CDC), the Italian *Cassa Depositi e Prestiti* (CDP), and the Portuguese *Caixa Geral de Depositos* (CGD). Although these sometimes have outside shareholders (i.e. private shareholders in the case of CDP, local governments for KfW), these are usually 100 percent state-owned. They are considered as indirect because of their different mission and nature. Similarly, the stakes held by a variety of fully state-owned entities such as the French *Entreprise de Recherches et de Activités Pétrolières* (ERAP), the *Finnish Social Insurance* Institution or the Greek *Military Pension Fund* are not consolidated to a direct holding.

Listed companies may hold stakes in other listed companies. In order to avoid double counting, we consider the market value of stakes held by governments in the first listed company in the control chain. In case of ownership structures *also* involving listed companies, for valuation purposes we exclude the holdings in the relevant tier(s).

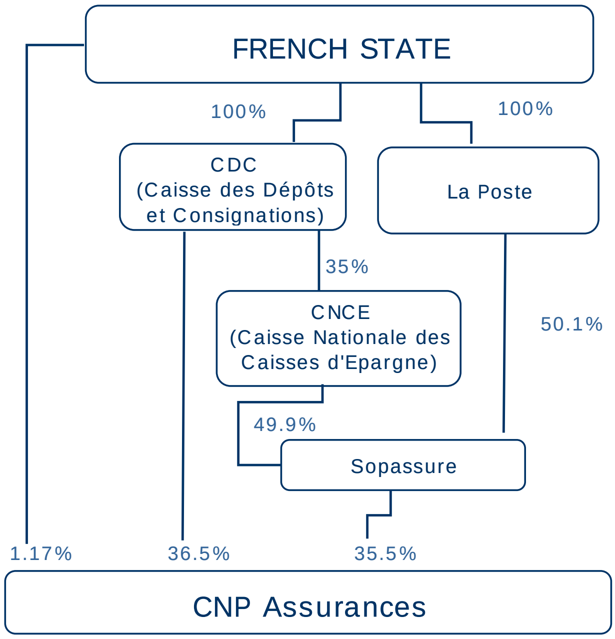
Complex ownership structures are common and pyramids

Direct and indirect state ownership are jointly present in 23 percent of the firms examined, while in around 19 percent of cases the state has only indirect stakes. A typical example of a combination of direct and indirect ownership structure is Deutsche Telekom, the German telecommunication giant. The federal government owns directly a 15.4 percent stake and indirectly another 22 percent stake through the Kreditanstalt für Wiederaufbau (KfW), the financial institution it owns with an 80 percent stake. The difference between direct and indirect ownership appears more starkly in more complex cases, such as CNP Assurances, the leading personal insurance company in France, privatized and listed via an IPO in 1998. The French government retains a mere 1.17 percent stake directly. Through a pyramidal structure that involves Sopassure holding, the state-run postal operator La Poste and the fully-owned lender CDC, the French government adds 60.2 percent of indirect ownership.[1]

Overall, adding indirect stakes, retained holdings value nears €300 billion

Finally, we calculate the market value of the indirect holdings in the 51 companies worth €65.57 billion. By adding the market value of indirect stakes to the direct portfolio value, we conclude that European governments have residual direct and indirect holdings worth €295.21 billion, almost half of the privatization revenues raised to date.

Figure 2. The Ownership Structure of CNP Assurances*



** As of 12/31/2005*
Source: Elaborations on Privatization Barometer

As Figure 3 shows, the inclusion of indirect holdings increases remarkably the total portfolio value for the many governments without changing significantly country rankings, with the exception of Germany. France and Italy increase their portfolio value by one third and are still in the two top positions with €118 billion and €42.5 billion, respectively.

France accounts for more than 1/3 of total European portfolio

The combined French value alone represents more than a third of the entire European portfolio, and around 8 percent of the total market capitalization of the domestic financial market. However, the most important increment as compared to the direct holdings is the one of Germany, ranking now third with €28.7 billion, mainly thanks to the stakes transferred to the KfW in the past three years. The top three countries' portfolios account for over 64 percent of the total. The data also shows that the distribution of residual holdings is wildly uneven. Not surprisingly, larger countries generally have more valuable residual stakes.

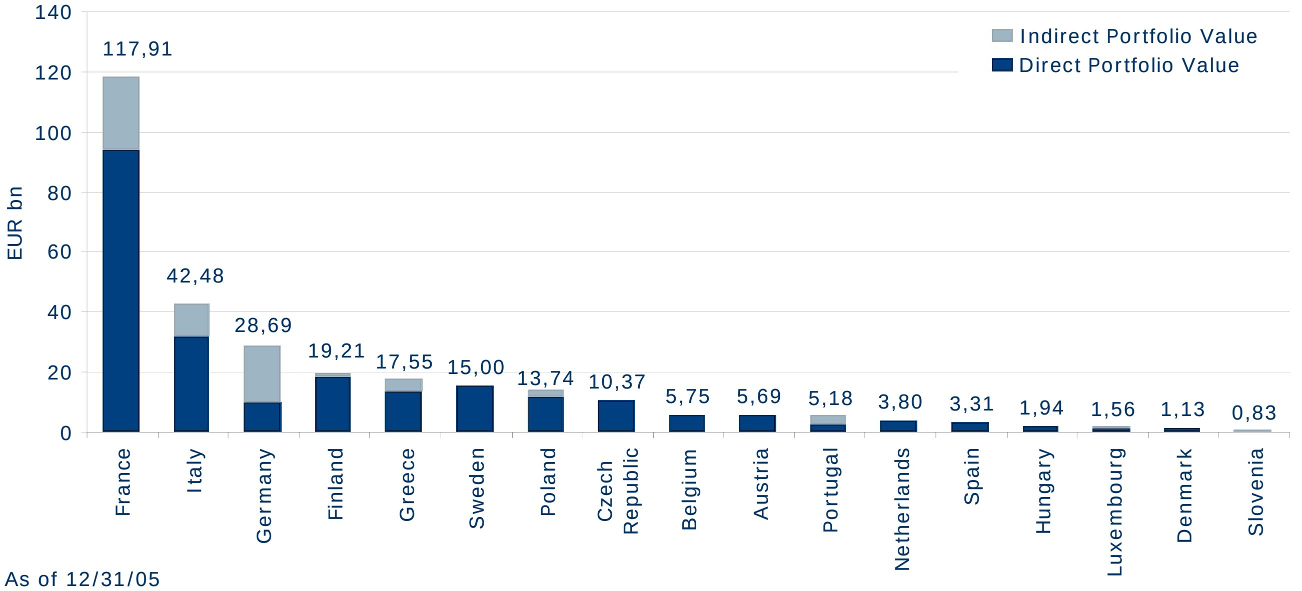
The middle rank position of the two largest transitional economies that entered the EU - Poland and the Czech Republic - confirms that privatization processes are far from being completed. On the other side, the low position of Spain is consistent with the advanced stage of the process in that country. It is worth noting the absence of the U.K., where the privatization process started: the most famous privatizing EU government retains no ownership stakes in listed firms.

The industry distribution of stakes

Retained stakes are concentrated in Utilities, Tlc and Oil&gas sectors

Table 1 documents the high concentration of retained ownership in strategic sectors. Utilities are in aggregate the most valuable retained shareholdings, with the 87.3 percent stake held by French government in EdF being alone worth €51.5 billion. Telecom privatization have accounted for the largest single industrial share of total privatization revenues, but still retained stakes in these companies are worth €67.18 billion. Since telecoms are so large and politically sensitive, governments almost always sell these in multiple *tranches*, spread out over many years. The large telecom stakes detailed in Table 1 therefore represent mid-way points in government divestment programs.

Figure 3. Central Government Portfolio Value*



* As of 12/31/05
Note : only countries with a portfolio value over €0.5 bn are included
Source : Elaborations on Privatization Barometer

Only slightly less valuable than telecoms are the aggregate values of the oil and gas companies, €66.96 billion. The largest western European oil and gas firms, British Petroleum and Total, as well as many of the next tier of companies such as Repsol and British Gas (BG Group), have been fully privatized, but many of the stakes remaining in state hands are extremely valuable. As noted above, Italy's 27.3 percent holding of Eni stock is worth €26.41 billion. This alone accounts for 9 percent of the total value of all retained holdings in partially privatized companies. Additionally, the 80 percent retained stake in Gaz de France is valued at €19.82 billion, and Finland's holdings in Fortum are worth €6.80 billion—even though the state owns barely half of the company's shares.

Financial companies (banks, insurance companies and stock exchanges) are collectively the fourth most valuable. Manufacturing and Other Industrials include a variety of firms accounting for €16.02 billion. The last two industries detailed in Table 1, transportation (mostly roadway companies, airports, and airlines) and Trade and Services are worth €11.43 billion and €3.61 billion.

The Top 20 most valuable stakes account for 4/5 of the total portfolio value

The 20 most valuable stakes retained by EU central governments in publicly traded companies listed in Table 2 account for more than €224 billion, over 76 percent of the total portfolio value. Significantly, the top ten major holdings are all in three "strategic" sectors: Utilities, Oil&Gas, and Telecommunications. Since electric utilities, oil and gas firms and telecoms have long been the mainstays of state sectors throughout Europe, and these firms also tend to be

Table 1. Government's Portfolio Value by Sector (EU25)

Sector	Direct Portfolio Value (bn €)	Indirect Portfolio Value (bn €)	Total Portfolio Value (bn €)
Utilities	79.66	5.07	84.73
Telecommunications	47.56	19.62	67.18
Oil & Gas	57.55	9.41	66.96
Banking, Finance & Insurance	16.81	12.87	29.68
Manufacturing and Other Industrials	12.11	3.91	16.02
Aerospace & Defence	9.02	4.94	13.95
Transportation Industry	3.76	7.67	11.43
Trade & Services Industry	3.16	0.45	3.61
Total	**229.64**	**63.94**	**293.57**

*As of 12/31/2005
Source : Elaborations on Privatization Barometer

Table 2. The Top 20 most valuable government's stakes in listed companies (EU25)*

Company Name	Country	Sector	Stake Value (bn €)	Direct Ownership Rights	Indirect Ownership Rights	Total Ownership Rights
Electricité de France (EdF)	France	Utilities	51.57	87.30%	0.00%	87.30%
Eni	Italy	Oil & Gas	26.41	20.32%	7.00%	27.32%
Deutsche Telekom	Germany	Telecommunications	20.41	15.40%	17.68%	33.08%
Gaz de France	France	Oil & Gas	19.82	80.20%	0.00%	80.20%
France Télécom	France	Telecommunications	17.69	18.48%	14.02%	32.50%
Enel	Italy	Utilities	12.42	21.84%	7.21%	29.05%
CEZ	Czech Rep.	Utilities	10.09	67.61%	0.00%	67.61%
TeliaSonera	Sweden	Telecommunications	9.58	45.31%	0.00%	45.31%
Deutsche Post	Germany	Transportation Industry	7.61	0.00%	33.36%	33.36%
Fortum Oyi	Finland	Oil & Gas	6.80	51.65%	0.56%	52.21%
CNP Assurances	France	Banking, Finance & Insurance	5.71	1.17%	60.47%	61.64%
Belgacom	Belgium	Telecommunications	4.98	50.00%	0.00%	50.00%
Nordea Bank	Sweden	Banking, Finance & Insurance	4.97	19.80%	0.00%	19.80%
PGNiG	Poland	Oil & Gas	4.66	84.75%	0.00%	84.75%
EADS	France	Aerospace & Defence	4.11	0.06%	15.10%	15.16%
PKO Bank Polski	Poland	Banking, Finance & Insurance	4.03	51.96%	0.00%	51.96%
EdP - Energias de Portugal	Portugal	Utilities	3.98	20.49%	20.39%	40.88%
Koninklijke KPN	Netherlands	Telecommunications	3.53	19.30%	0.00%	19.30%
Neste Oil Corporation	Finland	Oil & Gas	3.30	50.10%	1.71%	51.81%
Renault	France	Manufacturing & Other Industrials	3.16	15.65%	0.00%	15.65%

*As of 12/31/2005
Source : Elaborations on Privatization Barometer

extremely large, it is no surprise that the most valuable retained stakes are also concentrated in these industries. The average total ownership is 45 percent, as compared to 31.22 percent of the full sample.

There might be a politically motivated reluctance to cease control

To conclude, privatization programs will not be constrained by inadequate inventories of saleable assets any time soon—especially considering the large amount of unlisted firms, entities and assets in the hands of states, and the local governments portfolios. What may be missing is the willingness of (some) governments to complete the privatization processes. The extreme reluctance to relinquish control over privatized companies is (also) witnessed by ownership structures that allow governments to exercise control beyond their actual ownership. This political constraint suggests that the actual, politically achievable value that can be received from selling off government stakes in the 123 companies might be significantly less than €295 billion.

Notes

[1] The overall effect of such structures is to maximize State control over a company, and often not over a single company but a group of companies. By using pyramids the state can secure control of a firm even though selling large chunks of its direct shareholdings. Such structures allow the governments to control corporate assets and decision-making significantly more than direct ownership would permit. Similar effects can be obtained also by other means we are not considering in this analysis - as our focus is the portfolio value – such as special statutory powers embodied in golden share mechanisms. However, our analysis suggests that retaining stakes, especially indirectly, remains the main device to keep control over partially privatized companies, at least in Europe.

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Turkish Privatization Proceeds Apace

Introduction

With growing economic and political stability since 2002, the Turkish privatization program has been revitalized.

Turkey's privatization program gathered new speed following the coming to power of the Islamist-based Justice and Development (AK) Party that captured 34.2 percent of the votes in the 2002 parliamentary elections. The AK Party's victory ended the 15 years of coalition governments, whose indecision had slowed the implementation of the privatization agenda. The new government of Prime Minister Recep Tayyip Erdoğan stepped up the privatization of many state-owned enterprises (SOEs) that had been sitting in the pipeline both in competitive and non-competitive sectors. Between 2003 and 2005, the value of total privatization transactions reached almost US$10 billion exceeding the privatization revenues collected in the prior seventeen years between 1985 and 2002. In November 2005 the largest ever deal successfully transferred 55 percent of Türk Telekom's shares to an international operator. The winning bidder was a consortium led by Oger Telecom of Saudi Arabia which had offered the highest price of US$6.55 billion. This single transaction made 2005 the record year since the inception of the Turkish Privatization program twenty years ago.

Rationale for Privatization

Privatization was intended to reverse state-led capitalism and to help build dynamic, private-sector led development.

Since the establishment of the Turkish Republic in 1923, the state-owned enterprises had increasingly played a dominant role in all competitive and non-competitive sectors of the economy. Their poor performance, however, had stifled economic development. Privatization began in 1985 as part of an economic reform package aimed at reversing the state-led capitalism and import-substituting industrialization of the past. Then Prime Minister Turgut Özal and his newly elected Motherland Party (ANAP) were keen to open up the economy through trade liberalization and strong emphasis on export promotion and private-sector led development. It was decided that SOEs had either failed or were no longer equipped to face the challenges of a dynamic market economy.

Turkish state-owned enterprises had become extensive, unprofitable and burdensome on the Treasury.

By 1985, SOEs employed 653,066 workers, representing 7.8 percent of all non-agricultural employment and accounted for about 11.5 percent of GDP, 30.4 percent in fixed investment and the bulk, 80.4 percent, of public sector indebtedness.[2] The heavy debt was the consequence of deteriorating financial and operational performance of the SOEs. The SOEs had become an increasing burden on the Treasury. The SOE managers were required to fulfill Government's non-commercial objectives such as income redistribution, regional development, employment creation and industrial and infrastructure development. At the same time, they were obliged to adhere to strict price

§ *I wish to express my thanks to John Nellis of Center for Global Development for his excellent suggestions which helped me to revise earlier drafts of this article.*

controls. On the other hand, the SOEs benefited from non-performance-based personnel regime (with real wage increases far in excess of corresponding productivity increases) and they received explicit and implicit subsidies of various kinds from the Treasury. The availability of guarantees from the Treasury on foreign borrowings, loans from the Central Bank, and easy commercial loans from state-owned banks gave the SOEs preferential and easy access to credit.[3] Furthermore, the majority of SOEs operated in monopolistic or oligopolistic markets shielded from competitive pressures by a high rate of protection— part of the then dominant import-substitution strategy.[4]

The Turkish government embraced privatization to reduce the financial burden of the state-owned enterprises in the national budget and to re-channel resources to the social sectors.

Efforts to reform SOEs by way of corporatization, commercialization, introducing hard-budget constraints and competitive pressures had not led to improved financial and operational performance. Following the example of Prime Minister Margaret Thatcher the Turkish Government embraced the transfer of ownership of the SOEs from state to private sector (domestic or foreign). Privatization was expected not only to reduce the state's involvement in economic activity leaving room for the private sector to flourish but also to relieve the financial burden of the SOEs on the national budget, develop capital markets and re-channel resources to social sectors such as education and health.

Gradual Implementation of Privatization

The lack of an effective legal framework prevented the implementation of an ambitious program.

Turkey was among the first OECD countries to embark on privatization but it spent a very long time laying gradually the legal, institutional and regulatory groundwork for the process. Actual sales were slow in coming. In 1985, the Government created the Housing Development and Public Participation Administration (HDPPA) with the intention of privatizing 244 SOEs (out of approximately 271 SOEs). Initially hardly any government assets were divested because the program encountered several legal, institutional and regulatory impediments.

In 1994, the parliament passed a Privatization Law creating the Privatization Administration as the executive body responsible for privatization....

After significant delays in 1994, the Government of Tansu Çiller managed to pass through the parliament a new Privatization Law (No. 4046). This ostensibly accelerated the process, providing greater flexibility in the choice of privatization techniques and emphasized transparency in all transactions. Another key innovation involved the explicit recognition of labor adjustment issues and redundancy payments for displaced workers. The Privatization Law defined the role of the Privatization High Council (PHC), transformed the former Public Participation Administration into Privatization Administration (PA) as the sole executive body responsible for the privatization process, and established the Privatization Fund as the official extra-budgetary account for privatization proceeds and expenditures. Another important legislation in 1994 was the passing of the Protection of Competition (Law 4054) to prevent abuse of dominant position by undertakings and agreements. The Competition Authority became operational in 1997 working closely with the PA ensuring that competition would not be violated after privatization.

...and the World Bank's technical assistance facilitated it.

However, additional assistance was needed to speed up the privatization program and help compensate the workers retrenched. The new government hence requested from the World Bank a Technical Assistance loan, "Privatization Implementation Assistance and Social Safety Net Project," in the magnitude of US$ 100 million. Despite the new legal framework and technical assistance loan, only small and medium sized SOEs were divested, mostly through sale of equity shares to strategic investors. All the physically and financially large SOEs remained in the PA's portfolio and were kept afloat via capital injections and payments for their outstanding debt liabilities from the Treasury or the PA.

Private investors and operators were discouraged by economic and political instability with the result that only a few small and medium sized enterprises were sold to strategic investors.

The macroeconomic and political climate did not help: high inflation rates of 90 percent a year between 1995 and 1997 combined with economic and political instability deterred most potential private investors and operators (domestic or foreign alike). There was also strong opposition from entrenched vested interests, notably senior bureaucrats in government departments and in SOEs themselves. The Workers' Union expressed serious concern about the possibility of mass retrenchments. Populist politicians expressed alarm over the possible adverse economic and political consequences of increased foreign direct investment via privatization. The members of the PHC frequently contested privatization transactions of the coalition governments (seven coalition governments were formed between 1992 and 1998).[5] Frequent changes in PA management further contributed to inaction and stalemate. The implementation of the privatization agenda was so slow that the World Bank's Technical Assistance loan utilized only one-third, US$ 34.4 million, of the original US$ 100 million committed for the period between 1995 and 2000 and the remainder of the loan had to be cancelled.[6]

As of the end of 2000, Turkey still lagged far behind the regional and emerging market comparators in terms of privatization.

Between 1985 and 2000, maximum privatization revenues per year only twice exceeded the US$ 600 million mark. In 1998, the sale of state's minority shares, 12.5 percent in İş Bank (the privately owned major bank), alone has accounted for over 60 percent of the year's privatization revenues.[7] In 2000, privatization revenues reached another new high of US$ 2.7 billion, mainly due to 51 percent block sale of POAŞ (major petroleum products retailer) and 21.5 percent shares of Tüpraş (petroleum refinery) offered to the public via the Istanbul Stock Exchange (ISE). Yet, by the end of 2000, Turkey still lagged far behind the regional and emerging market comparators in terms of privatization.

Acceleration of Privatization

In the aftermath of the 2002 elections, Turkish privatization accelerated and significant gains were recorded…

The pace of Turkish Privatization finally began to quicken post-2000. The political will of the new government, the macroeconomic stability achieved, and the generous loans from the World Bank—all contributed significantly to recent acceleration. In April 2001, Kemal Derviş, the Economy Minister of Prime Minister Bülent Ecevit's government, designed and started the implementation of "The Transition Program for Strengthening the Economy." The reform package with full backing by the International Monetary Fund (IMF) was in response to the economic and financial crisis experienced in November 2000 and February 2001. The new AK Party government continued to implement the reform agenda with the objectives of reducing the share of the SOEs in domestic borrowing in the national budget via enterprise reforms and privatization. Significant gains were recorded in a short period of time. The public sector indebtedness as a share of GNP dropped significantly from 16.5 percent in 2001 to 5.9 percent in 2004 and inflation came down from 68.3 percent in 2001 to 9.32 percent in 2004.[8] The results achieved quickly increased the confidence of the domestic private sector as well as Turkey's international economic and political partners.

Under the direction of the new Prime Minister, the PA was given the degree of autonomy it needed to facilitate and implement the privatization agenda with its staff of 300. Metin Kilci, President of the PA, recently announced that Turkey was finally enjoying the kind of political resoluteness that it lacked but absolutely needed in the past for privatization success.[9] The PA was able to

…including a newly revised privatization strategy for Türk Telecom and a loosening of legal requirement for foreign ownership…

revise a new privatization strategy for Türk Telekom after two failed attempts. The separation of the regulatory functions from telecommunications policy by creating an independent Telecommunications Authority in 2000, and the provisions of a new law in 2001 to privatize Türk Telekom's shares up to 100 percent were both necessary but not sufficient. After conducting an interactive market testing process, the PA pushed for legislation in 2003 lifting the 50 percent cap on foreign ownership and clearing the way for Türk Telekom's majority privatization to a private foreign operator.

… with generous World Bank loans to facilitate labor restructuring.

Generous World Bank loans reimbursed the PA easing its financial burden of labor restructuring. Lack of budgetary resources to finance the severance packages for the workers declared redundant would no longer be held responsible for slowing down privatization. By the end of 2005, the used portion of the first World Bank loan combined with the second loan dedicated to labor restructuring reached US$ 268.6 million.[10] A new loan for another US$ 465.4 million for the next five years will bring the total World Bank loans dedicated to privatization related labor restructuring to US$ 734 million.[11]

Trends and Preliminary Outcomes of Privatization Transactions Undertaken

The Turkish government has relinquished direct ownership but maintains indirect control over a number of state-owned enterprises.

Since 1985, for the last twenty years, the PA privatized, fully or partially, 180 SOEs representing 66 percent of around 271 SOEs.[12] In the roughly half of the firms that were fully state-owned, the government totally divested its own shares but the minority shareholders—the Pension Fund, several municipalities, or other state-owned enterprises, kept their small stakes of 1 or 2 percent. In the other 90 that were partially state-owned (joint ventures with private sector), the state transferred its shares fully to the private sector—but the minority shares owned by the state-owned banks and by other SOEs remained, representing an indirect form of state control.

The state, however, has completely withdrawn its direct ownership from a number of sectors: cement, agribusiness (animal feed production and milk-diary products), forest (paper products), civil handling and catering services and petroleum distribution. (See Annex) Indirect and minority state ownership remains in sectors such as tourism, textiles, iron and steel, sea freight and meat processing sectors. There remain 70 enterprises in the portfolio of the PA (24 SOEs and 6 toll motorways, 2 Bosphorous bridges, 28 electricity assets, 5 ports and 5 other entities) and 21 SOEs are in the portfolio of the Treasury and not yet

Table 1. SOEs Privatized and Not-Yet-Privatized

Status	Number of SOEs	Government Stake
SOEs Privatized	180 (66%)	Ninety fully state-owned and ninety partially state-owned
SOEs Not-yet-privatized, remaining in PA's Portfolio	70 (26%)	Majority fully state-owned and minority partially state-owned
SOEs Not-yet-privatized, remaining in Treasury's Portfolio	21 (8%)	All fully state-owned
TOTAL	**271 (100%)**	Two-thirds fully state-owned and one-third partially state-owned

Source : Compiled from various data collected at the PA and the Treasury.

transferred to the PA for privatization. While the PA was busy preparing the SOEs in its own portfolio for privatization and privatizing them, the Treasury was also busy reforming the SOEs in its own portfolio via enterprise and labor restructuring.

Revenues Generated

2005 saw the greatest privatization revenues ever achieved in a single year as a result of shares in oil and gas, petrochemical, tobacco and telecommunications enterprises.

Most recently, the PA was able to revive and successfully completed the previously canceled sales of several large enterprises such as Tüpraş (an oil refinery), Petkim (a petrochemicals firm), and the tobacco side of Tekel (state-owned drinks and tobacco manufacturer), and Türk Telekom. The privatization transaction value in 2005 alone reached US$ 8.2 billion, the majority from previously mentioned sale of 55 percent of Turkish Telecom's shares to an international consortium led by Oger Telecom.[13] However, the buyer will pay in four annual installments and thus only US$ 1.31 billion entered the Treasury on November 14, 2005. Gross privatization revenues at the end of 2005 are expected to reach US$ 2.98 billion—the highest sum ever achieved in a single year.

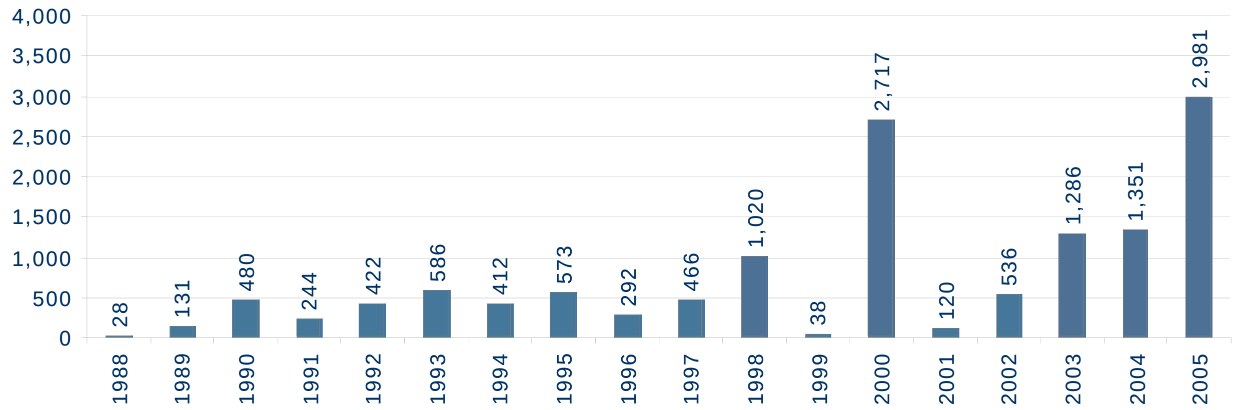
Privatization was accomplished by the sale of equity shares to strategic investors, public offerings, and the sale of assets.

Gross privatization revenues for the entire period between 1988 and 2005 amounted to US$ 13.68 billion (including only US$ 1.31 billion for Türk Telekom that has entered the Treasury directly, not the total amount of US$ 6.55 billion). These revenues were collected via three basic privatization modalities, alone or combined. For most of the divestitures, the PA sold equity shares via competitive bidding or negotiation process. Next popular modality was the public offering to domestic and institutional investors. Only in ten enterprises, the PA chose a combination of selling equity shares to strategic investors with public offering.

No loans or discounts were made available to workers to purchase equity shares in privatized enterprises.

The modalities, however, did not include any employee-management-buyouts or selling equity shares in privatized enterprises directly to employees and workers. No loans or discounts were made available to them to purchase the shares offered at the ISE either. The second phase of Türk Telekom's privatization (to take place a year after the transfer of ownership in November 2005) has reserved 5 percent of the shares for the employees while simultaneously offering 10-15 percent to the public.[14]

Figure 1. Trend in Annual Privatization Revenues, 1988-2005 (US$ millions)



Source : Data provided by the PA, Ankara, Turkey; 2005 revenues include the first installment of US$ 1.31 billion for 55% of Türk Telekom's shares which was transferred to the Treasury for the first time, not to the Privatization Fund (the extra-budgetary privatization account at the PA).

Domestic and Foreign Ownership in Major Privatized SOEs

Domestic direct investors played an important role in the process…

In most cases, domestic Turkish investors became the new direct owners and operators of 37 privatized SOEs accounting for 62 percent of major enterprises privatized via block sale of equity shares. Foreigners became direct owners and operators only in 22 privatized companies, representing 38 percent of major privatized SOEs via equity sales. However, the enterprises divested to foreigners are in key sectors: cement (France), white goods (Germany), the soft drinks (USA and Germany), chemicals (Germany), telecommunications products (Netherlands), cable (Sweden and Finland), automotive (Italy), fertilizer (Luxemburg), airline services (Sweden and Denmark), and electronic products (Taiwan), and most recently telecommunications (Saudi Arabia and Italy).

…however, foreign direct investors and operators were predominant in key sectors.

Direct sales to foreigners generated US$ 1.67 billion privatization revenues between 1986 and 2005, representing only 38 percent of SOEs privatized by via block sale of equity shares. However, the bulk, 78 percent, of these revenues, came from the first installment payment of US$ 1.31 billion for Türk Telekom. The sales to foreigners prior to this transaction amounted only to US$ 362 million.[15] This is not surprising. Compared to Hungary, Czech Republic and Poland, Turkish privatization program has not managed to attract foreign participation. Extensive privatization in these countries in the 1990s was significantly responsible by 2004 for constantly increasing inward FDI stock to GDP ratio to 60 percent in Hungary, 53 percent in the Czech Republic and 26 percent in Poland. Turkey's ratio of FDI stock to GDP, however, has stabilized at 10 percent.[16] The privatization of Türk Telekom should reverse this trend as new investors and operators start financing a large investment plan.

Stimulus to Istanbul Stock Exchange

Private institutional domestic and foreign indirect investors purchased equity shares in privatized enterprises through the Istanbul Stock Exchange.

Private institutional domestic and foreign investors became partial owners of privatized enterprises as each purchased half of the equity shares in 17 privatized enterprises offered to public through the ISE.[17] Teletaş (a highly profitable telecommunications enterprise) was the first to be privatized in 1988 when the state decided to dispose 18 percent of its shares and offered them to the public. Other major SOEs such as Erdemir (iron and steel producing plant), Arçelik (white goods manufacturer), Petkim (oil refinery), Tüpraş (oil refinery), Poaş (major petroleum product refiner and distributor), Turkish Airlines (THY),

Table 2. Share of Privatization Modalities, 1986-2005

Privatization Modalities	Percentages
Sale of Equity Shares	46%
Public Offering	30%
Sales of Assets	24%
Total	**100%**

Source : Compiled from data collected at the PA.

Table 3. Domestic and Foreign Direct Ownership in Privatized Major SOEs, 1986-2005

	Block Sale of Equity Shares	Percentage Share
Domestic Investors	37	62%
Foreign Investors	22	38%
Number of Major SOEs	59	100%

Source : Compiled from various data collected from the PA and the Treasury.

Migros (supermarket chain), İş Bank, Tofaş (automotive manufacturer), and most recently Vakif Bank followed suit. These 9 privatized enterprises (with the exception of Vakif Bank) privatized via the ISE alone have high market capitalization and high liquidity and trading volume: they jointly account for 34 percent of the total trading volume in the ISE-30 (the blue chip index of the Istanbul Stock Exchange) and 19 percent of total market capitalization (US$ 152 billion—almost a third of GNP in 2004) traded on the ISE.18

The growth of Istanbul Stock Exchange was critical to the success of the privatization program.

Public offering has not been beneficial only for the ISE. The presence of an emerging ISE has also been instrumental to the progress of the privatization program and capturing a good share price for the privatized SOEs. Petkim, Poaş, Erdemir and Tüpraş are good examples. The largest boost to the ISE is expected when the remaining 10-15 percent of Türk Telekom's shares is offered to the public in the future. The good performance of the privatized enterprises in the ISE also benefited the shareholders. The 9 privatized companies offered through the ISE contributed to more than half, 52 percent, of the dividends distributed by the ISE-30 and 38 percent of all dividends distributed.

Financing and Cost of Privatization

Sixty percent of the Privatization Administration's revenues came from privatization cash proceeds, with the rest generated by dividends and other income from the enterprises not yet privatized.

Between 1986 and 2004, the bulk, 60 percent, of PA's financing came from privatization cash proceeds and the other 36 percent from dividend and other income from the SOEs under its portfolio. The external loans made up a small portion of PA's total revenues. (Table 4.) The total cost of the privatization program, on the other hand, reached US$ 10,438 million. The bulk of these costs, 56 percent, went to finance the capital increase and provide loans to the SOEs transferred from the Treasury, and another 3 percent was dedicated for paying the severance payments to displaced workers. This is simply a reflection of the PA assuming the role of the Treasury in terms of providing budgetary transfers to these SOEs, mainly as capital injections and loans. The PA used the transfers to restructure the SOEs and prepare them for privatization.

Table 4. Financing and Cost of Privatization, 1986-2004 (US$ in millions)

	1986-2002	2003-2004	TOTAL	Percentages
SOURCES OF FINANCE	**11,119**	**3,120**	**14,239**	**100%**
Privatization Cash Proceeds	7,225	1,389	8,614	60%
Income from Dividends and Privatization Bills	3,500	1,562	5,062	36%
External Loans and Grants	394	169	563	4%
COST OF PRIVATIZATION	**7,554**	**2,884**	**10,438**	**100%**
Consulting and Public Relations	239	13	252	2%
Capital Increase and Credit to SOEs	5,084	783	5,867	56%
Labor Restructuring for SOEs	191	67	258	3%
Loan Payments and Other Expenses	2,040	2,021	4,061	39%
TRANSFERS TO TREASURY	**3,403**	**0**	**3,403**	

Source : Compiled from data provided by the PA, and www.oib.gov.tr; similar data for 2005 was not yet available.

Table 5. Treasury-Guaranteed Foreign Debt Stock of SOEs (US$ millions)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
3.301	3.021	3.222	3.126	2.704	2.612	2.68	2.834	3.097	3.462	3.352	3.48	3.192	2.794

Source : Data gathered from theTreasury, Kamu Yonetimi Raporu, February 2005, p. 105; 2004 figure is only for the first 3 quarter.

The Treasury only received the revenues left over after the Privatization Administration had paid for the total cost of the program.

However, only a remainder of the revenues after paying for the cost of the privatization program appears to have been transferred to the Treasury. The total transfers to the Treasury for the entire period between 1986 and 2004 are only US$ 3.4 billion, 24 percent of PA's total revenues (US$ 14.2 billion) or 40 percent of total privatization cash proceeds (US$ 8.6 billion).[19] There were no transfers from the PA to the Treasury during 2003 and 2004. But, it appears that a total of US$ 1.77 billion will enter the Treasury in 2005 (US$ 1.31 billion the direct transfer of the first installment of the privatization proceeds from Türk Telekom together with PA's own estimated transfer of US$ 464 million from its privatization related revenues).[20]

Impact on the Treasury

There remains significant Treasury-guaranteed outstanding foreign debt stock of the not yet privatized state-owned enterprises.

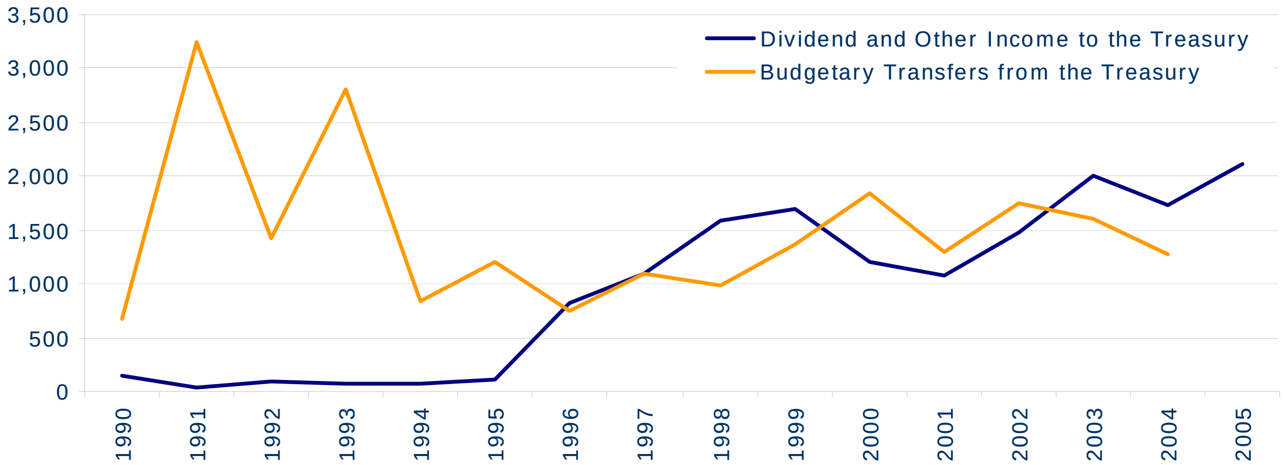
What the Treasury received in the past as transfers from the PA or what it would receive at the end of 2005 alone partially covers its financial burden vis-à-vis the SOEs not yet privatized. *First*, the Treasury-guaranteed outstanding foreign debt stock of the SOEs has not changed much over the years. (Table 5.) Largest Treasury-guaranteed debt stocks belong to EUAS (electricity generating company), Turkish Airlines (THY), Ereğli (steel and iron plant), TMO (soil producing plant), and Tüpraş (petroleum refinery).

Since 2002, the dividends and other income from state-owned enterprises not yet privatized to the Treasury have exceeded the budgetary transfers.

Second, the Treasury and the PA continue to inject on a yearly basis significant amount of capital, forgive or cover duty losses and give other assistance or "aid" to the SOEs not yet privatized in their respective portfolios. Capital injections constitute the bulk of these transfers. While the share of the budgetary transfers to the SOEs in GNP decreased from 2.13 in 1991 to 0.91 in 2000 and, most recently, to 0.42 in 2004 [21] or in absolute terms from US$ 3.3 billion in 1991 to US$ 2.8 billion in 1993, US$ 1.8 billion in 2000 and even to US$ 1.3 billion in 2004, they remain substantial.

Inflows from the SOEs to the Treasury have increased significantly after 1996. This was partly the result of a special decree in 1996 requiring the SOEs to share 10-15 percent of their gross sales revenue with the Treasury in addition to dividends. After 2002, the dividends increased significantly and even surpassed the contributions from sales revenues as the SOEs operating surplus increased, and the total inflows began to exceed the outflows.

Figure 2. Inflows to and Outflows from the Treasury (US$ millions)



Source : Calculated from the tables on SOEs in www.hazine.gov.tr, 2005 data is projected. These figures include inflows and outflows from the Privatization Fund.

The Treasury has benefited from the improved performance of state-owned enterprises, the elimination of price controls, and cost savings from labor force reductions.

The reasons for improved SOE performance are two-fold: One is the SOE's ability to set their own prices and increase their total sale revenues, and second is the cost savings from major labor force reduction that the SOEs have effected under the public sector reform (freezing new hires and introducing voluntary or involuntary retrenchment for all remaining SOEs) and privatization program. While the total wage bill increased by only 6 percent from US$ 6.6 billion in 2000 to US$ 7 billion in 2005, the total sale revenues for all SOEs increased by 83 percent from US$ 37.9 billion in 2000 to US$ 69.2 billion in 2005. The reductions in labor force more than compensated for the increase in average annual labor cost per worker in dollar terms from US$ 15,190 in 2000 and to US$ 22,860 in 2005, leaving the wage bill almost constant.[22]

Total state-owned enterprise labor force was reduced by half during the last twenty years.

Total SOE employment shrunk from 653,066 in 1985, to 643,058 in 1990, to 486,669 in 1995, 434,655 in 2000, to 306,465 in 2005 as projected, a reduction of 53 percent over the twenty years.[23] Nonetheless, the SOEs remaining in the portfolio of the Treasury maintain two times the labor force of the SOEs in PA's portfolio. For example, as the SOEs continued to be transferred from the Treasury to the PA, the employment for the SOEs in the portfolio of the Treasury went down from 379,073 in 1998 to 224,023 in 2004 (excluding the labor force reduction for Türk Telecom), and the employment for the SOEs in the portfolio of the PA increased from 78,021 in 1998 to 105,687 in 2004 despite retrenchments.

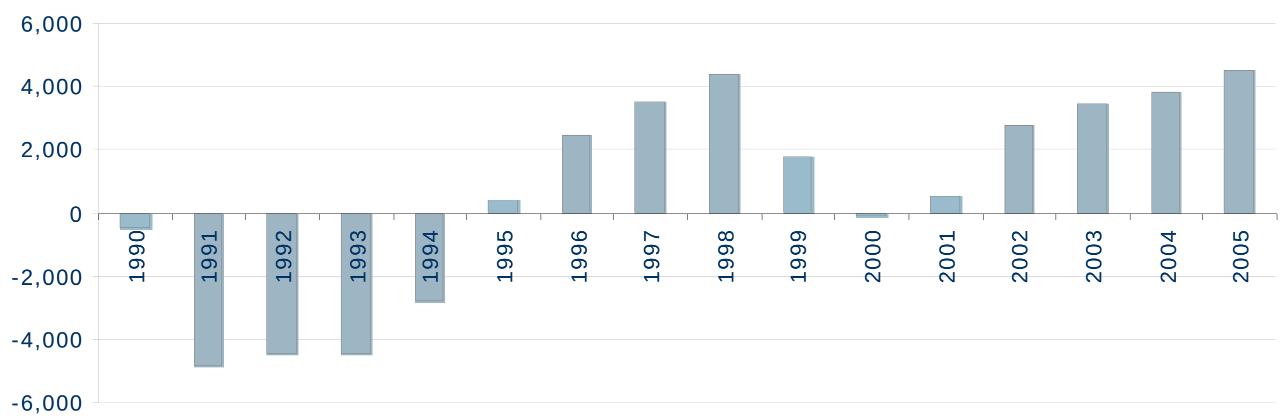
Impact on Labor

Of this reduction, the loss of 60,000 jobs was the consequence of privatization. During the last five years, approximately 20,000 of these were compensated by the Privatization Administration.

Total labor reduction during the last twenty years as a consequence of divestitures is not reported precisely anywhere. The Treasury documented that 60,000 employees and workers lost their jobs in SOEs combined in the portfolio of the Treasury and of the PA.[24] The PA, on the other hand, reported that approximately 20,000 workers were displaced via privatization between 2000 and 2005 while its total cost of labor restructuring reached US$ 258 million (Table 4.) However, the bulk of these involuntary retrenchment expenses were reimbursed by the two World Bank loans.

The first, a Privatization Implementation Assistance and Social Safety Net Project, had a specific social safety net component for the retrenched workers for

Figure 3. Trend in Operating Surplus/Deficit of Remaining SOEs (US$ millions)



Source : Calculated from data on all SOE performance in US$ provided by the General Directorate of State-Owned Enterprises, The Undersecrataria t of Treasury, Prime Ministry, Republic of Turkey, December 2005; data for 2005 is projected.

the five year period between 1995 and 2000. This component actually disbursed only half, US$ 18.6 million, of US$ 34.4 million spent for all privatization related activities. But it is not clear how many workers benefited from this very loan. (The un-spent portion of the loan, US$ 65.6 million, was cancelled in May 2000.[25])

World Bank loans are reimbursing the Privatization Administration for the cost of severance and other job-loss related payments…

A second, larger, Privatization Social Support Project, was signed in 2000, intended to disburse US$ 250 million covering the period between 2000 and 2005. This loan had three main components: (a) reimbursing the PA for financing the severance and job loss related payments to workers displaced by labor retrenchments, (b) providing labor redeployment services to displaced workers during privatization and helping them re-enter the labor markets, and (c) monitoring the social impact of economic reform program and assisting with the design and formulation of supportive economic and social policies.[26]

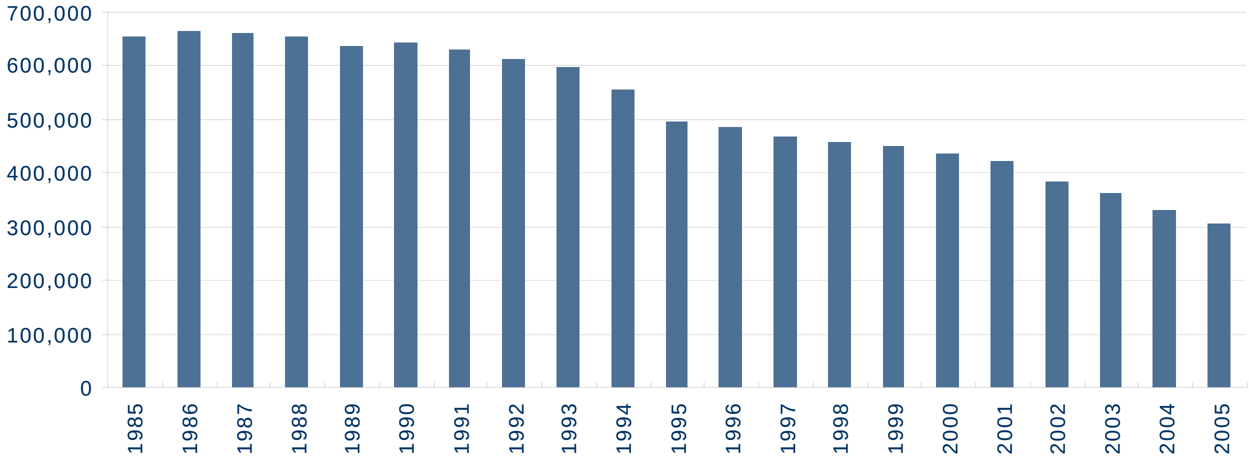
… and are providing incentives to further accelerate privatization.

These loans decreased PA's reluctance to proceed with labor restructuring and to negotiate severance packages with the labor unions.[27] As of November 2005, the PA had received US$ 211.6 million of the loan funds for costs incurred in the severance payments for 17,041 workers at 41 privatized enterprises.[28] This suggests that the average payment per worker was a generous US$ 12,400. The PA also received from this loan US$ 23.3 million for Special Job Loss Compensation and US$ 3.7 million for Special Retirement Assistance Payments for the employees under "civil servant" category, all made to terminated workers from privatized enterprises. Total reimbursement to the PA from this second loan has thus far reached US$ 238.5 million.[29] Additionally, a total of 30, 741 former SOE workers have benefited from government-supplied (and World Bank-funded) retraining and business development services, valued at US$ 25 million as of June 2005.[30]

The World Bank is presently measuring the impact of its loans dedicated to labor-restructuring but not the impact of the entire Turkish privatization program on labor.

The social impact assessment of labor restructuring component of the World Bank loan is monitored by the General Directorate of Economic Research in the Treasury. Surveys were conducted to assess the economic status of workers displaced by privatization (a sample of 3000 workers), their coping strategies (a sample of 200 workers), and determine the effectiveness of labor deployment services (a sample of 4000 workers) on 15 enterprises (6 already privatized and 9 to be privatized) over a period of three years. The preliminary results indicated that most of the displaced workers used their severance payments against direct consumption for daily needs, paying debts and investing in real estate. Those

Figure 4. Change in Total SOE Employment, 1985-2005



Source : Employment data provided by the General Directorate of State-Owned Enterprises, The Undersecratariat of Treasury, Prime Ministry, Republic of Turkey Treasury, December 2005; 2005 is projected.

trained by KÖSBEG, one of the leading redeployment agencies, have reported slightly higher positive outcome for finding jobs compared to the ones using the services of IŞKUR, the employment agency. However, the final report has not yet been completed with policy recommendations.[31]

Neither the Privatization Administration nor the World Bank has assessed the impact of the whole privatization program on the stakeholders—consumers, workers, privatized enterprises, new owners, the Treasury, and the overall economy.

Neither the PA nor the World Bank has assessed the privatization impact of the entire privatization program on the stakeholders such as consumers, workers, privatized enterprises, government (net fiscal impact), and new owners (foreign and/or domestic). Nor has there been an evaluation on the overall economy via increased investments and exports from privatized enterprises, increased direct employment as well as the contribution of privatized enterprises to capital market development. The Treasury claims to be eager to see the results of such an overall impact assessment with an emphasis on net fiscal impact, but it has not yet launched or funded such a study.

Challenges Ahead

Notwithstanding remarkable progress, challenges remain: privatizing the infrastructure enterprises (electricity generation and distribution, railways and ports) as well as the state-owned banks.

The major remaining challenges to the completion of Turkey's privatization agenda include: proper preparation of more consumer sensitive infrastructure enterprises in electricity (generation and distribution), transport (ports and railways), natural gas, mining, agriculture, and the state-owned banks with nationwide presence. The biggest tests to Turkish privatization will be privatizing the electricity generation and distribution, bringing private participation to ports and railways via concession and lease arrangements, and transferring the state ownership and control in the state-owned banks to the private sector.

Privatizing Infrastructure Enterprises

The Turkish government has initiated a "textbook" model for a comprehensive competitive restructuring of the electricity sector…

Turkey's planned electricity sector reforms encourage private participation in investment, operations and management. The Electricity Market Law in 2001 provided for industry regulation and a comprehensive competitive restructuring of the sector. The law allows the un-bundling of the state-owned and operated vertically integrated state monopoly, or off-taker, (TEAŞ) into a separate generation (EÜAŞ), transmission (TEIAŞ), a wholesale trading and contracting company (TETAŞ) along with one for holding the contracts and liabilities of the Independent Power Producers, and distribution company (TEDAŞ). This framework follows broadly the "textbook" model for electricity reform which has been attempted throughout the world but implemented fully in only in a handful of markets[32]—and successfully in even fewer.

…with private participation in electricity distribution.

In 2004, an Electricity Sector Reform and Strategy Paper prepared together with the Ministry of Energy and Natural Resources were announced. Subsequently steps were taken to privatize the distribution company (TEDAŞ). Government has already restructured TEDAŞ into 20 regional units in preparation for privatization. The state-owned TEDAŞ will remain as the owner of the assets and the shares of the companies but the operating rights in each of the 20 regions will be sold to private owners and operators domestic or foreign. The buyer will operate the network and be responsible for all investments under a concession contract with TEDAŞ. Government anticipates that the privatization of the distribution sector could take at least 2-4 years. Therefore, it is eager to invest with the World Bank assistance to upgrade the distribution facilities (neglected since 1997).[33]

Among the challenges will be privatizing and bringing competition into electricity generation in a market where IPPs already supply 20% of generating capacity under favorable contracts.

Just how the government will be able to privatize and bring competition into electricity generation in a market where existing Independent Power Producers (IPPs) already supply 20 percent of generating capacity under favorable contracts is not clear. The government has passed several and often long-disputed acts of legislation for three different Build Operate (BO) frameworks that allow private entry into generation. The first BO framework (1984) was not sufficient to attract private investment, and the second one (1994) enhanced the attractiveness of BOT projects by authorizing Treasury guarantees for the obligations of the off-taker (via Power Purchase Agreements) and fuel-supplier (in the case of the gas-fired IPPs) and provided tax exemptions. Power Purchase Agreements with the state monopoly, TEAŞ, obliged the latter to buy 85 percent of the power output for a period of 15 to 20 years and to transfer the assets to the state at the end of the contract period. The third framework (1997), on the other hand, allowed the private firms to retain ownership of the facility rather than transfer it to the state. This has proved more successful in attracting foreign investment but at a very high price to the utility. Foreign investors were motivated by the market prices and take-or-pay contracts with TEAŞ for off-take backed by Treasury guarantees. These obligations for capacity and energy charges have been putting a serious financial burden on TEAŞ and their contingent liabilities on the Treasury. Even though the Energy Market Law in 2001 was intended to create a playing field among all IPPs, it remains to be seen how the government will be able to undo the Treasury guarantees and renegotiate the existing IPP contracts. Proper competition can only emerge when there is a level playing field between the new entrants subject to market forces and the incumbents with favorable contracts. The Turkish government has not yet announced its plan for how to do that.[34]

Proper competition in electricity generation will depend upon a level playing field allowing for new entrants and the renegotiation of favorable contracts with the incumbents.

Another challenge will be the privatization of state-owned railways and ports with continued World Bank technical assistance and support.

The Turkish government is also about to restructure the state-owned railways and ports company, TCDD, with the intention of introducing competition, and private ownership and operation. At present, TCDD operates its passenger and freight services with substantial losses at a high cost to the Treasury. The enterprise is severely overstaffed. The most recently approved World Bank funded project will assist the government to set up a new legal framework for unbundling ports and railways and allowing TCDD to operate on a commercial basis, and receive public service obligations (PSO) payments for services rendered to the government for fulfilling social and political objectives. The project also expects to increase the transparency and accountability of TCDD operations, restructure its labor force, modernize the enterprise's core infrastructure and operating assets, divest all non-core services and bring in private participation into freight operations.[35]

Privatizing State-Owned Banks

Next in the privatization agenda are the state banks which have complete control over cash management of state-owned enterprises.

Next in the privatization agenda are the two state-owned and operated banks, Halk Bank (lending to small business and artisans) and Ziraat Bank (lending to agricultural farmers), and a special public bank owned by foundations, Vakif Bank, all supervised and regulated by the Banking Regulation and Supervision Agency (BRSA). These banks had close ties to SOEs holding exclusive rights to SOE deposits as the SOEs and foundations were barred from opening an account with private banks and can only bank with state-owned entities. This latter practice had given the state-owned banks complete control on the cash management of SOEs and foundations. Yet the poor management and performance of the three of them in the late 1990s—Halk, Ziraat, and another

Poor management of the state-owned banks was the major contributing factor to the financial crisis of 2001…

Emlak Bank with the exception of Vakif Bank—was the major contributing factor to the financial crisis of 2001.

…but recent reforms improved their performance significantly.

Recent reforms to date include: closing the insolvent Emlak Bank while merging its banking liabilities and performing bank assets with those of Ziraat Bank, restructuring the financial balances and the governance of Halk and Ziraat Banks, increasing their financial and administrative autonomy (Law 4603), preventing them from being assigned duties for fulfilling social objectives without advance payment from the general budget,[36] the reduction of 30,000 staff (reducing total employment in Halk and Ziraat from 60,000 in 2000 to 30,000 in 2004) and the closure of 800 branches, and preparing Vakif Bank for privatization.

The three state-banks still account for a large part of the banking sector and their balance sheets are dominated by government bonds on the asset side.

The Halk, Ziraat and Vakif Banks are only three among the total of 51 banks in Turkey but they account for a large part of the total sector. In 2003 these three banks jointly held 37.7 percent of total bank loans and deposits, and 33.8 percent of total banking assets.[37] More importantly, the share of government securities in their total assets has increased from 52.2 percent in 2003 to 70 percent in 2005.[38] This is considered the most serious impediment to their privatization which will be conducted by the Treasury through the PA.

The recent partial privatization of Vakif Bank was very successful despite the fact that over 40% of its assets were in government bonds.

Yet the recent privatization experience of Vakif Bank which had over 40 percent of its assets in government bonds has been encouraging. Under the guidance of a group of international financial advisors, Vakif Bank offered 21.89 percent of its shares to the public in 2005. As of November 15, 2005, demand was 5.9 times greater than expected. Ninety-three percent of this demand came from international institutional investors. This was an extraordinary turnout for the first public bank offering in Turkey, especially after the tender for the majority of Vakif Bank's shares in 2002 did not result in any viable bid despite its relative good performance.[39]

Conclusion

Since 2002, Turkish privatization has accelerated and the Privatization Administration has successfully privatized important enterprises, including Türk Telecom.

Privatization was announced in Turkey twenty years ago but it has progressed very slowly. Following its electoral victory in November 2002, the new AK Party Government accelerated privatization as an essential structural reform aimed at creating a competitive economy for a prospective EU membership. The Privatization Administration has successfully privatized more important enterprises, Türk Telekom among them, and increased privatization revenues not only to the Privatization Fund but also directly to the Treasury. Privatization was also accompanied with enterprise reforms and labor restructuring for the SOEs. As a result, the performance of the remaining SOEs significantly improved generating higher dividends and other income while reducing the need for budgetary transfers from the Treasury.

Privatization of the remaining loss-making and heavily indebted state-owned enterprises will provide the final challenge.

Several factors contributed to recent acceleration: The political will of the new government, foremost among them, enhanced macro-economic stability, a revised legal and pro-competitive regulatory framework, and the generous World Bank loans to ease the burden of labor restructuring on displaced workers. Obstacles and challenges remain. Next in line for privatization are the more difficult and financially important cases, that is, loss-making and heavily indebted SOEs (electric generation and distribution companies, railways, and ports), together with the state-owned banks. Nonetheless, the present Turkish government's resolve to transform the Turkish economy appears unwavering.

Notes

[2] The World Bank, "Privatization Implementation Assistance and Social Safety Net Project," Staff Appraisal Report, Table 2. Key Performance Indicators, 1994, p. 3
[3] The World Bank, "Privatization Implementation Assistance and Social Safety Net Project," 1994, p. 5
[4] Cevat Karataş, " Privatization in Turkey: Implementation, Politics of Privatization and Performance Results," in Journal of International Development, Vol. 13, 2001, p. 94
[5] Cevat Karataş (2001), op. cit., p. 108
[6] Interview at the World Bank Country Office, Ankara, Turkey, November 21, 2005
[7] Metin R. Ercan and Ziya Öniş, "Politics within the State: Institutions and Dilemmas of Turkish Privatization in Comparative Perspective," Revised Draft, Bosphorous University and Koc University, September 2000, p.10
[8] The World Bank, "Main Economic Indicators—Turkey," www.worldbank.org, updated October 2005
[9] Iskender Öztunali, "At the Threshold of Key Privatization Projects," Turkey Investor, , Issue 20, September-October 2003, p.1
[10] See section *Impact on Labor*, p. 13 for details on the use of funds from the first loan, Privatization Implementation Assistance and Social Safety Net Project, and the second loan, Privatization Social Support Project."
[11] The World Bank, "Project Appraisal Document, Second Privatization Support Project," Report No. 31738-TU, May 10, 2005
[12] Total number of SOEs were not mentioned anywhere; 271 is an estimate from various data sources.
[13] This amount excludes the not yet completely finalized transactions and the expected revenues from 51% sale of Tüpraş (oil refinery) to the consortium of Koc-Shell Group for US$ 4.14 billion and 46.12% sale of ERDEMIR to OYAK Group for US$ 2.77 billion while it includes the public offering of Tüpraş shares.
[14] Interview at the Privatization Administration, Ankara, Turkey, November 21, 2005
[15] Data is provided by the Privatization Administration.
[16] Kâmil Yilmaz, "Towards a Foreign Direct Investment Strategy for Turkey," Koc University, Executive Summary of the paper prepared for Foreign Investors Association (YASED), Istanbul, Turkey, 27 October 2005, p. 3
[17] Individual domestic investors appear risk averse especially in the aftermath of the 2001 financial crisis and do not choose to invest in individual stocks and especially in stocks of recently privatized enterprises.
[18] Osman Birsen, President of Istanbul Stock Exchange, "Interaction between Privatization Programs and Stock Exchange," unpublished manuscript, 2005
[19] Privatization gross revenues reported at Privatization Administration's website, www.oib.gov.tr are US$ 10.8 billion, higher than the privatization cash proceeds entering the Privatization Fund. The difference is most likely explained by payments made against the debt liabilities of the SOEs at the time of privatization.
[20] Interview at the Privatization Administration, Ankara, Turkey, November 21, 2005
[21] Data gathered from www.hazine.gov.tr website, Table 1. SOEs Financing Requirements
[22] Data is provided by the General Directorate of State-Owned Enterprises, The Undersecretariat of the Treasury on SOEs sales revenues and operating expenses in US$, December 2005
[23] Ibid.
[24] Interview at the General Directorate of State Owned Enterprises, The Undersecretariat of Treasury, Prime Ministry, Republic of Turkey, November 21, 2005
[25] Interview with the World Bank Country Office, Ankara, Turkey, November 21, 2005
[26] Project Coordination Unit, "Project Management Report: Privatization Social Support Project," July-September 2005, prepared by, Privatization Administration, Ankara, Turkey, p. 6
[27] Interview with the World Bank Country Office, Ankara, Turkey, November 21, 2005
[28] If, however, the workers who received severance pay funded from the loan are rehired in the six month period following privatization transaction, the PA is expected to refund the amount to the World Bank.

[29] Project Coordination Unit (2005), op. cit., p. 15
[30] Interview with the World Bank, Country Office, Ankara, Turkey, November 21, 2005
[31] IMPAQ, “Preliminary Findings for Social Impact of Privatization,” presentation slides, The World Bank-funded Privatization Social Support Project (PSSP), November 2005
[32] Efe Çakarel and Joshua House, “IPP Investment in Turkey’s Electric Power Industry,” Stanford University, Center for Environmental Science and Policy, Program on Energy and Sustainable Development, Working Paper No. 32, November 2004, p. 10
[33] The World Bank, “Project Information Document (PID): Concept Page,” Report No. AB1748, July 25, 2005, p.2
[34] Efe Cakarel and Joshua House, (2004), op. cit., p. 10
[35] The World Bank, “Railways Restructuring Project, 2005-2009: The Project Brief,” www.worldbank.org.tr
[36] The World Bank (IBRD Program Document, 2004), op. cit., p. 19
[37] The World Bank, “IBRD Program Document for a Proposed Programmatic Financial and Public Sector Adjustment Loan in the Amount of US$ 1 billion to the Republic of Turkey,” Report No. 25795-TU, May 21, 2004, p.14
[38] International Monetary Fund, “IMF Country Report for Turkey,” No. 05/412, November 2005, p.36
[39] Dünya: Ekonomi ve Politika, “VakifBank’a Rekor Talep,” November 15, 2005, p.7

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The PB Index
Performance Analysis

Overview

The PB Index tracks the performance of shares of privatized companies that are listed for trading in domestic stock markets of the enlarged European Union.

The PB Index is capitalization weighted, and denominated in Euro. It is restricted to ordinary shares of privatized companies trading in the stock exchanges of the European Union, including the ten new accession countries.

It is subject to a quarterly review by the PB Index Administrator, who ensures the overall consistency with the purposes of the Index. Index maintenance implements the adjustment for company additions and deletions and stock price adjustments due to corporate actions (including dividends) and merger and acquisition (M&A) activity.

The new version of the PB Index, which is presented in this Newsletter for the first time, tries to take into account more precisely M&A operations which may affect the risk and return profile of privatized companies. Particularly, the privatized company's share price is replaced by the one of the acquiror *(a)* if the acquiror is a European company listed in a stock market of the enlarged European Union and *(b)* if the acquiror's market capitalization is not more than double of the one of the target. The first condition avoids to include in the PB Index non European stocks exposed to different systemic risk. The second is based on the assumption that in case of M&A the idiosyncratic factors affecting privatized companies spill over only if the private acquiring company is comparable in size.

Following these rules, a Composite Index, two regional sub-indices (one including EU15 and one the ten new accession countries) are constructed, together with five sector sub-indices (Banking, Industrial, Oil & Gas, Utilities, and Telecom).

As of June 2005, the PB Composite Index includes 214 stocks. The two regional indices include 158 companies of EU15 countries and 56 companies of the ten new accession countries of Eastern Europe. The five sector sub-indices Banking, Industrial, Oil & Gas, Utilities, and Telecom include 31, 34, 10, 42, and 21 stocks, respectively (see Table 1).

A more detailed description of the PB Index can be found in the Rulebook (available at www.privatizationbarometer.net/site/rulebook.pdf).

Analysis

In this section, we briefly describe the return and risk characteristics of privatized companies over the last year, and for longer periods (up to 3 years).

Figure 1 refers to the PB Composite Index, which includes the whole set of privatized companies for which we track the performance. The figure shows that, had one invested €100 mil in this index at the end of 2002, after three years the investment would be worth €164 mil. The base date is now set in proximity to a period when European stock markets stop their long standing post-March 2000 decline. It is thus not surprising to find higher performance of the PB Composite over the three year period. The cumulative return of the PB Composite is now as high as 71.7 percent (Table 2).

Overall, privatized companies outperformed the (European) Dow Jones STOXX Total Market Index (TMI), which we use as a benchmark. On a two and three years basis, the PB Composite gained (annualized) excess returns of 4.3 and 5 percent, while it slightly underperformed the benchmark during 2005 (Table 3).

The analysis of the regional indices shows a slightly lower abnormal performance of the PB Old Europe with respect to the PB Composite (over the last two and three years), while the PB New Europe tracks closely the performance of its benchmark. As we already noticed, a similar behavior of the PB New Europe and its benchmark (i.e. the Dow Jones EU Enlarged TMI) is explained by a high fraction of overlapping capitalization between these two indices (almost 75 percent). The slight rescaling of the abnormal performance of the PB Old Europe with respect to the PB Composite is instead due to the presence of stocks from the enlarged Europe in the latter but not in the respective benchmark.

The analysis of our five sector benchmarks over the last year shows higher raw cumulative returns in the oil and gas and industrial sectors (31 percent), followed by the banking and utilities sector (27 and 26 percent, respectively). Not surprisingly, the PB Telecom index confirms the dismal performance of the sectors during 2005 (Table 2).

Over the last year, PB Indices did not boast the bright over-performance that we were accustomed to comment in our previous analyses. In 2005, the PB Composite has underperformed the benchmark by 1.8 percent. However, all our sector indices - with the only exception of the PB Utilities - are still in positive territory.

Particularly, PB Banking Index showed a strong over-performance relative to the Dow Jones STOXX Banking, gaining an additional 7.2 percent on a yearly basis. This high yield is largely attributable to the strong performance of two primary German banks such as Bankgesellschaft Berlin and Deutsche Postbank, and two Italian banks, Unicredit, gaining strong returns after the successful merger with Hypovereinsbank, and Capitalia. Bank Austria Creditanstalt, a subsidiary of HBV, keeps a prominent position in the ranking by yearly return. The stellar returns of the Portuguese BANIF are also noteworthy, even if they likely do not have a large bearing on aggregate performance of our banking index (Table 3).

Table 1. PB Indexes Constituents (as of 12/16/2005)

PB Indexes	# of Constituents	Old Europe	% Old Europe	New Europe	% New Europe
Composite	220	160	72.73%	60	27.27%
Banking	31	24	77.42%	7	22.58%
Industrial	34	30	88.24%	4	11.76%
Oil & Gas	12	8	66.67%	4	33.33%
Telecom	21	16	76.19%	5	23.81%
Utilities	44	38	86.36%	6	13.64%

Source: Elaborations on *Datastream*

Table 2. PB Indexes Returns

PB Indexes	Value as of 12/16/05	3 Months	6 Months	1 Year	2 Years	3 Years
Composite	164.771	1.773%	10.222%	21.374%	47.593%	71.746%
Old EU	160.260	2.132%	11.895%	19.792%	44.144%	66.996%
New EU	235.913	-1.283%	20.552%	42.632%	116.861%	135.120%
Banking	181.014	9.480%	18.724%	27.993%	50.729%	94.011%
Industrial	188.424	7.456%	17.484%	31.266%	60.269%	111.610%
Oil & Gas	154.436	-1.874%	11.205%	31.667%	57.616%	59.555%
Telecom	129.288	-1.840%	0.679%	-1.573%	17.003%	35.636%
Utilities	170.471	1.577%	14.446%	26.081%	64.362%	73.249%

Note: The base date is the 12/02/2002. Return indicates the % increase/decrease of the index.
Source: Elaborations on *Datastream*

Table 3. PB Indexes Average Excess Returns

PB Indexes	Benchmarks	1 Year	2 Years	3 Years
Composite	DJ Stoxx TMI	-1.852%	4.308%	5.024%
Old EU	DJ Stoxx TMI	-3.434%	2.871%	3.895%
New EU	DJ Stoxx EU Enlgd TMI	-0.440%	0.345%	0.149%
Banking	DJ Stoxx Banking	7.206%	6.996%	8.078%
Industrial	DJ Stoxx Indl Goods&Serv	0.924%	7.022%	9.074%
Oil & Gas	DJ Stoxx Oil & Gas	0.436%	1.250%	1.323%
Telecom	DJ Stoxx Telecom	1.080%	2.348%	2.310%
Utilities	DJ Stoxx Utilities	-0.337%	1.414%	0.842%

Note: The base date is the 12/02/2002. Average excess return indicates the historic average differential return of the index to its respective benchmark. All values are annualized.
Source: Elaborations on *Datastream*

Figure 1. Performance of the PB Indexes

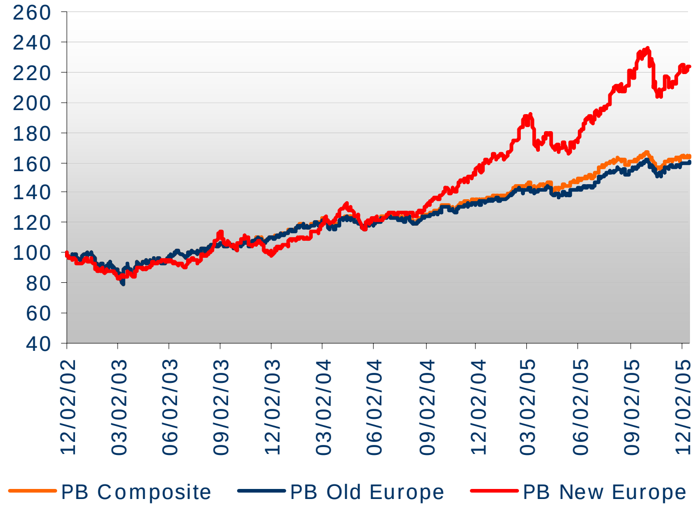

Figure 2. Cumulative Excess Returns of the PB Indexes

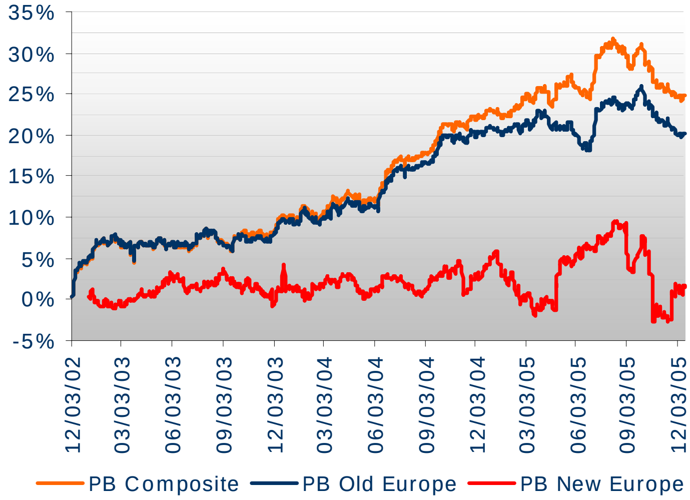

Figure 3. Performance of the PB Indexes

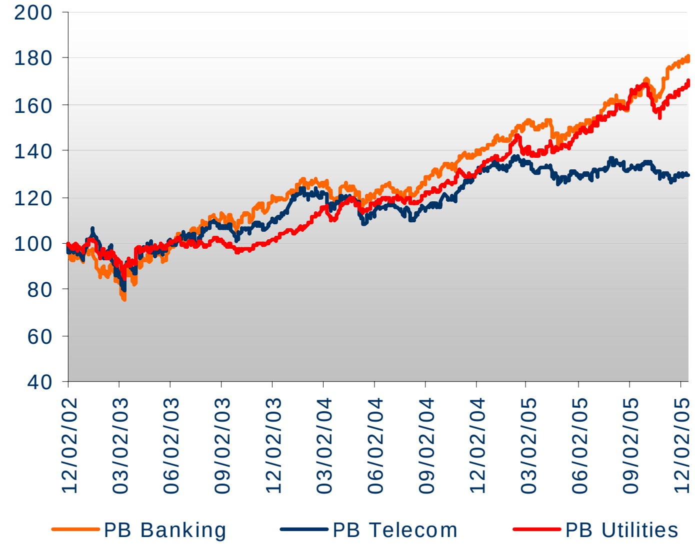

Figure 4. Cumulative Excess Returns of the PB Indexes

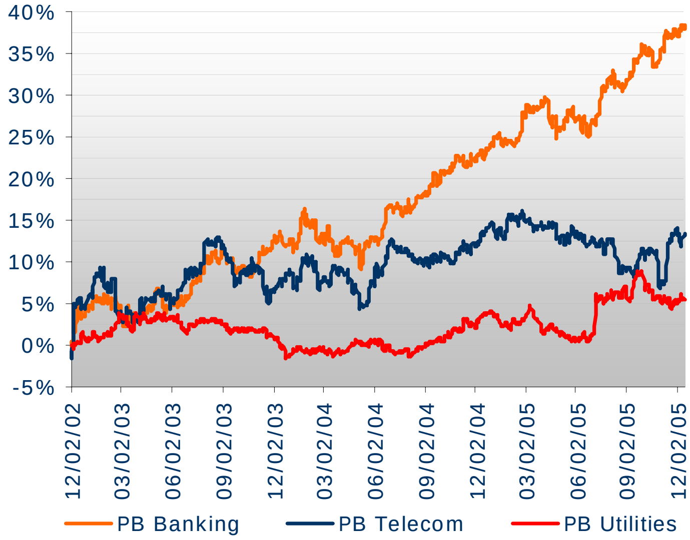

Figure 5. Performance of the PB Indexes

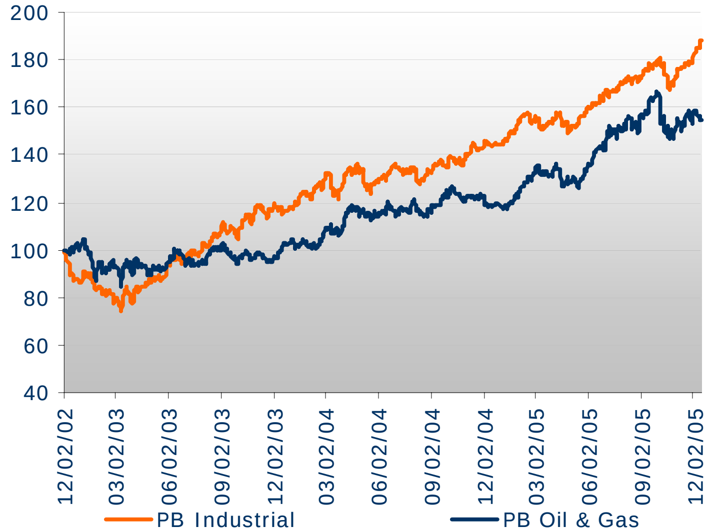

Figure 6. Cumulative Excess Returns of the PB Indexes

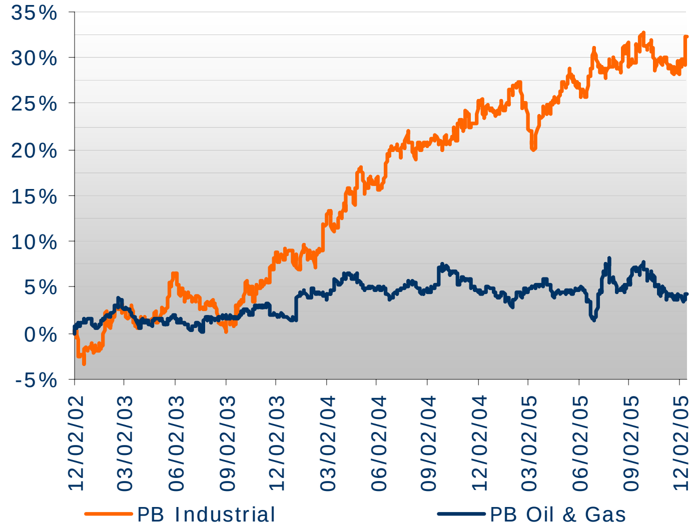

Table 4. PB Index TOP & WORST 10 Performers

OLD EUROPE

	TOP 10 Performers					*WORST 10 Performers*			
	Company	**Nation**	**Value as of 12/16/05**	**1 Year Change (%)**		**Company**	**Nation**	**Value as of 12/16/05**	**1 Year Change (%)**
1	Salzgitter	Germany	42.70	199.86%	**1**	Alitalia	Italy	0.93	-52.53%
2	BANIF	Portugal	15.85	147.66%	**2**	Austrian Airlines	Austria	6.50	-33.94%
3	Rautaruukki	Finland	19.52	127.77%	**3**	AEA Technology	UK	1.45	-30.29%
4	OMV	Austria	49.21	119.69%	**4**	Olympic Catering	Greece	2.41	-21.24%
5	Finnair	Finland	11.75	109.82%	**5**	Telecom Italia	Italy	2.44	-18.46%
6	Metso	Finland	23.50	101.20%	**6**	ACSM	Italy	2.16	-15.95%
7	Kobenhavns Lufthavne	Denmark	285.77	94.14%	**7**	Deutsche Telekom	Germany	13.93	-15.27%
8	Verbund	Austria	290.00	87.08%	**8**	France Telecom	France	20.91	-14.30%
9	Bull	France	9.20	84.00%	**9**	Public Power Corp	Greece	18.00	-11.24%
10	Rolls Royce	UK	6.00	68.54%	**10**	Iberia	Spain	2.30	-7.26%

NEW EUROPE

	TOP 10 Performers					*WORST 10 Performers*			
	Company	**Nation**	**Value as of 12/16/05**	**1 Year Change (%)**		**Company**	**Nation**	**Value as of 12/16/05**	**1 Year Change (%)**
1	LASCO	Latvia	1.85	193.65%	**1**	Globus	Hungary	1.05	-55.51%
2	CEZ	Czech Repu	24.95	129.53%	**2**	Elektrim	Poland	0.82	-48.43%
3	EGIS	Hungary	90.90	103.26%	**3**	Krosno	Poland	1.91	-37.17%
4	KGHM	Poland	15.19	95.50%	**4**	Stalexport	Poland	0.43	-32.81%
5	Richter Gedeon	Hungary	157.70	77.11%	**5**	Swarzedz	Poland	0.22	-31.25%
6	PKN Orlen	Poland	15.99	72.68%	**6**	Bedzin	Poland	7.41	-22.97%
7	MOL	Hungary	79.48	55.87%	**7**	Raba	Hungary	2.23	-21.20%
8	IMPEXMETAL	Poland	18.26	55.54%	**8**	KRUSZWICA	Poland	6.95	-20.21%
9	Bank BPH	Poland	181.30	52.92%	**9**	Sokolow	Poland	1.30	-5.11%
10	Rafako	Poland	4.88	52.50%	**10**	Bytom	Poland	3.14	-3.38%

Source: Elaborations on *Datastream*

Table 5. PB Index Old Europe Sectorial Top Performers

		Company	Nation	Value as of 16/12/2005	1 Year Change (%)
Banking	**1**	BANIF	Portugal	15.85	147.66%
	2	DVB Bank	Germany	160.00	62.54%
	3	National Bank of Greece	Greece	36.96	55.16%
Industrial	**1**	Metso	Finland	23.50	101.20%
	2	Kobenhavns Lufthavne	Denmark	285.77	94.14%
	3	Rolls Royce	UK	6.00	68.54%
Oil & Gas	**1**	OMV	Austria	49.21	119.69%
	2	British Gas	UK	8.13	61.63%
	3	Saipem	Italy	13.61	55.90%
Telecom	**1**	TDC	Denmark	50.45	61.80%
	2	OTE	Greece	18.08	36.76%
	3	Telekom Austria	Austria	18.85	35.61%
Utilities	**1**	Verbund	Austria	290.00	87.08%
	2	International Power	UK	3.66	64.13%
	3	Red Electrica de Espana	Spain	25.13	57.06%

Table 6. PB Index Old Europe Sectorial Worst Performers

		Company	Nation	Value as of 16/12/2005	1 Year Change (%)
Banking	**1**	Banco Espirito Santo	Portugal	13.450	2.83%
	2	Agricultural Bank of Greece	Greece	4.680	8.08%
	3	BCP	Portugal	2.090	11.76%
Industrial	**1**	Thomson	France	18.040	-6.43%
	2	Flughafen Wien	Austria	54.000	-4.29%
	3	Outokumpu	Finland	12.700	-3.93%
Oil & Gas	**1**	British Petroleum	United King	9.210	25.99%
	2	Eni	Italy	23.800	33.77%
	3	Repsol	Spain	25.140	33.87%
Telecom	**1**	Telecom Italia	Italy	2.438	-18.46%
	2	Deutsche Telekom	Germany	13.930	-15.27%
	3	France Telecom	France	20.910	-14.30%
Utilities	**1**	AEA Technology	United King	1.450	-30.29%
	2	ACSM	Italy	2.160	-15.95%
	3	Public Power Corp	Greece	18.000	-11.24%

Source: Elaborations on *Datastream*

Interestingly, the poor showing of several key TLC players (such as Telecom Italia, Deutsche Telecom, and France Telecom, all among the worst performers of the year) did not affect dramatically the overall performance of the PB Telecom, which gained a 1 percent abnormal return over the year

Privatized companies operating in the industrial sector also performed slightly better than their peers, especially stocks of the aerospace and defense sector (such as Rolls Royce, the pan-European consortium EADS and the British BAE Systems). High yields are found for companies operating transports systems such as Copenhagen Airport and Frankfurt airport and the toll-road French operators APRR, and Autoroutes du Sud de la France.

As customary, we also report the risk-adjusted performance yielded by our PB Indices. We have therefore calculated the conventional Sharpe ratio, given by the differential return of our index relative to a risk-free investment (namely, the 3-month Euro Interbank Offered Rate) divided by the standard deviation of the differential return. The Sharpe ratio has also been computed for our benchmarks, in order to gauge the differential risk-adjusted performance. We have also computed the Information ratio, given by the differential return relative to its benchmark divided by the so called tracking-error volatility (i.e. the standard deviation of the excess returns). While the Sharpe ratio provides a measure of return per unit of total risk, the Information ratio provides a measure of active risk and hence of relative risk-adjusted performance.

Data availability allows us now to calculate these ratios for the three-year period, which is the conventional time-horizon used by asset managers and investment consultants.

In relative terms, privatization companies performed well also after controlling for volatility. Over the 36-month period, the PB Indices show higher Sharpe ratios with respect to all benchmarks. A slightly lower value of the Sharpe ratio is reported for the PB New Europe Index, which nevertheless boasts a value 1.85, confirming the attractiveness of risk-adjusted yields in the new accession countries (Table 7).

The analysis of the Information ratio is particularly interesting. A top quartile manager has typically an information ratio of 0.50 or higher. The information ratio of the PB Composite Index is more than double (1.07). This value indicates approximately 120 basis points of out performance relative to the benchmark Dow Jones STOXX TMI for every 120 basis points of (active) risk (Table 8).

The PB Old Europe, and Banking and the Industrial indices also yield values in the top quartile of the distribution of the information ratios. Indeed, the excess returns gained by privatized companies survive when they are adjusted for risk.

As a final step, we have estimated a conventional Capital Asset Pricing Model (CAPM), where excess returns over the risk free asset are regressed against a market risk factor and sector excess returns. Not surprisingly, the returns of portfolios constructed on our PB Indices display a high beta (i.e. the estimated coefficient of the market return). Nevertheless, the PB Composite, Old Europe, Banking and Industrial Index regressions yield intercepts which are statistically different from zero. These intercepts are the conventional *Jensen's alpha*, a widely used measure of over performance over large and broadly diversified portfolios. Our most conservative estimates based on daily data yield an alpha of 2.1 basis points for the PB Composite (Table 9). A back of the envelope calculation suggests that a passive investment in a fund based on the PB Composite index gained approximately 5.5 percent excess returns on an annual basis with respect to a broadly diversified portfolio. Indeed, the most recent results confirms our previous analyses. Privatized companies are emerging as a distinct asset class with a very attractive risk profile. As such, they may represent a new opportunity for global investors.

Table 7. PB Indexes Sharpe Ratios

Indexes	PB Index	Benchmark	PB Index	Benchmark	PB Index	Benchmark
	1 Year		*2 Years*		*3 Years*	
Composite	2.054	2.250	1.899	1.447	1.220	0.850
Old EU	1.831	2.250	1.725	1.447	1.120	0.850
New EU	2.149	2.338	2.729	2.864	1.853	1.986
Banking	2.395	1.839	1.719	1.223	1.296	0.901
Industrial	2.853	2.680	1.988	1.464	1.792	1.200
Oil & Gas	1.796	1.799	1.488	1.428	0.795	0.722
Telecom	-0.356	-0.407	0.471	0.268	0.488	0.355
Utilities	2.237	2.076	2.556	2.220	1.398	1.186

Note: Sharpe Ratio indicates the historic average differential return of the index over a risk-free asset (Euribor Interbank Offered Rate 3m) per unit of historic variability of the differential return.
Source: Elaborations on *Datastream*

Table 8. PB Indexes Information Ratios

PB Indexes	1 Year	2 Years	3 Years
Composite	-0.453	1.005	1.074
Old EU	-0.930	0.695	0.848
New EU	-0.087	0.062	0.025
Banking	1.485	1.238	1.206
Industrial	0.166	1.172	1.345
Oil & Gas	0.112	0.332	0.352
Telecom	0.166	0.350	0.295
Utilities	-0.079	0.362	0.196

Note: Information Ratio indicates the historic average differential return of the index to its respective benchmark per unit of historic variability of the differential return.
Source: Elaborations on *Datastream*

Table 9. PB Indexes Jensen Alphas

PB Indexes	Jensen α	β	R-squared
Composite	0.023%	0.916	89.89%
	(2.25)	(83.13)	
Composite*	0.021%	0.623	91.08%
	(2.14)	(8.88)	
Old EU	0.019%	0.936	90.31%
	(1.85)	(85.09)	
Old EU*	0.016%	0.589	91.70%
	(1.69)	(8.53)	
New EU	-0.003%	1.017	89.24%
	(-0.11)	(70.65)	
Banking	0.031%	0.990	85.55%
	(2.04)	(67.84)	
Industrial	0.030%	0.914	79.75%
	(1.97)	(55.32)	
Oil & Gas	0.006%	0.976	95.92%
	(0.75)	(135.12)	
Telecom	0.016%	0.883	79.79%
	(0.90)	(55.40)	
Utilities	0.010%	0.852	91.79%
	(1.26)	(93.20)	

* Market sectorial controls included
Source: Elaborations on Datastream

Selected News

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AUSTRIA

2005-11-28 - **Telekom Austria Sale Unlikely Before Fall 06 Vote**

VIENNA (Dow Jones)--Austrian privatization agency OIAG said it considers the full privatization of **Telekom Austria AG** unlikely before legislative elections in autumn 2006.
However OIAG Chairman Peter Michaelis told journalists that the agency would still thoroughly examine any proposals from interested parties who fulfill all the requirements for the privatization.
OIAG holds 25.2% in Telekom Austria plus 5% underlying a convertible bond.
Michaelis also ruled-out a further privatization through a secondary public offering. "We won't sell the 25% stake on the stock exchange, as this would spark covetousness for Telekom Austria," Michaelis said.
He also said OIAG won't pursue a full privatization during this legislature period.
Regarding a possible sale or floatation of Telekom Austria's mobile unit, Mobilkom Austria, Michaelis said this wasn't currently an issue.

DENMARK

2005-10-19 - **Germany, Denmark Agree To Sell Ferry Operator Scandlines**

BERLIN (AP)--Germany and Denmark agreed to sell off Baltic Sea ferry operator **Scandlines AG**, which is jointly owned by Germany's national railroad and the Danish government.
German Transport Minister Manfred Stolpe and his Danish counterpart, Flemming Hansen, signed a joint statement authorizing negotiations on a sale, Stolpe's Ministry said.
Scandlines operates routes between Germany, Denmark, Sweden and the Baltic nations. At present, the government in Copenhagen and German railroad Deutsche Bahn AG each hold 50% stakes in the company.

FRANCE

2005-10-27 - **French Prime Minister Says His Government Won't Privatize Areva**

PARIS (Dow Jones)--French Prime Minister Dominique de Villepin said the privatization of nuclear engineering company **Areva** isn't part of his government's plans.

Villepin said he considers Areva of strategic importance because of its role in the nuclear sector and said only a state-controlled company can provide the necessary guarantees "for our citizens as well as our foreign clients."
In November 2004, France's then-Finance Minister Nicolas Sarkozy announced plans to sell a 35% to 40% stake in Areva - the world's largest builder of nuclear reactors - with the sale expected by the end of the summer.
Earlier this year, the government postponed the deal indefinitely to focus on the selloff of Gaz de France and Electricite de France.

2006-01-23 - **France To Privatize Cotton Producer Dagris**

PARIS (Dow Jones)--The French Finance Ministry unveiled plans to privatize **Dagris**, an agricultural cooperative that is one of the world's largest cotton producers. Dagris, which stands for Developpement des Agro-Industries du Sud, is owned 64.7% by the French state.
Dagris has annual revenue of EUR422 million and employs 2,127 people. Besides cotton, it is also active in the oilseed market.

GREECE

2006-01-09 - **Privatizations Among Greece's Top 2006 Economic Priorities**

ATHENS (Dow Jones)--Privatization of a number of state controlled companies is among the Greek government's top economic objectives for 2006, Finance Minister George Alogoskoufis said.
"The listing of the Postal Savings Bank and a placement of **Agricultural Bank of Greece**," are among planned privatizations Alogoskoufis reiterated, as is "the further privatization of **Emporiki Bank**, in collaboration with the French."
France's Credit Agricole currently has a stake of around 9.1% in Emporiki and is seen as Greece's preferred buyer for part or all of its 41% stake.

ITALY

2005-10-12 - **Italy Budget To Include Eni, Enel Stake Sale**

ROME (Dow Jones)--Italy's 2006 budget calls for the government to reduce its stake in energy companies **Eni SpA** and **Enel SpA**, Prime Minister Silvio Berlusconi said in a speech.
"In order to further reduce the public debt, further privatization of Enel and Eni is planned, as well as further sales of state-held real estate assets," Berlusconi said, referring to measures contained in Italy's 2006 budget.
As part of its plan to raise EUR28 billion-EUR30 billion by reducing its stakes in Enel, Finmeccanica and Eni to around 10% each, the 2006 budget plans to introduce a so-called "poisoin pill" for the two companies that would defend them from possible takeovers.

NETHERLANDS

2005-09-13 - **Dutch State To Remain Majority Shareholder In Airport**

AMSTERDAM (Dow Jones)--Dutch Minister of Finance Gerrit Zalm said in a statement that he wants to move swiftly to partially privatize the national airport **Schipol**, through an initial public offering.
Currently, the Dutch government holds a 76% stake in the national airport, Schiphol; the city of Rotterdam has a 2% stake; and the city of Amsterdam, where the Schiphol is located, has a has 22% stake.
In the statement, the Finance Minister said it is important the governments maintain their combined majority stake.
In June the Dutch parliament approved the sale of a minority stake in the airport, providing the government maintains a majority holding and control over the facility.
After consultation and research into various options, the Finance Minister concluded the best option for reducing the government's stake in Schiphol, while still being able to raise future capital, is through an IPO.
In the statement the Minister didn't say by how much the government's stake will be privatized nor did it give a precise timeline for the initial private offering.

2005-12-07 - **Dutch Government Sells 8% Of Incumbent KPN**

AMSTERDAM (Dow Jones)--The Dutch government said it has sold an 8% stake in the country's incumbent telecommunications operator **Royal KPN NV** and plans to further lower its holding in the future. The government sold 105 million shares to ABN Amro Rothschild and 60 million shares to KPN itself. The state said it intends "to further reduce its shareholding in KPN over time" and that it has agreed with ABN Amro Rothschild to a lockup on its remaining shares of 180 days.
The Finance Ministry said the sale halves its stake in KPN to around 8%. Moreover, the Ministry said in a statement that it plans to dispose of its so-called golden share "as soon as possible," and no later than Dec. 31 2005.

UNITED KINGDOM

2005-08-28 - **Government Mulls Plan To Sell British Nuclear Group**

LONDON (Dow Jones)--U.K. government ministers are studying plans to privatize **British Nuclear Group Ltd.**, the nuclear cleanup business owned by state-owned British Nuclear Fuels PLC, the Sunday Times said citing senior nuclear industry executives.
British Nuclear Group accounts for about three-quarters of British Nuclear Fuels's business and is valued at more than GBP2 billion.
U.K. project management specialist, Amec PLC and its U.S. rival, Fluor Corp, have already expressed interest. No date has been set for the privatization and a final decision isn't expected until next year at the earliest, the report said.

2005-10-16 - **Government Eyes UK Atomic Energy Agency Sell-Off**

LONDON (Dow Jones)--The U.K. government is set to announce the first moves toward selling the **U.K. Atomic Energy Agency**, which oversees six U.K. nuclear sites, the Observer on Sunday reports, citing sources close to the negotiations. The move is intended as the first step toward a public-private partnership, and possible privatization of the agency. Companies including Amec PLC and U.S. engineering firms CHM2-Hill Cos., Bechtel Group Inc. and Jacobs Engineering Group Inc. have expressed interest.

2006-01-12 - **QinetiQ Says To Proceed With Initial Public Offering**

LONDON (Dow Jones)--U.K. defense research company **QinetiQ Group PLC** said that it intends to proceed with a planned initial public offering on the London Stock Exchange.
The offer of existing and new ordinary shares will be to institutional investors in the U.K. and abroad as well as eligible employees. It's expected the IPO will be priced in February, QinetiQ said in a statement.
QinetiQ is involved in the research and development of technologies for the aerospace, defense, electronics and information technology industries.
The Ministry of Defence holds a 56% equity stake in QinetiQ while U.S. private equity company Carlyle Group LP holds a 31% stake with management and employees holding the remaining 13%. Carlyle though owns a majority of the voting stock. The Ministry of Defence and Carlyle intend to sell part of their holdings but will continue to retain a "significant" stake in the company after the IPO, according to the Ministry.
Both the key shareholders are widely expected to sell around half of their holdings, according to a person familiar with the matter.
The company is expected to have a market capitalization in excess of GBP1 billion although this could vary depending on market conditions.
The IPO is expected to raise gross primary proceeds for the company of around GBP150 million and significant secondary proceedings from the sales by the Ministry of Defence and Carlyle of some of their holdings, QinetiQ said.
The Government will retain a so-called "special share" in the company to protect the defense and security interests of the U.K.

2006-01-22 - **Ministry of Defence To Sell Half Stake In QinetiQ**

LONDON (Dow Jones)--The U.K.'s Ministry of Defence is to sell half its shareholding in **QinetiQ Group PLC** as part of the flotation of the defense research company, the Independent on Sunday newspaper reported.
The government's stake will be cut to below 30% from 56%, bringing in up to GBP300 million, while U.S. private equity group Carlyle Group LP will cut its holding to 17% from over 30%, the paper said. The paper didn't disclose the source of its information.
A prospectus for the company's initial public offering is expected to be published around the middle of next week, people familiar with the situation have told Dow Jones Newswires. Pricing of the offering is expected in February.

CZECH REPUBLIC

2005-07-19 - **Czech Government To Sell Subsonic-Jet-Maker Aero Vodochody**

PRAGUE (Dow Jones)--The Czech government is planning to open a tender to sell the state-owned subsonic-jet manufacturer **Aero Vodochody AS**, the Finance Ministry said in a statement.
The planned tender will be the government's second attempt to privatize the cash-strapped jet-maker since 1998 when it sold a 35.9% stake in the company to Boeing Co. for about $30 million. Last October the government bought back Boeing's stake in Aero Vodochody for a symbolic price of 2 koruna, bringing to an end months of tension between the Czech side and the U.S. aircraft giant over the fate of the Czech company.
According to some local media reports, the government is likely to launch the Aero Vodochody tender in September when it makes the final $215 million payment to Aero Vodochody creditors.

LITHUANIA

2005-10-14 - **Lithuanian Parliament To Consider Mazeikiu Nafta Deals On October 20**

VILNIUS (Prime-Tass)--The Seimas, Lithuania's parliament, is scheduled to consider on October 20 a bill authorizing the government to sell up to 30.66% in Lithuanian oil company **Mazeikiu Nafta** and to buy a 53.7% stake in the company owned by an affiliate of Russian oil company Yukos, the Seimas' press service said.
The government plans to retain a 10% stake in Mazeikiu Nafta so as to influence the buyer's decisions, the Seimas' press service added. The Lithuanian government earlier indicated that it wanted to find a new majority owner for the refinery, since Yukos could not guarantee stable oil supplies to the refinery due to its notorious problems with Russian authorities.
Companies that have indicated interest are TNK-BP, Lukoil, ConocoPhillips and Kazakhstan's KazMunaiGaz.

POLAND

2005-07-01 - **Polish Treasury To Sell 19.9% Stake In Daewoo-FSO To Avto-ZAZ**

WARSAW (Dow Jones)--Poland's State Treasury Ministry signed a preliminary agreement to sell a 19.90% government stake in car manufacturer **Daewoo-FSO Motor Corp.** to the Ukrainian company Avto-ZAZ, the Ministry said in a statement. The stake will entitle the Ukrainian company to 84.31% of voting rights. South Korea's Daewoo still owns the remaining shares.
The agreement has yet to be approved by Poland's antitrust body and the Ministry of Internal Affairs and Administration. The statement doesn't disclose financial details.

2005-07-29 - **Polish Treasury, Sairlines To Pursue LOT Airline Public Offer**

WARSAW (Dow Jones)--Polish Treasury Ministry, Sairlines Europe B.V. and national airline LOT SA signed an agreement on cooperation leading to the carrier's public offering, the Ministry said in a statement.
"The agreement relates to joint activities aimed at **LOT SA** listing at the Warsaw Stock Exchange," the statement said. The statement didn't reveal possible timing of the offering but according to LOT's current strategy, the Warsaw Stock Exchange debut is planned for mid-2006.
Poland's Treasury owns a 67.96% stake in LOT. A 25.1% stake formerly owned by bankrupt airline SwissAir is currently under the control of Sairlines Europe, while the rest is in the hands of company employees.
The initial public offer would involve a capital increase and the sale of the 25.1% stake held by Sairlines.
Plans call for the treasury to maintain at least a 51% stake in the carrier.

2005-10-06 - **Nafta Polska Mulls Sale Of 7.8% In Lotos**

WARSAW (Dow Jones)--Poland's government agency for the oil sector Nafta Polska is considering the sale of a 7.8% stake in oil refiner and retailer **Grupa Lotos**, daily Parkiet reports quoting Nafta Polska Deputy President Cezary Nowosad as saying that given the current market valuation of oil companies the sale would be beneficial to the State Treasury.
Nafta Polska owns 52% of Lotos, while the State Treasury owns 7%.

2005-12-07 - **Polish Treasury To Float More Pulawy, Police Shares In 1H 06**

WARSAW (Dow Jones)--Poland's State Treasury plans additional public offerings in chemical companies **Zaklady Azotowe Pulawy SA** and **Zaklady Chemiczne Police SA** in the first half of 2006, Treasury Minister Andrzej Mikosz said. The offerings will follow the part-privatization of both companies earlier this year.
Mikosz added in 2006 he also plans the initial public offerings of media distributor **Ruch SA** and coal mining company **Jastrzebska Spolka Weglowa SA**.

SLOVAKIA

2006-01-25 - DJ Slovakian Government To Halt Privatizations March 31

BRATISLAVA (Dow Jones)--Slovakia's centre-right government agreed to halt privatization decisions from March 31 to parliamentary elections due in September, CEEMarketWatch reported.
The government will also recommend that the state-run National Property Fund, or FNM, does the same.
The move could have an impact on several privatizations currently in the system.
The FNM is set to make final decisions by the end of March on the sale of 51% stakes in heating plants in Bratislava, Martin, Kosice, Trnava, Zvolen and Zilina. The FNM is also preparing to sell the Cargo Slovakia carrier by

the end of March. The sale is expected to raise 15 - 20 billion Slovak koruna.

The privatization of the Bratislava and Kosice airports, worth some SKK15 billion, would seem set to be completed by the deadline although potential legal hurdles remain.

Table 1. Announced Deals

Date of Announcement	Company Name	Country	Percent for Sale	Method of Sale	Date Expected (as announced)	Rescheduling /Notes
Jan-06	Dagris	France	unspecified	Private Sale	unspecified	
Jan-06	Qinetiq	Uk	unspecified	IPO	unspecified	
Jan-06	Agricultural Bank of Greece	Greece	unspecified	unspecified	2006	
Jan-06	Emporiki	Greece	up to 41	Private Sale	2006	
Dec-05	Koninklijke KPN	The Netherlands	unspecified	Public Offer	unspecified	
Nov-05	Telekom Austria	Austria	up to 30	unspecified	after autumn 2006	
Oct-05	Scandlines AG	Denmark & Germany	unspecified	unspecified	unspecified	
Oct-05	Eni SpA	Italy	unspecified	Public Offer	2006	
Oct-05	Enel SpA	Italy	unspecified	Public Offer	2006	
Oct-05	Atomic Energy Agency	UK	unspecified	Private Sale	unspecified	
Sep-05	Schipol (national airport)	The Netherlands	up to 49	IPO	unspecified	
Sep-05	Izar's Assets	Spain	N/A	Private Sale	unspecified	
Aug-05	Nozema	The Netherlands	up to 59	Private Sale	unspecified	completed
Aug-05	BNG	Uk	unspecified	Private Sale	unspecified	
jul-05	VVF Vacances Holiday Arm	France	unspecified	Private Sale	end of 2005	
Apr-05	GIMV	Belgium	30 - 35	unspecified	unspecified	
Jun-05	ASF	France	50.00	unspecified	2005	completed
Jun-05	SAPRR	France	76.00	unspecified	2005	completed
Jun-05	SANEF	France	70.20	unspecified	2005	completed
Jun-05	OTE	Greece	10.00	Public Offer	aug 2005	completed
Jun-05	Snam Rete Gas	Italy	up to 30	unspecified	2005	postponed to 2008
Apr-05	OPAP	Greece	16.40	Public Offer	mid 2005	completed
Apr-05	Enel	Italy	10.00	Public Offer	1H2005	completed
Jan-05	Athens Intl. Airport	Greece	up to 55	unspecified	Jun-05	postponed to 2006
2005	GalpEnergia	Portugal	unspecified	unspecified	2006	
Dec-04	Olympic Airlines	Greece	unspecified	Private Sale	2005	postponed to 2006
Nov-04	Areva	France	35 to 40	IPO	1H2005	canceled
Nov-04	Portucel Tejo	Portugal	unspecified	Private Sale	2005	completed
Nov-04	Electricidade dos Acores	Portugal	40.00	Private Sale	2005	completed
Oct-04	Post Office	Belgium	up to 49	Private Sale	2H2005	completed
Oct-04	DCN	France	up to 49	unspecified	2005	completed
Oct-04	Iberia	Spain	5.30	Private Sale	2005	
Oct-04	Endesa	Spain	3.00	Public Offer	2006	
Oct-04	Altadis	Spain	2.80	Public Offer	2005	completed
Oct-04	Aldeasa	Spain	5.60	Public Offer	2005	completed
Oct-04	TV2	Denmark	51 to 66	Private Sale	1Q2005	postponed
Sep-04	Aeroports de Paris	France	up to 49	IPO	1Q2005	postponed to 1H2006
Sep-04	RAI Radiotelevisione Italiana	Italy	20 to 30	IPO	1Q2005	postponed
Sep-04	Aguas de Portugal	Portugal	up to 49	IPO	2H2005	postponed
Sep-04	EDP	Portugal	up to 20	Public Offer	2004	
Jul-04	SANEF	France	20 to 30	IPO	1Q2005	completed
Jun-04	Deutsche Bahn	Germany	unspecified	IPO	2006	postponed to 2008
May-04	Electricité de France	France	up to 30	IPO	end 2004	completed
May-04	Gas de France	France	up to 30	IPO	end 2004	completed
Mar-04	Oesterreichische Post AG	Austria	49.00 §	IPO	2H2006	
Feb-04	Koninklijke KPN	The Netherlands	unspecified	Public Offer	2005	completed
Jan-04	DONG	Denmark	up to 49	Private Sale	1H2005	
Jan-04	Deutsche Flugsicherung	Germany	74.90	unspecified	2006	anticipated to 2005
Jan-04	Postal Savings Bank	Greece	up to 40	IPO	2005	postponed to 2006
Jan-04	Depa	Greece	unspecified	Private Sale	2004	suspended
Jan-04	Aer Lingus	Ireland	up to 50	unspecified	2005	
Jan-04	Red Electrica	Spain	18.50	Public Offer	2004	postponed to 2006
Jan-04	Post Danmark	Denmark	25.00	Private Sale	1Q2005	completed
2004	Fraport	Germany	18.30	unspecified	2005	completed

§ Previously announced for 25,10 stake.
Source: *DowJones*

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