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Reporting on privatization in enlarged Europe

A sizzling 2004!

THE WEBSITE ON PRIVATIZATION IN EUROPE

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Editor:
B. Bortolotti

Scientific Advisor:
W.L. Megginson

Researchers:
L. Farinola
V. Milella
E. Panetti

c/o Fondazione Eni Enrico Mattei - FEEM
Corso Magenta 63, 20123 Milano - Italy
tel +39 | 02 | 5203.6968
fax +39 | 02 | 5203.6946
e-mail: info@privatizationbarometer.net

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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 indexes, 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

Dopo la battuta d'arresto che ha caratterizzato l'inizio del nuovo secolo, nel 2004 le privatizzazioni hanno ripreso quota grazie a una massiccia ondata di vendite che ha interessato l'Europa. Con 80 operazioni per un controvalore pari a oltre 55 miliardi di Euro, le dismissioni ritornano in termini di ricavi ai livelli dei gloriosi anni 90. Rispetto al passato più recente, questa nuova ondata presenta alcune caratteristiche distintive, quali il ritorno alle offerte pubbliche di vendita, dopo un lungo periodo in cui hanno prevalso le vendite dirette, l'aumento della dimensione media delle operazioni e la presenza di operazioni importanti nell'IT e nel settore finanziario. La ripresa del processo e le sue principali caratteristiche sono state fortemente influenzate da un fattore comune, cioè dall'andamento positivo dei mercati finanziari europei, che hanno triplicato nel corso del 2004 l'attività di emissione sia primaria che secondaria.

Spinti dalla necessità del risanamento di bilancio imposto dai criteri di Maastricht, la Francia, l'Italia e la Germania hanno concluso nel corso del secondo semestre vendite per circa 33 miliardi di Euro, quasi quattro quinti delle dismissioni totali. Più della metà dei proventi sono stati realizzati attraverso operazioni indirette, nella forma di *spin-off* da grandi società privatizzate (ad esempio, Pages Jaunes e TDF da France Telecom, GAGFAH da BfA, la grande banca tedesca) e di trasferimenti di partecipazioni da parte di istituzioni finanziarie controllate dallo Stato (quali ad esempio il KfW). Fra i nuovi paesi dell'allargamento, spicca la Polonia che ha sorpassato nel semestre molti paesi della Vecchia Europa nella classifica per proventi. Indubbiamente le società privatizzate polacche, grazie agli elevati rendimenti ottenuti nel corso del 2004, stanno riscuotendo grande interesse da parte degli investitori internazionali, come testimoniato dallo straordinario successo dell'IPO della principale banca polacca, PKO-BP.

Ma al di là dei proventi, che cosa è successo realmente nei paesi post-comunisti? Le privatizzazioni hanno davvero contribuito allo sviluppo economico e sociale? John Nellis, uno dei principali esperti di privatizzazioni nelle economie in transizione, ci offre alcune risposte nell'articolo che pubblichiamo in questo numero. Sebbene siano certamente una politica di *second best*, nella maggior parte di quei paesi non sembrano esserci alternative possibili ad una politica di privatizzazioni combinata ad un processo di rafforzamento istituzionale. Attendere che il quadro istituzionale sia perfetto prima di intraprendere le

vendite potrebbe infatti essere rischioso in quanto offrirebbe un alibi per mantenere le imprese pubbliche sotto il controllo di una burocrazia inefficiente. E quando finalmente le riforme arriveranno, potrebbe essere troppo tardi. Potrebbe infatti non esserci più nulla da vendere.

Nei casi in cui rimangano proprietà da vendere, si apre il tema delicato della scelta del metodo di privatizzazione, che naturalmente dipende dagli obiettivi dello Stato venditore. La lettura dell'articolo di Massimo Pappone e Giacomo Ciampolini di Goldman Sachs offre spunti importanti per affrontare il tema dalla prospettiva del banchiere d'investimento. A seguito del crollo del mercato azionario nel 2000 e del conseguente aumento della volatilità, gli emittenti (ed in particolare i governi) hanno cominciato a privilegiare transazioni rapide rivolte a investitori istituzionali, spesso associate a garanzie di prezzo minimo, quali i cosiddetti *accelerated book-built offerings* (ABO) e i *block trades*. Rispetto alle offerte tradizionali sul mercato, queste transazioni accelerate garantiscono velocità di esecuzione, certezza dei ricavi, riservatezza e costi contenuti. Recentemente, la possibilità di cogliere di sorpresa il mercato con queste transazioni accelerate a basso rischio ha tenuto lontano gli emittenti dai collocamenti sui mercati. Ma quando esiste una forte domanda potenziale sul mercato retail e l'incertezza viene compensata da una buona *equity story*, allora la bilancia può pendere nuovamente in favore delle classiche OPV. Dall'analisi di Enel3 (la più grande operazione al mondo dal 2000) impariamo che un'offerta globale ben strutturata può esser fattibile e profittevole per tutte le parti coinvolte anche in un contesto di mercato difficile.

La disponibilità dello stato dell'arte delle tecniche di privatizzazione ha consentito di ridurre sostanzialmente la proprietà pubblica nel mondo, ma il declino non è avvenuto in modo simmetrico nelle diverse aree geografiche e nei vari settori. Inoltre, lo sforzo verso la privatizzazione è molto diminuito di intensità negli anni recenti, nonostante l'evidenza empirica continui a dimostrare notevoli miglioramenti di efficienza nelle imprese pubbliche privatizzate. Curiosamente, sta emergendo una forte dissociazione fra il consenso degli economisti sugli effetti delle privatizzazioni e la percezione del fenomeno da parte della popolazione, soprattutto nelle aree meno sviluppate del mondo. Diventa quindi prioritario analizzare nel concreto il fenomeno e individuare le cause degli eventuali fallimenti per evitare di ripetere gli stessi errori nel futuro. Florencio Lopez-de-Silanes sintetizza i risultati empirici sulla performance operativa delle privatizzate, sulla dinamica dell'occupazione e su altri aspetti economici e sociali relativi alle privatizzazioni quali l'accesso e la qualità dei servizi e la distribuzione del reddito, giungendo ad una conclusione molto netta: le privatizzazioni non solo generano benefici, ma questi tendono ad essere condivisi dalla società. Vendere però non basta. Per generare i benefici attesi, la politica di privatizzazione deve essere accompagnata da un adeguamento della regolamentazione e delle istituzioni che consenta l'aggregazione dell'informazione, prevenga gli abusi di posizione dominante e faciliti i

processi di ristrutturazione aziendale. Anche queste sono indicazioni utili per le privatizzazioni del futuro.

Fra i tanti attori coinvolti, il Privatization Barometer segue attentamente gli interessi di una particolare categoria di stakeholder: gli azionisti. Gli indici PB seguono infatti la performance di alcuni portafogli costituiti dalle azioni di 218 società privatizzate nella Vecchia e Nuova Europa. L'analisi delle caratteristiche di rischiosità e di rendimento dei nostri indici mostra chiaramente che fondi azionari basati su queste società producono valore aggiunto. Nel corso del 2004, gli indici PB New Europe e Utilities hanno guadagnato rispettivamente il 54 e il 26 percento, battendo i rispettivi benchmark Dow Jones Stoxx di 13 e 7 punti percentuali. L'elevata redditività di questi indici persiste anche quando si tiene conto della rischiosità dell'investimento. In questa prospettiva, risulta interessante anche il profilo rischio-rendimento del PB Composite, che replica la performance del Dow Jones Stoxx TMI contenendo però sensibilmente la componente di volatilità.

Concludiamo con le nostre previsioni per il 2005. Data la congiuntura relativamente favorevole sui mercati azionari e l'ingente valore delle operazioni attualmente in corso, ci si aspetta un consolidamento del trend positivo osservato nel 2004. Anche se non è realistico attendersi presto i volumi record del 2000, prevediamo comunque che questo possa avvenire nell'arco del prossimo quinquennio. Il grande ciclo delle privatizzazioni degli anni 90 è concluso. Ma un nuovo ciclo sembra alle porte.

English Version

After the turn-of-the century plunge, privatization is coming back strong. A massive wave of State-sell-offs swept Europe in 2004, with most of the action during the second half. With 80 deals totaling over €55bn, privatization activity is back near the glory day levels of the late 1990s. This new wave has distinguishing features: it marks a shift from private placements to equity offerings, an increase in the size of the deals, and a comeback of large-scale operations in the IT and financial sectors. The resurgence of the process has been strongly affected by the positive outlook in European stock markets, where primary and secondary equity issuance nearly tripled during 2004.

Hard pressed to meet convergence criteria, France, Italy, and Germany launched during 2H2004 privatization sales worth €33bn, almost 80 percent of total activity reported in the semester. More than a half of this amount has been raised through indirect privatizations, such as spin-offs from privatized companies (for example, Pauge Jaune and TDF from France Telecom, and GAGFAH real estate company from BfA, a large German bank, etc.) or transfer of shares from government-owned financial institutions (such as KfW). Among new accession countries, Poland surpassed in terms of privatization activity several important countries of the Old Europe. Indeed, Polish privatized companies, which earned stellar returns during 2004, attracted much attention from international investors, as witnessed by the highly successful IPO of PKO-BP, the largest national bank.

But what has really happened in post-socialist countries? Has privatization been beneficial or detrimental to economic growth and social progress? John Nellis, one of the leading experts on privatization in transition economies, provides some answers in the article published in this issue. Although privatization may often be a "second-best" policy, in most countries there is little alternative but the continuing pursuit of privatization in combination with institution building. The risk is that under the alibi of waiting until countries "get their institutions right", bureaucrats will continue to misuse the resources of the State-owned enterprise sector. When reforms will finally arrive, there may not be anything left to sell.

When something *is* left to sell, the most suitable privatization method has to be chosen according to the seller's objectives. By reading the article by Massimo Pappone and Giacomo Ciampolini, from Goldman Sachs, we get the investment banker's point of view on this important policy issue.

Following the collapse of equity markets in 2000 and the subsequent increase in volatility, divesting shareholders (and governments in particular) have started to pursue faster transactions, often with minimum price guarantees: Accelerated Book-built Offerings (ABO) and Block Trades. As compared with fully marketed offerings, accelerated transactions guarantee speed of execution, certainty of proceeds, confidentiality, and low costs. Recently, the ability to take advantage of a positive market window and surprise the market by selling a stake with limited price risk outweighed the advantages of marketed offerings. But when there is retail support and uncertainty is curbed by a strong equity story, the scales may tip in favor of fully marketed offerings. From the case study of Enel's follow-on privatization (the largest sale around the world since 2000), we learn that well-structured global offerings are feasible and may turn profitable for all parties concerned even when issuers face unstable market conditions.

The availability of state-of-the-art privatization techniques allowed governments to decrease substantially their ownership around the world. However, this decline has not been symmetrical along regions and sectors. Furthermore, privatization efforts stalled in recent years, despite the empirical evidence of strong performance improvement of State-owned enterprises. A cosmic "disconnect" is arising between the academic consensus and how privatization is perceived especially in the poorer regions of the world. In these circumstances, it is imperative to analyze the true record of privatization and understand the causes behind failures in order to improve the process in the future. In his article, Florencio Lopez-de Silanes summarizes the empirical results on the effects of privatization on operational performance, employment, and other measures of welfare such as access and quality of services and the distribution of wealth. His conclusion is straightforward: privatizing countries do benefit, and the gains as shared with society. But the establishment of a regulatory and institutional framework that allows efficient information gathering, prevents market power abuses, and foster restructuring processes, is a key policy complement to privatization. These recommendations should help in the design of future rounds of State sell-offs.

The Privatization Barometer takes very seriously the interests of one economic class involved in the privatization process: the shareholders. PB Indexes track the performance of portfolios restricted to (ordinary) shares of 218 privatized companies in the Old and New Europe. The analysis of the risk and return characteristics of our PB Indexes suggests that there is value in privatization-related funds. During year 2004 high returns are found in the PB New Europe (54 percent) and Utilities (26 percent). Importantly, these two new indexes strongly outperform their respective benchmarks (13 and 7 percent) and remain valuable even when we adjust for risk. Finally, our analysis suggests that the risk-return profile of the PB Composite may also be interesting.

To conclude, we can state our forecast for 2005. Given the continuing strength of global stock markets, the resurgence of stock issuance, and the value of deals presently in the pipeline, we expect a consolidation of the increasing trend observed in year 2004. Even if it is not likely to see a repeat of 2000’s extraordinary volume of privatization’s any time soon, we could well see total SIP and asset sale proceeds exceeding US$100bn for the first time in five years. The big privatization cycle of the 1990s is put in the past. But a new one may be round the corner.

Bernardo Bortolotti

University of Turin and FEEM

Privatization Trends in Europe

Privatization strikes back

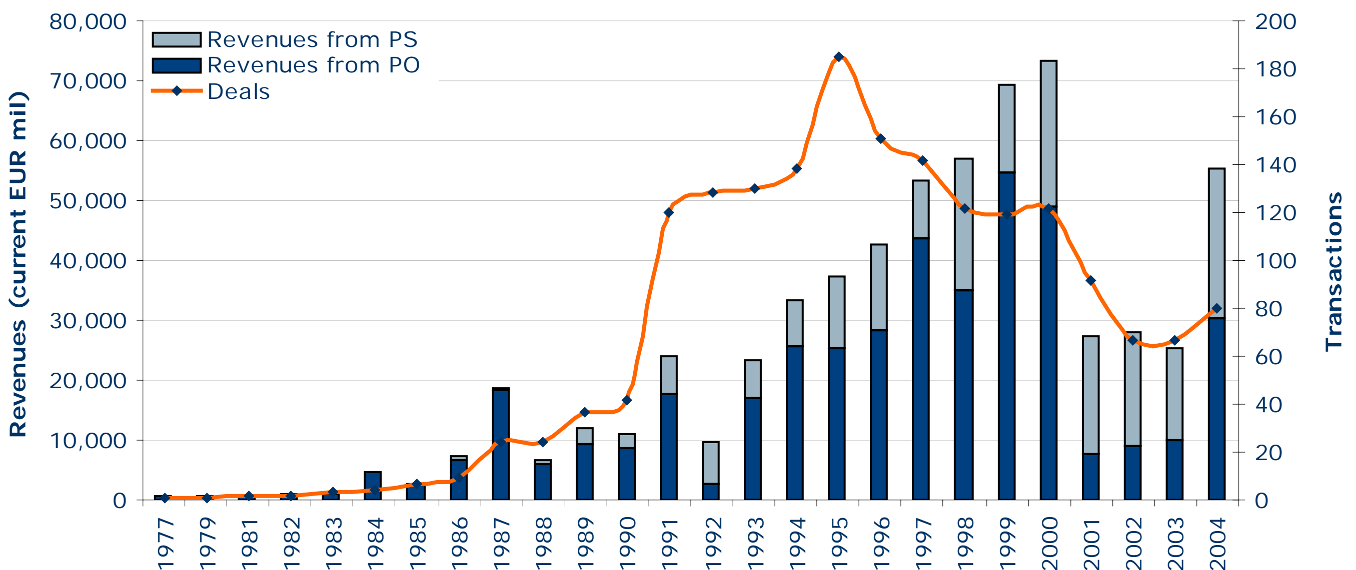
With the bear market firmly put to rest, privatization swept Europe during 2004, particularly during the second half. The totals were impressive. 80 transactions were executed raising over €55.3bn. The forecast stated in the previous PB Newsletter was confirmed; 2004 marked a solid increase over the previous year and, from a broader perspective, a definite resumption of the process after the turn-of-the-century plunge. Revenues increased by 52 percent versus 2003, bringing activity back very close to the peak levels of the late 1990s (see Figure 1).

Three features of this new privatization wave appear particularly interesting: *(i)* the resurgence of equity issuance in primary and secondary markets, *(ii)* the sheer size of the deals, and *(iii)* the comeback of operations in the IT (especially telecommunications) and financial sectors.

IPO activity resumes, and several privatized companies come back to the market with important secondary share issues

The year 2004 witnessed ten sizeable IPOs, clustered in the months of June and November, in the core European countries and in the new accession country Poland. Furthermore, several major privatized companies came back to the market, implementing important secondary share issues. Among these, the October *monstre* offering by Enel, the Italian electricity giant, and France Telecom's seasoned offer stick out.

Figure 1. Privatization in EU25, 1977 - 2004



Source: *Privatization Barometer*

Sheer size of the deals

Governments' determination to take privatization seriously last year was clearly visible from the value of the deals. The average deal size was €691mil during 2004, approximately double that of the previous year. Clearly, deal size and sector are often the two sides of the same coin, since TLC operators, utilities and banks are almost everywhere the largest companies listed on national exchanges.

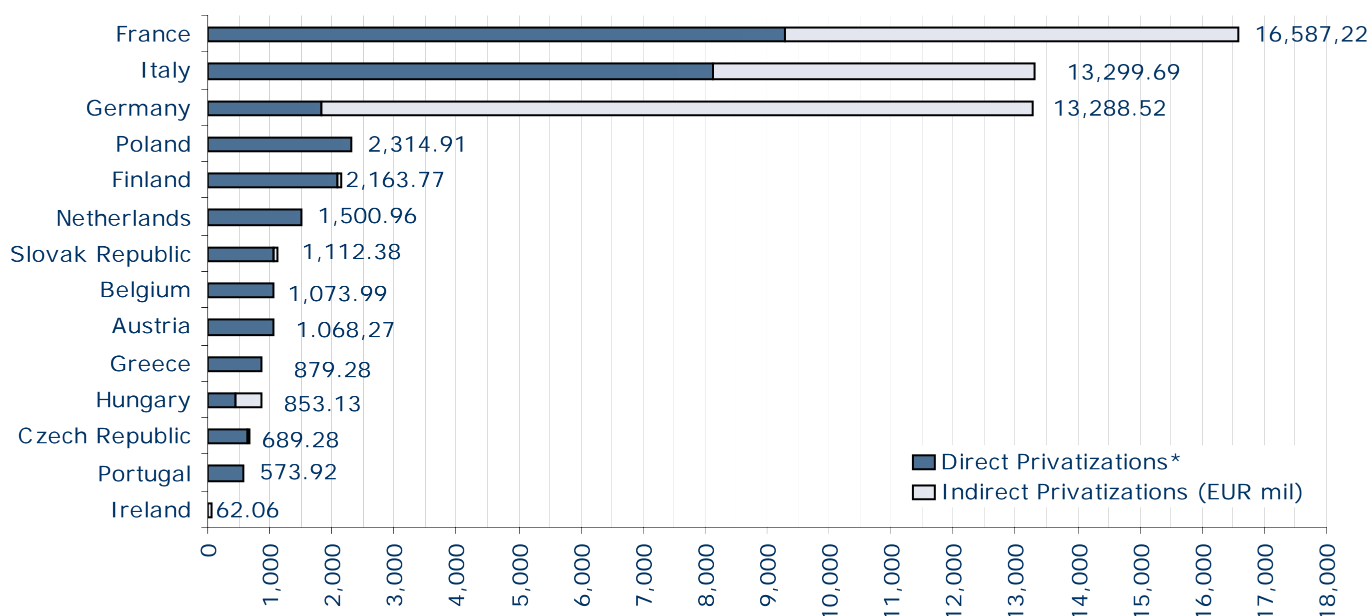
Under the urgency to meet Maastricht criteria, a core group of "Old European" countries heavily push ahead privatizations

As usual, the bulk of privatization activity last year was concentrated in the countries of Old Europe, which implemented 66 percent of transactions and raised 92 percent of proceeds (Figure 2). Three countries received the overwhelming majority of revenues: France (30 percent), Italy and Germany (both 24 percent). It is certainly not surprising to find these core EU member states heavily engaged in privatization, as they are also those facing (together with Greece and Portugal) severe fiscal problems and difficulty in meeting the Maastricht criteria. In France and Germany, public finance conditions rapidly deteriorated in 2004 due to fiscal deficits mounting well above the EU15 average. Italy's sustained privatization effort was mainly intended to curb public debt, which is still higher than the country's GDP.

Direct vs Indirect privatizations

An important distinction has to be made between direct (or first level) privatizations, where the government divests its direct shareholdings in companies, and indirect (or second level) privatizations. The latter category comprises spin-offs from SOEs or privatized companies (such as Deutsche Postbank from Deutsche Post, or Terna, the Italian electricity grid, from Enel) and the transfer of shares from financial entities partly owned by the state (such as Germany's KfW, France's Caisse des Dépôt et Consignations, and Italy's Cassa Depositi e Prestiti). This distinction has important consequences in terms of revenue allocation. In direct privatizations, sale proceeds flow directly to government coffers, while in indirect privatizations the proceeds go to the divesting company, which may decide to distribute them to shareholders as extraordinary dividends.

Figure 2. Distribution of Privatization Revenues by Country, 2004



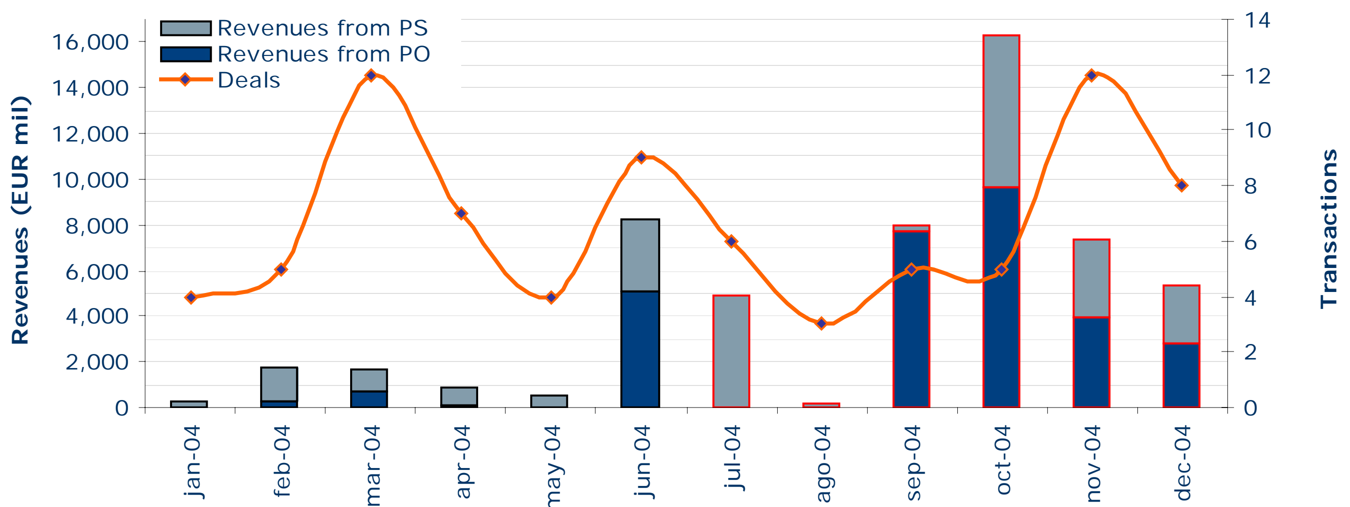
* Direct Privatizations refer to the sale of government's direct stakes. Indirect Privatizations include spin-offs and transfer of shares from government owned companies.
Source: *Privatization Barometer*

Some caution is thus needed when we look at aggregate data on privatization revenues. When there is both a direct and an indirect privatization deal, involving the shares of the same company, revenues can be double-counted if the state is a shareholder of the divesting entity executing the indirect privatization. For example, in October KfW sold 4.67 percent of Deutsche Telekom's share capital, raising around €3bn (US$3.7bn). The German government, which directly owned another 26.1 percent of Deutsche Telekom, didn't receive any cash from the sale as it had already booked the proceeds when it sold Telekom shares to KfW. In December, the government sold 3.3 percent of Deutsche Telekom to KfW, which did bring €1.6bn (US$2.1bn) to government coffers.

In 2004 indirect privatizations represent a large portion of European divestitures

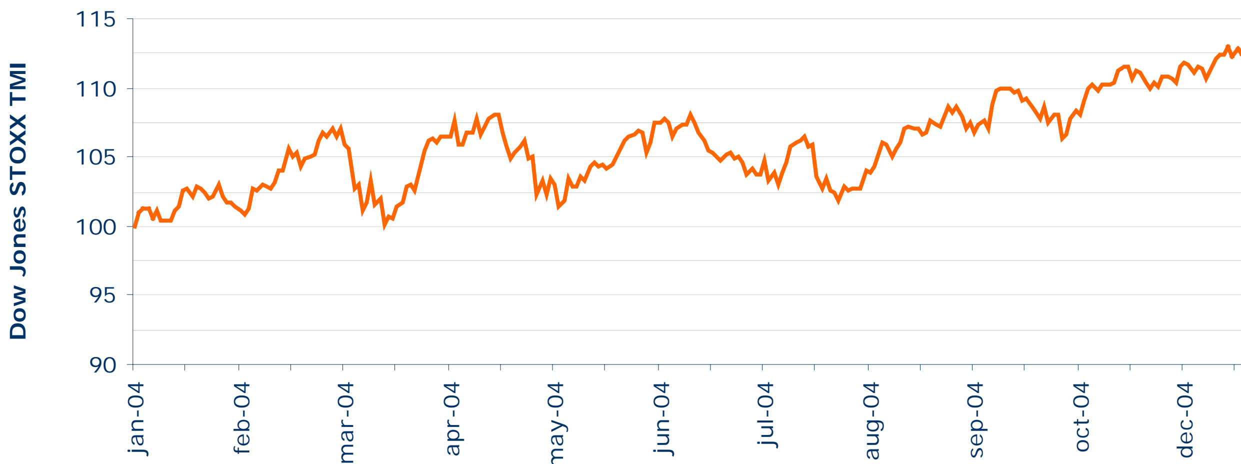
The detailed data available allows us to distinguish precisely direct and indirect privatizations (Figure 2). Indirect privatizations account for a sizeable fraction of privatization activity in Europe (45 percent). Not surprisingly, the overwhelming majority of these deals are concentrated in France, Italy, and Germany, where large privatized holding companies and State-owned financial institutions are still very important. Interestingly, Germany obtained the lion's share of revenues from indirect privatizations.

Figure 3. Total Privatization Revenues and Transactions in EU25, 2004



Source: *Privatization Barometer*

Figure 4. Equity Markets in EU25, 2004



Source: Elaborations on *FactSet*

Positive market conditions boost privatizations in Q3 and Q4

We now turn to comment on the most recent evolution of privatization sales. In 2H2004, European privatizations involving 37 companies raised almost €42bn in total proceeds. European equity markets gained 6.25 percent during the period. This positive market outlook favoured sales, which clustered in Q4 when markets gained the most. October saw an impressive concentration of large deals, involving behemoths such as Enel, Deutsche Telecom, TPG – the Dutch postal group - and Belgacom, as well as an important German real estate company. The combination of these deals yielded €16bn monthly revenues, an unprecedented total since the turn of the century. The resurgence of equity markets affected the choice of the privatization method. In sharp contrast with previous years, public offerings struck back during 2004 accounting for 57 percent of total revenues.

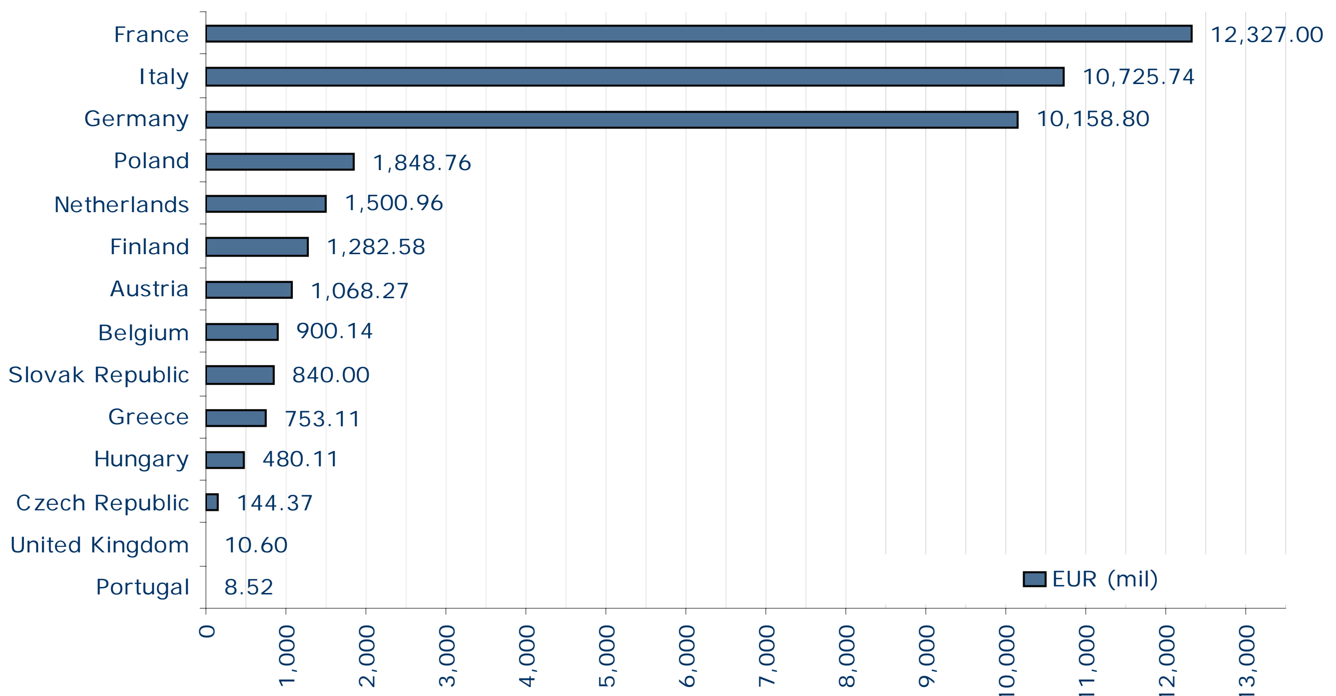
France, Italy, Germany and (surprisingly) Poland lead the 2H2004 ranking by revenues

During the second half of 2004, we report privatization activity in 14 countries of the enlarged EU. France, Italy, and Germany lead the country ranking in terms of total revenues. Poland gained the fourth position, surpassing several important countries of the Old Europe. The €1.8bn raised by the Polish government in a semester represent an extraordinary result in the context of the new Europe. However, the Polish privatized companies, which yielded stellar returns during 2004, are attracting a lot of attention from international investors. Investor appetite partly explains the successful floatation of PKO-BP, Poland's largest bank. Among accession countries, we find Hungary also holds a prominent position, thanks to MOL's spin-off of its gas assets.

A consolidation of the trend is foreseeable for 2005

So what can we predict for 2005? Given the continuing strength of global stock markets, the resurgence of stock issuance, and the value of deals presently in the pipeline, we predict that privatizations will continue to increase in number of total volume throughout this year. The American IPO market reopened with a vengeance after Google's IPO in August, and

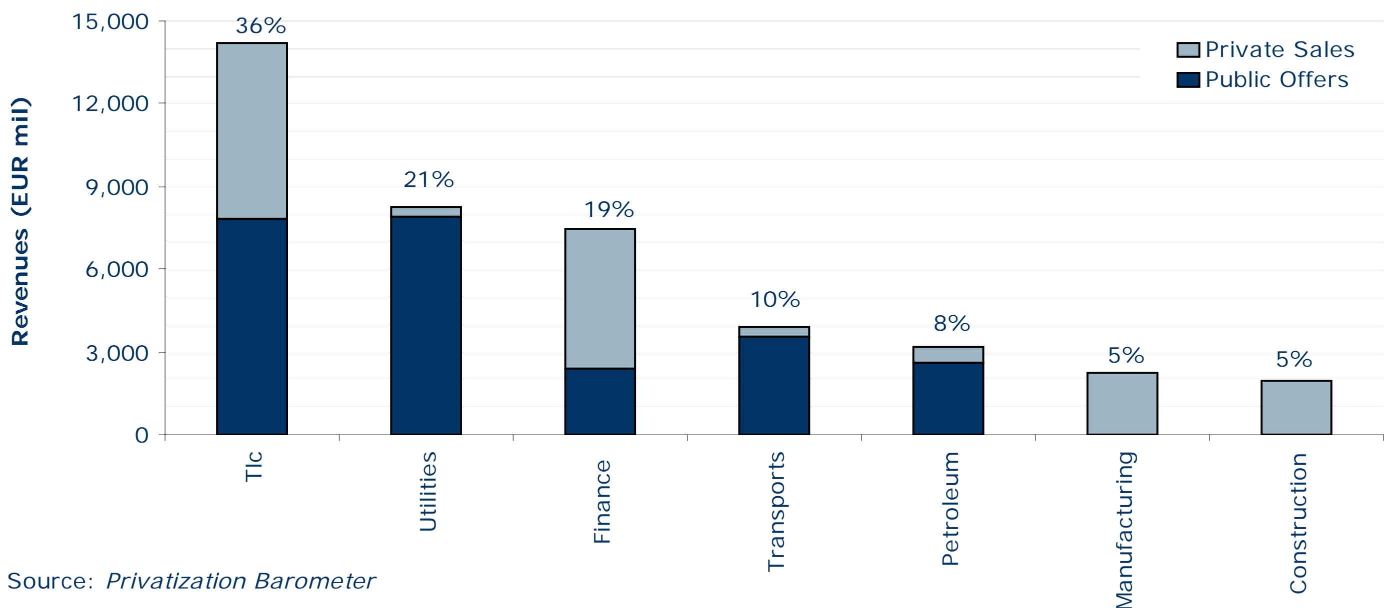
Figure 5. Distribution of Privatization Revenues by Country, 2H2004



Source: *Privatization Barometer*

international institutional investors rediscovered their appetite for emerging market equity. Though we are unlikely to see a repeat of 2000's extraordinary volume of privatization's any time soon, we could well see total SIP and asset sale proceeds exceeding US$100bn for the first time in five years. Although most European governments have already at least partially privatized most of their major SOEs, and thus will be constrained from launching huge new sales by a lack of "inventory," a conservative estimation of the value of direct government's stakes in partially privatized firms worldwide is almost US$800bn. A sizeable chunk of that inventory is likely to be sold during 2005.

Figure 6. Distribution of Privatization Revenues by Sector, 2H2004



Source: *Privatization Barometer*

William L. Megginson
University of Oklahoma

Major Deals of 2H2004

Global economic recovery and markets upswing drive the new privatization wave …

After four years of severely depressed stock issuance activity in world capital markets, the stars finally realigned during the second half of 2004 for global equity offerings in general, and share issue privatizations (SIPs) in particular. A rapidly growing world economy, with continued low interest rates and low inflation, contributed to a sharp increase in stock market capitalization - especially outside the United States. European equity issuance nearly tripled, from US$51.5bn during 2003 to US$135.8bn during 2004, with the bulk of the issues being marketed after June.
Privatization share issues in Europe increased similarly, from US$13.1bn in 2003 (and US$9bn in 2001 and 2002) to US$34.4bn in 2004. As we show in the *Privatization trends* section, this volume was even more concentrated in the second half of 2004 than was the case for non-privatization stock offerings.

…especially during the second half of 2004

During the first half of 2004, European governments raised a mere €13,3bn through privatization share offerings and assets sales; the Italian government received more than a half of this amount with a single offering in October, through the sale of a 19.6 percent stake in Enel in a highly successful public offering that raised €7.6bn (US$9.6bn). Other European governments executed more than a dozen large privatization sales, and raised an additional €16.5bn (US$21bn), during 2H2004. Add in asset sales, and total privatization revenues for EU governments during the second half of 2004 reached €42bn (US$53bn). Five European privatization sales raised at least €2.5bn each, including two unusually large asset sales by the German government. All told, governments around the world executed no fewer than 21 public and private offers that raised at least US$1bn each, and the global value of privatizations during 2H2004 was approximately US$65bn. These are truly numbers unseen since the glory days ended in 2000, and they bring the total value for privatizations worldwide to almost US$80bn during 2004.

Sales in Old Europe

The third placement of shares of the Italian electricity giant Enel represents the largest privatization since year 2000

As noted above, the largest sale of 2004 was **Enel** 3 in October. Everything about this company seems larger than life, including its IPO in 1999, which raised a record €16.8bn, and the second tranche sale in 2003, which raised €2.2bn in one of the earliest large accelerated book-building operations - and then performed abysmally for stockholders during the following year. In contrast to the first two offerings, however, Enel 3 was an unqualified success for all concerned, as described quite well in the Pappone and Ciampolini article in this newsletter. The offering was 2.5 times subscribed, and all of the international tranches were met with enthusiastic demand - particularly the 10 percent tranche allocated to Japanese investors. The

Italian government priced the 1.15bn shares on offer at €6.64 on October 23, and Enel shares closed at €6.83 when trading resumed on October 25. Total proceeds, after the underwriter exercised the Green Shoe option, was €7.62bn (US$9.52bn). After the offering, Enel shares continued to appreciate, and closed out trading in 2004 at €7.231 per share.

Accelerated book-building operations(ABOs) gain ground

One intriguing aspect of privatization sales during 2H2004 was the growing popularity of accelerated book-building operations (ABOs). These offerings were employed by several governments to sell large blocks of shares quickly. No government was fonder of these sales than France, which executed the second and third largest SIPs during this period using accelerated book-buildings. In September, the government raised €5.1bn (US$6.2bn) by selling a 10.85 percent stake in France Telecom at a small discount in one of the largest ABOs ever executed. At the end of September, the state-owned electric utility, Electricité de France (EdF) sold its 2.3 percent residual stake in the oil company **Total** in another ABO, raising €2.59bn (US$3.17bn). EdF sold its shares at a 1.2 percent discount to the closing price of €170 per share immediately prior to the offering, and Total shares dropped an additional 2.2 percent on the news of the sale. France even executed a third, albeit smaller, ABO during December when the government sold an 18.40 percent stake in **Air France-KLM**. This offering raised €680mil (US$910mil), and cut the government's retained ownership to below 20 percent.

French IPOs, vivement!

France also saw two large initial public offerings during the second half of 2004. In July, state-controlled France Telecom raised €1.46bn (US$1.79bn) through an IPO of **Pages Jaunes**, FT's directories subsidiary. All proceeds were retained by FT, but since this sale reduced the French state's overall holdings in state-owned companies, it qualifies as a privatization. FT sold a 36.3 percent stake in Pages Jaunes (retaining 62 percent), and the institutional investor tranche of the IPO was three times subscribed. The shares, which were offered to retail investors at a €0.30 per share discount, closed their first day's trading at the institutional investor offering price of €14.41 per share. Finally, November saw the IPO of a 30 percent stake in **Société des Autoroutes Paris-Rhin-Rhone** (SAPRR) that was 13 times subscribed. This primary offering raised €1.31bn (US$1.70bn) for SAPRR, and the shares closed up 2.9 percent on the first day of trading. During his whirlwind tenure as France's Finance Minister during 2004, Nicolas Sarkozy also began preparing several major French SOEs (especially Gaz de France and Electricite de France) for ultimate privatization - though on terms highly favorable to the firms' existing workers.

Germany catches-up with the third and fourth largest European deals of the semester

The third largest privatization sale of 2H2004 was the sale by Germany of a large chunk of its public housing portfolio to international investors in early October. The private sale of 100 percent of **GAGFAH** raised €3.6bn (US$4.5bn). The secondary offering of a 4.67 percent stake in **Deutsche Telekom** by the German state-owned bank KfW, also executed during October, raised €2.97bn (US$3.72bn). This sale, the fourth largest privatization of 2H2004, reduced the German government's direct (26.1 percent) and indirect (10.4 percent) stake in DT to barely one-third. This was executed through an accelerated book-building operation at a price of €15.05-15.20 per share, which was a slight premium over recent trade prices of €14.95-15.03 per share. The German government also reiterated its desire

to fully divest its holdings in DT as rapidly as market conditions permit, so additional sales seem likely during 2005.

For a small country, Portugal has long punched above its weight regarding privatization, and it did so again in late November, when the state-controlled utility **Energias de Portugal** (EDP) executed a €1.2bn (US$1.5bn) capital increase. This sale of an additional 657mil shares increased the firm's total capitalization by 22 percent and was launched in order to finance EDP's acquisition of the Spanish utility group Hidroelectrica del Cantabria SA. Although the Portuguese government fully subscribed to the capital increase - and therefore the transaction does not qualify as a privatization according to the PB definitions - its holdings were to be reduced by a sale of a 5-5.5 percent stake back to the company. The issue was fully subscribed by investors. Intriguingly, only days after this offering closed and EDP acquired Hidrolectrica, the European Union rejected a plan for EDP to merge with Gas de Portugal on anti-trust grounds.

Table 1. Deals, 2H2004

Date	Company	Nation	Sector	Percent for Sale	Value of Transaction (EUR mil)	IPO	Direct/ Indirect Priv.*	Method of Sale
07/08/04	Pages Jaunes (France Telecom)	France	Tlc	35.68	1,460.39	y	Indirect	Public Offer
07/14/04	Blackpool Airport Ltd	United Kingdom	Transports	100.00	10.60	n	Direct	Private Sale
07/15/04	New Real SpA (ENEL)	Italy	Finance	100.00	1,395.82	n	Indirect	Private Sale
07/23/04	Fernwasser Sachsen-Anhalt GmbH	Germany	Utilities	100.00	21.50	n	Direct	Private Sale
07/23/04	Six Agricultural Farms	Hungary	Agriculture Industry	100.00	52.13	n	Direct	Private Sale
07/31/04	GSW (Bankgesellschaft Berlin AG)	Germany	Construction	100.00	1,923.87	n	Indirect	Private Sale
08/03/04	Forras Rt	Hungary	Finance	n.a.	15.93	n	Direct	Private Sale
08/17/04	Hellenic Petroleum SA	Greece	Petroleum Industry	8.21	194.87	n	Direct	Private Sale
08/19/04	Trustfin	Czech Republic	Services Industry	100.00	1.15	n	Direct	Private Sale
09/02/04	France Telecom SA	France	Tlc	10.85	5,085.24	n	Direct	Public Offer
09/13/04	SNET	France	Utilities	35.00	122.49	n	Direct	Private Sale
09/15/04	Kemira Fine Chemicals Oy (Kemira)	Finland	Manufacturing	100.00	70.62	n	Indirect	Private Sale
09/16/04	OKD	Czech Republic	Natural Resources	45.88	143.22	n	Direct	Private Sale
09/29/04	Total SA (Edf)	France	Petroleum Industry	2.30	2,593.97	n	Indirect	Public Offer
10/01/04	GAGFAH - Housing Portfolio (BfA)	Germany	Finance	100.00	3,640.02	n	Indirect	Private Sale
10/11/04	Deutsche Telekom AG (KfW)	Germany	Tlc	4.67	2,974.38	n	Indirect	Private Sale
10/20/04	Koninklijke TPG NV	Netherlands	Transports	15.20	1,500.96	n	Direct	Public Offer
10/22/04	ENEL SpA	Italy	Utilities	19.60	7,621.34	n	Direct	Public Offer
10/29/04	Belgacom	Belgium	Tlc	5.30	548.03	y	Direct	Public Offer
11/01/04	Snecma SA	France	Manufacturing	66.00	678.67	n	Direct	Private Sale
11/03/04	Sponda Oyj	Finland	Finance	14.80	76.53	n	Direct	Private Sale
11/03/04	MOL Rt - gas assets (MOL)	Hungary	Petroleum Industry	75.00	412.05	n	Indirect	Private Sale
11/05/04	Geopost Logistics Holding SA	France	Transports	100.00	12.07	n	Direct	Private Sale
11/08/04	BIAC	Belgium	Transports	70.00	352.11	n	Direct	Private Sale
11/08/04	TDF (France TELECOM)	France	Tlc	36.00	386.27	n	Indirect	Private Sale
11/10/04	PKO Bank Polski SA	Poland	Finance	38.50	1,810.13	y	Direct	Public Offer
11/11/04	National Bank of Greece SA	Greece	Finance	7.46	558.25	n	Direct	Public Offer
11/15/04	Azienda Elettrica Municipale	Italy	Utilities	8.80	267.08	n	Direct	Public Offer
11/24/04	Pekaes SA	Poland	Transports	n.a.	38.63	y	Direct	Public Offer
11/25/04	SAPRR	France	Transports	30.00	1,308.09	y	Direct	Public Offer
11/27/04	STM (Finmeccanica)	Italy	Manufacturing	10.30	1,441.50	n	Indirect	Private Sale
12/02/04	Telekom Austria AG	Austria	Tlc	17.00	1,068.27	n	Direct	Public Offer
12/08/04	TeliaSonera	Finland	Tlc	5.30	1,090.61	n	Direct	Public Offer
12/08/04	Slovenske Elektrarne	Slovak Republic	Utilities	66.00	840.00	n	Direct	Private Sale
12/09/04	Air France - KLM	France	Transports	18.40	679.81	n	Direct	Public Offer
12/20/04	Deutsche Telekom AG	Germany	Tlc	3.30	1,599.03	n	Direct	Private Sale
12/22/04	Edita	Finland	Manufacturing	n.a.	44.82	n	Direct	Private Sale
12/24/04	OGMA	Portugal	Manufacturing	65.00	8.52	n	Direct	Private Sale

* 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,* and *Securities Data Corporation*

The auction of BIAC is the largest European airport privatization

The largest airport privatization executed by a western European government during 2H2004 was the €735mil (US$950mil) auction of a 70 percent stake in Brussels' International Airport **BIAC (Zaventem Airport)** during late November. Australia's Macquarie Airports won the auction, and purchased 36 percent of Zaventem from the Belgian government and the remaining 34 percent from individual shareholders. The Belgian state plans to retain the "strategic" 30 percent stake indefinitely.

The €600mil (US$680mil) capital increase by Austria's **OMV Group** in early December was, in many ways, a repeat of the Energias de Portugal's offering one week earlier. The state-controlled (35 percent) Austrian oil and chemicals company launched this offer, plus an associated bond issue, in order to finance its acquisition of **Petrom**, Romania's largest oil company. OMV purchased the Romanian government's stake for €669mil (US$812mil), and also committed to raising its overall holdings to 51 percent by investing an additional €723-855mil (US$878mil-US$1.04bn) directly in the company. This means the total value of the Petrom deal could reach €1.524bn (US$1.85bn) if OMV invests the full amount proposed in Petrom. The acquisition was completed on December 14.

Rounding out Western Europe's privatization action for the second half of 2004 was the early November asset sale by France Telecom of its 36 percent stake in the wireless and multimedia company **TDF** to an international investment group. Although TDF's workers' council voted against the sale, it was completed by month's end. FT raised €386mil (US$502mil) from this divestiture, and is likely to book an €80-150mil capital gain on its investment in TDF.

Sales in New Europe

Poland successfully privatizes its most important bank PKO-BP, raising a tremendous amount of revenues for new accession country

By far the largest privatization deal in New Europe during 2H2004 was the secondary offering of a 38.5 percent stake in **PKO-Bank Polski**, Poland's largest bank. This heavily oversubscribed offering yielded the Polish government €1.81bn (US$2.35bn), and was the nation's largest privatization in more than four years. One quarter of the offering was reserved for PKO employees, with an additional quarter reserved for domestic retail investors. The other half of the offer was split between Polish and international institutional investors. The government offered purchasers a 4 percent discount in price, as well as a bonus share offer for investors who retain their shares for at least one year. PKO-BP's shares closed the first day's trading up 19.5 percent. After the sale, which included exercise of an over-allotment option, the Polish government's retained stake in PKO-BP fell to 51 percent. The success of the PKO-BP offering is itself a sign of how much stock market conditions changed during 2004, since the government had attempted to divest its holdings (through asset sales) in the company a number of times before without success.

Slovakia sells the majority of stock of its power (including nuclear) generator Slovenske Elektrarne to Italy's Enel

Rounding out Europe's privatization parade for 2H2004 was Slovakia's asset sale of a 66 percent stake in **Slovenske Elektrarne**, the country's dominant power generator, to Italy's Enel in mid-November. The Slovak government received €840mil (US$1,089mil) directly from the sale, and Enel promised to invest up to an additional US$1.9bn in renovating two coal-burning power plants and increasing production at a third, nuclear plant. The total value of

this deal could thus surpass US$2bn, though the final amounts will remain unknown for some time. Interestingly, Enel is prohibited from operating nuclear-powered plants in its Italian home market.

A glance outside Europe

Japanese electric utilities

Although Europe accounted for over half of worldwide privatization proceeds during 2H2004, governments in Africa, North America and especially Asia executed a dozen significant sales and raised over €10bn (US$13.1bn). Six of these sales raised at least US$1bn. The largest was Japan's IPO of **Electric Power Development Company**, popularly known as **J-Power**, in early October. The government sold its entire 100 percent stake in J-Power, and raised ¥375bn (US$3.38bn) for itself, in this pure secondary offering.

Canadian and Russian oil & gas sector

Two other governments - Canada and Russia - disposed of residual stakes in very large companies during 2H2004. Canada sold its remaining 19 percent holding in **Petro-Canada** for CAD3.2bn (US$2.5bn) in a SIP during October, while one month earlier Russia raised €1.61bn (US$1.99bn) by selling its residual 7.6 percent holding in Lukoil directly to America's ConocoPhillips. The Lukoil deal was actually the largest privatization in Russia's history, and came after President Vladimir Putin signaled his approval of the sale to ConocoPhillips two months earlier.

The Yukos affair

Unfortunately, any good will Russia might have earned with investors with the Lukoil deal was more than offset by the increasingly bizarre saga of its treatment of (vendetta against?) Yukos and the company's founder, Mikhail Khodorkovsky. Having earlier seized the principal assets of Yukos for alleged non-payment of taxes, the Russian government "auctioned" the firm's assets in a rigged bidding contest in mid-December. Since only hand-picked Russian bidders were allowed to participate, the auction raised a mere €7bn ($9.4bn), less than half what the company would fetch in a real auction. This farce reached its final *denouement* when the winning "bidder" was immediately purchased by the state-controlled company Rosneft, which itself is being merged with the mighty state-owned Gazprom - thus marking the effective renationalization of Yukos. Khodorkovsky remains in jail.

India's power generation

India also executed a politically significant privatization with its November IPO of a 10.25 percent stake in **National Thermal Power Corporation**. This pure secondary offering raised Rs54bn (US$1.2bn) for the Indian government and gave a much-needed boost to its ambitious, but heretofore flagging, privatization program. The NTPC issue was 11 times subscribed, and yielded an 11 percent first day return for the Indian government.

China, Morocco, and Thailand

Finally, three other IPOs raised relatively large sums during 2H2004. The largest was the December primary (capital raising) offering of 2.8bn newly issued shares in **Air China**, the country's flagship air carrier. This sale increased the shares outstanding by 31 percent and raised US$1.1bn for the company. Morocco raised €800mil (US$1.07bn) through its secondary offering of a 15 percent stake in **Maroc Telecom**. This represents a huge sum for such a small country, and the IPO was 21 times subscribed and yielded a 15.4 percent initial return for selling shareholders. Finally, Thailand executed an extremely well received offering of roughly half the

shares in **Thai Oil** during October. The total value of this issue was THB32.6bn (US$788mil), though all but US$66mil of these proceeds went to the company's creditors, including the state-owned Thai Military Bank. The first day return to Thai Oil shareholders exceeded 30 percent.

Two Norwegian deals in eleven days

Finally, Norway wins the prize for most opportunistic issuer of 2H2004 in that the government executed two sales of a combined 5.8 percent stake in **Statoil** in the space of eleven days during July. The state sold a 4.6 percent stake on July 7 in an (apparent) ABO that raised NKr8.43bn (US$1.24bn). Lehman Brothers purchased the shares from the state at a 4.5 percent discount to their closing price of NKr88.50 per share the previous day, and immediately resold the shares for NKr85.00 each to institutional investors in Europe and the U.S. Once this offering became known, Statoil shares fell by 4 percent. Undeterred, the Norwegian government soon thereafter executed a weeklong offering of Statoil shares targeted at individual investors. A total of 7,344 people purchased shares - some in lots of 10,000 - and the state raised a total of NKr1.4bn (US$162mil) from this second offering. Combined, the two sales reduced the Norwegian government's holdings in Statoil from 81.7 to 74.34 percent.

John Nellis

Center for Global Development, Washington DC, and International Analytics, Bethesda – MD.

Privatization in Transition States: A Brief Assessment

Introduction

Privatization is controversial in post-socialist countries as the community has a conflicting perception of the process

Of the many changes in public policy in post-socialist countries, none has generated as much controversy as privatization. No other issue has been subject to such dramatically differing interpretations by analysts, journalist observers and the public at large - concerning its desirability or necessity, the manner in which it was carried out, and its impact. In the past decade a large "disconnect" has arisen worldwide, but particularly in these "transition" countries. Economic and financial assessments generally conclude that privatized firms exhibit increased efficiency, profitability and returns to shareholders. The majority of affected citizenries are unimpressed; they associate privatization with lost jobs, higher prices and shady deals promoting the interests of foreigners, the well-connected and the outrightly corrupt. Disaffected populaces may overlook some economic gains, but their perceptions count politically. For recent example, Viktor Yuschenko rallied considerable support in the momentous 2004 elections in Ukraine by repeatedly denouncing the privatization of the huge *Krivorizhstal* steel mill, claiming that it was improperly sold, at a heavily discounted price, to a consortium that included the son-in-law of the country's president. The allegation fell on highly receptive ears.

What are the key issues?

What has actually happened in privatization in post-socialist countries? Has the process been beneficial or detrimental to economic growth and social progress? Why has privatization been so contentious? To answer these questions, one needs, first, to review the evolution of viewpoints on the importance and centrality of privatization in countries rejecting central planning; second, to examine how much and what sort of privatization has taken place; and third, to assess the evidence on the economic, financial and social effects of ownership change. Only then can one offer a summary judgment. Attempting all this in a short note necessitates bold generalizations.

Initial conditions

"Privatization is the transformation itself..."

At the outset of the transition many indigenous reformers argued that privatization was much more than an option or a possibly desirable policy. The view presented below is that of a Czech, but it was shared by reformers in Germany, Russia, Estonia, Hungary, Poland and elsewhere.

> *«Privatization is not just one of the many items on the economic program. It is the transformation itself. Without a well-defined and feasible privatization strategy the program would become just another hopeless attempt to reform the unreformable...privatization must be conceived of and viewed as an end in itself.»* (Triska, 1992, 104)

This assertion had four roots: One, the massive number of firms and the high percentage of productive capacity in state hands. Two, inside socialist enterprises, a pervasive mentality of dependence on the state for guidance, inputs, finance and markets. Three, the fear that the communists might regroup and attempt to reacquire control of the state. Four, the daunting mechanics of transferring ownership in countries where the citizenry possessed neither the resources to buy firms nor the skills to run them; but where years of socialism had inculcated the notion that the assets really belonged "to the people."

Fast privatization was needed

The large number of firms led reformers to seek *speedy methods of sale or transfer*. The concern was that ownership change would take centuries if one used the methods applied in OECD countries, that divested fifteen firms a year, when the sector contained three, eight, fifteen thousand or more potentially privatizable entities.

The choice of mass privatization through vouchers

The need to combat the dependency mentality and at the same time build barriers to the return of the communists pushed reformers to adopt *mass privatization* aimed at spreading ownership widely and deeply into society. The idea was that to build capitalism one needed lots of capitalists, and fast, both to put the assets back to productive work, and to create a group willing to fight for and sustain the transition. In retrospect it is easy to see that communism was so discredited that its adherents never really had much of a chance of regaining political control, but that was not at all obvious in the early 1990s. The fear that the window of opportunity might be closed led reformers to opt for rapid and massive ownership change.
The issue of how to promote local ownership led to the principal technical innovation applied in privatization in transition countries: the use of *vouchers*, freely (or cheaply) and widely distributed, that gave masses of ordinary citizens the means to obtain an ownership stake in the privatized firms.

The process is launched

Privatization becomes a consensus policy endorsed by International Financial Institutions (IFI)

Based on these calculations, reform teams in Russia, the Czech Republic, Estonia, Hungary and, eventually, just about every other transition country touted privatization's necessity, predicted that its application would yield large and immediate benefits - Anatoly Chubais, head of the Russian privatization program, famously predicted that the Russian voucher would shortly be equal in value to a Lada car - and set to work divesting state assets as rapidly as possible. External economists mostly followed suit. By the mid-1990s, it was hard (though possible) to find external observers who were not enamored of privatization. The World Bank, International Monetary Fund and the European Bank for Reconstruction and Development viewed rapid and mass privatization as a *sine qua non* for their support, strongly endorsing the process in their documents, pronouncements and conditionality.

In five years the process gathers pace…

Country after country thus embarked on ambitious privatization programs, many with IFI support. Between 1990 and 1995 the post-communist economies transferred to private hands somewhere in the neighborhood of 50,000 firms. More firms were divested in the small (population 10mil) Czech Republic alone than had been privatized in the rest of the world

…especially in the Czech Republic, the former East Germany, and Russia

combined since the launching of the process in Britain in the late 1970s. More than 8,000 firms were privatized in the former East Germany, about 15,000 medium- to large-sized companies in Russia, and, even a country as remote and removed from the market as Mongolia managed to privatize 4,500 business units, using vouchers.

Other methods of sale are gradually introduced. Tenders and direct negotiations are used in order to sell high potential firms

Voucher privatization was not the only method used. For example, Czech authorities held a set of large, high potential firms (e.g., breweries, the car industry) out of the voucher program and sold these by tenders and direct negotiations. The Slovak program, originally indistinguishable from the Czech, shifted exclusively to direct sales in its second phase, following the 1992 peaceful dissolution of the previously united state. Hungary, East Germany, Estonia and latterly Poland eschewed (in the main) the use of vouchers and concentrated the bulk of their efforts on finding core purchasers. A number of countries farther south and east, concerned about the workability of vouchers and not seeing much appetite on the part of investors for direct sales, turned to MEBOs, i.e., management/employee buyouts. The Russian voucher program gave so many incentives to managers and workers - "insiders" - that it could more correctly be termed a MEBO/voucher combination. Using all these methods, with voucher sales leading the way, an enormous number of firms and amount of assets was transferred to private hands in a remarkably short time.

First results and deepening doubt

Optimism about rapid privatizations spread until the first half of the 1990s…

At the outset, optimism ran high. It was assumed that the rapid sale of thousands of East German firms to (mainly) West German investors would quickly produce good results. In the early 1990s, the Czech Republic combined a mass voucher scheme with low inflation and miraculously low unemployment; rapid privatization appeared to contribute to these achievements. The Russian voucher program was generally well implemented, and observers predicted rapid restructuring and a return to growth in the 15,000 firms divested in this program. Poland's mass privatization program for large firms stalled for political reasons, but it was assumed that it would quite quickly come on line and add to the robust private sector activity seen in the country, which stemmed from new entrants and the generally successful privatization of small business units.

…however expected benefits fail to materialize and doubts on privatization multiply under the shadow of corruption, unfair implementation and the overall context of economic decline

But starting in 1995 and becoming more evident in 1996, as economic decline or stagnation persisted, as the promised return to growth failed to materialize, as more and more evidence of corruption, fraud and official chicanery in privatizations surfaced, as foreign and minority shareholders found themselves unable to exercise their ownership rights, or learned that the worthwhile assets had mysteriously been siphoned out of their firms and they were left with a mass of liabilities, as numerous sales of highest potential remaining firms went forward in clearly non-transparent ways (most blatantly in Russia), doubts on privatization surfaced and multiplied.

The social side of the problem was most evident: even in some of the less corrupt settings privatization often degenerated into a "two-sided grab fest by fund managers and enterprise managers" (Ellerman, 1998, 11, describing the Czech situation); and the farther east one traveled the more obvious the

corruption and the poorer the results. The negative public perception of privatization began to grow.

The high (and social) costs of privatizations in these countries probably represent the unavoidable price that had to paid to get transition economies into the market system

Nonetheless, despite unfair implementation, the extraordinary enrichment of a very few, and the disappointment of most voucher holders, privatization could still be defended. If new private owners, no matter how they acquired the assets, were quickly restructuring the firms, increasing the efficiency in the use of resources and positioning them to survive and thrive in the competitive markets in which they now had to operate, then one could argue - and a number of analysts have so argued (e.g., Shleifer and Tresiman, 2000, discussing Russia) - that the unjust initial distribution of state assets was the regrettable but unavoidable price that had to be paid to get these economies into, or back into, the market system. Thus, the key economic, as opposed to political or legal, questions were: Is privatization contributing to overall economic performance? and, How are new private owners performing?

Making sense of the empirical record

Strong privatizing countries now have the region's highest private sector percentages of GDP activity and the best records in attracting FDI…

At the aggregate level, taking the transition states as a group, there is a strong correlation between the total amount of privatization carried out and the rapidity and strength of the return to growth; that is the overcoming of the output drop that inevitably followed the rejection of central planning. The strong privatizers - e.g., the Baltic states, the Czech Republic, Hungary, Slovakia, and to a lesser extent, Poland and Slovenia - now have the region's highest percentages of GDP accounted for by private sector activity and the best records in attracting direct foreign investment - both, but especially the latter, linked to privatization. Moreover, they have seen the best rebounds in production and highest growth rates of GDP per capita (EBRD, 2004).

…while farther east and south countries accomplished fewer or more troubled privatizations.

However, outcomes vary according to the location of the country in the transition region. Countries in Southern and Eastern Europe and Central Asia have, compared to their Central European neighbors, suffered deeper and more prolonged production declines and macro-economic instability. They have also accomplished either fewer, or more troubled privatizations (or both), in terms of finding good new owners who initiate and carry through the needed restructuring, and the degree of transparency of transactions. A plausible explanation is that meager and poor privatization has contributed to their general economic malaise - but many think that these privatization woes are indicative symptoms rather than the cause of general economic problems. Why?

Institution-building is key

Experience shows that there is a set of "institutional underpinnings" to the market - property rights; enforceable contracts, or, more generally, court decisions that are timely and based on the law, not payments or social precedence; regulatory agencies that deliver timely, law-based decisions that are reasonable and credible for both investors and consumers; a public administration that meets modicum standards of predictability, competence and probity. Countries with such an institutional base are more attractive to investors and manifest more and better privatization transactions. These market-supporting legal and economic institutions (or the ability to create and sustain them) are clearly more prevalent in countries closer to western

markets. Thus, ownership matters; but so do a daunting number of other factors drawn from geography, history, economic policy, and culture as well.

The successful case of Estonia

To illustrate, extensive privatization in Estonia certainly contributed to the country's relatively rapid and robust transition. But Estonia possessed a number of characteristics in addition to a commitment to privatization - geographic location, a heritage of commercial contacts with the West, a historical familiarity with capitalist laws and legal systems; an unusual degree of openness towards foreign investor/owners (as long as they were not Russian); choice of the German model of privatization and acceptance of substantial German technical assistance to help in implementation - that heavily affected privatization's, and the economy's success. The point is that the association between privatization and overall economic performance is a complex two-way flow.

Privatization contributed to the restructuring of firms, and positively affected their efficiency and financial operating performance…

At the level of the firm, the issue is somewhat easier to analyze, but the conclusions have shifted over time. The early interpretation (a la Triska, above) was that any and all forms of private ownership would be superior to public management. And the first few empirical studies in Central European countries (e.g., Frydman *et al.*, 1997; Pohl *et al.*, 1997) did find positive signs of restructuring, increased efficiency and financial improvement in privatized firms, as opposed to continued problems in companies retained by the state.

…but exceptions abound in the east and south

However, analysts could not at first find these positive results in countries farther east or south. Several studies based on pre-1995 data in Russia, Armenia and Georgia (see Djankov and Kreacic, 1998), for example, found few performance differences between privatized and state-owned firms. These results could be discounted on the grounds that it was still too early to reach definitive conclusions. More troubling, however, were follow-up investigations in a few central European settings that disputed the early glowing reports in these countries. And several additional factors emerged that further diluted enthusiasm for rapid, mass, voucher-led privatization.

Counterfactuals

These included:

- Poland had a surge of growth in the mid-1990s, without mass privatization, leading many to question the importance of ownership change (see Pinto and van Wijnbergen, 1995);

- Transparency problems and signs of weak post-privatization restructuring emerged, especially in countries championing the voucher approach (e.g., Russia, the Czech Republic, Slovakia, Lithuania, Mongolia);

- Estonia and Hungary evidenced good privatization to strategic investors, and overall economic progress, without the use of vouchers.

A deeper understanding is needed, but small privatized companies are restructured, SOEs are not

All this led to a deepening of the inquiry, away from a focus on ownership change in general and toward the question of whether differing methods of sale produced different types of owners, and led to differing degrees of success.

Later studies (many summarized by Djankov and Murrell, 2002) found that almost all forms of privatization produce restructuring results superior to

those seen in state-owned firms. Even mass privatization through vouchers, so out of favor by the end of the 1990s, has found defenders; recent research concludes that if the choice is between continued state-ownership or mass privatization through vouchers, the latter is the better option. (Bennett *et al*., 2004)

Large shareholders are the best choice…

Still, privatization producing core, concentrated owners is the "first best" choice. It yields better results, in terms of faster and deeper restructuring, than methods that diffuse ownership widely to workers, or citizens at large, or the "insiders" - workers and managers - in the firm. Countries that are able and willing to install high quality new owners obtain superior efficiency and equity outcomes. Moreover, these results hold when they are corrected for "selection bias."[1]

…especially foreign investors

A corollary finding is that there is usually a performance premium when the firm is sold to a foreign investor/owner. For example, the Czechs find that the firms held out of the voucher program and sold to strategic, often foreign investors, outperform by a variety of measures those transferred to domestic owners (Peter, Svejnar and Terrell, 2004).

These conclusions are both encouraging and discouraging for proponents of privatization. Encouraging in the sense that one sees clear firm- and societal-level gains:

When privatization works…

When the property rights of market actors receive a modicum of protection; meaning that the privatization transaction has a good chance of being correctly conducted, thus increasing the likelihood of attracting new owners with the skills and resources necessary for the restructuring of the firm, and providing them with the incentives and environment to put these resources to work.

This is now largely the case in Central Europe, the Baltic states, a few parts of the former Yugoslavia, and, to a lesser but growing extent, in Romania and Bulgaria. In these countries, privatization, despite some flaws and errors, has proved its worth.

…and when it does not work

The discouraging aspect is that an important subset of the transition economies - mainly in countries farther east - still lack the institutional base that improves transaction quality, and attracts the desired sort of investor. For these countries the prescription is: Prior to privatizing, improve your investment climates and "get your institutions right." But this is not at all a simple matter. The regrettable fact is that there are no simple or quick ways to create or reinforce the needed institutions. Save in exceptional circumstances (one important instance noted below) they evolve slowly, more from deep-rooted societal causes than from external or governmental interventions. This has led one knowledgeable expert to conclude: "over time the development paradigm has shifted from "get your prices right" to "get your institutions right"; the latter instruction has proved as useless as the former." (Shirley, 2003)

Conclusions

Privatization is a fact of life in Central Europe

In Central Europe, privatization is far from popular, but it is an accepted and irreversible fact of economic life. Clearing up the moral debris from the messy allocation of state assets has taken time and effort, but the scandals will eventually fade. The obligation of these countries to adopt the EU institutional framework will assist them, by providing the public with assurances that remaining divestitures will be properly carried out.

In the countries of the former Soviet Union, privatization outcomes are more ambiguous, and anti-privatization arguments are gaining ground

It is in the countries that were once part of the Soviet Union (minus the Baltic countries) where the ultimate outcome is less predictable. Most of these states still own a large amount of assets. The ambiguous results of their early privatizations have led many workers, officials and some few intellectuals (foreign as well as domestic; see Stiglitz, 1999) to support the maintenance of state ownership - or at least the continued heavy involvement of the state, particularly in the fields of utilities and transportation, oil and gas (witness the December 2004 effective renationalization of Yukos oil in Russia), and banking and finance. The anti-privatization argument is as follows: ownership change in these settings should (some say temporarily; others indefinitely) take a back seat to building the institutional foundations of a market system. Rather than hurriedly privatize, most probably to a criminal few, better to tolerate and subsidize the inefficient state sector. In the interim, policy should emphasize building institutions, strengthening competitive forces, and enlarging the private sector not through privatization, but by encouraging new entry. In this manner, institutionally-weak countries can move gradually to a market system without paying too high a price in terms of heightened corruption, increased inequality of wealth and income, and massively increased societal cynicism.

This approach is appealing, particularly in countries where EU membership is either a distant hope or an impossibility. It suggests that errors once perceived can henceforth be avoided, and it promises medium-term economic progress with minimal imposition of short-term political pain.

Alas, the obstacles to carrying out the approach are numerous and large.

- Without the spur of EU entry, their creation could and probably will take many years.

Inaction is expensive, especially regarding reform of utilities

- Under financial pressure many countries have raised prices for the products of state-owned utility firms to the point where they cover variable costs. But revenues are still insufficient to allow for repair, modernization and expansion of the networks, the needs for which are massive. Tapping private capital markets is the solution; for this to happen, normally, private owners or partners are required.[2]

The longer the delay in reform, the greater the political opposition to enactment

- Part of Poland's recent economic difficulties is due to the persisting financial dead weight of a number of large loss-making state firms that were not privatized in the early 1990s, during the heady period of "extraordinary politics"[3] when much was possible. What the public and unions may have accepted in 1991, they adamantly reject in 2004. Adjustment postponed is pain compounded.

Sometimes delays are strategic

- Perhaps most important, many of those advocating gradualist reform and continued state-involvement do so not out a desire to minimize pain and

build institutions, but rather as a pretext to protect their political prerogatives and economic rents. The same governments that privatized poorly cannot reasonably be expected to make a success of fundamentally reforming firms under continuing state ownership.

These factors do not "prove" the impossibility of the successful application of a gradualist approach to enterprise reform in institutionally weak settings. But they do persuade one of how difficult and lengthy the process would be.

The conclusion is that in most countries there is little alternative but the continuing pursuit of privatization. True, there are a number of minimally reformed transition states - e.g., Azerbaijan, Belarus, Uzbekistan - where it is difficult to think that acceptable transactions can occur under any circumstances; where one might argue that it is better to allow bureaucrats to continue to misuse the flow from state firms than hand over the entire stock to criminals. At least, according to this argument of despair, when and if reform arrives, there might still be something left to sell.

Our argument is just the reverse: Better to place the assets in the hands of people with incentives to use them for profit, rather than leave them under the control of officials with no interest in the long-range health of the firm. Then, when and if reform arrives, there will be an entity left worth taxing.

Thus, privatization should continue. Certainly in a more careful and cautious manner; certainly with additional attention in infrastructure firms to building regulatory mechanisms prior to the change of ownership; certainly by making all possible efforts to put core, experienced owners in charge of the firms; certainly by expanding the use of externally-supplied institutional surrogates such as IFI guarantees and off-shore arbitration; certainly, in sum, by taking all possible steps to enhance transparency and good practice in corporate governance. However, the lesson of experience is that one cannot wait for the arrival of institutional perfection before changing ownership. While new private owners proved not to be a sufficient condition for the transition, they remain a necessary one.

Notes:

[1] "Selection bias" refers to the possibility that it is not privatization that produces good performance in a firm, but rather that only the high potential firms get privatized. Ruling it out is a major methodological issue in assessments of privatization.

[2] In September 2004 Citicorp agreed to lend US$300mil to the corporatized Russian state-owned railway corporation, showing that it is possible for state firms in risky settings to tap private capital markets. However, the company is not just an unusual but an absolutely unique Russian state-owned firm. It is the only one that has earned a risk rating from a Western rating agency, based on a thorough revamping of its management structures and financial procedures, including its accounting and auditing systems and reports to shareholders. Reform can happen under state ownership; but it is, so far, a great rarity.

[3] A term invented by the former Minister of Finance of Poland, Leszek Balzerowicz.

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Massimo Pappone, and Giacomo Ciampolini

Goldman Sachs International

From marketed offerings to accelerated transactions - and back! The Enel case

Introduction

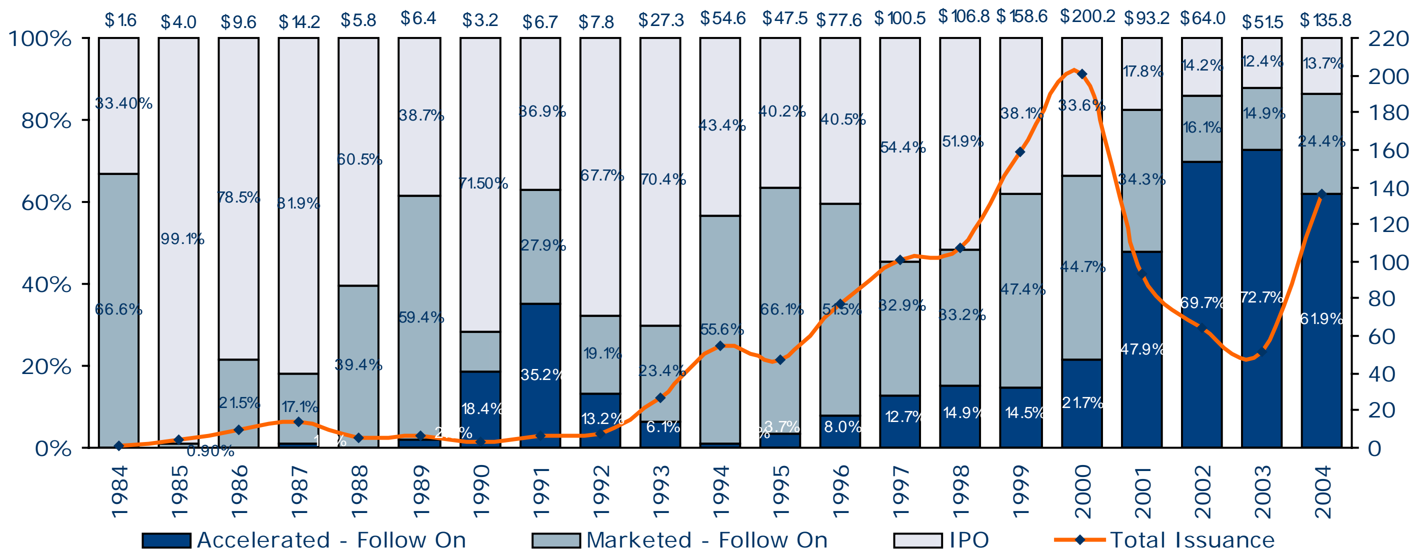
Accelerated transactions have gained the lion's share in equity issuance as response to bad market conditions

Equity capital markets have been particularly volatile and often difficult for issuers during the past four years. This had consequences not only on the overall level of issuance in the market (US$52bn of total issuance in 2003 vs. US$200bn in 2000), but also on the methods followed by issuers and shareholders to sell shares on the market. For many years the traditional methodology used to place a large stake in a company, both through a capital increase and the sale of secondary shares, has been the marketed offering, addressed to both institutional and retail investors. Following the collapse of the equity markets in 2000 and the subsequent increase in market volatility, with the Volatility (VIX) index raising from 21 percent in March 2000 to 45 percent in August 2002, the trend has changed significantly, with selling shareholders privileging faster transactions, often with a minimum price guarantee by the underwriters: Accelerated Bookbuilt Offerings ("ABO") and Block Trades.

ABOs and Block Trades

ABOs are transactions where the underwriting banks build a book of demand in a short period of time and price and allocate the transaction at the end of the process, while Block Trades are transactions where the syndicate banks buy shares from the selling shareholder(s) at a fixed price and then proceed to redistribute them to investors, taking full price risk during the process. These deals are sold exclusively to institutional investors and usually executed in one or two days versus the one to three weeks of bookbuilding for traditional marketed offerings.

Figure 1. Equity Issuance in European Stock Markets (US$bn)



Source: *Equityware*

This important trend has affected not only corporate issuers, but, more specifically, European Governments in their privatization efforts, as it is highlighted in the following table which shows, over the past 20 years:

- the breakdown of European equity issuance (excluding rights offerings), in terms of IPO/marketed follow-on/accelerated follow-on offerings

- the same breakdown for European privatizations.

Starting from 2001 privatizing governments have been largely involved in accelerated transactions

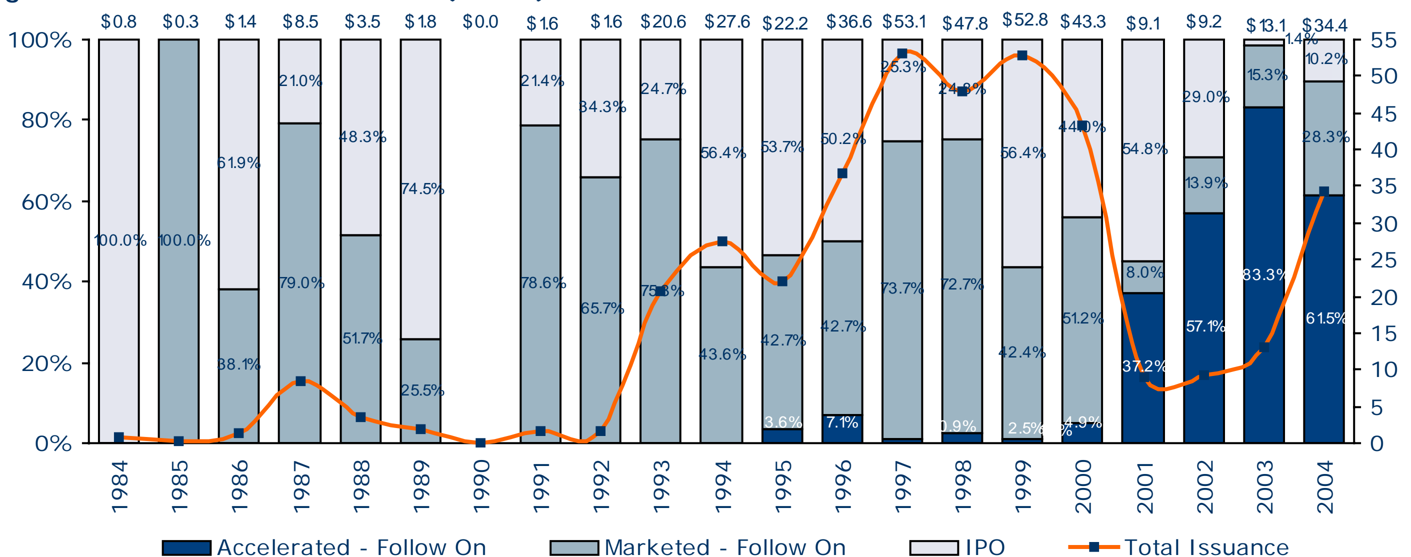
From 1984, date of the British Telecom privatization, to 2000, the record year for European equity issuance, accelerated transactions (including ABOs and Block Trades) represented less than 20 percent of the overall volumes (with the exception of 1991 when the Allied-Lyons and Elsevier block trades brought the percentage to 35 percent) and less than 10 percent of all privatizations. In 2001 the unstable market conditions, and the subsequent willingness to reduce the level of market risk, which is implicit in the fully-marketed transaction, started favoring accelerated transactions, which represented almost 50 percent of overall market issuance. Governments, though, did not start using this execution methodology aggressively until 12 months later, but embraced it entirely, so that in 2003 83.3 percent of privatizations were executed through accelerated transactions (while in the same year accelerated offerings represented 73 percent of all European equity issuance). Since 2001 until Enel 3, over €41bn of privatization offerings have been executed through ABOs and block trades, versus €4bn sold through marketed offerings.

Accelerated transactions vs. marketed offerings

The key differences between accelerated and marketed transactions

Speed of execution and subsequent market risk exposure are not the only key differences between accelerated and marketed transactions. Significant differences also exist in terms of: i) preparation time and documentation; ii) management involvement; iii) investor base; iv) size achievable; v) price obtained; vi) aftermarket behavior.

Figure 2. Share Issue Privatization (US$bn)



Source: *Equityware*

In particular:

A leaner due diligence such that deals are slated in few days

i) Preparation time and documentation: Marketed offerings generally require a prospectus to access retail investors. Preparation of the documentation necessary to launch the deal is based on extensive due diligence on the company, its business, financials and business plan and requires an offering circular. Depending on specific conditions, preparation generally requires a period ranging from 5-6 weeks (without a retail component) to 3-4 months (if stock exchange and regulatory approval is also needed). Large privatizations also involve several banks at different levels and legal documentation is extensive. On the other hand, accelerated offerings are addressed exclusively to professional institutional investors which rely only on publicly available information to make their investment decision; legal documentation is leaner and preparation time can be less than one day.

No road-show is needed

ii) Management involvement: Management involvement in marketed offering is much more intense. Aside from the time required to address underwriters' due diligence, develop the equity story and prepare the offering circular, as well as the other documents needed, one of the most relevant features of a marketed offering is the management roadshow during the bookbuilding period, which absorbs one to three full weeks of management time (generally 2-3 weeks for privatizations). The roadshow allows to broadly market the equity story of the company and to highlight any developments and future plans that could lead investors to buy into the company at the time of the offering. In accelerated transactions, management involvement is usually completely absent or limited to a few phone calls with investors during the day in which the deal is marketed.

Shares are targeted to institutional investors only

iii) Investor base: Marketed offerings generally target both a broad number of institutional investors and the retail investor base, while accelerated transactions are distributed exclusively to professional institutional investors and often to a limited number of them. Within the broad category of institutional investors, accelerated offerings, given the very short bookbuilding period, favor hedge funds and long money institutions which are characterized by a fast investment decision process and a lean structure. Pension funds and institutions with slower decision making and internal authorization process are often not involved in ABOs and Block Trades.

Deal size matters…

iv) Size achievable: Although there are no theoretical limitations in terms of size achievable through an accelerated offering, the largest transactions ever executed are still in the €5bn region versus the €10bn or more often achieved with marketed offerings. This is due mainly to the fact that for transactions larger than €3 - 5bn the investor base capable of reacting sufficiently fast to allow the success of an accelerated offering starts being a constraint. In fact, accelerated offerings larger than €3bn have been executed successfully mostly for large, liquid stocks with a solid investor base and a very well globally known equity story such as: Vodafone (€130bn market capitalization), France Telecom (€58bn market capitalization) and Royal Bank of Scotland (€77bn market capitalization).

Limited underpricing is often necessary, but banks often take full price risk

v) Price obtained: Accelerated offerings are usually priced at a discount to the previous day's close or, at best, at market (with a few exceptions). In Block Trades the price to the seller is certain before distribution to investors begin. In ABOs, although there is a bookbuilding process, sellers often ask

to the syndicate banks for a minimum price guarantee. Although the relative certainty of price offered by accelerated transactions is clearly an advantage, these type of offerings don't allow issuers to profit from a potential improvement in stock price during the marketing period.

The number of shares is fixed beforehand (no green shoe) in order to minimize negative prize impact

vi) Aftermarket behavior: Marketed offerings often include an over-allotment option that allows syndicate banks to stabilize the stock price in the immediate after market according to the relevant market regulations. This is theoretically possible also in accelerated transactions, but extremely rare as it requires increasing the numbers of shares to be distributed at the time of the offering. In addition, during the bookbuilding period of marketed offerings the share price has the time to adapt to the level at which the market is ready to absorb the offering, while the speed of accelerated transactions sometimes leads to a negative aftermarket performance, when deals are priced or sized too aggressively.

Uncertainty drives the choice of faster transactions, but public (marketed) offerings are striking back

Taking into account all the differences outlined, the table below highlights the different key objectives which are met by the two types of offerings, both in the context of privatizations and in general terms: this explains why ABOs and Block Trades have become significantly more frequent since 2001: accelerated transactions have become a favorite in markets characterized by low retail support, high price volatility and significant uncertainty. The ability to take advantage of a positive market window and surprise the market by selling a stake with limited price risk outweighed the advantages granted by marketed offerings. Although this is likely to remain true for most corporate issuers in the near future, on the other hand governments often have a different set of objectives, also with respect to retail investors, which could favor a comeback of marketed offerings for executing privatization transactions.

This is particularly true following the success of the largest and most successful privatization of 2004: the €7.6bn Enel follow-on offering.

Table1. Objectives of Marketed vs Accelerated Transactions

Marketed Offering	Accelerated Transactions
- Maximize size achievable by tapping all available institutional and retail demand	- Speed of execution
- Expand investor base	- Certainty of proceeds
- Increase knowledge of the equity story	- Minimize management involvement
- Profit from the potential positive price action during bookbuilding	- Confidentiality
	- Low costs

Enel case study

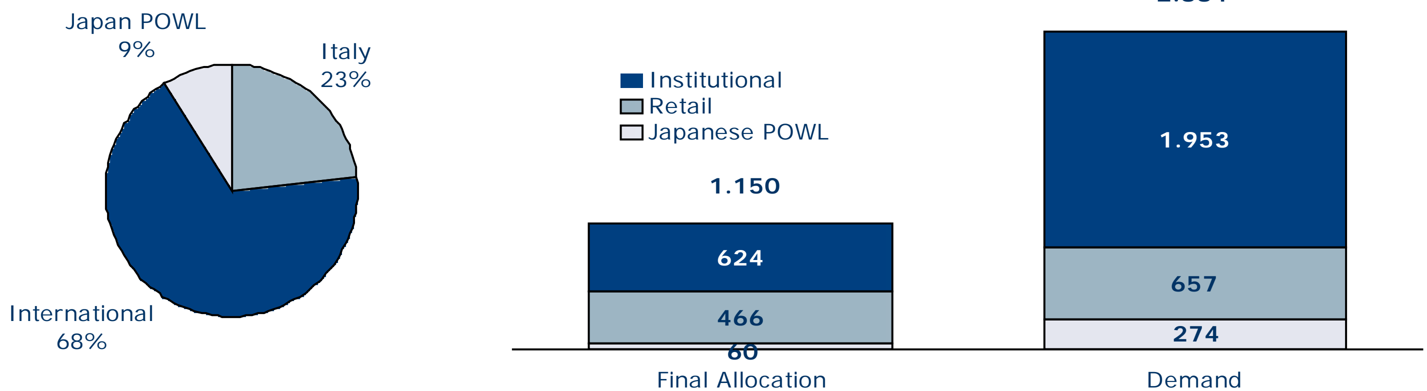
An electricity giant is put on sale

The initial public offering of Enel in 1999 was a landmark €16.6bn transaction and it is to date not only the largest privatization, but also one of the largest equity offering globally. In 2003, when the Italian Ministry of the Economy and Finance ("MEF") decided to sell an additional stake of Enel to reduce its stake to just above 50 percent, speed of execution, certainty of proceeds and a relatively small targeted size (6.6 percent of the company or €2.2bn) pointed the MEF in the direction of an accelerated transaction. The block trade was executed on 30 October at a 0.18 percent premium on the closing price of the previous day, a very tight pricing for a transaction of this size. In 2004, the MEF decided to sell an additional stake of Enel, but this time both objectives and market conditions were different: the MEF wanted to maximize demand for the offering in order to reduce its stake to 30 percent, selling 20 percent of Enel (or approximately €7.5bn) in one single transaction. The MEF objective was challenging, as the contemplated transaction would have been the largest deal executed since the €12bn Deutsche Telekom follow-on and the €9bn Telia IPO in 2000. It became immediately apparent that an accelerated transaction of the size planned would have stretched the potential investor base to its limits and may have required a significant pricing discount. The MEF decided therefore to opt for a marketed offering, also in light of the success of the June 2004 €1.7bn IPO of Terna (a subsidiary of Enel) which generated retail demand in excess of €1bn from more than 200,000 retail investors, demonstrating resurgent demand from this category of investors for companies with the appropriate equity story.

Pricing at market

The decision proved extremely successful: Enel 3 was successfully priced on October 25, 2004 at €6.64, a 0.31 percent discount on the previous day close and a 1 percent premium on the price at the date of announcement in August. Compared to an average discount of approximately 3 percent on the announcement date for accelerated transactions larger than €1bn over the past two years. The deal was 2.5x oversubscribed with €19.2bn of demand generated by institutional and retail investors. Retail in particular was a great success compared to other recent transactions in Italy: total retail demand was more than €4bn from over 650,000 investors. The following table highlights a breakdown of demand for the offering.

Figure.3 Institutional Allocation Breakdown at 6.64* **Demand at €6.64 (mil shares)**



*Overall demand figures and geographic allocations as reported to Consob in accordance with Italian regulation.
Japanese POWL = Public Offering Without Listing

In the aftermarket Enel performed very strongly: it was up 2.5 percent on the first trading day post pricing and 4.9 percent after 1 month versus a performance of -1.1 percent and 4.6 percent of the reference S&P/MIB index.

Market conditions aside, there were several structural characteristics of the offering that helped its success and confirmed that a marketed offering can be the optimal choice given certain requirements and objectives:

Broad targeted investor base

The MEF and the syndicate banks decided to address the broadest possible investor base by aiming the offering to Italian retail investors, Italian institutional investors, International institutional investors through a RegS offering, US Qualified Institutional Buyers ("QIBs") investors through a 144A offering and, for the first time for an Italian company, Japanese institutional and retail investors through a Public Offering Without Listing ("POWL"). The POWL proved to be particularly successful, generating demand in addition of €1.8bn or approximately 10 percent of total demand.

Strong equity story

Enel's equity story was appealing to both institutional and retail investors. High dividend yield (also through a special dividend), a successful restructuring story, favourable exposure to the high cost of oil and a favourable competitive environment for electricity in Italy attracted investors in Italy and abroad. Retail was particularly attracted by the high dividend yield, which also included the dividend to be paid out in November 2004 following the Terna disposal earlier in 2004.

Strong marketing campaign

The syndicate banks and Enel management were involved in a very broad and intensive retail and institutional marketing campaign. Prior to the launch of the offering the syndicate banks had in excess of 100 face to face meetings and 700 contacts with institutional investors in 10 countries, with the objective to educate them on the equity story of Enel. During the three weeks of bookbuilding Enel's management, divided in two teams led by the CEO Mr. Scaroni and the CFO Mr. Conti, met in one-on-one meetings with approximately 130 investors and with hundreds more during several lunch and breakfast presentations around the world.

To ensure maximum success also to the retail offering, Enel's management spent three days of the roadshow presenting to the retail network representatives of all major Italian banks, in order to ensure that the equity story was well understood and communicated in every branch.

Retail incentives

The structure of the retail offering and an effective use of incentives also contributed to the success of the transaction. The retail tranche was divided in five different sub-tranches: general public, large orders (or "lotto maggiorato", with a minimum order size equivalent to 10 times the standard order), current shareholders, IPO shareholders, employees. The innovation of this transaction was the tranche reserved to IPO shareholders: in order to qualify for the preferential treatment an individual had to have bought shares in the IPO and retained them long enough to receive the bonus share awarded following the IPO; given the type of investor the Enel stock appeals to, this category included more than two million people. The different retail categories received different type of incentives in terms of bonus shares, in both cases should they hold their allocation for more than 12 months: employees and IPO shareholders received bonus shares in a 8 for 100 ratio, while other retail investors received bonus shares in a 5 for 100 ratio.

The differentiated bonus share approach made the IPO shareholders' tranche the most successful, representing more than 40 percent of overall retail demand from in excess of 350,000 people.

The syndicate is strengthened

Given the size of the transaction the MEF decided to strengthen the IPO syndicate, originally led by Mediobanca and Merrill Lynch as Joint Global Coordinators and Joint Bookrunners, by adding Goldman Sachs and Morgan Stanley as two additional Joint Bookrunners. The increased number of bookrunners allowed the syndicate to target the broadest possible number of investors, therefore maximizing distribution power.

As a further testament of the success of the transaction, Enel's follow-on offering won the IFR award for European Equity Issue of the year 2004 with the following motivation: "Most years see one truly market-defining trade. For European ECM in 2004, that trade was unquestionably the third sale of Enel shares be the Italian Government. Not only was it the year's largest equity deal anywhere in the world, but it proved that retail buyers had returned to the equity markets with a vengeance."

Conclusions

The experience of the past three years has showed the usefulness and advantages of accelerated offerings to issuers. Nevertheless, this type of transaction does not provide the ideal solution to every situation. Enel's success proves that in certain circumstances a well structured marketed offering can allow sellers to achieve size and pricing superior to accelerated transactions. Several other Governments, including the German one for Deutsche Telekom and Deutsche Post have already announced that they will consider again marketed transactions for their privatization programs.

Florencio Lopez-de-Silanes

Yale University and NBER

Dos and Don’ts in Privatization: Evidence from Less Developed Countries

Privatization around the world

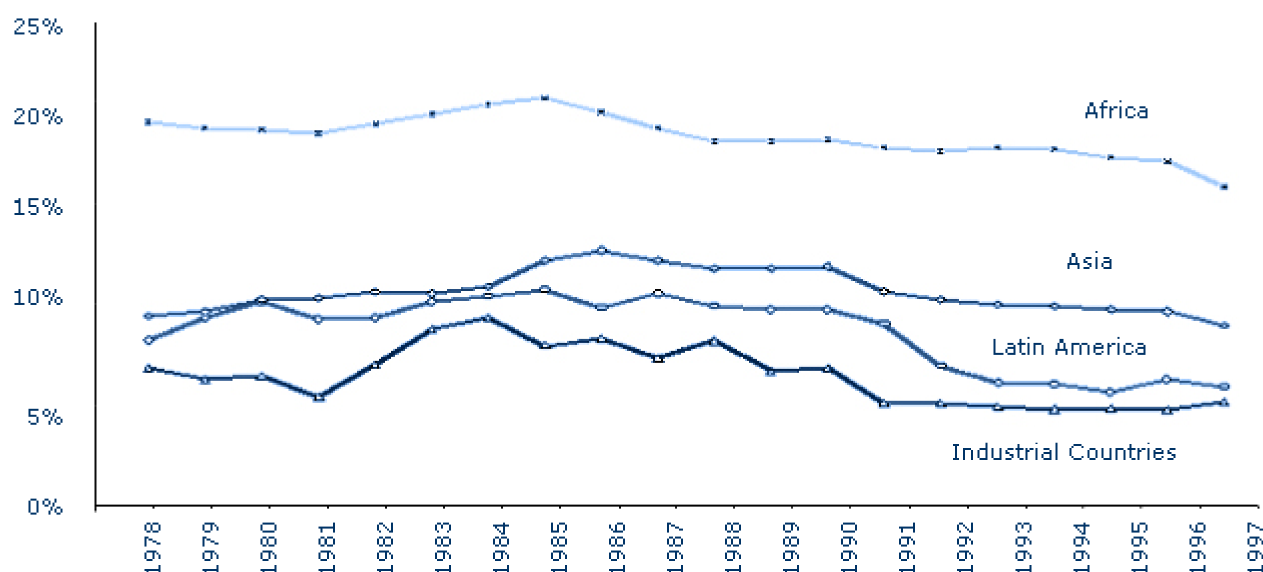
Strong SOE underperformance leads to reassess the role of the state in the economy…

Fifty years ago, many famous economists and politicians favored state ownership of firms in several industries, as monopoly power and externalities produced market failures. In the last twenty years, however, the mounting evidence on poor performance of state-owned enterprises (SOEs) around the world and other developments in the fields of contract and ownership theory have led to a reassessment of the benefits of state ownership in production.

…and privatization spread out in developed and developing countries

These two developments gave rise to the privatization wave of the 1980s and 1990s reassessing the role of the state in the economy in light of the efficiency improvements of privatized firms. If we look at SOE activity over time, industrial countries have pursued privatization less vigorously than developing nations, but they started at a lower base. Between 1984 and 1996, SOE participation in industrial countries declined from a peak of 8.5 percent to about 5.0 percent of gross domestic product (GDP), while production from state-owned companies declined more steeply in developing countries (see Figure 1). Privatization has also evolved differently along geographical regions. Outside of former communist countries, one of the most active regions has been Latin America, where SOE participation in GDP dropped

Figure 1. Share of State Owned Enterprises in Total Output



Source: Chong, A., and Lopez-de-Silanes, F., 2004. "Privatization in Latin America, What does the Evidence Say?" Economìa 4(2): 37-111.

from a high of 10 percent in 1985 to just 5 percent in 1997, only marginally above the level of industrial countries. Countries in Asia and Africa have also engaged in privatization, albeit at a lower scale. The state-owned sector in these countries has diminished in importance, but still represents a significant share of GDP today.

The distribution of revenues in LDCs

Throughout the world, annual revenues from privatization soared during the late 1990s, peaking in 1998 at over US$100bn. Transition economies and Latin American countries have been the most active in privatization. Countries in Eastern Europe and central Asia accounted for 21 percent of total privatization revenues in developing countries during the 1990s, second only to Latin America (see Figure 2). Meanwhile, privatizations in Sub-Saharan Africa, South Asia and The Middle East and North Africa account for less than 10 percent of developing countries' privatization proceeds.

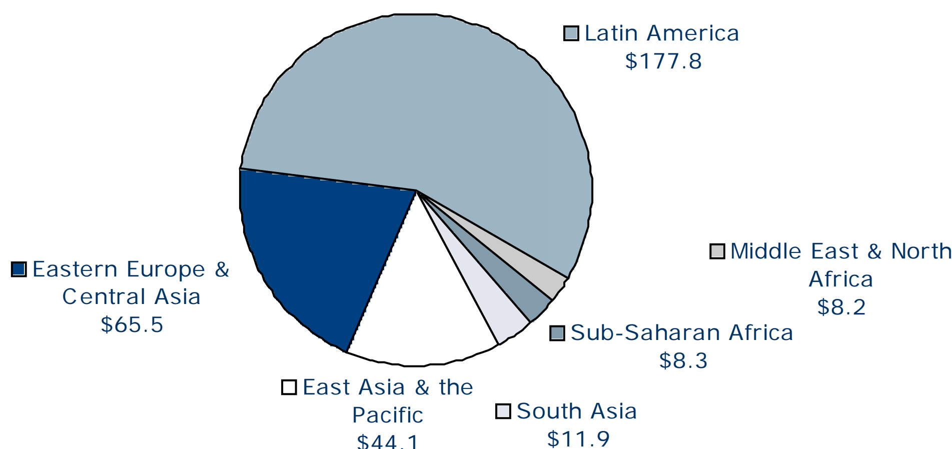
Despite privatization, ownership of banking is still pervasive

Nevertheless, even in countries which have privatized extensively, many sectors remain shielded from competition by significant state ownership. A clear example of this is government ownership of banks. Data for the late 1990s shows that, after bank privatization programs had been completed in many countries, the world mean of government ownership of the top ten banks was still 42 percent.

The end of the big privatization cycle calls for an overall assessment

Thus, while government ownership has decreased significantly because of privatization, this decline has not been symmetrical along regions or sectors. Privatization efforts have greatly stalled in recent years, despite empirical evidence of improved firm performance, output increases and quality improvements around the world. Attackers point to instances of failures drawing general conclusions about the negative effects of privatization as a whole. In these circumstances, it is imperative to analyze the true record of privatization and understand the causes behind failures in order to improve the process in the future.

Figure 2. Proceeds from Privatization in Developing Countries (US$bn), 1990-1999



Source: Chong, A., and Lopez-de-Silanes, F., 2004. "Privatization in Latin America, What does the Evidence Say?" Economìa 4(2): 37-111.

The Benefits of Privatization

A first series of criticisms of privatization suggests that the profitability increases registered in the early literature are not robust. These claims are by and large not substantiated by the new empirical evidence. Megginson Nash and Van Randenborgh (1994) is the classic reference that set up the tone of the positive effects of privatization. In one of the most recent and comprehensive studies on the benefits of privatization, Chong and Lopez-de-Silanes survey the operating performance of comprehensive privatization samples that span across industries and firm sizes in seven Latin American countries. Their results show significant profitability and output increases for the median firm (Chong and Lopez-de-Silanes, 2004). The main results are summarized in Table 1 and are robust to several potential sources of bias.

The clearest result is that profitability increased significantly, as net-income-to-sales improved by 14 percentage points and operating-income-to-sales by 12 percentage points, for the median firm privatized in the region. The driving force behind this increase in profitability was an improvement in efficiency, as costs per unit decreased 16 percent and the ratio of sales to employees increased by an impressive 65 percent. These improvements do not appear to be due to increased investment, as the ratio of sales to assets increased only 16 percent and was statistically insignificant for most countries.

Redundant workers are laid off

One of the most interesting results is the change in employment following privatization. With only one exception, all countries for which data is available show a significant decrease in the number of employees, equivalent to approximately 24 percent. Despite a significantly reduced workforce and a relatively unchanged asset base, privatized firms increased output by a staggering 40 percent. The evidence suggests that SOEs suffered from excessive employment.

The robustness of all of these results is confirmed using industry-adjusted indicators which allow us to distinguish the effects of general macroeconomic movements or industry specific events from the direct effects of privatization at the firm level. Looking at these indicators, output increased by about 28 percent following privatization and employment fell by 20 percent.

Table 1. Changes in Performance of Privatized Firms in Latin America

Indicator	Median Change (%)
Net - Income sales	14
Operating - income - to - sales	12
Cost per unit	-16
Sales - to - employment	65
Sales - to - assets	16
Employment	-24
Output	40

Median change of performance of privatized firms for the comprehensive samples of seven Latin American countries (Argentina, Bolivia, Brazil, Chile, Colombia, Mexico and Peru).
Source: Chong, A., and Lopez-de-Silanes,F., 2004. "Privatization in Latin America, What does the Evidence Say?" Economìa 4(2): 37-111.

The Impact of Privatization on Other Dimensions of Welfare

The distributional aspects of privatization

The second series of criticisms center on the overall welfare effects of privatization for consumers and workers. It is often claimed that privatization may negatively impact consumer welfare through decreased access, reduced quality of goods and services and an unequal distribution of wealth. These concerns are significant because the poorest segments of society are generally the main consumers of goods and services previously produced by SOEs.

Access to basic services improves after privatization

A first generation of privatization studies shed light on this subject by analyzing case studies in several countries. Galal and others, for example, analyze twelve privatization cases in Chile, Malaysia, Mexico, and the United Kingdom, including firms in sectors such as airlines and telecommunications (Galal *et al*., 1994). Their results indicate that privatization led to welfare gains of about 25 percent of pre-privatization sales in eleven of the twelve cases. Similarly, work by many other authors documented improvements in access to services such as water, power, port infrastructure and telecommunications.

More recently, a new generation of studies based on more detailed data and econometric techniques has corroborated the early results in terms of access and quality. For instance, Fischer, Serra, and Gutiérrez (2004) find improvements in access and service quality in the telecommunications sector in Chile, where the number of phone lines in operation increased six-fold, bringing density levels from 4.7 lines per 100 inhabitants in 1987 to 23.1 lines in 2001 (Fischer, Serra, and Gutiérrez, 2004). The average length of the waiting period for a new phone line dropped from 416 days in 1993 to only six days in 2001, while the waiting list for a phone dropped from a peak of 314,000 households in 1992 to only 32,000 by 2001.

Other positive impacts on consumer welfare

In spite of these numbers, one may still be concerned about the distributional impacts of privatization, as improvements may not necessarily reach the poorest sectors of society. Galiani *et al.* (2004) offer some of the best data available for the municipal level in Argentina, where about 30 percent of localities privatized water delivery services (Galiani, et al., 2004). Their results show that the number of households connected to the water network increased by 11.6 percent as a result of privatization. Furthermore, the authors designed a clever test that maps water delivery to infant mortality in an effort to directly address the concerns about quality after privatization. Their regressions show that, controlling for other factors, child mortality fell by 5 to 7 percent more in areas that privatized water services than in those that did not. The effect was largest in the poorest municipalities, where child mortality fell 24 percent.

These are only some examples of the recent wave of evidence in privatization that is providing robust evidence about its impact in consumer welfare.

The second aspect of the welfare effects of privatization that has received criticisms is the well-being of workers in privatized companies. The idea behind this position is that the potential source of the gains after privatization may not be efficiency improvements but transfers from workers via lower employment and wages. In this area, the new series of studies with detailed firm level information across Latin America show that although the

number of workers falls, real wages to remaining workers increase substantially. Additionally, even under the extreme unfavorable assumptions, the median savings from labor costs explain on average 20 percent of the gains in profitability ratios.

To summarize, a new wave of empirical studies on privatization provide robust evidence about the general success of these programs improving efficiency and increasing welfare for society as a whole. What remains is to try to make sense of the failure cases that the literature and the press have pointed out. The next two sections point to the areas where most failures lay.

The Proper Role of Politicians in the Privatization Process

Good rules and contracts are key to garner the benefits of privatization

The third series of criticisms of privatization, and one of the two basic factors that explain failure cases, involve the opacity of the process that may lead to collusion or corruption. The government plays a key role in privatization as it prepares firms to be sold and designs the rules and contracts.
Cases of failure are linked to problems in these areas. Countries that have established clear and generalized rules and contracts for all privatizations have seen the benefits of standardization of the process, increased investor certainty and less room for arbitrary decisions that may lead to cases of corruption.

A policy advice: do not restructure the SOE pre-privatization

Government restructuring of SOEs prior to their sale is likely to be fraught with political difficulties given that this may be the last chance for government officials to extract private benefits. Restructuring programs can be defended rationally on grounds that they may increase revenues from the sale or help minimize layoffs and ensure the firm's survival. Nevertheless, available empirical evidence now suggests that restructuring policies do not lead to higher revenues for the government. For the case of Mexico, López-de-Silanes (1997) shows that, after controlling for endogeneity, the optimal policy seems to be to refrain as much as possible from restructuring SOEs before they are sold. Some of the most popular measures, such as debt absorption, do not increase net prices, while measures such as the establishment of investment and efficiency programs actually reduce them. There is empirical evidence that even labor force retrenchment prior to privatization may not produce clear benefits as such programs lead to adverse selection and the best workers leave only to be rehired again after privatization (Chong, and López-de-Silanes, 2003).

Based on the empirical evidence, part of the failures in privatization are explained by poorly-designed contracts, casuistic programs and too much government involvement in restructuring of firms before the sale.

The Role of Complementary Policies to Privatization

The last series of criticisms of privatization, and the final set of reasons that explain cases of failure, are due to delays in setting up the appropriate regulatory and institutional framework after privatization. Privatization should not be looked at in isolation. Its success depends on appropriate de-regulation or re-regulation of privatized firms, as well as the creation of

stable property rights institutions that foster the development of financial resources needed by privatized firms to grow independently from the state.

The success of privatization is related to appropriate deregulation o re-regulation

Re-regulation is needed for cases with market power to ensure that firms do not exploit consumers. Similarly, a good dose of de-regulation is needed in sectors with prior substantial government participation as they tend to be protected by a web of regulations, originally instituted to cut the losses of SOEs and reduce fiscal deficits, but which now stifle competition and allow firms to reap extraordinary benefits.

De-regulation complements privatization in two ways. First, product market competition provides a tool for weeding out the least efficient firms; a process which may take too long if regulation inhibits new entry or makes exit costly. Second, de-regulation may raise the cost of political intervention. Whereas an inefficient monopoly can squander its rents without endangering its existence, an inefficient firm in a competitive industry would have to receive a subsidy to stay afloat. The introduction of competition thus forces politicians to pay firms directly for engaging in politically motivated actions.

Corporate governance improvements are functional to successful privatization

Finally, the lasting success of privatization also rests on the establishment of an institutional framework that promotes good corporate governance. Poor governance increases the cost of capital and may thus prevent privatized firms from undertaking needed investments. The development of stock and credit markets needs a solid regulatory framework that promotes investor protection and disclosure.

The role of creditor rights

Before privatization, government banks are typically used as a source of financing. Yet the banking sector is often one of those turned over to private hands. If financing for privatized companies is expected to come from private credit institutions, then creditor rights and the efficiency of courts must be strengthened and streamlined. Without proper bankruptcy procedures, financial institutions will be reluctant to lend in fear of potential losses.

Improving enforcement of law is an essential complementary policy

The reform of corporate governance institutions through the establishment and enforcement of effective securities, corporate, and bankruptcy laws should become an essential complementary policy to prevent cases of abuse by controlling shareholders and to promote the development of stable sources of funds for privatized firms to finance their growth. We should not forget that it was precisely a lack of private funding that pushed many troubled firms into the hands of the state in the first place.

Conclusions

The empirical evidence on privatization lines up: countries that privatize benefit and the gains are shared with society. There are of course mistakes, as with all policies, but these do not warrant throwing privatization out the window. There are two key lessons from the empirical record that should be applied to future privatization programs in order to maximize the probability of success. First, ensuring a clear and homogeneous process that applies to all firms and reducing government restructuring of firms prior to privatization are essential mechanisms to keep the system at check and avoid unnecessary opacity and delays. Second, the establishment of a regulatory

Privatizing countries benefits and gains are shared with society

and institutional framework that allows efficient information gathering, prevents market power abuses, and fosters the development of financial alternatives for firms to implement their restructuring processes is a key policy complement to privatization. These recommendations should help in the ongoing round of privatizations.

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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.

In addition to the Composite Index, two regional (one including EU15 and one the ten new accession countries) sub-indexes are constructed, together with five sector sub-indexes (Banking, Industrial, Oil & Gas, Utilities, and Telecom).

The PB Composite Index includes 218 stocks. The two regional indexes include 156 companies of EU15 countries and 62 companies of the ten new accession countries of Eastern Europe. The five sector sub-indexes Banking, Industrial, Oil & Gas, Utilities, and Telecom include 37, 36, 12, 39, and 23 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 past year, starting (mainly) from January 1, 2004.

Figure 1 refers to the PB Composite Index, which includes the whole set of privatized companies for which we track performance. The figure shows that, had one invested €100mil in this index, the investment would now be worth €116mil.

Table 1. PB Indexes Constituents (as of 12/21/2004)

PB Indexes	# of Constituents	Old Europe	% Old Europe	New Europe	% New Europe
Composite	218	156	71.56%	62	28.44%
Banking	37	27	72.97%	10	27.03%
Industrial	36	31	86.11%	5	13.89%
Oil & Gas	12	9	75.00%	3	25.00%
Telecom	23	16	69.57%	7	30.43%
Utilities	39	32	82.05%	7	17.95%

Source: Elaborations on *FactSet*

Table 2. PB Indexes Returns

PB Indexes	Value as of 12/21/2004	1 Month	3 Months	6 Months	9 Months	1 Year
Composite	116.691	0.150%	1.447%	4.459%	11.762%	16.234%
Old EU	115.361	0.130%	1.302%	4.019%	11.166%	14.940%
New EU	155.609	0.575%	4.965%	16.056%	26.861%	54.085%
Banking	115.803	0.218%	1.800%	5.394%	12.872%	15.370%
Industrial	118.756	0.174%	1.404%	3.678%	12.862%	18.242%
Oil & Gas	117.850	-0.143%	-0.560%	1.124%	10.233%	17.361%
Telecom	112.960	0.293%	3.080%	6.580%	10.418%	12.605%
Utilities	127.332	0.394%	2.420%	6.371%	15.915%	26.583%

Note: Return indicates the % increase/decrease of the index. All values are annualized.
Source: Elaborations on *FactSet*

Table 3. PB Indexes Average Excess Returns

PB Indexes	Benchmarks	1 Month	3 Months	6 Months	9 Months	1 Year
Composite	DJ STOXX TMI	0.326%	0.840%	1.046%	1.174%	1.363%
Old EU	DJ STOXX TMI	0.242%	0.636%	0.718%	0.742%	0.896%
New EU	DJ STOXX EU Enlarged TMI	2.352%	5.673%	7.171%	10.617%	13.503%
Banking	DJ STOXX Banking	0.464%	1.371%	2.328%	2.700%	2.734%
Industrial	Dj STOXX Industrial	0.375%	0.371%	0.467%	0.869%	2.541%
Oil & Gas	DJ STOXX Oil & Gas	0.557%	3.170%	7.322%	9.551%	8.616%
Telecom	DJ STOXX Telecom	-0.598%	-2.603%	-5.838%	-8.120%	-7.784%
Utilities	DJ STOXX Utilities	1.156%	3.316%	5.733%	7.286%	7.283%

Note: Average excess return indicates the historic average differential return of the index to its respective benchmark. All values are annualized.
Source: Elaborations on *FactSet*

Figure 1. Performance of the PB Indexes

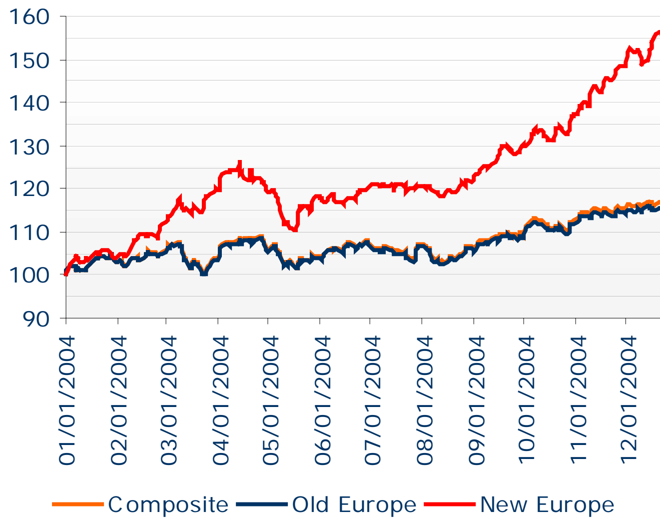


Figure2. Excess Returns (%) of the PB Indexes

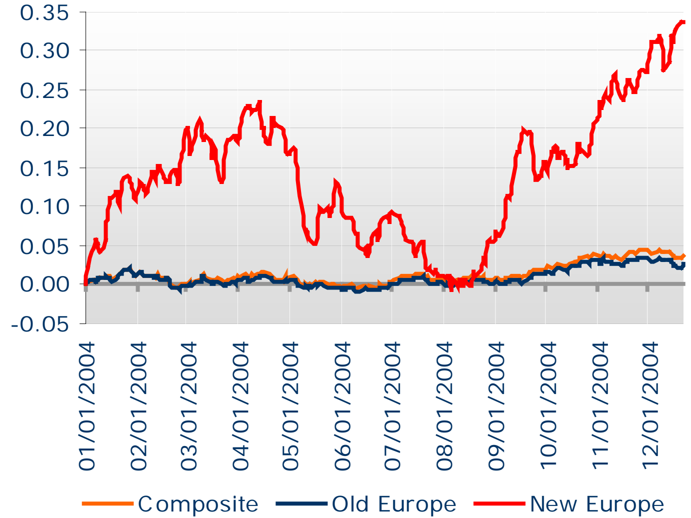


Figure 3. Performance of the PB Indexes

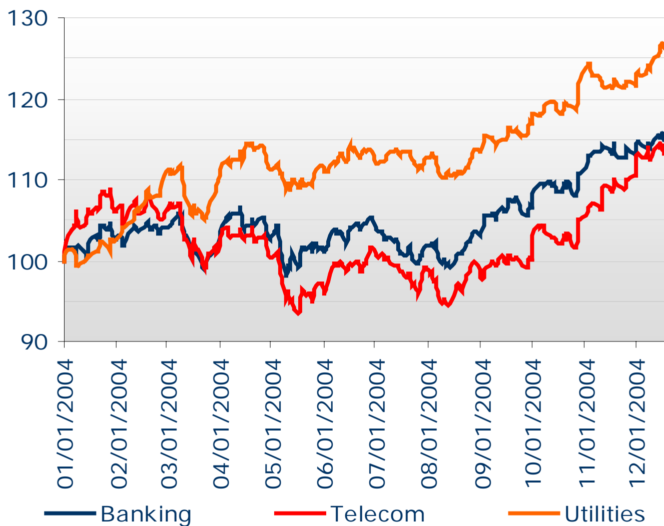


Figure 4. Excess Returns (%) of the PB Indexes

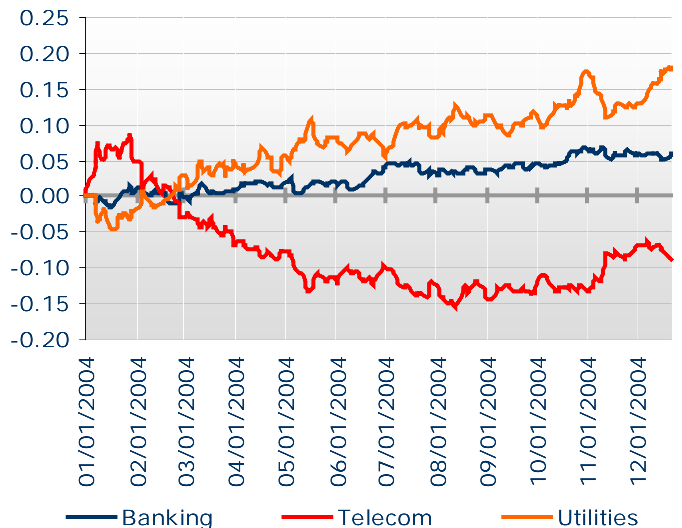


Figure 5. Performance of the PB Indexes

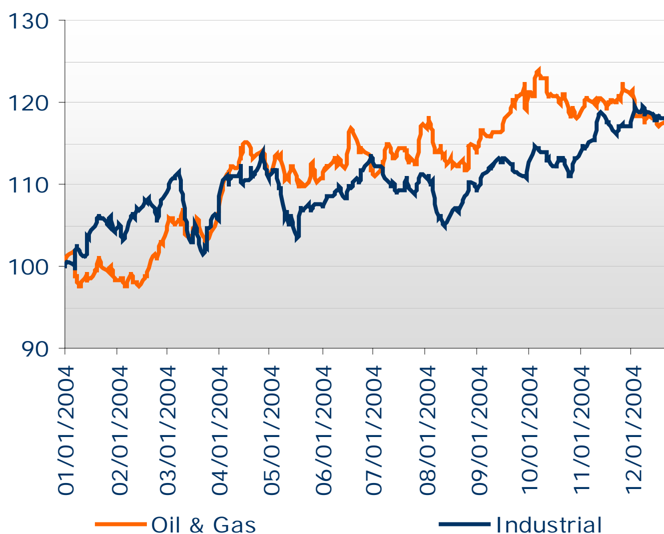
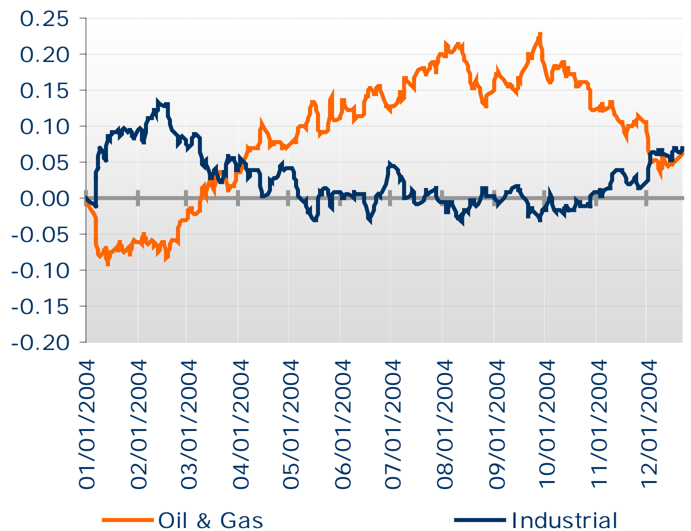


Figure 6. Excess Returns (%) of the PB Indexes



Source: Elaborations on *Fact Set*

The overall performance of the composite index is quite in line with that of the Dow Jones STOXX Total Market Index (TMI), which we use as a benchmark. However, the PB Composite Index out-performed the benchmark, especially during Q4 2004, earning 1.36 percent excess returns on a yearly basis.

The similar behavior of the PB Composite Index and of the benchmark is not particularly surprising, given that both indexes are capitalization-weighted and that several privatized companies are the largest listed companies. It is therefore likely that more weight is given in the benchmark to the constituents of our PB Composite Index.

Stark differences in performance appear when we analyze the PB regional and sector indexes. Higher performance is found for stocks of privatized companies of New Europe, which rallied in Q4 gaining 54 percent over the year. Interestingly, the stocks of privatized companies of the New Europe yielded a 13.5 percent abnormal return relative to the Dow Jones STOXX EU Enlarged Total Market Index (Figure 2). This fact shows that an investment strategy of cherry picking privatized companies may pay off extremely well in new accession countries.

The analysis of our five sector benchmarks for 2004 shows high raw returns in the telecom sector (23.1 percent), followed by the industrial and oil & gas sectors (10.8 and 10.5 percent, respectively). Slightly lower performance is reported in the banking and utility sectors (9.0 and 7.8 percent, respectively) (as shown in Figure 3 and 5).

The PB Oil & Gas Index marked a strong over-performance relative to the Dow Jones STOXX Oil & Gas, gaining an additional 8.6 percent on a yearly basis. This high yield is largely due to the stellar returns obtained by three new Europe stocks, Slovnaft, MOL, and PKN Orlen, the former state monopolies in the Slovak Republic, Hungary, and Poland. Austrian large cap OMV, which boasts the top performance of the sector in Old Europe, also had a great impact on our index.

Privatized utilities also performed remarkably well. The PB Utilities Index out-performed the benchmark by 7.2 percent, driven by two Italian local utilities Hera and Acegas, and by CEZ and Elektrim, two companies operating in the Czech Republic and in Poland.

The PB Banking and Industrial Index marked some over-performance relative to the Dow Jones STOXX Banking and Industrial Index, gaining approximately 2 percent on a yearly basis. High returns have been driven by some banks from new Europe, such as Hungary’s OTP Bank, which gained 122 percent over the year, and also by the Bank Austria Creditanstalt, the sector’s top performer in Old Europe.

The PB Industrial Index is driven by the stellar returns obtained by some Austrian privatized companies such as VA Technologie, whose stock price more than doubled under the pressure of the Siemens takeover bid, and two companies operating the main airports in Denmark and, again, Austria.

Interestingly, privatized telecom operators did not contribute to the TLC rally which swept Europe in 2004. The PB Telecom Index significantly

under-performed the Dow Jones STOXX Telecom Index, and the majority of TLC privatized stocks, including bellwether stocks such as Cable & Wireless, BT, and FT yielded lower returns with respect to the benchmark. Furthermore, among over-performing companies, only a few are blue chips (such as Telecom Italia and Telekom Austria), while the majority are companies of the new Europe which have a lower weight in the index.

Higher returns are generally accompanied by overall higher volatility. It is therefore important to risk-adjust the excess returns yielded by our PB Indexes. We have therefore calculated the conventional Sharpe ratio, given by the differential return of our index relative to a risk-free asset (namely, the Bundesbank 90-day bill) divided by the standard deviation of the differential return. We have also computed the Information ratio, given by the differential return relative to its benchmark divided by the tracking-error volatility (i.e. the standard deviation of the excess returns).

Data availability allows us to calculate these ratios for one-year, 15 and 18-months time periods. Even if it is more customary to evaluate risk-adjusted performance for longer periods (from 3 to 5 years), ratios based on daily data may provide some useful information (Table 7 and 8).

Overall, PB Indexes performed quite well after controlling for volatility. Over the 18 months period, the PB New Europe Index sticks out, with 0.88 and 1.13 Sharpe and Information ratios, respectively. A value higher than one is generally accepted as a very good number in the fund management industry. This allows us to conclude that PB companies of the New Europe represent an extremely interesting investing opportunity.

The PB Oil and Gas Index also obtained a significant result in terms of the Information ratio, which reports a value of 0.79. Remarkable performance is also reported for the PB Utilities Index, which gains the second highest ranking according to the Sharpe ratio (0.62).

Interestingly, our PB Composite Index reports lower excess returns than three PB Indexes described above (1.36 percent). However, the values of the Sharpe ratio and especially Information ratio (0.37 and 0.55, respectively) suggest that the risk-return profile associated with the index may still be interesting.

Disappointing performance is found in only one out of eight PB indexes, namely in the PB Telecom Index. But the PB Indexes (New Europe, Oil & Gas, and Utilities) that we highlight show either the highest excess returns and the highest risk-adjusted performance. Indeed, there seems to be value in privatization-related funds. Keep track!

Table 4. PB Index YTD TOP & WORST 10 Performers

OLD EUROPE

	YTD TOP 10 Performers					YTD WORST 10 Performers			
	Company	**Country**	**Value as of 12/21/04**	**YTD Change (%)**		**Company**	**Country**	**Value as of 12/21/04**	**YTD Change (%)**
#1	VA Technologie AG	Austria	58.500	128.43%	**#1**	Olympic Catering S.A.	Greece	2.790	-68.30%
#2	OMV AG	Austria	218.250	84.83%	**#2**	STMicroelectronics N.V.	France	14.400	-33.02%
#3	Hera S.p.A.	Italy	2.170	74.86%	**#3**	AEA Technology PLC	UK	2.270	-25.62%
#4	Voestalpine AG	Austria	56.000	73.37%	**#4**	Volkswagen AG	Germany	33.48	-24.17%
#5	Verbund AG	Austria	160.500	73.33%	**#5**	Deutsche Lufthansa AG	Germany	10.340	-19.96%
#6	OPAP S.A.	Greece	19.720	72.98%	**#6**	Agricultural Bank of Greece S.A.	Greece	5.820	-19.83%
#7	Corus Group PLC	UK	0.735	72.61%	**#7**	Thessaloniki Water Supply & Sewerage S.A.	Greece	4.060	-19.12%
#8	Boehler-Uddeholm AG	Austria	91.190	70.32%	**#8**	Greencore Group PLC	Ireland	2.950	-16.90%
#9	Bull S.A.	France	0.480	68.41%	**#9**	Thomson France	France	19.160	-15.46%
#10	Fortum Oyi	Finland	13.630	66.63%	**#10**	Aeroporto di Firenze S.p.A.	Italy	9.580	-15.15%

NEW EUROPE

	YTD TOP 10 Performers					YTD WORST 10 Performers			
	Company	**Country**	**Value as of 12/21/04**	**YTD Change (%)**		**Company**	**Country**	**Value as of 12/21/04**	**YTD Change (%)**
#1	Zaklady Przemyslu Odziezowego Vistula S.A.	Poland	7.887	630.14%	**#1**	Novotrade Rt.	Hungary	0.314	-72.64%
#2	Wolczanka S.A.	Poland	8.425	456.27%	**#2**	Globus Konzervipari Rt.	Hungary	2.009	-49.52%
#3	Zaklady Odziezowe Bytom S.A.	Poland	3.199	344.19%	**#3**	Mostostal Warszawa S.A.	Poland	1.465	-40.88%
#4	Prochnik S.A.	Poland	0.332	185.07%	**#4**	Borsodchem Rt.	Hungary	7.619	-29.32%
#5	Fabryka Kotlow RAFAKO S.A.	Poland	3.321	137.56%	**#5**	Raba Rt.	Hungary	2.770	-18.56%
#6	Elektrim S.A.	Poland	1.575	136.81%	**#6**	Pannonplast Rt.	Hungary	4.645	-12.58%
#7	CEZ A.S.	Czech Rep.	10.418	131.57%	**#7**	Richter Gedeon Rt.	Hungary	88.410	-5.80%
#8	Slovnaft A.S.	Slovak Rep.	73.198	123.22%	**#8**	Kopex S.A.	Poland	11.331	3.07%
#9	OTP Bank Rt.	Hungary	22.763	122.62%	**#9**	Orbis S.A.	Poland	9.224	3.63%
#10	MOL Rt.	Hungary	52.740	118.50%	**#10**	Eesti Telekom A.S.	Estonia	7.050	6.66%

Source: Elaborations on *FactSet*

Table 5. PB Index Old Europe Sectorial Top Performers

		Company	Country	Value as of 12/21/04	YTD Change (%)
Banking	**#1**	Bank Austria Creditanstalt AG	Austria	65.290	61.21%
	#2	National Bank of Greece S.A.	Greece	23.640	48.18%
	#3	Mediobanca Banca di Credito Finanziario S.p.A.	Italy	11.910	38.49%
Industrial	**#1**	VA Technologie AG	Austria	58.500	128.43%
	#2	Kobenhaven Lufthave A/S	Denmark	152.266	63.84%
	#3	Flughafen Wien AG	Austria	57.000	53.23%
Oil & Gas	**#1**	OMV AG	Austria	218.250	84.83%
	#2	Fortum Oyi	Finland	13.630	66.63%
	#3	Saipem S.p.A.	Italy	8.780	36.97%
Telecom	**#1**	Telekom Austria AG	Austria	14.000	42.86%
	#2	Telecom Italia S.p.A.	Italy	2.940	25.11%
	#3	Hellenic Telecommunications Organization S.A.	Greece	13.060	24.62%
Utilities	**#1**	Hera S.p.A.	Italy	2.170	74.86%
	#2	Verbund AG	Austria	160.500	73.33%
	#3	Acegas APS S.p.A.	Italy	8.100	57.59%

Table 6. PB Index Old Europe Sectorial Worst Performers

		Company	Country	Value as of 12/21/04	YTD Change (%)
Banking	**#1**	Agricultural Bank of Greece	Greece	5.820	-19.83%
	#2	DePfa Deutsche Pfandbriefbank AG	Germany	76.450	-6.75%
	#3	Unicredito Italiano S.p.A.	Italy	4.200	-1.87%
Industrial	**#1**	AEA Technology PLC	UK	2.270	-25.62%
	#2	Aeroporto di Firenze S.p.A.	Italy	9.580	-15.15%
	#3	Jenoptik AG	Germany	7.910	-9.08%
Oil & Gas	**#1**	Total S.A.	France	159.700	8.35%
	#2	PB PLC	Uk	7.292	13.42%
	#3	Hellenic Petroleum S.A.	Greece	7.920	13.79%
Telecom	**#1**	Cable & Wireless PLC	UK	1.643	-13.30%
	#2	Kingston Communications (Hull) PLC	Uk	0.872	-5.49%
	#3	France Telecom S.A.	France	23.420	3.35%
Utilities	**#1**	Thessaloniki Water Supply & Sewerage S.A.	Greece	4.060	-19.12%
	#2	MVV Energie AG	Germany	15.400	0.00%
	#3	Public Power Corporation S.A.	Greece	20.020	2.14%

Source: Elaborations on *FactSet*

Table 7. PB Indexes Sharpe Ratios

PB Indexes	1 Year	15 Months	18 Months
Composite	2.164	0.748	0.372
Old EU	2.167	0.707	0.334
New EU	1.933	1.207	0.882
Banking	1.487	0.516	0.117
Industrial	2.722	1.019	0.430
Oil & Gas	1.947	0.844	0.544
Telecom	0.667	0.206	-0.009
Utilities	2.368	0.923	0.625

NOTE: Sharpe ratio indicates the historic average differential return of our index to the Bundesbank 90-day bill per unit of historic variability of the differential return.
Source: Elaborations on *FactSet*.

Table 8. PB Indexes Information Ratios

PB Indexes	1 Year	15 Months	18 Months
Composite	1.051	0.645	0.555
Old EU	0.805	0.428	0.352
New EU	1.674	1.179	1.136
Banking	1.295	0.742	0.442
Industrial	0.678	0.710	0.260
Oil & Gas	1.034	0.796	0.790
Telecom	-1.327	-0.844	-0.662
Utilities	1.420	0.617	0.564

NOTE: Information ratio indicates the historic average differential return of our index to its respective benchmark per unit of historic variability of the differential return.
Source: Elaborations on *FactSet*.

Selected News

All news are available in PB News section – News are provided by DowJones News, all rights are reserved.

BELGIUM

2004-10-05 - **Post Gets Green Light To Search For Partner**

BRUSSELS (Dow Jones)--Belgian Prime Minister Guy Verhofstadt next week will give the **Post Office** the green light to search for an outside partner. The government will hold on to a majority stake of the Post Office which remains the biggest employer in the country.

DENMARK

2005-01-07 **- Denmark To Pick Buyer Of Postal Company Shares Soon**

AMSTERDAM (Dow Jones)--The Danish government will disclose within weeks the winner of the bidding round for a 25 percent stake in Danish postal firm **Post Danmark**.
Dutch postal and logistics firm TPG NV and Germany's Deutsche Post AG are among the candidates. The other bidders are most likely to be Royal Mail, Norwegian Post and French company La Poste.
The government aims to finalize the deal within a couple of months.

2004-10-08 **- Danish Government and Parties Agree On Sale Of DONG Shares**

COPENHAGEN (Dow Jones)--The Danish government has reached an agreement with the other main political parties for the sale of shares in oil and gas company **DONG A/S**, the Finance Ministry said Thursday.
The parties have agreed that the country's pipelines and storage facilities would stay in public hands and the state would retain a majority stake in
The parties are open to a complete sale of DONG's shares, but any such sale before 2015 would require unanimous agreement, the ministry said.
Finance Minister Thor Petersen said he expects that the government can in time sell all of its shares in DONG, depending on how fast the gas market develops into a well-functioning and competitive market.
"I am glad that broad political support for the conditions on the sale of DONG has been attained. With this background, the government will prepare the sale of a minority stake in the company," said Petersen.
He added that it was the government's intention to sell the shares to a wide range of owners through an initial public offering on the Copenhagen Stock Exchange.
The ministry didn't give a time frame for the IPO.

FRANCE

2004-11-24 - **French Government Asks EdF, GdF To Prepare 2005 IPO**

PARIS (Dow Jones)--The French Finance Ministry Wednesday said it has asked **Electricité de France** and **Gaz de France** to prepare the ground for their partial privatization in 2005.
The Ministry said it has asked EdF to prepare a share issue worth between €8bn and €11bn to help restore finances at the world's largest power company as measured by installed capacity.
GdF must also carry out preparatory work for a "limited" capital increase in 2005, the Ministry said in a statement.

GERMANY

2005-01-11 - **Government To Sell Air Traffic Control Stake In 05**

FRANKFURT (Dow Jones)--The German government wants to sell a 74.9 percent stake in **Deutsche Flugsicherung** - Germany's air traffic control service - before the start of 2006, earlier than previously announced, Financial Times Deutschland reported Tuesday, without citing sources.
In December, the government said it plans to sell its stake by the end of 2006, retaining only 25.1 percent in the service.
The sale, being prepared by Germany's transport ministry, could raise several hundred mil euros, the paper says.

GREECE

2005-01-11 - **Greece To Privatize Country's Postal Savings Bank**

ATHENS (Dow Jones)--Greece's privatization committee has approved a listing of the Greek **Postal Savings Bank** on the Athens Stock Exchange, the Finance Ministry said late Monday.
The committee didn't specify the timing of the listing nor the size of the stake to be offered.
Greece's center-right New Democracy government, which won elections in March last year, is looking to raise €1.5bn in 2005 from privatizations.
The previous socialist government had already slated the Post Savings bank for privatization and had indicated it would sell up to 40 percent of shares in an initial offering.

2004-12-10 - **New Greek Government Puts Olympic Airlines Up For Sale**

ATHENS (Dow Jones)--Greece's new center-right government Friday said it is launching its first attempt to privatize Greece's flagship carrier **Olympic Airlines SA**.
Lazard, National Bank of Greece, Emporiki Investment Bank and Alpha Finance are acting as financial advisors for the privatization of the airline and **Olympic Airways Services SA**, the government said in newspaper advertisements.
Olympic Airlines was formed in December last year after Greece's previous socialist government, which lost power in March, merged Olympic Airways, Olympic Aviation and Macedonia Airlines into one single unit. Ground handling and maintenance services were spun off into a separate company, Olympic Airways Services.

The socialist government had made several unsuccessful attempts to privatize the struggling Olympic Airways whose debts were estimated to be running at more than €100mil a year.
In March, European Union regulators opened a formal investigation into the previous government's plans to salvage the carrier while the E.U. Commission said in September it will investigate additional state aid to Olympic Airlines.
The latest attempt to sell the airline is part of the new Greek government's target to raise around €1.6bn in 2005 from privatization efforts.

ITALY

2004-07-30 - **Italian Budget Plan 2005-2008 sets EUR100B From Privatizations**

ROME --The Italian government late Thursday approved a four-year economic plan that will serve as a blueprint for budget adjustments, including spending cuts and new tax revenue worth €24bn in the 2005 budget.
The proposed cuts, two-thirds of which are driven by structural reforms rather than one-off measures, are designed to keep Italy's budget deficit below 3% of gross domestic product, as required by the European Union's Stability and Growth Pact.
To rein in Italy's huge debt, the government has put forward an ambitious privatization program worth about €100bn over four years.

PORTUGAL

2004-11-22 - **Government May Delay AdP Privatization**

LISBON (Dow Jones)--The Portuguese government may delay or cancel plans to sell off up to 49% of water company **Aguas de Portugal SA**, Diario Economico reported.
The environment ministry is reviewing a number of factors, including the legal, political and financial impact of the planned selloff and will make a final decision by the end of November. The state had planned to sell up to 49% of the company via a billion-euro rights issue aimed at financing investment in the water system infrastructure.

2004-11-05 - **Govt To Sell Portucel Tejo, EDA Stake**

LISBON (Dow Jones)--The government has approved the privatization plan for pulp maker **Portucel Tejo**, via a direct sale for not less than €40mil, Publico reports.
At its weekly cabinet ministers' meeting, the government also approved a plan to sell 40% of utility **Electricidade dos Acores**, the electricity provider for the Azores islands. A 34% EDA stake will be sold in a single bloc, with the additional 6% sold to employees and other small shareholders.

SPAIN

2004-10-15 - **Spain To Sell Stakes In Iberia, Altadis, Aldeasa In 2005**

MADRID (Dow Jones)--The Spanish government confirmed Friday it's planning to sell its remaining stakes in airline **Iberia SA**, tobacco company **Altadis SA** and retailer **Aldeasa SA** in 2005.

A spokesman for state holding company SEPI said that the divestments complete a privatization process started during the last decade and that the government is waiting for "the best moment to sell" the stakes.
SEPI will sell its 5.3% stake in Iberia, 2.8% of Altadis and 5.6% of Aldeasa. It also intends to reduce its 28.5% stake in national grid operator **Red Electrica de Espana SA** to 10% next year.
Both Iberia and Aldeasa were privatized by Spain's previous conservative government, through the sale of controlling stakes at different stages, while Altadis was formed through the merger of Spain's state-run Tabacalera and French company Seita in 1999.
In the case of REE, the sale of a 18.5% stake was planned by the previous government for 2004.
SEPI's chairman said Thursday that the government expects to raise €786.66mil from these divestments. The company also plans to sell its 3% stake in utility **Endesa SA** in 2006.

CZECH REPUBLIC

2004-12-08 - **Czech Government Approves Cesky Telecom Sale Timetable**

PRAGUE (Dow Jones)--The Czech government has approved a timetable for selling dominant Czech fixed-line operator **Cesky Telecom AS**, the finance ministry said Wednesday.
The government will seek a strategic investor to buy the state's 51% stake in Cesky Telecom. If, however, a partner isn't found by March 31, then the government will opt for a market placement.
The government also decided Wednesday that the tender will be open to telecommunications services providers, network operators, or consortia where network operators have significant influence.
The sale of Cesky Telecom to an investor could net the government an estimated CZK60bn (US$1=CZK22.8).

2005-01-04 - **Nine Parties Show Interest In Cesky Telecom Stake**

PRAGUE (Dow Jones)--The Czech Republic's National Property Fund said Tuesday that nine potential investors have expressed interest in the state's 51.1% stake in telephone company **Cesky Telecom AS**.
"The government's advisers have been addressed by nine potential investors so far and begun talks on signing confidentiality agreements with them," National Property Fund spokeswoman Petra Krainova told Dow Jones Newswires in a telephone interview.
Krainova didn't disclose further details on the potential bidders.
Credit Suisse First Boston and Ceska Sporitelna AS are advising the government on the sale.
Analysts have estimated the government stake to be worth about €2bn, meaning the sale would probably be the highest transaction on record in Central Europe.
Krainova said the government's sale commission will set a deadline later this month for preliminary bids.
The government decided in December to sell its Cesky Telecom holdings in a public tender, setting a March 31 deadline for finding either a strategic buyer or a consortium that includes both financial and strategic investors.
If it doesn't find a suitable buyer by then, the government said it will offer its stake in a market placement.

So far, Switzerland's Swisscom and Denmark's TDC A/S have expressed an interest in buying the stake.
Market participants say other interested parties include the U.K.'s Vodafone Group PLC, Telekom Austria AG, and France Telecom's SA mobile arm Orange.

HUNGARY

2005-01-12 - **Hungary To Privatize Rest Of MOL, Railways In 05-Report**

BUDAPEST (Dow Jones)--Hungary will sell off large chunks of a handful of remaining state-owned enterprises in 2005, Marton Vagi, recently appointed chief executive of the state privatization company APV Rt. , said in a radio interview Wednesday.
Although APV had denied plans to sell the state railways **MAV Rt.** late last year, the recently appointed Vagi told Klub Radio that it might happen this year, without going into detail.
Vagi confirmed earlier statements that the remaining stock in oil and gas company MOL Rt. and FHB Bank Rt. will be sold off, as well as broadcaster Antenna Hungaria Rt. and Budapest Airport Rt., the operator of Hungary's only major international airport.
APV sells and manages state assets on behalf of the Hungarian government.
Vagi said privatizing the national post Magyar Posta Rt. wasn't on the agenda and won't be even for the next 2-3 years. He added that the Posta will have to undergo reforms so it measures up against publicly traded companies.

2004-12-28 - **Hungarian Airline Malev For Sale On Easier Conditions**

BUDAPEST (Dow Jones)--Hungary's state privatization company APV Rt. Tuesday put flagship airline **Malev** up for sale - this time on slightly easier conditions.
Earlier failed privatization rounds had required bidders to buy the entire company outright. This time the government will allow a year for the payment to be made, but the buyer must still purchase the state's entire 99.95% stake.
The bidding deadline is Feb. 28.
The selection process will put an "80% emphasis" on the financial offer, APV said, which should include taking over a part of Malev's debt. The company's debt stood at HUF36.7bn (US$1=HUF180.54) in July.
Unlike previous rounds, the buyer won't have to take over the entire debt, but APV said it would favor bidders who take over the largest chunks.
APV said it would base the other 20% of its decision on the bidder's five-year business plan, including preserving Malev's status as a flagship carrier and having a good employment strategy.
Malev, which has more than 3,000 workers, posted a HUF13.5bn loss in 2003 and probably won't break even this year, APV said earlier this month.
In previously failed privatization rounds, potential buyers included China's Hainan Airlines, Austrian Air and Icelandair, as well as an investment group called Aviation Solutions Consortium.
Aviation Solutions, the only valid bidder at the last round in September, offered HUF150mil for Malev at that time but the bid didn't meet required conditions, APV said.

2004-12-10 - **MOL, FHB, Antenna Sales Due in 2005**

BUDAPEST (Dow Jones)--Hungary plans to sell in 2005 the remaining state-owned stakes in oil and gas company **MOL Rt**. and mortgage bank **FHB Rt**., Finance Minister Tibor Draskovics told Napi Gazdasag in an interview.
Hungary also plans to sell radio and television signal broadcaster **Antenna Hungaria Rt.**, and airport management company **Budapest Airport Rt.**
Hungary will sell its MOL stake when it sees market conditions for the transaction favorable, but there's no reason to wait with the sale for long, Draskovics said. Another consideration is that the sale method should prevent MOL from becoming an easy acquisition target, he added.
Regarding FHB, the government wants to ensure that the mortgage notes issued by FHB will maintain their value. That's why the government will need to be careful with selecting the buyers or to ensure that in some other way, the minister said.

2004-11-02 - **Hungarian PM Outlines Privatization Plans**

BUDAPEST (Dow Jones)--Hungarian Prime Minister Ferenc Gyurcsany outlined his government's privatization plans in Parliament Tuesday, in response to criticism from the opposition, state news agency MTI said.
The center-left government plans to sell off its remaining 12% stake in Hungarian oil and gas company **MOL Rt**. as planned, Gyurcsany confirmed, It also plans to sell a further stake in mortgage bank **FHB Rt.**, the prime minister said.
But the privatization of the state-owned post office Magyar Posta Rt. isn't on the agenda, nor is the sale of the country's only nuclear plant Paksi Atomeromu Rt.
"What's more, the government doesn't think that the other assets in (state-owned electricity wholesaler) MVM Rt. should be privatized," MTI quoted Gyurcsany as saying. Paksi is part of MVM.
The government never wanted to sell agricultural companies engaged in forestry and it doesn't want to sell domestic long-distance bus companies under Volan Rt., Gyurcsany added.
Lottery company Szerencsejatek Rt. won't be sold either, but the company needs to be reorganized. The sale of radio and television signal broadcaster **Antenna Hungaria Rt.** could only take place after its contract with state-owned public television is finalized. The sale of airport management company **Budapest Airport Rt.** should be at least party linked to the ongoing sale of flagship air carrier **Malev Rt.**, Gyurcsany was also quoted as saying.
Hungary has sold nearly all of its state assets over the past decade while it has transformed into a market economy from a command economy.
Center-right opposition politicians have recently started to attack new Prime Minister Gyurcsany for his plans to finish the privatization process with the sale of remaining assets. The Fidesz party has been campaigning for a referendum to stop the government from selling state assets.

POLAND

2005-01-05 - **Polish Treasury Min. Plans To Privatize Over 100 Firms In 2005**

WARSAW (Dow Jones)--The Polish Treasury Ministry plans to privatize more than 100 state-owned companies this year, including top insurer **Powszechny Zaklad Ubezpieczen SA (PZU)**, and several energy and chemical sector firms.

The plan was presented Wednesday to the parliamentary treasury committee by Treasury Minister Jacek Socha.
The ministry strategy assumes several initial public offerings on the Warsaw Stock Exchange, as well as an IPO of the **Warsaw bourse** itself.
The plan aims at budget revenues of PLN5.7bn (US$1=PLN3.0995), down from PLN10.2bn last year, but could be exceeded if the IPO of about 20% of PZU, estimated at PLN3-PLN4bn, succeeds.
But privatization of the insurer hinges on approval by the parliament of a compromise the government reached with PZU investor Eureko B.V. in December over control of the company.
Some of the ministry's privatization plans for this year could be also hampered by a political campaign ahead of parliamentary elections, which are now expected in June.
"As few privatizations as possible should be carried at the time of parliamentary elections," said Kazimierz Marcinkiewicz, head of the committee, and a member of the opposition party Law and Justice.
Following are key elements of the 2005 privatization schedule presented by the Treasury Ministry:

Company	Sector	Method	Timing
ZEC Lodz	Energy	Tender	January
PZU SA	Insurance	IPO	Q2
ENEA	Electricity	IPO	Q2/Q3
PGNiG	Gas	IPO	Q2
Grupa Lotos	Oil Refining	IPO	Q3/Q4
Kozienice	Electricity	IPO/Tender	Q3
Dolna Odra	Electricity	Tender	Q3/Q4
Warsaw Stock Ex.	Financial	IPO	Q4
ZEC Bydgoszcz	Energy	Tender	Q3/Q4
Ostroleka	Electricity	Tender	Q3/Q4
Police	Chemical	IPO	Q3/Q4
Pulawy	Chemical	IPO	Q2
Sarzyna	Chemical	Tender	Q4
Zachem	Chemical	Tender	Q4
Kedzierzyn	Chemical	Tender	Q4
Tarnow	Chemical	Tender	Q4

2004-12-20 - **Poland To Consider Sale Of 17.6% Stake In PKN Orlen In 05**

WARSAW (Dow Jones)--Nafta Polska, a Polish government agency responsible for privatization of oil assets, may recommend a sale of its 17.6% stake in the country's largest refiner **PKN Orlen** next year, Nafta Polska's president said Monday. Krzysztof Zyndul told reporters that a sale of PKN Orlen could be recommended after the government regains control over Naftoport, a key oil terminal on the Baltic sea, and PKN Orlen decides on its corporate strategy.

SLOVAK REPUBLIC

2005-01-14 - **Slovakia Mulling Sale Of Remaining Slovak Telecom Stake**

BRATISLAVA, Slovakia (AP)--The Slovak government is considering selling its remaining 49% stake in the country's dominant fixed-line telephone operator, **Slovak Telecom A.S.**, a minister said Thursday.

"We'll get an analysis made and we'll prepare everything so we can sell this stake in the future," Telecommunications and Transportation Minister Pavol Prokopovic was quoted as saying by the TA3 private television station Prokopovic said the government would like to start the complex sale procedure of its stake in Slovak Telecom before the administration's term in office expires in 2006.
"Whether it will be in this or next year, I don't dare to say," Prokopovic said, adding that he first wants to see what the analysis will say about the sale's effectiveness for the state.
"But I don't see any reason why we should keep them," he added.
Deutsche Telekom AG bought a 51% stake in the company for €1bn in 2000. The remaining shares are in the hands of the Slovak government and the Slovak National Property Fund. The telecommunications ministry has a 34% stake and the property fund, a state agency in charge of privatization, has 15%

Table 1. Announced Deals

Date of Announcement	Country	Company	Percent for Sale	Method	Date Expected	Rescheduling /Notes
mar - 04	Austria	Oesterreichische Post AG	25.10	Private Sale	2006	was postponed in 2003
oct - 04	Belgium	Post Office	up to 49	Private Sale	2H2005	
jan- 04	Denmark	Post Danmark	25.00	Private Sale	1Q2005	being finalized
jan - 04	Denmark	DONG	up to 49	Private Sale	1H2005	
may - 04	France	Electricité de France	up to 30	IPO	end 2004	delayed (2005)
may - 04	France	Gas de France	up to 30	IPO	end 2004	delayed (2005)
nov - 04	France	Areva	35 to 40	IPO	1H2005	
sep - 04	France	Aeroports de Paris	up to 49	IPO	1Q2005	
oct - 04	France	DCN	up to 49	unspecified	2005	
jul - 04	France	SANEF	20 to 30	IPO	1Q2005	
jan - 04	Germany	Deutsche Flugsicherung	74.90	unspecified	2006	anticipated (2005)
jun - 04	Germany	Deutsche Bahn	unspecified	IPO	2006	postponed (2008)
2004	Germany	Fraport	18.30	unspecified	2005	
jan - 04	Greece	Postal Savings Bank	up to 40	IPO	2005	
dec - 04	Greece	Olympic Airlines	unspecified	unspecified	2005	
dec - 04	Greece	Olympic Airways Services	unspecified	unspecified	2005	
jan - 04	Greece	Depa		Private Sale	2004	delayed (2005)
sep - 04	Italy	RAI Radiotelevisione Italiana	20 to 30	IPO	1H2005	
feb - 04	The Netherlands	Koninklijke KPN	unspecified	unspecified	2005	
sep - 04	Portugal	Aguas de Portugal	up to 49	IPO	2H2005	postponed
nov - 04	Portugal	Portucel Tejo	unspecified	Private Sale	2005	
nov - 04	Portugal	Electricidade dos Acores	40.00	IPO	2005	
oct - 04	Spain	Iberia	5.30	Private Sale	2005	
oct - 04	Spain	Altadis	2.80	Public Offer	2005	
oct - 04	Spain	Aldeasa	5.60	Public Offer	2005	
oct - 04	Spain	Red Electrica	18.50	Public Offer	1H2005	was planned for 2004 by previous govt
oct - 04	Spain	Endesa	3.00	Public Offer	2006	

Source: *DowJones Newswire.*

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