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Dear Ladies and Gentlemen,

Thank you for inviting the European Bank for Reconstruction and Development (EBRD) to the annual forum of the Northern Dimension Business Council.

Throughout the past twenty years of change the EBRD has remained committed to catalysing investment, promoting market-oriented change, working with the Russian government, with foreign investors and with local companies. EBRD has invested over EUR 20 billion into the economy of more than 50 Russian regions since 1991. Russia accounted for 30% of EBRD's total annual business volume of EUR 9 billion in 2011. Russia remains the largest recipient country of EBRD funding.

[We see less volatility in global markets and early optimism in the US is fuelling expectations that the world economy has moved into sustainable recovery – albeit the oil price is still seen as a significant risk. Relieved after the ECB's second major injection of liquidity into the European banking system, followed by an orderly Greek default, industrial investors should gradually become more upbeat on investment in growth opportunities. Russia, one of the large emerging markets, already feels some renewed investor interest albeit from a low level. Russia's own economic recovery has been sustained with annual growth of 4 per cent per in the past couple of years. We anticipate growth of 4.2 per cent in 2012 and more industrial investments fuelled by reforms and accession to WTO and OECD.]

[It is a priority to diversify the export of Russia's natural resources to Asia and Europe. It is clear that the necessary investments need private capital and know-how. But large scale greenfield investments anywhere take time to plan and implement. Industrial groups are naturally cautious and it has also become difficult to borrow long-term for new investments. Many banks are still struggling to meet their Basel III and European Banking Authority (EBA) capital requirements – which determine the ratio of capital banks need to hold to the amount of money they are lending. Many Russian and Western companies are seen as riskier borrowers, because they are not highly rated by the ratings agencies or are not rated at all. Hence many companies face limited access to long-term loans.]

In these times the financial institutions must work together more closely. We are often discussing large investment projects with institutions such as the EIB, IFC, Sberbank, VTB, VEB, RDIF and Rusnano. For example last year EBRD and EIB provided a joint financing package for Mondi Syktykvar. The EBRD loan portion finance forest roads and support to SME loggers.

On this note let us turn to today's main agenda, which focuses on the potential for large scale greenfield investments the Russian forestry sector.

"...the focus of the EBRD Forest Policy Dialogue Study..."



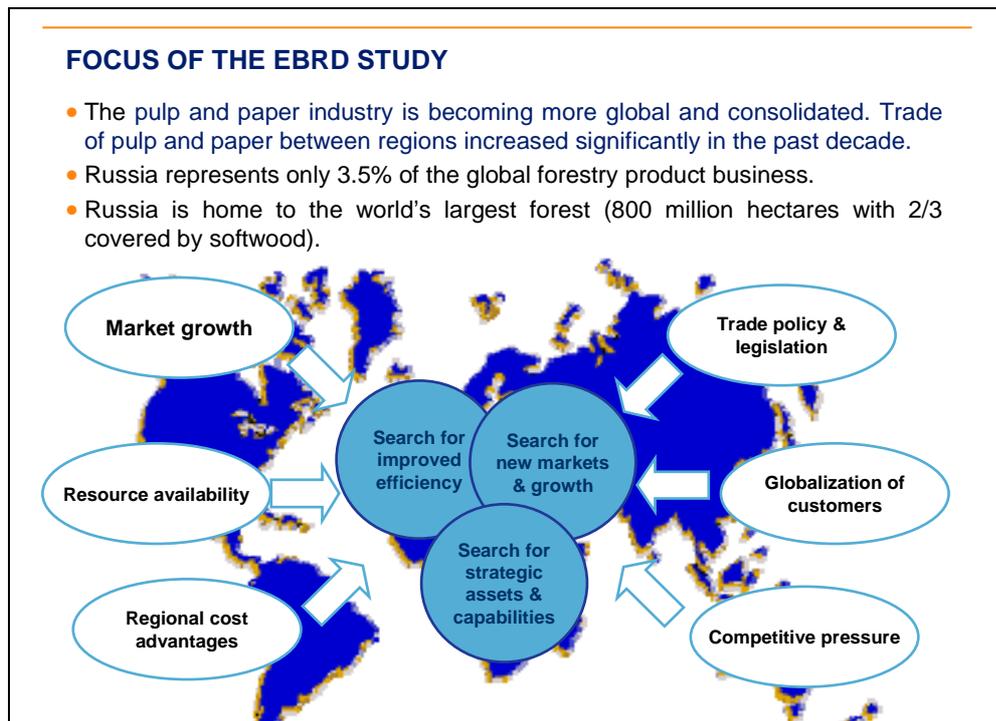
It is over fifteen years since the ERBD began financing investments in the Russian forestry sector. Among the initial projects was an EBRD equity investment in Syktykvar pulp and paper mill. Many other types of projects have since followed and involved sustainable forestry management, industrial restructurings, environmental upgrades, good corporate governance and legal reforms.

Today's presentation is part of our efforts to promote constructive dialogue about the reforms needed to attract more investments into the forestry sector. Our logic is built on three simple observations:

- **First**, we are encouraged that local and foreign investors continue eyeing investments in the Russian forestry sector in spite of the uncertainties and difficulties in the world economy.
- **Second**, we note investors perceive the investment climate in Russia as less attractive compared to the investment climate in a number of other emerging market countries, which are competing to attract forestry investors.
- **Third**, forest industry players think that the Russian Government has all that is needed to launch a proactive, game-changing action plan in order to win over investors.

It is against this background that we commissioned a report on the investment attractiveness of three Russian forestry regions compared with competing investment destinations elsewhere on the planet Earth. We were interested in exploring the use of existing best practises from within Russia as well as practises developed in countries competing with Russia for forestry investors.

Following an international tender, Pöyry Management Consulting won the assignment to carry out the study. Petteri Pihlajamäki, who is director of Pöyry Management Consulting, will be available to help answer any questions you may have on the presentation.



Sceptics say that the larger strategic investors are not seriously interested in large scale greenfield investments in the Russian forestry sector. The sceptics point to the fact that Russia with its large forest still only represents 3.5% of the global forestry business. The sceptics say that larger brownfield investment has happened, but stress that Russia's youngest pulp mill is 30-years-old and built in Soviet times when there was no need to repay expensive loans or pay dividends to private owners.

Optimists focus on the fact that international trade liberalisation will continue. Over the past 10 years Europe became a net importer of market pulp and a net exporter of paper. The past 10 years' decline in US and European paper consumption made paper capacity in Europe idle and pushed producers to restructure. Pulp production is moving to low wood costs areas while paper production is moving closer to consumers. We have all seen the Nordic integrated pulp and paper plants restructuring and reallocating assets, and a transformation in pulp and paper industry will continue to play out in the years to come. The optimists say that

Russia's investment climate, if reformed, will make the huge Russian forest attractive in the global game for greenfield investors.

FOCUS OF THE EBRD STUDY

- 10 greenfield pulp mills built on planet Earth in the last decade.
- Russia's youngest greenfield pulp mill is more than 30 years old.
- 3 Russian regions were analysed as options for the next greenfield pulp mill, which will comply with best standards for sustainable forestry management.



The EBRD report compares the three forest regions (Vologda, Krasnoyarsk and Khabarovsk) with five countries competing for industry players with the money and strategic interest to invest in a greenfield pulp mill. Such benchmark analysis is by its nature complex because the various locations have different climatic conditions, different forest species, different infrastructure levels, different host government policies etc. For the benchmarking purposes, we have selected the capacity level of 1.3-1.5 MM tons/year i.e. that of the largest currently constructed pulp mills around the world, but want to note that in Russia lower capacity levels, at e.g. 0.8-1.0 MM tons/year, may be more viable in certain conditions.

FOCUS OF THE EBRD STUDY

- The 3 Russian regions were benchmarked against 5 countries competing for industry investors, who are planning their next greenfield pulp mill.



"...the benefits of a greenfield pulp mill in Russia..."

In order to reduce these complexities, it has been necessary to focus the analysis on greenfield pulp mills. At the same time a greenfield pulp mill is generally seen as an attractive investment in the eyes of host country governments.

A GREENFIELD PULP MILL HAS MANY BENEFITS FOR RUSSIA... IF OWNED AND OPERATED BY A GOOD INDUSTRY PLAYER.

- A new pulp mill will **improve self-sufficiency in chemical pulp** and support the growth of the Russian domestic paper, tissue and board industry, which is already challenged by tightening availability and high prices of recovered fibre.
- A new pulp mill improves **employment and welfare in local forest communities**.
- A new pulp mill generates **economic growth and tax revenues**.
- A new pulp mill has a positive **knock on effect to other industries** such as the production of solid wood products and packaging for the domestic and export markets.
- Working with **respected industry players** gives comfort to the Russian authorities that a new mill will comply with **high standards** of financial transparency, social responsibility and sustainable forestry management.

In Russia a greenfield pulp mill would bring many benefits if it is owned and operated by a good industry player.

- A new pulp mill will improve the country’s self-sufficiency in chemical pulp and support the growth of the Russian domestic paper, tissue and board industry, which is already challenged by tightening availability and high prices of recovered fibre.
- A new pulp mill improves employment and welfare in local forest communities. We should also note that young professionals in the 3 Russian forestry regions are not particularly interested in a career in the forestry sector because the sector is perceived as ailing. A greenfield pulp mill, owned and operated by a respected industry player, can contribute to a better image.
- Naturally a new pulp mill generates economic growth and tax revenues and it will also have a positive knock on effect to other industries such as the production of solid wood products, packaging and bioenergy for the domestic and export markets.
- Working with respected industry players gives comfort to the Russian authorities that the investor can be trusted to comply with high standards of financial transparency, social responsibility, staff development and sustainable forestry management.

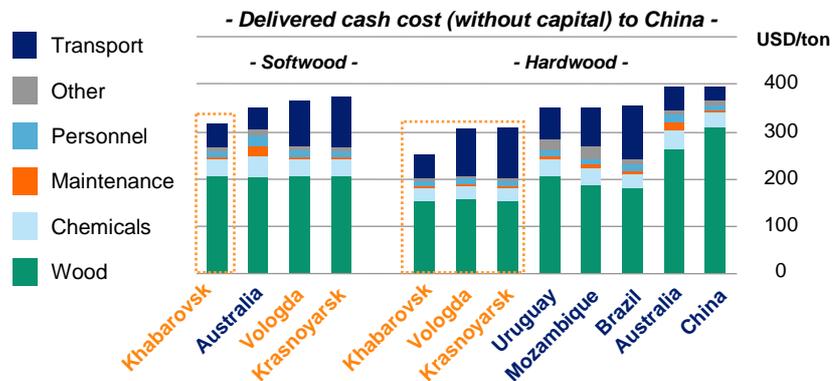
"...attractiveness of the investment in a greenfield pulp mill ..."

But does it make financial sense to invest in Russian pulp? The study shows that the cash cost of Russian pulp delivered to China is competitive.

	<u>Russia</u>	<u>Competing countries</u>
○ Softwood pulp	320-370 US\$/ton	350 US\$/ton
○ Hardwood pulp	350-310 US\$/ton	350 – 390 US\$/ton

RUSSIAN PULP HAS VERY COMPETITIVE CASH COST...

- Russia is cost competitive for exporting pulp to Asia, especially China. The pulp is, however, sold at a discount due the impact of larch and a variety of hardwood species.
- Wood accounts for about 60% of delivered cash costs among the selected projects. Transport and other production costs account for less than 20% of delivered cash costs.

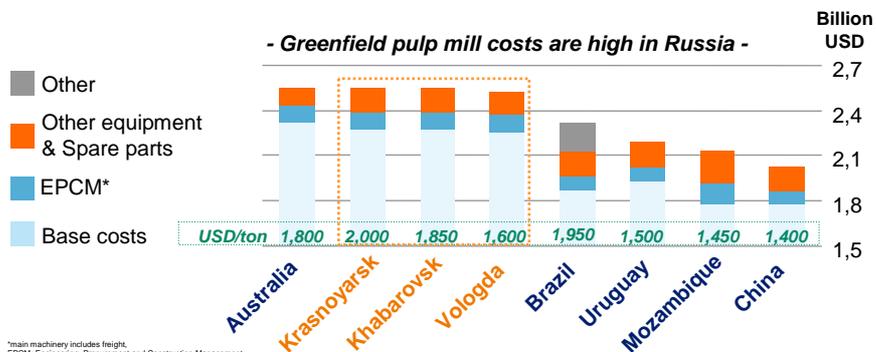


So on this parameter Russia is doing well. But what is the investment cost of a world class, competitive size market pulp mill in Russia and in the competing countries?

- **Russia** **US\$ 2.5 billion** **1.32 million tons/a**
- **Competing countries** **US\$ 2.0 - 2.5 billion** **1.45 million tons/a**

... BUT THE RUSSIAN GREENFIELD IS A DISADVANTAGE

- Greenfield pulp mill construction cost is driven by (i) size, (ii) fibre mix, (iii) infrastructure, and (iv) non-refundable taxes and duties.
- Hardwood pulping has higher yield than that of softwood resulting in higher output on similar assets. The capability of producing both grades increases the investment.
- Due to regional cost factors and forest structures, the need to produce both hardwood and softwood makes the Russian pulp mill expensive. Swing mills are estimated to reach production of 1.3 million t/a, whereas hardwood mills would reach 1.5 million tons/year



*main machinery includes freight, EPCM: Engineering, Procurement and Construction Management

Due to the raw material composition, the capacity of a pulp mill is lower in Russia compared to the competing countries. The capital expenditure per capacity ton is therefore 1,900 US\$/ton in Russia vs. 1,400 – 1,750 US\$/ton elsewhere.

Will a new pulp mill be “digging green gold”? The study shows that a greenfield pulp mill will yield about 10% return on investment in Russia. The return in Uruguay is slightly higher.

The return on equity is 7% - 17% depending on mainly host government tax policies. The return on equity for a mill in Russia would be about 13%. All these return estimates are on a real basis.

“GREEN GOLD”? ...A GREENFIELD PULPMILL YIELDS 10% ROI

USD, million	Vologda	Krasnoyarsk	Khabarovsk	Australia	Brazil	China	Mozambique	Uruguay
Investment	2,700	2,700	2,700	2,700	2,500	2,200	2,300	2,300
Output 1,000 t/a	1,375	1,300	1,275	1,450	1,450	1,450	1,450	1,450
Gross revenue	910	890	840	900	920	920	920	920
Cash costs	(440)	(450)	(380)	(480)	(500)	(570)	(500)	(490)
Depreciation	(140)	(140)	(140)	(140)	(130)	(120)	(120)	(120)
EBIT	290	270	290	190	250	210	260	270
ROI %	11 %	10 %	11 %	7 %	10 %	9 %	11 %	12 %
Equity ratio %	50 %	50 %	50 %	50 %	50 %	50 %	50 %	50 %
Interest rate %	5.3 %	5.3 %	5.3 %	4.4 %	5.3 %	4.8 %	6.2 %	5.7 %
Interest payment	70	70	70	60	70	50	70	70
Taxes	40	40	40	40	60	40	40	0
Net income	180	160	180	90	120	120	150	200
ROE, %	13 %	12 %	13 %	7 %	10 %	11 %	13 %	17 %

- The return on investment (ROI) is 7 - 12 %.
- The return on equity (ROE) is between 7% – 17%
- Vologda and Khabarovsk show a better potential for returns than Brazil and China - assuming loan interests at market rates. However, BNDES in Brazil and CIC in China offer subsidised loans to greenfield investors.
- The highest returns are found in Uruguay, which is host to the majority of greenfield mills built in the past decade – partly due to attractive tax incentives.
- Pulp mills need 50% equity to survive the market cycle.


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Moreover, market pulp prices are volatile and that makes a pulp mill’s free cash flow very tight at the bottom of the price cycle. This hinders financial leveraging of a pulp mill. A greenfield pulp mill project needs to be financed with 50% equity to be considered a sustainable project within the finance community. This means that a greenfield market pulp project in Russia, without infrastructure investments, requires about US\$ 1.25 billion equity.

“GREEN GOLD”? ... THE PULP PRICE VOLATILITY HAS A HUGE IMPACT ON A GREENFIELD MILL’S ABILITY TO SERVICE DEBT.

50% of investment must be equity financed

USD, million	Vologda	Krasnoyarsk	Khabarovsk	Australia	Brazil	China	Mozambique	Uruguay
EBITDA	300	295	320	200	230	175	235	245
Debt service	205	205	205	195	190	160	185	185
Taxes	20	15	20	0	10	0	10	0
Repair capex	25	25	25	25	25	20	25	25
Free cash	50	50	70	(20)	5	(10)	15	40
ROE	5 %	5 %	6 %	(0 %)	2 %	0 %	3 %	5 %

- NBSK sold for 600-650 USD/t and the BEKP 500-550 USD/t in China during industry cycle downturns.
- If loans have 12 year loan tenors, then substantial cash flow is needed for debt service due to high investment costs.
- At 50% equity ratio and market based financing, Australian and Chinese greenfields will have negative cash flows during industry cycle downturns.



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Who has the commercial interest, industrial resources and can afford such a greenfield investment? And, moreover, also has capacity to provide a creditworthy project completion guarantee to mobilise the debt package of another US\$ 1.25 billion?

The honest answer is that we must look among the top 5 market pulp producers and the top 5 integrated paper producers. Indeed, such companies as Botnia, Stora Enso, Södra and UPM have studied projects of this scale in Russia, but so far have not proceeded with greenfield investments.

Only Mondi and International Paper (as partner in the Ilim Group) have committed very large US\$ 1 billion brownfield investments in their existing pulp and paper mills in Russia.

Naturally we do not want to out-rule an option that a major Russian natural resource company could also be a candidate for a greenfield pulp mill investment based on its balance sheet, and assuming that it would be able to build up required industry competence.

WHO ARE THE POTENTIAL INVESTORS WITH THE MONEY AND STRATEGIC INTEREST?

	- Integrated Paper Companies -	- Market Pulp Producers -
<i>Investment rationale</i>	<ul style="list-style-type: none"> • Reduce cost structure of raw material supply • Improve raw material self sufficiency 	<ul style="list-style-type: none"> • Capitalise on demand growth for fibre in Asia
<i>Existing production assets</i>	<ul style="list-style-type: none"> • Focus on wood free papers, liner boards and carton boards • About 10 million tons of paper and board capacity • Among top 5 within the industry • Present in North America, Europe, Asia 	<ul style="list-style-type: none"> • Focus on market pulp (bleached softwood and hardwood pulps) • About 4 million tons of market pulp production capacity • Among top 5 within the industry • Present in North America, Europe, Asia
<i>Balance sheet</i>	<ul style="list-style-type: none"> • 20 billion USD in size with debt to equity ratio of about 0.80 • Capacity to mobilise 6 billion USD of new debt to facilitate growth in pulp and paper production 	<ul style="list-style-type: none"> • 9 billion USD in size with debt to equity ratio of 0.66 • Capacity to mobilise 3.6 billion USD of new debt to facilitate growth in market pulp production

In the course of carrying out the study, we noted that the government in Brazil seems to have an empowered task force, which is focused on maintaining a dialogue with the top 10 industry players. The task force's mission is to attract investors, and it is empowered to discuss the reforms and support needed to realise these projects. Russia should perhaps establish its own credible and properly empowered task force.

The top industry players agree that Russia has good potential, but the risk and reward must have a better balance. So what are the main risks in the three Russian forest regions compared to the competing countries?

STRATEGIC INVESTORS SAY RUSSIA HAS GOOD POTENTIAL, BUT HIGH RISKS WITH LITTLE INCENTIVES

rating ++/+/0/-/--	Vologda	Krasnoyarsk	Khabarovsk	Australia	Brazil	China	Mozambique	Uruguay
<i>"Russia has good potential for viable investments on greenfield pulp mills"</i>								
Profitability (net income)	+	+	+	-	0	0	+	+
Investment cost	-	-	-	-	0	+	+	0
ROE, over economic cycle	+	+	+	-	0	0	+	++
ROE, bottom of economic cycle	+	+	+	-	0	0	+	+
Attractiveness unadjusted for risks	+	+	+	-	0	0	+	++
<i>"But project implementation and operating risks in Russia make a high barrier"</i>								
Construction cost risks (infrastructure, roads)	-	--	--	0	+	+	--	+
Operating environment uncertainties	-	--	--	+	+	+	--	+
Access to skilled workforce	0	-	-	+	+	0	--	+
Secured ownership of critical resources	0	0	0	+	+	-	0	+
Raw material cost risks	-	--	--	+	0	-	-	+
General cost inflation pressure	-	-	-	+	-	-	0	0
Project implementation and operating risks	-	--	--	+	+	0	--	+
<i>"And other regions in the world use effective incentive packages to attract investors"</i>								
National financing programmes	0	0	0	0	+	+	0	0
Attractive tax/duty framework	0	0	0	0	-	-	+	++
State financing for infrastructure investments	-	-	-	0	+	+	-	+
Financial incentives to attract investments	0	0	0	0	+	+	0	+
General assessment on attractiveness	0	-	-	0	+	+	-	+



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First, how does the 3 Russian regions compare with the competing countries on the basic wood supply? ...

What is the type of wood source?

- Russia **Natural Boreal forests; mixed species**
- Competing countries **Plantations; Eucalyptus, Acacia, Pine**

What is the typical annual growth of the forest, m³sub/hectar?

- Russia **1.0 – 3.5**
- Competing countries **17 – 35**

How much forest land is needed to feed a modern pulp mill?

- Russia **3 – 10 million hectares**
- Competing countries **0.2 – 0.3 million hectares**

What is the average wood transport distance?

- Russia **300 – 550 kilometres**
- Competing countries **100 – 300 kilometres**

On the count of wood supply, Russia appears to be far apart from the competing countries. This adds to the unpredictability of the operating costs estimate, making it necessary to insert a safety margin in the cost calculations.

POOR INFRASTRUCTURE AND DIFFICULT NATURAL CONDITIONS LEAD TO MAJOR WOOD AVAILABILITY RISK IN RUSSIA

	Vologda	Krasnoyarsk	Khabarovsk	Australia	Brazil	China	Mozambique	Uruguay	
Slowly growing natural forests with high species variation require large forest area and long transport	Species variation	Medium	High	High	In Control	In Control	In Control	In Control	
	Annual growth, m ³ sub/ha	3.5	1.5	1.0	25	35	17	25 est. 28	
	Forest area (1,000 ha)	2 900	7 600	10 000	210	160	320	220 200	
Difficult climate and poor infrastructure lead to wood availability risk and require large road networks to be built in Russia	Transport; Aver. distance	300 km	450 km	550 km	125 km	100 km	300 km domestic	150 km 300 km	
	Climatic condition	Hard	Severe	Hard	Adeq.	Good	Good	Adeq. Good	
	Wood supply issues	Major infra development need, large wood inventories needed			Draught	Competition for land	Other land uses	Low skilled labour	Land area for forests
	Availability risks	Access to forests restricted by poor infrastructure			Forest Fires	Social pressure	Import price	Un-known	Minimal



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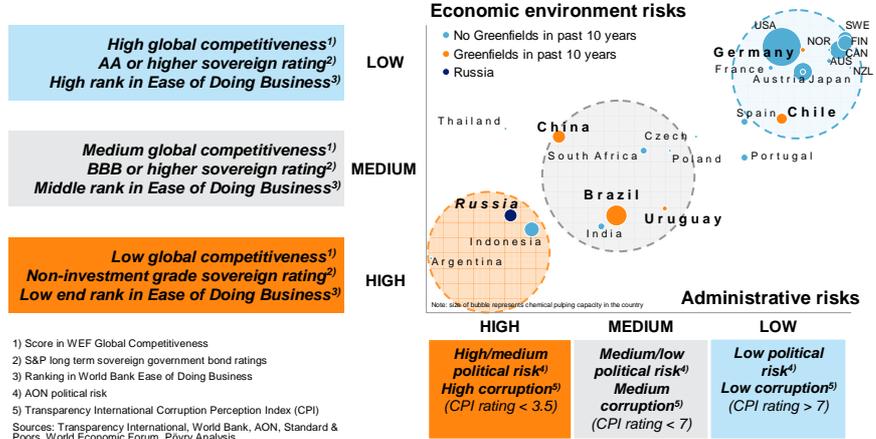
Second, the study reveals not surprisingly that a pulp mill must be built in the middle of its raw material source, forest. In Russia this means a remote location, with scant infrastructure, and no track record of major construction works. Good quality SMEs are the backbone in the market for industrial forest services, which is a core strength in places like in Finland and Canada. SMEs can build and service roads, but such SME practically do not exist in these 3 Russian forestry regions. This adds to the unpredictability of the investment estimate, and requires an additional safety margin in the cost calculations.

So far we have looked at the findings from the point of view of greenfield construction and operational costs. But how does the political, economic and regulatory environment impact the project?

We know that investors are looking for stable and predictable investment environments. In a global comparison, based on several independent analyses, Russia ranks low compared to the countries where pulp mills have been built. What holds Russia back are a poor administrative framework and worse than average competitiveness.

INVESTMENT CONDITIONS ARE UNFAVOURABLE IN RUSSIA

The chemical pulp industry is established in areas with a generally favourable operating environment. Russia suffers from poor administrative framework and worse than average competitiveness



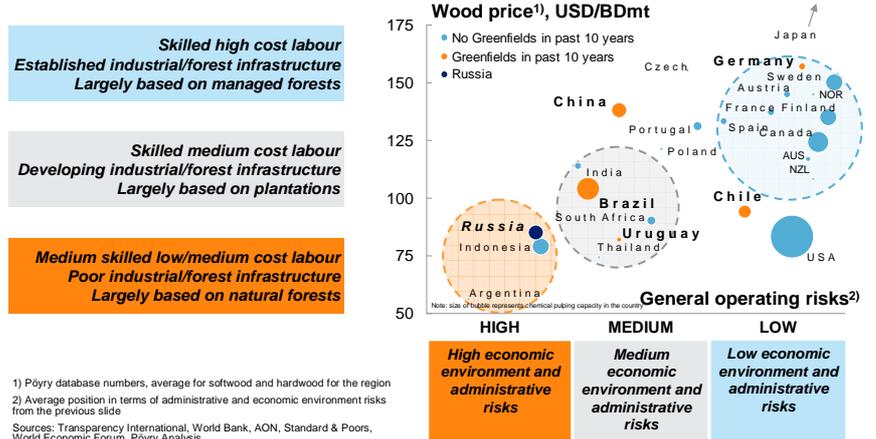
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It is an important finding that low wood prices do not compensate for a weak general operating environment.

LOW WOOD PRICES DO NOT COMPENSATE FOR WEAK GENERAL OPERATING ENVIRONMENT

The chemical pulp industry is established in areas with favourable general operating environment and expands in regions with low cost of raw material (Brazil, Chile, Uruguay)



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The factors related to the investment environment add one more element of unpredictability to the profitability calculations and require yet more safety margins in the cost calculations.

So, to sum up, what are the unpredictable elements?

- Investment estimate
- Operating cost estimates
- Wood cost estimate
- Investment environment

Do the estimated rates of return provide enough safety cushions to absorb these unpredictable elements?

Hardly at 10 - 11% ROI. But it should be noted that one country with a reformed investment climate has been chosen for the construction of a pulp mill with a ROI of 11.5%.

So, what are the 4 key factors preventing a new greenfield pulp mill in Russia?

- Uncertainty of reliable wood supply
- Uncertainty of wood logistics infrastructure investments
- Unpredictable investment environment
- Low costs do not compensate for unpredictability

"...the reform agenda ..."

Is the conclusion that the sceptics are right, that large greenfield pulp mills make no sense in Russia? Without reforms, the sceptics will outnumber the optimists. But that is where the Russian Government comes into the picture. The study analysed the best practises for how sound private investments can be facilitated thanks to reforms and providing infrastructure support.

REFORM ACTION PLAN TO CONVINCE AN INDUSTRIAL PLAYER TO INVEST IN A GREENFIELD PULP MILL IN RUSSIA

- **Improved financial viability:**
 - Allow the use of modern and tested *international forest management practises*
 - **Priority Investor Status** to cover the entire wood supply zone
 - Federal, regional and/or third party *funds for infrastructure* outside the mill fence
- **Reduced implementation risks:**
 - **Adequate amount of forest leases** are reserved within logical wood supply zone
 - **Priority access to expiring leases** in the wood supply zone
 - **Special Project Zone** which allows adapting international standards and norms that reach the same or better performance in terms of health, safety and environment
 - **An efficient one-stop-shop (one entity)** for the filing of all applications and the processing of all permits and licences needed for the project.
- **Improved investment incentives:**
 - **Competitive financing mechanism and tax schemes** will be developed to match the conditions at competing investment destinations (countries).


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The study suggests that the Russian Government has the option to go for “a game changing action plan” along the following lines:

A first reform package should focus on the improvement of the financial viability of a greenfield pulp mill by reducing operating and investment costs. The 4 specific actions needed in this first reform package are:

- o *First*, modern and tested forest management practises should be piloted in the wood supply zone.
- o *Second*, the Priority Investor Status should be granted to cover the entire wood supply zone, including adjacent Oblast(s).
- o *Third*, federal, regional and/or third party funding timed to project implementation milestones should be used for the development of infrastructure outside the mill fence, including utilities, logistics, housing and municipal infrastructure.
- o *Fourth*, investor should be given facilitated access to an optimal mill site.

The second reform package should focus on reducing implementation risks. The 5 specific actions needed in this first reform package are:

- o *First*, the Federal and regional authorities should ensure that adequate amount of forest leases are reserved for the project within the logical wood supply zone.
- o *Second*, the project should have a priority to take control of expiring leases in the wood supply zone and solutions should be sought for current lease contracts to supply the project.
- o *Third*, special purpose and project specific Visa and Work Permit programmes should be piloted for required foreign experts during the project implementation phase and start-up of commercial operation.
- o *Fourth*, international standards and norms that reach the same or better performance in terms of health, safety and environmental issues should be allowed (piloted) in the project’s industrial zone.
- o *Fifth*, a single entity ‘one-stop-shop’ should be created for filing and processing all legal documents and applications/granting all required permits and licences for a project.

The Third and final reform package should focus on the improvement of the overall attractiveness of Russia as an investment destination via development of tax/financing schemes that make it worthwhile to choose Russia over key competing countries..

"...conclusion ..."

Let us conclude by summarising that a greenfield investment in pulp and paper is all about trust, reform and financial partnerships.

As one prominent world player in the forestry sector explained to us recently, a greenfield pulp mill can be realised in Russia, if the Russian Government guarantees adequate competitive fibre supply and shares the infrastructure costs needed for a pulp mill.

In fact, a clear cooperation between the local government and a private investor is often on offer in other emerging market countries, precisely to help attract good investors into the forestry sector.

EBRD would welcome other institutions such as VEB, Sberbank, RFID working with EBRD in the appraisal, structuring and support for large viable projects in this sector.

The EBRD has the highest (AAA) credit rating. EBRD can tailor long-term equity and loan financing to a greenfield projects' future cash flow. The Bank's financing requirements are outlined in the booklet "*A guide to EBRD Financing*". The guide is available in various languages on www.ebrd.com.

Our website has also a summary of the findings of our Russian Forestry Policy Dialogue Study

Thank you!

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