

# BUSINESS MIR ECONOMIC BULLETIN

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## ECONOMIC SURVEY

# GLOBAL FINANCIAL CRUNCH HITS RUSSIA

Following the Black Tuesday September 16, when trading was suspended on the RTS and the MICEX, Russia was hit by the Black Friday October 3, following which the exchanges collapsed on October 6.

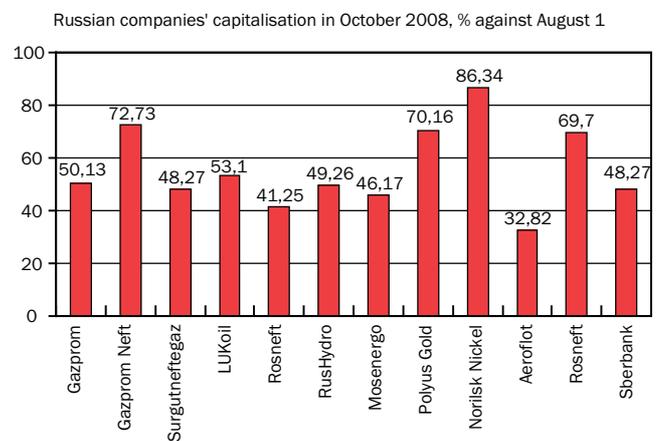
The RTS index plunged to 866.9 points and the MICEX index, to 752 points. Trading has been stopped several times on the two exchanges, and the government approved billions of roubles of financial injections into lending institutions. Russia has seen several hikes followed by deep falls, along with the rest of the world where exchanges are tottering at the edge of collapse.

The current global financial crisis is not only very strong, but will also last long. Back in March, FC Novosti predicted, alongside other analytical agencies, "The global negative processes are running so strong that many fear a lasting recession that will undercut the economy not by percentage points but several-fold. Most of those who make these negative forecasts would like to be proved wrong, but..."

After that, we saw an upward jump in May and a smooth glide down in the summer.

Now the default, which many analysts feared with good reason, has reached Russia, although from an unexpected direction. The government has so far enough funds to pay its debts, and only a few banks and leading companies have serious problems. But the stock market has collapsed, endangering the future of the most successful and pro-market Russian companies. The country is facing a liquidity crisis, which may grow – or has already grown – into a full-blown banking crisis.

Prime Minister Vladimir Putin has said the country has a way to stabilise the situation. We do have safety bags, but unfortunately they may prove not enough for the many economic entities that may need them. The government is now using non-market regulation tools, the same as all other countries. Compared with the Paulson Plan and the US \$700 billion bailout programme, the Russian measures are much less radical.



Yet many analysts cringe at the unprecedented rights granted to the Central Bank and the Finance Ministry. They believe that the domination of the gas, energy and railway monopolies is now being complemented with similar measures in the financial sphere.

This could be a good solution in a critical situation, although when the financial crisis reached Russia in August 1989 the government first of all monopolised foreign trade and currency regulation. At that time, Russia had modest international reserves and was not integrated in the global economy as strongly as it is now.

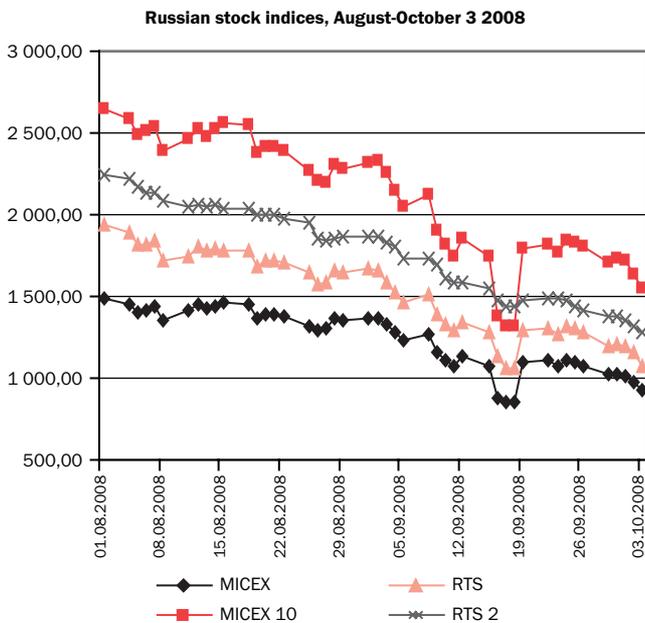
However, in 1989 we mustered the courage to refuse Western financial assistance, which would have spurred inflation in Russia's unbalanced economy. Today the Russian economy is balanced much better, has eased its dependence on the commodities sectors, and does not need financial assistance.

Analysts wonder why the Russian government has not chosen to rely on the experience it gathered in 1989. They hope that the anti-crisis measures will be temporary, just as the weakening of the Central Bank's reserve requirements and taxes on lending organisations are temporary.

Besides, the Russian stock market is only part of the Russian economy, which also has strong defence and nuclear sectors, the insurance market, the consumer sector and small businesses, as well as the banking sector where Sberbank, VTB and the Bank of Moscow are not the only lending organisations.

The Russian market is highly volatile because it is small in terms of turnover and the number of securities floated. It reacts nervously to any negative and positive foreign news, and was seriously affected by the flight of foreign investors before the September financial shocks, encouraged also by the war in the Caucasus.

It would not be right to blame the collapse of the Russian market on foreign investors, because the majority of them withdrew their money from Russia's "safe haven" long before Georgia started bombing South Ossetia. The fall of Russian ADRs on foreign exchanges could not capsize the MICEX and the RTS.



Don't look for speculators' collusions against Russia either. Some of them decided to go the whole hog, so as to gain from the inevitable subsequent growth of the market. But many shares can turn into cheap newsprint because of bankruptcies.

The fall on the Russian market on September 16 was provoked by the US exchanges' reaction to the bankruptcy of Lehman Brothers, but the events of October 3 have deeper roots. That day, all companies around the world fell, but Russian companies fell the hardest, as they usually do.

The fact that Russia is part of the global economy – even though it is not a WTO member – does not mean that the same crisis management scenario can be applied to all countries. The difficult part is to choose the right direction at a time when the majority of countries are taking emergency

measures to stop the collapse of the US market and prevent it from hitting their national economies.

At the same time, we must remain calm and confident, if we want to minimise losses from the crisis. The Russian government has rapidly drafted and approved additional measures to support companies working in crucial sectors, notably small and medium businesses. It has also proclaimed readiness to stimulate investors who channel funds into economic modernisation.

For their part, businesses have expressed solidarity with the country's authorities and readiness to work jointly to overcome problems.

Prime Minister Vladimir Putin said at a meeting with foreign businessmen in Sochi, on the Black Sea coast: "We see tension also on our trading floors, but we have reasons to think that it is not due to our problems. There are no systemic problems in the Russian economy. All of its economic indicators are normal."

The second anti-crisis package, which the Russian lawmakers have promptly approved, does not at all contradict Putin's idea, although some may not like it.

They stipulate that any Russian bank or company can appeal to Vnesheconombank (VEB) for a loan to repay or refinance its foreign loans taken out before September 25, 2008. The loans will be issued on commercial terms. To ensure this, the Central Bank will open deposits with VEB for these loans, whose total upper limit will not exceed \$50 billion.

The Central Bank has been allowed to issue loans to commercial organisations without a pledge, which will quickly inject enough liquidity into the banking sector. To maintain the interbank lending market, the Central Bank may sign agreements with banks on repaying part of potential losses from lending to other financial organisations.

And lastly, RUR250 billion (\$9.54 billion, or €7.04 billion) has been appropriated in the 2008 and 2009 federal budgets for supporting the stock market. As much as RUR75 billion will be used this year to increase the authorised capital of VEB, which has started insuring the leading banks' efforts to support the stock market.

Amidst the high seas of the global crisis, the Russian Central Bank and Finance Ministry have rapidly learned to use long-term tools for influencing the situation. Therefore, we are convinced that the Russian stock market will resume normal operation relatively quickly. Since the situation in the world will change, this will make Russia an even more attractive destination for foreign investment.

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## BANKING AND FINANCE

### Sberbank to Borrow \$1bn for Three Years

Sberbank is taking a \$1bn syndicated loan for three years at LIBOR + 85 basis points, two bankers from the banks arranging the loan told Vedomosti. The effective rate including the commission fee will be around LIBOR + 2%, said a banker familiar with the progress of the transaction.

According to Reuters, the syndicate's arrangers are the Bank of Tokyo – Mitsubishi, Barclays, Deutsche Bank, DZ Bank, ING, JPMorgan and SMCE. A manager from one of them said the syndicate included 12 banks, the mandate was signed on September 2, 2008, and funding was planned for early October.

Sberbank, Russia's largest state-owned savings bank, has been active on debt markets this year. In July, it placed \$500mn worth of Eurobonds at 6.468% and its supervisory board decided to issue RUR60bn worth of Russian bonds.

### Sberbank Raises Loan Rates for Legal Entities

Russia's largest state-owned savings bank Sberbank has raised interest

rates on some loans for legal entities, Irina Kibina, head of the bank's public relations, told the Interfax news agency. Terms of some loan agreements with corporate clients allow the bank to change the cost of the loan unilaterally, she said.

Sberbank may take advantage of this right if the Russian Central Bank significantly changes the refinance rate, she explained.

According to the Central Bank's statistics for July 1, 2008, the total sum of loans Russian banks issued to domestic companies was RUR8.8tn (\$348.38bn, or €242.62bn), with Sberbank accounting for RUR3.6tn, or 41%.

On January 1, 2008, the bank's share was 43.4%.

Experts believe the main reason for the current increase in the interest rates is that loan resources have become more expensive for Sberbank itself, as well as for the entire banking system.

### Top 30 Banks Net \$8.8bn i Profits in Seven Months

The Russian Central Bank has published consolidated statistics on the country's top 30 banks as of August 1, 2008.

According to it, these banks' profits in the first seven months of 2008 amounted to RUR226.5bn (\$8.8bn, or €6.3bn), up 24.2% from RUR182.4bn in the same period of last year. In July 2008, their profits grew by 12.4%.

The banks' assets as of August 1, 2008 totalled RUR16.0982tn. Out of this sum, monetary funds, precious metals and stones accounted for RUR265.478bn, funds on accounts with the Central Bank for RUR490.625bn, correspondent accounts for RUR214.5529bn, and stocks for RUR1.57628tn.

Russia's top 30 banks on August 1 included Absolut Bank, AK Bars, Alfa Bank, Bank Saint Petersburg, VTB North-West, the Bank of Moscow, BSGV, Vozrozhdenie, VTB, VTB24, Gazprombank, Bank Zenit, MDM Bank,

Nomos Bank, Petrocommerce, Promsvyazbank, Raiffeisenbank Austria, Rosbank, Rosselkhozbank, Russian Standard, Rus Bank, Sberbank, Sviaz-Bank, Citibank, TransCreditBank, Bank Trust, Uralsib, URSA Bank, Unistrum Bank, and UniCreditBank.

This list has not change from July 1, 2008.

### ADG Group Borrows \$45mn to Build Shopping Centre in Novosibirsk

OOO Ploshchad Marksa, which is part of the ADG group, and UniCredit Bank have signed a loan agreement on financing a project to build a shopping and entertainment centre Kapital in Novosibirsk. The \$45mn loan is provided to the company for seven years.

By now, Kapital has 80% of the necessary leasers. The anchor leasers are the Megas hypermarket (5,300 sq m), the nine-hall movie theatre Kinomax (3,600 sq m), the children's entertainment zone Igromax (800 sq m), and the M-Video and Sportmaster stores. The centre will also have a six-concept food court.

The ADG group launched the Kapital project in February 2007. The centre is expected to open in the second half of 2009. It consists of four levels, three of which accommodate shopping areas and one (the basement) a parking lot for 400 cars. The centre's aggregate area is 50,700 sq m, the shopping area is 27,200 sq m and the area of the shopping gallery is 12,200 sq m.

### Putin Promises Banks Compensations from Central Bank

The Russian government is prepared to do much to help Russian banks and return money to the inter-bank credit market.

Prime Minister Vladimir Putin said at a conference held to discuss the development strategy until 2020 and measures to support financial markets that the Central Bank would be able to compensate the banks' possible

losses on the market of inter-bank credits.

"To support the market of inter-bank credits, the Central Bank will be allowed to sign agreements with certain banks to repay part of their losses from crediting other lending organisations, should they sustain such losses," Putin said.

According to the prime minister, this is one of the four new proposals of the government and the Central Bank aimed at supporting financial markets.

### **Government to Invest \$1.7bn in Offshore Prospecting until 2020**

The government will provide RUR43bn (\$1.7bn, or €1.2bn) until 2020 to finance geological exploration of Russia's offshore areas, while RUR570bn (\$22.8bn, or €15.6bn) will come from non-budget sources, Deputy Natural Resources Minister Sergei Donskoi said at the government hour meeting in the parliament's upper house.

The ministry estimates Russia's recoverable offshore reserves at 100 billion metric tons (735bn bbl) of oil equivalent, including around 17bn tons of oil and gas condensate and around 82 tcm (2894.6 tcf) of natural gas, including free and dissolved gas.

### **Alfa Bank to Finance Acquisition of Serbia's Ikarbus**

Alfa Bank has completed the deal to provide a €13mn long-term loan to Avtodetal-Service for acquisition of 100% in Ikarbus AD, a Serbian producer of modern buses well known in East and West Europe, the bank said in a statement.

Avtodetal is a major producer of auto parts and components and part of the AMS Group holding company. It is also the general producer and supplier of the Ulyanovsk Automobile Plant.

The acquisition will allow the group to set up full-cycle production and enter the Russian bus market.

## **MACRO-ECONOMICS**

### **Russia's Positive Trade Balance Up 60% in Seven Months**

Russia's Federal Customs Service said the country's foreign trade turnover in January through July 2008 was \$433.8bn, up 51.4% from the same period last year. Exports amounted to \$282.3bn (up 53.2%) and imports to \$151.6bn (up 48.2%).

Russia's positive trade balance grew 59.5% year on year, to \$130.7bn from \$81.9bn.

### **Arctic Development Russia's Strategic Task**

Russian President Dmitry Medvedev has instructed the government to draft a plan on state policy regarding Arctic development by December 1, 2008.

The Arctic region is of strategic importance for the country and should become its resource base in the 21st century, he said.

To ensure this, Russia needs to tackle a number of issues, notably create a firm legal framework to regulate activities in the Arctic and secure external borders of Russia's continental shelf, and reduce the disproportion in the development level of Arctic territories and other regions.

Medvedev focused on the development of Arctic transport infrastructure, the backbone of which is the Northern Sea Route. To modernise its infrastructure, the country needs a cutting-edge navigation and search & rescue system. It also needs to expand its port network and develop the route as its strategic national route, the president said.

### **Parliament Approves 2010-2011 Federal Budget**

The State Duma, the Russian parliament's lower house, adopted in the first reading the 2009 federal budget

and a two year budget for 2010-2011 at a plenary meeting Friday.

The 2009 federal revenues are planned at RUR10.927tn (\$428.7bn, or €301.4bn), or 21.2% of the country's gross domestic product, and expenditures at RUR9.025tn (\$354bn, or €249bn), 17.5% of GDP. The budget surplus will be RUR1.902tn (\$74.6bn, or €52.5bn), or 3.7% of GDP.

Oil and gas income will be RUR4.693tn (9.1 % of GDP) in 2009, RUR4.526tn (7.7%) in 2010, and RUR4.637tn (6.9 %) in 2011.

Interest expenditures are expected at RUR198bn in 2009, RUR233 in 2010 and RUR308bn in 2011, and non-interest expenditures RUR8.827tn, RUR10.086tn, and RUR11.009tn, respectively.

Russia's Reserve Fund will grow to RUR5.147tn (\$202bn, or €142bn) in 2009, RUR5.914tn in 2010, and RUR6.761tn in 2011, each amount representing 10% of relevant GDP.

Russia's National Welfare Fund will be RUR3.331tn (\$130.7bn, or €91.9bn) in 2009, RUR4.588tn in 2010 and RUR6.08tn in 2011.

The budgets are based on projected GDP growth of 6.7% next year, 6.6% in 2010 and 6.2% in 2011, and on tentative global Urals price of \$95 per bbl in 2009, \$90 in 2010 and \$88 in 2011.

### **Russia's International Reserves Down Due to Capital Flight**

According to the Central Bank of Russia, capital flight in August reached approximately \$5bn due to a decline in prices of the main Russian exports, which reduced the country's international reserves by \$14.264bn.

The figures were provided in the report on monitoring the economic situation in Russia in the first eight months of the year prepared by the Economics Ministry and published on its site on September 29.

In January to the end of August, international reserves have grown by

\$103.748bn, compared with \$112.308bn in the same period of last year. As of September 1, 2008, they totalled \$581.638bn.

### **Russia's Trade Balance Up 70%, to \$138.1bn, in Eight Months**

Russia's trade balance in January to the end of August 2008 was positive and totalled \$138.1bn, an increase of 70% year-on-year, according to the Economic Development Ministry.

The figures were provided in the report on monitoring the economic situation in Russia in the first eight months of the year prepared by the Economics Ministry and published on its site on September 29.

The trade balance was growing due to an increase in the positive balance of commodities, which account for a substantial part of Russia's foreign trade. At the same time, negative balance in the export of machinery, equipment and consumer goods was growing.

In the reporting period, Russia's foreign trade totalled \$524.6bn, up 49.2% compared with a growth of 18.8% in the first eight months of 2007.

Exports reached \$329.8bn, up 50% (9.3% in January-August 2007), due to growing prices of the main Russian exports.

## **FUEL AND ENERGY**

### **Russia to Set up Federal Hydrocarbon Reserves**

A national mineral reserve fund for future generations may be set up in Russia before the yearend. It will include a significant part of offshore fields.

The government resolution on forming the fund, drafted by the Natural Resources Ministry, has been coordinated with specialised agencies and

ministries. After endorsement by the Justice Ministry, it will be submitted to Prime Minister Vladimir Putin for signing.

Experts say some offshore licences that have been disputed by Russia's largest state-controlled crude producer Rosneft and energy giant Gazprom may remain in reserve for many years.

### **Russia Needs to Encourage Small, Medium-Sized Oil Producers**

Over half of oilfields in the Khanty-Mansi Autonomous Area are past their peak production, said Alexander Filipenko, governor of the West Siberian region.

In his opinion, the problem can be solved by changing taxes.

"Tax reduction will attract small and medium-sized businesses to the sector and encourage development of independent oil companies," he said. "This will allow raising the number of operating wells to approximately 17,000, which will yield 5-8 metric tons of oil daily."

Filipenko added that investment in innovative oil production technology was necessary to increase oil recovery and solve some other pressing problems.

At present, the Khanty-Mansi area accounts for 58% of Russia's oil output and 7.5% of the world's. Investment in the area's economy this year will amount to RUR400bn (\$15.5bn, or €11.1bn).

### **LUKoil May Manage BP's Stake in CPC**

British Petroleum may pull out of the Caspian Pipeline Consortium either by selling its stake or by giving it in trust to its partner in the project, LUKoil, a source in the CPC told the Oil News Agency.

BP holds a stake in the CPC through two companies, LUKARCO BV (its joint venture with LUKoil; share in the consortium 7.5%) and Kazakhstan

Pipeline Ventures (a JV with KazMunaiGaz, 1.75%). The British oil major owns 46% and 19% in these companies respectively.

"At present, BP is considering two variants: selling its stake or giving it in trust management to LUKoil," the Interfax news agency reported.

### **WGC-2 Considers Purchase of Coal Companies**

Wholesale generating company WGC-2 is considering acquisition of coal companies to ensure fuel supply to its power plants, the company's CEO, Stanislav Neveinitsyn, said.

"We are looking for coal assets that would be of interest for both existing plants (Troitsk, Serov) and new ones," he said.

The Troitsk district power plant consumes 6mn metric tons of coal annually and the Serov plant 2mn metric tons. Besides, WGC-2 is currently building a new coal unit at the Troitsk plant.

The company's current coal supplier is Rusal. But if it buys a coal asset, it may not need its services any longer.

WGC-2, established in 2005 as part of the restructuring of Russia's electric power sector, operates five hydropower plants in different Russian regions.

## **NEWS OF KEY COMPANIES**

### **Comstar Takes Control over Stream TV Regional Assets**

Comstar – United TeleSystems, Russia's leading integrated telecommunications operator, said in a press release that it has started the integration of regional operators of Sistema Mass Media (SMM) that provide cable TV and broadband Internet access services in 40 Russian cities

with a total population of over 15mn people.

Comstar is taking over the management of Stream TV Group, the largest pay TV operator in Russia.

Approximately 30% of Stream TV's network has been modernised to provide triple play services (VoIP, Internet and pay TV). Comstar-UTS and Stream TV's combined share of regional broadband market stood at 13% as of the end of last year.

The management agreement was approved by the Comstar and SMM boards of directors.

The next stage of the integration process will be the acquisition of Stream TV Group from SMM. The structure of the deal is currently under discussion and the assets are being independently valued by Ernst & Young.

Comstar expects to complete the deal by the end of 2008.

Investment in modernisation of Stream TV's infrastructure may reach \$60mn, said Comstar president Sergei Pridantsev.

### **Alisher Usmanov Wins Udokan Tender**

The Mikhailovsky mining and dressing plant (GOK), which belongs to Russian billionaire Alisher Usmanov and is part of the Metalloinvest holding company, has won the tender for the Udokanskoye copper deposit. The results of the tender were announced in Moscow on September 10.

The state-owned corporation Russian Technology earlier promised Metalloinvest to provide assistance in developing the deposit if it won the tender. The parties even prepared a joint feasibility study for the project. Details of the corporation's participation are not disclosed.

According to the Russian Federal Agency on Subsurface Use, the deposit's B+C1 reserves totalled 14.43mn metric tons of copper as of January 1, 2008. Its C2 reserves are

estimated at 5.52mn metric tons. The average copper content is estimated at 1.56%. The starting payment for the deposit is RUR4.5bn (\$175.9mn, or €124.3mn). The winner will receive a licence for 20 years.

Investment in the project will amount to some \$1.6bn. It will create several thousand new jobs and bring the Russian government over \$3bn in revenues.

### **Yandex to Build Data Centre in Moscow Region**

Yandex, a leading Russian Internet and technology company, has launched the construction of another data centre in Ivanteyevka northeast of Moscow. The new data centre will begin operation before yearend.

The new 2,500 sq m (26,910 sq ft) 4 MW facility, connected to Yandex's fibreoptic main, will house over 7,000 servers, the company said in a statement.

Yandex operates Russia's largest Internet search engine, with daily audience of 8mn people. As of August 2008, Yandex had approximately 55% of the Russian search market, compared to Google's 21%.

The company employs over 1,000 people in six offices in Russia and Ukraine.

### **Mechel Waives Yakutian Coal Licence**

Russia's mineral resources regulator, Rosnedra, had to cancel the results of the bidding for the Undytkanskoe coalfield in Yakutia, with estimated P3 reserves of 905mn metric tons.

The auction winner, Tula Incom, which is affiliated with Mechel, one of Russia's leading metals and mining groups, issued an official statement giving up the right to develop the asset.

The Yakutian division of the regulator said that a winning bidder has a legal right to relinquish the licence won without stating reasons and

without penalty. However, the company will lose its down payment, which in such cases goes to the federal budget according to established procedure.

In Mechel's case, the loss will be around \$2mn.

According to expert estimates, the Undytkanskoe auction held in April-July was one of the largest and longest. The bidders made over 7,000 auction steps, and the lot was sold for a record price of RUR35.195bn (\$1.4bn, or €968.5mn).

Apart from Mechel, the bidders included holding companies Sakha Ugol, Yakutugol and Kolmar Project.

## **MERGERS AND ACQUISITIONS**

### **AvtoVAZ Agrees to Pay \$300mn for Izhavto**

AvtoVAZ's board of directors will consider a deal to buy 100% of car manufacturer Izhavto from the SOK Group on October 1 in Paris, the Vedomosti business daily reported.

The Samara-based SOK Group, a diversified private industrial holding focused on car manufacturing and retailing, offered AvtoVAZ to acquire Izhavto for \$500mn at the beginning of this year.

Russia's largest automaker asked the Troika Dialog brokerage to evaluate the asset. After a due diligence process that lasted several months, sources close to Troika cited a preliminary estimate of \$350mn.

However, the AvtoVAZ board does not plan to approve a price higher than \$300mn, a source close to the board said. The low price is attributed to Izhavto's encumbrances and debt.

AvtoVAZ and Troika have declined to comment, and SOK has ignored the request as well.

## **Polyus Gold to Buy into KazakhGold**

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The board of directors of Polyus Gold, Russia's leading gold producer, will meet on September 30 to consider the acquisition by the company or its subsidiary of 50.1% of the issued and to be issued share capital of KazakhGold.

KazakhGold has confirmed that the parties are negotiating the partial offer.

Polyus Gold will buy the stake with own funds and shares.

KazakhGold Group Limited is the largest gold mining company in Kazakhstan with three principal operating mines, Aksu, Bestobe and Zholymbet, and a further eight new properties acquired in 2005. Its primary objective is to become the leading low-cost gold producer in central Asia.

Before 1990, the three mines produced approximately 7 metric tons of gold a year.

KazakhGold, the parent company of Kazakhaltyn, one of Kazakhstan's largest gold producers, is listed on the London Stock Exchange (KZG).

## **Russian Billionaire Plan Banking Group**

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Onexim Group, the investment vehicle of billionaire Mikhail Prokhorov, has acquired 100% of APR Bank, a small Moscow lender.

Prokhorov needs a banking licence to set up a banking group to service his holding company, which controls miner Polyus Gold and the TGC-4 utility as well as other assets, and other clients.

The new banking group, MFK, will be set up through a merger of APR and other banking assets, including Rosbank Asset Management Company.

MFK will focus on corporate banking, asset management for individuals and companies, and private banking. The chairman of its board will be Sergei Koshelenko, a former Rosbank deputy chairman.

As soon as they close the deal and receive regulatory approval, Onexim plans to ask the Central Bank if they could use the name MFK.

The original MFK bank, founded by Prokhorov and his partner Vladimir Potanin in the 1990s and folded into Rosbank in 2001, will now be resurrected as a new financial conglomerate, Onexim said in a statement.

Onexim plans to boost the bank's equity to \$500mn as part of its 2009 development strategy.

## **LAW AND LEGISLATION**

### **Financial Security of Tour Operators to Be Increased 15-fold**

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A bill increasing the financial security of tour operators in international business by 15 times has been submitted to the State Duma, the lower house of Russia's parliament.

The proposed amendments to Article 17 of the federal law on the tourist business increase the operators' financial security to RUR150mn (\$5.9mn, or €4.14mn) from RUR10mn.

Vladislav Reznik, the author of the bill and chairman of the house committee on the financial markets, said the amendments should improve protection of Russian tourists and service standards in the Russian tourist business.

An appendix to the bill mentions the situation with Detur, the Russian subsidiary of Turkey's Vasco Detur, which went bankrupt in summer 2008 affecting thousands of tourists, who have filed claims by far exceeding the operator's financial security standards.

### **Russian Parliament Proposes VAT Payment by Instalments**

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A group of parliamentarians have proposed payment of value added tax by

instalments in amendments to the Tax Code (Part Two, Article 174) to be debated at the lower house of Russia's parliament (State Duma).

The bill is designed to make VAT deductions to the federal budget more regular.

The Tax Code says VAT should be paid during the sale of goods (work, services, property rights) in the country and for work or services for one's own needs according to the results of the tax period (three months) not later than the 20th day of the month following said tax period.

MPs Yuri Vasilyev, Yevgeny Fyodorov, Gleb Khor and Andrei Makarov propose that a procedure be adopted in which the size of the VAT calculated by taxpayers according to quarterly tax declarations is to be paid to the budget in equal monthly instalments (not later than on the 20th day) during three months following a corresponding tax period.

### **Severstal to Increase Steel Output to 13.4mn Tons by 2018**

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Severstal plans to increase steel output at its subsidiary, the Cherepovets steel works, to 13.4mn metric tons a year within a decade. Cast iron production will reach 9.6mn metric tons, Andrei Lutsenko, the company's technical director, said at the international congress on modernisation of Russia's steel industry through reconstruction, commissioning of new facilities, construction of mini plants and development of service steel centres.

In the sector of hot- and cold-rolled steel, 100% of casting will be made into rolled steel. The production of cold-rolled steel will be increased to 4.3mn metric tons, of moulded sections to 704,000 metric tons and of coated cold-rolled steel to 1.4mn metric tons annually.

Severstal is a leading international steel producer by profitability. Its focus on high value-added products in attractive niche markets and successful track record of acquiring and integrating high-quality assets in America,

Italy, France and the UK has enabled Severstal to earn more than other Russian steel producers.

## INVESTMENT PROJECTS

### Inter RAO to Build Windmill Farm in Jordan

Russian electricity export-import operator Inter RAO UES will bid in the tender for the construction of a wind park project at Al Kamshah in Jordan.

The winner is to design, build, supply equipment, operate and service wind generators and an auxiliary power plant. The project will be implemented according to the build-own-operate (BOO) principle within 20 years.

If Inter RAO wins the tender, it will register a 100% subsidiary in Jordan to operate the project.

The results of the tender are to be announced in October 2008. According to its conditions, Jordan's Energy Ministry will buy the electricity produced at the wind farm.

### Eurasia City, Tashir to Build Satellite Town near Moscow

The Tashir Group and development company Eurasia City have set up a parity venture for implementing the Konstantinovo project, Tashir's press service said.

The project provides for developing areas in the Domodedovo District of the Moscow Region, 11 km (7 miles) from the Moscow Ring Road (MKAD).

A satellite town for 150,000 people is to be built on an area of 3,087 hectares (7,413 acres). The total development area will be 6.5mn sq m of housing and 2.6mn sq m of commercial real estate. Investment in the project will exceed RUR375bn (\$14.66bn, or €10.36bn).

About 700,000 sq m of housing will be built on an area of 190 hectares (about 470 acres) by the end of 2012. The social infrastructure facilities to be built in the Western District will include three schools, six kindergartens, one fitness centre, an outpatient clinic and a large shopping centre.

Investment in the construction in the Western District will total \$1.6bn.

Eurasia City and Eurasia Logistic are controlled by a co-owner of Kazakhstan's bank TuranAlem.

The Tashir Group was set up in 1999 to build shopping and office premises. Its main beneficiary is Samvel Karapetyan.

### Zarubezhneft to Set up Joint Venture with Rusvietpetro

An agreement on PetroVietnam's acquisition of a 49% stake in Rusvietpetro is to be signed in late October.

Zarubezhneft, a leading foreign trade company in Russia's oil and gas sector, set up the Rusvietpetro venture in July this year to develop four blocks of the Central Khoreiver Depression in the Nenets Autonomous Area, in the north of European Russia.

Zarubezhneft has informed the Vietnamese partner about the terms on which PetroVietnam is to join Rusvietpetro, Nikolai Brunich, head of the Russian company, said at a meeting of the Russian-Vietnamese intergovernmental subcommission in Hanoi.

Oil production in the Central Khoreiver Depression is to begin in 2011. Zarubezhneft plans spend about \$200mn on building a required infrastructure. Proven oil reserves of the four blocks total 100mn metric tons (735mn bbl).

The venture is to start oil production in 2011 and to increase it to 6.44mn metric tons per year (129,682 bpd) by 2017.

Within five years after the companies receive licences, they are to explore the blocks and drill exploration wells.

Production there will continue for 57 years and should yield 112.6mn metric tons (827.6mn bbl) of oil.

### Guta Clinic to Invest \$100mn in New Medical Centre

Guta Clinic plans a new medical centre in Rublevskoye Shosse, an elegant suburb west of Moscow.

Investment in the project is estimated at \$100mn, which is a record investment in Russia's private health services.

According to its investors, the centre will be fitted out with most cutting-edge equipment, up to the highest international standards.

Guta Clinic President Yelena Gushchina said that Moscow residents with high and middle incomes would be able to afford its services.

"An average bill in this new clinic will be \$250-\$300, considering the general growth in prices three years from now. I mean outpatient services, of course, as hospital prices will be much higher," she told Business FM.

The project will begin bringing profit in five years, according to expert estimates.

Guta Clinic is part of the Gosincor-Holding Financial and Investment Corporation, a group of companies controlled by Russia's State Investment Corporation.

### AMUR to Acquire Australia-based Mitsubishi Plant and Galant Platform

The Automobiles and Motors of Urals (AMUR) in Novouralsk, the Sverdlovsk Region, is considering a possibility to establish a car manufacturing facility and is negotiating with Mitsubishi acquisition of the equipment of the plant it has closed in Australia.

The Japanese corporation assembled Mitsubishi 380 (Galant) cars at Mitsubishi Motors Australia Ltd.

Apart from the equipment, AMUR intends to acquire the Mitsubishi 380 platform.

The outcome of the talks will be known in the second half of October.

Russia is one of the few countries where Mitsubishi delivers US-assembled Galant cars. But merely 1,667 Galants were sold in the first seven months of this year.

The design capacity of the Australian plant is 30,000 cars annually, but it produced only 10,000 Mitsubishi 380 cars in 2007 and was closed in March, Russia's Autostat (Automotive Statistics) analytic agency reports.

The equipment and the platform are estimated at about \$100mn.

AMUR plans to produce sedans, off-roaders and minivans. Earlier it was going to invest \$150mn in the project, but its net profit last year was merely RUR570mn (\$22.6mn, or €15.6mn) and revenues totalled RUR2bn (\$79.5mn, or €54.9mn).

AMUR needs co-investors, and the administration of the Sverdlovsk Region and the TGI Group are looking for them.

### **Estar Metallurgical Group Breaks Ground for €350mn Rostov Smelter**

Estar, a major Russian metallurgical group, has begun the construction of an electrometallurgical plant, Yuzhnorussky, in southern Russia.

Investment in the project, which is to be completed in about three years, will be €350mn-€370mn.

The new facility, designed by German engineers Concast AG of the SMS group, will employ 1,500 people and produce 960,000 metric tons of steel a year.

Its products will mainly include concast billets, I-beams, H-beams, and angle and channel beams. It will make around 900,000 tons of medium section products a year.

It is also planned to build a plant to produce technical gases jointly with Italy's Siad, a leader in the field of air separation plants. The facility will produce 8,000 cu m of oxygen, nitrogen and argon per hour, which is enough to supply the smelter and other consumers in the region.

Investment in the construction will be as much as €50mn.

## **INTERNATIONAL COOPERATION**

### **Russian Railways Builds Railway in Libya**

A groundbreaking ceremony for a new railway line has been held in Libya.

Russian Railways will build a 554-km (344-mile) 1435 mm twin-track line between Sirt and Benghazi in Libya on the Mediterranean coast. It will connect the country's major cities and in the future will form part of the international transport corridor in northern Africa.

The four-year construction project will cost €2.2bn and will be carried out by Russian specialists working with Libyan companies.

The project will require 30 rail and 23 road overpasses, as well as four major railway terminals and 24 stations, of which 14 will service passengers, two passengers and cargo, and four cargo. The railway will also have four operations stations.

Construction will require over 203,000 cu m of concrete and 40,000 metric tons of metal. Diesel traction will be used at the first stage of the project and at the second stage the line will be converted to electricity.

"This is the first major transport project in the history of the two countries," said Vladimir Yakunin, President of Russian Railways.

### **General Motors, GAZ Group Agree on Joint Ownership of VM Motori**

US automaker General Motors and the Russian GAZ Group, Russia's largest producer of light commercial vehicles owned by billionaire Oleg Deripaska, have agreed on the joint ownership of VM Motori, a diesel engine designer and manufacturer in Italy.

GAZ has purchased the remaining 50% of the company from Penske Corporation, a diversified transportation firm, which operates more than 300 franchised dealerships in 19 states, Puerto Rico, the United Kingdom, Germany, and Brazil. GM bought half of VM Motori from Penske Corporation last year.

GM has partnered with VM Motori for the past 10 years to produce diesel engines for its Opel cars, develop technology for GM Daewoo, and design the new 2.9L V-6 turbo diesel for the European 2009 Cadillac CTS, which will emerge on the European market already next year.

"This equity ownership agreement enables GAZ Group to access world-class diesel engine design and manufacturing," said Sergei Zanozin, CEO of GAZ Group.

Mike Arcamone, vice president of GM Powertrain Europe, said: "Our joint venture agreement with GAZ Group provides business opportunities to expand our diesel engine business with new customers."

### **Russia-Venezuela Consortium to Lead in Latin America's Energy Sector**

The oil and gas consortium of Russia and Venezuela, to be established next spring at the latest, may in future become the leader in Latin America's oil and gas sector, Russian Energy Minister Sergei Shmatko told the press.

He said the intergovernmental agreement the sides plan to formulate and sign would be open to other players. "As we see it, the companies will sign a special intergovernmental agreement in oil and gas cooperation, which is

very significant in political terms," the minister said.

Shmatko earlier said that the draft Russia-Venezuela intergovernmental agreement to establish an oil and gas consortium would be ready before the end of October and would be submitted for consideration of the bilateral intergovernmental commission and subsequently the governments of both countries.

Russia will invest "tens of billions of dollars" in the consortium, Shmatko said.

## INDUSTRY REPORTS

### Share of National Footwear Producers in Russia Dropped to 10% in 2007

The footwear market in Russia, including the "shadow sector," increased 15.1% in physical terms in 2007, independent surveyor Express-Obzor has reported. In terms of value, footwear sales totalled almost RUR435bn (\$17.26bn, or €11.9bn).

Russia imports most of its footwear. Last year, Russian producers met merely 10% of the demand, less than in 2006. In 2007, official production in physical terms dropped by almost 50% of output in real terms.

Most footwear was produced last year in the Central Federal District (40.4%) and the Southern Federal District (30.5%). China was the main footwear exporter to this country in real terms (82% of all imported footwear) and in terms of value (71%).

Among other significant footwear exporters are Italy, Turkey and Germany.

In the next two years, the growth rate of the footwear market will slow down, and will reach 9% in real terms by the end of 2009, which is evidence of a gradual saturation of the market.

### Russian Jewellers' Consumption of Gold Up 8.6% and Silver Up 17% in 1H08

The Russian jewellery industry in the first half of this year increased the consumption of gold by 8.6%, to 38.238 metric tons, and of silver by 17%, to 122.9 metric tons year-on-year, Boris Borisov, first deputy head of the Russian Assay Office, said.

The Assay Office tested and stamped 23.33mn Russian gold jewellery pieces weighing a total of 63.73 metric tons. On the average, each piece contains about 60% of pure gold.

It also examined 19.91mn Russian-made silver articles weighing a total of 132.86 metric tons, which contain approximately 92.5% of pure silver.

The Assay Office also stamped 9,220 platinum jewellery pieces and 3,250 palladium articles, their total weight being 67.53 kg and 18.35 kg respectively.

A total of 22.65mn Russian gold jewellery pieces weighing 58.682 tons and 15.785mn silver jewellery weighing 113.47 tons underwent expert examination at the Assay Office in the first half of 2007.

## RATINGS

### NRA Upgrades Individual Solvency Rating of IDGC Centre

The National Rating Agency (NRA) has upgraded the individual reliability rating of the Interregional Distribution Grid Company of the Centre (IDGC Centre) to A+ (high reliability, first responsibility level).

A company with the high reliability level can meet all its credit and debt obligations without losing solvency and financial stability. It has a small risk of losing solvency in the event of an increased debt as regards the existing obligations.

The NRA upgraded IDGC Centre following the establishment of the unified operating company and due to the improved quality of its corporate governance and increased transparency.

IDGC Centre operates through 11 branches and two subsidiaries. It was a subsidiary of electricity monopoly RAO UES, whose reform stipulating the spinning off of nearly all its assets ended on July 1, 2008.

### S&P Upgrades UniCredit Bank to BBB+

Standard & Poor's Ratings Services raised its long- and short-term counterparty credit ratings on Russia-based UniCredit Bank to BBB+/A-2 from BBB/A-2. The outlook is stable, the bank said in a press release.

"The upgrade reflects the bank's progress in expanding its business and maintaining a healthy financial profile," S&P credit analyst Elena Romanova said.

The Stable outlook reflects S&P's confidence that its firm position and good knowledge of the Russian banking services market, combined with support from the UniCredit Group, should help UniCredit Bank to develop according to the chosen strategy, provided it maintains a balanced attitude to risk management, she said.

### S&P Puts Moscow Region and Associated Companies on CreditWatch List

Standard & Poor's has placed the Moscow Region's BB long-term credit rating and local scale ruAA rating on CreditWatch with a Negative outlook.

The ratings agency also put on the CreditWatch the companies associated with the Moscow Region – the Moscow Regional Investment Trust Company (MOITK, B-/-, ruA-), the Mortgage Corporation of the Moscow Region (IKMO, B-, ruBBB), and Mostransavto, a state-owned company for passenger bus transport in Moscow (CCC+; ruBB+).

By putting the Moscow Region's ratings on the CreditWatch list, S&P's

expressed its concern that the region will have to render considerable support to the regional companies which find it increasingly difficult to borrow independently because of increased interest rates.

## REGIONS

### Hydro Considers Building Plant in Murmansk Region

Hydro, a Fortune Global 500 supplier of aluminium and aluminium products, is considering building an aluminium plant with a design capacity of 450,000 metric tons in the Murmansk Region, northwest Russia.

The Norwegian company is studying various scenarios, including the supplies of local raw materials and deliveries from Northern Europe and Brazil.

### Eclipse 500 Jets to Be Manufactured in Ulyanovsk in Late 2009

By the end of 2009, a plant for the manufacture of Eclipse 500 very light jets (VLJ) will be commissioned in Ulyanovsk (Volga Region).

The project will attract investment of RUR5bn (\$198.3mn, or €136.7mn) to the region.

It was presented at the VII International Investment Forum Sochi-2008 in Sochi in September 2008. Total investments in the project will amount to \$300mn.

Eclipse 500 manufactured by Eclipse Aviation is a small business jet powered by two turbofan engines.

Jet engines provide a service ceiling of 12,500 m (41,000 ft), maximum speed of 685 km/h (425 mph) and a range of 2,084 km (1,295 miles) with three to six passengers. Its maximum takeoff weight is 2,710 kg.

### Sitronics to Spend \$1bn on Microelectronics Plant in Voronezh

Russia's third microelectronics plant is to be established at the Sitronics plant in Voronezh, central Russia. Modernisation will require around \$1bn.

Sitronics is a supplier of telecom, IT and microelectronic solutions to Russia, the CIS, Central and Eastern Europe, the Middle East and Africa. It has over 3,500 clients and offices and outlets in 32 countries, exporting its products to more than 62 countries.

### Russia's Largest Biofuel Plant to Be Built in Ivanovo Region

The Ivanovo-BioToplivo limited liability company has decided to build a biofuel plant in Teikovo, in the Ivanovo Region (central European Russia).

The plant worth RUR5bn (\$198.33mn, or €136.65mn) is to be built within two years. The main investor is the Moscow-headquartered Konti Group specialising in housing construction using modern technologies.

### Kolmar Holding Borrows \$70mn from Korea Development Bank

The Kolmar Holding has taken a loan of \$70mn from the Korea Development Bank (South Korea) to finance the construction of the Ingalinsky coal mining and processing facility in the Republic of Sakha-Yakutia (northeast Siberia), said Lev Kuznetsov, Kolmar's director general.

The project will comprise a mine and a coal preparation factory with an annual capacity of 3.2mn metric tons. Financing for the project will total \$300mn.

The Kolmar Holding has been investing in coal mining projects in South Yakutia for several years now.

### Memo to Build Airport in Irkutsk Signed

The administration of the Irkutsk Region and the Russian Transport Min-

istry signed a memorandum of cooperation at the Fifth Baikal Economic Forum to build a new airport in the East Siberian region.

The airport project was developed at the request of Prime Minister Vladimir Putin.

A total of RUR16bn (\$633.41mn, or €441.14mn) will be allocated from the federal budget for the construction of airport infrastructure in 2010-2015.

The Baikal Economic Forum is one of Russia's biggest business forums. It is held in Irkutsk once every two years beginning in 2000.

### Pskov Region to Have Municipal and Farm Machinery Plant

Poland's PRONAR plans to build a plant to produce municipal and farm machinery in 2010, with investment of around €60mn maximum, in the Pskov Region, northwest Russia.

PRONAR is one of Europe's largest manufacturers of farm machinery, mostly tractors for municipal purposes and farming with a capacity of 35-260 hp, as well as 86 types of multipurpose trailers with a lifting capacity of between 1.5 metric tons and 35 metric tons.

### Rostov Region to Present over 15 Investment Projects at Sochi Forum

The Rostov Region (in southern Russia) will present over 15 investment projects at the VII International Investment Forum Sochi 2008, to be held on September 18-21.

Another participant, the Aston company, intends to sign a memorandum on cooperation with the Rostov Region's government to implement four investment projects in the region worth a total of about \$150mn.

The projects include building a factory to produce starch products and glucose-fructose syrups at the Novoaleksandrovska industrial zone in the Stavropol Territory, building a 6 MW

thermal power plant, that will use a cardinally new type of fuel – sunflower seed shells, for the Morozovsk sunflower oil extraction plant, building greenhouses jointly with the Dutch Agrotech Didam BV, and modernising the Millerovo oil extraction plant within two years without stopping production.

The Aston group of companies, headquartered in Rostov-on-Don, is a large, dynamically developing multirole agro-industrial holding that has been on the market since the early 1990s. It is one of the largest operators on the Russian grain and oil markets.

### **Water Park Worth \$109mn to Be Built in Novosibirsk**

The investment council of West Siberia's Novosibirsk Region led by Governor Viktor Tolokonsky supported a project to build the city's first water park.

Poseidon Park, to be divided into four zones with 42 perimeter amusements, will be built in the Leninsky District of the city on an area of 54,000 sq m. Designers say it will be one of the largest water amusement parks in Russia.

The project, worth RUR2.8bn (\$109mn, or €77.6mn), will be implemented in two stages, first the sports block to be built by 2010, and then a hotel. The Poseidon water park will host synchronous swimming events and training of rowing teams.

By decision of the investment council, RUR57mn will be allocated for the project from the regional budget.

### **Ivanovo Region to Have Petrochemical Plant**

The international holding Indorama together with its Russian partner, the Europlast association, plans to launch petrochemical production in the Ivanovo Region within the local textile cluster.

Investment in the project will total RUR50bn (\$1.96bn, or €1.38bn).

Indorama CEO Aloke Lohia said a plant to manufacture synthetic fibres and

fabrics based on petrochemical products would be built within the textile industrial cluster in the next four or five years.

Among other things, his company is willing to manufacture polyester, which is now the most popular fibre in the industry whose quality is similar to that of cotton, he said.

### **St Petersburg Developer to Build \$431.5mn Logistics Park in South Russia**

M-Industry, a St Petersburg-headquartered development and investment group, has started the construction of Yuzhny, a Class A logistics park in the Teuchezhsk District of the Republic of Adygeya (North Caucasus).

The company said the groundbreaking ceremony for the project worth RUR11bn (\$431.5mn, or €303.4mn) took place on September 17, 2008.

The logistics park will include a total of 300,000 sq m of office buildings and warehouses to be built on an area of 60 ha; offices will take up 15,000 sq m.

The first stage of the project will be completed by 2010, and the second one will last from 2009 to 2011. The developer plans to commission the facility in the fourth quarter of 2011.

The park's convenient geographical location close to the M4 Don highway is one of the project's strengths: its terminals will handle the heavy cargo traffic moving along the federal route linking central and southern Russia.

### **New Auto Components Plant to Be Built in Togliatti**

Anvis Rus, a 100% subsidiary of the German Anvis Group, formerly Woco Michelin AVS BV, has launched the construction of a plant in Togliatti (Samara Region), which will manufacture anti-vibration auto components.

The plant is to be commissioned in the third quarter of 2009, but it will start production in January on the leased premises. The construction will proceed in three

stages. The capacities of the plant's first stage will ensure an annual turnover of €25mn. The plant will manufacture engine support systems, engine mount dampers, muffler supports and other components.

Russia's largest automobile manufacturer AvtoVAZ will be the main customer of Anvis Rus. They have signed contracts for the development and manufacture of components for Lada Priora and Lada Kalina cars, the future Lada 2116 family, and Lada 4x4 (Niva) cars.

Anvis Rus will also cooperate with the GAZ Group, Russia's second largest automaker, and is negotiating components supplies with the GM-AvtoVAZ plant in Togliatti, the Sollers (formerly Severstal Auto) plant in Yelabuga, and the Volkswagen plant in Kaluga.