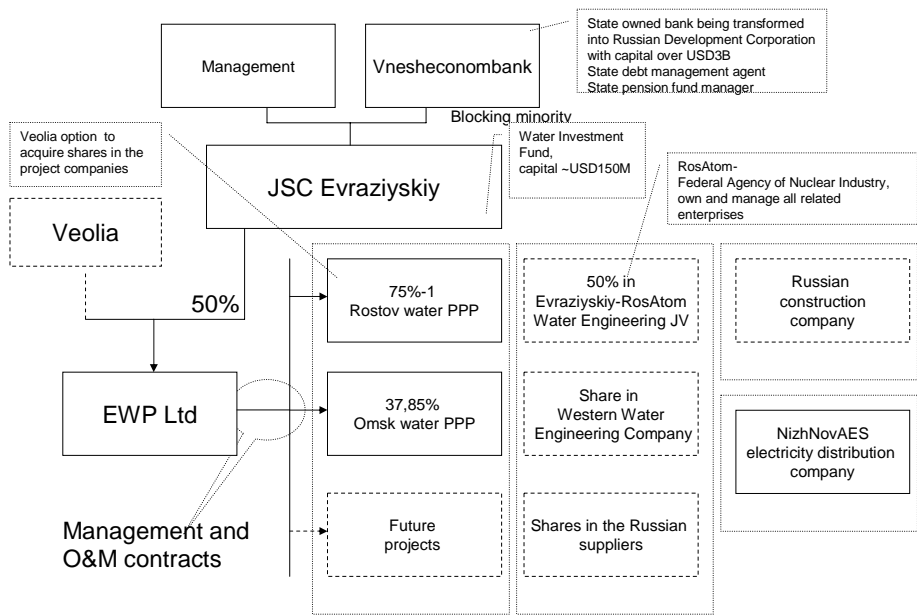


Developing Russian water operator

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Principal structure



Why private investments in water industry in Russia become active?

- Target very conservative assessment of value for 25-year 1M people water utility concession in Russia is about USD60-120M (under current tariff trend and without consideration of massive reconstruction of affordable housing that would result both in connection fee growth and increase in CAPEX)- still twice less prices of recent transactions in Eastern Europe
- Average 10-year CAPEX plan is USD 80-150M (under current quality enforcement regime) half of which may be self-financed
- Target equity investment is USD16-30M (without consideration of increasing leverage potential and availability of the state subsidies)
- Stable utility concession contract achievable (marketable) in 5 years may generate RoE 20-30% comparable to other opportunity investments of private capital in Russia now

Building local expertise in water

- Owners:
 - Experience in energy, utilities and civil service
- Management
 - Hiring executive staff with experience in municipal management, tariff regulation, BPR, technical part of the WB water project and water utility finance
- Transaction expertise
 - Experience of inventing and managing of over 50 local transactions for RKS
 - Local and international law firms were engaged
- Operational expertise:
 - Major gap where the company should rely on existing management
- CAPEX expertise:
 - Existing network of state owned project institutes, possibly one is to be acquired through privatization
 - Existing network of international and local engineering service providers

Selection of strategic partner to build industry competence

- 10 international companies approached for alliance:
 - 1 company has not got approval from the Board to operate in Russia
 - 4 companies interested in project by project cooperation
 - 1 company proposed takeover of the existing projects and development role for new opportunities
 - 2 companies proposed management assistance without capital commitment
 - 2 companies proposed share acquisition in EWP and selective project participation
- One- the most aggressive one- was selected and engaged after 1 year process. Terms of cooperation being under development:
 - Gradually building 50% share of Veolia in EWP
 - Options to acquire shares in existing and future project companies and build them to even level
 - COO and CFO responsibilities given to Veolia
 - Arm length technical and management assistance
 - Joint engineering and competence center to be integrated into Veolia R&D network
 - Exclusive joint development in Russia, Ukraine and Central Asia

Strategy

- Required critical size of the service area for sustainability of the business is over 7M people
- Principal target area:
 - Russia
 - Ukraine
 - Kazakhstan
 - Shanghai Cooperation Area
- Concession-like contracts for water utilities in the urban areas over 300K people, obviously subject to legal, economic and technical considerations
- Management, service or lease contracts for water utilities in the smaller cities or in larger areas with greater economic uncertainty
- ROT/BOT/etc. - water or waste water treatment plants worldwide (after completion of the business unit)

Some issues

- Perceived role of IFOs:
 - Making market very slowly without real ability/commitment to analyze legal and economic environment allowing PPP in the sector
 - Making market for themselves and for the local municipal or national bureaucracy and for foreign consultancies
 - Making market for foreign operators
 - Providing no support to develop local industry
- Who has sovereignty over local utility
 - Antimonopoly issues of preventing IFO-engaged municipality from future transactions with other actors
 - Local legal public procurement requirements vs. IFO procurement rules
- PPP for people or PPP for IFO: minimal necessary complexity of tenders:
 - Competence-cost-speed-benefit analysis
 - Alternatives: public offer