



Investment Series 2011

## Russia re-emerges as a desirable investment destination

In all likelihood, the recent financial crisis will go down in history as the point in time when the balance of global economic power began to tilt away from the West toward BRIC—the acronym coined 10 years ago as shorthand for the emerging economies of Brazil, Russia, India, and China. But while history might also record that China's spectacular growth dominated the headlines in the immediate aftermath of the crisis, Russia's re-emergence as a global free-market economic superpower may prove to be of equal long-term significance.

The fortunes of these two BRIC nations are by no means unconnected. The growing interdependence of Russia and China was graphically illustrated this January when a new crude-oil pipeline running from Eastern Siberia to the Pacific Ocean came into operation. About 15 million metric tons of crude oil is expected to flow annually through the new pipeline during the next 20 years, overturning decades of Russian dependence on European markets and in the process strengthening its negotiating position with its traditional customers.

With global oil prices set to rise and domestic business morale also boosted by the country's success in winning the rights to host the 2018 World Cup, Russia has begun 2011 with high hopes—and ambitious plans to attract inward investment. In an attempt to reduce economic dependence on the central government, stakes in 11 state-run companies will be offered for sale to both domestic and foreign investors over the next five years. This part-privatization scheme—Russia's biggest since the 1990s—will see the government offload minority stakes in the banking, shipping, rail, oil, and energy sectors. The move is forecast to raise between \$20 billion and \$30 billion by 2013.

As a result, opportunities for investors will extend far beyond the utilities and commodities sectors that have created the new high-profile breed of billionaire oligarchs such as Vladimir Lisin (steel) and Mikhail Prokhorov (technology). The liberalization of the Russian economy has already created a whole new strata of dynamic small-to-medium-sized companies that can only grow in the wake of the broader privatization drive that the government is initiating, in which hundreds of SMEs are also to be sold off or part-privatized. This two-tier initiative is being launched against a backdrop of wide-reaching revisions to the legal framework regulating foreign investment, as well as a resurgent economy whose recovery from the seismic shocks of recent years only serves to demonstrate its underlying strength—and its long-term promise.

## A major makeover for the telecom sector

"Telecommunications is the core and foundation of the Information Society," says Russia's Minister of Telecommunications and Mass Communications, Igor Shchegolev. "This makes the modernization of the country's telecommunications system both a key step toward the foundation of a modern information society, and a necessary condition for the development of the country's economy."

Russia's sheer scale makes the realization of Shchegolev's vision a formidable task. The total length of the country's trunk network amounts to 245,000 kilometers and—because some of it was built as far back as the 1960s—parts of it work on analog technology. Shchegolev, however, remains undaunted and believes that by using fiber-optic communications lines in conjunction with DWDM (dense wavelength division multiplexing) equipment, the average throughput of optical lines can be doubled across the Russian Federation by the end of next year. As a result, he anticipates that Russia's overall telephone-line capacity will also have doubled by the time the XXII Winter Olympics gets underway on the mountains behind the Black Sea city of Sochi in 2014.

The Russian government has set itself an overall target, for 2015, to reach penetration levels of 60 lines per 100 inhabitants across the entire country. But Shchegolev sees the development of Russia's

information infrastructure as a means to an end, with the ultimate objective being access to the services that broadband Internet access can provide: digital TV and mobile communications, among other things.

The process is already underway. The number of Russians online soared from 12 million in 2007 to 33 million by the end of 2009, and the average Russian with Internet access spends about eight hours a week online—up there with Canadians and other heavy users. The commercial opportunities that such digital enthusiasm presents can only increase if, as predicted, broadband access trebles over the next three years.

The shift toward a digital economy has presented so-called "legacy" companies with a whole host of challenges and pitfalls, and the ITC companies that can successfully steer such businesses through this obstacle course are inevitably in big demand. One company that saw the way the wind was blowing was IT solutions provider Asteros, when it realized that its future lay less in IT solutions (or "box moving" as its CEO Mikhail Erenburg puts it) than in systems integration. In the last two years, Asteros has cultivated a portfolio of prestigious clients



Minister of Telecommunications and Mass Communications for the Russian Federation, Igor Shchegolev.

that includes MegaFon, VimpelCom (one of Russia's largest mobile operators), and MRSK Siberia, which last year entrusted Asteros to manage some 30,000 hardware units and more than 250 business applications.

"From the beginning our strategy was to focus on big, complex, and difficult projects," says Erenburg. "Although we are second in terms of market size, we have picked up the top three IT infrastructure projects in terms of complexity. So focusing on complexity has enabled us to grow comparatively fast. Even in the past 12 months—which Erenburg readily admits was a crisis year for IT, as the market dropped by 35%—Asteros managed to achieve 10% growth, and began to become a magnet for talent. "We have been focusing on treating our people well and on attracting people from the market," he explains. "It was the first time that teams came to us and said 'we've heard about you guys, we want to work with you, here is what we can do.'"

The emergence of such skilled IT workers will be music to Minister Shchegolev's ears as he recognizes the need for the country to develop a high-tech-savvy labor pool. One of the chosen instruments to achieve this is the establishment of a series of technoparks—mini Silicon Valleys where clusters of business startups can feed off each other's skills and experience. "We need to create the regulatory and economic conditions conducive to an 'ecosystem' suitable for young IT companies," he says. "The focus of our work should be the real needs of innovators, people, and companies."

Much of the onus for delivering the infrastructure that will allow such innovation to blossom is falling on the group of telecommunications companies that come under the umbrella of Svyazinvest, Russia's state-controlled (and largest) telecommunications organization. But developing an information society has global implications and in that sense the role of companies like TTK promises to be equally important. Founded in 1997 by the Russian railway operator JSCo RZHD, TTK now operates the largest fiber-optic communications network in Russia. Using the infrastructure of its

## Investing in Telecom

## Telecominvest

The convergence of telecom and information technologies, mobile and fixed line, opens a wide range of opportunities for Telecominvest.

The company is in constant vigilance in respect of new technologies and ideas in telecom and the Internet to develop both existing and new businesses. The mobile voice and data operator and a major Telecominvest subsidiary MegaFon, has recently claimed the second spot in the telecoms segment in Russia.

With an effective management team and structure, the company focuses on high profitability and social responsibility.

St. Petersburg office:  
54 Nevsky prospect  
St. Petersburg, Russia 191011  
Phone: +7 (812) 325 50 35  
Fax: +7 (812) 604 06 41  
office@telecominvest.ru | www.telecominvest.com

Moscow office:  
3-1 Khlymovsky tупик  
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parent company, its network is laid across Russia's vast railway system and stretches over 53,000 kilometers.

While TTK is one of the three leading alternative operators of fixed communications to the Svyazinvest network and provides 33% of long-distance channel leases, its key strategic importance for Russia's development lies in its access to JSCo RZhd's international rail connections, which include the Trans-Siberian Railway—the shortest terrestrial link between Japan, China, and other Asian countries on the one hand, and Europe on the other. TTK has taken advantage of its access to the railway network to establish the EurasiaHighway, a wholesale SDH/DWDM-based transit service engineered specifically to meet the high-performance connectivity requirements of international operators, global communications providers, and customers looking to link Asia to Western Europe.

This focus on its international strategy bore spectacular fruit in 2008 when TTK was responsible for providing reliable and uninterrupted television transmission from Beijing to Europe for the duration of the Olympics, and again in 2010 when the company won the rights to deliver the televi-

sion signal from the Winter Olympic Games in Vancouver to Russia. This experience will hold it in good stead in the next few years, not just in regard to the Winter Olympics in Sochi, but also the global demand for coverage of the 2018 FIFA World Cup. TTK also happens to be the official sponsor of the Russian National Football Team.

TTK's acting president, Artyom Kudryavtsev, is very optimistic about the company's prospects: "Domestically the market is already well developed but there is growing demand for modern telecommunications both from the corporate and retail markets. Today, Russia has about 30% of broadband penetration, and the government expects that to increase to 70% by 2015. We are looking to secure capitalization of \$3 billion as well as 15% market share of the residential broadband market by 2015."

Another set of winners from this exponential growth will be those traditional telecommunications operators that recognize that the added value in the Information Age lies as much in content as in network capacity or hardware. One such company is OJSC Telecominvest. Set up in 1994 by St Petersburg's leading telecom enterprises

to provide effective management for their subsidiaries, which include mobile operator OJSC MegaFon, billing system and CRM solution provider CJSC Peter-Service, and the Internet service provider CJSC Web Plus.

Such diversification is increasingly critical, according to OJSC Telecominvest's CEO, Vladimir Streshinsky. "Telecom is gradually becoming a utility like water or electricity," he says. "In the past few years we have seen a huge transfer of value from telecom operators to Google and Apple, which have captured the market by providing a unique customer experience. These days, customer loyalty is less with the mobile operator than with the handset manufacturers, operating systems producers, and content providers. That's why we believe it is important to have the ability to create synergy in order to maximize value." This diversification is underpinned by a commitment to the expansion of its 3G networks through capital expenditures, which he believes will give Telecominvest a competitive edge over the rest of the field.

By the time the 2018 World Cup comes around, Russia's digital landscape will have altered beyond recognition. ■

## Joining the jet set

**If there is any truth in the old saying that if you want to make money out of a gold rush you are better off selling the picks and shovels than actually digging for precious metals, then Jet Infosystems has been in the right place at the right time for the best part of the last 20 years.**

Founded in 1991, just as Russia and its neighbors in the CIS began to embrace the principles of the free market, the company has been consistently providing the country's business pioneers with evolving and reliable IT infrastructure and security solutions—the modern-day equivalent of those picks and shovels—ever since. As a result, Jet Infosystems is a much-valued partner of several leading companies operating in banking, telecommunications, retail, oil, and energy, as well as the public sector.

Managing Director Vladimir Yelisseyev attributes the company's hard-earned reputation to a combination of reliability and innovation. "We have an excellent long-term relationship with all our clients

**"Committed to innovation, our employees are constantly striving to come up with new ideas and finding ways to improve our services."**

and partners," he says. "They know that once we engage in a project, that project will be delivered on time and to their specifications. IT is an area where there is always the potential for things to go wrong, but we are a company that never backs down and we always deliver exactly what we promise. And we are committed to innovation; our employees are constantly striving to come up with new ideas of ways we can fine-tune and improve our services."

Yelisseyev, as well as the company's president, Eugene Shablygin, and CFO Oleg Molodykh, are all alumni of Moscow State University's Physics Department, and have instilled in their staff a passion for the potential of IT to transform the business environment. From the outset, they identified the gap for a company

focusing on IT infrastructure, technological support, and security solutions. As a result, Jet Infosystems is now the unsung hero behind several major Russian and CIS business success stories of recent years. Those stories include:

- **The development and implementation** of an uninterrupted IT service strategy for VimpelCom, one of Russia's largest mobile phone operators with over 89 million subscribers.
- **The provision of ongoing outsourcing and technical support** for the systems in the datacenter of the retail chain M.video, which operates in 77 cities across Russia.
- **The deployment of an IT services management** for Kazakhstan's fast-expanding JSC Halyk Bank.

Despite the Russian economy feeling the force of the global financial crisis, Jet Infosystems has actually expanded its business in recent years. Yelisseyev explains: "I think the past two years clearly highlighted why we are a strong and reliable company. Like most IT companies our revenue decreased, but our careful management policies, coupled with our clear and focused strategy, allowed us to actually increase our profit in 2009.

"Our approach is three-fold," Yelisseyev continues. "First, we have a very clear focus on the central part of IT instead of desktop software, primarily high-end software solutions; second, we are market leaders when it comes to technological support and outsourcing; and finally, we provide excellent IT security solutions. We see a lot of potential in IT security and customized business solutions—this is definitely a growth avenue for Jet Infosystems."

In addition to offices across Russia from St. Petersburg to Vladivostok, the company has a well established presence in Azerbaijan, Ukraine, and Kazakhstan. Working with Kazakhtelecom on a national project to construct the New Generation Network (NGN) in the Republic of Kazakhstan, Jet Infosystems developed the local networks in Almaty, Astana, and Karaganda, as well as a long-distance network connecting 10 Kazakhstan regional capitals and more than 50 exchanges throughout the country. The Almaty network has 160,000 subscribers; the Astana network has 40,000.

After the NGN was launched, Kazakhstan moved to a new city code system, and the NGN technology replaced an

obsolete national telephone network, increasing efficiency and reducing per-minute costs. As a result, most long-distance traffic in Kazakhstan now runs on the NGN standard. The successful completion of the project earned this glowing praise from Kazakhtelecom's CIO, Marat Abdildabekov: "Together with Jet Infosystems, we have implemented many sophisticated national-level telecommunications projects. As a result, long-distance and international call quality has improved dramatically, and our subscribers now enjoy advanced telecommunications services. We would like to thank the specialists at Jet Infosystems for their expertise, skills, and creativity. These experts are indeed dependable and results-oriented."

As well as expanding its geographical boundaries, Jet Infosystems seeks to spread its operations further afield. It will not be short of ringing endorsements

**"We see a lot of potential in IT security and customized business solutions—this is definitely a growth avenue for Jet Infosystems."**

from satisfied customers: "Jet Infosystems means confidence," says M.video's IT operations director, Igor Veselov. "With their support we feel our operations have been optimized, business tasks receive more attention, and our corporate performance has improved."

Aleksey Gerasimov, head of the Banking Operations Department at UniCredit Bank (Russia), also sings the praises of doing business with Jet Infosystems. "Our bank belongs to one of Europe's leading financial groups—so our clients deserve the best. We needed a high-tech system that would provide the highest-quality service in the industry. Luckily, UniCredit Bank hired Jet Infosystems to do the job. Now the bank leverages a fully integrated customer relationship management system based on Oracle Siebel CRM.

"This powerful, innovative platform has already empowered our team to deliver the flawless customer service experience that our clients expect," Gerasimov continues. "It has already vastly improved our internal business processes." With endorsements like these, the Jet Infosystems success story looks set to continue. ■

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## Russian bears set to become bulls

In the fall of 2010 Prime Minister Vladimir Putin announced that he would be lifting the long-standing limitations on foreign ownership of Russia's banks. With his government also looking to reduce its holdings in several large state-owned banks, the announcement caused a ripple of excitement among the international banking community.

And it was not just the prospect of acquiring a minority stake in a handful of state-controlled banks that wetted investors' appetites: Just as Russian banking stocks were among the first to suffer from the expected crisis in 2008, they were also among the earliest beneficiaries of expectations of an economic recovery. The global financial crisis had a considerable effect on the development of the Russian banking sector. With the risks and bad debts relating to

non-financial borrowers rising quickly towards the end of 2008, the banks were forced to increase their rates and shrink their volume of lending.

Government intervention nevertheless helped maintain stability and, critically, confidence in the country's banks. As a result, life is beginning to return to normal. Lending to non-financial institutions rose by 5.6% and to private individuals by 6.5% between January and August 2010. With deposits from individuals soaring by 16.5% over the same period, it would be surprising if the Russian banking sector wasn't on the investment radar screen right now.

A stable banking sector is a standard yardstick against which many investors measure a country's attractiveness, and Russia would appear to be pursuing the right policy in its efforts to bring in FDI. Olga Plaksina, chairperson of the IFD Kapital conglomerate, certainly hopes so: "Russia has a lot to offer as an investment destination and regrettably not enough businessmen and companies realize this. I have studied, worked, and lived in the U.S. for several years, and I

have always tried to act as an ambassador for my country.

"A country's image is very important, and unfortunately very few positive aspects of Russia and the opportunities it can bring investors are known or understood abroad," continues Plaksina. "There have been significant, successful steps taken to make the legislation more investor-friendly, and Russia's business environment is dynamic and fast-paced."

**"Russia has a lot to offer as an investment destination and regrettably not enough businessmen and companies realize this."**

IFD Kapital has not just benefited from these changes but also helped effect them. In recent years it has worked with the Ministry of Finance to increase financial literacy among the country's citizens, as well as educating them about the instruments at their disposal to help them invest their personal cash assets and in the management and augmentation of their capital funds.

IFD Kapital Group's aggregated assets of US\$11 billion make it one of



Olga Plaksina,  
Chairperson of IFD  
Kapital Group's  
Executive Board.

Russia's biggest companies, which suggests its chairperson knows what she is talking about. Established in 2003, the group has evolved into an integrated private investment fund with interests in several sectors of the Russian economy, including oil and gas, construction, power generation, mass media, and high-tech industries, as well as pensions and the banking sector.

One of IFD Kapital's major holdings is in the Petrocommerce Banking Group, one of Russia's top 20 banks with a widespread network of branches, sales points, and ATMs across the Russian Federation. The group has no intention of resting on its laurels. "We only invest our own capital," says Plaksina, "and the financial crisis confirmed that we are an extremely solid financial institution. We are not actively pursuing the sale of any of our assets right now—but we are always open for discussion with any interested investor."

While the other countries in the BRIC grouping may be able to lure investors with the size of their population and their spectacular rates of growth (albeit from a low base), one of Russia's principal attractions is the relative quality and maturity of its market. One respected analyst recently argued that around 68% of the Russian population could be termed as middle class—compared to 31% in Brazil and only 13% in China—and that the country consequently offered commercial opportu-

**While the other BRIC countries are able to lure investors with the size of their populations, Russia's attractions are the quality and maturity of its market.**

nities not just for multinationals with hundreds of millions of dollars to spend on establishing a market share, but also for middle-sized companies looking to identify and exploit specific sector gaps in the market.

This was also the conclusion reached by B&N Bank president and CEO Mikail Shishkhanov when he sat down with his

senior team to review Russia's post-crisis financial landscape. "I asked my top managers what our strategy was," he recalls, "because we need an exit strategy down the line. The conclusion we came to was that we should be looking to affect an IPO in the next five to 10 years.

"Eventually we hired a consultant and we are now clear where we are going and what we are about—we are the one-stop shop for medium-sized companies looking to establish a presence in the Russian market," Shishkhanov continues. "We will not just look after all their due diligence, financial, and tax requirements, but we will also connect them with clients and help facilitate the deals they want to make. We have a big department that organizes deals between Russian clients and foreign producers, especially in terms of capital-fixed assets."

Post-crisis, such strategic reappraisals have been taking place within many of the country's banks that have come through unscathed. In the wake of Putin's announcement, Russia's financial services sector is very much open for business. ■

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## Profits grow on the fat of the land

The state of Russia's agricultural sector is of great importance, both domestically and internationally. "Agriculture plays a special role in the country's economic, social, and cultural development," explains Agriculture Minister Elena Skrynnik. "Almost 30% [40 million people] of the Russian population live in rural areas, and agriculture represents around 5% of GDP." She is also very aware of the industry's significance in a global context. "Our country could become a force to be reckoned with in the international agricultural arena as a guarantor of food supplies," she says.

For this vision to become a reality, the minister and her colleagues in President Dmitry Medvedev's government recognized that there needed to be significant investment in the modernization of the industry's production processes to increase

efficiency and reduce the costs of production. Toward this end, in 2009 they established the state-controlled United Grain Company (UGC), which brings 31 cereal companies, including the port elevators in Novorossiysk, Yeisk and Kaliningrad, under co-ordinated control. While Skrynnik sits on UGC's board, responsibility for the day-to-day running lies with its CEO, Sergey Levin. One of Levin's immediate tasks is to raise 10 billion rubles (US\$320 million) from private investors and banks to rebuild UGC's plant and infrastructure.

"Most Russian elevators, long-term storage facilities, and trade and port terminals were built in Soviet times, and even the most modern ones date back to the 1980s," Levin says. "This means that all the services related to storage and transportation are much more expensive than our competitors. It simply wasn't practical for the private sector to bear the costs of modernization that we required to make the sector competitive—which is why UGC was created."

The creation of UGC had an immediate impact on the sector's performance, with 2010 sales up 500% over the previous



Minister of Agriculture for the Russian Federation, Yelena Skrynnik.

year to US\$160 million. Levin is now aiming to top the US\$200 million mark for 2011.

UGC's chief executive will oversee an ambitious raft of investment programs that are expected to attract more than 13 billion rubles over the next two years. The primary project will be to increase the export capacity of the existing Black Sea deep-water grain terminal at the Novorossiysk

**"Agriculture plays a special role in the country's economic, social, and cultural development, and agriculture represents around 5% of GDP."**

Complex Grain Production (NCGP). The reconstruction of the NCGP will increase transshipment capacities of the complex from 3.5 to 5 million tons of grain per year.

Other projects include construction of a new deep-water grain terminal in the Black Sea port of Taman, and a new deep-water terminal in the Russian Far East

at Nakhodka port. This new terminal will increase grain transshipment capacity to the Eastern and Southeastern Asia markets. Construction of five river and shallow-water sea grain terminals—situated in the basins of the Sea of Azov and the Volga and Don Rivers—will also secure cheaper grain delivery and will open access to the European part of Russia and grain export markets.

Critical to UGC's long-term success, according to Levin, will be the ability and willingness to act decisively—and fast. "The agricultural market, particularly in Russia, is characterized by fast-changing external factors, not least of which is the weather. So we have to be prepared to take decisions fast and immediately." How well he manages to balance this requirement to react quickly with his obligation as a civil servant to pass his major policy decisions by the state-controlled board is likely to be the benchmark by which his tenure will be judged.

Another objective close to Elena Skrynnik's heart is to increase Russia's ability to feed itself, and to this end she has set herself the goal of saturating the

poultry and pork markets with domestic produce by the end of 2013. Organizations such as the Cherkizovo Group are key to her thinking. Formed in 2005 through the amalgamation of the Cherkizovo and Mikhailovsky agro-industrial groups, Cherkizovo is now structured into three operating divisions: processed

**"The agricultural market is characterized by fast-changing external factors, not least of which is the weather. So we have to be prepared to take decisions fast and immediately."**

meat production, poultry, and pork production, which among them serve over 80% of the population of some 115 million consumers.

The Cherkizovo Group is a publicly traded company and its CEO, Sergei Mikhailov, believes that his company—and the Russian agricultural sector in general—offers the overseas investor an unsung opportunity, both in terms of the size of the market and profitability. "I would say that as a sector we are probably about 20 to 30 years behind the U.S. or Brazil in terms of our development,

and there is great growth potential. In Soviet times," he continues, "we used to eat roughly 80 kilograms of meat per year. That has dropped to 60-65 kilograms, so there is room to grow in terms of domestic production. As for the group itself, we are generating EBDA margins of 40% in pork and 20% in poultry, which is higher than almost anywhere else in the world."

Although the group's domestic market is likely to be Mikhailov's focus in the short term, he sees no reason why Cherkizovo should not be an internationally recognized brand in the longer term. "We will only be supplying our own market for the next five years. Looking at the bigger picture, Russia is one of the few countries in the world that can add considerably to the supply side in the next 20 to 30 years, as we have a lot of land and not too many people.

"From a company's perspective," he concludes, "we have invested a lot of money in increasing the efficiency and lowering the costs of our operations. The Russian market is so under-developed that to guarantee quality you have to do everything yourself." ■



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## Elevating Russia's position within the world food market

United Grain company plans to attract at least 500 mln. USD in financing for the 2011-2013 investment program, 75% of which will come from private investors and banks. Projects include:

- Increase the export capacity of the existing NCGP Black Sea deep-water grains terminal
- Construction of a new deep-water grains terminal in the Black Sea port of Taman
- Construction of 5 river and shallow-water sea grains terminals, situated in the basins of the Azov Sea, Volga and Don Rivers
- A new deep-water terminal on the Far East in the port of Nakhodka
- Reconstruction of 10 main cargo-forming elevators.
- Modernization of the elevator infrastructure
- The creation of the Transport Grains Company



United Grain Company Russia, 107139, Moscow, Orlikov lane, 3/1, Tel.: +7 (495) 647-39-94, +7 (495) 647-39-83  
Fax: 8 (495) 647-39-98, E-mail: [info@oaoozk.co](mailto:info@oaoozk.co), [pr@oaoozk.com](mailto:pr@oaoozk.com)