



Russian Forestry

Federal Policy versus Regional Reality

St. Petersburg, October 25, 2009

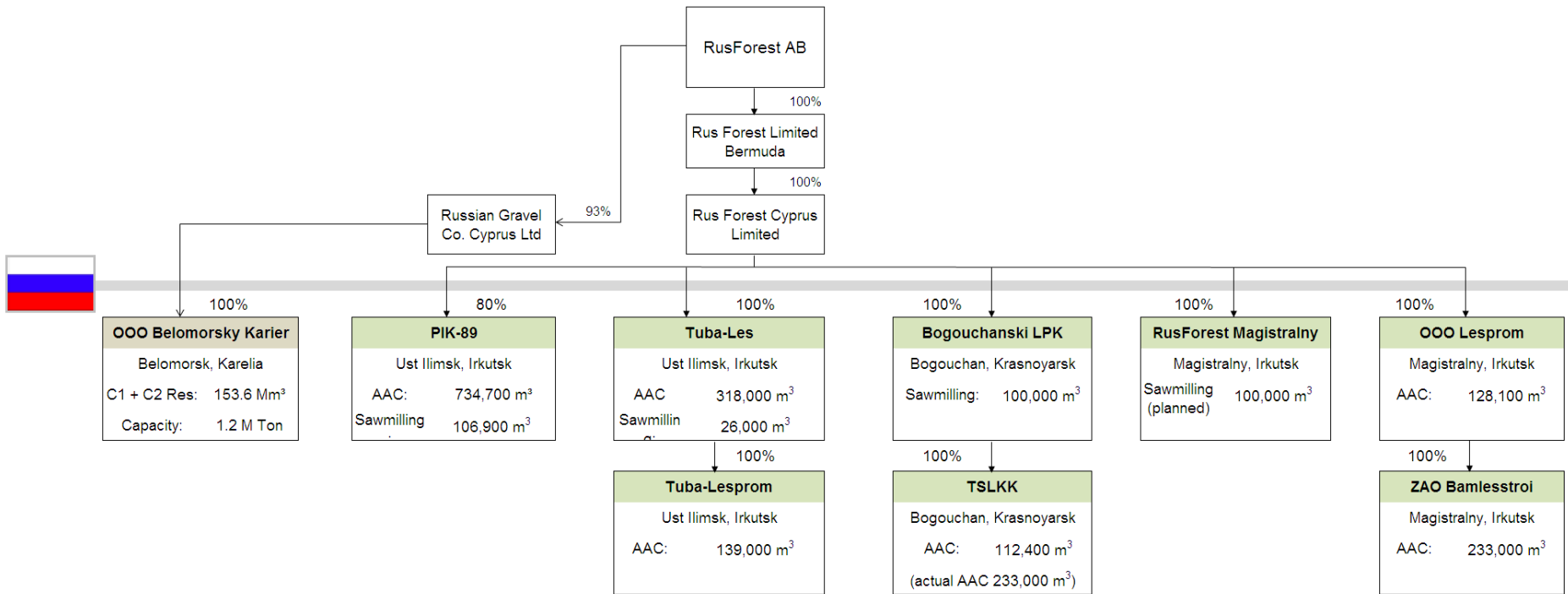
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Legal Structure

- ✓ RusForest AB acquired 50% of RusForest Limited from Vostok Nafta through an issue in kind
 - 8,537,640 shares issued
 - Vostok Nafta owns 46.7% of RusForest AB as per 30/6, 2009



*Simplified Legal Structure

AAC Summary

- ✓ Total Forest Area of over 1 million hectares, with around 80% Softwood - predominantly Pine and Larch
- ✓ Total AAC of 1.655 mln m³ as at June 2009
- ✓ Harvest of around 600,000 m³ during 2008
 - Will increase to over 1 million by 2010

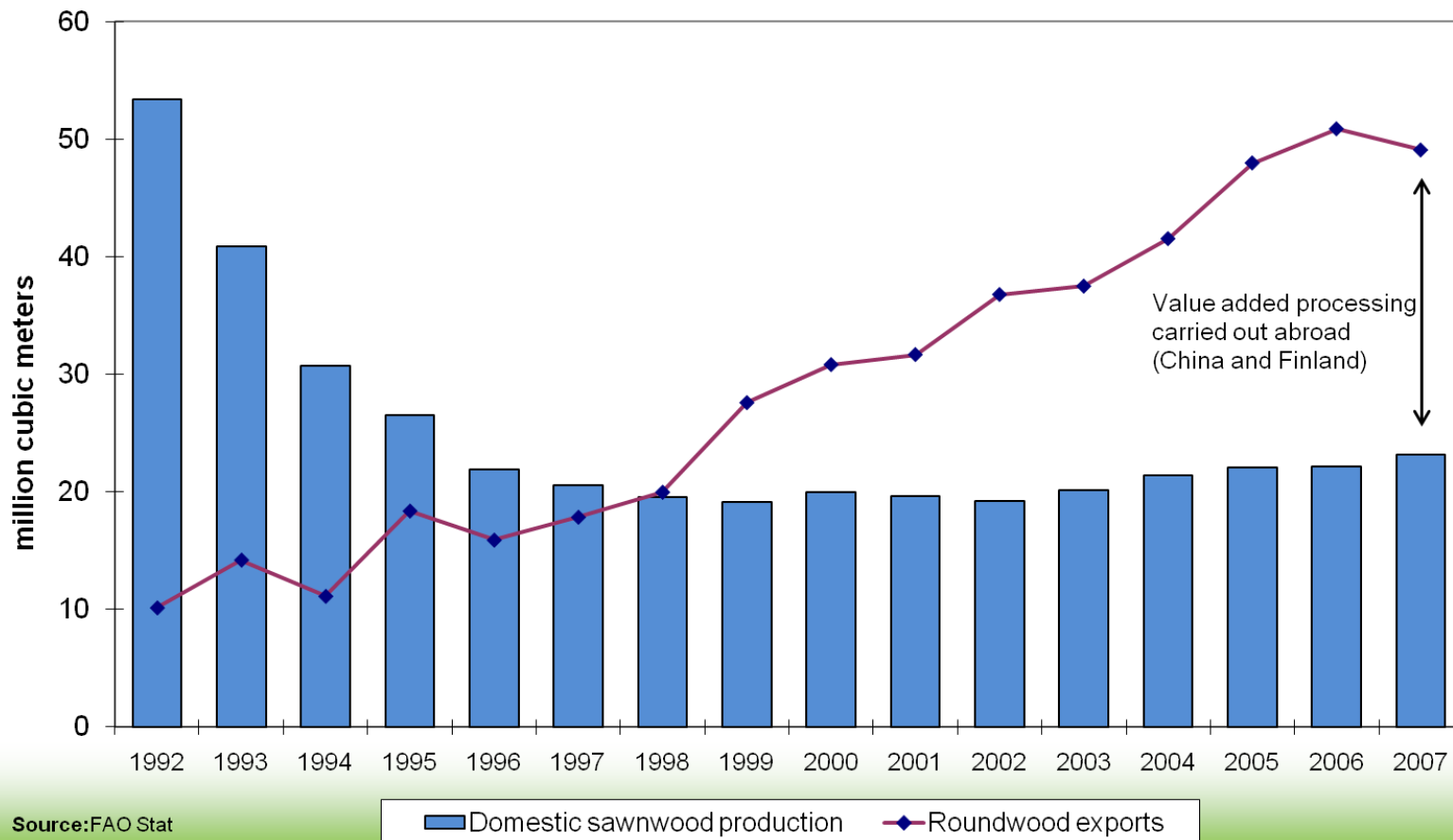
RusForest Subsidiary	AAC m3	Tree species							Softwood % of AAC	Area hectares
		Pine	Larch	Spruce	Fir	Cedar	Birch	Aspen		
Total holding										
PIK Group	734,700	50%	20%	7%	5%	5%	8%	5%	85%	436,033
Tuba Group	457,000	28%	18%	10%	15%	4%	15%	10%	66%	257,750
Bamlesstroi	233,000	0%	70%	0%	10%	10%	0%	10%	85%	231,554
Lesprom	128,100	47%	10%	23%	0%	0%	10%	10%	80%	30,988
TSLKK	112,400	25%	50%	12%	2%	6%	3%	2%	96%	48,695
Grand Total	1,665,200	35%	28%	9%	8%	5%	9%	7%	80%	1,005,020



Purpose of Export Duty

- ✓ The introduction of an export duty makes sense when combined with improvements in investment climate

Comparison of growth in roundwood exports versus sawnwood production, 92 - 07



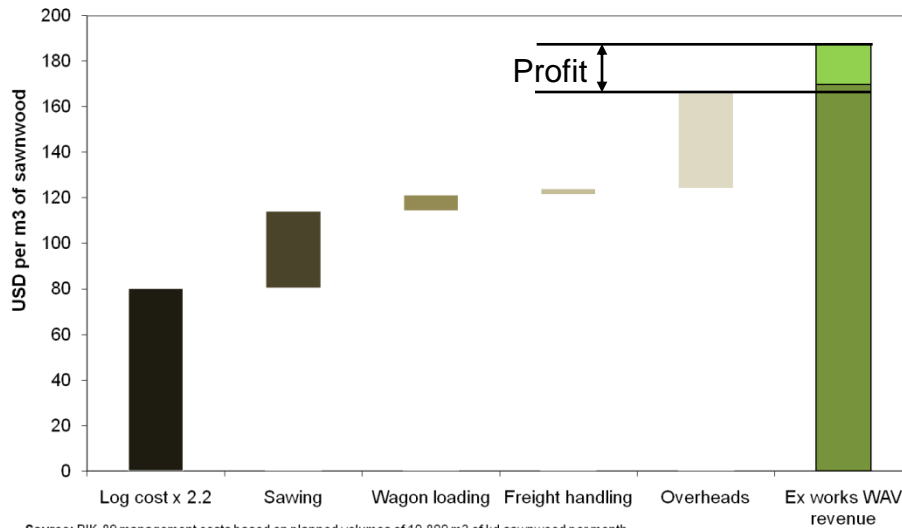
Source:FAO Stat



Chinese competition

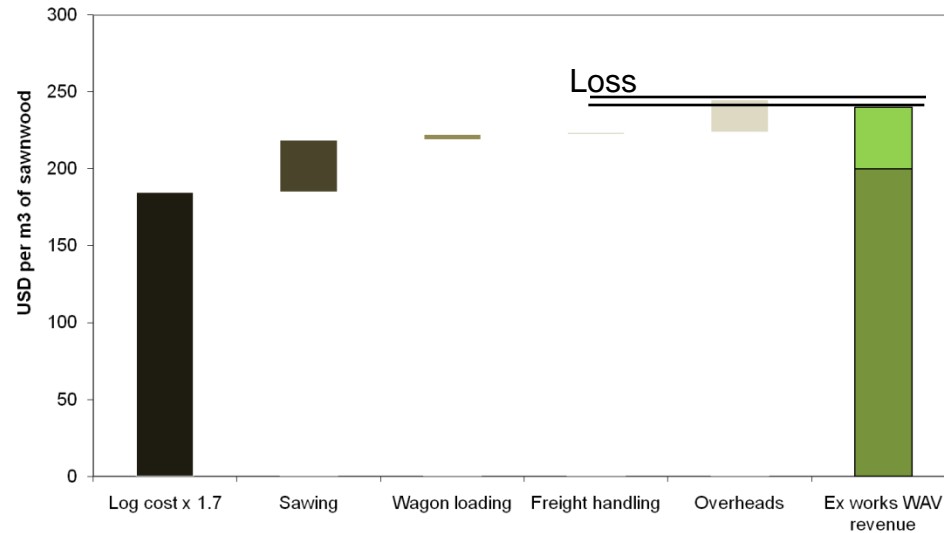
- ✓ Even if 1) costs are $\frac{1}{2}$ of Russian levels; 2) the sawmilling yield is 60%; and 3) wood chip revenue is 3 times higher – the economics still don't make sense!

RusForest - mill value chain



Source: PIK-89 management costs based on planned volumes of 10,800 m3 of kd sawnwood per month.

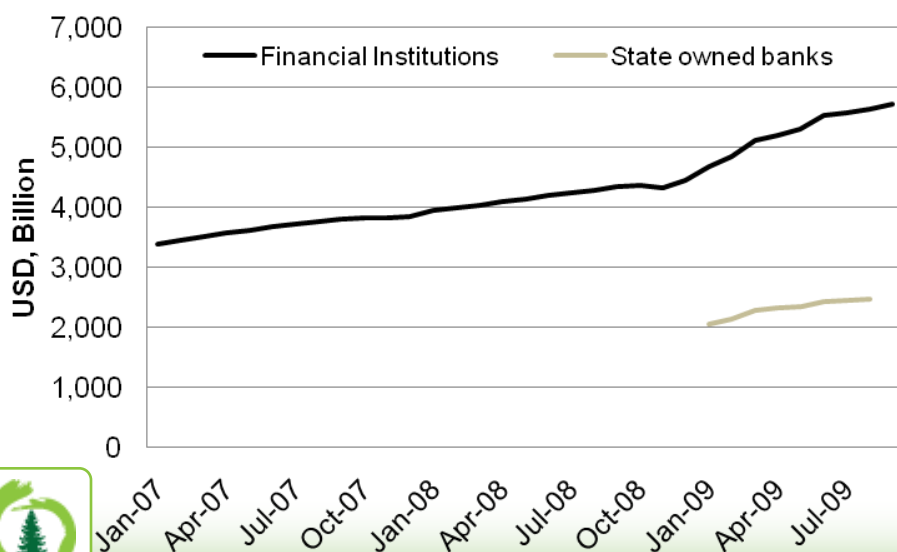
China - sawmilling value chain



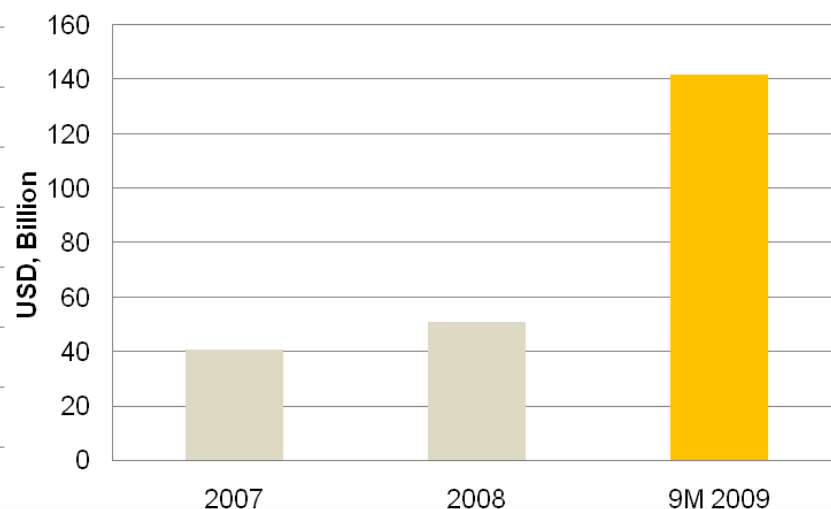
China's role in processing

- ✓ The role of the Chinese government is not entirely clear – the suspicion is that loans to the wood processing industry from state banks are propping up the sector
 - Chinese bank lending is now above 5.7 Trillion USD
 - And has increased at an average rate of 141.82 Billion USD per month during the first nine months of 2009

Chinese Total Loan Growth



Average monthly increase in lending



Duties to promote Domestic Industry

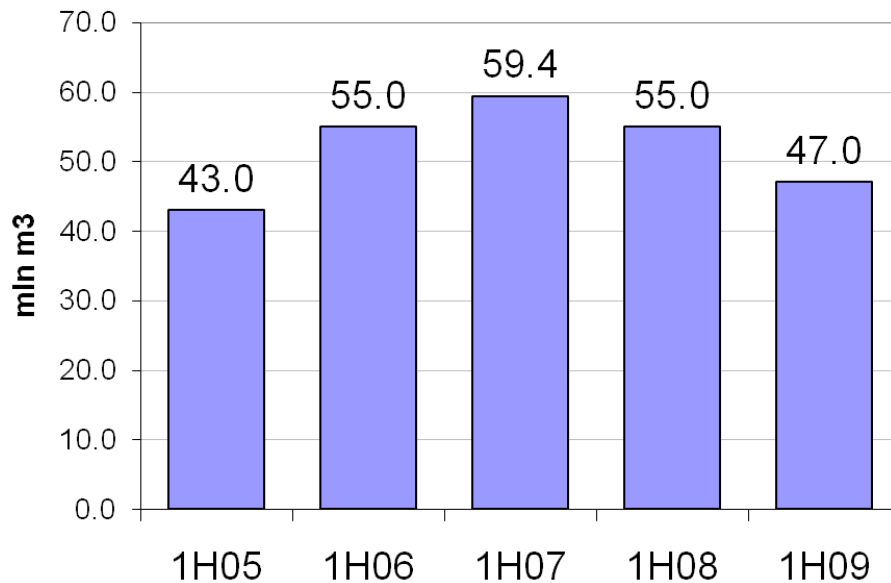
- ✓ Economic theory says that export/import duties hurt consumers, but reality shows the following industries have been supported by export duties
 - Indonesia was transformed to the worlds largest plywood exporter (with it's market share moving from 4 to ~80%) through roundwood export taxes, export restrictions and economic incentives for domestic producers during the 70ies and 80ies
 - Canada had a more than 100 year history of log export taxes and bans to help develop domestic wood processing industries up until the late 90ies when raw log exports increased exponentially with devastating results for forestry industries and employment
 - Or according to the WTO: “Export taxes on primary commodities (especially unprocessed) work as an indirect subsidy to higher value-added manufacturing or processing industries ... In this way, export taxes provide an incentive for the development of domestic manufacturing or processing industries with higher value-added exports.”



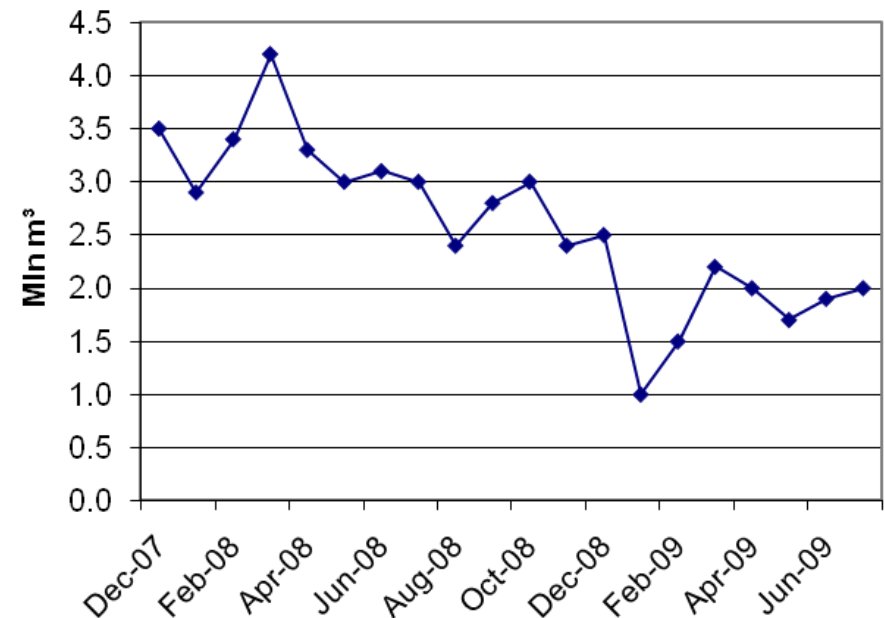
Russian Log Exports

- ✓ We are currently seeing the worst of both worlds:
 - Declining logging business...
 - ... and little investment in processing

Russian Harvesting Levels, 05 – 09

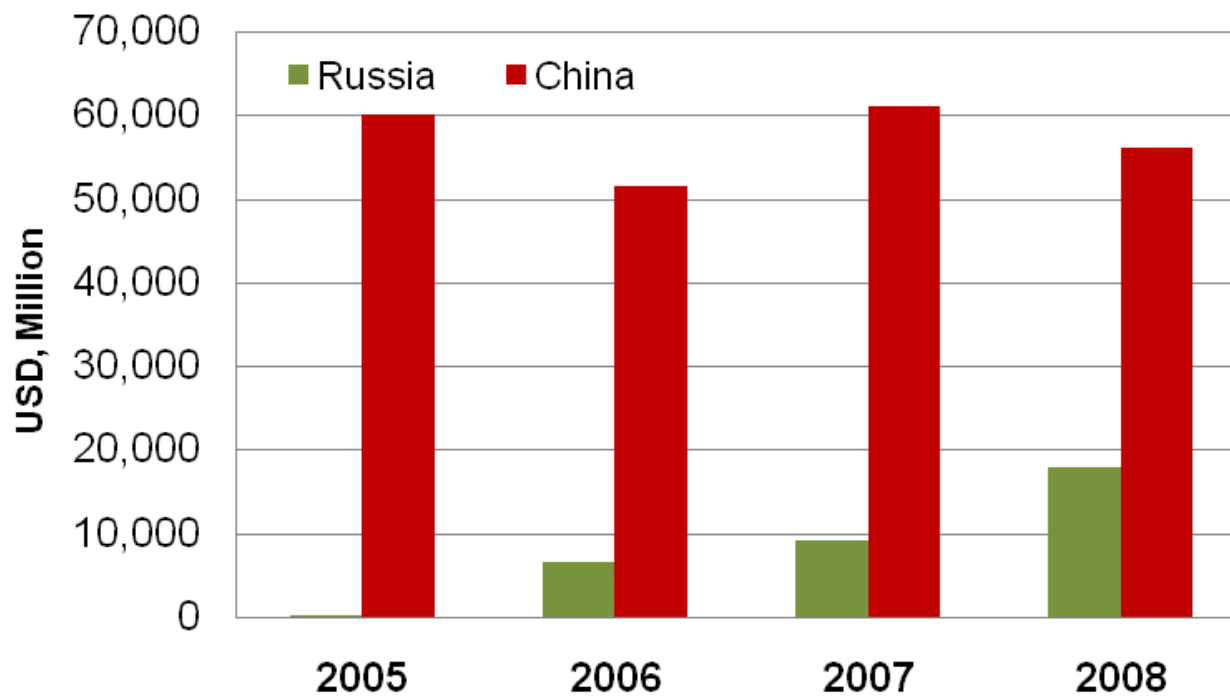


Russian Exports of Roundwood, 07 – 09



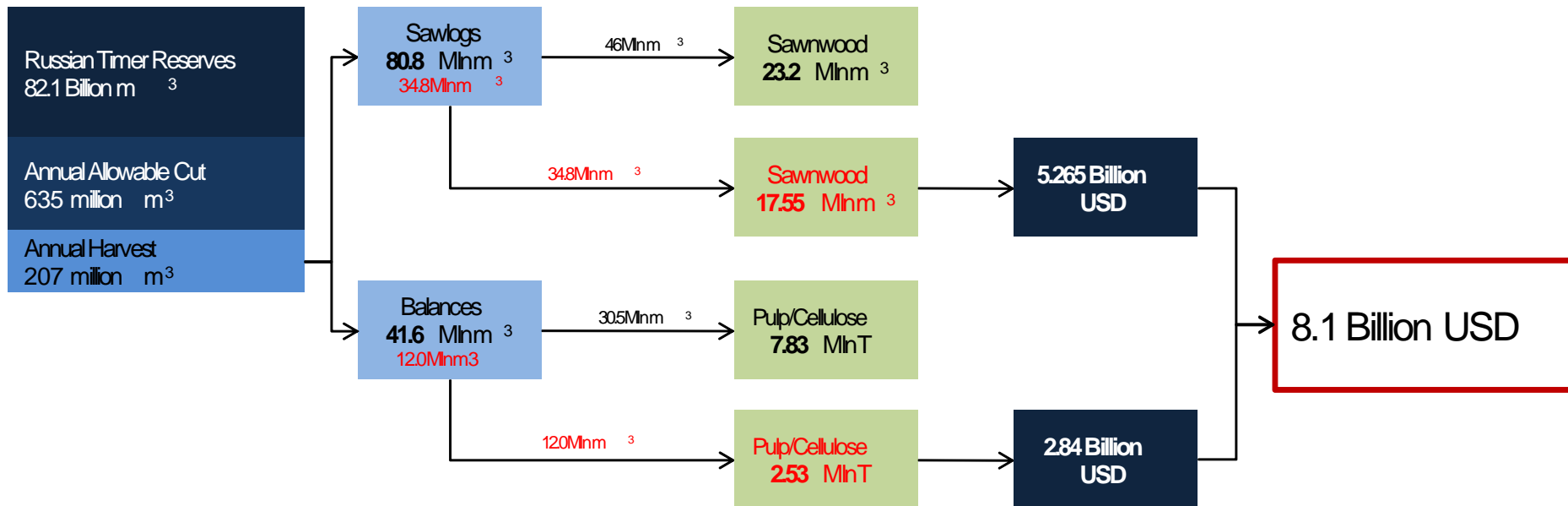
Investment Activity

Net FDI Fund Flows, 2005 to 2008



Russian Forestry

Forestry Flowchart 2007, Implied needed investment into processing capacity



- ✓ Given approximate investments in sawmilling and pulp capacity, Russia would need at least 8.1 Billion USD in investments into domestic processing if duties lock in raw material..
- ✓ Not counting the massive investments needed in associated infrastructure



Land and Infrastructure Allocation

✓ No new power and no priority status

✓ Priority Status, 7.7 million AAC, and 5 megawatts of power with plans for a further 150 megawatts

Bogouchansky LPK, September 08

Kraslesinvest, October 09



The head of Kraslesinvest = head of regional power company (Krek)

There is no electricity

- ✓ In reality there is electricity for some, but not for others
- ✓ We first spoke about electricity in February 2006, since then the following have received power

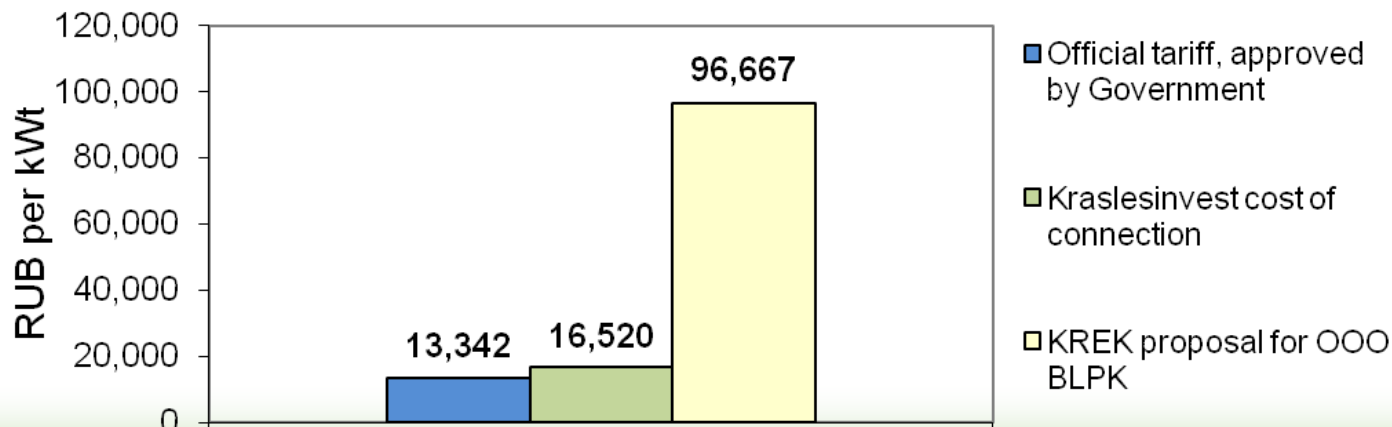
User	Power Received	Estimated power required 2010	Power Balance
Kraslesinvest	3.0	0.0	+3.0
Moststroi	2.0	1.0	+1.0
Local Hospital	4.0	0.5	+3.5
			= +7.5
Boguchan LPK	0.8	3.8	-3.0



How much does power cost?

- ✓ Our request for 1.2 megawatts can apparently only be met by rebuilding power supply to a local village at a cost of RR 116 million – the resulting power cost is 7.5 times higher than the regulated rate.

Rate Comparisons



How do we get power?

- ✓ Negotiate a consolidated position with the following,
 - Krasnoyarsk Regional Energy company (KREK)
 - MRSK Siberai (distribution)
 - Krasnoyarskenergo (generation)
 - Kraievoi administration (owner of KREK)
 - Bogouchan regional administration
 - Sibles service
- ✓ Its impossible to achieve a consensus – we have been running around in circles for three years.



RusForest's investment plans

- ✓ We believe in Russia's competitive advantage and will continue to invest outside Krasnoyarsk. We have the potential to raise money and increase domestic wood processing and create jobs.
- ✓ In Krasnoyarsk we have frozen our investment
- ✓ We will continue fighting for access to electricity, but need some Federal support.



Conclusions

- ✓ Introduction of export duty only makes sense when combined with an improvement of investment conditions in the region
- ✓ If you ignore all the rhetoric, it seems that in wayward regions nobody cares about;
 - Achieving the Federal goal of increasing domestic processing,
 - Creating good jobs in remote rural areas,
 - Increasing tax revenues,
 - Introducing responsible forest management.



What we need from the Federal Government

- Fight corruption in wayward regions
- Building electricity and other infrastructure, and most importantly providing equal access to that infrastructure
- Stopping poorly controlled and state funded "mega projects", which crush the private sector

