

PRI Project Development LLC, a New York based company, is active in the European markets in transition, providing services as a Project Developer and a Financial Advisor to the companies seeking investments. PRI's most known completed projects in the countries of the Former Soviet Union were: obtaining Working Capital for the Lithuanian Refinery Mazeikiu Nafta and preparation for finalizing of privatization of JSC "Central Telegraph", Moscow. In his interview to Alexander Levinsky of Izvestia Newspaper, Victor Politis, founder and President of PRI, talks about how a western financial advisor sees the peculiarities of the Russian national business.

Q. During the last week of 2001 the business "barometer" of the Russian Economy – RTC index – showed "clear and bright". It crossed over the psychological barrier – the 250 mark. The experts though are inclined to think that it is the stock market brokers themselves that are "to blame" for this rise. Their annual fees depend on the level of the latest annual sales. Analysts think that this growth was mainly due to the inflow of Russian capital. They forecast that this year the index will exceed the 300 mark due to foreign capital inflow. What do you think about this?

The situation in the Stock Market does not necessarily reflect the situation in the economy. In Russia, for instance, stocks of a limited number of companies are being traded in the market. Besides, all over the world, stock markets are very emotional and are being "cooked in their own juice". In other words, the people who work there pursue their own profit. For example, in the USA after September 11, the stock market fell drastically, after which it rose again. But does it mean that the economy got stronger? Even if the stock market rises there by 1000 points – it will not show the real situation in the Economy. I think that the true index of a strong economy is new jobs and citizens with pockets full of money. Look at Russia – unemployment and underemployment. Maybe the value of 80-100 companies, whose stocks are being traded at the market, is underestimated according to the international criteria. The prices for these stocks are rising. But this does not do anything for the people. Will the stock market cross the 300 mark? I do not know. Maybe. So what? Only few will benefit from this. And foreign investors will probably make the same mistake as they did before: they will see that the market is rising and forget that it will fall again.

Q. What hinders the successful development of the Russian Economy?

The main obstacle is that almost no new projects are being developed in other than several major industries, such as oil and gas, metallurgy. In order to stimulate true economic development, attract international financing, create new jobs and secure stability, we need to develop new projects in all industries.

Unfortunately, practically in every industry we can see misunderstanding of the fact that in order to obtain financing, it is not enough to only have a good idea. There are projects, which are evaluated at up to \$100 million with very well prepared technical aspects, but their owners most often do not even try to understand whether there is a demand for the product in the market and how much the market is prepared to pay. For example, a Moscow project we were offered to develop in November.

Q. What industry does this company belong to?

Mostly – manufacturing of quality engines for automobiles in Russia. Official dealer of one of the Russian automobile manufacturers decided to start manufacturing automobile engines of the European quality. For two years they were negotiating with the western manufacturers who had the dormant production line in Russia. The Russian company was not able to find financing to buy and assemble the line. The seller was tired of waiting and decided to sell

the line by parts. At this point the Russian company invited us. But after they got the project (which satisfied the seller), showing the way out of crisis situation, they decided that they also need to secure 100% guarantee that no matter what the situation with country's economy and politics would be, they would get the financing. It became clear that the project under consideration had no chances to be developed in the nearest future.

Q. You probably had the similar problems before? Your first project in the NIS countries was Lithuanian Refinery Mazeikiu NAFTA in 1995.

We worked with the state-owned company, which was on the edge of complete failure and for two years we acted as their temporary top management. And when we completed the project and the company started to show profit, the Government decided to sell it. IMF demanded that Lithuanian government privatized the refinery as soon as possible. The USA State Department (despite the rules according to which there must be a tender - two Russian companies were going to participate in this tender) put pressure on the Lithuanian Government and the only buyer which was left, was an American company. Under this pressure, which I consider not only unfair, but even criminal, the Government gave in and did not listen to us. We told them that the company was the main player in the country's economy, that it provided about 25% of all the tax money. In spite of our efforts the decision was made to sell the refinery to Williams, an American company. You also should bear in mind that the Government had hired Williams to manage the refinery. Can you imagine the situation: The company, which was going to buy out the refinery, had been hired to manage it! It's an absurd situation. This was the game in favor of the USA and against Russia. That was ridiculous, because the Russian company was selling oil to the refinery.

Q. I see that you continue to follow up with the companies after the projects are completed....

For three years already, we have been following the situation in order to understand who could come to help them.

And what political games are played around Mazeikiu NAFTA? First they intended to sign a Letter of Intent to sell stocks to Lukoil, then – Yukos. By the end of the year they rejected Yukos as well. At present, the representatives of Mazeikiu NAFTA and Williams want to continue negotiations with Yukos, but they wish to get better terms and conditions for themselves.

First of all, Williams' work was really very poor. The present Government realizes that a big mistake had been made. A. Brazauskas, who was the President of Lithuania before and with whom we worked at that time, has now become the Prime Minister. He is a very pragmatic and a very "transparent" person. He is very angry now though. I believe, that when he became the Prime Minister, he stopped the process, including the situation with Yukos. He did this not only because of the advantages one company could get over the other, but he was trying to avoid an even more confusing situation with Williams, Yukos and the Government. Brazauskas, being a pragmatist, does not want to involve new participants in the conflict. Lukoil has a serious presence in the country. Their office, for instance, is located directly across the street from Mazeikiu Nafta. For many years its General Director served as General Director for the Lukoil representation in Lithuania. There is one more problem for Yukos in Lithuania, and that is the fact that there are still some ethnic prejudices alive. The company was labeled as belonging to a definite group – Jewish or something else. Thus the choice to work with Yukos was a slap in the face for some politicians. What would you do? I would recommend Brazauskas to have top international lawyers review the contracts, which

were signed with Williams by the previous Government. Their cooperation caused tragic problems for the small country: its largest tax payer found itself in disaster with huge debt, it owes the Government, unlike the situation when we completed the project.

Q. You have completed several projects in Russia. In different industries – forestry, telecommunications... What are these projects, what is unique about them and what do they have in common?

The most unique one is the Preparation for Finalizing Privatization of Central Telegraph (CT). They hired ING Barings to find investor for a 22% stake, which belonged to the government. The task was to evaluate the company not on the basis of the existing business, which was declining, but taking into account the profits of the future projects in telecommunication. Barings spent a year and did not realize that the evaluation they were preparing was based on the demands of their client – CT. The Company was ready to start telecommunication business alongside telegraph services. CT as a client insisted that the project is ready and costs over \$60 million (it was too high for 22%). Baring as a consultant had a very strong conflict of interests: on the one side, according to the contract they were to find a buyer, on the other side, they themselves had the right to buy the shares. In the USA or in Great Britain it would cause a big scandal.

Q. You are saying that they could benefit from the low numbers of valuation of the company?

Absolutely. After the whole year without any results the auditing firm of CT – Arthur Andersen – asked me to interfere. We signed the contract with the General Manager of CT (late now, to our regret) Vyacheslav Roubtsov. The first thing we did – we told Barings not to expect their invoices to be paid (by that time, this amount added up to approximately \$0.9million. Thus, we became the “bad guys” in the relationship of Barings with its client.

To convert a telegraph company into a telecommunication company is not an easy task, especially in the political climate of Moscow, where everyone fights each other. 22% of the company belonged to the Government, 15% - to the Management and the employees and the rest belonged to the Voucher Funds. But not all of the owners were investors. We put all technological projects aside and started a market research – what was the market prepared to pay for? Instead of the technological project we developed a marketing project. We showed that there was a market, the cost of the required infrastructure and what cooperation was necessary to establish – sellers, strategic investors and so on. We participated in working out of a contract on joining MCTN, lobbied for granting CT the numerical volume. Then we did something very unusual. We persuaded Mingosimuschestvo (Ministry of Property), that not a single investor will invest the required funds in such a small company, and it is necessary that the Government agreed to take only insignificant part of the obtained funds to the budget and was allowed to spend up to 80% for the company's development. It was the first case of this kind in Russia. Mingosimuschestvo lobbied the Project and the rules were changed only for CT. However, as soon as it happened, local advisor/ investment bank persuaded Roubtsov that in order to continue the project and maintain good relationship with Svyasinvest, it is necessary to hire them. I met them and realized that it was not about professionalism as an advisor, but about politics. We decided not to fight.

Q. Does this mean that you quit the CT Project?

Yes. But nevertheless, the CT Project showed that it is possible in Russia to implement

projects, create jobs, and secure economic development, especially in the regions in a relatively short period of time, like 6 to 7 months.

Q. You are working now on the project on one of the refineries. Could it be Moscow Refinery?

We have not really started yet. In 2002, we are generally going to work on different projects – from copper mines to wood processing... We are negotiating with the owners in the regions.

Q. In case you do not want to give up the commercial secret or the names of regions, could you at least give us the numbers indicating the costs of the future projects?

We visited 7-8 regions. Each of them has its own list of projects with approximate cost of \$5 bn - \$6 bn. We offered them to select 1-3 projects for us to develop in 2002, that is to create a prototypical successful project in order to change the image of the region among investors and creditors. Look what India is doing in some sectors. Russia is in a more favorable situation compared to India, but every day it's losing its position. If small and medium projects are financed with the local money, they will fall under control. That's why financing should come from the international sources.

Q. What businesses do you call small and medium? It is differently understood in Russia and in the "West".

I don't mean very small projects, individual entrepreneurs, like restaurant owners. It's about the projects which require financing starting from \$15 million to \$75-\$80 million. The projects which will require billions of dollars, such as construction of a pipeline from Russia to China, will be controlled by big companies and politicians. Obviously it's not for us.