Emerging private water company of Russia

Presentation to the World Bank Water Week
Washington, D.C.
March 2007
PPP water market has been emerging in Russia since 2003 ...

![Graph showing population changes over years]

- Population in the area of the new contracts
- Population in the area of the lost contracts
- Total served population

#11
#15
#20
#22
#3
#15 Total number of existing contracts
Market development was driven by entrepreneurs

- Major developers:

  - Interros, major Russian private equity group created Novogor group that took opportunistically 49-year contract for the City of Perm with annual turnover over 50M USD. Project company has capital of USD300. Novogor-Perm was sold to RKS in 2006 reportedly for USD58M.

  - Alfa-Eco, another major Russian private equity group has acquired failing water engineering company of Rosvodokanal that took number of contracts in the areas of business operations of the sister businesses in the Alfa-Eco portfolio. Overall capital engaged into development is estimated at USD15-20M.

  - RAO UES, national electricity company, Gasprom bank and 5 private equity and industrial groups created RKS, Russian Utility Systems. The company, exploiting energy debt leverage of the utility sector and political connections, quickly took about 50 short-term renewable lease contracts in district heating, water and electricity distribution. The company was restructured with only UES and KES-Renova group stay to be shareholders. Capital of the company was increased from USD 30M to USD160M in 2006.

  - Former top management of RKS project quit the company and created EWP, Eurasian Water Partnership.
Principal structure of EWP/Evraziyskiy

Russian Private Investors

Vnesheconombank

20%

JSC Evraziyskiy
Water Investment Company
Capital over USD150M

Veolia

50%

EWP Ltd

Management O&M and/or service contracts

75%-1 Rostov water PPP
Population 1.1->2M
Turnover USD65M
20 year CAPEX program USD760M

37.85% Omsk water PPP
Population 1 M
Turnover USD85M
20 year CAPEX program USD400M

Future projects
(over 15 projects under development)

State owned bank being transformed into Russian Development Corporation with capital over USD3B
State debt management agent
State pension fund manager

RosAtom-Federal Agency of Nuclear Industry, own and manage all related enterprises

50% in Evraziyskiy-RosAtom Water Engineering JV

Share in Western Water Engineering Company

Shares in the Russian suppliers

Veolia option to acquire shares in the project companies

Veolia

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Veolia option to acquire shares in the project companies
Market is unstable and volatile, experiencing slow flight to more demanding clients and better quality contracts

<table>
<thead>
<tr>
<th>Contract changes in major cities</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term renewable lease</td>
<td>Perm</td>
<td>Baranau</td>
<td>Krasnodar Kaluga reg.</td>
<td>Petrozavodsk</td>
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<td>Orenbourg</td>
<td>Volgograd</td>
<td>Tver</td>
<td>Sochi</td>
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<td>Blagoveshensk</td>
<td>Novorossiysk</td>
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<td>Tomsk</td>
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<td>Vladivostok</td>
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<td>Long-term lease</td>
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<td>Kirov</td>
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<td>Long-term lease and investment</td>
<td>Omsk</td>
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<td>Rostov</td>
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<td>contract</td>
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<td>Contract sold to another operator</td>
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<td>Novorossiysk</td>
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<td>Novorossiysk</td>
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<td>Perm</td>
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<td>Tambov</td>
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<tr>
<td>Contract lost</td>
<td>Orel</td>
<td>Volgograd</td>
<td>Tver</td>
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2003-2007:
- Market is unstable and volatile, experiencing slow flight to more demanding clients and better quality contracts.
- Contract changes in major cities.
Rostov PPP project

- **JSC Evraziyskiy**
- **City of Rostov Don**
- **EWP**
- **JSC Voda Rostova** Equity ~USD60M
- **Federal Agency**
- **Regional Gvt**

**Management and outsourcing contracts**

**Investment Subsidy Agreement**

- 20 year USD553M private source CAPEX plan
- 25 year investment contract
- 25 year lease
- 5-year tariff plans

**5 year subsidies:**
- USD196M- State Invst Fund
- USD30M- Region and City Gvts
CAPEX program for the Rostov agglomeration

Water

Waste water

1

2+3
• **1st phase:**
  – Modernization of existing assets (incl. works under expanded WB loan):
    • New water pipelines (39 km), pumping stations (1.5 M m3/day)
    • Pressure zones, SCADA
    • Deep underground sewage collectors (4 km)
    • Reconstruction of the water treatment plant
    • Modernization of the second line of the waste water treatment plant
  – Infrastructure for newly developing urban areas in Rostov: New water intake, raw water pipelines (60km), water treatment plant (150K m3/day)

• **2nd phase:**
  – Local water treatment plants in the Rostov suburban areas
  – 2nd phase of the water intake and water treatment plant to supply 2 agricultural districts and the City of Taganrog
  – Extension of the sewage collectors in Rostov

• **3d phase:**
  – Waste water treatment plant in the Cities of Taganrog, Azov, Novocherkassk
  – Extension of the sewage collectors in Rostov
  – Modernization of waste water treatment plant in Rostov
Government effort to improve regulation is expected to backfire to the level of investment activity in the near term

<table>
<thead>
<tr>
<th>Recent legislation</th>
<th>Intentions towards water utilities</th>
<th>Impact to market development</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concession law, 2005</td>
<td>Introducing concession as a major tool of PPP in any area of public infrastructure. Concession is granted to construct, modernize and operate infrastructure. No exclusivity for service rights</td>
<td>Early termination mechanism doesn't comply with reality of the existing Budget Code. Implementation of the law may compromise existing contractual models</td>
</tr>
<tr>
<td>Water Resource Code, 2006</td>
<td>Liberalizing access to water resources through replacing water use licenses with contracts.</td>
<td>Making uncertain long-term water rights No exclusivity for public utilities to operate water resources in the municipality</td>
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<tr>
<td>Tariff regulation law 2004/2005/2006</td>
<td>Arresting inflation pressure from housing and utility tariffs, gradually transferring regulator responsibilities to regional level, introducing new methodology for tariff regulation,</td>
<td>POOR TO IMPROVING</td>
</tr>
<tr>
<td>Anti-monopoly law and protection of competition law, 2006</td>
<td>Keeping water utility not a monopoly</td>
<td>Making impossible contractual agreements on tariff formula until water becomes a monopoly. Creating potential to disbundle supply chain of the water utilities</td>
</tr>
<tr>
<td>Lease of public assets antimonopoly regulation, 2006</td>
<td>Requiring competitive tender prior to already existing obligatory public hearings on lease award</td>
<td>Creating barriers for municipalities to launch PPPs in the absence of significant up front public investments to register property, perform engineering study and develop specific contract</td>
</tr>
<tr>
<td>Federal Investment Subsidies, 2006</td>
<td>Supporting investments to build infrastructure for supply of the new urbanization areas</td>
<td>POOR TO IMPROVING</td>
</tr>
</tbody>
</table>
To accommodate quick and uncertain market development we shift our strategy from being integrated operator to being water investor and water system integrator as separate business activities.

**Diagram Description:**

- **EWP** (Eurasian Water Partnership)
  - Invested service operator
  - Service to manage and ensure quality of water supply and waste water service of the water utility (operate is an option)
- **JSC Evraziyskiy**
  - Suppliers of goods and services for water utilities
  - Bundling of separate service and works contracts
- **Investments to develop suppliers**
- **Investments to develop service contracts**
- **Investments to develop real estate**
- **Investments to develop concessions**
- **City**
- **Water Utility**

**Textual Content:**

- Investments to develop suppliers
- Investments to develop service contracts
- JSC Evraziyskiy
- Investments to develop real estate
- Investments to develop concessions

*Service to manage and ensure quality of water supply and waste water service of the water utility (operate is an option)*
• Evraziyskiy investment company
  – From major focus of equity investment in PPPs to equal focus on investment into the Russian water equipment and service suppliers:
    • Emerging portfolio of USD100M equity investment opportunities in desalination, ultrafiltration, industrial services, disinfection, pipes, water construction contractor
  – From focus solely on investing into Russian capital intensive PPPs in the water sector to search for PPPs opportunities in Russia and achievable markets:
    • Rep office in Kazakhstan
    • Missions to Ukraine
    • Studies in Southern Europe
  – More attention to downside investment opportunities:
    • To catch real estate opportunities that appear because of investments into water infrastructure made by our water company

• Eurasian Water Partnership
  – From management contracts and development support to system integrator model (bundled service and investment outsourcing contracts)
    • … to increase target market from proprietary water companies of Evraziyskiy to any municipal or private water company
    • … to build industry competence and to expand marketing activities through strategic sourcing cooperation agreements with suppliers
  – From focus on major strategic partnership to focus on partners with available local resources
    • … priority to alliance with Water Utility of St-Petersbourg
    • …more opportunistic and project based cooperation with international water majors (subject to final offer from Veolia)