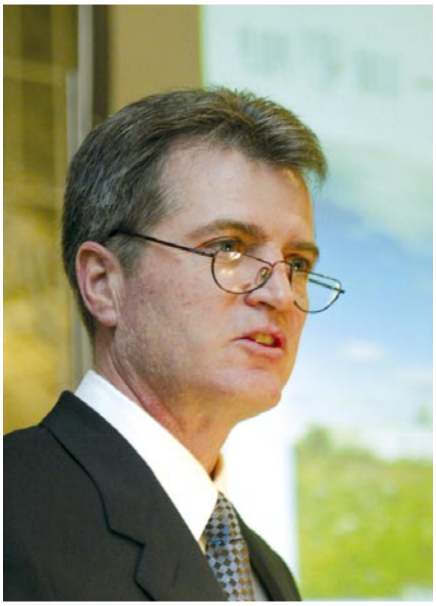
"AT THIS STAGE OF MARKET DEVELOPMENT A JOINT VENTURE WOULD DETRACT FROM OUR FOCUS. WE LIKE FULL CONTROL OF OUR BUSINESS"



Frank Graves, Executive Vice President / Chief Managing Director, Strategic Development, Ilim Pulp

Statistics attributed to authorities in the Krasnoyarsk Region claim that Russia currently exports $5b worth of timber a year, yet this could rise to over $100b – surpassing oil and gas as the country's leading source of hard currency earning. What do you make of such claims?
It is certainly bullish, but they are right from the point of view that the potential is all to the upside. We haven't seen many new projects developed in Russia since the '80s. The potential is there: it is a very strong local market that is only going to increase.

Demand in Russia is growing at 8-11% a year, depending on which area you are talking about. The technical demand is increasing: new equipment and new technologies are going to be put in.

One out of every five softwood trees in the world grows in Russia. It is an enormous resource, which is being totally underutilised. The Annual Allowable Cut – the equilibrium point – is about 550m cubic metres. The actual cut is around 160m cubic metres. This means that every year 400m cubic metres of wood is building up, waiting to be cut. It isn't being used and is at the point, to use the Russian term, of 'natural death' – the wood dies and goes to waste.

All that potential needs to be exploited somehow. The question is, who is going to do it? Whether it will be Russian players or foreign players remains to be determined.

And Ilim Pulp is positioning itself to take advantage of the potential?
That is what we have been doing since we started. We have plans in place. For example, we are increasing production at one of our Siberian mills from a nominal level of 500,000 tons a year to about 730,000 tons a year. We are investing the money, it is an ongoing process and we will see that production going to market next year. This is the story of what we are doing at all of our mills.

Our capital investment plans have two variants. One is a go slow, cautious, approach, whereby we invest about $400-$450m over the next four years. This will see us substantially increase production and move into more value-added grades. The other approach sees us spending $750m dollars and expanding very aggressively.

From the market point of view, there is strong demand for our products both in Russia and globally. Russia does have a number of competitive advantages, not only wood, but also low energy costs (which are not as favourable as they were, but which are still favourable), and labour costs which are quite reasonable for high-quality people.

As a foreigner employed in the senior management of a Russian pulp and paper company, are you surprised that so few Russian pulp and paper companies have appointed foreign expertise?
It is really a question of how a company looks at itself. The shareholders at Ilim Pulp took the position a number of years ago that while it is a Russian company, it is selling to export markets – over 70% of our products go to external markets. We are a global player in the pulp and paper market – that affects our products and our prices. Most of our sources of capital and equipment – the technology,

the markets and the trends – are dictated to us and don't come from Russia.

Also, while we are a private company, there is always a desire at some point to monetise the value of the shares – through an IPO or through a strategic or financial investor – which means that you need to have the expertise.

There is speculation of pulp and paper relocating to Russia. Is this trend still very tentative?

It is quite tentative. Up till now the foreign players have been looking and developing an understanding of how the market works. Stora Enso has opened a couple of corrugated board plants, which are relatively small investments. UPM has installed some basic saw milling capacity. The foreign players are going to come at one point. The competitive advantages are here. No one is going to put a pulp mill in Sweden. South America definitely has an advantage on hardwood pulp, but if you are looking for softwood pulp, then Russia is the place you want to be.

Do you believe that the Putin administration offers the stability necessary for significant investment in the sector?

The government understands the issues. Installing a world class pulp mill costs upward of a billion dollars, depending on how much the government is going to do on the infrastructure side. In reality, there are very few sites in Russia that have the infrastructure for such a project. It is a massive country. It is one thing to site a mill, but there are also considerations of energy supply, transportation (how to get the raw materials in and the product out) and a place for people to live. And how do you get the trees? Who is going to build the roads into the forests? These are all not cheap questions. Logging roads cost between one to two million dollars a kilometre!

With these questions, the devil is in the details. Getting that infrastructure in many places is extremely difficult.

Existing players, such as ourselves, have a competitive advantage in these areas. We have massive sites which have the developed infrastructure. We have had discussions with potential foreign investors who want to start a new project. We will continue to have discussions on a number of joint ventures with different players, we have good sites, and if we can get agreement, we will jointly develop our business. rir