

Sovetskaya Gavan (Russian Far East) Regional Update

July 2006

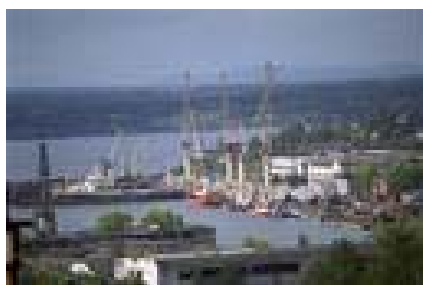
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SUMMARY

The Sovetskaya Gavan District is one of the most dynamically developing regions of the Khabarovsk Krai. District's timber and fish producing enterprises play a significant role in the Krai's international trade and provide a number of commercial and investment opportunities that may be of interest to U.S. businesses. The demand for U.S.-made construction equipment will definitely increase since a \$3 billion project of the transportation node development in the territory will be started soon. The district is also one of the most attractive locations/sites for foreign investments.

GENERAL INFORMATION



The District of Sovetskaya Gavan (Sovgavan), established in 1925, occupies 15,600 sq. km. on the west coast of the Tatarskiy Channel on the eastern slope of the Sikhote-Alin Ridge. The district population is approximately 50,000 people. The primary share of the population lives in the city of Sovetskaya Gavan - the District's administrative center (over 30,000 people), located 541 miles north of Khabarovsk. The District is predominantly mountainous and covered with coniferous forests. The climate is monsoon with average annual precipitation of 650-1,100 mm. The average January temperature is -18C, August is +16.4C; the average annual temperature is +0.3C.

Sovetskaya Gavan is an important regional transportation hub providing access to both the Baikal-Amur and Trans-Siberian railroads. A one-track, 320-mile railroad connects Sovetskaya Gavan with Komsomolsk-on Amur, the major industrial center in the Russian Far East, from which the trains have access to all destinations in Russia. The trip by train from Khabarovsk to Sovetskaya Gavan takes 23 hours. The available track allows shipping up to 15 million tons of cargo annually. In order to

double the turnover, a reconstruction of the existing track is required, which will cost an estimated 75 billion rubles (\$2.8 billion). A domestic airport located 20 miles from the city used to provide regular flights to Khabarovsk, but when in 2004 the Lidoga-Vanino gravel highway opened and connected Sovetskaya Gavan, Vanino, and Khabarovsk, and included Sovgavan into Russia's overall automobile network, passengers' demand for air transportation diminished and flights lost profitability. The distance to Komsomolsk-on-Amur is 320 miles, Khabarovsk – 390 miles, Vladivostok – 940 miles.

The District has mineral deposits of construction stone, brick clay, sand and gravel materials and minor deposits of tin and copper. Sovgavan's forests are rich with spruce, white fir, Mongolian oak, ash, birch and larch. Its fish resources include river species—primarily salmon types, and sea species—flounder, navaga, rasp, pollack, herring, squid, etc.

The Sovetskaya Gavan gulf is 1.4 miles wide and 7.5 miles long. Its depth ranges from 22 to 37 feet. The gulf is ice-free from late March until January and partly serves as a naval base. In January 2000, a border guard post was established on the basis of Yakor plant so that the local enterprises will have additional opportunities to operate internationally. A number of industrial enterprises in Sovetskaya Gavan have mooring lines, which they use for transshipment services.

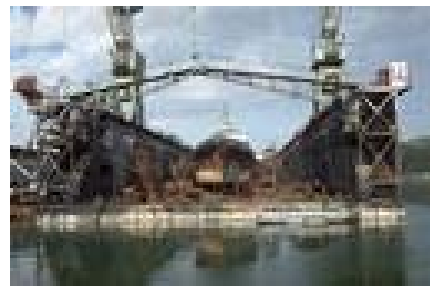
INDUSTRY

During the past few years, the Sovgavan District enjoyed stable industrial growth. The District's major industries are shipbuilding and ship repair, fisheries, and timber and wood processing. These sectors offer the best sales prospects for U.S.-made equipment and machinery, as well as investment opportunities for American companies. The best sales prospects for U.S. manufacturers include:

- Wood processing equipment, especially dry kilns and sawmills
- Logging and tree hauling machinery/equipment
- Road-construction machinery
- Fishing vessels and tankers
- Fish processing equipment

Shipbuilding and Repair

For decades, Sovetskaya Gavan was a shipbuilding and repair center for Khabarovsk Krai. Its two ship repairing plants, Yakor and Severniy, were the most important industrial enterprises of the district and the largest employers in Sovetskaya Gavan, handling almost all the municipal infrastructure. Today, there are no shipbuilding activities in the District, while ship repair is being maintained on the site of the former Yakor Ship Repairing Enterprise (went bankrupt in 2002).



Sovetskaya Gavan Ship Repair Yard (SGSR) is a successor of Yakor Plant. Currently, SGSR provides foreign and domestic marine vessels (mostly fishing boats) with

diversified repair services. Starting on January 1, 2006, DV Metal from Komsomolsk became the crisis manager for the SGSR. During the past two years, the company repaired 26 vessels. SGSR also owns two floating docks and specialized berths to perform repair of the hull parts, seaborne machinery, fuel equipment, fishing and fish processing equipment. Pokrovskiy Mine also intends to purchase Yakor and employ it as a dock terminal.

Severniy Shipyard/ Pallada

The Severniy (Northern) joint stock shipyard was traditionally engaged in repair of large ships and manufacturing of smaller auxiliary ships (hulks and lighters of up to 500 tons) and mechanical equipment for the fishing fleet. Today, Pallada Company, a branch of the Amurskiy Shipbuilding Plant (Komsomolsk-on-Amur) operates on the base of Severniy, utilizing its production facilities for ship repair.

Amurskaya ERA

Amurskaya ERA Company is a Sovgavan subsidiary of a Komsomolsk-based company, which provides the following services:

- vessel electrical mounting service
- repair of electrical equipment
- customs warehouse for temporary storage

Fishing Industry



Both the Tatarskiy Channel and the Sea of Okhotsk are rich in fish as well as crab, shrimp, squid, and octopus. The share of fishing industry in the District economy is traditionally high, reaching 50 percent. In 2005, the District accounted for 60.5 percent of fish and sea products caught in the Khabarovsk Krai. The bulk of their production, up to 90 percent, is exported directly to foreign countries, outside of Russian customs border.

Over 20 fish industry enterprises operate in the District. The largest operations are Vostokrybprom Ltd., Sovgavanryba Lts., Polluks Ltd., Vostokryba Ltd., Kometa Ltd., and Prostor Fishing Enterprise.

The production capacities of Vostokryba, the largest enterprise in the District fishing sector, allows it to process all types of fish and other fish products in large quantities. The plant has recently installed a line for production of 250 kilograms of the pollack fillet per hour.

In 2006, planned activities aimed at expansion of the near-shore fishing, production upgrade and expansion will allow for the considerable increase of the fish products. Despite overall production increase, more than half of all fishing enterprises are currently operating at a loss. Lack of investment capital, shortage of working capital, and product transportation difficulties are hampering the performance of the fish industry in general, and especially the development of expanded trade relations.

The fish sector is traditionally an important exporter in the Krai. The primary exported items are pollack fillet and caviar, frozen salmon and herring, crabmeat and red caviar. The exports continue to be focused on non-processed or low-processed frozen product. The primary exporting companies are Sovgavanryba Ltd., Pollucks Ltd., and Vostokryba Ltd. These operations account for 95 percent of the District's export of fish products.

Timber Industry

Traditionally, the district has been noted among the largest timber producers of the Krai. Approximately 12 logging enterprises are operating currently in the area. Most felling areas are located 60–100 miles from Sovetskaya Gavan. The annual allowable cut is 2,464,800 cu. meters. During 2004, the District harvested 646,500 cubic meters of timber, which was an 11 percent increase



over 2003 performance. About 90 percent of the total volume of lumber produced in the district is exported to the South Asian countries. For years, China and South Korea have been the largest markets for the local fir, larch, and spruce but during the last few years, since the prices on the Japanese lumber market have been growing, the portion of export from Sovgavan to Japan has considerably increased. In 2004, timber and wood processing enterprises of Sovetskaya Gavan exported 500,000 cubic meters of timber products. The share of round logs was 83 percent.

The District Administration seeks to promote deep wood processing technologies in the area. Local timber enterprises intend to explore new technology, purchase modern equipment, etc. Fart Ltd. and Hermes Ltd. have already installed new wood processing shops to produce high quality sawn goods.

Hermes Ltd.

Hermes, established approximately 15 years ago, is one of the most reputable companies in the area. Annually, it harvests over 70,000 cubic meters of timber, and produces 20,000 cubic meters of sawn goods for export. The company possesses a fleet of 6 carriers with a displacement from 4,000-6,000 tons. Hermes also runs a construction subsidiary and a chain of grocery stores in Sovetskaya Gavan, Vanino, and Khabarovsk. The Company is interested in cooperation with U.S. businesses.

Triton Ltd.

Triton Limited Liability Company was established in 1998. It exports about 200,000 cubic meters of logs to Korea, Japan, and China annually. The Company is interested in cooperation with the U.S. shipping companies in transporting logs to Japan, China and Korea.

Vanino-Tairiku

One of the most sophisticated manufacturing operations in the Krai today is the Tairiku Sawmill plant near Sovetskaya Gavan. The plant is a Russian-Japanese joint venture, which produces approximately 20,000 cub. m. of kiln dried pine lumber annually and then, ships it to the Japanese market from the port of Vanino. Raw material for the mill is sourced out of the Lake Baikal region, and delivered to the mill

by rail. Mill residual waste is used for power generation for both the mill operation and nearby villages.

SMEs and Trade

As of January 1, 2005, 124 small enterprises were registered in Sovetskaya Gavan employing 20,550 people and 2,109 private entrepreneurs not registered as legal entity employing over 3,300 people. Ten percent of SMEs operate in industry sector, 8 percent in construction, 12 percent – fishing and fish processing, 8 percent – timber and wood processing, 37 percent in trade and catering.

During the past year, small business accounted for 18.5 percent of the District's gross product, 20 percent of overall timber production, 8 percent of production of consumer goods and 100 percent of production of construction materials.

During 2005, the District's retail turnover increased 17 percent and totaled \$35 million. Food products account for 60 percent of the retail trade and non-food products for 40 percent.

Vostok

Vostok runs several businesses including a chain of stores marketing consumer goods and home appliances, and a furniture manufacturing facility. The Company also expanded and established a construction subsidiary and a firm providing design and engineering services.

Transportation



The unique location of Sovetskaya Gavan on the shore of the gulf predestined development of a large transportation complex on its territory. The Sovetskaya Gavan gulf is one of the largest and deepest gulfs of Russia on the shore of the Sea of Japan. The trading seaport is located in the Sovgavan gulf and possesses seven cargo districts, including Sovgavan Port U.S.-Russian Joint Venture, Gavanbubker Ltd., Nord Ltd., SSRK Ltd., Prichal-Trading Ltd., and Khabarovskenergo oil pier. Since 1993, the port operates all year long. It possesses sufficient vacant territories to make further expansion available. Eight stevedore enterprises provide forwarding, brokerage, inspection, and other services.

Sovgavan Port U.S.-Russia Joint Venture

In 1996, the Global Forestry Management Group, a consortium of ten timber enterprises from the U.S. northwest, and Expraes, a Khabarovsk joint stock company, established two joint ventures in Vanino and Sovgavan. Sovgavan Les harvested wood, while Sovgavan Port processed and transshipped the timber on the basis of the Terminal joint stock company. At this time, GFMG has sold its share of Sovgavan Les to a Russian company. GFMG currently owns 70 percent of the Sovgavan Port's shares, with the Khabarovsk Krai Government owning another 25 percent, and individual shareholder holding 5 percent. The primary destinations for timber transshipped by Sovgavan Port are China, Japan and Korea.

Development of the Vanino–SovGavan Transportation Node

A number of large construction projects are currently being implemented in the Muchke Bay of the Vanino District as a part of development of a large transportation node. Further project implementation also requires development of industrial and social infrastructure calling for dozens miles of pipe laying, additional power resources construction, modernization of roads and communication.

BANKING

Four regional and federal banks have opened their branches in Sovetskaya Gavan to service one of the most economically active territories in the Russian Far East. The representative offices of Vneshtorgbank, Sberbank, Dalkombank, and Rosbank operate in the District.

During 2005, the District banks reported a 22.8 percent increase in cash turnover. Small businesses are an important part of the financial institutions' credit policy. During 2005, 162 loans were provided to small businesses, including express loans for up to 18 months, which was a 28 percent increase from 2004 results. Trade and catering, services sector, agriculture, transportation and food processing traditionally receive the primary share of loans.

SOVETSKAYA GAVAN ON INTERNET

In May 2006, the information portal of the Sovetskaya Gavan District was put on the Internet to become of the Krai's most dynamic and modern resources of its kind. The District's web site provides updated information on political, economic and social life of the area and introduces its history, investment climate and recent government activities. There is also a section on business development in the District and the information about the most promising projects. The Sovetskaya Gavan web site is located at www.sovgavan-rayon.ru (in Russian only).

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