



RAZGULAY GROUP

Restructuring of the Group's Assets

In June - July 2007 Razgulay Group completed disposal of 3 out of 39 companies controlled by the Group. Companies sold had the least fit with the Group's overall development strategy. Companies sold included ZAO "Kolpnyansky Sugar Mill", OOO "Azov port elevator" and ZAO "Bugulminsky KHP No.1".

ZAO "Kolpnyansky Sugar Mill" was acquired by the Group in 2005. Its sugar beet processing capacity is 300,000 tons p.a. In 2006 the mill processed close to 180,000 tons of sugar beet.

Kolpnyansky sugar mill is located in the Oryol region. Razgulay Group owns another sugar mill there – ZAO "Otradinsky sugar mill". Otradinsky sugar mill has higher efficiency, more capacity (500,000 tons per annum; plans for harvesting and acquisition of sugar beet in the current harvesting season are 400,000 tons including 167,500 tons of sugar beet grown by the Group's companies). Development potential of Otradinsky mill is much higher than that of Kolpnyansky mill: in the next 2 years the Group plans to modernize and renovate Otradinsky sugar mill and increase its annual capacity from the current 500,000 to 800,000 tons. Otradinsky sugar mill also has much better prospects of broadening its sugar beet supply base. Based on the above considerations the management of the Group decided to divest the Kolpnyansky sugar mill and focus the Group's efforts on developing just one sugar mill in Oryol region – specifically, the Otradinsky mill. It should also be mentioned that after completion of Otradinsky modernization project the aggregate capacity for sugar beet processing owned by the Group in Oryol region will return to the pre-disposal level.

Proceeds from disposal of Kolpnyansky sugar mill will be invested in renovation and modernization of the Group's sugar mills with the highest potential. Those investments will allow the Group to offset (already in the current harvest season) the annual capacity loss of 300,000 tons from disposal of Kolpnyansky sugar mill through increased production at Tihoretsky, Kshensky, Chishminsky and Alekseevsky sugar mills by the same 300,000 tons p.a. For the next harvest season the Group's sugar beet processing capacity will increase further – by an additional 600,000 tons p.a. (including close to 300,000 tons p.a. of annual capacity increase at Otradinsky sugar mill).

OOO "Azov port elevator" was built by the Group in 2003. It is located near the city of Azov in Rostov region. The elevator is capable of loading ships of the «river-sea» class with deadweight of up to 5,000 tons. Total grain storage volume is 37,000 tons and trans-shipment capacity is up to 1.5 million tons p.a.

Azov port elevator was built during the period when record-breaking grain exports (up to 19 million tons p.a. in 2002) coincided with a shortage of trans-shipment capacity for exported grain. The elevator became a leading competitive factor of the Group in this business area and by 2006 the elevator was able to secure leading positions in grain trans-shipment among Russian elevators of similar size.

However, in recent years the grain market was influenced by the following trends: growing livestock population (both in poultry and pig farming) simulated by state support of animal husbandry leads to significant growth of domestic grain consumption. We see grain production volumes growing, but at a slower pace than domestic consumption – thus export forecasts must be reviewed. At the same time a lot of export-oriented grain trans-shipment capacity was put on the market during the past few years. This led to excess capacity in the market niche of shallow-port grain trans-shipment facilities. For instance, in 2006 total capacity of shallow-port elevators was 8 million tons p.a. while actual grain exports via them was only ca. 2.9 million tons. This led to margin compression in the business of grain export via shallow-port elevators.

At the same time disposal of Azov port elevator will not lead to any decrease in export operations of the Group. The Group actually intends to increase its exports volumes primarily through more shipments from the deep-water sea ports of Novorossiysk and Tuapse (the Group has obtained trans-

shipment quotas for its goods for the 2006-2007 season). It is further expected that margins on grain exports will actually improve. The Group does not intend going forward to completely abandon the idea of grain exports via shallow-port elevators.

It is expected that proceeds from the sale of Azov port elevator will be used for the Group's participation in projects for construction of deep-sea port terminals.

ZAO Bugulminsky KHP No. 1 was acquired by the Group in 2003. This grain processing facility is located in the city of Bugulma in the Republic of Tatarstan. The facility has annual grain processing capacity of 64,300 tons

This transaction is a part of the strategy of the Grain sub-holding of the Group. This strategy envisages modernization of key companies within the Group and obtaining funding for such modernization from a number of sources – including proceeds from divestment of less efficient assets.

The greater part of proceeds from divestment of Bugulminsky KHP No.1 will be used for modernization and renovation of another cereals production facility of the Group – OAO «Gerkules». The latter company has a better geographic location from the viewpoint of access to raw materials (inputs) and logistics. The above-mentioned investments will lead to increased capacity at OAO «Gerkules» (at least to the level when annual cereal production capacity of the whole Group will not decrease), modernization of production facilities with replacement of a large portion of production equipment, expansion of product range (all types of cereals, combined fodder, flour) and fixed cost savings (due to economies of scale at one production site).

A part of the proceeds received from the divestment of Bugulminsky KHP is expected to be invested in development of products sold under the Group's own (private) labels.