



# INVESTMENT CRISIS

**The pulp and paper industry has almost exhausted its inner development potential. If we do not raise foreign investments within the next few years, the industry will stagnate.**

The year of 2004 can be considered quite beneficial for the Russian pulp and paper industry (PPI). The yearly production growth amounted to 5.4% according to statistics. This complies with the development dynamics (5.5%) of the prior period. PPI's lagging behind the whole RF industry production growth rates is quite insignificant (6.1% per year) and the industry persists within the country's average rates.

However, industry participants are not satisfied with the middle position – in fact, they are concerned. Optimists expect a 5% increase in output that will remain for a year or two, while pessimists predict that growth rates will decrease between 1-3% in the near future. Still, both agree that widening potential through the cosmetic modernizing of existing capacities has almost been exhausted. There is a need for industry modernization, introducing new lines and machines and for the construction of new factories. This problem is hard to solve as the industry has low investment appeal and pulp and paper plants have no sufficient internal funds.

The PPI will have a hard time unless we can find a way out in the next several years. Native players will lose some of the western markets and start to experience pressure from foreign producers within the Russian area. The future depends a lot on the governmental policy concerning the timber complex.

## EXHAUSTED POTENTIAL

After significant production rates dropped in the 1990's, the PPI enterprises did their best to return to their abandoned positions. All large and medium-sized industrial complexes have reconstructed and modernized their production plants, repaired conventional technologies and partially implemented new technologies.

Some projects are being executed or are planned for 2005. Segezha PPM, for example, continues to reconstruct and modernize equipment along the execution workflow, including the modernization of pulp cooking machines. Mondi Business Paper Syktyvkarsky LPK signed a contract with Finnish Andritz Power for the delivery of equipment for sodium regeneration boiler reconstruction in the current year. The Sverogorsk mill is going to finish papermachine reconstruction, which will increase its output by summer. Ilim Pulp also continues to execute its large-scale investment program.

Most plant capacity modernization measures are continuing to be performed at the expense of the industry's inner reserves. According to Bumprom, internal funds make up 86% of the investment volume in the timber complex (LPK) and debts amount to only 14%. It is obvious that quite cheap projects (amounting up to \$50 billion) with a medium payback period are preferred as PPC lacks available funds. In a number of cases, existing resources were redirected by shareholders to other economic spheres due to the industry's low attractiveness for investors.

The possibilities of morally and physically obsolete plant capacities being upgraded by moderate investments are progressively less. "By 2004, most pulp and paper enterprises reached production volumes close to the maximum for the existing capacities. The industry's inner potential has almost been exhausted," says Anton Loiter, Arkhangelsk Pulp and Paper Mill's (APPM) marketing and sales director. The largest enterprises of the industry - Kotlas PPM, Solikamskbumprom, Kondopoga, Volga - already work to the breaking point of their work load. Medium enterprises are also approaching their maximum capacity.