

Contents

RUSSIA INFRASTRUCTURE TOP STORY

1. Big bulk neighbour for NCSP: New sea port to be built on Black Sea
2. Fesco wants Transcontainer
3. Global Ports IPO pricing values company at \$2.4bn
4. Globaltrans: Conference Meetings Takeaways
5. Mostotrest: Conference Meetings Takeaways
6. Railway Reform In South East Europe and Turkey Can Boost Growth And Cut Delivery Time In Half
7. Russia may abolish port cargo handling tariff regulation
8. VTB Capital successfully places a OJSC "Western High-Speed Diameter" bond issues

RUSSIA INFRASTRUCTURE NEWS

9. City of Moscow to replace over 800 public transport vehicles in 2011
10. Globaltrans: Conference Meetings Takeaways
11. LSR acquires large brick plant in Moscow region
12. Moscow eyes fourfold increase in subway ad revenue to \$100 million
13. Mostotrest: Management Meeting Wrap-Up
14. Sobyenin says can solve Moscow's traffic, corruption problems
15. Three Bridges and One Road: Siberia, Far East and China

RUSSIA INFRASTRUCTURE FINANCE & STATISTICS

16. Rail cargo handling in January-May decelerated to 4.3% y/y
17. UTair airline to pay out \$2.5m in 2010 dividends

RUSSIA ROADS

18. Moscow to spend \$1.2bn on city roads
19. Mostotrest: Conference Meetings Takeaways
20. Russian education ministry buys 325 school buses from GAZ for RUB360m
21. TransContainer, German company to set up JV in Kaluga Region
22. St Petersburg highway project operator places RUB10bn bonds

RUSSIA TRAINS

23. City of Moscow to spend RUB150bn per year to develop metro
24. Ekaterinburg metro to get \$4.3m on safety systems
25. Evraz to invest \$525m in rail wheel, track production by 2013
26. First Cargo IFRS net profit soars to RUB20bn in 2010
27. Putin reappoints Yakunin as Russian Railways' president
28. Putin wants to prevent changes in terms of First Cargo Company sale
29. Rail loadings in May: Trends persist
30. Russian government may compensate Russian Railways for 2012 tariff freeze
31. Russian Railways to offer Eurobonds in 2012
32. RZD hopes to invest \$1.5bn of state funds in Mongolian coal project
33. Vagonmash to supply \$177m rail cars for St. Petersburg metro

RUSSIA PLANES

34. Aeroflot receives first Sukhoi Superjet 100 - source
35. Aeroflot sells loss-making Nordavia: Deal closed
36. Domodedovo Airport passenger traffic up 13% in January-May
37. Fly-over payments to Aeroflot estimated at \$200m
38. Hochtief Airport develops \$900m Emelyanovo airport modernization plan
39. Lipetsk Airport to get \$45m RF funding on modernization
40. Novosibirsk's Tolmachevo Airport passenger traffic up 24% y-o-y Jan-May
41. Russia's Sky Express passenger traffic up 5% on year in January-May
42. Russian government to auction 25.5% stake in Siberia Airlines
43. Sheremetyevo Airport passenger traffic up 18% on year in January-May
44. Sheremetyevo's board of directors approves the valuation of the airport and Terminal D
45. St Pete's Pulkovo Airport passenger traffic up 15% in Jan-May
46. United Aircraft Corporation, Airbus and EADS have halted the A320/A321 Passenger-to-Freighter conversion program

RUSSIA SHIPS

- 47. Cargo terminal in Koltsovo airport to cost \$32m
- 48. FESCO shareholders approve paying no dividends for 2010
- 49. NCSP: Operating Results for 5M11 - May Disappoints
- 50. Northwestern Shipping shareholders OK paying RUB5m in 2010 dividends
- 51. Russia fails to sell 25.5% government stake in Amur Shipping Company
- 52. Russian property agency to sell state's 20% stake in Arkhangelsk Seaport
- 53. Sberbank Capital sells 10% in Global Ports for \$238m to N-Trans
- 54. Seaport of St Petersburg shareholders OK paying RUB33.7m in 2010 dividends
- 55. Sovcomflot to approve \$5.5bn invest program in September
- 56. Summa Capital to build \$300m port complex in Primorsky region
- 57. United Shipbuilding Corporation buys 25.5% in Nizhegorodsky Teplokhod

CIS INFRASTRUCTURE

- 58. Belarus' rail freight traffic up 14.8% y-o-y in January-May to 62m tonnes
- 59. Belarusian Railway's capital investments up 60% y-o-y in January-April

- 60. China's Eximbank to give Belarus \$1 bln loan
- 61. Lukashenko OKs project to reconstruct Minsk airport with Chinese loans
- 62. Investors to be sought for reconstruction of underpasses in Kyiv subway
- 63. Odesa seaport forecasts 11% growth in net profit in 1H11
- 64. Railcar prices went up by 17% YTD in June
- 65. The Ministry of Infrastructure considers tax concessions to truck and bus importers
- 66. Ukraine plans to buy more than 2.6 ths school buses
- 67. Ukraine wants to build 2,000-4,000 km of roads per year
- 68. Ukrainian Railways might buy more passenger trains
- 69. Ukrzaliznytsya plans to invest \$1.6bn in locomotive fleet by 2017

EURASIA INFRASTRUCTURE

- 70. Reopening of Stepanakert airport likely to go to international mediation

Top story



Big bulk neighbour for NCSP: New sea port to be built on Black Sea

Renaissance Capital

Event: On Friday (3 June) Reuters reported that a new bulk cargo port called Taman will be built on the Black sea basin. RBC Daily reported today (6 June) that total investments will reach RUB150bn (\$5.4bn), with a third financed by the government, and the remainder coming from private investors. An interest has reportedly been expressed in the port's construction by Uralkali, SUEK, United Grain Company, Metalinvest and UCL Holding (which has looked at the possibility of creating three terminals for containers, coal and metals). Development planning is expected to be completed by 2012, and construction to begin in 2013. Russian Prime Minister Vladimir Putin wants the port to reach 65mn tpa turnover by 2020 (35mn tpa turnover by 2015).

Action: Neutral for Novorossiysk Commercial Sea Port's (NCSP) operations in the short term; however, Taman could add competitive pressure on the port in the long term, in our view.

Rationale: Taman's bulk capacities are expected to exceed those of NCSP, with liquid cargo accounting for about 70% of the port's 80-85mnt annual turnover on a standalone basis. Details on projected terminals and capacities in Taman are not currently available. In the worst case scenario, Taman could put competitive pressure on NCSP with respect to grain, ferrous metals, iron ore, accounting for 7% (about 10% with normal functioning, with no affect from export bans), 10%, and 3%, respectively, of NCSP's FY10 volumes, as well as container transportation. ●

Ivan Kim

Fesco wants Transcontainer

VTB Capital

It was obvious from FESCO's presentation at the Russia Calling London Session Conference that acquiring Transcontainer is the company's most important strategic theme at the moment; indeed, a major part of any meeting was typically dedicated to it. The timing and structure of the deal, as well as its final price, are far from clear.

Despite having a backup plan, we believe that FESCO's share price will continue to be under pressure as a result of uncertainty over the acquisition. There is 19% upside to our 12-mo target price of USD 0.60.

And this deal is indeed important: the companies would fit well from both the operational and the geographical points of view, triggering further business development and potentially unlocking the large potential for synergies. While acquiring a 25% stake



www.fesco.ru

is viable and financially easier for FESCO (given that it already owns a 12.5% stake), the company would still be a major bidder were a 50% stake to be offered (although in that case, some asset disposal or capital markets event would be required).

As desirable as this deal is, FESCO is not going to buy Transcontainer at any price: once the exact terms of the disposal have been approved by the seller, Russian Railways, FESCO's management will determine a price ceiling. In case of failure, there is a backup plan: develop a competing business by buying several terminals around the country which, in addition to that which is to be constructed in Moscow and the existing terminal in Vladivostok, would form a convenient hub system around the country. The final network might have a capacity of up to 2mn TEUs and require up to USD 0.5bn in purchasing and construction capex. ●

Global Ports IPO pricing values company at \$2.4bn

bne

Global Ports yesterday set a price range of \$14.70-\$16.10 for its upcoming IPO in London, valuing the company at \$2.2 - \$2.4bn, reports Reuters.

The container terminal operator stands to raise up to \$572m through listing 35.5m shares. The majority of the offer will comprise existing shares sold by owner N-Trans, the company said. Global Ports hopes to see \$100m come in via the sale of new shares to fund investment.

Global Ports stressed that it is offering investors exposure to a rapidly growing segment, claiming the Russian container traffic market is expected to grow by over 18% annually until at least 2013, supported by Russian economic development and growing volumes of imports and exports.

Whilst commodities-facing floats out of Russia have struggled in general this year, offers from companies exposed to domestic consumption have mostly pushed their way through. However, investors continue to demand a sizable discount and are currently unwilling to simply cash out owners.

Controlling around 30% of Russia's container ports market, Global Ports is owned by N-Trans, which has also sold shares in its Globaltrans and Mostotrest subsidiaries on the public markets. According to sources cited by Reuters on June 7, Global Ports plans to issue \$100m worth of new shares, with N-Trans also selling a unspecified batch of existing shares.

The company aims to have an overall free float of 25% following the float, the earlier report said. One source said analysts had calculated a 'fair value' for the company of around \$3bn. Should the listing go through at that level it would raise \$750m. "There will be a significant secondary component to the offering, although

the public market will determine the final valuation," the source told Reuters.

The company said it will invest the net proceeds from the sale in its ports operation. Deutsche Bank, Goldman Sachs, Morgan Stanley and Troika Dialog have been hired as bookrunners.

Global Ports said its revenue grew by 61% to \$122.9m in the first quarter. The Russian container ports market has grown at CAGR of 18.6% since 2000, and is expected to continue at a similar rate, the company said, citing Drewry Shipping Consultants. ●

Globaltrans: Conference Meetings Takeaways

VTB Capital

Globaltrans' meetings with investors at the Russia Calling London Session Conference confirmed the talk of acquisitions which is sweeping across the transportation market. Globaltrans has two acquisition targets: Freight One (the main aim, in our view) and Transcontainer (we think that the motives for this are more questionable). While Freight One might provide the long-awaited force for Globaltrans to rerate, it seems unlikely. And in the absence of that, we remain neutral on the stock with 13% upside to our 12-month target price of USD 20.

Those investors who attended the meetings of both FESCO (which is keen to acquire Transcontainer) and Globaltrans (will be bidding for Freight One) saw that FESCO's preparations for the acquisition were more advanced. While, on the one hand, this is logical, given that FESCO is already an owner, already in the BoD and has already started cooperation; it might also reflect the bidder's belief in its success.

Globaltrans' presentation contained no slides mentioning the acquisition of Freight One and its potential benefits. Typically, the discussion of this topic lasted no more than five minutes: yes, we



www.globaltrans.com

shall bid; yes, we realise there are other strong bidders, but we shall participate as this is an open auction and the starting price of USD 6bn for the whole company looks very attractive to us; no we do not have a price ceiling in mind; no, we do not have enough money for this acquisition; yes, we shall use the capital markets, a combination of debt and equity.

In case of failure, Globaltrans' plan B is just to buy more gondolas. The fact that the heavily indebted new owner of Freight One is likely to exit the market for new gondolas would help Globaltrans to do that at attractive prices, supporting its 'growth at a low cost' reputation. Still, we think it would take the company several years to achieve the size of Freight One in gondolas (70-80,000). It is also far from clear whether the market would absorb that many railcars given that improved efficiency would probably ease what, in our view, is the artificial deficit problem at the moment.

As for bidding for Transcontainer, management gave no additional motives except for adding the quickly growing container segment. From whatever angle, a FESCO-Transcontainer tie up looks more convincing to us than Globaltrans- Transcontainer. ●

Mostotrest: Conference Meetings Takeaways

VTB Capital

Mostotrest's meetings with investors at the Russia Calling London Session Conference reconfirmed the three pillars on which the company's investment case is based. Mostotrest is one of the major beneficiaries of Russia's large infrastructure upgrade plans: its order book (and, hence, revenues) continues to rise. Management is focused on profitability. The resulting profits are to be redistributed to shareholders not only through capital gains but also through dividends. We continue to see Mostotrest as a rapidly growing, cheap (2012 EV/EBITDA of 6.1) exposure to the Russian transport infrastructure market and are reiterating our Buy recommendation as our 12-month Target Price implies 41% upside potential.

Despite the fact that Moscow has still not announced the new tenders for creating and upgrading the city's transport infrastructure (although financing for those that have already been signed has resumed in full), Mostotrest has continued to enjoy a flow of quality orders thanks to its regional diversification. Since the beginning of the year, contracts totalling USD 1.3bn have been added to the 2010 order book of USD 8.4bn (itself an all-time high). On our estimates, January-May construction did not exceed USD 1bn, putting the total order book at USD 8.7bn (or 3.5x 2010 revenues) at the end of May.

While the ongoing uptake of orders is satisfying, Mostotrest CFO Oleg Tanana was specific that volumes were not a priority. "We are not rushing for any tender in the hope that building up

the order book will spur Mcap; rather we continue to focus on complex projects that should give us a good profitability." He sees a normalised level of the latter at 9-10% (EBITDA) and this is exactly where it is in our model. At 12%, last year's was artificial as it was the first time that IFRS had been applied to Mostotrest's recently acquired subsidiaries, ETS and TSM. They were required to reflect profit under the percentage of completion method, not only for the current period but also for all previous ones.

We continue to see the growth in construction materials as one of the major potential destroyers of margins. CFO's believe is that should the increase be capped by 20% per year, that would be manageable and could be compensated through a combination of inflation coefficients built into contracts, direct contracts and own production. Fair, in our view.

Chairman Georgy Koryashkin pointed out that improving cash flow, supported by new orders and profitability, will continue to be distributed to shareholders.

All three large groups of Mostotrest's shareholders are eager for good returns.

While the dividend policy stipulates a 30% payout, last year it stood at 49% and is likely be higher than the benchmark in the future. ●

Railway Reform In South East Europe and Turkey Can Boost Growth And Cut Delivery Time In Half

World Bank

Train transit times between Ljubljana and Istanbul can be reduced by half - a staggering 25 hours - if much-needed reforms in the rail sector are made, according to the new World Bank report, *Railway Reform in South East Europe and Turkey: On the Right Track?*, released today in Brussels.

"A test run of the Bosphorus Europe Express train in 2009 showed that a container train from Ljubljana, Slovenia can reach Istanbul, Turkey in 35 hours, but in practice often takes over 60 hours," said Carolina Monsalve, Transport Economist in the World Bank's Europe and Central Asia region, and author of the report. "This is a

dramatic time difference with enormous economic consequences. The greater the efficiency of the rail sector, the larger the range of markets in which the rail companies across the region can successfully compete."

The much-needed reforms not only reduce transit times and help state rail companies reap economic benefits from enhanced coordination, management, and organization, they will also bring railways in South East Europe and Turkey closer to standards required by the European Union (EU), and enable healthy competition of the rail sector in order to improve rail freight and passenger services.

The new Railway Reform in South East Europe and Turkey: On the Right Track? report revisits the railways of the region five years after the 2005 benchmark study, Railway Reform in the Western Balkans, to assess the progress made by the state rail in institutional reform, operating and financial performance, and integration. The report looks at the state of the railways in ten countries: Albania, Bosnia and Herzegovina, Croatia, Kosovo, Montenegro, Former Yugoslav Republic (FYR) of Macedonia, and Serbia, together with Bulgaria, Romania, and Turkey.

The railways of South East Europe and Turkey experienced significant declines in traffic volumes in 2009. This reflected the impact of the international financial crisis unleashed in the last quarter of 2008 and its contractionary impact on the economies of the region and elsewhere. Lower traffic volumes translated in most cases into a serious deterioration of the financial performance of the state-owned railways. This brought home the costs of failing to implement essential reforms to improve the operational and financial performance of the sector when the economy was strong.

The report stresses that there are three main reasons for prioritizing changes in the railway sector. Firstly, to ensure compliance with the requirements of relevant European Union (EU) directives. Secondly, countries can begin to reap the envisaged benefits of adopting this institutional framework. Finally, when competition is introduced, to enhance the ability of state rail incumbents to compete with new entrants without requiring increased levels of support from the state.

With the exceptions of Bulgaria and Romania, which are already EU member states and the region's lead reformers in the sector, all of the countries covered in the report aspire to join the EU. For candidate countries - such as Croatia, Turkey, or FYR Macedonia - there is particular urgency in complying with EU directives. For potential candidate countries, like Serbia and Albania, there is more time. However, precisely because those countries are

further behind, the need to start accelerating the reform process now becomes even more compelling.

In addition to improving their chances of being accepted into the EU, there are many intrinsic economic benefits for these countries to gain by meeting the institutional framework set by the EU. The main objectives behind the rail reforms introduced in Europe in the 1990s were to improve competition; create more and better integrated international freight rail services; improve the efficient use of infrastructure capacity; facilitate the creation of a single European rail space; and increase the share of rail compared to other transport modes. These objectives are as relevant today, if not more so, to the countries covered in this report as they are to the EU member states themselves.

With the current corporate governance structure and existing operational performance, state rail incumbents will find it increasingly challenging to compete with new players when rail markets are opened and competition introduced. From a public policy perspective, a gradual set of reforms aimed at turning around the financial results of the state railways is less costly socially and politically, than dramatic layoffs at a time of acute crisis. In addition to implementing the required legislation, state rail companies need to change their cultures in order to become more business-oriented. They need to focus on meeting customer needs, and providing efficient, cost-effective services.

In addition to providing efficient rail services to passengers, rail freight services are critical in the production, trade, and distribution of materials. Competitive transport services, in all transport modes, are a critical element in a country's economic competitiveness.

While rail reform has been largely moving on the right track, the report stresses that the pace of reforms needs to be stepped up.

"The main objective of this report is to serve as wake-up call of the urgent need for stepping up the reform process," said Monsalve. "Those countries that aspire to be members of the EU need to understand that moving quickly on these reforms will greatly improve their chances of receiving a positive opinion from the EU regarding rail transport regulations, as well as boost their growth."

Monsalve emphasized that "Scarce public resources need to be used efficiently and effectively to finance the necessary upgrades in rail infrastructure and essential passenger services, not to prop up inefficient state railways weighed by excessive employee numbers and outdated management practices. The ultimate aim of the reforms is to improve railway services." ●

Russia may abolish port cargo handling tariff regulation

bne

The Russian government could abolish the regulation of tariffs for the handling and storage of cargo in the country's seaports, Prime news agency reported on June 9 after Prime Minister Vladimir Putin instructed the Ministry of Transport to develop a programme to liberalise tariffs at Russia's ports.

The government plans to decide whether to abolish tariff regulation by the Federal Antimonopoly Service (FAS) depending on the results of an experiment started recently at a port in St. Petersburg, Putin is quoted as saying.

Under the experiment, the tariffs for handling and storage of cargo in the port are not regulated by the government. Putin

plans to issue a ruling on when the experiment must be finished and an analysis of its results conducted.

Aton brokerage writes:

We see the news as generally neutral for NCSP. First, in our view NCSP's tariffs are unlikely to be liberalised as the port is a quasi-monopoly in the Southern region of Russia; second, NCSP has never had any problems getting the FAS to approve its tariffs. We believe that even if NCSP's tariffs are liberalised and flexibility is added to the tariff-setting policy, the tariff levels themselves would likely remain the same. ●

VTB Capital successfully places a OJSC "Western High-Speed Diameter" bond issues

VTB Capital – press release

VTB Capital has successfully placed two domestic bond issues of OJSC "Western High-Speed Diameter" with a total volume of RUB 10bn. Initially, investors were offered two bond issues - Series 01 and 02 - of a 20-year tenor worth RUB 5 bn each. Coupons were set at 8.5 - 9.0% per annum with a five-year option. Clearing of the par value of the bonds was guaranteed by the state.

The placement was nearly two times oversubscribed and over 55 bids from investors were put forward, allowing the coupon to be decreased to 8.75%. The major buyers were banks, investment companies and private investors. Attracted funds will be directed by the issuer towards a large infrastructure project of building a highway in St. Petersburg.

Alexey Konochkin, Deputy Head of DCM at VTB Capital, said: "We are satisfied with the results of OJSC "Western High-Speed Diameter" debut placement. We managed to attract significant interest from investors - with the bids totalling RUB 19bn - and were thus able to place the bonds at coupon rate that was suitable for the issuer".

VTB Capital arranged the bonds placement along with the support of Sberbank and VEB Capital. ●

Russia infrastructure news

City of Moscow to replace over 800 public transport vehicles in 2011

bne

The Moscow city government plans to purchase over 800 buses, trolleybuses, tram cars, and metro rail cars in order to replace existing ones in the city's transport system in 2011, Prime news agency reports, citing a city government statement.

The financial details were not provided, but the agency says the government plans to purchase 570 buses, 100 trolleybuses, and 30 tram cars, as well as 80 metro rail cars to replace those used on the Koltsovaya and Kalininskaya metro lines.

The government also plans to buy 80 metro rail cars for the Mariiono-Zyablikovo section of the Lublinskaya metro line once it is completed, Moscow Mayor Sergei Sobyanin says.

shall participate as this is an open auction and the starting price of USD 6bn for the whole company looks very attractive to us; no we do not have a price ceiling in mind; no, we do not have enough money for this acquisition; yes, we shall use the capital markets, a combination of debt and equity.

In case of failure, Globaltrans' plan B is just to buy more gondolas. The fact that the heavily indebted new owner of Freight One is likely to exit the market for new gondolas would help Globaltrans to do that at attractive prices, supporting its 'growth at a low cost' reputation. Still, we think it would take the company several years to achieve the size of Freight One in gondolas (70-80,000). It is also far from clear whether the market would absorb that many railcars given that improved efficiency would probably ease what, in our view, is the artificial deficit problem at the moment.

As for bidding for Transcontainer, management gave no additional motives except for adding the quickly growing container segment. From whatever angle, a FESCO-Transcontainer tie up looks more convincing to us than Globaltrans-Transcontainer.

Elena Sakhnova

Globaltrans: Conference Meetings Takeaways

VTB Capital

Globaltrans' meetings with investors at the Russia Calling London Session Conference confirmed the talk of acquisitions which is sweeping across the transportation market. Globaltrans has two acquisition targets: Freight One (the main aim, in our view) and Transcontainer (we think that the motives for this are more questionable). While Freight One might provide the long-awaited force for Globaltrans to rerate, it seems unlikely. And in the absence of that, we remain neutral on the stock with 13% upside to our 12-month target price of USD 20.

Those investors who attended the meetings of both FESCO (which is keen to acquire Transcontainer) and Globaltrans (will be bidding for Freight One) saw that FESCO's preparations for the acquisition were more advanced. While, on the one hand, this is logical, given that FESCO is already an owner, already in the BoD and has already started cooperation; it might also reflect the bidder's belief in its success.

Globaltrans' presentation contained no slides mentioning the acquisition of Freight One and its potential benefits. Typically, the discussion of this topic lasted no more than five minutes: yes, we shall bid; yes, we realise there are other strong bidders, but we

LSR acquires large brick plant in Moscow region

VTB Capital

News: LSR has acquired 93.44% in Pavlovskaya Keramika, one of the largest facing bricks manufacturers in the Moscow region for RUB 1.238bn (USD 44mn). The plant's annual production capacity is 70mn bricks. The plant was built in 1970 and significantly modernised in 2006-08: obsolete buildings were substituted with new workshops with fully automated manufacturing process.

Our View: According to the company, as soon as the plant reaches full production it will gain a 17% share in the facing brick market of the Moscow region. This would allow LSR to take a beneficial position in terms of facing brick supply to other market players as well as fulfill its own projects' needs. The products will be supplied not only to Moscow region, but also to other regions including St Petersburg, Vladimir, Ryazan and Vologda. We note that LSR is the largest ceramic bricks manufacturer in Russia and the acquisition allows the company to expand to the new market and further strengthen its position on the market.

We estimate annual production of the plant at about 30mn

bricks in 2011, while full capacity utilisation is to be reached by 2012. Taking into account current prices, this would translate into a revenue stream of about RUB 240mn in 2011 and RUB 560mn in 2012. We assume an EBITDA margin of 25-30%, that LSR is capable to achieve due to the synergies coming from the availability of the resource base as well as modernised plant equipment (vs. LSR's brick division EBITDA margin of 1% in 2010, 13% in 2009 and 38% in 2008). This translates into an EV/EBITDA of 17-21x in 2011F and 7-9x in 2012F, which looks high in absolute terms, however given the recovering growth prospects, synergies effect and premium for control, the acquisition price looks reasonable to us and so we take this news positively. The stock now implies 75% upside potential to our 12-month TP and we are reiterating our Buy recommendation.

Moscow eyes fourfold increase in subway ad revenue to \$100 million

RIA Novosti

Ads in the Moscow metro could bring around \$100 billion to the city economy after the authorities sign a deal with a new provider later this month, the Moscow government's head of advertising told the Rossiiskaya Gazeta daily on Thursday.

A tender to find a new company to manage the lucrative advertising space until 2015 will be held on June 21, nine days before the contract of current contractor Olymp comes to an end.

"I am sure that the tender will be successful," advertising head Vladimir Chrenikov said. "Seven companies have already applied to take part. Our forecasts suggest the tender could bring in at least 3 billion rubles [\$106 million] in place of the current 700 million [\$25 million]." Advertising is the Russian capital's third biggest source of income, bringing in 2.3 billion rubles (about \$82 million) in 2010.

The authorities expect a rise in demand for underground advertising after legislation banning ads on scaffolding and the sides of buildings comes into force at the end of the year.

Mostotrest: Management Meeting Wrap-Up

Aton, Mikhail Pak

On 7 June, Aton hosted an investor meeting with Mostotrest management represented by CFO Oleg Tanana and IR chief

Olesya Lapina. The meeting left us with a generally positive impression and we note the following key takeaways.

Acquisitions. Mostotrest plans to extend its expertise into various spheres, seeking greater vertical integration. As such, the company is in touch with a number of companies specialising in road maintenance, production of steel bridge structures and design and project institutions, which could be potential acquisition targets. Mostotrest estimates that it could spend up to RUB4bn on these acquisitions. Longer term, Mostotrest is considering broadening its expertise into the construction of stadiums (FIFA World Cup 2018) and car parks.

In addition, Mostotrest is investigating the possibility of entering the tunnel construction business (which may proffer yield margins on a par with bridge building, i.e. 20-25% on the gross profit level). This step could potentially be accomplished by establishing a JV with a foreign company.

Financing issues. Mostotrest is comfortable with its current debt load and the terms that Russian banks (Sberbank, Gazprombank and VTB) offer. In the company's view, it does not require any substantial long-term financing.

Moscow contracts. Mostotrest notes that following Sergey Sobyenin's appointment as Moscow mayor, the city's spending on transport infrastructure has been suspended. The company, however, believes that once the city authorities have finished studying the existing contracts as well as potential plans for Moscow's transport infrastructure development, new tenders will be launched. Given that Sobyenin has put Moscow's transport infrastructure problem at the top of his agenda we believe that related spending will resume shortly.

Profitability levels. Mostotrest does not traditionally provide guidance regarding its profitability levels but suggests that its long-term EBITDA margin should be in the region of 9-10%.

We were left with a generally positive impression of Mostotrest and maintain that the company is best positioned to capitalise on upcoming public and private spending on transport infrastructure. Its powerful shareholder base, improving corporate governance (though already the best in the sector) and clear growth prospects support our view that Mostotrest offers one of the best (if not only) exposures to the Russian transport infrastructure sector.

Sobyenin says can solve Moscow's traffic, corruption problems

Reuters

Seven months after his appointment by President Dmitry Medvedev, Moscow Mayor Sergei Sobyenin says he can improve

public transportation and reduce corruption in Russia's capital, making it a more attractive place to live and invest in, Reuters reports.

"Moscow's biggest plus is that it is the capital of Russia," he is quoted as saying in an interview. "The biggest financial flows are here, the headquarters of the biggest financial companies are here."

"If you are talking about the possible income from investments in Russia, in Moscow, then I think the return on the investment is significant," he says. "There are, of course, more significant risks of making losses, but that's a question of management and professional decision making."

Three Bridges and One Road: Siberia, Far East and China

Ria Novosti

The Prospects for Cooperation between Russia's Siberian and Far Eastern Regions with China in View of the Vladivostok APEC Summit

The United States, which holds the APEC presidency in 2011, is preparing to host the APEC summit in Honolulu this autumn where it will unveil ambitious and almost revolutionary proposals aimed at advancing the real integration of the Asia-Pacific region. These include proposals on a free-trade zone within APEC, reducing customs and tariff barriers, etc. If the plan is successful, it will turn APEC from a club of presidents into a genuine integration group that will make a bid for world economic leadership. ___After the Americans, the APEC presidency in 2012 will be passed to Russia, which will host the next APEC summit in Vladivostok on Russky Island. The challenge that faces us involves building infrastructure for the summit on the island ("out of the 19th century and straight into the 21st century") and coming up with a package of comprehensive proposals on the further development of APEC. ___That would pose a serious challenge against the backdrop of the game-changing ideas of the American presidency. ___The reason for this is that our involvement in the economic integration of the region has been minimal so far. The Far East is still largely perceived as a military outpost, while frequent pledges to develop it economically have failed to produce the desired results. This is confirmed by the results of the latest census which produced stark evidence of the continuing outflow of residents from the area in spite of all the rhetoric about the "windfall profits" of the 2000s. ___In order to be prepared to host the 2012 APEC summit we have to offer a program that would lead to a qualitative leap in our openness and the integration of the Russian Far East and Siberia in international economic relations. That is impossible without intensification and a logistical breakthrough in the relations between the border areas of Russia and China. ___That is why an imperative of future relations between Russia and China is a new openness to

investments into the Russian regions of Siberia, the Trans-Baikal area and the Far East. The aim is to create capital-intensive high-added value production in Siberia and the Far East and attract foreign investments into the production of Russian goods. ___That is a fairly new approach and its implementation may cause some concern based on historical stereotypes. For Russia the main fear stems from the psychological stereotype whereby "if we let the Chinese into Siberia we will lose it." That fear may be challenged by statistics which prove that the apocalyptic forecasts of the 1990s regarding "the yellow threat" have not come true and that the Chinese presence in Siberia, the Trans-Baikal area and the Far East is stable and is not out of line with the permissible migration balance (it is certainly better than the migration balance in Moscow). Secondly, there is already evidence that Chinese investments have had a positive impact in Russia (mainly along the Chita-Blagoveshchensk-Khabarovsk line) where the Chinese are contributing to the development of our production infrastructure and to raising the living standards of our citizens. ___On the other hand, the main benefit of that project for Russia is also obvious: the accelerated industrial and infrastructure (hence, social) development of Siberia driven by foreign investment. Another plus for Russia stems from the notion that it is a lesser evil, and that if Russia does not open up Siberia and the Far East to investments (and thus maintain an active position within APEC) very soon the issue will be solved without us and Russian Siberia will be a prize for whoever wins the American-Chinese stand-off. ___The answer to the problem may be the promotion of the concept of "co-development" of the border regions of Russia and China. The Chinese regions located close to Russia (Heilongjiang, Inner Mongolia, Jilin and to some extent Liaoning in the north-east and the Altai area of Xinjiang in the north-west) have interests in developing cooperation with Russia that often do not coincide with those of the central authorities in Beijing. During the course of foreign economic conferences the economic managers of China's border areas have often criticized Beijing, demanding greater autonomy for the border regions in their economic relations with Russia and permission to allow Russian investments in China. ___Besides, a crucial internal problem for China's north-eastern regions is the existence of old industries (giant factories built under Mao Zedong) which are operating at a loss, are inefficient and require huge investments to be retrofitted and reoriented to other markets. The presence of the obsolete industries aggravates social problems in north-eastern China, which often prompts local people to migrate to Beijing and Shanghai inside China and to Russia. All this leads to widening gaps in the development of various Chinese regions, marginalizing the north-east while the priority is given to the development of China's "seafront showcase" in the east (around Shanghai) and south (Guangzhou and Hong Kong). ___In this context, many representatives of China's north-eastern provinces push for the need to coordinate the economic policies of the border regions of Russia and China and indeed their co-development. The Chinese regions raise this topic at the annual meetings of the Russian-Chinese intergovernmental border cooperation commission. The idea, though, has until recently found little support among the central authorities in Beijing or Moscow (in Beijing because it is reluctant to grant independence to the regions and to allow Russian investments into China; in this country, due to the above-mentioned fears of Chinese penetration of Siberia). ___And yet this approach could boost the development of the Russian regions in Siberia and the Far East in the new APEC environment. Above all, it would shift the debate on the regional aspect of Russian-

Chinese interaction from the level of mutual fears to that of daily economic interaction, with the discussion and formation of mutually beneficial investment projects. ___A milestone political decision aimed at overcoming these problems was made in 2009 when Russian and Chinese leaders adopted a joint program of cooperation between the regions of the Russian Far East and Eastern Siberia and the north-east of China. The challenge now is to implement the program. So, Russia could recommend developing an official plan for the co-development of border territories (a kind of "co-development five-year plan"). The regions must take part in the development of the plan, which is in fact more important for the Chinese regions (in terms of opening them up and distancing them from the centre) than for Russian regions. ___Obviously, the first "co-development five-year plan" will be modest and will involve stand-alone projects. The development of the transport infrastructure is particularly important (especially in the context of APEC). Two ideas that have been shelved need to be "unfrozen." The first is building a highway between Russian Altai and the Chinese city of Altai in northern Xinjiang, from the Chuysk highway across the Republic of Altai and the 50-kilometre western stretch of the Russian-Chinese border wedged between Kazakhstan and Mongolia, which currently has no transportation routes whatsoever. There was no need for it in Soviet times when Soviet-Chinese trade bound to and from Western Siberia and Central Russia passed through eastern Kazakhstan and the Druzhba station on the Kazakh-Xinjiang border. After the collapse of the USSR, Russia lost a direct transport link with western China. ___At the beginning of the 2000s the Altai administration under Governor Alexander Surikov lobbied the idea of a direct highway, an idea that had the support of the Xinjiang regional government. At the same time one could observe how Gazprom's interest in building a western gas pipeline from Russia to China through this 50-kilometre section of the border waxed and waned. It looks as if the talks on this section of the pipeline are close to moving on to a practical stage. Building the gas pipeline and highway across Altai will contribute to the region's development. ___Moreover, a direct road from Xinjiang to Western Siberia would greatly intensify contacts with China for Central Russian regions (which makes little economic sense today because of the huge transport costs involved in moving goods across the Far East and the whole of the Trans-Siberian Railway). ___Another project that has been on the back burner is the construction of a bridge across the Amur River to link Blagoveshchensk and the Chinese city of Heihe across the river. The bridge would facilitate economic ties between the Amur Region and Heilongjiang Province (currently linked by ferry during the summer) and would help to revive the economy of the most remote and depressed part of the Trans-Siberian line between Chita and Blagoveshchensk. However, that project was kept on

the shelf for political reasons (mainly on the Russian side). ___In terms of political accords, the adoption of the aforementioned joint program has changed the situation. It lists the Blagoveshchensk bridge as an agreed project. The program also includes the common view that it is viable to build two more bridges across the Amur, a railway bridge in the Jewish Autonomous Area leading to Birobidzhan and a motor bridge to Khabarovsk via the border islands, some of which were handed over to China in the process of border delimitation. ___If these three bridges are built they will bring the discussions of integrating our Far East into the economic links of APEC to a practical level. That would have a dramatic effect on the region's economy and could ensure a more rapid development for the region in the future. ___As for institutionalizing co-development, there are already early positive signs on the western section of the border where, because of the sparsely populated northern Xinjiang Province, there is no demographic imbalance between Russia and China, like in the Far East, and fears of the "yellow threat" are much less prevalent. ___In the early 2000s, at the initiative of Altai Governor Surikov, a macro-region of cross-border cooperation called the Great Altai was created bringing together the Russian Altai Territory and the Republic of Altai, the Chinese Xinjiang and the adjacent areas of Kazakhstan and Mongolia. That cross-border region, modeled on the European Union's "euro-regions" (specifically the Alps-Adria mountainous region), has the support of the Russian Foreign Ministry and is making good headway, mainly through interaction between the legislative assemblies of these regions and in the cultural and environmental spheres. In implementing co-development, that experience could be applied in the regions on the eastern section of the border where day-to-day interaction is much more intensive. ___Thus, if one were to translate the main conclusion into the idiom of Chinese wall newspapers, the slogan would be "three bridges and one road." It would include the Russian Far East and Siberia in APEC's ambitious integration projects and indeed make Russia a natural (or "multilane") bridge between the Asia-Pacific region and Europe. If that happens, the Vladivostok summit will be remembered not only for the impressive construction projects on Russky Island, but for major economic decisions that would mark a significant step in increasing Russia's global competitiveness. ___Oleg Barabanov, D.Sc. (Political Science), is head of the MGIMO European Studies Institute, Professor at the world economy and international affairs faculty of the National Research University Higher School of Economics, and co-author, with Sergei Karaganov and Timofei Bordachev, of the Valdai Club report "Through Harmonious Development to Regional Stability. Russia and China in the New World Architecture

Russia infrastructure finance & statistics

Rail cargo handling in January-May decelerated to 4.3% y/y

Alfa, Russia

Yesterday, Russian Railways reported that rail cargo turnover in May amounted to 180.4bn tkm and was up 4% y/y. Cargo handling increased by 3% y/y to 106.2mt.

On a cumulative basis, rail cargo handling continues to decelerate. The y/y growth dropped from 8.8% in 2010 to 4.3% y/y in January-May, suggesting that the post-crisis recovery growth is gradually returning to the normal levels seen in 2004-2007. The main driver was a deceleration in construction materials and cement transportation from 19% y/y and 7% y/y in January-April to 16% y/y and 3% y/y in January-May, respectively. At the same time, the container segment continued to deliver a solid performance, increasing 20% y/y (21% in January-April); however, its contribution to total growth is low.

The overall results are somewhat disappointing, as January-May numbers are below our full-year forecast of 6% y/y growth. However, at this point we view them as NEUTRAL for Globaltrans.

At the same time, solid growth in the container segment is positive for Transcontainer, as it supports our optimistic view on the development of the container market in Russia and rail container transportation in particular.

Iouli Matevossov

UTair airline to pay out \$2.5m in 2010 dividends

Marchmont

Sverdlovsk region-based UTair airline has announced plans to pay out \$2.5m in 2010 dividends, up 9.1% on 2009 payouts.

The company's 2010 net profit reportedly totaled \$7.8m. Thus dividends account for 25% of the firm's profit.

Russia roads

Moscow to spend \$1.2bn on city roads

bne

Moscow's City Hall will allocate about \$1.2bn of not-yet-dispersed funds to road construction, Vedomosti reports, citing a city official.

The money, which represents 84 percent of the RUB39.5bn (\$1.4 billion) that remains unspent, will be used to build and

repair major transportation arteries of the city, said Marina Ogloblina, head of the city's department of economic policy and development.

"This includes a segment of the Fourth Ring Road, Komsomolsky Prospekt in Lyubertsy, rebuilding Bolshoi Akademichesky, an intersection of Dmitrovskoye Shosse, rebuilding Leningradsky Prospekt, and other major road projects," she is quoted as saying by the paper.

Mostotrest: Conference Meetings Takeaways

VTB Capital

Mostotrest's meetings with investors at the Russia Calling London Session Conference reconfirmed the three pillars on which the company's investment case is based. Mostotrest is one of the major beneficiaries of Russia's large infrastructure upgrade plans: its order book (and, hence, revenues) continues to rise. Management is focused on profitability. The resulting profits are to be redistributed to shareholders not only through capital gains but also through dividends. We continue to see Mostotrest as a rapidly growing, cheap (2012 EV/EBITDA of 6.1) exposure to the Russian transport infrastructure market and are reiterating our Buy recommendation as our 12-month Target Price implies 41% upside potential.

Despite the fact that Moscow has still not announced the new tenders for creating and upgrading the city's transport infrastructure (although financing for those that have already been signed has resumed in full), Mostotrest has continued to enjoy a flow of quality orders thanks to its regional diversification. Since the beginning of the year, contracts totalling USD 1.3bn have been added to the 2010 order book of USD 8.4bn (itself an all-time high). On our estimates, January-May construction did not exceed USD 1bn, putting the total order book at USD 8.7bn (or 3.5x 2010 revenues) at the end of May.

While the ongoing uptake of orders is satisfying, Mostotrest CFO Oleg Tanana was specific that volumes were not a priority. "We are not rushing for any tender in the hope that building up the order book will spur Mcap; rather we continue to focus on complex projects that should give us a good profitability." He sees a normalised level of the latter at 9-10% (EBITDA) and this is exactly where it is in our model. At 12%, last year's was artificial as it was the first time that IFRS had been applied to Mostotrest's recently acquired subsidiaries, ETS and TSM. They were required to reflect profit under the percentage of completion method, not only for the current period but also for all previous ones.

Elena Sakhnova

Russian education ministry buys 325 school buses from GAZ for RUB360m

bne

Russia's Education and Science Ministry has bought 325 school buses worth a total of RUB360m from Russian automaker GAZ Group, Prime news agency reports, citing automaker's press office. The agency adds that In 2010, the ministry and regional governments bought 330 school buses worth a total of RUB348m.

TransContainer, German company to set up JV in Kaluga Region

bne

Russian container shipping company TransContainer and Germany's DB Schenker Rail Automotive GmbH have signed an agreement to set up a joint venture to provide logistics services to automobile parts suppliers and car manufacturers in the Kaluga Region, Prime-Tass reports, citing the Russian company. The value of the deal was not provided.

The agreement was signed in an effort to meet demand from a growing number of automobile parts suppliers and car manufacturers in the region.

St Petersburg highway project operator places RUB10bn bonds

bne

Russian company Western High-Speed Diameter, operator of a project to build St. Petersburg's Western High-Speed Diameter highway, has placed its first and second bond issues worth a total of RUB10bn, Prime news agency reports, citing a company statement.

The rate of the first coupon was set at an 8.75% annually for both issues. The bonds were offered in 1,000 ruble denominations and have a 5-year buyback offer.

Russia trains

City of Moscow to spend RUB150bn per year to develop metro

bne

The Moscow government is prepared to spend up to RUB150bn per year on the future development of the Moscow Metro, Moscow Mayor Sergei Sobyanin said on June 5 in an interview with Russian television channel Rossiya-1, Prime news agency reports. In 2011, the Moscow city authorities plan to allocate 56 billion rubles on upgrading the city metro, while in 2012, 80 billion-90 billion rubles are expected to be allocated for these purposes, Sobyanin said.

He added that the city government planned to cooperate with the Russian government and private investors in Moscow Metro construction projects, the news agency says.

Ekaterinburg metro to get \$4.3m on safety systems

Marchmont

Authorities in Sverdlovsk region expect to receive \$4.3m from the federal budget to install modern safety systems in Ekaterinburg metro, Rossiyskaya Gazeta reports.

Specifically, the metro is reportedly to be equipped with the face recognition system.

Evrast to invest \$525m in rail wheel, track production by 2013

bne

Evrast Group S.A., which operates in Russia, plans to invest \$525m in the production of rail wheels at its Novokuznetsk Steel Plant (NKMK) and railway tracks at its Nizhny Tagil Iron and Steel Works (NTMK) by 2013, the company's Vice President Alexei Ivanov says, Prime news agency reports.

Of the total, the company plans to invest \$485m in the reconstruction of railway track production, including \$225m invested in 2010 and \$130m planned for 2011. As a result, the agency says, total track production is to increase to 950,000 tonnes by 2013 from the current 650,000 tonnes.

Investments into the reconstruction of wheel production are expected to amount to \$40m, including \$8m spent in 2010 and \$25m planned for 2011, Ivanov said. The company's annual wheel production capacity is to increase 61% to 580,000 tonnes in 2012 compared with 2010.

First Cargo IFRS net profit soars to RUB20bn in 2010

bne

The net profit of Russian freight rail operator First Cargo Company increased to RUB19.9bn in 2010 from about RUB4.4bn in 2009, as calculated under International Financial Reporting Standards (IFRS), Prime reports.

CEO Igor Asaturov attributed the significant growth to an increase in shipments and the improved efficiency of the company's operations, the company said in a report.

Putin reappoints Yakunin as Russian Railways' president

bne

Russian Prime Minister Vladimir Putin has signed a ruling to reappoint Vladimir Yakunin as president of Russian state-owned railroad company Russian Railways for a period of four years, Putin said at a meeting on June 11, Prime news agency reports. "The decision was taken following positive results of the company's operations, with good dynamics, and taking into account the way the company passed through the difficult period of the economic crisis," Putin is quoted as saying.

Putin wants to prevent changes in terms of First Cargo Company sale

bne

Russian Prime Minister Vladimir Putin has instructed Russia's Transportation Minister Igor Levitin to prevent any changes in the terms of an auction to sell a government stake in First Cargo Company, a wholly-owned subsidiary of railroad company Russian Railways, Prime news agency reports.

Russian rail freight carrier Globaltrans CEO Sergei Maltsev told Putin that there were attempts to widen the range of investors by allowing financial entities and state corporations to take part in the auction, adding that such attempts should be refused. Levitin added that he had received proposals to abolish a term, under which an investor should own no fewer than 15,000 cars. "Pay attention to this and reduce these attempts to zero," Putin told Levitin, Prime reports.

Rail loadings in May: Trends persist

Renaissance Capital

Event: According to a Russian Railways press release yesterday (6 June), total railway cargo loading in Russia increased 3% YoY in May 2011 (vs 2.3% YoY in April). Cumulative loading reached 504.2mnt YtD, up 4.3% YoY.

Action: Generally positive for Globaltrans and TransContainer, in our view.

Rationale: Overall the general trends observed since the beginning of the year continue to persist, with total volumes and the majority of main cargo (coal, oil, and oil products) showing tiny growth YoY following the post-crisis recovery. The strongest performances YoY in 5M11 were demonstrated in iron ore (+9.3% YoY in 5M11), ferrous metals (+4.7% YoY), and building materials (+23% YoY), indicating that current activity in the industrial and infrastructure environment remains supportive for Globaltrans operations and should help the company reduce the empty run ratio, as building materials are a major return cargo category. Container transportation also remained solid, with volumes up 15.7% YoY in 5M11 (+14.6 YoY in 4M11), supporting TransContainer's performance.

Ivan Kim

Prime news agency reported on June 10 that Russian Railways said in a statement on June 10 that its cargo traffic increased 4.7% on the year to 565.306m tonnes in January-May.

Russian government may compensate Russian Railways for 2012 tariff freeze

bne

The Russian government may provide subsidies to state-owned railroad company Russian Railways in 2012 to compensate for the company's lost income due to limits imposed on the growth of railroad tariffs, Deputy Prime Minister Alexander Zhukov said at the St. Petersburg International Economic Forum, Prime reports. Zhukov said that the government was yet to finalize the volume of the subsidies.

Prime reported on June 8 that the Federal Tariff Service has no plans to consider increasing Russian Railways' tariffs.

The service's director, Sergei Novikov, was quoted as saying that the railway company had not submitted any applications to increase its tariffs and the service had received no instructions to consider the matter.

Russian Prime Minister Vladimir Putin stated earlier that the annual growth of tariffs for services of Russian natural monopolies should be restructured in line with Russia's consumer price inflation and should not surpass 5%-6% in 2012. Economic Development Minister Elvira Nabiullina told reporters in May that Russian Railways could lose 18 billion rubles in revenue in 2012, if tariffs are capped.

Russian Railways to offer Eurobonds in 2012

bne

State-owned railroad company Russian Railways plans to offer Eurobonds in 2012, the company's First Vice President Vadim Mikhailov says, Prime news agency reports.

Mikhailov is quoted as that the company's current investment program for 2012 amounts to RUB358bn, with RUB50bn coming from selling stakes in its subsidiaries.

The agency adds that Mikhailov did not rule out that Russian Railways' board of directors could consider increasing the 2012 investment program in August-September after receiving the financial results for January-June.

RZD hopes to invest \$1.5bn of state funds in Mongolian coal project

bne

Russian Railways (RZD) hopes to receive \$1.5bn from the state to put railway infrastructure in place for the Tavan Tolgoi coal project in Mongolia, a source from RZD's top management, Interfax reports.

"We're prepared to invest \$1.5bn in the project if the state gives us the cash," the source is quoted as saying, without specifying the the overall cost of the Russian bid to develop the coal field.

Russia planes

Aeroflot receives first Sukhoi Superjet 100 - source

bne

Flag carrier Aeroflot Russian Airlines has received its first Sukhoi Superjet 100 passenger plane, a source familiar with the matter says, Prime news agency reports.

"Aeroflot Russian Airlines has signed an acceptance certificate, the airplane is presently in the process of getting a registration number," the source is quoted as saying.

The first flight on the airplane was expected to be carried out from the city of St. Petersburg prior to the June 16-18 St. Petersburg International Economic Forum.

Vagonmash to supple \$177m rail cars for St. Petersburg metro

Marchmont

State-run St. Petersburg metro operator Peterburgsky Metropolitén has signed a \$177m contract with rail car plant Vagonmash for new rail cars, Vagonmash reports.

Under the contract the plant is to supply 24 rail cars, including eight leading cars equipped with operator cabins and 16 middle cars.

The priority requirement to the new rail cars is the use of energy saving technologies: the rail car salons are to be lit with luminous line of the reflected light, and operator cans are to be equipped with light-diode lamps.

All rail cars are also to have electricity energy meters in order to optimize energy consumption in metro.

Aeroflot sells loss-making Nordavia: Deal closed

Renaissance Capital

Event: Last Friday (10 June), Aeroflot announced the completion of the sale of its subsidiary, Nordavia. According to the company, the total value of the deal was \$235mn, including \$7mn in equity and \$228mn in liabilities, accounting for Nordavia's debt and operational leasing and part of its operating liabilities.

Action: Overall, positive for Aeroflot, in our view. The exclusion of the loss-making subsidiary is likely to improve Aeroflot's profitability and leverage.

Rationale: Nordavia was a loss-making subsidiary of Aeroflot, even at the operational level, with a negative EBIT of \$25mn in 2010, vs EBIT of \$804mn reported for the Group. In 2010,

Nordavia brought \$39mn of net loss to Aeroflot Group's net profit of \$253mn. The company will deconsolidate \$228mn of Nordavia's liabilities this year, and expects additional net income of up to \$60mn in 2011 from the exclusion of Nordavia's retained losses. According to Aeroflot's press release, the routes previously covered by Nordavia will be served by Rossiya, which was added to Aeroflot Group as the result of the merger with Rostekhnologii's assets.

Ivan Kim

Domodedovo Airport passenger traffic up 13% in January-May

bne

Passenger traffic through Moscow's Domodedovo International Airport rose 12.8% year-on-year in January-May to 8.630m people, Prime reports, citing a statement from the airport. Of the total, international passenger traffic rose 11.5% to 5.181m people, while domestic passenger traffic amounted to 3.450m people, up 14.8%, the airport said.

In May, passenger traffic through Domodedovo rose 24.3% to 2.265m people.

Fly-over payments to Aeroflot estimated at \$200m

Alfa Bank

According to Vedomosti, fly-over payments to Aeroflot in 2010 are estimated at \$200m by the audit commission for the upcoming AGM, which is 10% lower than in 2009. More than half of this amount (or ~\$107m) is paid by Air France and Lufthansa for Trans-Siberian routes.

We view the news as POSITIVE for Aeroflot. The company has never officially disclosed the amount of money it gets from fly-over agreements. However, the general consensus was that these royalties amount to roughly \$400m, close to the Airline revenue agreements line in its IFRS statements. These payments were considered as crucial for the company, making it profitable at the operating level (Aeroflot's operating income was \$500m in 2010 and \$278m in 2009). However, now the company has turned out to be profitable even without these payments, which is a positive signal and confirms the latest statements made by the company's

officials. Moreover, Aeroflot spent around \$83m out of the \$200m it gained in fly-over payments on financing the modernization of the Russian air industry last year. Therefore, the total amount of fly-over money left to Aeroflot was just half of its net income in 2010.

Iouli Matevossov

Hochtief Airport develops \$900m Emelyanovo airport modernization plan

Marchmont

Germany's Hochtief Airport GmbH has presented the Emelyanovo airport modernization plan to authorities in Krasnoyarsk region, Kommersant reports.

Investment into the airport modernization is reportedly estimated at \$897m.

The plan is to bring the Emelyanovo airport in accordance with C class under the IATA classification, which is the level of most European airports.

Specifically, the funds are to be spent on modernization of life support systems, lengthening of the parallel main taxiway in order to increase capacity of the take-off runway, reconstruction of the apron, development of new parking spots and other facilities.

Under the plant, by 2015 the passenger traffic capacity at the airport is to grow to 2.5 million people, and by 2030 - to 3.5 million passengers.

Lipetsk Airport to get \$45m RF funding on modernization

Marchmont

Lipetsk Airport expects to get \$45m from the federal budget on the airport facilities modernization, Kommersant reports.

The project has reportedly been approved by the federal expertise agency Glavgosexpertise.

Under the project, the funds are to be spent on modernization of the runway, expansion of the apron and reconstruction of the air terminal complex.

The works are scheduled to be completed in 2012.

Airlines, known under the S7 Airlines brand, Prime reports, citing the agency's official bulletin.

The starting price for the stake has been set at RUB1.873bn, with bids for the July 27 auction being accepted until July 20.

Novosibirsk's Tolmachevo Airport passenger traffic up 24% y-o-y Jan-May

bne

The passenger traffic of Russia's Tolmachevo Airport increased 23.6% year-on-year to 893,799 people in January-May, Prime news agency reports, citing a statement from the airport. In May, the airport's passenger traffic rose 21.1% on the year to 207,900 people.

Russia's Sky Express passenger traffic up 5% on year in January-May

bne

The passenger traffic of Russian low-cost airline Sky Express rose 5% year-on-year in January-May to over 423,000 people, Prime reports, citing a company statement.

In May, the company transported 94,700 people, up 21% year-on-year.

Passenger transportation increased 8% to 590.895m passenger-kilometers in January-May.

Russian government to auction 25.5% stake in Siberia Airlines

bne

Russia's Federal State Property Management Agency plans to hold an auction for the government's 25.5% stake in Siberia

Sheremetyevo Airport passenger traffic up 18% on year in January-May

bne

The passenger traffic of Moscow's Sheremetyevo International Airport rose 17.6% on the year to 7.729m people in January-May, the airport said in a statement, Prime news agency reports. International passenger traffic increased 18.7% on the year to 4.979m people in this period, while domestic traffic grew 15.7% on the year to 2.750m people.

Sheremetyevo's board of directors approves the valuation of the airport and Terminal D

Alfa Bank

Yesterday, the board of directors of International Airport Sheremetyevo (IAS) approved the valuation of the airport and Terminal D, prepared by Ernst&Young.

We view the news as NEUTRAL for Aeroflot, as at the beginning of May, the shareholders of Terminal D - Aeroflot, VEB and VTB - agreed with the valuation of the Terminal, giving the green light to the merger with Sheremetyevo. Therefore, the news was largely expected.

According to Ernst&Young, the value of Sheremetyevo and Terminal D is \$1.9bn (RUB53bn) and \$385m (RUB10.8bn), respectively. We welcome the progress of the merger process as the deconsolidation of Terminal D will improve Aeroflot's P&L and balance sheet, decreasing its debt burden.

St Pete's Pulkovo Airport passenger traffic up 15% in Jan-May

bne

Passenger traffic at St. Petersburg's Pulkovo Airport increased 14.9% on the year to 3.092m people in January-May, Prime news agency reports, citing Northern Capital Gateway, the airport's management company.

International passenger traffic outside the Commonwealth of Independent States (CIS) rose 8.0% on the year to 1.178m people in this period, while CIS passenger traffic increased 52.7% on the year to 328,259 people, and domestic passenger traffic increased 14.6% on the year to 1.585m people.

United Aircraft Corporation, Airbus and EADS have halted the A320/A321 Passenger-to-Freighter conversion program

Metropol

United Aircraft Corporation (UAC), Airbus, and EADS have made a joint decision to halt the A320/A321 Passenger-to-Freighter (P2F)

conversion program due for economic reasons. Recent market developments, including strongly increasing passenger traffic and the success of the upcoming A320neo, have resulted in greater-than-anticipated demand for the A320 passenger plane and lower demand for cargo aircraft. Moreover, high demand for passenger aircraft has pushed up demand for used A320s, thus reducing the number of planes available for conversion.

Unearned revenue. The Airbus Freighter Conversion (AFC) joint venture was established between EADS, Airbus and UAC in April, 2007. According to joint venture terms, UAC production sites were to produce and install all cargo handling equipment. The first conversion kit was slated for manufacture in 2011, with serial conversion in 2012. The JV planned to convert 40 aircraft by 2016, for an estimated USD 200mn in revenue.

Impact on stock. The news is negative for UAC, although we believe the impact on the stock price will be short-term since the project revenue of USD 200mn over 2011-2016 accounts for only 3.3% of 2011E revenue of USD 5.9bn, or 0.3% of estimated revenue through 2016. As a consequence, we reiterate our BUY recommendation and fair price of USD 0.023.

Andrey Rozhkov

Russia ships

Cargo terminal in Koltsovo airport to cost \$32m

Marchmont

Total investment into the first-phase construction of a cargo terminal in Ekaterinburg's Koltsovo airport is estimated at about \$32.4m, Sverdlovsk region officials report.

The complex is reportedly to be built on a 197,000-square-meter land site.

Under the project, area of the terminal buildings is to total 39,000 square meters, including 13,100-square-meter cargo terminal building, 13,700-square-meter office and storage spaces and other facilities. The cargo terminal building is also to have a parking lot for 350 cars near it.

Construction is to be carried out in two stages. Under the first stage, scheduled to be carried out in 2011-2012, 17,000-square-meter facilities are to be commissioned. Another 22,000-square-meter space is to be build in 2018-2022.

Total investment into construction of both launch complexes of the terminal has yet to be disclosed.

FESCO shareholders approve paying no dividends for 2010

bne

The annual general meeting (AGM) of shareholders of Russia's Far East Shipping Company (FESCO) has approved paying no dividends for 2010, the company's President Sergei Generalov told reporters, Prime news agency reports.

NCSP: Operating Results for 5M11 - May Disappoints

Aton

NCSP released its operating results (which reflect tonnage of cargo handled) for May 2011 and 5M11 on Tuesday (14 June). The figures are weak in our view: after solid cargo turnover growth of 6.7% YoY in April, NCSP reported an overall decline of 2.4% YoY in May.

Liquid cargo growth remains in the positive zone, but the 0.9% YoY rise recorded in May was rather lacklustre (April: +11.7% YoY). Crude oil shipments decreased 2.6% YoY in May (+9.4% YoY in April). Oil product shipments gained 36.6% YoY as Primorsk Port (PTP) started loading oil products in 2011.

Bulk cargo transshipment results for May were slightly below the April results (-37.7% YoY vs -32.6% YoY in April) mostly due to a decrease in iron ore loaded. Growth rates for other bulk cargoes were in line or better than in the previous month, but not enough to compensate for the fall in iron ore volumes.

General cargo volume growth improved vs April. Transshipments of ferrous metals, which contribute most of general cargo turnover, rose 6.1% YoY (they fell 7.1% in April). Later in 2011, we believe that volumes may improve further if the political situation in North Africa stabilises.

Container traffic (in TEU) recorded another month of strong results: 48.2% YoY (51.1% YoY in April) despite the diminishing low base effect.

Bottom line

NCSP's results for May 2011 were uninspiring after the outstanding performance of April. However, we note that if we exclude the effect of the grain export ban, total cargo rose 3.1% YoY. Given that the ban is expected to be cancelled in July, we expect to see improvements later in 2011.

Northwestern Shipping shareholders OK paying RUB5m in 2010 dividends

bne

The annual general meeting (AGM) of shareholders of St. Petersburg-based Northwestern Shipping Company has approved paying RUB4.908m, or 0.51 rubles per share, in dividends for 2010, Prime news agency reports, citing the company's press office.

Russia fails to sell 25.5% government stake in Amur Shipping Company

bne

Russia's Federal State Property Management Agency has failed to sell the government's 25.5% stake in Amur Shipping Company, Prime news reports, adding that the agency said the auction to sell the stake did not take place because all the bidders were rejected.

Russian property agency to sell state's 20% stake in Arkhangelsk Seaport

bne

Russia's Federal State Property Management Agency is to sell the government's 20% stake in the charter capital of Arkhangelsk Commercial Seaport at a public auction, Prime-Tass reports, citing the agency as saying the starting price for the stake is set at RUB13m.

No timeframe was given for the auction.

Sberbank Capital sells 10% in Global Ports for \$238m to N-Trans

bne

Sberbank Capital, a unit of Russia's largest bank Sberbank, has sold 10% in Russian container terminal operator Global Ports for \$238m to N-Trans, the largest private transportation and infrastructure group in Russia, Prime news agency reports.

Seaport of St Petersburg shareholders OK paying RUB33.7m in 2010 dividends

bne

The annual general meeting (AGM) of shareholders of Russian company Seaport of Saint Petersburg has approved paying RUB33.7m in dividends for 2010, Prime news agency reports, citing the company's press office.

Sovcomflot to approve \$5.5bn invest program in September

bne

Russian shipping company Sovcomflot plans in September to approve an investment program until 2017 worth \$5.5bn, company CEO Sergei Frank says, Prime reports.

Under the program, the company plans to order 22 ships in 2011-2013 worth a total of \$1 billion, Frank told reporters on the sidelines of the St. Petersburg International Economic Forum. He added that during the forum Sovcomflot plans to sign contracts to provide two ships to Russian gas giant Gazprom for liquid natural gas (LNG) transportation. The ships are expected to be able to transport up to 170,000 cubic meters of LNG each, Prime says.

At the forum, Sovcomflot has already signed an agreement with Russian oil major Lukoil on the supply of lubricant oils to Sovcomflot's ships, the shipping company said in a statement. Sovcomflot, also known as Sovkomflot, or the Modern Commercial Fleet, is based at the Baltic port of St. Petersburg and specializes in petroleum and LNG shipping.

Summa Capital to build \$300m port complex in Primorsky region

Marchmont

Group Summa Capital, owing port assets in Novorossiysk, Primorsk and Kaliningrad, intends to invest about \$300m in its first port project in the Far East.

The company is reportedly to build a transshipment complex near the Northern part of the Vrangeli Bay in Primorsky district.

The port's projected annual transshipment capacity is 15 million tons of coal and 3 million tons of general cargos.

The complex is scheduled to be launched in 2013.

United Shipbuilding Corporation buys 25.5% in Nizhegorodsky Teplokhod

bne

Russia's state-controlled United Shipbuilding Corporation has purchased a 25.5% stake in the Nizhny Novgorod Region-based shipbuilding company Nizhegorodsky Teplokhod, Prime news agency reports.

United Shipbuilding Corporation said it bought the stake from the Federal State Property Management Agency. The value of the deal was not provided.

CLS infrastructure

Belarus' rail freight traffic up 14.8% y-o-y in January-May to 62m tonnes

bne

Belarusian Railway's freight traffic increased 14.8% year-on-year in January-May to 62.4m tonnes, Prime reports, citing a representative in the administration of Belarusian Railway carrier. Transit freight traffic rose 11.1% to 21.9m tonnes in January-May, while exports, up 31.8% to 15.1m tonnes, were almost twice as high as imports, the agency says.

Belarusian Railway's capital investments up 60% y-o-y in January-April

bne

Capital investments by organizations that make part of Belarusian Railway organization rose 60% on the year in January-April 2011 to RB492bn, Prime news agency reports, citing a Belarusian Railway statement.

Most of the investments were channeled in infrastructure development and renovation of rolling stock.

China's Eximbank to give Belarus \$1 bln loan

RIA Novosti

Export-Import Bank of China agreed on Tuesday to provide over \$1 billion in loans to finance joint projects in Belarus, which is in the midst of a financial crisis.

China's Eximbank will allocate a \$654 million loan to build a bleached sulfate plant together with Industrial and Commercial Bank of China, \$340 million to modernize a highway linking the capital Minsk and Belarus' second largest city of Gomel and \$64 million to electrify some railroads.

Eximbank head Li Ruogu said his bank and Minsk were in talks to provide another \$400 million to build a second runway at Minsk national airport, while Belarus Prime Minister Mikhail Myasnikov said his country was ready to jointly build an industrial park.

The Belarusian ruble has come under severe pressure in the first five months of the year from a large trade deficit, generous wage increases and loans granted by the government ahead of the December 2010 presidential elections, which spurred strong demand for foreign currency.

In spring, the country's authorities devaluated the national currency by 36 percent, froze prices on some staple foods and introduced fuel rationing to keep the lid on the deepening crisis.

The Belarusian government has applied for loans from Russia and EurAsEC, a post-Soviet economic bloc. Russia said it would support loan disbursement to Belarus via EurAsEC, which approved a \$3 billion bailout.

The Belarusian authorities also said the country intended to raise up to \$8 billion from the International Monetary Fund to stabilize its finances.

Lukashenko OKs project to reconstruct Minsk airport with Chinese loans

bne

Belarusian President Alexander Lukashenko has approved the investment project to reconstruct National Airport Minsk in 2011-2014, create an international passenger transit terminal, equip the airport with security and alert systems and build a second airstrip capable of receiving Airbus 380 aircraft, Prime news agency reports.

The investment project envisages involvement of Chinese loans and China National Precision Machinery Import & Export Corporation will act as the general contractor to design, construct and reconstruct property, engineering and transport infrastructure, the agency says.

Investors to be sought for reconstruction of underpasses in Kyiv subway

Kyiv Post

Forty-nine underpasses in Kyiv subway stations have been included in the list of objects that need investment, the press service of Kyiv City State Administration has said.

The decision was made on June 10 at a meeting of the tender commission for involving investors in financing the construction, reconstruction, and restoration of residential and non-residential objects, unfinished constructions, and the engineering and transport infrastructure in the city.

According to the commission head, the deputy head of Kyiv City State Administration, Ruslan Kramarenko, the commission at its next meeting will set the conditions of a tender and a mechanism for project implementation.

Read more: <http://www.kyivpost.com/news/city/detail/106709/#ixzz1PQQttGU>

Odesa seaport forecasts 11% growth in net profit in 1H11

bne

Odesa maritime merchant port expects net profit of UAH205m in January-June 2011, 10.8% up on the same period of 2010, Prime reports, citing the port's press service.

Cargo turnover at the company in the period will total 13.3m tonnes, up 2% on the first half of last year.

Railcar prices went up by 17% YTD in June

Art Capital

Railcar prices continue to rise in the CIS region. In June the average price of a gondola car increased by another 2% MoM, and the cumulative increase YTD comprised 17%. Compared to June 2010, the price went up by 35%. The prices of Ukrainian manufacturers outpaced those of Russian producers as the difference has reached \$5.3 ths per a gondola car.

Oleksiy Andriychenko: Given the concurrent increase in the output of new cargo railcars (see "Railcar Machinery: 2011 outlook", April 2011 for more information), the rising prices underscore the persistence of cargo railcar deficit in the CIS market, which is POSITIVE for Ukrainian manufacturers. We expect the prices to go up on average by 25% in 2011, which is consistent with the current dynamics. At the same time, we note that following Putin's remarks regarding dumping prices of Ukrainian producers, a gondola car price in Ukraine went up by 22% compared to only 12% in Russia. Thus that today new offer prices in Ukraine are 7% higher than those in Russia. In the short-run, the premium in the price of a Ukrainian railcar has no impact on purchases of Ukrainian rolling stock as all domestic production lines are working at near full capacity due to unsatisfied demand. We reiterate our BUY rating for Ukrainian railcar manufacturers.

The Ministry of Infrastructure considers tax concessions to truck and bus importers

Art Capital

Ukraine's Association of International Automobile Freight Operators is lobbying for the enactment of temporary tax concessions for importers of buses and trucks. In particular, the draft law, currently considered in the Ministry of Infrastructure, envisions zero VAT rate for imported buses using Euro-2012 as the reason for the preferential treatment.

Oleksiy Andriychenko: The news is MODERATELY NEGATIVE for Bogdan Motors, which signed a memorandum with the Ukrainian government in December 2010 and was selected as the primary supplier of tourist and airport buses for Euro-2012. According to Boris Kolesnikov, Ukraine will need as many as 400 buses for the tournament and Bogdan can use its domestic production base as an advantage to supply European-quality buses at prices 30% cheaper. The annulment of the VAT tax for imported buses would completely destroy this advantage. At the moment, the results of the lobbying are unknown, but we will keep an eye on the development of the story. We confirm our BUY rating on LUAZ stock with a \$0.051 target.

Ukraine plans to buy more than 2.6 ths school buses

Art Capital

The Cabinet of Ministers decided to extend the school bus program to 2015. The government plans to purchase 2642 school buses using UAH 372.58 mln of state funds and UAH 428.1 mln of local budget funds.

Oleksiy Andriychenko: The news is POSITIVE for Bogdan Motors [LUAZ, BUY, \$0.051] and Ukravto [AVTO, U/R], which participated in the program in the past. AvtoZAZ plant, controlled by Ukravto, created a special school bus version to participate in the program, while Bogdan Motors redesigned one of its Isuzu-based models. Going forward, both companies, in addition to Etalon and LAZ, stand to benefit from the program. In 2010 the state purchased 112 units, and in 2011 the number already went up by 2.5 times. Altogether in 2003-2010, the government purchased 2615 school buses, spending UAH 335.8 mln. We reiterate our BUY rating on LUAZ stock and review our AVTO target.

Ukraine wants to build 2,000-4,000 km of roads per year

bne

A total of 1,500 kilometers of roads will be built in Ukraine in 2011, Ukrainian Premier Mykola Azarov says, adding that the government wants to increase that figure to 2,000-4,000 km next year, Interfax reports.

"We set the goal of building 1,000 kilometers of roads in 2011, but the president... says that we should build 1,500 kilometers. Since the president sets the tasks, we'll build 1,500 [kilometers of roads]," Azarov is quoted as saying at the opening of a section of the Stryi-Kirovohrad-Znamianka highway bypassing Babanka (Cherkasy region).

Ukrainian Railways might buy more passenger trains

Foyil Securities

Ukrainian Railways (UZ) would be able to buy more local trains if the costs associated with the transportation of subsidized passengers were compensated, reported Ukrainian News, citing UZ General Director Volodymyr Kozak. According to Mr. Kozak, UZ's losses from carrying passengers that did not pay for their passage in Jan-Apr of this year were UAH 138m, which is equivalent to the price of three local trains. According to UZ's officials, the large number of passengers that do not pay for transportation reduces the ability of UZ to renew its train fleet.

Our view: Passenger transportation has been a loss-making activity for UZ since the independence of Ukraine. That government officials are talking about it publicly suggests that reforms are on the horizon. Should UZ get funding for passenger trains, Luganskteplovoz (LTPL, Buy) and Kryukiv Carriage (KVBZ, Buy) would compete for the orders, since both companies make passenger trains that may be of interest to UZ. However, until this issue is clarified, there will be no effect on LTPL or KVBZ. Nevertheless, we believe that both these stocks are undervalued and we maintain our Buy ratings for both stocks.

Alex Nekrasa

Ukrzaliznytsya plans to invest \$1.6bn in locomotive fleet by 2017

Dragon Capital

News: Ukrzaliznytsya (UZ), the Ukrainian railway monopoly, has announced plans to invest UAH 2.1bn (\$264m) to renovate its fleet in 2011, relying heavily on government support in financing of the program. Overall, the company's CAPEX plan envisages UAH 12.5bn (\$1.6bn) of investments in the renovation of its hauling fleet and purchase of 275 locomotives. (Interfax, Kommersant)

Dragon view: The news is positive for Luhanskteplovoz, the near-monopoly producer of electric locomotives in Ukraine and sole manufacturer of main-line diesel locomotives in the CIS. The news also supports Ukrzaliznytsya's earlier statement that it will buy 40 electric locomotives from Luhanskteplovoz in 2012 (please see our Daily from May 16, 2011). Meanwhile, we maintain our positive view on the company and reiterate our Buy recommendation on the stock.

Eurasia infrastructure

Reopening of Stepanakert airport likely to go to international mediation

Clare Nuttall in Almaty

The re-opening of the airport in the Nagorno Karabakh Republic's capital Stepanakert, has been put off until September.

The planned reopening has already added to the tensions between Armenia and Azerbaijan, with Yerevan insisting the opening will go ahead, while Baku threatens to shoot down aircraft flying over Nagorno Karabakh Republic (NKR) airspace. Despite the strong words on both sides, however, the issue is most likely to go to international mediation.

Stepanakert airport was due open, for the first time since the Nagorno Karabakh war, on May 9, 2011. The opening date has since been put back to September, the head of the Nagorno-Karabakh civil aviation department, Dmitry Atbashyan, told News.am. Atbashyan told the Armenian newswire that construction work was still underway, and that the decision to postpone had not been prompted by Azeri opposition to the plans.

There have been no flights from Stepanakert airport since the six year war began in February 1988, when the majority ethnic Armenians of Nagorno-Karabakh, backed by Armenia, tried to secede from Azerbaijan. Although a ceasefire was agreed in May 1994, a peace treaty between the two sides has never been signed. NKR remains part of Azerbaijan under international law, although it is de facto independent and increasingly integrated with Armenia.

The NKR government is currently funding reconstruction of the airport, and plans to operate three flights a week between Stepanakert and Yerevan. Although Armenia's national carrier Armavia has said it does not plan to launch flights to Stepanakert, the Armenian government is strongly behind the reopening.

Speaking to journalists on March 31, Armenia's President Serzh Sargsyan said he planned to be on the first flight, and that Armenian Defence Minister Seyran Ohanyan would be on the plane with him. "I declare I will be the first passenger of the first flight," Sargsyan told a press conference.

Other Armenian politicians have been similarly gung ho about the plans. Galust Sahakyan, Chairman of the Republican Party of Armenia (RPA), that the airport would open whether the Minsk Group - the body set up by the Organization for Security and Co-operation in Europe (OSCE) to encourage a peaceful, negotiated resolution to the conflict - liked it or not. Meanwhile, Aram Safaryan, Secretary of the Prosperous Armenia group, stressed the importance of the airport for NKR's economic development.

Stepanakert hopes that the reopening of the airport could help to stimulate the NKR economy, by improving links to the outside world. Investment in road infrastructure within the republic is one of the government's priorities. In August 2010, Armenia and NKR also agreed to increase economic cooperation. In 2010, according to the NKR authorities, the tiny republic achieved economic growth of 5.5%, outstripping both Armenia and Azerbaijan.

Baku has been angered by the plans, and, in a letter to the International Civil Aviation Organisation (ICAO), threatened to shoot down any aeroplanes violating its airspace. Under international law, NKR is still part of Azerbaijan, and no country - even Armenia - has recognised it officially.

Armenia and Azerbaijan are both signatories to the 1944 Chicago

Convention on civil aviation, which sets out the measures that need to be taken for an aerodrome to open. "All signatories need to comply with the standards set out in the convention and its annexes, and this needs to be done at state level. It is the responsibility of the state where the airport is located," explains ICAO spokesman Denis Chagnon.

"NKR is not recognised by a single country, including Armenia, and under international law it is still part of Azerbaijan. If Azerbaijan wants to close the airspace it has the right to do so legally," says Lawrence Sheets, Caucasus project director at the International Crisis Group.

Sheets points out that in nearby Abkhazia, which declared its independence from Georgia in 2008, the airport has remained

closed even though the republic's independence has since been recognised by Russia and several other countries. According to Sheets, the situation in NKR is "more likely to play out legally", with the NKR authorities taking the matter to international arbitration, rather than going ahead and opening the airport.

Chagnon told bne that the ICAO had not yet been formally requested to start mediation between the two countries. However, he points out that when the ICAO's quasi judicial mechanism has been used to settle disputes between states in the past, they have always been resolved successfully. "It's an effective mechanism," he said.