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For obvious reasons, generation companies need to keep a close eye on input prices. What is your current assessment of gas price fluctuations on the Russian power market?

For starters the vector of the curves of both gas and electricity prices is roughly the same, although there is a significant gap between the two. Between 2010 and 2012, gas prices increased by roughly 23 percent while electricity prices went up by only 13 percent. So even though the vector is the same, there is no 100 percent correlation between these variables for various reasons. One of these reasons is that this is a regulated business and that – as a generation company – we are not necessarily entitled to mirror the gas price increases. A second reason is that electricity prices are structured in a much more complicated manner than fuel prices alone. There is a complex set of variables such as efficiency rates, the available equipment, the rates of repair, the overall balance in the energy mix, and so forth. So even though electricity prices will increase if gas prices go up, the overall price formation for electricity is much more complicated.

Is the business attractive in Russia today?

This is a different discussion. Our industry is desperately waiting for the second wave of reforms. The current state of the market is very regulated and hands-on driven, which is not good for investments. If one were to ask me if the market in its current state is attractive, I would even have to answer negatively. The current electricity prices do not provide for payback even at a moderate rate of return of 13 percent. This situation leads to an increasing quantity of equipment becoming obsolete. This ageing equipment in turn reflects on the stability and security of the power system as such. There is no incentive to invest in modernization as long as the market drivers are not there.

In the last week of January 2013, however, a certain trend emerged: the Ministry of Energy officially contracted the Carana Consulting Group to write the proposal for the second wave of reforms. This company was also behind the initial reform of the energy system of Russia in 2007-2008. It is able to think out of the box whilst maintaining a great sense of realism. They are very market-oriented but also understand that reforms in Russia should be very carefully administered in order to have a positive outcome. The backbone to these reforms is the market mechanisms that will hopefully allow investors to modernize their equipment

Has a timeline been provided already?

The timeframe for this report is between 2014 and 2020, which is a normal timeframe for such a complex and fundamental market. This sounds like a very sound and realistic approach.

E.ON Russia has already invested significantly in its “New Build Program” in recent years. Was this then justified?

It was justified for different reasons, in a time when we were granted ‘guaranteed capacity payments.’ This was the first and only wave –when RAO UES was dismantled – that led to significant investments. For the overall economy and the system as a whole, I believe that these guaranteed returns have been a good thing. Right now, we do not face any threats of instability due to a lack of power, which is the fundamental criterion for any society.

Are there still any ongoing investments now?

A number of investments at the Berezovskaya GRES plant are yet to be completed by 2015. In total, our investments for the coming years will amount to a significant chunk of over EUR 1 billion.

At the same time, however, we do not believe that this country needs new generation in the future. While there are regional differences, the system itself is sufficient to support the expected growth of the economy. What this industry needs is modernization and for this a reform is required.

I am not sure whether what will be achieved in these reforms will be what is now aspired to, but the success rate will significantly grow if gradual development can take place.

E.ON is already known for its state-of-the-art equipment in Russia vis-à-vis the other generation companies here...

That is true but a number of our stations now face the risk of becoming inefficient in the years to come, should the rules not change. In order to prolong their reproductive lifetime, they need to be given a facelift. This is not possible right now because there is no payback period at all. Two options therefore present themselves: we can either ask the government for support or make the reforms happen. Frankly, we prefer the second option rather than the first mainly because one-off government stimuli do not benefit the market as a whole.

Is efficiency only a matter of investing more?

A couple of aspects come into play and a first is the quality of the assets that we had acquired. Another aspect is our capability to be very professional about running our equipment efficiently: ensuring repairs where needed, within the budget, on time, in a safe manner, and so forth. This is the philosophy we follow. Companies also need to be very smart in purchasing fuel, spare parts, etc. In this respect, the E.ON Group helps a lot in achieving economies of scale. We use first-class suppliers in Russia as well as in other parts of the world and we can build on that. It goes without saying that for other aspects we need to adjust to certain local

requirements. These are simple aspects, but their combination enables one to achieve operational excellence.

The regulatory aspect on the other hand is very important in Russia too. The efficiency of the business – surprisingly – also depends on this. Therefore, companies need to be a trustworthy partner to the authorities at all levels. Unpredictable and non-transparent companies have no place. We value our relationship with the authorities.

How do you rate this relationship today?

In my view, this relationship is rather positive. We have been enrolled as a member of the Foreign Investment Advisory Forum (FIAC) – a very respected body in the country– as from this year. Right now, we have all three international investors represented there, which gives us the opportunity to build up a small community and concentrate on things related to our industry. We are also part of the market structures. We feel involved and are of the opinion that our voice is heard in everything that is going on: we are local. We also speak at and sponsor events such as the Investment Forum in Krasnoyarsk, where our exposure is significant. This is one of the indicators that our relationship is fairly good, even though there is always room for improvement.

E.ON has also been one of the first companies to invest here. Right now, we are harvesting the results of this decision. The new equipment we have installed in our stations is state of the art, which reflects on the results. We took a significant risk that is now paying off and hope this will continue.

Not all of the promises have been fulfilled, but we hope that we will now see the second wave of reforms coming. The exposure of the E.ON Group to Russia is quite extensive through different entities: E.ON Russia, E.ON Ruhrgas, a 15 percent stake in the Nord Stream pipeline, and a 25 percent stake in the Yuzhno Russkoje gas field through a joint venture with Gazprom. There is a special focus on Russia which results in both risk and opportunity. E.ON Russia has a power brand attached to its name. We can build on this brand to develop in areas that were previously probably unheard of.

Russia is considered a strategic market for E.ON worldwide. Is this purely in anticipation of the second wave of reforms?

From my perspective, the strategy of the E.ON Group is to develop outside of the European Community. The E.ON Group is therefore looking at markets like Brazil and Turkey, while it is keeping its eyes and ears open for other opportunities too. Russia is a priority indeed. The operations here have very solid financial results and we are rather satisfied with the investments that we have made here. Right now, we are developing our strategy for this market further.

A first reason why Russia is a strategic priority is the country's growing economy. Even though this growth may not be double-digit, the growth rate is stable. In addition to that, we have a fleet that is second to none here. It is one of the best fleets for the company globally and the third largest after Germany and the UK: it

has a special spot in the heart of the Group. An important part of our strategy further dictates specific efforts to keep these assets very efficient. Having such assets in Russia deserves a clear-cut strategy for the years to come.

We are doing great, but there is no reason we should not do better. We are therefore also investigating possibilities in decentralized generation, a growing market. One may say that this might cannibalize part of our traditional business but on a country scale this risk is probably very low. This business will grow anyway, so the question is whether it will grow with us or without us. We have built up a lean and mean group within the company that will primarily focus on this business opportunity. So far, the response from the market has been fantastic. Due to the investments we have made here, we have a very powerful contracting group in our company with a lot of expertise we would like to build on. By investigating and developing this business path, we can retain this talent in the company.

How do you rate E.ON's managerial capabilities in Russia in order to deliver and implement all this?

Although Russia was incorporated into the world community years ago, some of the best management practices – like matrix cooperation – are still not easily translatable in this country. This is the challenge we have internally in the company as well, because we have to grow the Russian company to align better with our Group standards.

The culture of our Group, its technologies and its Human Resources Development (HRD) are extraordinary across the globe. As a local management team, we can significantly learn from that. We are still on the learning curve, both in Moscow and in the different stations we manage. We have to carefully filter our talent and provide our people with opportunities. Our HR strategy will become an integral part of our business development strategy for the coming years here.

Do you see yourself competing with other growth markets of the Group – like Brazil– to attract future investments?

The E.ON Group has the capacity to invest in various economies simultaneously. At the same time, the Russian operations are as good as self-sufficient too.

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