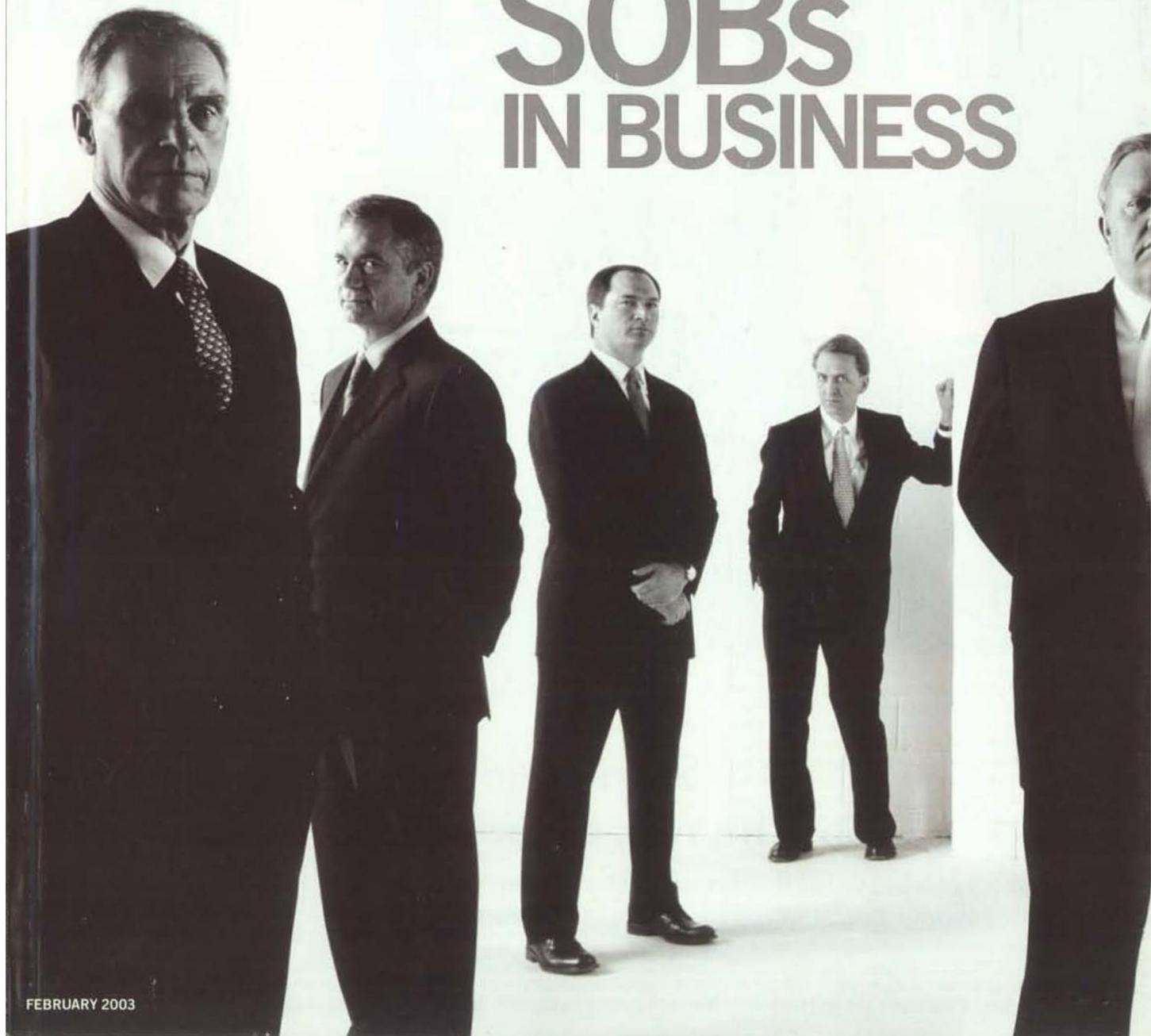


EXCLUSIVE: GEOFF BALLARD BREAKS HIS SILENCE | THE NEW

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SEND LAWYERS, GUNS AND MONEY

Last spring, Frank Graves left a quiet life as a Toronto executive for a job as COO of the largest forestry company in Russia. The Russian business community, hungry for foreign expertise, welcomed him with open arms. Others brought out guns

FRANK GRAVES PREFERS TO FACE THE room, which puts him at odds with the lunch crowd at Bosco, a Moscow restaurant popular for its view across Red Square. His table angles away from the window. If he cranes his neck, Graves might still see Lenin's tomb and the magnificent pines at the Kremlin palace's storied walls, but he seems far more interested in monitoring the traffic in the restaurant. His bodyguards hover unseen nearby. "Unfortunately, security is important to me," Graves explains. "Nobody will eavesdrop on us over here."

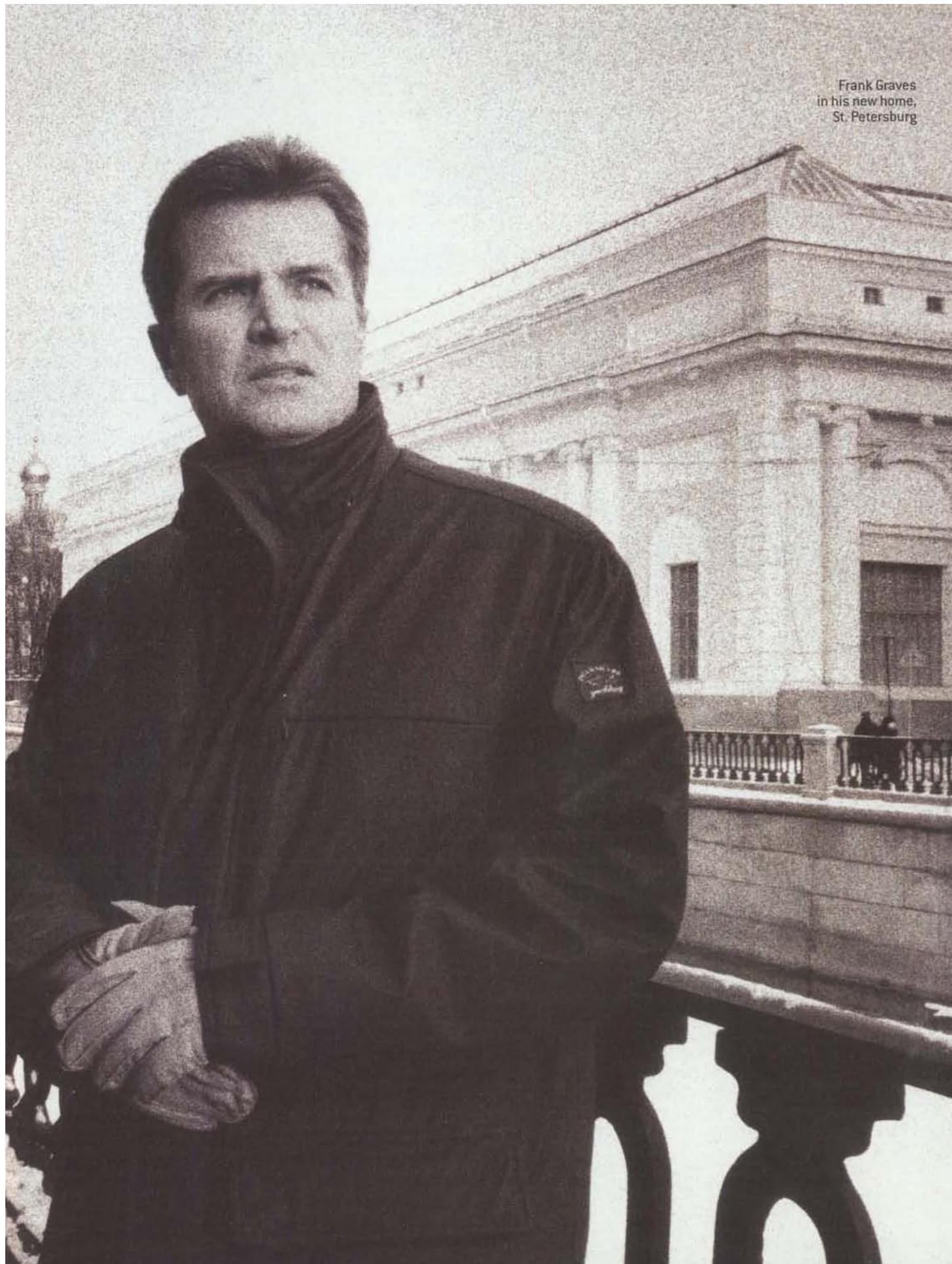
Last April, 46-year-old Graves quit his job as chief operating officer of Tembec International Sales Co. in Toronto (a subsidiary of Tembec, the forest-products company) and signed on as COO of Ilim Pulp of St. Petersburg, Russia's largest forestry enterprise. He was hired to restructure the private firm, which employs 49,000 people and has stakes in seven operations in Russia and the Czech Republic—including

{ BY PAUL WEBSTER }

Photographs by Stanley Greene/VU



Frank Graves
in his new home,
St. Petersburg





major pulp mills and paper-product manufacturing plants—and prepare it for a public offering by 2005. “I took the job because the company is already the eighth largest in the industry internationally and could easily be dominant in five years,” says Graves about Ilim. “I figured it’s the most exciting pulp-and-paper opportunity in the world.”

Ilim turned out to be even more exciting than Graves had anticipated. Three months before he arrived in St. Petersburg with his wife and 12-year-old son, a sizable private army seized control of Ilim’s Bratsk pulp-and-paper mill in Siberia. After forcing Ilim’s managers to flee at gunpoint, the interlopers used a court order written by a judge thousands of kilometres away to impose new management under the direction of 34-year-old Russian aluminum king Oleg Deripaska.

A famously aggressive operator, Deripaska faces allegations in New York district court that he used death threats and fraud to build his empire. Through a series of felicitous deals, he has

stitched up 70% of Russian aluminum production, amounting to annual sales of \$4.5 billion (all currency in U.S. dollars). Part of Deripaska’s good fortune is a vast network of connections and a mother-in-law who happens to be Tatiana Yeltsin, the former Russian president’s ultrainfluential daughter.

Last year, Deripaska announced his intention to build another empire, this time in the forestry sector. Ilim’s assets were his first target. Four months after the Bratsk takeover, Ilim was hit with another judgment on Deripaska’s behalf, this time from a judge in Kemerovo, a remote jurisdiction where Ilim has no operations. The ruling ousted the managers at Ilim’s Kotlas pulp-and-paper plant in northwest Russia, allowing Deripaska to seize Ilim’s 61% stake in it. Until news of the ruling arrived, Ilim lawyer Derek Bloom was unaware legal actions had even been launched. The company had just recovered from the Bratsk attack, thwarted only after a tough court fight. Then Deripaska’s group flew in 80 men commando-style to take Kotlas.

Graves was ready to respond this time. "As soon as we heard Deripaska's security people were moving into the area, we got an army of our own together," he says. "By the time they were ready to roll, they knew we would fight very hard to keep them out, despite their court order."

By June, the plant entrance was blocked by railcars and concrete barriers. Scores of Ilim security staff stood ready at the barricades. "It was a siege," Graves says. The fear of impending violence carried 1,000 kilometres to Ilim's offices in St. Petersburg. "I changed cars four times last summer," Graves says. "We vary our routes. My wife's driver is an ex-military guy and my son, Steven, goes to school in a bus with two security escorts."

The family has previous experience with this kind of trouble. Seven years ago, when Graves worked as commercial director of the forestry company Jari Cellulose in Brazil, Steven was kidnapped along with the son of another executive. The boys were released unharmed after French security forces intervened. All the same, Graves says he's never seen a "war zone" like the one he found in Russia.

Ilim's operations are highly profitable, with estimated sales of \$1 billion in 2002—hence the obvious attraction for Deripaska, whose representatives declined to grant interviews or answer written questions for this article. But there's another ostensible motive: Deripaska has mounted ideological arguments against foreign involvement and ownership in key Russian assets. Whether driven by economic nationalism or mere acquisitiveness, Deripaska's tactics are unambiguously forceful. So far, Graves says, more than 50 lawsuits challenging Ilim's ownership have been filed in courts, most of them in remote places where Deripaska has previously found judicial favour.

"The strategy seems to be death by a thousand cuts," Graves

says. "He's got 150 people working overtime to ruin several companies." According to Graves, when Ilim regained control of the Bratsk facility in February, 2002, the plant's bank accounts were empty and its product had been sold on unfavourable terms. He estimates the damage at \$60 million. "He's an asset-stripper," Graves says about Deripaska, glancing around the restaurant and choosing not to use stronger words. "That's as much as I care to say about him here."

Gunpoint threats and courtroom acrobatics are well-known takeover tactics in Russia. For Ilim, the effects have been severe. When the company was thrown into legal jeopardy, its credit was cut, forcing

plant managers to rely solely on cash flow for an investment program aimed at increasing production and reducing environmental emissions. (Ilim has been legally bound to fulfill these funding obligations since 1994, when its plants were privatized.) What's more, a series of court judgments barring railroads from carrying its products for export has severely dented revenues.

On the political front, Ilim faces a barrage of allegations in the Russian press that it hasn't honoured its investment commitments under privatization laws. According to press releases from Deripaska's holding company, "Ilim Pulp lost its rights to majority control of the Kotlas facility as a result of its failure to fulfill its obligations to the state."

"Last June, we realized the situation is extremely serious," Graves says. "By then, the government, the banks, the rest of the industry was telling us to give up. We decided to be the first to fight back." To date, Graves says, Ilim has pumped \$20 million into a legal and public-relations fight aimed at winning

every case in every jurisdiction, refuting what Graves calls "disinformation" about its investment program while continuing with ambitious restructuring.

In a country where few have withstood the kinds of tactics Ilim has faced, the decision to fight was key, turning the Ilim story into a weathervane. Could the government, observers asked, enforce its widely praised legal and commercial reforms? The fact that people were watching the situation ultimately aided Ilim's survival strategy.

Last summer, working with its minority U.S. shareholders, Ilim persuaded the U.S. government to advise the Kremlin that there's more riding on the case than control of a few pulp mills. This stressed that foreign governments and investors were aware of the Russian courts condoning unscrupulous takeover tactics backed by threats of violence. Ilim hoped to signal to Russian President Vladimir Putin that tolerating corruption could spoil Russia's chances at rapid admission to the World Trade Organization. It's the kind of petition Putin would surely notice—after all, he has staked his reputation to WTO acceptance.

"We're not asking for special favours," Graves says, gesturing toward the Kremlin as he leaves the restaurant. "We just want the government to enforce the rule of law."

RUSSIAN BUSINESS RELATIONS CAN BE AS OPAQUE AS Grand Master chess. As a result, often the only thing that stands out is personal bluntness. Graves spoke at an industry conference in St. Petersburg in late October. After opening with a few frat-boy remarks about hangovers—the result of a party sponsored by Ilim the night before—he quickly turned to the company's restructuring efforts. He didn't mince words: "For too long, operations in Russia have



been based on Russian standards. We're saying that might be fine, but we expect Western performance."

Following Graves, a senior academic gave a discursive lecture on what the Kyoto Protocol will require of "the representatives of the financial structures of the world in attendance." Graves, the senior such representative in attendance, chewed gum and fidgeted impatiently. His attention snapped back to the podium after the academic made way for the finance director of a Russian timber company, who outlined her company's strategy to recover from recent bankruptcy. ("There's a lot of talk about strategy here," Graves notes. "It's a favourite word in Russia.") But when her strategy turned out to be demands for government grants, the gum-chewing intensified.

Graves headed back to his office, pausing to tell a local radio reporter that although the profit potential in Russia is exciting, the major obstacle remains "heavy reliance on central planning, which limits flexibility."

Clockwise from top left: Graves, the foreigner, is the odd man out at lunch with a group of Ilim's Russian executives and shareholders; in his office, briefing a staffer; at home with wife Manon and son Steven. At right: Graves's nemesis, the well-connected Oleg Deripaska (left) meets with President Putin



LIM IS HEADQUARTERED IN AN ELEGANT EARLY-19TH-century Italianate building not far from Nevsky Prospect, St. Petersburg's corridor of palaces, cathedrals and bridges. The company restored the building, leaving antique heating stoves, carefully retouched decorative friezes and warm parquet floors in many offices. It's a casually aristocratic environment Graves clearly relishes. But parallels to the leisured world of Russia's prerevolutionary equestrians stop there.

After lunch in the executive dining room, and trading a couple of jokes about the suit of armour propped in the corner—someone suggests adopting it as the company uniform—Graves tackles four flights of stairs back to his office and an afternoon of meetings.

The first is with Marina Kochurikhina, a DuPont representative selling work-site safety services. Graves tells her there were deaths reported in the company's Bratsk mill last year; he has not been told how many. Heatedly, he adds that "the

plant managers said they would try for a 50% improvement. I said, let's have zero tolerance, and I'm cutting your bonuses 25% for every death. I need a basic safety plan for all the operations."

After that, things move much faster than Kochurikhina seems to have expected. Once she outlines DuPont's services, Graves asks her for a ballpark price. Kochurikhina admits she didn't bring pricing information.

Graves calls Dan Breck into his office. Also Canadian, Breck is Ilim's director of capital investments and technical development, and an industry veteran from B.C. Both men don't seem surprised when Kochurikhina says DuPont has been offering safety services for only the past two years in Russia—so the company can't yet demonstrate local results. But Graves suggests the Bratsk plant needs DuPont right away.

"The plant is just a horror," Breck warns her.

"Safety is good for everyone," she says, smiling.

"The priority is to get results," Graves says, dropping his pen.

Soon after the meeting, Ilim began negotiating its safety contract with DuPont.

In the 11 months Graves has been on the job, he's delivered a five-year strategic plan, reorganized management, replaced the Soviet-era pay system with an approach based on performance bonuses, broken the organization down into three product-line units, hammered out a long-term capital investment plan, developed a corporate governance code and delivered a new budget system, all the while waging battle with Deripaska and, at times, worrying if there'll be bullets to dodge.

Above: Graves inside Ilim Pulp's Italianate, casually aristocratic headquarters. Left: checking in with one of his omnipresent guards.

Right: workers at an Ilim-owned cartonboard mill on the outskirts of St. Petersburg. The company is committed to funding a program aimed at improving workplace safety

It would be a tough assignment under any conditions. But in Russia, rich in legacies—seven decades of centralized economic planning followed by a decade of gunpoint privatizations, massive asset-stripping, foreign capital flight, civil war, severe political turbulence, deep xenophobia and growing economic chauvinism—the difficulties dwarf anything Graves saw in the Brazilian forest industry.

“People here don’t like team approaches,” he elaborates. “Management power is jealously guarded, and getting people to share information is brutally hard. People accept accountability with great reluctance.”

Most major Russian companies still carry the legacies of Soviet planning in their bones. The key concern for managers is how to get rid of them. Many companies, especially in the oil sector, have brought in Western executives. But in an intensely nationalistic country, where every citizen is ingrained at school with Russia’s many achievements in the arts, science and historical heroism—notably repulsing both Napoleon and Hitler—Western expertise can face friction.

The free-market enthusiasts who flooded Russia after 1991, many on missions from the World Bank and the International Monetary Fund, learned a painful lesson in 1998, when mismanagement, deeply rooted in Yeltsin-era corruption, forced the government to devalue the ruble fourfold, triggering a staggering economic crash.

What seems to make Graves’s plan more promising than most is the fact that Ilim has solid international markets, is profitable, and sits atop an unparalleled natural resource base. Its facilities, where workers earn wages up to three times the national industrial average, produce 2.3 million tonnes of pulp and paper. In a country where economic output remains 30%

to cool it. Haig is an American investor who bought a 1% share in the Bratsk mill when it was first privatized in 1994, and a 1.75% interest in the Kotlas operation nearly two years ago. The driver ignores him. It’s not until the car stops at the plant gate that Haig breathes easy again—that is, until he’s overwhelmed by the stench of rotten eggs.

The car threads through mazes of rusting pipes semi-clad with disintegrating asbestos, past railcars loaded with chemicals and logs, past clusters of abandoned, unfinished or possibly burned-down buildings, all dwarfed by massive smokestacks billowing grey soot into the low-lying clouds.

Haig seems undaunted by the vast sprawl of apparent chaos, ruin and pollution. Emerging from a steam-like cloud spewing at ground level from an invisible source, we walk to the administrative building—sanctuary. It has a fresh coat of paint, and past the heavies in camouflage at the entrance, the offices turn out to be newly renovated and immaculate. “This is a very good sign,” says Haig, who has toured dozens of post-Soviet plants and mines while building a \$210-million fund investing in the former Soviet Union. “It shows they care.”

That’s the message plant manager and 37-year Kotlas veteran Yuri Zayats wants to convey. Kotlas employs 15,000 and provides the only income in the region. It was known in Soviet days as a *kombinat*, since it combines various industrial activities: pulp-and-paper products, packaging, chemical, lumber and electricity production, as well as construction and transportation. Zayats says conditions at the plant, and in town, are quickly improving, which is why workers and townspeople firmly oppose a takeover. He admits the plant is an environmental mess, but says the plan is to invest \$370 million at the facility over the next four years, to bring it in line with



below 1990 levels, with thousands of factories shuttered and a third of the population plunged into a kind of poverty unimaginable in the West, Ilim’s vital stats aren’t merely impressive—they’re an economic miracle.

THIRTY MINUTES BEFORE THE PLANE TOUCHES DOWN at Koryazhma, a mill town of 44,000 built by prisoners sent to operate the Kotlas plant when it opened in 1961, clear-cuts begin to scar the landscape. This could be an aerial view of Canada’s hinterland. But unlike the land surrounding Canadian mills, rather than converging into a massive cutover, the cuts thin out again, engulfed by a landscape that both foresters and environmentalists agree has felt remarkably little impact from industry. In fact, Russia’s total allowable cut is as high as four times the current volume.

On the narrow road from the airport to the mill, our company car hits 160 kilometres an hour. Ian Haig asks the driver

Western environmental and product-quality standards.

Marcella Moohan, a reporter for *Pulp and Paper International*, a Brussels-based industry journal, remains skeptical. A tough-minded Scot, Moohan has toured numerous plants in Eastern Europe. A visit to the Kotlas facility left her underwhelmed. “It doesn’t look good,” she says tersely, noting she was shown around in her soft-soled moccasins without a hardhat. She did, however, see some evidence of Ilim’s claim that it has spent \$100 million on new equipment. “I saw quite a lot of very expensive new process-control and automation stuff, plus they built this giant crane pulley system,” she says. “I can’t say for certain if it was \$100 million but I don’t think it was a boot in the bum off of it.”

Moohan wants to know what Ilim plans for personnel. She’s been through the plant’s finishing facility, which employs 300 women bundling shipments, and asks why it isn’t automated.

“We could put those women out of work and replace them

with equipment which would pay for itself in three months," admits Ilim's director of public relations, Slava Bytchkov. "But if we did, the mayor would create severe problems. The efficiencies would backfire because of anger in the plant and the town. We have to work on building the local economy, winning trust, and solve the overstaffing problem when we're ready." Moohan seems impressed to hear this. "But they'll still have to go, won't they?" she asks.

FOR FRANK GRAVES, THE IILIM JOB carries a massive responsibility to 49,000 workers in four communities, two of which are mill towns that entirely depend on the company. His strategy seems to be working: raising wages, nurturing Ilim's core growth areas—pulp, industrial packaging and lumber—and either subsidizing the more unprofitable parts of the business over the short term or setting them free to sink or swim. Fifteen new logging businesses employing 5,000 were spun off from the Kotlas operation in 2002.

Last summer, this comparatively compassionate approach won the support of the unions and plant communities against Deripaska. Then came a cherished payoff: With local mayors and governors lined up behind Ilim, and the international investment community watching, Vladimir Putin instructed prosecutors to ensure legal decisions in the case were "in accord with federal laws."

In Russia, messages from the Kremlin are interpreted as a form of divine intervention. "Getting Putin's attention has been part of the strategy right from the beginning," Graves says. Shortly after the president intervened, prosecutors requested a re-examination of the rulings against Ilim.

On Nov. 4, those rulings were thrown out, and the judge who gave Deripaska his take-over writ was suspended. Ilim's case was to be retried, this time with lawyers in attendance. But Deripaska proved relentless: In mid-December, both Bratsk and Kotlas were, once again, under attack. Deripaska made another bid for a court order to oust Kotlas's managers, but Ilim's lawyers managed to thwart his plan.

Although Graves says Deripaska's effort to bankrupt Ilim has kept the company in crisis for more than a year now, he is encouraged by the legal victories: "It's starting to look like we'll win this." If so, Ilim will be back on course for a public offering in 2005, according to Graves's plan.

In the meantime, fighting back has already been worthwhile on two fronts. "It's forced a lot of discipline on the company," Graves says with the quiet satisfaction of a strategist. "And it's also focused a heck of a lot of international attention on Ilim's amazing potential for growth." **IR**