

The Russian Defense Industry Digest

July 12, 2004

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RESTRUCTURING AND PRIVATIZATION

THE STRONGEST SURVIVES

There is no government policy in the defense industry any longer

Russkii Fokus, June 28, 2004, p. 41-43, Ruslan Pukhov

From March this year, one can speak about the absence of any distinct government policy in the defense industry and civilian aircraft area at all. The program developed by Ilya Klebanov underwent revision as far as a year ago. Boris Alyoshin's concept has not even become an official document. Given the absence of the market player such as the state, the groups existing in the defense industry has started competing between each other - so, perhaps, this competition will result in a viable defense industry structure taking shape by itself.

(...)

The Russian MiG Aircraft Making Corporation passed to a single balance sheet in 2000; the shaping of the Sukhoi Aircraft Holding Company, the Irkut Scientific Production Corporation, the Tactical Missile Weapons corporation, Aerospace Equipment and the Baltic United Shipbuilding Company was completed by 2003. A corporate structure will be created by the end of this year that will unite the developer and manufacturers of Mi helicopters. Sukhoi is probably the only company in shaping which the state played the leading positive role. In the rest of the cases, this role was either played by the heads of the facilities, or their owners, or third-party players, like, for instance, Rosoboronexport acting through the Oboronprom ("Defense Industry") company.

The main accent is laid on processes of consolidating facilities and design bureaus into single companies.

(...)

The structure of the new Cabinet as regards managing the defense industry appears to be absolutely inefficient. (...) To all appearances, departments of the Industry and Energy Ministry on the one hand and the Federal Industry Agency on the other hand will soon be intensely competing.

Aside from the formal centers, one can see a dramatic increase in the influence of informal centers.

These are primarily some individual personalities in the presidential administration, for example Victor Ivanov who controlled the consolidation process in the air defense development and production area (the Air Defense Concern) before, too, and who dramatically stepped up his interferences in the aircraft industry in October 2003 when MiG was going through staff crisis (Nikolai Nikitin's dismissal and Valerii Toryanin's appointment). Sergei Chemezov, the new director general of Rosoboronexport, is becoming a key player in the helicopter development and production area, being actively involved through Oboronprom which he controls in building a holding company that unites all Mi helicopter plants and the design bureau. Shipbuilding assets are being consolidated on a market basis, without governmental programs, and the key players here are the IST group of companies (Alexander Nesis is the owner) which controls the Baltic Plant and Mezhprombank (Sergei Pugachev is the actual owner) which has actually become the owner of Severnaya Verf.

(...) Paralyzed as a result of the March administrative reform, the state - at least for a while - has turned the defense industry into an arena for more or less free competition between half a dozen of economical and political/departmental groups which, even hoisting the banner of government control "in the strategically important sector," pursue quite mercantile interests in reality.

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'POINTS OF GROWTH' INSTEAD OF MILITARY HOLDINGS

Will become the priority of the government's new program

Vedomosti, July 08, 2004, p. A2, Aleksei Nikolskii, Alexander Bekker

The government has revised its plans for defense industry development. Officials have now shifted their focus from creating vertically-integrated holding to

creating "points of growth" that are to be ensured by several priority programs for developing arms and dual-purpose hardware. (...)

The Russian government's plan of action which the Cabinet will consider today contains new hi-tech development priorities. An Industry and Energy Ministry official says this section was drawn up by the ministry, as well as the Federal Industry Agency and military agencies.

The priority according to the document is "concentrating resources on developing and manufacturing multi-purpose and high-performance types of weapons." Similar goals were set before, too, but the 2001 defense industry reform and development program focused on creating several tens of government-controlled vertically-integrated holdings. Meanwhile, the priority now is to develop specific systems, as the Industry and Energy Ministry official explains, for which facilities will be able to coordinate their efforts independently, without finalization with officials.

In doing so, the program says the "shaping of backbone integrated structures and public facilities" will continue and "highly qualified managers" should be attracted to run them. One of the document's developers explains the government is not going to eliminate holdings that have been shaped, but it will not either forcibly speed up the shaping of new ones - this has ceased to be the main way of defense industry reform.

A defense facility manager says such "programmed" method of running the sector has long been used in the West. "Cooperation between facilities in a market economy cannot arise as ordered from above, but only for a specific contract, and the unsuccessful experience of shaping holdings proves that," the manager says.

Ret. Gen. Vitalii Shlykov, a member of the foreign and defense policy board, says rejection of the "crazy bureaucratic idea to build holdings" is the right decision of officials. However, Western experience shows a simple increase in defense contracts cannot yield positive results,

he believes. "In the 1970s, under Carter, the American defense industry 'shrank,' a lot of businesses went to the civilian sector, but higher military spending under Reagan resulted in just a 5-10% growth in military production. The same is happening in Russia now - defense contracts multiply, but prices for defense products grow even faster," he says. The expert believes simple concentration of funding proposed by the government will yield nothing - "the old defense industry will not do anything or charge prices so high that all the money will go nowhere." He says there is no point in maintaining the specialist defense industry of the Soviet type, as Russia cannot afford it for economic considerations. "What's most important is that we preserve hi-tech industry which could reshape to manufacture arms in danger, while one shouldn't maintain specialist military plants in time of peace with the exception of a small number of highly specialized facilities such as munitions production," Shlykov says. Choosing specific priorities will not be easy, either, according to him. The government official says priority programs that might be used for civilian purposes include the Global Navigation Satellite System (GLONASS) and other dual technologies. A Defense Ministry source says the priority of GLONASS has been talked about for several years already, but there is a constant shortage of funds for actual development of the system, because growth in budget allocations cannot catch up with inflation.

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DEFENSE INDUSTRY REFORM WILL NOT TOLERATE MISTAKES - SAKIT ALLAKHVERDIEV, DIRECTOR GENERAL OF AKHTUBA COMPANY

Izvestia (Moscow issue), July 08, 2004, p. 4, not mentioned

Question: Mr. Allakhverdiev, what is your vision of your plant's destiny in light of the conducted reform?

Sakit Allakhverdiev: Akhtuba is to join the Okeanpribor ("Ocean Instrument") Concern which is to be set up in accordance with an act of the Russian president. The concern has included five federal state unitary enterprises and three joint-stock companies. Our facility has got certain experience of work in the market place. This is privatization experience, which was acquired rather long ago, bankruptcy experience and the experience of setting up a new joint-stock company, wholly owned by the state by the way. I should say this experience has currently resulted in Akhtuba's operations practically entirely confined to fulfilling government defense contracts with production growth rates at 363.9% this year. Not every facility is likely to be able to boast of such figures currently. That is why as leader of the facility I care about how it will operate within the new concern.

Question: Do you think the establishment of the concern will lead to the situation worsening at your facility?

Sakit Allakhverdiev: In this case, I am more concerned with the destiny of the entire sector, not just a specific facility. The working commission for the establishment of the concern provides for a scheme to create the concern when the federal state unitary enterprise Morfizpribor ("Marine Physical Instrument") Central Scientific Research Institute is transformed into a joint-stock company and becomes the head company buying the mentioned shareholdings. I believe serious changes in federal legislation are not to be expected in the next few years, less so development of special legislation regulating defense industry processes, so we will proceed from the legislation in effecting the Russian Federation which regulates processes in the establishment of legal entities in general and companies in particular. Meanwhile,

the legislation in effect does not contain the notion of head organization or company, it does not grant it any special rights. It would be more logical to call such a head organization a holding company which owns controlling interests in the facilities making up the concern. In this situation Morfizpribor will have to carry out two types of activity that are barely compatible. On the one hand, it will continue to carry out its main activity remaining a Russian shipbuilding leader, designing and developing new hardware samples. On the other hand, the institute will have to take up purely managerial activities working with the shareholdings it will own. This work is specific, they will have to manage parts of the concern indirectly, through securities management and representatives in the boards of directors. Such works will require special knowledge and experience and it seems to me this will not contribute to the efficiency of the facility's operations in either area.

Question: So what do you suggest?

Sakit Allakhverdiev: It would be more logical in this situation to establish a holding company wholly-owned by the state. Such a legal entity will handle only managerial activities as regards the facilities making up the concern. Concentrating in one hands the management of facilities with related operations and one task - development and manufacture of hydro-acoustic navigation stations and communications, such a holding will be able to carry on singly government policy in all spheres of life of the concern members.

Question: However, the law currently prohibits federal and local government agencies to institute companies "unless federal laws establish otherwise"...

Sakit Allakhverdiev: If it is possible in the foreseeable future to pass a special law like this allowing establishment of a company in the defense industry whose shares will belong to the state, the problem will be lifted. And I believe such a federal law regarding the defense industry is necessary to raise officials' responsibility when they make some or other decision. If no such law is to be expected, however, there are also some other options to set up a joint-stock company with 100% of its shares to be later on transferred to the state. When a company has been established and registered, the state can transfer to it some shareholdings of the concern member companies on certain terms. There are such examples. As a result, we will have a company with 100% of its shares belonging to the state. This will make it possible to place the concern's activities under control of the state, specific agencies and officials.

(...)

Question: What role do you allocate to the military in defense industry reform?

Sakit Allakhverdiev: (...) It is absolutely logical that the Russian Defense Ministry that directly ensures the

state's security, its territorial inviolability and the security of its citizens is the most concerned about efficient operation of the defense industry. Meanwhile, it appears presently that the national defense industry structure and management system reform process sometimes goes round the opinion of the Defense Ministry and without its participation in this process.

We are by no means the only ones to formulate the above-mentioned position. A report by the foreign and defense policy board titled "Military development and modernization of the Russian Armed Forces" reflects the following position:

"Control over the condition and development of the defense industry, as well as all financial resources allocated for defense should be placed at the disposal of the Defense Ministry as is a worldwide practice. Of course, on condition of a drastic transformation of its structure, functions and tasks..." It turns out we are unanimous with the military on this matter. Besides, if defense industry reform, in particular establishment of new integrated structures is carried out with the direct involvement of the Defense Industry, it will be much more efficient to conduct conversion, oddly enough. Who else, if not the Defense Ministry can see better what operations may be stripped of state funding and what assets of defense facilities may be restructured and transformed into a basis for dual or civilian facilities? In years of epidemic privatization when many defense facilities came to be on the brink of destruction without government defense contracts, various conversion programs were developed and funded, even if not in full.

But those funds were just "eaten" by facilities, the programs were not carried through. I speak about it because I witnessed such an approach myself. I am sure it is worthwhile going back to military production conversion programs. But at an absolutely new level of defense industry development. Using new defense industry development leverage will not only allow efficient operation for national security, but also ensure new funding mechanisms for this sector. Only successful conversion activities, carried out in association with the Defense Ministry, establishment of dual-purpose productions will necessarily be able to attract private investments in the defense industry. There is simply no other way.

Translated by P. Pikhnovsky

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FINANCING, INVESTMENT, CREDITS

IRKUT GOES TO LONDON

the corporation is to place ADRs soon

Vedomosti, July 8, 2004, p. B2, Andrei Lemeshko

Irkut is seeking the status of a full-fledged public company. Following the floatation of its shares at the stock exchange, in the near future the corporation has plans to launch an ADR-placement program. Next year Irkut intends to get a listing at the London Stock Exchange. (...)

Irkut Corp. was founded in 2000 on the basis of Irkutsk Aircraft Association (IAPO) and some research and designing companies: the Beriyeв TANTK, Russian Avionics design bureau, Beta Air and Itela companies. Irkut has lately acquired the Yakovlev Design Bureau. Irkut's gain for 2003 totaled \$368 million, the net loss - \$4.86 million. NPK Irkut has been mainly producing Su-30KM planes and Be-200 amphibious planes. The company's stock of orders has been valued at about \$5 billion.

Irkut has been the first Russian defense company to perform its IPO. In late March the company sold an 23.3% stake in its stock to Russian and Western investors. After the IPO Irkut was trying to rejoice its new shareholders. According to a source, within days Irkut may announce launching the program of ADR-placement. The talks are underway now with The Bank of New York, which is to become the depository of the ADR program. Irkut officials provide no comments on this information, but the corporation's employee confirmed that the talks with The Bank of New York are underway. A source close to the company says the program could be launched this fall, after the company gets an approval of the Federal Financial Markets Service and the U.S. Securities and Stock Exchange Commission.

It is envisaged to convert into ADRs the entire stock in free circulation (about 25% of shares now). According to our source, during IPO launched in March the company couldn't offer its securities to U.S. companies. The ADR

placement will enable to expand the range of potential investors. The source notes that the negotiations with The Bank of New York also concern acquisition of the listing at the London Stock Exchange. According to the source, Irkut hopes to get the listing in early 2005.

The analysts approve Irkut's plans but urge not to overestimate its significance. Vyacheslav Smolyaninov of UralSib notes that the company has repeatedly announced similar plans. Therefore, it won't become a sensation for the market and won't have serious impact on the quotations of Irkut's. Smolyaninov agrees that the issue of ADRs will enable to increase liquidity of company's shares, but won't alter the fundamental appraisal of the company. Denis Nushtaev of Metropol notes that the investors are watching the company's financial indicators closer. Their interest for the corporation will be first of all accounted by Irkut's fulfillment of the sales growth declared. He notes that the ADR placement and getting a listing will widen the range of potential investors. Nushtaev thinks these measures may accelerate the purchase of Irkut's stock by EADS. In his opinion, Irkut may follow the path of the Consolidated Machine-Building Works, which are more interesting for foreign rather than domestic investors. Besides, the listing will enable Irkut to access cheaper Western loans and contribute to more successful promotion of company's products, in the USA as well.

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PROMISING PARTNERSHIP

Russkii Fokus, No. 23, June 28-July 4, 2004, p. 53, not indicated

Question: Gazprombank has been involved in the International show of arms, military equipment and ammunition. Is this a new business?

A. Kaznacheyev: (...) The bank has every opportunity to service defense enterprises and has been a reliable partner for many of them for a while.

Gazprombank always participates in most significant arms shows arranged in Russia, such as MAKS international aerospace show, the Naval Show in St. Petersburg. We are familiar with the Nizhny Tagil arms show either. Each show envisages new contracts for defense industry enterprises of Russia, which means new opportunities for Gazprombank to offer most interesting

terms on servicing and financing new contracts.

The sphere of our interests covers almost all branches of the defense industries: the aviation, the navy, the anti-aircraft systems, conventional arms, manufacture of ammunition, etc.

(...)

Being one of the largest banks in Russia, Gazprombank has the opportunity of crediting defense industry enterprises to almost unlimited amounts and any credit terms. We are financing execution of individual contracts, retrofitting, purchases of new equipment to the period of 3-5 years through the use of leasing schemes. (...)

Question: You've said that Gazprombank is sophisticated at crediting defense industry enterprises? Where does it find its expression?

(...)

A. Kaznacheyev: The amount of loans taken out to the defense enterprises has exceeded 15 billion rubles over past several years. The list of our respected clients includes Severnaya Verf Shipyard, KNAAPO, MiG, the Chernyshev MMPP, Progress company, etc.

MEZHPROMBANK HAS PURCHASED THE MAJORITY HOLDING OF SEVERNAYA VERF SHIPYARD

The structures affiliated with Mezhprombank have purchased the majority holding of Severnaya Verf Shipyard from the New Programs and Concepts company (NPK). International Industrial Bank is the owner of an 53% stake in Severnaya Verf Shipyard according to the register of shareholders. However, none of the companies provide official comments on the transaction.

Valery Pogrebenkov, press secretary of NPK called the information about the transaction "rumors deserving refutation." Mezhprombank only said that the talks with NPK are underway. At the same time, the extraordinary meeting of shareholders of Severnaya Verf is scheduled for August 21. (...)

According to Svetlana Yermolayeva, general director for public relations with Severnaya Verf, the shipyard has made the latest crucial decisions under active involvement of Mezhprombank.

In the near future Severnaya Verf could enter the United Industrial Corporation (OPK) management company, founded by Mezhprombank.

OPK is supposed to unite all non-profile banking assets. It will be managing the bank's assets in the sphere of fuel and energy industry, the shipbuilding, aircraft industry, machine-building and other industries.

OPK's tasks will include: restructuring the holding's industrial assets, attracting finance, optimizing the management system.

GAZPROMBANK CREDITING SEVERNAYA VERF

Gazprombank has raised the limit of crediting for Severnaya Verf Shipyard to \$140 million, opening a new line of \$90 million for 3 years. The finance has been allocated to finance the shipyard's expenditures on the supply of two project 956E destroyers under Chinese contract. Severnaya Verf plant is situated near the exit from the Marine Canal of the Gulf of Finland; its machinery, availability of covered slipway with four building berths and the lifting device with a floating dock enable to build and repair various ships and vessels under requirements of all classification societies. The plant's

output rose by 20% in 2003 as compared to the definitive indicators of 2002 to reach 7.4 billion rubles.

Translated by A. Ryabochkin

MILITARY HARDWARE PRODUCTION & ARMS TRADE

IN THE INTERESTS OF THE GROUND FORCES

At the Eurosatory-2004 show Rosoboronexport presented a new catalog of export samples of arms and military hardware

Voyenno-Promyshlenny Kuryer, No. 24, June 30-July 6, 2004, p. 8, Mikhail Tulyev

At the Eurosatory-2004 arms show conducted in Paris on June 14-18, 2004, Rosoboronexport, the organizer of the Russian exposition presented its new Catalogue of export samples of arms and military hardware for the Ground Forces.

The catalog is published in English and aimed primarily at foreign commanders of the ground Forces and experts of procurement organizations from abroad. It contains information about 130 samples of arms: armored and engineering equipment, missile and artillery systems, fire control systems, special use weaponry, small arms, ammunition and simulators.

The experts-oriented publication describes in detail and gives characteristics of such pieces of Russian armored and engineering equipment as T-90S and T-80U tanks, BMP-2 and BMP-3 infantry fighting vehicles, BMD-3 airborne armored vehicle, combat reconnaissance patrol vehicle and armored personnel carriers. (...)

The section of missile and artillery arms contains the wide range of high-precision missile systems, multiple launch rocket systems, howitzers and antitank cannons, guidance and fire control systems.. The catalog displays well-known for many foreign states and prior export samples: Smerch and Grad multiple rocket launchers, Kapustnik-B automated fire control system, export, designed for both Russia-made and foreign arms.

The small arms and ammunition section shows the

series of the world-known Kalashnikov assault rifles, including upgraded AK-74M, AK105 rifles and AK-101 and AK-102 assault rifles specially designed for the NATO 5.56 mm round, as well as upgraded Kalashnikov machine guns, KORD large-caliber machine gun, Dragunov SVD and SVDS sniper rifles, small, medium and large caliber (12.7x108 mm and 14.5x114 mm) rounds.

One of the catalog's sections is devoted to the special operations units' weapons. Among them, first of all, are various pieces of export-oriented small arms, including underwater assault rifles and handguns, multipurpose portable grenade launchers, submachine guns, special ammo, sights, binoculars, surveillance and night vision devices and body armor. All of them are in use by the Special Forces units of Russia, which is raising their export potential.

The publication also offers technologies of complex ammunition recycling and programs for effective upgrade of arms and military hardware.

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ASSEMBLED IN BUILDING BERTH

Murena-E ship is being constructed in Khabarovsk for the Republic of Korea

Voyenno-Promyshlenny Kurier, No. 25, July 7-13, 2004, p. 8, Vladimir Shvarev, deputy editor-in-chief of ARMS-TASS agency

The first section of the Murena-E landing hovercraft has been put into the berth of the Khabarovsk Shipbuilding Plant. Representatives of the client (South Korea) and the Khabarovsk regional government attended the ceremony of laying up the ship, which opened a large export order.

According to Gennady Koshkarev, general director of the plant, construction of several Murena landing ships becomes the plant's largest order over past several years. Similar vessels were earlier constructed for the Russian navy alone. Overall, three Murena-E hovercraft ships will be supplied to South Korea in 2004-2005 as a repayment of Russia's state debt. South Korea may raise the purchases of ships of that class, given their performance and combat properties.

The project 12061 Murena-E hovercraft was designed by the Almaz Central Marine Design Bureau under the supervision of Chief Designer Alexander Shlyakhtenko. It has the capacity of 24 tons, can make 55 knots per hour, deliver assault units with arms at the distance until 200 nautical miles, fulfill rescue and save those in distress. The Murena-E ship is armed with anti-aircraft missiles, an AK-306 automatic 30-mm gun and mines.

Russia has been developing military cooperation with

South Korea in several spheres at once. KBP of Tula performed supply contracts related to the Metis anti-tank missile systems and guided missiles for tanks and infantry fighting vehicles. Besides, KBP has executed several contracts on rendering services for South Korea, including installation of Russia-made thermal imagers for a batch of anti-tank missile systems supplied earlier. Simulators and training were supplied to prepare the personnel. Along with supply contracts, KBP has been settling all issues with South Korea - founding a maintenance center, personnel training, supply of checking equipment, etc.

KBP is now actively working with the Arms and Military Hardware Research Department of South. The design bureau of Tula offer installation of their systems to mobile chassis produced in Korea. South Korea has researched a good 155-mm howitzer. Discussed at the moment is the adaptation of Krasnopol missile for the use by the howitzer. South Korean navy has been interested in installation of the Kashtan system and other weapon systems on the ships, researched on a nationwide shipbuilding program.

Russia's most successful cooperation with South Korea belongs the sphere of helicopter vehicles. The year

of 2003 marked the 10th anniversary of first supplies of Ka-32 helicopters to South Korea. The maintenance center was founded in 1994. LG International Corporation (LGIC), which is an exclusive distributor of Ka-32 and Mi-172 Russia-made helicopters in South Korea and Southeast Asia, was selected the provider on helicopter supplies under the program on repayment of Russia's debt.

Via LGIC, the Kumertau Aircraft Producing Enterprise (KumAAP) concluded in June 2002 with the South Korean Defense Ministry a contract for supply of seven Ka-32 transport of helicopters. The supplies will be complete in 2004. Together with the helicopters, South Korea will receive extra equipment, while South Korean specialists will be trained at a training center in Kumertau. The contract is being performed as a repayment of Russia's debt to South Korea.

LGIC is now working over opportunities of promoting Mi-172, Ka-50, Ka-52, Ka-226 Ansat helicopters, as well as Be-200 amphibious plane to South Korea. Despite the loss to Sukhoi Corp at the Su-35 tender, Russia has managed to gain a sound footing on the Korean aircraft market. A contract for supply of 23 Il-103 light multirole planes was concluded in May 2002. The Il-103 planes are being supplies to the repayment of Russia's state debt.

Lukhovitsky aircraft production and testing complex affiliated with RSK MiG has been performing the contract.

On the whole, the major part of arms supplies to South Korea from Russia has been performed as a repayment of state debt. The first contract on purchase of Russia-made arms and military hardware for repayment of debt, which totaled 1.47 billion then was concluded in July 1995. The amount to be written off was \$457 million, \$240 million being the share of arms and military hardware supplies. South Korea received 33 T-80U tanks, 33 BMP-3 infantry fighting vehicles, 770 Metis-M anti-tank missile systems, Igla portable missile systems, Ka-32 helicopters, missile weapons and ammunition. The Minsk aircraft carrying cruiser and several hundred of T-54 and T-55 tanks were scrapped.

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PLANTS TO GET STANDARDS

Only 40% of defense industry enterprises have passed certification

Delovoi Peterburg, July 6, 2004, p. 7, Olga Kiseleva

By the end of 2004 the defense and industry & energy ministries plan to compose a draft decree, launching the mechanism of mandatory standardization. Under the draft decree, obligatory for execution are the standards specified in the federal law "On technical regulations," and all standards worked out afterwards. All existing standards are advisable now.

Simultaneously, the ministries have started the struggle for quality of defense industry products. According to Vladimir Muravnik, senior deputy chairman of the Federal Defense Order Service, the growing numbers of reclamations is due to absence of certified system of quality management and electronic corporate management technologies at the majority of enterprises. "Certification is voluntary. However, we must be certain of the quality of products," Vladimir Muravnik said. In the issue of licenses for the right of executing defense orders preference will be given to enterprises, which have been certified. Within next two years it is planned to certify all enterprises in the industry and raise the role of military representatives during the product acceptance.

The sphere of defense industries has several systems of certifying the quality management. Russian systems include Oboronsertifika (Defense Certification), Military Registry, Oborontest (Defense Test), Russian Registry, international includes ISO 9001:2000 system. According to

experts, the cost of certification and supervisory audit has been \$4,000-8,500. Creation of the system of quality management (personnel training, introduction of the electronic corporate management system, attraction of consulting companies) may cost an enterprise some \$1-5 million.

"Any toughening of requirements at a definite stage is linked to increasing the prime cost of products, since it could be tied to the personnel training and retrofitting. It is then impossible to speak about losses alone, since the expenses will be repaid. Large enterprises, which are working on defense orders for a long time, won't face hardships with new requirements. The scheme of work on the defense order is a big problem now. The preparatory stage before certification and licensing procedures is very expensive for an enterprise. For instance, the price of a Defense Ministry's license for one kind of activity is 5 minimum wages, whereas the preparatory cost makes 500,000 rubles. We have 30 similar licenses."

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TULAMASHZAVOD PREPARING FOR SERIAL PRODUCTION OF NEW SAMPLES OF ARMS

(...)

Tulamashzavod has been paying heightened attention to upgrading old arms and developing new samples lately.

The prototypes of the following items are being tested: the Palash artillery system with up-to-date methods of target detection, the missile and artillery mount on the basis of AK-306 Vikhr system, upgraded samples of the Kashtan system and ammunition storage systems for the Kashtan systems. In the near future the plant is ready to start serial production of all above kinds of weapons.

Prototypes of absolutely new combat modules for the

Kliver, Bakhcha and Pantsir infantry fighting vehicle have been produced with the future prospective. Potential clients are interested in these samples already now. The Kliver and Pantsir systems are predicted to enjoy high demand. (...)

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VYMPPEL SHIPYARD OF RYBINSK HAS LAID UP A LARGE SURVEY BOAT ON THE ORDER OF THE RUSSIAN NAVY

The laying ceremony took place in Rybinsk in the first decade of June. "The survey service of the navy needs new vessels," Yuri Gorev, deputy chief of the department for shipbuilding of the Russian navy said at the ceremony.

The survey vessel is supposed to be commissioned in the 3rd quarter of 2005. It'll be put into service at the Baltic Fleet. It is designed for exploration of the bottom relief, sounding and ensuring safe passage of combatant ships and vessels. In 2002 Vympel Shipyard won the tender for construction of the lead survey boat. Overall, it

is planned to build over 40 similar vessels; the navy has been the customer.

Translated by Andrei Ryabochkin

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CONVERSION

AIRCRAFT INDUSTRY GOES INTO COMA

Russkii Kurier, July 07, 2004, p. 7, Maksim Logvinov

Only three facilities manufacturing aircraft for civil aviation may soon be left in Russia. At least, state support has been promised to them only. These are the Ulyanovsk Aviastar, Voronezh and Kazan aircraft plants. "They are capable of satisfying entire demand for aircraft not only in Russia but also in the CIS," Yuri Koptev, head of the defense industry department at the Industry and Energy Ministry, said yesterday. "So we focus on them only." The remaining five aircraft plants, among them the facilities in Samara, Saratov and Smolensk, have not blended with the Ministry's scheme, so they will soon simply die. Their current state can hardly be called life though: the Saratov aircraft plant plans to manufacture just one Yak-42D in 2004, the Samara plant plans on An-140. Those facilities the Ministry is going to support are currently in a state of

apparent death, too. While the Kazan aircraft plant alone manufactured annually 230-240 planes in the Soviet time, all Russian aircraft makers manufactured just 12 long-range airplanes in 2003.

Meanwhile, as Koptev says, they can reach breakeven only making 35-40 planes a year. This is not a utopia: even considering their almost ten-year downtime, they can quite swiftly establish production of more than 100 machines. The trouble is though there is no one to buy them - airlines have no money to buy new hardware. And it is just ridiculous to speak about manufacturing aircraft for leasing - the plants can barely make both ends meet without that. The only way out of this stalemate is therefore development of leasing programs in cooperation with the state and investors. These aims will require a

total of \$1.736 billion, including \$377 million to be allocated from the budget and another \$340 million to be attracted from private investors, whereas around \$900 million will be borrowed. If it is really possible to obtain all this money, Russian facilities will completely satisfy the demand of national airlines by 2010: about 536 air vehicles, including 273 airplanes will be assembled.

This is the optimistic scenario, though. If the state takes no part in developing leasing schemes in aircraft, airlines may go into crisis as soon as in 2006-07, according to the Transport Ministry. After all, their fleet is steadily becoming obsolete: just 7% of Russian airlines' 1,600 planes are up-to-date national models (Tu-204, Tu-214, Il-114) that meet international requirements to noise and harmful deliveries. Another 17% are foreign airplanes that carry up to 40% of passengers along international airways. And even now it is already unclear whether large-scale purchases of foreign hardware or national industry development should be launched. It is currently no problem to find quality and inexpensive foreign airplanes: European and American airlines are actively getting rid of

obsolete models that are still quite suitable for operation. More than 2,000 aircraft made in the early 1990s are offered on the world market at dumping prices, according to Koptev, which so far can fly worldwide because they meet international noise requirements. However, a new provision will come into effect next year which recommends raising these requirements even higher. It is so far recommendatory, but it may soon become obligatory. It will then only be possible to use obsolete foreign aircraft on the domestic market. Let alone the fact that staking on imports will kill the national aircraft industry for sure, not only civil but also military, Koptev assures.

□

TANKS GO TO MARS

This nation's armor vehicle designers can also solve outer space problems

Rossiiskaia Gazeta, June 08, 2004, p. 5, Sergei Ptichkin, Boris Yamshanov

(...)

Tanks are not only armor and firepower, they are also the focus of highest intellect. The best evidence of this is the fifty-year plus experience of the All-Russian Scientific Research Institute of Transport Engineering. The institute was founded 55 years ago in Leningrad, based on the Kirov Plant. It soon turned out that tank making ideologists were not only capable of practically solving "down-to-earth" and purely combat tasks, but also outer space ones.

The tank institute became a world science center at the turn of the 1950s and 1960s when it was headed by Vasilii Stepanovich Starovoitov, the father of Galina Starovoitova. Vasilii Starovoitov and Sergei Korolev held a secret meeting in 1963 at which a sort of engagement of tank men to space sector workers occurred.

(...)

Korolev was attracted by the ability of the tank makers to create unique suspension mounts.

The Soviet Lunokhod-1 on November 17, 1970, became the first vehicle in human history to be delivered to our natural satellite and work there ten months and a half - this is known to everyone. But only specialists know that the chassis for the moon vehicle were designed on the basis of the suspension mount for Soviet tanks.

Tank know-how was afterwards used to develop equipment for the Venus-13, Venus-14 and Vega stations to study Venus soil. It was the tank makers that designed space vehicles for surface studies of remote planets with

an untraditional way of movement, developed a whole range of onboard equipment for orbital space stations and interplanetary spacecrafts. They were very actively involved in work on Project Buran.

And it caused a real stir when it was worldwide acknowledged that Russian stabilizers of tank guns work best in space.

Based on systems used to stabilize and point tank gun barrels with recoil exceeding 100 tons, triaxial stabilized platforms were developed for the Argus research complex for the international program Mars-96 and the Orientator precision pointing platform for the Mir orbital station; a biaxial pivoting floor is being developed for the Russian segment of the International Space Station.

Under a contract with foreign space centers, the tank makers from St. Petersburg have developed an original design for a Mars research vehicle with a changeable geometry of the motor vehicle chassis; a movable penetrometer for the study of Martian soil; and drive mechanisms for huge spacecraft antennae. The Russian tank men are prepared for a peaceful attack of their unique and absolutely peaceful machines to Mars.

□

SAIGA DOES NOT MISFIRE

Russia, N27, July 01-07, 2004, p. 5, Olga Yevseeva

Russia's arms capital, Izhevsk, has witnessed a general meeting of the Union of Russian Arms Makers. The place was not chosen by chance. Firstly, the president of the union, arms designer Mikhail Kalashnikov will be 85 on November 10 this year. Secondly, the Union of Russian Arms Makers is celebrating its tenth anniversary, while it was Izhevsk arms makers who initiated the union of defense facilities.

Just one in ten facilities in this sector in Udmurtia has been able to disentangle itself from conversion nets and launch an international market crusade. This is first of all the Izhmash concern, a defense industry leader in the Soviet time. This is where world-famous Kalashnikov submachine guns were manufactured.

(...)

Fate has played an evil trick on Izhmash. They started to make hunting guns here as far back as in 1824. After WWII, however, the Defense Ministry ordered the facility to pass on almost entirely to manufacturing Kalashnikov submachine guns. Izhmash designers had to pass over many of their hunting and sporting gun designs to the Izhevsk Mechanical Plant and to other national facilities. Meanwhile, the Izhevsk Arms Plant had started its work on hunting and sporting guns practically from scratch.

The Izhevsk arms makers reentered the hunting and sporting guns market in 1993. "Peaceful arms" production began with small batches - 6,000 guns a year. The complexity in market development consisted in the absence of trading experience. The range of world and national manufactures had been developed for several decades. Izhmash specialists had to develop new samples every six months. Originally, even the fact that those arms had no matches in the world led to certain difficulties on the market. The world had seen nothing like using combat technology in manufacturing hunting and sporting arms.

Izhmash retains its position at the expense of original design: rifled hunting and sporting arms have no analogues. The plant has strong positions in selling sporting arms for biathlon. Austrian-based Antschuetz is probably the only matching rival. This concern almost the only market player on the smooth-bore self-defense arms. Air guns vanished from the market when Saiga emerged: they became unnecessary because there are arms based on Kalashnikov which fire better, farther and more reliably. A new product, Saiga 030, has not only been acknowledged the market's best but also a backbone

product in the category.

On the eve of the jubilee meeting of the Arms Makers Union, Izhmash became a member of practically all arms shows conducted over the world.

In March, the concern took part in the IWA 2004 international trade exhibition of sporting and hunting arms and accessories in Nuremberg. Practically the entire range of sporting and hunting products was shown: Sobol, Korshun, Bars, Los, SM-2, Saiga, Tigr, Biatlon, Rekord. A number of contracts were signed with firms from Europe and Latin America for supplying Saiga and Tigr.

In April, right after the closing of the show in Nuremberg, the concern received a delegation from Hungary. It was interested in smooth-bore and rifled arms for commercial and amateur hunting, sporting arms and knives. The firm is going to act as dealer in Hungary, Slovakia, Slovenia and Romania. The guests took special interest in "military-style" hunting arms. In the opinion of the Hungarian delegation, such products will currently enjoy the biggest demand in the above-mentioned countries. The sides agreed to continue cooperation and discussed contract and pricing terms, the delivery procedure and the issue of licensing trade.

Having taken part in the international show of special equipment and arms and military hardware for land forces, air defense forces and navy which occurred in April in Malaysia (DSA), the concern signed a series of contracts with Asia Pacific states.

Apart from firearms, Izhmash demonstrated dummies of the Kitolov-2M and Krasnopol high-precision guided artillery systems intended to hit small-size land targets. The defense ministries of Indonesia, Malaysia and Vietnam showed interest in those weapons.

Experts think the facility has good prospects: there is a clear concept of what to do and where to go and there is its own original niche where no one actually competes with the arms makers from Izhevsk. This is presently the most dynamically developing facility among those involved in manufacturing sporting and hunting arms in the country.

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WILL MIG MAKE TU-334?

The Tu-334 airplane was yesterday officially granted the type certificate, a document confirming commercial

usability of the model. Simultaneously, the Tupolev company which owns copyright to the Tu-334 announced

its intention to organize full production of the machine at the Kazan or Ulyanovsk aircraft plants. The Russian MiG Aircraft Making Corporation which had been assigned establishing Tu-334 production by the government as far back as in 1999 refused to comment on Tupolev's decision.

The issue of Tu-334 assembly has rather a long history. The machine began to be designed as far back as in the Soviet time and they were going to establish production at Kiev-based Aviant. When Russia and Ukraine became independent on each other, the Taganrog Beriev Aircraft Scientific Production Complex was appointed Russian assembler of the Tu-334. They never found required financial resources though. In 1999, the Russian government issued an order transmitting the Tu-334 to MiG. The corporation was supposed to spend money it earned on combat aircraft exports to organize civilian production at its plant in Lukhovitsy, Moscow region, by way of conversion. Failure to fulfill this order served the ground for dismissing MiG director general Nikolai Nikitin

in late 2003.

The current leadership of the corporation yesterday proved unprepared to give us official commentary on the state of the Tu-334 program. Off the record, one MiG designer called the program a "sluggishly moving process."

"No one says MiG won't manufacture the Tu-334," Igor Shevchuk said yesterday. "They will move toward that as fast as their financial condition allows." He did not explain how soon and at what expense it is planned to organize assembly of the machine in Kazan or Ulyanovsk.

Translated by P. Pikhnovsky

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PERSONAL LINE

NEW BOARD OF DIRECTORS OF IRKUT CORP. ELECTED

The new board of directors was elected at the annual meeting of shareholders of Irkut Corp.

The board of directors consists of 11 members, including Sergei Chemezov, general director of Rosoboronexport, Mikhail Pogosyan, general director of Sukhoi Company, Alexei Isaikin, president of Volga-Dnepr group of companies, Alexei Fyodorov, president of Irkut Corp., etc. Oleg Demchenko, general director of the Yakovlev Design Bureau was elected CEO of Irkut's board of directors.

The new board of directors will have the following committees: on strategic development and planning, on budget, on audit, on information, on relations with

shareholders, on personnel and remunerations.

Almost all the committees will be headed by independent directors, whose number grew from 3 to 5 (only two executive directors remained). The relations between the joint-stock company and the directors will be formed on contractual basis.

□

THE BOARD OF DIRECTORS OF ARSENAL MACHINE-BUILDING PLANT (ST. PETERSBURG) HAS BEEN ELECTED

The new board of directors was elected at the annual general meeting of shareholders of the Arsenal Machine-Building Plant.

The board includes: Vladimir Grigoryev, senior deputy general director of the Arsenal Machine-Building Plant, Mikhail Gusev, general director of Nordprofil, Sergei Korolev, general director of the Arsenal Machine-Building Plant, Vitaly Menchik, general director of Ligovsky 29 company, Mikhail Sapego, chairman of the board of directors of the Arsenal Machine-Building Plant, Sergei Sharagin, deputy general director of the Arsenal Machine-

Building Plant, Grigory Polishchuk, a representative of the state.

Translated by A. Ryabochkin

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CIS MILITARY-INDUSTRIAL COMPLEX

THE AIRCRAFT INDUSTRY AT THE CROSSROADS

The idea to create an aircraft concern has reached the prime minister

Zerkalo Nedeli (Kiev), No. 24, June 19-25, 2004, p. EV, Valentin Badrak, the Center for the survey of the army, conversion and disarmament

Ukrainian Prime Minister Victor Yanukovich recently held a meeting regarding problems of the development of the Ukrainian aircraft sector. (...) It became evident in late May that the Ukrainian aircraft industry, which split into two groups, could not exist in its previous form. Some experts said that it was unprofitable to promote products on the world's markets in small groups. Others said that aircraft companies wanted to live according to old rules. To all appearances, the prime minister supports integration projects. Observers say that the destiny of the Ukrainian aircraft industry will be determined in June.

The prime minister made sure that the problem of merger of aircraft enterprises is not a problem of the Ministry for Industrial Policy. It should be noted that opponents of integration processes propose to postpone the final decision to the end of 2004 despite the fact that there are only state-run aircraft plants in Ukraine.

Designers of aircrafts opposed serial producers at the meeting. It's logical. The Antonov design bureau is in a stable situation. Firstly, it has an enterprise, which transports heavy cargo. The design bureau does not want to share this money with other producers. Secondly, precisely designers dictate the will in the sector of the aircraft policy. (...)

The ratio of expenses on the creation of an experimental model of an aircraft to the cost of a serial aircraft is ten to one. In other words, the creation of the An-140 aircraft, which costs \$8.5 million, cost around \$85 million. The price of the An-148 aircraft (\$15 million) means that the design bureau spent around \$150 million on its creation.

However, this is just part of the truth linked with the position of the designer. The Soviet management understands that it would be very difficult to play the main role in the top management of holdings if aircraft companies merged. Concerns may bury all Soviet approaches to developing the aircraft industry.

Some Ukrainian officials support the idea of independent development of aircraft enterprises. The point is that the creation of concerns means financial risks, and part of responsibility for possible failures may fall on officials. (...)

Producers are more mercantile. It's more profitable for them to produce one aircraft than different models. (...) However, aircraft plants need turnover, which means credits and investment in order to produce for instance

2,000 An-140 planes.

(...)

The creation of the Antonov aircraft concern on the basis of three state-run enterprises - the Antonov design bureau, the Aviant plant (Kiev) and the Kharkov aircraft plant - is aimed at realizing two ideas. The first boils down to passing a common industrial policy and creating a joint service center. The second idea is linked with the creation of an attractive investment field in the aircraft industry.

The search for investors did not begin suddenly. In April 2004 Russia changed the rules of the game for foreign investors: before investors could not purchase more than 25% of enterprises' shares. At present the share of foreign investment may reach 49%. In this situation Ukrainian enterprises may become outsiders on some markets. If foreign rivals gain control over Russian enterprises Ukrainian companies will lose traditional suppliers of spare parts. Some representatives of the aircraft industry state that it would be reasonable to become shareholders of Russian enterprises. However, it's impossible to do this right now. Firstly, the law does not let Ukrainian state-run enterprises invest money in foreign enterprises. Secondly, the investment potential of the most successful Ukrainian enterprises is not high. The merger of several aircraft enterprises would make it possible to influence the strategy of development of Russian suppliers in the prospects.

(...)

It should be noted that Ukraine is creating integrated structures in other sectors. In particular, the Ukraviaremont corporation will consist of enterprises, which offer repair services. In addition, Ukraine plans to merge enterprises producing spare parts. Analysts say that these mergers will lead to redistribution of property.

Translated by Alexander Dubovoi



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