Eurasian Private Equity Group

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EPEG SMALL COMPANY BUYOUT FUND
Invitation for Investor Participation

On behalf of Eurasian Private Equity Group, I am pleased to announce the formation of the EPEG Small Company Buyout Fund. The Fund is an international variable capital company recognized as a private international collective investment scheme in the Republic of Cyprus.

The investment objective of the Fund is to achieve substantial long-term capital appreciation from investments in Russia. The Fund will pursue growth opportunities through expansion-stage equity investments in established small companies with strong management teams, takeovers of failing ex-Soviet enterprises and selected real estate investments. The Fund is the first investment vehicle focused on the Russian lower mid-market managed by leading Russian professionals. It is expected that the majority of the Fund’s investments will be located in the Russian Northwest.

The Fund is currently seeking $50 million in aggregate subscriptions at first close. We expect aggregate subscriptions will total $150 million at final close. I invite you to review the Fund’s marketing materials and Memorandum of Offering and contact us for more information. We look forward to hearing from you.

Sincerely,

Dr. Igor V. Kostikov
Chairman of the Board of Directors

Who We Are

Eurasian Private Equity Group (EPEG) is the Investment Advisor for the EPEG Small Company Buyout Fund. EPEG brings together a seasoned group of Russia-focused investment professionals led by former Russian cabinet minister Dr. Igor Kostikov. The Fund is governed by its Board of Directors and is managed by the Investment Advisor. Though this is a first-time fund, Dr. Kostikov has assembled a group of professionals, resources and strategic partners well-positioned to capitalize on the real story of Russia's amazing economic performance.

What We Do

The EPEG Small Company Buyout Fund is unique in its market focus, management composition, competitive advantages and in-house resources. The Fund's investment focus is diverse without being diffuse. The Fund will focus on lower mid-market buyouts, takeovers of ex-Soviet enterprises, and selected real estate opportunities, three rapidly growing areas of one of the world's leading emerging markets. The Russian lower mid-market space contains a wealth of expansion-stage equity investment opportunities in established small companies with strong management teams which are well-placed for growth. Investments in government privatizations and takeovers of failing ex-Soviet enterprises are facilitated by the Investment Advisor's reach and unique contact network. Privatizations and takeovers of ex-Soviet enterprises are well suited to benefit from the same 'building' skills used in buyouts. Finally, real estate in Russia has returned tremendous capital appreciation. A possible core difference versus developed real estate markets is the absence of a boom-bust cycle driven by monetary policy fluctuations. The Investment Advisor believes Russian real estate to be fundamentally undervalued due to the recent transition to private property and undeveloped credit markets. The Fund's access to financing gives it a competitive advantage when levering real estate returns as Russia lacks commercial mortgage facilities. Key Fund strategic partners, Phoenix Construction & Development and Driada Real Estate Services allow the Fund to more effectively, safely and quickly deploy a significant amount of capital in development projects which maintain attractive risk characteristics. Our management team's experience, proprietary deal flow, local market knowledge and contact network in both the public and private sector coupled with the new Russian investment paradigm may be a compelling reason to invest.

Why Us

Russia was ranked as the world's number one emerging market in 2005. Its tremendous growth has precipitated a flood of new foreign investment as well as several new investment companies and vehicles. The majority of foreign investment flows has been into foreign mutual funds focused on listed equities. The combined Russian market grew 84% in 2005 and large foreign mutual funds employing Western capital have mirrored this performance. However, reviewing the growth drivers of these returns show that the five largest public companies comprise 90% of the value of the Russian stock market and 83% of the market's daily volume while the top 15 companies comprise 98% of capitalization. These companies, Gazprom, Lukoil, Transneft, Surgutneftegaz, Norilsk Nickel, and Sibneft among others are nearly uniformly natural resources companies. A review of leading foreign mutual fund portfolios shows an average 70-80% natural resource-related weighting. The Investment Advisor believes improving macro-economic fundamentals and domestic market growth is being confused with the growth of a few natural resources companies driving a hot stock market on the back of spiraling commodities prices. It is prudent to consider the upside left in these few companies, the point at which the strong price of oil/natural resources is reflected in valuations and how much risk is being taken by such concentration. The Russian market is certainly growing but the cheerleading of a few companies' stocks has muddied the understanding of what this growth is, where it is reflected, who is growing and what '#1 emerging stock market in the world' actually tells us. We believe the true story of opportunity in Russia has different foundations.

It is our belief that the truly untapped opportunity is not the recent stellar performance of a few listed companies but rather small and medium sized businesses just now reaching the level of sophistication necessary to exploit the opportunities offered by an increasingly wealthy country of 145 million. With the period of 1991 to 1999 essentially lost years, growth and development of markets to serve this vast population has occurred only recently. With grocery chains, pharmacies, service companies and retailers, among others, growing quickly and many new segments just now developing critical mass such as consumer credit, business leasing, tourism, and suburbs construction, lower mid-market private equity is poised to outperform.

The current Russian government has implemented a simplified tax policy while boosting tax collection. The petro-dollar boom has been managed responsibly with the government applying the entire surplus to paying down the country's debt. Disposable income levels have doubled in five years feeding rapid consumer-led expansion. There is strong strategic interest boosting trade sales along with good domestic liquidity. From an investment perspective it is an underserved market. According to the Russian Venture Capital Association, the majority of direct investments are in the middle market, with a focus on expansion-stage or early-stage deals and an average deal size of US$5 million. The Russian opportunity is retail rather than tech. Developed markets require outsized risks to pursue outsized returns. In Russia, real opportunities for superior returns can be had by investing in a small retail chain requiring capital and management expertise before being sold to a strategic player in 3-5 years. Russian managers are exceedingly bright but there is a real lack of quality management systems and practices, transparency and internationally accepted accounting practices. This is an area where private equity can add the most value. Introduction of transparent accounting and financial controls and good corporate governance directly contributes to higher exit valuations. Alternately, capital scarcity is still a real issue for most Russian companies. Fragmented markets populated by dozens of growing mid-market companies without access to expansion-stage capital are a great environment for private equity.

Russia's unruly transition to a market economy has not allowed many domestic investment professionals to build attributable track records and strong relations with foreign sources of capital. One of the greatest challenges is filling the professional fund management gap to open Russia's possibilities up to international investors. Russia has a depth of investment opportunities and returns have been spectacular. Until recently the only private equity capital in the country was from quasi-governmental organizations such as OPIC, EBRD and IFC. Two camps are now emerging as the 'private' private equity market in Russia starts in earnest. There are existing and newly raised large funds in equities and private equity run by foreign and Russian managers backed by these agencies. There are also smaller foreign-run private equity funds in the mid-market again anchored by OPIC, EBRD, IFC and similar agencies. These funds are generally well-established vis-à-vis organizational structure and well-run by foreign professionals with longer track records than their Russian counterparts. Similar to the now-developing Asian PE market, most Russian practitioners have difficulty presenting their history in a manner which Western LP's can comprehend. Unless a manager worked under the umbrella of an EBRD or similar mandate, domestic professionals operated in an opaque environment only recently lifted with the strengthening of the legal framework and tax-collection policies. Thus few funds have been established by independent Russian professionals, the people who best know the cultural and investment landscape. If the investment opportunities for Western capital previously were restricted to large foreign mutual funds, large foreign private equity funds and smaller foreign private equity funds, the EPEG Small Company Buyout Fund is an attractive alternative. Only now can Western investors back a 'Russian' Russia-focused fund investing in the lower mid-market led by a Russian general partner of the stature and experience of Dr. Kostikov.