

# Industry Insights

*The facts for your business*

## Construction and infrastructure in Russia

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# Agenda

- Executive Summary
- Construction: Role in the Economy
- Residential Real Estate
- Commercial Real Estate
- Construction Equipment Fleet
- Geographic Coverage of the Sector
- SWOT Analysis
- Regulation and State Involvement
- Industry Players – Top 20
- Investment Projects
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- Appendix – Details of Selected Projects

This report is an overview of the construction industry in Russia rather than an exhaustive report. We would be happy to provide a more detailed report on a specific subject.

This document contains several examples of descriptions of investment projects. A more detailed version of the report is available upon request.

# Executive summary

*“The industry is struggling as a result of the current crisis but the reduction has not been as bad as 2009”*



- Construction is the **7<sup>th</sup> largest** sector of the economy, employing **5-6 million** people
- Residential construction, core of the sector, saw a **34% decline** in mortgages on 2014 (**2009: -77%**) due to falling disposable incomes
- At the same time, a record **85.3 million sqm** of new residential real estate was built
- The government continues to subsidize the **12% p.a.** interest rate on mortgages for individuals
- Commercial real estate lease rates have **stabilized**, while office space and warehouse segments are expected to contract in Moscow (**5% and 31%**, respectively)
- **Major construction projects are in progress** – they have not been put on hold
- **Foreign companies still have a chance to participate in the FIFA 2018 World Cup** and infrastructure construction projects
- Basic construction materials (e.g. cement and bricks) are largely localized
- **Finishing materials, sanitary equipment, electric/wiring equipment are mostly imported**
- Construction equipment fleet requires upgrade: **40%-50%** of equipment is obsolescent. This represents a **market opportunity for international manufacturers**
- The government is modernizing legislation: **231 new construction standards** were developed. More than half of them will become EEU legislation

# Construction: Role in the economy



**7<sup>th</sup>**  
largest sector



**6%**  
is the sector's contribution to the economy



**5-6 million**  
people are employed in the sector



**8%**  
of total working population



**218,000**  
companies work in the sector



**98%**  
of players are small and medium companies

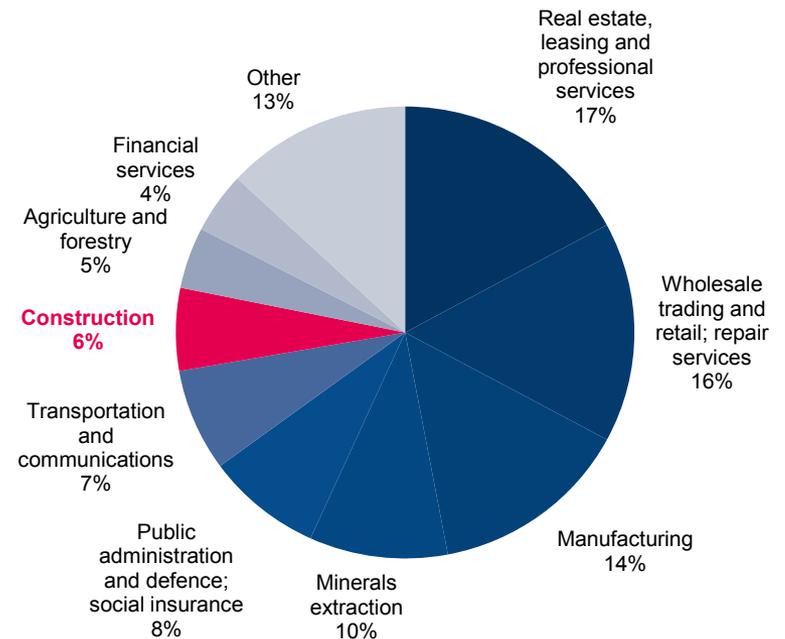


**85 m sqm**  
of residential real estate was built in 2015 – an all time record



**90%**  
of total investment is represented by residential construction

## Share in gross value added in 2015



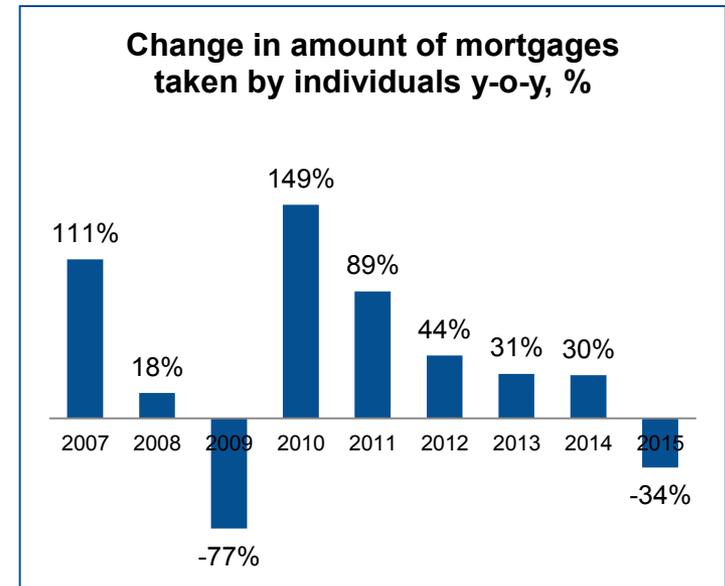
Source: Federal State Statistics Service (Rosstat)

# Residential real estate

*“Supply up – demand down”*

*“Growing trend: building more budget housing”*

- In 2015, mortgages were **down 34%** in Rouble terms compared to 2014
- This drop was **not as severe as in 2009** when the decline was twice as significant (**77%**)
- **85.3 million sqm** of new residential real estate was completed – an all time record for Russia!
- This is 1.4% more than in 2014, and exceeded expectations by 12%
- **76.2 million sqm** of new flats will be built in **2016** while new building permits were issued to build **112 m sqm** of new flats
- **45%** of new flats were budget class – growing trend to build more housing of this category
- The government will continue to subsidize the **12% p.a.** rate until 2017 – 1/3 of all loans



Source: Central Bank of Russia

# Commercial real estate

- Sales in office space and warehouse segments are expected to **contract** in Moscow (**5% and 31%**, respectively)
- Lease **rates tend to be denominated in Roubles** – a major change from 2015 gaining momentum in 2016 and beyond. They are not expected to change
- Currency volatility drives two different behaviours: **tenants want to sign long-term leases** in Roubles while **owners want to limit terms to 3-5 years**
- Reduction in new space and flat/growing acquisition will result in a reduction of available space, which may push **rates up**
- Information for 2015 represents expert estimates based on actual transactions while numbers for 2016 represent a forecast
- **Decreasing supply protects the market from further devaluation**

*“Lease contracts re-negotiated into Roubles”*

*“Declining supply”*

	Office space		Warehouses	
	2015	2016F	2015	2016F
Bought/leased space, 000's sqm	1,050	1,000	1,313	900
Lease rate, RUR/sqm/year (net of VAT and opex)	14,600-25,000*		3,500-4,500*	
Commissioned space, 000's sqm	700	400	800	600

Sources: Knight Frank, JLL

\* No change in rates is expected.

# Construction equipment fleet

# 54,500

construction equipment units in use

*“Dependence on foreign produced equipment and the degree of overall park obsolescence represent a significant market opportunity for international manufacturers”*

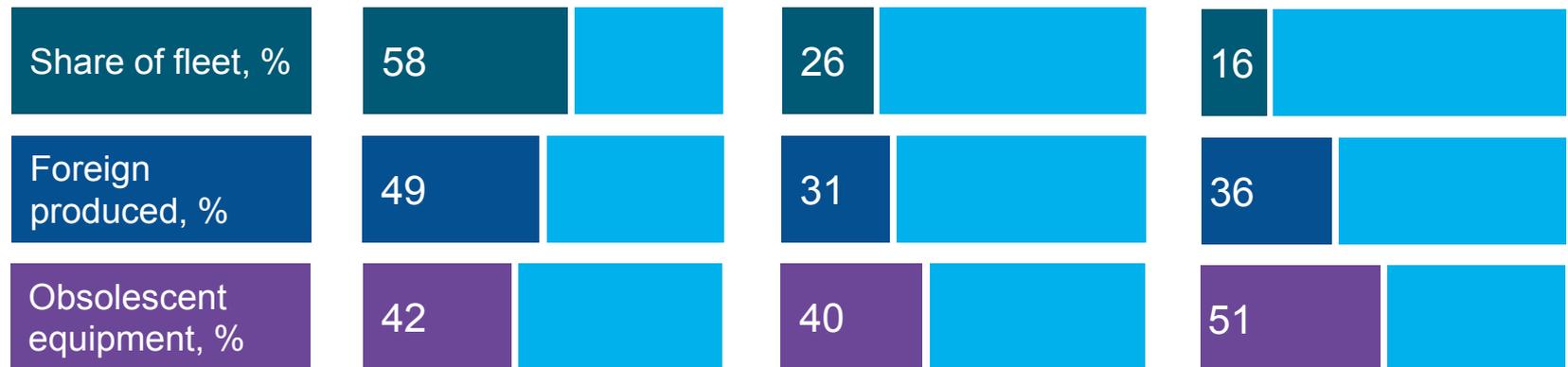
Earthmoving equipment



Cranes



Tractors



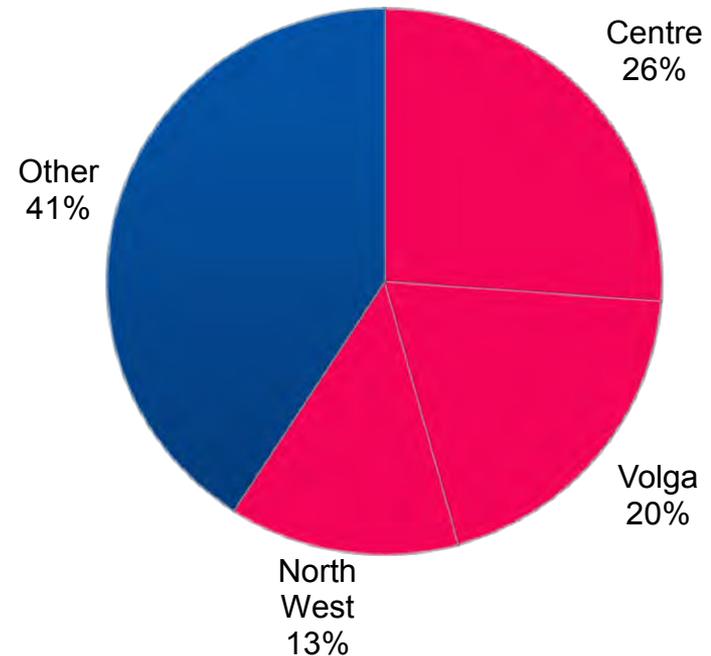
Source: Rosstat

# Geographic coverage of the sector

*“New projects are planned in the eastern part of the country”*

- **RUR 5.9 tn** was total construction expenditure in 2015
- **Three Federal Districts** – Centre, Volga and North West – account for almost **60% of expenditure**
- **Siberia and Crimea will increase** their share as the Sila Sibiri (Power of Siberia) pipeline and Kerch Strait bridge projects progress towards completion

**Construction expenditure by Federal District, %**



Source: Rosstat

# SWOT Analysis

## Construction industry

### Strengths

- Cheap energy
- Resources
- Large market
- Significant demand

### Weaknesses

- State involvement
- Equipment requires modernization (old or no local equivalent of foreign equipment)
- Know-how
- Bureaucracy
- Corruption
- Difficult to obtain construction permits (Ease of doing business rank 119)

### Opportunities

- Large areas
- Know How through localization
- Special Economic Zones, Industrial Parks
- Localization law (import substitution order № 2068 from 16.10.2014)
- Modernization needed

### Threats

- Devaluation of the rouble
- Bankruptcy of construction companies
- Competitors from Asia (China, Japan, Korea)

# Regulation and state involvement (1)

*“Reforms and harmonization of regulations under way”*



- Legal framework is complex but is undergoing change
- Main laws are Civil Engineering Code and Technical Regulations (both national and Customs Union):
  - Safety of buildings and structures
  - Fire safety
  - Safety of lifts
- Government is streamlining technical rules and budgeting norms – this will be finished in 2017-2018
- In 2015, the Ministry of Construction developed 231 construction standards. More than half of them will become EEU legislation
- Work is underway to harmonize with Eurocodes (European standards specifying how structural design should be conducted within the EU). Nation-specific appendices were designed

# Regulation and state involvement (2)

*“This industry is self-governed”*



- Government requires compliance with certain national standards and rules of construction (by decree)
- Compliance with other rules is voluntary
- The industry has been self-governed since 2010
- Self-governing professional organizations (SRO) are authorized by the government to grant permissions to companies to carry out the following activities in Russia:
  - Engineering surveys
  - Design
  - Building
  - Reconstruction
  - Overhauls
- About 500 such SROs operate today

# Industry players – Top 20

“The sector is mostly privately owned”



	Company	Revenue in 2014, RUR bn	Specialization
1	Stroygazmontazh	225	Oil and gas industry
2	Mostotrest Stroitelstvo	151	Roads and bridges
3	Tashir	134	Commercial and residential real estate
4	Stroygazconsulting	109	Pipelines and roads
5	Stroytransgaz	103	Oil, gas and electric power industry
6	LSR Construction Group	92	Residential real estate
7	Mosinzhpoeekt	84	Infrastructure
8	Spetsstroyengineering	72	Defence and government
9	FSK Lider	62	Residential real estate
10	Morton	61	Residential real estate
11	PIKstroitelstvo	61	Residential real estate
12	Globalstroy-Engineering	60	Oil and gas industry
13	Etalon	51	Residential real estate
14	SU-155	50	Residential and industrial real estate
15	Velesstroy	50	Oil, gas and electric power, infrastructure
16	MIC Group	46	Residential real estate
17	Renaissance Construction	46	Commercial real estate
18	Transengineering	46	Roads, oil and gas, other industries
19	Graviton	44	Infrastructure
20	SK MOST Group	44	Bridges and tunnels

Sources: Forbes Russia and RBC

# Investment projects (1)



FIFA 2018 World  
Cup projects



Top 40 industrial  
and infrastructure  
projects



Localization  
projects

# Investment projects (2)

## FIFA 2018 World Cup

- Total investment: RUB 663 bn
- Organization committee Russia 2018 under Ministry of Sports
- 3 categories of infrastructure:
  - Sports (stadiums, training camps, sports schools, sport halls)
  - Transportation (airports, streets, bridges, railway terminals)
  - Hospitality (hotels, healthcare, facilities)
- Construction sites in 44 cities:
  - 11 cities hosting games + 33 other cities



# Investment projects (3)

## FIFA 2018 World Cup – Stadiums

### – Main construction companies – all Russian:

- Crocus International
- Sroytransgaz
- Mosinzproject
- Sinara Development
- Inzhtransstroy - SPb
- Sport engineering (FGUP Sport-In)
- Intersportstroy



### – Foreign companies involved:

- SPORTFIVE (Germany; consulting)
- GMP International GmbH (Germany; architecture)
- AECOM (USA; Management support service)
- IMG (USA; Management support service)
- Hilti (Liechtenstein; anchors)



# Investment projects (4)

## Allocation of Top 40 by region

*“The Far Eastern district leads by total value, number of projects and number of sectors”*

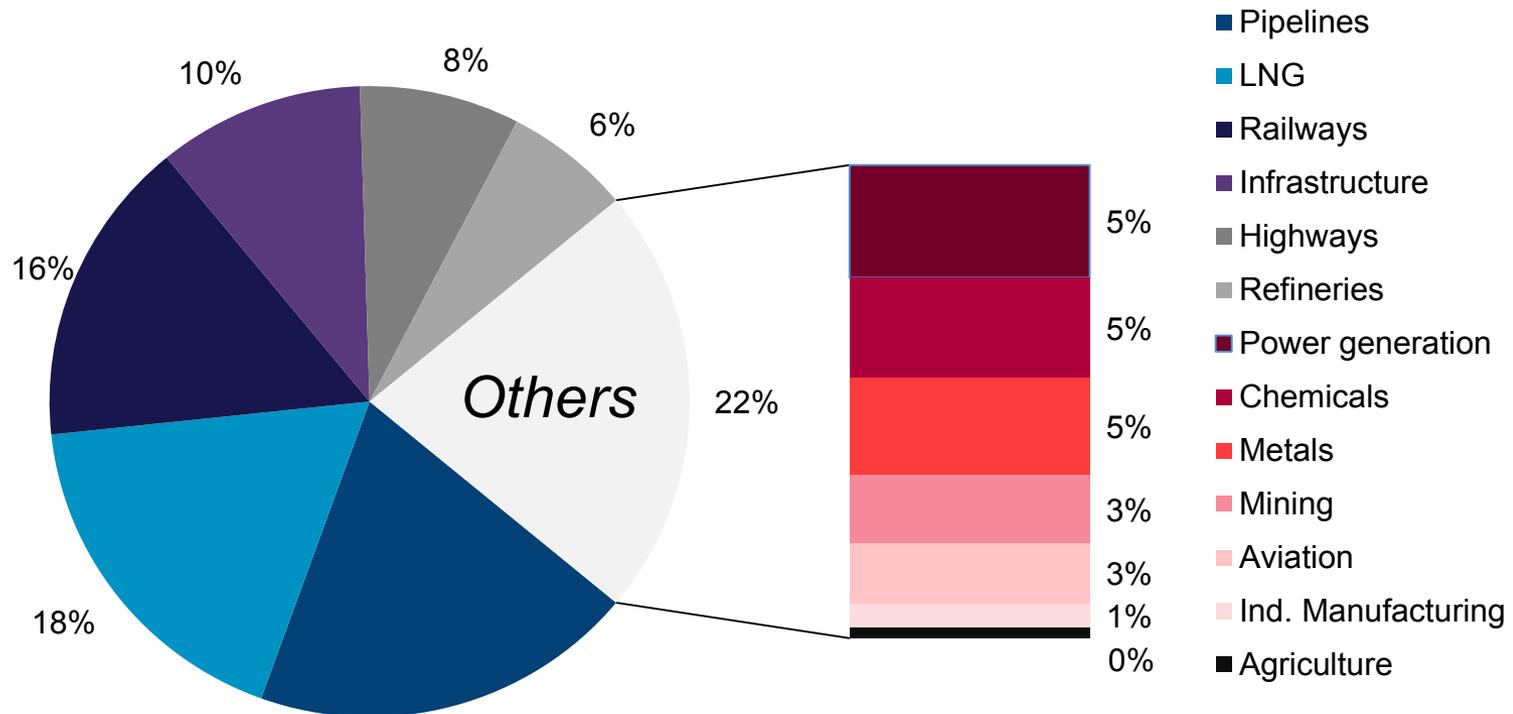
Federal district	Qty	Industrial sector	Total investments, RUR bn	Average investments, RUR bn	Investment size range, RUR bn
Far East	8	Pipelines, LNG, industrial manufacturing, power generation, mining, refineries, railways	2 845	356	60 - 770
Central	7	Aviation, railways, highways, metals, refineries	2 738	391	42 - 1 400
Southern	3	Pipelines, mining, refineries	1 324	441	48 - 1 190
Urals	8	Pipelines, infrastructure, power generation, metals, LNG, refineries	1 148	143	40 - 680
North West	4	Infrastructure, agriculture, refineries	922	231	50 - 630
Siberian	5	Aviation, railways, refineries, metals	600	120	68 - 164
Volga	3	Chemicals, mining	412	137	54 - 290
Crimean	1	Infrastructure	247	247	247
North Caucasian	1	Chemicals	140	140	140
<b>Total</b>	<b>40</b>		<b>10 376</b>	<b>2 206</b>	

*Source: Top 40 investment projects, RA Expert  
Projects in defense and nuclear power generation are excluded.*

# Investment projects (5)

## Top 40 industrial and infrastructure projects

Investment by industry in 2014-2018, RUR 10 376 bn



*“Pipelines, LNG, roads and infrastructure account for 72% of total value of projects”*

*“Insufficient investment in Aviation and Industrial Manufacturing”*

# Investment projects (6)

## Top 40 industrial and infrastructure projects – Examples

- Railways
  - High speed rail link Moscow – Kazan
- Aviation
  - Sheremetyevo Airport
  - Domodedovo Airport
  - Zhukovsky Airport
- Liquefied Natural Gas
  - Yamal LNG
- Pipelines
  - Sila Sibiri (Power of Siberia)
- Refineries
  - Kirishi-2 Oil Refinery
- Power generation
  - Kankunskaya HEPP

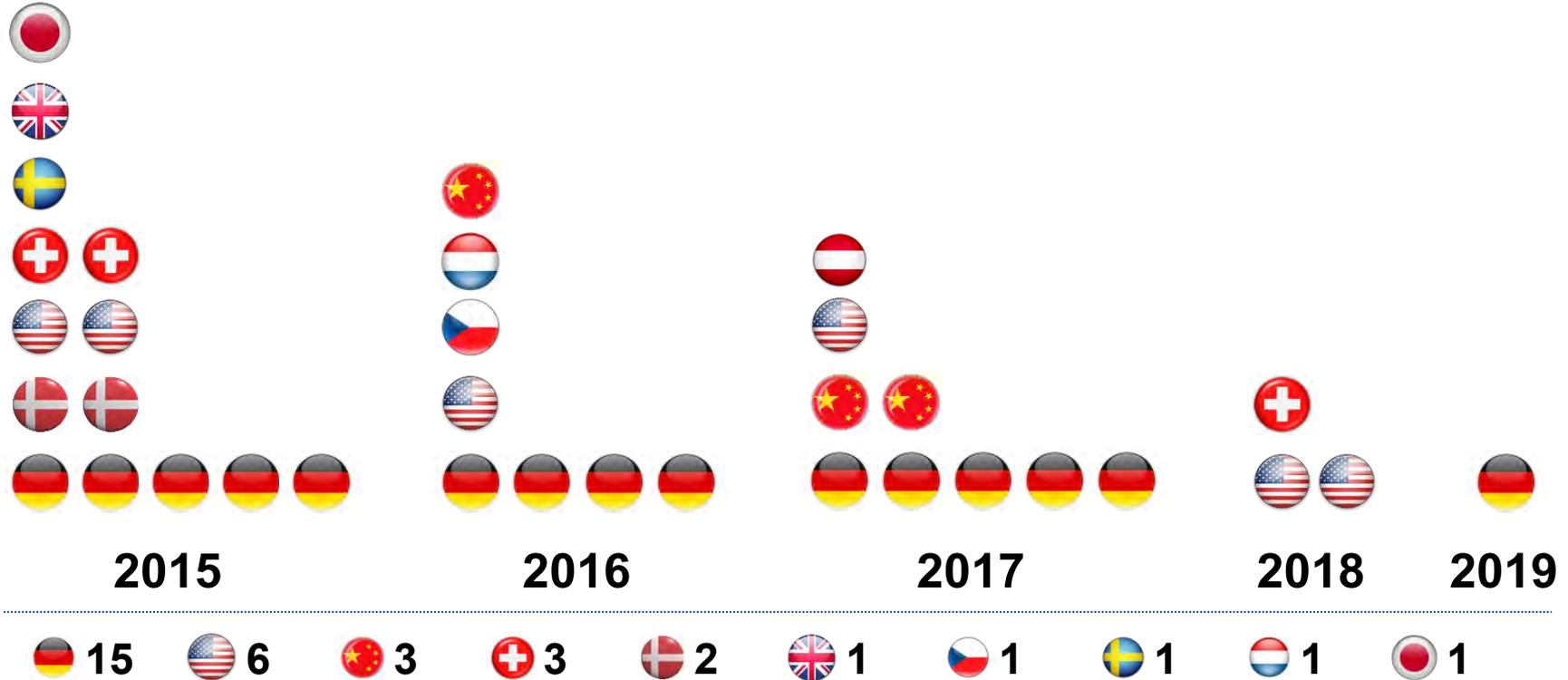


# Investment projects (7)

## Localisations, 2015 – 2019

*“Localisation continues despite the crisis”*

- 14 production sites were launched in the middle of the crisis
- Germany leads by number and size of investments
- Another 14 sites are active construction in progress



# Our industry-specific services (1)

- **Market research/ business partner search**, incl.
  - Sub-contractors, law firms, insurance providers
  - Support in obtaining SRO membership and permits
- **Company registration**, incl.
  - Legal and business address
- **Tax and legal services**, incl.
  - Intercompany agreement or internal debit notes to PE
  - Tax advice for managers (short- und mid-term stay) in Russia, annual tax returns
  - Tax and legal due diligence
  - Transfer pricing
- **Interim management**, incl.
  - General Director, head of branch or representative office
  - Risk management



# Our industry-specific services (2)

## — **Import services**, incl.

- Customs handling and consultation
- Consultation regarding appropriate customs value
- Certification
- Coordination with the logistics provider, DDP-services



## — **Accounting outsourcing**, incl.

- Financial accounting with focus on rules for mid- and long-term projects (IAS 11 and PBU 2)
- Transformation and reporting according to IFRS/US GAAP/HGB
- Payroll accounting with special knowledge about shift work, regional coefficients and corporate compensations
- Tax accounting with special rules for mid- and long-term projects



## — **IT services**, incl.

- System Admin set up and permanent help desk
- ERP systems implementation

# Appendix – Details of selected projects

# Details of selected projects

This document contains several examples of descriptions of investment projects. A more detailed version of the report is available upon request.

## High speed rail link Moscow – Kazan



- Planned investment RUR 1.2 trillion
- Key features of the Moscow-Kazan HSL Project:
  - Track length: 770 km
  - Travel time: 3 hours
  - Maximum speed: up to 400 km/h
  - Rail gauge: 1520 mm
- Main construction company:
  - JSC High-Speed Rail Lines
    - Mosgiprotrans, Nizhegorodgrazhdanniiproject, China Railway Eryuan Engineering Group Co. Ltd, PGUPS, VNIIZhT (design)
    - SYSTRA (France; electrification)
    - Vossloh AG and AO BET (rail fastening systems)
- Possible investors
  - Siemens/ German Initiative (approx. EUR 2 bn)



## Yamal LNG (1)

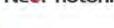


- Located on the Yamal Peninsula, above the Arctic Circle
- Utilizes the resources of the South Tambeiy Field
- Investment over RUR 680 billion
- Operated by JSC Yamal LNG, a joint-venture of NOVATEK (60%), TOTAL (20%) and CNPC (20%)
- The project includes:
  - Natural gas production (used ARKTIKA Drilling Rigs)
  - Construction of the Yamal LNG Plant
  - Liquefied gas storage
  - Construction of Port Sabetta
  - LNG shipping
  - Construction of power generation facility



## Localisations, 2015 – 2019 (1)



- |   |   |   |
|---|---|---|
|   |   | Factory for EPS and ABS Systems in Samara, opened in 2015, investment: EUR 26 million   |
|  |  | Harvester factory in Krasnodar, opened in 2015, investment: EUR 120 million   |
|  |  | Engine plant in Kaluga, opened in 2015, investment: EUR 250 million   |
|  |  | Machine building plant in Ulyanovsk, opened in 2015, investment: EUR 70 million   |
|  |  | Refrigerator and compressor production plant in Klimovsk (Moscow Region), opened in 2015, investment: not disclosed               |
|  |  | Drilling rigs production plant in Volgorechensk (Kostroma Region), opened in 2015, investment: RUR 4 billion                      |
|  |  | Production of photonic integrated circuits for telecommunications equipment in Moscow, opened in 2015, investment: USD 30 million |

- High speed rail link Moscow – Kazan
- Sheremetyevo Airport
- Domodedovo Airport
- Zhukovsky Airport
- Yamal LNG
- Power of Siberia
- Kirishi-2 Oil Refinery
- Kankunskaya HEPP
- Localisations, 2015 – 2019



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