Russia

Opportunities and barriers to inbound construction

G20 rankings & data

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<th>G20 heatmap rankings</th>
<th>Construction industry value</th>
<th>10</th>
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<td>Country financial health</td>
<td>Construction industry value</td>
<td>3</td>
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<tr>
<td>Construction industry, real growth</td>
<td>Announced spend on construction in next 3 years</td>
<td>3</td>
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<td>Budget balance</td>
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<td>14</td>
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<td>Country financial health</td>
<td>GDP/Head</td>
<td>10</td>
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<td>Credit ratings rank</td>
<td>8</td>
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<tr>
<td>Ease of doing business</td>
<td>Doing business overall rank</td>
<td>16</td>
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<td>Dealing with construction permits rank</td>
<td>19</td>
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<td>Business transparency rank</td>
<td>19</td>
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<td>Tax regime</td>
<td>BDO overall tax rank</td>
<td>6=</td>
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<td>World bank – paying taxes rank</td>
<td>16</td>
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Financial metrics

| Total fiscal stimulus announced | £bn |
| Announced spend on construction in the next 3 years including fiscal stimulus to construction | £150bn |
| Construction industry value – 2009 | £51bn |
| Main corporate tax rate | 24% |

Construction sector metrics

<table>
<thead>
<tr>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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</thead>
<tbody>
<tr>
<td>Construction industry value, £bn</td>
<td>35</td>
<td>42</td>
<td>51</td>
<td>60</td>
<td>69</td>
<td>77</td>
</tr>
<tr>
<td>Construction industry, real growth, per cent y-o-y</td>
<td>16.4</td>
<td>10.3</td>
<td>9.4</td>
<td>9.9</td>
<td>6.2</td>
<td>5.6</td>
</tr>
<tr>
<td>Construction industry, per cent of GDP</td>
<td>5.1</td>
<td>5.2</td>
<td>5.3</td>
<td>5.6</td>
<td>5.6</td>
<td>5.7</td>
</tr>
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BDO review of tax

- One of the lowest headline corporate tax rates
- Thin capitalisation restrictions can disallow interest costs in a wide range of circumstances
- Tax depreciation regime is comparable with many other countries
- A number of useful local tax incentives apply in certain locations

Overall scoring

6/10
6= out of the G20

BDO ease of doing business

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<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
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<tbody>
<tr>
<td>Very easy</td>
<td>Quite easy</td>
<td>Average</td>
<td>Quite difficult</td>
<td>Very difficult</td>
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</tbody>
</table>

Top construction firms

PIK, LSR, Inteko, Glavstroy, Systema-GALS,
Transstroy, Glavmoststroy, DSK-1, SU-155,
Moststroyekhantaiyi, Centerdorstroy,
Mosinzhstroy, Mostotrest, Sibmost,
BAMtunnelstroy are among Russian large-scale construction companies. International companies such as Strabag, Enka, Vinci also operate across Russia.

Existing relationships between owners of some companies and some officials give significant competitive advantages for those companies, and can make entrance into the Russian construction market for the first time difficult.
“We consider that because Russia’s corporate taxation rate is lower than any of the other European nation in the G20, our competitive construction sector tax rating is merited despite its somewhat complex tax filing system.”

Richard Kelly
Partner, Head of Construction

Opportunities and barriers

 Ranked 16th overall in our G20 heatmap. Despite a challenging environment for inbound companies, there remain some opportunities, especially in the growing road sector.

 Russia’s construction industry is worth £42.3bn. Today, construction workers make up approximately 9.64 per cent of Russia’s total workforce. The Russian construction industry is home to more than 130,000 organisations and enterprises, which include 114,000 construction companies and 9,000 producers of building materials. 97 per cent of all companies are small-scale enterprises – each with fewer than 50 employees. Construction growth has been slipping in Russia since it reached its peak of year on year growth in 2007 (16 per cent), mainly because of the global financial turmoil.

 The construction industry is largely centred around Russia’s major cities, Moscow and St. Petersburg.

 Year-on-year growth of the construction sector is forecast to fall to 5.7 per cent by 2012, from a high of just under 10 per cent in 2010. The announcement that Sochi will host the 2014 Winter Olympics has given the construction sector a boost. Russian government officials estimate that more than £7.2bn will be required to develop Sochi’s transport system in time for the 2014 Winter Olympics.

 The Russian government has announced plans to spend about $1tn (£728bn) over the next 10 years to improve infrastructure. Russia’s Prime Minister Vladimir Putin has reiterated the government’s commitment to invest $314bn in transport infrastructure to 2015, with the government contributing around 50 per cent of this. Though with confidence among private investors waning, this now seems a challenging target. The road sector is seen as a major priority and includes the expansion of the country’s roads by 17,000km, which includes, for example, the £632m contract to build a 19.5km section of the highway that will connect the Moscow Ring Road to the Moscow-Minsk highway.

 There are plans to increase Russia’s railway network by 3,000km. There are plans to construct 100 airport runways, and upgrades of ports are also planned to allow annual cargo capacity to reach 400m tonnes.

 The Russian PPP market is potentially very large. One of the smallest current PPP roads in Russia, the Orlovsky Tunnel in St Petersburg, at around $1bn (£728m) is still substantially bigger than the largest road PPP in relatively mature markets such as Germany – the A1 at €472m (£489m). Given that the first projects being developed are mostly in the transport and, to a lesser extent, the utility sector, there is scope for future use of PPPs to develop other social infrastructure.

 Reasons Russia is attractive for inbound construction activity

• The state federal programmes such as development of road construction exist, and can be considered as a stable source of cash flow for involved firms.

• The Russian PPP market is potentially enormous. The first projects being developed are mostly in the transport and, to a lesser extent, the utility sector; there is scope for future use of PPPs to develop other social infrastructure.

 Barriers/challenges to construction activity

• High levels of corruption and the Yukos affair highlighted the risk of rising government interference in business.

• The economy is expected to contract by -4 per cent in 2009. With Urals oil set to average just under £29 per barrel over the course of the year, the country’s external and fiscal dynamics are set to worsen considerably. The current account, which has posted large surpluses since 1999, is forecast to fall into deficit by 2010.

• The growth rate of the construction industry is falling.

• For inbound companies, the situation remains hampered by red tape, restrictions in the energy sector, protectionism and creeping state involvement in several sectors of the economy.

• The government requires approval by the respective ministry or state agency responsible for any foreign investment project that exceeds RUB100m (£2m).

 BDO viewpoint and advice

 Pitfalls to avoid when doing business in Russia

• High levels of corruption can bring many pitfalls.

• Not having an understanding of the myriad of regulations affecting the industry.

 Practical advice for inbound construction activity

• If an international company intends to operate across Russia it should establish a Russian legal entity. A representative office of an international company is not allowed to conduct business operations within Russia.

• Ensure local experts are engaged to understand local market conditions.

• Entry into Russia can be eased by establishing strategic relationships with local companies.

 Useful tax and other incentives for inbound construction activity

Main depreciation rates:

• Buildings – Tax depreciation must be claimed on a straight line basis over the useful life.

• Other tangible assets – may be depreciated on either a straight line or a declining balance method, in pools grouped according to their useful life (in ten groups from 1 year to 30 years).

Other incentives:

• A number of tax incentives are available at a regional level, including a potential exemption from property taxes in some areas of Russia.