Overview of Stevedoring Sector in Russia in 2016

With the support of:
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Introduction

The stevedoring sector is an integral link in the international trade chain. Around 60% of Russia’s cargo imports and exports are processed in seaports¹. The balanced and timely development of port infrastructure should improve the competitiveness of Russian exports on the global market.

The stevedoring sector has been developing impressively over the last 16 years: between 2000 and 2016 the cargo turnover of Russian seaports increased almost four-fold. Moreover, it is forecast to increase by another 14%-18% by 2020². EY closely monitors the current processes. We prepared this report with the support of the Association of Commercial Seaports in order to analyze expert opinions about further development of the sector, key constraints, and sources of financing for investment projects.

We conducted a market survey for this report to learn respondents’ opinions on a number of key issues. The survey covered 26 companies, including stevedoring holding companies, stevedoring operating companies, and raw material suppliers who own cargo terminals in seaports.

Among respondents were top managers, including CEOs, CFOs, Sales Directors, Strategy Directors, and Logistics Directors.

We thank all the participants for sharing their opinions, and we hope this overview will be of use to both them and a wider range of investors.

¹ https://customs.news/porty-rossii-obespechivayut-60-ved-strany/
² According to Federal Target Program “Development of the Transportation System in Russia (2010-2020)” as amended on 27 February 2017
Current Market Positions of Russian Seaports

International trade is the main driver behind the development of the port industry. Around 90% of cargo is transported by sea\(^3\). The US and China were the leading countries in terms of foreign trade turnover in 2016 ($3.7 trillion each), while Russia’s turnover was around $0.5 trillion.

Foreign trade turnover in Russia declined by 11.4% YoY in dollar terms in 2016\(^4\), which was mostly due to the reduced exports in monetary terms because of low raw materials prices. In volume terms, however, exports of Russia’s main products, coal and oil, increased by 9.6% and 4.2%, respectively. Since raw material exports account for the majority of cargo turnover in Russian seaports, the positive trend in volume terms helped sustain the growth in overall cargo turnover.

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4. Central Bank of Russia
As well as foreign trade volumes, the cargo turnover and concentration of seaports in any particular country are impacted by the length of the coastline, the location of the manufacturers, and internal logistical routes, which determine whether transit cargo flows can be serviced. Despite comparable foreign trade volumes, the coastline in China is 37% shorter than that of the USA (14.5 thous. km vs 19.9 thous. km). The above factors explain why most of the giant ports, including Ningbo, Tianjin, Shanghai, and Qingdao (with cargo flows of over 500 million tons per annum), are located in China.

Russia’s foreign trade volume is about one-seventh of China’s, while the coastline is 54% longer (22.4 thous. km vs 14.5 thous. km). These factors in particular explain why Russia has no giant seaports with cargo turnover comparable to the largest seaports of China. Nevertheless, the scale of the main ports in Western Russia is comparable to the largest ones in Europe, and Russia’s port industry as a whole is extremely promising in terms of opportunities for both increasing foreign trade volumes and developing internal logistics routes to service transit cargo flows.

The largest volume of cargo in Russia in 2016 (131 million tons) was processed by Novorossiysk commercial seaport, which ranked fourth amongst European ports. Moreover, the cargo turnover steadily increased between 2014 and 2016.

The new port of Ust-Luga has also steadily increased cargo turnover, having captured volumes from Big port Saint Petersburg, which, in turn, had recorded a declining trend. It is worth noting that the combined cargo turnover of Ust-Luga port and Big port Saint Petersburg increased by 1.4% in 2016, while the largest seaport in Europe, Rotterdam, posted a decline of 1.1%.

As of year-end 2016, the Register of Seaports in Russia included 67 seaports, located along the seashores of 12 seas that lead to three oceans as well as the Caspian Sea. In geographical terms, Russian seaports are located in five sea basins (Baltic, Azov-Black Sea, Caspian, Arctic, and Far Eastern).

The three largest seaports in Russia in terms of transhipment volumes in 2016 were Novorossiysk (38.6 million tons of dry cargo and 92.8 million tons of liquid cargo), Ust-Luga (30.9 million tons of dry cargo and 62.5 million tons of liquid cargo), and Vostochny (35.8 million tons of dry cargo and 32.7 million tons of liquid cargo).

Sources: ACS, data of foreign ports

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5 https://www.cia.gov/library/publications/the-world-factbook/
7 Source: Seaports, No. 2, 2017
Largest Seaports of Russia in Terms of Cargo Transhipments, 2016

### Azov-Black Sea basin

<table>
<thead>
<tr>
<th>No.</th>
<th>Seaport</th>
<th>Liquid cargo, million tons</th>
<th>Dry cargo, million tons</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Novorossiysk</td>
<td>92.8</td>
<td>38.6</td>
</tr>
<tr>
<td>2</td>
<td>Kavkaz</td>
<td>12.6</td>
<td>20.6</td>
</tr>
<tr>
<td>3</td>
<td>Tuapse</td>
<td>16.3</td>
<td>8.9</td>
</tr>
<tr>
<td>4</td>
<td>Taman</td>
<td>10.7</td>
<td>2.8</td>
</tr>
<tr>
<td>5</td>
<td>Rostov-on-Don</td>
<td>3.8</td>
<td>9.2</td>
</tr>
<tr>
<td>6</td>
<td>Azov</td>
<td>0.4</td>
<td>6.2</td>
</tr>
</tbody>
</table>

### Baltic basin

<table>
<thead>
<tr>
<th>No.</th>
<th>Seaport</th>
<th>Liquid cargo, million tons</th>
<th>Dry cargo, million tons</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Ust-Luga</td>
<td>62.5</td>
<td>30.9</td>
</tr>
<tr>
<td>8</td>
<td>Primorsk</td>
<td>64.4</td>
<td>-</td>
</tr>
<tr>
<td>9</td>
<td>Big port Saint Petersburg</td>
<td>6.54</td>
<td>42.1</td>
</tr>
<tr>
<td>10</td>
<td>Vysotsk</td>
<td>11</td>
<td>6.1</td>
</tr>
<tr>
<td>11</td>
<td>Kaliningrad</td>
<td>2.4</td>
<td>9.3</td>
</tr>
</tbody>
</table>

### Caspian basin

<table>
<thead>
<tr>
<th>No.</th>
<th>Seaport</th>
<th>Liquid cargo, million tons</th>
<th>Dry cargo, million tons</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>Makhachkala</td>
<td>2.8</td>
<td>0.4</td>
</tr>
<tr>
<td>13</td>
<td>Astrakhan</td>
<td>0.03</td>
<td>2.6</td>
</tr>
</tbody>
</table>

### Arctic basin

<table>
<thead>
<tr>
<th>No.</th>
<th>Seaport</th>
<th>Liquid cargo, million tons</th>
<th>Dry cargo, million tons</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>Murmansk</td>
<td>11.4</td>
<td>22</td>
</tr>
<tr>
<td>15</td>
<td>Varandey</td>
<td>8</td>
<td>-</td>
</tr>
<tr>
<td>16</td>
<td>Sabetta</td>
<td>2.8</td>
<td>-</td>
</tr>
<tr>
<td>17</td>
<td>Dudinka</td>
<td>1.2</td>
<td>-</td>
</tr>
</tbody>
</table>

### Far-Eastern basin

<table>
<thead>
<tr>
<th>No.</th>
<th>Seaport</th>
<th>Liquid cargo, million tons</th>
<th>Dry cargo, million tons</th>
</tr>
</thead>
<tbody>
<tr>
<td>18</td>
<td>Vostochny</td>
<td>32.7</td>
<td>35.8</td>
</tr>
<tr>
<td>19</td>
<td>Vanino</td>
<td>2.3</td>
<td>27.9</td>
</tr>
<tr>
<td>20</td>
<td>Nakhodka</td>
<td>6.6</td>
<td>16.7</td>
</tr>
<tr>
<td>21</td>
<td>Prigorodnoye</td>
<td>16.4</td>
<td>-</td>
</tr>
<tr>
<td>22</td>
<td>Vladivostok</td>
<td>3.1</td>
<td>11.3</td>
</tr>
<tr>
<td>23</td>
<td>DeKastri</td>
<td>11.3</td>
<td>0.2</td>
</tr>
<tr>
<td>24</td>
<td>Posyet</td>
<td>1</td>
<td>7.2</td>
</tr>
<tr>
<td>25</td>
<td>Shakhtersk</td>
<td>-</td>
<td>4</td>
</tr>
</tbody>
</table>

Sources: Seaports, No. 2, 2017, EY analysis.
Cargo Transhipment Trends in Russian Seaports

The increase in cargo transhipment volumes across Russian seaports in 2009-2013 was largely in line with the growth of international sea trade. Further, despite the negative Russian GDP growth, it has even exceeded the global growth level since 2014. Moreover, the increase in cargo transhipment volumes across Russian seaports has outperformed the increase in Russian exports as a whole.

Thus, Russia’s stevedoring sector demonstrated steady positive growth in cargo handling in 2009-2016. Over that period, cargo transhipment volumes across Russian seaports increased by almost 1.5 times, from 496 million tons to 722 million tons.

It is worth noting that the increase in dry cargo transhipment volumes has significantly outperformed that of liquid cargo. This trend is due to the more than two-fold increase in coal transhipment in Russian seaports in 2009-2016, while crude oil transhipments barely increased in

Accumulative Growth Indices in 2009-2016, %

Sources: Rosstat, Oxford Economics, Clarkson research, EY analysis.

Cargo Transhipment in Russian Seaports in 2009-2016, million tons

Source: Rosstat
2009-2015, starting to grow steadily only in 2016. Moreover, Russian seaports saw a 60%-70% increase in the transhipment volumes of other types of dry cargo, including grain, mineral fertilizers, and containers compared with 2009.

Cargo turnover across Russian seaports increased by 6.7% in 2016 to reach 722 million tons. Like in previous years, the increase was mostly due to the increased transhipment of export raw materials: coal (by 13.0 million tons) and crude oil (25.9 million tons).

The coal transhipment volumes mostly increased due to the Far Eastern seaports' cargo to the Asia-Pacific Region.

The new projects which helped significantly increase crude oil exports YoY in 2016 include the transhipment centre in the harbor waters of Murmansk seaport (+8.8 million tons) and the first oil from the Novoportovsk oil and gas condensate deposit (+2.8 million tons).

The increasing crude oil transhipment volumes along with the shrinking oil product transhipment volumes is due to the so-called ‘tax maneuver’. According to its parameters, the export rate is 30% of the crude oil rate for light oil products, and 100% for dark ones. In the medium term, the rates should motivate oil companies to increase the oil refining depth. However, not all oil refineries have yet managed to fully modernize their facilities.

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**Cargo Turnover Growth across Russian Seaports in 2016 vs 2015 by Cargo Type, million tons**

<table>
<thead>
<tr>
<th>Cargo Type</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>650</td>
<td>677</td>
</tr>
<tr>
<td>Mineral fertilizers</td>
<td>660</td>
<td>670</td>
</tr>
<tr>
<td>Grains</td>
<td>670</td>
<td>677</td>
</tr>
<tr>
<td>Ore</td>
<td>680</td>
<td>687</td>
</tr>
<tr>
<td>Timber</td>
<td>690</td>
<td>697</td>
</tr>
<tr>
<td>Container cargo</td>
<td>697</td>
<td>704</td>
</tr>
<tr>
<td>Other dry cargo</td>
<td>700</td>
<td>707</td>
</tr>
<tr>
<td>Crude oil</td>
<td>707</td>
<td>714</td>
</tr>
<tr>
<td>Oil products</td>
<td>714</td>
<td>721</td>
</tr>
<tr>
<td>Other liquid cargo</td>
<td>721</td>
<td>728</td>
</tr>
</tbody>
</table>

Sources: ACS, EY analysis

**Distribution of Transhipment Volumes across Russian Seaports by Cargo Type**

<table>
<thead>
<tr>
<th>Cargo Type</th>
<th>2009</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil</td>
<td>496</td>
<td>722</td>
</tr>
<tr>
<td>Container cargo</td>
<td>496</td>
<td>722</td>
</tr>
<tr>
<td>Ore</td>
<td>496</td>
<td>722</td>
</tr>
<tr>
<td>Oil products</td>
<td>22%</td>
<td>22%</td>
</tr>
<tr>
<td>Grains</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Metals</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Other dry cargo</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Coal</td>
<td>19%</td>
<td>19%</td>
</tr>
<tr>
<td>Other liquid cargo</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Mineral fertilizers</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Sources: ACS, EY analysis

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8 https://ria.ru/economy/20170101/1485051739.html
Given this, the levelling of duties on crude oil and dark oil products has made crude oil a more profitable export than dark oil products.

Overall, the cargo structure in Russian seaports in 2016 has remained unchanged since 2009 – the total share of coal, crude oil and oil products is around 70%.

At the same time, we highlight the increasing share of coal transhipment and falling share of crude oil, which reflects the export trends from Russia for these commodity items: since 2009, coal exports from Russia have increased by 61%, compared with just 3% for crude oil.

The bulk of coal and crude oil is exported from Russia by sea. The percentage of volumes transhipped in Russian seaports to total export volumes is rising. This stems from the increased share of coal and crude oil supplies to the Asia-Pacific region, which are mostly carried by sea, as well as the reduced transhipment of Russian cargo through the seaports of Ukraine and the Baltic countries.

**Largest Market Players in Russia, 2016**

Companies operating on the Russian stevedoring market vary in scale, business structure and cargo specialization. Some are part of vertically-integrated holdings transhipping predominantly the cargo exported by the respective holding. Others are not part of vertically-integrated holdings but consolidate assets for the transhipment of one or two types of cargo for third-party companies. A third company type consolidates a portfolio of separate stevedoring companies, performing transhipments of all types of cargo. And a fourth type consists of small stevedoring companies transporting a specific type of cargo within just one port. With the sector growing, most of the large stevedoring companies increased the cargo volumes they handle at their terminals in 2016.

The largest dry cargo volume in 2016 (41.6 million tons) was transhipped by the stevedoring holding company Managing Port Company OOO (UK Kuzbassrazrezugol), which consolidates the largest specialized coal terminals: Rosterminalugol AO (Ust-Luga, Leningrad region) and Vostochny Port AO (Vrangel bay, Primorsky Krai). The cargo portfolios...
of Rosterminalugol AO and Vostochny Port AO are secured by contracts with coal producers from various Russian coal basins.

SUJEK AO ranks second in terms of dry cargo volumes. It transmitted 37.4 million tons of coal in 2016 through its terminals Murmansk Commercial Seaport PAO, Daltransugol AO (Vaninsky bulk terminal), and Stevedoring Company Maly Port OOO.

It is followed by general logistics groups NCSP PAO and UCL Holding, which handled 33.3 million and 26.9 million tons of dry cargo, respectively.

Despite the recovery in emerging markets (transhipment of containerized cargo in Russia in 2016 was +6.5%), Global Ports, which specializes in the transhipment of containerized cargo in Russia, demonstrated a reduction of volumes by 9.7%. Due to the toughening competition, Global Ports’ transhipment volumes in the Baltic seaports declined by 15.0%. This reduction was partially compensated by the increased transhipments in Vostochny seaport of the Far Eastern basin.

The share of total dry cargo transhipment volumes of the 10 largest companies in 2016 was around 61%. However, no clear conclusions can be drawn about the degree of consolidation or competition based on this breakdown, as these companies deal with various types of cargo, with each having its own market structure.

In particular, the coal transhipment sector is dominated by major vertically-integrated coal producers UK Kuzbassrazrezugol, SUJEK AO, Mechel PAO, and EVRAZ, whose combined share is around 77% of coal transhipped in Russia. These companies consolidate the largest specialized coal terminals in Russia, through which they export their own coal above all.

Mineral fertilizers in Russian seaports are almost fully transhipped by stevedoring companies belonging to the three largest fertilizer producers: MCC EuroChem AO, Uralkali PAO, and PhosAgro PAO. These companies’ shares of total mineral fertilizer transhipment volumes in Russia in 2016 were 47%, 41%, and 12%, respectively. These companies’ bulk terminals are located in various seaports of the Azov-Black Sea, Baltic, and Arctic basins: MCC EuroChem AO - in the Tuapse and Murmansk seaports, Uralkali PAO - in Big port St. Petersburg, and PhosAgro PAO - in Ust-Luga. At the same time, the transhipment of Russian fertilizers through competitor seaports in the Baltic countries increased by 7.8% in 2016 to reach 7.4 million tons (around 46% of all fertilizer transhipment volumes in Russian seaports), which can be regarded as volumes to be potentially rerouted via Russian seaports.

Containerized cargo is mostly transhipped at the terminals of Global Ports, NCSP PAO, FESCO, UCL Holding, and DeloPorts, whose share of overall containerized cargo turnover is around 74%. Global Ports is the largest specialized holding company for transhipping containerized cargo, with a share in Russia of around 30%.

The four largest specialized grain terminals in Russia are Novorossiysk Grain Terminal AO (NCSP PAO), Novorossiysk Grain Plant PAO (United Grain Company AO), KSK Grain Terminal AO (DeloPorts), and Taman Grain Terminal Handler OOO (Glencore).

In 2016, their total share was 37%. The first three tranship grain at Novorossiysk seaport, and the fourth does so at Taman seaport. Around 40% of grain is transhipped by relatively small companies to river barges and river-sea vessels in small ports of the Azov-Black Sea basin (Rostov-on-Don, Azov, Yeisk, Taganrog, and Temryuk) and Volga-Don (Kamyshin, Bagaevskaya, and Kalach-on-Don).

In 2016, the 10 largest companies in liquid cargo transhipment volumes in Russia accounted for around 84% - the list comprises major enterprises engaged in the production and transportation of crude oil and oil products.

The largest company in Russia in terms of liquid cargo transhipment (29%) is NCSP PAO (controlled by Transneft PAO and Summa Group), which consolidates oil-loading facilities in Novorossiysk and Primorsk seaports. NCSP PAO transhipped 112.9 million tons of liquid cargo in 2016 (+5.1% YoY). Meanwhile, the share of liquid cargo transhipped via Baltic countries is declining.

The transhipment of Russian liquid cargo in the seaports of the Baltic countries fell by almost a half over the year - from 19.8 million tons in 2015 to 10.1 million tons in 2016. Around 9 million tons of oil products are exported via Baltic seaports by Transneft PAO. According to the company, all of the cargo flows will be rerouted through Russian seaports such as Ust-Luga, Primorsk, and Novorossiysk by 2018.

New oil-loading facilities commissioned in 2016 include RPK NORD OOO and Gazpromneft-Yamal OOO.

**Structure of Liquid Cargo Transhipment in Russia by Company, 2016, % of Total in Natural Terms**

<table>
<thead>
<tr>
<th>Company</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Novorossiysk Commercial Sea Port PAO (NCSP)</td>
<td>29%</td>
</tr>
<tr>
<td>Transneft PAO (excluding NCSP)</td>
<td>16%</td>
</tr>
<tr>
<td>Nevskaya Truboprovodnaya Kompaniya OOO</td>
<td>12%</td>
</tr>
<tr>
<td>Ust-Luga Oil AO</td>
<td>8%</td>
</tr>
<tr>
<td>LUKOIL PAO</td>
<td>6%</td>
</tr>
<tr>
<td>Rosneft Oil Company PAO</td>
<td>5%</td>
</tr>
<tr>
<td>Gazprom PAO</td>
<td>4%</td>
</tr>
<tr>
<td>Exxon Neftegas Limited</td>
<td>4%</td>
</tr>
<tr>
<td>SVL Marine Transit Services OOO</td>
<td>3%</td>
</tr>
<tr>
<td>OTEKO AO</td>
<td>3%</td>
</tr>
<tr>
<td>Others</td>
<td>2%</td>
</tr>
</tbody>
</table>

Sources: Seaports, No. 2, 2017, companies’ public data, EY analysis

10 [http://www.tks.ru/logistics/2017/06/02/0006](http://www.tks.ru/logistics/2017/06/02/0006)
RPK NORD OOO owns Umba VLCC, which is used in the Murmansk seaport waters for off-shore transhipment of Gazpromneft PAO's Russian Arctic crude oil produced at the Novoportovsk oil and gas condensate deposit (Yamal) and the Prirazlomnoye field. Deliveries from the Novoportovsk deposit commenced in May 2016. Crude oil output was 2.8 million tons in 2016. It is expected to reach 6.3 million tons by 2018.

Cargo Turnover across Russian Sea Basins

The volumes of cargo transhipment in Russia vary strongly across different sea basins. At the same time, the transhipment of specific types of cargo is located in particular sea basins. This stems from the geographic location of production facilities and the specific nature of the logistical routes connecting cargo shippers and cargo receivers. Thus, the majority of metals and grain is transhipped through the seaports of the Azov-Black Sea basin; containerized cargo and mineral fertilizers are mostly transhipped through the Baltic basin; coal, liquified gas and timber are mostly transhipped through the Far Eastern basin; crude oil is mostly transhipped through the Baltic, Azov-Black Sea and Far-Eastern basins; and oil products are mostly transhipped through the Baltic and Azov-Black Sea basins.

Most cargo volumes are transhipped via the seaports of the Azov-Black Sea (33.8%), Baltic (32.8%), and Far-Eastern (25.7%) basins. Their combined share was 92.3% in 2016. The share of seaports in the Arctic basin was 6.9%, while that of the Caspian basin was below 1%.

Although the volumes of cargo transhipment across Russian seaports steadily increased in 2009-2016 at an average rate of approximately 5.5% per annum, the trends were different across the sea basins.

Cargo transhipment volumes in the seaports of the Azov-Black Sea and Baltic basins increased by 43% and 39%, respectively, over 2009, which was approximately the same as the overall Russian rate.

Cargo turnover in the seaports of the Far-Eastern basin grew at above-market rates, and almost doubled versus 2009. This result was achieved primarily due to
the increased transhipment of exports by Russia’s largest coal producers to the Asia-Pacific countries, as well as of Russian crude oil ESPO from the oil-loading port of Kozmino. Since its commissioning in 2009, the cargo turnover of Transneft - Kozmino Port OOO has doubled, and amounted to 31.8 million tons of crude oil in 2016.¹⁴

The decreasing crude oil transhipment volumes in 2009-2014 resulted in a reduction in cargo turnover at the seaports of the Arctic basin, but the trend reversed in 2016. In line with the Development Strategy of the Arctic Zone of Russia to 2020, as well as given the expanding operations of oil and gas companies in the Arctic and Yamal regions, we can expect steady growth of the Northern Sea Route in the medium term and a persistent positive trend in cargo turnover.

Cargo turnover in the seaports of the Caspian basin continues to decrease, having declined by 39% since 2009. This is due to the reduced transit of crude oil produced in the Eastern Caspian regions - crude oil suppliers are redirecting their traffic flows to Azerbaijan and Georgia. Along with this, the transhipment volumes of dry cargo at Caspian seaports (mostly grain and metals) are stable, and fall within the range of 3.0 to 3.5 million tons per annum. The development of the Caspian seaports is complicated by their geographical position: due to the particular nature of the Caspian Sea, the transhipment volumes depend solely on the trade volumes between the Caspian states. The future of the Caspian basin is likely linked to the development of the International North-South Transport Corridor which connects the Baltic countries with India and Iran. The sea route connecting Central Asia with the Azov Sea, which is part of the world ocean, travels through the Volga and Don rivers and the Volga-Don canal. The fairway section of the rivers and canal from the Caspian to Azov Sea is around 1,100 km long, and the tonnage of vessels is limited (the guaranteed depth of the canal is around 4 m). As of today, these factors severely undermine the competitiveness of the Caspian seaports in international trade compared with the seaports of the Azov-Black Sea basin.

¹⁴ http://tass.ru/tek/3946177
Development Prospects

According to the Association of Commercial Seaports (ACS), the capacity of transhipping complexes in Russia across all types of cargo in 2016 increased by 3.8% YoY\(^1\) to 967 million tons\(^2\). In absolute terms, the increase was 36 million tons, which is 3 million tons higher than the target for 2016 stipulated by the Federal Target Program “Development of the Russian Transport System (2010-2020)\(^3\). According to the ACS forecast, stevedoring capacity is to increase by another 37 million tons in 2017 to reach 1,004 million tons\(^4\).

The accumulative capacity increase in 2016-2017 - based on actual data for 2016 and the ACS forecast for 2017 - is around 72 million tons, which is in line with the increase assumed for the period in the FTP. In 2018-2020, the FTP envisages a further capacity increase of 136 million tons. According to the FTP, therefore, the capacity of transhipment complexes in Russia across all types of cargo may increase by 173 million tons by 2020 compared with 2016, to reach 1,140 million tons.

Compared with the previous version of the FTP of 5 October 2015, the forecast capacity increase by 2020 has been reduced by 25.7 million tons. This primarily stems from the more conservative forecast of global demand for raw materials.

According to our survey, the sector participants have fairly positive expectations, and have adopted strategies aimed at further growth.

When asked about medium-term strategic goals, the majority of those surveyed (over 70%) highlighted, in addition to upgrading worn-out equipment and improving the quality of services, widening

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3. As amended on 27 February 2017
stevedoring capacity at existing terminals. Nevertheless, around 15% intend to reduce production capacity, which is due to the surplus containerized cargo transhipment capacity that appeared in 2016.

EY has compared the measures outlined in the FTP “Development of the Russian Transport System (2010-2020)” with relevant public information on projects under development in the stevedoring sector.

Under the best-case scenario, if all the port projects currently being implemented at different stages are completed within the stipulated time-frames, the increase in transhipment capacity between 2017 and 2022 may come to 319 million tons according to EY estimates (271 million tons for dry cargo and 48 million tons for liquid cargo) as well as 7.5 million TEU. This increase is 1.8 times higher than the target growth in capacity stipulated by the FTP “Development of the Russian Transport System (2010-2020)”. Excluding from the calculations those projects whose likelihood of postponement according to EY estimates is fairly high, the increase may amount to 175 million tons (139 million tons for dry cargo and 36 million tons for liquid cargo), as well as 4.5 million TEU, which is approximately in line with the FTP target.

Two large-scale projects have been announced for Taman seaport: the construction of a bulk cargo terminal which is fully funded by NCSP PAO¹⁹, and the construction of a new dry-cargo district by a public private partnership (the expected strategic investor is NCSP PAO). These projects are expected to increase dry cargo transhipment capacity in the Azov-Black Sea basin by 82 million tons, which the respondents believe may lead to a capacity surplus for handling bulk cargo in the region.

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¹⁹ http://www.oteko.ru/about/

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Which priority strategic tasks did your company tackle in 2016 / will be tackling in the medium term?

<table>
<thead>
<tr>
<th>Strategic Task</th>
<th>2016</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upgrading worn-out equipment</td>
<td>85%</td>
<td>81%</td>
</tr>
<tr>
<td>Improving service quality</td>
<td>81%</td>
<td>81%</td>
</tr>
<tr>
<td>Expanding stevedoring capacity at existing terminals</td>
<td>62%</td>
<td>73%</td>
</tr>
<tr>
<td>Offering additional services at stevedoring terminals</td>
<td>54%</td>
<td>58%</td>
</tr>
<tr>
<td>Cutting operational costs</td>
<td>62%</td>
<td>54%</td>
</tr>
<tr>
<td>Reducing the debt load and achieving financial flexibility</td>
<td>31%</td>
<td>35%</td>
</tr>
<tr>
<td>Integrating the stevedoring business into related transportation and logistics business</td>
<td>31%</td>
<td>35%</td>
</tr>
<tr>
<td>Reducing capacity, selling assets</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Constructing new stevedoring terminals</td>
<td>4%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Transhipment Capacity Increase in 2017-2022, million tons

<table>
<thead>
<tr>
<th>Capacity as of year-end 2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>FTP targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulk cargo terminal in Taman seaport</td>
<td>967</td>
<td>+35</td>
<td>+47</td>
<td>+122</td>
<td>+49</td>
<td>+38</td>
<td>+10</td>
</tr>
<tr>
<td>Construction of a new dry cargo district in Taman seaport</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Coal transhipment projects</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Transhipment projects for crude oil, oil products, LHC, and LNG</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Grain transhipment projects</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mineral fertilizers transhipment projects</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other projects</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Forecast capacity by 2020-2022</td>
<td>1,286</td>
<td>1,400</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FTP targets</td>
<td>1,140</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: FTP “Development of the Russian Transport System (2010-2020)”, companies’ public data, information agencies, EY analysis
Key Investment Projects across Russian Seaports with Commissioning Term Falling Between 2017 and 2022

**Baltic basin**

- Further development of the Bronka transhipment complex in Big port Saint Petersburg
- Construction of a transhipment oil-loading complex in Primorsk port
- Reconstruction of the container terminal in Kaliningrad seaport
- Construction of a coal terminal in Vysotsk port
- Construction of a terminal for LNG production and transhipment in Vysotsk port

**Azov-Black Sea basin**

- Construction of a new dry cargo district in Taman seaport
- Implementation of a comprehensive project by OTEKO AO to construct various terminals in Taman seaport
- Third-stage of the construction of Taman Grain Terminal Handler OOO
- Construction of a terminal for the transhipment of ammonia and carbamide in Taman seaport
- Reconstruction of and addition to NCSP PAO's capacity in Novorossiysk seaport
- Increased KSK grain terminal capacity in Novorossiysk seaport
- Increased NUTEP container capacity in Novorossiysk seaport
- Construction of a grain terminal in Azov seaport

**Arctic basin**

- Development of the Murmansk transport hub, construction of a coal terminal
- Construction of an LNG terminal in Sabetta seaport
- Construction of a coal terminal in Beringovsky seaport
- Construction of a coal terminal in Dikson seaport

**Far-Eastern basin**

- Third-stage of the construction of a coal complex by Vostochny Port AO in Vostochny seaport
- Construction of the Sever coal terminal in Vostochny seaport
- Construction of the Sakhatrans coal terminal in Vanino seaport (Muchke bay)
- Construction of a coal terminal in Vanino seaport (Burny cape)
- Construction of an alumina transhipment terminal in Vanino seaport
- Construction of a coal terminal in Vera seaport
- Construction of an LHCG terminal in Sovetskaya Gavan seaport
- Construction of grain terminals in Zarubino seaport

According to EY estimates, all the planned projects, if implemented, will increase transhipment capacity by 319 million tons, together with 7.5 million TEU, in the period from 2017 until 2022.

Source: companies' public data, FTP, EY analysis
Moreover, OTEKO AO intends to build a new logistics hub in Taman seaport by 2019 for the transhipment of 14.5 million tons of grain crops and soybeans, raw sugar and soybean oil meal\(^{20}\). According to the declared plans, the overall increase in specialized grain terminal capacity at the Azov-Black Sea ports is planned at 32 million tons, which is comparable to current grain exports from Russia. Moreover, Zarubino port in the Primorsky Krai intends to build specialized grain terminals by 2020 with total capacity of around 6 million tons. They are expected to service export cargo flows from Siberia and the Russian Far East, as well as transit cargo flows from the north-eastern provinces of China to southern ones.

The planned capacity addition for transhipping crude oil, oil products, LHCG and LNG by 2021 is 49 million tons. The extra capacity for these types of cargo has been calculated based on the plans of the oil companies to increase their exports via Russian seaports. We highlight in particular the especially large project to construct an LNG terminal in Sabetta port, which should increase the transhipment of LNG and gas condensate by 18 million tons by 2020. This will be supplied to the Asia-Pacific region and Europe.

We also focus on coal transhipment projects.

The global market for power plant coal and coking coal is currently around 1.2 billion tons\(^{21}\). Combined exports of these types of coal from Russia increased by 10.1% in 2016 to reach 174 million tons (152 million tons of power plant coal, and 22 million tons of coking coal). Thus, Russia’s share of the global market is around 14.5%. According to the International Energy Agency, the medium-term increase in power plant coal consumption will fall behind that of all other types of energy resources, which is in line with the global trend of switching to greener and renewable sources of energy. However, Russia is still capable of increasing its coal exports by gaining market share, due to its coal's high quality, competitive cost base, flexible pricing policy of local producers, and improving transport infrastructure.

Under the moderate-case scenario in respect of global demand for power plant coal (an increase of 1% per annum on average) due to switching to greener energy sources, a more positive trend can nevertheless be expected for coking coal. This is driven by the forecast growth of the metallurgical industry in the Asia-Pacific region and Europe.

Based on the research, we estimate the combined potential capacity addition versus 2016 of all new specialized coal terminal construction projects by 2020-2022 at 122 million tons. The interest in constructing specialized coal terminals reflects overall positive expectations around the coal industry. According to the Russian Ministry of Energy, Russian coal exports in 2017 will increase by 14 million tons (or 8%) YoY. The growth will be mostly generated by Asia-Pacific countries.

The Ministry estimates the medium-term annual increase in coal exports to these countries at 4 million to 5 million tons\(^{22}\).

The respondents expressed mixed opinions regarding a shortage and / or surplus of coal capacity in the Azov-Black Sea and Arctic and Far-Eastern basins, which indicates uncertainty over these markets. Nevertheless, many respondents from the Baltic basin anticipate a medium-term shortage in coal transhipment capacity. Views that there may be a shortage of capacity in the Baltic basin may point to the potential to reroute export flows from Baltic seaports to Russian ones. Baltic countries’ seaports transhipped 16.3 million tons of Russian coal in 2016.

\(^{20}\) [http://www.oteko.ru/2017/01/23/]


\(^{22}\) [https://www.kommersant.ru/doc/3395749]
Taking a closer look at coal projects in the Far East, two of them stand out as being nearly ready: the third-stage construction of the coal complex by Vostochny Port AO at Vostochny seaport, and the construction of a new railway line from Toki Station to the Daltransugol AO bulk terminal in Vanino seaport (commissioned in late 2016). The increased transhipment capacity in 2017 under these projects is expected to be 15 million tons and 5 million tons, respectively.

The plans to construct new specialized coal terminals are in line with the long-term strategic goals for developing the coal industry. The coal industry development program of Russia until 2030 under the best-case scenario stipulates an increase in Russian coal exports from 174 million tons in 2016 to 240 million tons in 2030. To strengthen the position of Russian coal companies on global markets, transport infrastructure – including seaports – needs to be developed at high speed. Should a “window of opportunities” emerge in the form of a sharp increase in global demand for coal, Russian transport infrastructure needs to become available rapidly, and to allow the export of additional cargo volumes at a competitive price.

The biggest risks for cargo owners investing in proprietary port capacity are that the moderate growth pace persists and that raw material prices remain low in the medium term. Given the limited impact of depreciation, Russian producers will see an increase in their production and transport expenses, which will make them less competitive against other countries on the target markets. The development of coal deposits in Eastern Siberia and the Far East may help to maintain the competitiveness of Russian coal products, which enjoy high demand in the Asia-Pacific region. Their location close to the borders coupled with the appropriate development of port infrastructure will help significantly reduce transport costs for cargo owners.

The state and business understand the significance of developing port infrastructure, and are planning multiple projects covering a wide range of cargo types. These projects can be successfully implemented if appropriate sources of funding and state support are provided.
Sources of Financing

Just like in other countries, due to budget and time constraints Russia tends to finance the development of railway and port infrastructure from private sources. Therefore, finding long-term financing is crucial.

Investments in Russian port infrastructure significantly increased in 2015-2016. Private investments in 2016 were focused on large projects such as the comprehensive development of Taman seaport by OTEKO AO; third-stage construction of the coal terminal by Vostochny Port AO; the new railway line from Toki Station to the Daltransugol AO bulk terminal in Vanino seaport; second-stage construction of the Bronka multifunctional marine transhipment complex; the LNG-terminal in Vysotsk seaport; and the LNG-terminal in Sabetta seaport.

The financing requirement between 2010 and 2020 under Marine Transport Program (Objective – Improved Competitiveness of the Transportation System of Russia and Realization of the Country’s Transit Potential), including port facility development projects, is estimated at RUB 557 billion, of which RUB 232 billion is needed from 2017 to 2020.

The projects will be implemented with the active involvement of private investors, who are expected to provide around 80% of the overall financing.

Under normal practice, the main items of the state’s capital investments are dredging works, the construction of access channels and port area, and reconstruction of publicly owned docksides. Capital investments of private businesses include the construction of proprietary docking facilities and terminals, and the procurement of equipment. Many stevedoring companies are forced to finance the construction of border checkpoints at their own expense, and subsequently to transfer them to the state for free. Moreover, seaport
development agreements may stipulate an obligation of the private investors to modernize publicly owned docksides, and to participate in the financing of approach routes.

According to our survey, proprietary funds are currently the main source of financing for stevedoring companies.

When planning their investments, almost all respondents (96%) are ready to invest own funds in the projects. At the same time, fewer than 60% intend to borrow funds.

Another popular source of financing is leasing, which 35% of the respondents are ready to use. Other sources of financing, including bonds, state subsidies, proceeds from the sale of assets, and attracting strategic partners, are less popular with the interviewees – the share in favor of each does not exceed 20%.

The average debt to assets ratio for Russian stevedoring companies is comparable to the ratio for international companies (31% vs 30%). At the same time, some Russian companies tend to rely more on borrowed funds.

Only a few banks and funds in Russia finance large infrastructural projects. The largest banks - Sberbank Russia, Bank VTB (PAO), and PAO Gazprombank AO - still play the main role in financing public private partnership (PPP) projects in Russia. Other active finance providers on the market are Vnesheconombank, Eurasian Development Bank, Leader Management Company, and Russian Direct Investment Fund. However, the cost of funding and requirements for project scale (typically over RUB 2 billion) are fairly high.
In the Far East, an active role is played by the Far East Development Fund (FEDF). The FEDF provides long-term concessional financing (at a 5% interest rate) for Far-Eastern projects (RUB 500 million and more). The FEDF target participation level in a project is up to a third of the total required financing amount.

According to our survey, most respondents (69%) see no significant changes in the availability of borrowed funds in 2016 vs 2015.

When structuring their investments and sources of financing, market participants take into account the expected profitability of the new projects. Respondents’ opinions on the current cargo transhipment fees imply pretty favourable pricing conditions for the majority of stevedoring companies.

### How did the availability of borrowed funds change in 2016 vs 2015?

<table>
<thead>
<tr>
<th>Available of Borrowed Funds</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Availability of borrowed funds did not change</td>
<td>69%</td>
</tr>
<tr>
<td>Borrowed funds became less available</td>
<td>23%</td>
</tr>
<tr>
<td>Borrowed funds (taking into account their cost) are now more available</td>
<td>8%</td>
</tr>
</tbody>
</table>

### Do the current cargo transhipment fees allow your company to implement the scheduled investment programs?

<table>
<thead>
<tr>
<th>Cargo Transhipment Fees</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>The current cargo transhipment fees make it possible for the company to invest in both maintenance and extension of capacity</td>
<td>58%</td>
</tr>
<tr>
<td>The current cargo transhipment fees make it possible for the company to only invest in the maintenance of existent capacity</td>
<td>27%</td>
</tr>
<tr>
<td>The current cargo transhipment fees only cover current operational costs – current operations are not profitable enough to carry out investment projects</td>
<td>11%</td>
</tr>
<tr>
<td>The current cargo transhipment fees fail to provide any positive financial results</td>
<td>4%</td>
</tr>
</tbody>
</table>
According to the survey, 58% of the respondents find the current fees sufficient to both maintain and grow their capacity. However, 27% believe that current operations only enable them to finance maintenance, while 4% claim they are loss-making.

When making investment decisions, respondents specifically consider currency risks.

80% see high currency risks from the initiative by the Federal Anti-Monopoly Service to switch cargo shippers to payments in Russian rubles. This stems from the fact that stevedoring companies have loans in foreign currencies, and use a lot of imported transhipment equipment at their terminals.
State Support for Private Investments

Infrastructural projects typically involve high capital investments, many participants, long implementation periods, and higher risks for private investors. The state must provide them with specific support measures in order to mitigate the risks and encourage investments.

Apart from financing infrastructure from the state budget, legislation stipulates the following types of state support:

- Concessions and other types of PPPs
- State and regional guarantees for loans raised;
- Budgetary co-financing of infrastructural expenses under investment projects in the Far East
- VAT breaks for stevedoring companies and residents of advanced development zones and the Free Port of Vladivostok (FPV).

Public Private Partnerships

Public private partnerships (PPPs) are an important mechanism for encouraging private investments in Russian seaport infrastructure, allowing the sharing of capital expenditures and risks by the state and private investors. This is confirmed by the findings of our survey.

According to 84% of respondents, port infrastructure construction/reconstruction projects should be implemented jointly with the state, and this is an essential requirement for further development of the industry. However, 8% believe that the funding should be primarily provided by the state; while the same percentage believe that private investors should be engaged.

It is worth highlighting the settled practice of implementing port-related projects through joint participation of the state and private investors under agreements which are not regulated by either Federal Law “On Public Private Partnership, Municipal Private Partnership in the Russian Federation” or applicable legislation.

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Federation, and Introducing Amendments to Certain Russian Legislative Acts” (No. 224-FZ) or Federal Law “On Concession Agreements” (No. 115-FZ). This poses heightened risks for private companies. Switching to partnerships based on these laws should help reduce risks and improve the availability of financing.

As of today, most stevedoring companies believe that the existing mechanisms applied according to the laws on PPPs/concessions do on the whole allow the implementation of joint projects to develop port infrastructure. However, respondents point to a number of issues, such as the lack of a detailed procedure to implement projects, lengthy approval procedures, issues related to land, and the impossibility of applying PPP/concession mechanisms to the reconstruction of infrastructure that is privately owned.

Though the first projects under laws Nos. 115-FZ and 224-FZ involving the development of road infrastructure and airports appeared back in 2009-2010, most stevedoring companies are only now taking a closer look at these mechanisms. The first such projects in port infrastructure are only expected to be announced within the next one to two years. Amidst the lack of state financial resources, concession seems to be the most likely format for implementing joint projects, under which the concessioner (private investor) finances the majority of capital expenses.

Both Federal Law “On Concession Agreements” (No. 115-FZ) and Federal Law “On Public Private Partnership, Municipal Private Partnership in the Russian Federation, and Introducing Amendments to Certain Russian Legislative Acts” (No. 224-FZ) allow the implementation of projects based on PPPs/concessions in seaports. The laws prescribe the following basic rules:

- Ports and their infrastructure facilities are envisaged by the laws as potential facilities for PPPs and concession agreements.
- These laws stipulate the possibility of state and private financing of these facilities. Apart from the above laws, Article 78 of the Russian Budget Code provides for the possibility of receiving state subsidies from the federal budget, the budget of a Russian constituent entity, or local budget according to the terms and within the time-frames stipulated by PPP, municipal-private partnership, and concession agreements.
- The laws describe in detail the procedure for concluding PPP and concession agreements. Amongst other matters, they describe tender procedures and procedures for concluding agreements without tenders at the initiative of a private entity.
- The legislation provides for the possibility of both technical maintenance of the facilities under the agreement and their operation by the private partner.
- The possibility of both the reconstruction and building of seaports and seaport infrastructure is provided for.
Along with this, 224-FZ provides for the possibility of the seaports and seaport infrastructure being privately owned (apart from seaport infrastructure which can only remain in federal ownership). This is possible in cases when the amount of funding for the building of a contracted facility by the state and the market value of the movable and/or immovable property transferred by the state to the private partner under the agreement, or the market value of the rights to such property being transferred, do not exceed in total the amount of funding for the building of these facilities by the private partner.

The table below compares agreements on public private partnerships / municipal private partnerships, and concession agreements under key criteria.

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Agreement on Public Private Partnership / Municipal Private Partnership</th>
<th>Concession Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parties to the agreement</td>
<td>Only a Russian legal entity can be a private partner. No unitary enterprises, establishments, public companies or other state-controlled organizations can be a private partner.</td>
<td>The concessioner is an individual entrepreneur, Russian or foreign legal entity, or two or more of the above legal entities acting without the formation of a legal entity under a simple partnership agreement.</td>
</tr>
<tr>
<td>Potential facilities</td>
<td>Seaports, river ports, specialized ports, their infrastructure, including artificial land plots, port hydraulic structures, excluding seaport infrastructure which may be federally owned and which may not be alienated into private ownership.</td>
<td>Sea and river ports, including artificial land plots, port hydraulic structures, and their production and engineering infrastructure.</td>
</tr>
<tr>
<td>Ownership</td>
<td>A facility can be privately owned, and then be transferred to public ownership.</td>
<td>The facility is owned by the state.</td>
</tr>
<tr>
<td>Funding</td>
<td>At the expense of the private partner with the potential reimbursement of a share of the costs.</td>
<td>At the expense of the concessioner with the potential reimbursement of a share of the costs.</td>
</tr>
<tr>
<td>Pledge of facilities</td>
<td>A private partner is entitled to pledge facilities covered under the agreement to the financing entity only, and only under a direct agreement.</td>
<td>The facilities cannot be pledged; only the rights under a concession agreement can be pledged.</td>
</tr>
<tr>
<td>Possibility of direct agreements</td>
<td>Stipulated.</td>
<td>Stipulated.</td>
</tr>
<tr>
<td>Private initiatives</td>
<td>Stipulated.</td>
<td>Stipulated.</td>
</tr>
<tr>
<td>Tender procedures</td>
<td>Cases for concluding agreements without tender are stipulated. Tender procedures are generally similar to the procedure for concluding a concession agreement.</td>
<td>Cases for concluding agreements without tender are stipulated. The tender procedure is stipulated by the Law on concession agreements.</td>
</tr>
<tr>
<td>Provision of land plots</td>
<td>Targeted provision is stipulated.</td>
<td>Targeted provision is stipulated.</td>
</tr>
</tbody>
</table>
VAT Breaks

State support can be provided in the form of reduced tax rates and tax exemptions. In this context, indirect taxation seems to be the most interesting, since VAT legislation stipulates a number of preferences for stevedoring companies.

In particular, the Russian Tax Code provides for a 0% VAT rate for a specific list of services in case proper documentary support is provided. These services include the following:

- Works (services) performed by Russian companies (except for pipeline transport organizations27) in sea and river ports which tranship and store goods to be moved across the Russian border, the forwarding documents for which contain a dispatch point and/or delivery destination outside of Russia,
- International transportation services,
- Freight forwarding services for products which are transported internationally,
- Works (services) involving the carriage (transportation) of goods delivered to or from Russia by sea vessels and combined (river-sea) vessels under a time charter party.

In practice, port services may encompass a broad list of activities which are not stipulated by the Russian Tax Code. This provides stevedoring companies with the option to apply both VAT exemptions and a 0% VAT rate to many of their business lines. However, many taxpayers encounter difficulties with applying the preferential tax regimen due to the requirement to collect a full set of documents and correctly complete them in a specified time-frame. Therefore, should a company decide to apply a tax benefit, it should specifically focus on the completeness and correctness of the document flow.

Another tax aspect requiring careful consideration by companies operating in ports is separate VAT accounting. For works/services performed (both those taxed at 18% or the 0% VAT rate, and VAT-exempted) companies must customize their ERP systems and maintain separate accounting for incoming VAT. This requirement stems from the fact that the incoming VAT on purchased goods / services, expenses on which are not directly associated with VAT-exempt activities, cannot be claimed but should be included in expenses for profit tax purposes. Currently, the correctness of separate VAT accounting is one of the key issues reviewed during tax audits initiated by controlling authorities.

Thus, while being strong stimuli for business development, tax benefits in practice entail special attention from the state. The state needs to work carefully on legislative initiatives, including discussing them with the companies to enable the correct usage of the benefits in practice.

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27 Works (services) performed by crude oil and oil product pipeline transport organizations are also subject to the 0% VAT rate if they meet certain conditions.
Tax Breaks for Investors in the Free Port of Vladivostok

Those investors carrying out investment projects in the Far East can benefit from tax preferences stipulated for the Free Port of Vladivostok (FPV). According to the Ministry for Development of the Russian Far East\textsuperscript{28}, this option has already been used by some investors: over 150 agreements have already been signed on accession to the FPV regimen.

Most of the profit tax is allocated to the budgets of the Russian constituent entities, which are empowered to reduce the regional tax rate. The regional legislation stipulates a reduction to up to 0\%\textsuperscript{29} for those taxpayers who are FPV members if they provide the required amounts of investment\textsuperscript{30}. The members are also entitled to apply a preferential rate of corporate property tax, which is also stipulated by the legislation\textsuperscript{31} of the Russian constituent entities. In turn, a number of municipal entities which are part of those Russian constituent entities that have accessed the FPV regimen offer land tax breaks.

Apart from being investors, the FPV members must also meet additional criteria to be able to apply reduced tax rates.

One of the criteria is the share of income derived from activities under the FPV. It should be 90\% or more. The above threshold increases the administrative burden on investors, as this necessitates separate accounting for income of the member of a preferential regimen. It should be noted, however, that the fulfilment of this criterion would be difficult to assess in the opposite case. Moreover, the procedure of accounting

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\textsuperscript{28} \url{https://minvr.ru/activity/svobodnyy-port-vladivostok/} (as of June 2017)

\textsuperscript{29} For the first five years after turning profitable, followed by 10\% (Law of the Primorsky Krai No. 330-KZ dated 19.12.2013)

\textsuperscript{30} RUB 5 million in a period not exceeding three years

\textsuperscript{31} Law of the Primorsky Krai No. 82-KZ dated 28.11.2003
for extraordinary income (interest rates, currency differences, etc.) remains unregulated. This issue is crucial for meeting the criterion of having a 90% share of income derived from FPV activities, since extraordinary income can be significant, as well as its share in overall income, especially at the initial stages.

The Russian Tax Code forbids FPV members from having standalone subdivisions registered outside regions that have accessed the FPV regimen, as well as including them in a consolidated group of taxpayers\(^\text{32}\). In most cases, the only way to meet this restriction is to register a new legal entity. A situation arises where tax benefits can only be used by newly created standalone companies within the FPV territory, while those stevedoring companies that have already invested in that territory and are operating there are deprived of the benefits.

The asymmetrical provision of preferences to current and new stevedoring companies may undermine the principles of fair competition. Therefore, the mechanisms for applying the Federal Law “On the Free Port of Vladivostok” should be revised. In February 2017, Primorye registered the Association for Supporting Residents of the Free Port of Vladivostok, one of the priorities of which is to draft suggestions and recommendations for developing and revising the FPV regimen.

\(^{32}\) Clause 1 Art. 284.4 of the Russian Tax Code
While being fairly optimistic given the industry’s growth and the state support measures, stevedoring companies name certain factors that constrain their development.

Over 50% named the slow development of railway infrastructure and insufficient depth of channels in the seaport waters as some of the main constraints.

A significant share of cargo is delivered to seaports by railway (47% in 2016). The insufficient carrying capacity of the main railway lines and railway sidings places limits on cargo owners’ opportunities to export their goods and, consequently, on the opportunity for seaports to increase their cargo turnover.

The water depth defines the maximum freight-carrying capacity of the vessels that can enter the port. Here, the larger the freight-carrying capacity, the lower the unit transportation cost when the vessels are fully loaded. Therefore, those ports which can be accessed by vessels with high dead-weight – all other things being equal – are more attractive to cargo owners, and have better prospects than shallow ones.
It is worth specifically focusing on the fact that slightly more than a third of respondents named documenting and customs clearance of cargo in ports as a constraint. Strictly speaking, stevedoring companies do not directly communicate with the customs authorities. When referring to issues with the customs authorities, the respondents were probably assessing the process of carrying out international trade transactions at ports in general.

**Railway Infrastructure**

No large-scale projects can be carried out in ports without sufficient development of railway infrastructure, which is a more time- and capital consuming process. Around 50% of cargo is delivered to Russian seaports by railway. A delay in removing railway infrastructural constraints not only negatively affects the efficiency of the ports, but may also become a reason for turning down projects to modernize terminals and build new facilities.

According to estimates, the length of bottlenecks on Russian railways will be 20 thousand km by 2020\(^3\). The map demonstrates the busiest parts of the railway infrastructure.

Late in May 2017, RZD OAO drew up a new draft long-term development program to 2025. According to the document, the RZD OAO investment program will need RUB 4 trillion up until 2025. The program will be financed from proprietary funds of RZD OAO (RUB 2,800 billion), state funds (RUB 660 billion), and loans (RUB 585 billion)\(^4\). The largest investment expense items of the program are the following:

- the first stage of upgrading the Baikal-Amur and Trans-Siberian railways - RUB 330.8 billion from 2017 to 2019; RUB 231 billion has already been invested
- Construction of access routes to the North-Western ports - RUB 221.1 billion during 2017-2025,
- Construction of a high-speed Moscow-Kazan network - RUB 200 billion over 2020 to 2025,
- Construction of access routes to the ports of the Azov-Black Sea basin - RUB 122.6 billion over 2017 to 2020,
- Northern Latitudinal Railway - RUB 105.9 billion.

**Bottlenecks on Russian Railways**

Source: Transport Economics and Development Institute AO

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\(^3\) [http://iert.com.ru](http://iert.com.ru)

In the Far East, the most pressing transport issue is the unequal development of the Baikal-Amur (BAM) and Trans-Siberian railways. The high load of the Trans-Siberian Railway may significantly constrain any increase in cargo transhipment in Vostochny and Nakhodka seaports, through which significant volumes of Russian coal are exported. Along with this, BAM must be significantly rebuilt, as it is already limiting the volumes of transhipped cargo in Sovetskaya Gavan and Vanino seaports.

A significant investment project is the comprehensive reconstruction of the Mga-Gatchina-Veimarn-Ivangorod line, as well as railway access routes to the ports located along the southern coast of the Gulf of Finland. Here we highlight the pressing issue of road access to Ust-Luga seaport, as the state has reduced investments in the construction of level crossings on the way to the port. Another bottleneck is the busy part of the Oktyabrsk railway between Moscow and Saint Petersburg.
To cope with the access limitations to the ports of the Azov-Black Sea basin on the North Caucasian railway, comprehensive reconstruction is required of the Kotelnikovo-Krymskaya line bypassing the Krasnodar node, as well as the reconstruction of the 9 km railway junction – Iurovsky – Anapa – Temryuk – Kavkaz line.

As part of the development of the Murmansk transportation node, a Vykhodnoi-Lavna line should be built as well as other railway infrastructure adjacent to the Murmansk port. According to the FTP “Development of the Russian Transport System (2010-2020)”, the Murmansk port is to become an all-year-round deep-water hub integrated into the International North-South Transport Corridor.

A project is currently being discussed to build a White Sea-Komi-Urals railway line. It is of special significance in light of the construction of a deep-water port in Arkhangelsk: the railway infrastructure would increase the transhipment of cargo from Siberia and the Urals.
Railway limitations are partially removed at the expense of cargo owners. For example, Daltransugol AO (SUEK AO) built its own railway line from Toki Station to the bulk terminal in Vanino; UK Kuzbassrazrezugol intends to build railway infrastructure at its own expense in Vostochny port to widen access routes to it; and Tuva Energy Industrial Corporation AO intends to participate in the construction of the Elegest-Kyzyl-Kuragino railway to connect the Elegest deposit with BAM. In 2011, Mechel PAO built a 321 km railway connecting the Elginsky coal mine with BAM. Currently, the matter of establishing a concession to manage the entire transport infrastructure of the Elginsky coal mine is under discussion.

The timely removal of railway bottlenecks is crucial for the successful implementation of seaport projects and increasing export volumes from Russia.

Relations with Customs Authorities

Customs clearance in seaports has undergone changes in recent years aimed at simplifying and speeding up the procedure. Despite a significant reduction of the administrative and bureaucratic burden, the speed of reform should be maintained at the current level to cheapen and further speed up customs clearance procedures.

In 2016, World Bank experts named the following measures required to improve the situation in seaports:

- Introduce a system for filing declarations prior to the cargo’s arrival,
- Apply inspection systems coupled with a risk-based approach to physical inspections of containers, which will allow a reduction in the share of inspected containers to below 10% of the total number,
- Introduce the ‘one stop shop principle’ for obtaining sales documents and approvals,
- Improve the effectiveness of the port and transport infrastructure.

Having analyzed the above measures, we see a trend towards automating and virtualizing customs clearance procedures. This is certainly in line with the market requirements, and reflects global trends towards improving information exchange processes.

Despite clear benefits of automation, however, it is difficult to simultaneously switch cargo carriers, customs authorities, and other market participants to innovative technologies. That said, a gradual transition is clearly underway. The automatic registration of customs declarations drastically reduces their processing time, as well as mitigating the risk of human error. Customs authorities do realize the need for changes, and are taking appropriate measures. At the
moment, around 80% of declarations are registered automatically. However, a declaration submitted prior to the cargo’s arrival at the port cannot be fully processed by inspectors, who must satisfy themselves of the actual presence of the container in the port.

Customs declaration processing algorithms, including the use of automatic risk management systems, aid the switching from automatic registration of declarations to their automatic issuance. The model is not fully developed yet; however, the main ideas are already stipulated in the new Customs Code which will be enacted on 1 January 2018. The Federal Customs Service is also expected to take steps towards implementing this technology.

The one stop shop principle, which is currently gaining popularity with many state authorities, is an efficient tool for automating customs procedures; however, switching to it is more challenging than, for example, the introduction of automatic registration and automatic issuance of declarations. This entails the need to drastically revise coordination between participants of foreign trade and the regulating authorities, since many of the latter are simultaneously subordinated to several government agencies. It is objectively challenging to combine the controlling technologies of border police, customs, veterinary and phytosanitary inspectors. Each authority is competent in its sphere and performs specific tasks. It is quite difficult to create a universal system which would enable an importer to submit just one specific set of documents and information on the cargo and which would automatically process all the documents to take account of the requirements of all regulating authorities. To build such a system, the controlling technologies and work methods of all the foreign trade participants would have to be completely reviewed and partially revised.

Some results have already been achieved with respect to automating customs procedures. For example, Portal Seaport software has been developed and is currently being tested. However, the system does not yet allow importers to avoid multiple controlling procedures and, essentially, only registers the fact of their completion. As noted above, this system can be switched to the ‘one stop shop’ mode if interdepartmental interaction is properly coordinated.

The implementation of new technologies also entails other issues. Above all, the system must be improved under which customs authorities play the role of coordinator of relations between all state regulatory authorities and process participants. Interaction is still separate between customs authorities and customs declarants (cargo owners), between other state authorities and cargo owners, as well as between cargo owners and shipping corporations and stevedoring companies. It is worth noting that major companies are attempting to create proprietary automated systems. However, these systems have drawbacks and limitations, since they cannot fully ensure that legally important actions related to state controls are carried out.

Additionally, stevedoring companies must cover the expenses on building and maintaining the checkpoint infrastructure required by state regulatory authorities, which eventually undermines their competitiveness and the investment attractiveness of the stevedoring business in Russia.

The respondents confirmed the pressing nature of the matter related to financing capital and operating expenses on creating checkpoints paid for by the stevedoring companies.

Historically, the port environment for state authorities was built at the expense of the stevedoring companies. The Law on State Border was amended in 2011 to enable private investments alongside state investments in the construction and setup of checkpoints. Currently, however, the law stipulates that checkpoints constructed at the expense of private investors may only be transferred to the Russian Border Services Agency for free.

According to the ACS, a draft law is planned in 2017 to introduce amendments to the Russian Tax Code to allow the inclusion of actual expenses on the construction (reconstruction) of checkpoints incurred by private investors as expenses reducing the taxable base in the event of their free transfer to state ownership, as well as maintenance expenses incurred by the investors. The draft law aims to reduce the tax burden on operators of sea terminals.

If customs procedures and tax legislation are promptly improved, the stevedoring industry will become more attractive and Russian seaports will become more competitive.
Conclusion

Our research shows that the stevedoring industry, which steadily grew during 2009-2016, continues to develop. The industry saw record-high investments in 2015-2016, of which approximately 70% came from private investors. Since 2009, coal transhipment volumes through Russian seaports have almost doubled. Meanwhile, crude oil transhipment volumes, which were almost unchanged during 2009-2015, increased by 12.8% in 2016. Steady positive growth (by 60%-70% during 2009-2016) has been seen in grain, mineral fertilizers, and containers. At the same time, crude oil, oil products and coal are still the main types of cargo transhipped in Russian seaports. Their share has remained almost unchanged since 2009, and is around 70% as of today.

The potential still exists to reroute cargo flows from adjacent countries to Russian seaports. 47.2 million tons of Russian cargo (6.5% of overall cargo flow in Russian seaports) were transhipped through the seaports of adjacent countries in 2016. This was mostly crude oil, coal, and mineral fertilizers.

To strengthen the position of Russian companies on the global market, transport infrastructure - including seaports - must be developed at high rates. The market participants do comprehend this, and plan many new projects.

Most of the respondents named the upgrading of worn-out equipment and improving the quality of services, together with the expansion of stevedoring capacity, as the priority strategic medium-term goals. The likelihood of reduced production capacity in the medium-term or a temporary freezing of projects was only mentioned by those companies engaged in the transhipment of containers. They highlight the current surplus of capacity and toughening competition.

As of today, proprietary funds are the main source of financing for stevedoring companies. At the same time, stevedoring companies are interested in using various mechanisms of state support to develop infrastructure, and are ready to consider project financing as a way to implement investment projects. Federal Laws Nos. 115 and 224 are intended to lay down a legal framework for complex infrastructural projects. While highlighting current problems, most respondents believe these laws to be useful for the industry. The next years are expected to see the launch of many concessional projects across seaports.

The current conditions for investing in the stevedoring industry are fairly favorable. However, the success of the projects planned by the stevedoring companies largely depends on the timely development of the appropriate railway, road, and port infrastructure, as well as the optimization of technologies utilized in state control procedures.

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About the Association

The Association is a membership-based, voluntary, self-managed, non-profit organization established at the initiative of legal entities rendering services in Russian seaports, which have come together based on common interests to achieve the goals stipulated in the Charter.

The Association was established to coordinate activities of its members, including all forms of business cooperation with each other, to provide support with opportunities for their industrial and social development, and to protect the rights and interests of its members.

The Association of Commercial Seaports comprises over 50 sectoral organizations and enterprises in sea transport across Russia. The main goal of the organization is to coordinate the efforts of the professional community directed at creating conditions for the effective development of sea transport enterprises and the fulfilment of Russia’s transport potential.

The ACS comprises leading commercial seaports, freight forwarders and agencies, as well as sea transport research and educational institutions.

See more about the ACS on http://www.morport.com/rus/

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