



Market Overview:

Russia's Construction Equipment Market

November 2007

Eastern Europe and Russia, in particular, is currently home to one of the most dynamic and attractive construction equipment markets in the world. The tremendous growth of Russian businesses, sustained high price of oil and gas, political and economic stability, as well as growing foreign direct investment and international trade have all contributed to the growth of Russia's construction equipment industry. As the construction boom continues across the country, considerable demand for Western made heavy construction equipment continues to grow.

Fueled by rapid economic growth over the last seven years, Russia is now one of the most rapidly growing construction equipment markets in the world. With an average of 10 to 25 percent growth in the market annually, Russia offers Western construction equipment companies enormous opportunities for growth and expansion.¹ The construction and mining machinery market in Russia is expected to continue to grow strongly for at least the next 3-5 years. The market for construction machinery was worth \$2.1 billion in 2006, and is estimated to reach as much as \$2.6 billion in 2007.²

Russia's Heavy equipment industry

According to Yevgeniy Kaplan, deputy director of the St. Petersburg Union of Construction Companies, over 50 percent of construction equipment in Russia is outdated, and the need for more and reliable equipment is surging.³ Since 2000, Russia's construction industry has annually grown by more than 10 percent and in 2007 will grow at a rate of 15 percent, exceeding the level of previous years.⁴ With foreign direct investment continuing to flow into the country and virtually every major Russian industry flourishing, the construction industry in Russia will continue to experience double-digit growth as it strives to keep up with the demands of the growing economy. According to the Russian government, the construction industry will be growing at a faster pace than the Russian economy as a whole in 2007, reaching 7.8 percent of the Russian GDP.⁵ "The current rapid growth of the construction industry will evidently continue in the medium term as it is based on numerous prerequisites shaped by national growth and the restructuring of the entire Russian economy after a decade-long recession."⁶

1 "Construction boom approaches the regions," PMR Publications. August 2006. Available on-line at:

www.constructionrussia.com

2 Robert Obekton, Richard Lucas. "The Russian construction and mining machinery market 2007," Russian Construction Review. Available on-line at:

http://www.aem.org/Intl/PDF/PMR/Russian_construction_and_mining_machinery_market-May2007.pdf

3 Yekaterina Dranitsyna. "Cramo to equip Russia's builders," St. Petersburg Times.

Available on-line at:

http://www.sptimes.ru/index.php?action_id=2&story_id=21425

4 "Opportunities in the Russian Construction Industry" M & A International

Available on-line at:

<http://www.mergers.net/downloads/reports/Russian%20Construction%202007.pdf>

5 Ibid

6 Ibid

In a report on emerging markets published in June 2007, Merrill Lynch predicted that Russia will spend \$195 billion on infrastructure in the next three years. “President Putin’s pledge to spend \$12 billion on new infrastructure for the 2014 Winter Olympics in Sochi represents just the tip of the iceberg.”⁷ Growth in the industry is also driven by growing oil and gas output and a burgeoning retail sector. The industry has also benefited from the effects of rising middle-class living standards, which is spurring residential construction and retail development.⁸ **In 2011, the value of the Russian construction industry is forecast to reach US\$91.83 billion.**⁹

Russian demand for Western made heavy construction equipment has grown considerably in recent years. The growing number of construction sites across the country fuels demand for more building machinery. An increasing amount of local Russian construction companies are investing in upgrading their aging fleets of Russia’s construction vehicles with better built and more efficient Western equipment. According to industry experts, Russian construction equipment is often less effective, ergonomic and cost-efficient than foreign counterparts.¹⁰ Russia’s openness to new technologies and Western vendors is currently very high, and statistics show that imports of construction equipment to Russia are on the rise as users of construction and mining machinery are keen to acquire the latest technologies for the same reasons as they are purchased elsewhere.¹¹

In 2007-2009 the construction machinery market in Russia is expected to enjoy annual growth of around 20 percent.¹² Demand is being driven by the booming construction sector and the overall poor state of machinery currently being used on construction sites across Russia. As a result, builders are facing a shortage of reliable equipment and are purchasing more machinery, with imported engineering vehicles becoming increasingly popular.¹³ Other major factors fueling demand include the increasing availability and popularity of leasing schemes among Russian clients, a greater willingness to rent construction machinery, and a plethora of new orders for machinery thanks to current national projects as well as various federal and national programs.¹⁴

“The attitude of buyers towards foreign equipment has also been changing. “Just two or three years ago, when faced with a choice between imported and domestic machinery, companies tended to opt for much cheaper Russian equipment,” Robert Obetkon, an expert on Russia’s construction market explains. “Now, more Russians are choosing imported machinery ensuring higher productivity and greater reliability, even at a higher initial purchase price,” Mr. Obetkon adds, “because of the growing popularity of new and used foreign equipment, the proportionate share of Russian manufacturers in the market has been declining steadily in recent times.”¹⁵

7 Vladimir Kuznetsov, “Investing in Russia’s Growth Sectors: Construction, Manufacturing, Retail Distribution. 7/11/07. Available on-line at:

http://www.russiablog.org/2007/07/investing_in_russias_growth_se.php

8 Ibid

9 Business Monitor. The Russia industry report. Available on-line at:

<http://www.businessmonitor.com/infra/russia.html>

10 “Construction boom approaches the regions,” PMR Publications. August 2006. Available on-line at:

www.constructionrussia.com

11 Ibid

12 PMR Publications. Construction Machinery Market In Russia. Available on-line at:

http://www.pmrpublications.com/index.php?pr_id=75

13 Ibid

14 Ibid

15 Ibid

Western equipment more affordable

In light of current strengthening of the Euro, U.S.-made equipment is getting a strong competitive edge in terms of prices on European markets, and especially Russia. Consequently, more and more Russian equipment vendors and resellers are starting to do business with U.S. manufacturers who, in turn, are bringing the latest U.S. technologies to the Russian construction equipment industry.¹⁶ The recent devaluation of the U.S. dollar to the Euro makes U.S. products even more appealing to Russian buyers who are increasingly looking to purchase quality U.S. products and take advantage of the weak dollar.

Construction industry booming

The construction industry in the world's biggest country has seen a major revival over the last few years. Since 2002, the value of construction works has increased significantly with 12.3 percent average annual growth.¹⁷ According to Russian government statistics, in 2006 Russia's booming construction industry was the second most profitable sector in the economy.¹⁸ According to the Federal Agency for Construction, Housing and Communal Infrastructure (Rosstroy), in 2006 investment in fixed capital in the construction industry increased by 13 percent.¹⁹ Investment in fixed capital in construction has been growing over the last three years at an average rate of 9.8 percent, and is estimated to be at more than \$5.3 billion in 2007.²⁰ Furthermore, with foreign direct investment in Russia on pace to double year on year in 2007 to \$50 billion, investment in the construction sector is most likely considerably higher than current available estimates.²¹

In addition the tourism sector is also experiencing growing investments in either new hotels or in restoration of existing hotels, primarily in the larger cities like Moscow, St.Petersburg, and Ekaterinburg. Construction of new office premises and business centers is also rapidly developing.²² An increasingly important segment of tourism construction and infrastructure spending is closely tied to real estate development in Russia. **Russian real estate, especially Moscow, is experiencing one of the greatest booms in modern history.**²³

The Russian construction industry is comprised of three chief segments:

- **Residential house building;**
- **Commercial and industrial real estate construction;**
- **Infrastructure building.**²⁴

16 Oganess Sarkisov. U.S. and Foreign commercial services. Available on-line at:

<http://strategis.ic.gc.ca/epic/site/imr-ri.nsf/en/gr119178e.html>

17 PMR Publications. Available on-line at:

http://www.pmrpublications.com/index.php?pr_id=82

18 Vladimir Kuznetsov, "Investing in Russia's Growth Sectors: Construction, Manufacturing, and Retail Distribution. 7/07 Available on-line at:

http://www.russiablog.org/2007/07/investing_in_russias_growth_se.php

19 "Construction boom approaches the regions," PMR Publications. August 2006. Available on-line at:

www.constructionrussia.com

20 Ibid

21 Foreign direct investment in Russia could reach \$50 billion in 2007. Available on-line at:

<http://en.rian.ru/russia/20071113/87872457.html>

22 Available on-line at: <http://www.di.dk/search/simpleSearch?query=russian+construction&submitsearch=S%F8g>

23 Vladimir Kuznetsov, "Investing in Russia's Growth Sectors: Construction, Manufacturing, and Retail Distribution. 7/07 Available on-line at: www.russiablog.org/2007/07/investing_in_russias_growth_se.php

24 "Opportunities in the Russian Construction Industry" M & A International

Available on-line at:

<http://www.mergers.net/downloads/reports/Russian%20Construction%202007.pdf>

Residential

The demand for heavy construction equipment is being driven by residential as well as commercial construction sectors. Last year, residential construction boomed, fostered by the national housing initiative and spurred on by great demand among Russia's population. The "Affordable Housing" National Project being implemented on a nationwide scale since the beginning of 2006 has stimulated the construction of residential buildings across the country. In May of this year, the Russian State Statistical Office reported growth in housing of 9.5 million m² of new housing (over 100,000 new apartments) in the first quarter of 2007, a 51 percent increase compared to Q1 last year.²⁵ Other factors contributing to growth in the residential segment is the mortgage boom, accelerating as interest rates go down (the mortgage market, currently worth some \$5 billion, is poised to grow to \$15 billion by 2010), and by the emerging Russian middle class.²⁶ The two other segments, however, are also developing vigorously due to a booming retail trade, revival of industry and large-scale government initiatives aimed at developing infrastructure.

Commercial

With the growing personal income of Russians, including those living in the regions, new retail premises are appearing on the landscape at an even more dynamic pace than new office space.²⁷ According to CWSR, investments in commercial real estate in the country had exceeded \$6 billion in 2006, which puts Russia among the ten European countries investing the most in this type of property.²⁸ In 2006, Business Week estimated that foreign investment funds invested as much as \$1.5 billion into Russian real estate projects, nearly double the level in 2005.²⁹ The market is especially attractive to commercial real estate investors who are seeing annual returns that are in the double digits vs. 4 percent to 5 percent in Western Europe and the U.S.³⁰ Analysts predict this growth to persist as demand continues to outstrip supply by a wide margin.³¹ Russian experts forecast that the current growth of real estate prices, significantly outrunning inflation, will continue in top Russian cities over the next 10-15 years.³²

Infrastructure

The largest projects in the infrastructure building segment are in development of networks of new rail- and motorways and construction/modernization of new and existing terminals (harbor, airports and railway stations). These projects are implemented as public-private partnerships. Over the next few years the government will focus on the development of transport infrastructure in the areas of Siberia and the Far East, close to China, which are areas that are rich in natural resources. The government plans to implement numerous large-scale

25 Robert Obekton and Richard Lucas "The Russian construction and mining machinery market 2007," PMR Publications. . Available on-line at:

http://www.aem.org/Intl/PDF/PMR/Russian_construction_and_mining_machinery_market-May2007.pdf

26 "Construction boom approaches the regions," PMR Publications. August 2006. Available on-line at:

www.constructionrussia.com

27 Ibid

28 Ibid

29 "The Russian Towers Are Coming," Business Week. 9, October 2006. Available on-line at:

http://www.businessweek.com/magazine/content/06_41/b4004066.htm

30 Ibid

31 Sabra Ayres. "Malls more than a capital idea in Russia" International Herald Tribune. 4 October, 2006. Available on-line at:

<http://www.ihf.com/articles/2006/09/26/business/remoscow.php>

32 "Opportunities in the Russian Construction Industry" M & A International

Available on-line at:

<http://www.mergers.net/downloads/reports/Russian%20Construction%202007.pdf>

projects of extracting and processing various types of raw materials in these regions.³³ Dynamic growth fueled by the power, mining, oil and gas industries has seen order backlogs for lifting equipment stretch into 2008.³⁴

Moscow

Moscow and the Moscow region form the largest construction agglomeration in Russia. It has a population of 17 million people as well as the highest concentration of economic activity in the nation. Twelve other cities with over 1 million residents also form important centers of the construction industry, as well as 19 other cities with populations ranging between 500 thousand and 1 million inhabitants.³⁵

The transformation of Russia from the 1990's crisis state to the world's 9th biggest economy is nowhere more evident than Russia's historic capital city, Moscow. Deemed the most expensive city in the World by Forbes magazine, with the highest concentration of billionaires, Moscow is expanding and its skyline is changing by the day. One of the city's ongoing projects is a Moscow business complex which will have about 25 high-risers, including at least seven buildings taller than any others now existing in Europe. Dominating the site will be the 2,008-foot-tall Russia Tower, which will be one of the tallest buildings in the world and is due for completion in 2012. Most of the rest of the center is to open in 2009 and 2010.³⁶

The high-level design and grand scale of Moscow reflects the wealth that Russia enjoys from oil, natural gas and other resources. According to one architect, **"the energy of cities goes through cycles, this is Moscow's time."**³⁷

St. Petersburg

St. Petersburg, the second largest city in Russia with a population of over 5 million people, experiences high demand for residential housing and commercial premises.³⁸ According to the Association for Economic Cooperation, the volume of construction works in the Northwest region in 2005 increased by 99.9 percent over the previous year, totaling around \$8 billion.³⁹ Average returns on commercial real estate investments are 7.5-9 percent, which is significantly higher than in most European countries.⁴⁰

St. Petersburg is becoming one of the prominent tourist destinations in Europe. Last year, more than 1.8 million tourists visited the city. Realizing benefits associated with tourism industry, the city of St. Petersburg is developing hospitality infrastructure that will support the high volume of visitors.⁴¹

33 Ibid

34 "Russia steps out of the cold," Hoist Magazine. Available on-line at: <http://www.hoistmagazine.com/story.asp?storyCode=2042168>

35 "Opportunities in the Russian Construction Industry" M & A International Available on-line at:

<http://www.mergers.net/downloads/reports/Russian%20Construction%202007.pdf>

36 David Holley. "Moscow- its prime residence," Los Angeles Times. 31 July 2007.

37 David Holley. "Moscow- its prime residence," Los Angeles Times. 31 July 2007.

38 Julia Vlasova. Construction Market Overview: St. Petersburg and Northwest Russia Regions. BISNIS. October 2006.

Available on-line at: http://www.bisnis.doc.gov/bisnis/bisdoc/0610NWR_ConstrReport.htm

39 Ibid

40 Ibid

41 Ibid

Sochi

Sochi's successful bid for the 2014 Winter Olympic Games has immediately drawn the attention of both Russian and foreign investors, who will spend at least \$20 billion in the development of the area. The Russian government will allocate as much as \$12 billion for the city's development, while foreign capital has already started to flow into the most promising economic sectors. According to investment bankers, "there will be a lot of money going to Krasnodar and Sochi to build up the infrastructure. There has always been quite a lot of money and there will be a lot more money coming to Sochi and Krasnodar in the near future. The regions in general are really the new sort of frontier for people coming into Russia."

Ukraine

Economic development in Ukraine has spurred the construction industry throughout the country. For the first half of 2007, total construction in Ukraine was reported up 14.4 percent relative to the same period a year ago.⁴² Residential building is accompanied with strong growth of the non-residential market. The steady growth of the construction market follows rocketing real estate prices on the Ukrainian market. Naturally, demand for construction equipment is also up.

With Ukraine earning the right to host the 2012 Euro cup and the government's planned investment into infrastructure, demand for heavy construction equipment is expected to continue to rise. Shortly after Ukraine won the right to host the 2012 Euro cup, Kiev's mayor announced the Ukrainian capital intends to build a world-class stadium for 200 million euros. The final game of Euro 2012 is scheduled to take place in Kiev.⁴³ Ukrainian President Viktor Yushchenko predicted the infrastructure investment cost to Ukraine to hold its share of the tournament would be between three and five billion dollars.⁴⁴

There are a lot of other plans for future construction projects throughout the country. For example Ukraine's capital, Kiev, is planning renovation of the industrial areas that were developed in the first half of the last century in historical suburbs of the City. Today locations of these areas are perfect for commercial building, offices, hotels and luxury residential buildings.⁴⁵

Eastern Europe should also provide a strong base for construction equipment demand in the coming years. Construction is the most dynamic sector of the East European economies, the market of 250 million people. Eight East European countries - Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia- entered the European Union in May 2004, and in April 2005 Romania and Bulgaria signed accession treaties to join the EU in 2007. "Based on the economic turnarounds experienced by other countries joining the EU, expected infrastructure and economic improvements will certainly help to strongly increase construction equipment demand going forward."⁴⁶

42 Construction Ukraine. Available on-line at: <http://www.constructionukraine.com/#Equipment>

43 Ibid

44 Ibid

45 Ibid

46 World Heavy Construction Equipment to 2009. Available on-line at: <http://www.the-infoshop.com/study/fd31893-h-c-equipment.html>

Opportunities

Aginsky Consulting Group (ACG) believes that the recent development in Russia's heavy construction equipment sector has created the ideal environment for North American companies to strategically enter the market. With Russia aspiring to become among the 5th biggest economies in the world by 2020, Russia's construction industry will continue to expand well into the next decade.

If you have any questions about this report or would like to obtain additional information regarding this opportunity, please feel free to contact Mr. Christopher Eddy at c.eddy@aginskyconsulting.com.