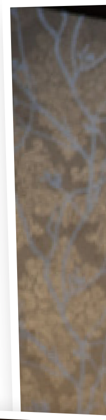
GETTING UP TO SPEED



Russia's export sector has undergone a series of rejuvenating measures but the feeling in Moscow is that more needs to be done, reports Finbarr Bermingham.

Much optimism greeted Russia's accession to the World Trade Organisation (WTO) in August last year – understandably so, given the fact that negotiations had dragged on for two decades. World Bank economists predicted that membership would bring US$49bn per year into the Russian economy. The fall of tariffs would give Russian exporters access to both lucrative foreign markets and the best modern machinery. The inevitable influx of foreign direct investment (FDI), we were told, would bring with it a host of skills and the opportunities to diversify its economy.

Less than six months on, a sense of realism has kicked in. As important as it was for Russia to become the last major economy to join the WTO, it was never going to be an all-curing panacea for an export sector so heavily dominated by oil and gas. The pace of the required reform has been slow, with the Russian government digging its heels in everything from a ban on the import of live pigs from the EU to the removal of fees charged to western airlines flying over Siberia. Even when conditions have been met, Professor Sergei Sutyrin, head of St Petersburg State University's world economy department and Russia's WTO chair holder, tells **GTR** that the accession "is significant and important, but it's not everything". And while in the long run WTO membership should yield plenty of benefits, there are other issues that need more immediate attention.

On the markets

For some Russian exporters, the trade finance market was open for business in 2012. In Q3, Uralkali, one of the world's largest potash fertiliser manufacturers, was able to raise US$205mn in pre-export finance (PXF) from a pool of seven international banks led by Bank of Tokyo-Mitsubishi UFJ (BTMU) and Sumitomo Mitsui Banking Corporation (SMBC). Steel manufacturer Metalloinvest raised US$1.5bn from Sberbank around the same time. And in December, fertiliser producer UralChem won a debut PXF of US$220mn from a club of Russian and foreign banks led by ING, Raiffeisen, Sberbank and VTB.

But for others, the market hasn't been so kind. Danila Kotlyarov is the finance director of Petropavlovsk Iron Ore, a greenfield manufacturer with operations in the Amur and Jewish Autonomous oblasts in the country's far east. Almost everything it produces is freighted over the border to China, as little as 40km away from some of Petropavlovsk's sites. Before 2008, Kotlyarov had little trouble tapping the markets for debt, but since then it's been more difficult. "Nobody's ready to give you money when you need

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it, but everybody's ready when you don't need it," he said at Exporta's Russia and Eurasia trade and export finance conference in Moscow in February.

Midcap manufacturers struggling to raise export finance isn't a problem exclusive to his shores, but Kotlyarov thinks "it's more of an issue in Russia". The company has been able to tap local markets for working capital facilities, it has no experience of attracting long-term funding locally. "It's expensive and there's not much expertise here in funding long-term projects, especially for greenfields with small cashflows," he says.

Petropavlovsk Iron Ore has had to look for support from China. "It's a typical issue for companies of this size, when you have a lack of security in terms of cashflow," Kotlyarov tells **GTR**. "That's why the only instruments we've been able to use are either equity – we just recently signed a deal with two big institutional investors in China – or a major credit line from Industrial Commercial Bank of China (ICBC), with Sinosure taking the main risk. We signed a deal with ICBC for a US$340mn export facility at Libor plus 2.8%, the proceeds to be used for building K&S mine using the Chinese engineering, procurement and construction contractor CNEEC. Chinese banks are still looking at this instrument as the major way of getting loans outside the country and give their support to local producers."

> "WE'RE WORKING TO CHANGE THE MINDS OF RUSSIAN BUSINESSES AND EXPORTERS."
>
> Mikhail Karyakin, Exiar

Further up the food chain, Gazprom Neft, a subsidiary of Gazprom and Russia's fifth largest oil producer, has also had to rely on ECA-backed financing. Last year, it received a €258mn 10-year unsecured syndicated loan backed by the Czech ECA Egap, its first ECA-backed support. While acknowledging the value of such options, Gazprom Neft's head of lending and structured finance Stanislav Popkov queries why it's become such a necessity. Speaking at the Moscow event, he questioned the inflexibility of trade financiers operating in Russia. "Banks should be offering more flexible instruments," he said, suggesting that prepayment and drawdown options should become more widespread. While trade finance volumes were down in 2012, the debt capital markets are booming. Offering such options on trade finance deals, says Popkov, would give banks a flexibility the bond markets couldn't hope to compete with.

Enter Exiar

The most viable immediate tonic for Russian exporters is Exiar, the country's own ECA. In a straw poll taken on a panel involving representatives from JP Morgan, Amsterdam Trade Bank, ABC International Bank and Sberbank only, Sberbank said it was lending extensively to Russian SMEs and midcaps (and even then, it's suspected that the majority of the lending comes through the assistance of international financial institutions, such as the EBRD's trade facilitation programme). The common feeling among trade financiers is that Exiar's establishment was overdue.

Sberbank's global head of trade and export finance Andrey Ivanov tells **GTR**: "This is not primarily a question of liquidity, because the liquidity's there. This is a question of risk appraisal and appetite. Not many banks in recent years wanted to take risks on buyers of Russian equipment in countries with high-risk profiles. Now we can in some cases get 95% protected by Exiar's policies and that's mitigating our risk."

Formed in October 2011, Exiar's first year in operation was largely spent introducing export-friendly initiatives to Russian legislation and building relationships with banks, corporates and other ECAs. "When we're talking about the Russian export market," Exiar's first deputy CEO Mikhail Karyakin tells **GTR**, "I'm not sure we can say that we created another US$1bn or US$10bn sales; what we're actually doing is working to change the environment for that. We're working to change the minds of Russian businesses and exporters, because the concept of export credit insurance has never been their core idea."

To date Exiar has helped close around 20 transactions involving Russian exporters. At the smaller end of the scale, it covered a US$5.15mn export contract through which the United Engine Corporation will deliver energy equipment to China and a similar-sized loan made by Novikombank which will see an Indian company import Russian machinery. It also signed a memorandum of understanding with aircraft manufacturer Irkut Corporation, which will see Exiar provide exporters of its MC-21 model with political and commercial risk cover. Other transactions, some up to US$100mn in volume and with long tenors, remain confidential, but Karyakin is confident that the quantity will increase in 2013.

> "THE OTHER POTENTIAL SECTORS FOR DEVELOPMENT WOULD BE MACHINERY AND TRANSPORTATION."
>
> Sergei Sutyrin, WTO

Sberbank's Ivanov says the bank worked with Exiar to help adapt eight tenets of federal, civil and tax law, and tells **GTR** that his team has a succession of Exiar-backed export finance transactions in the pipeline involving "machinery, equipment, and satellite and launching technology in countries from Mexico to Indonesia, from Vietnam to Cameroon".

Winston Churchill once described Russia as a riddle wrapped in a mystery inside an enigma. And while from the outside, Russia's failure to produce world-class exporters (oil and gas behemoths aside) is baffling, internally, the wheels are turning. There is no quick fix for the kind of economic transition Russia is undergoing, but with the modernisation process underway, things seem to be moving in the right direction. GTR

GAINING AN EDGE

According to Professor Sergei Sutyrin, Russia's WTO chair holder, simply joining the WTO is not enough. Russian corporates and government must work together to make exports more competitive. Sutyrin tells **GTR**: "We have to change the situation from the inside – to make a more business-friendly environment – and this is officially on the agenda. This is about removing administrative barriers, which can be expensive for SMEs. Giants like Gazprom have very substantial resources to deal with these administrative problems, but for SMEs it's a huge thing."

The purging of corruption also needs to be bumped up the agenda, particularly if Russian companies hope to obtain funding from foreign banks. He says: "It's a problem which creates a negative attitude to Russia; to Russian companies and products. The mass media in foreign countries tend to focus heavily on this specific negative side of Russian society."

Sutyrin says that diversification of the country's exports should be a priority, considering Russia has the second-largest reserves of natural resources in the world. "There are a large variety of raw materials," he explains. "The other potential sectors for development would be machinery and transportation. Russia and Belarus have good experience constructing and manufacturing components for energy production, such as hydropower plants and atomic energy. The relatively low level of fertilisers used by our agricultural sector gives us the chance to export relatively clean agri-products such as grain. Russia is now one of the world's leading grain exporters."

As to the impact of WTO accession on Russia's banks, Sutyrin expects it to be negligible. He explains: "Foreign banks which want to be in Russia were already there before accession. The barriers that existed previously weren't too significant for financial institutions to overcome. The situation for foreign and domestic banks is pretty much the same and while banks may see some increased demand from international clients, this is not directly linked to WTO accession."

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