



Minister of Transport Igor Levitin, left, and First Deputy Prime Minister Sergei Ivanov, charter Russia's new transport strategy.

RUSSIA

Exploring New Horizons

The Russian economy is resurgent and finally finding ways to overcome the perennial challenges of its vast size and historic dependence on natural resources.

Russia may cover more landmass than the U.S., Canada, or China but it is one of Earth's most sparsely populated nations. Its 142 million citizens are concentrated unevenly in urban pockets scattered across an area of 17 million square kilometers, from Vladivostok on its eastern shores to St. Petersburg on its European borders. Between them lie enormous tracts of unpopulated steppes, tundra and forest.

The logistics of transporting goods, services, and people across this huge continent have always been daunting, and in the context of the Government's drive to transform Russia into a knowledge-based 21st century global economy are now more critical than ever.

The responsibility for supplying these logistics now lies with its new generation of private-sector transport enterprises. Supervised by Transport Minister Igor Levitin, some former divisions of the state-owned Russian Transport sector are being spun off, refinanced by private-sector capital, and are enthusiastically embracing the pressures and demands of a free-market economy.

While Mr. Levitin judiciously reinvests the returns from the privatization program back into Russian Railway's basic infrastructure, companies such as rail container transportation specialists Transcontainer are overlaying this with a flexible and thoroughly modern logistics system to

ensure that consumer and commercial goods are delivered across the country on time and at competitive prices. The experience of Russia's air passengers has also been transformed by the country's relatively young commercial airlines sector, where companies like Transaero have put price flexibility, and a commitment to both safety and quality of service at the top of their agendas.

Russia's natural resources currently account for 80% of all its exports and are therefore critical to the nation's economic prosperity—but the globalized nature of today's world economy has required a radical rethink about both its ownership and structure. This re-evaluation is spearheaded by Energy Minister Sergei Shmatko, whose policy influences oil giant Rosneft's future course. "The energy strategy for Russia up to 2030 will be a transition towards innovation," says Minister Shmatko. "In that regard ROSNEFT is cooperating with leading western universities such as Stanford and Austin, as well as leading global corporations in the oil industry such as ExxonMobil, Shell, Schlumberger, and Halliburton, to make sure Rosneft is at the forefront of such innovation."

Russia's second great challenge is finding ways of weaning its economy off the very resources that are helping drive its growth. To do so, it has recognized that it needs to find a means of attracting international experience, expertise, and investment. Its Special Economic Zones (SEZ) have become a central part of this campaign. In the space of five years, the state-run SEZ company has built up a network of these zones that stretches from Kalingrad in the northwest to Irkutsk in the southeast. These have "great potential for economic growth," according to SEZ's CEO Oleg Kostin, who has already attracted the likes of Nokia-Siemens, Novartis, and Ford to move in. "We act as a One Stop Shop and take care of the administrative procedures. We assist our residents and solve any issues that hinder the investors' projects. Then when the construction is completed the SEZ assists in promoting the operations of its incumbents, obtaining any necessary licenses, and overcoming any obstacles that arise." The SEZ's have become so successful that they are fast becoming symbolic microcosms of the new Russia, where foreign investors are encouraged and welcomed in helping the national economy diversify into dynamic new areas. ●

TRANSAERO: RUSSIA'S HIGH FLYERS

In November Russia's oldest private airline reached a preliminary agreement to buy four 747-8 passenger aircraft—just days after it had placed an order for four 700-seater Airbus A380s.

THESE TWO AGREEMENTS are just the latest steps in a remarkable 20-year journey that has seen Transaero grow from a standing start to become Russia's second largest airline with a fleet of 74 aircraft.

In the first nine months of 2011, it carried 6.56 million passengers, which is a 29.5% increase on last year, the highest growth rate among the top 5 carriers in Russia. Transaero is certainly one of the Russian aviation market's icons. The company launched flights in 1991 just as the USSR collapsed and has the unusual distinction of having signed licences with the old Soviet Union as well as with the Russian Federation that replaced it. It is also happens to be run by the dynamic husband and wife team of Alexander and Olga Pleshakova, who have been at the forefront of bringing Russian aviation into the 21st century.

CEO Mrs. Pleshakova likes to say that since its birth Transaero's highs and lows have mirrored those of the Russian Federation, but that is too modest. Although Transaero suffered in the downturn triggered by the 9/11 terrorist attacks, the company has actually gotten stronger with each subsequent crisis. It avoided defaulting when the rouble devalued in 1998. When Russian air traffic fell by 8.3% in 2009, Transaero's numbers actually grew by 3%. Its ability to outperform its domestic market has continued since then. In 2010 it carried 6.6 million passengers, a growth rate of 32.3%, well ahead of the national figure of 26%.

The secret of Transaero's success lies partly in its commitment to meeting customer needs and expectations. Very early on, it recognized there was pent-up demand for a quality service among Russian air travellers, who until then had not been provided with international quality. Transaero spotted the gap in the market and became the first Russian carrier not just to add modern, American-made aircraft to its fleet but also to offer a new, much-improved standard of service on its domestic routes. It recognized that in some cases its customers were also prepared to pay for a better service and pioneered the provision of a Business Class service on domestic routes as well.

TODAY IT OFFERS A FOUR-TIER SERVICE

on many of its long-haul domestic and international flights and caters to everyone from the low-budget traveller to those who like to travel in style; its Imperial class customers can eat 19th century Russian cuisine while they relax in fully reclining gold-embroidered seats after being delivered to its VIP lounge in Domodedovo International Airport in an E class Mercedes. Passenger safety has also always been of paramount importance to the Pleshakovs. From the outset they insisted that their foreign-made aircraft were flown by pilots who had themselves had the benefit of overseas expertise, and many of them were trained by recognized market leaders such as Boeing Company,



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Lufthansa, and British Airways. In 2010 Transaero was ranked among the world's top 10 safest air carriers—hardly surprising since it has not had a single accident in the 20 years it has been in existence.

From those humble beginnings Transaero has grown to be not just second in Russia but the 8th largest in the world on routes to leisure destinations, performing flights from Moscow, Saint Petersburg, and 10 other regional airports. With this track record Transaero certainly merits its iconic status, but maybe that is no accident. "When we started the company we used to compare ourselves to Virgin Atlantic," Mrs. Pleshakova recalls, "because we found we had a lot of common in terms of our creativity and the priority we placed on the safety of our passengers."

If Sir Richard Branson was a cross between an ideological soul mate and

a role model in Transaero's early days, it is Singapore Airlines with whom Mrs Pleshakova identifies today. In

July the two companies entered into a codeshare arrangement that will allow Singapore's national carrier to sell tickets on Transaero domestic flights and Transaero to extend its network by adding its code to its new partner's flights from Moscow to Singapore and from Moscow to Houston.

AND THE STORY DOES NOT END THERE.

Transaero is going to develop its fleet and both its domestic and international route network. With their reputation for reliability, innovation, and commitment to customer satisfaction it should be no surprise that lots of financial institutions are lining up to assist the company with their development through long-term credits and lease agreements. And Mrs. Pleshakova is quick to point out that Transaero's main asset is that it has one of the most professional teams in the Russian transport sector. ●

TRANSCONTAINER'S STOCKS REACH RECORD HEIGHTS

After all the turmoil we have seen in the financial markets recently, anybody who still believes that the stock markets are always right would do well to look at the recent experience of TransContainer, one of Russia's latest state-owned enterprises to be privatized.

IN OCTOBER 2010, following Russian Railways decision to float part of its rail cargo operation, TransContainer's Initial Public offering (IPO) raised just \$400 million in Moscow and London. The valuation was at the low end of expectations with investment gurus muttering that the company was simply too expensive given its limited track record and the drubbing it had taken during the economic slump of 2009. Instead of the \$525 million RZD had been hoping to raise, it had to settle for \$400 million. Those gurus must be eating their words now. In September of this year TransContainer announced that its first-half net profits had soared by 620% on the back of a 33% rise in revenues. The doubters should have done their homework better, because TransContainer operates in one of the most fundamentally sound sectors in the Russian market. Over 40% of the company's revenues come from its rail-based container transportation services, where it specializes in providing clients with the containers, rolling stock, and logistical back-up they need to deliver their freight across Russia's vast expanses.

THIS IS A GOOD PLACE TO BE RIGHT NOW. With its vast land mass, poor road infrastructure, and historically low

car ownership, the Russian rail network has always been of vital social and economic importance to the country. The dominance of rail transport stems from the huge distances between its industrial pockets—from Vladivostok on the Sea of Japan to St. Petersburg on the Gulf of Finland—making its average rail transportation span of about 4,000 kilometers among one of the largest in the world, double that of China's and four times as long as Europe's.

THE FUTURE FOR THE RAIL CONTAINER has never been brighter than it is today. In something of virtuous circle, the RZD is using the revenues accrued from the privatization of niche rail-based operations such as TransContainer itself to upgrade the infrastructure that it needs to provide its clients with a better service. Although the 2008 crisis badly affected the container transportation market, today the converse is true; along with its fellow BRIC countries of Brazil India and China, Russia is enjoying an economic boom that is driving a nationwide demand for goods and services. TransContainer's fortunes are subsequently tied to the fortunes of, among others, the automotive industry. Only one in five Russians currently own their own car, compared to 47% in the U.S., and that is a statistic that will



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only go one way as disposable incomes rise. This is nothing but good news for companies like TransContainer, which help deliver car components to foreign car producers in Russia. "We fulfill around 200,000 contracts every year and have 20,000 permanent clients on our books," says CEO Petr Baskakov, "and the car sector accounts for around 12% of all our operations."

OTHER GROWTH MARKETS FOR TRANSCONTAINER are likely to be the pulp and paper sector, driven by Russia's drive to exploit its trees and forests which are one of its most abundant natural resources; construction machinery, as the Government ratchets up its investment in the country's urban and industrial infrastructure; and non-perishable goods.

But the rail container transportation market is an increasingly competitive one, and Mr. Baskakov and his colleagues are making proactive efforts to increase transportation volumes and improve profitability by both investing in

new technology and entering into agreements with their international counterparts to increase the company's reach. In 2009, for instance, TransContainer entered into an agreement with the German company DB Schenker to offer their clients in the chemical an "intermodal" transport system—a combination of road, rail, and sea transport—to haul containerized chemical goods between Europe and Russia.

"Projects such as transportation of VW parts are conducted in partnership with DB Schenker. Our partners carry cargo on the European narrow gauge system and then we carry it on a wide gauge through the Ukraine, Belarus, and Russia to the end client," explains Mr. Baskakov. TransContainer has also set up a joint venture in China and opened a subsidiary company in Korea to help it penetrate the Far Eastern markets. What the customer wants is what the customer gets. A recent report identified reliability, flexibility, and speed of service as the benchmarks for success in this competitive but growing market. TransContainer ticks all three boxes. ●

SPECIAL ECONOMIC ZONES IN RUSSIA

Russia is the world's largest territory in terms of arable land and gas production; it ranks fourth in terms of electricity generation and seventh in GDP by purchasing power parity with over \$2.2 trillion (in 2010). With a skilled human resource base and a fast-growing middle class, Russia is simply too big a market to ignore.

THE COUNTRY HAS UNDERGONE SIGNIFICANT CHANGES since the collapse of the Soviet Union, moving from a centrally-planned to a more market-based and globally-integrated competitive economy. Russia is now facing challenges in changing from its oil and gas based economy into becoming one of the world's leading countries in the fields of high tech and modern production. In response to that challenge, the Russian Government is embarking on a policy of modernization to stimulate the new range of industries that will help to raise national living standards and economic competitiveness.

One of the principal agents chosen to effect this change are the Special Economic Zones (SEZs) that have now sprung up across the country. The SEZs have become a resounding success for attracting FDI into Russian economy. Since they were introduced in 2005, they have grown in number to 24 and host 270 registered companies with a combined total investment of over \$10 billion.

ONE OF THE KEYS TO THE SUCCESS behind the SEZs initiative was the Russian government's decision to place their development under the control of the state-run management company JSC SEZ. A second key reason is the range of incentives to the businesses that chose to locate there, as SEZ CEO Mr. Kostin explains. "We finance the construction of the infrastructure and transport network inside the zone; and we help companies with the paperwork involved in setting up inside the zone. Every SEZ investor is given a project manager who is their "One Stop Shop" on whom they can call whenever they need help with bureaucratic procedures. Once they are in the zone, they don't have to pay property and transport taxes; we offer low-cost land leases and we build their offices for them, which they can either buy or lease from us." Thus, SEZ is a great offer for investors to set up their projects in Russia, with full-scale infrastructure supply and no connection fees. Implementation of projects within Special Economic Zones enables clients the chance to reduce total investment expenses up to 30%.

THERE ARE FOUR TYPES OF RUSSIAN SEZ: industrial, innovation, tourism, and port development. The Industrial Zones concentrate on attracting companies involved in the automotive and parts, machinery, electronic equipment, construction materials, chemicals, and others. They are located in the centers of major industrial regions. Proximity to production resources, access to existing infrastructure and key throughways are the main advantages of

the Industrial Zones. The advantages of the Industrial SEZ are appreciated by such transnational giants as Rockwool (Denmark), Bekaert (Belgium), Yokohama (Japan), Preiss-Daimler (Germany), and Sisecam (Turkey), among others. The Alabuga Industrial Zone in the republic of Tatarstan has been dubbed the "Russian Detroit" by the national media now that it hosts assembling facilities for Fiat vans and Isuzu trucks. But Alabuga's most spectacular success was the announcement last month that the Ford-Sollers Joint venture (that was recently set up there) will build the Ford Explorer in its Tatarstan plant. It will not only be the first Ford product to be manufactured at a Sollers plant in Russia but will make Alabuga the only place in the world outside Chicago that manufactures the Explorer.



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The Innovation Zones seek to attract existing business and start-ups working in the fields of cutting-edge technology such as nano- and biotechnologies, ICT, pharmacy, and advanced materials. All four are world-class innovation hubs created in scientific and educational centers. Leading Russian universities and R&D institutes are located nearby each zone and provide highly educated and skilled professionals to meet the investors' needs. Companies such as Novartis (Switzerland), DivX (USA), Solagran (Australia), Ze Poly (Taiwan), and Plastic Logic (UK) decided to locate their R&D centers in the SEZ for innovation in Moscow, Saint-Petersburg, Dubna, and Tomsk.

The Port Zones' principle advantage is their close proximity to some of the fastest-growing logistic hubs. SEZs for Tourism offer the opportunities to set up hotels and resorts in some of Russia's most picturesque and popular destinations, including the famous Baikal Lake.

As such, the Special Economic Zones have a multi-benefit effect. They stimulate the modernization of different industries in the Russian economy and present a wonderful opportunity to global companies to set up or expand their own businesses in one of the largest and fastest growing markets in the world. ●

ROSNEFT: AN INTERNATIONAL ENERGY PARTNER

Arctic partnership marks a new era for Russian energy company Rosneft.

IN AUGUST 2011, Russia's leading energy company, Rosneft, announced the conclusion of a Strategic Partnership agreement with ExxonMobil that marked a significant step forward for the company's operations both within and outside Russia. The ExxonMobil partnership centered on a \$3.2 billion program to explore the untapped oil resources of the Kara (Arctic) and Black Seas. Additionally, the partnership provided Rosneft with the opportunity to acquire an equity interest in a number of ExxonMobil's exploration and operating assets in North America, including offshore blocks in the Gulf of Mexico, tight oil reserves in Texas and Canada, as well as participation in a number of other international projects. The news sparked heightened interest in a company whose initial IPO in 2006 represented one of the largest and most successful Russian listings in recent years.

ROSNEFT IS WELL ESTABLISHED AS an efficiently-run Open Joint Stock Company. Core business operations include the exploration, development, production, and sale of crude oil and gas, and the refining, transportation, and sale of petroleum products. According to Rosneft President Eduard Khudainatov, the company's current financial performance is strong with considerable growth yet to come. Rosneft is active across all areas of the energy industry—and particularly downstream, where the company currently owns and operates seven large

refineries and four mini-refineries, enabling it to process about 45% of its crude oil production. Rosneft operates proprietary terminals that help it capture higher margins on crude oil and petroleum product exports, and the company also runs 1,800 service stations.

THE RUSSIAN ENERGY COMPANY'S VAST

and high-quality reserve base represents a significant attraction to the investment community. Total proven hydrocarbon reserves amount to 22.8 billion barrels, and proven liquid hydrocarbon reserves have placed Rosneft at the top of global ranking tables among publicly traded companies. Working alongside ExxonMobil, the company will now initiate joint operations to develop this huge resource base.

The Rosneft and ExxonMobil partnership is set to create an Arctic Research and Design Center for Offshore Developments (ARC) in St. Petersburg. The Center, to be staffed by both Rosneft and ExxonMobil employees, will use and develop technology to support the joint projects taking place in the Arctic. The technology will focus on ice-class drilling as well as the development of production ships and platforms able to withstand the harsh Arctic environment. A joint Rosneft-ExxonMobil study of developing tight oil resources in Western Siberia will also be conducted.

The new partnership strengthens Rosneft's strategy for growth. The company's exploration projects can already be found in Russia's most promising oil and gas regions, in Eastern Siberia,



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the shelves of Russia's Black, Caspian, and Azov seas, and the Russian Far East. In 2010 Rosneft was awarded several blocks on Russia's Arctic shelf with potential recoverable crude oil resources of 35 billion barrels. This reaffirmed the company's role in leading offshore exploration and affirmed its strategy in securing sustainable long-term production growth.

Rosneft has come to represent the partner of choice for foreign companies looking to enter the Russian energy sector. The company has already run successful joint ventures and partnerships with an impressive array of companies including BP, CNPC, and Sinopec as well as ExxonMobil.

"Essentially, people see us as a reliable, strong partner with a no nonsense approach to business and the ability to deliver," says Eduard Khudainatov. Such successful foreign partnerships have demonstrated

Rosneft is an attractive company to investors not just because of its natural resources—but also due to its adherence to sound business principles, particularly those providing cost efficiencies and enhanced shareholder value.

FIVE YEARS HAVE PASSED SINCE

the original Rosneft IPO, during which time the company has made considerable progress and displayed a sound grasp of financial strategy. "We believe in the importance of liquidity, especially in a down market like this one," says Khudainatov. "We see this as an opportunity to prove the company's credentials in less than favorable market conditions." Certainly such liquidity provides Rosneft with many options, and there is little doubt that the company is emerging as a key player in the global energy sector. ●