Transport & Logistics in Russia: Returning to Growth

A Market Insights report from TransRussia/ TransLogistica

www.transrussia.ru
Russia. The world’s largest country. With a surface area greater than the size of Pluto, and the ninth largest population in the world, the nation requires huge levels of trade, and an expansive transport and logistics industry, to remain prosperous.

After years of underperformance, growth and optimism is returning to the nation’s transport and logistics sector.

2018 heralds a return to the huge freight levels that entered and exited Russia prior to 2014’s economic crisis – and brings with it enhanced opportunities for foreign companies – not just in pure investment, but also as a market to sell transport services and technologies.

TransRussia/TransLogistica is proud to bring you this Market Insights report into Russia’s current transport and logistics environment. Inside, you will find plenty of useful information detailing the state of the Russian transportation industry, how market recovery is well on its way, and how international businesses can get involved.

CONTENTS

TRANSPORT & LOGISTICS IN RUSSIA ............................................................ 3
Transport & Logistics: An Overview ............................................................... 4
Sector Spotlight: Sea Transport .................................................................... 5
Sector Spotlight: Road Transport ................................................................. 7
Sector Spotlight: Rail Transport ................................................................... 9
Sector Spotlight: Air Freight ....................................................................... 11
Sector Spotlight: Third Party Logistics ........................................................ 13

THE FACTFILE ......................................................................................... 14
The Factfile: Ease of Doing Business in Russia ............................................. 14
The Factfile: Useful Resources ..................................................................... 16
TRANSPORT & LOGISTICS IN RUSSIA

RUSSIA: A SNAPSHOT

GDP: $1.28 trillion (2016)
Annual GDP growth: 2.1% (2017 est.)
Population: 144.3 million (2016)
FDI Inflows: $19 billion (2016)
In 2016, 7.1 billion tons of freight was transported throughout Russia – a figure that includes both international and domestic cargo loads – according to data from Russia’s Federal State Statistics Service.

Road transport is king, accounting for roughly 70% of total freight turnover, with rail coming in second place. But of course, Russia is reliant on both air and sea transport to move goods in and out of the country. Some 60% of Russia’s entire international trade, for instance, is covered by maritime transportation.

The real issue affecting the market is Russia’s economic downturn – and its current recovery. The collapse of global oil prices, sanctions, and the fall in rouble, hit Russia’s economy hard in 2014. Both imports and exports contracted, negatively affecting cargo loads across all transport modes.

Crucially, however, the economy has re-entered growth mode – and transport levels are rising once more. Additionally, there are more factors at play that make Russia a key investment market for international players. The drop in the rouble has triggered greater export levels, as commodity prices dropped, meaning higher freight traffic volumes leaving Russia. Cross border e-commerce is also increasing cargo loads on road, rail, and air modes – and creating further demand for third party logistics services.
With over 37,000 km of coastline, and maritime borders that include the Pacific Ocean, Baltic, Black and Caspian Seas, Russia enjoys a hefty sea transportation presence. In fact, as much as 60% of all of Russia's international trade is carried by cargo ships.

While Russia took an economic nosedive in 2014, sea freight remained rather resilient, even though cargo volumes obviously dropped off with Russia's decreased levels of international trade. Since 2006, says the Russian Maritime Ports Association, the sector’s total turnover had increased 77.4% by 2016.

Collective cargo turnover bounced up 6.7% across all Russian ports in 2016, reaching a whopping 721.9 million tons. On the container front, Russia is recovering too. 3.99 million TEUs passed through Russian container terminals during 2016, representing a 1.4% increase against 2015's traffic levels.

*Cargo turnover (2016):* 721.9 million tons – 6.7% year-on-year increase

*Container traffic (2016):* 3.99 million TEUs – 1.4% year-on-year increase

*Cargo turnover (Q1 2017):* 183.3 million tons – 9.5% year-on-year increase

*Container traffic (Q1 2017):* 1.07 million TEUs – 11.8% year-on-year increase
This growth looks like it is continuing through 2017. During Q1, Russia’s seaports handled 183.3 million tons of cargo, showing a 9.5% year-on-year rise against January-March 2016. Likewise, container traffic is expanding too, posting an increase of 11.8% to 1.07 million TEUs in Jan-March 2017, compared with the same period in 2016.

Arctic regions posted the biggest cargo upsurge, as freight levels rose a staggering 40.6%, to just shy of 50 million tons. Out in the Far East, home to the ports of Vladivostok, FENDING, Vanino, and more, freight levels also rose. While not as drastic as the performance seen in the Russian Arctic, volumes grew 8.3%, achieving roughly 175 million tons of dry bulk and liquid cargoes.

Alexei Bezborodov, head of research agency InfraNews, suggest the future of Russia’s sea trade no longer lies in imports. Instead, export expansion, driven by a lower ruble rate and higher agricultural output, will be the industry’s key driver.

Having said that, increased trade levels in Asia-Pacific, the Middle East, and Africa will likely result in an influx of international goods passing through Russian maritime centres.

To accommodate heightened sea freight levels, the need to expand facilities now rests on the minds of Russia’s port authorities. Several big infrastructure projects are planned. At Vladivostok, a 6.7 hectare logistics hub is under construction. Elsewhere, on the Black Sea, the port of Taman is getting a complete, $258 million upgrade, including new bulk cargo and grain terminals.

Arkhangelsk in North-West Russia is to see construction of a new deep-water port, with first cargoes passing through there by 2025. Planned for year-round operation, involving the deployment of icebreakers in the winter, Archangelsk’s newest port facility will be able to handle 30 million tons of freight annually and act as an alternative route for cargo flows to and from Europe, North America, and China.

International port operators are also entering the market. Dubai’s DP World, for instance, is in talks to acquire a minority stake in Fesco, Russia’s largest port operator.

As the maritime industries are integral to Russian prosperity, expect to see more investment in port facilities, fleets, and cargo-handling technologies as the decade closes.

---

**Arctic sea freight (2016):**
50 million tons – 40.6% increase

**Far East sea freight (2016):**
175 million tons – 8.3% increase.
In Russia, road transport is a major player. Between January-October 2016, 69.4% of Russia’s total cargo turnover was carried by the nation’s hauliers. Across the full year, truck loads came to a staggering 5.1 billion tons – a 1.9% recovery against 2015’s levels.

Recovery is the operative word. Russia’s recent economic woes caused some hard times for its truckers. With the devaluation of the rouble, costs skyrocketed, putting a large number of independent drivers and SMEs out of operation. As many as 80% of Russia’s haulage companies are private enterprises. Subsequently, the stagnation of the Russian economy spelled disaster for many of these companies.

It is not all negative news for Russian road transport though. The growth in freight turnover carried on trucks and road vehicles signals returning strength in the sector.

Cargo turnover (Jan-Oct 2016):
5.1 billion tons – 1.9% increasing.

Increase in European exports (Jan-June 2017):
20% increase

New unit sales (2016):
53,000 new trucks – 4.2% increase
market – and there are a couple of industry trends that could become key growth drivers. Truck-based exports to Europe, for example, rose 20% during the first half of 2017. On the domestic front, road shipments of containerised freight grew 6% during the same period, suggesting confidence, and demand, is there.

It is not all smooth sailing however. There are a few measures being implemented that encourage caution for operators looking to move cargoes around Russia via road. The foremost of these is Russia’s Platon toll system.

Since 2015, trucks weighing over 12 tons pay road fees electronically via Platon. Proceeds go to a state-run road maintenance fund. The system, which was rolled out in 2015, has been very controversial – not least due to the level of toll increases seen since its inception.

In April 2017, Platon tolls rose 25% – increasing trucking companies’ overheads, and having a knock-on effect for their customers. Higher tolls equals higher delivery costs – and trucking outlays could rise between 15-17% by the year’s end.

Fleet sizes have also shrunk. Truck fleets are 10% smaller than in 2014, in part due to the drop in numbers of SME and independent operators. But this tide might be turning. In 2016, truck sales expanded by 4.2%, with 53,000 new trucks sold.

Infrastructure-wise, Russia’s roads tend to hold the industry back. In its Western and Southern Regions, which are outfitted with modern highways, things are fine. But in Siberia and the Far East, it’s a different story.

President Putin is fully aware of this. That’s why he ordered the road network’s length to be doubled by 2022. Once completed, Russia would boast over 2.4 million kilometres of road, including highways and rural routes.

Road transport might not be one of the quickest recovering transport markets in Russia right now – but that only opens the market up to further investment. Likewise, the green shoots of sector-rehabilitation are showing, with the increased truck loads seen over the past 18 months, so remain optimistic regarding Russia’s trucking industry.
Russia and railways are inseparable. Since the Imperial Era, when the Trans-Siberian Railway was first built, rail routes have come to play a vital role in Russia’s transport mix.

A new dawn is coming for Russian rail. RZD, the nation’s railway monopoly, is pouring billions of dollars into developing the network nationwide, including extensive investments in rolling stock, infrastructure, high-speed route construction and more.

But what about rail freight? What is the state of the market? According to the statistics, it looks like it’s regaining its health.

Russia, in terms of rail freight turnover, is the world’s third largest market. Importantly, volumes carried across Russia’s 83,000 km long network are climbing. The ton-to-kilometre ratio 2.34 trillion t/km seen in 2016 was a 1.6% year-on-year against 2015’s stats.

**Ton-to-kilometre turnover (2016):**
2.34 trillion t/km – 1.6% increase

**Cargo carried (2016):**
1.22 billion tons – 0.6% increase

**Container traffic (2016):**
3.26 million TEUs – 10.2%
2017 continues this growth. Between January-July, total cargo transported rose from 706 million tons to 730 million tons – an increase of 3%.

In total, 1.22 billion tons of cargo was transported on Russian railways in 2016. This was higher than the levels seen in 2015, but only represented a rise of 0.6%. A small increase, to be sure, but an increase nonetheless – encouraging given Russia’s recent poor economic and international trade performance.

RZD also enjoyed solid growth in containerised freight too. Statistics from the carrier say that cargo volumes in this sector jumped up 10.2% in 2016. 3.26 million TEUs were carried by RZD that year – which was actually a new Russian record.

Internationally, Russia’s rail tendrils stretch from the beaches of the Baltic to the Pacific Ocean. Its reach is likely to keep growing. Transport corridors, such as the North-South Transport Corridor linking Russia to India, and the Primorye corridors in the Far East, are to further reinforce Russia’s status as one of the world’s foremost rail freight markets.

The effectiveness of Russian railways internationally can be seen in its interactions with China. 15% of total freight train traffic between China and Europe is carried along Russian routes. As such, $43 billion is being spent on China-facing infrastructure in Russia’s Far Eastern regions to develop new connections between Asia and Europe.

Cross border e-commerce is another factor fuelling increased freight traffic along the Russian rail network. Again, much of this is coming from China. RZD and Russian Post signed a deal recently to carry small packages and orders bought online from Chinese suppliers, suggesting digital retail will become a key growth driver and opportunity maker in Russia.

In Russia, rail transport has to be robust and forward facing. RZD’s future strategy, which includes acquisition of 1 million new freight wagons, 23,000 modern locomotives, and installation of 20,700 km of track, suggests this is exactly the case.

Opportunity wise, Russia has a lot of potential entry points. From rail technologies, to rolling stock, to cargo-carrying opportunities, the nation is open and welcome to towards receiving foreign investment.
Air freight holds a minority market share in terms of Russia's total freight traffic. And, like most transport modes throughout Russia over the past couple of years, it has taken a few knocks.

For example, cargo volumes in April 2016 fell 13% compared with the previous year. Throughout 2014-2015, freight levels had also dropped at all major Russian airports.

Total domestic air cargo levels total around 510,000 tons, although, according to a report from Boeing, Russia's airports say actual volumes are roughly half this. Internationally, Russia handles roughly 260,000 tons a year — over half of all overseas air freight handled in the CIS.

However, the skies are clearing. The market is poised for lift off.

According to Robert van de Weg, former CEO of Russia's largest air freight operator AirBridgeCargo (ABC), Russia's air cargo sector is preparing for an upswing.
Freight volumes are starting to rise again, backing up Mr van de Weg’s optimistic outlook. Take a look at ABC’s performance during the period January-October 2016. At this time, the airline transported 498,177 tons of cargo – a year-on-year increase of 29%.

Russia’s Federal Agency for Air Transport keeps the good news coming. Their statistics reveal that, throughout the first four months of 2017, Russian air carriers collectively moved 344,300 tons of freight. This represents a 22.6% increase compared against the same period in 2016.

In April 2017 alone, Russian airlines transported 93,000 tons of freight. Cargo turnover was also up 23% to 2.3 billion tons/km during this month too.

Overall, International turnover rose 22% during 2016, reaching a ratio of 5.7 billion tons to kilometre. Total turnover soared 20% as well, peaking at a total ton/kilometre of 6.5 billion tons.

Overseas freight features heavily at Russian airports. Seven international markets account for 50% of total turnover: China, Germany, US, the Netherlands, France, Italy, and Israel.

Predictions for Russia’s air cargo health are good. Turnover and traffic is expected to gradually grow until at least 2021.

One of the key issues behind the decline in air transport in Russia is the tango of sanctions and counter sanctions dropped between the country, the EU and the US. Russia’s economic performance also negatively affected trade.

Crucially, Russia is stepping both its exports and the level of imports it receives from non-sanctioned trade partners. China, the Russia’s second largest trading partner, is keen to bump up Russia-bound exports, and Russia is ready to reciprocate. Air transportation is expected to play a big role in this.

Russia is ready to receive more air freight traffic. Moscow’s Sheremetyevo, Russia’s busiest airport, is building a new cargo terminal with a million ton annual capacity. Projects like this herald new confidence in Russia’s air freight industry – and suggest the opportunities for international carriers will grow going forward.
Third party logistics (3pl), while heavily popular in well-established Western markets, remains comparatively underdeveloped in Russia. Even so, revenues generated by the sector totalled around $16.9 billion in 2015, according to logistics research company Armstrong & Associates. Russia’s third party market is by far the largest in the CIS, which is collectively valued at around $23.4 billion.

Outsourcing of transportation services takes a 22% market share in Russia, or roughly of a fifth of the entire transport and logistics industry. Comparatively, 3pl service providers cover 65% of the European market and 48% of China’s.

There are roughly 4000-6000 logistics companies in Russia. Out of these, only 100 can really be considered true third party logistics service providers. Some of the big names include Eurosib, Nienshants Logistics, STS Logistics and a subsidiary of Russia’s railway behemoth RZD, RZD Logistics.

Crucially, the unsaturated nature of the market means international firms are well positioned to advance into Russia. Why? Well, there are a few factors. Firstly, 3pl as an industry is a fairly new phenomenon in post-Soviet Russia. Misapprehensions regarding the type of services on offer, and the fact many Russian companies handle transportation in-house, hampers industry development too.

While domestic firms might be struggling to meet international service standards, foreign firms are making headway into Russia’s outsourced logistics industry. The big players are true global giants, such as DHL and Kuehne Nagel.

The fact that the Russian
outsourced transport sector is relatively unorganised creates space for international companies to expand. There certainly is plenty of potential for the future – especially with trends such as exploding cross border e-commerce activity suggesting a shake up in the 3pl market is coming soon.

Digital retail sales topped out at $4.2 billion in Q1 2017, up 14% year-on-year, with goods coming from Europe, China and even further afield. E-commerce is growing every year in Russia, suggesting a greater need for 3pl services will emerge going forward.

Itella, a Russia-centric postal and logistics service from Finland’s Posti Group, now offers dedicated e-commerce delivery and fulfilment options for its Russian customers as a result of the growth in online shopping across the country.

As well as cargo carrying, there is also warehousing, fulfilment, and logistics centre construction to consider too. All of these form part of third party services. While the big contemporary trend in Russia’s warehousing sector is built-to-suit facilities, more commercial properties are being built by outside developers.

In Moscow, in Q4 2016, 471,000 square metres of warehousing space was sold or built throughout the city. As of 2017, vacancy rates in Russia’s capital stood at around 12%, which highlights the strained nature of storage in Russia’s largest city.

So, third party logistics in Russia: underdeveloped, ready to expand, and fertile ground for international companies to grow their Russian operations.
THE FACTFILE: EASE OF DOING BUSINESS IN RUSSIA

Russia Global Competitiveness Index Performance: Overall Rank (WEF, 2016)

<table>
<thead>
<tr>
<th>Country</th>
<th>WEF Global Competitive Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>43</td>
</tr>
</tbody>
</table>

Russia Global Competitiveness Index Performance: Basic Requirements (WEF, 2016)

<table>
<thead>
<tr>
<th>WEF Metric</th>
<th>Global Competitiveness Rank</th>
<th>Global Competitiveness Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutions</td>
<td>88</td>
<td>3.6</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>35</td>
<td>4.9</td>
</tr>
<tr>
<td>Macroeconomic environment</td>
<td>91</td>
<td>4.3</td>
</tr>
</tbody>
</table>

Global ranking refers to a country’s rank on the WEF 2016-2017 Global Competitiveness Index (out of 138). Score refers to that country’s performance in specific sectors between 1-7 (1 being the lowest score; 7 being the highest).

Problematic Factors for Doing Business in Russia (WEF, 2016)

<table>
<thead>
<tr>
<th>WEF Factor</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation</td>
<td>13.8</td>
</tr>
<tr>
<td>Tax rates</td>
<td>13.3</td>
</tr>
<tr>
<td>Corruption</td>
<td>10.9</td>
</tr>
<tr>
<td>Access to financing</td>
<td>10.7</td>
</tr>
<tr>
<td>Tax regulations</td>
<td>7.7</td>
</tr>
<tr>
<td>Policy instability</td>
<td>6.7</td>
</tr>
<tr>
<td>Inefficient government bureaucracy</td>
<td>6</td>
</tr>
<tr>
<td>Foreign currency regulations</td>
<td>5.2</td>
</tr>
<tr>
<td>Inadequately educated workforce</td>
<td>4.6</td>
</tr>
<tr>
<td>Inadequate supply of infrastructure</td>
<td>4.3</td>
</tr>
<tr>
<td>Insufficient capacity to innovate</td>
<td>3.6</td>
</tr>
<tr>
<td>Poor work ethic in national labour force</td>
<td>3.6</td>
</tr>
<tr>
<td>Government instability</td>
<td>3.1</td>
</tr>
<tr>
<td>Restrictive labour regulations</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Please note: from the list of factors, respondents to the World Economic Forum’s Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

<table>
<thead>
<tr>
<th>WB &amp; IFC Ranking Metric</th>
<th>Doing Business Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall rank</td>
<td>40</td>
</tr>
<tr>
<td>Starting a business</td>
<td>26</td>
</tr>
<tr>
<td>Getting credit</td>
<td>44</td>
</tr>
<tr>
<td>Protecting minority investors</td>
<td>53</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>45</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>140</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>12</td>
</tr>
<tr>
<td>Resolving insolvency</td>
<td>51</td>
</tr>
</tbody>
</table>

Countries are ranked by the World Bank and International Finance Corporation on their performance in the above metrics against 190 reviewed countries.

Russia Heritage Foundation Economic Freedom Index Ranking (Heritage, 2016)

<table>
<thead>
<tr>
<th>Economic Freedom Index Score</th>
<th>Economic Freedom Index global rank</th>
<th>Economic Freedom Index rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>57.1</td>
<td>114</td>
<td>Mostly unfree</td>
</tr>
</tbody>
</table>

Government Transparency in Russia (Transparency International, 2016)

<table>
<thead>
<tr>
<th>Country</th>
<th>Corruption Perception Score</th>
<th>Corruption Perception Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>131</td>
<td>29</td>
</tr>
</tbody>
</table>

Countries are ranked by Transparency International according to their corruption score. A rating of 100 means free from corruption.

Russia Credit Ratings (Trading Economics, 2017)

<table>
<thead>
<tr>
<th>Financial Institution</th>
<th>Credit Score</th>
<th>Credit Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P</td>
<td>BB+</td>
<td>Positive</td>
</tr>
<tr>
<td>Moody's</td>
<td>Ba1</td>
<td>Stable</td>
</tr>
<tr>
<td>Fitch</td>
<td>BBB-</td>
<td>Stable</td>
</tr>
</tbody>
</table>
THE FACTFILE: USEFUL RESOURCES

http://eng.rzd.ru/
RZD Russian Railways

http://www.rs-class.org/en/
Russian Maritime Register of Shipping

https://www.asmap.ru/
Association of International Road Hauliers (Russian language link)

http://www.morport.com/rus/
Association of Sea Commercial Ports (Russian language link)

Ministry of Transport of the Russian Federation

http://eng.customs.ru/
Federal Customs Service of the Russian Federation

http://www.favt.ru/
Federal Air Transport Agency (Russian language link)

http://www.transport-exhibitions.com/Market-Insights
ITE Transport & Logistics Market Insights
TransRussia/TransLogistica is the largest exhibition dedicated to transport and logistics services and technologies in Russia and the CIS.

The event is a unique opportunity to meet and engage with Russian and international transportation specialists. It allows exhibitors and visitors a platform to network, showcase their latest products and services on the market, and expand their cargo loads throughout Russia.

345 Russian and international companies exhibited at 2017’s show alongside 14,745 industry visitors from Russia and around the world.

TransRussia/TransLogistica is the ideal place to explore and enter the Russian transport and logistics sector.

For more information visit www.transrussia.ru/en-GB

ITE Transport & Logistics, part of the ITE Group, is one of the world’s foremost organisers of transportation exhibitions. Specialising in high quality trade shows, the group’s reach spans from Russia through Turkey and the Middle East to Indonesia and Southeast Asia.

For more information visit www.transport-exhibitions.com
Contact us:

Julia Wocka-Gowda  
Sales Manager  
T: +44 (0) 207 596 5188  
E: transport@ite-exhibitions.com