The Russia bear awakens

Alexandra Dockreay

20/10/2017

With the Russian economy on the mend, investment commitments have been pouring into the country this year from the Middle East and Asia, particularly in the energy sector.

Earlier this month a delegation from Saudi Arabia pledged billions of dollars of investment into Russia's oil and gas, infrastructure and technology sectors. And now this week comes the ninth annual “Russia Calling!” investment forum in Moscow, hosted by VTB Capital, which is likely to herald a fresh slew of economic announcements.

Even OECD-based investors are now eyeing the burgeoning M&A pipeline in the country.

Forging new partnerships

Russian Direct investment Fund (RDIF) has been building various new partnerships with Chinese entities during the second half of this year, while the Japan Bank for International Cooperation and Italian utility Enel have also signed new collaboration agreements with the sovereign wealth fund.

Saudi Arabia has made a play for increased reciprocal investment in the energy and oil and gas sectors, launching a $1 billion energy fund this month with capital from Saudi's Public Investment Fund (PIF). PIF and Saudi state-owned investor Mubadala also agreed to invest $100 million in transport projects in Russia by becoming shareholders in the United Transport Concession Company.

The increase in foreign investment comes as the Russian economy improves, as Peter Stonor, VTB Capital’s global head of transport, infrastructure, industrials and utilities says: “Inflation is below the government’s 4% target, and headline inflation is down at 3% which has rarely been seen in Russia. Local interest rates are coming down, there was just a key rate cut from 9% to 8.5% and people are forecasting its decline to 7% or below by the end of the next year. The rouble is now stable around 60 roubles to the dollar, where it has been for 12 months-plus now. We’ve had three quarters of GDP growth, but for Q2 [this year] it was 2.5% which is showing real recovery.”

Transport

Shareholder diversification for the operator of Pulkovo Airport, the main airport in St Petersburg, has demonstrated the appetite of investors for Russian infrastructure from the Middle East and China.

VTB Capital completed the sale of a 25% equity stake in the operator of Pulkovo Airport on 1 September. RDIF brought in local private equity firm Baring Vostok, Mubadala, and sovereign wealth funds from Qatar, Saudi, the United Arab Emirates (UAE), Kuwait and China into the deal. A year earlier Qatar Investment Authority acquired another 25% of the operator for around €240 million.

Stonor says: “The [Pulkovo Airport] deals are spurring on quite a few other airports to look at a similar structure. In addition, Russian aviation traffic is actually up 21% in the first nine months of 2017. There are three large Moscow airports and three large regional airport portfolios and there's a lot of interest from their shareholders."

With all these Moscow and regional airports in private hands, most sale rumours are connected to Domedovo International Airport in Moscow, while of the regional airport operators, Novaport is the main one to watch.

The Western High Speed Diameter, a Rb120 billion toll road PPP financed in 2012, opened to traffic on 4 December 2016. The operational history is ticking up and with two banks as shareholders – VTB Capital and Gazprombank – a sale is on the horizon.

Meanwhile, an M&A deal is nearing completion in the ports sector. UAE government controlled port operator, DP World teamed up with RDIF to buy 35-40% of Fesco Transportation Group, the largest port operator in the Russian Far East, as well as being a rail rolling stock operator. Their investment awaits approval from the Federal Antimonopoly Service. Summa Group, GHP Group and TPG are the existing shareholders.

Russia Far Eastern container port traffic rose 35% in the first nine months of 2017. "Given the recovery in volumes, there is general interest in the port sector," Stonor comments.

The government part-owns ports operator Novorossiysk Commercial Sea Port, which has long been a potential candidate for privatisation.

Energy

Russian oil giant Rosneft has this week welcomed a new shareholder, with private conglomerate CEFC China Energy completing a purchase of 14% equity for $9.1 billion, with an agreement to sell CEFC 11-13 million tonnes of crude per year.

Siberian hydropower and aluminium producer En+ will be listing on the London and Moscow stock exchanges next month, to raise $1.5 billion and test the appetite in the public markets. Its owner is Russian oligarch Oleg Deripaska, through vehicles including Basic Element.

This year VTB Capital has completed a couple of structured equity transactions for power producers, which Stonor says are "with a view to future potential on-sales to strategic investors or the public markets".

In March VTB Capital assumed ownership of 13% of shares in the hydroelectric utility RusHydro for Rb55 billion, in an attempt to reduce its debt pile, while in June the bank completed a smaller equity restructuring for TNS energo, an independent electricity supplier. VTB acquired 19.9%.

An emerging markets leader

Inbound investment has been coming from private and public foreign entities this year. Stonor explains: "There is a backdrop of increasing interest in emerging markets, so the outlook is looking pretty bright for infrastructure and interest from overseas. That's mainly coming from China…, but also international investors - clearly sovereign wealth funds and strategic operators but increasingly more OECD-based investors."

He adds, "Russia is being seen as the most overweight market for emerging markets investors, given the recovering economy and perceived value opportunity in the market based on where assets are priced."