Infra in Russia – an exciting investment destination

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01/12/2021

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Russia has been a very rewarding destination for public market investors – but what about private investment in Russian infrastructure, particularly given the lack of returns and opportunities available in the infrastructure market globally?

In the public equity markets, the MOEX Russia index has provided a total return of almost 400% to investors since 2010 (an equity IRR of over 14%) and is up over 23% so far in 2021.

Russian equity capital markets have raised about US$10 billion in 2021, with a number of sizeable IPOs attracting US and European institutional investors across the consumer & healthcare (EMC, Fix Price), technology (Cian, Softline, Ozon) and transport & industrials (Sovcomflot, Segezha) sectors. VTB Capital acted as a bookrunner on each of these landmark deals, securing diverse interest from both Russian and international investors.

The story is similar for Russian bond investors, with international investors enjoying years of strong and stable returns and now accounting for over 50% of Russian sovereign Eurobonds.

Investment returns are underpinned by strong Russian macroeconomic fundamentals – low sovereign debt and unemployment, large foreign exchange reserves, stable interest rates and inflation, strong GDP growth and increasing FDI. Russia continues to offer good value, trading at half the average emerging markets PE ratio and providing high dividend yields and returns on equity.

Less well publicized are the strong returns also enjoyed by investors in private markets, particularly in the infrastructure sector.

Weathering the pandemic

As the world's largest country, Russia not only holds vast natural resources but also huge transport corridors, power & utility networks and telecoms infrastructure to connect its enormous landmass. Spending on Russian transport infrastructure over the next 10 years is forecast to be US$30-45 billion per year, of which the majority is to be funded from private sources. Existing Russian Public-Private-Partnerships (PPPs) are valued by the National PPP Centre at over US$60 billion as of September 2021 (60% in transport, 18% in utilities and 22% in social and other sectors).

Russian infrastructure has proven very resilient to the pandemic and offers exciting growth opportunities. For example, Russian domestic air traffic was the first aviation market to return to growth while air travel penetration still remains low (at less than 1 trip per head vs 3-4 per head in other European countries), offering exciting opportunities in airports. In the maritime sector, containerisation remains low and faster transit times (both across the Russia rail network and via the arctic sea route) provide the platform for exciting growth. Russia has the world's second largest rail and third largest road networks, with an increasing number of PPPs providing opportunities for private investment.

Energy infrastructure

Russia has the world's largest share of natural resources and is the 4th largest electricity producer with the cheapest electricity prices globally. Energy transition is now a focus, with the Russian Ministry of Energy targeting to reach almost 100GW of renewable energy by 2050, throwing up new opportunities across hydro, solar, wind and (in the longer term) hydrogen and other pioneering energy technologies. Significant opportunities also exist in telecom and digital infrastructure following a number of recent transactions in the sector.

Sustainable investment is an increasing priority, with steps taken by a number of Russian companies to raise green finance, for example Russian Railways has raised over US$1bn through 3 green bonds and Russian PPPs have started to issue green bonds.

So it's not all about public markets - investors who turn to the Russian private infrastructure market can look forward to greater diversification and an exciting pipeline of large opportunities at attractive returns in traditionally "core" infrastructure segments.

Notably, as a pioneer in infrastructure investment in Russia, VTB has generated equity IRRs of over 20% over the last 10 years across its private direct infrastructure investment portfolio, with landmark infrastructure PPPs including the US$1.7bn Pulkovo St Petersburg Airport modernization (Russia's first airport PPP), the US$7bn Western High Speed Diameter toll road (the largest toll road PPP worldwide at the time of award) and the US$1.6bn M11 Moscow-St Petersburg Highway. VTB infrastructure projects manage over 200km of toll roads and serve 20 million airport passengers as well as millions of other infrastructure users across the country.

To date, VTB has attracted over US$18 billion of investment into Russian infrastructure, including US$6.5 billion in equity and loans from VTB Group itself. Equity co-investors have included many leading international strategic and financial institutions including Fraport, Vinci, QIA, Mubadala, Baring Vostok Capital Partners and the Russia China Investment Fund (a JV with CIC).