Russian Government Supports for Industrial investment projects and its Real effects on the Investor's Financial Model

Four Square

by MonDef

Moscow

Preface

Ladies and Gentlemen,

We hereby present our report concerning Russian Government Supports for Industrial Projects and its real effects on Financial Model. It is obvious that the subject is wide and it took a lot of effort to simplify it. We therefore called the report a simple "Four Square", as we believe that the most appropriate way to explain the content is to divide into parts so that will be visually and analytically comprehensible.

In the first section of this report, we mainly focused on practical issues that investors for industrial projects often face, such as:

- Why Invest in Russia?
- Where are the most popular locations in Russia to invest for Industrial Projects?
- Which kind of technical risks may occur during the investment?
- What key factors for the banks and the investors the most important to evaluate the investment project?

The 2nd section explains the main definitions of the most popular territories in Russia, the status of investors and regulations in general.

In the 3rd, we show what kind of tax and infrastructure preferences are provided by the territory in numbers and compare them in simple tables.

In the last section, we analyzed a typical project with an investment budget of 10 mil EUROS (RUB 750 mil) and calculated how tax preferences and state fund's loans with a lower interest rates really affect the financial model in terms of NPV, IRR and payback period.

We hope that this exclusive 'Tailor-Made' report will provide you with a step-by-step road map for transparent and reliable investment analysis.

Thank you for your business, your trust and your confidence.

MonDef Team_

Who we are_

- We are an international company with a team of engineers and economists.
- We are an independent company. This is the greatest value of our intellectual business.
- Therefore, we may not have any conflict of interests with anybody, any parties, any establishments.

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A. Introduction

Why To Invest in Russia?

- Dynamic Economic Growth
- Successful track record of Inflation and Key rate under crisis conditions
- Hard currency reserves
- One of the Largest Consumer Markets
- Russia ranks among the top three profit markets in the world.
- Plenty of vacant market niches and investment opportunities
- Vast Natural Resources
- Unique Geographic Position

Where to Invest in Russia?

- Land Plot with the best technical and infrastructure conditions
- Status must be secured by Laws
- Supplier/Buyer and raw material conditions
- Access to main roads
- Available qualified personnel

Technical risks during the investment

- Uncompleted permission.
- Reliable general contractor / team
- Increasing prices of construction or raw materials.
- Supply chain is broken.
- Building completed but no power.
- Incorrect calculation of gas, electricity and water
- Wrong equipment
- Efficiency

Where are banks and investors looking?

- PB - Payback Period
- NPV - Net Present Value
- IRR - Internal Rate of Return
- Break Even Point

B. The most popular investment locations in Russia_

Special Economic Zone

- A territory created to attract foreign investors to Russia.
- Preferential rates are regulated and guaranteed primarily by Federal legislation
- Free custom zone condition for residents is provided
- All necessary engineering and transport infrastructure are provided (the lowest for state SEZ's)
- Very low cost of land plot (excl. private SEZ's)
- Scheduled inspections and penalties are possible to check for non-compliance with the initial investment plan
- SPIC contract is available (see section III - Main Definitions)

Industrial Park

- Specially organized territory for new production facilities
- Provided with infrastructure as well as necessary administrative and legal conditions
- Managed by a specialized company
- Created for the development of industry throughout the Russian Federation
- Possibility to use benefits under state support programs
- Preferential taxation applies only at the regional level
- Possible benefits for foreign equipment without VAT regardless of the FREE CUSTOMS ZONE.
- SPIC contract is available (see section III - Main Definitions)

TASED

- A special legal regime has been established in the territory to ensure accelerated socio-economic development.
- Created to support underdeveloped and economically backward regions of Russia
- More suitable for local manufacturers
- Restrictions for foreign specialists (<20%)
- Shortage of highly qualified specialists due to their outflow from such regions
- Possible lack of infrastructure created for the industry in the desired area
- To use the free customs zone regime the resident applies itself and fulfills all conditions
- SPIC contract is available (see section III - Main Definitions)

Neutre Land Plot

- Land plot on the territory without specific conditions to the above-mentioned zones,
- Lack of supply of necessary infrastructure
- Risky for new visitors
- Technical and juridical due diligence difficulties
- Unpredictable frequency of inspections
- Higher rates of energy tariffs

C. Government supports – In General_

✓ - provided
✓ - on condition

Special Economic Zone

Tax benefits	✓
Benefits for insurance premiums	
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

Industrial Park

Tax benefits	✓
Benefits for insurance premiums	
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

TASED

Tax benefits	✓
Benefits for insurance premiums	✓
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

Neutre Land Plot

Tax benefits	✓
Benefits for insurance premiums	
Customs preferences	✓
Other state support programs	✓
Infrastructure and Capacity	✓

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C. Government supports - Who regulates?

✓ - provided
✓ - on condition

Special Economic Zone

Federal level	✓
Regional level	✓
Municipal level	✓

Industrial Park

Federal level	
Regional level	✓
Municipal level	✓

TASED

Federal level	✓
Regional level	✓
Municipal level	✓

Neutre Land Plot

Federal level	
Regional level	✓
Municipal level	✓

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C. Government supports – Taxes_

- provided
- on condition

Special Economic Zone

Profit tax	fed	2%
Profit tax	reg	0…13,5%
Property tax	fed	0% (~ for 10-12 years)
Land tax	fed	0% (~ 5-10 years)
Transport tax	reg	0% (~ 5-10 years)
VAT (import)	fed	0%

Industrial Park

Profit tax	fed	3% (2017-2024)
Profit tax	reg	0…17%
Property tax	reg	0%...2,2% (~ for 4 years)
Land tax	reg	0%...1,5% (~for 4 years)
Transport tax	reg	2…500 rub/hp
VAT (import)	fed	0…20%

TASED

Profit tax	fed	0% (5 years)
Profit tax	reg	0..5..10..17% (5 + 5 + more than 10 years)
Property tax	reg	0% (~ for _ years)
Land tax	reg	0% (~ for _ years)
Transport tax	reg	2…500 rub/ac
VAT (import)	fed	0…20%

Neutre Land Plot

Profit tax	fed	3% (2017-2024)
Profit tax	reg	0…17%
Property tax	reg	0%...2,2% (~ for _ years)
Land tax	reg	0%...1,5% (~for _ years)
Transport tax	reg	2…500 rub/ac
VAT(import)	fed	0…20%

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C. Government supports – Social Funds _

- provided
- on condition

Special Economic Zone

pension fund	22%
social insurance fund	2,9%
federal compulsory medical insurance fund	5,1%

Industrial Park

pension fund	22%
social insurance fund	2,9%
federal compulsory medical insurance fund	5,1%

TASED

pension fund	6% (for 10 years)
social insurance fund	1,5% (for 10 years)
federal compulsory medical insurance fund	0,1% (for 10 years)

Neutre Land Plot

pension fund	22%
social insurance fund	2,9%
federal compulsory medical insurance fund	5,1%

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C. Government supports – Customs_

- provided
- on condition

Special Economic Zone

VAT - import (only within the FCZ)	0%
DUTY	No charge

Industrial Park

VAT	20% 0% - Tax Code of RF, article №150
DUTY	Charge

TASED

VAT - import (only within the FCZ)	20% 0% - if a free custom zone is created by a resident
DUTY	No charge if a free custom zone is created by a resident

Neutre Land Plot

VAT	20% 0% - Tax Code of RF, article №150
DUTY	Charge

C. Government supports – Support Programs_

✓ - provided
✓ - on condition

Special Economic Zone

SPIC 2.0	✓
Regional investment project (federal or regional)	✓
Industry development fund	✓
Made in Russia	✓
Investment Protection and Promotion Agreement	✓
Subsidies	✓
MSP Corporation / Regional guarantee organizations	✓

Industrial Park

SPIC 2.0	✓
Regional investment project (federal or regional)	✓
Industry development fund	✓
Made in Russia	✓
Investment Protection and Promotion Agreement	✓
Subsidies	✓
MSP Corporation / Regional guarantee organizations	✓

TASED

SPIC 2.0	✓
Regional investment project (federal or regional)	✓
Industry development fund	✓
Made in Russia	✓
Investment Protection and Promotion Agreement	✓
Subsidies	✓
MSP Corporation / Regional guarantee organizations	✓

Neutre Land Plot

SPIC 2.0	✓
Regional investment project (federal or regional)	✓
Industry development fund	✓
Made in Russia	✓
Investment Protection and Promotion Agreement	✓
Subsidies	✓
MSP Corporation / Regional guarantee organizations	✓

C. Government supports - Main Definitions_

- **SPIC 2.0 (СПИК 2.0)** – is the second revised version of the well-known "Special investment contract". This type of contract is aimed at investors to introduce modern technologies (specified in the list approved by the Government of the Russian Federation) in order to produce in Russia those products that are competitive on the world market.
- **Regional Investment Project (РИП)** – is a project that differs both in Federal and regional purposes.
- **Industry Development Fund (ФРП)** – provides financial support for industrial production with the loans with low rates, lower than commercial bank loans, leasing programs etc. For foreign investors IDF created "Foreign investor's navigator" where the main information about Doing business in Russia can be found (https://gisp.gov.ru/invest/de/ru-RU)
    - Federal type of supports provide loans between RUB 50-500 mil. with a interest rate of 1-5%,
    - Regional support of loans are between RUB 5-100 mil. with a rate of 1-5%.
- **«Made in Russia» Status** - the localization that gives an opprtunity to participate in state procurement programs and other government support programs. The acquisition of this status takes place in three schemes:
    - The product has to be indexed in Annex to the RF PP No. 719,
    - SPIC 2.0 is signed,
    - Country of origin of the product (Commonwealth of Independent States).
- **Investment Protection and Promotion Agreement (СЗПК)** – Federal Law "Protection of Investment Activities" signed by the President of the Russian Federation on April 1, 2020
- **MSP Corporation (МСП)** – a Corporation that provides guarantees to investors for the payment of loans
- **Regional guarantee organizations** – Provides additional guarantees for MSP projects

IV- Financial Model - Main Project Assumptions

Closed area:
10,000 m2 on a
2 Ha land plot

Technical Information

	Unit	Amount
Area Information		
Land plot	Ha	2,0
Building Area	m2	10 000
Infrastructure		
Electricity	MW	1,5
Gas	m3/h	400
Water supply	m3/d	5
Duration	months	15
Labor	per	15
Shift	unit	1
Average salary	Rub/m	40 000

Investment Costs

Scenario I

Item	Rub (mil)	
Land Plot	40	5%
Construction	250	33%
Equipment	400	53%
Infrastructure	60	8%
Total	**750**	**100%**

Scenario II (TOSER and SEZ)

Item	Rub (mil)	
Land Plot	-	0%
Construction	250	38%
Equipment (all importe	400	62%
Infrastructure	-	0%
Total	**650**	**100%**

2 scenarios:
I: RUB 750 mil
and
II: RUB 650 mil

Taxes and Profit Margins

VAT	20,0%
Profit Tax	20,0%
Property Tax	2,2%
Personal Tax	13,0%
Social Funds	30,0%

Margins

Operational Expenses	65,0%
Administrative Expenses	22,0%
EBITDA/Income	13,0%
Net profit/Income	5,0%

Interest Rate	10%

Cost/Income
87%,

EBITDA margin
13%

Investor's Questions

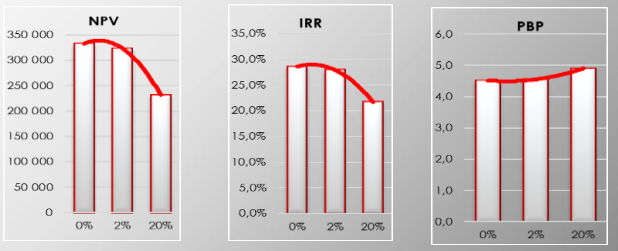
- When will the project pay back ? (PB)
- How much interest does an investment bring me? (IRR)
- What if, I use loan instead of equity?
- What is the interest rate and what for?
- How much tax preferences effect the Fin. Model?
- How the Infrastructure and Land cost effect results?

Lets analyze them on the next page!

IV- Financial Model - Scenario I: If we assume, total cost is RUB 750 mil for all

Profit Tax

Location	%	NPV	IRR	PBP
TOSER	0%	333 151	28,6%	4,5
SEZ	2%	323 652	27,9%	4,6
IP	20%	231 717	21,7%	4,9
Δ (max-min)	20%	101 434	6,9%	0,4

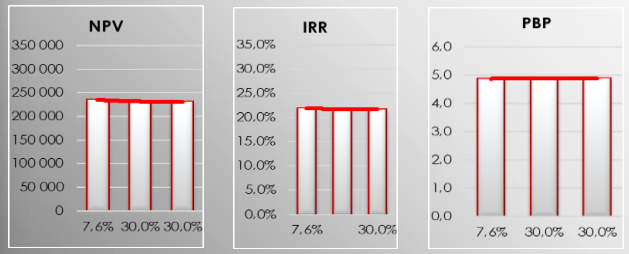


Total cost : RUB 750 mil.
Profit tax changes from 0% to 20%

While other rates stay maximum (Social funds 30%, Property Tax 2,2%, and interest rate 12%)

Social Tax

Location	%	NPV	IRR	PBP
TOSER	7,6%	235 323	21,9%	4,9
SEZ	30,0%	231 717	21,7%	4,9
IP	30,0%	231 717	21,7%	4,9
Δ (max-min)	22%	3 606	0,2%	0,0

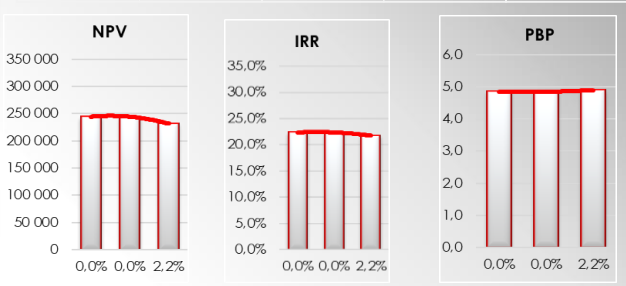


Total cost : RUB 75 mil.
Social fund changes from 7,6% to 30%

While other rates stay maximum (Profit tax 20%, Property Tax 2,2% and interest rate 12%)

Property Tax

Location	%	NPV	IRR	PBP
TOSER	0,0%	244 492	22,3%	4,8
SEZ	0,0%	244 492	22,3%	4,8
IP	2,2%	231 717	21,7%	4,9
Δ (max-min)	2,2%	12 775	0,6%	0,1

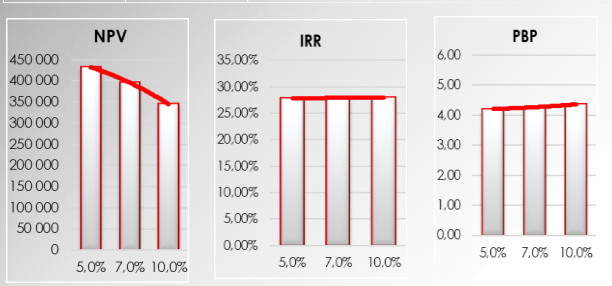


al cost : RUB 750 mil.
Property tax nges from 0% to 2,2%

ile other rates ay maximum cial funds 30%, fit Tax 20%, and erest rate 12%)

Interest Rate

Location	%	NPV	IRR	PBP
TOSER	5,0%	432 343	27,85%	4,21
SEZ	7,0%	395 821	27,91%	4,27
IP	10,0%	345 163	28,00%	4,36
Δ (max-min)	7%	87 180	0,1%	0,2



Total cost : RUB 7 mil.
Interest rate changes from 0% 12%

While other rate stay maximum (Social funds 30 Profit Tax 20%, a property tax 2,2

* All in mil Rub, PB in years

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IV- Financial Model - Scenario II: Cost changes due to Land Plot and Infrastructure

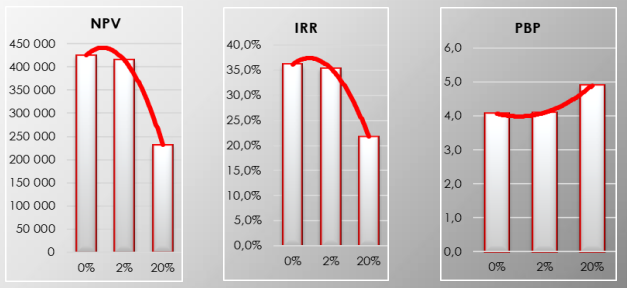
Total cost : RUB 650 mil. for TASED and SEZ where RUB 750 mil. in Neutre land plot

Profit tax changes from 0% to 20%

While other rates stay maximum (Social funds 30%, Property Tax 2,2%, and interest rate 12%)

Profit Tax

Location	%	NPV	IRR	PBP
ТОСЭР	0%	425 000	36,2%	4,1
ОЭЗ	2%	414 571	35,4%	4,1
ИП, СУ	20%	231 717	21,7%	4,9
Δ (max-min)	20%	193 283	14,4%	0,8



Total cost : RUB 650 mil. for TASED and SEZ where RUB 750 mil. in Neutre land plot

Social fund changes from 7,6% to 30%

While other rates stay maximum (Profit tax 20%, Property Tax 2,2%, and interest rate 12%)

Social Tax

Location	%	NPV	IRR	PBP
ТОСЭР	7,6%	317 500	28,2%	4,4
ОЭЗ	30,0%	313 896	28,1%	4,4
ИП, СУ	30,0%	231 717	21,7%	4,9
Δ (max-min)	22%	85 783	6,5%	0,5

Total cost : RUB 650 mil. for TASED and SEZ where RUB 750 mil. in Neutre land plot

Property tax changes from 0% to 2,2%

While other rates stay maximum (Social funds 30%, Profit Tax 20%, and interest rate 12%)

Property Tax

Location	%	NPV	IRR	PBP
ТОСЭР	0,0%	324 904	28,6%	4,4
ОЭЗ	0,0%	324 904	28,6%	4,4
ИП, СУ	2,2%	231 717	21,7%	4,9
Δ (max-min)	2,2%	93 187	6,9%	0,5

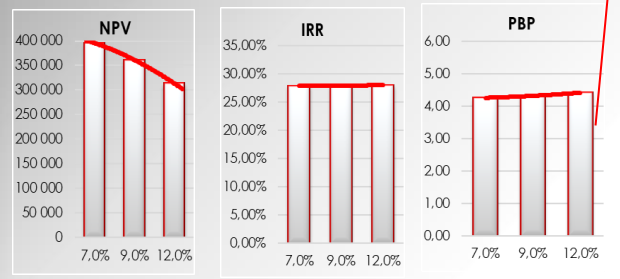
Total cost : RUB 650 mil. for TASED and SEZ where RUB 750 mil. in Neutre land plot

Interest rate changes from 0% to 12%

While other rates stay maximum (Social funds 30%, Profit Tax 20%, and property tax 2,2%)

Interest Rate

Location	%	NPV	IRR	PBP
I	7,0%	395 821	27,91%	4,27
II	9,0%	361 527	27,97%	4,33
III	12,0%	313 896	28,05%	4,43
Δ (max-min)	5%	81 925	0,1%	0,2



* All in mil Rub, PB in years

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