Russian Leasing Market in 2005

Market volume and rates of growth

In the year of 2005 the volume of the Russian leasing market amounted to 9 billion dollars (The share of the participants of the survey equaled 67% of the leasing market, the companies made transactions for the total amount of 6 billion dollars, VAT included). Year's income of leasing companies was a little less than that – 4 billion dollars. **In a year's period the integrated cost of new transactions increased by 41% (64% in 2004, table 1).**

Thus, rates of growth of leasing companies are ahead of almost all the major sectors of the financial system of the country and exceed considerably the rate of growth of economy on the whole. Consequently the absolute number of transactions increases together with their role in the economy of Russia.

While in 2001 the share of leasing in GDP equaled 0.5%, in asset investment – 3%, in 2005 these numbers increased to 1,1% and 7,1% respectively.

Russia is becoming one of the leading leasing countries: while in 2004 it took the 11th place in the world rating, in 2005 it's very likely to enter the top ten outstripping Austria and Australia. Though it will be clear only after EuroMoney's (London Financial Group) rating in the end of 2006.

Gradually leasing is taking its niche as one of the key financial mechanisms of capital renewals. Even at this point leasing in Russia has become the major means of purchasing the most important assets such as agricultural machinery and equipment, breeding cattle, aviation, automobile and railway transport. According to **Vladimir Putin**, the President of the Russian Federation, "for the past several years leasing proved itself as an efficient mechanism of attraction of financial resources into real sector of Russian economy. At present it is hard to imagine successful development of the key sectors, including power industry, aerotechnics and agriculture, without its active employment."

Tab. № 1. Volume and growth rates of Russian leasing market in 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005
New leasing business, in milliard US dollar	1,4	0,4	1,2	1,7	2,5	3,9	6,4	9
Growth rates (net increase)	n/d	3,5 times as less	200%	42%	47%	56%	64%	41%

Market growth factors

For the last 4 years, the average rate of leasing market growth exceeded 50% a year. The trend is expected to remain in the future. Considerable growth of the market is determined by the following factors:

Favourable legislation:

1. After the revocation of tax concession for capital investments, companies acquiring fixed capital at the expense of own funds cannot use part of expenses to decrease tax base when calculating the profit tax (only bank credit percent can be applied to production costs). When using the mechanism of leasing, enterprises get the right to record leasing payments fully in production cost.

2. The right for accelerated amortization of the subject of leasing (coefficient of 3) helps to save on profit and property taxes.
3. The new version of the Federal Law "On Leasing", adopted at the beginning of 2002, was brought into compliance with a number of other legislation acts, including the Tax Code, which considerably increased leasing activity efficiency.
4. The repeal of leasing firms' licensing removed the bureaucratic barriers for the development of leasing firms.
5. Lack of any special supervision over leasing activities and special requirements for leasing companies (e.g. capital adequacy requirements) leads to faster work and flexibility of lessors compared to banks.

A great demand for leasing determined by high level of capital assets' amortization in Russian economy (over 60% on average). Apart from that, a great demand from middle-sized enterprises, which have an extreme need of long-term financial resources.

Low risks of leasing scheme compared to the major part of other debt financing tools. (Subject of leasing remains in the ownership of the lessor till the leasing transaction is completed).

Market players

At present there are about 700 leasing companies operating on the territory of Russia. Since leasing activity is not subject to special regulation and licensing, most of these companies are small. Each year about 300 leasing companies make transactions to the total sum of more than 1 million dollars, and 400 companies – to the total sum of less than 1 million dollars.

In 2005 30 leasing companies made transactions worth more than 100 million dollars each.

Leasing companies may be divided into the following major groups:

1. **Companies established by banks.** Most of large lessors constitute this group. Among them are *Uralsib*, *Avangard Leasing*, *IMB Leasing*, *Alfa Leasing*.
2. **Companies established by equipment and transport suppliers.** Among the largest companies in this group are the following: *RTC-Leasing* (telecommunications), *Volvo Finance Service Vostok* (Volvo cars), *Leasing Company Kamaz* (Kamaz cars), *Scania Leasing* (Scania trucks), *Caterpillar Financial* (special equipment), *DaimlerChrysler Leasing Avtomobili* (Daimler Chrysler cars).
3. **Companies with foreign capital.** These companies normally specialize in the most liquid subjects of leasing – passenger and railway transport: *Hansa Leasing* (railway transport mainly), *Europlan* (cars mostly), *Brunswick Rail Leasing* (railway transport), *Locat Leasing Russia* (passenger and railway transport mainly).
4. **Independent leasing companies.** Such companies either expanded their sources of financing, or were established as independent from the start. Those are mostly small regional companies, operating as leasing agents for banks and large lessors.
5. **Leasing companies with state participation.** Those are the companies established by the state for the purpose of reorganizing the most important sectors of economy. Among them are: *Rosagroleasing* (agriculture), *Ilyushin Finance* (aerotechnics), *Rosdorleasing* (road construction), *State Transport Leasing Company* (airport ground equipment), *Financial Leasing Company* (aerotechnics, ships, oil and gas extraction equipment, military equipment, machine building, road construction equipment, medical and healthcare

equipment). State companies are also established by regional authorities with the aim of stimulating the development of small business in the region.

Market trends in 2005

The main trend of leasing market in 2005 was the competition increase between lessors, which led to considerable market revitalization on the whole.

In this respect the most important event in 2005 was the appearance of 5 international gigantic leasing companies in the Russian market. Those are: Austrian *FB Leasing*, Italian *Locat Leasing Russia* (by Uni credit), Dutch *ING Leasing*, French *Arval* (by BNP Paribas) and Latvian *Parex Leasing*.

So far international financial groups, leasing companies and banks have been rather cautious about Russia: lessors with foreign capital could be counted on the fingers of one hand. Among the most universal companies are *Raiffeisen Leasing*, *IMB Leasing* and *Europlan*, plus several specialized companies under suppliers, such as *Scania Leasing*, *Volvo Finance Group*, *DaimlerChrysler Leasing Avtomobili.*

But the time has come: high rates of market growth, high profitability and low credit risks did not leave foreigners indifferent. Russian leasing appeal turned so high that some companies chose it to start their promotion in Russia with. While *ING Leasing* and *Arval* (BNP Paribas) were established on the basis of foreign banks, functioning in Russia for a quite a long time, *FB Leasing* and the financial group *Uni Credit* which stands behind *Locat Leasing Russia* decided to start their business in Russia with leasing companies. No wonder, since leasing is a world-known reliable financial instrument.

Efficient management was there to strengthen the reliability of leasing. Both the CEOs of the two companies are well known in Russia: *FB Leasing* was headed by Andreas Lange, former Head of *DaimlerChrysler Leasing Avtomobili*, Chairman of the International Committee of Rosleasing Association, and Dmitri Shabalin, former CEO of *IMB Leasing*, *Raiffeisen Leasing* and *Nomos Leasing*, joined *Locat Leasing*.

New companies are coming up with ambitious plans: *FB Leasing* is planning to increase its annual lease portfolio volume to 600 million US dollars, *ING Leasing* – up to 1 billion US dollars in the next couple of years. So far *Locat Leasing* has been the most successful increasing its portfolio for the period of one year from zero to 55 million US dollars and taking 26th place in the rating done by the Russian Association of leasing companies. The plans are quite realistic taking into account the access of the companies to the huge and cheap financial resources of their parent institutions. However, the strict requirements to transaction reliability may become the limiting factor: companies are planning to work with the most liquid subjects of leasing, such as motor and railway transport. Competition in these segments is very high and it keeps on increasing.

New Russian leasing companies are emerging in the market. In the year of 2005 such companies as *Leasing Company of Small Business of the Republic of Tatarstan*, leasing company *KAMAZ,* leasing company *Prado* (under a financial services group of the same name), *Integral Leasing* (under the *Integral Bank*) have started their work on the territory of Russia. However these companies lack the resources, which are available for daughter companies of international giants and are not likely to influence the market considerably.

High rate of competition is proved by Herfindahl-Hirshman index, which equals 0.03[1]. It tells that there are quite a number of companies in the market, and the share of each of them is not very big.

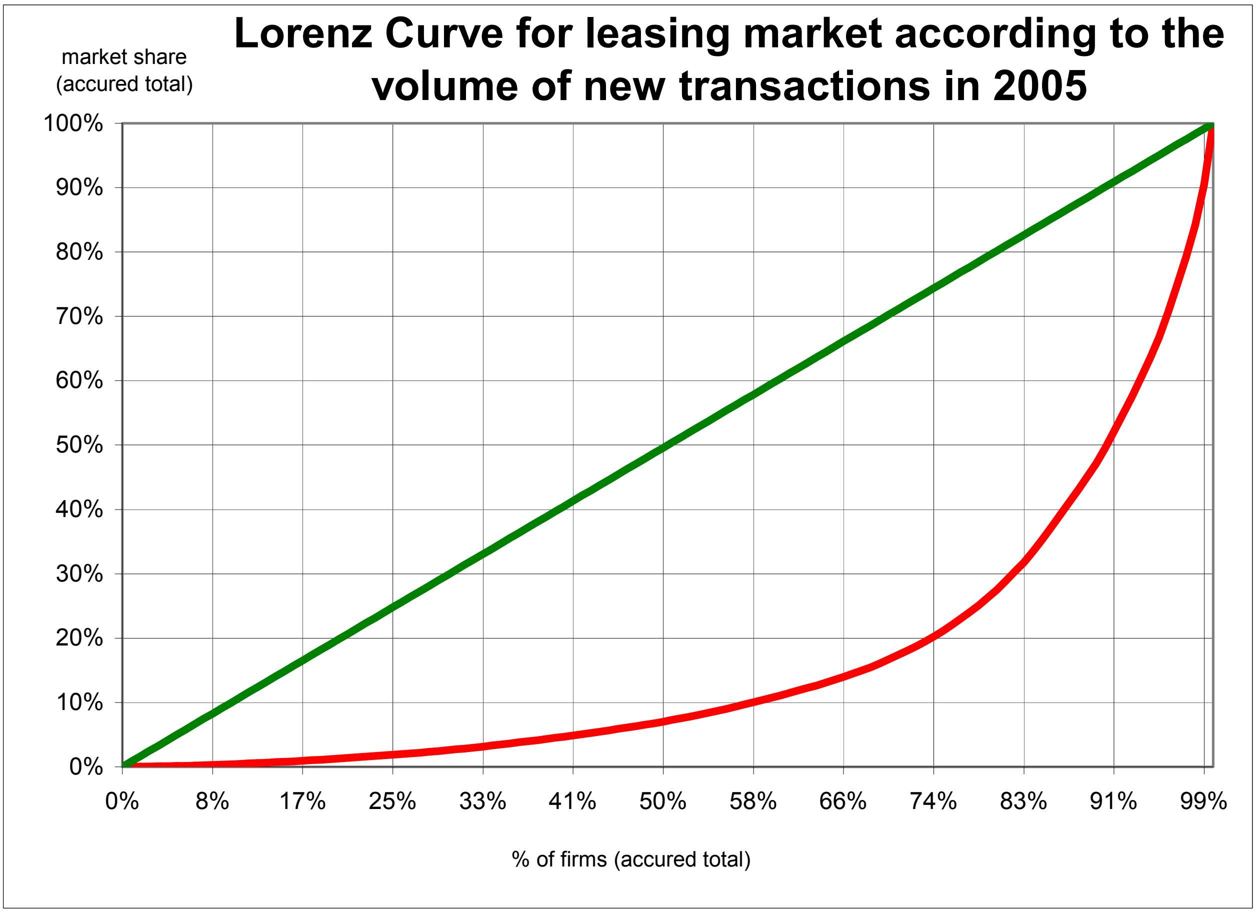
It can be derived directly from the Lorenz Curve for the Russian leasing market according to the volume of new transactions, that the cumulative share of 10% of largest companies amounts

[1] 0 – perfect competition, 1 - monopoly

to about 50% of the market (See Diagram 1). Compared to leasing markets of European countries this level of concentration is not very high.

Thus, 75% of the Russian leasing market belongs to 61 companies, while in Europe the number of companies controlling 75% of the leasing market differs from 2 to 33 companies, depending on the country. On average, in the developed European countries, 75% of market fall at only 11 companies.

Diagram 1



Source: Russian Association of leasing companies

Increasing competition forced leasing companies look for new market niches. Most of them were rather successful. Previously, operating leasing was mostly typical of foreign markets, but in 2005 it also appeared in the range of services offered by many Russian leasing companies. The main difference of operating leasing from traditional leasing so typical for Russia is that after the lease contract expires, the subject of leasing is not passed into lessee's ownership, but is returned to lessor. Therefore operating leasing contracts are normally shorter-term compared to financial leasing contracts.

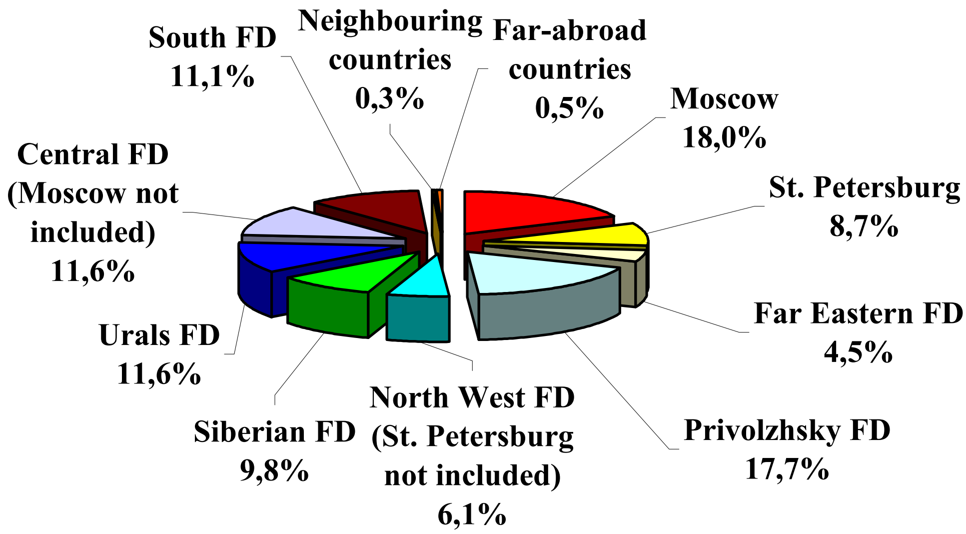
Operating leasing has its own market niche. First of all, supplying high-technology equipment, which depreciates quickly and thus it is more convenient for the customer to renovate it every 2-3 years, than to get in the ownership. Secondly, supplying equipment for occasional or seasonal works, e.g. in construction or agriculture. The demand for short-term lease is peculiarly high which is very important in the situation of high competition in auto leasing.

Leaseback transactions occupied their niche in portfolios of leasing companies. According to a leaseback transaction leasing company buys the customer's fixed assets and then puts it to financial lease to the same customer. It is very popular among companies that have equipment at their disposal but incur deficit of free capital.

High rate of competition leads to expansion of regional networks of leasing companies. The fact that the share of Moscow offices is declining but is increasing in other regions proves the trend towards development of regional business.

Moscow is still a clear first according to the number of leasing companies (18% of overall number). Privolzhsky Federal District is not far behind, with 17.7% of offices. Central offices and their affiliates are well distributed in other regions of Russia (See Diagram 2 and the rating of cities according to the number of leasing companies).

Diagram 2. Distribution of head offices and branch offices of leasing companies in the regions



Source: Russian Association of leasing companies

Rating of the cities according to the number of head offices of leasing companies and their branches

1	Moscow	68
2	St. Petersburg	33
3	Ekaterinburg	13
4	Samara	13
5	Novosibirsk	12
6	Rostov-on-Don	12
7	Chelyabinsk	12
8	Voronezh	10
9	Krasnodar	9
10	Yaroslavl	9
11	Volgograd	8
12	Nizhni Novgorod	8

13	Stavropol	8
14	Tumen	8
15	Irkutsk	7
16	Kazan	7
17	Perm	7
18	Kaliningrad	6
19	Krasnoyarsk	6
20	Saratov	6
21	Ufa	5
22	Veliky Novgorod	4
23	Izhevsk	4
24	Omsk	4
25	Pskov	4
26	Tomsk	4
27	Vladivostok	3
28	Vladimir	3
29	Kaluga	3
30	Kirov	3
31	Novorossisk	3
32	Togliatti	3
33	Almetievsk (Republic of Tatarstan)	2
34	Arkhangelsk	2
35	Astrakhan	2
36	Vologda	2
37	Ivanovo	2
38	Kemerovo	2
39	Lipetsk	2
40	Murmansk	2
41	Naberezhniye Chelny	2
42	Orenburg	2
43	Petrozavodsk	2
44	Ryazan	2
45	Surgut	2
46	Syktyvkar	2
47	Tver	2
48	Tula	2
49	Khanty-Mansisk	2
50	Yuzhno-Sakhalinsk	2

Another 37 cities, not in the list, have 1 leasing company each.

The information provided according to 121 companies participating in the survey.

Source: Russian Association of leasing companies

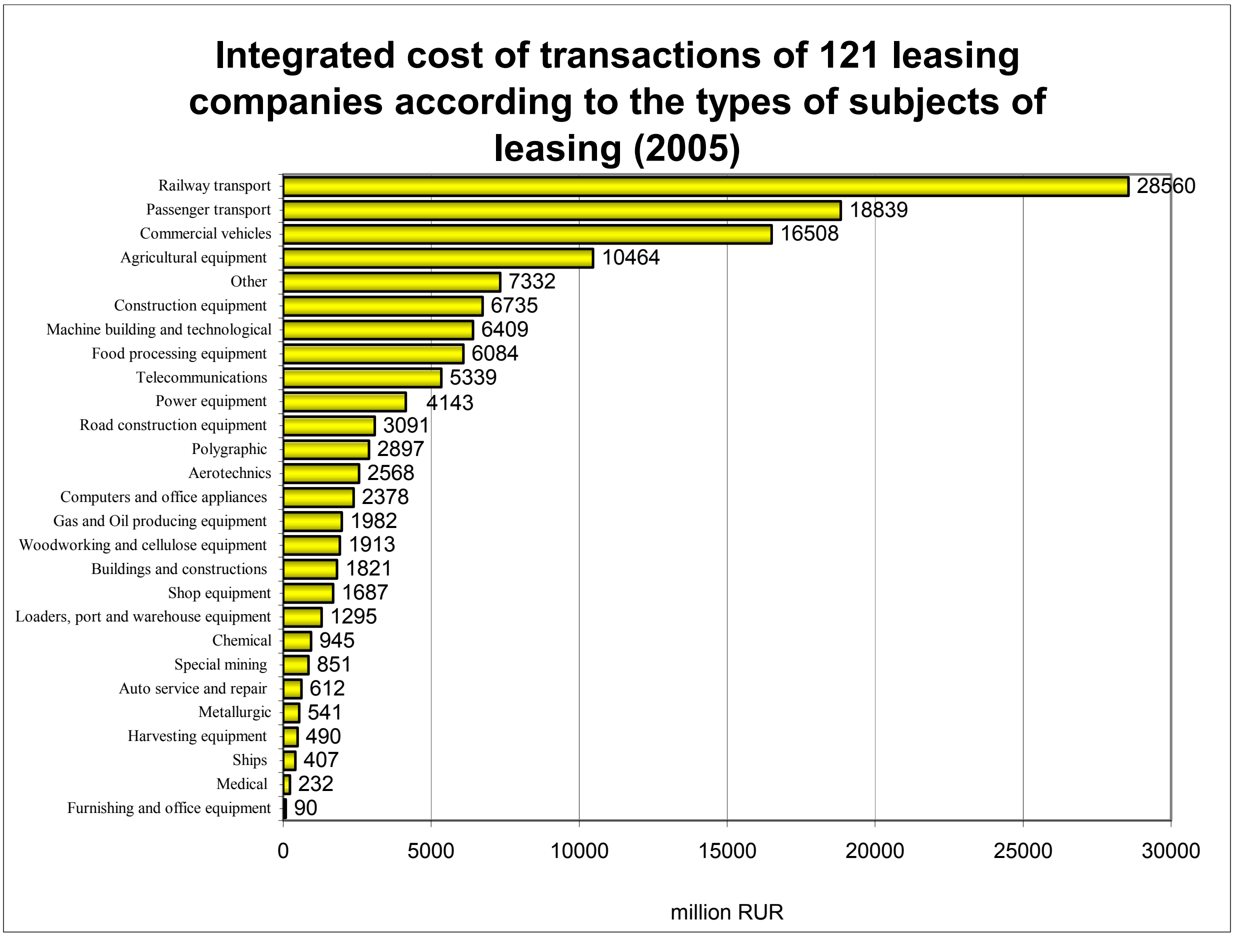
Changes in the structure of the market

The year of 2005 was marked by structural changes of the market – both in the segments and in the positions of the leading companies in the rating.

Among the leaders of the market are passenger and commercial vehicles transactions, which are far ahead of all the rest of the subjects of leasing (See Diagram 3). Historically this segment has been the most attractive for lessors. Almost all the Russian leasing companies work in this segment due to sound liquidity of transport, which secures a transaction. Most of leasing companies, emerging in the market, start their work in this very segment. Only after accumulating some experience, they move on to market niches of higher risks. That is why the increasing attention to leasing market and appearance of new market players, affect transport leasing first of all.

Apart from passenger transport, sound liquidity is taking railway transport leasing to the leading positions. Though it should be mentioned that there were additional incentives in the segment. First and foremost, it is the increasing demand of *Russian Railways* JSC. In the year of 2003 *Russian Railways* JSC held an auction for leasing of 1000 high-sided wagons. In 2004 the number increased to 4,600 and to 7,000 in 2005.

Another factor that caused the increase in the portfolio value of railway transport transactions was the double advance in price for the last two years. Changes in the legislation that allowed shortening depreciation time of railway transport, were very favourable for the development of leasing in this segment. Taking into account the multiplication factor, the segment became suitable for leasing. Because of the quick development of the segment, relatively new companies became the leaders in the market, those are *Magistral Finance, Hansa Leasing, Brunswick Rail Leasing.* Largest market players, *Russian-German Leasing Company*, *Alfa Leasing,* are engaged in the segment as well. Naturally, new companies appearing on the market are planning to work in the segment of passenger and railway transport leasing.



Source: Russian Association of leasing companies

Considerable changes have taken place in the positions of the market leaders. The appearance of the new leader of the rating – *Magistral Finance* – is also the consequence of the development of railway transport leasing and the auction held by *Russian Railways* JSC, which was won by *Magistral Finance*. The second place belongs to *Uralsib*, which trebled its portfolio to RUR 9.2 billion. This might be explained by the process of consolidation of the *Uralsib financial group*. As a result of consolidation, the financial group became one of the largest in the country, which told on its leasing activities. During the consolidation into one leasing structure – the *Uralsib* leasing company – *Region Leasing, NIKOIL-Leasing* and *Capital* were united, which turned to be the largest consolidation in the Russian leasing market.

The same applies to *Europlan*, which got the leading position very quickly after taking over *Rolf-leasing*, the largest car lease operator in the market.

Another newcomer got into the top ten of the rating – *Hansa Leasing,* subsidiary of the largest Scandinavian financial group, proves the high potential of foreign companies on the Russian market. Having worked for only 2 years on the Russian market focusing on railway transport mainly (high-competitive segment), the company managed to increase its portfolio to RUR6.5 billion. The same scenario applies to *Brunswick Rail Leasing*, which appeared in April 2004, specializing in the same segment. These two examples of rather young companies, outstripping the Russian largest leasing companies with more than 10 years of experience, give the possibility to forecast the leaders of the leasing market in several years. On top of that, in 2005 another 5 international giants advanced claims to similar achievements.

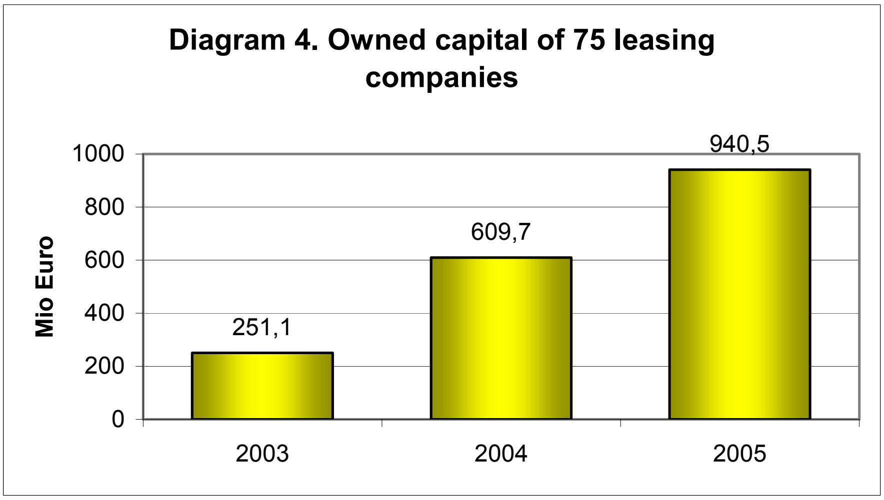
Prospects

The appearance of foreign giants was not only a good rouse in the leading ten of the market. It actually started a conceptually new stage of leasing market development.

The thing is that leasing companies used to work under banks mainly. Attracting resources from banks, they operated in separate market segments, which were hardly accessible for banks themselves. When giving credits, banks treated the final lessee, and not the leasing company, which put them into a disadvantageous position of bank agents.

However, a new paradigm of leasing business has started emerging. The leading leasing companies have reached sufficient business volume to go out of banks' control and start competing fairly with them. Owned capital is the key factor in this case since it is the main indicator for investors. In this respect leasing companies are as competitive as banks.

Another figures, such as portfolio volume, regional network, and diversification of sources of financing are on the same level with banks. The appearance of foreign leasing companies strengthens the trend. On the one hand, it is due to the fact that the companies are large themselves and are able to compete with banks. On the other hand, their appearance stimulates the enlargement of domestic leasing companies. High reliability of leasing transactions, independence from banks, considerable competition are very likely to make leasing conditions far more advantageous than those of credit.



Source: Russian Association of leasing companies

Research methodology.

The research was conducted in accordance with the methodology of LEASEUROPE. All in all, 121 Russian leasing companies participated in it. According to our estimations, the business of these companies equals 60% of the Russian leasing market.