Russian Far East:

Russian Far East Market for Forestry/Woodworking Equipment

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Date (January 2007)
ID:# 137054

Summary

This report provides a snapshot of the Russian Far East (RFE) forestry sector and the potential for U.S. forestry/woodworking equipment. The report also highlights commercial and investment opportunities for U.S. companies. Being dependent on the Pacific Rim timber markets (mostly Japan, South Korea, China, and to some extent, the U.S.), RFE timber companies are need to re-tool their production lines to meet a growing demand in high-end quality lumber. Also, the RFE construction industry has also created an almost insatiable demand for value-added construction board, beams, doors, and window frames. Currently, the forestry industry presents strong potential for U.S. suppliers of harvesting and woodworking equipment as well as profitable partners for U.S. investment. Competition in the sector is primarily domestic, but there is a growing representation of European, Asian, and U.S. equipment suppliers in the major RFE cities. Sawmills, planers, dry kilns, saw chains and bars, finger-jointing equipment, and different types of heavy logging equipment are among the best sales prospects in the local market. Local end-users are mainly concentrated in the southern part of the RFE (Khabarovskiy and Primorskiy krais, Sakhalin, and Amurskaya Oblast), where resources are diverse and felling and processing are more developed. Customs clearance, certification, financial tools, and infrastructure in the RFE can be a challenge for equipment exporters. Sales through local dealers/agents will provide the best market entry. End Summary.

Market Demand

Next to energy, timber is the next big wave of economic development in the RFE. The forest resources of the RFE are enormous, accounting for almost 40% of Russia's national 82 billion m^3. The estimated allowable annual cut (ACC) is over 90 million m^3, which is about 20% of Russia's ACC. The major share of high-quality coniferous (red pine, spruce, larch, fur – about 80%) and deciduous (ash, oak, birch, asp – about 20%) resources is accessible in Khabarovskiy and Primorskiy krais, Sakhalin, and Amurskaya Oblast. The Sakha Republic (Yakutiya) is the richest in forest resources (about 50% of the RFE's total timber stock), but its remoteness from timber markets combined with transportation challenges (undeveloped infrastructure and high transportation costs) currently prevent this region from being one of the key-players in this sector.

Although the RFE has long been one of the largest wood harvesting and timber exporting regions of Russia (principal export markets for RFE timber are China, Japan, and South Korea), local wood-processing and furniture production industries are still underdeveloped. It is estimated that only 10-15% of logs harvested in the RFE are processed domestically. In 2005, the RFE exported 14.5 cubic meters (m^3) of raw logs, but produced 12.5 million m^3 of lumber and 1.2 million m^3 of engineered board. This is due to the poor state of wood processing facilities in the region. Most of the equipment used in the RFE's forestry/woodworking sectors (with the exception of joint ventures, where new machinery is usually supplied by a foreign partner as their contribution to authorized capital) is outdated and needs to be replaced. Harvesting methods currently leave tremendous amounts of waste. As a result, often only 45-50% of the harvest is usable. The absence of equipment to utilize low-grade timber (logs with 10-18 centimeters in diameter) significantly reduces economic harvest levels. Along with the undeveloped manufacturing base, a shortage of experience in international product quality standards is another impediment to local production of engineered lumber. The RFE forestry companies are facing competition with other suppliers, including Canada, New Zealand, Chile. These trends are driving RFE logging companies to search out state-of-the-art engineered lumber production technologies to meet the lumber sizes, grades, moisture, species, etc. requirements.

Due to the new Federal Mortgage Development Program and the Russian Federation's National Priority Project to provide affordable and safe housing, a large number of RFE citizens are gaining access to bank financing to improve their living conditions. The trend is stimulating growth in the construction of inexpensive houses, based on the use of modern foreign technologies. Local wood processing companies are hard pressed to re-tool and modernize their production facilities to meet the demand for engineered lumber (building and finishing materials, windows, doors, furniture). Also, the development of high-end wood processing is a policy being advocated by RFE regional governments as well. As an example, the Khabarovskiy krai government issued regulations (though unrealistic given current production) requiring logging companies to process at least 20% of their harvest at local facilities. Efficiency and maximum use of harvested timber are therefore critical issues for the RFE's forestry and woodworking industries, and U.S. technologies and equipment represent needed solutions. Cash-strapped small- and medium-sized saw mills are especially interested in production machinery designed for these types of businesses with a smaller-scale capacity and correspondingly lower prices.

However, competition from the Chinese forest processing industry will have a growing impact on the RFE timber industry during the next five to ten years creating impediments to local value-added products manufacturing. The volume of RFE log exports to China has increased dramatically during the last three years; the volume of legal export in 2005 was 26 million m^3. Even more problematic is that Illegal felling and unregistered Sino-Russian border trade is enormous. About 90-95% of timber traded between China and Russia passes through land border crossings. Finally, favorable Chinese tariff and tax policies (value added taxes on imported Russian timber is half the regular rate) benefit the Chinese log importers. Russian timber is cheap, stable and abundant, with relatively low transportation costs. In China, IKEA alone has over 200 furniture manufacturing shops. If current trends are maintained, the RFE will become the single largest supplier of raw logs to huge sawmill industry in Northeast China. The processed timber made from Russian logs is then exported to Japan, Taiwan, and other Asia-Pacific countries.

Best Prospects

Since the U.S. industry of engineered wood products has extensive experience in development of advanced materials and construction of modern mills, U.S. companies may find a high potential in Russia marketing the following equipment and technologies:

Logging and harvesting equipment (HS Code 870190):

- log skidders;
- tractors equipped with hydro manipulators for log lifting;
- log lifting;
- harvesters;
- forwarders;

- machinery capable to access a 30^0 steeply slope;
- equipment for bundling;
- forestry hand/portable tools including pruning and bush saws, band and chain saws (HS 84678);
- saw mills (HS Code 846591);
- portable clippers;
- woodworking machine tools.

Wood-processing equipment:

- de-barkers, chippers, rotary peelers;
- kiln dryers (HS Code 841932);
- veneer, plywood, particle and fiberboard, glue laminated board, parquet flooring making machinery;
- MDF/OSB plant;
- equipment and automatic/complex lines, which use saw dust, chips;

- moisture measuring systems;
- planners and finger-jointing equipment (HS Code 846592);
- grinding, sanding, lapping machines (HS Code 846593);
- presses;
- glues and varnishes;
- wood treatment products;
- biomass boiler;
- waste-treatment equipment (sawdust-briquetting machines);
- small logs processing technology for “trash” logs with 10-18 centimetres in diameter.

Domestic Competition

Russian-made woodworking equipment does offer a wide assortment of de-barkers, horizontal band saw mills, round saw mills, gang saws, planers, sanding machines. Such equipment allows a medium-quality, standardized lumber production for construction sector. Domestic equipment is relatively inexpensive and practically all end-users have several types of it. However, this equipment is not used to produce high-end quality items. Despite the lower cost and wide availability of Russian-made equipment, local purchasers prefer imported one to comply with particular manufacturing technique and requirements. Imports of woodworking equipment include direct supplies to end-users and supplies to wholesale trading firms and distributors. The majority of foreign importers have representative offices in Moscow, St. Petersburg, Siberia, and RFE. German, Italian, Finnish, Swedish and especially Japanese and South Korean equipment and harvesting machinery have long dominated the market. Firms from the U.S. are acquiring their own market share in recent years with their reliable product.

Key Suppliers Competitive Analysis

Competition is becoming sharper with the increasing potential of the RFE market for equipment. The status of Asian countries, especially Japan, is very strong due to not only its proximity, but established trade relations and flexible approaches to doing business in the region. At the same time, European (German, Finnish, Swedish, and Italian) exporters also have gained a stable position in the RFE forestry market. U.S. companies have to be oriented towards long-term relationships, be willing to invest time and money in promoting their products, and be ready to provide flexible sales terms and conditions.

A. Local Competition

There is not any serious local production of forestry equipment in the RFE. Small amounts of basic woodworking machinery and some heavy equipment, produced by the Khabarovskiy Machinery Plant and Khabarovsk-based Graviton gang saw mills manufacturer, are not competitive. Located thousands of kilometers away from the RFE logging sites, the Altaisk Tractor Manufacturing Plant (southern Siberia) producing skidders, the Uralsk Automobile Plant (UralMash), and Moscow Automobile Plant (MAZ) with their timber carriers represent the Russian-made transportation machinery. A dozen of companies (DalTekhMashService, DalAvtoTekhMashService, GAZ AvtoPoisk, etc.) act as regional dealers offering KAMAZs, Urals, KRAZs, their spare parts, and post-sales services. Newly Independent States manufacturers (Minskiy Automobile Plant, ByeloRussia) are even more remote, and lack direct access to the RFE market. According to the local statistics the RFE average harvesting enterprise employs mainly skidders and chainsaws. The share of relatively new units (1999-2000 year-made) doesn't exceed 13% of all skidders; the bulk of the heavy-duty machinery is refurbished Urals, KAMAZs, and KRAZs. Generally, these brands initially employed by the military do not meet requirements of reliability and carrying capacity for 60 miles hauling.

However, with the on-going rise of the industry, domestic manufacturers are trying to increase their market share and have actively started developing local distribution channels. Domestic products are attractive by their affordable prices (4-6 times lower than imported analogues), but at the same time low quality and substandard technical characteristics considerably decrease their competitiveness.

B. Foreign Countries Competition

Japanese and South Korean firms sell through trading houses like Sumitomo, Marubeni, KOTRA. In a few cases, the Koreans supply their second-hand equipment themselves on and often arrange financing terms based on barter for timber products. Japan has been the RFE's main partner in this sector for over 20 years, and is ranked number one in sales of forestry equipment in the RFE market with the leading Japanese machinery and equipment trademarks being Komatsu and Kobelco.

Japanese machinery and heavy equipment for forestry sector have been supplied under several bilateral government agreements providing preferential loans and credit lines through major Japanese trading corporations. Most of these also involved barter deals when equipment was provided in exchange for round wood and lumber. Forestry companies state that Japanese competitors offer end-user-friendly payment terms and flexible prices, which is a major determinant on the price-sensitive market. There is a substantial amount of Japanese logging equipment being serviced by the Komatsu Parts' service center and warehouse operations based in Khabarovsk but direct sales of Japanese equipment and machinery have almost stopped. Now, Japan supplies forestry and wood-processing equipment to the RFE in smaller amounts as part of separate barter deals, or as a contribution to the authorized capital of Russian-Japanese JVs. Today, Japan’s involvement in the market is more often that of a JV partner in local lumber shops. There is a number of successful Russian-Japanese JVs: 1) Tairiku runs a well-equipped sawmill plant in the North of Khabarovskiy krai producing kiln dried pine lumber for the Japanese market; its annual capacity is about 20 thousand m3. The equipment was provided by the Japanese partner. 2) Technowood, is another JV between TerneyLes (Russia) and two Japanese firms (Sumitomo Corporation and Seven Kogyowood) and is one of the most dynamic JVs in the RFE. With its annual capacity of 40 thousand m3 Technowood manufactures 65 types of engineered lumber products, almost entirely exported to Japan. 3) TerneyLes is also a partner in Russian-Japanese JV Hardwood in Plastun, Primorskiy krai. These JVs are also equipped with machinery supplied by the Japanese partner. However, they source their equipment worldwide including significant purchases of German-made (Weinig) equipment. Most recently, the Komsomolsk-based (Khabarovskiy krai) Flora and Sojitsu Corp. (Japan) established a plywood manufacturing facility in the Komsomolsk area. Japanese, Swedish, and German companies are expected to be the major equipment suppliers for the project.

European (Finnish, Swedish, German, Italian, Norwegian) companies have a strong reputation in the local market for their quality and the advanced features of their equipment. Such names and trademarks as Weinig, Stihl, Husqvarna, Partek, Valmet, Volvo, Loglift, Katres, Owren and Timberjack (which is now owned and distributed by John Deere) are highly respected by local companies. Volvo Truck Corporation offers second-hand heavy machinery through its Western Russia dealers, service and maintenance being carried out by its certified service center in Vladivostok. Loglift, Partek, Husquarna, Bosch, Gardena, GRIGGIO, and Stihl are present in the RFE market through their local agents and dealers, although their distribution networks are still underdeveloped. There are units of dry kilns manufactured by KATRES (Czech), Eisenmann (Germany), Stroi CAD sawing machines (Slovenia) in the RFE. Germany is very aggressive at the RFE market with its Deutsche Bank providing financing under a guarantee from Vneshtorgbank (Russia). The German firm HDM Ost has a rep office in Vladivostok and is interested in purchasing large amounts of engineered lumber (glued panels and boards) and can serve as an equipment supply channel. Michael Weining AG lines for production of parquet board and end/edgejointing of sawn materials is good selling product in the RFE, where word-of-a-mouth is one of the best marketing tools. Lesozavodsk-based (Primorskiy krai) EvroOkno firm runs an Italian-made automatic windows and doors production line with an annual capacity of 20 m^2. Timberjack (Finland), the world’s leading designer, manufacturer, and distributor of forest machines, exemplified successful performance on the local market. Over 60 Timberjack harvesters and 70 forwarders are operating in the sector, harvesting about 35% of the RFE timber. Dallesprom-Timberjack provides guarantee services for Timberjack logging equipment to the RFE strategic customers.

Barter trade with China also involves cheap, abundant and unprotected Chinese laborers to cut RFE wood with Chinese equipment and machinery. The estimated annual volume of such trade is about $200 million.

Chinese-manufactured wood-processing equipment is price attractive to local businesses experiencing severe deficit of financial resources, but at the same time, it is associated with low quality levels, and no after-sale warranty and service. In most cases, Chinese sellers are willing to illegally indicate a lower price on the invoice to decrease customs duty and tariffs for their Russian customers. Many Chinese businessmen run wholesale timber yards in the Sino-Russian boarder sites in the Khabarovskiy krai, Jewish Autonomous Oblast, and the Amurskaya Oblast.

Since 2004, several Chinese companies (Asia Pulp and Paper Group (APP), China National Pulp and Paper Corporation (CNPPC), Keban Dyansin Group) have independently been approaching the RFE regional administrations with investment projects of a pulp mill construction in Khabarovskiy krai worth from $400 million up to $1, 200 million. However, some voices say that this may be one of a illegal channels for shipping a high-quality Russian timber as pulp to China. Shenyan-Khabarovsk, a recently established Russian-Chinese JV started manufacturing MDF (Medium Density Fiberboard) in the Khabarovsk Metal Working Plant. Many Chinese export firms are listed under false names and aliases, which allow them to hide company profits. These fly-by-night companies use obsolete Chinese equipment with a high percentage of manual labor.

C. U.S. Market Position

Due to the economic recession in Japan in early 2000, U.S. heavy machinery dealers have (Caterpillar, DRC) encountered aggressive competition of Japanese-made brands. However, the current and the U.S. West Coast geographical proximity to the RFE does make U.S. equipment very competitive. U.S. equipment do benefit also benefits from the high respect of local companies for its high-quality, dependability and productivity. Unfortunately, U.S. companies enjoy limited penetration in the RFE market of wood-processing machinery overall. This is largely due to limited targeted marketing efforts of U.S. companies which results in information regarding American manufacturers or distributors of woodworking machinery being insufficient or unavailable.

Oregon Cutting Systems, John Deere (which now owns Timberjack), Caterpillar, Wood-Mizer, Hamre Equipment, and Koetter Dry Kiln are well known brands in the RFE; the latter three are the most successful in selling their equipment through Russian distributors and agents. Caterpillar's warehouse, along with after-sale maintenance support, has given the company many competitive advantages. Koetter Dry Kilns (Illinois) has become one of the best-selling U.S. brands in the RFE. This success was achieved by extremely flexible, custom-tailored approach necessary for the RFE sophisticated market. Koetter also started to offer expertise in waste-utilization and quality control, to make RFE-produced lumber more competitive on international markets. In 1999, Wood-Mizer, a worldwide known sawmill equipment manufacturer, established its consignment warehouse in Khabarovsk. Wood-Mizer sells sawmills, de-barkers, setworks, diamond sawmill sharpening machines, and various band saws providing after-sales services, warranty services, training for operators, and spare parts supply.

Although considered highly risky and challenging, the RFE forestry sector has attracted U.S. investment into several projects. For example, VostokLes is a small U.S.-Russian JV located not far from the city of Khabarovsk. It operates a woodworking facility, processing mainly hardwood (ash and oak) to be exported to Japan and Indonesia. The largest U.S. presence in the forestry sector is a JV established by the Global Forestry Management Group (GFMG). In 1996, the GFMG, a consortium of several small timber mills from the U.S. northwest, and ExpraLes, a Khabarovsk firm, established two JVs in Vanino and Sovgavan, Khabarovskiy krai. SovgavanLes harvests and Sovgavan-Port sorts and handles the timber export.

A limited number of local firm represent the U.S. woodworking equipment. Global Edge, one of Russia's largest distributors, offers a variety of U.S. equipment including Timber Harvester, High Point Tool, Heartwood, Baker Products, Unique Machine & Tool Co., The Tailor, and Lenox.

In January 2004, the Commercial Service Vladivostok supported the USAID-funded Winrock International Forest Project (Russia Forest Resources and Technologies Project) and R.E. Taylor and Associates, LTD. (Canadian counseling firm) to bring a delegation of RFE forestry companies and high-level government officials to the Pacific Northwest. The primary purpose was to foster mutually beneficial relationships between RFE mills and U.S. finished product producers seeking to expand their supplier base, especially those U.S. manufacturers willing to supply state-of-the-art equipment in barter trade. In May 2005, the same organizers brought a Forestry Trade Mission to the Khabarovsky and Primorsky krais. Six U.S. companies -- Blue Linx Corp., USNR Equipment Co., American Forest and Paper Assoc., Weyerhaeuser Co., Brightwood Corp., Evermark Ltd. -- participated in the mission.

Participants met face-to-face with about 20 pre-screened Khabarovsky and Primorsky krais sawmills, furniture factories, molding/door jams/panels/window beams manufacturers and with representatives of banks, ports, freight forwarding companies, RFE railroad, customs, and local administrations. As a direct result of the mission, USNR (machine systems for dimensional lumber and engineered wood products manufacturing) has opened representative offices in both Moscow and Khabarovsk.

Prospective Buyers

Essentially all Russian forestry companies are now partially or fully privatized and end-users are free to choose vendors of imported machinery. The structure of end-users has also changed -- practically all the RFE state-owned holdings (DalLesProm, PrimorskLesProm, SakhalinLesProm, AmurskLesProm) have split into smaller private companies. As a result, almost half of the RFE forestry companies are small and regularly experience financial constraints. This category of customer is very price-sensitive and highly interested in credit terms and flexible payment schemes. As a result, only medium and large companies and holdings are the traditional clients of U.S. equipment exporters. Forestry equipment end-users are mainly concentrated in the southern part of the RFE (Khabarovskiy and Primorskiy krais, Sakhalin, and Amurskaya Oblast), where wood-cutting and processing are most developed. According to interviews, many are accustomed to purchasing equipment through representative offices of foreign companies based in Western Russia as opposed to local agents. These huge holdings usually have established supply channels and relationships with vendors to receive competitive sales proposals. Only large companies can finance large-scale projects, such as the construction of new production facilities or refurbishment of existing ones.

Leading logging and milling firms in the RFE that may be partners to U.S. equipment suppliers are: Ros-DV (Khabarovsk), JV Rimbunan Hijau International with 100% of Malaysian capital, Magma, Taiga, JV Forest Starma, Dallesstroy, Flora, Dynasty-Drev, Lidoga-Trading, JV Vanino-Tairiku with 100% of Japanese capital, JV Rimbunan-Khidjau RFE Company Ltd. with 100% of Malaysian capital, JV Arkaim LTD with 90% of Russian and 10% of Norwegian capital (Khabarovskiy krai), Incom, RM-Trading (Vladivostok), PrimorskLesProm, TerneiLes group of companies with daughter Russian-Japanese JV STS Technowood and JV PTS Hardwood, Plastun, Les Export, IuchegorskLes, Primorskiy GOK, Araliya, Berkut, (Primorskiy krai), SakhaLes, Tabaginskiy DOK (Yakutiya). Indeed, this list will expand considerably in 2007 if the regional authorities are successful. When entering the RFE market, U.S. companies are encouraged to arrange meetings to discuss their goals and priority issues with regional governmental bodies as almost every RFE region has developed a regional program for the development of forestry sector. Of course, the Commercial Office in Vladivostok can assist with all such arrangements.

Surprisingly, despite the afore mentioned transportation challenges, the Republic of Sakha (Yakutiya) is perhaps the most advanced RFE territory in implementing deep processing of timber. Its 430 forestry companies are projected to produce over 180 thousand m^3 of high-end engineered lumber annually starting this year. The Republic now requires every foreign firm to first present their products and goals of expansion in the Yakutiya market to the Ministry of International Affairs and the Ministry of Forestry.

Market Entry

Woodworking machinery can supplied either through distributors or directly to end-users. Distribution through a local agent is one of the best vehicles to penetrate the RFE market. However, even U.S. firms have established a distributor or agent in western Russia, the remoteness and local specifics of the RFE market do not allow it to be effectively covered from such a huge distance. After-sales service including short-term delivery of spare parts is critical. Therefore, to be successful in this expansive market, U.S. companies are encouraged to have a regional representative office and a local warehouse with spare parts if not separate dealers for different regions/krais, as distribution network and infrastructure are still undeveloped in the RFE. Locals reps are more flexible, have a better access to end-users and are better attuned to the logic of a fluctuating and challenging business environment. Being aware of all the "ins and outs", local agent can be especially valuable when it comes to complicated and intricate issues of obtaining equipment certification and permissions, as well as customs clearance. U.S. equipment suppliers are expected to provide promotional support, and sometimes training and detailed clarification of their requirements to avoid misunderstandings that can occur due to different business practices and approaches.

Direct Sales. Direct sales are a highly productive way of selling products if it is done in person. This is especially true in Russia, where traditionally personal relationships often mean more than signed agreements. U.S. firms should invest time and resources in establishing strong relationships with potential clients and regional administrations. The first sale can be difficult and time consuming but it is a critical step to gaining recognition and future sales. At the same time, a considerable share of the potential customers and end-users in the RFE forestry sector are located in the harsh taiga, and this can make them inaccessible to foreign vendors who have not effectively planned their sales trips. Such challenges and the high costs associated with either regular travel or presence, make the direct sales approach affordable to very few companies.

Joint Venture (JV). JVs while a regular aspect of the market are fraught with risk. The RFE forestry sector is notorious for grey business practices and corruption. Local governments, though proclaiming a foreign investment friendly policy, have been involved in number of highly profile expropriation attempts. Interested investors will have to be ready for economic and political uncertainties, corruption, both government and mafia (very often they are closely connected) interference, differences in business practices of this region, which is often named the "wild East" in comparison to the U.S. "wild West". But with the huge demand of the Pacific Rim markets for RFE timber, high returns on the investments can compensate for these risks. U.S. Companies investing in the RFE lumber and high-end products manufacturing facilities with the purpose of exporting them to neighboring Asian and Pacific Rim markets, as well as Europe, will benefit from their entrepreneurial drive due to vast and relatively inexpensive timber resources and cheap labor. However, it should be noted that U.S. investment does not necessarily imply use of U.S.-manufactured equipment.

International Tenders. International tenders are arranged and conducted by the RFE Department of Natural Resources and the Tender Committee whose members are appointed by the Governor. The RFE regional Tender Operator is responsible for preparing financial documents and conducting the tender. For more information on RFE regional tenders for international companies, please contact the U.S. Commercial Service Vladivostok.

Market Issues and Obstacles

Import Climate. In general, the regulatory climate for importing forestry/woodworking equipment into Russia is favorable. Customs duties on this machinery vary from 5% to 10% plus a value added tax 15%. Recently, through Government Resolution No.168 of March 24, 2006, the Russian Federation has adopted temporary import duties for certain kinds of equipment for a 9-month period beginning April 29, 2006. Within this period, import duties are waived for about 700 kinds of industrial equipment, including forestry machinery (HS Codes 8427;28;29;30;33) and woodworking machinery (HS code 8465). Please note that only 39 specific HSC positions within the forestry and woodworking machinery groups are tariff exempt. U.S. exporters may contact the U.S. Commercial Service in Russia directly with specific questions about whether certain products are included. The official publication of Russian Federation (RF) Government Resolution No. 168 of March 24, 2006 as well as the full list of the equipment under the resolution (in Russian) can be found at http://www.rg.ru/2006/03/29/poshlini-dok.html

U.S. suppliers should be very careful to comply with customs requirements and regulations. Failure to properly complete shipping documents and provide the necessary number of these documents may result in penalties and high storage fees at a customs warehouse. Shipments of goods to Russia must be accompanied by documents that prove that the product meets Russian quality, safety, and measurement standards. Getting certification, permissions, and customs clearance can become a nightmare without a helping hand of a local partner. Alternatively, the Russian Standards Committee, Gosstandart, can certify the products.

Under discussion since 2004, a new Russian Federation Forest Code was only approved by President Putin in December 2006 and comes into power on January 1, 2007. Until the new code is fully implemented, the lack of a clearly established state legislation for the timber sector, shortcomings in the customs regulation for the export of timber and lumber, and high tariffs for transportation will remain the primary factors hindering a more rapid development of this sector in the near term. According to RF Chief of Ministry of Economic Development Germann Greff, duties on round log export out of Russia will grow annually until 2010 starting in 2007. In July 2007, export duties for round logs will go up to 10% (as compared to the current 4%), but will not exceed 6 Euro/m^3, while export duties for lumber should be decreased to stimulate milling development in the RFE. Today, a company also has to pay a VAT on engineered board in the amount of 24%/m^3. Thus it is currently more cost-effective for a logging company to sell raw timber. One other short term impediment constraining growth in the sector is the constrained market demand for the locally produced wood products (doors, windows, furniture). Local products are often of lower quality than imports due to obsolete equipment; shortage of qualified staff; excessive control and checking; and problems with information exchange.

Competitive Factor. In order to enhance their market share, U.S. companies should bear in mind the factors critical to Russian end-users, such as pricing, quality, and payment terms. A good business approach is to propose a favorable package deal (training, servicing, and perhaps full or partial financing of a promotion/advertising campaign, etc) to compensate for the high transportation costs in comparison to Asian suppliers. Barter deals are successfully applied by the Asians, and can be considered by U.S. firms.

Financing. Financing of equipment purchases is the most sensitive issue, and U.S. companies should be flexible regarding payment terms for the equipment. Although external financing is available from foreign and local banks, as well as foreign and local government and private funds, the single largest impediment to expanding local milling and value-added capacity remains the shortage of working capital for equipment and low level of investment activity. In an effort to resolve this, most of the major Russian banks have considerably enlarged their investment portfolios with investments into RFE timber sector. In May 2005, Vneshtorg Bank opened a $50 million loan to the Vanino-based timber company to develop a wood processing facility. EBRD is also currently considering multi-million investments into a number of wood processing operations in the region. A number of larger successful Russian conglomerates successful in other profitable regional industry sectors (gold – Artel Amur, diamond mining – Almazy Anabara, fisheries – Poseidon) are also acting as local investors. However, interest rates are still very high.

Interested U.S. companies should also consider countertrade or barter deals, which are successfully being used by the Japanese, South Koreans, and Chinese. Supply of logging or wood-processing equipment in exchange for timber or processed wood products is a popular financial scheme in the RFE forestry sector. A U.S. company may propose a partnership in a JV, especially projects administered or sponsored by regional governments with priority given to export-oriented projects. The Russian party is likely to provide a production facility and workforce and will be expected to facilitate the project through the numerous Russian bureaucratic procedures and barriers. The American partner may be expected to supply the machinery, up-to-date technologies and to train local workers. U.S. firms are strongly encouraged to consult with the Commercial Office and qualified legal counsel throughout the negotiation process.

Leasing has proven to be especially promising for the RFE market because of its economic effectiveness, flexibility and accessibility in comparison with bank finance. Equipment suppliers also appreciate leasing as it offers additional sales opportunities. DeltaLeasing, created by the U.S.-Russia Investment Fund is a local leasing company, providing financing for small and medium-size enterprises to purchase U.S. equipment via a general guaranty facility approved by U.S. Ex-Im Bank in 2002. The program is of great value to U.S equipment vendors and manufacturers as it helps increase their sales without taking on additional credit risk in Russia. Utilization of leasing schemes may create additional advantages for U.S. equipment suppliers in their competition with European, Asian and domestic manufacturers. Within last five years DeltaLeasing has provided financing to 12 projects in the RFE forestry sector with total value of $3.1 million.

Trade Events

Participation in local trade shows/conferences and international events focused is very important for promotion of new products and establishing contacts with key industry people. Interested U.S. companies should take advantage of key industry trade shows and exhibitions to increase visibility of their products and services and find potential dealers or consumers. The Commercial Service in Vladivostok is actively involved in assisting U.S. Companies to take advantage of such events and is sponsoring a number of activities to help U.S. companies to access this important and underdeveloped market. One example is the video conference currently being planned to connect Pacific Northwest equipment, building supplies and finished product providers with the leading construction companies in the Russian Far East. Another currently identified venue where we will be supporting U.S. companies is DallExpoMebel, the annual Spring Woodprocessing, Furniture Design and Interior Exhibition, organized by the Khabarovsk International Fair. A catalog booth as well as assistance including enhanced briefings and one-one scheduled appointment will be available to any U.S. company visiting or exhibiting at the show. Exhibiting in Russia is particularly effective when combined with the U.S. Commercial Service's Gold Key Matching Service. (For more details of our products and services please see: http://www.buyusa.gov/russia/en/products_services.html

For More Information

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