CEEMEA Business Group

Russia Business "Gossip" – what executives are saying and thinking

by Dr. Daniel Thorniley
President, DT-Global Business Consulting
danielthorniley@dt-gbc.com

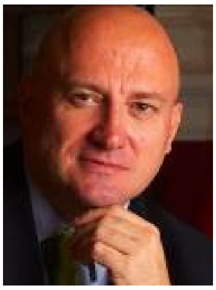
20 July 2015

IN ASSOCIATION WITH: anaplan, Baker & McKenzie, EY Building a better working world, Radius Group

Content

Contact: Dr Daniel Thorniley, President, DT Global Business Consulting GmbH
E: danielthorniley@dt-gbc.com / www.ceemeabusinessgroup.com

About the author



Dr Daniel Thorniley

danielthorniley@dt-gbc.com

Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) which is Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in CEEMEA, global and emerging markets especially Russia. These companies are part of the CEEMEA and Russia Business Group, which is an advisory and consultancy service. The services of the Group include written position papers, presentation slides and private client meetings as well as in-house presentations.

Danny writes a well-received monthly position paper on the Russian market as well as quarterly presentation slides on other CIS markets. He visits Moscow on business every 2-3 weeks and hosts 8-9 private meetings of the Russia Business Group annually. The most recent one was attended by some 140 senior executives. He is also invited to make some 50 speeches/presentations each year by clients across the world on global business trends, business operations, emerging markets, corporate best practice. Many of these speeches are focused on Russia and the CIS and he has made some 60 "Russia presentations" to visiting western CEOs explaining the positives of the market without being naïve.

For 23 years (until the closure of the Vienna office) Danny was Senior Vice President and Senior Consultant at The Economist Group, Vienna on global corporate business trends, with specialisation in BRIC.

Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

Danny is regarded as a charismatic speaker who can present detailed business and economic analysis in an easily digestible fashion with a great deal of genuine humour. Danny is renowned for not using powerpoint presentation slides - never. Dr Thorniley has also given guest presentations at Executive MBA courses on behalf of Oxford University, the University of Chicago, IESE (Spain) and the Central European University in Budapest. The executive MBA students at Chicago rated him "best speaker" on 12 occasions out of 12 over 5 years.

He has worked on a personal basis with companies operating in emerging markets for 26 years and has personal contacts with most senior western MNCs operating in the Russia and the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level and has long-standing personal friendships with leading executives.

He holds and has held a number of non-executive and advisory board memberships.

Dr Thorniley was educated at Oxford University. He holds a Bachelor of Arts degree, a diploma and a doctorate degree in Soviet political economy.

He has published three books, including one on Russia with Macmillan (UK/USA) and two with Profile books on Doing Business in Global Emerging Markets.

His beloved daughter is called Natasha after he read Tolstoy's War and Peace when he was a young man. One of his other favourite books is Master and Margarita by Bulgakov.

Executive summary

(For a list of key business factors which remain constant, see the appendix at the end of this paper)

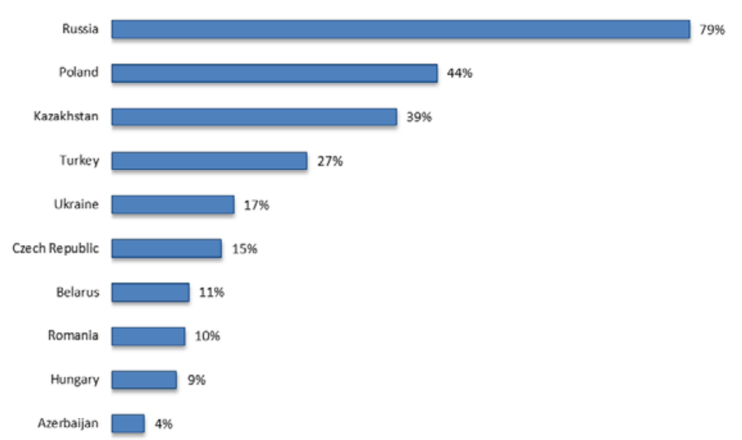
- "Those who are not localised will be out of the market or very weak", comment last month from managing director of western health company.
- Business results vary by sector. In general: pharmaceutical and health are performing not too bad; B2B/industrial is still the weakest link but recovering from the deep low levels of the turn of the year; and consumer products are mixed and after a solid start tot the year, they witnessed deceleration in May-June.
- Many companies fear a slight downturn in business this summer.
- "It's not just a question of working harder; it's a question of working smarter".
- Companies in some sectors are localising more; but more executives complain that getting localisation right is not so easy.
- Profits are coming down. But for many companies this means they are no longer the No 1-2 corporate profit provider in their company but often still in Top-5 or Top-10.
- Consumers are less willing to test new brands.
- We discuss below the paradox that: many companies plan 8-10% rouble sales growth this year and predict a stabilised rouble, but then tend also to forecast much sharper sales drops when denominated in FX. The answers lie in the extent companies could raise prices and what the corporate exchange rate is that is used in budgets and reforecasts.
- Many companies could not raise prices sufficiently to compensate for the rouble and inflationary effects.
- More companies have stated that cross-border trade(Russia-Ukraine) is actually holding up for business while those who see the actual or potential collapse of cross border business are still for the moment in a small minority.
- Russian retail is slowing in parts but some big players still report solid profits and Russian retail is moving more into the regions and western suppliers are happy to follow.
- "I think there is great potential for the market but we must be patient for the next 2 years".
- Financing is getting a bit better as interest rates fall but nothing is easy on this front.
- Nearly all companies paid "average white collar staff" and blue-collar staff below inflation in 2015 and many companies will continue that policy into 2016.
- Russian talent is still on the move and finding new opportunities; getting good talent is only marginally easier than 18 months ago.

Russia remains the No1 priority market for the next 3 years

In our summer Survey of CEE markets, Russia retains top spot as a priority market. The question has multiple answer options and hence why the total of replies exceeds 100%. But the figures show that Russia is still the most important market in the region strategically.

Which are your priority markets for the next three years?

Top 10 responses; countries ranked by number of responses



Source: CEEMEA Business Group CEE Benchmarking Survey June 2015

Pharmaceutical and health sector

Key factors in this sector include:

- The move to localisation as companies decide which products they will choose in time for January 2016 legislation.
- Some companies are considering registering product in Kazakhstan in order to take advantage of quicker registration and CIS market access in the Eurasian Economic Union.
- Sales to federal authorities are still struggling and have been for 18 months or so.
- Sales to regional hospitals and local authorities are a bit better but also suffer from tight budgets and/or budget cuts.
- OTC/pharmacy sales remain sound and many companies with an OTC profile are doing well or better.

The MD of a major European pharmaceutical company chipped in about the debate on volume or price recently:

> I hear sometimes too much focus on price. Yes, I know that's where the action is to be found and in the OTC sector. But if you gouge prices too much, you can alienate a lot of partners and lose market share. We are mixed about volume or price and try to differentiate product by product, customer by customer, if that is feasible.

Several executives have underscored the fact that OTC (pharmacy) is more resilient. As the MD of another major pharmaceutical company said in Moscow last month:

> The further away I get from government, the more money I make!

This was underscored by the MD of a US major investor who commented that:

> It's fairly clear: in government and other tenders we are growing at 10% and that, as you know, is good. But in OTC we are increasing sales by 45%, admittedly with much of that coming from higher prices.

But this is not to deny that business is also tough in many parts of this sector. The MD of another US investor also noted last month that:

> It's clear even in our sector that we are not going back to the glory days. We are actually finding it difficult to raise prices too much and managed only 10% last year and we will aim for 7-10% this year. That means we got hit hard by the FX rate. For non-tender products, we need to be affordable but that's a challenge in this environment. We are working to build more relationships in the regions: this is the right approach but it will take time.

This executive concludes with what many executives from all sectors would echo:

> There are now easy solutions, there is no panacea.

The MD of a US health company gave a detailed outlined of business last month in Moscow and here is summary of the remarks:

- The health market in 2015 is down -35% in sales in US dollars and within that medical devices are minus -10% in roubles which is about -30% in dollars.
- In our portfolio of retail products we are up 15% in roubles so that is good but for us this is a relatively small part of the business.
- *We raised prices and were able to remain the No 2 profit contributor in the CEEMEA region on 3 times more volume than Turkey for example.
- *For 2016 we plan flat growth of about 0-2% but then except 5-10% expansion in 2017-18 with solid profits on these sales.

- We believe the outlook is good because compared US health consumption per capita is 10 times larger than in Russia and European consumption is 4-5 times higher. There will be some convergence.
- “I think there is great potential for the market but we must be patient for the next 2 years”.
- Russia used to represent 80% of our total CIS business while now it is about 73%.
- In Ukraine we see pharmacy sales down -20% and public health sector purchases down -70%.
- Our receivables are good and our bad debt is 0.7%, one of the very best in the company globally.
- We invoice in US dollars or Euros but we have discussed “special FX rates” for our partners.
- Some 85% of medical devices are imported and obviously there is now a very strong push from the Russian government to localise.
- But we have to ask whether we are motivated to localise, and it can be hard to convince headquarters given the complex and often contradictory regulatory environment: in the past we faced 1-2 new regulations per annum, now it is 8-10. But there are market access benefits so it is a trade- off.

This executive also underlined some of the themes we have been discussing on HR and talent management (See our June HR Report):

- We did reduce headcount in the spring by 10-15%, mostly sales executives and replaced them with more reliance on distributors.
- We are following industry averages for salaries which means below inflation.
- But we did pay 2014 bonuses in Euros at the market rate so that made staff pretty happy.
- Talent is moving: we are seeing people at GM minus 1 and GM minus 2 looking for new jobs and getting them.

Consumer goods and retail sector

One executive running a European consumer products company in Moscow noted in a humorous way the issue of growing the business through price increases or via volume:

> We have been discussing the issue of price or volume in our company [note: and there are valid mixed views about what does and should drive the business in Russia]. It’s really up to me and other managers to figure it out. It depends on your business model and what you want to achieve and how. But if I can’t figure this out, then my grandmother can run this business instead of me!

The MD of a confectionary company commented last week in Moscow that consumers are less willing to test new brands now whereas traditional brands are holding up better. He also summed up the change to value as follows:

> It is no longer the stomach making the decisions but the pocket/wallet.

He also summed up the situation regrading profitability which is shared by many companies in that, “In terms of profits we are now close to the corporate global average whereas 20 months ago, we were the world leader”.

The MD of an Italian food company commented, along with many other consumer products and food & beverages companies, that the spring has seen some slowdown and that May was the weakest month so far. He summed up the thoughts of many when he said:

> Autumn with be the Rubicon and then we will know whether we have survived the crisis or not.

Much will depend on the famous resilience of the Russian consumer which is coming under severe pressure with rising inflation and falling real wages.

The CIS managing director of European retail outlet commented two week ago in Moscow that “Our business is good and turnover is up 13%”. He went on to say that:

> We are continuing with our plans for new stores and the only difference is that we might delay the timing of some. But the first quarter for us was great and the second quarter is still good. Yes, we are diversifying our store offerings as we want to catch the consumer at as many "points" as possible.

This executive who is well experienced also noted:

> It's not just a question of working harder; it's a question of working smarter. That applies to me as MD and all my (few) expatriates and our Russian management team.

He also raised the very good question:

> But given that we have done reasonably well so far, how the hell do we come up with a budget for 2016?

Certainly for all managing directors, budget planning for 2016 will be more complicated than usual whether 2015 has proven a better-than-expected year or a terrible one. Given that "base effects" are so skewed and that 2015 was impacted by so many external factors, getting the foundations right for the 2016 budget will be a challenge. One executive semi-seriously suggested:

> I honestly don't have a clue what to do. Obviously we will have scenarios based on macroeconomic factors and trading conditions but I think we will stick a finger in the air and say "something like 2015"! And see whether headquarters buys that.

The MD of an international apparel company made the following comments three weeks ago at dinner in Moscow:

> Expectations were set low thank heavens as we made a re-forecast in December when things were bleak so our corporate mood is not too bad. We are not discounting as much as before and thus our rouble sales were down -3% in the first quarter. But we have been able to register double-digit profit as we have reviewed the whole business and for example negotiated lower rents for most of our stores. In Ukraine our business is doing well thanks to 100% price increases which were remarkably absorbed. In Russia price increases are limited so far to 23%. I still think there is a premium story in Russia and we still see it.

This executive summarised his experience positively for two remains:

> This crisis has been an opportunity to rebase our business. Frankly too much has been expected from the Russian market. We did report many stellar years but nothing lasts forever.
>
> We are also planning to buy our warehouse and upgrade our office facilities. Our global management remains committed to the Russian market and despite this bump we still feel strongly that it will be a good, steady market in years to come.

The crisis as an opportunity to rebase the business was a theme echoed by an executive in the tobacco industry:

> In 2014 we were the world's largest profit contributor and grew profits locally by 30%. This wasn't sustainable and I see this as a healthy crisis. We are still doing very well in roubles and over-budget and clearly lower-priced products are benefitting us. We have a very broad portfolio and we are selling at all points but affordable products are helping a lot. We are getting hit by the slowdown in the construction sector and lower remittances for the migrant workers. This downtrading is not to the extent that it's destroying the market. Generally things are "OK".

On the important point of price increases, this executive echoed what many managers have stated:

> The Russian consumer is used to price rises. He/she does absorb them and the consumer is resilient.

We have argued frequently that when it comes to brand or value, that there is a shift to value taking place in the market but that there is still room for brand/premium and quality. We also note that as in many other markets the mid-price/mid-value sector is usually very difficult and/or getting hollowed out. The managing director of a major European consumer goods company concurred last week in Moscow:

> On down-trading, indeed “the middle” gets squeezed everywhere while in Moscow top-end price points still perform. Consumers look for value – they want the same premium product, but at a more affordable cost, so they’re more inclined to wait for season-end markdowns or seek out clearance stores. Our factory store business is absolutely on fire for the last 12 months and there’s no sign of a slow-down.

The MD of a European flavourings and ingredients company commented at a dinner last month:

> Premium is definitely NOT dead. Sure there are shifts but our customers pay us premium price for quality product and pass that on to the end consumers. Sure I know a diverse portfolio is very useful: no argument. But we shouldn’t over-react and think the premium game is over; it’s not.

The MD of a company providing kitchen & bathroom fittings noted the trends as follows:

> The market is down -40% but is better in price terms and our aim and success to date is to steal market share. We have been able to displace competitors. We are growing by 12% in roubles and this is thanks in large part to improving and investing in our distributors. The business was good until April and then started to trail off. My concern is that we have made investments into distribution but will they pay off now?

Regarding the much-discussed question of consumer segments, he noted that:

> Premium and super-premium are doing well in our sector but mid-brand and mid-price are getting badly hit while discount is hugely competitive and trying to make all this work is challenge.

On the downbeat side, this executive confirms the majority opinion that: “Ukraine is a disaster and receivables are almost impossible”. This is the consensus but a surprising minority still report remnants of good business which is actually remarkably but we stress that this is a small minority of companies.

The MD of European consumer product company noted that his sales were slowing through the spring:

> We were growing at the start of the year at 12-14% but this has drifted down to 5-6% by mid-June. Non-food downtrading is sharper than for food, and local suppliers are charging in FX or using an FX peg. We are also noting a rather scary trend in retailers coming up with more own label.

The B2B, industrial sector

As we noted in a recent report, several sectors of the B2B sector are still struggling badly, especially automotive and trucks and IT sales generally and especially to government. Also several B2B companies faced near-death business experiences in February when there appeared to be no business future left. However, since then many have reported an upward trend and can now see how they will survive. But as some of our anecdotes below testify, it is still tough for many.

We have argued in other papers and above that generally the B2B/industrials sector started the year quite badly or worse and that recent months and weeks have seen an improvement for many companies as finances ameliorates a bit with lower interest rates and more Russian customers are approaching western suppliers and wanting at least to talk about projects. But experiences are still very broad within the B2B sector and some companies still struggle badly.

Nor should one get too carried away as some sectors remain strained for this year: in the B2B sector where financing is most challenging, 43% of all companies predict negative rouble sales and fully 50% forecast negative rouble profits for 2015. These companies will need a strong and sustained rouble shift to improve on these figures and most of all, they need better financing options which do not look quickly forthcoming despite a marginal easing in liquidity this spring.

The MD of one western conglomerate noted this week in Moscow:

> There may be talk of things getting better but the hard economic numbers don't really reflect that. Some of the sectorial output numbers start to resemble 2009. If my company is any bell-weather, our top line in dollars fell by 50% but it is masked by a meaningless local currency growth number that reflects our attempts to compensate while capital expenditures for us and others are a fraction of previous plans.

Regarding limited staff reductions which does seem still to be the norm (see our recent HR report), this executive was more sceptical stating that:

> OK, I agree in part that there are not sweeping staff reductions, not yet. But a lot of temporary employees are not being renewed and soft attrition happens every day.

The executive in question as self-aware enough to ask "Or am I too pessimistic"?

This is sober thinking but for every tough story, there is usually a more upbeat one. The regional director of telecom equipment provider noted last week in London that:

> We were expecting to be struggling badly at the moment but most things are reasonable and better than excepted. Yes we are growing in roubles but thanks to our financing, FX rates that we obtained and price rises we are still growing in low-mid single digits in Euros. I think that's not bad.

The MD of a US company suppling to the agricultural sector saw things as fairly balanced:

> It's not a drama. We are doing relatively well. There is huge increased volatility: some see threats, some see opportunities. Overall the agricultural sector is not doing badly. Those who have local production and have managed the devaluation well have done OK or better. However, the agricultural sector is generally low profitability and 75% is local market and so export revenues are limited which make financing always an issue.

The executive went on to summarise several interesting points:

- Fundamental drivers are the same: the farmers want quality.
- We have raised prices by 50% and broadly customers have accepted this.
- We also have to phrase our contracts very commercially because due to seasonal factors we only get paid 6 months later. We have almost entirely shifted the rouble risk to our customers and once again, this has been broadly accepted.
- It's a very competitive environment with many Russian competitors.
- We presume that the time of better/stronger margins may be over and we have to re-jig how we judge the market but still at fairly good levels.
- The Ministry of Agriculture is telling us and all other western suppliers: you must localise and move added-value into Russia.

How's your business this summer?

As we noted above, divergent trends are taking place in the economy and across business sectors:

- **Consumer products** had a good start to the year and now see softening.
- **Industrials** had a bad start to the year and some are seeing the first signs of a rally, but not all.
- **Pharmaceuticals** were the strongest sector but have also seen a stabilisation or small softening in market expectations.

Even while there is some increase in market stability and some companies are doing better than expected, hardly any executives are revising budgets and forecast for this year upwards. Executives want to see a lot more sustainability in the market before they jack up targets

How do you see your sales developing over the summer period (4-5 months of May to August/September) compared with the first quarter of 2015?

- A boom in business 4%
- Sales creeping up 33%
- Same trend as Q1 26%
- Sales down slightly 25%
- A slump in business 11%

Who is investing in Russia?

The regional MD of a US conglomerate asked this week: “Are companies continuing with new investments”? And we can see from the Survey figures below that investment is continuing. Further localisation is on-going especially in pharmaceuticals and health given new legislation in January 2016. We also hear quite consistently that retail and consumer product companies are investing steadily in warehousing, logistics and distribution to enhance market share. Several B2B/industrial investments are coming on stream this year but we hasten to add that nearly all of these are on-going investment which was committed before the Ukraine crisis. Large new production plants are fewer now than before. The executive in question here commented:

> For us to get through any sizeable investment in Russia now or for the next 18 months is probably impossible and I think that’s the same for most industrial US companies. Getting funds to build up sales headcount is not a problem given that our rouble sales are good and FX ones not bad and not great. I could even push for more marketing money and perhaps even something for distribution providing it wasn’t too expensive! But serious investment is out of the question for now.

We have asked executives whether they will be postponing investment and for 15 months the proportions have been very constant: about 66% say they will continue investing, while about one-third will postpone investing. Last month those planning to postpone investment actually dipped down to 26% from 33% some 7-8 weeks ago. Once again we see very distinct sectoral trends:

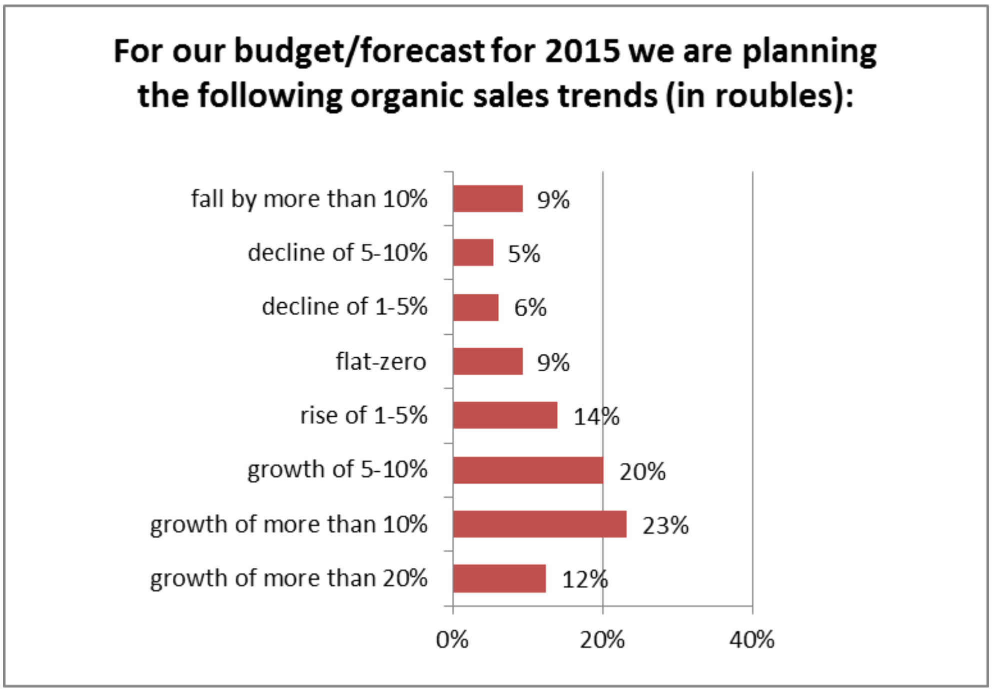
- Across all sector 73% plan to continue their investments.
- Among consumer products this rises to 81%.
- For B2B firms the proportion is much lower at 59%.
- While fully 81% of pharmaceutical/health firms will continue their localisation.

A puzzle and a suggested solution

Why are many executives predicting reasonable rouble sales and yet such bad FX sales when they predict the rouble to be around its current “strong-ish” levels?

Generally western companies (excluding automotive, some sectors of IT and some sectors of industrial products) are forecasting reasonable rouble sales growth in 2015 (for the breakdown by sector see below with industrials forecasting softer trends). But overall:

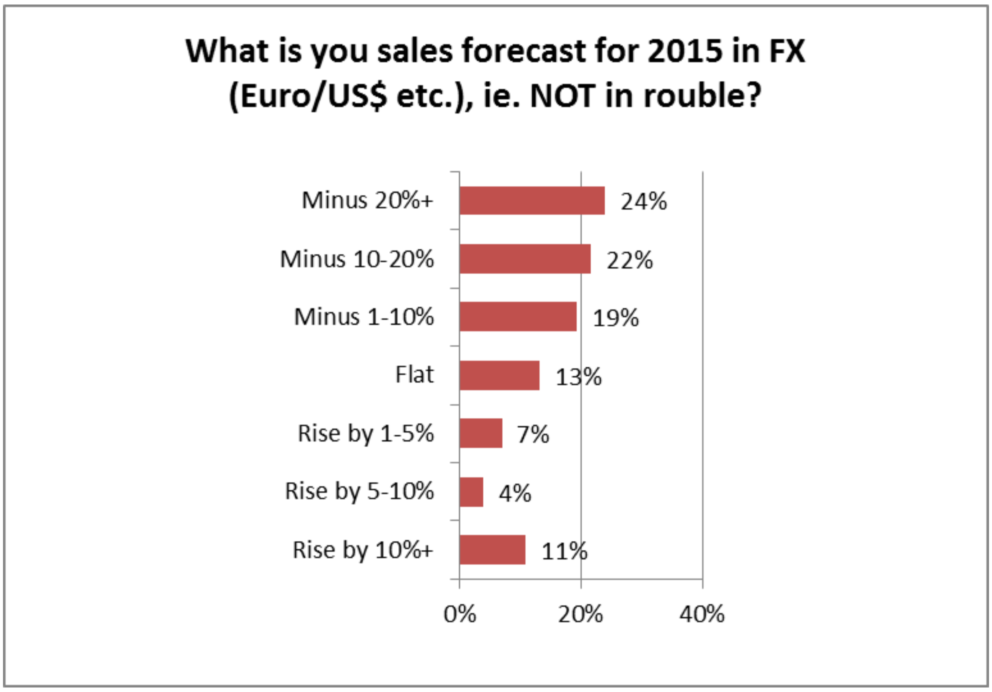
- 35% of companies predict double-digit rouble sales growth.
- 34% estimate single-digit rouble sales growth.
- 9% expect flat rouble sales.
- 20% predict negative rouble sales.



Compared with other CEEMEA markets, these numbers are not bad at all. Of course all then depends on the FX exchange rate and one argument is that if a company can grow sales at 9% in roubles and the rouble is stable, then this ought to entail FX sales growth of also around 9%. Clearly such a rouble/FX result would be comparatively very good and provide a solid basis for business this year in Russia for many companies.

But the FX expectations of companies are much worse than the rouble ones.

- Only 11% predict double-digit FX sales growth.
- Another 11% forecast single-digit FX sales increases.
- 13% look to flat FX sales.
- 20% forecast single-digit declines.
- And fully 44% predict double-digit FX sales declines.



Given this divergence between rouble sales outlook with the FX sales one, one might expect that these executives were predicting a sharp fall in the rouble. But this is NOT the case.

- 60% of respondents forecast the rouble at 60-65 to the Euro.
- While another 29% predict 65-70.
- 66% of executives forecast the rouble at 55-60 to the US dollar.
- And 27% predict 50-55 to the dollar.

Initially this is a big puzzle and an apparent contradiction.

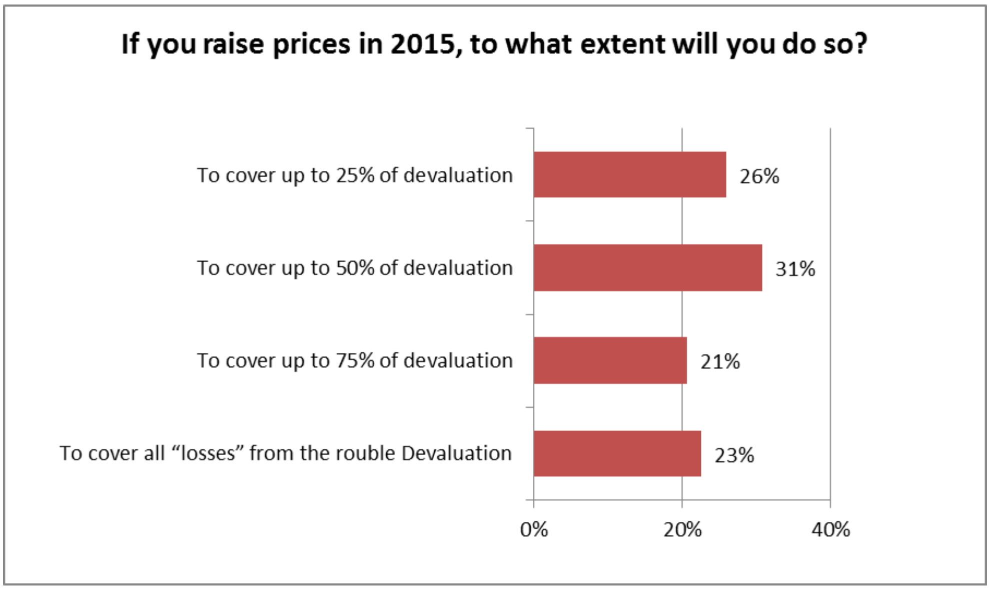
There are probably at least two explanations:

1) Companies have not been able to pass on the full extent of the devaluation and inflation effects.
2) Companies have been stuck with unrealistic FX rates set in budgets and re-forecasts many months ago.

The managing director of a major apparel company helps explain the conundrum.

> Everyone's raised rouble prices, so rouble sales compare favorably versus previous year. However, many brands/companies have not fully passed on the actual FX impact to consumers. We have increased prices by around 25%, while simply reflecting the FX swing would require an increase of 40%+. But we can't price ourselves out of the market. There's a limit to what the consumer can afford. As a result, we can report a nice upside in rouble sales, but the picture is not so great in actual Dollar or Euro terms.

And our chart following below substantiates this.



At the start of this year many companies planned to start raising prices in February and expected to then raise prices again one or two more time during 2015. However, after 55% of companies raised prices in February the strong rouble appreciation meant that some western companies faced the outlook of windfall profits and wholesalers and distributors are now debating with their western suppliers whether discounts and rebates are appropriate.

Most companies now predict that further price increases will be difficult to pass on through the supply chain presuming the rouble stays close to current levels and inflation continues to creep downwards. Perhaps at best companies will be able to bring in 1-2 small price hikes but this is all questionable.

One FMCG company admitted that they are now taking price reductions because with price increases of 45-60%, they over-shot what was necessary

Please excuse the following language, but one MD of a consumer goods company put it quite simply last month in Moscow:

> If you have not raised prices by now, then you are screwed!

Profit outlook (in roubles)

It seems that consumer goods companies predict much weaker rouble profit trends in 2015 than for sales and this would indicate more downtrading and discounting which are increasing as trends and this is manifested in our Survey below and from anecdotal comments. For example among consumer product companies, 12% of consumer product firms forecast negative sales this year but a much larger 36% predict negative profits. So profits will be more squeezed from competition, own label and the shift to more affordable products.

The squeeze on profits is noticeably less in the pharmaceutical and health sector where profit expectations match fairly closely those for sales: 38% double digit growth, 48% single digits and only 16% flat or negative.

In the B2B sector sales are under pressure with 33% of respondents forecasting negative sales this year and profits match these numbers or are slightly worse with 50% of companies expecting negative profit growth this year.

What is the 2015 business outlook?

What is your budget for sales in 2015 (in roubles)?
(Figures are rounded and therefore may not total exactly 100%)
(Taken from our June Survey)

	2015 results **All sectors**	**Consumer products**	**Pharma/ health**	**Industrial/ B2B**
Growth of 20%+	12	15	6	0
Growth of 10%+	23	42	22	6
Growth of 5-10%	20	11	42	6
Growth of 1-5%	14	7	13	25
Flat-zero	9	4	6	18
Decline of 1-5%	6	7	6	0
Decline of 5-10%	5	7	3	12
Decline of 10%+	9	4	0	31

Consumer product companies are now predicting better sales in 2015 than they anticipated 6 weeks ago after a good first quarter; but much will depend on how soft the summer turns out to be.

Given that companies predict mostly negative consumer spending in 2015, much of the planned sales increases will have to come from price rises and we know that most consumer product firms implemented their first set of price increases for 2015 in February ranging from 8-22%. Until recently many companies were predicting a tough profit outlook but the strengthening rouble combined with the February price increase means that many companies have seen some profit concerns diminish.

After quite bullish and strong estimates over recent weeks, pharmaceutical and health companies in this sector have adopted a more sober outlook: fewer pharmaceutical and health firms are now predicting double-digit growth compared with 6-7 weeks ago and more are clustering in high single digits.

The outlook is much more thoughtful in the industrial sector thanks to interest rates, financing access, sanctions and business confidence: automotive and IT could possibly recover from the bad lows of 2014 but 61% of firms predict flat or negative sales which is the worst sectoral forecast by far. And profits are strained at the same levels too. Industrial and investment trends will hold back business, and financing will be extremely tough. On the plus side, companies in this sector will also benefit from increasing import substitution and western companies will supply the equipment for Russian firms.

2015 sales projections for CIS markets (in local currency)

For comparative purposes, we provide here the forecast sales results in local currencies fort the major CIS markets. It suggest that in recent weeks, the outlook for sales in Kazakhstan has slowed somewhat while Russia now matches or surpasses expectations for the rate of sales of most other CIS markets. When we combine this with the fact that Russia is also the volume market with it representing 80% of sales for 80% of companies, then the combination of volume and rate of sales growth does mean that Russia remains the critically important market in the region and not much has changed about that in the last 16 months.

2015 results	**Russia**	**Ukraine**	**Kazakhstan**	**Belarus**
Growth of 20%+	12	10	16	9
Growth of 10%+	23	8	11	18
Growth of 5-10%	20	8	28	16
Growth of 1-5%	14	7	11	11
Flat-zero	9	14	23	28
Decline of 1-5%	6	9	8	9
Decline of 5-10%	5	22	3	7
Decline of 10%+	9	22	0	1

Appendix 1 - 25 key business issues that executives have to monitor

1. Short-term financial planning is agony.
2. Companies were caught again in a "budget trap" last autumn when original targets were set for Russia in 2015; companies have to readjust and reforecast and manage expectations.
3. Surprisingly or not many western companies survived 2014 reasonably well at least in rouble terms.
4. The managing director of one major western food & beverages firm with $2bn sales in Russia said in January: "2014 was great; now it's over".
5. Some companies are concerned that a deeper business recession will kick-in during late spring this year as the full impact of inflation and collapsing real wages finally pulls the consumer down; most executives predict a moderate rally for 2016 but a noticeable minority expect still quite hard times at the start of 2016
6. Localisation: western companies realise that to get deeper into the local markets and to access local tenders, they need to be more localised and this is an on-going trend.
7. Diversification: being a diversified conglomerate is proving good for some firms as this spreads the risk and while some sales to some sectors may have slumped (automotive, IT) , they are compensated by comparatively stronger sales elsewhere (consumer related).
8. Several companies report privately that they are making large investments in logistics and warehousing; some companies with large existing market shares want to protect those or plan to expand this market share.
9. Two-thirds of companies report that they are not postponing investments this year: consumer goods and food & beverage companies plan the fewest postponements while pharmaceuticals are also fairly positive with most delays expected in the B2B sector.
10. Market share is rightly the key focus for companies who engage in best practice.
11. Generally pharmaceuticals and health are the favoured sectors, consumer products are average (good/mixed) and B2B is the weakest business sector with recently the IT and automotive industry sticking out as badly strained sectors.
12. For pharmaceuticals and IT firms, selling to the federal government is the biggest challenge as government spending is cut back.
13. IT and pharmacy sales to consumers have been the more upbeat part of these industries.
14. This supports the view that the Russian consumer has proven remarkably resilient until March 2015.
15. Some companies predict that consumer spending will be hit radically in spring 2015 as the full impact of higher inflation and weaker wages sets in.
16. Brand or value? Executives are having strong debates about whether premium brands will hold up this year against the economic odds. One managing director of a food company with two plants in the country states: "Our premium products are weakening while our mid-brands and discount products are performing strongly. I think 2015 will see a big slow down for the premium end". Others think they will have to work harder to sell premium brands. Most appreciate that they will need to widen their portfolio to reach more consumer segments.
17. Related to this, the Russian regions remain important as a part of business strategy and have been so for many years now but companies realise they must do more to compensate for a slowing Moscow.
18. Volume or Price? Executives also debate heatedly about whether to put their business focus on growing and protecting volumes or price increases. Generally volumes are going to be harder to achieve.
19. It does seem that much business growth in 2015 will come from price rises; companies raised prices in 2014 by a 10-30% range and many jacked up prices again in February 2015.
20. Financing will remain challenging for B2B sales even though the central interest rate fell back to 14% in March.
21. Manufacturing firms complain about rising input costs.
22. Aniti-westernism? About 50% of companies report some degree of anti-western attitudes in B2B tenders and B2G ones. Regarding anti-western consumer behaviour, some 23% of companies report this feature but this is more difficult to gauge: do consumers simply prefer cheaper non-western brands?
23. More western B2B firms are being asked by Russian officials, "Where do you source from"? Consequently some are turning to suppliers in Asia or non-Western sanctioning countries to avoid Russian reprisals and also to find cheaper inputs.
24. Some managing directors are very wary of cutting too deeply: "We cannot fully fix most of the short-term problems without taking steps that will certainly damage the long-term health of the business".
25. Generally western companies are not cutting back on staff (75% not at all, not yet) while the rest are so far making small cuts; companies are keeping a tight rein on salaries and paying below inflation (90%).

Appendix 2 - Economic outlook tables

These two economic tables are provided for reference purposes and will be published again in our July economic report whereas this paper focuses more on business sector trends.

Macro-economic data 2009-2018

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
GDP	-7.9	4.3	4.3	3.4	1.3	0.6	-3.7	0.6	2.0	2.6
Retail sales	-5.5	6.3	7.2	5.7	3.9	2.5	-5.8	1.5	2.5	2.8
Household spending	-7.6	5.5	6.8	7.9	4.7	1.8	-5.0	1.0	2.1	2.8
Real wages	-2.8	4.4	4.9	8.2	5.2	1.9	-7.3	0.0	3.1	3.0
Disposable income	1.0	3.7	2.8	3.7	3.3	2.1	-3.3	1.0	2.5	2.9
Inflation (year-end)	8.8	8.7	6.1	6.6	6.5	11.4	12.0	7.7	6.6	6.3
Unemployment rate	7.9	7.6	6.5	5.3	5.5	5.3	5.9	5.8	5.7	5.5
Gross fixed investment	-17.9	5.6	9.8	6.0	-0.3	-4.8	-8.5	0.5	3.2	3.8
Industrial output	-10.8	8.3	4.7	2.6	0.3	1.1	-3.0	0.7	2.4	3.0
FX reserves ($bn) year-end	447	485	510	528	509	385	328	330	350	360
Rouble/$ (year-end)	30.3	30.4	32.1	30.4	32.9	58.0	57.0	60.0	62.5	64.8
Rouble/Euro (year-end)	43.4	40.0	41.5	40.1	45.1	72.0	63.0	65.0	65.0	68.0
Budget balance (% of GDP)	-6.3	-3.5	-0.2	0.0	-0.5	-0.5	-3.2	-1.9	-1.0	-0.5
Current-account balance (% of GDP)	3.8	4.9	4.9	3.6	1.6	2.7	3.6	3.3	2.8	2.2

Consumer-related statistics: by year and monthly

	2012	2013	2014												2015					
	year	year	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June
Disposable income	3.7	3.3	-1.5	1.0	-6.8	1.9	5.8	-2.9	2.3	3.4	0.6	2.1	-4.7	-7.3	-0.8	-1.6	-1.8	-4.0	-6.4	
Real wages	8.2	5.2	5.2	4.6	3.1	3.2	5.0	2.1	1.4	-1.2	1.5	0.3	0.5	-4.7	-8.0	-7.4	-10.6	-13.2	-7.3	
Real retail sales	5.7	3.9	2.4	4.1	4.0	2.6	2.1	0.9	1.2	1.4	1.7	1.7	1.8	5.3	-4.4	-7.2	-8.7	-9.6	-9.2	
Unemployment	5.3	5.5	5.7	5.6	5.4	5.3	4.9	4.9	4.9	4.8	4.9	5.1	5.2	5.3	5.5	5.8	5.9	5.8	5.6	
Industrial output	2.6	0.3	-0.2	2.1	1.4	2.4	2.8	0.4	1.5	0.0	2.8	2.9	-0.4	3.9	0.9	-1.6	-0.6	-4.5	-5.5	-4.8
Fixed investment	6.0	-0.1	-7.0	-3.5	-4.3	-2.7	-2.6	0.5	-2.0	-2.7	-2.8	-2.9	-4.8	-2.4	-6.3	-6.5	-5.3	-4.8	-7.6	
Consumer prices	6.6	6.5	6.1	6.2	6.9	7.3	7.6	7.8	7.5	7.7	8.0	8.3	9.1	11.4	15.0	16.7	16.9	16.4	15.8	15.3
Budget deficit (running)	0.0	-0.5	0.4	0.3	1.4	-0.4	-0.1	-0.1	-0.1	-0.2	-0.4	-0.5	-0.6	-0.6	-1.6	-1.8	-1.8	-1.9	-2.4	

As ever, I hope you have enjoyed this paper and found it useful. If you have any comments or queries, do get in touch on danielthorniley@dt-gbc.com.

BAKER & MCKENZIE

Reliability Across Borders

Argentina
Australia
Austria
Azerbaijan
Bahrain
Belgium
Brazil
Canada
Chile
China
Colombia
Czech Republic
Egypt
France
Germany
Hungary
Indonesia
Italy
Japan
Kazakhstan
Korea
Luxembourg
Malaysia
Mexico
Morocco
Myanmar
Netherlands
Peru
Philippines
Poland
Qatar
Russia
Saudi Arabia
Singapore
South Africa
Spain
Sweden
Switzerland
Taiwan
Thailand
Turkey
Ukraine
United Arab Emirates
United Kingdom
United States
Venezuela
Vietnam

RUSSIA

UKRAINE

KAZAKHSTAN

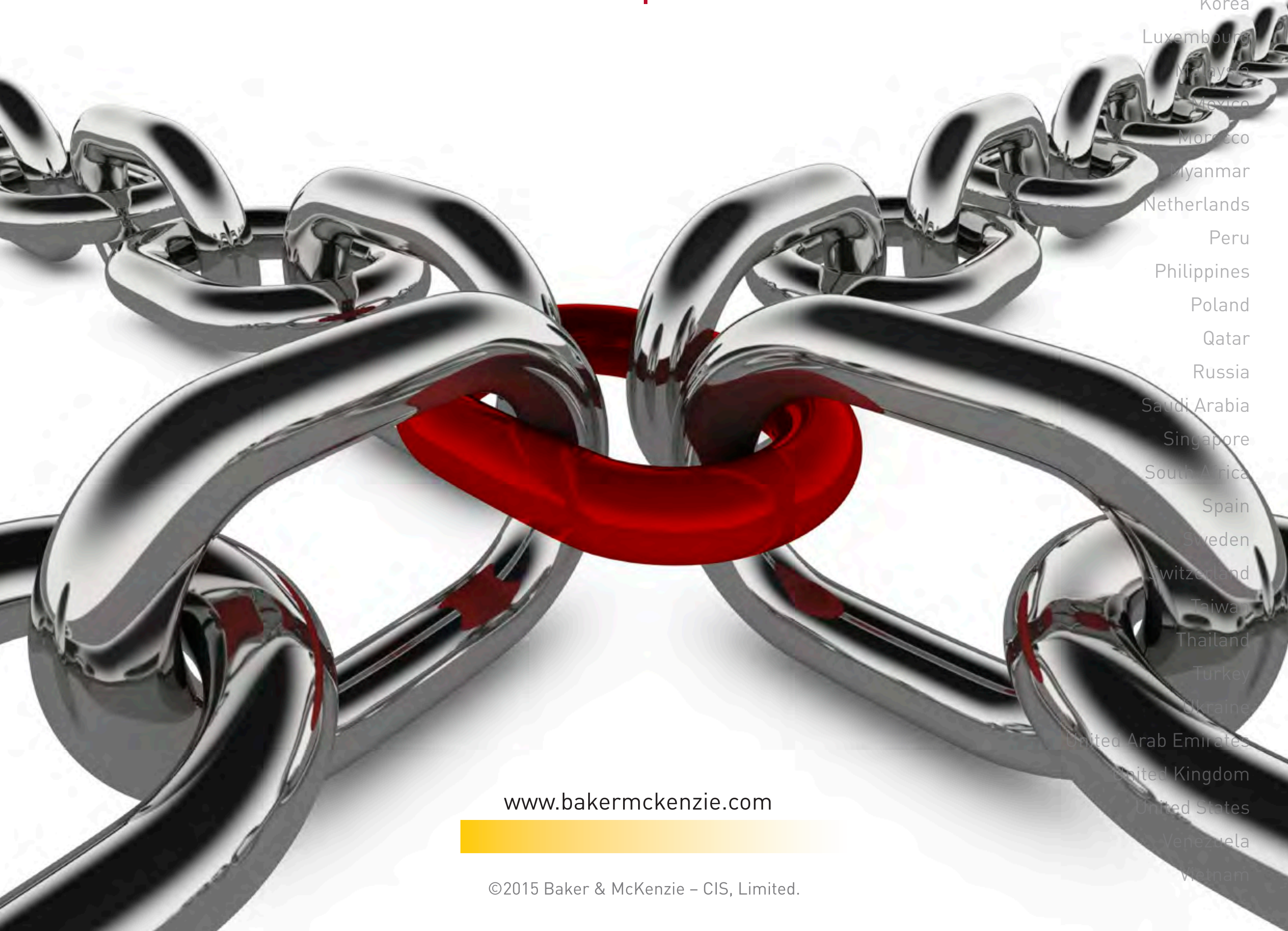
AZERBAIJAN

Moscow

White Gardens
9 Lesnaya Street
Moscow 125047 Russia
Tel.: +7 495 787 2700
Fax: +7 495 787 2701
moscow@bakermckenzie.com

St. Petersburg

BolloevCenter
4A Grivtsova Lane
St. Petersburg 190000 Russia
Tel.: +7 812 303 9000
Fax: +7 812 325 6013
st.petersburg@bakermckenzie.com



www.bakermckenzie.com

PAUL HARTMANN AG was seeking to co-locate our first factory in Russia with a national distribution center. Also, the project had to meet stringent global quality standards and risk mitigation requirements, which made this project even more complex. With Radius Group, we found a responsible development partner who provided a comprehensive build-to-suit development and financing solution, and delivered a high-quality building on-time and on-budget.

Dr. Felix Fremery
Chief Process Officer, PAUL HARTMANN AG

We designed, implemented and financed a robust real-estate solution meeting Russian codes and German manufacturing best-practices, as well as PAUL HARTMANN AG's exacting requirements. Radius Group is proud to have fully realized PAUL HARTMANN AG's high expectations.

Chris Van Riet
Managing Director, Radius Group

DETAILS DELIVERED.

(1) High-powered ventilation & extraction system designed to German engineering standards maintain a dust-free manufacturing environment
(2) Co-location of manufacturing and distribution drives cost efficiencies and lowers lead times
(3) Information systems implementation provides seamless connectivity with PAUL HARTMANN AG operations worldwide
(4) Facility achieved BREEAM's highest rating for sustainable construction of any building in Russia in 2013

PAUL HARTMANN AG South Gate Industrial Park, Moscow

WWW.RADIUSRUSSIA.COM
MILLENNIUM HOUSE 12 UL. TRUBNAYA 7TH FLOOR MOSCOW 107045 RUSSIA
T +7 495 662 5550 F +7 495 662 5551


EY
Building a better working world
25 years of our practice in the CIS
GETTING ALL YOUR EXPERTS TO THE SAME PLACE IS GOOD. GETTING THEM ALL TO THE RIGHT PLACE IS BETTER.
Being in the same place doesn't mean much without mutual understanding. Our global teams work closely with yours, to help you overcome challenges and grasp opportunities.
Find out more at ey.com