CEEMEA Business Group

Russia and CIS sales 2015

Survey results

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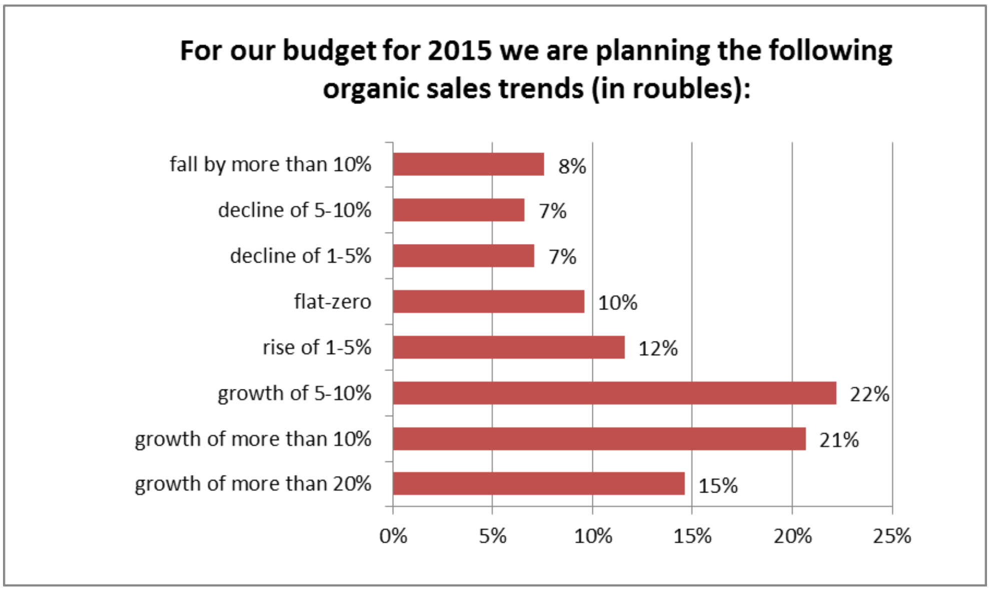
IN ASSOCIATION WITH: BAKER & MCKENZIE, EY Building a better working world, Radius GROUP



The forecasts for rouble sales in 2015 are quite strong and similar to the final results achieved in 2014 and it seems companies have used the 2014 results as a strong bench-mark for this year: “Let’s repeat (in roubles) what we managed last year and that will be something”. Presumably much of this rouble growth will come from price increases: obtaining strong volume growth will be harder and of course when translating these results into FX, all depends on the oil and rouble price and exchange rate. We also note below that achieving profit growth to match sales growth is very hard in the consumer products sector and also within B2B while pharmaceutical and health looks a bit stronger and suggest steady demand in that’s sector and/or the willingness to pay for pretty products. However, tighter federal reimbursement will prevent any overall profit “boom”.

It’s worth repeating: forecasts are quite solid and could become harder to achieve especially with a bad start to the year presumed. However, anecdotally and from our Survey it seems the first quarter has turned out more mixed for companies rather than being an overall slump.

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

	2015 results **All sectors**	**Consumer products**	**Pharma/ health**	**Industrial/ B2B**
Growth of 20%+	15	10	19	6
Growth of 10%+	21	29	20	12
Growth of 5-10%	22	30	39	7
Growth of 1-5%	12	13	8	25
Flat-zero	10	5	3	6
Decline of 1-5%	7	0	3	18
Decline of 5-10%	6	5	5	6
Decline of 10%+	7	7	3	19

Consumer product companies are aiming for double-digit sales increases in 39% of companies while another 30% aims for high-single digits. Some 5% predict flat sales and 12% budget for negative rouble sales trends. Compared with last year and even this February, more companies are forecasting single-digit growth rather than double digits and this is presumably based on not repeating the year-end 2014 flurry of consumption. More companies are now clustered around the 10% growth level, just above or just below.

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 followed by at least another set later in the year: one single price increase often ranges at 6-16%. Despite this, many consumer goods companies predict a tough profit outlook: with some 31% forecasting negative profits this year and only 26% aiming for double-digit profits while 39% budget for double-digit sales increases. Clearly sales look like being easier to achieve than profits.

However, given the recent strengthening of the rouble, this forecast for weak profits in the consumer goods sector and in B2B as well could turn out to be too gloomy: some companies after raising prices in February on the back of a rising rouble are now facing possible windfall profits!

Remarkably pharmaceutical and health companies are budgeting for stronger numbers than in 2014 at least at the double-digit growth level and unless federal spending kicks in, this looks like a stretch unless companies plan significant price increases in those sectors where they can do so. But several pharmaceutical sectors are unable to raise prices by law. Almost 40% of companies in this sector forecast double-digit sales with a similar number predicting strong single digit sales. Now 14% except flat or negative sales trends in 2015.

The outlook is 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 43% 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 to become more self-sufficient and given that some companies have a conglomerate structure supplying to different customer bases, this may explain why 18% are upbeat looking to double-digit sales growth this year with almost one third clustered in single digits and mostly in low single digits.

2015 sales projections for CIS markets (in local currency):

2015 results	**Russia**	**Ukraine**	**Kazakhstan**	**Belarus**
Growth of 20%+	15	7	10	7
Growth of 10%+	21	7	13	15
Growth of 5-10%	22	6	24	19
Growth of 1-5%	12	6	9	15
Flat-zero	10	20	28	27
Decline of 1-5%	7	11	6	11
Decline of 5-10%	6	20	7	4
Decline of 10%+	7	21	2	1

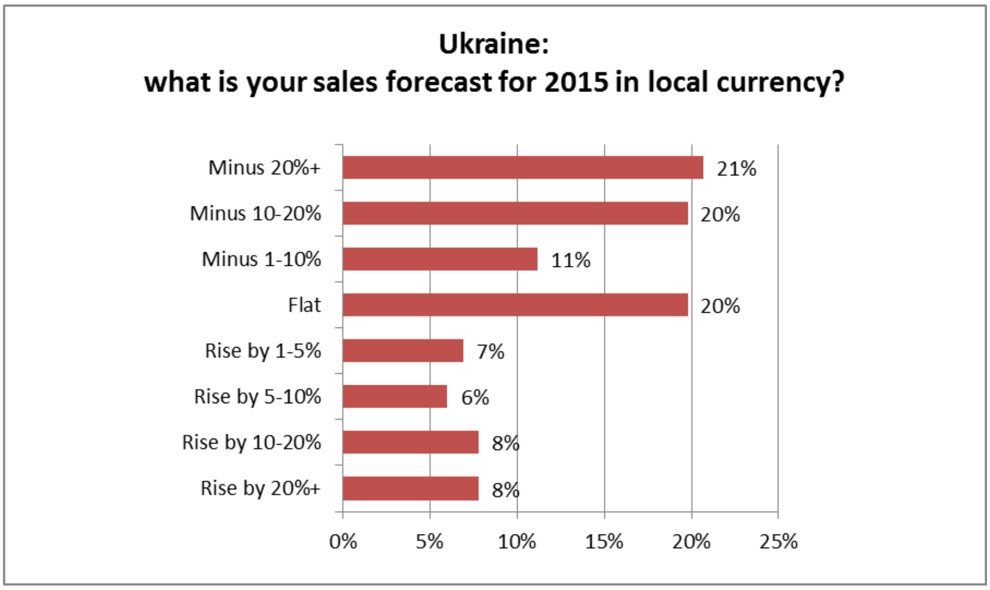
Some quick comparisons can be made:

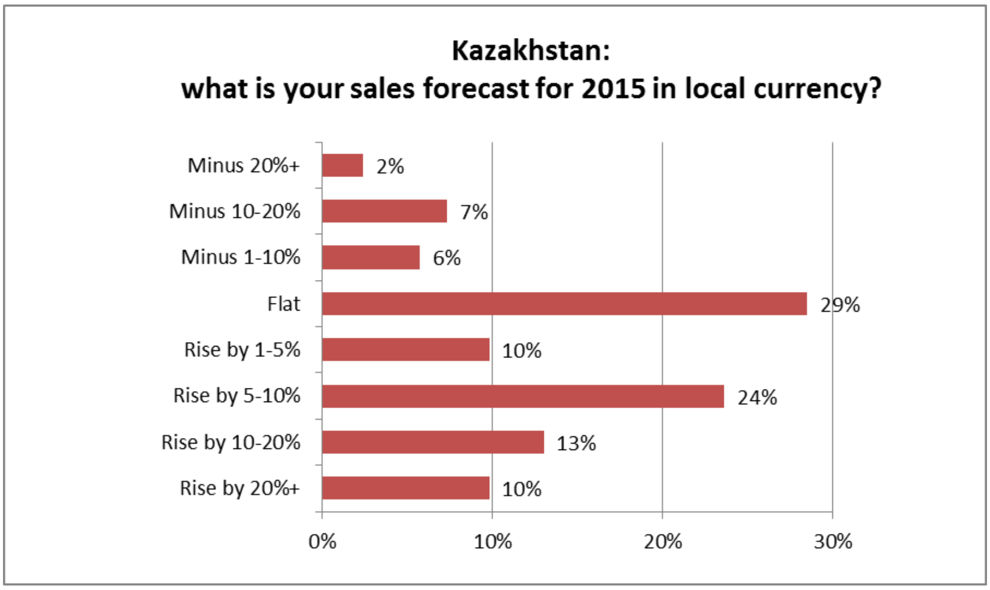
Kazakhstan: expectations are starting to moderate as we suggested they would. The market was the joint best-performing market two months ago but as Russia seems to stabilise, in Kazakhstan those predicting strong sales growth have diminished. Still it is a good-looking market and this is backed up anecdotally. BUT there is a clear warning also that tenge devaluation is possible in the current environment and that would alter these numbers quite a lot. Such devaluation after Belarus and Azerbaijan would be no surprise.

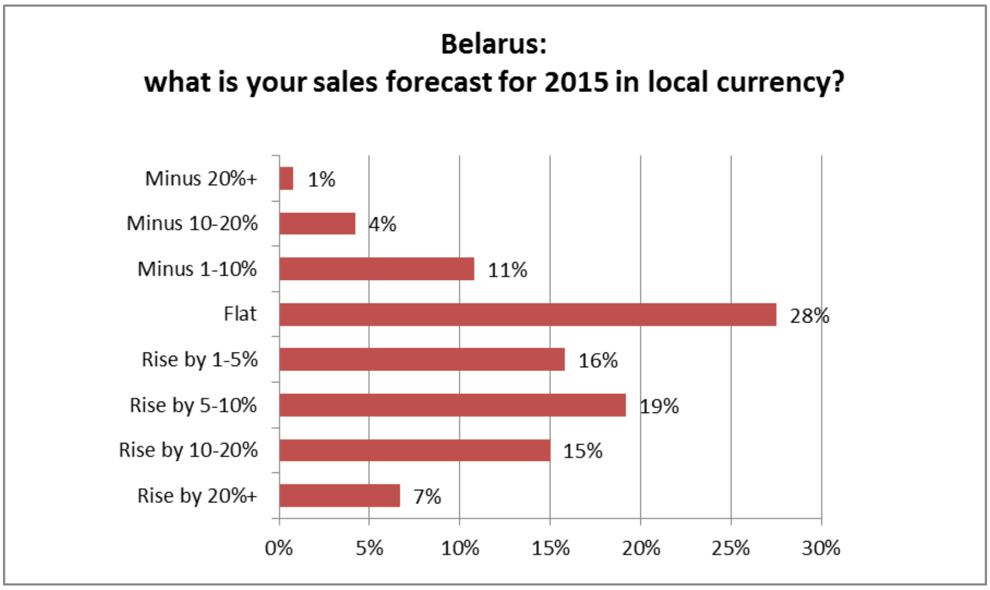
Ukraine is looking very tough for another year and worse than in 2014 because there will be no good start to this year. We have recently downgraded our economic and business outlook for Ukraine (see our quarterly reports). 2015 will be much harder with perhaps some improvement in the last quarter. Much will depend on

IMF support, whether a default occurs and whether there is a public easing of the conflict in eastern Ukraine. These numbers in local currency are not good and if the hryvnia depreciates badly this year (and of course with the free float it collapsed at the start of 2015), then FX results will be very bleak for a second year running and in FX terms Ukraine could show up much worse than even in 2014. A possible debt default (restructuring) could hurt confidence more but such an eventuality may be postponed to 2016 or not.

Belarus is a small market and results are worsening compared with 2014 as the Belarus rouble comes under increasing pressure. Executives have tweaked down their forecast marginally for 2015.

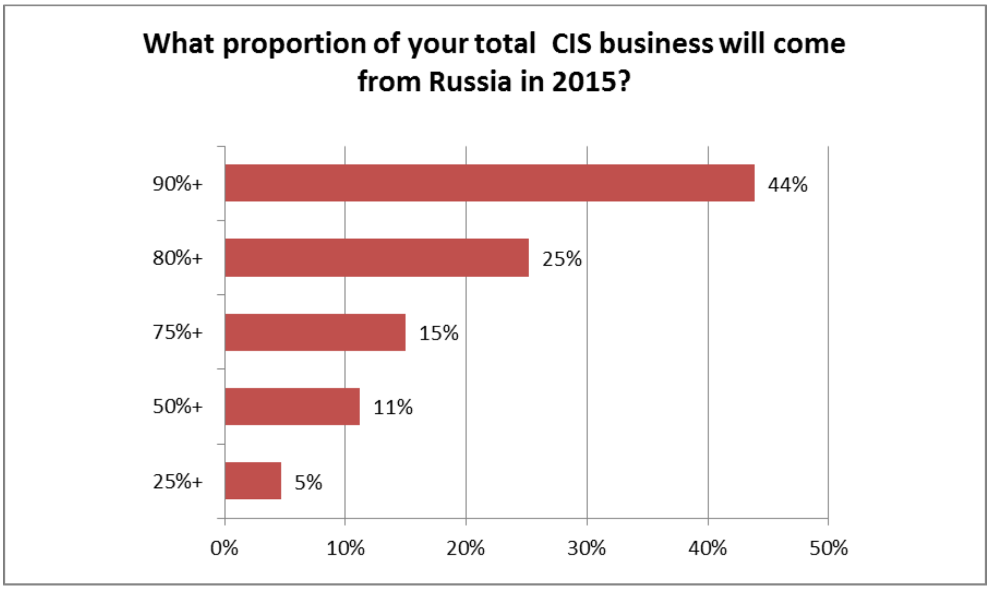






How big is the Russian market in the CIS?

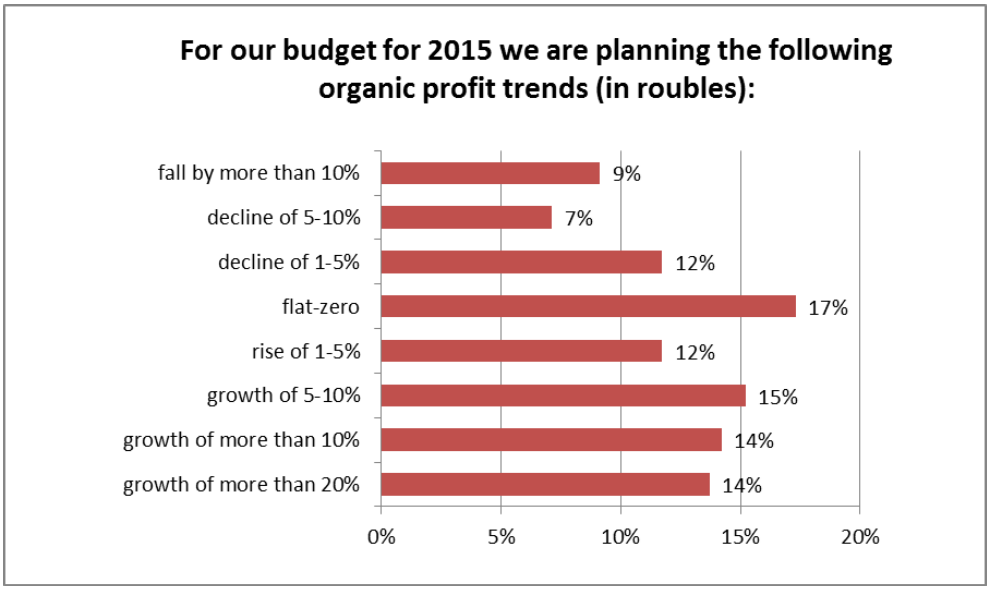
Russia remains the huge, massive volume market. These numbers match anecdotal remarks we have used for many years. For some 84% of companies Russia represents more than 75% of their volume sales.



Profits in 2015 (in roubles)

For our comments on profits, see the executive summary above and remarks included in sales outlook for 2015 above.

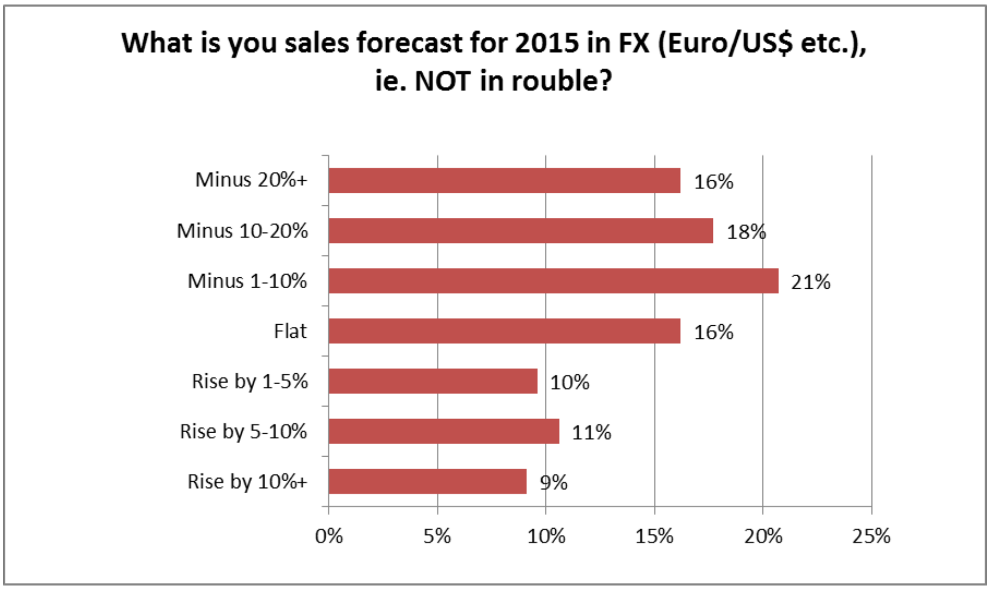
In summary: profits could turn out to be tougher to achieve than sales especially in consumer products and B2B as consumers/clients want more affordable products and services. One the plus side, the strengthening rouble and the introduction of price rises could actually help profits become bearable or decent or even potentially better than that. There is scope for windfall profits for some companies but we do not want to exaggerate this trend.



But looking at the numbers in FX and not roubles:

This is where brutal reality kicks in. Remarkably 28% of companies plan for sales increases in 2015 in FX but 54% look to negative FX results. Obviously everything depends on the oil price and the exchange rate. As we argued above, if things go right with oil or sanctions, then the rouble can improve a lot and quickly and FX results would turn around as well. Some companies will be predicting some stabilisation or decelerating rate of currency decline in 2015 and that's reasonable.

We have seen an improvement in this indictor in the last 8 weeks with more companies looking at losses around 10-20% (18% of respondents) and fewer looking at massive FX losses of more than 20% (this is down from 28% of companies to "just" 16%) and another 16% predict flat FX results. While the proportion predicting negative FX results remains stable at 54%, the depth of the losses has been somewhat mitigated.



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