CEEMEA Business Group

Russia Business Survey
Monthly Findings: Key Factors Driving Business

Based on Survey Results (February 2015 - 9th Month)

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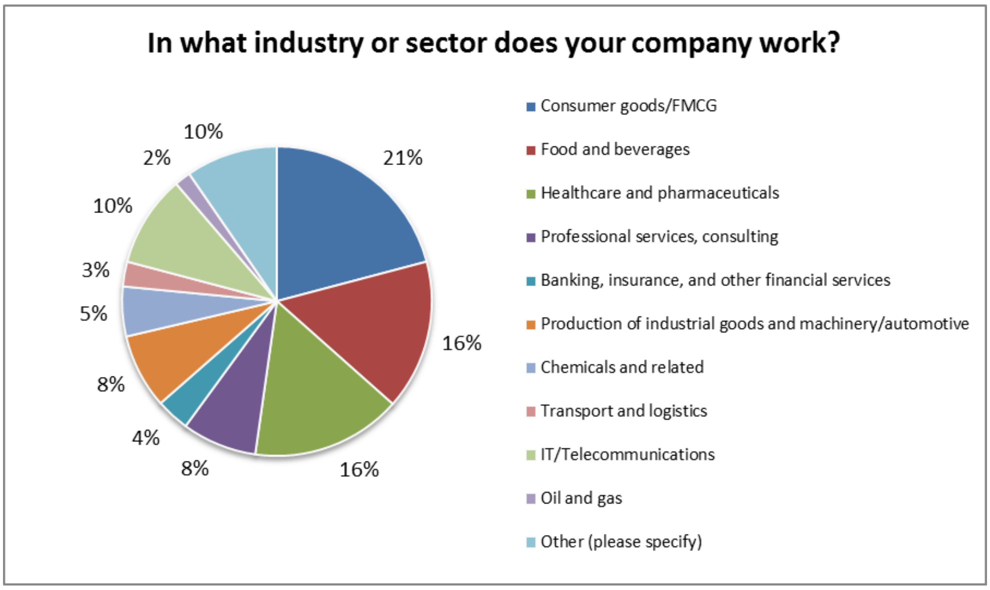
Background

This is a summary report of our findings from the seventh survey related to business operations: the findings are based on replies from some 115 senior managers working in western companies in Russia.

<u>We think this report provides the most detailed hands-on current analysis available of what companies are thinking and planning regarding their business in Russia.</u>

There is also much more general economic, rouble and business commentary added as well.

Thank you for participating.



Russia Business Survey: February results and commentary

Introduction

This Survey was conducted in mid-February after a 5 week break.

Results and corporate sentiment in December-January were very tough but both the business results and corporate mentality showed signs of resilience.

Anecdotally and in our findings two strands are apparent for the moment:

1) Some relative stability has emerged in the market and several of our survey indicators point to this
2) But the business outlook in the short-term and probably through the whole year will be very challenging as economic numbers deteriorate.

Moving forward from this second point, consumer product companies and pharmaceuticals will face slower federal budget spending, collapsing real wages, spiking inflation and weakening consumer confidence while B2B firms will suffer from the lack of financing holding back investment at very low negative levels along with very soft industrial output.

A current good patch?

It is not often that the Financial Times has two positive articles on the Russian economy in one edition as it did last week. The newspaper correctly pointed out that in the first two months of 2015, the Russia stock market was the best performing in the world (or in the Top 3) while the rouble was the best performing currency in the world!!

These comments are factually accurate but of course stem from the basis that the Russian stock market and currency were both the worst performing ones in the world for 2014. This is partial bounce-back.

Regular readers will know that I have long argued that there is still a best –case for Russia which involves:

1) A rise in oil prices (which we have seen and forecast but no one knows how sustainable this will be)
2) Some perceptions of stabilisation in Eastern Ukraine although the bar for expectations in this region is very low.

At the moment there is more logic and rational supporting a continued mini-rally for oil or some stabilisation at $60-65 over the coming weeks and months because this could be based on market factors: 1) supply-demand, 2) queries about how long the Saudis will want to keep the price down and 3) less shale supplies as some of those wells are turned off. Whereas it is more difficult to gauge developments in Eastern Ukraine as they are driven by politics and personalities.

Recent FX trends also support our recent argumentation that rouble volatility would be the “name of the game” for some time and we are seeing that with a 20% appreciation in recent weeks. The good news for now is that the volatility is of course in a positive direction. But there are still too many “unknowns” to make sensible medium-term projections. And we stick with our opinion that short-term planning for at least the first half of this year will verge on the impossible, as many executives have argued.

Executive summary

1) After a very hard turn of year, several indictors such as sales outlook, FX rates, receivables, downtrading, and route to market have all stabilised in recent weeks. Some relative stability has arrived in the market, for now.

2) Companies are trying hard not to cut their staff levels too quickly (73% making no staff reductions so far). The headcount cuts which are planned are relatively small and companies are still planning some new hires in key positions.

3) Salaries are rightly under sharp scrutiny and have been for 12 months or more. More companies than ever are now planning to pay below inflation in 2015 (approximately 80%). Of course as inflation rises this year, real wages will fall in western companies but also across the Russian economy. So it is definitely not just western firms doing this. Also companies are currently tending not to raise salaries even though inflation is accelerating. This is the status for now.

4) 2014 did finish in rouble terms on a high note at the end of the year for many companies, but not all. But as one executive clearly put it: “2014 was great for us. But now it’s over”.

5) In terms of business sectors: pharmaceuticals and health, which had been the strongest sector throughout last year, flagged a bit due to slow federal sales and came behind consumer products in terms of roubles sales growth of the whole year. Thanks to an end-year surge, consumer products finished 2014 as the strongest sector. The B2B sector also rallied relatively well at year-end but still produced the weakest results in 2014 and the softest outlook for this year. But when looking ahead to this year, pharmaceuticals and health sales are again the most bullish.

6) In the last month, a number of companies have tweaked up their sales budgets for 2015: the proportion of companies planning double-digit growth has risen from 29% last month to 41% this month.

7) Planned rouble sales growth for 2015 is now remarkably similar to the results achieved in 2014. Last year was one of many contradictory swings and then mini-rallies and thus executives must be expecting both a tough year in 2015 but with some possible upside, which at the end of the day is how many budgets are constructed!

8) Some 41% of companies budget double-digit rouble sales growth this year, 31% look to single-digit sales with 10% at flat levels and 17% forecasting negative rouble sales.

9) When we translate this to FX results, 20% expect to grow FX in single digits and 6% in double digits. But 17% expect flat results and 57% predict negative FX sales performance in 2015. These numbers feel about right but everything (up or down) will depend on oil, sanctions and the exchange rate.

10) If the rouble does stabilise on average throughout the year or even appreciates a bit more, then the solid rouble sales forecasts of this year will translate into similar strong results denominated in FX. This is a big potential upside but with no guarantees.

11) Russia is the big volume market in the CIS for more than 80% of companies. In terms of sales growth with Kazakhstan softening a little bit with possible devaluation concerns, Russia is also close to No 1 with Kazakhstan followed by Belarus which is also “average/softening” and Ukraine only likely to start a business recovery in 2016, although 25% of firms in Ukraine budget double-digit sales growth this year in local currency but against a highly inflationary background.

12) Given that most executives predict negative consumer spending trends and industrial output and investment will be also negative, then much rouble sales growth will have to come from raising prices and/or finding new customers/new regions and offering new products or solutions. Achieving volume growth will be harder. Many companies raised prices in February for example.

13) Executives anecdotally are fearful though that Q2 of 2015 will be very hard and “transformational” for business.

14) **In another survey we conducted in early December, Russia remains by far the key priority market across the whole CEEMEA region for some 54% of companies thanks to its volume and potential.** The 54% figure compares with 34% who select Poland, 25% opting for Turkey and 22 choosing Kazakhstan (this is a multi-choice answer and so the total is over 100%.

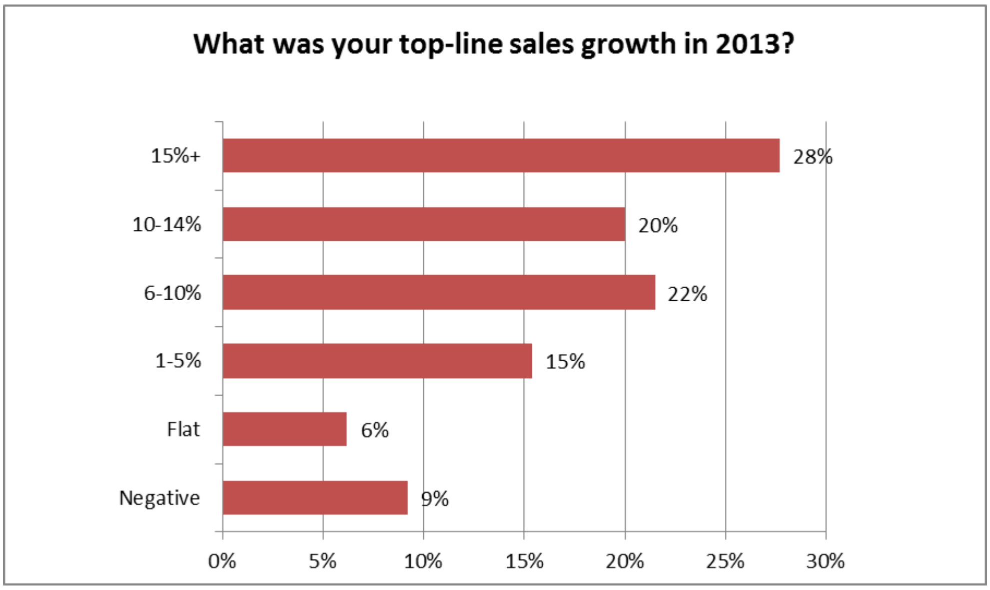
15) Executives anecdotally rightly fear escalating inflation. This ended 2014 with an average about 7.8% and finished the month of December at 11.3%. We expect prices to rise 12-17% in the first 4 months of 2015 and then much will depend on the oil price and the rouble. It now seems almost certain that 2015 average inflation will be over 10% at around 12%.

16) The supply chain has stabilised this month with 14% frozen, 52% greatly reducing purchases but 34% buying as they did before the crisis.

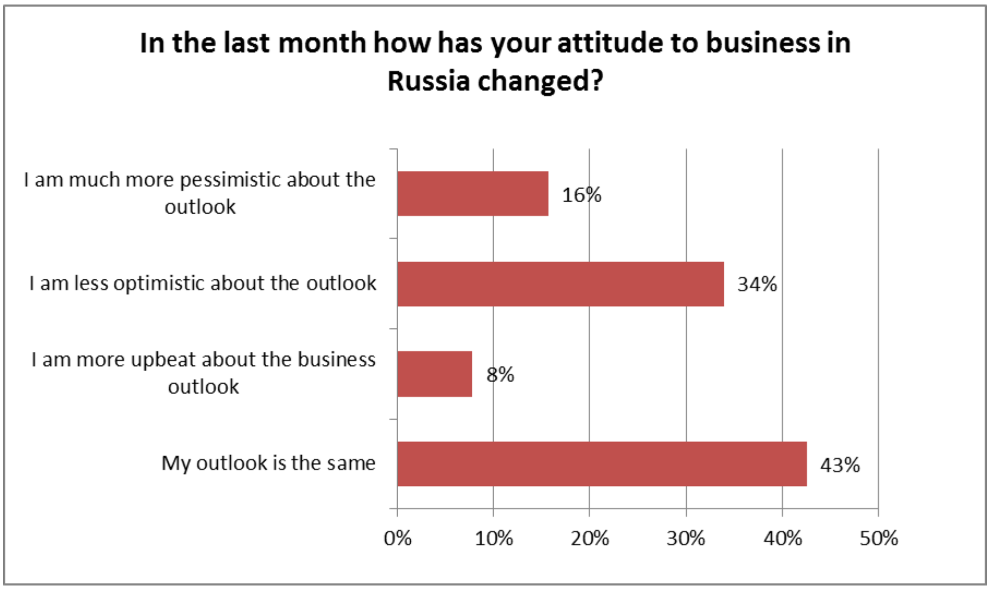
17) The situation with receivables is not too bad either, not yet: almost 40% see no deterioration during the crisis and 47% have only experienced small problems.

18) Those planning to postpone investment have also stabilised at 36% of companies with fewer making such plans in consumer products and food & beverages.

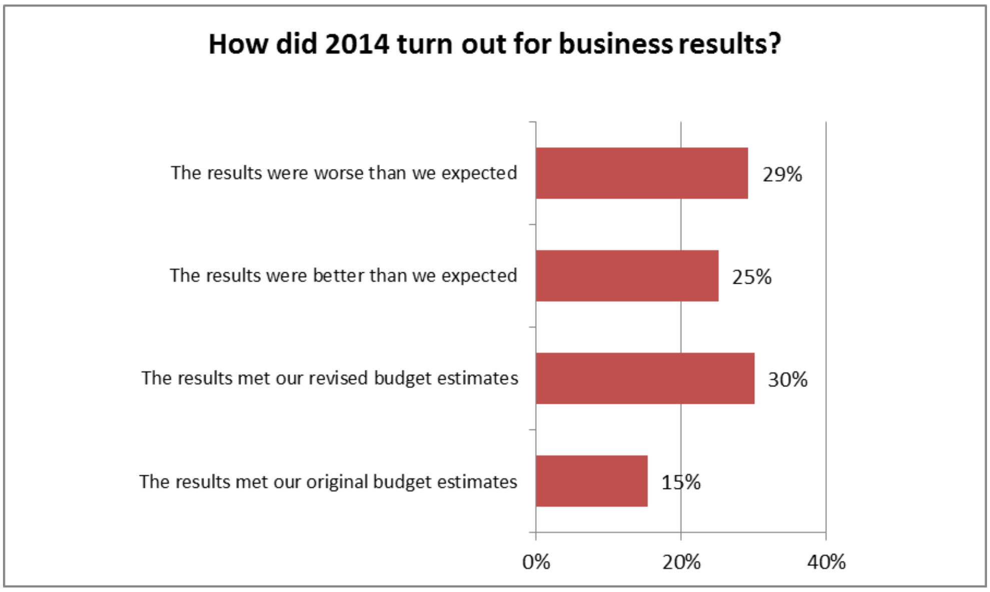
For reference purposes: looking far back at 2013



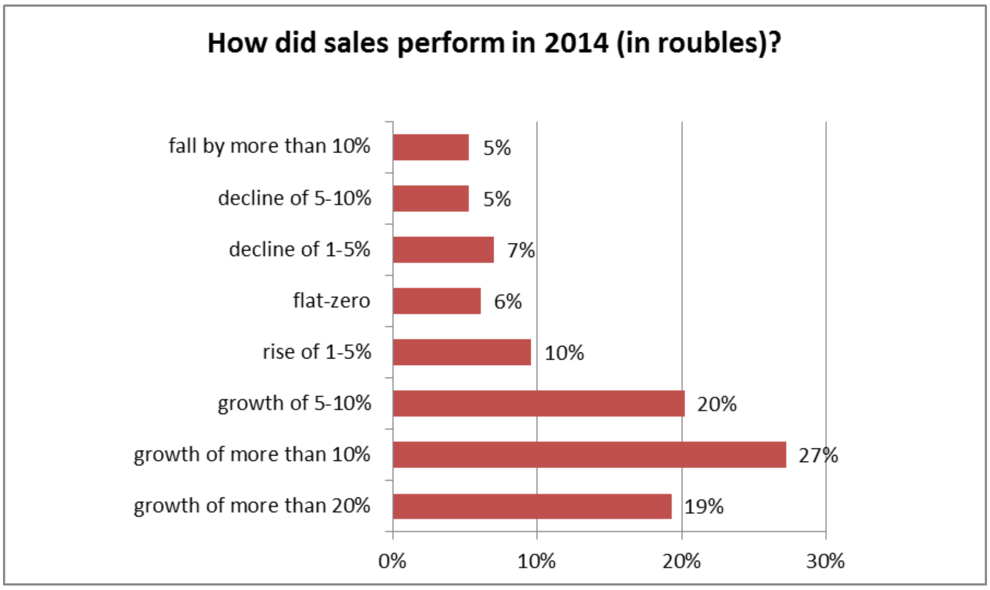
We perhaps need little reminding of the “good old days” and it is worth noting that despite the trend slowdown in business through 2013, fully 48% of companies reported double-digit sales growth with decent profit levels last year, while 37% recorded single-digit sales expansion. The gloomy side of last year was that 15% of firms finished the year flat or negative, which was a worse figure than in previous years when usually only 5-8% of companies reported such numbers.



As we noted above, this is where we see quite a strong shift to stabilisation: in February 43% of executives repsonded that their outlook remains the same compared with 17% in January. The proportion of executives who are pessimistic or "less otpimistic" has also fallen but we are not over-reacting on the positive side either: fully 50% are far from upbeat and again, as we note above, many executives are preparing either for a tough spring ahead or for a tough future 12 months. But to repeat: executives are proving resilient and the mood is better or more stable than in December and January.



As we noted above, 2014 turned out relatively and remarkably better than we could have expected and the final quarter of last year was a strong one and in some cases a spectacular one as Russian consumers bought up foods and durables to "get ahead of inflation and devaluation". Some 15% of respondents met original budgets for the whole year which is a big achievement; almost 30% met revised budgets and of course remarkably one quarter of respondents reported better than excepted results. This is of course all in roubles which are bleaker in FX. And we never cease to say that several sectors: automotive, IT and industrials sectors and even some parts of pharmaceuticals reported very bad figures.



Compared with results recorded in January, there was some slight tweaking by executives in their final results assessment but the dynamics remain very much the same. Some 46% were able to post double-digit sales growth (in local currency). Results improved markedly during November to the end of the year. So generally a curiously good end to 2014 but this is of course NOT sustainable.

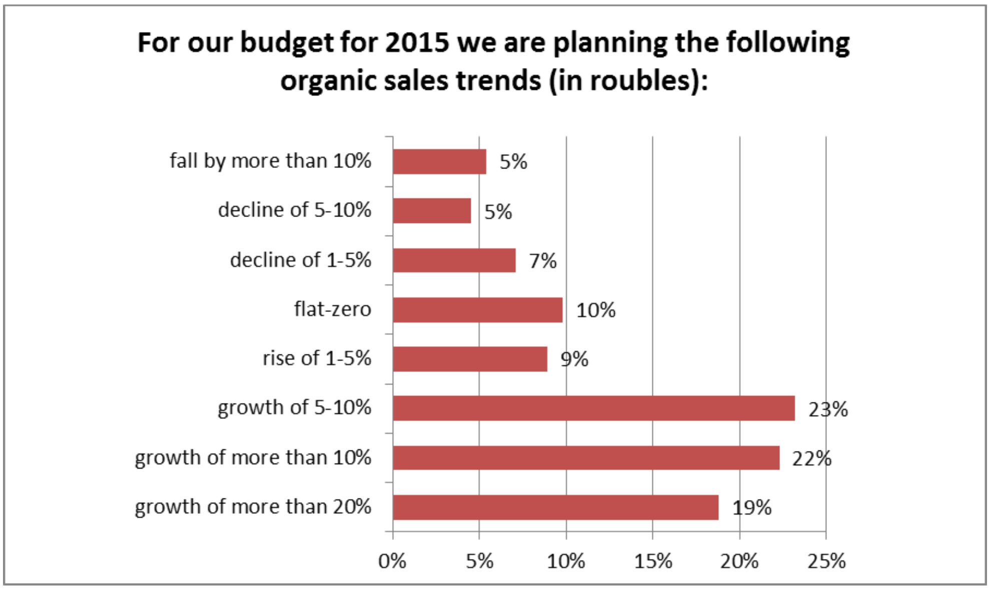
The results for 2014 by sector are provided here in an easy-on-the-eye comparative table:

How did your sales perform in 2014 (in roubles)?
(Figures are rounded and therefore may not total exactly 100%)

	2014 results **All sectors**	**Consumer products**	**Pharma/ health**	**Industrial/ B2B**
Growth of 20%+	19	25	11	25
Growth of 10%+	27	37	33	12
Growth of 5-10%	20	8	28	25
Growth of 1-5%	10	12	11	0
Flat-zero	6	4	0	12
Decline of 1-5%	7	5	5	0
Decline of 5-10%	5	4	6	12
Decline of 10%+	5	3	7	13

The categories are clear: pharmaceutical and health survived well on a declining trend and sales to the federal government were weakest, sales to the private health sector quite good as were retail/OTC sales. Consumer products started the year quite well and finished on a strong note and thanks to this closing trend and due to poor federal pharmaceutical purchases, the consumers sector actually ended 2014 even stronger than the health sector for sales. And even industrials performed better than excepted 2-3 months ago as some Russian firms spent year-end budgets and dug out some final cash. So a consumer flurry and a pick-up in B2B which had struggled for most the year.

What is the 2015 outlook?



The forecasts for 2015 are quite strong and remarkably 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.

> **It's worth repeating: forecasts are quite solid and could become harder to achieve especially with a bad start to the year presumed.**

What is your budget for sales in 2015 (in roubles)?

(Figures are rounded and therefore may not total exactly 100%)

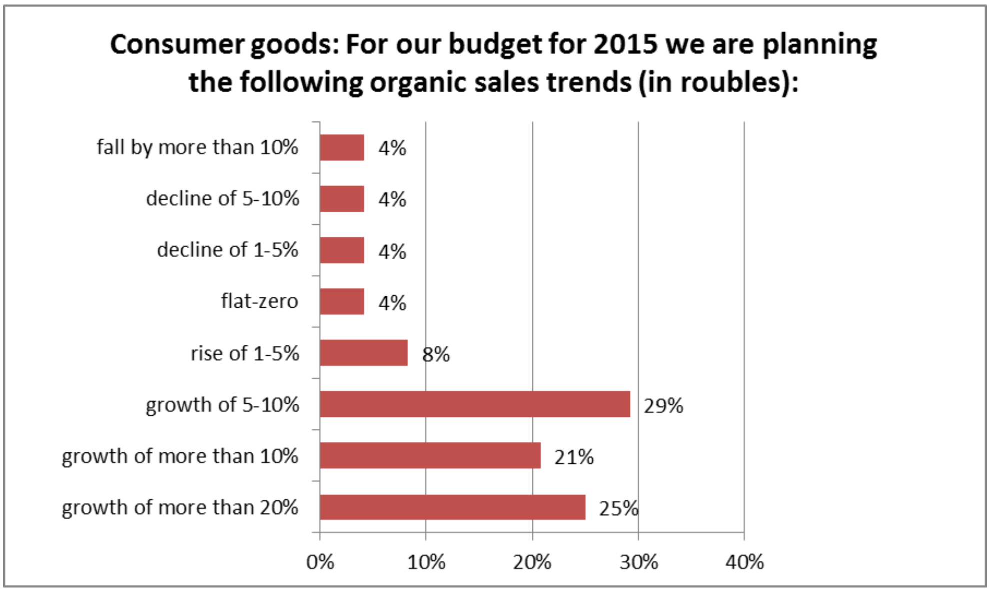
	2015 results **All sectors**	**Consumer products**	**Pharma/ health**	**Industrial/ B2B**
Growth of 20%+	19	25	29	12
Growth of 10%+	22	21	29	25
Growth of 5-10%	23	29	24	4
Growth of 1-5%	9	8	12	3
Flat-zero	10	4	6	11
Decline of 1-5%	7	5	0	22
Decline of 5-10%	5	3	0	10
Decline of 10%+	5	4	0	12

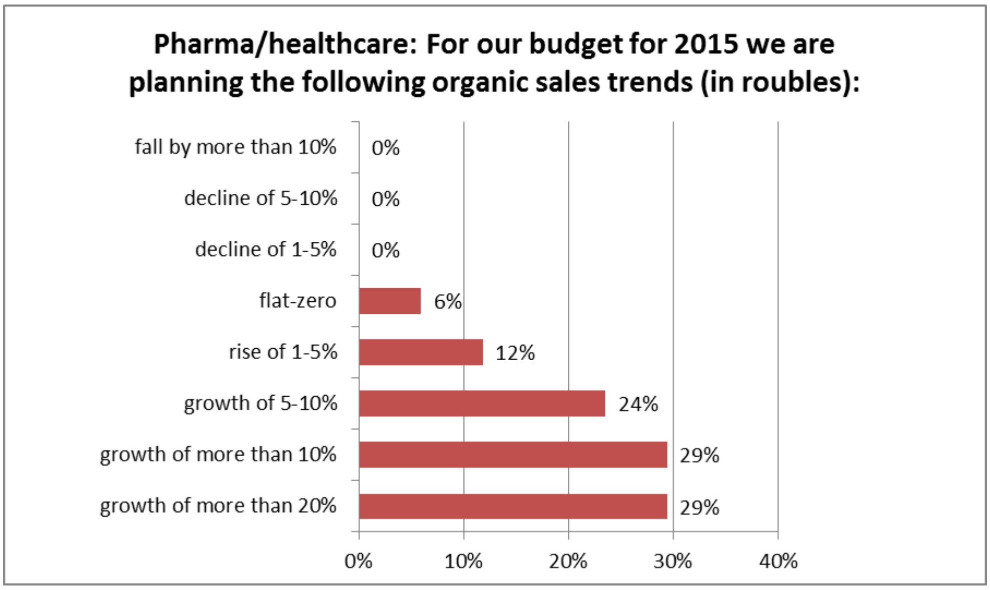
Consumer product companies are aiming for double-digit sales increases in 46% of companies while another 29% aims for high-single digits. Some 4% predict flat sales and 12% budget for negative rouble sales trends. Compared with last year more companies are forecasting single-digit growth rather than double digits and this is presumably based on not repeating the year-end 2014 flurry of consumption.

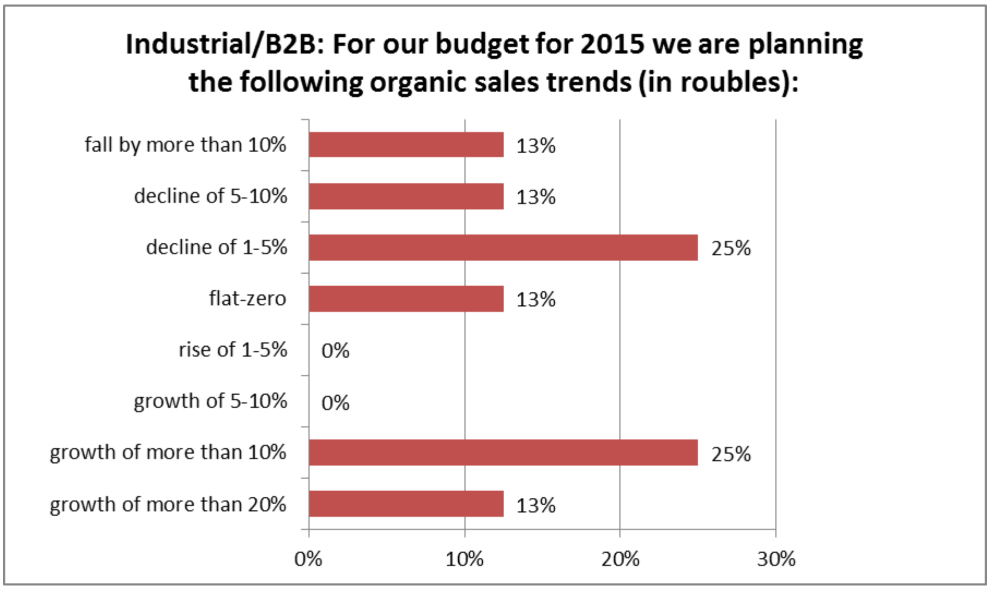
Given that companies predict mostly negative consumer spending in 2015, much of the planned sales increases will have to come from price rises and we know that most consumer product firms will implement their first set of price increases for 2015 in February followed by at least another set later in the year: one single price increase often ranges at 6-16%. Thus some/many companies last year raised prices by 20-25-30% and could do so again this year depending on inflation but more so on the rouble.

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. Fully 60% of such companies forecast double-digit sales and another third predict single-digit increases. Also hardly any of these respondents forecast flat or negative growth.

The outlook is more thoughtful in the industrial sector: automotive and IT could possibly recover from the bad lows of 2014 and 44% of firms predict flat or negative sales which is the worst sectoral forecast by far. 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 37% are upbeat looking to double-digit sales growth this year.







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

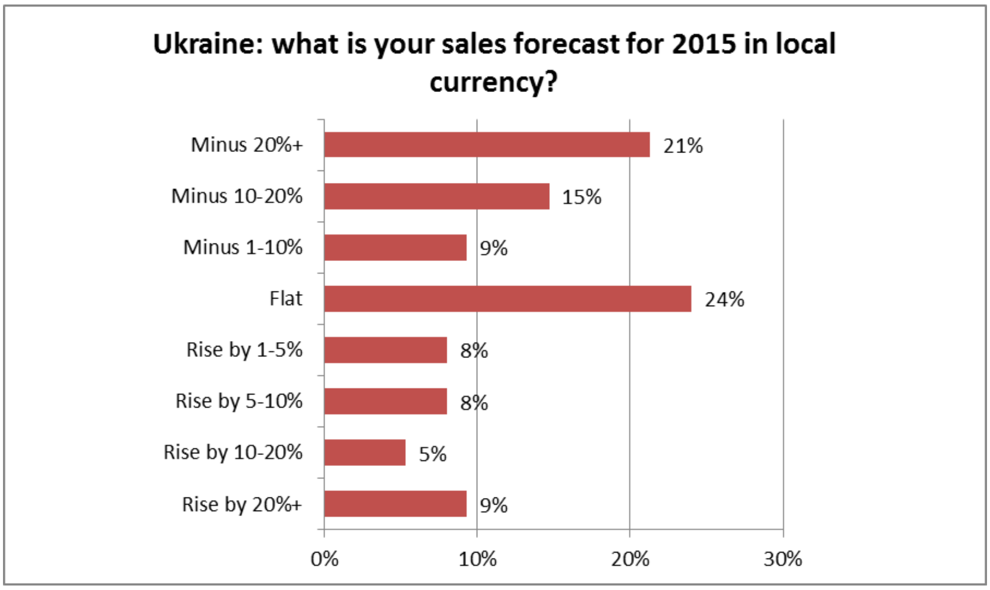
2015 results	Russia	Ukraine	Kazakhstan	Belarus
Growth of 20%+	19	9	14	8
Growth of 10%+	22	5	26	16
Growth of 5-10%	23	8	20	28
Growth of 1-5%	9	8	16	12
Flat-zero	10	24	25	25
Decline of 1-5%	7	9	5	5
Decline of 5-10%	5	15	1	5
Decline of 10%+	5	21	3	1

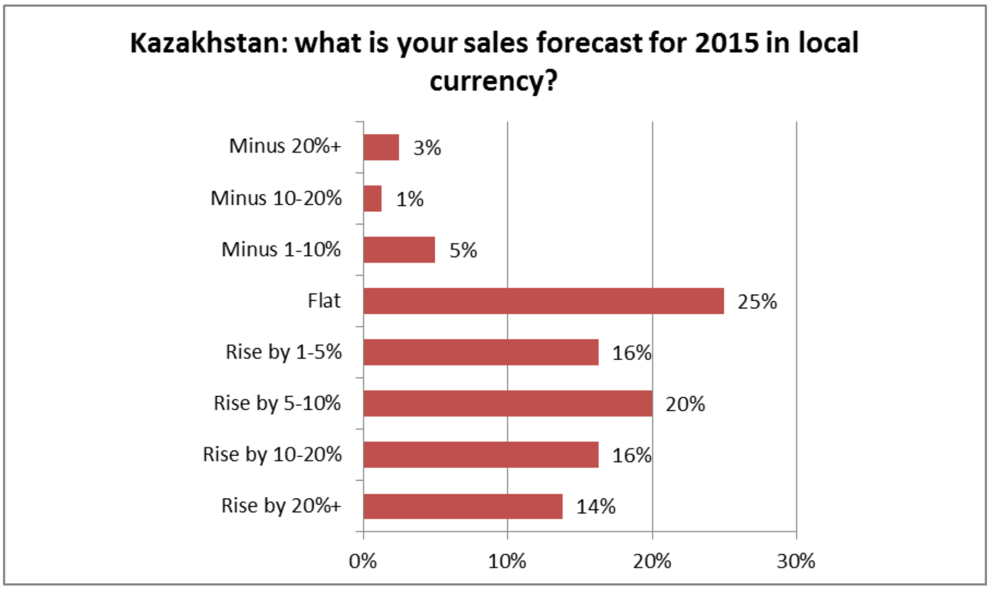
Some quick comparisons can be made:

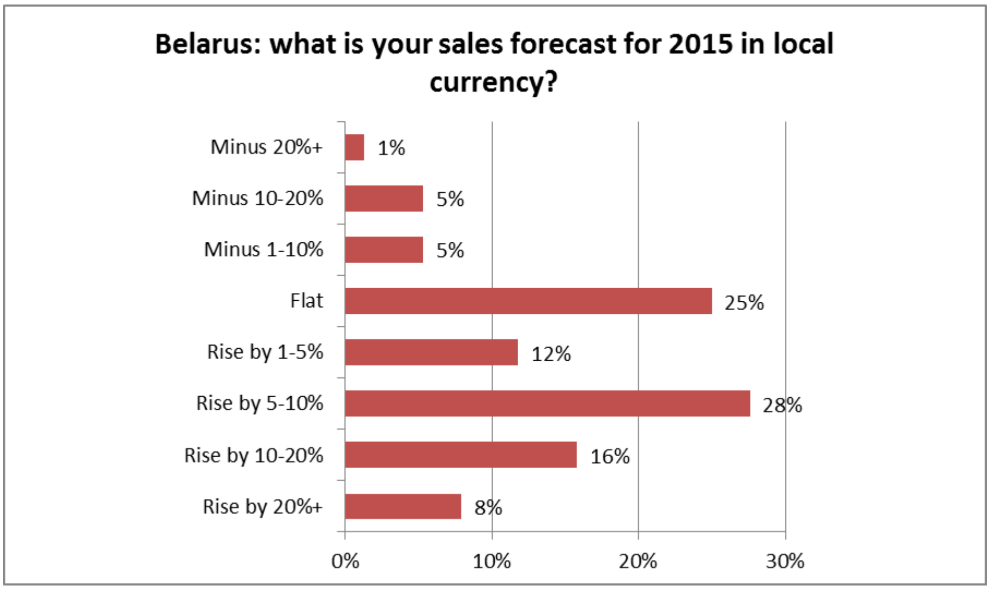
Kazakhstan is now only joint best-performing market this year as Russia seems to stabilise and in the last month fewer companies now plan double-digit growth in Kazakhstan. Still it is a good-looking market and this is backed up anecdotally. BUT there is a clear warning also that tenge devaluation is 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. 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.

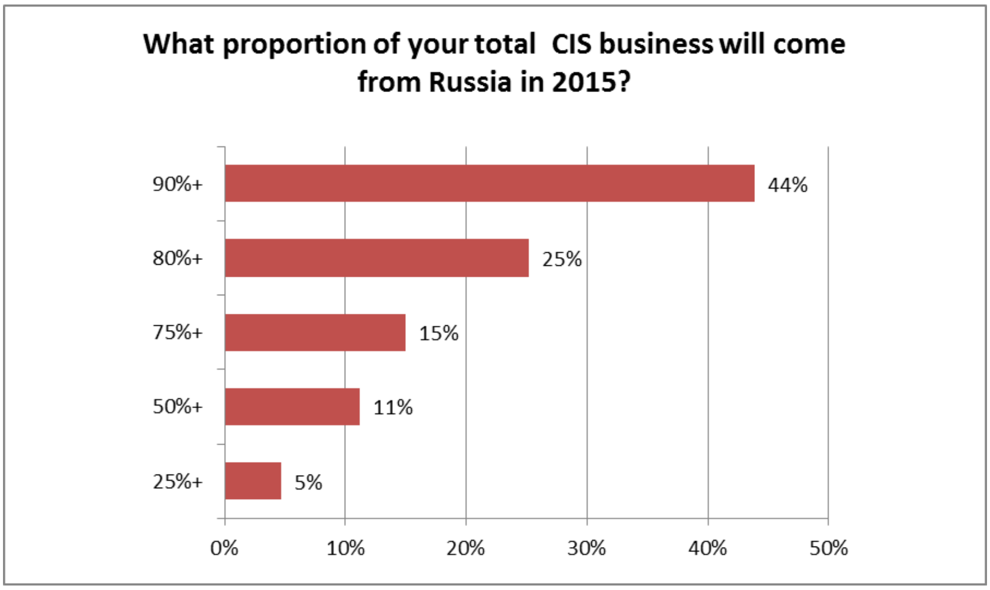

Ukraine: what is your sales forecast for 2015 in local currency?
Minus 20%+
21%
Minus 10-20%
15%
Minus 1-10%
9%
Flat
24%
Rise by 1-5%
8%
Rise by 5-10%
8%
Rise by 10-20%
5%
Rise by 20%+
9%
0%
10%
20%
30%


Kazakhstan: what is your sales forecast for 2015 in local currency?
Minus 20%+
3%
Minus 10-20%
1%
Minus 1-10%
5%
Flat
25%
Rise by 1-5%
16%
Rise by 5-10%
20%
Rise by 10-20%
16%
Rise by 20%+
14%
0%
10%
20%
30%


Belarus: what is your sales forecast for 2015 in local currency?
Minus 20%+
1%
Minus 10-20%
5%
Minus 1-10%
5%
Flat
25%
Rise by 1-5%
12%
Rise by 5-10%
28%
Rise by 10-20%
16%
Rise by 20%+
8%
0%
10%
20%
30%

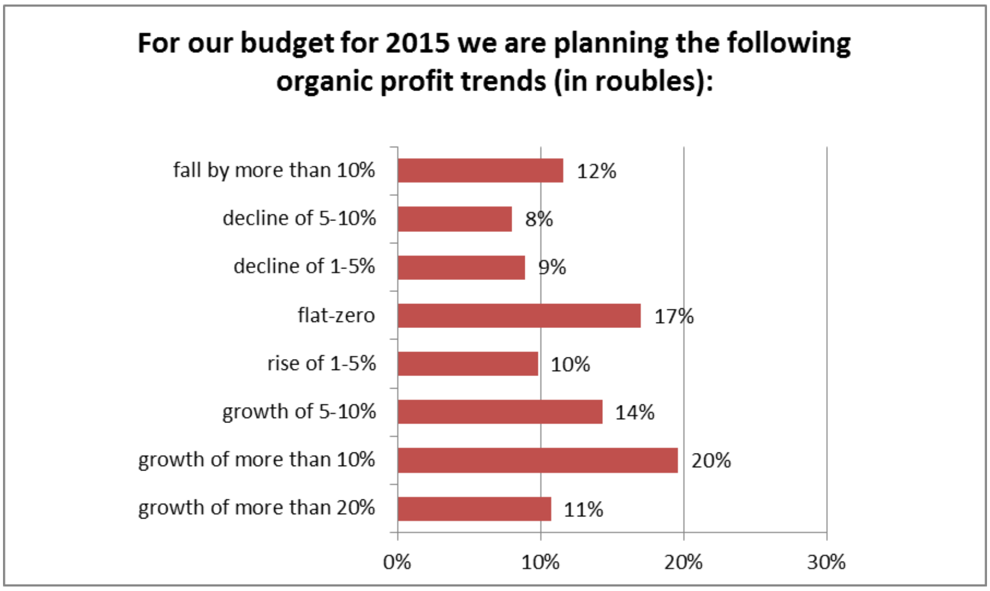
How big is the Russian market in the CIS?

Russia remains the huge, massive volume market. These numbers match anecdotal remarks we have used for many years.



Profits in 2015 (in roubles)

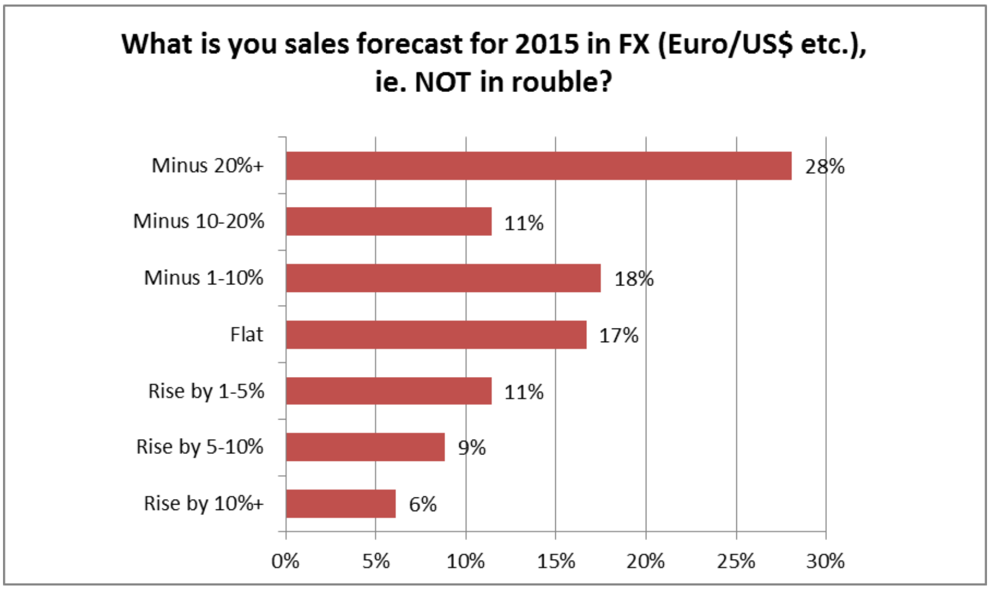
Profit expectations for 2015 are generally expected to be slightly weaker than sales with more clustered in negative, flat and single-digit territory. We will discuss in future papers likely profit trends but the consensus is that companies often reported super profits in the past and these will fall now to often still reasonably good levels compared with other markets. However, companies will have to manage costs very tightly to achieve any reasonable level of profit.



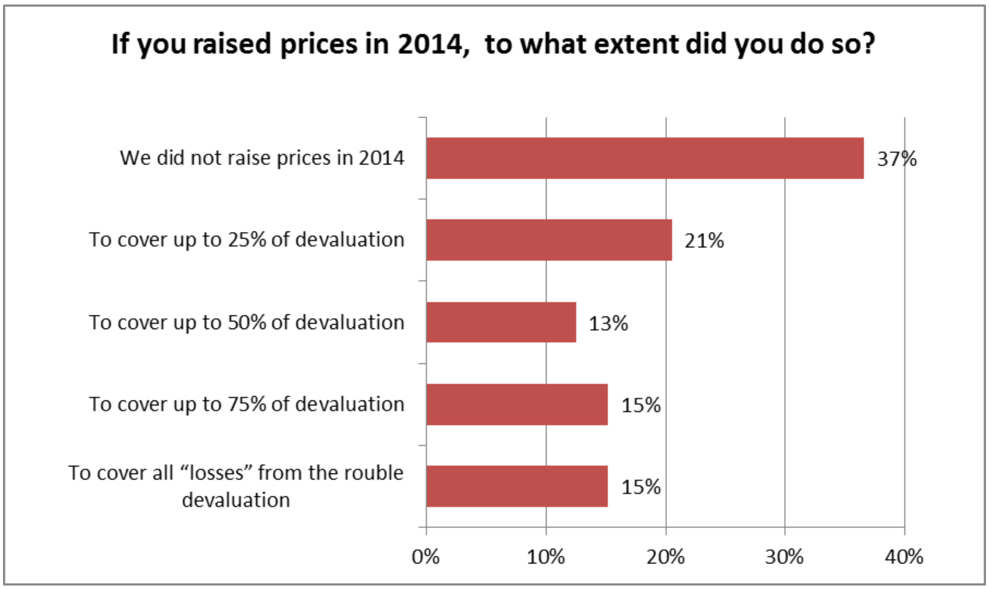
But looking at the numbers in FX and not roubles:

This is where brutal reality kicks in. Remarkably 26% of companies plan for sales increases in 2015 in FX. 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.

Another 17% predict flat FX results while some 57% forecast negative FX results and there is nothing wrong with this! Rouble sales and domestic demand from consumers and companies will be strained. The oil price can go anywhere: up, down, flat, and predicting negative FX results is probably sober and sensible for many, many companies.

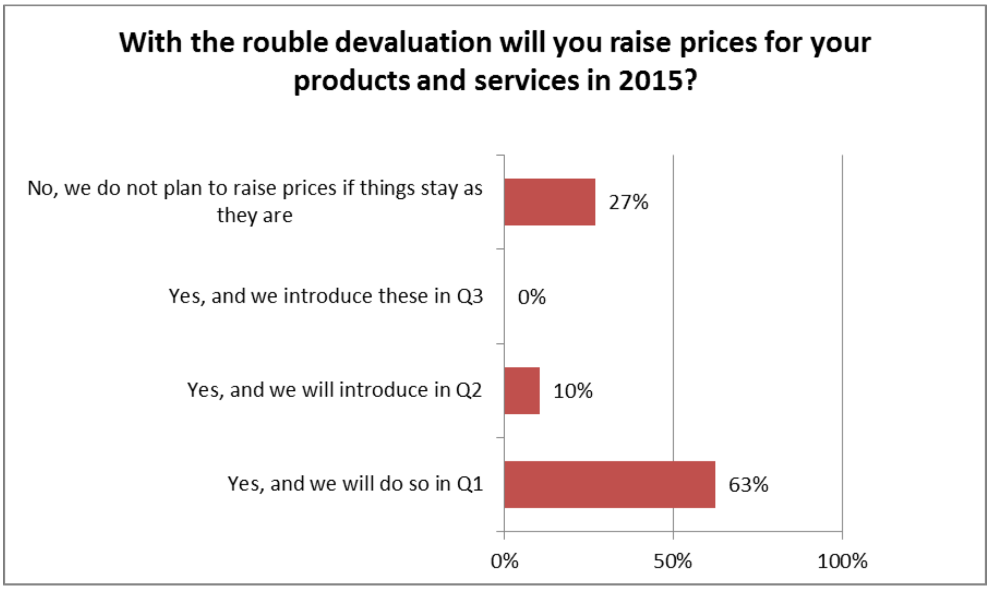


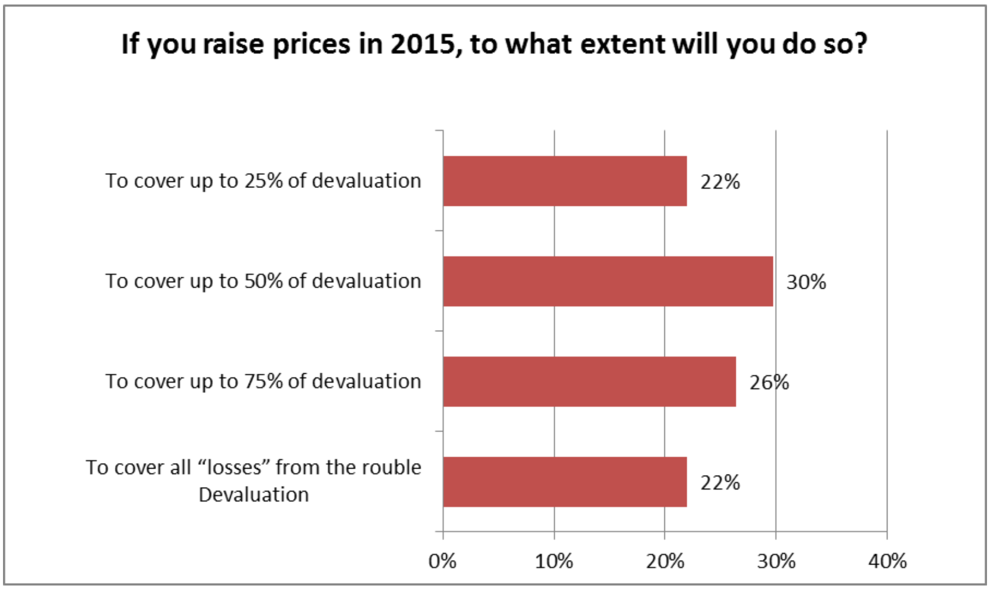
Raising prices to protect the business:

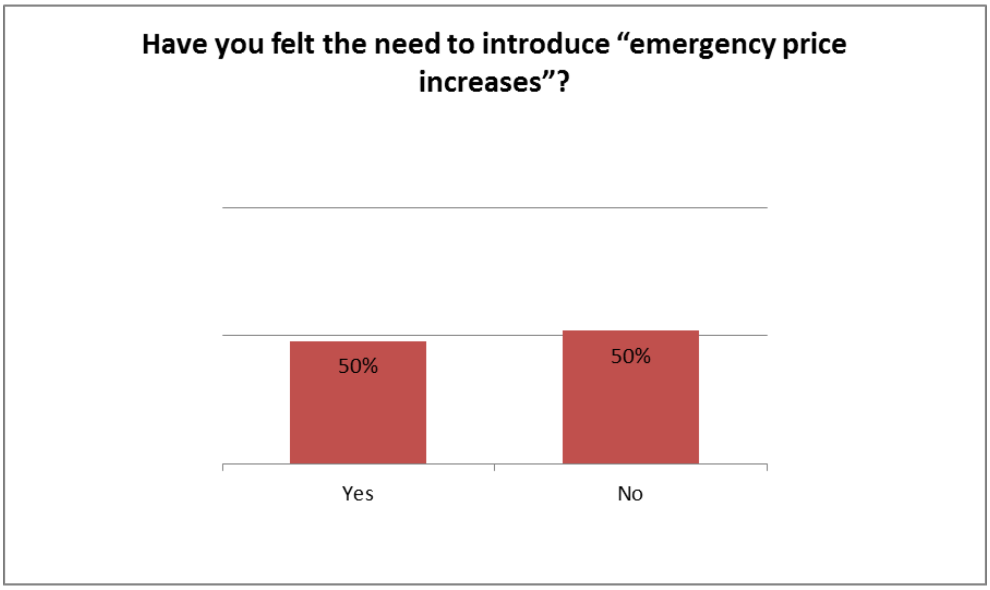


The surprising figure of 37% of companies who are not raising their prices is in part explained by those who invoice in dollars/Euros and by those who operate in some sectors such as reimbursed pharmaceuticals where price rises are not permitted in some segments. In plans for 2015, somewhat fewer companies (27%) plan to forego a price increase and the majority plan to bring in price rises in the first quarter of this year and we think many companies implemented these in February. Companies will now wait and see what happens with inflation but more importantly with the rouble. Companies are more adept at handling price rises to manage moderate/strong inflation than they are with protecting their profits against a crashing currency. In other words, if the rouble does stabilise this year, fewer price increases will be required.

It is important to note *that at least until mid-January most executives comment that price rises have been well absorbed by consumers and companies have not seen sales plunge or market share deteriorate due to these higher prices: at least not yet.*





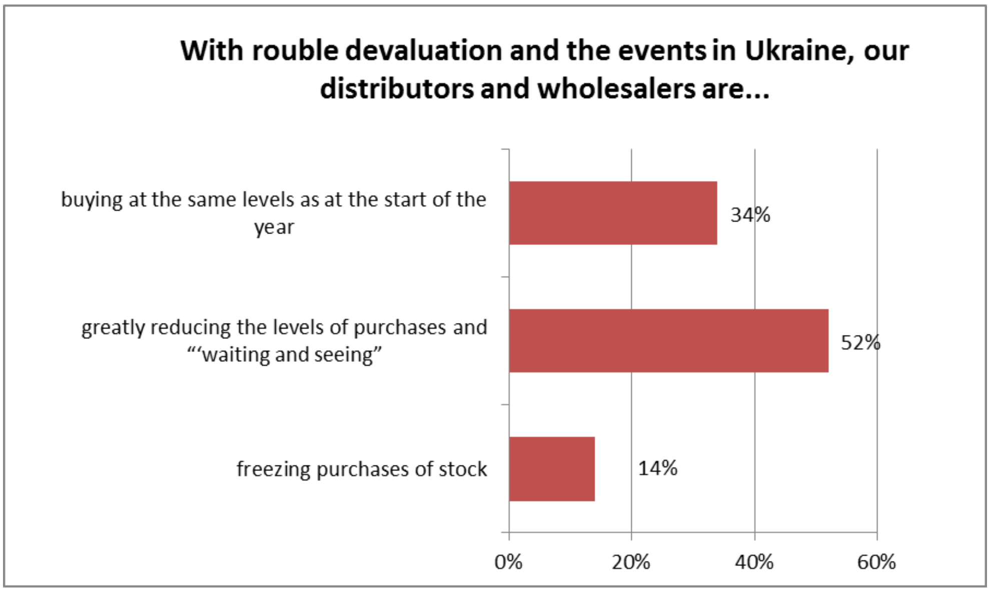


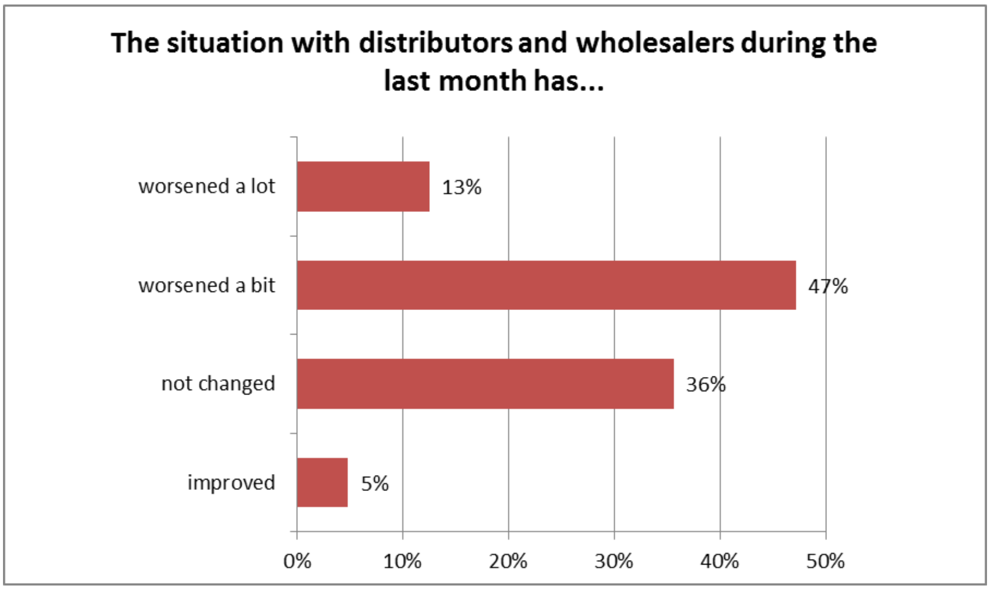
Working with the supply-chain

This indicator worsened in the summer 2014 and then stabilised in September-October followed by a mild deterioration to mid-November and then once again though it deteriorated at the turn of the year. However, as with several other indicators, we are now seeing some moderate stabilisation: some 14% of companies report the freezing up of distribution while the number reporting "greatly reduced levels of purchases" stays at 52% and the number who see business as usual has stabilised at 34% today after a sharp fall in this indictor in December.

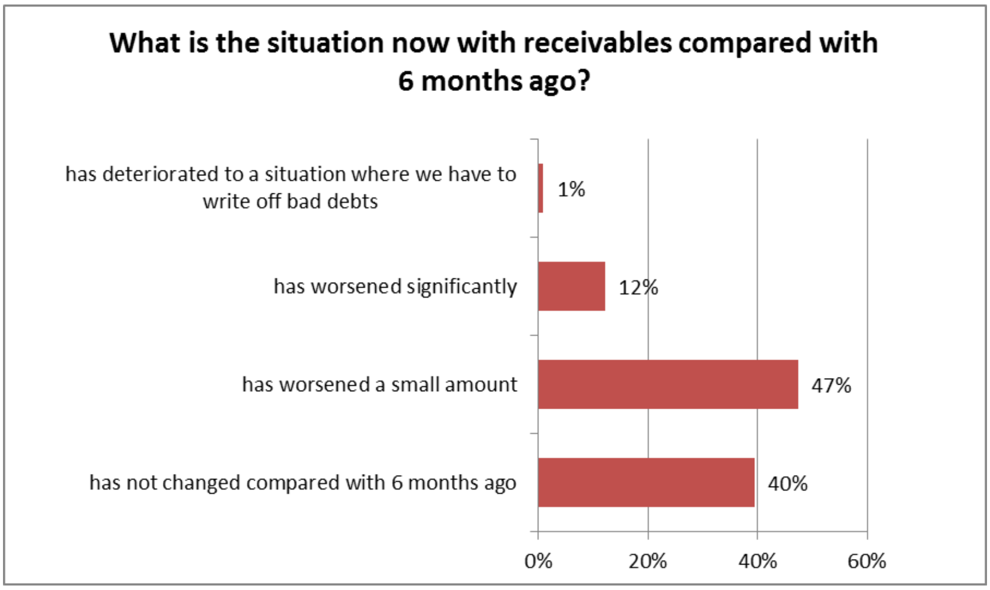
Again there are fluctuations by business sector and pharmaceuticals come out best by far with consumer products not bad or mixed but with 55% of B2B companies reporting a "great reduction" and hence the less confident outlook in this sector. Once again the pharmaceutical sector comes out best with 50% replying that there has been no change at all in the distribution system.

The situation regarding this indicator has in fact hardly changed in the last 4-5 weeks pointing to at least temporary stabilisation and perhaps "finding a bottom". But tough financing conditions could see deterioration later this year.

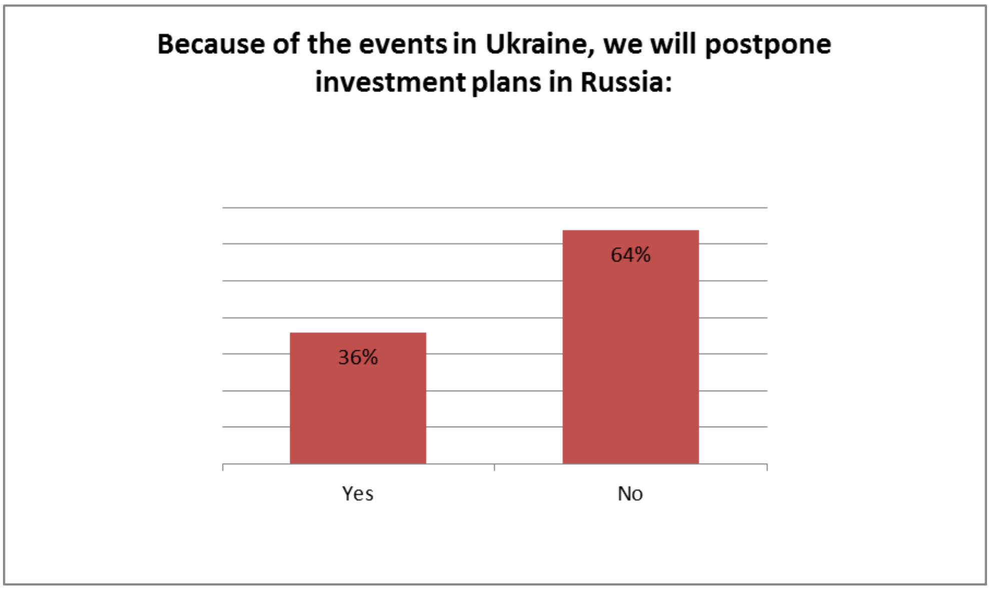




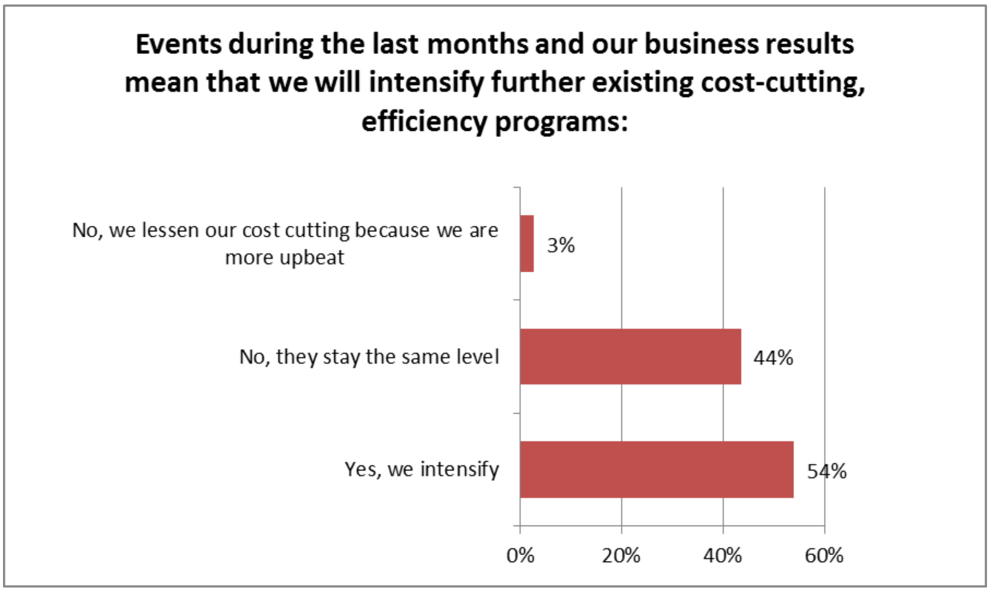
Receivables, investment plans and cost management trends



Receivables are one of the indicators which have stabilised in the recent 6-8 week period which again is a positive: the number of those stating they have worsened a "small amount" is 47%. Some 12% of firms note a significant worsening and 1% refer to bad debts. Still, 40% of companies remark that there has been no deterioration at all on the 2013 status. The payment morale generally for many years in Russia has been very good. But within the CEE region, Russia now ranks second worse in a table out of 23 markets surveyed. Within Russia there are no major discrepancies in the trends across different sectors.

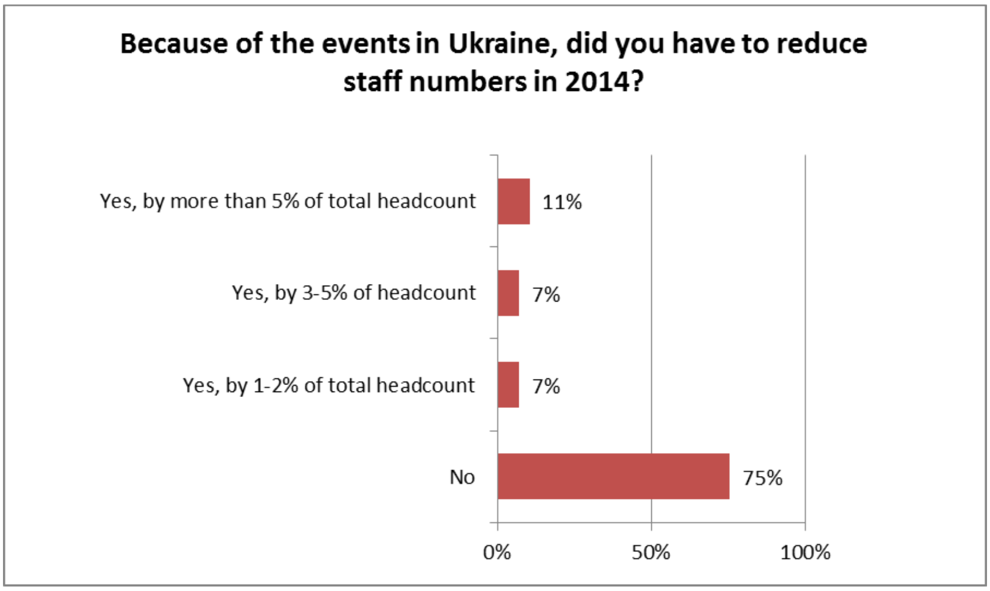


This proportion of approximately one third versus two-thirds has been fairly stable since April 2014 with marginal deterioration and again we might have expected worse figures recently but the spilt is still 64% versus 36%. But some major market players with substantial market shares in different sectors are accelerating investment and becoming quite aggressive especially in building logistics and distribution centres and warehouses. Clearly this does not apply to the majority of firms. We also note that consumer product firms and food and beverage companies are more resilient in their investment plans whereas marginally pharmaceutical companies are taking stock more; it is again the B2B sector which is holding back most.



This indicator is another one staying fairly constant simply because companies are either indeed continuing to intensify or are maintaining cost cutting programs that were already introduced. Cost management is the name of the game. This will not go away and with focus on supply chain and manufacturing processes. Companies want to cut least in sales and marketing but are doing so in some cases. They appear to be holding back so far with staff cuts.

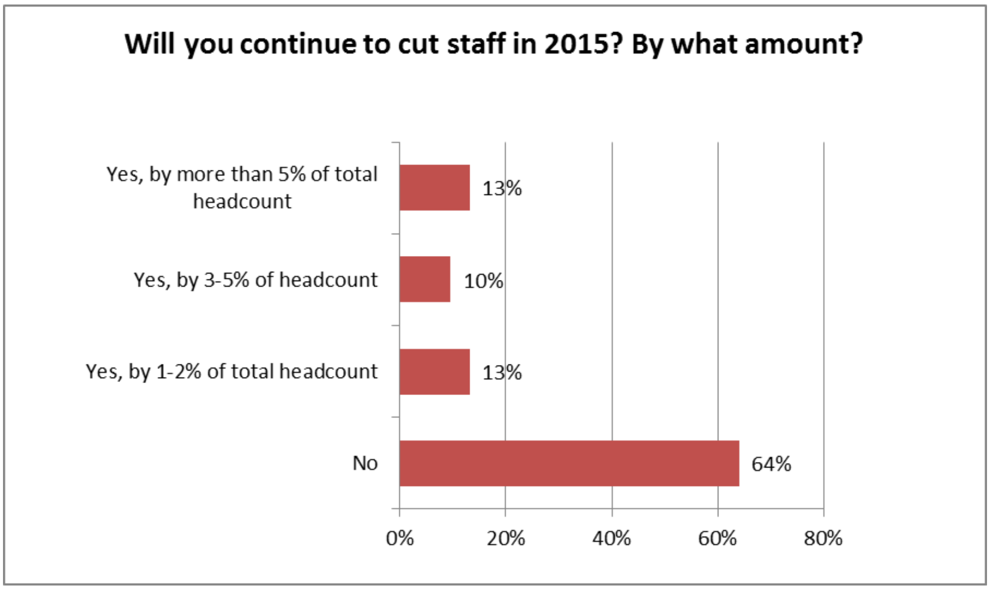
Looking after the headcount



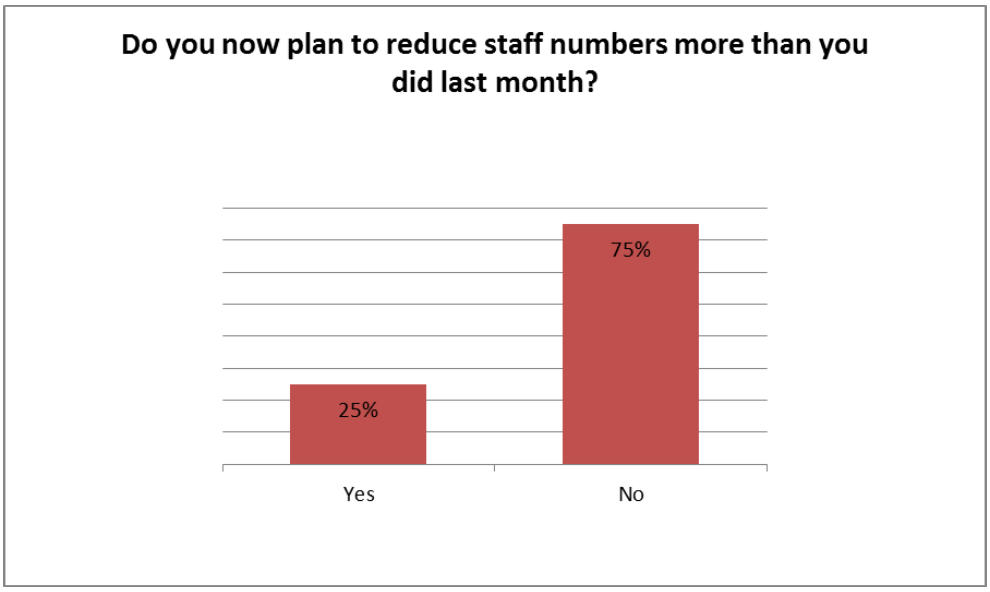
Last year companies were reluctant to fire staff and the proportion stating they have not done so is stable at 75% of companies. Some 14% of firms have made limited reductions of barely 1-5% of total staff and only 11% of companies have made cuts of more than 5% of total staff.

This approach is the best one and if sales and profits can be sustained at bearable levels, staff cuts may not become prevalent. But there is a clear risk that further staff reductions may take place and this risk increased noticeably toward the end of the year given falling sales expected in 2015 and tighter profits.

However our other surveys show that (until December) Russia remains the No 1 market in the CEEMEA region where companies still plan to hire new staff over the next 3 years.



Here we see that the number of companies not cutting staff is now down to about 64%, which is a 10% decline on last year and fits with our assessment that more companies "will have to reduce staff more this year". Most of the planned cut-backs are moderate with 23% looking to reductions of 1-5% of total staff and 13% proposing deeper cut-backs. There will be some churn as some companies do plan new hires and replacement ones. This indicator could worsen over the spring.



Salary trends 2014 and 2015

Given that salary decisions are now set for 2015, there is little change in our indicators but we are seeing some marginal movement to raise salaries a little bit by a small number of companies and at the margins. But this movement is marginal and not enough to change the indicators below regarding trends in salaries above or below inflation. In other words, companies overall have NOT decided to re-jig or increase their salaries to compensate for the rising adjustments in headline inflation.

<u>Overall, the clear conclusion for now remains: companies are trying hard to protect their headcount but are determined to manage their costs and will keep salary increases firmly below inflation, which actually matches trends visible in the Russian economy overall and within the Russian civil service. It seems that everywhere real wages (after inflation) will now trend at -5% to -10% this year.</u>

The clear point about 2014 and 2015 is that companies will keep a very tight rein on salaries. For 2015 more companies are planning for below inflation pay increases as inflation rises further in Russia from an average 7.8% in 2014 to an average figure in 2015 which could range from a low of 9% to a worst case of 14-15%.

There are variations of course and these are averages and white collar covers a large number of positions. To assist you in budget planning, the following two tables compare previous periods (benchmarked to inflation) and also show what companies plan in 2014 and 2015 in absolute percentage terms.

Salary comparisons 2014-2015 in absolute terms

What salary increase in roubles did you pay (do you plan) <u>in absolute terms</u> in 2014 and 2015?

	2014	2015
Plus 10%	3%	12%
5-10%	27%	55%
1-5%	15%	16%
Flat	20%	13%
Negative	0%	4%

While this table makes it look like companies are being more generous, this is not the case. Given that inflation is rising noticeably in 2015, when salaries are benchmarked against inflation, they are tighter (see the next table below).

What salary increase did you pay (do you plan) in the coming 12 months?
Salary comparison over time benched to inflation - "average" white collar staff members

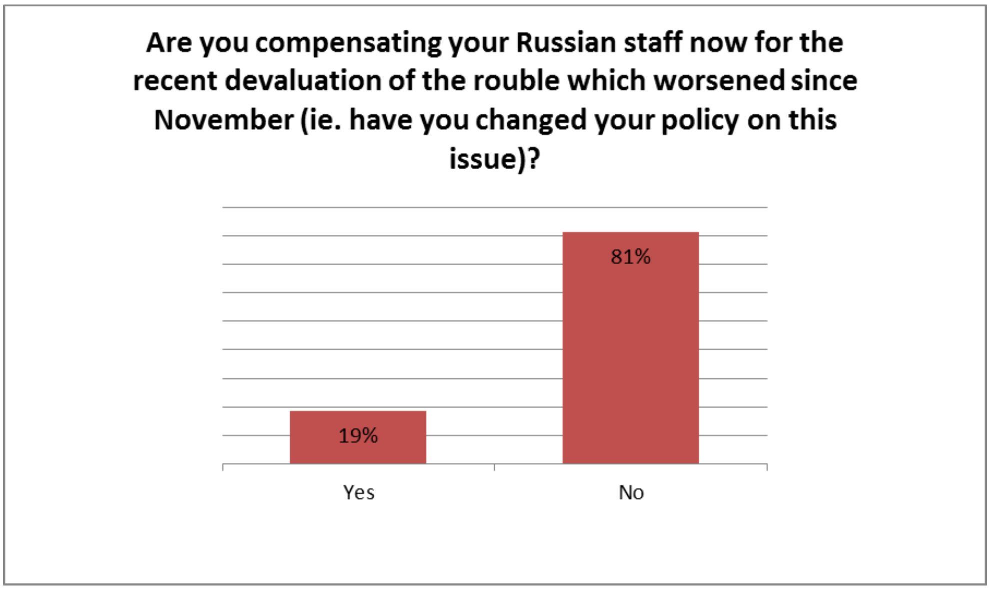
% of companies	January 2013	January 2014	September 2014
Salary below inflation	3%	14%	87%
Salary at inflation or + 1-5%	70%	80%	13%
Salary at inflation +5-10%	25%	6%	0%

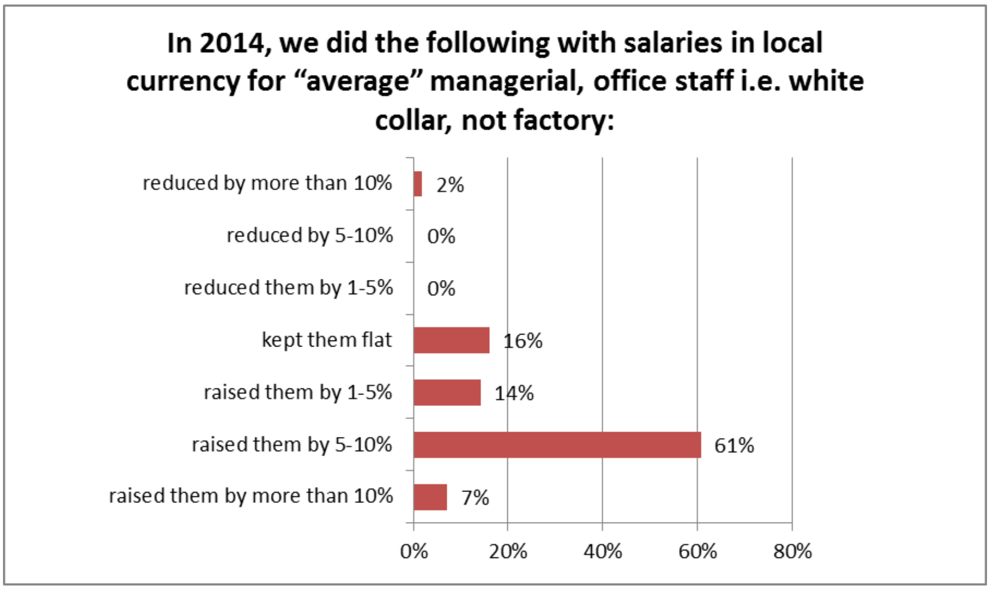
Source: Russia Business Group Surveys

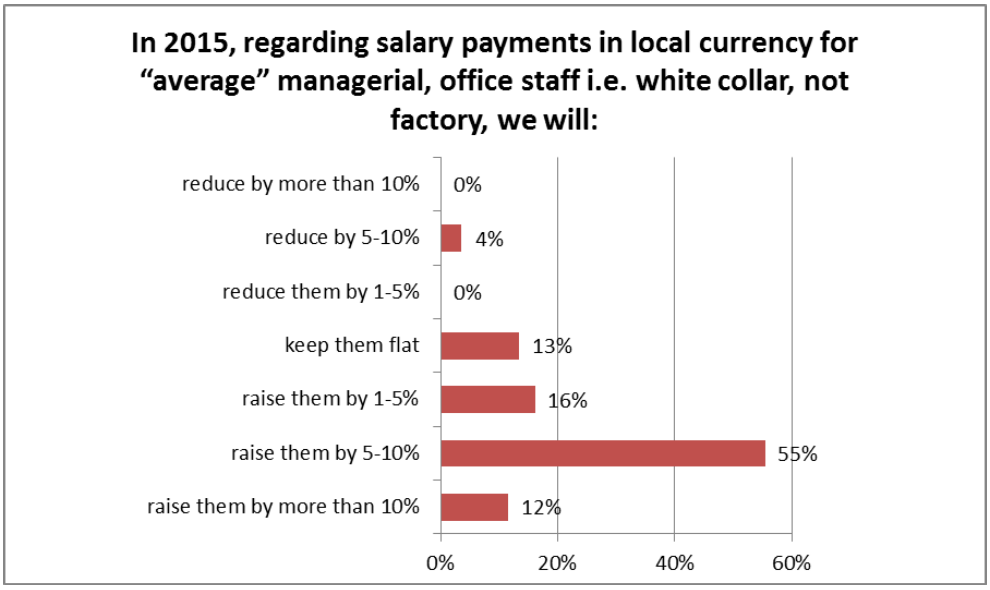
The numbers in these two tables match up/correlate when we presume that inflation in 2014 will average about 7.8% and will average 11-13% in 2015.

Instead of cutting staff numbers, companies are offering lower salary increases for "average" white collar staff. The upward pressures for top talent remain high but these very high levels have also declined and decelerated. What is very manifest is that while in January 2013 it was almost unheard of to propose salary increases below inflation, this has changed radically with 87% of companies now in this situation.

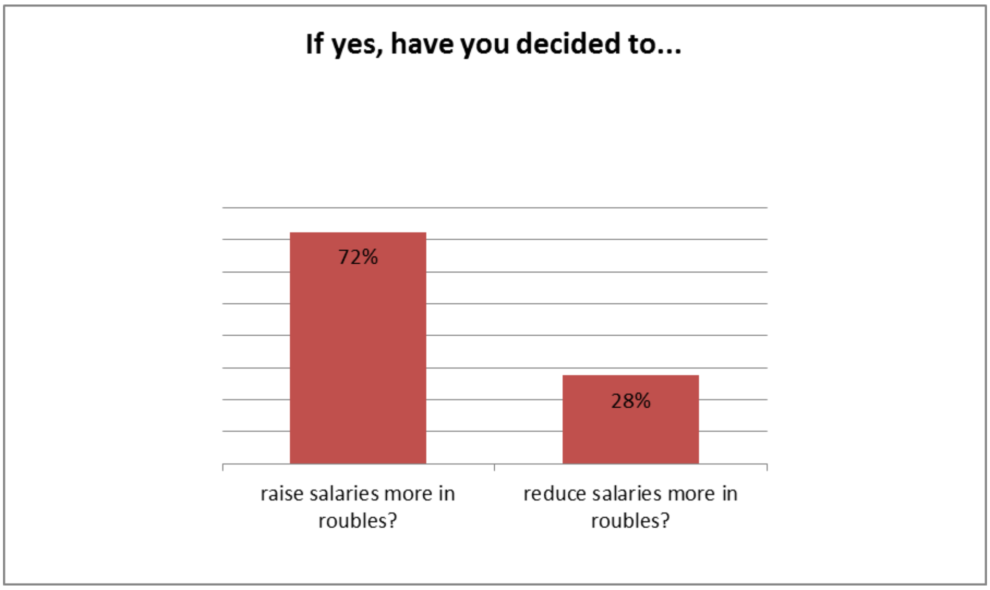
Also note that 81% of companies are not compensating Russian staff for the devaluation of the rouble.

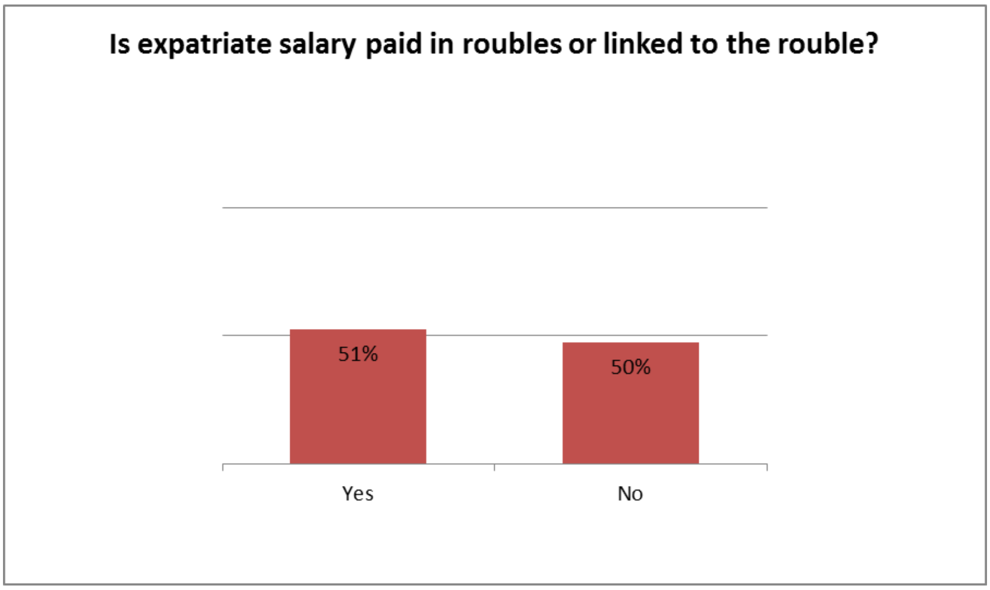


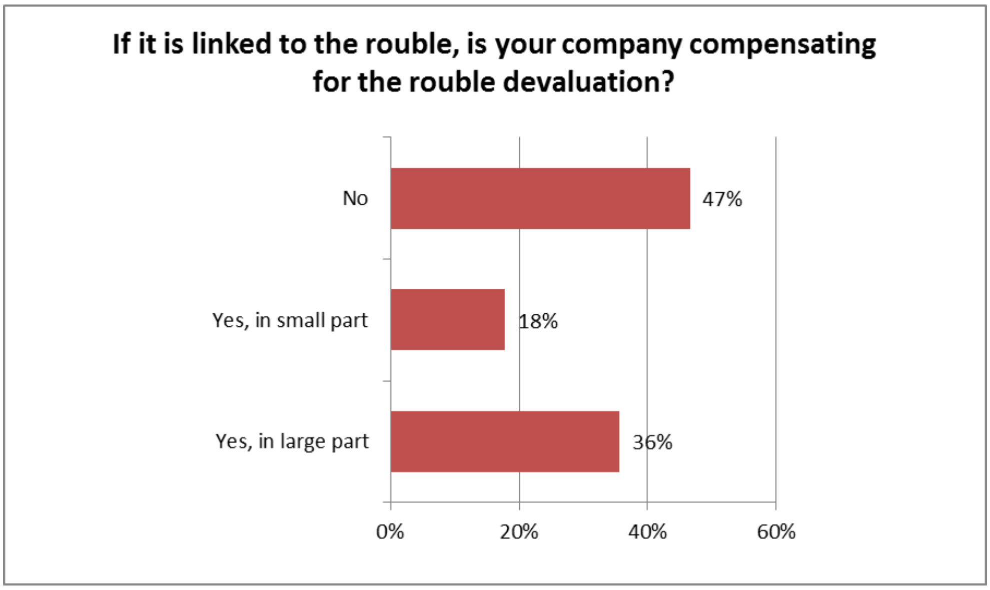



In 2015, regarding salary payments in local currency for "average" managerial, office staff i.e. white collar, not factory, we will:
reduce by more than 10%
0%
reduce by 5-10%
4%
reduce them by 1-5%
0%
keep them flat
13%
raise them by 1-5%
16%
raise them by 5-10%
55%
raise them by more than 10%
12%
0%
20%
40%
60%

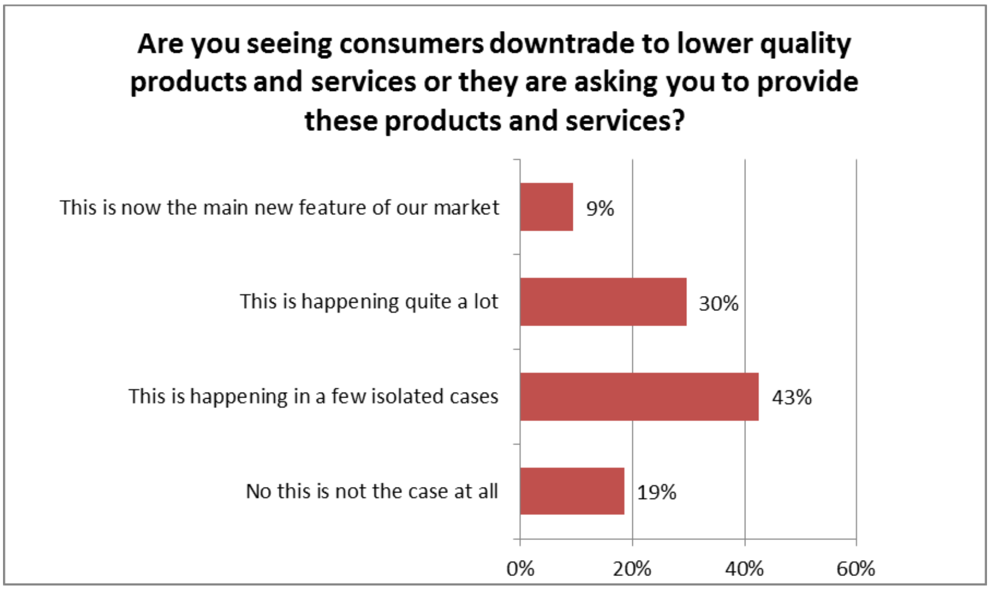

Have you changed your overall salary policy for 2015 in the last few months?
23%
77%
Yes
No


If yes, have you decided to...
72%
28%
raise salaries more in roubles?
reduce salaries more in roubles?

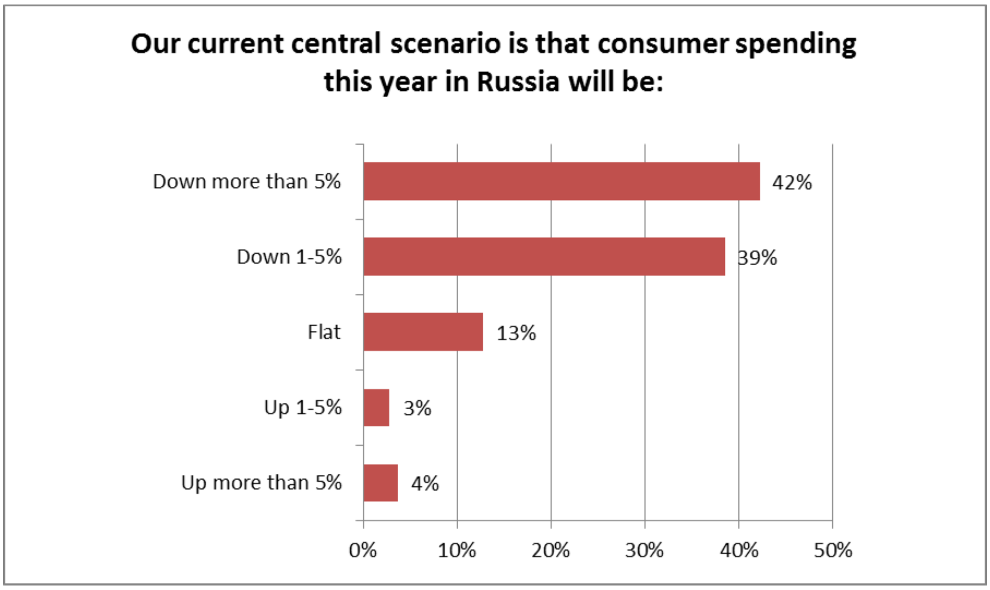

Is expatriate salary paid in roubles or linked to the rouble?
51%
50%
Yes
No


If it is linked to the rouble, is your company compensating for the rouble devaluation?
No
47%
Yes, in small part
18%
Yes, in large part
36%
0%
20%
40%
60%

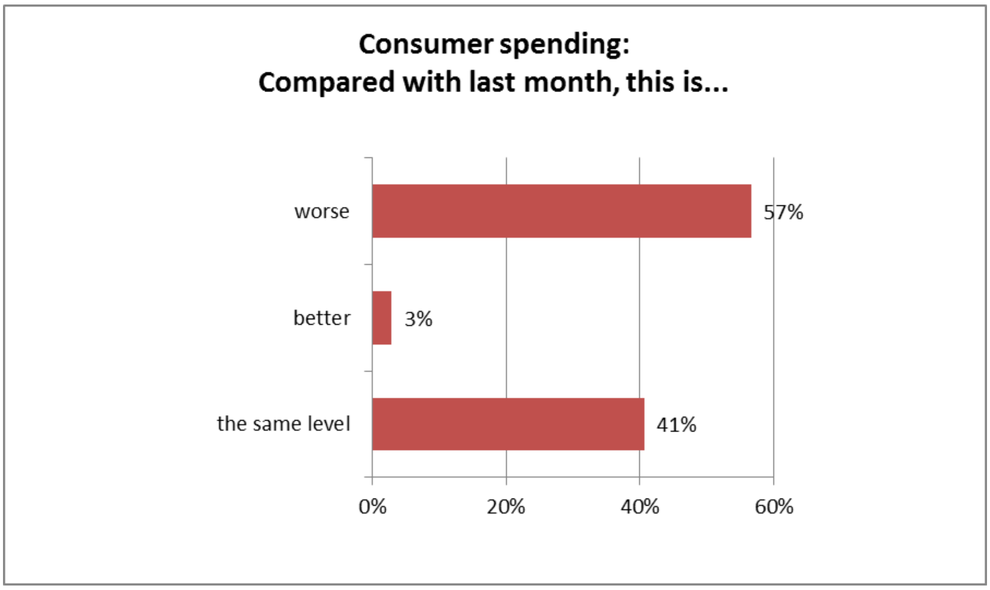
The Russian consumer outlook



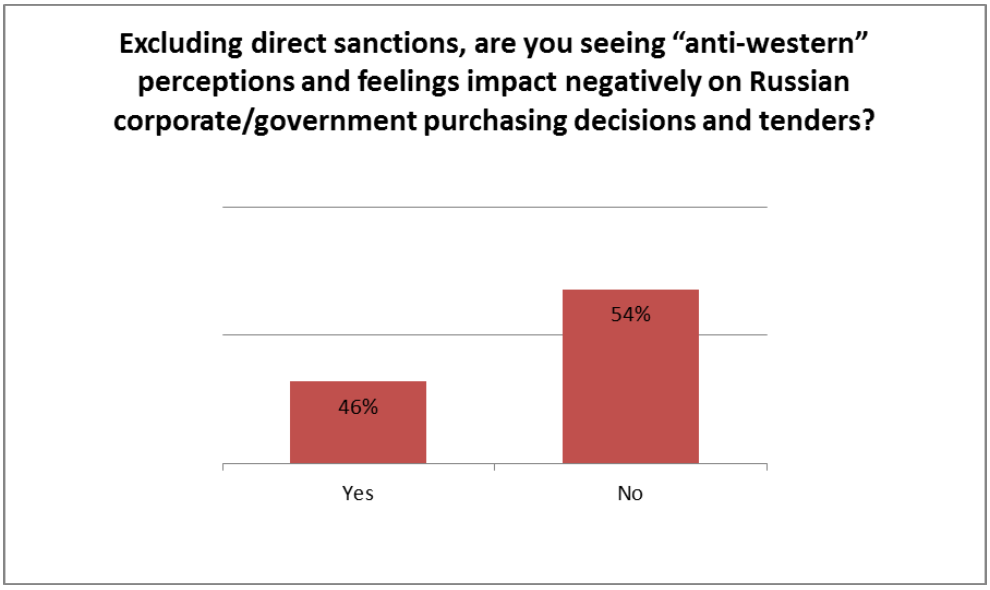
This indicator has also stabilised in recent weeks which is perhaps surprising but some of this has been factored in already and we presume it will deteriorate further over the next 2-3 months as inflation rises and real wages deteriorate quite sharply. For some 39% of companies downtrading is a serious issue in their business. The trend takes place most of all in the consumer sector but we are seeing these pressures in B2B and IT as well and in government tenders of course. But the figures also show that 19% of respondents are not affected. On the positive side those who state downtrading is isolated, is stable around 43% of respondents. Compared with other CEE markets, Russia has worsened in this category while the toughest market for downtrading is not surprisingly Ukraine.



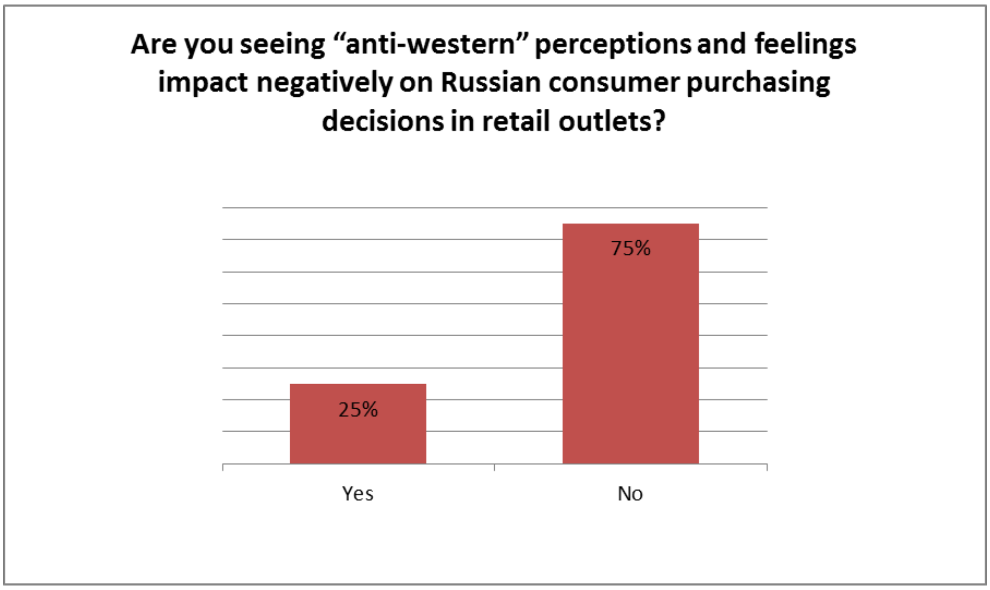
Given the rouble crash and slowdown in real wages and softening retail sales over the last two months, this indicator has deteriorated hugely over the last three months. The end of 2014 finished very strongly but that is now over. Only 7% of executives think consumer spending will be positive this year with 13% looking at flat expenditure. But the number predicting negative spending has risen from 34% last November to 82% today.
Spiking inflation, collapsing real wages and falling consumer confidence are all playing their part. This is why we noted above that consumer product companies will have to be very creative and raise prices as well to make their numbers.



This indicator has stabilised at weaker levels.



This indicator has stabilised in the last 4-6 weeks after deteriorating at the end of 2014. Some companies report losing one or two contracts which they think they would otherwise have won. But we are not yet seeing many companies reporting a large loss of business, although this remains a worse case that can develop. Companies are being asked, "Are you localised?" and then also asked "From where do you source your inputs?" and some companies are turning to Asian suppliers rather than regular western ones.



It is more difficult to gauge whether end-consumers in shops are actively deferring purchases of western products because of anti-western feeling. There may be more public talk of this than reality and it is a feature difficult to gauge and quantify. Consumers of course may be turning away from some western brands purely based on price/value decisions. But it is not a feature to be trivialised. Luckily at 75-25 split it is a minority problem at the moment but this indictor did worsen marginally in the last month. It is open whether it will continue to do so.

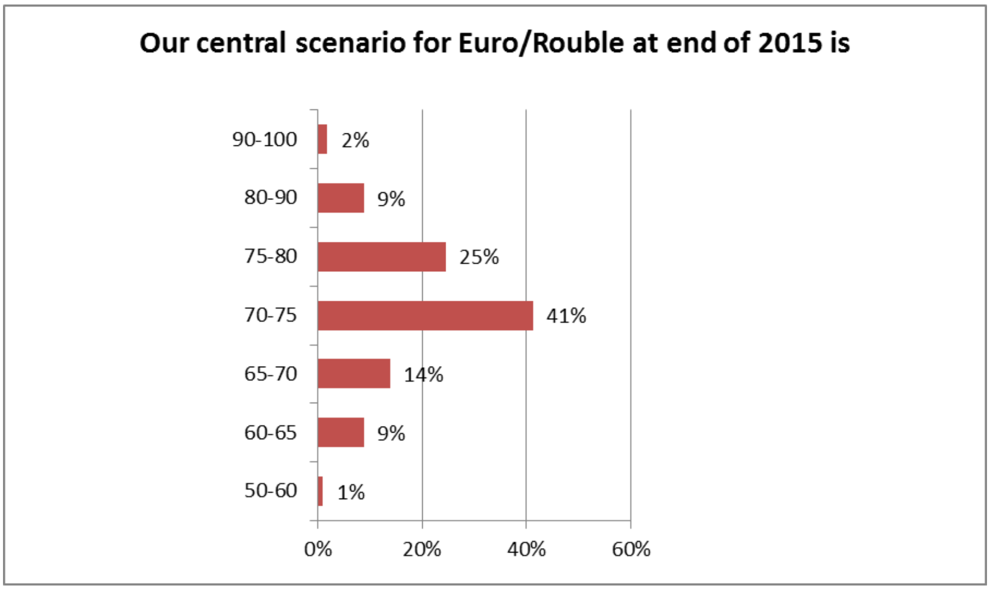
The currency outlook

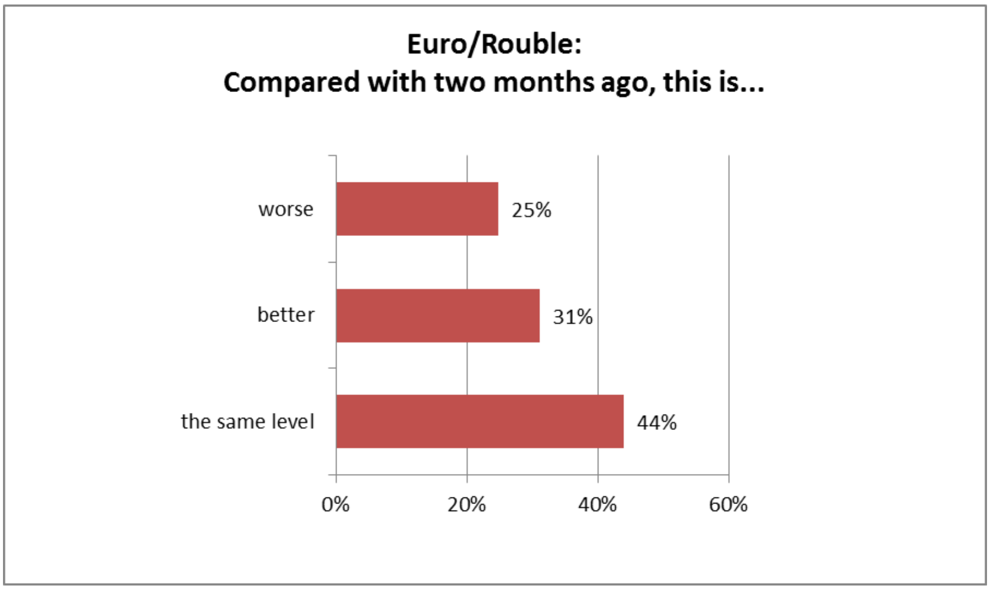
Executives have clearly matched the markets in their improving perceptions regarding the currency. Most corporate expectations are sensibly quite close to current FX rates of 61-62 to the US dollar and 68-70 to the Euro. The FX rate could still go either way and could improve by 5-20% in the coming 2-3 months or deteriorate by that amount depending on the two major swing factors of the oil price and events in Eastern Ukraine.

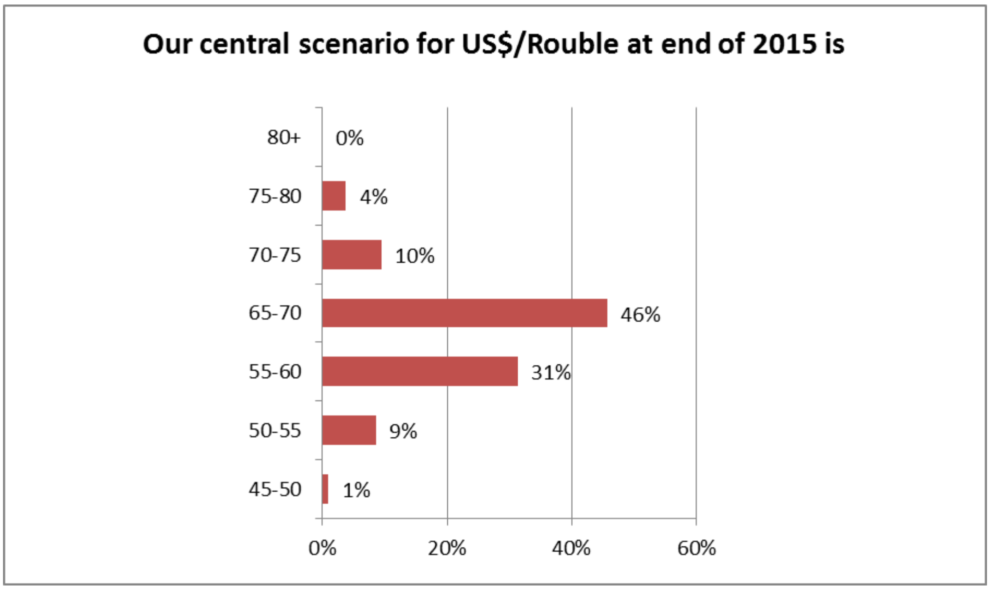
Our own estimates in our economic reports argued that the current "rally" could materialise and we stick with forward estimates close to where we are for now but always factoring in some more downside this year by 5-10%.

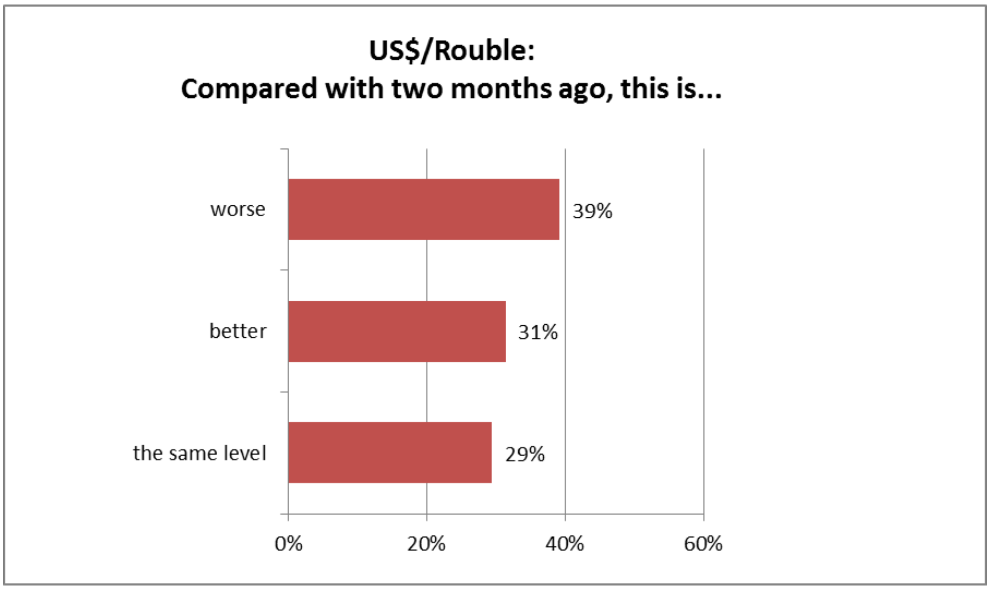
December and January saw a veritable tsunami regarding the Russian rouble making it the worst performing currency in the world versus the dollar and Euro. However, coming from that low base, until 1 March 2015, it has been the world's best performing currency along with an improving stock market. As we have long argued, improvements in the oil price and even moderate amelioration in eastern Ukraine have helped turn things around. However, there is a very long way to go before we arrive at any sustainable stability or appreciation.

Once again here is our rouble analysis. The rouble has fallen so badly because:
1. Ukraine crisis but this is being surpassed.
2. The collapsing oil price: Russia has apparently lost a 1-2 year "breathing space" because until three months ago the consensus was that oil would be around $100 in 2015 and part of 2016.
3. The Saudi decision not to support the oil price last November was a global game changer. OPEC looks busted as an organisation.
4. The dollar is surging as US tapering finishes and US interest rates will rise in 2015.
5. Sanctions are tightening dollar liquidity.
6. The Central bank probably left the rouble in its corridor for too long and speculators had a one-way bet through October and November until the free-float was introduced.
7. The free-float meant that the rouble had to find its own market price or equilibrium.
8. Capital flight is rising but we think this has been factored in.
9. Massive speculation is taking place and probably accounts for 10-20% of the fall.


Our central scenario for Euro/Rouble at end of 2015 is
90-100
2%
80-90
9%
75-80
25%
70-75
41%
65-70
14%
60-65
9%
50-60
1%
0%
20%
40%
60%


Euro/Rouble:
Compared with two months ago, this is...
worse
25%
better
31%
the same level
44%
0%
20%
40%
60%


Our central scenario for US$/Rouble at end of 2015 is
80+
0%
75-80
4%
70-75
10%
65-70
46%
55-60
31%
50-55
9%
45-50
1%
0%
20%
40%
60%

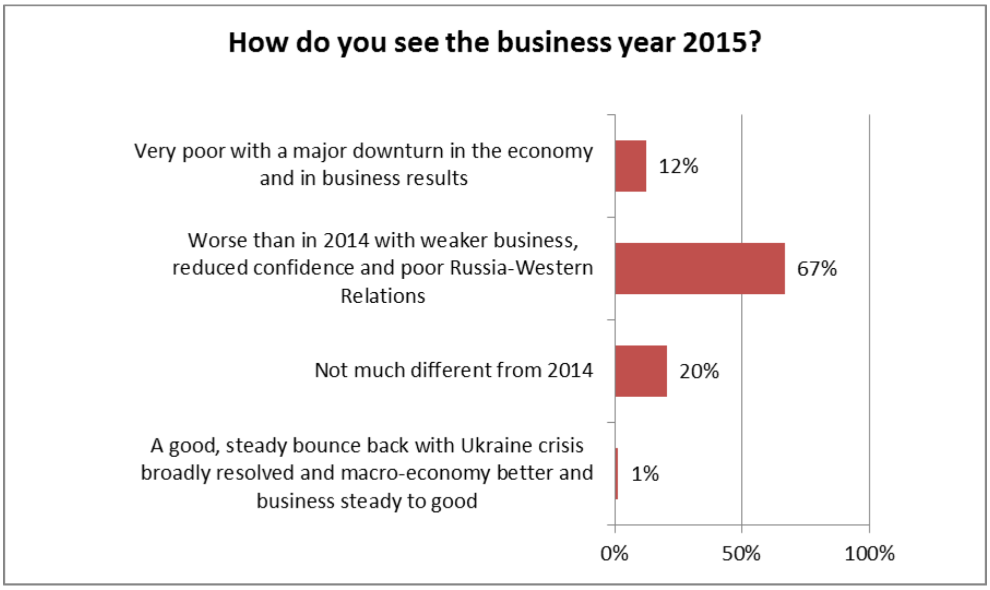


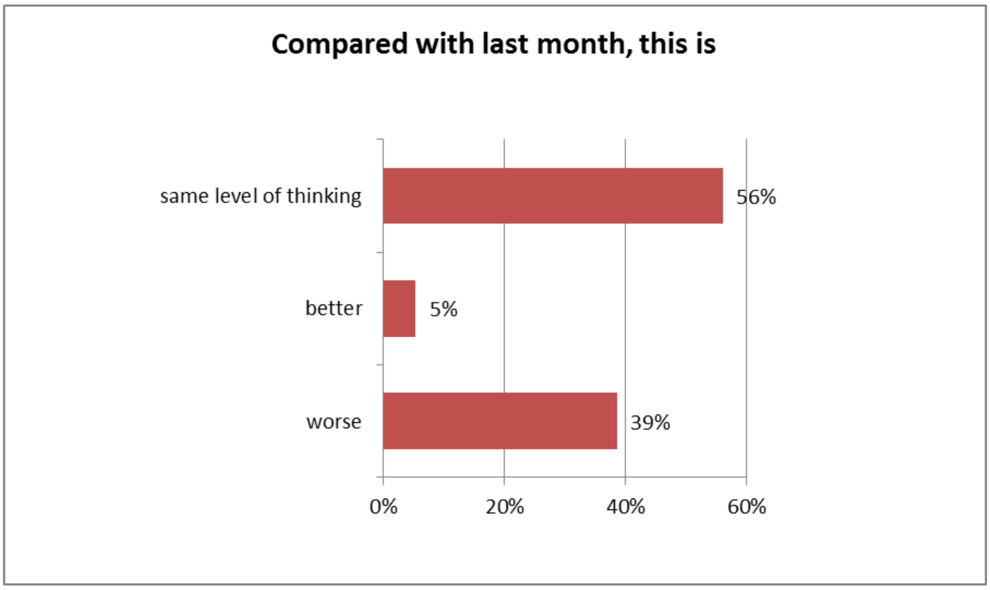
The final questions: looking ahead

The outlook for 2015 worsened at the turn of the year but again this indicator has stabilised in February admittedly at a low level with 67% now expecting this year to be worse than 2014. More executives are also talking more of how the real pain will start to be felt in spring 2015 and more companies are planning to hunker down more in 2016 and at the start of that year.

After all this commentary it still remains to be said that “until today” many companies have survived (quite well) or better than expected. But (very) tough times still lie ahead. Business results will depend in large part on how the rouble fares and so much of that will depend on the external factor of the oil price.

Once again, we advocate along with many Group members “Never waste a crisis” and staying close to customers, partners and staff through the difficult times remains best practice in Russia and anywhere else. Russians are like elephants. This is not an insult! It merely means that they have good memories and will remember how you treat them in these hard times.





If you have any queries or comments, do get in touch at danielthorniley@dt-gbc.com.

2 March 2015

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

HARTMANN

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

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