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UZBEKISTAN

WINDOW OF OPPORTUNITY



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EXECUTIVE SUMMARY

Large-scale reforms

Despite having long been left off of investors' maps, Uzbekistan is now opening up and offering investment opportunities. Following a change of leadership at the end of 2016, the country has seen its investment climate improve rapidly, putting it on track to become an attractive destination for capital.

Uzbekistan's potential also relies on strong macroeconomic fundamentals, with a strong domestic market, a relatively young and cheap labor force, abundant natural resources, a relatively diversified economy and fast-improving infrastructure. Overall, Uzbekistan benefits from macroeconomic stability, which, combined with the current reforms, is opening up opportunities in diverse economic sectors such as financial services, construction, and tourism.

Leveraging a positive macro-environment, the country is undertaking large-scale reforms to generate further economic growth and improve the investment climate. In recent years, Uzbekistan's business climate has improved tremendously, leapfrogging in the World Bank's Doing Business ranking from 166th place in 2012 to 76th place in 2019. Fast-paced reforms are in progress to address the barriers in the legal environment, as well as within the tax and customs systems. The currency liberalization in September 2017 is one of the most significant reforms.

New investment opportunities

For now, Uzbekistan remains an overlooked investment destination, with a level of foreign direct investment (FDI) significantly lower than similar countries. Nevertheless, confident in the country's strong potential, some first movers are already investing in Uzbekistan, with more than 7,500 companies with foreign capital operating in Uzbekistan today. In February 2019, Uzbekistan issued its first-ever five-year and ten-year eurobonds with a total value of one billion dollars, oversubscribing four times, to be ultimately allocated to more than 150 investors from Great Britain, Europe, USA, and Asia. This is another sign of a growing investor interest in the country.

With the new pace of reforms in the country, investment opportunities are emerging in both "traditional" sectors and "new" ones. Traditional sectors for Uzbekistan, such as the oil and gas industry, the mining sector, agriculture and the textile industry, rely mostly on natural resources. These industries are well established today, but their full investment potential is yet to be reached. On the other

hand, global trends, such as digital transformation, increasing income and spending, and the demographic trajectory, open up significant development potential in sectors that are relatively new for Uzbekistan, among them the financial and banking sector, the construction industry, the telecom sector, and tourism.

Uzbekistan still needs to mitigate several risks that may affect its current positive trajectory of change. The main risks stem from the country's geographic position — Uzbekistan being landlocked and neighboring countries with a history of political instability. Population dynamics prompt the country to create more and better jobs for its growing population. Moreover, Uzbekistan needs to maintain its unprecedented speed of reforms, while ensuring predictability for business owners and a high level of quality in the lawmaking process. Finally, the country needs to address uncertainty related to utility costs.

Five strategic success factors for investors

For investors today, winning in Uzbekistan is largely dependent on their ability to leverage the five key strategic success factors: (i) arriving sooner rather than later, (ii) relying on local expertise, (iii) developing an adaptive strategy, (iv) betting on people rather than capital, and (v) understanding Uzbekistan as part of a bigger system.

INTRODUCTION

Overvalued market and investor pessimism

The changing global economy, with its ups and downs over the last decade, is causing investors to reassess their strategies and take advantage of opportunities in both traditional and less traditional asset classes.

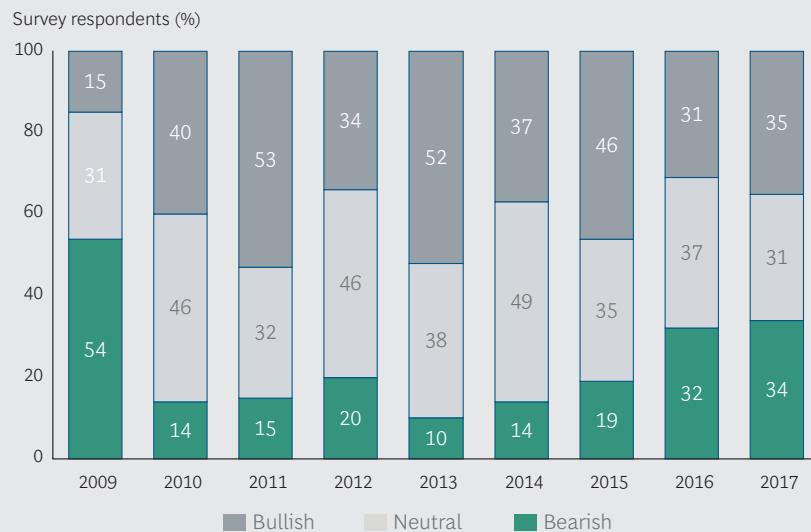
In BCG's ninth annual investor survey¹,

¹ The survey – conducted in October–November 2017 by BCG – received responses from more than 250 portfolio managers and buy-side and sell-side analysts, representing firms that are collectively responsible for approximately \$500 billion in assets under management. BCG has conducted the survey every year since 2009 to understand investors' views on global

conducted in late 2017, 68% of the investors interviewed thought the market was overvalued – by an average of 15 percentage points – and therefore they expected lower total shareholder return (TSR) in the coming years. This is more than double the 29% of investors in the 2016 survey who thought the market was overvalued.

capital markets and priorities for shareholder value creation, soliciting their outlook on and expectations for the global macroeconomic environment, equity markets, and the continued ability of companies they invest in or follow to create value. Read the complete survey at <https://www.bcg.com/publications/2017/survey-increasingly-concerned-investors-seek-long-term-value-creation.aspx>.

FIGURE 1 | Investor skepticism is at its highest since the 2007-2008 crisis



Note: Every year, respondents are asked, "where would you place yourself on the bear-bull spectrum for this year's performance of the equity markets you follow?" In 2017, they were asked that question about the next three years, through 2019.

Source: Increasingly Concerned Investors Seek Long-Term Value Creation, 2017–2019 analysis

The pessimistic investment sentiment on equity markets and in the macroeconomic environment in 2017 was at its highest since 2009. More than a third of investors (34%) were skeptical of the market's potential for the next three years, a substantial jump from 19% in 2015. Among self-described bearish investors in the 2017 survey, 79% cited market overvaluation as the reason for their pessimism.

Against this stark backdrop, investors are adopting a longer-term perspective. They are looking for sustained value creation, and 57% of respondents agree that investments should be made in emerging markets. While this context may lead risk-averse investors to seek safe investments in traditional destinations and assets, it also offers great opportunities for higher returns in "new frontier" markets that are unsaturated and cheaper for investors willing to explore them.

Indeed, in the current low-yield environment, emerging markets have attracted many investors in search of growth and higher yields. However, frontier markets, or countries in the early stages of their development, offer investors even greater potential. For investors with long-term investment horizons who can withstand volatility, frontier markets can provide high growth potential and portfolio diversification benefits. Frontier markets also offer the advantage of low correlations with other global markets.

An economic shift towards Asia

The global economic center of gravity continues to shift toward Asia's sustained growth and development of consumer economies and investors unwaveringly seek exposure to the region for diversification and returns. As the economic realignment from West to East unfolded over the past decade, it remained clear that the region's increasing population would drive growth for the foreseeable future. Economies within Asia are projected to expand through continued industrialization and infrastructure development, a rising middle-class consumer society, and increased production and export of natural resources.

In this context, Asia's projected 2020 growth rates of 6% per annum by far outstrip the Latin American and Caribbean regions that are forecast to grow only by 2.2%. Brazil is slowly climbing out of a deep recession. Growth in Sub-Saharan and North Africa and the Middle East is also forecast to remain slow, at 3.4% and 3.1%, respectively².

China symbolizes the shift in global economic power away from the developed G7 economies. It has experienced rapid, double-digit growth over the first four decades of its reform thanks to an investment-driven model for manufacturing and exports. Moreover, China has a strong positive impact on the whole region acting as both a global and a regional locomotive. The Belt and Road Initiative (BRI), where Central Asia is to play a major implementation role, is an illustration of China's positive influence on neighboring countries. Chinese companies already own a large part of the FDI stock in extractive industries in countries such as Kazakhstan and Turkmenistan. The implementation of BRI, however, will foster Chinese involvement in building infrastructure facilities and enhancing industrial capacities. In addition, agriculture and related businesses are being targeted.

A new frontier for investors

International institutions and private equity funds agree that the Central Asian countries are becoming new FDI destinations thanks to two main characteristics: an abundance of natural resources and a large population that enhances the market size. Indeed, these markets have vast natural resource deposits, but most importantly they are home to a young and well-educated workforce capable of converting this raw metal, mineral, and energy wealth into long-term sustainable economic growth and regional prosperity.

According to the OECD, the region's economic dynamism over the last 20 years has been impressive. Between 2000 and 2010 the region's gross domestic product gained an average of 8% per year, while between 2011-2018, the growth rates averaged at 5.4%. According to the Asian

² World Bank Global Economic Prospects, June 2018

Development Bank, the outlook for the subregion brightened in 2017 after a few years of regional slowdown, thanks to stable oil prices, growing trade with neighboring China and Russia, and rising remittances. Growth is forecast at 4.0% in 2018 and 2019, up from earlier forecasts of 3.5%, with improved projections for Kazakhstan, expected to grow by 3.1% in 2019³, and forecasted growth of 5.0% for Uzbekistan in 2019. According to the State Committee of the Republic of Uzbekistan on Statistics, the country's GDP in 2018 was 407,514.5 billion soms in current prices, a 5.1% increase in real terms since 2017.

Moreover, the region has the advantage of neighboring and being influenced by fast-growing economies such as India and China. The Central Asian markets form an important geo-strategic and economic trade hub

³ International Monetary Fund forecast, November 2018

and transit corridor, linking Asia with Europe, Africa and the Middle East, especially in the context of the Belt and Road Initiative.

Due to their high potential, some Central Asian countries are already on investors' maps. This is the case for Kazakhstan, which is an emerging destination for investments. Between 2008 and 2017, the cumulative greenfield FDI⁴ into the country reached \$82 billion⁵. With FDI mainly concentrated in the extractive sectors so far, the country's diversifying economy still offers attractive new opportunities. Uzbekistan, with its recent major transformation efforts, is showing all the prerequisites for attaining a similar growth trajectory.

The country combines high potential in terms

⁴ Hereinafter only greenfield FDI is considered, as having more impact on the economic growth than M&A deals
⁵ FDI Markets, includes greenfield data only



Central Asia is poised to become a significant actor in this new global paradigm and the next frontier of economic opportunity for the world's investors.



Central Asia has significant potential for strong growth over the next decades. The countries in this region are substantially below their potential production / economic output levels.



In 2017, the Government of Uzbekistan launched an ambitious program of market-oriented reforms that are unprecedented in the country's modern history (...) The country's reform momentum has also created new opportunities for regional cooperation in Central Asia, including in energy, transport, water, and economic connectivity.



We welcome the efforts of the Uzbek authorities to liberalise the economy and advance political reforms, which are opening the country to its neighbours and the international community. We also hope that the role of civil society in the country will grow.

of macro-level conditions (a large domestic market with 33 million people, abundant natural resources, diversified economy, political stability in the wake of the recent transition of power) and strong governmental will to implement the reforms needed to improve its investment climate.

Since late 2016, the new leadership has announced many plans for systemic economic reforms and the creation of favorable conditions for investors. Uzbekistan's government is fully aware of the importance of investment for the country's development and is now creating strategies to attract investors. This translates into comprehensive political, economic and legal reforms to make Uzbekistan more competitive and attractive for investors. The market is opening up to foreign capital as measures

are implemented to address the legal, regulatory, procedural and institutional barriers affecting the investment and business life-cycle. Those measures, combined with Uzbekistan's existing economic potential, make it a great destination for investors looking to diversify their portfolios.

Based on current economic and political dynamics, the outlook for Uzbekistan in the coming years is positive. If this proves true, Uzbekistan will become a major player in the region and catch up with other transitional countries that followed the same trajectory in the past decade, such as Georgia or Kazakhstan. The emerging additional potential results from the ongoing integration processes in Central Asia. The country's new leadership is proactive in restoring the old ties to its neighbors as well as building

LARGE-SCALE REFORM AND STRONG FOUNDATION

AS THE BASIS FOR INVESTMENT ATTRACTIVENESS

A course towards economic growth

Aware of the country's challenges, but confident of its strong potential, Uzbekistan's leadership is actively trying to remove barriers for investors, making reform of the investment climate a high priority.

Elected in December 2016, the new president, Shavkat Mirziyoyev, has declared that private business and foreign investment should be

the main drivers of future growth. This new attitude has not been fully implemented yet and the country has a challenging set of reforms to design and implement, but the first results are already visible.

One of the symbolic measures taken by the new government is the online "virtual reception hall" that was launched in September 2016 to bolster dialogue with the public. Similar initiatives have been launched for

FIGURE 2 | Fast-paced transformation to improve the investment climate and open the country to foreign investments

| DECEMBER 2016 | FEBRUARY 2017 | APRIL 2017 | JUNE 2017 | SEPTEMBER 2017 | JANUARY 2018 | OCTOBER 2018 |
|--|---|--|--|---|--|--|
| Election of Shavkat Mirziyoyev as president | Adoption of the Development Strategy for 2017–2021 | Creation of the State Committee for Investments | Release of political prisoners | Currency liberalization | Implementation of numerous reforms, year of entrepreneurship | Continued reform |
| <ul style="list-style-type: none">In September 2016, the parliament confirmed Mr. Mirziyoyev as the interim presidentOn December 4, 2016, he won a presidential election, receiving 88.6% of the vote | <ul style="list-style-type: none">The strategy outlines the government's political, economic, and social priorities, including measures to liberalize the economy | <ul style="list-style-type: none">The Committee was created to realize the country's investment potential through the creation of favorable conditions and implementation of major reforms | <ul style="list-style-type: none">The president ordered a review of the individual cases of persons in custody: 18 high-profile political prisoners were freedAround 16,000 people were removed from a security "watchlist" | <ul style="list-style-type: none">The government liberalized the currency market to lift the existing currency exchange barriers, and committed to market-based principles in setting the exchange rate for the national currency | <ul style="list-style-type: none">Green corridor in airports to limit customs inspectionsSimplification of the tax system, including the implementation of tax monitoringTwo-year moratorium on business inspections, etc. | <ul style="list-style-type: none">Simplification of customs procedures and reduction of import dutiesTax reformLand allocation and construction regulation reformEnergy reformsCreation of a unified investment code |

Source: press research, official websites

lower and regional governing bodies and they receive complaints from citizens and businesses about everyday issues in relations with governmental entities. These centers have become quite popular with the public, receiving as many as 2.67 million applications by late March 2019¹.

In April 2017, the State Investment Committee was created to guide the country's investment potential by creating favorable conditions for attracting FDI, overseeing major reforms, coordinating regional and industrial strategies, and expanding cooperation with international financial institutions, foreign governmental financial institutions, major companies and banking structures.

Significant steps have been taken on the path toward privatization. A drastic reduction of state participation in the economy is underway to create a healthy competitive environment and new jobs in the private sector. More than 540 entities were privatized in 2017, from which 228 billion soms were raised (\$27.8 million)². In February 2018, the government passed a law developed by the Economic Ministry to decrease state

participation in the activities of commercial entities. Public assets will be reviewed for their competitiveness to establish a list of industries and spheres of activity where the transfer of state property, including state shares and state enterprises, to business operators will be implemented. For instance in October 2018, Uzbekneftegaz put up for public auction 156 of its non-core assets. Privatization will mainly concern industries such as metallurgy and mining, oil and gas, and chemicals.

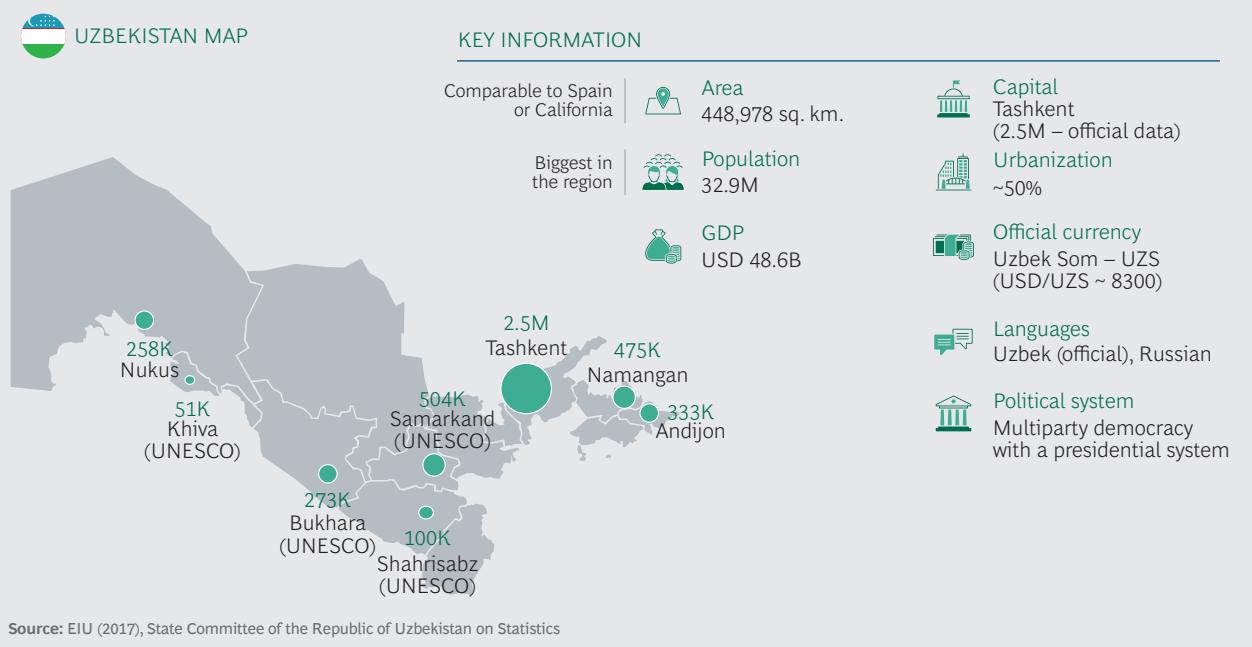
Improving macroeconomic fundamentals

Uzbekistan has all the prerequisites to attract international investment. It has a large population, and it is growing rapidly, creating a brisk domestic market for consumer goods. In addition, the workforce in the country is highly qualified, abundant and relatively cheap, making production of labor-intensive goods attractive. The country is also rich in natural reserves. However, thanks to its diversified economy, Uzbekistan is not dependent on them. Lastly, the good condition of the infrastructure (roads and rail lines) will allow Uzbekistan to become a supply and production center for neighboring countries.

¹ <https://pm.gov.uz/ru>

² State Committee of the Republic of Uzbekistan on Statistics

FIGURE 3 | Uzbekistan fact sheet



A large and growing, unsaturated consumer market of 33 million

Uzbekistan is the most populous country in Central Asia, with a population of 32.9 million³, which is comparable to Malaysia and Morocco. In comparison, the total population of its regional neighbors – Kazakhstan, Kyrgyzstan, Tajikistan and Turkmenistan – is 38.9 million. Uzbekistan's population is growing fast, at the natural rate of 0.5 million people a year, placing it 15th out of 51 countries in Asia in terms of absolute population growth. It is expected that the population will reach 35 million by 2025 and 40 million by 2050, thus contributing to the domestic market increase. Most of the population is concentrated in the southern, eastern and central parts of the country. State Committee of the Republic of Uzbekistan on Statistics reports that 50.6% of the total population lives in urban areas⁴, while the World Bank puts that indicator at 36.5%⁵.

The country's population is also relatively young, with a median age of 28, and 72%

3 State Committee of the Republic of Uzbekistan on Statistics, July 2018

4 State Committee of the Republic of Uzbekistan on Statistics

5 World bank data; the difference is mostly a matter of defining the size of a settlement that is considered an urban area

of the population under 40⁶, due in part to the demographic boom that occurred in the 1980s and 1990s with 3-3.5% p.a. population growth rates⁷. Combined with a gradual rise in average income, this demographic dynamism is the main reason why the consumer goods market is so attractive. One example of this is the accelerated transition towards organized retail in the supermarket and convenience store sector, which made up 6.3% of the total retail sales (traditional markets and organized retail) in 2017. In comparison, modern retail only represented 4.4% in 2015 and 5% in 2016, and it is projected to grow to 9.5% by 2022⁸. Given a growing younger generation with a propensity to spend more of its income, organized retail is expected to double its market share in the next ten years. Moreover, the youth also offers opportunities for new technology markets, such as mobile operators. Indeed, the number of mobile subscribers in the country increased by ~7% year-over-year in 2017, and amounted to 22.8 million people in January 2019⁹, reaching a more than 65%

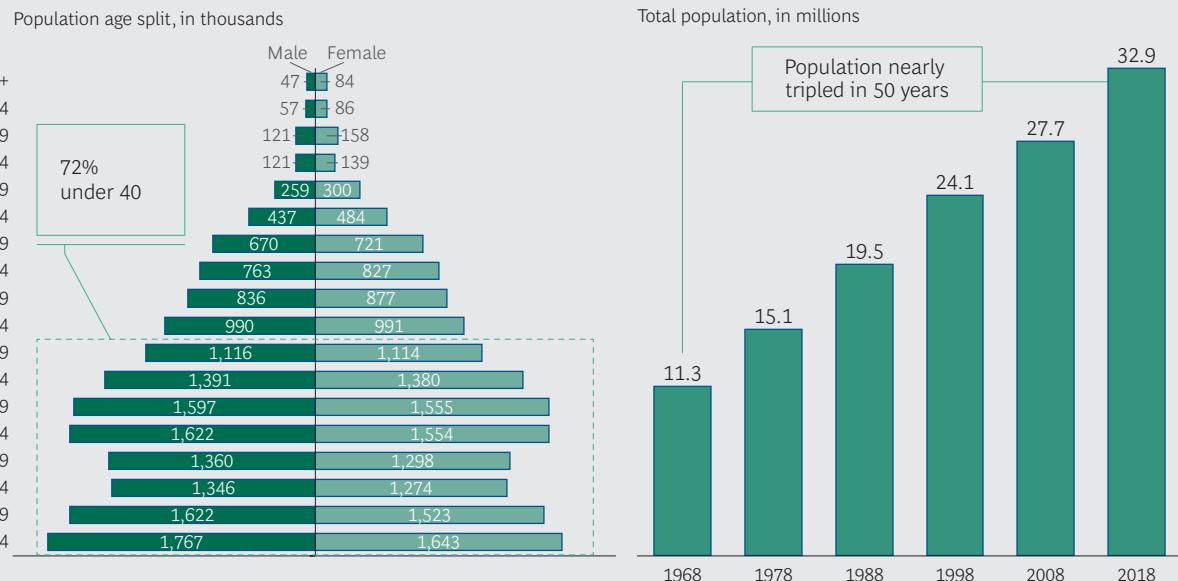
6 State Committee of the Republic of Uzbekistan on Statistics

7 Idem

8 United Nations, Department of Economic and Social Affairs and State Committee of the Republic of Uzbekistan on Statistics

9 Socioeconomic Situation in the Republic of Uzbekistan in January–December 2018, a report by the State Statistics Committee of Uzbekistan

FIGURE 4 | Uzbekistan age pyramid and population growth



Source: State Committee of the Republic of Uzbekistan on Statistics

penetration rate that remains below peer countries (e.g., 142% in Kazakhstan and 159% in Russia).

An abundant and competitive labor force

Being the most populous country in Central Asia, Uzbekistan also has the largest labor force in the region. The country enjoyed a steady increase in its labor force, from 12.5 million in 2000 to about 15.2 million people in 2017¹⁰, comparable to the whole population of Cambodia.

The average salary in Uzbekistan is among the lowest in the world, at \$225.8 per month in 2018, a 79.3% increase on 2017 figures (the USD to som rate was 5,121.14 soms to one dollar in January – December 2017, and 8,068.87 soms to one dollar in January – December 2018). It is comparable to Moldova (\$314) and Vietnam (\$236), and more than half the average salary in Kazakhstan (\$516)¹¹.

The country offers universal access to general education, and secondary education attainment is 99%. In addition, Uzbekistan

has relatively strong vocational and education training systems. However, despite high secondary education rates, Uzbekistan needs a greater number of people with higher education degrees, whose share today is only 15.8%¹². To address this issue, the government intends to spend \$458.7 million as part of its 2017-2021 higher education development plan, which aims to increase enrolment in higher education and improve the quality of the educational system¹³.

High literacy rates and an abundant labor supply make labor-intensive industries, such as mining, agriculture, textile and machinery production, attractive for investments in Uzbekistan.

Resource-rich and diversified economy

Uzbekistan also enjoys vast natural resources, including gas, gold, copper and uranium. The country ranks tenth in gold mine reserves, behind Australia, South Africa, Russia and the U.S., among others. The Muruntau gold field, located in the

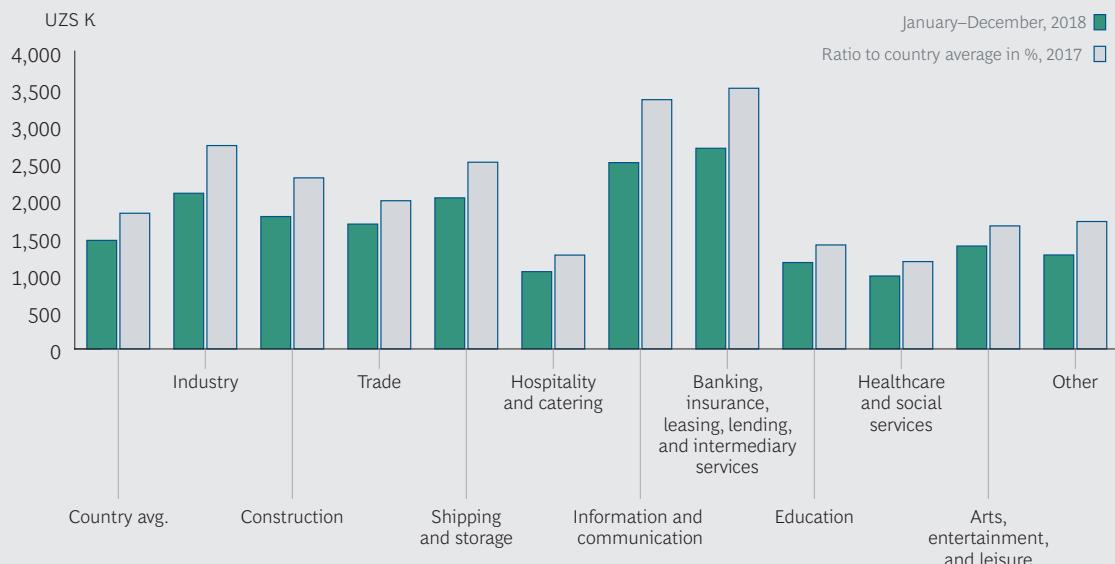
¹² World Bank. Indicator name: Educational attainment, at least bachelor's or equivalent, population 25+, total (%) (cumulative)

¹³ Resolution of President of the Republic of Uzbekistan “On Measures to Further the Development of the System of Higher Education,” April 2017

¹⁰ International Labor Organization (ILO)

¹¹ Trading Economics

FIGURE 5 | Average monthly gross salary in Uzbekistan by type of economic activity



Source: Social and Economic Condition of the Republic of Uzbekistan in January–December 2018, a report by the State Committee of the Republic of Uzbekistan on Statistics, pp. 266-267

western part of the country, is the biggest in the world by output (62 tons a year)¹⁴. Uzbekistan's gold mine reserves are estimated at 2,500 to 5,000 tons¹⁵. Moreover, the country has the tenth largest copper reserves in the world.

Nevertheless, natural resource extraction has not reached its full potential. Despite its reserves, the country is only the twentieth largest producer of copper globally. Uzbekistan's underutilized resource base creates opportunities for investment expansion within the supply chain in nonferrous metallurgy, building materials production and the chemical and petrochemical industry. Foreign investment will help attract new technologies, accelerate the production of mineral resources, and ultimately boost the economic activity in the region, improve employment rates and ensure growing tax incomes.

As mentioned above, Uzbekistan has a significantly diversified economy, with no sector representing more than 20% of the GDP. Because of this diversity, the industrial infrastructure is well developed in the country,

¹⁴ Thomson Reuters GFMS

¹⁵ Golden Front

with much expertise, ability and technology available. The numerous industries create domestic demand and a domestic market for a wide range of products.

Relatively high macroeconomic stability

Thanks to strong growth rates and a low level of public debt, Uzbekistan benefits from relatively high macroeconomic stability.

Since the mid-2000s, Uzbekistan has enjoyed robust GDP growth, owing to favorable trade terms for its key export commodities, government economic management and limited exposure to international financial markets, which protected it from the economic downturn. From 2004 to 2016, Uzbekistan saw economic growth rates of 7% to 9% per year. According to Socioeconomic Situation in the Republic of Uzbekistan in January–December 2018, a report issued by the State Committee of the Republic of Uzbekistan on Statistics in early 2019, the country's GDP grew by 5.1% in 2018. Small-sized private businesses in all sectors of the economy created most of the jobs, which contributed to private income growth and poverty reduction. Increased exports of gas, gold, and copper, coupled with high commodity prices, generated state budget revenues that

FIGURE 6 | Uzbekistan's world ranking for reserves and production of natural resources



Source: Natural gas: BP Statistical Review of World Energy, June 2017; Gold & Copper: U.S. Geological Survey, Mineral Commodity Summaries 2017; Uranium: Uranium 2016: Resources, Production and Demand, a Joint Report by the Nuclear Energy Agency and International Atomic Energy Agency; Uzbekistan State Committee on Geology and Mineral Resources

financed large increases in investment and salaries. This, in turn, bolstered consumption. The International Monetary Fund (IMF) forecasts that GDP growth will continue at a rate of about 5% in 2019, supported by favorable external demand and commodity prices, an increase in agriculture, and a growing construction sector¹⁶.

Uzbekistan benefits from a relatively low level of public debt. As of the first six months of 2018, Uzbekistan's public debt was around \$8 billion, that is, less than 20% of the GDP¹⁷. It is worth noting that all public debt is external. Uzbekistan per capita debt in 2016 was \$246 per inhabitant (versus \$136 in 2006), making it the country with the 17th lowest level of debt per capita out of 184 countries.

In 2016, Uzbekistan's economy was hit by the recession in Russia – Uzbekistan's second-largest trading partner and its main source of remittances from Uzbeks working abroad. It was also affected by the sluggish economic growth of the country's largest trading partner China, as well as by falling prices for natural gas, copper and cotton, Uzbekistan's main export commodities. According to the World Bank, all these factors contributed to a slight reduction in the country's GDP growth in 2016, and the challenging external environment forced the new leadership to look for alternative drivers for economic growth.

A well developed logistical infrastructure and opportunities to boost cooperation in the region

Even though Uzbekistan is a double landlocked country, it benefits from its strategic location in the center of Central Asia, sharing borders with all of the Central Asian states. Transportation infrastructure in Uzbekistan is probably among the most developed in Central Asia.

Uzbekistan has a good railway system with a total length of 5,800 km of railways, of which 4,300 km are in public use. This represents a density of 12.9 km of track line per 1,000 km², comparable to Turkey (15.6 km) and Norway

(12.9 km)¹⁸. In 2018, the annual passenger turnover increased by 6.1% to 22.3 million people, and cargo turnover increased by 0.8% to 68.4 million tons¹⁹. Railways account for about 34% of the country's domestic freight turnover (including pipelines)²⁰ and almost 80% of the total volume of import and export freight traffic. The country is continuing its effort to expand and modernize its railway infrastructure. Construction of the Urgench–Khiva line (400 km) and electrification of the Karshi–Kitab line (122 km) were started in 2017. Uzbekistan has railway lines connecting the country to all neighboring states and they create close proximity to Russia and China. A railway line has been built from Termez Khayraton (Uzbekistan) to Mazari Sharif (Afghanistan) that is currently operated by O'zbekiston Temir Yo'llari railroad company. To increase the transit potential even further, China, Kyrgyzstan and Uzbekistan reached an agreement in 2017 on a new railroad between Uzbekistan and China, through Kyrgyzstan, to connect East Asia with Southern Europe either through Turkmenistan, Iran and Turkey or on the new Baku–Tbilisi–Kars (BTK) high-speed railway inaugurated in October 2017. Despite the difference of rail-gauge between the former Soviet Union republics and other countries, the China–Kyrgyzstan–Uzbekistan railway will reduce transportation time between China and Europe by 7-8 days. Rail line construction was planned to start in 2018, however the discussion of the project is still ongoing. The line will significantly improve Uzbekistan's connectivity, with shorter and cheaper access to Chinese seaports.

The road system stretches 184,000 km, of which 42,000 are major highways in public use²¹. With a density of 95 meters of road per square kilometer, Uzbekistan is comparable to Iceland (125 m per sq km) and Australia (105 m per sq km)²². The road network reaches all of the country. However, road quality should be improved, as technology and policy have not been up to advanced standards. According to the

¹⁸ UNECE Transport Statistics Database

¹⁹ State Committee of the Republic of Uzbekistan on Statistics

²⁰ State Committee of the Republic of Uzbekistan on Statistics

²¹ <http://evu.uz/ekonomika/kachestvennyie-avtomobilnyie-dografi-v-blagopoluchnoe-budushhee.html>

²² <http://www.nationmaster.com/country-info/stats/Transport/Road/Road-density>

¹⁶ IMF, "Uzbekistan: Staff Concluding Statement of the 2018 Article IV Mission," March 2018

¹⁷ Uzbekistan Central Bank



Committee for Automobile Roads, Ministry of Transport of Uzbekistan, 452 km of new roads were constructed in the country in 2017–2018²³.

In February 2018, transit procedures on road and rail transport were simplified²⁴ and truck traffic was initiated on the China-Kyrgyzstan–Uzbekistan transportation corridor²⁵. The 950-kilometer route will reduce travel time for trucks from eight days to two days and cut transportation costs by \$200-300 per ton of cargo. Road connections to Turkmenistan have significantly improved with the opening of road and rail bridges over the Amudarya river²⁶, and those to Tajikistan, with the opening of one new rail line and nine vehicular border crossing points.

Its geographical location, solid logistics infrastructure and cheap, qualified and abundant labor force make Uzbekistan an attractive option as a supply and production center for Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Afghanistan, where efficient local production is hard to achieve.

Reforms required for sustainable economic growth

Over the last seven years, Uzbekistan has made significant improvements in its business climate, leapfrogging in the Doing Business ranking from 166th place in 2012

²³ <http://www.uzavtoyul.uz/ru/post/yollar-songgi-yillardagiozgarishlar.html>

²⁴ <https://mft.uz/ru/news/ozbekiston-hududida-tranzit-qilish-tartibini-soddalashtirishga-qaratilgan-ozbekiston-respublikasi-farmoni-imzolandi>

²⁵ <http://www.globaltimes.cn/content/1091016.shtml>

²⁶ <https://www.gazeta.uz/ru/2017/03/07/bridges/>

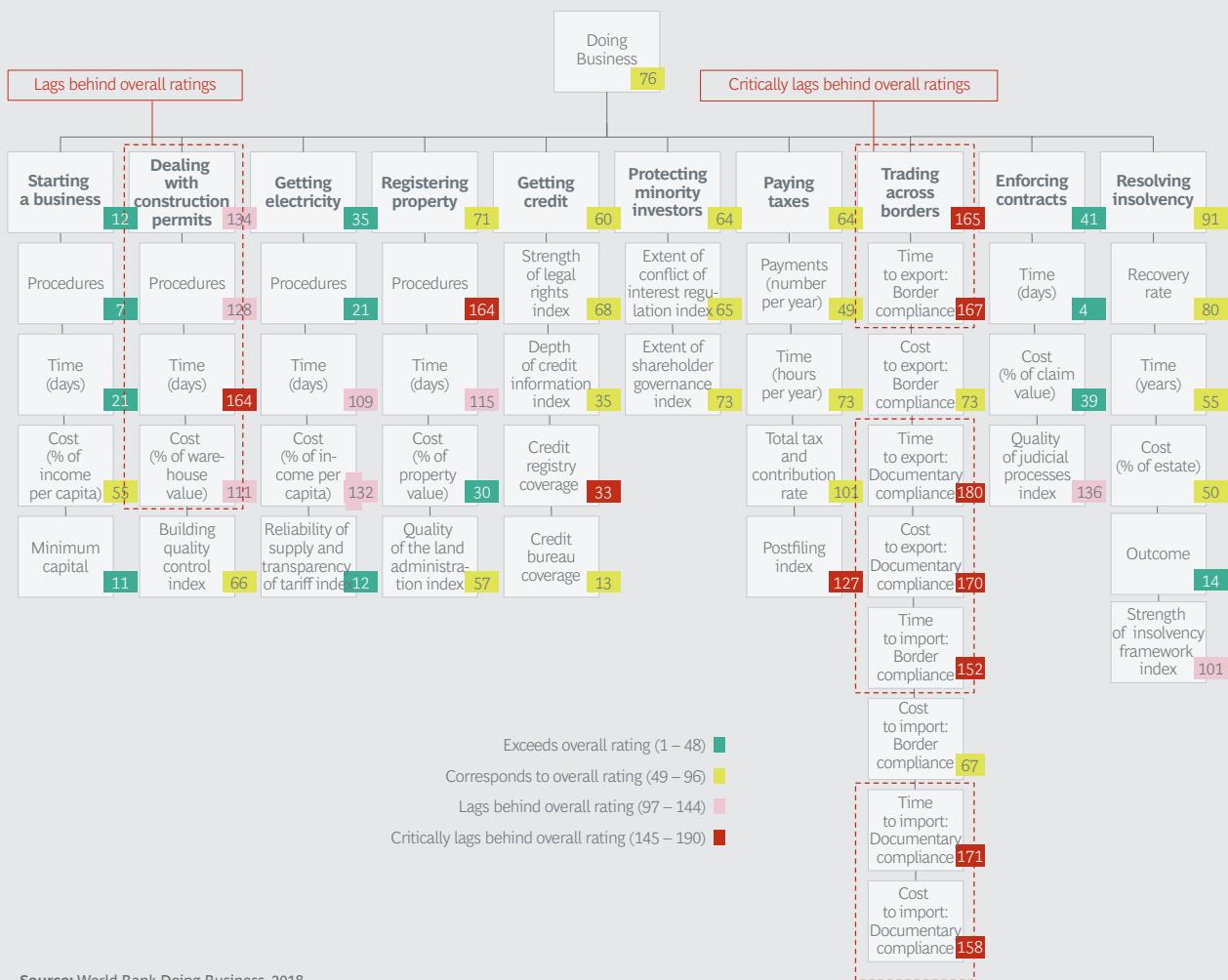
to 76th place in 2019. However, despite these achievements, the country keeps on working to eliminate legal barriers to conducting business, as well as in the tax and customs systems. Among high priority reforms are those aiming to improve cross-border trade and obtaining of construction permits (including the allocation of land for permanent use), where Uzbekistan stands at 168th place and 135th place, respectively²⁷. The results of BCG's research also confirm the need for these changes. Over 80% of surveyed investors have run into issues while trying to obtain construction permits, 45% of respondents pointed to challenges in the customs regulations.

President Shavkat Mirziyoyev has declared reducing state control over economy as a key-priority reform. The results of state control are, first, corruption, manual provision of exceptions and adjustment of terms, which weakens institutions and degrades trust, and second, excessive complexity in the government's operation.

As in most transitional economies, inefficiency and corruption complement each other in Uzbekistan. This problem is fully recognized by the government and is being addressed. The state has gradually begun to deregulate and privatize state monopolies. At the same time, massive attention is paid to investor and citizen feedback on the much-needed justice reform and fight against any acts of corruption. The country launched an administrative reform to fight corrup-

²⁷ Though the Doing Business rating methodology has been questioned by some experts, the improvement observed is fully supported by real-life examples and anecdotal evidence based on interviews with investors and experts.

FIGURE 7 | Uzbekistan progressed in DB 2019 rankings, but certain areas still need to be improved



Source: World Bank Doing Business, 2018

tion. Successful implementation of reforms would help change the public opinion — in the Corruption Perception Index, Uzbekistan ranks 156th out of 176 countries, the lowest in Central Asia.

Uzbekistan is also taking efforts to improve government effectiveness. The World Bank rated the country at -0.56 on its government effectiveness index in 2017, on a scale of -2.5 (weak) to +2.5 (strong). The country's rating has been slowly improving over the past 20 years (it was at -1.33 in 1998), but the current government considers the pace unacceptable and is considering revamping the organization of the civil service and the process of policy development. Closing the gap with the developing economies will remain a challenge, but the example of countries like Georgia, which has made rapid improvement in the assessment, shows

that it is possible to move into positive territory (e.g. Georgia's +0.57) within the next 4-5 years.

Historically, Uzbekistan statistical data has been highly unreliable and difficult to access, which limited predictability and the accuracy of planning. An initiative to centralize and facilitate the publication of data is underway. The Central Bank, for example, has started to publish information that was previously inaccessible, such as credit rates. However, the initiative implementation process is likely to take several years.

Uzbekistan has a large shadow economy, estimated by experts at over 50% of the country's GDP, according to First Deputy Economy Minister Mubin Mirzayev's statement in January 2018. The government is working hard to fix this problem with measures such

For more than a decade I was very cautious about expanding my successful business. “Staying under the radar” ensured that the state or people close to it wouldn’t see the company as a lucrative target for takeover. This year, everything has changed. I am planning to more than double the scale. It is very clear that the new president is willing and able to ensure that proper, job-generating companies have a green light to grow without feeling threatened.

QUOTE FROM A LOCAL ENTREPRENEUR

as the currency liberalization that took place in September 2017. In 2018, the Uzbekistani government focused on reforming the tax system to encourage entrepreneurs to declare real data about their business. However, in the meantime, the large unofficial sector in the country’s economy renders some public statistics inaccurate.

Fast-paced reforms as a means to address investors’ main concerns

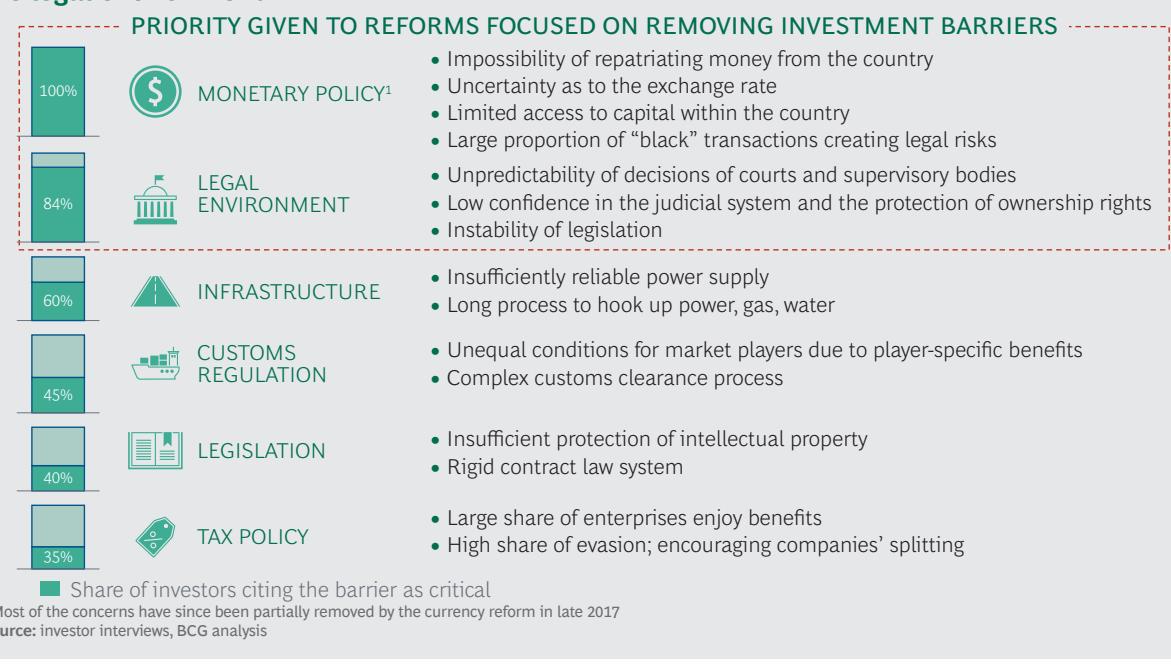
To address these challenges, Uzbekistan undertook five major business reforms, earning the country a spot in the top 10

global improvers for the third time, according to the World Bank Group’s latest Doing Business 2019: Reforming to Create Jobs report. Improvements have been made in the following areas: Starting a Business, Protecting Minority Investors, Paying Taxes and Getting Electricity.

Previously named a top improver in 2012 and 2015, Uzbekistan is carrying on its strong reform agenda, with some of the reforms already implemented in 2017–2018.

Local businesses will be among the first to enjoy the effective change in government priorities.

FIGURE 8 | According to investors, the most essential areas for reforms are monetary policy and the legal environment



Investors' opinion: the most essential areas for reform are the financial and legal environments

In 2017–2018, BCG conducted a series of interviews on the investment climate in Uzbekistan that included foreign and local investors, international institutions, state-owned enterprises and local government agencies. Respondents represented broad areas of various fields such as agriculture, construction, oil and gas, finance, technology and IT, pharmaceutical, retail, chemicals, food, textile and garments, and banking.

The survey identified the main barriers, the elimination of which will significantly improve the business environment. The initiated reforms pursue a number of key objectives:

- Repatriating profits
- Simplifying procedures, regulating and complying with the legislation, ensuring equal treatment of all players, improving transparency
- Improving reliability of electricity, gas and water supplies and making it easier to connect to them
- Eliminating unequal customs treatment for certain market players and simplifying customs clearance procedures
- Reducing tax burden rate and simplifying the tax regime

Capital flow restrictions led to inefficient allocation

Because of the tax regime before September 2017, the larger part of the population's savings in UZS could not be involved in the turnover of capital. Moreover, problems were caused by the rules for obtaining loans: preferential loans drained bank reserves and did not allow efficient allocation of capital; banks were overregulated and performed supervisory functions in place of government bodies.

Non-compliance with law is an important barrier for 84% of investors interviewed

Until recently, the court system in the country was unpredictable, not always fully competent when dealing with unfamiliar or complicated cases, and suffering from corruption.

The rights of minority interest holders were poorly protected, although some improvement has been made recently. Uzbekistan holds 93rd place in the Rule of Law index, with its neighbors falling within the range of 73rd-111th place, including Russia in 92nd place.

Evidence suggests that the impact of barriers will gradually decline in the next 3-5 years, although at varied rates. Lifting capital flow restrictions was one of the first reforms launched. Currency conversion has been allowed since September 2017, cross-border capital movement restrictions have been lifted, new legislation has created the necessary framework for digital and Islamic banking. The Central Bank has increased the refinancing rate, banks have relinquished their tax control functions, and restrictions on circulation of physical cash have been lifted. Recently, the controlled use of cryptocurrency has even been allowed. These measures, coupled with gradual capital markets reform, are intended to convert idle savings into investment.

The court system is also a source of weakness and in need of a thorough reform to employ regional best practices and digital solutions, in order to provide more consistent and predictable rulings.

Nontransparent administrative processes deter many foreign investors from coming to Uzbekistan

Historically, investing in the country typically required signing an investment agreement with government representatives at the highest level, which limited access to investment and created significant costs and compliance risks. Terms of investment agreements varied to a degree that led to an unequal competitive environment for different investors – new entrants could have better terms than those previously offered to others.

We consider legal complexity to be an element of the compliance cost but these additional costs may prevent investment in Uzbekistan from being profitable

QUOTE FROM AN INTERNATIONAL HIGH-TECH COMPANY EXECUTIVE

We don't understand how to work from now on, the banks don't understand, the suppliers don't understand — the conditions are changing too fast

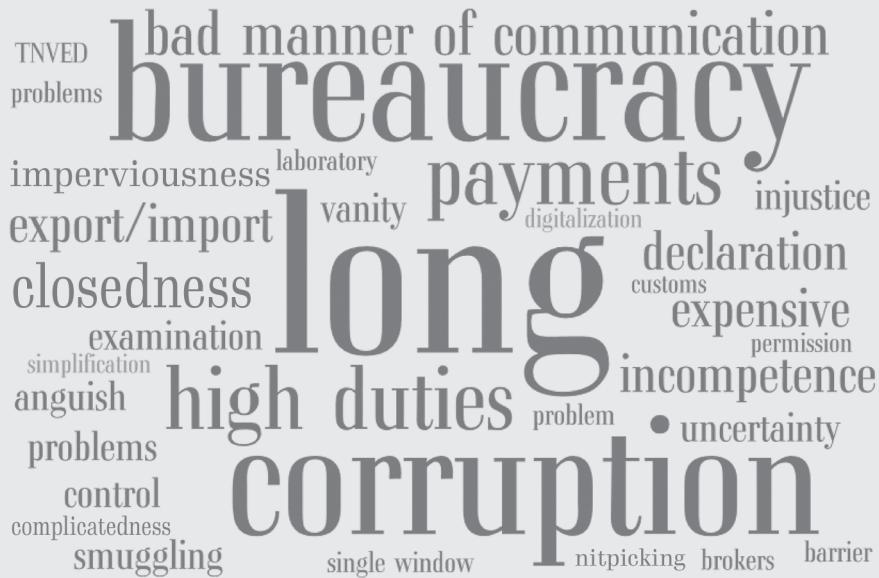
QUOTE FROM A CONSUMER GOODS BUSINESS EXECUTIVE

In addition, not all regulations were transparent and publicized – government and departmental documents often contained classified sections. That practice caused uncertainty and a high level of perceived regulatory risk. Uzbekistan's government also views this practice as harmful to relations with investors and the public and is looking into limiting the use of regulations banned from publication.

Customs regulation and barriers to cross-border trade are mentioned as a critical issue in Uzbekistan by almost half the investors interviewed

Customs regulation was not well perceived by the investors interviewed, which is also reflected in the low ranking (165th place) in the Trading across Borders section of Doing Business 2019. Government leadership is aware of this issue and the president recently highlighted it in one of his speeches. “The spread of bureaucracy and red tape, the lack of transparency in the activities of customs bodies and the unreasonable delay in the introduction of modern forms of customs procedures reduce the investment attractiveness of the country,” he said.

FIGURE 9 | The most repeated words used by investors to describe customs regulation



When the deal risk is too high, we are forced to act through our partners, which limits possibilities for business development

QUOTE FROM AN INTERNATIONAL INDUSTRIAL COMPANY EXECUTIVE

Application of the customs code suffers at times and tarnishes the perception of Uzbekistan by investors, who view customs operations as long, expensive and nontransparent. The corpus of legislation is complex and difficult for traders to navigate, and it lacks harmonization, leading to contradictions and compliance issues. These issues mean that the customs code and its application need to be streamlined. Revision of key laws and regulations is one of the expected outcomes of the customs reform that is being developed with support from the World Customs Organization. On January 1, 2019, customs charges were radically reduced. Uzbekistan has set off on the road to one of the most liberal customs policies in the world.

Among the issues in customs regulation, the following are most often mentioned by investors:

- An excessive and inefficient certification system
- Inefficient customs valuation: excessively complex requirements for the valuation method and artificial distortion of customs value
- A relatively high burden of customs, combined with insufficient protection of local producers in strategic industry segments

However, recent government reforms will help resolve some of those problems, starting a process that is bound to improve the investment climate in the short-to-medium term. There is also a positive trend in terms of transferring the certification rights from federal to regional authorities.

The first steps in currency liberalization

Since September 2017, Uzbekistan has had a convertible currency²⁸, and it is on its way to eliminating other historical financial issues. Previously, currency conversion was rare: currency controls had long hampered entrepreneurship and led to the development of a multibillion-dollar cash black market. However, since September 5, 2017, it has been possible for both individuals and companies to purchase and sell foreign currency for import and export operations, profit repatriation, repayment of loans and other operations. The liberalization process led to a depreciation of the local currency by half. However, this devaluation mostly impacted state-owned enterprises with import costs, since the private sector was already using the commercial market rate for international transactions. Moreover, the exchange rate has stabilized since then and risks of further devaluation are now mitigated and considered low, due to the country's macroeconomic stability, and especially thanks to relatively high gold and foreign currency reserves.

Issues with conversion are the root of all evils in Uzbekistan's economy, cancel the restrictions and a boom will follow immediately

QUOTE FROM AN INTERNATIONAL INDUSTRIAL COMPANY EXECUTIVE

Further gradual, focused liberalization of capital and price controls are planned within the foreign exchange reform.

Equal treatment of all market players

Historically, Uzbekistan adopted a planned and rigid economy that overregulated the business environment. During the transition period, the

²⁸ Currencies can be freely exchanged by companies, and individuals can freely exchange foreign currency into Uzbekistan som.

state prioritized the most problematic areas of the legal environment through targeted reforms such as:

- Implementing a fair and transparent land allocation process: since July 1, 2018, legal entities and individuals can acquire land for permanent use, for business and urban development purposes, via online auctions on a single e-trade platform, E-IJRO AUKSION.
- Ensuring fair market competition: in its transition to a wider and more private growth base, the government started instituting a set of reforms on January 1, 2018, to limit protectionism and preferential measures. The changes include the abolition of individual tax exemptions in favor of industry-wide solutions; development of a transparent, logical and fair process for disbursing government aid; and implementation of nondiscriminatory access to resources.

Infrastructure modernization initiatives

Major progress has been made in improving the electricity supply in the country. In 2017, the process for obtaining an electricity connection was streamlined by introducing a turnkey service at the utility that provides all connection-related services. With this reform, Uzbekistan has reduced the cost for an entrepreneur to connect to the electricity grid from 1232% of the average monthly income per capita to 883%. On the Getting Electricity indicator of the Doing Business rating, Uzbekistan moved up 51 places to a global ranking of 35th.

On the infrastructure side, major public investment has been made to develop renewable energy in the country. To expand capacity and further diversify the country's fuel source balance, a presidential decree issued in 2017 states that investments of \$2.65 billion will be allocated in hydropower development from 2017 to 2025. The state plans to develop 18 new hydropower projects and modernize 14 existing plants. In addition to hydropower plants as renewable energy sources, Uzbekistan has good prospects for solar energy, with an estimated gross potential of 51 billion tons of oil equivalent, as well as 360 million tons of oil equiv-

alent for wind energy. Similarly to electricity, aging gas and water infrastructure are also undergoing modernization.

Improved efficiency and transparency of the customs system

The government is aware of the negative perception of Uzbekistan's customs processes. Even though Uzbekistan's customs code is relatively modern and is mostly aligned with World Customs Organization recommendations, its application is imperfect at times and tarnishes investors' perception as they come to see customs operations as long, expensive and nontransparent. Practical barriers to cross-border trade were mentioned by 45% of investors interviewed by BCG as a critical issue in Uzbekistan.

Some measures have already been implemented in 2017 and 2018 to remedy these problems. In particular, the speed of trade border crossing was significantly improved thanks to the launch of a risk management system that assesses the reliability of consignments and directs them either to "green" (no examination) or "red" corridors, putting an end to the practice of 100% consignment examination. On January 1, 2018, a dual-corridor system was also introduced for individuals at international airports, significantly reducing time spent at the border.

The business community saw significant positive changes in 2018 already, thanks to the high speed of the modernization reforms. The government's objective is to implement an ideological shift to transform the perception of customs from a center of state profit to an agency facilitating international trade and maintaining reasonable control.

Simplification and unification of the tax system

Reforms have been implemented to simplify and improve Uzbekistan's tax system over the past five years. These reforms included the adoption of a new tax code that combines the introduction of corporate income tax reserves and the elimination of some small taxes with a reduction in the unified social tax paid by employers and the corporate income tax rate. As a result, the number of payments neces-

sary to comply with tax requirements has been significantly reduced. In 2017, in particular, paying taxes in Uzbekistan was made easier and less costly by the introduction of an electronic system. As a result, the number of payments was reduced from 58 to 10 – below the average 11 payments in OECD high-income economies – and the time to prepare, file and pay the taxes dropped from 202 to 181 hours.

Since January 1, 2018, numerous measures have been implemented to continue the simplification reform. In particular, tax monitoring, a modern form of tax control, has been introduced. It facilitates an efficient exchange of information between tax authorities and taxpayers and offers comprehensive assistance in solving tax issues. Although two coexisting tax regimes (general and simplified²⁹) remain for now, which creates a degree of complexity for business owners, alignment of the two regimes is part of the comprehensive reform that is underway.

In early 2018, all forms of inspection of business enterprises were placed under a two-year moratorium. Scheduled inspections are now carried out according to a plan and should not exceed once every three years³⁰.

In February 2018, the president formed a commission to develop a new Tax Code. A first draft, based on international benchmarks, with contributions from experts and representatives of business and civic organizations, was completed and published for open discussion in November 2018. Its entry into force is expected as early as this July.

Improved quality of life in Tashkent

Tashkent is considered a livable city by expatriates. With a 54.6 rating (out of 100) for livability, Tashkent has a EIU ranking similar to Casablanca (57.8), Istanbul (57.8), Jakarta (54.6), and Hanoi (54.2)³¹.

²⁹ Originally intended to support small and medium-sized enterprises, the simplified regime offers a lower tax burden. It is used by 80% of enterprises, while the general regime is used only by state-owned enterprises or when the obvious size of the business makes it unavoidable.

³⁰ Four years for farms, microfirms, small and medium enterprises.
³¹ According to the 2015 Global Livability Ranking published by the Economist Intelligence Unit. The livability score is a combination of factors from five main categories: Stability, Healthcare, Culture & Environment, Education, and Infrastructure.

Tashkent is an extremely safe and secure city. Many foreigners are impressed by its very low crime rate, due primarily to the heavy police presence in the center of the city. However, the expanding population has meant that the crime rate has increased over the last few years, particularly for street and petty crimes like pickpocketing. Violent crimes against foreign nationals are extremely rare³².

It is quite easy to find housing that meets European standards

QUOTE FROM A GERMAN EXPATRIATE LIVING IN TASHKENT

Tashkent has a grade of 75 (out of 100) for education, a rating equivalent to that of Athens or St. Petersburg. Many English-speaking expatriates send their children to Tashkent International School, a not-for-profit, community run school that offers international-style schooling and the International Baccalaureate. Established in 1994, it has grown with the expatriate community, and now has over 400 students in total. The British School of Tashkent, founded in 2010 and teaching the English curriculum, is also very highly regarded. The French school also offers classes from preschool through 12th grade.

Although public healthcare is not yet on a par with the West, the Tashkent International Medical Clinic offers care that meets Western standards. It is staffed with English-speaking local and expatriate doctors.

Western-style housing is easily accessible for expatriates. The median rent for a large apartment meeting Western standards in Tashkent's city center is estimated at around \$410 a month³³.

Over the last few years, the Uzbekistani government has embarked on a major reconstruction program in the center of the city. Roads, government buildings and parks are all being rebuilt.

³² UK Foreign Office travel advice website

³³ According to teleport.org, an online database that focuses on quality-of-life data to help users find suitable cities for living and working.

DIGITAL RENDERING OF THE TASHKENT CITY PROJECT

© State Unitary Enterprise Toshkentboshplan



Construction of the Tashkent City business center is planned in the center of the capital on an area of 0.7 km². The project includes the construction of an industrial park, eight business centers, a shopping mall, restaurants, a cultural center and apartment complexes.

The city also benefits from a good mass transit system. The metro system is typical of the old Soviet style with large and impressive stations, and is quite modern, while new buses and trams are in service after being renovated in 2008.

Tashkent has a number of interesting museums, including the Amir Timur Museum and Navoi Literary Museum, as well as the famous Alisher Navoi Opera and Ballet Theatre and the Ilkhom Theatre, a progressive theater with productions in Russian, often with English subtitles.

Uzbek and Russian are the dominant languages, so a rudimentary understanding of at least one of them is a major asset for successful integration into Tashkent life. Many local residents do not speak fluent English, although a knowledge of English may be more common in the Russian communities.

Tashkent is connected to more than 50 international cities, with direct flights to Asia and the Middle East (Kazakhstan, Turkey, Thailand, Israel, the United Arab Emirates, Kyrgyzstan, Tajikistan, Turkmenistan, Afghanistan, Azerbaijan, India, Pakistan, China, South Korea, Japan, Malaysia, Singapore, Iran), Europe (Russia, Belarus, Latvia, Germany, Spain, the United Kingdom, France, and Italy), and the United States of America, served by the national carrier, as well as foreign operators.

SOME FIRST MOVERS ARE ALREADY INVESTING IN UZBEKISTAN

First major investments in Uzbekistan

Uzbekistan has signed over \$15 billion in foreign direct investment agreements in total in recent years, with \$2.4 billion in 2017 alone. According to the State Committee of the Republic of Uzbekistan on Statistics, 7,560 companies with foreign capital operated in Uzbekistan as of January 1, 2019. In early 2018, according to the State Committee for Investments, their portfolio of investment projects comprised more than 300 projects in various industries, for a total of \$9 billion.

Several case studies of first movers can be cited as examples of successful investment in Uzbekistan. In the automotive sector, in particular, Daewoo Motors established a car assembly plant in Uzbekistan in 1996. It was

followed by General Motors. In the wake of that success, Uzbekistan's State Committee for Investments and South Korea's Evergreen Motors signed a memorandum of understanding in November 2017 on the mass production of Hyundai commercial vehicles in the country. In November 2018, the investment agreement was signed and construction began. The total budget of the project is \$200 million. The new plant in Namangan Region is expected to deliver its first products as early as September 2019, in addition, Evergreen Motors will begin production of forklifts, with a total value of over \$50 million. During the visit of Russian president Vladimir Putin to Uzbekistan, a number of bilateral agreements were signed, including a contract for the construction of a nuclear power plant jointly with Rosatom. The cost of the project is about \$11 billion, with completion sched-



THE WORLD BANK

The World Bank is ready to significantly increase its presence in Uzbekistan and to support the reforms in the country

WORLD BANK CEO, KRISTALINA GEORGIEVA

European Bank
for Reconstruction and Development



The region can be challenging, with lack of access to financing and unstable electricity supply among the chief obstacles to doing business. But it is also full of great promise. Central Asia's massive investment needs can be turned into big opportunities

EBRD PRESIDENT, SIR SUMA CHAKRABARTI

AKFA GROUP'S SUCCESS STORY

Established in 2001 in Tashkent, AKFA Group was initially a producer of extruded aluminum profiles. Nowadays, the company has evolved into a diversified holding, involved in manufacturing, construction, retail, food production, healthcare, education, entertainment, and mass media. Currently, AKFA has a headcount of over 15,000 and exports one third of its products.

The company's initial core business in construction materials and furnishings has been growing at a steady pace. AKFA currently manufactures 40,000 tons of extruded aluminum per annum and extended its value chain to aluminum composite panels (12,600 tons p.a.) in 2015 and windows and frames in 2016. Imzo, the company's window production facility, became the first fully automated factory in Uzbekistan, and has since branched off into two separate production sites in Shymkent (Kazakhstan) and Osh (Kyrgyzstan).

AKFA's second-biggest line of business is the production of home appliances and electrical products under the Artel brand. The business is well diversified both in terms of

production locations and product lines. The production sites today, are based in Uzbekistan (Tashkent, Jizzakh, Navoi, and Karakalpakstan) as well as in Kazakhstan (Shymkent). The range of products include TVs, air conditioners, vacuum cleaners, washing machines, microwave and mini ovens, refrigerators and freezers, as well as electric and solar boilers, gas stoves, PC displays, etc. The annual manufacturing output ranges from 250,000 to 600,000 units.

Recently, the Group started to focus more on rolling out its service branches.

In 2017, The Artel Technical School started training industrial workers in high-tech skills.

The same year, AKFA MEDLINE began to provide high-end healthcare services.

The next step for the Group's business is to expand into the lucrative confectionery industry, which still struggles to compete with imports despite the sector's rapid growth. The company should become a unique high-quality producer in the region.



uled for 2028. Also Eco-Kultura, a Russian agricultural group, intends to open the largest production of tomatoes in Uzbekistan. The total greenhouse area will be 314 hectares, and the project will collect some \$472 million in investments.

In addition to foreign investment made independently or in partnership with the government, Uzbekistan also has a number of successful fast-growing local enterprises. A

good example of that is the AKFA Group holding. In 2001, it started as a small extruded aluminum profile plant, which has now grown to become a diversified conglomerate with a headcount of over 15,000 people.

One of the core elements of its success is a strong network of partnerships with multinationals from Korea, Turkey, Italy and China, which enabled AKFA to master challenging technology and gain access to potential export markets.

International development institutions are also aiming to reinstate or expand their presence in the country. This was marked by the return of the European Bank for Reconstruction and Development (EBRD) to Uzbekistan in 2017. The World Bank is also helping Uzbekistan develop economically by supporting 16 projects worth a total of \$2 billion. These projects support agriculture and water resource management, energy, transportation, health-care, education, urban development, water supply and sanitation. In January 2018, the World Bank's board of executive directors approved additional financing for the agroindustry development project in Uzbekistan to expand access to domestic and global markets and improve the productivity of the agroindustrial sector, with a \$500 million loan from the International Bank for Reconstruction and Development.

New investment opportunities in various sectors of the economy

With the new pace of reform in the country, investment opportunities are emerging in both “traditional” and “new” sectors. Traditional sectors for Uzbekistan, such as the oil and gas industry, the mining sector, agriculture and the textile industry, rely mostly on natural resources. They are well established

today, but their full investment potential is yet to be reached. Global trends, such as digital transformation, an increase of income and spending and the demographic trajectory, open up significant development potential in sectors that are relatively new for Uzbekistan, e.g., the financial and banking sector, the construction industry, the telecom sector, and tourism.

This report is not intended to name the most attractive investment opportunities, nor can we provide any specific investment advice. However, an illustration of changes in various sectors – both traditional and new – is useful to demonstrate the speed and breadth of transformation in the country.

“The usual suspects”: optimization of traditional sectors



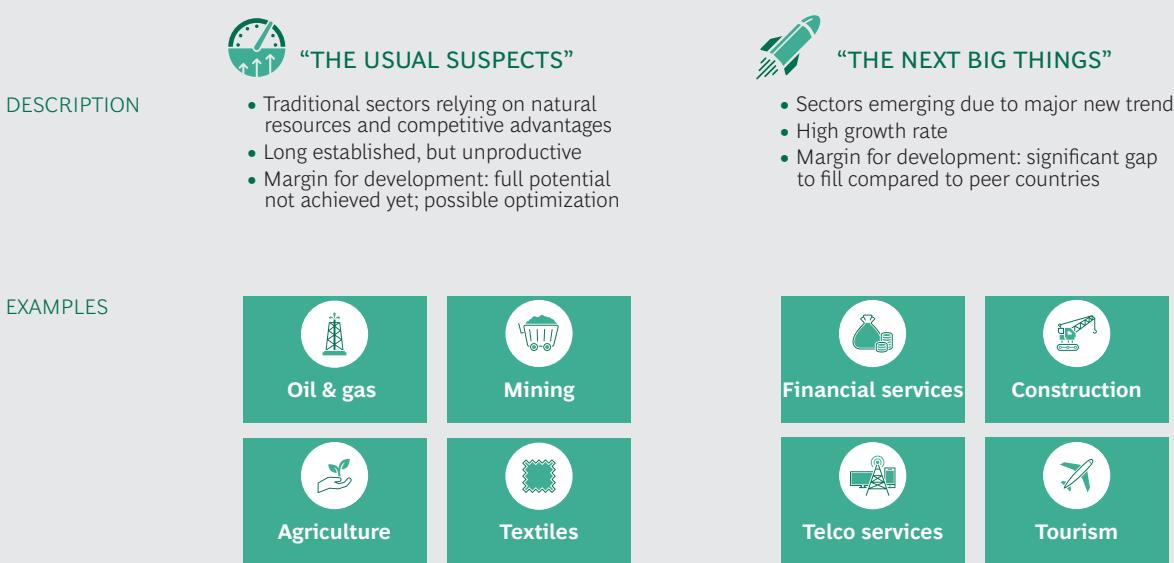
Oil and Gas

The oil and gas sector is a leading industry in Uzbekistan. The sector accounts for about 15% of the GDP, and employs more than 103,000 people¹. The country holds 1.1 trillion cubic meters of proven natural gas reserves², which is comparable to the reserves

¹ Uzbekneftegaz website

² All oil and gas reserve and production data are from the BP Statistical Review of World Energy, 2018

FIGURE 10 | Opportunities are opening in both traditional and new sectors



Source: BCG analysis

of Kazakhstan and Azerbaijan (1.1 trillion and 1.3 trillion cubic meters), but significantly lower than neighboring Turkmenistan (~20 trillion cubic meters).

Despite the fact that the current gas production volumes are enough to meet the consumption needs of Uzbekistan itself (~45 billion cubic meters per year), and to support exports to China, Russia, and Kazakhstan (~12 billion cubic meters in total), rapid economic growth in Uzbekistan is challenging the industry to provide for the future gas needs of the country. According to experts, the demand for natural gas in the country might exceed its own production volumes as early as in 2025-2030, notwithstanding the planned partial substitution of coal, hydro, and nuclear energy for gas in power generation³.

A well-developed system of transmission and distribution pipelines and underground gas storage makes it possible to transport Uzbekistani gas, and maintain transit from Turkmenistan, rich in resources, to China, Russia, Kazakhstan, and other neighboring countries. Currently,

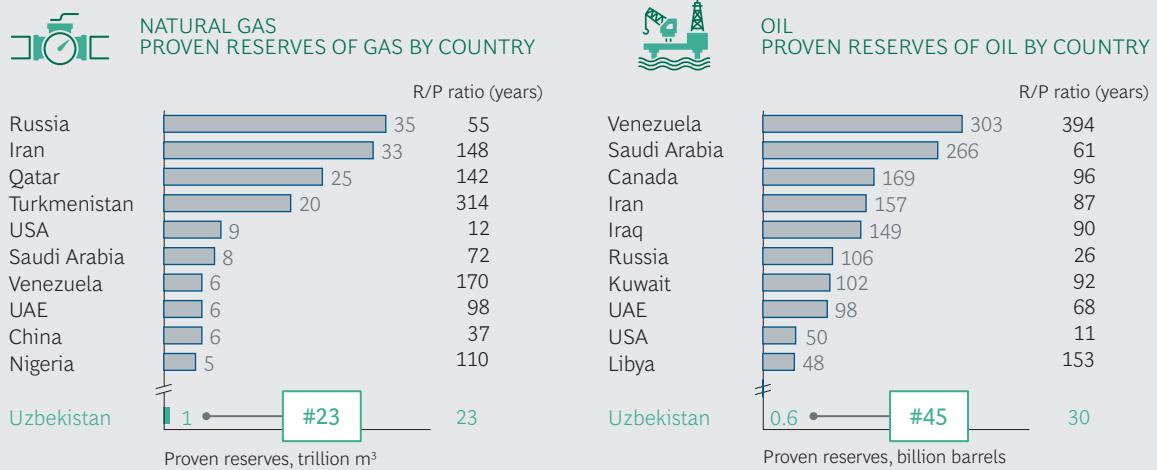
³ On October 19, 2018, President Shavkat Mirziyoyev of Uzbekistan and President Vladimir Putin of Russia launched a joint project to build a nuclear power plant in Uzbekistan with a total capacity of 2,400 MW, with the first unit to be launched in 2028.

three branches of the Central Asia–China main pipeline cross Uzbekistan, with a total supply capacity of up to 55 billion cubic meters per year. Russia might be another possible gas supply and transit destination with the use of the Soviet-era Central Asia–Center gas pipeline.

Proven oil reserves in Uzbekistan are small (less than 0.6 billion barrels) compared to oil-rich neighboring countries such as Kazakhstan and Azerbaijan (30 billion and 7 billion barrels, respectively). Combined with relatively low oil production volumes in the country (~2.5 million tons per year), this creates the need to import oil for the country's refineries (the largest ones are the Bukhara and Fergana refineries), which are potentially capable of processing up to 11 million tons of oil per year to supply petroleum products to the rapidly growing Uzbekistani market.

The oil and gas industry of Uzbekistan is highly concentrated. The biggest player, Uzbekneftegaz, the Uzbek national oil company, is a vertically integrated state-owned holding company working along the whole value chain (exploration, development, drilling and completion, oil and gas production, refining and distribution). Uzbekneftegaz is also a party to joint ventures and production sharing agreements.

FIGURE 11 | At the current rate of production in Uzbekistan, there will be enough gas reserves for ~23 years, and oil, for ~30 years



The industry has traditionally been the largest area of foreign investment in Uzbekistan. Over the past 10 years, the oil and gas sector accounted for up to 40% of all direct foreign investment. Several international players are already present in the industry. Among major foreign players are LUKOIL, Gazprom, China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC), Korean companies (as part of a consortium) KOGAS, Lotte Chemical, and GSE & R. In 2018, agreements were concluded with BP and SOCAR for exploration work in Ustyurt area.

Major recent investment projects in Uzbekistan include:

- In November 2017, the Russian company LUKOIL completed the first construction phase of the Kandym gas processing plant. The second phase was commissioned in April 2018. The plant has the capacity to refine 8.1 billion cubic meters of natural gas annually. LUKOIL is also designing a production sharing agreement (PSA) in the southern part of Gissar, planning to invest \$8 billion in these projects by 2020. LUKOIL has also announced plans to enter the distribution sector, building a gasoline station network with Uzbekneftegaz.
- Gazprom, another Russian giant, is also active in exploration and development projects in Uzbekistan. Since 2004, Gazprom has run production at the Shakhpakhti field; in 2009, as a result of exploration work, Gazprom discovered the Dzhel field, for which the company signed a production sharing agreement in 2018.
- In December 2017, New Silk Road, an oil and gas joint venture between CNPC and Uzbekneftegaz, began natural gas production in Bukhara Region. Production volume is expected to reach 1 billion cubic meters by 2021. Gazprom and CNPC are the largest buyers of natural gas exported from Uzbekistan.
- In 2008, a \$4 billion Uzbek-Korean joint venture was established to construct a gas-chemical complex in Ustyurt. South Korean investment amounted to \$1.4 billion. Commissioned in May 2016, the complex

includes five enterprises with a processing capacity of 4.5 billion cubic meters of gas per year and a production capacity of 500,000 tons of polymers (polyethylene and polypropylene) per year.

- In April 2019, the ownership of Fergana refinery was transferred to investors that will invest 875 million dollars in modernization of the refinery to produce Euro 4 and Euro 5 fuel.

Uzbekneftegaz is constructing a synthetic liquid fuel plant called OLTIN YO'L GTL (the Golden GTL Path), a unique project even by the standards of the global oil and gas industry. The project, worth \$3.7 billion, is being implemented with technology provided by Sasol. The plant will produce more than 1.5 million tons of synthetic fuels per year (kerosene, diesel, naphtha, etc.).

Based on the current resource base and the country's growing demand for oil and gas resources, priorities for foreign investment in production should be exploring existing and new areas (such as the Aral Sea basin) and attracting oilfield service companies to implement modern oil and gas production maintenance and intensification technology. The transportation segment projects in demand include repairing and upgrading gas transportation and gas distribution systems in Uzbekistan, including projects to expand underground gas storage facilities (to balance out seasonal gas consumption fluctuations). In the refining segment, the top of the agenda includes attracting investment to produce motor fuels and oils that meet modern environmental standards to supply the growing and undersupplied fuel market in Uzbekistan.



Mining

Four main factors make mining activities in Uzbekistan attractive for foreign investors. First, Uzbekistan has significant mineral reserves that offer broad opportunities to increase the capacity of existing enterprises or create new ones. Second, the country has a highly developed and efficient mining industry, a suitable infrastructure and highly skilled manpower. Also, many deposits can be developed by open mining, which is the cheapest

method. Finally, Uzbekistan has a relatively favorable investment climate and mining receives support from the government.

The government is currently preparing legislative acts that will further enhance the attractiveness for foreign companies and investors of exploring and developing deposits of strategic minerals. As a first step in this direction, a text was issued as part of a resolution of Uzbekistan's Cabinet of Ministers that lists, for the first time, more than 140 sites, including gold, silver, copper, uranium, tungsten deposits as well as a number of promising areas, open to foreign investment.

To improve the efficiency of management, the Cabinet resolved to entrust a number of public assets including the Almalykskiy mining and smelting plant, to external managing entities, including foreign companies.

Uzbekistan entered into an exploration agreement with Rosgeoperspektiva, a Russian group that will explore for copper and gold deposits in southern Uzbekistan. The project will involve a total of \$3 million in investments in the first year of exploration, with the operator receiving the right to use the exploration areas for a period of five years. IFG Capital have signed a memorandum of understanding with India's SUN Group to carry out joint geotechnical surveys and start production of seven wolfram deposits. The partnership expects to collect over \$300 million in investments at the production stage.

Orano, one of the leaders of the global atomic industry, intends to create a joint nuclear energy venture with the Uzbekistan State Committee for Geology and Mineral Resources. An arrangement to that effect was reached during the visit of president Shavkat Mirziyoyev to France in fall 2018. The parties are working out the details of this arrangement.



Agriculture and Food Production

Agriculture represents a 30% share in the country's GDP and employs about 26% of the labor force⁴. Uzbekistan offers advantages for

⁴ Socioeconomic Situation of the Republic of Uzbekistan in January–December 2018, a report by the State Committee of the Republic of Uzbekistan on Statistics

growing several crops at competitive prices, such as a favorable climate, relatively low salaries and domestic production of fertilizers.

The country has high potential for agricultural exports. Currently, Uzbekistan's agriculture is oriented toward domestic demand. Exports of agricultural products contributed approximately 9.7% to Uzbekistan's external earnings in 2017 (food products representing 6.3% of Uzbekistani exports by value, making them nearly two times more valuable than exports of cotton, a long-time Uzbekistan mainstay⁵). Only around 10% of local production is now exported⁶, but this share is increasing. The logistic proximity of Uzbekistan to large export markets makes it possible to deliver fresh produce at competitive prices. In 2017, the export volume of fruit and vegetable products grew by 15.6% in comparison to 2016 and reached \$708 million. In 2018, export of fruit and vegetable products further increased by 35.5%. The main export items are tomatoes, apricots, cherries, grapes, peaches and peanuts, which are sold at premium prices in markets such as Russia. In 2017, the main export markets were Kazakhstan (46%)⁷, Russia (18%), Afghanistan (7%), China (6%), Turkey (5%), Kyrgyzstan (4%) and Iraq (2%)⁸.

The government is taking measures to encourage both production and exports. The government has instituted a policy of diversifying agriculture production, reallocating land previously used for cotton growing to fruit and vegetable crops. Recently, the government placed a standing order for fresh fruits, vegetables, potatoes, melons and grapes. The order calls for the O'zbekoziqovqatxolding food industry holding to purchase the goods for further processing, the Uzbekoziqovqatzahira association to handle storage and Uzagro-export to export them. Under a presidential decision effective since July 2017, entrepreneurs may export their farm products directly to foreign partners.

However, the Uzbekistani agriculture industry remains underdeveloped and would benefit

⁵ State Committee of the Republic of Uzbekistan on Statistics

⁶ U.S. Department of Commerce, State Committee of the Republic of Uzbekistan on Statistics

⁷ Kazakhstan's share may be overestimated due to the fact that some products only transit via Kazakhstan to be exported to Russia at a lower VAT rate.

⁸ State Committee of the Republic of Uzbekistan on Statistics

GOLD DRIED FRUITS' SUCCESS STORY

Created in 2012 by Uzoman Capital, the first private equity fund in Uzbekistan, founded by the State General Reserve of the Sultanate of Oman and the Fund for Reconstruction and Development of the Republic of Uzbekistan, Gold Dried Fruits LLC grows about 20 kinds of fruits and vegetables and more than 10 different herbs on a total of 3,900 hectares in three districts.

The company started with the production of dried dill purchased from local farmers. Over time, it gradually expanded its product range to other dried fruits, vegetables and herbs. In 2014, to further integrate production and improve quality control over raw materials, the company acquired land in Uzbekistan and now only sells products – fresh, dried or frozen – that it grows itself.

In addition to growing fruits and vegetables, GDF has storage, freezing and drying facilities. The company's manufacturing plant transforms up to 120 tons of fresh agricultural products per day into high-quality dried vegetables and herbs.

The plant uses modern equipment imported from countries such as Germany, Belgium and Turkey. In 2015, a multipurpose refrigeration complex with a total area of 10,000 square meters and a production capacity of 8,200 tons a year was built to store, freeze and package finished products.

Since its creation, GDF has expanded the scope of its export to CIS countries, with gradual development of European and Asian markets. Exports represent 95% of the company's total production. In 2016, around 20,000 tons of fruit and vegetable products for a total value of around \$6 million were exported to dozens of countries around the world, with 80-90% of the exports going to Russia, where Uzbek products are in high demand and benefit from a positive reputation as being organic. In 2017, GDF's exports amounted to more than 42,000 tons, which represented a total value of \$14 million. Following this exponential growth, the company is targeting exports of \$100 million in 2019.



greatly from investment in innovative cultivation and processing technologies. Prior to 1991, packaging in Uzbekistan was outsourced. After the breakup of the USSR, Uzbekistan was left with a small industry that was geared toward packaging chemicals. Existing food processing and packaging equipment is antiquated or does not meet present needs. Innovative cultivation technologies (intensive growing, drip irrigation, modern greenhouse facilities) and development of logistic infrastructure and services in the entire supply chain to target markets (transportation, storage, cooling, pack-

aging, certification, customs, etc.) are slowly being implemented and will make it possible for the country to reach its full potential and create new opportunities for businesses. In December 2017, the Chinese company Wanbang announced that it would invest \$500 million in projects in the Uzbekistani agricultural sector. Uzbekistan and the Chinese company agreed to implement 15 projects for the production, processing and packaging of agricultural products, including livestock products, as well as exporting, importing and re-exporting finished products. During the first

Russia–Uzbekistan Interregional Cooperation Forum 2018, agreements were made to create dedicated distribution centers for Uzbekistan in cities across Russia. The Uztrade foreign trade company and RusAgroMarket Holding will build a wholesale distribution center in the Orenburg Region. An agreement between the administration of the Surkhandarya Region and ECO Kultura (a Stavropol-based company) will support the opening of an agricultural production, storage, processing and packaging complex with an annual capacity of 65,700 tons. Ufa will open a trade house for Uzbek produce, which will be delivered through a dedicated green corridor. The project is estimated at \$800,000 and is expected to bring a turnover of \$45 million annually. Given Uzbekistan's potential to develop into a major food exporter, demand for modern packaging and processing equipment is likely to grow.



Textiles

Uzbekistan has a large textile industry, which represents around 3.8% of the country's GDP, with high potential for development thanks to several competitive advantages. The textile industry benefits from local raw materials. Uzbekistan is the world's sixth largest producer of cotton. The country grows about 3.5 million tons of raw cotton annually and produces 1.1 million tons of cotton fiber⁹. It also produces silk and wool.

Cotton processing and fabric production remain below optimal levels and are expected to grow. The government has expressed its intention to develop the textile industry further and process more of its own raw cotton into intermediary or consumer goods for export. According to Uztextilprom, a major association of textile producers, about \$1 billion will be allocated for the modernization of the textile industry between 2015 and 2020. Currently, the cotton processing rate is ~70%. According to a government forecast, Uzbekistan is expected to achieve full processing of cotton fiber in 2021.

⁹ A new system for selling cotton to textile enterprises was implemented in 2018, liberalizing price setting for raw cotton. In the past, enterprises purchased raw materials from monopoly supplier Uzpahtasanoatexport. In the new system, textile enterprises finance the basic costs of farming raw cotton by advancing at least 60% of the contract's value.

In 2017, government measures to support textile enterprises, including preferential customs treatment, were implemented.

Between 2010 and 2014, the textile industry in Uzbekistan received and spent foreign investments worth \$785 million, and 147 new textile enterprises, with investors from Germany, Switzerland, Japan, South Korea, the U.S., Turkey and other countries, were launched. The Uzbekistani textile industry is export-oriented: in 2018, export amounted to \$1.6 billion (+41% to 2017), of which 45% was cotton yarn and 37% was finished products.

At present, the textile industry in Uzbekistan produces relatively low-quality textiles. Additional investment in technology, as well as talent procurement, will be required to improve the quality and sophistication of the output, which will allow the industry to move into higher price segments for export products and compete with countries such as Turkey, rather than Bangladesh. A major barrier has been overcome: global brands used to avoid Uzbekistan due to its use of involuntary labor for cotton picking. In September 2018, the U.S. Department of Labor, citing the results of ILO, government and independent human rights activists monitoring, pronounced that the systematic use of child labor in cotton harvesting in Uzbekistan had stopped.

The next big things: potential in high-growth sectors



Financial Services

International agencies rank the Uzbekistani financial sector as "stable." The total assets of Uzbekistan's commercial banks increased twofold in 2017 and equaled 166 trillion UZS (almost \$25 billion). In 2018, this figure increased to 214 billion soms¹⁰. According to Moody's, the "stable" ratings of the Uzbekistani financial sector can be ascribed to the country's rapid economic growth, providing favorable conditions for Uzbekistani banks.

With a domestic private loan to GDP ratio at only 18%¹¹, banking penetration remains low,

¹⁰ Central Bank's 2018 Statistical Bulletin (<http://cbu.uz/ru/publikacii/buleten>)

¹¹ Estimate from Silk Capital, an investment banking subsidiary focused on the Uzbekistani market

INDORAMA KOKAND TEXTILE'S SUCCESS STORY

Indorama Kokand Textile LLC (IKT) is a joint venture created by the Indorama Group (Singapore), through its subsidiary Indorama Industry Pte Ltd (75% stake), with the National Bank of Uzbekistan (NBU) (25% stake initially, now diluted to below 10% as a reflection of the government's confidence in Indorama's ability to run the business).

The company was launched in Uzbekistan in July 2011 as part of Indorama's strategy to establish a presence in the emerging economies of Central Asia and expand its global spinning business. IKT has since expanded its operations in a phased manner by enhancing its manufacturing capacity in 2013, 2015 and 2016, for a total investment of \$165 million. IKT employs more than 1,100 local workers.

IKT mainly serves the global market for spun yarn, targeting more than 80% of exports to Latin America, Europe, Bangladesh, the CIS and Turkey, and thus creating a global marketplace for a Made

in Uzbekistan product. IKT generates over \$100 million in export revenues annually.

The company also provides high-quality compact cotton yarn to the domestic industry for further value addition as fabrics and garments. IKT has made a positive impact on the domestic textile industry by introducing front-end technology, international management and operations practices and HSE standards, as well as creating local capacity, which brought about the growth of the domestic cotton fiber processing industry from less than 200,000 tons in 2010 to more than 700,000 tons in 2017.

The summer of 2018 saw the promulgation of the Cabinet of Ministers' Resolution on Measures for Indorama (Singapore) to Create Modern Cotton and Textile Manufacturing Capacity in the Republic of Uzbekistan. The project will attract \$340 million in foreign direct investments in 2019–2023 to create a large-scale cotton cluster based on the existing facilities of Indorama Kokand Textiles JV.



offering high development potential. This ratio is indeed one of the lowest in the world: the ratio of domestic crediting of the private sector to the GDP is 26% in Azerbaijan, 33% in Kazakhstan, 56% in Russia and 27% on average in the world's least developed countries^{12,13}. The banking sector is expected to grow at a higher pace than the economy on average, as demand for consumer, mortgage, and other types of loans and financial instru-

ments has not yet been met and financing of the economy is expected to continue to rely on banks in the coming years.

The Uzbekistani banking sector is also affected by large single-borrower concentrations. Corporate borrowers represent around 80% of large/medium banks' total gross loans. On average, a bank's 20 largest outstanding loans account for more than 200% of its capital. However, the proportion of retail loans is gradually growing, helping mitigate this concentration risk.

12 UN classification

13 World Bank data, 2016

At present, the financial sector remains highly state-controlled. Three large state-owned banks hold approximately 56% of the total assets and capital of the entire banking system, while privately-owned commercial banks are small niche players. Moreover, the credit market is highly segmented. State-owned enterprises often enjoy preferential access to credit, especially for foreign exchange lines of credit granted at highly preferential terms, depressing banks' profitability. On the other hand, the private sector mostly only has access to the domestic currency segment of the credit market¹⁴.

Banking regulation is stringent in Uzbekistan. The country's central bank maintains close supervision of second-tier banks by introducing stricter requirements than in force internationally. In 2018, the regulatory capital adequacy ratio (levels 1 and 2) in the banking sector was 12.5%, and it was increased to 13% effective January 1, 2019.

Several reforms are underway to open the financial sector further to foreign investors. The government announced a possible amnesty of capital in 2018, encouraging companies and individuals to transfer money held abroad to local banks and invest in the development of the country. That measure could potentially give a massive boost to the banking sector and is a good basis for increasing economic activity. However, additional reforms are still needed to build the public's trust in the banking system and allow banks to operate in line with international best practices.

With the fast-pace reforms, foreign investors are beginning to take an interest in the Uzbekistani banking sector. According to the Central Bank of Uzbekistan, there were 29 commercial banks operating in Uzbekistan as of January 1, 2019, five of which have some foreign ownership. In 2017, Turkish Ziraat Bank purchased 50% of UT Bank (Uzbekistan-Turkish Bank) from Agrobank for \$14 million, taking full control of it. Moreover, the People's Bank of Kazakhstan (Halyk Bank) opened its Tenge affiliate in Uzbekistan in 2018.

¹⁴ IMF, "Uzbekistan: Staff Concluding Statement of the 2018 Article IV Mission," March 2018

Uzbekistan is on track to legalize cryptocurrencies, aiming to become a major player in the crypto world. A law regulating electronic money could come into force in 2019. President Mirziyoyev has also called for active development and promotion of contactless payments in the country by expanding the use of international payment systems.

Construction

The construction industry is among the fastest growing sectors in Uzbekistan and is one of its major economic drivers, contributing ~6% to the country's GDP in 2017–2018. Between 2007 and 2016, construction volume grew on average by 15% yearly in absolute terms¹⁵. The construction boom is expected to intensify over the next 5 to 10 years due to a series of fundamental growth drivers.

Future economic growth and high demand for houses will propel the industry. Thanks to the stable economic growth of the country in recent years, real estate construction grew stably at 7% and it is expected to continue at a similar pace in the coming years. Moreover, residential space is at a premium in Uzbekistan, with only 15 m² of housing per capita, which is significantly lower than in Kazakhstan (21 m²), Russia (25 m²), Eastern Europe (40 m²), or the U.S. (70 m²). However, this gap is expected to close gradually, reinforcing demand for construction and real estate.

Uzbekistan has sufficient sources of raw materials to produce goods locally. Production of construction materials grew 16% annually in 2016 and 2017. The main materials produced in Uzbekistan are cement, slate and drywall. Nonetheless, existing manufacturing capacities are not sufficient to meet domestic demand for cement, ceramic and tile, glass, plumbing fixtures and thermal insulation, creating attractive business opportunities. For instance, in October 2018, Russia's Eurocement Group began the construction of what is to become Central Asia's largest cement factory in Uzbekistan. The cost of the project is over \$160 million.

¹⁵ State Committee of the Republic of Uzbekistan on Statistics

KNAUF UZBEKISTAN'S SUCCESS STORY

Knauf has been present in Uzbekistan since 2005, when the company became the main shareholder in the Bukharagips plant, assuming investment obligations for its development and modernization.

After a major upgrade of the plant in 2009, the company began production of dry construction mixes. It now produces 60,000 tons of mixes annually. In 2011, the company opened a new plant to produce drywall in the Bukhara Region with an annual capacity of 20 million square meters.

Knauf produces construction materials that are in great demand both within and outside of Uzbekistan. The company exports products worth a total of \$1.14 million to

Turkmenistan and Afghanistan annually. The company also extracts about 40,000 tons of gypsum a month, more than half of which is sold to other enterprises – cement plants and competitors that produce drywall, dry mixes and plaster.

In May 2018, the company launched a new drywall line. After overhaul, drywall production capacity of the line increased by 30% to more than 30 million square meters annually. The cost of the project was more than €16 million. Knauf's total investment in two plants in Bukhara amounted to \$75 million. The company plans to build a new plant for the production of dry construction mixes close to the drywall plant, with more than \$20 million to be invested in the project.



The government offers support to the construction industry. In particular, a presidential decree issued in 2016 announced measures to support the construction of affordable housing in urban and rural areas and thus meet the growing needs of the population¹⁶. Several types of imported building material are exempt from customs duties to reduce construction costs. The government also provides financial, infrastructural and legal incentives for investors wishing to build plants to produce materials that are not yet made locally.

¹⁶ In 2016, more than 86,000 houses and 88,000 apartments were constructed with a total area of 12 million square meters, thanks to the involvement of developers and local and international banks. The national multistory apartment house construction program for 2018-2020 envisages building over 1,000 apartment houses with 43,000 apartments, while the national rural housing program foresees construction of over 15,000 new houses every year from 2017 to 2021.

Telecommunications

Uzbekistan is a fast-growing telecommunications market, especially for mobile broadband. The fixed line market in the country remains underdeveloped, mainly due to the dominance of the mobile segment. However, Uzbekistan's mobile market remains underdeveloped compared to peer countries. In 2017, mobile penetration reached ~65%¹⁷. Five mobile operators are present in the country, with two operators – Beeline (owned by VEON) and UCELL (owned by TeliaSonera) – occupying more than 90% of the market.

Internet penetration has increased dramatically in the last ten years, from 4% to 61%, driven by the strong growth of mobile broad-

¹⁷ Socioeconomic Situation of the Republic of Uzbekistan in January–December 2018, a report by the State Committee of the Republic of Uzbekistan on Statistics

band. The countrywide launch of 4G (LTE) by mobile operators in 2016 facilitated the rise of the mobile broadband segment. Moderate to strong growth is forecast over the next five years as the penetration of mobile broadband increases to regional and global averages.

However, average revenue per user (ARPU) is low in Uzbekistan for mobile subscriptions, compared to other countries in the region, at

only \$4.10 a month. This limits the financial attractiveness of the Uzbek market for investors. However, the forecast volume increase for mobile broadband demand is expected to counterbalance the price effect. The volume of mobile broadband traffic is forecast to increase 20-fold by 2025¹⁸ to meet the growing demand (in particular for video and other multimedia content).

18 Ovum, BCG analysis

HUAWEI UZBEKISTAN'S SUCCESS STORY

Huawei Technologies is one of the largest Chinese telecommunications companies, known around the world as a leading producer and solution provider in the field of information and telecommunications.

In its 18-year history in Uzbekistan, the company has equipped several mobile operators with telecommunications hardware and software. It launched the first 3G network in Uzbekistan and the first 4G network in the CIS. In 2015, in a joint venture with Uzbektelecom, Huawei also launched Uzmobile, the national mobile operator. In 2016, in a JV with Uzbektelecom, Huawei launched production facilities for optical equipment. The total cost of the project was \$3 million, which was equally split between the two companies.

Huawei also provides products and advanced ITC solutions for large organizations and enterprises in education, energy and other areas.

In the consumer segment, Huawei mobile phones are gaining popularity among Uzbekistani citizens. According to the

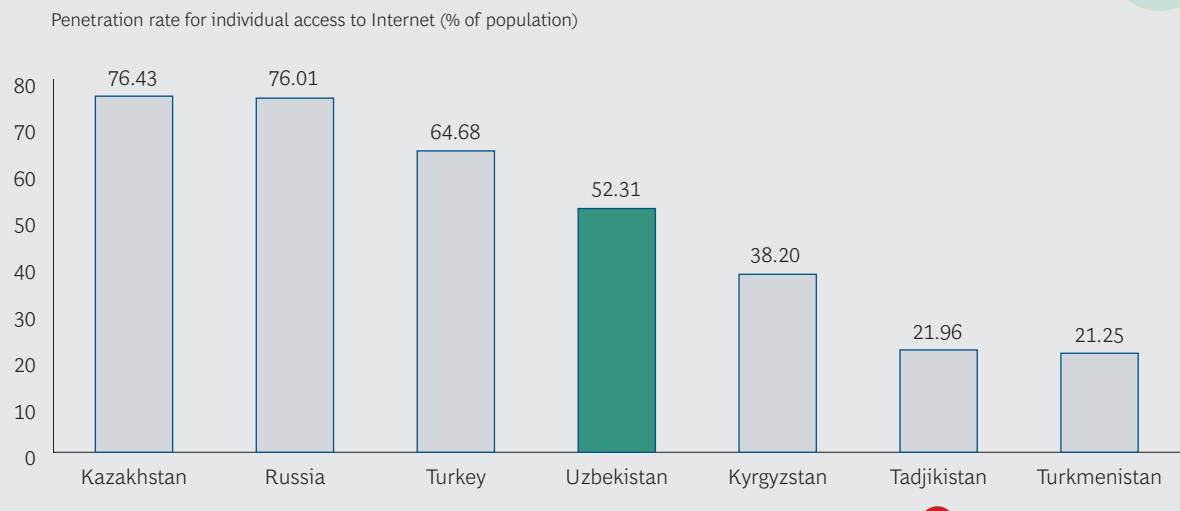
company, 65% of Uzbekistan's population uses communications services based on Huawei equipment.

Since 2012, the company's Tashkent office has been the regional headquarters for all of Central Asia, the Caucasus, Turkey and Mongolia. Huawei's CEO stated that moving the regional headquarters from Istanbul to Tashkent was made possible by the support of both governments and other partners.

Huawei has developed social programs in the country, such as Seeds for the Future, launched in January 2017. In a partnership between Huawei and Tashkent University of Information Technology, students were selected to participate in two-week training courses in China. The two institutions also launched a new research and educational project, HAINA (Huawei Authorized Information and Network Academy), in 2016 to help train professionals in information and network technologies. Through these programs and similar activities, Huawei is trying to support the development of digital skills in the country.



FIGURE 12 | Penetration rate for individual access to Internet



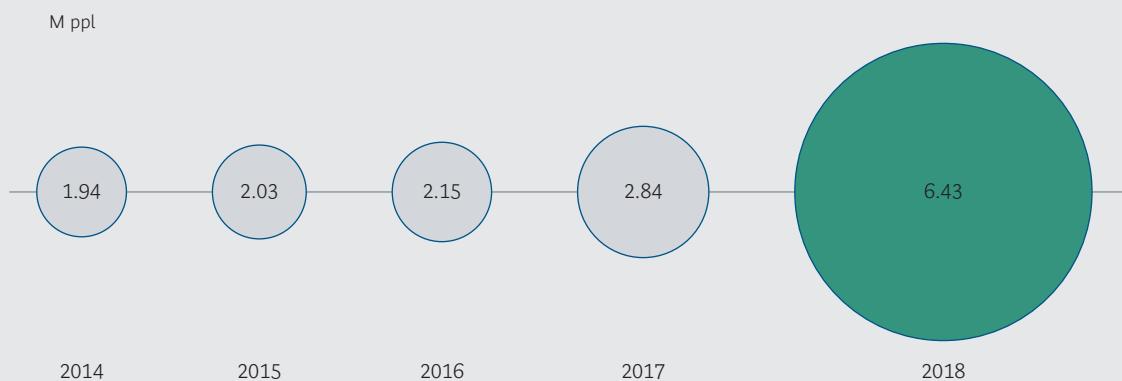
Source: International Telecommunication Union (ITU), 2017 data

Telecommunications infrastructure is relatively well developed in Uzbekistan, compared to neighboring countries. As of 2017, more than 18,000 base stations were installed throughout the country. Nevertheless, the infrastructure needs further development and improvement to close the penetration rate gap. Network coverage for mobile broadband is still low in Uzbekistan,

with only 17% of the country – mainly in the large cities – covered by 4G networks. Investment is ongoing to improve the infrastructure¹⁹.

¹⁹ In 2017, almost 2,000 km of fiber-optic cable was laid nationwide and Internet throughput was doubled. Uzbekelecom commissioned 898 km of fiber-optic cable and 213 additional base stations in 2018. Moreover, a joint venture with Huawei is planned to produce equipment for GPON fixed broadband technology, while a joint venture with another

FIGURE 13 | Number of foreign visitors to Uzbekistan



Source: Social and Economic Condition of the Republic of Uzbekistan in January–December 2018, a report by the State Committee of the Republic of Uzbekistan on Statistics

Uzbekistan suffers from a deficit of qualified ICT and digital specialists. Currently, the country offers only limited educational opportunities in this field, which results in a low level of digital literacy and insufficient digital skills to meet the growing demand in the sector.

As is the case in most countries, the telecom sector is highly regulated in Uzbekistan. In addition to the high investment costs, this makes the telecom industry difficult to enter for potential new operators. Moreover, recent bribery scandals have negatively impacted the sector and its attractiveness for foreign investors.

Nevertheless, despite administrative barriers to entering the sector, telecom in Uzbekistan is an attractive industry for investors, due to its dynamic development. The success of the Chinese company Huawei is proof of the country's potential. Moreover, thanks to its fast-developing infrastructure, Uzbekistan may have the potential to become a regional broadband highway and hub for neighboring countries.



Tourism

Tourism is a burgeoning industry that requires investment to reach its full potential.

Of all the countries in the region, Uzbekistan has by far the greatest tourism potential, thanks to the richness of its historical and cultural heritage (such as the Silk Road and the legendary cities of Samarkand, Bukhara and Khiva), the variety of its natural sites and very good security conditions. There are over 4,000 ancient monuments spread across the country.

company will specialize in the production of optical cables, splitters and other materials to increase fixed broadband access in the country. <http://www.uz24.uz/technologies/dovedut-li-skorosty-interneta-v-uzbekistane-do-urovnya-sng>



Five sites are included in the UNESCO World Heritage List and 30 more are under consideration for it²⁰. This historical and cultural heritage offers great opportunities for the development of the tourism industry.

In 2017, Uzbekistan welcomed around 2.7 million international visitors. According to State Committee of the Republic of Uzbekistan on Statistics, the number of international visitors increased by 2.3 times in 2018, to 6.4 million people. However, these numbers do not reflect the country's full potential and can be increased further. According to the State Agency for Tourism Development, the sector generates a turnover of \$170 million a year. Therefore, tourism's contribution to the GDP and employment is very low today – 3% each, while average worldwide indicators are 10%.

The tourist infrastructure has made fair progress in recent years, but it requires significant additional investment to reach international standards. 795 tour operators and about 880 tourist accommodations operate in the country²¹. A rising number of hotels, offering more than 39,000 beds, are beginning to meet modern international standards²².

The Uzbekistani government is facilitating tourism from abroad. Uzbekistan Airways, the national aviation company, makes regular flights to more than 40 European, Asian and American cities. In addition, the government has signed major contracts with Airbus and Boeing to modernize its fleet. A lowcoster possibility is also being discussed. Recently, the government also announced plans to transfer

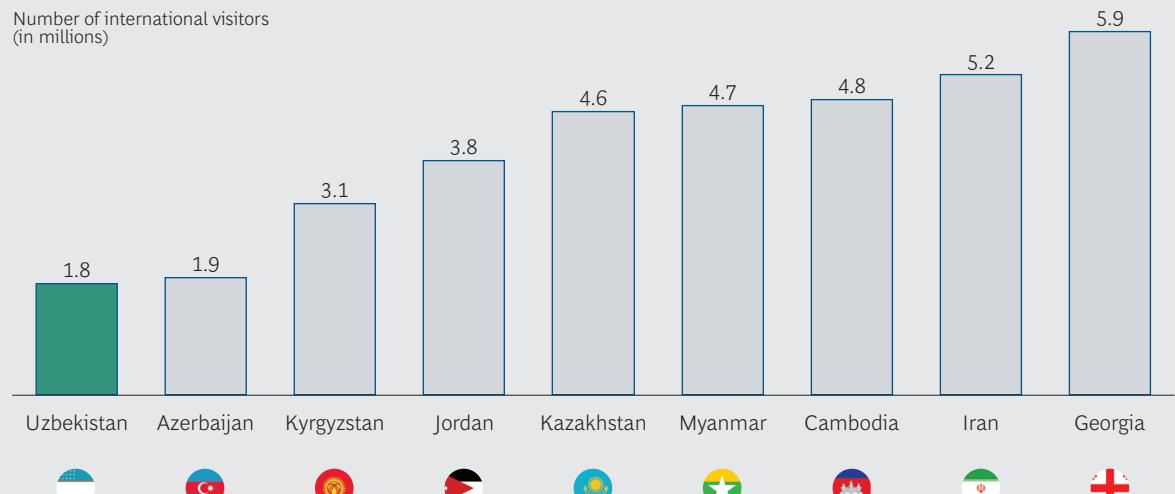
20 <http://whc.unesco.org/en/statesparties/uz>

21 <https://uzbektourism.uz/en>

22 Ibid. and <https://stat.uz/ru/ofitsialnaya-statistika/sotsialnaya-sfera/turizm/2488-gostinitsy>



FIGURE 14 | Number of international visitors by country in 2015



Source: World Tourism Organization, 2015

ownership of the Karshi, Andijan, Nukus and Navoi airports to a specialized company and establish an “open skies” policy at these airports²³. In 2017, over 2.6 million passengers were carried on air transport into Uzbekistan (an 8% growth on the 2016 figure)²⁴.

Measures to promote tourism also include a more accommodating visa policy. In February 2018, Uzbekistan extended its visa-free regime for 30 days from the date of entry for citizens of seven countries²⁵ and a simplified procedure for obtaining tourist visas will apply to travelers from 39 more countries²⁶. In addi-

tion, Uzbekistan introduced electronic entry visas (E-Visa) in July 2018 to facilitate visa applications for tourists.

The government wants to diversify its tourist flow, which is now mainly composed of young retirees, draw tourists to new regions of the country and extend the tourist season (which is concentrated in the months of April–June and September–October). The development of new tourist activities such as ecotourism or sports tourism are also under consideration. Tourism development, hotel construction and staff training are objectives that will require important investments, both public and private, to overcome the challenges currently faced by the industry.

23 <https://www.gazeta.uz/ru/2018/02/22/open-sky/>

24 World Development Indicators, World Bank

25 Israel, Indonesia, the Republic of Korea, Malaysia, Singapore, Turkey and Japan

26 The list includes countries of the European Union, East Asia and the Middle East, as well as India, Canada, New Zealand and

the U.S.

RISK MITIGATION

Dependence on neighboring countries

Sharing borders with Afghanistan, Kyrgyzstan and Tajikistan, Uzbekistan's position in the middle of Central Asia can be a source of vulnerability. These neighboring countries' internal instability could slow down Uzbekistan's growth. Moreover, as a double landlocked country, Uzbekistan requires the development of efficient infrastructure and logistics systems. Uzbekistan has low diversity in terms of trading partners, with Kazakhstan, Russia and China being its biggest partners, contributing roughly 45% to the country's foreign trade. This creates high dependence on their economic stability, and an economic slowdown in either Russia or China could negatively affect Uzbekistan. In addition, Uzbekistan does not have direct land access to these countries and thus it is also highly dependent on relationships with Kazakhstan, the Kyrgyz Republic and other neighbors through which transit routes to Russia and China lie. Bilateral efforts are made to improve the terms of transit of goods through neighboring countries (simplification of procedures, reduction of tariffs). Also the Uzbek national railway operator, O'zbekiston Temir Yo'llari, continues the construction of a new track in Afghanistan which is intended to reach the Iranian Bander Abbas seaport.

Potential changes in migration trends

The state faces a major challenge in creating more and better jobs for the population while the labor force is growing at an average rate of 2.9% per year, exceeding the annual job creation rate as the younger generation reaches working age. Lack of jobs and relatively low salaries lead many Uzbeks to seek work abroad. The mass labor migration of 2 million to 6 million Uzbeks to Russia, Kazakhstan and other countries has partially alleviated the problem in the short run. However, possible changes in migration rules in these countries could force migrant workers to return home, which could cause a sharp increase in unemployment and endanger social stability in the country. In 2017, the amount of cash transfers by individuals to Uzbekistan from Russia alone equaled \$3.9 billion¹.

The rapidly changing regulatory field

The speed of change in the regulatory field is unprecedented: on average, the president signed substantial decrees every two days in 2017. Such a dynamic regulatory environment creates new business opportunities and allows for rapid positive change. However, funda-

¹ Central Bank of Russia

mental rules that were considered advantages by enterprises at the initial planning stage may soon vanish or become disadvantages due to regulatory changes. Moreover, due to the speed of changes, there is a risk that some of the new laws may be poorly drafted, cross-checked and aligned, leading to contradictions and diversity of interpretation. In September 2017, the president approved a Concept of Administrative Reforms, which may act as a guideline for upcoming regulatory changes. It is necessary to ensure the high quality of the lawmaking process and its predictability and transparency for business owners, without losing the current unprecedented tempo of change. In early 2019, the Ministry of Investments and Foreign Trade was created by consolidating the State Committee for Investments and the Ministry for Foreign Trade, to oversee the implementation of a uniform state policy in the area of investments and coordinate the efforts to attract foreign investments.

This will also help build internal capabilities of managing large-scale change at the state level.

Uncertainty regarding utility costs

Utilities are operated by state-owned enterprises such as Uzbekenergo and Uzneftegas and consumer end prices are subsidized by the government. As the state plans to liberalize these fields, consumer prices will rise gradually to offset the investment required to expand and modernize the infrastructure in these fields. Thus, for sustainability of reforms in the long-term, it will be necessary to control public tensions arising from price increases, especially for lower income, socially disadvantaged citizen groups. Moreover, it might be harder for the state to manage inflationary challenges, especially if liberalization is synchronized with much-needed banking reform, which should expand the monetary base.

WINNING IN UZBEKISTAN

Boasting a unique combination of opportunities and challenges, Uzbekistan is an attractive place for investment among frontier economies. Provided that the pace of change and willingness to change remain as high as they have been for the past two years, Uzbekistan will present a golden opportunity for investors. In spite of concerns, foreign investors can thrive in Uzbekistan by focusing on five strategic priorities that have been identified from analyses of the country's context and evolution, as well as success stories of local and foreign investors.

Arriving sooner rather than later

As is the case for most frontier markets, Uzbekistan will offer a high return on investment. Currently, a lot of segments remain untouched by investment. Due to the fragmented nature of Uzbekistan's market, competition occurs between categories of players rather than companies. Consider retail. The country is slowly opening up to supermarket chains, but for now most retail sales take place in traditional marketplaces rather than organized stores, especially outside the main urban areas. Supermarket companies still need to help change attitudes in favor of more modern retail. Korzinka, a supermarket chain established in 1996, is a pioneer in this segment and is now among its biggest players. Moreover, the company is gradually opening stores in rural regions to be the first established brand in

those areas and thus benefit from the growing modern retail market.

In the next few years, many segments will be characterized by low competition. First movers will have a better chance to maintain their market shares after more players enter the market because they will be well established.

Relying on local expertise

There are several examples of successful local businesses that were established in recent decades but are prevented from scaling their business due to lack of funds. While looking at opportunities in Uzbekistan, investors should keep in mind that, besides buying assets, they can also build on the human resources of the country.

This is why numerous investors have chosen to enter the market through joint ventures with local companies. Joint ventures allow them to take advantage of local business expertise, experience and networks that may be key to success in Uzbekistan. The country will need to develop its corporate legislation to stimulate more joint ventures.

Developing an adaptive strategy

Uzbekistan has evolved at an unprecedented rate over the last year, making it critical for investors to monitor new changes closely.

This applies in particular to the regulatory and legal environments. Investors need to stay abreast of reforms and new laws to remain fully compliant in an ever-changing environment.

This attention to change should not be limited to passive monitoring. To thrive in Uzbekistan, investors need to be agile and apply adaptive strategies to identify attractive sectors and new consumer trends early.

Betting on people rather than capital

Thanks to low labor costs, labor-intensive companies are more attractive in Uzbekistan than those based on complete automation. Even though the country will probably follow the trajectory of other developing countries and leapfrog towards a more digital society, it will be highly reliant on labor-intensive industries for the next decade.

This is a factor in the choice of industry to invest in, as well as the choice of business model and strategy. This is especially true since Uzbekistan's culture is based on relationship building and is not yet compatible with fully automated business models. Banks are more likely to succeed if they open branches with relationship managers and SMEs than if they only maintain a presence through ATMs and a digital footprint. Moreover, due to unemployment pressure, the government is more likely to support businesses that create jobs.

Understanding Uzbekistan as part of a bigger system

Beyond the large and growing domestic market, opportunities can be seized in the countries neighboring Uzbekistan. The country has the potential to become a manufacturing and/or logistical hub in Central Asia, which is itself a dynamic and attractive developing region¹.

Thanks to its strategic location, Uzbekistan can become a regional logistics hub in Central Asia in the next three to five years, provided it continues to improve its infrastructure. This scenario is becoming more probable as China announces new logistics projects in the region, such as the construction of the China–Kyrgyzstan–Uzbekistan railway. This project aims to shorten the delivery time of Chinese goods to Persian Gulf countries and the EU, but it will also benefit Uzbekistan, as the railroad will encourage growth along its path. It will create a new transportation corridor that will reduce the price of Uzbek goods thanks to lower transportation costs and provide access to ports on the Persian Gulf and Pacific Ocean. This project however has not been launched yet and is still under discussion between the parties. Uzbekistan officials are also discussing the construction of a second railway in Afghanistan. The Trans-Afghan railway will be a key logistics link for Uzbekistan and it will strengthen the country's position as a logistic hub.

Its cheap and relatively well-trained labor force will allow Uzbekistan to position itself as a manufacturing platform in the coming years. The country also benefits from competitive production prices in segments such as agriculture, textiles and construction materials. These industries are rapidly growing and have the potential to develop exports to Russia and Central Asia. Aware of this potential, Uzbekistan's government has launched an electronic trading platform, ZoodMall, to increase the country's competitiveness and help local producers, manufacturing companies and dealers sell their goods without intermediaries on international online markets. The electronic platform will serve as the basis for developing close commercial ties with neighboring countries and increase multilateral trade volumes. Uzbekistan entrepreneurs will be able to reach more than 300 million potential buyers with this project.

¹ To learn more about opportunities in Central Asia, refer to BCG publication Central Asia — One Region, Many Opportunities

FOR FURTHER READING

BCG has published other reports and articles that may be of interest to senior executives.

On Central Asia
Investing in Central Asia — One Region, Many Opportunities
A report by BCG, September 2018

BCG Review No. 44.
Special edition: Kazakhstan (BCG Review № 44. Специальный выпуск: Казахстан)
A publication by BCG, May 2018

BCG Review No. 41.
Special edition: Kazakhstan (BCG Review № 41. Специальный выпуск: Казахстан)
A publication by BCG, June 2017

BCG Review No. 38.
Special edition: Kazakhstan (BCG Review № 38. Специальный выпуск: Казахстан)
A publication by BCG, May 2016

Other publications
Pioneering One Africa: The Companies Blazing a Trail Across the Continent
A report by BCG, April 2018

Lotus Nation: Sustaining Vietnam's Impressive Gains in Well-Being
A publication by BCG, March 2016

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