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# Russia Outlook 2014

## *Growth in Transition*

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# 2014: Growth in Transition

- ❑ The steady decline in growth through 2013 has shaken Kremlin complacency. President Putin, for the first time in December, acknowledged that the problem is local rather than external contagion and needs a domestic policy response.
- ❑ The Finance Ministry & Central Bank needs to better coordinate actions and the government needs to incentivize investment and boost confidence.
- ❑ A more intense debate within government is expected after the Sochi Olympics end
- ❑ Without remedial action growth in 2014 may be close to 2.0%. Growth of 3.0% is possible with an effective policy response.
- ❑ Preparations for the FIFA World Cup in 2018 will act as a spur for infrastructure spending in the eleven cities and regions which will host games
- ❑ The boom in the consumer/service sectors is over but rising disposable incomes, low unemployment, the expanding middle-class and changing lifestyles can sustain growth at above EM average rates

# Where should investors be focused?

<b>Direct Investment</b>	Co-investment with state agencies and at a regional level in infrastructure, especially transport sector preparations for World Cup '18 will provide opportunities agriculture, food and pharma sectors – both at manufacturing/production level and machinery/service supply.
<b>Private Equity</b>	Healthcare, education and leisure industries technology sectors.
<b>Consumer/Services</b>	Boom period is over but growth and sector expansion will continue as economy develops and middle class expands.
<b>Equities</b>	Index gains are more likely in 2 <sup>nd</sup> half. A full year gain of circa 15% for MICEX due to risk premium contraction & EM recovery 1 <sup>st</sup> half gains may come in gas names, dividend themes and Tech/Media....2 <sup>nd</sup> half from export sectors, especially steel
<b>Debt</b>	Yield gap contraction for Eurobonds in the 2 <sup>nd</sup> half as the economy picks up. Ruble debt to remain sluggish due to Pensions Fund revenue switch
<b>Ruble</b>	Continue under downward pressure all year, albeit with CBR interventions to control weakness, ahead of a free float in early '15.

# Events in 2014

<b>January</b>	EU-Russia Summit, 27 <sup>th</sup> & 28 <sup>th</sup> in Brussels
<b>February</b>	Winter Olympics, 7 <sup>th</sup> – 23 <sup>rd</sup> in Sochi US debt ceiling suspension ends – will be binding in late March if not revised
<b>March</b>	Paralympics, 7 <sup>th</sup> – 16 <sup>th</sup> in Sochi
<b>May</b>	St. Petersburg Economic Forum, 22 <sup>th</sup> – 24 <sup>th</sup>
<b>June</b>	G8 Leaders Summit, 4 <sup>th</sup> & 5 <sup>th</sup> in Sochi Tighter restrictions on smoking in public places, 1 <sup>st</sup>
<b>September</b>	Russia regional elections, 3 <sup>rd</sup> ...held nationally
<b>November</b>	G20 Summit, 15 <sup>th</sup> & 16 <sup>th</sup> in Brisbane, Australia
<b><i>Also in 2014</i></b>	Euroclear access to ruble corporate debt market (1 <sup>st</sup> Qtr) Euroclear access to local equity market (expected 2 <sup>nd</sup> or 3 <sup>rd</sup> Qtr) Kazakhstan expected to be admitted to W.T.O. Armenia and Kyrgyzstan expected to join Customs Union Russia may submit final claim to sovereignty over Lomonosov Ridge (Arctic) Denmark will submit a formal claim to greater Arctic sovereignty UN-Iran preliminary agreement should be confirmed or end in summer Turkey elections: Local at end March and Presidential in August

# Russia S.W.O.T. Analysis

## Strengths

- Strong Balance Sheet & fiscal reserves
- Natural resources provide cash flows
- Stable society & politics
- Very low unemployment & high education
- Low personal and corporate taxes

## Weaknesses

- Deteriorating workforce demographics
- Low base of domestic investment capital
- State dominance in key industries
- Slow pace of reforms
- Inefficient budget allocations

## Threats

- Oil price as shale & other sources grow
- Corruption, weak legal process, red tape
- Costs (manufacturing) are rising too fast
- No obvious political will to make changes
- High debt amongst active consumers

## Opportunities

- Infrastructure & industry modernisation
- Consumer/Service sectors still expanding
- Staging major events is a catalyst
- OECD membership can force change
- Customs Union – Eurasia Union market

# Economics & Politics in 2014

- ❑ GDP is expected to grow 1.9%. It may be better if the government and Central Bank + Finance Ministry introduce effective policy changes early. Qtr 1 '14 may be bad (worst) on a year-on-year basis.
- ❑ CPI ended 2013 at 6.6% but should end 2014 at 5.5%. Central Bank is likely to start rate cuts in Qtr 1. The Key rate (5.5% today) may be cut 75bps in '14
- ❑ Retail sales should grow at 4% and investment spending is expected to recover to circa +1.6% from negative growth in '13. Real wage growth of 4.5% (5.5% in '13) is expected.
- ❑ There are no obvious threats to either domestic social or political stability. President's Putin's approval rating remains high and stable.
- ❑ Likely to see more rapprochement with the formal opposition groups.
- ❑ Russia is expected to continue building on the positive geo-political engagements seen in 2013.
- ❑ Cabinet changes are possible as early as spring, but (most likely) depends on the trend in the economy

# Capital Market Themes

- Equities** Russia market sentiment will continue to be dictated by global EM trends  
1<sup>st</sup> half '14 will see continuing positive momentum and flows into US and other DMs  
2<sup>nd</sup> half should see that trend reverse as investors focus on better growth prospects in EM  
Countries with good balance sheets, current account surplus, and political stability will be favoured – Russia included on that list  
1<sup>st</sup> half equity performance should be best for high dividend payers, sectors with high earnings momentum and the gas sector  
2<sup>nd</sup> half should see a return to favour of the high-beta steel sector, reflecting more optimism about the global economy and China/Asia growth
- Ruble** Central Bank will initially stick with stability priority but will have to further widen the band  
Key Rate (5.5%) will be cut by 74 bps this year  
Rate cuts, stimulus measures and move towards full convertibility in late 2014 or early 2015 will further weaken the ruble.
- Debt** US Fed's tapering action will be the dominant driver in all debt markets  
Yield gap on Russia Sovereigns should contract in the 2<sup>nd</sup> half, especially if oil holds above \$100 p/bbl (less budget pressure) and the economy picks up  
Ruble debt market will continue to lag mainly due to the a) weaker ruble outlook and b) the decision not to fund the savings part of the pensions fund this year. That will cut at least \$15 bln from the ruble debt market in 2014



# How does Russia compare?

- ❑ Russia's expected 2013 and forecast 2014 growth lags other major emerging markets . The government does, however, have greater scope to rectify this and push growth towards 3.0% in '14
- ❑ Russia's budget execution is very favourable compared to others but is the most vulnerable to one single revenue source, i.e. hydrocarbons
- ❑ Russia's Current Account surplus in 2011 was 5% of GDP; was 3.7% of GDP in 2012 and fell to 1.5% in 2013. The deterioration last year is a major cause for concern and may further undermine the ruble.

Selected Emerging Markets - Key Data Comparison				
	GDP '2014 (F)	Consumer Inflation	Current Account	Budget Balance
	% growth	% YoY	% of GDP	% of GDP
<b>China</b>	7.3%	3.0%	2.0%	-2.0%
<b>India</b>	5.1%	10.5%	-3.3%	-4.5%
<b>Indonesia</b>	5.0%	8.6%	-2.8%	-2.4%
<b>South Korea</b>	3.6%	0.9%	4.1%	0.9%
<b>Brazil</b>	2.5%	5.7%	-3.0%	-3.6%
<b>South Africa</b>	3.0%	5.6%	-5.1%	-4.2%
<b>Turkey</b>	3.0%	7.6%	-5.9%	-1.5%
<b>Russia</b>	2.0%	6.5%	1.5%	-0.4%
Source: Bloomberg, JP Morgan Research, Macro-Advisory				

# P.E. Comparison

## Developed Markets

	Current Yr.	Next Yr.
S&P 500	15.5	14.0
Euro Stoxx 50	12.9	11.4
Nikkei 225	20.7	18.1
FTSE 100	12.9	11.9

## Asia EM

	Current Yr.	Next Yr.
Shanghai Comp	8.0	6.9
India	15.1	12.7
Indonesia	12.5	11.1
Thailand	11.4	10.1

## EMEA

	Current Yr.	Next Yr.
<b>Russia, RTS</b>	<b>4.4</b>	<b>4.5</b>
Turkey, XU100	8.7	7.6
Poland WIG20	12.8	11.4
South Africa, JALSH	13.9	12.6

## Latin America

	Current Yr.	Next Yr.
Brazil	9.8	9.0
Mexico	17.9	15.6
Chile	14.4	12.5
Argentina	9.3	8.4

*Russia is by far the cheapest rated market. But a big part of the reason is because of the dominance of low growth natural resource & state companies*

# Reasons for the P.E. discount

- Market structure – dominance of low growth/regulated/state industries
- Sharp slide in the economy through 2013
- High-Beta vulnerability to global EM trends
- Too small domestic investor base
- Poor international perception of Russia
- Political headlines
- Bad corporate governance headlines

Russia Total Market - Sector Weights		
Industry Sector	Mkt Cap \$ mln	% of Total
Oil	\$263,468	34.7%
Gas	\$134,655	17.7%
Banks/Financials	\$95,504	12.6%
Telecoms	\$91,086	12.0%
Consumer	\$44,154	5.8%
Utilities	\$33,297	4.4%
Media/IT	\$31,601	4.2%
Chemicals/Fertilizers	\$25,099	3.3%
Transport	\$12,412	1.6%
Metals	\$8,635	1.1%
Real Estate	\$8,039	1.1%
Manufacturing	\$5,337	0.7%
Construction/Materials	\$2,606	0.3%
Food Producers	\$2,366	0.3%
Pharmaceuticals	\$1,872	0.2%
<b>Total</b>	<b>\$760,131</b>	<b>100%</b>

# What may spark a re-rating?

- ❑ **Effective policy changes** *economic growth slipped in 2013 because consumer & business confidence fell + the cost of borrowing and the difficulty of accessing credit stayed high. Conflicting policies from the CBR and MinFin kept liquidity tight. Investors hope to see more stimulus in 2014*
- ❑ **Earnings growth** *industries outside of extractive industries may again see double digit growth*
- ❑ **Dividend increases** *dividend payouts are rising and provide a strong market base support*
- ❑ **Euroclear access to local equities** *this is expected in the spring or summer. The event will open the local market to foreign investors and also should lead to the closing of the discount gap between locals and DRs. Magnit and MTS local shares are amongst the stocks expected to benefit*
- ❑ **Commitment to O.E.C.D. membership** *the government has declared its intention to meet membership requirements within a couple of years. Evidence that this is actually happening will be positive for the reform programme and investor perceptions about Russia risk.*
- ❑ **Political rapprochement continues** *the president surprised many by meeting with non-parliamentary opposition groups and releasing high profile prisoners. Further actions along these lines would clearly be positive in terms of investor perception of change.*
- ❑ **Reform progress** *investors hope to see more high profile anti-corruption actions and further progress on the World Bank's Ease of Doing Business rankings*

# Macro Economic Indicators

## Summary macro data

- ❑ The slower growth in 2013 was due to a decline in investment and slower consumption. Policy contradictions did not help. There is still a big question mark over 2014 growth and a lot will depend on what changes the government and the Central bank make in the spring
- ❑ The ruble slipped through 2013 and looks set for further weakness in 2014 as the CBR cuts rates, the government is forced into some stimulus actions and as the CBR prepares for a full free float in early 2015.
- ❑ The Key Rate (CBR benchmark) is expected to be by 75 bps from the current 5.5% rate. CPI ended '13 at 6.5% but is still expected to reach 5.5% by end '14.
- ❑ The Federal Budget may run a deficit of up to 1.0% of Urals averages \$95 p/bbl this year. But the country's Balance Sheet is in very good shape.
- ❑ The main concern is the continuing high level of capital flight and the shrinking Current Account.
- ❑ The government is expected to step up efforts to eliminate tax avoidance/evasion this year but should not change personal/corporate taxes or VAT. Taxes on alcohol and tobacco will rise.

	2009	2010	2011	2012	2013(F)	2014(F)
GDP, Nominal, \$ bln	\$1,219	\$1,478	\$1,950	\$2,010	\$2,075	\$2,160
Growth, real % YoY	-7.8%	4.5%	4.3%	3.4%	1.4%	1.9%
Industrial Production, real % YoY	-9.3%	8.2%	4.7%	2.6%	-0.1%	0.5%
Retail sales, % YoY	-5.5%	4.4%	7.2%	5.9%	3.9%	4.0%
Budget, balance % of GDP	-5.9%	-4.0%	0.8%	0.0%	-0.4%	-1.0%
CPI - Year end, % YoY	8.8%	8.8%	6.1%	6.6%	6.5%	5.7%
PPI - Year end, % YoY	13.9%	16.7%	12.0%	5.1%	2.5%	3.5%
Lending, average, %	15.3%	10.8%	8.5%	9.1%	10.0%	9.0%
Deposit, average, %	8.6%	6.0%	4.4%	5.5%	5.0%	4.5%
Real disposable income, % YoY	1.9%	4.3%	0.4%	4.2%	3.5%	2.0%
Nominal monthly wages (Rub p/m)	18,800p.	21,100p.	23,500p.	26,700p.	30,000p.	33,000p.
Unemployment, %	8.4%	7.5%	6.6%	5.7%	5.5%	5.3%
Trade balance, \$ bln	\$111.6	\$151.7	\$198.2	\$193.3	\$175.0	\$155.0
Current Account, \$ bln	\$48.6	\$70.3	\$98.8	\$74.5	\$32.0	\$20.0
FDI, gross \$ bln	\$36.5	\$43.5	\$52.9	\$55.0	\$55.0	\$60.0
Capital Inflow/Outflow, \$ bln	-\$56.9	-\$33.6	-\$80.5	-\$56.8	-\$70.0	-\$40.0
Foreign public debt, \$ bln	\$44.3	\$46.6	\$49.3	\$70.0	\$76.0	\$85.0
Foreign private debt, \$ bln	\$425.4	\$442.1	\$492.6	\$567.8	\$660.0	\$700.0
Foreign public debt, % of GDP	3.6%	3.2%	2.5%	3.5%	3.7%	3.9%
Total foreign debt, % of GDP	38.5%	33.1%	27.8%	31.7%	35.5%	36.3%
Foreign exchange reserves (ex gold), \$ bln	\$417	\$444	\$454	\$487	\$475	\$475
Rub/\$, year end	30.0	30.9	31.4	30.8	32.9	36.0
Rub/Eur, year end	43.8	40.8	41.5	40.3	45.3	46.0
Average Urals, \$ p/bbl	\$61	\$78	\$109	\$110	\$108	\$95

Source: Federal Statistics Service, Central Bank of Russia, Sberbank-CIB, Macro-Advisory estimates

# Oil Price: stable for now

- ❑ Brent has averaged close to \$108 p/bbl for three straight years
- ❑ Medium term outlook is for little change
- ❑ Demand for oil is forecast to rise by an average of 1.2 million barrels per day in 2014 (same as last year)
- ❑ North American supply is rising fast and is expected to add 1.2 million barrels in 2014 (+1.3 mln in '13)
- ❑ But that extra supply is balanced by continuing supply disruptions in Sudan, Libya, Iraq
- ❑ The big question mark is when these issues will be resolved and when Iranian oil flows will increase?
- ❑ Supply problems may soon emerge in Venezuela and Nigeria
- ❑ Longer term the growth in Shale oil poses a problem for traditional oil producers – but a price collapse is unlikely as US oil costs are rising fast.
- ❑ Historically there is a close link between the value of the US dollar and the oil price.

World Oil Supply & Demand (daily million barrels), History & Forecast						
	2007	2008	2010	2012	2013(E)	2014(F)
<b>Supply</b>						
United States	7.4	7.7	7.8	9.2	10.3	11.3
Other North America	6.9	5.7	6.3	6.6	6.9	7.2
Europe	5.0	4.8	4.1	3.5	3.3	3.2
OECD Asia	0.6	0.6	0.7	0.6	0.5	0.5
<b>Total OECD Supply</b>	<b>19.9</b>	<b>18.8</b>	<b>18.9</b>	<b>19.9</b>	<b>21.0</b>	<b>22.1</b>
Russia	10.1	10.1	10.5	10.7	10.9	11.0
Other CIS	2.7	2.9	3.1	3.0	3.0	3.0
Other Non-OECD	15.0	15.4	15.6	15.8	15.7	16.2
<b>Total Non-OECD Supply</b>	<b>27.8</b>	<b>28.4</b>	<b>29.1</b>	<b>29.5</b>	<b>29.6</b>	<b>30.2</b>
Process Gains	2.5	3.4	3.9	4.0	4.2	4.2
OPEC NGLS	4.4	4.5	5.6	6.3	6.4	6.6
OPEC Crude	31.1	31.7	30.9	30.1	30.0	29.3
<b>Total World Supply</b>	<b>85.7</b>	<b>86.8</b>	<b>88.4</b>	<b>89.8</b>	<b>91.2</b>	<b>92.4</b>
<b>Demand</b>						
North America	25.5	24.2	24.1	23.7	23.8	23.9
Europe	15.3	15.4	14.7	13.7	13.7	13.6
OECD Asia	8.4	8.1	8.2	8.6	8.4	8.4
<b>OECD Demand</b>	<b>49.2</b>	<b>47.7</b>	<b>47.0</b>	<b>46.0</b>	<b>45.9</b>	<b>45.9</b>
Russia-CIS	4.1	4.2	4.2	4.5	4.6	4.7
China	7.6	7.7	8.8	9.6	10.2	10.6
Other Asia	9.5	9.7	10.9	11.4	11.6	11.9
LatAm	5.7	6.0	6.0	6.5	6.6	6.8
Mid East	6.5	7.2	7.3	7.6	7.8	8.0
Other	3.1	4.3	4.2	4.2	4.5	4.7
<b>Total Non-OECD Demand</b>	<b>36.5</b>	<b>39.1</b>	<b>41.4</b>	<b>43.8</b>	<b>45.3</b>	<b>46.7</b>
<b>Total World Average Daily Demand</b>	<b>85.7</b>	<b>86.8</b>	<b>88.4</b>	<b>89.8</b>	<b>91.2</b>	<b>92.6</b>
Source: International Energy Agency						

# 2013: Key Market Indicators

- ❑ Investor sentiment towards emerging markets remained poor because of US Fed tapering concerns and because of slowing growth, relative to historic trends
- ❑ Investors switched over \$12 bln from EM funds to Us equities last year
- ❑ Russian indices mainly followed the trend in EM markets
- ❑ US dollar denominated Russian indices lagged MICEX because of the ruble slide
- ❑ The CBR contained ruble weakness but it still lost due to concerns about the sliding economy and with contagion from EM currency weakness
- ❑ The widening of the yield gap in Russian debt was a pure contagion move with EM debt trends

EM Indices, Commodities and Currencies in 2013*		
	Index/Price*	2013 full year
RTS Index	1,442.2	-5.6%
MICEX Index	1,503.4	1.9%
RDX USD Index	1,712.9	-1.1%
Kazakhstan KASE	918.0	-5.3%
Ukraine UX	910.0	-4.3%
Turkey ISE	67,810.7	-14.9%
Shanghai Composite	2,116.0	-6.7%
India BSE	21,140.5	8.0%
Brazil Bovespa	51,507.2	-15.5%
MSCI EM Index	1,002.8	-5.0%
MSCI World Index	1,659.7	24.0%
S&P 500	1,848.4	29.6%
MSCI EMEA	328.4	-8.0%
MSCI Latin America	3,200.8	-15.7%
MSCI Asia	446.2	18.1%
MSCI Frontier Markets	594.5	27.8%
Copper, \$ p/lb	\$339.65	-7.0%
Brent, Fwd, \$ p/bbl	\$110.80	-0.3%
Gold, \$ p/oz	\$1,205.90	-28.0%
Rub/US\$	32.855p.	-8.0%
US\$/Eur	\$1.377	-4.3%
<b>Bond Yields</b>	<b>Jan 1 '13</b>	<b>End December*</b>
UST - 10 Yr Yield	1.77%	2.99%
Russia - Eurobond '28	3.83%	5.65%
Russia - Eurobond '30	2.55%	4.13%
OFZ - 10y		7.67%
Source: Bloomberg		
* prices at close December 31st - US\$ except where indicated		

# Stock & theme picking is key

- ❑ Even though the index performance was neutral through 2013, there was a very significant variation in price movement between the best and worst stocks.
- ❑ The fast growing IT and media sectors delivered very big double-digit price gains while the metals, especially gold producers, lagged very badly.
- ❑ The top five performers are all New York DR listings.

## Best and Worst Russia DRs in 2013\*

### Top Performers

### Laggards

QIWI*	229.4%	X5 Retail Group	-6.1%
Luxoft*	117.6%	Ukrnafta (Eur)	-7.5%
Yandex	100.3%	Novorossiisk Seaport	-8.8%
EPAM	93.0%	MD Medical	-9.4%
CTC Media	79.8%	Gazprom	-9.6%
Magnit	64.0%	Norilsk Nickel	-9.8%
Sistema	59.0%	TCS Group*	-10.3%
Megafon	40.8%	Tatneft	-12.3%
Chelyabinsk Zinc	30.2%	KazMunaiGas	-12.8%
Mail.Ru	29.3%	VTB	-13.4%
Eurasia Drilling	26.1%	Rosneft	-14.5%
AFI Development	25.2%	Novolipetsk	-16.6%
Raven Russia Plc (GBP)	25.2%	Severstal	-18.8%
Halyk Bank	25.0%	Ferrexpo (GBP)	-20.8%
Vimpelcom	23.4%	TMK	-23.0%
* prices at close December 31st - US\$ except where indicated			
** performance is from IPO listing price			



# Russian DRs: Top Ten for 2014

- ❑ Aeroflot      \$2.6 bln Mkt Cap...40% FF...national airline...good earnings growth...expected to be the first state privatization sale in 2014
- ❑ CTC Media      \$2.1 bln Cap...37% FF...TV station operator...good dividend yield and earnings growth
- ❑ Eurasia Drilling      \$6.7 bln Cap...34% FF...oil field services...double digit earnings growth expected
- ❑ Evraz      \$2.6 bln Cap...22% FF...steel maker...high dividend yield...high-beta play on global growth
- ❑ Gazprom  
good      \$95 bln Cap...40% FF...world's biggest gas producer...bad news reflected in low PE...dividend yield....may benefit from state efforts to cut spending waste and boost efficiency
- ❑ LSR Group      \$2 bln Cap...33% FF...house builder / building materials...strong earnings recovery in '14
- ❑ Novatek      \$40 bln Cap...22% FF...independent gas producer...LNG exporter from '15...eps growth
- ❑ PhosAgro      \$3.6 bln Cap...11% FF...fertilizer producer...strong earnings recovery in '14 ...high div yield
- ❑ X5 Retail      \$4.5 bln Cap...36% FF...food retailer...has lagged Magnit and is a lot cheaper...speculative
- ❑ Yandex      \$14 bln Cap...70% FF...biggest internet provider...still very fast segment of the economy

# New equity issuance 2012 - 2013

- ❑ The number and value of IPOs & SPOs exceeded the result of 2012.
- ❑ Only one formally launched IPO was pulled due to poor investor interest
- ❑ The state was involved in only one privatization issue - Alrosa

New Equity Issuance: IPOs, SPOs and Strategic Stake Sales* in 2012 & 2013					
	Total raised	Month		Total raised	Month
<b>2012 IPOs</b>			<b>2013 IPOs</b>		
RusPetro	\$265	January	Moscow Exchange	\$498	February
MD Medical	\$408	October	QIWI	\$213	May
Megafon	\$1,830	November	Luxoft	\$80	June
Multisistema	\$3	December	Alrosa	\$1,300	October
			TCS group	\$1,087	October
<b>Total IPOs</b>	<b>\$2,506</b>		<b>Total IPOs</b>	<b>\$3,178</b>	
<b>SPOs</b>			<b>SPOs</b>		
GlobalTrans	\$520	July	PhosAgro	\$467	April
Polyus Gold**	\$636	Q3	VTB	\$3,300	May
			PIK Group	\$330	June
			NMOS	\$600	October
<b>Total SPOs</b>	<b>\$1,156</b>		<b>Total SPOs</b>	<b>\$4,697</b>	
<b>Strategic Shareholder sales Sales</b>			<b>Strategic Shareholder sales Sales</b>		
Mail.ru	\$122	March	Yandex	\$607	March
Highland Gold	\$130	April	Eurasia Drilling	\$122	September
Sberbank	\$5,200	September	QIWI	\$288	October
M.Video	\$146	September	Luxoft	\$95	November
Mail.ru	\$408	September			
GlobalTrans	\$200	October			
<b>Total Strategic S/H sales</b>	<b>\$6,206</b>		<b>Total Strategic S/H sales</b>	<b>\$1,111</b>	
<b>Total Equity Issuance for 2012</b>	<b>\$9,868</b>		<b>Total Equity Issuance for 2013</b>	<b>\$8,986</b>	
Source: Macro-Advisory estimates					
* equity sales excludes sales from one strategic shareholder to another strategic shareholder					
** sale of 7.5% of Treasury shares to CIC/VTB					

# Performance in '13 – Expected in '14

- ❑ New equity issuance in 2013 performed very well. Partly because issuers have learned to do better due diligence and listen to potential investors. Partly because those new issues are in the faster growing sectors of the economy, e.g. technology and media.
- ❑ The state's previously ambitious privatization programme has been considerably delayed and little is expected in 2014
- ❑ The likely volume & value of private shareholder issuance is completely dependent on market conditions and investor interest. Some potential issuers have made their interest known (list below) but the total value of all issuance waiting for the right time is thought to be circa \$25 bln.

## Performance of IPOs/SPOs in 2013

### Planning an IPO in 2014\*

Obuv Rossii	Shoe manufacturer
Metro	Cash & Carry business
Lenta	Food retailer
Rostelecom	Fixed line telecoms
Aeroflot	Airline
Bashneft	Oil producer – targeting a London listing
IGSS	Seismic Exploration business
Detsky Mir	Children's Toys retailer – maybe 2014 or 2015
Rosnano	Technology developer...part of privatization programme

Issue	IPO/SPO	Price - Dec 31st	Issue Price	Gain/Loss
QIWI	IPO - May	56.00	17.00	229%
Luxoft	IPO - June	37.00	17.00	118%
PIK Group	SPO - June	2.32	1.90	22%
VTB	SPO - May	0.05	0.04	21%
Moscow Exchange	IPO - February	64.75	55.00	18%
NMOS	SPO - October	960.00	875.00	10%
Alrosa	IPO - October	35.00	35.00	0%
TCS group	IPO - October	15.70	17.50	-10%
PhosAgro	SPO - April	9.79	14.00	-30%
Source: Macro-Advisory, Bloomberg				

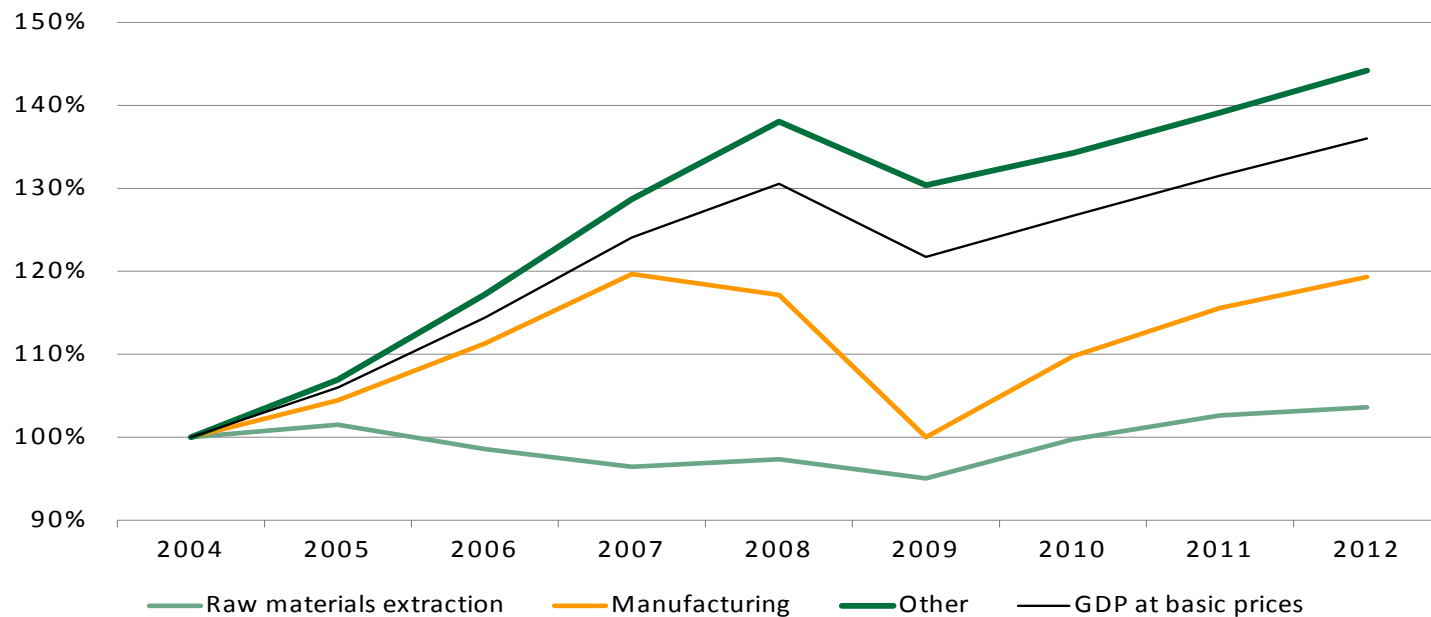
\* According to a public statement made by an executive or owner

# Evolution of growth drivers

- ❑ In Putin's first term (2000-'04) as president the main source of growth was the combination of rising oil & gas wealth plus the low base-effect from the 1990's
- ❑ In Putin's 2<sup>nd</sup> term (2004-'08) the main growth driver was the rapid increase in disposable income and real wages. This drove a very significant consumer led boom.
- ❑ The global crisis in late 2008 impacted severely in Russia and led to a credit crisis and recession in 2009
- ❑ 2009-2010 was a significant turning point as a series of crisis exposed the fragile infrastructure and the need for much greater investment and efficiency
- ❑ 2012 and 2013 have been "lost years" as the government preferred relative domestic stability over real reforms against the backdrop of global contagion risk
- ❑ Policy inconsistencies, declining confidence, slowing investment plus "too slow" reform progress have now stalled economic growth.
- ❑ The need for a new growth model is now obvious and will have economic, social and political consequences if not achieved. There is a greater sense of urgency today.

# Extractive industries contribute little

- ❑ Consumption and services expansion have been much more important drivers of overall growth since 2004
- ❑ A conservative budget policy has cut the direct role of hydrocarbon revenues as a growth driver



# Advantages: strong balance sheet

- ❑ Russia has the world's fourth largest financial reserves and total sovereign debt is just under 10% of GDP... total sovereign foreign debt is at 3.5%.
- ❑ The federal budget was in surplus in 2011, balanced in 2012 and is set for a small (-0.4% of GDP) deficit this year.
- ❑ The budget "fiscal rule" caps the amount of oil revenue which may be spent by the budget, with any surplus going to savings. The plan is to cut the non-energy budget deficit from 11% (of GDP) to 5% by end of this decade
- ❑ The budget assumes an average oil price of \$93 p/bbl (Urals) for '14 and \$95 p/bbl in '15/'16. But, to balance, the budget needs an average of \$108 p/bbl in '14; at \$115 p/bbl in '15 and \$109 p/bbl in '16.
- ❑ Russia's "Sovereign Wealth Fund" is divided into a budget "rainy day" *Reserve Fund* and a *Wellbeing Fund*. Both hold just under \$90 bln each. The *Wellbeing Fund* is to made available to help part fund major infrastructure projects planned ahead of the 2018 FIFA World Cup.
- ❑ The Russia Direct Investment Fund (R.D.I.F.) has attracted significant commitments from sovereign wealth funds in 2013 for co-investment projects mainly in infrastructure

# Advantages: consumer will still grow

- ❑ The consumer boom has ended but growth should still be above the EU average. Consumption and debt statistics are still well below EU averages except for mobiles
- ❑ Salaries are still rising in real terms, albeit this is not a good trend overall.
- ❑ Russia has the largest consumer base in Europe with a total population of almost 143 million and 55 million households. Plans for the Customs Union may raise the populating base to over 200 million. Russia is the world's fifth biggest consumer market, by spending volume.
- ❑ Retail spending totalled just under \$700 bln last year. More than 50% was non-food
- ❑ Based on the OECD definition of Middle Class, 55% of Russian households are in that category compared to 30% in Brazil, 21% in China and 11% in India. Wealthy households are also more numerous with 15% of Russian households boasting annual income above \$50,000 compared to 5% in Brazil, 2% in China and 1% in India
- ❑ Russia's GNI coefficient \*(41.7) is better than in Brazil, China or the US (45) but is well below the EU average (30.4)

# Stable politics

- ❑ President Putin's approval rating has remained stable throughout 2013
- ❑ Survey's show that people are becoming more concerned about the future direction of the economy and the country
- ❑ President Putin opened a dialogue with the non-parliamentary opposition parties for the first time
- ❑ December's "constitutional amnesty" and the pardon of Khodorkovsky are viewed positively at home and abroad
- ❑ President Putin's international standing markedly improved through 2013

Approval Ratings for President and Prime Minister										
	Jan '12	July '12	Oct '12	Nov '12	Dec '12	Mar '13	May '13	Oct '13	Nov '13	Dec '13
<b>Vladimir Putin</b>										
Approve	64%	67%	67%	63%	65%	63%	64%	64%	61%	65%
Disapprove	34%	32%	32%	36%	34%	36%	35%	35%	37%	34%
<b>Dmitri Medvedev</b>										
Approve	57%	59%	61%	54%	57%	54%	54%	51%	46%	51%
Disapprove	41%	39%	38%	45%	42%	45%	46%	49%	53%	47%
<i>Source: Levada Center</i>										



# Cabinet changes are possible

- ❑ Polls show a decline in support for the PM...mostly due to the weakening economy
- ❑ A majority of people expect a weak economy again in 2014 and are saving or delaying spending in the meantime
- ❑ There continues to be a lot of speculation about Cabinet changes in the spring...this is possible but only very likely if the economy suffers further deterioration in Qtr 1

Trusted Politicians		Jan '12	Mar '12	Sept '12	Dec '12	Mar '13	Oct '13	Nov '13	Dec '13
Putin	President	41%	44%	36%	34%	35%	33%	32%	36%
Medvedev	Prime Minister	28%	28%	23%	19%	17%	14%	11%	14%
Shoigu	Defense Minister	11%	9%	10%	14%	18%	17%	19%	19%
Zyuganov	Leader Communist Party	12%	14%	8%	8%	9%	10%	8%	9%
Zhirinovskiy	Leader LDPR	12%	9%	8%	8%	9%	8%	9%	8%
Prokhorov	Businessman-Independent politician	4%	8%	5%	4%	6%	5%	5%	5%
Patriarch Kirill	Head of Church	7%	5%	6%	3%	3%	3%	2%	4%
Matveenko	Leader of the Federation Council	5%	4%	4%	4%	4%	3%	3%	3%
Lavrov	Foreign Minister				4%	5%	5%	5%	6%
Sobyanin	Moscow Mayor				5%	2%	6%	4%	5%
Mironov	Founder member of A Just Russia	8%	6%	4%	3%	4%	4%	3%	3%
None of the above		17%	15%	22%	20%	20%	22%	25%	20%
No opinion		5%	4%	10%	9%	6%	6%	6%	7%
Source: Levada Center									

# Reforms: progress over past 18 mths\*

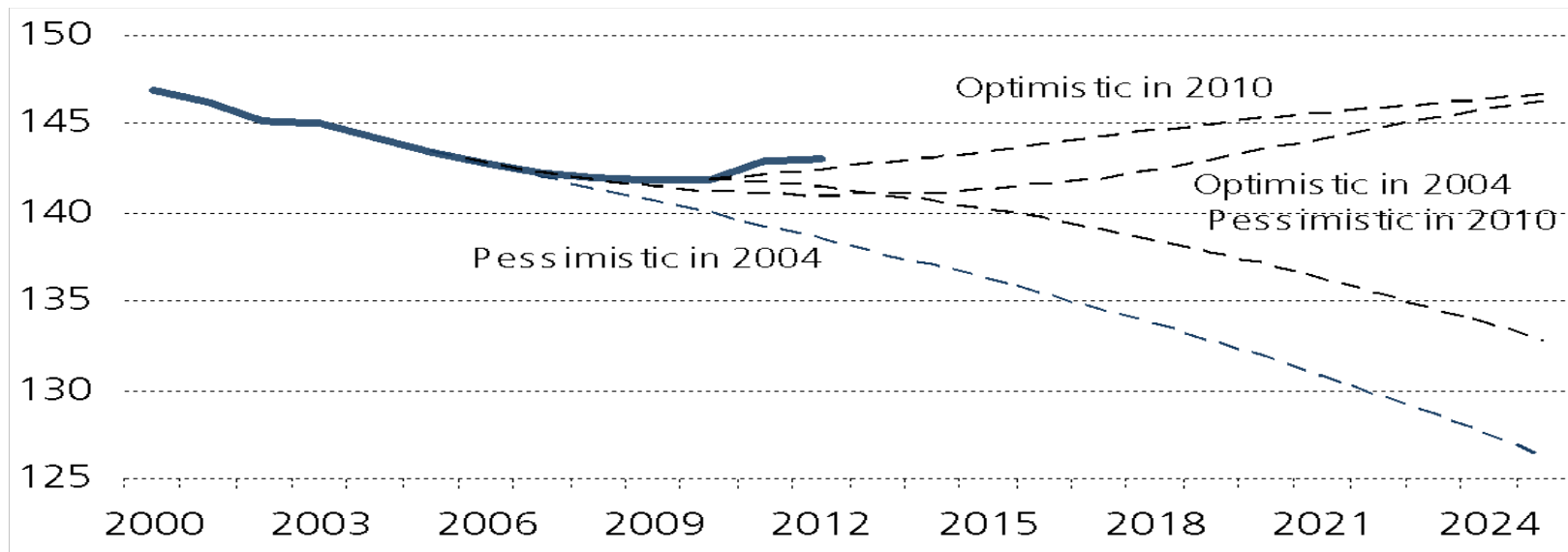
- ❑ WTO membership (August 2012) was a big step forward.
- ❑ The business amnesty, aimed at releasing those convicted of minor “white-collar” crimes was signed this spring
- ❑ Russia’s ranking in the World Bank’s Ease of Doing Business Survey rose from 111<sup>th</sup> (last year) to 92<sup>nd</sup> this year. The target is set at 20<sup>th</sup> by 2020.
- ❑ Customs procedures have been improved. Some visa procedures have been eased.
- ❑ There is a much more visible campaign against corruption – state officials now have a much higher standard of disclosure to adhere to
- ❑ Russia has achieved relatively good fiscal and monetary stability...the budget fiscal rule should prevent future over-reliance on oil revenues
- ❑ Financial sector and capital market reforms have already had very positive results
- ❑ The Customs Union (Russia, Kazakhstan and Belarus) is set to expand to a Eurasian Union in 2015...Armenia and Kyrgyzstan have agreed to join.....Ukraine is possible.

*\* Start of current presidential term*

# Dramatic change to demographics

- ❑ Russia reported a natural population increase in 2013 – the first time since 1991.
- ❑ The birth rate has increased, people are living longer and general health is improving
- ❑ Immigration has been an important factor in recent years
- ❑ Workforce demographics is still a problem which will require retirement/pensions changes plus changes to net immigration policies.
- ❑ But the outlook is a lot less dire than was expected even five years ago.

***Previous fears of a shrinking Russia are no longer valid***



# Slowly improving bureaucracy

- ❑ Still a long way to go in some areas...but Russia is placed higher than Brazil, India or China in 2014

World Bank Ease of Doing Business Survey - Breakdown of Russia Ranking 2013 & 2014								
	2013*	2014		2013*	2014		2013*	2014
<b>Starting a new business</b>			<b>Registering Property</b>			<b>Getting credit</b>		
Rank	100	88	Rank	46	17	Rank	105	109
Procedures	8	7	Procedures	5	4	Disclosure Index (0-10)	3	3
Time (days)	18	15	Time (days)	44	22	Depth of credit Info (0-6)	5	5
Cost (% of income p/capita)	2.0%	1.3%	Cost (% of income p/capita)	0.2%	0.1%	Public registry coverage (% of adults)	0.0%	0.0%
Minimum Capital (% income p/capita)	1.4%	1.2%				Private registry (% of adults)	45.4%	59.2%
<b>Construction permits</b>			<b>Enforcing contracts</b>			<b>Protecting investors</b>		
Rank	180	178	Rank	10	10	Rank	113	115
Procedures	42	36	Procedures	36	36	Extent of disclosure (0-10)	6	6
Time (days)	344	297	Time (days)	270	270	Extent of Director liability (0-10)	2	2
Cost (% of income p/capita)	129.2%	89.0%	Cost (% of income p/capita)	13.4%	13.4%	Ease of Sharholder suits (0-10)	6	5
						Strength of investor protection(0-10)	4.7	4.7
<b>Getting electricity</b>			<b>Paying Taxes</b>			<b>Trading across borders</b>		
Rank	188	117	Rank	63	56	Rank	162	157
Procedures	10	5	Payments per year	7	7	Documents to export	8	9
Time (days)	201	162	Time (hours)	177	177.0%	Days to export	21	22
Cost (% of income p/capita)	1573.7%	293.8%	Total tax payment	54.1%	50.7	Cost to export (\$ p/container)	\$2,820	\$2,615
						Documents to import	11	10
						Days to import	36	21
						Cost to import (\$ p/container)	\$2,920	\$2,810
Source: IFC, World Bank. Ease of Doing Business report			* 2013 rankings and scores have been revised					

# Reforms: more progress is needed

- ❑ The perception is of Russia as a difficult and dangerous place to do business,
- ❑ The cost of doing business in Russia (e.g. rising wages) is rising in real terms
- ❑ Russia has a high % of people with university degrees ... but too many are emigrating
- ❑ Interest rates are too high and access to domestic sources of capital is still difficult
- ❑ The percentage of SMEs in the economy is too small...planned incentives are modest
- ❑ The privatization programme continues to move far too slowly.
- ❑ Workforce demographics & pensions reform are set to become a major issues
- ❑ OECD membership timetable is still too vague.
- ❑ Proposals to merge senior courts and to allow law enforcement agencies to open tax investigations are viewed with concern by the business community

# State investment priorities

- ❑ Infrastructure spending is a key priority and will get a boost from the 2018 World Cup preparations...but PPP legislation needs to be improved
- ❑ Agriculture and food manufacturing have been identified as strategic priorities with the aim of greatly cutting food imports. Agriculture machinery is already a big and growing market.
- ❑ Similarly with Pharmaceuticals
- ❑ Leisure, Healthcare and Education sectors
- ❑ Transport and logistics
- ❑ Oil field services will get a boost from the expected increase in Brownfield capex
- ❑ JV's with the state enterprises in the so-called strategic sectors, e.g. shipbuilding.
- ❑ Regional employment projects are also a state priority and incentives for start-ups or JVs are expected to be more available in the coming years.
- ❑ **Note: Some of Russia's regions have made significant progress in improving the business climate and have attracted a lot of inward investment**

# What's next?

- ❑ Expect a much more vigorous fiscal and monetary policy debate after the Sochi games end. It is now accepted, at the very top of government & for the first time, that new growth measures are needed.
- ❑ The main problem has been the Kremlin's reluctance to support changes which may be short-term painful and which may lead to a drop in public support or create uncertainty.
- ❑ But there are a number of factors which can act as catalysts for the reform agenda;
  - ❑ *Major international events to be hosted in Russia*
  - ❑ *The economy is likely to play a bigger role in the next election cycle*
  - ❑ *The emerging middle class in Russia and lifestyle changes*
  - ❑ *Russia's existing infrastructure has been starved of investment for far too long and cannot be ignored*
  - ❑ *The growth of Shale (oil and gas) presents a long-term threat to traditional O&G revenues*
  - ❑ *Russia wants to join the OECD. Entry terms are very vigorous.*
  - ❑ *Tariff and competition changes as a result of WTO membership start to "kick in" after 3 years (from Aug '12)*
- ❑ Key dates ahead for Russia include;
  - ❑ February 2014      Sochi Olympics (7<sup>th</sup> – 23<sup>rd</sup>) followed by Paralympics in March
  - ❑ June 4-5          Annual G8 summit in Sochi
  - ❑ 2015                Plans to evolve the Customs Union into a larger Eurasian Union.
  - ❑ April/May 2016    International Ice Hockey World Championship in Russia
  - ❑ December 2016    Duma elections
  - ❑ March 2018        Presidential election
  - ❑ Summer 2018      FIFA World Cup in Russia. 11 host cities.
  - ❑ 2019                Winter University Games in Krasnoyarsk

# Macro history & forecasts\*

	2000	2004	2007	2008	2009	2010	2011	2012	2013(F)	2014(F)	Possible change factors
<b>Key Indicators</b>											
GDP, Nominal, \$ bln	\$251	\$591	\$1,299	\$1,660	\$1,219	\$1,478	\$1,950	\$2,010	\$2,075	\$2,160	
Growth, real % YoY	10.0%	7.1%	8.5%	5.2%	-7.8%	4.5%	4.3%	3.4%	1.4%	1.9%	Towards +3% if the right policy actions are taken in the spring
Industrial Production, real % YoY	11.1%	6.4%	6.8%	0.6%	-9.3%	8.2%	4.7%	2.6%	-0.1%	0.5%	
Private Consumption, real % YoY			14.3%	10.6%	-4.8%	5.1%	6.4%	6.6%	3.5%		
Gross fixed investment, real % YoY	17.7%	11.7%	21.0%	10.6%	-14.4%	5.8%	10.2%	6.0%	-0.1%	1.6%	Could be higher if lending rates are cut and confidence grows
Retail sales, % YoY	9.0%	13.3%	16.0%	13.5%	-5.5%	4.4%	7.2%	5.9%	3.9%	4.0%	Could be higher if lending rates are cut and confidence grows
Budget, balance % of GDP	1.4%	4.3%	5.4%	4.1%	-5.9%	-4.0%	0.8%	0.0%	-0.4%	-1.0%	
CPI - Year end, % YoY	20.2%	11.7%	11.9%	13.4%	8.8%	8.8%	6.1%	6.6%	6.5%	5.7%	
CPI - average, % YoY			9.1%	14.1%	11.7%	6.9%	8.6%	5.1%	6.5%	6.0%	
PPI - Year end, % YoY			21.0%	-7.0%	13.9%	16.7%	12.0%	5.1%	2.5%	3.5%	
PPI - average, % YoY			15.7%	21.7%	-7.2%	14.9%	17.3%	6.8%			
<b>Commercial Bank Rates</b>											
Lending, average, %			10.0%	12.2%	15.3%	10.8%	8.5%	9.1%	10.0%	9.0%	
Deposit, average, %			5.5%	5.7%	8.6%	6.0%	4.4%	5.5%	5.0%	4.5%	
<b>Social Indicators</b>											
Real disposable income, % YoY			11.9%	1.9%	1.9%	4.3%	0.4%	4.2%	3.5%	2.0%	May rise higher if the economy expands towards +3%
Real wage growth, % YoY			15.8%	11.0%	-2.7%	4.4%	4.1%	8.6%	5.5%	4.5%	
Nominal monthly wages (Rub p/m)			13,600p.	17,100p.	18,800p.	21,100p.	23,500p.	26,700p.	30,000p.	33,000p.	
Unemployment, %			6.5%	6.2%	8.4%	7.5%	6.6%	5.7%	5.5%	5.3%	
GDP Per Capita, \$'000	\$1,725	\$4,118	\$9,206	\$11,773	\$8,639	\$10,475	\$13,830	\$14,205	\$14,561	\$15,158	
<b>Trade &amp; flow indicators</b>											
Trade balance, \$ bln			\$128.7	\$179.7	\$111.6	\$151.7	\$198.2	\$193.3	\$175.0	\$155.0	
Current Account, \$ bln	\$46.3	\$60.0	\$76.6	\$102.3	\$48.6	\$70.3	\$98.8	\$74.5	\$32.0	\$20.0	The shrinking C/A surplus through 2013 is a big concern
FDI, gross \$ bln	\$4.4	\$9.4	\$55.1	\$75.0	\$36.5	\$43.5	\$52.9	\$55.0	\$55.0	\$60.0	
Capital Inflow/Outflow, \$ bln			\$81.7	-\$132.8	-\$56.9	-\$33.6	-\$80.5	-\$56.8	-\$70.0	-\$40.0	The lower figure assumes better domestic confidence in 2H 14
<b>Debt &amp; Reserves</b>											
Foreign public debt, \$ bln	\$144.0	\$98.0	\$46.4	\$32.7	\$44.3	\$46.6	\$49.3	\$70.0	\$76.0	\$85.0	
Foreign private debt, \$ bln			\$419.0	\$452.0	\$425.4	\$442.1	\$492.6	\$567.8	\$660.0	\$700.0	
Foreign public debt, % of GDP	57.4%	16.6%	3.6%	2.0%	3.6%	3.2%	2.5%	3.5%	3.7%	3.9%	
Total foreign debt, % of GDP			35.8%	29.2%	38.5%	33.1%	27.8%	31.7%	35.5%	36.3%	
Foreign ex change reserves (ex gold), \$ bln	\$28	\$125	\$465	\$413	\$417	\$444	\$454	\$487	\$475	\$475	
Rub/\$, average	28.1	28.8	25.6	24.9	31.8	30.4	29.4	31.1	31.9		
Rub/\$, year end			24.6	28.2	30.0	30.9	31.4	30.8	32.9	36.0	Weakest period is likely to be late spring-summer as
Rub/Eur, average			35.0	36.4	44.2	40.3	40.9	39.9			government shifts policy priority to growth
Rub/Eur, year end			35.8	38.0	43.8	40.8	41.5	40.3	45.3	46.0	implies \$/E at 1.38 end this year and 1.28 end 2014
Average Urals, \$ p/bbl	\$29	\$38	\$69	\$95	\$61	\$78	\$109	\$110	\$108	\$95	Watch for production trends in Iran/Iraq/Libya/Africa generally.

Source: Federal Statistics Service, Central Bank of Russia, Sberbank-CIB, Macro-Advisory estimates



# Who we are

*Macro-Advisory provides a bespoke consulting service for investors and companies who want to better understand the business and investment trends, opportunities and risks in Russia and across the C.I.S.*

*The two senior partners have a combined 35 years of Russia & CIS experience*



The image shows a brochure with a city skyline at night. Below the skyline, the text reads: "Moscow is building one of the largest Financial Service Centers in Europe". Below this, there are four small square icons arranged in a 2x2 grid. The main heading "CONTACT US" is in bold. Below it, the address is listed: "Myasnitskaya 24/7", "Dom 3-4/4", "Moscow 10100", "Russian Federation". The email address "Email: info@macro-advisory.com" and the telephone number "Telephone: +7 916 349 2039" are also provided. The background of the brochure features a grid of squares in shades of brown and blue.

**Moscow is building one of the largest  
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