



Current Russian Business Environment - A Finnish Perspective

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Helsinki, 18.3.2015

EAST OFFICE OF FINNISH INDUSTRIES OY



- Founded in 2008 to strengthen our shareholders' business in Russia
- 24 leading shareholders
- Represents around 80% of all investments made in Russia by Finnish companies
- Finnish Ministry of Foreign Affairs as a partner (*Public Private Partnership*)
- Offices in Helsinki and Moscow (and soon in Saint Petersburg)



Minister of Education Andrei Fursenko, Konecranes' CEO Pekka Lundmark, UPM Vice President Hans Sohlström and Admiral Juhani Kaskeala at East Office board meeting, Moscow, 2010



Fortum CEO Tapio Kuula, YIT Vice President Kari Kauniskangas, Ambassador Matti Anttonen and Rosnano's CEO Anatoly Chubais in Moscow, 2010

Russian Strategy of Shareholders

2014

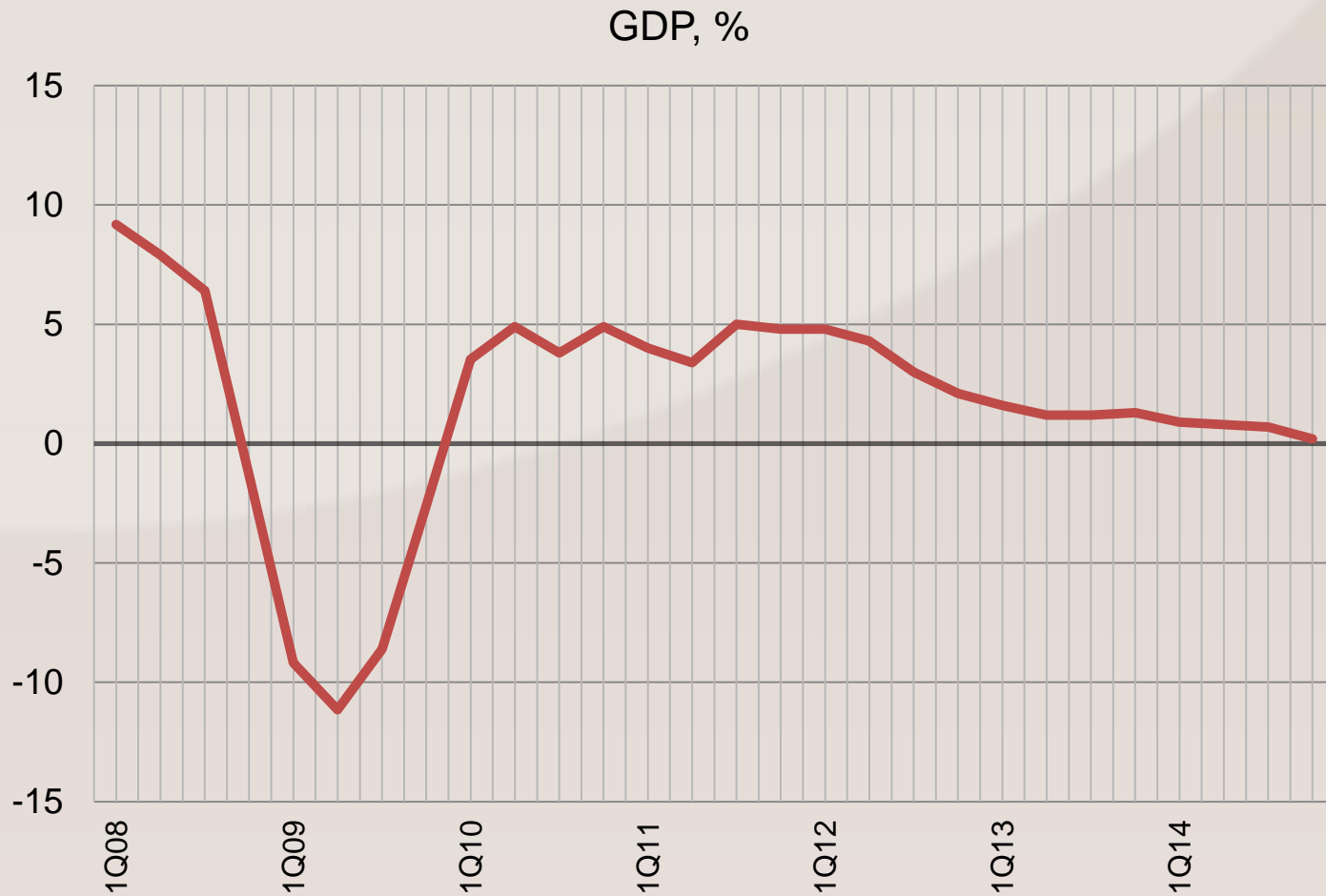
2013

	1	2	3	4	5
1. Sales 1H2014 vs 2013			2,9	3,2	3,4
2. Market Share 12 mos			3,0	3,3	
3. Domestic (1) vs. foreign (5) competition?			2,6	2,9	
4. Sales expectations 2H2014-1H2015			2,7	3,6	
5. Sales vs other markets			2,8	3,7	4,0
6. Investments in Russia		2,1	3,1	3,3	

(1 = poor/less, 5 = better/more)

- **Lower sales in 2014**
 - Market share unchanged
- **Domestic competition on the rise**
- **Expectations down**
- **Interest in Investing more to Russia**
 - 2012 five invested more, 2013 only two
 - 2014 nobody

The Trend started long before Maidan...

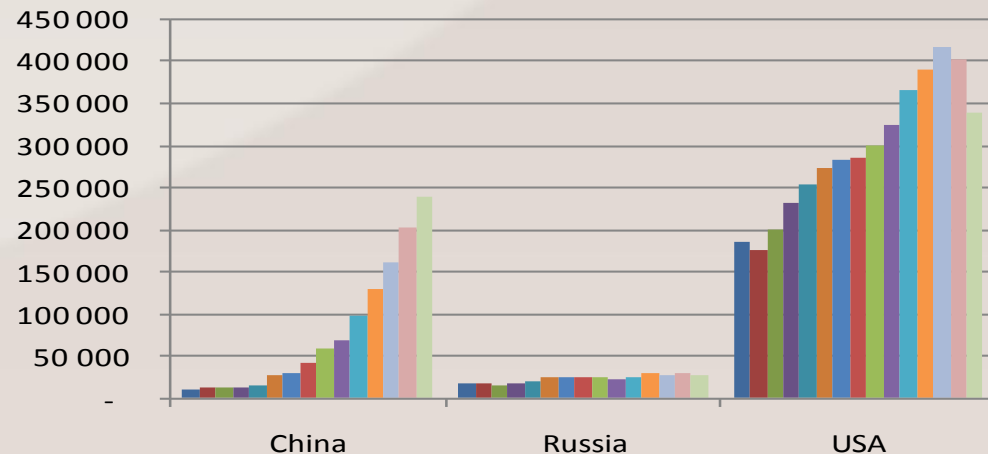


Source: Rosstat

Problems to solve

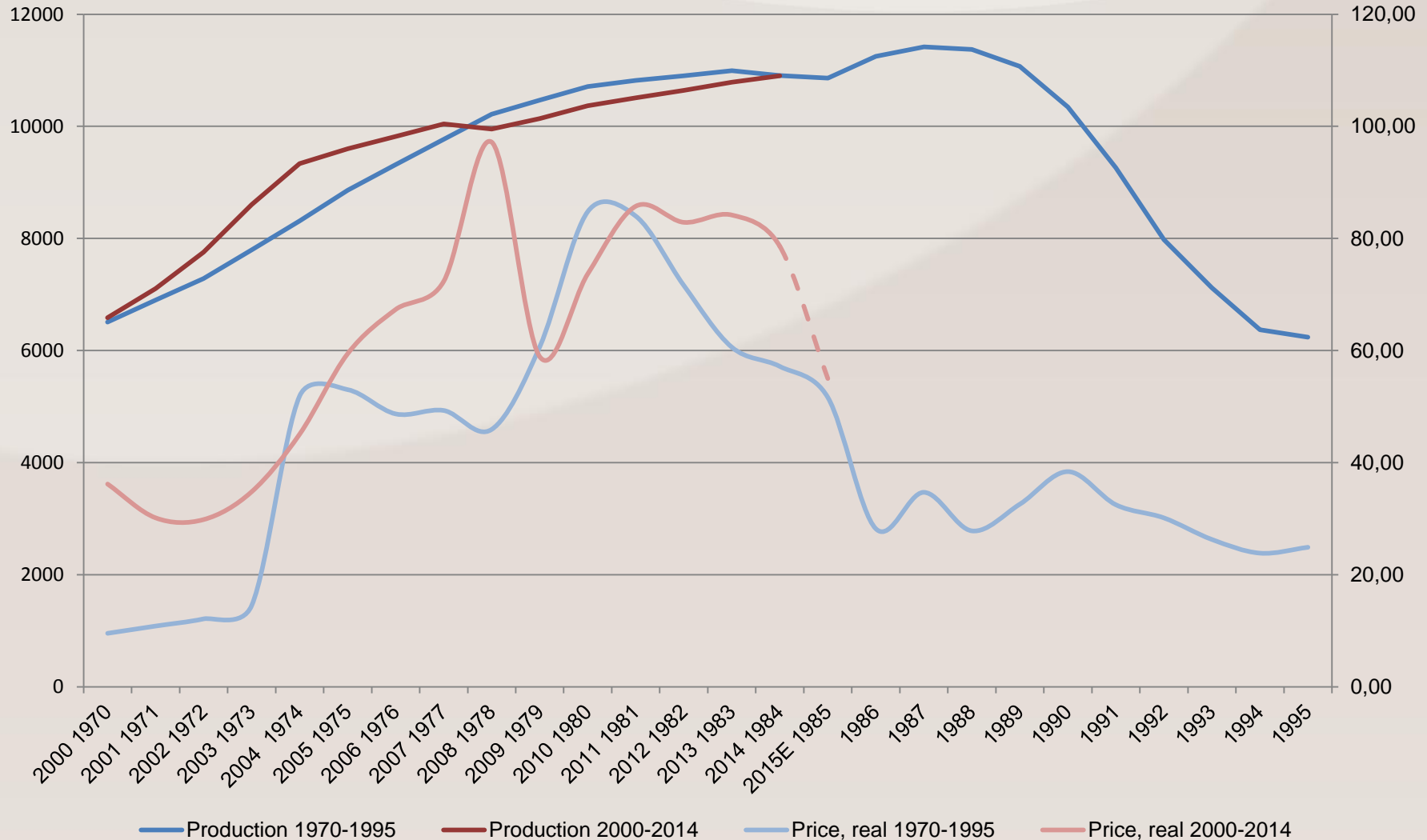
- Dependency on Raw Material exports
- Demografy issues
- Bureaucracy, Corruption , Political risks, True Competition

Patent applications by country of origin, 1995-2009



IMPORTANT: Problems in the Banking and Finance Sector!

Price of Oil ...production in Russia



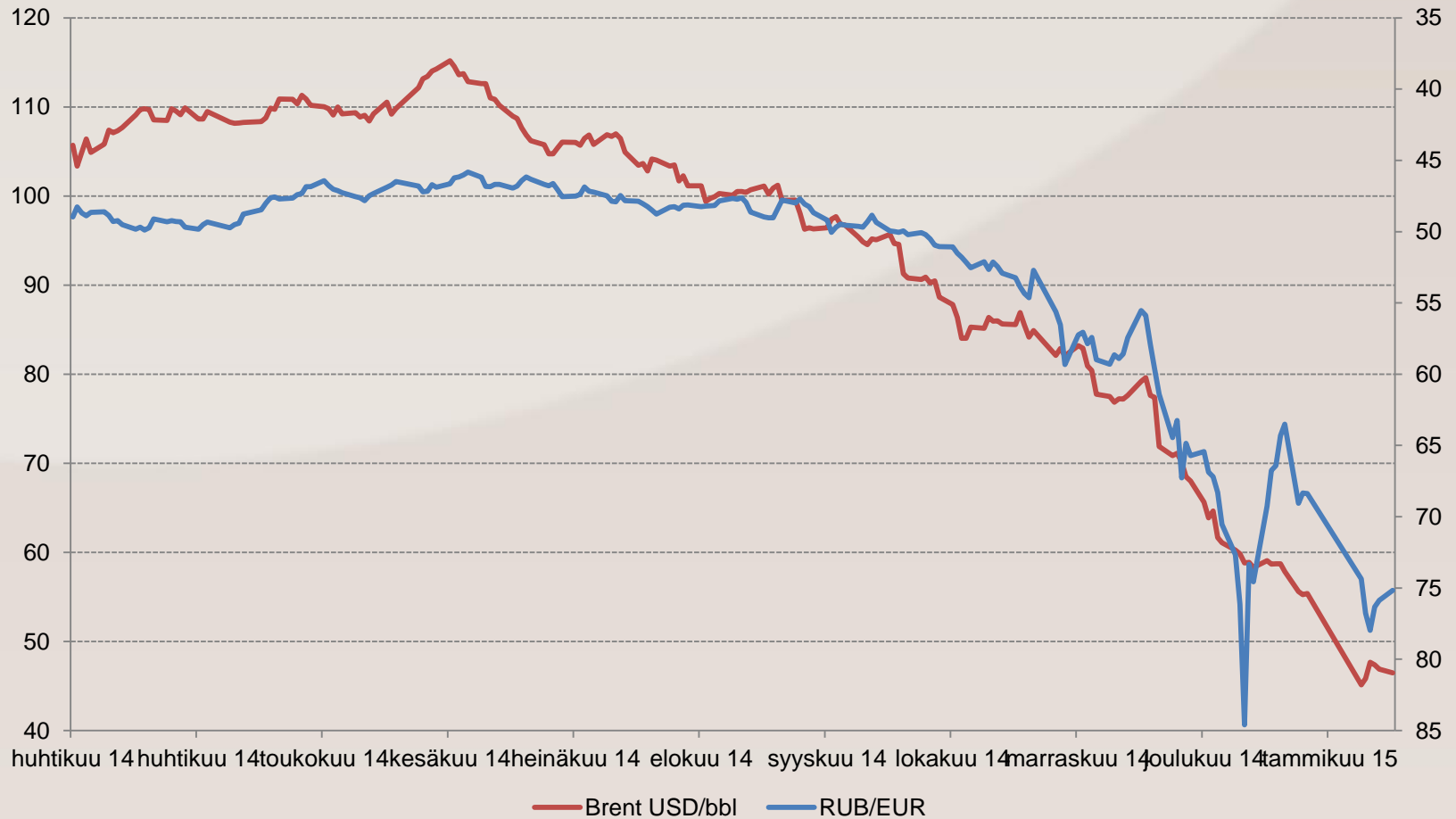
Higher production costs for oil



Sanctions and Business Environment

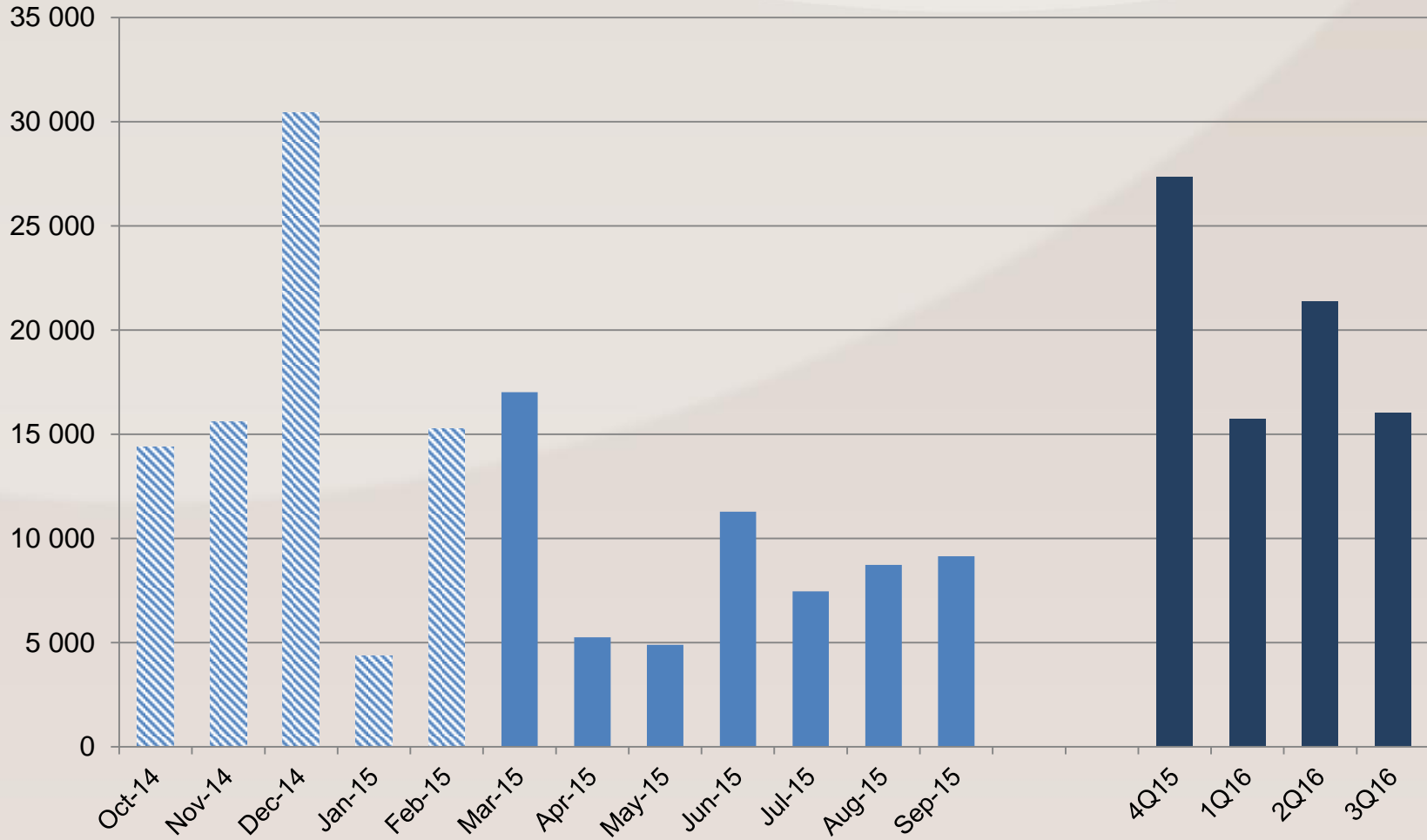
- Sanctions do work, but not quite as planned...
- Russian sanctions, purpose and reality
 - Rising costs of agriproducts and inflation
- EU&US: Lack of finance from abroad
 - Change in foreign debt last year. 732 mrd USD -> 599 Mrd. (around 450 mrd in foreign currency)
 - Currency reserves now 380 mrd USD and Trade Balance is positive
- S&P and Moody's downgrades Russia to Junk > effects?
- New Sanctions?

RUB and Oil



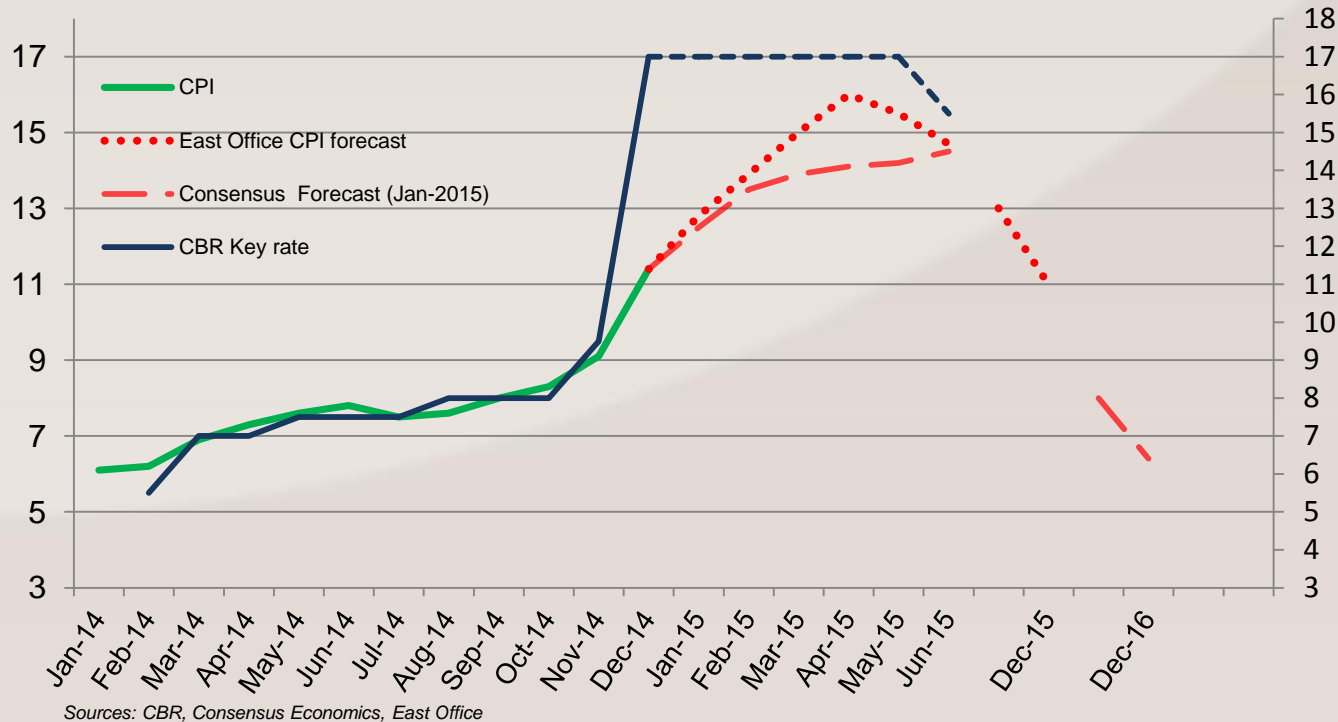
Foreign Debt Repayment Schedule

USD mln



Source: CBR 1.10.2014

Inflation



- Foodstuff 2014 15,7 %
- Devaluation, Import ban and restrictions
- High interest rates

Foreign Trade

- 1-11 2014 down 5,2 %, Trade Balance 57 bn USD surplus
- 40% Devaluation effects in 2015?
 - Import prices -40 – -50 % higher?
 - Export more competitive, production in Russia lucrative?
- Structural changes possible?
 - A long and rocky road...

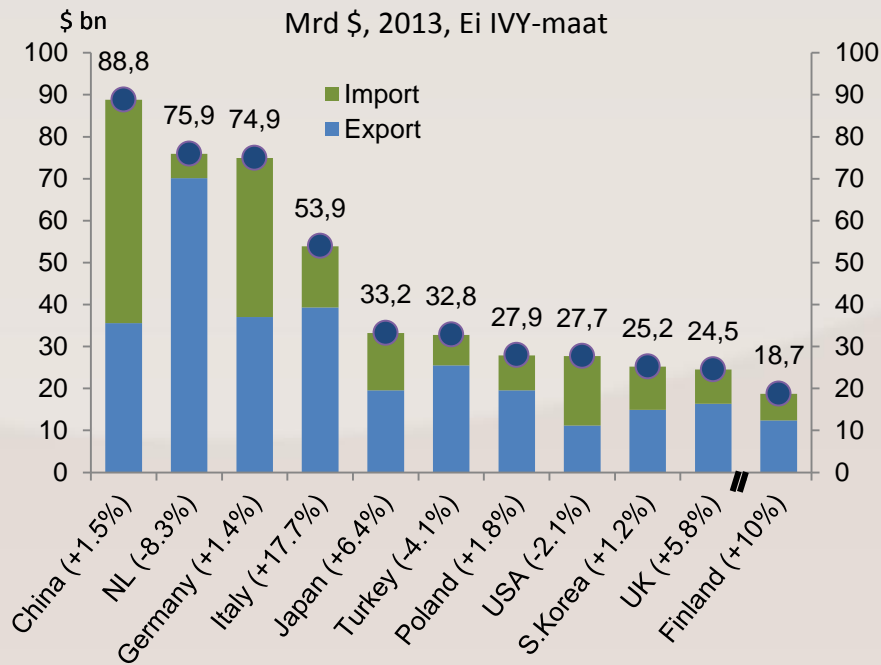
Russian population



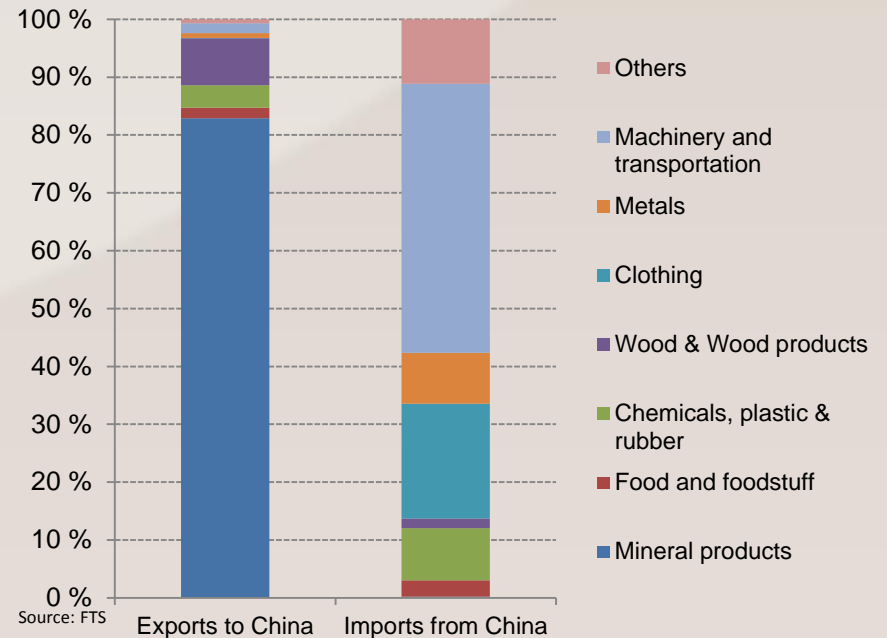
«Federal subjects of Russia by population density 31.01.2010» участника собственная работа. Original uploader was Алексей Глушков at ru.wikipedia - Russia - blank map (2009-01).svg. Под лицензией Общественное достояние с сайта Викисклада - https://commons.wikimedia.org/wiki/File:Federal_subjects_of_Russia_by_population_density_31.01.2010.svg#mediaviewer/File:Federal_subjects_of_Russia_by_population_density_31.01.2010.svg

China and Russia

Biggest trading partners

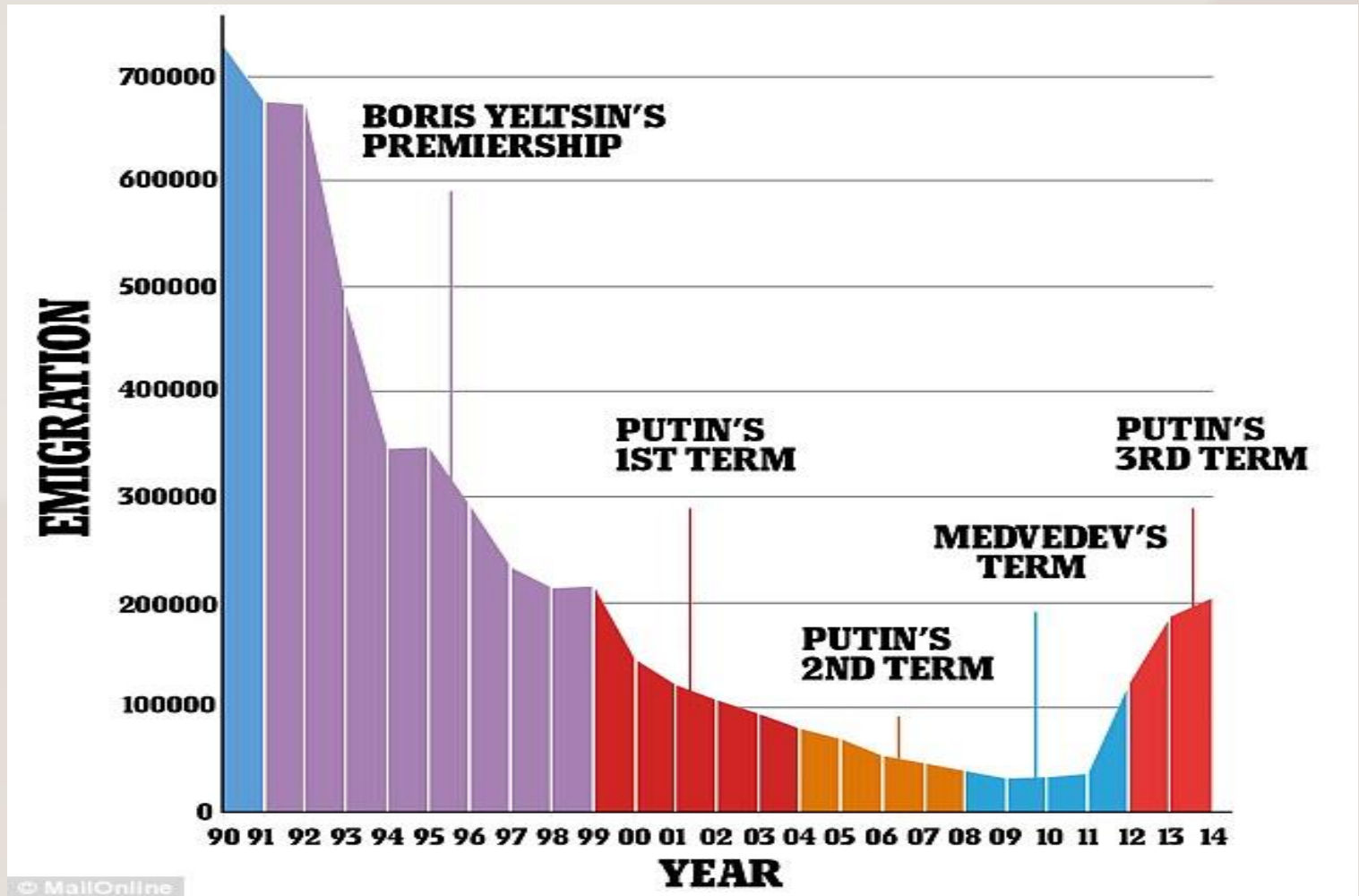


Structure of Trade



2014 export to China + 4,9 %, Import from China 8,2 %.
China represents 11 % of Russian Trade. (EU 48 %)

Brain Drain



Government plan to save the economy from 280115

- Structural change of economy, stability (leading companies), labour market balance, inflation and softening the effect of inflation
- Support to companies which replace imports. Defence and hightech.
- Small and Medium sized companies get support. Taxes and Bureacracy. Regional Taxes etc.
- Compensation to pensioners and families with children. RUB20.000 one off. Inflation fix on pensions and index on 2014 level.
- Support to banks and a Trash bank to be established. 250bn RUB to capitalize banks (3.3 bn EUR).
- Finance to Real Sector. More than RUB 500 bn (EUR 6.6bn). VEB 300 bn RUB. 230 bn RUB state guarantees. Special Gov. Committee to decide.
- Defence Industry support. Compensation of devaluation losses.
- Budget costs cut by 10%, excluding defence industry, agriculture and debt service. 5% cuts per year for 3 years.
- Cuts in central government, Special fringe packages will be deleted.

Scenarios

- In any case economic difficulties will continue past 2015
 - Current GDP forecasts for 2015 from -1% to -8%
 - Inflation in Feb past 16% y/y
 - Private consumption and investment down in 2015 5-10%
- Scenarios
 - 3 Economic scenarios
 - Oil price: 60/Base, 80/Optimist, 40/Pessimist
 - Conflict in Ukraine freezes
 - Geopolitics
 - Base assumption: conflict in Ukraine freezes
 - Positive case: de-escalation and reforms in Russia

Base scenario

	Oil	GDP	RUB/EUR	Investment
2015	60 USD/bbl	-4 %	70	-10%
2016	70 USD/bbl	0%	65	0%

- Slowly recovering oil prevents collapse of economy and government budgets
- Devaluated currency helps to balance budgets and to make domestic production more competitive
 - Still reserve fund exhausted in two years - government stakes on rising oil
 - Devaluation starts to reverse: connection with oil, fear premium from ruble fades away with Ukraine conflict freezing
- Economy returns to low growth, driven by state enterprises and import substitution. No immediate pressure for structural reform.
- Import substitution the main economic policy

Optimist Outlook

	Oil	GDP	RUB/EUR	Investment
2015	80 USD/bbl	0%	70	0%
2016	90 USD/bbl	3%	70	5%

- Situation in Ukraine freezes, keeping Russia out of capital markets, but no further destabilizing effect
- Quickly rebounding oil price provides windfall cash to fund investments after foreign debts paid off
- Income likely used to fund investments in import substitution
- Budget restraints loosened: consumption can and will grow.
 - Elections coming in 2018
- "Imported growth" can continue: Income from fuels continues to be transferred into domestic demand and support for inefficient structures

Pessimist Outlook

	Oil	GDP	RUB/EUR	Investments
2015	40 USD/bbl	-8%	80	-15%
2016	40 USD/bbl	-2%	80	-5%

- Low oil price keeps the economy strained with currency, economic decline continues past 2015
- Few growth opportunities when budgets and credit drained
- Sharp decline may force reforms in the economy
 - Positive effect over longer term
- In longer run, if structural reforms are passed, economy may reach a growth path of 5%
 - Market structures: improving efficiency; property rights; deregulation; culture change in government organs
 - Access to capital markets essential in large scale reformation of the economy in absence of petrodollars

Geopolitics

1. When frozen conflict in Ukraine, no improvement in economy
 - Likely when price of oil recovering
 - Economy muddling through as in last 5 years

2. Geopolitical de-escalation
 - Possible when resources to keep conflict running drained: return to international co-operation as an exit
 - Lifting sanctions – access to capital markets
 - More likely accompanied with economic reform

3. Further military expansion
 - Another potential if unlikely consequence of economic stagnation
 - Low oil price keeps budgets strained and prevents social transfers and subsidies to economy -> Social unrest, requires diversion
 - Lightest consequence an embargo from most of the world