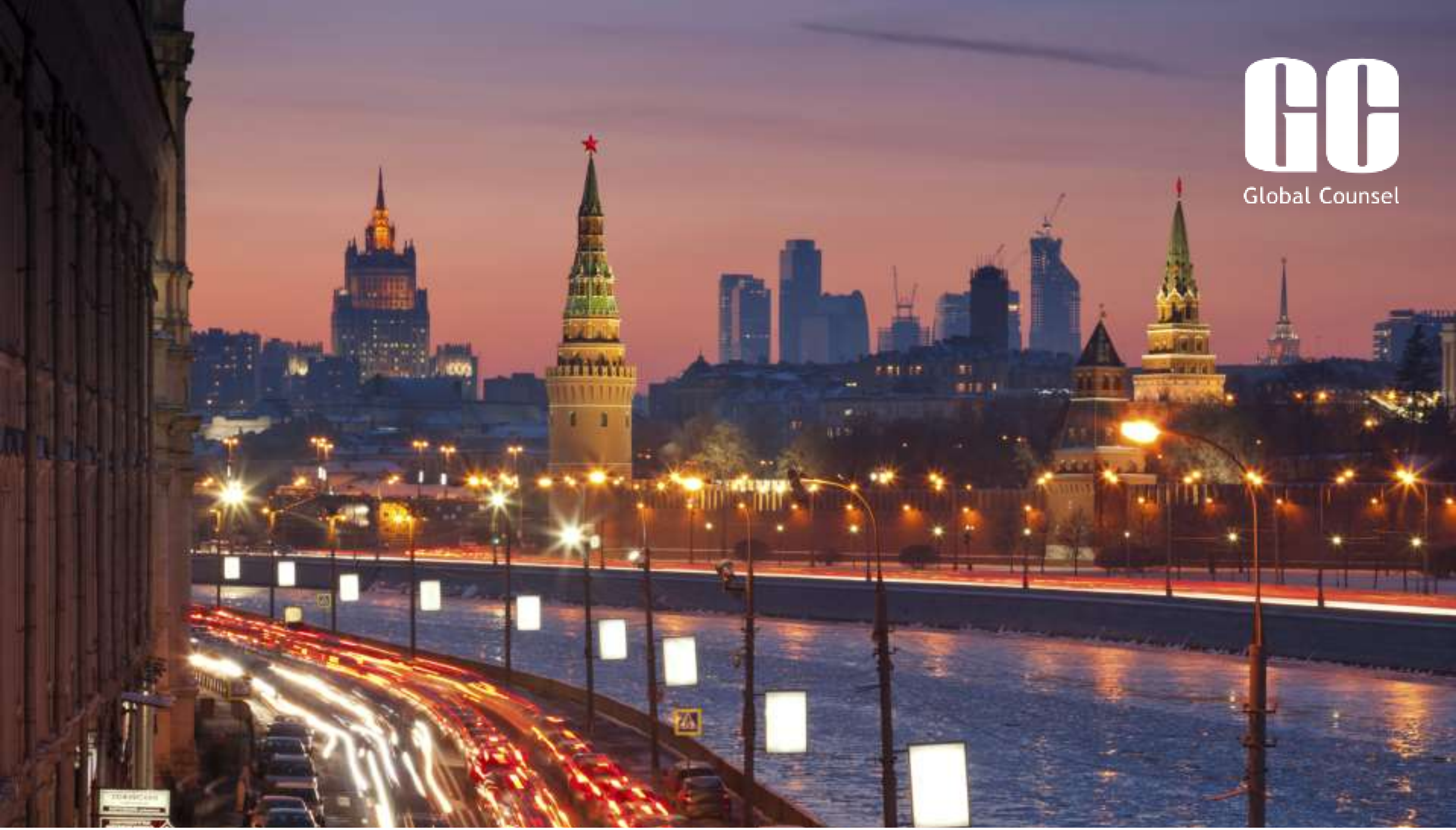


Multinationals in Russia in 2015

In their own words

Preface

Russia's political economy defies simple categorisation. It has always been a difficult place to do business, if sometimes a very profitable one. Since the start of last year the environment facing foreign businesses has been subject to several shocks: first, sanctions, then a fall in oil prices, and throughout, a more volatile environment for public policy than even seasoned Russia investors have become accustomed.

18 months after sanctions were first introduced, this report seeks to identify and explain how many of the largest foreign investors in Russia view the economy's prospects, the strategies that they themselves are adopting in the country, and how they evaluate Russia's public policy.

At the heart of this analysis is an assessment of what 46 major foreign investors have published about Russia in their own financial reports. This has been tracked and analysed in each quarter from the start of 2014 through to the end of the second quarter of this year.

Our analysis shows how both perspectives on Russia and strategies in Russia vary across sectors in some fundamental ways. It suggests that foreign investment in Russia may be reaching a critical fork in the road. It raises questions for policymakers in Russia as well as for the businesses themselves.

About Global Counsel

Global Counsel helps businesses across a wide range of sectors anticipate the ways in which politics, regulation and public policymaking create both risk and opportunity. We also help businesses to develop and implement strategies to meet these challenges.

The firm was founded in 2010. Our senior team are former public policymakers who have worked at the highest level in the British government and European institutions, and who have direct experience of working in Russia. They draw on a global network of business people, policymakers and opinion formers.

The authors of this report are Gregor Irwin, Thomas Gratowski and Alexander Smotrov.

Executive summary

This report examines how international businesses are faring in Russia after 18 tumultuous months in which sanctions have been imposed, oil prices fallen and policy has been volatile. We look at what some of the biggest international investors are saying about Russia in their published reports, covering the six quarters in 2014 and the first half of 2015. In particular we examine how the 46 companies in our sample assess Russia and whether their actions show they are committed to the market or stepping back, and we consider what aspects of Russian policy are exacerbating or alleviating the concerns they may have.

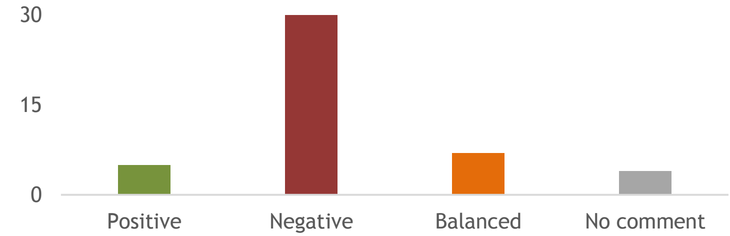
We find that there is a significant contrast between the overall outlook of firms and their actions. The overwhelming majority of firms have a bleak assessment of Russia, due to both structural and cyclical factors, with six times as many viewing the market negatively than those that view it positively. Even so, we find that twice as many firms are committed to the Russian market and expanding their presence there as those that are reducing it, although there is an even larger group of companies that are either standing still or not reporting changes.

We also find considerable difference in the assessments and behaviours of companies across sectors. Healthcare stands out as the sector that is the most optimistic and where many firms remain strongly committed to the Russian market. Financial firms, followed by the energy majors, are the bleakest in outlook and the most negative in terms of their strategies, with several taking steps to stop or suspend some operations.

A number of firms are behaving in a striking way which appears counter-intuitive on the surface level. In several sectors we find examples of companies that are downbeat in

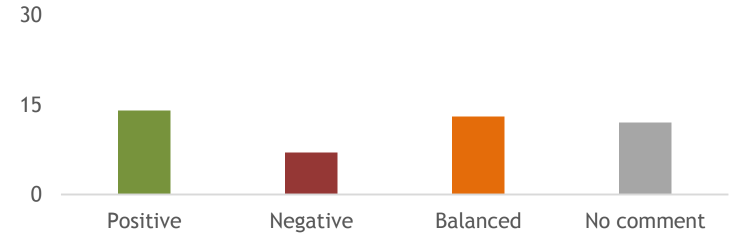
Outlook for the Russian market

Number of companies



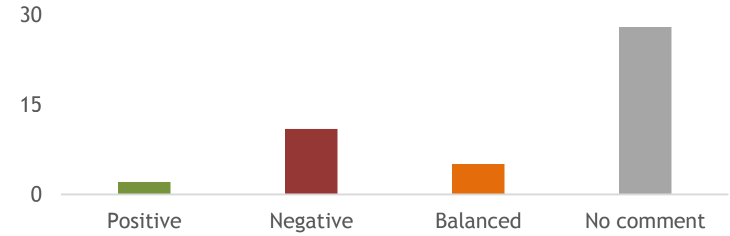
Commitment to the market

Number of companies



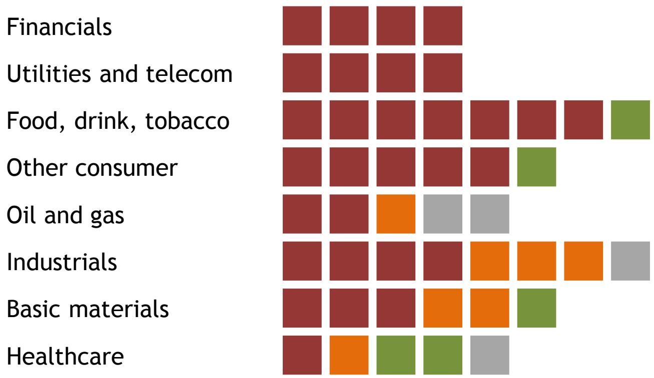
Views on public policy

Number of companies

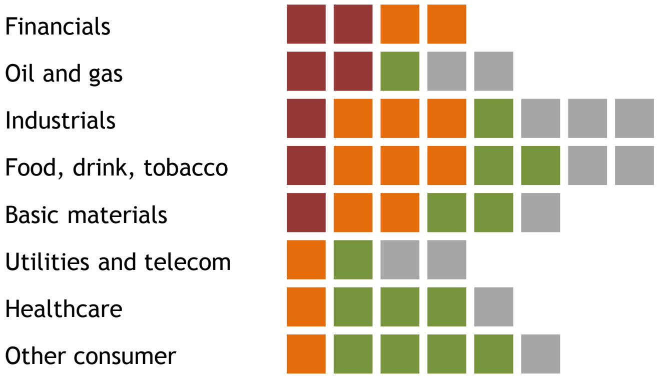


Executive summary

Market momentum
Distribution of companies by outlook



Company commitment
Distribution of companies by behaviour



Colour code: red for negative sentiment, amber for balanced sentiment, green for positive sentiment, and grey where there is no comment in the financial reports.

their assessment of the Russian market, but are still taking concrete steps to expand their operations. We describe this counter-cyclical strategy as 'doubling down'. The strategy is most prevalent in the non-food-and-drink consumer sector. There are many possible explanations. One is that the firms are holding their options open. Another is that they genuinely see counter-cyclical opportunities and are seizing them.

The differences in behaviour across sectors partly reflects how the shocks buffeting the economy have impacted in different ways, but also Russian policies. Foreign banks in Russia are not only concerned about the effect of sanctions on external financing and capital flows, but also Russian monetary and exchange rate policies. Elsewhere there is concern about Russia's food embargo, tempered by uncertainty over how significant its long-term impact will be. Russia's localisation policy is a an important issue in many sectors, but some firms appear to be embracing this more actively than others, particularly in healthcare.

Many firms are still reassessing their Russia strategy and we conclude this is a critical moment for foreign companies in Russia. We do not yet know whether the commitment being shown to the Russian market in the face of widespread pessimism about market conditions will be sustained. Some of Russia's problems are undoubtedly structural, with growth slowing in the years running up to 2014. Much will undoubtedly depend on whether the factors that have caused the market outlook to deteriorate so rapidly in 2014 – sanctions, oil prices, and some aspects of policy – are temporary. If they are not then we expect that more firms will begin to reduce their exposure in Russia in the months ahead.

Introduction

Russia has always been a challenging place for international firms to do business. The combination of protectionism, political risk and an opaque business culture has made it a hard market to penetrate and to sustain success. But for many, the rewards have been worth the risk, particularly as the economy nearly doubled in size in the decade after 1998, helping average living standards catch up fast with those in the EU.

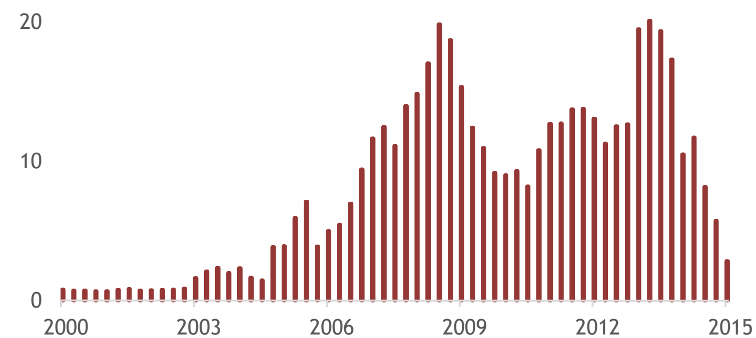
More recently Russia's economic performance has been less impressive and last year the economy was dealt a double blow by sanctions and a collapse in the oil price. From March 2014, the EU, the US and several other countries progressively imposed sanctions on Russia in response to the Ukraine crisis. These have effectively cut off external financing to Russian businesses and restricted investment in the energy sector. Almost 18 months later the sanctions remain in place and are unlikely to be relaxed until the Minsk II peace accord is implemented.

The fall in the oil price was every bit as dramatic and arguably even more challenging. The price of a barrel of Brent crude was $110 in the middle of 2014, just as the sanctions were beginning to have effect, but fell to half that value by the end of the year. For an economy that has become steadily more dependent on energy exports and tax revenues from the energy sector, this was both unexpected and deeply damaging.

Both shocks have contributed to a sharp slowdown in the economy. Russia's problems did not begin in 2014 – growth has been trending down since 2010 due to long-term structural weaknesses and imbalances in the country. But shocks have caused Russia's economic problems to intensify sharply and its weaknesses have been further exposed as a result.

Russian GDP has been trending down since 2010
Percent

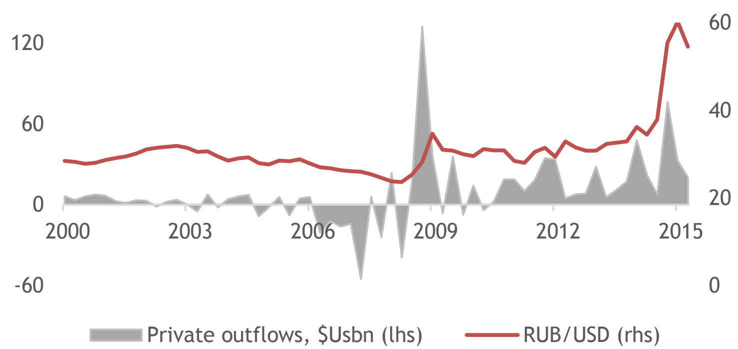
FDI inflows have been volatile
Four quarter rolling average, $USbn



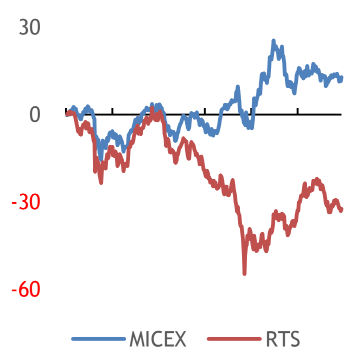
Source: CEIC

Introduction

Capital outflows have put the rouble under pressure



Stock market fortunes have been mixed
Cumulative change in 18m from 1/1/2014



Sector	Percent change
Metals & Mining	+2
Oil & Gas	-24
Consumer & Retail	-41
Electric Utilities	-44
Industrial	-51
Financials	-54
RTS	-32

Note: the MICEX index is denominated in roubles; the RTS index and its industry sub-components are denominated in dollars.

Source: CEIC

The shocks of 2014 have put the government's fiscal position and economic management under stress. The central bank has struggled to cope with inflation and a weaker rouble, first defending the currency before letting it fall. The government has faced competing demands from well-connected businesses that need financing, and popular demands to maintain spending as the economy has slowed. Foreign exchange reserves fell by one third between the start of 2014 and the middle of 2015.

The Russian government has responded with its own sanctions and policies that appear intended to protect domestic businesses. In August 2014 Russia introduced an embargo on food imports from the EU, US and other countries. The government hopes to stimulate local production, but the policy has been disruptive for retailers and pushed up consumer prices. The business environment also appears to be getting tougher elsewhere, particularly for foreign firms, with the government pushing ahead with a policy of localisation in many sectors.

With private capital leaving, the Russian government faces a difficult challenge to retain and attract foreign investment, just as this becomes more important. The welcome extended by the Russian government appears to vary from one sector to the next, depending on both the policy needs of the government and the extent of local capabilities and competition.

This report examines how international businesses are faring after 18 tumultuous months. We look at what 46 of the biggest international investors are saying about Russia in their published reports. We examine whether they appear committed to the market or are stepping back. And we consider what aspects of Russian policy are exacerbating or alleviating their concerns.

Our approach

Our approach is to examine the statements made about Russia by a sample of 46 foreign firms in publically available investor documents. These documents vary according to the reporting requirements of the country in which each firm is based. Where available we use published annual and quarterly financial reports. Where necessary we supplement this by examining corporate presentations that may accompany these reports. We cover the six quarters between Q1 2014 and Q2 2015.

Our analysis of these reports is along three dimensions:

MM **Market momentum**. This is what firms say about the state of the economy and the sector in which they are operating and in particular whether or not they see this expanding.

CC **Company commitment**. This is what companies themselves are doing in Russia and in particular whether they are taking actions that increase or decrease their exposure.

PP **Public policy**. This is what the firms say about public policy in Russia, either in general or in their particular sector, and whether they view the direction as positive or negative.

In each case we use a simple scoring system to summarise what our analysis reveals for each company. Where the assessment is positive we score this as +1 and colour code it green. Where it is negative we score this as -1 and colour code it red. Where it is neutral we score this as zero and colour code it amber. Where there is no statement we do not score it and colour code it grey. A summary of our analysis for each company and the scores for each metric is provided in the annex.

Sample selection

The sample of companies is predominately drawn from the 2014 membership of the Foreign Investment Advisory Council in Russia. This forum for foreign investors was established in 1994 to work with the Russian government to improve the business environment and includes many of the largest and most established foreign investors. We have included 44 corporate members of the Council, excluding five companies that either do not publish financial statements or made no reference to Russia in their financial statements. We have supplemented this sample by adding two of the largest foreign banks in Russia, in order to draw conclusions regarding this important sector. 27 of the companies are based in the EU and 11 in the US. The firms and the eight sectors they are drawn from are shown below.

Food, drink, tobacco - 8	BAT, Cargill, Carlsberg, Coca-Cola, Mondelez, Nestle, PepsiCo, Unilever
Basic materials - 6	Alcoa, BASF, Bayer AG, International Paper, Kinross Gold Corporation, Solvay Group
Oil and gas - 5	BP, Eni, ExxonMobil, Royal Dutch Shell, Total
Industrials - 8	ABB, Finmeccanica, Lafarge, Mitsui, Siemens, Schneider Electric, Tetra Pak, United Technologies Corporation
Other consumer - 6	Ford, Metro AG, Mitsubishi, Procter and Gamble, Renault, SCA
Healthcare - 5	Abbott, AstraZeneca, Novartis, Sanofi, Takeda
Financial - 4	Deutsche Bank, UniCredit, Raiffeisen, Societe Generale
Utilities and telecom - 4	E.ON, Enel, Fortum, Telenor

Corporate perspectives

Market momentum

The vast majority of firms reported a deteriorating Russian market; the rouble the number one concern, but other concerns including falling oil prices, capital outflows and underlying structural weaknesses in the economy. Those firms that were positive typically saw an underlying strength in their particular sector, with healthcare the most buoyant.

- Almost half of firms identified the depreciation of the rouble and exchange rate uncertainty as having numerous impacts on their business. Mondelez, for example, noted that it has limited ability to hedge against currency losses. E.ON noted that the lower rouble has pushed up Russian fuel costs.

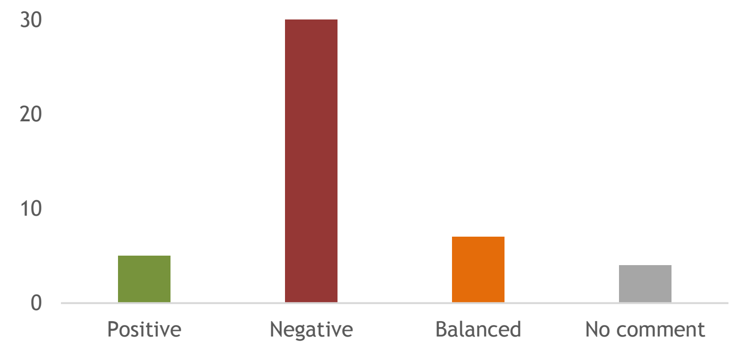
- Some firms, such as SCA and Telenor, downplayed the impact of the rouble as affecting the translation of profits and asset values only. Schneider Electric temporarily benefitted, as their customers built up inventory in anticipation of further depreciation, while Raiffeisen Bank International noted the lower rouble reduced costs in Russia.

- Some firms like Mitsubishi emphasized weakness in the Russian market itself. Siemens, Carlsberg and Enel noted the impact of the Russian recession on their business. Bayer AG reported that capital outflows are weakening economic activity. UniCredit noted the problems Russian businesses are having in accessing western capital markets. Bayer AG, AstraZeneca and Deutsche Bank all identified lower oil and commodity prices as a source of economic weakness.

- Kinross Gold Corporation suffered a particular setback when Moody's downgraded them alongside the Russian sovereign, as it receives substantial cash flow from Russian operations.

Corporate bears now dominate in Russia

Number of companies by views expressed on market momentum



The (relative) optimists in healthcare

AstraZeneca MM
- Revenue grew 26% in the first half of last year and 18% over the full year.

Takeda MM
- Russia continues to be one of Takeda's priority markets delivering double-digit sales growth.

Novartis MM
- Double-digit growth in constant currency terms, but in dollar terms, sales in Russia dropped significantly.
- Russia was the biggest driver of growth in the over-the-counter segment in common currency terms.

Sanofi MM
- Sales in Russia increased by 7.1% in 2014 and by 0.5% in the first quarter this year when measured at constant exchange rates.
- Consumer health and diabetes treatments particularly strong.

Company commitment

Despite the mostly gloomy market outlook, several firms are continuing to expand their operations in Russia, and not only in the healthcare sector. For now, those that are expanding their commitment to the Russian market outnumber those that are cutting back.

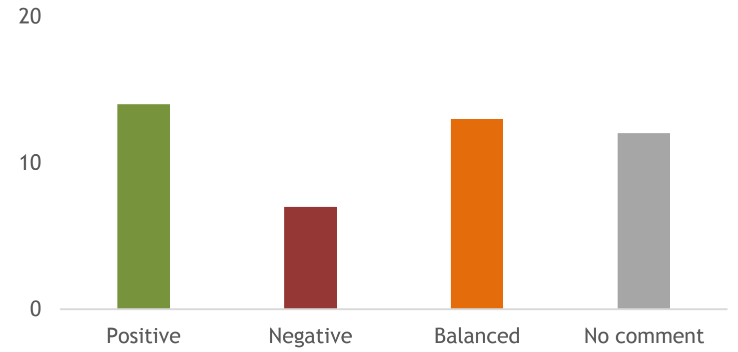
- Several companies reported that they are opening new facilities, production lines or outlets in Russia. Others are launching new products or proceeding with joint ventures. For example, Cargill has opened a new plant while purchasing a stake in a Black Sea port, Unilever has launched new products, and Metro AG has opened new stores. Renault launched a new vehicle which is being built locally as part of a joint venture. Abbott Laboratories acquired a Russian pharmaceutical manufacturer. ExxonMobil reported that in May last year, shortly before sanctions affecting the energy sector were introduced, it completed new joint venture agreements with Rosneft to develop projects in the Arctic.

- Of course, not all firms are expanding in the Russian market. Carlsberg has shut down two breweries, accounting for 15% of its capacity. Deutsche Bank shed its asset management business while cutting its credit exposure. Raiffeisen Bank reduced risk-weighted assets and tightened lending criteria. Lafarge disposed of one plant while opening another. BASF is continuing to develop gas fields, but cancelled a swap deal with Gazprom, which it is now trying to revive.

- For many firms it may be too early to tell just how committed they are to Russia. Some of the expansion seen in 2014 and at the start of this year reflects plans made before the geopolitical tensions developed.

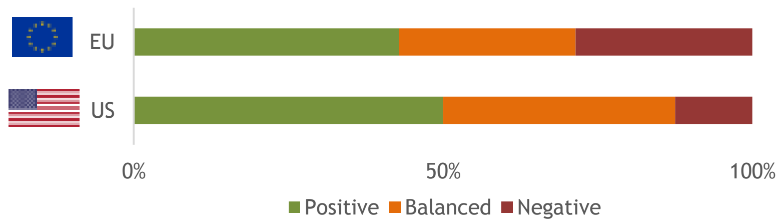
Many firms still have an appetite for expansion

Number of companies by the degree of commitment shown to the market



US firms appear moderately more committed

Percentage of firms by commitment to the market



The sector with the most firms expanding is ‘Other consumer’

‘Other consumer’ firms showing signs of increasing commitment

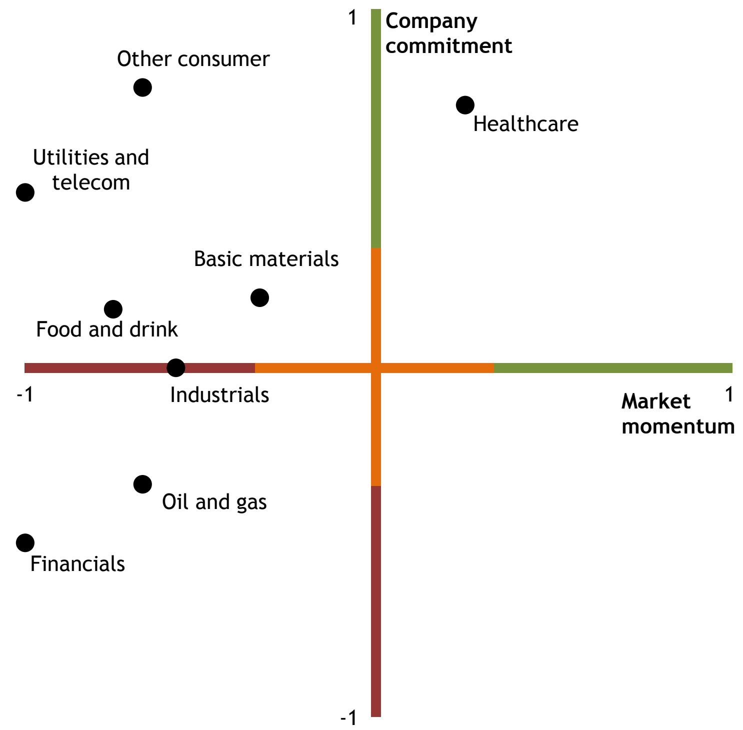
METRO RENAULT Ford SCA

Differences across sectors

We observe markedly varying sentiments towards Russia across sectors. This is much more significant than the small variation we observe across companies when grouped by their home market. The single sector that stands out is healthcare, but there is also a wide variation across all sectors in terms of company commitment.

- Sentiment regarding market momentum is largely negative in all sectors except healthcare. The relative optimism in healthcare reflects the particular circumstances in the sector at the moment. Specifically, Russia remains highly dependent on foreign-made drugs and medical products, with margins relatively high.
- The picture is more varied across sectors in terms of company commitment. The sectors that are the most negative are the financial sector and oil and gas. These are the sectors most directly impacted by US and EU sanctions. However, other factors may also be at play. Banks are able to scale up or down their exposure more quickly than firms in other sectors, while oil and gas companies are directly affected by lower oil prices as well as sanctions.
- There is another trend that can be observed here, which is that firms in sectors that are focused on serving the domestic Russian market appear more committed than those operating in Russia to serve export markets. The consumer and utilities sectors are two examples. A partial exception is food and drink, which most likely reflects the impact of the Russian ban on certain food imports, although in this sector the picture varies according to the business model and the extent of reliance on imports, rather than a Russian supply chain.

The picture varies dramatically across sectors
Average scores in different sectors



Note: the average scores are calculated based on assigning +1 to positive sentiment, -1 to negative sentiment, and zero where the sentiment is balanced. Firms are excluded where there is no comment in the financial reports.

Public policy

Most international firms do not comment on Russian public policy in their financial statements. Those that do are almost invariably negative. Comments are most common in three areas of policy: the Russian embargo on food imports from selected countries, financial policies, and policies that impact specific sectors. Comments in this last category are sometimes positive.

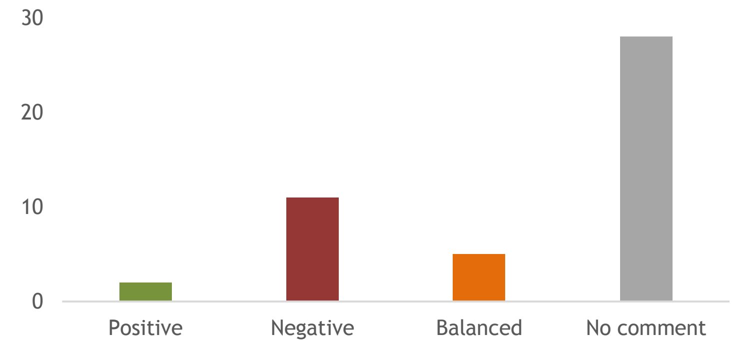
- Concerns over Russia's embargo on food imports are expressed by retailers as well as producers. However, the severity of the problems this is creating is unclear, with most playing down the materiality of the long-term impact. Cargill notes that wheat export restrictions have created problems.

- Criticism of Russian financial policies is typically stronger. Raiffeisen Bank has criticized the inability of the Russian central bank to stabilise the exchange rate, while UniCredit reports that aggressive monetary tightening by the central bank contributed to the slowdown in the economy. Kinross Gold Corporation warns that any restrictions on its ability to convert roubles to foreign currency would be damaging.

- The two sectors with the most to say on Russian public policy are healthcare and utilities. Fortum welcomes the government's roadmap for heat sector reform, while E.ON is critical of new price caps affecting the power system. In healthcare, Takeda notes the importance of the Russian government's commitment to the sector for its business. SCA was affected by 'inconsistent' government reimbursement policy concerning one of its products, but this was quickly reversed. There is a universal silence on Russian public policy from the oil and gas companies in our sample.

Comments on Russian public policy

Number of companies by views expressed on public policy



Concerns about Russia's embargo on food imports

Tetra Pak	PP	▪ The ban was highly disruptive in 2014, but is unlikely to have a major effect on the group in the long run.
Mondelez	PP	▪ Russian sanctions on sourcing raw materials from Eastern Europe are impacting on the business.
PepsiCo	PP	▪ Russian sanctions are not expected to have a material impact on the company's results or financial position.
Metro AG	PP	▪ Food prices have risen dramatically as a result of the embargo and this is likely to persist. ▪ Business activities in Russia remained stable in spite of the import ban.

Evidence from investor surveys

The findings from our analysis of what foreign investors say in their corporate reports, are consistent with recent surveys of foreign investor sentiment in Russia. However, our analysis goes further by identifying the impacts on specific companies and the particular actions they are taking as they adapt to changing market conditions.

- EY has surveyed foreign investors in the FIAC (see page 7 which explains how our sample also includes the membership of the FIAC) regarding their perceptions of the investment climate in Russia. EY found that while almost three-quarters of firms believe the market has worsened, almost half are still planning to either increase their investment or expand geographically. EY also identified both positive and negative changes in the Russian regulatory environment.

- PWC has surveyed a somewhat larger sample of Russian and international businesses and found that the number of businesses negatively affected by the crisis is almost five times those that have been positively affected. Their assessment of how revenues have been impacted across different sectors is broadly consistent with our analysis of how firms in different sectors assess market momentum in Russia.

- Each of these surveys – and our own analysis – need to be interpreted with caution as their sample sizes are limited. However, combined, the consistency in the messages enables us somewhat to draw stronger conclusions, including some about the strategies that are being adopted by different firms. This is the subject of the next section in this report.

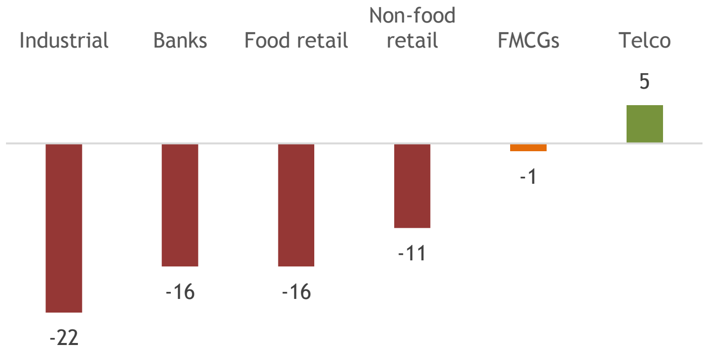
Overview of positive and negative regulatory changes

Positive changes	Negative changes
Customs Union customs code and regulations	Personal data protection law
Introduction of electronic documentation systems across operations	Law on foreign capital controls in the media
Clarified customs law enforcement	Law on undesirable organisations
Federal contract system	Law on temporary agency work ban
Law on rapid growth regions	Tighter alcohol sales controls
Promotion of long-term contracts	Sharp fluctuations in the refinancing rate
New property tax incentives for investors	Proposed amendments to the commerce law
Improvements in migration procedures for highly skilled workers	Ban on food imports
Financial incentives to support investors	Restrictions on the participation of foreign companies in government procurement

Source: EY, *Investment climate in Russia – foreign investor perception*

Reported revenue dynamics in the past 12 months

Percent, per industry



Source: PWC, *Russia's current economic downturn: a 360º view*

Corporate strategies

Strategy 1: stepping back

Many of the most pessimistic multinationals in Russia are taking steps to reduce production or otherwise cut their exposure to the market as might be expected. These firms are in a wide range of sectors, but particularly the financial sector and oil and gas.

- International banks have felt the chill in the Russian market more severely than any other sector, and have also been the quickest to respond in terms of cutting their exposure. During 2014 Deutsche Bank cut its credit exposure in Russia from €1bn to €5bn, and shed its asset management business. More recently (after the end of Q2 2105) the company announced that it will cut its investment banking operations. RBI, which is the second largest foreign bank in Russia after UniCredit, has cut its exposure in several areas as its share price came under pressure in 2014 in part due to problems in Russia. UniCredit's assessment of the market is bleak, but for now it is reporting fewer steps to reduce its presence.

- The energy majors have said little in their financial reports about Russia, with the notable exception of Total which describes the impact on its joint ventures and exploration licences. The company also recognised an impairment on its Shtokman investment last year, although problems there probably pre-date sanctions and the oil price fall.

- Carlsberg is unusual in that it is the only food, drink or tobacco business in our sample that is scaling back its operations, despite no fewer than seven out of eight firms in the sector viewing the market negatively.

Carlsberg Group

Case study

Denmark | Food, drink, tobacco

Carlsberg has long been looking for a way to reverse a steady decline in sales in the Russian market which has been hit in recent years by a combination of higher government duties and intense competition.

The company's problems were exacerbated in 2014 by weak consumer spending and the rouble devaluation. Both factors had impacts on Carlsberg's operating profit in Russia and put pressure on the Group's overall performance.

The company faces a declining market in Russia in terms of volume, but has been able to increase sales in terms of value because it has raised prices and reduced pack sizes. But in January 2015 Carlsberg had to shut down two breweries, accounting for 15% of its capacity in Russia, in order to remain competitive.

This was the most visible part of Carlsberg's broader strategy to adapt the structure of its Russian and Eastern European operations in response to changing market conditions, while ensuring the long-term health of the overall business.

Key milestones for Carlsberg in Russia

1992	Enters Russia through a stake in Baltika
2012	Buys out minority shareholders in Baltika
2010s	Battles to keep largest market share in Russia (up to 40%)
2015	Closes two breweries, equivalent to 15% of capacity

Strategy 2: doubling down

Six firms in our sample adopt a strategy that appears counter-intuitive, which is to step up their commitment to the Russian market, despite being pessimistic in their assessment of the prospects for the market. However, on closer inspection, it is possible to understand this behaviour and why it is that some firms appear to be 'doubling down' in very difficult market conditions.

- Auto producers Ford and Renault are both investing, despite a dramatic decline in new car registration over the period, with Ford increasing funding for is joint venture and building a new plant. This may partly be due to a combination of long-lead times for investment in a capital-intensive sector, combined with what is often highly cyclical demand. It may suggest that both firms remain confident about long-term prospects despite the current problems in the market.

- Utility firm Fortum is investing in new power units and hydropower capacity. One explanation may be the Russian government's commitment to heat sector reform, which Fortum expects will encourage investment in energy efficiency and which may, therefore, boost the firm's district heating business.

- Perhaps the starkest examples are provided by Cargill and Unilever. Not only do both firms see the market deteriorating, but they also have concerns about public policy in Russia. Nevertheless both firms are expanding, with Cargill constructing a new plant and buying a stake in a port, while Unilever has expanded its product offer.

Case study

France | Other consumer

Renault has seen mixed results in Russia recently, which is its third biggest market globally. Russian car registrations fell by 36% in the first half of this year compared with the same period in 2014, illustrating how tough the Russian auto market has become. Renault, however, failed to maintain its share over this period as its registrations fell by 40%.

Despite this, Renault appears committed to the Russian market. The Renault-Nissan Alliance, which has a two-thirds stake in Russia's largest car producer AVTOVAZ, continues to target a market share of 40%. In March last year the joint venture launched the new Logan model in Russia, which is being built at the AVTOVAZ plant in Togliatti, which has long served as a base for the country's automobile industry. Meanwhile Renault's dealership network of 180 garages is now larger than any other foreign-owned brand.

The company's current strategy in Russia is to preserve profitability by allowing temporary production cuts, while closely monitoring financial risks in the Russian market.

Key milestones for Renault in Russia

1970	Cooperation agreement with the USSR signed
1998	Moscow joint venture launched (fully owned since 2012)
2013	Obtains a controlling stake in AVTOVAZ plant in Togliatti
2014	Becomes largest foreign-owned car dealership in Russia

Strategy 3: business as usual

There are only a small number of firms that are both optimistic about the Russian market and increasing their commitment to the market. During the boom years for FDI in Russia, from 2004 through to the start of 2014, most foreign firms would have fallen into this category. In many respects this is what we might describe as 'business as usual'.

- Bayer AG, SCA, AstraZeneca and Takeda Pharmaceutical are the only firms that are positive both in terms of their outlook for the market and the commitment they are showing to the market. Two other firms, Finmeccanica and Solvay Group, are relatively balanced in their assessment of the Russian market, but are still expanding nonetheless.
- These businesses are neither oblivious to nor fully insulated from the economic problems in Russia. Indeed, Bayer AG and AstraZeneca are explicit about the challenges facing the Russian economy. What sets these firms apart is their relatively sound performance despite these difficulties.
- From financial reports alone it is difficult to draw concrete conclusions about why some firms are able to operate in this way, although some tentative conclusions may be drawn. In some cases, as with healthcare, the sector as a whole is performing relatively well. In others, such as for SCA and Solvay Group, the firms have a strong production base in Russia that enables them to serve the local market with a degree of insulation against external shocks. SCA emphasises that the rouble fall only implies a translation effect for profits. For other firms, such as Bayer and Takeda, it may simply reflect their long-term commitment to Russia as a priority market.

AstraZeneca

Case study

UK/Sweden | Healthcare

AstraZeneca continues to build its presence in Russia. Revenue in Russia grew 26% in local currency terms during the first half of last year and 18% over the full year, significantly outperforming the market with growth in its retail market share. The company reported strong sales growth in several product lines in the first half of this year.

AstraZeneca launched the Forxiga diabetes drug in Russia in 2014. The company is continuing its strategy of localising production to secure its market position, growth potential and alignment with government healthcare priorities. During 2014 its plant in Kaluga region continued to make progress on regulatory validation. Commercial production is expected to start at the end of 2015 with a full-cycle production of 30 different drugs by 2017/18. The total investment in the greenfield site is $223mn, which is slightly less than AstraZeneca's annual sales in Russia.

While the company has noted that international sanctions and global oil price developments could potentially affect business in Russia, so far it says this has not been the case.

Key milestones for AstraZeneca in Russia

1993	Astra and Zeneca enter Russian market (merging in 1999)
2011	Localisation plans announced
2012	MoU signed to create Russia's first biomedical data bank
2015	Production scheduled to start at new plant in Kaluga region

Summary of corporate statements on Russia

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ABB Industrials Switzerland MM CC PP	Orders increased in Q2 last year, but revenues in Russia were falling by Q4 and by Q1 this year lower volumes were weighing on divisional results and pushing down the operational EBITA margin.
Abbott Laboratories Healthcare USA MM CC PP	Abbott agreed to acquire Russian pharmaceutical manufacturer Veropharm in the second quarter in 2014, with the deal completed at the end of last year, establishing Abbott as top-five branded-generics company in Russia.
Alcoa Basic materials USA MM CC PP	The fall in the rouble impacted on 2014 results, particularly in Q2, and in Q4 sanctions on Russia were reported to be impacting the commercial transportation business in particular. Alcoa proceeded with a joint venture with VSMPO-AVISMA in 2013, which will see high-end aerospace products being manufactured in Russia, but in March 2015 sold off a rolling mill in Belaya Kalitva. The company reported in Q2 this year that it is unable to pass-through the cost of metal premiums to can sheet packaging customers in Russia.
AstraZeneca Healthcare UK/Sweden MM CC PP	Revenue in Russia grew 26% in the first half of last year and 18% over the full year, although AstraZeneca noted in the full year results that potential international sanctions and global oil price developments could affect business in Russia. AstraZeneca is continuing to build its presence in Russia. The company launched Forxiga in Russia in 2014. During 2014 the company's facility in Vorsino continued to make progress on its regulatory validation with commercial production expected this year. AstraZeneca reported strong sales growth in several product lines in Russia during the first half of 2015.
BASF Basic materials Germany MM CC PP	Share performance was weighted down by increasing uncertainty regarding business in Russia, while currency effects in Russia were sharply negative. A swap deal with Gazprom which would have given BASF additional oil and gas reserves in Russia did not take place, but BASF continued to develop gas fields in western Siberia through a joint venture. The mutually imposed sanctions negatively affected trade. In Q2 2015 oil and gas production increased in Russia.

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BAT Food, drink, tobacco UK MM CC PP	Although BAT was able to increase market share during the first half of 2014, the depreciating rouble and a shrinking market with lower volumes contributed to a deteriorating outlook. In Q2 this year BAT reported lower volumes and excise driven price increases. Profits at constant exchange rates have been impacted in Russia by the devaluation of the rouble, which has led to higher raw material input costs. However, in the second quarter this year BAT reported an increase in its share of the declining Russian market.
Bayer AG Basic materials Germany MM CC PP	Bayer increased sales in Russia throughout the whole period, with consumer care particularly strong, but expects to see a significant decline in economic activity there due to an outflow of capital, sanctions and lower oil revenues. The company is expanding its position in Russia, which it describes as an important market.
BP Oil and gas UK MM CC PP	Sanctions have had no material adverse impact on BP, but the company warned in the second quarter last year that further economic sanctions could adversely impact its business and strategic objectives in Russia, specifically its income, production and reserves and its investment in Rosneft. Sanctions could also have an impact on BP's reputation.
Cargill Food, drink, tobacco USA MM CC PP	The company made strong gains in the first half of 2014 with its staple foods business in Russia despite a difficult operating environment. Cargill began constructing a new seed-crushing plant in Volgograd, which was reported to be nearing completion in Q2 2015, and purchased a stake in a Black Sea port. In 2015 the company said that the Russian-Ukraine conflict has been costly, both because of the forced closure of its oilseed processing plant in Donetsk (in eastern Ukraine) and lost opportunities in the region due to the economic contraction. Russian restrictions on wheat exports created challenges that were noted in the first quarter this year.
Carlsberg Food, drink, tobacco Denmark MM CC PP	The company has faced a declining market in volume terms, but has been able to increase sales in value terms because it increased prices and reduced pack sizes. The fall in the rouble impacted on operating profit in Q1 last year and at the end of the year Carlsberg noted that both falling GDP and the rouble devaluation will put pressure on the Group's overall performance. In January this year Carlsberg shut down two breweries, corresponding to 15% of its capacity in Russia, in order to remain competitive, although this year the company launched the new Boilermaker product. In Q2 this year the company reported a 19% reduction in inventories held by distributors compared to last year, driven by the significant slowdown of the economy.

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Coca-Cola Food, drink, tobacco USA MM CC PP	Coca-Cola experienced a high single-digit decline in unit cases in the Russia-led business unit in the first quarter of this year as a result of continued political and economic instability. By the second quarter this year this had become a low single-digit decline. This was in contrast with growth over the course of 2014, especially at the beginning of the year when it was favourably affected by the Sochi Olympics. The company also recorded a loss of $36mn as a result of the restructuring of its juice operations in Russia.
Deutsche Bank Financial Germany MM CC PP	The company noted the deteriorating economy in Russia during 2014 which it blamed on sanctions and the weak trend in commodity prices. It also noted the elevated geopolitical risks between Russia and the West regarding Ukraine, but did not expect this to have a material impact on credit losses. Deutsche Bank shed its asset management business in Russia during 2014 and cut its credit exposure by €1bn to €5bn by the year end.
Enel Utilities and telecom Italy MM CC PP	Enel was hit hard by the depreciation of the rouble with revenues falling by €198m in 2014 despite higher prices and sales up 0.6% in rouble terms. 2014 was described as especially challenging for Russia with international sanctions severely restricting access to capital markets. Revenues and EBITDA fell further in the first half of 2015. Expectations for Russia have deteriorated due to geopolitical tensions, the low price of oil and the country slipping into recession.
Eni Oil and gas Italy MM CC PP	Eni divested from the Russian Arctic in 2013. There are no other significant references to Russia in the financial reports published over the period.
E.ON Utilities and telecom Germany MM CC PP	EBITDA in Russia during 2014 was down 9% in local currency terms due to higher fuel costs and by 25% once adverse currency movements were taken into account. In the first half of this year the declines were 20% and 40% respectively. E.ON is continuing with its new-build power station project at Berezovskaya GRES. The political crisis between Ukraine and Russia and sanctions against Russia have not led to adverse developments in Russia's energy policy environment, although there were still several noteworthy regulatory developments during 2014 including the establishment in 2015 of price caps affecting parts of the country's power system.

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ExxonMobil Oil and gas USA MM CC PP	ExxonMobil noted that sanctions have prohibited some exploration activities. Even so, the company progressed its joint venture with Rosneft in the Kara Sea during 2014, maintained its interest in the Caspian Pipeline Consortium which is investing in increased capacity, and continues to be involved in the Sakhalin-1 investment project. In May ExxonMobil completed new joint venture agreements with Rosneft to develop seven blocks in the Russian Arctic.
Finmeccanica Industrials Italy MM CC PP	Finmeccanica reported in Q3 last year that revenues were substantially in line with 2013. Increased activity in the Airborne and Space Systems and Land and Naval Systems sectors managed to offset the slowdown in Security and Smart Systems, particularly in relation to the activities of the Russian Post Offices. In the results presentation for the second half of this year, Russia is included among the 'target regions' in the new group commercial model.
Ford Other consumer USA MM CC PP	Ford faced a challenging market environment in Russia during 2014 due to lower industry volumes, a weaker rouble and adverse changes to the industry segmentation, dragging down pre-tax results. However, Ford increased funding for its Ford Sollers joint venture, taking a controlling interest in the first quarter this year. Ford Sollers plans to build a new engine plant this year and in Q2 reported that it had started production of the new Fiesta for Russia at the plant, which is Ford's seventh locally-assembled vehicle.
Fortum Corporation Utilities and telecom Finland MM CC PP	Fortum met its rouble profit target but the depreciation of the rouble negatively affected its euro-denominated results during 2014 and the first quarter this year. A major power unit in Nyagan was commissioned last year and two units will be commissioned this year in Chelyabinsk. In December Fortum announced its intention in increase its hydropower production capacity by 60%. The Russian government approved a roadmap for heat sector reform in 2014 that will encourage investments in energy efficiency. In Q2 2015 the company said it is continuing negotiations on the restructuring of the territorial generating company TGC-1 in Russia.
International Paper Basic materials USA MM CC PP	International Paper suffered losses due to the weakening rouble. While sales prices in roubles increased, volumes were flat in 2014 compared with the year before. Sale volumes for the European and Russian uncoated papers business in the first half of this year were almost two percent lower than the same period last year.

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Kinross Gold Corporation Basic materials Canada MM CC PP	Kinross suffered foreign exchange losses last year due to the depreciating rouble. However, its Russian operations outperformed in terms of costs and production levels during Q2. The downgrade of the Russian sovereign by Moody's also led to a downgrade of Kinross because the company receives substantial cash flow from its Russian operations. Geopolitical problems have not resulted in increased direct material costs, although the crisis has increased uncertainty and risks. Kinross states that it remains business as usual at its operations in Russia's far east, where the company has operated uninterrupted for the past 20 years. In its annual report for 2014, Kinross notes the risk of an adverse material effect on its business in the country due to Russian imposed retaliatory sanctions. The company also notes that any restrictions on its ability to convert roubles to foreign currency would be damaging. In Q2 2015, Kinross reported that Russia continues to perform well and is on track to be at the higher end of production and the lower end of cost of sales guidance for the year.
Lafarge Industrials France MM CC PP	The company suffered from the depreciating rouble, but sales volumes in Russia increased in 2014. Lafarge opened a new plant south of Moscow in the second quarter last year and reported in the second quarter this year that production has begun successfully. However, Lafarge also disposed a cement plant in the Urals at the end of November last year. In Q2 this year Lafarge reported strong cement volume growth in a "challenging construction sector".
Metro AG Other consumer Germany MM CC PP	Sales measured in roubles grew through most of last year largely due to higher prices but partly driven by high short-term demand for consumer durables, which led to double-digit growth in many segments. The fall in the rouble, however, had an effect on euro sales, profits and assets valuations. While Metro opened five electronics stores and nine cash and carry stores in Russia over the period, the political situation forced the company in Q3 last year to put off its planned IPO. In Q3 the company reported that business activities remained stable in spite of the import ban.
Mitsubishi Other consumer Japan MM CC PP	Mitsubishi reported a sharp contraction in the Russian market in its annual report released in the first quarter this year but said that it is working to further strengthen its operating base there.

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Mitsui Industrials Japan MM CC PP	Mitsui only mentions Russia in connection to slowing EU exports to the country, which negatively affects the EU economy.
Mondelez Food, drink, tobacco USA MM CC PP	The depreciation of the rouble had a negative effect on revenues last year and the company only has a limited ability to hedge against currency-related losses. However, Mondelez still considers Russia to be one of its key markets. Russian sanctions on the sourcing of raw materials from Eastern Europe are affecting business. In Q2 this year the company reported that it is continuing to take actions to protect its near-term operating results, financial condition and cash flow due to 'significant' currency movements in Russia.
Nestle Food, drink, tobacco Switzerland MM CC PP	Despite inflationary pressures and a deteriorating economic environment, Russia remained a driver of growth for Nestle in Central and Eastern Europe in 2014, although there was a slight slowdown towards the end of the year. In Q2 this year the company said careful management of pricing had protected its competitiveness in an inflationary environment.
Novartis Healthcare Switzerland MM CC PP	Russia is delivering double-digit growth in constant currency terms though in dollar terms sales dropped significantly because of the fall in the rouble. Russia was the biggest driver of growth in the over-the-counter segment in common currency terms and is now the second largest market. Excedrin products were launched in Russia in the second quarter last year. Novartis received regulatory approval for a new drug in Russia during 2014. Nevertheless, Novartis noted the risk that political instability in Russia could lead to significant business disruption or adverse business conditions in the future and the company reported weaker sales due to a declining economy in the second quarter this year.
PepsiCo Food, drink, tobacco USA MM CC PP	The depreciation of the rouble reduced net revenue growth for the business last year and in the first quarter this year. PepsiCo's exposure to Russia fell significantly in dollar terms between March 2014 and June 2015, both in terms of net revenue and long-lived assets, largely due currency changes. Sanctions imposed by Russia have not and are not expected to have a material impact on the results of the company's operations, its consolidated results, or financial position. In the first 24 weeks this year Russia accounted for 4% of total net revenue, compared to 7% in the same period last year.

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Procter and Gamble Other consumer USA MM CC PP	The company performance both in Russia and globally has been significantly affected by currency exchange rate fluctuations led by Russian rouble. Procter and Gamble saw this as a primary risk which could adversely impact its business results and/or financial condition.
Raiffeisen Bank International Financial Austria MM CC PP	Raiffeisen's Russian business has been widely affected by the geopolitical crisis. The rouble depreciation negatively affected performance in euro terms with falling trading income, falling assets due to translation effects and decreasing deposits. Non-performing loans in Russia have increased. The geopolitical and macroeconomic situation put a drag on RBI's share price, which dropped more than 50% during 2014. On a positive note, the depreciation of the rouble reduced costs in Russia. RBI also noted that Russia is an important market with high growth, high return on equity and the largest regional contribution to its net income, although this declined over the period. Because of deteriorating macroeconomic conditions, RBI will reduce risk-weighted assets in Russia by 20% by 2017. It has tightened lending criteria, cut exposure to cyclical sectors, reduced maturities and increased collateral. RBI sees slowing economic momentum in 2015. RBI emphasises that EU and Russian sanctions have not had a material direct impact on growth. However, initial sanctions contributed to the deteriorating sentiment among investors. The RBI also noted the Russian central bank's inability to stabilise the rouble. Furthermore, it said that Russia's government failed to enact reforms in the previous cycle and that if it fails now it will be a significant drag on growth.
Renault Other consumer France MM CC PP	In 2014 Renault increased its market share in Russia, which is its third largest market. However, the economic problems saw Renault car registrations fall by 40% in H1 2015 against an overall market decline of 36%. Renault's current strategy is to preserve margins by allowing production cuts, with its market share down 0.5 percentage points to 7.3% in the first six months of this year. Meanwhile, the Renault–Nissan Alliance, which has a two-thirds stake in Russia's largest car producer AVTOVAZ, continues to target a market share of 40%. Last year this joint venture launched the new Logan model in Russia, which is being built at the AVTOVAZ plant in Togliatti.
Royal Dutch Shell Oil and gas UK/Netherlands MM CC PP	Growth slowed in Russia last year, which Shell describes as an important market. Shell had to pause its liquids-rich shale exploration activities in 2014 as a result of the EU and US sanctions prohibiting certain oil and gas activities in Russia.

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Sanofi Healthcare France MM CC PP	Sales in Russia increased by 7.1% in 2014 and by 0.5% in the first quarter this year when measured at constant exchange rates, with consumer health and diabetes treatments particularly strong. However, net sales fell by 5.9% in the second quarter this year due to tough economic conditions. Results have been affected by the fall in the rouble. Sales have also impacted by the 'monetary crisis' which led to a reduction in inventories held by wholesalers in the fourth quarter of last year.
SCA Other consumer Sweden MM CC PP	SCA reported strong growth in Russia in 2014 and the first half 2015 across its various brands and downplayed the effect of rouble devaluation saying that it would only impact the translation of profits as the company both produces and sells in Russia. In Q2 2015 the company reported a 46% growth in personal care revenues compared to the same quarter last year, in part due to charging higher prices. SCA inaugurated a new production line at its Sovetsk facility in 2014. Earlier that year the company was adversely affected by a change in the Russian reimbursement policy, but this was subsequently reversed.
Schneider Electric Industrials France MM CC PP	The underlying market in Russia was weak in the first quarter this year, pushing down the IT segment in particular. In 2014 the business was affected by the geopolitical headwinds including the tensions between Russia and the West. In the building segment the Russian operation was resilient over the year, and saw an increase towards the year end due to inventory build-up by customers who anticipated further currency depreciation. By contrast the IT segment saw a decline due to distributor destocking over the year. In Q2 this year the company reported continuing weakness in Russia. The environment is expected to remain difficult. The chairman and CEO has said Schneider has a lot to do to readjust operations to the 'new normal' in Russia.
Siemens Industrials Germany MM CC PP	Recession in Russia contributed to a disappointing performance in 2014. The power transmission business was affected by a significant decrease in Russian electrical infrastructure during the 2014 fiscal year. The outlook for 2015 is uncertain because the future of the Ukraine conflict and the reaction of Western countries is not foreseeable.

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Société Générale Financial France MM CC PP	SocGen's assessment of the Russian market deteriorated over 2014 from 'satisfactory' and 'healthy' to 'under pressure' by the end of the year. After a significant goodwill write-down in Q1 2014 the bank performed well during the year due to what it describes as proactive asset and liability management. However, its results in Russia deteriorated in Q1 this year, with loans down 9.7% on the year end, revenues falling 38.7% and a net loss of €108m. Credit outstanding was down 15% in Q2 compared to the year before due to an 'increasingly selective' approach to loan production. Net banking income was down 30% on the year, but increased 15% on the quarter due to a recovery in margins. Costs are down due to a 1,200 reduction in headcount. Nevertheless, SocGen remains committed to the Russian market despite a slight decrease in its exposure to Russia over the last year.
Solvay Group Basic materials Belgium MM CC PP	Solvay has been exposed to the substantial devaluation and the increased volatility of the rouble-euro exchange rate with the impact noted in Q4 last year. The CEO down-played the impact of sanctions in Q1 last year. In September 2014 Solvin, which is 75% owned by Solvay, and its joint venture partner Sibur inaugurated the RusVinyl PVC facility, valued at €96m in the 2014 annual accounts. In Q2 2015 the company reported they are further ramping up production at this facility in a good market environment.
Takeda Pharmaceutical Healthcare Japan MM CC PP	Russia continues to be one of Takeda's priority markets as it is delivering double-digit sales growth. Takeda's commitment to the Russian market is two-fold: to maximise the sales of its existing brands portfolio and to penetrate the market with new products. The company has successfully responded to the Russian government localisation targets by opening a factory in Yaroslavl to sustain future growth. Russian healthcare policy including nationwide health insurance and reimbursement schemes and the continuation of the government's public commitment to healthcare will impact on the business.
Telenor Utilities and telecom Norway MM CC PP	Telenor's exposure is through its 43% investment in VimpelCom Ltd which controls Russia's third largest mobile provider Beeline. In the 2014 annual report Telenor recognised the negative translation impact of the fall in the rouble on the value of this business.

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Tetra Pak Industrials Sweden MM CC PP	In 2014 Russia was the fourth biggest Tetra Pak market and the geopolitical situation in Russia and Ukraine affected the Group's performance negatively. Milk production slowed in Russia over the year as poor profitability caused a further contraction in local herds. A key factor was the Russian ban on dairy imports which curbed trade growth to a certain extent. The ban was highly disruptive in 2014, but is unlikely to have a major effect on the Group business in the long run.
Total Oil and gas France MM CC PP	Total has been significantly affected by US sanctions against Novatek, its partner shareholder in the Yamal LNG project. To comply with sanctions the financing plan was put under review in Q3 2014. Total has not acquired additional shares of Novatek since July that year. Total's Russian assets are among the most sensitive to falling oil prices. The company recognized a $350m impairment on its Shtokman field investment in Q1 last year due to high costs and uncertain profitability. In Q2 2015 Total reported production had begun at the Termokarstovoye gas field, while in July it signed an agreement to transfer its Bazhenov exploration licenses to OAO Lukoil. This also sets out the conditions under which Total and OAO Lukoil could potentially resume joint activities in Russia.
UniCredit Financial Italy MM CC PP	The 2014 annual report noted that while the economy has suffered a structural slowdown over several years, this was reinforced by the Ukraine conflict and sanctions. Sanctions have significantly restricted the business of Russian companies and access to Western capital markets, making them increasingly dependent on financial aid provided by the state. Aggressive policy tightening by the central bank contributed to the slowdown that is likely to see Russia in recession this year, with an easing of sanctions needed to restart growth. In the last month of 2014 UniCredit Group's market risk was negatively affected by higher market volatility, driven by turbulence in Russia. But the sanctions imposed so far have not had any discernible impact on the bank's loan portfolio and at the time of the 2014 report it was not experiencing deposit outflows exceeding normal operations. In Q2 2015 the company said the recession in Russia is likely to be shallower, but also longer than previously expected, with prospects for recovery postponed until 2017 or beyond by long-standing structural weaknesses and the consequences of sanctions.
Unilever Food, drink, tobacco UK/Netherlands MM CC PP	Unilever's performance in Russia in 2014 was mixed. The market was soft during the year with sales down towards the end as consumer incomes were squeezed. This was exacerbated by geopolitical events which the company sees as a factor holding back growth. Nevertheless, Unilever launched Domestos Ultra Power in Q2 2014 and expanded its offer in the green tea segment in the first quarter this year. In Q2 2015 Unilever reported that volumes were down in Russia as high inflation and high interest rates have put pressure on consumer demand.

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United Technologies Corporation Industrials USA MM CC PP	UTC's sales in Russia in 2014 were unchanged from the year before. In the annual report the company noted that while Russia is a key supplier of certain commodities and parts, it has taken steps to minimize the potential for disruption to its business, although at the time of the report the company had not seen significant signs of disruption.

Conclusions

Conclusions

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In this report we find that while a large majority of foreign companies share a negative outlook for the Russian market, there is much greater variation in what the same firms are actually doing in Russia. In particular, several firms are still expanding their operations, even as others step back. Moreover, we find examples of firms ‘doubling down’ and increasing their commitment to the market even though their assessment of the outlook is bleak. Behaviours vary across sectors, in ways that both reflect how the shocks impacting on Russia affect those sectors differently, but also how the policy environment varies across sectors; supportive in some, but also negative in many others. Healthcare is the most optimistic sector, with financial and energy firms the most pessimistic.

Several firms are likely to be at a fork in the road in their Russian strategy, with the path they take dependant on both the external environment and internal policy choices of the government. The choice for many firms is between cutting losses, holding options open, or seizing counter-cyclical opportunities. For now, we see examples of all three approaches. Unless the environment for business improves, however, the balance will almost certainly shift, with more firms stepping back from the Russian market.

For many firms this is a balancing act between immediate risk and the uncertain future opportunities that can be exploited if they maintain their market presence and the environment improves. Striking that balance and making the right strategic choices will require a very careful reading of both the internal policy environment and the external factors impacting on Russia in the months ahead.

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Global Counsel is able to help businesses understand what the issues identified in this report mean for them.

Political and economic developments in Russia and changes in the business environment create many risks and some opportunities. We are able to help businesses follow and interpret these developments, identify the risks and opportunities in their sector and develop strategies to respond to these changing circumstances.

If you would like to find out more please contact the author of this report at g.irwin@global-counsel.co.uk.

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