CEEMEA Business Group

Russia Business Survey

The 2016 Budget Outlook

by Dr. Daniel Thorniley
President, DT-Global Business Consulting
danielthorniley@dt-gbc.com

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IN ASSOCIATION WITH: anaplan, Baker & McKenzie, Cushman & Wakefield, EY Building a better working world, Radius Group

Background

This is a summary report of our findings from our survey related to business operations: the findings are based on replies from some 108 respondents taken at the end of September/start of October and we compare these figures with initial draft numbers for the 2016 budget, which we compiled 6-7 weeks earlier at the end of August when 163 replied to that earlier survey.

A major intention behind some of the questions and findings was to find out if and what had changed during the 6-7 week period and whether companies had altered their draft/initial 2016 budgets.

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

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

The executive summary

Business strategy summary

- One third of companies are engaging in more scenario planning in their 2016 budget compared with earlier budgets. This means of course that 69% are following their usual approach to scenario planning (but many executives may feel that they have sufficient scenarios to begin with)
- Only 13% of companies are pushing back the final submission of the 2016 budget from an early/mid-autumn date to one later in 2015 (note: this applies of course to companies working with a calendar fiscal year)
- Some 29% of executives are more pessimistic in their 2016 budget assessment at the start of October compared with 6-7 weeks earlier (end of August/start of September). Global and Russian/rouble volatility and little economic improvement may have caused this.
- BUT curiously when we compare figures for the 2016 budget plan compiled in early October they are generally a bit stronger than those compiled 6-7 weeks earlier at the end of August/start of September. There does seem to be some mis-match in perceptions and number crunching here.
- Anecdotally executives are complaining about the extreme economic and business volatility experienced in 2015.
- Also from conversations it seems increasingly that business results stem from the leadership stance of management in Moscow and at European, global headquarters.

Sales summary

- Something fairly dramatic is happening in proposed sales growth denominated in FX (foreign currency) in 2016 draft budgets and this is now substantiated by both our recent surveys, and the trend for higher FX sales results in 2016 is getting stronger.

Companies planning double-digit and high single-digit FX sales growth in 2015 and in 2016 draft budgets

	2015	2016 (1st draft)	2016 (2nd draft)
Double digit FX sales 15	7%	9%	16%
High single digits (5-10%)	3%	11%	19%

- Put another way, in the last 6-7 weeks the number of companies planning to grow sales in FX by more than 5% has jumped from 20% to 35% and this compares with a figure of just 10% in 2015. The tables below analyse the details.
- **<u>These numbers do look like a stretch and a bit on the optimistic side.</u>**
- We still presume that those executives who anticipate and budget or such strong FX growth are assuming that they will meet their targets for rouble sales growth AND THEN that 2016 will see less oil price and rouble volatility, which would then ensure "automatically" decent FX results on the back of steady rouble growth.

- **69% of executives predict that the rouble will be close to its current level versus the Euro at the end of 2016. 79% of respondents predict the rouble will be close to current levels versus the US dollar at the end of 2016.**
- In 2015 those expecting negative FX sales growth is a huge 65% but in both 2016 budget drafts this has fallen to "just" 30%. So it is worth bearing in mind that almost one third of respondents are still not upbeat regarding FX sales growth.
- Profits in FX for 2016 are also budgeted at a better level than FX sales or last year's FX profits: this means that companies plan to continue cost reductions while maintaining some price increases.
- Rouble/LOCAL currency sales growth in 2016 has shifted upwards from a cluster of high single digit increases to low double digit increases.
- In Russia more companies have upgraded their double-digit plans for 2016 in LOCAL currency/roubles:
  In 2015 those expecting double-digit sales growth in roubles amounts to 34% of companies.
  In the first draft budget for 2016 (first days of September) this rose to just 44%.
  But in the second 2016 draft budget (first days October) this climbed to 47%.
- Those planning single digit rouble growth have therefore shrunk from 46% in the first draft budget to 38% now.
- Over the last 6-7 weeks many executives have upgraded their 2016 plans for sales growth in Ukraine in local currency (and this may be due to the economic stabilisation which appears to have started in Ukraine).
- Some 54% of companies plan to raise prices in 2016 by 1-10% while 28% plan not to raise prices at all and the latter will include companies in restricted sectors such as reimbursed pharmaceuticals and those companies who invoice in FX.

Investment summary

- Some 29% of respondents plan new FDI in 2016 and that is 34% from consumer product firms. This is positively surprising. The figure has been substantiated in two recent surveys and does not appear to be a fluke!

HR summary

- Given a better budget outlook in 2016, fewer companies plan layoffs in 2016: in 2016 some 70% plan no lay-offs at all compared with 51% in 2015.
- Staff cuts have so far been on a small scale, mostly below 10% of total staff and any cuts in 2016 are also aimed to be below 10%.
- Salary increases in 2016 are budgeted to be below inflation once again for 76% of companies BUT more companies (34%) plan salary increases at inflation or just above.
- This is happening because inflation will come down from 15% in 2015 to 9% in 2016 and also because some companies plan to tweak up white collar average salary increases.
- BUT hardly any companies plan solid above inflation pay increases and most will cluster at about a 7% nominal pay increase, which was also "the average nominal figure" in 2015.

The numbers

The following two tables help you reflect on the above commentary:

Organic sales growth in Roubles, 2015 and 2016
(second preliminary budget for 2016, % change)

	All companies		Consumer products		Pharma/health		B2B/industrial	
	2015	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**
20%+	13	16	19	12	9	16	0	0
10%+	21	31	30	46	21	37	6	6
5-10%	22	30	19	25	29	26	28	24
1-5%	17	8	20	5	26	10	11	24
Flat/zero	10	9	3	4	6	5	28	47
Minus 1-10%	8	5	3	8	3	5	12	0
Minus 10%+	8	1	6	0	6	0	17	0

In recent weeks more companies have upgraded their forecast for rouble sales growth in 2016: before the majority were clustered in high single digits while now more are clustered in low double digits.

Taking all companies together, those planning double digit growth in 2016 has climbed to 47% compared with 34% in 2015.

Of all companies those budgeting for negative rouble sales growth declines noticeably from 16% to just 6%.

Consumer goods companies had a good start to the year but have flagged a bit in the summer and autumn, but still a massive 58% predict double-digit sales this year and another 30% are forecasting single digits (much of this growth stems of course from price rises).

Note: several executives in the food & beverages sub-sector of consumer goods argue forcefully that such growth figures are unattainable in their category given on-going trends and likely consumption patterns.

Pharma/health companies have been flagging through 2015 after starting the year with perhaps too strong expectations. Now 30% predict double digits in 2015 with a big cluster of 55% of respondents excepting single-digit sales growth this year and then 15% either flat or negative.

In 2016 more pharma/health companies budget provisionally for double digits up to 53% from 30% last year and there is still a good cluster of 36% budgeting for single digits and only 10% now planning for flat/negative sales next year. Much will depend of course on trends in federal/reimbursed sales, developments from localisation and price increases in the OTC sector.

Executives in the B2B/industrial sector budget for sober improvements in 2016 after a tough 2015. For 2016 no respondent company is planning negative sales (although we imagine that some non-respondents in automotive and IT could still be negative next year and/or prefer not to budget for such a scenario). Many companies climb from negative to flat sales (fully 47% in 2016) and more companies budget for single digits in 2016 (48%) compared with 39% this year.

Foreign currency sales - how the budget drafts are developing

FX sales outlook in 2015 – 2016

All companies

	2015	2016	
		1st draft	2nd draft
+10%	7	9	16
5-10%	3	11	19
1-5%	10	24	13
Flat/zero	13	27	22
Minus 1-10%	20	20	21
Minus 10+	45	10	9

We commented above on these numbers. Clearly they show a strong improvement in the first 2016 draft budget which is continued though into the second draft.

Clearly these numbers show a strong FX improvement for 2016, which would require some stabilisation in the oil price and the rouble value. **This looks a little optimistic** BUT given that the consensus of the oil price of still over $50 per barrel and one would “guess” that eastern Ukraine and sanctions ought not to worsen, then the presumption is that the rouble will not fall in 2016 to the same extent that it did in 2015.

FX sales outlook 2015 and 2016 by sectors

	2016		
	Consumer products	Pharma/ Health	B2B/ Industrials
10%	18	5	0
5-10%	13	31	11
1-5%	18	5	32
Flat/zero	19	15	37
Minus 1-10%	26	26	15
Minus 10%+	5	16	5

The FX growth is led by consumer product companies where now some 18% anticipate double digit FX sales growth and 32% budget for single digit FX expansion. *Note: several executives in the food & beverages sub-sector of consumer goods argue forcefully that such high growth figures (whether in roubles or FX) are not achievable in their category given on-going trends and likely consumption patterns.*

Pharmaceutical and health are somewhat less upbeat with only 5% looking at double digits and 36% predicting single-digit FX growth while 42% do forecast negative FX sales growth.

In the B2B sector a recovery from a very bleak 2015 is moderately anticipated: while no company forecasts double-digit FX growth, a hefty 43% look at single digits and a big cluster expect flat FX sales (37% of respondents)

Rouble sales, FX sales and what they mean for price rises

The big discrepancy in 2014 and 2015 of steady rouble sales and much worse FX sales stems from the inability of most companies to compensate fully through price rises for the devaluation, inflation and excise duties.

The following has happened with price increases:
- With the rouble collapse at the turn of 2014-15 most companies raised prices by 8-20% in February with the expectation of raising prices once or twice more in 2015.
- But when the rouble strengthened from March through June, many executives felt that pushing through further price rises would be increasingly difficult if not impossible.
- However by mid-August the rouble collapse ensured that more companies started to plan for September increases and Russian retail reports receiving letters of upcoming price hikes of 10-15%.
- Companies will evaluate through the autumn whether they will decide on another hike in November and/or February 2016.

In 2016 some 54% of companies plan to increase prices by 1-10% and another 17% forecast increases of 10-20%. Some 28% plan not to raise prices and some of these will be in restricted sectors such as reimbursed pharmaceuticals or will include companies that invoice in FX.

Will you invest in Russia?

On-going FDI in 2015

Some 26% of respondents have on-going, current investment in manufacturing FDI or logistics and distribution facilities. This rise to 39% among consumer product companies and many of these are investing in distribution and logistics rather than “pure” manufacturing factories.

26% of pharma/health companies have such investment while the number softens to 20% among B2B firms.

But it seems that by the end of this year many projects will have reached fruition and so the numbers for companies with on-going investment at the end of the year shrinks to 5% for B2B and just 14% for pharma/health which certainly does indicate that many such companies have already positioned themselves for localisation to meet new regulatory requirements in January 2016.

Will you make new FDI in 2016?

Here the numbers are surprisingly promising with 29% of companies planning new investment in Russia.

By sector the numbers are as follows for 2016:
- 32% of pharmaceutical companies plan direct investment in manufacturing, warehousing or logistics.
- 37% of consumer products companies.
- 11% of B2B companies.

As we noted above much of this depends on global and local leadership strategies and plans for the long-term in the market and aims for capturing market share over the long term as well as regulatory “pull onshore” in the pharmaceutical sector.

Human resources

How many staff will you cut and what will you pay in 2015 and budget for 2016?

At the start of 2015 some 80% of companies did NOT plan staff cuts, but by September this number is down to 51%. However, the staff cuts that have taken place have tended to be small and 35% of companies have limited cuts to below 10% of total staff. Many cuts are natural attrition and removal of poor performers. But some companies have started initial serious cuts to normal staff.

The intention in 2016 budgets is again to restrict staff reductions, and now 70% of companies are forecasting no staff cuts in 2016 while 27% of companies will keep cuts to within 10% of total staff with most staff cuts planned in the range of 10% of total staff.

However, if the business outlook turns bleaker (which is not the budget of most companies), then more staff cuts will be implemented.

Overall, the clear conclusion for now remains: companies are trying hard to protect their headcount but are determined to manage their costs and will keep salary increases firmly below inflation, which actually matches trends visible in the Russian economy overall and within the Russian civil service. It seems that everywhere real wages (after inflation) in 2015 will now trend at -7% to -10%.

In 2015 companies kept a very tight rein on salaries. For 2015 more companies are planning for below inflation pay increases as inflation rises further in Russia from an average 7.8% in 2014 to an average figure in 2015 of 14%.

There are variations of course and these are averages, and white collar covers a large number of positions. To assist you in budget planning, the following two tables compare previous periods (benchmarked to inflation) and also show what companies planned in 2014 and 2015 in absolute percentage terms and budget for 2016.

Salary comparisons 2014-2016 in absolute terms

What salary increase in roubles did you pay (do you plan) in absolute terms in 2014 and 2015 and do you budget for 2016?

	2014	Feb.15	Jun.15	Aug.15	2016 budget
Plus 10%	3%	12%	6%	11%	20%
5-10%	27%	55%	53%	52%	52%
1-5%	15%	16%	18%	18%	18%
Flat	20%	13%	22%	18%	10%
Negative	0%	4%	1%	0%	1%

What salary increase did you pay (do you plan) in the coming 12 months?

Salary comparison over time benched to inflation - “average” white collar staff members

% of companies

	Jan 2013	Jan 2014	Jan 2015	Jun 2015	2016 budget
Salary below inflation	3%	14%	89%	96%	76%
Salary at inflation or + 1-3%	70%	80%	11%	4%	34%
Salary at inflation +3-10%	25%	6%	0%	0%	1%

Given that companies are budgeting for better rouble sales and much better FX sales and profitability, it seems that at the margins, a few more companies plan slightly higher pay increases in 2016. The proportion of companies paying increases at inflation or just above is rising because 1) some companies are slightly tweaking pay increases and 2) inflation is predicted to fall from 14% to 9% in 2016. So for average white collar staff, there will be some slight sense of improvement; but we stress that salary levels will remain tight through 2016. Again if the climate deteriorates further this autumn, then companies will also re-examine proposed increases.

Instead of cutting staff numbers, companies are offering lower salary increases for “average” white collar staff. The upward pressures for top talent remain high, but these very high levels have also declined and decelerated. What is very manifest is that while in January 2013 it was almost unheard of to propose salary increases below inflation, this has changed radically with 96% of companies in this situation in summer 2015.

Also note that 78% of companies are not compensating Russian staff for the devaluation of the rouble.

CIS 2016 budgeted sales

In 2015 and 2016 Russia will represent 78-85% of total sales revenue from the CIS markets. In addition to being the huge volume market, sales trends in both 2015 and budgeted ones for 2016 are stronger than in other CIS markets. Russia is the “big baby”.

2016 sales budgets for CIS markets (in local currency)

	Russia	Ukraine	Kazakhstan	Belarus
Growth of 20%+	16	12	13	9
Growth of 10%+	31	21	17	13
Growth of 5-10%	30	22	33	29
Growth of 1-5%	8	14	8	14
Flat-zero	9	23	18	32
Decline of 1-5%	4	6	8	2
Decline of 5-10%	1	4	2	2
Decline of 10%+	2	0	0	0

Some quick comparisons can be made:

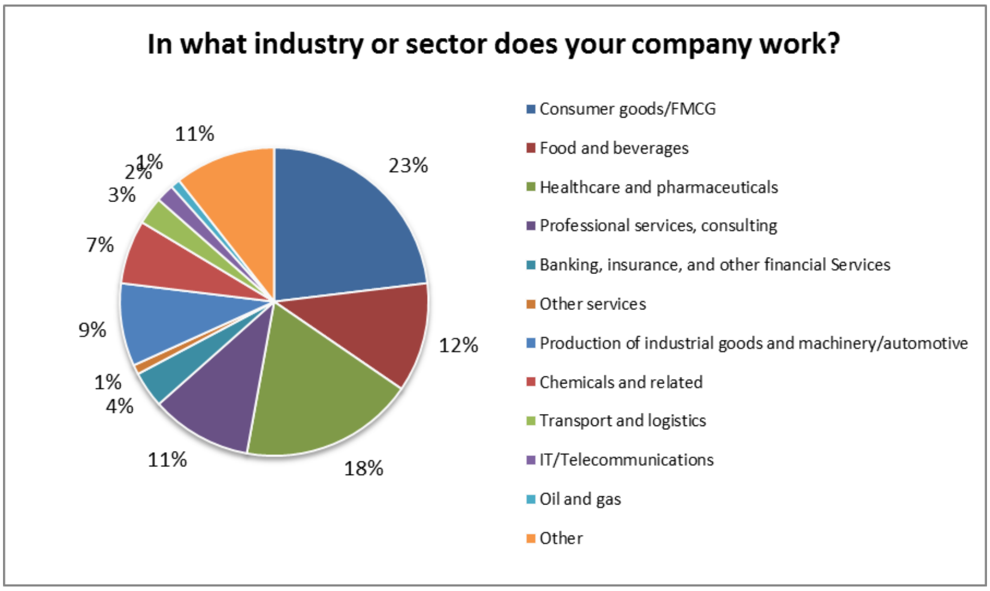
Kazakhstan: expectations are starting to moderate as we suggested they would. The market was the joint best-performing market at the start of 2015 but has now fallen behind Russian projected sales for 2015 and 2016. The tenge was devalued in August as we predicted in our central scenario. For the time being and next 12-18 months, Kazakhstan will remain the No 2 market behind Russia.

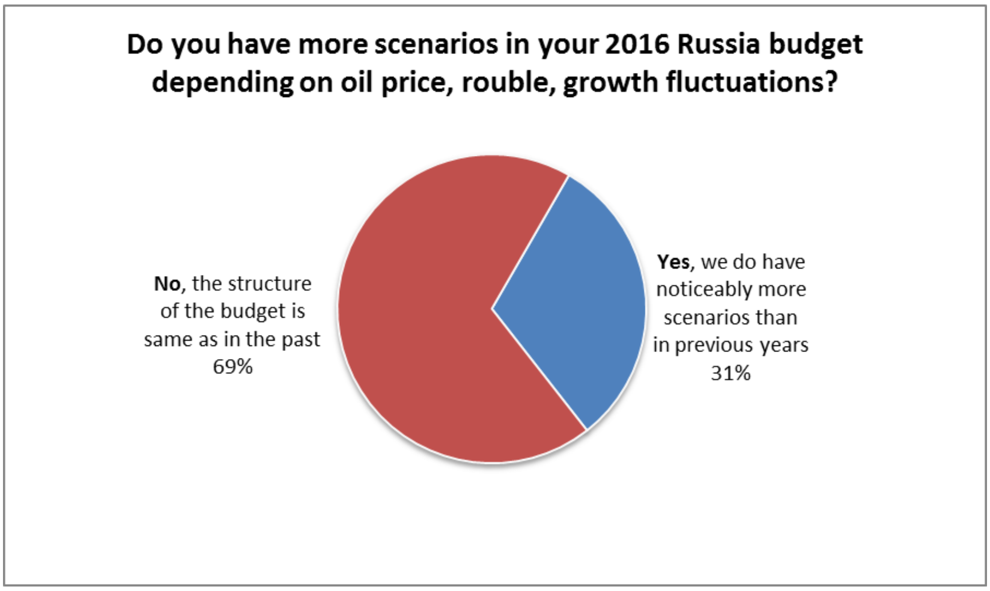
Ukraine: there has been an upward surge in expectations in the market for hryvnia sales growth. For example, those predicting double-digit growth 2 months ago numbered 16% and now this number has risen to 31% while those bracketed in single digits have increased from 25% to 36% now.

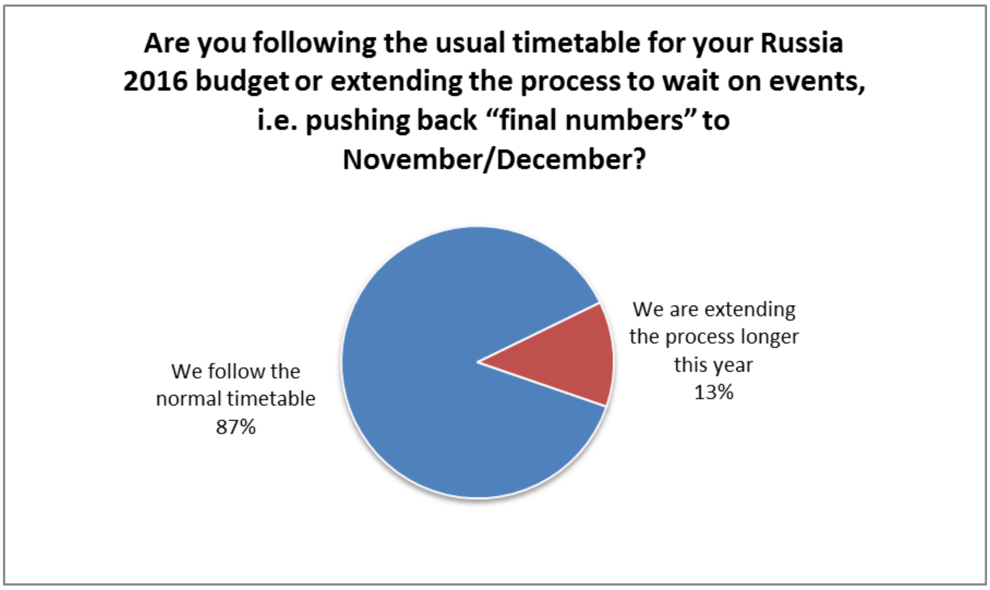
This may stem from recent economic stabilisation or the perception that the bottom has been hit and a slow recovery will now proceed. The recent debt agreement may also have improved the mood as well as the sense that the worst may also be over in eastern Ukraine. Most companies are struggling in hryvnia and very badly in FX but remarkably about 5-10% of western companies are doing very well in local currency and even not bad in FX, but we stress they are a minority. The 2016 budgets now appear much stronger than 6-7 weeks ago and much better than excepted 2015 results.

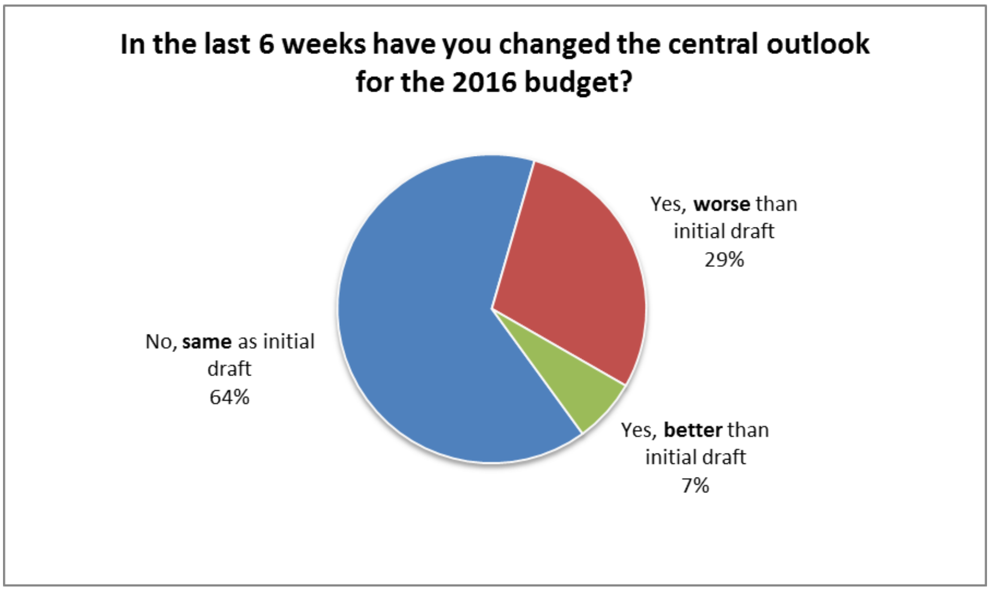
Belarus is a small market and results are worsening compared with 2014 as the Belarus rouble comes under increasing pressure. Executives have tweaked down their forecasts marginally for 2015 and budgets for 2016 are not ambitious with a large cluster predicting flat sales.

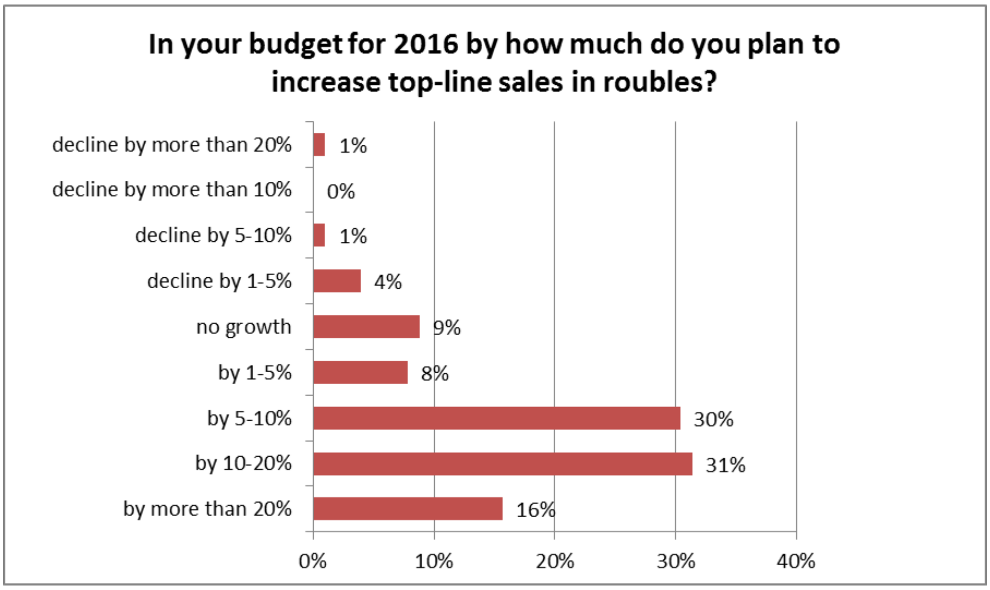
Survey charts on the following pages

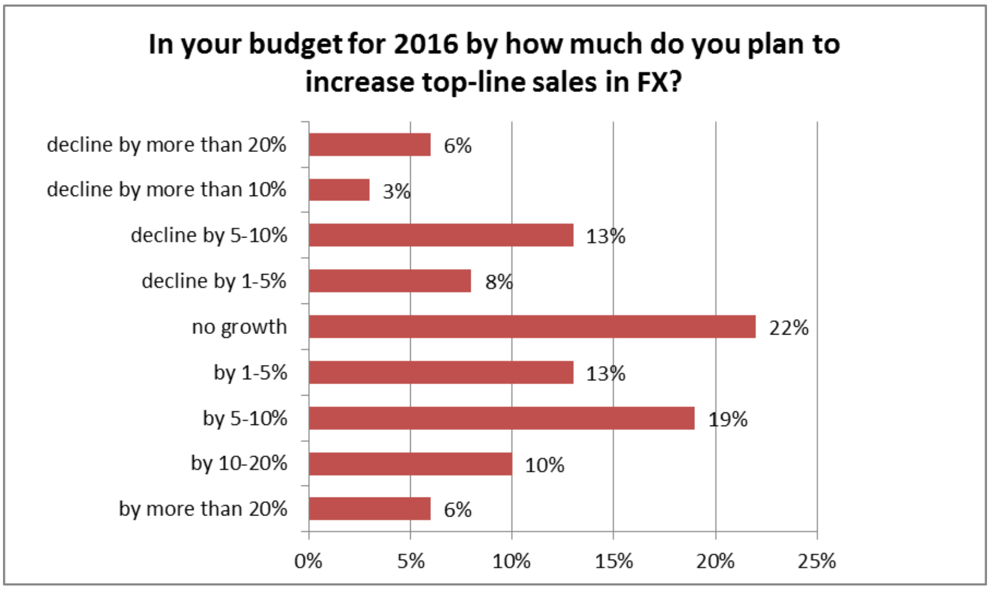

In what industry or sector does your company work?
Consumer goods/FMCG
Food and beverages
Healthcare and pharmaceuticals
Professional services, consulting
Banking, insurance, and other financial Services
Other services
Production of industrial goods and machinery/automotive
Chemicals and related
Transport and logistics
IT/Telecommunications
Oil and gas
Other
23%
12%
18%
11%
4%
1%
9%
7%
3%
2%
1%
11%

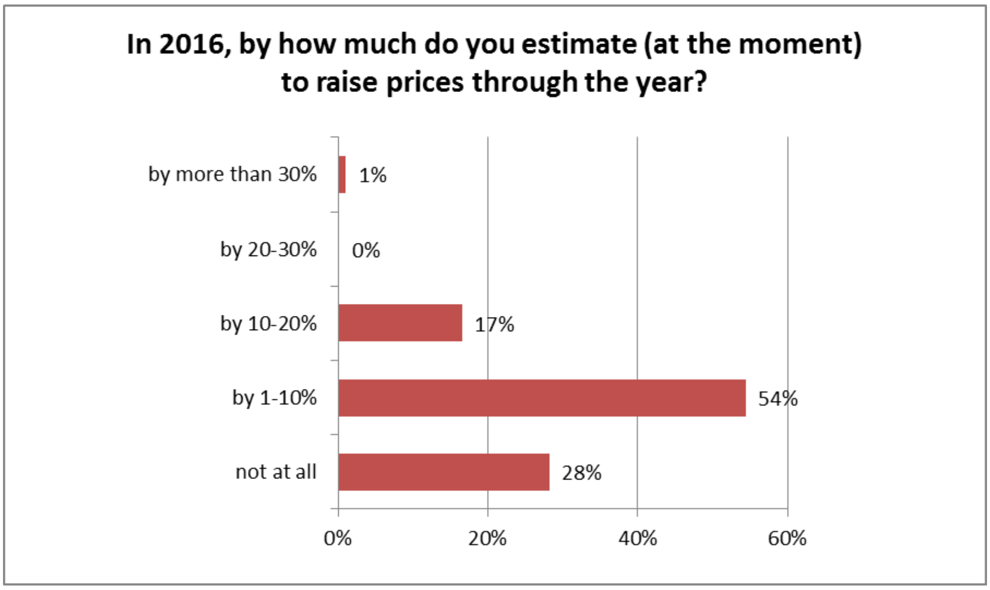

Do you have more scenarios in your 2016 Russia budget depending on oil price, rouble, growth fluctuations?
No, the structure of the budget is same as in the past 69%
Yes, we do have noticeably more scenarios than in previous years 31%

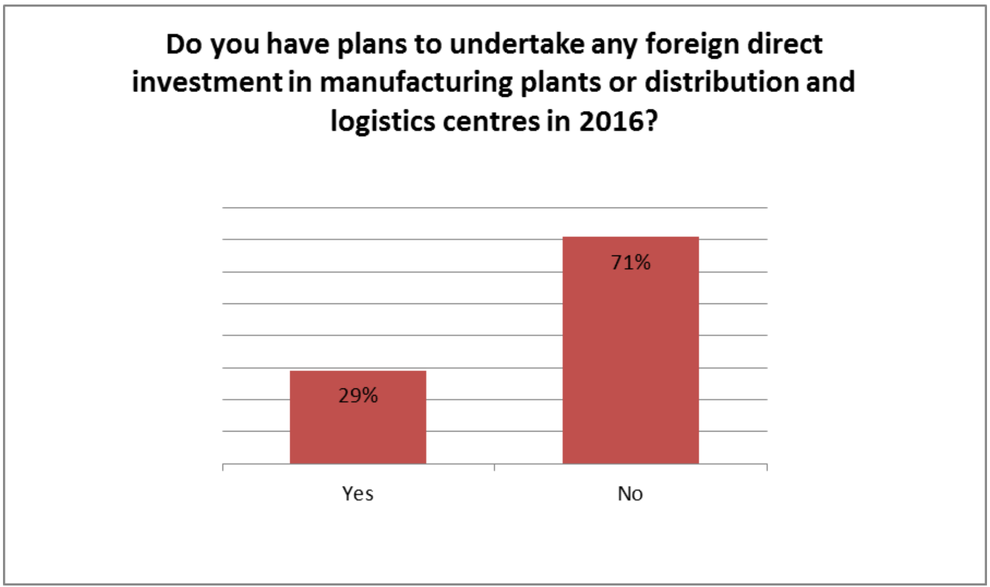

Are you following the usual timetable for your Russia 2016 budget or extending the process to wait on events, i.e. pushing back “final numbers” to November/December?
We follow the normal timetable 87%
We are extending the process longer this year 13%

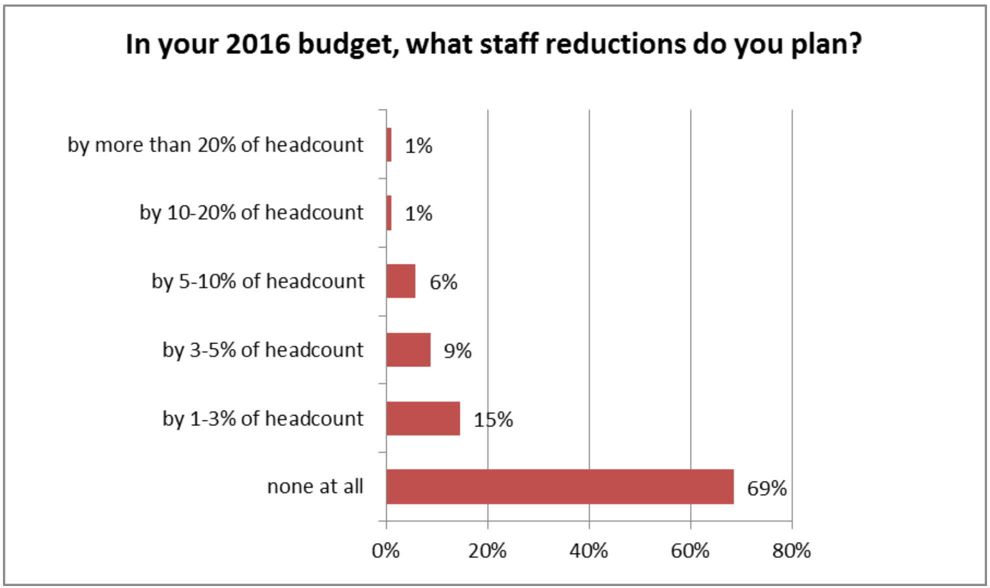

In the last 6 weeks have you changed the central outlook for the 2016 budget?
Yes, worse than initial draft 29%
Yes, better than initial draft 7%
No, same as initial draft 64%

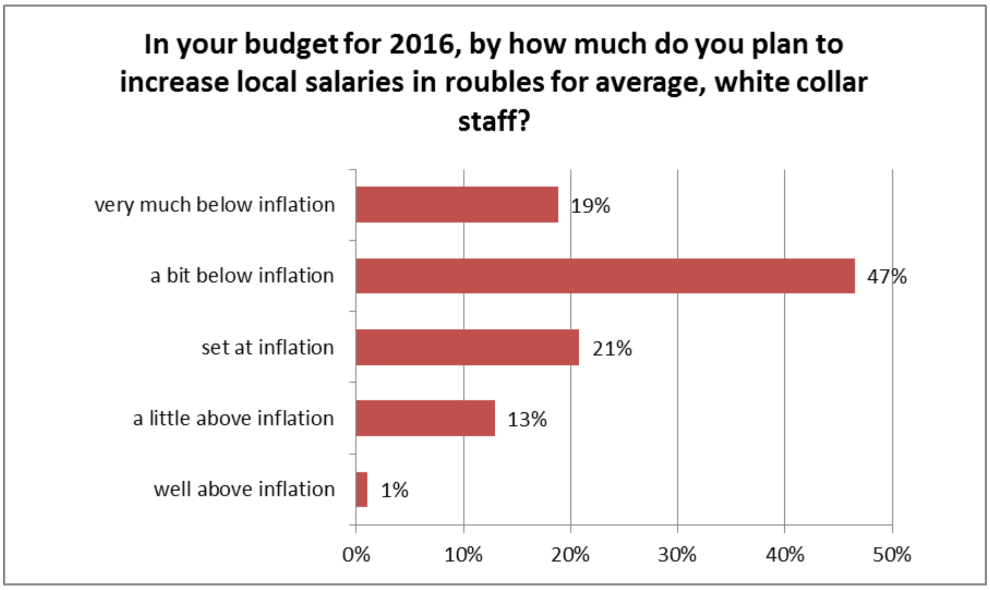

In your budget for 2016 by how much do you plan to increase top-line sales in roubles?
decline by more than 20% 1%
decline by more than 10% 0%
decline by 5-10% 1%
decline by 1-5% 4%
no growth 9%
by 1-5% 8%
by 5-10% 30%
by 10-20% 31%
by more than 20% 16%
0% 10% 20% 30% 40%

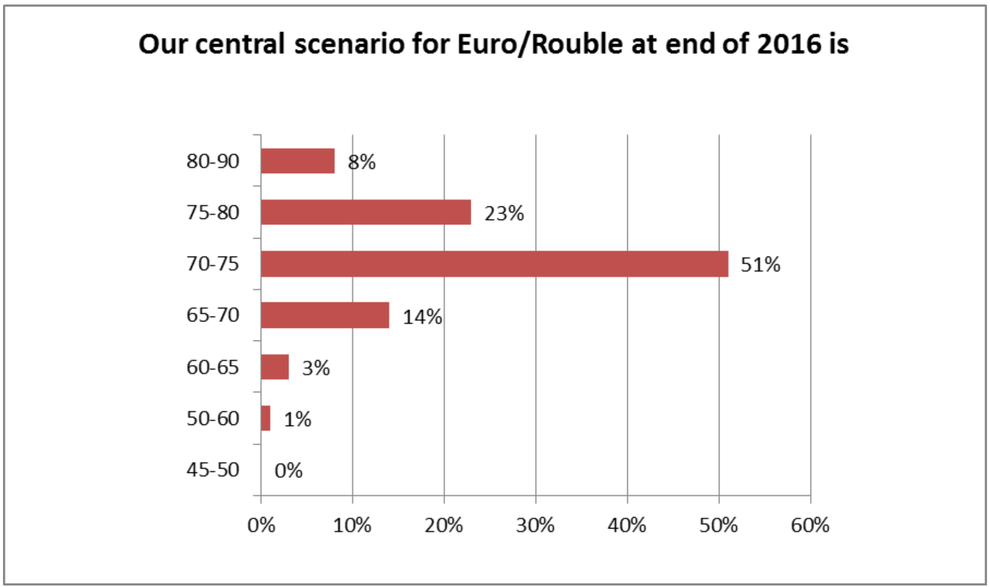

In your budget for 2016 by how much do you plan to increase top-line sales in FX?
decline by more than 20% 6%
decline by more than 10% 3%
decline by 5-10% 13%
decline by 1-5% 8%
no growth 22%
by 1-5% 13%
by 5-10% 19%
by 10-20% 10%
by more than 20% 6%
0% 5% 10% 15% 20% 25%

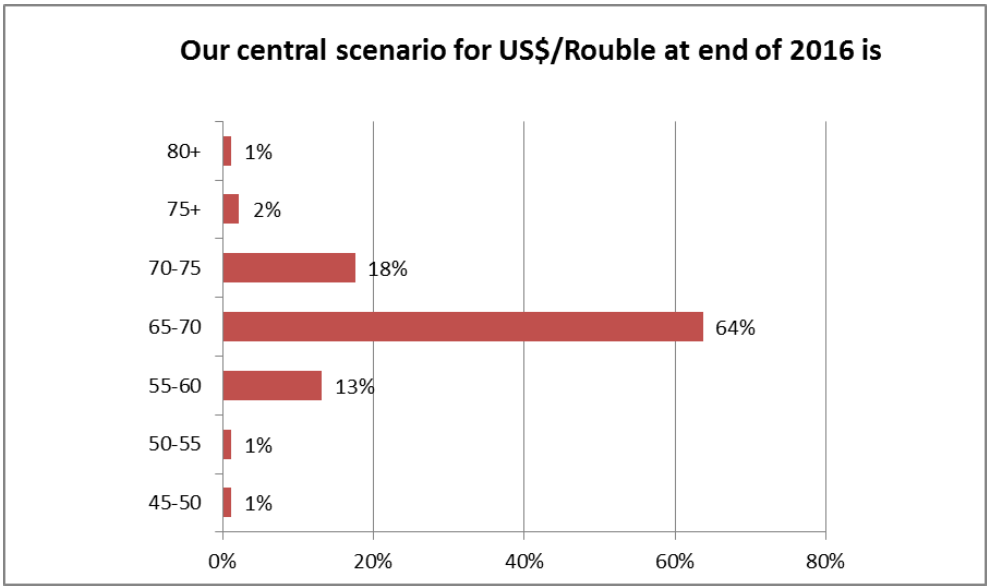

In 2016, by how much do you estimate (at the moment) to raise prices through the year?
by more than 30%
1%
by 20-30%
0%
by 10-20%
17%
by 1-10%
54%
not at all
28%
0%
20%
40%
60%

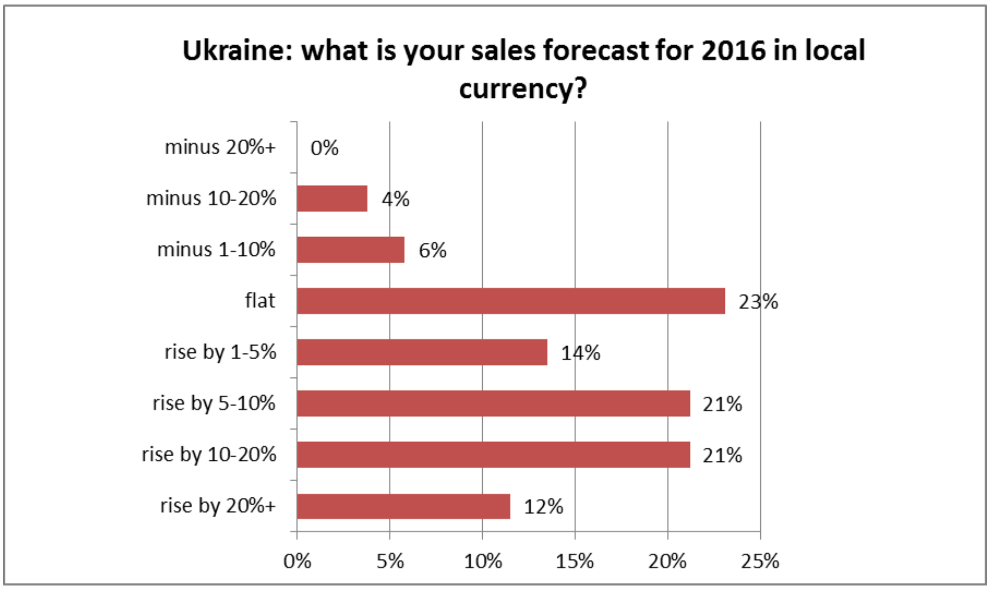

Do you have plans to undertake any foreign direct investment in manufacturing plants or distribution and logistics centres in 2016?
29%
71%
Yes
No

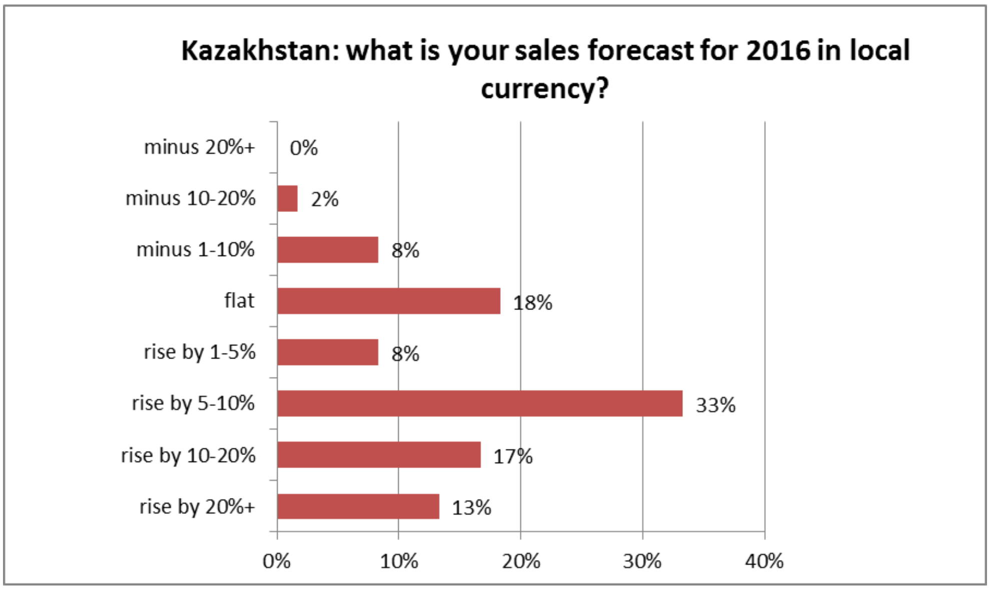

In your 2016 budget, what staff reductions do you plan?
by more than 20% of headcount
1%
by 10-20% of headcount
1%
by 5-10% of headcount
6%
by 3-5% of headcount
9%
by 1-3% of headcount
15%
none at all
69%
0%
20%
40%
60%
80%

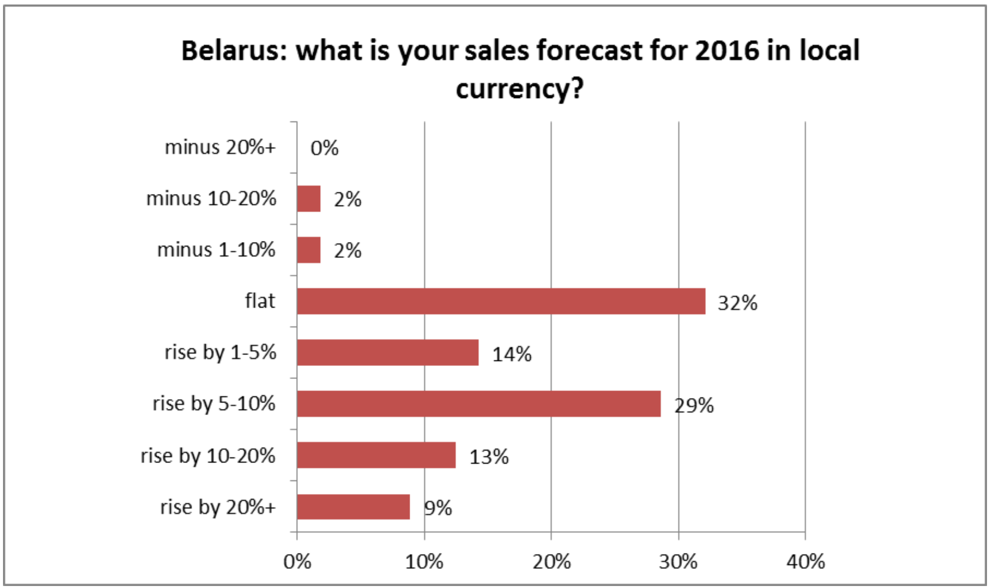

In your budget for 2016, by how much do you plan to increase local salaries in roubles for average, white collar staff?
very much below inflation
19%
a bit below inflation
47%
set at inflation
21%
a little above inflation
13%
well above inflation
1%
0%
10%
20%
30%
40%
50%


Our central scenario for Euro/Rouble at end of 2016 is
80-90
8%
75-80
23%
70-75
51%
65-70
14%
60-65
3%
50-60
1%
45-50
0%
0%
10%
20%
30%
40%
50%
60%


Our central scenario for US$/Rouble at end of 2016 is
80+
1%
75+
2%
70-75
18%
65-70
64%
55-60
13%
50-55
1%
45-50
1%
0%
20%
40%
60%
80%


Ukraine: what is your sales forecast for 2016 in local currency?
minus 20%+
minus 10-20%
minus 1-10%
flat
rise by 1-5%
rise by 5-10%
rise by 10-20%
rise by 20%+
0%
4%
6%
23%
14%
21%
21%
12%
0%
5%
10%
15%
20%
25%


Kazakhstan: what is your sales forecast for 2016 in local currency?
minus 20%+
minus 10-20%
minus 1-10%
flat
rise by 1-5%
rise by 5-10%
rise by 10-20%
rise by 20%+
0%
2%
8%
18%
8%
33%
17%
13%
0%
10%
20%
30%
40%


Belarus: what is your sales forecast for 2016 in local currency?
minus 20%+
minus 10-20%
minus 1-10%
flat
rise by 1-5%
rise by 5-10%
rise by 10-20%
rise by 20%+
0%
2%
2%
32%
14%
29%
13%
9%
0%
10%
20%
30%
40%

DT-Global Business Consulting GmbH, Address: Keinergasse 8/33, 1030 Vienna, Austria,
Company registration: FN 331137t
and GSA Global Success Advisors GmbH, Hoffeldstraße 1, 2522 Oberwaltersdorf, Austria
Company registration: FN 331082k

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