Russia through a lens

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Contents

We are pleased to present the latest edition of Russia Through a Lens, the macroeconomic journal produced by the Deloitte Research Centre in Moscow.

Established in December 2015, the journal is published quarterly and falls under the Research Centre's monitoring activities.

In Russia Through a Lens, we focus on current key trends in the Russian economy and present our research in the following fields:

- Russia in Figures: statistical analysis
- Latest from Deloitte Research Centre
- Top M&As

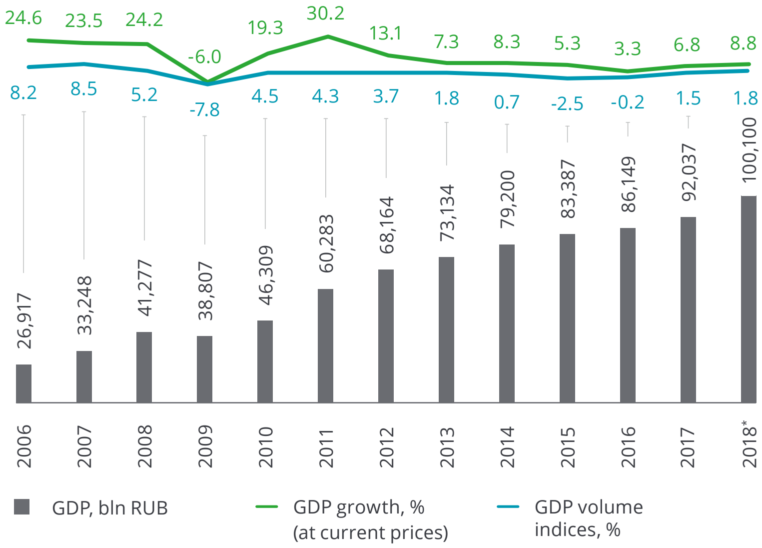
If you have any questions or suggestions regarding this research, please do not hesitate to contact us at: cisresearchteam@deloitte.ru

Created by the Deloitte Design Group, Moscow

Russia in figures

GDP

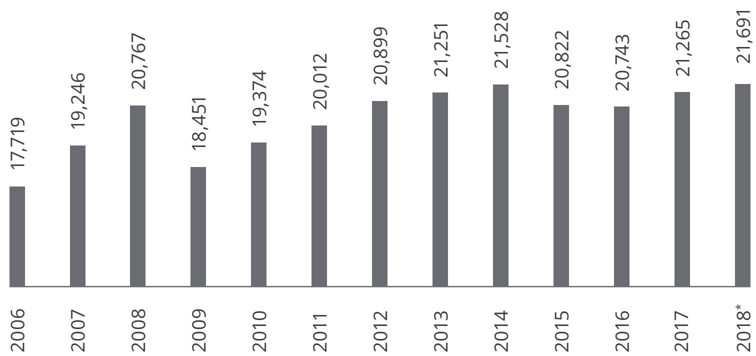
GDP dynamics



Source: Rosstat, (*forecast) Institute for Economic Forecasting of the Russian Academy of Sciences (IEF RAS)

In June 2018, the Federal State Statistic Service (RosStat) adjusted its figures, increasing manufacturing output to 2.1 percent for 2017 (previously 1 percent) and to 3.2 percent for January-May 2018 on the same period of 2017.

Q2 GDP (at constant price 2016), bln RUB



Source: Rosstat, (*forecast) Central Bank of Russia

> "This year Russia is set for a growth of 1.6-2.1 percent."

Maxim Oreshkin,
Minister of Economic Development of the Russian Federation

According to the Russian Ministry of Economic Development, January–May 2018 saw a growth of 1.8 percent. Manufacturing and transportation as well as the wholesale and retail industry became the key contributors to a higher growth in April–May on Q1 2018. In addition, the last two months have also seen a recovery continuing in the construction industry.

Source: "Overview of the Economy. June 2018" by the Russian Ministry of Economic Development

The Russian Central Bank expects a YoY growth rate of 1.8–2.2 percent for Q2 2018.

Source: "Economy: facts, estimates, commentaries. May 2018" (analytical commentaries by the Russian Central Bank).

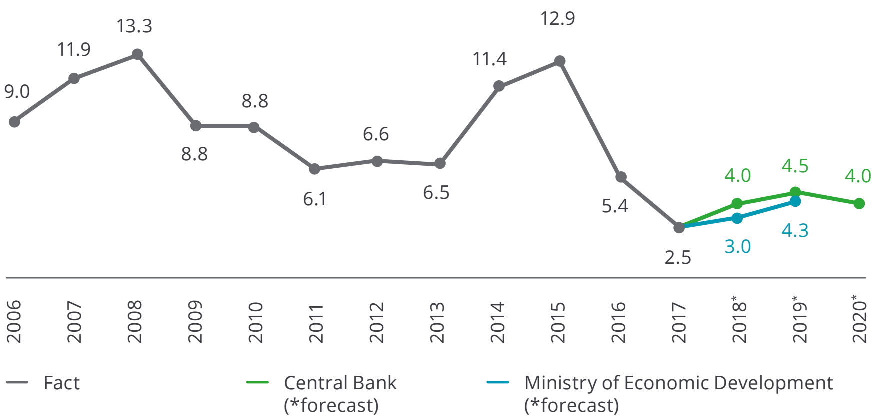
GDP forecasts

Source	2018	2019	2020
Economist Intelligence Unit	+1.7%	+1.8%	+1.6%
The Ministry of Economic Development	+1.9%	+1.4%	-
Central Bank	+1.5% - +2.0%	+1.5% - +2.0%	+1.5% - +2.0%
IEF RAS	+1.8%	+2.1%	+2.2%
Standard & Poor's	+1.8%	+1.7%	+1.7%
Moody's	+1.5%	-	-
Fitch	+1.8%	+1.9%	+1.5%

Source	2018	2019	2020
European Commission	+1.7%	+1.6%	-
World Bank	+1.5%	+1.8%	+1.8%
International Monetary Fund	+1.7%	+1.5%	+1.5%
European Bank for Reconstruction and Development	+1.5%	+1.5%	-
Gaidar Institute	+1.5%	+1.4%	+1.6%
Organisation for Economic Cooperation and Development	+1.8%	+1.5%	-

Inflation

Inflation rate, %



"We expect a higher VAT rate to contribute about 1 pp to the inflation.... Based on our estimates, inflation may increase beyond the target, up to 4.5 percent, for a short period of time next year and then go back to 4 percent."

Elvira Nabiullina,
Governor of the Bank of Russia

Inflation rate forecasts

Source	2018	2019	2020
International Monetary Fund	3.5%	4.0%	4.0%
Vnesheconombank	3.5%	4.0%	-
Bloomberg poll (consensus)	2.9%	4.0%	-
Interfax poll (consensus)	4.0%	4.1%	-
Economist Intelligence Unit	4.0%	4.4%	4.2%

Inflation in January-May 2018*: 1.6 percent
Inflation target** in 2018: 4.0 percent

*The inflation figure is the consumer price growth rate over the corresponding month of the previous year.

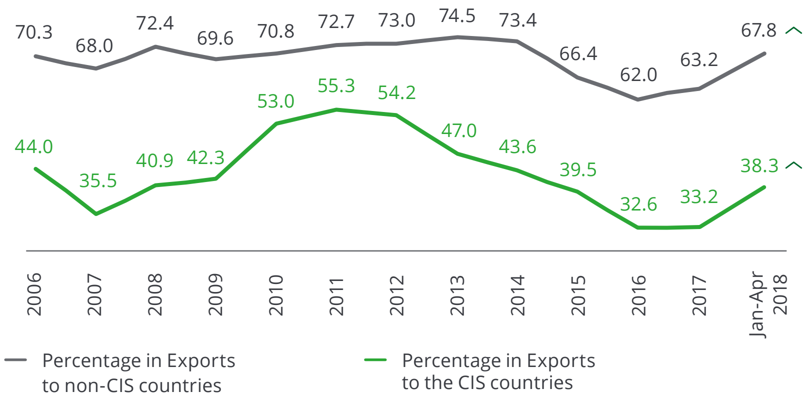
**The inflation target is set for the consumer price growth rate over the corresponding month of the previous year (Source: Central Bank).

Trade structure

Period: January–April 2018

- Foreign trade turnover: USD 215.2 billion (+23.8% YoY)
- Trade balance: surplus of USD 65.3 billion (+USD 17.9 billion YoY)
- Exports: USD 140.2 billion (+26.8% YoY)
  Share of the CIS countries 12.2%, non-CIS countries 87.8%
- Imports: USD 75.0 billion (+18.6% YoY)
  Share of the CIS countries 11.1%, non-CIS countries 88.9%

Share of energy products in total exports, %
(January 2006 – April 2018)



Source: Federal Customs Service

Amid the steel and aluminum duties from the USA, Russia is considering additional import duties on US products where similar products are available on the Russian market. The total impact from these retaliatory measures is expected to amount to almost USD 540 million. The Russian government expects this would be a commensurate response to export losses incurred by Russia as a result of the US sanctions.

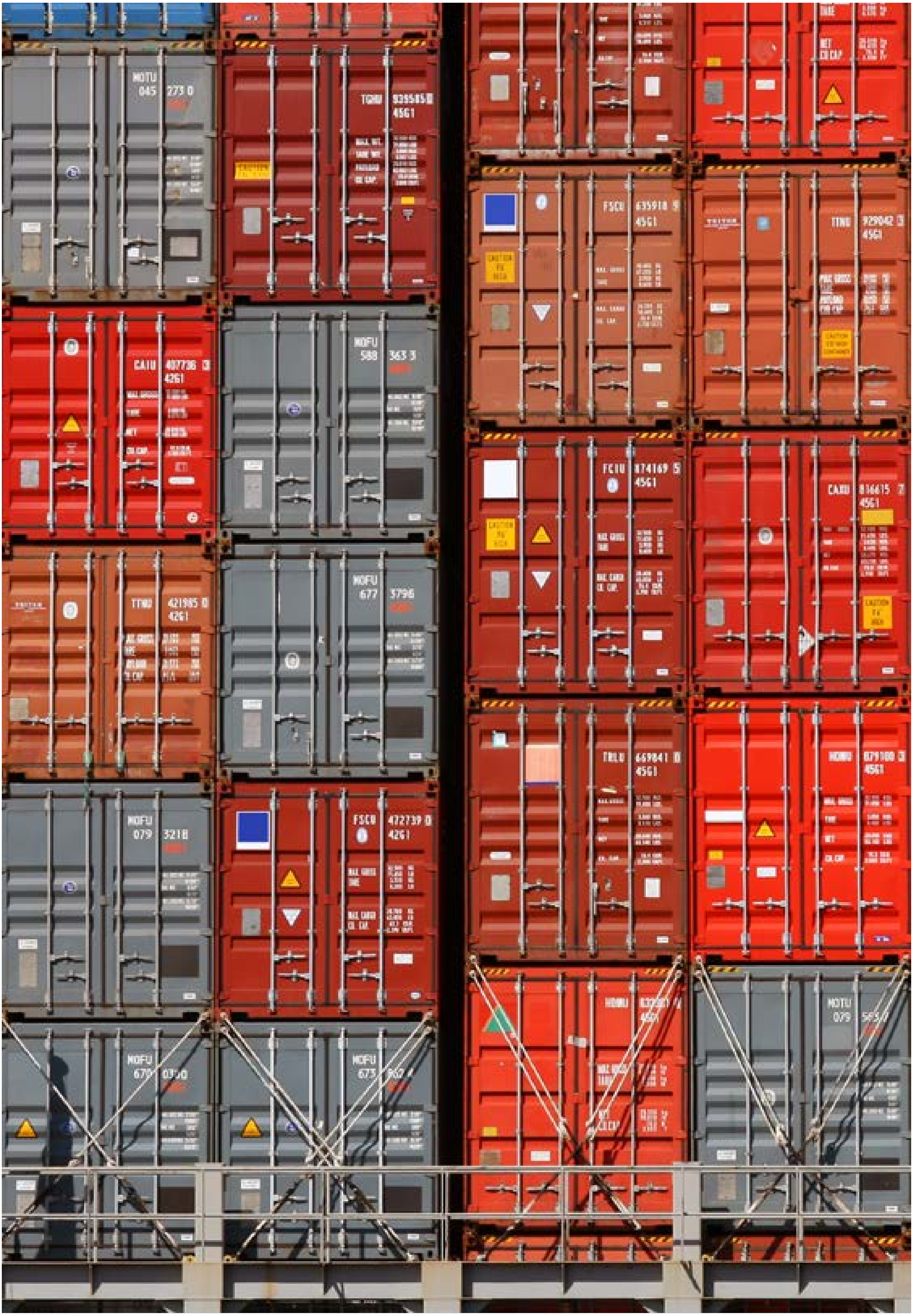
Source: Russian Ministry of Economic Development

Share of products in total exports to the CIS/non-CIS countries (January-April 2018)

	To non-CIS countries	To the CIS countries
Energy products	67.8%	38.3%
Metal products	10.4%	12.5%
Chemical products	5.0%	13.2%
Machinery and auto	4.2%	15.8%
Food and agriculture products	4.8%	9.0%
Timber, pulp and paper products	3.0%	4.3%

Share of products in total imports from the CIS/non-CIS countries (January-April 2018)

	To non-CIS countries	To the CIS countries
Machinery and auto	49.3%	20.7%
Chemical products	19.5%	14.7%
Food and agriculture products	12.3%	20.4%
Metal products	5.8%	18.7%
Textiles and footwear	6.1%	7.5%
Energy products	0.5%	4.6%



Exports (January–April 2018):

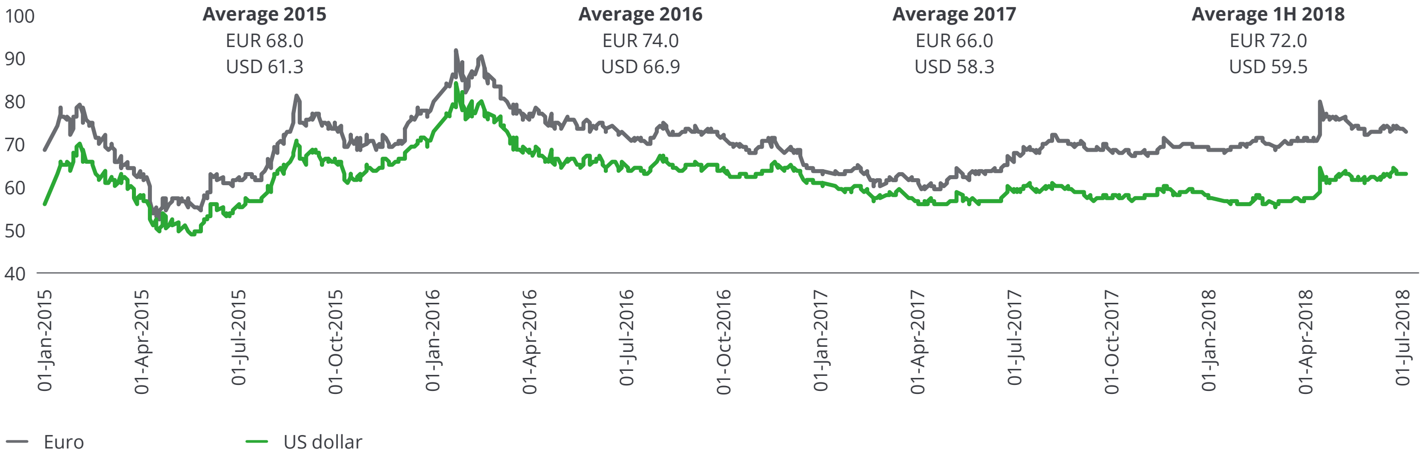
	Percentage of exports	In monetary terms YoY	In physical terms YoY	Categories
Energy products	**64.2%**	**27.2%**	**6.8%**	
			18.1%	Kerosene
			17.0%	Coal
			7.0%	Gasoline
			5.3%	Natural gas
			-10.8%	Liquid fuels
			-4.6%	Electricity
			-2.8%	Coke
			-1.8%	Crude oil and oil products
Metal products	**10.7%**	**36.7%**	**15.4%**	
			39.9%	Cast iron
			20.1%	Copper and copper alloys
			15.7%	Aluminium
			11.5%	Semi-finished products of iron or non-alloy steel
			-12.4%	Flat iron non-alloy steel
			-2.1%	Ferroalloys
Chemical products	**6.0%**	**16.2%**	**5.1%**	
			24.3%	Products of inorganic chemistry
			23.7%	Abstergent
			3.1%	Plastics
			-0.7%	Rubber
Machinery and auto	**5.6%**	**29.1%**	**n/a**	
		47.4%		Electrical equipment
		30.9%		Optical instruments and apparatus
			-5.6%	Passenger cars
			1.5%	Trucks
Food and agriculture products	**5.3%**	**26.5%**	**39.4%**	
			59.6%	Wheat
			49.3%	Cattle meat
Timber, pulp and paper products	**3.1%**	**23.0%**	**0.9%**	
			10.0%	Plywood
			3.3%	Cellulose
			3.2%	Lumber
			-7.6%	Rough wood
			-1.2%	Paper

Imports (January–April 2018):

	Percentage of imports	In monetary terms YoY	In physical terms YoY	Categories
Energy products	**0.9%**	**15.5%**	**-9.7%**	
Metal products	**7.2%**	**25.2%**	**26.0%**	
			27.5%	Ferrous metals
			-9.1%	Pipes
			-1.1%	Flat rolled products of iron or non-alloy steel
Chemical products	**19.0%**	**19.9%**	**5.6%**	
			29.7%	Fertilizers
			11.1%	Plastics
			11.2%	Abstergent
			2.3%	Inorganic chemistry
			1.8%	Paint
Machinery and auto	**46.1%**	**20.4%**	**n/a**	
		28.0%		Electrical equipment
		17.3%		Mechanical equipment
		16.6%		Optical instruments and apparatus
			45.3%	Passenger cars
			-10.4%	Trucks
Food and agriculture products	**13.2%**	**10.3%**	**9.7%**	
			230%	Sunflower
			19.6%	Milk
			9.7%	Cheese and curds
			7.8%	Fish
			-35.4%	Meat
			-45.3%	Butter
Textiles and footwear	**6.2%**	**16.8%**	**4.3%**	

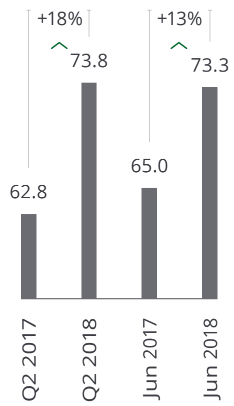
Currency rate

RUB vs. EUR, RUB vs. USD

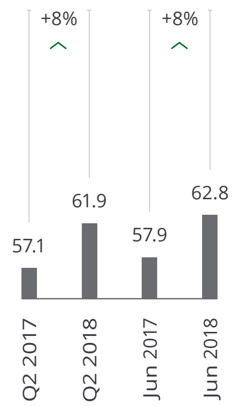


Source: Central Bank of Russia

EUR vs. RUB



USD vs. RUB



Source: Central Bank of Russia

EUR forecast (average per year), RUB

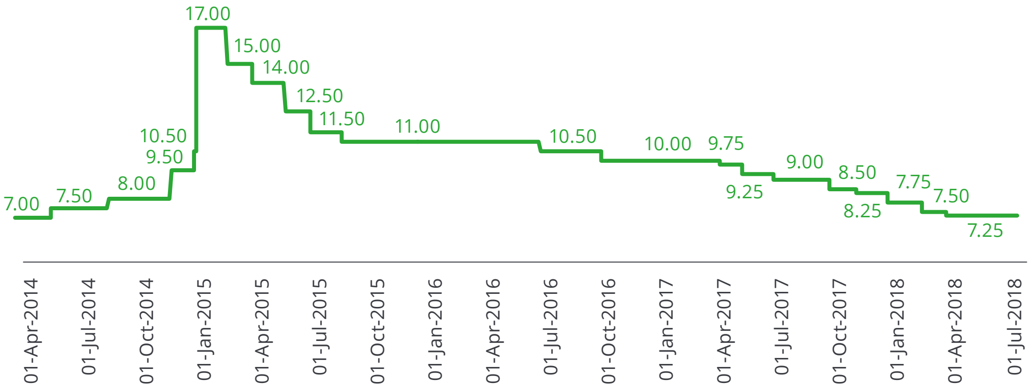
Source	2018	2019	2020
IEF RAS	73.3	71.5	70.4
Economist Intelligence Unit	73.1	71.3	72.6

USD forecast (average per year), RUB

Source	2018	2019	2020
Ministry of Economic Development	61.0	63.0–64.0	63.0–64.0
Gaidar Institute	58.9	58.8	58.1
IEF RAS	61.1	63.5	64.0
Economist Intelligence Unit	60.1	59.4	60.0

The Central Bank's key rate, indexes and credit rating

Central Bank of Russia key rate, %



Source: Central Bank of Russia

“At the current stage, due to the realized inflationary risks, we have to continue with a slightly aggressive monetary policy. We estimate this will be sufficient for preventing an inflationary side effect from the tax measures in the pipeline.”

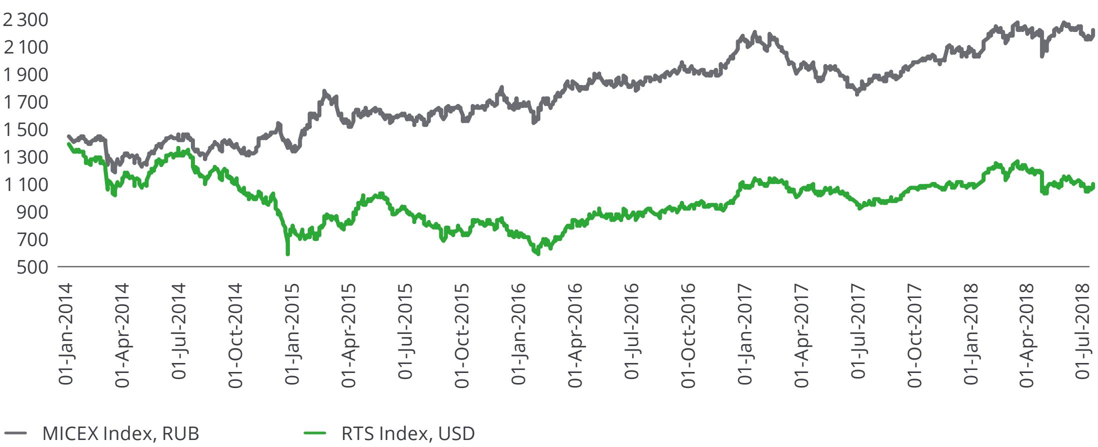
Elvira Nabiullina,
Governor of the Bank of Russia

Forecast of the key rate year-end, %

Source	2018	2019	2020
IEF RAS	6.75	5.75	5.25
Economist Intelligence Unit	7.00	8.00	7.80

On 15 June 2015, the Russian Central Bank resolved to maintain a key interest rate of 7.25 percent per annum, which is just slightly higher above a neutral interest rate range of 6–7 percent estimated by the Central Bank.

Indexes (daily): January 2014–June 2018



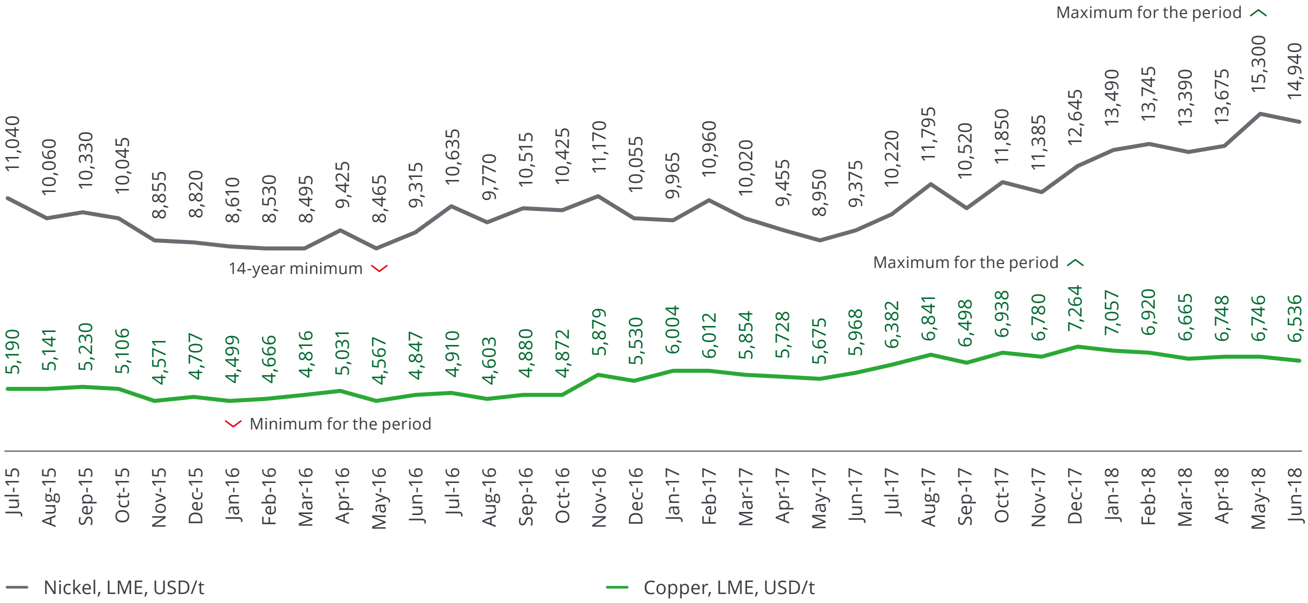
Source: Moscow Exchange

Russia's credit ratings

Agency	Rating	Outlook	Date
S&P	BBB-	Stable	23 Feb 2018
Moody's	Ba1	Positive	25 Jan 2018
Fitch	BBB-	Positive	23 Feb 2018

Top pricing (nickel and copper)

Nickel and copper



Source: Finam Holdings

Nickel forecast, USD/t

Source	2018	2019	2020
World Bank	13,983	14,043	14,144
IMF	13,781	14,077	14,251

Copper forecast , USD/t

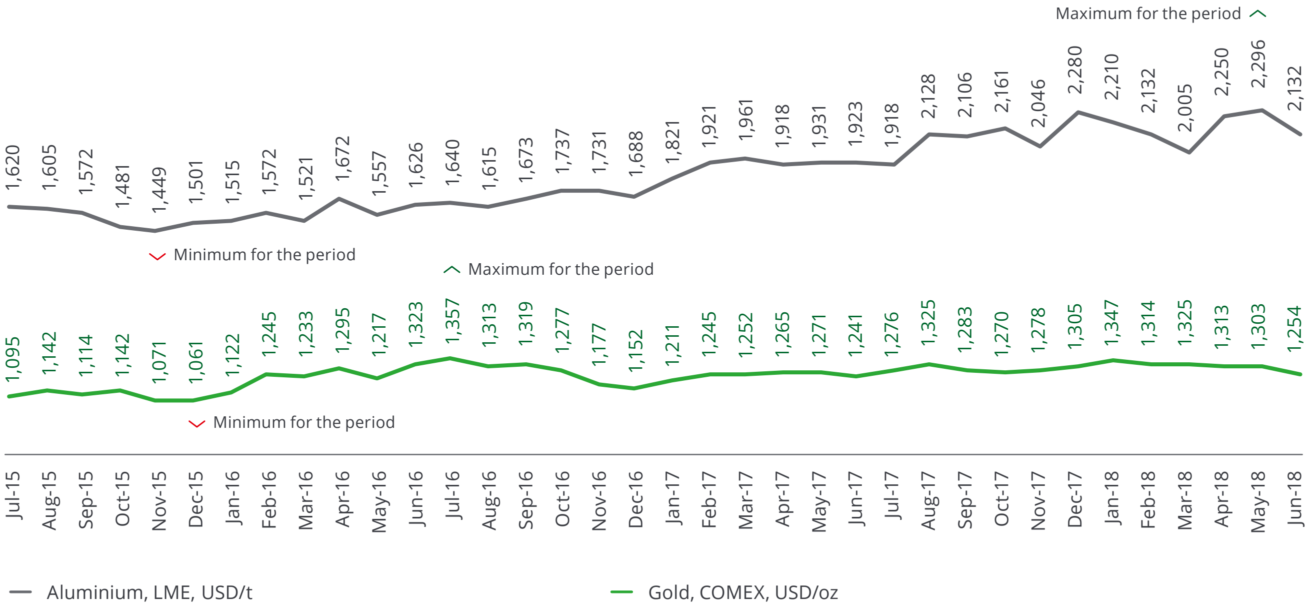
Source	2018	2019	2020
World Bank	7,043	6,923	6,824
IMF	7,132	7,228	7,242
Pan Pacific Copper	7,280	7,720	-

Nickel prices led on the upside with the metal finding support from declining exchange inventories – indicating healthy consumption – and the expectation of greater demand in line with the development of the electric vehicle sector.

Source: Metal Bulletin

Top pricing (gold and aluminium)

Gold and aluminium



Source: Finam Holdings

Gold forecast, USD/oz

Source	2018	2019	2020
Goldman Sachs	1,375	1,450	-
World Bank	1,346	1,302	1,263
Morgan Stanley	1,355	1,412	1,460
Credit Suisse	1,375	1,300	1,300
Oxford Economics	1,321	1,323	-
Merrill Lynch	1,357	1,450	-
JPMorgan	1,405	1,475	-
Citigroup	1,350	1,370	-

Aluminium forecast, USD/t

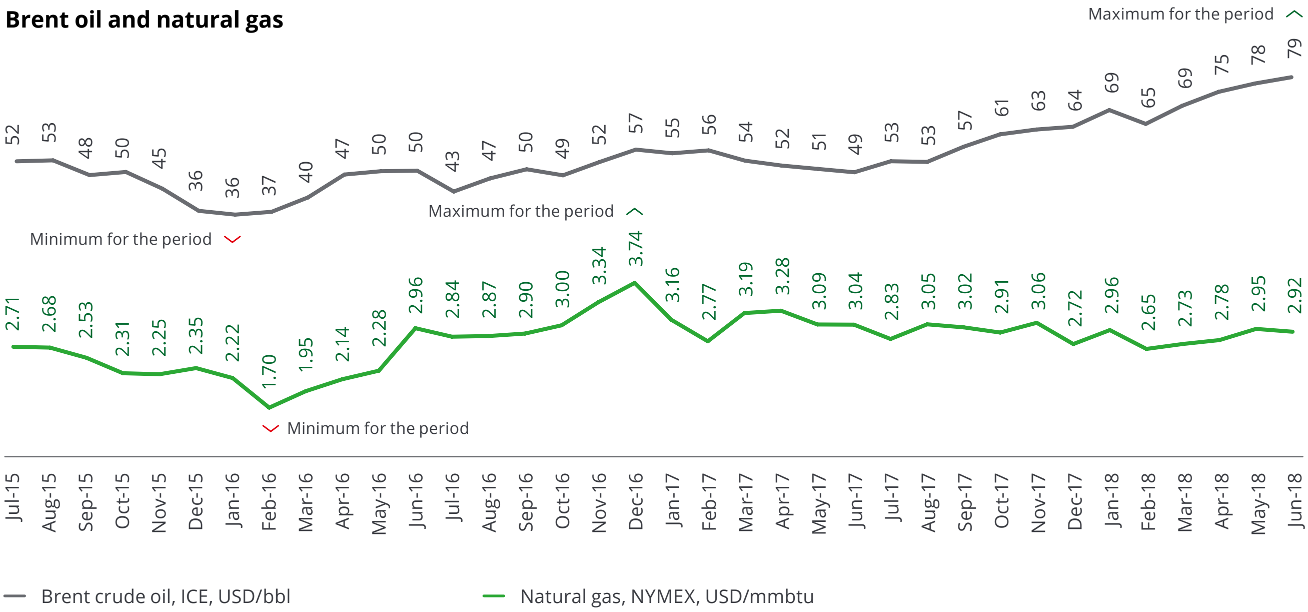
Source	2018	2019	2020
World Bank	2,253	2,133	2,106
Morgan Stanley	2,116	-	-
IMF	2,208	2,235	2,261
Oxford Economics	2,033	-	-
Merrill Lynch	2,426	-	-
JPMorgan	2,237	-	-

The United States has introduced additional import duties on steel and aluminum (25 percent and 10 percent, respectively), with effect from 23 March 2018. At the initial stage, these duties took effect mostly against Russia and China, but from 1 June 2018, they also took effect for Canada, Mexico and EU countries on 1 June 2018.

Source: U.S. Customs and Border Protection

Top pricing (oil and gas)

Brent oil and natural gas



Source: Finam Holdings

Natural gas forecast, USD/mmbtu

Source	2018	2019	2020
World Bank	3.1	3.1	3.2
IMF	2.8	2.8	2.8
Economist Intelligence Unit	3.0	3.3	-

Brent crude oil forecast, USD/bbl

Source	2018	2019	2020
US Energy Information Administration	71.1	67.7	-
World Bank	65.0	65.0	66.0
IMF	64.7	60.7	58.0
European Central Bank	66.0	66.0	67.0
IEF RAS	68.0	68.0	68.0
JPMorgan	70.0	65.0	-
Economist Intelligence Unit	72.0	70.0	65.4
Central Bank of the Russian Federation (Urals)	67.0	-	-
The Ministry of Economic Development (Urals)	69.3	63.4	-

In a move to tackle a global glut and support oil prices, OPEC and non-OPEC producers, including Russia, took a decision in December 2016 to cut joint oil output to 1.8 million bpd, with the October 2016 output as a baseline. However, 2018 saw the reduction reach 2.8 million bpd, with OPEC+ agreeing to boost output by an additional 1 million bpd to keep up with the established target. The deal will continue in effect until the end 2018. A meeting to discuss future cooperation plans has been planned for September 2018.

"We have invited Russia to join as an observer, an associated member. We believe they are considering it. We are looking forward to their official confirmation. I can assure that the entire membership of OPEC would welcome Russia."

Khalid al-Falih,
Saudi Arabia Energy Minister

Latest from Deloitte Research Centre

Deloitte CFO Survey of the Leading Companies in Russia

Key findings

Financial climate in 2018

- Overall, by early 2018, the positive expectations concerning financial prospects became more moderate. Over a half of CFOs **(55 percent)** did not expect significant changes in the current financial position of their companies.
- The highest share of 'optimists' was observed among the CFOs of manufacturing companies **(40 percent).**
- CFOs of small companies (up to 250 people) were the most pessimistic **(22 percent).**
- In the past six months, the number of CFOs expecting company revenue growth increased by **11 p.p.**
- Expectations regarding operating profit have remained almost flat since the second half of 2016. Presently, over half of the companies **(60 percent)** expect profits to grow.
- The expectations regarding operating profit growth are higher by **9 p.p.** compared to the second half of 2017.
- CFOs do not expect the cost of capital to change significantly in the next six months **(65 percent).**
- This time, CFOs cited expected increases in the number of staff more frequently **(6 p.p.).** Overall, this indicator increased by **10 p.p.** in the past two years.
- A total of **73 percent** of CFOs expect salaries to increase. These expectations were significantly lower **(15 p.p.)** just six months ago.
- Our experts expect increases in operating costs by **50 percent,** number of staff by **48 percent,** and company revenues by **28 percent.**

Uncertainties, risks, and development strategies

In early 2018, we saw gradual increases in the level of uncertainty. Starting from the second half of 2017, the uncertainty increased by another **10 points** reaching the 2H2016 level.

The higher level of uncertainty seems to have had an impact on the risk appetite as in the past six months it has decreased by **29 points.**

Risk factors that had the most negative impact on business in Russia in 2018:

- Higher trade barriers / protectionism
- Geopolitical risks
- Lower core business revenue
- Rising barriers to entry into new markets
- Lower consumer interest in new products

Priority business strategies in Russia in 2018:

- Ongoing cost control
- Business development through organic growth
- Cost cutting

Business drivers and barriers

Business drivers in Russia in 1H2018:

- Production costs
- Digitalization
- Liquidity

Barriers for business drivers in Russia in 1H2018:

- Focus on core operations
- Currency risks
- Domestic production

About company clients and innovations

- Almost one in two survey participants **(49 percent)** said that his/her company implemented the balanced governance policy, i.e., equally took the interests of both the company and its clients into consideration.
- One in two CFOs **(51 percent)** noted an increase in new clients compared with the previous year (with the balance reaching **0.42**).
- One in two respondents **(49 percent)** noted that their company's value rose after implementing innovative approaches. Among them, one in three respondents **(33 percent)** indicated that their company grew by 5 percent, almost half **(52 percent)** indicated a 5–10 percent growth, and another **11 percent** witnessed a 10–20 percent increase in their company's value.
- In early 2018, the innovation ratio of companies was estimated at **0.15.** Last year, it increased by **4 points.** The highest growth occurred in 1H2017.
- Over one third of respondents **(37 percent)** said that their company plans to spend 1–5 percent of its revenue on R&D in 2018. This trend shows that companies want to implement a digitalization strategy.
- Most innovations are implemented by dedicated divisions in **66 percent** of the companies surveyed.
- According to our respondents, the market and competition are seen as the key drivers for digital strategies. The management strategy ranks the second.

Deloitte CFO Survey of the Leading Companies in Russia

Business strategies in 2018

Prospects of developing business abroad

78% of the companies surveyed cooperate with foreign partners.

22% of companies surveyed do not cooperate with foreign partners.

42% plan to expand their business relations into other regions.

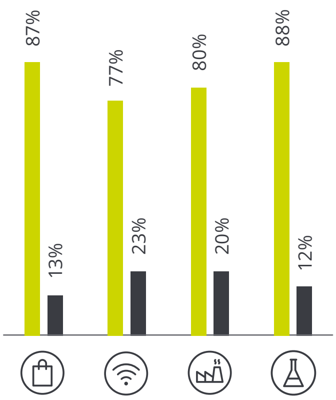
58% do not plan to expand their business relations into other regions.

Definitions

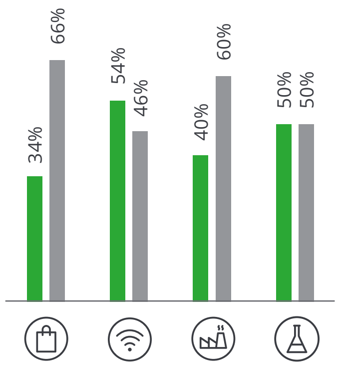
Industries

- Consumer business
- E&R (Energy and resources)
- Manufacturing
- Technology, media and telecommunications
- Financial services and insurance
- Healthcare and pharmaceuticals

Cooperation with foreign partners by industry



- Enter in partnerships
- Do not enter in partnerships



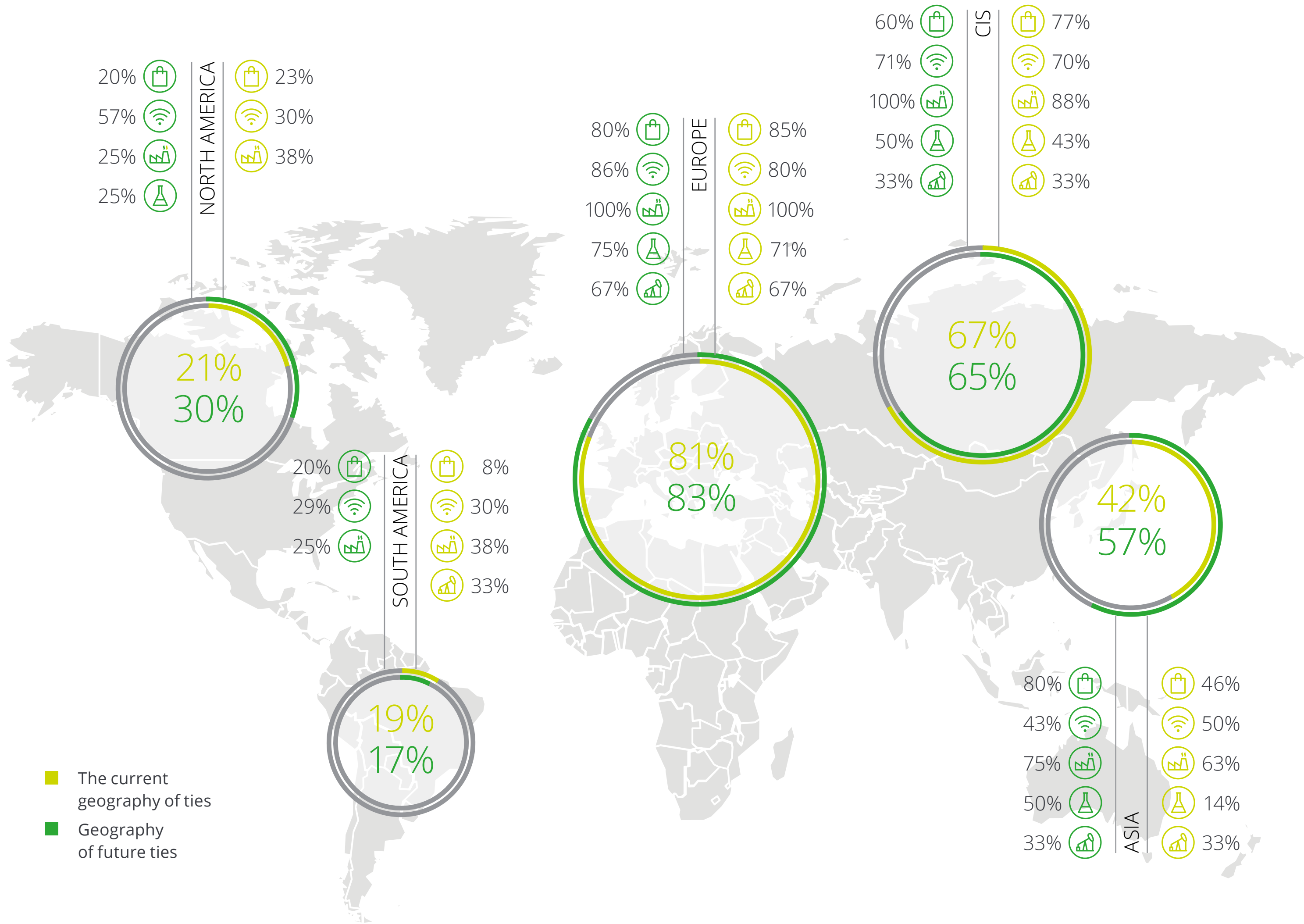
- Plan to enter in partnership
- Do not plan to enter in partnership

Trends

- In the previous 2017 year, the number of companies that cooperate with foreign partners remained almost flat (**2 p.p.** above average). At the same time, the number of companies that plan to expand the geography of business relations has significantly decreased by **9 p.p.**

Highlights

- Consumer and healthcare companies (**87** and **88 percent,** respectively) partner with foreign companies more frequently than others. However, **54 percent** of respondents of TMT companies plan to expand their cooperation. The representatives of other industries are not likely to expand the geography of business ties next year.



Trends

- Upon comparing the current geography of business ties with cooperation plans, one can notice that the respondents tend more often to expand business ties with North America (**9 p.p.** above average) and Asia (**15 p.p.** above average)

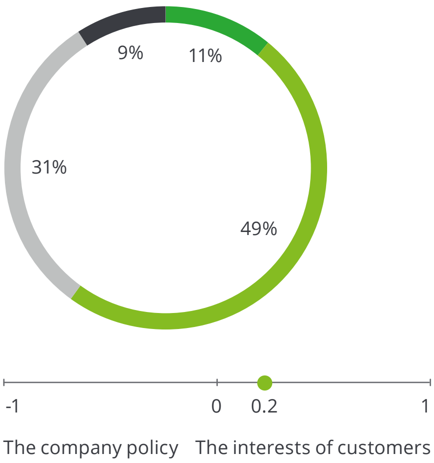
Highlights

- Consumer companies plan to expand ties with partners in Asia (**34 p.p.** above average) and South America (**12 p.p.** above average). Plans to develop cooperation with partners in South America are more often reported by oil and energy companies (**33 p.p.** above average).
- Respondents of TMT companies mostly tend to expand ties with companies in North America (**27 p.p.** above average).
- Respondents of medical and pharmaceutical companies plan to develop business ties with North America (**25 p.p.** above average) and Asia (**36 p.p.** above average).

Deloitte CFO Survey of the Leading Companies in Russia

Clients of companies

Client focus



- The focus is on the company policy rather than on customers' interests/needs
- The interests of customers and the company policy are approximately equally significant
- The interests/needs of customers are more of a priority than the company policy
- The interests of customers are an absolute priority

- Almost a half of companies **(49 percent)** pursue a balanced policy in taking into account both the interests of the company and its customers.
- A third of companies **(31 percent)** see the interest of customers as an important priority, while **9 percen**t of respondents consider it an absolute priority.
- **11 percent** of CFOs surveyed confirmed that the company's policy is a priority as opposed to customers' interests.
- Meanwhile, none of the respondents said that the company's policy is an absolute priority.

Number of customers

- Up
- Down
- Balance

Trends

- **51 percent** of CFOs reported that the number of new customers in the previous year has increased (the net balance is **0.42**).
- One in three CFOs indicated an increase in the number of regular customers **(36 percent),** individual customers **(27 percent),** and private companies **(31 percent).**
- The positive trend is that the number of customers experiencing financial difficulties is decreasing in most companies. This is the only indicator reflected in the negative part of the balance **(-0.09).**

Highlights

- The representatives of the TMT industry more frequently report an increase in customers that are government-owned corporations **(15 percent).** They also report a **38 p.p.** decrease in the number of customers experiencing financial difficulties.
- The most significant increase in the number of new customers was cited by respondents from the FSI industry **(80 percent).**
- The highest increase in individual customers occurred in consumer business **(40 percent),** FSI **(40 percent),** as well as the medical and pharmaceutical industry **(38 percent).** At the same time, the number of customers among privately held companies increased by **40 percent** in the manufacturing industry and consumer business.

HDG 213 MAG
CMD
TERR
VOR 1
VOR 2
UPPER DU
LOWER DU
BACKGROUND
AFDS FLOOD
PROGRESS

Overview of steel and iron market

Key findings

After the industry stabilised in 2016, global output and consumption of steel continued to grow in 2017:

- Steel output up 5.3 percent at 1,691 million tonnes.
- Steel consumption up 3.6 percent at 1,657 million tonnes.

The increase in output was partly due to China increasing production to a higher-than-expected level during the last six weeks of 2017. However, forecasts for 2018 indicate that global steel output will increase by a moderate 0.5 percent and global steel consumption will go up 1.3 percent.

The current US trade policies make predictions more difficult. After the US imposed duties on steel, domestic prices grew by more than 25 percent above the global market in April.

Russia's metals production index was 96.4 percent in 2017. However, a closer look at products by category reveals that many products demonstrated positive dynamics by yearend as compared to the previous year. Wire products and seamless casing pipes showed the highest growth – 31.7 percent and 19.8 percent, respectively.

In monetary terms, Russian exports of basic metal products were up 38 percent for rolled products and up 116 percent for tube products in 2017.

At the same time, Russian imports of basic metal products increased by 42 percent for rolled products and 40 percent for tube products in 2017.

Based on EBITDA for 2017, NLMK has become the top performer in the Russian steel market.

Investments

While seeing a huge potential for enhanced processing technology to spark growth for Russian steelmakers in terms of new capacities, new products, and new product lines, experts from the Institute for Scientific Forecasting of the Russian Academy of Sciences point to insufficient strategic investment in this area. At the current stage, over 50 percent of exports (pig iron, blooms, and hot-rolled products) go to other countries for further processing.

Consumers

The metals industry has a customer engagement model that is focused on relatively simple tasks to serve the needs of construction businesses, large fuel and energy customers, transportation companies, and the machine-building industry. Developing an SME segment that would be based on the use of metal products requires a relevant engagement model, which Russia has started to build.

Governance

The metals industry is particularly known for the fact that key management and strategic decisions are concentrated in the hands of large shareholders. Despite this, experts believe that the industry has one of the most efficient governance models. This model enables a low risk of conflict between owners and managers, while the international nature of the metals industry helps to reduce other risks related to economic processes in a specific country. This allows us to conclude that the existing challenges will not have any significant impact on the development of the industry in the mid-term.

The industry is undergoing a change, with steelmakers transforming into investment companies to distribute their income more efficiently to areas other than their core operations.

Overview of steel and iron market

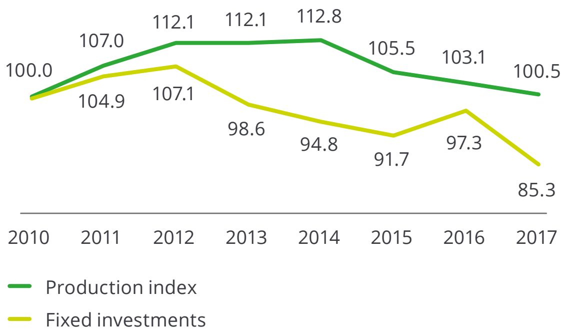
Metals industry in Russia – challenges and opportunities

Investment and production

In 2011–14, the metals industrial production index only showed a marginal growth of 12 percent. In addition, the period from 2015 to 2017 witnessed a downturn in steel production, causing physical output in 2017 to reach the level of 2010.

This came amidst fixed investments decreasing gradually in 2013–15 and 2017. In 2017, fixed investments in terms of volume were just 85.3 percent compared to 2010.

Trends in steel output and investments (% on 2010)



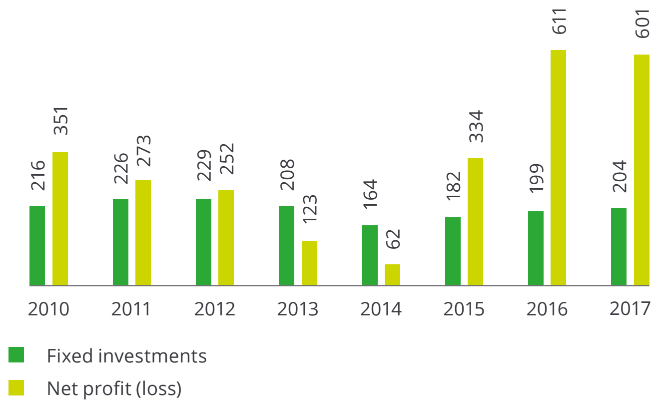
As the post-crisis production rebound comes to a halt, there is a need to find new areas for investing in growth. The transition from the post-crisis mindset to strategic thinking requires decisions and frameworks to support this move. There are new ideas and related implementation approaches being developed that rely on cross-industry and intercompany structures. Putting these approaches into practice will inevitably bring investments into the industry.

Investment and profit

By 2017, the metals industry saw a net profit increase by almost fivefold on the pre-crisis year of 2013, reaching RUB 601 billion at 2010 prices. However, this did not have any impact on fixed investments that have been continuing at about RUB 200 billion for the last eight years.

This increase mainly resulted from the rouble becoming weaker by the end of 2014, triggering a sharp increase in export revenue (in rouble terms) while production costs increased just marginally.

Net profit to investments in the metals industry (RUB billion at 2010 prices)



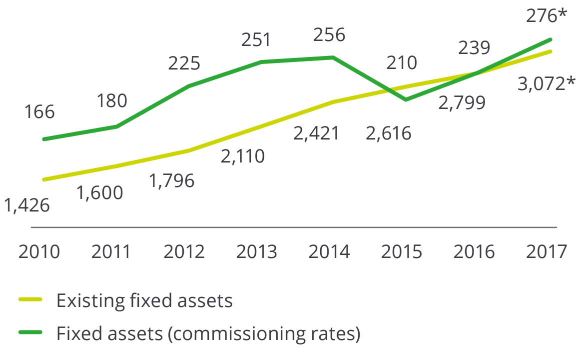
Despite the resulting boost in profit, limited opportunities for efficient investment in production activities require new investment solutions. This would require further changes to corporate governance. The existing production management framework is augmented by a mechanism for managing investments and delivering strategic initiatives.

Investment and fixed assets

The number of fixed assets in metallurgy has increased approximately two-fold since 2010 and in 2017 their number is estimated at 3,072 billion rubles.

The entry of fixed assets over the period under review has grown at a moderate pace (an average of 7% per year). The exception was in 2015, when there was a sharp reduction (by 18%).

Fixed assets in the metals industry (RUB billion)



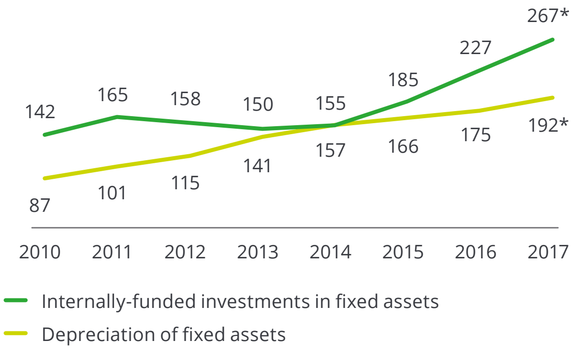
The trends in fixed assets are indicative of an investment pause caused by the uncertainty in both the international and local markets for finance, metal products, and steel equipment.

Investment and depreciation

The year 2017 saw fixed internally-funded investments rise, increasing to RUB 267 billion after the "downward" period of 2012–14 and accounting for 70 percent of total investment in the industry.

While the metals industry witnessed depreciation rates for fixed assets go up by 26 percent on 2010, these rates have been continuing at generally the same level over the last four years (113 percent on average)

Internally funded investments in the metals industry (RUB billion)



Developments in internally-funded investments have been driven by global market issues. Limited access to international financing has resulted in loans being replaced with internal funding. In 2014, metal prices went up as the rouble was down, providing metal producers with internal funds. Despite a weakened rouble and the industry running a large amount of imported equipment, the marginal growth in depreciation rates over 2015–17 can be indicative of problematic depreciation policies in Russia. There is a deferred revaluation at play that may unfold in the future.

*Based on calculations by the Institute for Scientific Forecasting of the Russian Academy of Sciences

Overview of steel and iron market

Metals industry in Russia – challenges and opportunities

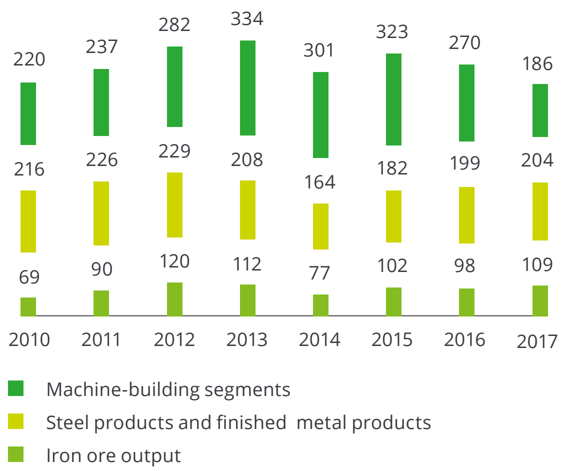
Investment by segment

In 2017, the segments for steel making and finished metal products saw the highest investment of RUB 204 billion.

Overall, investment in fixed assets by metals-related industries did not show any significant growth compared to 2010.

The lack of a balance between investment in metal production and consumption needs to be dealt with as it can threaten future growth in the metals industry. Business development hinges on growth in demand and consumption. The industry needs a stronger focus on developing the local metals market to offer clients finished products. Global steelmaking practices attest to the high efficiency of investments in enhanced processing when compared to the need for additional processing by end customers in the construction or machine-building industries.

Investments by segment (fixed investments, RUB billion at 2010 prices)

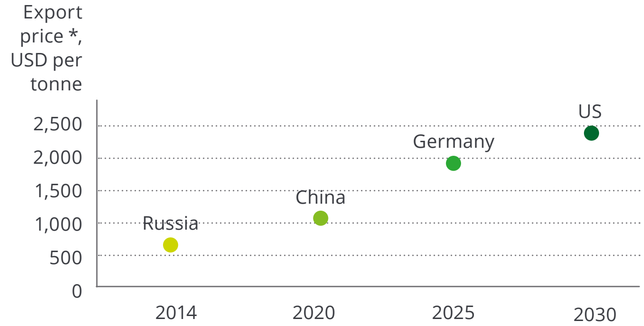


Investment and prices

Russia is lagging behind the world's leading producers in terms of average export prices for metal products. Therefore, export prices by global leaders can be used as a target strategic indicator for the Russian metals industry for the period until 2030.

Russia can set a potential goal to reach the pricing level of China by 2020, Germany by 2025 and the USA by 2030. This can be achieved by developing local steelmaking capacities for enhanced processing, as well as by optimising the export mix to reduce the share of pig iron and semi-finished products exported for further processing.

Strategic price targets for Russian metal products classified under TN VED codes 72-73



*The export price for each country is arrived at by dividing the total dollar value of exports for products under TN VED codes 72–73 (except for products under TN VED codes 7203 and 7204) by total exports (in tonnes) for the same TN VED codes. TN VED code 7203 covers direct reduced iron ore products and other sponge iron coming in briquettes, pellets, or similar shapes. TN VED code 7204 covers ferrous metal scrap and waste, as well as remelting scrap ingots that are used as an input for metal products.

Oilfield services market overview

Key findings

+18% The previous year saw a growth trend in oil prices, with an average increase of 18 percent since 2016.

2x RN-Burenie, a drilling arm of Rosneft, saw its share in the overall market supply grow by 5 percent to reach 25 percent in an almost two-fold growth since 2014.

+12% In 2017, production drilling was 27.6 million m, up by 12 percent versus 2016.

-1% Well maintenance costs are slightly down by 1 percent versus 2016.

+9% In 2017, exploration drilling was up by 9 percent, reaching 990,000 m after a slight drop in 2015/16, as compared with 2014.

-32% A decrease by 32 percent in well workover costs is due to the fact that 28 percent of overall maintenance costs in 2016 were related to workover activities by Gazprom Neft in Yamal.

+3% Vertical drilling increased by 3 percent to 16.4 million m, reaching the pre-crisis level of 2013.

+26% 2D seismic exploration has grown by 26 percent versus 2016 in physical units.

+27% Horizontal drilling increased by 27 percent (2.4 million m).

+3% 3D seismic exploration is slightly down by 3 percent versus 2016 in physical units.

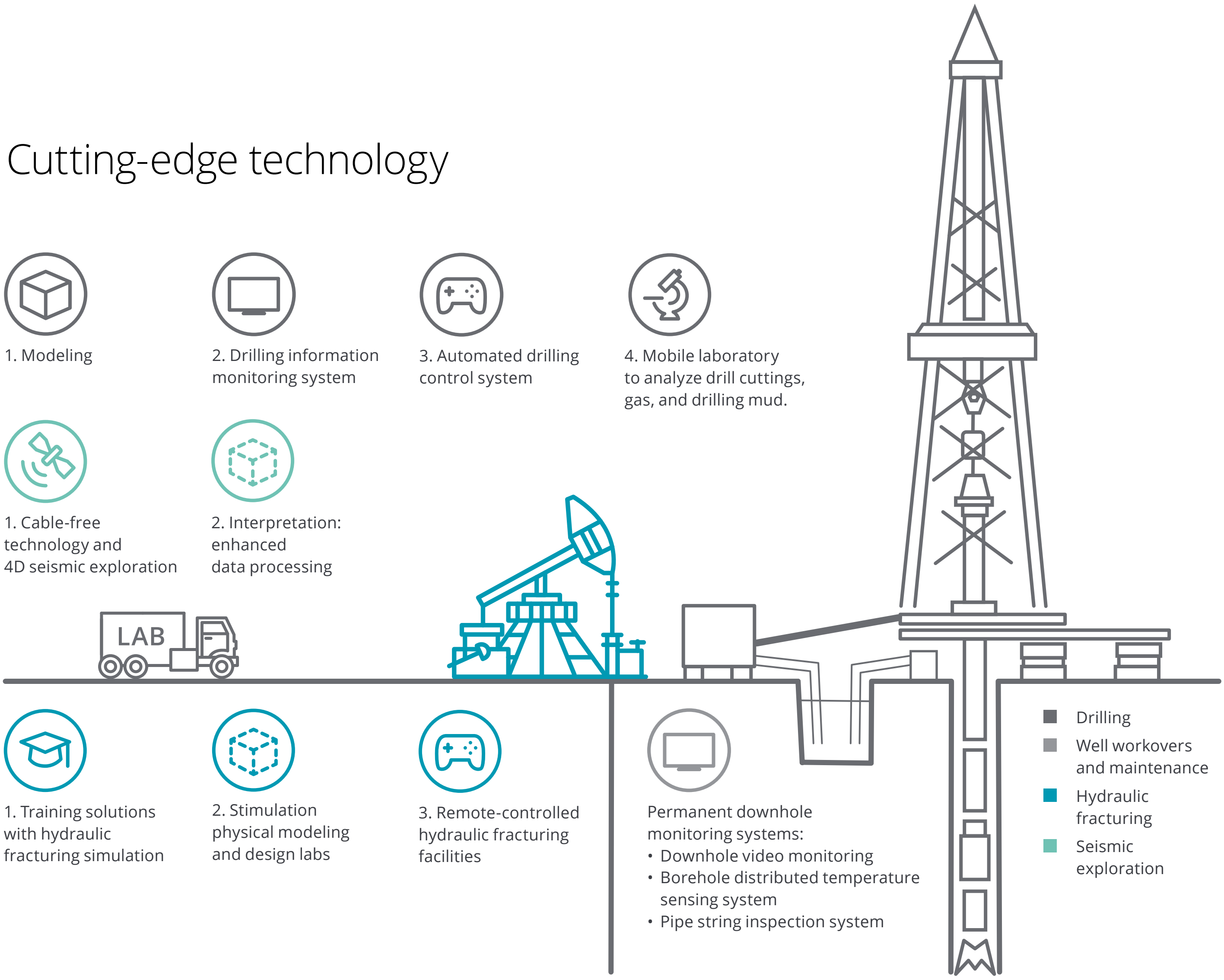
Old brownfield sites in Western Siberia

account for additional growth in horizontal drilling at mature deposits.

Lagging technological development

is a key barrier for oilfield services in Russia.

Cutting-edge technology



Oil and gas drilling and servicing operations are the most capital intensive part of the industry. The persistent low oil prices, unstable geopolitical climate, limited access to global technology, output cuts under OPEC+, stricter environmental requirements, and rising shale technology bring cost saving to the forefront. The oil production and oil servicing segments can achieve cost optimization by gradual digitalization. In this context, bringing together multiple technologies is increasingly important. To accelerate this integration, there is a need for industry-wide standards with regard to digital technology.

Estimates and practical experience have shown that digital technology has the potential for wide adoption with both new and aging wells and deposits. Digital solutions can significantly boost the performance of these assets while delivering cost savings and making available additional financial sources.

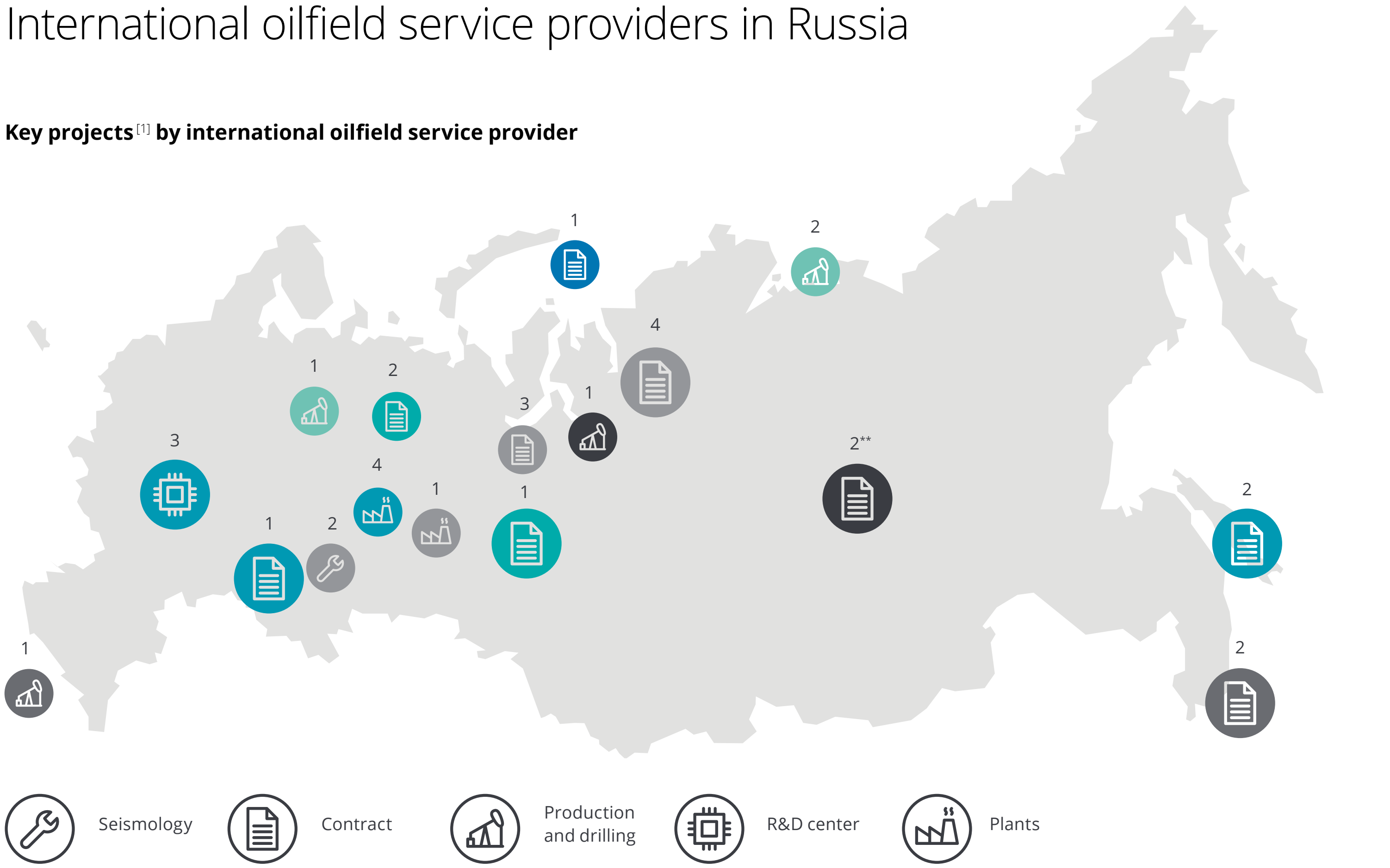
"The demand for digitalization solutions from both oil producers and service providers persists at a low level. The shrinking international oilfield service market has put some projects on hold due to the lack of high-quality solutions and technology readily available from Russian oilfield service providers, both independent and vertically integrated. As a result, it is the situation itself that drives the need for technology, including digital solutions, rather than competition. Most importantly, smaller specialist companies do offer ready-made solutions. However, our current estimates are that the market's readiness for digital transformation is rather low."

Dmitry Egorov,
Chief Engineer, Automation Projects
Argosy Group

Oilfield services market overview

International oilfield service providers in Russia

Key projects[1] by international oilfield service provider



■ **Schlumberger**

1. In 2018, OOO Technology Company Schlumberger entered into a contract with PAO ANK Bashneft to provide technical support services for managing drilling fluids.
2. In 2017, OOO Schlumberger Vostok entered into a lease and maintenance contract for electrical submersible pumps with RN-SakhalinMorNefteGaz.
3. OOO REDALIT Schlumberger is a resident in the Lipetsk Industrial Special Economic Zone, with investments totaling almost RUB 4 million.
4. Radius-Service produces positive displacement motors and other oil equipment in Perm Krai.

■ **Weatherford**

1. In 2018, OOO Weatherford entered into a contract with Rosneft to provide directional drilling services.
2. OOO STU entered into a contract with Bashneft to provide well cementing services in 2018.

■ **Saipem, a subsidiary of Eni**

1. The company along with Rosneft is part of the project aimed at drilling the first exploration well in the Western section of the Black Sea. On 21 March 2018, the companies completed drilling operations at a wildcat well (Maria-1), discovering a unique carbonate formation with a thickness of more than 300 meters.[2]
2. Rosneft has appointed Saipem to develop a feasibility study and provide services to manage the Eastern Petrochemical Complex project. It is expected to be completed by late August 2018.

Source: Central Dispatching Department of the Fuel and Energy Complex, Vedomosti, neftegaz.ru, Oil&Capital, Kommersant, Spark-Interfax, Rosneft

One of the issues facing Russian oilfield services companies is the technological lag when compared with their foreign counterparts. International companies use advanced technology, invest in R&D, and have access to highly qualified talent. In the mid-run, Russian oilfield service providers cannot be expected to meet the standards required for offshore projects and operations in permanently frozen regions.

The sanctions have benefited producers from China and Southeast Asia. China has emerged as a notable player in the Russian market for oilfield service equipment. The share of equipment from China, South Korea, and Singapore is expected to grow in Russia within the next three years. Jereh, a Chinese producer of gas compression units for LNG plants, equipment for drilling, cementing, and improved oil recovery, has taken timely steps to deploy an extensive Russian network providing warranty repair services, as well as a warehouse for spare parts.

In July 2017, Schlumberger and the Russian Direct Investment Fund, with the support of investors from China and Middle East, announced their plans to acquire stakes in EDC – 51 percent and 16.1 percent, respectively. However, while negotiating the deal with Schlumberger, the Federal Antimonopoly Service (FAS) set forth the condition that the company agree to either transfer its stake in EDC for operational management or sell it to a Russian entity should the US impose more sanctions against the Russian oil and gas industry. Schlumberger agreed and started working on the legal aspects transferring control. On 8 February 2018, the company submitted the second application to FAS with suggestions made based on the regulator’s commentaries on certain terms and conditions of the deal.

In summer 2017, Baker Hughes launched a new facility in the Tyumen region to produce well completion equipment. The new plant will work to supply Russian drilling and oil and gas companies with advanced equipment. Its primary focus is on localizing production and technologies, optimizing the supply chain, and shortening the delivery cycle for end customers.

Halliburton
1. OOO Burservis is a drilling provider.
2. In early May 2017 Halliburton launched drilling operations for Lukoil in the Vostochno-Taimyrsky block.

Baker Hughes
1. In 2017, OOO Neftepromyslovoye Oborudovaniye (Oilfield Service Equipment, Tyumen) entered into a contract to supply submersible pump cable to RN-YuganskNefteGaz.
2. OOO OrenburgNefteGeoFizika provides exploration, geophysical, and geochemical services.
3. The company entered into an equipment service and maintenance agreement with RN-YuganskNefteGaz.
4. Also, Baker Hughes entered into a contract with RN-Vankor to provide comprehensive maintenance services for electrical submersible pumps.

ZPEC
1. Zhongman Petroleum and Natural Gas Group (ZPEC, Shanghai) have entered into a contract with Rosneft to provide drilling and casing liner installation services as part of the construction of production wells in the Kharampur field by 2019.
2. The company and ZPEC are also in negotiations concerning their participation in a project by Gazprom Neft to develop the Chonsky fields in Siberia.

COSL
1. China Oilfield Services Limited (COSL) has leased Nanhai-8, a semi-submersible drilling floater, to GazpromNeft Geologorazvedka for the purpose of constructing the Rusanovskaya No.6 exploration well in the Kara Sea.

[1] Key projects are large investment R&D and manufacturing projects, including contracts with a value of at least RUB 500 million

[2] Project has been frozen in March 2018

Top 5 M&As

(Russian companies)

Target company	Industry	Bidder company	Seller company	Deal value (USD, mln)*	Additional information
Rosneft OJSC (9.18% stake)	Energy & Resources: Oil	Qatar Investment Authority	Glencore Plc	4,427	With this acquisition, Qatar Investment Authority (QIA) will hold an 18.93% stake in Rosneft, while Glencore will hold a 0.57% stake. QIA will become the third largest shareholder in Rosneft OJSC after the Russian government, which owns 50% and British Petroleum (BP Plc), which owns 19.75%.
Magnit OJSC (11.82% stake)	Consumer: Retail	Marathon Group	VTB Bank OJSC	1,019	The transaction is expected to enable Marathon Group to expand its product portfolio in the retail market. With this acquisition, VTB Bank OJSC will hold a 17.28% stake in Magnit OJSC.
Mostotrest PJSC (94.2% stake)	Construction: Transport Infrastructure	Arkady Rotenberg (private investor)	TFK-Finance OJSC	896	In April 2015, TFK-Finance OJSC acquired a 38.63% stake in the company from Marc O'Polo Investments Ltd., and made a mandatory takeover offer for the remaining shares in the company, post which it held a total stake of 94.20%. With this deal, TFK-Finance OJSC will not hold any stake in Mostotrest PJSC.
Mail.ru Group Limited (2.87% stake)	Technology, Media and Tele-communications	Gazprombank JSC, Russian Technologies State Corporation, USM Holdings Limited	MegaFon PJSC	248	The partnership will unite expertise in the telecommunications, IT, financial services and hi-tech sectors, which will enable the companies to enter into new markets and create cross-sector industrial solutions. The transaction will strategically and financially benefit the shareholders of MegaFon PJSC: the proceeds received from the sale will reduce the debt of MegaFon PJSC.
Sfat-Ryazan OOO	Industrial products and services	NefteTrans-Service ZAO	JSC OTEKO	207	The transaction is expected to enable JSC OTEKO to increase sales volumes in its key segments. The transaction is aligned with OTEKO's strategy to develop port and industrial facilities in the port of Taman.

*Public information on deal value

Source: Merger Market

Global wind

Top news: Russia and China

16 June 2018
Chinese companies discuss participation in Arctic LNG-2 liquefied natural gas project
The production capacity may reach some 19.8 million tons per year. Novatek estimated the project capex at USD 10 billion.

4 June 2018
Investors from China and India set to invest USD 500 million in gold production in TransBaikal Region
Indian investment company SUN Gold and Chinese state-owned gold mining company China National Gold plan to invest in the development of the Klyuchevskoye gold ore deposit. The planned volume of ore extraction is over 12 million tons per year. The gold will be produced domestically.

24 May 2018
VimpelCom and Huawei signed joint agreement to develop 5G communications in Russia
VimpelCom (the owner of the Beeline brand) and China's Huawei agreed to develop a partnership in the sphere of pilot testing and integration of 4.5G and 5G process solutions and the Internet of Things.

11 May 2018
Construction of joint Russian-Chinese medical cluster to start in 2H 2018
The Russian-Chinese medical cluster will be located in the Special Economic Zone near the Ulyanovsk river port in Ulyanovsk Region. It will become Russia's largest medical equipment production center. The total value of foreign investments in the project will reach USD 1.5 billion.

10 April 2018
Far East Development Fund found Chinese partner for implementing large-scale construction project on Russky Island in Vladivostok
China Communications Construction Company (CCCC, a state-owned corporation) may invest over RUB 20 billion in creating the infrastructure and constructing the Congress and Exhibition Center.

Top news: Russia and Europe

7 June 2018
Stora Enso to invest RUB 500 million in Novgorod Region
The Novgorod Region government signed an agreement with Finland-based Stora Enso, which will invest RUB 500 million in a sawmill upgrade in Novgorod.

5 June 2018
Austrian group to build a plant in Novgorod Region
Hasslacher Norica Timber group (Austria) will invest RUB 1.5 billion to launch its second plant in Malaya Vishera in order to engage in value-adding forestry processing.

30 May 2018
Medical equipment plant to be built in St. Petersburg
Sarstedt will buy a 4 ha land plot from VTB in Maryino Industrial Park to build a medical equipment plant there. Sarstedt is expected to invest approximately RUB 750 million in the project.

19 April 2018
Bekaert to invest RUB 1 billion in a production upgrade
Bekaert, a global leader in steel wire transformation and coating technologies, will invest RUB 1 billion in the third production stage of its plant in the Lipetsk Special Economic Zone.

9 April 2018
Kipszer and ISK Lenzhilstroy to invest EUR 105 million in new poultry plant
Jointly with St. Petersburg-based SK Lenzhilstroy, Hungary's Kipszer will invest RUB 7.5 billion in the construction of a goose breeding and processing plant for meet and liver production.

9 April 2018
Valeo to invest EUR 17 million in Togliatti plant
Valeo will invest EUR 17 million in a Togliatti plant to launch a new production line.

Source: InvestinRussia.com

Useful stickers

OUTCOMES OF SPIEF 2018
SPIEF 2018 was held under the slogan "Building a Trust Economy".

BP STATISTICAL REVIEW OF WORLD ENERGY
We project Russia to remain the world's largest energy exporter, with exports meeting over 5% of global energy demand by 2040.

NATIONAL REGIONAL INVESTMENT CLIMATE RANKING
In 2018, the investment climate improved in 78 out of the 85 Russian regions.
(in Russian)

QS WORLD UNIVERSITY RANKINGS 2019
Twenty-seven Russian universities are among the world's best 1,000 universities.

WORLD WEALTH REPORT 2018
According to the report, the number of US-dollar millionaires in Russia hit a new record, increasing from 182.1 to 189.5 people (+4 percent) in 2017.

THE WORLD CUP AND ECONOMICS 2018
Goldman Sachs predicts the FIFA World Cup 2018 winner.

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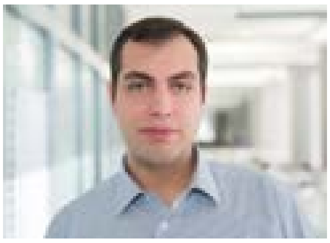

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