

# Reserved optimism in a challenging time

Survey of financial directors, 2009

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# About the survey

**Although consumer demand is declining and it is hard to forecast future developments, the CFOs of major Russian companies are optimistic about the future and expect the current economic situation to improve. Over half (52%) of the CFOs of major private companies are convinced that the Russian economy will take a positive turn in the next 12 months.**

Financial directors are among those who know the market outlook and the situation in their own companies well. They are responsible for crucial business decisions and the implementation of company strategy in an unstable situation characterized by falling demand and limited external financing. Financial directors play a vital role in their companies' business management, corporate governance and investment activities. Their views on the market situation and on future trends and strategies for overcoming the crisis are important and helpful in understanding current and future processes.

For the first time, the international advisory firm Ernst & Young and the Independent Directors Association (IDA) have conducted a survey of the financial directors of major companies in Russia. The goal was to obtain first-hand information on how Russian companies view the economic crisis and on their efforts to minimize external and internal risks in these turbulent times. To this end, Ernst & Young partners and consultants held 57 meetings and interviews with financial directors in April 2009. The survey shows the negative aspects of the crisis and strategies for overcoming it. Its findings reveal a wide range of opportunities for operating effectively under any circumstances.

***Karl Johansson, Managing Partner,  
Ernst & Young in the CIS:***

"Our survey indicated that, despite a number of adverse factors in the current situation, CFOs are optimistic about the Russian economy and expect the first signs of recovery some time next year. This optimism is very important for supporting economic activity and companies' readiness to seize new opportunities when the market begins the next growth cycle."

***Alexander Filatov, Executive Director,  
Independent Directors Association (IDA):***

"The results of the survey are helpful in understanding the prospects for Russia's economic development and in analyzing the strategy for overcoming the crisis. Quite notable, we believe, is the favorable assessment by companies of their ability to raise external financing for investment projects at present, as expressed by 52% of the participants. We share this optimism, because we see that Russia's economy offers opportunities and that corporate governance and independent directors will be drivers for building investors' confidence in the Russian market."

# Key findings

The first half of 2008 prevented the crisis from dramatically impacting the year's financial results. Only 11% of companies finished last year with a loss. In the latter six months, however, over half (56%) of major Russian companies cut production, and 58% saw falling sales.

The current difficulties have not shaken respondents' reserved optimism about the future. Over 40% expect that the Russian economy will begin to grow as early as in the first half of 2010. Noteworthy is a significant difference between the forecasts of companies with state participation and private companies. While most CFOs of private companies expect the situation to improve in the near future, and only 14% do not expect an economic upturn before 2011, this pessimistic view is shared by 42% of companies with state participation.

Opinions also differ by industry. Power & utilities and diversified industrial products companies are the most pessimistic about how long the crisis will persist. At the same time, respondents were unanimous in the belief that the oil & gas sector will be the engine that will pull the Russian economy out of the crisis.

Fifty-eight percent of respondents said they would welcome financial support from the government. Over half of companies with state participation that needed government support have already received it. This explains why 42% of companies with state participation describe government support as adequate and timely, noting that the government is making every possible and necessary effort in the current environment.

Declining consumer demand is viewed as a major external risk, with 53% of respondents regarding it as the most important risk of all. Inability to forecast future developments ranked as internal risk No. 1 (44%). As a result, most Russian companies (93%) have already revised their strategies for 2009 or plan to do so.

Cost cutting (95% of respondents point out the increasing importance of cost reduction), cash flow control (89%) and risk management (65%) now rank as top priorities. Management of customer and partner relations (53%) and restructuring (43%) have gained significantly in importance. And the current financing structure is the main weakness according to 70% of respondents.

As a result of strategy revision and cost minimization, over half of companies (53%) have cut personnel in the past 12 months. On average, these companies terminated 10.7% of their employees and plan to cut staff by another 11.6% in the next 12 months. Companies have significantly cut back on bonuses: 35% of survey participants discontinued their incentive programs and year-end bonuses. Fifty-six percent of companies do not plan to pay dividends. However, nearly half of companies (48%) have not cut back on compensation packages for senior management.

In spite of the challenges and problems described above, 52% of CFOs favorably assess their companies' ability to raise external financing for investment projects at the present time (100% before the crisis began).

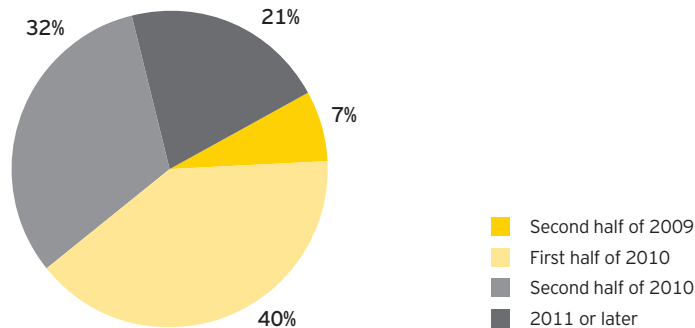
Moreover, 94% of CFOs believe that their companies can develop and remain highly attractive to investors.

# Analysis of results

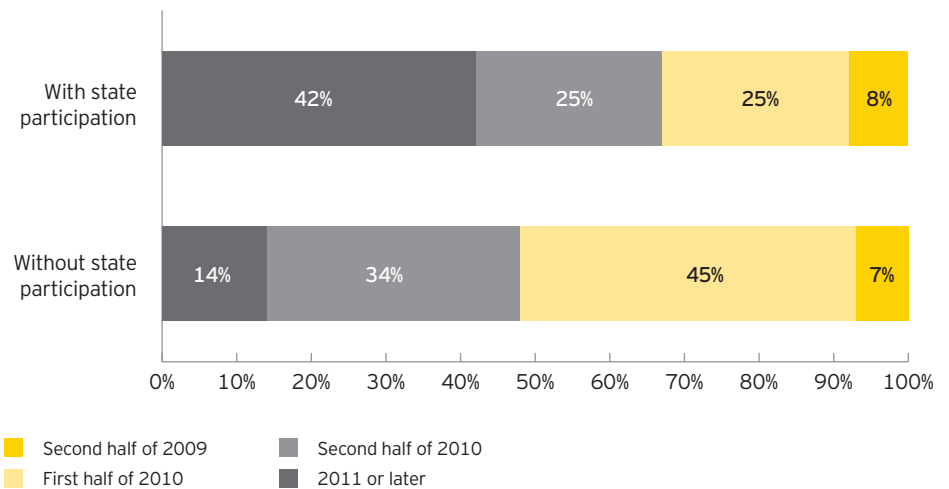
Forty-seven percent of CFOs expect the Russian economy to begin recovering from the crisis in the first half of 2010 or earlier.

## 1. When will the recession end in Russia?

Nearly half of respondents (47%) expect the Russian economy to begin recovering from the crisis in the first half of 2010 or earlier. The great majority of CFOs are convinced that the situation will take a favorable turn by the end of next year (79%).



It is important to note, however, that this optimism is shared primarily by private companies. Companies with state participation are generally far more pessimistic. Forty-two percent of companies with state participation don't see the crisis ending before 2011, whereas over half (52%) of private companies look forward to improvement in the next 12 months.



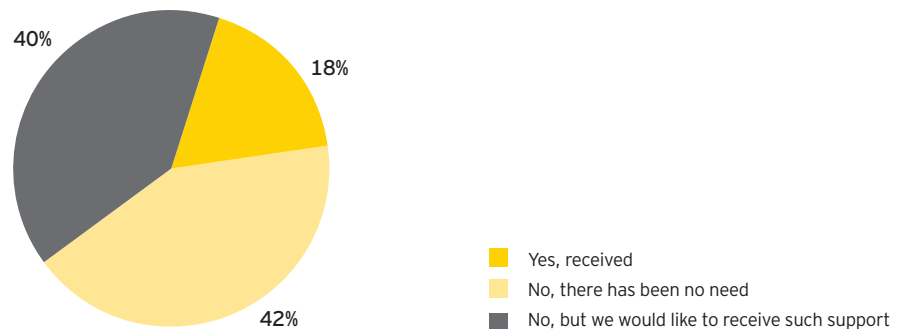
Power & utilities and diversified industrial products companies were the most pessimistic, while telecommunications, IT and financial services showed the most optimism.

**Forty-two percent of companies with state participation characterized government support as adequate and timely.**

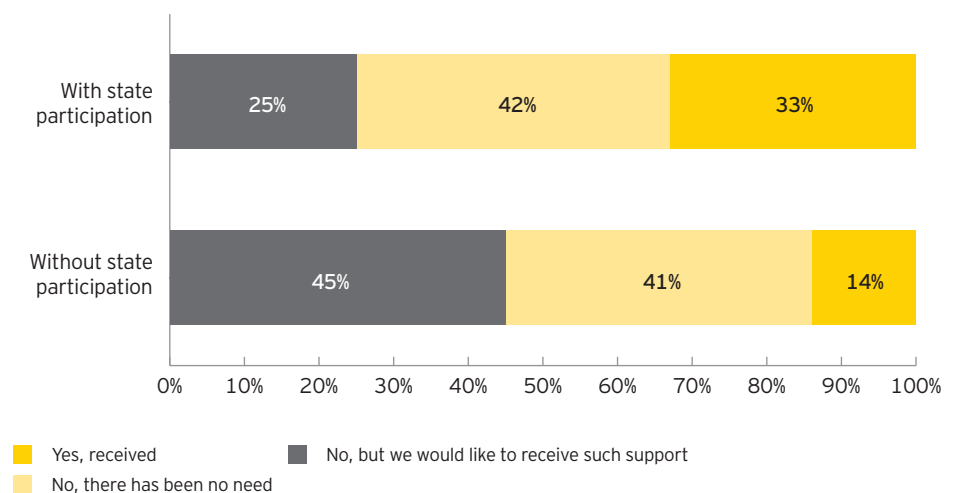
## 2. Effectiveness of government measures

Experts estimate that the total amount available to support the economy during the crisis is over RUB 3 trillion and USD 52 billion. Since the recession began, some RUB 1.5 trillion and USD 13 billion have been utilized to refinance the banking system, replenish liquidity and capitalize the financial system as well as to support the real sector by refinancing loans and gradually devaluing the ruble.

Fifty-eight percent of respondents said they had received or would like to receive support from the government. Eighteen percent of companies had already received financial assistance:



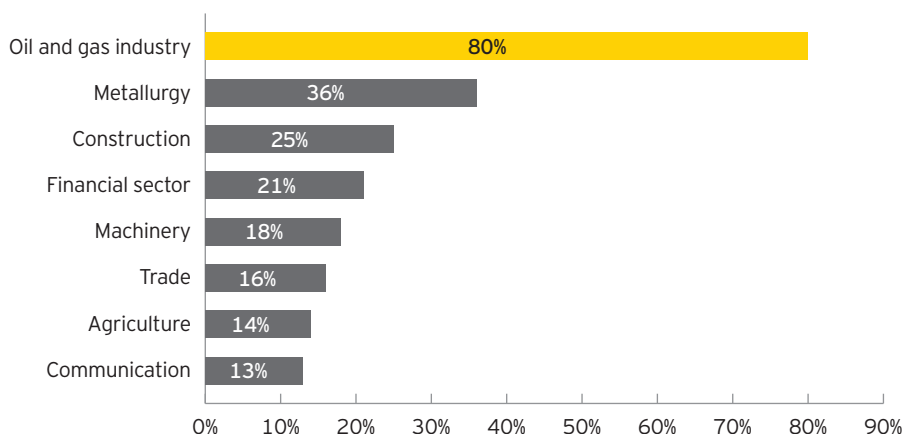
Government support was typically provided to companies with state participation. This explains why 42% of companies with state participation describe government support as adequate and timely, noting that the government is making every possible and necessary effort in the current situation. Thirty-three percent of companies with state participation that needed support have received it in a timely manner, while the figure for private companies is 14%.



Forty percent of companies that received financial support from the government regarded its impact on their financial position as material.

### 3. The industry that will drive Russian economic recovery

The overwhelming majority of CFOs agreed that the oil & gas sector will drive the Russian economy's recovery from the crisis. Metallurgy, construction and financial services are the other three industries that respondents believe will contribute to this recovery.



**Inability to forecast future developments is the most important internal risk (44%).**

### 4. Risks and vulnerable areas at the present time

Respondents view declining consumer demand (53%) as well as limited borrowing opportunities and the credit market (23%) as the major external risks for their companies' growth. Competition, currency risks and prices for fuels and non-fuel products are of least concern.

Forty-four percent of respondents named inability to forecast future developments as the most important internal risk. Insufficient liquidity (15%), working capital management (11%), maintenance of prior production levels (9%) and shrinking capital (9%) are also among today's top five business concerns. Protection of data and intellectual property and IT maintenance were hardly mentioned by CFOs.

CFOs name the financing structure (70%), complexities involved in developing strategy (43%) and risk management (38%) as the most vulnerable areas of business in today's challenging and volatile environment.

Opinions split on debt financing. Half of CFOs reported difficulty in obtaining the requisite debt financing, while the remaining 48% believe that sufficient external financing is available.

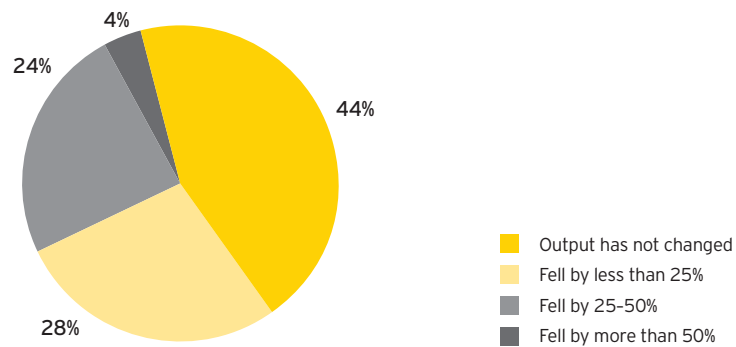
**Fifty-six percent of companies have cut production in the past six months.**

## 5. Impact of the crisis on company performance

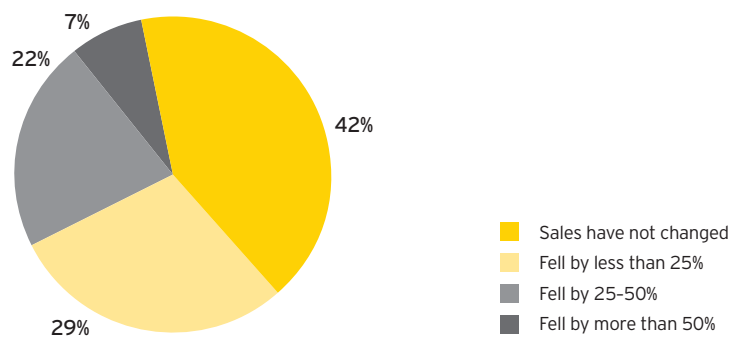
The first half of 2008 prevented the crisis from dramatically impacting the year's financial results. Only 11% of companies finished last year with a loss. Of late, the situation has changed markedly.

As of the beginning of May 2009, the Ministry for Economic Development and the World Bank forecast that GDP will fall by 6% this year. The survey participants also report decreasing output.

Forty-four percent of companies have not cut production in the past six months. The rest report difficulties:



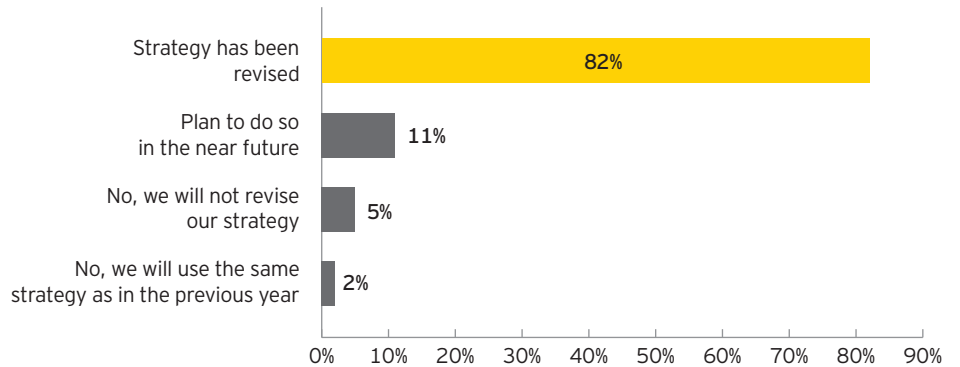
In the past 6 months, the change in the sales volumes of surveyed companies has been almost identical to the change in output:



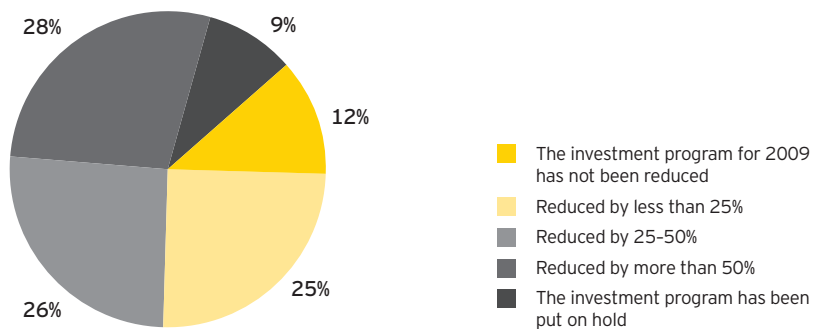
**Eighty-two percent of companies have revised their 2009 strategies or intend to.**

## 6. Russian companies revise their strategies in the crisis

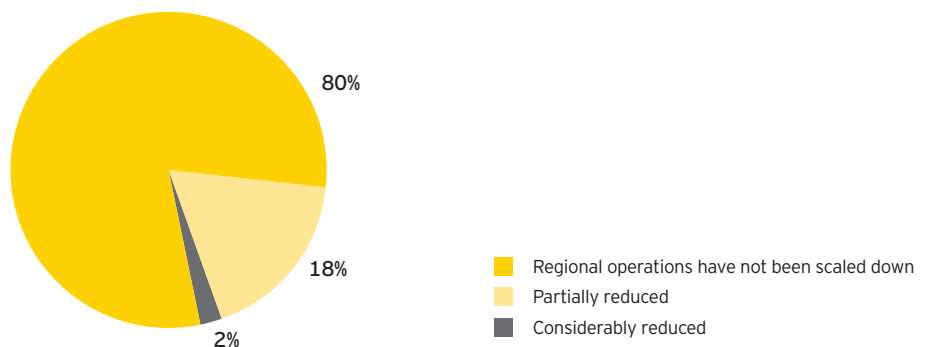
Most Russian companies have revised (82%) or plan to revise (11%) their strategies for 2009:



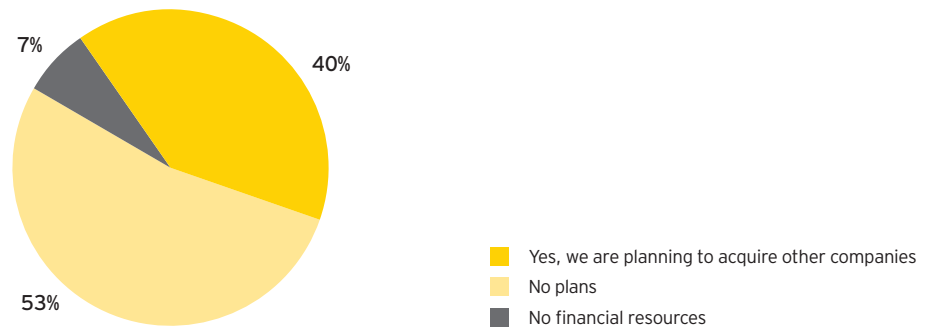
Strategy revisions have had a dramatic impact on major Russian companies' investment programs for 2009:



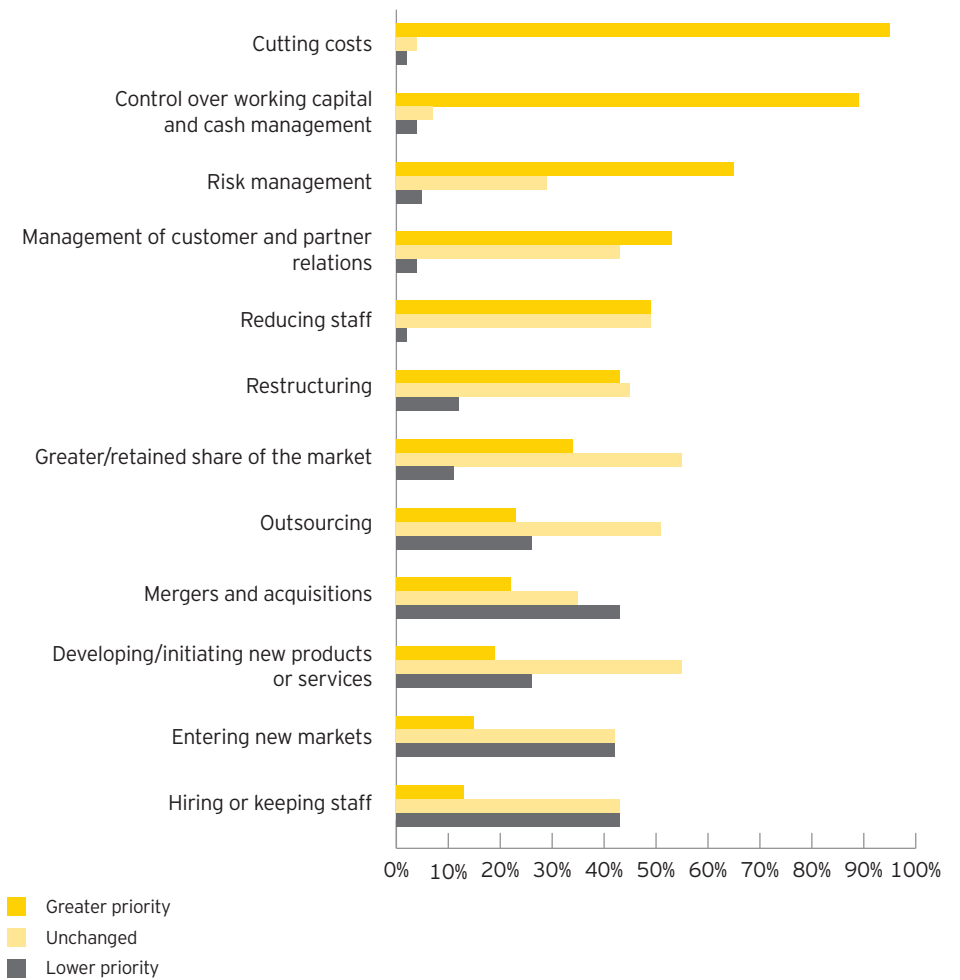
Only 20% of companies intend to scale down their regional operations as part of their strategy adjustment agendas:



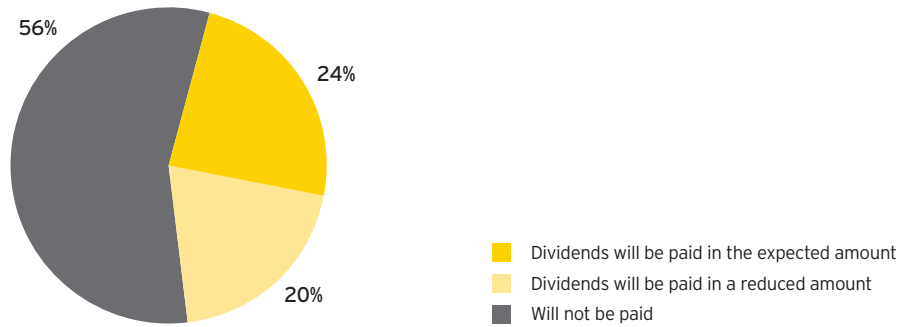
In spite of the crisis, 40% of respondents still see an opportunity to acquire companies in the near future (in 2009):



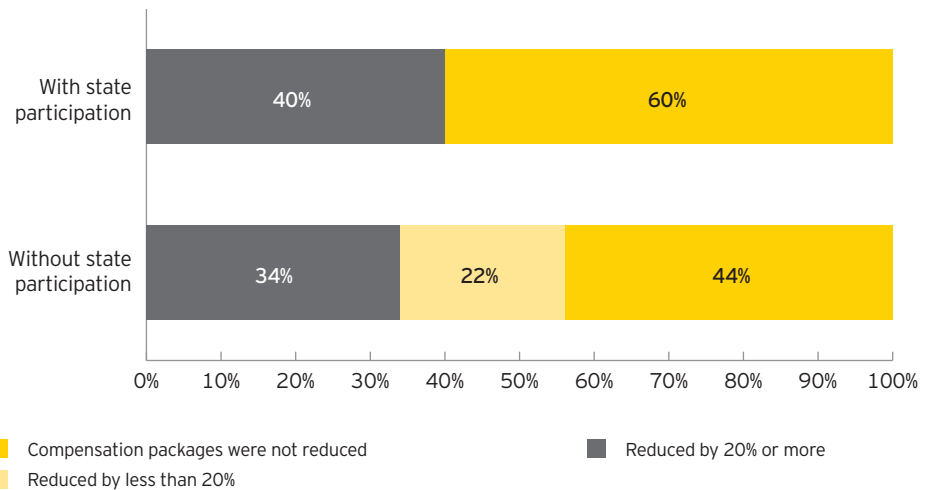
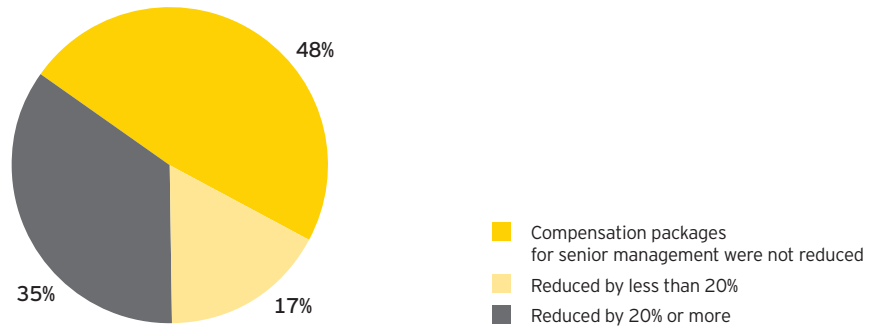
According to the CFOs, strategy revisions have to do primarily with the need to cut costs, focus on managing risks and control financial resources. Management of customer and partner relations and potential restructuring have become critically important.



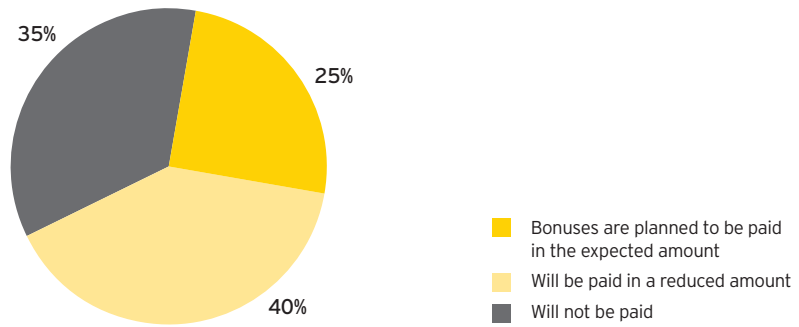
Limiting dividend payments is a component of cost-cutting programs:



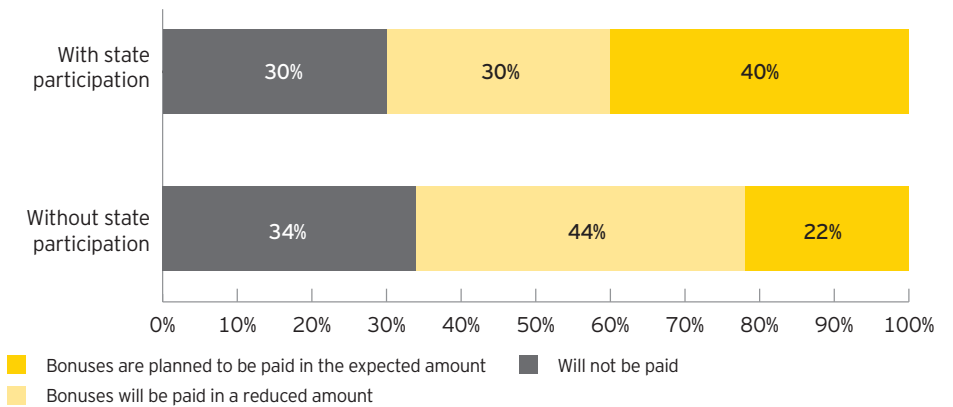
At the same time, nearly half of companies have not cut compensation packages for senior management. Such reductions are most popular with companies with private equity:



Nearly a third of companies discontinued their incentive programs and year-end bonuses.



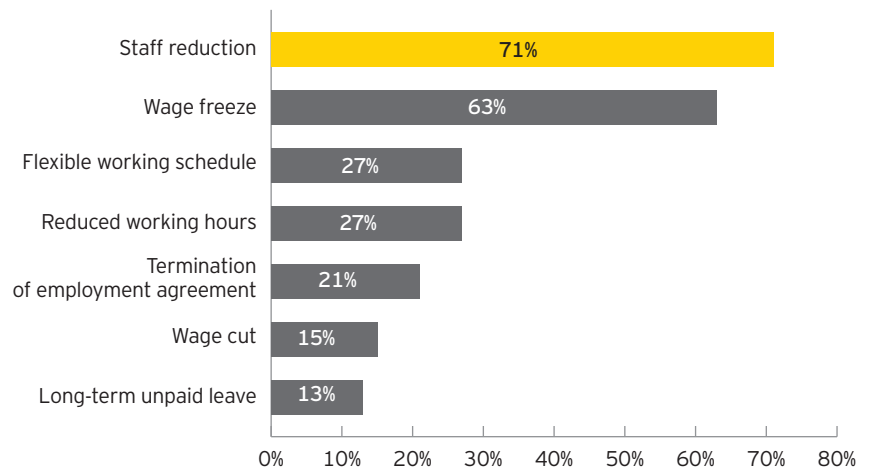
Close to 70% of both private companies and companies with state participation are prepared to continue paying either reduced or full bonuses.



**A ninth of all respondents reported that they had not cut staff and were not planning to do so.**

Over half of the companies had to cut staff in the past 12 months. For these companies, staff cuts averaged 10.7% of their total headcount.

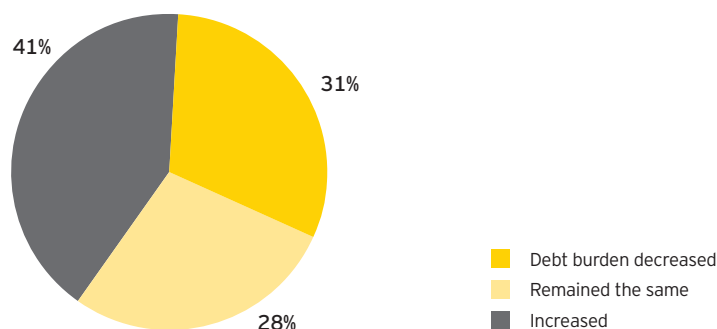
In spite of the measures already taken, many CFOs expect more staff cuts in the next 12 months. As a result, staff may be reduced by 11.6%.



Only a ninth of all respondents reported that they had not cut staff and were not planning to do so.

## 7. Financing structure

Forty-one percent of CFOs said their companies' debt burden had increased in the past nine months (total debt as a percentage of operating cash flow).



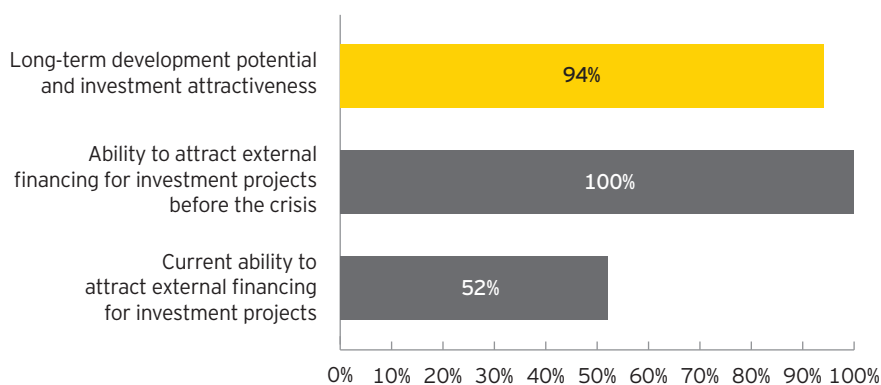
Companies continue to borrow from Russian banks, while borrowings from foreign banks and bonded loans have declined significantly. The table below shows the number of companies (of the 57 surveyed) that use one or another debt instrument.

| Debt instrument                     | 2008 | 2009 |
|-------------------------------------|------|------|
| Russian bank loans                  | 48   | 47   |
| Foreign bank loans                  | 40   | 28   |
| Corporate bonds in rubles           | 11   | 6    |
| Corporate bonds in foreign currency | 22   | 16   |
| Financial leasing                   | 20   | 8    |

**Most CFOs believe their company's outlook to be better than average.**

## 8. Favorable assessment of future growth prospects

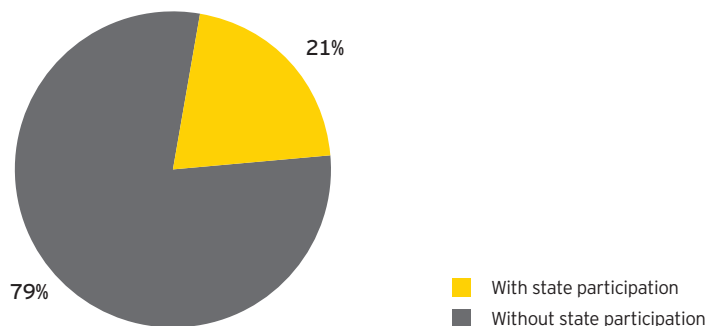
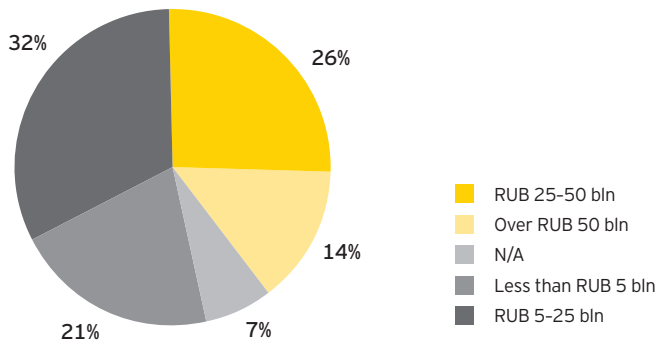
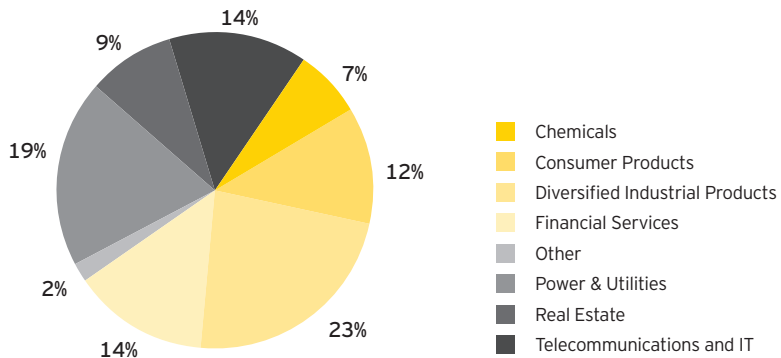
All companies (100% of respondents) favorably assessed the availability of external financing before the crisis. To date, this number has dropped by almost half (52%). Ninety-four percent of CFOs favorably assess long-term growth prospects for their companies.



# Respondent profile

**Fifty-seven financial directors of major Russian companies participated in the survey. Over half of the companies surveyed are among the two hundred major Russian companies topping the most recent Finance 500 list. The aggregate revenue of companies taking part in the survey is over RUB 2.5 trillion.**

Companies in all sectors of the economy took part in this survey. The majority represent diversified industrial products (23%), power & utilities (19%), telecommunications and IT (14%) and financial services (14%). To obtain a comprehensive picture, we held interviews with the financial directors of major Russian companies, 40% of which have an annual turnover of more than RUB 25 billion (as of 2007), and 21% are companies with state participation.



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## About the Independent Directors Association

**The Independent Directors Association (IDA)** is a professional organization uniting Russian and international corporate directors and corporate governance experts committed to the development of the institution of independent directors.

**Mission:** Assisting Russian joint-stock companies in improving their performance by implementing corporate-director best practices.

**Goal:** Establishing and maintaining professional and ethical standards of independent directors' activities.

This survey has been prepared by the Center for Business Knowledge, based on interviews with 57 financial directors of Russian companies held in April 2009. This publication contains summary information intended for general guidance only. It must not be regarded as a substitute for a detailed survey report or other referenced materials or serve as the basis for a professional judgment. Ernst & Young cannot accept any responsibility for losses incurred by any person acting or refraining from action as a result of any material in this publication. No part of this document may be reproduced or used in any form, whether wholly or in part, without the permission of the copyright holder, Ernst & Young (CIS) B.V. For permission to reproduce or use this survey in any other way, please contact Aleksey Rybnikov at Aleksey.Rybnikov@ru.ey.com.

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2009 is the 20th anniversary  
of our activities in Russia