DOING BUSINESS IN RUSSIA

The International Rating of the Best Russian CEOs

Magnit Home Grown Retail Giant

Aeroflot Flying High

MegaFon Getting Connected

DIXY Victory in the Aisles

The Moscow Times
BIG ON DETAIL

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Inspiration in Tough Times

The ‘CEO of the Year Russia 2014’ awards come at just the right time. They celebrate the achievements of the best CEOs. They are a lesson in the possible, a benchmark to aspire to and something to be proud of.

But they also show what skills, knowledge and foresight CEOs will need to navigate the economic currents. The specialists who constructed this ranking of top CEOs with The Moscow Times — BRAINFORCE AG and Obermatt of Switzerland — found that only about 30 per cent of the analyzed CEOs in 2014 were able to beat their peers in terms of combined performance. Many more Russian companies underperformed.

The authors of the rating say they still see many CEOs who do well in times of growth but who struggle in times of recession. A strong, experienced and talented CEO will also perform well in economically challenging times.

We also celebrate another group of individuals — along with companies, projects, and even the odd country — that have done most in the past year to improve the quality of life and raise Moscow’s profile as a global center of business and culture. The Moscow Times Awards highlight the ways in which our capital city is changing for the better.

Observers might ask why small and mid-sized businesses are underrepresented. SMEs represent only 15 per cent of Russia’s GDP, much less than in other big economies, where they create most of the new jobs as well as the future champions. Efforts are underway to fill that gap, such as the Startup Academy at Moscow School of Management SKOLKOVO and perhaps in the future The Moscow Times awards will have even more to celebrate.
You are often compared to Sam Walton, the man who successfully changed American retailing because he understood shoppers in mid-sized towns, not just in the big cities. Do you have a similar understanding of Russian consumers?

I think that the word “understood” does not fully explain the success of the Walmart business. “Understand” is a very general verb. Still, if we use this term, probably, we understand provincial shoppers better than the urban ones. But today our stores are in great demand in cities as well. I can’t say whether we have a similar understanding or not. Though I’m compared to Sam Walton, frankly speaking, I am not very much familiar with his business. Yes, I know that it’s the largest chain in the world and that it works in a big store format, but that is all I know. We try to focus more on ourselves, rather than look around.

Many big real estate developers have been slow to expand into Russia’s regions. Is this holding back the development of the regions?
Every region has its own real estate developers that are strong. I don’t think that Moscow’s big developers determine the growth of regions. It depends on other things, like the number of people in a region and the conditions for running a business. These things constitute the basis, rather than where big developers move.

You are from Krasnodar, which historically was a center of Russian agriculture. How is it developing now and will Magnit play a role?

I hope that we contribute to the city’s development by paying taxes to the local budget. We are undoubtedly interested in development as citizens; I carry out some of my projects, and I hope we make our contribution, which I plan to increase in the future. We have a program for the city’s development but considering the fact that Krasnodar once used to be a Cossack village, a lot should be done to alter the architecture. Now the city is evolving in the right direction. We can see changes but everything takes time and patience, which we sometimes lack. The transport network is troublesome, our city suffers some of the biggest traffic jams in the country. We should handle the problem.

One of your first businesses dealt in perfumes and personal care products and this is still a fast developing segment. Why do you think Russian consumers want to try many different brands rather than to pick one favored brand and stick with it?

Well, this can be simply explained. The thing is that prior to 1985, and up to the nineties, we had a single brand for everything. Now as a way of exercising their choice, buyers prefer to try everything. “Under-consumption”, as we used to have, still exerts its influence. I often say that it’s easier to compete with Russian entrepreneurs than with foreign ones. Our businessmen want to get money quickly and then only to consume. Evidently our “hungry childhood” still shows through. With the passage of time, things will evolve as they have in other European countries. But for the time being Russian buyers will go on changing brands rather actively, and this factor will remain.

Does the fickleness of customers create challenges for retailers and how should retailers respond?

The changing of brands is not a sign of the buyer’s fickleness. Our procurement system works to supply them with the goods they need. Fickleness reveals itself only if we don’t meet this demand, and then the buyer shifts to other stores. This is our business: to keep consumers. It does not depend on whether they are loyal to certain brands or not.

Information technology is a part of Magnit’s success; the ability to keep stores supplied in good time. Will Magnit introduce online-shopping and is customer pick up or home delivery a future possibility? I respond to this question quite often. With the existing system of logistics I don’t see the future for Internet trade in foodstuff on mass. Will there be a segment for this business? Probably, yes. Let’s say for “white collar” professionals, who are financially able to order goods. For the rest of the population, in my opinion, it would be an unaffordable service for at least the next 10 to 15 years.

Would you say that logistics is the most important aspect of retailing? You have Russia’s biggest transport fleet so you must know better than most the challenges of road and rail. To take one example, the road between Krasnodar and Armavir has just one lane in each direction. What would be the quickest way to overcome transport problems, especially in food producing regions? We can’t say that logistics is the most important aspect, because our business is multifactorial. Price forming, trade cost price and assortment policy are also of importance. But, undoubtedly, logistics is one of the most crucial blocks. How do we overcome transport problems? There is only one way: to invest in the construction of roads. There are no other ready-made solutions.

Russia is self sufficient in poultry and is increasing its beef live-stock. From the point of view of a retailer, what would be the best products to produce locally and what should be imported?

I see several segments in the Russian economy that are underinvested due to various factors. These include the production of milk, cheese, cattle, vegetable and fruit growing. These are the main spheres that require investments and whose imports should be replaced. Over the course of time the menu of our citizens has changed. At present the production of cheap fruit, vegetables and dairy products are the important tasks. Cheap fruit includes, for example, apples, and cheap vegetables means tomatoes and cucumbers. Dairy products play a key role in the diet of the buyer. That is why if we speak about foodstuff security, though I don’t like the word “security”, efforts should be put in these directions.

You have grown Magnit organically, without takeovers, and you are applying the same approach to football, with your soccer academy and soccer schools. How long will it take to produce a UEFA-level team in this way?

There is no such term as “UEFA-level”. Teams can be of a top level, strong, mid-tier or weak. Now we play in the UEFA Europa League. It is sports. Some seasons you play, others not. When it comes to our Academy, I’ve said it a lot of times already. I would like to have 11 graduates playing. Unfortunately, money is of huge importance in modern football and the place where your team plays frequently depends on the club’s budget.
The Russian retail market is one of the largest in Europe with turnover of almost 24 trillion rubles in 2013. Observers predict that its growth, however, will slow down to 2 per cent by 2017 from 16 per cent in 2007. Several waves of sanctions, which hit the local market earlier this year, are forcing consumers to adapt their expenses to galloping prices with the inflation level seen to exceed 7 per cent by the end of the year.

The retail trade is one of the largest spheres in Russia; it is by six times larger than agriculture and by 13 times than the telecommunications industry, according to Retail.ru. By market volume, Russian retail ranks in fifth position globally, with $651 billion of turnover. That places it after Germany with $678 billion, Japan with $1.2 trillion, China with $2.1, and the U.S. with $2.8 trillion, Retail.ru said.

Foodstuffs occupy almost half on the Russian retail market, while home and garden products occupy 8 per cent, and clothes and

**Grocery Chains a Safe Port in Rough Seas**

By Yekaterina Yezhova
to large thoroughfares, like the Trans-Siberian Railway and the Baikal-Amur Mainline.

Otkritie Capital’s analysts say they are positive on the stock market share prices of many Russian food retailers, such as DIXY and Magnit, and that big players will continue to take market share from the second tier competitors. This will compensate for global economic difficulties, they said in an investor note.

Retailers face risks, however. These include a weaker-than-expected economy, falling currency and the rising cost of credit; regulatory risks such as price controls or changes in taxation; pressures on margins resulting from a changing supplier base and likely lower rebates; and finally the risk of volatility in inflation that may depress the sector’s revenue growth.

Russian consumers have contributed strongly to growth in recent years, but those consumers are now under pressure. The average Russian shopper monthly earns 31,500 rubles ($690), and an average cheque per a store visit was at 540 rubles ($11) in July. Citizens call at stores for purchases three times a week. Sixty-nine per cent of people prefer neighboring stores and most of them say they are willing to pay higher prices for fresh products, according to research company Romir.

One fifth of shoppers retains the hoarding instinct and buys products with a longer shelf life in order to have reserves and save money in case of a price hike.

In mid-September, Russian trade chains, grocery suppliers and producers signed a memorandum seeking to limit the growth in retail prices of foodstuff in response to sanctions. The document was agreed by representatives of the Retail Companies Association (ACORT), comprising such major retailers as Magnit, X5 Retail Group and DIXY, among others, as well as by representatives of industry associations, like RusBrand.

Apart from the growth in prices, suppliers and producers pledged not to allow an artificial decrease in grocery procurements and promised to contribute towards the increase of domestic production. Trade chains promised not to reduce sales, to maintain the quality of products and to facilitate access to their shelves for Russian-produced goods.

**THE TURNOVER OF THE RUSSIAN RETAIL MARKET**

<table>
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<tr>
<th>Year</th>
<th>Volume, trn rbl</th>
<th>Share of foodstuff, %</th>
<th>Share of non-foodstuff, %</th>
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<td>2012</td>
<td>21.4</td>
<td>47</td>
<td>53</td>
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<tr>
<td>2013</td>
<td>23.7</td>
<td>47</td>
<td>53</td>
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<tr>
<td>2014 (prelim)</td>
<td>24.1</td>
<td>46</td>
<td>54</td>
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<tr>
<td>2015 (prelim)</td>
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<tr>
<td>2016 (prelim)</td>
<td>25.0</td>
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Source: Russian Economic Development Ministry

**GROWTH AND INFLATION IN RUSSIA’S ECONOMY**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP, %</th>
<th>Retail Turnover, %</th>
<th>Inflation, %</th>
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<tr>
<td>2014 (prelim)</td>
<td>0.5</td>
<td>1.9</td>
<td>7.2</td>
</tr>
</tbody>
</table>

Source: Accenture Russia
Aiming for Victory in the Aisles

Russia’s top four retailers are all grocery chains, a sign of the tough competition in this sector. As President of DIXY Group since 2009, Ilya Yakubson has transformed the company through a mix of organic growth and acquisition. DIXY Group is a winner in the CEO of the Year Large Company category, for growth and operating performance.
What has been the reason for DIXY Group’s successful record of growth on the Russian market?
The company has managed a number of important modifications over recent years. We completed the integration of the Victoria group of companies and neighborhood stores received a new image and positioning. We also carried out a legal restructuring and several complicated and expensive projects that enabled us to demonstrate impressive results both in terms of operating efficiency and growth rates.

The Russian grocery market has a lot of retail styles, with international and local influences. Are any characteristics unique to the Russian market or the Russian consumer?
The Russian retail sector is rapidly approaching the international one in terms of its technologies, assortment and other parameters. It can no longer be considered separately from global retail, especially in its use of marketing, logistics and IT which are as advanced as in any country. As to the consumer, the frontline issue here is a matter of general human needs and expectations: a store should be clean, products should be fresh and personnel should be polite. Everyone likes discounts, auctions and loyalty programs. We are part of a huge retail industry and all standard techniques are at work in Russia.

DIXY has a series of store formats: mostly neighborhood stores but also supermarkets and compact hypermarkets. Will market trends favor one format over another in the future?
All the three formats of stores operated by DIXY are popular and have their own customers. There are no signs of cannibalism among them and all the three types develop successfully. DIXY is a neighborhood store with a wide range of products for every day at fair prices. We call DIXY’s customers “our neighbors”, as they can call at a store five to seven times a week. Victoria is an ideal example of a sub-premium supermarket with lots of own food production, farmers’ corners and ecological products. Megamart develops in the regions beyond the Urals; it’s the most profitable division of the company. Stores offer a wide range of assortment of purchases for a week, a large share of local produce and the highest level of loyalty. More than 90 per cent of regular customers use loyalty cards.

DIXY Group is one of the top retailers in Russia. It bought the Victoria chain a few years ago and announced plans to double the number of its stores in Russia to 3,000. Is that still your target? DIXY is the third-largest retailer by revenue, sales areas and the number of stores among national retail operators. We confirm all the earlier announced plans of expansion. Preliminary results for the year 2014 support our earlier announcements and they will be successfully carried out and even exceeded.

DIXY has announced plans to roll out its convenience stores in the Central Federal District. Which are your priority regions in Russia?
We continue to develop our regional presence and growth potential is immense here. We are starting to penetrate neighboring regions. The priority directions are Yekaterinburg, Tyumen and Nizhny Novgorod.

The group has nine distribution centers. What role does your logistics operation play in DIXY’s success?
Logistics is the heart of retail. DIXY invests huge amounts into the expansion of this function: equipment for distribution centers, the purchase of automobile transport and improvement of logistical infrastructure. We will launch one more distribution center of 40,000 square meters in 2015 in the city of Noginsk. An active expansion into the Central Federal District would be impossible without it.

The Russian economic ministry has raised its forecast for food price inflation because of sanctions to about 13 per cent. How is DIXY reacting to the issue of price pressures? Will we see more own-label products?
DIXY actively promotes its private label. As of the moment, its share in the chain’s sales is about 10.6 per cent, and we plan to double this figure by the end of 2015. The company develops its own trademark in three directions: goods “of first price” under the Pervoye Delo (First Case) brand, which is an economical and simple solution in each category. The “D” brand offers goods of a similar or a better quality than those of brands-leaders with prices cheaper by 20 to 40 per cent. It also comprises exclusive trademarks for categories where the emotional component is important, such as alcohol, chocolate and the like.

The grocery segment has been the one of the fastest-growing segments of the retail market in recent years. Do you expect this to continue?
There are no signs of stagnation in the segment. The market has a huge potential for growth and improvement. The financial indicators of large trading chains back up this conclusion.
Aeroflot aims to be among the top five European carriers and the top 20 global carriers by 2025. How far are you towards meeting that objective and what still needs to be done?

Aeroflot aims to be a top-five European and top-20 global airline in terms of passenger traffic and revenue by 2025. We are currently on track to achieve these goals and some expert industry assessments have even put us ahead of schedule. For example, Aviation Week’s 2013 Top-Performing Airlines ranking placed Aeroflot seventh globally among large carriers with more than $6 billion of revenue, ahead of peers including Lufthansa, Air China, International Airlines Group (British Airways and Iberia) and Air France-KLM.

Aeroflot offers a premium service compared to many airlines, in terms of young aircraft, food and beverage, refunds on tickets and so on. But this also keeps ticket prices high. Do you plan to change that? One of Aeroflot’s priorities is to make air travel in Russia more accessible, and we have done
a lot in this area. On our initiative foreign pilots have been granted permission to work in Russia, and non-refundable tickets have been introduced. All of this has a positive effect on reducing the cost of tickets.

The most essential step is the creation of a national low-cost air carrier. We are dedicated to increasing mobility and accessibility of transport among Russia’s regions, and our budget carrier is focused on price-sensitive customers.

As for Aeroflot this is an airline offering a premium level of service that is highly rated by all our passengers and international trade organizations. In terms of in-flight quality of service, Aeroflot is the best in Europe and among the leading airlines globally. For the past three years our airline has grown its Net Promoter Score, which reached 58 per cent in 2013, surpassing that of some of its most eminent competitors. This year the British consultancy Skytrax, which produces the most authoritative quality of service rankings globally, named us the Best Airline in Eastern Europe for the third time. The safety and comfort of our passengers are our main priorities. Today Aeroflot has the youngest fleet in the world among major airlines and the highest level of service on board.

We are fully aware that it is impossible to claim the global title without being a national champion.

These are our main competitive advantages and are key drivers of our success.

You have called for an end to monopoly on international routes so that the market is liberalized, as is happening domestically. How would this benefit Aeroflot?

Russia has an open market with four to seven competitors serving each destination. We believe that this is a good thing, because companies can thrive only in a competitive environment. Passengers can see all the benefits that Aeroflot offers, such as its modern fleet, service and exceptional punctuality, only by being able to compare us with other airlines. In the end the passenger is always the winner.

The EU sanctions grounded Aeroflot’s low-cost unit Dobrolet by stopping it from leasing Boeing aircraft. You’ve rebranded the airline as Pobeda, which means victory. How have you solved the leasing issue?

The imposition of severe sanctions against Dobrolet made it impossible to use this historic Russian brand, but the low-cost project is still an important part of our strategy. This was the main reason for Aeroflot Group to launch a new budget carrier with different name. The choice of the name Pobeda is directly related to the upcoming anniversary of the victory in the Second World War, and is illustrative of defiance and symbolizes victory over the difficulties and external challenges faced by Russia and its people this year. Under the brand Pobeda the company is launching winter season flights to a number of Russian cities and different regions, from the south to Siberia.

Pobeda will have 40 aircraft by 2018. What is the number at launch, and how many domestic Russian routes will you serve initially?

Pobeda currently has four new single-aisle Boeing-737-800 NG that are designed to carry 189 passengers in a single class. Next year we are planning to extend the fleet up to 13 aircraft. In November 2014 Rosaviatsiya issued an air operator certificate to Pobeda and in accordance with Russian legislation the carrier started selling tickets. Pobeda will make daily flights from Moscow to Volgograd, Samara, Yekaterinburg, Perm, Tyumen and Belgorod. The carrier completed its maiden flight on December 1 from Vnukovo International airport, Terminal A. Tickets are in high demand among our passengers. In the first 12 hours alone, Pobeda sold 7,000 tickets to six destinations. The most popular destinations are Yekaterinburg, Tyumen, Perm and Volgograd.

Aeroflot received its first Sukhoi Superjet 100 last year. How many will it operate, and over what timetable?

Aeroflot is the launch buyer and the largest Russian operator of Sukhoi Superjet-100. At the moment we have 10 SSJ-100 in full specification. The total order stands at 30 aircraft. At the end of November 2014 Aeroflot and Sberbank Leasing struck a deal for the purchase of 10 aircraft through financial leasing. We expect that these 10 aircraft will join our fleet by the end of April 2015. The SSJ-100 is designed to carry 87 passengers in two-class composition with 12 seats in business class and 75 seats in economy class. The maximum flight range is 2,400 kilometers so the aircraft serves both domestic and international destinations.

Aeroflot achieved a number of firsts in its history: the first airline to operate a route exclusively with jet aircraft and the first regional jet service. How will the airline distinguish itself in the future, as the market becomes more competitive?

Aeroflot Group is the powerhouse of the Russian aviation market and aims to occupy a competitive place alongside major airlines globally. As I said at the beginning our goal is to become a top-five European and top-20 global airline in terms of passenger traffic and revenue. Aeroflot today is an airline with a global outlook. Together with our Skyteam partners we serve more than 1,000 destinations in 177 countries. As a national carrier our company prioritizes the development of domestic destinations, particularly to improve transport accessibility in remote regions of Russia. We are fully aware that it is impossible to claim the global title without being a national champion. The domestic market is our core, and the basis for our growth internationally.
Rival Approaches to Air Travel

Russia’s airline industry is about to undergo another wave of transformation with the launch of more budget seats through Aeroflot’s Pobeda subsidiary.

By Mark Gay

It is not by any means the first Russian budget airline — Red Wings and Blue Wings (half Russian) have come and gone, and before them SkyExpress and Avianova. Even Pobeda (Russian for victory) is a replacement for the suspended Dobrolet, which was grounded when western sanctions forced it to cancel its leasing arrangements.

But with the might of Aeroflot behind it, Pobeda may stand a greater chance of success. It offers prices 20 to 40 per cent lower than Aeroflot, a higher density of seats, one cabin class, and with extras at a price, such as checked luggage, in-flight food, numbered seats and priority boarding.

Aeroflot’s CEO, Vitaly Savelyev, says he aims to make air travel more accessible. “The most essential step is the creation of a national low-cost air carrier. We are dedicated to increasing mobility and accessibility of transport among Russia’s regions, and our budget carrier is focused on price-sensitive customers,” he told The Moscow Times publication, Doing Business In Russia.

The timing of its launch — the first flight was scheduled for December 1st — amid an economic downturn, raises a number of challenges. Airlines may want to raise their prices in the face of falling revenues, yet the federal government is pressing carriers to lower their prices, for example to develop the tourist industry in Sochi, as delegates to the Wings of Russia International Aviation Forum discussed in October.

Savelyev said the effort to trim costs was not limited to Pobeda. “On our initiative foreign pilots have been granted permission to work in Russia, and non-refundable have been introduced. All of this has a positive effect on reducing the cost of tickets.” Russia’s transport min-
An Analysis of Doing Business in Russia 2014

The industry is working to clear obstacles to cheaper flights by removing the obligation to provide food in flight. The Duma changed the law to let Russian airlines offer different classes of fare and non-refundable tickets.

Aeroflot modeled Dobrolet around internal cost savings. Assuming Pobeda continues with the same model, it will fly new aircraft with a rapid turnaround, gaining the maximum from improved fuel efficiency. It also sells tickets through online channels, restricting administrative staff to the very low hundreds. CAPA Centre for Aviation’s analysis suggested that aircraft leasing would generate savings but western sanctions rendered that more difficult. Sanctions remain a risk if the EU or U.S. impose new requirements or restrictions on third country operators, especially in terms of destinations.

Pobeda operates new Boeing 737-800NG aircraft from Moscow’s Vnukovo airport, initially serving the domestic cities of Samara, Yekaterinburg, Perm, Kazan, Tyumen, Surgut, Belgorod and Volgograd. The minimum fare in one direction is 999 rubles ($22) plus fees and taxes.

Aeroflot currently intends for Pobeda to have 40 737s serving at least 45 domestic and international destinations.

In addition to internal cost savings, many European budget operators benefit from regional airports reducing the fees they charge for landing and baggage handling. In the case of Britain’s easyJet or Ireland’s Ryanair, for example, regional airports are even willing to subsidize airlines, effectively paying them to bring tourist and business visitors. European Union rules allow the payments so long as they do not seriously distort competition.

About 85 per cent of Europe’s 450 airports are state owned, according to the industry’s trade body, Airports Council International Europe, and most of them are small and loss making. They receive about $4 billion of taxpayer money, much of it redistributed through the EU’s regional support plan.

The ACI says airports need subsidy as their costs are higher, per passenger, than for big airports. Politicians agree, and favor the boost that airports can give to the local economy. Last year the Scottish government bought Prestwick airport near Glasgow and the Welsh administration bought Cardiff.

Aeroflot has younger aircraft than many global competitors. It continues to modernize, even while it reverses the depletion of Russian jets within its fleet, with the recent planned addition of 10 SuperJet-100s.

The distribution of airports is greater in Europe: nearly two-thirds of Europeans live within two-hour’s drive of at least two airports. One difference with Europe is the longer flight distance on domestic Russian flights, which averages 2,000 kilometers, or almost double the average for flights within Europe.

Full-cost airlines like Air France and Lufthansa are struggling to control costs while low-cost airlines like Ryanair are raising profit forecasts (as of September). The big, scheduled airlines fear that competing directly with low-cost airlines, or launching their own no-frills subsidiaries, would cannibalise their revenues. Aeroflot also faces growing competition from low-cost carriers on international flights to Europe.

Aeroflot has some advantages, however. On the plus side, it already has younger aircraft than many global competitors. It continues to modernize, even while it reverses the depletion of Russian jets within its fleet. In November Aeroflot signed an agreement with Sberbank Leasing to take delivery of 10 SuperJet-100s in a $354 million contract.

Aeroflot also has lower wage costs than many of its competitors. Both Air France and Lufthansa failed to persuade pilots to reduce long haul costs or to discuss expanding their low-cost units, Transavia and Eurowings, respectively.

Lufthansa’s operating margin was 2.6 per cent in 2013, Air France-KLM’s was a negative -0.89 per cent. Aeroflot’s was 6.8 per cent. But when Europe’s airlines improved their profitability in the first half of 2014, Aeroflot suffered a net loss for the first time since 2008.

International margins are likely to have suffered as international capacity grew only 0.5 per cent in the first half. European routes were more profitable than Asian and North American destinations, as were Russian routes. Aeroflot’s domestic market share was 38 per cent in the first half of the year.
Little room for New Players in the Telecom Sector

By Vladimir Kozlov

Russia’s telecom market is a paradox: highly competitive yet difficult to enter. With Tele2 now part of Rostelecom the country has four players on the federal level. All are involved in rolling out the latest-generation LTE services.

Russia’s telecom market is likely to keep growing thanks to the development of mobile and data services, and subscription television, compensating for lower revenues from voice services. They may also help cushion the industry from the economic slowdown.

The growth of data services may eventually cannibalize other traffic such as voice and SMS, as users go online to use services that were traditionally the role of the mobile phone.

“We expect the pace of growth in Russia’s telecom market to slow down,” said Renaissance Capital’s telecom analyst Alexandra Serova. “This is due to the high penetration of mobile devices, cannibalization of telecom services and the overall macroeconomic situation. This in turn has an impact on demand from individual and corporate customers, the sales of more contemporary mobile devices and the investment plans of telecom companies.”

She does not expect stagnation in the market, she added. “Over the next couple of years, telecom operators’ revenues will continue to grow at a slow pace.”

Anna Lepetukhina, senior analyst, Sberbank Investment Research, said voice traffic services are no longer growing and in some segments they are shrinking. “Even though there might be nominal growth, its pace is decelerating from year to year.”

However analysts say considerable growth is still possible in mobile internet and data services. The increased penetration of smartphones and subscribers’ growing willingness to use data services will drive average revenue per user (ARPU) higher, ensuring continued growth in the segment, Lepetukhina said.

There is already a trend for revenue growth in mobile internet at the expense of ARPU for voice services. Revenues in the mobile internet segment are increasing at a rate of over 30 per cent, year-on-year.

By the end of 2014 the penetration rate for Russia is expected to be 185 per cent, according to IC Insights. As many people have more than one subscription, the actual percentage of the population that has a cellphone subscription is estimated to be about 70 per cent.
Such phones remain costly, although telecom operators have spent time and effort on promoting the use of smartphones among the population, offering basic models that allow people to access the internet. This trend may slow, as people become less willing to upgrade their smartphones to more expensive models. “Upgrading smartphones will be more problematic,” said Lepetukhina.

Whether mobile phone operators respond by cutting rates or prices is a moot point, experts say. “There is a probability that one of the operators will go ahead and offer “crisis tariff plans,” said Lepetukhina. “If it happens, other operators will have nothing to do but follow suit, which would lead to an overall decrease in prices. But it won’t necessarily happen.”

Russia’s telecom sector is highly consolidated, and the arrival of new major players in the short term is unlikely. In the mobile segment, the big three companies, Mobile TeleSystems (MTS), MegaFon and Beeline account for 83 per cent of all Russian mobile subscribers, according to data for the second quarter of 2014 provided by ACM-Consulting.

According to Lepetukhina, a completely new player is unlikely to enter the market as there are restrictions on available frequencies. “There are no indicators that there will be a sufficient frequency resource for a new player in the near future,” she said.

Opportunities for new entrants is likely to remain limited, making unlikely the introduction of virtual operators, or licensed providers that buy network services at wholesale rates and sell them on to customers.

The entrance of new regional players may put downward pressure on prices. Rather than kicking off a new round of competition, however, this could simply raise the bar for new entrants.

The big three have no reason to introduce mobile virtual network operators (MVNOs) by their own initiative, said Lepetukhina. “The existing operators aren’t interested in creating competitors for themselves. Nothing obliges them to allow other companies to use their networks. And building a completely new network would be costly and difficult.”

Still, the country’s fourth-biggest mobile operator is gaining momentum. Tele2 Russia was sold to the Russian bank VTB last year and then to Rostelecom, giving it access to the LTE licences that it failed to win on its own. While expanding operations to new Russian regions, it also plans to launch operations in Moscow in the near future. Currently, it accounts for roughly 15 per cent of the market.

Tele2 already operates in many regions and may grow further, leading to some increase in competition and perhaps downward pressure on prices. Rather than kicking off a new round of competition, however, this could simply raise the bar for new entrants.

“Given Tele2’s development plans, which include the launch of 3G and entering new regions, the competitive environment will become more active, which will make it difficult for new players to enter the market,” Serova said.
Ringing the Changes

MegaFon has focused almost exclusively on the Russian market, where it has about 70 million subscribers. MegaFon’s Executive Director, Consumer Business, Mikhail Dubin says rather than expand overseas, the company aims to offer the most advanced technology at home. MegaFon is a winner in the combined performance ranking.

Last year MegaFon demonstrated almost double-digit growth. How has 2014 differed from 2013?

Firstly, the geography of Russian LTE networks has significantly expanded. MegaFon today provides high-speed mobile Internet in 68 Russian regions. We will reach 70 regions by the end of the year. MegaFon’s LTE network is the biggest in the country, covering an area home to 40 per cent of Russia’s population, roughly 60 million people.

Another important result from this year, for us and for the industry on the whole, is the commercial launch of our LTE Advanced network. MegaFon was the first in the world to offer clients mobile Internet access at speeds of up to 300MB/s. As an example, this speed means a 1.4 GB video can be downloaded in less than a minute. Just recently these speeds seemed impossible but now people in Moscow and St. Petersburg are enjoying them. In future, we plan to gradually expand the coverage area.

This year clients in Russia were given the option to switch to a different operator without changing their number (Mobile Number Portability). Talk of MNP has been ongoing since the mid-2000s and only now has this option become a reality. I’m not fond of talking about it as “freedom from mobile slavery” but it’s certainly something that was needed because there are clients who want to change operator but hold onto their number.

And finally, this year our clients are using smartphones and tablets a lot more. This summer, sales of smartphones overtook telephone sales. Today, if we look at sales on the whole, smartphones account for 60 per cent, while sales of normal phones have dropped to 40 per cent. I have the sense that they will continue to fall.

You mentioned the launch of your LTE
Advanced network. Experts say that right now penetration of LTE Advanced-enabled devices is still very low, so the network is not actually any use and is more about image for operators.

Similar things were said when we started building 4G networks. In 2012, we launched a 4G network with one modem. Now, just two years later, there are around 100 smartphones and tablets that support this technology. When we launched the new network back in February, one router, MegaFon Space, only supported it but now such speeds are available on at least three smartphones. And very soon we’ll be offering a new compact router with LTE Advanced support in our stores. The number of such devices will increase significantly in 2015.

What mobile products and services are you interested in? What products do you plan to launch?

As before, we’re concentrating on releasing affordable MegaFon-branded smartphones and tablets. Sales of budget mobile devices have been growing much faster than other segments for the second year running. That’s the trend today and I’m certain it will continue next year as well. Budget smartphone consumers are fairly sensitive about price. For half of them it’s their first mobile device with access to the Internet. We have cut the price of Internet options by 20 to 30 per cent especially for such clients.

We see particularly big potential for video services. At the beginning of the year we launched Smotri+, a service where people could watch the Olympics and Football World Cup. It was downloaded more than 2 million times during the Olympics, which is indicative of the significant interest in video streaming. Another popular service is MegaFon TV, where users can watch Russian and foreign TV channels in digital anywhere with Internet. In a year, the number of active users of this service has risen 50 per cent. We think this is a very promising area and plan to develop it.

Of course we are interested in everything around mobile finance. Firstly, this is mobile apps where people can pay for services using mobile Internet. Secondly, this is MegaFon payment cards. And thirdly, this means expanding the financial services we offer in our MegaFon retail offices. In addition to paying for services, this includes money transfers, loan payments, topping up transport cards and much more.

How is MegaFon developing its recent acquisition, Scarletel? What will happen with competition between mobile Internet and fixed line?

I don’t think it’s a matter of competition. It’s more about everything converging towards some kind of synergy. Mobile and fixed line Internet complement each other very well. In cities, customers prefer to use fixed line Internet at home, while outside their apartments they stay online with mobile. But there are regions in Russia where it simply doesn’t make economic sense to put in a fixed line. Mobile Internet in places like that is the only “window to the world”.

MegaFon has a subsidiary, NETBYPNET, which offers fixed line access and provides home Internet, paid TV and phone services in 80 Russian cities. This asset will develop by offering service bundles. Yota is a niche operator that knows its audience well and what to offer it. This operator will of course continue to develop and grow.

Some say consumers continue to spend on phone services despite slowing economic growth. Have we reached the stage where these services have become an integral part of people’s expenses or does it depend on each individual?

Compared to other sectors, telecom is of course less exposed to the negative impact of macroeconomic factors. Firstly, mobile has genuinely become an integral part of daily life. Phones are now one of those things people never leave the house without, likes keys and wallet. Secondly, mobile services are now incredibly affordable. The average mobile bill is now slightly over 300 rubles, which is less than people spend on transport. But of course we are not completely isolated and are prepared for our subscribers to focus on optimizing expenses if the economic situation gets worse. In this case, I think the operator that offers the best value for money will have the advantage.

With a population of 143 million people, Russia’s telecoms market is the biggest in Europe. Do you think it will reach maturity like the western European market, which is now seeing weak growth and profitability? Or do you think the Russian market will develop differently?

Compared to the US, Japan and South Korea, the western European market looks fairly conservative. I think Russia, in terms of interest in innovation and the speed at which these innovations are introduced, is closer to the leaders. Technologically speaking, we are up there with them, and across many criteria we are way ahead. This is in large part because of the regulator’s extremely reasonable approach. A simple example: we received our license to build LTE networks through a competitive tender. In countries where these licenses were sold, the development of 4G networks has been much slower simply because operators spent a lot of money on the licenses and not on building the networks.

The average quality of mobile services in Russia is much higher than in any European country. And prices are several times lower.
Foreign Companies in Russia for the Long Term

Philippe Pegorier heads French power company and train maker Alstom’s operations in Russia, Ukraine and Belarus. And since May, he has chaired the Association of European Businesses, or AEB, a Moscow-based lobby group with over 600 member companies.

Do you think the crisis has shaken European companies’ faith in the Russian economy?
We had a survey by market research company GfK, which showed in its most recent report in May that European companies are very confident in the long term. Thanks to the growth of the middle class, modernization of infrastructure and so on, it is clear that Russia is developing. Maybe not as fast as western businesspeople, western politicians and western journalists would like, but you should not forget that Russians have never in their history lived so free and in such good conditions as now.

Short-term, of course, there could be difficulties, but at companies that have been here for a long time, such as Alstom and Siemens, we know there have already been many crises, and we survived.

So there is a crisis. There will be other crises in the future. But we stay here because we know that between the crises we will rise with the country, as the market rises.

What do sanctions against Russia mean for the EU?
Economic sanctions will have a very bad influence on European economies, raising unemployment and causing bankruptcies.

There is a choice: Do they [European governments] want to prioritize the quality of life of their own citizens, or of people abroad, Ukrainians? I think with elections inside the EU, in France, Denmark, Italy and so on, the message of voters is: We want the EU to look to us, not to look abroad.

No election was ever won on external policy. Always, everywhere, elections are won on domestic policy. The problem of Russia, and sanctions on Russia, is one of domestic policy. The problem of Ukraine is one of external policy.
This is a question that politicians have to answer, but we have to raise it.

Do you think Russia’s much-discussed “pivot east” threatens Europe’s role in the Russian economy?
Russia is a very big country, and China, like Europe, is its neighbor. It is normal that Russia has ties with both. Even in the Soviet era there were ties with China. I think there is space for everybody. At the same time, the EU accounts for 75 per cent of foreign investment in Russia. The Chinese are still not at this level and will need a long time to get there. The EU’s presence in Russia is historical, centuries-old and important.

What is the role of the Association of European Businesses, especially in this current crisis?
The association’s role is to promote the activities of our 650 members with European and Russian authorities.
We are here to advocate economic growth and create value. In this situation, that means being clearly against economic sanctions against Russia and also promoting de-escalation everywhere. Because escalation is bad for business in Russia of course, but first and foremost in Ukraine. We will, of course, comply with any economic sanctions, but we look a priori to avoid them.
We are also working toward the establishment of new long-term ties between the EU and Russia and the negotiation of a free-trade agreement between Europe and Eurasian Union [a bloc that unites Russia, Belarus and Kazakhstan].

How do you lobby the Russian government? Who are you in contact with?
We are in contact with everybody. With the economic ministries, with the Foreign Ministry — Foreign Minister Sergei Lavrov regularly accepts our invitations to speak to the association — and with the State Duma and the Federation Council.
It is always better to lobby before laws are written than after they are adopted. So we try to influence laws during their creation, in the interest of our members or European business or to say: attention, this law may have a bad influence on our relations.
Russian lawmakers are very open to discussion. I will not say we always agree, but at least we discuss. Just as we also now — especially now — do not always agree with the European Commission or different European governments.

How has Russia’s economic slowdown affected Alstom’s operations and your sector in general?
Alstom is between two phases of investment. The market is flat. Investment around the winter 2014 Olympic Games in Sochi is over, and a new phase of investment to modernize infrastructure for the 2018 Football World Championship is set to start. We are confident that Russia will have to modernize the host cities. They will need new public transportation and metro systems, and new electricity networks. How would you describe your relations with state companies?
Our clients are mainly state companies. We produce locomotives for Russian Railways and metro and tram cars for cities and municipalities. We also work with energy companies Inter RAO, Rosatom and RusHydro. We have very good relations with state firms, even partnering with them. We have a joint venture in nuclear with Rosatom, for example. Nuclear is very touchy, and we are dealing perfectly with them.

How do you handle staffing with expats and Russian workers?
The most difficult thing is to find good high-level Russian employees who speak English. With expats, attracting them is a question of what we pay. But the problem with expats is that usually — at least in our company — they do not speak Russian, so you do not use these two resources for the same thing.
When, for example, we are at the design concept stage of a new type of locomotive, it is better to have expats. These transfer their know-how to Russians — after all, we need Russian people for production and so on. Expats are not here for life, they come for a couple of years.

How do you manage staff in Russia?
The traditional way to rule a Russian company is pyramidal: It all goes to the general director, who signs everything. That is the Russian way.
Western companies, especially big companies like Alstom, are organized in a matrix structure. So what I need to do in my position is to mix both, to straddle the pyramid and the matrix. It is a bit complicated. I would not say it is impossible, because we are managing it, but it is a challenge.

What advice would you give to a foreign company that wants to come to Russia?
First you need to establish confidence with your clients. Russians only do business with their friends. You need to know them, you need to spend time with them and only then can you do business.
Would you say the SKOLKOVO project is mainly academic focused or commercially focused?

SKOLKOVO Foundation and Skoltech are separate legs compared to Moscow School of Management SKOLKOVO but in the long run we see it as a very good ecosystem. I have faith in the idea of Russia’s Silicon Valley and I see potential for great synergy in the mid-term future. Coming back to the SKOLKOVO Business School, definitely we are not a commercial project. However, we must consider our business performance as we operate within sensitive financial constraints and we are not publicly funded. We are privately born and have a brilliant bunch of founders with strong positions within the Russian business elite.

SKOLKOVO Business School is not about profit but about development, about creating a new business environment in Russia where entrepreneurs and managers can find tools for their personal and professional growth and for communication with local and federal authorities. The chairman of our supervisory board is the Russian Prime Minister Dmitry Medvedev who was involved in the project from the very start. Mr Medvedev believes strongly in this project and he supports us in terms of his attention, his personal involvement,
and through meetings with our students and our faculty.

The core idea of SKOLKOVO Business School is to create an epicenter of expertise for individual, corporate, regional and country development. That is why our biggest focus is corporate educational programs that are based not just on theoretical knowledge but on unique solutions to help companies reach their strategic goals.

It sounds like it has parallels with some of the corporate universities. There is a difference. We act as a business partner and help our clients to realize their strategies through a unique environment encouraging managers to broaden their horizons. We give participants an opportunity to take a fresh look at their business, to realize their potential, and to prepare for challenging new tasks. Corporate universities usually work with huge numbers of people. We are targeting leadership teams at the helm of the strategic business lines of the company.

We construct each corporate program individually: faculty, experts, subjects, cases and guest speakers are chosen according to the most relevant issues facing the company.

What use do you make of outside resources, for example international companies with expertise in cargo or logistics?
In the business school we attract three categories of experts who work with the students. The first is professors from the top tier western business schools like INSEAD, Wharton, and so on. The second category is practitioners: people without any formal academic title but with a long background in a particular area, ready to share their knowledge. The third category is international and Russian corporations, leaders in their areas and we have launched several joint projects with them. One of the brightest examples of such cooperation is our chair in project management, sponsored by Schlumberger and headed by professor Jean-Marc Soucy who has 30 years’ experience with BP and personally runs many projects on the ground.

To which parts of the Russian economy do you pay most attention?
We have been operating for eight years and have experience of cooperating with different companies and sectors: oil and gas, companies like BP, Lukoil, Transneft; metals and mining, where the biggest example is Evraz; we are working with Avtodor, the state corporation in transportation; in the banking sector, in electricity, with the National Grid companies and many others.

Given your experience with the Moscow administration, where you were Deputy Mayor for Economic Policy, what do you think of development of city public officers?
It is one of our strategic goals. Several years ago we had initial experience with Arkhangelskaya oblast, both the administration and the Northern (Arctic) Federal University. You know that the federal government pays a lot of attention to developing the Russian regions and there is a huge need for training programs for public administration and project leaders in those regions. We had a yearlong program with the Moscow’s Department of Science, Industrial Policy and Entrepreneurship, which works with small and midsize enterprises (SMEs). This year we also successfully conducted the training program, titled Managing Innovation Projects, for Moscow officials responsible for innovation and industry, who had to find ‘smart’ and effective solutions introducing innovation into daily urban reality.

What is the key skill that you are trying to promote in the industrial realm and also in the administrative functions?
I mentioned this key word “change”, within companies, within the personality, in industry, to change the region and to change the country. It is not about providing knowledge. It is about creating teams having concrete skills, an entrepreneurial approach and pro-active attitude, able to manage change and becoming change leaders.

Do you have any area in which you want to increase ties with international companies, universities and organizations in order to share Russian experience?
If you are talking about special joint ventures or partner universities we do not have such a partner but we cooperate with a bunch of world’s top universities in terms of faculty, academic exchange and sourcing as it is our ‘must’ to provide top class professors for all our educational programs and that is what we do on a continuing basis.

How many alumni do you have now and what is your ambition?
We have 10,000 attendees of all our programs but for our certificated international business education programs MBA and Executive MBA as well as our SKOLKOVO Original programs (Practicum for Directors, Startup Academy, Open programs) we have about 700 alumni. They are all active, successful people and one of the liveliest and strongest business communities in Russia.
Small and big business are not the opposite ends of the spectrum as people often suppose. Mature companies often rely on small companies to generate new products but the relationship goes deeper than simply ‘buying up’ innovation and talent. Startups are nimble and small firms can change and adapt more quickly — something that big firms now recognize as a valuable trait. This has produced a whole industry of “change consultants” and motivators but it has also switched the focus of business schools, which do less teaching by the book and now try to get involved in the very process of reshaping businesses.

Pekka Viljakainen recently joined the Moscow School of Management SKOLKOVO as a mentor, leading a bimonthly program. A successful international businessman, he was recently appointed to the board of Pochta Rossii, the national postal operator, which has 400,000 employees.

The much-used word, “change” means little, he argues, unless executives have access to information about their own company, free of bias or personal interest. Executives must then use that information to imagine, visualize and predict what the market wants. Leadership is no longer simply about control. Rather it is about feeling confident enough to make mistakes and competent enough to correct them quickly.

“The leader’s key competence is to be creative. Creativeness is to give your own flavor and predict where the world is heading but most leaders are frightened to predict because somebody might say they made a mistake.

“If you are in a silo-based monolithic organization you order some slides from a consultant and the board says this is our strategy. If it goes wrong you blame the consultants. This is not how you do change in a modern organization because instead of three lovely consultants, you want 20,000 people to tell you how to change your organization. You want to hear from those who are in the very frontline dealing with the clients. The whole mentality to identify and develop that information is very different. You have to discover it fast and then you have to be the guide to lead this change.”

One attribute that small companies can teach bigger firms is their internationalism. The Finnish company Supercell is the most expensive games company in the world. It was started four years ago and is now worth 3 billion euro. It has 250 staff from 60 different nationalities.

“They know when they have finished their product that it is already suited to the Brazilian market or the Argentinian. But that needs a different type of leadership that builds trust with the staff whether they be Polish, Argentinian or Chinese.”

A growing number of entrepreneurs is addressing the deficit of small and mid-sized companies in the Russian economy. The drivers of this growth range from investors and venture capital companies to business schools and start up academies.
The leader’s key competence is to be creative, to predict where the world is heading. But most leaders are frightened they might make a mistake.

Some small Russian companies are actively reimagining reality — creating a market for a product that did not previously exist. The video creation and sharing service Coub is building a market for ultra-short films that are a kind of visual Twitter. Anton Gladkoborodov and his brother Igor founded the firm in 2012, which now employs 30 people in its offices in Moscow and New York.

The firm attracted $1 million of investment from Phenomen Ventures, which also invested in the taxi app Hailo, and Brothers Ventures, founded by entrepreneurs David and Daniil Liberman. Later Vaizra Investments provided another $2.5 million. Coub boasts a monthly audience of 50 million people globally, while over 600,000 coubs were made in the last 12 months.

Anastacia Popova, head of marketing, said Russia currently accounts for up to 70 per cent of Coub users, while the rest of them mostly come from Ukraine, Hungary, the United States and the Baltics.

Augustin Celier, a graduate in political sciences from Paris, chose Russia as the most promising location for his furniture business, founded two years ago. He spotted a gap in the market, between self-assembled furniture and expensive imports. His answer was to begin manufacturing his own designs, selling them through a showroom in Elektrozavod, in eastern Moscow. He also imports mid-priced sofas from France.

Celier found a Russian partner with whom to start the business, which he believes will become the next big seller in Russia’s furniture landscape. His company Marc-Aurele, part of another company he founded, Udobno, designs furniture in Russia but has it manufactured by a third party in Romania. In addition it imports from France and operates its own showroom. It markets and sells furniture through the Internet.

Celier says the Russian market was lacking a provider specifically targeting the middle-market price range. “Stylish furniture at affordable prices is completely lacking in Russia today, despite increasing demand in Moscow and St. Petersburg and other important cities, as proven by the significant volume of imported furniture from Europe at incredibly high prices.”

A mobile chip and pin validation system for credit cards, and a wearable alarm button for vulnerable people are among successful startups launched by alumni of Moscow School of Management SKOLKOVO. Both firms have already raised millions of dollars in funding from investors.

Knopka Zhizni or Life Button has raised over 35 million rubles, or about $1 million, for its medical alert service for the elderly and disabled. Founded in November 2010, its financing came from Rintech, a systems integrator in the social and health sectors. The company also sees applications in the corporate sector.

Smartfin, producer of the 2Can payment card reader for use with smartphones, launched in September 2012. Its product, comparable to Square and iZettle of the US, allows merchants to accept bankcard payments from their customers using a mobile terminal. The company has so far raised more than $5 million from venture capital partners. Nikolai Zhmurenko, CEO of Smartfin, had worked for 13 years in telecoms companies, including as a CFO, before he joined Moscow School of Management’s Startup Academy. “Managing your own project, even if it is not as big as previous companies I worked for, requires somewhat different, broader competencies than working as an employee. I was looking for where to get the missing experience and the Startup Academy Skolkovo caught my attention.”

Despite these success stories, SMEs represent only 15 per cent of Russia’s gross domestic product (GDP). The burden of administration and penalties is only part of the issue. Germany has the best-performing SMEs in Europe. They account for 54 per cent of GDP and 62 per cent of employment. That share of employment is evenly divided between medium, small and micro business.

Michael Harms, Chairman of the German-Russian Chamber of Commerce, said the structure of industry in Germany is very different. Most Russian SMEs are in services and local industry, unlike German mid-sized companies that are active in industry and on a global level. “To transfer this whole philosophy and the whole structure is not easy. Even the United States does not have such an SME sector, which is a feature of German or German-speaking countries predominantly, though also in Italy.”

On the other hand the question of the Russian SME sector is in the first instance a question of business climate. “You need low transaction costs, a stable business environment and economic freedom. You do not need too much state interference or the dominance of large state-owned monopolies. Unfortunately we have all these things in Russia. Politicians clearly see this problem; prime ministers and presidents have mentioned this in their speeches for 10 years now.”

Pekka Viljakainen said he saw signs of change: “If you look today at the 20 biggest Russian companies, their leadership teams are younger than anywhere in Europe. Look at the ministries: the deputy ministers are young compared to me and I’m the old guy at 42. I call them the digital cowboys, born post Soviet time, or since 1985. I clearly see that the same generation is also taking power in politics.”
Industry shows its Metal
in a tough Climate

By Vladimir Kozlov

Steel companies are unlikely winners from the ruble’s tumble but competition from China is adding to the impact of the market’s cyclical downturn.

While many sectors struggle to adapt to the slowing economy, the ruble’s slide against the dollar makes domestic steel exports more profitable, allowing the steel industry to fight back against cyclical pressures.

According to the state statistics agency, Rosstat, in the first six months of 2014, Russia’s crude steel output rose by 1.7 per cent, steel sheet by 1.3 per cent and steel pipes by 2.6 per cent, from the same time a year ago.

Over the same period, Russian steel exports rose by 52 per cent in volume terms and by 38 per cent in ruble terms, compared with the first half of 2013. There was an especially substantial surge in exports to non-CIS countries.

“Russian steelmakers have traditionally been competitive in export markets thanks to lower production costs, and the ruble’s devaluation has made them even more competitive,” said Dmitry Glushakov, a senior analyst at Alfa-Bank.

“And although market conditions in most of Russian exporters’ traditional territories are gradually becoming less favorable due to steel exports from China, which increased by 50 per cent this year, Russian steel exports are sure to remain significant.”

Increased export revenues have allowed Russian mills to dramatically improve their stock market performance.

Against the backdrop of Russian stocks’ overall poor performance, major domestic steelmakers’ stock has risen substantially since the beginning of this year.

Since January 2014, Russian stocks have lost 31 per cent of their value; steelmakers’ stocks have been doing well. Novolipetsk Steel Plant increased by 21 per cent, Severstal by 41 per cent and Magnitogorsk Steel Plant by 17 per cent between July and November.

“We are optimistic about growth prospects for Russian steel companies,” said Glushakov. “Exporters’ revenues are linked to the dollar, while their production costs are in rubles. So, the ruble’s loss in value is set to increase steelmakers’ profits, which, in turn, should be appreciated by the stock market.”

Historically, Europe, Central Asia and South East Asia have been priority markets for Russian steelmakers. They have been exploring other territories, as well, but prospects there could be limited.

“In 2014, because of high prices for steel in North America, Russian mills stepped up exports to that region,” said Glushakov. “But as import duties on Russian steel are expected to be introduced in the United States, next year, Russian mills are likely to focus on Europe and Central Asia.”

He added that prospects in South East Asia are unclear because of tough competition on the part of Chinese steelmakers.

Financial sanctions are unlikely to have a major impact on the Russian steel industry, experts say. However Russian banks are exposed to the sector. Coking coal producer Mechel accumulated $8 billion of debt as the price of coal used for steelmaking collapsed.

The continuing problem is the glut of supply that hit the market hard at the end of last year. Steel producers are expected to continue efficiency measures and efforts to shed loss-making assets, especially if European and Chinese demand continues to decline.
Steelmakers to Benefit from China Focus

By Mark Gay

The strained relations with western governments may have a silver lining for steel companies as Russia accelerates work on new pipelines to Asia.

Because of sanctions, some western producers of technical equipment have stopped supplying Russian energy companies. In addition, the shift towards Asia, including a 30-year gas supply deal with China, requires heavy investment in new infrastructure. Siberian projects are reported to include about 770 billion rubles ($16.5 billion) of expenditure, about a quarter of the value representing steel pipes. Most of the pipes used in construction of the 4,000 kilometer Power of Siberia gas transmission system will be manufactured domestically.

The domestic market produces higher margins for Russian steelmakers but producers are ready to capitalize on the international spot market.

It is not yet clear how sanctions will affect demand from the oil and gas industry. The restrictions on some Russian companies raising finance in Europe and the U.S., combined with the high cost of borrowing in rubles, are likely to further depress growth in the Russian economy.

Severstal has said it may compete head-to-head with more expensive Chinese producers. The company is looking for overseas markets with the best margins, particularly after the U.S. in October declared that it would scrap a deal exempting Russian flat-rolled steel producers from high import duties. The deal had been in force for 15 years. U.S. steel producers had complained to the U.S. Commerce Department that Russian prices were lower. Severstal argues that the quality of its mining assets, modern operating practices and its investment in technology allow it to produce more efficiently.

The company has just sold two U.S. plants that it had modernized extensively: Columbus, Mississippi and Dearborn, Michigan. In September Severstal sold its U.S. operations, collectively known as Severstal North America, to Steel Dynamics and AK Steel Corporation, respectively.

In 2004 Severstal acquired Dearborn in its $285 million takeover of Rouge Industries, and acquired the Columbus operation three years later. It invested about $1 billion in each plant.

Analysts said Severstal had no pressing financial need to sell the international plants, which accounted for about 17 per cent of Severstal’s earnings in the first three months of 2014. However the cyclical downturn in the steel industry has led many companies to focus on cutting costs.

The largest pipe maker TMK may consider an initial public offering for its U.S. unit, TMK IPSCO, to raise funds, the company told Reuters. Reducing debt is a theme for many of Russia’s biggest companies that expanded strongly in recent years as the global markets boomed.

Reducing debt is a theme for many of Russia’s biggest companies that expanded strongly in recent years, some of them making acquisitions as the global markets boomed up until 2008.

However the ruble’s weakness is a bonus for those companies that sell their output in dollars. Steelmaker NLMK reported a 77 per cent increase in third quarter net income and it expects sales in this quarter to rise by two to five per cent. Exports contribute more than 50 per cent of revenues, while 80 per cent of its costs are in rubles.
Where is the activity coming from at the moment?
We are seeing more investment from Asia, countries like China and South Korea. Looking at Russia’s regions, a lot more manufacturing is going out into the regional cities and Moscow region. It is not so much about moving out of Moscow but rather the investor-friendly regional governments that are building transport infrastructure that is especially helpful to the industrial sector.

About 15 years ago most of our work was in two cities. Now, by number, 80 per cent is regional, though by value 50 per cent is still in Moscow and St. Petersburg.

Some would-be investors have complained at conferences about the cost of finance within Russia, saying that borrowing costs must come down if the economy is to develop. Do you agree?
The cost of finance has always been high in Russia, though it is higher at the moment. The key difference is the exchange rate and the ability to refinance internationally and that is the issue caused mainly by sanctions. Once that clears and the ruble stabilizes then development will continue irrespective of the high finance rates.

In recent years retailers have invested a lot of effort in broadening their presence in Russia but this trend slowed significantly in 2014.

Companies have moved their emphasis on multiple retail programs from Russia to southern Europe, the Balkans - Montenegro, Croatia, Serbia. These countries are taking up some of the slack. There is an across-the-board slowdown in Europe and a change of focus on where those programs are going.

Given the ruble situation and people hanging on to their money, consumer spending is bound to be slower for months, if not for a year or more. As it takes two years to get these retail stores up, there is not the confidence there, so it is going to be three or five years.

But Russia remains a strong market for investors in commercial real estate (CRE) across many sectors and I don’t see that waning. It will spike up and down and it will be back with a vengeance.

Is AECOM seeing a change in the type of projects, perhaps more government work, as a result of the state of the economy?
There is a cautious and hesitant level of investment from foreign manufacturers across a broad spectrum: foodstuffs, household or automotive.

On bigger infrastructure projects there is a shift to the public sector, especially those that are
What are the main challenges in the Russian market?
You see the ruble going up and down and the interest rate changing periodically. This affects everyone. In CRE and the residential sector, the price cannot keep up with inflation because buyers are not ready to accept a 20 or 30 per cent increase in price. This puts some projects on hold or means developers have to change their business plan.

In industry something similar applies because demand, for cars, for example, has fallen. Customers cannot get credit so easily and the cost has gone from 12 per cent a year ago to 18 or 19 per cent now.

In beverage, some clients producing, say, juice import all their raw materials from Europe. Although the cost in euros has risen by 20 or 30 per cent they cannot adjust their price in the market because there are big players who can keep their price level and that would simply eliminate all the small companies.

In food, we have one project at a chicken farm where the price of meat and poultry is going up, the investment is still the same, but most of the equipment comes from Europe and the U.S. and that is costing more in foreign exchange terms.

How can AECOM help in such a situation?
Take the chicken farm. They want to proceed because there is market demand for their product but they want to review the business plan. We are helping them to cut costs out. We can do value engineering on their equipment to perhaps get the same quality of equipment but at a lower price, or just look for different suppliers or construction materials to get a lower or similar price.

Which sectors are better withstanding the economic currents?
There are a number of big projects in the energy sector.

One advantage of AECOM is that it has different business lines so we can act in different sectors. None of these business lines is constant.

There is scope for infrastructure to expand. We are expanding our relationship with the regions, with affiliated offices where we have projects.

We are working on the legacy plan for several of those venues so that they can be developed after the games, as a location for commerce, tenants, entertainment and parks. We are involved with Volgograd, Samara and Nizhny Novgorod and are now in close discussions with Kaliningrad to see how we could develop our relationship.

A month ago we signed a project at Sheremetyevo airport where they want to extend the terminals and link them all by tunnels, and all this has to be finished before the World Cup.

In St. Petersburg we are working with Gazprom on the Lakhta Tower and we are proceeding with another development for them.
The Moscow Times Awards highlight the ways in which our capital city is changing for the better. They mark the achievements of the individuals, companies and projects that have done most in the past year to improve the quality of life and raise Moscow's profile as a global center of business and culture. We celebrate the winners and recognize the brilliant ideas and sheer hard work that often goes unnoticed. The names that appear on these pages make us proud to live, work and play in Moscow.

According to Andre Martin, the group’s regional general director, the construction is the company’s largest investment in the country. Lafarge built the plant with the European Bank for Reconstruction and Development, its co-shareholder in Russia. The location, in the village of Ferzikovo, was chosen for its proximity to Moscow. It will also serve the booming industrial, home, and road construction activity in Kaluga Region.

The Ferzikovo facility is a dry-line cement plant, which uses 2.5 times less energy than conventional technology. The use of alternative fuels in the future could reach nearly half, and will help the plant contribute to the preservation of non-renewable natural resources and reduce Co2 emissions.

Shortly before the opening, Lafarge announced a merger with the Swiss group Holcim, after which the company started selling assets. As a result, by the end of 2014, the group had only one factory left in Russia — the one in Kaluga region.
Country Partner of the Year

FRANCE

In a year when the West and Russia swapped trade and economic sanctions, France has taken perhaps the most balanced position in its partnership with Russia. Despite European Union sanctions against Gennady Timchenko, the co-chairman of the Economic Council of the Russian-French Chamber of Commerce (CCIFR), the second annual France-Russia conference went ahead at the National Assembly in Paris, in April 2014. The “Observo” analytical center of CCIFR took part. On the eve of the event, the leaders of CCIFR Emmanuel Quidet and Pavel Shinskiy met the French Foreign Minister Laurent Fabius, lobbying on behalf of the Franco-Russian business community.

In late May, along with the Ginza Project group, CCIFR held the first festival of French gastronomy in Moscow.

Best Business Center

WHITE GARDENS

Tenants began to occupy the premium-class business center built next to White Square Office Center, near Belorusskaya, between 2013 and 2014. The development company Coalco launched the project which moved, through VTB Capital, into the portfolio of Roman Abramovich’s investment company, Millhouse Capital. The deal was estimated at $700-750 million — second only, in terms of valuation, to the White Square Office Center itself (O1 Properties paid about $1 billion for the property). White Gardens is one of Moscow’s few “green buildings,” built from environmentally friendly materials and certified with an international BREAM certificate. Each tier of the two buildings is connected by a transparent gallery with spacious terraces and gardens.

Person of the Year in Culture

ANDREY ZVYAGINTSEV

After the screening of the film “Leviathan” at the Cannes Film Festival, critics awarded Andrei Zvyagintsev the prestigious Palme d’Or award. Russian and western media embraced the social drama. The Guardian called the film a “new Russian masterpiece” after its premiere at Cannes. The film’s title refers to the biblical story of Job, and offers a comparison of the Old Testament monster with the version of described in the work of Thomas Hobbes. The state machine deprives the hero of everything — his land, house, wife, freedom. At the beginning of the film, the new Job files a complaint with a court; by the end a church is built on the land that was taken from him. “There has not yet been a more harsh and accurate depiction of modern Russia in our film industry,” Vedomosti newspaper wrote of the film.

Best Business Event

GLOBAL ENTREPRENEURSHIP CONGRESS (GEC 2014)

The first Global Entrepreneurship Congress was held in 2009 in Kansas City, the headquarters of the Ewing Marion Kauffman Foundation, named after the now deceased entrepreneur and philanthropist. The foundation’s goal is to help young people start and run businesses, to promote education about entrepreneurship, and to find alternative ways to commercialize new knowledge and technologies.

In mid-March, when the world was discussing the risk of investing in Russia, the Kauffman Foundation, together with the city government, held the Global Entrepreneurship Congress in the Manezh exhibition hall. The fund plans further cooperation with the Skolkovo Fund, Moscow’s Center of Innovative Development, the VEB Innovation Fund and the world’s largest accelerator in the field of clean technologies, Cleantech Open.
Best Cultural Center

JEWISH MUSEUM AND TOLERANCE CENTER

One of the most interactive and high-tech museums in Moscow was opened in November 2012 on the territory of the constructivist architecture monument to the Bakhmetevskovo fleet. The building’s reconstruction and the creation of the exposition took about 10 years. Prior to the Jewish Museum, the Garage modern art center occupied the location. The museum’s program offers not only a modern view of the history and culture of the Jewish people, but takes an open approach to all world cultures. Thanks to its broad approach one can see truly unique exhibitions: contemporary art from China featured in an exhibition last fall, and in the summer the descendants of a tribe of Indians and Russian settlers of America’s Fort Ross presented the exhibition “Indians in the 21st Century. Fort Ross: People of One Earth, Then and Now.”

Best Cultural Event

CIRCLE OF LIGHT

During the Moscow International Festival, Circle of Light, designers from around the world and professionals in the field of two- and three-dimensional graphics used the capital’s architecture as a canvas for multimedia and light installations. Moscow’s Department of Media and Advertising organized the annual festival for a fourth time in mid-October. It took place at the All-Russia Exhibition Center, at Ostankino and in the Tsaritsyno museum. In addition, light installations were shown in the evenings on the facade of the Bolshoi Theatre and along part of Kuznetsky Most street. The festival also featured a competition on projection mapping, Art Vision, and master classes by leading international experts on how to work with light.

Corporate Citizen of the Year

MTS

The mobile phone operator has been implementing a federal socio-educational project called “The Web for All Ages” for two years now, training older people to use the Web with the company’s own employees and volunteers. Training is carried out based on an educational program developed by experts at MTS Internet Development Fund and the Faculty of Psychology of Moscow State University for the elderly. In just seven lessons, you can learn about navigating and searching for information on the Internet, how to use e-mail and social networking, internet banking, e-commerce and so on.

In Moscow, by the end of October 2014, more than three million people had acquired new skills to help them use the Internet. Since 2013, MTS has been conducting the project in oblasts and cities such as Samara, Omsk, St. Petersburg, Tula, Kirov, Perm, Kemerovo, Amur, Kamchatka and Sakhalin, and also in Belarus.

In 2014, courses were also opened in the Russian Republic of Tatarstan. In total, more than five million people have taken part in the training program “The Web for All Ages” in Russia throughout the existence of the program. Knowledge has been shared by more than 100 volunteers and employees of MTS and its retail network.
Humanitarian of the Year

ALEVTINA HORINYAK

A physician for five decades, Alevtina Horinyak spent the past 20 years working as a district doctor in Krasnoyarsk. In 2009, she personally wrote out a prescription for a terminally ill cancer patient for the drug, Tramadol, which cost 286 rubles. Two years later, the Federal Drug Control Service initiated criminal proceedings against Horinyak and her assistant for forgery and the illegal acquisition of potent drugs. In June 2013, a court issued a fine of 15,000 rubles to each of the accused. Horinyak’s lawyer managed to get a re-examination of the case, but prosecutors continued to insist on an indictment and up to eight years in prison.

Horinyak did not give up and refused to accept the charges against her and her assistant. Several petitions were filed in support of Horinyak. On Oct. 21, a Krasnoyarsk court fully acquitted the 72-year-old doctor. The criminal case against her — as well as the suicide of Rear Admiral Apanasenko in the winter of 2014, a tragedy attributed to his inability to obtain painkillers — forced the authorities to adapt. In the Krasnoyarsk region, according to Horinyak, pharmacy management now provides an adequate supply of the analgesic Dyurogezik for cancer patients.

Best Cultural Center

WI-FI IN THE METRO

Maxima Telecom is the only company providing free access to Wi-Fi in the Moscow metro, and it was created specifically for the purpose. The company does not use the city budget but invests its own and borrowed funds.

On its web site the company says that passengers shouldn’t feel any difference between using the Internet at home and Wi-Fi in the metro. In order to achieve that it uses equipment from leading manufacturers, including Cisco Systems and RADWIN. Equipment for the network was installed at most subway stations. A transmitter and antenna is located in the head and tail of the train carriages. The network was designed to take into account the future growth of the metro, and it connects to the Internet at two points in different parts of the city, with a total capacity of up to 40 Gb/s.

Development of the network began in September 2013, when the wireless network appeared on the Circle Line. By late October, Wi-Fi was available on eight metro lines out of 12, with full service due by the end of 2014.

Person of the Year

ANDREI KONCHALOVSKY

In early September, film director Andrei Konchalovsky received the Silver Lion award at the International Venice Film Festival for his film “White Nights of Postman Alexei Tryapitsyn.” This semi-documentary, in which only one role was performed by a professional actress, is an observation of the lives of the inhabitants of a small village in Arkhangelsk region. But when he learned that the Russian Oscar Committee intended to nominate the film for an Academy Award, Konchalovsky in an open letter said that he was withdrawing his film from consideration.

“There are two reasons for this — one personal and one public. In recent years, I have sharply criticized the ‘Hollywoodization’ of the Russian market and the pernicious influence of commercial American cinema on the formation of the tastes and preferences of our audience. It just seems absurd to me to compete for a Hollywood prize.

“On the other hand, the Oscar itself is overvalued today by a certain group of filmmakers. It creates the illusion of global recognition and is a kind of testament to cinematographic qualities, which, of course, are not written in stone,” Konchalovsky said, explaining his decision.

The Russian premiere of the film, at his insistence, was not shown in movie theaters, but on Channel One as the director chose instead to reach a bigger audience.
BRAINFORCE AG helped to prepare the ‘CEO of the Year Russia 2014’ awards and it is the representative of the ranking system in both Russia and China. **Martin Schneider**, Chairman and CEO of BRAINFORCE and Managing Director of its German unit, explained the thinking behind the awards and what they tell us about Russian business.
In your experience, how do Russian CEOs compare with CEOs on other global markets?
Obermatt compares the performance of a CEO against an international peer universe. This means that the CEO has to compete globally and therefore a winning CEO has beaten at least 50 per cent of his global competitors. Nevertheless the fact that only about 30 per cent of the analyzed CEOs in 2014 were able to beat their peers in terms of combined performance indicates that the Russian companies do underperform in general. Of course, this is not the case for the winning CEOs.

What are the key management trends that you identify in Russia? For example, we know that Russian companies have more homegrown talent and use fewer expats than before.
From our observation, there is a growing number of well-educated CEOs in Russia. However, we also observe that the demand for good CEOs still exceeds supply by far. We still see many CEOs who are doing well in times of economic growth but not well in times of economic contraction. A strong, experienced and talented CEO will also perform well in economically challenging times.

How narrow is the peer universe for each company? How many competitors do you include in a peer universe and where do you set the boundary: i.e., do you compare food retailers only with other food retailers, or with retailers in general?
The usual peer universe consists of 30 to 70 companies and they include product peers, food retailers for example, but not only. To come up with enough companies for a statistically meaningful result we usually also include companies which have the same economic cycles. This can be a company in a similar field of activity, such as other retailers, or suppliers and customers.

Which industry sectors did you consider for the competition?
We cover all industry sectors except for private equity companies since PE companies are usually invested in different industries and therefore cannot be compared among each other.

What is the relationship between BRAINFORCE and Obermatt regarding the CEO of the Year awards?
For “CEO of the Year – Russia – 2014”, Obermatt analyzed publicly traded companies headquartered in Russia with market capitalization over 3.5 billion rubles in 2013. The source for the financial data is Thomson-Reuters and Obermatt AG. The Source for the CEO data is BRAINFORCE AG, Switzerland. The source for Peer Universes is Obermatt AG. And Obermatt executes all the calculations.
BRAINFORCE is Obermatt’s exclusive representative of the CEO Ranking in Russia and also in China. More countries will be added in coming years.

How can companies use the BRAINFORCE and Obermatt data, for example, to establish pay levels?
There is no direct relationship between the CEO ranking and the compensation of CEOs. However, Obermatt’s specialty is to establish benchmarks of individual companies that, as a result, could be used to design a compensation or performance bonus for the CEOs involved.

Typically, the board of directors would hire Obermatt for such analysis in order to design compensation and performance bonuses of the CEO of that company.

As well as being involved in the CEO Awards, BRAINFORCE is a specialist in interim management. Do you see a need for this service among Russian companies?
Interim management is a modern, innovative approach to management in special situations of growth or change in general. The higher the level of efficiency, effectiveness and transparency in a company - and the more it is demanded - the more value interim management brings to a company.

What is the advantage of using interim managers?
The main reasons why interim management is so effective are that it provides an unbiased view, focusing on results rather than on personal career goals like employed managers. It also brings seniority and a strong track record, and a deliberate over-qualification for a specific assignment. This means no learning curve is required and there is immediate availability thanks to a large pool of qualified, independent interim managers. Matching the right interim manager with a specific situation is another advantage, taking into account the personality and cultural fit with the client organization.

When a CEO or specialist, or a team, is ‘helicoptered’ into a company, how do you overcome issues of trust?
Trust is best built by previous proven experience and proven achievements and independent, solid references... and further enhanced by standards of quality.
## CEO of the Year 2014 Medium and Large Companies

### Combined Performance

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# EXPOCENTRE’S EXHIBITIONS
IN MOSCOW IN 2015

**Chemical industry**
- Interlakokraska / 3–6 March 2015
- Tires & Rubber / 21–24 April 2015
- Plastics Industry Show / 19–22 October 2015
- Khimia / 19–22 October 2015
- International Chemical Assembly – ICA, Green Chemistry / 19–22 October 2015

**Machinery manufacturing and metalworking industry**
- TechnoForum / 19–22 October 2015

**Electric power industry**
- Elektro / 8–11 June 2015
- Elektro. Autumn / 27–30 October 2015

**Optical industry**
- Photonics. World of Lasers and Optics / 16–19 March 2015

**Research & Innovations**
- Expopriority / 22–24 April 2015

**High technology, Information and communications**
- Navitech / 22–24 April 2015
- Sviaz-Expocomm / 12–15 May 2015

**Woodworking industry**
- Mebel / 23–27 November 2015

**Health care**
- Zdravookhranieniye / 7–11 December 2015
- Healthy Lifestyle / 7–11 December 2015

**Logistics**
- STL – Sklad. Transport. Logistika / 2–5 March 2014

**Food industry and agriculture**
- Prodexpo / 9–13 February 2015
- Agropromdizh / 5–9 October 2015

**Construction, finishing materials**
- Mir Stekla / 8–11 June 2015

**Textile industry**
- Integmash / 14–17 April 2015

**Consumer goods**
- Consumexpo. Winter / 19–22 January 2015
- CJE. Spring / 24–27 February 2015
- CJE. Autumn / 22–25 September 2015
- Obuv. Mir Kozhi. Autumn / 29 September – 2 October 2015
- Mir Detstva / 22–25 September 2015

**Advertising**
- Reklama / 22–25 September 2015

**Exhibition industry**
- 5pEXPO / 17–19 June 2015

Subject to alteration

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