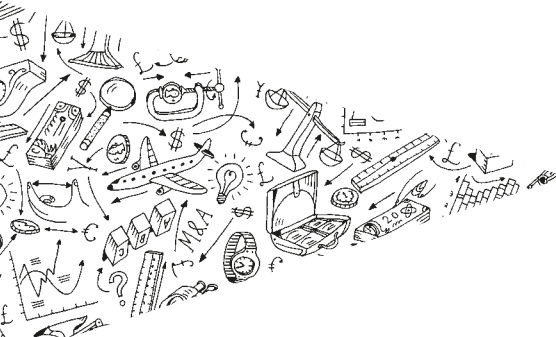


# Global Capital Confidence Barometer

## Russia



## Overcoming headwinds

### About this survey

Ernst & Young's Capital Confidence Barometer is a regular survey of senior executives from large companies around the world conducted by the Economist Intelligence Unit (EIU).

Our panel, the "Ernst & Young 1,000" is comprised of selected Ernst & Young clients and contacts and regular EIU contributors.

This snapshot of our findings gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their capital agenda.

### Profile of respondents

- ▶ Panel of over 1,000 executives surveyed in July and August 2011, including 45 respondents from Russia.
- ▶ Companies from 57 countries including Australia, China, France, Germany, India, Japan, UK, the US and Russia.
- ▶ Cross-section of respondents from over 19 industry sectors.

### The Capital Agenda

Based around four dimensions, it helps companies consider their issues and challenges and understand their options to make more informed capital decisions.

- 1. Preserving capital:** reshaping the operational and capital base.
- 2. Optimizing capital:** driving cash and working capital and managing the portfolio of assets.
- 3. Raising capital:** assessing future capital requirements and assessing funding sources.
- 4. Investing capital:** strengthening investment appraisal and transaction execution.



Our fifth bi-annual Global Capital Confidence Barometer, finds that almost half of respondents are focused on growth in the next 12 months, with only 7% now focusing on survival – the lowest number since the barometer was first published in 2009.

There is a new paradigm with M&A activity and market volatility now able to co-exist. Currently, leading companies are shrugging off continued market upheaval and focusing on growth and M&A. For them this is not 2008 all over again. They have spent the past three years reducing the financial risk on their balance sheet and taking tough efficiency measures needed to strengthen their positions, which helps them manage in volatile times.

Russian respondents are generally optimistic overall, however, they are cautious.

- ▶ The state of the Russian economy is stable or improving
- ▶ The likelihood of short term volatility is high, mostly due to global factors
- ▶ Most see asset values increasing in the next twelve months
- ▶ Russian companies are increasingly looking at divesting assets to focus on core assets and fund M&A growth plans, which may signal increased deal activity
- ▶ Cash will be the primary source of deal funding in the next twelve months in Russia, as deleveraging continues

Despite these positive indications, mounting regulatory pressures, most importantly tax regulation, may represent a risk to growth and profitability in the future.

*Hakob Sarkissian – CIS Leader, Transaction Advisory Services,*

*Pip McCrostie – Global Vice Chair, Transaction Advisory Services.*

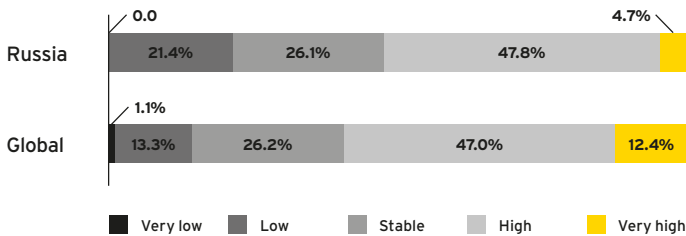
# Economic outlook

July and August marked a return to volatility not seen since the early days of the economic crisis. The US credit rating downgrade, the debt crisis in the eurozone and weakening economic data from around the world sparked dramatic stock market activity and ultimately the global re-pricing of risk. The financial turmoil has already moved to corporates and consumers, and also sovereign debt and currencies. Russia of course has also been affected.

## Capital market conditions volatile

In April 2011, more than two-thirds of our Russian respondents indicated that global capital market conditions were improving. However, the unsettling developments over the last two months have driven widespread acceptance that volatility will remain across all markets over the next six to twelve months.

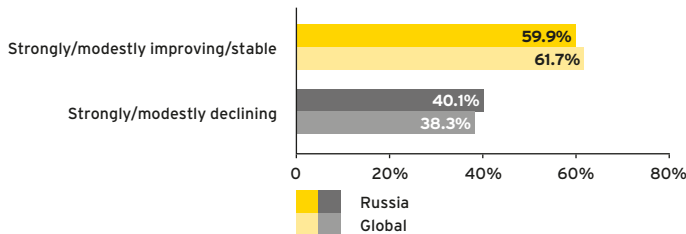
What is your view of the likely short-term volatility of the global markets?



## Global economic outlook stable

Despite ongoing uncertainty throughout the survey period, two-thirds (60%) of the surveyed Russian companies executives said that they felt the global economy was either stable or improving.

What is your perspective on the state of the global economy today?

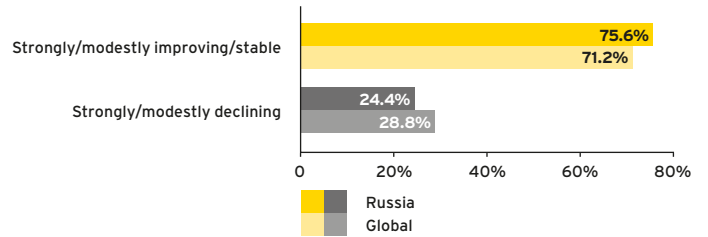


**60%** of Russian respondents surveyed said that they felt the global economy was either stable or improving.

## Russian economic outlook stable

The outlook in the Russian economy is noticeably more upbeat than the global outlook. When asked their perspective on the state of the Russian economy 76% cited a stable or improving environment. Russian companies are less confident in the global economy because of limited international experience. This creates tremendous opportunity for those that are most rigorous in evaluating risk and assessing cross border investment opportunities.

What is your perspective on the state of your local economy today?

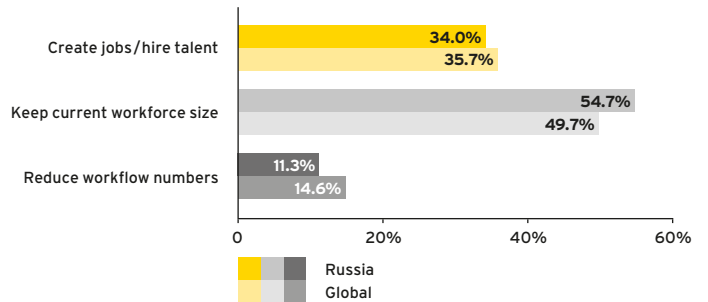


**76%** When asked their perspective on the state of their local economies 76% of Russian companies cited a stable or improving environment.

## Employment outlook stable

Eighty-nine percent of the Russian participants of the survey expect to maintain or increase their workforce over the next 12 months. While there are clearly some workforce reductions related to new and long standing cost reduction programs, companies are starting to reinvest for growth.

With regards to employment, which of the following does your organization expect to do in the next 12 months?



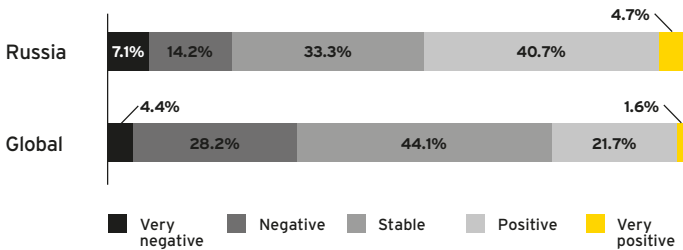
**90%** of Russian mining, oil & gas and utilities sector respondents plan to create jobs or maintain their current workforce levels.

# Access to capital

## Credit availability supports growth

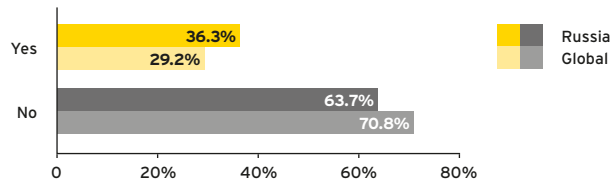
Russian respondents believe credit availability is adequate to support growth plans, with more than three quarters (79%) saying capital market conditions are stable or positive.

Please indicate your level of confidence in credit availability at the global level:

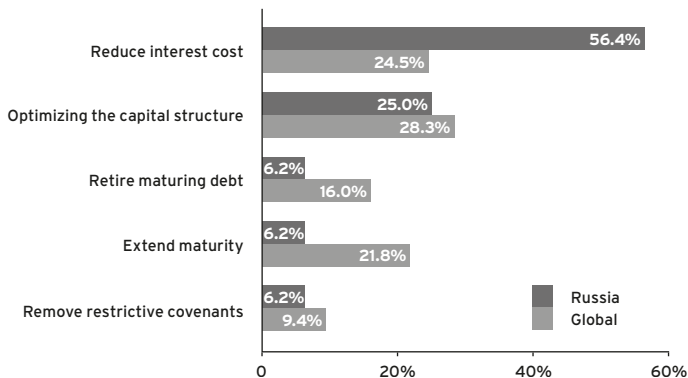


More Russian companies are taking advantage of available credit markets – 36% in October 2011 compared with 22% in April 2011. More availability of lower cost debt will enable them to reduce interest cost and optimize the capital structure. Capital markets are particularly accommodating to larger cap financially stable organizations.

## Do you plan to refinance loans or debt obligation in the next 12 months?



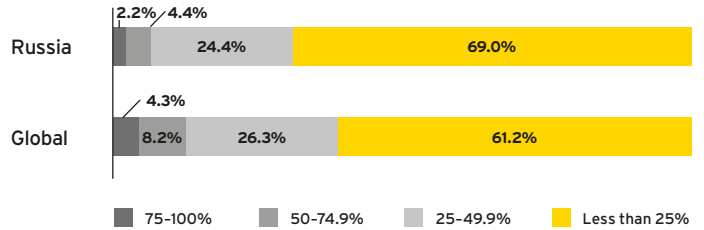
## What will be the primary purpose of your refinancing?



## Deleveraging continues

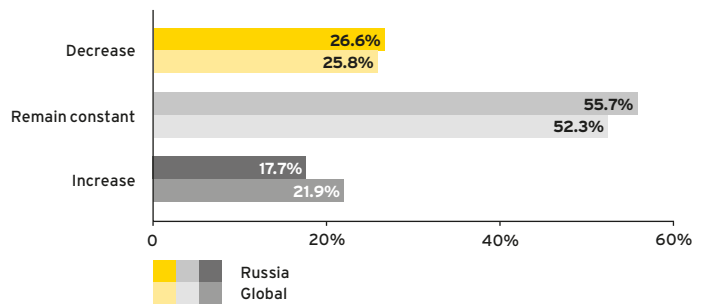
Balance sheet leverage of Russian companies has not changed since April 2011 – 69% now have a debt to capital ratio of less than 25%, compared to 70% in April 2011.

## What is your current debt to capital ratio?



Eighty-two percent of Russian companies plan to maintain or reduce their debt to capital ratio over the next 12 months. This is consistent with a Russian deleveraging theme we have observed since October of 2010.

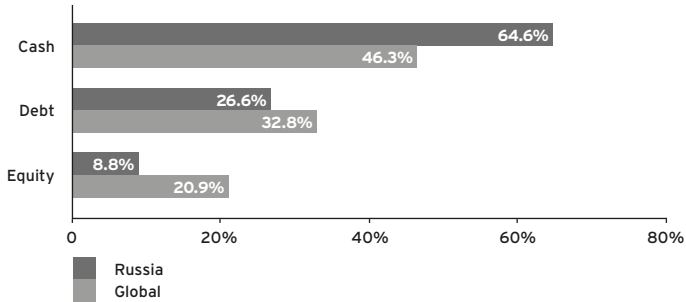
## How do you expect your debt to capital ratio to change over the next 12 months?



## Cash remains the primary funding source for deals

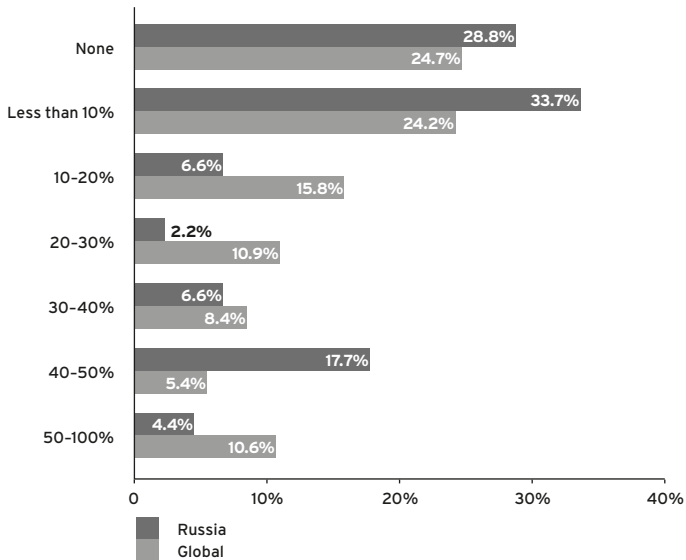
With high cash balances and concerns about increasing leverage, 65% of Russian companies plan to use cash and only 27% debt as their primary funding source for deals.

### What is your primary source of deal financing in the next 12 months?



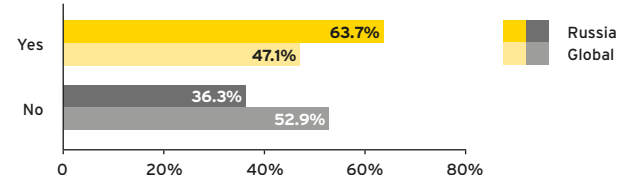
For deals planned in the next 12 months, 69% will use debt to fund 20% or less of the deal value.

### What percentage of your acquisition funding in the next 12 months will be in the form of debt?



When exploring their options for financing deals, many Russian companies (64%) view the excess working capital of an acquired company as a source of deal funding.

### Do you view excess working capital of an acquired company as a source of deal funding?

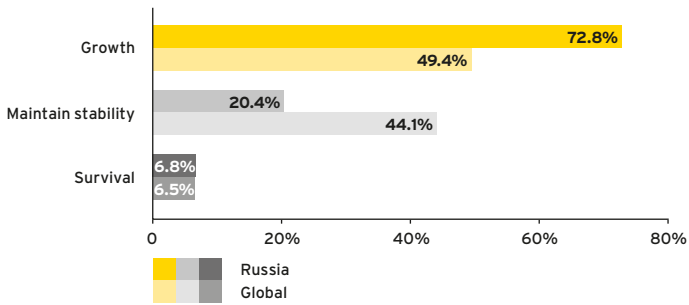


# Growth

## Growth and stability primary focus for C-Suite

Most Russian companies participating in the survey (93%) are focusing on stabilizing and finding opportunities to grow their business in the next 12 months. Seventy-three percent of the companies are making growth their top priority. Only 7% cite survival as an imperative.

Which statement best describes your organization's focus over the next 12 months?

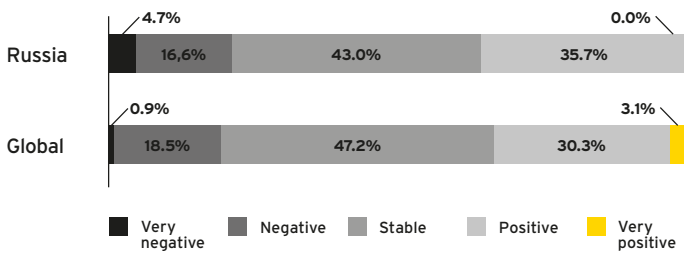


**90%** of mining, oil & gas and utilities sector respondents in Russia are focused on growth.

## Corporate earnings outlook stable to positive

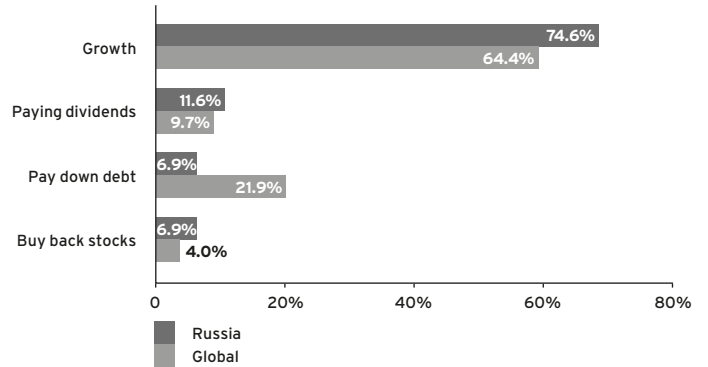
Focus on cost reduction and efficiency has most corporates in Russia positioned for stable to growing earnings. Thirty-six percent feel positive or very positive about corporate earnings potential despite concerns over short-term volatility.

Please indicate your level of confidence in corporate earnings at the global level:



For those with excess cash flow in the next 12 months, three quarters of Russian companies (75%) prioritize investing in growth, followed by paying dividends and paying down debt. Very few plan to deploy excess cash toward stock buybacks which often have a long term impact.

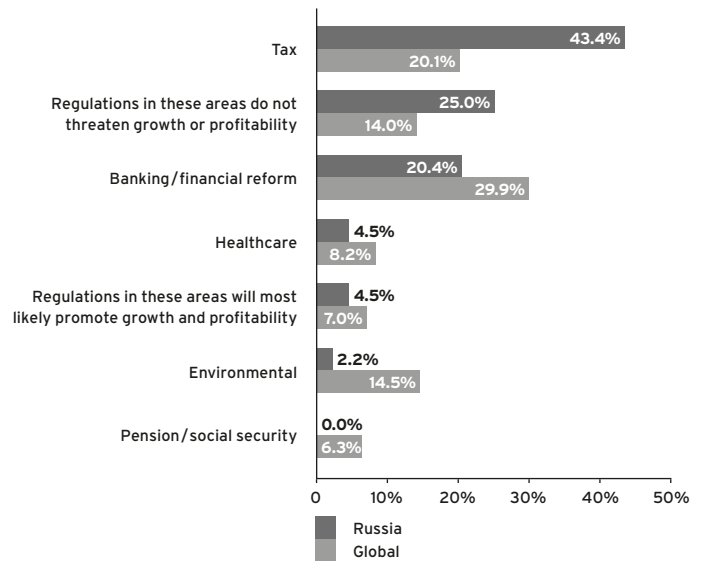
If you have excess cash, which of the following will be your priority over the next 12 months?



## Regulatory environment impacts growth

Seventy-five percent of respondents have concerns that mounting regulatory pressures in Russia across a number of areas could potentially impede growth. Tax regulation is viewed to have the broadest potential impact across all sectors in Russia. Banking financial reform is also of concern. However 25% of respondents do not see any risks to growth because of the regulatory environment.

What areas of regulation pose the most significant risks to growth and profitability for your organization over the next 12 months?



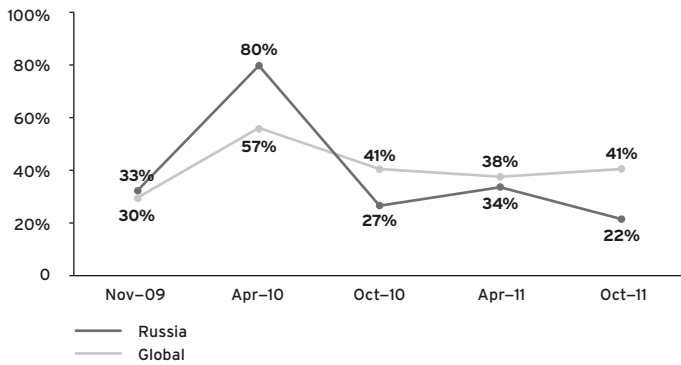
**40%** of Russian mining, oil & gas and utilities sector respondents say the regulations do not threaten their growth or profitability.

# Mergers and acquisitions outlook

## Appetite for deals decreasing

Despite a positive outlook for the M&A environment at the global level, Russian deal makers' appetite to acquire in the next 12 months has decreased, with 22% of respondents expecting to make acquisitions in the next 12 months compared with 34% in April 2011.

Does your company expect to make acquisitions in the next 12 months?



## Favorable environment for deal making

When asked to express their confidence around the volume, quality and likelihood of closing deals, from 65% to 79% of surveyed Russian companies responded that the macro deal environment is stable to improving – which may be a potential positive signal for future activity, provided market volatility decreases.

Please indicate your level of confidence in the following at the global level:

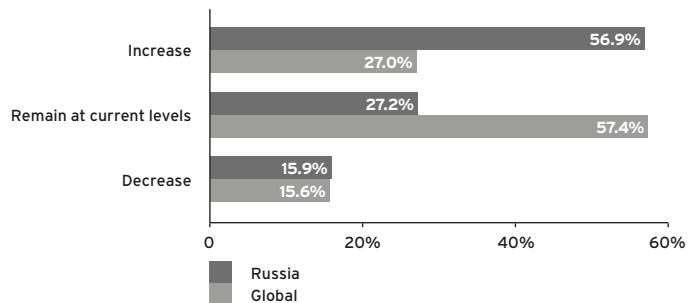


## Higher valuations may impact deal activity

Another indicator of the situation in the deal market is the outlook on asset valuations. With 84% percent expecting asset prices to remain at current levels or increase over the next 12 months, corporates may not be inclined to deploy their cash reserves toward acquisitions.

Historically, stable asset valuations create a conducive environment for deal making, but only 27% of Russian respondents are expecting assets prices to remain at current levels. The expected increase in Russian asset valuation may restrain deal making activity.

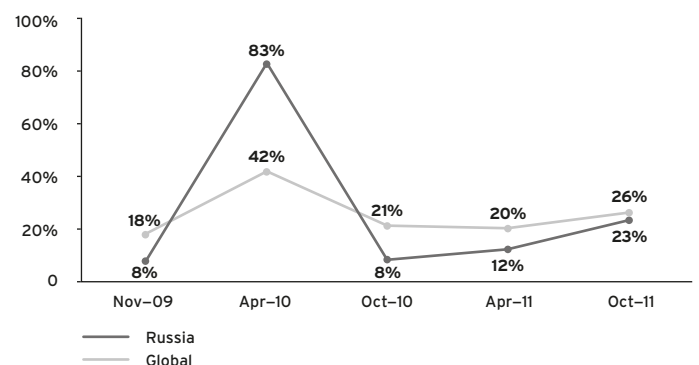
What do you expect the price/valuation of assets to do over the next 12 months?



## Increasing divestment levels supporting activity

The willingness of Russian companies to divest assets is an important element in the deal market. Twenty-three percent of Russian respondents see divestments as likely or highly likely in their organization over the next 12 months compared with 12% in April 2011.

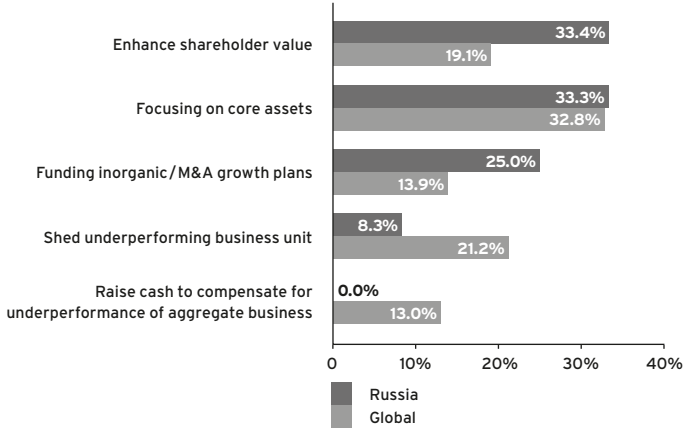
Does your company expect to make divestments in the next 12 months?



**33%** of health & pharma and 30% of mining, oil & gas and utilities companies are likely to make divestments in the next 12 months.

The top three reasons for executing planned divestitures are enhancing shareholder value, focusing on core assets and funding inorganic/M&A growth plans.

**What are the main drivers of your company's planned divestment activity?**



**Europe and Asia Pacific may continue to attract Russian investment capital**

In an increasingly global economy, many continue to pursue investment opportunities beyond their local geographies. The Eastern Europe and Asia Pacific markets are among the most attractive for Russian investors due to their growth potential, expanding domestic demand and resilience to the current market volatility. The top five regions that Russian companies are likely to invest in according to the survey:

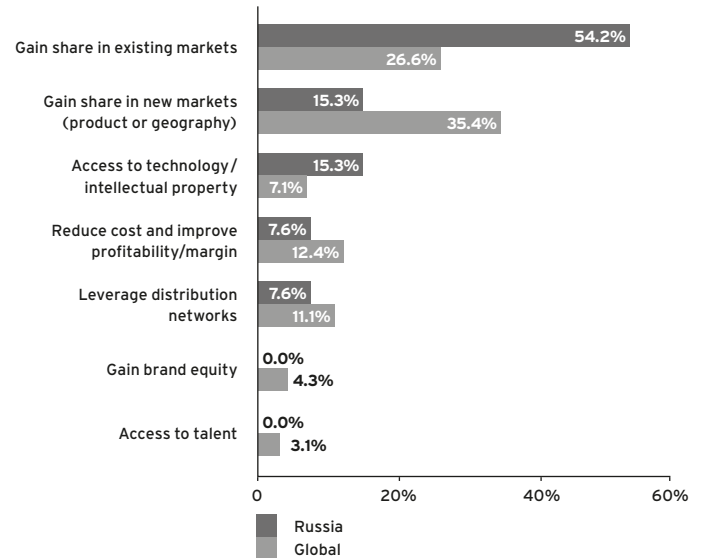
1. Eastern Europe
2. Asia Pacific
3. Western Europe
4. Latin America
5. North America

When considering cross-border deals (i.e. excluding Russia acquisitions) companies from Russia are most likely to acquire in:

1. China
2. India
3. Brazil
4. Germany
5. France

Eighty-five percent of Russian respondents said the primary purpose for investing in these markets was to gain share in existing markets, to access technology/intellectual property and to gain market share in new markets (products or geography).

**What are the main drivers of your company's planned acquisition in your chosen market/country?**



## Management talent and innovation drive value from deals

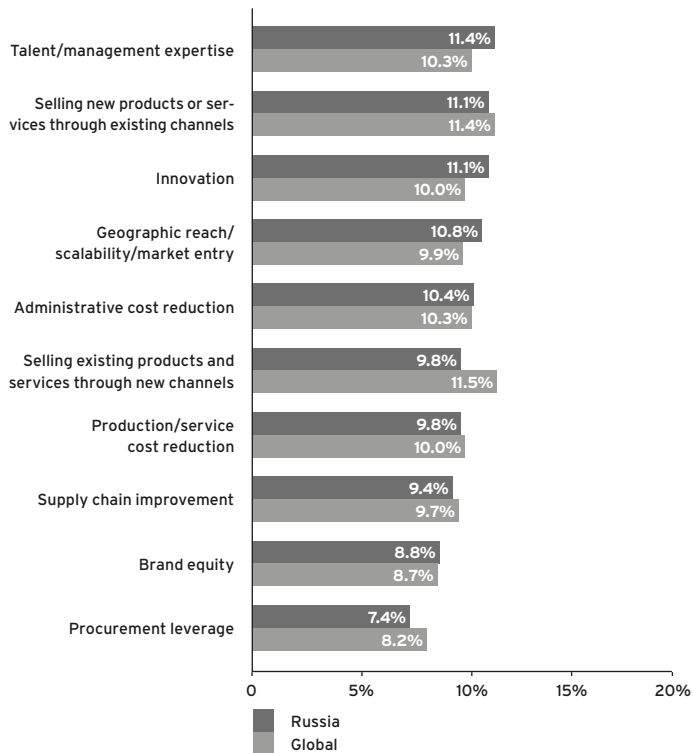
For those Russian companies who have closed deals in the last 12 months, the top four areas of planned and realized value creation were:

- ▶ Talent/management expertise
- ▶ Innovation
- ▶ Selling new products or services through existing channels
- ▶ Geographic reach/scalability/market entry

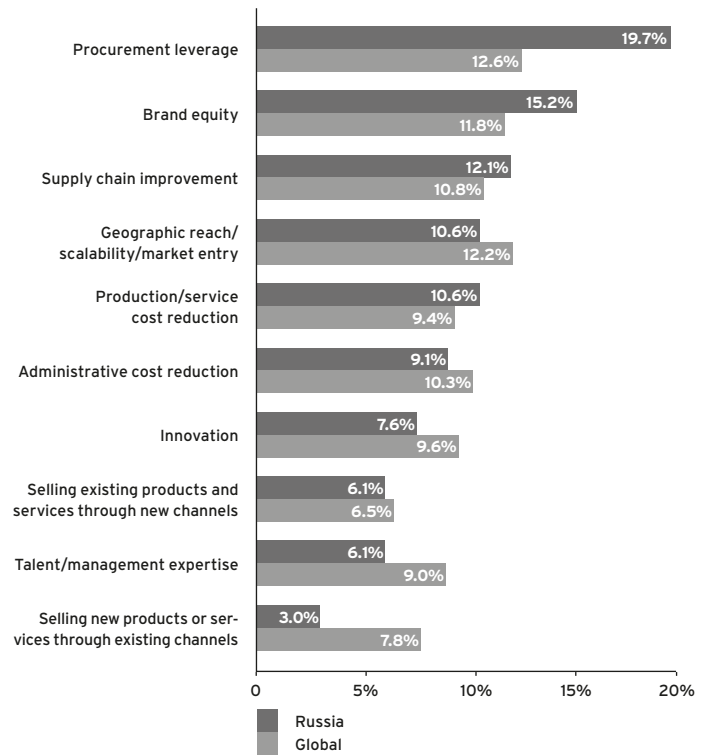
Similarly there are several areas where many have found unexpected value – principally through procurement leverage, brand equity and supply chain improvement.

Where did you achieve the most significant value creation in the deals you have done in the last 12 months, which were expected or unexpected?

### ▶ Expected



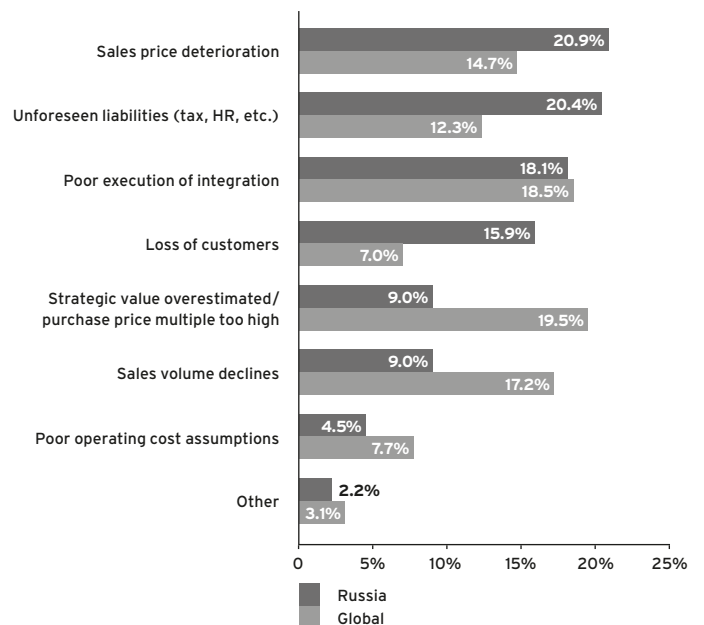
### ▶ Unexpected



## Opportunities for improvement in deal making

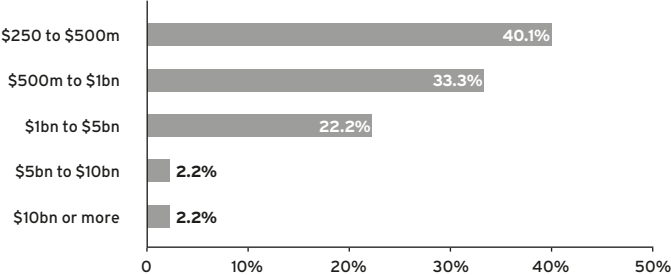
When considering past deals, most Russian respondents that failed to meet expectations fell short due to sales price deterioration, unforeseen liabilities and poor execution of integration. Many also cited loss of customers as a key reason for failing to deliver expected value.

For transactions completed recently, what were the most significant issues that contributed to the deal not meeting expectations?

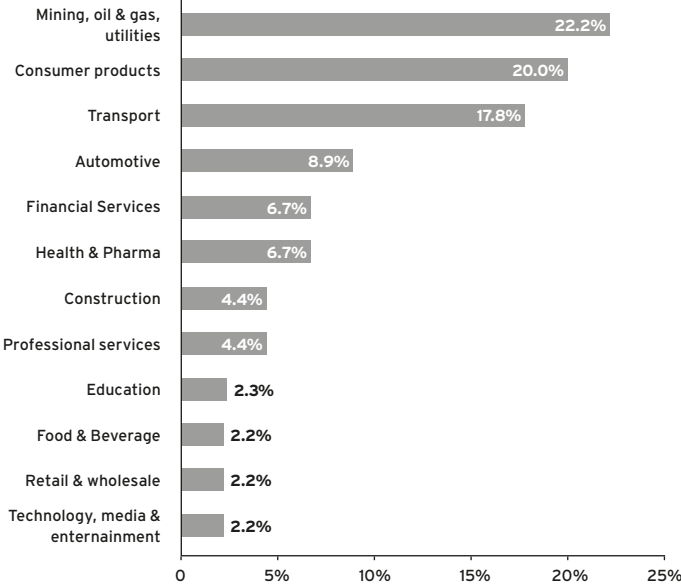


# Survey demographics – Russia

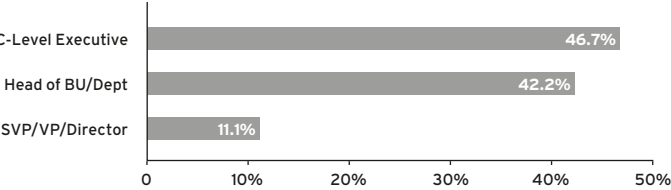
What are your company's annual global revenues in US dollars?



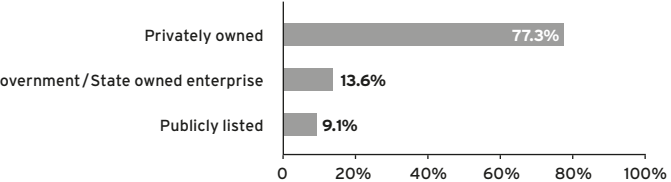
In which industry sector is your company?



What is your position in the organization?



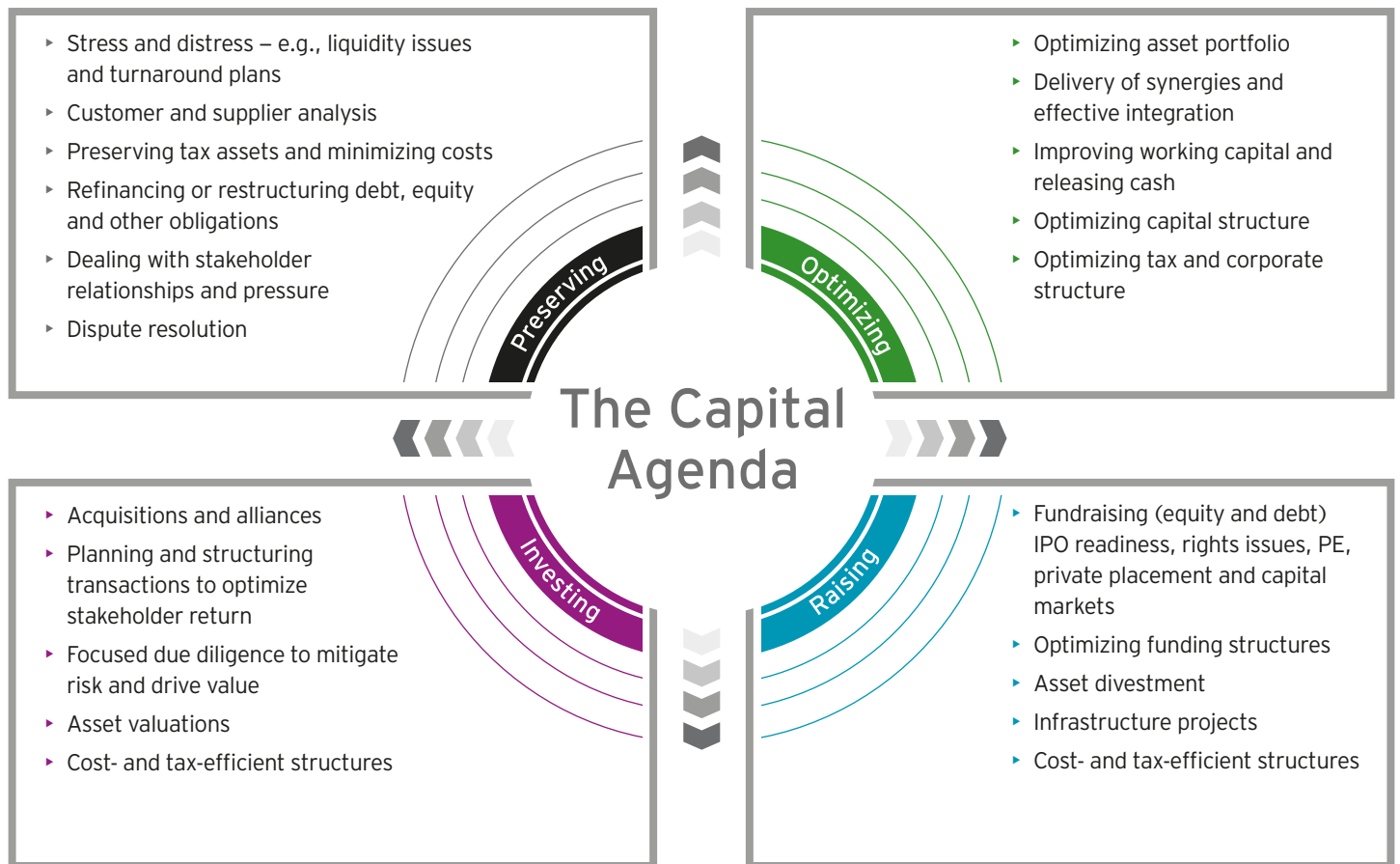
What is your company's type of ownership?



# Understanding your Capital Agenda

A strong Capital Agenda needs to be at the heart of all strategic boardroom and management decisions. The findings of our Capital Confidence Barometer provide useful insights into the ways companies are raising, investing, optimizing and preserving capital.

Using the Capital Agenda will help companies consider their issues and challenges and, more importantly, understand their options to make more informed strategic capital decisions.



# Contacts

If you would like to discuss your company's capital agenda, please contact your usual Ernst & Young advisor or any of the contacts listed below.

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## Acknowledgements

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\*The Ernst & Young 1,000 is a panel Ernst & Young clients and contacts and Economist Intelligence Unit contributors who participate in the Capital Confidence Barometer on a biannual basis.

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Assurance | Tax | Transactions | Advisory

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