

Making Money in Russia's Food & Beverages Sector!

POTENTIAL, OBSTACLES AND PRACTICE

LNV Seminar

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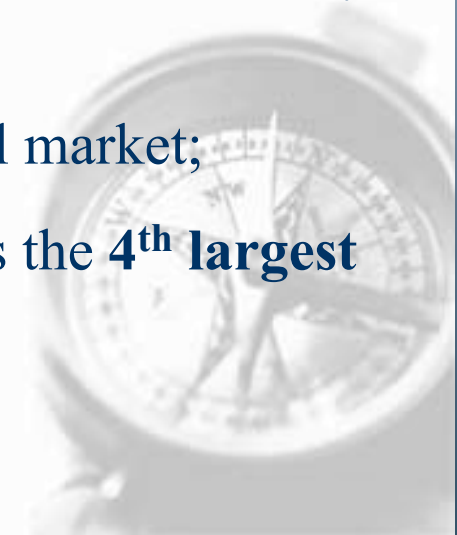
Contents of the presentation

1. What is the **image** we have of Russia and what is the **reality**;
2. The **opportunities** and **risks** of the Russian market;
3. The **Russian F&B** sector;
4. **Steps** to take for successful market entry;
5. **Do's** and **Don'ts**;
6. Conclusion and **answers** to your questions.



There's no reason **NOT** to be in Russia

1. Russia was ranked as the **second most attractive** retail market in the Global Retail Development Index 2006; The **largest** retail market in Eastern Europe.
2. Russia has seen **increased** retail food sales from 2001 to 2006 at a CAGR of 25%, but this percentage is declining;
3. From 2006 to 2011 the food retail CAGR is expected to be **14%**;
4. In 2006, retail **food sales** accounted for over **46%** of Russian retail sales, yet this percentage is declining;
5. **Moscow and St. Petersburg** have a 40% share of the retail market;
6. The food sector contributes 12% to the Russian GDP and is the **4th largest industry**;
7. So.....: **HURRY!**



Our image is predominantly negative:

1. Mafia – Oligarchs (Abramovich, Berezovsky);
2. Cold;
3. Russian bear;
4. Risks and danger;
5. Unreliable;
6. But also positively: Culture!



Relevant is that Russia is a country with:

1. More than **50%** of her external trade with the EU;
 - Oil and gas income contribute 15-20% to GDP;
2. A **stable political situation**. Parliamentary elections (2007) and Presidential elections (2008), but Putin remains predominant;
3. Economic: **Oil and Gas** / Increasing purchasing power and real disposable income / Growth in many sectors;
4. Growing **wealth** but also growing difference between rich and poor / Neglect of crucial sectors such as education and public health;
5. 17 million squared kilometres surface / 11 timezones;
6. **Slavonic culture** / Different sense of individual responsibility / Pride;
7. Many **successful foreign businesses!!!**

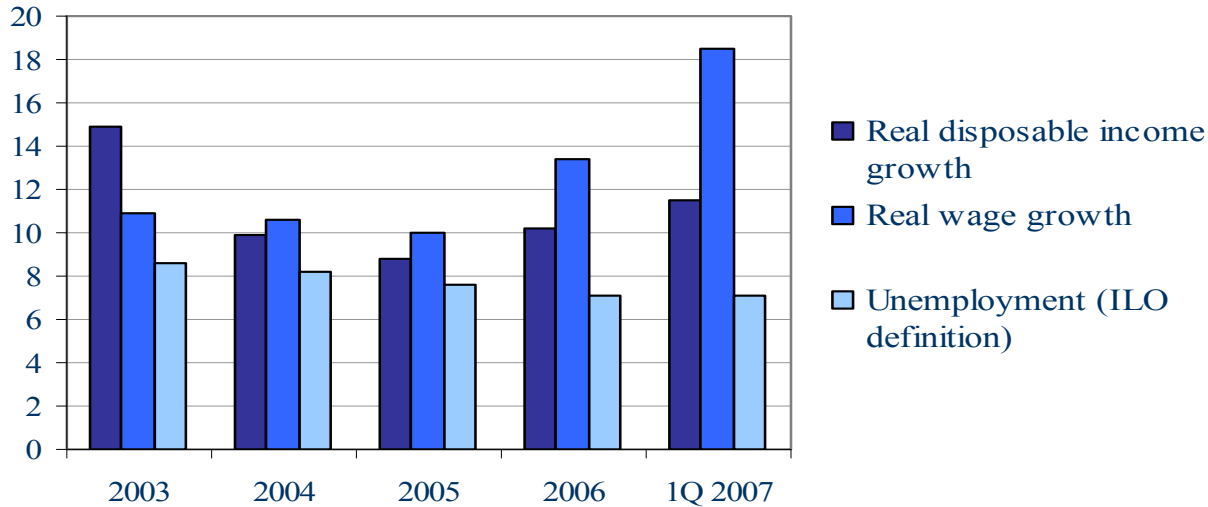


What are the opportunities on the Russian market?

1. Population of **142 million**. (8th in the world);
2. Disposable income grows with **10%** per year;
3. 15% of population has **high purchasing power** (21 million people);
4. 119 000 **millionaires** and 53 **billionaires** (33 in Moscow); Russia's 100 richest businessmen increased their wealth to U.S. \$248 bln. in 2006 from \$141 bln. in 2005;
5. Income is concentrated in **large cities** in Western Russia;
6. 75% of household income is spent on **consumption**;
7. Average GDP growth of 6,7% (1999 – 2006); **5% (2008 - 2011)**;
8. High natural resource commodity prices are a **blessing** for economic stability;
9. 30% of economy in grey sector and not accounted for;
10. Growing **demand** for consumption goods, innovative products, value-added services and modern equipment and technologies;
11. Plenty of quantitative potential but strong qualitative **competition**;
12. WTO: lower import tariffs, increased FDI, more competition and efficiency.



What are the opportunities on the Russian market?

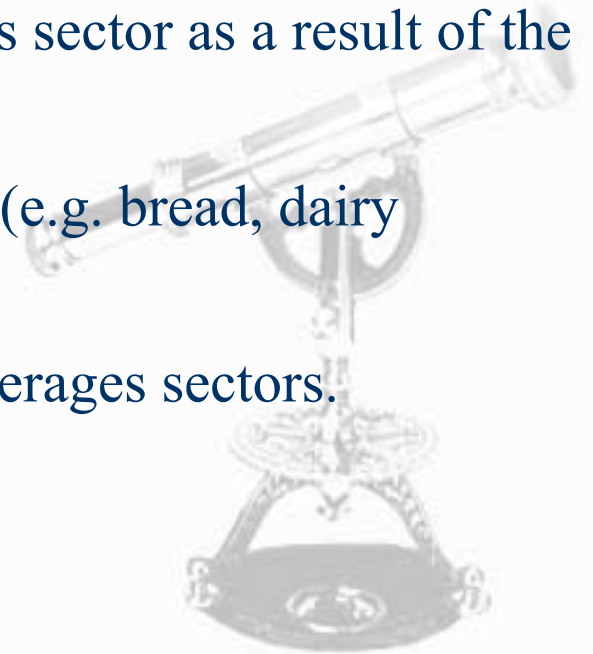


Indicators	2001	2002	2003	2004	2005	2006
GDP growth (%)	5.1	4.7	7.3	7.2	6.4	6.7
Industrial production growth (y-o-y, %)	4.9	3.7	7.0	8.3	4.0	3.9
Fixed capital investment growth (y-o-y, %)	8.7	2.6	12.5	10.9	10.5	12.6
Federal government balance (% of GDP)	3.0	2.3	1.7	4.2	7.5	7.5



Markets

1. Oil & gas, energy / Agribusiness / Automotive and automobile / Packaging / Construction materials / Telecom & IT / Manufacturing / Logistics Services & Trade / **RETAIL**.
2. Food & Beverages:
 - a. **No growth** expected in the alcoholic beverages sector as a result of the rising excise taxes;
 - b. **Single digit** growth in traditional food sectors (e.g. bread, dairy products, etc);
 - c. **Double digit growth** in all other food and beverages sectors.



What are the risks on the Russian market?

Political:

1. The succession of **Putin** in 2008 can lead to some unrest as much depends of Putin's personal power. But: bread over democracy.

Regulative and administrative:

1. Changing and ambiguous **legislation** and **regulations**;
2. Difficult but not impossible to enforce contractual and ownership rights;
3. Bureaucracy.

Economic and financial:

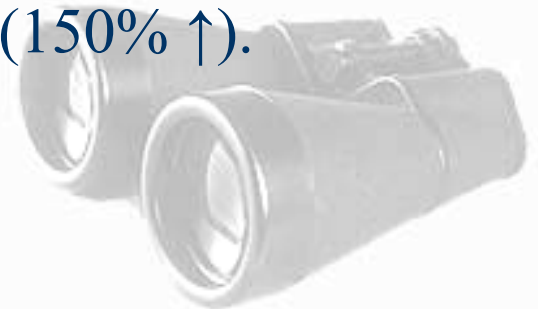
1. Underdeveloped banking system. Financing is expensive and scarce;
2. Underdeveloped SME and absence of strong bourgeoisie / middle class;
3. High and increasing **costs** (+10% per year). Moscow is now the most expensive city in the world;
4. Underdeveloped **infrastructure** (gas, electricity, water and heat).

HR:

1. Difficult to find good **staff**. Check backgrounds, networks and loyalties.

Will Russia remain stable?

1. Continuing **high prices** for oil and gas:
 - Account for 30% of GDP;
2. Low level of consumer **credits** and mortgage lending (The Russian owns his house, car, dacha);
3. Consumptive **spending** can be easily (temporarily) reduced by the Russian consumer;
4. Consumption over **democracy**;
5. Foreign **investments** reached \$90 billion in 2007 (150% ↑).



The Russian F&B sector: Growth

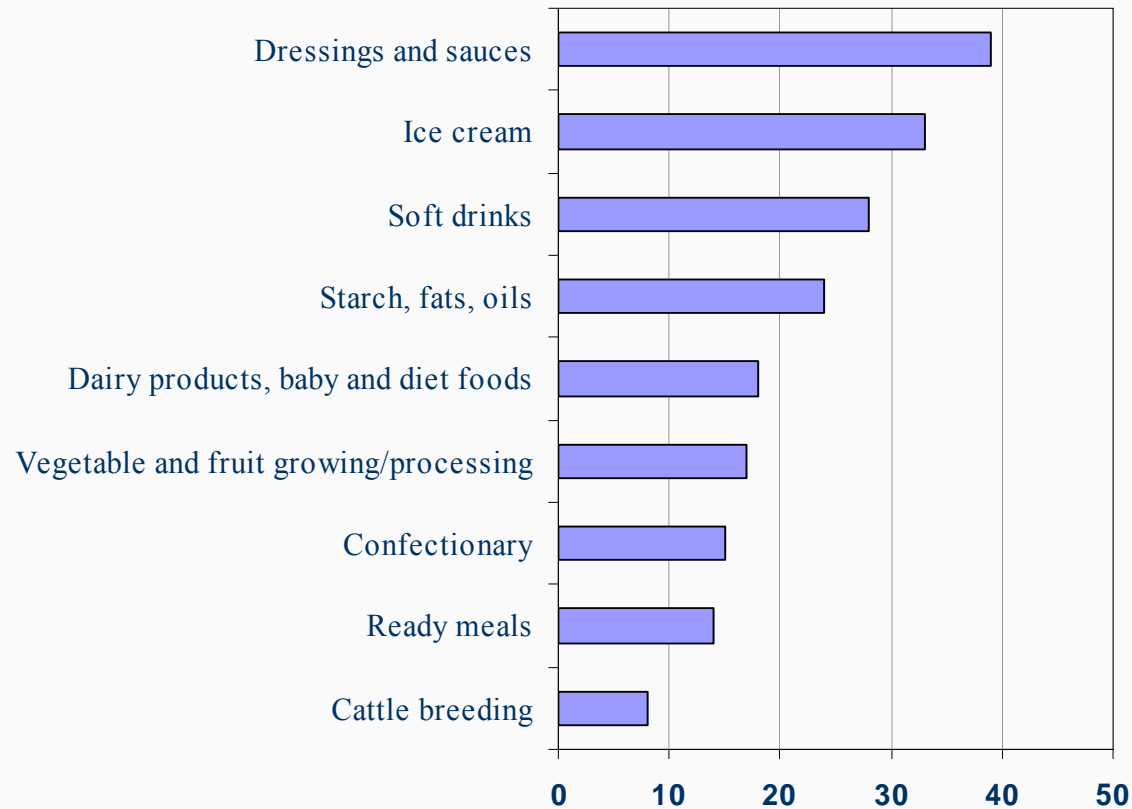
1. According to ACNielsen, from 2005 to 2006, the Russian food market grew in cash terms by **11%** as compared to 4% in the global and 3% in the European markets.

Reasons:

1. Increasing **disposable income** of the population;
2. **Unsaturated** consumer market;
3. Russian consumers still spend a large part (**30-35%**) of their disposable income on food (in the EU – 12-15%). However, this is slowly changing;
4. Thrust by **hypermarkets** and **large supermarkets** (e.g. Carrefour plans to open 5 – 10 stores per year; Pyaterochka from 1000 to 2200 stores in 4 yrs).

The Russian F&B sector: Highest growth

Projected growth rate for the next three to five years (%)



Source: Ernst & Young

The Russian F&B sector: Adverse factors

1. Increased **competition** and;
2. Growing **influence** of retail chains:
 - a. **Falling product prices** and more stringent requirements on quality, packaging, terms of delivery, and returns;
 - b. **Falling margins** for producers and distributors.
3. Legislation and regulations;
4. **HR**;
5. Poor **logistics**.

Most of these factors **benefit** foreign producers and retail chains as they are better adjusted to dealing with the demands of the Russian market.

The Russian F&B sector: Trends

Increased competition and retail pressure forces industry players to:

1. Enhance **production** capacities;
2. Create and introduce **new products** to the market;
3. Build and develop **brands**;
4. Expand **geography** of sales;
5. Improve in-store **merchandising**;
6. Create more value and get **higher margins**;
7. Both **producers and distributors** are pushing retail chains to decrease their profit margin (which is still up to 80%);
8. Seek **strategic partnerships** with Western partners.



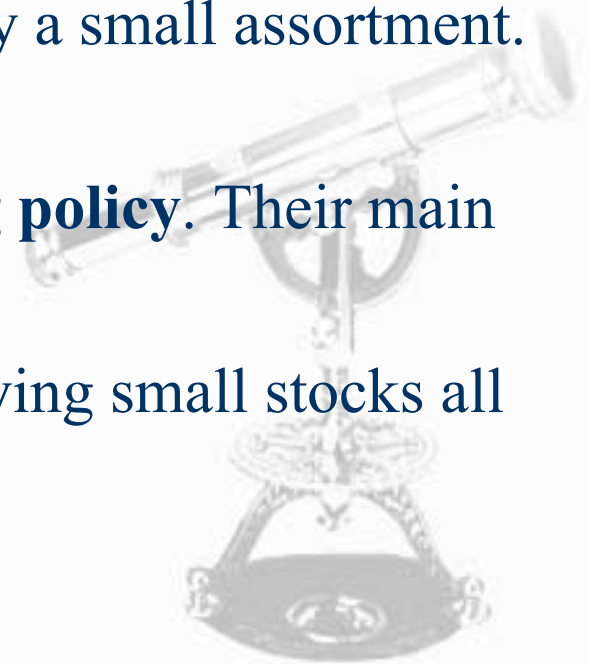
Players in the Russian F&B sector: Producers

1. 2500 enterprises, most of them **small** or **middle-sized**, work on the local market. Only a few are national players (Wimm-Bill-Dann, Cherkizovski, Baltika, Ochakovo, Lebedyansky, etc);
2. 35% of equipment is **obsolete** and **lack** of qualified staff and management;
3. First wave of **equipment renewal** on the biggest and most profitable plants is accomplished. Now the second wave is ongoing;
4. Development of **vertically integrated** holdings (from raw materials to marketing and distribution);
5. Growing competition causes more manufacturers to form holdings or to expand via **Mergers & Acquisitions**;
6. Producers will continue to rely on **imports** of raw materials, as the Russian agricultural production does not meet the demand.



Players in the Russian F&B sector: Distributors

1. The distribution system in Russia is still relatively **unorganized** and **fragmented**;
2. The roles of the actors in the distribution chain are often **unclear**, for example, the distributor is often also the importer and wholesaler;
3. Distributors are small and middle sized and carry a small assortment. There are **no national players**;
4. Most of the distributors have a **weak marketing policy**. Their main function is delivering products to retail outlets;
5. Distributors are starting to form **holdings** by buying small stocks all over Russia.



Players in the Russian F&B sector: Food Retail

1. Food retail chains had a market share of only 20 to 25% in 2006, so there is **big potential** for growth. This share is expected to grow to 40% by 2010. However, open markets (50%), small shops and kiosks are still very popular;
2. **Small turnover** compared to European chains - the largest Russian food retailer X5 had a turnover of EUR 2,5 bln in 2006;
3. In 2005, the most widespread formats among modern retail chains were **discounters** and **supermarkets** with 38% and 37% respectively. Hypermarkets amounted to 13% and convenience stores to 3%;
4. Russian **regional chains form** 41% of the total retail chains, Russian federal chains 36% and foreign chains only 23%;
5. Active **M&A process**. Large cities are saturated, while chains are expanding into the regions;
6. **Private label** products are developing quickly;
7. **Underdeveloped** merchandising mechanisms.

Main players in Russian Food Retail



Рамстор

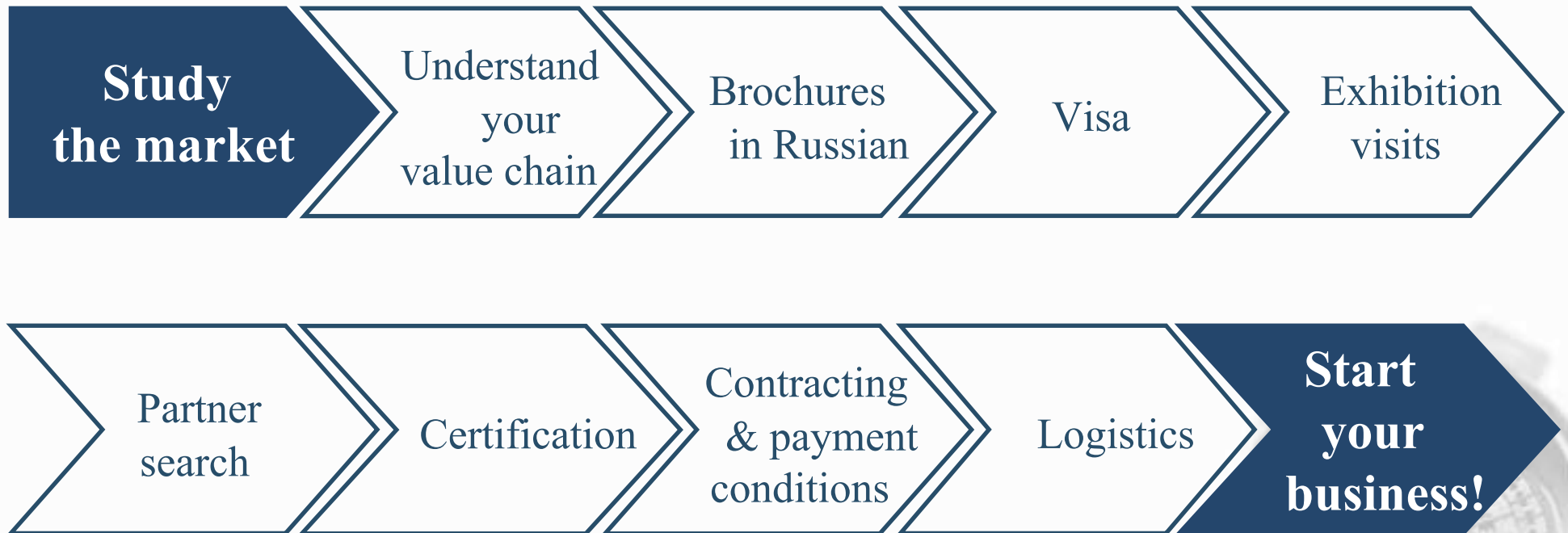


Source: Retailer Magazine

Players in the Russian F&B sector: Consumers

1. Majority of the population pays more attention to **price** than to **quality** of products. BUT in big cities preferences are changing to high quality, healthy and diet products;
2. Russians consume a lot of **potatoes, cereals and bread**. Gradual increase in the consumption of fresh vegetables, fruits, meat and fish;
3. **Seasonal** consumption of fruits and vegetables due to underdeveloped logistics network;
4. Low **summer** demand for fresh vegetables and fruits due to availability of vegetables and fruits grown at the family dacha;
5. **Typical Russian** products (dairy products such as smetana, kefir, and tvorog and home-made preserved vegetables) will continue to form a large part of the ration;
6. **Preferences** often strongly depend on advice from friends and neighbours. However, Russian consumers are influenced by advertisements;
7. Russians prefer **locally produced** food products (especially dairy, meat and bread products), as these are considered more natural and healthy;
8. More and more people eat **out of home** and purchase ready made meals.

Steps to take:



How to look for a local partner

1. Know your specific market

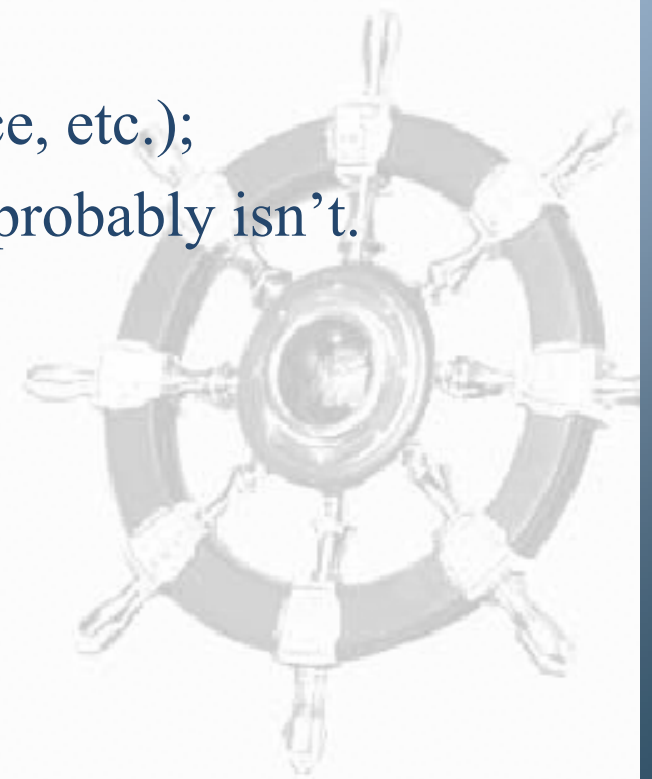
2. Know the players in your value chain

3. Know the behaviour of your consumer

4. Select a suitable distributor or retail partner

How to search for a partner

1. Choose your partner carefully:
 1. Good **management**;
 2. Strategy and growth **prospects**;
 3. Decent company **infrastructure**;
 4. Sufficient **transparency** (tax, legal, finance, etc.);
 5. Common **sense**; if it doesn't seem right it probably isn't.
2. When in doubt: use advisor;
3. When still in doubt: Don't continue!!!

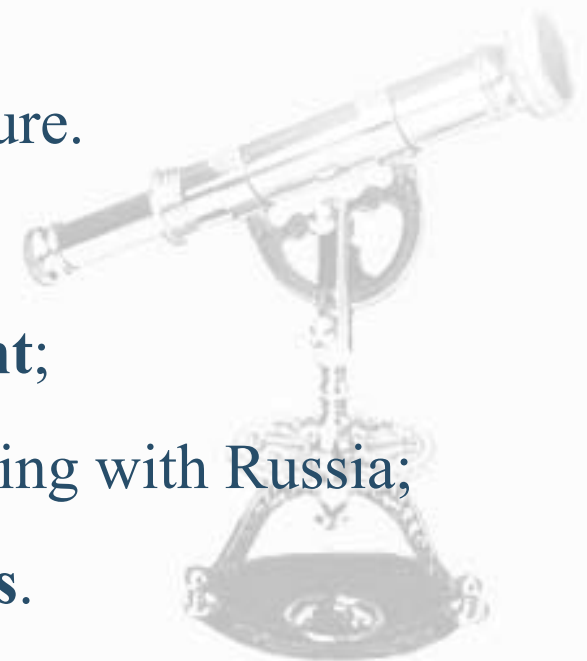


How to deal with Logistics

1. Customs;
2. Certification and documents;
3. DDP deliveries without local representation;
4. Need to compete with grey imports;
5. Take into account the weak logistics infrastructure.

Therefore important;

1. Good and trustworthy **agent/partner/consultant**;
2. Good **transport company** experienced in working with Russia;
3. Solid preparation and **uniformity of documents**.



Contracting and payment conditions

1. Draw up a clear **bi-lingual contract**;
2. **Conservative** payment conditions;
3. **Do not** immediately give **exclusivity**.



What do you hear around Moscow's Expat kitchen tables?

1. Returns higher than anywhere else;
 1. **Stock market** 2006 ↑↑ 70%;
 2. Gazprom capitalization from 30 bln \$ to 300 bln \$ in 3 years;
 3. Upgraded country ratings (Fitch: BBB+, Moody's: BAA2);
2. It takes determination, flexibility, stamina and hard work but **success** in Russia is very well possible;
3. The **foreign media** are much too negative;
4. Russia is not more difficult than **China**;
5. **BRIC**.



What is the secret of success of foreign companies in Russia?

1. They are there and they are **committed**;
2. They **like** it 😊;
3. They **understand** Russia and its potential;
4. They are ready to be **flexible**;
5. They are **entrepreneurial**.



Do's

1. **Enjoy** Russia!
2. Do your homework and **know** your market;
3. Gain some knowledge of the Russian **language** and **culture**;
4. Stay in **control** (of finances and management);
5. Create **win-win** situation;
6. Use experienced local (general, tax and legal) **advisors**;
7. Limit your **exposure** and risks;
8. Dedicate and commit sufficient **financial & human resources**;
9. Be **flexible** and **patient** (e.g. bureaucracy, market development);
10. Think well about the **location** of your office, warehouse, and production;
11. Understand the Russian **perspective**!



Understand the Russian perspective

1. Be aware of cultural **differences** and language barriers;
2. Building of **trust** and personal relationships is key;
3. Informal communication **networks** are most important;
4. Relatively **short-term** vision;
5. Vertical **authority**;
6. During first contacts the Russian partner may **promise** more than can be delivered (without bad intent!);
7. Russian businessmen can be imposing. **Weakness** is not shown;
8. The **external appearance** is very important;
9. Russian businessmen think, speak and act **fast!**



Don't

1. **Underestimate** the market or your Russian business partner;
2. Think Russia is **Europe**;
3. Think Russia is **cheap**;
4. Think it is easy to find the right **staff**;
5. Let yourself in with **corruption** (payments on the basis of contracts or through third parties);
6. Give immediate **exclusivity** to distributors;
7. Forget to register your **trademark**;
8. Forget your **visa** and do not forget to have your passport on you;
9. Think **transfer** of goods and money is easy.



Conclusions and advice:

1. Russian F&B sector is growing strongly, but the growth peak has already been passed. So **be quick**;
2. **Contradiction** between **unsaturated** consumer market and **growing** disposable income on the one hand and **price sensitive** consumers and **unorganized** food retail on the other hand. It will take 5 to 10 years before the market reaches the level of development seen in Western Europe;
3. **Imports** of food products will continue to increase in the coming 3 to 5 years as domestic production does not meet the demand;
4. Each F&B sector has its **specific characteristics**;
5. Come with **quality** and **added value**;
6. Be ready to make a long-term **investment**;
7. **Prepare well** and think through all the steps;
8. **Understand** Russia;
9. Have **fun** and make money!



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