

Russia & CIS Express

*Our Russia & CIS
Business Group discuss
business opportunities,
what's happening in
some key industries,
economic and political
developments in
Russia, CIS and
Eurasia.*

Winter 2011

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From our Editor

Welcome

Welcome to the Winter 2011 issue of CIS Express. One of our contributors to this issue, our new country managing partner for Russia, David Gray, characterizes his nearly two decades in the country as ‘never a dull moment’. Since our last issue in Spring 2011 it’s fair to say that Russia has lived up to that description. Both politically and economically, events are unfolding at a breakneck pace.

One of the features of Putin’s terms in office – and his enduring popularity – has been the continued success of the Russian economy, which as we show in our economic analysis on Page 2, continues to grow in marked contrast to its European neighbours. But while Russia has so far been largely insulated from the impact of the Eurozone crisis, the EU is Russia’s largest trading partner and accounts for more than 50% of exports. The continued turbulence in Europe may well start to have a negative impact on the Russian economy, and there are already signs that some industries, for example steel, are beginning to feel the effects.

In more local developments, the negotiations with Ukraine over gas prices have, at the time of writing, yet to be finalized. Every day offers a different rumour of agreement only for that to be swiftly denied by either party. Strained relations with another ex-Soviet Republic, Georgia, have, however, improved as indicated by Georgia’s acceptance of Russia as a member of the WTO. Georgia was the only country, of 153 member nations, that was continuing to oppose Russia’s accession. Following agreement with Georgia, the date for Russia to join has now been set as 18 December at the next WTO ministerial meeting.

The economic impacts of Russia’s WTO accession have been estimated by the World Bank as a one per cent increase in annual GDP, with other commentators suggesting that membership could boost the Russian stock market by as much as 5%. In addition, WTO membership will offer greater comfort to foreign investors about the reliability and security of investments in Russia. This development will sit well with the government’s aims to increase foreign direct investment. That ambition has been further boosted

1. In this document, “PwC” refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom), which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

by the announcement of a new US\$10 billion sovereign wealth fund, The Russian Direct Investment Fund, that will start operating in early 2012. The fund is unusual in that it will only make investments in deals that also involve foreign investors. The fund aims to boost Russia's credibility as a foreign investment destination, and it has secured the advice of a number of high-profile global investors to act as advisors, as well as having board members that include the former World Bank President, James Wolfensohn. Further bolstering the flow of investment in the Russian economy is the government's efforts to push Russian businesses to invest domestically.

Against this backdrop, this issue of the *Express* looks at some key developments that are reshaping aspects of the Russian economy. We cover how concerns about improving the general level of health of Russian citizens are driving changes in the pharmaceutical industry, which is seeing many global businesses investing in production facilities in Russia. We examine the impact that the UK Bribery Act may have on doing business in Russia, and we report on the buoyancy of the Moscow hotel market that is faring considerably better than some of its European competitors. We also provide an analysis of the Russian media and entertainment market. Russia is predicted to be among the fastest growing markets in the world over the course of the next few years, with digital media growing particularly fast. Russian businesses such as *Mail.ru* are not only

prospering in Russia, they are making their mark on the global stage too.

Yet positive developments in Russia have to be seen against an increasingly troubled global outlook. How Russia and the countries in the region fare in such a volatile environment will likely prove a severe test of political and economic leadership in the coming months. The only certainty is that any dull moments will continue to be in very short supply.



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BRICs: Consumers and public spending to keep Russia growing

Each quarter, PwC's Macroconsulting team produces an in-depth Economic View report focused on the fast-growing BRIC economies (Brazil, Russia, India and China). These reports can be downloaded at www.pwc.co.uk/economy

Here is a summary of some of the highlights from the latest edition, focusing particularly on the analysis on Russia.

The fast-growing economies first characterised as BRICs (Brazil, Russia, India and China) some ten years ago continue to grow at a rate that easily outstrips the sluggish and even 'negative' growth of developed economies in the west. Accordingly, over the last decade, the share of economic power and global GDP BRICs enjoy has decisively shifted to those countries.

However, one of the challenges associated with such strong economic growth is the inflationary pressure that it brings. Inflation in all the BRICs, largely driven by commodity and food prices, is running at levels that have required central banks in all four countries to tighten monetary policy. One of the impacts of these central bank interventions has been to dampen growth rates to some extent and the latest figures for Russia show that, in common with the other BRICs, the pace of growth may be slowing.

Russia's economy grew by 3.4% in Q2 2011, compared with 4.1% in the previous quarter. The impact of rising interest rates appears to have manifested itself in a reduction in investment activity. Other areas such as consumer spending and retail sales look to be continuing to grow strongly.

Inflation easing slightly

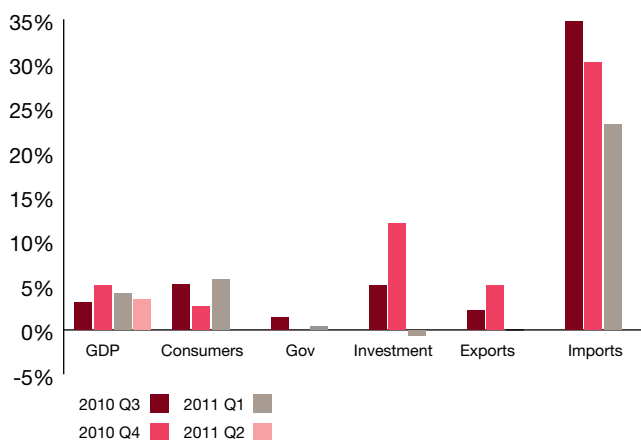
A combination of measures taken by the Russian authorities has helped to ease inflationary pressures. These include monetary tightening earlier in the year, and the banning of grain exports accompanied by selling grain domestically at discounted prices. As a consequence, inflation has dropped to 8.2% in August 2011 compared to 9.6% in January 2011. Going forward, we expect inflation to average 8.3% in 2011 and 7% in 2012.

Threats

The sovereign debt crisis has seen investors fleeing to 'safe havens'. This movement has had a negative impact on the Russian economy and has prompted the finance ministry and the central bank to offer a US\$5 billion credit line to domestic banks in order to avert any possible liquidity crunch.

Russia is aiming for a balanced budget this year, while the forecast for next year's deficit is 1.5% of GDP. These targets are based on an average annual oil price of US\$105/

Chart 1: The Russian economy, year-on-year growth rates



Source: Source: Federal State Statistics Office; breakdown of GDP not yet available for Q2 2011



“...the Russian economy is expected to expand by 4.4% and 4.3% in 2011 and 2012 respectively, driven largely by consumer and government spending.”

Shopping mall, Moscow

barrel this year and US\$95/barrel in 2012. However, the combination of weakening global demand and oil price volatility poses some risks to achieving those budget deficit targets. Achieving those targets is also likely to be tested by growing public expenditure in the run up to the Parliamentary elections in 2011 and the Presidential elections in 2012.

Growth outlook

The moderation in the Index of Industrial Production (IIP), which has grown at 4.9% in the year to Q2 2011 compared to 10.9% in the same period last year, and a downward trend in the Manufacturing Purchasing Managers' Index (PMI), suggest that industrial activity is likely to remain sluggish for the rest of the year. However, contraction there should

be compensated for by increased government spending. This is likely to pick up ahead of the parliamentary election this year and presidential election in 2012. Overall, the Russian economy is expected to expand by 4.4% and 4.3% in 2011 and 2012 respectively, driven largely by consumer and government spending.

Our man in Moscow

Profile: David Gray, Managing Partner, PwC Russia

David Gray, who became Managing Partner for PwC Russia in July of this year, believes that a long-term perspective is a key component of success in the Russian market. And he should know. Having arrived in Russia in 1994 for what was then a one-off audit assignment, he has spent the majority of the last 17 years helping to build PwC's business in Russia and seeing the country change dramatically in that time.

Working in Russia, he says, has given him a ringside seat to observe how much the country has changed over the past two decades. He points to significant developments in terms of infrastructure, in the ease of doing business in Russia and the general changes to quality of life from which millions of Russians have seen major improvements in their day to day lives. And even though he acknowledges that people still have complaints about, for example, the tax system, he suggests that the administration is considerably better than it used to be and there is official commitment at the highest level to continue to

modernise and improve. The country, he says, is overall on an upward curve.

Unrealistic expectations

One of the challenges that Russia faces, David argues, is that expectations for the pace of change were always likely to exceed the practical reality on the ground. The idea that a country could change almost overnight from decades of an autocratic government and a command economy into a fully functioning liberal democracy with a free and transparent economy is inevitably going to be confounded by slower progress to those goals. But positive progress, he says, is unquestionably evident in many aspects of Russia today.

Not least of which is the continued diversification and development of a thriving economy. Russia's world-class resource base has meant that in recent years Russia's appeal as a trading partner has understandably focused on natural resources. However, the image of the Russian economy as solely a commodity play, he says, is now changing as the potential grows for businesses in many sectors to capitalise on a much more diverse range of opportunities.

Growing diversity of opportunities

The growing breadth of those opportunities is increasingly reflected in the development of PwC's business in Russia. The firm is seeing its practice diversify and, for the first time, it is no longer the Energy, Utilities and Mining business that is the largest practice group. The top slot now belongs to the Consumer and Industrial Products group. Diversity is also spreading geographically, with busy offices opening in regional cities such as Novosibirsk, Kazan, and Ekaterinburg – and more locations planned in the near future. Moscow remains a key focus, but rapidly

growing regional business centres are where David sees demand for PwC's services growing fastest.

International reach

As well as developing their businesses in the domestic market, Russian businesses are increasingly keen to raise their international profile and attract capital that will allow them to expand into new markets. Consequently, David sees one major focus for PwC's growth as the many smaller businesses that have ambitious plans for growth both domestically and internationally.

That increasing desire to move beyond Russia's borders and seek opportunities on the world stage is demonstrated by the number of Russian businesses seeking to raise capital internationally. In 2010 alone, Russian companies raised over \$1.7 billion on the London Stock Exchange, with a freight operator, a leading Russian retailer and an Internet business among those making initial public offerings. PwC's services are focused on helping similar businesses to achieve the right approach and transparency to make sure that they are in the best possible position to attract capital for expansion and development.

Growing optimism

The dynamism of the economy is just one of the indicators David points to that suggest Russians are more optimistic about the prospects for their country than they have ever been. When he started in Russia, he says, many of the new recruits to the PwC office saw it as an escape route from Russia. Today, that position has been completely reversed, with young recruits keen both to build a local career with PwC and base their family life in Russia.

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Red Square, Moscow



Of course, it's not simply a one-way flow. There are many opportunities for international companies investing in the Russian market and PwC's practice is working hard to help them make the best of those opportunities. The demand for luxury goods, for example, is one area in which international business is flourishing. The growing Russian middle class, with increasingly high disposable incomes, is a natural

market for well-established global top end brands. As growth spreads beyond Moscow and the other major cities, a national trading presence will become increasingly important for international businesses to capitalise on Russia's growing wealth.

Summing up his career in Russia to date, David says that he can think of few places in the world that could

offer the sheer variety and range of opportunities that Russia has provided. Working in a country that has witnessed major upheavals and radical transformation may not, he says, be for those who prefer a more predictable routine. But for those who relish change and exploring new possibilities, Russia's promise to offer few, if any, dull moments is unmatched.



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David Gray joined PwC UK in London in 1987. He joined PwC Russia in Moscow in 1994 and was appointed Managing Partner in July 2011.

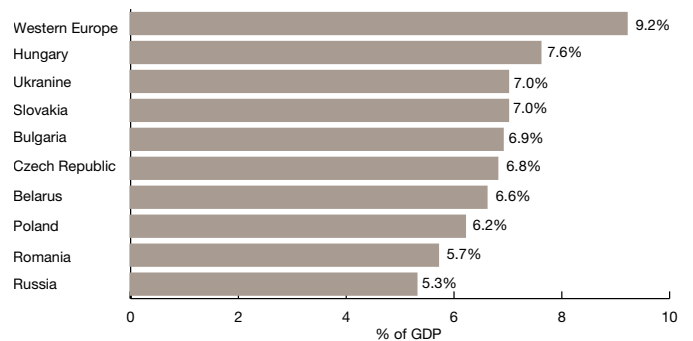
David works on the Russian and IFRS audits of some of Russia's largest companies including Gazprom, RAO UES, Federal Grid Company, RusHydro and the diamond producer AK Alrosa. He is a member of the Institute of Chartered Accountants in England and Wales.



The Russian pharma market – opportunities, challenges and growth

The latest WHO statistics (2009) show that per capita spending on health in Russia was US\$475 (5.4% of GDP) compared with US\$ 7410 (16.2% of GDP) in the United States, (the world's highest spender on healthcare) and considerable distance from the average levels seen in Europe.

Healthcare expenditure as % of GDP, 2009



Source: OECD, Worldbank



particularly vulnerable groups in society. Under the DLO (*Dopolniteloe Lekartsvvennoe Obespechnie*) launched in 2005, treatment for specific illnesses (the '7 Nosologies' including hard to treat conditions such as hemophilia, multiple sclerosis and cystic fibrosis) are available for reimbursement, as are drugs prescribed from the government-defined Essential Drug List (EDL) for the 5% of the population that form the most socially vulnerable groups.

There are plans for other measures that will improve healthcare coverage further including efforts to raise the quality of polyclinics, increase physicians' incomes, and improve equipment and materials available. Progress in implementing these and other programmes is patchy – and is likely to remain so until after the Presidential elections in 2012. However, what is clear is that the projected growth of the Russian economy, the government commitment to expanding healthcare and a raft of reforms are together setting the scene for a rapid expansion of the Russia healthcare market.

Pharma 2020

The pharmaceutical industry will have a key role to play in the development of that market and will itself be subject to a number of reforms over the course of the next few years. Today the pharma industry in Russia is dominated – in

In Russia today a significant amount of healthcare and drug spending (more than 75%) is paid directly by patients from their own pockets. Following the collapse of the Soviet Union, healthcare standards plummeted and have also been badly impacted by the more recent effects of the financial crisis. The net result is that many Russians today have a lower life expectancy than they had at the end of the Soviet regime, with the incidence of many serious diseases at levels far higher than those experienced by their European counterparts.

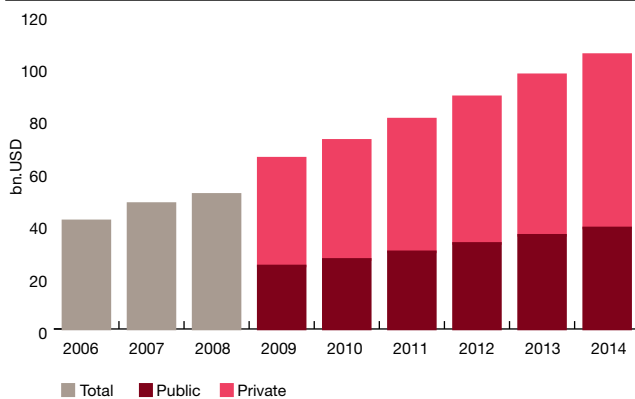
Responding to the health crisis

However, in recognition of the crisis in Russian health, the government – at federal and regional levels – has made a commitment to both increasing spending on healthcare and finding ways to create a more universal system of drug coverage. Accordingly, health spending has increased in the last year and is expected to increase by 10% per annum over the course of the next few years.

Some of the key initiatives taken by the government include the creation of programmes that are focused on addressing specific conditions or

The Russian government's deliberate shift towards favouring local production means that global pharma businesses that wish to address this growing market will need to develop entry or expansion strategies that ensure they are not disadvantaged by the preferential treatment available to local producers.

Russian healthcare spend, 2006-2014f



Source: CIRA, Bloomberg

Transformational challenges

For Russian companies to achieve the transformation of quality and scale of production that the programme envisages will be a major challenge. The majority of production in Russia (75%) is generics. Russian customers, however, express a general preference for branded goods – as they perceive these to be of higher quality than locally manufactured generic equivalents. The analysis of Russian production may add some credibility to this view as currently only approximately 10% of Russian companies are GMP-certified. However, under the 2020 programme's aims, all Russia manufacturers will have to comply with Good Manufacturing Practice (GMP) standards by 2014. And making that transition is likely to prove extremely testing for many of them. While there are some 500 local producers in Russia, these tend to be small operations that will find it hard to generate or attract the investment required to modernise or expand significantly. Larger businesses are hampered by outdated plant and equipment that will require major funding to equip them to compete directly with their multinational counterparts.

value terms – by imported products from foreign multinationals that between them account for nearly 78% of the market.

With a view to changing the composition of the Russian pharmaceuticals market in favour of local producers, the government has launched the Pharma 2020 programme, developed and managed by the Ministry of Industry and Trade. Russia's high dependency on imports is perceived as adding considerably to the overall cost borne by consumers and the government sees an opportunity to

create an indigenous industry, along with a specific pharma R&D cluster, that can help develop a local specialist industry and eventually see Russian businesses compete in international markets.

The Pharma 2020 programme has set out a target of increasing the ratio of Russian-produced to imported drugs to 50% of the total value of pharmaceuticals by 2020. In addition, the programme seeks to increase Russian exports eight-fold on 2008 levels by the same date and create a modernised manufacturing and R&D hub.

Global to local

These local challenges do, however, create some major opportunities for global pharma companies to enter the market at scale. By partnering or acquiring their Russia counterparts they will be able to help them achieve the requisite standards and achieve a stronger position in a fast-growing market. Some global businesses have already announced their intentions to make significant investment in Russia, such as plans by Novartis to invest \$500 million to build a new facility in the St Petersburg region by 2015, Astra Zeneca's \$150 million investment in new production facilities south west of Moscow and one of the largest generic manufactures in the world, Teva, headquartered in Israel, has announced a \$100 million investment.

As they draw up similar plans, pharmaceutical manufacturers will need to bear in mind a number of developments that have yet to be resolved with any real clarity. These largely focus on the distinction in government policies towards local and imported compounds and how these are defined in a number of forthcoming legislative initiatives.

For example, the definition of local production is likely to exclude compounds that are bulk imported and repackaged and relabeled for the Russia market. Customs regulations will create an additional disadvantage for foreign manufacturers and any supply contracts under tenders that manufacturers enter with the Russian authorities generally will be priced down by 15%, placing local suppliers in a favourable financial position compared to foreign manufacturers.

Risks and rewards

The Russian government's deliberate shift towards favouring local production means that global pharma businesses that wish to address this growing market will need to develop entry or expansion strategies that ensure they are not disadvantaged by the preferential treatment available to local producers. How that is likely to manifest itself in practice is direct investment in building new facilities or acquiring or working with local manufactures in joint ventures. As they do so they will also need to bear in mind the broader considerations that all businesses

face when investing in Russia. These include ensuring that due diligence of any potential acquisition is as thorough as possible and being aware of the tax implications that may arise from creating a local presence in Russia. Intellectual property issues, too, will also be to the fore. There are some cases pending in Russia that have highlighted the importance of intellectual property protection, with, for example, Pfizer taking action to protect its Viagra patent – the latest in a series of potential infringements that have exposed weaknesses in Russia's IP regime and enforcement.

But while there may be challenges, there are unquestionably major opportunities. The expected growth rate for Russia's healthcare market, combined with the measures that are in place to encourage local manufacturing and hamper imports means that global pharma businesses that seek to compete in the Russian market will need to devise suitable local strategies. Their business models may need to adapt to suit the unique conditions in Russia. But there are considerable prizes on offer for those that take the right approach.



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Martin is a Partner in PwC Germany's pharmaceuticals and healthcare practice in Munich. He has more than 20 years' experience in the pharmaceuticals industry in Europe, Russia and CEE and has advised several top 10 pharma companies on their market entry strategies into Russia. Martin began his career as a research chemist at Bayer in Germany, was a sales representative to physicians in private practice as well as hospital accounts, and moved on to lead key cardiovascular product launches. Martin joined PwC in 2010.



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UK Bribery Act 2010 – A BRIC guide

The UK Bribery Act, which came in to effect on 1 July 2011, is applicable to all UK entities but of particular relevance to commercial organisations operating in what can be perceived as “higher risk” countries.

PwC UK’s Forensic and Emerging Markets teams, together with PwC Legal UK, have recently produced *Responding to the UK Bribery Act 2010* with the Brazilian Chamber of Commerce for Great Britain, the Russo-British Chamber of Commerce, the UK-India Business Council and the China-Britain Business Council, as well as local PwC Forensics teams in those countries.

Responding to the UK Bribery Act 2010 looks at how the Act could impact on businesses operating in, or doing business with, the BRIC countries in particular. The paper examines how companies can reduce those risks, as well as protect themselves from the potentially damaging results of falling foul of the Act - not least in financial and reputational terms.

Certain business and cultural challenges are relevant across many countries. However, some challenges are specific to the BRIC economies. Under the Act, a UK party may now be held liable for the corrupt behaviour of an overseas intermediary, and companies with representative offices in the UK are also bound by it.

Where Russia in particular is concerned, there are a number of business practices which could be seen as potentially breaching the Act. These include giving of gifts to develop business relationships;

providing business partners and government officials with hospitality to obtain improper business advantage; using subcontractors or intermediaries recommended by large customers, especially by state-owned commercial organisations, as a pre-condition for winning business; and ‘charitable’ or ‘sponsorship’ payments to support current or former government officials or government initiatives, and which may be viewed as a form of ‘protection’ money. All these highlight the need for constant vigilance, as well as adequate policies and supervision, when operating within the Russian business environment.

Stephen Dalziel, Executive Director of the Russo-British Chamber of Commerce, who sat on the editorial committee during the development of *Responding to the UK Bribery Act 2010* noted, “Gangster capitalism, which was prevalent in Russia during the 1990s following the Soviet Union’s collapse at the end of 1991, has resulted in Russia having a reputation – both within and outside the country – as a place where bribes are necessary to get things done.”

Russo-British Chamber of Commerce

The Russo-British Chamber of Commerce (RBCC) promotes, facilitates and supports business between Russia and the UK.

It is independent of government in both countries and is funded by membership fees, events and publication sponsorship.

RBCC aims to be the first point of contact for Russian companies wanting to do business in the UK and for British companies wanting to do business in Russia.

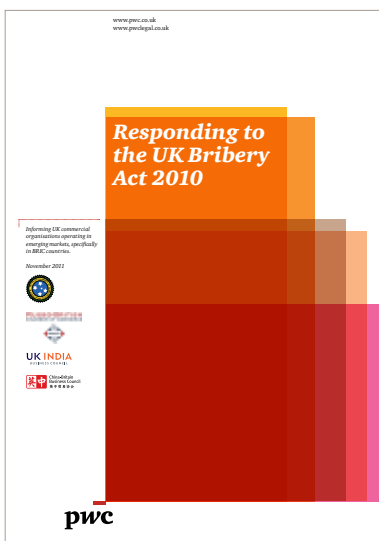
More information about the RBCC can be found on www.rbcc.com. Contact the Executive Director in London, Stephen Dalziel, at stephen.dalziel@rbcc.com

“The common sense approach to doing business in Russia should be to keep it clean, honest and transparent. The profits will speak for themselves.”

“But 20 years later, Russia is a very different country. The generation that has grown to maturity in the post-Soviet period consists of entrepreneurs (many of whom have studied good business practice in the West) who have learnt how to conduct business cleanly, particularly in partnership with Westerners, they have learnt that profits flow from the application of Western best practice.”

He concludes, “The RBCC always stresses to its members, and any other British commercial organisations considering doing business in Russia, that there is absolutely no need to give bribes or indulge in other corrupt practices in Russia. A foreign commercial organisation has only to do this once – for example, by passing money in a brown envelope – and they are indelibly marked. Such reputations are then almost impossible to lose.”

Read *Responding to the UK Bribery Act 2010* at www.pwc.co.uk/bric



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Tony is PwC UK’s Forensic Services Emerging Markets leader and specialises in civil and criminal financial fraud investigations. He has extensive experience of investigating bribery and corruption (including FCPA) allegations and financial statement fraud.

As PwC’s Asia Pacific leader between 2002 and 2006, Tony was heavily involved in the development of PwC’s Forensic Services business in Asia and so has firsthand knowledge of the region and its business practices.



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Faisal is a qualified Chartered Accountant and joined PwC UK in 2006, having spent six years in the field of forensic accounting in India.

Faisal runs our Forensic Services’ emerging market team and has considerable investigations experience, particularly in developing countries.



Entertainment and Media – a Russian growth story waiting to happen

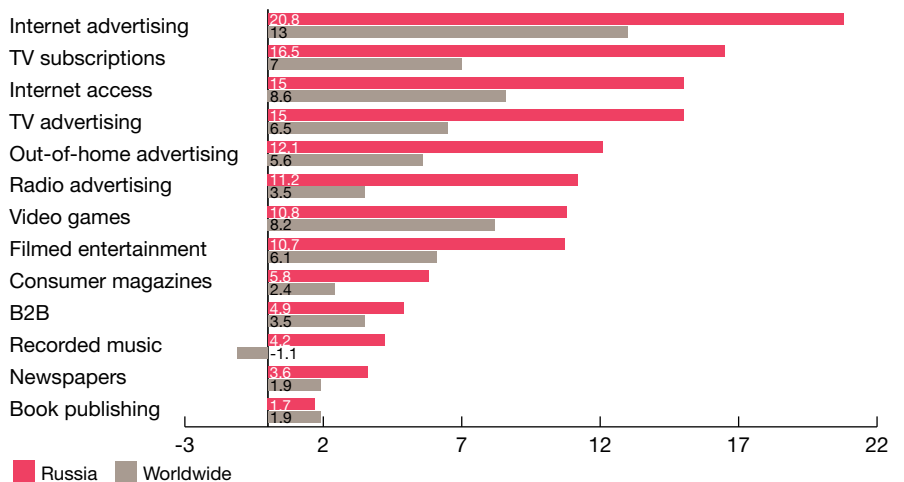
Russia's entertainment and media (E&M) market will be one of the fastest growing in the world over the next few years, expanding at twice the rate of the global average¹. And it is the digital and internet sectors, powered by Russian consumers' strong appetite for new services and content, that are set to grow particularly fast. By 2015 Russia looks likely to be among the top five media markets overall in the EMEA region.

The trends that are driving growth in the Russian market are in many respects fundamentally the same as in others around the world, as entertainment and media becomes an ever more globalised industry. But there are distinct characteristics of the Russian market which mean certain sectors, such as TV advertising – that will see relatively slow rates of growth in much of the world – will continue to show significant advances in Russia.

Overall, growth in nearly every segment of the Russian E&M market will outstrip projected worldwide averages, as shown in the chart below.

In five years, the Russian E&M industry is predicted to double in size, reaching \$35 billion+ in annual revenues. While many of the global trends that are creating

Chart 1: growth rate by segment, Russia vs worldwide



Source: CIRA, Bloomberg

1. Global CAGR 2011-2015: 5.7%, Russia: 11.7% (Source: PwC's *Global Entertainment & Media Outlook 2011-2015*)

growth in markets around the world are also found in Russia, the country's scale and growing prosperity – and a relatively low current consumer base in some sub-sectors – are helping to fuel much faster rates of growth.

Traditional and new media grow together

As the largest country in the world by geographic size, Russia presents some unique challenges and opportunities. For example, extending the infrastructure required for broadband internet coverage across the entire country is clearly a major undertaking, requiring significant investments of time and resources. Broadband internet connections today are available to only approximately 60-65% of the Russian population. But that relative lack of penetration means that Russia will also avoid some of the cannibalisation of TV revenues by online services that are increasingly a feature of media markets in western economies. The growth in television revenues will continue to be strong, as these services reach across the entire country. In fact, Russia's TV advertising market will be the largest in the EMEA region by 2012 and is predicted to grow by 15% over the next four years.

However, it is Russians' burgeoning appetite for digital content and services that will create the fastest growth in the years ahead. By 2015, Russia internet advertising alone is predicted by PwC to double and achieve revenues of more than \$2 billion.

Addressing the digital consumer

Digital consumers want many of the same things that their counterparts in the analogue world require. They are looking for quality, relevance and value. But the nature of digital interactions also means that they want personalised content and services that are tailored to their distinct preferences. They want to be able to consume content how, where and when they choose and they will seek and share the opinions of broad groups of their digital peers through social networking sites. Some major Russian businesses have already started to capitalise on these trends and are achieving market leadership by offering the right combinations of services and, by doing so, growing large and successful businesses.

Local winners, global players

One in particular, Mail.ru, is not only the largest internet business in Russia, it is also now one of the largest internet businesses in Europe. It has made a number of key acquisitions and holds stakes in global players such as Facebook, game app developer Zynga and social discount business Groupon. Mail.ru has leveraged its market leading position as an email provider in Russia to span across the range of online and digital services. As well as mail and portal services, it also operates the two largest instant messaging services in Russia, ICQ and Mail.ru Agent, social networking platforms and the country's largest online gaming platform.

Mobile internet – a growth story for the future

While likely to remain in the near future a relatively minor factor in the overall media market (with only 1% of internet advertising likely to come from mobile) the mobile market is set for rapid growth in the future.

Mobile operators are seeking opportunities to capture a greater share of the digital value chain by acquiring broadband operators and adding value through digital content and services. Much of the present growth in mobile digital platforms is confined to the larger urban centres, such as Moscow and St Petersburg, which are able to support the infrastructure required for mobile internet.

Another fast-growing Russian business, Yandex, is the market leader in the most dynamic online subsector – content search. Yandex has a 60% market share, leading global rivals such as Google and Yahoo, and completed a \$1.43 billion IPO on Nasdaq in May 2011. The search related advertising market already commands 60% of total internet advertising and will become an increasingly competitive market as the opportunities available in Russia continue to grow.

Continued problems with piracy go some way to explain the absence of global players, such as iTunes, in the local market. However, Russian businesses offering digital content are emerging. They are exploring different business models to meet the demands of Russian consumers. Some, such as ivi.ru, are pursuing an advertising funded model while others are going to market with a subscription model for premium content. This includes now.ru that charges users directly for new release local and international video content.

Enter the global majors

The strong prospects for the Russian media market will make it an increasingly attractive proposition for global majors. Some are already marking out their territory with acquisitions and by creating joint ventures. Notable among these are Disney, which has already rolled out a dedicated cable channel, opened retail stores and licensed DVD distribution, and Sony Pictures which has formed a joint venture, Monumental Pictures, with Patton Media Group. And many others are set to follow.

All in all, these are exciting times for the Russian E&M industry. And the buzz is extending way beyond Russia's borders. With all the indicators suggesting that Russia will become one of the largest markets in the world, local and global players are developing the business models and strategies that will enable them to capitalize on growing demand from Russian consumers. Those that are most successful will reap the rewards

from paying the closest possible attention to the changing demands of those consumers in both the digital and traditional sectors. This is a market where the customer, above all else, rules.

This is a market where the customer, above all else, rules.



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Natalia has led PwC Russia's Entertainment & Media practice since 2004.

She works with large-scale Russian and international E&M clients, many of which are leading media holdings companies and content producers in Russia.

Natalia is a regular presenter at key E&M industry events, both in Russia and internationally.

Moscow hotels - more rooms in the inns by 2012

The Hospitality & Leisure team at PwC UK has recently expanded their stable of UK hotel forecasts and have produced a forecast for 17 key European cities, including Moscow.

At the recent launch of the forecast, PwC UK economist Richard Snook outlined indicators which suggest Russia will experience GDP growth of 4.4% in 2011 and 4.3% in 2012. This compares to worldwide GDP growth of 2.9% in 2011 and 3.3% in 2012.

Against this backdrop there is considerable hotel construction currently underway in Russia, with the Sochi Winter Olympics in 2014 and World Cup in 2018 meaning large pipelines for new build hotels.

In Moscow, there are 20 hotels and 4,600 rooms in the pipeline. These will add to the existing 136 hotels with 36,000 rooms, 700 of which have opened in the last year. Over half the city's accommodation is made up of 3-star hotels.

Because of this, our European hotels forecast shows that Moscow will struggle to absorb all the city's new hotel supply additions and occupancy rates will increase by 0.4% in 2011 and 2.5% in 2012, taking the 2012 forecast average occupancy level to 63.9%. This is in the same ballpark as Rome (66.8%) and Frankfurt (66.1%), but falls

short of London at 83.6% and Edinburgh at 81.2%.

PwC UK's Head of Hospitality & Leisure Research, Liz Hall commented, "Despite the lowish occupancy rates we forecast for 2012, our hotel clients suggest that there are significant opportunities for international hotel operators in Moscow. Indicators are leading us to think that revenue per available room (RevPAR) rates in Moscow will increase by 4.1% in 2011 and 5.6% in 2012."

"Those projected RevPAR increases in 2012 rank Moscow at equal fourth place on our table - between Amsterdam (6.5%) and Berlin (5%) and at exactly the same level as Madrid. This is a solid position when you compare Moscow to some of

those at the bottom: Rome at -0.1% and Belfast at -0.9%," Liz added.

As well as Moscow, other cities featured in the European hotels forecast include Berlin, Istanbul, Stockholm, Vienna and 12 others.

To read the full report, please go to: www.pwc.com/hospitality



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As Head of Research for PwC UK's Hospitality & Leisure group, Liz Hall leads on the firm's half-yearly UK Hotels Forecast. She frequently presents on the UK hotel industry at events in both the UK and Europe, and is responsible for producing the inaugural European Hotels Forecast.

Facts & figures: Mongolia

Capital: Ulaanbaatar

Population: 3,133,318 (July 2011 est.)

Major language: Mongolian is the official language (spoken by 95% of the population); there is also a variety of dialects (Oirat and Buryat) and, in the west of the country, Kazakh and Tuvan are spoken. Russian is the most frequently used foreign language, though English has been gradually replacing Russian as the second language.

Monetary unit: The Mongolian Tugrik (after the Australian dollar, the world's best performing currency in 2010)
1 GBP = 1910.3333 MNT

Area: 1,564,115.75 km² – 19th largest in the world

Climate: Mongolia is land-locked. It has an average altitude of 1,500 metres above sea level, is surrounded by high mountains and has an extreme continental climate. Winters are long and very cold; summers are hot but short. The average yearly rainfall is 200-220 mm. Mongolia enjoys 250 sunny, clear days a year, leading to it being known as the “country of blue skies”.

Economy: Economic activity in Mongolia has traditionally been based on herding and agriculture. However Mongolia's extensive mineral deposits have attracted foreign investors. The country holds copper, gold, coal, molybdenum, fluorspar, uranium, tin, and tungsten deposits, which account for a large part of foreign direct investment and government revenues.

In 2010 Mongolia boasted the world's best performing stock market and second fastest growing economy. That same year Mongolia achieved an historical high in foreign direct investment (US\$1.4bn), exports rose by 54% to US\$2.9bn, and coal exports almost trebled. There are currently 5,000 expats in Mongolia and this is forecast to rise to 500,000 within a decade.

Interest rates: The benchmark interest rate in Mongolia is 12.25 per cent. Interest rates decisions are made by the Bank of Mongolia (Mongolbank)

Mongolian Stock Exchange: The Mongolian Stock Exchange (MSE) was founded in 1991 by decree of the Mongolian government to privatise state-owned assets. In 2010 the MSE was the world's best performing stock exchange. Its main index is the MSE Top-20 and in 2011 the market capitalisation of its listed companies was US\$2 billion. www.mse.mn

Natural resources: Mongolia has a diverse landscape ranging from forested mountains and hilly grasslands to vast steppe and deserts. Its economy is dependent on natural resources, and the richest resources are minerals: coal, copper, fluorite, gold, iron ore, lead, molybdenum, oil, phosphates, tin, uranium, and wolfram. It is predicted that the pace of oil production may one day outstrip the revenue generating capabilities of all other Mongolian industries. In fact, experts predict that the Mongolian economy may receive a larger boost from oil than almost all of its natural resources put together.

Main exports: Recently, Mongolia's export market has increased dramatically and now exports goods to 59 countries, with the majority of its products going to China (according to the National Statistics Committee). Its main exported products are copper, coal and oil. Almost 80 % of all its products were exported to China; 75.9 % of its gold was exported to Canada; and 75 % of its spar was exported to Russia.

GDP: National Statistics Office of Mongolia data released in August reveals record GDP growth of 14.3% year-on-year during the first half of 2011 and the Mongolian economy having its best first half of the year in a decade. GDP growth was an incredible 29.1% year-on-year, fuelled by strong mining sector output. Industrial production contributed 19.4% to GDP growth and coal mining surged 39.4%. The share of coal production in mining output increased to 25% in 1H2011 from 20% in the previous period. Iron ore output jumped 279.1% year-on-year. Mongolia remains an attractive destination for foreign investors. Surging investment opportunities and revenues, favourable commodity prices, an abundance of opportunities in the resource sector and an improving business environment brought about a record high FDI of US\$1.44bn in 1H2011, up 127% year-on-year, according to Bank of Mongolia data.

Unemployment rate: 11.5% (2009)

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Mongolian shepherd boy



PwC Mongolia opened its office in Ulaanbaatar in September 2010 and focuses on working with clients in energy, utilities and mining; financial services; communications, entertainment, media and technology; and consumer and industrial products.

As part of its commitment to develop the country's accounting, auditing and financial sectors, PwC Mongolia sponsors a scholarship programme for students studying accounting and auditing in selected Mongolian universities and institutes.

To find out more about PwC Mongolia, please contact

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