



Business and Financial Climate in the Far Eastern region

Deloitte CIS Research Center
Moscow 2018

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Introduction



Sergey Lavsky

Managing Director,
Deloitte CIS,
Vladivostok Office

We are pleased to present the results of our financial climate research of the Russian Far Eastern Federal District.

In recent years, the Russian Far East has been a particular focus for both federal authorities and large Russian and foreign companies. The Far Eastern economy has great growth potential, and the District is taking active steps to increase its investment appeal and to help businesses develop.

In the course of our research, we surveyed top managers of the leading Far Eastern companies. Based on this survey, we tried to measure the sentiment of the business community and identify key strategies and constraints for business development. We placed a strong emphasis on digitalization and innovation strategies implemented by Far Eastern companies. We also tried to gather the most relevant statistical information about the District's economy.

The research covers the following key topics:

- Macroeconomic overview of the Far Eastern economy
- Labor and capital market
- Financial climate

This report has been prepared by the Deloitte CIS Research Center. We hope that you will find it informative and useful.

If you have any questions or suggestions regarding this report, please contact us at cisresearchteam@deloitte.ru.

Key findings

Key economic indicators

Gross regional product (GRP) of the Far Eastern Federal District

- Accounts for about **5.5 percent** of the national figure.
- In 2017, the Far Eastern GRP totaled **RUB 3,960 billion**, and in 2018, it is forecasted to reach **RUB 4,209 billion**.
- **Sixty-four percent** of the District's GRP is contributed by the Republic of Sakha, Primorsky Territory and Sakhalin Region.
- Key economic sectors include the mining industry (**28 percent**) and transport and communications (**13 percent**).

Labor market

- In 1H 2018, the average nominal wage in the Far Eastern Federal District was **RUB 52.8 thousand** per month, which is **24 percent** above the Russian average.
- Moreover, the average subsistence level for all Far Eastern regions is **1.5 times** higher than the average for Russia (**RUB 15.3 thousand** versus **RUB 10.0 thousand**).
- The average value added per worker in the Far Eastern Federal District is **RUB 1,172 thousand** – **22 percent** above the national average according to data for 2016.
- In 1H 2018, the unemployment rate in the District decreased to **5.4 percent**.

Business climate and investments

- In 2017, fixed asset investments in the District amounted to **RUB 1,217 billion**, with an increase of **22 percent** from 2016.
- The leading Far Eastern regions in terms of investment growth are represented by Amur, Yakutia and Sakhalin Regions (**+44 percent**, **+40 percent** and **+25 percent**, respectively).
- At comparable prices, core capital investments in the Far Eastern economy grew by **17.1 percent** in 2017, which is significantly above the national level (**4.4 percent**).

External trade relations

- The District's exports exceed imports by almost **4 times**.
- The main trading partners are China and the Republic of Korea, which account for **27** and **25 percent** of the District's total commodity turnover, respectively.
- Key export categories:
 - oil and oil products – **52 percent**
 - precious stones – **18 percent**
 - fish and seafood – **11 percent**
- Key import categories:
 - machinery and equipment – **35 percent**
 - vehicles – **13 percent**
 - metals – **9 percent**

Financial climate in 2018

The level of financial optimism in the Far Eastern Federal District aligns with the country's average (0.28).

- Financial climate estimates are highly uneven:
 - positive – **55 percent**
 - negative – **27 percent**
- About **half** of the respondents in the Far Eastern Federal District expect a growth in revenues (**52 percent**) and operating profit (**44 percent**).
- One in three Far Eastern companies (**33 percent**) plans to increase its capital expenditures.
- Every third company (**32 percent**) plans to increase its headcount, and **42 percent** report an anticipated salary increase.

Top 3 financing sources:

- Internal sources
- Borrowings from banks in Russia
- Russian and foreign investments

- Companies in the Far Eastern Federal District are more open to Russian and foreign investments than companies in Russia on average.

Uncertainties, risks and development strategies

The level of uncertainty in the District is much higher than the national average, leading to a lower risk appetite.

Risk factors with an extremely negative impact on Far Eastern businesses in 2018–2019:

- Increased business regulation in Russia
- Lower core business revenue
- Weakening of the Russian ruble
- Geopolitical risks
- Stagnation in the Russian economy

The following risks are more important for Far Eastern companies than for companies in Russia on average:

- Higher trade barriers/protectionism
- Weaker external demand
- Increasing cost of capital

In 2019, half of the companies are planning a price increase averaging **8 percent**.

A third of the respondents in the Far Eastern Federal District (**33 percent**) expect additional price increase in 2019 (by an average of **2 percent**) due to the VAT rate's hike to 20 percent.

Priority business strategies for the Far Eastern Federal District in 2018–2019:

- Ongoing cost control
- Cost cutting
- Increase of cash flows
- Increase of domestic production
- Organic growth

The following business strategies are more important for Far Eastern companies than for companies in Russia on average:

- Increase of domestic production
- Expansion into new markets
- Debt reduction

The key development directions for the Russian Far East are the CIS and Asia.



Business customers and innovations



- Overall, 1H 2018 saw a re-alignment of the customer portfolios of Far Eastern businesses (a decrease in the share of state orders and business refocusing on the B2B segment).
- **Forty-five percent** of the respondents in the Far Eastern Federal District report higher profitability through innovations.

Top 3 technological innovations:

- Advanced accounting systems (**50 percent**)
- Full automation of selected business processes/chain of business processes (**50 percent** and **36 percent** respectively)
- Cloud technologies and big data processing solutions (**32 percent** and **27 percent** respectively)

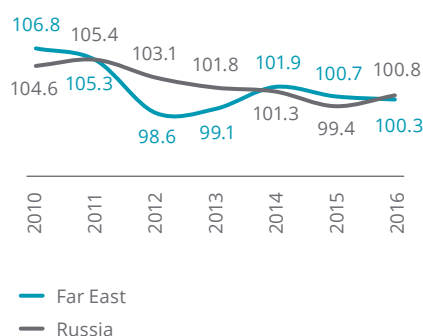
One in two companies in the Far Eastern Federal District (48 percent) does not engage in R&D.

- In 2018, R&D costs of Far Eastern companies averaged **2.0 percent** of their revenues, which is almost half that of the average for Russia (**3.7 percent**).
- R&D is generally carried out by dedicated units within a company, as indicated by **33 percent** of the respondents.
- **Key digitalization drivers:**
 - Management strategy
 - Market and competition
- **Key digitalization barriers:**
 - Access to infrastructure
 - Staffing

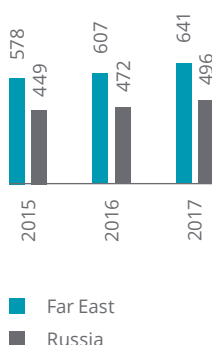
Economy in figures

Gross regional product

**Real GRP,
% from the previous year**



**GRP per capita,
RUB thousand**



Trend

- The GRP of the Far Eastern Federal District makes up around **5.5 percent** of the national figure. It amounted to **RUB 3,960 billion** in 2017 and is projected to reach **RUB 4,209 billion** in 2018.
- In 2010–2016, the District's GRP grew at an average of **1.8 percent** per annum in real terms (net of inflation), which is slightly behind the national average of **2.3 percent**.
- The Far Eastern GRP per capita exceeds the national level by almost one third (**29 percent** as of 2017).

Real GRP forecast for the Far Eastern Federal District

	2017	2018	2019	2020
Physical GRP index, %	2.54%	1.42%	2.04%	2.55%

Highlights

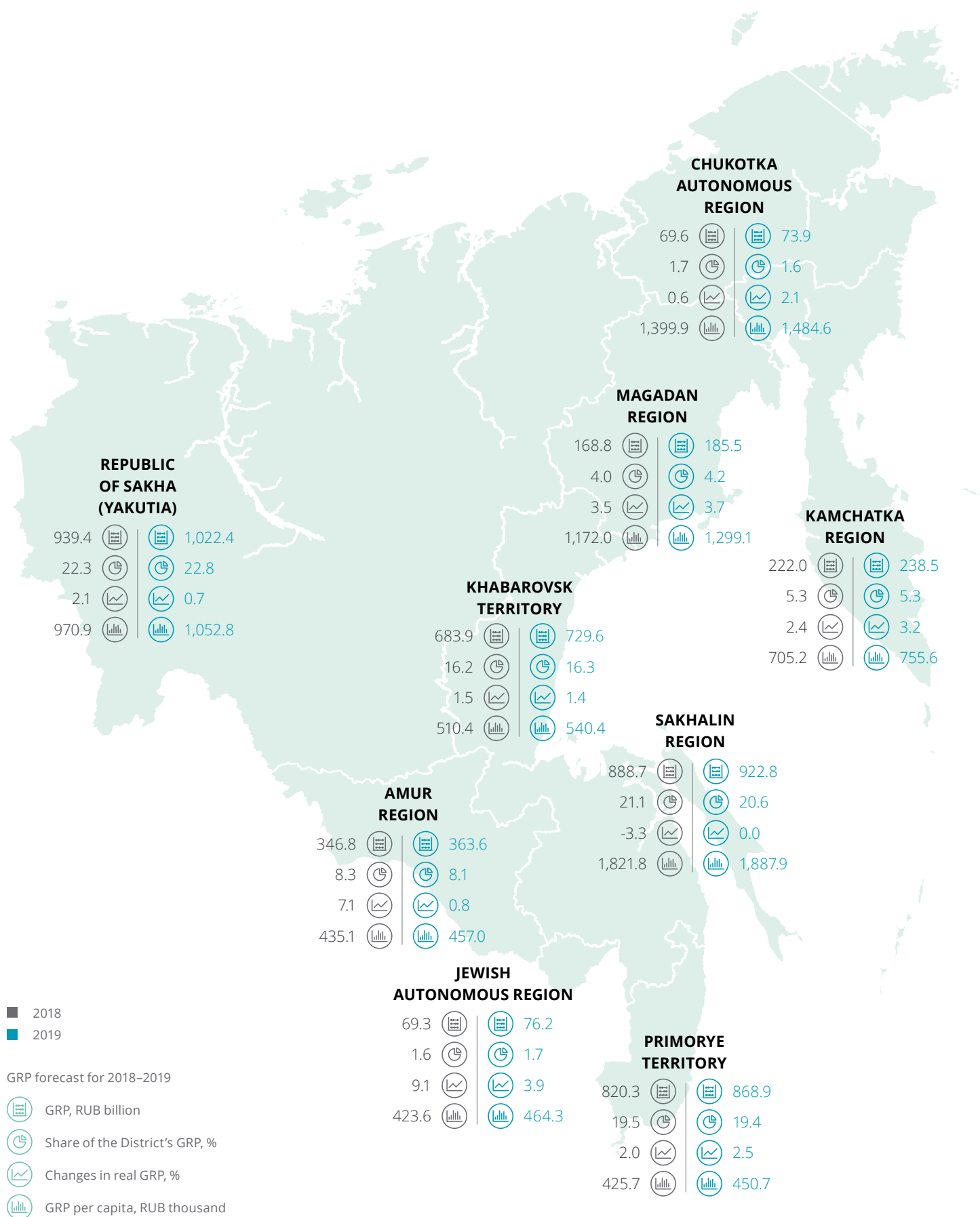
The Republic of Sakha, Primorye Territory and Sakhalin Region lead the way among all the Far Eastern regions in terms of the size of the economy, accounting for **64 percent** of the District's GRP.

According to the base development scenario, the highest mid-term growth of real GRP is anticipated for Far Eastern regions with smaller economies largely influenced by individual investment projects. These are:

- The Jewish Autonomous District (growth forecast for 2018 – **9.1 percent**). The Kimkan and Sutar iron ore concentration projects may also have a significant impact.

- Amur Region (growth forecast for 2018 – **7.1 percent**). This growth will be driven by increasing freight turnovers and construction volumes for the Blagoveshchensk (Russia) – Heihe (China) international border crossing, Power of Siberia natural gas pipeline and Amur Gas Processing Plant near the city of Svobodny, Amur Region (one of the world's largest gas processing plants).
- Magadan Region (growth forecast for 2018 – **3.5 percent**). This progress will be fueled by the development of gold-mining facilities in the Yano-Kolyma gold province and the implementation of investment projects in the energy sector.

On the other hand, the Sakhalin Region is expected to demonstrate a **3.3 percent** GRP decrease in 2018. This is partly due to reduced production for the Sakhalin-II project as part of the Piltun-Astokhskoye reservoir management plan.



Source: Regional Far Eastern governments, social and economic development forecast orders (base scenario)

Structure of the economy

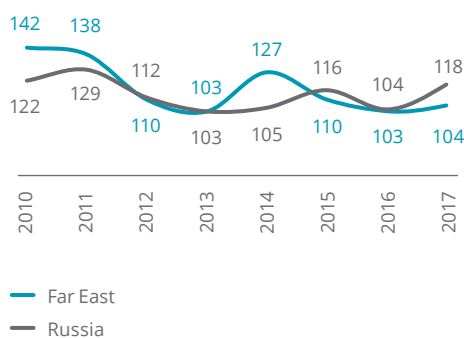
GRP and employment structures

	Economy structure in 2016		Employment structure in 2016		Gross value added per worker RUB thousand
	RUB billion	%	'000 people	%	
Mining	1,059	28	114	4	9,334
Transport and communications	496	13	341	10	1,454
Commerce	398	11	562	17	708
Manufacturing	361	10	416	13	867
Finance and real estate	274	7	245	8	1,118
Agriculture and fishing	267	7	236	7	1,133
Construction	252	7	282	9	894
Healthcare	169	4	225	7	752
Education	135	4	281	9	482
Other	346	9	503	16	687

- Key economic sectors are the mining industry (**28 percent**) as well as transport and communications (**13 percent**). These industries also show the highest added value per worker (**RUB 9,334 thousand** and **RUB 1,454 thousand** respectively).
- Overall, value added per worker averages **RUB 1,172 thousand**, which is **22 percent** higher than for the country as a whole (**RUB 957 thousand**).

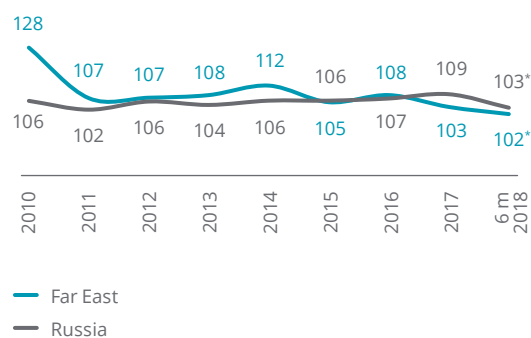
- In the Chukotka Autonomous Region, the Republic of Sakha and Magadan and Sakhalin Regions, the mining industry accounts for **40–55 percent** of the GRP.
- The transport and communication sector has the greatest relevance in the Primorye and Khabarovsk Territories, making up **24** and **20 percent** of their GRP, respectively.

YoY changes in own mining products shipped, %

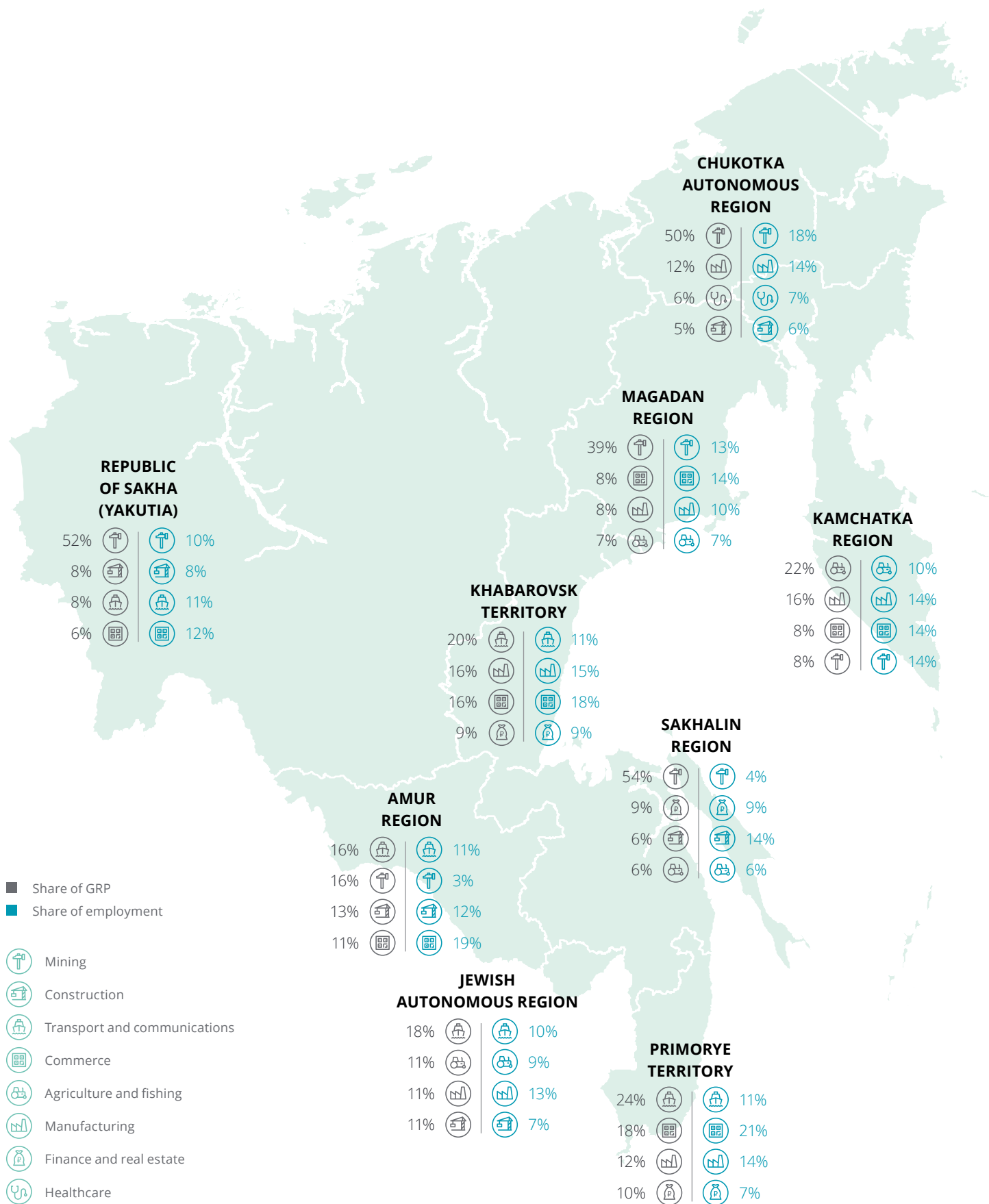


- The Republic of Sakha and the Sakhalin Region account for **78 percent** of the mining products shipped by District in 2017.

YoY changes in the freight moved by sea ports, %



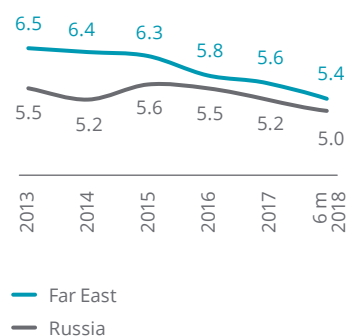
- With **144 million tonnes** of freight moved in 2017, Far Eastern sea ports contribute **25 percent** of the national sea traffic.
- Sixty-two percent of the freight carried within the Far Eastern sea basin is represented by bulk cargo and **38 percent** – by liquid cargo.



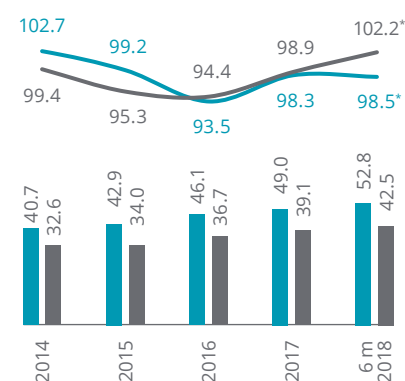
Labor market

- The District's unemployment rate has been reducing since 2013. However, it is still slightly above the national average (**5.4 percent** vs. **5.0 percent** in 1H 2018).
- The average nominal monthly wage in the Far Eastern Federal District is around **25 percent** higher than the all-Russian figure, which adds a burden to businesses due to higher payroll costs.
- In 1H 2018, the highest payroll level (**RUB 98 thousand**) was recorded by the Chukotka Autonomous Region, and the lowest level (**RUB 38 thousand**) – by the Jewish Autonomous Region.
- Higher wages are explained by higher expenses. The subsistence level in various regions of the Far Eastern Federal District is **1.5x** above the country's average (**RUB 15.3 thousand** vs. **RUB 10.0 thousand** in Q1 2018).
- At the same time, real income in the Russian Far East has been falling for three years now starting from 2015, and this trend persists over 1H 2018.
- The average inflation rate in 2017 was **2.07 percent (0.45 percentage points below the national average)**.
- In the previous year, Yakutiya saw the largest increase in prices, and the Amur Region saw the lowest (**4.44 percent** and **1.71 percent**, respectively).
- In 1H 2018, inflation grew **2.08 percent** from December 2017.

Average unemployment rate during the year, %



Changes in real income and average monthly wage



* % from January–June 2017

Changes in real monetary income, % from the previous year

— Far East
— Russia

Average nominal monthly wage, RUB thousand

■ Far East
■ Russia

Human capital development index

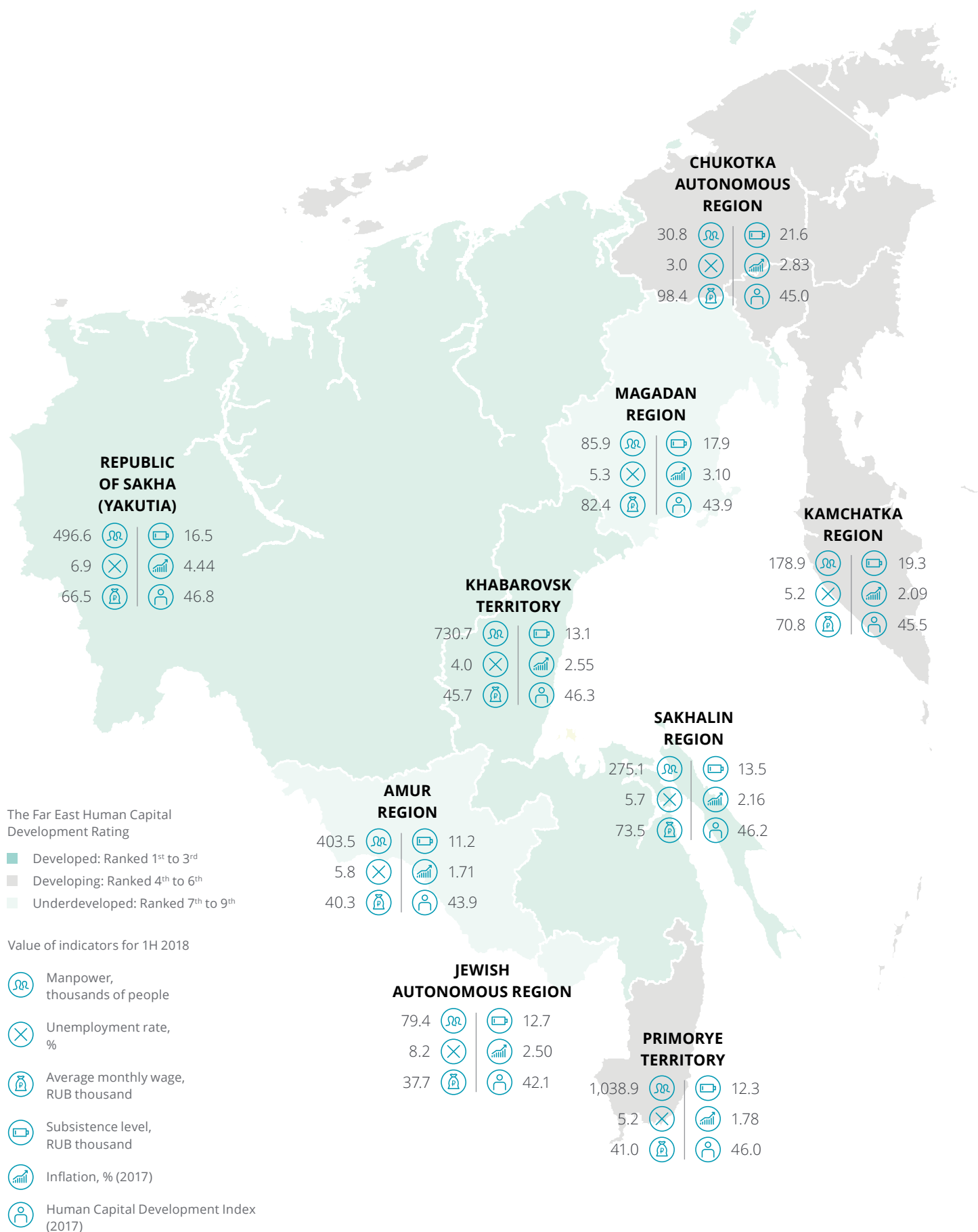
The Far East Human Capital Development Agency calculates an integrated index based on 146 indicators grouped into three categories:

- Population size (demographic and migration data)
- Human capital quality (health and longevity, education and cultural level, economic activity)
- Living standards (welfare, quality of life, safety, labor market environment)

This data is used to generate the overall rating and individual ratings for each of the categories. Based on these ratings, all Far Eastern regions are broken down into three groups (developed, developing and underdeveloped).

The Republic of Sakha leads the pack with an overall rating of **46.8**. This region also has the highest rating for population size (demographic and migration data).

Chukotka Autonomous Region is leading in terms of human capital quality and living standards.



External trade relations

Period: January 2017 – June 2018

- Aggregate exports: **USD 34.4 billion**

Top-3 commodity export categories

Category	Aggregate exports, USD billion	Share in exports
Mineral fuels, oil and oil products	18.0	52%
Precious and semi-precious stones	6.3	18%
Fish and seafood	3.9	11%

Top-5 export markets

Category	Aggregate exports, USD billion	Share in exports
Republic of Korea	9.6	28%
China	7.8	23%
Japan	7.6	22%
Belgium	3.7	11%
India	1.2	3%

- The District's exports exceed imports by almost **4 times**.
- Key trading partners are the Republic of Korea and China.
- The Sakhalin Region accounts for almost half of the exports (**48 percent**), and **22 percent** – by the Republic of Sakha.
- Key export categories:
 - Mineral fuels – **77 percent** of exports are generated by the Sakhalin Region
 - Precious stones – **98 percent** of exports are generated by the Republic of Sakha
 - Fish and seafood – Primorye Territory accounts for nearly **39 percent** of all exports, and Sakhalin and Kamchatka – for **24 percent** each.

- Aggregate imports: **USD 9.2 billion**

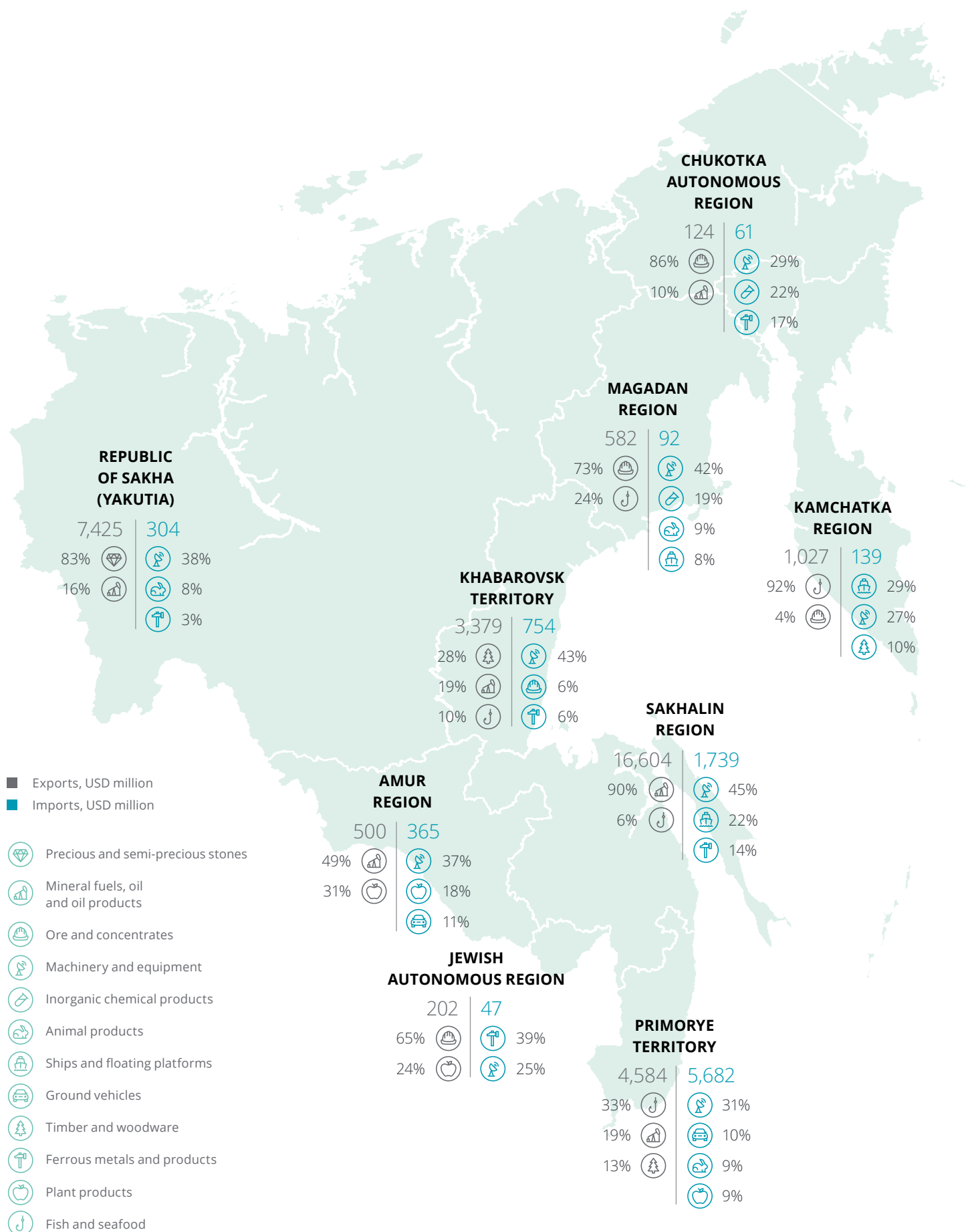
Top-3 commodity import categories

Category	Aggregate imports, USD billion	Share in imports
Machinery and equipment	3.2	35%
Vehicles	1.2	13%
Metals	0.8	9%

Top-5 import markets

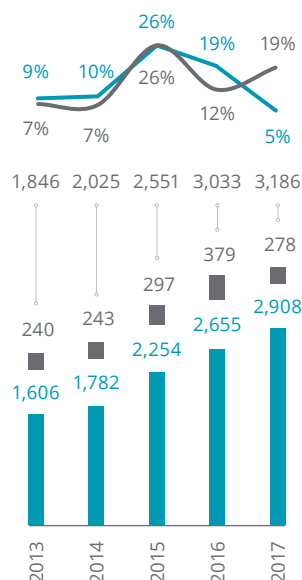
Category	Aggregate imports, USD billion	Share in imports
China	4.2	45%
Republic of Korea	1.2	13%
Japan	0.9	9%
USA	0.6	7%
Brazil	0.3	3%

- Almost **two thirds** of the District's imports (**62 percent**) are attributable to the Primorye Territory, and **19 percent** – to the Sakhalin Region. It is worth noting that the Primoriye Territory is the only region in the Far Eastern Federal District with trade balance deficit (import exceeds export).
- The Far Eastern Federal District mainly imports equipment, vehicles (primarily ships) and ferrous metals.
- Key import categories:
 - Machinery and equipment (Primorye Territory – **55 percent**, Sakhalin Region – **24 percent**)
 - Vehicles (Primorye Territory – **57 percent**, Sakhalin Region – **32 percent**)
 - Metals (Primorye Territory – **46 percent**, Sakhalin Region – **35 percent**).



Small and medium enterprises

Changes in the key performance metrics of SMEs



- Revenues of small and micro-sized businesses in the Far Eastern, RUB bln
- Revenues of medium businesses in the Far Eastern, RUB bln

Changes in aggregate SME revenues, %

- Far East
- Russia

- In 2017, Far Eastern SMEs earned **RUB 3.2 trillion**. However, with its **5 percent** YoY growth rate, the District is well behind the national average of **19 percent**.
- The SME sector creates **20 percent** of jobs in the District.

Source: Rosstat, Federal Tax Service

Government support for SMEs

- In 2016, federal government grants for Far Eastern SMEs totaled **RUB 522 million**.
- Total loans to SMEs issued by the Russian Ministry of Economic Development amounted to **RUB 8.5 billion** in 2016.

Source: Small and Medium Businesses in Russia–2017 (statistical digest)

The Affordable Loans for SMEs Program

implemented in collaboration with the leading Russian banks, seeks to support and facilitate the development of small and medium-sized businesses in the Russian Far East. There are two standard loan products: a working capital loan (maximum maturity: 3 years, maximum interest rate: 12.5 percent p.a.) and an investment loan (maximum maturity: 10 years, maximum interest rate: 13.5 percent p.a.).

Progress as of September 2017:

- Number of projects financed: **382**
- Total cost of the projects: **RUB 9.6 billion** (businesses, the Far East Development Foundation, and banks invested **RUB 4.4 billion, RUB 3.0 billion** and **RUB 2.2 billion**, respectively)
- Number of businesses financed: **332** (micro-sized businesses – **258**, small businesses – **67**, medium businesses – **7**)
- Number of new jobs: **7,000**

Source: Far East Development Foundation

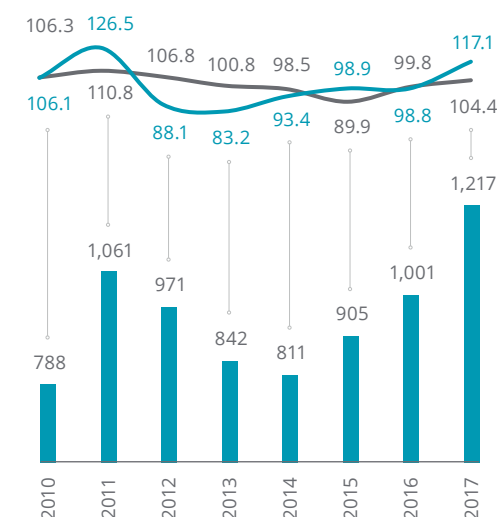
Far-Eastern Hectare

- During its first two years, this initiative yielded some 120 thousand land plot applications (**41 percent** – for a main house, **13 percent** – for a country house (“dacha”) and **46 percent** – for business purposes). The last category is represented by agricultural, tourism and other business projects (**26, 12** and **8 percent** respectively).
- As of July 2018, **42.2 thousand** applicants received a land plot, **7.5 thousand** obtained approval and the remaining **70 thousand** were under consideration. The average rejection rate for all regions is **4 percent**.
- **Four out of five** applications are filed by the District’s residents. Other Russian regions are primarily represented by Moscow and Moscow Region (3.7 thousand applications), Saint Petersburg and Leningrad Region (1.4 thousand applications), Krasnodar Territory (730 applications) and Sverdlovsk Region (around 700 applications).
- The highest demand has been recorded for land in Primorye Territory, the Republic of Sakha, Khabarovsk Territory and Sakhalin Region, with 47.4 thousand, 20.4 thousand, 17.3 thousand and 15.2 thousand applications, respectively.
- Applicants can enjoy 35 government support measures including beneficial borrowing conditions, government grants and promotion programs. However, only 1.6 thousand applicants have used these measures over the program’s life (i.e. less than 4 percent of the total number of applicants who received a land plot). Government support granted totaled RUB 257 million (an average of RUB 160 thousand per applicant).

Source: На Дальний Восток.рф federal information system

Investments

Changes in core capital investments



■ Changes in core capital investments in the Far East, RUB bln

Index of core capital investments, comparable prices, %:

— Far East

— Russia

- The Far Eastern Federal District has seen an increase in core capital investments since 2014. In 2017, investments totaled **RUB 1,217 billion** (**22 percent** growth YoY).
- The Amur Region, the Republic of Sakha and Sakhalin Region lead the way in terms of investment growth (**+44 percent**, **+40 percent** and **+25 percent**, respectively).
- At comparable prices, core capital investments in the Far Eastern economy grew by **17.1 percent** in 2017, which is significantly above the national level (**4.4 percent**).

More than 50 percent of the total 17-percent investment growth is attributable to residents of TASEGs (Territories of Advanced Social and Economic Growth) and the Free Port of Vladivostok. These include foreign investors that invested over RUB 90 billion in the District's economy – 26 percent of the total foreign investments in the Russian economy in the previous year."

Aleksandr Galushka
Minister for the Development
of the Russian Far East
until May 2018

Successful Far East investment projects

Project	Investor	Amount invested in 2017 (aggregate)	Region	Expectations
Natalka Mining and Processing Plant	PJSC Polyus	RUB 60 billion (RUB 126–158 billion)	Magadan Region	<ul style="list-style-type: none"> • Five percent increase in annual gold production • Status of the world's second largest gold producer for Russia (No. 1 is China).
Kimkano-Sutar Mining and Processing Plant (Iron ore)	Petropavlovsk – Iron Ore LLC	RUB 23.5 billion	Jewish Autonomous Region	<ul style="list-style-type: none"> • The plant will be completed in late 2018 • Upon commissioning of the Nizhneleninskoye – Tongjiang bridge, production will be export oriented.
Production of planed and dimensional timber	Amur Timber Company (RFP Group)	RUB 7.5 billion (RUB 12 billion)	Khabarovsk Territory (Komsomolsk TASEG)	<ul style="list-style-type: none"> • Forty percent increase in timber production and 80 percent increase in wood pellet production by 2020
Pig breeding facility	JSC Mersi Agro Sakhaklin	RUB 2.3 billion	Sakhalin Region (Yuzhnaya TASEG)	<ul style="list-style-type: none"> • Construction of an advanced pork processing plant to be launched in 2019 • Covering regional demand
Amur Oil Extracting Factory	Amuragrocenter LLC	RUB 2.4 billion	Amur Region (Belogorsk TASEG)	<ul style="list-style-type: none"> • Production of soy protein isolate to meet 65 percent of the domestic demand
Production of container board and corrugated packaging materials	LLC USSURIYSK Industrial Park	RUB 1.2 billion (RUB 2.8 billion)	Primorye Territory, Free Port of Vladivostok	<ul style="list-style-type: none"> • Phase-out of the District's imports (corrugated packaging)

Investments

Government support for Far Eastern investment projects

TASEGs

The Far Eastern Federal District has 18 TASEGs designed to facilitate international competitiveness and market expansion in the Asia-Pacific countries.

Results for 2017:

- Number of TASEG residents: **251**
- Total investments: **RUB 2,720 billion**
- Anticipated number of jobs – **43 thousand**

“Two hundred new companies and 15 thousand new jobs will appear in Far Eastern TASEGs and the Free Port of Vladivostok by the end of 2018. By 2020 we will have as many as 350 new companies and 34 thousand new jobs.”

Aleksandr Krutikov
Deputy Head of the Ministry
for the Development of the Russian Far East

Benefits and preferential treatment

TASEG		FPV
Income tax		
0% 5%*	year 1–5	0%
12%	over 5 years	12%
Land tax		
0%	year 1–5	0%
Property tax		
0%	year 1–5	0%
to 2.2%**	over 5 years	from 0.5% to 1.1%**
Unified social tax		
7.6%	year 1–10	7.6%

* For Kamchatka Krai

** Depending on the region

Free Port of Vladivostok

An area with special regimes in customs, tax, investment, and related regulation. The special regime extend to the key harbors of the Far East (the Khabarovsk Krai, the Sakhalin Region, the Kamchatka Krai, the Chukotka Autonomous District, and the Primorsky Krai).

Results for 2017:

- Number of residents: **432**
- Total investments: **RUB 366 billion**
- Number of new jobs: **36 thousand**

Social and Economic Development of the Russian Far East and the Baikal Region Government Program

The program aims to create conditions for advanced social and economic development of the Russian Far East, as well as the Irkutsk Region, the Republic of Buryatia and the Trans-Baikal Krai, ensure support to local investment projects and improve the District's investment appeal. The program includes a federal target initiative focused on the development of the Kuril Islands in 2016–2025.

KPI	2017			2025
	(actual performance)	(target)	Progress	(target)
Accumulated investments	RUB 294 billion	RUB 202 billion	146%	RUB 2,352 billion
Number of jobs	23.6 thousand	15.8 thousand	149%	113.1 thousand
Population increase	10.6 million people	10.7 million people	—	11.2 million people
Tax collection	RUB 1,006 billion	RUB 1,062 billion	95%	RUB 2,113 billion

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Funding***, RUB mln	13,586.1	20,516.9	20,552.6	20,306.8	46,652.3	46,652.3	46,652.3	46,652.3	46,652.3

*** Pursuant to Russian Government Decree No. 362 “Amendments to the Russian Government Program ‘Social and Economic Development of the Russian Far East and Zabaikalye Territory’” dated 30 March 2018

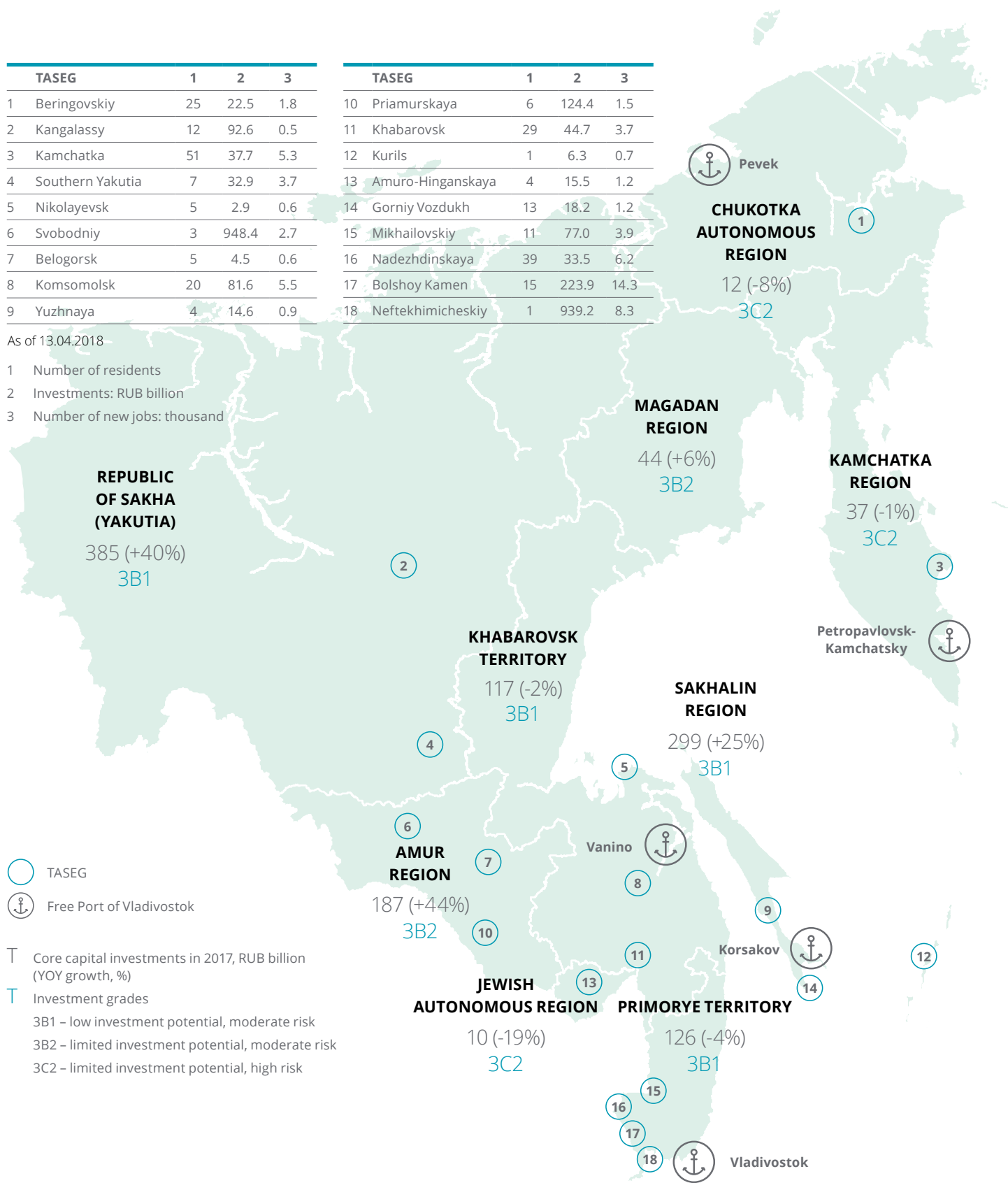
Source: Russian Far East Development Ministry, Russian Far East Development Corporation

TASEG	1	2	3
1 Beringovskiy	25	22.5	1.8
2 Kangalassy	12	92.6	0.5
3 Kamchatka	51	37.7	5.3
4 Southern Yakutia	7	32.9	3.7
5 Nikolayevsk	5	2.9	0.6
6 Svobodniy	3	948.4	2.7
7 Belogorsk	5	4.5	0.6
8 Komsomolsk	20	81.6	5.5
9 Yuzhnaya	4	14.6	0.9

TASEG	1	2	3
10 Priamurskaya	6	124.4	1.5
11 Khabarovsk	29	44.7	3.7
12 Kurils	1	6.3	0.7
13 Amuro-Hinganskaya	4	15.5	1.2
14 Gorniy Vozdukh	13	18.2	1.2
15 Mikhailovskiy	11	77.0	3.9
16 Nadezhdinskaya	39	33.5	6.2
17 Bolshoy Kamen	15	223.9	14.3
18 Neftekhimicheskij	1	939.2	8.3

As of 13.04.2018

- 1 Number of residents
 2 Investments: RUB billion
 3 Number of new jobs: thousand



- T Core capital investments in 2017, RUB billion (YOY growth, %)
- T Investment grades
- 3B1 – low investment potential, moderate risk
- 3B2 – limited investment potential, moderate risk
- 3C2 – limited investment potential, high risk

Source: Russian Far East Development Ministry, Russian Far East Development Corporation

News

Top news: Russian Far East and China

21 August 2018

China proposed to build a high-speed highway between Vladivostok and the Chinese border city of Suifenhe

The cost of the project is estimated at USD 7 billion, the highway will be 180 km long.

20 August 2018

Chinese conglomerate CCCC will conduct dredging work in the Primorsky Krai

China Communications Construction Company Ltd. (CCCC) won a tender to conduct work for LLC Shipbuilding complex Zvezda for RUB 15.3 billion.

11 July 2018

Dongjin Group (China) to invest USD 120 million in an agricultural cluster in Khabarovsk Territory

The joint project agreement envisages the construction of a dedicated seaport for agricultural shipments, and the development of agricultural storage infrastructure.

13 February 2018

Dung Dairy Farming to invest USD 302 million in milk production in the Russian Far East

A memorandum of intent between Dung Dairy Farming and the Mikhaylovskiy TASEG outlines an agreement to implement an investment project involving the construction of animal farming units in Primorye Territory.

Top news: Russian Far East and Japan

28 May 2018

Iida Group Holdings to consolidate Primorsklesprom

The Japanese investor intends to build two added-value wood conversion and timber production facilities in Primorye Territory. A portion of their products will be exported and the rest will be used in the manufacturing of prefabricated houses. The company's investments into Russia may reach as much as USD 220 million.

25 May 2018

A USD 85 million soy and rapeseed growing facility to be constructed in Primorye Territory

Sojitz Corporation (Japan) and MKR Capital (Russia) signed a memorandum to implement a full-cycle soy and rapeseed production facility in Primorye Territory.

24 May 2018

Mitsui (Japan) to establish a ship management company in Primorye Territory

Japanese ship operator Mitsui O.S.K. Lines Ltd. intends to establish a ship management company in Primorye Territory for managing ships and storage barges.

15 December 2017

A new engine plant to appear in Primorye Territory

Mazda Sollers – a Russia-Japan JV resident in the Nadezhdinskaya TASEG in Primorye Territory will invest RUB 5 billion in the construction of an engine plant. Previously, the company invested RUB 3 billion in a local car manufacturing project.

Center for International Cooperation on Russkiy Island

- In the course of the Eastern Economic Forum–2017, the Far East Development Foundation and the Silk Road Research and Planning Center signed an agreement as part of the preparation and implementation of a project to establish the Center for International Cooperation on Russkiy Island (Vladivostok). The project investments totaled **RUB 45 billion**.

Russian-Japanese investment platform (JPPV)

- In April 2018, the Far East Development Foundation, the Far East Investment and Export Agency, and Japan Bank for International Cooperation created a platform to promote Japanese investments in the Russian Far East.
- The key objective is to facilitate Japanese investments in the Far Eastern TASEGs and the Free Port of Vladivostok and to provide end-to-end support to investors, from investment decision through project launch.
- Over the first few months the platform yielded **four projects** with a total worth of **RUB 3.5 billion**.

Business calendar

Vladivostok

2nd International Environmental Festival
GreenFest

27-29 September 2018

26th International Construction Trade Show
27-29 September 2018

Vladivostok Russkiy Island

22nd Annual ASPA Conference

3-5 October 2018

Russian Meetup: APR IT Community Forum
5-6 October 2018

International Active Living Trade Show
ActiveLife Expo

15-17 November 2018

5th International Medical Technology,
Equipment and Products Trade Show
MedHealth Expo

15-18 November 2018

Moscow

New Projects in Eastern Siberia
and the Far East: 3rd Annual Eastern Oil
and Gas Forum and Trade Show

3-4 July 2019

Khabarovsk

20th Interregional Amur Trade
and Industry Fair-2018

20-23 September 2018

21st World of Medicine Trade Show Health
and Beauty TourExpoService-2018

20-23 September 2018

Science. Education. Youth Policy.
Trade Show-2018

20-23 September 2018

22nd Far Eastern Transport. Special-purpose
Machinery, Vehicles and Transportation
Trade Show-2018

20-23 September 2018

Yakutsk

Telecommunications. Safety-2018:
8th Interregional Information
Technology Fair.

6-8 November 2018

8th Interregional Fair
SAKHAPROMEXPO-2018

6-8 November 2018

16th Interregional Fair Northern
Construction Industry. Energy Industry.
Utilities Sector-2019

12-14 March 2019

Interregional Fair MEDEXPO.
Health and Beauty – 2019

3-5 April 2019

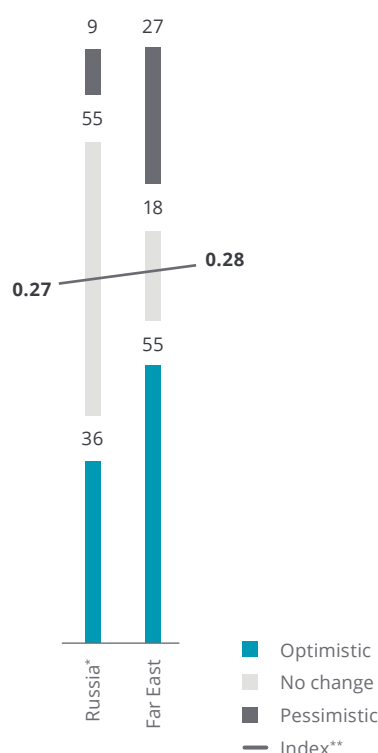
Financial climate

Outlook for businesses

Financial prospects

In July 2018, Deloitte CIS surveyed businesses operating in the Far Eastern Federal District. When analyzing the survey findings, we compared them with the insights from the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia.

? What do you think of your company's financial prospects today as compared to the situation 6 months ago (early 2018)? (%)



Trend

- Overall, the Far Eastern respondents are rather optimistic about financial prospects. The District demonstrated the same level of sentiment (**0.28**) as the country as a whole.
- More than half of the Far Eastern respondents (**55 percent**) expressed an optimistic view of their company's future financial position. This is inconsistent with the views of CFOs from other Russian regions who generally do not expect significant changes – this response was given more often than in the Far Eastern Federal District (by **37 percentage points**).
- A pessimistic scenario was more often voiced in the Far East. The share of this response exceeds the national average by **18 percentage points**.
- The differences in the views in the Far Eastern Federal District and nationwide generally indicate differences in the business environment across various segments.

Highlights

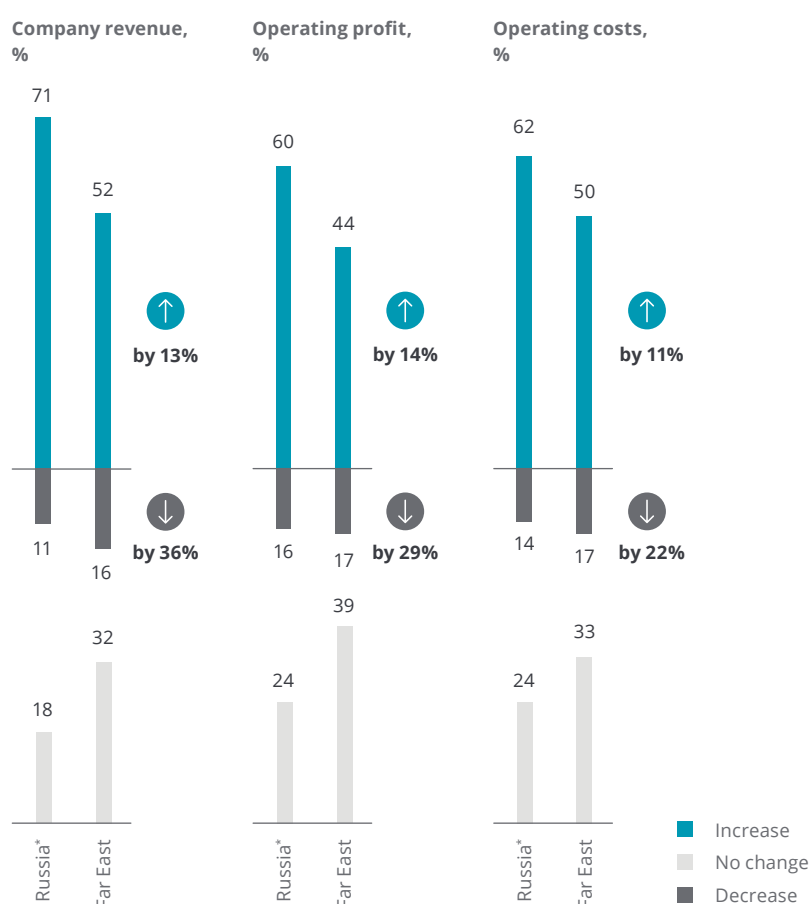
- Companies with revenues from **RUB 2 to 10 billion** were the most optimistic. The share of CFOs who gave an optimistic response is **28 percentage points** higher than the average figure.
- Consumer sector representatives also reported higher-than-average (**+23 percentage points**) estimates of the business outlook for their companies.
- Pessimistic sentiments were recorded for the oil and gas and energy sectors, and for companies with revenues less than **RUB 2 billion (43 percent each)**.

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

** Index: weighted balance of respondents on a scale of -1 to 1 where 1 percentage point equals 0.01

Expected changes in key corporate financial metrics

? What changes do you expect in the key metrics of your company over the next twelve months?



Trend

- Revenue and operating profit growth expectations in Russia as a whole are higher than in the Far Eastern Federal District.
- Currently, half of the Far Eastern companies surveyed (**52 percent**) expect their revenues to grow by an average of **13 percent**, and only **44 percent** anticipate an operating profit growth by an average of **14 percent**.
- Changes in operating costs are expected by two thirds of the respondents (**67 percent**), with most of them (**75 percent**) more inclined to predict an increase in costs by **11 percent** on average.

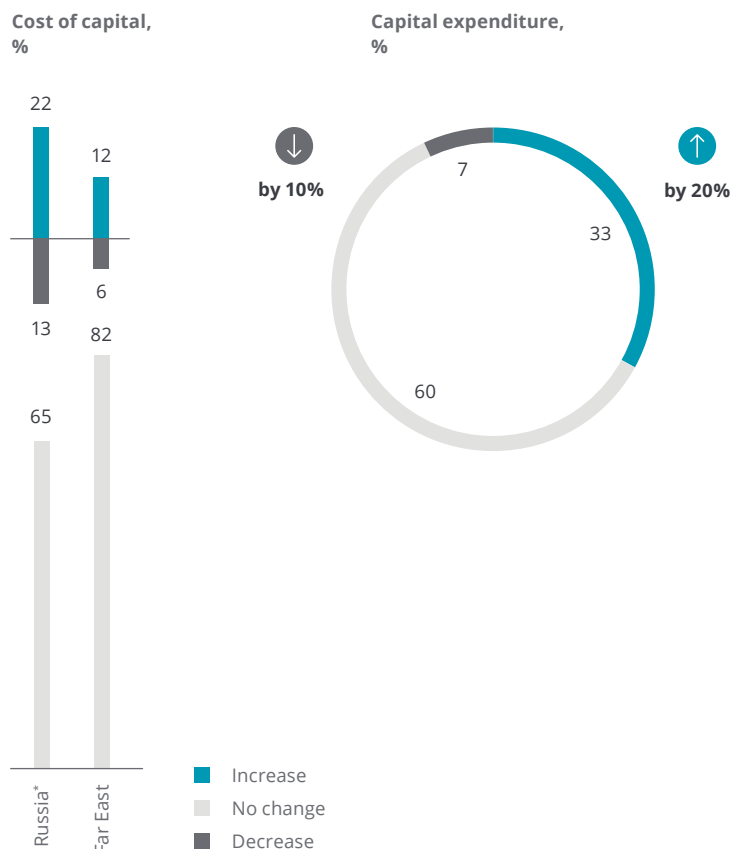
Highlights

- Revenue growth, on the other hand, is more often anticipated by the oil and gas and energy sectors (**57 percent**) as well as companies with revenues from RUB 2 to 10 billion (**60 percent**).
- Companies with revenues from RUB 2 to 10 billion tend to project an increase in operating revenues. The share of this response for this category is **16 percentage points** above the average.
- An increase in operating costs is more often expected by companies with revenues of less than RUB 2 billion (**23 percentage points** above the average).

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

Expected changes in key corporate financial metrics

? What changes do you expect in the key metrics of your company over the next twelve months?

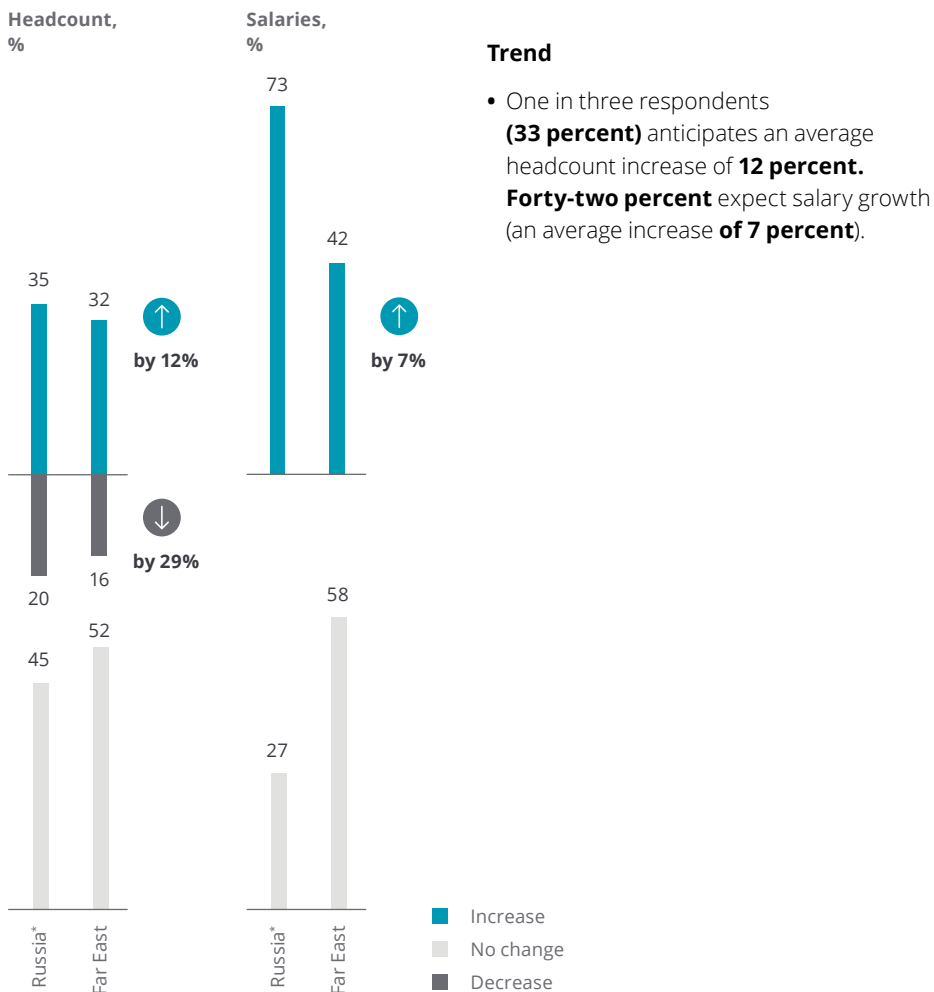


- An absolute majority of the Far Eastern businesses surveyed (**82 percent**) do not expect significant changes in capital costs. Only **12 percent** anticipate an increase in the cost of capital.
- Over half of the companies surveyed (**60 percent**) think that their capital expenditure will remain flat. At the same time, one in three respondents (**33 percent**) anticipates an upward trend, the average estimate being **+20 percent**.

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

Expected changes in key corporate financial metrics

? What changes do you expect in the key metrics of your company over the next twelve months?

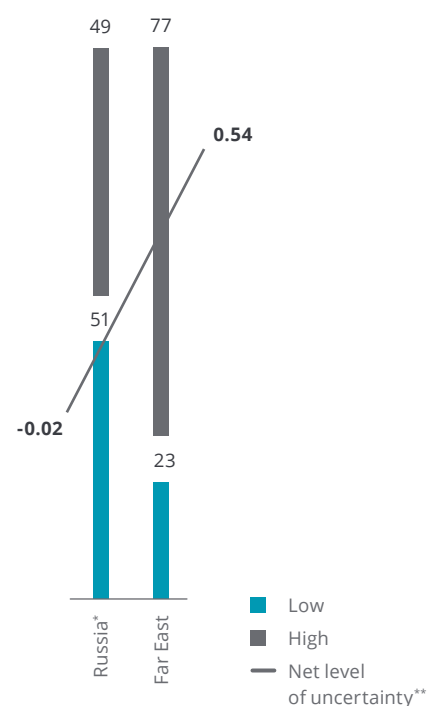


* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

Uncertainty and risks

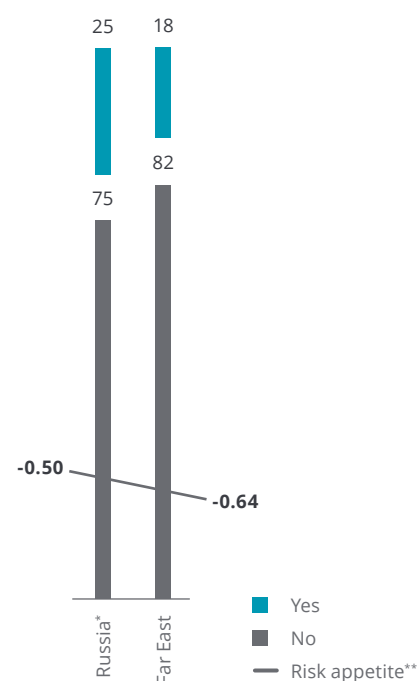
? What is your assessment of political and economic uncertainties affecting the strategic decision-making in your company?

Uncertainties in strategic decision making, %



? Do you think now is a good time to take risky decisions impacting your business?

Risk appetite, %



Trend

- The level of uncertainty in the Far Eastern Federal District significantly exceeds the national level. The net level of uncertainty for the District is **0.54**, being **56 points** above the Russian average.
- The majority of the Far Eastern respondents (**77 percent**) rate the current political and economic situation as highly uncertain.
- Given that the national CFO survey was held in March 2018, the high uncertainty level of the today's political and economic environment cited by the Far Eastern Federal District may be attributable to recent political developments such as new US sanctions against Russia introduced in May 2018.
- A rather high level of uncertainty reported by the Far Eastern respondents resulted in a subdued risk appetite (**-0.64 – 14 points** below the national average).

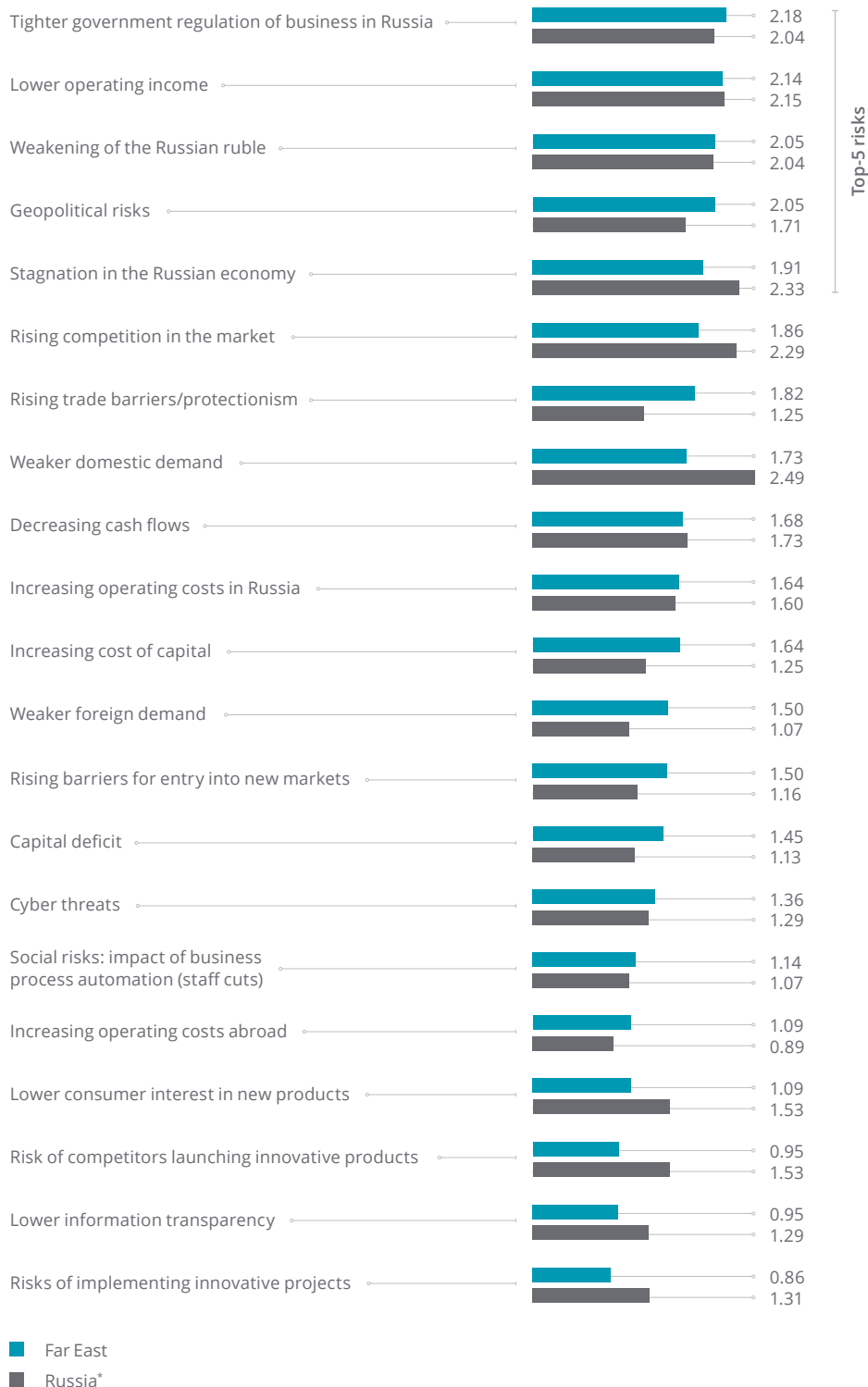
Highlights

- Eighty-three percent of the Far Eastern companies surveyed with revenues of RUB 2 to 10 billion cite a high level of uncertainty, and none of the respondents in this group are prepared to make risky decisions.
- Companies with annual revenues over RUB 10 billion are more likely to take risks (by **26 points**).

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

** Index: weighted balance of respondents on a scale of -1 to 1 where 1 percentage point equals 0.01

Key risks for businesses in the Far Eastern Federal District in 2018–2019



- Tighter government regulation is seen as a key risk, which is estimated to be significantly higher than the average for Russia (by **14 points**).
- Also, respondents from the Far Eastern Federal District are more concerned with geopolitical risks (by **34 points** than in Russia on average). This may be because of the higher level of uncertainty driven by the new sanctions against Russia introduced after March 2018 when the national CFO survey was conducted; higher trade barriers/protectionism (**+57 points**) and an increase in the cost of capital (**+39 points**).
- At the same time, the Far Eastern respondents are less concerned with the risks having the largest impact on the business environment in Russia according to the national CFO survey, such as weaker domestic demand, stagnation in the Russian economy and rising competition (**76, 42 and 43 points** respectively).
- Importantly, risks relating to innovative products were rated the lowest among all the key risks and significantly lower than in Russia on average.

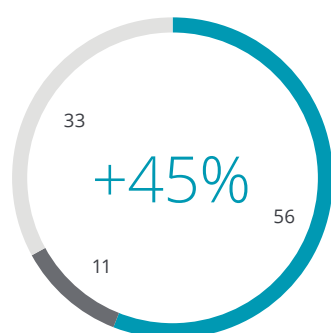
* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

Impact of recent developments on Far Eastern businesses

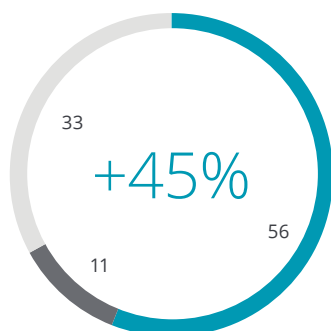
? What impact have these events had on your company?

Positive impact

Establishment of TASEGs, %

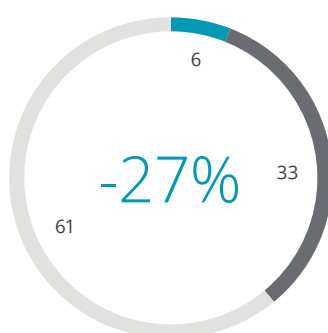


Establishment of the Free Port of Vladivostok, %

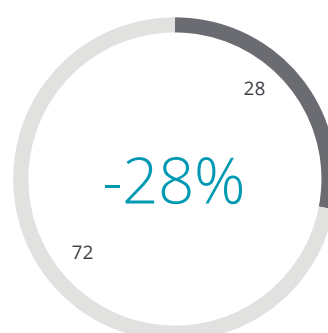


Negative impact

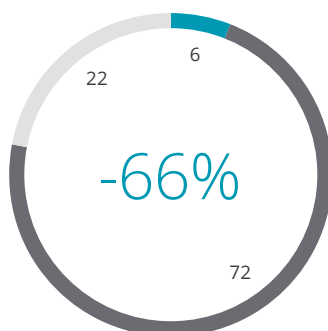
Draft law on the raising of the retirement age, %



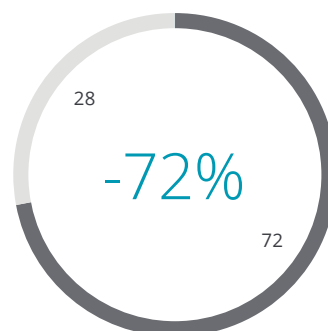
Adoption of the Yarovaya Law, %



Draft law on VAT increase to 20%, %



Introduction of US sanctions against Russia, %



■ Positive
■ No impact
■ Negative

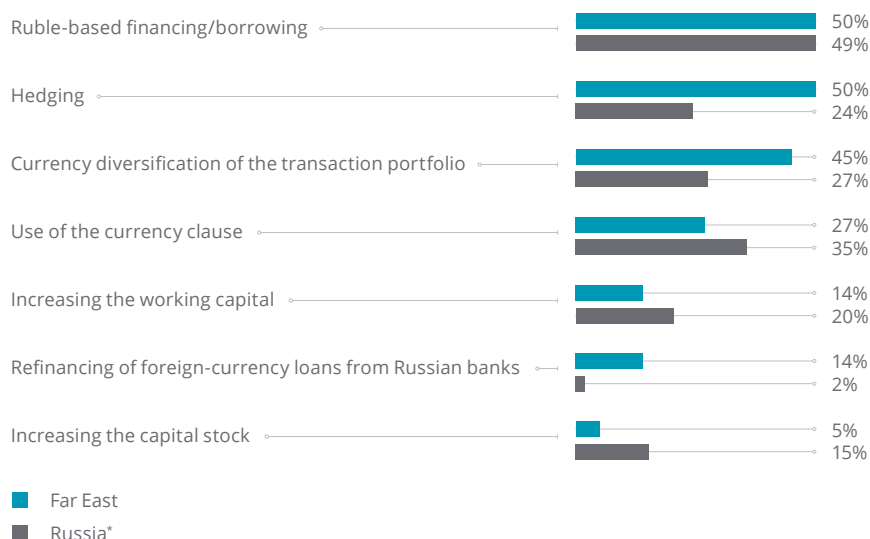
■ Positive
■ No impact
■ Negative

- More than half of the Far Eastern respondents noted a positive impact from TASEGs and the Free Port of Vladivostok (the overall impact was rated at **+45 percent**).
- The impact of these developments is estimated as extremely positive by companies with revenues over RUB 2 billion (**19 percentage points** above the average). At the same time, representatives of oil and gas and energy companies more often (by **13 percentage points**) indicate a negative impact from TASEGs.

- The majority of the District's respondents believe that the passing of the draft law on the raising of the retirement age and the Yarovaya Law will not have an impact on their companies. These responses were given by **61 percent** and **72 percent** of the respondents, respectively. However, around one third of the respondents assess the impact of the above events as negative (**33 percent** and **28 percent**, respectively).

- The draft law for the 20% VAT and the new US sanctions against Russia will have a negative impact on businesses according to the estimations of most respondents. The overall impact is estimated at **-66 percent** and **-72 percent** respectively).
- US sanctions present higher concerns for oil and gas and energy companies and companies with revenues of over RUB 10 billion (by **14** and **16 percentage points**, respectively).

Currency risk management



Trend

- Companies adapt their currency risk management strategies to the market environment. Ruble-based financing and hedging both came out as the number one risk mitigation strategy used by the Far Eastern respondents (**50 percent** each).
- We noted that ruble-based financing is equally popular in the Far East and nationwide, while hedging is widespread in the Far East by a margin of two to one (by **26 percentage points**).

Highlights

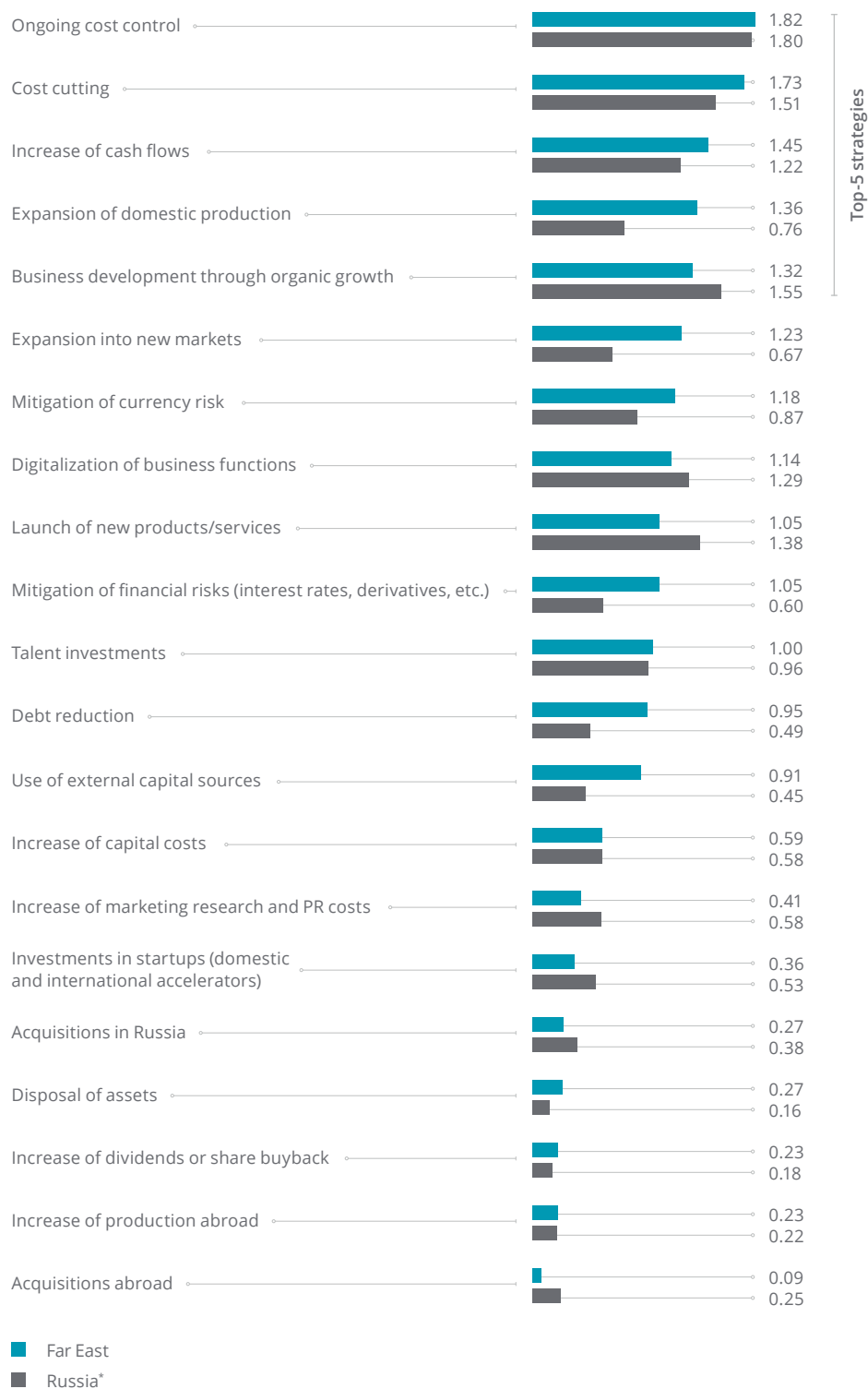
- Ruble-based financing/borrowing has higher appeal for consumer sector companies and companies with revenues of less than RUB 2 billion (**28 and 21 percentage points** above the District's average, respectively). In addition, smaller businesses more often tend to use a currency clause in their contracts (**16 percentage points** above the District's average).
- Hedging is the most attractive strategy for companies with annual revenues over RUB 10 billion (**28 percentage points** above the District's average).
- Currency diversification of the transaction portfolio is the favorite risk management strategy of the oil and gas and energy sectors (**12 percentage points** above the average).

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

** Fixing finished product prices in a currency other than currency of contract

Business development strategies

Priority business strategies in 2018–2019



Trend

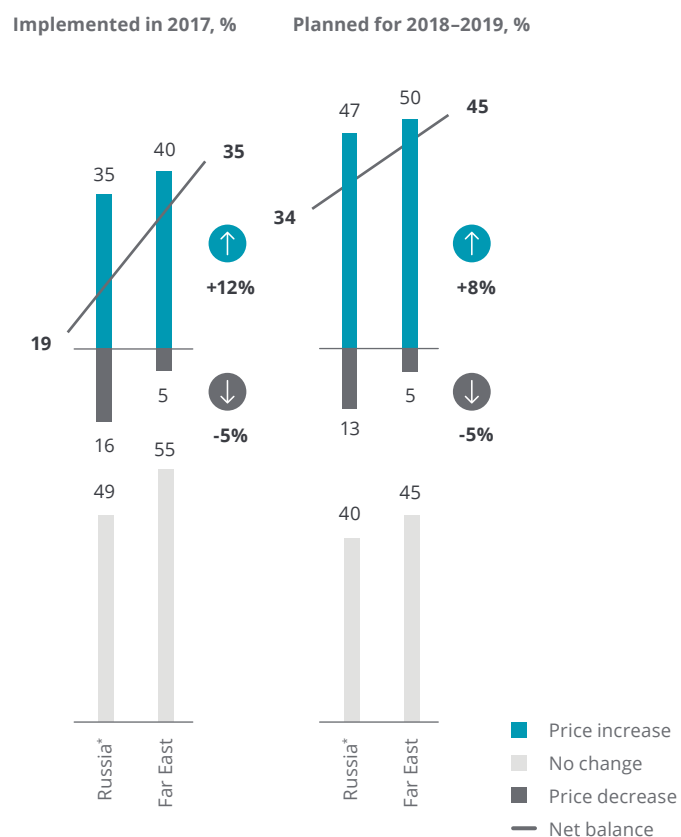
- Ongoing cost control is the unrivaled leader both in the Far Eastern Federal District and in Russia in general, with an index of **1.82** and **1.80**, respectively. The following two strategies in the Far East ranking differ from those identified for Russia as a whole.
- Cost cutting ranks second, with an index of **1.73**, which is **22 points** above the national figure). Increase of cash flows, with an index of **1.45**, is the third favored strategy.
- Increase of domestic production and expansion into new markets hold much higher appeal for Far Eastern businesses than for Russia as a whole (the Far East index exceeds the national index by **60** and **56 points**, respectively).
- Notably, digitalization and the launch of new products are used below average (by **15** and **33 points**, respectively).

Highlights

- Organic growth and cost cutting are more often rated as relevant strategies by companies with revenues less than RUB 10 billion (by **34** and **26 points** respectively). Oil and gas and energy companies hold the same view.
- Experts from the consumer sector favor an increase in domestic production **20 points** above the average.
- Debt reduction is more highly rated by companies with revenues less than RUB 2 billion (by **34 points**).

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

Pricing policies



Trend

- Over half of the Far Eastern respondents (**55 percent**) reported that their companies did not change their pricing policies in 2017. However, another **40 percent** of the companies surveyed increased their prices by an average of **12 percent**.
- In 2019, half of the companies are planning a price increase averaging **8 percent**.
- Remarkably, price increases are primarily anticipated in the oil and gas and energy sectors (**71 percent**).
- A third of the respondents in the Far Eastern Federal District (**33 percent**) expect additional price increase in 2019 (by an average of **2 percent**) due to the VAT rate's hike to 20 percent.

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

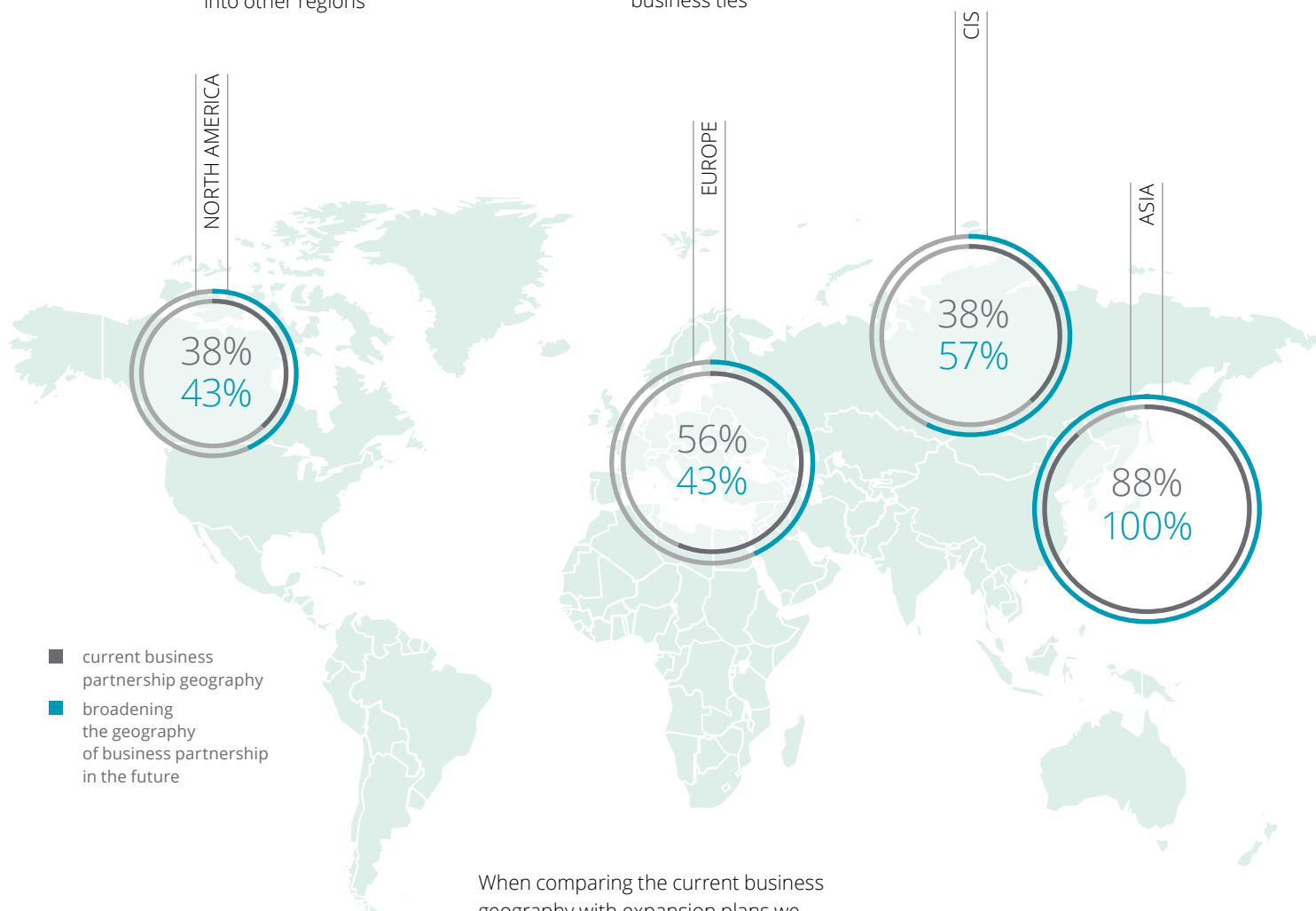
Prospects of developing business abroad

80% of the companies surveyed cooperate with foreign partners

20% of the companies surveyed do not cooperate with foreign partners

35% plan to expand their business relations into other regions

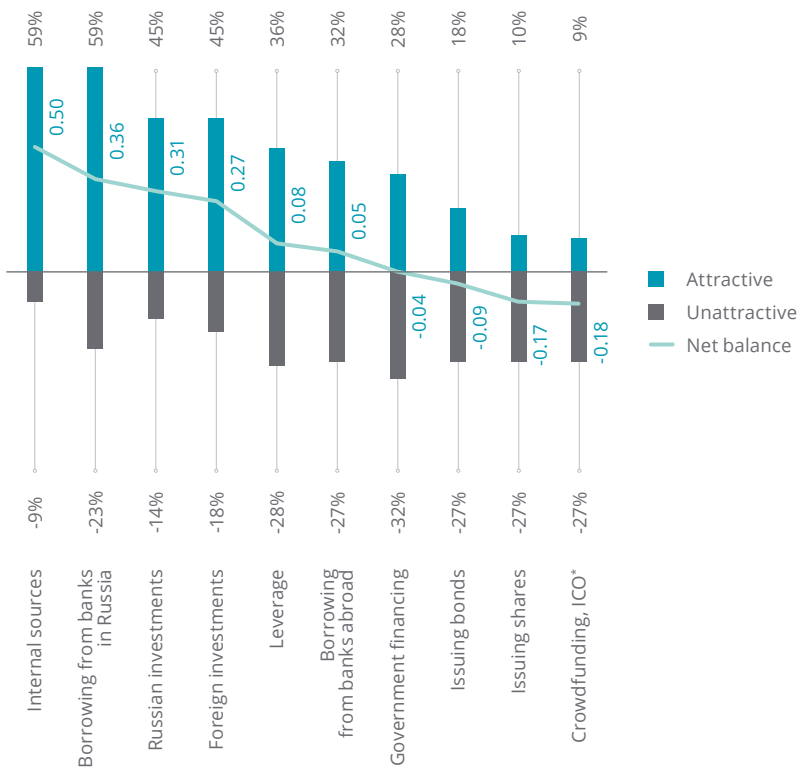
65% do not plan to expand the geography of their business ties



When comparing the current business geography with expansion plans we noted that Far Eastern companies generally intend to develop business ties with the CIS countries (**19 percentage points**) and Asia (**12 percentage points**). The results for developing business ties with Asia align with the national trend.

Financing sources

? Please rate the attractiveness of the following financing sources for your organization.



Attractive financing sources

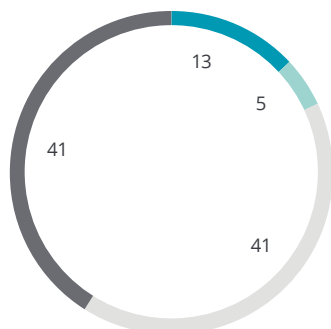
- Internal sources
- Borrowings from banks in Russia
- Russian and foreign investments

- The first and second positions in the Far East ranking coincide completely with those in the national rating.
- Internal sources are mostly favored by companies with revenues of less than RUB 2 billion (**12 percentage points** above the average).
- Borrowing from Russian banks is highly relevant for most companies in the oil and gas and energy sectors (**71 percent**). Also respondents from those industries more often prefer foreign investments (**12 percentage points** above the average).
- Companies with revenues of RUB 2 to 10 billion rate the efficiency of borrowing **14 percentage points** above the average.
- Companies in the Russian Far East are more focused on raising Russian and foreign investments than companies in Russia in general. In the country as a whole, both sources are generally viewed as unattractive.

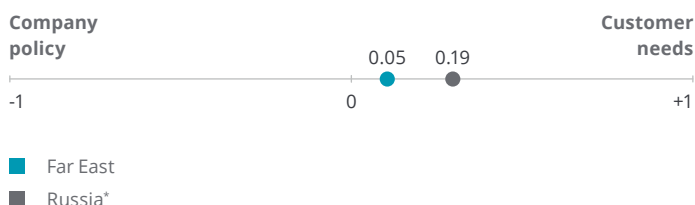
* Crowdfunding – the practice of funding a project or venture by raising donations from a large number of people.
ICO (Initial Coin Offering) – a blockchain-based fundraising tool similar to crowdfunding.

Business customers

Customer focus, %



- Company policy has absolute priority
- Company policy has somewhat higher priority than customer interests/needs
- Company policy and customer interests have equal priority
- Customer interests/needs have somewhat higher priority than company policy

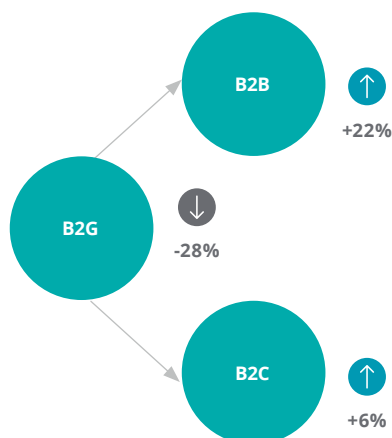


- Forty-one percent of companies in the Far East have well-balanced internal policies.
- One in five respondents (18 percent) stated that their company prioritizes internal policy over customer interests. For most of the businesses, company policy is an absolute priority.

- Forty-one percent of the business representatives indicated the primacy of customer interests.

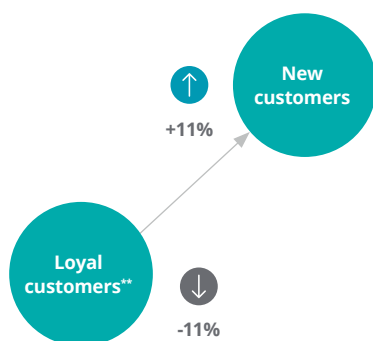
Customer portfolio

Customers by segment



- Overall, 1H 2018 saw the re-alignment of the customer portfolios of Far Eastern businesses (decrease in the share of state orders and business refocus on the B2B segment).

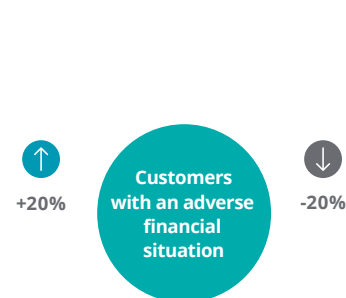
Customers by loyalty



** Over 2 years

- Respondents generally point to a minor increase in the share of new customers in their company's portfolios.
- This is consistent with the "expansion into new markets" strategy above, which is a strong priority for companies in the Far East.

Customers by payment capacity



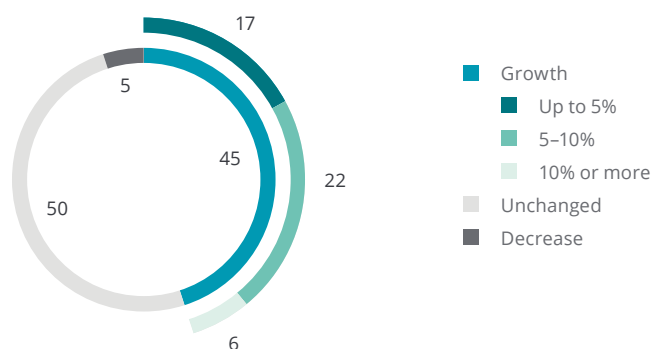
- On average, the District's share of customers with an adverse financial situation has remained at the same level. While 20 percent of the respondents have managed to reduce the share of such customers, another 20 percent say that it has increased.

* Based on the findings of the 1H 2018 Deloitte CFO Survey

Innovations and digitalization

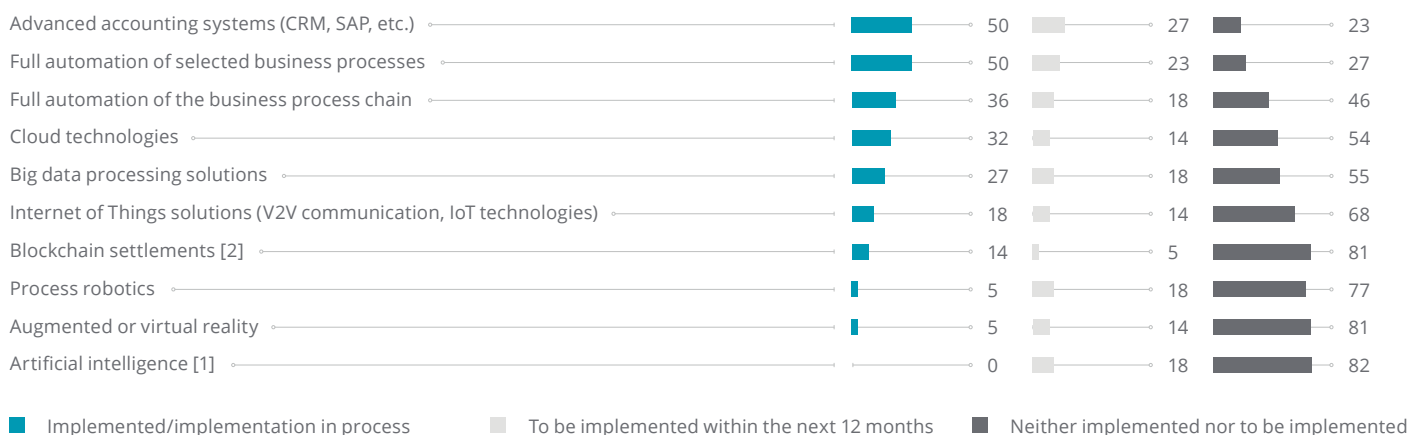
Innovations and profitability, %

? What is the economic effect of innovation on your company's profitability?



- **Forty-five percent** of the respondents in the Far Eastern Federal District reported higher profitability after they had introduced innovations. Among them, **17 percent** indicated an increase in profitability of up to 5 percent, and **22 percent** noted that the increase was from 5 to 10 percent.

Use of innovative technologies, %



Trend

- Advanced accounting systems and full automation of selected business processes are the most popular technological innovations in the companies of the Far Eastern Federal District (**50 percent** each). These technologies also demonstrate leading positions in other Russian regions.

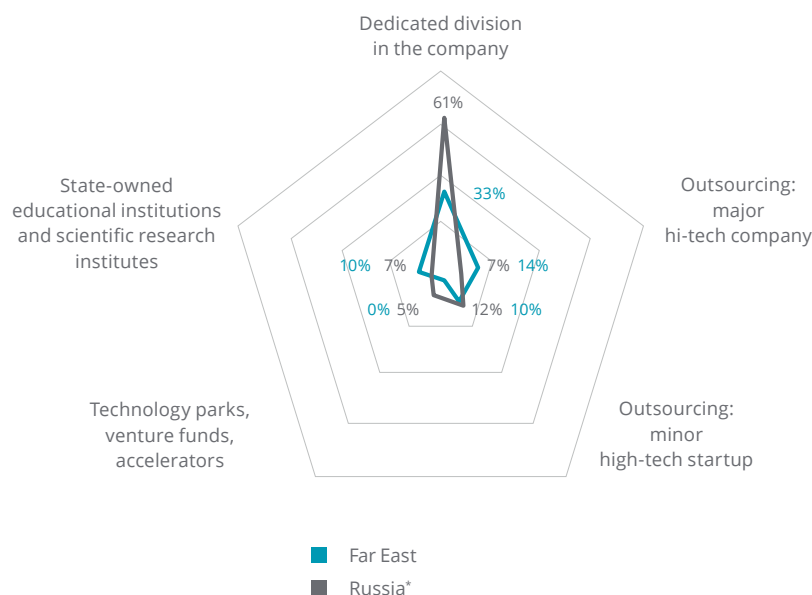
Highlights

- Companies with revenues of more than RUB 10 billion implement innovative technologies more often than other companies. Almost **eight out of 10 respondents** representing large companies (**78 percent**) reported a full automation of selected business processes. Oil and gas and energy companies gave this response somewhat less often (**57 percent**).
- Full automation of the business process chain, big data processing and blockchain-based settlements are also popular among the largest companies of the Far Eastern Federal District (**11, 15 and 19 percentage points** above the average, respectively).
- Oil and gas and energy companies more often (by **14 percentage points**) tend to implement cloud technologies.

[1] Artificial intelligence (computers that model and deliver various types of human intellectual processes or behavior)

[2] Blockchain (a special structure for recording groups of transactions)

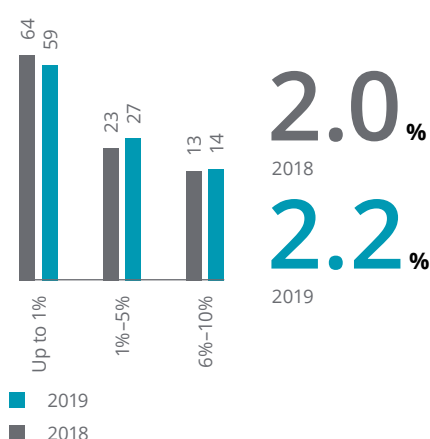
Map of innovation sources



- Almost half of the companies in the Far Eastern Federal District (**48 percent**) do not engage in R&D (**11 percentage points** above the average for Russia).
- A dedicated unit within the company serves as the main source of innovation both in the Far Eastern Federal District and in Russia as a whole (**33** and **61 percent**, respectively). However, only one in three Far Eastern companies has such a dedicated unit in place.
- Technology parks, venture funds and accelerators are the least popular sources of innovation used only by **5 percent** of Russian companies and none of the Far Eastern companies.

R&D expenses in 2018–2019

Average R&D expenses in the Far East
(% of the revenue)



Trend

- In 2018, research and development expenses averaged **2.0 percent** of the revenue in the Far Eastern Federal District and **3.7 percent** in other Russian regions.
- In 2018, most Far Eastern companies (**67 percent**) invested less than 1 percent of their annual revenues in R&D.
- In 2019, average anticipated R&D investments will total **2.2 percent** of revenues.

Highlights

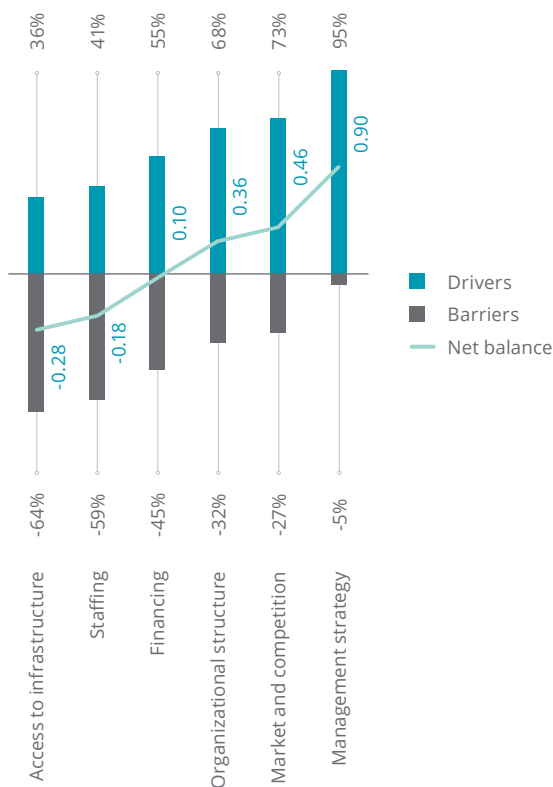
- Companies earning more than RUB 10 billion a year tend to spend 5 to 10 percent of their revenue on R&D (**19 percentage points** above the average).
- Three out of four companies in the Far Eastern consumer sector (**75 percent**), and **83 percent** of companies with revenues of RUB 2 to 10 billion have R&D expenses of less than 1 percent of their revenue.

* Based on the findings of the 1H 2018 Deloitte CFO Survey of the Leading Companies in Russia

Digitalization drivers and barriers

82%

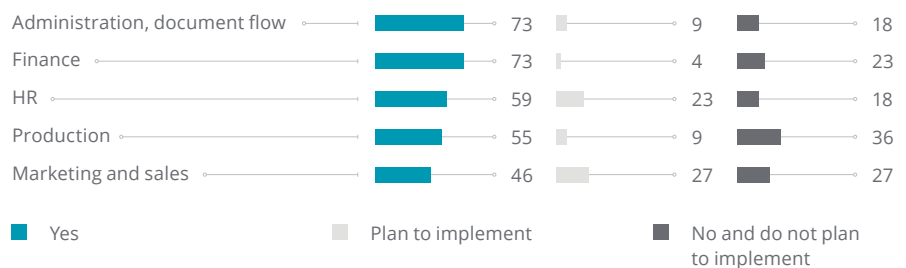
of Far Eastern companies see a need for improving their cost efficiency through the automation of key processes.



- Management strategy came as an absolute leader among all drivers, with a balance of **0.90**. Market and competition was ranked second, with a balance of **0.46**. The Russian experts surveyed named both drivers as the key drivers.
- Notably, the findings of the all-Russian survey revealed that infrastructure is a driver of the digitalization strategy (the balance is **0.13**), while respondents in the Far Eastern Federal District classified this strategy as a true barrier (the balance is **-0.28**).

Investments in business unit automation

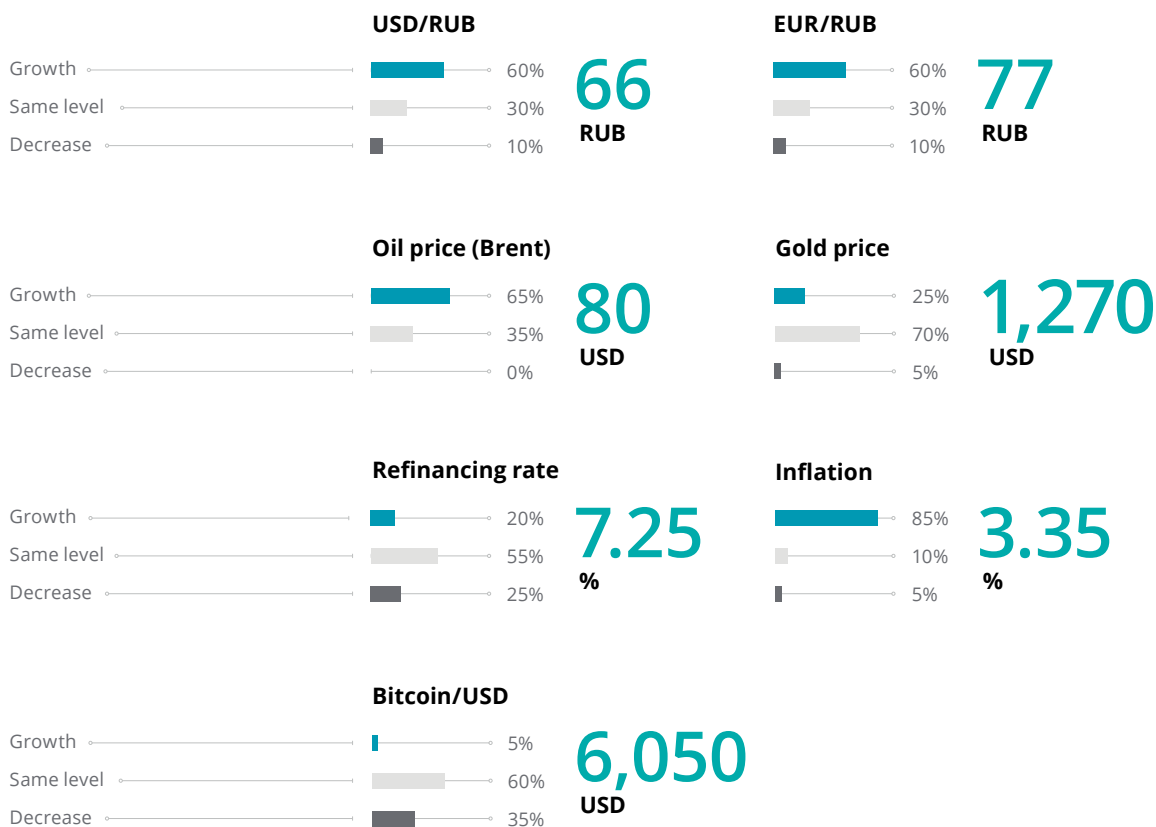
- Most often, Far Eastern companies invest in the automation of document flow and the finance function (**73 percent** each).
- Oil and gas and energy companies more willingly invest in production automation (by an average of **19 percentage points**), while **25 percent** of the consumer sector companies only plan to do so.



Expectations of Far Eastern business leaders

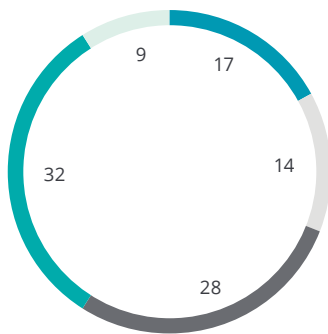
Anticipated changes in the key metrics

We asked our Far Eastern respondents about their expectations regarding changes in exchange rates and commodity prices for autumn 2018.



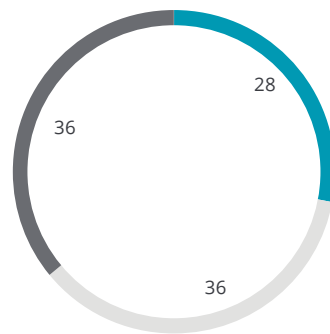
Our respondents

Revenue in 2017, %



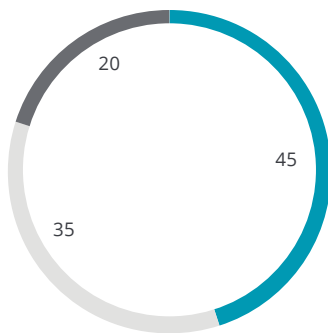
- RUB 0-0.8 bln
- RUB 0.8-2 bln
- RUB 2-10 bln
- RUB 10-100 bln
- Over RUB 100 bln

Number of staff, %



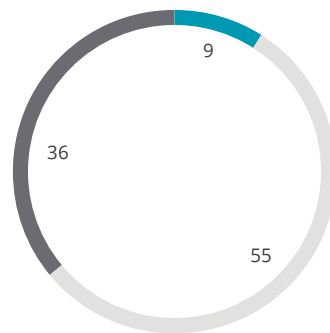
- Up to 100 employees
- From 100 to 1,000 employees
- Over 1,000 employees

Industries, %



- Consumer sector
- Oil and gas and energy sector
- Other:
 - TMT
 - FSI

Strategy implementation horizon, %



- 1-2 years
- 3-5 years
- Over 5 years

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If you have any questions about this research, please do not hesitate to contact us.



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