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PBN Canvasses Foreign Investors

The PBN Company conducted an independent survey of foreign investors' opinions of Russia's investment climate for the Russian Ministry of Economic Development and Trade and the Foreign Investment Advisory Council (FIAC). More than 100 current investors and more than 50 proven investors in emerging markets other than Russia participated in the survey.

The survey found that current investors are even more bullish on Russia than they were last year, when The PBN Company conducted the first *Russia: Investment Destination* survey. Four in 10 reported that 2005 sales increased more than 30 percent, and nearly three in 10 said profits grew in excess of 30 percent. More than 90 percent said they plan on increasing both their business operations and investments in the next three years.

Even the majority of companies currently not investing in Russia plan to do so. Almost two-thirds of non-investors said they are planning to enter the Russian market in the next

Russia's Investment: Opportunities and Barriers

Why Some Companies Are Investing and Others Aren't

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Foreign Investors Speak

Clarity, Consistency and Communications Top the List

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Facts about Russia's FDI

Strong Trends, but Still Far Behind China

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three years. Only one third said they have no plans to invest in Russia.

"This survey once again proves that the vast majority of foreign investors in Russia operate both successfully and profitably. Both empirically and in the opinions of foreign investors, the trends are heading in the right direction," explains Peter B. Necarsulmer, PBN's Chairman and CEO, who led the study team.

FDI Rose 33.6% in 2005

Since 2002, the average annual growth rate of FDI in Russia is 79 percent. Russia received a total of \$16.7 billion in FDI in 2005, according to the latest estimates of the Central Bank of Russia.

The survey found that investors' perceptions of the risks of investing appear to be relaxing, while the perceived rate of return on investments as compared to other countries is improving. "These dual results are the underlying reasons more and more current investors plan to increase their investments in Russia, and more potential investors plan to enter the market soon" says PBN's Chairman and CEO Peter B. Necarsulmer.

The survey results were presented to Minister of Economic Development and Trade German Gref and other ministers and agency heads, as well as FIAC members, at a FIAC Standing Committee on April 21. As reported in *Vedomosti*, Minister Gref warned at that meeting, "It is clear that the list of problems hasn't changed in comparison to last year's survey." Corruption, administrative red tape, inadequate and inconsistent legislation and selective interpretation and application of the laws remained at the top of the list of barriers to foreign investment, according to survey participants.

Foreign investors also urged the Russian government to do a much better job promoting investment opportunities in the country. "The survey is clear. There needs to be more effective communication, not only abroad, but for investors already active in Russia," explains Necarsulmer. "But more and better communication is only part of the answer. For Russia to achieve its outstanding competitive investment potential, there must be substantial progress in resolving the real problems on the ground faced by domestic and foreign investors alike."

In this edition of Access PBN, we report on and analyze some of the major findings of Russia: Investment Destination 2006. A copy of the complete report can be found at www.pbnco.com/fiacsurvey2006



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Russia's Investment: Opportunities and Barriers

Again this year, foreign investors said the size of the Russian market and the country's sustained economic growth are the top two features that most attract them to Russia. Nine in 10 said the size of the market and 82% cited the country's strong record of economic growth. Other attractions were the high quality and low cost of human resources (57%), overall political stability (48%) and macroeconomic stability (46%).

The top four obstacles to investment this year were also the same as last year, except this year bureaucracy was cited as a bigger problem than corruption by foreign investors. More than eight in 10 said bureaucracy and red tape was the top barrier, followed by corruption (78%). The other two top barriers to investment this year were inadequate legislation (71%) and selective interpretation and application of laws (67%).

Two Thirds Impacted by Corruption

Since corruption ranked as the top concern among investors in the 2005 *Russia: Investment Destination* survey, a series of questions were added to this year's survey to probe this issue more deeply. Almost two-thirds of current foreign investors said their company has been directly impacted by corruption. Tax authorities (32%) and traffic police (28%) were the two institutions most frequently cited by current foreign investors as practicing in corruption.

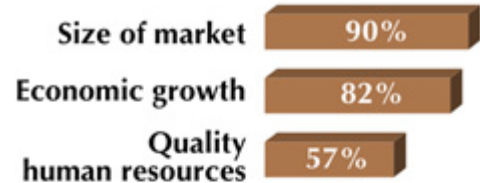
Almost 90 percent of respondents say reducing corruption at all levels is the top measure the Russian government should undertake to improve the investment environment. Seven in 10 investors agree that "decisions of many Russian courts in commercial disputes are very susceptible to financial, political and other improper influence."

"Hassle-Factor" a Growing Issue

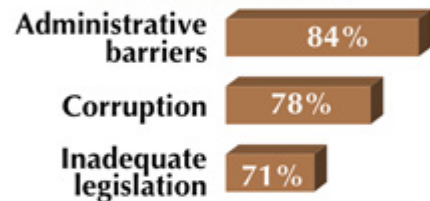
While corruption remains a salient and undiminished concern, the "hassle-factor" of doing business in Russia

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Three top advantages to investment?



Three top barriers to investment?



"Foreign investors are looking to the Russian government to solve the ...problems impacting their business operations in Russia."

*Peter B. Necarsulmer
PBN Chairman & CEO*

appears to be increasing for investors. Administrative barriers, including licensing, permitting, and red tape, surpassed corruption as the top investment barrier this year. When current investors were asked to name the top problem their company faces on a daily basis in Russia, the number one answer was "excessive regulations for visas and work permits."

"Foreign investors are also looking to the Russian government to finally solve some of the underlying, persistent problems impacting their business operations in Russia," says PBN's Chairman Peter Necarsulmer. "Some of the problems are relatively simple to fix, like relaxing and streamlining the procedures for work permits and visas. Others are much more complex and endemic — especially corruption."

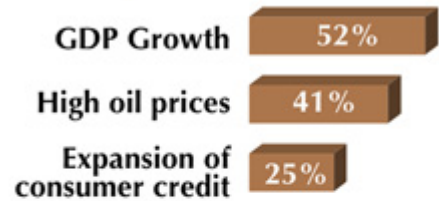
Investors were asked to name the top three developments in the past 12 months that impacted their outlook on Russia positively. Those developments were Russia's GDP growth (52%), high oil prices (41%) and expansion of consumer credit (25%). The top three most negative developments in the past 12 months were back tax claims against Russian companies (38%), expansion of the state's holdings in the energy sector (24%) and the aggressive business tactics of certain Russian companies and financial-industrial groups (22%).

Investors Optimistic About Future

The majority of current investors are optimistic about the future. More than half said they believe the investment climate in Russia will improve in the next two years, while only 14 percent said it would get worse.

Certain developments on the horizon will add to the attractiveness of Russia as an investment destination — with admission into the World Trade Organization being a key factor. More than half of the investors said that Russia's eventual admittance into the WTO would have a significant positive impact on their business development in the country.

Three top positive developments in Russia?



Three top negative developments in Russia?





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Foreign Investors Speak

The quantitative results as well as the verbatims offered by foreign investors found a common theme in *Russia: Investment Destination 2006*. Clarity, consistency and better communications were frequent appeals by the companies participating in the survey.

Herman Verstraeten, Chairman of the FIAC Image of Russia Working Group and Chairman of Unilever CIS, explains, "Investors want clear policies on which economic and industrial sectors foreign investors are most welcome, and they want consistent application and enforcement of laws and regulations. Providing clarity and consistency on these issues could unleash significantly more foreign investment in Russia."

One in three current investors believe that the Russian government "is genuinely interested in attracting foreign direct investment," while a similar number of respondents believe the government is not. Additionally, 40% believe that the Russian government seeks investment in "specific sectors of the economy on very strict terms."

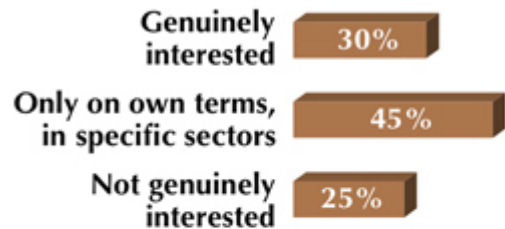
Consistency in Application of Laws

Investors are also looking for consistency in application and enforcement of laws impacting foreign investors. "Treat investors equally well at all levels of administrative power and at all stages of investment projects," said one foreign investor. Seven in 10 investors said that inadequate and inconsistent legislation is a barrier to investing — up from 51 percent in 2005. Two thirds cited selective interpretation and application of laws as a barrier.

As in 2005, foreign investors this year again urged the Russian government to be more active in promoting Russia as an investment destination. Investors also want "*clarity and consistency in communications*," said one participant. Three quarters of all respondents said that the government should do a better job of communicating with investors and should invest more time and resources in foreign investment promotional activities.

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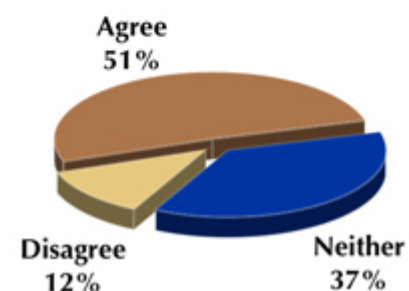
Is Russia Interested in FDI?



"Foreign companies are succeeding in Russia — a fact that is not readily apparent to their non-investing counterparts in the United States, Europe and Asia."

*Herman Verstraeten
Chairman of the
FIAC Working Group*

Russia's Investment Climate Better Than Portrayed by Media?



Foreign Investors Succeeding in Russia

"There is clearly a frustration among investors that Russia's image abroad does not match the realities on the ground," says Verstraeten. "Foreign companies are succeeding in Russia — a fact that is not readily apparent to their non-investing counterparts in the United States, Europe and Asia."

Five in 10 agreed with the statement Russia's investment climate is better than portrayed by international media. "Russia is not as bad as many people think, but not as good as we want it to be," was the observation of one investor.

Foreign investors are willing to do their part and the government should find useful and meaningful roles for them in expanding FDI in the country. "Major international investors should be called on to promote Russia as an investment destination. Success stories of foreign companies doing business in Russia is the country's best calling card," said an investor participating in the survey.



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Facts about Russia's FDI

By all accounts, 2005 was a good year for foreign investment in Russia. Official figures of the Central Bank of Russia estimate FDI at \$16.7 billion — a 33.6 percent increase from \$12.5 billion in 2004.

Since 2002, Russia has experienced a steady increase in FDI. Investment levels were essentially flat from 1998-2002, at approximately \$3 billion annually. The average annual growth rate in FDI since 2002 is 79 percent.

Russia's solid performance contrasts with the other BRIC economies. China experienced flat growth in FDI last year — nevertheless attracting \$60 billion in investment from foreign companies in 2005. India's growth rate was modest at 15.2 percent or \$6 billion, while Brazil saw foreign investment decline from \$18.2 billion in 2004 to \$15.6 billion in 2005.

More Favorable Views of Russia

International investors are viewing Russia more favorably in terms of the country's comparative economic and financial benefits. Russia ranked fourth in total FDI among all emerging markets in 2005 — trailing only China, Hong Kong and Mexico. Russia was also among the top 10 most favored investment destinations, according to A.T. Kearny's Foreign Direct Investment Confidence Index of 2005.

The *Russia: Investment Destination* survey conducted for Ministry of Economic Development and Trade and FIAC identified encouraging trends in view of the perceived risks of investing in Russia compared to other investment destinations. While foreign investors continue to believe that the competitive rate of return on investment remains high in Russia, fewer investors rate Russia's investment risk as large as last year. For example, 35 percent of foreign investors in 2006 said Russia had a higher risk of investment compared to other emerging markets. In 2005, 54 percent of the respondents said Russia had higher investment risk than other emerging markets. Similar trends can be observed in the case of Brazil (2006: 44% v. 2005: 59%), and India (2006: 44% v. 2005: 57%).

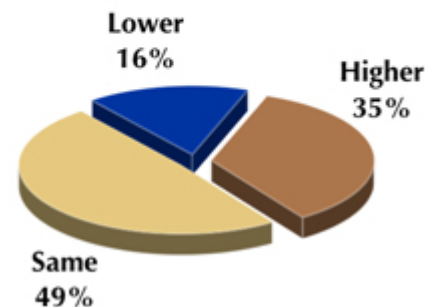
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Foreign Direct Investment in Russia, USD billion



While the trend in foreign investment is headed in the right direction, there is still considerable progress to be made.

Risk of Investment Russia vs. Other Emerging Markets



While the trend in foreign investment is headed in the right direction and investors are attracted to Russia for a number of key factors — from the size of its market and strong macroeconomic indicators to solid industrial productivity and ongoing trade liberalization — there is still considerable progress to be made. Some analysts believe that Russia's FDI could be in the \$40-\$50 billion range if key risks and barriers to investment were reduced.

The survey also warns that overconfidence in the current trends could lead to complacency. "Should this sense of complacency set in, all the Russian government needs to do is look at the recommendations and advice of the foreign investors participating in *Russia: Investment Destination 2006*. They have made their opinions and views abundantly clear. And, while optimists at heart, they are realists in their views on what Russia needs to do to reach its full potential as one of the world's top destinations for foreign investment," concluded the report.



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News from PBN Worldwide

Five-Oh. Following in her husband's footsteps, PBN's President Susan Thurman turned 50 in May. Combined, Peter and Sue are 100 years old — oh my!

Email Sue: Susan.Thurman@pbnco.com

Five-Oh, Again. Sergey Konovalenko, Director of Government Affairs for PBN•Moscow, also turned 50 in May. Happy Birthday, Sergey!

Email Sergey: Sergey.Konovalenko@pbnco.com

Four-Oh. Right behind them is Peter Svensson, PBN's CFO. He turned 40 in May. Congratulations Peter!

Email Peter: Peter.Necarsulmer@pbnco.com

Three-Oh. And last but certainly not least is Sam Vanderlip, who just turned 30! Sam is a Senior Account Manager in Moscow.

Email Sam: Sam.Vanderlip@pbnco.com

Bells are Ringing. PBN•DC Associate Account Manager Anna Balishina was married in April. Oh what a beautiful bride!

Email Anna: Anna.Balishina@pbnco.com

Center Stage. PBN had an active role in the recent Russian Economic Forum in London. Two clients — Russia's Rolf Group and Norway's Telenor — were on the platform at the Forum. PBN•London also organized a very successful Breakfast Briefing, at which Rolf Group CEO Matt Donnelly addressed a City of London audience on the company's impressive expansion over the last few years and its future plans.

Email Trevor: Trevor.Barton@pbnco.com

Smooth as Silk. Romans Baumanis, head of the PBN•Baltics operation, made a presentation at the US–Baltics Trade Mission, in cooperation with the Latvian

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Susan Thurman, PBN's President and COO, celebrated her birthday in the wilds of Oregon with sister Jan and husband Peter B. Necarsulmer, PBN's Chairman and CEO (not pictured).



In true Russian style, PBN•DC Associate Account Manager Anna Balishina and husband Oleg were married in a traditional Orthodox ceremony in Krasnaya Gorka, on the Sunday after Orthodox Easter.

Road Union and the Customs Brokers Association, on the Silk Road, a proposed land transport corridor connecting Northern China and Latvia via Kazakhstan and Russia. The new route will facilitate the growing trade flows between Northern China and the West.

Email Romans: Romans.Baumanis@pbnco.com

Taking Stock. PBN•Kyiv Senior Vice President Myron Wasylyk presented advice on planning for an IPO and the outlook for future issuers at the 2nd Annual Ukrainian Investment Summit, organised by the Adam Smith Institute in London recently. The summit was well attended, both by Ukrainian companies looking to attract investment for abroad and by the UK business and financial community.

Email Myron: Myron.Wasylyk@pbnco.com

Fundraising. PBN•London Vice President and Managing Director Trevor Barton will chair a seminar on investment opportunities in Bulgaria, and opportunities for Bulgarian companies to raise capital on the London financial markets, in London on 15 June. If you are interested in attending, Trevor would be pleased to put you in touch with the organizers.

Email Trevor: Trevor.Barton@pbnco.com

Promo. Galina Bliznyuk, formerly PBN•Moscow's receptionist, was recently promoted to our Media and Issues Monitoring Department. Congrats Gala!

Email Galina: Galina.Bliznyuk@pbnco.com

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