

Russian Financial Markets and Asset Management

The real growth is still waiting to happen

Watch for the start of economic reforms. Start building the infrastructure to take advantage

Andrei Akopian

Managing partner

Summer Wang

Business development manager, Hong Kong

Caderus Capital

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China and Russia are close, but still far away

Cross-border investment activity is very low

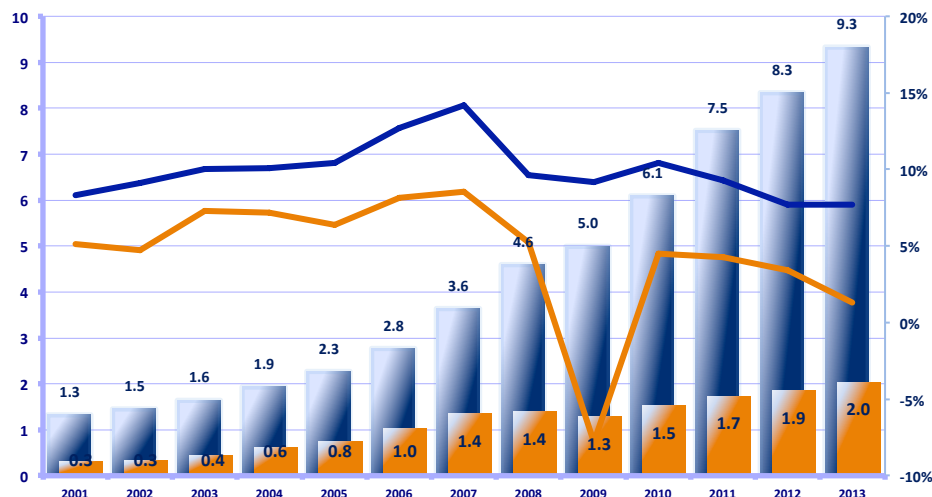
Two major neighbouring countries need to start growing stronger ties

- State wealth funds started co-investing: USD2bn joint CIC-RDIF PE fund
- Russian banks issued dim sum bonds in 2013 in HK
- Not a single Russia-dedicated QDII fund or ETF in China yet
- No China-focused investment funds in Russia yet, 1 MSCI China ETF launched
- Growing interest towards Chinese investment products in Russia

The size of the economy is different

A larger economy and a bigger financial sector in China

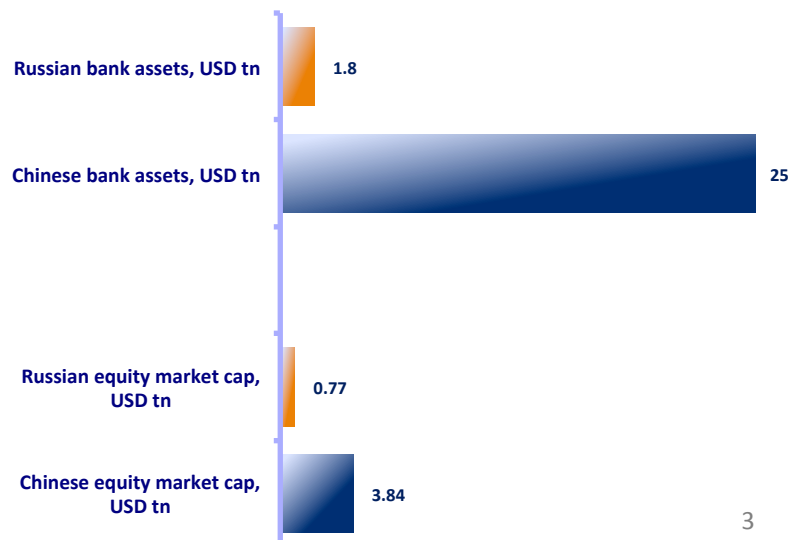
Chinese (blue) and Russian (orange) nominal GDP (USD tn) and real growth, rhs %



Source: PRC National Statistics Bureau, Russian Statistics Agency, Caderus research

- Total bank assets (Dec 2013):**
 Russia USD 1.8 tn (+16% year-on-year)
 China USD 25 tn (+16.5% yoy)
- Domestic equity market cap (Dec 2013):**
 Russia USD 772.1bn (excl. LSE and NY)
 China USD 3.84 tn (excl. HK and NY)

- Chinese GDP is 5x larger and grows 6x faster
- 2013 state budget: +\$736 bn /-\$762 bn (RU)
 (“+” revenue/“-” expenditure) +\$2.1tn / -\$2.3tn (CN)
- 2013 budget to GDP: +36.1%/-37.4% (RU)
 +23% /-25% (CN)
- 2013 budget deficit: -1.3% (RU)
 -1.9% (CN)



A different look at GDP growth

Growth in USD terms is more telling

- RU GDP growth in USD was 25%-37% before the 2008 crisis, reinforced by an appreciating rouble
- Growth rates in 2011-2013 were around 10% in USD terms
- 2014 might see the Russian GDP decline in USD terms
- Main challenges:
 - A decline in investments by private sector and state companies
 - A slowing growth of private consumption
 - Declining export commodity prices
 - A weak currency: RUB is down 9.8% YTD

Chinese (blue) and Russian (orange) USD-terms GDP growth, rhs %



Source: PRC National Statistics Bureau, Russian Statistics Agency, Caderus research

The trend has changed

Will it shift again any time soon?

- The relative size of the Russian to Chinese economy in US dollar-terms was growing until 2007, but not thereafter

Russian GDP as a share of the Chinese GDP in USD terms (red line, rhs %)

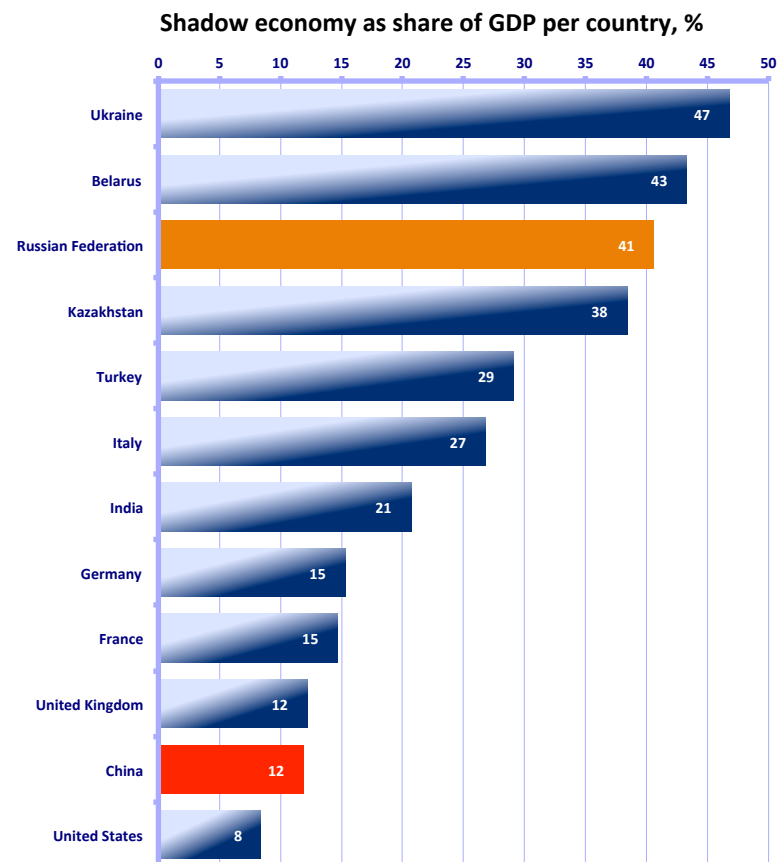


Source: PRC National Statistics Bureau, Russian Statistics Agency, Caderus research

There is more economy than meets the eye

Shadow economy picked up since 2008

- Shadow economy is adding up to 41% more to GDP in Russia and 12% in China (World Bank)
- Government recent estimates (2013): 48m officially employed against 23m working in the “unofficial” economy



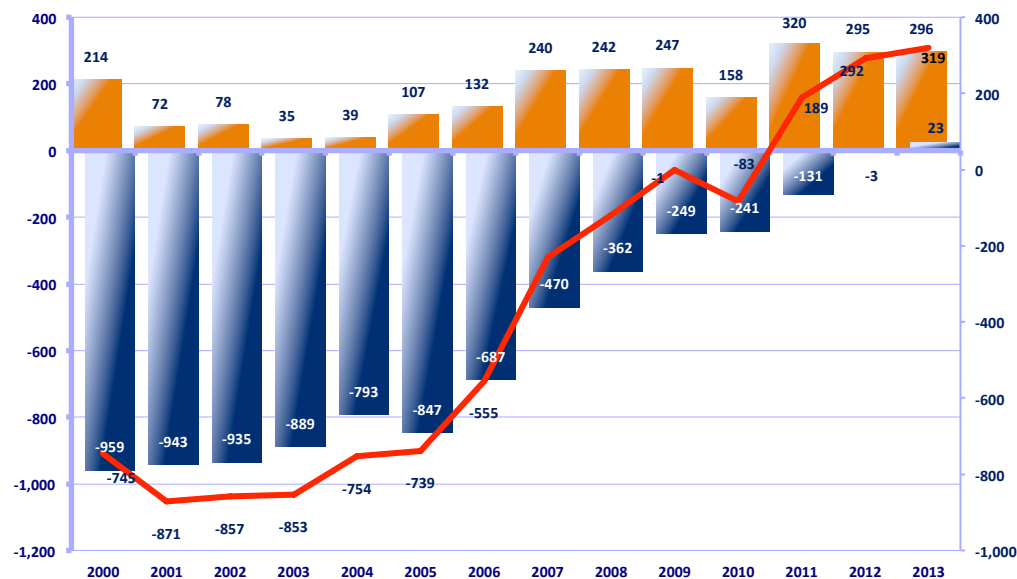
Source: World Bank 2007, Caderus research

Population growth is key

Consumption, savings and investment growth

- Russian population dynamics turned from negative to positive in 2011
- Population growth is very concentrated in a few regions in Russia
- Moscow has been the magnet for working population from other Russian regions and also from neighbouring countries
- Population aged 15-59:
920 mn in China (-1.9% yoy)
94.1 mn in Russia (+10.2% yoy)

Russian population organic growth (blue bars), net immigration (orange bars) and total growth (red line), '000s



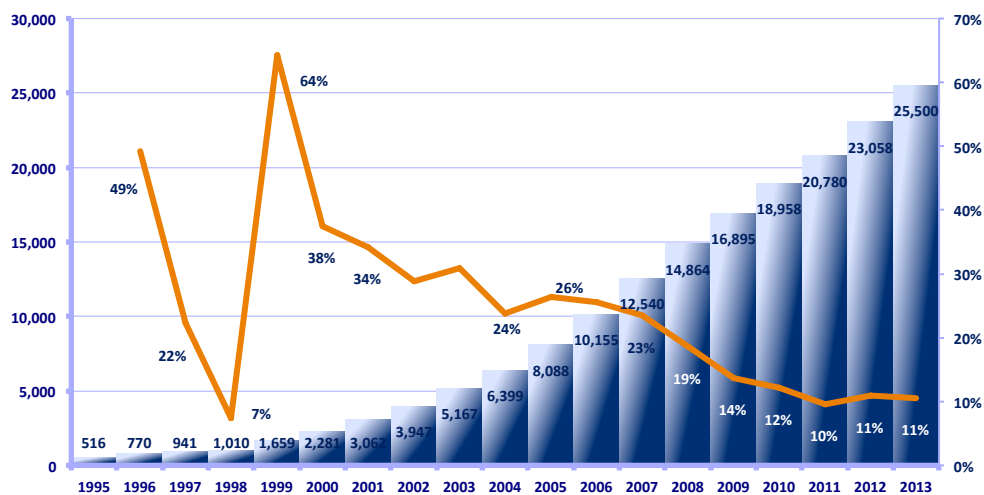
Source: Russian Statistics Agency, Caderus research

PPP per capita GDP and income

Good numbers hide uneven distribution of income

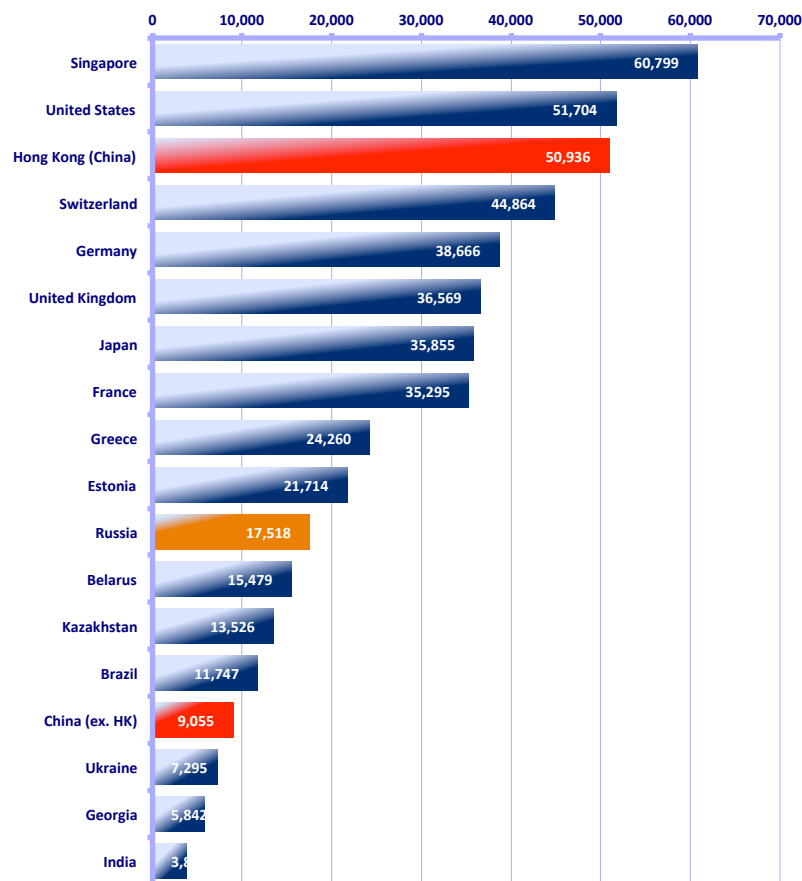
- Mean wealth of Russia's 110m adults was USD10,976 last year (USD22,230 in China) - Credit Suisse 2013 report
- Median wealth was USD871 (USD8,023 in China))
- Total wealth USD1.2tn (Ru), USD22.2tn (CN)
- 110 billionaires own 35% of all wealth in Russia

Russian per capita income (RUB) and nominal growth yoy, % rhs



Source: Russian Statistics Bureau, Caderus research

PPP-based per capita GDP, current international dollars



Source: IMF, Caderus research

Russia is not Moscow, Moscow is not Russia

Average per cap income is double the average for Russia

- Moscow population is:**

12.1 mn or 8.5% of Russia's total

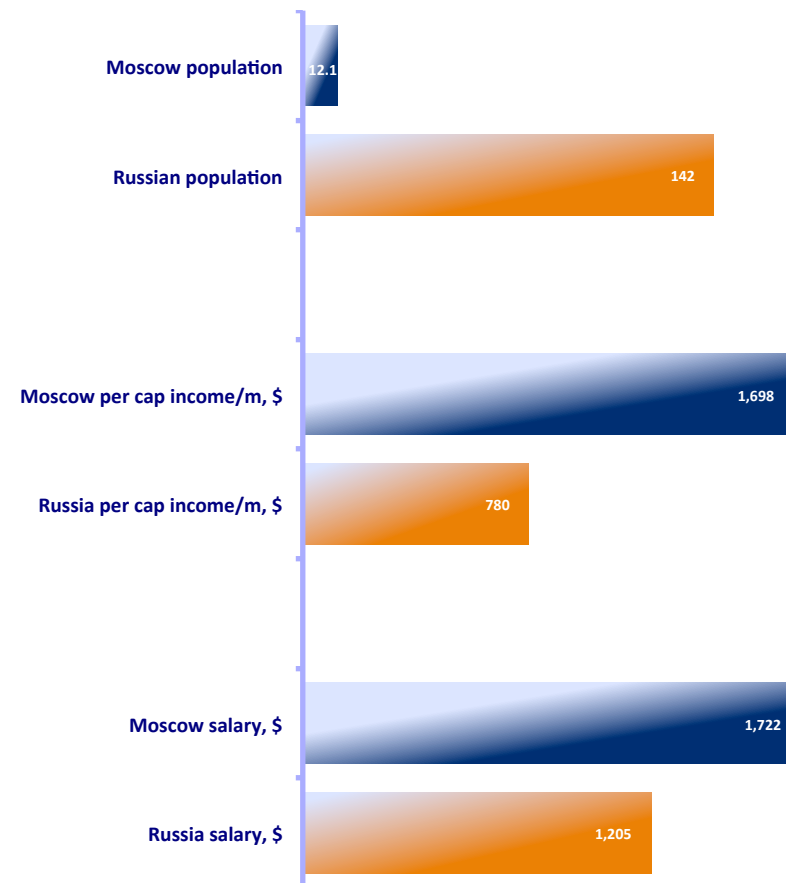
16 mn and 11.3% including suburbs
- Average monthly per capita income in 2013:**

Russia: RUB25,500 (USD780; +10.7% yoy)

Moscow: RUB55,500 (USD1,698; +14.3% yoy)
- Average monthly salary in Dec 2013:**

Russia: RUB39,400 (USD1,205; +8.5% yoy)

Moscow: RUB56,300 (USD1,722)



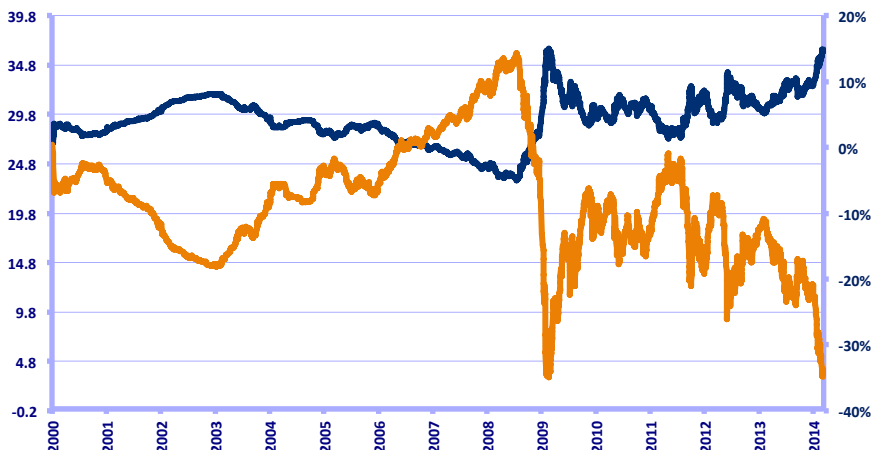
Source: Russian Statistics Agency, Caderus research

Some more Russian macro

Reserves and state debt look good, ruble disappoints

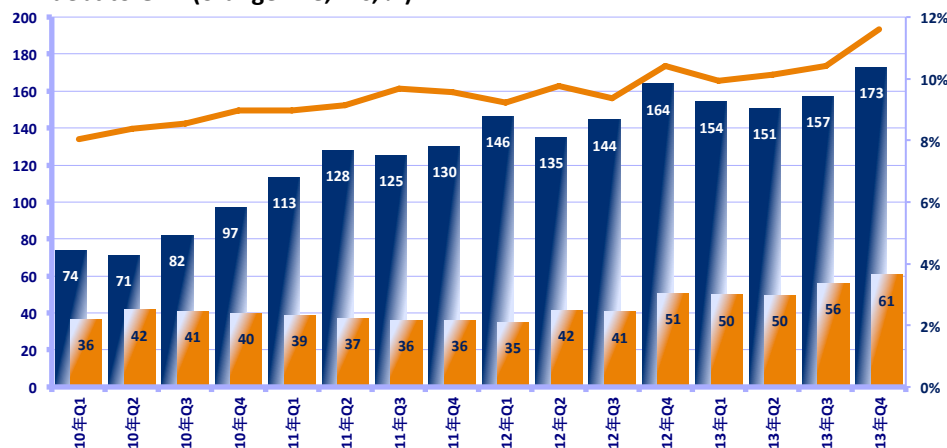
- Foreign currency reserves: USD 469bn (Ru)
 (all data for 2013) USD3,821bn (CN)
- Inflation: 6.48% (Ru), 2.6% (CN)
- Sovereign debt/ GDP: 12% (Ru), 21% (CN)
- Budget deficit: -1.3% (Ru), -1.9% (CN)

Ruble to USD rate (blue); Ruble to USD rate change (orange) since January 2000 (rhs, %)

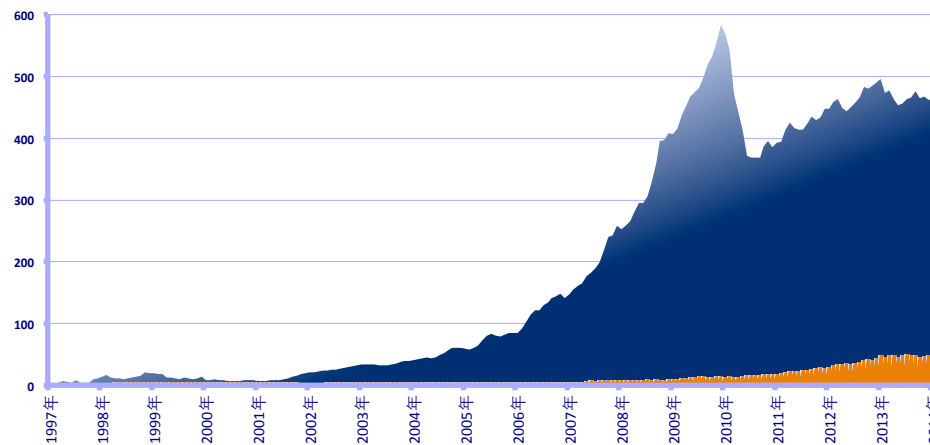


Source: Central Bank of Russia, Caderus research

Russian state internal (blue bars) and foreign currency debt (orange bars), state debt to GDP (orange line, rhs, %)



Russian foreign currency reserves (blue) and gold reserves (orange), USD bn

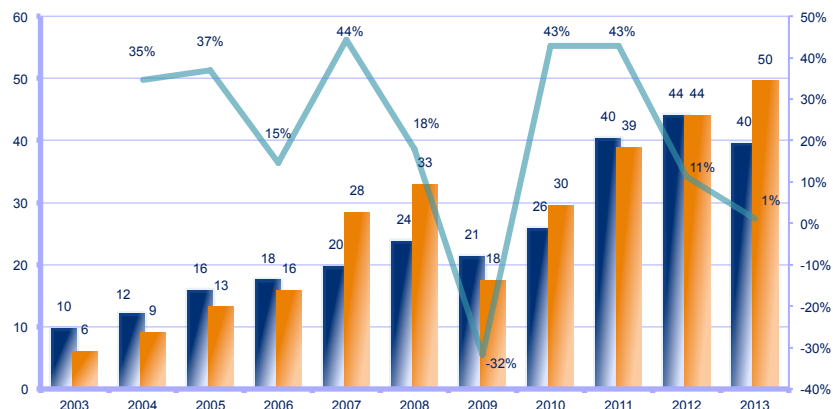


Source: Central Bank of Russia, Ministry of Finance, Caderus research

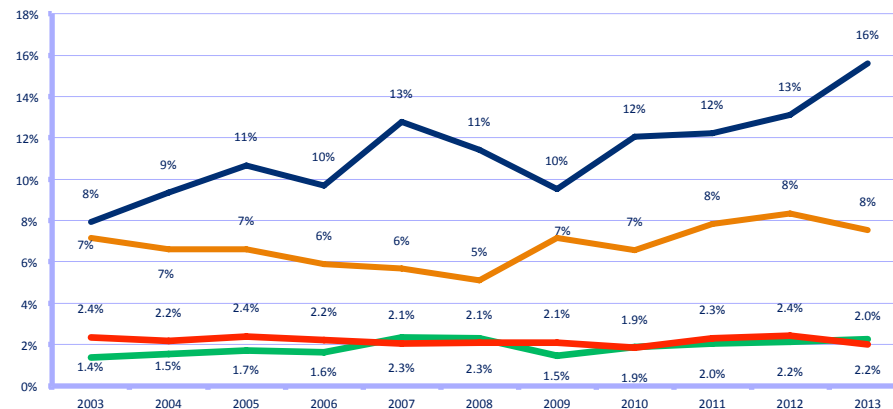
China – Russia bilateral trade

One-way growth

Exports from Russia into China (blue columns, USD bn), imports to Russia from China (orange columns, USD bn), bilateral trade growth (line, rhs, %)



Imports from PRC to total imports to RU (blue), exports to PRC as % of total exports from RU (orange); imports from RU as % of total imports to PRC (red), exports to RU as % of PRC exports (green line)



Source: Russian Statistics Agency, PRC National Statistics Agency, Caderus research

- Russian exports to China fell 10.2%, imports rose 12.6% in 2013 yoy
- Imports from China now make up 15.6% of total Russian imports

Russian financial markets

A good opportunity to invest (in a while)

Extremely low valuations. Watch for the start of macro reforms.

- **Very cheap equity market**
- **No restrictions on inward portfolio and direct investment**
- **Ongoing market infrastructure reforms**
- **Lack of domestic liquidity, low free float**
- **Low investment activity of domestic retail clients**

Russian equity market

Valuations were low even before March: opportunity?

2013	Russia	China
Domestic equities mkt cap, USD tn	0.77	3.8
% of GDP	38%	41%
Average free-float	27%	83%
Free-float market cap, USD tn	0.21	3.2
Number of issuers:	271	2,495
Number of stocks:	334	2,539
Avg daily trading, USD bn	1.3	40.4
Average mkt P/E	4.1	10.4
Average mkt P/B	0.7	1.4
Retail investor accounts, mn (2012)	0.85	227.2
Retail investors as % of population	0.6%	17%

MICEX index performance 1997-2014



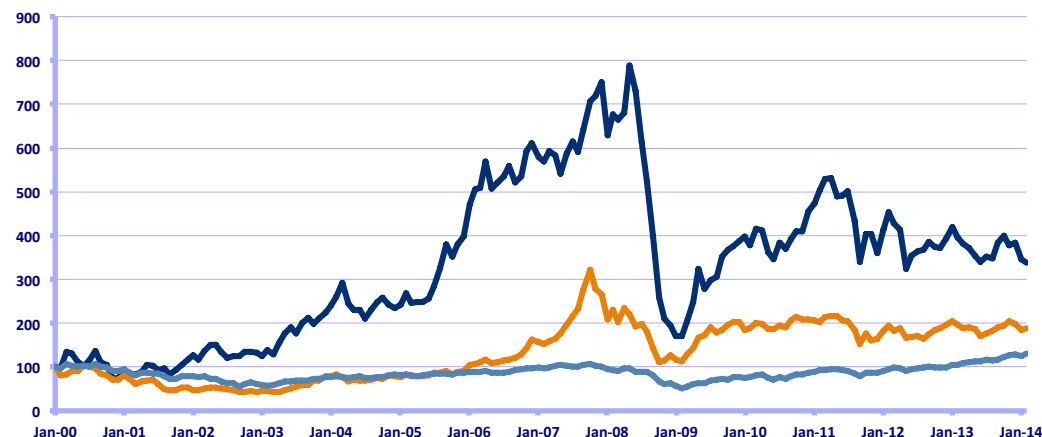
Source: Moscow Exchange, Caderus research

Performance compared: MSCI Indices

Surprising results

- Russia was the star performer for most of the time before 2008
- US market had the lowest performance on a 14-year horizon
- Russia has been falling since this data was published by MSCI on 28 Feb 2014, losing some of its advantage
- Russia is 6.11% of the MSCI EM index, China 19.81% (end 2013)
- MSCI EM index is tracked by international funds with total AUM of about USD1.5tn

MSCI Russia (blue line), MSCI China (orange line) and MSCI USA relative performance 2000-2014 (28 Feb) rebased to 100

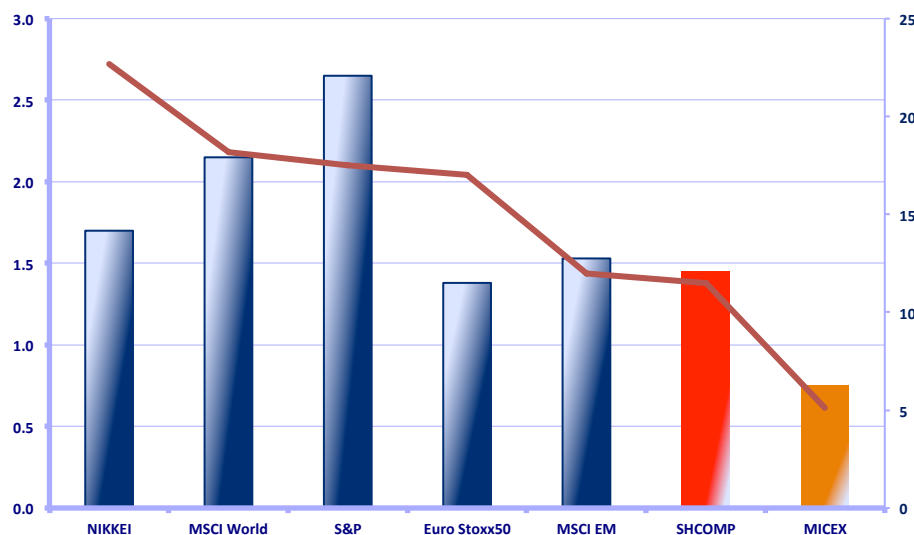


Source: MSCI, Caderus research

Russia vs the world: indices compared

Looking competitive overall

World indices compared : P/E and P/B in 2013



World indices compared: EBITDA margin (bars) versus dividend payout ratio (line), %



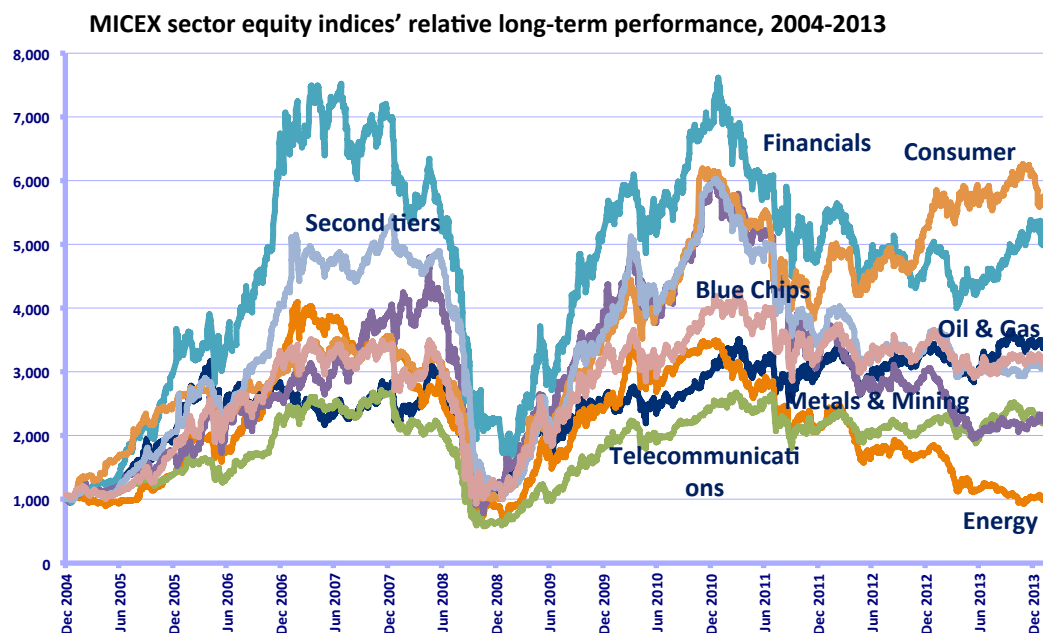
Source: Bloomberg, Caderus research

- The cheapest market both by P/E and P/B. Even cheaper since 1 March.
- Companies' margins look good, dividend pay-out ratio lags behind
- Dividend yield can effortlessly be even better

Sector equity indices: relative performance

Consumer and financials rule; energy is back in 2008

- Financials stocks have provided better exposure to growth and better protection during most of the time since 2004
- Second tier stocks perform well in good times only
- Energy stocks have suffered the most due to unstable regulation
- Oil & Gas stocks have displayed a relatively stable performance



Source: MICEX, Caderus research

MSCI Russia: index composition

Captures most of the market liquidity

- 22 stocks in the index
- Index covers about 85% of the total free-float of the Russian equity market

Top 10 stocks	Mkt cap RUB bn	Mkt cap USD bn	Weight, %	Running total	Sector	Sector weight
Gazprom	1,647.7	45.1	22.5%	22.5%	Energy	39.6%
Lukoil	1,001.8	27.4	13.7%	36.2%	Energy	24.1%
Sberbank	983.9	27.0	13.5%	49.7%	Financials	74.8%
Magnit GDR	523.3	14.3	7.2%	56.8%	Consumer	100.0%
Novatek GDR	414.4	11.4	5.7%	62.5%	Energy	10.0%
Nor Nickel	331.2	9.1	4.5%	67.0%	Materials	54.2%
MTS ADR	319.7	8.8	4.4%	71.4%	Telecom Svs	51.3%
Tatneft	299.1	8.2	4.1%	75.5%	Energy	7.2%
Rosneft	284.4	7.8	3.9%	79.4%	Energy	6.8%
VTB	218.4	6.0	3.0%	82.4%	Financials	16.6%
Total	6,023.9	165.0	82.4%			

Source: MSCI, Caderus research

	Sector weights	Running total
Energy	56.8%	56.8%
Financials	18.0%	74.8%
Telecom Svs	8.5%	83.3%
Materials	8.4%	91.7%
Consumer	7.2%	98.9%
Utilities	1.2%	100%
	100%	

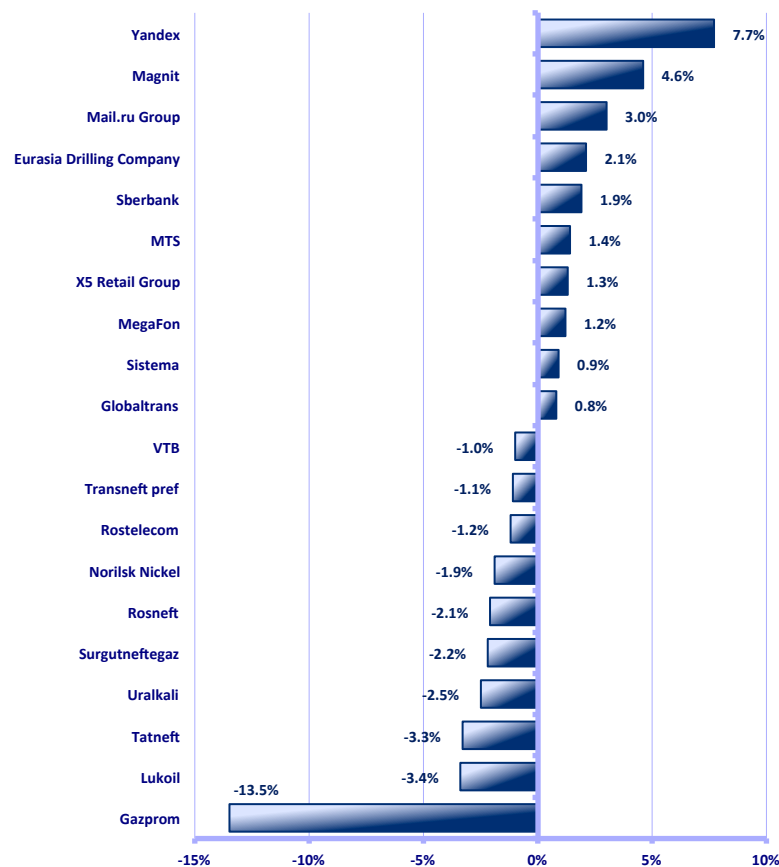
Source: MSCI, Caderus research

More and less popular blue chips

Heavily underweight oil & gas, overweight fin, TMT

- Overweight growth stocks
- Sector overweights: Internet, retail, mobile
- Underweight oil & gas, especially Gazprom

Popularity of individual stocks relative to MSCI benchmarks



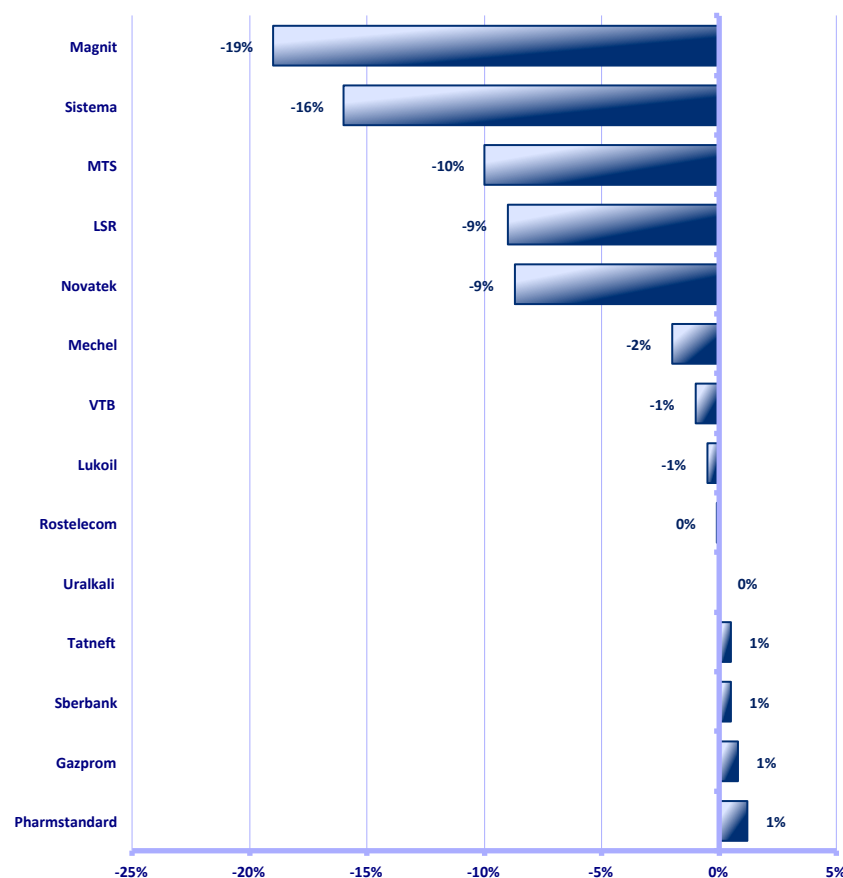
Source: Sberbank investment research

Russian stocks: between Moscow and London

Better infrastructure in London, reforms under way

- 45%-55% of trading in Russian stocks happens in London (LSE)
- The ratio is even higher for the blue chips
- This is partly due to the domination of foreign funds in the total free-float
- Major change: Euroclear and Clearstream are launching direct settlement for the Russian local stocks (1 July 2014)
- This worked as a game-changer for the Russian bond market in 2012-2013

Local stocks to ADR/GDR discount, %



Source: Moscow Exchange, LSE, Finam research

Russian fixed income market

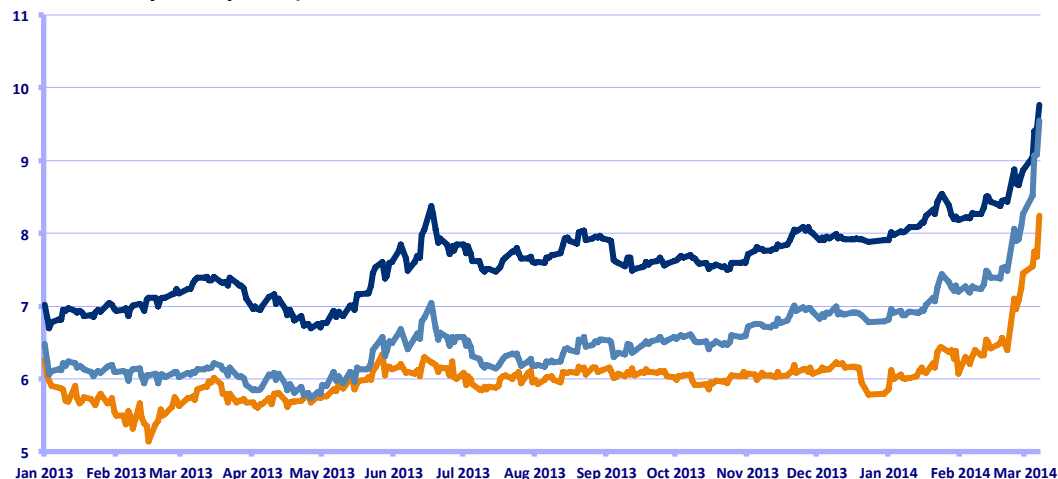
Market infrastructure reforms boost liquidity

- Bond market size on MICEX is USD245.9bn (99% of total, 14 March 2014)
- Daily volumes USD1-1.5bn, 2/3 OFZ, 30% corporate, the rest in regionals
- Direct access to RUB local bonds through Euroclear, Clearstream (2013 for govt, April 2014 for corp. bonds)
- Foreign ownership of government RUB bonds went up to 25% over the last two years
- Yields have been going up substantially since February 2014

USD bn, 14 March 2014	Total at par value	Weight, %	Daily turnover at market price
Corporate bonds	130.5	53.1%	0.37
Federal bonds (OFZ)	95.6	38.9%	0.75
Regional bonds	19.8	8.1%	0.05
Total	245.9	100%	1.18

Source: MICEX, Caderus research

Russian government RUB 0-coupon bond yield dynamics, % (1y – orange, 3y – light blue, 10y – deep blue)



Source: Central Bank of Russia, Caderus research

Financial market regulator

Mega-regulator: Central Bank of Russia

- **Since late 2013 the Central Bank of Russia is supervising:**
 - **Russian commercial banks**
 - **Insurance companies**
 - **Asset management companies**
 - **Pension funds**
 - **Brokers**
 - **Exchanges**
 - **Microfinance companies**
- **No license or quota is required to invest in Russia and out of Russia for institutional investors**
- **Russian individual investors can freely invest overseas up to EUR70,000 /year**

Russian asset management industry

Still in the early stages of growth

Low risk tolerance, lack of trust, short-term investment perspective

- **Low average retail savings levels, very high wealth concentration**
- **Preference for personal active management, need for full control among HNWI**
- **Bank deposit or direct real estate investment are the main alternatives**
- **Equity market negative dynamics**
- **Capital flight, negative expectations since 2011**

Who owns Russian equity market

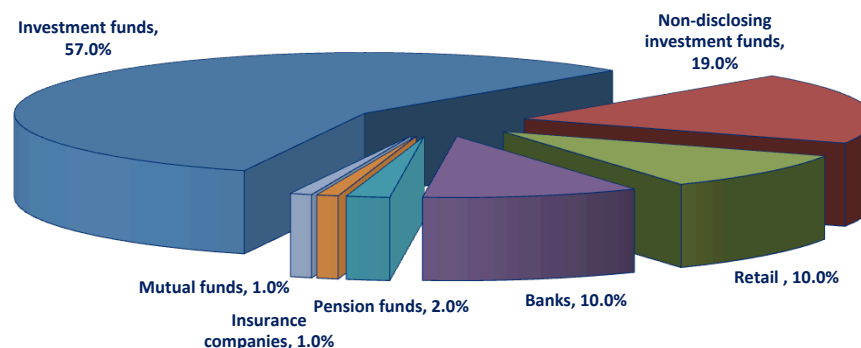
Very small retail, tiny mutual fund sector

- Market free-float at about 25% of total market cap
- Retail investors own 10% of free-float (USD20bn)
- Russian banks own about 10%

(Sberbank research, Q3 2013)
- Mutual funds (PIFs) hold just under 1%
- Global funds, global emerging markets funds and index funds

are the key holders of free-float in Russia

Russian equity free-float holders by investor type, 2013



Source: Sberbank investment research

Russian investors: onshore and offshore

Different regulation and mobility, different approach

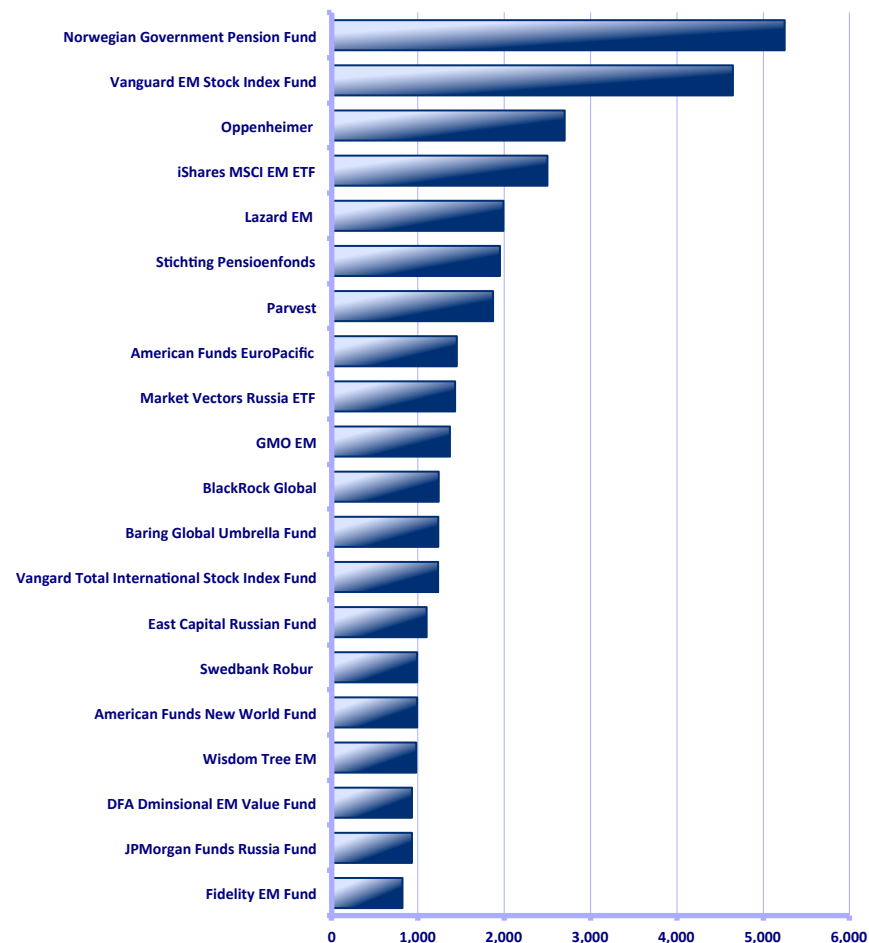
- Russian private capital has been actively migrating to offshore jurisdictions and “safe heavens” since the breakup of the Soviet Union
- Total exported capital out of Russia is estimated between USD500bn and USD1tn
- Up to 75% of accumulated FDI into Russia is Russian capital reinvested into Russia
- Offshore capital is more flexible and mobile, there is little regulation and low taxes, no capital controls.
- Many ultra HNWI's have established family offices in Moscow and in London, managing own offshore capital
- Base currency for offshore investments is mainly USD. Currency risk is easier to manage.

Funds investing in Russia

Dominated by US and European institutional investors

- 4 000 Russian and international funds own USD156 bn, or 76% of total free-float (as of Q3 2013)
- 14 large funds own USD30bn (28% of funds' total)
- Foreign investors own around 70% of the Russian equity market free-float
- 1/3 are from the US, 1/3 are from Europe, 1/4 are from the UK, 9% from elsewhere (Sberbank research)

Top 20 funds by their Russian equity stakes in 2013, USD m



Source: FactSet, Sberbank investment research

Pension funds in Russia

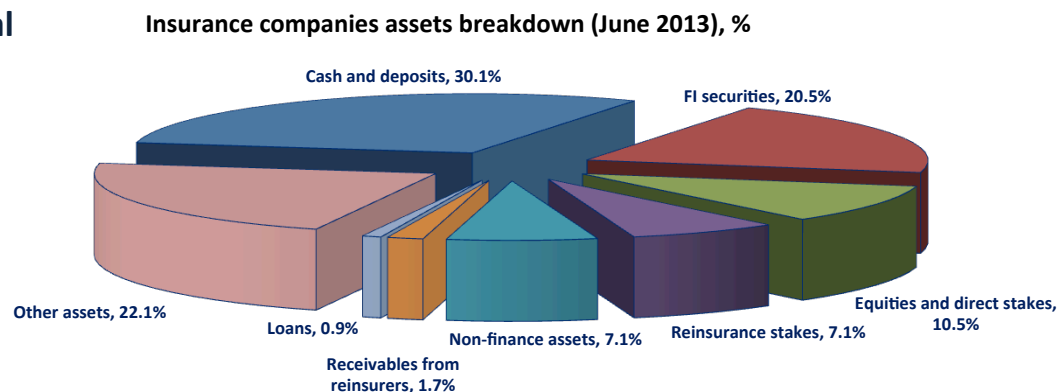
Large long-term players, good asset growth until 2013

- Pension assets are accumulated by the State Pension Fund of Russia (70.2% of total assets of RUB1.79tn in 2012, 99% managed by VEB) and 126 Non-state Pension Funds (NPFs)
- Pension assets are managed by the State Management Company (VEB) and 49 private management companies
- Pension assets consist of 1) pension savings (mandatory contributions) and 2) pension reserves (voluntary contributions of individuals and their employers). Different investment rules apply.
- Allowable overseas investments for pension savings include currencies, mutual funds investing in foreign securities and financial institutions bonds (up to 20% of AUM each)
- Minimum return target: to beat inflation
- Good industry growth marred by changes in regulation in 2013

Insurance companies

Very conservative investment style

- Total number of insurance companies: 454 (H1 2013)
- Total assets: RUB1,158bn (USD32.2bn, H1 2013, +3.6% yoy)
- Insurance companies were actively using discretionary management before 2008, suffered losses
- Slowly developing in-house investment capabilities
- Fixed income portfolio 20.5% of total
- Equities portfolio 10.5% (June 2013)



Source: Central Bank of Russia, Caderus research

Mutual funds (PIFs) in Russia

Still awaiting boom times

- A much smaller industry by assets under management:

Russia: 407 FMCs, AUM: RUB1.87tn (\$51.2bn)

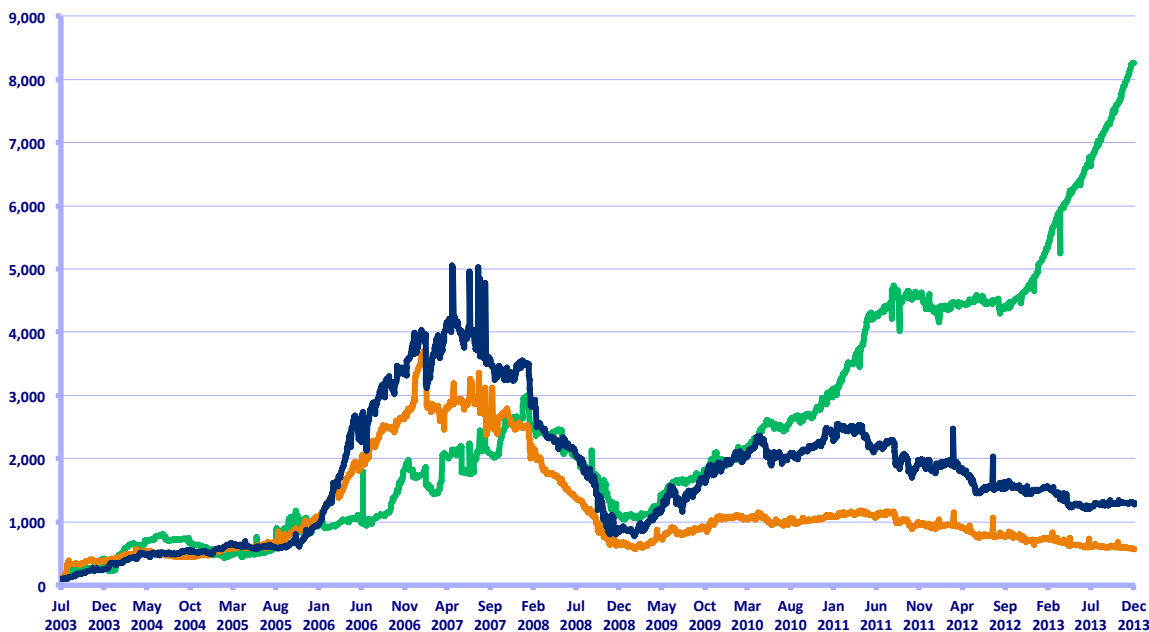
China: 82 FMCs, AUM: CNY29,1tn (\$477.2bn; +8.14% yoy)

- Top 10 FMCs are managing 67% of all mutual funds assets

Bond mutual funds are most popular

Equities mutual funds are at a low point

Mutual funds AUM index: equities (blue line), bonds (green line), mixed (orange line)



Source: National Ratings Agency, Caderus research

- During the boom years 2005-2007 equities mutual funds were leading the market
- Real growth of bond funds assets started in summer 2012 under the influence of the Euroclear/Clearstream reform
- Mutual funds investing in equities is at a very low point

ETFs in Russia

A nascent industry

- **We found 7 ETFs with Russian exposure of >50% of AUM**
- **We found 76 more ETFs with Russian exposure of >1% of AUM**

(data by Morningstar)

- **First ETFs started trading in Moscow in 2013**
- **MSCI China ETF was launched in February 2014**
- **Concept is still new, trading volumes are very low**

Chinese asset managers' Russia strategy

Caderus interview-based research (summer 2013)

- In H2 2013 Caderus conducted a series of interviews with Chinese asset management industry participants asking about their attitude and plans for the Russian markets
- Russia generally looks like a complete unknown for most of them due to lack of visibility, information exchange, investment cooperation and professionals with dual-market expertise
- We identified a number of FMCs planning to invest in various financial instruments in Russia, due to the increasing competition within China
- As a big market with a lot of potential, Russia can offer a major business development opportunity for Chinese FMCs
- The key is to watch for the start of sweeping macro reforms and have the investment infrastructure ready by then.

Thank you

Our contacts



CADERUS CAPITAL

Andrei AKOPIAN
Managing partner

+79175776911
+852-81799277

aa@caderus.com
www.caderus.com

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