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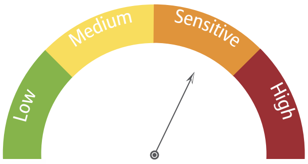
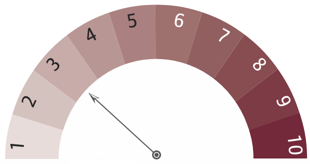
Retail in Russia

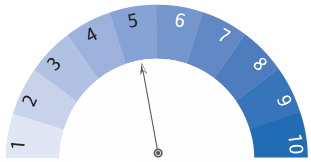
The **capabilities** and **expectations mismatch**



Retail Non-Payment Risk (Q1 2017)



Digital Pressure



Digital Potential

- **After -4.5% in 2016, growth resurgence and inflation cooling will support the progressive recovery of retail sales in Russia in 2017-18, that may eventually find their way back in the positive territory.**
- **2016 witnessed the lingering struggle of Russian retailers: debt levels dramatically improved from 130% in 2016 from 258% in 2014, while the EBIT fell to 3% from 6.1% two years ago.**
- **Food grocers and discounters benefit from the essentiality of their offer while Electronics and Independent food retailers are the first victims of the 2015-2016 recession.**

Catering to the needs of far-flung provinces and GenZers

Russia went through a series of simultaneous crises. Tense politics, a confidence shock, an oil-price tumble, and currency depreciation combined to make life difficult for local retailers. Retail sales sharply decreased during the recession years of 2015-2016, declining by -9.3% and -4.5% respectively. However, consumer spending is thus expected to grow by +1.5% in 2017 and +1.8% in 2018, signaling brighter prospects.

The country's vast size poses some serious challenges. Companies such as X5 or M-Video increased their footprint in under-served rural regions and smaller cities. Getting closer to the customer remains the best strategy to secure earnings and benefit from low rent and property prices, and avoid insolvency, a fate that befell companies such as Deti Zao and Planet Stroi in 2016. Although e-commerce represents only 2% of retail sales, digital plays an increasingly important part in Russia's economy. Whereas today, e-shoppers make up only 25% of the population, a number almost -20pp lower than the European average, it is clear online shopping is on an upward trend. The Russian population is relatively young: 15 to 34 make up 28% of the population. These millennials and GenZers can be attracted by online and mobile offerings. The rise of online giants such as Ozon and Ulmart make such investment needs all the more pressing.

Fine-tuning local expansion and digital investment

The financial situation of Russian retailers deteriorated in 2016 as a direct consequence of the recession. Profits plummeted to 3% in 2016 down from 6.6% in 2013. This impacted equity levels, leading solvency down to a mere 25%. On top of that, the slight improvement of indebtedness was not sufficient to push debt to acceptable levels (net gearing of 130% in 2016 versus 258% in 2014). As a result, Euler Hermes assesses the risk of non-payment in the Russia's retail sector as Sensitive. However, retailers are well aware of the long-run challenges they face. Respondents to the Euler Hermes Digital Retail survey ranked tapping into big data as their top challenge to tackle, followed by mastering omni-channeling, and the cost of online presence.

Again, the sheer geography combined with a difficult economic background means that logistical efficiency suffers. Russia is ranked 141st out of 160 countries in the World Bank LPI index. Customs is a particularly thorny issue.

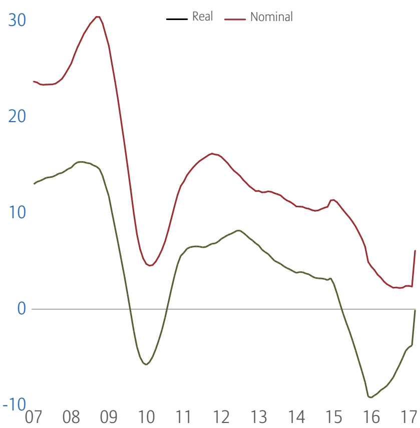
Looking forward: What does it all mean for businesses?

The main question Russian retailers face is how to invest in an innovative and efficient way in rural areas expansion while embracing the next generation of digital and m-commerce customers. But the still-adverse economic environment and a tight financial situation can make it quite difficult to implement such an ambitious strategy in the short run.

✓ Promising sub-sectors: Food grocers and discounters benefit from their must-have status.

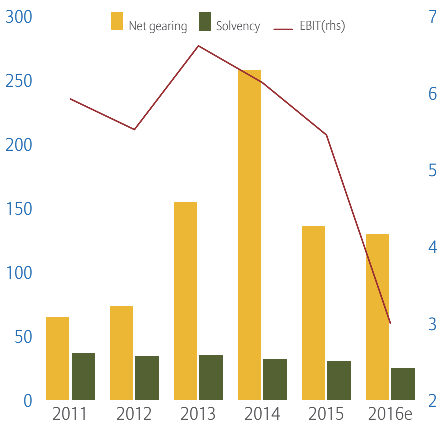
✓ Sensitive sub-sectors: Electronics and independent food retailers have paid the price for a two-year recession. ■

Chart 1 Retail sales in Russia
in %, 12m/12m, as of March 2017



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of Russian listed retailers



Sources: Bloomberg, Euler Hermes calculations