BRAZIL'S ECONOMY, SIMILAR IN MANY WAYS TO THAT OF RUSSIA, HAS BEEN SUCCESSFUL IN ATTRACTING FOREIGN INVESTMENT SINCE DECEMBER 2008. WHAT LESSONS COULD RUSSIA LEARN FROM THE SOUTH AMERICAN COUNTRY? HERE, MICHAEL PUGH AND THERESA HUDSON ASK:

# Should the Russian Bear Learn the Samba?

By **Michael Pugh**, Partner, Lovells CIS, and **Theresa Hudson**, Trainee Solicitor, Lovells CIS

THE RISE IN OIL PRICE from $40 per barrel at the end of December 2008 to $70 per barrel by mid-June 2009 has fuelled growth in the Russian RTS index of over 140 percent from 492.59 in mid-January to 1,202.64 in early June 2009. This rise however sits uncomfortably with a number of key Russian economic indicators such as an estimated decline in GDP in 2009 of between 2.2 percent (the government estimate) and 4.5 percent (the World Bank estimate), an increase in unemployment to 10.2 percent at the end of May 2009 compared to 5.4 percent in June 2008 and a record level of capital flight in 2008 of $130 billion, the flip side of which is the sharp drop in foreign investment and lending into Russia.

Russia is not alone in its experience of the global economic crisis. Many other markets have suffered from the severely restricted supply of liquidity. Yet in some of these countries issuers have successfully re-entered the international debt markets (for example, the issue of £1,500 million of corporate bonds by BP Capital Markets plc in the UK in March 2009, and five issues by French EDF of bonds totaling $13.8 billion between January and May 2009). Most notably, Brazil, similar in many ways to Russia, has been successful in attracting foreign investment since December 2008, while Russian creditors seeking to raise foreign debt are being scrutinized by strict Western-led "face-control" that severely curtails the ability of the Russian economy to refinance itself through international debt. This has meant that the international capital markets remain closed to all but the most blue-chip of semi-sovereign Russian issuers. So this leads us to the ask: What moves has Russia made to overcome the obstacles and how do these compare with the management of the Brazilian economy? And: whether the Russia bear, by changing some of its steps and its image in the eyes of the international investor community can pass through the current "face control" and tap the international debt markets, thereby refinancing its economy with external debt.

> "Russian creditors seeking to raise foreign debt are being scrutinized by strict Western-led "face-control" that severely curtails the ability of the Russian economy to refinance itself through international debt."

## Russia's Response to the Crisis

### Financial Support

Following the sharp fall and temporary closure of the Russian stock markets in September 2008, the government established a $50 billion fund administered by Vnesheconombank (VEB) to refinance foreign debt. For a number of reasons, including budget cuts, in March 2009, the funding program was closed after the allocation of only $11 billion. Finance Minister Alexei Kudrin stated on February 4, 2009, that a contributing factor to the decision to close the program was the U.S. dollar liquidity in the Russian financial system thanks to the institution of a dollar deposit service by the Central Bank of Russia (CBR) in December 2008. Russian banks' deposits of U.S. dollars with the CBR were used to provide Russian commercial banks with a source of dollars with which to refinance the existing foreign currency loans between Russian companies and foreign banks. As a result, the government took the view that its program was not the best way to spend its reserves; with CBR assistance the banks had the means to repay and refinance their existing foreign currency loans (and, in theory, those of Russian corporates).

After the decision to close the fund, the government declared that it would not invest directly in the real economy and that corporates should look to Russian banks for liquidity. To this end, the government mandated state-owned banks VEB and Vneshtorgbank (VTB) to distribute government funds to Russian commercial banks. Effectively, by ensuring the liquidity of a number of key commercial banks, the government delegated the bulk of its responsibility to these banks to distribute funds within the real economy. This approach was designed to ensure that the state assistance measures would simultaneously support both the finance and real sectors as the funds allocated would flow through both sectors. It was also intended to

PepsiCo is one of the world's largest food and beverage companies, with 2008 annual revenues of more than $43 billion. The company employs approximately 198,000 people worldwide, and its products are sold in approximately 200 countries. Its principal businesses include: Frito-Lay snacks, Pepsi-Cola beverages, Gatorade sports drinks, Tropicana juices and Quaker foods. The PepsiCo portfolio includes 18 brands that generate $1 billion or more each in annual retail sales.

Pepsi's history in Russia began in 1959 when former PepsiCo Chairman and Chief Executive Officer Donald M. Kendall, then Pepsi-Cola International President, personally introduced Soviet Chairman Nikita Khrushchev to Pepsi-Cola at the historic American National Exhibition in Moscow. At that event, visitors sampled some 3 million cups of Pepsi. Many years later, Kendall reached a landmark barter agreement with the Soviet government, under which his company provided soft drink concentrate in exchange for Stolichnaya vodka. As a result, in 1974 Pepsi-Cola became the first Western consumer product to be made and sold in the Soviet Union with the opening of the initial franchise bottling plant in Novorossiysk. PepsiCo now operates six beverage plants in Russia with its bottling partner The Pepsi Bottling Group (PBG), as well as a state-of-the-art Frito Lay snack manufacturing facility.

In 2008, PepsiCo and PBG purchased the biggest natural juices producer in Russia – Lebedyansky.

Today, PepsiCo and PBG comprise one of the largest food and beverage providers in Russia, with a broad range of products available in 98 percent of Russian food stores. In addition to popular carbonated soft drinks Pepsi, Mountain Dew, 7UP and Mirinda, PepsiCo and PBG together offer a broad portfolio of locally relevant brands that Russians know and love, including Ya, Tonus, Fruktovy sad and Frustyle juices and nectars from Lebedyansky, Aqua Minerale water, Adrenaline Rush energy drinks, and a variety of Frito-Lay snacks, such as Lay's Potato Chips made with potatoes from local farmers, and Hrusteam crispbreads.

As the market grows, so do the companies' investments in the Russian economy. In early July, 2009 PepsiCo has announced that it plans to invest US$1 billion in Russia over three years, together with its partner PBG. The investment will bring the total investment in Russia by PepsiCo and PBG to $4 billion since the late 1990s, building businesses which provide direct employment for more than 12,000 people and indirect employment for over 30,000 across the country. In 2009 a new beverage facility is opening in Domodedovo, and a new snacks manufacturing plant is expected to open in the southern city of Azov.

PepsiCo's commitment to sustainable growth, defined as Performance with Purpose, is focused on generating healthy financial returns while giving back to communities the company serves. This includes meeting consumer needs for a spectrum of convenient foods and beverages, reducing the company's impact on the environment through water, energy and packaging initiatives, and supporting its employees through a diverse and inclusive culture that recruits and retains world-class talent.
In Russia, PepsiCo actively supports Russian communities and promotes environmental sustainability through initiatives to educate local farmers and help them improve crop yields. These activities include grants to academic institutions to support agricultural innovation and advanced training seminars to promote development-oriented farming among local growers who supply potatoes for Frito-Lay snacks.


* Unilever's brand