522 SW 5th Ave., Suite 708
Portland, OR 97205 USA
Toll Free: 877-WITH-ACG
Direct Line: 503-922-0818
info@aginskyconsulting.com
www.aginskyconsulting.com

ACG Russian/Ukrainian Overview of the Power Tools Market

December 29, 2007

We have structured the research in the following sections:

1. Investment Climate in the emerging markets

In today's global economy emerging markets, especially those of Eastern Europe, provide ideal business climates for investment. The Emerging Markets Private Equity Association expects, that **"over the next decade emerging markets will grow at over twice that of developed markets!"** PE investments in emerging markets have higher rates of return than those of Western Europe and the United States. Limited Partner returns surpassed expectations in emerging markets 52% of the time in 2007, which is up from 25% in 2006.[1] Furthermore, 63% of the LPs anticipated that emerging market private equity funds would deliver **substantially** higher returns over the next five years.[2]

2. Russian Macroeconomic Overview

Since 1999, Russia has experienced outstanding growth rates, constantly improving macroeconomic conditions, and a growing involvement in the global economy. These achievements, together with high world oil prices, political and economic stability, and skyrocketing foreign direct investment have all contributed to the growth of the country's economy.

<u>Russia's growth</u>: Russia is the fastest growing economy in the G8 group of industrialized nations. Over the last seven years, Russia's economy has grown by an average rate of 7 percent each year and is projected to grow at that rate through 2010. In 2006 and 2007 Russia's growth exceeded all expectations (7.9 percent GDP growth), accelerating in several key economic sectors such as retail, real estate, tourism, and communications. Russia has a very stable macroeconomic situation. Inflation runs below 10 percent, foreign currency and gold reserves have increased to around $400 billion and are now the world's third largest after China and Japan.[3] The strength and stability of the economy was noted by the major credit rating agencies (S&P, Moody's and Fitch), all of which awarded Russia an upgraded investment rating in 2006.[4] In addition, the stable political environment has contributed to make the country one of the favorite destinations in the region for foreign investors.

<u>Russia's Investment Climate</u>: The excellent macroeconomic conditions make Russia a thriving capital market that foreign investors are increasingly finding more attractive.

Foreign investment for the *first half* of 2007 totaled $67 billion,[5] compared, for instance, to $14 billion in Poland in the *entire* 2006.[6] Economists say that, "unlike in China, there are no signs of overheating of the economy detectible. Modern Russia has never before seen such a growth rate and economists expect the tendency to continue." [7] Given the most favorable conditions offered by the Russian market, the size of domestic investment is soaring as well, with local entrepreneurs reinvesting their capital in the country's economy.

Russia is open to foreign investment and President Putin has repeatedly stated that foreign investment is critical to the economic development of Russia. Russia's vigorous GDP growth and rising incomes have attracted increasing interest from foreign investors. Approximately 75% of the Russian economy is privatized and there are many factors that make buying into Russia a good decision.[8] By 2012, 87% of private equity investors are expected to be investing in Russia compared with 61% today. PE returns in the US are currently 17.2%, while they are 23.1% in Russia/Eastern Europe.[9]

Many regions have developed laws and programs to attract foreign direct investment. The 1991 investment code guarantees foreign investors rights equal to those of Russian investors. This code also prohibits the nationalization of foreign investments in Russia. Russia has adopted a new land code in 2001 which allows for foreign ownership of Russian land. Russia implemented a series of amendments to its laws on currency controls in 2004, which allow companies investing in Russia to freely exchange their money into foreign currencies.[10]

In the past years, Russia's model of economic growth has notably changed, with retail, telecommunication, and construction, among others, becoming key drivers of the country's booming economy.[11] Citizens' real incomes have doubled over the past six years and consumer demand is thriving. The flourishing Russian economy has given rise to a growing middle and upper class that "has caused an explosion in all types of consumption."[12] Not only is Russia's per-capita income, at purchasing power parity (PPP), well above that of Mexico, Brazil, Turkey, China, and even EU members Romania and Bulgaria,[13] but also "70% of Russians' income is disposable, vs. around 40% for a typical Western consumer,"[14] making it a very attractive market for all types of consumer goods, including power tools.

3. Ukrainian Macroeconomic Overview

"Market growth and a relative lack of market saturation make Ukraine the third most attractive consumer market in the world." – A.T. Kearney

After Russia, Ukraine is by far the most important economy in the Commonwealth of Independent States (CIS), producing four times the output of the next ranking country. Its population is nearly 50 million people and its GDP (at Purchasing Power Parity) is more than $350 billion.[15] With rich farmlands, a well-developed industrial base, highly trained labor force, and a good education system, Ukraine has become a major Eastern European power. Ukraine has experienced rapid growth since the turn of the century and these trends are expected to continue into the future.

<u>Ukraine's Growth</u>: The annual economic growth has averaged 7.4 percent per year since 2000, reaching 12.1 percent in 2004 and 7.0 percent in 2006.[16] GDP grew by more than 50 percent from 1999 to 2004, which, in combination with a significant improvement in the country's fiscal position, led to a dramatic decrease in its debt-to-GDP ratio. Personal incomes are also rising rapidly and total disposable income grew to $49.9 billion dollars in

2005, a 23 percent increase over 2000.[17] Consumer spending in Ukraine has increased by 25 percent YOY to $50.7 billion in 2004, and expanded by an estimated 35 percent to $68.5 billion in 2005.[18]

Ukraine's Investment Climate: Ukraine actively encourages foreign trade and investment. Its foreign investment laws allow Westerners to purchase businesses and property, to repatriate revenue and profits, and to receive compensation in the event that property is to be nationalized by a future government. Ukraine passed more than 20 laws in 2006 to bring its trading regime into consistency with the World Trade Organization standards. These changes are validated by positive indicators such as dramatically heightened investor interest, a surge in foreign direct investment (FDI), sales by financial and industrial groups of subsidiaries and banks, continued growth of services, increases in light industrial production, and continuous entry of small and medium enterprises. In 2005 and 2006, Ukraine received a record amount of FDI, bringing total foreign investment in Ukraine to $19.9 billion.[19] This figure is expected to grow to more than $21 billion in 2007.[20] Russian and European exporters dominate the Ukrainian market, while US exports are steadily climbing, reaching over $500 million in 2006.[21]

4. Russian Real Estate and Construction Market Highlights

Russia is home to a rapidly developing real estate and mortgage market. The tremendous growth of Russian businesses has contributed to the growth of Russia's real estate market and created considerable demand for affordable housing and all types of construction equipment. Thirteen cities in Russia have populations of more than a million which provide ample markets for tools manufacturers.

Residential construction increased by 15% in 2006, which is the highest annual growth rate since 1991.[22] As a whole, the construction industry grew by 19.5% in real annual terms in 2006, accounting for 5.8% of GDP growth.[23] Long-term growth in the housing market is being stimulated by the Russian government. In 2005, Russian President Vladimir Putin launched the National Priority Project (NPP), a national initiative focused on heavy investment in education, healthcare, agriculture, and housing. The housing component of NPP includes $3.5 billion in annual state guarantees to develop Russia's affordable housing sector.[24] This means an estimated one to one and a half billion square feet of new housing will be brought onto the market every year.[25]

According to the Russian Government, about 13.5 billion square feet of available housing is needed to meet the present housing demand of the Russian population. Most of the current available housing in Russia is old, outdated, and rundown. A recently conducted population census in Russia revealed that over half of all private householders occupy buildings that were constructed between the 1950's and 1980's.[26]

Growth is robust in the commercial sector, which runs complementary to the housing sector. In 2006, *Business Week* estimated that foreign investment funds invested as much as $1.5 billion into Russian real estate projects nearly double the level in 2005.[27] The market is especially attractive to commercial real estate investors who are seeing annual returns that are in the double digits vs. 4% to 5% in Western Europe and the U.S.[28] Analysts predict this growth to persist as demand continues to outpace supply by a wide margin.[29]

Construction of entertainment centers and shopping malls is also on the rise (with 17 new shopping centers being completed in Moscow alone in the coming months), as developers look to reap the benefits of rising incomes and growing consumer spending. Expansion is also occurring outside of Russia's major cities as developers have begun investing in the 13 cities with populations of more than one million that are throughout the vast country. By the end of 2008, 11 large shopping malls with a total of about 22 million square feet of new retail space will open in cities like Yekaterinburg, St. Petersburg, Nizhniy Novgorod, and Samara.[30] Despite the spectacular growth, the market is still considered to be in its infancy and is expected to continue to drive demand for housing in the coming years.

The U.S. government reports that Russia has a large potential market for the U.S. construction and building supplies. Traditionally, European manufacturers have been better represented in Russia than U.S. firms. However, given the dollar/euro exchange rate, Russian importers of building products/supplies have expressed an increased interest in U.S. suppliers.[31]

5. Russia's Retail Sector

According to AT Kearney's 2007 'Growth opportunities for global retailers' market study, "Global retail is experiencing an explosive modernization as investment rushes into developing markets. As the wealthiest markets mature, more retailers are pursuing new growth opportunities. Retailers that can identify the most promising markets will become fierce global competitors – able to saturate the obvious markets and gain first-mover advantage in new ones."[32] Rising consumer demand for new and better products and increasing incomes have significantly enhanced the growth of emerging markets' retail sector. In Russia, consumer spending has risen rapidly for the past few years, fueled by an income growth rate of 10 percent last year (2006) and 11 percent the year before.

According to AT Kearney's study, for the third year in a row Russia is ranked the second best market in the world for retail – ahead of China and Mexico, and the first in Europe.[33] In terms of volume, within Europe, Russia's retail is more than three times higher than that of the second-placed Poland.[34] More spending by Russian consumers translated into an overall retail sales growth rate of 25.5 percent in 2006 and there is no sign of slowing down.[35] Growth is expected to increase at an average rate of 11.29 percent YOY through 2011, with the <u>top retail chains expecting to register 42 percent average revenue growth</u>.[36] According to the RNCOS report 'Russian Retail Sector Analysis (2007-2011),' "Russian retail sales reached approximately US$318 billion last year (2006). This has made Russia the second most lucrative and twelfth largest retail market throughout the globe."[37]

6. The CIS Power Tools Market

As incomes rise, consumers in the CIS markets are becoming more and more likely to engage in Do-It-Yourself home improvement projects. Both commercial and residential construction projects are on the rise and the demand for the tools to fuel these endeavors is growing. Last year, Russia, Belarus, and Ukraine accounted for 15% of the value of the European power tools market, currently worth about 3.3 billion euros.[38] The European power tools market, largely fueled by the dynamism of Eastern Europe, grew at 4% in dollar terms in 2006, outpacing the global growth rate of 3%.[39] One of the most important growth regions globally is the emerging markets of the former Soviet Union.[40]

A. Market capacity and trends in Russia

According to industry experts the electrical tools market in Russia was $600-900 million in 2007 (or more than one million pieces per year), and can reach $1.2 billion by 2010.[41] The electric instrument market growth is 20-25 percent a year in Russia and the CIS.[42] About 80 percent of that growth is generated through imports.[43] According to Bosch, their market in Russia has grown 20-30 percent a year.[44]

The market share for domestic manufacturers is down from 60 percent in 2000 to around 20 percent in 2004.[45] This sharp decline has stabilized and Russian manufacturers should not see much more of a decline in coming years. And over half of the market belongs to Chinese manufacturers.[46]

B. Market capacity and trends in Ukraine

According to the U.S. Commercial Service, the Ukrainian market for hand power tools has shown an estimated 15-20 percent increase in 2003, 2004, and 2005 and continues to grow at a similar pace. The market for electromechanical hand tools is 90 percent dependent on imports. The most saleable hand power tools are those produced by Bosch (estimated 26 percent market share with 20 varieties of tools), followed by DeWalt (17 percent), Makita (8 percent), Metabo (7 percent), Sparky (5 percent) and Hilti (3 percent).[47]

According to current market developments, Ukrainian end-users buying tools may be divided into three groups. An estimated 60 percent of sales of electromechanical hand tools are to companies from the construction industry, either large corporate entities or small repair and house remodeling concerns. About 30 percent of hand tools sold in Ukraine are for furniture, window, shutters, doors and other woodworking articles. The remaining 10 percent of imported hand tools is supplied to companies installing HVAC system equipment, security systems, computer wiring, TV cables and other installation services.[48]

C. Recent foreign investment

BOSCH is the most officially established Western brand in the CIS. In August 2007, Bosch Power Tool opened their first professional power tool plant in Russia. It was opened in a small city of Engels near Saratov city. The total cost of the plant was $374 million and their 2007 investments were $ 2.7 million. Their first production was a hammer drill with planned production of 45,000 pieces in 2007.[49] They expect 2.3 million pieces of forty different types to be produced in this facility by 2010. They plan to start production at 200,000 pieces per year (priced at approximately €100-150 per piece) and they expect to reach a capacity of one million pieces per year. The tools from this facility will be sold both in Eastern and Western European markets. Bosch currently exports more than 300 types of products to Russia, with revenues in this market reaching more than €100 million a year.[50]

D. Competitive landscape

The Russian and Ukrainian power tools markets are fragmented and competitive; however because of extraordinary growth across the construction, real estate, and consumer goods industries, there lies great opportunity for further growth in the power tools sector. Competitive factors in the market include pricing strategy, consumer/end-user credit, after-sales parts, service, training, and most importantly innovation. Any model of power tool has a limited shelf life of up to two years, thus making innovation the primary driver of the industry.

Russian manufacturers produce products that have worse design, weight, and ergonomics than their Western counterparts, but often their reliability is the same or even better because they still use local military standards.

There are two distinct market share leaders in the Russian market. According to "METABO EURASIA," Bosch and Makita have approximately the same market share, but Makita is the market leader.[51] According to "Energy Consulting" analysis, Bosch has 20-30 percent of the market share of professional construction electrical tools in Russia.[52] According to Bosch, they have more than a 20 percent share of the market.[53]

The Russian/CIS leading manufacturers are as follows:
Interskol/Izhevsk Mechanical Plant/Bykovo Electroinstrument Plant
PNPPC – Perm Scientific Device
Kirovsk Electromachinary Plant LEPSE

Other Russian Manufacturers	Leading CIS Manufacturers
Konakovo Mechanical Tool Plant	FIOLENT, Ukraine
Saratov Electrotechnical Plant	Microtech, Ukraine
Perm INKAR	MICRON, Ukraine
Moscow Radiotechnical Plant	MOTOR-Sich, Ukraine
Moscow Electroinstrument Plant	DAUER, Latvia
Smolensk Diffusion Instrument	REBIR, Latvia
Beloreck Mechanical Tool Plant	
Voronezh Electrotechnical Plant	
Novosibirsk Instrumental Plant	
Pavlovsk Instrumental Plant	
Serpuhov Instrumental Plant	

The major exporters of power tools to the CIS are companies based in Western Europe, the United States, China, and Japan. The main brands exported into the Russian/CIS market are Makita, Bosch, Metabo, Black & Decker, De Walt, Atlas Copco (AEG, Milwaukee, and Atlas Copco), Hitachi, Kress, Ryobi (TTI), Skil/Bosh, HILTI, FLEX, and FESTO.

Other foreign participants include SANDVIK, STANLEY, ELU, PARTNER, GARDENA, JUNKRS, ARISTON, JOBI, SADOLIN, GLASURIT, and PEUGEOT.
From Poland: JOBI, JUCO, SLOWEK, KUBALA, KUZNJA, EGA
From Germany: PROXXON, DRESS, S&R POWER, OSBORN
From Austria: KAUFMANN, ALPEN
From Asia: Wenzhou Topsky Enterprise, HONITON, ASSIST, etc.

Leaders by specialization are:
Concrete – HILTI
Wood – FESTO
Metal/ship industry – FEIN

This summary report contains some general information about the Russian, Ukrainian, and other CIS power tools markets. For additional information on these markets please contact **Aginsky Consulting Group** (www.aginskyconsulting.com) at info@aginskyconsulting.com or by telephone at 877-WITH-ACG.

Endnotes

1 "EMPEA Quartely Review Q2 2007," EMPEA. June 2007.

2 Ibid.

3 RIA Novosti, May 21, 2007. Available online at: http://www.cdi.org/russia/johnson/2007-115-4.cfm

4 Russian IT quarterly. Available on-line at: http://www.reksoft.com/misc/reksoft_co/files/137/Russian_Economy_Outlook.pdf

5 Kommersant July 23, 2007. The Russian Investment Boom Continues

6 Polish information and Foreign investment Agency. Available on-line at: http://www.paiz.gov.pl/nowosci/?id_news=1350&lang_id=1

7 Kommersant July 23, 2007. The Russian Investment Boom Continues

8 "2006 Investment Climate Statement – Russia," U.S. Department of State. Accessed: October 17, 2007. Available online at: http://www.state.gov/e/eeb/ifd/2006/62376.htm

9 Ibid.

10 Ibid.

11 "Where until 2004 and largely 2005 the growth model was based on an accelerated extraction of natural resources, primarily hydrocarbons, in recent years the structure and sources of growth have absolutely changed. Exports, including the exports of hydrocarbons, have ceased to be the main motive force of economic development, being supplanted by investment demand and the end household demand." Interfax News Agency , Source: The Financial Times Limited. Available on-line at: http://www.tmcnet.com/usubmit/2007/05/21/2641275.htm

12 Business Week, "Russia: Shoppers Gone Wild," February 20, 2006 Available on-line at: http://www.businessweek.com/magazine/content/06_08/b3972071.htm

13 International Monetary Fund, World Economic Outlook Database, April 2007, for the year 2006.

14 Business Week, "Russia: Shoppers Gone Wild," February 20, 2006. Available on-line at: http://www.businessweek.com/magazine/content/06_08/b3972071.htm

15 "Country Report: Ukraine," The World Bank. November 1, 2007. Available online at: www.worldbank.org

16 U.S. Department of State: Bureau of European and Eurasian Affairs. March 2007. Available online at: http://www.state.gov/r/pa/ei/bgn/3211.htm

17 "Overview of Ukrainian Retail," Dragon Capital Corporate Finance. Available online at: http://www.horizoncapital.com.ua/files/Ukrainian%20Retail%20Overview%20(Eng).pdf

18 Ibid.

19 "Ukrainian Commercial Guide," US Commercial Service. March 2007. Available online at: http://www.buyusainfo.net/docs/x_2557634.pdf

20 U.S. Department of State: Bureau of European and Eurasian Affairs. March 2007. Available online at: http://www.state.gov/r/pa/ei/bgn/3211.htm

21 Ibid.

22 Todd Prince. "Mortgage Market Set to Almost Double in 2007," The Moscow Times -20 march, 2007. Available on-line at: http://www.realestate.moscowtimes.ru/archive/realestate/116

23 Adisa Banjanovic. "Housing in Russia becomes state priority," US Commercial Services. 21 May, 2007. http://www.realestate.moscowtimes.ru/archive/realestate/116

24 "Russia: Mortgage Market," US Commercial Services. August 2006.

25 Adisa Banjanovic. "Housing in Russia becomes state priority," US Commercial Services. 21 May, 2007.

26 "Russian Forestry Review 2006." Available on-line at: http://www.russianforestryreview.com/files/docs/rfr_promo.pdf

27 "The Russian Towers Are Coming," Business Week. 9, October 2006. Available on-line at: http://www.businessweek.com/magazine/content/06_41/b4004066.htm

28 Ibid

29 Sabra Ayres. "Malls more than a capital idea in Russia" International Herald Tribune. 4 October, 2006. Available on-line at: http://www.iht.com/articles/2006/09/26/business/remoscow.php

30 Ibid

31 "Overview of the Russian market for building products," BISNIS publication. Available on-line at: http://www.buyusainfo.net/docs/x_4470620.pdf

32 "Growth opportunities for global retailers." A.T.Kearney, 2007

33 Ibid.

34 "Russia Tops Europe's Retail Ranking." Available on-line at: http://www.themoscowtimes.com/stories/2007/10/30/058.html

35 "Growth opportunities for global retailers." A.T.Kearney, 2007.

36 Russian Food Market Projected to Touch US$ 227 Billion Level. Available on-line at: http://www.rncos.com/Blog/2007/03/russian-food-market-projected-to-touch.html

37 "Russian Retail Market to Hit US$ 744.92 Billion Mark by 2011." Available on-line at: http://www.newswiretoday.com/news/18038/

38 "Bosh Opens New Factory in Russia," Moscow News. April 10, 2007. Available on-line at: http://www.mnweekly.ru/business/20071004/55280663.html

39 Ibid.

40 By Uwe Raschke, President of the Power Tool Division of Robert Bosch GmbH on the occasion of the technical press conference in Leinfelden on 27 and 28 February 2007 Available online at http://www.bosch-presse.de/TBWebDB/en-US/PressText.cfm?id=3031

41 Bosch-Russia. Accessed December 28, 2007. Available on-line at: http://www.boschmarket.ru/news/18.html

42 "Analysis of the Power Tools Industry in Russia," June 8, 2006. Restco-ru. Available on-line at: http://www.restko.ru/market/732

43 Ibid.

44 Ibid.

45 Bosch-Russia. Accessed December 28, 2007. Available on-line at: http://www.boschmarket.ru/news/18.html

46 "Bosch locates in Engels – company has reached an agreement on construction of a new factory with local administration," Tatyana Nikitina. Kommersant – Online Journal. July 26, 2007. Available on-line at: http://www.kapital-rus.ru/region_news/detail.php?ID=1827

47 U.S. Commercial Service Reports. Available online at http://www.buyusa.gov/ukraine/en/21.html

48 Ibid.

49 "Bosch locates in Engels – company has reached an agreement on construction of a new factory with local administration," Tatyana Nikitina. Kommersant – Online Journal. July 26, 2007. Available on-line at: http://www.kapital-rus.ru/region_news/detail.php?ID=1827.

50 Bosch-Russia. Accessed December 28, 2007. Available on-line at: http://www.boschmarket.ru/news/18.html

51 Ibid.

52 "Bosch locates in Engels – company has reached an agreement on construction of a new factory with local administration," Tatyana Nikitina. Kommersant – Online Journal. July 26, 2007. Available on-line at: http://www.kapital-rus.ru/region_news/detail.php?ID=1827

53 Bosch-Russia. Accessed December 28, 2007. Available on-line at: http://www.boschmarket.ru/news/18.html