

Street view

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Travel notes from our **emerging markets equities** research team

With 100 million users, Russia has the seventh largest internet user base globally, and members of the emerging markets team went to Russia during December 2017 to take

a deeper look at the internet ecosystem and get an inside view on prospects for growth in the coming years – Geoffrey Wong, Head of Emerging Markets and Asian Equities.

Russia: the prospects for digital growth

"Trips to gain an on-the-ground perspective are a key part of the Emerging Markets Equities team's research process because they allow us to find unconventional sources of information and insight that go beyond financial data and desktop research."

Geoffrey Wong

Head of Emerging markets and Asian equities

During our trip to take a closer look at the Russian internet industry we visited major listed internet and telecoms companies, plus several non-listed companies involved in e-commerce, online marketplaces, and e-hailing services, as well as advertising agencies, and private equity companies with large stakes in fast-growing internet firms.

The key takeaways from our trip to Russia break down as follows:

Digital to become dominant source of advertising revenue

During our meetings we learned that digital advertising currently accounts for around 40% of total advertising revenues and is poised to become the dominant source of advertising spending in the future.

Recent data from the Association of Communications Agencies of Russia show that digital advertising spending is growing at a much faster rate than traditional mediums, growing 23% y-o-y in the first nine months of 2017, compared with 13% for TV advertising and 2% for radio advertising, and a 10% y-o-y decline for print advertising¹.

Our interviewees told us that as digital advertising expands its dominance, social media advertising will take a larger share of online ads than search advertising. By 2030, digital ads are expected to represent approximately two-thirds of Russia's total ad market, implying a CAGR of 12%, according to estimates by Goldman Sachs.



E-commerce remains an under-penetrated market, has strong potential but near-term challenges

E-commerce accounts for approximately 4% of total retail sales in Russia, meaning it is comparatively under-penetrated when measured against other emerging markets like China (c.17%), and 9%, on average globally according to Goldman Sachs, and our interviewees expect healthy growth in the coming years.

Indeed, e-commerce or online sales in Russia are growing at a healthy rate, our interviewees estimated that growth was around 20% y-o-y in 2017 and at a faster rate than overall retail sales, which have been recovering recently as economic momentum has gathered pace. That said, we learned that growth for domestic companies could be challenging due to a lack of sufficient logistics infrastructure, as well as competition from Chinese peers.

E-hailing has structural underpinnings for growth

Poor infrastructure, including a lack of public transport, plus the high cost of car ownership, means Russia has robust structural underpinnings for growth of its e-hailing market.

Yandex Taxi and Uber, now merged, cover approximately 75 million to 80 million Russian users – c. 55% of the population – yet only 8% of taxi rides are currently bought online, according to Goldman Sachs. During our interviews, we learned that profitability should improve, particularly as companies are expected to reduce the rate of subsidies for passenger rides.

Many companies working to develop a 'superapp'

Tencent's success in developing its Wechat superapp is prompting many Russian internet companies to build an app with a similar online ecosystem of their own. Such an offering would include payments, games, taxis, food delivery, messenger services etc, to both increase engagement and their potential to monetize their user base.

An internet ecosystem which favors local players

While Russia's market is not hostile to players from the US or China, during our visits and interviews we felt that foreign companies won't be allowed to dominate the market. In fact, Russia is one of the few markets where Google and Facebook don't dominate search and social media – even though Facebook is present in Russia, our research shows its user base is only 1% of the total user base, while Google's revenues are less than 1% of its total.

Longer-term outlook: Consolidation and less competition are likely

Our interviewees told us that consolidation and less competition in the industry is likely. Companies with large offline user bases, such as MTS and potentially even Sberbank, want to take a share of the digital business. Similarly, online players realize that a successful e-commerce model is probably a mix of online and offline.

The shift toward online advertising, strong potential for e-commerce, low costs of mobile internet usage, structural underpinnings for e-hailing, and the limited presence of foreign competitors, means that the growth prospects for the Russian internet market look good.

Russia's internet ecosystem is primed for growth

The shift toward online advertising, strong potential for e-commerce, low costs of mobile internet usage (USD 1.5 for 1GB, vs. USD 8.8 in the US), structural underpinnings for e-hailing, and an internet ecosystem which favors local players, means that the growth prospects for the Russian internet market look good.

The team will continue to watch closely Russia's dominant internet players as they expand their e-commerce offerings to see how their respective strategies pan out and whether they are able to capture this growth opportunity.

www.ubs.com/assetmanagement

1 Source: Russia Beyond: Russia's online advertising market on the rise, but print and TV counterparts stalling
www.rbth.com/business/326691-russia-advertising-market

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