



Business Outlook in Azerbaijan

Deloitte CIS Research Center
2017

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Introduction



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Managing Partner
Deloitte Azerbaijan

We are pleased to present the first edition of Business Outlook in Azerbaijan, the Deloitte Research Centre's macroeconomic journal.

We focus on the current trends in Azerbaijan's economy and present our key research findings.

In August–September 2017 Deloitte CIS conducted a survey of the top management of Azerbaijani companies. It serves as the basis of our integrated research on the state of the business environment in Azerbaijan.

If you have any questions or suggestions regarding this research, please do not hesitate to contact us: cisresearchteam@deloitte.ru

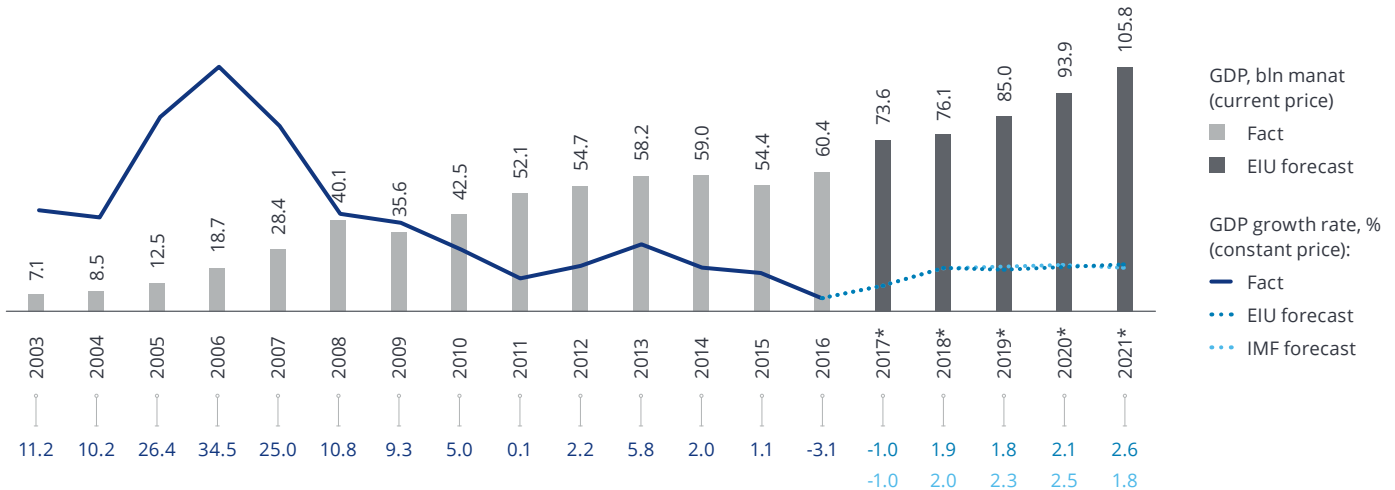
01 Azerbaijan in figures





Key macroeconomic indicators

Gross domestic product, 2003–2021

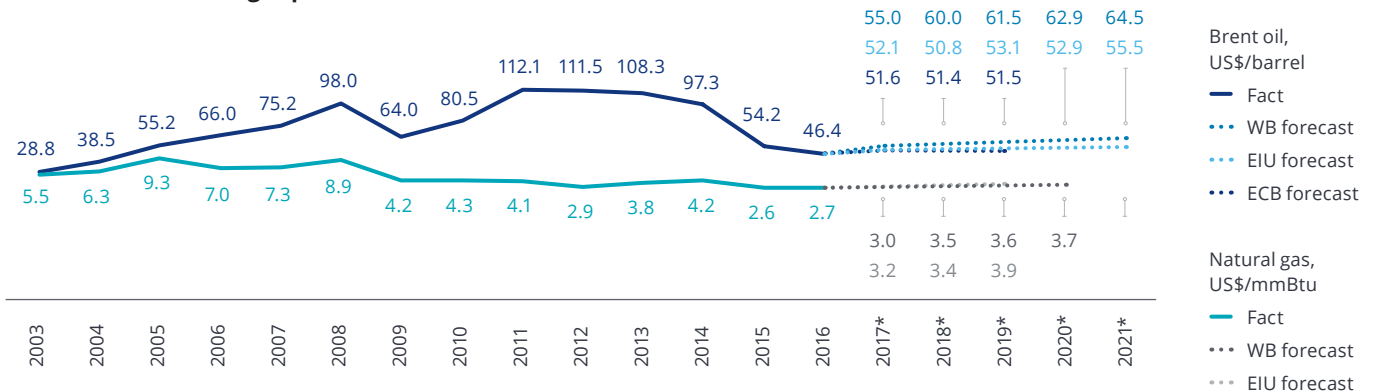


Source: Historical data – UN statistics, State Statistical Committee of the Republic of Azerbaijan

*Forecast – Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

In September 2017, the Economist Intelligence Unit (EIU) forecasted an economic contraction of 1% in 2017, caused by tight fiscal and monetary policy, low private consumption, and declining oil production, owing to the existing ageing wells and the lower productivity of new wells.

Brent oil and natural gas price



Source: Historical data – Finam Holdings

*Forecast – EIU, World Bank (WB), European Central Bank (ECB)

“A decrease in 2016 GDP was expected. The oil and gas sector still accounts for the biggest share of Azerbaijan’s GDP, and oil export revenue represents most of the total export revenue. In addition, many non-oil sectors directly depend on the oil revenues. Non-oil GDP strongly depends on the allocation of funds from the state budget in this regard. Therefore, the fall in world oil prices has affected and continues to affect the value of Azerbaijan’s economy. As a result, its GDP started to drop practically from the first month of 2016.”

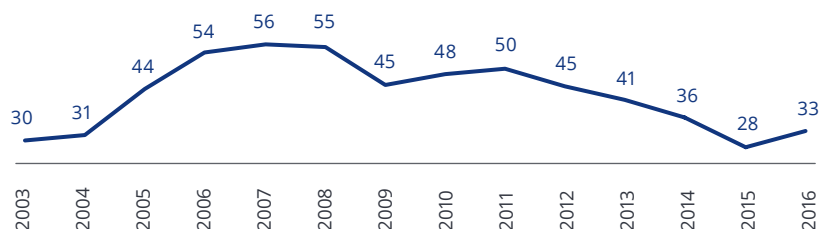
Vugar Bayramov

Chairman of the Center of Economic and Social Development

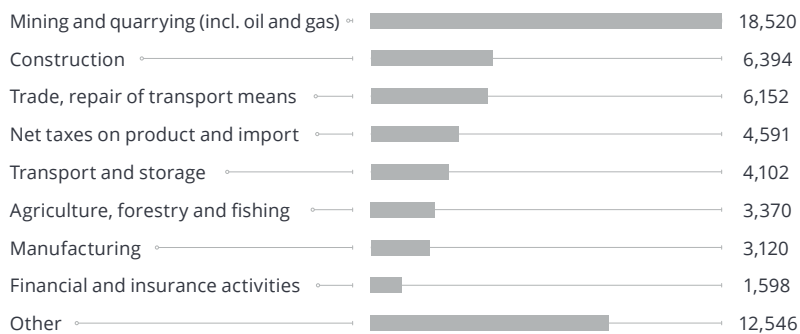


Key macroeconomic indicators

Dynamics of oil and gas sector share in total GDP, (%)

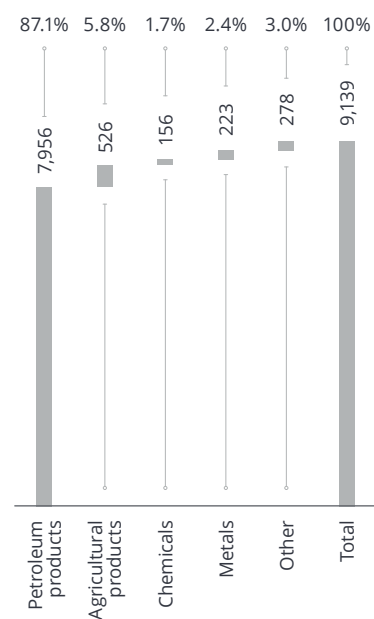


2016 GDP structure, (mln Azerbaijani manat)



Source: State Statistical Committee of the Republic of Azerbaijan

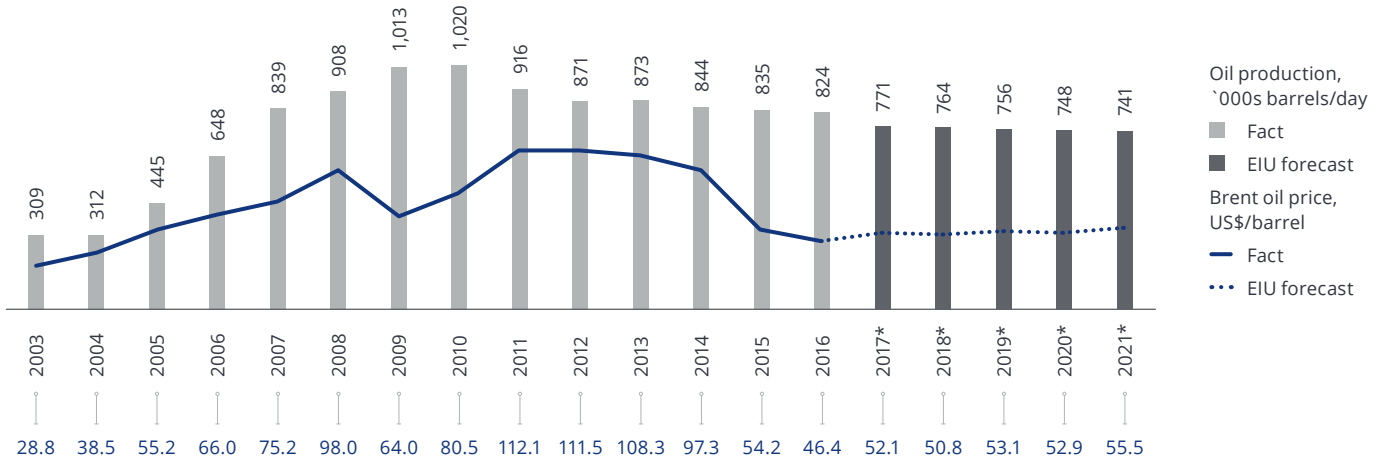
Structure of goods export 2016, (mln US\$)





Key macroeconomic indicators

Oil production and Brent oil price



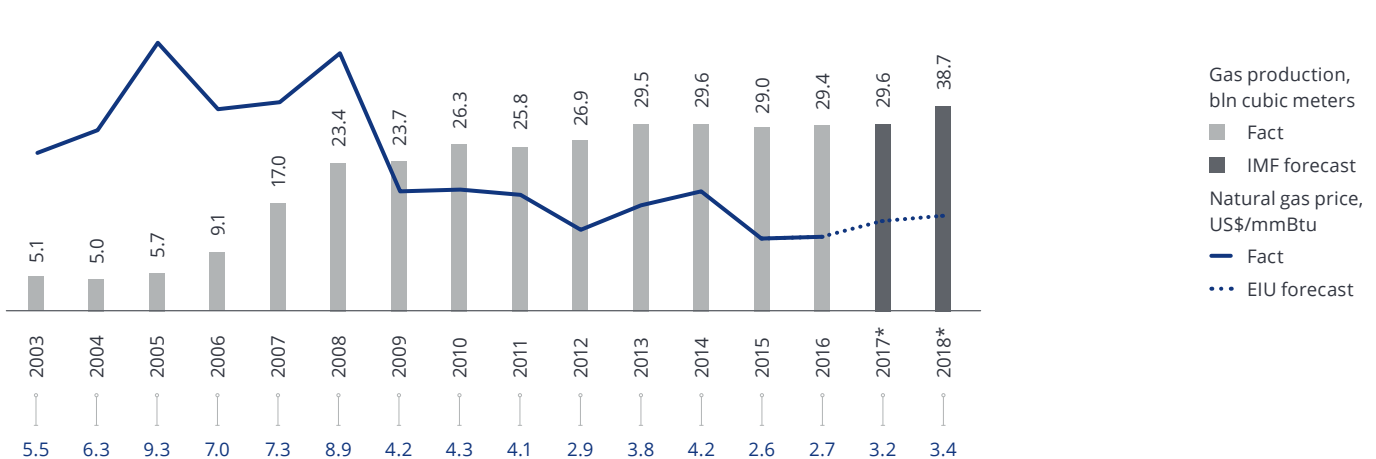
Source: Historical data – EIU, Finam Holdings

*Forecast – EIU

Oil output is forecasted to decline in 2017–21. Risks are oriented to the downside, as stabilization of production will be limited by weak investment.

Source: EIU

Natural gas production and price



Source: Historical data – State Oil Company of the Azerbaijan Republic (SOCAR), The Oxford Institute for Energy Studies, Finam Holdings

*Forecast – IMF, EIU

The Shah Deniz is one of the world's largest gas-condensate fields located on the shelf of the Caspian Sea 70 km southeast of Baku. The first stage began operations in 2006 and currently has the capacity to produce around 10 billion cubic meters of gas per annum (bcma) and approximately 50,000 barrels a day of condensate. Shah Deniz Stage II is a giant project that will add a further 16 billion cubic meters per annum (bcma).

Source: British Petroleum

"2017 is an important year for BP and for the Shah Deniz II project, which is already around 90% complete. We have planned a series of key completion milestones for this year. We are committed to achieving all of these milestones on schedule to make BP's 25th anniversary celebrations in Azerbaijan a big success."

Ewan Drummond

Vice President of BP's

Azerbaijan-Georgia-Turkey projects



Key macroeconomic indicators

Price indices of consumer goods and paid services rendered to population

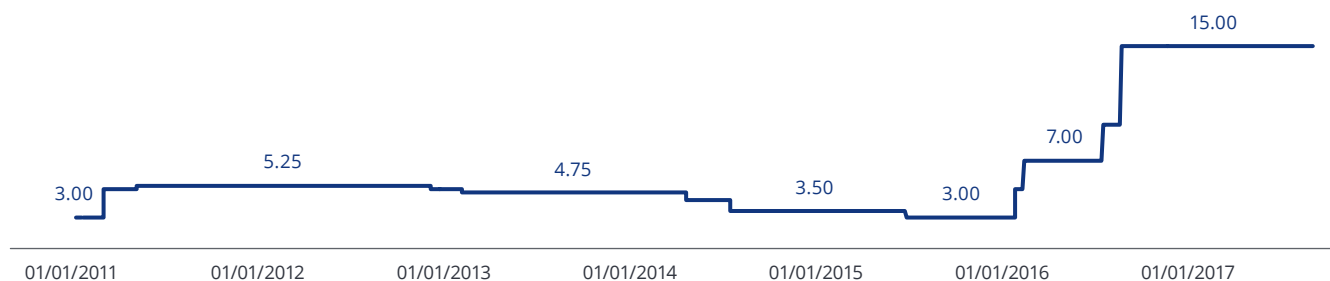


Source: Historical data – State Statistical Committee of the Republic of Azerbaijan,

*Forecast – EIU, IMF

According to the State Statistics Committee, average annual inflation stood at 14% over Jan–Aug 2017.

Refinancing rate, (%)



Source: Central Bank of the Republic of Azerbaijan

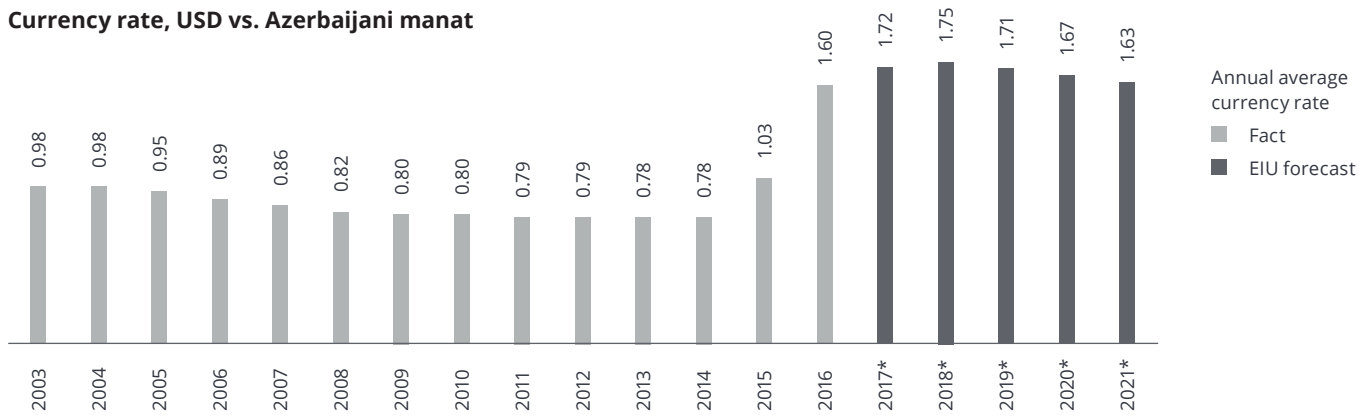
On 18 September 2017, the Management Board of the Central Bank of the Republic of Azerbaijan made the decision to leave the refinancing rate and other parameters of the interest rate corridor unchanged (the refinancing rate is 15%, the corridor floor is 10%, and the corridor ceiling is 18%). The Management Board of the Central Bank of Azerbaijan will next hold an interest rate meeting on 15 November 2017.

Source: Central Bank of the Republic of Azerbaijan



Key macroeconomic indicators

Currency rate, USD vs. Azerbaijani manat



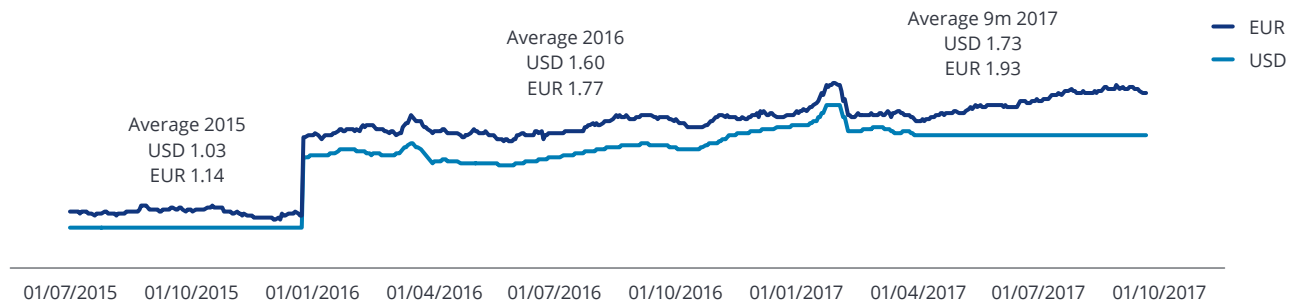
Source: Historical data – Central Bank of the Republic of Azerbaijan,

*Forecast – EIU

The launch of Shah Deniz II will boost export earnings, however, gas prices are projected to remain relatively low and oil prices are expected to remain broadly flat. The EIU forecasts a modest appreciation of the manat against the dollar of about 2% per year in 2019–21.

Source: EIU

EUR and USD vs. Azerbaijani manat, Jul 2015–Sep 2017



Source: Central Bank of the Republic of Azerbaijan



Key macroeconomic indicators

Budget of the Republic of Azerbaijan

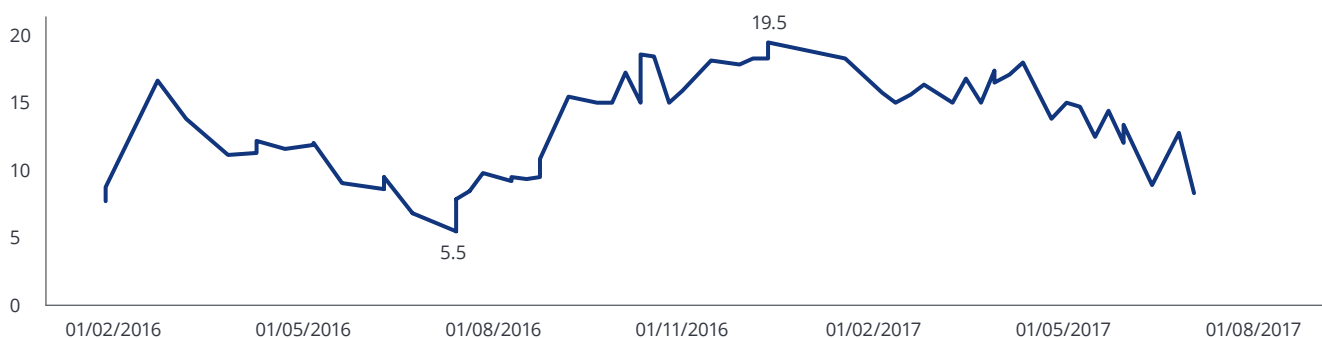


Source: Central Bank of the Republic of Azerbaijan

*Forecast – EIU

In September 2017 the EIU forecasts an economic contraction of 1% in 2017, caused by tight fiscal and monetary policy, low private consumption, and declining oil production, owing to the existing ageing wells and the lower productivity of new wells.

Yield on Azerbaijan's Tbills (%)

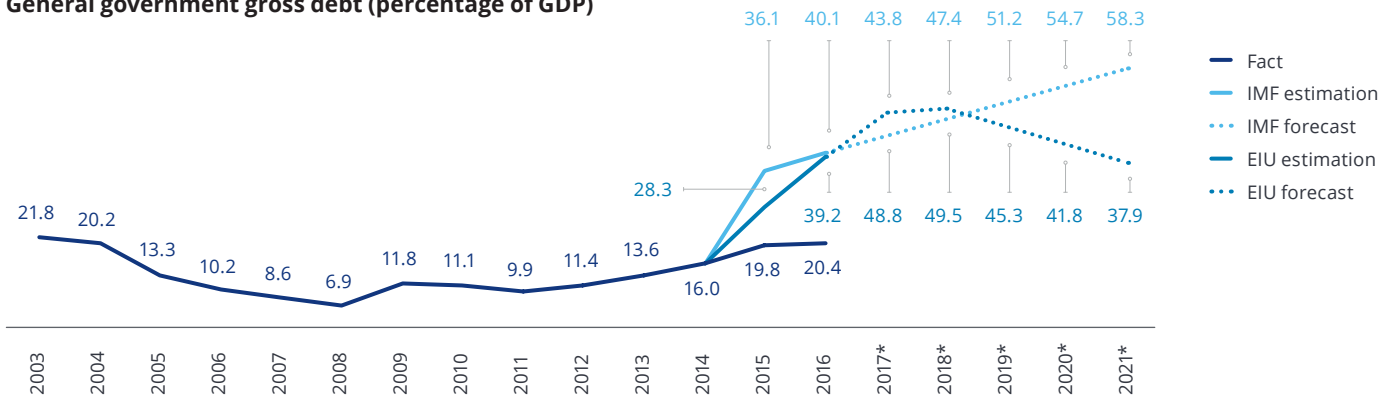


Source: Central Bank of the Republic of Azerbaijan



Key macroeconomic indicators

General government gross debt (percentage of GDP)



Source: Historical data – The Ministry of Finance of the Republic of Azerbaijan

Estimation and *Forecast – EIU, IMF

“The increase in government debt correlates with the steps taken to improve the financial situation of the International Bank of Azerbaijan. Its debt will pass to the government and the government will issue Eurobonds in order to pay this debt. For that reason, the upper limit of external borrowing would increase by 4 billion manats. We have to do this. This Bank is also a state bank and the president gave the order to privatize it. We need to improve its financial situation before we can privatize it. Azerbaijan’s government debt can hardly be considered big.”

Vahid Akhmedov

Member of the Milli Majlis, Deputy Chairman of Milli Majlis’s Committee on Economic Policy, and Member of Parliament

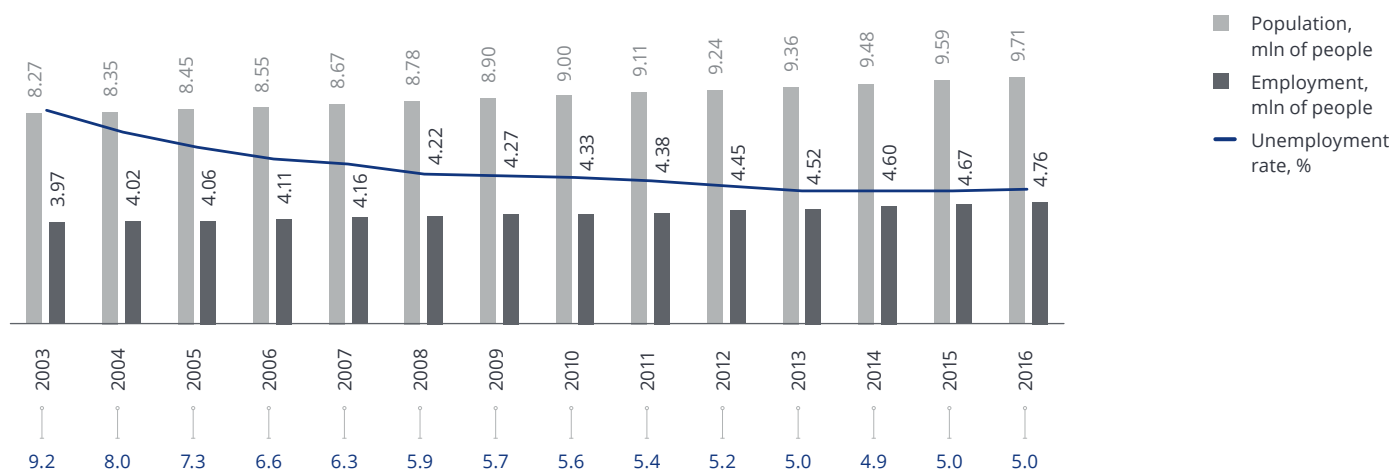
In May 2017 the state-controlled International Bank of Azerbaijan (IBA), the country’s largest bank, announced a foreign debt restructuring plan. As part of the restructuring, on 1 September the Ministry of Finance issued seven Eurobonds worth a total of US\$2.27 bln, with maturities ranging from end 2017 to 2032, and the IBA issued a US\$1 bln seven-year Eurobond.

Source: EIU

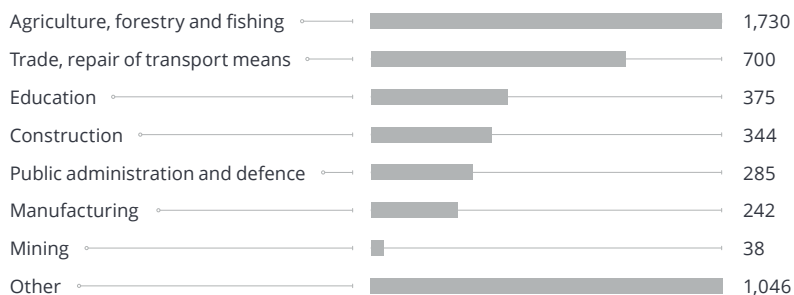


Key macroeconomic indicators

Population and employment



Distribution of employed population by economic activity ('000s of people)

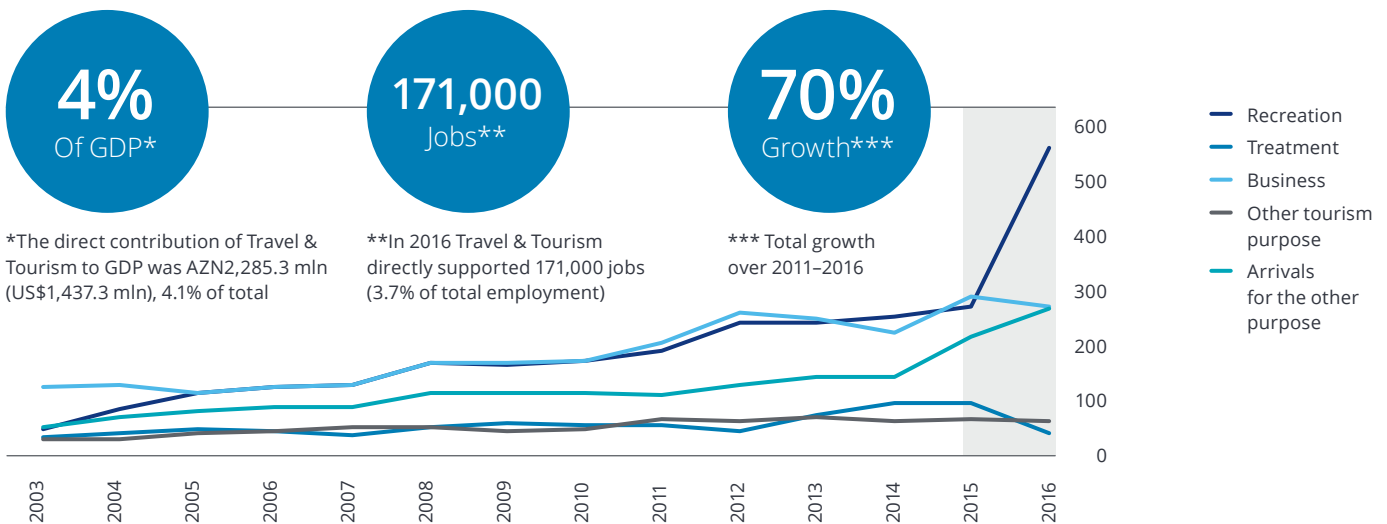


Source: State Statistical Committee of the Republic of Azerbaijan



Tourism

Number of accommodated persons in hotels by purpose of travel, ('000s persons)



Source: State Statistical Committee of the Republic of Azerbaijan,
World Travel & Tourism Council

"In January–August 2017, the increase in the number of tourists was 23.1% (1.818 million people) and this is a positive trend."

"During the reporting period, the volume of transactions carried out by foreign citizens also increased by 97%, and purchases were made for AZN 713,000,000. This is almost a two-fold increase and a real contribution to the economy of the country"

Abulfas Garayev

Minister of Culture and Tourism of Azerbaijan



Sport news

F1 and UEFA Champions League

2.99

million
viewers*

Top 5 F1 Broadcasts 2017:

1. Azerbaijan Grand Prix (live): **2.99** million viewers
2. British Grand Prix (live): **2.86** million viewers
3. Bahrain Grand Prix (live): **2.82** million viewers
4. Spanish Grand Prix (highlights): **2.65** million viewers
5. Monaco Grand Prix (live): **2.55** million viewers

The season high is clearly Azerbaijan across the metrics analyzed, not only the highest average of the season but also recording a decent percentage rise year-on-year. The only other race to increase year-on-year is Spain, with the Catalonia race seeing a 6 percent rise compared with 2016. During 2016, a combined average audience of 2.63 million viewers watched Formula 1's 21 races across Channel 4 and Sky Sports.



UEFA Champions League Group C

Chelsea (England)

Athletico (Spain)

AS Roma (Italy)

Qarabağ (Azerbaijan)

Qarabağ qualified for the UEFA Champions League group stage for the first time in the club's history. Qarabağ will be the first Azerbaijani team to play in the group stage of Champions League.

"It's an incredible feeling to play in the Champions League, but we're there for the first time so it will be hard for us and we'll show our potential in the games."

Dino Ndlovu

Qarabağ FC player

Source: f1broadcasting.co, Qarabağ website

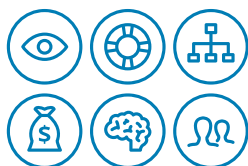
* Worldwide viewers across Channel 4 and Sky Sports.



Top 10 M&A deals of the last 15 years

	Date	Target company	Bidder company	Seller company	Deal Value USD (mln)	Deal Dom. Industry
1	16/08/2010	Azeri-Chirag-Gnashli project (5.63% stake)	BP Plc; Chevron Corporation; Itochu Corporation; INPEX Southeast Caspian Sea Ltd.	Devon Energy Corporation	3,416	Energy
2	30/04/2015	Shah Deniz gas field (15.5% stake); South Caucasus Pipeline Company Ltd. (15.5% stake)	Petronas Gas Berhad	Statoil ASA	2,250	Energy
3	31/12/2014	Shah Deniz gas field (10% stake); South Caucasus Pipeline Company Ltd. (10% stake)	Turkish Petroleum Corporation	Total S.A.	1,500	Energy
4	06/05/2014	Shah Deniz gas field (10% stake); South Caucasus Pipeline Company Ltd. (10% stake)	BP Plc; State Oil Company of the Azerbaijan Republic	Statoil ASA	1,450	Energy
5	28/04/2003	Azeri-Chirag-Gnashli project (10% stake)	INPEX Southeast Caspian Sea Ltd.	Lukoil OAO	1,354	Energy
6	28/03/2013	Azeri-Chirag-Guneshli field (2.72% stake); Baku Tbilisi Ceyhan Pipeline Co. Ltd. (2.36% stake)	ONGC Videsh Ltd.	Hess Corporation	1,000	Energy
7	22/02/2008	Karasu Operating Company (85% stake); Kura Valley Operating Company (80% stake)	Global Investment Energy	Nations Petroleum Company Ltd.	340	Energy
8	12/02/2008	Azercell Telekom B.M. (35.7% stake)	Azertel Telekomunikasyon ve Yatirim Dis Ticaret	Republic of Azerbaijan	180	Telecommunications: Carriers
9	06/06/2007	Binagady Project (37.5% stake)	RussNeft NK OAO	AzenOil Company BV	150	Energy
10	25/08/2008	Baku-Castel OJSC (92.8% stake)	JSC Baltika Breweries	Brasseries Internationales Holding (Eastern) Ltd. (BIH Eastern)	50	Consumer: Other

02 Azerbaijani business environment



Deloitte CIS would like to thank all those who participated in the survey we conducted in August–September 2017 as part of our “Business Outlook – Azerbaijan” project. We do appreciate your time and your interest in our research. Your expert opinions allowed us to conduct an integrated analysis of Azerbaijan’s business environment, as well as to study the sentiments and expectations of market participants about their companies’ development and the market overall.

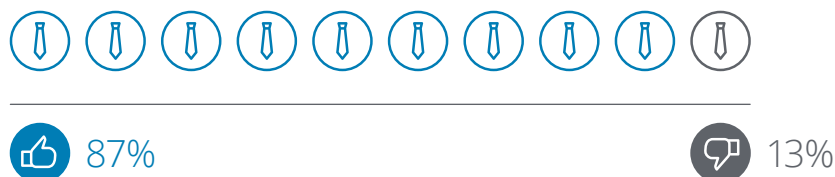
We are pleased to present you with the key findings of our research. We hope that you will find it useful and informative. We would be grateful if you participate in our next survey.

Please feel free to contact us if you have any questions about this report.

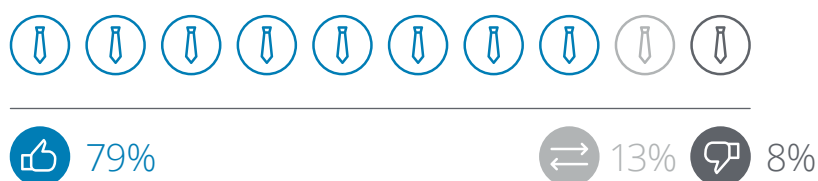


Financial outlook

Respondents were asked to assess the current market position of their companies (in 2H 2017):



Respondents were asked to assess their company's outlook (in 2018):



With 87 percent of the respondents having a positive view of how their companies perform, Azerbaijan's overall business environment is clearly perceived as positive.

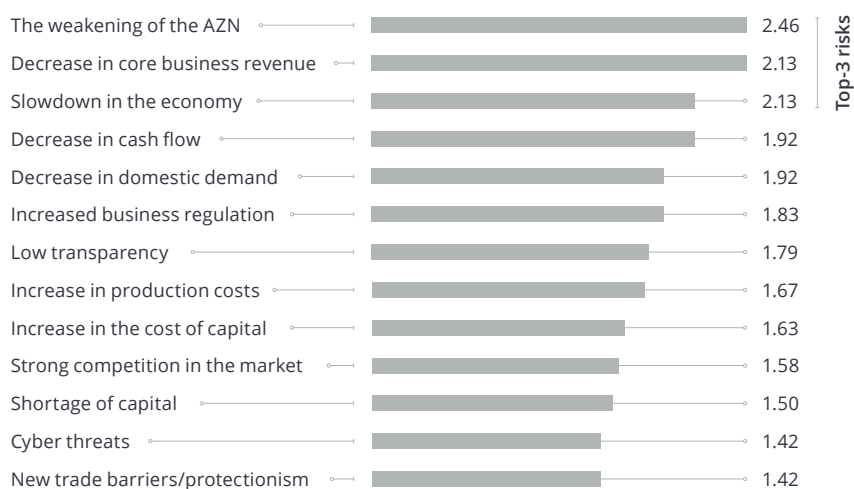
Moreover, the majority of respondents are optimistic about 2018: 79 percent are expecting improvement. Only 13 percent believe that the situation will remain unchanged and 8 percent expect the situation to deteriorate.

Such a positive outlook on Azerbaijan's business environment and the respondent's optimism may be due to the fact that after facing difficult challenges in 2015–2016 companies are now finally seeing signs of a stabilization.



Risks rating

Respondents were asked to evaluate the impact of the risks [on the scale of 1 to 3]

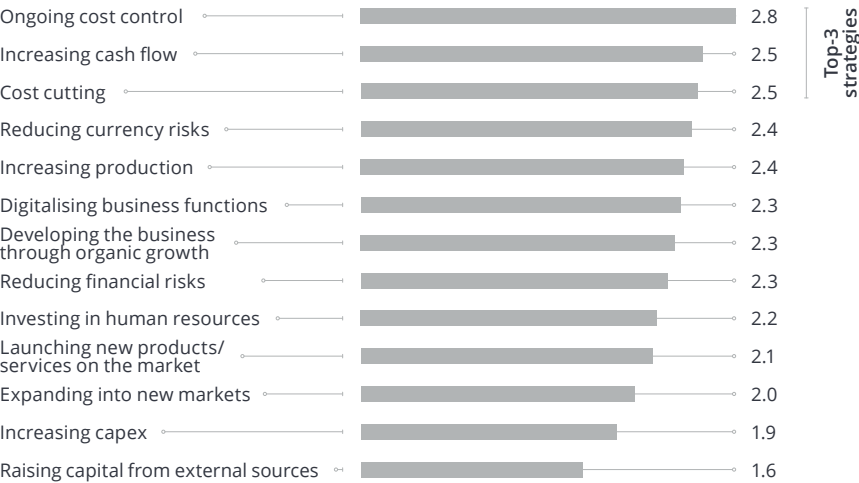


Our survey has shown that the Azerbaijani business is focused on macroeconomic issues: downside risks for the exchange rate of Azerbaijani manat, a slowdown in the national economy and a decrease in domestic demand; as well as concerns about a possible decrease in revenue and cash flow.



Strategies rating

Respondents were asked to evaluate the priority of the strategies [on the scale of 1 to 3]

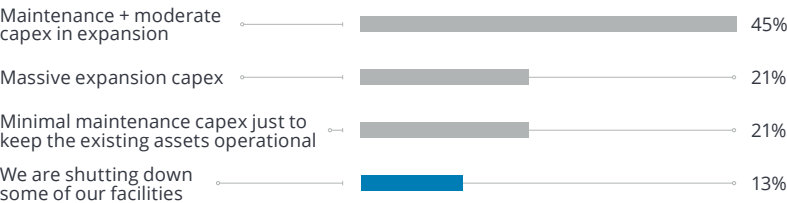


Improving operational performance is a high priority for Azerbaijani companies: cost control and optimization as well as increasing cash flow are in demand.



Current approach to capex

Respondents were asked about their current approach to capex



FSI companies are more often shutting down some of facilities (43%) than companies from other sectors

The majority of respondents (66 percent) specify that the current level of capex is sufficient for expansion: 45 percent for moderate and 21 percent for massive expansion.

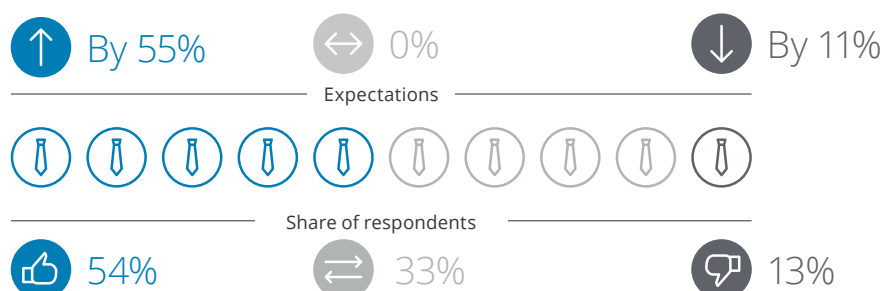
Another 21 percent of companies hold minimal maintenance capex just to keep their existing assets operational. And 13% of companies are forced to shut down some facilities.



Economic expectations

Respondents were asked about expected changes in key financial metrics over the next 12 months

Revenue (in AZN)



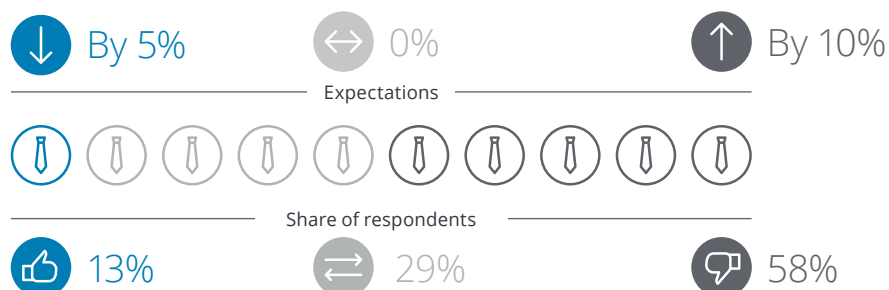
Opinions on the revenue changes are divided: 54 percent believe the revenue of their companies will increase (by an average of 55%), while 13 percent hold the opposite view (expected decline by 11%) and 33 percent indicated that the revenue will remain the same.



Specific patterns:

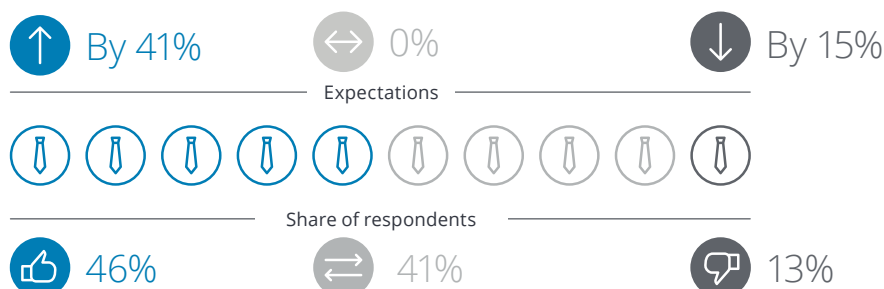
FSI companies expect the decrease in revenue more often (43%) than companies from the other sectors.

Operating expenses (in AZN)



Typically, revenue growth is generally accompanied by an increase in operating costs. Our survey has found that 58 percent expect operating costs to grow by an average of 10 percent.

Operating profit (in AZN)



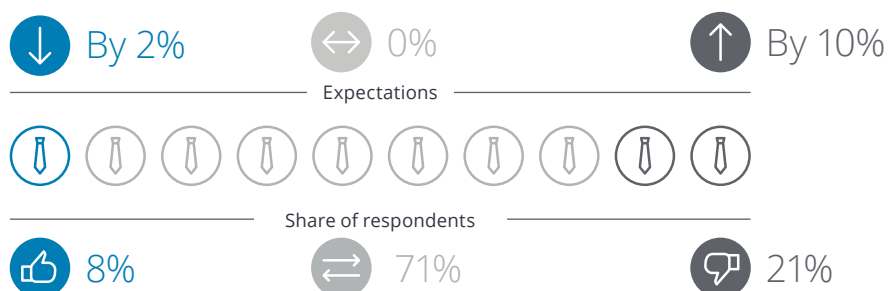
Almost half of companies (46 percent) believe that the operating profit will increase (expected average growth of 41%) while 42 percent of respondents forecast that it will remain unchanged. Only 13 percent of experts expect a decline in operating profit – by 15%.



Economic expectations

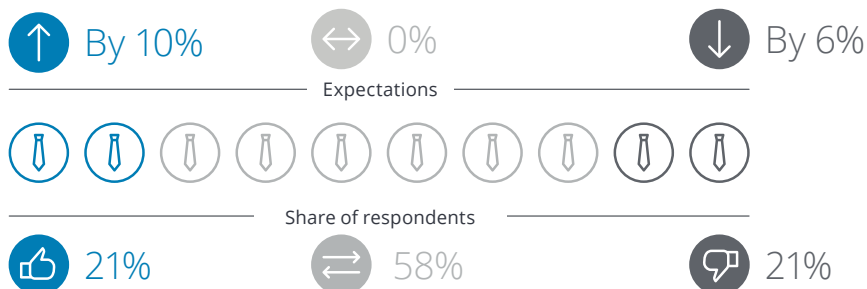
Respondents were asked about expected changes in key financial metrics over the next 12 months

Cost of capital (in AZN)



The majority of respondents (71 percent) expect that the cost of capital will remain at the same level. However, 21 percent of experts forecast an increase in the cost of capital by an average of 10%. About 8 percent think that the cost of capital will decline slightly (by 2%).

Number of staff



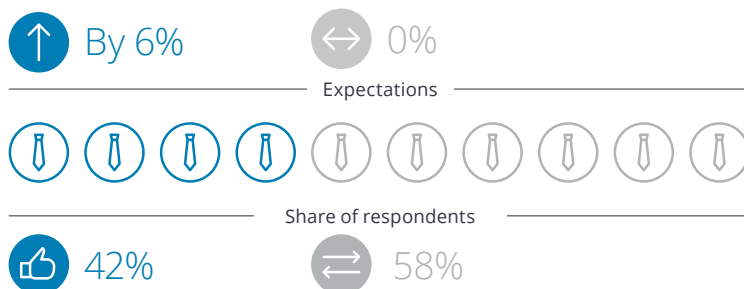
Outlook on the number of staff: 21 percent of respondents forecast an increase (growth will be 10%), while another 21 percent expect the opposite (a 6% decline). Fifty-eight percent believe that the number of employees will remain the same.



Specific patterns:

Not a single FSI company is going to increase its current number of staff.

Average wages (in AZN)



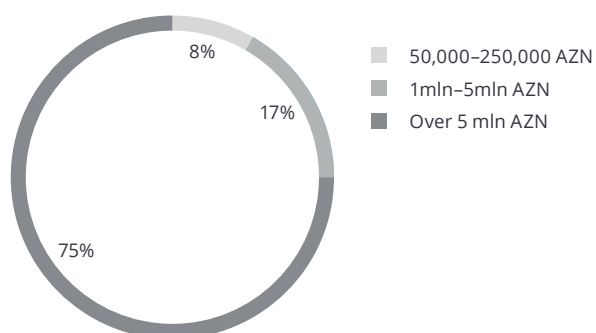
Of the respondents surveyed, 42 percent expect an increase in the average level of wages – in their opinion, growth will be 6%.

A significant number of companies (58 percent) do not consider wage adjustments. Given an inflation forecast of 13%, this indicates a decrease in the real income of employees.

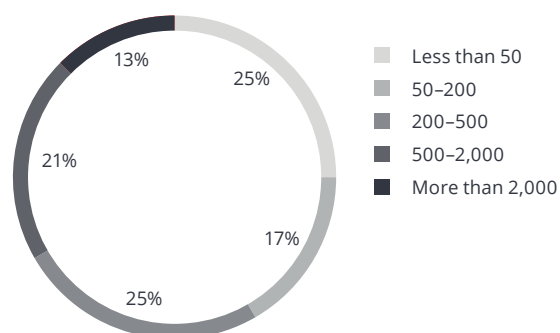


About respondents

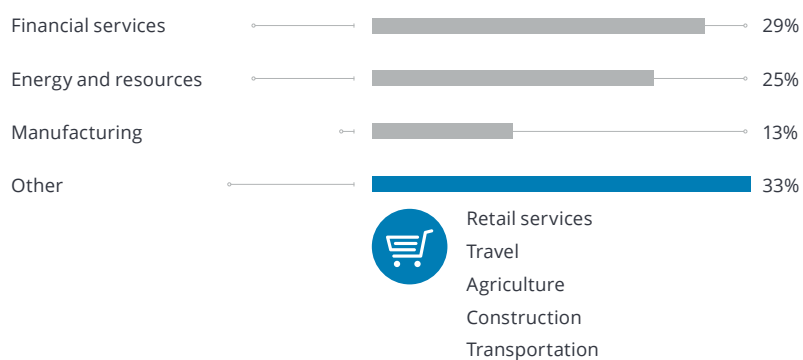
Company's annual gross revenue in 2016



Total number of permanent employees



Companies by industry



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