



# Baltic CFO Outlook

October 2014

## Executive Summary

- According to the Baltic CFO Outlook 59% of the CFOs in largest companies in Baltics assess current overall financial position of their companies as favourable. 10% estimate it as very favourable.
- In comparison with the previous CFO Outlook, which was done in March 2014, not the optimism of Baltic CFOs has somewhat declined. In spring 51% of largest companies estimated that the business climate during next six months will be either favourable or very favourable. Now only 41% agree to this opinion.
- 40% of respondents in all three Baltic States expect a cash flow increase up to 10% during next 12 months. Another 13% expect that cash flow increase will exceed 10%. In March 47% of CFOs expected a cash flow increase up to 10% and 18% of respondents expected a larger increase in turnover in their companies.
- Concerns about demand remain as the main concern for companies for the next year. Worries about availability of skilled labour and foreign competition have somewhat increased while concerns about labour cost, cost of raw materials and access to capital have lost their relevance.
- 56% of Baltic CFOs expect that the sanction war between Russia and the West will have a negative impact on their business. 32% of respondents think the effect will be neutral while 13% think the sanctions might have a positive effect on their business opportunities.

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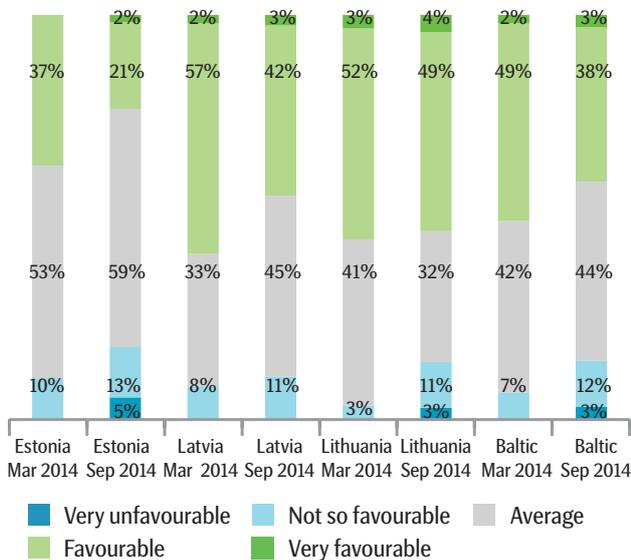
Baltic CFO outlook is based on a survey conducted by SEB:

- Around 160 largest Baltic companies participated
- Respondents – CFOs of the companies
- Hot topic: Consequences of geopolitical unrest on Baltic businesses

## Assessment of business conditions in the next 6 months of the company

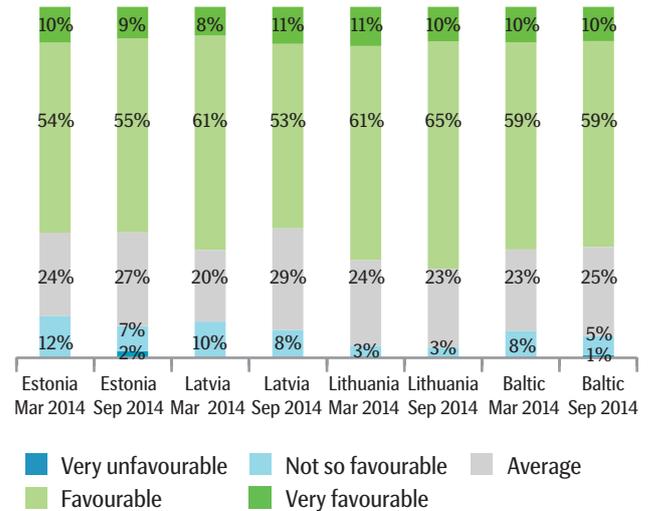
At the start of the year, forecasts and the expectations of businesses predicted that economic conditions this year would improve, which was largely reflected in the results of the March survey. However, the Eurozone economy continued to stutter. Moreover, the Ukraine conflict has grown in scale and has begun to depress not only the current economic mood, but is also beginning to resonate in future forecasts. CFO survey results indicate that the mood of businesses has become slightly more cautious. There has been an increase, albeit a slight one, in the number of those with a negative outlook, even though broadly speaking, for the time being, there are no radical changes in the assessments.

## Assessment of business conditions in the next 6 months of the company



The first CFO review was compiled shortly before the political upheavals in Ukraine began to take an unpredictable trajectory, as a result of which the overall mood in all three Baltic States was comparatively positive. Since then, the scale of the Ukraine conflict has significantly expanded and has shaken the prospects for the whole region. This is also reflected in the deterioration of the mood of businesses, which has a corresponding knock-on effect on opinions regarding the conditions for business during the next six months. In all three countries, there has been an increase in the number of businesses that consider the situation as being not so favourable. In Estonia and Lithuania, a small group of businesses (i.e. 5% and 3%) consider the situation to be very unfavourable, although such an assessment is not evident in Latvia. Meanwhile, in Latvia and Estonia, there has been a more visible contraction in the group of businesses that consider the situation to be favourable. In Lithuania, the reduction of this group has been negligible, which could be explained by positive domestic consumption trends. Among businesses, there are also clear optimists, whose opinions remain untouched by geopolitical events. At present, the majority of businesses have adopted a more cautious position due to the increase in uncertainty. However, for the time being, Russian sanctions and other measures disrupting economic collaboration have not had a significant impact on the economies in the Baltic region and economic forecasts predict growth, albeit of a slower pace. A larger effect stems from the stagnation within the Eurozone economy. However, businesses in all three Baltic States are working hard to diversify their risks. This means that, until next year when the Eurozone economy could start to demonstrate more substantive growth and efforts of Baltic companies to enter new markets could start to bear their initial fruit, the mood of businesses could well remain decidedly cautious.

## Assessment of the overall financial position of the company

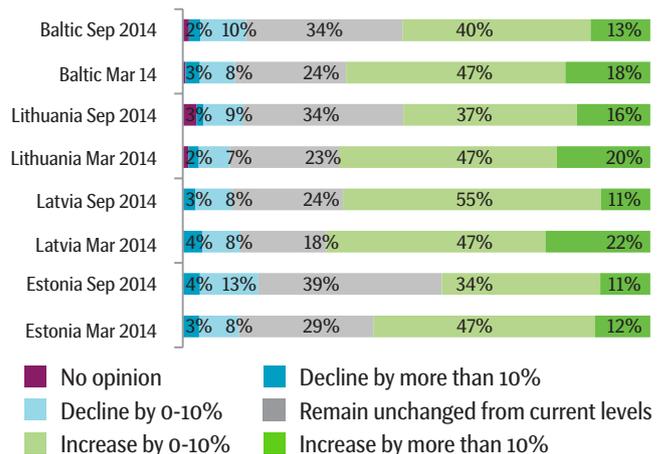


Despite the slightly varying macroeconomic background in each of the Baltic States, there have been no significant changes in the assessments of the financial status of companies since the spring. In Estonia, a small proportion of very unfavourably-minded businesses have emerged. There has been a slight reduction in the number of businesses that view their financial situation as unfavourable, and an increase in the proportion that have a neutral opinion of their situation. In all probability, there is a division here among those businesses that have proved able and are still trying to adapt to the slow growth of the Estonian economy. However, more significant changes have been observed in Latvia, where the proportion of those businesses who consider their financial situation to be favourable has fallen from 61% to 53%. Accordingly, the proportion of businesses that hold a neutral view of the situation has risen from 20% to 29%. In Lithuania, since spring the structure of opinions has remained virtually unchanged.

### Normunds Staņevičs, CEO of Rīgas piena kombināts (Food Union Group)

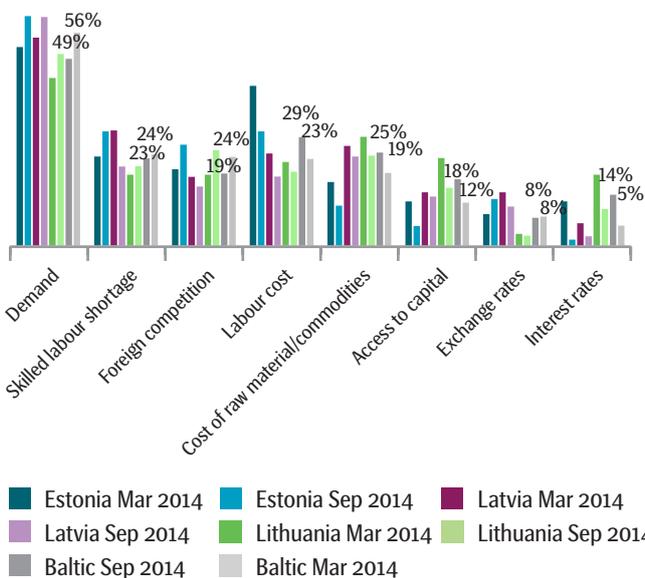
As a result of embargo on daily products imposed by Russia our company suffers from decline in our turnover. Nevertheless, we plan to maintain EBITDA level at the previous level. The overall sentiment in the market and unpredictability motivates us to mobilize: we are reviewing efficiency of internal processes with a focus on opportunities to cut costs. Prospects of further decline in value of Russian rouble pose additional threats.

## Cash flow changes in the company over the next 12 months



Naturally, the more complex the business environment, the more corrections are needed to their business plans. Since March, businesses have become more cautious in regard to their plans. There has been no significant change in the proportion of businesses that anticipate a decline in turnover. However, there has been an increase in the proportion of businesses that hope to keep turnover at its current level, and a decline in the percentage of businesses that are predicting an increase in turnover. Despite everything, this opinion is still dominant – overall 53% of Baltic businesses forecast an increase in turnover in the near future. The least changes have been observed in Latvia, where 66% of financial directors surveyed expect an increase in turnover. However, it should be noted that, compared to March, the number of businesses that anticipate an increase in turnover of over 10% has halved. In Lithuania, such an increase in turnover is forecast at 16%, compared with 20% in March. Meanwhile, in Estonia the proportion of such businesses has remained virtually unchanged at 11%. An increase in turnover is predicted by 53% of Lithuanian and 45% of Estonian respondents, which is less than in March, when this was predicted by 67% of Lithuanian and 59% of Estonian respondents respectively.

## Greatest concerns for the companies in 2015



The main concerns of businesses are reflected by those trends which have been observed for some time now in macroeconomic data. The most visible and persuasive concerns that preoccupy businesses in all three Baltic States are related to demand, which has become more relevant since March. Most likely, it will remain relevant for some time to come. In Lithuania and Estonia, concerns have increased about the availability of skilled labour, which points to both long-term problems and the negative impact of emigration. Meanwhile, this issue is no longer as relevant in Latvia. As we mentioned in the previous report, it is and could well remain a slightly overrated problem for some time to come, and therefore the proportion of businesses concerned about the availability of skilled labour has fallen slightly. At the same time, however; one should note that in certain segments this definitely remains a highly acute problem.

In attempting to expand and diversify business, exporting is one of the best, and more often than not, the only strategy. Therefore, it is entirely logical that businesses are concerned about the weak export situation, primarily in Europe, which is currently going through a complicated phase, thus heightening competition for a place in these markets. This is confirmed by both Lithuanian and Estonian businesses. Latvians are relatively more timid when it comes to securing export markets, due to

which the loss of relevance can be explained by favourable trends in niche markets or else the structural characteristics of respondents.

It is interesting to note how the issue of labour costs has declined in relevance in all three countries. This indicates that other issues are more important and the confidence of businesses regarding the loyalty of their employees has increased.

Meanwhile, concerns about changes in raw material costs have also declined, which reflects overall global trends of falling raw material prices.

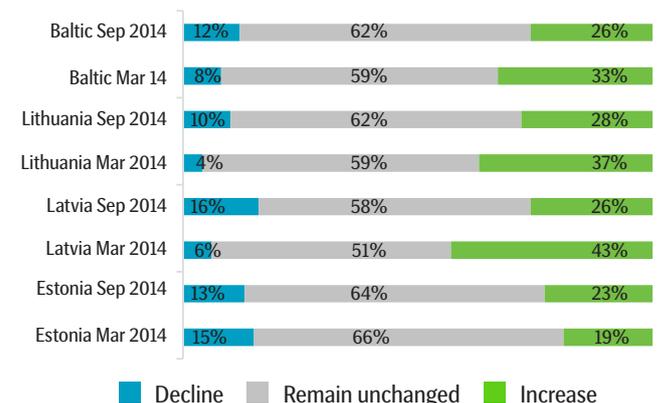
Likewise, given the client base and the consolidation of the mutual relations between businesses and banks, which to a great extent points to the financial stability of the respondents, as well as prevailing monetary policy trends in Europe and elsewhere in the world; concerns among businesses about the availability of financing and interest rates are insignificant and have continued to decline.

In summary – compared to Estonian and Lithuanian businesses, the trend of Latvian businesses, for which the only current issue that has increased in relevance is demand while the level of other concerns has fallen, goes slightly against the overall trend.

**Gints Bukovskis**, CFO of Lattелеcom

It is important to keep working on new business ideas, promote innovations and develop new services to improve income. Europe's telecommunication industry is on the brink of serious reforms because of its high fragmentation and overregulation which discourage investment and technological progress. As a result we see that Europe's competitiveness in the global market is declining.

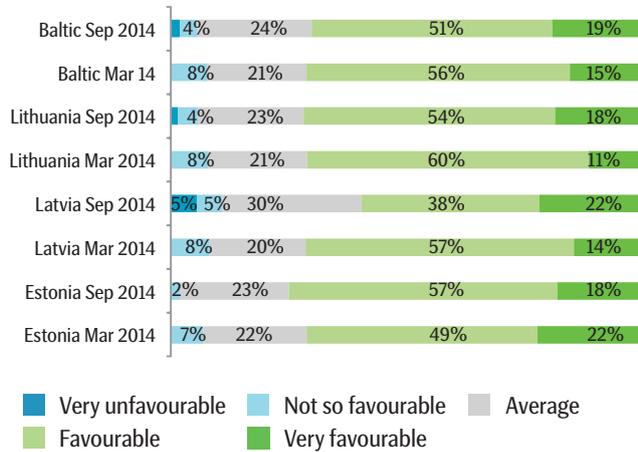
## Changes in the number of employees in the company in the next 6 months



Even though economic growth in Latvia and Lithuania is faster than in Estonia, opposing trends dominate the plans of each country's businesses in relation to changes in employee numbers. During the past six months, the number of Estonian respondents not planning any changes in their number of employees has remained virtually unchanged. However, there has been an increase in the number of businesses planning to hire more employees and a decrease in the number of enterprises planning to reduce employee numbers. Most likely, this reflects the current situation in the labour market, which is characterised by a low level of unemployment and the full load of production capacity being attained. In contrast, despite faster growth, the proportion of Lithuanian businesses planning to increase their number of employees has declined from 37% to 28%. More rapid changes have been observed in Latvia, where the proportion of such businesses has fallen even more

distinctly – from 43% to 26%. Moreover, in both Latvia and Lithuania, there has been an increase in the number of respondents that plan to reduce their number of employees. However, one has to admit that this proportion of businesses is comparatively small and approximately on a par with the Estonian level.

## Lending attitude of financial institutions towards the company

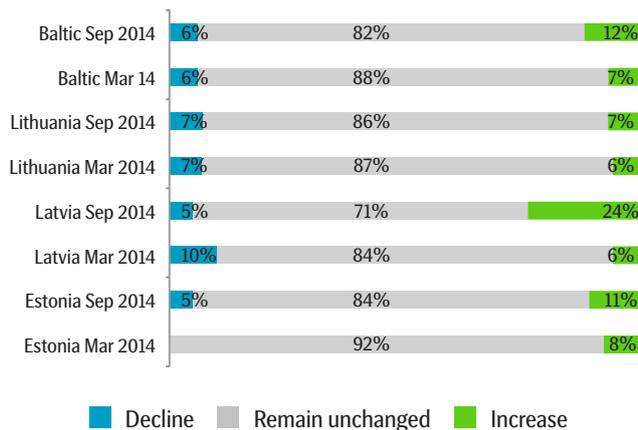


A similar story, where the opinion of Lithuanian and Latvian businesses differs from the opinion of the financial directors of Estonian businesses, can also be observed in regard to the attitude of businesses to financing possibilities. In Estonia, there has been a fall in the proportion of dissatisfied businesses, while the number of businesses offering neutral assessments has remained unchanged, and there has been an increase in the number of satisfied businesses. There has been negligible fall in the number of businesses that were very positive in their assessments. At the same time, in Latvia and Lithuania one can observe a stratification of opinions. This confirms that the situation varies across various segments of the economy, which duly affects the availability of financing. In both Latvia and Lithuania, there has been a rise in the proportion of very dissatisfied businesses, but at the same time, there has also been an increase in the proportion of businesses that are very satisfied. Most likely, in the immediate future differing opinions will remain the order of the day, because the tempo of economic growth in the short-term will be slow.

**Antanas Kavaliauskas, CFO of AB Rokiskio Suris**

Lending attitude is excellent. Banks understand our needs, specific issues, risks and opportunities and they help to achieve our goals by proposing sufficient and appropriate lending instruments.

## Probability of counterparts default in next 6 months

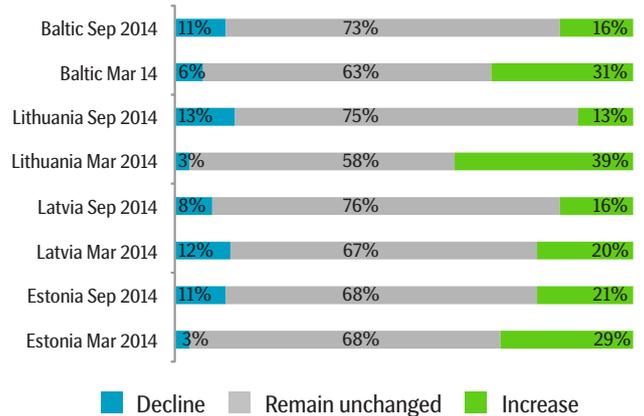


Uncertainty has prompted businesses to reconsider their attitude towards their business partners. The greatest increase in concerns about the solvency of their business partners has arisen among Latvian businesses – the number of businesses that rate the risk of their partners' insolvency as credible has quadrupled from 6% to 24%. In Estonia, there has been a slight increase in the number of such businesses, while in Lithuania it has remained almost unchanged. Likewise, the number of Latvian respondents that anticipate an improvement in the solvency of their partners has halved (from 10% to 5%). In Estonia, there has also been an emergence of businesses that anticipate similar trends. There were no such trends back in the spring – this confirms the differing nature of businesses' opinion about the situation.

**Gints Bukovskis, CFO of Lattelecom**

Currently we see no significant changes in our partners' financial stability. Nevertheless, the level of caution will increase since some of the businesses affected by sanctions will not succeed in reorienting to alternative markets. It is clear that presence of sanctions will have a negative effect on solvency of our partners.

## Development of interest rate environment in the domicile country over the next 12 months



During the past six months, in all three Baltic States there has been a fall in the number of businesses that expect an increase in interest rates. This is most evident in Lithuania, where businesses are increasingly coming to terms with the imminent introduction of the euro, because overall these changes involve more favourable financing conditions. Therefore, there has been an increase in the number of financial directors who expect a fall in interest rates; even though the majority believes that the status quo will prevail in this area. Overall, the prevailing opinion in all three states is that rates will remain unchanged.

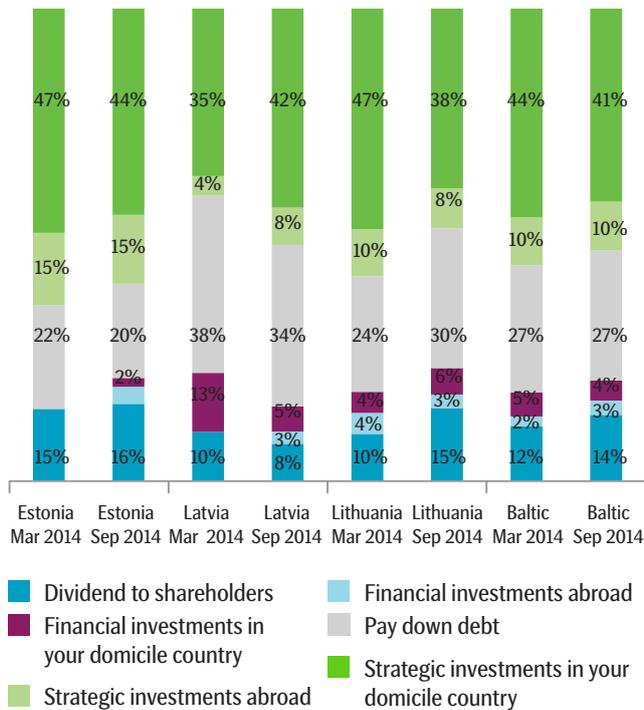
Whereas, in Lithuania the proportion of businesses that expect a reduction in rates is equal to those anticipating an increase in rates, in Latvia the corresponding proportions are double, i.e. 16% and 8% respectively. In Estonia, 21% of businesses expect rates to rise, while 11% of respondents expect them to fall.

The fact that there are businesses that expect more favourable financing terms is possible, because, for example, they envisage banks being compelled to compete or through the improvement in the compatibility of their financial returns to the requirements set by banks. On the other hand, businesses understand that an improvement in global economic conditions will be followed by a rise in interest rates.

Managing director Arturas Zaremba, UAB Akmenes Cementas

Currently we see no significant changes in our partners' financial stability. Nevertheless, the level of caution will increase since some of the businesses affected by sanctions will not succeed in reorienting to alternative markets. It is clear that presence of sanctions will have a negative effect on solvency of our partners.

## Use of current cash surplus in the next 6 months



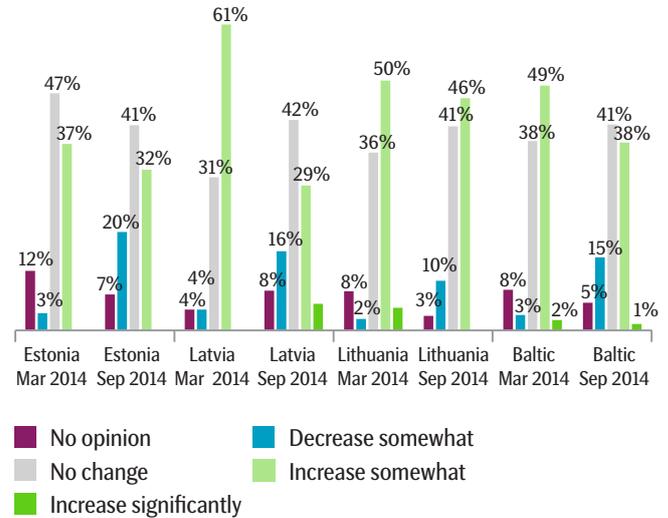
In Estonia, there have been no significant changes during the past six months in the action plans of companies with surplus cash. A slight interest has emerged in financial investments. 44% plan to focus on investments to boost growth in the domestic market. 20% plan to reduce debt volumes. 15% are considering possibilities to make strategic investment overseas, while 16% plan to distribute their available funds in dividends.

In Latvia too, there have been no significant changes, although there are some slight indications of an improvement in the appetite for investments. 42% of respondents plan to make strategic investments in the domestic market; a 7% increase during the past six months. There has been a slight reduction in the emphasis on the reduction of existing liabilities (34%). An equivalent number of respondents plan to make strategic investments in other countries and to pay out available funds in the form of dividends (8%).

In Lithuania, in stark contrast to Estonia and Latvia, there has been a slight increase in the accent on repayment of debts (30%) and the payout of dividends (15%). Meanwhile, the percentage of businesses that plan to make strategic investments in the domestic market has fallen from 47% to 38%.

Overall, one must conclude that the mood of Baltic businesses is dominated by a focus on the growth of the domestic market. In many cases, this denotes an emphasis on securing their existing positions and reflects the stress of the recent crisis, which compels businesses to continue allocating available funds to the settlement of debts. For the time being, the mood of businesses precludes anticipation of faster economic growth and an increase in banks' credit portfolios until the current level of uncertainty drops.

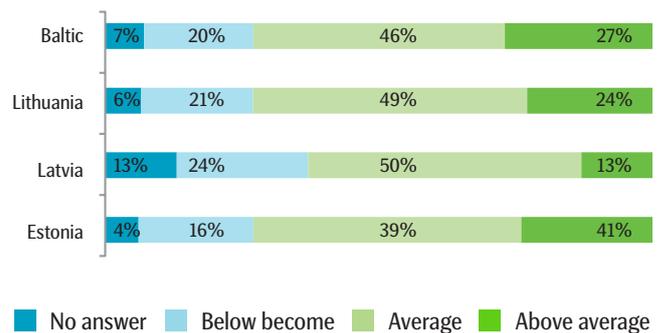
## Expected changes in the levels of corporate acquisitions and mergers in domicile country over next 12 months



As regards to the short-term plans of businesses, the prevailing opinion is that changes are not anticipated and there is also the possibility that activity will decline. This can be explained by the caution which still prevails among businesses, even though 38% of Baltic businesses anticipate a slight increase in interest in the acquisition of new assets or sale of existing ones. In this regard, the biggest decline in optimism has been observed in Latvia. However, an increase in caution and pessimism can also be noted in the opinions of Lithuanian and Estonian businesses.

## Hot topic for this edition: Consequences of geopolitical unrest on Baltic businesses

Evaluation of the negative impact caused by geopolitical unrest in the global economy on your business



Lately, a significant factor affecting the pace of economic growth throughout the Baltic region and the means of each individual country is geopolitics, which has not ranked as a risk factor in this region for a long time.

The most negative impact of the current turbulence is perceived by Estonians (41%). Latvians are the most optimistic in their opinions – just 13% of Latvian respondents surveyed consider recent geopolitical upheavals to be extremely negative. The majority of participants in the study in all three countries consider the negative impact to be average. In all probability, this is attributable to the fact that businesses still believe that the existing risks can be managed and limited, and they do not have a critical effect on commercial activity.

At the same time, one fifth of financial directors surveyed believe that geopolitical tensions are nothing out of the ordinary, and most likely, corrections are of a short-term nature and the resultant risks can be compensated in other markets. Naturally, in the opinion of Baltic businesses, this issue is primarily connected to Russia, Ukraine and the deterioration in the overall security situation in the region, and less to events in Africa and the Middle East, which also have a huge influence on geopolitical events.

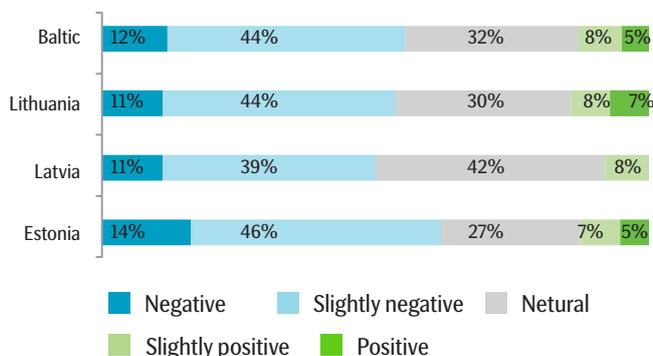
**Pirje Raidma**, Member of the Board of Ekspress Grupp, CFO

We are feeling strong impact of the Russia-Ukraine crisis on the Estonian economy in the sense of unawareness of the possible future events. This uncertainty is forcing us to be ready to face different scenarios in the coming years.

**Normunds Staņevičs**, CEO of Rīgas piena kombināts (Food Union Group)

The embargo on dairy products imposed by Russia has a direct effect on operations of Rīgas piena kombināts. Russia was the largest of our 20 export markets. In 2013 our exports to Russia comprised 41% of our total export portfolio and about a half of our turnover. Before sanctions were imposed we exported to Russia cream cheese, butter, ice cream and other dairy products. Now we only export ice cream and we are looking for opportunities to expand in our existing export markets (Baltics, Belarus, Azerbaijan and Kazakhstan). We are also exploring opportunities in new export markets (China, Western Europe).

## Evaluation of consequences caused by sanctions against Russia and Russian counter sanctions against rest of the world on company's business



Appraising the data overall, one must conclude that Russian sanctions have not had a visible effect on the opinions of businesses. One must assume that possible risks arising from collaboration with Russia were already taken into account before the start of this collaboration and that such a turn of events comes as no surprise. Accordingly, on average 32% of respondents – more in Latvia and less in Estonia – have a neutral opinion on the deterioration in relations between Russian and western countries. Of course, the impact of such a development within this relationship cannot be positive; therefore 44% of Baltic businesses expect that confrontation will most likely have a negative impact. Another 12% are convinced that the impact of sanctions will clearly have a negative outcome. However, on the other hand, it is no surprise that approximately the same number of businesses forecast a positive impact. This will definitely not be the last time that Baltic businesses will draw on their historical experience, contacts and knowledge to take advantage of the possibilities which businesses in other countries will be unable to do, and turn this situation to their advantage. This is also confirmed by the prospects and elasticity of the Baltic economy, as well as the fact that the Baltics will continue to be the bridge between the East and the West.

Undoubtedly, at present the spotlight is on the breakdown in collaboration and increasing lack of trust between Russia and the West, the direct impact of which on economic processes is currently quite limited. However, this also applies to the investment climate beyond the Baltics. In regard to collaboration with Russia, each country's mutual level of engagement varies. Therefore, differences in the opinions of businesses are not surprising. It is anticipated that, in time, these may well become more consistent. Differences in opinion could be related to information space nuances and mentality, etc.

## Macroeconomic outlook for Baltics 2014-2015

### Estonia

Estonian economy has lost its momentum and has been showing meagre growth rates hardly above zero for over a year. The second quarter showed an upswing in the GDP growth, to 2.4% yoy. However, it is too early to interpret this as a sign of recovery to permanently higher growth rates. In fact, a higher growth rate was brought by lower imports, triggered by weak investment activity. While also exports remained weak, the contribution from net export was positive because imports dropped even more. There have been a couple of quarterly upswings reaching around 2%, but the growth structure reveals rather weakness than the strength of the economy, as it was brought about by imports drop caused by weak investments. Therefore the quarterly upswings in GDP will likely prove to be temporary. The main growth driver of the economy remains to be domestic consumption, which has increased at relatively steady rate. Simultaneously decreasing unemployment and employment reflect the shrinking labour force. The weakness of the economic growth is caused by both export and investments.

### Latvia

Latvia's economy which has been EU's fastest growing economy during the past two years, has been in a gradual slowdown since the third quarter of 2013 when year-on-year GDP growth was as high as 4.6%. In the first half of 2014, yearly growth ended up at modest 2.5%. The slowdown is largely connected to the Russia-Ukraine conflict. The construction industry has continued to show strong growth; also retail sales growth has been decent. However, stagnation in service sectors is somewhat surprising. This could be explained by the potential impact of the Ukrainian conflict.

It is apparent that growth will face continued headwinds in the coming months. Aside from the tensions between Russia and the West, the economic rebound in the Eurozone is still sluggish. Exports will continue to increase at weak levels. In this uncertain external environment consumers will play a stabilising role. Consumer confidence is at a historically high level and has been fairly resilient during the Ukraine crisis.

Private consumption will remain robust. Meanwhile, entrepreneurs will remain very cautious, which will affect the already weak capital spending activity. We expect the government to speed up its mobilisation of EU funds. This will be one of the priorities of the current and new government. All in all, Russia's sanctions and economic slowdown – the country accounted for 18 per cent of Latvia's total exports in 2013 – will have an impact on the Latvian economy, but it will not be powerful enough to bring growth to a halt. We expect GDP to grow by 2.5 per cent this year, 2.7 per cent in 2015 and 3.4 per cent in 2016.

### Lithuania

Macroeconomic situation in Lithuania remains rather favourable. In the first half of 2014, real GDP increased by 3.1%, driven by consumption and investment. Export performance has been fragile but its weakness was primarily due to drop in exports of oil refinery, which suffered a loss of competitiveness on the European market after shale revolution in the US. Other export categories demonstrated positive results. Sluggish demand in Russia and Eurozone had negative impact on export development and will continue exerting downward pressure in the nearest future. In August 2014, Russia imposed import sanctions on food products what will have additional negative impact on Lithuanian exports. Food industry and transport sector will suffer the lion's share of the direct harm which may reduce country's GDP up to 1% during 2014-2015. On the other hand, the affected companies put their effort in compensating the loss on other markets. Increased geopolitical tension weighs down on household and business sentiment and therefore threatens the recovery of consumption and investment. Real wages will grow by 4-5% in 2015-2016, supported by labour shortage and increase in minimum wages. Rising wages and employment, cheaper central heating and low inflation will back up consumption. Provided that geopolitical situation stabilizes and euro zone growth strengthens next year as expected, Lithuania's GDP is forecasted to rise by 3.2% in 2015 and 4% in 2016. In December 2014, Lithuania will launch LNG terminal which will help securing diversified gas supply and reduce dependence on monopolistic Gazprom supply. In 2015, electric power links to Poland and Sweden will be opened and Lithuania will thus gain access to new energy markets. As of January 1, 2015, Lithuania will join Eurozone. Euro introduction will have positive effect on the country's business climate and borrowing costs both for companies and the government.