

Russia Is Getting Wealthier

By [Plamen Monovski](#)

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There is one piece of good news coming out of Russia that has not been widely noticed: At the start of September, Russia's poverty rate fell to 13.7 percent, the State Statistics Service reported.

This is just one piece of the larger success story. Wealth in Russia is rising. One of the main reasons for this is that the government has successfully carried out reforms in sectors that are key to the country's economy.

The retail sector was the first to take off more than a decade ago, but its development is essentially apolitical. The government didn't need to do more than free prices and ensure that companies have access to capital. Retail turnover has been running well ahead of growth in gross domestic product, driven upward by the fast increase in incomes.

Reform to the telecommunications sector was the state's first big top-down reform. It started in 2002 and has also been a huge success. The quality of phone lines is beyond any comparison to Soviet-era telephony. There are 141 SIM cards for every 100 people in the

country, far ahead of any of the other BRIC countries (Brazil is the closest with 78 SIM cards per 100 people), while the value of the leading companies has soared.

Banking reforms started in 2004 and led to the sector's assets growing by 50 percent a year until the crisis struck two years ago, while Sberbank's shares rose several thousand percent over the period, easily outstripping the 860 percent gain on the RTS Index.

Automobiles have also been a phenomenal success. Despite the widespread impression that Russia has failed to attract much foreign direct investment, nearly every major international automobile manufacturer is present in St. Petersburg today thanks to tax breaks and other perks offered by the Kremlin. Car sales and manufacturers' shares have exploded as a result, and the Kremlin has proved that it can attract major manufacturers when it puts its mind to the task.

Likewise, Gazprom's shares have increased about 20-fold since the so-called ring fence — restrictions on foreign ownership of domestically traded shares — was removed in 2006. And the breakup of the government's electricity monopoly Unified Energy System, which started in summer 2008, has sent the value of the various utilities soaring as investors — domestic and foreign — poured billions of dollars into the sector.

The Russian equity market looks very different depending on where you stand. From a distance, it looks unattractive and volatile. Fortunes can be made and lost in less than a quarter. But when viewed up close, focusing on specific corporate and reform stories, there are gems to pick up at every turn.

Thanks to a poor investment image, the Russian equity market is the only one among the BRICs to remain heavily undervalued. Russian stocks are currently trading at a price-earnings ratio of less than eight times, and this is expected to fall to 6.3 next year as corporate earnings recover. This compares with India's 19 times, China's 15 times and Brazil's 13 times as of late September. In other words, Russia gets no credit from investors for the reforms that have already been carried out.

But look closer at the representative companies in each of the sectors that have been overhauled, and the picture is the opposite. Here are two good examples: Independent gas producer Novatek's stock is currently trading at a price-earnings ratio of 20.1 times, and the shares of leading supermarket chain Magnit are trading at more than 30 times.

Over the past 10 years, the RTS Index was the best-performing in the world. The RTS rose 829 percent between 2000 and 2010 — four times more than the next best performer, the Shanghai Composite Index, which was up 190 percent. Indeed, of the 10 best-performing funds in the world in the past decade, half of them were Russian.

The upshot of the economic crisis is that it could jump-start Russia's modernizing reforms. But even if this does not pan out as expected, the earnings growth of companies coupled with the sector-specific reforms will still be enough to offer investors a slew of attractive investment opportunities.

Plamen Monovski is chief investment officer of Renaissance Asset Managers.

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