

# Iron and steel industry report



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# Global iron and steel market

The iron and steel industry is a basis for the development of a number of industries in the global economy: the defense industry, transportation and heavy engineering, energy and construction (including aeronautical and shipping construction). Moreover, the iron and steel industry is closely related to the chemical industry and light industry. It shows that the iron and steel industry has the potential to contribute to the competitiveness of national producers and to the growth of the national economy.

## Production

Over the last 35 years, the iron and steel industry has seen significant changes. In 1980 716 mln tonnes of steel was produced and the following countries were among the leaders: USSR (21% of global steel production), Japan (16%), USA (14%), Germany (6%), China (5%), Italy (4%), France and Poland (3%), Canada and Brazil (2%). According to the World Steel Association (WSA), in 2014 world steel production amounted to 1665 mln tonnes - a 1% rise

in comparison with 2013 (see Figure 1). The list of leading countries has changed significantly. China ranks first and is far ahead of other countries (60% of global steel production), the share of other countries from the top-10 is 2-8% - Japan (8%), USA and India (6%), South Korea and Russia (5%), Germany (3%), Turkey, Brazil and Taiwan (2%) (see Figure 2). Besides China, other countries that have strengthened their positions in the top-10 are India, South Korea, Brazil and Turkey.

**Table 1. Global steel production statistics (mln tonnes)**

Geography	Steel production					
	Production volume, mln tonnes			Changes		
	2012	2013	2014	2012	2013	2014
European Union	162.9	160.4	169.2	-0.05	-0.02	0.05
Other Europe	38.7	37.6	36.2	0.05	-0.03	-0.04
CIS	82.1	80.4	105.1	-0.01	-0.02	0.31
NAFTA	118.6	116	119.9	0.03	-0.02	0.03
Central & South America	46.1	45.9	45.2	-0.03	0.00	-0.02
Africa	15.2	15.8	15.6	-0.02	0.04	-0.01
Middle East	22.1	23.4	28.1	0.06	0.06	0.20
Asia & Oceania	989.4	1043.3	1116.3	0.04	0.05	0.07
World	1,480.9	1,528.4	1,637.0	0.0	0.0	0.1
China	731	822	822.7	0.06	0.12	0.00
World excl. China	749.9	706.4	814.3	0.0	-0.1	0.2

Source: WSA

At the beginning of 2015, the production of steel decreased by 1.8% in comparison with the first quarter of 2014. The production in terms of volume (for January – April 2015) amounted to 536,485 mln tonnes. As practically China alone was sustaining the positive dynamics in the industry over previous decades, the decrease in global production can be explained by the fall in steel prices and by the sales slowdown in China.

Geographical analysis of the production dynamics shows the following trends at the beginning of 2015 (January-April):

- European Union: decrease in steel production – 0.3% (to 58.1 mln tonnes)
  - France – decrease by 3.6% (to 5.3 mln tonnes)
  - Italy – decrease by 9.6% (to 7.8 mln tonnes)
  - Germany – decrease by 2% (to 14.7 mln tonnes)It should be noted that from the beginning of 2015, production in Poland increased by 14.8% (to 3.2 mln tonnes)
- North America: decrease in steel production – 7.2% (to 36.9 mln tonnes)
  - USA – decrease by 8.5% (to 26.3 mln tonnes)

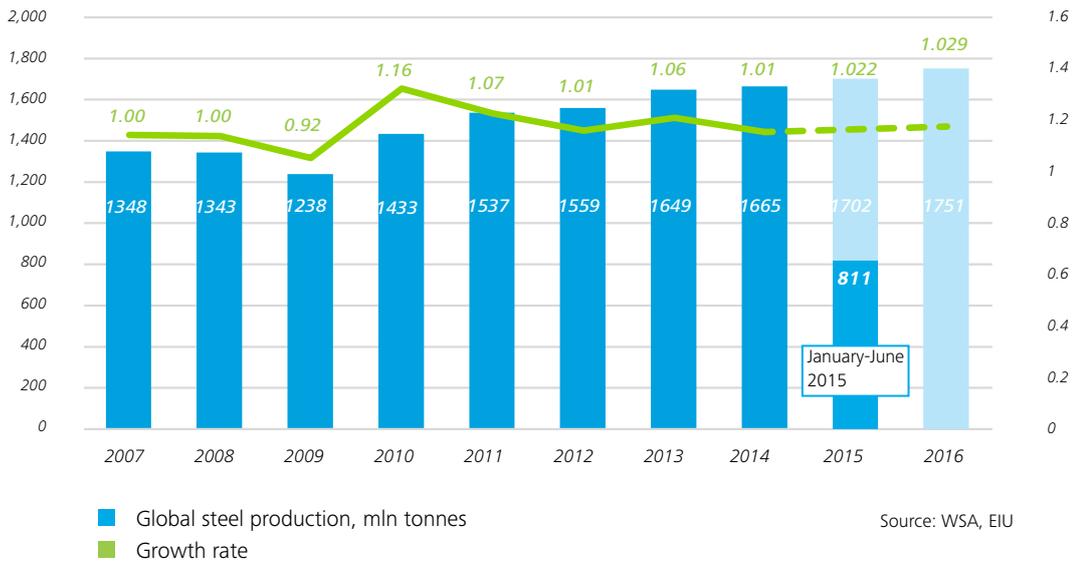
- South America: increase in steel production – 0.2% (to 14.8 mln tonnes of steel)
  - Brazil – increase by 1.6% (to 11.3 mln tonnes)
- Asia: decrease in steel production – 1.1% (to 365.7 mln tonnes)
  - China – decrease by 1.3% (to 270 mln tonnes)
  - African countries – decrease by 8.5% (to 4.8 mln tonnes)
  - Middle East – increase by 1.5% (to 9.2 mln tonnes)
  - Oceania – increase by 5.9% (to 1.9 mln)
- Russia: increase in steel production – 5.2% (to 24.3 mln tonnes)
- Ukraine: decrease in steel production – 29.8% (to 7.1 mln tonnes)

So, at the beginning of 2015, the global production of steel is characterized by a decrease in market size.

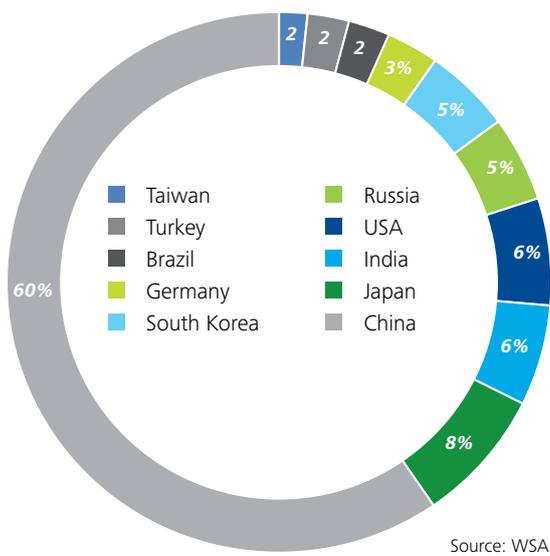
 **Expert forecast:** Despite the trend towards decreased steel production in the global market, Economist Intelligence Unit (EIU) experts still forecast a rise in steel production over the next two years: in 2015, the expected growth is 2.2%, in 2016 – 2.9% (see Figure 1).



**Figure 1. Global steel production, mln tonnes**



**Figure 2. Top-10 steel producers (share, %)**



## Consumption

Iron in all its forms (cast iron, steel and rolled metal) is the most used construction material in the modern global economy. It retains the leading place in construction ahead of wood, competing with cement and interacting with it (ferroconcrete), and still competing with new types of constructional materials (polymers, ceramics).

For many years, the engineering industry has been using ferrous materials more than any other industry.

Global steel consumption is characterized by an upward trend (see Figure 3). The average growth rate of consumption in 2014 was 3%. A lower growth rate can be seen in developed countries (2%). Developing countries have a higher level of steel consumption (1,133 mln tonnes) (see Table 2).

**Table 2. Global steel consumption statistics (mln tonnes)**

Geography	Steel consumption					
	Volume of consumption, mln tonnes			Changes		
	2012	2013	2014	2012	2013	2014
EU	140	135	138	1	0.96	1.02
Other Europe	35	37	38	1	1.06	1.03
CIS	57	59	61	1	1.04	1.03
NAFTA	132	132	136	1	1.00	1.03
Central and South America	47	49	51	1	1.04	1.04
Africa	27	28	30	1	1.04	1.07
Middle East	49	49	53	1	1.00	1.08
Asia and Oceania	943	986	1016	1	1.05	1.03
World	1,430	1,475	1,523	1	1.03	1.03
Developed countries	390	384	390	1	0.98	1.02
Developing countries	1,040	1,091	1,133	1	1.05	1.04
China	660	700	721	1	1.06	1.03
BRIC	799	843	871	1	1.06	1.03
MENA	63	64	69	1	1.02	1.08
World excl. China	770	775	803	1	1.01	1.04

Source: WSA

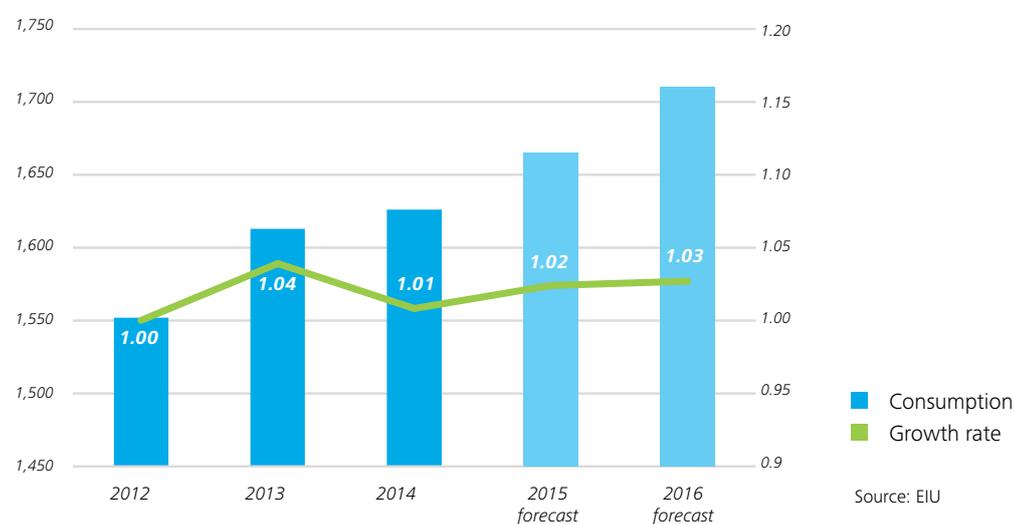
 **Expert forecast:** The forecasts for steel consumption over the next two years are ambiguous. According to the EIU, in 2015 the trend of increasing steel consumption will continue. The experts forecast an increase in steel consumption by 2.4%, but this forecast assumes the relative stability of demand in China, which represents half of the global demand for steel. The main share of steel consumption in China relates to the

construction sector in which the situation in 2015 is uncertain. The experts do not make definite forecasts and say that the current macroeconomic conditions will have a significant impact on the balance of production and consumption on the global steel market. WSA experts agree that growth will continue, but they forecast a slowdown in the growth of apparent global steel consumption in 2015 in comparison with 2014

to 0.5% (to 1,544 bln tonnes) and in 2016 to 1.4% (to 1,565 bln tonnes). WSA and EIU experts explain this by pointing to the slowdown on the real estate market. At the end of 2014, the slowdown in demand for steel in China amounted to 3.3% (to 710.8 mln tonnes) for

the first time since 1995. In 2015 it is expected that the trend will remain the same and the decrease will amount to 0.5% to 707.2 mln tonnes and in 2016 to another 0.5% to 703.7 mln tonnes. The expected trend is presented in Table 3.

**Figure 3. Global steel consumption, mln tonnes**



**Table 3. Forecast of consumption by country**

Country	2014 (actual volume, mln tonnes)	2014 (actual growth rate)	2015 (forecasting growth rate)	2016 (forecasting growth rate)
China	710.8	−3.3%	−0.5%	−0.5%
United States	106.9	11.7%	−0.4%	0.7%
India	75.3	2.2%	6.2%	7.3%
Japan	67.5	3.5%	−2.4%	1.1%
South Korea	55.4	7.0%	2.7%	2.0%
Russia	43.1	−1.4%	−6.7%	−1.6%
Germany	39.2	3.0%	1.5%	2.3%
Turkey	30.7	−1.8%	3.0%	1.1%
Brazil	24.6	−6.8%	−7.8%	3.1%
Mexico	22.5	11.7%	2.6%	3.9%

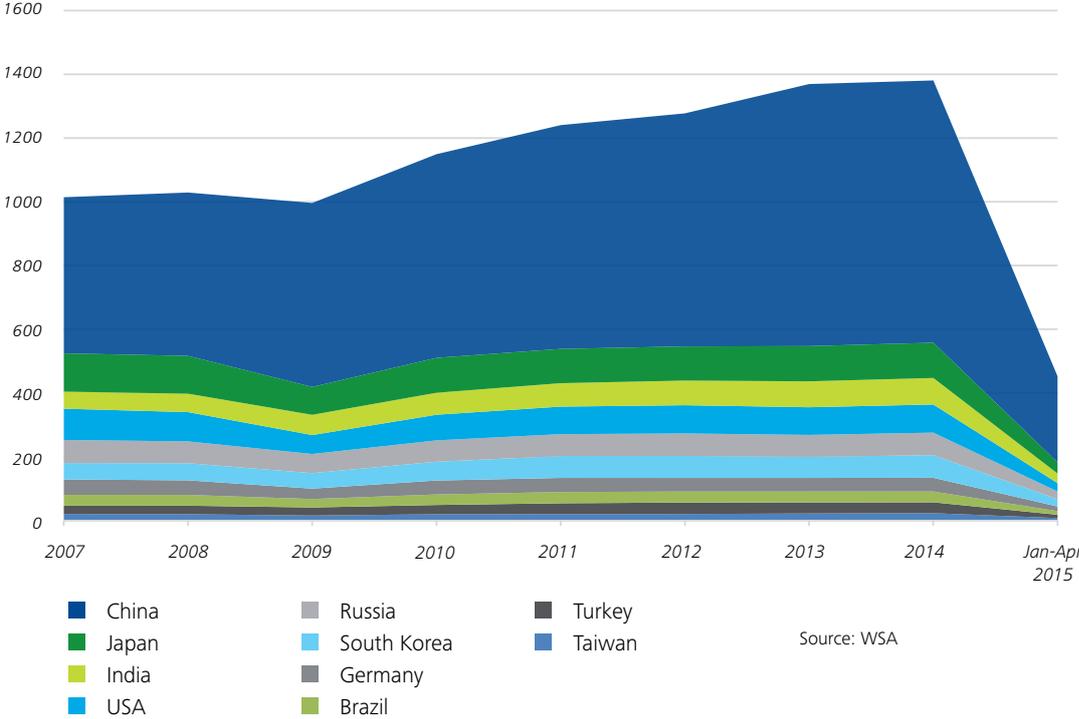
Source: WSA

# Russian iron and steel market

Russia is one of the leading producers of ferrous metals. Over the last few years, the Russian Federation has been ranked fifth by steel production in the world. In 2009 almost all the countries considerably reduced the production of steel, only China, India, Iran and some other countries were the exception. In the USA, the reduction of steel production was tangible. The reduction of steel production in the Russian Federation was not so considerable. Russia ranks fifth in the world after China, Japan, the USA and India. The country closest to Russia by volume of steel production is South Korea.

At the end of the first quarter of 2015, Russia is still at fifth place by global steel production. According to the forecasts, the steel production of the leading steel producers will not grow considerably. The exception is the Indian ferrous materials market, which, according to experts, has been actively developing in recent years. It can be concluded that by 2020 Russia will probably retain fifth place in the rating of the leading steel producers (see Figure 4).

**Figure 4. Top-10 steel producers (thousand tonnes)**



## Production

The production of ferrous materials play an important role in the Russian economy and in its industrial potential. The industry's share of the country's GDP is 4% and of industrial production - around 18%.

Last year the production of steel on the Russian market slightly increased. In 2014 the index of metallurgical production and of finished metal products was 100.6% in relation to 2013. The main constraint for the market is the production of the finished metal products which declined by 1.3%, and metallurgical production increased by 2.2%.

From January to April 2015, the Russian market for iron and steel retracted, the index of metallurgical production and finished metal products in Russia amounted to 95.7% as compared with the respective period in 2014, including metallurgical production (97.4%) and the production of finished metal products (91.0%). This trend includes a seasonal component, which is why we use indexes without calendar component to identify pure market dynamics. When seasonality is controlled for, the trend towards reduction in metallurgical production and the production of finished metal goods remains, but at a considerably lower level – 0.8% as compared with April 2014. It should be noted that these trends in metallurgical production in the first half of 2015 correspond to the trend of the last five years (see Figure 5, Table 4).

Figure 5. Metallurgical production dynamics in Russia

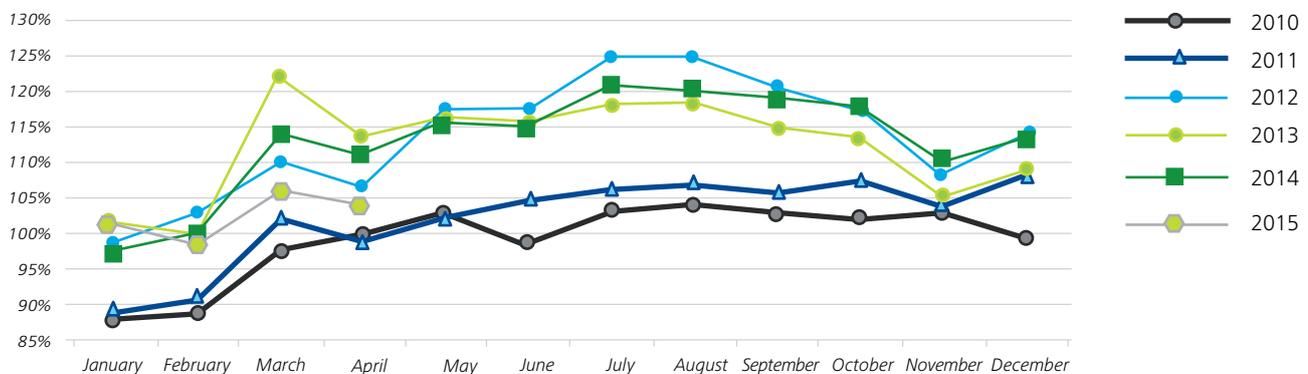


Table 4. Production of main types of iron and steel production in Russia

Production	Market in physical quantity, 2014	Market growth rate, 2014	Market in physical quantity, Jan-Apr 2015
Steel	70.3 mln tonnes	102.2 %	23.6 mln tonnes
Rolled ferrous metal products	61.2 mln tonnes	103.4 %	20.2 mln tonnes
Cast iron	51.4 mln tonnes	102.9 %	17.2 mln tonnes
Steel pipes	11.5 mln tonnes	113.6 %	3.7 mln tonnes

Source: RF Ministry of Economic Development

## Export

The iron and steel industry is important for Russian export, which is based, aside from fuel and energy, on metals and metal products.

At the beginning of 2015, there was a positive trend in the export of iron and steel products. In January — April 2015, the share of iron and steel products in Russian exports was 12% and in the same period of 2014 was around 10%. (Table 4).

Iron and steel are exported mainly to non-CIS countries (see Tables 6 and 7).

**Table 5. Shares of different goods in Russian exports, January-April 2015 (US dollars)**

Item	Share in export
Crude oil	25.20%
Oil products	21.83%
Gas, billion m <sup>3</sup>	12.43%
Liquid fuel not containing biodiesel	8.94%
Diesel fuel not containing biodiesel	8.42%
Machinery and equipment	6.25%
<b>Ferrous metals</b>	<b>4.58%</b>
<b>Ferrous metals (except cast iron, ferroalloys, waste products and scrap)</b>	<b>3.33%</b>
Bituminous coal	2.69%
Aluminium	2.07%
Liquified natural gas, mln m <sup>3</sup>	1.82%
<b>Semi-finished carbon steel products</b>	<b>1.48%</b>
<b>Carbon steel flat-rolled products</b>	<b>1.03%</b>
Potassic mineral fertilizers	0.99%
Mixed-mineral fertilizers	0.94%
Wood products	0.86%
Motor gasoline	0.82%
Refined copper	0.81%
Nickel	0.80%
Nitrogenous mineral fertilizers	0.72%
Wheat and meslin	0.68%
<b>Cast iron</b>	<b>0.41%</b>
Anhydrous ammonia	0.39%
Synthetic rubber	0.39%
Wood products, 1000 m <sup>3</sup>	0.38%
<b>Ore and iron concentrate</b>	<b>0.38%</b>
<b>Ferroalloys</b>	<b>0.36%</b>

Source: Deloitte calculations based on Russian Federal Customs Service statistics

**Table 6. Export of iron and steel products in 2014, mln US dollars**

Item	Total	Non-CIS countries	CIS
Ore and iron concentrate	1,951.1	1,737.3	213.9
Ferrous metals	20,522.2	16,966.3	3,555.9
Ferrous metals (except cast iron, ferroalloy, waste products and scrap)	14,474.8	11,501.2	2,973.6
Cast iron	1,692.8	1,629.2	63.6
Ferroalloy	1,965.2	1,870.2	95.0
Carbon steel semi-products	6,587.4	6,480.0	107.4
FRP of carbon steel	4,436.5	3,275.6	1,160.9

Source: Russian Federal Customs Service

**Table 7. Export of iron and steel production in 2014, thousand tonnes**

Item	Total	Non-CIS countries	CIS
Ore and iron concentrate	22,997.4	19,947.4	3,050.0
Ferrous metals	39,258.6	33,196.1	6,062.4
Ferrous metals (except cast iron, ferroalloy, waste products and scrap)	26,089.5	21,565.4	4,524.0
Cast iron	4,359.4	4,217.4	142.0
Ferroalloy	912.5	859.4	53.1
Carbon steel semi-products	13,511.8	13,269.7	242.2
FRP of carbon steel	7,614.5	5,923.0	1,691.5

Source: Russian Federal Customs Service

 **Expert forecast:** In the long-term, Russia can retain its position on the list of the largest producers of iron and steel on the global market. However, due to sharp competition with the Chinese metallurgical industry, which tries to deal with overproduction through export, the increase in iron and steel exports may be limited.

### Consumption

Iron and steel in Russia is used by the following industries:

- Motor industry
- General machinery and equipment
- Construction
- Upstream
- Construction of main oil and gas pipelines

Pipe production is the most significant industry demonstrating a high rate of steel consumption in recent years.

In particular, according to the Fund for the Development of Pipe and Tube Production, pipe consumption in Russia is structured in the following manner:

- Pipeline transport, hydrocarbon extraction: 65 % – 75 %
- Mechanical engineering: 3 % – 5 %
- Construction and utility services: 21 % – 27 %
- Power engineering: 1 % – 3 %

The internal consumption of metal products depends on the situation in the abovementioned industries.

This year, the Russian construction market showed the most significant decrease in the last ten years due to a lack of investment and a reduction in mortgage lending and the population's real income. The decrease in the volume of construction has led to a decrease in the demand for metal.

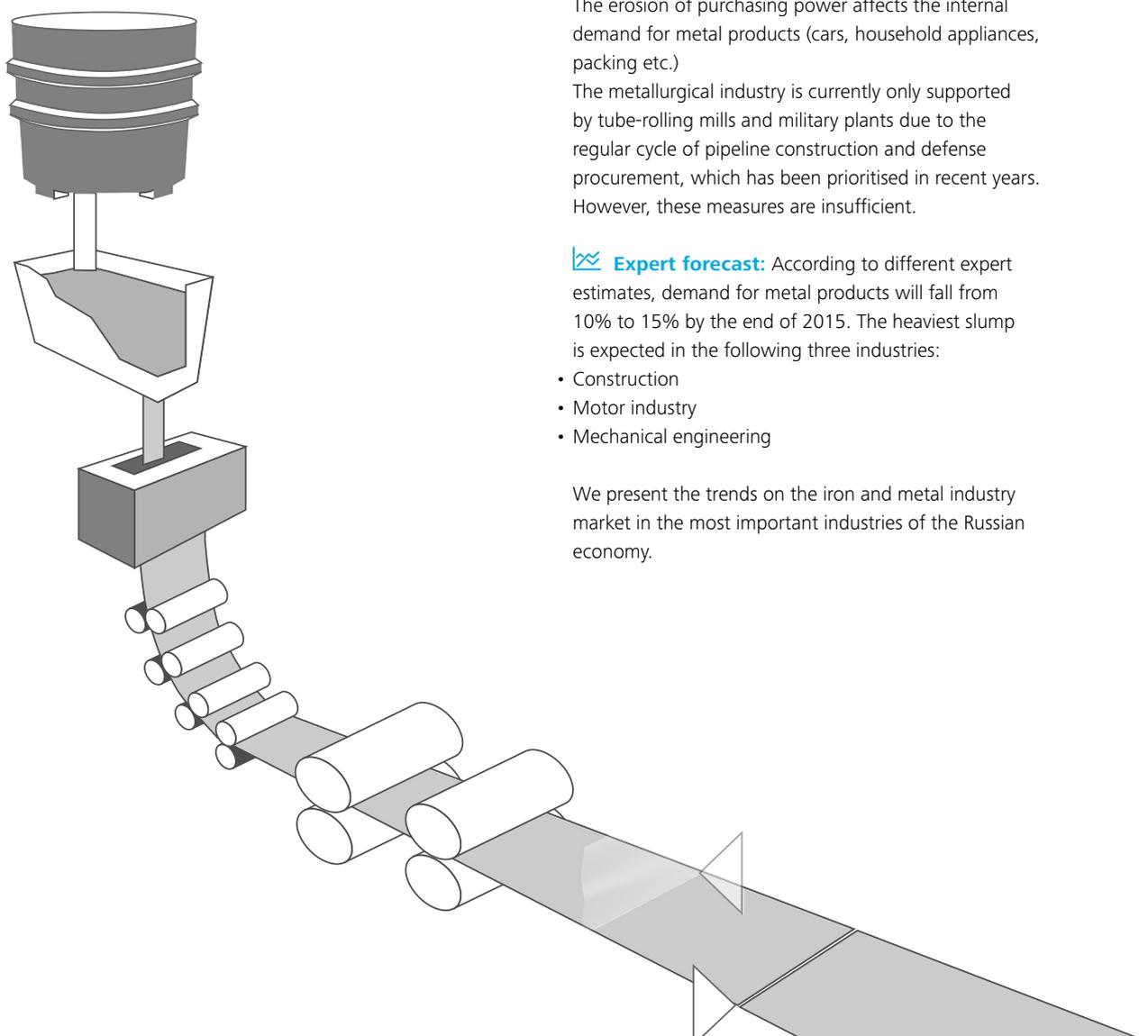
The erosion of purchasing power affects the internal demand for metal products (cars, household appliances, packing etc.)

The metallurgical industry is currently only supported by tube-rolling mills and military plants due to the regular cycle of pipeline construction and defense procurement, which has been prioritised in recent years. However, these measures are insufficient.

 **Expert forecast:** According to different expert estimates, demand for metal products will fall from 10% to 15% by the end of 2015. The heaviest slump is expected in the following three industries:

- Construction
- Motor industry
- Mechanical engineering

We present the trends on the iron and metal industry market in the most important industries of the Russian economy.



## Construction

According to United Metallurgical Company (OMK), in 2013-2014 the consumption of structural steel members in the Russian federation amounted to 1.8 and 1.9 mln tonnes, which is 20% lower as compared to the respective indicator in 2012.

The reduction in demand for metal products from the construction sector in 2015 is related to stagnation in construction and industrial production. The main reasons for this reduction in demand are:

1. 2-2.5 times reduction in mortgage lending (RF Ministry of Economic Development estimate)
2. GDP reduction
3. Reduction in investment

In comparison with 2014, the reduction in the apparent consumption of metal products is estimated

to be from 10% to 30%, depending on the region, and this contraction is unlikely to end in the nearest future.

New orders mainly come from the large construction companies that, in particular, work with investment projects at the federal or regional level, including the preparations for the 2018 FIFA World Cup and the 2019 Winter Universiade in Krasnoyarsk, and the construction of the Kerch Strait bridge.

 **Expert forecast:** In 2015 the consumption of metal products is expected to fall to the level of 2007 (1.7 mln tonnes) due to stagnation in construction and industrial production. The recovery of this market is forecasted for 2016 due to the recovery of investment activity and the construction of sports stadiums for 2018 FIFA World Cup in Russia.



### Pipe production

According to TMK, after four months of 2015, the consumption of welded pipes has fallen by 22% and of weldless pipes - by 4%. The consumption of oil pipes has fallen by 5%, however this reduction is related to the fact that companies made purchases last year and in 2015 their stocks were almost used up. The quantity of new wells and the drill metrage increased this year by around 15% which is why the ultimate consumption will increase.

The only segment that is growing significantly (by 81%) is the large diameter pipe segment. The intermittent growth is due to large pipeline projects.

 **Expert forecast:** The most stable metal products consumption is expected in the steel pipe segment due to the construction of large major pipelines such as Turkish stream and Power of Siberia which, according to TMK estimates, will require 4.5 mln tonnes of pipes.

### Motor industry

During the first six months of the current year, according to railway statistics, direct supplies of ferrous metals (rolled iron, cast iron) to OAO Avtovaz decreased by 9.8%, and in 2013 - by 21.7%. This is the lowest level of supplies for the company for the period from 2006, except 2009 (86.7 tonnes). The record level of purchases (377 thousand tonnes) for this period occurred in 2008. Also, in June of the current year, according to railway statistics, direct supplies of cast iron, rolled iron, pipes and semi-finished products to the major Russian plants producing farm machinery amounted to 7.8 thousand tonnes, which is 37.2% lower than in June 2014.

 **Expert forecast:** According to the non-profit partnership Russian Steel, in 2015 a 15% reduction in metal consumption is expected in the motor industry.



## Pricing

The dynamics of prices on iron and steel products in 2014 and at the beginning of 2015 are characterized by oscillations in different directions.

Prices on export production (cast iron, ferroalloys, rolled iron) have increased since 2014 because the producers orientated themselves by the global prices, taking into account the exchange rate. Prices on cast iron, ferroalloy and other metals have increased by 14.9% from the beginning of the year. The most significant surge in prices (62.2%) has been observed for direct-reduced iron products, with export increasing from August 2014. Prices on goods for the internal market grew much more reservedly because of low internal demand. The fall in investment activity and the 2014 abolition of the indexation of regulated tariffs on gas (wholesale prices) for grid operators and on railway freight traffic, predetermined the decrease in prices on casting (-11.6%) and on steel (-2.5%), and at the same time, prices on cast iron and steel pipes grew slightly by 3.2%.

According to the recent statistics of the Federal State Statistics Service, from January to April 2015, there was a slowdown in the growth of prices on the majority of iron and steel products. At the same time, the price on some types of product, which are sold on the Russian market, decreased.

Therefore, the key price trend on the Russian iron and steel market is the reduction of demand in the real economy and the increase in demand from the pipe industry related to the implementation of major investment projects by oil and gas companies.

According to the Ministry of Economic Development of RF, the net financial result for metallurgical companies in 2014 was 65% higher than the result for the same period of the previous year and amounted to 228.6 bln rubles. The profits of the metallurgical companies for 2014 amounted to 175.2 bln rubles, however, the share of profitable metallurgical companies decreased in comparison with the previous year by 1.6% and stood at 59.7%. Following losses from October 2014, the net financial result in the iron and steel industry became positive in February 2015. As a result, in January-February 2015, the balance was 55.1 bln rubles. It should be noted that one year before, this indicator was negative and amounted to -30.2 bln rubles.

On balance, the financial position of companies on the Russian iron and steel market has improved. Importantly, this trend applies to both companies manufacturing products for export (cast iron, ferroalloys) and those orientated towards the internal market. The profits of companies specialized towards external markets for January-February 2015 amounted to 47 bln rubles, which is 65% higher than the previous year. The profits of companies specialized towards the internal market amounted to 9.1 bln rubles. Principally, these positive dynamics in the companies' financial positions can be explained by the considerable surge in prices (9.8%) and volume of output (18.5%).

# Key Findings

## Trends in the development of the Russian iron and steel market

1. The general decline in the economy exerted a negative influence on the financial situation of most companies in the Russian metallurgical industry. The financial position of most of the companies improved in 2014. The major reason for the strengthening of the financial position of the companies is the ruble devaluation. As the majority of the Russian metallurgical companies' sales are for export and the expenses are incurred in ruble equivalent, the ruble devaluation yields a positive effect, revenue revaluation and improved competitiveness on the market at large. The exception is foreign-currency loan servicing. The increase in profitability is possible due to the decrease in prices on ore and coal.
2. The absence of growth on the local market as a consequence of the slowdown in the Russian economy is also the reason of the orientation of Russian metallurgical companies towards export. A decline in consumption is an inevitable consequence and is typical for all industrial during the deterioration of a country's economic situation and an increasing level of uncertainty.
3. In 2014 Russian metallurgical companies focused on optimization. If in 2013 they successfully reduced their expenses, in 2014 they sold non-core and unprofitable assets.
4. The market is characterized by the appearance of loan refinancing issues. There are limitations for Russian metallurgical companies as regards refinancing their obligations and obtaining new credit. At the end of 2014, geopolitical, monetary, financial, economic and other macroeconomic risks brought about structural reforms of international relations. The introduction of sanctions against Russia, including sanctions against the financial sector, had a negative impact on business, in particular, on the refinancing of companies' existing loans and the receipt of new loans.
5. The market is characterized by an increase in competitive relations in terms of sale policies. In the context of raised competition between China, Japan, Turkey, Ukraine, the EU countries and other leaders of metallurgical products supply, Russian companies do not always have sufficient advantages to strengthen their positions as suppliers of iron and steel products on the global market.
6. After the events of the end of 2014 and the beginning of 2015, the Russian market managed to regain its attractiveness for metallurgical companies. By April 2015, there was the reduction in prices. The reason for hypersensitivity in prices is the Russian metallurgical companies' aspiration to align internal and export prices. However, this aspiration has led to active resistance from metal consumers - pipe and car manufacturers, who appealed to the regulators against their suppliers. The RF Ministry of Industry and Trade took part in the resolution of this case. However, due to the surge in the annual growth rate of Chinese export by 56.4%, in January—February 2015 there was a huge decrease in the global prices of rolled steel. The decrease in export prices (in US dollars) on hot-rolled steel in March 2015 as compared to December was 15.3%, and on cold-rolled steel - 5.6%. The ruble appreciation in spring led to a rise in prices calculated in dollars on the internal market. As a result, a slowdown of the price surge without direct state intervention became possible in spring due to two factors:
  - 1) Decrease in the profitability of export operations
  - 2) Shrinkage of the domestic market

### The economics of expectations on the Russian iron and steel market

RF Ministry of Economic Development forecast (of 28 May 2015):

- 1) Supplies of metallurgical production will grow in real terms during the whole forecast period (2016-2018)
- 2) The total value will increase from 41 bln US dollars in 2014 to 48 bln dollars in 2018
- 3) The growth of export supplies of ferrous metals is expected at about 7% (for ferrous metals).

#### Forecast explanation:

- During the whole forecast period, there is an investment pause. The level of investment in fixed assets in the Russian Federation in 2018 is 94.6% (option 1) or 100.8% (option 2) as compared with 2013. These dynamics assume stagnation in the domestic consumption of ferrous and nonferrous metals and products. The driver of growth in the metallurgical industry will be exports.
- The shift in the ruble exchange rate from 31.8 ruble/US dollar in 2013 to 38.0 ruble/US dollar in 2014 and 58.7–60.0 ruble/US dollar in 2015 increased the ruble income of export-oriented metallurgical companies by 19.5% at the end of 2014 and by 54.5%–57.9%

according to the estimates for 2015, which will considerably improve the companies' financial and economic indicators.

- London Metal Exchange experts do not expect a significant reduction in global prices for ferrous and nonferrous metals in 2015.
- In 2015 the volume of import supplies of ferrous and nonferrous metals and products will decline by 75%-90% respectively, depending on the exchange rate of the national currency, the decrease in investment in the economy of the Russian Federation and the limitation of Ukrainian imports (primarily of ferrous metals). As the investment processes reactivates and the ruble strengthens, the import supplies of metals and products will grow slowly.

At the beginning of the second half of 2015, experts are not forecasting the deterioration of the financial position of the companies in the iron and steel and non-ferrous metal industry. The market is characterized by a high level of uncertainty in relation to the volume of demand for finished goods. Therefore, the RF Ministry of Economic Development has declared a neutral investment policy, which will be limited by efficiency, quality, ecological and social projects.



# Contacts



**Andrew Sedov**  
**Leader of the Metals group in Deloitte, CIS**

Partner, Head of Consumer and Industrial Products Audit department  
+ 7 (495) 787 06 00 ext. 2260  
[asedov@deloitte.ru](mailto:asedov@deloitte.ru)



**Vladimir Perfiliev**  
**Director, Consumer and Industrial Products Audit (Metals)**

Deloitte CIS  
+ 7 (495) 787 06 00 ext. 8060  
[vprofiliev@deloitte.ru](mailto:vprofiliev@deloitte.ru)



**Olga Nesterenkova**  
**Senior business development coordinator, Consumer and Industrial Products, Deloitte CIS**

Deloitte CIS  
+7 (495) 787 06 00, ext. 1939  
[onesterenkova@deloitte.ru](mailto:onesterenkova@deloitte.ru)

## Authors:



**Marina Elovskaya**  
**Senior Manager**

Business Development Department, Deloitte CIS  
[melovskaya@deloitte.ru](mailto:melovskaya@deloitte.ru)



**Lora Zemlyanskaya**  
**Senior Specialist**

Deloitte CIS Research Centre  
[lzemlyanskaya@deloitte.ru](mailto:lzemlyanskaya@deloitte.ru)



**Yulia Durnova**  
**Specialist**

Deloitte CIS Research Centre  
[ydurnova@deloitte.ru](mailto:ydurnova@deloitte.ru)



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