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Industry Insights

The facts for your business

IT Outsourcing & Software Development in Russia

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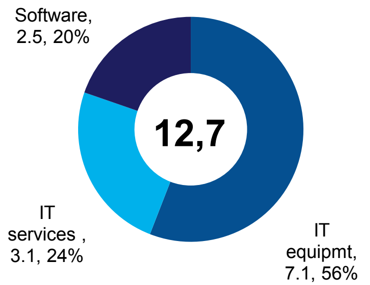
September 2016

Contents

This report is an overview of the IT Outsourcing & Software Development in Russia rather than an exhaustive report of the entire IT industry. We would be happy to provide a more detailed report on a specific subject.

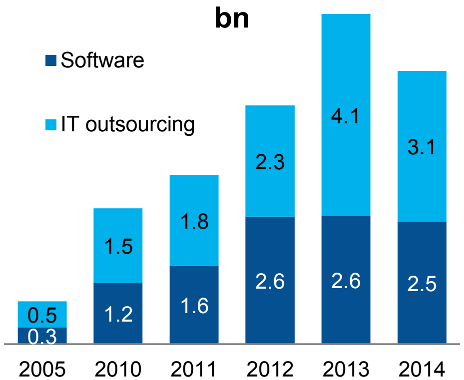
Executive Summary (1)

Russian IT market, USD bn; %



Sources: Rosstat, IDC, Frost & Sullivan

Purchases of software and IT outsourcing services in Russia, USD bn

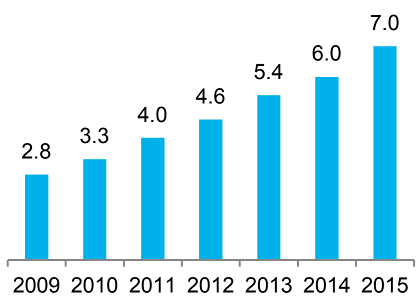


Source: Rosstat

- The Russian IT outsourcing and software development market is estimated at **USD 12.7 bn**, which accounts for approximately **1.1% of GDP**
- Companies in Russia purchased **software** for a total of **USD 2.5 bn** and **IT outsourcing** services for **USD 3.1 bn** in 2014
- **Russia's exports** of software and IT services were estimated at approximately **USD 7 bn** in 2015
- Russia's exports of software and services increased by **17%** in 2015 compared to 2014. From 2009, this market segment has **increased by a factor of 2.5 showing a CAGR of 16.5%**
- State agencies purchased via public tenders software for a total of **USD 1.4 bn**, **77%** of the value was foreign software
- The Russian IT market is going through a **structural change**: hardware sales are declining as business process automation software, cloud services, Big Data solutions, outsourcing and business analysis systems are in greater demand
- **The Ruble's devaluation makes the country attractive as an exporter of services from the cost perspective**
- There are more than **3 500** software companies, of which **60%** have export revenues

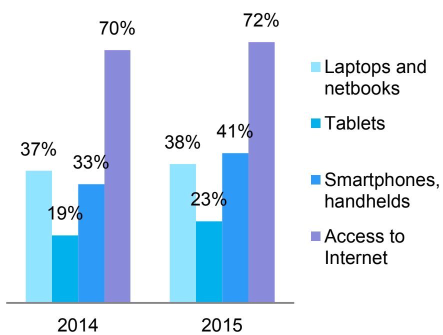
Executive Summary (2)

Export of software and IT services from Russia, USD bn



Source: Russoft

Access to IT, % of households



Source: Rosstat

- **Established software hubs** are in Moscow, St. Petersburg, Nizhny Novgorod and Novosibirsk. Moscow is well-known for business application programming whereas others are centers for scientific programming
- Russia is home to **brands** that have gained or are gaining **international renown**, such as Kaspersky, Yandex, InfoWatch, Positive Technologies, Prognoz, EMC, Diasoft, Naumen, Parallels, Acronis, Auriga, Data Art, First Line Software, MERA, Reksoft, Return on Intelligence and Maykor. In addition, there are hundreds more companies in the sector
- **Russia is #12** in the global mobile gaming industry with **USD 1.3 bn** revenues
- **IT outsourcing market is changing**: oil & gas companies are reducing their expenditures while banks and retail companies are spending more
- About **25 000** IT professionals graduate every year from universities. This is not enough due to a deficit of specialists due to strong competition with integrators and vendors for talent
- Very strong school of mathematics: highly **complex mathematical analysis and algorithmic thinking** differentiate Russia from other countries

Executive Summary (3)

"The Russian software development sector offers huge opportunities and growth. It is a focus sector of the Russian government strategy for the future Russian economy."

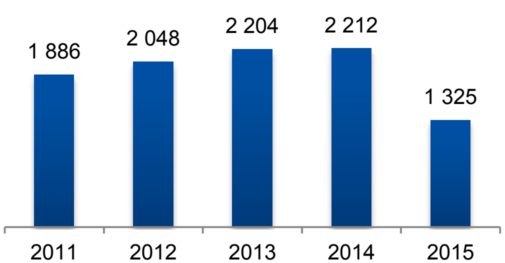
- **Consistently strong results in the ACM International Collegiate Programming Contest**. Russian students won the contest 10 times: St. Petersburg ITMO University won 6 times (the only six-time winner in the world) and St. Petersburg University won 4 times (most recent win in 2016). Top 10 global performers in 2016 included teams from Urals Federal University (Ekaterinburg) and Nizhny Novgorod State University
- Estimates of software developers working in Russia range between **400 000** (Microsoft) to **890 000** (EDC)
- **102 million** Internet users (**71%** of population), the country has very quickly embraced the Internet and new technologies
- The government provides significant **tax incentives** for software companies
- The government is pushing for **local software champions.** Government agencies and state-owned companies have to justify why they buy foreign software if there is a Russian equivalent in such fields as business applications, antivirus software, information security, and Internet servers in business environment
- **List of Russian-made software** was established in 2015
- **30 science and technology parks** have been created to serve as the impetus for the sector's development in the future

Russia: Facts & Advantages

Vast potential

Indicators	2015
Public debt, USD bn*	112
Public debt as a % of GDP	9%
Private debt, USD bn	165
Private debt as a % of GDP	13,2%
Human Development Index (HDI)	0,798
Unemployment, %	5,9

GDP, USD bn



**Year-end exchange rates were used.*
Source: Federal State Statistics Service (Rosstat), FocusEconomics, UNDP, Central Bank

- Russia is a major market with **144 million** inhabitants, of which **74% live in urban areas**
- **Very close to Europe** with strong historic and economic ties
- **77 million** people are working age (aged 15-72)
- **Good education system** with a strong technical/science heritage
- **100%** of population is **literate** with **95%** with at least **upper secondary education**
- **950** state and private **universities** produce **1.2 million graduates** a year (almost double from 2000)
- According to OECD, **54%** of those aged 25-64 have attained **university degree**
- Approximately **30%** of graduates major in **sciences and technology**
- **12th largest economy in the world** measured by GDP in real terms: **USD 1 325 billion**
- **6th largest economy in the world** measured by GDP based on PPP valuation
- **GDP per capita** in 2015 at current prices: **USD 9 055** (and USD 25 411 based on PPP)
- **Significant progress** in World Bank's 'Ease of doing business' ranking: **51st place in 2016 (2015: 62nd)**

IT Outsourcing and Software Development: Role in the Economy

1.2%
is the sector's contribution to the economy

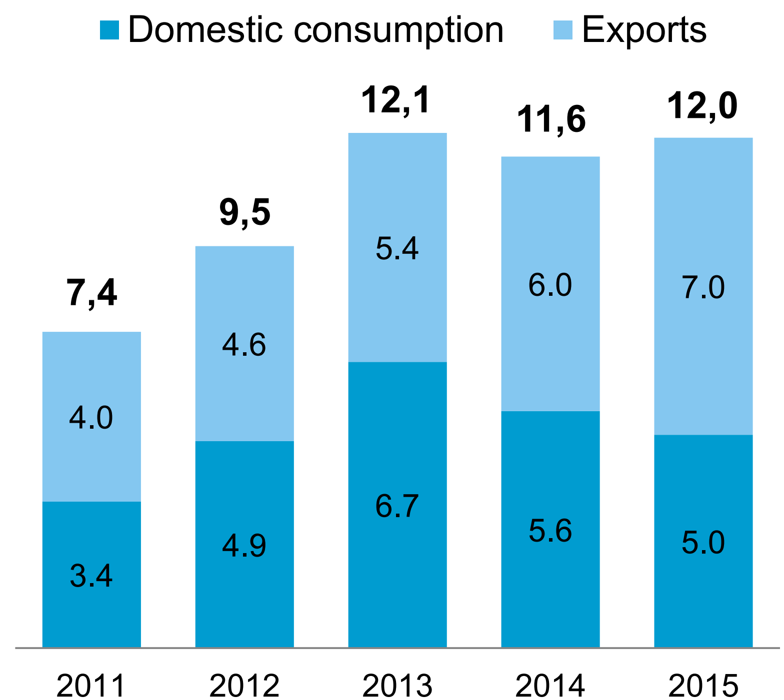
890 000
Specialists

1.1%
of total working population

3rd
Leading country in software exports after India and China

90%
of players are small and medium sized companies

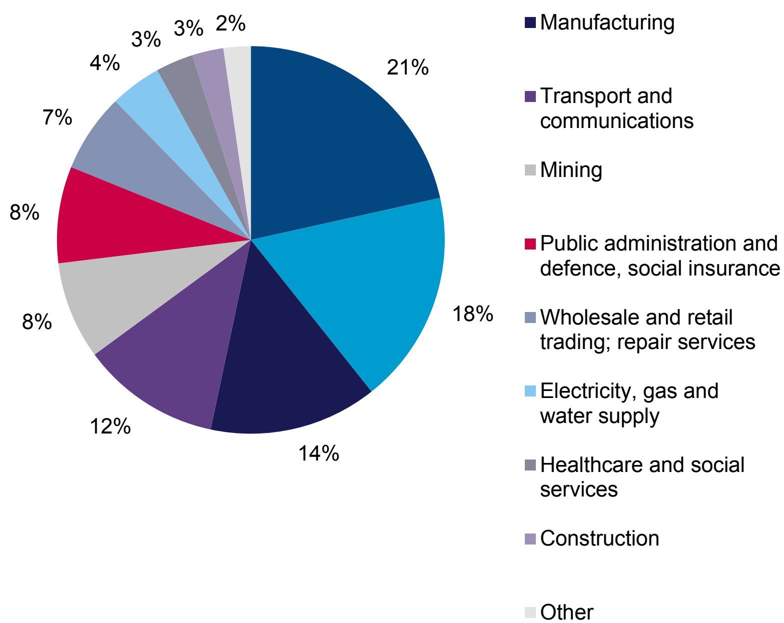
Russia's software and IT outsourcing services market, USD bn



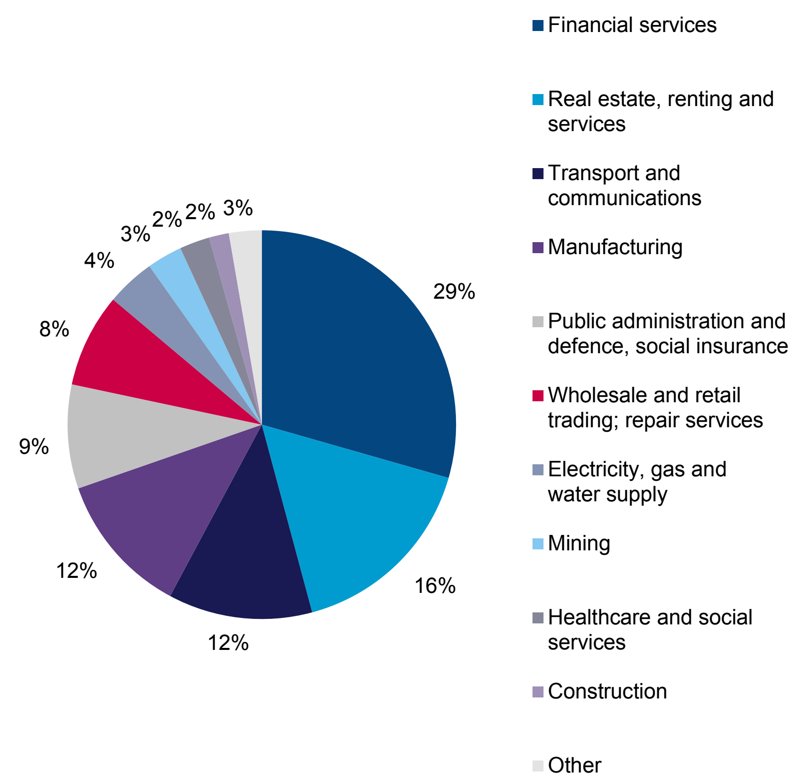
Sources: Rosstat, IDC, Russoft, own estimates

Target Markets (1)
Customers by Industry

Users of IT Outsourcing Services by Industry, %



Software Purchases by Industry, %



Source: Rosstat

Target Markets (2)
IT Outsourcing

- Russian government agencies and private sector have been actively outsourcing IT support functions to independent local players
- Top IT outsourcing projects involved creation of large databases and servicing IT infrastructure of retail outlets in multiple locations

Customer	Sector	Provider	Geography	Years
Russian Post	Services	Maykor	All Russia	2014-2017
Federal Treasury	Government	I-Teco	All Russia	2014-2015
Universal Electronic Card	Transport	Maykor	Moscow Region	2015-2022
Rosreestr (Real Estate Registry Service of Russia)	Government	I-Teco	All Russia	2015
Analytics Center, Supreme Court of Russia	Government	Orbita Service	All Russia	2015
Pension Fund of Russia	Government	Technoserv	All Russia	2015
MegaFon Retail	Retail	Maykor	500 cities	2015-2016
Sberbank (macro-region branch)	Finance	IT Center Voronezh Reg.	6 regions	2014-2015
Rostelecom	Telecoms	Maykor	Volga Fed. Dist.	2014-2017
Baltbet	Services	Maykor	190 cities	2014
Rostelecom – Retail Systems	Retail	Maykor	All Russia	2015
Pochta Bank	Finance	Jet Infosystems	All Russia	2014
Sberbank (macro-region branch)	Finance	Maykor	Eastern Siberia	2014
Kari	Retail	Maykor	All Russia	2015-2016
Bank Otkrytie	Finance	Maykor	All Russia	2014-2015
Detski Mir	Retail	Maykor	All Russia	2015
Melon Fashion Group	Retail	Maykor	All Russia	2015

Source: TAdviser

Target Markets (3) Data Centers

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Strong concentration in the two capitals with a number of new centers launches driven by legislation changes

- 170-180 large- and mid-sized data centers operate in Russia (iKS-Consulting)
- Vast majority of data centers are in Moscow and St. Petersburg
- Data centers in other areas are scarce
- Revenues are showing double-digit growth
- Prices have not basically changed since 2014 in order to attract new clients
- Data centers serve not only Russian companies but also firms based in the EU

Rating	Company	Number of racks	Power supply, MWt
1	DataLine	2 718	26,6
2	MMTS-9	1 358	6,5
3	Linxtelecom	1 200	17
4 (5)	SafeData	1 190	14
5 (4)	Selectel	1 190	12,8
6	KROK	990	11
7	TrustInfo	960	8
8	Stack Group	901	8,7
9	DataPro	850	20
10	DataSpace	820	9,5

Source: CNews

Target Markets (4)
Software Development

Based on the Russoft survey of software developers, their target industries are as follows:

Year of Survey/ Vertical Markets	2011	2012	2013	2014	2015
Information Technology	74%	70%	74%	75%	68%
Banking	23%	36%	26%	27%	34%
Telecom	26%	38%	31%	35%	27%
Industrial Manufacturing	27%	36%	38%	40%	37%
Business Logistics, Travel & Transportation	28%	37%	29%	33%	31%
Government	21%	31%	24%	34%	28%
Power Supply, Gas & Oil	17%	22%	22%	24%	29%
Healthcare & Pharmaceuticals	23%	29%	28%	31%	28%
Retail & Distribution	26%	41%	29%	31%	24%
Education	21%	28%	28%	31%	24%
Science & Research	18%	28%	26%	31%	20%
Gambling & Entertainment	9%	17%	15%	18%	17%
Media	13%	20%	18%	15%	18%
Sport & Travel	10%	20%	17%	18%	11%
Insurance	13%	28%	15%	15%	15%
Building & Real estate	12%	23%	17%	21%	28%
Services	27%	40%	35%	31%	26%
Financial Services	25%	30%	26%	27%	21%
Energy	17%	22%	21%	20%	24%

Source: russoft.ru

Target Markets (5)
Software Development

- USD 5 bn market volume
- Largest growth in custom software development services
- Trend toward development of ready-to-use solutions
- Strong increase in export volumes
- More than 3 500 active software companies
- Leading software developers by revenue band:

USD 500m+

	Company	HQ location	Product
1	1C	Moscow	Accounting, databases
2	Cognitive Technologies	Moscow	Enterprise functional management
3	EPAM Systems	Minsk/Moscow	Bespoke development
4	Kaspersky Lab	Moscow	Antivirus
5	Center of Financial Technologies	Novosibirsk	Banking software
6	Luxoft	Moscow	Bespoke development

USD 100-500m

	Company	HQ location	Product
1	Abbyy	Moscow	Optical text recognition, form entry, dictionaries
2	Acronis	Moscow	Back-up and data storage
3	CBOSS	Moscow	Billing systems for telecoms
4	Parallels	Novosibirsk	Virtualisation
5	SKB Kontur	Ekaterinburg	DMS, accounting
6	Prognoz	Perm	Business intelligence
7	Transas	St Petersburg	Transport management
8	Veeam	St Petersburg	Availability and back-up solutions

Note: Companies are sorted alphabetically within their revenue groups
Source: Russoft, TAdviser

Target Markets (6)
Mobile Applications Development

- Thanks to the pervasive use of smartphones and other mobile devices, mobile apps have become very popular
- Russian market of mobile apps is estimated at USD 1.3 bn in 2016 (J'son & Partners Consulting)
- Russia is #5 globally by the number of downloads
- Russia is #3 in the global retail mobile conversion rate index (Criteo)
- Leading software developers by revenue band:

	Developer	Rating	No. of Apps
1	CleverPumpkin	8,73	145
2	Touch Instinct	5,29	110
3	Sebbia	5,1	137
4	e-Legion	4,9	102
5	REDMADROBOT	3,86	99
6	Infoshell	3,25	96
7	MobileUp	2,46	73
8	Smorodina	2,14	50
9	King Bird Studio	1,99	75
10	Asmo-Press Media Group	1,98	209

Source: CMS Magazine

Target Markets (7)
Major Offshore Development Centers

- Moscow, St. Petersburg and Novosibirsk are the leaders in the software development industry
- The former cover around 70% of the total market
- St. Petersburg is the leader in graduates from IT, science and engineering with 28 000 graduates p.a., Moscow 24 000 and Novosibirsk 15 000

Labor Market in Software Development

- St. Petersburg labor market with approx. 232 000 IT employees and average salary of USD 18 000 p.a.
- Moscow labor market with approx. 510 000 IT employees and average salary of USD 21 000 p.a.
- Russian educational system is traditionally strong in fundamental sciences and math, leading to Russian programmers being well trained in problem solving and algorithmic thinking
- Russian labor market is far more stable than Indian, leading to very low personnel attrition rates (below 10% annually vs. 20-25% or higher in India)

Average gross monthly salary in 2015 (in USD)								
	Java	1C	C#/.NET	C++	Delphi	PHP	Python	Ruby/ Rails
Junior Programmer	908 - 1 020	1 057 - 1 131	797 - 1 001	760 - 908	946 - 1 001	853 - 890	946 - 1 038	853 - 1 094
Programmer	1 594 - 1 761	1 428 - 1 576	1 428 - 1 650	1 279 - 1 761	1 465 - 1 798	1 539 - 1 706	1 576 - 1 798	1 576 - 1 835
Senior Programmer	2 299 - 2 503	2 521 - 2 762	2 114 - 2 262	2 243 - 2 521	2 188 - 2 577	2 132 - 2 466	2 243 - 2 503	2 262 - 2 503

St. Petersburg
-
Moscow

Sources: software-russia.com

Import Substitution (1) Software

- The government is pushing an active import substitution agenda in key segments, including software development
- Federal Law #188-FZ dated 29.06.2015 provides for preferences to local software producers involved in state tenders; the law has been in effect since 01.01.2016
- If a Russian equivalent of a foreign software program or database is available, the customer should buy it. If it does not want, it should publicly justify why
- Criteria for treating software as that of Russian origin set out in the law:
  - Exclusive rights to this software are owned by Russia, its region or municipality, a Russian company or non-commercial entity in which Russia has more than 50% of shares, and Russian citizens
  - A foreign entity should have no control over the owner of rights
  - Payments in favor of foreign entities should not exceed 30% of all payments for this specific software
- Government's Decree #1236 dated 16.11.2015:
  - Establishes a log (registry) of Russian software and sets out rules of maintaining it
  - Contains a procedure of justifying why software made in Russia is not appropriate for the customer
- The registry is maintained by the Ministry of Communications
- It currently has approximately 1 200 product records; 2 260 more applications are pending
- Each record has details of the product, including brief description, technical architecture, distribution chart, production cycle, etc.
- Link to the registry: https://reestr.minsvyaz.ru/reestr/

Import Substitution (2)
Russian IT Market

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	Import Share %	
	2014	**2025**
ERP. CRM. BI …	75	**25**
Antivirus	60	**40**
Internet / Cloud Services	50	**10**
Server operating systems	75	**50**
PLM. CAD. CAM. CAE	88	**50**

SWOT Analysis
IT Outsourcing and Software Development

Strengths

- Large educated workforce
- Highly developed IT technical skills
- Expertise in complex non-standard solutions
- High concentration of technical universities in main IT cities
- Low attrition rate
- Nearshoring opportunities because time zones are more aligned with Europe and the U.S.
- Existing significant players
- Special tax regime for software companies

Weaknesses

- Insufficient supply of IT specialists and strong competition from integrators and vendors
- Language skills are less developed than in some other CEE countries
- Visa requirements cause difficulties to travel to Russia
- Legal restrictions in internet related IT

Opportunities

- Significant devaluation of currencies makes Russia attractive from the cost perspective
- Growth of nearshoring
- Growth potential of existing industry players, they have attained major market niches
- Increasing interest in complete IT outsourcing and cloud services
- Improved marketing of Russia's IT export potential
- Preferences to Russian software products and service providers at state tenders
- Subsidies to high-tech industry

Threats

- Competition not only from traditional rivals (China and India) but also from other Asia Pacific players and Central and Eastern Europe
- Legislation changes and isolationism
- Stalemate in sanctions
- Continued brain drain

Current Tax Exposure
Non-accredited IT Companies

– Corporate Profit Tax:	20%
– Simplified Tax regime:	
• As tax on profit (normal rate)	15%
• As tax on turnover (normal rate)	6%
– VAT normal rate	18%
– VAT reduced rate	10%
– VAT on exports	0%
– Personal Income Tax	13%

Tax and Regulatory Advantages and Benefits State-Accredited IT Companies

1. Reduction of Social Contributions

Social Contribution to:	Accumulated Income threshold in RUR p.a.*	Common rates	IT accredited company				
			2016	2017	2018	2019	2020
Social fund	≤ 718 000	2,9%	2%	2%	2,9%	2,9%	2,9%
	> 718 000	0 %					
Pension fund	≤ 796 000	22%	8%	8%	13%	20%	22%
	> 796 000	10%	0%	0%	0%	0%	10%
Insurance	-	5,1%	4%	4%	5,1%	5,1%	5,1%
Accident insurance	-	0,2%					
Interim results I	≤ 718 000	30,2%	14,2%	14,2%	21,2%	28,2%	30,2%
Interim results II	718 001 – 796 000	27,3%	12,2%	12,2%	18,3%	25,3%	27,3%
Interim results III	> 796 000	15,3%	4,2%	4,2%	5,3%	5,3%	15,3%

2. Other benefits

- Accelerated deprecation of IT equipment
- Lower minimum salary for foreign Highly Qualified Specialists
- >3 000 accredited companies

Establishing Legal Presence

- Usually as an OOO (limited liability company)
- Registration with tax authorities within 5 working days
- Further registrations with non-budgetary funds, opening of bank accounts usually take another 3 weeks
- Minimum charter capital RUR 10 000 (≈ EUR 140)
- 100% foreign ownership possible
- Legal address required
- One or more general directors as single executive body
- Foreign general directors possible but Russian citizen is required until work permit is received
- Work permits for foreigners as Highly Qualified Specialists in 3 - 4 weeks
- Special accreditation for software companies is possible in case certain criteria are fulfilled

IT Industry Parks (1)

Skolkovo

- High tech business area
- Technopark 95 000 m^2
- 336 resident companies
- 8 600 jobs
- Generating RUR 19.4 bn in revenues
- Strong government support and financing, grants and top infrastructure
- Clusters for IT, energy, biomed, space & nuclear
- Management school & private research university
- Collaboration with international companies such as IBM, Siemens, Nokia, Microsoft, Cisco, EMC, etc.
- Tax benefits for residents

http://sk.ru/

IT Industry Parks (2)

Tomsk SEZ

- IT, Nanotech, Biotech focus
- 34 000 m^2
- 60 resident organizations, of which 27 in software
- and hardware, 13 foreign organizations
- 2 000 jobs
- Generating RUR 1 bn in revenues
- Special tax and customs regime
- Close to Tomsk Scientific Centre of the Russian Academy of Science

http://www.investintomsk.com/investicionnye_vozmozhnosti/tomskaya_osobaya_ekonomicheskaya_zona/oez_tvt/

IT Industry Parks (3)

Kazan IT Park

- Platform to support for promising IT startups
- 30 000 m^2
- 157 resident companies
- Approximately 4 000 jobs
- Generating RUR 8.7 bn in revenues
- Special tax regime applicable

http://new.itpark-kazan.ru/

Our industry-specific services (1)

- **IT services**, incl.
  - System Admin set up and permanent help desk
  - ERP systems implementation
- **Market research/ business partner search,** incl.
  - Advice on localization options (partner search, special economic zones, industrial parks, etc.)
- **Company registration and business set-up**, incl.
  - Legal and business address
  - Office search
- **Tax and legal services**, incl.
  - IT company accreditation
  - Intercompany agreements
  - Labor contracts
  - Service agreements with private entrepreneurs
  - Tax advice for managers (short- und mid-term stay) in Russia, annual tax returns
  - Tax and legal due diligence
  - Migration services (visas, work permits)
  - Transfer pricing

Our industry-specific services (2)

- **Interim management**, incl.
  - General Director, head of branch or representative office
  - Risk management
- **Recruiting services**, incl.
  - Front-office IT professionals
  - Local office management, accountants etc.
- **Outstaffing**, incl.
  - Employment of your team by SCHNEIDER GROUP
  - Work place, office equipment, secretary services provided by SCHNEIDER GROUP
  - Business software potentially provided by SCHNEIDER GROUP
- **Accounting outsourcing**, incl.
  - Financial accounting
  - Transformation and reporting according to IFRS/US GAAP
  - Payroll accounting with special knowledge about local salary-related regulations
  - Tax accounting

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