Table of Contents

Introduction 2

Impact of the crisis on companies' activities 3

Current performance in comparison to pre-crisis benchmark 4

Current performance versus previous quarter (Q3 vs. Q2 2009) 7

Top issues that companies are facing now 10

Companies' reactions to the downturn 11

Activities whose importance to business will change in future 14

Market share strategy 16

Planning in a turbulent environment 17

External financing 18

Anticipated impact of crisis on 2009 profits compared to 2008 19

Expectations for Ukrainian economic recovery 19

Conclusion 23

Characteristics of the participants 24

Contacts 26

Introduction

Ernst and Young and the European Business Association (EBA) are proud to present the results of the fifth *Impact of the economic crisis on Ukrainian companies* survey. The first survey was carried out in late October 2008, when Ukrainian companies first felt the effects of the crisis. We studied the top issues companies faced since the onset of the crisis, seeking to understand how companies reacted to the changing economic environment and adapted to the new economic conditions and how they planned to manage through 2009.

We conducted this study every quarter to identify trends that are emerging from the crisis and how businesses are evolving because of this experience. We received primary information directly from decision makers on the current situation of their businesses.

Participants in the fifth survey are key executives from 68 domestic and international companies representing different industries. Some 27% of the participants represent Ukrainian companies; foreign companies account for 73% of total respondents. Some 49% are global companies, 21% are European enterprises and 3% are regional companies operating in CIS countries.

By size, 44% of the respondents are small enterprises with less than 200 employees. Another 35% of the participants are big companies with over 1000 employees and 21% are medium-sized companies with between 200 to 1000 people.

This survey, conducted from 20 December 2009 to 13 January 2010, gathers companies' opinions about business performance and anti-crisis activities implemented in the third quarter of 2009.

We ask how the crisis impacted companies' activities and compare their performance to pre-crisis results. We also analyze the dynamics of sales volumes and production capacity against previous quarter results, look at the most important issues that companies are facing at the moment and learn what new challenges businesses are facing in the market.

While cost reduction efforts continue, more focus seems to be placed on new activities that allow companies to compete on entirely new levels. In this report we also discuss dynamics of companies' strategies from the beginning of 2009 and the growing importance of specific activities rather than cost reduction measures.

We also report on currency risk mitigation measures implemented by the companies in the third quarter of 2009 and how companies are planning, hedging currency risks or obtaining external financing.

The survey further discusses to what extent the current economy will impact the profits of companies in 2009, which reveals some positive expectations/changes for many.

The 2010 presidential elections have been an important factor for business planning. Because of this important event, we analyze the participants' opinions concerning the endpoint of the Ukrainian economic downturn and their expectations for a future recovery. We also track the dynamics of the responses throughout 2009.

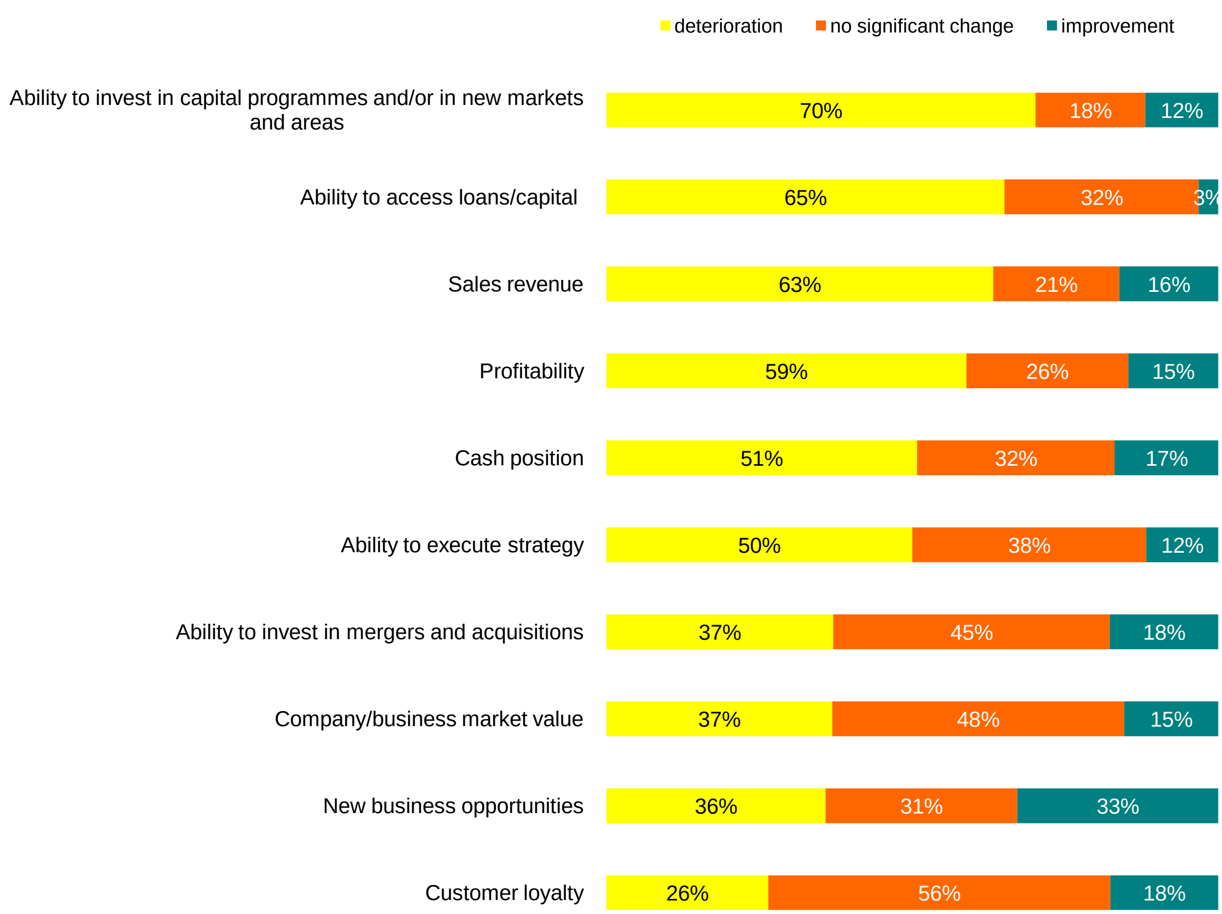
Impact of the crisis on companies' activities

The Ukrainian economy continues to adapt to the ongoing economic downturn. The economic environment significantly impaired companies' plans to invest in new capital programs and new market areas, as indicated by a deterioration of this activity among 70% of the respondents. The majority of companies still suffer from a lack of loans/capital (65%), declining sales revenue (63%) and lackluster business profitability (59%).

At the same time improvement of these measures was indicated by a few. While not too many companies are focusing on new business opportunities, 33% of respondents indicated improvements in this area. Access to capital increased according to 8% of respondents, which is 6% more than last quarter. A larger proportion of companies improved their cash position, +11% over the last quarter, and increased their market value and profitability (both +7%).

A focus on customer loyalty programs was indicated by an increase of positive responses by 5%. Sales revenue is also up to 16% (+2% from Q2).

Comparing the third quarter with previous quarters indicates a positive trend and improvement in most of the areas in question.



Current performance in comparison to pre-crisis benchmark

While sales volumes, one of the key business indicators, are continuing to be lower than pre-crisis 2008, for the first time since our survey in Q4 2008, there was an overall improvement in sales. Compared to the previous quarter, 9% fewer respondents recognized reductions in sales. (Figure 1).

Those companies that experienced improvements in sales (29%) saw increases in sales of between 5% and 20% (Figure 2). Unfortunately, the majority (62%) continued to see sales declines of 11% to more than 40% (Figure 3).

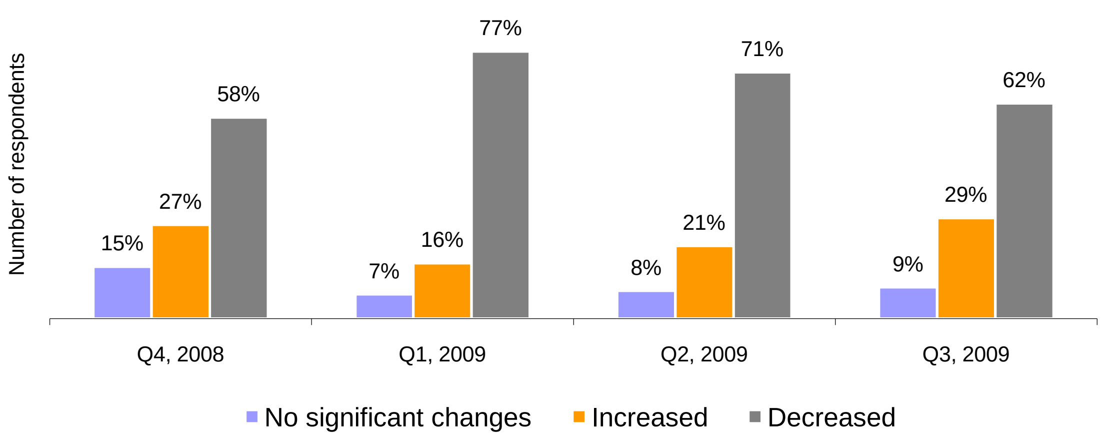
Changes in production capacity closely follow the changes in market demand for products or services. The majority of respondents (around 60%) lowered their production or service capacity to meet the lower demands in the market since the start of the economic downturn. The majority lowered their production or service capacity in Q3 2009 from 11% to 40% (Figure 6).

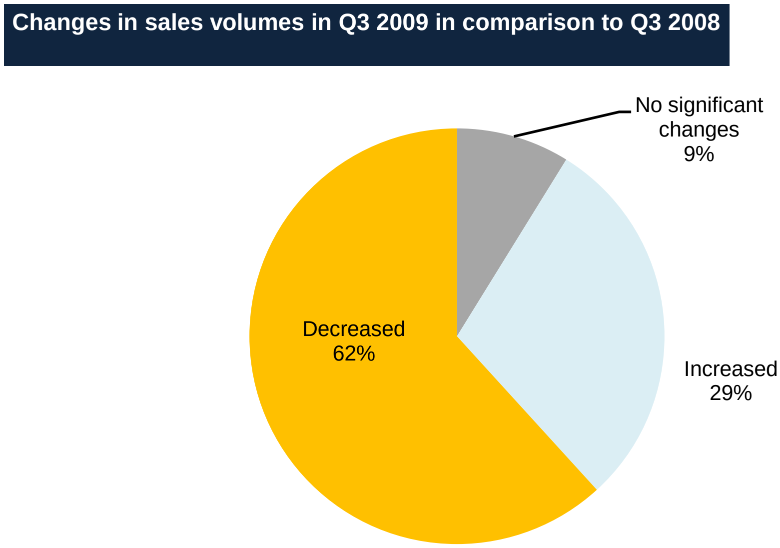
Improving sales volumes as indicated in Figure 1 do not proportionally correspond with the changes in production and service capacity. Increases in production capacity are much slower. Figure 4 demonstrates that from the beginning of 2009 the share of companies that have lowered their production or service capacity is becoming smaller (-2% quarterly). Companies are not in a rush to increase their capacity given uncertainty in sales volume increases.

Companies either have enough capacity to satisfy current demand or are stretching their resources until further trends are more positive. Those 18% of respondents who increased production or service capacity did so moderately, from 5% to 20% (Figure 5).

Changes in sales volumes in comparison to the pre-crisis period

Figure 1. Changes in sales volumes compared with pre-crisis period




Changes in sales volumes in Q3 2009 in comparison to Q3 2008
No significant changes 9%
Increased 29%
Decreased 62%

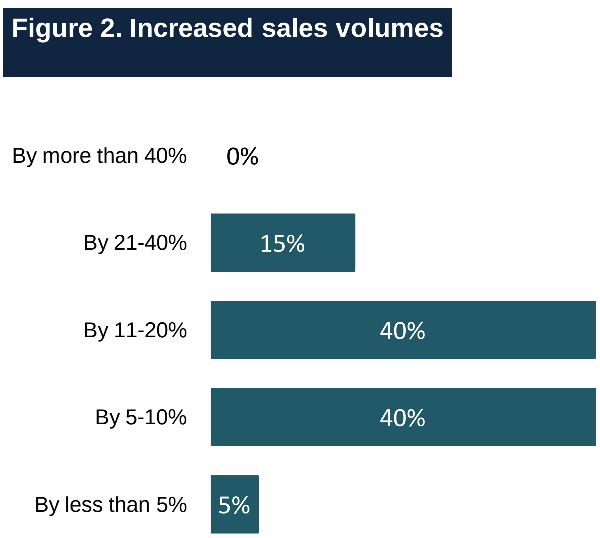


Figure 2. Increased sales volumes
By more than 40%
0%
By 21-40%
15%
By 11-20%
40%
By 5-10%
40%
By less than 5%
5%

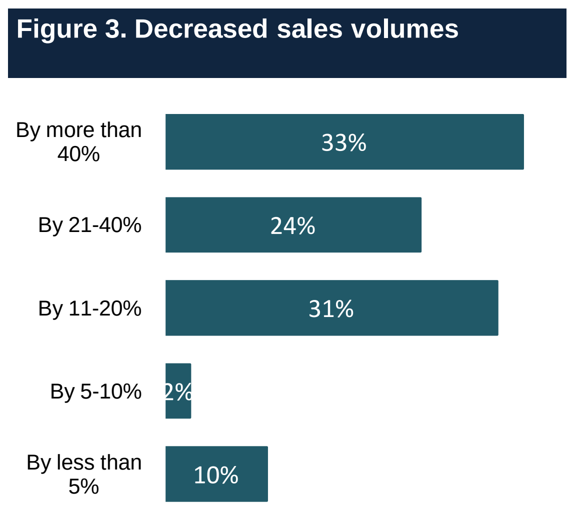
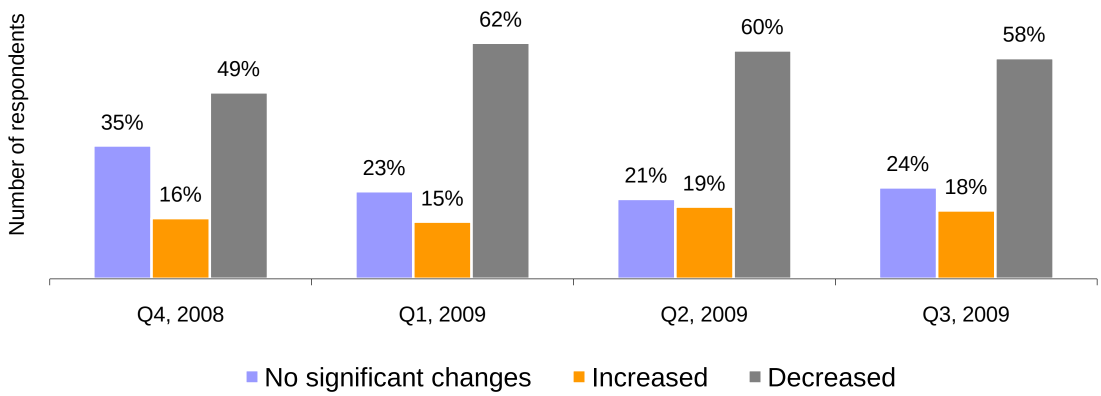


Figure 3. Decreased sales volumes
By more than 40%
33%
By 21-40%
24%
By 11-20%
31%
By 5-10%
2%
By less than 5%
10%

Changes in production and service capacity in comparison to pre-crisis period

Figure 4. Changes in production/service capacity compared to pre-crisis period



Changes in production/service capacity in Q3 2009 in comparison to Q3 2008

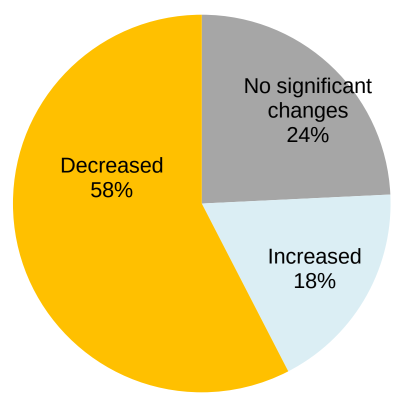


Figure 5. Increase in production/service capacity

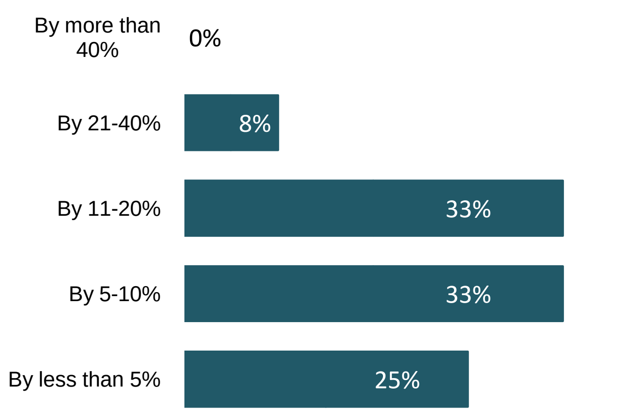
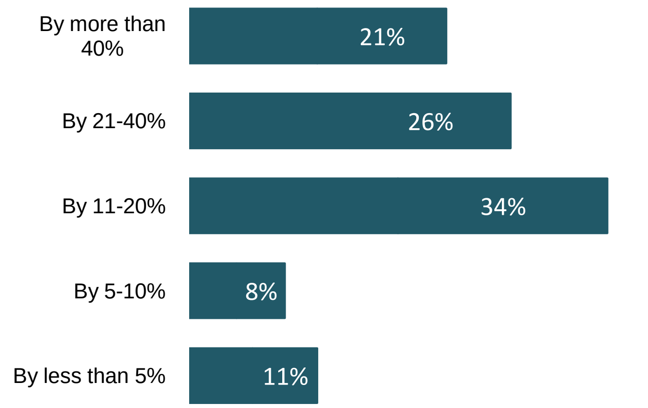


Figure 6. Decrease in production/service capacity



Current performance versus previous quarter (Q3 vs. Q2 2009)

By comparing the dynamic changes in sales volumes and production capacity with the previous quarter, we observed the following trends.

In the third quarter 2009, a drop in sales was reported by a larger number of respondents (34%). The majority of companies that reported sales volumes declines indicated the decrease as being between 5% and 20% (Figure 9).

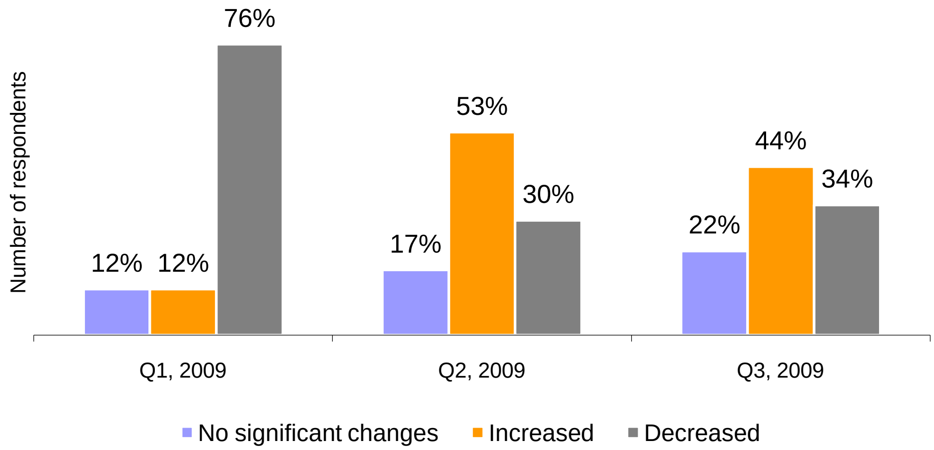
A smaller number of companies (44%) witnessed an increase in sales as compared to Q2, when the first and very significant growth of sales volumes was indicated since the beginning of the 2009 (Figure 7). The 44% of companies that experienced an increase in sales saw them increase from 5% to 20% (Figure 8). Besides the economic conditions, it is also important to remember that some companies may experience a seasonal business slowdown in Q3.

Keeping the same level of production or service capacity or lowering it still prevailed throughout 2009. 47% of respodnents decided to keep their capacity at the same levels as in the second quarter 2009 (Figure 10). Only 5% fewer companies reduced production or service capacity in Q3, in comparison with Q2 2009. 30% of those companies, which lowered their production capacity did so up to 40% (Figure 12).

In the third quarter, fewer companies (23%) reported increases in production capacity. Those companies that increased their production or service capacity did so by up to 20% (Figure 11).

Changes in sales volumes in comparison to previous quarter

Figure 7. Changes in sales volumes compared with previous quarter



Changes in sales volumes in Q3 2009 in comparison to Q2 2009

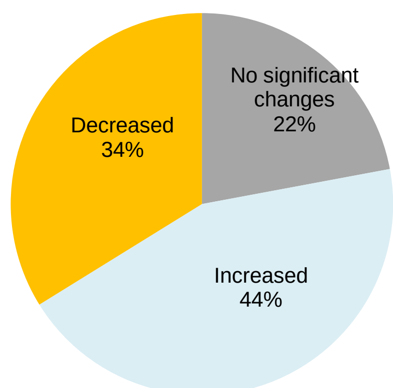


Figure 8. Increased sales volumes

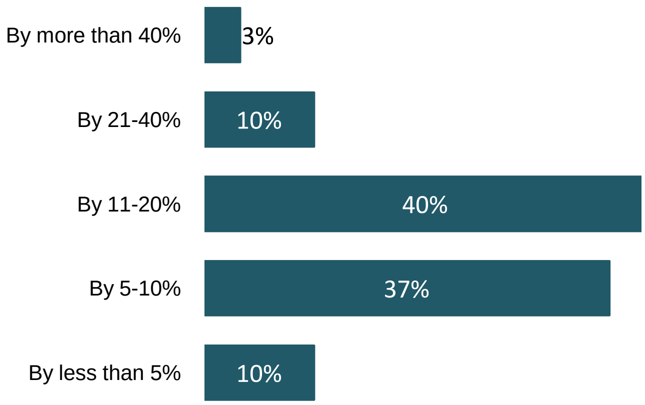
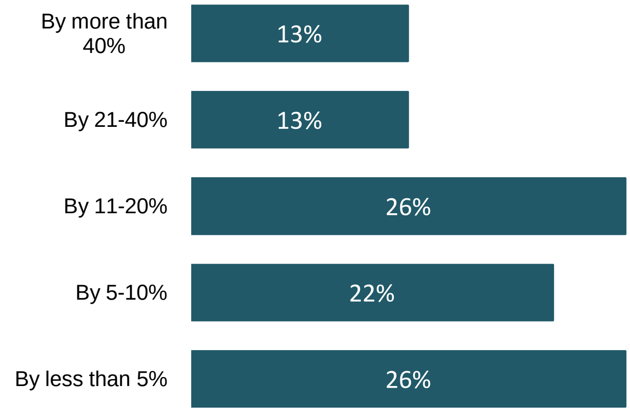
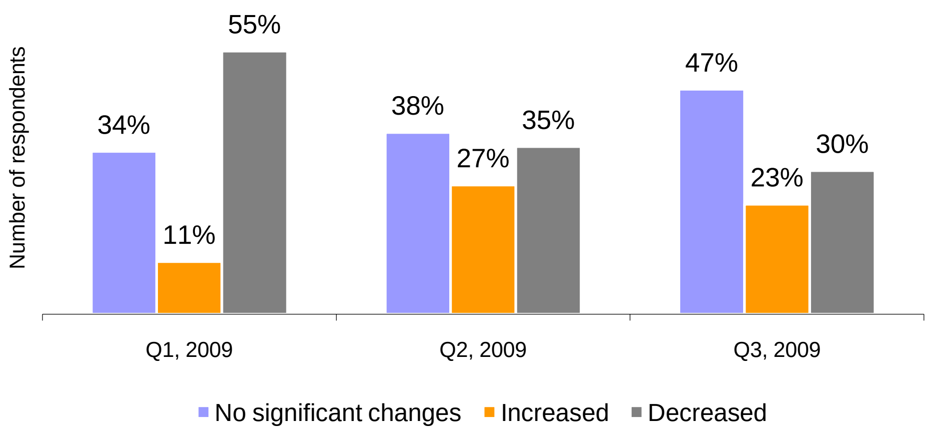


Figure 9. Decreased sales volumes



Changes in production/service capacity in comparison to previous quarter

Figure 10. Changes in production/service capacity compared with previous quarter



Changes in production/service capacity in Q3 2009 in comparison to Q2 2009

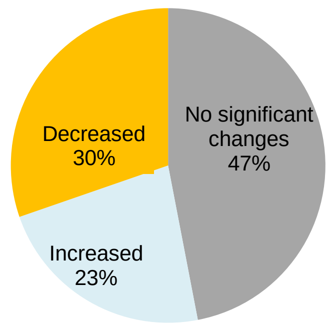


Figure 11. Increase in production/service capacity

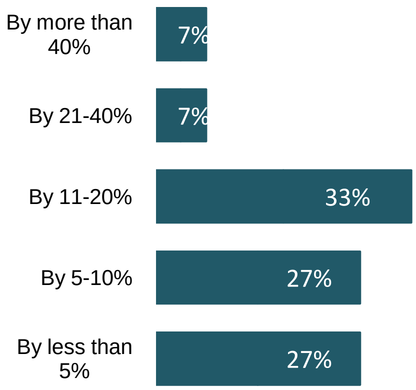
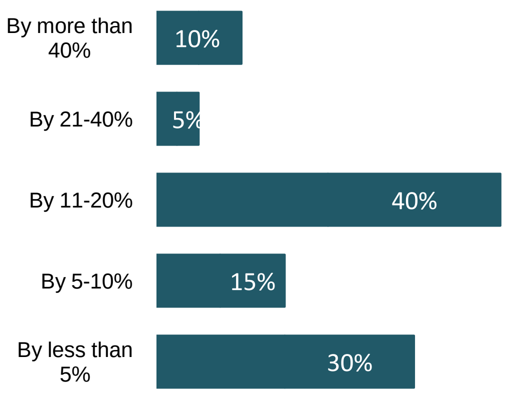


Figure 12. Decrease in production/service capacity



Top issues that companies are facing now

Until the third quarter of 2009, the top five problems that companies faced since the beginning of the crisis survey remained the same. They were the devaluation of the hryvnia and inflation, delayed payments by partners or clients, reduction in sales, and reduced overall operating expenses.

This time the results indicated that the decline in demand for services/products is no longer the top priority (it lost 13% of its responses since the last quarter). Almost half of the respondents (49%) indicated that competitive pricing pressures are now the most crucial issue in the market.

As a result of the decline in sales and of adaptation to the new economic conditions, the majority of companies lowered their prices and offered discount programs. This created price competition in the market and greater pressure for companies' overall bottom lines.

For 68% of respondents, the volatility of the hryvnia caused by the current economic situation, concerns about inflation and the country's economic instability remain top concerns.

Other important issues, such as delayed payments by partners/clients and lower sales, continue to worry 49% and 43%, respectively.

Main problems that companies are facing at the moment	
Devaluation of the hryvnia/inflation	68%
Delayed payments by our partners or clients	49%
Competitive pricing pressures	49%
Lower sales	43%
Reducing our overall operating expenses	43%
Decline in demand for our services	32%
Downsizing or laying off employees	32%
Increased costs of financing	24%
Unavailability of capital	15%
Market fluctuations and, as a result, the reduced market capitalization of our company	10%
Our company has not yet experienced the economic crisis	3%

Companies' reactions to the downturn

Companies continue to respond to the economic downturn with various cost reduction efforts. All participants reported that they are undertaking or have already undertaken some form of cost reduction activity.

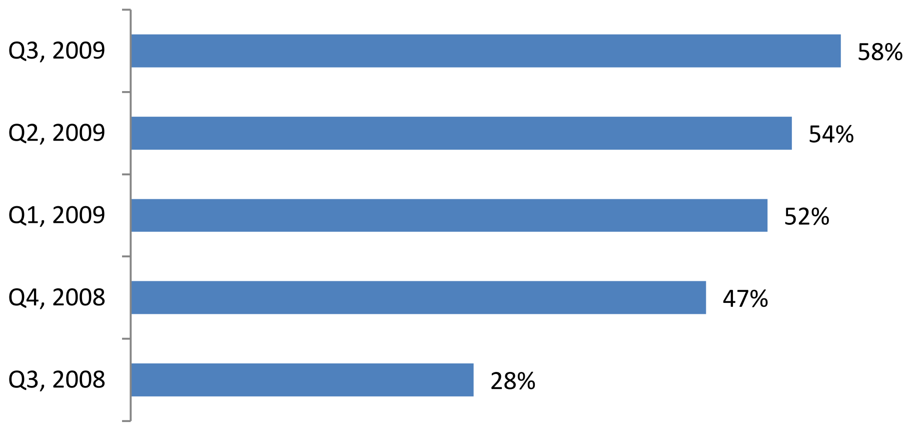
Most businesses reported that they opted for traditional ways to reduce costs, such as reduction of administrative expenses (82%) and negotiating better terms with landlords and property owners (80%). The third most important measure remains improving operational efficiency; it is a goal for 62% of respondents. These cost reduction activities are certain to help companies remain more competitive and profitable in the longer term.

In the third quarter, personnel lay-offs (58%) became a higher priority for business, as shown by an increase from 54% in Q2. Personnel lay-offs captured separately in Figure 13 indicate that companies continue to consider this measure as an important tool in long run cost reduction programs.

Other reduction efforts that have declined in significance are salary reductions of personnel, which dropped in the responses by 6% from Q2, and cutting marketing and selling costs (53%), whereas some respondents indicated an increase of financing in this area of their business.

Types of cost reduction activities undertaken

Figure 13. Among the types of cost reduction activities undertaken: Lay-offs

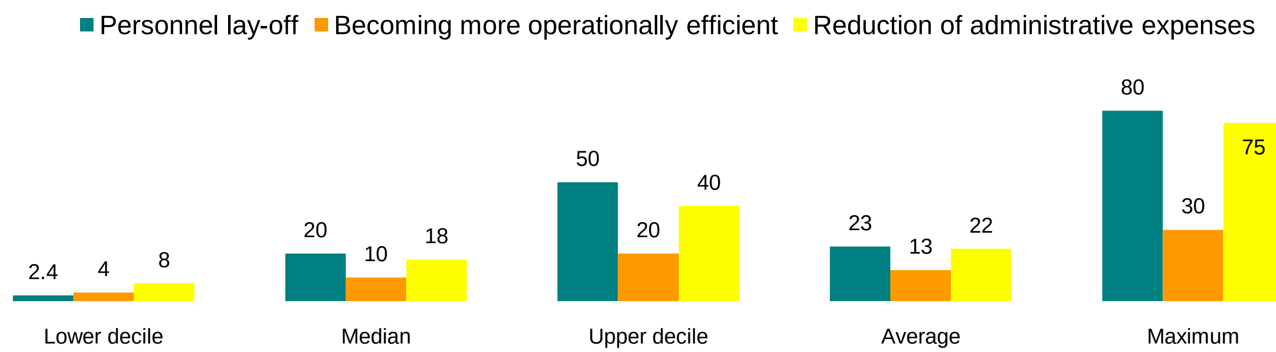


Since the first quarter of 2009 over 50% of respondents have continued their cost reduction activities: cutting administration expenses, improving operational efficiency, personnel lay-offs, cutting marketing and sales costs and negotiating better terms with landlords and property owners.

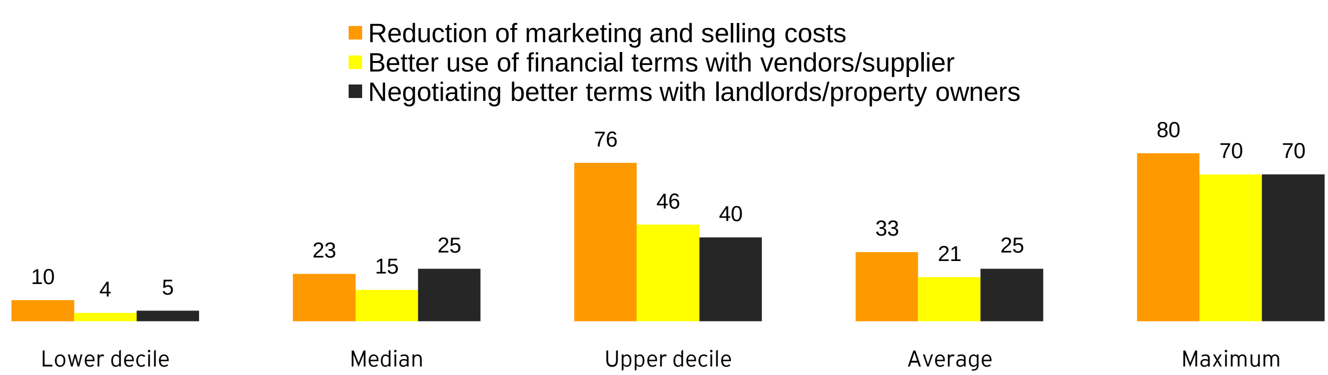
Negotiating better financial terms with vendors and suppliers became important to over 50% of respondents only in the second and third quarters of 2009.

The top six cost reduction activities listed above have been implemented by over 50% of the respondents. The results and percentages of the cost reduction activities undertaken are considered in detail below:

- **Reduction of administration expenses:** estimated percentage of reduction varies from 8% to a maximum 75%. The average is 22%. The average decreased by 2% from Q1 2009.
- **Becoming more operationally efficient**: percentage of improvement varies from 4% to a maximum 30%. The average is 13%. The average slipped 11% from Q1 2009.
- **Personnel lay-off**: estimated percentage of reduction varies from 2.4% to a maximum 80%. The average is 23%. The average increased by 2% from Q1 2009.



- **Reduction of marketing and selling costs**: estimated percentage of reduction varies from 10% to a maximum 80%. The average is 33%. The average decreased on 7% from Q1 2009.
- **Better financial terms with vendors and suppliers**: estimated percentage of discount varies from 4% to a maximum 70%. The average is 21%. This is similar to the result of Q2, when the average accounted for 20%.
- **Negotiation of better terms with landlords and property owners:** estimated percentage discount offered varies from 5% to a maximum 70%. The average is 25%. The average slipped 6% from Q1 2009.



Activities whose importance to business will change in future

The priorities of businesses are beginning to change. Rather than reducing costs, managing risks and improving their working capital situations, companies reported other issues – issues that were considered of lower importance or even at the bottom of the list in earlier surveys. At the same time, business activities that were more important in the second quarter are of less importance in the third.

For instance, managing customer relationships was ranked as the most important, with 80% of respondents indicating so, as opposed to 68% in Q2 2009.

Developing and launching new products and services was an important factor for 67% of respondents, as compared to 54% in Q2 2009.

Rising pricing pressures in the market are forcing companies to look for new ways to compete, beyond price. While there is no more opportunity to compete on pricing within their existing strategies, companies are looking for new ways to create added value to their products and services, possibly through increased/improved customer care or entirely new product lines and service offerings.

Managing risk and working capital and cash still remain of key importance to over 61% of companies.

Increasing business interest in attracting and retaining personnel was another emerging priority in the third quarter 2009. This activity has risen by 24% since Q2 2009.

It should be kept in mind, however, that a question earlier in the survey about cost reduction activities indicated that companies continue to see elimination of staff redundancy as a way to reduce costs.

This question about the changing importance of various activities reveals that other issues are becoming more important. Figure 14 shows the trends for different activities: managing customer relationships, developing new products and services, expanding into new markets. More companies are focusing on these activities.

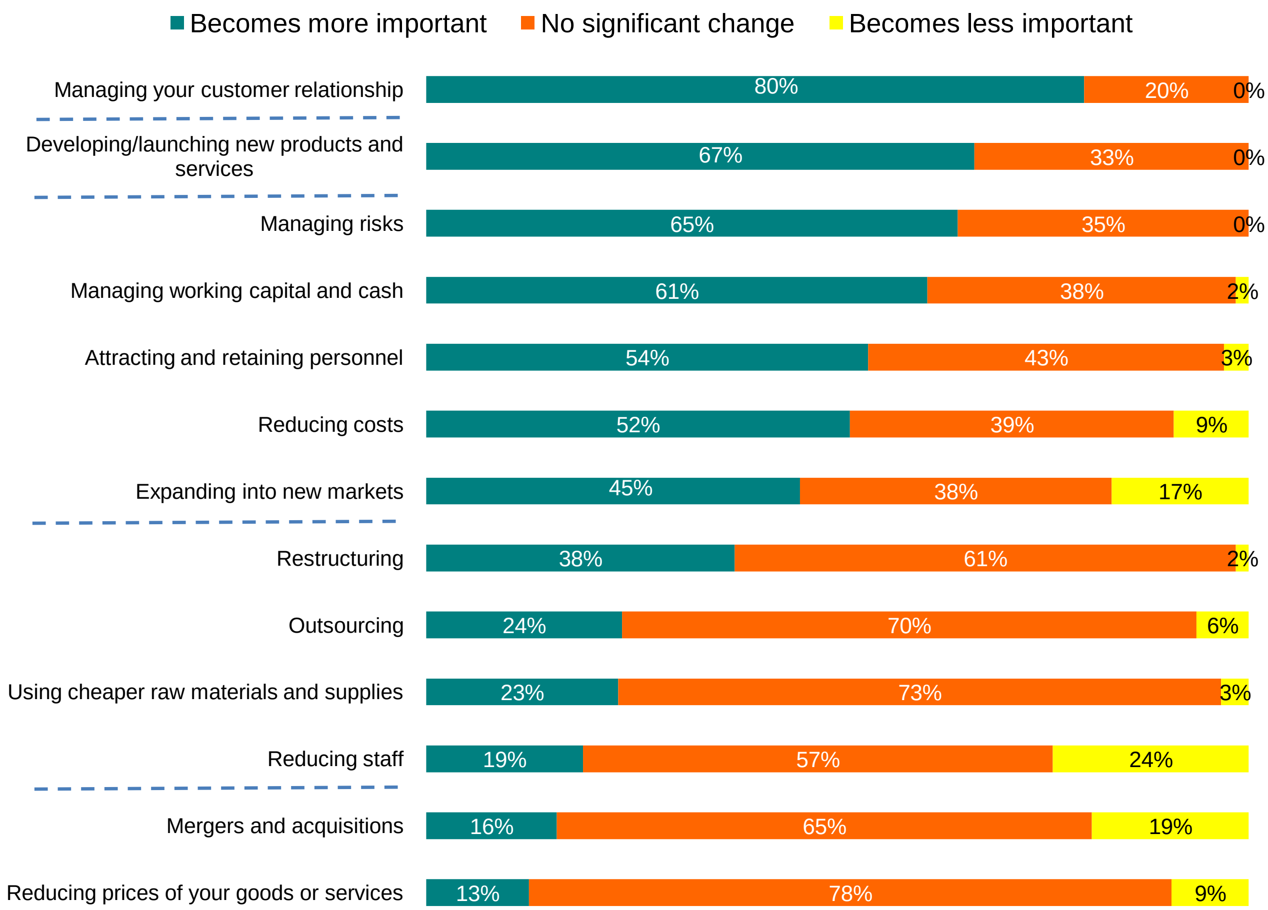
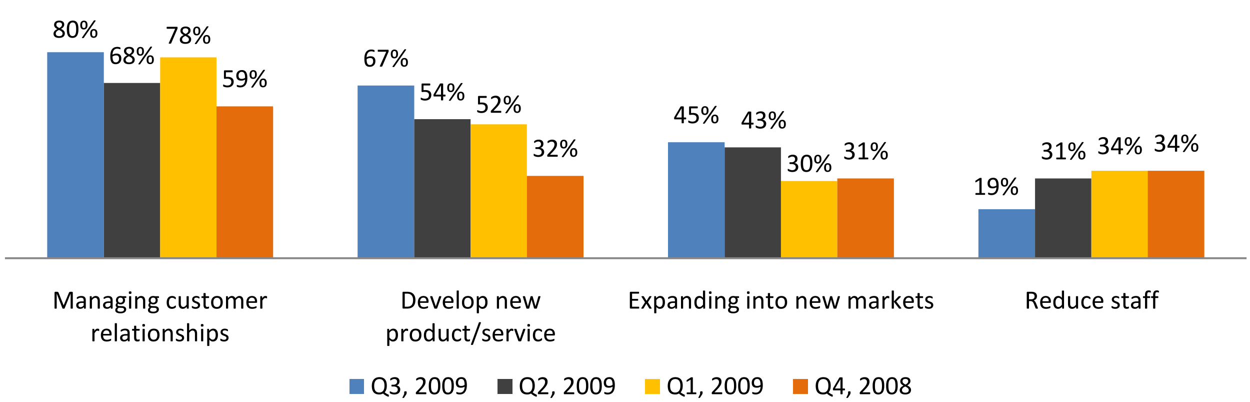


Figure 14. Dynamic of activities whose importance will increase in the future



Market share strategy

Companies retain their positive outlook regarding the sizes of their market share in the shrinking domestic economy. This indicator demonstrates that companies are offering positive responses to the current economic crisis in terms of market share and penetration.

Half of the respondents (51%) reported plans to grow their market share in the near future, 46% plan to maintain current market share and only 3% expect a reduction. None of the survey participants indicated plans to exit the market.

These responses were supported by a 90% participant confidence level in their plans to achieve their stated strategies. Since the beginning of 2009, confidence in marketing growth strategy grew dramatically, from 22% in Q1 2009 to 51% in Q3 2009 (Figure 15). This trend indicates that business expects growth to continue in the periods ahead.

Market strategy

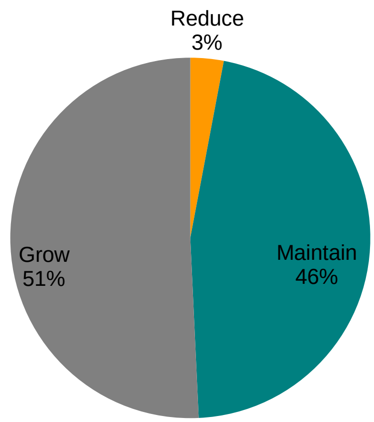
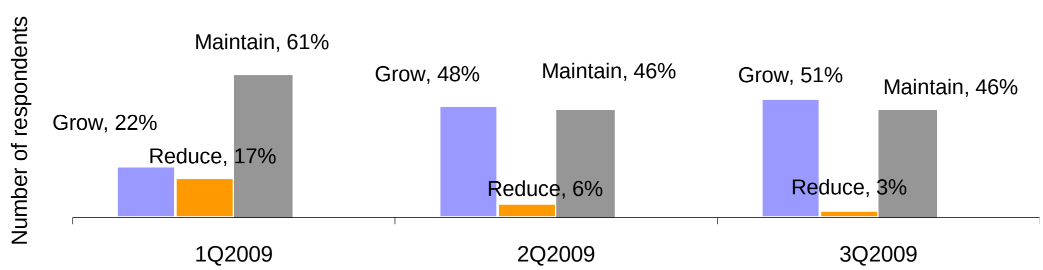


Figure 15. Dynamics of companies' market strategy



Planning in a turbulent environment

Most businesses in Ukraine use one of three currencies for planning and budgeting purposes: the Ukrainian hryvnia, the US dollar or the euro.

In the third quarter of 2009 the euro and dollar once again became the primary currencies for planning and budgeting purposes. They are used by 35% and 32% respondents respectively, whereas the hryvnia, the primary currency reported during the previous two quarters of 2009, lost this status, falling from 42% in Q1 2009 to 27% in Q3 2009. This may indicate that companies are hedging currency risks and planning ahead for post-election economic turbulence in Ukraine.

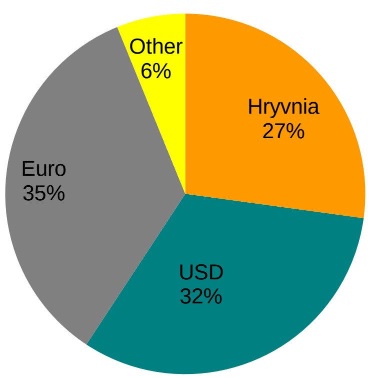
Companies' respondents reported the following exchange rate for the currencies:

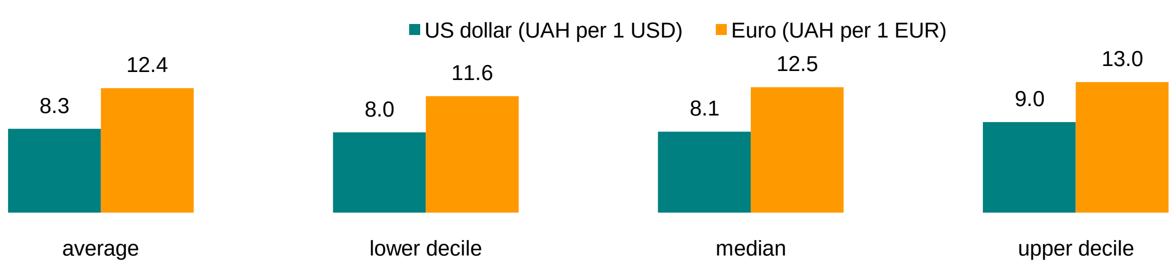
The US dollar rate used by companies in third quarter 2009 ranged from 8 UAH per 1 US dollar to 9 UAH, with an average of 8.3 UAH per 1 US dollar.

The euro rate used by companies in third quarter 2009 ranged from 11.6 UAH per 1 euro to 13 UAH, with an average of 12.4 UAH per 1 euro.

Among the other currencies, the companies reported the British pound (GBP) at a rate of 13.5UAH for 1 GBP and the Swiss franc (CHF) at a rate 7.55 UAH for 1 CHF.

Currency application





The results continue to demonstrate companies' concerns about the hryvnia's devaluation. Respondents indicated that they will continue managing currency exchange risk throughout the course of the year.

Three quarters of respondents (around 25% in each group) used several risk mitigation measures: transferring to a single currency, performing daily currency buying and selling transactions or using multiple currencies.

A small number of respondents indicated taking risk measures such as hedging transactions (15% of respondents) or using other currency mitigation methods.

By comparing the popularity of currency mitigation measures throughout 2009, we recognize that the popularity of available measures remains relatively stable. In first place is using a single currency, the second choice is daily buy/sell transactions and the third choice is diversification of currencies. However, in the second quarter hedging transactions was in third place.

#	Currency risk mitigation measures planned for 2009	% of companies
1	Transfer to using primarily a single currency in your business	28%
2	Daily currency buying/selling transactions	25%
3	Diversification by linking transactions to different currencies	24%
4	Hedge transactions	15%
5	Other:	8%
	• Obtaining loans in local currency • Price increase of 15% for goods and services • Change of payment deadlines for clients • Request for 100% pre-payment • Considering risks in pricing	

External financing

We also evaluated companies' level of access (or lack of thereof) to capital during the crisis.

The majority of respondents (59%) stated that they did not require external financing to support their business in 2009. Of those that did, 18% applied for a bank loan or for a loan from another financial institution and received financing while another 15% of the respondents did not apply for financing because of the current market situation. These concerned borrowers would consider using financing if the economic situation were different.

Surprisingly, only 8% of respondents indicated that they needed financing in 2009 but were unable to receive it.

Comparison of the results with those from the previous quarter shows that a larger number of respondents shifted to saying that they had no need of bank loans or other external financing. This represents a 21% increase for this response, while the other available choices saw decreases.

External financing in 2009	% of companies
We do not need bank loans or other external financing for our operations	59%
Yes, we applied and received financing	18%
In 2009 our company has not applied for financing with a view to a change in the market situation	15%
We applied but were unable to receive bank loans (or other financing) in 2009	8%

Anticipated impact of crisis on 2009 profits compared to 2008

Companies had a rather optimistic outlook towards the end of the year regarding their profits in 2009 compared to 2008.

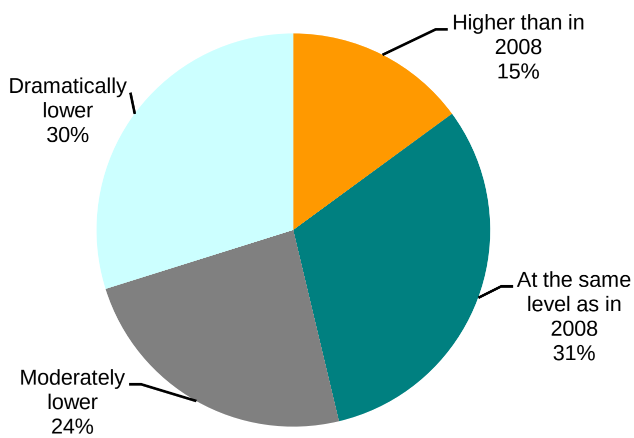
In the third quarter 2009, a significantly smaller number of companies (30%) continued to expect that their profits would be dramatically lower than they were before the crisis. This number, however, is 21% lower than the same number for the second quarter, 2009.

Another positive sign is the higher number of companies (31%) expecting their profits to be at the same level as in 2008. There was a 23% increase in responses over Q2 2009.

Some 24% of companies expect their profit earnings to be moderately lower than in 2008 and 15% of respondents expect an increase in profits compared to 2008.

It is possible that anti-crisis measures, which a majority of companies effectively applied throughout 2009, are showing some positive results for as many as 70% of respondents. They are expecting their profits to be from slightly lower to higher than they were in 2008.

Anticipated impact of crisis on 2009 profits compared to 2008. Profits expected to be:



Expectations for Ukrainian economic recovery

When will the Ukrainian economy stop falling?

The majority of respondents remain positive about the economic future of Ukraine; however, expectations for the timeline for recovery have slipped.

In this survey, as well as in previous ones, a significant number of respondents (72%) indicated that they believe that the Ukrainian economy will stop falling in 2010.

Expectations that 2009 would see the end of the economic decline evaporated as the year's end neared. Although the economy was pretty stable during the pre-election period, only 8% of respondents believe that the relatively stable economy through the end of 2009 was actually the end of Ukraine's economic slide.

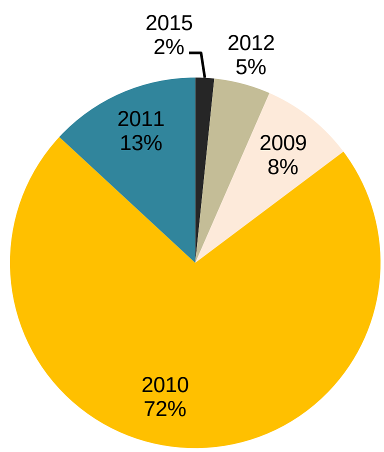
Somewhat worrying is the percentage of respondents (20%) who think the economy won't bottom out until 2011 or even 2012-2015.

Figure 16 indicates the dynamic changes in the respondents' answers to this question from the beginning of 2009. Note that 7% more respondents believe that the economy will stop falling only in 2011.

Those who believe that the economy will bottom out in 2010 think that it will do so in the second or third quarter of that year.

We asked an open-ended question to let participants reveal their views as to why and when the Ukrainian economy will stop falling. We received a variety of answers. Some focused on the causes for further decline while others addressed possible factors that could lead to its improvement (see below).

The Ukrainian economy will stop falling in:



The Ukrainian economy will

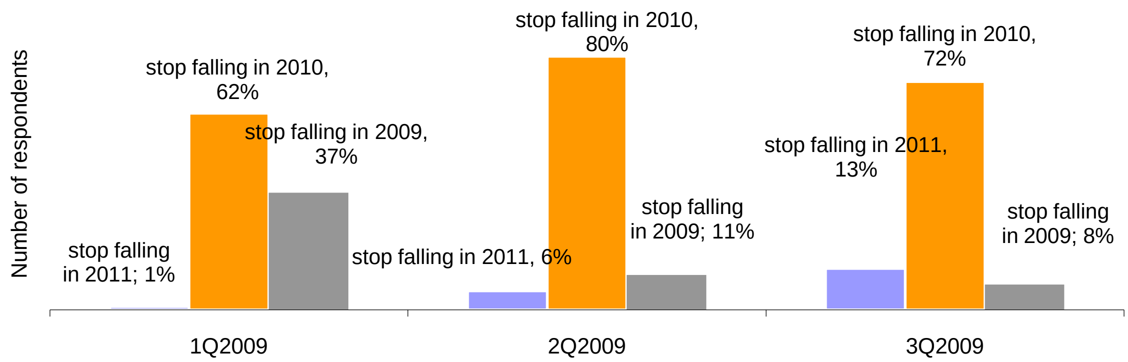
Continue sliding because:

- There will be slow recovery in developed markets and this will impact demand for Ukrainian commodities
- Prohibitive regulations restrict foreign investor interest in investing in Ukraine
- Political turbulence
- Incompetence of management

Improve because:

- After the presidential elections, the government will implement further anti-crisis measures and policies
- Continued subsidies for heat and transport
- The economy is already at the bottom
- World market recovery
- Increased demand for steel product exports
- Growth of GDP
- Stabilization of the economy
- Football (soccer) championship in 2012

Figure 16. Companies' expectations about when the economy will stop falling



Recovery of the Ukrainian economy

Given the results about when the economy will stop falling, it seems respondents are less confident of an economic recovery in Ukraine in the near term. The majority of respondents (51%) believe that the recovery will begin only in 2011, most likely in the first or second quarter.

Some 41% of respondents believe that the economic recovery will begin in 2010. Most of these expect the recovery will start in the third or fourth quarter.

Another group of respondents (9%) expect the recovery to occur in either 2012 or in 2013.

Figure 17 demonstrates the dynamics of respondent confidence in the recovery of the Ukrainian economy. While in the first quarter of 2009 72% of respondents were confident that the recovery would start in 2010, in the third quarter only 41% remained confident about that. Each quarter, a larger number of respondents have shifted their assumptions about economic recovery towards 2011, from 22% in Q1 to 50% in Q3, 2009.

The Ukrainian economy will start recovering in:

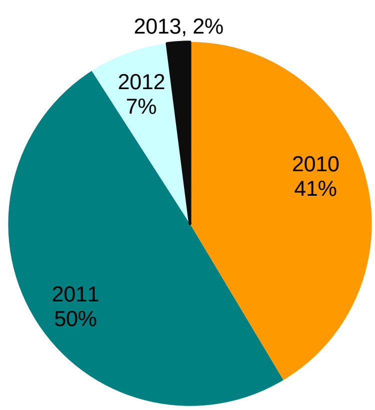
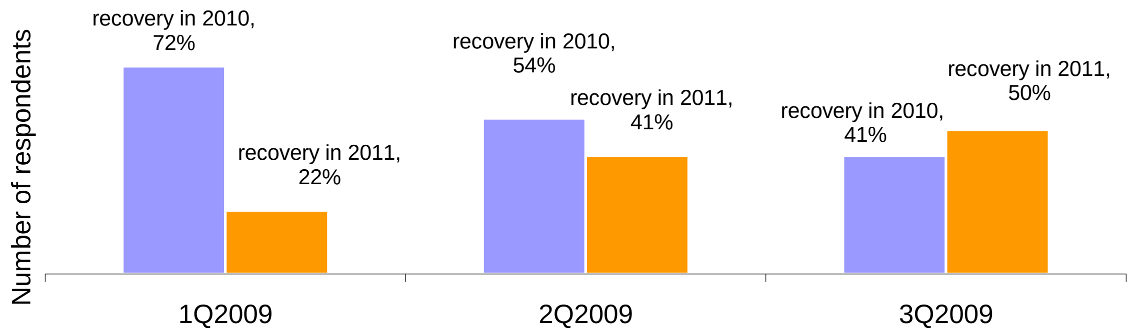


Figure 17. Dynamics of companies' expectations about when the economy will start recovering



Conclusion

While the survey for the second quarter revealed how companies were adapting their businesses to current economic conditions, this survey showed that they were taking confident steps towards new ways of doing business. Overall, the companies are shifting from pure anti-crisis measures and cutting costs to more exciting initiatives, such as new business opportunities and investments into new products/ services.

Businesses also recognized slightly better business results, such as increased profitability and cash positions, higher sales revenues and better access to capital.

Although the majority are still experiencing downturns in sales volumes and therefore decreased production or service capacity, we noted a slow trend towards growing sales volumes throughout 2009. The majority of respondents noted sales volume growth of between 5% and 20%. However, companies were not rushing to increase their production capacity to meet this increased sales demand. The majority are not yet confident in the stability of their sales or the economy.

In addition to the traditional top issues that have been mentioned throughout the crisis, we found a new emerging problem: growing competitive pricing pressures on the market. Not surprisingly, as a result of declining sales, the majority of companies lowered their prices and offered discount programs in order to maintain or even grow their market share.

Personnel lay-offs remained one of the major cost reduction activities that companies undertook. However, managing customer relationships, developing and launching new products and services and attracting and retaining personnel have grown in importance to companies.

While price competition remains part of today's environment, companies reported that they are looking for new ways to create added value for their products and services. This may possibly include increased/ improved customer care and entirely new product lines or service offerings.

Other important facts from this survey included:

- There is growing confidence among companies about their plans to grow (51%) or maintain (46%) market share.

- 67% of companies now use foreign currencies for budgeting and planning purposes

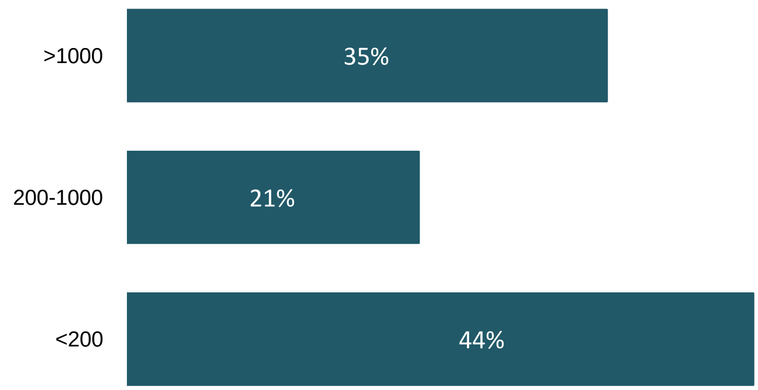
- 70% of respondents indicated that their profits in 2009 will be from slightly lower to higher than they were 2008.

After the presidential elections in early 2010, the majority of respondents believe that the Ukrainian economy will stop falling in 2010, perhaps by the second or third quarter, and will start to rebound in the same year, in either the third or fourth quarter. A small percentage of responses indicated that the economy already stopped falling in 2009. Time will tell who is correct.

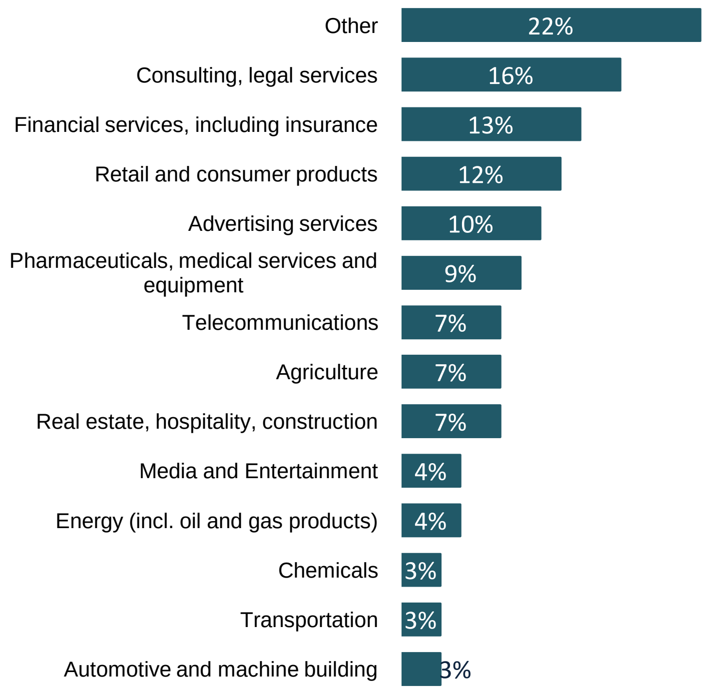
Characteristics of the participants

Total number of participants	68

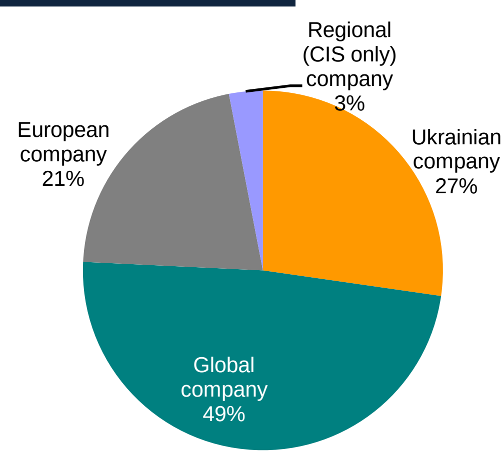
Total number of employees



Industry



Region of company operations



Contacts

Adlai Goldberg
Partner, Business Advisory, Ernst & Young Ukraine
Tel: + 38 044 490 3042
Fax: +38 044 490 3030
Email: Adlai.Goldberg@ua.ey.com
ey.com/ua

Svetlana Smayls
Senior Consultant, Business Advisory, Ernst & Young Ukraine
Tel: + 38 044 490 3000
Fax: +38 044 490 3030
Email: Svetlana.Smayls@ua.ey.com
ey.com/ua