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Winning Brands, Winning Formats*

2005/2006

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Romania

Romania

ECONOMIC OVERVIEW

2004 was the fifth consecutive year of economic growth for Romania. Furthermore, the growth was the highest of the past 15 years. According to preliminary figures, the GDP rose by approximately 8.3 %, being among the highest growth rates in the Central and Eastern European region.

The national currency appreciated significantly against both the euro (4%) and the US dollar (11%).

GDP and CPI

GDP and CPI

	2001	2002	2003	2004
GDP growth (%)	5.7	5.0	5.2	8.3
CPI average (%)	34.5	22.5	15.3	11.9

Source: EIU, August 2005

Unemployment

Unemployment

	2001	2002	2003	2004
Unemployment rate (%)	9.6	8.5	7.6	6.6

Source: EIU, August 2005

Economic forecasts

Key economic forecasts

	2005	2006	2007
GDP (%)	5.3	4.9	5.3
CPI average (%)	8.9	6.9	5.5
Unemployment rate (%)	6.2	6.8	6.9

Source: EIU, August 2005



Area ('000 sq km)¹: 238.4
(US 9,600 – EU25 3,981 – World 133,700)

Capital²: Bucharest
(Number of inhabitants: 2.1 million)

Population (million)³: 21.7
(US 293 – EU25 456 – World 6,376)

GDP (USD billion)³: 70.3
(US 11,735 – EU25 12,723 – World 39,503.5)

GNI per capita (USD)¹: 2,260
(US 37,870 – EU25 22,810 – World 5,110)

Currency: Leu (ROL)

Languages: Romanian (official), Hungarian, German

Main religions: Eastern Orthodox (87%), Protestant, Catholic

Government type: Republic

Sources: CIA Factbook; (1) World Bank 2005; (2) City Population; (3) Economist Intelligence Unit 2004 data

REGULATORY ENVIRONMENT

Foreign direct investment

After many years of low foreign investments, Romania managed to attract around EUR4 billion in 2004, the highest amount registered since 1990. The increase in foreign investment was the result of major privatisations (the sale of the national oil company Petrom, and the sale of gas and some electricity distribution companies) as well as a rise in green-field projects (large European retailers continued their expansion in Romania and more automotive spare-parts producers were relocating their production here), and the increased subscribed share capital for major Romanian companies. With a FDI growth rate of more than 127% (in USD terms) in 2004 versus 2003, Romania has managed to be close to other CEE countries, which benefited from high FDI per capita for several years now.

FDI

	2001	2002	2003	2004
FDI (ROL bn)	35,674	32,701	65,403	151,618
FDI (USD bn)	1.2	1.1	2.2	5.1

Source: EIU, August 2005 (Exchange rate: December 31, 2004)

Expected impact following EU entry

Romania signed the European Union accession treaty on 25 April 2005, marking a milestone in the country's modern history. EU membership is set for 1 January 2007, if all prior actions are taken. However, in case of major shortcomings observed during the preparation for accession, the entry can be delayed by one year, in compliance with the postponement clause included in the Accession Treaty.

Negotiations for EU accession were officially launched in 2000. In October 2004, the European Commission's Progress Report on Romania stated that the country's economy meets the criteria to be regarded as a functional market economy and, at the end of 2004, the European Commission confirmed the provisional finalisation of all negotiation chapters.

There are a number of risks and opportunities associated to the EU accession. Looking at what happened to other countries following accession, we can expect price increases for products and services, which will most probably result in a decrease in consumption due to the low purchasing power. Also, progressive elimination of custom duties will increase competition, especially in the food sector. Consequently, some Romanian producers may encounter problems and even disappear.

On the flip side, Romania's future accession to the EU is likely to improve the country's image and stimulate the inflow of foreign direct investment, especially from current EU countries, which could relocate some of their production facilities in Romania to lower production costs.

Property/Real estate regulations

The applicable law prescribes a few restrictions on the acquisition of real estate. A foreign company or individual may not acquire title to land in Romania. This restriction will be eliminated after Romania's accession to the EU.

Other circumstances under which foreign citizens and stateless persons are allowed land ownership in Romania are in compliance with an international treaty to which Romania is party and on a reciprocal basis; or by inheritance under the laws of intestacy.

Other regulations

Property tax

A local tax is payable quarterly by owners of buildings and ranges from 0.5-1% for legal entities. The tax is calculated on the book value of the building.

There is also a land tax, which is fixed at set amount per square meter. For land situated within a town, the tax varies according to location, zone and utilisation, while land outside towns is taxed at ROL1 per hectare, irrespective of all other considerations.

Competition law

Romanian competition regulations have been largely harmonised to be consistent with EU law in terms of undertakings (restrictive agreements and concerted practices, abuse of a dominant position, mergers), economic concentrations and state aid. New competition regulations have been issued recently to bring Romanian legislation into line with EU state aid regulations.

The Competition Council is the Romanian autonomous administrative authority in the competition field. The Competition Council observes the enforcement of the legal provisions on anti-competitive practices (restrictive agreements and abuse of dominant position) and controls economic concentrations (mergers and acquisitions) in order to protect, maintain and stimulate competition and a normal, competitive environment, with a view towards promoting consumers' interests.

The Ministry of Finance has prerogatives for establishing and adjusting regulated prices for natural monopolies or economic activities, unless other authorities are designated to this purpose by special laws.

Agent contracts

Legislation on permanent commercial agents was adopted in August 2002 to implement the provisions of Council Directive 86/653/EEC of 18 December 1986, on the coordination of the laws of the Member States relating to self-employed commercial agents.

Romanian law establishes specific conditions under which agent agreements fall within the scope of competition regulations on vertical restraints.

Protection of consumers

Several consumer protection acts were enacted lately, a significant part of these being scheduled to enter into force on 1 January 2007 or upon Romania's accession to EU (e.g., the Consumer Code, certain provisions of Law 240/2004 on the liability for defective products).

Law 296/2004 on the Consumer Code provides that all laws on consumer protection will be incorporated in the Consumer Code as an Appendix within 18 months of its publication (1 July 2004). Although this is a desirable line of action, it may prove difficult to implement in practice, given the large number of laws, decisions, regulations and other pieces of legislation enacted for the purpose of protecting consumer interests. The National Consumer Protection Authority remains the relevant authority in this field.

Similarly, Consumer Credit Law was passed by Romanian Parliament at the end of June 2004 and came into force within six months of being published on 6 January 2005. Consumer Credit Law implements Council Directive 87/102/EEC for the approximation of laws, regulations and administrative provisions of the member states concerning consumer credit. The relevant authority in the field of consumer credit is yet to be decided.

At the end of 2004, the Romanian Government adopted a decision prescribing injunctions for the cessation of unlawful practices in the field of consumers' collective interests. The decision transposes the provisions of Directive 98/27/CE and is aimed at facilitating remedial action for the protection of consumers' collective interests on the assumption that the unlawful practices are perpetrated by a business entity based in Romania against consumers of an EU member state.

For this specific situation, the decision allows the relevant organisations of the EU member state to refer the matter to the competent authorities in Romania to take the action provided by law, subsequent to notifying the business entity responsible for the unlawful practices and the relevant consumer protection organisation in Romania in order to bring to an end the unlawful practice.

Retail trade rules

Specific rules on retail sales of products and services exist in Romania, which cover market practices, promotional activities and sales structures (small, medium and large). Also, various types of traders need permits, and product packaging and labelling must comply with certain requirements. These rules are not applicable for sales of pharmaceutical products or fuels, which are subject to separate conditions.

Retailers are free to set opening and closing hours at their own discretion, however, they should observe Romanian labour legislation.

DEMOGRAPHICS AND CONSUMER BEHAVIOUR

Population

Population evolution

Population

	2001	2002	2003	2004
Population (m)	22.4	21.8	21.7	21.7

Source: EIU, August 2005

Population by age group

As in other European countries, the Romanian population figures reflect a clear trend of ageing. However, the birth rate – the main indicator for demographic development trends – has been on the rise in Romania in 2004, with ten newborn babies per thousand capita, as compared to 9.8 per thousand in 2003 and 9.7 per thousand in 2002. The National Statistics Institute reports that the upward trend maintains for the second consecutive year, and this is the main positive signal with respect to ending the demographic decline over the past ten years.

Age profile

% of total population	1998	2003	2008 (f)
0 – 14 years	19.1	16.9	15.9
15 – 64 years	68.0	69.0	69.7
Over 65 years	12.8	14.0	14.5

Source: EIU, July 2004

Urbanisation of the population

The ratio between urban and rural population in Romania is completely different compared to other European countries. Around 47 % of Romanians are living in rural areas, reflecting the imbalances of the economy. A modern society registers between 5% and 12 % of the population in the agricultural field. However, the situation is expected to improve in the future as, alongside the development of the country's economy, more jobs will be created in the urban areas, resulting in migration to these areas.

Urban/Rural split

% of total population	1998	2003	2008 (f)
Urban	54.9	53.3	56.1
Rural	45.1	46.7	43.9

Source: EIU, June 2004

Income/Buying power

The average net wage has accelerated to real 11.3% year-on-year (YoY) in March 2005 after 13% in February and 15% in January, thus continuing the ascending trend registered in the last two years – 9.5% YoY in 2004 and 8.7% YoY in 2003. However, with only around EUR189 per month, the Romanian's net wages have plenty of room for growth to catch up with their neighbours' salaries. According to Romania's recently approved Pre-accession Economic Programme the average gross salary in the country is expected to grow by 60 % by 2008 from the 2004 level, according to government sources.

Average net income real growth

Year	%
2002	3.8
2003	8.7
2004	9.5

Source: National Institute for Statistics

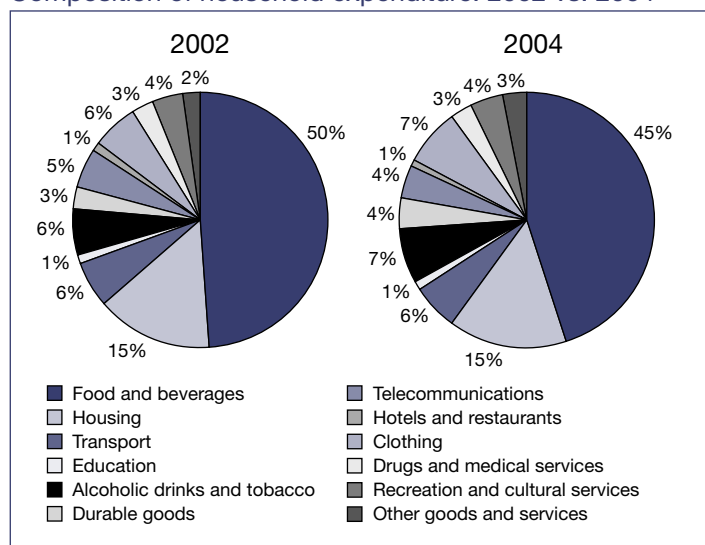
Consumer behaviour

Average household spending patterns

Food and basic services, such as housing, electricity, heating and water, account for about 60% of total expenditure, due to the still low average household income. However, there are signs that consumer behaviour is changing. Consumers are spending less on basic needs (e.g., food) and more on luxury products and services (e.g., durable goods, restaurants and hotels, recreation etc).

Durable goods expenditures have increased from 3.2% in 2002 to 4.1% in 2004, as well as expenditures for hotel and restaurant services from 6.1% to 7.4%. Generally, all expenditures have increased in proportion in the total household spending, except for food and beverages which decreased by five points in 2004 versus 2002.

Composition of household expenditure: 2002 vs. 2004



Source: INSSE

Note: The figures in the graphs represent % of household expenditure.

Lifestyles/Shopping habits

The modern retail concepts have remodelled the landscape of the domestic retail, changing consumers' behaviour in Romania, especially in the large urban areas.

33% of the Bucharest people like to shop at hypermarkets, supermarkets, cash and carry, and discount stores. Only 10% of the Bucharest inhabitants shop in traditional stores, while 57 % opt for a combination of old and new style stores.

Modern consumers tend to do their shopping on a weekly basis, or even less frequently, and prefer larger stores where they find all the products they are looking for at a better price than in smaller shops.

Nevertheless, there are major differences in income and lifestyle between urban and rural areas, as well as between big cities and small cities. In the big cities, people have already adopted a Western lifestyle and spending patterns, while in the small cities and in the countryside they still keep many of their old habits. As the modern retail chains penetrate smaller towns, and economic development increase incomes in these areas, the differences are likely to narrow.

Brand/Price sensitivity

Both brand name products and private/own labels are gaining popularity and market share, against non-branded products, as these branded products are becoming more affordable for the average consumer.

The private/own labels business is still in its infancy, but according to market specialists is gaining ground at the expense of branded products. These product categories developed by the retail chains target especially the food sector but also other fast moving consumer goods (FMCG), even electronics departments.

Retailers like Billa, Cora, Carrefour, Metro, XXL and Mega Image, which already launched a range of own products, wish to persuade highly price-sensitive Romanian customers that these brands are cheap and also of good quality. If this is the case, besides better margins these products may ensure long-term customer loyalty to the retail chains.

RETAIL & CONSUMER SECTOR PERFORMANCE

Major consumer goods players

Romania represents the second-largest market after Poland, therefore being targeted by a large number of Romanian as well as foreign consumer goods producers. Some international consumer goods companies, such as Philips or Unilever, have set up their regional headquarters

in Romania. A number of consumer goods sectors are dominated by foreign investors. For example, the beverage sector is dominated by Greek and Austrian investors, the electric machinery and apparatus by Turkish and Swedish, the milk sector by Dutch, and the agriculture sector by Italian and American investors.

Key food companies

Milk and dairy	Edible oil	Meat processors	Beverages	Sweets and snacks
Covalact & Campina JV	Argus	Agricola International	Brau Union (Heineken)	Chipita Romania
Danone	Interoil (Bunge)	Aldis	Coca Cola HBC	Excelent
Delta	Muntenia (Bunge)	Angst	Ursus Romania (SAB Miller)	Kraft
Dorna	Unirea (Bunge)	Avicola Bacau	European Drinks	Nestle
Friesland	Ultex	Cristim	Interbrew	Orkla Foods
Hochland	Ulvex (Suntory Agrochemical)	Caroli	Quadrant Amroq (Pepsi)	Star Foods
Prodlacta	Olpo Ulei (Cargill)	Tabco Campofrio	United Romanian Breweries Bereprod	Supreme Chocolat

Source: Companies' annual reports

Key non-food companies

Clothing	Cosmetics and detergents	White goods	Tobacco
Brainconf	Beiersdorf	Arctic	British American Tobacco
Jolidon	Colgate Palmolive	Electroarges	Gallaher
Rosko Textil	Henkel	Electrolux	Japan Tobacco International
Sorste	Procter & Gamble	Tehnoton	National Tobacco Company (SNTR)
Steilmann Romania	Unilever	Uzina Mecanica Cugir	Philip Morris

Source: Companies' annual reports

Major retail players

Retail sales

Romanian retail sales grew rapidly in 2004 after a modest growth over 2000-03. The expansion has been stimulated on the demand side by the rise in real wages and the rapid growth of consumer credit, and, on the supply side, by the rapid development of retail chains and shopping malls.

Total retail sales grew by 17.6% YoY in 2004, following growth of 5.7% in 2003. Sales of non-food goods continued to grow faster than sales of food, beverages and tobacco. Strong real growth has continued in the first quarter of 2005 (17.8% as against the same period in 2004).

Romania's retail sector is a very dynamic one, with modern retail outlets progressively replacing the small retail outlets, kiosks and street vendors. Foreign retailers such as Metro, Selgros, Carrefour and Cora have rapidly spread beyond Bucharest to large provincial towns.

Total retail sales growth

	2002	2003	2004
Total sales (USD bn)	11	13.3	26
Total sales (EUR bn)	8.1	9.8	19.1
Growth rate real terms (%)	0.8	5.7	17.6

Source: EIU and the National Institute for Statistics
(Exchange rate: 31 December 2004)

Breakdown by number of stores

Number of stores	Hypermarkets	Supermarkets	Discount stores
2004	5	80	30
2003	3	60	20

Source: PwC estimation

Key food retailers

Retail formats	Group name	Store brands	Number of stores (2004)	2004 net sales (EUR m)
FOOD				
Hypermarkets	Carrefour	Carrefour	4	222
Supermarkets	Rewe	Billa	15	N/A
Discount	Rewe	XXL Mega Discount	4	N/A
Cash and carry	Metro	Metro	21	1,039

Source: Companies' annual reports

Key specialty stores

Retail formats	Group name	Store brands	Number of stores (2004)	2004 net sales (EUR m)
SPECIALTY STORES				
DIY	Metro	Praktiker	7	62
Home equipment (electrical goods, furniture)	Altex	Altex	110	N/A
Department stores	Nova Group	Unirea	1	N/A

Source: Companies' annual reports

Food retail channels

Hypermarkets

The hypermarkets consist of four Carrefour hyperstores and one Cora (Louis Delhaize).

Supermarkets

The main supermarkets chains are Billa (Rewe Group) and Mega Image (Delhaize Group). Besides the international chains, there are also a number of independent chains, such as Artima, Univers'All, Angst, Nic, La Fourmi, which have also developed their network shops.

Discount stores

The main discounter chains are XXL Mega Discount (Rewe Group) and Profi (Delhaize).

Convenience stores

Convenience stores are mainly operated by local companies. The Lithuanian VP Market opened a chain (Albinuta) in 2004, which is rapidly expanding in Bucharest.

Non-food retail channels

Department stores

Department stores are dominated by local operators (Unirea, Cocor). In some major Romanian cities, an investment fund controls some of the department stores under the Winmarkt brand. Also, two shopping malls were opened in Bucharest (Vitan Mall and Plaza Romania) by the Turkish Anchor Group and one in Iasi by a local investor (Iulius Mall).

Consumer electronics

The home appliances and electronics sector is mainly controlled by local operators. The landscape of home appliances and electronics is changing as retailers open larger-sized stores in top locations, such as shopping malls and hypermarkets, to meet higher standards and benefit from a larger number of customers.

Representative chains are Altex, Flanco, Domo, Cosmo, Genco, Mondo and Romanel.

Furniture

The furniture retailers are also trying to benefit from the large number of customers attracted by hypermarkets, some opening large-sized stores near hypermarkets.

Representative chains are Mobexpert, Elvila, Adorama, Neoset and Berloni.

Clothing and shoes

Clothing and shoes chains have shown a recent preference for modern locations inside the large commercial centres such as malls and hypermarkets.

Representative chains are Kenvelo, Steillman, Collins, La Strada, Leonardo and Marks & Spencer.

Cosmetics

Representative stores are Beauty Shop-Sephora, Dumarex, Ina Center and Body Shop.

IT and computers

Representative chains are dominated by local operators such as Flamingo, UltraPro, Best Computers, K-Tech, Depozitul de Calculatoare and Germanos.

Books

The main integrated supermarket of both books and IT&C is operated by a local company, Diverta.

M&A activity

Large Romanian and foreign companies have acquired important market shares in their segments through mergers and acquisitions in recent years. Examples of transactions in the consumer and retail market are listed below.

M&A activity

Year	Acquiring company	Target company	Nature of business	Equity stake
2004	DBG Eastern Europe II	Flanco	Household appliances and electronics retail chain	N/A (minority shareholder)
2004	Henkell&Sohlein	Astese Production	Wine producer	100
2004	PepsiCo and General Mills	Star Foods	Snacks producer	100
2004	Romanian American Enterprise Fund	Domo	Household appliances and electronics retail chain	20
2004	SAB Miller	Aurora SA	Beer producer	81
2004	Smithfield	Com Tim	Pig farm and meat processor	100
2003	Bunge	Muntenia	Edible oil producer	100
2003	Excelent	Kandia	Chocolate producer	60
2002	The Coca Cola Company	Dorna Apemin	Mineral water producer	96
2002	Orkla Foods	Topway	Food producer	100

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

Challenges

Increasing competition

Competition will increase in the next year due to the opening of new stores, and the entrance of new players and the rapid development of the existing ones.

There are international chains, which announced rapid development in 2005 (Rewe with discount stores Penny Markt, Tengelmann with discount stores Plus, Schwarz Group with Kaufland hypermarkets, etc). These chains will be opened in Bucharest and also in all major cities during the next four to five years.

Identify the winning format

The challenges faced by retail players are their adaptability to change in accordance with the development of the consumer behaviour and capacity of identifying the winning format in the targeted areas.

Opportunities

Potential of the Romanian market

Romanian retail sales per capita are USD630 compared with an average of more than USD2,000 per capita in Hungary, Czech Republic and Poland. These figures show the potential for the Romanian market considering the annual growth of the economy, which will be approximately 4-5% per year, according to government forecasts.

The retail sector in Romania is expected to expand substantially in the medium term, reaching about EUR17 billion in 2008, according to the Economist Intelligence Unit.

The main drivers of the increased consumption are expected to be the higher real wages, reductions in income taxes and the continuing growth of consumer credit.

Western retailers facing slow volume growth in mature markets will be attracted to fast-growing consumer markets such as Romania; therefore an increased competition is expected in the future.

Consequently, M&A activity is expected to pick up with the wide spread of large multinationals into Romania over the next period.

Emerging trends

Development of hypermarkets and supermarkets

Industry specialists believe that the hypermarket and supermarket segments – not the cash and carry segment, which is more developed due to its early entry – are likely to accelerate their development, especially outside Bucharest.

Although the most attractive regions in Romania, including Bucharest and surrounding areas, western Romania, north-eastern and central, have already been targeted by investors, there is still a lot of room for growth.

Growth in less attractive regions

Less attractive regions like the north-eastern region and south-western can also offer some advantages for late entrants, being underdeveloped and less competitive.

The main retail players will be looking to control costs due to potential margin shrinkage. This will lead to the development of logistics platforms and partnerships with logistics and distribution companies. On the other hand, industry specialists agree that the future trend is the development of logistics platforms. This will most likely lead to the decrease of the number of retailers (especially the small ones).