DT - Global Business Consulting

RCIS RUSSIA-CIS Business Group

Russia Business Case Studies
Business Gossip and executive thinking

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IN ASSOCIATION WITH:

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Introduction and sources (1)

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- These remarks were made to me during the last 2 weeks by managing directors and senior managers at international and Russian companies.
- The range of business results year on year is quite wide: one pharma company is growing last year and this by 100% while one hotel chain is declining by minus -93%. You must be somewhere in that range!
- One or two of the remarks were made in public webinars.
- As usual though, no matter what the source of remarks (public or private), I prefer not to mention the name of any company or individual and do this as a professional courtesy.
- These remakes are NOT intended to be structured or comprehensive for the sectors which they discuss: B2C, B2B, B2G and others. Rather they are an insight into executive thinking and commentary.
- Our economic reports and business Surveys provide the comprehensive data.
- As a quick addition to the comments and quotations to provide some context, I have included two recent slides from our business Survey which indicate that pharma and medical are doing well and will probably continue to do so sustainably (and manufacturing output numbers from this sector are also strong), then comes consumer products (depending on categories) and then B2B with engineering, manufacturing, chemicals, automotive coming behind. But the worst sector is unsurprisingly professional services and services generally.

Introduction and sources (2)

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- Nearly all executives agreed that January-February saw good or very good business and for nearly all the first half of March was good and second half of March not bad. The divergence came in April when some sectors saw their outlets completely closed while others could sell through supermarkets and while some industrial plants were “key/critical” and others not.
- The overall mood is surprisingly positive, rational even among executives facing big double digit drops. This crisis is seen more as fact of life and also a global one, not just a Russian one: “Ok, we’re down -25% and…? We’ll do our best”
- The remarks below depict good and bad results and trends but additionally executive from insurance, office equipment, IT business solutions, infrastructure/roads also spoke about how their business was out-performing other regions and hooding up well or in one or two cases surging. re was also some
- Most executives concurred with trends outlined in our recent report Work from Home and Offices.

A word from the Russian consumer (1)

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- **One Russian home carer (not in the business world) confided with me the following:**
- "Danny, when we girl friends chat over the phone, we share with each other how the current situation has many parallels with the Soviet period. Then and now we don't go on foreign holidays (the borders are closed again and we have no disposable money); we think and dream of going to Crimea!; we think (cheaper) Russian products are better than the unreachable western brands. There is a "dificit" of products and services in that we can't afford them now when 3-4 months ago we could do so to some extent. More and more people on modest incomes can only focus purchases on essential and basic needs. All little luxuries have to be cut. Now we are back to the times when "we put our noses against the "vitrina" (or on our phone) and gaze at the many, many things that we can't afford. It's a time of belt-tightening and the mood is very quiet".

- Many workers/labourers from CIS countries ran home in March as borders closed and informal jobs started to evaporate.
- Many Russians left Moscow and its higher cost of living to return to their home region and to live with family rather than pay Moscow rents and to look for jobs in the regional economies.
- Those in Moscow who were engaging in the hot "buy to let" property (Kvartira) market are left in a much more insecure market place with mortgages and less rental income.

A word from the Russian consumer (2)

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- The worry now is that the consumer is exhausted entering a period of insecure jobs, higher unemployment, negative wages and with real disposable income perhaps even weaker given that openings for entrepreneurial and rental activity will be weaker.
- Across the whole range of middle and lower-middle incomes and low incomes, Russian consumers will be forced to forego and defer purchases or insist on discounts and promos. Affordability is the name of the game. Any consumer products company who does not experience that is beating the trend and doing something special or benefits from some special/niche product or service.

Sales results for 2019 and 2020
By industry in local currency

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- In our previous Survey some 31% expected to have sales growth for 2020 but in early May this number has fallen to only 24%. Some 13% expect flat sales and the majority of 62% forecast declining sales numbers (of which 47% are in the negative double-digits).
- Results in FX are worse: only 11% of all companies expect to see growth, 10% think they will be flat and 78% say they will see sales decline (58% in the double-digits). The numbers vs. last month are similar, but the share of companies in negative double-digits has increased from 43% to the 58%.
- While last months results were slightly better for the non-Russian CIS countries (vs. the Russia figures), these have now worsened as well, and in Ukraine especially 84% see either flat or declining sales growth. The best results currently come from Kazakhstan, where "only" 73% expect to see flat or declining sales trends.

Sales growth in roubles, 2019 and 2020

	All Companies			Consumer Prod.			Pharma/Health			B2B/Industrial		
	2019	2020	Δ	2019	2020	Δ	2019	2020	Δ	2019	2020	Δ
Growth of 20%+	12	3	-8	10	3	-7	27	8	-18	9	2	-7
Growth of 10-20%	23	4	-19	28	10	-18	27	0	-27	19	2	-17
Growth of 5-10%	22	9	-13	23	7	-16	33	33	0	18	4	-13
Growth of 1-5%	14	8	-7	10	17	6	13	0	-13	18	4	-13
Flat-zero	8	13	5	3	13	11	0	25	25	14	10	-4
Decline of 1-5%	7	4	-3	15	7	-9	0	0	0	4	4	1
Decline of 5-10%	5	11	6	8	13	6	0	8	8	5	10	5
Decline of 10-20%	4	21	18	0	17	17	0	0	0	7	29	22
Decline of 20%+	5	26	21	3	13	11	0	25	25	7	33	26

Source: DT-Global Business Consulting, Russia-CIS Business Group Survey. April/May 2020. Number of responses, in %.

Please note: in order to improve readability, we show no decimal points. This can lead to "rounding error".
For example: 8.51 - 4.26 = 4.25. Once these numbers are rounded, it appears as if 9 - 4 = 4.

Sales results for 2019 and 2020
FX and CIS overview

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Sales growth in FX, 2019 and 2020

	All Companies			Consumer Products			Pharma/Health			B2B/Industrial		
	2019	2020	Δ	2019	2020	Δ	2019	2020	Δ	2019	2020	Δ
Growth of 20%+	10	0	-10	8	0	-8	20	0	-20	9	0	-9
Growth of 10-20%	26	2	-24	31	7	-24	47	0	-47	17	0	-17
Growth of 5-10%	22	5	-18	26	0	-26	20	25	5	21	2	-19
Growth of 1-5%	13	5	-9	10	10	0	13	0	-13	16	2	-13
Flat-zero	10	10	0	5	14	9	0	8	8	16	9	-7
Decline of 1-5%	6	7	1	10	7	-3	0	8	8	5	6	1
Decline of 5-10%	4	14	10	5	17	12	0	17	17	3	11	7
Decline of 10-20%	4	20	16	3	21	18	0	8	8	7	23	17
Decline of 20%+	4	38	33	3	24	22	0	33	33	7	47	40

Source: DT-Global Business Consulting, Russia-CIS Business Group Survey. April/May 2020. Number of responses, in %.

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Russia/CIS sales growth in local currency, 2019 and 2020

	Russia			Ukraine			Kazakhstan			Belarus		
	2019	2020	Δ	2019	2020	Δ	2019	2020	Δ	2019	2020	Δ
Growth of 20%+	12	3	-8	18	3	-15	17	2	-15	11	0	-11
Growth of 10-20%	23	4	-19	27	0	-27	25	2	-23	24	2	-22
Growth of 5-10%	22	9	-13	9	6	-3	10	13	3	20	9	-11
Growth of 1-5%	14	8	-7	18	6	-12	13	4	-9	11	16	4
Flat-zero	8	13	5	6	32	26	13	19	5	9	13	4
Decline of 1-5%	7	4	-3	6	10	4	4	8	4	9	13	4
Decline of 5-10%	5	11	6	6	19	13	10	10	1	9	18	9
Decline 10-20%	4	21	18	3	10	7	4	23	19	2	18	16
Decline of 20%+	5	26	21	6	13	7	4	19	15	4	11	7

Source: DT-Global Business Consulting, Russia-CIS Business Group Survey. April/May 2020. Number of responses, in %.

Please note: in order to improve readability, we show no decimal points. This can lead to "rounding error".
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The MD of a specialised food company (1)

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- Our key concern has been business continuity and staff safety.
- Working from home has gone well and we did not lose efficiency and the work in our factories goes well.
- We offered incentives to factory workers and have suffered no absenteeism.
- 16 March was a calendar date for me: on that date our key accounts started to phone me asking to increase their regular orders by 100-200-300% on annual demand!!
- In the last two weeks of March we grew 200% on the same period in 2019.
- E-commerce also rose 500% in March (from a small base)
- In the second half of May we saw more balanced but highly positive orders.
- May should see a drop as retailers sell out stock and June will show what the new normal trend will be.
- We do not engage in any long-term planning. At most we do monthly planning and try to meet orders!
- We are keeping prices stable. In autumn we will review given that we have imported products and inputs and will need to see where the rouble is.
- **For me the Russian consumer is no longer resilient.**
- **The Russian consumer has been hit over several years and transformed entirely into a "normal", western consumer focused on price, value for money, promos.**
- **The Russian consumer behaves like their European counterpart: only difference is the amount of cash in pocket.**

The MD of a specialised food company (2)

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- We sharply decreased promotional activity investments BUT we know it will come back in autumn.
- There will also be consolidations in the food business.
- Currently we have no problems with receivables.
- We do engage in TV advertising given that more people are sitting on their sofas and not all are watching their telephones and DVDs. This is time for going back to the TV a bit.
- And we did not put new launches on hold but “went for it”.
- **Another MD at a specialised food company commented: We are seeing a polarisation in spending: on premium at the top and cheap/promo at the bottom. The mid-range, mid-price is a tough place to be.**

The MDs of indirect sales companies

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- These are comments of executives from different companies.
- We have a blend of beauty, nutritional, personal care and home care products.
- As unemployment and insecurity rises, more people will turn for income to our model.
- Our nutritional products are clearly selling very well.
- Our bespoke store and channel stores were closed in March and most of April.
- In March we offered additional bonuses to our sellers.
- In March our sales in Russia were still surging by 20%+ and by 50%+ in Kazakhstan but by April this had turned negative in Russia and declined to a rate of 30% in Kazakhstan.
- We expect a much slower second half year as the consumer is hit and takes stock.
- But shoppers will come back to our stores (which account for a substantial part of our business) and we think that Russians like shopping and will also like the indirect model.
- But there are big questions: how do we modernise the indirect model? How does social selling work now?
- Society is not now the same as before: will it stay changed or revert back to some pre-crisis “normality”.

Two commentaries from the food sector

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- The MD of a major food company also remarked: We echo several trends in the sector. We posted a very good first 4 months at +20% and after good Q1, April was good but softer second half of month but May is “strange” because it looks solid!
- I expect an inevitable slowdown through the year but with our excellent start, we could finish the full year at +4-5% which would be excellent of course.
- And of course on-line sales are growing by 100% from a smaller base but they will represent 20%+ of our sales this year compared with 8% in 2019.
- The MD of a food delivery company noted:
- The next steps will entail: recovery and retooling; managing changed customer expectations as they have turned more to home deliveries as that is more convenient so we have to remodel our take-away business.
- The fall off in take-away business has been massive and this means whatever the second half of year, we will be down -25% after a very good 2019.
- There has been little government, regional support for the SMEs and small retailers.
- When the unlocking takes place, we estimate that many (not all) consumers will go back to old habits very quickly and we need to be prepared for that.
- We anticipate back to regular sales levels in August but the spring numbers will have pushed us into the red for the full year.
- Over the summer we expect more staying at home relatively than before despite a return to restaurants and bars and take-aways and there will be no (little) tourism in-out for quite some time and so that means more domestic consumption for our products!

The MD of an international alcohol company

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- We want to maintain relationships as our business is not allowed e-commerce yet.
- The field-force can work through digital but they are eager to get face to face again.
- “On-trade” of course through restaurants and bars is of course very bad.
- There is a possibility that 30% of customers (outlets, bars) will disappear after the crisis.
- When the bars and restaurants open up, I am not convinced that we get even 50% back immediately.
- It will be two halves in society: those who want to go out and socialise and those who want to stay more safely at home.
- On-trade business, which is our priority, is still holding up well and I would say our customers “are fine”.
- In March our sales of whisky and rum were increasing at 30-50% on last year and the trend was still good in April at +30% growth.
- The summer could stay good as some unlocking takes place.
- Less outward tourism means more roubles are spent at home.
- I am happily surprised that April and early May held up so well. But I expect 2020 to be down by minus -10/15% and we think that first half of 2021 will be tough as well at flat or negative.
- Affordability will be the key, critical KPI and we are maintaining the affordability of our key brands.
- We think with a good business model, we can capture more market share and some will be able to clean up the market as some leave the market or make mistakes and perform badly.
- As you say Danny, operational excellence will be super important.
- We will introduce a price increase this year of just 3% this year presuming no inflation/rouble shocks.

The MD of a consumer durables company

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- This is a global crisis and not a Russian one and that helps in discussions with global US HQ.
- All our clients remain closed but some are opening up in some regions but only a small number.
- We have switched of course to digital options and are shifting resources but while we will upgrade this for the future, our main channels will be stores and distributors in the future. That's what I believe in large part. But yes, the world will change and we will do some restructuring and do strategic thinking about business in a new normal.
- Off-line may well bounce back quicker in Russia than in western Europe and the US because Russians do like shops and the shopping experience.
- Market share is now the name of the game.
- I expect sales to trend like this after a very good Q1 when we posted 18% top-line growth: April down -90%, May down-70% and June down -40%.
- I expect some solid growth increase in Q4 and Q3 will decide the year.
- I take the view that if I could finish the whole year at zero/flat then zero means I am a hero!
- But flat sales outlook seems too ambitious and I estimate/hope that we finish the year at about -15% best case and -20% worst case.
- Currently clients cannot pay and won't be able until activity resumes.
- This is nothing super-critical!
- Kazakhstan all stopped paying while in Ukraine some of our big customers managed to pay 50%.
- In Russia we had planned a small price increase this year in our budget of 4-5% and we will add a small addition to that of 2-3% given we think inflation will be slightly above our budgeted figure of 4.5%.

Executive comments from the pharma/medical sector (1)

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- The regional manager of one European machinery company which supplies to the Russian pharma industry commented:
- We are inundated with requests from Russian pharmaceutical companies for our machines and a line costs 1-2 million dollars each and we are get dozens of orders and we can't meet demand.
- Russian companies clearly want to have good production capacity for pharma and to upgrade their capacity.
- The MD of one European medical company noted:
- Moscow may get through his medical crisis but Moscow is not Russia. When you get 30 kilometres outside Moscow, the quality of care and hospitals plummets and even within Moscow, it is far from good universally. In several regions it is decelerating and there is little systemic structure. I would say 80% of hospitals in the regions have serious issues.
- Executives generally believe that the National Projects will be trimmed but that the allocation for pharma will be broadly untouched. This majority was expressed thus: I cannot believe that they will need to cut so far that they reduce health procurement. But it is possible that health officials at the ministry summon us and suggest that we re-negotiate the price downwards. That is certainly possible.
- One executive from a US pharma company argued: In fact less money should be directed at infrastructure and roads and they should even boost he health element in the Projects.

Executive comments from the pharma/medical sector (2)

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- One executive held a minority view that: The government will need to cut more deeply and allocations in the National Projects will be diminished in absolute terms.
- The MD of another European medical company outlined the general trend for many: There is a lot of work. Testing for Covid-19 is taking up a huge amount of time and perhaps testing of other illnesses will suffer. Russia is testing a lot and perhaps the population will benefit from the many vaccine programs on children in the past including the Soviet period.
- As in other sectors, MDs are worried that some partners will not be able to pay or more fundamentally will disappear: “We are going to see some partners, customers, pharmacies and distributors go under for sure even in our “strong” sector.”
- The trends in recent years have been clear:
- Until the National Projects arrived, sales to the EDL and federal programs was hard work and many companies had years with sales growth of 0-5% while OTC sales were generally strong but also decelerated in 2018. For most of 2019 federal sales surged especially oncology and cardiology but other products as well. And OTC picked up as well.
- Some pharma companies in 2019 were growing 15-35% and higher on 2018 and 2020 started very well.
- Given the health crisis and the duration of the National Projects until 2024, it looks like pharma and chemical sector will be strong and sustainable and growing in strong double digits.

Executive comments from the pharma/medical sector (3)

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- During 2020 and beyond the general public will also be willing to continue buying out-of-pocket and noticeably vitamin sales and nutritional products are doing very well at 15-35% growth and while this may decelerate as income pressures grow, it also looks positive for a sustained period.
- The MD of one pharma company outlined his business thus:
- We are still on a big growth curve: 2019 was very strong and the first 4 months are similar or slightly lower.
- We were close to triple digit growth in rouble last year but this was on the back of a sluggish 2017-18 and we are priority sector.
- There is no fall off in prescriptions at the moment.
- In the short-term patients are not getting their regular treatments with the Covid crisis and this is seen in other countries. Cancer patients are getting delayed diagnostics and those under treatment don't get the drugs they need.
- Most MDs talk of decent and good profit margins.

Executive comments from the B2B sector (1)

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- B2B is the sector which overall is going to be worst hit. But of course there are many sub-sectors.
- Overall agriculture and suppliers into that sector will survive well or very well and some MDs talk of "Our worst case is zero or +2% but I think +10% is possible and in a very best case +12% is possible".
- The MD of one major industrial conglomerate with large production plants outlined his business:
- The first thing is that we have had several fantastic years in Russia and 2019 was also very good in roubles and in FX. Russia has been for several years a star global market for our company. So we are coming off a high into a trough.
- Yes, Q1 was very good double-digit growth.
- We will face supply chain disruptions and consumer price leverage will eventually fall away.
- Currently the part of our business which supplies automotive is down "only" -50% and with luck we could finish the year in this division at -17% with stagnant/negative growth in 2021.
- Aerospace is very hard and in western Europe this is down -90% while in Russia again we expect only -50% in May-June but I see little real bounce back here for global supply/demand reasons.
- Our packaging business is relatively strong and while it is negative, I can see how this could climb back to about zero for the full year.
- We plan for some decent recovery in Q4 but we are hugely uncertain about Q3 and some colleagues are quite skeptical.

Executive comments from the B2B sector (2)

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- We are going to be negative this year by 15-25% and next year we think zero upwards to +10% or 15% depending on the bounce effect in our business.
- But overall, Russia is no worse than our other markets and in fact it is set to out-perform many developed markets and as I say, coming from a high base and with historically very decent profit margins.
- The MD of one construction related company said: Our plants have not stopped producing and we plan no redundancies for now or few in the future. Our people are very good and I don't want to lose them. We interviewed 1,600 candidates to get 45 factory operatives in Tatarstan.
- We are flat or +5% now but I expect -10% to -15% for the whole year. It will depend on seasonality and the level of government spending.
- The MD of a European manufacturing company noted: I am waiting for June to see where we stand. How many companies will have gone bust by then? Q3 will be tough for us as the current pipeline will have dried up and we will be waiting for the new one to start, if it does. And I wonder what shape the banks will be in.
- The MD of another construction-related company notes: Q1 was also good and April was "crazy good" and surprising.
- Construction in St Petersburg for example is still booming.
- Government support is currently for the active phase which means we do not know what's in the pipeline for orders which means big uncertainty.

Executive comments from the B2B sector (3)

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- The new legislation for mortgage structures also helps but again this is time-limited and so what follows then?
- We imagine and presume that business will be increasingly tougher through the year.
- In our plants we are currently running at 75% capacity which is again very good for now.
- We expect price deflation for raw materials for the foreseeable future.
- The construction company partners want to postpone meetings with us which is not a good sign but they too are left in the dark and so that goes down the chain to us.
- The plants are operating and the transfer to home was well implemented.
- The energy level from work at home is flagging a bit. We also need and want the office for client meetings.
- We are reluctant to make forecasts and with long project pipelines and pre-orders, it is all the more difficult.
- **We will be about -15% this year and that's accepted by HQ and globally that's not bad at all. And for 2021 it's tricky but I forecast about zero to +5% and we will be fighting for market share in a period of over-capacity.**
- I think the construction sector will need until Q2 of 2021 to achieve some kind of "normality" or more likely a "new normality" and until then I expect some bumps up an down and some surprises, good and bad!

Executive comments from the energy sector

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- The MD of a company supplying into the oil and gas sector commented:
- For cyclical and energy sector reasons, 2019 was very hard but we managed to stay positive numbers against background of low activity with projects and orders falling off more in Q4 of 2019. This was followed by bleak Q1 2020 which was -30% on last year.
- 2020 can't see a sustained recovery so I anticipate -20% in roubles in 2020 and -25% in dollars.
- This is not a Russia problem but a global energy sector challenge.
- And it will be the first year in our 18-year existence in the market where we post red figures.
- The team's reaction has been excellent and we don't want to downsize at this stage and would look to absorb the losses and plan for a 2021 recovery.
- We want to assure our customers of a regular supply chain when they need us.
- We see speculative games played with the oil price and we see shifts in US policy with production/export cuts.
- The OPEC+ saga ended up with production cuts and lower prices! What can one say?!
- We know that stocks are high and over-supplied but with China ticking along now and some Asian demand rising and with Europe unlocking, you can see a moderate oil price recovery and that's happening.
- And this of course helps to stabilise the rouble.
- So, 2020 will be our worst year in two decades but honestly, we are not despondent and not panicking. I expect/hope for a moderate rally in 2021 and then a bit of stabilisation.
- But the virus may have something to say about that….or not.

Executive comments from professional services sector

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- The following remarks stem from 2-3 executives in this branch.
- The MD of one executive search company commented that:
- “Most business is frozen postponed but like others, we had a very good Q1. But Q2 will be very bad while we anticipate Q4 will see some rally. And the story revolves around Q3: what will it be like”?
- I have to say that our clients are not as badly off as I would have expected: some are actually doing very well, as you know. But even those struggling are not depressed.
- We are still having active discussions with clients in pharma and food and retail.
- And yes, this is not just Russia crisis but a global one: it’s not a “Russia problem”.
- We are discussing how to manage business in 2021-22: how do we keep business going in a new reality?
- We will offer selective discounts to clients.
- Another MD noted: We will decrease a lot of salaries by 10-20% for the short-term and if things stay sticky, we will have to trim staff eventually and that will affect 10% of our staff in the first stage. Our intention is furlough of 6-9 months and then hopefully to have an offer to return but we can’t promise and will not do so.
- We maintain good public relations with clients and stay in close touch with frequent contacts and updates.
- We will look at additional services such as outplacements, evaluations and new training systems.
- Several MDs in this sector sated that: This crisis allows us to look at short-term crisis management but also at longer-term strategy.
- Executives also commented that: We can now focus on projects which we have forgotten or ignored due to lack of team and focus and it’s no bad thing to address those projects for development purposes.

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