Roland Berger
Strategy Consultants

Situation in the Russian automotive market and opportunities for the automotive suppliers

1st Russian-Japanese Investment Forum
Round table „Investments into Russian automotive industry“
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Content

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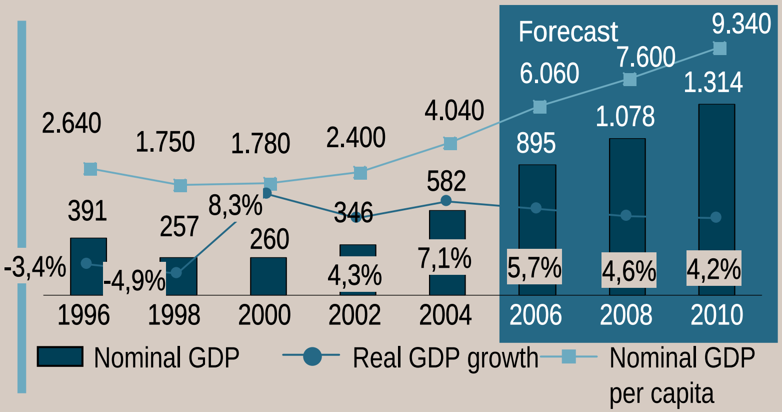
A. Booming economy in Russia – Automotive industry as one of major drivers

Booming Russian economy: stable growth and positive outlook

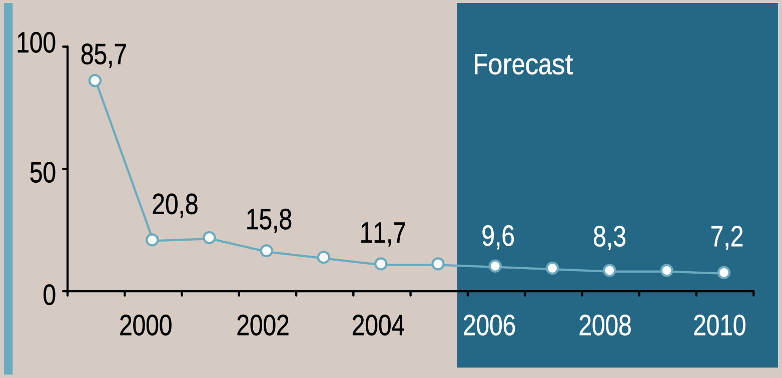
Russia's macroeconomic development

Economic growth

GDP growth [USD bn]

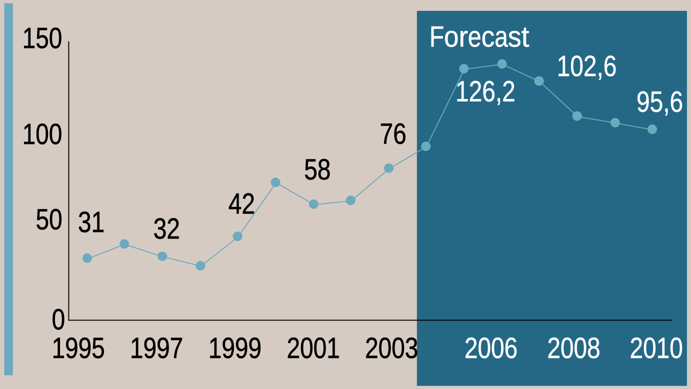


Inflation [%]

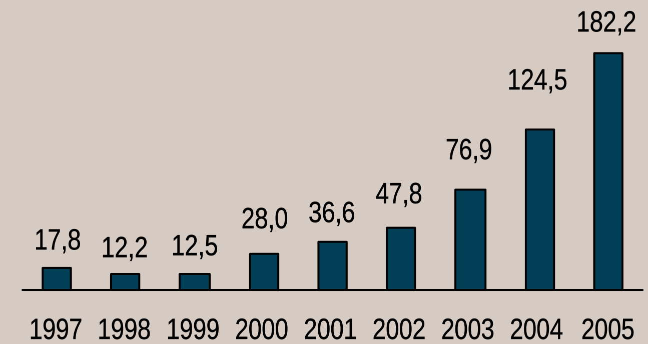


Macroeconomic stability

Trade balance 1995-2010, [USD bn]



Foreign currency reserves [USD bn]



Source: EIU, Goskomstat

Russia managed to improve major macroeconomic indicators significantly in just 7 years after the crisis in 1998

Development of macroeconomic indicators

	1998	Δ 7 years	2005	2006e
GDP [USD bn]	**257**	**x 3**	**741**	**895**
Inflation rate	**84,4%**	**1/8**	**10,9%**	**9,6%**
Budget profit/deficit +/- [as % of GDP]	**- 6,0%**	**+12%**	**+ 6%**	**4,2%**
Currency reserves [USD bn]	**12,2**	**x 15**	**182,2**	**290**
International trade [USD bn]	**115**	**x 3**	**332**	**374**
Annual FDI [USD bn]	**2,8**	**x 6**	**16,1**	**15,0**
Annual FDI [as % of GDP]	**1,1%**	**x 2**	**2,1%**	**1,7%**

Source: Goskomstat, Roland Berger

Despite some drawbacks Russia currently has a good investment climate

Business environment

–

1 **Economic problems**

- Old industrial structure and **necessity of restructuring**
- **Dependence on oil prices**
- Insufficient international **competitiveness** and integration into global economy

2 **Administration and image**

- Sluggish and **inefficient administration**
- Bureaucracy and **corruption**
- Russia's **bad image**

+

1 **Stable policy**

- Increasing **political stability**
- **Western orientation**
- **Broad support among population**

2 **Increasing legal security**

- Stronger **investor and shareholder rights**
- Creation of **clear business framework**
- More **open and transparent**

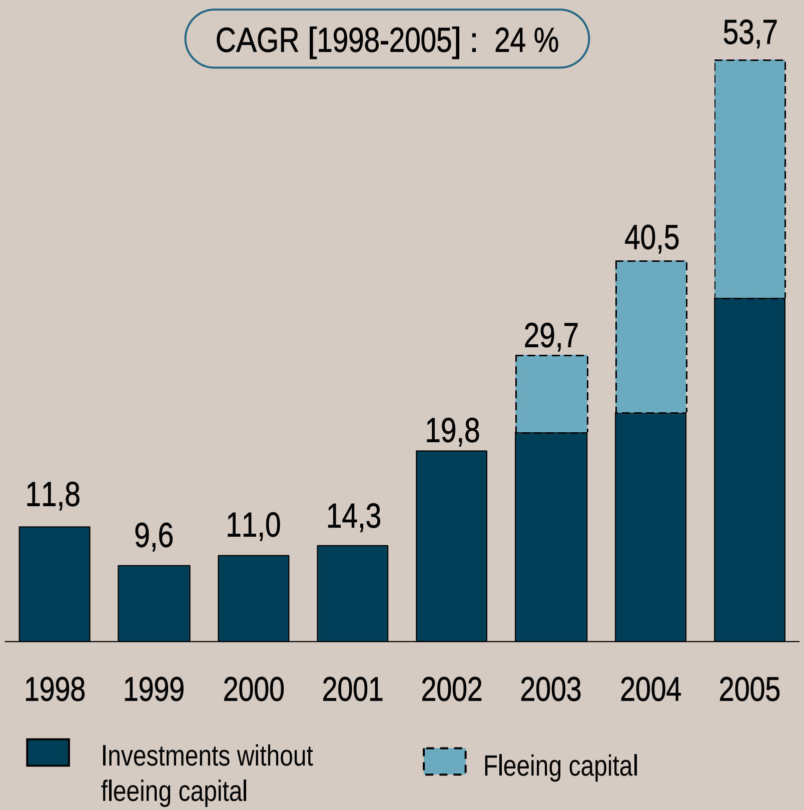
3 **Liberalization of the economy**

- **Lower monopolization** and **higher liberalization**
- **Financial stability**
- **WTO talks** in final stage

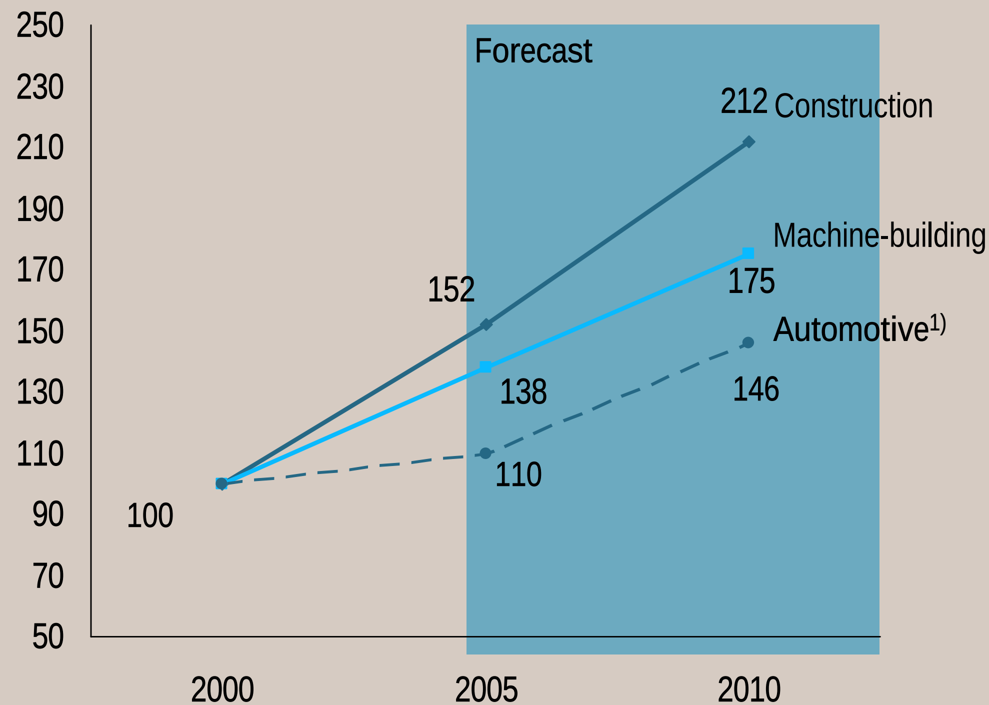
Source: Roland Berger

Foreign investments have been showing an impressive growth in the recent years: automotive industry among major growth drivers

Foreign investments in Russia, 1998-2005 [USD bn]



Development of selected industries 2000-2010e – Production indices [2000=100%]

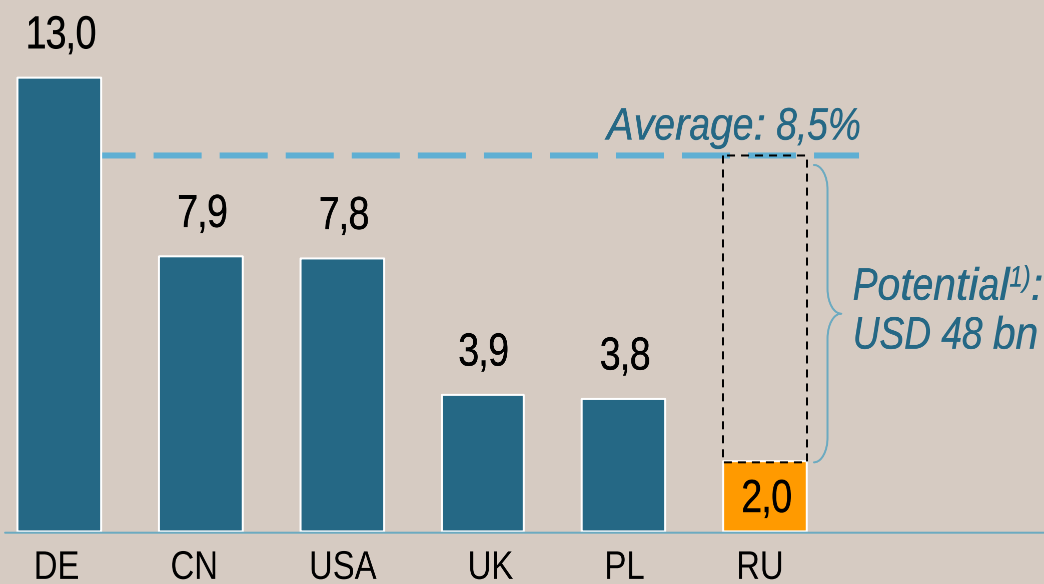


1) Passenger cars

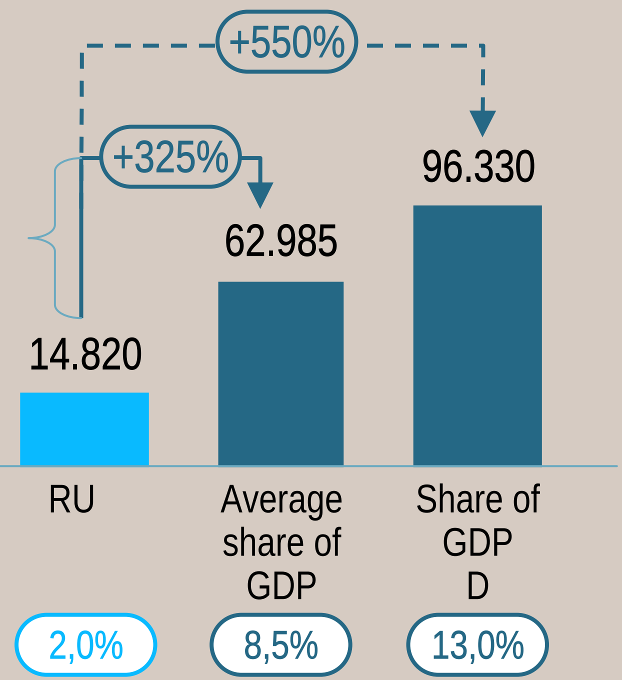
Source: Goskomstat, Roland Berger

International comparison shows that the potential of automotive industry for Russia's economy is far from being exhausted

Automotive industry share of GDP, 2004 [as % of GDP][1)]

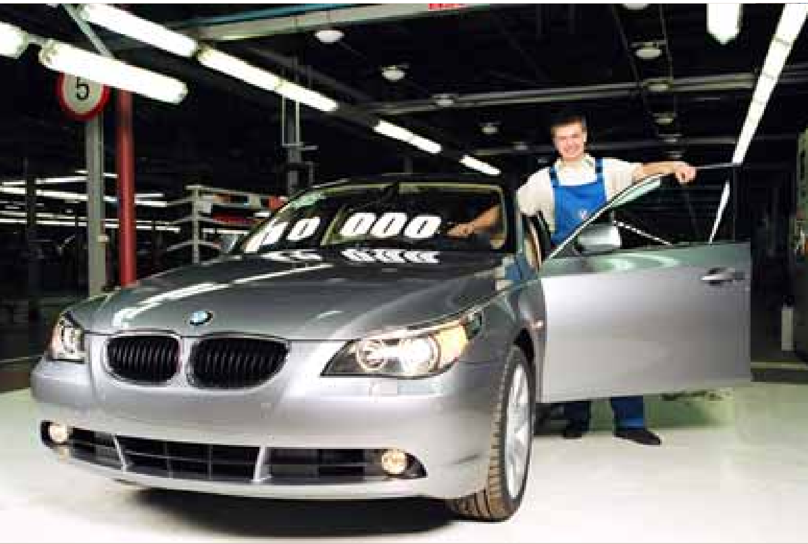


Automotive industry potential share of GDP in Russia [USD m][1)]



1) If reaching average level, based on nominal GDP of USD 741 bn in 2005

Source: EIU, Roland Berger

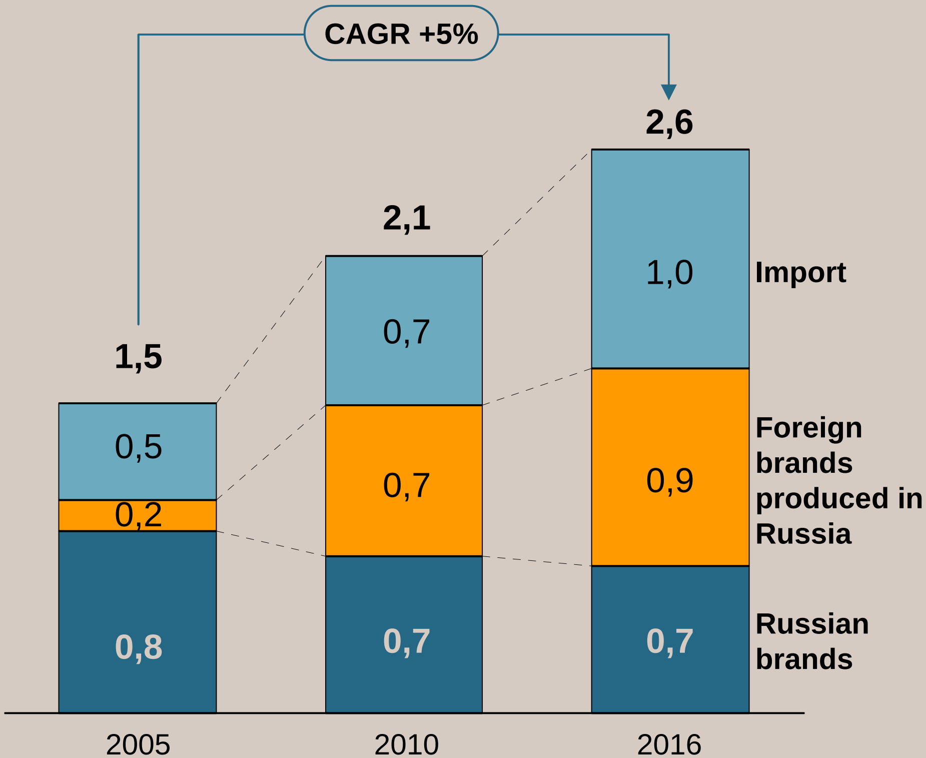


B. Russia – A promising market for the international automotive industry

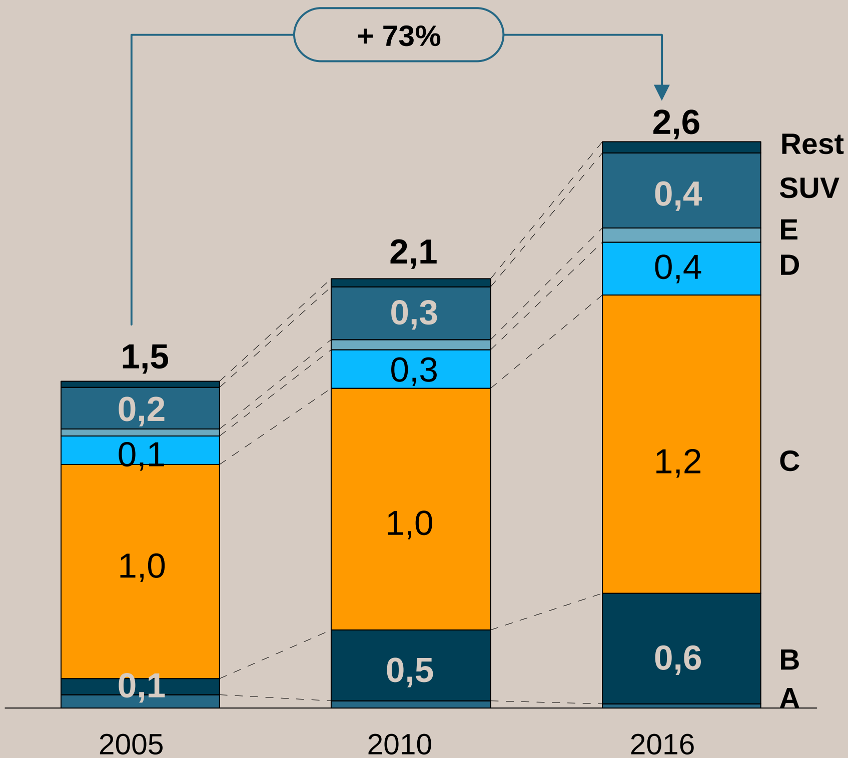
In 2016 Russian automotive market will reach 2,6 m units – B and C classes will enjoy the highest growth rates

Development of the Russian automotive market 2005-2016

Market volume by vehicle origin,
[m units]



Market volume by segments,
[m units]

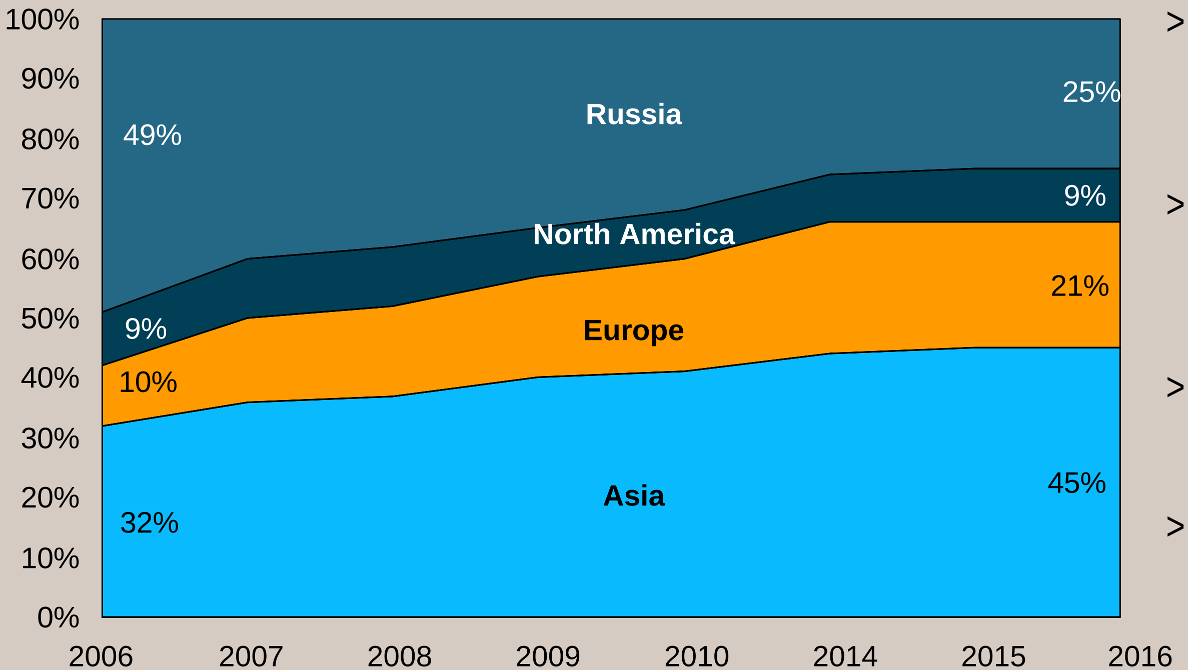


Source: ASM-Holding, Goskomstat, Roland Berger

Asian brands are currently the leaders among foreign companies in Russia - European OEMs have yet to catch up

Sales distribution by brand origin

Shares of regions [%]



Comments

- Mostly Japanese OEMs invested into brand and network development in Russia
- Korean OEMS increased their sales thanks to the contract assembly by local industrial partners
- Market development and local production should go in parallel
- Big question – the future AVTOVAZ' strategy

Source: ASM-Holding, Goskomstat, Roland Berger

Total production capacity of foreign OEMs in Russia will reach 1 m units by 2010

Plans of foreign OEMs in Russia

	2005	2010
KIA	11.780	8.000
BMW	2.293	2.000
GM	1.918	40.000
Chery / ABTOTOP	0	150.000[1)]
VW	0	115.000
Renault	10.246	120.000
Hyundai / ТАГАЗ	42.451	100.000
GM-AVTOVAZ	51.819	50.000

PSA ?

	2005	2010
Ford	33.038	72.000
Toyota	0	50.000
Nissan	0	50.000
GM	0	25.000
KIA / Izh Avto	3.031	65.000
SsangYong	22	15.000
FIAT / СЕВЕРСТАЛЬ АВТО	0	40.000
Great Wall	0	45.000

SOP planned for 2007-2008

in Partnership with a Russian company

1) Low probability

Source: ASM-Holding, Roland Berger

There are already several economic incentives existing, which can be used by foreign manufacturers

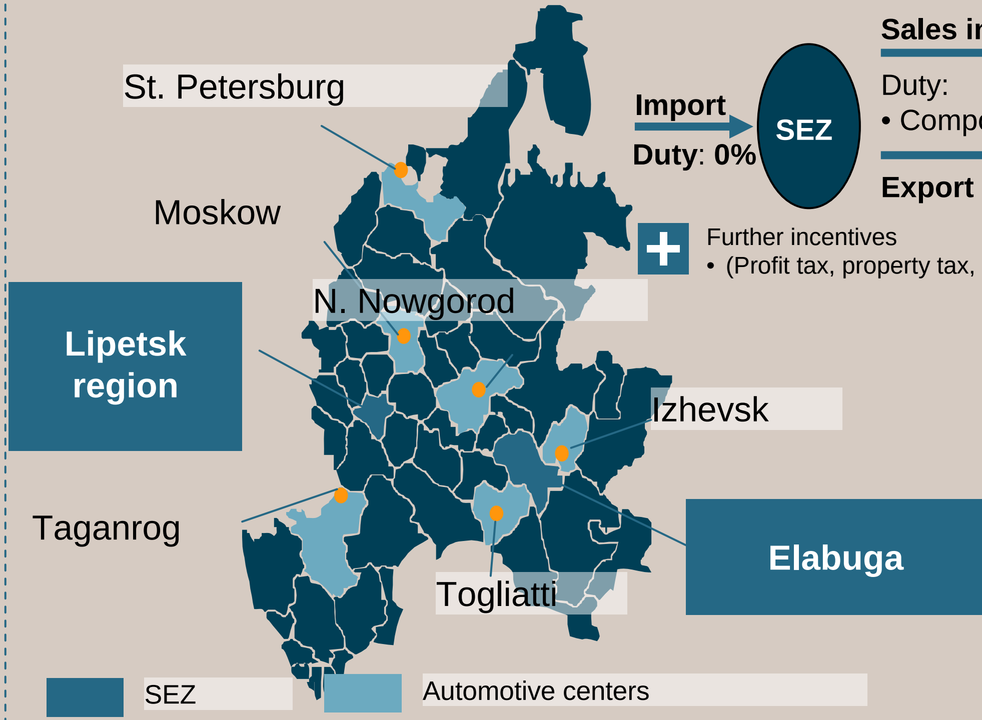
Overview of state economic incentives

Regional incentives without special economic zones

- **Profit tax** – up to 4% exemption
- **Property tax** – partial or full exemption (2,2% of property value)
- **Rent** – low percentage of the cadastre price
- **Infrastructure** – possible investments on behalf of regional authorities

– St.-Petersburg – Nissan- and Toyota-factories – city covers infrastructure investments

Special economic zones (SEZ)



Import
Duty: **0%**

SEZ

Sales into Russia:
Duty:
• Components – **8%**[1)]

Export is duty free

+ Further incentives
• (Profit tax, property tax, rent etc.)

1) Average calculated for a C segment car

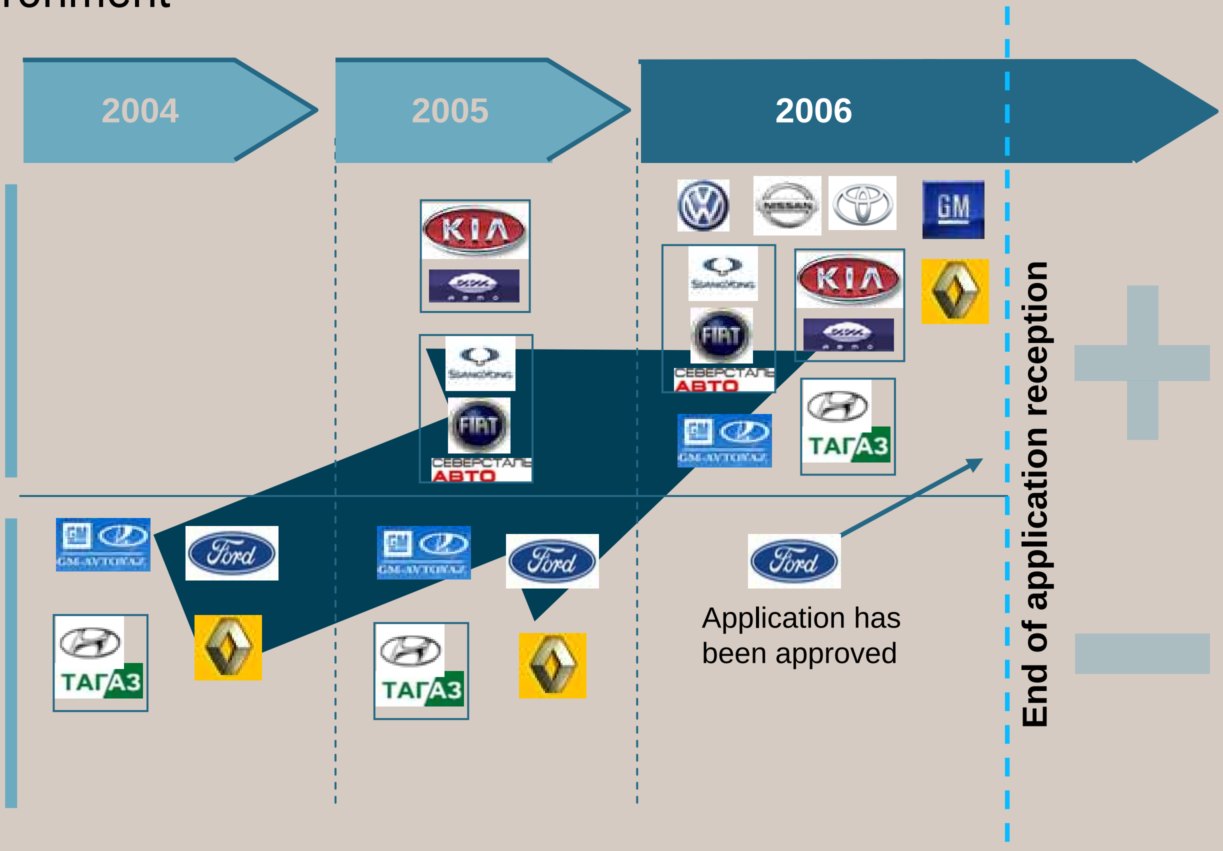
Source: SEZ federal law, Roland Berger

Decree 166 is the most crucial incentive for OEMs, however it is not yet applicable to suppliers

Legal environment

Decree 166[1)]
(since 2005)

Decree 135
(since 1998)
or no special conditions



Comments

- Decree 166 is much more attractive for OEMs – every assembly plant switches to it
- End of application reception planned for the end of 2006
- Decree 166 is not yet applicable to suppliers – a similar rule is being prepared

1) Only for industrial production: welding, painting and final assembly

Source: legal documents, Goskomstat, Roland Berger

C. Chances for automotive suppliers

Products and know-how of Russian suppliers are not state-of-the-art – modernization of the industry is necessary

Supplier industry situation and problems in Russia

Situation on the local supplier industry

- Russian OEMs have **quite high vertical integration** – for this reason there is **no developed supplier industry** yet
- Products for Russian OEMs **don't correspond to western standards**
- **Actual environmental guidelines** (EURO-3 etc.) are partially **not yet implemented**
- **Western OEMs determine the growth** of the car market, however their **production volume is still too low**
- Import duties for component (5-20% without any special conditions) are already quite low

Problems of the supplier industry

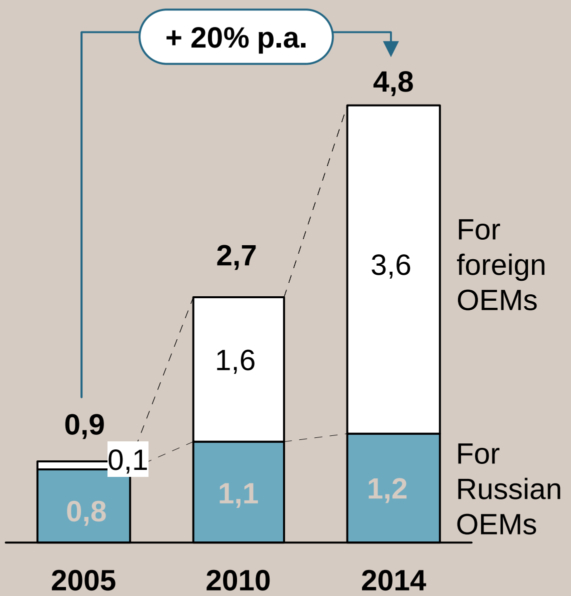
- Traditional **close ties** with **one OEM**
- **Uncompetitive products**
- **Modernization is necessary** to reach western production standards
- **Insufficient know-how** for the production of modern and complex components
- **Investments into modern production capacities** and **products** for western OEMs are still very often **unprofitable** because of **low volumes**
- Import of western components for local assembly is still a reasonable alternative

Source: Roland Berger

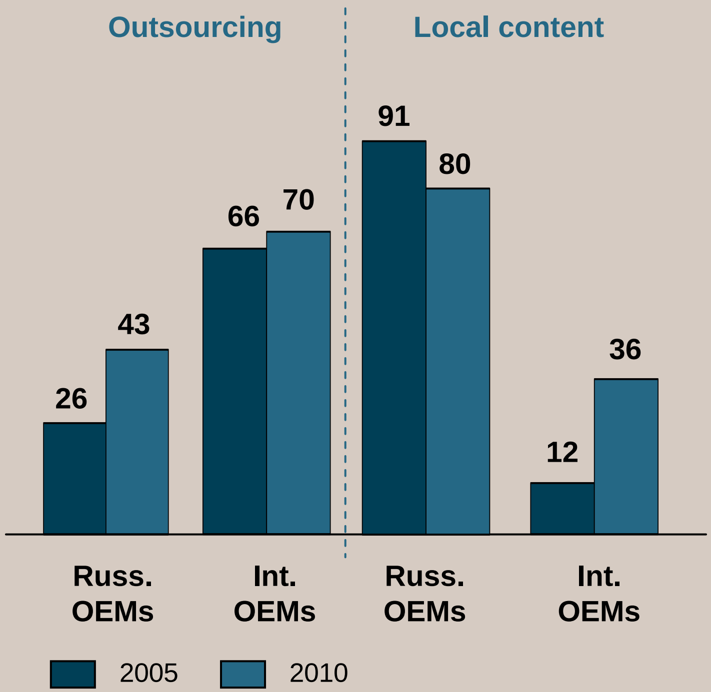
Supplier market for local production grows at 20% p.a. – increasing localization and outsourcing share as major growth drivers

Development of the car supplier market 2005-2014

Supplier market for local production [EUR bn]



Growth forces [%]



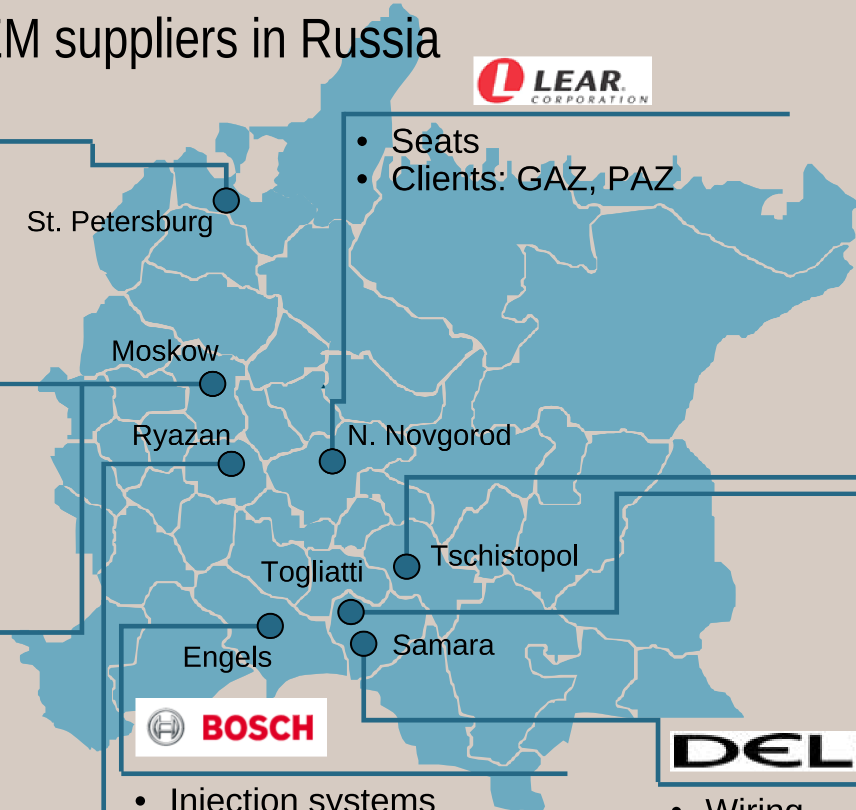
Comments

- > Supplier market for local production grows at 20% p.a. on average
- > Supplier industry will take over a greater share of value creation from OEMs in the future
- > Triple growth of local procurement volumes of foreign OEMs

Source: ASM Holding, Goskomstat, Roland Berger

Until now only few large international suppliers set up local production in Russia

Overview of foreign OEM suppliers in Russia



JOHNSON CONTROLS

- Seats
- Clients: Ford, Hyundai

MICHELIN

- Tiers
- Clients: Aftermarket
- Production volume in 2005: 2.1m units

Glaverbel

- Windows/Glass
- Clients: Ford

MAGNETI MARELLI

- Lights
- Clients: AvtoVAZ, GM-AvtoVAZ, GAZ, UAZ

LEAR CORPORATION

- Seats
- Clients: GAZ, PAZ

SIEMENS VDO Automotive

- Instrumental panels, Tachometer
- Clients: AvtoVAZ, GM-AvtoVAZ, KamAZ

TENNECO Automotive

- Exhaust systems
- Clients: GM-AvtoVAZ

BOSCH

- Injection systems
- Clients: AvtoVAZ, GM-AvtoVAZ

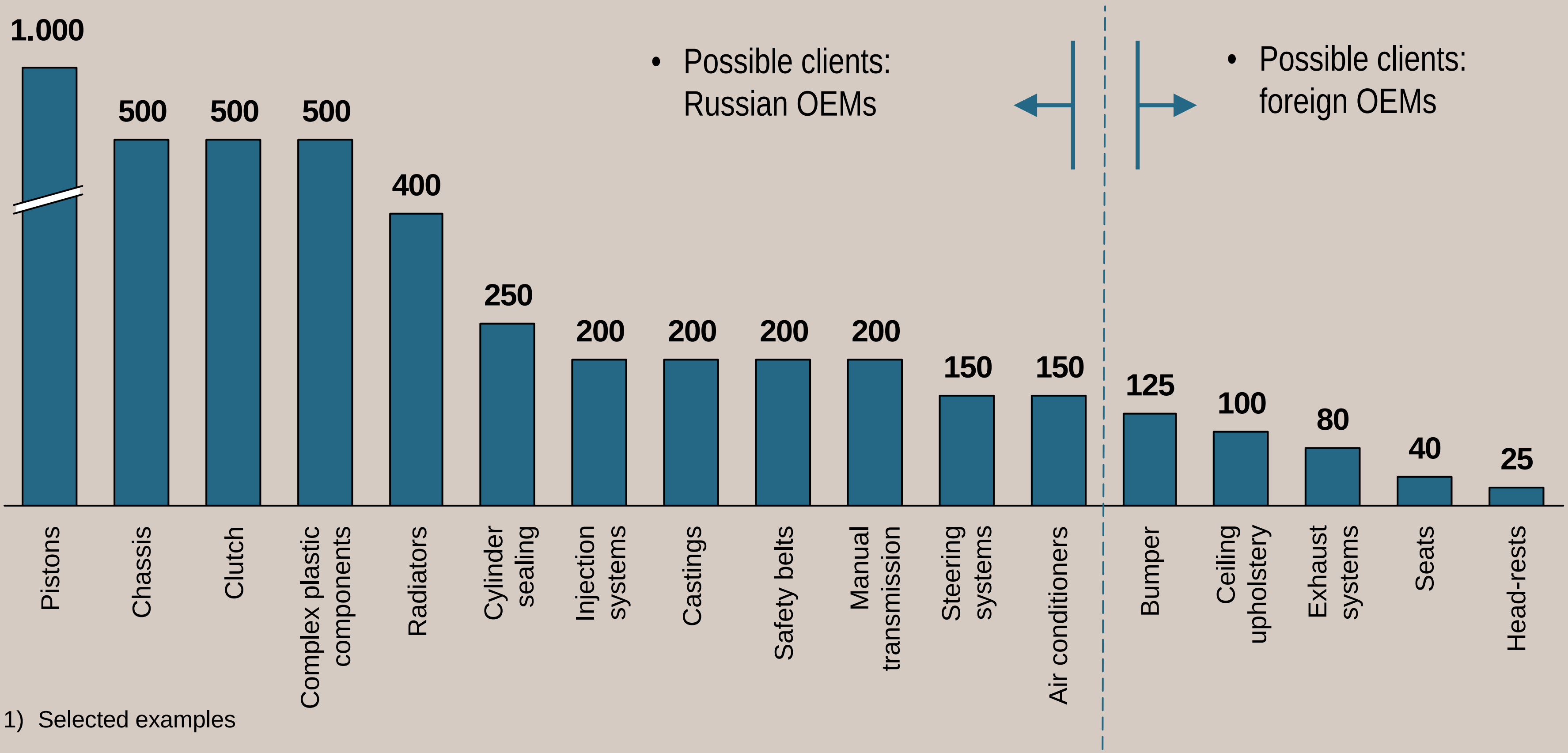
DELPHI

- Wiring
- Clients: AvtoVAZ, GM-AvtoVAZ, Ford

Source: Company information, Roland Berger

For many components, critical volume is still available at the local OEMs only

Critical mass of annual car production is necessary ['000 units]1)

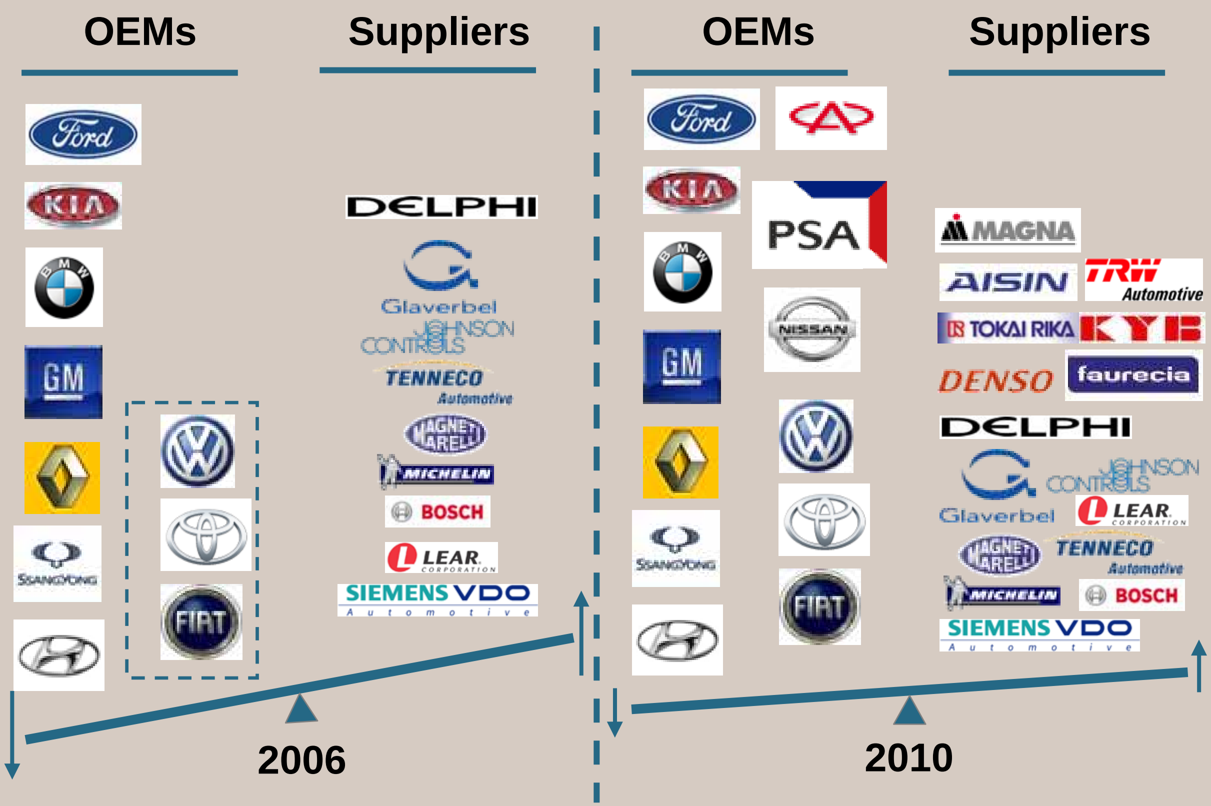


1) Selected examples

Source: Interviews, Roland Berger

Clear plans of international OEMs give the suppliers necessary security for planning and decision making

Market entry of foreign OEMs and suppliers



Comments

> Considering disclosed plans of foreign OEMs **global suppliers** have a **very good chance now**

> Many **suppliers will follow** their major **clients,** such as Toyota, Nissan, Volkswagen

Preparing for SOP

Source: Roland Berger

In case of a thorough analysis, market entry risk in Russia can be well managed and significantly reduced

Steps of the market entrance strategy development

1 Market analysis

- Development of the **client markets** (OEMs)
- Development of the **own market** (suppliers)
- **Competitor** activities

2 Products and target clients

- Definition of the launch product portfolio
- Identifying **target clients** and best ways of **approach**
- **Sales volume** forecast

3 Development of the business model

- Development of the **Marketing and Sales strategy**
- Definition of the **procurement strategy** (incl. localization)
- Definition of the **added value share/production flow**
- Development of the **logistics concept** – long distances to be considered
- **Personnel and F&E concept**

4 Evaluation of different sites

- **Evaluation** of **alternatives** considering following issues:
  - **Infrastructure**
  - **Duties and taxes**
  - **Business incentives/subsidies**
- **Business Case** (rough) as a basis for decision making

5 Preparation for implementation

- Selecting **market entrance form** based on the experience of other companies
- Development of the **action plan**
- Clarification of **legal issues**

Source: Roland Berger

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Russian suppliers are very interested in joint production with a foreign partner

Company

- Big German automotive supplier

Project aim

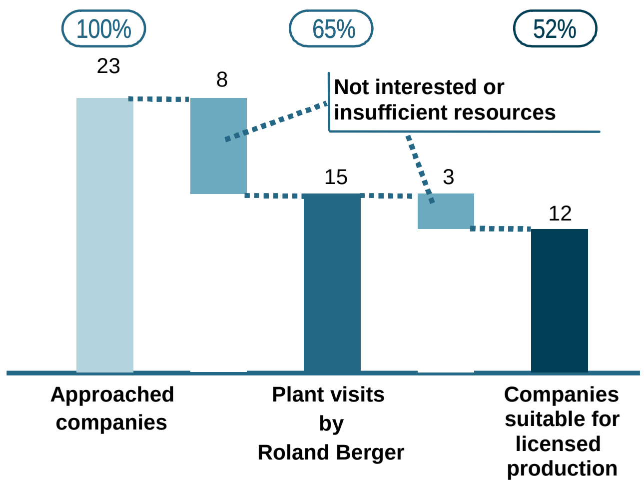
- Finding a partner for license production in Russia

Results

- 3 partners after 8 weeks

Russian companies are highly interested in a strategic partner

Research results



Project flow and results

- Defining criteria for a Russian partner
- Selecting the site
- Selecting companies for the long-list and detailed research
- Prescreening by Roland Berger
- Joint client visits
- Business-concept

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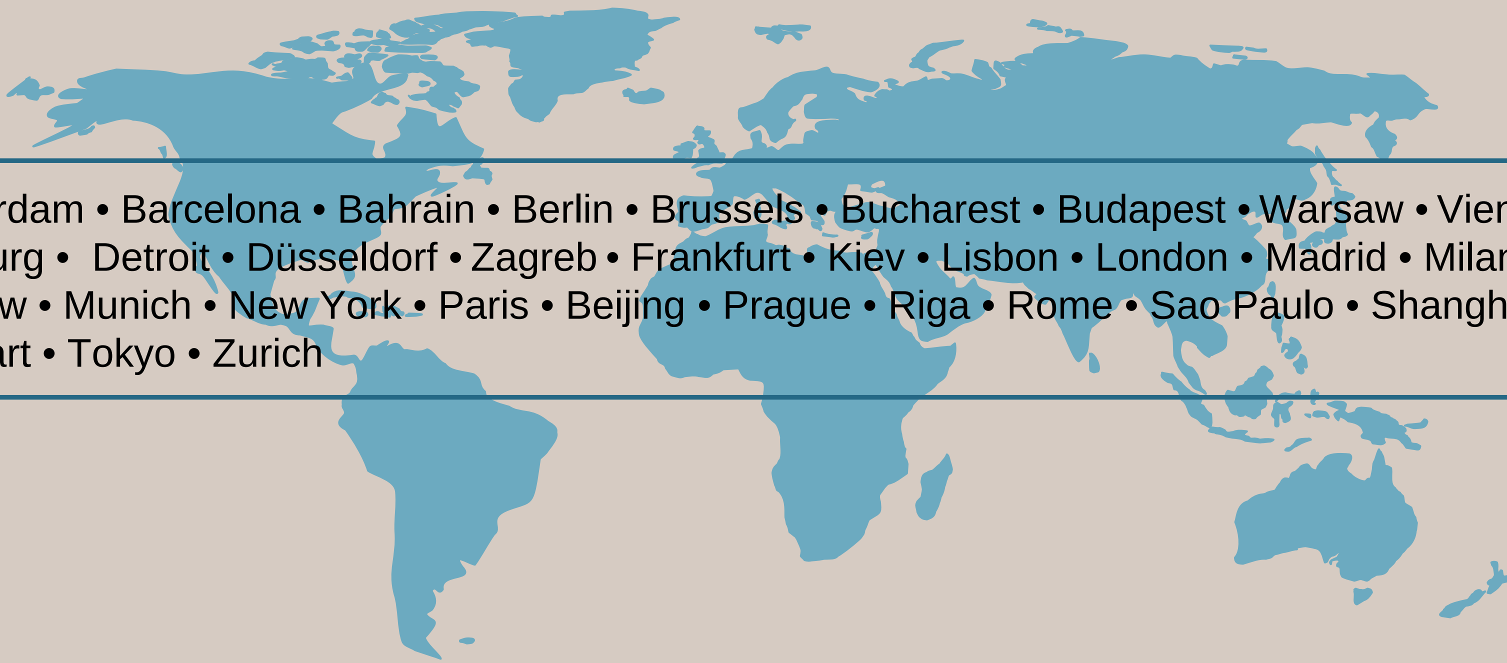
D. Roland Berger Strategy Consultants

Roland Berger Strategy Consultants is the leading strategy consultancy with global presence



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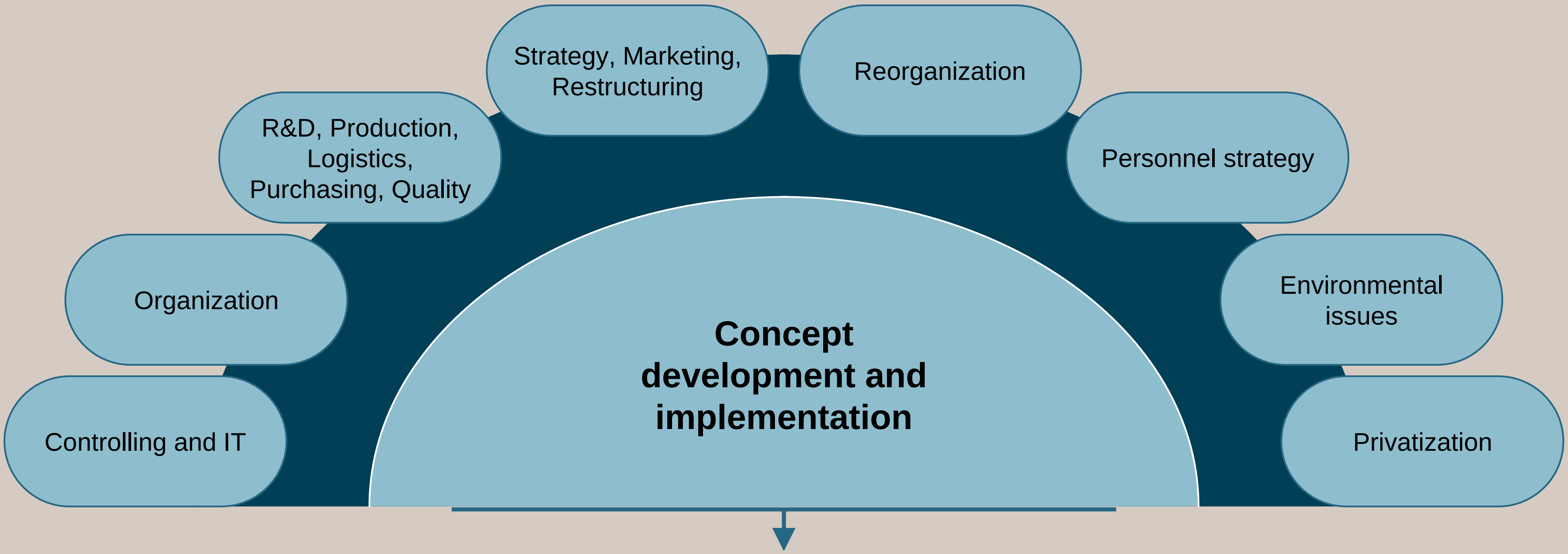
Sales 550 m EUR – 1 700 employees – 32 offices in 23 countries

30% out of Top 1 000 companies worldwide and 40% of leading European companies are our clients

Source: Roland Berger

Main goal of Roland Berger – developing a complete strategic solutions for top management

Specialization of Roland Berger Strategy Consultants



**Strategic goals of top managers:
competitive advantages, efficiency and growth**

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Key to success: interdisciplinary teams of experts from global functional and industrial competence centers

Industrial experts

Competence Centers								
Automotive	Energy and Chemicals	Consumer Goods and Retail	Engineered Products and High Tech	Financial Services	Infocom	Pharma and Healthcare	Public Sector	Transportation

Functional experts

Competence centers
Corporate Development
Information Management
Operations Strategy
Marketing and Sales
Restructuring and Corporate finance

Regional experts

Regions
Western Europe
Central and Eastern Europe
USA
South America
Japan, China
CIS and Baltic States
South-Eastern Asia

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Competence center Automotive serves the leading companies of the industry

Selected clients

OEMs	Suppliers	Service providers
GM	DELPHI Interior & Lighting Systems	Deutsche Post
TOYOTA	SIEMENS	Volkswagen Bank
RENAULT	JOHNSON CONTROLS	MAHAG
DAIMLERCHRYSLER	DENSO	TOYOTA FINANCIAL SERVICES
PSA PEUGEOT CITROËN	MAGNA	NÜRNBERGER VERSICHERUNGSGRUPPE
FIAT	TRW	SIXT Aktiengesellschaft
BMW	MICHELIN	BERGÉ y Cia., S. A.
Audi	Valeo	debis
		Europcar

Key facts Roland Berger automotive

- **One global pool** of professionals (~120)
- Automotive experts in **22 offices worldwide**
- Serving **more than 100 clients** across the globe since 2000
- **More than 300 projects** since 2000

Roland Berger has gathered wide-ranging experience in the automotive sector in Russia, Ukraine and the Baltic States

Selected clients and projects in Russia, Ukraine and the Baltic States

SELECTED CLIENTS

- АВТОВАЗ
- KAMAZ
- RENAULT
- BEKAERT
- DAIMLERCHRYSLER
- TOYOTA
- ŠKODA AUTO
- DACIA
- brose Technik für Automobile
- PSA PEUGEOT CITROËN
- RÁBA Rába Automotive Group
- Miba
- JOHN DEERE

SELECTED PROJECTS

- Developing a competitive Russian automotive supplier industry
- Partner search to set up license production for a large European automotive supplier
- Company strategy for one of the leading automotive producers in Russia
- Screening vehicle producers in Russia

- Market potential and partner search for Austrian automotive supplier
- Marketing and sales strategy for a large Russian tire producer
- Business strategy for a large Russian petrochemical holding company
- Market entry strategy for the Russian steel cord market

- Russian market test for trucks assembled in a third country
- Russia strategy for the truck sector
- Market potential for commercial vehicles in Uzbekistan, Kazakhstan, Ukraine

- Market entry strategy for leading European car financing bank

- Asset sales in Eastern Europe and China

Source: Roland Berger

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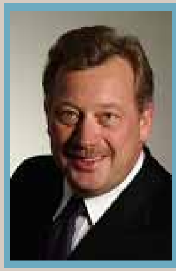
Your contacts for the issues related to automotive business in Russia

Contacts



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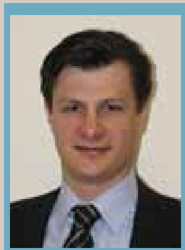

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