



Automotive Investments: Climate in Russia, Focus on St. Petersburg and Leningrad Region

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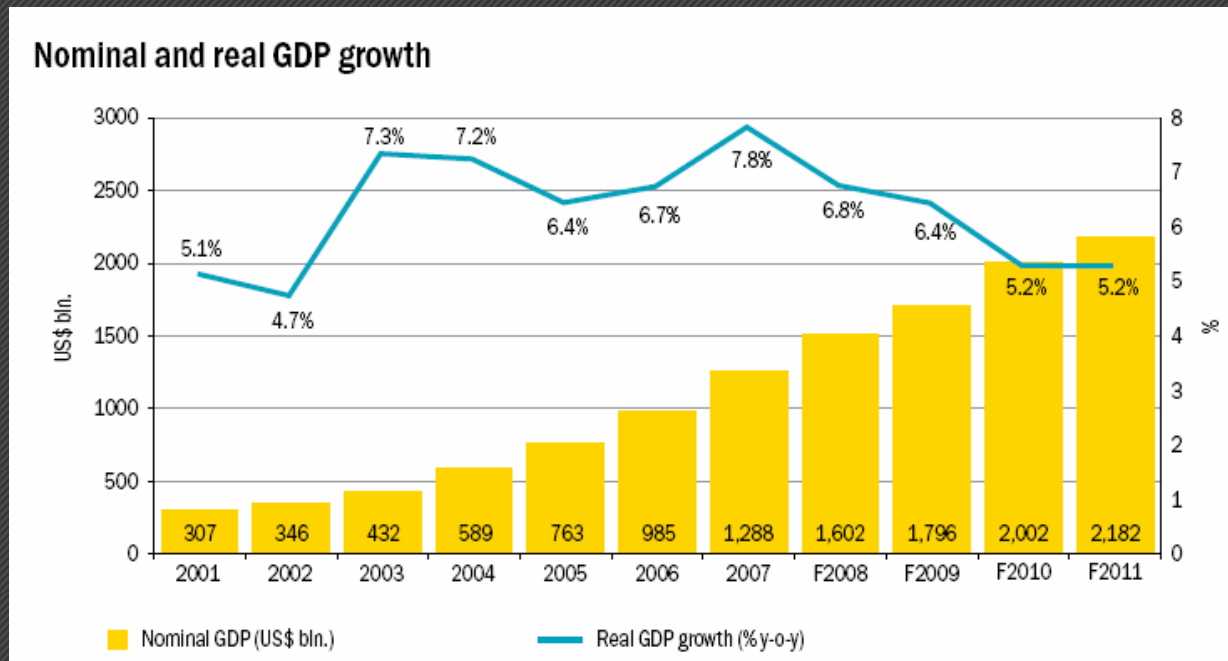
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Russian Profile for Automotive Investments

Russian economy

- ▶ High oil prices support continued growth and strong ruble
- ▶ Domestic consumption surge (purchasing power grew by 13.5%)
- ▶ Most major ratings agencies - S&P, Moody's and Fitch – have upgraded Russia's investment rating
- ▶ Strong growth in the machine-building and automotive sectors (up to 10% and 5% in the last 5 years) and expected further growth of 12% to 2015

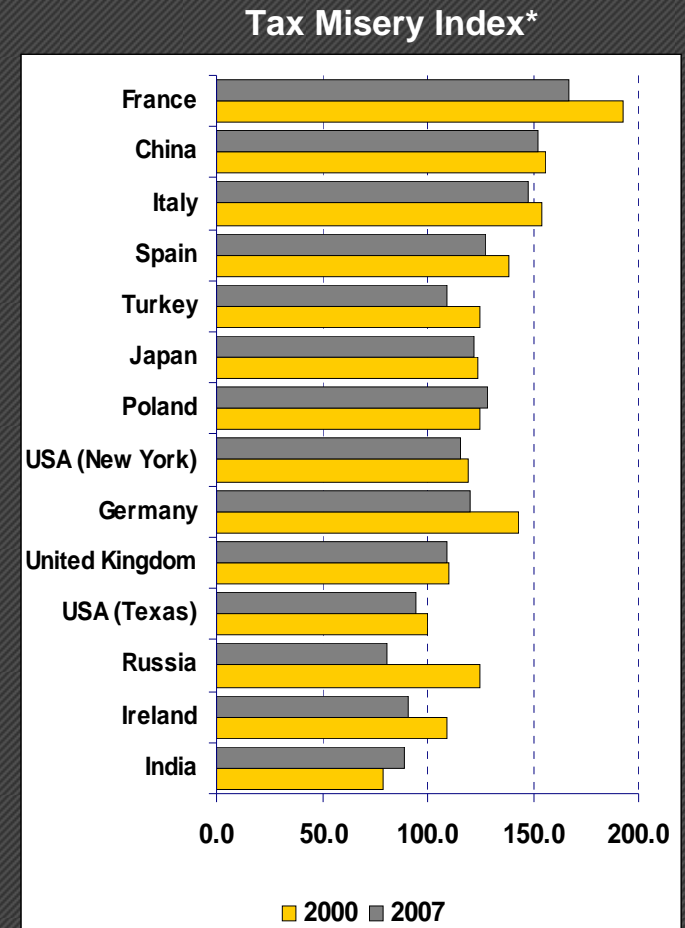


Source: Rosstat, Ministry of Economic Development of the Russian Federation, Ernst & Young

Tax situation improved

- ▶ If not a “tax heaven”, Russia is among less “tax miserable” places now
- ▶ A few problems still remain, primarily related to implementation
 - ▶ Still many uncertainties in application of tax law
 - ▶ “Form over substance” approach is usually taken by the tax authorities
 - ▶ “Budgetary plans” for tax collection
 - ▶ Tax audits result in tax litigations in most cases
 - ▶ Practical difficulties in VAT refund

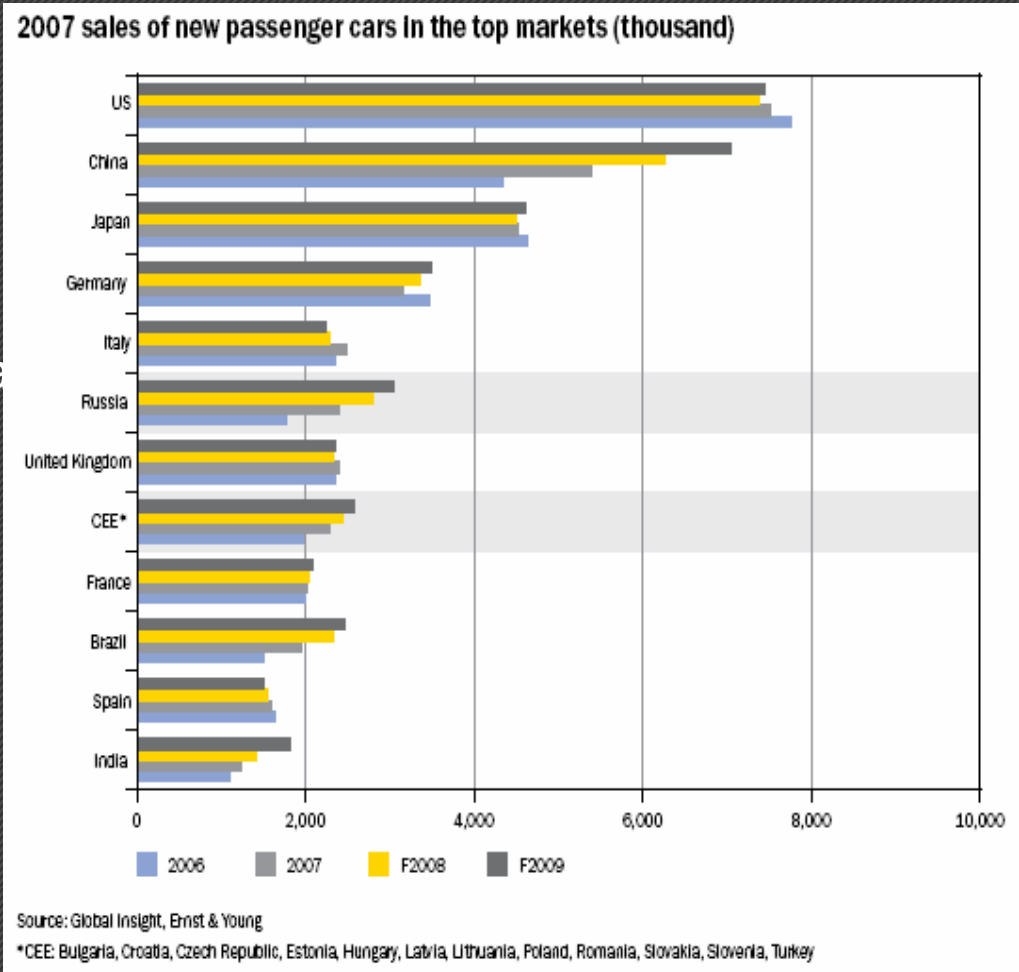
*Tax Misery Index is a sum of sizes of major tax rates. The higher the index, the higher is the tax load



Source: Forbes (May 2007), EY Research & Analysis

Russian automotive market in global context

- ▶ Traditionally leading markets such as the US, Germany, and Japan showed a negative dynamic in car sales in 2007
- ▶ China, India, and Russia surpass all sales forecasts
- ▶ In 2007 Russia turned out to be third in Europe and sixth in the world
- ▶ By 2012 the Russian Federation may sell more than 4.6 mln. passenger cars annually



WTO membership

- ▶ Russia has been negotiating for WTO membership since 1993. Last year it completed the majority of bilateral negotiations including that with the US.
- ▶ Multilateral negotiations with 60 countries have already been conducted. Will Russia join the WTO in the near future???
- ▶ WTO membership followed by trade liberalization is likely to have a positive macroeconomic impact on total trade turnover and volume of FDI into the country.
- ▶ 7 years of transitional period.
- ▶ Change of customs duties foreseen on the 5th year of the transitional period:
 - ▶ Passenger cars, 0-3 years old: from 25% to 15%;
 - ▶ Vans (engine > 2.8 l.) + SUVs (engine 3.5-4.2 l.) down to 12.5%;
 - ▶ SUVs (engine > 4.2 l.) down to 10%;
 - ▶ Passenger cars, 3-7 years old: from 25% to 20%;
 - ▶ All vehicles, > 7 years old: no change.
 - ▶ New CVs: no change.
- ▶ Industrial assembly implications
 - ▶ the companies which succeed to apply before the deadline can in future enjoy the benefits of the procedure
 - ▶ new Agreements on industrial assembly are not to be signed
 - ▶ new concept of industrial assembly which does not contradict to WTO rules is under consideration of RF Government

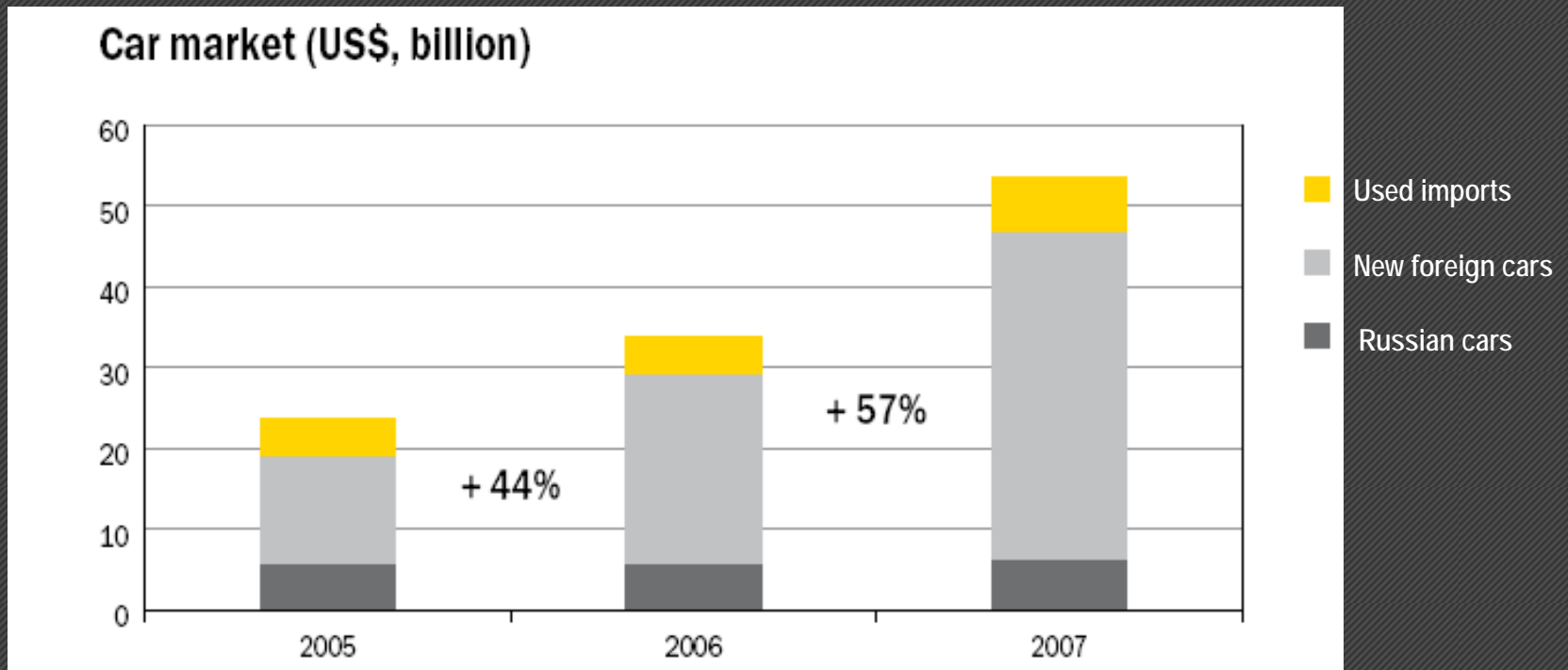


Russian Automotive Market

- ▶ **A record level of investment in the industry**
- ▶ **Commitment of most of the leading automotive players to establish manufacturing facilities in Russia with overall new capacity over 1.5 million units by 2012**
- ▶ **A continued restructuring by Russian automotive players coupled with several international acquisitions**
- ▶ **A clearly intensifying trend of a shift in new car purchases not only toward foreign brands, but also toward a higher price segment**
- ▶ **A further aggressive expansion of car dealerships into the regions**
- ▶ **Intensifying competition in the car finance market with the appearance of many new players, including OEM banks, as well as attractive credit instruments**

Russian Automotive Market

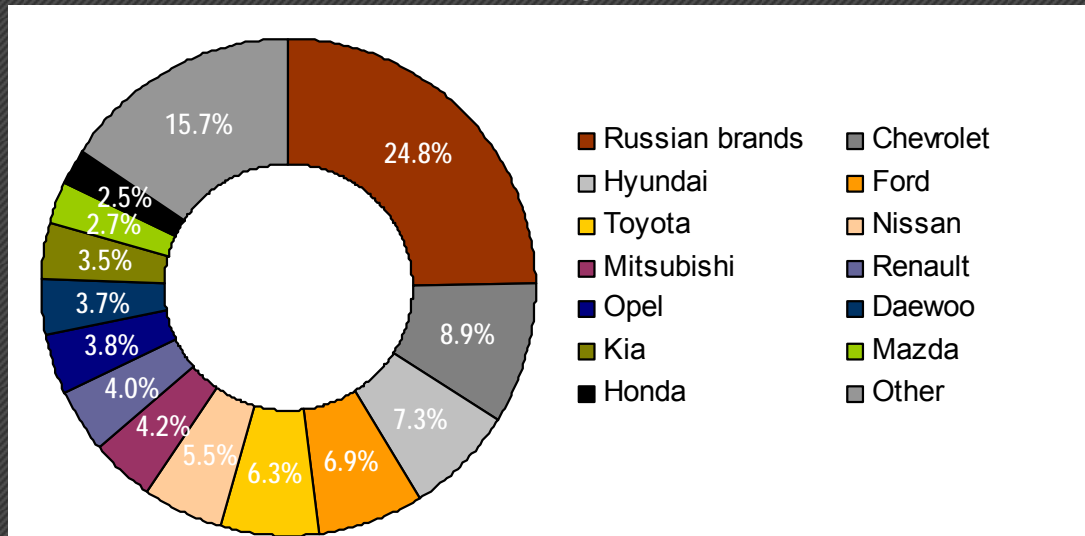
- ▶ Passenger car market sales estimated at over US\$50 billion in 2007
- ▶ New foreign brands sales (both imported and locally produced) estimated at more than US\$40 billion
- ▶ Russian brand sales fell to US\$6 billion



1 half-year 2008 Sales of Passenger Cars

Market share by brand in 1H 2008

▶ Foreign brands sales continue to go up, however the sales growth rate has slowed (+47% in 1H 2008 comparing to +70% in 1H 2007)



Passenger Cars ('000)	2007	1H 2008	1H 2007	% Growth
Russian	752	349,500	304,700	15
New Imports	1,194	760,600	521,500	46
Foreign Russia-made	452	300,500	198,600	51
Used Imports	380	201,800	160,100	26
TOTAL	2,786	1,612,400	1,184,900	36

Source: ASM-holding

OEM presence in Russia



- ▶ Most global OEMs committed to manufacturing in Russia (over 1.6 mn cars);
- ▶ By 2010 the foreign OEM capacities are expected to overweigh the domestic ones;
- ▶ The CV market is closely following the passenger car market
- ▶ Number of OEMs from China is reducing significantly

The Russian components industry

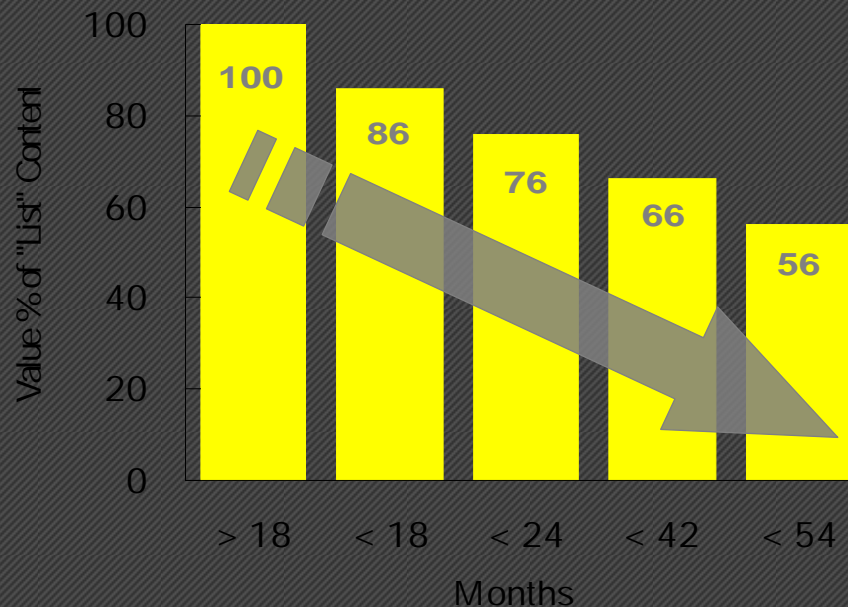
- ▶ **Lack of the traditional tier division of component manufacturers due to the high level of integration with the major OEMs;**
- ▶ **Lack of a competitive technologies among Russian manufacturers as a legacy of the highly integrated vehicle manufacturing coupled with highly amortized equipment make most local component manufacturers not that attractive;**
- ▶ **The relatively long-term process of adapting new technologies and applying know-how to local manufacturers;**
- ▶ **Economies of scale are a must for attracting major foreign component manufacturers (most require a good over 200,000 units of car production in order to make an investment economically viable).**

Suppliers presence in Russia



Decreases # 166 & 566 – conditions of application

- ▶ **Welding, painting, assembling**
 - ▶ 14% after 18 months (1.5 years)
- ▶ **Value reduction of the list**
 - ▶ 10% 24 months later (2 years)
 - ▶ 10% 42 months later (3.5 years)
 - ▶ 10% 54 months later (6 years)



~ 70 positions

Decree #166

Amendments

~ 130 positions

+
Seat parts
Engine parts
Safety bags
Other

Import duties

- ▶ CBUs – 25%
- ▶ Assembly – 15%
- ▶ Components – 0-5%

Source: Ministry of Economic Development and Trade

The industrial assembly legislation

Vehicles

- ▶ **Welding, painting, assembling**
 - ▶ in 18 months (1.5 years), 30 months (2.5 years) for new manufacturing
- ▶ **Value Reduction of the List**
 - ▶ 10% 24 months later (2 years)
 - ▶ 10% 42 months later (3.5 years)
 - ▶ 10% 54 months later (6 years)
- ▶ **More strict requirements on Value Reduction in SEZ (Elabuga, Lipetsk)**
 - ▶ up to 50% 54 months later (6 years)

Auto components

- ▶ **Organisation of serial output**
 - ▶ in 18 months (1.5 years), 30 months (2.5 years) for new manufacturing
- ▶ **Value Reduction of the List**
 - ▶ 10% 18 months later (1,5 years)
 - ▶ 10% 30 months later (2.5 years)
 - ▶ 10% 40 months later (3.3 years)

Possible ways of reduction:

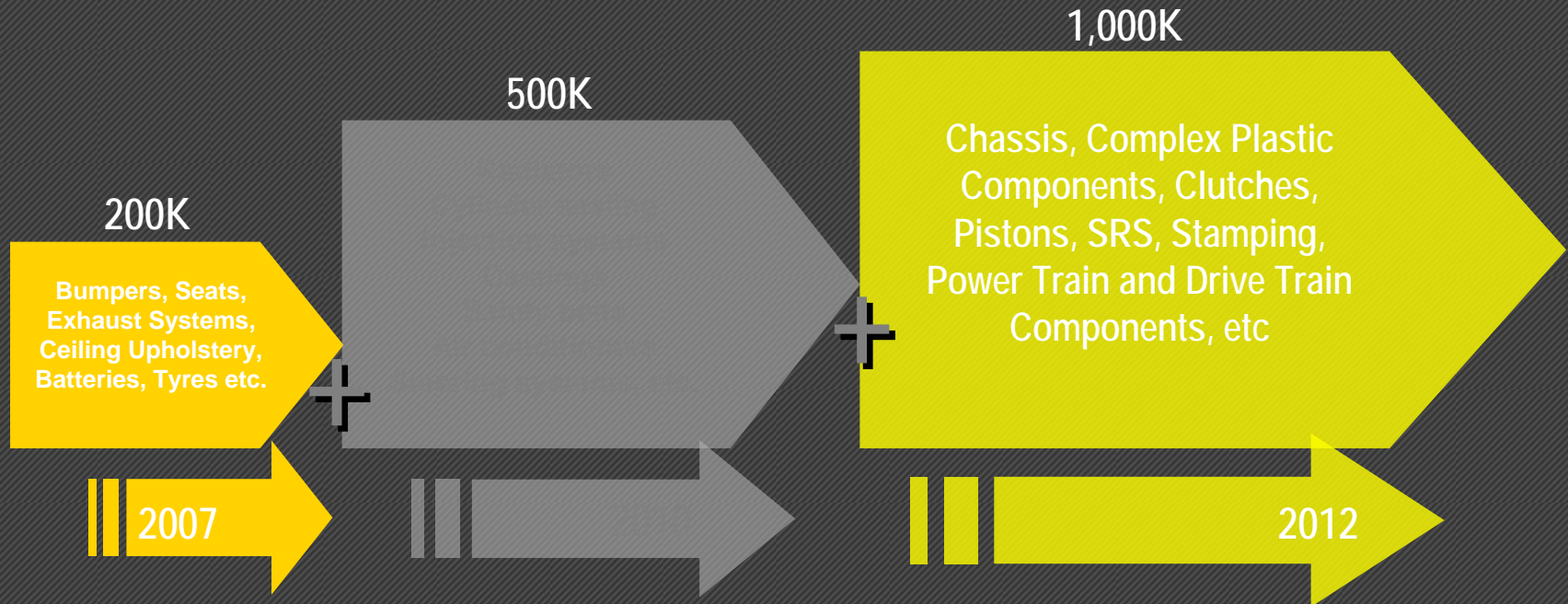
- ▶ organization of auto (sub) components production in Russia;
- ▶ purchase of auto (sub) components at the domestic market; and
- ▶ importation at the standard rather than preferred customs duty rates.

Why do OEMs require local content?

- ▶ Decree 166 (OEMs) was passed in 1H2005 and Decree 566 only in the end of 2006;
- ▶ Almost all new OEMs project are run under decree 166;
- ▶ OEMs who operated under different regimes (e.g. Ford under decree 135) switched to decree 166;
- ▶ Suppliers are coming with a substantial lag in time;
- ▶ Decree 566 still contains a number of uncertainties;
- ▶ Very few suppliers have already signed an agreement with MEDT (most just memoranda of understanding)
- ▶ Will decree 566 be extended to ensure investment into component manufacturing?

Localization matters

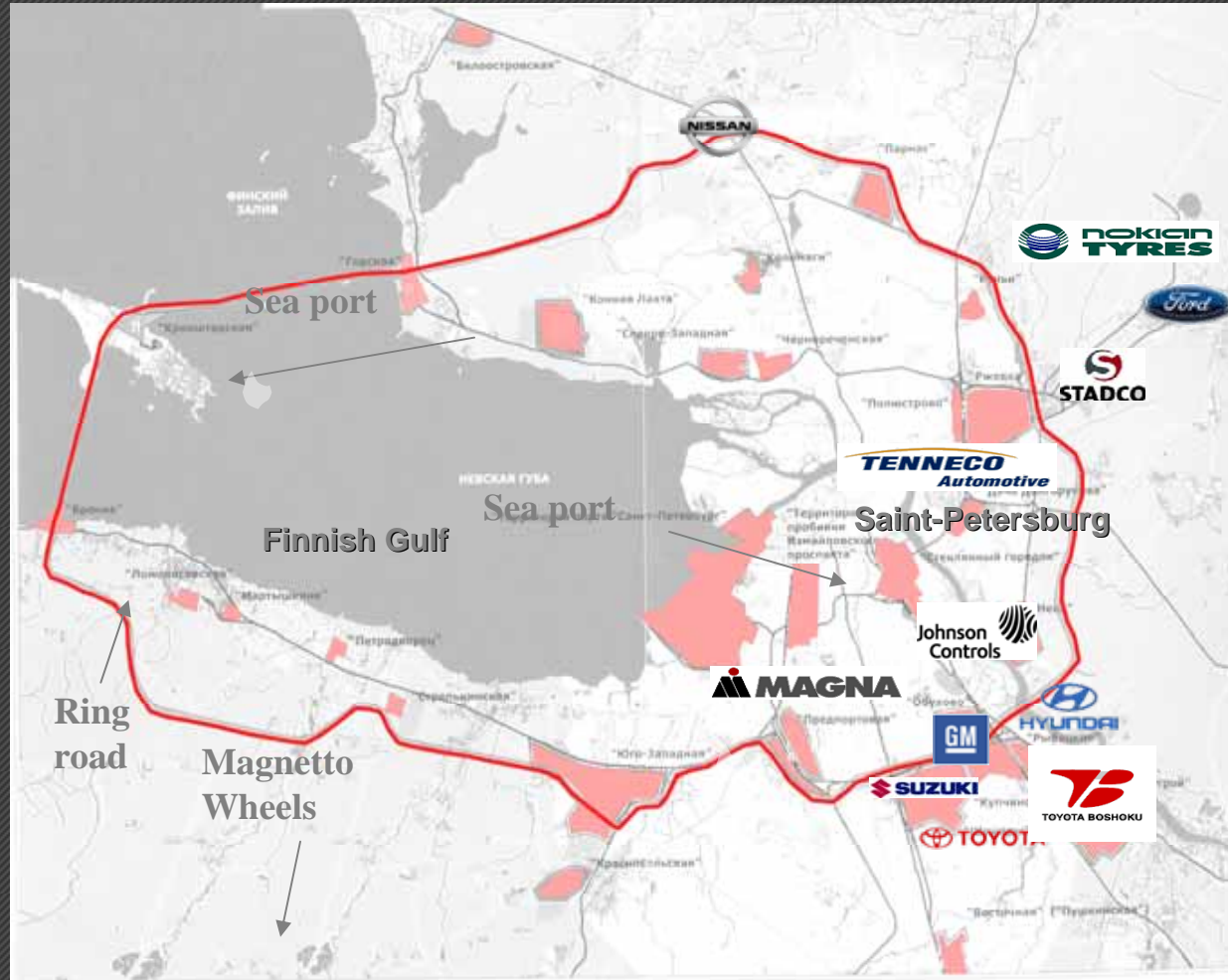
- ▶ By 2010 there will be more than 1,000,000 foreign passenger cars produced in Russia;
- ▶ By 2015 there the production of foreign OEMs will increase about four times;
- ▶ The share of work outsourced by Russian OEMs will rise to 45% in 2010;
- ▶ The same period will have a three-fold increase to 39% in the locally made components in foreign vehicles;
- ▶ Attractive opportunity for international suppliers as Russian OEMs prefer to purchase components from them because of greater quality, environmental and safety standards.



Source: Ernst & Young Analysis

Investment Climate in St. Petersburg and Leningrad Oblast

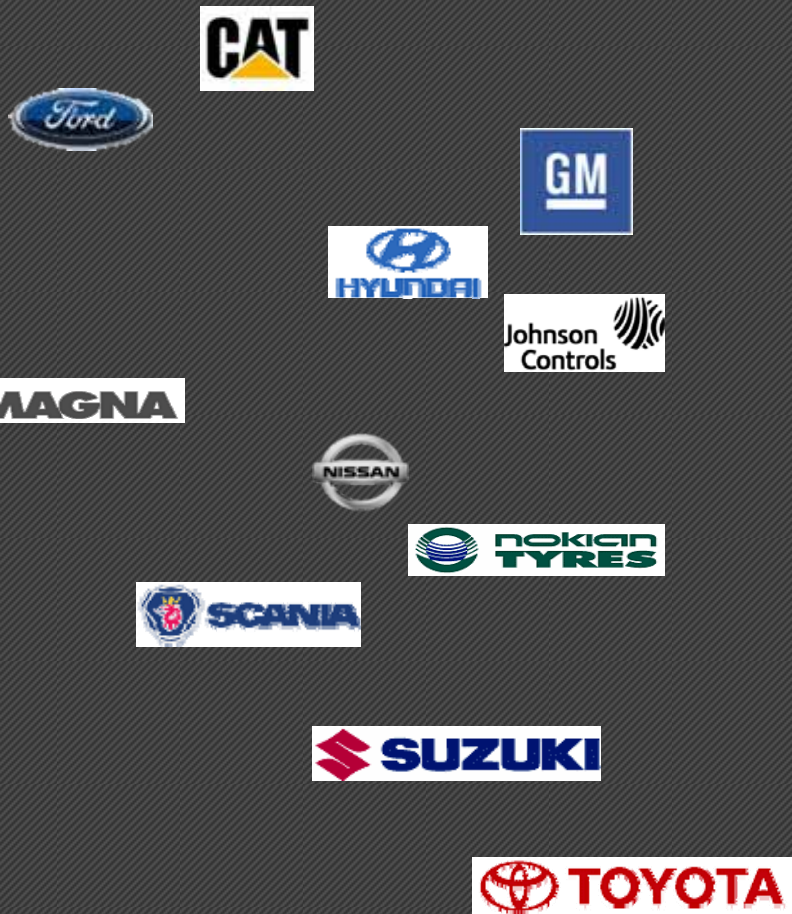
Automotive Cluster in St.Petersburg and Leningrad Oblast



Source: St. Petersburg government .

Automotive Cluster in St. Petersburg and Leningrad Oblast

- ▶ Caterpillar
- ▶ Ford
- ▶ General Motors
- ▶ Hyundai
- ▶ Johnson Controls
- ▶ Magna International
- ▶ Nissan
- ▶ Nokian Tyres
- ▶ Scania
- ▶ Stadco
- ▶ Suzuki
- ▶ Tenneco
- ▶ Toyota
- ▶ Toyota Boshoku



Source: www.st-petersburg.ru

Advantages of Investing in St. Petersburg and Leningrad Oblast

Advantages of St. Petersburg and Leningrad Oblast

- ▶ Convenient geographic location and developed infrastructure
- ▶ Favorable macroeconomic conditions
- ▶ Political stability
- ▶ Investment legislation
- ▶ Tax exemptions
- ▶ Qualified labor

Tax Incentives to Promote Investment

	St. Petersburg		Leningrad Oblast
Profits Tax	Investment of no less than <u>RUR 150 m</u>	Investments in processing industries of no less than <u>RUR 3 bln during 3 consequent years</u>	<u>Tax rate:</u> - reduced from 24% to 20%
	<u>Tax rate:</u> - reduced from 24% to 20% (for investments of over RUR300 m) - reduced from 24% to 22% (for investments of over RUR150 m) <u>Duration:</u> 3 years	<u>Tax rate:</u> - reduced from 24% to 20% <u>Duration:</u> 5 years	
Assets Tax	<u>Tax rate:</u> - reduced from 2.2% to 1.1% <u>Duration:</u> 3 years	<u>Exemption from the tax</u> <u>Duration:</u> 5 years	<u>Exemption from the tax</u> <u>Duration:</u> payback period + 2 years
Subventions	NONE		Profits tax refund (difficult in practice)
Agreement with government authorities	NOT REQUIRED (except for major investment projects)		YES (a business plan with an accredited consultant's conclusion is required)

Executive Authorities Concerned

- ▶ St. Petersburg
 - ▶ **Committee for Investments and Strategic Projects**
 - ▶ Chairman: Maxim Sokolov
 - ▶ +7 (812) 576-6988

- ▶ Leningrad Oblast
 - ▶ **Committee for Economic Development and Investment Activity**
 - ▶ Chairman: Grigory Dvas
 - ▶ +7 (812) 576-40-14
 - ▶ First deputy, head of investment department: Sergei Kuklin
 - ▶ +7 (812) 274-14-46

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