

# Automotive market in Russia and the CIS

Industry overview

February 2010





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# Opening statement

Dear Reader,

2009 was one of the most challenging years for the Russian automotive industry:

- ▶ What had been the fastest growing light vehicle market in the world in mid-2008 is now just a memory; rapid growth had been spurred by low unemployment and interest rates, and expanded access to credit.
  - ▶ Currently, unemployment has surged above 8%, GDP contracted by 7.9% in 2009 and is expected to recover slightly in 2010, and decline in consumer confidence, real wages and credit availability have pushed auto sales lower.
  - ▶ Light vehicle sales were down by almost 50% in 2009 compared to a year earlier, but there are signs of optimism as improving credit conditions and soon to-be-introduced scrapping incentives are expected to help reverse the trend in 2010.
- ▶ Russia's heavy truck market grew rapidly in mid-decade, and is still the largest single truck market in Europe despite a recent significant decline in production.
  - ▶ The Russian automotive component manufacturing sector is experiencing a very difficult period and the local supplier base lacks competitiveness and major global suppliers.
  - ▶ Automotive retail has been severely impacted by liquidity issues due to huge vehicle inventories built up in 2008 and high leverage intended for aggressive expansion.

This report outlines our view of the current situation on the Russian and the CIS automotive markets as well as our outlook for possible market development in the following years. Despite the recent slowdown in sales volumes, we remain positive about the long-term prospects for the Russian automotive industry and believe that the next few years will be extremely important as the industry's new competitive landscape develops. In such challenging yet promising times for the automotive business, we would be glad to share with you our market experience and assist you through prudent investment as well as risk, operational and cost management advisory services.

**Ivan Bonchev**  
CIS Automotive Leader

# Russian economy

The Russian economy - like the global economy - faced significant challenges in 2009. Feeling the pressure of the global economic downturn and low commodity prices, the domestic economy entered the year on a downward trend with a depreciating local currency and slumping exports. The situation was further aggravated by the global liquidity squeeze which, coupled with the weak domestic banking sector, has negatively affected Russian industrial output and fueled rising unemployment. At the same time, depressed consumer confidence put a dent

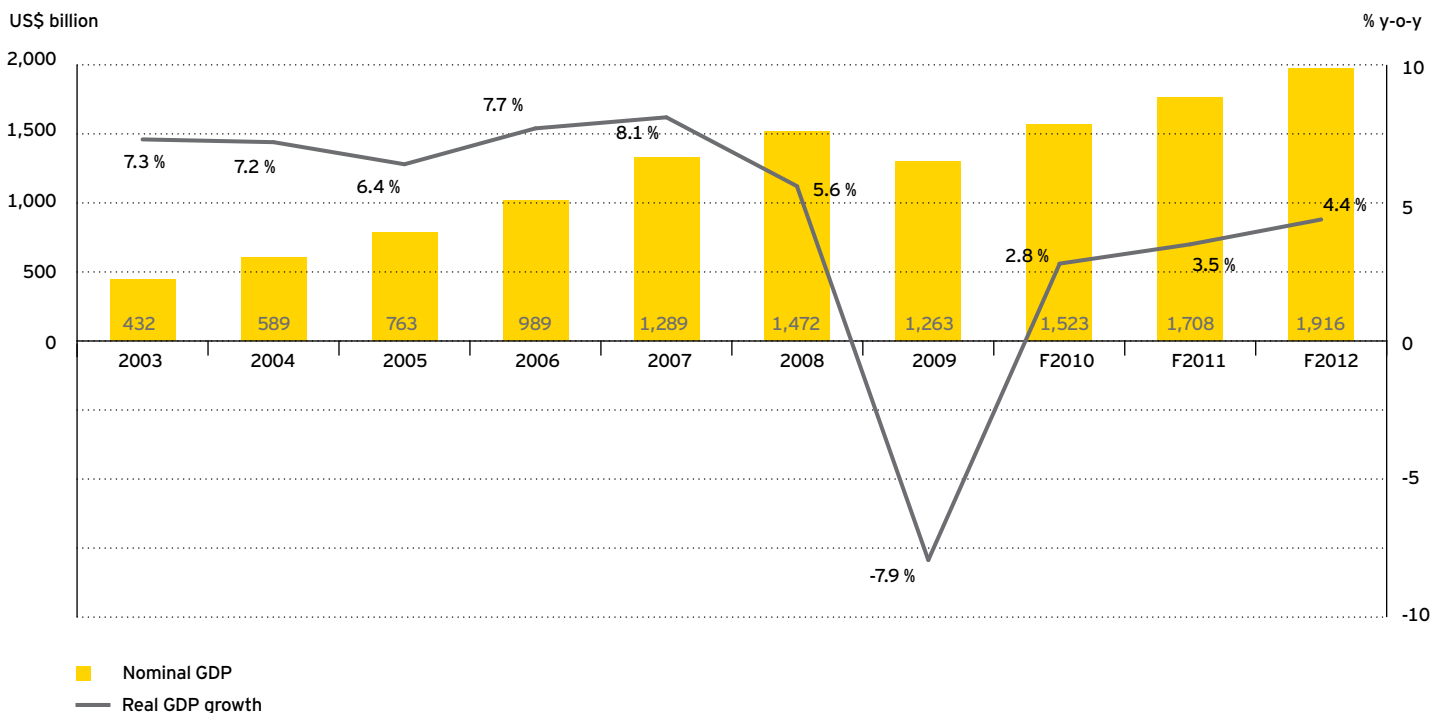
in domestic demand, further postponing economic recovery. To combat these conditions, the Government of the Russian Federation initiated a major support program with the main aim of maintaining current liquidity in the economy through direct injections and lending auctions, while at the same time supporting domestic manufacturers by imposing additional restrictions on imports.

As a result of these measures, by mid-2009 the economic situation had stabilized and a welcome uptick in commodity prices helped

liquidity re-accumulate and kick-started growth. The brightening of the economy has improved the situation in the labor market, with unemployment slowly retreating. However, despite the positive signs, the economy was still stagnant as the banking sector remained hesitant to provide sufficient financing to enable a quick recovery of domestic industries.

The first signs of actual economic growth in Russia materialized in the second half of 2009. Supported by stable commodity prices, the energy sector was the first to

## Nominal and real GDP growth



Sources: Rosstat, Ministry of Economic Development of the Russian Federation, IHS Global Insight, Business Monitor International, Ernst & Young estimates

overcome the impact of the economic downswing and helped to lift overall domestic demand. At the same time, the industrial sector also began to recover after carrying out major restructuring initiatives and working to improve liquidity. The overall recovery has ultimately translated into an improvement of the domestic stock market, which has started to recoup losses incurred since the last quarter of 2008. Based on these solid fundamentals,

the Russian ruble ultimately began to rise against the major international currencies as the domestic balance of payment got some backing.

The bottom line is that 2009 was so dramatic that the interventions that occurred have raised questions over the Government's proper role in supporting the Russian economy. It is a given that the liquidity injections at the beginning of the

year were critical in ultimately stabilizing the economy. However, it should be noted that government help now becomes a potential hazard to future economic growth, as the Government may be tempted to withdraw its fiscal stimuli too early for a stable platform of growth to be created, or too late as the Russian economy starts to overheat.

## Macroeconomic indicators

	2007	2008	2009	F2010
Population, million	142.2	141.8	141.4	141.1
Nominal GDP, US\$ billion	1,282.1	1,650.7	1,238.6	1,513
Nominal GDP, change in %	29.6	28.8	-23.3	19.4
Real GDP, change in %	8.1	5.6	-7.9	3 – 3.5
GDP per capita, US\$	9,018.1	11,643.1	8,916.5	10,719.0
Foreign direct investment, US\$ billion	55.1	70.3	40	40.4
Consumer price index, %	11.9	13.3	8.8	6.1
Industrial output, US\$ billion	767.1	947.6	663.1	761.5
Industrial output, change in %	7.1	2.3	-10.8	2.6
Spot crude, US\$	70.3	95.7	61.1	70.1
Real income growth, %	12.2	3.4	1.9	2.6
Unemployment rate, %	6.1	7.0	8.2	8.9
Average monthly wages, automotive industry, US\$	548	697.1	422.5*	494.3*
Average monthly wages, Russian economy, US\$	530.3	695.5	561.4	655
RUB/US\$	25.6	24.9	31.6	28.8
RUB/EUR	35.1	36.5	44.0	41.1

\* Ernst & Young estimates

Sources: Rosstat, Ministry of Economic Development of the Russian Federation, CBR, IHS Global Insight, Business Monitor International, Ernst & Young estimates

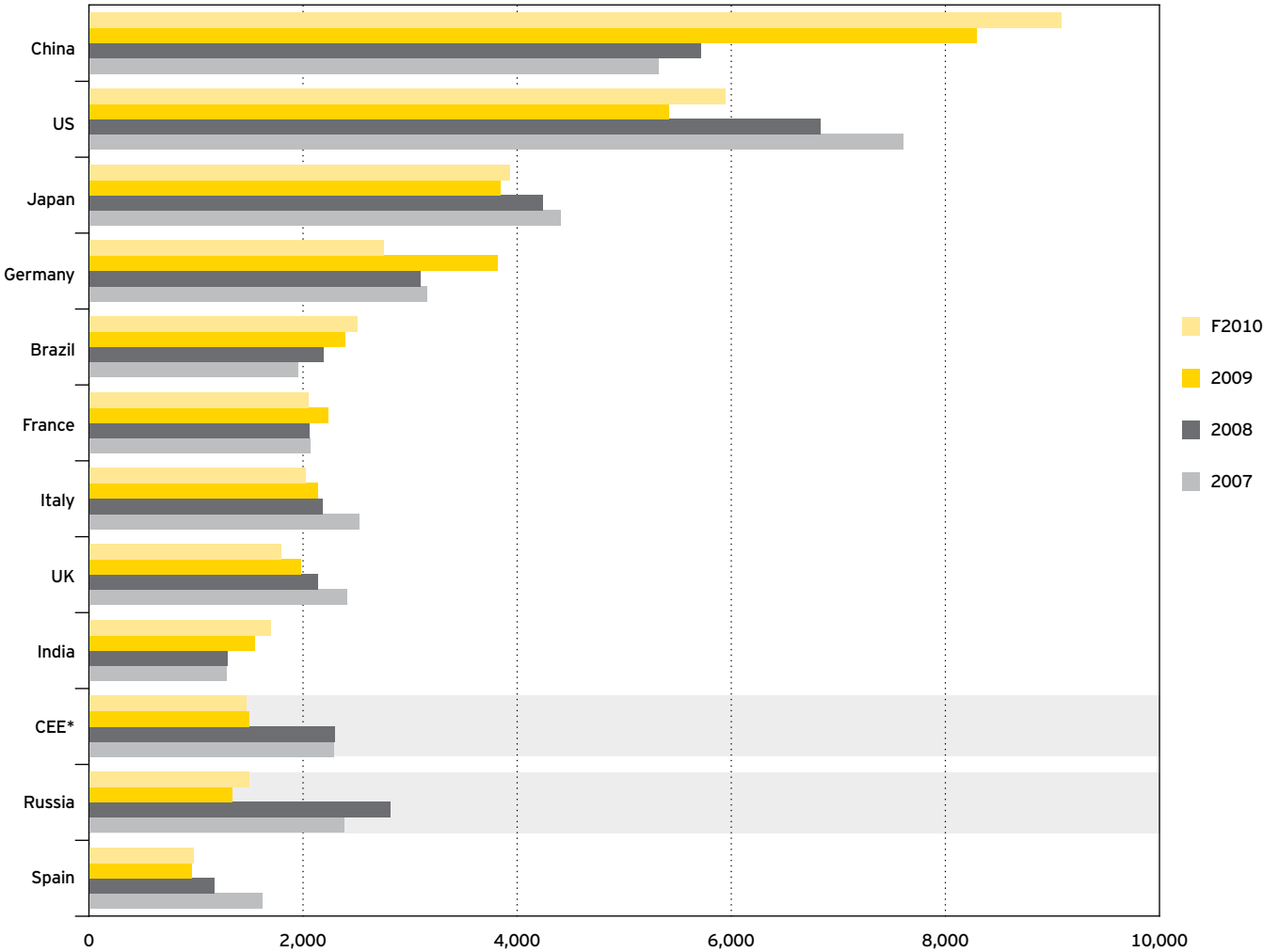
# Russian automotive market in a global context

Dramatic declines in consumer demand, driven largely by the global recession and illiquid consumer debt markets, have precipitated a number of negative events

impacting both automotive OEMs and suppliers alike. North American and European light vehicle production and sales levels have reached their lowest levels in

more than a decade, while conversely Asian markets overall have reached their highest levels ever.

**2009 sales of new passenger cars in the top markets, thousands of units**



Sources: IHS Global Insight, Ernst & Young estimates  
 \*CEE: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, Turkey

In North America, severely depressed consumer demand and the bankruptcy filings by Chrysler and General Motors largely curtailed vehicle production during the second quarter of the year and sent shockwaves through the supply chain. Highly publicized bankruptcies, including Delphi, Visteon, Lear, Cooper-Standard, Metaldyne, and others, sent further ripples throughout the Tier 2 and Tier 3 supply chain. An anticipated collapse of the overall supply chain was only averted by dramatic restructuring by many suppliers as well as strong action by governments, OEMs and larger suppliers alike to get funds flowing quickly once vehicle production resumed in earnest later in the year. Historically low valuations and financial distress have led to dramatic changes in the ownership of public debt and equity amongst public automotive suppliers and OEMs.

As many European governments rolled out scrapping incentives, vehicle sales were stabilized in 2009, but are expected to fall in many markets in 2010. Scrapping programs favor small cars as the relative price advantage is higher, so sales of A- and B-segment vehicles will be hit in the near future, while sales of medium and large vehicles seem due to recover somewhat. Scrapping programs and manufacturers' incentives resulted in substantial discounts on new vehicle sales, and such incentives might become difficult for automakers to shun now that consumers have become accustomed to them, as has been the case for years in the North American market.

In contrast to the "mature" market dynamics in North America and Western Europe, Asia is collectively a net exporter of light vehicles, with output exceeding domestic sales in nearly all markets. However, while sales and production have continued to

increase in Asia in the face of the global recession, future increases will be relatively dependent on a return to growth in the North American and European markets, which will have to consume some of that increase.

For a time in 2008, Russia was the fastest growing light vehicle market in the world. That ended abruptly as economic conditions worsened, with car sales down almost 50% in 2009 compared to the year before. Improving credit conditions and soon-to-be-introduced scrapping incentives are expected to end the slide and lead to a slight recovery in Russian vehicle sales in 2010.

2009	Population, million	Passenger car parc, million	Car density (cars per 1,000 people)
UK	61.8	31.45	508
Germany	81.9	41.38	504
Poland	38.1	16.66	438
US	307.8	133.99	435
Czech Republic	10.5	4.52	435
South Korea	48.3	13.23	268
<b>Russia</b>	<b>140.9</b>	<b>32.58</b>	<b>231</b>
Brazil	198.1	23.33	119
Turkey	74.8	6.69	87
China	1,336.3	32.02	24
India	1,198.0	9.68	8

Sources: IHS Global Insight, Ernst & Young estimates

# Russian automotive industry

Being highly sensitive to the domestic economic situation, the Russian automotive industry witnessed one of the most challenging years in its history. The beginning of 2009 was especially hard for the sector, as light vehicle sales fell to half of their previous volumes and all market participants were affected.

At the beginning of 2009, in order to help ailing domestic players, the Russian Government implemented a major protectionist initiative by raising import tariffs on vehicles, while depreciating the local currency. Despite the obvious effect of limiting imports, these actions alone were not enough to substantially change the situation for local producers due to the underlying weak demand, which pushed some companies to the brink of insolvency. These difficulties led the Government to provide direct liquidity injections to struggling automakers, as their possible failures jeopardized social stability in the regions in which they were located.

By the end of 2009, as the economy finally began to come out of its skid and the Government increased its capital commitments to local producers, the situation in the Russian automotive industry largely stabilized. Key local players initiated major restructuring programs aimed at optimizing their cost structures. The Government has largely supported these programs through direct capital lending, but in order to obtain this support, manufacturers had to scale back their planned headcount reductions due to political concerns over employment levels. Although these actions were beneficial from a near-term social standpoint, such decisions may contribute to deteriorating competitiveness of the Russian automotive industry in the mid to long term, as

domestic manufacturers remain burdened by excessive labor forces and underutilized production capacity.

It should be noted, however, that the Russian automotive market suffered a more severe slump than its western neighbors, as government interventions were not undertaken immediately. Specifically, the scrapping incentives which are now widely credited for keeping western markets afloat in 2009, have not yet been introduced in Russia, though a March 2010 start to these incentives seems likely.

Overall, 2009 was a hard landing after the recent rapid growth of the local automotive industry; the difficulties have rapidly reshaped the competitive landscape in both the automotive manufacturing and distribution segments. The year saw many bankruptcies, particularly in the automotive retail segment, as many of even the largest Russian companies failed to adjust to falling demand. On a positive note, 2009 did provide a turning point for the surviving companies to address the operational inefficiencies they developed during the "easy" period of double-digit growth. Although the Russian market has now lost its European lead in sales volume, it still maintains substantial drivers for long-term momentum (low level of car density, vastly outdated car parc, extensive geography, etc.), which should enable the resumption of double-digit annual market growth in the midterm.

## Government stimulus

### Light vehicle (passenger cars and light commercial vehicles) market

Throughout 2009, the Government introduced a number of market interventions, including:

- ▶ Import duty increase on vehicles in order to replace imports with local production and protect ailing domestic manufacturers (extended in 2010)
- ▶ Subsidized interest rates on the purchase of domestically produced vehicles (extended in 2010)
- ▶ Direct subsidies and guarantees to help restructure domestic OEMs
- ▶ Relaxing the aggressive schedule of transition to Euro-4 emission standards
- ▶ Car scrapping program (to be launched in 2010)

### CV market

Apart from increased state purchases of CVs, the Russian Government provided or committed to provide financial support to strategic local CV producers by granting them loan guarantees and subsidized loans.

Several nationwide government initiatives, or special federal programs, contribute to the support of the CV market and are likely to drive Russian CV market growth in the future. Planned government budget allocations for 2009-2011 amount to RUB2.7 trillion<sup>1</sup>, of which over 60% will come from state spending aimed at the development of Russia's transportation system and development of the Far East and Trans-Baikal regions.

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<sup>1</sup> US\$88.7 billion as of 1 February 2010

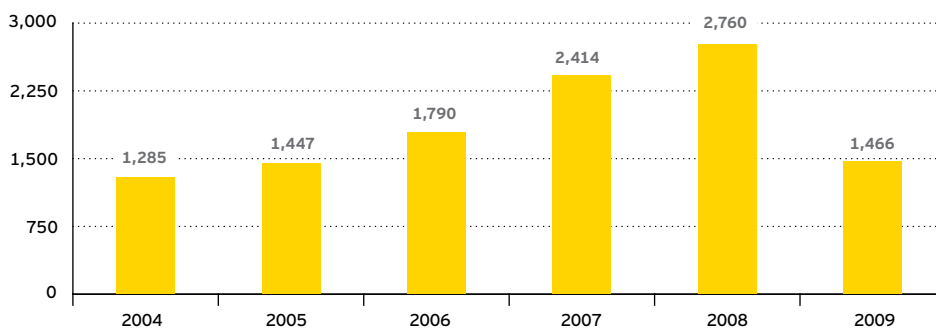
# Light vehicle market

After extensive growth during 2004-2008, the Russian light vehicle market declined by 49% in unit sales in 2009 from the previous year. In the extremely unfavorable market

situation, new light vehicle sales reached 1.47 million units. However, the market showed positive signs at the very end of the year, with an improving economy and

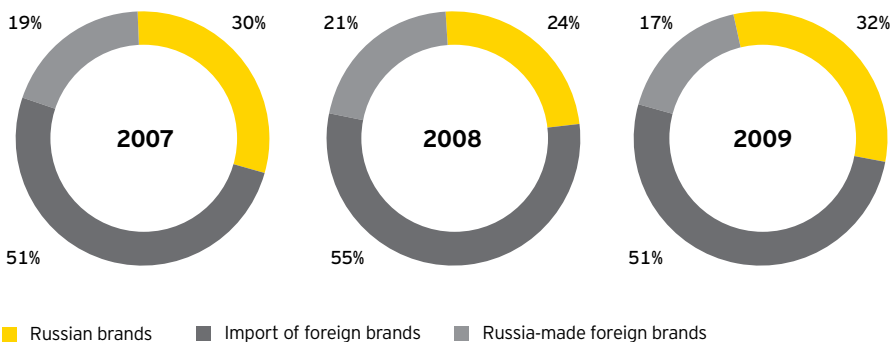
increased government support: in December 2009, sales of new light vehicles increased by 22% compared to November 2009.

## New light vehicle sales in Russia, thousands of units



Sources: ASM Holding, Avtostat

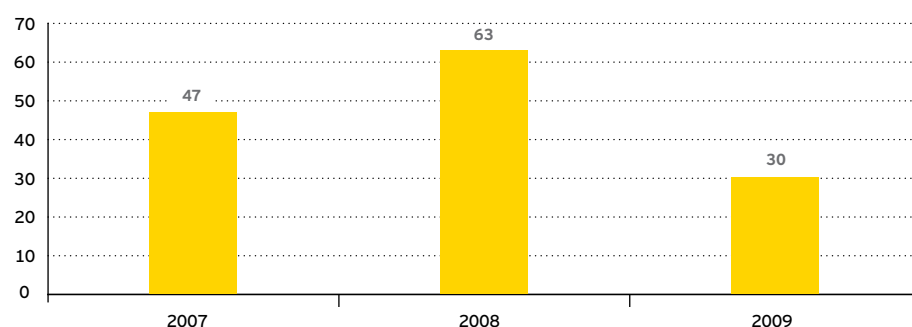
## Passenger car sales breakdown by volume, %



Sources: ASM Holding, Ernst & Young estimates

Sales of Russian brands declined slightly less than sales of foreign brands (-46% in 2009 compared to 2008), both imported and domestically produced (-51%). This was due to declining incomes (which helped make cheaper domestic models more appealing to Russian consumers), depreciation of the Russian ruble and import duty increases.

## Car market, US\$ billion

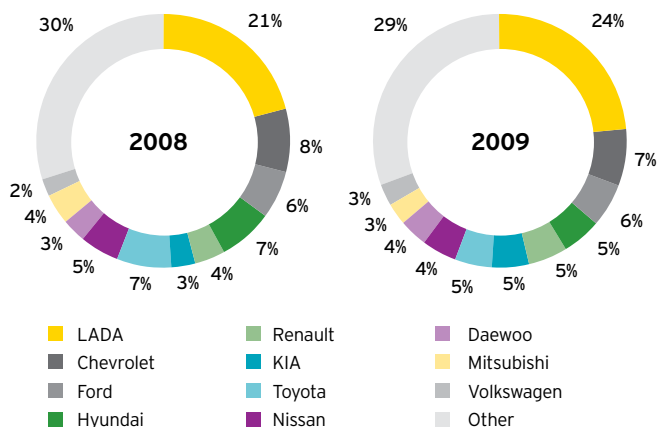


Sources: AEB, Price N, Ernst & Young estimates

Local manufacturers were hurt by the sales slide. Sales of new imported light vehicles declined by 74% in 2009, and total light vehicle production in Russia fell by 59%. Domestic brands as a share of total production fell from 59% in 2008 to 53% in 2009.

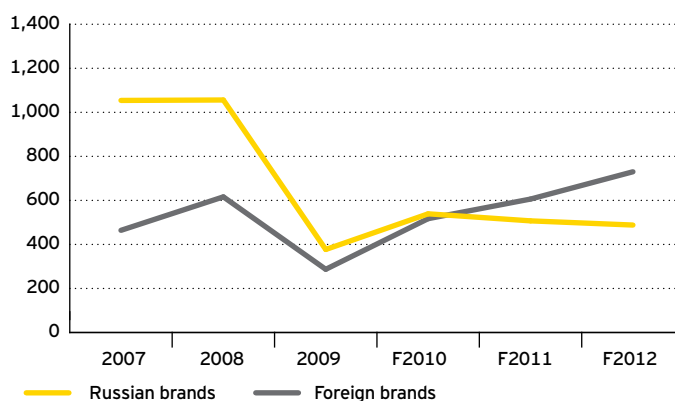


### Market share by brand in terms of volume, %



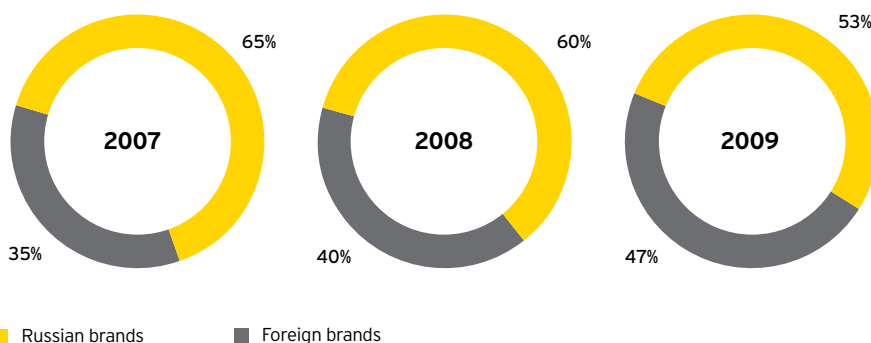
Sources: AEB, Ernst & Young estimates

### Russian light vehicle production forecast, thousands of units



Source: IHS Global Insight

### Passenger car production breakdown by volume, %



Sources: ASM Holding, Ernst & Young estimates

The following market drivers are expected to prevail in the short term:

- ▶ Government-supported initiatives including the car scrappage program, due to start in March 2010, would lead to increased sales share for the low-cost segment
- ▶ Increased import duties continue to put a significant dent in foreign-brand car sales and new imports
- ▶ As household income continues to deteriorate, more automotive retailers will focus on used vehicle sales and aftermarket service and parts sales

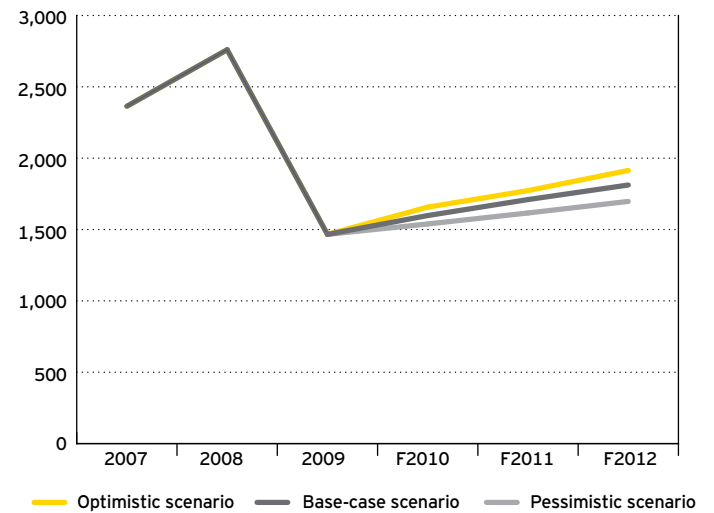
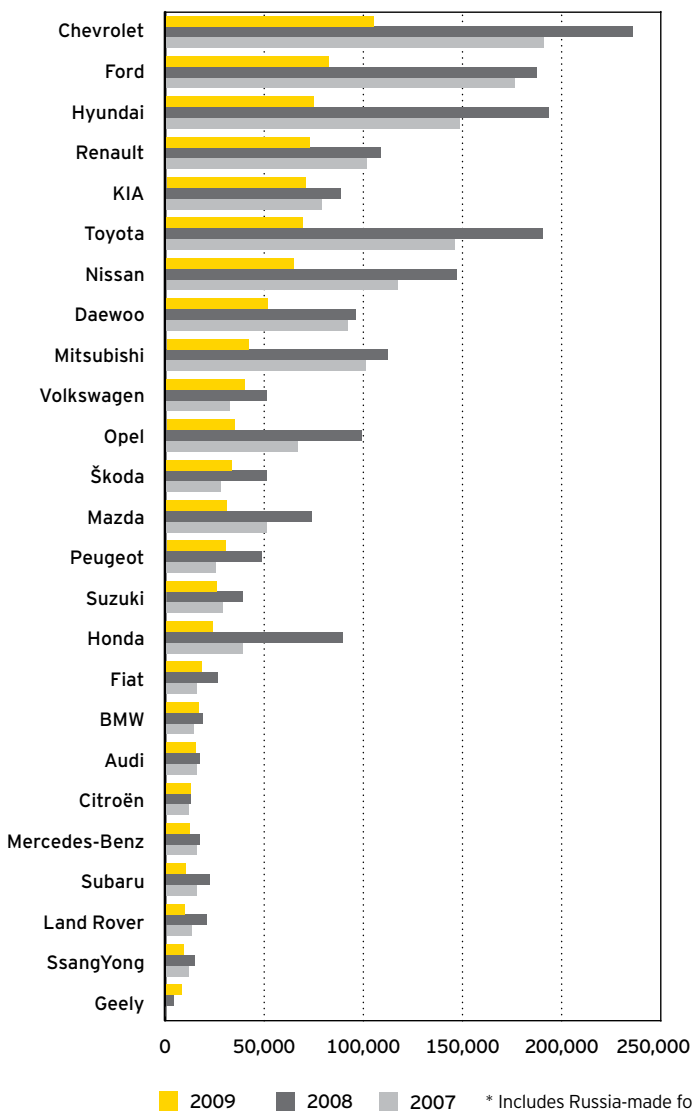
Key mid- and long-term market drivers:

- ▶ The aging car parc and relatively low car density compared to developed automotive markets bode well for future new vehicle demand
- ▶ The overall Russian economy is likely to see slow growth at best in 2010-2012, leading to a slow industry recovery that will have to be driven by consumer spending
- ▶ Several international passenger car manufacturers have announced plans to increase capacity at their existing plants or open new production facilities in Russia

We have compiled a consensus forecast of the dynamics of the light vehicle market in 2010-2012, based on projections of various international and Russian market subject-matter professionals and our market understanding. Which scenario will be played out largely depends on the overall macroeconomic situation, credit market conditions and the efficiency of government support programs.

**Sales of top 25 new foreign brands by volume\*, units**

**New light vehicle sales forecast, thousands of units**



Sources: Avtostat, AEB, J.D. Power, IHS Global Insight, Ernst & Young estimates

# CV market

Decreases in cargo shipment and passenger turnover due to weakened economic activity have significantly affected demand for CVs, especially in the construction, mining and chemical industries. Commercial vehicle sales in 2009 fell by 71% to 42.7 thousand units, and CV production decreased by 63% to 40.8 thousand units.

While the sales volumes of all market players dropped significantly, the market share of local brands grew from 57% in 2008 to 68% due to their strengthened competitive advantage as a result of several protective measures:

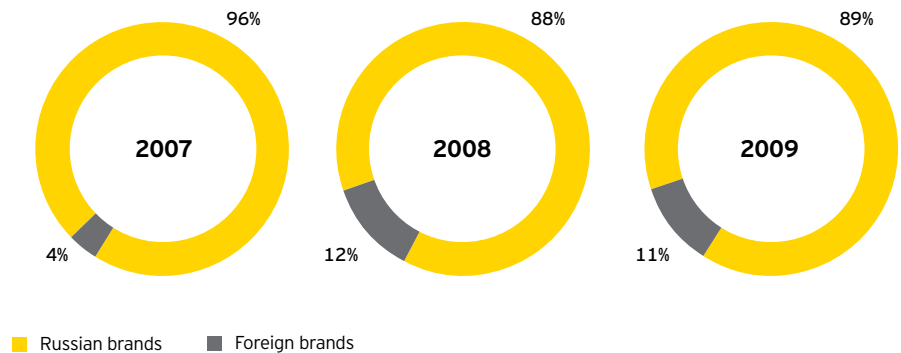
- ▶ Customs duty increase: the Russian Government imposed a 25% import duty on the majority of new heavy trucks and a prohibitive import duty on used foreign trucks older than five years (earlier import duties varied between 10% and 15%, depending on the vehicle's weight, engine size and age)
- ▶ Increased state orders: additional allocations from the federal and regional budgets for CV purchases
- ▶ In-country shifts: currency devaluation at the beginning of 2009

In the midterm these measures may have the effect of intensifying foreign manufacturers' plans to localize production. The future dynamics of the market will largely depend on the pace of economic recovery in Russia, and the volume of state orders, and the availability of loan financing and leasing.

In our optimistic scenario, we forecast that commercial vehicle sales in unit terms will rebound by 24% in 2010, and show over 50% sales growth in 2011 and 2012 due to the overall economic recovery and increased government CV purchases.

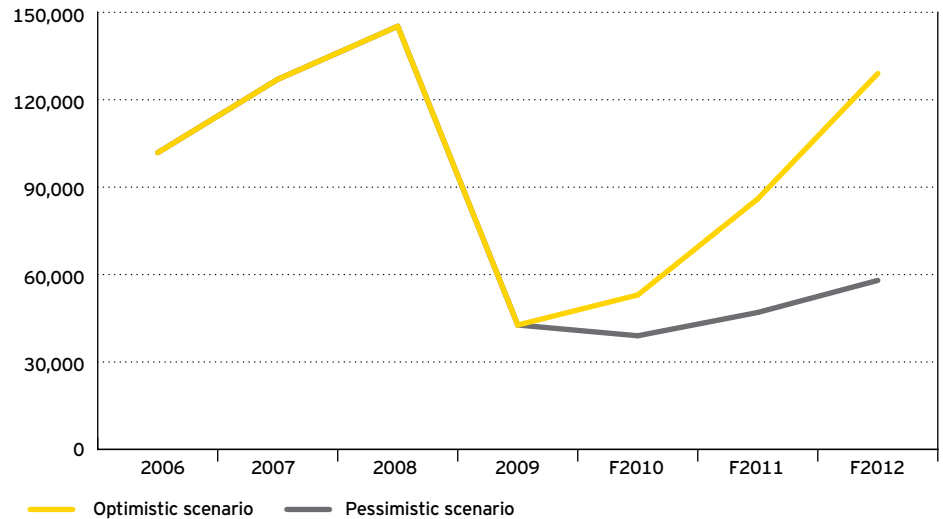
In our more pessimistic scenario, we expect that Russian CV sales will show a 9% decline in 2010 as the economy continues to stagnate, with a slower rebound in 2011 and 2012 and annual CV sales growth rates of 21% and 23%, respectively.

## CV production breakdown by volume, %



Sources: ASM Holding, Ernst & Young estimates

## New CV sales forecast, units



Sources: J.D. Power, IHS Global Insight, Ernst & Young estimates

# Automotive components market

While 2009 was a challenging year for automotive OEMs in Russia, it was even tougher for suppliers and aftermarket producers. The light vehicle production decrease of 59% dealt a blow to component demand, and even the sizeable aging car parc was not enough to ensure a stable aftermarket in the face of such economic turmoil. Spare parts sales were down 15% as well, triggered by the more frugal use of certain vehicles.

The major Russian OEMs managed to restructure their debts with government support. However, most independent suppliers did not receive such state support, and with much lower demand from OEMs, a number of them are on the brink of bankruptcy. Making interest payments and maintaining sufficient working capital remain major issues for most domestic component manufacturers.

As outlined previously, most Russian suppliers are still highly dependent on domestic OEMs and vice versa. At the same time, they are generally not yet competitive enough to meet the high requirements of global OEMs, which have started slowly ramping up vehicle production in Russia and are very interested in localizing sourcing. New OEMs in Russia will have to invest a lot of time and effort in developing their local supplier base, despite the high educational and technical level of the suppliers' current workforce.

Global OEMs are also interested in seeing their traditional Tier-1 and Tier-2 partners follow them as they enter the Russian market. Nevertheless, insufficient production volumes remain a major hurdle for most global suppliers who consider that sort of investment in new facilities. As a result, cooperation with established Russian suppliers will be the dominant avenue for the near-term development of the automotive component supply base. Few global suppliers have invested in their own greenfield operations in Russia, as the majority that have entered the market have decided to partner with local players to take advantage of existing workforce and infrastructure and, in certain cases, enhanced OEM and aftermarket access. Russian suppliers participating in these arrangements can benefit from access to global automotive know-how and technology transfer as well as improved quality and process management systems.

The challenging economic environment has created a number of transaction opportunities in the automotive supplier marketplace that would have previously been impossible. Russian companies that appeared confident and tough to negotiate with before the downturn are currently more amenable to selling or sharing high-quality assets and market access in return for financial and technological support. Furthermore, the credit crunch has accelerated the process of restructuring the highly vertically integrated Russian OEMs, and as a result, a number of carved-out component businesses are likely to emerge in 2010.

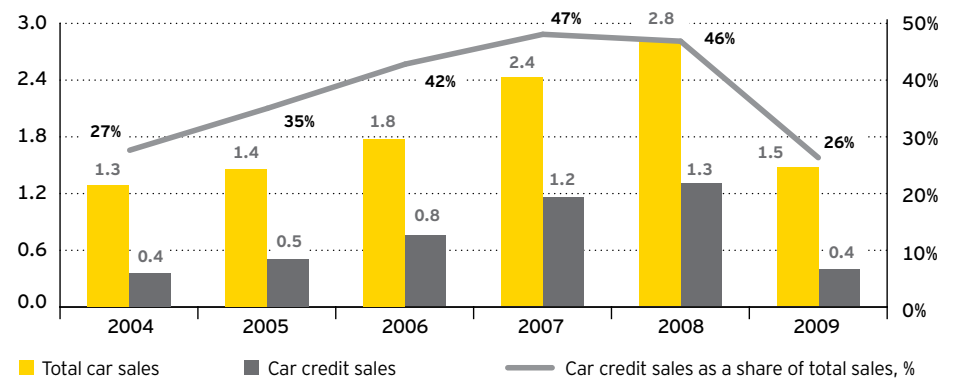




# Passenger car loan market

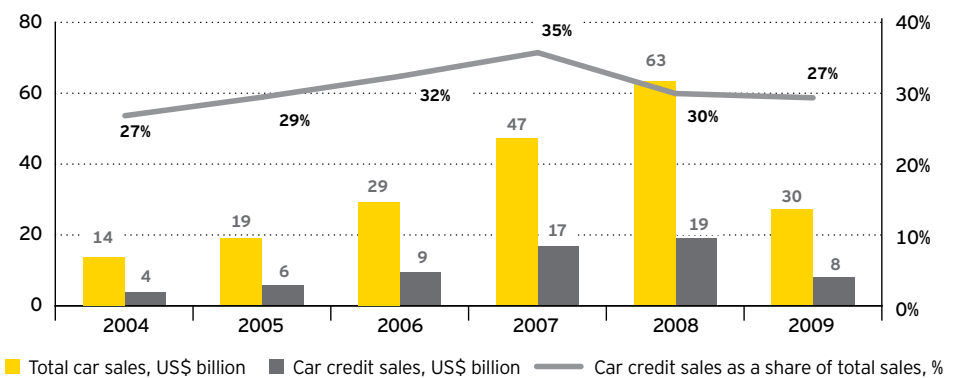
In 2009, sales of passenger cars on credit amounted to 387,300 units, a decrease of 69.3% from 2008. At the start of 2009, credit sales fell dramatically due to the high liquidity risk faced by banks and increases in their cost of funding. The situation improved in the middle of the year after the Government began subsidizing lower interest rates on car loans. Sales in the second half of the year were supported by slight increases in purchasing power and improving bank liquidity. As a result, credit sales as a share of total sales in 2009 exceeded market forecasts and accounted for 26% of total light vehicle unit sales (though this was still down substantially from 46% in 2008). For 2009 as a whole, credit sales under the government program to subsidize interest rates on car loans amounted to approximately 71,500 units, or 18.4% of total credit sales.

**Passenger car credit sales in Russia, millions of units and share of total sales**



Sources: AEB, Avtostat, CBR, Price N, RBC, ROAD, Ernst & Young estimates

**Passenger car credit sales in Russia, financial value and share of total value**



Sources: AEB, Avtostat, CBR, Price N, RBC, ROAD, Ernst & Young estimates



# Dealership networks

Despite steady development towards a mature, transparent dealership scheme, the typical Russian dealership structure still exhibits several differences from its western counterparts. Chief among these differences is the fact that new car sales still remain the main source of revenue for a typical Russian dealer, while service and used vehicle sales are secondary.

Typical Russian dealers, who geared their businesses around rapid market growth, were hit hard by the subsequent slump in new car sales in 2009. Burdened by capital expenditures to fund recent expansion and personnel sized for sales predicted at double the recession levels, many Russian dealerships struggled to withstand the initial impact of the crisis and were forced to reconsider their capital structure in order to

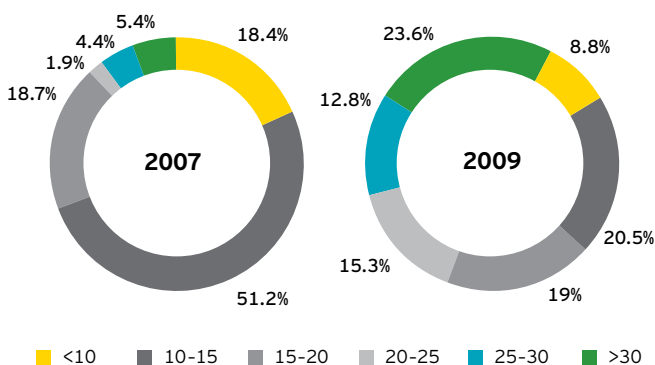
maintain operations. Predictably, only a few have managed to successfully restructure their debts. Aggravating this situation, some of the key international OEMs have revisited their dealership contracts, further eroding margins and taking out liquidity. This has caused a wave of insolvencies as even some of the largest Russian dealers failed to remain solvent in the face of tough market conditions.

However, some of these situations have created market opportunities for the stronger players who have managed to quickly optimize their cost structure and adapt to new market conditions. Such companies, both local and international, were ideally positioned to seize market share from their ailing competitors and are positioned to reap more benefits in the

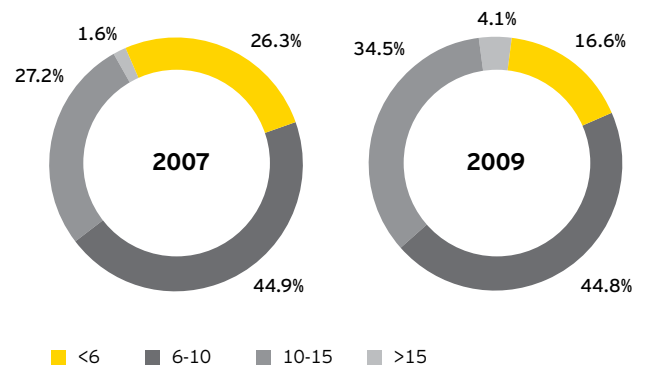
midterm as the market resumes its growth. The Russian new vehicle dealership industry was substantially reshaped in 2009 in terms of competitive landscape and operational structure. Most of the dealers who were able to survive are shifting away from the old profitability model, which relied heavily on new car sales, and are actively moving to a more mature state by focusing on other profit centers. Regional expansion, which was seen as one of the main trends in previous years, mostly stopped (with some exceptions) as dealers re-adjusted their market expectations. However, in the midterm, low car density in some Russian regions will continue to provide solid impetus for further geographic expansion of dealerships as the market starts to recoup.

## Car sales per price segment, thousands of US\$

Foreign brands



Russian brands



Sources: AEB, Price N, Ernst & Young estimates



# Automotive logistics

Quite unlike the rest of Europe and North America, Russia's railroad transport system exceeds its road transport network by approximately 10 times due to the country's size and historic focus on rail transport. Another important mode of transport in Russia is shipping, with great use being made by the automotive industry of the advanced seaports in such places as St. Petersburg and Kaliningrad. The heightened importance of the railroad and individual seaports requires accurate and sophisticated logistics processes at these bottlenecks.

The global economic and automotive downturn has had a significant impact on automotive logistics. In the past, economic growth and increasing industrial globalization drove logistics providers to continuously increase their capacities. This is not the case any more, with the sharp downturn of Russian vehicle production (along with decreased imports) leading to substantial overcapacity in the local automotive logistics sector.

While the far-flung distribution of vehicles throughout the country offers some tolerance for logistics companies to utilize their capacities, automotive manufacturers' vehicle production supply chains require a robust and seamless supply of components. This gives logistics companies only limited possibilities to optimize their assets; failing to do so could negatively impact their profitability. Smaller local logistics companies are hit hardest due to their limited geographic focus and higher dependency on individual customers. Due to the challenging market environment, logistics providers, like others in the industry, have launched initiatives focusing on cost cutting, restructuring and process optimization to help increase their capacity utilization and profitability.

Recovering automotive demand in Russia will offer future growth potential for large international logistics companies focusing on inbound and outbound logistics, and for smaller local companies concentrating on the automotive industry's demands and leveraging their local experience, presence and flexibility. These factors will allow automotive companies in Russia to choose their logistics service providers on a case-by-case basis to fit their specific needs.

# CIS automotive markets

## Ukraine

### Market characteristics

- ▶ Since 2009, Ukraine and its main trading partner, Russia, have suffered from the global downturn to a similar degree. Vehicle sales plummeted approximately 70%, and no scrapping program, which could have slowed the downswing, has been implemented. Likewise, vehicle production was affected by weakened demand and declined by 80%. The CV segment has experienced a similar decline.
- ▶ Prior to the current slump, the Ukrainian car market had grown at a fast pace over the last few years and still promises high long-term growth potential in view of the country's vast population, below-average car density compared to neighboring countries and an aging car parc.

- ▶ UkrAVTO is the largest domestic car manufacturer and produces vehicles in cooperation with Russian AvtoVAZ, Daimler, GM, Chery and others. AvtoKrAZ is the sole Ukrainian manufacturer of heavy commercial vehicles, with a high volume of exports.
- ▶ For years AvtoVAZ's Lada has been the best-selling brand in the car market.

### Investment attractiveness

- ▶ Compared to more advanced new EU member states, Ukraine still maintains the competitive advantage of being a relatively low-cost country. Accordingly, some automotive players reacted to increasing salary levels in countries such as Poland and Hungary by relocating their labor-intensive production to Ukraine.
- ▶ In addition, Ukraine is a natural gateway to the auto markets of Russia and

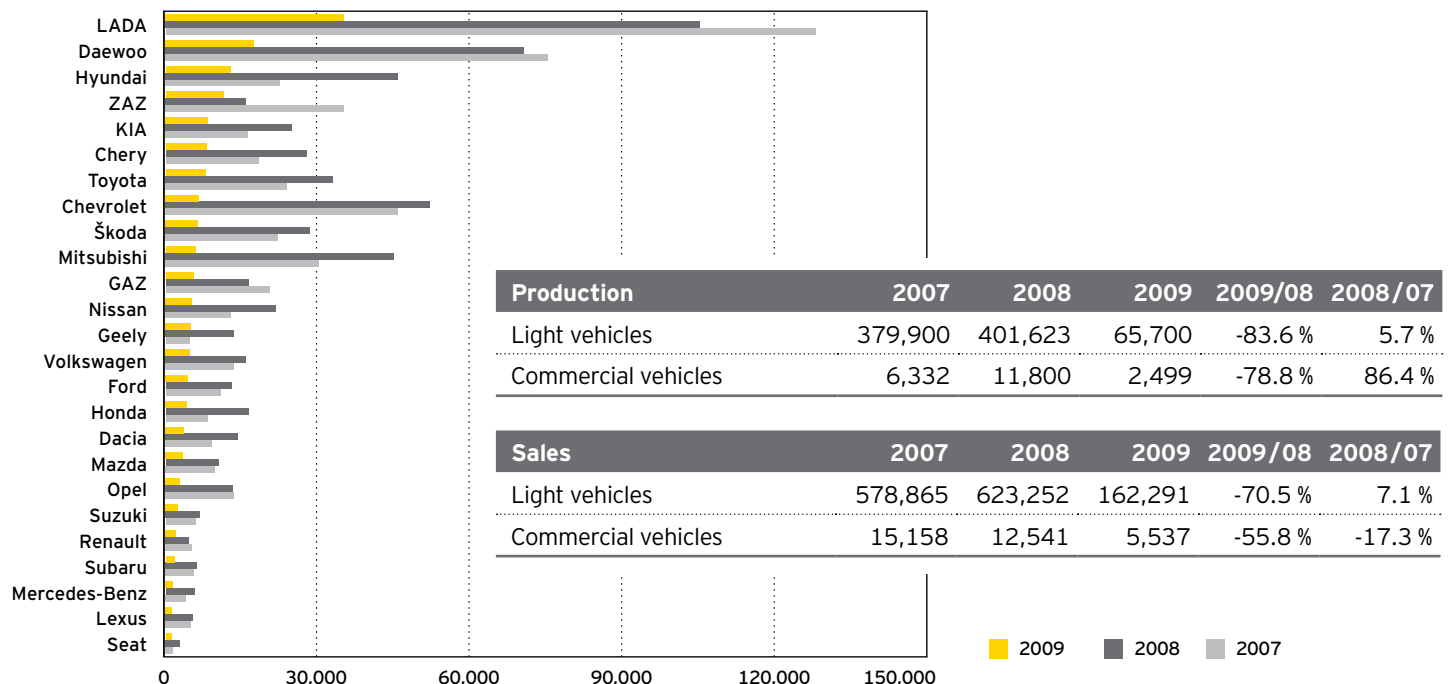
Central Asia, and investors benefit from duty-free exports to other CIS countries.

- ▶ The country aspires to EU membership and joined the World Trade Organization in 2008. Accordingly, import barriers have been lowered for second-hand vehicles. However, in the current turbulent economic environment, protectionist measures have been strengthened again.

### Outlook

Slow automotive market growth in Ukraine is expected in 2010 as the local economy slowly recovers.

### Sales of top new light vehicles in Ukraine, units



Sources: IHS Global Insight, ASM Holding



# Kazakhstan

## Market characteristics

- ▶ Kazakhstan, with an area of over 2 million square kilometers, is one of the world's 10 largest countries in terms of area. Accordingly, means of transportation are of key importance, particularly in the CV segment.
- ▶ Private car purchases have gained in importance recently as rising oil demand in Russia and the rest of Central Asia has led to increased real income for the population of Kazakhstan. Though the car density in Kazakhstan is far below the global average, it is significant for Central Asia.
- ▶ Like the rest of the CIS, Kazakhstan's automotive demand has suffered since the global economic crisis began. Local vehicle production plummeted over 77% in 2009. Sales declined by 23% for light vehicles and were down 54% for CVs.

- ▶ The country is a clear net vehicle importer, as the domestic production level is marginal. Over 90% of vehicles are imported from either Russia or Uzbekistan. Imports from other regions are less common due to pricing issues and the low availability of parts.
- ▶ "Grey" second-hand vehicle imports account for more than half of all car sales. In order to stem this activity and improve air quality, Euro 2 standards are currently required for imports and the level will be raised to Euro 3 in 2011.
- ▶ AZIA AVTO is the domestic assembler affiliated with the Russian car manufacturer and market leader AvtoVAZ. The company already has alliances with Škoda, GM and KIA. Moreover, AZIA AVTO plans to form a joint venture with the Russian car maker Sollers.
- ▶ KAMAZ, the Russian commercial vehicle manufacturer, has assembly facilities in Kazakhstan.

## Investment attractiveness

- ▶ Kazakhstan is the wealthiest state and best-performing economy in Central Asia. This makes the country an attractive trading partner for foreign investors.
- ▶ However, Kazakhstan's substantial raw material deposits are the origin of its prosperity, and that makes the country reliant on the success of its energy exports. The Kazakh Government is conscious of this interdependence and is working to develop other industrial sectors.
- ▶ Kazakhstan joined a customs union with Belarus and Russia in order to facilitate trade, as this will result in the Russian import tariff being cut by 1%. This should broadly increase business activity within the Union. The agreement went into effect at the beginning of 2010.

## Outlook

- ▶ Forecast figures for Kazakhstan promise a slight improvement in 2010, as the economy of Central Asia overall is expected to recover.
- ▶ The country will benefit from the new customs union as its viable export market area is broadened.

Production	2007	2008	E2009	2009/08	2008/07
Light vehicles	6,290	3,271	734	-77.6%	-48%
Commercial vehicles	2,299	1,898	512	-73.0%	-17.4%

Sales	2007	2008	E2009	2009/08	2008/07
Light vehicles	41,478	44,500	34,281	-23.0%	7.3%
Commercial vehicles	10,119	9,912	4,501	-54.6%	-2%

Source: IHS Global Insight



# Belarus

## Market characteristics

- ▶ Despite its small population, Belarus is almost equal to Kazakhstan in terms of car sales and has the highest vehicle density among CIS members.
- ▶ Belarus is home to one of the leading heavy CV producers in the former Soviet Union, the state-owned Minsk Automobile Plant (MAZ). The brand holds a market share of about 20% in the Russian CV market.

## Investment attractiveness

- ▶ Belarus has not yet been a target for foreign investment in the automotive sector, but the Government is working on plans to modernize the sector in order to catch up with the global automotive industry. In 2008, plans

were announced that MAZ would get involved in light vehicle production as well.

- ▶ The economy is still mainly state-controlled, but the Government is showing signs of openness.
- ▶ The most important trading partner for Belarus is Russia. But Belarus also shares a border with new EU member states, and business activities with these countries account for 33% of the country's foreign trade.
- ▶ Belarus recently joined the new customs union with Kazakhstan and Russia, which may increase its business with both countries.
- ▶ MAZ has plans for further expansion. MAZ trucks are to be assembled in Venezuela for export to Brazil. The company is also negotiating with several African states and has new agreements in place with Azerbaijan

and Vietnam in addition to existing alliances in Uzbekistan and Kazakhstan. MAZ is also considering investing in Pakistan and launching exports to the United Arab Emirates (UAE) and other parts of Africa.

## Outlook

The forecast of CV production in Belarus is for renewed solid growth in 2010, continuing for the next few years.

Production	2007	2008	2009	2009/08	2008/07
Light vehicles	232	240	161	-32.9%	3.4%
Commercial vehicles	25,548	26,291	11,457	-56.4%	-2.9%

Sales	2007	2008	E2009	2009/08	2008/07
Light vehicles	25,039	34,806	23,341	-32.9%	39%
Commercial vehicles	25,368	26,480	10,533	-60.2%	4.4%

Sources: IHS Global Insight, ASM Holding



# Uzbekistan

## Market characteristics

- ▶ Uzbekistan's car parc and density are far below the level of its neighbor Kazakhstan, although Uzbekistan has a larger population (27 million people). However, its economy has still to catch up with its larger lower-density neighbor.
- ▶ Despite the global downturn, new car sales in Uzbekistan increased slightly in 2009 and are expected to continue to grow in 2010. The same trend can be noted for car production. In the CV segment, however, Uzbekistan's production was down in 2009.

## Investment attractiveness

- ▶ Uzbekistan's investment attractiveness lies in its role as a vehicle exporter, as the country is the largest vehicle manufacturer in Central Asia.

- ▶ In line with the creation of GM Uzbekistan in 2007, the Government implemented an expansion program in order to build up the automotive sector. Under this program, component suppliers were exempted from VAT and profit tax.
- ▶ The main consumption market for the output of this sole Uzbek light vehicle producer is Russia. But as that key trading partner grapples with the effects of the global downturn, GM Uzbekistan is being forced to expand its sales radius.
- ▶ Thus, Uzavtosanoat, the domestic joint venture partner of GM Uzbekistan, recently began exploring new business opportunities.
- ▶ Recently, GM Uzbekistan announced plans to enter new markets in North Africa, South America and Afghanistan in 2010.
- ▶ Uzavtosanoat founded a joint venture with the South Korean automotive supplier Chasys. Initially, the new factory intends to supply GM Uzbekistan with advanced lighting, but other components may follow.

- ▶ In order to strengthen the domestic transport sector, Uzavtosanoat also established a 49/51 joint venture with MAN at the end of 2009 for the assembly of 500-1,000 heavy commercial vehicles per year.
- ▶ Other foreign players are finding their way into the country, despite a lack of market liberalization and an unstable regulatory environment. EvoBus GmbH, a subsidiary of Daimler representing the bus segment, and MCV Commercial Egypt planned to establish bus production in Uzbekistan as of the end of 2009.

## Outlook

- ▶ The economy of Uzbekistan is growing, and the nascent automotive industry remained quite resilient during the global downturn. Uzbekistan can function as a supply hub for Central Asia, which is expected to recover from the global crisis in 2010.
- ▶ It is a positive sign that Uzavtosanoat took several steps to lessen its dependence on the Russian market and focus more on other markets.

Production	2007	2008	2009	2009/08	2008/07
Light vehicles	171,809	195,038	205,011	5.1%	13.5%
Commercial vehicles	-	-	-		

Sales	2007	2008	E2009	2009/08	2008/07
Light vehicles	53,496	56,496	60,612	7.3%	5.6%
Commercial vehicles	4,632	4,404	2,589	-41.2%	-4.9%

Sources: IHS Global Insight, ASM Holding



# Ernst & Young's involvement in the automotive industry

As a leading professional services provider in the automotive sector, Ernst & Young has been at the forefront in advising on the pressing challenges faced by industry players.

Today, we have over 144,000 people in 140 countries. Ernst & Young's Automotive practice includes over 7,000 professionals, serving more than 1,000 automotive clients.

Our CIS Automotive group, supported by the network of Ernst & Young's Global Automotive Center, provides consistent and high-quality service to our automotive clients in the CIS.

## Our clients

Globally, Ernst & Young provides assurance, tax, transactions and advisory services to many of the world's leading automotive businesses:

- ▶ Ernst & Young is the №1 auditor of automotive companies in the 2008 Forbes Global 2000 in terms of the number of companies audited (30.9%).
- ▶ Ernst & Young is the leading Big Four auditor of the 2008 *Automotive News'* Top Global Vehicle Manufacturers in terms of companies audited – 12 out of 49 companies (23.8%).
- ▶ Ernst & Young audits the greatest number (5) of the top 10 companies on the 2008 *Automotive News'* Top Global OEM Suppliers list.

With the opening of our Moscow office in 1989, we were the first professional services organization to establish operations in the CIS. We currently have over 3,400 people working in Moscow, St. Petersburg, Novosibirsk, Ekaterinburg, Togliatti, Yuzhno-Sakhalinsk, Almaty, Astana, Atyrau, Baku, Kyiv, Donetsk, Tashkent, Minsk, Yerevan and Tbilisi.

## Our involvement in the CIS automotive industry

We have a strong commitment to the automotive industry, with a focus on developing long-term relationships with the people and organizations who will make this industry grow:

- ▶ We chair the Automotive Components Committee (ACC) of the Association of European Businesses (AEB) in the Russian Federation, the major lobbying body of foreign suppliers in the country.
- ▶ We are an active member of the Association of Russian Automotive Dealers (ROAD).
- ▶ We produce the bi-annual Dealership Satisfaction Index Survey in Russia.

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# List of acronyms and initialisms

<b>AEB</b>	Association of European Business
<b>CBR</b>	Central Bank of Russia
<b>CEE</b>	Central and Eastern Europe
<b>CIS</b>	Commonwealth of Independent States
<b>CV</b>	Commercial vehicle
<b>EU</b>	European Union
<b>GDP</b>	Gross Domestic Product
<b>GM</b>	General Motors
<b>Light Vehicles</b>	Passenger cars and light commercial vehicles (below 3.5 tons, with several exceptions reaching the highest range of 6 tons)
<b>OEM</b>	Original Equipment Manufacturer
<b>RBC</b>	RosBusinessConsulting
<b>RF</b>	Russian Federation
<b>ROAD</b>	Association of Russian Automotive Dealers
<b>Tier 1</b>	First-level direct supplier to OEMs and aftermarket
<b>Tier 2</b>	Second-level supplier to Tier-1 and OEMs
<b>Tier 3</b>	Third-level supplier to Tier-1 and Tier-2 component manufacturers
<b>VAT</b>	Value Added Tax

**About Ernst & Young**

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