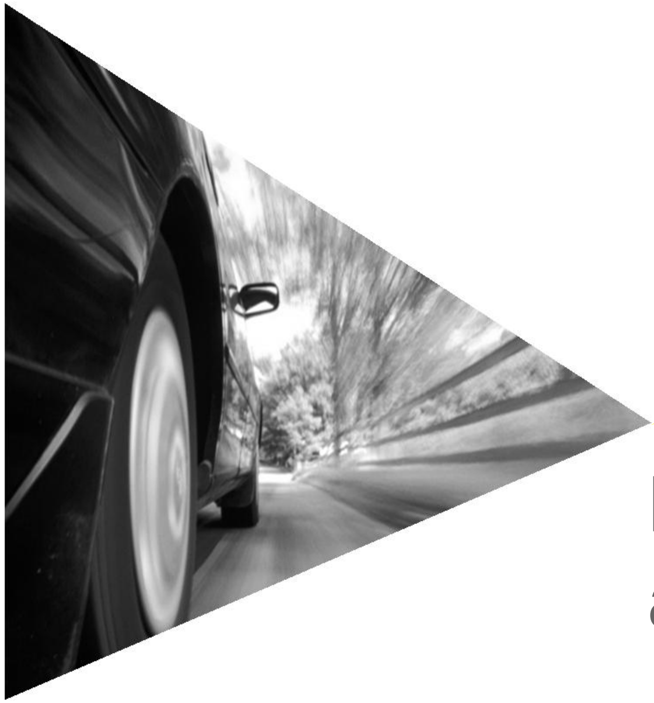


Localization in the Russian automotive industry

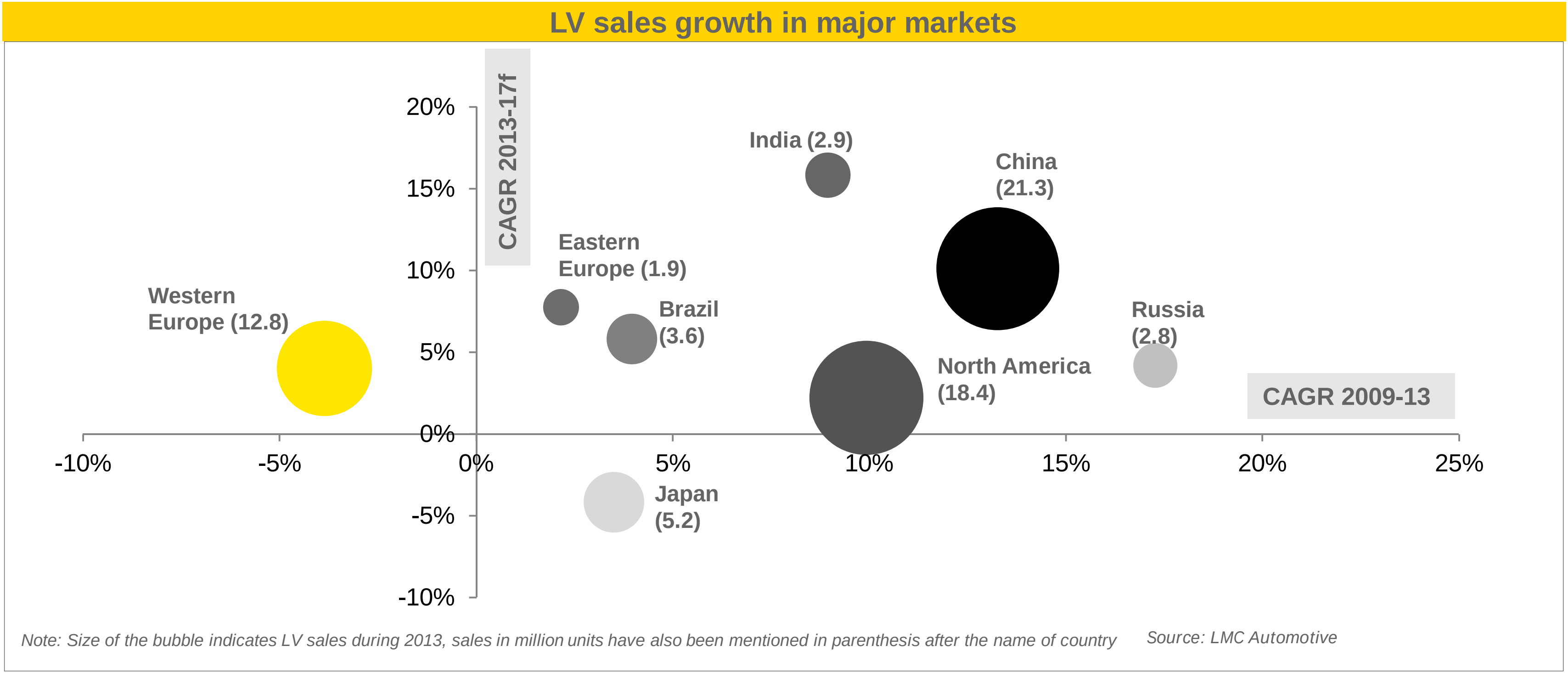
Andrey Tomyshev
Head of the Automotive Group in the CIS

1 July 2014

EY
Building a better working world

Context - Global automotive market outlook

Global LV sales growth is estimated to be driven by BRICS market

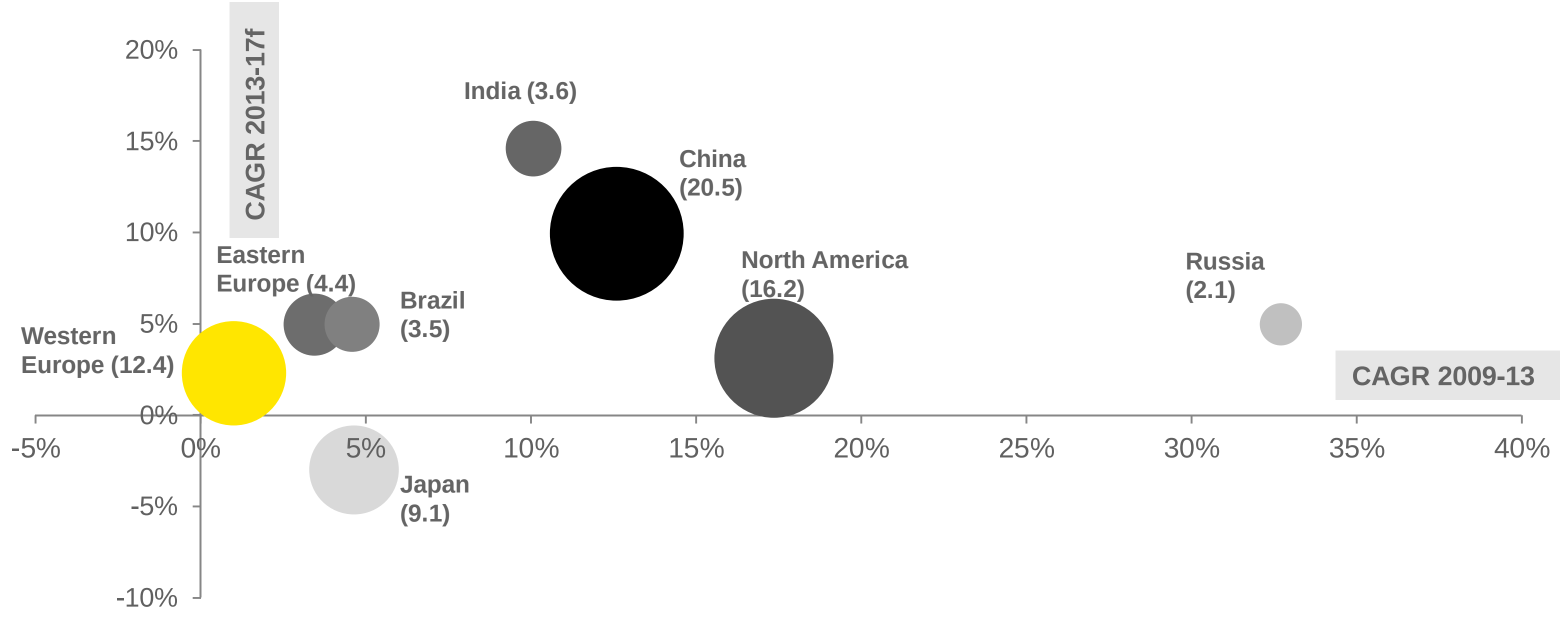


Markets offering growth over the next few years:

- **North America:** growth anticipated in the near term; SUVs and pickup trucks outpacing the overall market growth
- **Brazil, China and India:** short-term slowdown in growth (restrictions on car sales in China and return of IPI tax in Brazil in 2014); however, medium-term growth story still intact; SUVs (especially in the interior regions and lower tier cities) to witness uptake in China
- **Russia**: sales decline, nevertheless, premium brands, Chinese brands and SUVs, both budget and premium models, witnessing growth; rising middle class, considerable age of park and low car density to drive growth in the long term.

Over the next few years Europe is estimated to witness higher production growth than in 2009-13

LV production growth in major markets



Note: Size of the bubble indicates LV production during 2013, production in million units have also been mentioned in parenthesis after the name of country

Markets offering growth over the next few years:

- **North America**: production of G segment (sports) cars and vans to grow fastly
- **Brazil:** production of SUVs and A segment (Basic) cars;
- **China, India:** production of SUVs and large-plus cars to witness highest growth;
- **Russia:** while for Russia production of Pick-up and C segment (Compact) cars to witness highest growth

*Period under consideration for the growth forecast: 2013-17 Source: LMC Automotive

Russian passenger car and automotive component market

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The Russian Automotive Industry at a glance…still a dynamic and high potential market for the global automotive industry

1. **114 vehicle programs** produced locally by **22** OEMs.
2. More than **twenty vehicle assembly plants** are currently operating in Russia with a total capacity of **2.8 m** units p.a. growing to over 3 m units m by 2020
3. Nearly **100** global OES are on shore, many of them with multiple operating locations.
4. About **600 local suppliers** are currently operating.
5. Over **4 200 car dealer** sales and service network.
6. Total car park of over **37 m** vehicles.
7. Car density at 306 vehicles per 1,000 population
8. Average age of car park at 11.5 years

Sources: IHS Global Insight; AUTOSTAT, EY Research.

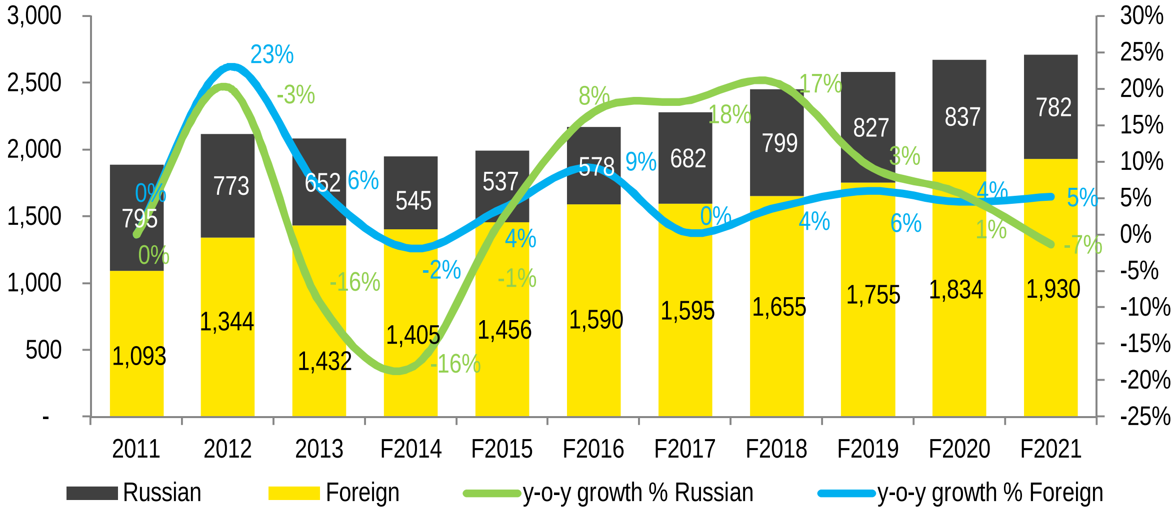
Automobiles output in Russia will grow in the long-term

- **2013 and 2014** are marked by **decrease** of output

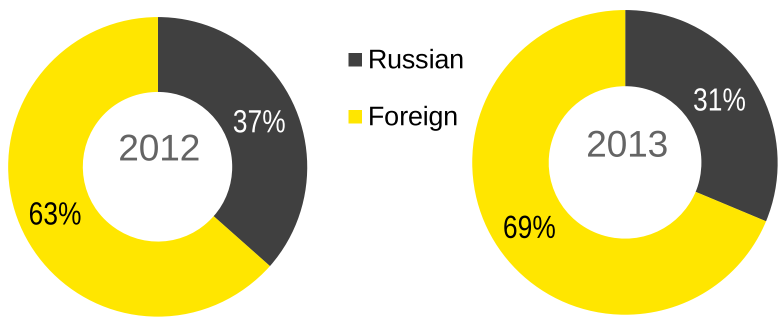
Stops of plants in 2014	
UAZ	Feb.-Mar.
AVTOVAZ	April
Ford Sollers	April-June
Nissan	2q14 (2 shifts instead of 3)

- **Long-term prospects are positive**:
  - Growth of car sales (>3m units by 2020)
  - New production facilities
  - Product range extensions
  - Government's 2020 Development Strategy
  - Supportive trade policies within constraints of WTO

LV, LCV production in Russia, historical and forecast data ('000 units)



Growth Car production breakdown, 2013 VS 2012

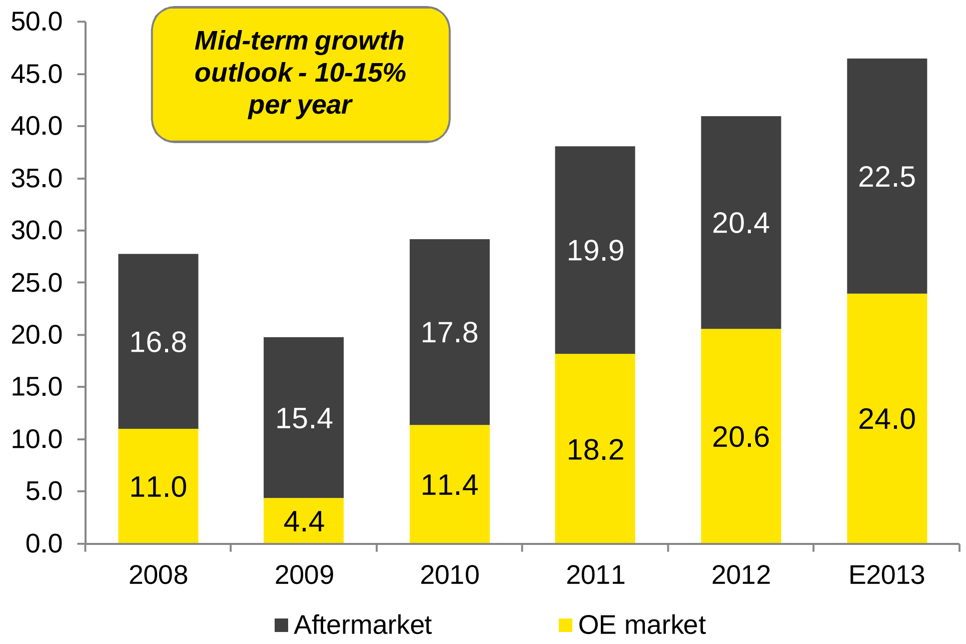


Sources: ASM Holding, LMC Automotive , EY estimates

Component market has also promising outlook

- The Russian component market is underdeveloped
- Outlook is promising due to number of factors:
  - Countries with annual car sales of 2-3 m are regarded as perspective by component producers
  - Localization of automotive production pushed by D166 and D566 decrees
  - Outsourcing of components production by Russian OEMs
  - Growth of used cars market
  - Growth of foreign brands in total fleet
  - Technological improvement and growth of price of the Russian brands
- Counterfeit imports are likely to remain a significant concern for the OEM's and OES'

Russian automotive component market, US$ bn



Sources: AUTOSTAT, EY Estimates

Localization in Russian automotive industry

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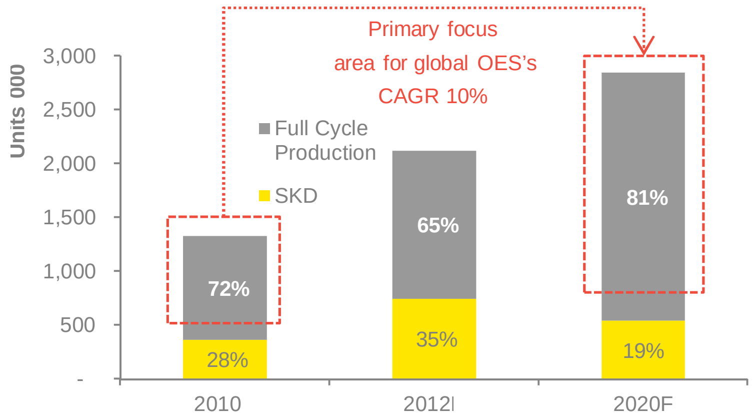
Localization and transition from SKD to full-cycle production – a robust supplier base is a key to success

- **SKD assembly** increased steadily to **35%** by the end 2012 as global OEMs entered the market and local OEMs production declined
- However, as OEMs strive to meet their localization commitments under D166, the **trend is expected to reverse to drive SKD down**
- A long-term increase in **full-cycle foreign brand production** is inevitable

SKD vs Full Cycle production forecast



Localization plans of global OEMs

OEM	Current level	Target (2015-2018)
Avtoframos	75%	80%
Hyundai	47%	No data
VW (with GAZ facilities)	42%	60%
Ford Sollers	37%	60%
PSMA	33-36%	46%
Nissan	34%	45%
GM	26% (51% with GM-AVTOVAZ)	60%
Toyota	15%	30%
Avtotor	15%	48%

As OEMs localize production and are moving towards full-cycle production from SKD, *OESs will have to quickly gain footprint in Russia* through partnerships or stand-alone operations

Source: LMC Automotive, AUTOSTAT, EY analysis
Note: SKD vs Full-cycle production do not add up to total vehicle production due to a number of facilities with unspecified scope of operations (less than 8% per year) .

About 100 global automotive suppliers are on shore representing ¼ of total number of players

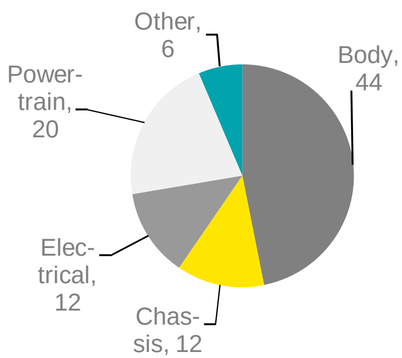
Body and powertrain are primary localization segments

- Among **the first OESs** entered Russian market were producers of large parts with low volumes and margins (**seats, interior elements, bumpers, lighting**)
- On opening of new assembly facilities and approaching localization checkpoint terms, **body** stamping became the primary localization segment (**2009-2013**)
- After introduction of **new industrial assembly** regime in **2011** (decrees signed by VW, Ford Sollers, AVTOVAZ-Renault-Nissan-IzhAvto and KAMAZ-Mercedes) focus on complex parts will be increasing – **powertrain, engines**
- Now up to **20 new OES plants** are in the pipeline, including expansion plans at existing facilities
- **OEMs** which signed new industrial assembly decrees in 2011 will also invest in construction of **engines plans** (VW, Ford Sollers)

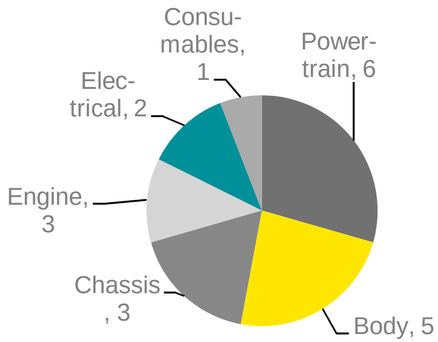
As OEMs localize production and OESs expand capacities, they will need for capable lower tier local component suppliers, *<u>however there have been significant challenges in sourcing such suppliers in Russia</u>*

Note: AUTOSTAT, publicly announced vehicle programs

<u>Localized international suppliers by component category</u>



<u>Planned plants by segment</u>



<u>Examples of automotive component projects:</u>

- *New cluster in Moscow Region to produce seats, tires, bumpers and driving wheels for Renault, PSMA, VW (EUR1 bn)*
- *AVTOTOR – 15 component factories in Kaliningrad region (EUR2.6 bn)*
- *VW and Ford Sollers - new engine plants in Kaluga and Elabuga*
- *GAZ – transmissions, axles and other parts for Mercedes-Benz Sprinter Classic in Nizhniy Novgorod*
- *Nissan – suppliers park in Leningrad region*
- *Toyota – body stamping and plastic parts in Leningrad region (EUR60 m)*
- *Derways – key components assembly in the Caucasus (EUR35 m)*
- *AZ Powertrain and AVTEC Ltd. – PSA engines for Chevrolet Niva in Togliatty*
- *Coşkunöz – body stamping for Ford Sollers in Elabuga (EUR50 m)*
- *Magna – plant in Naberezhnie Chelny (potential supplies to Ford Sollers)*

Key challenges and key stakeholders in the localization process

Key challenges are in sourcing of lower tier local suppliers meeting global QCD standards

- Insufficient scale of operations of local suppliers
- Lack of investment in R&D, plant, technology
- No experience in modern management disciplines
- Low quality demonstrated by local suppliers

Majority of local manufacturers are unable to meet global QCD standards

Among all stakeholders lower tier OESs are the missing link

- Consumers
- Government
- OEMs
- Tier 1 OESs
- Tier 2- Tier n OESs
- Raw materials suppliers

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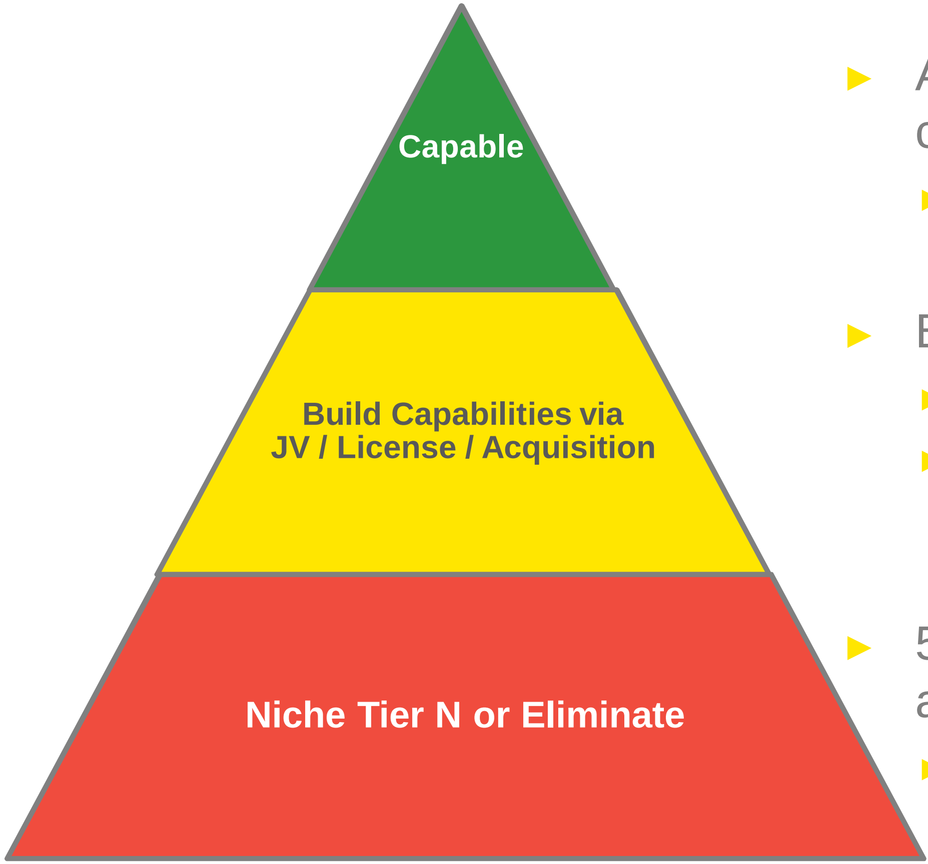
Perhaps consolidation of the legacy Russian supply base of approximately 600 suppliers can address the challenge…



- A dozen are capable or building capabilities
  - likely to survive on stand alone basis
- Between 35-60 need a partner
  - JV, license, acquisition
  - Some potential for consolidation within commodity
- 500 plus become Tier N or will go away
  - Largest potential for consolidation to provide needed scale

…which may require Federal government-supported program for restructuring of suppliers industry

- Survival of legacy suppliers and growth of presence of global suppliers require strong government support program
- Development of program may require analysis of suppliers’ shareholder structure, segregating them by assets and product quality, level of technology and spotting product niche gaps

Areas of Government support

1 Assisting local suppliers in operational restructuring and improvement of strategy

Aim - to prepare local suppliers for consolidation and raise appetite of foreign suppliers for cooperation

Operating restructuring
- Cost cutting
- Splitting business into parts to be sold to different investors
- Spotting of underperforming parts of business to spin them off or close them
- Improving production process and eliminating technological bottlenecks
- Renegotiation of terms with providers of capital

Strategy improvement
- Should start from identification of prospective segments for consolidation and localization
- Should be done in close cooperation with OEMs and OESs

- *For example - Lighting, chroming and grey iron casting – potential for consolidation*
- *Powertrain, engines, electronics – ongoing potential for localization by foreign companies in cooperation with Russian firms*

2 Enabling global suppliers for business combinations with local suppliers

- Upon business combinations legacy suppliers could provide tangible assets (land, buildings, production facilities), access to aftermarket and production nominations from Russian OEMs, while foreign companies – provide technology

Presenter

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Background

- Andrey is a senior manager in Transaction Advisory Services Department and has 9 years experience in this area.
- Accredited appraiser of American Society of Appraisers (ASA).
- MSc in Economics (Moscow State University).

Professional services

- Business valuation, financial modeling, comprehensive investment research including preparation of business plans of investment projects, commercial review, and market research.

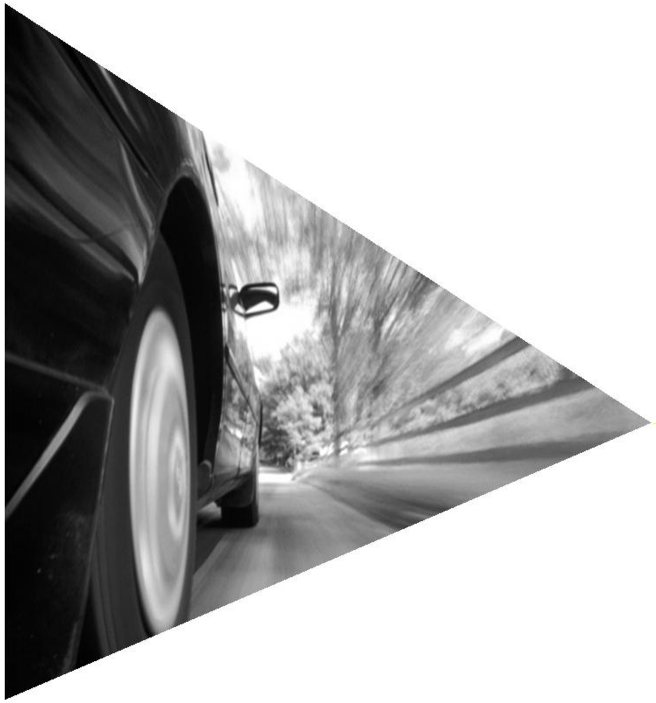
Industry expertise

- Automotive, industrial products, oil & gas, petrochemicals.

Professional experience

- Participated in more than 80 projects for financial modeling, business valuation, and preparation of comprehensive investment research for the purposes of finance raising, mergers and acquisitions, financial reporting, business reorganization, issue and exchange of securities, etc.
- Provided expert testimony on behalf of the client. This included review of the valuation reports prepared by experts of the counterparty in a lawsuit, defeating arguments/answering questions of the counterparty, assisting in preparation of documents submitted by the Client's lawyers, appearance in arbitration court.
- Led a significant number of projects in automotive industry, including:
  - Preparation of long-term development plan and financial model for major Russian automobile dealer in the course of independent business review.
  - Review of results of assets valuation under preparation of consolidated IFRS statements of the large Russian OEM.
  - Valuation of the large CIS trucks producers for internal purposes.

Thank you!



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