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Crisis and the Russian machine building industry. Competitiveness issues

View of Simon ♦ Kucher & Partners



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15th of September, Moscow

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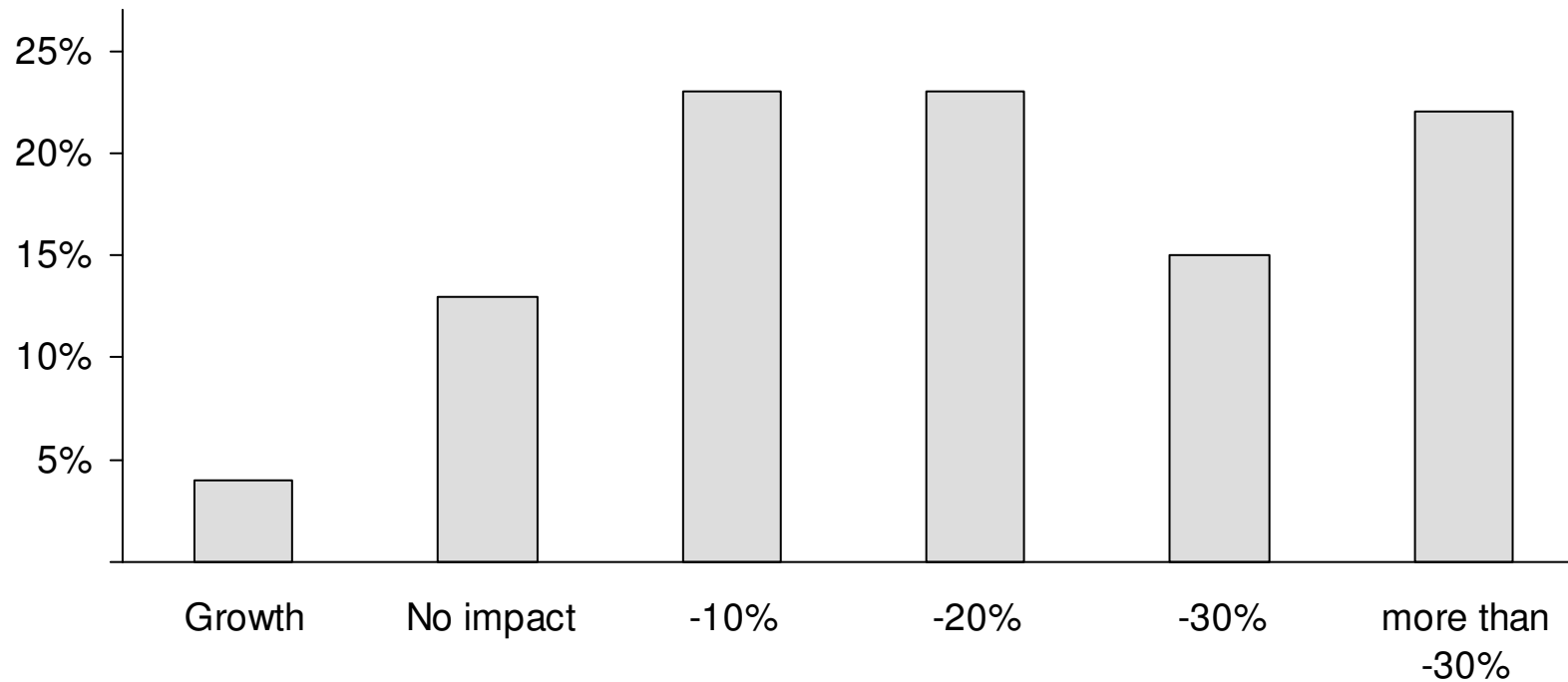
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- A solid red triangle pointing to the right, serving as a bullet point for the first item in the list.
- 1. Current state of affairs in the machine building market**
 2. State support and competitiveness
 3. What is awaiting us?

Study: Significant revenues decrease expected in Russia



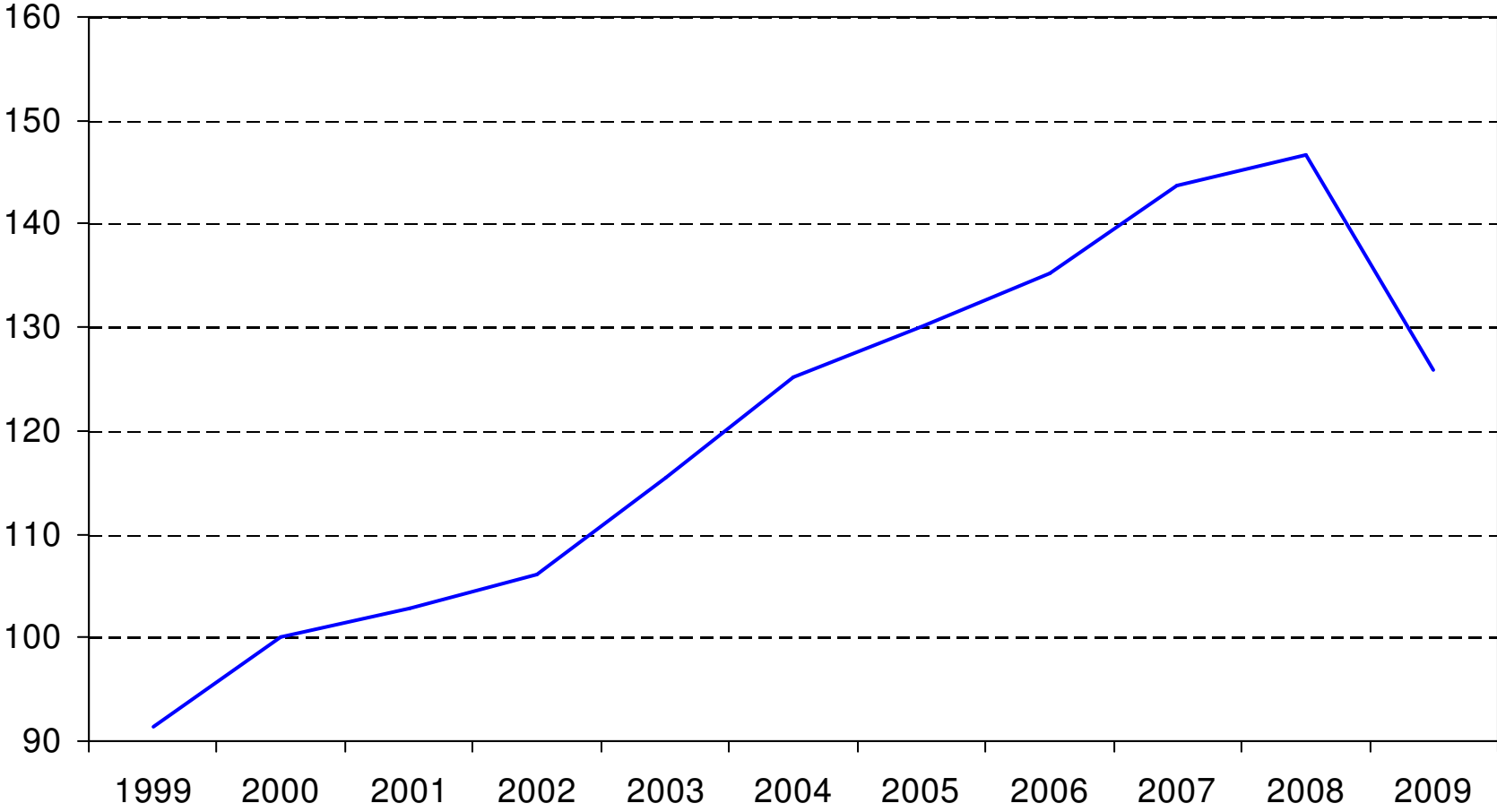
Impact of crisis on revenue

*If you are actively engaged on Russian market:
What will be the impact of the crisis on your revenue in Russia?*



Source: Simon – Kucher & Partners Study May 2009 among approx. 1600 German mid-sized companies

Perception of the crisis: Steep ascent, steep descent (Russia)

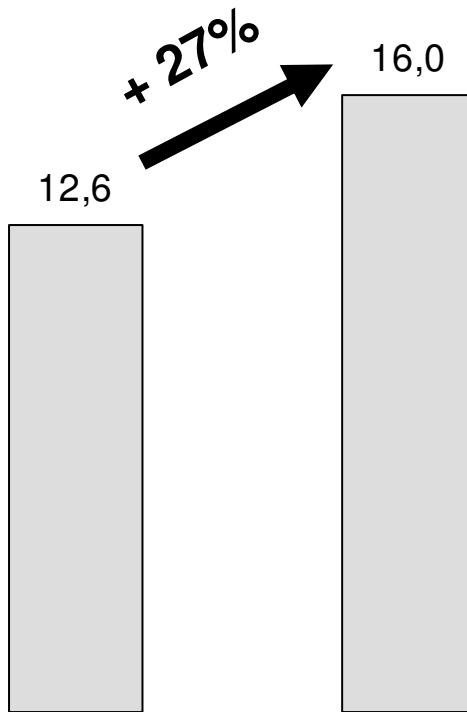


Industrial production (Basis 2000 = 100)

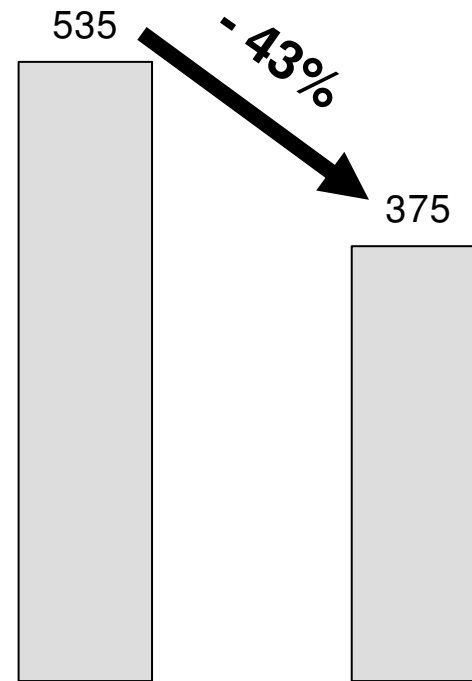
The case of Cessna



1st half 2008
order backlog in \$ billion



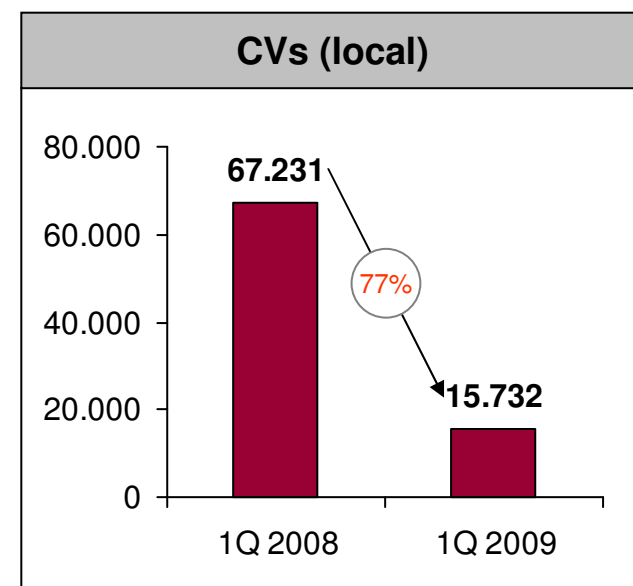
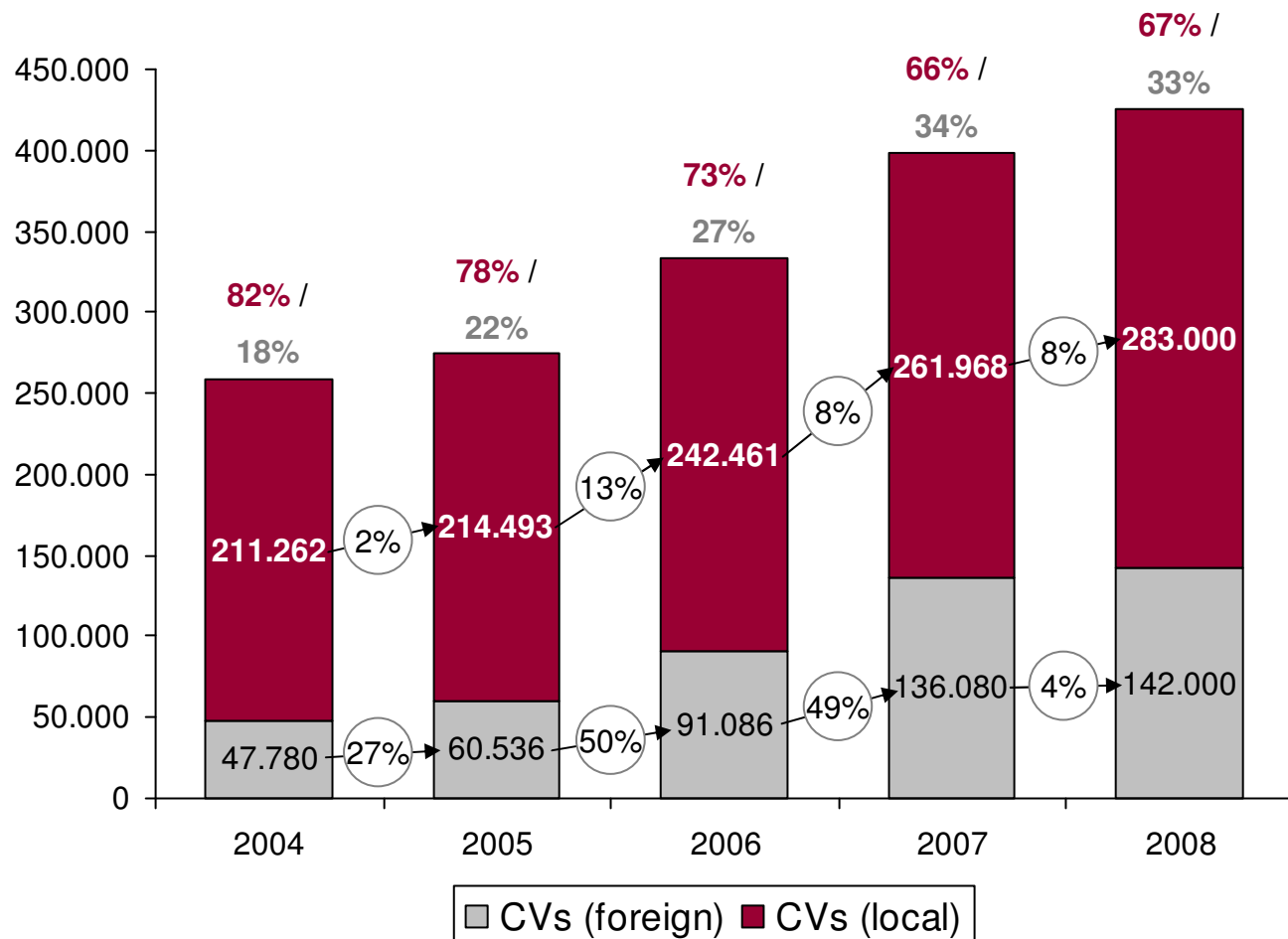
Descent beginning of 2009
plane orders



Structure of growth and decline. Russian CV market



Russian manufacturers steadily lost market share to the foreign competition in the last years. The start of the crisis led to a dramatic sales decline of domestic CVs.

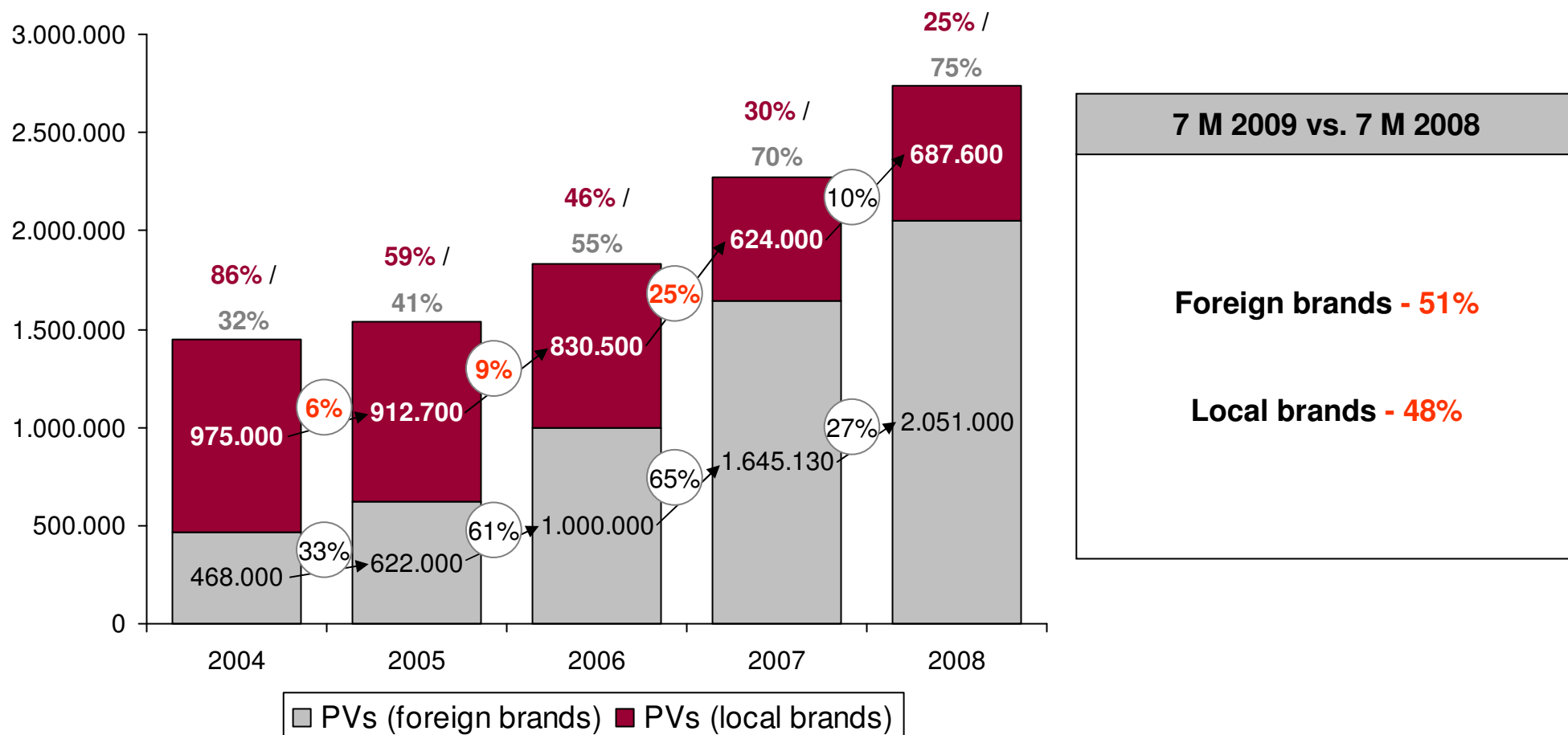


Source: ASM-Holding, Avtostat

Structure of growth and decline. Russian PV market



Russian manufacturers steadily lost market share to the foreign competition in the last years. In 2006 foreign OEMs got more than 50% of the Russian market. The start of the crisis led to a further dramatic sales decline of domestic PVs.



Source: ASM-Holding, Avtostat, AEB

- Crisis uncovered the structural problems of the Russian industry
- Even cheap RUR and customers' preferences for Less Expensive Alternatives could not improve sales of the Russian companies
- Russian government is forced to take short- and long-term measures to insure the survival / competitiveness of the home industry
- Foreign business will be affected by the state measures on the full scale.

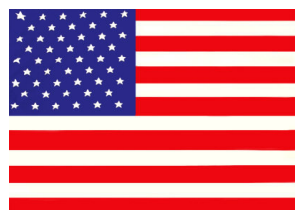
1. Current state of affairs in the machine building market

 **2. State support and competitiveness**

3. What is awaiting us?

- State purchase obligations
- Temporary increased import duties
- Directives to banks to increase credit portfolio
- Credit subsidizing for local households (cars)
- List of companies for receiving state support
- Merger of VAZ and KAMAZ
- Trinity union for entrance to WTO
- Employment incentives of the state
- ...

Retrospective of long-term governmental incentives. Smooth approach

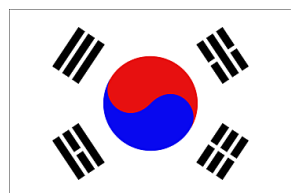


80-ies

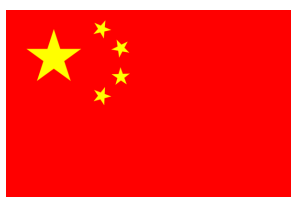


90-ies

Situation	State measures	Results
<p>Losses in competition with Japanese on the local market</p>	<p>Bargained slight mid-termed import restrictions with Japanese producers</p>	<p>Companies minimized lag from Japanese producers on their own in 5 years</p>
<p>Production of outdated vehicles by foreign concerns</p>	<p>Lowning taxes to create market for import, restrictive taxes after</p>	<p>From 1,05 m. annual output of outdated vehicles to 2,53 m. of modern vehicles in just 10 years</p>



1975-1985



80-00-ies

Situation	State measures	Results
No industry	<ul style="list-style-type: none"> ▪ Capital concentration ▪ Export orientation ▪ Support, obligations in return ▪ Restrictive import taxes ▪ License purchasing 	<p>90% localization in 15 years</p> <p>Leading positions on the world market</p>
No industry	<ul style="list-style-type: none"> ▪ Imposing min. investment/added value ▪ Only JV possible ▪ Localization obligations ▪ 40% of total investments – in supplier industry ▪ Part of R&D should be done in China ▪ 60% of total investment is made by the state itself ▪ Lowering taxes to create market for import, restrictive taxes after 	<p>From 5.000 annual output to 3,1 mln in just 20 years</p>

Special case Central Europe



Significant state measures, yet motivating market economy mechanisms. One should mind unique economic/geographical/socio-demographical preconditions

**Taxation preferences
for investors**



Clusterization



Capital concentration

What would be the way for the development of the Russian machine building industry?

High capital concentration

- State corporations
- Vertically integrated holdings
- Financial-industry groups



OR

Low capital concentration

- Small and mid-sized companies
- "Hidden champions"



1. Current state of affairs in the machine building market

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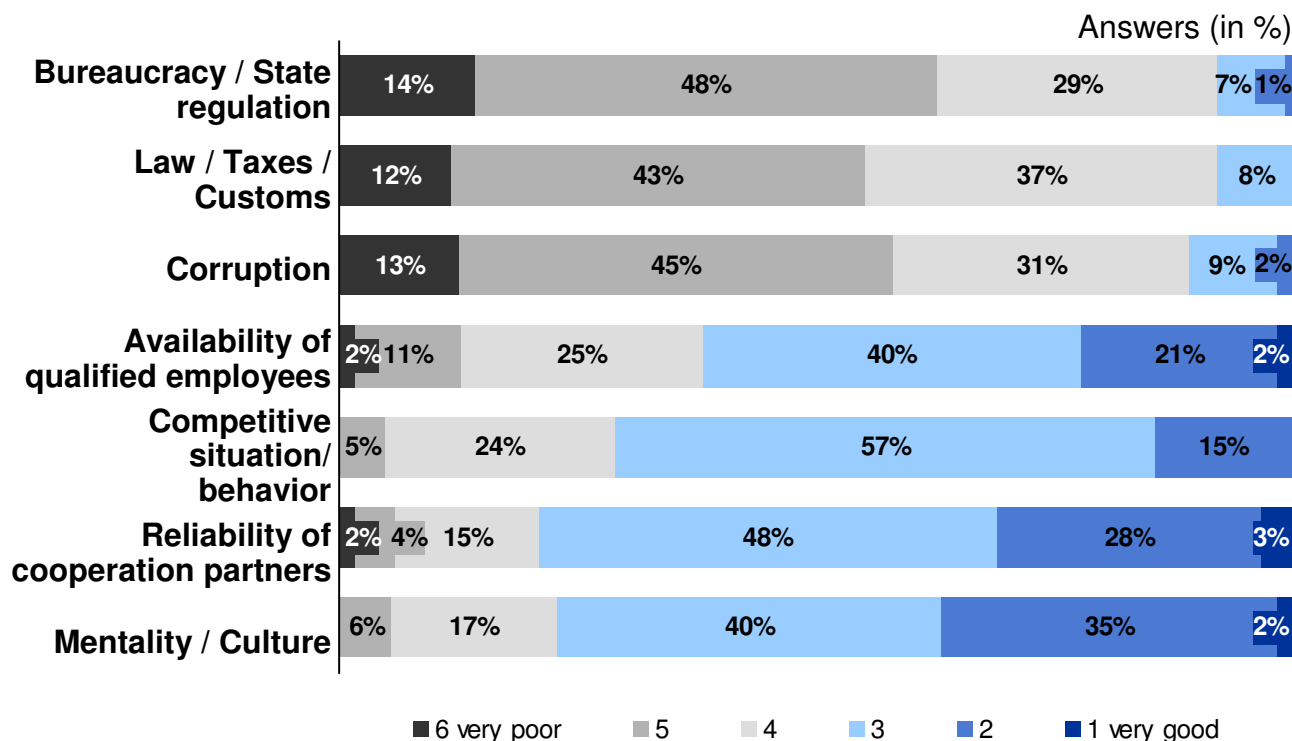
Study: heavy burdens



Bureaucracy, corruption, tax systems and customs are considered major impediments for investors.

Basic conditions for investors

Not taking the current crisis into consideration: How would you rank the following basic conditions in respect to successful involvement in Russia?



The **state-imposed** conditions for investors are clearly seen **negatively**.

Market-imposed conditions and cultural factors are viewed **more positively** by investors.

"We often feel like the tax officials are milking us for money. But we declare everything honestly."

Harald Purainer,
CFO Schattdecor
(about his production location in south Russian Pensa)

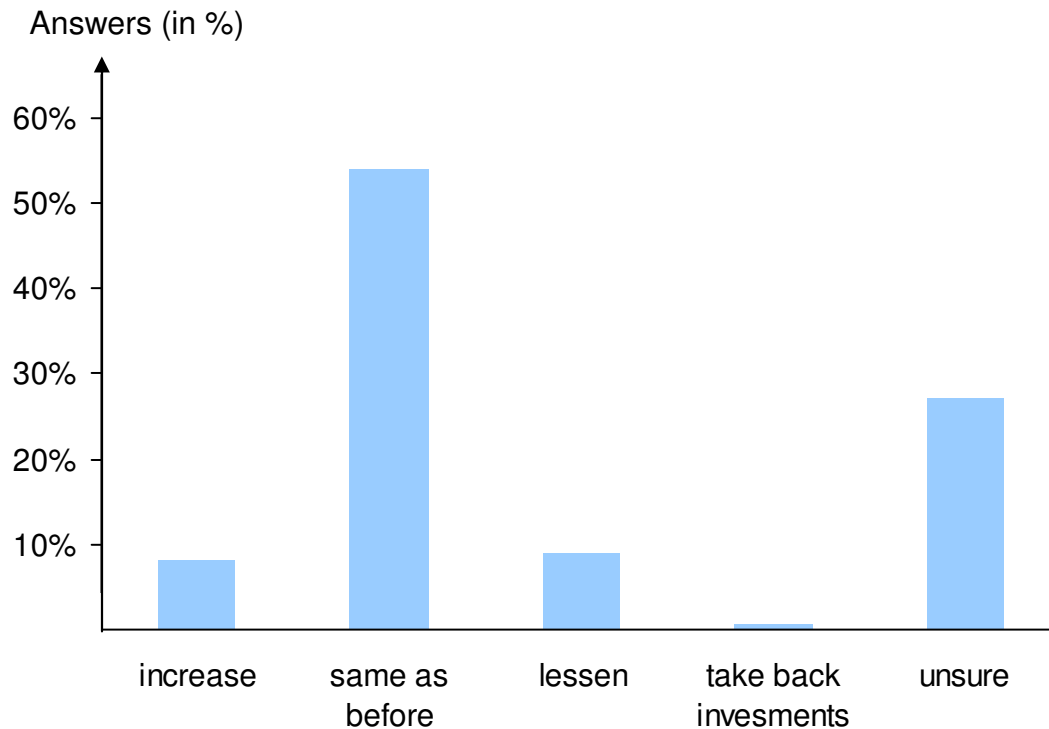
Study: never give up



Almost none of the respondents are planning to leave Russia because of the crisis – the market seems to be too lucrative.

Investment Plans

What kind of investment plans do you have in Russia?



Only one percent of the companies plan on disinvesting from Russia, which would indicate that German mid-sized companies see the crisis in Russia as a **revenue crisis, not a cost crisis.**

Generally speaking, **investment plans remain unchanged.**

- As close dialog with the state as possible
- Striving for clear and feasible rules
- Getting ready for protectionism
- Thinking not only federally, but also regionally
- Strive dialog with local market leaders

Profile of Simon-Kucher & Partners



Offices

18 Offices

Employees 2009: 450



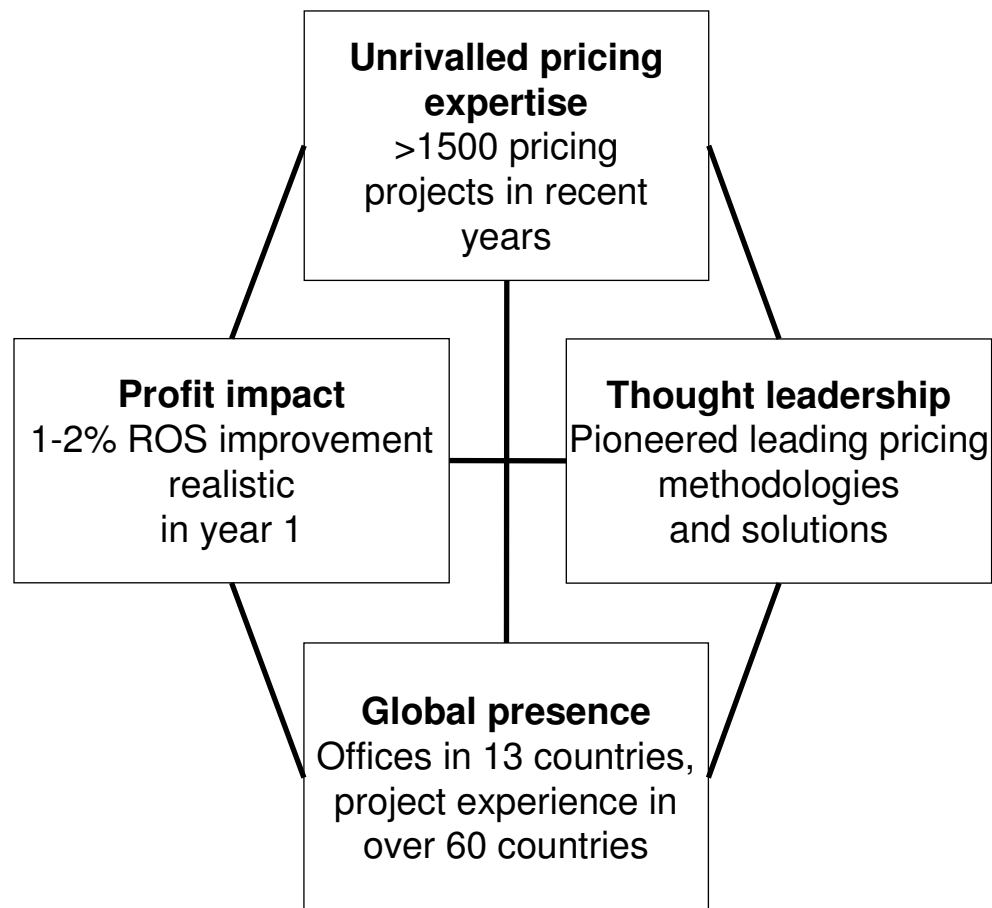
Revenues 2008:
98.7 M. Euro

Average growth: 25%

Industries

- Automotive
- Chemicals
- Construction/Building
- Consumer Goods
- Consumer Electronics
- Energy/Utilities
- Engineering
- Financial Services
- Industrial Goods
- Life Sciences
- Logistics
- Passenger Transportation
- Sports / Entertainment
- Technology
- Telecommunications / IT
- Tourism

The combination that makes SKP unique in pricing



Simon-Kucher & Partners is the specialist for "Smart Profit Growth"



How others describe us:*

BusinessWeek

"world leader in giving advice to companies on how to price their products"

The Economist

"...the world's leading pricing consultancy..."

THE WALL STREET JOURNAL

"pricing strategy specialists"

Peter Drucker

"... in pricing you offer something nobody else does."

Competence-Ranking "Marketing & Sales"

Rank	Consultancy	Score*
1	Simon-Kucher & Partners	401
2	Boston Consulting Group	370
3	McKinsey & Company	346
4	Bain & Company	344
5	Roland Berger	338

manager-magazin 08/2007

*Source: *BusinessWeek*, January 18th, 2004; *The Wall Street Journal*, September 22nd, 2003; Letter to Prof. Simon, SKP Chairman und Founder, June 3rd, 2003; "Business Consulting", Gilbert & Czerniawska, 2005, *The Economist Books*

* Maximum 500;
Data source: DGMF, IMB (Institute for Management & Consulting); Survey of 264 Top Managers