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Abbreviations

AEB Association of European Business
CBR Central Bank of Russia
CEE Central and Eastern Europe
CIS Commonwealth of Independent States
E Estimation
EurAsEC Eurasian Economic Community
F Forecast
GDP Gross domestic product
IPO Initial public offering
JV Joint venture
ROAD Association of Russian Automotive Dealers
OE Original equipment
OEM Original equipment manufacturer
RBC RosBusinessConsulting
WTO World Trade Organization
Dear Reader,

In 2012, the development of the Russian automotive industry was largely determined by trends set in motion in 2011. In particular, the role and priority of the industry in Russia were revisited, and the next few years are likely to witness a quantum leap in the industry as it continues sustainable growth.

This report outlines our view of the current state and future development of the Russian and CIS automotive industries. We remain positive about the long-term prospects of the Russian automotive industry and believe that realized and declared investments will help to change the current situation in the industry and make it more competitive in the next few years. We would be glad to share with you our market experience and assist you in your business activity, helping you identify investment opportunities, as well as providing risk, operational and cost management advisory services.

Foreword

Alexei Ivanov
Partner
CIS Transaction Advisory Services Leader

William A. King
CIS Automotive Group Leader
Executive summary

3.5% – forecast growth for 2013 GDP in real terms
5% – annual forecast growth for light vehicles from 2013-16
4% – annual forecast growth for commercial vehicles from 2013-16

After stellar growth in 2011, the Russian automotive industry showed relatively moderate growth during 2012.

Moving away from volatile growth, the Russian economy and its automotive industry are stabilizing and are expected to enjoy a moderate growth rate for the next five years.

Key highlights of the study are:
• Russia to remain one of the most attractive markets in Europe due to low light vehicle density and advanced age of car fleet
• Light vehicle market exceeded pre-recession sales level, but 2013 likely to witness only flat or moderate growth
• Russian economy expected to grow at a moderate pace in 2013, with increase in household consumption to make up for an uncertain external economic environment
• Foreign players and government support steer automotive industry toward stable growth path
• Light vehicle financing market to see moderate growth in 2013 due to turmoil in global financial markets and rise in average car lending rates
• Car dealerships actively developing in line with international standards and attracting further investments
• Automotive logistics market witnessing a structural change with collaboration among large players and changing mix of transportation modes
• Domestic players dominate commercial vehicle market, but foreign brands gradually increase share of sales
• Positive outlook for the Russian bus market based on considerable age of vehicles used for passenger transportation and expected government support
• Automotive component market will undergo a paradigm shift led by regulatory support and technology transfer from partners
• Belarus and Ukraine posted the highest levels of sales growth in the CIS region during 2012
### Key considerations

<table>
<thead>
<tr>
<th>Key areas</th>
<th>OEMs</th>
<th>Suppliers</th>
<th>Retail and distribution</th>
</tr>
</thead>
</table>
| **How will demand for vehicles and mobility evolve?** | • Focus value propositions on cost of ownership benefits for customers  
• Consider getting first mover advantages on telematics capabilities | • Cooperate with market entrants to support their expansion in the region  
• Help build capabilities of existing component industry  
• Build demand for base commodities to automotive standards  
• Consider strategies to capture the growing opportunities in aftermarket segment | • Develop service and parts capabilities to be more consumer-friendly and price-competitive  
• Consider partnering with mobility providers to provide customers with in car infotainment options  
• Encourage OEMs to provide more robust telematics capabilities |
| **How will products need to adapt?** | • Modify vehicle programs to meet needs of local customers and the environment they operate in  
• Focus on compact city and luxury car segments  
• Leverage expected growth in SUV segment | • Evaluate which emission reduction/fuel efficiency and safety technologies are likely to have the most significant potential  
• Consider developing low-cost products with features desired in the region | • Consider balancing selling vehicles with selling related services packages  
• Develop and maintain communications mechanisms to keep customers coming back to dealership  
• Incorporate sustainability into the core business strategies for long-term revenue growth  
• Consider social media and an internet-based sales and marketing strategy  
• Consider collaborating with international investors |
| **How will business models need to adapt?** | • Leverage social media and internet for better brand visibility and customer connection  
• Consider collaborating with foreign entrants to leverage their technology and platform capabilities | • Consider forming strategic alliances with OEMs to collaborate right from the advanced research phase of the R&D process | • Consider a multi-brand retail and distribution strategy  
• Grow and develop new profit centers, e.g., pre-owned, financing, accessories and aftermarket  
• Evaluate distribution footprint and expansion opportunities to capitalize on growth potential of region |
| **What are the new market dynamics?** | • Strengthen positioning of Captive financial units  
• Get ahead of the coming telematics wave | • Consider enterprise management systems that enable visibility across lower tiers of the supply chain  
• Leverage special economic zones (SEZs) for new or expanded production capacity |  
| **What are the supply/value chain issues and implications?** | • Closely monitor compliance with agreed to localization programs  
• Monitor evolving legislation to optimize tax and duty advantages offered by government |  

Russian economy expected to grow at a moderate pace in 2013, with increase in household consumption to make up for uncertain external economic environment

In 2012, the growth rate of Russia’s real GDP was 0.9% less than in 2011 and reached 3.4%, maintaining positive dynamics and surpassing the global and EU growth rates by 0.8% and 3.6%, respectively. The continuing growth of Russia’s real GDP resulted from the recovery of the labor market, a decline in the unemployment rate and rising consumption, but was hampered by shrinking investments:

- The decrease in the unemployment rate in 2012 is initially estimated at 1.3%.
- In 2012, the growth rate of final consumption at current prices is expected to reach 4.9% year-over-year.
- Foreign direct investment in Russia is expected to drop by more than US$7 billion, or by 15%, as compared to 2011.

In August 2012, Russia became a full-fledged member of the WTO, which resulted in the revision of a number of protectionist measures in economic policy and may in the long term have an impact on the industry-specific competitive environment, in particular, related to production aimed at the domestic market.

Stimulating domestic production is especially important. The growth rate of imports has recently outpaced the growth rate of consumption and exports, which is a key factor in slowing GDP growth rates. While in Q3 2012 the growth rate of finished goods imports declined to 9.6% against 17.9% in Q3 2011, the overall growth of imports in 2012 is likely to outdo the growth of consumption and gross capital accumulation.

In 2013, real GDP is expected to grow at a moderate rate of 3.5% despite the uncertain external economic environment. An increase in household consumption is predicted to remain the key factor of GDP growth despite the tightening of fiscal policy.
### Macroeconomic indicators

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Population, million</td>
<td>141.9</td>
<td>141.9</td>
<td>142.9</td>
<td>142.9</td>
<td>143.0</td>
<td>142.4</td>
</tr>
<tr>
<td>Nominal GDP, US$ billion</td>
<td>1,648.9</td>
<td>1,229.4</td>
<td>1,484.9</td>
<td>1,898.2</td>
<td>2,006.7</td>
<td>2,092.6</td>
</tr>
<tr>
<td>Nominal GDP, change in %</td>
<td>27.5</td>
<td>-26.4</td>
<td>21.7</td>
<td>27.8</td>
<td>5.7</td>
<td>4.3</td>
</tr>
<tr>
<td>Real GDP, change in %</td>
<td>5.3</td>
<td>-7.9</td>
<td>3.9</td>
<td>4.3</td>
<td>3.4</td>
<td>3.5</td>
</tr>
<tr>
<td>GDP per capita, US$</td>
<td>11,694.4</td>
<td>8,609.4</td>
<td>10,404.8</td>
<td>12,958.4</td>
<td>13,427.5</td>
<td>14,699.2</td>
</tr>
<tr>
<td>Foreign direct investment, US$ billion</td>
<td>75.0</td>
<td>36.5</td>
<td>43.3</td>
<td>52.9</td>
<td>45.0</td>
<td>55.0</td>
</tr>
<tr>
<td>Inflation, %</td>
<td>13.3</td>
<td>8.8</td>
<td>8.8</td>
<td>6.1</td>
<td>6.6</td>
<td>6.4</td>
</tr>
<tr>
<td>Industrial Production Index, US$ billion</td>
<td>993.4</td>
<td>707.4</td>
<td>925.5</td>
<td>1,192.5</td>
<td>1,229.0</td>
<td>1,283.1</td>
</tr>
<tr>
<td>Industrial Production Index, %</td>
<td>0.6</td>
<td>-9.3</td>
<td>8.2</td>
<td>4.7</td>
<td>3.1</td>
<td>4.4</td>
</tr>
<tr>
<td>Crude oil, US$ per barrel</td>
<td>94.4</td>
<td>61.1</td>
<td>77.5</td>
<td>108.3</td>
<td>108.1</td>
<td>98.1</td>
</tr>
<tr>
<td>Real disposable income growth, %</td>
<td>11.5</td>
<td>-3.5</td>
<td>5.2</td>
<td>0.8</td>
<td>3.0</td>
<td>3.7</td>
</tr>
<tr>
<td>Unemployment rate among economically active population, %</td>
<td>6.3</td>
<td>8.4</td>
<td>7.5</td>
<td>6.9</td>
<td>5.6</td>
<td>5.8</td>
</tr>
<tr>
<td>Average monthly wages, machinery industry, US$</td>
<td>696.7</td>
<td>546.7</td>
<td>683.6</td>
<td>670.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Average monthly wages, all sectors, US$</td>
<td>695.1</td>
<td>586.7</td>
<td>689.7</td>
<td>795.0</td>
<td>853.7</td>
<td>906.0</td>
</tr>
<tr>
<td>Exchange rate RUB/US$ (annual average)</td>
<td>24.9</td>
<td>31.8</td>
<td>30.4</td>
<td>30.3</td>
<td>31.1</td>
<td>31.6</td>
</tr>
<tr>
<td>Exchange rate RUB/€ (annual average)</td>
<td>36.4</td>
<td>44.2</td>
<td>40.2</td>
<td>41.0</td>
<td>40.4</td>
<td>39.7</td>
</tr>
</tbody>
</table>

**Sources:** Federal State Statistics Service (Rosstat), Ministry of Economic Development of the Russian Federation, Central Bank of Russia, IHS Global insight, Business Monitor International, Economist Intelligence Unit

In general, external economic activity is still held back by global economic challenges such as Eurozone debt issues and the slowdown of economic growth in China. In the event of a global economic recovery, the increase in Russian exports may become an additional driver for GDP growth.

The long-term potential of Russia’s economic development, to a great extent, depends on solving institutional problems, promoting competition, further developing the legislative framework, reducing government participation in the economy and introducing new technologies in production and management.
In 2012, the global automotive market demonstrated moderate growth. The key growth drivers were as follows: increasing sales in emerging economies, primarily China and India; growing demand in the US and recovery of Japanese output after the earthquake and tsunami.

The persisting Eurozone debt crisis has caused stagnation in EU economies and led to a drop in new light vehicle sales. Negative trends were particularly marked in Italy and France, where 2012 sales dropped by 22% and 12%, respectively.

The global automotive market is expected to maintain its moderate growth rate in 2013 due to the positive dynamics of sales in emerging markets. Zero or negative growth of sales is projected for developed economies, except the US.

Development of transport infrastructure for the growing vehicle fleet is becoming a major challenge for emerging markets, while developed markets are primarily trying to renew the car fleet and are most dependent on consumer preferences.

Russia to remain one of the most attractive markets in Europe due to low light vehicle density and advanced age of car fleet.
In 2012, light vehicle sales in Russia exceeded the pre-crisis level for the first time due to the increase in household incomes and satisfaction of deferred demand.

In the long term, the Russian market will remain one of the most attractive in Europe due to low light vehicle density and the advanced age of car fleet. Based on 2012 results, light vehicle density in Russia was 260 vehicles per 1,000 people, which exceeds the similar indicator for 2011 (250 vehicles) but is still far behind the comparable figures of developed countries.

In 2012, the average age of the Russian car fleet was 11.8 years, while the average age of local brands was 14.8. The car fleet’s age structure reveals a need to replace obsolete vehicles. At the same time, the utilization levy charged on imported used cars will shift consumer preferences toward domestically produced new cars.

### Light vehicle density, 2012

<table>
<thead>
<tr>
<th>Country</th>
<th>Population, million</th>
<th>Light vehicle fleet, million</th>
<th>Vehicle density per 1,000 people</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>315.31</td>
<td>202.23</td>
<td>641</td>
</tr>
<tr>
<td>Germany</td>
<td>81.89</td>
<td>43.56</td>
<td>532</td>
</tr>
<tr>
<td>France</td>
<td>63.61</td>
<td>31.74</td>
<td>499</td>
</tr>
<tr>
<td>UK</td>
<td>63.24</td>
<td>31.55</td>
<td>499</td>
</tr>
<tr>
<td>Poland</td>
<td>38.32</td>
<td>18.17</td>
<td>474</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>10.51</td>
<td>4.64</td>
<td>442</td>
</tr>
<tr>
<td>South Korea</td>
<td>48.59</td>
<td>14.61</td>
<td>301</td>
</tr>
<tr>
<td>Russia</td>
<td>143.00</td>
<td>37.22</td>
<td>260</td>
</tr>
<tr>
<td>Ukraine</td>
<td>44.94</td>
<td>8.04</td>
<td>179</td>
</tr>
<tr>
<td>Brazil</td>
<td>198.36</td>
<td>24.93</td>
<td>126</td>
</tr>
<tr>
<td>Turkey</td>
<td>74.51</td>
<td>8.35</td>
<td>112</td>
</tr>
<tr>
<td>China</td>
<td>1,353.38</td>
<td>69.83</td>
<td>52</td>
</tr>
<tr>
<td>India</td>
<td>1,258.35</td>
<td>21.51</td>
<td>17</td>
</tr>
</tbody>
</table>

Sources: IHS Global Insight, Datamonitor, AUTOSTAT analytic agency, Ernst & Young estimates
In 2012, the Russian automotive industry showed moderate growth rates as compared to 2011. Sales of new light (passenger and light commercial) vehicles increased by 11%, with sales of new commercial vehicles increasing by 5% year-over-year. Simultaneously, production of light vehicles is estimated to have increased by 13% and that of commercial vehicles by 5% against 2011.

The light vehicle market is characterized by the expanded production of Russian-made foreign brands. In 2012, local output of commercial vehicle foreign brands reached 17% of the total output. In general, domestic producers of commercial vehicles manage to maintain a large market share due to their competitive pricing policy and government support.

In 2012, major regulatory changes in the market were as follows: reduction of import duties on vehicles as a result of the ratification of the protocol on Russia’s accession to the WTO, introduction of the vehicle utilization levy and a ban on the import of vehicles with less than a Euro-4 emission class.

The Russian automotive industry still has great potential for further development, owing to the low light vehicle density and age of the vehicle fleet. Moreover, the evolution of the industry is supported by government policies aimed at creating new, and expanding existing, production facilities and attracting additional investment to the industry.
Transaction activities in the Russian automotive industry

Based on a review of nearly 40 announced and ongoing 2012 transactions, inbound OEM-led deals dominated the market.

The transactions were driven primarily by the sustained policy of the Russian government to stimulate local production through special customs duty terms and by the continued growth of the Russian new car sales market. The inbound interest focused largely on the benefits of the industrial assembly regime, which gives substantial customs duty exemptions to automotive component importers in exchange for production capacity and localization commitments.

Major announced OEM development plans and deals, 2012

<table>
<thead>
<tr>
<th>Date</th>
<th>Summary</th>
<th>Status</th>
<th>Form</th>
<th>Value US$m</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 Dec 12</td>
<td>Renault-Nissan and Russian Technologies created JV to finalize strategic partnership with AVTOVAZ</td>
<td>Confirmed</td>
<td>JV</td>
<td>Approx. 740 (planned Renault and Nissan investments till mid-2014)</td>
</tr>
<tr>
<td>28 Nov 12</td>
<td>Renault won auction for 5.9% stake in Avtoframos and consolidated 100% ownership</td>
<td>Confirmed</td>
<td>Equity stake</td>
<td>63 (equity stake value)</td>
</tr>
<tr>
<td>28 Nov 12</td>
<td>Scania to invest €70m in Russian projects over next three years</td>
<td>Planned</td>
<td>CAPEX</td>
<td>90 (planned investment in Russia)</td>
</tr>
<tr>
<td>23 Nov 12</td>
<td>Avtotor and Magna to form car-manufacturing JV in Kaliningrad region</td>
<td>Confirmed</td>
<td>JV</td>
<td>Approx. 3,200 (investments in project)</td>
</tr>
<tr>
<td>29 Oct 12</td>
<td>ZIL signed agreement with Hyundai on commercial vehicle manufacturing</td>
<td>Confirmed</td>
<td>Contract production</td>
<td>Approx. 380 (total required investments in ZIL)</td>
</tr>
<tr>
<td>12 Oct 12</td>
<td>Sollers, Mazda JV started serial production of CX-5 cars</td>
<td>Confirmed</td>
<td>JV</td>
<td>322 (investments in JV)</td>
</tr>
<tr>
<td>02 July 12</td>
<td>Finasta became exclusive importer/distributor of JAC Motors in Russia, companies may form a JV</td>
<td>Confirmed</td>
<td>Distribution contract</td>
<td>5 (Finasta planned investment by summer 2013)</td>
</tr>
<tr>
<td>01 June 12</td>
<td>Isuzu Motors to increase stake in Sollers-Isuzu joint venture to 45% for undisclosed sum</td>
<td>Confirmed</td>
<td>Equity stake</td>
<td>Undisclosed sum</td>
</tr>
<tr>
<td>03 Apr 12</td>
<td>VDL and MAN interested in acquiring 92.6% stake in AMO Plant</td>
<td>Planned</td>
<td>Acquisition</td>
<td>28 (target value)</td>
</tr>
<tr>
<td>20 March 12</td>
<td>KamAZ: Daimler could consolidate blocking stake by middle of the year</td>
<td>Planned</td>
<td>JV</td>
<td>200 (speculated price for 10% stake)</td>
</tr>
<tr>
<td>12 March 12</td>
<td>Avtotor to buy 60% stake in Magna NN 2</td>
<td>Confirmed</td>
<td>JV</td>
<td>Approx. 1.3 (equity stake value)</td>
</tr>
<tr>
<td>29 Feb 12</td>
<td>Fiat and Sberbank signed Letter of Intent on vehicle production and distribution in Russia</td>
<td>Planned</td>
<td>JV</td>
<td>Approx. 1,140 (total maximum investment in project)</td>
</tr>
</tbody>
</table>

Sources: mergermarket, Ernst & Young analysis
However, as the deadline to conclude industrial assembly agreements expired in December 2012, we expect investor focus to shift toward other market entry options, including greenfield investments in special economic zones and industrial parks. Nearly a dozen special economic zones (SEZs) and industrial parks (IPs) currently operating in Russia provide various material tax and legal benefits to investors. A shrewd investor should carefully assess the terms and conditions offered by different SEZs and IPs prior to making a decision on market entry.

We forecast an upswing in JV/M&A activity in the auto-component sector in 2013 as OEMs aim to meet component localization targets and component makers seek to take advantage of the continued growth in the Russian new and used car sales and after-sales markets and benefit from the ongoing government support for the industry (e.g., interest rate subsidies, R&D support, Far Eastern production support, bearings production support).

### Major automotive component sector deals and planned investments, 2012

<table>
<thead>
<tr>
<th>Date</th>
<th>Summary</th>
<th>Status</th>
<th>Form</th>
<th>Value US$ (m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>24 Dec 12</td>
<td>GAZ Group and FinnvedenBulten to form JV producing fasteners</td>
<td>Confirmed</td>
<td>JV</td>
<td>Approx. 9 (Bulten’s approximate investment in JV)</td>
</tr>
<tr>
<td>29 Aug 12</td>
<td>Volkswagen to spend €250m building engine plant in Kaluga, plans to invest €1b in Russia by 2018</td>
<td>Planned</td>
<td>CAPEX</td>
<td>Approx. 1,300 (total planned investment in Russia by 2018)</td>
</tr>
<tr>
<td>13 July 12</td>
<td>Yazaki fully acquires Industrial Volga Company</td>
<td>Confirmed</td>
<td>Acquisition</td>
<td>Undisclosed sum (IVC’s sales in 2012 estimated at US$43 million)</td>
</tr>
<tr>
<td>29 Feb 12</td>
<td>Pirelli and Russian Technologies finalize transfer of Voronezh Tire Plant from Sibur</td>
<td>Confirmed</td>
<td>Acquisition</td>
<td>Approx. 300 (total value of Voronezh Tire Plant and Kirov Tire Plant)</td>
</tr>
<tr>
<td>28 Jan 12</td>
<td>AvtoVAZ sells steel wheels division to mefro wheels GmbH</td>
<td>Confirmed</td>
<td>Acquisition</td>
<td>Undisclosed sum</td>
</tr>
<tr>
<td>10 Jan 12</td>
<td>Sibur sells 100% of Sibur-Russian Tires to management and group of investors</td>
<td>Confirmed</td>
<td>Acquisition</td>
<td>Approx. 280 (transaction value)</td>
</tr>
</tbody>
</table>

*Sources: mergermarket, Ernst & Young analysis*
Light vehicle market

Russian light vehicle market exceeded pre-recessionary sales level; however, 2013 likely to witness only flat or moderate growth

In 2012, total sales of new light vehicles increased by 11% over 2011 and reached 2,935,111 units, exceeding the record figures of 2008 (2,897,459 units). The highest year-over-year growth was registered in the first months of 2012. In H1 2012 sales increased by 14% as compared to H1 2011. The sales peak came in June 2012, when over 272,251 new vehicles were sold. In Q4 2012, the growth slowed due to economic decline and uncertainty on the financial markets. However, the dynamics against the previous year remained positive.

The key drivers of the sales increase were as follows:

- Growth of consumer income and recovery of demand
- Further development of the car loan market in Russia
- Stable macroeconomic environment in Russia

Optimistic OEM sales forecasts based on the rapid growth of the market in 2011 (39% in volume terms) influenced the sales increase in H2 2012. By Q3 2012 dealers had to offer discounts and organize marketing campaigns due to substantial stocks of vehicles.

Automotive industry will see evolution of technology with regulation changing from Euro-2 to Euro-5 fuel standards scheduled for the next three years (from 2013 – Euro-3, from 2015 – Euro-4 and from 2016 – Euro-5). Moreover, on 1 September 2012, the utilization levy on vehicle producers and importers took effect. The levy on imported light vehicles varies from RUB17,000 to RUB700,000, based on the category, vehicle age and engine volume.

The key drivers of light vehicle sales in the near future will include:

- Aging vehicle fleet (the average age of vehicles in Russia is 12 years; in Europe, 7 years)
- Relatively low density of cars as compared to developed automotive markets (260 cars per 1,000 people in Russia vs. 532 cars in Germany and 641 cars in the US)
- Growing number of car lending programs provided by banks jointly with OEMs
- Development of infrastructure and highways
Sales of Russian brands as a share of the total light vehicle market declined from 25% in 2011 to 21% in 2012. However, sales of Russian-made foreign brands rose steadily throughout the year and increased a total of 23% against 2011. The share of imports in the market structure has declined by less than 1% year-over-year since Russia's accession to the WTO, and the utilization levy hasn't yet had a significant effect on the sales structure.

The mix of light vehicle segments has also changed. The share of premium vehicles dropped dramatically, and consumer preferences shifted to the middle price segment (from US$15,000 to US$25,000).

Overall, in 2012 the light vehicle market generated US$75 billion, demonstrating an increase of 15%.1 Imported and Russian-made foreign brands prevailed in the sales structure with a 90% share (US$67 billion).

Utilization levy for M1\(^2\) category vehicles, RUB

<table>
<thead>
<tr>
<th>Engine type</th>
<th>New vehicles</th>
<th>Vehicles more than 3 years old</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric motor</td>
<td>17,200</td>
<td>106,000</td>
</tr>
<tr>
<td>With engine capacity:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 1,000 cc</td>
<td>17,200</td>
<td>106,000</td>
</tr>
<tr>
<td>1,000-2,000 cc</td>
<td>26,800</td>
<td>165,200</td>
</tr>
<tr>
<td>2,000-3,000 cc</td>
<td>51,200</td>
<td>322,400</td>
</tr>
<tr>
<td>3,000-3,500 cc</td>
<td>69,400</td>
<td>570,000</td>
</tr>
<tr>
<td>Over 3,500 cc</td>
<td>110,000</td>
<td>700,200</td>
</tr>
<tr>
<td>Imported by individuals for personal use</td>
<td>2,000</td>
<td>3,000</td>
</tr>
</tbody>
</table>

Source: Resolution No. 870 of the Russian Government of 30 August 2012 regarding the utilization levy applied to vehicles

Light vehicle market breakdown by origin, %

Sources: ASM Holding, Ernst & Young estimates

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\(^1\) The M1 category includes vehicles that are used for passenger transportation and have no more than eight passenger seats besides the driver's seat.

\(^2\) According to the estimates prepared by Ernst & Young.
Sales of top foreign brands, units (including Russian-made foreign brands)

Source: AEB

Light vehicle market, US$ billion

Sources: AEB, Price N, Ernst & Young estimates

Market share by brand in terms of volume, %

Sources: AEB, Ernst & Young estimates

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In 2012, light vehicle production continued to expand, reaching 1,968,789 units and demonstrating a 13% rate of growth against 2011. The increase was largely attributable to the 23% rise in output of Russian-made foreign brands along with a slight reduction in the output Russian brands (by 3% in 2012). According to ASM Holding, in 2012 Russian-made foreign brands amounted to 1,328,613 units (68% of the total light vehicle output in Russia), while Russian brands accounted for 640,176 vehicles. In 2012-2015, budgetary support to Russian-based car producers will amount to RUB29.6 billion (approximately US$900 million), and 57% of that total will be allocated to producers implementing innovation projects.
Changes in import duties as a result of Russia’s accession to the WTO

<table>
<thead>
<tr>
<th>Light vehicles</th>
<th>Before accession to the WTO</th>
<th>Upon accession to the WTO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2011</td>
<td>2012</td>
</tr>
<tr>
<td>New</td>
<td>30%</td>
<td>25%</td>
</tr>
<tr>
<td>But not less than</td>
<td>€1.2-2.8 per 1 cc of engine capacity</td>
<td>But not less than €1.0-2.35 per 1 cc of engine capacity</td>
</tr>
<tr>
<td>Used, less than 5 years</td>
<td>35%</td>
<td>25%</td>
</tr>
<tr>
<td>But not less than</td>
<td>€1.2-2.8 per 1 cc of engine capacity</td>
<td>But not less than €0.45-1.0 per 1 cc of engine capacity</td>
</tr>
<tr>
<td>Used, 5-7 years</td>
<td>35%</td>
<td>25%</td>
</tr>
<tr>
<td>But not less than</td>
<td>€2.5-5.8 per 1 cc of engine capacity</td>
<td>But not less than €0.45-1.0 per 1 cc of engine capacity</td>
</tr>
<tr>
<td>Used, over 7 years</td>
<td>€2.5-5.8 per 1 cc of engine capacity</td>
<td>€1.4-3.2 per 1 cc of engine capacity</td>
</tr>
</tbody>
</table>

Source: Unified Customs Tariff of the EurAsEC Customs Union, open sources

We have compiled a forecast for the Russian light vehicle market for 2013-16 based on materials and estimates of leading global and Russian automotive analytical agencies as well as our expertise and analysis.

The key drivers of passenger car production in the next few years will be as follows:

- Creation of new production facilities
- Extension of the product range of Russian-made foreign brands
- Russian economic recovery
- Government support under the 2020 Development Strategy aimed at replacing imports with domestic production
- Trade policy aimed at domestic production and establishing a vehicle scrapping fee (mandatory vehicle utilization levy)
In 2012, the Russian light vehicle financing market generated US$26 billion, an increase of 20% year-over-year. Credit sales exceeded 1 million units, which is 15% above the 2011 level. The share of car credit sales rose to 35% of total sales. Despite completion of the government program for subsidizing car loan interest rates, the market showed spectacular growth, resulting from the following trends:

- Recovery of consumer confidence and car loan demand
- Improvement of car loan availability
- Growing competition in the car loan market
- Diversification of car loan products

Turmoil in global financial markets, coupled with the expiration of the government-sponsored car lending program, resulted in a rise in average car lending rates at the year-end, which will produce a cooling effect on the market in 2013. However, growing competition between banks encourages greater choice and special offers capable of supporting the development of the car loan market. Sberbank tops the RBC’s H1 2012 bank rating by quantity of loans issued, having almost doubled its figures year-over-year. Captive banks of global vehicle manufacturers are gradually strengthening their positions, in particular, those of the major OEMs, Toyota Bank and BMW Bank. Moreover, the Renault-Nissan Alliance, in partnership with UniCredit Group, is founding a captive bank on the basis of the UniCredit subsidiary in Omsk. The new bank’s operating activities are scheduled to begin in 2013.

The slowdown of the car loan market in H2 2012, against a background of increased volatility of the financial markets and deterioration of macroeconomic indicators, will likely lead to moderate growth of the car loan market in 2013. Another key factor driving this slowdown is the high rates of interest (average of 14% to 16%) charged on light vehicle loans, which is comparable with emerging markets (for instance, about 16% in Brazil and 12% in India), but well above rates in Western economies (4.1-4.6% in the US).
Dealership networks

Car dealerships actively developing in line with international standards and attracting further investments as OEMs expand networks

The development of dealership networks in Russia is closely linked with the development of the market for new and used vehicles. Despite a more than 20% rise in the sales of new and used vehicles in 2012 (in terms of value), the number of active dealership centers in Russia rose by a mere 5%, to a little over 4,200. It is also interesting to note that 15 dealer groups (out of approximately 400) contribute to over 20% of new car sales in Russia.

The activity of dealership centers in 2012 was marked by the following trends:

- Growing demand for used and new vehicles
- Increase in regional vehicle sales and the development of dealership centers in large regional centers
- Toughening competition between dealership networks
- Growing scope of financial products and services available to vehicle owners
- Dealership networks expanding the range of brands they represent

Since dealership networks are sensitive to financial market trends, rising uncertainty in the second half of the year, caused by the crisis in Europe and a slowdown in business activity in Russia, had an adverse effect on the automotive industry. However, a considerable rise in car sales, including the growth of demand for used vehicles, enabled dealership networks to sustain their revenue growth.

As a whole, the car dealership business in Russia is moving towards the global model by increasing sales of used vehicles and expanding the range of services. International investors are expressing a growing interest in the dealership business in Russia. In late 2012, Mitsubishi Motors Corporation and Mitsubishi Corporation raised their stake in ROLF Import LLC (which only imports and distributes Mitsubishi vehicles) to 58%. ROLF Import LLC is a member of ROLF Group, one of Russia’s largest dealership groups. Other options to raise financing (IPO and private equity financing) are limited by Russian dealers’ relatively low profit margins and an unfavorable situation on capital markets. Market players are optimistic about M&A deals between dealership networks, particularly at the regional level. Further growth of the dealership business in Russia will depend on market trends and the macroeconomic situation, which will determine the accessibility of credit facilities for dealership networks.
Automotive logistics

The number of cars transported across Russia in 2012 approached 3 million units, a 7.8% increase year-over-year, which came as a result of vehicle sales growth and development of the automotive logistics market. However, the limited capacity of the market, low quality of infrastructure, insufficient transport to haul vehicles and a gloomier macroeconomic outlook for 2013 were factors that held the market back.

The automotive logistics market saw a sharp rise in rail transportation (from 9% in 2011 to 27% in 2012), resulting from the expanding output of Russian-made foreign brands and the convenience of using trains for long-distance carriage. However, transportation of vehicles by truck is relatively cheap, and deliveries can be made to the dealer's doorstep, which is why a large number of vehicles are transported by car haulers.

The beneficial factors that underpinned the growth of the automotive logistics market included the national strategy for development of the public road system and government allocations for road construction and repairs. Federal budget allocations for the development of the public road system in 2013 will amount to more than RUB450 billion. A total of RUB263 billion will be made available from the Federal Road Fund in 2013 for the development of the public road network. Budget allocations for major repairs and maintenance of federal public roads in 2013 will amount to RUB182 billion (up 44% from 2012).

An important trend in the Russian automotive logistics market is the growing level of cooperation between the largest logistics operators. The aim is to create a single logistics network from the site of assembly to the site of sale, which involves moving vehicles by various means of transport. In the future, the situation in the market will be determined by how fast car sales rise, how accessible credit and fleet leasing resources are and how stiff the competition is between logistics operators.
The Russian commercial vehicle (CV) market is slowing down. According to preliminary data, in 2012 sales of new commercial vehicles increased by 5%, against 56% in 2011. In absolute terms, the sales volume of new commercial vehicles is estimated at 132,000 units. Despite an expected insignificant decrease in sales volumes, Russian brands will maintain a 45% market share against 49% from total sales year-over-year.

Like the automotive industry as a whole, in 2012 the CV market faced the following regulatory changes:

- Reduction of import duties on commercial vehicles following the ratification of the protocol on Russia’s accession to the WTO in accordance with the Unified Customs Tariff of the EurAsEC Customs Union
- Introduction of the utilization levy
- Ban on the import of vehicles in an emission class less than Euro-4

From 2013-16, annual market growth is expected to be 4% in volume terms. The trend results from moderate growth in individual and enterprise purchasing power. Market growth will also be driven by the growth of vehicle volumes exported from Russia to the CIS and development of the industrial assembly of foreign brands in Russia.

In 2012, CV output increased by 5% year-over-year. Domestic brands still dominate in the CV production structure. At the same time, the share of foreign

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4 Medium-duty and heavy commercial vehicles (weighing over 6 tons and in exceptional cases over 3.5 tons).
brands in the CV production structure has been gradually increasing, reaching 17% in 2012 and reflecting the interest of foreign producers in the Russian market.

In 2012, a number of manufacturers announced plans to develop their business in Russia:

- German truck producer MAN expects to launch a new CV production facility in Shushary, near St. Petersburg, early of 2013. The capacity of the facility will be 6,000 units per year. Investment in the project totaled €25 million. Moreover, MAN is considering establishing its own retail chain in Russia.
- Despite an uncertain outlook on the further development of the industry, OAO KAMAZ reconsidered its 2020 investment program and increased it from RUB60 billion to RUB62 billion.
- Daimler plans to localize truck cabin production in Russia. In 2013, it is planning to launch pilot production of KAMAZ trucks with Daimler cabins. In 2014-15, cabins will be supplied to the joint venture of Daimler and OAO KAMAZ (Mercedes-Benz Trucks Vostok). Investment in the project may total RUB6 billion.
- Volvo Group has decided to construct a facility to manufacture cabins for commercial vehicles under the Volvo and Renault brands in Kaluga. The capacity of the facility will be 15,000 units per year. Investments in project are estimated at RUB3.75 billion.
- Scania plans to expand its production in Russia to 7,000 trucks per year. By 2016, it plans to invest about €70 million in both production expansion and dealer network development.

Changes in import duties as a result of Russia’s accession to the WTO

<table>
<thead>
<tr>
<th>Before accession to the WTO</th>
<th>Upon accession to the WTO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial vehicles (5-20 tons)</td>
<td></td>
</tr>
<tr>
<td>New</td>
<td>25%</td>
</tr>
<tr>
<td>Used, less than 5 years</td>
<td>30%</td>
</tr>
<tr>
<td>Used, 5-7 years</td>
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</tr>
<tr>
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</tr>
<tr>
<td>Used, over 7 years</td>
<td>€4.5</td>
</tr>
</tbody>
</table>

Sources: Unified Customs Tariff of the EurAsEC Customs Union, open sources

Utilization levy for N° category vehicles, RUB

<table>
<thead>
<tr>
<th>Fully loaded mass of vehicle</th>
<th>New vehicles</th>
<th>Vehicles more than 3 years old</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-8 tons</td>
<td>165,000</td>
<td>684,000</td>
</tr>
<tr>
<td>8-12 tons</td>
<td>201,000</td>
<td>1,036,500</td>
</tr>
<tr>
<td>12-20 tons</td>
<td>220,500</td>
<td>1,509,000</td>
</tr>
<tr>
<td>More than 20 tons</td>
<td>435,000</td>
<td>1,770,000</td>
</tr>
</tbody>
</table>

Source: Resolution No. 870 of the Russian Government of 30 August 2012 regarding the utilization levy applied to vehicles

° The N category includes vehicles used for cargo transportation - commercial vehicles and chassis.
Positive outlook for the Russian bus market based on considerable age of vehicles used for passenger transportation and expected government support

According to preliminary estimates, in 2012 sales of buses, minibuses and buses-on-truck-chassis exceeded 69,000 units, demonstrating a 14% rate of growth against 2011. The share of domestic brands is expected to dominate in the sales structure, gaining 7% against 2011 and reaching 63%.

According to experts, positive market dynamics will persist, backed by the following:

- Need for new buses due to the considerable age of vehicles used for passenger transportation
- Expected government support for fleet renovation (in 2012, there was a program of federal subsidies for municipal transport procurement)

In accordance with Federal Law No. 89-FZ (version as of 28 July 2012), “On Production and Consumption Waste,” dated 24 June 1998, starting 1 September 2012 the utilization levy is applicable to buses as well as to light and commercial vehicles. The utilization levy charged on new buses will vary from RUB90,000 to RUB300,000, and on buses more than three years old from RUB150,000 to RUB780,000, depending on the engine volume.

### Utilization levy for M2\(^7\) and M3\(^8\) categories vehicles, RUB

<table>
<thead>
<tr>
<th>Engine capacity</th>
<th>New vehicles</th>
<th>Vehicles more than 3 years old</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2,500 cc</td>
<td>90,000</td>
<td>150,000</td>
</tr>
<tr>
<td>2,500-5,000 cc</td>
<td>180,000</td>
<td>450,000</td>
</tr>
<tr>
<td>5,000-10,000 cc</td>
<td>240,000</td>
<td>660,000</td>
</tr>
<tr>
<td>Over 10,000 cc</td>
<td>300,000</td>
<td>780,000</td>
</tr>
</tbody>
</table>

Source: Resolution No. 870 of the Russian Government of 30 August 2012 regarding the utilization levy applied to vehicles

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\(^6\) Minibuses and buses-on-truck-chassis are excluded unless otherwise stated.

\(^7\) The M2 category includes vehicles that are used for passenger transportation, have more than eight passenger seats besides the driver’s seat and whose maximum weight does not exceed 5 tons.

\(^8\) The M3 category represents vehicles that are used for passenger transportation, have more than eight passenger seats besides the driver’s seat and whose maximum weight exceeds 5 tons.
In 2012, Russian bus output totaled 16,200 units, which is 3% more than in 2011. The annual output growth in the segments of minibuses and buses-on-truck-chassis was 30% and 36%, respectively. Total production in all segments maintains positive dynamics with a CAGR of 17% since 2009. However, pre-crisis production volumes (over 67,000 units in 2007 and 88,000 units in 2008, respectively) are still unachievable. Suburban and city buses prevail in the bus production structure, accounting for 57% and 42% of the total bus output, respectively.

**Dynamics of bus/minibus/bus-on-truck-chassis production, thousands of units**

Sources: ASM Holding, Ernst & Young estimates

**Bus production breakdown by segment, %**

Sources: ASM Holding, Ernst & Young estimates
Automotive component market

In 2012, demand for automotive components slowed, following lower growth rates on the automotive market. According to experts, in 2012 the size of the market will be US$41.8 billion, demonstrating an 8% growth rate as compared to 33% in 2011. However, the OE market share is expected to increase by 2% to a total of 49%.

Given the Russian automotive industry's prospects, last year we saw component producers taking a keen interest in launching new production facilities, particularly in close proximity to OEMs:

- **Russian manufacturer AVTOTOR Holding and Canadian component producer Magna International announced the signing of an agreement on cooperation to establish an automotive production cluster in Kaliningrad. It is planned to set up at least 15 component production plants and up to six plants of various OEMs. By 2018, the design production capacity of the automotive cluster will amount to 250,000 vehicles per year. Total investments in the project are estimated at RUB100 billion.**

- **Spanish producer and components designer Grupo Antolin plans to launch a second plant in Leningrad Region by 2015, becoming an anchor resident of the Tosnensky Industrial Park and investing €30 million in the project.**

- **German bearing producer Schaeffler plans to build an automotive component plant in Zavolzhye industrial area in Ulyanovsk. Total project investments are estimated at RUB2 billion. The plant’s commissioning is scheduled for 2014.**

- **Sollers’s Strategic Committee has adopted a new development strategy for Zavolzhsky Engine Plant (ZEP). In accordance with this strategy, ZEP is a major platform for the creation of industrial parks. Forecasts indicate that foreign component producers will participate in establishing industrial parks in order to support the localization of Russian automotive production. The first residents have already launched their operations at the ZEP platform.**

Moreover, in January 2013, the Ministry of Economic Development of the Russian Federation signed an Agreement establishing a special industrial economic zone (SIEZ) in Lyudino Town and District in Kaluga Region. Engineering (automotive components production) and construction material industrial clusters are planned to be established in the SIEZ. It should be noted that a number of arrangements with investors in automotive component production have already been made.
Ratification of the protocol on Russia’s accession to the WTO and new rules of access for goods and services to the Russian market are other factors affecting the further development of the automotive components market. According to the WTO accession terms, Russia has to eliminate exemptions on imported components provided to companies which have industrial assembly agreements valid through 2020. In order to carry on obligations under industrial assembly agreements, in September 2012 the State Duma of the Russian Federal Assembly approved the draft law, “On government support for producers of motor vehicles, assembly units and blocks,” in the first reading. According to the draft law, from 2018 to 2020, companies engaged in vehicle and component production are entitled to receive subsidies from the federal budget to compensate for higher import duties on goods used in production.

Despite continuing growth, the market for Russian automotive components is still underdeveloped. The main barriers to further development are as follows:

- Low competition and poor quality of products
- Insufficient investment in the development of technologies
- Reduction of import duties and, consequently, the opportunity to import components at lower tariffs
- Strong dependence of component producers on a limited number of OEMs and suppliers
Belarus and Ukraine posted the highest sales growth in the CIS region during 2012

Car sales in Ukraine, Kazakhstan, Belarus and Uzbekistan expanded by 17% in 2012, compared with a 26% rise in 2011. Car manufacturing in all of these countries grew at a faster pace than car imports.

Ukraine

Ukraine remains the second largest light vehicle market in the CIS. In 2012, light vehicle sales reached 261,001 units, an 18% year-over-year rise, or 45% of the 2008 total.

The recovery of demand for light vehicles in Ukraine is underpinned by a low density of cars, the high average age of cars (18 to 19 years), and the growing purchasing power index. However, there are a number of factors that are likely to create a headwind for light vehicle sellers in Ukraine in the short and medium term. These include rising prices for foreign vehicles due to an increase in import duties, the high inflation rate and less accessible car loans compared with the pre-crisis level.

The demand for lower-priced vehicles in Ukraine is largely satisfied by domestic production. As a result, production depends largely on domestic market demand. Also, a considerable number of Ukrainian-made vehicles are exported to Russia. Medium- and high-cost vehicles are imported primarily from the European Union and Russia.

In 2012, 192,090 units were assembled in Ukraine, up 38% from 2011.

Kazakhstan

Growth in car sales in Kazakhstan slowed to 14.5% in 2012, with a total of 48,327 units sold. That’s in comparison to a 96% increase in 2011. The considerable rise in car sales enabled the car market to recover from the crisis and perform better than in 2008. Among the most frequently sold brands were Lada and Daewoo, which reflects customer preferences for relatively low-cost vehicles.

Following a 6% decline in 2011, car manufacturing rose by 20% in 2012 to 4,183 units. However, imports cover more than 90% of the demand for light vehicles in Kazakhstan.

The key car manufacturing project currently under way is the construction of an AVTOVAZ assembly facility in Ust-Kamenogorsk. The launch of the first phase of the facility will allow up to 90,000 units to be assembled per year, and starting in 2014, when it reaches full capacity, the facility will manufacture 120,000 units.

Belarus

According to expert estimates, car sales in Belarus rose by 50% in 2012 to a total of between 24,000 and 25,000 units. The key factor behind the growth was a shift in customer preferences from used vehicles imported from Europe to new C-class value vehicles, including Russian-made vehicles (which accounted for around 30% of the market in 2012). Chinese car makers also succeeded in consolidating their market positions, reporting a 30% rise in sales.

Although domestic manufacturing rose by 67%, it remains insignificant in absolute terms, with a total of 289 vehicles built during the course of the year. A considerable increase in domestic car manufacturing may come in 2013, as China’s Zhejiang Geely Holding Group has announced plans to open a new factory for assembling Geely SC7 sedan vehicles. Experts estimate that car manufacturing in Belarus may triple in 2013.
Uzbekistan

Uzbekistan remains the largest automotive vehicle producer among the selected countries. In 2012, car production rose by 13% on the back of growing consumer demand in neighboring countries, primarily in Russia. Uzbekistan concluded a series of cooperation agreements with China, which makes experts optimistic about the prospects for production growth in the country.

Although sales are rising, reaching 94,400 units in 2012, they remain low in absolute terms. Between 85% and 95% of all light vehicles sold are assembled domestically. The reasons for this include high import and excise duties.

<table>
<thead>
<tr>
<th></th>
<th>Belarus</th>
<th>Kazakhstan</th>
<th>Ukraine</th>
<th>Uzbekistan</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>20,754</td>
<td>18,853</td>
<td>175,165</td>
<td>77,969</td>
<td>292,741</td>
</tr>
<tr>
<td>2010</td>
<td>13,749</td>
<td>21,560</td>
<td>173,915</td>
<td>81,478</td>
<td>290,702</td>
</tr>
<tr>
<td>2011</td>
<td>16,644</td>
<td>42,200</td>
<td>220,618</td>
<td>87,876</td>
<td>367,338</td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>428,694</td>
</tr>
</tbody>
</table>

Sources: IHS Global Insight, LMC Automotive (formerly J.D. Power), ISI Emerging Markets

<table>
<thead>
<tr>
<th></th>
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<th>Kazakhstan</th>
<th>Ukraine</th>
<th>Uzbekistan</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>198</td>
<td>1,242</td>
<td>62,571</td>
<td>117,900</td>
<td>181,911</td>
</tr>
<tr>
<td>2010</td>
<td>227</td>
<td>3,701</td>
<td>79,073</td>
<td>156,880</td>
<td>239,881</td>
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<tr>
<td>2011</td>
<td>173</td>
<td>3,494</td>
<td>139,605</td>
<td>182,107</td>
<td>325,379</td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td>4,183</td>
<td>192,090</td>
<td>205,337</td>
<td>401,899</td>
</tr>
</tbody>
</table>

Sources: IHS Global Insight, LMC Automotive (formerly J.D. Power), ISI Emerging Markets
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.

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- Ernst & Young audits 36% of the Fortune 1000 automotive sector companies
- Ernst & Young audits 34% of the Forbes Global 2000 automotive sector companies

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 4,500 people working in 19 offices in eight countries in the CIS region.
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The global recession reset the automotive sector landscape. As the sector recovers, automotive companies across the value chain must focus on profitable and sustainable growth, financial and operational stability, investments in new technologies and seizing opportunities in high-growth markets.

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