EMPLOYERS' FEDERATION OF AUTOMOTIVE INDUSTRY

18.09.2013

Brussels

UKRAINIAN CAR INDUSTRY OVERVIEW

1

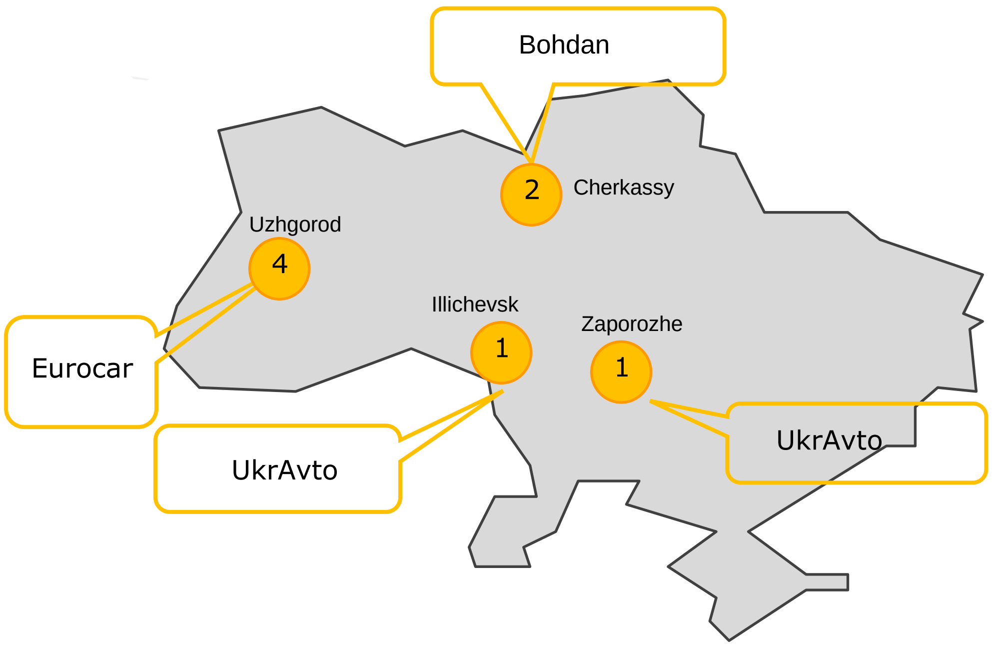
Summary

Ukraine car industry – core data

Indicator	Ukraine
Population 2013	45,5 Mio
Population growth rate	0,56 %
Share of employed in automotive sector from total employed	<0,1%
GDP growth 2012	0,2 %
GDP per capita 2012	5.770 €
Share of automotive sector in GDP	0,9 %
Inflation (official)	0,1 %
Unemployment	7,8 %
Car density (per 1000 people)	158
Average car age	18,7
Trade deficit formed by automotive import 2012	-3,9 bln $
Exchange Rate (4.09.2013)	1 USD = 8,1 UAH; 1 EUR = 10,6 UAH

2 Market review

Car producers in Ukraine: capacity underloading



Enterprise	Model	Model
PrJSC Zaporozhe Automobile Building Plant (ZAZ)	CKD	ZAZ Lanos, ZAZ Sense, ZAZ Vida, ZAZ Chance, ZAZ Forza
PJSC LuAZ (Bogdan Motors)	CKD	Bogdan (VAZ 2110), Hyundai Tucson
PrJSC Eurocar	SKD	Skoda (Octavia, Rapid, Fabia, Superb, Roomster, Yeti)
Kremenchuk car assembly plant Ltd. (KrASZ)	SKD	Geely (MK-1, MK Cross, Emgrand), SsangYong (Rexton, Kyron, Korando)

Car production by year	05	06	07	08	09	10	11	12
In k units per year	**196,7**	**267,2**	**380,1**	**400,8**	**65,6**	**75,3**	**97,6**	**69,7**

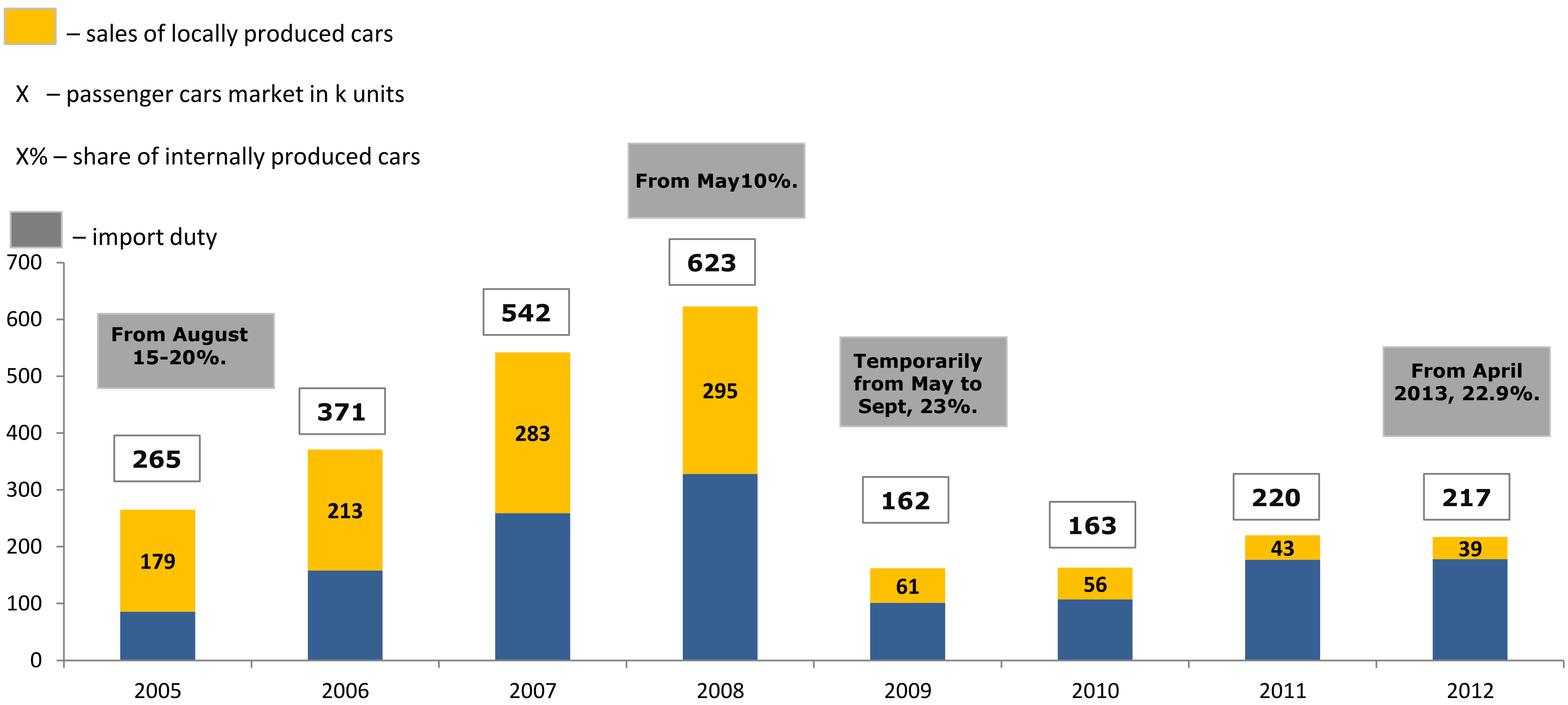
Existing total plant capacity in 2012 amounted to **400 k units** per year

Current average plant capacity loading is only **17,4%.**

Source: Ukrautoprom

4 New passenger cars market

Passenger cars sales dynamics of locally produced and imported cars



- The share of imported cars in total sales has grown from 43% to 82% during 2006-2012
- The sufficient drop of production volumes in 200-2012 was caused by the import growth after import duty lowering from 25% to 10% and demand decline resulted by finical crisis.

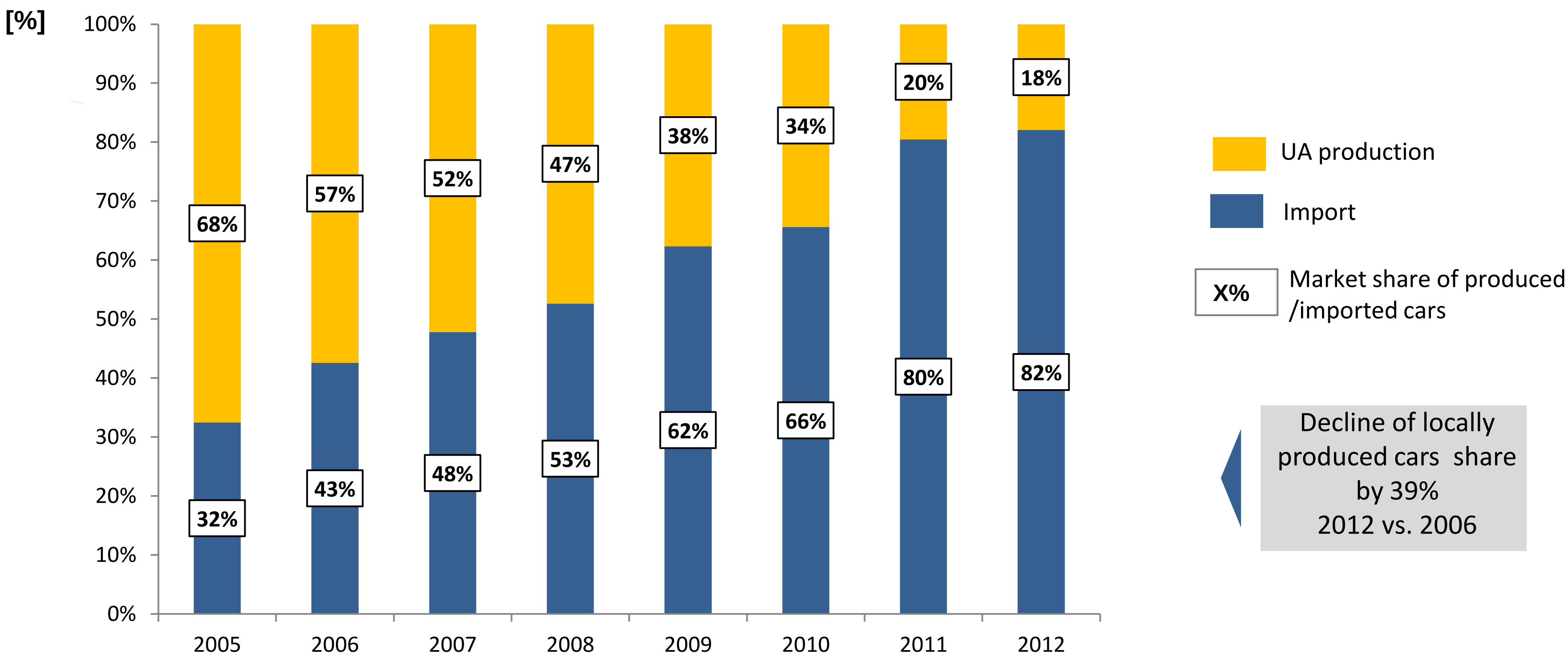
5 New passenger cars market
Import vs. production

Number of employees engaged in automotive production

2008
36 252

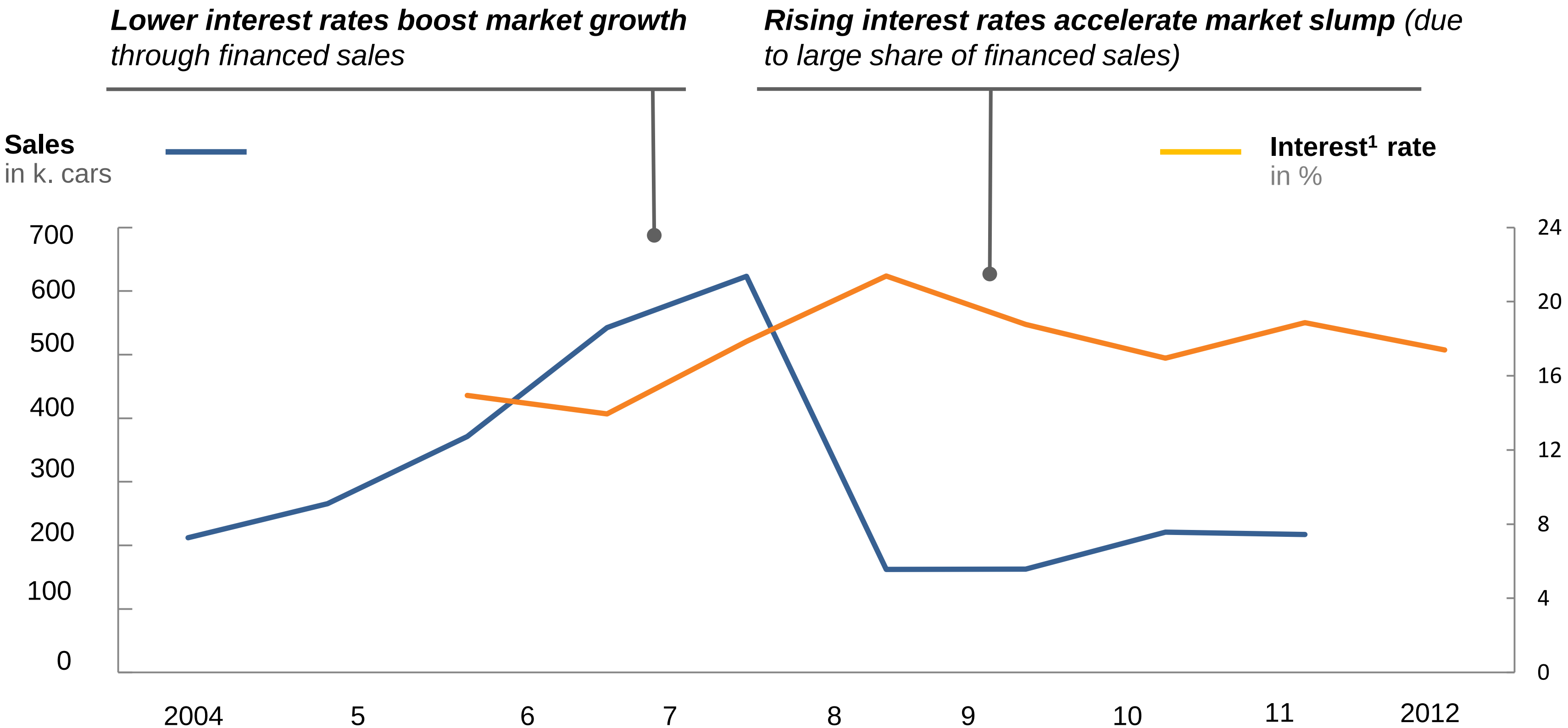
-46%

2011
19 500



Decline of locally produced cars share by 39% 2012 vs. 2006

6 Loan Car Sales
Sales of financed cars slumped due to high interest rates

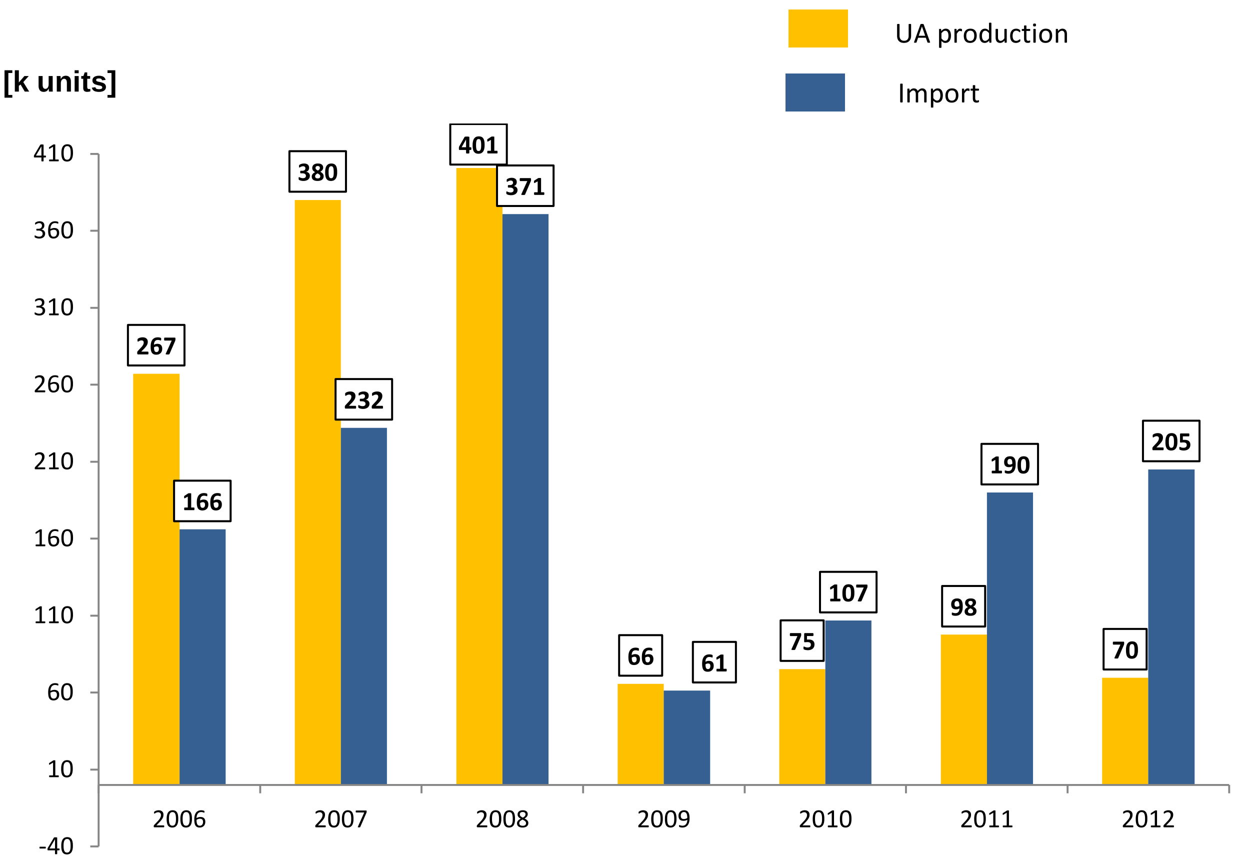


Loan sales share in %			31	38	34	5	11	17	17

1 Average interest rate for car loans (UAH, 3 years tenor)
2 Without leasing

7 Macroeconomic effect

Cars import is one of major factors of balance of payments negative result



In 2012, Ukraine has imported 1.8 time more cars than produced domestically (import - 205 k units, production - 69.7 k units).

Negative external trade balance (-14.8) bln USD, 24% of which is formed by automotive import. Trade deficit with EU amounts to $ 4.5 bln, 20% of which is formed by automotive trade.

8 Financial crisis consequences

Significant economic drop in Ukraine: automotive industry striking facts

- The harsh decline in production volumes in 2009-2010 was caused by import increase due to customs duty lowered form 25% to 10%
- Production volumes declined 6 times compared to 2008
- Labor productivity declined 2 times
- General decline for automotive industry at the level of -84%
- Social consequence of crisis: automotive industry employment declined by 18,955 persons, which constitutes half of the industry’s personnel
- Industrial assets depreciation amounted to 73% compared to 69% before
- Share of car and car components production in national GDP declined from 3,6% (2008) to 0,9% (2012).
- All these negative factors had very mare or slow recovery recently, UA market still haven't reached the level of 2004
- Negative dynamics continues despite even the fact of recent governmental support and new regulatory framework (which are introduced very short time ago and at rather late stage of general deep decline in industry to give the sufficient effect)

9

Financial crisis consequences

Prerequisites and key problems of automotive industry development

- Low purchasing power of population: due to the financial crisis and national currency devaluation the average level of income per capita declined by 1/3 compared to the level of 2008

- In 2008 Ukrainian financial marked was shaken by a harsh decline in UAH/USD exchange rate. During 2008 Ukrainian Hryvnia devaluated by 38% to USD

- Interest rates increased by 1.5 times and, as a result, credits were mostly frozen from November 2008 and continue to show very slow dynamics for recovery, even though, interest rates remain extremely high (around 19%) in comparison to other European countries which hampers recovery of national production

- Production decline and inability of local producer to overcome crisis consequences, fortified by harsh credit and debt pressure, led to the overall misbalance in trade, government and local producers doing the utmost by changing regulatory framework and pushing up the industry using different incentives
- Negative balance of international trade in 2012 is (-14.8) billion USD, 24% of which is formed by automotive imports.

10 Milestones

Governmental support for automotive sector during crisis period

UA passenger car market growth can be sustained only via

increase in demand → growth of customers incomes ← supported by growth in real sector of economy

Ukrainian automotive industry needs stimulation, support and protection in order to sustain recovery

During crisis period governments of leading countries in the EU, Latin America, Middle East, USA and Russia reacted immediately with implementation of the national programs for car industry protection and recovery

Governmental support implemented through import duties, financing and scrappage programs

Import duties	**Russia**	Raised import duties to 30% for new cars and 35% for used cars, after WTO joining 25% + utilization fee
	Uzbekistan	Introduced new levy for import of passenger cars
	Brazil	Has 35% import duty level irrespective of its WTO membership
	India	Has 105% import duty level irrespective of its WTO membership
	Ukraine	**Lowered its import duty to 10% in 2008 (crisis start) and after harsh decline and long non-recovery has introduced special import duties in mid 2013 + utilization tax on Sept 2013**

Ukraine’s European perspective requirements, as well as its WTO obligations, creates barriers for governmental support and programs for industry, as result vanishes country's chances for industry revival as well as existence in general.

11

Automotive industry regulatory framework
Recent changes and Government plans within the general import replacing policy

Tariff regulation

- **Introduction of special import duties**
  Introduced on 13.04.2013 till 13.04.2016 for 3 years term
- **Introduction of utilization fee laws**
  Accepted by Parliament on 04.07.2013. In force from 01.09.2013
- **Car bodies excise duty increase**
  Replaced by utilization fee. In force from 01.09.2013

Normative regulation of SKD, CKD, components production

- **Resolution of the Cabinet of Ministers № 1031**
  Changes approved by the Cabinet of Ministers on 11.07.2013r. In force from the moment of publication (15 Aug 2013).

Additional legislative support

- **Law on automotive industry support**
  Under elaboration
- **Concept of passenger cars industry development till 2020**
  Approved by Ministries and other authorities
- **Program of economy development activation for 2013-2014 stipulating automotive industry support in form of state guarantees and setting principles of public procurement of domestically produced vehicles.**

12

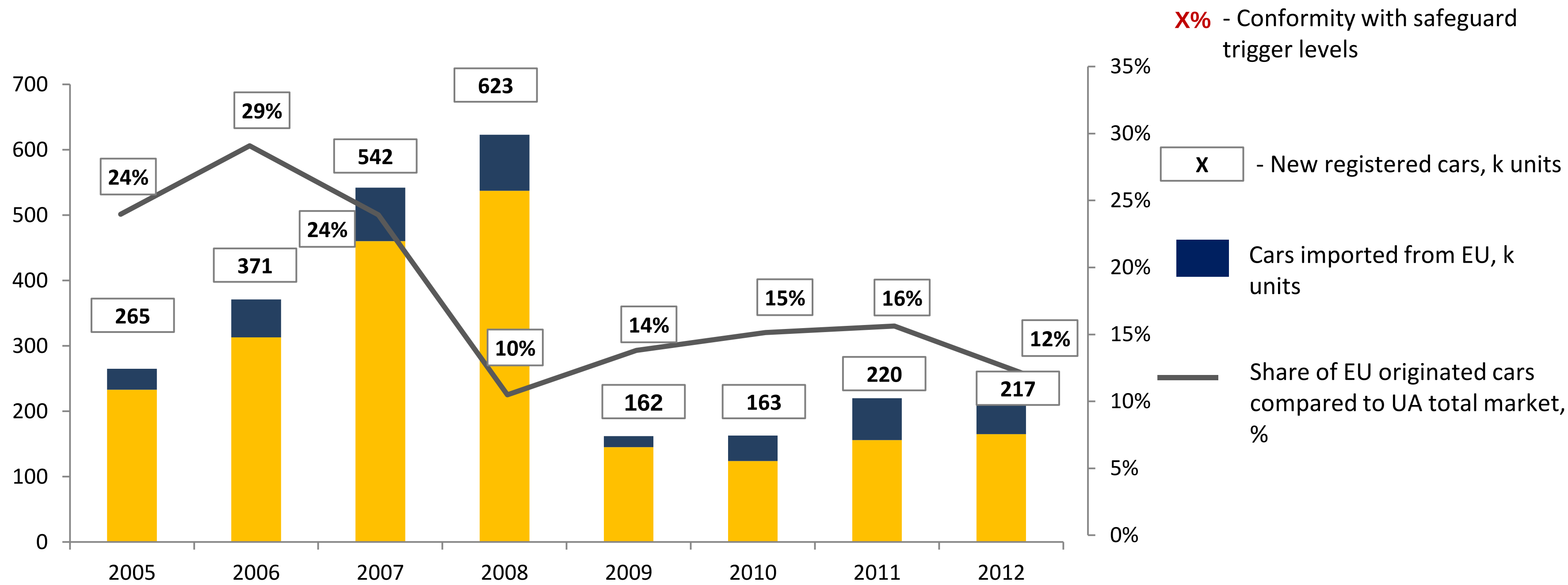
FTA with EU
Agreement terms and conditions for automotive

- Import duty will decline from 10% to 0%within 10 years.
- The duration of the safeguard clause for automotive industry will be up to 15 years starting from year 2 of the FTA
- Two triggers are to be met:
  - an annual import volume of 45.000;
  - a market share of imports in total market between 20% and 25%
- In a case when both "conditions" are met, the safeguard mechanism, based on MFN rate (10%), will be triggered 60 days following the date when the two criteria met and apply until the end of the calendar year
- After year 15 no safeguard measures are applicable while import duty is 0%.

Year	1	2	3	4	5	6	7-10	11-15
Trigger level, units	No safeguard	45 000	45 000	45 000	45 000	45 000	45 000	45 000
Trigger level MS, %	No safeguard	20%	21%	22%	23%	24%	25%	25%
Max safeguard measure incl. import duty, %	No safeguard	10%	9%	8%	7%	6%	5% -> 0%	0%

13 FTA with EU: automotive safeguard measures
Applicable to car market of Ukraine – retrospective analysis

Year	2005	2006	2007	2008	2009	2010	2011	2012
Quantity of new registered cars, k units	**265**	**371**	**542**	**623**	**162**	**163**	**220**	**217**
Cars imported from EU (trigger 1), k units	**32**	**58**	**82**	**86**	**17**	**39**	**64**	**52**
Share of EU cars in total market (trigger 2), %	**12%**	**16%**	**15%**	**14%**	**10%**	**24%**	**29%**	**24%**
20% of new registered cars	53	74	108	125	32	33	44	43
25% of new registered cars	66	93	136	156	41	41	55	54



Taking into account possible market growth and retrospectively low market share of EU originated cars **Ukraine can hardly count on application of safeguard mechanisms** in view of non meeting trigger criteria.

14

Free Trade Agreement EU-Ukraine
Consequences for Ukraine and implications mitigation

- Liberalization of the Ukrainian automotive market hold dire implications and consequences for the Ukrainian automotive industry and the economy in general, namely budgetary, financial, social areas
- These implications will affect employment, economic activity and the general quality of life

Ukraine is counting on an adequate level of technical, financial and consulting aid and assistance from the European Commission, Financial European Institutions and European automotive structures

- **Allow Ukraine to keep global safeguard measures within the end of their validity (2016) as well as all other additional taxes as per se without restriction to the terms of their application**
- Assist Ukraine with the implementation of higher European standards (in order to ensure that EU standards are met), especially in light of Environmental requirements and Ukraine's dedication to developing better Environmental norms and technologies.
- Provide with budgetary assistance to cope with the problems that will arise in the social (e.g. employment) and financial spheres of the automotive industry.
- Encourage European Financial Institutions (EIB, EBRD, etc.) through various credit facilities and financial instruments to assist the Ukrainian automotive industry in implementing higher European and Environmental Standards.
- Encourage European automotive manufacturers to cooperate with Ukraine in improving technologies for engines and other parts.

European Union should take into account current state of automotive industry and UA Government recent effort directed towards its recovery. All eliminations and cancellations as well as any changes to regulatory framework in automotive sector influencing the level of safeguard and support will trigger direct implication and effect on industry recovery and the level of employment in the country which is creating de facto potential purchasing demand for EU goods and services.

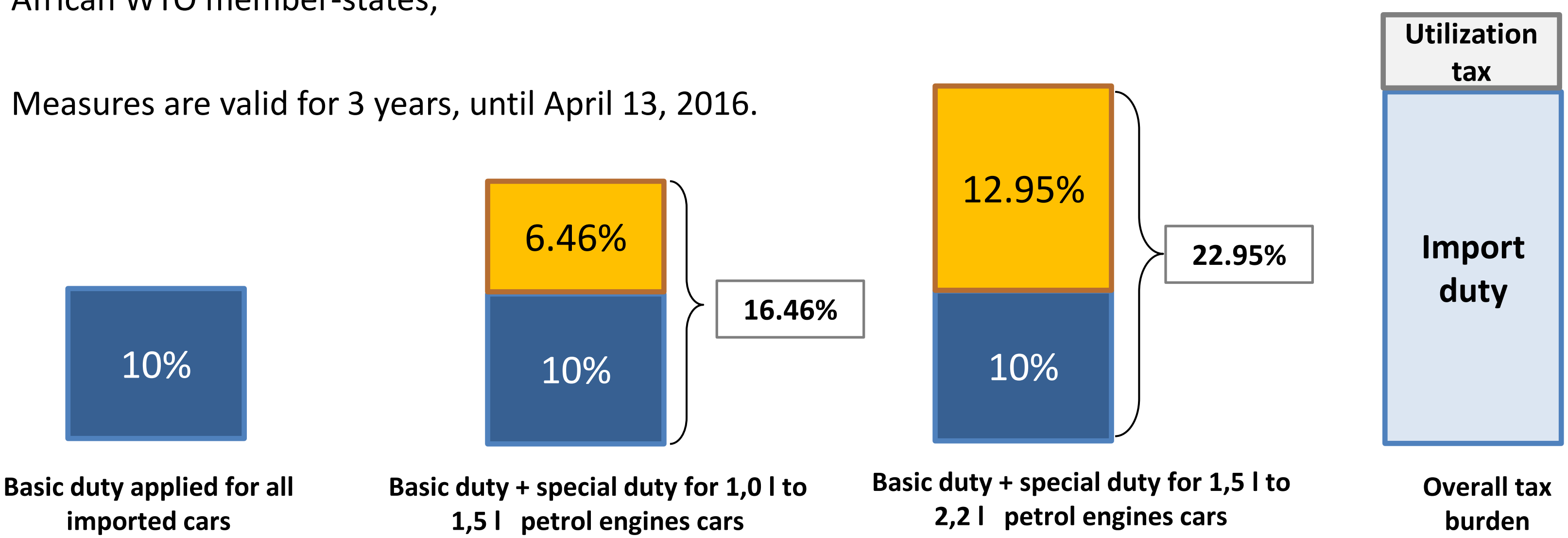
Thank you.

0

Regulatory framework

Import Duties Increase on FBU cars

- On March 14, 2013 the Decision on introduction of the safeguard measures had been published in the official governmental newspaper and thereby came into force.
- Safeguard measures introduced higher customs duties for imported FBU passenger cars:
  - 1,0 l to 1,5 l – 6,46 % (10% + 6,46 % = 16,46 % in total)
  - 1,5 l to 2,2 l – 12,95 % (10 % + 12,95 % = 22,95 % in total)
- New duties apply to cars with petrol engine only, and are NOT valid for diesel engines;
- New duties cover all countries (incl. CIS/Russia, EU, South Korea and Japan), with the exception of some African WTO member-states;
- Measures are valid for 3 years, until April 13, 2016.



0

Regulatory framework

SKD and CKD regulatory requirements in Ukraine

The Cabinet of Ministers of Ukraine approved the Resolution #1031 on 11 July 2013, which enacts a series of substantial changes into the existing SKD and CKD assembly requirements. It was published on 15 August 2013.

t	36 months	37-48 months	48-60 months	60-72 months	72-84 months	84 -96 months	
SKD models number	4, if 1 CKD in 36 months	$2xN_{CKD}$ of 1 brand					0
Localization level	No requirements	> 20%	> 25%	> 30%	> 40%	>50%	

CKD production facilities : > 25.000 per year

CKD realization term: < 36 months

Local components share: over 50% (for year 8)

SKD production: the same brand as CKD, depending on CKD production volumes

Average annual localization level: $\boxed{L = \left(1 - \frac{V}{P}\right)}$

L – average LC level;

V – customs value of imported goods by the enterprise under the List approved according to the Program (w/o SKD car body) in sales prices;

P – total cost of produced goods w/o excise duty and VAT.

The approved Program of CKD production facilities modernization (construction) allows to:

- Import car bodies free from utilization fee ($2750), fulfill SKD assembly
- Import components at 0 duty rate

0

Regulatory framework

Utilization tax

The Law introducing utilization fee is in force from 1 September.

The following coefficients are applied to passenger cars depending on the engine volume:

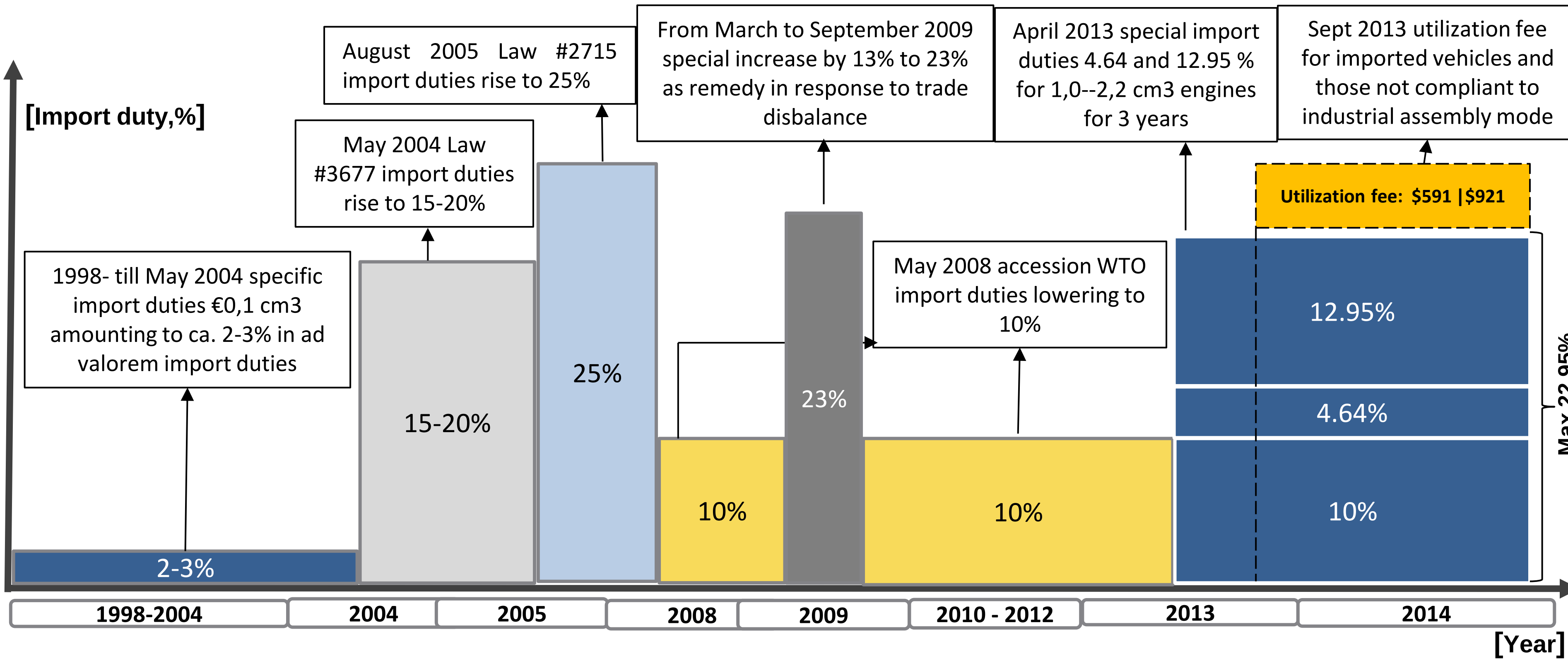
Engine volume	Coefficient	Amount
Cars		
Not more than 1000 cm3	0,86	591 $
Over 1000 cm3, but not more than 2000 cm3	1,34	921 $
Over 2000 cm3, but not more than 3000 cm3	2,56	1 760 $
Over 3000 cm3, but not more than 3500 cm3	3,47	2 386 $
Over 3500 cm3	5,50	3 781 $
Car bodies		
General rate	4	2 750 $
For industrial assembly*	0	0 $

* Car producers may qualify for tax exemption for car bodies import under industrial assembly mode (SKD) without utilization tax ($2750) as well a for 0 duty rate for components only in case of fulfillment of the Program for Establishment or Modernization of Production Facilities (“CKD Investment Program”) or in case of operating the existing CKD production facility.

0

Regulatory framework

Historical milestones



Law on Special Economic Zones, 1998-2005 20% income tax/duty free and VAT free import of parts, components and goods, equipment to SEZ	Duty free regime for components for industrial assembly stipulated by Cabinet of Ministers Resolution #1031	New criteria for industrial assembly set forth by changes to Cabinet of Ministers Resolution #1031 for next 8 years