Automobile Industry: Overview

The Russian automotive industry is far behind its U.S., Western European, and Japanese counterparts in terms of productivity, quality and customer service. Russian makes are outdated, substandard and unsafe. Nonetheless, Russia's automotive sector is healthier than many other industries, because demand is still high and growing.

Despite past economic turmoil, the total number of vehicles in Russia has increased rapidly over the last several years. Russian cars and used imports make up the largest number of new vehicle registrations. The total Russian motor vehicle fleet is estimated at 33 million units, including 23 million cars. Fifty percent of those cars are more than 10 years old. In 2003, Russian ownership increased to 152 vehicles per 1,000 inhabitants, almost triple the 1993 rate of 59 per 1,000. Annual car sales in Russia have increased from 800,000 in 1992 to 1.5 million in 2003. First quarter 2004 statistics indicate and market analysts concur, that the growth trend will continue. Increasing household incomes has led demand and the interest in newer models by Russian car-owners. Annual market growth of at least 10 percent is expected for the next few years.

The following tables provide information about the number of motor vehicles manufactured in Russia (2002-2003) and vehicle types produced by specific manufacturers. Slight inconsistencies in the data represented in the different tables may be the result of the fact that information provided by local manufacturers is not always accurate and reliable. For example, sources may mistakenly report the number of manufactured vehicles as the number of sold vehicles. Nonetheless, statistical data is important in demonstrating market trends.

Table 1

Russian Car Market

	2002		2003		2004 (1st Quarter)	
Built by:	Thousand units & market share	$ billion & market share	Thousand units & market share	$ Billion and market share	Thousand units & market share	$ Billion & market share
Russian Manufacturers	842 (59%)	3.7 (35%)	870(58%)	4.3(35%)	222(68%)	1.4(47%)
Foreign Makes Made in Russia	11 (0.8%)	0.1(1%)	54 (3.6%)	0.6(5%)	22(6.5%)	0.3(10%)
New Imports	117 (8.2%)	2.7 (25%)	170 (11.4%)	3.5(28%)	43(13%)	0.9(30%)

Used Imports	447(31%)	4 (38%)	400(27%)	4 (32%)	41 (12.5%)	0.4(13%)
Total	1417 (100%)	10.5 (100%)	1495(100%)	12.4 (100%)	328 (100%)	3.0 (100%)

Table 2

Local Production of Cars by Russian Manufacturers

Company	2002 # of units) & market share	2003 # of units) & market share	% of change
AutoUAZ	702,966 (73%)	699,889 (73%)	-0.44
Izh-Avto	65,751 (6.5%)	78,495 (8.3%)	19
GAZ	65,648 (6.5%)	56,783 (6%)	-13.5
Kamaz/ZMA	38,500 (4%)	40,013 (4%)	4
UAZ	33,648 (3.5%)	32,748 (3.4%)	-2.67
RosLada	42,926 (4.5%)	28,718 (3%)	-33.1
SEAZ	19,435 (2%)	20,005 (2.1%)	3
Tota	968,874 (100%)	956,651 (100%)	-1.26

Table 3

Local Production of Cars by Foreign Manufacturers

Company	Model Produced	2002 # Units	2003 # Units
GM-AutoUAZ	Chevy-Niva SUV	323	21,759
Ford Vsevolozhsk	Ford Focus	2,474	16,261
Avtotor-KIA	KIA-Rio and others	3,473	6,987
Avtotor-BMW	BMW, 3-5 series	2,241	1,428
TAGAZ	Hyundai Accent	2,490	5,896
AvtoFramos	Renault Clio Symbol	149	1,239
Total		11,150	53,570

The tables above shows that major Russian carmakers increased sales in 2003, although the number of vehicles manufactured is slowly decreasing. The market share of used imports decreased drastically in the beginning of 2004 due to high import taxes introduced by the Russian government in 2003. The market share of new imports is growing steadily and market share of foreign makes assembled in Russia has increased from 1% of the market in 2002 to 10% in the first quarter of 2004. The market share of Russian manufacturers also rose in the first quarter of 2004 due to increased import taxes, although there was no change between 2003 and 2002 figures. The sales of new foreign cars continued to rise despite the higher import tax. This phenomenon is explained by the desire of Russian customers to drive high quality vehicles rather than outdated inexpensive, low-quality cars produced by Russian manufacturers.

The market share of foreign cars manufactured in Russia is growing faster than new imports and domestic assembly. Industry analysts believe that this trend will continue. The existing foreign assembly projects recently announced a planned increase in production in 2004-2005, and new projects promise even greater growth. Domestic production of foreign cars may reach 100,000 units in 2004 and as many as 200,000 units by 2006.

Table 4

Local Production of Buses and Vans

	2000 # Units	2001 # Units	2002 # Units	2003 # Units
Total	54,000	60,000	70,000	77,000
Incl. large city transit buses	1,500	2,500	2,700	3,000

Table 4 shows that customers demand is currently focused on small and mid-size buses and vans. Although the production of large city transit buses has doubled since 2000.

Table 5

Bus Purchase by State and Municipal Entities

	1999 # Units	2000 # Units	2001 # Units	2002 # Units
Total	5,367	6,901	9,694	12,000
Incl. Used	2,267	2,620	4,241	5,760

New Light Vehicle Sales in Russia								
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Car	1,069,602	1,284,370	1,413,312	1,726,124	1,923,412	2,044,583	2,166,910	2,249,771
Share of Foreign brands	20.3%	31.7%	42.5%	51.4%	55.3%	56.2%	58.7%	61.6%
LCV	164,938	187,488	219,084	233,793	242,581	253,010	275,080	292,322
Share of Foreign brands	2.3%	3.3%	8.7%	11.7%	18.5%	25.7%	31.7%	38.4%
Grand Total	**1,234,540**	**1,471,858**	**1,632,396**	**1,959,917**	**2,165,993**	**2,297,593**	**2,441,990**	**2,542,093**
Share of Foreign brands	17.9%	28.1%	38.0%	46.7%	51.2%	52.8%	55.6%	58.9%

Source: Global Insight

The increase in sales of buses to municipal mass transit authorities in the recent years has exceeded local production. The demand has been met by imports of used buses from European countries. Municipal mass transit authorities often prefer used imports to new domestically produced buses, because of the substandard quality and excessive maintenance costs. In 2003, the Russian government, lobbied by domestic bus manufacturers, introduced prohibitive import taxes on used buses aged 7 years and older. In many Russian towns and villages older used imports have been the only alternative to overpriced new imports and low quality domestic buses that require huge maintenance costs.

The Russian government has worked to reconcile the interests of local bus manufacturers and municipalities by reducing import taxes for imported bus components, such as engines, gearboxes, etc.

Table 6

Local Production of Trucks

2000 # Units	2001 # Units	2002 # Units	2003 # Units
188,254	175,973	174,250	194,603

The current truck fleet in Russia is estimated at 4.6 million units, including 500,000 imported trucks. Domestic haulage is primarily serviced by locally manufactured trucks, while imported vehicles are predominantly used for international shipping. According to transportation industry experts, the truck haulage market will grow 20 percent by 2010. Approximately half of the existing truck fleet in Russia is ten years old or older. Many of these vehicles are registered, but are not actually used for transportation of goods (abandoned). The Russian government's introduction of Euro-2 regulations and increasing competition of imports has required domestic manufacturers to modernize their models and production facilities. After the stagnation of the 1990's, all Russian truck manufacturers are showing signs of recovery; increasing production, purchasing modern equipment, optimizing management and launching new models. In 2003, the Russian government introduced new prohibitive import taxes for used trucks aged 7 years and older. This change was lobbied by domestic truck-manufacturing firms. As a result, import of used trucks significantly decreased and sales of domestic vehicles indicated new growth.

Future Prospects

The first quarter of 2004 reports from all major Russian manufacturers indicates significant growth in production. Analysts foresee at least 10% increase in sales of domestic cars in 2004.

The Russian government anticipates that the total market for cars will be two million units by 2005 and three million by 2010 (approximately $18 billion), the truck market expects to sell 250,000 (approx. $10 billion) and the bus market will grow to 65,000 units (approx. $3 billion) in 2005. Industry analysts also expect that all sub-sectors of the Russian automotive industry will continue to grow.

Russian Automotive Industry Features

The Russian automotive industry has always been more vertically integrated than in western or Asian countries, with domestic manufacturers satisfying 80 percent of their component needs from internal (company) sources. However, the traditional practice of internal part sourcing is changing as new component suppliers enter the market by separating from their parent companies.

The demand for cars and light commercial vehicles remained relatively stable prior to, and following the implementation of market reforms in 1992, unlike heavy machine-building industries. Within the automotive sector itself, car production did not decline as seriously as bus and heavy truck production. Consequently, component suppliers selling primarily to car producers were able to stay in business. For a while, low quality and retrograde products forced Russian car manufacturers to purchase imported components. AvtoVAZ, the largest Russian car manufacturer, even used a number of imported components in its models, including fuel injection systems, electrical equipment, and power steering. However, this trend reversed after the 1998 financial crisis, when manufacturers returned to domestic suppliers because of increased higher import prices. Despite favorable conditions, Russian component manufacturers did not have sufficient funds to modernize their facilities and significantly improve the quality of their products. Now that the country has recovered from the 1998 crisis, all major Russian automotive manufacturers are interested in importing and developing an arrangement with an international supplier. The goal is to encourage those suppliers to establish manufacturing projects in Russia in order to reduce costs of imported components.

Previous Commercial Service reports have described barter agreements between vehicle manufacturers and component suppliers, when manufacturers used vehicles as payment for components and such transactions were made through intermediary firms often owned and managed by relatives or close friends of automotive executives. In the end, vehicle manufacturers suffered because they purchased low-quality components at inflated prices. Now that management teams have changed at almost all Russian automotive companies, those barter practices have been abolished.

Vehicle manufacturers understand that in order to maintain strong sales of domestic vehicles, they must provide better quality at competitive prices. This goal may be achieved only if local assemblers use modern components, either imported or produced in Russia under license from well-known foreign manufacturers.

Russian Light Vehicle Sales to Rise 20% in 2006, Global Insight Forecasts

Sales of new light vehicles have accelerated in Russia so far this year and are expected to rise 20% to 1.95 million units in 2006 as a whole.

Global Insight Perspective	
Significance	New light vehicle sales are expected to rise steadily in Russia over the next four years, spurred by a buoyant new car market, and could reach 2.55 million units by 2010.
Implications	Changes in taxation on imported cars and preferential tariffs granted to foreign manufacturers setting up production in Russia mean that the structure of the Russian car market is changing radically but Russian brands are still holding firmly to their domestic market.
Outlook	Russian manufacturers continue to have the upper hand thanks to their ability to propose simple, inexpensive vehicles. However this competitive advantage is gradually being undermined by foreign carmakers' ability to compete in

	the lowest price segment.

Manufacturer Profiles

The following profiles describe Russia's major automotive manufacturers.

AvtoVAZ

AvtoVAZ is the largest and most advanced manufacturer in Russia. The company was established in 1970 in cooperation with FIAT. From 1970 to 1992 the average Russian dreamed of purchasing a "VAZ". After reforms were launched in the early 90s, VAZ prices skyrocketed. As a result, demand for VAZ makes fell as buyers chose cheaper used foreign makes. VAZ company management did not adequately respond to the new challenges and lost market share to imports and market-oriented competitors such as GAZ. The August 1998 financial crisis provided a sorely needed boost to AvtoVAZ sales. The last five post-crisis years have allowed the company to remain competitive, although the average price for AvtoVAZ cars has been increasing and has reached as much as $6,000.

From 1970 to the present, AvtoVAZ has manufactured 22 million vehicles. In 2003, VAZ produced 699,889 cars and reported almost $4 billion in revenues, and about $160 million in profits. With 12,000 employees, antiquated equipment and ineffective processes, car assembly requires 30 times the man-hours compared to assembly in the West. The financial situation of the company is slowly improving after several years of decline. Recently, major international portfolio investment companies have reportedly expressed interest in purchasing AvtoVAZ shares. The recent annual report of Templeton Russia and East European Fund indicates that the Fund purchased 0.58% of AvtoVAZ equity worth of $5.6 million. AvtoVAZ, contrary to majority of other Russian automakers, is a publicaly traded company, working hard to improve transparency and corporate governance.

Due to a lack of available financing and inadequate management AvtoVAZ has not launched new, up-to-date models for the last several years. AvtoVAZ still manufactures the same models that were developed in eighties and the beginning of nineties. These models lack modern features that competing vehicles have in base versions, such as air bags, ABS, air conditioners, power windows, etc.

In 2004, AvtoVAZ borrowed $240 million from Deutsche Bank. Company management did not reveal the purpose of this loan, however, industry experts believe that this loan will be used to finance the development of a new B-class model, the Kalina. The Kalina is scheduled for launching by the end of 2004. AvtoVAZ has announced that all the company's older models will be replaced by 2008. The success of this new ambitious plan will depend on AvtoVAZ's ability to compete with new imports. So far the only competitive advantage of AvtoVAZ vehicles has been their low price, with newer models with modern features coming on-line costs will be higher, risking AvtoVAZ's last competitive advantage.

In June 2002, the Commercial Service Russia team met with the CEOs from AvtoVAZ and the GM-AvtoVAZ joint venture to discuss opportunities for U.S. automotive component manufacturers. According to AvtoVAZ officials, the average imported content of AvtoVAZ vehicle exceeded $640 per unit until 1998. However, due to the Russia's financial crisis and the devaluation of the ruble, the company reduced imported content to $200 per unit. The firm is interested in increasing import content in order to improve the quality of its vehicles. Company officials specifically mentioned electric system and electronic components, and trim as priority import items. AvtoVAZ would also like to import systems that are not manufactured by Russian industry, such as air conditioners, ABSs, power steering and automatic gearboxes.

AvtoVAZ is interested in purchasing quality components manufactured in Russia by foreign companies and will be supportive of international automotive component manufacturers that plan to invest in Russia. AvtoVAZ executives expect that U.S. companies will either establish joint ventures, license technologies to existing suppliers, or set up subsidiaries in Russia.

There are several examples of VAZ's successful cooperation with foreign tier-1 suppliers that have established their plants in Russia. In 2003, Tenneco Automotive invested $3 million in a manufacturing facility in Togliatti. This facility is manufacturing 150,000 exhaust systems annually and plans to start production of shock absorbers in the near future. An Italian company, Autocomponent Engineering, established a joint venture with the SOK Group. The new joint venture will manufacture airbags for both the GM-AutoVAZ and for AutoVAZ. The current plan of the joint venture is to manufacture 80,000 steering wheels with air bags in 2004.

GAZ

GAZ, like other Russian vehicle producers, experienced hard times in the early 90s, but managed to recover because: GAZ production was more diversified than that of other manufacturers; Nikolay Pughin, a former Russian automotive industry minister, was appointed general director and persuaded the federal government to grant GAZ a loan towards production line modernization; and the company started to focus on marketing and to create a dealer network throughout Russia. In 1994 GAZ started production of a new light commercial vehicle (LCV), the GAZ-3302 "GAZELLE" (load capacity 1.5 metric tons). At that time it was the only domestic LCV in the Russian market. Designed as an exact replica of Ford's Transit, GAZELLE has been a GAZ bestseller in recent years. The base model was followed by a minivan and a SOBOL, a one-ton capacity LCV and minivan. GAZ' passenger car, the VOLGA, entered production in the seventies and has been upgraded to the VOLGA GAZ-3110.

In 2000, GAZ was acquired by Sibal, the largest Russian aluminum manufacturing company. Sibal consolidated equities of several automotive and bus manufacturing firms under the RusPromAvto holding consortium. The new management team of GAZ has improved the financial position and significantly enhanced distribution practices. Currently, industry analysts believe that GAZ is a well-positioned Russian manufacturer due to effective management and considerable investments in new model development and production modernization.

In 2003 GAZ reported a 21% increase in annual sales over 2002; the company's sales totaled more than US$ 1.4 billion. According to the company's report, GAZ manufactured 216,035 vehicles, including 66,613 cars and 149,422 trucks and buses.

GAZ actively cooperates with foreign firms. The company recently signed a contract with the German corporation Bosch that supplies components such as fans and fuel filters, as well as some parts for GAZ-made diesel engines produced under license with Steyr of Austria. Several U.S. companies, including Lear Corporation, have taken advantage of opportunities in the Nizhny Novgorod auto industry. Lear produces seats for GAZ automobiles. The new 3111 model design was contracted to the Detroit-based firm Venture. Also, Michigan-based Haden, Inc., sold body-finishing equipment to GAZ.

UAZ

Severstal Group, the largest Russian steel manufacturing company, through its subsidiary Severstal-Avto, controls UAZ. UAZ produces off-road vehicles, LCVs and minivans. In 2003, UAZ reported sales of 78,538 vehicles worth of $380 million and profits of $20 million. Approximately 20% of UAZ vehicles are exported to NIS countries and Asia.

During the last several year's car production at UAZ has steadily increased, while production of LCVs and minivans has decreased. All UAZ products are outdated and of low quality. In 2000, UAZ launched updated models of its sport utility vehicles, the 3160 and 3l62, however these models did not find a receptive market in Russia. UAZ has recently announced that new modernized SUV models and a new LCV would be launched shortly.

UAZ actively cooperates with Western companies. The company purchased new equipment from Swiss, German and Italian firms. Recently, UAZ purchased painting equipment worth 12 million Euros from the German company Eisenmann. The equipment will be procured and put into operation by August 2004. During meetings with the Commercial Service, UAZ officials expressed interest in cooperation with U.S. companies in joint production of components such as engines, transmission parts and gearboxes.

OAO ZIL

The Moscow city government expropriated ZIL in 1996. After several years of unsuccessful operations and considerable decline in production, the company was restructured in 2003. The first year after restructuring, ZIL manufactured 13,274 vehicles, predominantly the "Bychok" LCV, worth approximately $200 million. Company officials set a 30% sale increase as a target for 2004. If the company achieves this goal, in 2004 ZIL production will exceed 17,000 trucks.

ZIL is conducting an aggressive marketing policy and developing its distribution network. However, many industry experts believe that these efforts are insufficient and ZIL is doomed to lose out to the competition from imports and more successful domestic manufacturers, such as GAZ. ZIL is staying afloat thanks to subsidies from the Moscow government. However, these subsidies are insufficient to modernize and restructure ZIL in order to produce competitive vehicles.

IZH-AVTO

During the 1990s Izh-Avto production declined and their assets degraded due to ineffective management, outdated production facilities and equipment, and lack of financing. By 1999, Izh-Avto was at the brink of bankruptcy and manufactured less than 10,000 vehicles annually. In 2000, the company was acquired by the SOK Group, a former AvtoVAZ dealer. SOK Group has grown into one of the key Russian automotive companies, controlling 25% of the Russian automotive component market and two assembly firms, Izh-Avto and RosLada. By improving management practices and investing significant funds in equipment modernization, quality control and launching new models, SOK Group managed to increase sales from less than $19 million in 1999 to almost $200 million in 2002. Annual production has grown almost ten times within last four years. SOK Group also invested in imported welding and painting equipment.

SOK's marketing strategy envisages active development of the low-end sector of the Russian car market by targeting those customers who are most price-sensitive.

In recent discussions, SOK managers repeatedly indicated their interest in cooperation with international automotive companies either in the form of joint venture or strategic partnerships.

AZLK MOSKVICH (AZLK)

AZLK is controlled by the Moscow city government and was the Soviet Union's third largest car manufacturer. In 1991, AZLK produced more than 100,000 vehicles. Since then, production volume steadily decreased until it stopped completely in 2001, due to ineffective management and notoriously poor quality cars. At the time, the Moscow government had expected that Renault would become AZLK's strategic partner, however the French automaker was not interested and instead, set up a new company, AvtoFramos. Currently, AZLK is under anti-crisis management, and industry analysts do not expect production to resume soon.

KAMAZ

KAMAZ is Russia's largest heavy truck manufacturer. The company manufacturers all types of trucks, including highway tractors, dumpers and special purpose vehicles with a haulage capacity between 4-20 tons. KAMAZ also produces a small car, the OKA, and city buses at separate facilities. The Russian Federal Government and the government of Tatarstan control the company. KAMAZ employs 52,000 working at their company headquarters in Kazan, and at 17 subsidiary firms. In 2003, KAMAZ manufactured 24,085 trucks (20% increase over 2002), and 39,500 cars (2.5% over 2002). The company's last year sales approached $900 million and net profit exceeded $60 million. KAMAZ's share of the Russian truck market has grown from 27.1% in 2002 to 36.4% in 2003.

KAMAZ management realizes that successful continued development of the firm is possible only through modernization of production facilities, quality improvement, and cooperation with leading international manufacturers of components and production equipment. Recently most of KAMAZ plants were ISO9001:2000 certified. Since then, the number of customer complaints has substantially diminished.

Pavlovo Bus Factory (PAZ)

PAZ is among Russia's major bus manufacturers and is the exclusive producer of mid-size city buses. Siberian Aluminum (Sibal), one of Russia's largest industrial groups, took control of PAZ several years ago. Rusavtoprom, a subsidiary of Sibal, also owns several key companies in the automotive sector, including Likino Bus Factory (LIAZ), Kurgan Bus Factory (KAVZ), Golitsyno Bus Factory (GolAZ) and Gorky Automotive Works (GAZ).

Before the PAZ factory was acquired by Sibal, the company's performance was extremely disappointing. The new management team has introduced effective management, investments in new model development and production modernization, as well as building a new dealer network throughout Russia. These measures helped to increase production from less than 7,000 units in 2000 to almost 12,000 in 2003. Recently, PAZ launched a new mid-size intercity bus and a large city transit bus.

PAZ's major challenge is that its principal customers are regional governments making purchases for local transit systems. Most regional governments lack funding.

Rusavtoprom management understands that cooperation with leading international automotive component and equipment manufacturers is the key to future development of their companies.

New Projects to Assemble Foreign Makes in Russia

There are several projects in Russia to assemble foreign vehicles. These projects may be categorized in two groups. The first group includes complete-knock-down (CKD) and semi-knock-down (SKD) assembly lines with limited capacity; importing almost 100 percent of the components. Avtotor in Kaliningrad, assembling BMW and KIA Rio, represents this group. TAGAZ, assembles Hyundai Accent and Sonata, and the SOK Group is launching the KIA Spectra assembly project. The second group of projects is assembly lines utilizing at least 50 percent domestic content. The most advanced among several announced projects are the Ford project in a suburb of St. Petersburg and the GM-AvtoVAZ project in Togliatti.

Ford Motor Company

In 1999 Ford's Board of Directors decided to invest $150 million to construct an assembly plant in Vsevolozhsk, a suburb of St. Petersburg. The new plant started operation in 2002. The planned annual production capacity of 25,000 Ford Focus vehicles by 2005 was surpassed because of demand, exceeding expectations. In 2003, the plant manufactured over 16,000 vehicles. The 2005 target will be reached in 2004. The plant's capacity is expandable up to

100,000 vehicles. The Russian government exempted the project from import taxes on components with the requirement that Ford raise local content to 50% within five years. So far, the share of locally sourced components is insignificant. Ford Vsevolozhsk is actively working with potential Russian suppliers. The company is interested in foreign component manufacturers with modern, high quality production facilities in Russia.

GM

The GM-AvtoVAZ joint venture that launched production of the Chevrolet-Niva SUV in September 2002, sold 25,000 cars in 2003, and set 60,000 vehicles as a sales target for 2004. The joint venture will be capable of producing 75,000 vehicles annually, and plans to expand volume to capture 20% of the Russian passenger car market by 2007. According to GM-AvtoVAZ officials, the joint venture is working with several local suppliers to improve the quality of their components. Company officials understand that the active involvement of Western manufacturers would significantly accelerate this process and confirmed that the firm is interested in purchasing components from Western subsidiaries located in Russia or from other joint ventures. GM-AvtoVAZ would be interested in cooperating with U.S. companies that are interested in investing funds and expertise to establish Russian subsidiaries.

In 2003, GM authorities announced their plans to start the Russian production of the Opel Astra sedan under the Chevrolet Viva brand. The vehicle will be manufactured by the GM-AutoVAZ JV, which is currently producing the Chevy-Niva SUV. It is planned that the JV will manufacture 17,000 Chevy Vivas in 2005. Project developers believe that local content for the vehicle will be more than 40 percent initially and will increase to 96 percent.

In 2004, GM officials announced plans to start investments in setting up an engine manufacturing facility in Togliatti. Investments in the Opel FAM-1 engine manufacturing plant are estimated at several million dollars and are expected to start in 2004. GM has also signed an agreement with Avtotor in Kaliningrad for joint assembly of the Hummer SUV.

Renault

In 1997, the Moscow city government signed an agreement with Renault to establish a joint venture (Avtoframos) to assemble the Renault-Megane from imported components. AZLK provided production space for the joint venture, but was not a participant. In 1999, Avtoframos produced 410 Meganes and 125 Renault-19s and reported total sales of slightly more than 1,100 locally manufactured and imported vehicles. While the company originally envisioned annual assembly of 100,000 Megan vehicles by 2000, later these plans changed and Avtoframos switched to assembling Clio Symbol models. In 2003, Renault revealed its plans to invest $250 million in launching a new X90-Logan model specifically developed for emerging markets. Start-up of the serial assembly is scheduled for 2005. Renault plans to produce 60,000 cars annually in the initial stages of the project development and to increase production up to 120,000 vehicles annually by 2010. This project will also require quality locally manufactured components.

BMW

In 1999, BMW established a joint venture with Kaliningrad-based Avtotor the assembler of the 523 and 528 models from imported components. Later, assembly of the 323 model was started. So far, the capacity of this joint venture is extremely limited due to the limited market for locally assembled luxury cars in Russia.

KIA

Avotor in Kaliningrad assembles Korean KIA carrs and light trucks. The company doubled production in 2003 over 2002. All the components for these vehicles are imported. Recently, Avtotor purchased modern welding and painting equipment and has earned ISO 9002 quality certification. The company is interested in locally manufactured quality components.

One of the leading Russian automotive companies, SOK (owner of Izh-Avto), announced their new project to assemble the Korean KIA Spectra sedan in Izhevsk. SOK is planning to invest $100 million in this project. The investment is intended for equipment modernization and localization of components. SOK management plans to commence CKD assembly of KIA Spectra in 2004 and to start equipment modernization worth $59 million the same year. Later, in 2005, modern welding and painting facilities will be installed. According to the project schedule, in 2004 SOK plans to assemble 40,000 KIA vehicles, which will increase to 120,000 units by 2007.

Hyundai

In 2001, Taganrog Automotive Company (TagAZ) signed a contract with Hyundai Motor Company for supply of Hyundai Accent assembly kits. In 2003, 5,896 cars were assembled and sold, an 80 percent increase over 2002. Recently, TAGAZ officials announced that they would start assembly of the Sonata model in 2004. Assembly will include welding and painting. The company plans to sell 17,000 Accents and 4,000 Sonatas in 2004. Manufacturing facilities at TAGAZ have capacity to increase production up to 120,000 vehicles annually.

Others:

In 2002, the Swedish firm Scania, invested $10 million and started SKD assembly of city buses from imported components in St. Petersburg. 94 buses were sold in 2003 and the sales target for 2004 was set at 150 buses. Since the existing plant's capacity is 400 Scania-Omnilink buses annually, (Scania officials believe that this target can be reached shortly), they have started negotiations with the local authorities regarding purchasing another site in order to expand production.

In 2003, the Russian company "Automobiles and Motors of the Urals" started assembly of Indian Tata trucks of loading capacity up to 4 tons in Novouralsk, near Yekaterinburg. The company is planning to assemble 400 units in 2004 and increase their production to 5,000 units annually in the near future.

The U.S. Company Elgin Systesm and the British firm Truck & Dumpers are reportedly implementing another truck assembly project in St. Petersburg.

Best Sales Prospects

8407	Spark-Ignition Piston Engines
8408	Compression-ignition Engines
84254	Built-in Jacking Systems
847989	Automotive Maintenance Machines
8511	Electrical Ignition or Starting Equipment
8512	Electrical Lighting or Signaling Equipment
870810	Bumpers And Parts
870839	Brakes And Servo-Brakes And Parts, Of Motor Vehicles
870839	Brakes
870840	Gear Boxes And Parts For Vehicles Of
870850	Drive Axles With Differential

870860 Non-Driving Axles And Parts

870870 Road Wheels And Parts And Accessories

870880 Shock Absorbers

870891 Radiators For Vehicles

870892 Mufflers And Exhaust Pipes For Vehicles

870893 Clutches And Parts For Vehicles

870894 Steering Wheels, Steering Columns And Steering Boxes For Vehicles

903180 Internal Combustion Engines Testing Equipment

903180 Wheel Alignment and Balancing Systems

903289 Electronic Ignition Analyzers

Imports

Table 4

Best Selling Imported Cars in the Russian Market Sold Through Official Dealers in 2003 and growth rates (by manufacturer)

Manufacturer/Brand	2002 (units)	2003(units)	Growth rate of 2003 over 2002(percent)	Growth rate trend: 1st quarter of 2004 over 1st quarter of 2003(percent)
Toyota	8,302	25,075	202	174
Ford	6,669	20,712	210	104
Daewoo	12,418	20,255	63	210
Mitsubishi	8,167	17,663	116	56
Hyundai	5,575	14,561	161	233
Kia	5,382	12,420	131	130
Renault	8,337	11,357	29	39
Nissan	8,026	9,470	18	156
Peugeot	6,984	8,762	25	22
Opel	2,865	7,318	155	161

Skoda	9,444	6,678	-29	-80
Volkswagen	6,625	6,335	-4	24
Volvo	2,929	5,027	72	11
Suzuki	1,912	4,044	113	Na
BMW	3,790	3,774	-0.5	32
Honda	1,340	3,574	167	134
Mercedes-Benz	2,135	3,205	50	65
Audi	2,700	3,111	15	37
Citroen	2,227	2,973	34	54
Mazda	641	1,862	190	215
Land Rover	839	1,582	89	90
Lexus	328	1,397	326	406
Subaru	571	1,272	123	330
Chevrolet	275	605	110	65
Chrysler	197	429	118	34
Saab	199	375	88	87
Rover	75	347	263	20
Jeep	183	332	81	na
Seat	127	250	97	na
Alfa Romeo	103	201	95	50
Jaguar	118	172	46	9
Ssang Yong	142	168	18	na
Mini	96	128	33	30
Fiat	248	103	-58	14
Bentley	0	70	Na	na
Cadillac	25	41	64	290
Maybach	0	12	na	na
Isuzu	45	12	275	na
Lancia	0	1	na	na
Total	110,280	195,693	77	89

The imported car fleet in Russia has increased from 594,000 in 1993 to almost 3 million in 2003. Of 1.5 million cars purchased by Russian customers in 2003, 570,000 were new and used imports. Of that total, official dealers reported sales of about 195,000 new foreign cars, while unofficial dealers and individuals imported the balance. In European Russia, the most popular makes are German, French, Korean and Japanese, while in the Russian Far East Japanese cars predominate.

The leading exporter of heavy trucks and city buses to Russia is Belarus, where the Minsk Automobile Plant with Western design, technology and components.

Almost all Russian vehicle manufacturers import components and manufacturing equipment. As mentioned above, meeting with managers of Russian OEMs has confirmed that they are ready to consider importing quality parts and equipment, however would prefer foreign suppliers to establish manufacturing facilities in Russia in order to reduce costs. Obviously, with this approach, business risks are born by foreign investors, however the growing market indicates a strong demand and steady growth potential.

Exports from Russia

Major Russian manufacturers such as AvtoVAZ, GAZ and KAMAZ export approximately 10 percent of all their sales to Asian, South American and NIS countries. Russian vehicles still have a relatively good market in former Soviet countries such as Ukraine, Georgia, Armenia, Moldova and Azerbaijan. Very few Russian component manufacturers are capable of producing components competitive in the world's automotive marketplace.

Competitive Situation

There are very few domestic automotive component manufacturers that can compete with western companies. Local firms suffer with ineffective management, outdated technologies and equipment and lack of financing for modernization. Their only competitive advantages are low prices and barter agreements with customers.

All major Western vehicle manufacturers have expressed interest in the Russian market. Many western component and equipment manufacturers are active in Russia. For example, Bosch of Germany has a joint venture in the Saratov region producing spark plugs and fuel injection equipment; Germany's ZF and VDO/Kienzle have extensive activities in Russia. ZF has discussed supplying automatic transmissions and a joint venture to produce power steering for GAZ, and heavy truck gearboxes for Kamaz. VDO has a joint venture with Vostok Watch Factory and Metem to produce dashboards for Autovaz. Austria's Steyr has long cooperated with GAZ and has licensed production of its diesel engine. Continental acquired the Moscow Tire Plant and Nokia announced a multi-million dollar investment in construction of a greenfield tire plant near St. Petersburg.

Financing

Car loan sales in Russia are increasing very rapidly. According to market analysts, car loan sales in Russia have grown from almost zero in 2000 to $400 million in 2003, and are expected to reach $1.4 billion by 2007. The interest rate for car loans varies from 5 to 12 percent and continues to decline. The number of banks operating in the car loan market doubled in 2003, and terms of repayment have eased considerably. While, in 2002 only 10 percent of cars in large

Russian cities were sold through a loan agreement, in 2003 this market share grew to 25-30 percent. However, in smaller cities and villages 95 percent of vehicles are still paid for upfront. Experts believe that loan programs will continue to expand to the regions and future loan sales may reach 40 percent in 2004.

Corporate bank financing is very limited. Russian assemblers and component manufacturers lack funding for modernization. The European bank for Reconstruction and Development (EBRD) may be a good source of co-financing for investment projects seeking to manufacture modern automotive components in Russia. EBRD officials have repeatedly confirmed their willingness to co-finance such projects in Northwest Russia. U.S. companies may also consider financing from the Trade and Development Agency (TDA) to conduct feasibility studies in Russia or orientation visits of Russian business representatives to the U.S. U.S. firms should also review and consider political risk insurance guarantees from the Overseas Private Investment Corporation (OPIC). The U.S. Commerce Department's SABIT program may finance internships for Russian managers at U.S. companies. The U.S. Export-Import Bank (EXIM) is currently restoring its operations in Russia, and may soon finance exports of U.S. products and services for projects in the automotive industry.

Market Access

Import Climate

A 18% Value Added Tax (VAT) applies to all imported goods. Import tariffs specific to automotive components are between 5-10%.

Certification

Certification is an important consideration for prospective imports, as any new product to be used or consumed by the public is subject to certification for quality, conformity, and safety. OEMs as end users may also require suppliers to obtain local certificates. Certification requires testing and approval of a product sample in one of a small number of labs. The final certificate permits the company to import its product for sale on the Russian market. The length of the certification procedure depends on the complexity of the product and the number of tests required. Gosstandart, the Russian certification authority, has mutual recognition agreements with a number of foreign certification agencies, such as DIN GOST TUV (Germany), SGS

(Switzerland), Mertcontrol (Hungary), and others. U.S. products holding such certification do not require re-certification in Russia.

Opportunities for U.S. Firms

U.S. firms will find their best opportunities in the local production of modern components and accessories, and selling them to assembly projects established by major foreign entities. There is also considerable demand for equipment to modernize aging assembly plants and component manufacturing facilities. The automotive aftermarket looks upon U.S. firms very favorably. Locally established U.S. component manufacturers finding insufficient opportunity in the OEM market should consider the aftermarket and exports from Russia as other methods to maintain high production volumes until the local OEM market improves.

Drawbacks

Foreign companies with joint ventures in Russia point to several obstacles that inhibit increased foreign investment in Russia, particularly in the automotive sector. Such obstacles include, contradictory legislation, lack of law enforcement, widespread corruption, an unpredictable political environment and barter transactions in the OEM market. Russian federal legislation does not provide any specific tax or import duty relief to foreign investors manufacturing automotive components. Moreover, intensified localization of component manufacturing could result in higher taxes for imported components. Foreign investors often complain that the quality of local materials supplied to their Russian facilities is low and that there is a lack of suppliers. Russian component manufacturers and foreign investors are actively lobbying for tax relief on investments ranging from $5 to $10 million. Current Russian legislation only benefits vehicle assembly projects with investments over $100 million.