Localization requirements

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WKO Business Breakfast
Moscow, June 7
Lack of diversification in the economy

- Dependency on natural resources

http://www.ariva.de/oelpreis-brent_crude-kurs/chart, 18.04.2017
Import substitution

- Russian market remains one of the largest and attractive markets in many industry sectors in the world
- measures to increase domestic production
- Russian industrial policy aimed at developing the manufacturing of Russian products that shall replace imports (import substitution program) and an increase in domestic production (localization).
Localization – General idea

- Ambitious import substitution plan for modernizing Russia’s Industry
- Aiming at producing 800 products from 19 industry sectors in 2020 by implementing more than 2,000 localization projects
- “Carrot and stick” method: exclusion of foreign suppliers from state tenders and offering incentives for companies that localize their production
- Promotion and facilitation of local production
- Fostering technological progress, bringing new technologies to Russia
Russian Industrial Policy

Government Decree
Import-subst.-program
Nr. 1936-R of 30.09.2014

Federal Law
„On Industrial Policy“
Nr. 488-FZ of 31.12.2014

Market access restrictions for foreigners:

Medical products, Machines, light industry, radio electronics for state procurement
Nr. 1289 / 30.11.2015, Nr. 791 / 11.08.2014

Special Investment Contracts for specific industries
Nr. 708 / 16.07.2015

criteria for determination of origin - “Made in Russia”Nr. 719 / 17.07.2015, amended by Nr. 744 / 02.08.2016

Restrictions in state procurement
Nr. 925 / 16.09.2016
General legal framework

- **General enactments:**
  - Federal law “On industrial policy” No. 488-FZ as of 31.12.14
  - CIS Agreement dated November 20, 2009
  - Government Decree No. 719 as of 17.05.2015 (amended by the Government Resolution No. 744 as of 02.08.2016, which is effective from January 1, 2017)

- **Pharma industry:**
  - Federal Targeted Program "Development of Pharmaceutical and Medical Industry of the Russian Federation until 2020" (Government Resolution No. 91 dated February 17, 2011)
    - 2011-2015
    - 2016-2020
  - Government Decree No. 1289 as of 31.12.2015 (Restrictions on tendering for state procurement of medical products from the list of vital and essential medical products)
Federal Law „On Industrial Policy“

- Diversification of the economy through industry incentives and product localization
- Federal and regional tasks
- General framework for industry specific development programs
- Guarantee of stability: Immunity for investors re. future changes in the Law
State Procurement

State procurement in the RF is governed by two laws:

• Federal Law No. 223-FZ, dated 18/07/2011, “On the Procurement of Goods, Work, and Services by Certain Types of Legal Entities” ( "Law No. 223-FZ"); and

State Procurement

- Law No. 44-FZ governs procurement by state and municipal agencies for state and municipal needs.
- Law No. 223-FZ applies to procurement by state-owned corporations, state-owned companies, entities in which the state owns over 50% shares/participation interest, entities that engage in regulated types of business (water supply, energy, etc.), natural monopolies, and budget-funded entities making purchases with non-budgetary funds.
- In order to participate in procurement under Law No. 44-FZ localization is necessary.
- In certain cases verification of localization may also be required in order to participate in procurement under Law No. 223-FZ.
Decree No. 925 – State Procurement

- Law No. 223-FZ does not regulate purchasing procedures in detail. It merely establishes the general principles of procurement.
- Decree No. 925: Effective from January 01, 2017: priority of all Russian goods, works, services in government procurements is established.
- 15% penalty rule for foreign suppliers:
  - Auctions: automatic price reduction of 15% if a foreign supplier wins a tender
  - Competitive tenders: price offered by Russian suppliers is fictiously reduced by 15% for the purposes of the winner determination
Decree No. 925 – State Procurement

Priority under No. 925 is not established if:

- procurement is made from a Sole Supplier;
- all bids offer to supply Russian goods;
- all bids offer to supply foreign goods;
- a bid offers both Russian and foreign goods, and the value of the Russian goods is less than 50 percent of the total amount of the bid;
- a bid in an auction offers both Russian and foreign goods, and the value of the Russian goods is more than 50 percent of the total amount of the bid.
Two types of tenders

<table>
<thead>
<tr>
<th>Type of tender</th>
<th>Type of restriction</th>
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</thead>
<tbody>
<tr>
<td>State procurement</td>
<td>No participation</td>
</tr>
<tr>
<td></td>
<td>Foreign goods are not allowed</td>
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<tr>
<td></td>
<td>Restricted participation</td>
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<tr>
<td></td>
<td>Foreign goods are not allowed if there are two local goods</td>
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<td></td>
<td>Conditional participation</td>
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<tr>
<td></td>
<td>Local goods have a 15% prioritization</td>
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<tr>
<td>Public company procurement</td>
<td>Priority</td>
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</tbody>
</table>
Example: Pharma

Pharma: Government Decree no. 1289

- Scope of application: government procurements of “life important (essential) pharmaceuticals”
- In case there are 2 bids in respect of domestic products (from the EAEU) belonging to the "life-important (essential) pharmaceuticals", foreign products must be excluded from the tender
- 15% “penalty rule” for foreign suppliers
Restrictions in the pharmaceutical market

- List of “essential medicines”
  - Exist two local equivalent medicines?
    - YES: Foreign medicines are not allowed
    - NO: Participant’s declaration of origin
  - NO: Local medicines have a 15% prioritization
    - CT-1 certificate
Products which need to be produced in Russia - Decree No. 719

- machine manufacturing
- automotive industry
- special machine manufacturing
- photonics and lighting engineering
- power engineering, electric and cable industry
- furniture and wood industry
- heavy engineering
- medical products
- pharmaceuticals
- radio electronics
- construction materials industry
- railway machinery
What is a “domestic product”?

- CIS Agreement
  - principle of sufficient processing
    - Basic rule: change of at least one of the first four digits in the customs classification code
    - The rule of ad valorem share (percentage of the value of foreign materials used in production of the final product at the final price of a medical product calculated in accordance with EXW conditions)
  - Technology and/or production processes in EAEU
Special Investment Contract (SIC)

- Special investment regime for certain industries (Decree No. 708 of 16.07.2015)

- Russian law provides for three types of SIC:
  - SIC on establishing or upgrading production;
  - SIC on localizing advanced technologies;
  - SIC on manufacturing products that have no comparable local products.

- The partner of the investor under a SIC can be the RF (federal level), constituent entities of the RF or municipalities (regional level), or a SIC can be signed as a trilateral agreement.
As a general rule, a SIC can be signed with the following terms:

- maximum term is up to 10 years;
- minimal amount of investments is 750 million rubles (if SIC will be concluded on a federal level).
- Constituent entities of the RF can stipulate another minimal amount of investments or completely eliminate this requirement or replace it with another term, for example, job creation with indication of minimum number of newly created jobs.

Additional criteria for SICs may be established for specific industries.
# Localization models

<table>
<thead>
<tr>
<th>OWN PRODUCTION*</th>
<th>CMO**</th>
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</thead>
<tbody>
<tr>
<td><strong>Pros</strong></td>
<td></td>
</tr>
<tr>
<td>• Full control on production process</td>
<td>• Profitable and quick-start projects</td>
</tr>
<tr>
<td>• Using of benefits from SICs</td>
<td>• No manufacturing license required</td>
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<tr>
<td>• Further localization is possible</td>
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<tr>
<td><strong>Cons</strong></td>
<td></td>
</tr>
<tr>
<td>• High investments</td>
<td>• Know-How-Transfer / risks in case of contract termination</td>
</tr>
<tr>
<td>• Time-consuming, long preliminary phase (construction stage, approval stage etc.)</td>
<td>• Sometimes providers require high contributions</td>
</tr>
<tr>
<td></td>
<td>• Not complete quality control</td>
</tr>
</tbody>
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* Teva, AstraZeneca, Berlin-Chemie, Novartis, Novo Nordisk
** Pfizer, Bayer, Eli Lilly
CMO

API, technological documentation

Local legal entity

CMO Partner
- Manufacturing facilities
- Equipment
- Qualified personnel

Pharmaceuticals

accounting | ERP | import | legal | tax
Current Localization Examples
Localizations, 2017 (1)

Agricultural machinery production plant in Lipetsk, opens in 2017, investment: EUR 6.5 million

Agricultural machinery production plant in Lipetsk, opens in 2017, investment: not disclosed

Agricultural machinery production plant in Samara, opens in 2017, investment: EUR 2.5 million

Gypsum plant in Chapaevsk (Samara region), construction start in 2015, opens in 2017, investment: RUB 1.25 billion

Car plant near Tula, construction start in 2015, opens in 2018, investment: USD 520 million

Car plant near Lipetsk, construction start in 2015, opens in 2017, investment: USD 30 million

Pet food production plant in Aksay (Rostov region), construction start in 2015, opens in 2017, investment: RUR 4 billion
Localizations, 2017 (2)

- Extraction and enrichment of high-quality quartz sand in Gus-Khrustalny district (Vladimir region), opens in 2017, investment: RUR 2 billion
- Bakery ingredient manufacturing in Stupino (Moscow region), opens in 2017, investment: RUR 1 billion
- Dairy farm in Bykovo (Moscow region), opens in 2017, investment: USD 500 million
- Dairy farm in Moscow Region, together with the Russian Direct Investment Fund (RDIF), opens in 2017, investment: USD 1.1 billion
- Hydraulic turbine plant in Balakovo (Saratov region), jointly with RusHydro, opens in 2017, investment: not disclosed
- Dairy farm in Ryazan region, jointly with RDIF and Banner Dairy (China), opens in 2017, investment: USD 1 billion
- Production of baby food (cereals) in Orel region, opens in 2017, investment: RUR 2 billion
Localizations, 2017 (3)

- Production of painting tools in Pskov region, construction start in 2016, to be launched in 2017, investment: RUR 173 million

- Production of industrial chillers in Pskov region, construction start in 2016, to be launched in 2017, investment: RUR 325 million

- Sprinkler production in Engels (Saratov region), construction start in 2016, opens in 2017, investment: not disclosed
Localizations, 2017 and beyond (1)

- Cattle food production plant in Lipetsk, construction start in 2015, opens in 2017-2018, investment: RUR 1.28 billion
- Agricultural machinery production plant in Voronezh, opens in 2017-2022, investment: RUR 4.4 billion
- Electric centrifugal component production plant in Lipetsk, construction start in 2016, opens in 2018, investment: RUR 3.8 billion
- Cable distribution cabinet production plant in Lipetsk, construction start in 2016, opens in 2018, investment: RUR 15 billion
- Polycrylamide production plant in Saratov, opens in 2018, investment: EUR 50 million
- French fries production plant in Lipetsk, jointly with Belaya Dacha (Russia), opens in 2018, investment: EUR 100 million
- Agricultural park to set up biological grain processing and produce grain protein, jointly with Agroservice (Tatarstan), opens in 2018, investment: RUR 15 billion
Localizations, 2017 and beyond (2)

**Boehringer Ingelheim**
- Joint production of two thrombolytic medicines at Petrovax in Moscow region, to be launched in 2019, investment: RUR 600 million

**Van Chen**
- Car production plant in Yesipovo (Moscow region), construction start in 2017 (planned), opens in 2019, investment: not disclosed
- Flour processing mill and lysine production in Ulyanovsk region, opens in 2019, investment: RUR 1.5 billion

**Bionorica**
- Pharma plant in Voronezh, opens in 2019-2020, investment: EUR 30 million
- Pharma plant in Kaluga, jointly with NovaMedica (Russia), opens in 2020, investment: USD 100 million

**R&R Ice Cream**
- Ice cream production in Moscow region, jointly with Nestle, opening date and investment: not disclosed

**CONCH**
- Cement production plant in Ulyanovsk region, opening date: not disclosed, investment: USD 500 million
Localizations, 2017 and beyond (3)

Stock breeding complex in Efimtsevo (Kaluga region), construction start in 2016, opens in 2019, investment: USD 400 million
Localization with SCHNEIDER GROUP - how can we assist?

Overall support in all questions re. localization
- Searching for partnerships (affiliate partner) and CMOs
- Business Partner Due Diligence
- Comprehensive legal and tax consultancy
- Assist you in choosing the right location for your production
- Interim Management
- Import
- Accounting and reporting
- Set up an IT infrastructure
- and many more services…
Since our clients expanded their sales markets, we also decided to expand geographically.

- **2003** Moscow
- **2004** St. Petersburg
- **2006** Kyiv
- **2007** Almaty
- **2009** Minsk
- **2012** Warsaw
- **2013** Aktau
- **2015** OWC Berlin
- **2016** Astana

In total 500 employees

Over 600 clients
Our services

- Market Analysis
- Market Entry *FAST TRACK*
- Customs and Import Handling and Product Certification
- Outsourced Staffing: Employment of your Employees by us
- Legal, Tax and Compliance Services
- General Director Function
- Legal and Business Address
- Fully Equipped Office Premises
- Accounting, Reporting and Transition to IFRS / US-GAAP or HGB
- B2B Electronic Document Interchange (EDI)
- Transfer Pricing
- Financial and Tax Due Diligence
- Internal Audit
- IT / ERP-Systems (MS Navision, 1C, SAP)
- Expert Recruiting
  (Accounting / Tax / IT)
- Event Management
- **stars**academy
- e-commerce solution
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