



Russia 2013: Opportunities in the Commercial Aircraft Market

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Brief Industry and Market Overview

The Russian aviation industry is controlled by state-owned corporations United Aircraft Corporation (UAC) and Russian Technologies (Rostech RT). The Russian government “strategic” significance of the aviation industry is explained by the integrative role it plays in the Russian economy. Due to its close relationship with other associated industries - component manufacturing and machine-building - the Russian aviation industry has a significant influence on Russia’s development towards a more innovative economy. The Russian government currently pursues the development of aviation through its state strategy “Development of the Aviation Industry for 2013-2025”. The program was approved in December 2012 and the total amount of funding to be allocated is 1.7 trillion Rubles (appx. \$56.6 billion).

The Russian aviation industry consists of the following manufacturing segments: aircraft, helicopter, aircraft engine, avionics, and air components. The industry includes 248 Russian enterprises. In 2011, total revenue was more than 608 billion Rubles (appx. \$20.2 billion). The industry provides employment for 400,000 personnel and contributes more than 1.1% GDP to the Russian economy, according to the Russian Ministry of Industry and Trade. As part of the aviation development strategy, the Russian government is interested in international cooperation on new aircraft projects and the transfer of Western technology. This is an opportunity for U.S. companies to get a foothold in the Russian economy and to engage in mutually beneficial aviation projects.

Despite Russia’s ambitious aviation development program, the industry is not able to deliver civilian aircraft in the required quantities to meet growing air traffic demand. The production of new civil aircraft in recent years has not exceeded 7-9 units per year, while pre-existing Soviet aircraft have become too inefficient to operate in terms of fuel efficiency and flight safety. Many airlines have embarked on comprehensive aircraft replacement programs. Major international manufacturers - Boeing, Airbus, Bombardier and Embraer – are currently filling this niche. The predominance of Western aircraft fleets in Russia also provides impetus for the growth of related aviation segments including air components, spare parts, MRO operations and airport ground support equipment, representing additional business opportunities for U.S. suppliers.

Market Demand

The demand for aircraft in Russia is driven by the growing air traffic needs. Despite the economic downturn of 2008-2009, the average growth rate of passenger traffic between 2001 and 2012 amounts to 11.4% annually. The cargo traffic for the same period was 6.1% annually. International air traffic is the most dynamic segment of this market. The major share of domestic air traffic belongs to long-distance flights, primarily through Moscow. The local and regional air traffic has less than 13% of the market, but it plays an important role in Russia’s air transportation. In 2012, the Russian Government intensified efforts to support regional aviation in order to connect the outlying regions and satisfy unmet regional air traffic needs. Under an innovative scenario of Russian economy’s development, the air traffic is forecasted to grow at 6.3-7.8% annually within the next 20 years.

The share of Western made aircraft in Russian airlines’ fleets amount to 63%. As of January 2013, the active commercial fleet of Russian operators totals 2,745 aircraft units, including 645 mainstream aircraft, 294 regional passenger aircraft, 137 cargo aircraft and 1,111 helicopters. Between 2008 and 2012, Russian airlines’ fleets received 540 Western manufactured passenger aircraft and 50 new Russian aircraft. During the same period, 14 Western cargo aircraft and 8 Russian made aircraft were delivered. In 2012, the Russian airlines’ fleet received 133 passenger aircraft, including 114 Western aircraft, 15 new Russian aircraft and 4 previous generation Russian aircraft. Due to the large number of aging Soviet aircraft in Russian fleets, fleet renewal is expected to continue in the near future. By 2031, it is forecasted that Russian airlines will require 1,540-1,870 of long-haul aircraft with a

significant share of narrow-body aircraft with varying seating capacity, and 420-500 regional passenger aircraft. The market need for cargo aircraft is much less significant and is not expected to exceed 260 aircraft.

Best Prospects

- New Aircraft Cooperation Projects - Sukhoi SuperJet-100 and MS-21 are two examples of international cooperation projects in which Western components and systems are widely used. Sukhoi SuperJet-100, put into operation in 2011, is a regional medium-haul (3,000-4,500 km) aircraft with 60-100 passenger capacity. MS-21 is a short-to-medium (5,500 km) aircraft with 150-212 passenger capacity and will be put into operation in 2017. SuperJet-100 contains an estimated 80% of Western air components, while MS-21 has 50% Western components. In the future, the share of Western components for the MS-21 is planned to be reduced down to 15%. U.S. companies are advised to monitor current and future projects in the Russian market for business opportunities. High level contact with representatives of UAC and Rostech is preferred, and frequent visits to Russia are recommended. It is also important to be aware of local and international competitors already present in the market to better assess one's own chances of winning contracts.
- Air Part Supplies - The quickly expanding Western aircraft fleets drive up the demand for aircraft spare parts and replacement components. The Russian aircraft spare parts market is estimated at \$600-700 million per year, according to Locatory.com, a global e-business aircraft spare parts platform. Russian airlines spend about \$150 million annually for maintenance and repair of 500 medium-haul Western aircraft (Boeing, Airbus), \$120 million annually for 300 long-haul Western aircraft and \$18 million monthly for 60 regional Western aircraft (Bombardier, CRJ). While most Russian airlines may already have well-established air parts supplier arrangements, some of them still continue to seek out opportunities, looking for better pricing, wider assortment, and more efficient delivery. Setting up one's own air parts stock in Russia is considered by Russian airlines and parts distributors as an attractive competitive advantage in this market segment.
- Microelectronics Product Supplies - The Russian electronics industry- which is the basis for the aviation, aerospace and the defense industry segments - is lagging behind in the serial production of electronics components compared to Western manufacturers. New products are being developed and tested, but until they are put into serial production, imports will continue to play an important role in filling in this market need. The types of products in demand are: semi-conductors, integrated circuits, power and high frequency modules - items that serve as production components for various systems and modules. Finding a local distributor with connections in various industries is considered to be an effective marketing strategy in this segment.
- Localized Western Aircraft Production and MRO - Russia's state corporation Russian Technologies is currently in joint venture negotiations with Bombardier to build the Q400 business aircraft in Ulyanovsk-Vostochny Special Economic Zone (SEZ). Rostech CEO Sergei Chemezov indicated the deal will be a 50-50 joint venture with an estimated investment of about \$100 million. However, no legally binding documents have been signed yet. In August 2012, FL Technics Ulyanovsk, a subsidiary of the international aviation service provider Avia Solutions Group (Lithuania), became the first resident company at Ulyanovsk-Vostochny SEZ to provide various MRO services, including A to D checks, engine and landing gear replacement, avionics and airframe modifications, flight hour inspections, structure maintenance, component maintenance and interior design-related services. FL Technics Ulyanovsk will provide maintenance service to both narrow and wide body aircraft, including the Airbus A320 and A380, Boeing 737 Classic, 737NG, 777, 787, 747 Bombardier CRJ 200, Sukhoi Superjet 100.

Ulyanovsk-Vostochny SEZ is part of the Special Economic Zones, a daughter structure of the Ministry of Economic Development of Russia, funded 70% federally and 30% regionally. Ulyanovsk-Vostochny offers fiscal discounts—no property, land, or transport taxes, lower profit tax (15.5% for residents), and the option of locating and using foreign goods (equipment, raw, components, construction materials) without paying duties and VAT. Special Economic Zones are becoming more common in Russia.

Key Suppliers

Boeing opened a sales office in Moscow in 1992 and has been co-operating with Russian aircraft design bureaus and scientific institutions through its Moscow-based Technical Research Center since 1993. In 1998, the Boeing Design Center was added. The Design Center employs Russian aerospace companies, mainly for structural engineering work, but also for manufacturing studies and systems engineering for its commercial aircraft range. While the design centre is owned by Boeing, most of its 1,200 staff comes from Russian partners such as Ilyushin and Sukhoi. In 2007, Boeing and VSMPO-AVISMA, the largest Russian titanium manufacturer, set up Ural Boeing Manufacturing (UBM), a 50/50 equity joint venture in Verkhnya Salda, to produce titanium parts for the Boeing 787 Dreamliner passenger jet.

Airbus has a regional office in Moscow to cover sales, marketing and public relations, develop cooperation projects with the Russian aviation industry, and provide on-the-spot airline support. The Engineering Center Airbus in Russia (ECAR) was established in Moscow in 2003 and employs about 200 engineers who concentrate mainly on airframe structures. The team handles about half of the fuselage-related structural work for the A330-200 freighter and now focuses on the A350 and A320 winglets. The company's main partner in Russia is Irkut Corporation, which is supplying the nose landing gear bay, keel beam and flap track for the A320 family. VSMPO-Avisma is another key partner to Airbus and its parent company, EADS, currently covering 60% of the group's titanium needs in semi-finished products and titanium forgings. In recent years, VSMPO-Avisma activities for Airbus are not limited to the supply of raw material and forging, but also extend to rough and pre-machining or of titanium parts for the landing gear of the A380 family.

United Technologies Corporation (UTC) established a representative office in Moscow in 1992. Comprised of several business units, UTC pursues various projects in several industries including aviation. In 2009, Pratt & Whitney was chosen as a supplier of Geared Turbofan engine for the new Russian MS-21 aircraft project. The definitive agreement on PurePower PW1400G engine for MS-21 aircraft was signed in June, 2012. Irkut Corporation also selected Hamilton Sundstrand electric integration systems for with Sukhoi Super Jet. The contract was signed in May 2006. In October 2011, Hamilton Standard Nauka joint venture was established to manufacture commercial aircraft heat exchanger management systems. HS-Nauka JV is the sole supplier of heat exchangers for the Boeing 787 and Airbus A380. Sikorsky is currently collecting and analyzing information on the local market's capacity for the company's main commercial aircraft, certification procedure, marketing and MRO opportunities.

Rockwell Collins opened a sales and service support office in Moscow in 1991. In the last few decades, Rockwell Collins has offered many commercial products to ensure that Russian aircraft meet FAA requirements to fly to the United States and Europe. Systems such as TCAS-II were certified on many Russian made aircraft, including the Tu 134, Tu 154, IL 62, IL 76, IL 86, Yak 40, Yak 42, An 12/An 24/26/32, An 140 and An 148. With the expansion of updated Russian fleets over the last few decades, Rockwell Collins has increased its presence and established the Moscow Engineering Center to provide specialized support and development for the new avionics systems for Russian commercial aircraft.

Honeywell opened a representation office in Moscow in 1974, followed by branch offices in St Petersburg and Kiev in 1992. Russia is currently Honeywell's largest national market within the Commonwealth of Independent States (CIS) from the former Soviet Union. All four major Honeywell Strategic Groups are represented: Aerospace, Automation and Control Solutions, Performance Materials and Technologies, and Transportation Systems. Honeywell auxiliary power units, brakes, and avionics are widely used on Russian aircraft and helicopters. Honeywell took part in the design of the Sukhoi SuperJet-100 auxiliary power system in cooperation with the Russian company MMPP Salyut.

Prospective Buyers

Russian airlines are the principle end-users of commercial aircraft, parts and equipment. In 2012, the number of commercial airlines dropped to 120, as compared to the maximum of 393 in 1993. Four major Russian airlines (Aeroflot, Transaero, UTair and S7 Airline) account for 60% of passenger traffic and a total of fourteen airlines account for 90% of all passenger traffic in Russia.

The Russian aircraft and air component manufacturers under the umbrella of the United Aircraft Corporation (UAC) represent another group of prospective buyers. One of the most successful companies is Sukhoi, which possesses a wide portfolio of internationally competitive military aircraft, including the Su-27, Su-30 and Su-35 models. In the commercial aircraft segment, the company's most important project is the Superjet 100. Komsomolsk-on-Amur Aircraft Production Association, Russia's largest aircraft enterprise located in the Russian Far East, is responsible for manufacturing Sukhoi products. Joint Stock Company Tupolev focuses on the commercial aircraft market with its Tu-204 and Tu-214 model. Mass production of Tu-204 aircraft is carried out by Aviastar SP, located in Ulyanovsk; while the Tu-214 variant is produced by Kazan Aircraft Production Association. Ilyushin focuses on the military cargo and transport sector. The main manufacturer of Ilyushin aircraft is the Voronezh Aircraft Production Association. Irkut Corporation has a portfolio of trainer and amphibious aircraft projects and competes in the onboard electronics and avionics niche. In the unmanned aerial vehicle segment, ZALA Aero and Vega Radio Engineering Corporation are among the leading companies.

Besides UAC, other significant state corporations are: 'Helicopters of Russia' Holding, Oboronprom and Russian Technologies (Rostech RT). 'Helicopters of Russia' Holding is the managing body of the consolidated Russian helicopters industry, represented by five helicopter assembly plants, two design bureaus, two components product plants, one overhaul and one helicopter service company providing aftermarket services in Russia and abroad. Oboronprom has 100% ownership of the 'Helicopters of Russia' Holding. Oboronprom is one of the largest Russian diversified industrial-investment groups in the engineering and high technologies industries. Besides helicopters, Oboronprom also monitors production of aircraft engines and compression stations, and the unique Pechora-2M air defense missile system.

Rostech RT has 32% ownership of Oboronprom. Rostech RT is a state owned corporation established in 2007 to promote development, production and exportation of high technology products. Rostech RT has consolidated assets of about 663 Russian enterprises along three main segments of the Russian economy: defense industry, civil strategic assets and ventures with dual use technologies, and civil assets of non-strategic significance.

Market Entry

In doing business in the Russian market, it is often not the product, but the attitude and the way in which business is performed that really matters. The desired attitude is best described by Russian partners when asked how U.S. firms can succeed in this market: "It is important to invest oneself". This means not only a financial investment such as setting up a representative office, sharing costs for product promotion or trade show booth rental with a Russian partner, but also, most importantly, a certain degree of commitment to Russian partners. This is especially true, when it comes to forging strategic partnerships with Russian high level aviation industry representatives, such UAC, Rostech RT and 'Helicopters of Russia' Holding. Frequent contact including trips to Russia to meet with Russian partners and principle customers and physical presence at trade shows are all very important in the Russian market. Building brand recognition and a long-term approach are very important.

Along with country commitment, a U.S. company should also promote a competitive advantage over their European competitors that will allow a U.S. company to win contracts. The Russian market is generally very competitive. In the air parts segment, for example, Russian partners appreciate competitive prices, integrator solutions capabilities (access to a wide range of parts), private warehousing (preferably in Europe) and a well-ran logistics route as selling points. Imports are sometimes viewed as an initial phase of cooperation that may lead to offers of localization or technology transfers. In the air parts segment, localization of consignment stock of commercial western parts may be viewed positively by Russian partners and increase their commitment to work with a U.S. supplier.

Market Issues & Obstacles

According to Russian legislation, commercial aircraft are divided into seven groups. Some of them are either fully or temporarily exempt of the import duty. The others are subject to 20% import duty, a customs fee (up to \$30,000) and 18% VAT. The end users may have to pay up 40% of the original price in taxes or duties. Unlike

private individuals, commercial operators can reimburse VAT, according to Russian tax code. With Russia's WTO accession, the import duty (for helicopters and civil aircraft) is expected to be reduced to an average of 7.8% within the seven year implementation period from the date of accession (August 2012).

Trade Events

HELI-RUSSIA (International Helicopter Show), May 16-18, 2013. Location: Moscow, Russia.

www.helirusia.ru/

MAKS-2013 (International Aviation and Space Show), August 27-Sept 1, 2013. Location: Moscow, Russia.

<http://www.aviasalon.com>

JET-EXPO (International Business Aviation Show), September 19-21, 2013. Location: Moscow, Russia

<http://2012.jetexpo.ru/en/about-us/jet-expo-2013.html>,

AERO TESTING RUSSIA (Aerospace Testing Equipment), October 22-24, 2013. Location: Moscow, Russia

<http://www.aerospace-expo.ru>

Resources & Contacts

United Aircraft Corporation <http://www.uacrussia.ru>

Mikhail Pogosyan, UAC President

ATO (Air Transport Observer) Events <http://www.events.ato.ru/eng/>

Organizer of professional events in the Russian aviation community

Russian Aviation News & Information Server <http://www.aviaru.net/english/>

Aviation News Agency "Aviport" (only in Russian) <http://www.aviaport.ru/>

Russian aviation industry news portal (English) <http://www.russianavia.net/>

For More Information

If you wish to obtain more information on the Russian Aviation Market and market entry strategies, please contact Bridgette Clark (Bridgette.Clark@trade.gov) or Vladislav Borodulin (vladislav.borodulin@trade.gov) of the U.S. Commercial Service in Moscow, Russia. Phone: +7(495) 728-5235; Fax: +7(495) 728-5585 and visit our website: www.buyusa.gov/russia/en.

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