INDUSTRY CONTROL 2016
Transportation Business Leaders’ Opinion Survey
INDUSTRY CONTROL 2016 SURVEY: A JOINT PROJECT OF THE CENTRE FOR TRANSPORT STRATEGIES AND DELOITTE

PURPOSE AND OBJECTIVES OF THE PROJECT
Support the transportation sector’s structural changes and consolidate the leading Ukrainian companies’ expert opinions regarding the most urgent and important issues of the transportation sector reforms

TEAM
CFTS was engaged to perform elaboration, technical implementation and direct surveying,
Deloitte assisted with assurance of the survey’s transparency and accuracy of its results

RESULTS
The presentation demonstrates the major facts and conclusions based on the conducted survey. We believe that this survey report will encourage an active dialogue between the state and the private sector with respect to the most acute problems of the transportation sector
INVESTORS, MAJOR OPERATORS AND CONSIGNORS, ALL OF WHOM JOINTLY CONTROL MORE THAN 70% OF THE UKRAINIAN CARGO TRAFFIC, PARTICIPATED IN THE SURVEY

RESPONDENTS’ PROFILES
Port operators, railway operators, international financial institutions (IFI) investing in Ukrainian transport projects, and consignors (cargo owners), all of whom jointly control more than 70% of the Ukrainian cargo traffic

The majority of the responses have been received from top management, more than 40% are responses from the CEOs

SURVEY METHODOLOGY
Four categories of respondents filled out two question categories related to the reform of (1) the railway and (2) the port sectors. All respondents’ answers were weighted equally

*- including USPA
EXECUTIVE SUMMARY
MARKET PARTICIPANTS WERE UNANIMOUS IN DETERMINING THE MAIN LINES OF THE SECTOR DEVELOPMENT

Fighting against corruption is market’s major requirement for the industry

Change to the model and methodology of tariff regulation for the railway and the ports

Development of a new strategy for the transportation sector is one of the major priorities

>60%

>55%

>35%
The change to the model and methodology of tariff regulation is the railway sector’s main development priority.

The tariff-setting mechanism shall be transparent. Likewise, there is a need for public monitoring system of rolling stock.

The market constituents consider the development of private traction in Ukraine to be well-timed.

Privatization of state assets, increase of private sector’s share in the development of ports.

Major development areas: decentralization of functions and creation of free port zones.

Main criteria to be considered when choosing investment offers: guarantee of cargo flow and modernization of port assets.

Development of the river fleet and dredging will solve the main problems of river transportation.

Rivers dredging shall be entirely financed by the state.

The respondents consider free access of fleet under foreign flag to Ukrainian inland waterways to be requisite.
STRATEGIC PRIORITIES
FIGHT AGAINST CORRUPTION AND TARIFF REGULATION REFORM ARE THE KEY SHORT-TERM PRIORITIES

The most important areas of focus of the transport reform in the short-term (2016)

- Fighting against corruption: 63%
- Change of the scheme and methodology of tariff regulation in the r/w and ports: 56%
- Development of a new integrated strategy for the development of the transport sector: 38%
- Creation of an independent regulator of railway tariffs and port charges (NCTR): 38%
- Stimulation of transit traffic (joint rate, discounts, preferences to large shippers): 34%
- Liberalization of rail freight (private traction, alignment of the cost of state and a private car, access of foreign operators to Ukrainian market): 34%
- Increased public funding of public infrastructure (railways and stations, dredging and development of port harbors): 31%

OTHER CONCLUSIONS
- The market constituents consider the creation of an independent market regulator and the elaboration of a new, integrated strategy for the development of the port sector to be of equal priority and importance.

OPINIONS BY SEGMENTS
- Key priorities for port operators: fighting against corruption and changes to the tariff-setting methodology.
- Consignors expect changes to the tariff-setting methodology in the first place.
- The most important issue for IFIs is passing the Law on railway transport, as well as simplification and acceleration of document workflow at railway stations and ports.
MID-TERM PRIORITIES: RAIL FREIGHT MARKET LIBERALIZATION, FIGHT AGAINST CORRUPTION, AND PRIVATIZATION OF STATE ASSETS

Key mid-term areas of focus of the transport reform (2017-2020)

- Liberalization of rail freight (private traction, alignment of the cost of state and a private car, access of foreign operators to Ukrainian market) 53%
- Fighting corruption 53%
- Privatization of state assets (except for strategic public infrastructure) 38%
- Development of a new integrated strategy for the development of the transport sector 34%
- Change of the scheme and methodology of tariff regulation in the r/w and ports 31%
- Increased public funding of public infrastructure (railways and stations, dredging and development of port harbors) 31%
- Cost cutting and improving of the logistics quality (to enhance the competitive advantages of export-oriented industries agribusiness and Metals and Mining) 31%

OTHER CONCLUSIONS
- Fighting against corruption is the priority both in the short-term and in the mid-term
- Privatization of state assets is the third most important issue in the mid-term

OPINIONS BY SEGMENTS
- Privatization of state assets is the most important issue for IFIs and port operators
- Liberalization of the freight market is the top priority for railway operators, while consignors give priority to fighting against corruption
MORE THAN 70% OF RESPONDENTS HAVE A FAVORABLE OPINION OF THE LAW ON RAILWAY TRANSPORT, BUT STILL POINT OUT THAT IT NEEDS FURTHER AMENDMENT

Appraisal of the draft Law “On railway transport of Ukraine”

| Transformation of the tariff system | 38% | 57% | 5% |
| Establishment of a National Transport Regulatory Commission (NCTR) | 38% | 38% | 19% |
| Access of private companies to the management of locomotives on the roads of general use | 38% | 48% | 14% |
| Equal access to infrastructure of UZ (both carrier and private operators) | 52% | 38% | 5% |
| Separation of functions (of infrastructure management, railway cars management and other actives management) | 57% | 38% | 5% |
| Corporatization of Ukrzaliznytsia (the creation of a public joint-stock company "Ukrainian zaliznitsya" which based on enterprises of Ukrzaliznytsia) | 33% | 38% | 24% |
| Stop of cross-subsidization (of passenger and freight train traffic, the introduction of the procedure of fiscal compensation) | 57% | 29% | 14% |

OTHER CONCLUSIONS
- 57% of respondents advocate for the improvement of tariff-setting
- About 30% of respondents are skeptical about the advantages of corporatization of UZ
- The majority of market players (90% of respondents) stand for equal access to infrastructure and for separation of functions

OPINIONS BY SEGMENTS
- IFIs expect a beneficial effect of the Law on the sector
- The consignors are the most critical about the Law
MORE THAN 50% OF RESPONDENTS EXPECT THE IMPLEMENTATION OF PUBLIC AUTOMATED SYSTEM OF TARIFF SETTING AND PUBLIC SYSTEM OF TARIFF DISCOUNTS

Creation of public automated system of tariff setting (which allows calculating the cost of transportation including all the additional services and fees)

Public system of tariff discounts, with a clear requirements to receive them (for big volumes, or regularity, etc.)

Separation of infrastructure, investment and wagon components by payments and purposes

Uniform tariffs for all participants of the transportation process (leveling the tariff for private cars and cars belonging to UZ or its subsidiaries)

Simplification and standardization of additional charges

The elimination of administrative pricing of wagons of inventory fleet (wagon constituent depends on the market situation)

Tariff calculation formula: the cost + margin of UZ; calculation is performed by NCTR

67%

57%

48%

48%

33%

29%

19%

OTHER CONCLUSIONS

• The top priority issues for market players are breakdown of tariff components and setting of a single tariff for private and UZ’s rolling stock

OPINIONS BY SEGMENTS

• 80% of consignors and 57% of railway operators stand for public system of railway tariff discounts. IFIs do not support public system of railway tariff discounts at all (0%)

• 100% of IFIs and 80% of consignors advocate for automated tariff setting, while only 29% of railway operators accept it
INFLATION AND PRODUCER PRICE INDEX ARE PRIORITY BENCHMARKS FOR TARIFFS ADJUSTMENT

<table>
<thead>
<tr>
<th>All respondents</th>
<th>38%</th>
<th>38%</th>
<th>24%</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFI</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cargo owners</td>
<td>30%</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Railway operators</td>
<td>71%</td>
<td>14%</td>
<td>14%</td>
</tr>
</tbody>
</table>

- The groups of respondents are significantly divided on the issue concerning the benchmark for tariffs level adjustment

OTHER CONCLUSIONS
- 40% of consignors believe that the tariffs shall be adjusted based on the prices of main transported products
- For IFIs, tariffs are linked solely to Producer Price Index
- The majority of railway operators (71%) support the tariffs adjustment based on the inflation rate

- The level of tariffs should be adjusted according to inflation
- The level of tariffs should be adjusted according to the PPI
- Tariffs for certain types of goods are set according to the rate of change in prices for the main transported products (for example, prices for the products of M&M - 58% of r/w cargo base)
62% OF RESPONDENTS STAND FOR A MORATORIUM ON TARIFF INCREASES DURING THE CRISIS

The necessity of moratorium on tariff increase during the crisis and economic recession

All respondents
- 62% Yes
- 38% No

IFI
- 25% Yes
- 75% No

Cargo owners
- 70% Yes
- 30% No

Railway operators
- 71% Yes
- 29% No

OTHER CONCLUSIONS
• International organizations and local market players strongly disagree on the necessity of moratorium

OPINIONS BY SEGMENTS
• The majority of respondents from IFIs do not consider the moratorium necessary
• More than 2/3 of consignors and railway operators, on the contrary, support the moratorium on the increase of tariffs during the crisis
38% OF ALL RESPONDENTS STAND FOR PUBLIC MONITORING SYSTEM OF ROLLING STOCK

**OTHER CONCLUSIONS**
- 24% of all respondents support the introduction of a single tariff for all participants in the transportation process.

**OPINIONS BY SEGMENTS**
- The key issue for IFIs is the implementation of software for fleet management, while for consignors it is public monitoring system.
- 90% of consignors do not give priority to setting a single tariff for all participants in the transportation process, while this is the key issue for railway operators.

<table>
<thead>
<tr>
<th>Management of rolling stock</th>
<th>38%</th>
<th>24%</th>
<th>19%</th>
<th>19%</th>
</tr>
</thead>
<tbody>
<tr>
<td>All respondents</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IFI</td>
<td>25%</td>
<td>25%</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>Cargo owners</td>
<td>60%</td>
<td>10%</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Railway operators</td>
<td>14%</td>
<td>43%</td>
<td>14%</td>
<td>29%</td>
</tr>
</tbody>
</table>

- Public monitoring system of rolling stock
- The establishment of a single tariff for all participants in the transportation process
- Implementation of the software for fleet management, out of the sphere of the administration of UZ
- Liquidation of UTLC (Ukrainian Transport and Logistic Centre)
91% OF THE MARKET SUPPORTS PRIVATE TRACTION IN UKRAINE

### Development of private traction in Ukraine

<table>
<thead>
<tr>
<th>Question</th>
<th>It's necessary</th>
<th>It is necessary subject to separate (additional) conditions</th>
<th>The market does not need this</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is there any need for private traction in Ukraine?</td>
<td>48%</td>
<td>43%</td>
<td>10%</td>
</tr>
<tr>
<td>Whether the competition &quot;on the routes&quot; is necessary</td>
<td>52%</td>
<td>38%</td>
<td>10%</td>
</tr>
<tr>
<td>(when several operators compete for cargo on the route)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Whether the competition &quot;for the routes&quot; is necessary</td>
<td>48%</td>
<td>33%</td>
<td>19%</td>
</tr>
<tr>
<td>(when several operators compete for the whole route)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is there any need for licensing?</td>
<td>33%</td>
<td>48%</td>
<td>19%</td>
</tr>
</tbody>
</table>

**OTHER CONCLUSIONS**

- 80-90% of the market supports different forms of competition
- 80% of respondents stand for licensing

**OPINIONS BY SEGMENTS**

- Consignors are apprehensive about the licensing of private traction
INVESTMENT IN RAILWAY INFRASTRUCTURE IS A PRIORITY FOR UZ.
FREIGHT ROLLING STOCK IS THE PREROGATIVE OF PRIVATE CAPITAL

- More than 90% of the market believes that private investors should participate in investments in freight rolling stock and locomotives.
- More than 75% of respondents stand for private investment in passenger rolling stock.

OPINIONS BY SEGMENTS
- 86% of railway operators hold that investments in freight rolling stock should be made exclusively using private capital.
- IFIs and consignors hold that investments in freight rolling stock should not exclusively be private.

Railway investment priorities

<table>
<thead>
<tr>
<th></th>
<th>Should be invested by UZ</th>
<th>Both sides (UZ and private)</th>
<th>Should be private investing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repair, modernization and construction of r/w infrastructure</td>
<td>57%</td>
<td>43%</td>
<td></td>
</tr>
<tr>
<td>Passenger rolling stock and locomotives</td>
<td>24%</td>
<td>67%</td>
<td>9%</td>
</tr>
<tr>
<td>Freight rolling stock</td>
<td>5%</td>
<td>43%</td>
<td>52%</td>
</tr>
<tr>
<td>Freight locomotives</td>
<td>5%</td>
<td>76%</td>
<td>19%</td>
</tr>
</tbody>
</table>
PORT SECTOR
The role of public-private partnerships in the port sector over the next five years.

- **60%** PPP will finance port facilities, the development of infrastructure is a priority of the State.
- **20%** PPP will be the only source of projects funding in the ports.
- **12%** Public funding will remain the main source of funding for the port industry.
- **8%** PPP does not fill the gap if public financing in will be reduced.

**OTHER CONCLUSIONS**
- The market has determined the public and private investment priorities.
- Less than 15% of respondents hold that financing by way of public-private partnerships will not be sufficient, and the State will remain the main investor in the sector.

**OPINIONS BY SEGMENTS**
- 18% of respondents among port operators think that it will not be possible to cope with sector financing through PPPs alone without state financing.
MORE THAN 60% OF RESPONDENTS STAND FOR JOINT PRIVATE AND STATE SOURCES OF FUNDING FOR PUBLIC INFRASTRUCTURE IN PORTS

<table>
<thead>
<tr>
<th>Source of Funding</th>
<th>Exclusively Public Funds</th>
<th>State and Private Companies Mutually</th>
<th>Exclusively Private Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dredging and development of water areas</td>
<td>36%</td>
<td>64%</td>
<td></td>
</tr>
<tr>
<td>Berths construction and repair</td>
<td>16%</td>
<td>76%</td>
<td>8%</td>
</tr>
<tr>
<td>The development of port railway stations and railways</td>
<td>32%</td>
<td>68%</td>
<td></td>
</tr>
<tr>
<td>Construction and repair of roads, automobile infrastructure in the port area</td>
<td>32%</td>
<td>64%</td>
<td>4%</td>
</tr>
</tbody>
</table>

OTHER CONCLUSIONS
- Nearly one third of respondents hold that the development of water areas and transport infrastructure in the port area is the prerogative of the State.
- The share of respondents who accept financing of public infrastructure in ports exclusively by private companies is 8%.

OPINIONS BY SEGMENTS
- All IFIs support mutual state and private funding for the construction and repair of berths.
- 82% of port operators support mutual funding of port infrastructure and berths.
73% OF PORT OPERATORS AND 56% OF ALL RESPONDENTS SUPPORT NON-PROFIT STATUS FOR THE UKRAINIAN SEA PORTS AUTHORITY

OTHER CONCLUSIONS
• The overwhelming majority of respondents support changing the USPA’s functions and competences

OPINIONS BY SEGMENTS
• Port operators unanimously consider changing the current USPA status necessary
• IFIs are split in their opinions on this issue
• The current status of the USPA satisfies only 10% of consignors

<table>
<thead>
<tr>
<th>Future developments in the functions and competences of the Ukrainian Sea Ports Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All respondents</strong></td>
</tr>
<tr>
<td>20%</td>
</tr>
<tr>
<td><strong>IFI</strong></td>
</tr>
<tr>
<td>25%</td>
</tr>
<tr>
<td><strong>Cargo owners</strong></td>
</tr>
<tr>
<td>20%</td>
</tr>
<tr>
<td><strong>Port operators</strong></td>
</tr>
<tr>
<td>18%</td>
</tr>
</tbody>
</table>

- The decentralization of functions, the creation of separate port authorities
- Leave as it is
- Maximize the competences of USPA in the implementation of investment programs and financial decisions (financial plan, procedures, etc.)
- Transfer USPA to non-profit organization with mandatory investment of all funds received from port fees in to public port infrastructure
THE MAJORITY OF Respondents ADVOCATE FOR THE CREATION OF FREE PORT ZONES AND CONSIDER IT TO BE NECESSARY FOR AN INCREASE IN CARGO TRAFFIC

| Desired results from the establishment of free port zones in Ukraine | Priority (1- low, 5-high) |
|---|---|---|---|---|---|
| Simplifying of regulation of operating in the port area | 12% | 16% | 8% | 20% | 44% |
| Reduction of fees and charges | 8% | 16% | 24% | 4% | 48% |
| Creation of a preferential regime for startup and taxation of industrial facilities in the port area | 28% | 12% | 8% | 20% | 32% |
| The increase of cargo traffic through the port | 12% | 4% | 12% | 20% | 52% |
| Free port zones are absolutely not necessary | 60% | 20% | 4% | 4% | 12% |

OTHER CONCLUSIONS

- The majority of market players consider the creation of free port zones in Ukraine to be necessary for the simplification of regulation in ports among other things
- Approximately half of respondents expect a reduction in fees and charges as a result of the creation of free port zones

OPINIONS BY SEGMENTS

- The main goal of the creation of free port zones for port operators is increased cargo traffic as well as reduced fees and charges
- From the perspective of IFIs, the main goal is simplifying port regulation
GUARANTEES OF CARGO FLOW AND CAPACITY UTILIZATION ARE THE KEY CRITERIA WHEN CHOOSING INVESTMENT OFFERS

Criteria for choosing investment offers

<table>
<thead>
<tr>
<th>All respondents</th>
<th>IFI</th>
<th>Cargo owners</th>
<th>Port operators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantees of cargo flow and capacity utilization</td>
<td>92%</td>
<td>100%</td>
<td>90%</td>
</tr>
<tr>
<td>Modernization of assets</td>
<td>80%</td>
<td>100%</td>
<td>60%</td>
</tr>
<tr>
<td>Reducing the cost of port services for clients</td>
<td>44%</td>
<td>75%</td>
<td>40%</td>
</tr>
<tr>
<td>The increase in tax revenues</td>
<td>36%</td>
<td>25%</td>
<td>40%</td>
</tr>
</tbody>
</table>

OTHER CONCLUSIONS

- Guarantees of cargo flow and modernization of assets are the most important aspects to be considered while choosing investment offers in respect to the ports
- Approximately 40% of respondents consider reducing the cost of port services for clients to be an important criterion

OPINIONS BY SEGMENTS

- IFIs emphasize reducing the cost of port services for clients (75%)
- Local market players consider reducing the cost of services and increased tax revenues to be equally important criteria
### Division of Powers of Port Management

#### Development and Approval of the Master Plan for Port Development
- **Centralized Management**: 56%
- **Local Authorities**: 44%

#### Approval of the Investment in the Port
- **Centralized Management**: 52%
- **Local Authorities**: 48%

#### The Financial Policy of the Port (Approval of Financial Plans, Distribution of Profits, etc.)
- **Centralized Management**: 52%
- **Local Authorities**: 48%

#### Operation and Maintenance of the By-Port Infrastructure (Road and Rail Entrances to the Port, Other Communications)
- **Centralized Management**: 32%
- **Local Authorities**: 68%

#### Operation and Maintenance of Port Infrastructure (Water Area, Marinas, Intra-Communications)
- **Centralized Management**: 36%
- **Local Authorities**: 64%

#### Regulation of Tariffs (The Size of Port Charges, Handling Rates)
- **Centralized Management**: 72%
- **Local Authorities**: 28%

#### Decisions on Land Allocation
- **Centralized Management**: 40%
- **Local Authorities**: 60%

### Other Conclusions
- 72% of respondents stand for the centralized setting of tariffs.
- A significant number of respondents (44%) believe that local authorities should independently determine the master plan for port development.

### Opinions by Segments
- The majority of consignors support the determination of financial policy at the local authority level. IFIs and port operators support the centralization of this function.
ON THE MAJORITY OF ISSUES, THE POSITION OF THE UKRAINIAN SEA PORTS AUTHORITY (USPA) COINCIDES WITH THE MARKET OPINION

- Development of infrastructure is a state priority when PPPs are financing port facilities: 60% of All respondents and 55% of Port operators.
- USPA supports the joint funding of public infrastructure in the ports: 64%-76% of All respondents and 55%-82% of Port operators.
- USPA considers non-profit status with mandatory investment of all received funds in ports to be optimal: 56% of All respondents and 73% of Port operators.
- From USPA’s perspective, the creation of free port zones is necessary: 60% of All respondents and 64% of Port operators.
- The key aspects to be considered when selecting investment offers:
  - Guarantees of cargo flow: 92% of All respondents and 91% of Port operators.
  - Modernization of assets: 80% of All respondents and 91% of Port operators.
  - Reducing the cost of services: 44% of All respondents and 36% of Port operators.
RIVER TRANSPORT
INSUFFICIENT DEPTH AND LACK OF FLEET ARE THE MOST SERIOUS PROBLEMS FOR THE INLAND WATERWAYS OF UKRAINE

The main problems in the development of river transportation in Ukraine:

- Insufficient depth: 63%
- Lack of fleet: 56%
- Insufficient funding of inland waterways (misuse of excise duty on fuel, the limited government funding): 50%
- The high cost of the additional charges (the passage of locks, the bridges): 50%
- Insufficient number of terminals: 31%
- Dollar value of port charges: 25%
- The high cost of pilotage: 19%
- Understated r/w rates which make river transportation a non-competitive alternative to r/w transport: 6%

OTHER CONCLUSIONS

- 50% of market participants consider insufficient funding for inland waterways and the high fees for passage through locks and for bridge opening to be the major obstacles in the development of river transportation in Ukraine.
- 31% of respondents emphasize the insufficient number of river terminals.

OPINIONS BY SEGMENTS

- IFIs consider insufficient funding of inland waterways to be the key problem.
38% of respondents believe that dredging should be financed using accumulated river traffic dues.

<table>
<thead>
<tr>
<th>Source of Financing</th>
<th>All Respondents</th>
<th>Cargo Owners</th>
<th>Port Operators</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31%</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td></td>
<td>38%</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td></td>
<td>31%</td>
<td>30%</td>
<td>50%</td>
</tr>
</tbody>
</table>

**OTHER CONCLUSIONS**

- 31% of respondents believe that dredging should be financed through subsidies. The same number of respondents (31%) suggest that financing should be provided by private companies with subsequent compensation by the state.

**OPINIONS BY SEGMENTS**

- Port operators do not support the use of river traffic dues to finance river dredging.
75% OF RESPONDENTS SUPPORT CONTINUOUS ACCESS OF FLEET UNDER FOREIGN FLAG TO UKRAINIAN INLAND WATERWAYS

Access of fleet under foreign flag to inland waterways of Ukraine

All respondents
- 75%
- 25%

IFI
- 100%

Cargo owners
- 60%
- 40%

Port operators
- 100%

- It must always be open (on an equal footing with Ukrainian fleet)
- It must be temporarily opened during construction of Ukrainian Navy
- It must be limited

OTHER CONCLUSIONS
- Respondents unanimously agree that fleets’ access should not be limited at this point

OPINIONS BY SEGMENTS
- All surveyed IFIs and port operators support continuous open access to Ukrainian inland waterways
- 40% of consignors support temporary open access while the Ukrainian fleet is under construction
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