



UkrainianAgribusinessClub

Doing agribusiness in Ukraine

2014





Dear colleagues!

In 2014, Ukraine appeared to be in a very complicated economic, political and geo-political situation. The upholding of the country's strategic path has encountered a number of internal and external obstacles. Nevertheless, I believe that at achieving stability in the nearest future, Ukraine will become a brand new country in both political and socio-economic contexts. I also dare to hope that the long-awaited "reload" will not pass by the agricultural sector of Ukraine.

The impact of the 2013/14 winter events on the investment climate in the agricultural sector of Ukraine is ambiguous. The new government declares its commitment to deregulation policies. However, only minor "cosmetic" changes have been made so far. The so-called soft landing strategy at reimbursement of the value added tax at exports of grains and industrial crops, in particular, is still to be evaluated. Reform of the licensing system, including mandatory certification of grain, inspection of agricultural equipment and other numerous and often meaningless approvals and permits is unclear as well. Hopefully, these issues will be clarified before the presidential elections (May 2014).

Concerning the improvement of the investment climate, we expect valuable contribution from cooperation with the international financial institutions which normally focus on elimination of fiscal deficits and structural adjustments, rather than filling of budgetary gaps. Therefore, such cooperation will inevitably lead to the implementation of reforms designed to equalize "rules of the game" for all market players and to the improvement of the country's positions in the ease of doing business rankings.

Signing of a political part of the Association Agreement between Ukraine and the EU and the unilateral reduction of trade barriers by the European Union sends strong signals to investors and creates favorable conditions for the development of the economy of Ukraine. Ukrainian Agribusiness Club repeatedly argued in favor of the Association with the EU, particularly underscoring its benefits for the agricultural sector of Ukraine. Hopefully, Ukrainian agribusiness will experience full benefits of the access to European markets after the economic part of the Agreement is signed and the Deep and Comprehensive Free Trade Area is established.

In addition, it should be noted that the agribusiness of Ukraine has its own capacity to overcome different challenges. If macro-level reforms are implemented successfully, agricultural producers will be able to demonstrate their huge production possibilities and economic potential, and ensure further growth and integration into the world economic system.

Wishing to achieve these goals,

*President
of Ukrainian Agribusiness Club*

Alex Lissitsa

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POLITICS AND MACROECONOMICS

POLITICAL SITUATION AND ITS IMPACT

Ukraine has experienced a dramatic change in its political landscape over the last three months. The anti-crisis memorandum between the former President and opposition, President's escape, return to the 2004 Constitution, appointment of interim President, formation of new parliamentary coalition and new "pro-western" government, appointment of presidential elections on May 25th, signing of the Association Agreement with the EU, annexation of Crimea, etc. — the list of the recent revolutionary changes is continuous.

It is already clear that the situation in Ukraine and the behavior of its main actors went far beyond the previously predicted scenarios. Given the dynamics of the latest events, it is hardly possible to make any projections about the further events. However, the preliminary conclusions are the following:

1. The political situation in the country will remain tense at least until the end of May — time when the presidential elections are to be held. Given the rapid change of the political landscape, a possibility of snap parliamentary elections also should not be excluded. Internal and external revanchist forces will continue stirring up the situation in the East and South of Ukraine seeking federalization of

the country or separation of its parts, or at least discredit legitimacy of the current government. Gradual fading of the "Maidan syndrome" may be replaced with new protests against unpopular reforms. It is possible that the right-wing radical parties will get actively involved into the "political game" legitimating their actions with the "betrayal of Maidan ideals" arguments, e.g. presence of disreputable officials in power, corruption, etc.

2. The former opposition traditionally was not ready to take over the state power. Their party programs were weak and their personnel policies were rather questionable. The new government has managed to appoint only new ministers, whereas division of the main decision-making power has not changed significantly. Not surprisingly, economic decisions of the new government. At the same time, the government demonstrated its willingness to implement deregulation policies. The first step in this direction was the adoption by the Parliament of the so-called deregulation law which provides for abolition of about 113 permission documents and procedures for business.
3. Signing of a political part of the Association Agreement with the EU is a significant step for Ukraine in terms of fixing its foreign policy priorities, but it is not an implementation of this policy yet. While the EU leaders are waiting for legitimately elected authorities in Ukraine, Russia continues to exercise economic, political and even military pressure on the country. Opening of the EU markets for Ukrainian goods and commodities is probably the best option for Ukraine at the current stage of transition. In this context, it is worth noting that some of the politicians are traditionally away from reality proposing immediate application for the EU membership of Ukraine.
4. The rescue of the country from the pre-default situation will require unpopular decisions. The new government has declared its willingness to offer such decisions and, to some extent, has already followed this path. At the same time, the role of international financial institutions and creditors is increasing significantly. It is likely that the key decisions will have to be agreed with them.
5. The future of the current government is unknown yet. On one hand, its reformation along with regrouping of the parliamentary coalition would be the most logical development of the situation. On the other hand, if crucial reforms are not implemented in time but the government establishes good relations with international leaders, the Cabinet of Ministers or at least its "economic block" may negotiate their further stay in power. In the nearest future, such negotiations will be acceptable by the society.
6. Finally, a few words about the agricultural sector regulations. Apart from the recent liberalization of veterinary import permits, deregulation policies remain to be just promises and do not benefit local producers. It is likely that some deregulation initiatives will be implemented before this publication is issued but this definitely will not be achieved by virtue of the Ministry of Agrarian Policy and Food of Ukraine.

The initiative on splitting up agriholdings into the companies that use up to 40-50 thousand hectares farmland is not appropriate because all of them already work as a bundle of clusters of the same size. This initiative will not impact on employment in rural areas, rent payments or production efficiency, but it will definitely complicate the operations of the listed companies and favor those of the "shady" companies.

The issue of finance is also highly debated. The existing state leasing companies, intervention funds, insurance pools, land banks, State Food and Grain Corporation of Ukraine and other state-owned bodies demonstrate a huge conflict of interests the state goes into by doing business itself and, at the same time, regulating it. We will see how this conflict is solved but, for sure, no quick solutions can be expected. Some improvements, however, are possible already in the short run. A good example is the introduction to the Parliament of the governmental draft law on abolition of the State Land Bank.

Last but not least, there will be no support to agriculture financed from the common fund of the state budget. Only special budget funds will be directed to the livestock and horticultural sectors. However, the duration of these programs is unknown. Taxation, i.e. the fixed (flat) agricultural tax and VAT accumulation are not going to be revised yet, whereas the regulatory monetary valuation of farmland for taxation purposes is in the "risk zone". ■

UKRAINE ON ITS WAY TO EUROPEAN INTEGRATION:

SHORT-TERM EFFORTS WITH LONG-TERM BENEFITS FOR AGRICULTURE

At the end of 2013, agri-food trade with the EU was still hampered by a combination of high tariffs and non-tariff measures (NTM) imposed differentially by Ukraine and the EU. For example, applied import duties on agricultural, food and agriculture-related products were higher in the EU than in Ukraine. At the same time, the NTMs, e.g. in terms of Sanitary and Phytosanitary Measures (SPS) as well as Technical Barriers to Trade (TBT) are estimated to be more extensive in Ukraine.

Now, after significant political changes in Ukraine, general policies indicate orientation towards strong support to further European integration. The Association Agreement (AA) is signed and the EU announced a unilateral lift of import tariffs till November 1, 2014. It can be expected that the Deep and Comprehensive Free Trade Agreement (DCFTA) will be signed by that time.

In this context, there are several aspects to be considered by the agribusiness community, acting in Ukraine.

During implementation of the full-fledged DCFTA, many tariffs will disappear, whereas the character of tariff reductions will differ. While the EU will eliminate almost all tariffs immediately, it also applies a wider scope of tariff-rate quotas. Ukraine will reduce tariffs more gradually and even preserve non-zero import tariffs for selected products but will apply tariff-rate quotas to just a few product groups. A study¹ has estimated that, due to the EU import tariffs reduction and despite binding tariff-rate quotas, Ukraine will be able to export about 20% more of agri-food products with the main contribution by exports of cereals, meat, tobacco and miscellaneous edible products. Oilseeds exports will benefit from export duties elimination, providing gains comparable with the impact of the EU import duties reduction. Decline in Ukraine's import duties is expected to result in approximately 7% of additional imports, mostly due to increased supplies of beverages, vegetable oils and fats, meat, mineral or chemical fertilizers, animal oils and fats, and sugar. Tariff liberalization could also generate new trade flows of products not previously traded by the EU and Ukraine. In medium and long terms, the opportunities for agri-food exports from Ukraine will overweight.

A key element of DCFTA, in general, is that Ukraine has to adjust to the EU regulatory framework. Thus, additional impact on trade is expected from lifting of NTM. However, the process will focus almost entirely on Ukraine, which will have to approximate in a wide range of areas to the EU legislation. Once legislative harmonization is successfully done, this should lower NTM trade barriers to an unprecedented level. For example, after the DCFTA has been fully implemented, EU producers will not be required to adhere to Ukrainian food safety standards anymore.

Further, traded products have to be in line with the EU standards, particularly for production technologies and quality of products. The EU products fulfill these requirements entirely.

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¹ APD/Policy Paper/01/2013 *The impact of the EU-Ukraine DCFTA on agricultural trade*. M. Ryzhenkov, S. Galko, V. Movchan, J. Radeke

Thus, the EU agri-food products could swamp into Ukrainian markets quite immediately after signing of DCFTA and will be slowed down just by the above mentioned gradual reduction of tariffs as well as by the lifting of NTM. These imports will cause increased competition for Ukrainian producers and, possibly, in short term, make obsolete domestic businesses face economic losses. It is up to the business community to get prepared for this challenge now. The current unilateral lift of the EU import tariffs provides a time slot for Ukrainian producers to adapt their technologies and product qualities to the EU requirements. Thus, these conditions have been improved in comparison to the situation of the end November 2013.

The Ukrainian government might get faced with temporary increased unemployment and decreasing tax payments. It is up to the government to carefully monitor the pace of potentially negative economic impact on domestic agri-food business, avoiding at the same time any state interventions. To mitigate pressure on domestic producers, state support in form of access to information, advisory services, re-training programs, etc. might be considered to avoid steep further rise of unemployment in rural areas. In this context, the government should make all efforts and put corresponding resources in place to get immediate access to the specific technical assistance programs and other support tools from the EU, particular EU-countries and other international donors, which support EU approximation of Ukraine.

Ukrainian producers and exporters fulfill the high EU production and quality standards so far only partly. The key message for the government is to quickly enable the Ukrainian producers to meet EU regulations. In any case, producers have to cover transaction costs in order to get competitive on the EU market. These transaction costs will have the character of investments as the returns can be expected only after successful positioning and selling of products on the EU markets. It is up to the Ukrainian agricultural producers to make business calculations in which cases the access to the EU market and respective transaction costs are meaningful. State support by Ukrainian government is expected to be limited to the provision of adequate information.

Most important seems the political dimension of the AA and the DCFTA as these agreements will set important signals to international and domestic investors. The agreements will indicate that the policy and economic framework of Ukraine is adapting to the EU standards in terms of corruption reduction, neglecting of particular economic interests in legislation and increasing trust in the jurisdiction. These aspects will, when comprehensively implemented by the state, open new business opportunities and lead to significant boost of production, employment and tax payments as well as general prosperity. Ukraine has a genuine chance to further develop its comparative advantage in production of and trade with agricultural products and to become a key player on international agricultural markets.

In order to make more use out of the advantages of the DCFTA, the government should elaborate immediately and introduce in the short term a strategy on the development of processing and infrastructural industries in order to insure a boost of high value added production. The Ukrainian government and the EU should provide further broad and transparent information for the affected industries, possibly through a common information campaign, in order to assist to understanding of the likely challenges and opportunities for the agribusiness community from the signing of the EU-Ukraine DCFTA. ■



MACROECONOMIC EXPECTATIONS: UKRAINIAN HRYVNIA DEVALUATION AND TRADE BALANCE²

As expected, escalation of political situation led to destabilization of the economy, which occasioned boost of exchange rate and devaluation of Ukrainian hryvnia (UAH). Conversely, such consequences indicate that fiscal and monetary policies are not favorable for doing business in Ukraine. However, the current situation may have both advantages and disadvantages.

In general, the regime of floating exchange rate was imposed due to significant decrease of international reserves and necessity to repay the international debts. The country has run out of reserves for stabilization of the exchange rate and has limited resources to maintain imports. Thus, it is difficult to forecast the future of hryvnia in the long run because some spikes were relative to political movements in February-March 2014. Market players will accordingly decelerate production growth and wait for better conditions.

Ukraine: General macroeconomic figures

	2008	2009	2010	2011	2012	2013
Nominal GDP, billion UAH (actual prices)	948,1	913,3	1082,6	1302,1	1411,2	1454,9
Gross agricultural output, billion UAH (actual prices)	154,4	157,2	184,9	265,1	258,3	306,2
Average nominal wages, UAH	1806	1906	2239	2633	3026	3265,0
Growth of average real wages (month over month of previous year), %	97	99,1	110,5	111	111	108,2
Consumer price index (month over month of previous year), %	122,3	112,3	109,1	104,6	99,8	100,5
Industrial price index (month over month of previous year), %	123	114,3	118,7	114,2	100,3	101,7
Unemployment rate (end of the year), %	3	1,9	2	1,8	1,8	1,8
Exports, billion \$	78,7	49,2	63,2	82,1	82,4	85,3
Imports, billion \$	92	50,6	66,2	88,8	91,4	100,7
International reserves to short-term debt on remaining maturity, %	68,0	67,3	70,3	53,6	38,9	32,9*
International reserves, months of imports	6,4	4,9	4,2	3,6	3	2,7**

*I-III Quarter

**I-II Quarter

Source: National Bank of Ukraine

Further volatility will depend on the possibility to intervene in domestic markets. However, monetary stability requires additional financial resources, which will be, most probably, provided by international financial institutions in the nearest future. At the same time, the government declared initiatives to reduce ineffective budget expenditure and implement market deregulation in order to improve business climate.

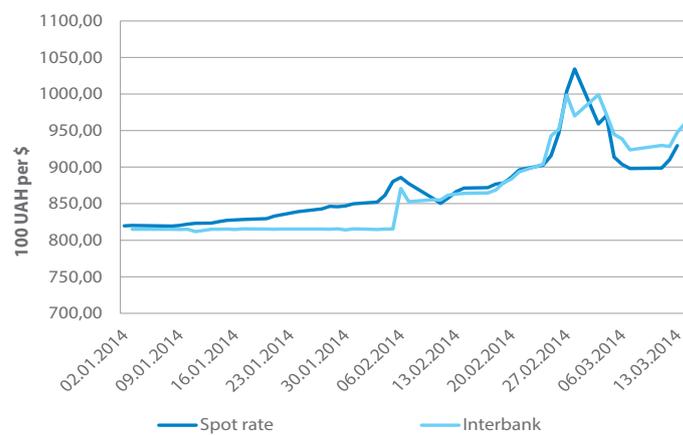
Ukrainian banks also reacted noticeably. Lack of financial resources and decrease in volume of deposits led to significantly higher interest rate. Such a sharp bulge coincided with the sowing campaign in agriculture and, in the nearest future, will increase the cost of agricultural production. Moreover, growth of interest rate will hamper the access to finance for agricultural producers.

² In cooperation with German-Ukrainian Agricultural Policy Dialogue

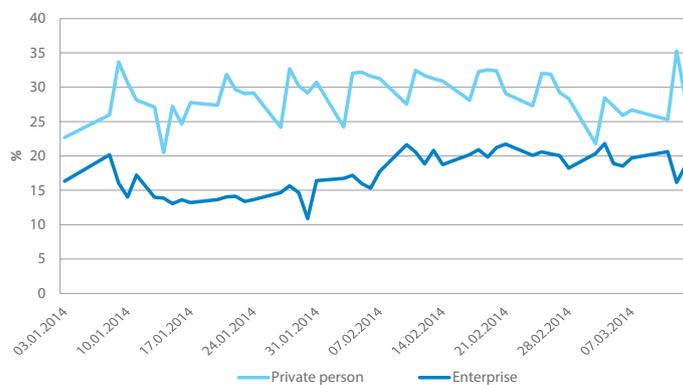
Concerning trade balance, reduction of the negative balance by \$8 billion was primarily the result of the decline in volumes of imported goods. Additionally, hryvnia devaluation is always beneficial for Ukrainian exporters. On one hand, it will improve the competitive position of Ukrainian goods both on domestic and international markets as well as the imported ones will be discouraged among Ukrainian consumers due to higher prices. On the other hand, export volumes directly depend on the demand and prices on international markets.

The current economic situation unweighs all forecasts, including production profitability. It is likely that, due to the lack of working capital and expensive debt capital, imports will decrease. Thus, the tendency towards increasing prices of imported goods will stay in place. ■

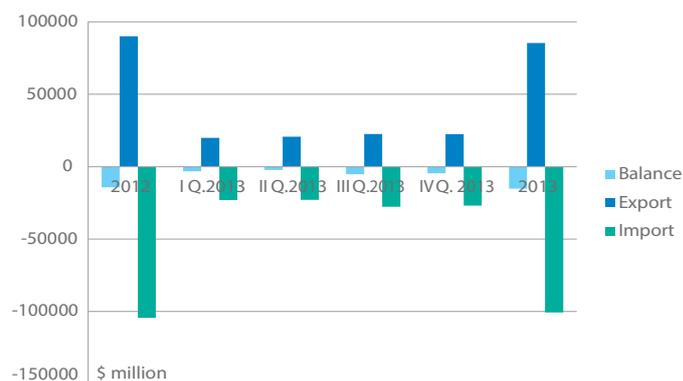
Exchange rate, January-February 2014



Average annual interest rates, January-March 2014



Trade balance dynamics in 2012-2013, \$ million



Source: National Bank of Ukraine



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There is no doubt that the issue of ownership right is not only an essential attribute of the rule-of-law state and a politically stable nation but also one of the key indicators of a country's investment attractiveness, the predictability of the business and investment protection. In the absence of a transparent system of registration of rights to real estate, relevant guarantees, available protection mechanisms, independent judiciary system and effective system of enforcing court decisions, one cannot even begin talks about any sort of qualitative or competitive business development.

Guarantees for the steadiness of ownership rights

The Constitution of Ukraine, whose rules have a direct effect, the Civil Code of Ukraine and other legislation of Ukraine as a whole, guarantee the inviolability of ownership right. Ukraine recognizes the equality of all forms of ownership and all owners before the law.

Provisions of the Constitution of Ukraine are detailed in many branches of Ukrainian legislation — constitutional, criminal, administrative, land, financial, civil, which set various legal mechanisms and instruments for the protection of ownership right. Legislation governing relations in this sphere is characterized by a restrained dynamics. Social and professional organizations along with legislative initiative groups regularly develop and submit for consideration proposals to strengthen the guarantees of the rights of owners and to improve the mechanisms for securing and protecting ownership rights in Ukraine. One of the most iconic legislative changes over the last few years has been the reform of the system of real property rights registration. Starting on January 1, 2013, Ukraine introduced a new titular registration system, which has numerous advantages compared to the previously applicable approach and is generally consistent with the European tradition. From now on, all the rights and encumbrances on the land together with the rights to buildings located on it are recorded in one register — the State Register of Property Rights to Real Estate. The law associates origin of the ownership right as such with mentioned registration.

According to the Ukrainian law, no one may be unlawfully deprived of ownership right or limited in its implementation.

Lawful expropriation

However, the Ukrainian law as much as the law of any other European country, allows depriving individuals of ownership rights, but only in cases and in the manner prescribed by the law. In particular, we are talking about: (1) termination of the right to property, which by law cannot belong to the person concerned; (2) buy-out of cultural heritage in order to prevent their damage or destruction; (3) buy-out of land and property located on it, for public needs; (4) expropriation of land and property located on the motives of public necessity; (5) foreclosure on the property under the owner's obligations; (6) seizure of the property in the public interest in the event of extraordinary circumstances, including natural disasters, accidents, epidemics,



epizootics, etc.; and (7) confiscation as a sanction for the committed offense. Practical application of the above tools has its own specifics in Ukraine and is often associated with certain difficulties, both legal and technical. Below we consider some of them.

Forced expropriation, regardless of the basis, could only be implemented by the court and, except for confiscation, with full compensation to the owner for the value of the expropriated property. In some cases such as buy-out of land and real property located on it, for public purposes, an option of compensation in non-monetary form is allowed, by providing the owner another piece of property, equivalent to the expropriated one. In first case, inevitable difficulties have to do with determining the amount of compensation. In the second case, there are considerable issues with defining an equivalent property item to be provided to the owner of the expropriated one. When the buy-out price is determined by the very authority that would carry out the buy-out or the court, which decides on expropriation, without statutory criteria for determining the price in each case and the equivalence of expropriated property, there is enough room for abuse. As practice shows, the compensation for the expropriated property as well as the provision of equivalent objects often does not consider the market value of such assets.

Also, the lack of specifics in defining the circumstances that determine public needs or public necessity, in defining the liabilities of the owner of cultural heritage item, which violation constitutes the basis for the expropriation of the corresponding property, often also contribute to abuse.

Moreover, from a practical point of view it is often forgotten that expropriation should only take place when the use of the relevant property without termination of ownership is not possible. At the same time, the legislation does not provide for liability in case of future use of expropriated for public needs or public necessity property for other purposes, which undoubtedly increases the risk of raids by both the state and by individuals using state authority as a tool to further establish control over other people's property.

We should also pay closer attention to legally undefined requisition and, moreover, nationalization with very little assurance to the owner. The legislation providing for the grounds, conditions, procedures, legal effects and guarantees the rights of the owners of requisitioned property is very general and quite superficial. There is no legislative act governing the procedure for nationalization in the interests of public order, which in connection with the situation in Crimea is a hot topic for Ukraine. At the same time, the Ukrainian legislation contains a general prohibition on the nationalization of foreign investments, which does not apply, however, in case of natural disasters, accidents, epidemics, epizootics.

Expropriation de facto

In addition to the above grounds for forced termination of ownership right, we should also mention cases of de facto expropriation. Instruments used in such cases are not included in the list of grounds for deprivation of ownership right, despite of the fact that in general they certainly meet the formal requirements of the legislation of Ukraine. The so-called re-privatization and judicial process are the two most evident forced expropriation instruments.

Thus, after the change of the economic model of management in the 90's, Ukraine is still undergoing the process of privatization of state property. After each parliamentary or presidential elections the law enforcement agencies and, sometimes, directly

privatization authorities immediately initiate a slew of litigation cases in order to deem certain previously conducted privatizations illegal based on lack of compliance with privatization plan, or in order to terminate the privatization contract by virtue of failure of any investment obligations or find it invalid on some purely formal grounds, or invalidate the privatization tender and its result, etc. Lack of legal regulation of privatization itself, competition, contradiction and inconsistency of legislation, legal uncertainty of re-privatization process and lack of legislative guarantees of investors' rights, as well as a selective approach to the use of property that becomes the target of re-privatization, practical problems of restitution and compensation for previously made investments, and the lack of accountability of civil servants related to illegal privatizations are the factors that negatively affect the position of investors and negate the basic guarantees of ownership right.

Also frequent are cases of expropriation by using judicial tools and mechanisms. Property owners often face the problems inherent in Ukrainian judicial system as a whole, such as bias, lack of transparency, inadequate procedural rules, the duration of court disputes and informal opportunity to influence the imposition of appropriate solutions. More often the courts are used in a chain of illegal schemes aimed at denying or depriving of the right of ownership. In the last decade, there were a significant number of claims for deprivation of ownership rights by invalidating the title documents or cancelling state registration of rights for frivolous or purely formal grounds. In addition, inadequate procedural law often contributes to problems with the definition of jurisdiction in disputes involving ownership that unduly restricts the owners in timely and effective opportunities to protect their ownership rights.

Another problem that is equally urgent is the often-encountered inability of the state executive service to ensure the enforcement of court decisions relating to the protection of property rights. With public officers continuously overworked and those required to satisfy the judgment trying as hard as they might to dodge that responsibility, the situation is further aggravated by the inadequate funding of the executive service by the state. All of this happens to be, but let us not forget the personal material interest of those responsible for executing the judgment and the lack of any responsibility for the failure of doing so.

Thus, we should admit that, despite of some positive reforms associated primarily with the introduction of a new system of registering titles to real estate, still the instruments to guarantee and protect ownership rights in Ukraine are far from being perfect. In general, this situation is typical for a developing country, including Ukraine, but, undoubtedly, it is the key to achieve a qualitative transformation of the Ukrainian society. Privacy and protection of property should be in deed and not in name one of the main functions of the Ukrainian state, since the protection of economic relations as the foundation for any social system is the most important task of any legal system.

Ukraine faces a number of acute practical challenges associated with the implementation of ownership rights and their protection. These problems cause the need for serious legislative work for the proper settlement of the issues of privatization, re-privatization, requisition, buy-out of property for public needs, expropriation, based on motives of public necessity. Also, an immediate action is required in order to establish effective and transparent mechanisms for the protection of ownership rights and the equality before the law of all the owners. We need to further reform the judiciary and the executive office. These steps are a prerequisite for the establishment of state of law in Ukraine and, consequently, to increase the attractiveness of Ukraine state for foreign investors.



TAXATION OF AGRICULTURE

In order to support the agricultural sector of the economy and to reduce the fiscal burden upon agricultural producers, the laws established special taxation regimes for agricultural companies:

- a fixed agricultural tax;
- special regime of application of the value added tax (VAT).

Fixed Agricultural Tax

The fixed agricultural tax is a tax, which is collected in relation to a unit of land area as percentage of its regulatory monetary value. Payment of the fixed agricultural tax replaces the following taxes and charges:

- corporate profit tax, including advance payment when distributing dividends;
- land tax for land used for agricultural production;
- charge for special use of water resources;
- charge for carrying out certain types of entrepreneurial activities (including trading activities).

All other taxes and charges are paid on the general basis, including a single social security contribution.

The eligibility for the fixed agricultural tax is subject to the following conditions:

- manufacturing of agricultural products and/or fish farming and fishing in lakes, ponds and artificial water reservoirs, processing of such products with the use of own or leased facilities, including tolling-based operations;
- use of agricultural lands (owned or leased);
- the share of agricultural production in the previous year is at least 75%, with the share of the agricultural production equalling the share of the income of the agricultural producer, derived from processing and sale of his own produce and derived products, in his aggregate income.

The following companies may not pay the fixed agricultural tax:

- those that earned over 50% of their income from selling ornamental plants, wild animals and birds, fur products and fur (with some exemptions);
- those that produce and/or sell excisable goods (except for sale of grape wine-making materials by companies engaged in primary wine-making);
- those that have tax indebtedness (arrears) as of January 1 of the reporting year, except for bad tax indebtedness which arose in the result of force majeure.

Tax authorities closely scrutinize whether a company has met the requirements to pay the fixed agricultural tax. In particular, they rigorously verify whether the company's production is agricultural and on what basis the company uses the land (e.g. whether there is a registered lease agreement).

The following types of agricultural land used by agricultural producers are subject to the fixed agricultural tax:

- arable land;
- hayfields;
- pastures;
- perennial plantations;

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- lands of water resources (internal water basins, lakes, ponds, water storage reservoirs).

The fixed agricultural tax is calculated on the basis of the regulatory monetary value of one hectare of agricultural land, which will be subject to indexation starting from January 1, 2015 in accordance with the rules set for the land tax.

Rates of the fixed agricultural tax

Types of land plots	Rates of the fixed agricultural tax (% of the regulatory monetary value)		
	general	in mountain areas and in the Forest region	for protected grounds
Arable land, hayfields and pastures	0,15	0,09	1,0
Perennial plantations	0,09	0,03	-
Lands of water resources	0,45	-	-

For the purposes of the fixed agricultural tax, a calendar year is defined as the basic reporting period. The tax is calculated by taxpayers as of January 1 of the current year.

The accrued amount of the fixed agricultural tax is broken down by quarters as follows:

- I and II quarters — 10% each;
- III quarter — 50%;
- IV quarter — 30%.

The quarterly amounts of the tax are divided into three equal installments and paid monthly to the appropriate account of the local budget where the land plot is located.

Special regime of application of the VAT (in force until January 1, 2018)

Any company operating in the fields of agriculture, forestry or fishery may choose a special regime of application of the VAT provided that:

- the principal activity of the company is the supply of agricultural goods or/and services produced on its own or leased facilities, including tolling-based operations;
- the share of agricultural goods and/or services makes up at least 75% of the total value of all goods and/or services supplied during 12 preceding consecutive reporting periods on aggregate.

In case this special regime is selected, the company transfers the due amount of the VAT not to the budget, but to a special bank account. This amount may be used by the company as a tax credit according to a general procedure; the remaining sum, if any, is not transferred to the budget but may be used for other production purposes.

Exemption from the VAT of supply of grains and industrial crops

The following transactions are released from the value added tax:

- supply of grains of commodity items 1001-1008 (save for commodity item 1006 and commodity sub-category 1008 10 00 00);
- supply (exports) of industrial crops of commodity items 1205 and 1206 (per the UCGFEA), save to supply of such grains and industrial crops by producers and companies, which purchased such grains and industrial crops from producers.

Exports of such commodities are not subject to taxation, save for exports by producers of such grains and industrial crops grown on agricultural lands which are owned or perpetually used as of the date of such export. The exception regarding grains and industrial crops grown on owned or perpetually used lands will remain in effect until October 1, 2014. Thereafter, the tax exemption will not apply to exports of the commodities referred to above by producers and companies, which purchased such grains and industrial crops from producers.

Prior to October 1, 2014, the tax credit with regard to acquired and/or manufactured noncurrent assets, which are simultaneously used in VAT taxable and VAT non-taxable transactions referred to above is to be formed to the full extent. The rule about proportional formation of the tax credit, as provided for by Article 199 of the Tax Code, will not apply in such cases. Pursuant to the effective laws this rule will not apply after October 1, 2014.

Supplies of wood of commodity items 4401, 4403, and 4404 (per the UCGFEA), except for pellets and granules of commodity sub-category UCGFEA 4401 30 90 00 are exempted from the value added tax until January 1, 2015.

Transfer pricing

The rules of transfer pricing have been in effect in Ukraine from September 1, 2013. They are applied for the purposes of the corporate profit tax (general basis) and value added tax. The transfer pricing rules (setting of a regular price) are applied to controlled transactions only if the aggregate value of such transactions with each counterparty is at least UAH 50 million (VAT exclusive) per calendar year. The following transactions are deemed to be controlled:

- purchase (sale) of goods (works, services) from (to) related foreign companies;
- purchase (sale) of goods (works, services) from (to) related resident entities which declared tax losses for the previous year, or which started applying a special regime from the beginning of the year, or which pay the corporate profit tax or the value added tax at a lower than the standard rate, or which have not paid the corporate profit tax or the VAT as of the beginning of the reporting year;
- purchase (sale) of goods (works, services) from (to) foreign companies which are registered in a jurisdiction where the applicable corporate profit tax is 5 per cent lower than in Ukraine, or which pay the corporate profit tax at this rate. The list of such countries with the low level of taxation is approved by the Resolution of the Cabinet of Ministers of Ukraine as of December 25, 2013 # 1042-p.

For the purposes of tax accounting of such transactions, tax payers are required to apply only the methods of setting the price as described in the Tax Code of Ukraine (in particular, the methods of comparable uncontrolled price, profit split, net margin, cost plus, and resale price), as well as to submit annual reports on controlled transactions to tax authorities, and, upon request of such authorities, all documents confirming the validity of prices and the actuality of the transaction.

Companies engaged in exports and imports of grains are allowed to maintain a deviation of the price of the transaction with foreign companies registered in jurisdiction with the low level of taxation by not more than 5% of the commodity item until January 1, 2018.

Any violation of the transfer pricing rules may trigger accrual of additional tax liabilities based on regular prices and application of penalties by tax authorities:

- a failure to submit a report — a penalty in the amount of 5% of the amount of the controlled transaction;
- a failure to submit documents — a penalty in the amount of 100 minimum wages.

Until September 1, 2014 additional tax liabilities for violations of application of methods of setting the regular prices will be accrued in the amount of UAH 1.



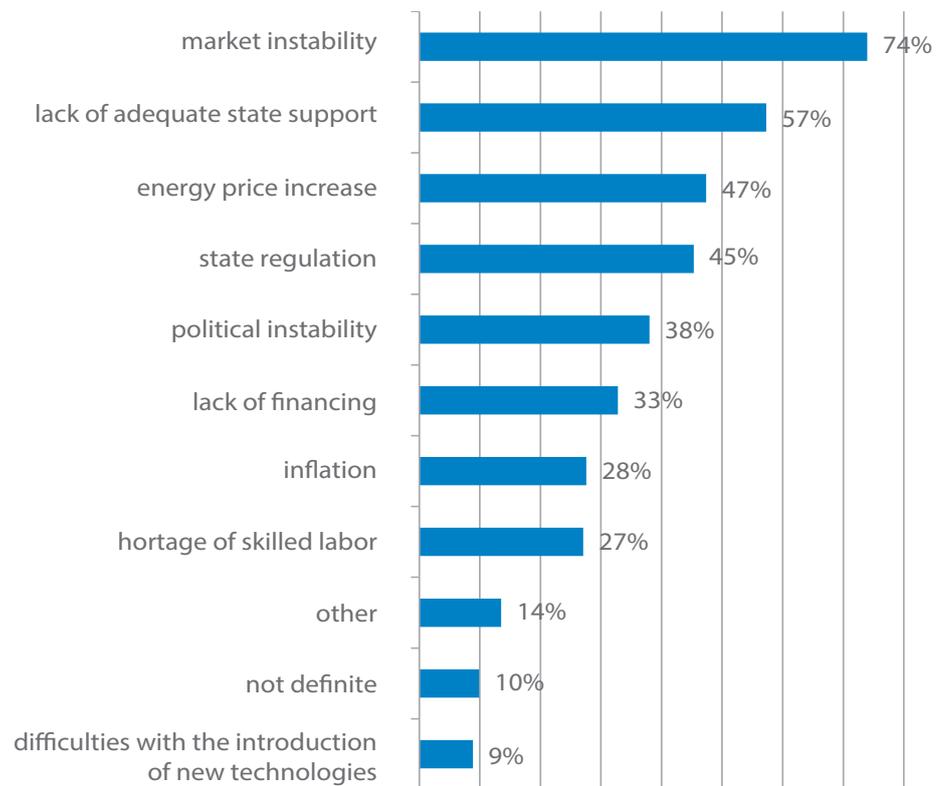
MAIN OBSTACLES FOR DOING AGRIBUSINESS IN 2014

It is no secret that the conditions of doing business for the Ukrainian agricultural producers are far from being favorable. Traditional problems during a sowing campaign and price fluctuations are often aggravated by increased overregulation of the industry.

Today, a number of factors constrain the development of agribusiness in Ukraine. Based on the opinions of farmers, the major constraint is, traditionally, market instability. Farmers are suffering huge losses because of the frequent price jumps both at input and output markets.

One of the main problems is also the lack of adequate state support. Because agricultural producers enjoy a number of tax benefits (see the above sections), the «adequacy» of state support primarily means the transparency of distribution of the direct support so that the most efficient producers are supported as well as the provision of farmers with the information about markets and participation in the development of social infrastructure in rural areas. 45% of farmers claim overregulation is the key bane of the sector. Instead of obtaining state support, farmers often get additional inspections and certifications.

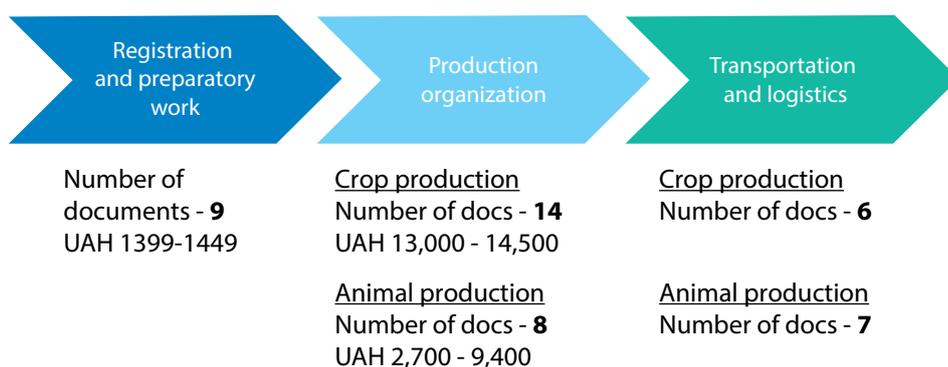
At the same time, farmers consider inflation, lack of financing and shortage of skilled labor as less problematic phenomena.



Source: AgriSurvey study «Agrobarometer 2.0: Investment and economic expectations of agricultural producers 2014»

DEREGULATION OF AGRIBUSINESS: HORIZON OF OPPORTUNITIES

In order to enable the full functioning of the agricultural commodity chain in Ukraine, its actors must get about 48 different permits, certificates and services from state authorities. Each of these permission documents and procedures induces transaction as well time costs for agribusinesses. Not surprisingly, most agricultural producers characterize the current situation as overregulation of the sector. Whereas the majority of developed countries are trying to reduce the number of permits and licensing procedures for agriculture, in Ukraine their number has been increasing in the last years. The high level of bureaucracy discourages investments, causes high interest rates on loans and minimizes incentives for the development.



Source: UCAB Legal Committee

Considering the World Bank's Doing Business ranking 2013, Ukraine's performance improved significantly. The improvements were visible mainly in the costs of setting up the business until its full legitimate operation. Company registration requires application for 6 state documents and takes 21 day on average. At the same time, in the top-ranked countries, one needs to apply for 5 documents and this takes 12-13 days on average. In the past few years, a number of regulations on the stage of getting construction permits were canceled in Ukraine. The other regulations were harmonized with the EU standards. However, the number of different forms that must be filled has not decreased despite the introduction of a common electronic reporting system.

Timelines and documents required to business start in Ukraine

Phase	Number of days	Number of documents
Registration	21	6
Construction	73	10
Access to electricity lines	277	10
Registration of property	45	8
Taxation	390 hours a year	28
Trade. Exports	29	6
Trade. Imports	28	8
Investigation of the fulfillment of the terms of the contract	378	30
Consideration of insolvency cases	1044	-

Source: World Bank

SUCCESS AND FAILURE STORIES OF FOREIGN INVESTMENTS IN UKRAINIAN AGRIBUSINESS

Examples of failure stories

Case 1

In 2007, a Germany-based company invested more than EUR 4 million in rapeseed and wheat production on the area of 11,600 ha in Ukraine. Harvested crops should have been shipped to Germany and used for biofuel production. However, after 6 years, the project has appeared to be unprofitable.

One of the reasons of failure was incorrect planning of the investment. To a great extent, the plan was to capitalize on the “biofuel euphoria”, which persisted in Ukraine at that moment. Nevertheless, the conditions for production as well as a wrong forecast led to failure.

As the project was established in the form of a public-private partnership, representatives of the local government were responsible for involvement of the consultants for evaluation of potential profits and preparation of the business plan. However, given lack of experience in communication with private consultants, they were not able to find and hire highly skilled professionals. This was particularly one of the key reasons of failure. To that effect, the German intern student was appointed as the project manager.

Another reason was that the investors decided to lease the land of former residential areas that have never been used for crop production. Thus, soil quality improvements required significantly more costs than expected. Finally, distance between land parcels was so long that it has notably increased costs of machinery transfer/transportation during the harvesting.

Case 2

In 2007, an Italian investor established a Group of Companies in Ukraine, which specialized in oilseed and grain production. The Group signed farmland lease contracts in different regions of the country with a total area of over 80 thousand hectares and also purchased new agricultural machinery for UAH 200 million.

In 2009, the Group was faced with trying to raider attack and seize its assets. In April 2010, it was announced insolvent. Apart from raiders who had connections with the local courts, another reason for failure was incomplete or late rental payments to landowners. This led to tensions and protests of landowners in the villages where the Group had been operating.

(An unofficial reason is that the Group was deliberately brought to bankruptcy by the investor in order not to repay the debts to the creditors.)

Case 3

A Company leased more than 150 thousand hectares in Ukraine and its equity shares were listed on one of the European stock exchanges. More than one third was in a free float.

In 2011, due to sugar overproduction, Ukrainian sugar plants were generally operating at the break-even point. Because of this, in 2012, the Company decided to leave the sugar business and focus on the production of corn, sunflower and soybeans.

At the end of 2012, Company announced an intention to restructure its land bank in order to increase productivity figures. The plan was to gradually withdraw from lease contracts for about 85 thousand hectares of arable land in the region with unfavorable weather conditions and move to a more suitable region. However, this plan was not realized whereas the Company's share price fell by 38,5% in 2013 followed by the start of the insolvency procedure of the parent company in January 2014.

One of the main reasons for the failure was that the major shareholder of the Company was little focused on the agricultural dimension of the business portfolio while paying more attention to his core preference — real estate. In addition, the



investor's main motivation for the investment in agriculture was high food prices and he streamlined the company's strategy towards increasing of its land bank. Reorientation towards improvement of efficiency was too late, apparently.

Case 4

A Holding Company, registered in the EU, is the parent company of a Ukrainian Limited Liability Company (LLC). The owners of the Holding Company were thinking of an IPO on one of EU stock exchanges and planned ahead for entry of new markets for their products. Nevertheless, in 2013, the business was almost run-over. LLC investors were disappointed with the results of the placement of depositary receipts. Because top-managers of the LLC were not ready to discuss all financial issues with the investors, the LLC was not able to raise funds for further advancement. Thus, one of the reasons for failure resided in the lack of finance aggravated by unfavorable conditions on stock exchanges due to Eurozone crisis. Another factor was the high costs associated with the LLC's dispersed land bank. Although the location of farms in 12 regions helped reduce weather risks, high transportation costs had a negative effect on profitability.

Examples of "moderate success" stories

Here, we describe several investment projects which were either "revitalized" based on revisited strategies or postponed due to different reasons.

Case 1

In 2007, a Company conducted an IPO on one of the European stock markets and raised \$110 million through offering of 54% of its securities. In 2008, the Company raised nearly \$22 million through additional emission of 5.4% of its shares. Nevertheless, in 2008, the Company's losses accounted for \$55.7 million while the market value of its shares dropped by 95%. In 2009, the Company almost stopped its investment projects in agriculture and financing of the social programs in rural areas. In 2012, the Company was acquired by a foreign investor for \$17.9 million.

Primary reasons for the failure were actually traditional: inaccurately planned strategy and complicated relations with local authorities. Firstly, the Company's managers accentuated the production output instead of focusing on profitability. Consequently, unfavorable market conditions led to decline of economic efficiency and the Company had to reduce operational expenses by 47% and, as a result, realization of the multidimensional \$50 million investment project was suspended. Secondly, the Company failed to get a \$9 million VAT reimbursement for exports of grains and oilseeds while the number of state inspections and controls at the Company's facilities "surprisingly" increased.

In 2013, the Company started a turnaround process. In order to rationalize the land bank, the Company reduced it from 97,000 hectares to 65,000 hectares through the sale of land lease rights in non-favorable regions. Major activities were subsequently concentrated in the regions where climate and precipitation were relatively stable. Proceeds from the sale of land lease rights amounted to \$5.6 million while the sales of assets helped save \$ 1.6 million a year. Finally, the Company has undergone rebranding and planned to start the process of cost cutting which was expected to save \$23 million (which is about 20% of the current value of the Company). Relationships with local authorities have stabilized.



Case 2

In 2010, a vegetable-processing Company leased 1.5 thousand hectares for vegetable production. Within three years, this area was planned to be increased to 6 thousand hectares which would enable 100% load of the new processing capacities in the region. It was expected that the new plant would run for the Ukrainian market as well as partly for exports to Belarus and Uzbekistan. The new plant had to become the largest in Europe and the Company intended to invest about EUR 40 million in its construction. A part of this sum had to be financed through EBRD funds.

Nevertheless, the Company has not even started the construction of the plant. Instead, the Company acquired its competitor.

This was not only the payback period comparison but also the absence of clear and simple procedures for land lease that made the Company revise its investment. At the plant design stage, the local administration proposed the Company to construct a 10 km-long power line, refusing to connect the plant to the existing line which passes nearby.

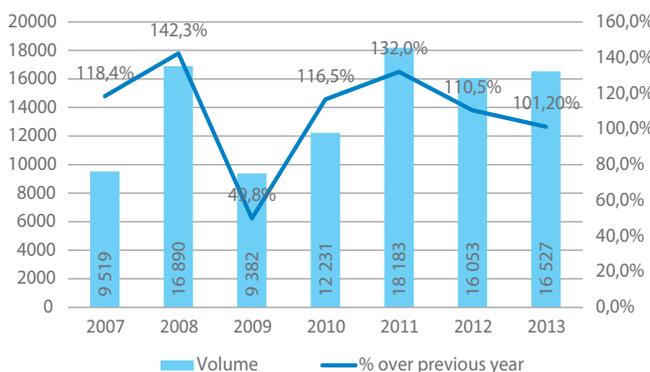
Another reason, mentioned in several mass media sources, was corruption at the local level. In order to get "assistance" from local authorities in arranging the construction process, the Company was "offered" to pay 10% to 20% of the future yearly revenue of the plant. The Company's Ukrainian office describes the current situation as a postponement of the project but even an approximate date of its start is not announced.

Case 3

A grain trading Company planned to invest \$50 million in construction of a silo in one of the Ukrainian ports. However, the Company froze this investment project. The main reason was the introduction of grain export restrictions by the Ukrainian government. This negatively affected financial figures and reputation of the Company as the restrictions caused problems with sales of the contracted grain to international partners. Another reason was non-reimbursement of about \$50 million of VAT at exports by the State Tax Service of Ukraine.

Generally, international grain trading companies are under high pressure in Ukraine. Despite huge investments they have made in logistics and port infrastructure over the last decade, authorities often accuse them of transferring global grain market volatility to local markets and of lowering prices for primary producers. This "blame game" usually starts before elections.

Capital investments in Ukrainian agriculture, UAH million



Foreign direct investments in Ukrainian agriculture, \$ million





Examples of successful projects

Case 1

In 2004, a Company bought a pig farm in Ukraine for \$1.9 million. According to the Company's top-management, it was the most reasonable option in terms of infrastructure and input supplies. The farm has 11,000 ha in use for production of forages. In 2007, the Company constructed a feed mill which covers its feedstuffs needs. In 2013, the Company launched a biogas plant at the pig farm and the total investment amounted to \$6.3 million. This helps to fully cover the farm's electricity needs and 50% of its gas needs.

At the heart of the Company's success are good relationships with authorities. In 2006, the Company established its Social Fund with annual budget of \$60-75 thousand to provide support to rural communities. This helped gain support and understanding of local and regional authorities.

The Company's key step to economic achievements was an in-depth risk analysis that helped minimize unproductive losses. The Company possesses its own construction company which enables that the development process is more cost efficient (savings of 40% of construction costs, according to the company's top-management).

Additionally, costs of pig fattening at the Company's farm are significantly lower than those of the competitors. The main secret is genetics — the Company uses only Danish breeds. Apart from that, one of the main advantages of the Company over its competitors is access to cheap bank loans (4% per annum). Last but not least, all the success factors would have no effect if there were no strong management team.

Case 2

In 2010, a Company built a plant for production of corn and sunflower seeds in one of the Ukrainian south-eastern regions. The total investment amounted to \$40 million. In September 2014, construction of the second production line will be finished with the total investment of \$16 million. Increase of production capacities is a clear sign of the project success. Essential feature of this success is correct demand planning and understanding of the local market. The Company chose the right location for its plant — the main clients are located within 300 km from the plant which allows for the best results with high quality seeds. Additionally, the Company established cooperation with local authorities and addressed improvement of qualifications of its employees including studying of origin country experience as one of the highest priorities.

Case 3

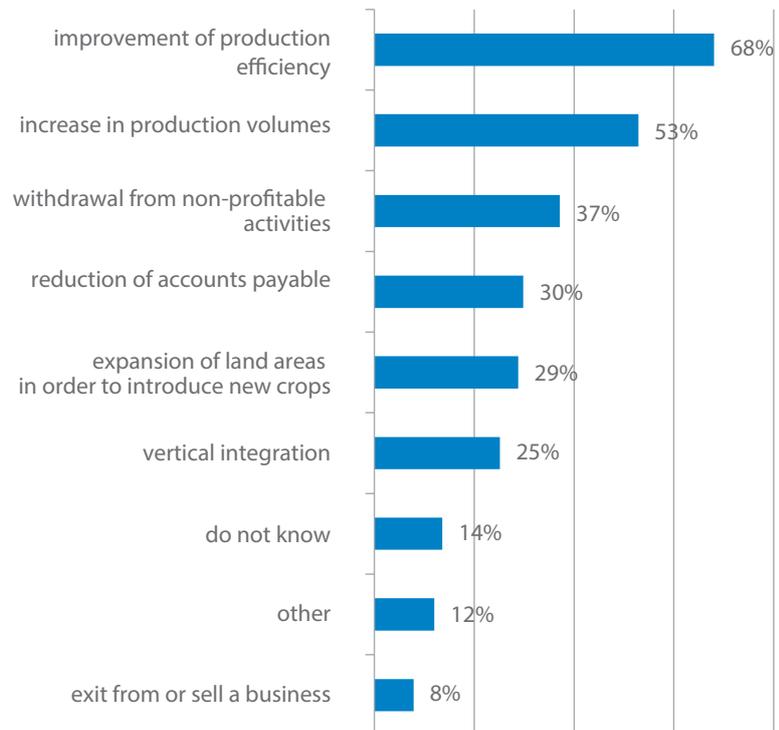
In 2008, a seed-breeding Company built a corn seeds plant in one of the central regions of Ukraine. In 2012, the Company launched a new complex for storage of seed potatoes in another central region. The investment constituted \$8 million. In 2014, the Company is planning to construct another corn seed plant in the same region and the total investment is planned about \$24 million. The success of these huge construction projects was possible due to the right choice of location. For example, the potato storage complex is located 3 km from the international highway. Relationships with local and regional authorities are not problematic and one of the main reasons for that is the Company's strong and well-known international brand.

MAIN PLANS FOR DOING AGRIBUSINESS IN 2014

For the most of agricultural producers, the main goal in 2014 will be the increase of efficiency and productivity. The major reason behind this aspiration is the decline of profitability of most crops produced in 2013. Another reason is the inability to further expand the area of the farmland used: only one third of producers are willing to expand their land areas in order to be able to introduce new crops or varieties.

Improvement of efficiency also involves withdrawal from non-profitable activities; about 37% of farmers expressed this intention. 30% of agricultural producers want to reduce accounts payable because loan repayments are becoming particularly constraining due to high interest rates in 2014. To a lesser extent, farmers are planning to vertically integrate with the processing industry.

Only 8% of farmers are willing to exit from agribusiness. Most of them are located in regions with unfavorable climatic conditions such as Transcarpathia, Ternopil and Luhansk oblasts).



Source: AgriSurvey study «Agrobarameter 2.0: Investment and economic expectations of agricultural producers 2014»



RESOURCES OF AGRICULTURAL PRODUCTION

FINANCIAL RESOURCES

SOURCES AND ACCESSIBILITY OF FINANCIAL RESOURCES IN 2014

The deficit of financing has long been blamed for the setback of Ukraine's agroindustry: farmers need resources both during spring and autumn field works and during the harvesting season. The deficit of financing for 2014 spring works, for instance, amounts to UAH 10.5 billion as per estimates of experts, while options of borrowing money or raising other resources remain rather limited.

Below we discuss those financing options, which are already available for agribusinesses as well as new instruments, such as agrarian receipts, that are being designed by market players.

In general, the financing instruments come in the following types:

- Traditional bank loans
- Leasing
- Debt financing via promissory notes, guaranteed payments and special partner lending programs
- State financing (forward purchases by the Agrarian Fund and State Food and Grain Corporation of Ukraine)
- External borrowings (IPOs, Eurobonds, loans from non-resident banks, etc.)

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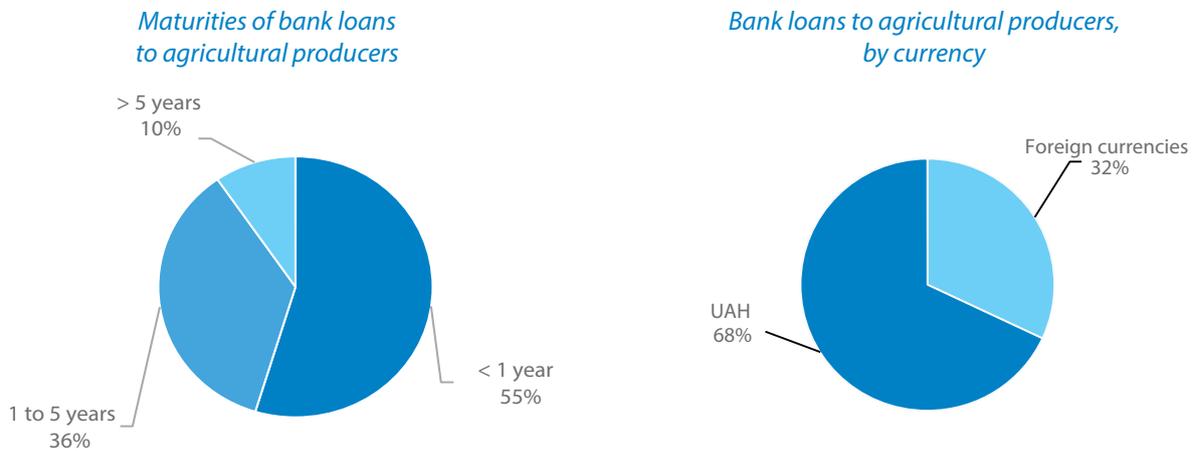
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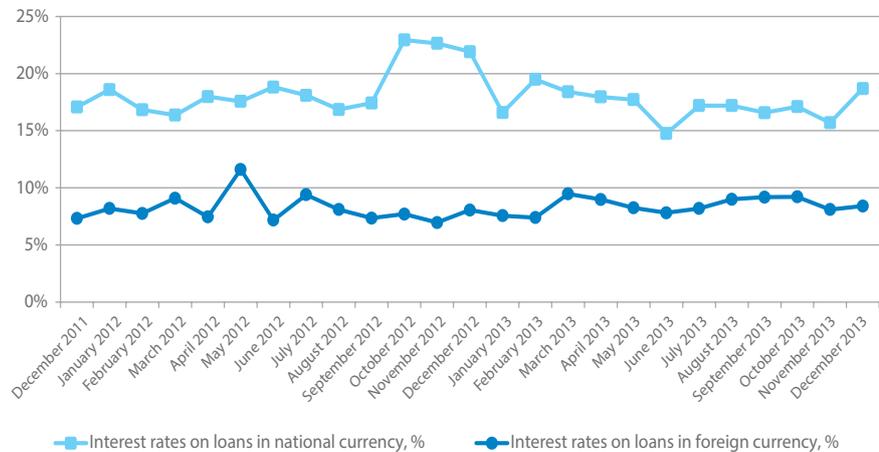
Traditional bank lending

Today, bank loans are the most common and accessible but by far not the cheapest financing option. They are offered to agricultural producers by numerous banks, of which, however, only five to ten are actually focused on this sector. According to the information of the National Bank of Ukraine, by the end of February 2014, agricultural entities obtained loans totaling UAH 44,267 million. The loans portfolio structure is summarized below.

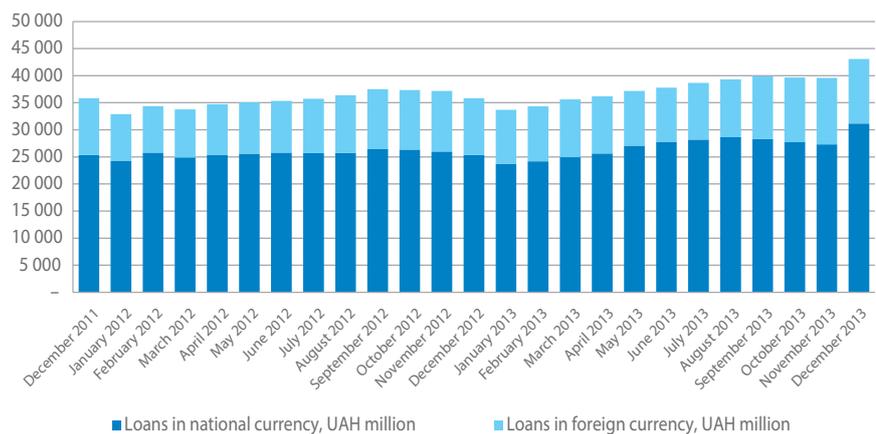


Source: NBU Statistical Bulletin (February 2014)

Dynamics of interest rates — loans to agricultural producers in 2011-2013



Structure of loans issued to agricultural producers in 2011-2013





Seasonality and increased risks of agribusiness, combined with the general deficit of liquidity and political tensions in the country, contributed to the moderate or even conservative approach to lending in 2013 and caused banks to impose additional requirements to the borrowers and collateral. Bankers do not generally bother about systematic delinquencies on USD-denominated loans issued before the 2008 downturn: all bad loans issued then have already surfaced and the appropriate workout strategies have been put in place, whereas the events of 2014 called for new responses and affected the planned lending volumes. The bankers recognize that any loan may become defaulted due to a wide variety of reasons that are often beyond their reasonable control; furthermore, being guided by the principles of prudence and wait-and-see, none of the bankers expressed readiness to share secrets of how the agricultural sector lending strategy should be modified. Western banks are having the hardest time: they have to comply both with the NBU's requirements and with often more stringent ones set by regulators in the countries where their parent banks are domiciled. Bankers say that the country's credit limits are being closed, which makes parent banks adopt more rigorous monitoring rules for new borrowers. Nevertheless, analysts claim that until recently banks with capital of Russian origin have been issuing loans more willingly.

The following products offered by the banks to the agricultural sector are of the highest demand:

- **Loans for working capital financing:** seasonal loans granted for a period of 6 to 36 months. On average, loans are issued for 6 to 12 months and are normally granted to meet the demands of spring and autumn seasons. The interest rates vary from 17% to 25%, and the repayment schedules are customized to consider the needs of the borrowers and their future cash flows.

Foreign currency loans normally bear lower interest rates but the requirements to the borrowers are more demanding (e.g. foreign currency-denominated revenue is a must) as in the current distressed environment foreign currency lending is treated by the banks as high risk transaction. It should also be mentioned that businesses are advised to take such loans only on the condition of a balanced currency position, i.e. provided that revenue in foreign currency is sufficient to service foreign currency loan, since otherwise the borrower may face additional foreign exchange risks.

Loans for replenishment of working capital may be issued for specific purposes provided in the contract, for example, to enable the borrower to purchase fuel or fertilizers or to pay salaries or rent for leased land plots. In such cases, banks monitor the usage of such resources.

Overdrafts, which help entities cope with unforeseen short-term liquidity gaps (with interest rates up to 40% per annum), have become popular recently.

- **Investment loans for purchase of machinery or financing of long-term projects** (e.g. construction of grain silos). The life time of such products is generally longer and constitutes 3-8 years, although there are shorter programs which are customized taking into account the specifics of the borrower's business. UAH-denominated loans in this category bear interest rates in the range of 17%-23.5% per annum.
- **Factoring transactions** provide an additional opportunity to quickly obtain unsecured financing (with down payment of 85%-95% of the contract amount, issued for 7-90 days).

The banks' customers are generally classified into the following groups:

- Large agriholdings (entities cultivating areas of 50 thousand and more hectares): systematic approach and customized solutions are being offered to such clients
- Mass market segment: from 3-10 to 50 thousand hectares (the whole product range)
- Farms: from 400 hectares to 3-10 thousand hectares (such customers are mostly granted working capital replenishment loans, including overdrafts and medium-term investment loans)
- Small farms: companies cultivating areas below 400 hectares (this category includes standard loans to retail customers bearing higher interest rates).

When evaluating agrarians for creditworthiness and reviewing their credit applications, banks are currently guided by the following criteria:

- Ability to provide high-quality collateral
- Operational business-processes, business administration system, and business development plans
- Qualified experienced management.

Availability of IFRS financial statements and a report from independent auditors significantly simplifies evaluating the financial position of a potential borrower, reduces the time frame of approving the loan application, and may affect the interest rate since higher transparency of the applicant's business reduces the risks. When reviewing financial statements, bankers pay attention to such ratios as EBITDA, EBITDA per hectare, debt servicing ratio and leverage ratio of a company or a group. Furthermore, financial statements provide details of assets owned by the group, which allows the bank to identify assets which could serve as collateral for the loan instead of collecting unsystematic information from the client's representatives. The users of the financial statements take a very cautious approach to fair values of biological assets (the reported fair values might be overstated) and prefer to ignore the results of revaluations for the purposes of calculation of financial ratios or make appropriate adjustments and decide on the basis of adjusted indicators.

Banks are readily accepting "quality" assets such as property, machinery (preferably not old), bank deposits, and corporate rights as collateral. Today collateralization of harvested grain (stored in certified warehouses) based on double warehouse certificates is increasing its attractiveness. As in such a case the loan life period may not exceed the period of the grain storage, this type of collateral is normally accepted against short-term loans. Creditors are reluctant to accept future harvests as collateral due to the increased risks attributable to such type of security. Most banks consider this type of collateral as a supplementary security, i.e. as an instrument enabling to minimize provisions for loan losses recognized in the lenders' own financial statements.

Furthermore, despite the crisis, in 2013-2014 banks have increasingly focused on establishing long-term partner relations with customers that include educational component such as arrangement of training sessions for the customers by well-known suppliers of machinery and other production resources (agrochemicals, seeds, etc.). Furthermore, banks which are focused on lending to agribusiness created specialized servicing teams that provide services mostly to farmers. If successful in building trust-based relations with their banks, farmers can expect more favorable terms of financing (including reduced interest rates) as well as higher limits of financing, which enables them to use credit resources more efficiently.

Leasing

Agricultural leasing programs are offered both by the banks crediting agriculture and by specialized leasing companies, often jointly, which boosts sales for the bank/the leasing company as well as for the machinery supplier, as the latter obtains access to the points of sales and the banking sales staff, and the banks, in turn, earn fees from servicing their clients and, in addition, receive commissions from lessors and machinery suppliers. According to the Ministry of Agrarian Policy and Food, in 2013, agrarians purchased 16 thousand units of machinery and equipment worth almost UAH 7 billion, of which the lion's share was procured via leasing contracts. According to the Ukrainian Lessors' Association, by the end of the 3rd quarter of 2013, agricultural sector accounted for 11.9% of the total amount of financial leasing contracts.

One of the advantages of leasing is lower interest rates varying from 9% to 12% per annum. Furthermore, leased assets could not be subject to foreclosure or enforcement of property, as the title to such assets may be transferred to the lessee only after completion of the final settlement. In addition, the leasing company or the bank involved into the deal can control the machinery supplier's compliance with its warranty or maintenance obligations. Leasing products are being standardized (one can lease the whole range of machinery offered by large and medium manufacturers), and decisions on such loans are taken very quickly, often within several days. However, the lenders grant loans only for the amount not exceeding 80% of the price of the leased equipment, which is linked to the internal evaluation of the collateralized items carried out to assess impairment losses.

As in the case of traditional loans, the repayment schedules are designed considering the seasonality of the agricultural business. This makes it possible to prevent outflow of funds that could be used to finance a sowing or harvesting campaign while the lease costs may be repaid using profits generated by the machinery.

Disadvantages of the leasing schemes include hidden machinery insurance premiums and hidden peg of the payables on the loan to the exchange rate of UAH to USD or EUR depending on the country of manufacturer. Pegging payables to foreign exchange rate works as follows: debt service payments or commissions are linked to the exchange rate ruling on the date of the invoice or on repayment date, often in one-way direction, i.e. in case of UAH devaluation below the rate fixed in the contract, the lessee is required to reimburse the difference to the lessor; on the contrary, repayments are not reduced if UAH appreciates. In practice, with the outbreak of the crisis of 2008, many debtors refused to pay foreign exchange differences going to court and claiming that repayments be fixed in UAH according to the original exchange rate or claiming invalidity of such contracts, both of which became a popular way of evading contractual commitments. Moreover, in 2013, there were certain rulings of courts of different instances in favor of lessees. Taking into account the new cycle of devaluation of UAH in 2014, the lessors foresee growing numbers of similar cases, which might cause systemic crisis in the industry. To ensure enforceability of their claims, many leasing companies amended their standard agreements by introducing provisions on modification of the repayment schemes.

Debt financing via promissory notes, guaranteed payments and special partner lending programs

In 2013-2014, financing promissory notes gained the highest popularity among the new instruments on the debt market — it provides certain freedom to agribusinesses, banks and intermediaries (distributors) and also to input producers (machinery, seeds,

agrochemicals, etc.). Promissory notes are normally issued on the most favorable terms within the scope of programs of cooperation with the largest input producers, but may also be issued under standard documentary operations programs offered by banks to their customers. A note-based financing program operates as follows: a farm procures inputs from a distributor against a promissory note (when concluding agreement, the parties shall discuss the distributor's readiness to accept the promissory note as payment), which is avalized by a bank acting as the guarantor of the repayment of the note. Subsequently, the distributor, in turn, transfers the note to a manufacturer, thus eliminating any risks it may face. The period of financing normally does not exceed 12 months.

If applied within the scope of programs of cooperation with large producers, such product is quite beneficial for all parties and first of all — for the agrarians: a promissory note is cheaper than a bank loan (average rate varies from 2% to 4.5%); the buyer may expect extra discounts on products purchased via notes; the loans are not pegged to foreign currency exchange rates (all currency risks are born by the manufacturer, although such risks are most probably incorporated into the selling price), and there are other non-monetary benefits (such as training of personnel and guarantees of timely delivery of materials and supplies, etc.) Banks can also benefit from such transactions by charging commissions and also due to the so-called "non-resource" or non-monetary form of the promissory notes (no liquidity issues).

One of the banks has offered a similar financing option in the form of guaranteed payments with a charge of 4%, which, however, are subject to stricter terms and conditions (both the buyer and the vendor must be the bank's customers, since all guaranteed payments are recorded and processed within the bank's online payment system). Apart from that, there are no programs of guaranteed payments by input suppliers, as a result of which the deal may end on the first stage leaving the distributor and the supplier exposed to currency and credit risks not incorporated into the original price.

Apart from financing based on promissory notes, farmers lay hopes on such instrument as agrarian receipts that have been formally introduced in March 2013, when the law on agrarian receipts came into force. The law had been drafted based on positive experience accumulated by Brazilian farmers who had been actively using the receipts as an instrument of their settlements with suppliers. Basically, such receipts represent the collateral of future harvest and are issued to obtain required resources when needed. There are commodity receipts (commitments to deliver specific goods) and financial receipts (payment obligations), and all such papers are subject to mandatory notarization. The requirement of the notary certification hindered the promotion of this instrument in the country: Ukrainian government has not managed to put in place a reliable uniform public registry of agrarian receipts to date. Analysts expect that this instrument will be fully operational only in the second half of 2014 or in early 2015.

As regards special investment programs, one can mention here the programs of credit financing and leasing of agricultural machinery on interest rates below market thanks to additional subsidies from suppliers. As a rule, such programs are actively promoted by global agricultural machinery producers and supported by banks as well as by leasing companies.

Public financing (forward purchases by the Agrarian Fund and State Food and Grain Corporation of Ukraine)

Recently, both the Agrarian Fund and the State Food and Grain Corporation of Ukraine have been actively promoting forward contracts system which allows access to the funding required for sowing and harvesting campaigns for agricultural businesses of any size.

Agrarian Fund pays an advance of 50-70% of the contract amount calculated based on minimum intervention price for respective type of grain specified in the forward contract. The final price is assessed based on the weighted average price quoted during three trade sessions held by the Agrarian exchange or other commodity exchanges accredited by the Agrarian exchange as of the date of execution of the grain purchase contract, net of the downpayment received and credit commission fixed based on the average weighted interest rate as determined with reference to the statistical data of the National Bank of Ukraine. It is expected that during 2014 the Agrarian Fund will purchase 1.2 million tonnes of grain under forward contracts.

According to the statements of the State Food and Grain Corporation of Ukraine, the corporation intends to sign forward contracts on purchase of 1 million tonnes of grain to be harvested in 2014, including 300 thousand tons of food wheat and 700 thousand tonnes of corn, and spot contracts to procure approximately 1 million tonnes of grain. The grains are purchased under EXW, CPT and FCA contracts.

The drawbacks of the instrument include the incremental costs of insurance of the crops (the advance payment under the purchase contract may be made only after the acknowledgement of insurance of the crops by the insurer) and the need to prepare a sizeable documentation package.

External borrowings (IPOs, Eurobonds issue, loans from non-resident banks, etc.)

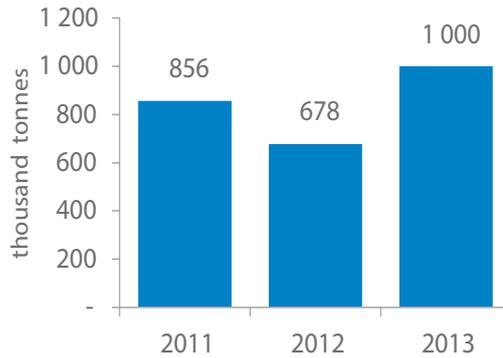
The year 2013 and the 1st quarter of 2014 turned out to be an extremely uncertain period for Ukrainian agrarian companies listed on international stock exchanges. The shares of majority of Ukrainian agriholdings have plunged against a background of the escalating economic and political crisis in Ukraine, publication of periodic statements about defaults of such companies as, for example, Agroton and Sintal, and a reduction of global prices for agricultural commodities.

None of Ukraine's agricultural companies conducted an IPO in 2012-2013. Only a handful of holdings — like Uklandfarming, Mriya, and Myronivskiy Khiboproduct (MHP) — stepped on the path of Eurobonds issue in early 2013. Uklandfarming was forced to offer its bonds several times since the first offering did not allow to raise the targeted amount (according to analysts, this happened partly due to the economic crisis in Cyprus, the country where the parent company of Uklandfarming is domiciled). After the events in the 4th quarter of 2013 and the 1st quarter of 2014, which resulted in deterioration of the economic environment and downgrade of Ukraine's sovereign ratings, it is predicted with a significant degree of certainty that international capital and debt financing markets are closed for Ukrainian companies, and this situation will hardly reverse till the end of 2014 or even 2015.

Agrarians may choose another option — attraction of less expensive credit resources from foreign financial institutions, including, among others, European Bank for Reconstruction and Development (EBRD) and International Finance Corporation (IFC). According to the press release recently published by the EBRD, in 2013 the bank granted to Ukrainian agrarians loans for the total amount of EUR 160 million and is ready to lend more. In comparison with traditional bank lending, loans from such institutions bear much lower interest rates (up to 10% in foreign currency) and, therefore, are more attractive for the borrowers. At the same time, the cost of servicing such loans, considering, inter alia, the total restructuring of the borrower's business processes to meet the strict requirements of the lender, is significant (both in monetary equivalent and in terms of labor resources required). In addition, these are mostly large companies who are eligible for such loans.



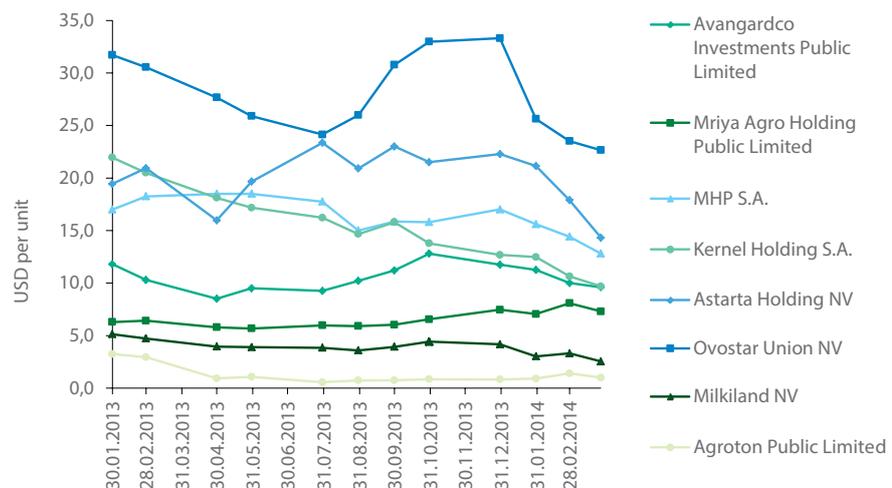
Purchases of grain by Agrarian Fund in 2011-2013



Today it is a common practice to attract foreign credit resources against insurance coverage provided by export credit agencies (ECAs) — entities, established in countries of domicile of exporters of equipment and machinery to facilitate exports of goods. Ukrainian agrarians have access to the programs of ECAs in the USA, Japan, UK, Germany, France, Netherlands, etc. Advantages of such

financing include lower interest rates, lower minimum volumes of financing offered (which makes such instruments accessible not only to large but also to medium-size farms), absence of collateral (which is replaced by insurance), and the option of separate financing of downpayment for up to 1 year. The amount of downpayment is normally 15% or more. The drawbacks of this option include the need to formalize warranties and guarantees, which may result in extra costs of verification and submission of the documentation, and also to have insurance payments which increase the effective interest rate. Furthermore, in 2014, some of these programs may be suspended in Ukraine due to significant downgrading of the country's sovereign rating.

Stock prices - Ukrainian agriholdings



Conclusions

The above demonstrates that there are no easy solutions to the problem of funding. Low interest loans are difficult to obtain and administer (e.g. the borrower is obliged to regularly submit adequate and up-to-date information), while the loans bearing higher interest rates are more accessible but result in painfully high costs for agribusinesses. The liquidity issues in the banking system and uncertainties in Ukrainian business environment aggravated by political and external risks which arose in 2014, have adversely affected the accessibility of financial resources. Banks, investors, agribusinesses and — the last but not the least — legislators need to come to an understanding and search for mutually acceptable solutions to the problems.

AGRICULTURAL BUDGET 2014: THE MAIN RECIPIENTS OF STATE SUPPORT

In 2013, Ukrainian agriculture became a leading sector by proceeds from exports — UAH 47 billion were contributed to the state budget by agricultural commodity exports. Nevertheless, the law on state budget 2014 provides for shortage of state financing of almost all programs in the agricultural sector.³

General agricultural budget was approved at the level of UAH 6.819 billion UAH, which is 1.902 billion less than in 2013. Primary recipients of the financial support are agricultural education and R&D (UAH 2.5 billion) programs of improvement of quality and safety (UAH 2.2 billion). In the core of state support is the financing of livestock breeding (UAH 888 million) and the development of hopgrowing, gardening, viticulture and berry-fields (UAH 100 million).

In 2014, expenditure will increase for the following programs:

- State support of the livestock sector — by 37% compared to 2013;
- Management and administration in the sphere of veterinary and phytosanitary services — 19%;
- Management and administration in the sphere of agro-industrial complex — 37%;
- Elimination of effects and ecological rehabilitation of mining areas of the state-owned enterprise “Solotvynskiy saltmine” in Zakarpatska region (+ UAH 2.8 million). In 2013, no expenditure for this program was planned.

In 2014, the largest reduction of expenditure is planned for the following programs:

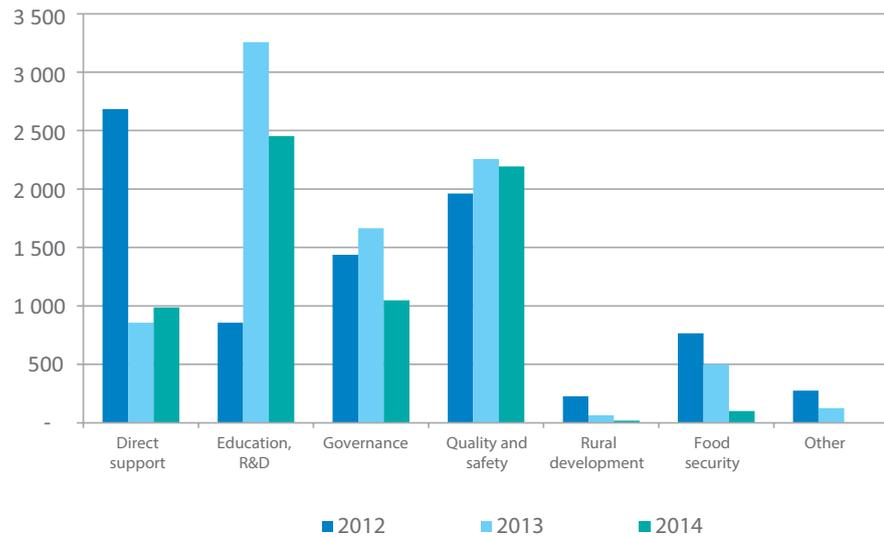
- implementation of land reform — by 90% compared to 2013;
- expenditures of the Agrarian Fund — 80%;
- reforms and development of communal utilities in rural areas — 73%;
- organization and development of institutions in the structure of the State Agricultural Inspection of Ukraine — 56%;
- education of fishery specialists at universities of 3rd and 4th levels of accreditation — 46%;
- trainings and improvement of qualifications of specialists in agriculture — 46%.

As compared to 2013, the law on state budget does not provide for expenditure along the following programs in 2014:

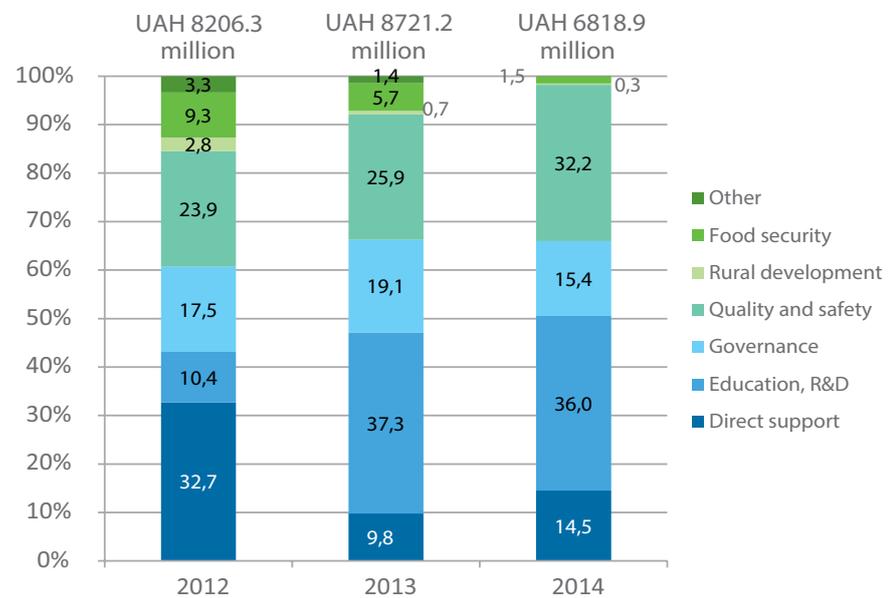
- Restructuring of the debt to employees of educational institutions (UAH 544.5 million in 2013);
- Issuance of state acts of the private ownership right to land in rural areas (UAH 106.9 million);
- Financial support of agricultural measures (UAH 96.8 million);
- State preferential loans to individual rural developers (UAH 20.6 million);
- Selection in fish breeding and reproduction of aquatic resources in inland waters and the Azov-Black Sea basin (UAH 9.2 million);
- Financial support to Ukrainian Laboratory of Quality and Safety of Agricultural Products (9,2 million UAH);
- Rehabilitation and recreation of children of agricultural workers (UAH 7.5 million).

³ The Law of Ukraine #719-VII “On State Budget of Ukraine in 2014” (16.01.2014) amended on 27.03.2014 by the Law of Ukraine #1165-VII “On Amendments to the Law “On State Budget of Ukraine in 2014”.

Breakdown of state agricultural budget, UAH million



Breakdown of state agricultural budget, %



Direct state support to agriculture, UAH million



Source: UCAB calculations based on the laws on state budget



Antoine Rebillard
Business Director at New Holland
Agriculture (Ukraine, Moldova)

New Holland is one of the world's leading producers of tractors, grain-, forage- and grape-harvesters, forage storage equipment and telescopic loaders. The equipment of New Holland is used in 160 countries. The company entered Ukrainian market in 1997. Since then, it has been steadily developing and increasing the proportion of its products on the Ukrainian market. Currently, New Holland has 22% of the Ukrainian tractor market and 35% of the Ukrainian combine harvester market.

New Holland company distributes its products via a dealer network. Dealers offer a variety of sales and financing schemes, such as leasing — a useful tool that provides certain advantages. This year New Holland and CNH Capital started to provide a possibility to purchase and finance agricultural equipment on more favorable terms. Leasing is becoming a very popular financial mechanism. The average penetration of leased equipment is 25%. The company also offers a leaseback program.

A classic example of our dealers' work is a newly built modern agri-technical service center at the LLC "Agroresurs". In the service center, customers can receive not only a tractor or combine but also the whole range of services that accompany machinery during the entire period of its exploitation: from pre-sales maintenance of equipment to its termination. In this regard, we fully meet the needs of our customers. The service center has also a training facility, where mechanics, service professionals and managers are regularly trained.

In order to inform customers about the qualities and advantages of New Holland products, the company holds a number of different activities in the regions of Ukraine. One of such activities is the «Demo Tour - 2014», which is scheduled for the period from April 1 till April 30 in 15 regions of Ukraine. Participants of the event will get to know New Holland team, which is always up for a fruitful cooperation. Together with its partners Maschio Gaspardo and Lemken, New Holland will demonstrate a highly productive and reliable tillage and sowing equipment. During the presentation of agricultural machinery, everybody will have an opportunity of a test drive and meet with New Holland representatives.

In such a difficult for Ukraine time, the strategic objective of New Holland is to expand its business. Currently, New Holland Agriculture staff is about 25 employees, a strong dealer network and branches in all regions of Ukraine. Exactly due to the highly qualified human resource potential of the company, the New Holland harvesters are Ukrainian market leaders for the third year in a row.

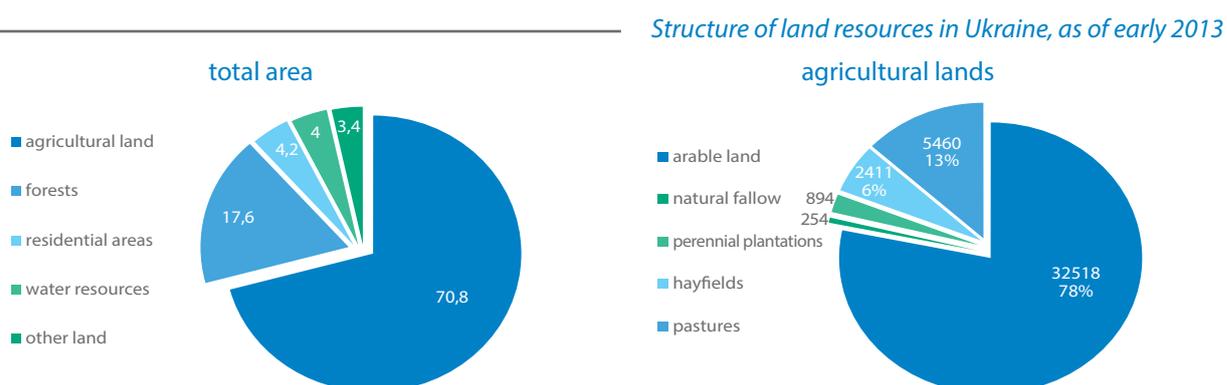
Developing and advancing its machinery, New Holland pays particular attention to the premium class cars and continues to update this product line. In addition, New Holland expands its machinery portfolio for small and medium-size specialized farms. This can be seen in the diversification of small and middle class tractors, the most prominent representative of which is a newly introduced TD5.110, which will become a worthy replacement for the old MTZ. Modernization and improvement of the machinery aims to increase productivity, facilitate exploitation and reduce operational costs.

Along with the improvement and extension of its product lines, New Holland continues to invest into operation and leasing programs of dealer networks and into technical service development. This strategy aims to improve quality of the customer services via expansion of New Holland dealer network and provision of the high level technical support.

LAND RESOURCES

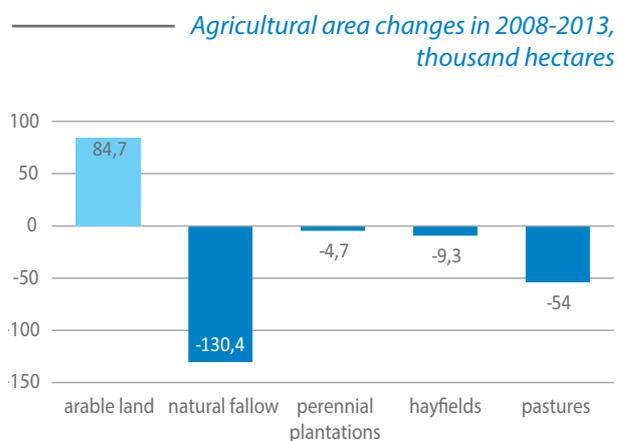
STRUCTURAL CHANGES IN LAND USE

Ukraine is one of those countries where concentration of agricultural land is very high. More than 70% of the country's total area is farmland; of those 78% is arable land.



Source: State Agency for Land Resources of Ukraine

Significant changes in the structure of land resources are not observed and expected currently. What should be mentioned is the reduction of farmland area in sub-urban regions where farmland is withdrawn from agricultural use and transformed into residential area. However, the main volumes are being transformed at the expense of natural fallows and pastures. In total, during 2008-2013, the area of agricultural land decreased by 113.7 thousand hectares and amounted to 41.65 million hectares. At the same time, the area of arable land increased by 85 thousand hectares.



The area of agricultural land in use of rural households and agricultural enterprises (including family farms) is 36.5 million hectares, which is 88% of the total area of agricultural land. The area of arable land in use of rural households and agricultural enterprises (including family farms) amounts to 31 million hectares or 95.4% of the total area of arable land.

Agricultural land area change by category of land user, thousand hectares as of the beginning of the year

	2008	2009	2010	2011	2012	2013	
						thousand ha	% arable land
Agricultural enterprises	21047	21019	20864	20590	20499	20666	93,9%
including family farms	3945	4016	4014	4012	4079	4173	95,2%
Households	15708	15585	15690	15898	15984	15815	73,6%
including marketable agricultural production	9173	9091	9214	9412	9472	9281	-

Source: State Agency for Land Resources of Ukraine

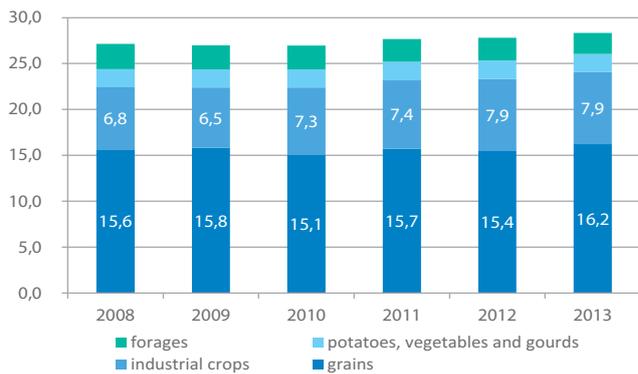
According to official statistics, the actual use of arable land (sown areas + fallow lands) is 29.5 million hectares. As a result, at least 1.5 million hectares is either abandoned or used unofficially. In the structure of actual land use, agricultural enterprises use about 70% of area, whereas the area in use of rural households is about 8.5 million hectares.

Total sown area under all crops amounted to 28.33 million hectares in 2013. This is 7% (or 1.9 million hectares) more than the average sown area in the period 2006 — 2008. Partly, this indicates the return of previously abandoned land to agricultural use as well as an increasing transparency of agricultural production through stricter state controls over agricultural land use.

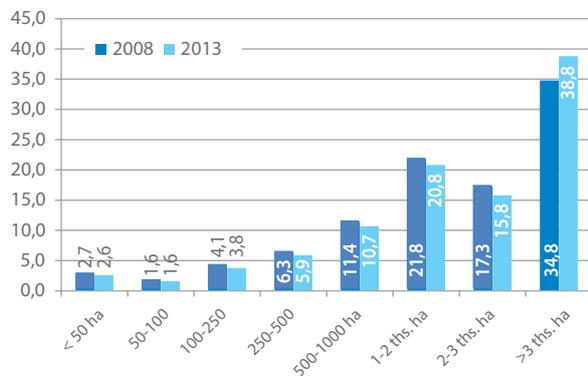
There were no essential changes in the structure of sown areas in the past years. The fact that is worth noting is the increase of area under industrial crops, primarily due to growth of the production of oilseeds such as sunflower and soybeans.

Also, there is a persistent trend toward consolidation of land use. The share of agricultural enterprises that cultivated over 3,000 hectares grew from 34.8% up to 38.8% in the last five years. It is likely that this tendency will stay in place in the mid-term perspective.

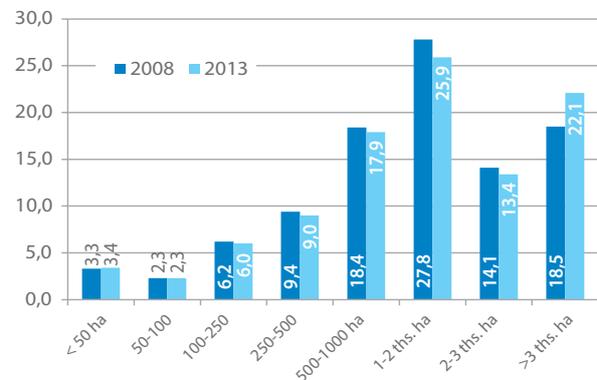
Dynamics of sown areas, million hectares



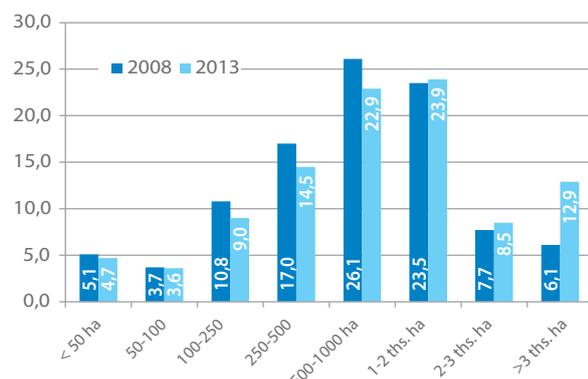
*Distribution of total sown areas by size of land users, %**



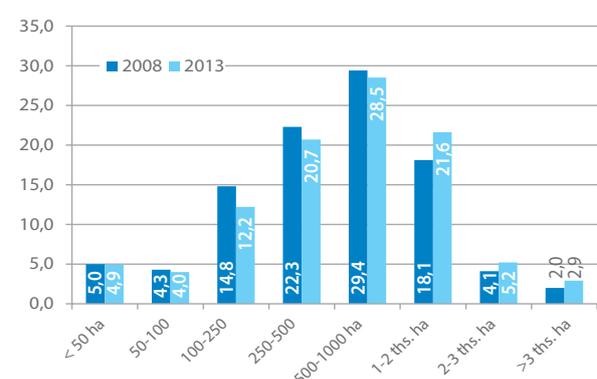
Distribution of areas under grains by size of land users, %



Distribution of areas under industrial crops by size of land users, %



Distribution of areas under forages by size of land users, %



* - estimated for agricultural enterprises only, i.e. excl. rural households



TAXATION IN THE SPHERE OF LAND USE

Land tax

The land tax is paid by a landowner or a land user. The payment is calculated on the following bases:

- for evaluated land parcels — the regulatory monetary value of the plot, with coefficients of indexation thereof;
- for land parcels without evaluation — the area of a land plot.

Rates applied to agricultural land

The Land Code sets forth the following rates of the land tax:

- for agricultural lands (arable land, hayfields, pastures) — 0.1% of the regulatory monetary value of such land plot;
- for areas under perennial plantations — 0.03% of the regulatory monetary value of such land plot.

Some categories of landowners and land users enjoy an exemption from the land tax. Among them are, first of all, landlords leasing their land to companies that pay a fixed agricultural tax.

Besides, the land tax is also not paid for:

- agricultural land located in radioactively contaminated or chemically polluted areas;
- agricultural land under temporary conservation or agricultural reclamation;
- state seed-trial grounds stations and land plots used for testing of agricultural crops;
- land plots of agricultural companies occupied with young gardens, vineyards and berry-fields till they enter the period of fruit bearing, as well as plots taken up by hybrid plantations, seed farms and seedbeds;
- land plots and the so-called “land shares”, leased to payer of the fixed agricultural tax.

Land lease

The rental fee for the use of agricultural land is determined on the basis of a lease agreement. However, it may not be lower than 3% of the value of the land.

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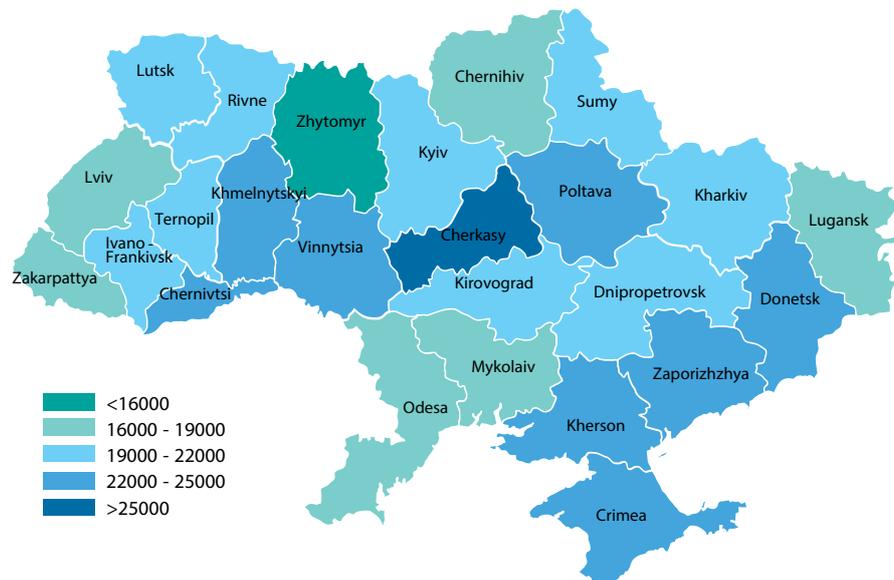
LAND LEASE MARKET

Land market has always been a sensitive issue among Ukrainian agrarians. As there is no common legislative ground for answering the questions such as “whom to sell?” and “for how much?”, nearly 70% of Ukrainian citizens reject the idea of agricultural land sales. Obviously, in the conditions of moratorium on land sales which is now in force, it makes sense to talk about agricultural land lease market.

In 2013, a new system of state registration of rights to land lease was launched in Ukraine.⁴ However, the majority of market players, i.e. agricultural producers, after investigation into the system, have conveyed discontent and expressed their willingness to return to a former mechanism of registration. Their main concern was about double registration of lease contract execution which is provided for by the newly introduced system. To that effect, market players complained about artificial constraints during the execution, the associated fine system and economically unreasoned regulatory monetary value (RMV) of agricultural land.

Up to date, as a result of joint efforts of several agricultural associations and other organizations, a draft law #3237 “On the Amendments to Several Legislative Acts of Ukraine on Verification of Notary Responsibilities and Peculiarities of Registration of Derivative Rights to Agricultural Land” was registered in the Parliament. This draft law provides for cancellation of double registration of land lease contracts. Another draft law — #3316 “On Amendments to Several Legislative Acts of Ukraine on Sustainable Use of Agricultural Land” — provides for the abolishment of obligatory crop rotation (land management) projects and the set of documents for registration of lease rights.

Regulatory monetary value of arable land in Ukraine, UAH



Source: State Agency for Land Resources of Ukraine

The RMV is determined annually by The State Agency for Land Resources of Ukraine with the aim to calculate rates of land tax and fixed agricultural tax as well as to provide the base for land rent payments.⁵ Despite the fact that agricultural associations have initiated numerous discussions, provided reasonable arguments and economic assessments of the RMV to the state institutions, the latter are unlikely to recognize the dramatic need for establishment of the RMV on a reasonable level.

Based on UCAB estimations, the RMV of agricultural land must not exceed UAH 15 thousand per hectare. Average profits per hectare of grains and oilseeds are UAH 400-500 (in the Steppe zone and some other regions, about UAH 1500). Given that, the income capitalization, even including refinancing rates of the National Bank of Ukraine, rejects the argument for RMV being more than UAH 14-15 thousand per ha on average. Considering the crisis of 2013/2014 marketing year (MY), most agricultural enterprises face hard times paying even average UAH 600-700 per hectare to pai (land share) holders.

⁴ See next section for more details.

⁵ Average RMV was established at the level of UAH 20,635.02 per hectare as of 01.01.2014.



THE LAND MARKET IN UKRAINE: WHAT DRAFT LEGISLATION TO EXPECT IN THE NEAREST FUTURE?

For Ukrainian land market and real estate market as a whole, 2013 was marked by the introduction of a new title registration system of property rights, which links the origin of the right to property with its registration, in contrast to the pre-existing actual approach, which considered the registration of the transaction, based on which the corresponding right arose, as a precondition of its action. The expectations from 2014 were rather modest and mainly reduced to the development of reform principles with regard to the registration of rights to real estate as well as further work on legislative initiatives, primarily on the development of the agricultural land market in Ukraine.

Improving the procedure of land rights registration

To remind, today all the rights and encumbrances on the land together with the rights to buildings located on them are recorded in unified register: the State Register of Property Rights to Real Estate (hereinafter — the “Register”). The law associates this registration with the emergence of the right itself. As a result of reforms, there are now two separate registries for land: the State Land Cadastre (hereinafter — the “Cadastre”) and, in fact, the above-mentioned Register. The Cadastre registers land as the target of civil rights and includes the information on the location, cadastral number, area, intended use, regulatory monetary value, its composition and limitations, while the rights to such land, including ownership and lease, are entered in the Register. Such a system of “dual enrollment” is new to Ukrainian legal reality. In fact, the new registers have replaced the pre-existing State Land Register, which contained the information on both the plots and the recorded rights to them.

At the moment, the mechanism of interaction between these registries as well as with the previously functioning State Register of Lands and other information systems is not worked out completely. In 2014 it was planned to address these issues to resolve problems related to transferring information from the State Register of Lands to the Cadastre, usually caused by the different formats of electronic data in these information systems. For this purpose the corresponding bill was developed, which also sets the order of interaction of new registers with other information systems, in particular, town-planning, water and forest cadastres. It is expected that the result of this interaction should be the unification of information in relation to land and other natural resources as well as improvement of recordkeeping.

Also, in this context, it is important to note that a change in the procedure for registering rights also prompted changes to the system of authorities, carrying out such registration. Registration of land plots in the Cadastre is performed by the local offices of the State Agency for Land Resources. The registration of rights to land and real property located on it in the Registry is performed by local branches of the Ministry of Justice. However, taking into account the backlog of concerns regarding the work of local departments of the Ministry of Justice over the past years, including the irrational approach to registration of municipal land by public authorities, at the end of the last year the website of the Parliament of Ukraine published a draft law that proposes to return some powers, in particular concerning the registration of the right to lease the land, to local governments. Considering the growing public and political debate on the issues mentioned, it is most likely that these legislative initiatives will be considered later this year.

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Increasing state control over the quality of land

Every year, the issues associated with deficiencies of existing mechanisms for the soil protection are becoming more and more evident. It is obvious that the current system of soil fertility protection in Ukraine, which has remained unchanged since the 60's, must be reviewed. Protecting soil fertility in land management projects in order to ensure ecological and economic grounds for crop rotation and prioritization has shown its ineffectiveness. First, the development of these projects requires farmers to invest significant time and money. This made farmers deliberately refrain from the development of such projects, as in this case it would be cheaper and faster to pay an administrative penalty for violating the law, rather than comply with it. Second, these projects seriously limit farmers' flexibility since they are often faced with the need to change the crop they cultivate and are unable to do so, since the project was designed and calculations were made for a certain type of agriculture/technology. Thirdly, the state is unable to effectively monitor whether or not these projects of rotations are in place. These circumstances led to the emergence of several bills, some of them aimed at simplifying procedures for the development of land rotation projects and some for the propose to abolish them altogether.

Following this trend, a draft law "On the Preservation and Protection of Soil Fertility" was developed and submitted for public discussion. It is fundamentally different because it strengthens the state control over the quality of the soil and shifts the responsibility for soil survey from agricultural producers to the state. First of all, the bill aims to give soil a separate legal status and legal protection as well as to ensure legislative support of its management, establishing rules for high farming standards, prevention of soil degradation and mitigation of possible ecological and economic risks associated with improper or environmentally unsafe use. To implement the provisions of the law, should it be adopted by the Parliament, a special national target program has been designed to conduct a large-scale study of agricultural land in order to assess its agricultural productivity features and objectively determine the value of soil for the purpose of reviewing the list of the most valuable groups of soil. Notably, the bill provides for mandatory agrochemical certification of land. It is assumed that the presence of agrochemical passports will be a prerequisite for the transfer of ownership or use of any agricultural land and agrochemical passport will be an integral part of the contract providing for the transfer of ownership right, lease or other use of such land for the benefit of third parties. It is entirely possible that this bill might be considered this year. Nevertheless, taking into account the difficult economic and political situation, it is most likely that the law, if adopted, will not be put into effect immediately, providing a study and agronomic land classification in several stages.

Preparing to launch the agricultural land market

Despite the extension of the moratorium on turnover of agricultural land until January 1, 2016, the work on the draft law "On Circulation of Agricultural Land" continues, the adoption of this law being the basic condition for the lifting of the moratorium after the deadline.

As far as acquisition of agricultural land is concerned, the current version of the bill gives a key role to the state, represented by the State Land Bank and the individual citizens of Ukraine if they meet a number of relevant requirements. One of the most discussed nuances of the bill is the exclusion of foreigners, stateless persons, foreign states, international governmental and non-governmental organizations as well as all



legal entities from the list of potential owners of land plots of this intended use. Additional concern arose from provisions limiting the amount of land within a district and in Ukraine as a whole, which can be transferred to related parties, 20% and 100 ha, respectively. The provisions of the bill limiting the term of the lease of land for commodity production to 15 years and providing the obligation of tenants to provide rural population living in the area with jobs and “a steady income” seem hardly justified. Violation of these obligations may constitute grounds for early termination of the lease.

In addition, the initiative to provide the State Land Bank with a pre-emptive right to purchase agricultural land as well as the very existence of this institution with the authority that actually combines the functions of three institutions: that of bank, a regulator of public lands and an individual player on the land market was met with harsh and well deserved criticism.

Despite of some reasonable proposals, in particular concerning the alienation of lease rights to municipal and public land to third parties, the transfer of such rights to the share capital of legal entities or into the mortgage, it seems quite clear that the bill in its current version will not help Ukraine’s investment attractiveness. It is expected that in the nearest future its provisions would undergo serious improvement in order to enhance the investment climate in the agricultural sector.

Obviously, in the current socio-political and economic conditions, we should not expect some radical and drastic steps in the regulation of land relations. It is most likely that we will not see any significant legislative initiatives this year. Chances are that the work will continue on the practical aspects of implementing the last year’s reforms: we expect that it would become easier, faster and cheaper to register land rights. At this point Verkhovna Rada has registered a number of legislative initiatives aimed at further improvement of how the registers and registration services operate as well as at removing practical shortcomings of the new registration system.

Also, the legislative work in preparation for the launch of the agricultural land market is most likely to continue. It is understood that any failure in finding social and political compromise that ensures the rational use of land, on one hand, and investment attractiveness of the agricultural market of Ukraine — on the other, is most likely to lead to yet another extension of the moratorium. Apparently, such a development would have negative economic and reputational consequences. Taking into account the declared EU orientation of Ukraine’s development, there is hope that the land market will finally be launched if not earlier than 2016, then, at least immediately after the expiration of the statutory period of the moratorium. ■



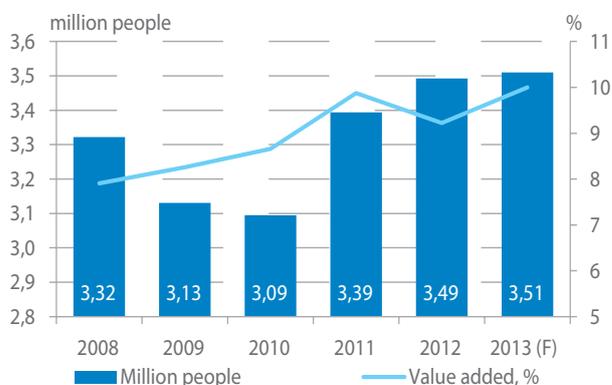
STRUCTURAL CHANGES IN AGRICULTURAL LABOR RESOURCES

According to official statistics, more than 3.5 million people are currently employed in agriculture, which accounts for 17% of all economically active Ukrainian citizens. At the same time, the share of agriculture in total GDP is 9-10% on average.

In the past years, the number of employees in agricultural sector remained fairly stable, with an upward trend.

However, the tendency toward the increase of agricultural labor figures is unlikely to be the sign of improving attractiveness of working conditions. The major share of working population continues to be shaped by self-employment in rural households. While the number of hired labor continues to decline — from 2008 to 2012

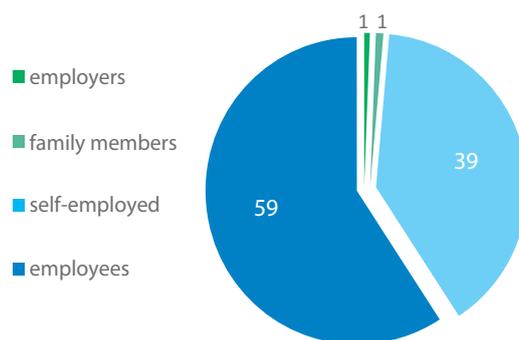
Number of citizens employed in agriculture



the number of employees in the industry decreased by more than 80 thousand to 700 thousand people — the share of self-employed continues to grow.

A private rural household is a specific form of agriculture, which is common to most post-Soviet countries. Despite the fact that the share of households in agricultural production is considerable (46.2% in 2013, including 41.6% in crop production and 56.6% in live-stock production), the level of marketability of their production is very low. Furthermore, taking into account the limited ability of agricultural labor market to expand, the issue of new spheres of employment in rural areas is crucial. Today a property of the agricultural labor market is a long-term trend toward the increase of both official and unofficial unemployment figures in rural areas. The self-employed population partly belongs to the group of unofficially unemployed. The share of rural population, employed in an informal sector of the economy, currently accounts for 47.5%, while the share of urban population is 11.6%.

Employment in rural areas, by status, %

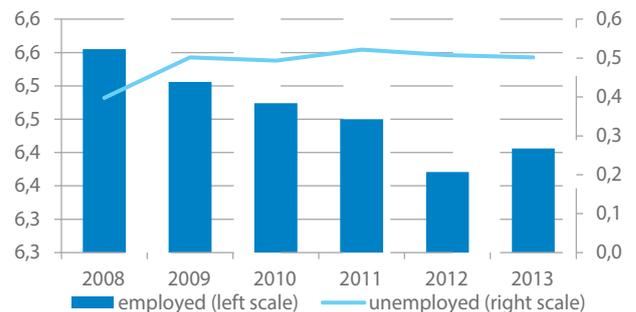


In 2013, the number of economically active rural population in the age from 15 to 70 years old was 6,908 million people. Thereof, employed population made up 6,406 million while unemployed — 502 thousand (7.3%). Economically inactive population amounted to 3.2 million.

Workload per 1 worker in crop production (at agricultural enterprises)



Economically active population in rural areas, million people

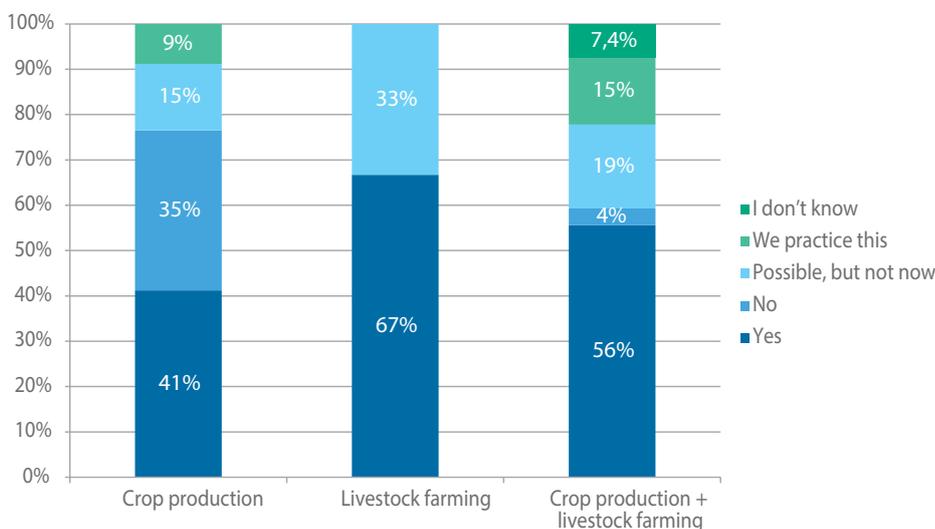


It is also worth mentioning that the workload per agricultural worker has considerably increased due to general reduction of the number of employed people. When talking about mid-size and large-scale agricultural enterprises, which use 16-18 million hectares in total, the area of agricultural land per one worker employed in crop production grew from 33 hectares in 2005 up to 55 hectares in 2012. Because agricultural production continues to intensify, such tendency will preserve in the nearest future, especially in mid-size and large enterprises.

DEMAND FOR LABOR RESOURCES

Nowadays more and more agricultural enterprises are faced with the deficit of qualified specialists of different occupations. For many enterprises, it is an obstacle to conduct even ordinary business operations. Therefore, "fights" for good agronomists or veterinarians became a common practice, whereas many agricultural enterprises refrain from buying new machinery or implementing new technologies, because they simply lack qualified specialists to make those improvements work. As a consequence, the labor market in agriculture is characterized by a high demand for key specialists.

According to the research of AgriSurvey agency, the most demanded specialists are agronomists, managers, mechanics and veterinarians.



Readiness of Ukrainian agricultural enterprises to hire graduates without experience at lower salary rates, % of respondents (agricultural managers)

Source: AgriSurvey

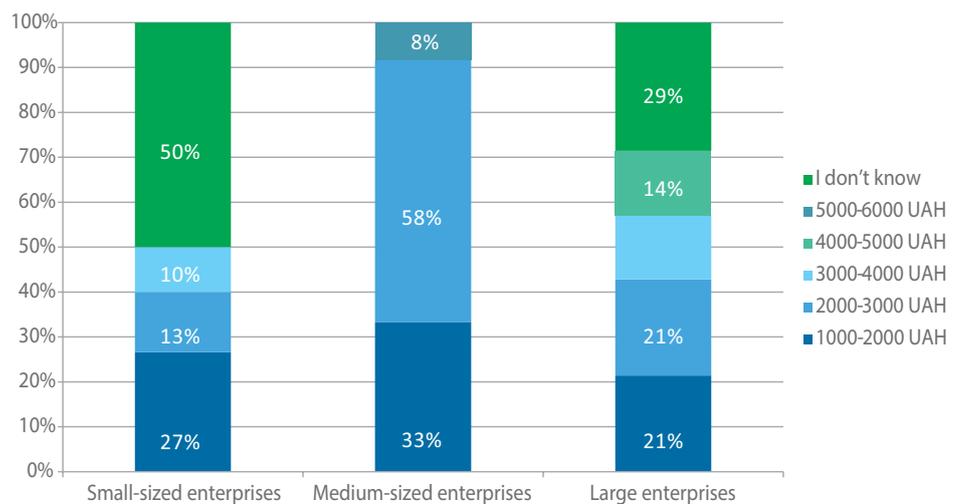
The situation on the agricultural labor market is to some extent confusing. On one hand, the majority of agricultural enterprises search for qualified and skilled personnel while, on the other hand, thousands of graduates of agricultural faculties and universities still cannot find the job. At the same time, agricultural enterprises claim they are ready to employ (and provide further practical education for) graduates due to the lack of personnel. Most often, such practices are used by agriholdings and large agricultural enterprises.

The most common way to find an employee in Ukrainian agriculture is personal contacts/connections and recommendations of colleagues. This approach has more disadvantages than advantages, but essential improvements need time and change of employers' values. About a third of all agribusinesses (27%) approach directly universities, whereas one fifth is prone to read announcements in print media. The most unpopular way of recruiting is to appeal to specialized recruitment agencies.

SALARIES IN AGRICULTURE

Salaries agribusiness is ready to pay to university graduates may vary depending on the size of an enterprise. The average salary of a newly employed graduate is UAH 2000-3000. Some large enterprises are even ready to pay UAH 4000-5000.

Salaries agricultural employers are ready to pay to graduates, % of respondents (agricultural managers)



Source: AgriSurvey



UKRAINE — IN THE FUTURE EVEN STRONGER

Head of the newly established company "CLAAS Ukraine" Holger WELCK believes in success of Ukraine

Ukraine with its rich resources plays an important role in global supplies of agricultural commodities and food products and has great perspectives for growth.

CLAAS has been working in Ukraine for more than 20 years and now, despite complicated political situation, we believe in stabilization and further development of this strong agricultural country as well as in improvement of our positions on the Ukrainian market. In October 2013, we established a new company, "CLAAS Ukraine Limited" with the strategic mission to strengthen our Ukrainian dealers' network in response to the issues of machinery sales and technical services.

As a new company we intend to become closer to our customers, better understand their needs and develop conditions for future constant development. Ukraine has colossal potential: the area of arable land is three times larger than in Germany; the significant share of the world's black soils is situated here; and for our customers in Ukraine, we have necessary equipment. In 2014, CLAAS will present a lot of innovations in Ukraine, such as a new series of self-propelled forage harvesters JAGUAR, machinery and equipment for procurement of green fodder, extra-powerful tractors XERION and the line of updated telescopic loaders SCORPION. As before, all CLAAS machinery may be purchased from our official dealers, which have their affiliates and service centers in almost all Ukrainian regions.

I strongly believe in the fact that there are a lot of ambitious and skilled young people who will lead this country to a high level of welfare. Here, agriculture plays a crucial role. CLAAS is ready to meet future changes: we became stronger due to our new team and we will use knowledge and experience of our specialists more actively. Thus, the preconditions for growth of both our company and Ukraine as a whole will be undoubtedly created.

Ensuring the best harvest!



For more details about purchase, please contact your nearest CLAAS dealer:

Agrotechsoyuz LLC (www.ats.in.ua): Sumy: 094 970-8580, Chernihiv: 04631 68-186;
Konkord Company (www.konkord.in.ua): Kyiv region: 04571 71-925, Vinnytsia: 0432 55-66-88,

Eridon Tech LLC (www.eridon-tech.com.ua): Rivne: 0362 64-2566,
Zhytomyr: 0412 48-0201, Cherkasy: 0472 71-23-78, Poltava: 0532 66-8552;

Lan Company LLC (www.lanclaas.com.ua): Ternopil: 0352 25-4435,
Lviv: 0322 42 0663, Chernivtsi: 0372 90 0678, Volyn region: 0332 293-031;

Privat Leasing LLC (www.pleasing.com.ua): Khmelnytskyi: 0382 72-0062,
Kherson: 067 537-64-81, Odesa: 067 567-1297; Kirovograd region: 067 231-8779;

Agrofirma Dobrobut LLC (www.dobrobut.kr.ua): Kirovograd: 0522 551-266;

Technique Machines International Company (www.tmi-claas.com):
Dnipropetrovsk: 0562 35-6491, Donetsk: 050 320-4636, Lugansk: 097 656-5565,
Melitopol: 0619 432-458, Kharkiv: 097 656-5565



www.claas.com

MACHINERY AND EQUIPMENT

EXPECTATIONS ON AGRICULTURAL MACHINERY MARKET

As forecasted in the previous issue of “Doing agribusiness in Ukraine”, the tendency towards growth of the agricultural machinery market, which has been in place since 2010, was not observed in 2013. Market stagnation is confirmed by the results of the survey of agricultural producers conducted by Agrisurvey agency in early 2014. The survey results demonstrate that a quarter of farmers do not intend to purchase new machinery in 2014; roughly, the same number of farmers are planning to update their machinery. The main question is, therefore, what will be the decision of those 50% of farmers, which have not made any decision regarding purchase of machinery yet. These results correlate with the results of the survey conducted by Agrisurvey at the end of 2013 whereby 43% of farmers answered they decide whether to buy harvesters or tractors based on the current financial situation at their enterprises. Such results and the fact that 20% of farmers intend to buy machinery only 1-3 months before its exploitation are, unfortunately, typical of a high level of uncertainty on the market. In this situation, machinery suppliers have to adapt in the way that the volume of the delivered parts is not being reduced but is stored for “better times” in order to be able to respond quickly to an urgent need from the customers/farmers.

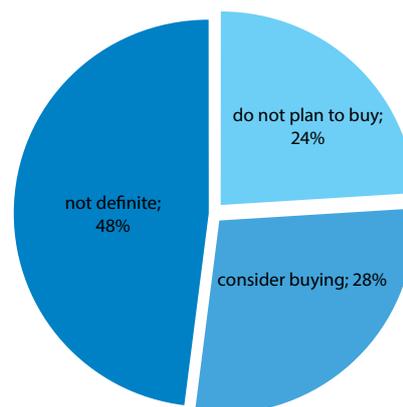
GEOGRAPHY OF AGRICULTURAL MACHINERY IMPORTS

The dynamic development of Ukrainian agribusiness in recent years was made possible by active implementation of new technologies. For example, in the last 10 years, the volume of the imports of tractors tripled (in monetary terms), exceeding \$600 million.

In 2009-2014, the main importing countries were the USA, Belarus and Germany. Despite high competition on the market of tractors, redistribution of the volume of imports in favor of more expensive tractors from the USA started in 2012. In 2013, the volume of sales of the US tractors increased by 12%, which led to the share of 32% of the market. Belarus has been the market leader until 2012. In 2013, its share was 18% (24% in 2011). Sales of tractors from Germany demonstrated significant growth in 2010 and 2011 (97% and 67%, respectively). In 2013, they declined by 13% while the market share of German tractors accounted for 11%.

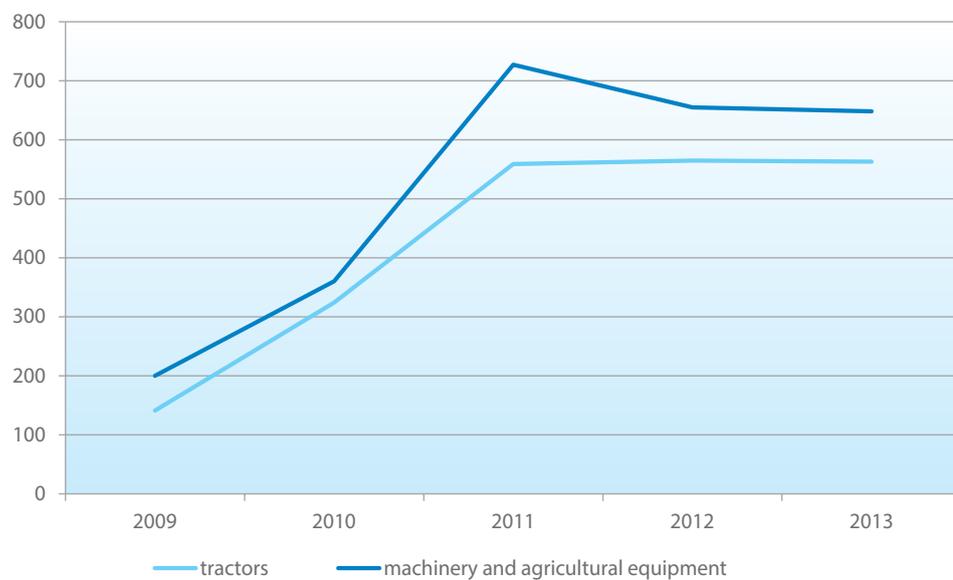
The volume of imports of other agricultural machinery and equipment grew 7 times in the last 10 years exceeding \$300 million. Market growth in 2009-2013 made up 29% in monetary terms. Agricultural machinery and equipment are mainly supplied from the USA, Germany and France. A leading position on the market with the 40% share is occupied by the USA. The supplies from the USA exceeded \$124 million in 2013. The second place with the market share of 22% belongs to Germany (\$68 million in 2013). The market share of French machinery is 7% (\$22 million in 2013).

Willingness of agricultural producers to buy machinery in 2014



Source: AgriSurvey

Imports of agricultural machinery to Ukraine, \$ million



Source: Information of market players

In general, it can be forecasted that the main market players will strengthen their positions through the development of dealer networks and service centers in Ukrainian regions. ■





Viktor SYCH

General Director of KUHN Ukraine

Since many centuries farmers have been tilling, sowing, harvesting, and producing milk and meat — there would be no life without this ancient profession. KUHN has been producing agricultural machinery since 186 years, making its contribution to the process of life sustainment through production of food.

Today the KUHN group of companies unites under its umbrella 10 machinery plants in France, Netherlands, USA and Brazil which produce almost all equipment necessary for farmers: plows, sprayers, spreaders of mineral and organic fertilizers, tillage and seeding equipment, shredders, hay tools including balers, choppers and mixers. In 2013, the production output made up EUR 1047.5 million, the highest turnover among producers of trailed and mounted farm machinery.

We continue our development: the product range is expanded and improved while production facilities are updated. In 2014, the KUHN family became larger — the company purchased a famous Brazilian manufacturer of self-propelled and trailed sprayers “Montana”, also well-known in Ukraine.

For more than 20 years, thousands of KUHN machines benefit to Ukrainian agricultural producers, be those livestock or crop farms, small farmers or large agriholdings. The reason is that they prefer modern technology and high quality for reasonable price and terms of financing as well as excellent and timely service, which is provided by our dealers. Many agrarians made their choice in favor of KUHN machinery because they can get everything they need from one producer.

Maintaining our reputation for such a long period in such huge country as Ukraine is not easy. However, for this purpose, we work together with our dealers, we build storage facilities for machinery and parts, we organize field days and demonstrations, we participate in conferences and seminars — we do everything to bring modern technologies to farmers and assist them in choosing machinery and equipment. We are focused on improvement of our product range, optimization of cooperation with dealers and close relations with agrarians, emphasizing excellence in service and financial instruments.

Be strong, be KUHN!



FOR DETAILED INFORMATION CONTACT your dealers and:
KUHN-Ukraine LLC, 3, Glazunov str., Kyiv
Phone/fax (044) 229-38-75, mobile (050) 397-29-53, (050) 469-59-94

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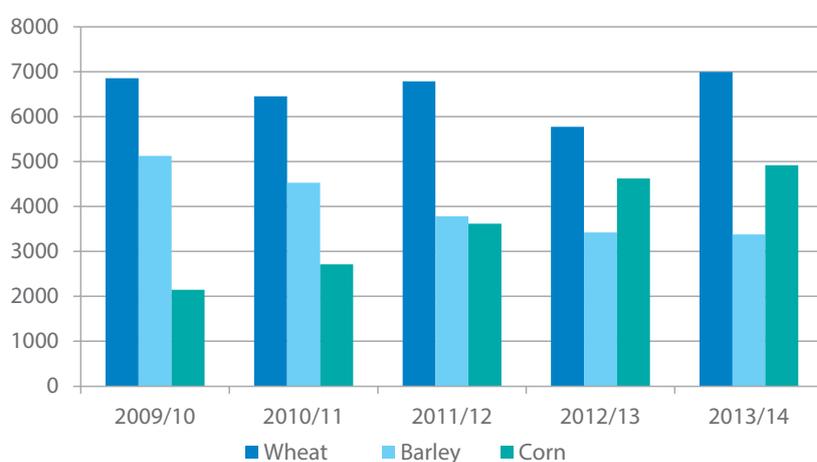
CHANGES OF SOWN AREAS

Ukrainian agricultural producers aim to increase gross crop production in order to realize the full production potential and strengthen their positions on global markets. According to the forecast of the US Department of Agriculture, in 2013/14 MY, Ukraine will become the third global exporter of corn with the share of 6.2% and, traditionally, the number one global exporter of sunflower oil with the share of 57.7%.

While domestic consumption remains relatively stable, the increasing production volumes allow for realization of the export potential. Growth of production volumes is possible to achieve in two following ways: intensification (crop yields growth) and extensification (expansion of sown areas). In the past few years, Ukrainian farmers tended to intensify the production process. However, extensification was also ongoing. The dynamics of sown areas reflect the intentions and expectations of farmers with respect to crop profitability.

For example, barley production has become less profitable. Barley is mainly used as feedstuffs (49% of total use) and export commodity (31%). In contrast to low profitability of production of most crops in 2013/2014 MY, barley is still on the list of economically efficient crops. However, the demand for barley on the international markets tends to decrease, causing reduction of the sown areas.

Production of corn was more attractive to produce because of higher demand. In 2013/2014 MY, however, global overproduction of corn led to significant decrease of prices and, as a result, its production was generally unprofitable in Ukraine. Thus, the expansion of areas under corn is expected to be less rapid than in preceding marketing years. According to the Agrisurvey study "Agrobarometer 1.0: Demand for seeds and agrochemicals 2014", nearly 80% of agricultural enterprises do not intend to change the sown areas under corn.



Dynamics of sown areas under grains, thousand hectares

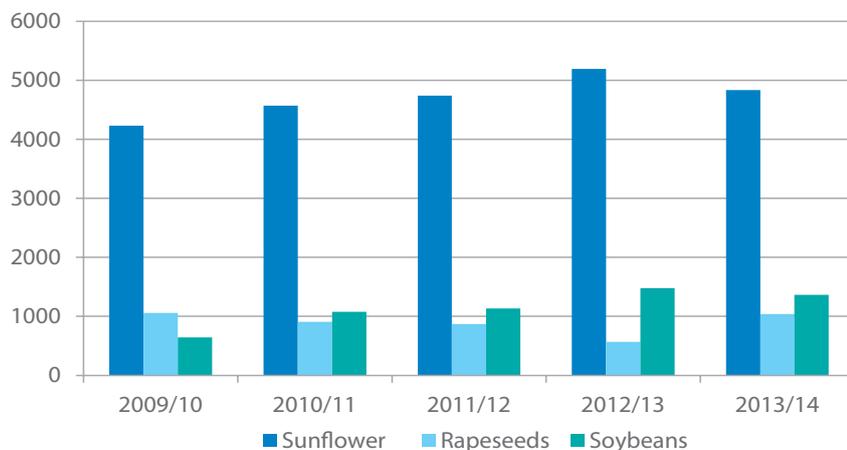
Source: State Statistics Service of Ukraine (2014)

Wheat areas remained stable. Noteworthy, more quality wheat was produced in the last years. Moreover, Ukraine is gradually changing from the producer of forage grain to a food grain producer: 81% of wheat exports were made up by food wheat as of early February 2014.

In 2013-2014 MY, only rapeseed areas demonstrated expansion. However, price decrease made this typically high-margin crop remarkably unprofitable. Despite this, more than 80% of the produced volume was exported in the first two months after start of the harvesting. It is worth noting that the Parliament of Ukraine registered a draft law that provides for the increase of export duty for rapeseeds up to 15% (but not less than EUR 30 per unit) in order to increase the processing volumes of rapeseeds within the country. Even if the draft is adopted, it shall be abolished as it violates the WTO rules.

Relatively stable prices for soybeans in the ongoing marketing year may lead to expansion of areas under this crop in 2014/15 MY.

Dynamics of sown areas under oilseeds, thousand hectares



Source: State Statistics Service of Ukraine (2014)

The sown areas of sunflower have been gradually increasing until 2012/13 MY. However, in 2013/14 MY, they slightly decreased due to state regulation of crop rotation. Despite the boost of oilseed processing capacities, their maximum utilization currently exceeds production of sunflower seeds by 3-4 million tonnes. The majority of experts assume that the cultivated areas of sunflower seeds will tend to stabilize at the level of 5 million hectares.

In general, essential changes in the structure of sown areas are not expected in Ukraine. In 2013/14, 6.3 million hectares of winter wheat and 1.0 million hectares of winter rapeseeds were sown. Additionally, it is expected that 18.5 million hectares of spring crops will be sown. However, this forecast can still change because, currently, there is a risk that about 20% of arable land will face problems with sowing due to political and economic crisis. The latter is aggravated by almost full absence of access to bank loans as well as by very high costs of crop protection products and seeds.

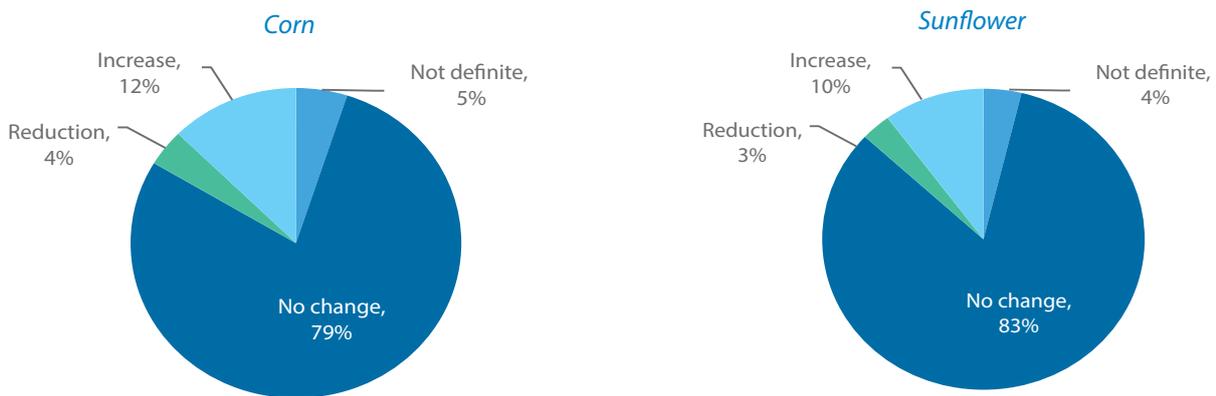
DEMAND FOR SEEDS

In contrast to a significant increase of purchases of corn and sunflower seeds in 2013, the boost of the market of seeds is not expected in 2014. Because of lower profitability of crop production in 2013/14 MY, most agricultural enterprises do not plan to considerably increase sown areas, partly because there is no spatial

possibilities for that while crop rotations must be followed. On average, 12% of agricultural producers intend to increase purchases of corn seeds and 10% — the seeds of sunflower.

Serious changes in the structure of areas under soybeans, wheat and rapeseeds are not expected either. The survey results demonstrate that the volume of purchased seeds will not be subject to huge transformations: only 5% of agricultural producers on average are ready to increase the purchase of seeds of soybeans, wheat and rape.

Generally, one should not expect a significant increase of seeds sales in 2014. At the same time, farmers do not plan to cut their seed budgets.



Source: AgriSurvey study "Agrobarometer 1.0: Demand for seeds and agrochemicals 2014"

GEOGRAPHY OF SEED IMPORTS

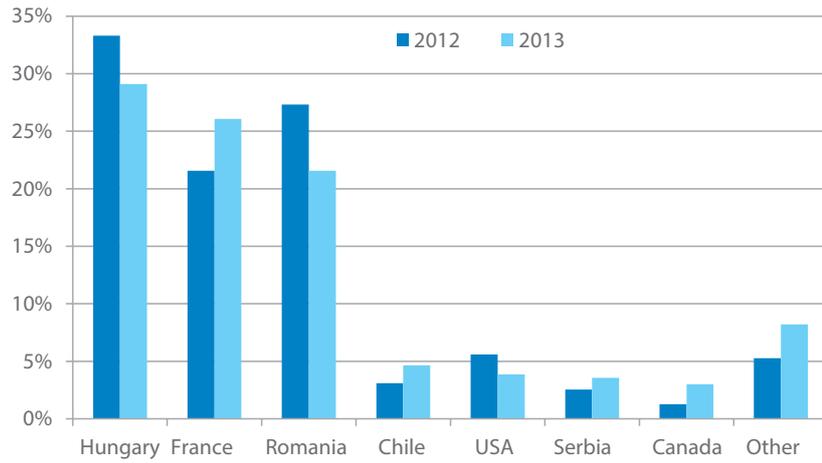
In 2013, the major shares of imported seeds in Ukraine were those of corn, sunflower and rape: 46%, 42% and 6%, respectively. Imports of the seeds of other crops were insignificant.

Three quarters of imported corn seeds were represented by three countries: Hungary, France and Romania. The tendency of the last year was a decline in imports of seeds of Hungarian and Romanian origin, while imports of the seeds of French selection grew. In 2013, the total volume of seed imports doubled due to diversification of supplies of corn seeds. However, in physical terms, imports increased only by 1% in 2013, which is a clear sign of market penetration. Furthermore, due to unfavorable financial situation in Ukrainian agriculture, there will be little prerequisites for growth in total value of seed imports in 2014.

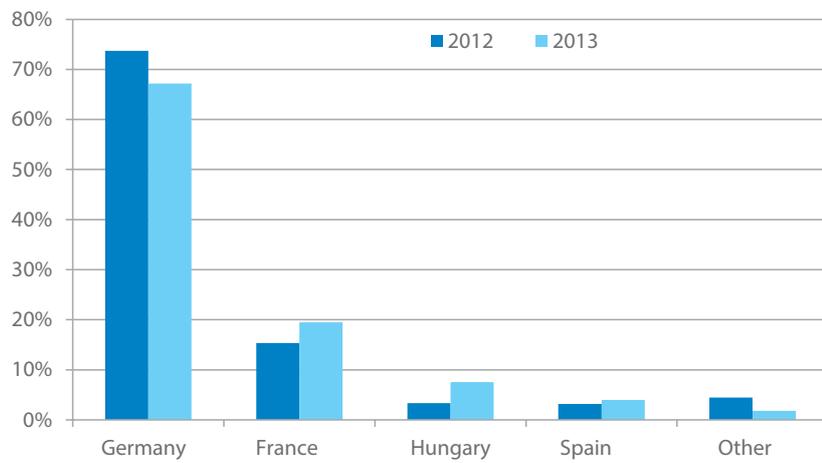
About 70% of imports of the seeds of rape are of German origin. Despite this, the share of seeds imported from Germany decreased in 2013, while the popularity of the seeds of French and Hungarian selection grew. This is partly due to the transition of farmers to more affordable seeds as the seeds from Germany are the most expensive.

More than a half of the imported volume of sunflower seeds comes from two countries: USA and Turkey. The volume of imports (in physical terms) increased by 13% in 2013 compared to 2012. Because the sown areas remained unchanged, this indicated that the share of imported seeds on the market had grown. Also of note is larger diversification of imports of sunflower seeds than in case with other crops.

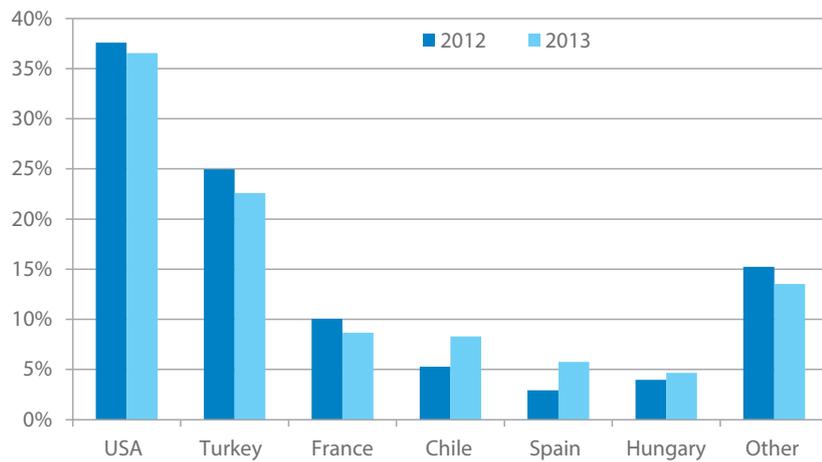
Geographical structure of corn seed imports, in physical terms



Geographical structure of rape seed imports, in physical terms



Geographical structure of sunflower seed imports, in physical terms



Source: State Customs Service of Ukraine

Farming with passion



"There is no success without passion."

When we thought about a perfectly fitting slogan for Horsch, we very quickly agreed on "Farming with passion". Because passion can be found in every Horsch product and motivates the actions of every single Horsch employee. From management board to service technician, everyone in the company lives the passion that turns a simple product into a unique one that excels due to innovations and uncompromising quality.

"We are and have always been farmers who concentrate intensively on an effective cultivation of the soil" say Michael and Philipp Horsch. "There is a future for farming and it is worth working hard for it, for the farmer as well as for the producer of agricultural equipment. Each time the farmer looks into the rear mirror of his tractor and sees a red machine he should know that he has gone for uncompromising quality."

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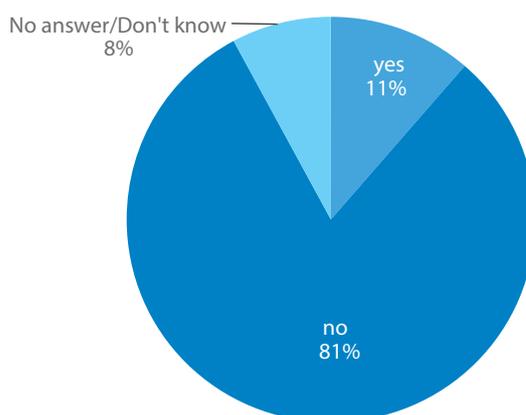
Farming with passion

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MINERAL FERTILIZERS

As of early 2014, the majority of Ukrainian agrarians were not faced with the deficit of mineral fertilizers. To some extent, this was the result of timely procurement in the fall of 2013. However, about 11% of agricultural producers faced the lack of fertilizers in January 2014 while 23% of them had to reduce their costs due to financial problems. Considering unstable economic situation and price increase of fertilizers, the conclusion is that more than one third of producers will lack mineral fertilizers in 2014 and this may lead to decrease of crop production volumes.

Will you face the deficit of mineral fertilizers in 2014?



Source: Agrisurvey study "Agrobarometer 1.0: Demand for seeds and agrochemicals 2014"

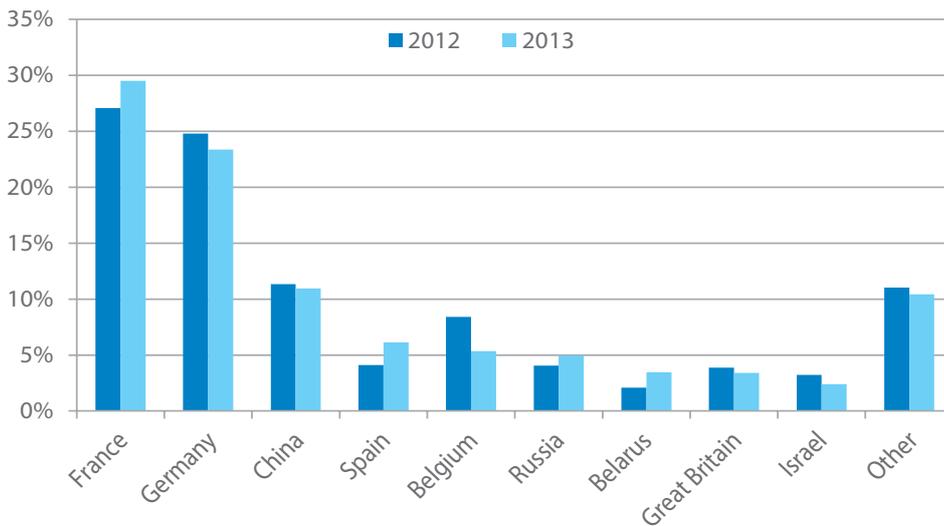
Price growth and subsequent fertilizer shortage is likely to primarily affect producers with 1500-2000 ha or more than 6000 ha farmland in use. Among them, 75% have already faced the deficit of nitrogen fertilizers.

Deficit of which fertilizers will you experience in 2014?	
Fertilizers	% of respondents
nitrogen	75%
phosphorous	9%
potassium	4%
complex	8%
all	4%

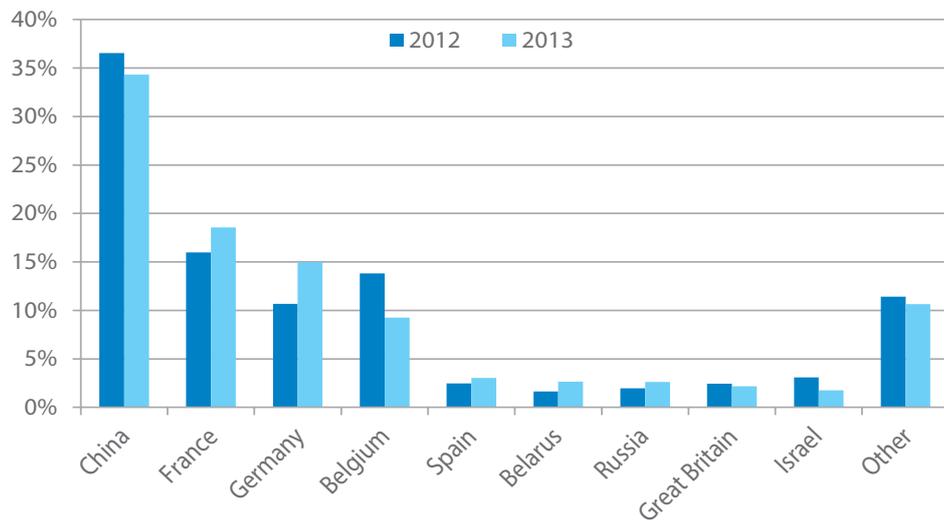
Source: Agrisurvey study "Agrobarometer 1.0: Demand for seeds and agrochemicals 2014"

CROP PROTECTION PRODUCTS: GEOGRAPHY OF IMPORTS

In Ukraine, 95% of the total volume of crop protection products (CPP) that is used in agricultural production is imported. The geography of imports encompasses more than 30 countries. Two thirds of the CPP supplied to the Ukrainian market are manufactured in three countries: France, Germany and China. The highest demand is for CPP produced in France and Germany — they represent more than a half of CPP traded in Ukraine. Spanish and Belorussian CPP strengthened their positions on the Ukrainian market in 2013 as compared to 2012 — their market value almost doubled.



Geographical structure of CPP imports, in monetary terms



Geographical structure of CPP imports, in physical terms

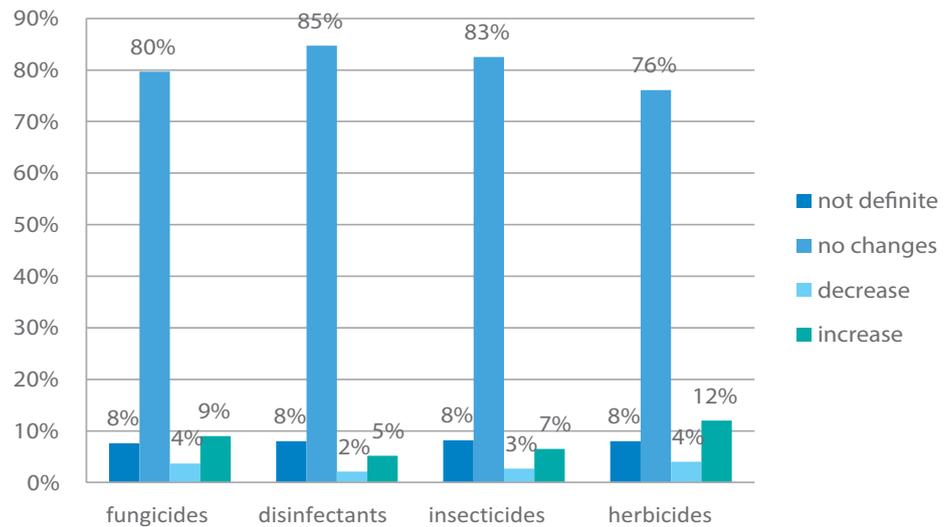
Source: State Customs Service of Ukraine

In physical terms, the leading suppliers of CPP to Ukraine are actually the same. However, here, the number one supplier is China. In general, as forecasted in last year's edition of "Doing Agribusiness in Ukraine", there were no dramatic changes on CPP market in 2013 — its volume reached the level of nearly \$700 million, which is comparable with 2012.

DEMAND FOR CROP PROTECTION PRODUCTS

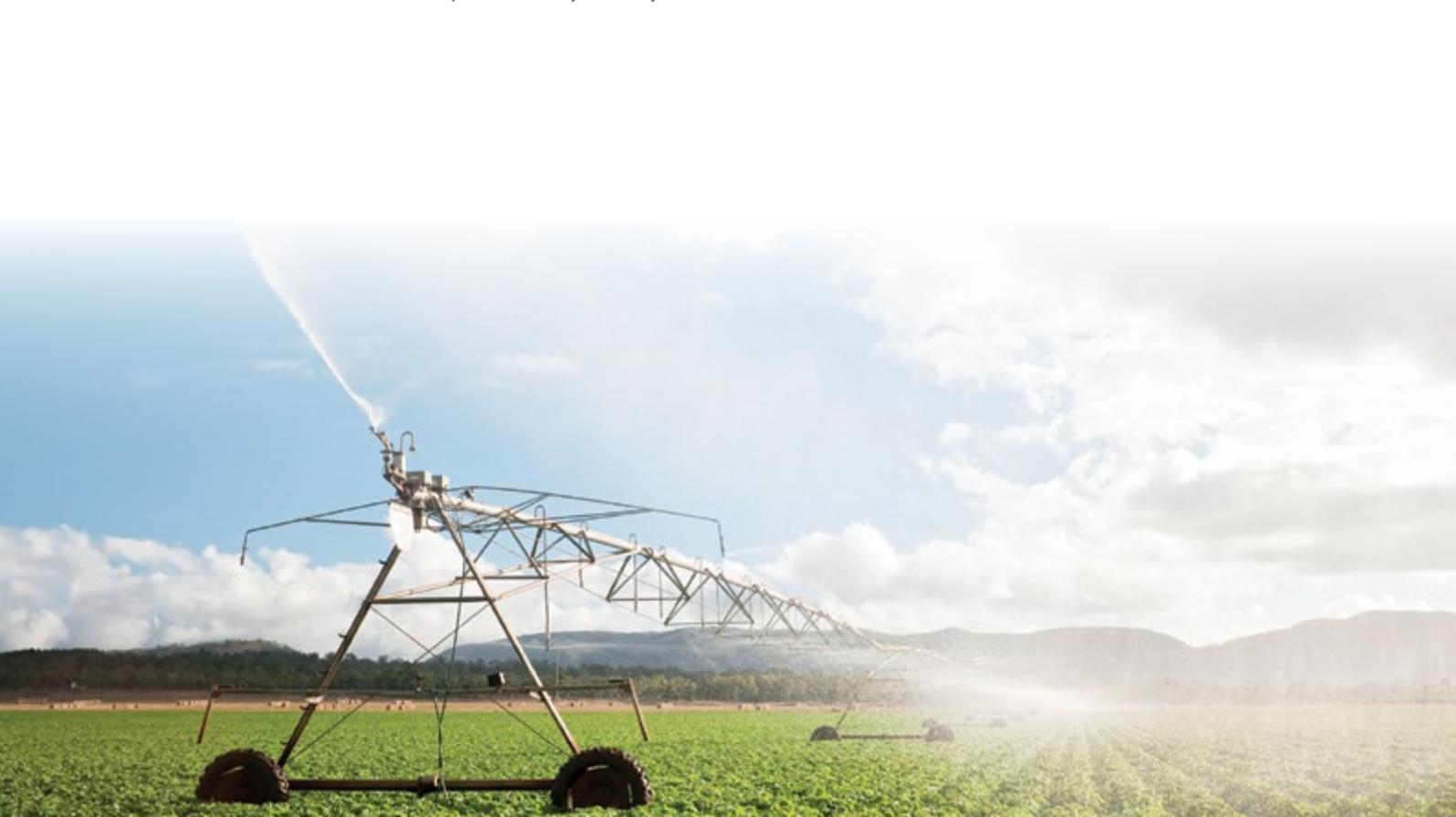
In 2014, despite the high degree of market uncertainty, farmers do not intend to decrease their purchases of CPP. According to the study of AgriSurvey agency, on average, almost 80% of agricultural producers do not have any intentions to change the volume of CPP purchases while 8% of them are planning to increase the demand. At the same time, only 3% of producers are willing to buy less.

Changes in demand for CPP in agrarians' opinion



Source: Agrisurvey study "Agrobarameter 1.0: Demand for seeds and agrochemicals 2014"

Demand for herbicides will grow more than that for other types of CPP. 12% of agricultural producers are ready to increase the use of herbicides due to planned acreage expansion under soybeans and sunflower. Additionally, a slight decrease of demand for seed disinfectants is being observed because more and more producers prefer to buy already disinfected seeds. ■





Csaba MOLNAR

**Commercial Unit Director,
Eastern Europe at DuPont Pioneer**

Ukraine is an important country on the global DuPont Pioneer investment map. It is one of the most rapidly developing and growing markets in the world with huge potential. In addition, Ukraine plays an important role in maintaining global food security, which is one of the key topics in our company.

These factors are in line with the potential business growth of DuPont Pioneer and provide our company with the possibility to expand and reinvest profits in Ukrainian economy, create new jobs and help agricultural producers to increase their productivity and profitability.

Our company has a long-term history in Ukraine, since Khrushchev's times. Today the investments of DuPont Pioneer in the country are represented by a research center in Lyubartsy in Kyiv region and a seed production complex in Stasi village in Poltava region. The latter was officially opened in June 2013.

Poltava region was selected for construction of our plant after detailed examination of soils, climatic and economic conditions. Currently, annual capacity of the plant is 500 thousand units of Pioneer® hybrid seeds of corn and sunflower. At this stage, total investment in construction already amounts to 40 million US dollars. Besides, we are in the process of evaluation of potential capacity expansion, which implies further investments.

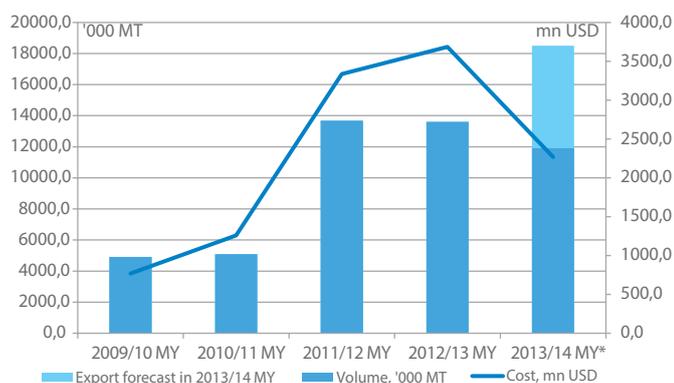
For competent businessmen, investments in Ukrainian agriculture are very advantageous. Ukraine is able to achieve the success, which is comparable to that of Brazil, and become a #1 global exporter of agricultural commodities. For that matter, strong support from the government, transparent business conditions and stable deliveries of high-quality seeds are crucial. We plan to continue the development of our business in Ukraine, because the potential is undoubtedly huge to increase productivity, efficiency and profitability. Land, climate and people of Ukraine inspire us to see very good perspectives in the country.

AGRICULTURAL MARKETS

CORN: QUEEN OF FIELDS

What does corn actually mean for Ukraine? Our country is ranked 5th in the world in terms of corn production and 3rd in terms of its volumes exported. In fact, each 6th tonne of corn sold on international markets belongs to Ukraine. By corn consumption, Ukraine is the 12th in the world. 22.5% of the total revenue from exports of agricultural commodities in 2013 came from the exports of corn.

Corn exports from Ukraine



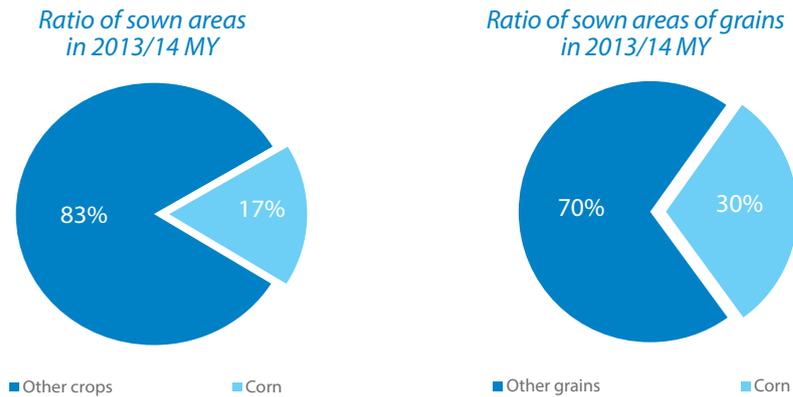
Source: State Statistics Service of Ukraine

In recent years, we have seen a clear trend towards an increase in the acreage of corn and intensification of its production.

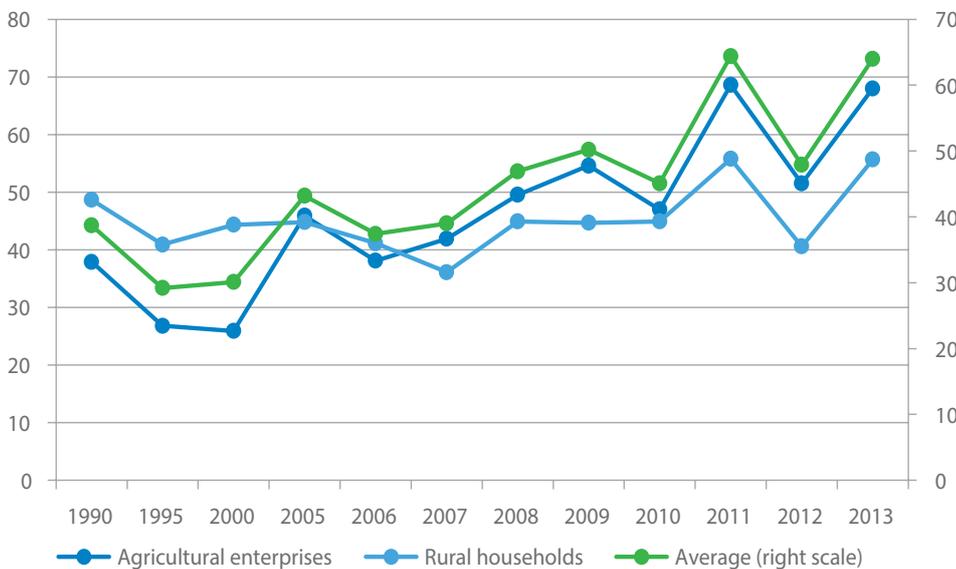
Corn became such widespread in Ukraine due to the ease of cultivation, profitability and suitable climate conditions.

4.9 million hectares have been allocated under corn in 2013/14 MY, which is 6.4 % (or 294.3 hectares) more than a year earlier. Corn sown areas are mainly concentrated in central and northern regions.

Corn yields are also growing from year to year. The exception was 2012 when the yields fell by 25.6% (or 16.5 dt/ha), but the situation changed in 2013 when average yields of corn reached 62.5 dt/ha. According to the data of the USDA, in 2013/14 MY, Ukraine is #3 global corn producer in the world in terms of yields, outperforming the world's average and such countries as Brazil (47.6 dt/ha) and China (60,3 dt/ha).



Source: State Statistics Service of Ukraine, calculations of UCAB



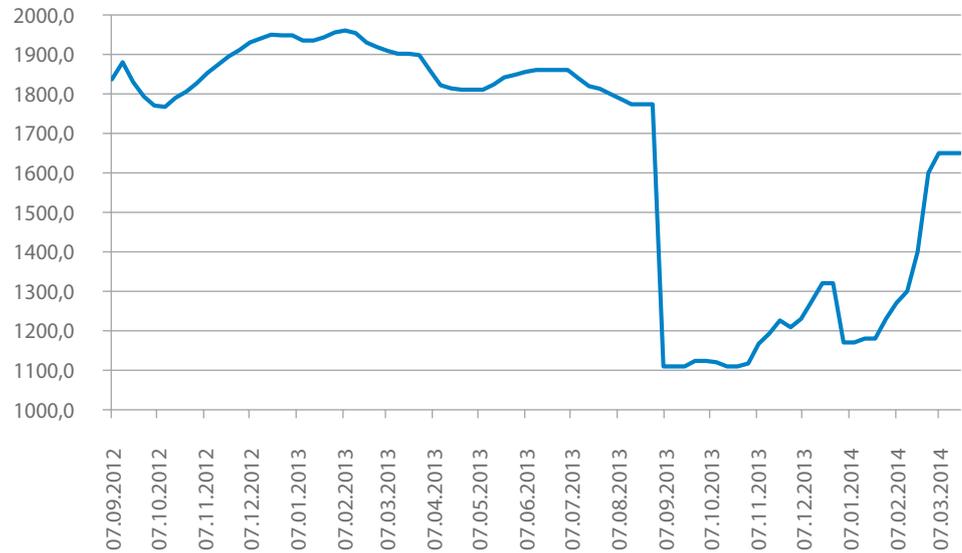
Source: State Statistics Service of Ukraine

Gross harvest of corn was 30.9 million tonnes in 2013/14 MY, 47.4% (or 9.9 million tonnes) more than in 2012/13 MY. Largely, this increase was achieved due to intensification of production.

In 2012, profitability of corn production was estimated at 19.8%; at the beginning of the harvesting campaign 2013, prices dropped by 37.4 % (or UAH 663.3/MT) down to UAH 1110/MT EXW. As compared to September 2012, the change was -39.6% or UAH -726.7/MT. Such price behavior provoked a decline in profitability, about 7% on average in pre-devaluation period. The question arises based on this dynamics:

"Is corn still the Queen of fields?" Ukrainian farmers still reply it affirmatively. 78.5% of farms surveyed by AgriSurvey agency, said they are not going to change the sown areas under corn. Although the issue of production costs is rather sharp, corn has all chances to keep the Queen title this year.

Corn prices,
Ukraine, EXW,
UAH/MT



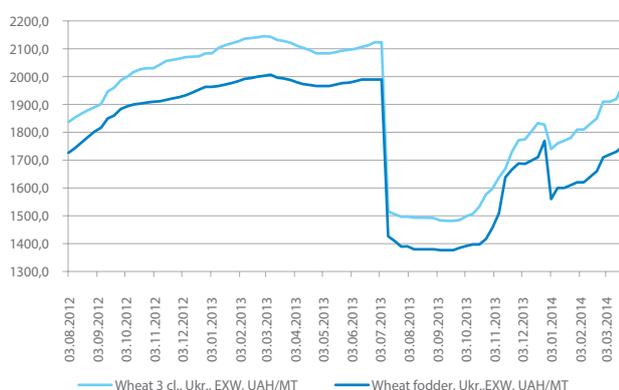
Source: UCAB price monitoring



WHEAT: ENSURING STABLE PROFITABILITY

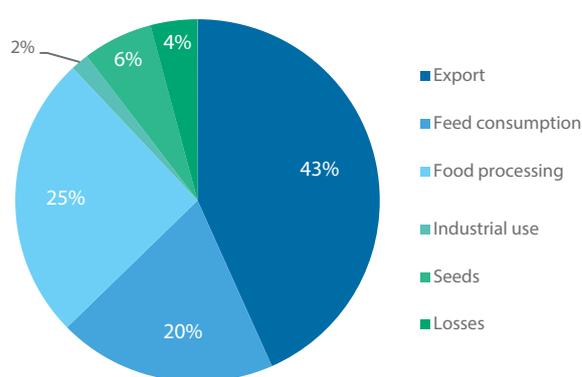
Wheat is one of the most stable crops in Ukraine in terms of market situation. Average price drop of 18.5% (or UAH 340/MT) for 3rd class food wheat EXW and 19.5% (or UAH 336.7/MT) for forage wheat in early 2013/14 MY was at smallest among all crops if compared to the similar period of 2012/13 MY.

Dynamics of wheat prices in Ukraine



Source: UCAB price monitoring

Use of wheat in Ukraine



Source: UCAB calculations

According to UCAB estimates, in pre-devaluation period, profitability of wheat production was 5%, which means decrease by 6.8 points compared to 2012. Despite the record world production of 712.7 million tonnes, wheat still managed to stay one of the profitable crops.

Total wheat sales were UAH 18.6 billion in 2013, which is UAH 0.9 billion UAH (or 4.8%) less than in the previous year. Increase in sales volumes by 7.9% (or 1 million tonnes) still had not allowed to hide the negative effect from the average price reduction by 11.7% (or UAH 182.1/MT).

Impact of the global market on pricing in Ukraine continues to grow. In the structure of wheat use, the share of wheat exports increased from 36% in 2012/13 MY to 43% in 2013/14 MY. In fact, each 16th ton of globally exported wheat is of Ukrainian origin. The share of food processing and forage consumption decreased from 29% and 22% to 25% and 20%, respectively.

On average, about 96% of wheat produced in Ukraine is winter wheat. For the 2014/15 MY harvest, Ukraine sowed 6343.7 thousand hectares of winter wheat, which is 88.2 ha (or 1.4%) less than in 2013/14 MY. Based on the Hydro-Meteorological Center data, wintering went off quite well.

The Ministry of Agricultural Policy and Food announced maximum areas for re-sowing up to 7% of winter crops, which makes it possible to talk about a good harvest of 2014/15 MY, but farmers still have to go through some critical points in spring, particularly, carry out a set of field works. The success of these works is still questionable due to increased cost of almost all production inputs in 2014. If farmers are sufficiently provided with inputs, wheat harvest is expected to reach 18.7 million tonnes in 2014/15 MY. This allows talking of the export potential about 7 million tonnes.

As a result, wheat will be among profitable crops in 2014/15 MY. However, whether it will become a high-margin crop or not depends on a number of factors such as political and economic conditions as well as Ukrainian and world market situation. ■

SUGAR: ONGOING FLUCTUATIONS

Since 2010, there has been a tendency toward sugar overproduction in Ukraine, which had a negative impact on the profitability of producers and processors of sugar beets. 33% less area was sown in order to stabilize the sugar market for the harvest of 2013/14 MY in comparison with 2012/13 MY. By the end of 2013, the gross harvest of sugar beet decreased by 42% (10.7 million tonnes) as compared to 2012, mainly due to reduction of harvested areas. Sugar beet yields decreased by 3% (down to 397.4 dt/ha).

The production volume of sugar in Ukraine amounted to 1,212 tonnes in 2013 (as of February 1, 2014) against 2,226 tonnes in the same period in 2012 (46% less). Vinnitsa, Poltava and Ternopil regions became leaders in sugar beet production in Ukraine with the total share of 49% in the structure of sugar production.

Average consumption of sugar is 1.8 million tons in 2010-2014, including industrial demand at the level of 40-45% of total use. Projected level of sugar production in 2013/14 MY is 1.35 million tonnes; taking into account the highest ever ending stocks of 0.9 million tonnes, it will fully cover domestic demand.

The trend towards decreasing capacities of sugar beet processing is ongoing. 38 factories (63 in 2012 and 77 in 2011) are involved in production of sugar in Ukraine. Most factories that do not belong to agriholdings exited from sugar business.

Sugar market in Ukraine, 2010-2014

	2010/11 MY	2011/12 MY	2012/13 MY	2013/14 MY (forecast)
General supply of the domestic market, thousand tons, including:	1866	2657	2854	2242
- own production, thousand tonnes	1543	2334	2206	1350
- stocks, thousand tonnes	323	323	648	892
Domestic consumption, thousand tonnes	1838	1860	1833	1826
Export, thousand tonnes	586	164	134	10
Import, thousand tonnes, including:	296	15	2	5
- raw sugar, thousand tonnes	247	6	0	0

Source: State Statistics Service of Ukraine

Overall, Ukraine imported 1.5 thousand tonnes of sugar (white and raw sugar) in 2012/13 MY, which is 10 times less than in 2011/12. The main volumes of white sugar imports were from Belarus (55%) and Denmark (25%). Exports decreased by 18% (133.7 thousand tons) and went to Kazakhstan (20%), Georgia (19%), Kyrgyzstan (18%), Moldova (10%), Uzbekistan (6%) and Turkmenistan (6%).

Total imports of sugar to Ukraine (white and raw sugar) amounted to 235 tonnes in September-December 2013/14MY, including sugar from Russia — 46 tonnes, Belarus — 45 tonnes, and the EU — 27 tonnes. Sugar exports in September-December 2013/14MY amounted to 8,678 tonnes (47% less than in the same period of 2012/13 MY). The main destinations were Georgia (62%) and Moldova (33%).

The price level of sugar from the 2013 sugar beet harvest will depend on the situation on domestic and foreign markets. The Cabinet of Ministers of Ukraine has increased the minimum sugar prices to the level of UAH 7,220.68/tonne (excluding VAT) for 2014/15 MY. Estimated production costs are expected to reach UAH 6.5 thousand. However, given the reduction in sugar production in 2013/14 MY, a significant reduction of stocks (down to 411 tonnes) is forecasted. This decrease, in turn, will cause price growth to the level of UAH 7,200-7,500 UAH/tonne. Thus, sugar market is subject to ongoing price fluctuations associated primarily with the desire of manufacturers to ensure profitability under the pressure of market stocks.

In general, due to limited domestic consumption and reduction of exports, Ukraine will continue to decrease sugar production. Decrease of production is mainly related to the reduction of sugar beet acreages in mid-size farms. At the same time (since mostly large producers will remain in the sugar business), an increase of sugar beet yields is likely to occur, thanks to significant investments in technological improvements. ■



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- Control length of cut
- Create even compaction across whole silage clam
- Assure better fermentation and conservation of nutrients
- Improve milk yield

HarvestLab – absolutely required for high quality silage!

Lab results of forage quality with your own hands.

High quality of forage constituent's measurements with accuracy up to 0.78% proven by independent institute Deutsche Landwirtschafts Gesellschaft (DLG) FOKUS.

Ability to measure nutrients of fresh and ensiled mass.

A way to calculate more balanced ration based on knowledge about nutrients and use it in efficient manner.

Be sure in the quality of your forage!

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MILK: UKRAINE AS FUTURE GLOBAL MARKET LEADER?

MARKET TRENDS IN UKRAINE

Milk has always been one of the major livestock products in Ukraine. 2013 was quite a successful year for milk producers. High farm-gate prices allowed producers to earn more while higher crop yields lowered feed prices in the second half of the year. By results of 2013, 11.5 million tonnes of milk were produced in all types of farms, which is 1% more than in the previous year. Agricultural enterprises increased their production by 2% up to 2.59 million tonnes. However, in 2013, the market felt the shortage of raw milk supplies because of substantial reduction of deliveries from rural households. Moreover, despite the high demand for milk from processors, the number of cows continues to decline. As of March 1, 2014, there were 2.5 million cows in Ukraine, which is 1.7% less than in the same period last year.

In 2013, the seasonal downturn of farm-gate prices did not occur for the first time since many years. Slight price drop in June and July was followed by an increase in August. The main reasons were the shortage of raw milk supplies and the high level of prices on the global market. In early December 2013, shortage of domestic supplies was even more drastic, and the prices grew to their record levels. In 2014, the situation is stable; prices fluctuate in the range from 0.3% to 2.0%.

Improvement of milk quality is a positive tendency in Ukraine. In particular, agricultural enterprises delivered 3.0% more high class milk and 4.5% more "Extra" class milk to processing plants in 2013 as compared to 2012.

Low feedstuffs prices and high farm-gate prices for raw milk will facilitate the development of the milk sector in 2014. The development of the dairy industry will mainly depend on political factors. Most of dairy exports, especially cheese, goes to Russia. A recent ban on imports of Ukrainian dairy products to Russia requires diversification of exports and adaptation to the standards of new markets.

Milk market indicators in Ukraine, million tonnes

	2009	2010	2011	2012	2013	2013 vs. 2012
Milk production	11,61	11,25	11,09	11,39	11,50	101,0%
including agricultural enterprises	2,24	2,22	2,25	2,54	2,59	102,0%
including households and other entities	9,37	9,04	8,84	8,85	8,91	100,7%
The volume of milk delivered to processing	4,67	4,74	4,61	4,71	4,57	97,0%
including agricultural enterprises	1,86	1,89	2,03	2,28	2,33	102,2%
including households and other entities	2,80	2,85	2,51	2,41	2,22	92,1%
Exports of dairy products (milk equivalent)	0,90	1,00	1,00	0,82	0,75	91,5%
Imports of dairy products (milk equivalent)	0,50	0,30	0,30	0,41	0,54	132,0%

Source: State Statistics Service of Ukraine

PROSPECTS FOR THE DEVELOPMENT OF DAIRY COOPERATIVES

In Ukraine, the process of industrialization of milk production continues: more than a half of milk is coming to processing from agricultural enterprises. As long as a sufficiently large volume of raw milk comes from private households, their role should not be underestimated. In the market economy conditions, it is getting increasingly difficult for small-scale rural households to compete with professional producers. Therefore, cooperatives of small-scale producers are becoming more important.

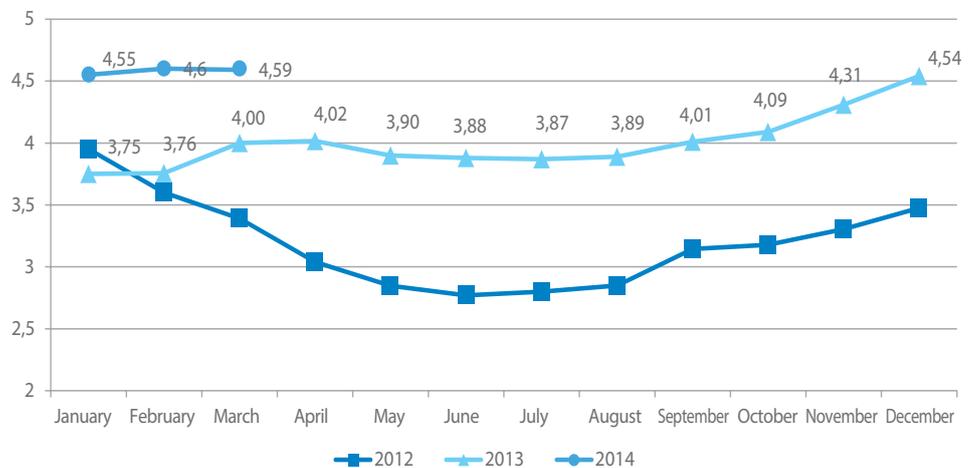
At the beginning of 2014, there were 290 dairy cooperatives in Ukraine, and only 69% of them were actually operating. The total number of operating production and service cooperatives was 121. The largest number of these cooperatives was in Cherkassy (33) and Vinnitsa regions (18 cooperatives).

Cooperatives are designed to perform a number of functions, both for households and for dairy companies. Agricultural service cooperatives (ASC) can provide services not only for the collection, storage and sale of milk but also for the procurement and purchase of feedstuffs, veterinary medicine, advisory services, etc. to households. Through participation in cooperatives, private households can get higher prices for delivered milk because of improved milk quality and formation of permanent consignments.

Today, the development of cooperatives in Ukraine is prevented by several factors. Namely, they are as follows:

- To create cooperatives, with all necessary equipment which is capable of providing high-quality milk, substantial investments are needed (at least UAH 200 thousand per cooperative which would deliver at least 1.5 tonnes of milk per day). These funds are not allocated from the state budget and it is hard to attract people in the villages to collect a bag of investment in ASC.
- Rural population is not ready fully to support cooperatives as there are collective stereotypes and mistrust of creating an organization that will work for the benefit of society. The population is also not very motivated to participate in general meetings and demonstrate personal initiatives in cooperative activities.
- There is significant competition on the milk market, which is not always conducive to the establishment of uniform rules and quality requirements and methods of raw milk collection. Under these conditions, there are farms that give substandard milk but still receive a high price for it. Staging and strict adherence to quality requirements of raw milk would improve milk procurement conditions and, consequently, the quality of dairy products. Further, it could contribute to a more civilized market for milk from households as well as stimulate households to unite in service cooperatives, which would take over functions of quality control and would act as self-standing players on the market of raw milk.
- Managing 1 or 2 cows is not economically viable. So there is a need to establish family farms with the number of cows 5 and above. Only with such number of cows, a family can generate income that is alternative to the minimum salary. It is true that at the moment there is a need to stimulate people's attitudes to their farms as to a small family business. To a certain extent, this is also prevented by the fact that family farmers are not getting the employment status (and social benefits), and it is not counted in their length of service/job experience.

Average farm-gate prices in Ukraine, 1st class milk, agricultural enterprises, UAH/kg



Source: UCAB price monitoring



- In addition, the issue of the development of cooperatives and family farms faces problems common to all agribusinesses, in particular, land lease, access to loans, etc. In the private household sector, the problem is even more acute, since there is no qualitative legal consulting support and commercial banks that would provide financing to this type of producers. For example, for the reconstruction of existing stables for ≤ 5 cows, one needs to attract funds in the amount of \$4 thousand; for the construction of a family dairy farm with at least 10 cows — about \$23 thousand. At the same time, the increase of productivity from realization of such projects for already existing livestock may reach at least 15%, according to our estimates.
- It should be noted that, in terms of state support, agricultural service cooperatives and their members are not on an equal footing with other market players such as agricultural production cooperatives or individual private households. Because agricultural cooperatives, which normally pay VAT, do not have the ability to reduce their tax burden, they get more expensive production inputs to serve their members. This reserve in the form of VAT, which other groups of producers have right to keep for their own development, could serve as a good basis for the transformation of subsidiary farms into family farms of the European type. A cooperative ownership in the future would continue to provide a range of services — from forage storage to milk collection and cooling.

In addition, a processing plant cooperation with a household via an ASC also eliminates subsidies they paid for milk, since an ASC as a legal person does not have the status of an agricultural producer. This implies that ASCs are in worse conditions than agricultural enterprises because of imperfect legislation.

Perspectives of dairy cooperatives are as follows:

- Today about 50 % of milk processed is delivered by households. Understanding the current shortage of raw milk and a slower, than expected, development of large-scale dairy farms do not give right to neglect this group of milk producers. Furthermore, production of cow milk provides additional incomes to approximately 2.5 million rural families. Therefore, the sector is significant in terms of support, rural development, creating jobs in rural areas, and providing raw materials to the processing industry.
- To achieve competitiveness and efficiency in this segment, systemic and purposeful work is necessary on the part of both, the government and dairy companies.
- Considering economic feasibility and socio-demographic factors, a promising group among private households for the development and support is the one with households which hold or are ready to increase the number of livestock to at least 5 cows of a dairy herd.
- Practice shows that for small-scale production, sooner or later there will be a need for sharing of a significant proportion of household resources: an organized collection of milk, procurement of forages, provision of veterinary services, etc. In addition, joint supplies of milk allow for a larger market power of the group of milk producers. Therefore, the agricultural service cooperative is a promising form of organization of small and medium-size producers of milk.
- As part of membership in the WTO, Ukraine plans by January 1, 2015 to ban the sales of raw milk and meat produced in households, which will negatively affect the income of private households. Thus, only cooperatives can help households sell their products.
- Experience shows that activities of cooperatives extend to the whole society, as they create jobs, pay taxes and solve social problems through cohesion of inhabitants in rural areas.



EU MILK QUOTA ABOLITION IN 2015 AND OPPORTUNITIES FOR UKRAINE

Tom O'CALLAGHAN
Independent Consultant

On April 1st 2015, for the first time in a generation, farmers in the European Union will be able to produce milk without any milk quota restrictions. Since the introduction of Milk Quotas in the 1980's, there have been dramatic changes in the global dairy market.

1. The growing demand for dairy products is occurring in markets outside of Europe.

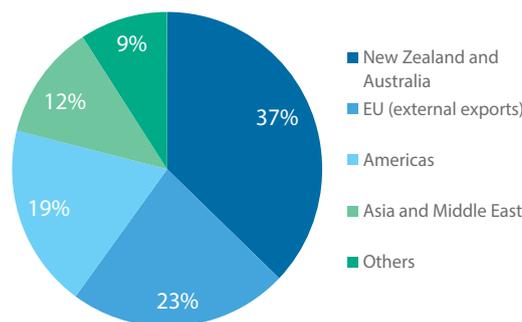
Dairy product imports (in milk equivalent '000 tons)

	Imports 2000	Imports 2012	Change
Asia & Middle East	17302	28822	67%
Africa	4870	7952	63%
Americas	9655	9073	-6%
Russia	1007	4385	335%
European Union	3500	1400	-60%

Source: USDA

2. Compared with many other farm commodities where 30 to 40% is traded globally, only 7% of global milk production is traded internationally. In recent years, New Zealand has surpassed the EU as the world's leading dairy exporter. The volume of dairy products traded globally has increased by 150% over the past 10 years. Such trade is expected to grow by 4 — 6% CAGR by 2020.

Leading global dairy exporting regions (in milk equivalent)



Source: USDA

Europe top-5 land prices (\$ per hectare)

	\$ per ha
Netherlands	\$65 449
Ireland	\$29 918
Denmark	\$26 346
United Kingdom	\$22 264
Spain	\$16 079

Even though many dairy farmers in the EU receive some of their income via subsidies, the milk quota system has created some impediments for dairy farmers in Europe. Farmers have had limited opportunities to expand production as:

- The cost of buying extra milk quota allotments has been expensive, e.g. Danish and Irish dairy farmers have spent approximately €2.3 billion on milk quota purchases over the past twenty years;
- Farmland prices have also proved prohibitive.



The post-quota dairy industry will be much leaner and efficient. Factors shaping this competitiveness are as follows:

- ~75% of the EU-28 milk supply is produced in just eight countries. In fact, the EU has failed to collectively fill its milk quota since the 2006/2007 production season. Milk production is expected to decline further in Southern Europe post-quota, but expand in Northern Europe.
- Supported by subsidies and funded by cheap credit, inefficient farmers continued to expand over the past decade. Coupled with this, increased global milk price volatility resulted in a dramatic decline of farmer numbers across Europe. For example, in 1995 there were 487,000 dairy farmers in Germany, France, Netherlands, Ireland and the UK combined. By 2010, this number had declined to 226,000. EU dairy farmer numbers may decline by a further 20-30% by 2020.
- The EU has all but abandoned direct product price intervention. The European dairy industry is gearing for expansion in open, non-subsidized, global markets.
- The European dairy processing sector has also undergone considerable consolidation. The top-26 dairy companies in 1997 have consolidated into nine companies today. In 2012, the top-10 European dairy companies (including Nestle, Switzerland) had a combined sales turnover of \$120 billion.
- Another interesting feature of the milk quota regime has been the increased specialization of dairy farmers, and their focused improvement on farm efficiency. This has also contributed to the emergence of innovative companies focused on improving farm efficiencies. For example, in Ireland, family owned Dairymaster is manufacturing and exporting milking machines globally with a unique system that helps achieve 5% more milk yield. Likewise, Keenan System is combining cattle feeding wagons with software to give proven benefits of two cents per litre milk yield and feed efficiency benefits.

Ukraine — emerging as a global dairy leader

There exist real and genuine reasons to consider how Ukraine can become a global dairy leader over the next 10 years.

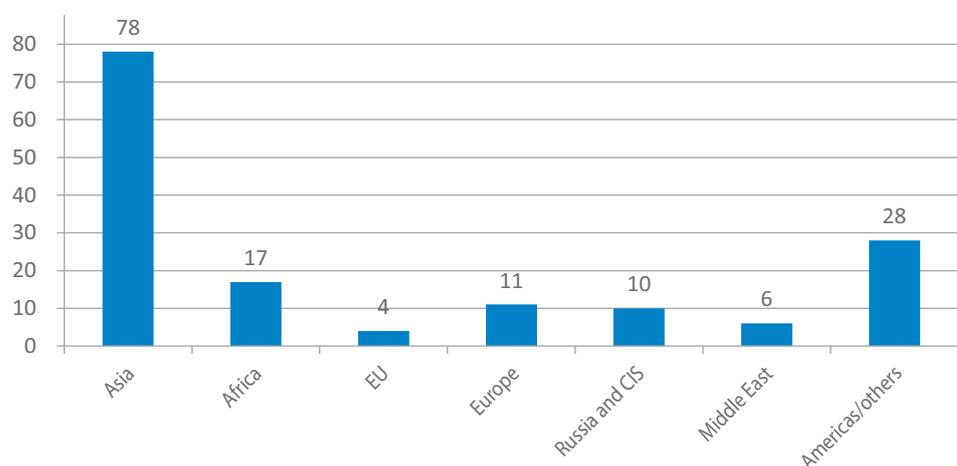
- 1. Ukraine has an abundance of capability** — Ukrainian milk production is now expanding and the industry currently produces >11 billion litres per annum. Ukraine proved itself capable of producing >25 billion litres in 1990. The country has a tradition of livestock husbandry and milk production. This fact is important! Developing large-scale dairy economies in China and South America has proved expensive in the absence of a strong historical dairy tradition.
- 2. Ukraine is ideally located to serve key markets** — Only 7% (~55 billion litres) of dairy products are traded internationally. Between 2000 and 2012 Asia, Africa, Russia and the Middle East increased their dairy imports by 18 million tonnes per annum. Ukraine is ideally located geographically to capitalize on increased consumption demand. Excluding the Americas, the total milk consumption growth within reach of Ukraine is >125 million tonnes or >10 times Ukraine's currently milk production output. It is worth noting, even though New Zealand produces 20 billion litres or 3% of the world's milk production per annum, it accounts for a massive 37% of global dairy product trade.

Let's not forget the domestic Ukrainian market, which has scope for growth beyond the current per capita dairy product of 92 kg (milk equivalent) per person. Compare

this Ukrainian average with other regions, e.g. Russia, 162 kg per person; European Union, 248 kg per person; USSR (1990), 296 kg per person.

3. **Ambition and attracting investment** — To satisfy consumer demand and food security, Saudi Arabia is currently farming dairy cows in the desert with feed imported from Argentina! The Chinese are building farms and factories in New Zealand. New Zealanders in turn are setting up farms in Chile. This list is not exhaustive. The opportunity exists for Ukraine to explore these opportunities and partnerships. Further up the supply chain, Ukraine has developed a strong expertise in semi-hard cheese production, and is second only to China globally in fermented dairy output growth between 2000-2012. On the potential side, the Ukrainian dairy industry should probably do more to explore market opportunities in fat-filled powders and whey products.
4. **Learn from the expansion bubble of the past decade** — The global dairy industry has grown considerably in the past decade. This gives Ukraine the opportunity to review and explore different options that would best suit local conditions. For example:
 - a. Continue to develop large-scale farming that focuses on low production costs so as to create the potential for a vibrant Ukrainian export industry?
 - b. Explore the possibility of medium- to large-scale on a grass based grazing platform? 13% of Ukrainian land is used for hay and pastureland. Could some of this land be used for the development of large-scale pasture based dairy farming in Ukraine?
 - c. Encourage a viable family farming model. Balanced with large-scale farming, is there an option for viable family farming units in Ukraine? For example 99% of all dairy farms in Ireland are family owned private farms. A farm with 100 cows in Ireland in 2013 would have generated sales of close to €250,000
5. **The opportunities and the potential success described above will not come overnight.** There is a need for a strong Dairy and Rural Development Policy to help build a world class dairy sector:

Expected Dairy Consumption Growth — 2010 to 2020 (billion kgs of milk)



Source: Rabobank



- a. A strong rural dynamic needs to exist to attract hi-calibre personnel into the industry. Dairy farming is complex, and is dependent on a broad skillset and infrastructure to make it successful, e.g. husbandry experts, genetics experts, nutritionists, veterinary, equipment suppliers, feed suppliers etc.
- b. Develop legal structures that facilitate dairy farming partnerships with overseas investors and service providers. This will help strengthen the industry via knowledge transfer and technological know how dissemination.
- c. Explore the possibilities of large-scale sovereign investment. It would appear that countries in the Middle East and China do not have the natural resources to satisfy their domestic demands for dairy products. Ukraine is one of the few countries globally with the land and water resources to develop dairy farming and processing capability to help satisfy the food security demands of these countries in the future. ■





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MEAT: IMPORT DEPENDENCE REDUCED

By results of 2013, meat production in all types of farms amounted to 2,397.9 thousand tonnes in slaughter weight, which is 8.5% more than in 2012. The largest growth rate was demonstrated by pig industry — 19% increase of output. Poultry production in agricultural enterprises increased by 12.4% and amounted to 975.7 thousand tonnes in slaughter weight.

Growth of domestic meat production helped to reduce the country's dependence on meat supplies from abroad. The volume of imported meat was reduced down to 225 tons (31% less than the volume of imports in 2012). Supply and consumption of domestic meat is increasing every year, which is positive for food security.

Supply and consumption of beef are lower than those of other types of meat in Ukraine. However, 99% of beef on the market is of Ukrainian origin. In addition, almost 24 thousand tons of beef were exported in 2013 (exclusively to the CIS countries).

In the structure of consumption of pork meat, imports amounted to 20% in 2013 which is 11 % lower than a year before. At the same time, pork exports decreased 4.4 times. A temporary ban on the import of pork from Brazil (from late March to mid-June 2013) has contributed to this situation as well. Besides, this allowed the USA to increase rapidly their share in the structure of pork imports (total imports of 13.2 thousand tonnes). According to different estimates, Ukraine will be able to further increase pork production and completely replace imports in the medium term.

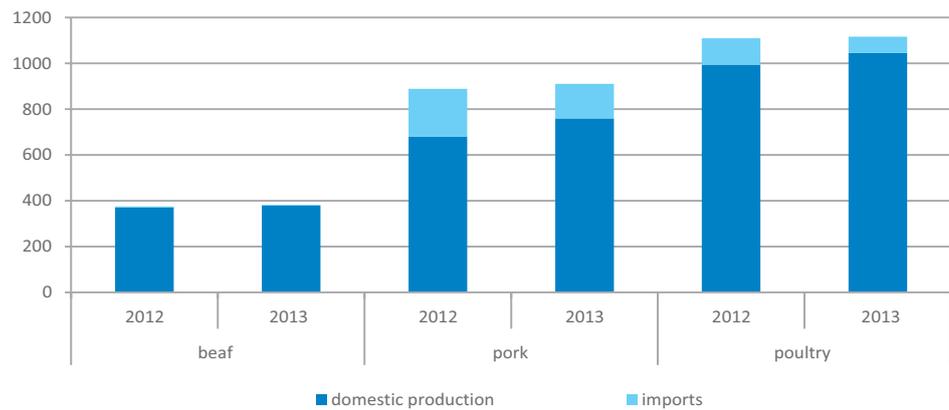
Demand and supply balance of meat in Ukraine

	2012	including:				2013	including:			
		beef	pork	poultry	other		beef	pork	poultry	other
Demand	2535,7	392,3	908,5	1189,3	45,62	2622,9	406,3	914,8	1261,9	39,94
Domestic market — total	2418,1	375,6	888,3	1108,6	45,62	2449,1	382,6	910,2	1116,4	39,94
including:										
end consumption	2408,1	371,6	885,3	1105,6	45,62	2439,1	378,6	907,2	1113,4	39,94
other consumption	10	4	3	3	0	10	4	3	3	0
Exports	117,6	16,7	20,2	80,7	0	173,8	23,7	4,6	145,5	0
Supply	2535,7	392,3	908,5	1189,3	45,62	2622,9	406,3	914,8	1261,9	39,94
Domestic market — total	2209,6	388,5	700,8	1074,7	45,6	2397,9	402,6	764,6	1190,8	39,94
including:										
own production	2209,6	388,5	700,8	1074,7	45,6	2397,9	402,6	764,6	1190,8	39,94
stocks	0	0	0	0	0	0	0	0	0	
Imports	326,1	3,8	207,7	114,6	0,02	225	3,7	150,2	71,1	0,04

Source: data of market players, calculations of UCAB

Domestic poultry production in the structure of consumption was 93% in 2013. Ukraine is self-sufficient in chicken meat but, because of the high demand for cheap raw material in the meat industry, poultry imports still remain significant, even though every year decreasing. Growth of poultry production in Ukraine will allow increasing of exports and growth of the local share on the market. In 2013, Ukrainian poultry producers managed to make first deliveries of chicken meat to the EU markets and expand the geography of exports to more than 80 countries in total. By results of 2013, Ukraine entered the list of top-10 poultry meat exporting countries and is planning to sustain its positions on the global market in 2014.

Consumption of meat in Ukraine, thousand tons



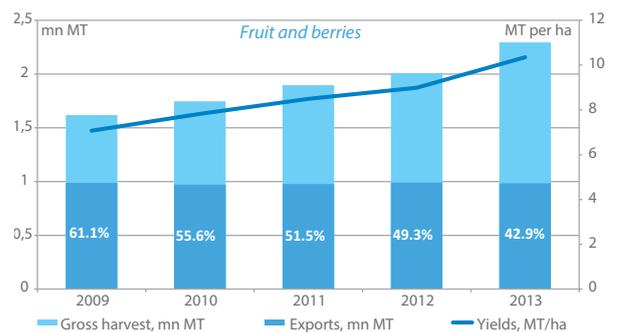
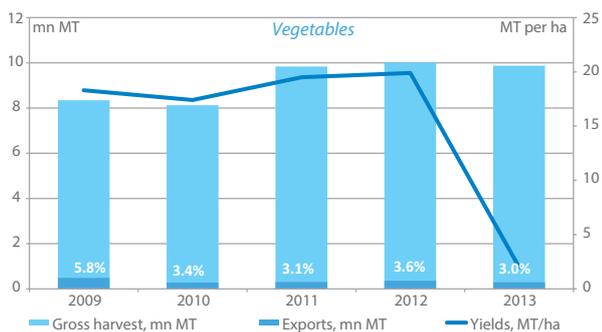
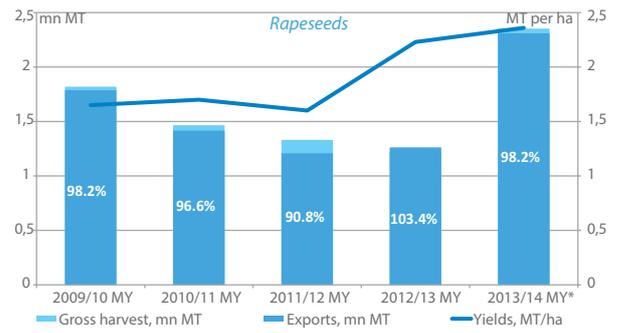
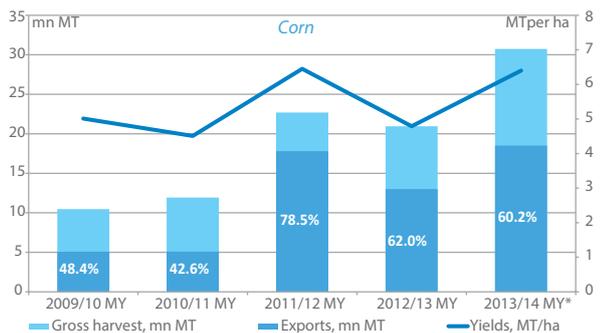
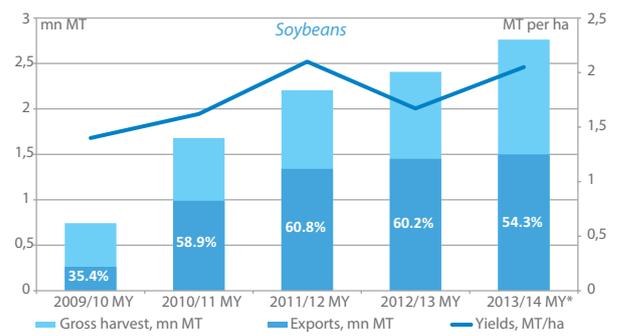
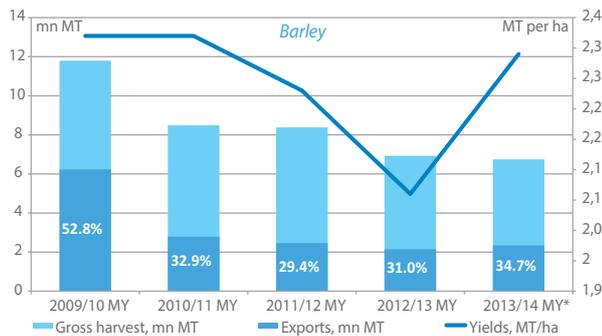
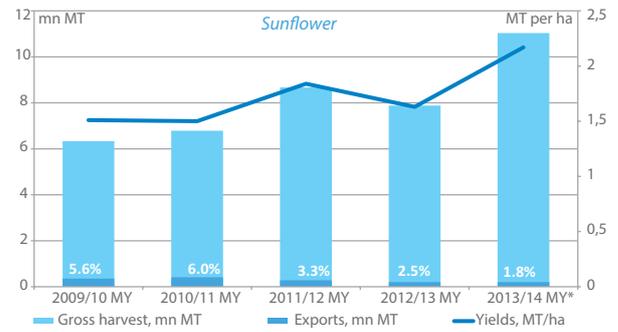
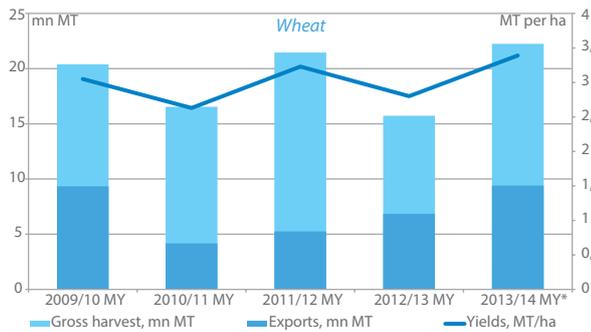
Source: State Statistics Service of Ukraine

What can we expect from the meat market in 2014? The predictions are as follows:

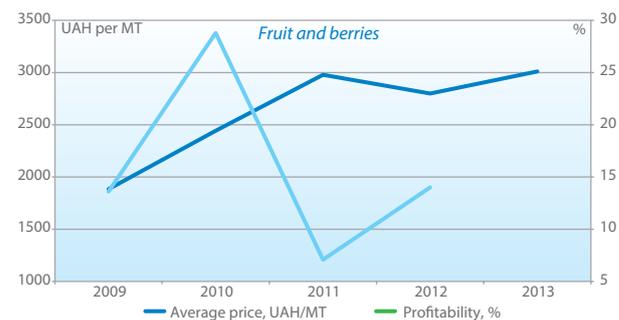
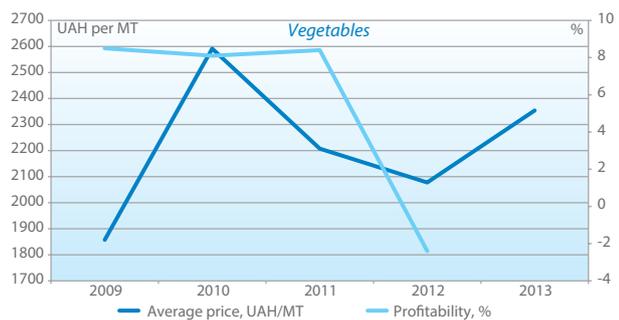
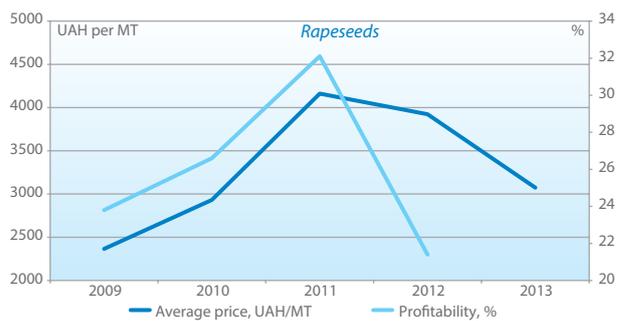
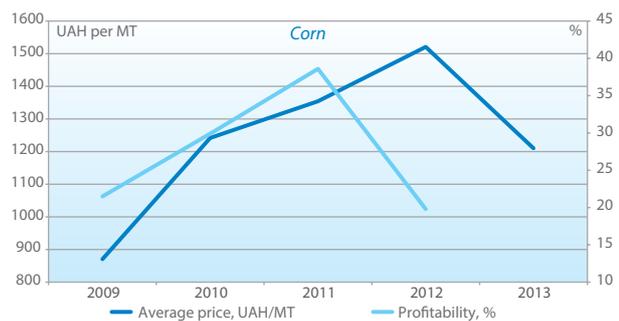
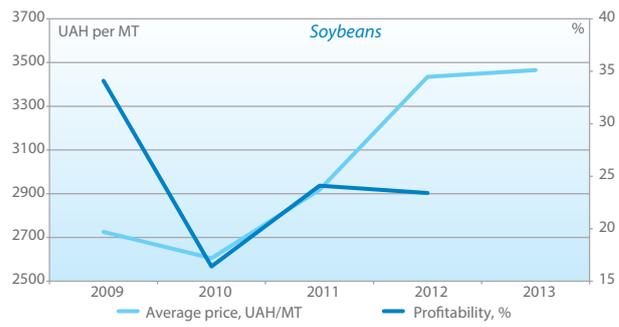
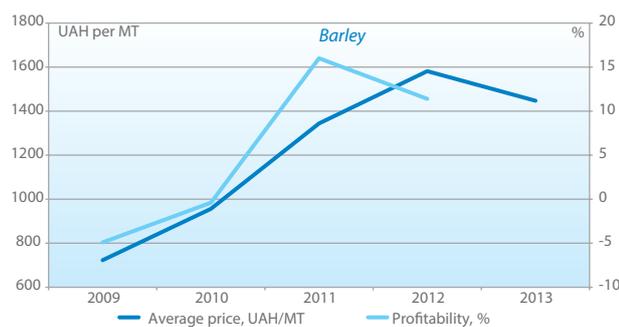
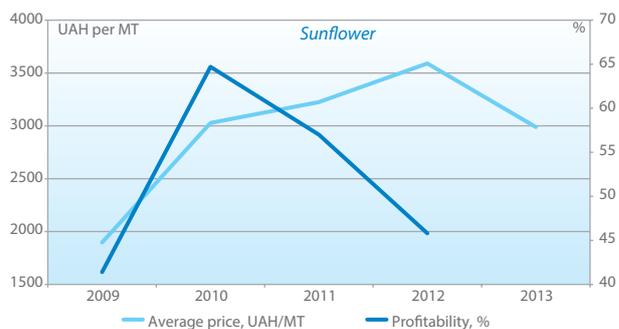
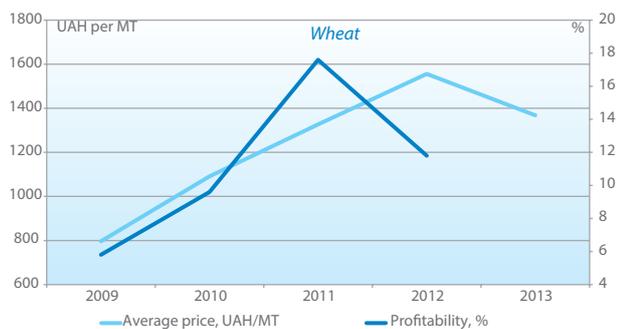
- increasing pork and poultry production but the growth rate lower than in 2013 due to the difficult economic and political situation in the country;
- reduction of beef production. Already at the beginning of the year, a considerable decrease of cattle is observed;
- growth of exports of poultry meat. Poultry producers are planning to continue their entry to the EU and Asian markets;
- reduction of imports of all types of meat. The devaluation of hryvnya will raise the price of imports and make local producers more competitive;
- favorable feedstuffs prices will allow for production cost cutting. ■

UKRAINIAN AGRICULTURAL MARKETS IN FIGURES

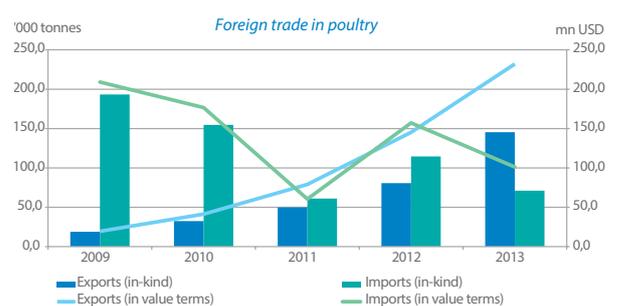
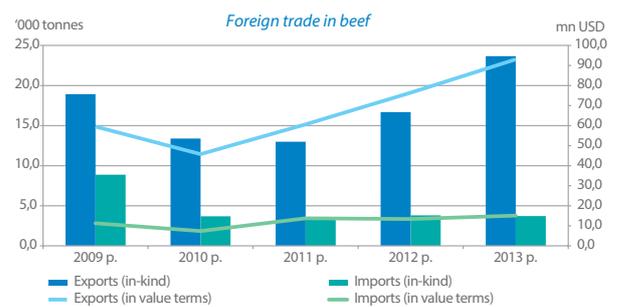
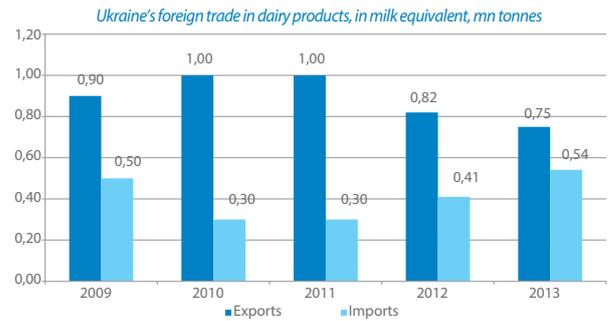
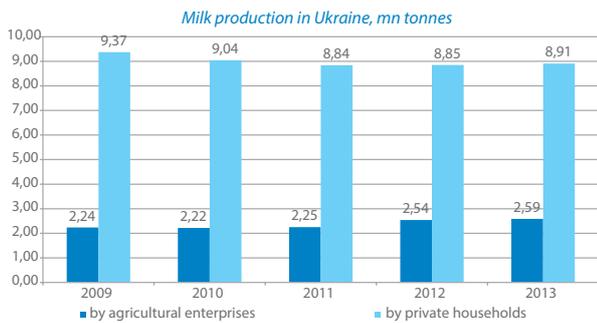
CROP PRODUCTION AND FOREIGN TRADE



CROP PRODUCTION: PROFITABILITY AND PRICES



LIVESTOCK PRODUCTION AND FOREIGN TRADE



CLIMATE CHANGE IN UKRAINE

OBSERVED AND PROJECTED CLIMATIC CHANGES ON THE TERRITORY OF UKRAINE

Yulia OGARENKO

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According to the studies of Ukrainian Hydro-Meteorological Institute (UHMI), annual average air temperature increased by about 1°C (compared to the period 1961-1990) over the last 20 years (1991-2013). In addition, record in the last 100 years monthly average temperatures (including both highest and lowest averages) were observed. However, temperature change patterns vary greatly from month to month and region to region. The highest increase of monthly average at 3°C was observed in the North-East and East of Ukraine in January while in Zakarpattya region (West of Ukraine) it rose to 1-1.4°C. In September, temperature did not change considerably while it decreased to 0.1-0.5°C throughout the whole territory in December. Moreover, increased frequency and intensity of extreme weather events stemmed from changes in atmospheric circulation and thermal regime was observed for the period from 1971 to 2010. Temperature increase in wintertime resulted in the upward trend in frequency of rain with sleet. Heavy snowfalls were also observed more often. High temperatures in the warm period of the year triggered an increase in a number and severity of heavy rainfall events, storms and hail.

In the near future (2011 -2030), quite opposite trends in the change of thermal regime depending on the month are projected. The most significant temperature change (comparing to present time) is likely to experience the East. The temperature might decrease in March (up to $-0.3^{\circ}\text{C} \pm 0.3^{\circ}\text{C}$) and quite possibly in January and February (up to -0.5°C). From April to May, the temperature might increase up to $0.3^{\circ}\text{C}-0.4^{\circ}\text{C} \pm 0.3^{\circ}\text{C}-0.4^{\circ}\text{C}$. However, a clear trend of temperature increase ($0.8^{\circ}\text{C}-1.3^{\circ}\text{C} \pm 0.4^{\circ}\text{C}-0.6^{\circ}\text{C}$) is projected starting from June by the end of the year. In the mid-term (2031-2050),



climate change projections show unequivocal increase of monthly average temperatures during the whole year. Winter season is likely to be much warmer with maximum temperature increase in December ($+2.2^{\circ}\text{C}\pm 0.4^{\circ}\text{C}$ across Ukraine). By the end of 21st century, temperature is projected to rise on average by $+3.2^{\circ}\text{C}\pm 0.6^{\circ}\text{C}$ in summer. Maximum temperature increase is expected in the South region in summer (up to $+4.3^{\circ}\text{C}\pm 0.6^{\circ}\text{C}$ in July) and in the North in winter ($+4.1^{\circ}\text{C}\pm 0.6^{\circ}\text{C}$ in December). Overall, projected changes of monthly and annual average temperatures could be an indicator of important seasonal changes (beginning and duration of the season), which should be taken into account especially in the planning of agricultural and energy sectors of the economy of Ukraine.

Modeling of changes in precipitation over three time horizons mentioned above shows that monthly sums of precipitation are likely to increase in winter and spring, especially in the North and East of the country. At the same time, summer rainfall will decrease almost in every region of Ukraine except for the western regions. It should be noted that this tendency will be intensified with time and decline in precipitation could reach 10% in the South of Ukraine by the end of 2030. By the middle of the XXI century a 10% decrease in precipitation could be spread further to several Eastern and Central regions of Ukraine and reach even a 20% drop in Zaporizhzhya. 80% of the territory of Ukraine might face rainfall decrease in summer by the end of 21st century. Though UHMI pilot studies provided insights into general trends of climatic changes over the territory of Ukraine, further research is needed to improve modeling techniques and increase reliability of results.

WHAT ARE THE LIKELY EFFECTS OF CLIMATE CHANGE ON AGRICULTURAL SECTOR IN UKRAINE?

Cumulative impact of climate change on agricultural sector depends on combination of factors, particularly, physiological productivity, disruptive weather events and availability and affordability of measures to compensate for unfavorable climatic conditions (e.g., irrigation). Although increased solar radiation could stimulate physiological productivity of crops, alteration of precipitation patterns and extreme weather events could undermine an expected increase in yields.

According to the 6th National Communication on Climate Change of Ukraine, expected changes of climate are likely to be favourable for key grains, which could bring a gross harvest of 85-90 million tonnes by 2050 if adaptation measures are implemented successfully. For example, productivity of winter wheat could increase by about 26% for the period from 2030 to 2040 (compared to base period 1995-2009). However, climate change poses a number of risks listed below which could seriously threaten agricultural production:

- increased frequency and severity of droughts during the vegetation period (including droughts combined with extremely high temperatures), which in some cases could result in harvest losses up to 40-60%;
- increased frequency of extreme weather events during the warm period of the year (heavy rains, thunderstorms, etc.);
- reduced frequency and increased intensity of precipitation, which prevents accumulation of soil moisture and impairs conditions for harvesting;
- increased number of winters with unstable snow cover combined with reduced temperature could increase the risk of crop failure;
- increased risks of damage of crops by pest attacks, which could reduce productivity by 20-30%;
- increased risks of soil cover instability, particularly, development of water erosion.

It should be noted that harnessing the opportunity of increased crop productivity with minimum losses due to disruptive weather events depends on the effectiveness of adaptation policies implemented by the Government as well as proactive business initiatives, which are discussed below.

WHAT IS THE ROLE OF THE GOVERNMENT IN ADAPTATION TO CLIMATE CHANGE?

The role of the state in adaptation to climate change, particularly in agricultural sector, could be focused on several aspects. First of all, the government is responsible for the long-term economic development of the country and, thus,

should foresee and be prepared to counter any threats, including climate change. It should coordinate activities across all sectors of the economy to ensure that adaptation measures in one sector do not intervene with the policies and development of others. Public funds should be secured in the state budget on the necessary research programmes to obtain the most precise assessments possible of observed climatic changes and its impacts on the economy of Ukraine, which should form the basis for the development of the country-wide strategy.

Moreover, state aid might be indispensable in dissemination of information and provision of training and extension services to agricultural producers on sustainable farming practices and available adaptation techniques. Finally, policy framework should provide flexibility for the business to take measures required for adaptation either in response to expected medium or long-term climatic changes or in response to short-term unfavorable weather events. In 2005, the Cabinet of Ministers of Ukraine declared the need for the development of the National Climate Change Adaptation Plan as well as regional plans of actions within 5 years. However, little progress was achieved by 2010. Hence, this task was set again in the Decree of the President #1119/2010 on the decision of the National Security and Defense of Ukraine. Since then, several versions of the plan were developed and discussed with various stakeholders but final version was not yet approved due to difficulties related to estimation and securing of required funds. However, the State Environmental Investment Agency of Ukraine approved the plan of priority measures on adaptation to climate change for 2012, which aimed to establish scientific and institutional basis for implementation of the state policy on climate change. A number of research projects were carried out (though not all results are published, yet) including the development of climate change scenarios for Ukraine in the medium- and long-term, spatial analysis of trends in the frequency and severity of extreme meteorological events, climate change impact assessment of productivity of grains and forest plantations, etc. In addition, a number of regional workshops were organized for government officials and other stakeholders and guidelines on identification of adaptation measures were developed for central and local authorities. Interdepartmental Working Group on Adaptation to Climate Change⁶ is working on the development of the adaptation strategy, which aims to integrate adaptation measures into state policies in particular area and also gradually implement short-, medium- and long-term measures depending on the availability of funding. Although nor strategy, neither plan on adaptation to climate change is approved at the national level, a regional plan is already available for Donetsk region and adaptation strategy for Kyiv region is in preparation.

To conclude, the government has already made first steps on the development of adaptation strategy to climate change, though specific policies and measures, particularly in agricultural sector, are yet to be developed. The government could play an important role in stimulating research in selection of crops and animal breeds, providing state aid for the development and implementation of innovative technologies and insurance solutions for adaptation to climate change.

WHAT AGRIBUSINESS IS ALREADY DOING TO ADAPT TO CLIMATE CHANGE?

As specified in one of the above sections, climate change brings opportunities to increase productivity of grains but more frequent weather extremes could significantly damage

⁶ It operates within the Interdepartmental Commission for the Implementation of the UN Framework Convention on Climate Change.

expected harvests. Thus, effective adaptation means timely identification of both risks and opportunities with subsequent implementation of certain actions to avoid or minimize negative effects of the former and take the advantage of the latter. Considering that the range of climatic changes as well as of resultant impacts across different scenarios and models varies considerably, agricultural businesses have to develop their adaptation strategies in situation of high uncertainty. Thus, win-win solutions should be implemented in the first place, which should help increase productivity on one hand and reduce risks and increase the resilience of agricultural producers to climate change on the other.

Despite the fact that the development of adaptation strategies by national governments is implemented with quite different pace, leading agricultural businesses across the world are investing significant resources in selection of stress-tolerant crops and introducing water-efficient technologies. It is clear among the businesses that the companies, which are the first to identify and address emerging risks, will be better positioned on the market than their competitors. Continuously increasing number of products and solutions to assist companies in adaptation to climate change are already available on the market. In addition to changing of growing patterns and spreading the risks through diversification of production, the key examples of adaptive practices and approaches which are being implemented by businesses are recorded in the database of the United Nations Framework Convention on Climate Change..

Business adaptation measures to climate change

Adaptation practice	Explanation
Production risk assessment	Assessment of climate change risks at a site the company is operating and designing specific actions within company's business planning.
Supply chain risk assessment	New tools to assess risks and sustainability of supplies in light of climate change are now being designed and implemented.
New traits and varieties of crops	Development and application of stress-tolerant plants (including technologies of genetic engineering) which are more resistant to weather extremes, e.g., abnormally high or low temperatures, water scarcity).
New products to increase stress-tolerance of crops	A number of companies are designing crop protection agents, which help to enhance crop tolerance to abiotic stresses and, thus, safeguard yields.
Resource efficient technologies	Application of resource efficient technologies (e.g., energy, water, input materials) helps to reduce production costs and increase resilience of farmers to stress-factors, which might be linked to climate change. In particular, implementation of precision (or drip) irrigation systems helps to improve resilience of farmers to water scarcity through efficient use of water resources.
Efficient greenhouses	Installation of energy and water efficient greenhouses (powered by renewable energy if possible) extends growing season and, thus, helps to reduce business risks or secure supplies of raw materials in case of serious yield damage due to droughts or other unfavorable weather events.
Innovative insurance schemes	Considering that traditional crop insurance schemes are usually very costly to administer (especially costs on assessing crop damage) and might not be commercially viable to all farmers, an innovative insurance approach was developed in India. Strong correlation between crop yield and rainfall underpins weather index-based insurance. Thus, expensive assessment of crop damages could be avoided because insurance payments are made when rainfall is lower than a certain threshold. This approach helped to reduce transaction costs considerably and, thus, make it more affordable especially to small producers.

About UCAB



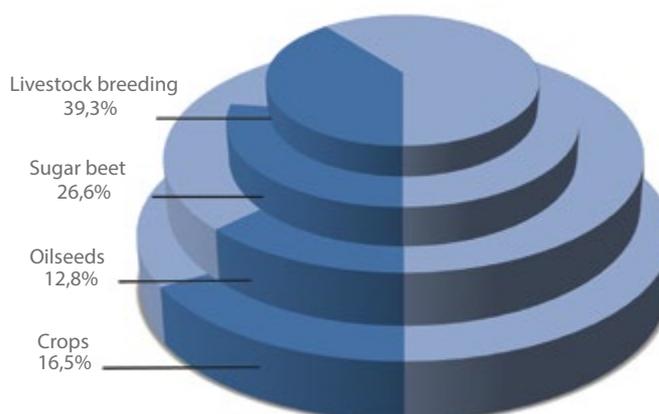
Association "Ukrainian Agribusiness Club" (UCAB) — is the association of leading agro-industrial companies in Ukraine, founded in 2007. The aim of UCAB is to defend the interests of agri-food market players and provide high quality services. In 2013, the important role of UCAB was traditionally confirmed by an increasing number of members.

UCAB aims to improve business environment and conditions for doing of agribusiness in Ukraine. The activities of UCAB cover almost all services necessary for agribusiness, ranging from search for personnel and investors to global issues such as increase of efficiency of agricultural production and the development of proposals for improvement of agricultural policy. Membership in the Association "Ukrainian Agribusiness Club" provides companies with a number of advantages such as provision with timely and updated information about agri-food markets, knowledge sharing, and advise in solving many practical problems.

In 2013, UCAB successfully holds the status of the Association #1 in the agricultural sector of Ukraine, bringing together 80 iconic representatives of the industry. In addition to services such as executive search, marketing, research, interaction with mass media, we have considerably increased our activities in the sphere of informing UCAB members about the preparation and approval of legislative and regulatory documents.

UCAB members represent all sub-sectors of agriculture in Ukraine and, in most cases, occupy leading positions in their spheres of activities.

Share of UCAB members and partners in agricultural production in Ukraine



In particular, they use more than 4.8 million hectares of farmland, representing 23% of the total land area in the use of agricultural enterprises in Ukraine; among agricultural enterprises, they produce 16.5% of the total output of grains, 12.8 % of oilseeds, 26.6% of sugar beet and 39.3 % of all livestock products. The share of agricultural products produced by UCAB members in Ukraine's agricultural GDP is 15%.



Input producers-members of UCAB are holding leading positions on the markets of agricultural machinery, crop protection products and seeds. Financial institutions-members of UCAB are leaders in the sphere of financing of agriculture in Ukraine.

UCAB activities are systemized in several **committees**. A UCAB Committee is a group of professionals and members of the Association, which is responsible for monitoring, analysis, information and lobbying in a particular area of agricultural production and input supplies.

The following committees are functioning within the UCAB structure today.

Committee on Engineering and Agricultural Technologies

The Committee was founded upon the initiative of key players of the agricultural machinery market in Ukraine, UCAB members, in order to support the improvement of business environment in the agricultural machinery market, discuss and propose improvements of specialized exhibitions, coordinate the exchange of useful information between the members of the Committee and others.

Agrochemical Committee

The Committee was established upon the initiative of the major global producers of crop protection products, which operate on the Ukrainian market, members of UCAB, in order to enable market access conditions for crop protection products, improve business environment, exchange experience and useful information between the members of the Committee and others.

Committee of Distributors of Crop Protection Products

Establishment of the Committee of Distributors was initiated by the local market leaders, UCAB members, in order to improve working conditions in providing farmers with crop protection products, enable deregulation of the market, as well as to exchange useful information and experience.

Legal Committee

Upon the initiative of the member companies of UCAB, the Legal Committee was established in 2013. The primary purpose of the Committee is comprehensive analyses of the legal framework and new legislative initiatives in order to develop a common position on specific issues that are important for regulation of agribusiness, impact on the legislative process and changes of regulatory field in the direction of liberalization and transparency of regulation of agribusiness.

About UCAB Service



UCAB Service — is the service partner of the Association “Ukrainian Agribusiness Club”. UCAB Service has a matrix structure, which includes three agencies that provide a full range of services for UCAB member companies and for all stakeholders: input suppliers, agricultural producers, food industry, food retail, international organizations, financial and academic institutions. UCAB Service agencies include: AgriEvent, AgriSchool and AgriSurvey.



The event agency which provides services and professional organization of business events, both private and corporate (conferences, seminars, round tables, business tours, B2B-meetings, etc.). Location search, selection and room rental, logistics, transport service, catering, etc. Since 2010, the agency has organized more than 110 national and international conferences and forums involving more than 10,000 visitors from 30 countries, in cooperation with leading Ukrainian and multinational companies, embassies, ministries and research institutions.



The project is dedicated to solving the problem of lack of modern knowledge and training in agricultural enterprises. It aims to improve professional skills of agricultural producers in key areas of agribusiness with a minimum extraction of specialists from the production process. Since 2012, AgriSchool has launched the following educational directions: Crop Production; Horticulture and Berries; and Management of Dairy Business. The agency organized more than 25 training workshops which were attended by more than 300 students. Besides, a series of corporate training seminars for leading agricultural companies in Ukraine were provided.



The agency provides multi-client and individual marketing and business consulting services to the agricultural and food sector companies; conducts qualitative and quantitative marketing research, economic analysis, business planning; develops market entry strategies, etc. Advantages of the agency include the team of highly qualified professionals in the field of agribusiness and a regularly updated database with over 10,000 contacts in the agricultural sector of Ukraine. Since 2010, the agency has conducted more than 100 studies, made about 18,000 individual telephone and face-to-face interviews with top managers of Ukrainian agricultural enterprises.



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