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Food Processing Ingredients Sector

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Report Highlights:

Ukrainian Market for food ingredients is expanding rapidly, but US suppliers are likely to face strong competition from EU-25 countries. Steadily growing incomes of Ukrainian population of 47 million sparked a boom in the domestic food industry, which is trying to satisfy domestic demand for innovative and high value added products. The majority of Ukrainian buyers prefer locally produced products, but this preference does not much affect the market for inputs.

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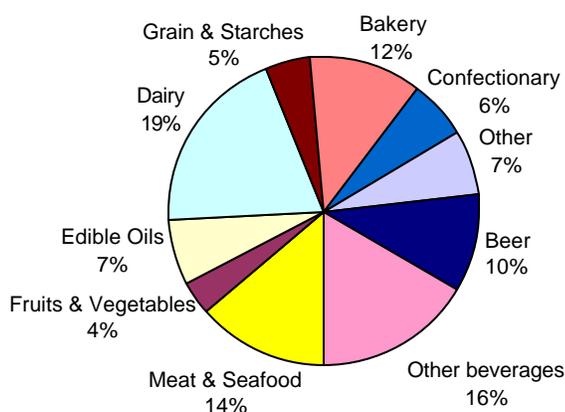
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SECTION I. MARKET SUMMARY

Ukraine ranks among the largest countries of Europe and boasts a population of about 47 million. With rich black soil, a favorable climate, Black Sea ports, and close proximity to the major consumer markets of Europe, the Former Soviet Union (FSU), North Africa and the Middle East, Ukraine may become an agricultural powerhouse of Eastern Europe. The country's vast agricultural potential provide Ukraine with excellent preconditions for strong economic growth in agricultural sector. The food-processing sector in Ukraine has developed rapidly in the last 5 years. The share of the food industry in GDP reached 5.1% with food industry share in manufacturing of 18.3%. In 2001, the industry grew by 26.0%, with a slowdown to 8.4% in 2002 and 6.0% in 2003. The fastest growth rate is observed in fruit and vegetable processing, edible oils production, pastry and biscuits, baby food and alcoholic beverages production.

Ukrainian Food Processing Sub-Sectors*



Source: State Statistics Committee of Ukraine

*By volume of the produce; tobacco industry is not included

More than 95% of all foodstuff consumed in Ukraine is produced domestically. Domestic production and consumption of most food and agricultural products in Ukraine are currently about half of that during the last years of the Soviet era. Between 1990 and 2002 consumption of meat, dairy products and fruits contracted the most sharply.

Table 1. Ukraine: Per Capita Annual Consumption of Major Food Products in kilograms. Percent Change 1990/2002.

Product	1990	1999	2000	2002	Change
Meat and meat products	68.2	33.0	32.5	33.0	-51.6%
Dairy products	373.2	209.9	197.7	223.0	-40.2%
Eggs, per unit	272.0	163.0	164.0	207.0	-23.9%
Bread products	141.0	121.8	124.1	130.0	-7.8%
Potatoes	131.0	121.9	134.5	130.0	-0.8%
Vegetables	102.5	95.9	101.0	108.0	5.4%
Fruit	47.4	22.1	29.1	28.0	-40.9%
Fish and fish products	17.5	7.2	8.3	11.1	-36.6%
Sugar	50.0	32.6	36.5	36.0	-28.0%
Vegetable Oil	11.6	8.9	9.3	10.4	-10.3%

Source: State Statistics Committee of Ukraine

At the end of 2003 the Ukrainian food processing sector was comprised of 2881 big industrial enterprises with gross output over 39 billion UAH (\$7 billion US) in 2002. Ukraine also has over 6,700 small and medium enterprises (with less than 50 employees and less than € 0.5 million in annual gross revenue). Since 1991 only half of the enterprises made needed investments and changed their managerial practices to cope with a competitive market environment. Approximately 51% of food processing enterprises lost money in 2003. The food-processing network was developed in Soviet time and was designed for big scale production and subsidized inputs. The number of enterprises in sugar processing, dairy and meat packing greatly exceeds market requirements, given the significant reduction in raw supplies and structural changes in agricultural produce. An insufficient number of oil crushing enterprises was quickly remedied by new enterprises build by big transnational companies and the complete renovation of old enterprises. Grain handling and processing facilities were also renovated with a number of export-oriented port terminals built from scratch.

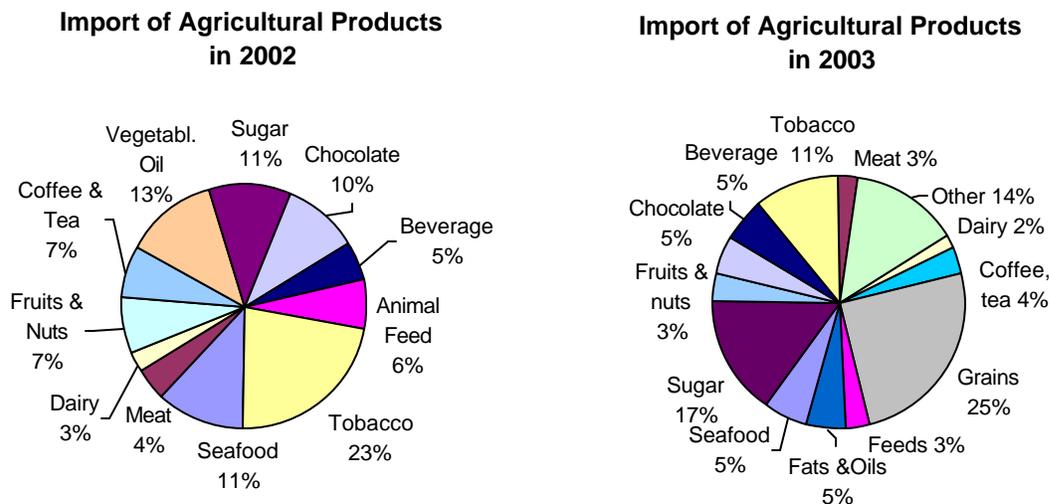
The average Ukrainian dairy processing enterprise is working at only about 52-57% of its capacity; pasta and bread producer at 51-60%; flour mill at 30-38%; fruit and vegetable processing or canning enterprise at 34-39% during the winter and spring and 60% during summer and autumn months (Survey of the processing industry conducted by World Bank / International Finance Corporation (WB/IFC). Thus many processors have substantial underused capacity and are capable of sharp production increases. Growing domestic demand for high quality goods eventually will lead to the increased import of ingredients and the production capacity to employ these imports will be in place.

A few big foreign and domestic producers dominate in many sub-sectors. The beer industry is dominated by 4 breweries responsible for 87% of the market, the confectionary industry – by 10 companies (over 70% of the market), dairy by 20-26 producers (over 70% of the market). Many of these big companies purchase their less efficient or smaller counterparts in different regions to expand production in new markets.

The total import of agricultural products to Ukraine in 2003 reached \$ 2.17 billion US (95% growth from 2002) with estimated import of food ingredients at \$1.52 billion US. It must be noted, that the year 2003 was unique due to extremely bad weather conditions and record low cereal crop. This resulted in massive grain imports, while in normal years Ukraine is a major grain exporter in the Eastern Europe. Also in 2003 parliament adopted unusually large raw sugar import quota, which resulted in import surge. In order to provide a more comprehensive sector overview import diagrams of both 2002 and 2003 are given below.

The export of ready-to-consume products was also growing. Competitively priced Ukrainian products sparked interest of price cautious buyers in Russia and other FSU countries, where Ukraine is struggling to restore its traditional markets. The export of processed food products reached \$1.3 billion US and continues to rise. This dramatically increases the demand for ingredients and opens new opportunities to US suppliers, which can extent their exports at the expense of the FSU markets.

The import of food ingredients to Ukraine is complicated by high custom tariffs and other barriers such as sanitary and phytosanitary measures, compulsory certification of imports, outdated Ukrainian standards, corruption, non-transparent and quickly changing legislation. The lack of clarity in the law means that it is difficult to understand actual non-tariff requirements for imported products. Even when a list of goods classified by HS 96 codes are provided, in many cases it is not clear why the control is applied. Ukraine is not a WTO member and does not use WTO consistent approaches either in tariff or in non-tariff regulations. Timing and conditions of membership are not yet known and the introduction of WTO compliant practices in legislation is slow and sporadic.



Source: State Statistics Committee of Ukraine.

The macroeconomic situation in Ukraine is fairly stable. Since January 2000, the Ukrainian government has embraced a strong economic reform program and focused its attention on the most critical areas with broad economic and social impact. Robust GDP growth in 2000 of 5.9% was followed by 9.2% growth in 2001 and 4.5% growth in 2002 (21.2% growth over the three years). The increase was mainly the result of strong industrial output growth (especially in manufacturing), a surge in retail trade, and good agricultural performance. The Ukrainian currency "hryvnia (UAH)" is unofficially pegged to the U.S. dollar, so the exchange rate is very stable and business is not a subject to exchange rate fluctuations. Inflation in the country is somewhat higher than in US and ranges from -0.6% (deflation) in 2002 to 8.2% in 2003.

Economic growth has now expanded from traditional industrial export goods to encompass agriculture, construction, and food processing. Privatized companies have figured prominently in this economic expansion. Agriculture has been significantly strengthened after the elimination of the collective farm system. Macroeconomic stability bodes well for increased imports in 2004 and beyond.

Imports of Agricultural Products

Nearly 97% of foodstuffs consumed in Ukraine are produced domestically. These products include meat, poultry and dairy products; macaroni, confectionery and bakery products, alcohol and non-alcoholic drinks, canned meat and vegetables.

Table 2. Ukraine: 10 Major Imports of Foodstuffs, CIF Value (US \$1000).

#	HS Code	Product Description	2002	2003	% Change
1	100190	Wheat except durum wheat	423	462,983	109,414%
2	170111	Raw sugar, cane	71,466	290,214	306%
3	240120	Tobacco, unprocessed, stemmed or stripped	107,377	123,227	15%
4	210690	Food preparations nes	48,406	66,042	36%
5	220820	Spirits obtained by distilling grape wine, grape	8,661	63,735	636%

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6	151190	Palm oil or fractions simply refined	42,365	39,585	-7%
7	210111	Coffee extracts, essences, concentrates	18,584	38,101	105%
8	240220	Cigarettes containing tobacco	23,639	37,126	57%
9	020714	Fowls, cuts & offal, frozen	24,125	35,922	49%
10	240310	Cigarette or pipe tobacco and tobacco substitute mixe	27,607	32,065	16%
	HS 1-24	Total	1,113,761	2,173,704	95%

Source: State Custom Committee of Ukraine.

Food products imported into Ukraine are mainly those not produced domestically. Among these products are:

- Coffee, tea and snack foods
- Canned fruit
- Canned vegetables
- Gourmet/delicatessen meat and fish products
- Chocolate products
- Cheese and yogurt
- Baby food
- Alcoholic beverages
- Juices
- Olive oil

Table 5. Ukraine: 10 Major Commodities Exported to Ukraine from the United States, CIF Value (1,000 US\$)

#	HS Code	Product Description	2002	2003	% Change
1	240120	Tobacco, unprocessed, stemmed or stripped	23,920	13,837	-42%
2	170111	Raw sugar, cane	864	3,482	303%
3	210690	Food preparations nes	1,304	2,304	77%
4	100630	Rice, semi-milled or wholly milled	209	1,988	849%
5	100190	Wheat except durum wheat	0	1,974	n/a
6	220710	Non denatured ethyl alcohol >80% by volume	0	1,902	n/a
7	020714	Fowls, cuts & offal, frozen	7,022	1,718	-76%
8	240391	Homogenized or reconstituted tobacco	1,135	1,579	39%
9	170230	Glucose, glucose syrup <20% fructose	929	1,245	34%
10	230910	Dog or cat food (retail)	739	1,136	54%
	HS 1-24	Total U.S. Exports	59,443	46,804	-21%
	HS 1-24	U.S. Share in the market, Total	5.3%	2.2%	-60%

Source: State Custom Committee of Ukraine.

The Ukraine - U.S. trade in food products and ingredients is not very large. This leads to highly volatile data and unclear prospects for individual U.S. commodities and commodity groups in Ukrainian market. The poultry import ban introduced in 2001 significantly changed the structure of trade, since poultry was the major U.S. food export commodity for a number of years. Growing imports of high value added commodities will follow a rise in consumers income above a certain level. So far U.S. suppliers supply mostly moderately priced goods for further processing. Imports of food ingredients, additives, seasonings, spices and fruit and vegetable products have increased significantly along with the sharp growth in Ukraine's domestic food processing industry.

Demand for inputs into food production is strong in the meat and dairy sectors, the beverage industry, and for such products as sauces, mayonnaise, margarine, juices and other non-alcoholic beverages. Growth is particularly strong for:

- Vegetable and fruit purees; dry concentrates
- Dried fruit including apricots, prunes and raisins
- Spices (pepper, vanillin, cardamom, cinnamon)
- Nuts (excluding hazelnuts and walnuts)
- Stabilizers, emulsifiers, flavorings, proteins, pigments, and other additives.

Tariffs and Import Taxes

Importers face a value-added tax (VAT), import tax, certain fees, and, if applicable, an excise tax (up to 300%). The VAT is levied at 20%, based on the customs value on the invoice. This is generally payable by the importer at the time of customs clearance. A promissory note can also be applied. Agricultural enterprises are exempted from VAT. They are also eligible for VAT tax refunds that are paid by the processor of milk and meat.

In January 2000, border checkpoints began collecting a new uniform customs duty, combining seven import fees: customs clearance, sanitary, veterinary and phytosanitary inspection, radiation, ecological control and other fees.

Ukraine employs a two-tiered system of general (full-rate) tariffs and preferential (partial-rate) tariffs. Imports from Western countries, including the United States, are usually assessed preferential tariffs. The current tariff schedule contain both *ad valorem* and minimal fixed (per 1 kilogram) import duties. The latter create serious problems for importers as many of fixed rates are unjustifiably high and often fail to make a distinction between cheap and expensive commodities. Import duties largely depend upon whether a similar item to that being imported is produced in Ukraine. If so, the rate tends to be higher. U.S. exports to Ukraine usually receive preferential customs rates if the following three criteria are met: (1) the company is registered in the United States; (2) the goods have a certificate to prove U.S. origin; and (3) the goods are imported directly from the United States.

Imports subject to an excise tax include alcohol and tobacco products. Excise duty rates are expressed as a percentage of the declared customs value, plus customs duties and customs fees paid for importing products.

Food and Agricultural Product Regulations

A veterinary inspection is required of all animal and food products as well as any other products, which could contain pathogenic organisms including:

- Canned meat, poultry and fish, cheese, butter sausages, baby food;
- Feed of animal and plant origin;
- Feed additives including animal and vegetable proteins, amino acids, vitamins, ferments, feed yeast and fats;
- Meat and poultry and their products, milk and milk products, egg products, fish products, honey.

Feed additives and feeds (including pet food) are also subject to compulsory certification by the scientific institution appointed by the GOU. Zero or minimum (€ 0.05/kg) tax rates are

fixed for most imported food products, which are not produced in Ukraine or produced in quantities below domestic demand. The tax rate on products produced in Ukraine varies from 10% to 30% or from €0.2 to €1.0 per kilogram.

Other Import Regulations

Non-tariff import regulations applied in Ukraine include:

- Import licenses
- Import quotas
- Registration of contracts
- Import restrictions/bans
- Certification
- Narcotic drugs control
- Veterinary, phytosanitary and ecological control

At the present time, import quotas are generally only applied for cane sugar imports.

Ukraine is not a Codex Alimentarius Commission member and maintains its own list of food additives allowed for human consumption. The list was adopted by the GOU decree in 1999 and last updated in 2001. Food additives not included in the list could not be imported to Ukraine separately or as an ingredient of another product.

A ban on U.S. poultry meat was imposed in January 1, 2002 and officially lifted in November 2003. However, talk of additional retaliatory actions against U.S. poultry, initiated by Ukrainian producers fearing increased competition and lower prices, has begun.

Table 6. Advantages and Challenges facing U.S. products in Ukraine

Advantages	Challenges
Ukraine's food sector is growing, revealing big opportunities for U.S. exports	Exports to a market in flux is risky
Rising incomes and changes in consumption patterns have led to increased demand for top quality high-value food products	Per capita average monthly income in Ukraine is still low and does not exceed \$90 US (478 UAH) as of yearend 2003
Insufficient quantity of domestically produced innovative high quality components for food industry	Severe competition of U.S. products with those from EU countries in close proximity
Bigger food producers are being formed through acquisitions and mergers	Majority of producers are price cautious and would not consider expensive components for mass production
Growth in direct foreign investment has led to increased utilization of imported food ingredients	High import tariffs, food safety regulations and sanitary and phytosanitary restrictions hamper the import of fresh produce and certain food ingredients
Ukraine's favorable geographic location promotes increased trade in processed food products to Eastern and Central Europe and the FSU	Underdeveloped domestic retail network with majority of foodstuffs sold through small stores and open air outlets
The growing popularity of U.S. fast food chains favors their existing procurement systems which source many food ingredients	It is difficult for U.S. products to compete on price with favored imports from free trade partners in the FSU

from the United States	
Ukraine looks to join the WTO by 2005. While accession will result in reduced tariff rates for food products, there will also likely be increased competition among potential suppliers of imported food products	Widespread corruption complicates exports to Ukraine significantly. Illegal imports of cheap food ingredients can cause a serious competitive threat to legal ones

SECTION II. ROAD MAP FOR MARKET ENTRY

Entry Strategy

There is no single market entry strategy recommended to new-to-market exporters. First, the exporter should define whether Ukraine is a key market for the product, or only insignificant occasional deliveries can be made. The following factors should be considered:

- The need for the product in the market, given consumers income trend and particular food sector development perspectives;
- Availability of the same or similar product produced domestically (often Ukrainian producers are capable of building barriers to trade by lobbying their interests in the GOU, Parliament or even veterinary or health inspection services).
- Availability of the same or similar products from EU or FSU as well as comparative advantage of U.S. product over competitive ones (e.g. quality, price, transportation expenses, packaging, labeling, etc.)
- Tariff and non-tariff regulations to the product. Note, that in many cases big Ukrainian food producers can lobby tariff reduction for much needed ingredients and can settle veterinary or SPS problems should they arise.

If Ukrainian market looks very promising it is recommended to establish a representative office to deal with buyers directly. Personal relationships are very important in Ukrainian business practices and few problems can be effectively resolved over the phone. It is a very common practice in Ukraine to do input purchases directly from the producer. Even if exporter's policy require work through the Europe or Russia based distributor most Ukrainian partners would try to contact producer directly.

In the past many U.S. companies dealt with Ukrainian partners through a representative office in Moscow. This is no longer very common. Note, that Ukrainian food components market is small at the moment and relatively few products could justify a representative office in Kiev. In this case the second market entry strategy can be recommended, which is used by the vast majority of U.S. exporters at the moment.

They work through a Ukraine-based importer or through the procurement service of the buyer (the latter is the most convenient if there are only 2 or 3 potential buyers). Due to frequent changes in Ukrainian legislation, non-transparent custom clearance rules, SPS and veterinary procedures, it is recommended to leave it to the Ukrainian partner's discretion. Ukrainian importers also take care of the whole logistic chain, inland transportation and distribution. There have been cases, when backed up by domestic processing industry, that importers were powerful enough to lobby tariff reduction (import of hops) or quota increase (cane raw sugar quota for 2003).

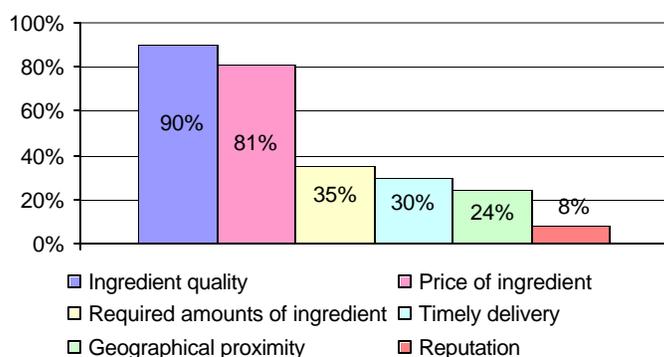
U.S. companies should approach potential Ukrainian partners with extreme caution. While the extent of information on Ukrainian companies has improved, there is still a significant dearth of background data and credit histories on potential Ukrainian distributors. This

presents the greatest obstacle to finding reliable, competent distributors. In order to obtain a due diligence report on a potential Ukrainian partner, a U.S. company is advised to contact either a law firm or use the services of the Dun & Bradstreet representative in Ukraine.

Selected products may enter the market under a different route, via a Ukraine-based U.S. intermediary who fits the distribution scheme better and works more effectively than Ukrainian importer. This could be the case if technical skills and expertise of the importer are not sufficient for product promotion.

WB/IFC survey show that the quality of inputs supplied for processing is the decisive factor influencing the choice of supplier by Ukrainian processors:

Significant factors influencing the choice of ingredient supplier by processing businesses, % of responses



Source: WB/IFC processing sector survey

WB experts note that the availability of the needed amounts of raw material is particularly important in the dairy sector, while timely delivery is more important for processors of fruit and vegetables. Geographical proximity was a factor for producers of mixed fodders. For closing ingredients supply contacts, the role of such factors as supplier's market reputation, personal connections and references of colleagues are not regarded as important.

Market Structure

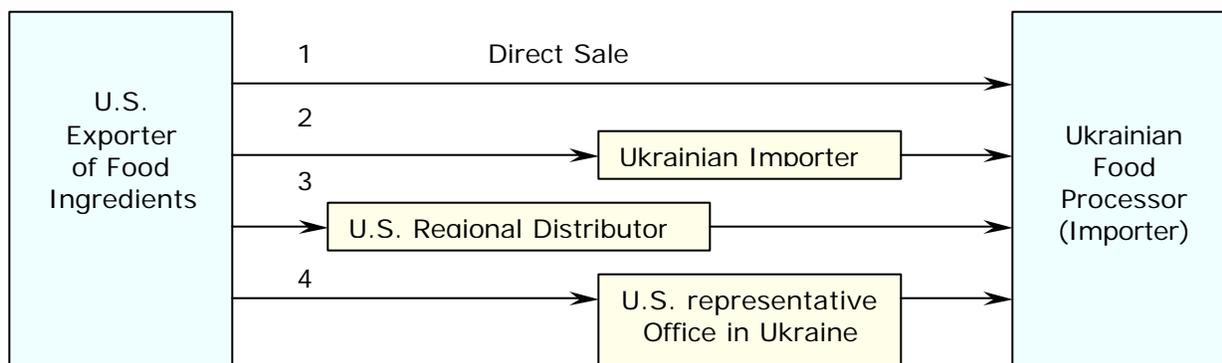
The Food Ingredients Distribution Chart summarizes all of the above. The majority of sales are done through the 2nd channel, with use of the Ukrainian distributor.

The U.S. Embassy in Kyiv strongly advises that all U.S. companies consider legal counsel before and while doing business in Ukraine. Ukrainian laws and regulations are vague and open to considerable leeway in interpretation, providing ample corruption opportunities for officials at every bureaucratic level. U.S. businesspersons are advised that partnership with a Ukrainian company is a challenge that is beyond the constant control of the U.S. partner and his legal advisors.

Regional projection is very important in Ukraine. The majority of exporters are concentrated on the market of Kyiv, where salaries (purchasing power) are the highest and the business climate is the most favorable. Kyiv is not the only hub of trade in Ukraine, though,. Look for distributors that have nationwide capabilities, including those in the cities of Lviv, Odesa,

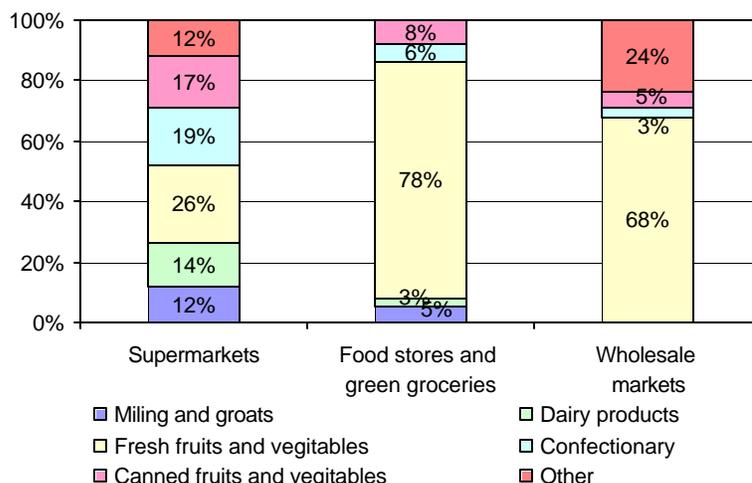
Zaporizhzhya, Donetsk and Kharkiv. These cities are in important industrial regions of Ukraine and are densely populated.

Food Ingredients Distribution



The proportion of imports in goods turnover in wholesale and retail chains varies both by specific commodity group and type of trade enterprise. Ukrainian supermarkets have the widest product mix and the biggest proportion of imports in all categories of goods. According to the industry survey conducted by the World Bank, the supermarkets and greengroceries tend to have the biggest portions of imported fresh fruits and vegetables on their shelves: 19% and 23% of their respective total turnovers. 13% of confectionery and 12% of canned products sold in supermarkets also come from abroad. Except for fruits and vegetables, food stores tend to stock products of mostly domestic origin. Imports' share in all other commodity groups is under 4%.

Proportion of Imported goods, percentage of overall import



Source: World Bank / IFC retail sector survey

Company Profiles

Almost all Ukrainian food processing companies were privatized during the first Ukrainian privatization campaign in 1994/98. The state still controls blocking shares in most of them,

but rarely use its voting power to influence managerial decisions. Since then property has been constantly redistributed from less efficient owners to more efficient ones. Minor shareholders in many cases have sold their shares to big financial groups capable of undertaking ambitious investment programs in order to replace Soviet outdated equipment and technology. In 1998-2004 many multinational holdings entered the market, purchasing the most promising enterprises in dairy, beverage, snack, and confectionary industries. Some local entrepreneurs were able to develop big and profitable businesses, which shape Ukrainian food processing sector nowadays. Small processing workshops that mushroomed in early 90's now can not compete with big players. Their market share is shrinking very fast.

Table 7. Major Ukrainian food producers

Product	Producer	Estimated Sales* \$1,000, (year)	Share in total output of the sector. %	End Use channels	Procurement Channels
Fish	Iceberg, Dnipropetrovsk	-	31.3	Retail and HRI	Direct
Red Meat and Poultry	Gavriliivsky Pptahivnychiy Complex, Kiev region	\$6,5000 (2003)	6.5	Retail and HRI	Direct, Distributors
	Mironovsky Hleboproduct (3 locations)	\$16,0000 (2003)	19	Retail and HRI	Direct, Distributors
	"YUNKERS", Donetsk Region	\$312 (2001)	22.6	Retail and HRI	Direct, Distributors
Dairy products	Shostkinskij M?skmolkombinat Sumy Region	\$7,408 (2001)	5.2	Retail and HRI	Direct, Importers
	Romenskij Molochnij Komb?nat Sumy Region	\$10,303 (2001)	2.7	Retail and HRI	Direct, Importers
	"Kmk Promserv?s" Kharkiv Region	\$1,205 (2001)	8.2	Retail	Direct, Importers, Distributors
	"Galakton", Kiev	\$34,353 (2002)	10	Retail	Direct, Distributors
	Laktalis- Ukraina, Mikolaev Region	\$8,192 (2001)	6.2	Retail	Direct, Distributors
Beer	"Obolon", Kiev	\$236,739 (2002)	22.4	Retail and HRI	Direct
	Sun Interbrew (3 Locations)	\$352,538 (2003)	33.8	Retail and HRI	Direct
	Bbh Ukraine (2 Locations)	\$174,409 (2002)	20.1	Retail and HRI	Direct
Hard Liquor, Vodka and Spirit	Soyuz V?ktan Ltd Crimea	\$17,012 (2001)	29.5	Retail	Direct, Importers
	Lokhvitskij Spirtokomb?nat Poltava Region	\$5,199 (2001)	6.7	Retail and HRI	Direct, Distributors
Sugar	Dubenskij Tsukrovij Zavod Rivne Region	\$294 (2001)	4.5	Retail and HRI	Direct, Importers
Starch dry	Dniprovsky Krahmalo-Patokovij Kombinat, Dnipropetrovsk Region	\$5693 (2001)	85.1	Retail and HRI	Direct, Importers, Distributors
Food concentrates (dry and condiments)	Tekhnokom Ltd, Kharkiv	\$12,745 (2001)	-	Retail and HRI	Direct, Distributors
Flour	Kiivmlyn, Kiev	\$22,804 (2001)	6.8	HRI	Direct, Distributors
Cereals	Skvirskij Kombinat Khlipoproductiv Kiev Region	\$2,507.5 (2001)	16.9	Retail and HRI	Direct, Distributors
Feed	Rozovsky Komb?kormovij Zavod Donetsk Region	\$5,561 (2001)	8.6	HRI	Direct, Distributors

Frozen Prepared Food	Herkules CJSC	\$1,470 (2003)	5.0	Retail and HRI	Direct, Distributors
	Aqua Trade	\$1,470 (2003)	5.0	Retail and HRI	Direct, Distributors
	Danika	\$882 (2003)	3.0	Retail and HRI	Direct, Distributors
Confectionery	Kiev-Konti, Donetsk (3 Locations)	\$27,763 (2001)	7.5	Retail	Direct, Distributors
Pasta (macaroni)	Khmelnitskaia Makaronna Fabrika Khmel'nitsk	\$5,285 (2001)	23.0	Retail	Direct, Importers
Non-alcohol beverages	Mirgorodskij Zavod M?neralnikh Vod, Poltava Region	\$4,673 (2001)	14.6	Retail	Direct, Distributors
	Coca-Cola Company Kiev Region	\$4,134 (2001)	17.6	Retail and HRI	Direct
	Pivzavod "Obolon", Kiev	\$104,661 (2001)	8.5	Retail and HRI	Direct, Distributors
Vegetable oil	Carg?ll Ltd Donetsk	\$7,228 (2001)	14.0	Retail and HRI	Direct, Distributors
	Olijno-Ekstrakcijnij Zavod, Dnipropetrivsk	\$83,586 (2001)	12.1	Retail and HRI	Direct, Importers Distributors

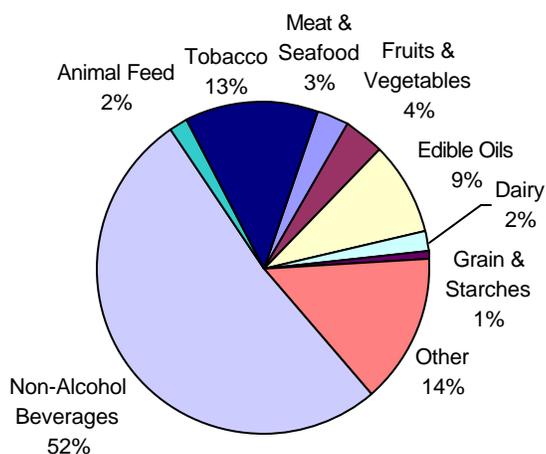
Source: State Statistics Committee of Ukraine, own calculations

* All revenues, excluding VAT & excises

Sector Trends

A major policy goal of the Ukrainian government (GOU) is to attract foreign investment. As of January 1, 2004, the total value of direct foreign investment (FDI) in Ukraine was \$5.9 billion. The food industry was a major recipient of FDI at nearly \$1.1 billion or 18% of the total investment. The major sources of foreign investment in Ukraine's food industry include the Netherlands (33%), the United States (16%), United Kingdom (10%) and Germany (8%). Other sources of investment include Russia, Switzerland, France, Spain, Denmark, Belgium, Austria, Finland, Norway and Sweden.

Foreign Direct Investments in Ukrainian Food Industry by Sub-sector in 2002



Source: State Statistics Committee of Ukraine

The food industry in Ukraine is becoming increasingly concentrated as less-efficient and small companies go out of business. This is resulting in vertically integrated operations where all stages of production “from the field to the table” are concentrated within one large company. Vertically integrated companies were seen increasingly growing in the fruit and vegetable, meat and poultry, milling and dairy industries.

Table 8. Ukraine: Major Food Industry Foreign Investors as of July 1, 2004.

Company	Product(s)	Country of Origin
Nestle	Confectionery; ice cream	Switzerland
Trilini International	Confectionery	USA
Kraft Foods	Confectionery; snack foods	USA
McDonald's	Fast food	USA
Cargill	Vegetable oil and animal feed	USA
Bongrain Europe	Cheese	France
Benye/Lactalis	Dairy	France
Wimm Bill Dann	Dairy	Russia
FoodMaster	Dairy	USA
Baltic Beverages	Beer; soft drinks	Denmark, Finland
SUN Interbrew	Beer	Belgium
Invesko Sim	Beer	Turkey
Pepsico	Soft drinks; natural water	USA
Coca-Cola	Soft drinks; natural water	USA
Bircher Benner	Dry Breakfast	Switzerland
Euro Foods	Dry goods; condiments	Spain
Agrovita	Meat and poultry processing	Sweden
UGF	Meat	USA
Suth Foods	Fruit and vegetable processing	Sweden
Shaller	Spices; meat, equipment	Austria
Billa AG	Food retail	Austria
Metro AG	Food retail discounter	Germany

Source: State Statistics Committee of Ukraine

Foreign investors prefer to invest in the processing and retail sectors rather than agricultural crop production. They also tend to bring their own processing equipment as well as packaging materials.

There are some significant investments made by major U.S. food producers. Cargill Inc. invested over \$50 million in oil crushing plant in Donetsk region. This enterprise is capable of processing 1000 MT of sunseed a day and is one of the biggest crushing facilities in Ukraine. Investments made by Coca-Cola Inc. in non-alcohol beverage sector exceeded \$ 270 million. By the end of 2003 McDonald's Corp. invested over \$ 82 million in the chain of 52 fast food restaurants. More investment in the sector has been announced for the year 2004 by other major U.S. fast food chains. This will lead to an increase in food ingredient imports. It is likely that new businesses will try to use the same ingredients as in the U.S. to maintain high quality and uniformity of their products.

The following trends will dominate Ukrainian food processing sector in the next two or four years:

- Increase of foreign direct investments in the food processing industry;
- Increase in use of additives (preservatives and stabilizers);
- Increase in consumption of processed fruits, vegetables, milk, fish, and meat products;

- Increase in demand for convenience food (highly processed, easy to cook, microwavable, and ready to eat products);
- Reduction of small food processors number, domination of the larger companies on most food markets;
- HRI sector, which plays minor role on the market now will start to develop;
- Growth of supermarket chains will speed up with new class of big discounters developing in big cities;
- Processed food consumption level is likely to grow in the medium term with low priced products dominating the market;

The trend for more healthy food consumption (low on fat and cholesterol, sugar free) is not yet evident in Ukraine. The diet of many low-income people is not nutritionally balanced and health concerns are found only in big cities, where consumers are wealthier and can afford more expensive products. GMO containing products have negative public perception in Ukraine and compulsory labeling make them easily identifiable in supermarkets. So far there were no GMO labeled products observed on the market and Ukraine lacks the technical abilities to enforce this requirement. Ukrainian legislation on GMO products is in development and it is difficult to forecast what measures will be adopted.

SECTION III. COMPETITION

Products from the EU countries are the main competitors for the U.S. food ingredients imported by Ukraine. CIS countries can't compete with European and US producers in high value added and processed products, but are quite successful in supplying cheap ingredients. Currently over 30% of food products (both processed and raw materials) are imported from the EU countries, and almost 19% from CIS. Possessing up-to-date technologies Germany, Netherlands, France and Italy are the main suppliers of food ingredients to Ukraine. As consumer preferences shift to more expensive products more opportunities will be opened for U.S. and European companies and less to CIS.

Competitive situation on Ukrainian food ingredients market

Product Category	Major Supply Sources in 2003**	Strengths of Key Supply Countries	Advantages and Disadvantages of Local Suppliers
Poultry meat* (Before poultry ban) Net imports: 100.6 TMT US\$ 43.9 mil (CIF) in 2003	1. U.S. – 85% 2. Netherlands – 2% 3. Belgium - 4% 4. Germany – 2%	European suppliers are price competitive and do not use chemicals, that cause concerns of Ukrainian Veterinarian service. Brazilian poultry supplies have started in 2003, but they are unlikely to be price competitive after the lifting of the poultry ban.	Quickly developing domestic suppliers are increasing their market share. Their technologies are not up-to-date and they rely on imported feeds. Domestic chilled chicken is more expensive and not distributed in small towns.
Nuts and dry fruits Net imports: 4.45 TMT	1. US – 10% 2. Azerbaijan –37% 3. Turkey – 28% 4. Iran - 7%	U.S. competitors supply mostly hazelnuts, pistachio, and walnuts, leaving almonds market for the U.S. suppliers. Most competitors are in close	There is no nut production in Ukraine. Insignificant quantities of walnuts come to the market from natural forests.

US\$ 6.6 mil (CIF)		proximity to Ukraine (mostly Black sea region) and offer good deals for price cautious Ukrainian buyers.	
Pet Food Net imports: 24.5 TMT US\$ 17.7 mil (CIF)	1. US – 6% 2. Russia – 48% 3. Hungary - 25% 4. EU – 15%	U.S. produced pet food meets competition from EU companies in premium segment and from U.S. subsidiaries situated in Russia and Hungary in the cheaper segment. American companies possess almost 80% of the market.	The industry is not yet well developed and satisfies only 4% of the local demand.
Fish and fish products Net imports: 245.1 TMT US\$ 88.4 mil (CIF)	1. US – 4% 2. Norway – 59% 3. Estonia – 9% 4. UK – 5% 5. Iceland - 4% 6. Russia – 2%	U.S. share on Ukrainian market is quickly growing while share of traditional exporters (Estonia and CIS countries) is shrinking. Norway promotes its products very aggressively, investing in processing and cold storages. Russian share is stable and surprisingly low.	Local production limited mainly by fresh water fish and Black sea basin fish. Atlantic fish quotas for Ukraine are small. Many popular among consumers species are not supplied by local fishermen and have to be imported.

* The poultry ban was introduced in 2002 and lifted in late 2003, so 2001 data are used.

Source: State Custom Committee, own calculations.

** In value

SECTION IV. BEST PRODUCT PROSPECTS

A. Products present in the market which have good sales potential

The following import sectors are the best developed and most likely will continue to grow in short term:

- Poultry meat (where U.S. produce is dominating) will continue to be a major export commodity for the next 3-4 years if the current open trade regime remains. It is likely that local producers of chilled and frozen poultry will be able to expand production and increase their market share. The size of the market is estimated at \$ 208 million and growing with local producers capable of supplying only one half of it;
- The seafood products market will develop very fast. Record high U.S. exports in 2003 prompt for good perspectives for 2004 and beyond. Insignificant domestic production of low quality products opens it for the imports. The annual consumption of fish and fish products in Ukraine have reach 445 TMT in 2003 with growth perspective to 816 TMT by 2010.
- Almond imports are growing due to the booming Ukrainian confectionary industry. The growth rate will slow down in 2004-2005, but market will continue to be sizable and attractive for American business.

B. Products present in small quantities but which have good sales potential

There are a lot of food products that are not exported to Ukraine in quantity for various limiting reasons. The major one is limited consumer incomes. Markets of commodities listed below are in the stage of development and larger quantities are likely to be supplied only in

3-5 years. Local production currently is limited and demand, though showing increase, is still small:

- Processed vegetables, ready-to-cook dishes and snacks (excluding chips);
- Baby food;
- Cheese and dairy products;
- Wine and hard liquors;
- Food ingredients for processing sector: non-sugar sweeteners replacing sugar, fructose, vegetable oils, protein or vitamin additives for production of diet and health food;
- Products for dietary consumption.

Due to complicated epizootic situation in EU countries and declining imports from there, US exporters may discover markets of albumin, dried whole egg powder and yolk, agar-agar, gelatin and similar products.

C. Food product imports not present in the market because they face Significant Barriers

- Read Meat (Beef and pork) is not present on the market due to lack of agreed health certificate. Ukrainian Veterinary Inspection Service demands imported beef not to be obtained from the animals treated with natural or synthetic estrogenic or hormonal substances and thyreostatic drugs. For pork there are some diseases control measures that prevent from signing a certificate;
- Some food additives and processed food products containing food additives are not permitted in Ukraine (thickeners, sweeteners, stabilizers, etc.). The list of allowed food additives available from the FAS-Kyiv office.

SECTION V. POST CONTACT AND FURTHER INFORMATION

Should you have any questions about this report or need assistance in accessing the Ukrainian market of food components, please do not hesitate to contact FAS/USDA post in Kyiv at the following Address:

Agricultural Affairs Office
10 Yuriy Kotsyubinsky St.,
Kiev, 01901

Tel: +38-044-490-4005
Fax: +38-044-490-4110
e-mail: AgKiev@usda.gov
Homepage: http://kiev.usembassy.gov/faskyiv_index_eng.html

Lists of importers are available from our office to exporters of U.S. food products. Country Commercial Guide Prepared by U.S. Foreign Commercial Service is available at http://www.buyusainfo.net/body2.cfm?dbf=ccg1&search_type2=int&country=Ukraine&logic=and&loadnav=no

For the most recent "The Exporter Guide" and product briefs on the market potentials for U.S. foodstuffs in Ukraine as well as in other countries, please visit Foreign Agricultural Service official page at www.fas.usda.gov.