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Global Agricultural Information Network

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Retail Foods

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Report Highlights:

In 2013-14 development of the food retail industry continued with the majority of retailers concentrated on counter-crisis activities and profitability increase. Chains were optimizing product selection in different locations and focusing on smaller store formats. Industry became more sophisticated as private labels and own procurement departments grew in significance. Share of imported products on the shelves increased in 2013, although local currency devaluation of 2014 may put this trend to a stop. A general economic slowdown and political unrests in 2013-14 are likely to depress industry in 2014-15. Many retailers will cut imports in response to weakened demand

General Information:

SECTION I. MARKET SUMMARY

After rapid expansion in late 2000's Ukraine's retail industry matured, changing its growth focus from rapid expansion of outlets to general profitability increase. Chains concentrated on existing locations turnover increase and precise tailoring of the product selection to fit changing demand. In recent years retailers did not hesitate to close a store should attempts to turn it into profitable business fail. This development strategy is in sharp contrast with initial industry explosive expansion period which ended in late 2008 with the first stage of the world economic crisis. Organized retail trade (supermarkets and convenience stores of different formats and sizes) is responsible for almost 50 percent of Ukraine's internal trade and further growth would require expansion into rural areas (30 percent of population) accompanied by profitability loss. Given limited resources availability many retailers are not ready for such expansion. However slow growth of organized trade share is unavoidable.

Concentration of the industry increased significantly in the post-crisis years and the process continues. Chain owners that developed retail enterprise as profitable "auxiliary business" either sold their stores to the major market players or went bankrupt. The "core" retail industry with dozen nation-wide chains and some strong regional players was formed. Growth strategies of the major players differs and will be discussed in the report. Unlike many western companies, Ukrainian retailers are trying to cover all profitable market segments expanding into smaller (rarely bigger) formats that are affiliated with the original mother company. Many of them have use mother company chain name with "Express" or "Mini" suffix.

Retailers believe that smaller stores allow for retail industry growth in the turbulent post crisis market environment. Small stores minimize the need for additional investments and allow retailers to cover areas where conventional supermarket construction is unjustified or excessively risky.

The largest chains have their own kitchens, mini-bakeries and processing shops. These departments allow chain stores to offer customers a variety of ready-made food products and semi-finished products. This includes various ready-made salads, bakery products, packaged meat cuts, fish and frozen semi-finished products. Supermarkets are also used as anchor stores in shopping centers and malls. In Ukraine shopping centers usually include boutiques, movie theaters, cafes, and restaurants (often connected to the food court). Due to the slow development of shopping centers, many retailers have rented out space to other non-food vendors.

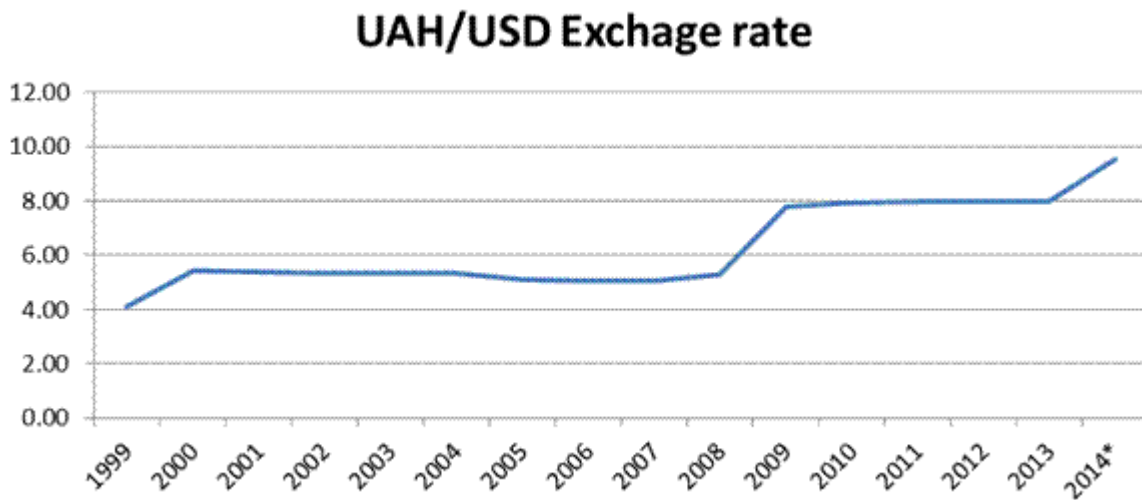
The economic and political crisis of 2013/14 is expected to have substantial negative influence on trade in the remaining months of 2014 and early 2015. The first quarter trade numbers suggest modest 2-5 percent trade turnover drop (denominated in local currency). However in many respects industry's performance in 2014 is expected to be similar to that of 2008-09 with significant drop in trade (USD denominated) and sharp imports reduction due to local currency devaluation and disposable income drop. Political uncertainty observed in eastern regions of the country will have additional negative impact on trade turnover as risks associated with shipments to these regions increase.

In 2014 many retailers are likely to undertake a major revision of their business models that may result in significant reduction of stock keeping units. Currently a significant number of different brands of the same product is offered to consumers in one store. This approach is typical for many mid- and upper scale chains with Ukrainian ownership offering from 8,000 to 15,000 SKUs per food supermarket. In many cases this excessive selection leads to decreased turnover and lower profits. The situation would worsen when real incomes of the population decrease due to economic crisis and currency drop. In this fight for survival on

shelves imported products are likely to lose more due to higher price.

According to industry's sources in the spring of 2014 many retailers reduced number of items for sale by ten percent; although experts believe that reduction many continue reaching 30 percent by year end. This scenario may take place if economic and political difficulty continues.

The macroeconomic situation in the country looks rather gloomy. The GOU and international organizations agree on significant 5-7 percent GDP decrease forecast in the current year with 12-14 percent inflation rate. In the spring of 2014 the National Bank of Ukraine liberalized the exchange rate abandoning unofficial currency peg of UAH 8.0 per USD 1. Increased currency exchange risks and increased exchange margins will have to be encountered by the importers.



** based on January-April exchange rate; current interbank currency exchange rate fluctuate around 11.9 UAH/USD*

Source: National Bank of Ukraine

Developments

Crimean Factor

Crimea's population exceeds 1.9 million permanent residents, with a significant additional number of tourists during a normal summer vacation season. Although tourist activity has decreased, the Crimean retail market remains significant with presence of all major Ukrainian retail chains including Metro Cash and Carry, Auchan, ATB, Novus, Fozzy Group (Silpo and Fora chains), Furshet and Retail Group (VK and Wellmart chains).

When this report was drafted there were no major ownership shifts in Crimean retail, although industry experts were anticipating sales of some Crimean operations to Russian retailers. As of early June most Ukrainian chains continue their operations in Crimea. The ATB chain even opened two new locations in

spring of 2014 while some other chains suspended their operations and/or transferred ownership to their Russian subsidiaries or separate entities.

Metro Cash and Carry (Metro Group AG) temporally suspended operations in April transferring the ownership of two existing outlets to specially created Retail Property 5 company. Auchan have moved operational management of their single newly built outlet under Russian headquarters while Novus did the same with their operations transferring eight stores to Planeta Sport LLC. Other Ukrainian chains this far continue operations searching for possible legal business options. ATB chain continues to operate supermarkets in 60 Crimean locations, Fozzy Group operates 17 supermarkets and Furshet operates 16. Retail companies carefully study Ukrainian legislation and watch international sanctions against companies located in Crimea.

Future M&As will depend on political developments. Through years of development Ukrainian chains occupied the best locations, researched local market and enjoy loyal clientele. Transfer to Russian goods on supermarket shelves will not add to their competitiveness as Russian food products up to 50 percent more expensive.

Due to the complexity of the situation, FAS/Kyiv would avoid any forecasts on Crimean retail development. Food prices in Crimea are also likely to increase due to expensive transportation and complex logistics. As of May 2014 Crimean prices for hard fat cheese exceeded Kyiv's price by 30-50 percent, soft cheese – 20-30 percent, pork – 20 percent, and candies – 20 percent. The smallest price difference was for pork poultry and fish – less than ten percent. In late May Russia started to enforce Russian legislation including food safety laws and import duties. This significantly complicated or even stopped supplies of Ukraine dairy products, sweets and meat resulting in an even greater price spike.

Historic Retail Development Overview

Before the world economic crisis of 2008 Ukrainian retail was expanding rapidly paying special attention to turnover growth and increasing the number of stores. In 2008 the industry reached a peak of expansion. In 2007 and 2008 trade turnover grew by 29-27 percent. The share of chains also grew from 26 percent to 33 percent for the same time period. Retailers' expectations were that the market would continue to grow at 20-25 percent rate until 2011-2012 when some saturation point was foreseen. After capturing the big cities with population over one million retailers concentrated on regional expansion. Growth in big urban centers remained attractive, but expansion costs were too high. An overheated real-estate market, problems with building permits, distribution of land plots, and an unclear business environment made development of supermarkets problematic. Many multinational chains considered the environment in Ukraine to be too hostile for market entry.

The booming retail sector got reflected in A.T. Kearney's Global Retail Development Index (GRDI) report. In 2005, Ukraine received 87 points (out of 100) and was ranked 4th among countries where international retailers were recommended to do business. The country slipped to 17th place in 2008 and kept this position in the 2009 report. From 2011, Ukraine completely disappeared from the list of 30 most attractive retail markets. The growth remained only in small-scale retail. Many chains concentrated on a smaller format as an adjustment to fewer available locations and in response to hostile business environment. Most self-service grocery stores were opened as replacements of old soviet-style stores where clerks served customers from behind the counter.

Regional development brought new challenges for national retail chains. Strong local competitors were reluctant to give up market share without a fight when nation-wide chains entered their ground in 2005-07. All national chains (with exception of ATB) started in the capital Kyiv where market size and consumer incomes were the largest. In the past five years competition fought for market dominance by fighting for the most advantageous real estate. Chains almost gave up trying to win over customers based on satisfaction of consumer preferences. Despite relatively low saturation of the Kyiv market, high rents and

the cost of real estate drove Ukrainian retail business to expand regionally.

Still, the development of retail in Ukraine continued at a fast pace with no clear distinction of supermarket formats. Any self-service store of 200-300 square meters would declare itself a "supermarket" with competition through low price offers. Some self-organization started only in 2008-2009 with international retailers entering the market and growing. Prior to the 2008 financial crisis many retailers saw the following formats as being worth attention: convenience stores, shopping malls, hypermarkets, and the gourmet grocery store niche. Convenience stores succeeded mostly due to low barriers to entry, abundance of locations, and low risks. Trade developments after 2009 suggest that over the crisis period, convenience grocery stores will remain viable in the near future, but longer industry trends suggest hypermarkets and shopping mall formats are likely to succeed.

Regional expansion was not an easy task for Kyiv retailers. Many sale practices successful in Kyiv proved to be inefficient in the regions. Many good locations were already occupied by local competitors unwilling to give up profitable plots cheaply. Many local chains started their own expansion programs by offering to sell their business to foreign chains or to nationwide competitors at the highest price. This development in turn led to real estate price growth in many regional markets contributing to a real estate price bubble. Local consumers happened to be loyal to local retailers and only significant price discounts could persuade them to switch. The product sets in many regions were very different from those in Kyiv with consumers preferring their local brands and local suppliers. Many regional retailers were quite successful and started their expansion into neighboring markets and even in Kyiv. Regional chains like Amstor, ATB and Pakko can be considered nationwide now.

State Regulation of the industry was quite messy. On one hand the Government of Ukraine attempted to support farm incomes, but also acted to limit food product costs to benefit consumers. After significant food price surges in early 2008, these controversial goals resulted in a law that limited trade margins to 15 percent for many food items. The list included bread, wheat flour, dairy products, buckwheat groats, meats, and some other staple foods. This law was adopted on May 16, 2008. Trade margins of many Ukrainian discount hypermarkets remained under the 15 percent threshold prescribed by law. On the other hand, smaller convenience stores in city centers would not stay in business if operated at a 15 percent margin. Many of them paid high rent for their space and would have to quit business should the law be enforced. In the end, all Ukrainian retailers found ways to get around the 15 percent strictures of the law.

Caught in the middle of rapid expansion programs many Ukrainian retailers were not able to service bank loans or to pay their suppliers. Many business growth strategies did not foresee the financial or economic downturn and retailers had no backup plans. Significant problems started in early 2008, when financial resources became scarce and very expensive due to a National Bank of Ukraine policy change. In early 2009 the values of domestic currency (UAH) was about half of what it was in the fall of 2008, so dollar denominated loans became significantly more expensive to repay. The UAH devaluation has brought unwelcome consequences for chains, which expansion was based on external financing. The burden was so significant that many retailers started a strategic investors search offering controlling-share acquisitions. Limited in financial resources small Ukrainian grocery store chains were the first to suffer. Some companies decided to keep control over their business and proposed only minor shares to address current liquidity problems. Many nation-wide chains are looking for financial support of this type.

Despite very pessimistic forecasts announced by industry experts, the majority of retailers managed to restructure their debt to keep their companies afloat. Chains conducted big cost saving programs, reviewed assortment, contracts with suppliers, and operational procedures. Major lenders had no other option but to agree on debt restructuring to avoid greater losses. Bankruptcies of major chains would result in significant losses due to multiple loopholes in bankruptcy legislation and unclear judicial enforcement in Ukraine. Besides, banks were interested in keeping chains as clients with good cash flows. In the past many banks attracted syndicated loans from abroad to finance Ukrainian retail. Throughout 2010-11 foreign banks were rather flexible in debt restructuring issues, receiving massive support from their governments. Banks were

so cooperative that many chains started withdrawals of their initial shares offers.

Many believe that debt restructuring of 2009-12 only postponed the problems of the industry, rather than resolving them. Problems of major chains may continue in 2013 should the second wave of economic crisis in Ukraine arrive. Some signs of upcoming slowdown became evident in the second quarter of 2012 when industrial production in Ukraine decreased by seven percent. Ukraine is likely to officially fall into stagnation after the 4th quarter results are published in early 2013.

Crisis developments have led to significant payment delays to food producers and importers. Even before the crisis many suppliers complained about contract terms that allowed for late payments (sometimes 60-90 days). For this reason many producers used distributors or limited their cooperation with Ukrainian retail. In 2008-09 payment delays extended to 150-180 days. This way chains are trying to collect some extra cash to insure timely loan payments. Some importers are seeking justice in Ukraine's court system, some stopped supplies to the chains, but the vast majority gave up and agreed on new discriminatory payment terms.

The crisis decreased the volume of imported food and led to a renaissance of the open-market and traditional grocery trade (per the growing gap between red and blue lines in the graph above) which recovered much faster. Significant contraction of external financing (no new bank loans or IPOs) will significantly restrain industry growth in the next couple of years. Some favorable factors like a drop in rental costs and general food price decreases will not offset the drop in consumer income. Some regional chains will not survive and will be forced to sell their business to bigger market players.

In 2012 prior to the Parliamentary election the Government of Ukraine (GOU) concentrated on populist policies in an attempt to attract votes. Issues with price growth for staple foods were debated in the press, so GOU insisted on maintaining the social products line in the retail. In 2012 the pressure concentrated mostly on bread products.

Political crisis that started in November of 2013 will have major negative impact on Ukrainian retail in 2014. The long-term impact is not yet clear, but disposable income decrease may lead to industry contraction by 5-10 percent with some stabilization in 2015.



**Both food and non-food items*

*** Forecast*

Mergers, Acquisitions and International Expansion

In comparison with earlier years of Ukrainian retail market development, number of M&As in recent years decreased significantly. Most retailers that were exercising risky expansion policy were purchased by bigger and luckier competitors after economic crisis in 2009/10. Nowadays relatively small number of chains is looking for expansion through acquisitions. Majority of purchases that took place recently concentrated in the most attractive and affordable "grocery self-service store" segment reflecting general market interest to smaller store formats.

Ukrainian Retail Group LLC purchased two local chains – Chumatsky Shliah and Stolichnyj Gastronom. Both chains were re-formatted to fit company's model. The first one joined the VK family while the second one was turned into popular VK-Express convenience stores.

The biggest event in retail M&A market in 2013 came from the foreign chains present in the country. On November 30, 2012 French Auchan Group announced the purchase of Real Hypermarkets in Central and Eastern Europe from the German Metro AG. In Ukraine the deal will include two big supermarkets in Kyiv and Odessa.

Cost of Ukrainian supermarkets is unknown, but the total transaction amounts to EUR 1.1 billion. The deal allowed Auchan to increase their chains in Poland, Romania, Russia and Ukraine by 91 stores, as well as 13 shopping malls in Russia and Romania.

Real's turnover in the four Eastern European countries in 2011 amounted to EUR 2.6 billion (pre-tax). The French company is expected to continue its development in Ukraine as it belongs to one of priority areas along with Western Europe and Asia. Ukrainian retail analysts predict an easy merge process as Real's and Auchan's business models are very similar and target the same clientele. Acquired Real supermarkets are spatially well positioned and are not in direct competition to existing Auchan outlets.

In general Ukraine does not provide good grounds for international chains to expand retail businesses. Rather, Ukrainian investment expanded into some less developed foreign markets (Moldova and Georgia). Many Russian retailers viewed Ukraine as a good territory for business development, but none of them met with success. Russian Perekrestok, Piaterochka and Patterson opened their stores in different cities. Another Russian chain the Patterson sold their business to the Ukrainian chain "Eco" back in 2007. Piaterochka also sold their locations in Eastern Ukraine to local competitors at the end of 2007. Perekrestok (X5 Retail Group) was more successful with 12 locations opened by the end of 2013 (renting 11 locations in Kyiv and oblast). This chain was the last to leave Ukraine in spring of 2014. The Chain reported that it would like to concentrate on Russia's market according to the announced in 2012 strategy. The Ukrainian business was responsible for less than 0.3 percent of the chain's turnover. However some Ukrainian observers attribute this decision to political crisis developing in Ukraine in the end of 2013-2014. Central Ukraine based Varus Chain became the buyer of X5's business. Terms and conditions of the deal are not known, but the Perekrestok brand will cease to exist in Ukraine.

Ukrainian expansion into neighboring countries was more successful. Two of the biggest Ukrainian retailers entered the Moldova market. Retail Group LLC (VK and VK-Express TMs) now owns 11 supermarkets

(through the purchase of the local Green Hills chain) and Furshet Ltd (La Furshet TM) also owns nine supermarkets under its own brand, all in Moldova. Furshet also declared future expansion plans for 2013 through franchising network in Georgia.

Due to market entry obstacles one international retailer decided to cooperate with one of the local chains. The joint venture of Furshet and Auchan Group (France) was established in March of 2007. The French retailer agreed on portfolio investment into the La Furshet chain. The mass media reported that Auchan Group created a Joint Venture through the purchase of 21 percent share of Furshet chain (for \$112 million), plus 34 percent share of Furshet in any Auchan hypermarket store opened in Ukraine or Moldova. Furshet also agreed to facilitate Auchan Group's search for new locations (one plot was provided in Kiev right after the deal) and lobbying its interest at the regional level. Another Joint Venture company (Auchan Group - 51 percent, Furshet management - 40 percent, independent investor - 10 percent) will start development of shopping malls in Ukraine. During 2012, Auchan bought back its share from Furshet and its owner. In November 2012 the parties split up and closed both Joint Ventures. Auchan announced that it will continue expansion in Ukraine without support from Furshet. However Auchan retained its ownership in Furshet chain and has options for future share expansion that can be exercised in 2014 and 2021.

Auchan's market entry in 2008 was the first western chain entry after Metro Group AG in 2003. The five Auchan stores in Kiev and five in other regions (after acquiring Real chain) so far are quite successful. The chain management claims that products are offered for sale with 15 percent price discount to other chains; suppliers are not charged any marketing cost and paid within two weeks after the product is sold.

It is next to impossible to build any reliable M&A forecast for the upcoming year in current turbulent political development and political conflict in the eastern regions of Ukraine. There is public information about possible cooperation between Ukriaani Retail Group (Vk, VK-Express) and Eurotech (Eurotech, Fresh and Kvartal chains) on logistics that might lead to closer cooperation in the future, however none of the companies has sufficient resources for full scale acquisition.

Foreign companies probably will wait until the situation in Ukraine stabilizes.

Major Retail Trends

Private Label Developments

Active development of private labels started almost decade ago as Ukrainian retailers gained market power and recognized importance of increased turnover for their profits. Major chains launched their programs in 2007-09. In many cases suppliers were unable to cover all marketing costs and shelving fees associated with product placement in a big chain. In those cases private label agreements looked mutually beneficial solution that allowed producers to increase market presence at limited cost. However producers' margins also remained below average and many of them complained about retailers' pressure forcing private label production. In most cases a big contract with one of the major chains insured short-term profit and assured sales for the duration of the contract. In the same time private label contract would prevent own brand developments, tied producers to sole sale source and insured only minimal profitability.

Economic crisis of 2008/09 put additional pressure on the food producers as many of them were unable to pay their bank loans or to provide loans in kind to major supermarket chains. Additionally some chains tha

went bankrupt in 2008/09 leaving significant unpaid arrears to suppliers and putting them on the verge of bankruptcy. The bad financial situation forced many food producers to seek financial support from the chains in exchange of ownership share. Many chains decided to take over food producers to insure supplies and build vertically integrated company. This way some private labels are produced at chains' own production facilities.

Majority of Ukraine chains started their private label programs with one label oriented on mass-market grocery products insuring the best price/quality ratio. With rare exception this one-label products over time evolved into multi-tier multi-brand programs. Existing private label ecosystems include all type of products – from the cheapest grocery to expensive gourmet food. Separate sub-brands are developed for drinks, including alcohol and different grocery product groups (like groats and canned food). In some cases the buyer can trace different labels from the bottom priced mass products to the upper segment; in some cases the labels are different. Foreign chains (Metro, Auchan) introduced some of their brands in Ukraine as well.

For years chains concentrated on domestically produced products for their private label programs. Selected commodities had to match certain price/quality ratio to be eligible and be mass-market products. Recently chains launched imported products private label lines in upper market segments. This works especially well for chains using multi-tier private label systems.

Searching the best price/quality ratio, Ukrainian retailers often concluded private label contracts with famous producers already present on their shelves under their own brand. Since Ukrainian legislation requires producing facility name and address on the label many consumers were able to choose the best price between own brand and private label of the same product. Naturally producers did their best to avoid this type of competition.

Private Label development strategies vary from chain to chain. Some do not concentrate much on their number operating just one or two (Furshet chain), while other operate dozens METRO, VK. Some keep different trade marks for different product groups (METRO) while others separated different trade marks by product price, quality and target audience. The good example of this approach is Silo chain operating Povna Charka, Povna Chasha, Premia and Premia Select brands. Although the first one is attributed to alcohol drinks, the remaining three are attributed to progressively more expensive products. In some cases the labels are used in the same grocery group to separate cheaper and more expensive products. Premia Select brand can be found in expensive imported product segment including cheese, chutney and like products.

Interestingly enough a lot of companies created a quasi-private label by marking products that were imported by the own procurement department of the chains. Many retailers put "own import" logo or note on the price tag on the shelf stressing the fact that the margin on this product is minimal, thus the price is the lowest possible. Chains do not recognize those logos as separate private labels, but they effectively serve the same purpose.

Information on share that private labels occupy in the turnover of the major chains often unavailable. Ukrainian Retail Group LLC recently announced that in 2013 private labels were responsible for 6 percent of the chain's turnover and expects their share to reach 8.5 percent in 2014. The chain is using 17 own labels with total number of over 1200 SKUs.

Development of private labels will continue in the near future. Despite obvious benefits that they bring to both retailers and food manufacturers their development remains subject to mutual compromise and remains love-hate relationship. In cases when producers or importer possess sufficient financial resources to create and promote its own brand this way seems preferential.

Over the last two years all nation-wide retail chains developed their own private-label programs. In most cases chains offer cheap and mid-price products in fruit juice, canned vegetables, dry fruits, grocery, frozen dumplings, and seafood product groups. Many chains sell products produced on their own premises (most

frozen products) that are not clearly labeled as the supermarket's private label or sold as no-name white label products. Own ready-to-eat products produced on sites are also not "private-labeled."

Most chains sell only food private labels. In 2008 Metro C&C Ukraine also launched its "H-Line" label with over 60 food and non-food items. By 2011 the PL line includes ARO, Horeca Select, Fine Food, Rioba. Silpo Chain has offered some non-food items under "Premia," "Premia-Select" and "Povna Chasha" private label. Own PL are also launched by major chains: Furshet, ATB, EcoMarket and Velyka Lyshenia. The price difference compared to branded competitors is five to 20 percent less.

Retailers see having a private label as a means to exclude of third party distributors from the logistics chain as well as a means to minimize promotion costs. Some cost is also saved during the bidding process when a supplier is chosen. It is too early to estimate the success of private-label programs in Ukraine since they are relatively new and coincide with significant changes in loyalty programs run by many big chains. Common for the western markets reliance on grocery items for private-label program is not evident in Ukraine. Private label bundles are quite diverse and do not coincide from chain to chain.

Structure of Trade Turnover

In recent past the Government of Ukraine maintained social programs for food. In many cases this cushioned income decrease and provided the retail industry with stable money flow. However, denominated in USD trade turnover number makes 2009 economic crisis and 2012 stagnation clearly visible.

Table 1. Wholesale Trade Turnover* (Million USD)**

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total Wholesale Trade Turnover	99742	132124	171066	199694	110522	132216	138932	136832	134512
Including									
Food	15440	20453	26036	29487	21604	24445	24406	26930	24991
Nonfood products	84303	111671	145029	170208	88918	107771	114526	109903	109522
Share in Turnover, %	19.5	19.8	19.8	19.0	12.8	12.6	13	13	13
Including									
Food	3.0	3.1	3.0	2.8	2.5	2.3	2	2	2
Nonfood products	16.5	16.7	16.8	16.2	10.3	10.3	10	10	10
Share of domestically produced products, %	13.7	12.9	12.4	12.0	8.2	8.0	8	7	7
Including								0	0
Food	15.3	15.0	14.9	14.2	9.6	9.5	9	9	9
Nonfood products	13.3	12.6	12.0	11.6	7.9	7.7	8	7	6

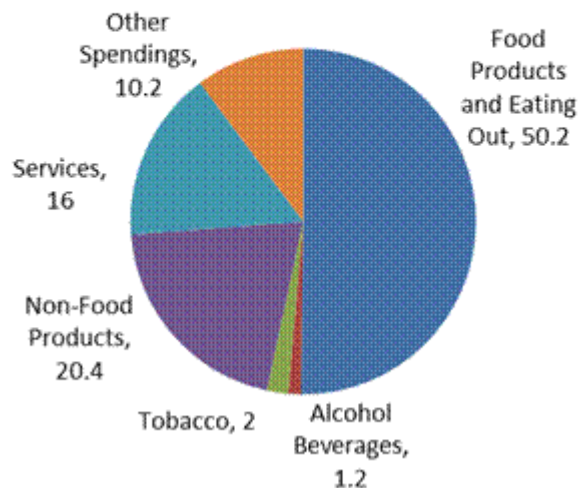
Source: State Statistics Service of Ukraine

* The numbers in the table do not include private trade and open-air market trade.

**Official annual average hryvnya-to-dollar rate was used to convert Ukrainian Hryvnas (UAH) to U.S. dollars.

Ukrainians spend almost half of their income on food products with staple food (bread, milk and dairy products, confectionary, fruits and vegetables) taking the largest share of the income. Subsistence farming play an important role in rural area where spending differs from average numbers presented in the table below. Backyard production serves as income supporting activity in cases when rural dwellers have outside employment, work on farm or retired. It also serves as a cushion for possible economic crises that shook Ukraine quite often in last ten years.

Spendings of Ukrainian Households in 2013, Percent



Source: State Statistics Service of Ukraine

Table 2. Organized* Food Retail Turnover Structure, Million USD

Product Group	2011	2012	Share in 2012, %	Per Capita Spendings, in 2012 USD
All Goods	43922	50703	n/a	n/a
All Food products	17098	20358	n/a	n/a
Food products in Retail	15672	18786	100 100.00	413
Meat and Poultry Fresh and Frozen	897	1147	6.1	25
Meat Smoked, Salted and Sausage Products	954	1072	5.7	24
Canned Meat, Prepared Meat Products	140	149	0.8	3
Animal Fats	4	5	0.0	0
Fish and Seafood	464	552	2.9	12
Canned goods, Prepared Fish Products	194	249	1.3	5
Milk and Dairy Products	773	935	5.0	21
Icecream	118	145	0.8	3
Curd Cheese, Melted and Soft Cheese	492	619	3.3	14
Butter	213	241	1.3	5
Eggs and egg products	196	248	1.3	5
Vegetable Oils	251	282	1.5	6
Margarine	43	43	0.2	1
Sugar	172	141	0.8	3
Confectionery	1277	1478	7.9	33
Flour	80	88	0.5	2
Bakery products (excluding confectionery)	439	490	2.6	11

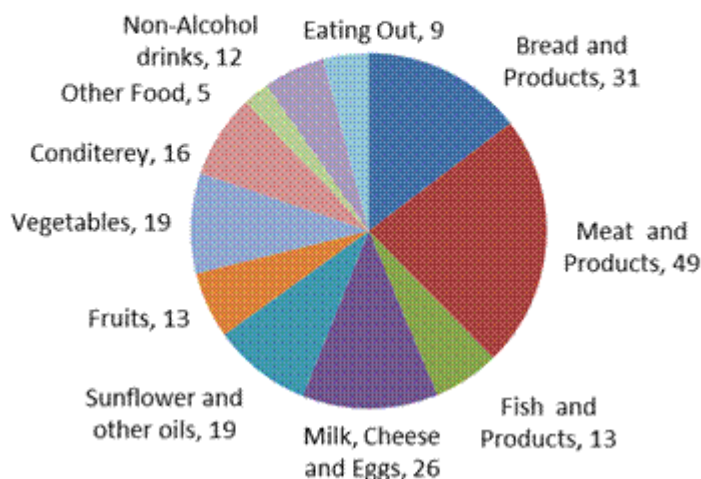
Cereals and Pulses	209	222	1.2	5
Pasta Products	166	165	0.9	4
Potato	88	90	0.5	2
Vegetables	356	389	2.1	9
Fruits, Berries, Grapes, Nuts and Melons	571	707	3.8	16
Canned Vgitable	163	186	1.0	4
Canned Fruits and Berries	51	55	0.3	1
Alcohol Beverages	2937	3253	n/a	72
- Wines and Spirits	1173	1244	6.6	27
- Mixed Drinks	129	153	0.8	3
- Vine	449	485	2.6	11
- Brandy	335	362	1.9	8
- Sparkling Wine (champagne)	188	211	1.1	5
- Beer	663	798	4.2	18
Tea	184	204	1.1	4
Coffee	315	367	2.0	8
Salt	11	13	0.1	0
Soft Non-alcohol Beverages	473	567	3.0	12
Mineral Water	260	333	1.8	7
Tobacco	2198	3317	17.7	73
Other Food Products (including honey)	979	1031	5.5	23

Source: State Statistics Service of Ukraine

*Over half of retail trade turnover remains in open-air markets or small businesses that do not report their turnover to authorities.

In money terms Ukraine belongs to a low-middle-income country group according to World bank classification. An average Ukrainian monthly spends slightly over 100 USD for food and beverages. A household survey conducted by the State Statistical Service of Ukraine reveals the following spending structure. It must be noted that in rural areas this structure may differ significantly.

Monthly Food Spending per Household* in 2013, USD



*One household in survey is 2.11 person

**** Total Monthly Spending for Food \$212**
Source: State Statistics Service of Ukraine

The share of imported goods in food retail is relatively low and limited by innovative and high value added products, although in organized retail outlets and in urban areas it is substantially higher. These outlets are where a substantial amount of unofficial imported product is sold. Larger cities and densely populated urban areas account for the largest share of retail trade turnover (Kyiv city captures twenty percent of the market, Dnipropetrovsk region – nine percent, Donetsk region – nine percent, Kharkiv region – seven percent, and Odessa region – six percent).

The proportion of imports 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, supermarkets and greengroceries tend to have the largest portions of imported fresh fruits and vegetables on their shelves: 19 percent and 23 percent, respectively. Some 13 percent of confectionery and 12 percent 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. However during last decade imported food products increased their presence from six to 14 percent. Basic food products (fish, meat, fruits) not produced in Ukraine occupy the largest share.

Table 3. Retail Turnover and Imports Share

Product Group	Retail Turnover			Imported Food Products		Retail Turnover comparison to 2012, Percentage
	Million USD	Percentage	Percapita, USD	Million USD	Share in total turnover	
All Food products	16083	41.1	353	x	x	106.6
Food products in Retail	14914	38.1	327	2077	14	107.3
Meat and Poultry Fresh and Frozen	966	2.5	21	49	5	117.9
Meat Smoked, Salted and Sausage Products	883	2.3	19	55	6	111.1
Canned Meat, Prepared Meat Products	166	0.4	4	11	6	147.7
- including meat semifinished products	81	0.2	2	4	4	-
Animal Fats	5	0	0	1	24	147.4
Fish and Seafood	424	1.1	9	158	37	110.4
Canned Goods, Prepared Fish Products	206	0.5	5	61	30	113.0
- including semi-finished fish products	37	0.1	1	9	25	-
Milk and Dairy Products	778	2	17	62	8	114.3
Icecream	140	0.4	3	4	3	106.4
Curd Cheese, Melted and Soft Cheese	495	1.3	11	83	17	110.3
Butter	188	0.5	4	5	3	112.6
Eggs and egg products	183	0.5	4	3	1	114.4
Vegetable Oils	212	0.5	5	14	7	102.6
Margarine	32	0.1	1	1	4	95.5
Sugar	121	0.3	3	2	2	131.0
Confectionery	683	1.7	15	105	15	112.0

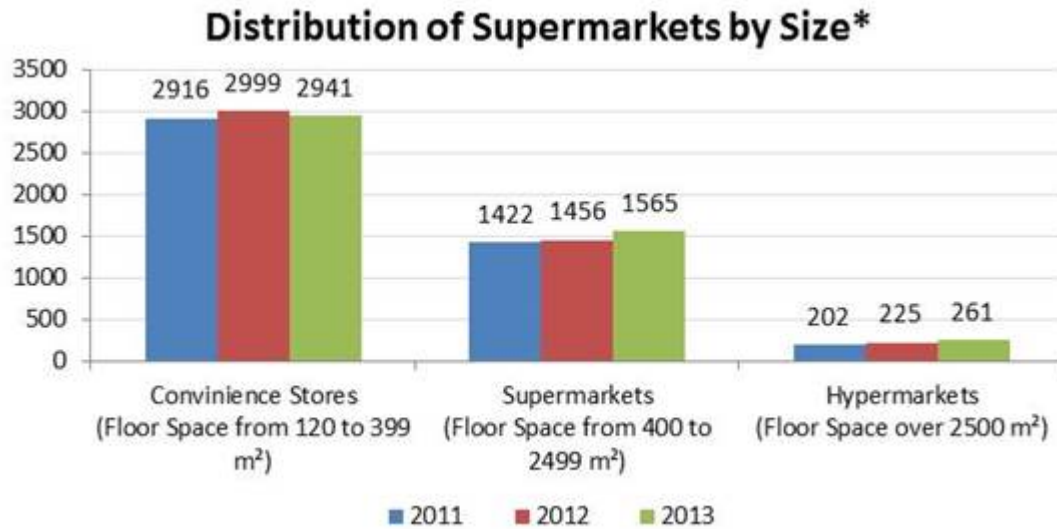
Pastry	441	1.1	10	34	8	104.9
Flour	71	0.2	2	3	4	106.3
Bakery Products (excluding confectionery and pastry)	383	1	8	10	3	103.4
Cereals and Pulses	174	0.4	4	17	10	110
Pasta Products	124	0.3	3	29	24	98.4
Potato	90	0.2	2	10	11	116.3
Vegetables	352	0.9	8	65	19	156.6
Fruits, Berries, Grapes and Nuts	498	1.3	11	235	47	115.1
Watermelons and melons	11	0	0	1	9	81.6
Canned vegetables	130	0.3	3	29	23	102.3
Canned fruits and berries	41	0.1	1	18	44	113
Alcohol Beverages	2525	6.5	55	433	17	102.2
- Wines and Spirits	929	2.4	20	166	18	100.9
- Mixed Drinks	122	0.3	3	7	6	100.2
- Vine	377	1	8	108	29	102.5
- Brandy	288	0.7	6	51	18	109.2
- Sparkling Wine (champagne)	146	0.4	3	24	17	101.6
- Beer	663	1.7	15	78	12	101.7
Tea	153	0.4	3	47	31	104.1
Coffee	288	0.7	6	158	55	108.3
Salt	10	0	0	0	3	103.4
- including iodized salt	3	0	0	0	3	-
Soft drinks	453	1.2	10	25	6	101.8
- including juices	176	0.4	4	10	6	-
Mineral Water	284	0.7	6	22	8	107.1
Tobacco	2573	6.6	56	129	5	94.4
Other Food Products (including honey)	830	2.1	18	197	24	109.4

Source: State Statistics Service of Ukraine

Ukraine's food product retail sector continues to develop and has a strong growth potential. Despite the growing number of supermarkets, traditional groceries and open-air markets remain the most popular retail outlet. In Kyiv, which captures approximately one-fifth of the food-product market and where one-sixth of the country's hypermarkets and supermarkets are located, open-air market sales account for between 30-35 percent of prepared food products and 70-80 percent of fresh meat. Open-air outlets account for 22 percent of national retail sales for the entire country although some experts give them a significantly higher share.

Despite current sluggish development of the big retail formats, hyper- and supermarkets are expected to account for 47-48 percent of retail food sales by 2015; chain convenience stores/discounters will capture 25-35 percent share, open-air markets 20-25 percent, soviet style stores (groceries, over-the-counter trade stores) 10-15 percent, and other outlets ten percent.

Despite close attention to smaller formats the share of supermarkets and hypermarkets was growing in 2013. Convenience stores peaked in 2012 and have shown some decline in number. As to floor space figures, the share of bigger trade formats is overwhelming and expected to grow when industry resumes development after current political and economic situation.

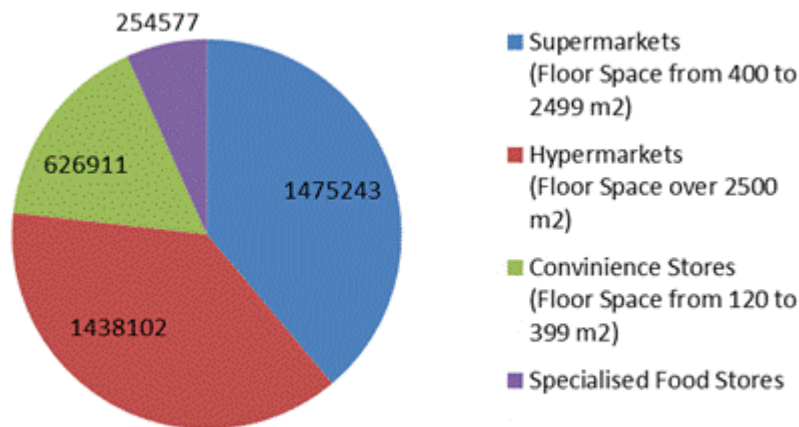


Source: State Statistics Service of Ukraine

*as of January 1st of each year;

Definitions of outlet type may be different from those used in the U.S.

Floor Space, M²



Source: State Statistics Service of Ukraine

Ukraine is one of the most populated countries in Europe with over 45 million people. A steady increase in personal incomes before 2008 had a positive impact on the development of the retail sector (an increase of 25 percent in 2008). Per capita income growth rates and the growth in the retail sector coincided. Over the past ten years, only three large European retailers (Billa, Metro and Auchan) entered the Ukrainian market to benefit from the growth. Usually, retailers enter markets in large urban areas, followed by expansion into smaller cities and towns. Although local supermarket chains still outpace foreign companies in terms of the number of outlets, foreign outlets have much better logistics, tested market-entry strategies, excellent personnel-training techniques, well-established connections to suppliers and solid

financial support. All these lead to a situation when three western companies are responsible for over 20 percent of Ukraine's organized large scale retail market.

Advantages and Problems for US Exporters

Advantages	Problems
Population of 45.6 million people; a number of consumers can afford purchasing high-quality food products	Due to economic crisis and erosion of incomes, majority of consumers continue to save money on food or rely on home produced foodstuffs.
Demand for higher quality food products is growing.	Volume of sales of higher quality food products is expected to shrink.
Ukraine's retail sector is on the rise, which creates a number of opportunities for prospective U.S. exporters.	Frequently changing trade legislation and policies often impact trade. Import tariffs were lowered by WTO accession but threatened with hikes "to protect Balance of Trade."
Urban life style changes increase demand for semi-finished and ready-to-cook products	Rapid development of local manufacturers of ready-to-cook products creates tough competition for similar imported goods
American-made food and drinks are still new for the majority of the population, but rather popular among the younger generation;	Growing number of domestically produced generic products; lack of knowledge of American products
In general retailers are open to new products in order to attract customers	Strong competition with suppliers of similar products from Russia and European Union
Existence of large importers experienced in importing food products to Ukraine	Difficulties in finding a reliable partner or distributor

SECTION II. ROADMAP FOR MARKET ENTRY

ENTRY STRATEGY

Every company must choose its own market-entry strategy that is dependent on preliminary market research results and the type of promoted product. The strategy is also dependent on the company's financial strength. However, some basic strategy trends exist for products entering the Ukrainian market:

- A prospective entrant is advised to estimate market perspectives of the product with respect to consumer preferences and incomes, local competition and sales channels (marketing research from specialized consulting firm may be required).
- A visit to a food product fair in Ukraine may be very helpful. These events can provide a market snapshot, as well as identify prospective importers and wholesale vendors. Usually only large companies participate in these fairs.
- Meetings with representatives of state regulatory bodies in order to obtain additional information on

import requirements. However Ukrainian logistics companies and custom brokers often can do a good estimate of full import cost. Companies can consult the Foreign Agricultural Service and Foreign Commercial Service, business consultants, and foreign partner companies already doing business in Ukraine.

- In order to make the first delivery, usually a large local import company is chosen. The company should have a good reputation and experience in customs clearance, and must have storage facilities and a developed distribution network. Make sure the company has experience working with Western suppliers and has experience in arranging regular supplies of food products. Western companies that strive to supply directly, circumventing Ukrainian mediators, often sustain losses due to lack of local market knowledge. A large domestic import company is usually better adjusted to local conditions, with established trade ties and contacts in state structures. Ukraine remains a country where personal contacts play an important role in business.
- Should the exporting company decide to open a representative office, it should be located in Kyiv where government authorities are concentrated. Other large cities may also be considered.
- Ukrainian import duty rates for food products are very uneven. Import duties for unprocessed goods or goods in large packages are often zero. Often these commodities require only minimal processing (frying, adding salt, and packaging for retail trade). Duties for packaged and ready for sale products are higher. Many companies test the market with finished products, and then look to process and package locally if the product is a success. This way they manage to reduce custom clearance costs. Many importers package tea, muesli, chocolates, chips, roast nuts and coffee beans in Ukraine. Packaging or production is often conducted in Russia or other Commonwealth of Independent States (CIS) countries. The commodity can be imported from these countries under Free Trade Agreements (FTA). FTAs are in place for 11 CIS countries. However, a potential importer should weigh transportation and certification costs.
- Supermarket entry costs vary greatly in Ukraine. Charges include a company's entrance fee, a shelving fee for each commodity, designated shelf fees, and a fee for positioning a pallet in the sales area. Entrance fees, designated shelves and pallets would range from \$100 to over \$250 each. Some payments are made once, and others are monthly charges. The exporter should be ready to pay the retailer a percentage of the trade turnover (calculated from sales or per one meter of shelf space). These payments are also made on monthly, quarterly or annual basis. There will be some payments associated with retail chain marketing costs, advertising booklets and in-store promotion actions. The total sum for all services and fees will range from \$1,000 to \$1,500, per commodity per store. All fees are negotiable and depend on a product type.

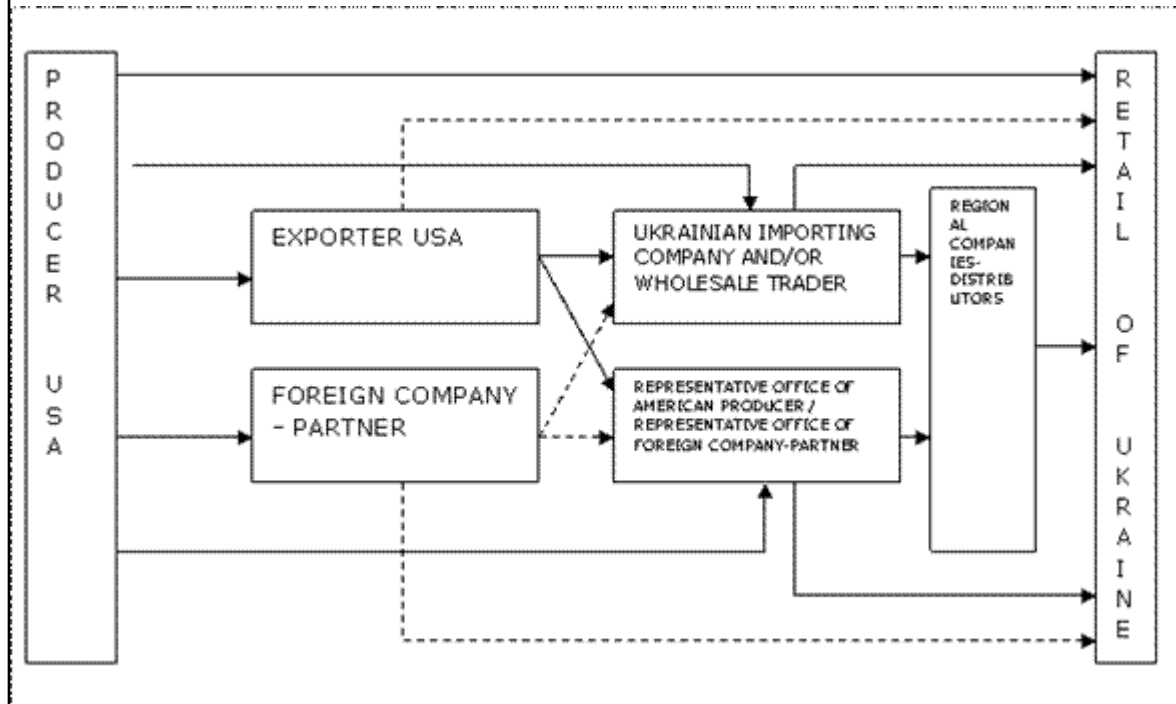
MARKET STRUCTURE

Distribution Channels

The vast majority of importers/distributors have offices in Kyiv or in the large Black Sea port of Odessa, however some regional players have grown into national-wide players mainlining their head offices in regional (Oblast) centers. Portside offices are often used solely for customs clearance procedures. Following arrival at port, the product is then shipped to a regional distribution center. Then the consignment is distributed to the regions or directly delivered to stores. Some importing companies purchase goods on CIP Kyiv terms and then customs clear in Kyiv. Truck deliveries from Western European ports are much more expensive and rarely practiced. Typically large importers supply a number of commodities to Ukraine. Some companies have exclusive contracts for distribution of food products in Ukraine; however there are cases of several distributors having the right to distribute a single product.

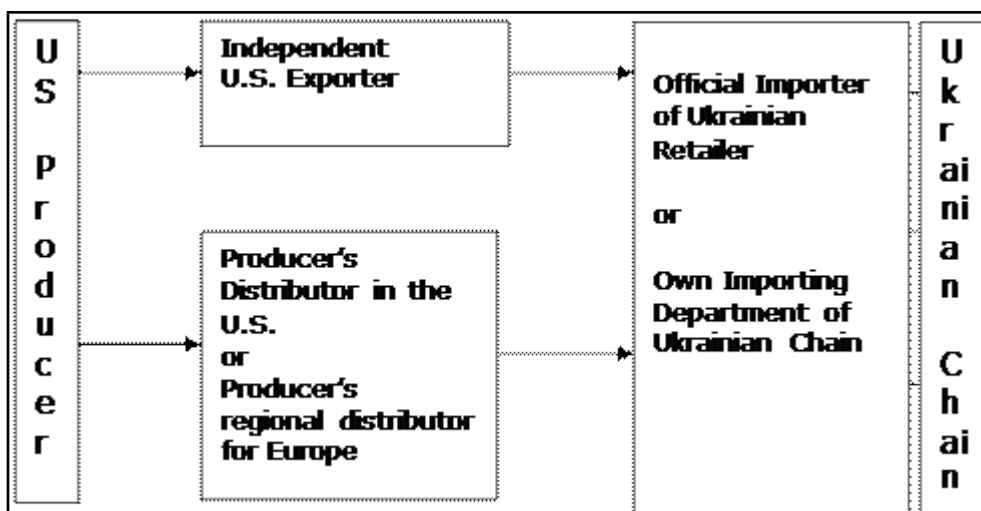
Often Ukrainian representative offices finalize agreements to be the exclusive supplier of goods to certain regional distributors. Retailers can cancel a direct supply contract with the representative office when it is unprofitable for a regional distributor to supply the retailer. There are several companies in Ukraine that pretend to be national distributors capable of regular deliveries of goods to retail trade companies all over Ukraine, however, these companies don't have such an efficient or far reaching distribution system.

Food Retail Distribution Channels



Own Importing Department Option

As noted previously the number of own procurement departments of major Ukrainian chains have grown dramatically. Almost every Ukrainian chain has one. Their role is important for mass market products where chains have significant experience and would like to control import flow themselves. Ukrainian chains often import seafood products, wine, grocery and delicatessen group. Independent importers increasingly concentrate on niche products and high-risk new to the market products. As soon as chains feel comfortable with import volume and value, they took over the product or product group and start own imports. It is unlikely for U.S. export to work immediately with the chain's own import department, especially if volumes are not going to be significant. Nevertheless this simplifies the supply chain significantly and can be illustrated by alternative distribution channel chart below. FAS Kyiv is aware of direct imports of U.S. fish, meat products and fruits and nuts.



In some cases Ukrainian producer may ask foreign producer about private label agreement. Retailer's designated importer usually takes care of labeling, conformity certification, licensing, import duties and other importing formalities. For more information, please refer to the most recent FAS [FAIRS Report](#).

Types of Retailers

As reported by the State Statistics Service of Ukraine, the number of retail food trade companies exceeded 22,200 by 2013. Over the past few years, the number of retailers was on the decline (three to six percent

annually), while the average floor space increased 7-16 percent annually. Many small food shops continue to go out of business.

Due to the quickly growing number of super- and hypermarkets in 2004-2014, experts estimate their market share at 45 percent, and it will continue to grow in the future. Traditional groceries in big cities are losing their clientele due to new and improved services that are provided by big retailers. Open-air markets and kiosks cannot compete due to low quality products (this is a major channel for uncertified and counterfeit goods), while traditional grocery stores cannot offer a wide assortment of products at low prices. Supermarkets are not completely driving out open-air wholesale markets and Soviet-type grocery stores, but forcing them to modernize equipment and marketing techniques.

Supermarkets, Hypermarkets

Owners privatized the majority of retail outlets during the first wave of Ukrainian privatization in the early 1990's. Large trade centers with a self-service system (the Soviet counterpart to supermarkets) built in the time of the Soviet Union ceased to exist after the first year of Ukraine's independence. Later, individuals or businesses purchased these food stores. In order to survive, the overwhelming majority of these stores sold both non-food and food products.

The stabilization of the economy helped to create the current retail structure. The first domestic supermarket chains emerged to satisfy the new and growing demand in early 2000s. These stores began to emulate western standards on floor space, product assortment, and quality of service.

The average floor space of a Ukrainian supermarket grew from 822 square meters in 2005 to 914 square meters in 2007 and 1,565 square meters in 2013. The first Ukrainian mall – "Karavan" (classified as hypermarket by the State Statistics Service) was built in Ukraine in 2004 with a total area of 13,000 square meters and total floor space of 8,000 square meters. The small floor space of many Ukrainian supermarkets is a result of limited capital and limited availability of buildings or land plots in proper locations suitable for such operations. Only Western investors and very few Ukrainian companies are capable of full-scale construction projects from the ground up.

According to supermarket owners, stock lists of smaller stores include 30–70,000 items, with 80-90 percent of these items of Ukrainian origin. Dairy and fish products, meat, bakery and spirits are widely represented. Supermarkets often cut their margins to attract as many customers as possible. The largest chain supermarkets use over 1,000 different suppliers represented by large wholesale companies, producers and importers. Local chains are adopting foreign practices and standards, and introducing production quality control departments and distribution centers. Many supermarkets are open around-the-clock.

There are several factors contributing to the rapid success of hypermarkets and supermarkets in Ukraine. First, retail chains guarantee higher quality goods. Second, the majority of chains offer attractive prices through improved logistics and substantial supplier discounts in return for guaranteed large procurements. These advantages attract customers from traditional wholesale open-air markets and grocery stores. Third, supermarkets guarantee comfortable shopping conditions (free parking, etc.), additional discounts for regular customers (discount cards), and additional services for goods purchased (home deliveries, internet shopping, etc.).

Due to the rapid market development and abundance of retail formats, local retail chains have had little competition from foreign companies. Today, Kyiv commands approximately one-fifth of all retail trade in food products conducted by specialized and non-specialized stores, as reported by official statistics. Meanwhile, according to some retailers these supermarket chains are only satisfying 45-50 percent of all

demand. Operators agree that the market for larger stores will continue to develop in the near-term despite the economic slow-down. Now supermarkets do not compete with each other, but with traditional open-air markets. The latest trend in supermarket development is to locate these trade outlets in shopping malls, which reduces construction costs and attracts additional customers. Construction of movie theaters also opens new possibilities for supplying the "American way of life" (popcorn, soft drinks and different snacks).

Important Note: Since most retailers in Ukraine are not publicly traded companies and do not publish information about their turnover, FAS-Kyiv used information from different open sources. Besides Ukrainian retailers often operate multiple chains (conventional supermarkets and small "near home" stores) reflected in the different table. This makes turnover estimation for particular type of outlet nearly impossible. Due to this fact turnover is provided in the table below and covers all types of outlet operated by a retailer. Turnover column is excluded from the "Convenience Stores Chain" table.

Table 2. Hypermarkets and Supermarkets Chains in Ukraine (Rating from Bigger to smaller chains)*

Retailer Name and Outlet Type	Ownership (Turnover in 2013)	No. of outlets as of 2014	Locations	Purchasing Agent Type
Sil'po supermarket	Fozzy Group (\$2.74 bln)	206	Nation -wide	Direct/importer
Fozzy, C&C		7	Nation -wide	
Le Silpo		2	Central Ukraine	
Metro, C&C	Metro Cash and Carry - "Metro AG" Germany (\$1.26 bln)	27	Nation-wide	Direct/importer
Metro Baza		4		
Furshet, Furshet Gurman, Narodnyi	Furshet LLC (\$0.64 bln)	117	Nation-wide, Moldova, Georgia	Direct/importer
Auchan	Hypermarket Auchan Ukraina (\$0.64 bln)	8	Nation-wide	Direct/importer
Velyka Kishenya, Velyka Kishenya Select, Prosto Market, Walmart, №1,	Retail Group Holding (\$0.6 bln)	43	Nation-wide (17 regions)	Direct/importer
Tavriya-V, Kosmos	Tavriya-V LLC (\$0.43 bln)	34	Southern/Central Ukraine, Kyiv	Wholesaler/Direct/importer
ECO-Market supermarket	Bayadera Ltd. (\$0.39 bln)	82	Nation Wide	wholesaler/direct/importer
Amstor, Amstor Express	Smart Holding Ltd (\$0.39 bln)	24	Eastern Ukraine, Kyiv	Direct/importer

Fresh, Arsen, Sojuz	Eurotech Ltd.	7	Western Ukraine	wholesaler/direct
PAKKO, supermarkets	Pakko Corp.	87+10	Western Ukraine	Direct/importer
Vopak, C&C				
Nash Kraj	Own stores of VolWest Group and Franchisees	65	Nation Wide	Direct/importer
Novus	BT Invest (Lithuania) (\$0.24 bln)	20	Central, Southern and Western	Direct/importer/wholesaler
Spar	Franchisees	36	Kyiv and Eastern Ukraine	Direct/importer/wholesaler
Colibris, Nash, 555	Avanta TD	52	Western Ukraine	Direct/importer
Varus	Omega Ltd. (\$0.39 bln)	31	Central-Eastern Ukraine	Direct/importer
Target, Simeina Kramnytsia Target	Target Trade Gropup	8	Kharkiv	Direct
Mega-Market, supermarket	Founder - Victor Yushkovskiy	6	Kyiv	Direct/importer
Natalka-Market, supermarket	"Natalka-Market" CJSC	6	Odessa, Mykolaiv	wholesaler/direct/importer

**Sources: Company information, expert estimates, FAS/Kyiv estimates*

Kiosks and Gas Marts

The number of kiosks, which were popular trade outlets in the early 1990's, has gradually diminished. The typical kiosk operates 24 hours a day and sells cheap alcohol, cigarettes and a limited number of food products. Limited floor space (usually 8-25 square meters) and a relatively wide stock list (on the order of 100-200 SKUs), as well as minimal required capital and operation costs ensures their existence. Competition from larger private stores and supermarkets that offered lower prices resulted in a reduction in the number of kiosks. They survive at road intersections, bus stops, underground stations, near open-air markets, in bedroom communities, and in rural areas. Kiosks offer a variety of the cheapest living essentials including food products. Lately, kiosks are becoming more specialized. For example, producers of meat and bakery products have opened kiosks to sell their own products near public transportation stops.

The number of modern gas stations continues to grow rapidly in Ukraine. Approximately 10-15 percent of all Ukrainian gas stations have stores that sell packaged food products. This includes mainly soft drinks, cookies, chocolates, and various snacks. These gas station stores account for 1-2 percent of all food stores. The service-store network is under development and is not viewed as a major revenue source by gas station managers. The developing network has good prospects and may increase its share of retail

sales.

Table 3. Kiosks and Gas Stations in Ukraine (ths.)

	2004	2005	2006	2007	2008	2011	2012	2013
Number of kiosks (stalls)	20.2	19.4	18.9	19.6	19.7	9.8	8.9	7.8
Number of gas stations	5.2	5.5	5.9	6.3	-	6.9	7.0	7.2

Source: State Statistics Service of Ukraine

Chain Convenience Stores and Self-service Groceries

Chain grocery stores are not yet very common in Ukraine, although becoming more so. The shortage of suitable land plots makes many retailers consider smaller formats. The Fozzy Group is developing a network of Fora and Bumi-market grocery stores. According to management, the chain may slowdown development of its Silpo supermarkets chain, but will not cut back on its Fora chain despite economic downturn. Their competitor - Dnipropetrivsk region based ATB Corporation, has a network of 372 stores, although these stores often close to supermarkets in size. Usually groceries are located in suburbs, offer a narrow product range and have limited floor space. These new groceries are quickly replacing the Soviet-style food stores. The average floor space varies from 300 to 500 square meters. Stock lists include an average of 1,500 to 3,500 items. Although recently many prefer to keep an expanded assortment up to 5000 SKUs. Grocery outlets have become rather popular among pension-age consumers who prefer to shop close to home. Retirees often make small purchases throughout the week. These outlets also target consumers with below average incomes and who generally purchase goods daily. These products tend to have a short shelf life (bread, dairy products, fruits and vegetables, etc.). Market analysts note that convenience stores lack regular customers and their market share is small. Nevertheless, grocery stores are very successful in small Ukrainian towns.

Table 4. The Largest Convenience Store Chains in Ukraine*

Chain Name	Owner/managing company	Type of the company	Trade outlet type	Number of outlets	Location
ATB (Discounter)	Corporation ATB (Ukraine) Floor Space: 280,500 m ²	Direct/wholesaler/importer	Convenience store	>650	The Biggest Nation-wide Chain
Fora, Bumi	Fozzy Group (Ukraine)	Direct / importer	Grocery / Discounter	178	Nation-wide
Brusnychka	Ukrainian Retail	Direct / importer	Grocery / convenience	102	wholesaler/direct/importer
Kvartal, Fresh-Market	Eurotec LLC	Direct / importer	Grocery / convenience	14	Northern and Central
SPAR Express	Spar Ukraine LLC.	Wholesaler / importer	Grocery / Convenience store	32	Eastern and Central Ukraine
Econom+	TK Econom Plus LLC.	Direct / importer	Convenience store	30	Zaporizhia

Absolute Express	PKF Lia LLC.	Wholesaler/Direct	Convenience store	31	Eastern Ukraine
Barvinok	Abris Capital Partners (Poland)	Wholesaler/ direct/ importer	Grocery	47	Western Ukraine
Bi Market	Bimarket LLC.		Convenience Store	16	Kyiv, Irpen
Rukavychka	TVK Lvivholod	Direct / importer	Self-service Grocery	50	Western Ukraine
Plus	RBB Group LLC.	Direct / importer	Convenience Store	41	Central Ukraine
Mars	Trade House Mars	Wholesaler/direct/importer	Grocery	10	Eastern Ukraine
Natalka Market	Natalka Trade	Wholesaler/ direct/ importer	Grocery	13	South Ukraine
Obzhora	Obzhora Chain	Wholesaler/importer	Grocery	15	Odessa Region
Kopeyka	Vit Almi LLC	Wholesaler/importer	Convenience store	29	Odessa Region

* Some chains can operate conventional supermarkets
Sources: Company information, open press, FAS Estimates;

Traditional Outlets: Independent Grocery Stores and Open-Air Markets

Stores with behind-the-counter sales (traditional groceries) are quite common in Ukraine. Some of these groceries are situated in central districts selling food products to office employees during the workweek and to a small number of urbanites. These stores have often been taken over by chain convenience store companies and converted into modern self-service convenience stores. Other traditional grocery stores survived in suburban communities in large cities. These stores are likely to leave the market due to fierce competition with supermarkets and modern convenience stores. They are losing clientele due to their limited product line, higher prices, poor customer service, and unprofessional vendors. In order to survive many offer round-the-clock operations and lease some floor space to sellers of industrial goods and services. Some are operating successfully in distant small districts of large cities and small provincial towns where the construction of supermarkets or modern chain convenience stores is economically unjustified.

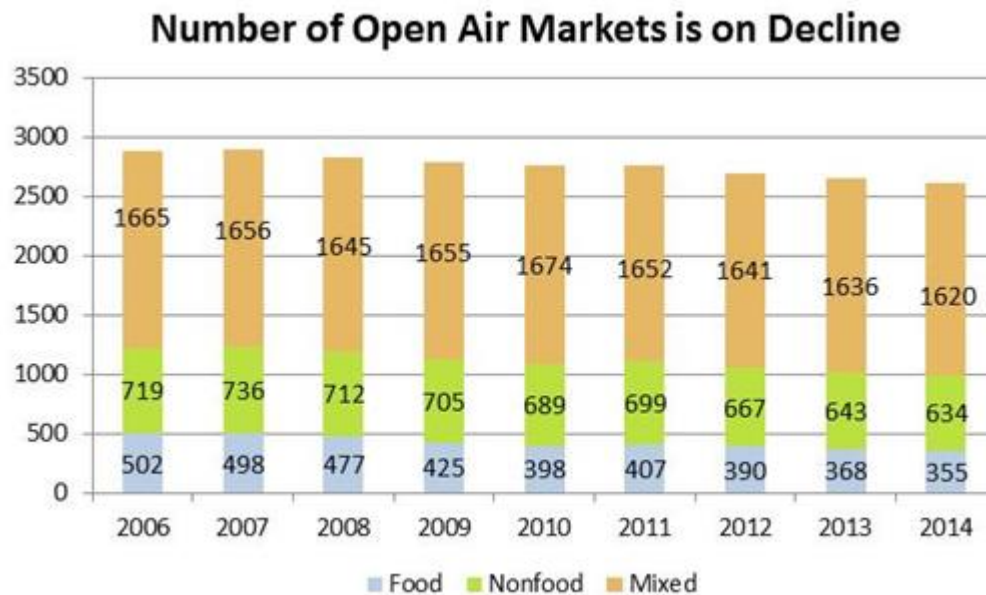
Grocery stores, especially those operating 24 hours a day, can be of certain interest to potential U.S. exporters. These outlets may become outlets for less expensive food products, manufactured abroad with long shelf life: alcohol drinks, assorted snacks, confectionery products, meat goods, canned goods, goods for elderly people. The overwhelming majority of these stores (except small ones with 150-200 square meter floor space) procure products through wholesale companies. Smaller ones buy products in Cash & Carry stores or from large wholesale open-air markets.

As reported by the State Statistics Service of Ukraine, there were 2,609 open-air markets (bazaars) of all types in Ukraine in 2013, including almost 355 food product open-air markets. Twenty five food open-air markets are located in Kyiv. At the same time, mixed open-air markets (rynoks) trading in both foodstuffs and non-food goods prevail in Ukraine and account for approximately 55 percent of the total number of markets of all types. The largest number of food product open-air markets in Ukraine is concentrated in the most populated regions. Typical Ukrainian open-air markets would include a space for farmers, while behind-the-counter kiosks sell packed and processed products. The open-air market kiosks zone would trade in low and middle cost products. Many people think that food products in traditional open-air markets are cheaper than in supermarkets. Elderly consumers are also confident in the high quality of products

offered at these wholesale open-air markets.

According to experts' estimates, in 2013, approximately 20 percent of food products in Ukraine were sold through this channel. For meat products this indicator reached 90 percent. These trade outlets are leading sellers of vegetables, fruits, meat, honey and dried fruits. At the same time, sales of dairy products, sunflower oil, and alcoholic drinks are gradually moving from open-air markets to outlets of other types. Open-air markets provide poor customer service, lack storage equipment and often sell low quality products for a price that is often higher than in supermarkets.

Improvement of service standards in open-air markets would lead to a marginal increase in competitiveness, but long-term prospects are still not very promising. Some renovated central open-air markets for food products in large cities were transformed into traditional elite supermarkets offering high-quality products. Bessarabskiy and Volodymyrskiy bazaars in Kyiv are good examples. These open-air markets located in the historical part of the city serve as shopping destinations for foreigners living in Kyiv and the Ukrainian elite. This category of markets can be interesting for American exporters of specialty meat products, seafood, semi-finished goods, microwaveable foods, mixtures of exotic dried fruits, nuts, confectionery goods, alcohol drinks, and traditional U.S. consumer food products, which ordinary supermarkets find inconvenient to stock due to low demand.



Source: State Statistics Service of Ukraine

It is quite likely that the number of traditional groceries, kiosks, and bazaars will decrease in the future, while the number of hypermarkets, supermarkets and self-service convenience stores would grow. Open-air markets together with "vegetable-fruit" stalls will compete strongly with modern stores in retail sales of fruits and vegetables. The number of kiosks will likely also diminish.

MARKET TRENDS

Modern Trade Promotion Methods

Chain stores regularly train their personnel and experiment with product layout, in order to maximize profit from one square meter of floor space. Many supplier companies have their own display schemes. In-store new product tasting and promotion campaigns are also quite frequent.

Many supermarkets are equipped with television screens for demonstrating commercials promoting goods and services. Traditional poster and panel advertisements are also popular. The largest supermarkets issue their own advertising booklets and discount coupons. They also practice direct-mail distribution of these booklets to potential customers and publish advertisements devoted to products or one specific country. In particular, one such edition published by Furshet was devoted to products of German origin. These methods can be applied to U.S. product advertisement.

Loyalty programs dedicated to specific brands were launched in 2006. The goal of these programs is to create long-term brand loyalty. Producers attempt to reduce marketing costs by developing marketing campaigns that represent more than one company. The main incentive tool used by program members is targeted coupons.

Digital technologies, such as mobile marketing, are widely used for Sales Promotion purposes. Scratch cards enable producers to link promotions with retail outlets. There are a number of in-store marketing technologies, which were purchased from the United States in 2006. Among them are in-store couponing (operated by Coupon Management System company from the Prospects Group) and on-floor stickers (operated by Floorgrafics, U.S.). Different refunds and rebate schemes have been tested by Prospects Company over the past three years.

Market Power

In the early days of the Ukrainian retail (2000 – 2002) sector, producers of food and agricultural products could dictate to supermarkets terms for positioning, marketing and payments of goods. Food products were viewed as anchor commodities attracting consumers to new supermarkets. The situation changed rapidly in 2004-2007, when retail chains acquired a significant market share in larger cities, attracting middle and high-income consumers. Retailers quickly realized that control over targeted consumers gave them control over producers. Producers of hard liquors, vodka and dairy products publicized these new problems, while many other supplies preferred to keep these issues quiet. Most problems were related to retailer recommended prices and price discounts some to product placement and associated fees. The threshold used to introduce products in Ukrainian supermarkets remains quite low if compared to Western chains, but it seems excessively high to many Ukrainian producers.

SECTION III. COMPETITION

The Government of Ukraine took a number of steps to protect domestic producers of food products in the mid-1990s. This resulted in high import tariffs and a complicated system of sanitary and phytosanitary requirements. The economic crisis of 1998 abruptly decreased individual incomes and drove consumers to purchase cheaper domestically produced products. All of these factors contributed to the robust development of the domestic food-products industry. Production of dairy and meat products (sausages, smoked foods), soft drinks, mineral water, juices, beer, confectionery, various appetizers, and chilled chicken meat is still on the increase. Introduction of high import duties made legal imports of many foreign

food products unprofitable, while the Ukrainian market remained open to food products originating in Russia and other CIS countries. The Free Trade Agreement among CIS countries facilitated trade. Russian-made products were charged only the value-added tax, which make their price comparable to similar Ukrainian products. Many imports from the EU and the United States cannot compete on price with CIS goods.

Main Delivery Sources and Volumes of Specific Product Imports to Ukraine

Product Category	Major Supply Sources in 2013 and their share*	Strengths of Major Supplying Countries	Advantages and Disadvantages of Local Suppliers
Pork Net Imports: 157 TMT US Supplies: 12,300 tons	1.Brazil 37 percent 2.Poland 10 percent 3. Germany 42 percent	Much lower prices, stable quality	Highly inefficient pork production in private households and in majority of industrial farms; Some production rebound in 2012-14 based on renewed technologies.
Almonds Net imports: 2.5 TMT US Supplies: \$ 17.0 mil.	1. U.S. – 99	U.S. product dominates this market. Competition is almost absent.	There is no local production, although there is a demand from snack and confectionary industries.
Fish and fish products Net imports: 464 TMT US Supplies: \$ 106 mil.	1. U.S. – 11 2. Norway – 28 4. Iceland - 12 5. China – 5 6. UK – 4	U.S. share of 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 storage. The Russian share is stable and surprisingly low.	Local production is limited mainly by fresh water fish and Black sea basin fish. Atlantic fish quotas for Ukraine are small. Popular fish species are not supplied by local fishermen and have to be imported.
Pet food Net Imports: 75 ths. tons US Supplies: \$2.7 mil.	1.France 13 2.Hungary 26 3.Russia 38	Exports of well-known pet food trademarks from Russia dominate in low segment. U.S. brands are perceived as high quality ones	Traditionally high number of home pets, large market potential; low demand for industrially produced pet food
Wine and Beer Net Imports: 85 million liters US Supplies: \$0.5 mil	1.Italy 21 2.Georgia 17 3.France 12	CIS origin wine is reasonably priced and has traditional brands. Western Wines are occupy the upper segment and perceived as high quality ones	Steady demand for locally produced wines; production experience; broad assortment and low prices; poor positioning of high quality vintage wines; traditional preference to sweetened wines

Snack food Net Imports: 50 ths. tons US Supplies: 1,000 tons	1.Poland 71 2.Russia 9	Countries of South America, Spain, Georgia, and Azerbaijan supply citrus fruits at right price/quality ratio	Essential volume of smuggling especially from Poland and the CIS states as well as lack of storage facilities; low cost of local production
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Sources: State Statistics Service of Ukraine, expert estimates

SECTION IV. BEST PRODUCT PROSPECTS

Category A: Products Present on the Market With Good Sales Potential

Product	2013 Market volume	2013 Import volume	Average growth of import over the last 3 years	Import taxes	Main factors hindering import development	Attractiveness of the market for the USA
Beef	440 ths. tons	3.7 ths. tons	-20 percent	15 percent	Consumer unawareness of U.S. high quality beef; Sizable domestic production, Complicated import procedures.	Insignificant specialized beef production; Constantly growing beef prices; Niche markets for meat delicacies (steak, etc.) and meat offal; Fast HRI development.
Pork	1032 ths. tons	220 ths. tons	Turbulent	10-12 percent	Competition from Brazilian, German and Polish pork, complicated import procedures.	Shortage of pork in the country; declining production; high prices; Demand for stable deliveries of both cheap and high quality product.
Fish and Seafood	~520 ths. tons	464 ths. Tons	10 percent	0 – 5 percent for all frozen fish; 10 percent for	Regular deliveries of high quality product from Norway; Shortage of	Growing demand for higher quality seafood from consumers; Significant demand

				prepared fish, live fish, Mackerel, Trout, some Crustaceous, Anchovy, Salmon and Lobsters.	suitable equipment at retail trade outlets; Deficit of proper storage facilities with below -20C temperature.	from supermarkets and HRI sector.
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* All imported products are subject to 20 percent VAT tax.

Category B: Products Not Present in Large Quantities but with Good Sales Potential

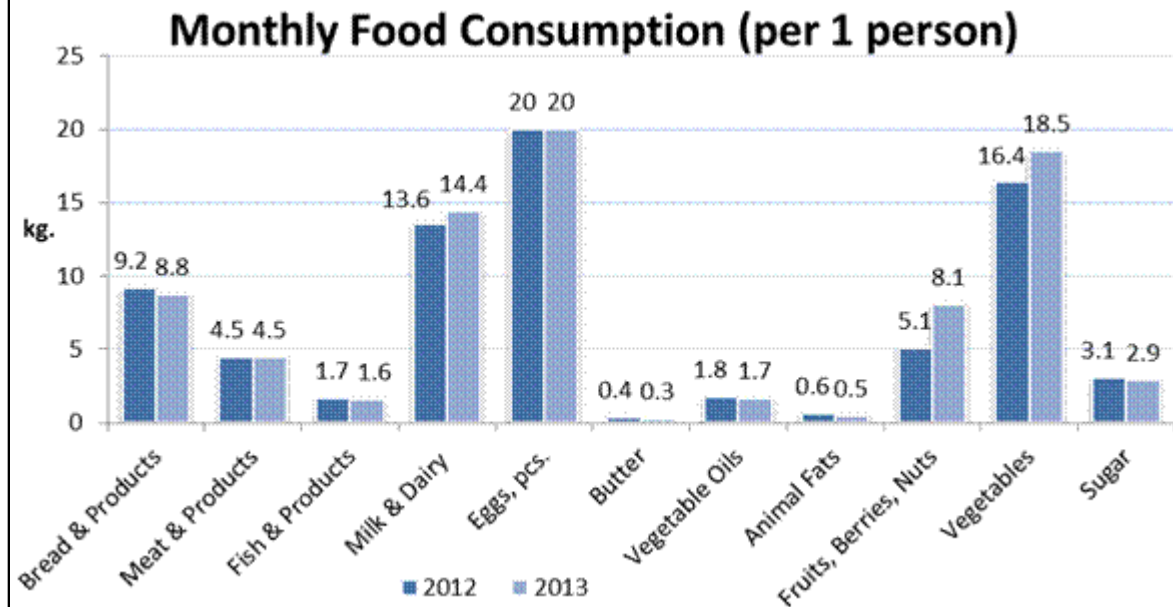
- Premium-class food products: meat specialties (meat for further cooking – steaks, fillet, etc.), smoked meat, cheese;
- Exotic seafood, ready-made high-quality canned fish;
- Cereals: muesli, instant porridge, ready-made rice, different sorts of ready-made packed rice;
- Food for diabetics;
- Specialized infant food, canned vegetables and infant fruit food;
- Exotic drinks/juices (from exotic fruits, energy drinks, vitamin drinks, root beer), drink concentrate, traditional drinks with different additives (tea/hot chocolate with additives);
- Semi-prepared goods, ready-made frozen food, microwaveable food;
- Packed food ingredients of high quality for cooking (brown sugar, sugar powder, high-quality spices etc.)
- High-quality beer snacks (a rapid increase in beer consumption over the last several years and stable forecasts regarding beer consumption growth in the future).
- The future aging of the population creates a niche market for this category of costumers. The low current incomes of this category make this market profitable only in the future.

Category C: Products Not Present Because They Face Significant Barriers (with barriers indicated)

- Any food product that has a genetically modified component in it (unclear and incomplete legislative framework for registration of GM products). Labeling of such was introduced at the end of 2009 and implemented in 2010.
- Ready-to-eat meat products (smoked meat, sausages, hotdogs) – high competition of similar Ukrainian products, significant veterinary clearance barriers.
- Inexpensive imported chocolates – strong competition from similar Ukrainian products;

SECTION V. ATTACHMENTS

Per capita Food Consumption (in 2012/13)



Source: State Statistics Service of Ukraine

Sales

Ukraine's Imports of Consumer Oriented Agricultural Products, Million USD

Commodity	Description	United States Dollars			% Share			% Change 2013/ 2012
		2011	2012	2013	2011	2012	2013	
	Total	3092	4069	4422	100	100	100	8.7
080300	Bananas And Plantains, Fresh Or Dried	153	285	316	5	7	7	11
210690	Food Preparations Nesoi	223	259	312	7	6	7	21
020329	Meat Of Swine, Nesoi, Frozen	122	292	305	4	7	7	5
210111	Coffee Extracts, Essences Etc.	257	226	221	8	6	5	-2
080520	Mandarins (Inc Tanger Etc) & Citrus Hybr	118	159	217	4	4	5	36
080510	Oranges, Fresh	87	112	144	3	3	3	29
180690	Cocoa Preparations, Not In Bulk Form, Nesoi	77	90	119	2	2	3	32
230910	Dog And Cat Food, Put Up For Retail Sale	95	105	117	3	3	3	11
090121	Coffee, Roasted, Not Decaffeinated	105	102	115	3	3	3	12
220421	Wine, Fr Grape Nesoi & Gr Must W Alc	73	80	96	2	2	2	21
	Other not listed	1308	1710	1961	42	42	44	6

Source: State Statistics Service of Ukraine

Ukraine's Imports of Consumer Oriented Agricultural Products from the U.S., Million USD

Com- modity	Description	United States Dollars			% Share			% Change
		2011	2012	2013	2011	2012	2013	2013/ 2012
	Total	72	135	166	100	100	100	23
020329	Meat Of Swine, Nesoi, Frozen	3	2	32	5	7	7	11
210690	Food Preparations Nesoi	15	20	22	7	6	7	21
020714	Chicken Cuts And Edible Offal (Inc Livers), Frozen	4	48	16	4	7	7	5
040510	Butter	0	0	14	8	6	5	-2
040700	Birds' Eggs, In The Shell, Fresh, Preserv Or Cookd	11	14	13	4	4	5	36
080211	Almonds, Fresh Or Dried, In Shell	6	9	11	3	3	3	29
040590	Fats And Oils Derived From Milk, N.E.S.O.I.	2	0	10	2	2	3	32
020622	Livers Of Bovine Animals, Edible, Frozen	2	4	8	3	3	3	11
350510	Dextrins And Other Modified Starches	8	8	7	3	3	3	12
080212	Almonds, Fresh Or Dried, Shelled	2	3	6	2	2	2	21
	Other not listed	19	26	27	26	19	16	5

Source: State Statistics Service of Ukraine

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