



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.09

Required Report - public distribution

Date: 8/29/2005

GAIN Report Number: UP5015

Ukraine

Poultry and Products

Annual

2005

Approved by:

W. Garth Thorburn II
U.S. Embassy Kiev, Ukraine

Prepared by:

Oleksandr Tarassevych, Ag. Specialist

Report Highlights:

In March 2005, Ukraine eliminated tax privileges associated with the Free Economic Zones resulting in a precipitous increase in real import duties for poultry. This created a significant obstacle for U.S. producers and jeopardized plans for further expansion of legal exports for 2005 and 2006. The market situation for U.S. suppliers is compounded because import duties for chicken parts are significantly higher than for whole chickens. Supported by considerable financial injections and high domestic poultry prices, Ukrainian poultry producers will continue to increase output in 2006. However, the domestic industry will be unable to satisfy domestic demand and imports (both legal and illegal) will persist.

Includes PSD Changes: Yes
Includes Trade Matrix: Yes
Annual Report
Kiev [UP1]
[UP]

Table of Contents

| | |
|---|-----------|
| Executive Summary | 3 |
| Section I. Narrative | 3 |
| Production..... | 3 |
| Marketing | 4 |
| Consumption | 4 |
| Trade | 5 |
| Policy..... | 5 |
| Section II Statistical Tables | 10 |
| Broiler Meat PSD Table | 10 |
| Poultry Meat Imports into Ukraine on RTC equivalent basis | 11 |
| (Whole birds and poultry cuts HS 0207 and cooked..... | 11 |
| poultry products HS 16023)..... | 11 |
| Frozen Chicken Export Trade Matrix, MT..... | 11 |
| (Whole birds and poultry cuts HS 0207..... | 11 |
| and cooked poultry products HS 16023) | 11 |
| Imported Broiler Leg Quarter Wholesale Price | 12 |

Executive Summary

Ukraine's poultry production in 2006 will continue to accelerate at a rapid rate, but the market is expected to be turbulent. Prohibitively high import duties make legal imports of U.S. poultry to Ukraine unprofitable even after amendments to the Customs Tariff in June 2005 that were aimed at reducing tariff rates. The market is characterized by a significant increase in demand for poultry, a surge in red meat prices and gradually declining efficiency of beef and pork enterprises. The domestic poultry industry has already announced a 31% production increase for 2006 and is likely to achieve this goal. Exports of US poultry to Ukraine in 2006 will be insignificant, unless legislative reforms significantly reduce the prohibitive tariff rates for poultry. US competitors might be able to take advantage of the situation by supplying whole chickens to Ukraine that face a much lower tariff rate. However, it is unlikely that Ukrainian traders will import significant amounts of whole birds given the current price level and size of available shipment allotments for sale. Imports of red meat in 2006 are expected to grow and will serve as a substitute for poultry.

Section I. Narrative

Production

Boosted by high prices for poultry and substitutable red meat products, production of poultry in Ukraine is expected to continue to grow in 2006. The lack of legal imports because of prohibitive tariff rates will provide additional incentives for local producers to increase production. The Ukrainian poultry Union has an ambitious plan to significantly expand output. The industry is planning to grow by 30% a year for the next 3 years. The plan is supported by publicly available business plans and open lines of credit from Ukrainian and foreign banks.

In 2006, the largest enterprises in the industry will continue to expand production significantly, while smaller enterprises will grow at a much slower rate. The two largest producers are now supplying over 64% of domestic production and their influence in the market is expected to continue for 2006. The largest Ukrainian poultry producer - Myronivsky Khleboproduct LLC. (Nasha Riaba brand) - is about to invest \$630 million in a new poultry operation. The expansion program will be undertaken with the cooperation of the World Bank's International Finance Corporation (IFC). The loan from IFC may reach \$60 million in 2005 alone with IFC taking over part of Myronivsky Khleboproduct. The deal continues a tradition of cooperation between the IFC and Myronivsky Khleboproduct, which began in 2003, when IFC granted a \$30 million loan to this Ukrainian poultry producer. The second largest producer - The Agromars Complex - decided to upgrade technology and expand production by issuing stocks for \$3.5 million in May 2005. The company also announced a franchising program that was launched in July 2005. It is expanding its production facilities which are expected to become operational by the end of 2005 or in early 2006.

In 2005, U.S. investors made some acquisitions in Ukraine buying poultry enterprises in the southern region. Investors purchased big idle facilities, which went out of business after the collapse of the Soviet Union. The facilities are well preserved, but have outdated technology and need a great deal of investment to purchase new equipment and capital to fund operational expenses. The new company is not expected to be a major market player in Ukraine until 2007 or 2008.

The main focus of expansion programs undertaken by Ukrainian poultry producers is on infrastructure and modernization of existing facilities. Poultry companies are investing in grain and oilseed storage facilities, feed processing enterprises (Myronivsky Khleboproduct),

slaughter facilities, incubators (Ruby Rose Agricole Co, Ltd., Agromars Complex and Kurgansky Broiler), and meat packing and semi-finished product lines (Ruby Rose and Myronivsky Khleboproduct). And, recently the first indication of the industry's expansion into turkey and duck meat emerged. Previously, these products were supplied by importers. Industry experts predict that in 5-years the industry will satisfy domestic demand and begin exporting to nearby markets. Presently, exports of frozen poultry to Russia and Byelorussia are limited.

There is concern in Ukraine over the recent outbreak of bird flue (A/H5N1) in Novosibirsk, Omsk and Kurgan oblasts of the Russian Federation. Reports suggest that infected birds might be migrating west which prompted the Chief Veterinary Officer in Ukraine to hold a press-conference to calm public's fear that the virus might infect Ukrainian birds. The CVO stated that there are currently no cases in Ukraine and acknowledged that the GOU has taken appropriate measures to insure public safety.

Marketing

The market in Ukraine for poultry products continues to have two distinctive segments: retail and further processing. Domestically produced chilled poultry product dominates the retail segment in big cities, while cheaper frozen meats are predominately consumed by processors and low income consumers in small towns (for more information on market segmentation see GAIN report UP 4015). The increase of the real import tariff led to a crisis in the "further processing" segment, which heavily relied on imported product. Many processors started to purchase domestically produced poultry (specifically looking for whole birds at a fixed wholesale price of 10 UAH per kilogram) that subsequently drove up prices in the retail segment. Clear product separation and distinct market segmentation that existed in Ukraine in previous years became blurred in 2005. Future developments will depend on availability of cheap imports and government policies.

Despite booming poultry production, poultry meat did not become a fully substitutable product for beef and pork in the processing industry. Traditionally, Ukrainians prefer sausages made of beef and pork. Attempts to fix the problem with aroma substances were not generally successful. Besides, Ukrainian poultry producers prefer to sell product through retail outlets in order to get a premium price for their chilled product. Producers continue to develop their own brands and develop franchising networks to more efficiently sell their product. The franchising chain that belongs to the biggest poultry producer has over 1,000 outlets located in all regions of the country. The chains were supported through aggressive advertising campaigns in the mass media. Huge demand for poultry products in 2005 however, made many expensive mass media campaigns unnecessary, thus only some sporadic promotional activity was noticed.

Consumption

Two contradictory trends collided on the consumption side. On one hand, incomes were growing (24.8% increase in 2004 alone) that resulted in a strong increase in demand for animal protein. On the other hand increasing poultry prices undercut demand. (Note: the average monthly disposable income in Ukraine remains quite low at UAH 442 (\$88) in April of 2005.)

Following the significant increase in real import tariff rates for poultry, the GOU attempted to prevent the rapid price increase through administrative pressure on the domestic industry. The end result was that the Ukrainian Poultry Union signed a special memorandum of Understanding with the Ministry of Agricultural Policy of Ukraine. The Union committed to increase poultry and egg production in return for fixing state support programs at the current

level. The later means VAT exemptions for agricultural producers, a fixed agricultural tax, partial commercial interest rate compensation, and 30% reimbursement for the purchase of Ukrainian produced machinery. The memorandum also fixed the wholesale price for whole chicken (chilled and frozen) at UAH 10 (\$2.0) per kilogram. The memorandum had a minimal affect. Processors lined up to purchase whole chickens at a low fixed price for their processing facilities, while retailers predominately offered chicken cuts at much higher price. In August 2005, the retail price for chicken legs in Kiev supermarkets ranged between UAH 23.5 (\$4.7) and UAH 25.5 (\$5.0) per 1 kilogram. Chicken parts and MDM were or sale for UAH 2-3 (\$0.4 - \$0.6) less per kilo.

Obviously, the price increase had a significant negative impact on demand. Only 24% of the population (middle and upper classes) are immune to the price change. The rest of the population had to cut consumption to 2003 levels. The significant drop in demand for poultry has led to a substantial increase in the amount of red meat imported into Ukraine for 2005.

Trade

Given the extremely volatile political environment, it is very difficult to make trade forecasts for the remaining months of 2005 as well as for 2006. If import tariffs continue to stay at current prohibitive levels, legal imports of poultry cuts and offal will not occur and the market will remain closed for US exporters. Importers will probably be able to import some frozen whole chickens under a more favorable 0.4 EUR per kilogram import duty, especially if domestic poultry prices continue to increase (See price table in the Section II). In private conversations, importers expressed disbelief that foreign suppliers will be able to provide Ukraine with a sufficient amount of whole frozen chickens. Additionally, traders questioned profitability of such imports given current prices and the 0.4 EUR per kilogram import duty. Trade in whole chickens will not resume until domestic price increases another 20% or so, or some legislative changes are introduced.

The smuggling of poultry is expected to skyrocket in the remaining months of 2005 and in 2006. It is likely that the current situation will mirror what happened in the late 1990's when the volume of illegal trade significantly exceeded the import volume of legal imports. Recent steps of the GOU aimed at reducing corruption in the Customs Service are not expected to be effective given the high margins that smugglers are getting on the market. Current high retail prices for chicken legs (25 UAH (\$4.8) per kilogram) and the short supply ensure illegal activity will continue.

Limited exports of poultry products from Ukraine are attributed mostly to prepared poultry products (HS 16023) exported to Russia and Belarus under free trade agreements. All these products are produced from imported poultry and offal. This enables Russian importers to circumvent meat quota limits imposed by the Government of Russia. An appropriate change is introduced in the PSD table for 2004 and 2005 to reflect these exports. Given the current market situation, all exports are expected to decrease in 2006.

Policy

Poultry imports quickly became a controversial political issue in the post "orange revolution" Ukraine. In January 2005, the new government came to power and committed to development of a more transparent and liberal economic environment. Free Economic Zones (the FEZs) where the majority of poultry imports entered Ukraine duty free were immediately targeted by the new government for elimination (for more information on FEZs please refer to UP 3011 report). Following their closure in late March 2005, prohibitive import tariffs went into effect throughout the country. Imports were no longer able to legally circumvent high import tariffs. Thus, a trade barrier was created that effectively stopped imports of poultry.

Occasional small shipments of imported poultry in April and May are explained by the arrival of pipeline shipments and poultry stored at customs bonded warehouses with expired or close to expired shelf life. FAS Kiev is aware of at least 4,000 tones of U.S. poultry products re-exported from Ukraine to other countries in June and July 2005 as a result of the high tariffs.

The government attempted to deal with the situation that was created with the elimination of tax privileges associated with FEZs. With the sudden drop in supply, a growing meat shortage and surging meat prices, the GOU decided to decrease prohibitive import duties to allow trade. A draft law was introduced to the Parliament in mid March. The draft law proposed to reduce import tariffs for most agricultural products. For poultry, this regulation initially proposed to reduce the import tariff rate to 20% *ad valorem* equivalent. This move was quickly opposed by the agrarian lobby. By using domestic industry protection arguments they managed to pressure the government to maintain the tariff at prohibitive levels. These new fixed rate duties when converted into *ad valorem* equivalent rates reached several hundred percent.

Following heated political debates in Parliament for over 4 months, the law was finally adopted in early July. Meat products were the most contentious issue and the agrarian lobby was successful in keeping tariff rates for poultry at prohibitive rates despite some tariff changes. Table 2 provides the renewed import tariff schedule for poultry products and compares the new rates with previous rates. Some tariffs are to be decreased upon Ukraine's accession to the WTO, but even then they will remain high.

Table 1. Ukraine's Import Tariffs for Poultry Products (Old versus New Rates)

| Ukrainian HS Code | Code Description | Old * Import Tariff Schedule | | New Import Tariff Schedule | |
|---|---|--------------------------------------|-----------------------------------|--------------------------------------|-----------------------------------|
| | | Official Ad valorem Import Duty Rate | Fixed minimum rate, EUR per 1 kg. | Official Ad valorem Import Duty Rate | Fixed minimum rate, EUR per 1 kg. |
| 0207 | Poultry Meat and Edible Offal (Total), including: | | | | |
| 0207 11 | Chickens, Not Cut in Pieces, Fresh or Chilled | 30% | 1,5 | 10% | 0.4 |
| 0207 12 | Chickens, Not Cut in Pieces, Frozen | 30% | 1,5 | 10% | 0.4 |
| 0207 13 10 | Chicken Cuts and Edible Meat Offal, Fresh or Chilled | 30% | 1,5 | 30% | 1,5 |
| 0207 13 20 | Chicken Halves and Quarters, not deboned, Fresh or Chilled | - | 0,7 | - | 0.7 |
| 0207 13 30 0207 13 40 0207 13 50 | Chicken Wings, Cuts, Backs, Necks, Backs with Necks, Wing Tips, Breasts, Fresh or Chilled | 30% | 1,5 | 30% | 1,5 |
| 0207 13 60 | Chicken legs and leg parts, not deboned, Fresh or Chilled | - | 0,7 | - | 0,7 |
| 0207 13 70 0207 13 91 0207 13 99 | Chicken Offal, Liver and other Cuts, Fresh or Chilled | 30% | 1,5 | 30% | 1,5 |
| 0207 14 10 0207 14 20 0207 14 30 0207 14 40 0207 14 50 | Chicken Cuts: Halves, Quarters, Wings, Backs, Necks, Backs with Necks, Wing Tips, Breasts, Frozen | 30% | 1,5 | 30%** | 1,5** |
| 0207 14 60 | Chicken Cuts, Legs and Leg Cuts, Frozen | - | 0,7 | -** | 0,7** |
| 0207 14 70 0207 14 91 0207 14 99 | Chicken Offal, Liver and other Cuts, Frozen | 30% | 1,5 | 30% | 1,5 |

Source: The Law of Ukraine "On Customs Tariff" as of July of 2005 and as of August of 2005.

All tariff rates are MFN rates.

* These tariffs were previously circumvented by importers situated in FEZs. However, in actuality FEZs were not tariff free because some fees such as FEZ registration payments and special taxes on production within the FEZs had to be paid. These charges are difficult to estimate.

** Import tariff rates for 02071410 - 02071460 will be reduced upon Ukraine's accession to the WTO to 10%, but no less than 0.4 EUR/kilogram.

Table 1 compares poultry tariff rates changes that were signed into law by President Yuschenko on August 8, 2005 and published on August 16, 2005 with tariff rates that were in place prior to that time. (Please note that the new rates go into effect only after they are published.) The changes in poultry tariff rates is uneven, some rates decreased, while others remained the same. However, the end result is that applied tariffs for all poultry products increased significantly since the beginning of the year. Prior to the elimination of FEZs, only 3% of all poultry trade was subject to import tariffs listed under the "old tariff schedule column" in Table 1. All other legal imports were transshipped duty free or processed and repackaged in the FEZs with very insignificant payments made to local budgets.

In order to estimate the impact the tariff changes will have on U.S.- Ukraine bilateral trade, the structure of poultry imports in 2004 must be analyzed. When the previous poultry ban was lifted in November 2003, the majority of poultry traded was poultry cuts and offal (HS 0207 14). As depicted in Table 2, chicken cuts and offal (HS 0207 14) accounted for approximately 90% of all imports, while whole chickens only 3%. Thus, introduction of the reduced 10% tariff rate (or 0.4 EUR per kilogram) for whole frozen chickens (HS 020712) will likely have no effect in a short run, but may lead to some market changes in 2006.

Table 2. Poultry Product Imports into Ukraine Following Reversal of the Poultry Ban of 2003 and 2004

| HS Codes | Description | 2003 | 2004 | Share of 6-digit HS Group in 0207 in 2004, % | Growth 2003-2004, Per cent |
|----------|---------------------------------------|-------|-------|--|----------------------------|
| 0207 | Poultry Meat and Edible Offal | 100,7 | 295,7 | | 294 |
| 020712 | Whole Chickens, Frozen | 5,3 | 8,5 | 3 % | 161 |
| 020714 | Chicken Cuts and Edible Offal, Frozen | 81,3 | 267,0 | 90 % | 329 |
| | Other 0207 | 14,1 | 20,1 | 7 % | 143 |

If imports of Chicken Cuts and Offal are broken down to HS 8-digit subcategories (see Table 3.), it is clear that 93% of all U.S. exports (\$ 56.2 Mln.) fall under HS 020714 category. The official import tariff for this category is unchanged at 30% of the CIF price or no less than 1.5 EUR per kilogram. Given an average declared CIF price for HS 020714 of \$ 0.41 per kilogram in 2004, the 1.5 EUR import duty transfers into a prohibitive 439% *ad valorem* equivalent tariff rate. This import duty effectively stopped imports of poultry beginning in April 2005 and will continue to be a major obstacle for poultry trade in 2006.

Table 3. Imports of Chicken Cuts and Edible Offal, Frozen (HS 020714), Million USD

| | | Ukrainian Market Total, Mln \$ | U.S. Share Mln. \$ | U.S. Share, % |
|-----------------|--|--------------------------------|--------------------|---------------|
| 02071410 | Chicken Cuts Separated from Bones, Frozen | 20,1 | 0,6 | 3,0 |
| 02071420 | Chicken Cuts, Halves and Quarters, Not Separated From Bones, Frozen | 74,2 | 56,2 | 75,7 |
| 02071430 | Chicken Cuts, Wings, with or without Tips, Frozen | 0,1 | 0,0 | 0,0 |
| 02071440 | Chicken Cuts, Backs, Necks, Backs with Necks, Wing Tips, Frozen | 4,5 | 1,1 | 24,2 |
| 02071450 | Chicken Cuts, Breast, Frozen | 0 | 0 | 0 |
| 02071460 | Chicken Cuts, Legs and Leg Cuts, Frozen | 0,7 | 0,1 | 20,0 |
| 02071470 | Chicken Cuts, Other | 10,1 | 0,3 | 3,0 |
| 02071491 | Chicken Cuts, Liver, Frozen | 0,1 | 0,0 | 36,2 |
| 02071499 | Chicken Cuts, Offal, Frozen | 0,3 | 0,0 | 0,0 |
| | Total | 110,1 | 58,3 | 53,0 |

Given the prohibitive import duty that has been in effect since March 29, 2005, it is very difficult to accurately forecast for 2006. The market continues to suffer from a significant deficit in poultry. This situation will prompt the government or parliament to act sooner or later but thus far the government has failed to find an effective and acceptable solution. Nevertheless, the forecasts for supply and demand in this report are built on assumptions of no legislative reforms and a stable market situation. A lot will depend on the world market situation and the ability of other poultry suppliers (Brazil and EU countries) to supply whole chickens (HS 0207 12) under the reduced to 0.4 EUR per kilogram tariff.

Section II Statistical Tables

Broiler Meat PSD Table

| Country | Ukraine | | | | | |
|-----------------------------|------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Commodity | Poultry, Meat, Broiler | | | (1000 MT)(MIL HEAD) | | |
| | 2004 | Revised | 2005 | Estimate | 2006 | Forecast |
| | USDA Official [Old] | Post Estimate [New] | USDA Official [Old] | Post Estimate [New] | USDA Official [Old] | Post Estimate [New] |
| Market Year Begin | | 01.2004 | | 01.2005 | | 01.2006 |
| Inventory (Reference) | 0 | 0 | 0 | 0 | 0 | 0 |
| Slaughter (Reference) | 0 | 0 | 0 | 0 | 0 | 0 |
| Beginning Stocks | 0 | 0 | 0 | 0 | 0 | 0 |
| Production | 150 | 208 | 260 | 280 | 0 | 370 |
| Whole, Imports | 0 | 8 | 0 | 10 | 0 | 20 |
| Parts, Imports | 130 | 288 | 150 | 105 | 0 | 25 |
| Intra EC Imports | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Imports | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL Imports | 130 | 296 | 150 | 115 | 0 | 45 |
| TOTAL SUPPLY | 280 | 504 | 410 | 395 | 0 | 415 |
| Whole, Exports | 0 | 0 | 0 | 0 | 0 | 0 |
| Parts, Exports | 5 | 0 | 6 | 0 | 0 | 0 |
| Intra EC Exports | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Exports | 0 | 5 | 0 | 5 | 0 | 0 |
| TOTAL Exports | 5 | 0 | 6 | 0 | 0 | 0 |
| Human Consumption | 275 | 504 | 404 | 395 | 0 | 415 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Dom. Consumption | 275 | 504 | 404 | 395 | 0 | 415 |
| TOTAL Use | 280 | 504 | 410 | 395 | 0 | 415 |
| Ending Stocks | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL DISTRIBUTION | 280 | 504 | 410 | 395 | 0 | 415 |
| Calendar Yr. Imp. from U.S. | 40 | 125 | 0 | 55 | 0 | 5 |

**Poultry Meat Imports into Ukraine on RTC equivalent basis
(Whole birds and poultry cuts HS 0207 and cooked
poultry products HS 16023)**

| Country | Ukraine | | |
|-------------------|------------------------|----------------|--------|
| Commodity | Poultry, Meat, Broiler | | |
| Time Period | | Units: | MT |
| Imports for: | 2003 | | 2004 |
| U.S. | 4259 | U.S. | 124610 |
| Others | | Others | |
| Brazil | 31393 | Brazil | 49801 |
| United Kingdom | 8142 | United Kingdom | 36841 |
| Belgium | 11919 | Belgium | 14984 |
| Germany | 10493 | Germany | 14200 |
| Hungary | 5406 | Hungary | 12190 |
| Denmark | 3607 | Denmark | 8099 |
| France | 1384 | France | 3087 |
| Netherlands | 3713 | Netherlands | 4447 |
| Canada | 2863 | Canada | 2598 |
| Total for Others | 78920 | | 146247 |
| Others not Listed | 4617 | | 5891 |
| Grand Total | 87796 | | 276748 |

Source: Ukraine's State Statistics Committee

**Frozen Chicken Export Trade Matrix, MT
(Whole birds and poultry cuts HS 0207
and cooked poultry products HS 16023)**

| Country | Ukraine | | |
|-------------------|------------------------|---------|------|
| Commodity | Poultry, Meat, Broiler | | |
| Time Period | | Units: | MT |
| Exports for: | 2003 | | 2004 |
| U.S. | 0 | U.S. | 0 |
| Others | | Others | |
| Russia | 5211 | Russia | 8064 |
| Belarus | 119 | Belarus | 134 |
| Total for Others | 5330 | | 8198 |
| Others not Listed | 3 | | 12 |
| Grand Total | 5333 | | 8210 |

Source: Ukraine's State Statistics Committee

Imported Broiler Leg Quarter Wholesale Price

| | | | |
|---------------|------------------------|----------------------|------------|
| Country | Ukraine | | |
| Commodity | Poultry, Meat, Broiler | | |
| Prices in | UAH | per uom | 1 kilogram |
| Year | 2004 | 2005 | % Change |
| Jan | 6,9 | 7,9 | 14% |
| Feb | 6,9 | 8,8 | 28% |
| Mar | 7,1 | 10 | 41% |
| Apr | 7,2 | 10,3 | 43% |
| May | 7,5 | 11 | 47% |
| Jun | 7 | 12,4 | 77% |
| Jul | 6,8 | 14,5 | 113% |
| Aug | 6,6 | | -100% |
| Sep | 6,5 | | -100% |
| Oct | 6,7 | | -100% |
| Nov | 6,9 | | -100% |
| Dec | 7,8 | | -100% |
| Exchange Rate | 5,05 | Local Currency/US \$ | |
| Date of Quote | 07/26/2005 | MM/DD/YYYY | |

Source: Ukrainian Importing Companies