VOLKOV KOZIAKOV & PARTNERS

LAW FIRM

The Business & Law Readers Digest

Beverages Industry in Ukraine

Banking and Finance // **Beverages Industry** // Corporate // Corporate Dispute Resolution // Due Diligence // Employment // Financial Services // Insurance // Investments // Kyoto Protocol Implementation // Logistics // Mergers and Acquisitions // Natural Resources // Oil and Gas // Representative Office // Land // Ukraine and the WTO // Ukraine and Russia // Tourism

Contents

Currently the Ukrainian market for low alcoholic and non-alcoholic beverages is rapidly developing. Large manufacturers are at the stage of extending and stabilising their businesses, and regional markets are witnessing the appearance of small enterprises

Non-alcoholic beverages

There is a wide assortment of non-alcoholic beverages in the Ukrainian internal market. Ukrainian products tend to be of high quality and reasonable price. Imported beverages make up a small percentage of products. The main competition takes place between the national producers.

Such a situation has presented an opportunity to surpass our neighbour Russia in the consumption of mineral water.

There is a trend of regular growth in the mineral water market. This positive growth is connected with the fact that the market is filled only to 40-50%, while the average Ukrainian drinks 11-15 litres of mineral water per year. This index is constantly increasing. The consumption of mineral waters is much lower in comparison with European indexes.

The dynamics of the market development have led to a greater assortment of waters. Represented in the market are table waters, medicinal table waters, carbonated and non-carbonated beverages. This development has affected not only the variety of the products but also the identification of production trends. The following companies can be considered as 'leaders':

- "Morshynskyy Zavod Mineralnych Vod "Oskar" OJSC
- The Coca-Cola Company
- "Orlan" CJSC
- "Pivzavod Rogan" OJSC
- "Svalyavskiye mineralnye vody" OJSC
- CE Kyiv Plant of Non-alcoholic Beverages "Rosinka"
- "Pivzavod Obolon" CJSC

The Ukrainian share of the export of mineral waters amounts to about 5%. The main exporters are TM "Obolon", "Mirgorodskaya", "Morshynska". "Pivzavod Obolon" CJSC ranks first in this sector.

Beer and low alcoholic beverages

Currently in Ukraine the beer sector is one of the most profitable ones, as beer consumption is increasing and making regular profits.

In 2004 the average annual consumption of beer by each Ukrainian citizen was 38 litres. This is half as much in comparison with the average in Russia and a third as much compared to Europe. Taking into consideration the dynamics of beer consumption, this index may reach the Russian level by 2010.

But this growth is not enough to allow us to speak of a 100% filling of the market. According to experts, in Ukraine the beer sector is filled to 70-80%. This allows for the fixing of the positions of both national and foreign companies.

This dynamic was the basis for stable development, and the entrance of over 50 enterprises into the Ukrainian beer market. Currently four brewing holdings are responsible for 94.07% of the total beer production:

- "SUN Interbrew Ukraine"
- "Obolon"
- Baltik Beverages Holding.
- "Sarmat"

In addition to the major companies there exist beer plants of lower scope, in particular: AOZT "Radomyshl", "Pivzavod na Podole", "Zaporozhskyy Pivzavod No. 1", "Berdichevskyy Pivzavod", "Mikulinetskyy Pivzavod "Brovar", unions "Chmelpivo", "Umanpivo", the Lisichanskyy pivzavod, "Nezhynskyy Pivzavod", and the Rovenskyy Pivzavod.

Small enterprises do not compete with the large holdings. The tendency of the last few years is a strengthening of competition in the Ukrainian beer market. The leaders' increased production turnovers replace those of weak competitors. Competition by large producers such as SUN Interbrew Ukraine and BBH creates an incentive for the national beer producers within new segments of the market.

According to experts, average-sized companies may be removed from the market in the near future. A few large players will profit in this business. However, this does not exclude the existence of the small plants which exist alongside them, which hardly affect the market structure but which provide variety to the national beer assortment. Today there is a large variety of beer producers.

There are five main kinds of beer in the market: light, dark, red, white and strong. Light beer sales make up about 90% of the main sales volume of the national beer market. The other 10% is divided between the rest, mainly dark beers.

A wide variety and large production volumes have resulted in a situation whereby beer export is higher than beer import. Generally Ukrainian beer is exported to Russia, but its share in the Russian market does not exceed 2% .
The main importers of Ukrainian beer are Russian, Belgian, German and Czech brewers.

Although beer profits are high, its production causes a lot of problems connected with its main components, hop and malt.

There is a lack of hops in Ukraine. The main hop importers are Germany, the Czech Republic, Slovakia and the USA. In Ukraine hops are grown in eight regions (Zhytomir, Kyiv, Volyn, Rivny, Chernigov, Lviv, Vinnitsa and Chmelnitsk). but the volume is not enough to sustain independent production and the quality of foreign imports is higher.

The absence of a technological base is one of the problems for hop production in Ukraine. The raw materials (hop extract and its granules) are not produced in Ukraine. The only apparatus for granule production is built in Zhytomir by "Ukrchmel" OJSC, while the large beer plants use hop granules or hop extract instead of hop cones.
Currently the main importer of hops and hop extract is "AG John Barth & Sohn". The ratios of this company with respect to hop extract import amount to 56. 34%, and for hop import - 59.36%.
The necessity of the Ukrainian brewing branch is valued at 350 - 400 thousand tons per year. The Slavutskyy Malt Plant owned by Soufflet Group as well as Malteurop, "Obolon" CJSC and Sarmat Brewing Group are the largest hop producers in Ukraine.

The most relevant question in this segment is the approach of World Trade Organisation (WTO) membership and the effect it will have on breweries. The producers say that WTO membership will not affect this branch significantly as there is strong competition in the internal Ukrainian market. It already aims for product quality equal to European standards.

Other low alcoholic beverages have failed to reach high positions in the internal market. In Ukraine the production leaders for low alcoholic beverages are:

- "Obolon"
- "Rosinka"
- "Alcotrade"
- "Soyuz Viktan"

Alcoholic Beverages

Alcoholic products make up a considerable part of the Ukrainian beverages market. In 2007 the volume of this segment did not change in comparison to 2006, but the consumers' preferences have shifted toward more qualitative and expensive beverages.

According to experts, in 2007 the segment of premium vodka increased twofold as well as demand for other expensive drinks, in particular cognac, wine and champagne. In 2008 this tendency is likely to be the same. However, after joining the WTO the excise charge will increase and, as a result, it will affect the price policy. It is estimated that alcoholic beverages will increase in price by 20%. In addition, joining the WTO will open up market channels in Europe for Ukrainian producers, which will allow them to reach the predicted results.

The liqueur and vodka plants "Khortitsa", "Nemiroff" and "Soyuz-Viktan" take the leading positions, controlling about 60% of total alcoholic beverage sales. In Ukraine about 40 companies bottle vodka, most of them operating at a local level in the provinces. The number of producers is connected with the fact that annual consumption of alcoholic beverages amounts to 350-400 million litres.
With such demand the producers plan to increase their facilities in 2008; Nemiroff by 20%, Soyuz-Viktan by 15%, and the Khortitsa brand plans to establish a business in St. Petersburg in order to increase its production volumes.

The volume of large national producers and the quality of their production are responsible for the relatively small amount of vodka which is imported. Statistics suggest that consumers prefer Ukrainian products.

In addition, the price of the final product depends on the price and quality of its components. The main component of alcoholic beverages is alcohol. Today 82 state alcohol plants have a licence for its production, among which 74 enterprises belong to Ukrspirt Concern; 5 are controlled by the Summy Regional State Administration (the Dubovyazovskyy, Novosuchanovskyy, Popovskyy, Stetskovskyy and the Naumovsyy alcohol plants); one enterprise is controlled by the State Administration of Affairs (the Chortkovskyy Alcohol Plant) and 2 enterprises are controlled by the State Committee on Medical and Microbiological Industry (the Ladyzhskyy and Mezhyrechskyy Alcohol Plants).

For the last few years the enterprises have been developing the production of ethyl alcohol. More than half of alcohol produced was sent abroad. Today the facilities of not even half of the alcohol plants are in use, while their products are used in the production of alcoholic beverages as well as for medical purposes and perfume production.

Product export is regularly growing; in the traditional markets of the CIS the enterprises intend to fix their positions in Poland and examine the possibilities for promoting their products in the USA and Canada.

Attention should be paid to cognac wine, a drink produced by fermenting wine culture from the grapes as a raw material.
According to official data, over 200 enterprises process grapes for wine, champagne and cognac production. Two large groups are distinguished; the traditional enterprises with their own vineyards and new companies engaged in wine bottling. The specific task of the latter is the efficient promotion of their trade mark. In practice it gives an opportunity to reach the wine and cognac market from any sector of the food industry. The enterprises with their own base of raw materials will develop, which guarantees the quality of wine. On the other hand, even the leaders of the wine industry do not intend to provide all of the grapes themselves. 70:30 is the optimal ratio between their own and purchased raw materials.

Currently the Ukrainian producers are approaching the international markets, conquering new markets and have won international competitions. Should this trend continue, Ukrainian producers may gain a higher profile among the international alcohol producers.

Volkov Koziakov & Partners
Law Firm
72a, Chervonoarmiyska Street
Olimpiysky Business Center, Suite 124
Kyiv 03150 Ukraine
tel. +380 (44) 207 0270 fax +380 (44) 207 0272
e-mail office@vk-partners.com http://www.vk-partners.com