Changes in the dairy industry. Possible ways to minimize the impact of the economic crisis.

Dairy market and output

Sales volumes in 2007

	Sales of manufactured products (in selling prices net of VAT and excise duties), millions UAH	Relative share in total sales volumes, %
Food products, beverages and tobacco products	85,595.6	
Dairy products and ice-cream	14,058.3	16.4
Meat and meat products	11,021.1	12.9
Bread and bakery products	4,633.4	5.4
Confectionery	3,902.5	4.6
Sugar	3,122.6	3.6
Alcoholic beverages	5,583.5	6.5
Ethyl alcohol	1,238.5	1.4
Wines	2,372.2	2.8
Beer	6,089.4	7.1
Mineral waters and non-alcoholic beverages	4,149.7	4.8
Tobacco products	6,691.3	7.8

Source: online date of the State Statistics Committee of Ukraine processed by the Association of Dairy Enterprises of Ukraine

Dairy industry in Ukraine: its past and present

Item No.	Item	Year		
		1990	2007	2008
1	Number of enterprises	643	441	367
2	Milk output, millions tons	24.5	12.3	11.7
3	Milk sales by processing enterprises, millions tons	18.0	6.0	5.4
4	Whole milk products, millions tons	6.43	1.38	1.3
5	Butter, thousands tons	444.1	99.7	84.6
6	Cheeses, thousands tons	183.8	244	248
7	Dried whole milk, thousands tons	61.1	13.9	-
8	Canned dairy products, thousands tons	415	112.6	114.8
9	Consumption of dairy products per capita (re-calculated into milk), kg	373	220	206

Output of key dairy products, thousands tons

	2004	2005	2006	2007	2008
Butter	114.4	117.9	102.3	100.0	84.6
Spreads and fat mixtures	47.7	79.7	80.7	82.6	79.7
Processed milk	686.3	827.8	798.9	845.8	796.6
Cream	23.1	20.6	13.5	14.2	18.2
Acidified milk products	462.6	494.0	519.4	532.0	528.7
Dried milk and cream	105.3	112.7	105.8	124.7	94.5
Fat cheese, including bryndza	222.8	272.4	215.7	244.6	248.1
Fresh non-fermented cheese and curd	70.5	82.9	92.4	92.7	92.1
Canned dairy products	99.9	104.4	96.7	112.7	114.8
Ice-cream	111.5	120.8	119.4	130.0	124.0

Exports and imports of dairy products, millions USD

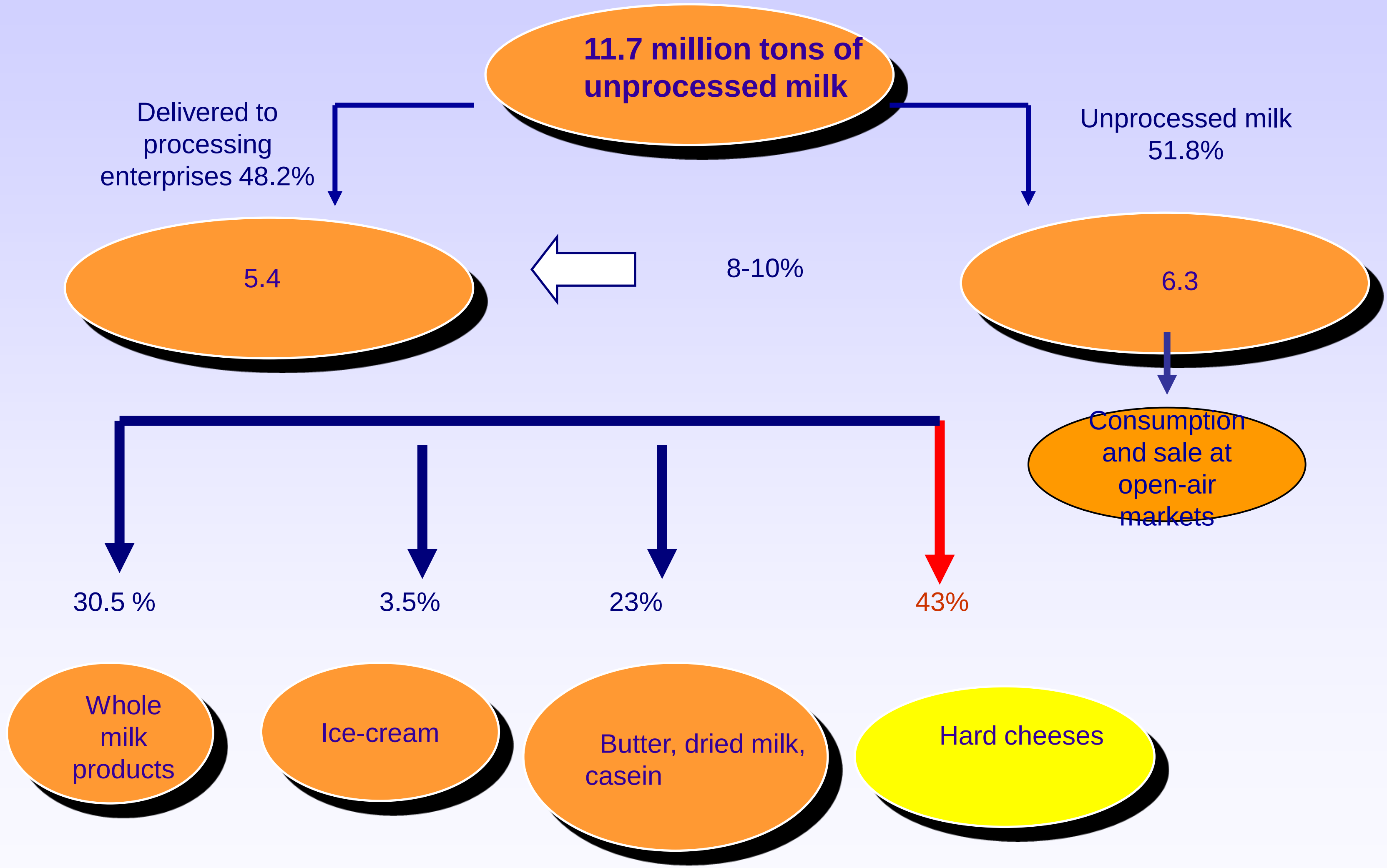
	2004	2005	2006	2007	2008
Exports	538.0	647.8	388.7	663.2	722.3
including to the Russian Federation	303.1	415.8	138.3	254.3	368.6
Imports	28.3	43.5	64.2	91.7	111.2

Key trends in dairy industry in 2008

- Stagnation in the industry
- Growing costs of a physical ton of manufactured products
- Growing costs of raw milk
- Shrinking exports of dried dairy products

Raw milk market

The distribution of processed milk in 2008



Milk resources, output, and sales volumes in Ukraine

	1990	*1995*	*2000*	*2004*	*2005*	*2006*	*2007*	*2008*
Total cow headcounts by the end of the year, thousands heads	**8,378**	**7,531**	**4,958**	**3,926**	**3,635**	**3,347**	**3,096**	**2,919**
including at agricultural enterprises	6,191	4,595	1,851	950	866	764	679	624
at private households	2,187	2,936	3,107	2,976	2,769	2,583	2,417	2,295
Average annual milk yield per one cow, kg	**2,863**	**2,204**	**2,359**	**3,185**	**3,487**	**3,652**	3,665	**4,030**
including at agricultural enterprises	2,941	1,908	1,588	2,475	2,952	3,090	3,147	3,376
at private households	2,637	2,722	2,960	3,410	3,643	3,815	3,804	**4,220**
Total milk output, thousands tons	**24,508**	**17,274**	**12,658**	**13,787**	**13,714**	**13,287**	**12,262**	**11,762**
including at agricultural enterprises	18,634	9,443	3,669	2,533	2,582	2,454	2,178	2,090
relative share, %	76.0	54.7	29.0	18.4	18.8	18.5	17.8	17.8
at private households	5,874	7,831	8,989	11,254	11,132	10,833	10,084	9,672
relative share, %	24.0	45.3	71.0	81.6	81.2	81.5	82.2	82.2
Total milk sales by processing enterprises of all categories of farms, thousands tons	**18,046**	**6,066**	**3,335**	**5,237**	**5,689**	**5,607**	**6,029**	**5,397**
including by agricultural enterprises	17,861	5,629	1,776	1,709	1,797	1,831	1,670	1,719
relative share, %	99.0	92.8	53.3	32.6	31.6	32.7	27.7	31.9
by private households	185	437	1,559	3,528	3,892	3,776	4,359	3,678
relative share, %	1.0	7.2	46.7	67.4	68.4	67.3	72.3	68.1
Relative share of milk sales in total milk output, %	**73.6**	**35.0**	**26.3**	**38.1**	**41.5**	**42.3**	**49.2**	**45.9**
including by agricultural enterprises	95.8	60.0	48.4	67.5	69.6	74.6	76.6	82.2
by private households	3.1	5.5	17.3	31.5	35.0	34.9	43.3	38.0

The balance of milk and dairy products (re-calculated into milk), thousands tons

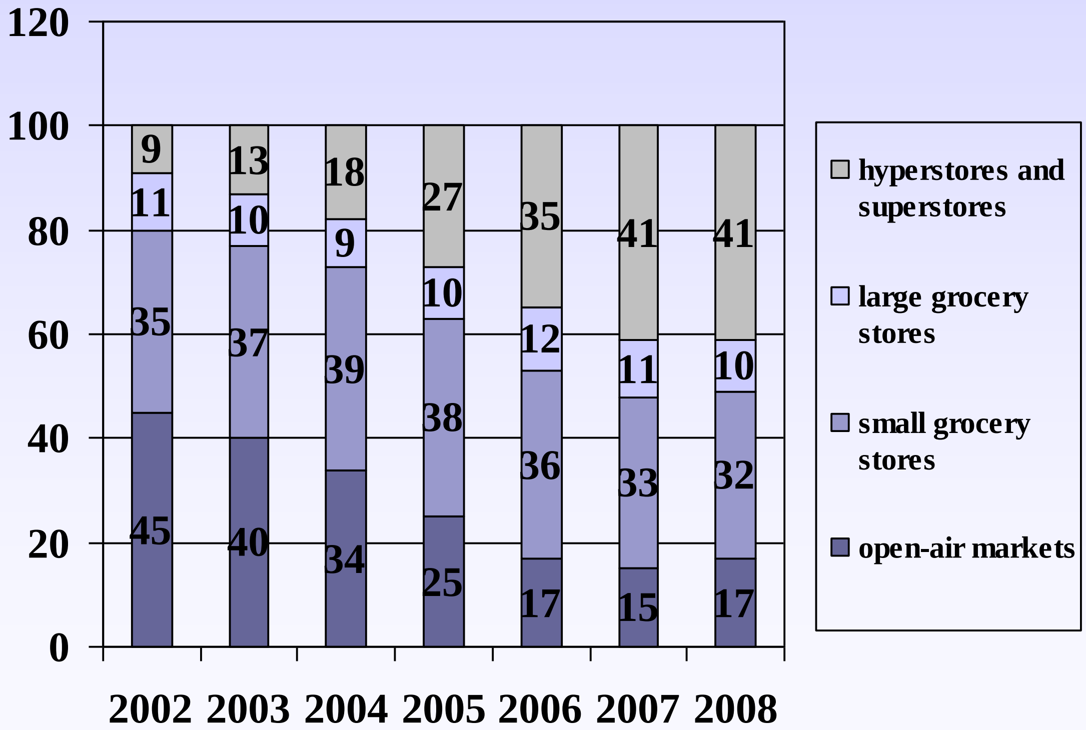
	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
Output	17,274	12,658	13,444	14,142	13,661	13,710	13,714	13,287	12,255	11,762
Change in inventories at the end of the year	-440	-394	-338	315	-106	-360	27	174	20	0
Imports	58	50	100	59	74	80	112	150	190	240
Total resources	**17,772**	**13,102**	**13,882**	**13,886**	**13,841**	**14,150**	**13,799**	**13,263**	**12,425**	**12,002**
Exports	1,420	1,100	1,900	925	1,145	2,126	1,901	950	1,000	1,386
Used as fodder	3,723	2,203	1,990	2,092	1,863	1,296	1,270	1,326	1,250	1,100
Inputs	80	10	5	10	6	3	3	7	6	0
Consumption fund	**12,549**	**9,789**	**9,987**	**10,859**	**10,827**	**10,725**	**10,625**	**10,980**	**10,169**	**9,516**

Source: **Agriculture in Ukraine*, a statistical bulletin, data of the Ministry for Agricultural Policy***

Sales channels for dairy products consumer market

Opportunities and threats

1. Sales grow in large superstores and shrink on open-air markets



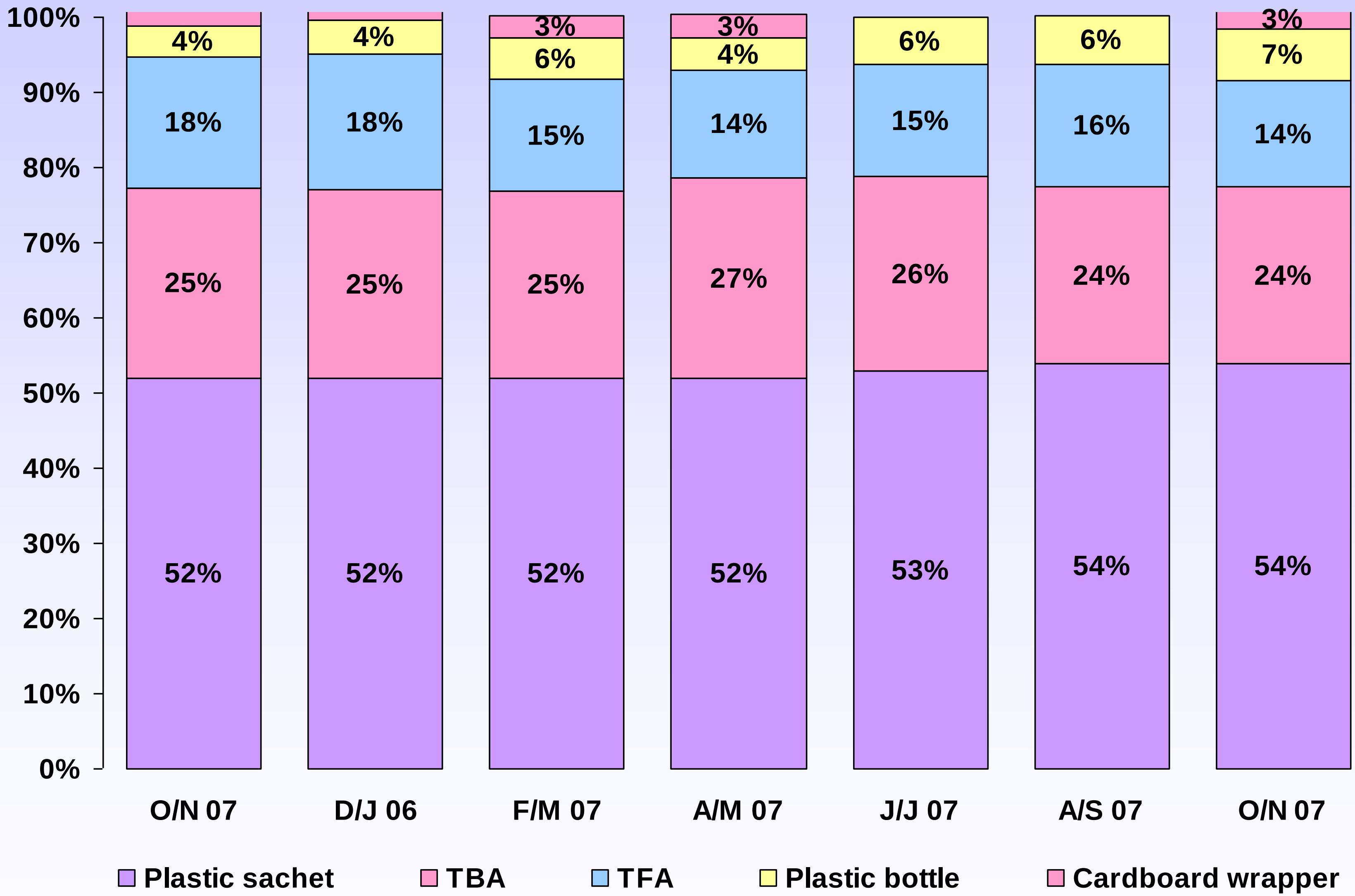
-Chains of superstores grow and become more aggressive, demanding higher discounts, a marketing budget and credits from producers.

+ Large areas of shelves give an opportunity to producers to expand the range of products.

-Large stores try to cut the number of suppliers, demanding higher quality supplies and higher quality goods.

+ Large producers with well-organized logistics and high quality products have more competitive advantages than small producers.

Relative share of various types of packaging for whole milk products (UAH)



Output of whole milk products (milk, acidified milk products, fresh cheese) in 2008, by producer

Producer	2007, tons	2008, tons	share over January-December 2008, %	January-December 2008 to January-December 2007, %	Residue, December 2008, tons
Ukraine	**1,164,607**	**1,157,759**	**100%**	**99%**	**3,132**
Unimilk	114,006	109,206	9%	96%	128
Wimm-Bill-Dann	80,111	75,013	6%	94%	99
Hercules	64,550	70,350	6%	109%	234
Loostdorf	60,178	68,232	6%	113%	836
Rainford	55,488	67,646	6%	122%	91
Galychyna	55,063	67,121	6%	122%	0
Lactalis	77,965	65,454	6%	84%	13
Milk Group	57,861	61,987	5%	107%	15
Milkiland	62,180	59,898	5%	96%	139
Pridneprovskiy	41,326	49,438	4%	120%	0
Milk Alliance	30,434	35,870	3%	118%	22
Lubny	24,272	28,298	2%	117%	32
Kupyanskiy Concentrated Milk Factory	20,989	27,426	2%	131%	345
Yuriya - Pervomaiskiy Dairy Plant	28,610	26,430	2%	92%	75
Danone	25,088	23,472	2%	94%	0
Others	**366,486**	**321,918**	**28%**	**88%**	**1,103**

Hard cheeses output in Ukraine

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Output, thousands tons	76.1	93.1	137.1	171.3	222.8	272.5	215	244	248
Growth against the previous year, thousands tons		17	44	34.2	51.5	49.72	-57.5	29.0	4.0
Output, growth rate		**22.3%**	**47.2%**	**25.0%**	**30.0%**	**22.3%**	**-21.1%**	**13.5%**	**1.6%**
Consumption, thousands tons	37.5	52.8	66.0	80.0	90.0	100	118	120	128
Growth against the previous year, thousands tons		15.3	13.2	14.0	10.0	10.0	8.0	2.0	8
Consumption, growth rate		**40.8%**	**25.0%**	**21.2%**	**12%**	**11.1%**	**18%**	**1.6%**	**6.7%**

Source: State Statistics Committee of Ukraine

Butter output in 2008 by producer

Producer	2007, tons	2008, tons	Relative share January-December 2008, %	January-December 2008 to January-December 2007, %	Residue, December 2008, tons
Ukraine	**99,234**	**83,813**	**100%**	**84%**	**1,192**
Milk Group	5,576	4,500	5%	81%	158
Milkiland	5,700	4,326	5%	76%	13
Milk Alliance	3,663	3,900	5%	106%	74
Ukrproduct Group	4,917	3,530	4%	72%	5
Terra-Food	1,903	3,126	4%	164%	20
Loostdorf	1,869	2,927	3%	157%	14
Galychyna	1,782	2,413	3%	135%	36
Roshen	2,022	2,231	3%	110%	17
Rud’	2,124	2,187	3%	103%	51
Rainford	1,840	1,741	2%	95%	2
Others	**67,838**	**52,932**	**63%**	**77%**	**802**

Rating of top spread producers in 2008

Producer	**Sales, tons**	**Share, %**
Ukraine	**80,399**	**100%**
Terra-Food	26,426	33%
Argo	18,093	23%
Andrushovka	8,781	11%
Galychyna	5,245	7%
Ukrproduct	2,598	3%
Rivera Milk	2,428	3%
Ruzhyn-Moloko	1,951	2%
Syry Volyni	1,811	2%
Mig	1,332	2%
Milker	1,255	2%
Others	**12,774**	**16%**

Ways to minimize the impact of crisis on dairy enterprises

1. Optimizing costs on the raw milk market:
- reducing transport and purchasing costs;
- setting up co-operatives for the purchase of raw milk (processor – commodity producer);
- supporting the development of agricultural enterprises – commodity producers.

2. Managing production costs:
- specializing production (optimizing the range of products);
- introducing energy-saving technologies.

3. Reducing logistics costs:
- diversifying risks through various sales channels (VIP, linear retail, wholesale).

4. Creating competitive advantages.

Forces influencing competition in this sector

The threat that new participants will enter the market

1. Strategic corporations
2. Administrative resource

Market power of partners

1. Raw materials
2. Ingredients
3. Spare parts
4. Energy supply

Industry

The striving of an enterprise to gain the most beneficial position among competitors

Market power of consumers

1. Retail chain
2. Changes in:
   - The demography
   - The culture of consumption
3. Purchasing capacity of the population

The threat that substitute products / substitute services will appear

1. Products with substituted butterfat («thermizated» products, «dairy» butter, «sour cream», «yoghurt», «hard cheeses with partly substituted butterfat", "processed cheeses with substituted butterfat"
2. Engineering service

Methods of creating competitive advantages

Fair:
- High quality products
- Specialization
- Lowered production costs
- Advertising support for trademarks
- Stable prices

Unfair:
- Non-standard products
- Resembling products
- Low prices for resembling products
- Consumer fraud
- Doing business “in the shadow”

Competitive “areas”:

1. Competition in raw materials
2. Competition in production:
   - New technologies
   - Modernized production capacities
   - Modern packaging decisions
   - Products meeting “strict” standards
3. Competition for consumers:
   - Forming the culture of consumption
     - Familiarizing consumers with the requirements to finished products
     - Developing new products, forming consumers’ attitude toward new products
   - Sale incentives (discounts, support, tasting)
   - PR-actions, sponsorship

First priority steps to help the industry out of the crisis

- The adoption of the State Program to create a favorable environment for stabilizing and developing livestock breeding for 2009-2015, where dairy industry should be emphasized separately;
- It makes sense to implement measures through regional programs for the development of dairy livestock breeding (expanding milk collection network, supporting milk collection stations with equipment for collecting, cooling, and storing milk, and so on);
- Regulation of the situation with VAT refunds;
- Cancellation of VAT and customs duties for imported equipment;
- Prohibition for intermediary structures to store and purchase raw milk;
- Introduction of amendments to DSTU “Milk for Storage”;
- Strict oversight of how the requirements of DSTU “Milk for Storage” are met;
- The setting-up of the State Authority to control safety and quality indicators of dairy products;
- The creation of an environment for fair competition (struggle against counterfeit);
- Further development of integration ties among collective agricultural enterprises, farmers, and milk processing companies;
- Financial support for dairy enterprises through the mechanism of cheap short-term and long-term loans, leasing transactions for upgrading and renovating production facilities;
- Improvement of the price formation system for domestic products along with optimization of trade supplements in the course of transferring domestic products from producers to consumers;
- Revision of statistical methods for collecting and processing information related to milk output and processing volumes;
- Developing a system for price monitoring and information related to the situation on and the condition of the milk and dairy market at the state level.

Thank you for your attention!