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Frishberg & Partners’ Roundtable: “Foreign Investment in Ukrainian Agriculture”

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Acquisitions in Ukrainian Agribusiness & Food Processing Sector

Since our earliest days, Frishberg & Partners has played an important role with respect to the commercial development of Ukrainian agribusiness and food processing.

For instance, Frishberg & Partners assisted Swedish investors with the valuation and acquisition of a majority stake in a food-processing facility near Kherson, in southern Ukraine. Our strict application of valuation techniques, as proscribed in Ukrainian privatization law, secured a favorable factory valuation on behalf of our client. Frishberg & Partners' contribution to this Swedish-Ukrainian venture constituted one of the first steps towards launching the now famous brand of sauces and juices throughout Ukraine.

We also played an integral role in creating the Slavutich brand of beer. Our legal advice to one of Slavutich's investors, Baltic Beverages Holding AB, began with a due diligence of acquisition targets. We assisted with the acquisition of pre and post-privatized soda-water and brewing facilities, prepared Privatization Plans associated with acquisition of pre-privatized entities, reviewed and negotiated share-purchase agreements in the case of post-privatized companies, prepared both cash and in-kind contributions to corporate capitalization in Ukraine, and obtained required Antimonopoly Committee approvals.

We also helped a major Dutch trader of cheese products to set up a dairy farm and yogurt-manufacturing facility near Kiev. This work involved joint venture formation with local partners; land-allocation issues; licensing and product certification, among other matters. One of the thorniest issues faced during the course of this project concerned preparation of a loan from the Dutch National Investment Bank, or "NIB", to the Ukrainian joint venture by way of the foreign investors' Dutch entity, which served as guarantor. This financing was needed to procure yogurt-manufacturing equipment (pressurized tanks, pasteurizing equipment, etc.).

Other issues addressed in this sector include: procurement of required licenses; attention to product-certification issues; and, long-term lease of agricultural land



Alex Frishberg

Alex Frishberg: Ladies and gentlemen, thank you for coming here today. We are pleased to welcome you to our first round table – one of several we have planned during this year – about foreign investment into the Ukrainian agricultural sector. As you know, Ukraine is the size of France, and its rich and fertile soil has always been on top of the list for any foreign investor in the agro-industrial sphere.

These foreign investors have always wanted to invest, but Ukraine has a moratorium in place on the alienation of agricultural land. Whether that’s good or bad for business is still an open issue, which we are going to talk about today. However, Ukraine continues to be full of investment opportunities in the agro-industrial complex – from production to actual harvesting and deliveries – well, the Ukrainian agricultural sector is interesting “from A to Z”.

The main rule that foreign investors have to know, and we can talk about the variations, is that foreigners are not allowed to own agricultural land, period. The given reason is because the forefathers of Ukraine spilled their blood for this land during World War II. Regardless of the reasoning why the moratorium is still here, foreigners are *not* allowed to own agricultural land. This does not, however, preclude them from leasing it and still making money off the harvests.

Importantly, foreign investors *can* own factories because factories are built on industrial land to which foreigners can obtain ownership rights. Again, please remember: the buildings on top of that land (factories, silos, etc.) can be owned by foreigners. I thought it would be interesting today to give the examples of both types of investment in the Ukrainian agricultural sector: (a) investment into farmland (and how it is harvested) and (b) investment into factories and infrastructure.



Ambassador Park, South Korea



Some projects in real estate, as you probably know, are very successful in Ukraine. If you take a look for instance at Chumak (the ketchup producing factory), whose entry into this market we assisted in the early years, it has become a huge success. A lot of other projects, however, became miserable failures, but the rules were always even. So what is the difference for foreigners? How do you prevent yourself from becoming a miserable failure that people will point fingers at forever?

Well, we have two experts here today who know a great deal through their own successful experience in Ukraine. They will tell us a few words about how to successfully invest into the Ukrainian agricultural market.

The two experts are Roman Fedorowycz, who just came from skiing and that explains his nice tan and general well-being. Roman is an ex-founder, CEO and land acquisition manager for Ukrainian Agrarian Investments, Ltd. It is one of the largest farming companies in Ukraine and Europe with over 300,000 hectares. Roman has close to 20 years' working experience in Ukraine, and he is a real live American. Arguably, Roman is one of the foremost U.S. experts in the area of how to lease land during the moratorium, how to efficiently manage production, how to make sure you actually receive your money, basically managing a normal large-scale farming operation. This is the topic about which Roman will speak.



Chris Jones



Our second expert is Mr. Jens Bruno from Sweden. He works with the agricultural holding company called “Grain Alliance” in Ukraine. They control roughly 40,000 hectares. They have expanded rapidly over the last five years when Ukraine had no control from *any* government officials. The company itself has been active in Ukraine for the last 10 years. It is interesting to note that Jens has also been involved in the construction of the first bio-ethanol plant in Ukraine and the CIS.

To begin with, Mr. Fedorowycz will share with us his experience in the sphere of farming. Then, Mr. Bruno is going to comment on his company’s farming activities, as well as his bio-ethanol project.

Roman Fedorowycz: Good afternoon. I would like to spend a few minutes – or actually most of my time – talking about what I feel is Ukraine’s most valuable resource: agricultural land.



Roman Fedorowycz



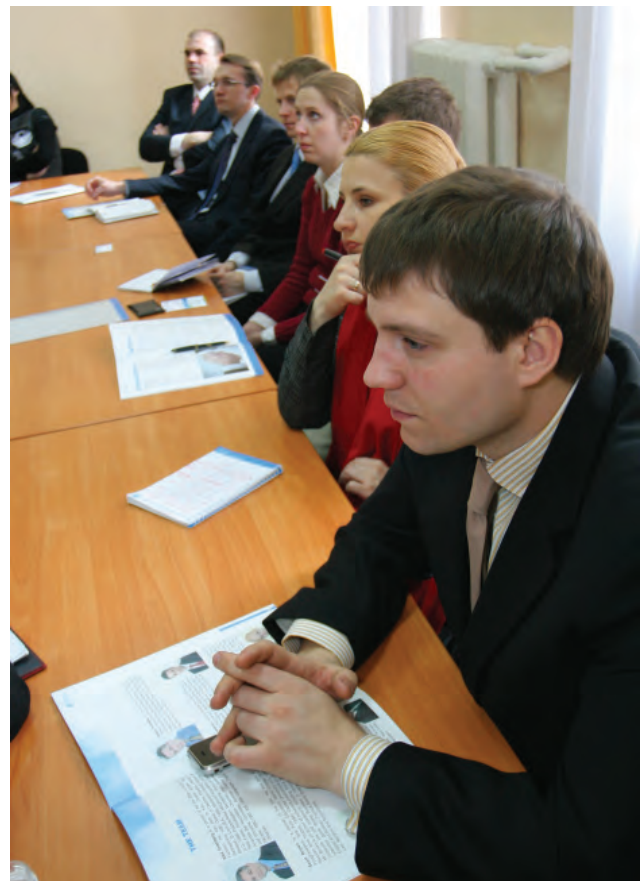
There are about 32 million hectares of arable land in Ukraine. 70% of it is very highly fertile black soil. Compare that to the EU which has about 100 million hectares. Ukraine comes out to a size of about one-third of what the EU has as far as arable land.

Ukraine also accounts for 30% of the world's best soils. This is what we call *chornozem* or black soil because of its high levels of humus, which is organic matter. Ukraine has a moderate continental climate – warm summers, cold winters – and an average rainfall of about 400-700 millimeters, which makes it very conducive to crop production.

Most of Ukraine's arable land is within 400 km of ports. This is very similar to other agricultural powers like Brazil and Argentina, with one big exception – Argentina and Brazil don't have any rail capacity or

any rail system throughout their countries, but Ukraine *does*. And actually, a great majority of Ukrainian land is within 70 km of the railroads and various elevators. This is very convenient for rail and truck delivery. There is also 25 million metric tons of shipment capacity in Ukraine. This is growing every year as investors expand and build new facilities.

Ukraine's land is also in a very favorable position. It is next to the EU, and close to North Africa, the Middle East and Asia. Why is this important? Egypt is the largest importer of wheat in the world. And other countries like Morocco and Algeria are not far behind. Saudi Arabia is the largest importer of barley, and Ukraine is one of its largest exporters.





The EU is the largest user of rapeseed in the world, and Ukraine traditionally ships almost all of its rapeseed to the EU. Ukraine is always in the top 3 every year in production of sunflower and sunflower oil, along with Russia and Argentina.

Now, I would like to talk about collective farm transformation. Once upon a time, all the land was government-owned, and it was organized into approximately 3,000 hectare farms, but some farms went up to 10,000 hectares. In the mid-90s, the land was privatized and divided into “pais” - similar to what a chess board looks like. It was given to the various employees of collective farms and retirees.

First, all the land was reorganized into what was called “certificates for land”. The certificates for land allocated every person an amount of hectares, but not an exact plot of land. Later, the certificates

were changed into government acts. The acts actually showed surveyed points and your exact position on the field.

If you can envision a chessboard: this square belongs to John; this square belongs to Maria; this one belongs to Paul, and so on and so forth. However, due to the moratorium on the sale of agricultural land, the land may only be leased.

In the mid-90s, all of these collectives were reorganized into private entities – limited liability companies, joint stock companies, cooperatives and private enterprises. Again, this was about a 3,000 hectare average. Thus, the average farm had to sign about 1,200 leases in order to put together a farming unit – some more, some less.



There are three kinds of agricultural land in Ukraine: first the pais (that is what the individual people owned); the second is unclaimed pais (while the pais were being allocated to various people, some people died; some people moved; and this was up to about 20% on various farms is what's called "unclaimed land".) This land can also be leased but you have to sign an agreement with the government district administration. The third category of land is government reserved lands. These lands are also owned by the state, but you could lease them through the government district administrations.

With respect to leasing land, the lease terms are typically about 5 years in Ukraine. However they can be as short as 1 year, and they are as long as 49 years, as the law allows. Rent is paid annually on these, which averages between 1½% to 6% of the cadastre value (typically \$30-\$45 hectare/year). The cadastre value was a theoretical value that was assigned to land in the 90s by the government on the basis of its potential production value.

Every year, the government adjusts this cadastre value to reflect inflation, but in fact historically the coefficient or the inflation adjustment has been actually less than a quarter of the actual annual inflation rate. Under Ukrainian law, the lessee also has the right of first refusal to enter new leases and to purchase the land once the moratorium comes to an end.

Regarding breaking leases, a lease cannot be terminated by the landowner, unless the conditions or terms are not met by the lessee and only in a court of law.

Now, let's talk about the moratorium law. This is the most interesting topic as far as why everybody is interested in Ukrainian land because they have the first





opportunity to purchase land. The moratorium can only be lifted if two laws are passed by Parliament: the Law on the Land Market and the Law on the Land Cadastre.

The Land Market Law will delegate how the land market will function – the rules, the regulations, and so forth. The Law on Land Cadastre will focus on organizational functioning of the land cadastre, including the metes and bounds and also the single register of all land in Ukraine.

Why is this interesting? A lot of people think that when 30 million hectares of land hits the market people will be able to buy land for about \$500 to \$1,000 per hectare. This will, of course, vary greatly, depending on the region, the rainfall, etc. Farming land is like fine wine – the longer you farm it, the better the productivity.

To compare with other places, like Romania and Poland, the average arable hectare goes for about \$4,000 to \$5,000 per hectare. Yes, a lot of that is due to the EU farm subsidies, but we are certainly heading into that direction when the moratorium ends.

The last thing I want to talk about is a new King of Ag company that arrived on the scene in 2003-2004. These are called “agro-holdings”. Currently in Ukraine, there are about 30 companies that have over 50,000 hectares of land. Five of them have over 200,000 hectares of land. Eight of them have done IPOs and have floated shares on various exchanges in Europe.



Still, if you look at all those holding (large and small), that is still only about 3 million hectares, which is only about 10% of the actual arable land. This trend will continue to increase. The size and number of those holdings are going to increase greatly. This is going to follow the model of Brazil and Argentina, where you typically have operators who are doing 500,000, 700,000, even a million hectares of land. So we are all heading into that direction. And now, without further delay, I turn the spotlight over to Jens.



Jens Bruno: As Roman has mentioned, there is huge potential when the moratorium is lifted, but I would also like to take one step back and just analyze the potential for why someone, for example, our company, should invest into agriculture in Ukraine. That is, why in agriculture, why are all these companies doing IPOs, what are all these bankers up to? Myself, I used to be a banker. I am backed by bankers. Your companies are also backed by bankers, I would guess. Why this interest?



Jens Bruno

There is no Bill Gates in the agriculture sector, yet this is the oldest sector on the planet. Why all of a sudden this enormous interest? The answer, which I think most of you already know, is the increase in global population – 6 billion people today on the planet. The UN forecasts that in 40 years, we will be 9 billion people. That is an increase of 30%. Given the fact that there will be some kind of economic growth, hopefully, on the planet, the UN estimates that the demand for agriculture products will increase by 70%. So how will the planet deal with this?

We can grow more land, but there is a limit to that as well. We could squeeze more out of each hectare.

Most of the agriculture is still on a low level globally. But the price mechanism will also correct this. So, prices will increase, maybe not as rapidly and drastically as they did 2005, 2006 and 2007, but in the long term agriculture will definitely be a lucrative business.



John Shmorgun



Agriculture will then go from being a business where you can have an EBITDA-margin of 15-20% to a business where you could have maybe a 50% EBITDA- margin. That is a huge difference. And now it is getting interesting for investors.

Even on a fairly short term, you could probably get a pretty good return on your investment. So, if you want to reap the benefits of this global population boom, you have to invest in agriculture. Where should you invest then? Well, in Ukraine, of course.

Here lies some of the most fertile soils in the world – 30% of the global assets of black soil. Thus, Ukraine is a very attractive place to invest. Then there are the peculiarities with the



Chris Jones

difficult year, we still managed to get pretty good margins. We had a turnover this year of 21 million USD, with an EBITDA-margin of 25 percent.

Is this great? No, it's not great, but it is far better than many of our competitors. In these conditions, we still managed to secure a profit, which, I would say, is some sort of indication of the potential here.

We have around 40,000 hectares, we cultivate around 31,000 hectares, and we are expanding rapidly. In fact, we acquired a new farm last week. Our ambition is, of course, to grow, but we have no ambition to just play the "land game", which is to accumulate land and make money from the potential upside of the arbitrage of the upheaval of the moratorium.

We are interested in creating good, solid yields that will last for a long time. Therefore, we do not expand just for the sake of expansion. We expand only when we see that we can still make money and still be profitable.

moratorium, but as I see it that is just an opportunity. It is sort of icing on the cake. Still, simply looking at the basics of the agriculture business, Ukraine has huge potential.

Our company (the core of our companies) is over ten years old, but we (the Swedish investors) entered Ukraine in the summer of 2008. So we bought when it was most expensive, and we got stuck here when the crisis hit. Still, we are long-term investors, and we still see the huge potential. Even though it was bad times in 2008, and 2009 was also a



Jens Bruno



That having been said, I won't say that it is more difficult to do business with leases, but it has its peculiarities. You cannot just go and get leases from people. There are also social responsibilities that often come with leases that you have to take into consideration, but you can deal with these responsibilities in various ways.

We try to be good citizens and take social responsibility. One can do this by either sitting as the "Godfather", handing out envelopes or one can do this in an organized way. We try to do it in an organized way where we accumulate a certain sum per leased hectare in a village which goes to a social fund.

We also try to buyout a lot of the existing infrastructure in the old companies that previously existed. We, so to speak, put our flag in the middle of these villages. Thus, even if the leaseholder would like to lease their

land to someone else, it is difficult for them because they are, in turn, tenants of houses which we own, or are in need of the infrastructure, the warehouses, the grain scales, and so on and so forth, which we own.

Our average lease time is about six to seven years, which might be short for some, but we still feel that we are pretty secure in the contracts we have. We have no feeling that people will evict us. There is always the risk, of course, but we try to be as fair as we can to the leaseholders. We recruit staff primarily from the villages where we operate. We employ almost all the people that worked there previously. We also provide education and training for the people. In general, as I said, we feel pretty secure with this lease system.

If the moratorium should be lifted, that would be a bonus, but we will see what will happen. There are many difficulties. It cannot simply be lifted out from under us. We can discuss later what kind of dangers lie on the path to lifting the moratorium.





Still, I would like to emphasize that the potential in Ukraine is not just in the land. It is definitely in the production. That is where the money is; that is where the true potential is in Ukraine. Ukraine has the potential for outreaching the US, Argentina or other similar countries, just because of the soils and the excellent climate. Of course, the infrastructure – the ports, the railroad system – is also a big bonus.

I don't know if I should go more into our business. Like I said, we have 15 farms that we control in four regions. Our strategy is to focus on a limited geographical area. Therefore, we have a radius between our farms of less than 80 km. Our strategy is then to create economies of scale by using less equipment for more land. Our equipment is divided into tractor brigades – using the Soviet wording there – and these brigades serve our lands. We can therefore use less equipment than a normal agriculture entity would use.

We also have computerized all the villages to get better control – hooked them up to the Internet so that they can work directly in our accounting system. You have to have a fair amount of control, not just for control issues but to get the management data so that we can make the company more efficient and actually produce less costly than our competitors. We are on the way of doing this. We are not there yet, but, as you know, everything takes time.





We were also, as Alex mentioned, involved in the construction of the first bio-ethanol plant in the former Soviet Union and the largest bio-ethanol plant in Eastern Europe. We have now sold our share in this company. We decided to consolidate our Ukrainian holdings to focus on agriculture. When we sold the bio-ethanol plant project, this factory was 75% completed. I still strongly believe in the business concept and I think that it will be very successful. Ukraine has a huge potential as a producer of bio-ethanol.

Talking as an investor, however, when we invested into this company, it was still illegal to produce bio-ethanol. Still, we really had no problems in securing land for the factory and getting the permits for building the factory. Then, of course, there was a lot of lobbying to change the legislation to make it legal to produce the bio-ethanol.

The situation when it comes to industrial land is a lot easier than when it comes to agricultural land. It is quite clear cut. Then, of course it comes down to what kind of production you will have there and what kind of licenses you need. That can be difficult, especially if it overlaps with the regional and the state regulations.





I cannot say it would be easy in the EU to get all the necessary licenses. I have no experience building a bio-ethanol plant in Sweden, but here in Ukraine it was not a major headache to secure the rights to the land and get permits to build a factory there.

Question: Was it a green project, or was it reconstructed in some way?

Jens Bruno: No, it was a completely greenfield investment.

Question: Was it industrial land or agricultural land?

Jens Bruno: It was industrial land, not agricultural land. The conversion of agricultural land into industrial land is a headache. That would really be difficult. When we did this, the factory was located not far from Zolotonosha. There was industrial land there.

Question: This was in 2009?

Jens Bruno: 2010, actually.





Alex Frishberg: Okay, looks like we are finished with the initial presentations, and everyone is eager to get to the question and answer period. Bur first, I will quickly go into a few issues, which I thought were very interesting, that were *not* said.

Our speakers explained quite nicely why there is a reason to invest in Ukraine, but neither of them went into the discussion of *how* they manage their respective operations profitably. When we prepared for this presentation yesterday, I listened carefully to our speakers, so I know the answer. Basically, Roman is employing the so-called “modern strategy” of delegating many of the tasks to subcontractors. In contrast, Jens employs the old-fashioned strategy of doing everything yourself. It’s very interesting how they approached the same animal in a different fashion, and yet both are profitable. Maybe you can get into this during the question and answer period.

For your considerations, here are some of the buzz words, and you can ask the questions along these lines or add new ones.

First, there’s moratorium. As all of you know, we have one. It will certainly be lifted sometime in the future, but we don’t know when. We also don’t know whether the lifting of the moratorium will be a blessing or a curse. The speakers reached a consensus yesterday, that lifting of the moratorium will be closer to a curse than a blessing for various reasons. One of them is taxation. Right now, the tax on land is very low (tiny if we are speaking about private land), but after the moratorium will be lifted, taxation will surely increase. You also can probably expect at least short-term fraud and corruption once you go through the process of lifting the moratorium and putting the land into the people’s hands. When you get the land, we talked about checking it for PH value and all kinds of soil tests. Suddenly, in retrospect, living with the moratorium, was not all that bad.





Second, there are problems of VAT refunds, which might be particularly painful to you. There was some export restrictions levied sometime, not as much recently. So, there are a lot of open issues out there. The floor is open for questions and answers.

Question: The moratorium is a central issue. I just wanted to hear maybe a few scenarios that you see playing out in terms of the degree to which it will be liberalized. Will it be shock therapy, gradual, or will the status quo stay the same? What kind of likely scenarios are likely to play out with this land moratorium issue?

Roman Fedorowycz: I'm a staunch believer... within the next year and a half or so – give or take six months to a year – I think the moratorium will be lifted. A lot of it is due to the fact that many of the deputies in Parliament either control/own one of these holdings or are helping one of these holdings. They are quite

interested in getting their hands on the land before the foreign capital gets extremely organized and comes in a big, big way.

Question: Any other scenarios playing out?

Jens Bruno: I don't know, but I just think the procedures of selling land are very difficult. I think there have to be some changes in the procedures and also in registering and re-registering the land. As we talked about it yesterday, the notary system has to be changed. I don't think you can actually do that within a six month period. I think it will take a bit longer. They have to develop new procedures and ways on how to handle the transaction of land.





Roman Fedorowycz: I agree. When Parliament passes these two laws that are necessary to end the moratorium, you will still need about six to nine months to put all the mechanisms and instruments in place.

Comment: Five, years, at least three...

Comment: I think about three to five.

Comment: The World Bank is ready to provide a loan. It was put in suspension for lots of reasons. The government and the World Bank have been working now for three years to create a map of Ukraine, an aerial map. Three years. They are still about a year and a half away from finishing it. Based on that map, we started assigning cadastre numbers, but you have to have a system to assign the numbers there, etc. So even if you lift the moratorium, it does not mean

that there is a registry. You can go ahead and buy land, as people will do, but of course it won't be *registered* anywhere. If you then go to the bank with your documents, the documents won't hold much "water", and you will be basically going to the bank with a piece of paper which cannot be registered. You cannot register it, and you cannot register liens against it, etc. Since the banks won't accept it, why buy land if you can't use it as collateral?

Comment: Good question. I don't know the answer to that question. Having worked in Russia, I always ask this question. In Russia there are long-term leases for the land and you can also buy land. I am assuming that some sort of work has been done in Russia as well in terms of registration of cadastre. I don't know.

Jens Bruno: No, they did a lot of work in Russia and created the cadastre system.





Comment: So we need to probably only look across the border to learn some lessons on how it may play out here in Ukraine. As far as pricing is concerned, you may be able to make some comparisons as to pricing of land with Krasnodskiy Krai or Tsentralniy Chernozem. So, that is one comment that we need to keep in the back of our minds.

Comment: I would like to add another comment on land. If you don't want to make a lot of money on agricultural land from the sale of it, sell it as commercial real estate or as residential real estate. If it is a farmer selling to another farmer, you are not going to make a lot of money.

Question: I have a comment and a question. My comment is that we have been hearing about

these agro-holdings. We mentioned that there are maybe thirty agro-holdings that have 50,000 hectares or more, and in some up to 300,000 hectares. So, my question is this: are all these agro-holding that we are talking about really able to manage this land?

Jens Bruno: At this point in time, I would say they are having difficulties. Everybody is having difficulties.

Question: Or are they just "land banks"?

Jens Bruno: I think it differs from case to case. Some of them are very profitable, while some of them are not. I agree it is very difficult. We





only have 40,000 hectares, and I can say it is very difficult to manage to get everything to work there. As Alex said also, we have a different strategy. We do most of it in-house. With all that soil sampling, laboratory, work, making soil samples, etc., we invest a lot of money into the land. I think in that aspect we are rather unique. One has to look at the global experience as well. If you look globally, all these very large agricultural operators are extremely profitable. I think it is only a matter of time until the successful ones will turn around and start making money.

Question: Basically, I see it as there are still a lot of farms that are being taken over and that are basically former collective farms. Not much has changed there as far as the people who are trained to work there and to try to really get the modern technology put in place. So you hear a lot of these bankers and investors talking about coming into Ukraine, but do they really

know that it is going to be difficult to talk about money to have 100,000/200,000 or 300,000 hectares? Furthermore, it is going to take a while to really have something like what they are talking about.

Jens Bruno: For sure. If you look at the average yields in Ukraine, they are still very low. They are on the level of famine if you compare Ukraine to the EU. For sure, it takes a lot of time. Also, for instance, the land issue, the moratorium and its consequences are that nobody invests really into that land. When we set up this laboratory, for instance, we realized that we had over 5,000 hectares with a PH level below 5.5, which makes it not very fertile. We started investing by adding different substances to improve the soil quality. I have not heard of anyone else doing this. Our experience is when taking over land, the soil could be in bad shape, and it takes some time for this to recover and increase the average yields per hectare.



Question: And it takes people I would imagine, too.

Roman Fedorowycz: Management and people are the single most difficult challenges facing any of these holdings. Many of the holdings have taken on a lot of land, and you hear a lot of rumors that they're getting rid of this land...but nobody's in a hurry to get rid of a hectare. On the contrary, they are adding land.

Question: Can you share your experience in customs handling with respect to exporting agricultural products?

Jens Bruno: We have both direct and through traders. I see no real problems with the logistics part. The railroad transport, for instance, is very expensive in Ukraine compared to other places due to the monopoly. As far as the quality of handling customs, there is no problem. But with respect to the VAT return, you have a situation now where the banking system does not work. We have to pay interest rates of 25-30%. You need to find some way to finance the working capital into the harvest because doing it just by cash is very difficult. So normally what you do is increase the volume of future contracts. Since there is no real organized commodities exchange here in the Ukraine, the market for local futures contracts is very small. Then you try as a small producer to focus on making contacts in Turkey, in Egypt and what not. But that becomes very difficult when the government decides not





to return VAT and take 20% out of the turnover. I understand the importers in these countries do not want to bear the risk of having to deal with Ukrainian customs. It is difficult. I don't know what the average time for the return of VAT is, but...

Comment: Over 18 months.

Jens Bruno: If it ever will be returned...

Roman Fedorowycz: That is a big problem. The logistics is easy. You can get a freight forwarded. You can move grain. We move grain from 40-50 elevators at a time, and it is not a difficult thing to organize.

Jens Bruno: I agree.





Question: Do they sometimes want to restrict the amount of grain? I don't know. Some people mention the risk.

Jens Bruno: There have been export restrictions and price control, but that was some time ago...

Jens Bruno: Then, last fall, there were rumors again that they would appear, but nothing happened. So we will see. That was, of course, very costly for Ukraine when they enforced this.

Question: Which do you prefer: lifting VAT subsidies for agricultural producers – they do not pay VAT - or refunding them?

Roman Fedorowycz: Agricultural producers do pay VAT, but the money comes into a special account, and you are allowed to use it for your production.

Question: Which do you prefer – refunding from budget or eliminating this almost-subsidy from the budget?

Jens Bruno: If you look at the tax system, it is unfortunately primitive in Ukraine. So actually, it would be better to just remove VAT





Comment: First of all, VAT is not a primitive system. A lot of countries use it.

Jens Bruno: No, no, no. I'm not saying that VAT is a primitive system. I'm saying the Ukrainian way of handling it is primitive.

Comment: I think sometimes you wonder why VAT was implemented. It's a complicated system which allows the government to collect rent. So these types of complicated systems are sometimes, I think, just purposely put in. It's not a system for Ukraine.

Question: Do you get any subsidies from the government? I'm not talking about indirect VAT. Do you get any subsidies at all?

Jens Bruno: We have tried for the interest rates. I think we got some money for that.





Jens Bruno: I don't think it was really worth the effort, too.

Question: So where does the government money go for subsidies?

Alex Frishberg: Good question.

Jens Bruno: *Maybe* someone gets it.

Question: We are talking about land, and we're certainly involved in land and expansion of operating farmland. What in your mind are some of the other sectors in agriculture associated with land – upstream or downstream – from where you see a future? Where can money be made? I'm thinking storage, processing, logistics....

Jens Bruno: One at the bio-ethanol plant was the

corn produced as raw material for bio-ethanol.

Comment: I don't see that. That's a dead end. We see in the US what's happening with bio-ethanol...

Roman Fedorowycz: For a production site, Ukraine is extremely well-positioned to produce lots of sunflower, rapeseed and soybeans, concentrating on oil seeds, which, I think, is where Ukraine is going to be headed. Instead of being the breadbasket, it is going to be the "oil basket" in the future.

Question: Are you thinking at all about livestock production in the domestic market?





Roman Fedorowycz: No, we have enough problems with the land. That is a whole different ballgame. It is very specialized. You need very special talent to make it work in Ukraine, but it is not that people aren't doing it. There are some pretty organized foreign outfits doing it.

Jens Bruno: I think that there has to be, if you're in agriculture, you have to be in livestock. That sort of comes with the territory. We have about about one thousand heads, maybe. When you go in and take over a farm - a former collective farm - there are always livestock there. Just getting rid of it cannot be done. So what we're doing is creating a separate entity for the livestock and, hopefully, we can develop that in some kind of direction. It is difficult. It's a different ballgame.

Roman Fedorowycz: We have a very different strategy. I visited a farm in Argentina that has 900,000 hectares. They don't even have a dog. They don't have *any* animals.



Question: I have a question for both speakers. Say you are right, and in a matter of a year and a half the moratorium is lifted. In your estimation, what will be the supply of land? What number of landowners will be prepared to sell their land instead of leasing it?

Roman Fedorowycz: I believe that about 75% will hit the market. Most of the landowners today are averaging over 60 years. Knowing the life expectancy in Ukraine, that is their last little lottery that they are going to win. Many people are really excited about moving fast and selling. At least 75%, I would say.



Question: When the moratorium is lifted, how prepared are you? How long will it take to be ready to sell?

Jens Bruno: It will take a while to raise the additional capital, but this is something that we are working on. We want to at least have a vehicle that will be attractive enough for investors to invest in and inject more capital for such an event.

Roman Fedorowycz: I think that on every continent in the world everybody is waiting for the moratorium to end here in Ukraine. I think that the capital is going to mobilize extremely fast and extremely large quantities of capital will come in.

Question: I have a few questions. The Party of the Regions has become the ruling party and they have their own policy on agriculture. To what extent do you think things will change in this respect? Do

you have any expectations of their orientation for reform? If agriculture has no prospects, will ethanol have no prospects?





Jens Bruno: I don't know about the Party of the Regions or how their agricultural policy might affect business. As far as bio-ethanol production, I am sure there will be a mandatory blending of 3-5% of bio-ethanol in a couple of years here in Ukraine, as soon as they get production up and running. The factory that we were constructing had a potential of providing maybe 1.8% or more. There is the potential production from the former vodka factories. This will also put Ukraine in a good position when it comes to renewable energy in the total energy consumption. For bio-ethanol I think definitely there is a huge potential, and I think the politicians are well aware of this. I think that the Party of the Regions will continue to support agriculture, as all the previous governments have done so far. I don't know if they will do something special. We will see.

Question: I have a question. Both of you represent the foreign capital behind you and you have gone through several stages in the market. You already have the infrastructure that has the holding company, the grain trading company and the farming company, which can not be compared with an average Ukrainian farmer. You will see a different perspective. And you already see the problem of getting financed. You talk to international grain traders and are asking them, "Well, can you finance a little bit of my contract that I will produce later?" So from where do you see in the near future the source of money for large-scale farming operations? For the medium- and small-size farms? Where will money come from to finance the farming sector if the local banking sector is knocked down?



Jens Bruno: It will most definitely be difficult for the smaller farms.

Roman Fedorowycz: Most of the small farms depended on the local banks to finance them, and now this is just completely gone.



Question: So where will *you* get financed?

Jens Bruno: We are getting to the share issue right now. We also have good relationships with our banks. I think all of the major banks here in Ukraine have stated that they want to be very active in the agricultural sector. There will still be financing, but it will definitely be expensive financing. That is the bottom line.

Roman Fedorowycz: A lot of the medium to large holdings will be successful in securing financing from organizations like IFC and EBRD, and those things are moving.



Question: So, we are talking about two or three?

Roman Fedorowycz: There are a number of them getting financed.

Question: Yes, but those numbers are relatively small. In relation to 200,000 hectares, 10 million dollars is nothing. You didn't tell me, but you spoke a little bit about IPOs. Are you going to try and play the IPO game?

Jens Bruno: No, I didn't mention IPO, I said it was a share issue.



Question: A share issue, which means?

Jens Bruno: A private placement, attracting investors through a private placement.

Question: So not credit financing. You will be looking for investors.

Jens Bruno: Well, for a combination. Of course you have to have both. You have to have a mix of debt and equity financing.

Question: Do you agree that it was already difficult last year? It will likely be more difficult this year for most of these lands. Only two Ukrainian companies received subsidies for their farming operations. Perhaps IPO is the wrong financial term, but it was the second placement or next placement. There were only two for the whole year. That was it. Nobody else got

any financing. So what is going to happen this year? Five, ten, nothing?

Jens Bruno: I think if you have a company that could show investors that it is actually making money. If you can show investors that the company is not producing two tons per hectare, but maybe up to 3, 4 or 5 or going up to ten or 11, then there will be no problem raising financing. All investors into agriculture are long-term. It is the lifting of the moratorium and the arbitrage there that is the icing on the cake. Big returns will come in the long-term.



Alex Frishberg:

Ladies and gentlemen, I would like to thank you very much for attending our presentation. It seems that economic crisis may have dampened the parade, and we are not seeing much financing extended to perfectly viable projects, but the profits are obviously there, the even in the worst of times. Just imagine what will occur once the foreign investors will discover that moratorium is good for business, and how little restrictions exist in this unique area, the field of agriculture in Ukraine. Once again, thank you very much for coming here, and we look forward to seeing you again at one of our events. And if you wish to be on our special guest list, just write to office@frishberg.com.ua. Thank you!



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Starting Agricultural Production in Ukraine

With food prices rising across the globe, adventurous foreign investors can find excellent business opportunities in Ukrainian agricultural sector despite (or perhaps due to?) the global economic crisis. Known as “the breadbasket of Europe”, Ukraine still boasts enormous land reserves that can grow various grains, seeds, fruits and vegetables. Plus livestock. And due to the crisis, at last everything and everyone is available for sale or rent at rock-bottom prices.

Immediately below we discuss the key issues involved in starting agricultural production in Ukraine, including: (a) obtaining land rights; (b) importing equipment; (c) obtaining financing assistance during these difficult economic times; and (d) miscellaneous issues.

1. Land Rights

The main question for foreign investors is whether there is any profit in buying Ukrainian farmland to start a farm business. Thus, at first glance land rights may appear to be a sore topic for investors since the current legislation temporarily prohibits the sale of agricultural land.

To circumvent this legislation, many investors have been successfully leasing farmland either on a short-term (2-5 years), medium-term, (5-25 years) or long-term (up to 49 years) basis. In the process, they have saved millions of dollars in cash, which would otherwise be necessary to purchase the land, making their business more profitable. This is an excellent reason why investors prefer leasing Ukrainian farmland instead of owning it outright.

Note, however, that the sale of non-agricultural land (industrial property) does not fall under the same restrictions that apply to agricultural land (i.e., moratorium on sale). Thus, a foreign investor can build and operate a 100% foreign-owned processing facility on its own industrial land while leasing fields from agricultural landowners until the moratorium on the sale of agricultural land is lifted.

In the past, the validity of lease agreements was often questioned and this risk (of potential disruption or even termination of business activity due to a legal technicality) was too great for many investors. In today's harsh economic climate, however, very few landowners would breach their lease agreements and refuse to lease their fields to a paying client. In order to lease agricultural land, it is only necessary to enter into a land lease agreement with the landowner and simply comply with the terms of the agreement. Of course, the land lease agreement should be properly drafted, registered with the authorities, and notarized.

Obtaining land rights to start agricultural production is relatively simple in Ukraine. The legal framework is quite straightforward and the numerous examples of successful foreign-owned operations exist, including Cargill and Chumak (formerly known as "South Foods"). While owning farmland is temporarily out of the question, a foreign investor may lease the fields anytime. Of course, certain inherent business risks remain, like with any other type of investment throughout the world, but this should not serve as a deterrent to taking advantage of Ukraine's black, fertile soil.

2. Importing Equipment

Importing foreign equipment is often a pre-requisite to starting agricultural operations due to the lack of quality machinery and/or outrageous prices in Ukraine. There are several ways in which foreign equipment can be imported, including:

(a) by contributing such equipment to a 100% foreign-owned company's share capital. This involves drafting and signing a founders' resolution, amending the company's charter, and registering amendments to the charter with the state authorities. In this case, no customs duties apply; however, 20% VAT will apply.

(b) via a leasing arrangement whereby the ownership of the equipment is retained by a non-resident, who receives regular payments for the use of the equipment. This arrangement is based on a financial leasing agreement, which complies with the requirements of the Law on Leasing and pursuant to which the ownership rights to the equipment will pass to the lessee upon full payment of the leasing agreement. Importantly, under a financial leasing agreement both the customs duty and a 20% VAT will apply to the imported equipment;

(c) by purchasing the equipment via a sale-purchase agreement. Such agreement must, at a minimum, provide for fundamental material conditions including the subject matter, price, payment schedule, title transfer, etc. Again, both the customs duty and a 20% VAT will apply to the imported equipment;

3. Obtaining Financing

The current land-related legislation prohibits using agricultural land as collateral, precluding the possibility of obtaining much-needed financing. However, rights to future harvests can serve as liquid collateral, giving rise to the possibility of financing according to the Civil Code of Ukraine and the Law on Pledges. Thus, in order to obtain a commercial loan from a creditor, an agricultural producer can enter into a loan agreement and secure the repayment of the loan by a pledge (collateral) agreement using the rights to a future harvest(s) as collateral. Normally, such pledge agreements are notarized and registered with the relevant state registry of pledges. Unfortunately, few loans are extended these days.

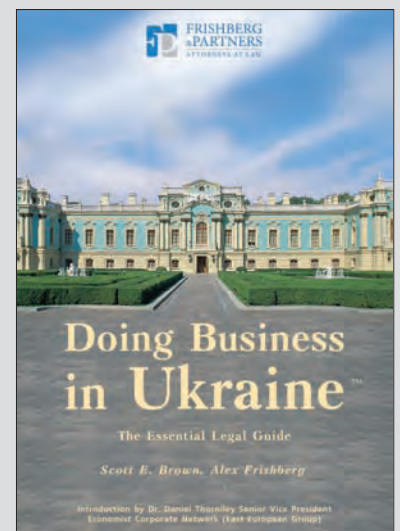
4. Other Considerations

Of course, as in any other jurisdiction, the Ukrainian government has a statutory right to regulate the market of agricultural products. It does so in the form of price regulation (e.g., setting minimum and/or maximum purchase price, when necessary), commodity and/or financial interventions, as well as the establishment of export and import quotas with respect to the agricultural products that are subject to regulation.

The list of agricultural products, subject to regulation, is established by law and includes certain grains and animal products. The measures that can be taken in respect of certain agricultural products are also established by law and can be used to avoid dumping, for example. It can also be abused: several years ago, Ukrainian authorities introduced a ban on the sale of grain, which caused alarm and anger among the grain traders.

Last, but not least, Ukrainian resident agricultural producers can enjoy a special VAT payment regime, provided they comply with the statutory requirements. According to this special regime, the producer retains the amount of VAT that it charges to the value of the supplied goods (services) instead of paying the tax to the budget. The producer uses the retained amount to compensate the tax paid or charged to a supplier in relation to the value of production factors. In cases when such amount of tax is in excess, the producer can use it for other production purposes. The relevant changes have been introduced to the legislation in order to support agricultural producers during hard times.

In conclusion, due to its enormous reserves of top-quality soil, Ukraine is undoubtedly one of the best places in the world for agricultural producers. And one day Ukraine will surely regain the long-standing status of being “the breadbasket of Europe.” The brave investors who decide to set up production during these turbulent times will undoubtedly be rewarded in the future, as they corner the market before their competition even enters Ukraine.



If you have additional questions, please contact us at:

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