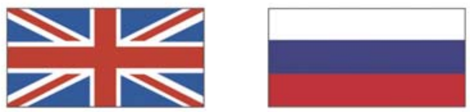
Nuffield Poultry Study Group

VISIT TO RUSSIA



6th – 14th October 2006

NUFFIELD FARMING

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Acknowledgements

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Contents

Summary

In October 2006 the Nuffield Poultry Study Group visited Russia to gain a better understanding of the commercial layer and poultry meat industries and make contacts with key people within those industries. We visited companies in and around Moscow and Tyumen.

Russia is the largest country in the world by land mass with the eighth largest population. Formerly the republic of the Union of Soviet Socialist Republics (USSR), Russia is now an independent country.

Following the economic crash in 1998, the Russian economy started recovering in 1999, entering a phase of rapid expansion, with GDP growing by an average of 6.7%. The recovery was made possible by high oil prices along with renewed government effort. Encouraging foreign investment is a huge challenge for Russia with a less than sufficient banking system, corruption, legal and political issues. However, there has been a significant inflow of European capital with investors attracted by low land and labour prices and higher growth rates than elsewhere in Europe.

Along with the rest of industry, Agriculture declined in the 1990's culminating with the crash in 1998. Since then it has been recovering with the help of the governments national project for agriculture and investment from non-agricultural companies. Poduction fell 50%, but is now nearly back up to 1990 levels.

Like the rest of industry the poultry industry has been rebuilding itself and it scheduled to reach 1990 production levels within the next couple of years. Poultry production is now also part of the national agriculture project. 20% of poultry are backyard flocks. In 2006 38 billion eggs and 1,550,000 tonnes of poultry meat will be produced. The meat industry aim to reduce imports from 45% to 25-30% in the next few years and are lobbying government to increase import tax to assist this. The future aim is to become totally self-sufficient in eggs and poultrymeat.

The facilities we visited were housed in old, shabby buildings, but there was a surprising level of investment in modern European technology coupled with highly educated staff who showed great attention to detail.

The Study Tour

In October 2006 the group visited Russia. The aim was to assess the Russian commercial layer and poultry meat industries. The group consisted of 10 Nuffield Scholars and three guests, from all sectors of the UK poultry industry (See appendix 1). We spent nine days visiting businesses and meeting key contacts from the industry.

We arrived in Moscow on Friday 6th October and spent the weekend sight seeing in and around the city, gaining an insight into life in Russia since the break up of the former Soviet Union. We included visits to the Kremlin and Red Square and the more cultured members of the group saw a performance of “Giselle” by the Bolshoy Ballet. We visited both small and large supermarkets and an open market to look at egg and chicken products. Our programme of visits within the poultry industry commenced on Monday with a briefing at the British Embassy. This was followed by a visit to an agricultural show where we were able to meet with the president of the “Poultry Union of Russia”. From there we spent the rest of the week visiting various businesses. (See Appendix 2 for itinerary).

It seems we had a lucky escape during our visit as news has just broken that homemade vodka laced with toxic household agents has turned Russia's national tipple into a killer. Hundreds have died of hepatitis and liver failure in the past few weeks after swigging the tainted liquor, alarming MPs and forcing the general-prosecutor to order a clampdown on moonshiners!

The Country

Russia, is a country that stretches over a vast expanse of Eurasia. With an area of 17,075,400 square kilometres, it is the largest country in the world by land mass, covering almost twice the territory of the next-largest country, Canada. It has the world's eighth largest population (142,400,000). Russia shares land borders with the following countries (counter-clockwise from NW to SE): Norway, Finland, Estonia, Latvia, Lithuania, Poland, Belarus, Ukraine, Georgia, Azerbaijan, Kazakhstan, China, Mongolia, and North Korea.

Formerly the dominant republic of the Union of Soviet Socialist Republics (USSR), Russia is now an independent country and an influential member of the Commonwealth of Independent States, since the Union's dissolution in December 1991. During the Soviet era, Russia was officially called the Russian Soviet Federative Socialist Republic (RSFSR). Russia is considered the Soviet Union's successor state in diplomatic matters.

Most of the area, population, and industrial production of the Soviet Union, then one of the world's two superpowers, lay in Russia. After the breakup of the USSR, Russia's global role was greatly diminished compared to that of the former Soviet Union. In October 2005, the federal statistics agency reported that Russia's population has shrunk by more than half a million people dipping to 143 million, although Russia remains the second largest country in the world by the number of immigrants from abroad.

Post-Soviet Russia

Prior to the dissolution of the Soviet Union, Boris Yeltsin had been elected President of Russia in June 1991 in the first direct presidential election in Russian history. In October 1991, as Russia was on the verge of independence, Yeltsin announced that Russia would proceed with radical market-oriented reform along the lines of "shock therapy".

After the disintegration of the USSR, the Russian economy went through a crisis. Russia took up the responsibility for settling the USSR's external debts, even though its population made up just half of the population of the USSR at the time of its dissolution. The largest state enterprises (petroleum, metallurgy, and the like) were controversially privatized for the small sum of $US 600 million, far less than they were worth, while the majority of the population plunged into poverty.

Russia's Congress of People's Deputies, in which the Communist presence was the strongest, attempted to impeach Yeltsin on March 26, 1993. Yeltsin's opponents gathered more than 600 votes for impeachment, but fell 72 votes short. On September 21, 1993, Yeltsin disbanded the Supreme Soviet and the Congress of People's Deputies by decree, which was illegal under the constitution. On the same day there was a military showdown, the Russian constitutional crisis of 1993. With military help, Yeltsin held control. The conflict resulted in a number of civilian casualties, but was resolved in Yeltsin's favour. According to different sources, the total number of deceased was between 300 and 2,000 people. Elections were held and the current Constitution of the Russian Federation was adopted on December 12, 1993.

The 1990s were plagued by armed ethnic conflicts in the North Caucasus. Such conflicts took a form of separatist insurrections against federal power (most notably in Chechnya), or of ethnic/clan conflicts between local groups (e.g., in North Ossetia-Alania between Ossetians and Ingushs, or between different clans in Chechnya). Since the Chechen separatists declared independence in the early 1990s, an intermittent guerrilla war (First Chechen War, Second Chechen War) has been fought between disparate Chechen groups and the Russian military. Some of these groups have grown increasingly Islamist over the course of the struggle. The total number of refugees and internally displaced persons from these territories today is about 100,000 people.

After Yeltsin's presidency in the 1990s, the former head of the FSB Vladimir Putin was elected in 2000. Although President Putin is still the most popular Russian politician, with a 70% approval rating, his policies raised serious concerns about civil society and human rights in Russia. The West and particularly the United States expressed growing worries about the state control of the Russian media through Kremlin-friendly companies, government influence on elections, and law enforcement abuses.

At the same time, high oil prices and growing internal demand boosted Russian economic growth, stimulating significant economic expansion abroad and helping to finance increased military spending. Putin's presidency has shown improvements in the Russian standard of living, as opposed to the 1990s. Even with these economic improvements, the government is criticized for lack of will to fight wide-spread crime and corruption and to renovate deteriorated urban infrastructure throughout the country.

The currency is the Ruble (RUB) and the exchange rate at the time of the visit was approximately 42 RUB per £1 sterling.

The Economy

More than a decade after the collapse of the Soviet Union in 1991, Russia is now trying to further develop a market economy and achieve more consistent economic growth. Russia saw its comparatively developed centrally planned economy contract severely for five years, as the executive and the legislature dithered over the implementation of reforms and Russia's ageing industrial base faced a serious decline.

Crash

After the breakup of the USSR, Russia's first slight recovery, showing signs of open-market influence, occurred in 1997. That year, however, the Asian financial crisis culminated in the August depreciation of the ruble. This was followed by a debt default by the government in 1998, and a sharp deterioration in living standards for most of the population. Consequently, 1998 was marked by recession and an intense capital flight.

Recovery

Nevertheless, the economy started recovering in 1999. The recovery was greatly assisted by the weak ruble, which made imports expensive and boosted local production. Then it entered a phase of rapid economic expansion, the GDP growing by an average of 6.7% annually in 1999–2005 on the back of higher petroleum prices, a weaker ruble, and increasing service production and industrial output. The country is presently running a huge trade surplus, which has been helped by protective import barriers, and rampant corruption which ensures that it is almost impossible for foreign and local SMEs (small and medium sized enterprises) to import goods without the help of local specialist import firms, such as the Russia Import Company. Some import barriers are expected to be abolished after Russia's accession to the WTO.

The recent recovery, made possible due to high world oil prices, along with a renewed government effort in 2000 and 2001 to advance lagging structural reforms, has raised business and investor confidence over Russia's prospects in its second decade of transition. Russia remains heavily dependent on exports of commodities, particularly oil, natural gas, metals, and timber, which account for about 80% of exports, leaving the country vulnerable to swings in world prices. Industrial military exports after undergoing sharp contraction is now the major non-commodity export. In recent years, however, the economy has also been driven by growing internal consumer demand that has increased by over 12% annually in 2000–2005, showing the strengthening of its own internal market.

The economic development of the country has been extremely uneven: the Moscow region contributes one-third of the country's GDP while having only a tenth of its population. GDP increased by 7.2% in 2004 and 6.4% in 2005.

GDP

The country's GDP (PPP) shot up to reach $1.5 trillion in 2004, making it the ninth largest economy in the world and the fifth largest in Europe. If the current growth rate is sustained, the country is expected to become the second largest European economy after Germany and the sixth largest in the world within a few years.

In 2005, according to the Federal Service of State Statistics, GDP reached $765 billion nominally (21.7 trillion rubles), equal to $1.6 trillion in international dollars (PPP; purchasing power parity). Inflation was 10.9% percent. Expenditures of the consolidated budget have reached 5942 billion rubles ($215 billion). The government plans to reduce the tax burden, although the time and scale of such a reduction remains undecided.

By August 17, 2006, Russia's international reserves reached $277 billion nominally and projected to grow to $320 billion by the end of this year and to $350–450 billion by the end of 2007.

Formed by the government in 2004 to take in the windfall revenues from oil exports (and try to prevent the ruble from appreciating), the Stabilisation Fund (SF) grew to $75 billion and is projected to achieve $110 billion by the end of the year, $173 billion by the end of 2007, and about $300 billion by the end of 2009. Using money from the stabilization fund, Russia paid off all of its Soviet-era debt to the Paris Club ahead-of-schedule on August 21, 2006

According to the Federal State Statistics Service of Russia, the monthly nominal average salary was about 10,975 rubles (about $408 nominally; about $740 PPP) in June 2006, 25.6 percent higher than in June 2005 and 7 percent more than in May 2006.

For the year of 2007, Russia's GDP is projected to grow to about $1.2 trillion nominally (31.2 billion rubles)

Challenge

Some perceive the greatest challenge facing the Russian economy to be encouraging the development of Small and Medium-sized Enterprises in a business climate with a young and less-than-sufficient functional banking system. Few of Russia's banks are owned by oligarchs, who often use the deposits to lend to their own businesses. The 2005 Milken Institute's ratings place Russia at the 51st place in the world, out of 121 countries by the availability of capital.

The European Bank for Reconstruction and Development and the World Bank have attempted to kick-start normal banking practices by making equity and debt investments in a number of banks, but with very limited success.

However, about twenty-five of the biggest banks of Russia get entry into Top 1000 banks of the world by *The Banker*. Many more Russian banks have very high international ratings by Moody's and Fitch, including "investment" level.

Other problems include disproportional economic development of Russia's own regions. While the huge capital region of Moscow is a bustling, affluent metropolis living on the cutting edge of technology with a per capita income rapidly approaching that of the leading Eurozone economies, much of the country, especially its indigenous and rural communities in Asia, lags significantly behind. Market integration is nonetheless making itself felt in some other sizeable cities such as Saint Petersburg, Kaliningrad, and Ekaterinburg, and recently also in the adjacent rural areas.

The arrest of Russia's wealthiest businessman Mikhail Khodorkovsky on charges of fraud and corruption in relation to the large-scale privatizations organized under then-President Yeltsin, contrary to some expectations, has not caused most foreign investors to worry about the stability of the Russian economy. Most of the large fortunes currently prevailing in Russia are the product of either acquiring government assets at particularly low costs or gaining concessions from the government. Other countries have expressed concerns and worries at the "selective" application of the law against individual businessmen, though the government actions have been received positively by most of the aggravated Russians.

Prospect

Encouraging foreign investment is also a major challenge due to legal, some cultural, linguistic, economic and political peculiarities of the country. Nevertheless, there has been a significant inflow of capital in recent years from many European investors attracted by cheaper land, labour and higher growth rates than in the rest of Europe. Amazingly high levels of education and societal involvement achieved by the majority of the population (including women and minorities), secular attitudes, a mobile class structure, and better integration of various minorities in the mainstream culture have set Russia far apart from the majority of the so-called developing countries and even some developed nations.

The country is also benefiting from rising oil prices and has been able to pay off all of its formerly huge debt. However, equal redistribution of capital gains from the natural resource industries to other sectors is still a problem. Nonetheless, since 2003, exports of natural resources started decreasing in economic importance as the internal market has strengthened considerably, largely stimulated by intense construction, as well as consumption of increasingly diverse goods and services. Yet teaching customers and encouraging consumer spending is a relatively tough task for many provincial areas where consumer demand is primitive. However, some laudable progress has been made in larger cities, especially in the clothing, food, and entertainment industries.

Additionally, some international firms are investing in Russia. According to the International Monetary Fund (IMF), Russia had nearly $26 billion in cumulative foreign direct investment inflows during the 2001-2004 period (of which $11.7 billion occurred in 2004).

Russia faces considerable income inequalities that hinder Russia's potential to become a more diversified economy.

Agriculture

Agriculture in Russia is struggling to rebuild as it transforms itself from a command economy to a more market-oriented system. Following the breakup of the Soviet Union in 1991, large State farms had to contend with the sudden loss of heavy government subsidies. Livestock inventories declined, pulling down demand for feed grains, and the area planted to grains dropped by 25 percent in less than ten years. The use of mineral fertilizer and other costly inputs plummeted, driving yields downward. Most farms could no longer afford to purchase new machinery and other capital investments. After about ten years of decline, Russian agriculture began to show signs of modest improvement. As in Ukraine, the transition to a more market-oriented system has introduced the element of fiscal responsibility, which has resulted in increased efficiency as farmers try to maintain productivity while struggling with resource constraints. Official data indicate a rebound in Russian grain yield in recent years, and although the bumper harvests of 2001, 2003, and 2004 are due in large part to favorable weather, most analysts agree that the gradual improvement will continue.

Crops

Wheat accounts for over half of Russia's grain production with average annual output of about 40 million tonnes. Planted area typically ranges from 23 to 26 million hectares. Winter wheat comprises about one-third of total wheat area but half of total production because of higher yield. Roughly 70 percent of Russia's wheat is classified as food-grade, or milling quality, and 30 percent as feed-grade. The combination of reduced feed demand and several bumper crops since 2001 has led to sharply increased wheat exports and lower imports.

Barley is Russia's second major grain with average production of about 16 million tons from 10 million hectares. Spring barley accounts for 95 percent of barley area and 90 percent of production. Barley is used chiefly as a feed grain, although an expanding brewing industry has boosted the demand for malting barley. Russia produces roughly 500,000 tons of malting barley against brewers' demand of about 1.2 million tons per year.

Russia plants millions of hectares of corn, but less than 20 percent is harvested for grain. The remainder is chopped for silage, usually in August. The area of silage corn declined by about 60 percent during the 1990's, from around 10 million hectares to less than 4 million. Corn forgrain area can fluctuate from year to year depending on the weather, with lower area during dry years, but typically ranges between 0.6 and 0.8 million hectares. Minor grains include rye, oats, buckwheat, and millet.

Sunflower seed is Russia's chief oilseed crop, and Russia is one of the world's top producers. Because of a combination of high price, low cost of production relative to wheat, and growing demand, sunflowers have become one of the most consistently profitable crops. Few soybeans are grown in Russia, with planted area of roughly 0.5 million hectares and production of 0.4 million tonnes. About half of Russian soybeans are grown in Amur oblast in the Far Eastern district. Russia produces 0.3 to 0.4 million tonnes of soyabean meal and imports an additional 0.3 million tonnes.

Livestock

Some 87.3 million hectares (215.7 million acres) are pastureland, representing just over 5% of the total land area. The livestock sector suffered dramatically following the 1999 crash. In 2001, the livestock population included: cattle, 27,294,000; sheep, 12,561,000; and pigs, 15,707,000. Russia also had 1.6 million horses, 335.6 million chickens, and 2.5 million turkeys in 2001.

2001 meat production volumes included (in 1,000 tonnes): beef, 1,872; pork, 1,498; mutton, 113; and poultry, 884. In 1999, Russia's livestock production was only 50% of that in 1990. Pork production suffered a similar decline and became the most expensive meat sold in Russia. The Russian pig sector further contracted in 1999 due to the 1998 ruble devaluation, weak demand, high credit costs, and inadequate grain supplies. Milk production in 2001 was estimated at 32.6 million tonnes (down from 55.7 million tonnes in 1991), and egg production amounted to 19.6 billion in 2001 (down from 47.5 billion in 1990). Infrastructural and distributional problems exacerbated the decline in production. Most Russian dairy farms were reported to be unprofitable due to low quality dairy cows, limited supplies of quality feed, and lack of support services. Continued decline in livestock production, especially poultry, as well as the rapid growth of imports have been a source of trade friction and political debate calling for restrictions on food imports into Russia. In 2001, Russia imported nearly $1.7 billion in meat and meat products.

Russia’s livestock sector has made significant progress in the last five years and is now reported to be back at 1999 production levels.

Credit

There has been improvement in the agricultural credit situation in Russia over the past five years – for some farms, at least – due largely to subsidies from the federal government. The national project for agriculture has given impetus to the growth of small farms. During 2006, 36,000,000,000 rubles in credit were given to more than 100,000 recipients (as compared to 3.4 billion rubles in credit to 2500 borrowers in 2005). Traditional farms and personal plots play an important role in the sector, providing more than 87 percent of all production.

The State offers in-kind credits, whereby seed, fertilizer, and other inputs are provided in exchange for grain harvested at the end of the season, though the use of in-kind credit is reportedly decreasing. The government also provides subsidies for the purchase of crop protection chemicals and fertilizers, and subsidizes two-thirds of the interest rate on loans from commercial banks, which provide the majority of farm credit. Banks remain cautious and insist on certain farm management practices and minimum levels of input use before granting loans (a policy which, according to some observers, has had a significant positive effect on overall efficiency in the agricultural sector), but banks' confidence is boosted by increasingly reliable guarantees from regional administrations who see stability of food production as a high priority. Banks recognize the inherent risk in agricultural financing, but also see agriculture as less risky than other industries and are generally willing to lend money to solvent, well-managed farms.

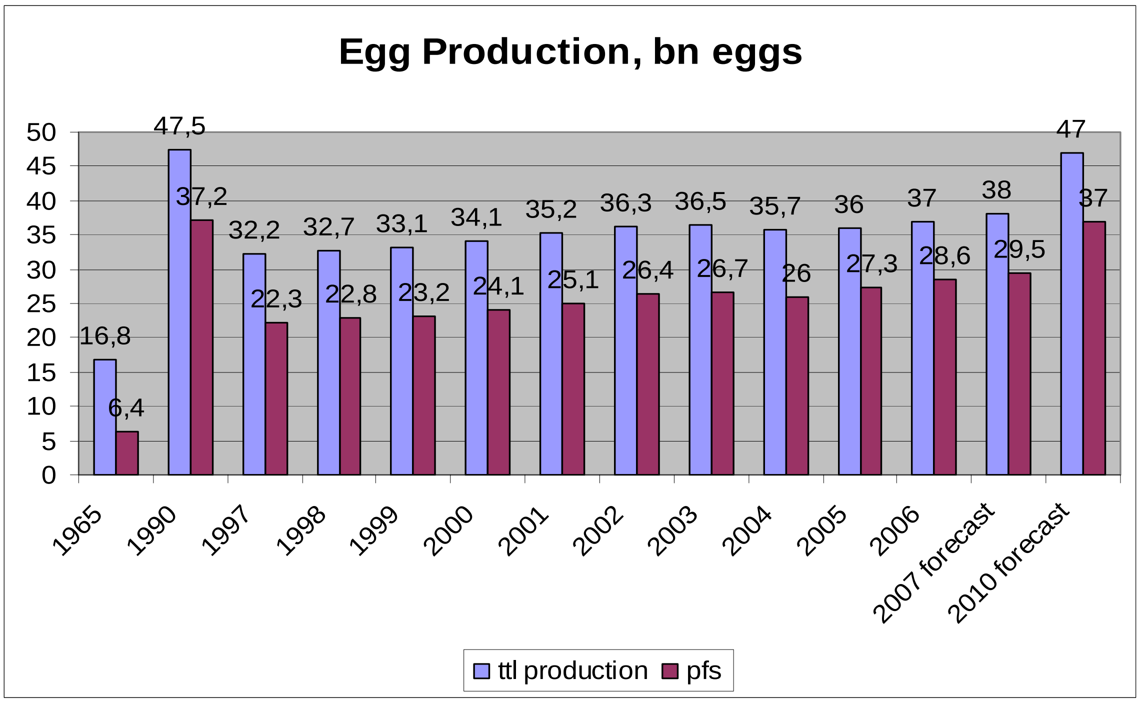
Over fifty percent of Russia's farms, however, are already saddled with considerable debt, due in part to the disparity between grain prices and production costs, and few farms are able to offer sufficient collateral to secure a loan. As a result, many farms are forced to rely on outside investors to guarantee loans. These investors, frequently referred to as holding companies, typically are large, cash-rich, traditionally non-agricultural companies that became involved in agriculture over the past five years. Some viewed crop production as a potentially highly profitable venture, and others were working to guarantee raw materials for vertically-integrated food-processing operations. Holding companies possess assets that satisfy banks' demand for collateral, and a farm that receives a commercial loan with the help of a holding company is still eligible for the federal interest subsidy. Many holding companies, particularly those who were attracted to agriculture by the high grain prices during 2000, have lost interest in crop production following two years of low prices and are bailing out. Investments in crop production don't pay off quickly, in contrast to investments in trade. Although some holding companies remain comfortable with the variable profitability of agriculture and will continue to work with farms, several prominent commodity analysts feel that the overall involvement of big companies in agriculture is declining.

This means that current prospects for significant, long-term investment in agriculture – particularly the purchase of agricultural machinery and grain-storage facilities – are somewhat dim. Land reform has been evolving in Russia since the basic right to own farmland was established in 1993, but "landowners" are still unable to use land as collateral in securing a loan. The situation, however, is not one that can be resolved quickly or easily through legislation alone. There is no mechanism currently in place to enable banks to evaluate the value of land based on its productivity before issuing loans, and banks likely would be reluctant to use land as collateral regardless of legislation. Furthermore, there are restrictions against non-agricultural use of land that is currently used for agriculture: if land is used for other purposes, the owner loses the title to the land. This imposes a limit on the land's resale value. Most observers believe that the use of land as collateral is years away.

The Russian Poultry Industry

The Poultry Union of Russia predicts that poultry production will soon be back up to the same level achieved in the early 1990's. Poultry production is now part of the national agricultural project. In 2007 60 farms which are part of this project will be offered reduced interest rates to assist in business development. This means that all regions will be in a position to double their production.

In 1990 47.5 billion eggs were produced in Russia, and consumption was 300 eggs/capita/annum. In 2006 38 billion eggs will be produced in total, with consumption of 244 eggs/capita/annum. 20% of poultry are backyard flocks (both eggs and meat). In summer, overproduction from these flocks causes a drop in value.



Source: Rosptitsesoyuz courtesy of Anton Polukarov Huhtamaki

In 1990 1,880,000 tonnes of poultry meat were produced. This year production will reach 1,550,000 tonnes. Poultry meat consumption is 2,700,000 tonnes per annum. 45% of poultry meat is imported from the USA. The Poultry Union are lobbying the government to increase import tax to reduce US imports. Their aim is for Russia to become totally self-sufficient in egg and poultry meat products in the future, but a mid term goal is to reduce imports of meat to 25 – 30%.

Cost of Production

Cost of production varies according to region, due to the vast size of the country. Where grain is produced locally in south west Russia the cost of meat production is 35 – 37 Rub/kg (£0.83/kg), in other parts where grain has to be bought in the cost may be 40 Rub/kg (£0.95/kg). The cost of production for eggs is 10-13 Rub/10 eggs This equates to approx 24p per doz. The exchange rate used for calculations is 42 Rub/£1 sterling.

Retail Prices

Eggs

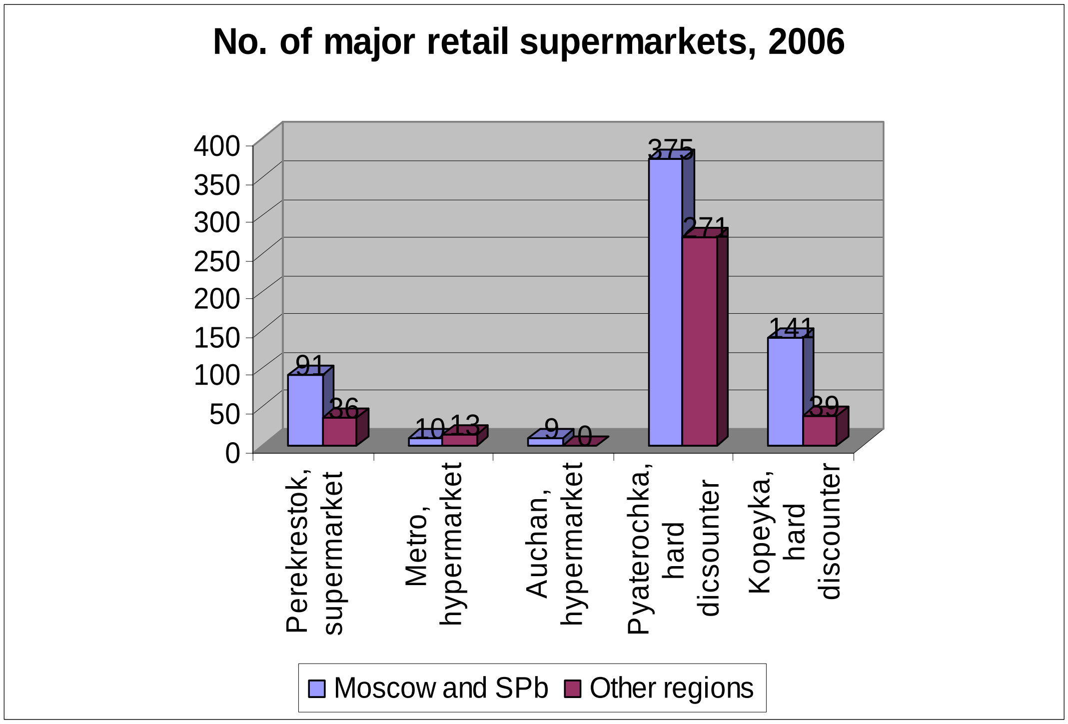
There was a large variation in egg prices depending on size and quality, ranging from 23.1 Rub /10 eggs (£0.66/doz) for 60-65g eggs to 32.48 Rub/10 eggs (£0.93/doz) for larger eggs. Both white and brown eggs were on sale

Meat

Whole frozen Brazillian chicken (1.2kg)	£1.30/kg (54.6 Ru/kg)
Whole frozen Russian chicken (2.25kg)	£1.55/kg (65.1Ru/kg)
Whole frozen Russian chicken (1.6kg)	£1.20/kg (50.4 Ru/kg)
Whole fresh Russian chicken	£1.40/kg (58.8 Ru/kg)
Breast Fillets fresh	£2.62/kg (110 Ru/kg)
Drumsticks	£3.02/kg (127 Ru/kg)

The Retail Sector

The majority of food in Russia is sold via local markets. Supermarkets, and hypermarkets have begun to spring up in Moscow and larger cities. The graph on the following page shows the number of major retail supermarkets in 2006 in Moscow and other regions.



Adoption of Technology

Unlike Ukraine, Russian companies are investing in european technology. The facilities we visited looked old and shabby from the exterior, but when inside were refurbished with modern european technology. This was the case for all the companies we visited.

Conclusions

- Following the economic crash of 1998, economic recovery has resulted in growth in GDP of an average of 6.7% annually in 1999-2005.

- Foreign investment is a major challenge due to corruption, as well as legal, cultural, linguistic and political factors.

- The banking system is weak. Russia is placed 51st in the world out of 121 countries by the availability of capital.

- There has, however, been a significant inflow of capital in recent years by European investors attracted by cheap land, labour and higher growth rates than the rest of Europe.

- Agriculture is rebuilding itself following the economic crash and will soon be back up to the production levels seen in the 1990's.

- Egg production is growing year on year and reached 38 billion in 2006.

- The meat industry is aiming to reduce imports from 45% to 25-30% in the mid term.

- Although buildings (and infrastructure) are poor, companies are investing in modern European technology.

- The Russian population is highly educated and high standards were seen in all the production facilities visited.

- Most eggs and meat are sold via local markets but the retail sector has started to develop