

USDA Foreign Agricultural Service

GAIN Report

Global Agricultural Information Network

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Ukraine

Dairy and Products Annual

2011

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Report Highlights:

Production of milk and dairy products is expected to contract in 2011/12. The number of dairy cows will decline insignificantly, continuing the 20-year trend. Exports in 2011 will be restrained by unusually high domestic milk prices and rather low quality of procured milk. Exports of cheese to Russia will contract, limited by strict sanitary measures. Exports of dried dairy products are well diversified and will remain sizable. Contrary to expectations, imports of butter will remain rather low.

Executive Summary:

Fluid milk production in Ukraine decreased in 2010 and expected further decrease by two percent in 2011. The number of animals is expected to decline in both the 2011 and 2012 years. Domestic milk prices are expected to remain high, complicating exports of Ukrainian cheese and dried dairy products. No significant shifts in domestic consumption of dairy products are expected. Consumers will remain price sensitive in all market segments, preferring price to quality. Use of cheaper palm oil in production of dairy products will remain significant.

The Ukrainian dairy processing market will follow the EU's consolidation trend. Smaller mergers and acquisitions in the cheese sector may follow the 2010 Danone and Unimilk merger. This merger should be finalized by the end of 2011 with the combined company's market share at 20 percent.

Ukraine will remain a big cheese exporter to neighboring Russia, but a raw milk shortage and problems with cheese quality will not allow for exports to increase. Imports of butter from Belorussia and/or New Zealand will remain insignificant. The cost of imported products is not attractive after the product clears customs and all duties are paid.

Record high milk prices have ignited some investment interest in dairy businesses. Throughout 2011 a number of agricultural companies announced plans to start or to expand their dairy herds, despite long decreasing trend in the number of cows and milk produced. Investments came mainly from big vertically integrated agricultural holdings previously specializing in crop production. These investments are numerous and usually range in size from 500 to 7,000 dairy cows per project. Investors are careful due to the significant investment needed, high risks, and long payback period. It is not clear if the flow of investments would continue if milk prices decline, but the need for diversification is apparent for many major grain and oilseed producers.

Production:

The bumper crop of feed grains expected in 2011 will help Ukrainian producers to keep their costs lower. It is expected that this year's crop will be similar to historical maximums achieved in 1990 and 2008. Grain trade policy—tariffs and value added taxes-- have also held down input costs, helping industrial dairy producers to maintain profitable operations from 2011 into early 2012. However, the impact of lower grain prices on milk production in households will be minimal due to general inefficiency of the industry.

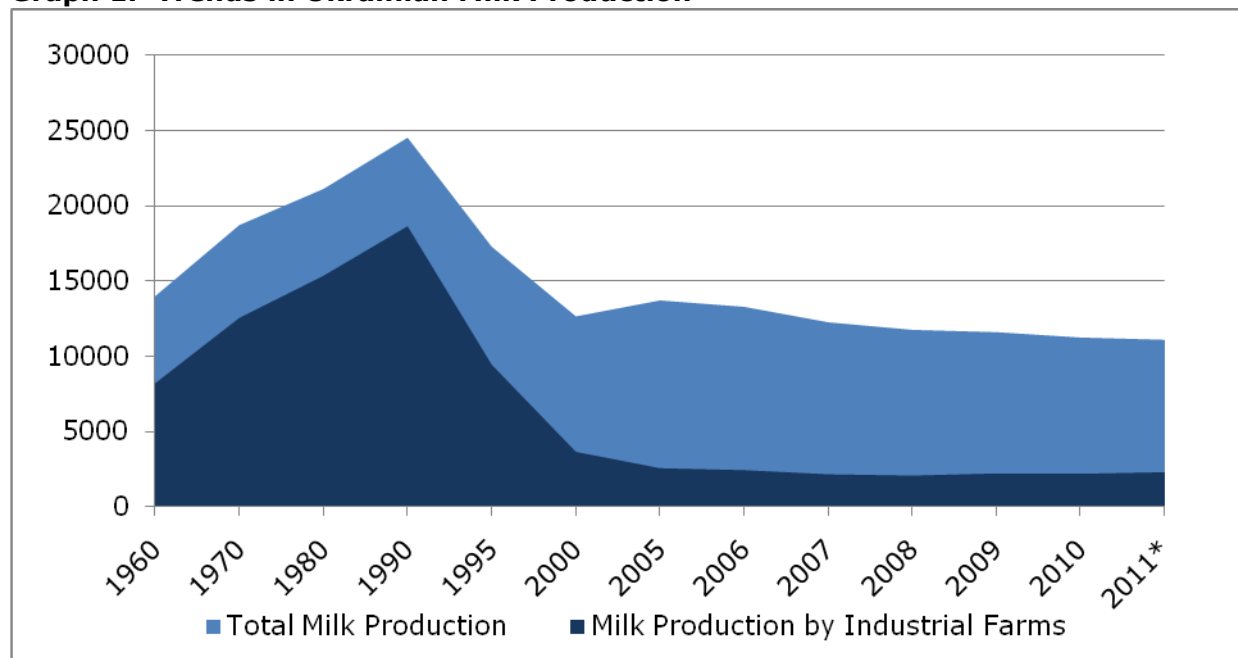
Although the price of beef has a limited impact on number of cows in Ukraine, this impact in recent years was negative. Consumers are losing interest to comparatively expensive beef. The shift in consumer preferences toward cheaper poultry meat reduced interests for livestock in recent years.

In 2010/11 the dairy market witnessed major fluid milk price growth that followed the continued decrease of animal numbers and major rise in feed costs. This raw milk price growth led to a record high processed dairy products price spike, which was not welcomed by the Ukrainian consumers whose incomes were slowly recovering after the financial crisis and currency devaluation shocks. Despite some dairy product consumption contraction (three percent in 2010 by value) there was no major consumption drop.

Ukrainian dairy processors will continue to obtain milk from two major sources: industrial farms and private households. For many years the ratio between the two sources remained almost

unchanged (around 20:80, respectively), but the share of industrial production grew in 2011 (see Graph 1). High milk prices in 2010/11 created a significant incentive for investments into industrial milk production despite generally hostile investment climate, financial instability and inconsistent governmental policies. Investments came from big vertically integrated agricultural holdings previously specialized in crop production and to a lesser extend from dairy processors themselves. The process is slow due to significant amount of investments needed, long investment return period, and high risks associated with it. According to the Ministry of Agricultural Policy and Food the cost of one cow place in big dairy complex varies between \$8,000 and \$10,000.

Graph 1. Trends in Ukrainian Milk Production



* Forecast

Despite some investments into industrial production, its share in total milk production remains low. Production of fluid milk has decreased in 2010 and expected to decrease in 2011 by 2-3 percent.

**Table1. Production Indicators for Farms of all Types
Jan 1st – Aug. 1st (1000 MT)**

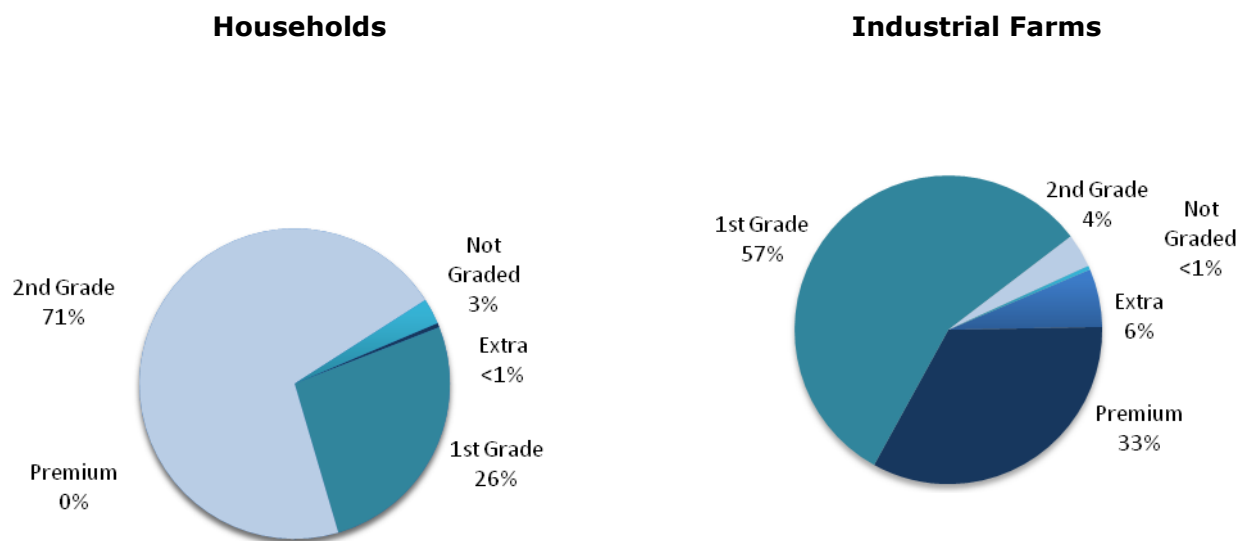
Milk production	2009		2010		2011		2011% to 2011
	Volume	Share	Volume	Share	Volume	Share	
Farms of all types	8163.1	100	7871.8	100	7697	100	97.7
Industrial Farms	1600.7	20	1578.2	20	1554	25	98.4
Households	6562.4	80	6293.6	80	6143	75	97.6

Source: State Statistic Committee of Ukraine

The quality of milk remains low, especially in household sector which supply mainly second-grade milk (see diagrams below). It's nearly impossible for quality controls to be implemented and enforced at the household level. In recent years the processing industry undertook a variety of program aimed at increasing milk quality. They included construction of village milk collection centers with chilling equipment, educational programs for cow owners, production co-ops, individual milking machines, and price incentives for quality milk. Most of them had proven to be

costly and had limited impact. Inevitable milk pooling does not allow for establishment of individual responsibility for low-quality product.

Quality of Milk Sold for Industrial Processing in the first half of 2011 by



Source: State Statistics Committee of Ukraine

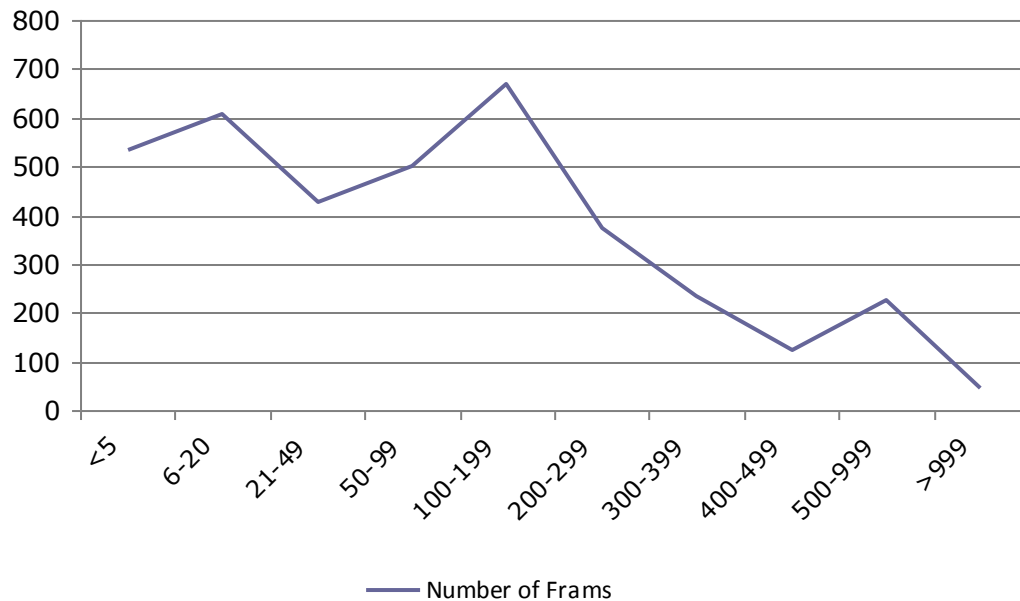
Milk Quality Norms (for Fat Content 3.4%, Protein 3.0%)

Indicator	Grade				
	Extra	Premium	1 st	2 nd	Not graded
Density (t=20°C) kg/m ³	>1027	>1027	>1027	>1027	>1027
Acidity, °T	16-17	16-18	<19	<20	<21
Somatic Sells Count 1000/cm ³	≤400	≤400	≤600	≤800	≤800
Bacterial contamination 1000/cm ³	≤100	≤300	≤500	≤3000	≤3000

Source: State Standard (DSTU) 3662-97

Industrial production of milk remains unspecialized. The number of farms with dairy cows dropped from 4,093 to 3,741 just during 2010. Most industrial farms view dairy enterprises as an auxiliary one and keep from six to 300 animals. Below is a distribution of animals in industrial farms that keep dairy herds.

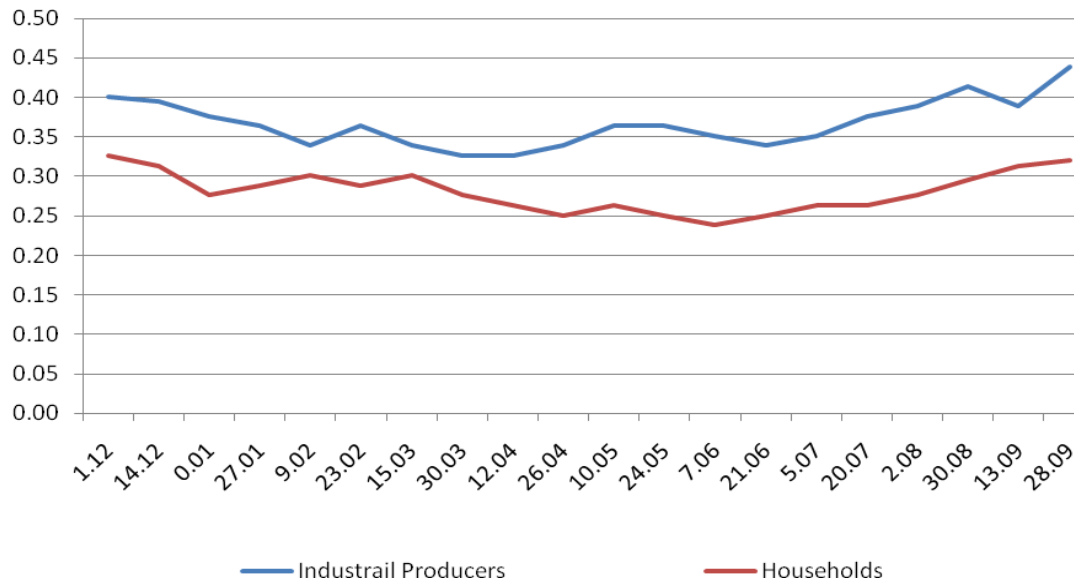
**Graph 2. Distribution of 3,741 Industrial Farms by Cow Number
(as of January 1st 2011)**



Source: State Statistical Service of Ukraine

High quality milk remains in great demand by milk processors who are ready to pay a premium price for it. According to Ministry of Agricultural Policy and Food information, in late September a typical dairy in central Ukraine would be able to buy raw milk from industrial farms at UAH 3.8-4.6 (\$0.48-0.58) per liter for different milk grades. In 2010 the price fluctuated around UAH 3.50-4.0 (\$ 0.45-0.51) in the same time period. Raw milk procurement price for households in 2011 even decreased to UAH 1.8-2.6 (\$0.22-0.32) from UAH 2.50-3.0 (\$ 0.32-0.38) a year before. Dairy processors continue to use specialized milk collecting companies that supply up to 70 percent of milk for further processing. Use of middlemen who break the monopoly of local dairy processors allows agricultural producers to receive a higher milk price, but prevent investments into milk collection system from the processors which in turn leads to lower quality of collected milk.

Fluid Milk Weighted Average Price* in Ukraine in 2010/11



Source: [Association of Ukrainian Milk Producers](#), own calculations;

* \$/kg for Industrial Producers and \$/liter for Households.

Production of milk in Ukraine remains highly seasonal with milk prices hitting the bottom in May–June. Previously noticeable significant month to month price fluctuation almost disappeared in 2011 due to a raw milk shortage.

State support of dairy producers in 2011 is minimal. Upon introduction of the new Tax Code in late 2010, the GOU completely dismantled the existing system of milk producer support through Value Added Tax (VAT) reimbursement. According to the old system, the processors accumulated VAT for produced products in special accounts and used it to increase the raw milk procurement price. The system used “automatic procedures” without government control. The GOU changed the policy in an attempt to control the subsidy money. According to the new system, the VAT payments were accumulated on the special state fund with consequent distribution to dairy farmers or used as compensation for construction of new premises or purchase of dairy animals. Due to contradictory regulations it is not clear how the system is going to function. According to industry contacts, dairy farmers did not receive any subsidy in 2011. Although GOU talks about revision of support program in 2012, Ukraine is not expected to increase support in 2012 to 2007–08 levels.

Important note on PSD number change

The PSD table was revised to match official statistics. The biggest revision was made to industrial fluid milk consumption. Previously, Post used its own calculations and information from industry experts to prepare this number. Recently, official information on milk procured by Ukrainian dairy processors became available from the State Statistics Service. The amount of milk procured by the industry happened to be somewhat lower than milk amount calculated by the experts and Post estimates. The possible explanation would be intensive unofficial use of cheaper palm oil to replace expensive milk fat. Production of unmarked dairy products by many Ukrainian dairy processors leads to a situation when reverse calculation revealed overestimated amount of milk fat and consequently overestimated amount of industrial use fluid milk in the PSD table.

Information on fake cheese, butter marked spreads and faked whole dairy product was publicly available before, but the extent was not clear. The press has reported about dairy products with zero milk fat or protein content. Ukraine's trade partners in Russia accused some Ukrainian producers in supplying cheese products with significant palm oil content. Lack of market control and reliable information made fluid use industrial milk estimates unreliable. Thus, from this year on Post will use official statistics for fluid milk industrial use.

Post also will continue to use official numbers for total milk production. This number is criticized by industry experts as being overestimated. Experts questioned how total milk yield was growing in recent years, while cow numbers were declining. They also questioned the data collection technique that is used for households' surveys. In these experts' view, no major improvement in animal husbandry practices took place that would explain such a productivity increase. However, possible productivity increases due to better feeding of smaller number of animals should also be considered.

Officially publish statistical information will continue being used in the report.

Consumption:

Slow economic recovery and continued crisis aftershocks will not allow major growth in disposable income in 2011/12. Analysts expect Ukraine's GDP may grow 4.5 percent in 2011, if demand for Ukraine's major exports, steel and chemicals remain stable. Although the disposable income is expected to grow in 2011 by 15 percent, Ukrainian consumers remain highly price sensitive, especially in lower income small towns and rural areas. Consumption of industrially produced dairy products in 2010/11 is likely to drop by 1-3 percent, although this drop will be uneven. Many producers show stable sales or modest growth in premium market segments for yogurt and infant formula. The biggest consumption drop is expected in the cheapest segment, as consumers shift from industrial to household products (mainly milk, soft cheese, and sour cream).

Prices of milk and dairy products are expected to remain high, which may lead to 2011 dairy market value increase despite a sales volume drop. Industry experts do not expect the price rise to be below the inflation level for 2011 (per the GOU forecast of nine percent). This price increase will result in further shift of demand into cheaper, lower quality market segments provoking producers on more intensive use of non-milk fat in dairy products, smaller packaging and other cost cutting methods. The demand for cheaper products is expected to continue throughout the rest of 2011/12. Consumers will be accepting lower quality for higher price and are used of vegetable oils in traditionally dairy products.

Trade:

The Russian Federation will be the major destination for Ukraine's cheese exports in 2011, but trade will remain limited by short domestic fluid milk supply. Russian dairy producers openly lobby against Ukrainian imports pointing out the intensive use of vegetable oils in Ukrainian dairy products and raw milk shortages. The amount of trade in 2012 will remain to be subject to political bilateral negotiations. Ukraine and Russia have an FTA that technically simplifies exports. Only Belorussia has similar competitive advantages. Although Russia's actively restricts imports through the technical regulations Ukraine has a significant market share. Russia is likely to continue trade restrictions through veterinary and sanitary measures in 2011/12

On July 15th of 2011 Russian Veterinary Authority Rosselkhoz nadzor announced results of the system audit of Ukrainian meat and dairy producers delisting 28 companies (six of them

temporarily). This inspection conducted by Rosselkhoznadzor was officially positioned as Custom Union (CU) inspection, so trade restriction would cover other CU members - namely Belorussia and Kazakhstan. Now only [23 dairy producers](#) (three processors delisted in a result of audit) and can export to Russia and CU. A number of companies were denied market access.

Imports of cheese and butter to Ukraine remain the subject to multiple technical restrictions that combine into a significant trade barrier. Import restrictions are imposed through two key GOU institutions: Ukraine's Custom Service (CS) and State Veterinary and Phytosanitary Service of Ukraine (SVPS). Importers complain that the CS assigns an arbitrarily high value for imported dairy products which results in increased associated import duty and Value Added Tax. In turn the SVPS indirectly qualitatively limited imports using the import permit procedures. Due to unclear and controversial legislation, the SVPS demanded import permits for all imported products of animal origin including dairy. In many cases importers were denied import permits because of some technicalities or errors in application. In some cases import permits were delayed, so importers suffered additional losses.

Trade estimates for 2010 were revised to converge with official statistics. The trade forecast for the remaining months of 2011, as well as for 2012 remains subject to trade policy changes and possible new TBT introductions.

Cheese

Cheese production in Ukraine decreased significantly in 2010 and continues to decline in 2011. Competition for raw milk in 2009/10 led to significant cost rise and consequent cheese price increase. According to industry experts, Ukrainian consumers faced two major price increases in 2010. Consumers were not ready for new price levels and responded by consumption contraction. For hard cheese internal demand in 2010 dropped by 14 percent. Facing lower demand the industry reacted in two ways: processors started to lower the price for traditional hard cheese (price started to decline in spring of 2011 stabilizing by mid-summer) and switched to production of cheaper cheese products using palm oil. In this way, producers were able to partially compensate the profit margin decline in production of hard cheese and meet increased costs.

The price drop in hard cheese helped to stabilize consumption in the middle of 2011, but expensive raw milk limits producers' ability for further price decrease. Production of cheese somewhat recovered, but is not going to grow back to the 2010 level.

Production of hard cheese-like products with extensive use of palm oil continues to gain popularity in 2011. Analysts believe that their share in production reaches 20 percent while in domestic retail they occupy even bigger share of 30 percent. The product is significantly (10-20 percent) cheaper than regular hard cheese and often sold as such without proper labeling. An outdated system of technical regulations allowed for marketing of this cheese product as regular cheese confusing consumers. The "palm oil cheese" is not welcomed by the traditional export market in Russia where import control is strict. Official appearance of this product on Ukrainian market provided Russian lobbyists with additional arguments to limit Ukrainian exports.

A lack of trust in Ukrainian producers led to an increase in imports of high quality cheese. Another factor that supported imports was Ukrainian cheese price growth. Previously imported cheese was significantly more expensive creating a distinct market segment. Nowadays imported (mainly from EU countries) cheese continues to be more expensive, but mass consumption cheese (Gauda, Emmental type) is just 10-20 percent more expensive in Ukrainian retail. Many affluent consumers prefer a safe bet and choose Polish, Dutch and German cheese over Ukrainian.

Butter

Production of butter in Ukraine in 2010 remained low. To satisfy the demand Ukraine conducted limited imports from neighboring Belorussia that started in 2009. Facing short raw milk supply Ukrainian producer preferred to maintain whole dairy products and cheese production and exports over production of butter and non-fat dried milk. Due to prices in 2011 the situation is not likely to repeat itself. Some butter imports did take place in early 2011, but in the middle of the year market turned against importers. By the end of 2011 butter imports are expected to contract 1.5 times if economic crisis in Belorussia would not make the Belorussian producers to drop export price. The GOU publicly announced possibility of imports from the New Zealand, but many analysts doubt this intention due to higher prices there.

Similarly to cheese, raw milk shortages lead to high market prices for butter and increased production of spreads and unmarked spreads sold as butter. In March 2011, the state body responsible for consumer rights and technical regulations Ukrmetteststandard conducted a butter testing. According to the results, approximately one-half of the butter samples happened to be unmarked spreads. The content of non-milk fats ranged from 15 to 60 percent in different samples of packaged products. One sample of unpackaged butter purchased on open-air market shown zero percent dairy fat content.

Production of butter in 2011 is expected to remain stable, close to the 2010 level. No significant exports or imports are expected. Lack of raw milk and low quality of the product makes return of Ukrainian butter to the Russian market unlikely.

NFDM / WDM

Production of dry milk in Ukraine depends on availability of seasonal milk. Dry products production lines are launched only if no other use of milk is possible. The trade margin of dry milk is the lowest among all dairy products. Besides production of non-fat dried milk (NFDM) is a function of butter production. Significant butter production decrease in recent years led to a drop of NFDM production. Butter/NFDM production decision is usually based on domestic price for butter and world market NFDM price, since domestic use of NFDM is rather limited.

Similarly to butter production, production of NFDM is expected to remain stable. Both factors (domestic butter price and the world market NFDM price) led to some NFDM production increase in 2011 despite fluid milk production decrease.

Production of Whole Dried Milk powder is expected to contract somewhat in comparison to the previous year. Attractiveness of WDM will continue to be the lowest among all dairy products and its production will remain dependant on external demand. Domestically it constitutes a very small market segment.

The Ukrainian statistics service provides only one number for dry dairy products (NFDM, WDM, and dry whey). Data in the PSD for NFDM and WDM were obtained from consulting with companies, industry representatives, and FAS/Kyiv market research.

Statistical Tables

Fluid Milk PSD Table*

Dairy, Milk, Fluid Ukraine	2010		2011		2012	
	Market Year Begin: Jan 2010		Market Year Begin: Jan 2011		Market Year Begin: Jan 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	2,758	2,736	2,690	2,631		2,560
Cows Milk Production	10,950	10,977	10,570	10,800		10,550
Other Milk Production	242	272	242	300		330
Total Production	11,192	11,249	10,812	11,100		10,880
Other Imports	1	1	1	2		2
Total Imports	0	0	0	2		2
Total Supply	11,193	11,250	10,813	11,102		10,882
Other Exports	0	0	0	0		0
Total Exports	20	16	20	15		15
Fluid Use Dom. Consum.	3,290	5,342	3,170	5,437		5,337
Factory Use Consum.	6,920	4,793	6,693	4,600		4,500
Feed Use Dom. Consum.	963	1,099	930	1,050		1,030
Total Dom. Consumption	11,173	11,234	10,793	11,087		10,867
Total Distribution	11,193	11,250	10,813	11,102		10,882

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*These are not official USDA numbers

Cheese PSD Table*

Dairy, Cheese Ukraine	2010		2011		2012	
	Market Year Begin: Jan 2010		Market Year Begin: Jan 2011		Market Year Begin: Jan 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0		0
Production	220	212	205	185		200
Other Imports	10	11	10	12		14
Total Imports	10	11	10	12		14
Total Supply	230	223	215	197		214
Other Exports	85	79	90	75		70
Total Exports	85	79	90	75		70
Human Dom. Consumption	145	144	125	122		144
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	145	144	125	122		144
Total Use	230	223	215	197		214
Ending Stocks	0	0	0	0		0
Total Distribution	230	223	215	197		214

1000 MT

*These are not official USDA numbers

Butter PSD Table*

Dairy, Butter Ukraine	2010		2011		2012	
	Market Year Begin: Jan 2010		Market Year Begin: Jan 2011		Market Year Begin: Jan 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0		0
Production	76	79	72	80		80
Other Imports	3	6	5	4		4
Total Imports	3	6	5	4		4
Total Supply	79	85	77	84		84
Other Exports	1	1	1	2		2
Total Exports	1	1	1	2		2
Domestic Consumption	78	84	76	82		82
Total Use	79	85	77	84		84
Ending Stocks	0	0	0	0		0
Total Distribution	79	85	77	84		84

1000 MT

*These are not official USDA numbers

Nonfat Dry Milk PSD Table*

Dairy, Milk, Nonfat Dry Ukraine	2010		2011		2012	
	Market Year Begin: Jan 2010		Market Year Begin: Jan 2011		Market Year Begin: Jan 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	2	2	2	2		2
Production	51	53	50	51		48
Other Imports	1	2	6	1		1
Total Imports	1	2	6	1		1
Total Supply	54	57	58	54		51
Other Exports	17	14	20	25		20
Total Exports	17	14	20	25		20
Human Dom. Consumption	35	41	36	27		29
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	35	41	36	27		29
Total Use	52	55	56	52		49
Ending Stocks	2	2	2	2		2
Total Distribution	54	57	58	54		51

1000 MT

*These are not official USDA numbers

Dry Whole Milk Powder PSD Table*

Dairy, Dry Whole Milk Powder Ukraine	2010		2011		2012	
	Market Year Begin: Jan 2010		Market Year Begin: Jan 2011		Market Year Begin: Jan 2012	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	0	0	0	0		0
Production	14	15	13	14		14
Other Imports	0	0	0	0		0
Total Imports	0	0	0	0		0
Total Supply	14	15	13	14		14
Other Exports	8	6	6	4		5
Total Exports	8	6	6	4		5
Human Dom. Consumption	6	9	7	10		9
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	6	9	7	10		9
Total Use	14	15	13	14		14
Ending Stocks	0	0	0	0		0
Total Distribution	14	15	13	14		14

1000 MT

*These are not official USDA numbers