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TRUMAN

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REPORT

NOVEMBER / 2018



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Founder, Managing Partner,
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Over the last four years, Ukraine has lost thousands of people, territory, processing plants, coal mines, oil wells, chemical plants – and a few million able-bodied citizens who have left the country to work abroad. This is one way of looking at the country in 2018.

However, when I look at Ukraine, I see the country that has risen 41 positions in the Doing Business index since 2013; where currency reserves have grown 230% in the last four years; inflation is down to less than a third of what it was; the National bank's achievements have been given high marks by the World Bank, the IMF and the EBRD; three-year budgets are now being adopted with a deficit that's down to less than a third of what it was; VAT reimbursements are handled automatically. In the first three quarters of 2018, decentralization reforms have raised local budget revenues by 25% compared to 2017. Meanwhile, price distortions on the gas market are being gradually eliminated. Ukraine is now the third largest poultry exporter to the EU – up 90% over 2017. Last year Ukraine was in sixth place for beer exports to Europe – up 50% over 2016. This year's grain harvest broke the previous record, set in 2016.

The list of changes that have taken place in the last four years is long, and whenever I name them, I am sure to hear, "Are you serious? I didn't know that."

Who does know all of this? Systematically, nobody. Even in Ukraine, few people are really aware of what is going on here, while abroad, the only time Ukraine comes up is when there is a war, a fire or a flood. It's natural: everyone is more interested in local developments, and grabbing their interest is an ongoing challenge that requires ongoing effort. Not just visiting exhibitions and investment forums, but making a point of meeting journalists there and telling them, at length and with enthusiasm, about the incredible changes taking place in Ukraine. Nobody does this. Corporate press officers aren't used to working with journalists. I deliberately searched online to find out about the volumes of beer Ukraine had exported to the EU, but after reading more than 20 news pieces, I did not find a single mention of the companies who were responsible for this growth.

Government agencies and state companies do nothing about that due to the complexity of approval process: write, approve, rewrite, reapprove... There are some rare exceptions, but that's what they are – exceptions. Where are investors supposed to find out from that there's a lot more going on in Ukraine than wars, fires and floods? Nowhere – until Ukraine begins to tell its own story. ■

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FINANCE

THE ECONOMY CALLS FOR MONEY

The banking sector has gone through a sanation period, and is now a lot healthier than a few years ago. This is something that bankers, businesses and international financial institutions seem to agree upon.

The screening of the market players, the introduction of capital requirements, the stress on risk management, the reinforced financial monitoring as well as more stringent demands on borrowers – all these factors are contributing to fair competition among the banks. The customer is the ultimate beneficiary.

Banks are now liquid enough and are able to meet the citizens' and businesses' demand for loans. The legal groundwork for the lending restoration has been laid: the Verkhovna Rada has supported key legislation on lender rights protection, the norms regulating bankruptcy procedures for legal entities have been refined, and bankruptcy is now applicable to natural persons, too. Banks are now relieved of part of the risks which used to be included in the interest and commission rates. The overall credit rating of the citizens is on the rise. Conscious businesses admit that banks are reliable partners, a pair of mindful eyes monitoring the companies' development.

Mass crediting is currently prevented by the refinancing rate. Still, the NBU maintains that the 18% rate should provide a healthy balance between the need to stem inflation and support economic growth.

Conversations with exporters revealed that businesses have an unmet demand for trade financing. Representatives of the banking sector admit that their customers have been deprived of part of the services. For instance, trade financing only accounts for a mere 6% of the total demand for financing.

Still, the transformation of the National Bank, the efforts of the international financial institutions and several years of hard work have not been in vain - Ukraine's banking sphere has changed fundamentally. This sets the stage nicely for crediting to be restored and the Ukrainian economy to be provided with money. ■

VOLODYMYR LAVRENCHUK
COB, Raiffeisen Bank Aval



OUR BANK'S GROWTH TESTIFIES TO POSITIVE REFORMS

How has the massive transformation of Ukraine's banking sector in the last few years and the departure of many unhealthy banks affected Raiffeisen Bank Aval's operations here, especially compared to the last major financial crisis?

It has, indeed. In the last three years, we've seen our operations become highly profitable and our customer base has grown. This is what our shareholders and management dream about. For example, our corporate lending portfolio has expanded by nearly 40% each of the last two years. The same is true for SMEs. These growth numbers testify to the effectiveness of the reforms that have taken place since 2014. They confirm the notion that honest competition based on transparent application of the regulations governing the banking sector to all market players leads to positive transformations. Reforms based on the unbiased application of capital requirements and risk management methods, and control over lending to related parties set the conditions for banks to properly compete. Customers win from this kind of honest competition.

Given that protecting creditor rights plays a major role in renewing lending, how do you expect the adoption of key legislation to change the situation on the bank lending market?

The Law "On protecting creditor rights," as we call it, is the result of a lengthy drafting process involving experts. We are satisfied with this bill, which the president signed into law on November 1. It contains quite a few updated instruments that will ensure the effective application of protections for both lenders and borrowers. The actions of the parties to an agreement now have more protection, based on the procedures for collecting, litigating and preparing for lawsuits, settling disputes out of court, and so on. This considerably improves the judicial environment for interactions between creditors and debtors.

Whether this will be enough to be able to say that we can now lend on a mass scale – no. For lending to revive, we need two more things. First is higher incomes among ordinary Ukrainians, which means greater creditworthiness. Second, the cost of money has to go down. We know that the National Bank plans to bring inflation down to single digits, which is directly linked to reducing interest rates for loans.

As you can see, we have a legal bridgehead. We also have experience in dispute settlement that we gained during the crisis years. Household incomes are on the rise. For now, the interest rates are not acceptable. When all these components are in place, we will have a better basis for mass personal lending, as well as commercial lending to businesses and organizations. Right now, with interest at 20% and higher, borrowing money is only possible short-term and not in all areas.



CUSTOMERS WIN FROM
BANKS' FAIR COMPETITION



How have requirements of borrowers changed, given that banks managed to accumulate vast volumes of NPLs?

Right now, banks around the world are instituting stricter requirements of borrowers in terms of revealing information about the ultimate beneficiary and about the nature of their commercial operations. This is what is known in the industry as KYC or "Know your client" and financial monitoring. This is world practice that has been introduced by the decision of bank regulators, governments and international financial institutions (IFIs). They can't be avoided. We can say that this is tightening requirements, but it won't work any other way. And so my answer is: it's become harder to borrow for those who have incomplete or covert documents regarding ownership, or who were engaged in activities that were not directly related to their statutory activities. Of course, in Ukraine, where 40% of the economy operates in the shadows, these conditions seem very harsh.

They could also seem burdensome because clients are meeting the requirements manually and on demand, rather than the lending institution getting this information through electronic registers. But the future is digital, which means that the next 3-5 years should resolve this problem.

What share of NPLs form Raiffeisen's lending portfolio?

Things are going very well now. During the crisis, NPLs were up to 50%, but now they're down to less than 20%, and we plan to have them down to 12% by the end of the year. Next year, they should be in the single digits.

I have to say that during and since the last crisis, borrowers have behaved far more constructively in terms of settling their debts, compared to before the crisis. The court system is also working more predictably now and artificial problems with the judiciary have gone down. New rules are making it possible for us to put together agreements to settle or write off debts on the go when there is no prospect of collecting. Those factors that used to restrain us for a long time have disappeared. This makes it possible to clean up our loan portfolios a lot faster.

What are the results of your many years of close work with the EBRD in issuing inexpensive loans?

We have two partnership agreements: one with the EBRD and the other with the European Investment Bank (EIB). They contain different conditions but have a common goal: to offer customers credit when the assessed risks of working with them are on the margin of our lending policies, that is, they are high enough and, based on formal requirements, we would have to reject such a borrower. So we share these risks with another bank. This makes it easier to monitor them and, should they prove unsuccessful, it won't be so painful. Between the two programs, nearly €35 million in credits have been given out. This seems to be an effective model for supporting business in Ukraine.

It seems that export credits are one of the underserved segments and exporters are feeling the pinch. How might this problem be resolved in specific sectors and what instruments does Raiffeisen offer exporters?

In Central and Western Europe, as much as 30% of financing is covered precisely by guarantees, letters of credit and promissory notes – what's known as trade financing. In Ukraine, this is at the level of 5-6% so far. This is very little and so the complaints are valid. When banks were constantly competing for capital, customers lost part of the services to which you are referring, and so banks and bankers need to hear this criticism.

As to Raiffeisen, we would like to increase the volume of export operations. We believe that we have the proper expertise

in trade financing, as we have been getting high marks from the EBRD as the best bank in this area for several years now. In fact, we are now the #1 bank for the number of guarantees issued. Still, I can confirm that the volume of such operations does not reflect the real needs of Ukraine's economy.

What are Raiffeisen's plans for expanding in sectors where you haven't been strongly represented in the past and where do you see the greatest demand for lending?

Firstly, there's the IT industry, which has become the third largest exporter in Ukraine after farming and steel. It's been growing by 27% a year. Of course, banks are keen to compete for their business. This is also a very demanding customer and providing them with quality service is among our priorities as a bank.

The second sector is renewable energy, which is becoming the main component of alternative energy. Right now, Raiffeisen is somewhat limited in this area.

The third area is infrastructure projects. The scales of financing that they needed are far beyond what any individual bank can take on. I predict that at some point we will see banking syndicates again, to handle this demand. This is a more complicated and requires greater expertise and lengthy preparatory work. But this is also something without which I can't imagine the banking sector playing a significant role in reviving Ukraine's economy. ■





YEVHEN STEPANYUK

Head of Financial Sector Reform Office at
National Bank of Ukraine

THE REFINANCING RATE IS ALWAYS A COMPROMISE

The National Bank reviewed its macroeconomic forecast on 25th October. The foreseen inflation rate was raised to 10.1%, while the refinancing rate remained unchanged. What kind of message is the NBU sending to the market?

You are right, the forecast inflation rate was raised by 1.2%. The refinancing rate remained as before, at 18%. The National Bank's management has been raising the refinancing rate at intervals for quite a long time. Last year's figure was 13.5%. Considering this fact, as well as the expected inflation dynamics over the next 12 to 18 months, the management has estimated that the refinancing rate is currently high enough to ensure that inflation reaches the mid-term goal of 5% by 2020.

The rate always represents a compromise between the objectives of the National Bank. These are currently clearly prioritized as follows: 1) price stability; 2) financial stability; 3) economic growth. It is regarding these goals that the acceptable refinancing rate is established for a certain period. The current 18% rate will provide a healthy balance between the necessity to lower inflation to the target level and the need to support economic growth.

It should be mentioned that strict monetary policies are not the only kind of signal the management has sent to the market in its official communication. The National Bank is deploying a proactive policy. This means it considers expected inflation dynamics when making decisions, rather than past data. Therefore, the NBU also communicates the risks to inflation reduction that it foresees.

Ukraine, as a relatively small open economy, is affected by global processes, such as the situation in foreign markets and the general dynamics of the world economy. We are influenced by policies determined by global state players and their central banks. The Federal Reserve System of the USA and the Bank of England are raising interest rates, the European Central Bank is winding down its quantitative easing program. Consequently, developed countries are becoming more attractive for investors. This means investment is ebbing away from developing countries.

Apart from the investment drain from developing countries, the management also stressed the risks associated with the increased speed of the global economy cooldown, the decrease in commodity prices and the further growth of energy resource prices in the world market.

With the current forecast, balanced monetary policies should contribute to a 5% inflation rate in 2020, which is half as much as the current figure. Should we expect a similar slump for the refinancing rate?

I would say that is true, theoretically. The refinancing rate is supposed to go down along with inflation, but there is no direct correlation here. At the early stages of inflation targeting, central banks tend to deploy somewhat more stringent policies than their more experienced counterparts under similar conditions. It is because they need to demonstrate their determination in ensuring price stability to earn the trust of the population and the market players. Additionally, there are a few other factors apart from inflation that the National Bank must consider.

The 2020 Strategy for Finance Sector Reform mentions renewed lending as one of the key goals. What are the indicators that will show that the objective has been achieved?

As a matter of fact, the strategic goal is not to reach a set measure, but rather to create favorable conditions allowing the citizens and the business sector to use loan funding more actively without creating substantial risks for the financial system. How do we achieve that? First, we must ensure the protection of lender rights, which requires reforms to the judicial and executive systems.

A lot has been done in this sphere. The Verkhovna Rada has supported crucial laws dealing with the protection of lender rights and improvements to state banks' corporate governance. The legal entity bankruptcy procedure has been optimized from a legal perspective, the institute of bankruptcy has been introduced for natural persons, too. The laws' implementation should improve the operation of the banking sector and contribute to increased economic activity.

The National Bank has got two divergent objectives on its hands: on the one hand, it should tackle inflation and stimulate citizens to save up, while on the other hand, it should provide the Ukrainian economy with a sufficient amount of funds. Which is the greater risk: to fail in curbing inflation or to prevent the economy from making its next leap by limiting capital availability?

As the National Bank has its priorities clearly defined, the answer is obvious – we target inflation in the first place. From a long-term perspective, it is price stability that forms the steady basis for sustainable economic growth.

Speaking about the availability of capital, banks are currently liquid enough and can fully meet the demand for loans to citizens and business entities. Polls indicate that banks remain optimistic

and expect more active crediting over the next 12 months.

Thus, the strict monetary policy deployed by the NBU this year is not an obstacle to crediting. The problem mostly comes down to finding the borrowers who are ready to take the money and return it in due time.

What kind of borrowers are banks looking for?

The first requirement is reliability. Borrowers need to provide verified reports and have a healthy credit history. The NBU will launch its credit registry in bilateral mode on 1st January 2019. Banks will be able to review their potential customers' behavior regarding loans they had received from other banks. This will bring us one step closer to high-quality banking risk assessment and will help protect financial institutions from accumulating non-performing loans. As it stands now, unfortunately, these make up a considerable part of the banks' portfolios..

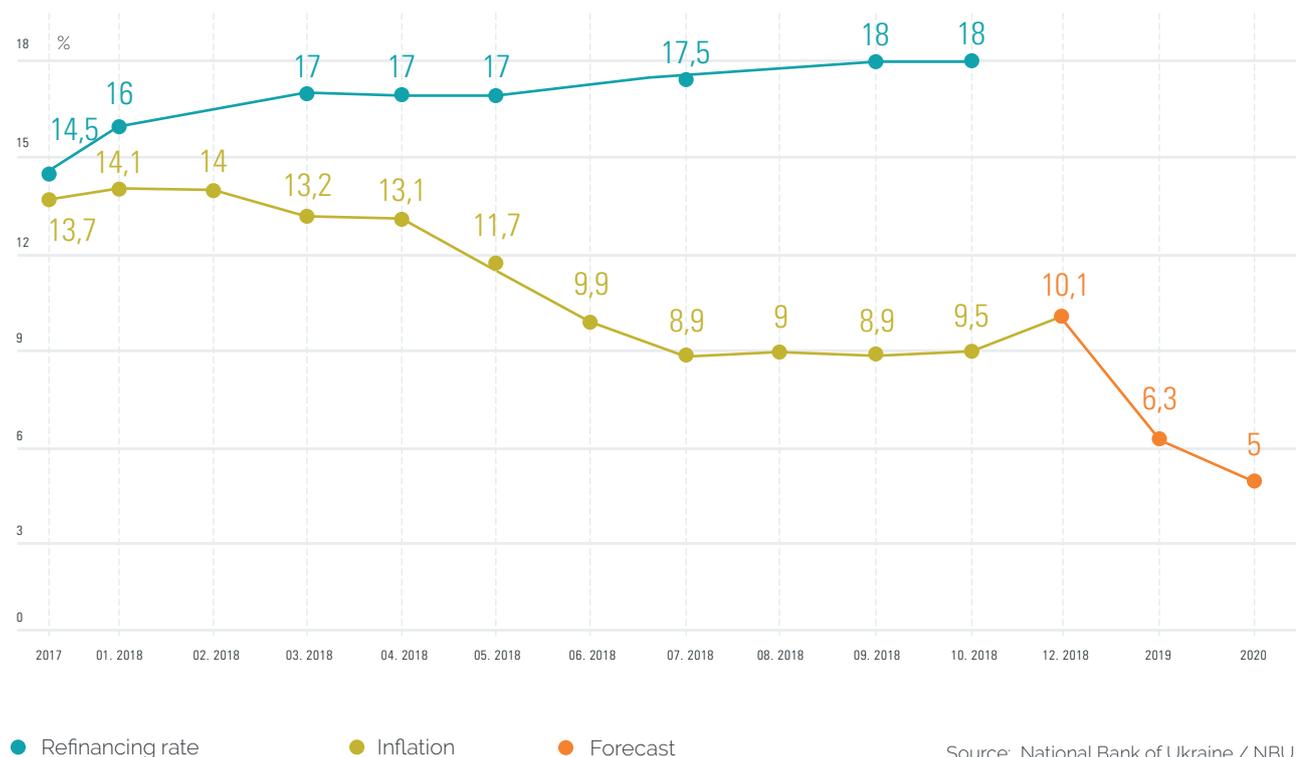
Does this mean borrowers will be faced with more strict conditions?

It depends on the borrower. Once the credit registry is operational, banks will be able to assess their risks more objectively, which should allow them to issue better-performing loans.

The latest poll on bank loans shows that financial institutions are ready to soften their demands to small and medium-sized enterprises. At the same time, they plan to be more demanding in their relations with large businesses and natural persons.

It is important for the banks today to get rid of the non-performing loans burden they have accumulated before. These loans end up on their balance sheets and distract them from performing proper banking activities. ■

NBU REFINANCING RATE AND INFLATION RATE IN 2018



Source: National Bank of Ukraine / NBU

IF LENDERS ARE UNPROTECTED, THE COUNTRY LOSES

1. We will have the chance to properly evaluate the effectiveness of the newly adopted normative acts governing the banking sector only when they come into effect. I hope that the problem of corruption in courts will also be resolved. It currently affects both banks and borrowers. People are deprived of the opportunity to borrow on favorable terms or cannot receive loans at all as banks are too cautious about the possible risks – they do not want to end up being unable to defend their rights in court. When lenders are unprotected, the country is at a disadvantage.

2. In addition to insufficient lender protection, the lack of good borrowers is also a problem. Perhaps their insufficient transparency would be a more accurate description. If the borrower has taken care to appear understandable to the bank, they may qualify for favorable lending conditions. And as for a person with transparency issues, even if they find a bank within the system to borrow from, they will get a loan under much poorer conditions.

3. For Ukrainian banks, it is difficult to compete with European ones in the implementation of trade financing. Customers, and especially the customers' partners, usually seek confirmation from first-class European financial institutions. It is easier for European banks to provide it; still, there is a certain price for it since confirmation of a letter of credit or a guarantee is a transfer pricing operation. Moreover, guaranteeing bankers receive a payment for the balance-sheet or, in this case, off-balance-sheet risk. Sometimes, it is exactly pricing that makes trade finance operations unprofitable.

4. Ukraine's image, as a country where the rights of the lender are unprotected, hinders the desire of counteragents to cooperate with the state. It affects the pricing of all financial instruments related to Ukraine.

« IMAGE OF A COUNTRY, WHERE THE RIGHTS OF THE LENDER ARE UNPROTECTED, HINDERS THE DESIRE OF COUNTERAGENTS TO COOPERATE »

5. Our bank follows the strategy of balanced asset enhancement in Ukraine. Clearly, we focus on highly reliable borrowers exclusively. We want to develop both the corporate and retail segments. At the same time, we do not get involved in usury, such as, for example, consumer loans at 80% or 100% per annum. We are not going to do this.

6. Corporate business will eventually yield big profits. But it takes a while to build a stable relationship with good borrowers.

7. The banking system has changed its requirements concerning client transparency. The customers, for their part, are not entirely



TARAS KYRYCHENKO
COB, PRAVEX Bank
(Intesa Sanpaolo Group)

happy, as there are more questions to answer now. But there is considerably less dirty money circulating in the system now.

8. PRAVEX is probably the "cleanest" bank at the moment. The share of bad debt in the loan portfolio is less than 2%. Bad loans are sold and gone. We could not sell the currency mortgages as they are covered by a moratorium. But they are earmarked and off balance. We sold everything that could be sold.

9. When expanding into new sectors, we do not keep profitability in focus. We rather consider whether we can afford to handle the risk of each particular client. If the client demonstrates eagerness to cooperate with us systematically and strategically, we will provide them with the best terms. We are interested in building relationships.

10. The banking system is making a profit. Hence there is an opportunity to invest, to develop services. The banking system is growing its assets. Therefore, it can finance households and businesses. The legal environment in the banking sphere has improved. I do not expect all these improvements to have an instantaneous effect, but the groundwork is now in place. ■

BANKS ARE A GROWING BUSINESS'S BEST PARTNERS

How complex is the financial organization of your business, given that it is a holding comprising assets in different industries?

We take an individual approach to each business. When we first started out in 2007, in addition to our own funds we actively used bank loans. We invested working capital in restaurants, returned it and then went on to invest in other restaurants. From a financial management point of view, I understood that it was wrong to place working funds in capital investments. But the payback period for some of our assets was only a few months! And so I could afford to take the risk.

At this stage, we try to combine own capital investments and bank loans. I prefer to pay the bank to share all the challenges of a certain project with it. In order to grow fast, businesses need partners. Within our strategy, we have chosen banks, not private lenders, to be partners. Clear terms and precise financing rules are the advantages the banks have. If the rules of the game suit both parties, cooperation works out perfectly. Moreover, partner banks ask the right questions, they monitor financial statements, that is, they carry out checks that businesses can use. It's always good to have an extra pair of eyes watching your business.

What were the terms you got your first loan under?

Pledge. The loan was provided to us by Bank Lviv - a local bank in the western region. How come? Because this bank was flexible, I had known its owner, and since we were unable to cover the loans with real estate, the bank took both the equipment and the corporate rights of the company - everything we had - as collateral. That is how we launched "Kryivka". The bank loan gave us the opportunity to start.

The fact that you hold assets in the restaurant and hotel business, light industry, and publishing business - you have over 20 active projects - indicates a breadth of business interests or a pragmatic diversification of financial risks?



ANDRIY KHUDO
Founder of the «IFEST» Holding

In addition to those named, it is also a matter of luck. When you come across ideas that you want to invest in, and partners you trust, you buy in.

What is the gearing ratio you use for business development?

We are actively reinvesting. I'm trying to keep a 50/50 ratio. At this point the value of credit financing is usually acceptable. Plus, the risk is then shared by the two parties equally.

Given your experience of working with three banks: Raiffeisen Bank Aval, OTP Bank, and Bank Lviv, what do you look at when choosing financial institutions to work with?

I think it is worth cooperating with at least three banks. This way, the business feels more at ease, having a diversified credit base. I mainly choose banks with foreign capital as I believe they have clear rules of the game and well-established procedures. But the main criterion is the cost of the resource and the bank's flexibility. For example, Raiffeisen Bank, and now Privatbank which we are negotiating with, offer a competitive credit resource, and, say, OTP has become expensive. When the credit resource cost exceeds 20%, it becomes a burden for the business.

You also had negotiations with the Austrian branch of Raiffeisen. However,

you are cooperating with its Ukrainian unit. Which credit conditions in Ukraine have played in favor of a decision to borrow from Aval?

We were just comparing. I would never allow myself to take foreign currency loans and invest them in the hryvnia business. Now, we are selling green coffee beans: we buy coffee in Latin America and sell it in Ukraine and Europe. If you re-export coffee to Poland, where prices are in euro, a dollar loan might be considered. But it makes no sense when you are selling to customers in Ukraine.

I have to say that dollar loans are quite competitive in Ukraine. We have a rather insignificant demand for foreign currency loans, so the rates on these can be quite interesting.

Since 2014, the banking system has undergone significant transformations. Having worked with banks for over 11 years, do those changes affect your business now?

The market has indeed cleaned up, and those who stayed will earn a good deal. Banks have become more healthy, and their credibility is being gradually restored. If this trend continues, it might bring about a release of Ukraine's domestic financial resources. And I dare say we may find ourselves surprised by just how large they are. ■

FRANCIS MALIGE
EBRD Managing Director,
Financial Institutions



STATE-DIRECTED LENDING COSTS THE COUNTRY TOO MUCH

As Managing Director for Financial Institutions at the EBRD, what priority is Ukraine at this new post?

In this new post, I'm in charge of investments and financial sectors for all 38 countries in which the EBRD operates, from Mongolia to Morocco, covering three continents: Europe, Asia and Africa. Still, Ukraine is among the EBRD's top five priority countries. Sometimes it's even #2 or #3. There are many items on the agenda, in terms of privatization, products for energy efficiency, women in business – all of these are part of the financial institutions framework. We finance a lot of trade as well. And of course there are non-bank financial institutions. That's insurance companies, capital market development, insurance funds, asset management, payment infrastructure – all of them are in need of investment and needed to reform the country. Those are all areas where I expect the EBRD to continue focusing its attention in Ukraine.

Which area is a greater priority with financial institutions, banks or non-banks?

It's more banks than non-banks in Ukraine. But in the Financial Institutions portfolio, banks and non-banks are equally important. For example, we have more non-bank investments in places like Turkey and Poland, perhaps because the non-bank market is a little bit more developed there. But I think it needs to develop in Ukraine as well, and that's why you will find the EBRD there. When the market is ready to develop, we'll be the first to step in.

How does the active presence of the IFIs in Ukraine affect financial sector development?

The World Bank, the IMF and the EBRD are the team that's looking at banking sector reform, the financial stability of the country, and its monetary policy. The partnership among these three IFIs is solid.

And the World Bank, of course, includes the International Finance Corporation, which is the WB Group's private sector arm.

Every time something moves in Ukraine's banking sector, the IFIs get together with the Ministry of Finance, the National Bank and banking associations to discuss.

Poor rule of law remains a top foreign investor concern. How has the legal framework for doing business in Ukraine changed over the past few years?

When I arrived in Ukraine in 2014, rule of law was a major problem in the banking sector. There were a lot of "pocket banks" dominated by related parties that were basically lending vast sums to their own shareholders. Since then, those banks



THERE'S A VERY STRONG LINK BETWEEN A COURT
SYSTEM THAT WORKS WELL AND A BANKING SYS-
TEM THAT LENDS WELL



have been closed down or nationalized. This has established a much more favorable rule of law environment for the entire banking sector.

One thing about rule of law that is very important for a banker is prudent banking decisions. Sometimes things go wrong, such as a client goes through difficulties. But if you have a good creditor rights protections, if you have an effective way to resolve this kind of situation in the form of a modern bankruptcy law, and if you have a court system that works well – all of these make good decisions about lending happen much easier. There's a very strong link between a court system that works well and a banking system that lends well.

Moreover, this is also in the interests of the entrepreneur. If you are a business owner and your company goes through some difficulties – the last thing you need is to spend 15 years in court. What you need is to spend maybe 6 months to wind the bankrupt business down and then, hopefully, start a new, more successful business, having learned from your mistakes. A modern bankruptcy code is a huge benefit to all involved.

Since the nationalization of PrivatBank, the majority of banking assets in Ukraine are state-owned. That's a problem that needs to be resolved through privatization. Another thing that will help the banking sector is better corporate governance. We now have better governance rules for state banks in the State Bank Law that has just been signed by the president and published, so the nomination of independent boards can proceed. This is a great step forward for the state-owned banking sector.

Why is it so important to have an independent supervisory board with absolutely no state interference in its work?

Otherwise, you will see a continuation of the state-directed lending that has cost the country so much already. Over the past 10 years, National Bank has had to invest \$15.5bn in recapitalizing its banks. That's almost the same as the original IMF programme worth \$17bn. How many schools, hospitals and kilometers of highway would this buy? And it went to state banks and banks being nationalized because the lending decisions of these banks were not always done professionally or for purely banking reasons. As long as you don't have independent governance,

this will continue.

Since the deputy chair of Oschad Bank's board was recently accused of embezzling, will the EBRD continue to work with this bank?

Business reputation is above all. When this sort of things happens with an existing client, as is the case of OschadBank, where we haven't invested yet, but we have been lending, the first thing we do is we ask for an analysis of the situation: what happened, how do they intend to deal with it, what measures need to be taken. And then we make our decision: if the bank is not working to fix the situation, we stop working with them. Sometimes we will offer help working together on an improvement plan.

The process with OschadBank continues. As there is an investigation, we are in dialog to determine what the response of OschadBank is going to be and what the EBRD's response should be.

What should be done to make Ukraine a country investors want to invest in?

The best advocates for investing in Ukraine are those who are investing in Ukraine. If we focus on the financial sector, we rarely meet someone who

says, "I'm so glad I invested in Ukraine." When diplomats, government officials or IFIs whose job is to help with reforms say Ukraine's making progress, our voice is listened to. Still, there's nothing better than a happy investor to encourage investment decisions. It works for the banking sector just as it works for the rest of economy.

The progress in Ukraine's banking sector has been huge. A few years ago, different regulations applied to foreign investors than to local ones. That was a major problem. Today, one major market distortion remains in Ukraine's financial sector – 100% guarantees on deposits are for state banks only. So if you are a Ukrainian citizen or a client in Ukraine and put your money in a state bank, it's entirely protected. But if you put money into privately-owned banks, it's guaranteed only to a certain amount. That's a market distortion that must be fixed so that conditions are equal for state banks, foreign-owned and private banks.

The conditions for healthy competition are there. Profitability is returning to the banking sector – also a good sign. It took years, an extraordinary transformation by the National Bank, and considerable patience among IFIs to change Ukraine's banking sector. But now it's fundamentally in much better shape. ■



TOP ACHIEVEMENTS

- The National Bank of Ukraine, together with the entire banking sector, was able to avoid devaluation, signals of which appeared in mid-summer.
- The banking sector was able to meet the conditions of the regulator in instituting KYC requirements and financial monitoring.
- Personal and consumer loans have picked up pace.
- Banking processes are going digital at an ever-increasing pace.
- Mobile banking has penetrated on a mass scale.

ENERGY

GTS: TO STAY WITH GAS TRANSIT

Ukraine's GTS is a unique system. The high pressure maintained in the pipes allows it to provide gas at the Western border as soon as it enters in the East.

Ukraine has reliably transmitted Russian gas to Europe. Yet, the transit function of the Ukrainian GTS is now under threat. As the gas contract between Ukraine and Russia is set to expire and the Nord Stream II project looms, the zero transit scenario is becoming ever more realistic.

There seem to be two instruments that might stop the project in its tracks: changes to the relevant EU Gas Directive and sanctions implemented by the US. Both come with strings attached. Should the Directive be amended, the pipeline will become subject to European law, stripping the project of its economic viability. However, the Ministry of Foreign Affairs of Ukraine is not expecting any of this to go through while Austria is heading the EU Council. Sanctions imposed by the US would definitely hinder the construction. However, even the slightest mention of these causes immediate indignation in Europe. It is fair to say that now is not the best time for Ukraine to resolve its issues by losing allies. This is why Naftogaz is trying to preserve transit by threatening Gazprom with new Stockholm arbitration lawsuits should the Russian company breach the current contract's terms.

Both the European Commission and the EU Delegation to Ukraine believe that continued gas transit through Ukraine is in the best interest of the EU. At the same time, they cannot but admit that the EU does see certain economic benefits in NS II. Ukraine keeps insisting that NS II is merely a political project, threatening Europe's energy and environmental security.

Europeans say that the best way for Ukraine to retain its transit volumes is to proceed with unbundling the GTS operating company and are happy to support the management procedures. The question is: is it worthwhile singling out the transit function when transit is by far not guaranteed? ■

GTS ISN'T JUST ABOUT TRANSIT



ANDRIY KHOMENKO
Acting President of
PAT Ukrtransgaz

■ INVESTMENT IN THE GTS

Based on the 10-year GTS Development Plan approved by the regulator, Ukrtransgaz intends to invest in upgrading Ukraine's gas transport infrastructure over 2018-2017 to the tune of more than UAH 60 billion or about US \$2bn. One third of that will go to reconstruction projects over 2018-2019.

Not long ago, we completed a tender worth UAH 2.3bn for work and equipment for reconstruction the Yahotyn Compressor Station. In fact, a new compressor unit will be built at this station by 2021. Instead of the current 12 machines with a power capacity of 6 MW, we will install four units with a capacity of 16 MW each. The new equipment will meet modern environmental standards and will have a much higher energy conversion efficiency (ECE), which will mean economies of up to 20 million cubic meters of fuel gas per year.

This project is a visible example of mutually beneficial cooperation with domestic manufacturers. The winner of the tender was a Ukrainian machine-building company called Zorya Mashproekt, whose equipment meets the requirements for reliability, ecological soundness and efficiency. In addition, our contract with them provides for the manufacturer to continue to service the equipment.

The next big project is modernizing the Bar Compressor Station. We launched it at the beginning of the year with a loan from Deutsche Bank. Construction on this object continues today.

Our third project is to start modernizing the #4 compressor unit at the Bilche-Volytsia Underground Gas Storage (UGS), which is the biggest underground gas storage facility in Ukraine. The tender has already been announced.

Other plans include reconstructing the Oleksandrivka and Dykanka stations for a total cost of UAH 2.5bn, as well as the Romny Compressor Station and re-equipping the #2 compressor unit at the Bilche-Volytsia

UGS, worth another UAH 2.6bn.

As to the pipelines, we have already completed the first phase of our reconstruction project of the Urengoi-Pomary-Uzhhorod line at our own cost and are preparing to change another four sections of the gas pipeline as part of a loan agreement with the EBRD and the EIB worth €300mn.

■ ZERO TRANSIT THREAT

Obviously, Gazprom's construction of a pipeline bypassing our system is setting up the conditions to cut back and even completely stop transiting Russian gas through Ukraine. This will inevitably affect the entire domestic economy, because the fees we get for transit amount to about 3% of GDP. One of the main factors in the reliable operation of the GTS is its optimal loading. The expiration of the transit contract is now the main risk for our further operations.

But it's important to remember: In addition to its function in transiting gas to Europe, Ukraine's GTS also supplies millions of Ukrainian consumers more than 30bn cu m of natural gas a year. Right now, given the uncertainty about the volumes of transit gas Ukraine can anticipate after 2019, our priority for modernizing is that infrastructure that will continue to distribute natural gas to domestic consumers, even if the conservative "zero transit" case comes to pass and no more Russian gas goes through our system to Europe.

We've chosen to upgrade the facilities I mentioned precisely to ensure that the GTS operates in the optimal fashion in the future. After all, they will be operating to provide gas to Ukraine's consumers, regardless of what happens with transit gas.

We have plans to reconstruct the GTS plant that moves gas between Russia and Europe as well. This includes a list of nearly 95 gas pumping units. After we determine how much transit volume there will actually be for the next 5-10 years, we will be able to immediately start carrying out our plans for upgrading transit facilities in line with the planned throughput.

■ INTERNAL RISKS

This next heating season could be one of the most difficult in recent years. There are a lot of external factors behind this: the transformation of Ukraine's gas market and our difficult interactions with Gazprom.

Unfortunately, the risk factors aren't always external to Ukraine. One more urgent question that needs legislation to be resolved is the unsanctioned siphoning of gas from the GTS. Because of this, at the end of September, Ukrtransgaz – and this means the state – had a shortfall of over UAH 27bn. This is the value of the gas that oblgases, the oblast gas distribution companies, took out of the system without permission. What's more, 70% of this debt belongs to companies in the RGC Group. In fact, this is a shocking number if you compare it to the last tranche Ukraine received from the IMF and it keeps growing relentlessly every month.

The notion of "unsanctioned siphoning of natural gas" does not exist in any other European country. It's a problem that needs to be resolved ASAP. We have been raising this issue at every possible level. In fact, we're counting on the new GTS Code, whose revised norms should, we hope, make it possible to put an end to this shameful practice. ■

GAZPROM WILL PAY FOR ITS DEEDS

What is your best-case scenario for Naftogaz's operations with Gazprom after 2019?

Let's be frank about this. It's going to be very hard to maintain our transit operations after 2019, once Nord Stream II is on line. Every cubic meter of transit gas that remains in the system will have to be gained in battle: incredible diplomatic skills, our own work, and the efforts of the government and the president personally.

There is still the off chance that Nord Stream II can be stopped. Right now, the challenge for the Ukrainian side is to show Ukraine's international partners all the threats that this project represents. This should make it possible to gain powerful support in countering the construction of this pipeline.

If Gazprom's actions lead to gas transit through Ukraine being terminated, Naftogaz will go to international arbitration to make Gazprom pay for its deeds.

Since Naftogaz intends to sue Gazprom for US \$12 billion in damages for the possible loss of transit through Ukraine, what is the legal basis for this kind of suit?

We have launched a new arbitration case in Stockholm. Naftogaz's claims include compensation for damages from Gazprom for not fulfilling its gas supply contract with us. This compensation is the difference between the revised contract price, based on the new formula determined by the previous arbitration panel, and the cost incurred by Naftogaz to substitute Gazprom gas with deliveries from Europe. The total amount of claims is actually already more than US \$12bn.

As to the legal arguments, we are basing them on the provisions of the current transit contract, which allows Naftogaz to revise transit rates to reflect the accelerated amortization and/or commercial depreciation of Ukraine's GTS due to the lack of transit after 2020. Our claims are quite solid. So the only real way for Gazprom to avoid being penalized is to abandon Nord Stream II. Only this would provide some assurance that transit through Ukraine will continue.

Given that our European partners tend to be highly pragmatic, how might they be persuaded that maintaining transit through Ukraine will be more commercially viable for EU countries than transporting it through Nord Stream II?

There is no economic basis for building Nord Stream II. Even if Germany doubles its purchases of gas, Ukraine's GTS can easily deliver the additional volume at a much better rate. We have been pointing out by every means possible to our European partners that Nord Stream II is a purely political project that threatens the European Union's energy and environmental security.

How is the process of unbundling the GTS operator going? What obstacles are there?

We're committed to unbundling, in line with the Law "On the natural gas market" as part of implementing the Third Energy Package. So, we are persistently working at unbundling and have made this one of our strategic objectives. In terms of the Naftogaz Group and with the Supervisory Board's coordination, we are taking all the necessary steps that are within our purview to prepare for the unbundling.

But there are two very important aspects that have inevitably slowed down the process. First, there is the situation with Gazprom. The transit contract between Naftogaz and Russia's Gazprom does not allow for rights and obligations under the contract to be transferred to third parties without the approval of the other party, in this case, Gazprom. It also designates Naftogaz as the provider of services under a contract that, among others, ensures the operation of Ukraine's GTS. Unbundling is precisely the transfer of rights and obligations connected to the transport of natural gas to a new company designated by the government that meets a clear list of criteria for being independent. Gazprom President Alexei Miller has made his position clear: the contract cannot be revisited. This already means that unbundling cannot be completed until the current contract with Gazprom expires in 2019.

The second point is that unbundling, in and of itself, is not the goal. The goal is to ensure the operation and development



ANDRIY KOBOLYEV
CEO, Naftogaz of Ukraine

of Ukraine's GTS on a European model and maintaining Ukraine's strategic transit role. This means that the terms of the unbundling need to be understandable, acceptable and convenient for potential strategic partners who will co-manage the system. Their involvement in the enterprise that will be set up after unbundling will be the main insurance that transit will continue, that Ukraine's GTS will continue to grow, that there will be effective communication with the EU, and that the company's interests will be protected in the face of Russia's aggression.

How financially stable is the GTS operator, given the huge debts incurred by oblast gas operators for unsanctioned siphoning of gas from the system?

The accumulated debt is already UAH 27.5bn (about US \$1 billion). Nearly 70% of that debt belongs to gas distribution operators in the RGC group's network. For the last three years, the operators in this network have claimed that the low distribution rate is justification for siphoning gas from the AT Ukrtransgaz network for their own technical use. AT Ukrtransgaz, on the other hand, pays from its own pocket for the siphoned gas, and so it has accumulated losses. This imbalance has led to considerable financial instability for the GTS operator.

In fact, this could lead to considerable complication in attracting an international partner to manage the Ukrainian GTS after unbundling. No one wants to be responsible for a gas transport system that allows oblasts utilities to siphon off gas without any controls. ■

JOHANNES BAUR

First Secretary, Head of Energy,
Environment and Transport Section,
EU Delegation to Ukraine



EUROPEAN PARTNERS COULD HELP MANAGE UKRAINE'S GTS

What progress have you seen in Ukraine's energy sector in the last few years?

In general, Ukraine has made huge progress in reforming the energy sector since the Maidan and has definitely improved its energy security. For one thing, it no longer depends on gas inputs from Russia and the country is now much more closely linked to the EU gas market. This is major progress. Another thing is Naftogaz Ukrainy, which was a huge loss-making company and contributed to the country's economic problems since 2014. Today, it is a profitable company and it is much better managed.

In addition, a number of important laws have been adopted, including specifically the gas law of 2015, which is fully compliant with EU requirements. Now the issue is implementation and, unfortunately, there we have seen a slowdown in activity over the last one or two years now, especially with unbundling Naftogaz and the retail markets. An unbundling decision was made in 2016, but it hasn't really been implemented. The Stockholm arbitration was one factor that contributed to this slowdown. But there were also other factors. Now it's urgent to complete the process or actually to start it.

What's very important is that by January 1, 2020, the old transit contract with Russia ends and we hope that we will have a new transit contract between Russia and Ukraine for the transmission of gas to the European Union and that an independent gas transmission system operator will be in place. This should already be established as a separate entity. What happens between now and January 1, 2020, is not yet fully clear. We have a proposal from Naftogaz for a road map, but this needs to be confirmed. We need a decision from the Government to set clear milestones in order to allow this unbundling to take place. Unbundling also means certifying the new independent GTS operator. This certification has to be done by the Ukrainian energy regulator and to be confirmed by the Energy Community secretariat. And this is, a step that is still to be prepared and the necessary decisions taken.

Given Germany's unwavering position in support of Nord Stream II, how important is it to the EU that Ukraine continue to deliver substantial volumes of natural gas?

I think it's in the interests of the EU that Ukraine remains an important transit

country with significant volumes. It is also clear that, whatever happens to Nord Stream II, it will most probably not be in place on January 1, 2020, so a solution has to be found for that period, no matter what. We hope very much and we're working hard to make sure there is a new transit contract and that it will be fully in line with European rules. That's the agreement – and a very positive agreement – that was reached already at the first trilateral talks between Russia, Ukraine and the EU in July.

We would like to set up the next new political meeting of the trilateral group as soon as possible, possibly in November, to see what progress can be made. On the Ukrainian side, it's important – and this is also a subject of reports in the trilateral group – that there is a clear view of how the unbundling will be done and that there will be an independent pipeline operator. The transit rate offered by this new GTS operator has to be economically advantageous. This is important, because if the transit rate is too high, Gazprom will use it as an easy excuse not to transit through Ukraine.

What can the EU do to bring Russia to the table on this?

We can't give any guarantees, of course. This is ultimately a decision that will be made in Moscow, but, as I said, we're working very hard under the leadership of Vice President Sefcovic. Through Ms. Merkel, we have a commitment from Mr. Putin that this will be seriously considered. This is all at the political level and we will ask the Russian side to honor this political commitment.

The position of the European Commission and EU delegation is that Nord Stream II is not a project that is in the interests of the European Union. As such, there have been a number of political statements by Vice President Sefcovic and the Commission has made proposals to have some influence over how Nord Stream will be operated in order to increase the security of supplies for the EU. We think that transit through Ukraine is in the interests of EU and want this transit to continue – among others because it is the shortest route to a number of EU countries, in particular in southern and southeastern Europe, and even to such important markets as Italy and Austria.

How will further decisions be made, given that this project represents Russia's influence over the European gas market?

Inside the EU, decisions on the energy mix are not the competence of the EU, but belong to member states. They can decide to build a pipeline or not to build a pipeline. There are just a number of conditions that need to be met in terms of environmental law and other matters, and European law has to be respected. This is current legal situation that we face which the EU Commission would like to change. Legal questions are one thing, political questions are another, and the discussions continue. Some member states support Nord Stream II, others are against. But, everyone agrees on the importance of keeping Ukrainian transit coming from Russia.

Given that it will affect Russia's Nord Stream II plans, how likely is it that amendments to the EU gas directive will be adopted to make all pipelines supplying the Union, including foreign ones, subject to EU law?

The discussions are still ongoing and some member states still have to be convinced that this is a good proposition. We are obviously in favor and we hope that it can be adopted. Of course, we also have to realize that the European

Parliament has an election coming up next year in May and the Parliament will stop its activities a few weeks before that. So there is really not much time left to agree to such a proposal. Some basic principles of European law should apply – not all laws or very detailed rules, such as those governing network codes, for instance, but some basic things should apply to all pipelines in order to increase the security of supplies for all members of the EU.

How likely is it that European companies involved in the construction of Nord Stream II will walk away from the project if the US threatens them with sanctions?

This is still an open question. There hasn't been any decision yet from the US government, and this is not an easy decision, I suspect. As far as I've been informed, though, European companies have already left and don't have any further financial interests in Nord Stream II. Some of them are still members of the consortium. The economic reality is that there's still some economic interest in the EU for this pipeline.

How are things going with getting European partners involved in managing Ukraine's GTS?

There's serious interest among European companies and we are in contact with various companies that have expressed interest. Obviously, there is interest among some of

Ukraine's immediate neighbors, for example Slovakia's Eustream, to keep the transit flows, as this is essential for them. So there is also huge interest among experienced pipeline operators in the European Union. But, indeed, now we need a decision from the Government about what happens with the unbundling – will they do that properly? – and then this can all go ahead.

The overall political situation is, of course, difficult. We are in a pre-election period. We already took note of some comments on this issue and, of course, it's unfortunate that this is very much a politicized discussion. I think it's in the interests of Ukraine to continue the unbundling and, if possible, to involve trusted European partners in the management of the pipeline system. I think European partners do not necessarily want to "take over" the property. That's not their intention. They want to help Ukraine operate and properly manage its pipeline system and to increase trust among European traders operating in Ukraine and trust towards Gazprom – because many of these European operators are, of course, working with Gazprom to ship Russian gas within the European Union.

Whatever is decided on Nord Stream II, unbundling Naftogaz and establishing a proper delivery system in line with EU laws is something that has to be done, no matter what. I also think it's the best thing that can be done to keep Ukraine involved in transit. ■





LANA ZERKAL
Deputy Foreign Minister
for European Integration

TALK ABOUT US SANCTIONS UPSETS PEOPLE IN EUROPE

What chances are there that the current European Parliament will amend the EU Gas Directive to make Nord Stream II come under EU legislation? That might, of course, make it unprofitable, but that's the way South Stream was stopped.

The question is not with the European Parliament so much right now as it is with the Council of Europe. With Austria heading the Council, the options for changing the Directive are very limited and the work is being blocked at the level of permanent representatives. Austria, Belgium, Germany and the Netherlands all oppose these changes and so they are artificially creating obstacles to this. For example, right now, the process has been stopped because of questionnaires that all member countries are supposed to answer. So, as long as Austria is heading the Council, we don't expect anything related to changing the Directive to move forward. The next country to head the Council will be Romania and so we are focused on working with the Romanians and other countries that oppose the building of Nord Stream II.

What kinds of channels of communication are there with these countries?

These are diplomatic channels, with constant communication at various levels: with officials from EU countries in Brussels, work in the capitals, constant meetings, coalition-building – this is the work we do every day. I should point out that politicians make decisions based on what business thinks and public opinion. These are all components of the work of a diplomat.

Russia has far more options for influencing public opinion. Russians are working hard in Germany: sponsoring football teams, participating in all kinds of competitions, and helping ordinary people. In short, everything that we here in Ukraine can't do because of limited resources.

What kinds of instruments for negotiating with EU countries are being held in reserve for now?

If they exist, no one's talking about them right now.

We're very focused on possible new sanctions from the US, but sanctions are a last-resort measure. What's more, the Trump Administration is more concerned with trade issues related to its tariff policies. For instance, Germany feels changes in tariffs on profitable sectors a lot more than any sanctions. Sanctions only annoy people and when we talk about US sanctions, the Europeans get annoyed, especially the Germans. The way they see it, they've done a lot for us in terms of regulating the situation in the east, but we keep talking with the Americans about applying sanctions against their companies.

These relations won't end today, so there's no point in offending them and sacrificing one thing for another. We need to find a balance of interests. German companies might be interested in Ukraine's GTS. We need to establish business cases so that they become interested in the fact that there is this GTS, and not simply offer us a chance to survive on a minimal volume of gas in our system.

How can their interest be stimulated?

First of all, that means establishing legal conditions like they are in the EU. Not adapting our legislation to EU legislation, but using European legislation in Ukraine and gaining access to the internal EU market. This is what we are currently working on with the Europeans.

I can't say that there's much of an appetite for this subject, either. They understand that this would effectively establish the same conditions for us as Sweden, Norway and other countries that are part of the common economic zone with the EU. But for us it will be the only way to ensure proper conditions for a gas market to operate in this country.

What's getting in the way of the trilateral group that's supposed to regulate gas issues between Ukraine, the EU and Russia?

The Russians are clearly waiting for the elections, as usual, and are counting on cutting a deal with whoever wins about the terms for delivering gas. Nothing new there. They were and are behaving in an uncivilized manner.

How do Europeans respond when Ukraine points out that Nord Stream II is not just about gas and business but also about security?

Unfortunately, the Europeans think in completely different categories. They are protected by Art. 5 of their NATO agreements, the presence of US military bases, and understand security very differently. The EU simply doesn't feel the potential for danger that Russians are creating by building Nord Stream II – even considering Ukraine's experience with the building of the Kerch Bridge, which has completely changed the rules for marine

communication.

The Baltic are more open to such challenges. But Old Europe, which has felt nothing but peace for decades, is still certain that money decided everything and economic interests come above all else.

« OLD EUROPE IS CERTAIN THAT ECONOMIC INTERESTS COME ABOVE ALL ELSE »

Given the serious commercial interest in Nord Stream II among our European partners, how much faith do you have in the possibility of countering it?

The situation could change, both for the worse and for the better. We don't know what the composition of the European Commission will be during its next term. We can't foresee, either, what the next European Parliament will look like. Likewise, we can't predict whom Ukrainians will elect. A "black swan" could fly in from any direction.

Our task is to work on ourselves. If we were more attractive for doing business in Ukraine, then there wouldn't be much appetite for Nord Stream II. It doesn't mean being ideal, but definitely reliable. ■



FOUR OPTIONS FOR UKRAINIAN GTS AFTER 2019

Scenario 1. Pessimistic. "Zero" transit

This scenario is possible when the Nord Stream II and the Turkish Stream pipeline system are constructed and commissioned. To boot, both of them will have to run at their maximum projected capacity, i.e. 55 billion cubic metres for Nord Stream II and 31 billion cubic metres for the Turkish Stream. Collectively, that would make 86 billion cubic metres.

The volumes of transit through the Ukrainian GTS over the last years range from 62.2 billion cubic metres in 2014 to 93 billion cubic metres in 2017. On average, the transit volume constituted 76 billion cubic metres. That is, in case the two projects are implemented, we will end up with zero transit.

Still, all of this is highly unlikely to happen in 2020, despite all the propaganda promoted by Gazprom. Even if the seagoing pipeline is laid by then, many other works related to surface facilities (gas compressor stations, pre-transport gas treatment units, control systems for technological processes, security systems, etc.) and gas outlet pipes will not have been completed by 2022.

Scenario 2. Optimistic. Nord Stream II running at 50% capacity

Even if Nord Stream II is built and commissioned, it is likely that it will be used for no more than half of its overall capacity. After all, the European Commission may demonstrate its political will and extend the effect of the Third Energy Package to offshore pipelines in the Baltic region. Accordingly, 50% of the capacity will have to be reserved for other suppliers. Apart from Gazprom, there are no other suppliers. Therefore, the only way out, similarly to Nord Stream I, lies in limiting its capacity.

Half-load of the Nord and Turkish Streams will cost the Ukrainian GTS about 43 billion cubic metres in transit losses. However, 40-50 billion cubic metres will remain. This figure may be more or less acceptable for us.

It is worth noting that, according to our estimates, the lower threshold for GTS load

is around 60 billion cubic metres of gas. With these volumes, the GTS retains its technological functionality as a system and operates relatively close to its breakeven point. However, our calculations are not in line with the European ones: to them, a 30-billion-cubic-metres load seems sufficient for Ukraine.

Scenario 3. Close to realistic. Quasi-guarantees

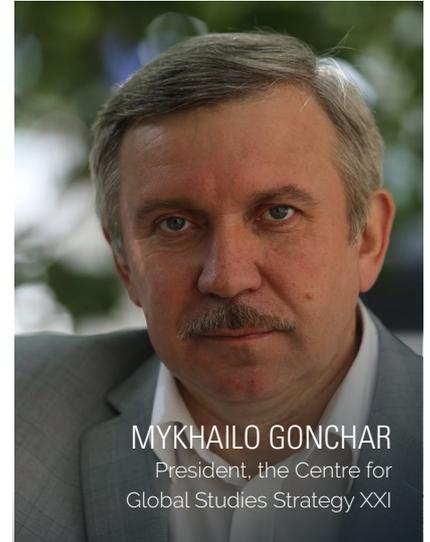
We are left with the transit of 30 billion cubic metres. This is half of what we need, exactly as much as Brussels considers acceptable for us, and twice as much as the Russians promise – 10-15 billion cubic metres.

In this case, only part of the gas transportation system will work, the rest becomes redundant. The GTS as a system will cease to exist.

Will this scenario be fulfilled should a European partner be involved into managing the Ukrainian GTS?

Yes, it will. But the problem is that this will not provide us with any guarantees of load or transit. We also need to protect ourselves from the speculations of our European partners, who will attempt to exhort favourable conditions for themselves under the guise of introducing European standards of management into the Ukrainian GTS. For us, transferring the gas handover point to our eastern border would serve as a transit guarantee. Let the European customers buy gas there, on the Ukrainian-Russian border. The USSR ceased to exist 27 years ago, but the Soviet gas border has been preserved.

However, it is unlikely that our European partners will play along. And Gazprom will never agree to this scheme. Europeans, represented by the European Commission, do not show much perseverance in forcing the Russian party and its European counterparts to transfer gas at the Ukrainian-Russian border. To me, this looks like the EU is ignoring Article 274 of the Association Agreement: the EU must take into account the Ukrainian potential and only having used the free capacities of our GTS, consider additional options.



MYKHAILO GONCHAR
President, the Centre for
Global Studies Strategy XXI

Is it complacent to assume that Nord Stream II will never be seen through?

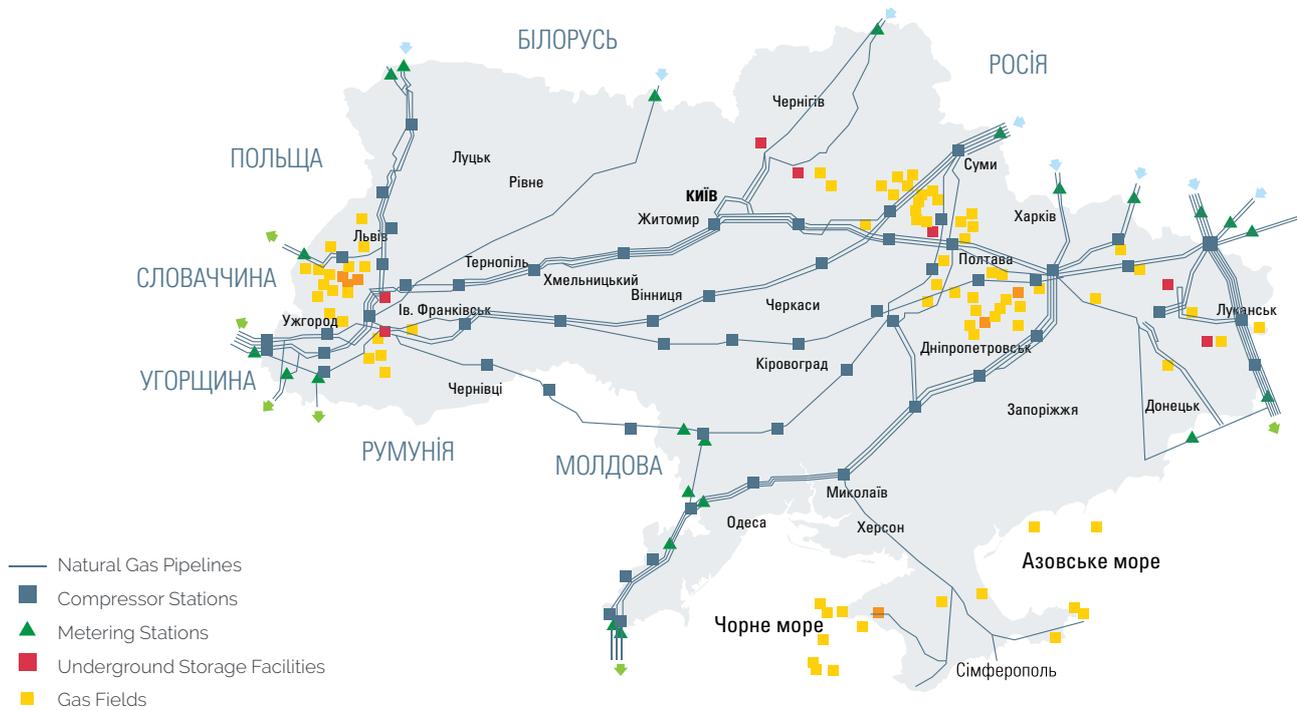
This is still a viable option. And the key to this project's success or failure lies in Washington. The issue is that Gazprom is not building the gas pipeline on its own. According to the Russian experts themselves, 90% of the project's components are supplied from outside Russia. Pipes, equipment, component parts, contractors, specialists – Russians do not have the technological capabilities to build a gas transportation system of this kind. American sanctions can strike not at Gazprom's partners in the consortium, but the implementers of this project – the contractor companies.

There is a certain percent of probability that the project will not be seen through even when the pipes are laid out on the sea bottom. Hopefully, the American strategy of delaying the decision on sanctions is designed to give Gazprom time to splash out on the project before it is stopped in its tracks.

Scenario 4. "The Black Swan".

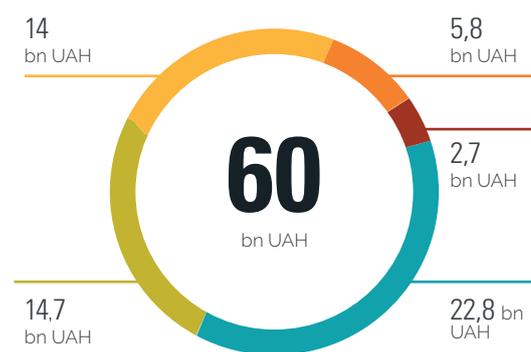
The pipeline can be fatally and irreversibly damaged as a result of unpredictable events in the Baltic Sea. ■

GAS TRANSPORTATION SYSTEM OF UKRAINE



GTS PARAMETERS	UNIT	NUMBER
Length of gas pipelines, total incl.	thousand km	38,55
main gas pipelines		22,16
branches		16,39
Gas transmission capacity:	bn cubic metres per year	
at the entrance		287,7
on the way out		178,5
Compressor stations	items.	72
Compressor sections	items.	110
Gas pumping units	items.	702
Capacity of compressor stations	MW	5443
Underground storage facilities	items.	12
Total active capacity of the underground storage facilities	bn cubic metres	31
Gas distribution stations	/items	1455
Number of employees	thousand people	128

PLANNED VOLUMES OF INVESTMENTS ACCORDING TO THE PLAN OF GTS DEVELOPMENT FOR 2018-2027 YEARS



- Pipelines
- Compressor stations
- Gas distribution stations
- Purchase of machinery and equipment
- Other production facilities

Source:
UKRTRANS GAS

TOP ACHIEVEMENTS

- Naftogaz won the compensation from Russian Gazprom for undelivered transit gas under the 2009 transit contract in the Stockholm Arbitration.
- Rapid and decisive actions by the government and Naftogaz to counteract Gazprom in an attempt to arrange a gas crisis on 1 March 2018. Effective use of the early warning system in accordance with the Association Agreement.
- Development Plan for the GTS for the period of 2018-2027 was approved. Intentions to invest 60 billion UAH were declared.
- The price distortion in the gas market is being eliminated with the gas price approaching the market price.
- Ukraine counters the implementation of Nord Stream II through systematic measures using legal instruments and support from the United States.



INFRASTRUCTURE

PORT INFRASTRUCTURE. INVESTING INTO THE FUTURE

The infrastructure of Ukraine's 13 seaports allows to transport around 250 mln tonnes of cargo annually. 90% of the volume is created by the Ukrainian economy.

Most of the infrastructure units represent Soviet heritage, requiring reconstruction and modernization, i.e. calling for substantial investment. This year's capital investments into port infrastructure amount to UAH 2 bn. Private investment contributes to these developments, too. A positive example of cooperation is represented by cases where private companies construct terminals, while the state, represented by the USPA, undertakes bottom dredging, pier reconstruction, breakwater setup. Plans have been put in place to attract up to \$ 30 bn through these cooperation mechanisms.

The share of private stevedore companies is currently down to 24% of the loading market: clumsy state-owned enterprises are losing ground to private initiatives. This is further aggravated by the fact that state-owned stevedores are not free to manage their own investments, but are what experts refer to "budget cash cows". The businesses' position is clear: reducing the state-owned share in ports will render them more efficient. This is why the projects of public-private partnership proposed by the Ministry of Infrastructure are warmly met. The fact that companies from Qatar, Turkey, the United Kingdom are demonstrating interest in the pilot projects, the Kherson and Olvia seaports, only goes to corroborate that.

Even though port fees were reduced by 20% earlier this year, they are still the highest among the Black Sea ports. The situation in the Azov Sea remains tense: the Kerch Bridge prevents large cargo carriers from reaching Ukrainian ports. Thus, the country's transit potential is not fulfilled.

Nevertheless, the reserve margin is still considerable for Ukrainian ports to compete not only with Black Sea, but also with Baltic Sea ports. ■

ANASTAS KOKKIN

Director General, SC "Container Terminal Odesa"



MODERNIZATION MEANS A COMPETITIVE ADVANTAGE

What are the advantages of "Container Terminal Odesa" (CTO) that make it competitive enough in the market?

Firstly, SC "CTO" is the largest terminal in the market. This is further helped by the construction of the new container terminal at the Quarantine Pier which will become the more modern, high-tech part of the terminal. Due to the availability of an additional waterfront, we can maintain performance at a level that satisfies our customers, global container lines, despite the fact that the Black Sea container market is not their key sphere of interest. Our capacities allow us to maintain flexibility in handling ships without creating queues. Flexibility is important, as idle ships come at a huge cost.

Secondly, modern high-tech equipment and technology, as well as professional, experienced staff provide us with the highest fleet processing performance.

Thirdly, we are, in fact, the only public terminal - a "common user terminal", if to speak in professional jargon. We provide equal working conditions for everyone: from the smallest container

vessels to large vessels of the leading world companies, taking into account the relevant container traffic flows.

Fourthly, we do not spare money to meet the requirements of sometimes rather capricious customers and always stick to a customer-oriented policy.

The Maersk company terminated its partnership with CTO a year ago. Despite the considerable loss of cargo turnover provided by Maersk, this did not significantly affect the growth rate of the CTO. How did you manage to equalize the turnover rates and overcome the loss of a high-profile client?

In spite of Maersk having left, CTO growth this year is more than 12%. Two factors have contributed. The first is that our large customers, such as the German company Hapag-Lloyd, or the Israeli

ZIM, have boosted their cargo traffic. The second is that we have attracted new customers. In particular, YangMing, one of the leading companies in the world, and the Japanese giant carrier Ocean Network Express (ONE).

As for Maersk, according to statistics, the company has lost a significant share at the Ukrainian container market this year. We cannot say this is connected directly with its exit from CTO and transition to the "Yuzhnyi" port, but industry experts are likely to reach this conclusion rather soon.

How much has the corporate parent HHLA already invested in CTO?

HHLA has been functioning in the Odesa port as an operator since 2001. Serious investments started in 2009-2010 with the construction of a new container terminal at the Quarantine Pier jointly with USPA. Thanks to German investments, an



THE CARGO FLOW CONTAINERIZATION RATE IN

UKRAINE IS LESS THAN 1%



additional 19,3 hectares were prepared, the state constructed a pier. The total investments of HHLA since its entry into the Ukrainian market amount to more than \$150 million. Taking into account the growth of freight traffic in recent years and the construction of the new terminal, CTO has paid taxes worth more than a UAH 1 billion to budgets of different levels. And we continue investing.

Would you mind sharing some information on the investment plans to be implemented in the Odesa port?

The investment program up to 2044 has already been approved. It is updated annually depending on the market needs. Since summer we have begun to develop the rear territories - the newly prepared 19 hectares of the Quarantine Pier. We are constructing the first container storage and handling platform. We plan to complete the construction and commission the platform by next summer.

We are planning to work quite seriously on improving the railway infrastructure at the terminal, and contemplating over the prospects of building an additional railway branch line.

The programme also involves investment in the IT sphere. Creating a modern WEB-platform and going fully electronic will significantly improve the quality of our work.

We have the opportunity to develop what is called a multifunctional terminal. We have the deepest pier in the Odesa port, so we can even offer our neighbours to work with their cargoes: to pass the grain, to load large Panamax at our terminal etc.

What trends in the development of the marine industry, as well as the Ukrainian economy in general, give you the confidence to stay optimistic when implementing large-scale investment projects and to predict their success?

Even with all the crises our country has already experienced and is still going through, Ukraine's economic development potential is enormous. Accelerating reforms in all the spheres will provide even more ground for optimism.

The cargo flow containerization rate in Ukraine is extremely low - less than 1%. Just to compare: leading European countries have a rate of over 40%, the Netherlands have over 50%. But here is an interesting fact: despite the fact that starting from 2014, Ukraine's seaports do

not serve the territory of the Donbass, container traffic is still on the increase since 2016. Imagine the potential the container market has in the future, considering the further containerization of available freight flows. This is what motivates us.

How do you assess the competitiveness of Ukrainian ports in the Black Sea?

Historically, Ukrainian port fees have been the highest in the region. This year they have been reduced by 20%. This has not yet produced a global effect, but we have marked the trend.

As for their competitiveness in general, there are objective factors giving grounds to expect the stable developments of Ukrainian ports: no other regional port can handle the export-import flows to Ukraine. Moreover, the modernization and the construction of modern port infrastructure, mainly with foreign investments, is the key factor that makes our ports equally technologically

the issue of a target loan from Germany to Ukraine for the construction of the breakwater. Following the approval by the Ukrainian government of the modified breakwater construction project in December 2017, the construction works started this spring.

The fact that CTO is ready to work at a serious worldwide level is already quite clear. But to what extent is the infrastructure out of the terminal ready to support your success?

Taking into account the most recent improvements, CTO at this stage is satisfied with the Ukrainian infrastructure capacities. I am talking in particular of the railway infrastructure. The launch of regular container block-trains to Dnipro, Kharkiv and Kyiv gave us a huge positive impetus. Companies in Europe work exclusively with routed railroad transportation using container block-trains. This is the most efficient way of organising shipping. Try to imagine the situation: a regular train would deliver a container in 8-10 days to the Dnipro



ADDITIONAL INFRASTRUCTURE INVESTMENTS AND TECHNOLOGICAL IMPROVEMENTS ARE NEEDED TO HANDLE PROSPECTIVE TRAFFIC FLOWS



developed as other ports in the Black Sea region. This is a fairly serious competitive advantage.

How do you go about establishing cooperation with state authorities concerning the implementation of infrastructure projects?

In 2009-2010, we established a long-term public-private partnership with Ukraine represented by the USPA on developing the "Quarantine Pier" project. The foreign investor has since fully met their obligations. Unfortunately, the same cannot be said of our partners: the piers were built well, but problems arose with the breakwater - it has deformed. These construction works were carried out by the USPA, we could not control them. For more than three and a half years there were continued trials, commissions and criminal cases. Finally, due to the powerful support of our corporate parent HHLA and the German government, the issue is, in fact, resolved. In particular, HHLA expressed its readiness to consider, together with the Ukrainian government,

river, while a container train can get the same task done in a single day. Time is money. This is especially true when it comes to transit time. Moreover, the customers may be assured of the timely delivery of their cargo.

Today, intermodal logistics, provided by the terminal together with the state structures, allow us to work at a satisfactory level. However, additional infrastructure investments and technological improvements are needed to handle prospective traffic flows. So we are already working on this.

As for the roads, half of a very serious project to thoroughly reconstruct the carriageway leading to the Odesa port has already been implemented by the USPA. We, the stevedoring and freight forwarding companies working in the port, are pleased to see this progress. After all, it is precisely us who provide huge profits to the budgets, including the USPA. ■

RAIVIS VECKAGANS

CEO, Ukrainian Sea Ports Authority



90% OF THE CARGO IS BASED IN UKRAINE'S ECONOMY

If you look at the entire list of facilities under USPA's management, which would you say gives a marine nation like Ukraine reason to be proud?

Our job involves constant 'stock-taking', constant improvement and development. This comes as no surprise, as we are responsible for maintaining and developing strategic infrastructure in Ukraine's 13 ports: port waters, 263 quays with a total length of over 40 kilometers, and 120 vessels: pilot boats, a specialized fleet, an icebreaker.

Most of the port infrastructure was built in Soviet times. Naturally, modernization and reconstruction are a constantly important issue. In the last few years, we've increased capital investment in this area by 150-200%. In 2015, UAH 650 million was invested. That went up to UAH 1.6bn in 2017 and this year we hope to hit over UAH 2bn.

How upgraded are Ukraine's port facilities for the purpose of Ukrainian exporters?

On the one hand, Ukrainian ports are not used up to 100% capacity, and the reserve margin is quite sufficient at the moment. At the same time by far not all of them use modern equipment and provide the best speed, volume and cost of reshipment. This applies to state stevedoring companies in the first place, who are, in many cases, losing out to their private counterparts

The USPA is focused on creating the necessary conditions to allow stevedores and cargo owners to enjoy competitive advantages in Ukrainian ports and develop their businesses with

the use of marine transport. With this in mind, port service fees were lowered by 20% at the beginning of 2018. The "Yuzhnyi" and "Chornomorsk" ports have seen major dredging projects allowing to reduce the cost of export.

What can be done so that the government doesn't always lose to private initiatives? How can uneven development be avoided and an equal playing field ensured, regardless of the owner?

The management of state stevedoring companies is pretty bureaucratic. It needs more flexibility compared to the management authorities of private stevedores. And so, in the last five years, the share of state stevedores in transshipment has gone down 17% and is now only 24%. That's why we support the Infrastructure Ministry's proposal to set up a public-private partnership for implementing projects. We have already selected two pilot projects: Kherson Port and Olvia Port.

What's special about these two ports?

First of all, of all 13 ports, their loading capacity is nearly 2.5mn tonnes, which is average. Secondly, feasibility studies confirmed that these two projects are ready to go. And thirdly, there are often complicated relations between port administrations, state stevedores and private ones. Neither of these two port has any of that. Finally, both Kherson and Olvia have maintained a single operating facility: platforms, rail and access to berths. This could be very interesting for an investor.

How does USPA persuade foreign investors to come to Ukraine's ports on a concession basis?

The infrastructure of our ports makes it possible to transship nearly 250 mn tonnes of cargo a year. Last year, we handled 133 mn t. Moreover only 10% of handling is transit, that is, the volume of cargo tied to possible geopolitical issues, where political or sanctions decisions might influence business. Most of the cargo we handle, 90%, is based in Ukraine's economy, and this is what we propose to international investors: more than 100 mn tonnes of farm products, metals, ores, and containers were, are and will continue to be processed at Ukraine's ports.

Ports provide the shipment of over 40% of Ukraine's international cargo loads. Additionally, Ukraine's favourable geographic position and transit potential remain to be fulfilled.

How much interest do you see that is backed by capital?

On September 19, USPA and our consultants from concessional project – the IMF and EBRD – jointly presented the feasibility studies of the two pilot projects. In attendance were 24 companies: grain traders and cargo owners, companies from Qatar, Turkey and the UK. They see Ukraine as a market and are looking at their options for investing in Ukraine's ports.

What criteria do you use to select foreign investors? Under what circumstances would you reject a company?

We would reject anything from Russia. This is the state's position, and in light of the recent well-known events, I think noone is going to be surprised about it. As to other countries, the main criteria are to guarantee a minimum amount of investment and cargo turnover, provide social guarantees, and pay the concession fee. Beyond that, tenders should determine who comes with the best proposal. International and state companies are on an equal footing here. Consortia creation is also welcomed.

How might the state and private business reach some kind of synergy in developing port infrastructure?

In the last decade, the ports have seen plenty of investment. Investors direct their money towards developing terminals, while the state, represented by the USPA, provides that the piers meet the required technical specifications and the depth of the water zone is sufficient.

For instance, we are now building a grain terminal in the Port of Mariupol. Mariupol Marine Trading Port, a state-owned stevedoring company, is building a terminal for transshipment capable of handling up to 2,5mn tonnes. We're also reconstructing the pier. In Odesa, we're working with Germany's HHLA to build a container terminal: our part is deepening the channel and building the cutwater. With MVCargo, we're jointly carrying out a huge investment to build a grain terminal in the Pivdennyi port. These are projects we can be proud of and they will be a benchmark for future ventures.

Altogether, USPA has signed memoranda of intent worth a total of US \$30bn with private sector businesses. Some of these plans go up to 2038.

How much has USPA been able to do to ensure the security of shipping, for instance, in relation to the hold-ups in the Azov Sea? What kind of threat does further aggression from Russia pose for Ukraine's shipping activities?

The geopolitical situation in the region is making it hard to expand cargo shipment. On the contrary, in Mariupol, we've seen a 10% decline compared to 2017, while in Berdiansk shipments are down 30%. Calculating the ultimate losses is impossible, however, because the economic impact goes well beyond the ports.

The Russian Federation's holding of shipping vessels coming through the Kerch-Yenikal Canal is illegal and it represents time lost for both ship and cargo owners. And lost time means lost money.

It's also important to understand that with the building of the Kerch Bridge, additional restrictions have been put in place in terms of sailing under it. Our clients have begun to use smaller vessels in order to be able to navigate under this bridge. Of course, the smaller the ship, the more costly it is to ship a tonne of cargo. The fact that the situation is also uncontrolled and unpredictable means that clients are redirecting their cargo to other ports to reduce their risks.

Right now it's hard to say that the situation is stabilizing. The Azov ports were designed for larger tonnage shipping and it's more convenient for exporters to work with large vessels. And so we can see that some of the cargo flow from this region is being handled in Mykolayiv or Odesa.

Despite the temporary difficulties, the Azov Sea ports continue to play an important role for business development in the East of Ukraine and we will continue to develop them in order to strengthen Ukraine's competitiveness on Azov.

Are you saying Ukraine has lost the option to do large-scale shipping in the Azov?

Unfortunately, we have to recognize that the Kerch Bridge makes it impossible to operate a large-tonnage fleet in the Azov. This is reducing the competitive edge of those of our clients working in these ports. For instance, Berdiansk handles enormous amounts of grain. Grain shipped in smaller vessels goes to the Mediterranean, Europe and North Africa. But China, the US and other very distant destinations are no longer competitive.

What about Ukraine as a transport hub at the regional level, if not globally? How ready are Ukraine's ports to handle a growing transit role in today?

We should take advantage of our location to ship to Georgia, Turkey and Iran. We can compete with Baltic ports and propose that Belarus export to China through the Black Sea. Going further, we can develop a Maritime Silk Road through the Bosphorus and Suez Canal. We're in the process of developing a strategy for attracting cargo from Asia following this route.

But we also need to understand that this is a serious competition. Many countries, including the Baltics, Belarus, Turkey, and Egypt want to be in the race as well and get their share of the cargo pie. We need to lobby our interests, promote our capacities, and offer infrastructure projects. And we need to appeal to Chinese partners – as partners, as a state and as a market. ■

SEA PORTS OF UKRAINE



Source:
Ukrainian Sea Ports Authority

13
seaports

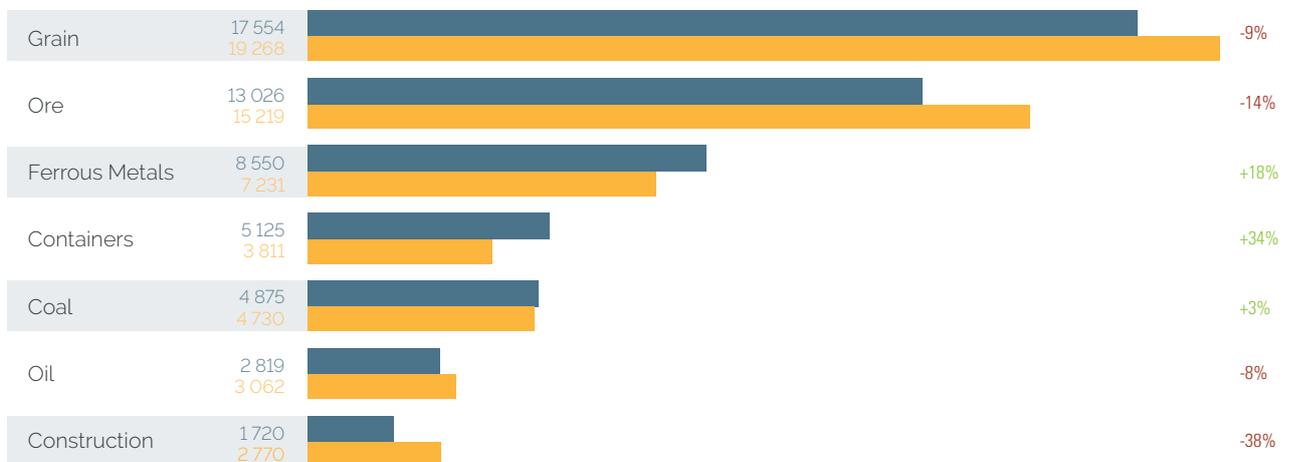
263
berths

40 km
the total length
of berths

133 mln
tons
cargo turnover
in 2017

8402 млн.
грн.
profit in 2017

THE MAIN CARGO TURNOVER DRIVERS



Source: Centre for Transport Strategies

■ 2018 ■ 2017

ANDRIY SOKOLOV
Development Director,
Stark Shipping



defending the legal rights of the shipowner, the shipping agents rely heavily on their knowledge of international law, Ukrainian legislation, and port customs. This applies both to the work of the port itself and to the legal basis for the operation of all the public authorities represented in the port.

What communication channels do agents use interacting with the state, local authorities, port administrations, and businesses?

All the possible options are used. As elsewhere, a lot depends on the company's ability to create clear, open, both formal and informal relationships within the current legislative framework. This simplifies interaction and understanding significantly.

Does the engagement of an agent increase the client's competitiveness and the flexibility of their work?

The shipping agent's involvement plays an important role in determining how quickly and smoothly the process of the vessel's berthing and departure will take place, as well as the loading process at the terminal. Therefore, the agent's operational efficiency affects the work of both the terminal and the shipowner. Let me be honest: the agent plays a frankly small role in the increasing the client's competitiveness, while their slow or clumsy work can cause fatal damage.

Does the Ukrainian market for these services have any peculiarities?

The market is quite saturated, mostly by Ukrainian companies.

The agent in Ukraine serves as the link between the terminal and the vessel. The agent coordinates the arrival time of the vessel to the port water area and the berthing time. If necessary, the agent provides the presence of a pilot and hires tugboats for escort. After the vessel is set up, the agent assembles a commission of border guards, customs officers, and a doctor, authorizing the beginning of loading-unloading operations. Later, the port warden and, perhaps, environmental experts may come to visit. Upon completion of the work, the agent collects the departure fee. If the controlling bodies have any questions to the vessel, the agent is involved directly resolving the dispute or addressing any issues and instructs the captain and the shipowner. In the absence of comments, departure is allowed and the vessel leaves the port. ■

SHIPPING AGENTS REDUCE RISKS

What is the financial benefit of working with a shipping agent?

Most stories of foreign companies successfully entering the Ukrainian market involve a Ukrainian "guide" company, helping their breakthrough. Shipping agents allow appropriate operation of the maritime industry's international-business-oriented segment. Local companies providing legal and consulting services reduce risks to reasonable levels.

The shipping agent's operational efficiency affects the speed of the vessel's berthing and departure. With considerable numbers of vessel calls, the time savings can be significant, as well as the financial savings, since the vessel spends less time in the port. All this comes along with the direct financial benefit resulting from the fact that shipping agencies operate a significant number of vessel calls and thus can provide direct discounts to shipowners.

How expensive are their services in Ukraine?

In the overall composition of freight costs, the services of shipping agents account for a very small share – about 0.3%. On the other hand, the agent's mistake or failure to act can lead to the vessel's demurrage, which is estimated at tens of thousands of dollars a day.

What should a customer consider when choosing a shipping agent to cooperate with?

Many try to look solely at the cost, as it is often quite difficult to fairly assess parameters such as "work comfortability" and "competence." Many of the explicit indicators of professionalism the customer might look at are fairly easy to replicate. For instance, the reports that the client receives from the agent. It is far more difficult to replicate the data acquisition technology for the report, the internal interaction scheme that provides rapid information reception and error elimination, the systematic improvement of work standards. For many, the company's size and its customer base make up a key assessment criterion.

What really matters when choosing an agent is their proactive approach. When trouble is brewing in the client's company, the agent has to: a) do their best to prevent the deterioration of the situation; b) involve the client in problem-solving in the early stages providing a ready-made set of solutions.

What tools and mechanisms do shipping agencies use to promote their clients' interests?

For the most part, it is crucial that the agent ensures the smooth transition of information from the shipowner to the company, and then to the relevant authorities. When

BUSINESS PREFERS TO SEE TRANSPARENT PORT FEES

How did Ukrainian businesses react to the 20% reduction in port fees (effective as of 1 January 2018)?

The reaction was unequivocally positive, this was a step the government had to take en route to raising the ports' competitiveness as well as improving the performance of Ukrainian goods in the global markets. At the same time, it was merely the first step, and there is still a lot of work ahead, as we are still more expensive than our direct competitors in the Black Sea region. The World Bank has estimated that port fees in Ukraine would have to go down another 54% before our ports become competitive while receiving enough to properly maintain port infrastructure.

On the other hand, we do realize that the reduction in port fees has to follow a change in the amount of dividends the Ukrainian Sea Port Authority pays to the state budget – from 50% to 30%. This would provide the USPA with more resources to develop its marine infrastructure.

Following the reduction in port fees, the cargo tonnage seems to have gone down. As a consequence, the ports' incomes must have fallen, too.

The tonnage did not go down significantly, and so the USPA has not incurred any severe losses. What we saw were seasonal fluctuations combined with a few other factors, and what we currently see is that the cargo tonnage is quite similar to last year's figures. And, nobody seems to bother how much larger the plunge would have been, had the government not reduced port fees. Their amount is just one part of the issue. We must also ensure that these collections are used as stipulated in the Law on Seaports. Currently, the situation is far from ideal. For instance, part of the collections were directed to developing inland waterways. There is no arguing about the rivers' importance. However, their development requires that the law on inland water transportation be adopted, clearly indicating their funding sources. Otherwise, all we are doing is cross-subsidizing.

The USPA and the Ministry of Infrastructure are now working on the new methodology for calculating port fee rates. How does business get involved in its development?

The methodology is now somewhat up in the air. The EBA's main concern is that the calculation should be as transparent as possible. It should reflect the original idea behind the document, which is finding the economically feasible port fee rate. The methodology's current edition does not live up to our expectations, containing a few critical matters, such as the introduction of two types of docking dues or the presence of an investment element while no proper control mechanisms are foreseen etc. Unfortunately, the business environment has not had any preliminary calculations presented to it, demonstrating the application of the methodology.

It is important to note that the Methodology is to be developed and presented together with a couple of other documents – the Procedure of Collecting and the Rates of Port Fees as well as the Procedure of Accounting and Utilizing Funds Collected as Port Fees.

Does the EBA have members interested in public-private partnership and considering port or dock-side infrastructure in terms of investment?

We do support the establishment of various public-private partnership mechanisms. The EBA believes that reducing the share of public ownership by involving national or international private investments in ports will contribute to their improved efficiency.

The business environment anticipates the second reading of the Concession Law. We support the draft law and hope to see it adopted soon, with amendments



YARYNA SKOROKHOD
Coordinator,
Logistics Committee,
European Business Association

suggested by the EBA. Part of our comments following the first reading have been taken into account, but we are still not entirely happy with the identification of concession items, environmental impact assessment, the conclusion of the contract with the leaseholder, the state support to concession projects as well as a number of final and transitional terms. We hope to see our suggestions incorporated into the law, as they necessary for it to bring about positive changes in various sectors of the economy highly anticipated by both business and government.

At the same time, we do acknowledge that each of Ukraine's sea ports has its own distinct heritage. Thus, the government's approach towards determining their future cannot follow a one-size-fits-all path. Some port need to move forward with concessions, while some might depend on privatization. These issues as well as a number of other questions vital to the country's marine industry should be resolved by the Sea Port Development Strategy. It has been formulated by the USPA and currently awaits approval by the Cabinet of Ministers of Ukraine. Another important step is the adoption of USPA's ownership policy. ■



REDUCING THE SHARE OF PUBLIC OWNERSHIP WILL

CONTRIBUTE TO PORTS' IMPROVED EFFICIENCY



PORT OPERATORS ARE NOT ABOUT EQUAL COMPETITION



SERHIY VOVK

Director, Center for Transport Strategies, Co-chair, AmCham Infrastructure Committee

Regardless of the fact that over 6,500 km of roads have been repaired over the past three years, the Road Fund was launched and has accrued more than UAH 32 billion, global port operators have entered Ukrainian ports, and low-cost operators have set up business at Boryspil, Ukrainians keep saying that the infrastructure is a mess. Why is that?

The thing is that Ukrainians do get to deal with infrastructure units that are over 80-90% worn out. In simple words we are talking of old wagons, old roads – obvious changes are quite few. Still, the good news is that Ukraine has got the best dynamics on the competitiveness rating of the World Economic Forum under the 'infrastructure' category.

From the business point of view, there is less room for optimism, as the overall quality of the transport system's services is in decline. Primarily, this is due to the changes at Ukrzaliznytsia. The rolling stock is majorly worn out, especially the locomotives, which leads to decreased productivity. Businesses can clearly see: an operation that used to take 1-2 days now takes a week.

Does Ukrzaliznytsia have any good news for business?

It must be understood that when Ukrzaliznytsia claims that the current problems have been piling up for years, that is completely true. A large share of the problems Ukrzaliznytsia faces relate to growth and reform.

The positive things to mention include the introduction of corporate governance within the company, the work of a truly independent Supervisory Board composed of highly professional members.

The communication between Ukrzaliznytsia and the market has undergone significant transformations as well. The railway used to hand down orders to businesses, while now it is a peer-to-peer conversation between two market players. There is room for dialogue, an opportunity for the parties to express their views, exchange ideas and reach an agreement.

Speaking about ports, how can we fix the disparity in the development of public and private port operators?

There is one reason for their inequality: the private operator can independently decide on where to spend the funds earned. State port companies, on the other hand, are budget cash cows. Therefore, there will be no equal competition until state stevedoring companies have a right to manage their own capital investments. Moreover, the client of a state company now has to coordinate their action with the respective ministry or other state bodies. All this leads to a decrease in the share of state operators in the maritime shipping market.

How do you assess the terms under which the Olvia and Kherson ports will be conceded? Might this be interesting for private investors?

The question for me is whether they will generate interest among a wide range of real investors. I believe that Olvia is a more attractive site, and even international companies will compete for it. As for Kherson, the port is a point of interest for domestic companies, which carry out the lion's share of transportations on the river shipping market.

The investors' willingness to engage in ports is primarily influenced by the balance of risks that are equally divided between the port operator and the state. Secondly, a successful project requires a proper feasibility study. We have got a catastrophic situation on our hands: of more than 350 infrastructure projects that have been announced, fewer than 20 have actually passed the feasibility study stage. That is, the rest of them make very little sense to investors.

Large businesses are actively investing in private port infrastructure. Based on your experience, who covers the cost of access roads to the ports?

It would be an ideal mechanism for public-private partnership. In other words, the state can build the roads, and a private company can build truck stations. This is a good point in favor of starting to work out a concession mechanism for port area roads. ■

« OF THE 350 ANNOUNCED PROJECTS, LESS THAN 20
HAVE PASSED THE FEASIBILITY STUDY STAGE



TOP ACHIEVEMENTS

- Reduction of port fees by 20% since the beginning of 2018.
- In 2018, investments in the development of port infrastructure will exceed UAH 2 billion.
- Large-scale dredging projects in the ports of "Yuzhnyi" and "Chornomorsk" will reduce the cost of exports.
- Launch of pilot concession projects at sea ports "Kherson" and "Olvia".
- Introduction of new corporate governance standards at USPA (formation of the Supervisory Board).

An aerial photograph showing a vibrant green field in the upper portion and a yellow field in the lower portion, separated by a dark, possibly paved, path or road. The text is overlaid on the right side of the image.

AGRICULTURE

THE GRAIN MARKET

As shown by the results of the first three quarters of 2018, the agrarian sector represents a major share of exports from Ukraine, with 36.8% of the total cost of goods.

This year's grain crop is estimated to amount to 65-67 mln tonnes, which is a decent figure. Wheat, barley, corn and soy lead the way among the crops. Agrarians are also paying attention to niche crops. Ukrainian grain is traditionally directed towards Europe, North Africa and the Middle East. Apart from that, Ukraine has discovered pathways to Asian markets: India, Indonesia, Malaysia, Japan and Vietnam. The country's full potential remains to be fulfilled in the African and Latin American markets; also, cooperation with China does not live up to the proclaimed intentions and the opportunities present.

Certain issues have been troubling market players for a long time. Chief among them is the agrologistics issue, railroad transportation in particular. Companies lament the introduction of routed grain deliveries from elevators, the shutdown of 'low-impact' railway stations and the increased transportation tariff. Many explicitly mention Ukrzaliznytsia as an eye sore. Business associations direct their efforts towards supporting agrarians in receiving VAT compensation for the period preceding the introduction of the electronic registry. The issue of what is referred to as the 'gray' grain market, amounting to 35-40% of the whole market volume, remains acute.

Ukrainian agrarian companies put their faith in innovation and invest heavily in new equipment and technology. This comes along with benefits: every single dollar invested in tech returns as two that same year. The innovative approach allows producers to increase crop yield, reduce losses and uphold the prestige of working in the agricultural sector.

The first Ukrainian agrotech park has become operational. It sets the objective of uniting domestic and foreign companies to communicate Ukraine's agricultural potential to an international audience. The rationale behind that is: an investor having earned money in Ukraine is the best possible advocate for doing business in the country. ■

VOLODYMYR OSADCHUK
CEO, COFCO Agri Resources
Ukraine LLC



CHINA'S MARKET COMES FIRST

How successful has this growing season been for Ukrainian grain producers and COFCO?

Early grains have already been harvested – the wheat crop is somewhat lower than last year – and nearly 50% of the late crop is already harvested as well, so this year looks as good as 2017 for grain producers. We estimate that the entire grain harvest will eventually be around 65-67 million t, which is quite good.

Wheat and barley are profitable for grain producers as there is plenty of demand on global markets. Since there were problems with harvests this year in parts of Europe, South America and Russia, especially with the fall crop, and prices are expected to go up once Russia ships its crop. The large supply of maize on global markets is pushing prices down, but we can still export over 20mn t. The demand is there and the market will absorb our maize, sooner or later.

What is COFCO's overall plan for Ukraine in the next few years?

Our company is part of a Chinese corporation, so our priority is to satisfy demand on the Chinese market. Of course, we are also an international company, a Chinese state corporation that works

with countries that have demand for our products. And so China is first, and then other markets. We supply 100% of Chinese demand with Ukrainian grain. Fortunately, there are a number of agreements regarding sanitary and phytosanitary requirements between Ukraine and China that allow us to export Ukrainian product to the Chinese market.

Trade between Ukraine and China often fails to reflect declared intentions and capacities, so where do you see points

« YOU HAVE TO BE IN CONSTANT COMMUNICATION WITH CHINA'S BUREAUCRACY TO GET RESULTS »

of breakthrough on the Chinese market, especially given the current trade war with the US?

It is true that the various Ukraine-China commissions are not 100% effective. The Chinese market is certainly interesting and has a lot of room for Ukrainian products. But the commissions have to ensure the Ukrainian side that they can guarantee deliveries of the specific item in China. China's very top-down system does not always make it easy to quickly find the necessary channel for resolving business

issues. You have to be in constant communication with their bureaucracy to get results.

Since COFCO International invested a substantial US \$75mn into its own terminal at the Port of Mykolayiv, how has this additional capacity affected performance?

Now that we have our own terminal, we've been able to work more efficiently because we can arrange our own logistics the way

we need. It also gives us more options to connect directly with growers, to plan our flows of goods, and to offer our customers better guarantees that shipments will be on time and of the expected quality.

What other infrastructure projects of a similar scale are you planning?

We are looking at a few possibilities. We are, first and foremost, interested in domestic logistics, because that's where we've experienced some problems, both on land and on the rivers. If the opportunity comes up, we will look at options of going

into another deep-water port besides Mykolayiv. And, of course, we have plans to expand our presence on the market.

How do you organize your logistics and where do you see room for improvement?

We use all kinds of transportation. Roads are for moving product within 200 km of our facilities: the terminal, the plant, the elevator and river loading points. We use rail to move product around Ukraine, and that's where we have problems. We use both Ukrzaliznytsia stock and our own but their turnaround time has increased from 10-12 days last year to over 20 days this year. There is a shortage of pulling power. This means we are forced to load more cars while efficiency is going down. This means huge losses for both our company and Ukraine's entire economy. Nor do we have much faith that Ukrzaliznytsia will become more efficient. The railway remains a major obstacle for business. By contrast, river transport is getting better, especially for companies that work at Mykolayiv Port, like we do. The only real problem is a shortage of barges.

What destinations do you see as

promising for Ukrainian grain and other products, and which of these interest COFCO Ukrainian office?

Our traditional markets include Europe, North Africa and the Middle East. These markets will grow as long as their populations continue to grow, but we don't expect a boom or even a serious rise in demand there. Ukraine has meanwhile discovered Asian markets – India, Indonesia, Malaysia, Japan, and Vietnam. If we continue to increase our crops of grains and oilseeds, our exports should expand to Africa as well. Its population is growing, as are investments into the region, and as the living standard rises, so will demand for quality food. Even now, the quality standards for food-grade wheat we send to Africa are as high as those for Egypt, Indonesia and other countries. In South America, we could find markets in Mexico and Brazil, but this would likely be occasional and inconsistent.

Where do Ukrainian grains stand on the global market?

Our position as a major exporter of forage wheat is solid. But I believe that we should focus on growing more high-protein food-

grade wheat. Sure, it's easier to export forage wheat and underinvest your dollars into the soil, but there's always strong demand for food-grade wheat.

What do you see happening on Ukraine's grain market in the next while – more variety, organic products?

It's become pretty obvious that wheat and barley are not moving. The volume has frozen at around 6mn hectares for wheat and 2mn hectares for barley and this area is not changing much. The only way to increase production is by increasing yields and using technology.

We see growth in oilseed, however. The area sown with these crops has nearly doubled, because there is demand for these crops because we can process them here. Ukraine is a leader in oil exports, so I think that soybean and rapeseed cultivation will dominate in Ukraine, as will their processing. We produce enough maize, so it's time to look at how to process it to a greater extent here. One possibility is investing in processing corn into bio-ethanol. I'm convinced that we should focus not on raw materials but on adding value here in Ukraine. ■



KATERYNA RYBACHENKO
CEO, Agro Region



TRACTOR OPERATORS TEXT ME ON TWITTER TO GET A JOB

■ GOOD COMPANIES CAN'T BE BUILT WITH BAD PEOPLE

The Swedish investment company EastCapital bought the "Agro Region" company from the former two-time Minister of Agrarian Policy of Ukraine. At the time, in 2007, Ukraine was on the rise. An agrarian asset in a multimillion state, complete with a wonderful location near Boryspil airport, seemed a sound investment.

As EastCapital shareholders were not closely familiar with the intricacies of agribusiness, they decided to leave the previous management in charge of the company. That decision turned out to be a mistake. In as little as a year, the company ran out of working capital, it accumulated huge bank debts. This is when we realized: good companies can't be built with bad people.

In 2009, I was invited to manage the company, being the only Ukrainian in EastCapital. A financial officer from Lithuania took over the accounting. We fired nearly all staff who were specialists in agriculture. Instead, we invited mathematicians, cybernetics, financiers,

economists – young people who had no clue about agronomics, but knew very well how to set up processes and control them (the average age of "Agro Region" employees is 33 years). It became a kind of a start-up. The motivation was extremely high, as the company's survival was at stake. This is how we succeeded.

We reduced the amount of land the company owned by 30% – to 38,000 hectares, cut the number of workers fivefold, stressed high-tech innovations and unique know-how in all processes, we provided decent working conditions and focused on the corporate culture. Over the next eight years, we have not lost a single person we did not want to lose. "Agro Region" has firmly established itself as one of the three most crop-yielding companies. 75% of the produce is exported. We have placed our bet on corn, soy, and sunflower.

■ IS AGRICULTURE NOT PRESTIGIOUS?

Ukraine has got a problem with agrarian education. Graduates of agrarian programs usually know little of what is actually needed to work in a modern agricultural

company. Therefore, starting from 2014, an agrischool has been functioning at "Agro Region": while receiving their university education, students attend the company's training course, covering a variety of subjects – from sowing to harvesting. They have assigned mentors, experts from leading foreign companies deliver lectures on seeds, fertilizers, soil analysis, modern agricultural technology. At the end of the course we arrange an exam, and the best students are offered jobs at "Agro Region".

There are also problems in terms of the perception of the agrarian profession – people believe it is not particularly prestigious. In 2013, we had a prominent case in our company. Our young Development Director decided to take part in a TV show. The idea of the show was simple: the participant mentions a few facts about himself to 20 girls, sitting with their backs turned to him; at any moment, each girl can press the red button to stop the conversation. When my colleague began with the fact that he was from Donetsk, half of the girls pressed the red button. That is, Donetsk was already unpopular back in 2013. But when he continued: "I work in an agricultural company", the remaining ten girls simultaneously declined further

acquaintance. It was kind of reality check for all of us: the agriculture was not sexy.

I cannot agree with this at all. Modern equipment, such as a sprayer worth half a million dollars, with a wingspan as wide as a Boeing's, needs a person in the cabin managing five computers at the same time. He or she must speak English and have degree in engineering. This is prestigious enough, isn't it?

The world does not stop. Now, tractor operators text me on Twitter to get a job.

■ TECHNOLOGY IN THE FIRST PLACE

We started introducing technological developments and innovations by attaching GPS-navigators and detectors to everything that moves: we had sensors, "friend or foe" recognition systems, QR-codes everywhere. We also created a round-the-clock dispatch centre, with software developed by our programmers. We launched it in the summer of 2012, before harvesting. It became fully operational in autumn. That fall one in two tractor operators, combine and truck drivers quit. Despite all the financial and non-financial motivation offered by "Agro Region", people kept quitting and looking for jobs with other companies, hoping to line their pockets dabbling with grain and fuel. Eventually, we completed the harvesting campaign successfully: the tech paid off before it was over. As a bonus, it resolved not only the issues of fuel economy and grain theft, but it also tossed out the people who cannot work honestly.

■ "TERMINAL Z"

35 hectares of "Agro Region's" land are some 5 kilometres away from the take-off runway of Boryspil airport. As a foreign investor, we frequently communicate with embassies, banks, chambers of commerce and industry, foreign businesses. Official delegations often request to have a look at Ukraine's renowned agrarian potential. We have hosted foreign delegations weekly over the last ten years. It has become common practice. But then, around year and a half ago, the World Bank delegation wanted to get a glance at Ukraine's agricultural sector. During the organizers' negotiations, I had a shadow of doubt as to whether we could represent the whole country. This is a great responsibility. We can speak freely on everything concerning "Agro Region", but we cannot speak for

« THOSE WHO HAVE EARNED MONEY IN UKRAINE ARE THE BEST ADVOCATES OF DOING BUSINESS HERE »

the whole country. That is when we had the idea of bringing several companies to a single location – the "Terminal Z" agricultural technology park. Its concept includes a coworking space, a zone for exhibitions and conferences and a hotel.

The French farmer cooperative Maisadour became our first partner, and they already have a 50-person office at "Terminal Z" as well as first in Ukraine R&D centre. They are a leading seed producer, a leader in the foie gras market with an annual turnover of €1.200 billion.

The idea of the park is to bring together companies that share the common view of transparent, socially-oriented, responsible business as well as to promote the brand of Ukraine. This is our way of communicating Ukraine's agrarian potential to an international audience. We know that some potential investors associate the

Ukrainian agricultural sector with best soil in the world, decent earnings and success stories, while others fear the unscrupulous companies that ruin Ukraine's reputation.

The country needs success stories. Those who have earned money in Ukraine are going to be the best ambassadors and advocates of doing business here.

For us, the "Terminal Z" project is highly personal, since we are also investors who entered the market in 2007 and nearly lost everything. However, we managed to rebuild the company, and now we want to show other investors that it is possible. "Terminal Z" can become an entrance point to Ukraine for new investors. Once they are in, the sky is the limit. ■



A DOLLAR INVESTED IN INNOVATION DOUBLES IN VALUE

PETRO MELNYK
CEO, Agricom Group



In terms of the Ukrainian grain market, how large is Agricom Group?

The Ukrainian grain market has a volume of about 64 mln tons annually. What we are able to produce with our 38,000 hectares of land is about 140,000 tons. But I would say that one thing clearly distinguishes Agricom Group from a conventional agro-holding – we are also engaged in processing the crops and selling the end-products. This is where we are holding the lead. Our factories, with the highest capacity in both Ukraine and Europe, have enabled us to control 30% of Ukraine's cornflake market.

How did you come about understanding that the cluster model was the optimal structure for your business?

A whole array of parameters is analyzed before a cluster is created, but the primary feature is geographic location. A technology working perfectly in one of the clusters might turn out completely wrong in a place that is different climatically and soil-wise. The cluster's location in relation to the control point is also an important factor, as well as the accessibility of the land plot when it comes to cultivation.

How long have you been operating this way?

It has been nearly five years. Agricom Group was established in 2014, as a minute shard left over from a ruined enterprise in the Luhansk region. The first year was tough. But what others saw as a crisis, we used as an opportunity. We managed to find partners, get banks onboard, then we attracted an investor who helped boost our development. The first pieces of land we owned were located in the East, and then came the regions of Chernihiv, Rivne. We had to evolve in order to survive.

What types of crops does Agricom Group specialize in?

We have got four primary crops: sunflower, wheat, rapeseed and corn. We also have a fifth type of produce that is different from cluster to cluster, but it is always a niche crop: soy, beans, lentils, peas or flax.

How do you see the niche crops' future in the domestic and foreign markets?

The reason we call these crops 'niche' one is that their share in

the Ukrainian market is quite small. Moreover, the consumers' purchasing power is lower than in some Arab or African countries, let alone Europe. This is why niche crops are export-oriented. There is a peculiarity about them: when a niche crop is overproduced in a single country, its price in the world market may tumble down.

When we do engage in growing a niche crop, we usually target a particular customer. For instance, we might bring it closer to organic foods.

Which type of transportation do you use to ship your produce to ports?

We use the rail, cargo trucks, too. The current situation in Ukrainian logistics is outrageous. Producers and manufacturers incur huge losses as they are unable to sell their goods in due time. The decisions made by the railroad monopolist, Ukrzaliznytsia, have come as big hits for the market. The shutdown of the so-called low-impact railway stations and the changes to the wagon provision system, all introduced as optimization measures, have effectively taken 80% of the market players out of competition.

Agricom Group is listed as one of the top-5 agricultural companies in terms of innovation. Out of the tech you have introduced recently, what would impress the public?

I would nominate artificial intelligence. The technology we have put in place calculates crop yield, providing us with forecast amounts and a real-life snapshot of what is happening in the field.

Each dollar invested in innovation returns no less than two the same year. A decent chunk of our innovations do not have as much to do with increasing income – they are focused on process automation. Experts in the agrarian sector are leaving the country en masse, so we are getting ready to face the challenge of qualified staff shortages. Automation allows us to have a single employee replace two, but the wage will be competitive and decent.

Agricom Group is not only engaged in growing grain but also has its own processing plants. Was it the income from grain sales that enabled the company to expand its activities?

We had an investor, or rather a partner, involved. \$ 11 million were invested into the plant's construction. We now produce three distinct cornflake brands that are not in competition among them, being targeted at different consumers.

While we were still in construction, we started working on our trademark, established a distribution system and made deals with national retail networks. This turned out to be the right strategy, allowing us to break even quite soon following the plant's launch. It is now generating income and is a sustainable element of our business.

How is the company's interaction with state authorities organized?

The way I see it, the best way for businesses to communicate with the state is by paying their taxes. ■

FORMING THE CONSOLIDATED BUSINESS POSITION



MARIA REVENKO

Senior Policy Officer (Agriculture Issues),
American Chamber of Commerce

What interests are shared by the companies in the Agrarian Committee of the American Chamber of Commerce?

Historically, AmCham's Agrarian Committee includes large grain producers and traders. As they all represent the same industry, the members' interests are often aligned, so it is a lot easier for us to come to a consensus on many issues.

We plan the Committee's work according to a list of priorities approved annually. This year's priority issues include: 1) agro-logistics, in particular the difficult situation with the transport of grain cargoes by rail; 2) VAT reimbursement for the period preceding the launch of the electronic registry; 3) the problem of the "gray market" of grain, accounting for 35-40% of the whole grain market according to experts from member companies. At the same time, new issues that the Committee needs to draw its attention to crop up as the year goes by. One of the examples are the so-called "soy amendments" posing that export VAT on soy and rapeseed should be compensated to the producers, but not the traders.

The Agrarian Committee examines legislative and governmental initiatives and provides comments to them. We work on draft bills and discuss them with different level authorities. We try our best have burning issues resolved as quickly as possible.

What level of representation do companies have in the Committee?

Most of the companies have GR experts, sometimes even separate

GR departments that cooperate with associations and public authorities. But here in the agrocommittee we have a different situation: only a few companies are represented by GR experts, most members are department directors or even directors general. The agrosphere is a complex industry, encompassing a whole range of issues: logistic, phytosanitary, financial etc. Discussing these often calls for the participation of experts in the relevant areas. But I would not say that a lack of GR specialists in some companies negatively affects their involvement in the Committee's activities.

What tools do you have to bring about change in the spheres of the members' interest?

We cooperate both with businesses and state bodies. The AmCham President Andy Hunder is a member of the National Reforms Council under the President of Ukraine. It is a nice tool helping to convey the thoughts of business to the President himself. Apart from that, members of the Chamber participate regularly in meeting with the President of Ukraine and the heads of governmental institutions. Moreover, AmCham itself is a platform where business may form its consolidated positions. We address the management of the ministries and the parliament once we have reached understanding among our members. We interact with other business associations and work hand in glove with the US Embassy.

Does the US Embassy get involved in protecting American companies in AmCham? Do you turn to them for help,

as the voice of America is more likely to be heard in the political cabinets?

We greatly appreciate the support provided by the U.S. Government and the U.S. Embassy in implementing a number of urgent and highly anticipated reforms in our country.

If we focus on AmCham's work directed outwards, rather than inside the country, how does the Chamber communicate Ukraine's success story to foreign audiences?

AmCham works in three areas: B2G – business-to-government, B2B – business-to-business, and B2U – business-to-Ukraine. The latter comes down precisely to promoting of Ukraine in the world.

The American Chamber of Commerce is the oldest business association in Ukraine, a member of the U.S. Chamber of Commerce, located just across from the White House in Washington, D.C., uniting over 3 million members under the motto "fighting for your business". It has been more than 26 years that the Chamber has been standing up for business here, in Ukraine.

The American Chamber of Commerce in Ukraine is also a member of the European Council of American Chambers of Commerce. The Chamber's President, Mr. Andy Hunder, is the Treasurer of this Council and delivers the voice of business at the highest level, among the top-management of the 44 Chambers representing 42 countries of Europe and Eurasia.

We also have an annual Country Profile publication describing the AmCham member companies and providing an economic overview. We always present it to foreign partners for them to get acquainted with the Ukrainian economic reality and its investment potential.

Foreign businesses are interested in Ukraine. We shall continue delivering to the best of our ability to support the development of Ukraine's economy, uncovering its potential in the international arena and promoting it to the world as an attractive investment destination. ■



VALERIY TKACHOV
Deputy Director for Logistics,
"Delta Wilmar"

ANY PROCESS AT UKRZALIZNYTSIA AFFECTS GRAIN MARKET

The agricultural market is the main driver of economic growth and the key export industry in Ukraine. According to the State Statistics Service, over the three quarters of 2018, Ukrainian agrarians exported products valued at \$ 9,495,421,000 (or 36.8% of the total exports value from Ukraine in January-August 2018). At the same time, the growth of agricultural export reveals the existing internal logistics problems.

Approximately 95-97% of grain cargoes are exported from Ukraine by water through sea grain terminals. However, it is worth noting the vital role of railways in the grain's movement from internal linear elevators to marine grain terminals. With the about 45-47 million tons of grain exported annually, more than 70% of it is transported to Ukraine's seaports by rail. Therefore, any processes taking place at Ukrzaliznytsia directly affect Ukraine's grain market.

Over the last two years, the state-owned railway monopolist, Ukrzaliznytsia, has been in continuous reform. The company's corporate governance system has changed radically; the basic approaches to work have shifted and, as a result, a major transformation of the railroad market has begun. From the market's point of view, these transformations are quite ambiguous.

1. With the locomotive fleet being limited, Ukrzaliznytsia decided to shift entirely to routed grain shipments from the elevators. When a company is short on resources, it is, of course, economically feasible to focus on grain shipment from those elevators that are able to ensure continuous block train shipments by loading 54 wagons a day. Yet, Ukraine's grain market was not technically prepared to

switch to this new shipment model. The total number of certified linear elevators in Ukraine is about 980, while there are no more than 750 elevators connected to the railway infrastructure. Among these, only about 70 are technically capable of loading block train shipments (54 wagons per day). This means that, in fact, only 6-9% of the total number of elevators in Ukraine are suited to the new conditions. It is important to understand that they are owned by a limited number of companies (6-8 large grain market players).

« UKRAINE'S GRAIN MARKET WAS NOT TECHNICALLY PREPARED TO SWITCH TO THE NEW SHIPMENT MODEL »

2. With an eye to eliminate redundant infrastructure, Ukrzaliznytsia compiled a list of railway stations where freight operations with grain cargoes were to be temporarily or permanently stopped. 19% of grain railway stations were closed. Ukrzaliznytsia identified these low-impact railway stations using the criterion of actual grain shipping volumes over the previous 3 years. Grain market players know very well that many of these stations ended up as low-impact because Ukrzaliznytsia would not provide them with the required rolling stock in the first place (due to the shortage of locomotives or wagons or due to the priority of block train shipments, etc.). It would have been right to estimate the availability of goods for carriage by rail at a certain station.

For example, the volume of grain harvested or the average filling volume of the elevators over 3 years in the station-adjacent area would be more objective criteria.

To be entirely fair, I have to mention that the market players themselves have also contributed to the stations becoming low-impact. Some of the line elevators use obsolete technology and cannot provide high load speeds. Their railroads are also often unsuited to loading large volumes of grain. These elevators rarely have any sort of flexibility in terms of working hours (they stick to an 8-hour working day, 5-day working week). There is also the adverse effect that the absence of long-term shipment planning has.

The routing of grain shipments and the closure of railway stations affected the market severely. About 90% of the linear elevators in Ukraine are now completely cut off from railway infrastructure. Of the 530 grain railway stations, grain is actually shipped from no more than 70 stations that can ensure block train shipment. Agrarians are stripped of access or face severe complications in terms of railway use in Zaporizhzhia, Dnipro, Donetsk, Luhanska oblasts; Lviv, Ternopil, Kharkiv, Poltava oblasts are also partially stranded.

The economic risks these innovations bring about are also significant, as they may cause the grain market to narrow. For an agrarian, the elevator is a trading platform. Farmers will not transport their grain to elevators where it cannot be sold or shipped from. The problem is that no less than 80% of the country's elevators might end up in this category. Some of them will close, and the field-to-elevator shipment interval will increase. With logistics issues making it difficult to export crops, domestic grain balances in Ukraine will grow. This will place a strain on its price (the domestic cost of the grain will decrease). When the price goes down to the floor level of cost-effectiveness, farmers will not be interested in growing grain anymore.

There is also the threat of the market being monopolized by a dozen companies that own large elevators capable of loading block train shipments.

3. Ukrzaliznytsia reviewed its rail transportation tariffs (the wagon component was deregulated; different classes of transportation have converged price-wise). This led to a sharp rise in the cost of transporting grain by rail. From the business perspective, the most important thing is that the customers of Ukrzaliznytsia should be able to predict tariffs and develop their business in view of them. Therefore, the grain market participants suggest: re-discussing each of the mechanisms for increasing rail tariffs (formulas, approval process, periodicity) with the management of Ukrzaliznytsia; setting clear terms applying to informing the market participants of any planned tariff changes; discussing the establishment of public control over the growth of tariffs (through the AmCham and EBA).
4. The problem of grain wagon distribution remains burning. They are distributed manually today involving a fair share of corruption. The bribe for getting a wagon reaches UAH 4000 per unit. As a result, only a limited number of companies enjoy access to common rolling stock, while others are barred from the system. The market participants suggest restoring the automated wagon distribution system following a review of the distribution algorithm.

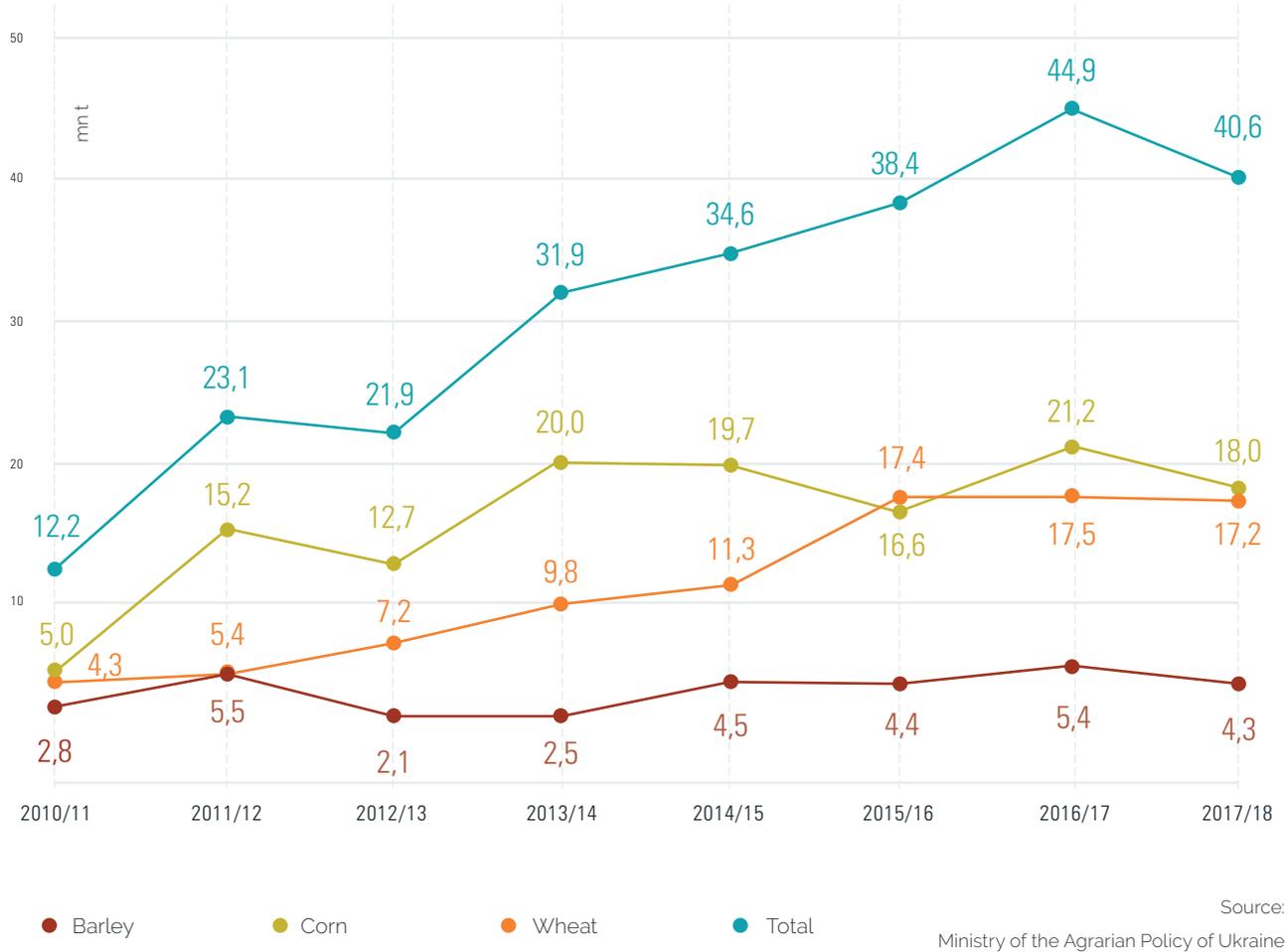
5. Grain-growers are also concerned about the grain theft on the railway during transportation, and the dismantling of private rolling stock en route to its destination. Ukrzaliznytsia, in fact, bears no legal or material responsibility for the incidents.

« THE CUSTOMERS OF UKRZALIZNYTSIA SHOULD BE ABLE TO PREDICT TARIFFS »»

Grain-growers suggest reviewing the general model of grain shipment by rail. This would mean abolishing the shift to routed shipments and switching to polygon ones (where grain is shipped alternately from different sections of the railway). For this purpose, Ukrzaliznytsia must delineate railway sections (polygons) and provide empty wagons to each according to a specified shipment schedule. A daily shipment standard for a single elevator will have to be introduced – at least 10 wagons, and the elevator has to stick to the set speed of shipment. At the time of grain shipment, the elevators should use a round-the-clock operation mode. Regarding the shippers, their responsibilities include expanding their planning horizon; planning the transportation only in accordance with the main plan in MESPLAN AS (monthly planning). This approach, in our opinion, increase the logistics chain's efficiency. And many colleagues stand at our side. ■

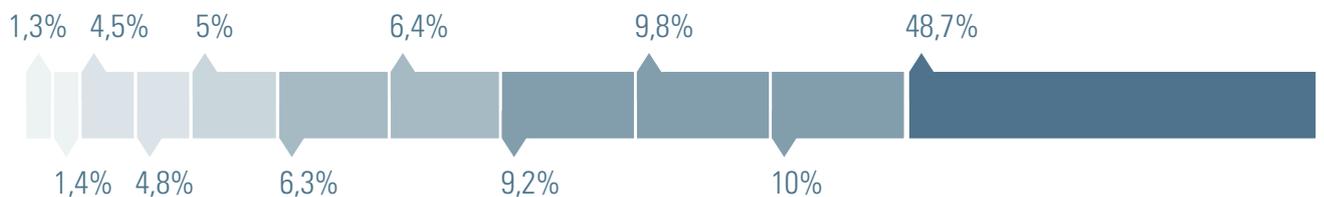


GRAIN EXPORT FROM UKRAINE



TOP-10 EXPORTERS IN 2017-2018

- Kernel — 10%
- ADM — 6,4%
- Glencore — 4,8%
- Soufflet — 1,3%
- Nibulon — 9,8%
- Bunge — 6,3%
- Cargill — 4,5%
- the rest — 48,7%
- COFCO — 9,2%
- CFGCU — 5%
- Olam — 1,4%



Source: Agroinsider

TOP ACHIEVEMENTS

- We expect a record harvest in the history of Ukraine. As of the end of November, more than 66 million tons of grain have been harvested, and the harvesting continues.
- Adoption of the draft law №6673, which allows the private sector involvement in the provision of services for the selection of product samples and the conduct of phytosanitary expertise.
- The Protocol "On sanitary and phytosanitary requirements for export of sunflower meal to China" was signed.
- The mass orientation of agricultural companies towards the introduction of innovative approaches to work and high-tech solutions.
- Ukraine now has its first agrotechnology park.



TETIANA GAIDUK

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TRUMAN AGENCY team brings together expertise from various fields: strategic planning, PA&GR, lobbying and international communications.

TRUMAN Agency conducts campaigns aimed at solving problems of Ukrainian business and opening new perspectives for the foreign companies in Ukraine.

Our team builds long-term and trustful relations with each client and partner. We do not recognize situational solutions. We prefer to develop and implement long-term strategies and maximize opportunities.

Understanding decision-making processes in Ukraine and abroad enables us to establish productive relations and bring the client to the goal. Of all possible tools, we choose the ones that work in each particular case.



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OUR FACEBOOK
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