



FRONTIER MARKET
ASSET MANAGEMENT

Lucky at Last? ***Springtime in Ukraine***

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"In Ukraine, we have lucky periods of government... and not lucky" Mykola Kovalski, Astarta

Children play at the fountain in Maidan Square, where encampments of the revolution stood three years ago. On the hulk of a building, burned in the fighting that killed dozens of people, a banner now hangs proclaiming "Freedom is our Religion."



Maidan Square, Kiev, Sunday June 18, 2017

Photo Larry Speidell

During our trip in June 2014, there were military tents here, along with piles of wood and tires to be burned in the event of an attack. With the success of the revolution, stages for rallies were in place and patriotic songs were being broadcast from loudspeakers.

Since those days of hope, Ukraine has suffered the official annexation of Crimea by Russia, and the unofficial annexation of the eastern provinces in the Donbass region by the same imposing and powerful neighbor. Separatists proclaim the region the “Donetsk People’s Republic” and the “Luhansk People’s Republic,” but Russian fingerprints are all over the area. And it was a Russian missile that shot down Malaysia Air Flight 17 in July 2014, less than a month after my colleague Andrea Clark and I had flown over the same spot on our way from Tbilisi to Riga. Now there is a stalemate as 30,000 locals and 15,000 Russians face off against the Ukrainian army.

In looking at Ukraine’s struggles, it is instructive to look back at the first attempt at independence in 2004, known as the “Orange Revolution.” I believe this section from Wikipedia is reflective of the facts.

“In 2004, Viktor Yanukovich, then Prime Minister, was declared the winner of the presidential elections, which had been largely rigged, as the Supreme Court of Ukraine later ruled. The results caused a public outcry in support of the opposition candidate, Viktor Yushchenko, who challenged the outcome.

During the tumultuous months of the revolution, candidate Yushchenko suddenly became gravely ill, and was soon found by multiple independent physician groups, to have been poisoned by TCDD dioxin. Yushchenko strongly suspected Russian involvement in his poisoning. All of this eventually resulted in the peaceful Orange Revolution, bringing Viktor Yushchenko and Yulia Tymoshenko to power, while casting Viktor Yanukovich in opposition.

Activists of the Orange Revolution were funded and trained in tactics of political organisation and nonviolent resistance by Western pollsters and professional consultants who were partly funded by Western government and non-government agencies but received most of their funding from domestic sources. According to The Guardian, the foreign donors included the U.S. State Department and USAID along with the National Democratic Institute for International Affairs, the International Republican Institute, the NGO Freedom House and George Soros's Open Society Institute...

Russian authorities provided support through advisers such as Gleb Pavlovsky, consulting on blackening the image of Yushchenko through the state media, pressuring state-dependent voters to vote for Yanukovich and on vote-rigging techniques such as multiple 'carousel voting' and 'dead souls' voting.”

Source: <https://en.wikipedia.org/wiki/Ukraine>

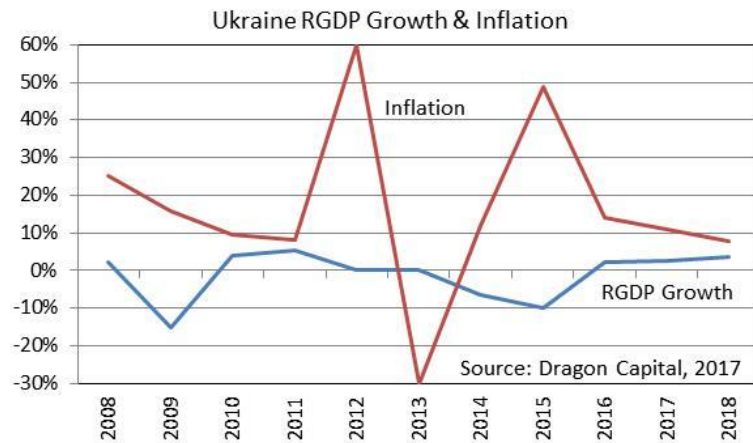


“This one map helps explain Ukraine’s protests” Washington Post, Dec 9, 2013 (Regional identification added)

The above map of the 2004 election, showing the regions that voted in favor of Yanokovich, foretold the mischief made by Russia after their puppet Yanokovich fled in 2014, leaving behind mansions and a personal zoo. Minus the breakaway regions, it is likely that Ukraine is better off now, with a new nation that believes in freedom from Russian meddling.

Ukraine's economy plunged 10% in 2015 while inflation rose to 48%. Real GDP per capita dropped 50% from 2013 to 2015.

The loss of control in the eastern provinces and a trade blockade there has cut the primary sources of coal and steel for the rest of Ukraine, but the loss may not be all bad. These are dirty businesses and have been dependent on subsidies.



Meanwhile, the IMF has used carrots and sticks to prod president Poroshenko to reduce corruption and reform procurement practices and the pension system. The IMF also wants land reform to create a free market, although that will be challenging because the current leasing system seems to please both small landowners and big farmers alike.

The table at right compares Ukraine with Egypt and Romania which I visited earlier this year. Ukraine is advanced in many ways, such as literacy and urbanization, but GDP per capita is lower because of the depressed economy. Also, the crisis with Russia has forced Ukraine to increase military spending to 3.8% of GDP versus 2.4% in 2012.

	Ukraine	Egypt	Romania
GDP Growth (2017 est)	2.5%	3.8%	4.0%
Inflation	11.0%	30% +	1.0%
Population (mil)	44.2	94.7	21.6
People / km sq	73	95	91
% Literate	100%	74%	99%
% Literate Female	100%	65%	97%
% under age 15	16%	33%	14%
Life expectancy	71.8	72.7	74.5
% Urban	70%	43%	56%
GDP / cap (PPP)	\$8,200	\$12,100	\$23,300
Electricity/cap kWh	3,234.6	1,511	2,222
% Unemployed	10%	13%	7%
Land (km sq)	603,550	1,001,450	238,391
Market Cap (\$ bil)	\$20.7	\$55.2	\$36.5
Market Cap/GDP	24%	16%	42%
GDP (Official Exch Rate)	\$87.2	\$342.8	\$86.5
GDP % Agriculture	14%	11%	3%
GDP % Industry	26%	36%	35%
GDP % Services	59%	53%	61%
Military exp % GDP	3.8%	1.8%	1.4%

Source: CIA Factbook, June 2017

Another problem is that the population has dropped by 9.5 million since 1993, including 2.5 million removed in 2014 in Donbass and Crimea. 30% of the population is over the retirement age of 55, placing a burden on young workers that has forced many of them to emigrate. A 22% "salary fee" is deducted from incomes to help pay for pensions. Pension reform will include raising the retirement age to 63 and ultimately to 65.

While the dark shadow of Russia overhangs Ukraine, the mood in Maidan Square on a sunny June day is bright. Passing a subway entrance, I heard singing and clapping, so I went down to investigate. There, amid small shops in front of the Globus department store, were six men with four banduras, traditional Ukrainian folk instruments that were restricted by the Russians in the 1870s. After a few minutes among the appreciative crowd, the singers' rousing songs were enough to make one take up arms and march on Moscow.



Bandurists in the mall beneath Maidan Square

Site Visits

It started with one cluck. And then suddenly a thousand chickens in the hen house were frantically squawking and screeching... The sound was deafening - all because I had stepped into the aisle between rows of cages.

In this facility, owned and operated by the agro-industrial company Ovostar, each cage holding six to eight hens is small enough to fit on top of a dining room table. The cages are stacked on shelves, four rows high. Each two story building, the size of a football field, holds 300,000 hens, and there are eleven poultry houses here.

Eggs roll from the cages to belts on the aisles and then converge on the separate factory buildings, where they are disinfected. Most are packaged for fresh sale, while a third of the eggs are used for liquid and dry egg products.

Fortunately, life is going to get better for the hens in some of Ovostar's poultry houses when they start a trial of bigger cages that have benches meeting EU standards.



Two escaped chickens wander the aisle at Ovostar

At least they are safe from bird flu, which is more of a hazard when chickens roam free, especially if they are near a lake that attracts other birds.

Further from Kiev, 150 km across lush rolling hills, MHP's Myronivka poultry factory "processes" 27,000 chickens per hour, 400,000 per day. With 2,100 union workers competing in teams, the factory operates two production shifts plus one cleaning shift 24 hours a day. Henry Ford would be proud of their "dis-assembly line" process.

Because the factory is kept at 2 degrees Celsius, visitors don a yellow jumpsuit, a big white parka and roomy gumboots with warm liners. A hairnet is worn too, but perhaps a shower cap might be preferred when standing under a conveyor of chicken bodies. By that point, they are dripping only water - I am told...

The pace is rapid. It takes only a few minutes from the time a headless de-feathered bird arrives in the clean room for it to be reduced to parts, packaged and sent either to the freezer or to the fresh shipment loading docks.

From grandparents in Germany, MHP buys breeders, with one rooster for every eight hens to produce the chicks. Then a quarter of the birds are harvested at 30 days for the Middle East where they prefer small chickens, while the rest are harvested at 45 days, 2.5 kg each.

All in all, it was an impressive tour. The plant is spotless, hygiene is paramount, and the workers seem content, especially since there are few jobs that pay so well here in the Ukrainian countryside. One can be sad for the chickens, but they are pampered during their brief lives, and they provide an essential source of protein to people around the world. And raising chickens is efficient: it takes only 2 kg of fodder to produce 1 kg of chicken meat (1.7 kg at MHP), while pork requires 4 kg and beef 6 kg.

"The Good Earth" – Pearl Buck, 1931

Ukraine has been called a breadbasket for centuries because of the rich black earth that covers two-thirds of the country. The real story of Ukraine today is not so much animals as crops: wheat, corn, sugar beets and sunflower seed.

This story is increasingly one of world class precision farming. At IMC, for example, yields per hectare have been improving dramatically:

Yield Tons.Ha	2014	2015	2016
Corn	8.1	7.3	9.1
Sunflower	2.6	2.8	3.2
Soy beans	1.7	2.6	3.4

At Astarta, sugar beet extraction rates have been improved, and the company hopes for another 10% gain in five years. Moreover, Astarta's profitability has been enhanced by reducing the natural gas consumption from 49 cubic meters per ton to 26 in ten years, with another 20% improvement possible by 2020. Also at Astarta, five crop sprayers now do the work on 30 hectares that 14 did three years ago.

Investing in the agriculture sector is not for the faint of heart. The companies are buffeted by global and local fluctuations in weather and plantings as well as demand changes. In addition, there can be trade and tariff issues and subsidy changes. In 2017, Ukraine is dropping its VAT relief subsidies, but agricultural companies still benefit from a low tax rate. Meanwhile, subsidies are 35% of factor income in the EU, 14% in Canada and 6% in the US.

Conclusion

“Always look... on the bright side of life” – Monty Python, 1979



Ukraine is not a perfect place by any means, but it is headed in a good direction. Corruption remains a problem, but some progress has been made. Weary drivers report that the traffic police are no longer racketeers, since they have all been fired and replaced with new recruits making a good wage of \$400/month. Also, the head of the railroad has been replaced with a technocrat whose mandate is to remove bottlenecks and perhaps even buy new railcars.

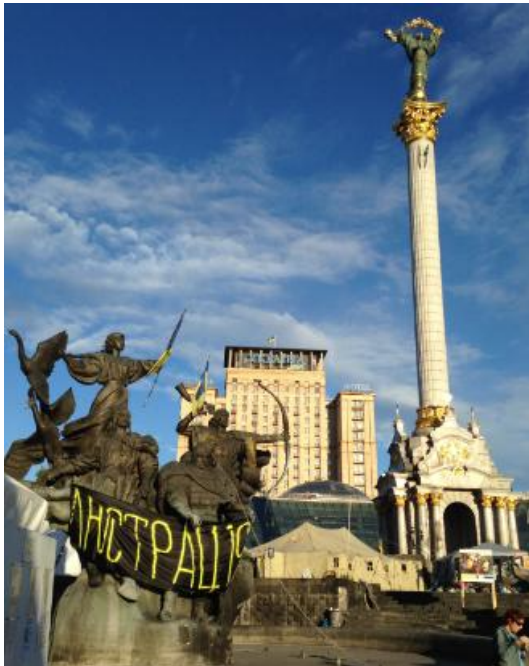
As for stocks, the state of the local market is dismal because of its low liquidity. The stocks to look at are in the agricultural sector and given the local turmoil, they have all chosen to be listed abroad, in Poland or London. Here is a summary of the main players, with their land bank of leased land and their crop focus:

	Mktcap (\$ mil)	PE 2017	Ha Leased	Sugar	Wheat/Corn	Sunflower	Eggs	Chicken	Other	% Export	% Exp 5 yrs
Kernel	\$1,455	6.9x	385,000			100%				95%	95%
MHP	\$927	7.9x	285,000		7%			85%	8%	60%	70%
Astarta	\$413	3.6x	250,000	44%	42%				14%	51%	65%
Ovostar	\$137	4.9x					100%			30%	50%
IMC	\$72	3.1x	136,000		69%	20%			11%	70%	90%

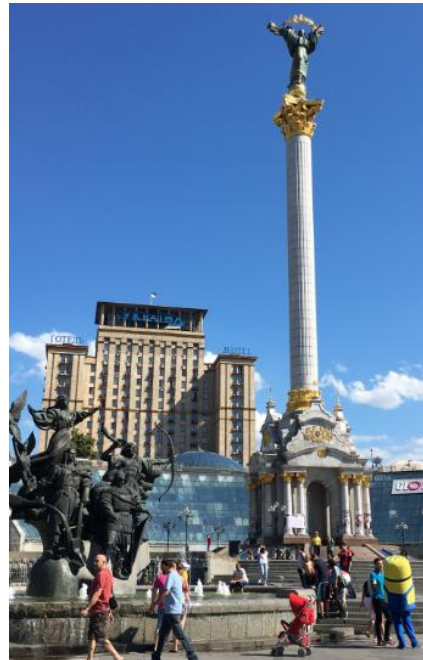
Source: Dragon Capital, FMAM March 2017

Since Ukraine is a mature market for agricultural products, all the companies are focused on exports. To invest, however, one needs to cast off the mindset that quarterly earnings matter. Instead a long-term view is what farmers have, and without that investors will always buy and sell at the wrong times.

Our view is that luck has turned for Ukraine. The country certainly deserves it.



A banner and tent in June 2014



Children and a Minion character in June 2017
Photos by Larry Speidell

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