FOOD PROCESSING EQUIPMENT IN THE RUSSIAN FAR EAST
U.S. Foreign Commercial Service

September 28, 2004

Author: Elena Borodina
Approver: John McCaslin

Source: U.S. Commercial Service Vladivostok

SUMMARY

Since 1999 the Russian food processing industry has been growing at a fast pace. This development was not the same in all the regions of Russia. The Russian Far East (RFE) food processing sector started to develop later, but in 2003 it grew 15%, which is higher than the country average of 5.1% (Goskomstat). Growing consumer demand for new and better quality food products, a healthy economy and further investment from both domestic and foreign sources are stimulating rapid expansion in the local food processing sector, which has created opportunities for U.S. manufacturers of food processing equipment. This report discusses the current situation and future outlook for food processing equipment in the RFE.

MARKET OVERVIEW

According to official statistics for 2003 (Goskomstat - Russian State Statistics Committee), food processing was the fourth largest industry in Russia (after energy, metallurgy, machine-building and metal processing), and accounted for 12% of industrial output. During the first quarter of 2004 the food processing industry grew by 8% in comparison with the same period of 2003.

According to Goskomstat total output (value basis) of the food processing industry in Russia has nearly doubled since 1999, reaching $25.9 billion in 2002. Equally impressive is the fact that net profit for the sector has increased by 50 percent during the same period. The table below details growth for specific product categories:

Table A: Key Indicators For The Russian Food Processing Sector, 1999-2002

	1999	2000	2001	2002	2002/2001 (% change)
Number of businesses (thousand)	22.9	25.4	24.7	23.3	-5.7
Value of food production (billion US$)	14.6	18.7	22.8	25.9	13.6
Net profit (billion US$)	1.0	1.2	1.5	1.5	0
Bread/bakery products (million tons)	9.2	9.0	8.6	8.3	-3.5
Pasta products (thousand tons)	707	704	764	831	8.8
Confectionery (thousand tons)	1,509	1,628	1,793	1,952	8.9
Meat, incl. offals (thousand tons)	1,113	1,193	1,284	1,390	8.3
Sausages (thousand tons)	948	1,052	1,224	1,443	17.9
Dairy products (million tons)	5.6	6.2	6.7	7.5	11.9
Canned/preserved foods (million cans) [1/]					
Vegetables, ex. juices or tomato products	322	386	417	489	17.3
Fruit juice	340	705	1,419	2,199	55.0
Fruits and berries	193	114	118	153	29.7
Tomato juice, paste, sauces, etc.	190	215	278	323	16.2
Dairy products	538	620	677	714	5.5
Canned fish/seafood	486	531	610	598	-2.0
Mineral water (million decaliters)	74	98	122	157	28.7
Vodka/liquor products (million decaliters)	134	123	131	139	6.1
Wine, grape (million decaliters)	18	24	27	32	18.5
Beer (million decaliters)	445	516	637	702	10.2

[1/] **Standard can = 335 grams**
Source: Goskomstat (Russian State Statistics Committee), USDA FAS GAIN Report RS4302

In 2003 growth in the food processing sector slowed down, as the demand for staple products was satisfied. The growing purchasing power of the population has created demand for higher quality products and makes food processing companies invest in new technology and branding. One of the fastest growing sectors in Russia is “healthy nutrition” products.

Recent developments in the Russian food processing sector include the formation of large vertically integrated agro-industrial companies, the slow-but-steady revival of the Russian farm sector, and accelerated investment by foreign companies.

Consolidation through mergers and acquisitions by both Russian and foreign business groups is also accelerating. This development leads to acquisitions of smaller regional manufacturers by large national companies and intensifies competition in the regional markets. The rate of consolidation is higher in the brewery, confectionary, dairy and juice manufacturing industries, but the trend is the same in meat and poultry processing, oils & fats manufacturing and other food sectors. The following table provides an estimate of the level of concentration in these sub-sectors:

Table B: Market Concentration In The Food Processing Sector

Product Sub-sector	Market Value 2002 ($Million)	Market Share – 10 Largest Companies (%)
Beer	2.65	71
Confectionery Products	2.13	60
Non-alcoholic Beverages	1.11	57
Dairy Products	3.92	21
Meat Products	4.66	15

Source: UFG (USDA FAS GAIN Report RS4302)

RFE REGIONAL TRENDS

The importance of the food processing sector for the Russian Far East can be seen from the volume of foreign direct investment going into this industry. In 2003 the RFE food processing industry attracted 65.5 million USD, 2% of total FDI into the region and the fifth biggest recipient of FDI after oil & gas, forestry, mining and metallurgy.

The performance of the RFE food processing industry in 2003 is reflected in the table below. Production in most of the industry sectors grew in 2003, but the contribution of different RFE regions was uneven.

Table C: RFE Food-processing industries' output in 2003

Product	Production output (tons)	% Change over 2002
Meat	11 895.5	+27.6
Sausages	27 259.0	+11.8
Milk products	96 904.9	+4.4
Confectionary	14 695.0	+6.9
Butter	1 640.8	+18.3
Vegetable oil	10 956.0	+24.1
Soft drinks	17 079 400 (gal)	+15.6
Beer	35 297 600 000 (gal)	+58
Bread & bakery	159 748.4	-5
Macaroni & Pasta	3 805	-37.7
Flour	45 100	-16

Source: Regional Goskomstat (published in The Dalnevostochny Kapital #9, 2004)

The increase in production by regions varied significantly: the highest growth in output was registered in Khabarovskiy Krai – 27.3%, in Primorskiy Krai and Sakha Republic – 7%, Amur Oblast – 6%, and other regions registered declines or no growth.

Meat production growth was the highest in Primorskiy Krai – 2.5 times (4235 tons) and Amur Oblast – 30.9% (3305 tons). Primorskiy Krai remains the leader in sausage production – 11, 663 tons, but growth in this sector was the highest in Yakutia, Kamchatka, and the Jewish Autonomous Republic.

The revival of the fishing industry after the new law on quotas has greatly influenced the food processing sector as a whole. Traditionally, fish processing in the RFE was represented by canning and smoking. Although the catch decreased in 2003, the production of canned fish almost doubled. The current trend in fish processing is increasing demand for value-added products – fillets, slightly smoked fish, semi-processed fish and sea food that requires minimum effort to cook. Unlike the dairy or meat processing sector, the fishing industry does not depend as greatly on the regional market, because most production is sold to other Russian regions or exported.

The food processing sector in the Russian Far East is limited by the low population scattered across a vast territory, lack of transportation infrastructure, and a shortage of most agricultural commodities and ingredients because of underdeveloped agriculture. High energy, storage and transportation costs also limit the competitiveness of RFE manufacturers outside their regions.

Most food-processing sub-sectors like dairy, bread & bakery and sausage production have a low level of consolidation. There are still many small food processing companies servicing only their local markets, and a few medium size companies competing within the RFE and Eastern Siberia regions. This situation is about to change. The growing presence of foreign and domestic companies in the regions increases competition and encourages regional companies to invest in modern, fully automated high-capacity production lines to decrease expenses and win a bigger market share. Naturally, only a few successful companies can afford this investment. The examples of vertically integrated food processing companies are: Ratimir (meat processing), VladKhleb (bakery, bread manufacturer), Mikhailovskiy Broiler (poultry).

Local financial groups often own and manage manufacturing companies from unrelated industries. This diversification is already causing problems for the owners, as the competition intensifies and the market calls for the improvement of the quality of their products and the sophistication of their marketing efforts. This situation might lead to divestment of their non-core businesses and further consolidation in various food processing sectors on a regional level.

The acquisition of local manufacturers by large domestic companies has started in some subsectors – dairy (Wimm-Bill-Dann owns Vladivostok Milk Plant), brewery (Baltika built a new plant in Khabarovsk, Rusich (Moscow) has purchased a 67.12% share in the local brewery “Pivoindustria Primorya”). The necessity to decrease distribution costs and maintain quality, as well as the emergence of strong local brands will further stimulate the entrance of domestic and foreign manufacturers into the regional market.

IMPORT MARKET

U.S. equipment

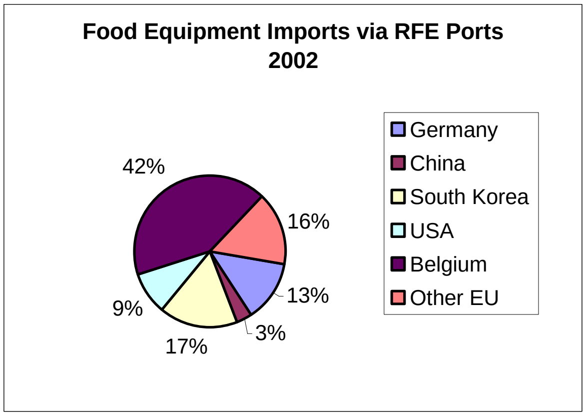
The Russian Far East food industry had strong economic ties with the U.S. West Coast from the early 1990s. As the RFE region has always depended on imported agricultural commodities, many companies importing agricultural products from the USA also purchased U.S. made equipment when they decided to start food processing businesses. The fish processing industry, which exported a lot of its products to the U.S. West Coast, also bought some fish processing equipment for ships in the United States. The first restaurants opened in the RFE after the start of economic reforms also imported U.S. food cooking equipment. This helped to form a positive image for U.S. equipment among local companies.

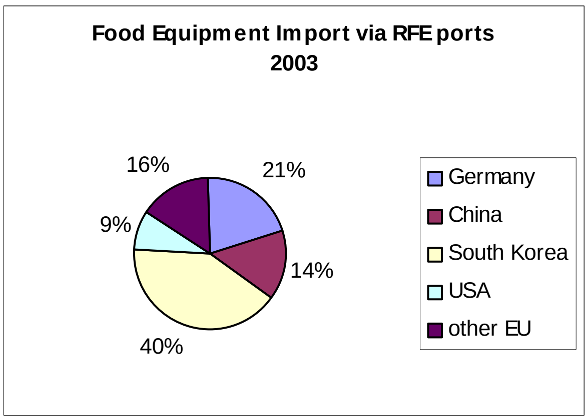
The financial crisis of 1998 put U.S. equipment out of reach for most of RFE businesses. The direct shipping line from the U.S. West coast to the RFE was closed due to the sharp decrease in U.S. exports to the RFE, and transportation costs increased dramatically. The food processing companies in the RFE had to look for alternative suppliers of equipment. There is still a steady demand for spare parts and service for the earlier imported U.S. made equipment. Unfortunately, parts orders take 2.5 months when placed with Moscow based distributors of U.S. brands. Unavailability and high prices for spare parts, long delivery time, high transportation costs along with high prices for equipment quoted by Moscow dealers are the major constraints for U.S. equipment in the RFE market. In 2002-2003 the market share of U.S. equipment was steady at 9%.

Third Country Competition

Large food processors prefer to import new high-capacity machinery. They purchase imported equipment either directly from manufacturers in foreign countries or from their representatives in Moscow and St. Petersburg. Regional distributors of food processing equipment provide service mostly to small and medium size companies, who are satisfied with domestically manufactured equipment or imports from China and South Korea. The majority of deals handled by local distributors of food processing equipment are not for complex technological solutions, but for the sale of some single unit with an average price of 20,000 –30,000 USD.

Currently European and Asian manufacturers dominate the food processing equipment market in the region. The tables and charts below show country of origin statistics (provided by RFE branch of State Customs Committee) for food processing equipment that comes to Russia via RFE ports.





Tariff and non-tariff barriers

High custom duties for equipment remain a barrier for foreign suppliers of equipment and a problem for Russian food manufacturers. Currently the tariff for imported equipment is 5-10%, plus 18% VAT . Also, the importer pays customs processing fees that are 0.05 percent of the value of the equipment paid in hard currency and 0.1 percent of the equipment value paid in rubles. In addition to tariff barriers, certification of imported equipment is a costly and time-consuming procedure. The payment of VAT is made during the customs clearance process, and the State must return it when the equipment starts operating. In reality, VAT is returned to the Russian manufacturer within one year at best. The figures below show the dynamics of imports of different types of food processing equipment to the RFE in 2002-2003.

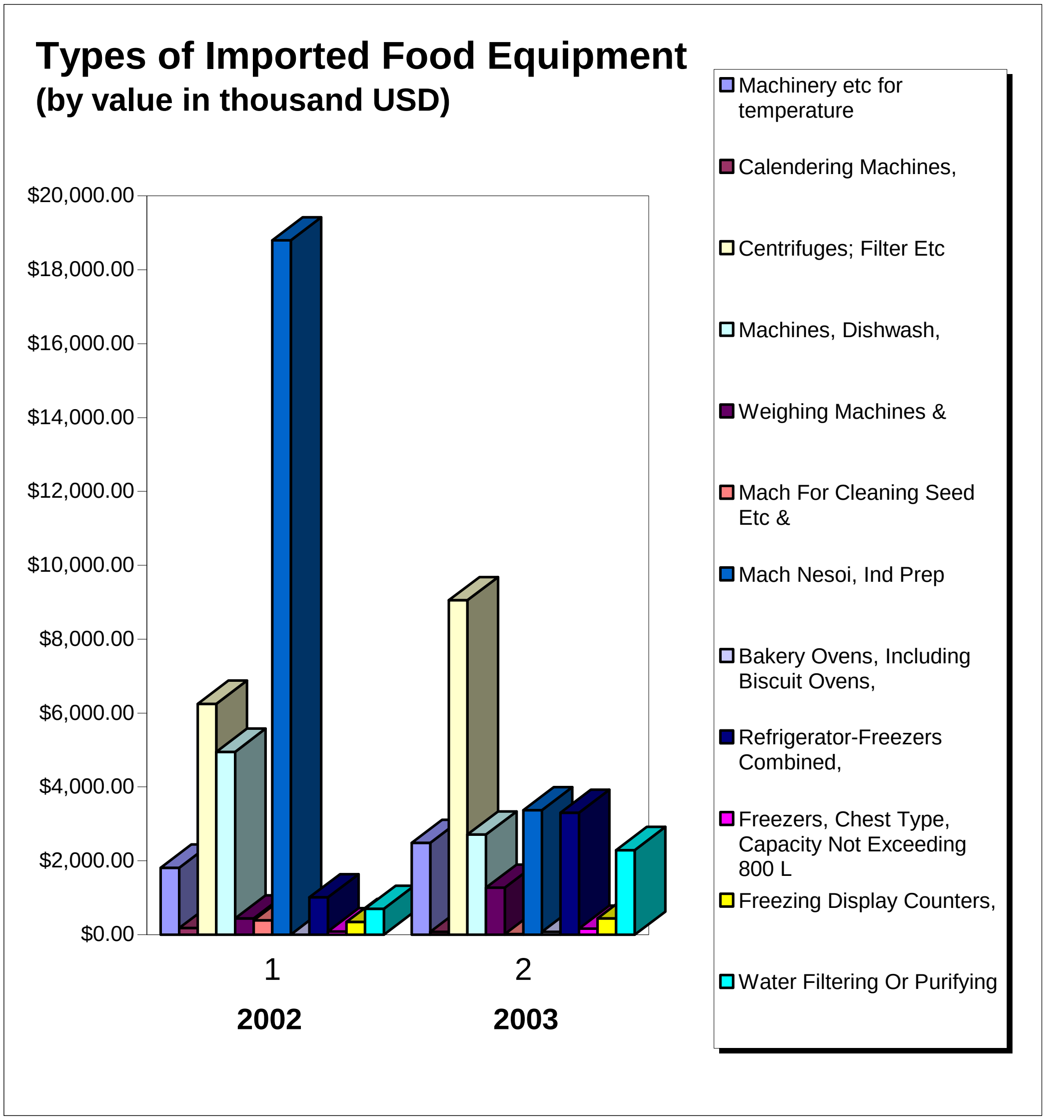

Types of Imported Food Equipment
(by value in thousand USD)
$20,000.00
$18,000.00
$16,000.00
$14,000.00
$12,000.00
$10,000.00
$8,000.00
$6,000.00
$4,000.00
$2,000.00
$0.00
1
2
2002
2003
Machinery etc for temperature
Calendering Machines,
Centrifuges; Filter Etc
Machines, Dishwash,
Weighing Machines &
Mach For Cleaning Seed Etc &
Mach Nesoi, Ind Prep
Bakery Ovens, Including Biscuit Ovens,
Refrigerator-Freezers Combined,
Freezers, Chest Type, Capacity Not Exceeding 800 L
Freezing Display Counters,
Water Filtering Or Purifying

Table D: Types of Imported Food Processing Equipment and Countries of Origin					
HS Customs Code	**Type of Equipment**	**2002 Countries of export**	**2002 Value in USD thousands**	**2003 Countries of export**	**2003 Value in USD thousands**
8419	Machinery etc for temperature change treatment w/heat, Pt	USA	723.78	USA	451.31
		Singapore	689,76	South Korea	489.87
		Germany	571.49	Germany	1544.74
		China	311.17		
		Japan	207.13		
8420	Calendaring Machines, cylynders & parts	China	171.1	China	38.63
		South Korea	10.1	Turkey	22.32
				Finland	11.1
8421	Centrifuges; Filter Etc Mach For Liq or Gases; Pts	USA	1881.84	USA	1453.25
		South Korea	1374.42	South Korea	2777.44
		Japan	1337.15	Japan	1721.04
		Finland	672.1	United Kingdom	1711.11
		Singapore	562.05	China	800.1
		Germany	422.5	Germany	593.49
8422	Machines, Dishwash, Clean Etc Cont & Fill, Pak Etc	South Korea	2528.29	South Korea	229.01
		Germany	1378.57	Germany	2482.08
		Italy	1043.61		
8423	Weighing Machines & Weighing Machine Weights; Pts	Iceland	199.63	China	926.87
		Denmark	115.01	Japan	163.26
		Germany	68.03		
		South Korea	55.36	South Korea	179.76
8437	Mach For Cleaning Seed Etc & Work Cereal Etc, Pts	China	268.36	China	13.1
		Turkey	121.76		
8438	Other machinery for manufacture of food or drink (not animal or fixed vegetable fats or oils); parts thereof bakery, confectionery, cocoa, chocolate, sugar, brewery machinery	Belgium	13704.41	China	820.9
		Denmark	2861.43	South Korea	1149.29
		Germany	2229.49	Germany	1400.28
841720	Bakery Ovens, Including Biscuit Ovens, Industrial, Nonelectric	China	0.6	China	38.63
				Turkey	22.32
				Finland	11.1
841810	Refrigerator-Freezers Combined, Fitted With Seperate External Doors, Compression Type, Volume Under 184 L	South Korea	1011.72	South Korea	2821.66
				Thailand	339.32
				USA	141.06
841830	Freezers, Chest Type, Capacity Not Exceeding 800 L	China	87.29	China	160.44
841850	Freezing Display Counters, Cabinets, Showcases And The Like	USA	31.47	Italy	61.17
		China	311.18	China	342.91
				South Korea	39.98
842121	Water Filtering Or Purifying Machinery And Apparatus			United Kingdom	1591
		South Korea	373.55	South Korea	373.55
		USA	325.08	USA	325.08
Total:			**34959.67**		**25247.17**

COMPETITION

EU manufacturers and distributors of food processing equipment (EMF, Fomaco via Schaller and Polyros) have representatives in the local market, and control supply of their equipment to most large and medium size food processing companies in the region. EU manufacturers offer assistance in financing large projects, arrange leasing, provide service for equipment assembly and personnel training.

Asian suppliers of equipment compete primarily by offering lower prices rather than aftermarket services, financing and training.

Russian manufacturers of food and agricultural processing equipment have a very strong position in the RFE market. Local equipment distributors usually have a dealership agreement with one or several Russian plants. Russkaya Trapeza, Tauras- Fenix, Berdsk Packaging Factory, Gran and other Russian manufacturers have representatives and sometimes showrooms in all major cities of the RFE.

There are a few local suppliers of food processing equipment: Dalremmash (Khabarovsk, Sales in 2002 – 2.2 million USD), Dalrybtechcenter (Vladivostok, Sales in 2002 -1 million USD), Kamre (Petropavlovsk-Kamchatskiy), Parus (Komsomolsk-on-Amur). Most of the local companies assemble the equipment from imported spare parts.

MARKET ENTRY

Distribution Practices

An effective way to enter the RFE market is to start working with local distributors of food processing equipment by supplying various spare parts for U.S. equipment presently working in the market. These companies are familiar with the local market and the financial abilities of prospective customers. Many of these firms also have show rooms and provide pre-sales adjustments and after-sales service for equipment.
An alternative way would be to establish an office in Moscow or St. Petersburg or operate through a Moscow-based distributor, which should have a well developed regional network of dealers.

A joint venture is another possible approach to enter the market. A foreign company could provide management and marketing expertise, while a Russian partner could bring in knowledge of the local market, as well as handle administrative procedures for obtaining product certification, customs clearance, etc.

A key to successful promotion of food processing equipment is availability of the most popular units in the local showroom. Russian distributors do not like to invest their own money in equipment unless they have exclusive rights to distribute it for several years. Provision of showroom equipment in the form of a loan or investment can be an option.

Financing

Financing of sales is the key issue for many equipment manufacturers targeting the Russian market. Domestic manufacturers have limited financial resources. Availability of inexpensive loans or leasing helps Russian distributors to expand sales, and gives them a competitive advantage. Naturally, close cooperation with local banks and insurance and leasing companies is required to secure such deals.

Most major Russian banks have offices in the RFE. Regional banks are also very active and aggressive in working with local clients. There are four very well established leasing companies in the RFE, and most banks offer their own financial leasing instruments.

Investment Opportunities

Technology transfer and assembly of modern food processing equipment from imported parts is a promising way to become established in the local market. Since local demand for equipment is limited, foreign investors should carefully choose the location for their operations. The increasing competition of logistics and freight forwarding companies on the Trans-Siberian Railway might present a good opportunity for covering a larger Siberian and Western Russian market rather than supplying only the RFE. The proximity of Asia can make export-oriented production of equipment in the RFE profitable due to the low cost of qualified labor and relatively inexpensive utilities. Many Russian regions have adopted foreign investment laws that grant significant tax breaks for foreign investors.

Trade Promotion Opportunities and Resources for Equipment Promotion

Participation in a well-organized trade show is one of the best ways for a company to enter the Russian market, facilitating contact with potential buyers and distributors. Trade shows and fairs in the bigger Russian cities are well established and usually attract a large number of visitors. The most popular trade shows are held in Moscow and St. Petersburg, but some regional trade shows represent good marketing opportunities when targeting small and medium size businesses.

U.S. firms are advised to exhibit at Russian trade shows, as they remain a powerful marketing tool and reassure Russian buyers that the company is committed to maintaining its presence in the Russian market. Companies occasionally make substantial floor sales at Russian exhibitions.

Upcoming Trade Show Events:

Event: AgroProdMash - 2004
The 9th International Trade Exhibition for Food Processing Technologies and Packaging.
Date: 03.10.-07.10.2005
Location: Expocentr, Krasnopresnenskaya Naberezhnaya, 14, Moscow

Organizer: Expocentr (http://www-eng.expocentr.ru)
Topic(s): Agriculture, Food industry

Event: Dalpischeprom
Trade Fair for regional food-processing companies, suppliers of equipment and ingredients, trade and food service equipment.
Dates: October 13-16, 2005
Location: 60 Seryshev Street, Khabarovsk 680038, Russia
Organizer: Khabarovsk International Fair
Phone: (7-4212) 718 982, 346-129, 344 736, 340 992
Fax: (7-4212) 346-129, 344-736
E-mail: fair@klan.khv.ru; http://khabexpo.da.ru

Event: Rosupack - 2005
The 9th international specialized exhibition of materials and technologies, machinery and equipment for manufacturing of packaging. Packaging for all industries.
Organizers: MVK, Ministry of Industry, Science and Technologies of the Russian Federation. Locatiuon: Moscow, Sokolniky Exhibition Center
Date: 20.06.2004-24.06.2004
Organizers: MVK (www.mvk.ru)Topic(s): Agriculture, Food industry
www.rosupak.ru

There are many opportunities for U.S. firms to sell food processing equipment and accessories in the Russian Far East. Specifically, the rapidly developing fishing, meat processing, bakery, soft drinks and dairy industries provide opportunities for U.S. firms. The growing number of restaurants, cafes and food service companies provide good potential for the sale of food service equipment. The need for energy, space, and labor-efficient equipment is becoming acute in order to stay competitive.

CS Russia offers assistance to U.S. companies interested in expanding their sales to the Russian market or developing contacts, including identifying distributors and arranging meetings with prospective buyers during business visits to Russia. For more information on CS Russia programs and services, please visit our web site: www.buyusa.gov.russia/en.

For further information you are welcome to contact the author of this report at CS Vladivostok:

Elena Borodina
U.S. Commercial Service Vladivostok
32 Pushkinskaya Street
Vladivostok, Russia, 690000
Tel.: (7-4232) 499-381
Fax: (7-4232) 300-092
E-mail: Elena.Borodina@mail.doc.gov

Internet: www.BuyUSA.gov/russia/en/

For additional information regarding market research specific to your products and services, ask about our Flexible Market Research and Customized Market Analysis programs by contacting us at 1-800-USA-TRAD(E) or www.export.gov or www.buyusa.com. Both reports provide timely, customized, reliable answers to your inquiries about a market and its receptivity to your products and services.