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Ukraine Agricultural Development Company (UADC)

Design of a Farm Finance Company for Ukraine

Contract No. CCN-0005-C-00-3123-00
Task Order #18
Prepared by Deloitte Touche Tohmatsu ILA Group Ltd.

Final Report

Submitted to:

USAID

AID/W Office of Enterprise Development
ENI/ED/AG

Deloitte Touche Tohmatsu International

February 1996

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EXECUTIVE SUMMARY

The Agency for International Development issued Deloitte Touche Tohmatsu ILA Group Ltd. a task order under its Omnibus Privatization contract to conduct "a rapid assessment and design of a financially self-sustaining private agricultural financial company for Ukraine, specifically targeted to provide short and medium term financing to Ukrainian farms." The ILA Group conducted the task order during the period from September 1995 through January 1996 with a team of two core staff members ably assisted by two independent consultants, Mssrs. Frank Naylor and Ken Peoples. The task order was conducted with the full participation and helpful support of the Citizens Network for Foreign Affairs as stipulated in the terms of reference.

Three basic conclusions emerged from the task order which form the basis for recommended follow-up action by AID. These conclusions are as follows:

1. ***An agricultural financing facility such as the Ukraine Agricultural Development Company (UADC) is not simply in the best interests of its equity participants; it is in the best interests of Ukraine.***

2. ***U.S. Government (USG) involvement in catalyzing the creation of such an institution adds significant value and should be pursued.***

3. ***The Agency for International development is the best indicated institution for channelling USG assistance in this endeavor.***

The task order accomplished the following specific results:

1. ***It rendered a conceptual design for a financing facility which best satisfies the diverse requirements of its potential shareholders.***

2. ***The interest of lending institutions capable of leveraging shareholders' equity was raised to the extent that serious proposals are now forthcoming.***

3. ***A Steering Committee has been formally constituted by prospective shareholders and charged with the mandate of implementing the conceived facility.***

4. ***Participation pledges were received by 7 companies representing $8.5 million in equity by January 31, 1996 and several other companies are still weighing the option to become a sponsoring investor in the UADC.***

The main recommendation presented as the outcome of this study is that ***the U.S. Government should commit to supporting the creation of the UADC.*** It should assign responsibility to carry out this task to AID and encourage the Agency to lend financial and moral support to the venture. In financial terms, it is recommended that AID structure a package of $3 million in administrative support to be provided on a grant basis together with $10 million in reimbursable start-up equity. The exact terms and conditions of the grant and the interest-free equity should be determined through a process of negotiation with the Steering Committee as agents for the company in formation AID should remain sensitive to the concerns of the UADC's private sponsors and strive not to erode their sense of ownership and responsibility for success of the enterprise. It is probably in Ukraine and the U. S. Government's best interest, however, for the UADC to involve as large a number of shareholders in the facility as is possible. Accordingly, it would be appropriate for AID to condition its equity participation on a provision to keep the capital subscription open to new investors during the entire time that their interest-free equity is on loan to the organization. This would, in effect, give the UADC the incentive to find new investors to buy down and replace the U.S. Government equity in the venture. AID will need to determine a mechanism through which to channel funds to the UADC. It will be essential to assign accountability and to introduce safeguards such that AID's financial contributions are appropriately managed and repaid. Various options are available and are advanced in the report.

Provided below is a synopsis of the recommended design and structure of the UADC.

Organization

- The design envisions a US company with its principal office in Europe and a representative office in Ukraine. The UADC would invest debt and equity in an affiliated leasing company operating in Ukraine. Suggested staffing has intentionally been kept at a minimal but adequate level to assure sound business operations.

Mission

- UADC will provide short term secondary or wholesale financing of suppliers/distributors input receivables to farm enterprises and intermediate term credit directly or through an affiliated leasing company for equipment.

Capitalization

- UADC capital consists of $20m from participating companies and $10m through a USAID reimbursable grant. An additional non-reimbursable USAID grant to cover some portion of the UADC administrative expenses will be provided. The terms and conditions of USAID grants must be negotiated with the incorporating shareholders.

Funding

- Leveraging may be obtained using a series of "loan pools" supported by various shareholders, UADC, and third party guarantees. These "loan pools" would be sold to international banks and institutional investors. The guaranteed pools, both funded and unfunded, would consist of Ukrainian agricultural input receivables of the companies also providing guarantees to financial institutions. The percent of guarantee would vary based on the terms and conditions established for that pool. The non-guaranteed pools would consist of loans enhanced by UADC, modest company guarantees, or third party guarantees.

- Leveraging for guaranteed pools has been assumed at graduating scales starting at $100m and increasing by $100m each year based on interested companies suggestions. Actual leveraging will depend upon negotiations with international banks and investors with UADC management and participating companies.

- Additional funding would be sought from international financial, and donor institutions, and international export-import facilities.

Leasing

- Debt and equity investment in an affiliated leasing company operating in Ukraine would provide medium term financing for agricultural and food processing equipment. Experience of a European based leasing company in the region has generated leveraging of 7 to 1. The leasing operation would be enhanced by UADC credit bureau and assistance in barter contract liquidation facilitating lease payments. UADC and the leasing company could provide combined financing package.

Credit Bureau

- UADC would establish a credit bureau consisting of the shareholders' collective credit information of distributors and farm enterprises in Ukraine. Information would be held confidentially and provide shareholders with categorized credit rating checks. No detailed customer information would be disclosed.

- Participating companies will have exclusive access to the UADC credit facility.

Credit Review

- Any credit receivable submitted for financing to UADC would be subject to an independent credit review. The review will depend upon the suppliers and distributors credit policies, customers' past repayment performance, and other information gained from the credit bureau. The review must provide the UADC with sufficient information to assess the likely repayment of the underlying credits.

Credit Allocation

- The design envisions that the capital of the companies should be available on an annual basis to finance their creditworthy customers. Any additional leveraging obtained by the UADC, including the USAID contribution, should be available to all creditworthy financing requests on a free market basis. Any US company wishing access to UADC credit facilities may be offered to invest in the UADC on terms and conditions, including any premium based on its value as a going concern, established by the UADC board of directors.

Insurance

- The World Bank is establishing a new political risk insurance program which could protect UADC and its shareholders against inappropriate government interference that adversely affects the economic value of the contractual agreements in Ukraine.

Sourcing

- Inputs eligible for financing by the UADC may need to be primarily though not exclusively US sourced. US AID will provide additional information on this subject.

This design is meant to serve as a guide for the companies to use as they determine how to develop and incorporate an actual farm finance company. Any and all design features are subject to change by the companies. Companies must undertake their own due diligence with respect to each aspect of the design including evaluating all legal, tax, accounting, and operational issues. It is expected that a steering committee of participating companies will need to consider and resolve each issue during the course of formation of the company. As a high risk venture, the participating companies should be prepared to lose any investment made in the credit company.

The design team sought to develop a design that meets the broadest range of strategic objectives of the companies interested in a farm finance company for Ukraine. A principal objective is to encourage participation by the largest possible group of agribusinesses in the establishment of the UADC. The design team recognizes that the UADC must provide significant benefits not readily obtainable by the companies individually in order to encourage their participation. The design specifically addresses the issues and provides the benefits that companies indicated were most important to them in supporting the expanded growth of the US and multinational agribusiness community in Ukraine.

1.0 INTRODUCTION

Ukraine has traditionally been known as the "bread-basket" of the former Sovier Union yet its agricultural performance has long been judged to fall short of its absolute potential. This "opportunity loss" from a resource base which is Ukraine's greatest source of international comparative advantage is particularly cruel in this era of economic transition. A revitalization of agriculture is absolutely essential for a turnaround of the Ukrainian economy and, if properly managed, could spearhead the overall transition to a market driven economy.

The lack of agricultural credit granted on a sound business basis is considered a primary bottleneck to the transformation of the Ukrainian agricultural sector. Demand for such credit is extremely strong and stems from a variety of sources, including individual farms, collective or joint stock company farms, state farms and private farm enterprises. While many are private or are undergoing some form of privatization, they have not yet been given ownership of their land to the extent that it can be mortgaged. The bottom line, as described in Appendix E, is that Ukraine's agricultural sector is still subject to extensive government regulation and influence, both direct and indirect. While many formal initiatives are underway to dismantle the State machinery in relation to this sector, (including liberalization of trade and pricing policies) there is a dire need to introduce complementary private sector influences directly into the dynamics of Ukraine's agricultural sector.

Ukraine's financial sector does not adequately meet the requirements of farming clientele. All agricultural producers need access to agricultural inputs in the way of seeds, fertilizer, crop protection, machinery, equipment, and technology to enable them to generate yields sufficient to cover costs and provide good returns. As described in Appendix F, the formal financial sector is currently providing very little financing to the agricultural sector. The primary agricultural bank, Bank of Ukraine, is overburdened with large non-performing loan portfolios allocated to state-owned farming enterprises and limited new financing continues to favor the state sector. The former state system of directed credit and agricultural subsidies from the Ministry of Agriculture and Food is being dismantled as it has been recognized as too costly for the government. While the Ministry has a number of plans for other programs to support the agricultural sector, none are likely to provide Ukrainian producers with financing to obtain the inputs and equipment they need.

In the presence of strong demand, and in the absence of adequate supply, international agribusiness firms have been providing credit for agricultural inputs through a network of Ukrainian distributors. Many have experienced significant losses in the process due to government crop export bans, failure of producers to repay and a variety of other reasons. In an effort to make input credit available during 1995, USAID developed a $175m Exim credit package that would have guaranteed payment of international suppliers. Technical difficulties in administering the program plus problems linked to the need for a sovereign guarantee of Exim financing rendered this package inoperable. The above factors have made it clear that alternative channels are needed in order to meet the credit needs of Ukraine's farming community. This is basis for wide agreement on the need for a private agricultural financial institution in Ukraine which could provide short and medium term credit for agricultural inputs and machinery.

In July 1995, at a USAID conference on agriculture in Kiev, US agribusinesses endorsed USAID/Ukraine's program of sponsoring the development of farm service centers through innovative public/private partnerships. It was further agreed that the lack of agricultural credit was hampering the modernization of Ukrainian agriculture but that this could be mitigated through the development of an agricultural finance facility. The conference participants also agreed that private companies should drive the creation of such a facility and that they should contribute the major portion of the facility's capital and provide for its operation. As a result of these discussions, the Agency for International Development issued Deloitte Touche Tohmatsu ILA Group Ltd. a task order under its Omnibus Privatization contract to conduct "a rapid assessment and design of a financially self-sustaining private agricultural financial company for Ukraine, specifically targeted to provide short and medium term financing to Ukrainian farms." The terms of reference for the study are presented in Appendix A. The following report presents the results accomplished under the task order together with a recommended course of action for the U.S. Agency for International Development as it carries this innovative concept into an implementation phase.

2.0 CONCLUSIONS, RESULTS AND RECOMMENDATIONS

2.1 Conclusions

Three basic conclusions emerge from this task order. These form the premise for a recommended course of follow-up action by AID. The conclusions are as follows:

1. ***An agricultural financing facility of the type proposed here is not simply in the best interests of its equity participants; it is in the best interests of Ukraine.***

2. ***U.S. Government (USG) involvement in catalyzing the creation of such an institution adds significant value.***

3. ***The Agency for International development is the best indicated institution for channelling USG assistance in this endeavor.***

Best Interests of Ukraine. Our terms of reference called on us to design an agricultural financing facility, not to assess the feasibility or validity of such an institution. Naturally, however, we were concerned to validate the premise that such a facility was indicated for the development needs of the country and that the concept could be rendered operable. The proposed design meets both of these tests. It meets the development needs of Ukraine in that it succeeds in introducing sorely needed private sector discipline into the economy and it does so in a manner which places the foreign participants in simultaneous competition with each other. Not only will the facility's shareholders jockey for market share with each other, they will expose the whole of the Ukrainian production chain (from producers and processors to traders and distributors) to competitive pressures. This will have the effect of compressing uneconomic behavior and establishing benchmarks for minimum performance standards throughout the sector. The inclusion of Western banks as partners in the facility adds a further set of benefits by introducing international banking pressures and principles into the Ukraine even if the foreign entities themselves are not present. The concept for the facility is operable insofar as it is designed to be a secondary financing institution and will operate largely off-shore. In this respect, the facility can begin operations with immediate effect and will not be stymied by the red tape which would accompany a highly visible direct presence. Ukrainian officials positioned high up in the Central Bank vigorously endorsed the notion that this would be an effective, acceptable approach to meeting the agricultural credit needs of their country.

U.S. Government as Catalyst. The U.S. Government, via USAID/Ukraine and the ENI bureau, has already played a tremendously valuable role in fostering the development of the idea at hand. The concept of an agricultural finance facility was an idea which originated from the private sector and USAID/Ukraine recognized it instantly to be a good one. It also recognized that the inherent competitiveness of private interests was such that nothing would likely emerge without the introduction of an impartial broker to harness various interests. In awarding a task order to design the facility, the USG has taken a first positive step in catalyzing the creation of the Ukraine Agricultural Development Company (UADC). It is appropriate at this juncture that it follow with a second step to lend a modest degree of financial support to the enterprise thereby ensuring its creation. USG *intent* to support the institution is perhaps as valuable as the *volume* of that support. The companies which are contemplating equity participation take great comfort from knowing the U.S. Government is a participating sponsor of the venture. This gives the concept more credence vis-a-vis discussions with the international banking community and provides a measure of comfort and support vis-a-vis the interface with Ukrainian officialdom. We conclude that U.S. Government financial support to the UADC adds significant value and is appropriate in the circumstances. Such support should be set at a level just sufficient to play a catalytic role and not so substantial as to dampen the assumption of leadership, responsibility and risk by private interests in the enterprise.

AID is the preferred channel for USG support. The Agency for International Development is, in our opinion, the most appropriate and propitious channel for funnelling a package of USG assistance to the UADC. This is so because the Agency's purpose is to be a change agent in the recipient country consistent with the interests of its American constituency. Ukraine is facing a critical fork in the road. AID represents the U.S. Government's best placed foreign policy tool through which to constructively influence Ukraine's choice of economic path. Moreover, time is of the essence in Ukraine's evolution and AID is equipped to act with the speed and flexibility required by the current circumstances.

The possibility of channelling support via alternative USG institutions was explored and ruled out in the course of this study. In particular, the possibility of lending support through the Overseas Private Investor Corporation (OPIC) was examined. The critical drawback of OPIC involvement is that this channel entails the need for a sovereign guarantee on the part of the Ukrainian Government. This requirement has been the ultimate show-stopper for other initiatives in Ukraine, most recently the financing package which was to be channelled through the Exim Bank. The private companies attracted to this venture are interested in an expedient solution to the credit problem. They are willing to accept an increased degree of risk in exchange for increased efficiency and effectiveness. OPIC, therefore, is not the preferred channel of the participating companies.

The possibility of channelling support via the West NIS Fund was also explored. The West NIS Fund exists for the purpose of taking equity positions in private Ukrainian enterprise. The UADC will exist more for the purpose of providing short term agricultural credits rather than to take stakes in the economic future of Ukrainian enterprise. Moreover, as is detailed in Appendix E, the prospective clientele of the UADC is not entirely private. On the contrary, Ukraine agriculture still has a long way to go in its transition from predominantly public to predominantly private. While, by its charter, this is a constraint to West NIS participation in the venture, it is not considered a drawback by the private sector proponents of the facility. There is however a subset of interests shared by the UADC and the West NIS Fund. Both entities have an interest in medium-term equipment financing but demand is so great in this area that it outstrips the potential of both entities put together. It seems appropriate to introduce two players in this market rather than limiting the niche to one. In addition, there is tremendous complementarity between UADC and West NIS roles with respect to distributors and other middle-men in the agricultural chain. West NIS proposes to structure packages designed to shore up and support this critical link in the chain. UADC and its sponsoring companies have every interest in seeing this done. Our conclusion is that the UADC and West NIS Fund are neither duplicative nor competitive; rather the two institutions are complementary and each has a vital role to play in the Ukraine economy.

2.2 Results

In carrying out this task order the following specific results have been achieved:

1. ***A conceptual design for a financing facility which best satisfies the diverse requirements of its potential shareholders has been developed.***

2. ***The interest of lending institutions capable of leveraging shareholders' initial equity has been piqued to an encouraging degree.***

3. ***A Steering Committee has been formally constituted by its private sponsors and charged with the mandate of implementing the conceived facility.***

4. ***A substantial degree of intent to participate in the formation of the UADC has been secured from U.S. agribusinesses.***

Conceptual Design. The design for the UADC is presented in full detail in the following chapters. It should be noted that the design team was cognizant of the fact that, in order to achieve success under this task order, it would need to satisfy as many interests as feasible among the pool of potential stakeholders in this facility. For this purpose, the design team devoted a great deal of effort to the iterative process of consultation in order to directly involve as many interested stakeholders as was possible before coming up with final recommendations. Whereas the team began by presenting potential investors with a conceptual design for the facility, this prescription underwent a significant metamorphosis before emerging in its final form. The consultative process involved various organs of the U.S. Government and the international donor community in addition to a multitude of U.S. and European agribusinesses. The Citizens Network for Foreign Affairs, AID's grantee charged with spearheading public/private agribusiness partnerships in the Ukraine, was instrumental in helping to arrange venues for this process.

Potential for Leverage. Many of the agribusinesses expressing interest in participating in the UADC were already involved in the business of granting supplier credit to their distributors or their farm level customers in Ukraine. Accordingly, there was a natural insistence that any new vehicle for channeling credit would need to offer added value as compared to what companies could independently achieve in the Ukrainian market. This premise was understood by the design team hence the achievement of enhanced leverage potential from a base of equity contributions was considered to be key to soliciting broad participation. In other words, it was essential to design a facility which, in total, would have a capacity greater than the sum of its parts. Both the design team and the interested companies felt that there would be greater chance of eliciting debt financing on the part of U.S. or European financial institutions if they realized that the facility drew on the combined strength of many corporations. This premise has indeed turned out to be valid. Although the U.S. banks contacted have so far remained aloof to the idea of participating in the UADC, a number of European banks including West Deutscheland Bank (West LB) of Dusseldorf and Union de Banques Suisse have received the concept warmly. Other banks are also thought to be interested and concrete steps to firm up competitive terms and conditions for debt financing are being pursued under a second phase of activity sponsored by the CNFA and the UADC steering committee.

It is interesting to note that the banks are attracted not only by the potential synergy of the facility and the opportunity it gives them to develop banking relationships with some of the world's top agribusinesses, but also by the fact that it opens an avenue to comfortable participation in meeting Ukraine's demand for credit. (The latter aspect points to the potential for significant positive externalities which could arise for the Ukraine from this project with respect to the introduction of competitive forces in Ukraine's financial sector.) It is also worth noting that the potential to achieve added leverage does indeed make the package more attractive to potential participants. A number of companies have decided to re-evaluate their initial negative stance on the project and this is being strategically managed by the Steering Committee. In the final analysis, as the likelihood of introducing a leverage kicker to UADC equity increases, so does the attractiveness of the UADC. This trend will provide momentum to the project and favor increasingly wider participation in the facility. Assuming that broad participation is a key objective of U.S. Government support for the entity, this outcome could be maximized by keeping the capital subscription period wide open for a while to come.

Steering Committee. Appendix C presents a list of those companies to whom the detailed conceptual design document was sent in early December. All of these companies were invited to decide at that stage whether they were interested in further involvement with the formation of the UADC. If so, they were asked to communicate their intent in writing and were invited to participate in a pre-organizational meeting set for December 19th, 1995. The December 19th meeting brought together the design team, members of CNFA plus twelve representatives of eight companies having a clear intent to pursue the formation of the UADC. The group agreed to a number of next steps, including the formation of an interim steering committee and the selection of John H. Costello, President of CNFA, as Chairman. The steering committee acknowledged that, while the overall trend was positive, the level of participation was still well below the $20 million target and all parties agreed to an action plan aimed at keeping momentum alive. In addition, it was decided that CNFA's legal counsel would be instructed to prepare a draft set of articles of incorporation, bylaws and the language for a subscription agreement. The formation of this steering committee was a remarkable achievement in and of itself. It gives testimony to the fundamental validity of the concept and it also provides AID with a point of contact for further interaction in the formation of the venture.

Participation. As at the end of January 1996, verbal or written indications regarding participation had been received from 28 potential investors in the UADC. Seven companies had responded positively with a serious intent to be included. Their pledges were communicated in writing and outlined various conditions for their participation. The maximum level of equity pledged by these companies would amount to $8.5 million. Additionally, six other companies were known to be still seriously considering the benefits of joining the venture. Their participation could potentially raise the total equity pledges to $11.5 million. Five other companies had indicated that they were still reviewing their decision without indicating which direction they were leaning in. Nine companies had, by that time, been able to conclude that the concept was not of interest to them or that they did not wish to participate. A tally of the company responses is presented on the following two pages and those letters which were received are all presented in Appendix B. Although the volume of equity pledges is still short of the desired target of $20 million, the trend is encouraging and the sponsoring core of companies is eager to continue the process of seeking participants. The steering committee is now driving the effort to solicit more equity and wider participation and this is likely to gain significant momentum once the banks' offers of debt capital are firmed up.

The conditions attached to participation by individual companies reflect reasonable concerns which must be addressed by the Steering Committee's legal counsel when drafting the shareholders' agreements. For example, Dow Elanco, Rhone Poulenc, Case and Monsanto all condition their participation on the raising of a minimum of $20 million in private equity and Rhone Poulenc and Monsanto add the conditions that a minimum of 10 or 15 companies respectively should be included in the shareholding structure. These stipulations are encouraging: they indicate that the companies appreciate the synergy offered by a cooperative venture and hence perceive wide participation to be in their best interest. Given the degree of participation obtained to date, the presence of a Steering Committee and the fact that suppliers of debt capital are now coming up with competitive offers for leverage, it is reasonable to conclude that momentum will continue to build and it is worth keeping the project alive for some more months to come.

Ukraine Agricultural Development Company

Company Response and Participation

Company	Participation	Letter of Intent Received	Lower Amount Indicated	High Amount Indicated	Company Interest Continues	Follow-up Planned
			Contribution Levels			
Dow Elanco	Y	Y	$2,000,000	$2,000,000		
Case	Y	Y	$1,000,000	$2,000,000		
DuPont	Y	Y	$500,000	$1,000,000		
Kiev Atlantic	Y	Y	$100,000	$500,000		
Iowa Export-Import	Y	Y	$100,000	$500,000		
Rhone Poulenc	Y	Y	$500,000	Potential Increase Yr. 2		
Monsanto	Y	Y	$500,000	$2,000,000		
Total Number "Letter of Intent Received:	**7**		**$3,700,000**	**$8,500,000**		
Companies known to have continued interest, but internal reviews or clearances are still in progress. Estimated amounts reflect discussions.						
Zeneca	YQ	N	$1,000 000	$1,000,000		
BASF (German)	Favorable but undecided					
FMC	YQ	N	$1,000,000	$2,000,000		
AgrEvo	Favorable but undecided					
Cargill	Favorable but undecided					
New Holland	Favorable but undecided					
Bayer AG	Favorable but undecided					
Subtotal	**6**		**$2,000,000**	**$3,000,000**		
Total estimated numbers	**14**		**$5,700,000**	**$11,500,000**		

Y = Yes
YQ = Qualified Yes
U = Undecided
N = No

Ukraine Agricultural Development Company

Company Response and Participation

	Contribution Levels					
Company	**Participation**	**Letter of Intent Received**	**Lower Amount Indicated**	**High Amount Indicated**	**Company Interest Continues**	**Follow-up Planned**
Companies still in review process and intentions are not yet known.						
DeKalb	U				U	Y
Valmont	U				U	Y
Caterpillar	U				U	Y
Uniroyal	U				Y	Y
Eli Lily	U				U	Y
Subtotal	**5**					
Companies indicating no continued interest or deferring action at this time						
Sandoz Agro	N				U	Y
Pioneer	N				N	N
Deere	N				N	N
FATA Hunter	N				U	N
Butler Manufacturing	N				U	N
Triple F Feeds	N				U	N
Golden Bear Apples	N				U	N
Ciba Geigy	N				U	N
Cyanamid International	N				N	N
Subtotal	**9**					

Y = Yes
YQ = Qualified Yes
U = Undecided
N = No

2.3 Recommendations and Next Steps for AID

The main recommendation presented as the outcome of this study is that ***the U.S. Government should commit to supporting the creation of a private agricultural finance facility for the Ukraine.*** It should assign responsibility to carry out this task to AID and encourage the Agency to lend financial and moral support to the venture. AID should keep alive the momentum gained to date as the various stakeholders in the institution work out their modus operendi. This may require some patience insofar as the various stakeholders have naturally competing interests and the process of arriving at a good quality shareholders' agreement may take some time. AID can and should remain a facilitator in the pre-organizational stage of development by acknowledging CNFA's role as a key proponent of the venture. CNFA and the Steering Committee should be given scope to carry the ball forwards with soliciting additional capital both in terms of debt and equity.

In financial terms, it is recommended that AID structure a package of $3 million in administrative support to be provided on a grant basis together with $10 million in reimbursable start-up equity. The exact terms and conditions of the grant and the interest-free equity should be determined through a process of negotiation with the Steering Committee as agents for the company in formation. It is recommended that AID remain flexible in structuring its own conditions for intervention recognizing that the degree of risk a stakeholder is willing to take in the venture should correlate with its influence over the genesis of the organization. Ultimately it is in everyone's best interest if the enterprise is truly private hence AID should remain sensitive to the concerns of the UADC's private sponsors and strive to not erode their sense of ownership and responsibility for success of the enterprise. It is probably in Ukraine and the USG's best interest, however, for the UADC to involve as large a number of shareholders in the facility as is possible. Accordingly, it may be appropriate for AID to condition its equity participation on a provision to keep the capital subscription open to new investors during the entire time that their interest-free equity is on loan to the organization. This would, in effect, give the UADC the incentive to find new investors to buy down and replace the U.S. Government equity in the venture. On another front, it is recommended that AID accept the need for a headquarters office to be established in a European country of other location in the band of European time zones. The choice of locations should be driven by business considerations rather than the perception

Eventually, AID will need to determine a mechanism through which to channel the funds to the UADC. It will be essential to assign accountability and to introduce safeguards such that AID's financial contributions are appropriately managed and repaid. Various options are available. One choice would be to disburse the funds directly to the UADC while assigning responsibility for auditing UADC's performance to a third party contractor. Under this scenario the third party would get involved only after the disbursement phase of the operation and its services would essentially audit the UADC's managerial and financial performance. In this respect the auditor would not share responsibility for the performance of the UADC; it would merely act as a watchdog and report on such. An alternative would be to disburse the funds to a competitively selected contractor, NGO or other entity. This party would exercise oversight of AID's interests in the UADC through both the disbursement and the repayment phases of the operation. Under this scenario, AID could assign a greater degree of responsibility to the overseer for the actual performance of the UADC vis-a-vis its repayment of the equity. It could create an incentive for a third party to take on this challenge by agreeing to involve them in the eventual re-deployment of the reimbursed equity for new purposes after successful collection. Under either scenario it is acknowledged that the third party will need to be independent of the UADC in all material respects.

3.0 APPROACH AND PREMISES OF THE DESIGN

In designing a finance company, hereinafter referred to under the working name of "Ukraine Agricultural Development Company " (UADC), the design team considered and evaluated all options described in the Task Order description as well as others provided by interested companies. The team was instructed by USAID to develop a plan that could begin implementation, at least on a limited basis, by early 1996 thus a propensity for an expedient solution was key in the design. Additionally, it was understood that the roles of USAID and the design team were to act only as catalysts and that the real drivers of the venture should be the investing companies.

Accordingly, the design team took an approach that elevated the importance of the views of potential stakeholders. A constant series of information gathering meetings was held with executives of US and multinational agribusinesses in the US, Brussels, London and Kiev. In Kiev, the team met with Ukrainian agribusiness executives, farmers, government officials, and banking institutions. In New York and London members of the team discussed potential leveraging options with international financial institutions, insurance companies, and commercial banks. To evaluate possibilities for incorporating a leasing company into the structure, team members and interested companies met with representatives from an existing leasing company, already serving countries in the region. The team also conducted field reviews of distributor facilities and gathered agricultural and banking data relevant to the objective of the project

The team initially designed UADC to provide primary credit directly to the farm as was proposed under the Task Order TOR. Under this scenario, the UADC credit analysis would focus on the repayment ability of the farm. It would require establishing field credit offices located in or nearby input and equipment distributor facilities to accept credit applications from farm customers of suppliers and distributors and so on. After returning from Ukraine and getting feedback from interested agribusinesses in a meeting held in D.C., the premises of the task order and the parameters of the design were revisited. Potential investors suggested some major changes impacting the design. The primary changes were as follows:

- **Direct primary lending for input packages was changed to secondary lending.** Interested companies expressed a dominating view that the UADC should not attempt to supplant the primary role currently played by themselves in the input supply chain. The new design substitutes the purchase of suppliers' receivables by the UADC for the previously considered direct lending role.

- **The concept of formal securitized lending was surrendered in favor of character-based lending.** The original design called for securitized lending whereby the UADC would make loans to Ukrainian farmers guaranteed by formal collateral. An analysis of Ukraine's legal/regulatory environment revealed Ukrainian contract law to be in its infancy and therefore unreliable or ineffectual. Inasmuch, a reliance on this approach would not add much benefit in the way of managing risk but would likely decrease the expediency of lending. Instead, it was discovered that most companies supplying inputs into Ukraine do so on the basis of relationships which both parties have an interest in making last for the future. Accordingly, lending tends to be character-based and the decision to grant supply credits is largely tied to the suppliers' estimate of the clients' capacity to generate revenue necessary to pay off the credit. Security is obtained in the form of barter contracts which are assigned to the creditor. Moreover, the companies felt that if character-based credit were to be managed through a pooled mechanism such as the UADC, the default risk to the borrower would increase because the default would violate the trust of a multi-party relationship rather than only that of a two-party relationship. For these reasons it was decided to premise the design upon a pooling of risks to be minimized through character based lending rather than stressing the improvement of formal securitized lending.

- **The need for medium term credit was addressed via incorporation of a leasing affiliate.**
  Upon visiting Ukraine it became clear that given the fragile state of the economy and legal environment, medium term credit would hold considerably less risk via leasing arrangements. Under leasing the physical ownership and control of the asset remains with the lessor. As such, it is easier to repossess the equipment than would be the case under financed sales. Moreover, with leasing the lessor can impose certain conditions such as regular servicing and maintenance and other safeguarding measures. Together these were felt to favor leasing as the preferred tack for addressing Ukraine's medium term agricultural credit needs..

4.0 CONSULTATIONS WITH POTENTIAL STAKEHOLDERS

Aside from continuing discussions with prospective investors, consultations were also held with other potential stakeholders. Discussions with international financial institutions such as World Bank, International Bank for Reconstruction and Development (IBRD), European Bank for Reconstruction and Development (EBRD), International Finance Corporation (IFC) and Western-NIS Enterprise Fund provided valuable input to the design.

4.1 The World Bank and the European Bank for Reconstruction and Development

The World Bank representatives indicated that they had a significant interest in the development of an agricultural credit facility in Ukraine. The World Bank is currently developing a comprehensive political risk insurance program which will be available for use by UADC in mid 1996 if all goes well. The World Bank does not plan to have loanable funds available for agriculture in the near term but is expecting to develop some program for this purpose during the next few years. It is recommended that UADC management keep apprised of those developments for potential leveraging opportunities.

EBRD officials indicated some interest in providing UADC with equity and debt some time after it is a "going concern". Both the EBRD and the IFC have already financed leasing companies in nearby countries-- the possibility of establishing an affiliation with these existing leasing companies to develop a leasing operation for Ukraine was discussed with interest.

EBRD additionally has approved a line of credit of approximately $130 million to place through financially and operationally sound Ukrainian private commercial banks for onlending to private Ukrainian businesses. As detailed below, working with Ukrainian banks with access to this line may present leveraging opportunities for the UADC. EBRD is also establishing a trade finance facility which will guarantee or confirm letters of credit of Ukrainian banks to facilitate financing imports and exports of agricultural inputs and products. Finally, EBRD has approved investment in Kiev Atlantic, a developing distributor of agricultural inputs in Ukraine. Therefore, through one or more of these activities, it would be possible for UADC to cooperate with the EBRD.

4.2 Western NIS Enterprise Fund[1]

The team met with representatives from the Western NIS Enterprise Fund (Enterprise Fund) to discuss their activities and possibilities for collaboration. The Enterprise Fund's primary responsibility is to facilitate the development of private business in Ukraine. In

[1] The Western NIS Fund was established for financing private business development in Ukraine, Belarus and Moldova. It cannot finance state or government-owned enterprises.

the agricultural sector, it is focusing its activities on equity funding of Ukrainian agribusinesses. The Enterprise Fund would probably not engage in short-term funding of consumables such as seed and fertilizer. and has concerns about the "private" nature of many Ukrainian farm enterprises Those activities may be better suited to UADC. It is clear that the activities of the Enterprise Fund and UADC could be complementary. Equity funding of farm service centers planned by the Enterprise Fund will allow the centers to improve their financial strength and increase their ability to serve the farms. The growth of the farms will mean more demand for short-term credit, which UADC could provide.

There is also opportunity for cooperation in the area of equipment sales or leasing due to huge demand for updated equipment. Anecdotal information has indicated, for example, an immediate need for 15,000 combines and an on-going need for 3,000-5,000 units a year. It is clear that the ability of Ukrainian farmers to maximize their annual crop production yield is contingent on replacement of all types of old and inefficient equipment. The lending capacity of UADC and the Enterprise Fund combined will not cover the total demand for equipment financing. This large market creates a range of opportunities for both the Enterprise Fund and UADC.

4.3 Ukrainian Banks

The team explored the possibilities of using Ukrainian, joint venture or foreign-owned banks in Ukraine as a part of the structure and found that there may be an opportunity for UADC to work with the Ukrainian banks. UADC could involve the banks by forming agent agreements, establishing loan participations, or through twinning arrangements, combined with technical assistance for agricultural lending. There are, however, several limitations which should be considered, including:

1) Private sector banking in Ukraine is still in the early stages;

2) Ukrainian banks have limited capital and lending capacity;

3) Institutional capability to conduct agricultural lending appears to be minimal.

The EBRD has approved a line of credit of approximately $130m to qualifying banks to make private sector loans in Ukraine. So far, only one bank has qualified and has been extended about $6m in EBRD funds; however, other banks are likely to qualify in the near future, according to EBRD representatives. The EBRD is prepared to consider a specialized agricultural lending program, twinning the UADC with qualifying banks combined with agricultural banking technical assistance.

4.4 Farm Service Centers

The secondary or wholesale financing design also provides maximum flexibility in making financing available for US agricultural inputs suppliers and equipment manufacturers to work with Farm Service Centers (FSCs), distribution centers that make or supply agricultural inputs and equipment, as well as provide technical assistance to farms. UADC is expected to operate as a secondary or wholesale finance company, to purchase supplier/distributor credits to agricultural producers; it will not be involved in making direct loans to agricultural producers. This approach permits suppliers to work with whichever FSC or distributor they choose and even encourages suppliers to establish their own FSCs.

5.0 PROPOSED DESIGN OF THE UADC

The UADC, as described in this report, is capable of being self-sustaining and providing significant credit capacity to serve a substantial segment of Ukrainian farms. Further, this facility when formed and operational has the potential to attract additional investment in Ukraine from other countries and international sources supporting the development of Ukraine agriculture and agribusiness. The proposed design of the UADC focuses on initial credit extensions for secondary or wholesale financing of suppliers/distributors' farm customers. It also provides for the formation of guaranteed and non-guaranteed "loan pools" at the suggestion of the potential investors. The guaranteed loan pools may be funded or unfunded depending on the interest of the companies and the terms offered by international banks. This will provide the opportunity for UADC to leverage its capital to meet the anticipated needs of the participating companies for loanable funds during the start up period of the company. The refocus of the UADC design to that of a secondary or wholesale financing institution resulted from active involvement in the design process on the part of interested investors.[2] The resulting design is intended to attract the broadest possible participation by US and multi-national agribusinesses in the capital funding and support of UADC.

5.1 Legal Organization

The UADC would operate as a US company[3] through a European office or subsidiary to effect financial transactions through a representative office or agency located in Ukraine. This off-shore status was developed as a result of extensive discussions with Ukrainian government representatives, private agribusinesses and a review of the major legal and regulatory issues. A more significant presence in Ukraine would mean significant delays due to required governmental approvals and licenses, especially if cash lending were involved requiring a banking license. The proposed organization and its proposed operations were informally reviewed by National Bank of Ukraine staff and, in their view, does not require a banking license.

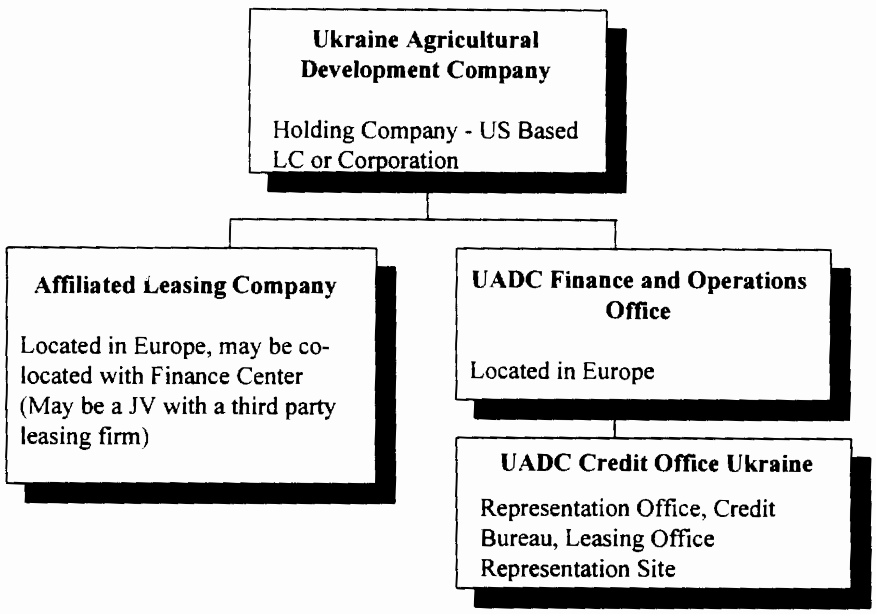
The organizational structure of UADC encompasses several entities in order to facilitate operations over various jurisdictions. UADC operations are intended to be "lean and mean" with no more personnel than necessary to accomplish its mission adequately. The US company, for example, is intended to be a holding company only and not have corporate operations or staff. The actual structure and staffing are matters for the participating companies to decide. The proposed UADC organization chart is shown on the next page.

[2] Although the US AID Task Order specifically states that the private agricultural financial company for Ukraine is "to provide short and medium term financing to Ukrainian farms", it would appear that a secondary financial company that indirectly provides financing flows through to the benefit of Ukrainian farms would be within that charge.

[3] Actual selection of jurisdictions for incorporation, office locations, and whether offices will be incorporated or representative offices will depend upon a full review of the legal, tax, accounting, and operational considerations of the participating companies. Those suggested here are for illustrative purposes only.

Ukraine Agricultural Development Company

Organization Chart



5.2 Capitalization

USAID has tentatively agreed to provide $10m of reimbursable funds to the capital of UADC. USAID's commitment depends on a variety of factors including their approval of the design, the commitment of private capital totaling $20m, and satisfactory incorporation of the UADC. The funds are targeted to be repaid in equal parts in the third and fourth years of UADC operations. USAID has also indicated a willingness to provide the UADC with some administrative and technical assistance funds. The exact amounts of assistance provided by USAID have not yet been decided or approved. The financial model reflects the team's recommendation which is that a total of $3m USAID in administrative and technical assistance be contributed on a pure grant basis and is to be spread over 3 years. The Steering Committee of participating companies must negotiate with USAID the full terms and conditions of their assistance. Due to the newness of this development approach, the design team cannot predict what conditions USAID may want and whether they would be acceptable to the companies. To date, USAID officials have expressed a strong interest in catalyzing the creation of the UADC and expects to support its development in some form.

The following chart illustrates the amount of capital contribution required by the investing agribusiness firms, according to the size of their worldwide sales volume:

These contributions are for voting stock:

Agribusiness firms	Capital Contribution
Major more than 500m sales	$500,000 - $1.5m
Mid-sized $100m-$500m sales	$500,000 - $1m
Small less than $100m sales	$100,000 - $500,000

Participating companies may also purchase additional nonvoting equity in the UADC in units of $100,000. The total minimum equity of the participating companies must be $20 million in order to obtain USAID's participation. The design team considers total equity of $30 million to be the minimum necessary to enable the UADC to produce a financially viable company within five years of operation.

5.3 Shareholders

Shares in the UADC should be offered to any US agricultural input supplier or foreign agricultural supplier with a major US operation. Companies seeking to become shareholders after the UADC becomes fully operational would be required to pay a premium for shares in the UADC based on its then value as a going concern. Equity participation may also be offered to international financial institutions[4] and Ukrainian companies on such terms and conditions as may be negotiated.

5.4 Management

The President and Chief Executive Officer (CEO) should be an international professional experienced in agricultural and farm supply finance. A Chief Financial Officer (CFO) and Chief Operating Officer (COO) should also be international professionals. A Ukrainian Financial Manager should be hired to team with the COO to develop an effective Central Credit Bureau and to develop strong Ukrainian financial executives. Internationally trained loan officers would also be needed. The CFO is expected to be located in the European office and the COO in the Ukrainian office. The CEO may need to spend considerable time, particularly in the early stages, at both locations.

[4] Such as the EBRD, IFC, or the Enterprise Fund.

5.5 Loan Funding

The UADC will seek to offer different types of pools of discounted loans or credits purchased from suppliers/distributors[5] to financial institutions. The financial institutions would be offered an interest in the loan pool discounted to maturity. To reduce credit risk, country risk to the financial institutions and pricing to the UADC, management should attempt different credit enhancements with different pools. Credit enhancements from companies whose credits have been purchased into a particular pool may include corporate guarantee for some percentage of the pool, guarantees against some percentage of the first risk of loss in a pool (5% to 40%, perhaps), and third party guarantees (insurance companies or banks) for some secondary risk of loss behind the corporate guarantees. Some pools may be unfunded and only require draws in the event of some loss of the pool. Discussion of how poling would operate and very generalized examples are detailed in the section 5.

Actual pools will have to be negotiated with interested financial institutions (initially, international banks), the UADC, and the shareholder companies. Terms and conditions are likely to depend on the size of a particular pool, the underlying credits securing the pool, the type of credits, the experience of the suppliers/distributors with the customers in the pool, the percentage corporate guarantees of the pool, the guarantee coverage between first percentage of loss of the pool or a combination, the number of shareholder companies involved in the pool, and their party guarantees of the pool, if any. Whether the forms of securities is asset-backed securities, discounted loan pools, negotiated bank lines of credit secured by loan pools, or other forms depends on the investors and the pools. Based on the suggestions of several interested companies, the team has assumed the ability to obtain additional pool funding based on significant company guarantees in the amount of $100 million per year for a total of $500 million in pool funding over the five-year period. The loan pools approach is expected to rationalize the credit risk and obtain funds from financial institutions best able to deal with the risks involved, thereby potentially able to obtain from commercial markets a greater volume of funds for Ukraine that other methods.

Finally, the UADC would attempt to obtain loanable funds in the form of grants reimbursable grants, long-term loans, and perhaps preferred equity positions from the EBRD, the World Bank Group, and various export-import and donor agencies of countries having an interest in developing Ukraine (including, Canada, Great Britain, Germany, the Netherlands, France, Italy, and Japan, to name a few). The UADC should also seek funding and credit lines from the US Export-Import Bank and the Overseas Private Investment Corporation. The forms of these extensions of funds would be determined by the UADC, its shareholders, and the international entities involved.

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[5] Supplier/distributor is often used together to reflect that the credit may be extended by the supplier, the distributor, or both depending on the financing arrangement these parties have in extending credit to the farm users to purchase inputs. The UADC is expected to purchase some portion of these credits.

5.6 Credit Allocation

In the early years of UADC operation prior to being able to obtain domestic or international funding for any creditworthy Ukrainian customer request, the participating shareholder companies will want assurances that they will be able to obtain some amount of financing for their creditworthy customers. The companies have expressed general agreement with the concept that their capital contribution should be available on an annual basis to finance their creditworthy customers. Any additional leveraging obtained by the UADC on its own efforts, including the USAID contribution, should be available to all creditworthy financing requests on a free market basis. Where companies enter a special pool guaranteed by the participating company in its own name to some percentage of any loans to their customers placed in the pool, then all funding obtained as a result of that guarantee should be available to the guaranteeing company's customers. Nevertheless, because no additional corporate guarantee has been anticipated also to be for the benefit of the UADC, the UADC must have an equivalent amount of capital supporting all loan pools. Required capital to support guaranteed pools may be considerably less if the guarantee were also to run to the UADC. For modeling purposes, the UADC has sufficient capital (at least 8 percent) throughout the five year modeling period to support the guaranteed loan pools increasing by $100 million each year.

When the UADC is able to achieve adequate available funding for financing any shareholder's creditworthy customer request, then all credit allocation should cease and the market and the relative financial merits of a customer's request determine whether financing should be extended. USAID may insist on the end of credit allocation and the offering of financing to non-participating companies as soon as practicable with annual reviews of the issue as a condition of their grants. The participating companies should establish an objective formula for when credit allocation should end. The participating companies have also expressed a desire that credit for non participating companies' customers should not be available until credit allocation has ended. Until that time, requesting non-participating companies may be offered to invest in the UADC on terms and conditions established by the UADC board of directors. A premium may be required above the initial capital contributions based on the valuation of the UADC as a going concern.

5.7 Eligibility for Financing

Any Ukrainian agricultural producer[6] or distributor of agricultural inputs of participating companies to producers, both shown to have a reliable repayment history and capacity would be eligible for financing by the suppliers/distributors. Their credit extensions would be purchased by the UADC on negotiated terms and conditions designed to be as uniform as possible to enhance the sale of loan pools in international markets. These credits will be discounted by the UADC at market rates of interest or where no current market exists, at a rate above operating costs with a reasonable rate of return. Credit may be used to purchase

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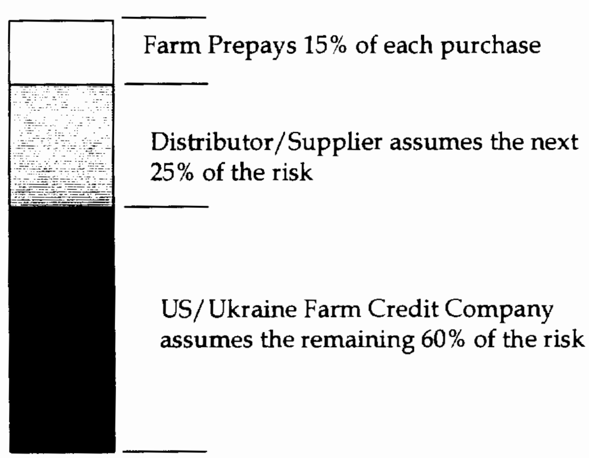
[6] Agricultural producer includes farmer, farm (both collective farms and joint stock companies), private corporate farming enterprise.

agricultural inputs (seed, crop protection chemicals, small scale equipment and machinery) from primarily, though not exclusively US sources. All equipment and machinery needing medium term financing should be channeled through the affiliated leasing company.

All receivables eligible for UADC purchase must have required the farming operation make at least a 15 percent down payment on the inputs purchased, the distributor/supplier finances the next 25 percent and the UADC purchase receivables totaling 60 percent of the total value purchased. The UADC must receive an assignment of the participating companies or their distributors commodities contracts with the farming enterprise for the inputs being financed Once receivables were accepted for purchase, the UADC from its European office would pay the supplier 60% of the inputs value to their offices in the US or Europe. No cash would be provided by the UADC to the distributor, farm or enterprise. At harvest, the distributor/supplier would be responsible for collecting the commodities from the customer on behalf of the UADC, liquidating the commodities and repaying the purchased receivables in hard currency to the UADC's European office. Any farming customer failing to repay will be precluded from receiving credits of inputs from any other shareholder supplier. A default against one participating company within the UADC is considered as a default on all.

Payment Structure



5.8 Credit Process

Prior to the purchase of any participating company receivables, the UADC must thoroughly review the credit extension process, including how UADC extends and obtains payment from the farming enterprises as end users of credit.[7] Any credit receivable submitted for financing to the UADC will be subject to an independent credit analysis. This process must be adequate to assess the risk of repayment by the farming customers based on all available information including the central credit bureau described below.

The actual credit process undertaken by the UADC in individual cases will depend upon the credits submitted by the suppliers/distributors for discounting, the pools into which the credit may go for sale into the international markets, the credit history that the supplier and distributor have had with the customer(s), and the security and credit enhancements attaching to the credits. The UADC management must work with the shareholder to develop an independent credit assessment process that is adequate to address the risks of the various types of credit but also streamlined to minimize administrative expense. Establishing credit but also streamlined to minimize administrative expense. Establishing credit policies and procedures for a secondary or wholesale financial institution that will purchase the credits generated by its shareholder has several difficulties. The primary difficulty is setting the credit standards such that each shareholder accepts as not intruding too extensively in its own business activities, but is thorough an adequate enough to prevent excessively risky credits being purchased of other shareholder. The credit assessment process must be open, transparent, and impartial to all shareholders' credits despite the fact that individual shareholders have differing experiences with their customers and with operating in the country.

The participating companies organizing the UADC may want to consider establishing a committee of disinterested representatives to review appeal of any rejected receivables of any participating company to avoid disputes on the creditworthiness of particular customers.

During the early years, it is assumed that there will be more creditworthy customer requests than available funding. To accelerate the growth of the UADC on a sound financial basis, the participating companies should strongly consider agreeing to present their strongest creditworthy customers for financing through the UADC.

5.9 Central Credit Bureau

As a condition for access to UADC financing, participating companies and their local distributors must provide the UADC, on a confidential basis, information about the credit history of their customers. The UADC management should develop an acceptable method for creating this credit bureau and for providing members access to information. This may involve, for example, participating companies providing an agreed upon detailed list of

[7] This may include UADC developed financing forms for suppliers/distributors to use in extending credit to farming customers.

items on each customer, allowing the UADC to use all information in making its own independent credit assessment of any customer receivable offered for purchase, participating companies could also check a potential customer's credit with the bureau and receive a categorized rating but no detailed information on the customer.

The UADC will continue to add to the central data base by assessing a customer's credit. Credit history will be largely the recommendations of other suppliers, local officials, and the community. The entire list of customers held by the central bureau would not be available to any one participating company. Many participating companies have viewed a credit bureau as a strong potential benefit.

5.10 Leasing

To accommodate the need to provide intermediate term equipment financing, the UADC may work with an existing equipment leasing company or set up a subsidiary for this purpose. The team and some equipment representatives have had discussions with representatives of one European based leasing company (Leasing Company) interesting in developing activities in Ukraine. The leasing arrangement described here is one option based on those discussions. Any actual arrangement would, of course, require negotiations between the Leasing Company and the UADC once established. In addition, there are other groups in the processing of establishing a leasing operation that the UADC management may want to consider. Finally, the UADC may decide to establish its own leasing subsidiary to ensure maximum control of operations.

The European based Leasing Company, already operating in Romania and Bulgaria, plans a similar approach in Ukraine. It seeks strategic investing partners to maximize its effectiveness by requiring a combination of debt and equity from each shareholder. While a strong capital base is considered important, the Leasing Company believes that access to credit lines is key to developing a successful leasing operation. In current operations, the Leasing Company has achieved leveraging of approximately 7 to 1. Current investors include the IFC, FMO (a Dutch government and banking consortium) and Cargill. Leasing terms are fairly uniform --three to five year full pay out leases without any residual value to the Leasing Company. Varying lease terms are expected to be offered as experience with customers and doing business in various countries makes flexible terms prudent. Terms are developed to suit the economics of the particular equipment involved. The Company obtains significant down payments equal to two to three months advanced lease payments and would expect this to be the case in Ukraine. Property, casualty, and theft insurance is obtained from local or international insurance companies to cover basic risk of loss or damage of equipment.

This Leasing Company is not captive to any equipment manufacturer and would not dedicate financing lines to particular brands of equipment. Nevertheless, companies that are indirectly affiliated with the Leasing Company are likely to be more known to the company, its equipment more understood, and therefore, leasing of these company's equipment more likely. The Leasing Company considers security and maintenance of equipment to be paramount. It has equipment teams as a part of its current operations that insure proper maintenance, winterizing, normal hour usage, and spot checking. Specialized metering controls are used where possible as further security. The Leasing Company will not concentrate its equipment leasing more than 25 percent in any one sector. Food processing and agricultural production equipment are considered separate sectors and therefore would permit concentration up to 50 percent of total leasing in those sectors.

For Ukraine, the Leasing Company would consider a similar investing group with the possible addition of the EBRD.[8] The Leasing Company believes that an investment and affiliation with a Ukrainian agricultural finance company, such as UADC, could provide several mutual benefits. Being associated with an industrial and financial group focused on providing comprehensive inputs packages to Ukrainian farming operations significantly improves the prospects that the farms will achieve the higher yields sufficient to cover financing for inputs and equipment. Coordination between UADC and the Leasing Company could be advantageous with regard to fashioning payment mechanisms in the Ukrainian barter environment. The central credit bureau function is also attractive to the Leasing Company.

The UADC could provide the Leasing Company with a company controlled site to hold equipment securely and ensure a sound maintenance schedule. The scarcity of fuel may indicate a need to provide a fuel supply component to the leasing contract to ensure proper use of equipment. The equipment suppliers experience with certain customers may permit more flexible operational terms. Food processing involving international partners may enable special terms depending upon the international partner's willingness to guarantee compliance with the leasing agreement.

A potential investment from the UADC in the Leasing Company of $5 million of debt and equity is envisioned for modeling purposes. The Leasing Company will seek to obtain additional debt and equity from other shareholders totaling $35m to $50m ($6m to $8m in capital) for beginning Ukrainian operations. Additional debt and equity would be sought as experience and demand warrants. The Leasing Company again believes that securing sound credit lines is key and that additional equity is more easily attained.

5.11 Insurance

The UADC will obtain World Bank Political Risk Guarantee Insurance or other available political risk insurance to protect the UADC and its shareholders against inappropriate governmental interference in its contractual obligations. Once the political risk insurance is in place, UADC may file a claim for any retroactive action by the Government of Ukraine that adversely effects a financial transaction of UADC. The cost is expected to be 3-5% of the value of the transaction.

[8] EBRD informed the Design Team that they are discussing debt and equity investments in two potential leasing operations for Ukraine, including this one. The Design Team asked EBRD officials to make the other group aware of the UADC's potential interest in investing in a Ukrainian leasing operations and to contact the Team if interested.

In addition, the UADC expects to explore use of insurance to reduce business risk and facilitate securitization of its loan pools for purchase by international financial and institutional investors. The UADC would anticipate obtaining other available political risk insurance until the World Bank insurance program is available. Other insurance may be obtained to reduce the credit risk of loan pools to lower funding costs

5.12 Bank Affiliations

The UADC may seek to enter into an arrangement with international and Ukrainian banks to provide transactions clearing, foreign exchange and other financial services. The UADC may also develop co-financing arrangements with banks receiving EBRD funds for lending to Ukrainian businesses.

5.13 Operations

The UADC should establish a representative office in Ukraine as soon as practicable following establishment of the off-shore companies. It is expected that a leasing company in which the UADC may invest would be established in Ukraine during the same timeframe. It is expected that all payments to UADC and the affiliated leasing company would occur outside of Ukraine.

5.14 Dividends

It is projected that the UADC will not pay dividends for the first five years of operations and all earnings will be retained. Thereafter, dividends or some other form of repatriation of the return on participating companies equity shall be distributed as determined by the board of directors. Any distribution or return from the affiliated leasing company during the same time period, if any, would be determined through discussions with the leasing company. To be conservative for modeling purposes, no distribution is assumed during the same five year period.

5.15 Audits

The UADC will be audited annually by an international accounting firm and provide shareholders with such audited financial reports as deemed appropriate.

5.16 Risk Factors

Investment in the UADC will be an illiquid investment. As such, equity in the UADC will not be publicly traded and may be difficult to divest. In addition, all of the UADC's loans will involve inherent risks. There can be no assurance on the timing and amount of dividends or other repatriation of income from the UADC, if any. There can be no assurance that the UADC will achieve its financing objectives. As earnings will be needed to respond to growing credit demands, the UADC will look to sell additional equity to obtain the necessary capital to support the UADC loan portfolio as well as to replace retiring USAID funds. Participating companies deciding to invest in the UADC should be prepared to lose the entire amount of their investment in the UADC.

5.17 Registration

The UADC, if established as a US company, will not be registered under the Securities Act of 1933, as amended, or the securities laws of any states. The Shareholders may not have a right to require registration of the UADC securities. These issues, if applicable, will have to be addressed by the incorporating participating companies and their counsel.

5.18 Lending Goals

By end of the five year period, the UADC expects to provide financing of $ 100m to $500m per year depending on the leveraging the company is able to achieve. This would impact up to one quarter or more of Ukrainian agricultural production facilities. In addition, the UADC will expect a substantially larger private producer population as a result of the investment.

6.0 OPERATING PLAN

The Operating Plan outlined below describes how the UADC should be organized, staffed, and funded. In addition a detailed description of a typical transaction is presented.

6.1 Holding Company

The design plan envisions the formation of a US company to act as the holding company for the business activities of the UADC. The parent holding company may be a Limited Liability Company or Corporation, whichever more effectively meets the operational requirements of the participating companies that provide equity for UADC. The design team has not reviewed the legal, accounting or operational considerations that the participating companies have in selecting actual jurisdictions and locations for UADC activities, outside of Ukraine. The actual UADC management or steering committee will have to perform their own due diligence before selecting the appropriate locations and corporate structures.

The design plan does not anticipate any initial requirement for the establishment of an office or hiring of staff for the holding company. In addition, the design plan does not designate the permanent location for the CEO of the holding company and UADC. It is proposed that all business activities will be handled from the site determined by the Steering Committee to be the principal office for UADC and that the office location for the CEO will be determined at the conclusion of start up activities for the firm based on operational needs.

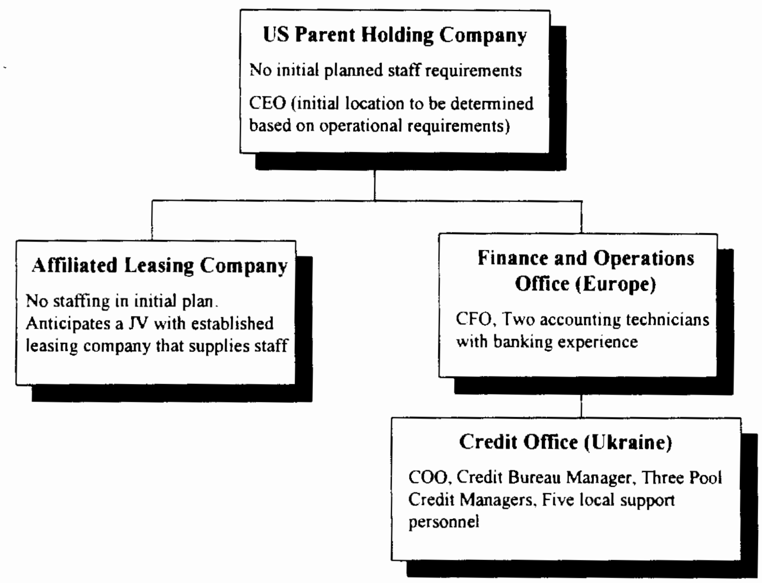
The CEO will be responsible for managing and directing the operations and financial activities of the holding company and UADC. The CEO will report to a Board of Directors elected by the shareholders of the holding company.

The following pages contain the proposed organization and staffing plan illustrations for all the operating entities.

6.2 UADC Finance and Operations Office

The UADC Finance and Operations Office will be the principal business office for the company. It should be located in Western Europe to facilitate more efficient operations and communications with the Ukrainian Representation Office. A Chief Financial Officer (CFO) and two accounting staff persons with banking experience would comprise the initial staffing of the Finance Office.

Preliminary Proposed Staffing Plan



The Finance Office is responsible for the following activities of UADC:

- ***Financial management of all UADC business activities***. This will include relationships with the participating companies, commercial banks, international financial institutions and insurance companies involved with the financial activities of UADC and its loan pools and with a leasing company for medium term equipment financing. The CFO will be responsible for fund management and arranging external funding to leverage UADC loan pools;

- ***Credit management and approval activities***. The Finance Office will be responsible for final approval of credit extensions to suppliers and distributors. It will verify that required documents have been obtained and executed as required by law and regulation and will insure perfection of security interests to the extent possible. The Finance Office will maintain the financial records associated with the establishment, disbursement, and repayment of all credit extensions by UADC. It will be responsible for the administrative support of credit records and communications with borrowers. The Finance Office will also be responsible for directing collection activities for UADC when required;

- ***Fund Receipt and Disbursement***: The Finance Office will be the site responsible for all currency transactions related to UADC credit operations. The office will make all disbursements for authorized payments under the terms of each credit extension and will be the receiving office for all currency repayments of credit extensions;

- ***Affiliated Leasing Company Clearing House***: The Finance Office will be the primary contact between UADC and the affiliated leasing company. The office may be responsible for disbursements authorized under credit extensions for equipment lease or rental payments to the leasing company or for receipt of repayments for those credit extensions. The Finance Office will be the site to maintain all leasing administrative and financial records associated with UADC affiliation with the leasing company; and

- ***Internal Administrative and Financial Management***: The Finance Office will maintain the primary administrative and financial records for all holding company, UADC and Affiliated Leasing Company business activities. The office will also maintain all personnel records at this site for the firm.

6.3 UADC Credit Office - Ukraine

The UADC Credit Office will be a representation office of the firm located in Ukraine. Initial staffing for this office will be a Chief Operating Officer (COO), Credit Bureau Manager, five Credit Pool Managers, and five administrative and financial support technicians.

The Credit Office will be responsible for the following business activities for UADC:

- ***Initial Credit Review and Recommendation***: The Credit Pool Managers should be responsible for the initial UADC review of supplier credit processes, initial review of all credit extension requests, documentation of credit extension requests, credit bureau review of the borrower, development of the credit extension terms and conditions, and final recommendation to the Finance Office through the COO for action on each credit extension;

- ***Credit Management***: The Credit Pool Managers should monitor the performance and business activities of each entity to which credit has been made. They will monitor barter contract collection activities at the end of the growing season and confirm that distributors are acting to arrange for export, conversion to currency, and repayment of credit extensions to the Finance Office;

- ***Credit Bureau***: With the cooperation of participating suppliers and their distributors the Credit Office will establish and maintain credit information concerning distributors and their customers on behalf of UADC. Participating companies and their distributors will be expected to negotiate with UADC terms and conditions to supply credit information, maintain its confidentiality, and restrict its use and access to this information for credit decision purposes. For the credit review process, it will be necessary to find or train a Ukrainian credit specialist, who understands the Ukrainian environment.

- ***Affiliated Leasing Company Representative Office***:[9] The Credit Office maybe cooperate with the affiliated leasing company to provide credit reviews, and where requested by with the leasing company provide initial review of all credit extension requests, documentation, credit bureau reviews, development of credit terms and final recommendations to the Finance Office. The Credit Office will assist the affiliated leasing company as agreed in monitoring the performance of agent distributors secure leased equipment, provide for its maintenance, verify the proper use of the equipment, facilitate the barter contract and liquidation as requested by the leasing company;

- ***Ukraine Banking Relationships***: The COO of the Credit Office may seek to establish agent, participation and twinning agreements with selected Ukraine and foreign owned banks in the Ukraine, particularly those approved to receive EBRD funding. The design team recommends that these banks be provided USAID technical assistance to train staff on proper analysis and extension of agricultural credit. The COO may establish working agreements to expand financial services and credit extension capacity that can be offered by UADC in Ukraine; and

- ***Ukraine Support Activities***: The COO will be responsible for cooperation and development of mutually useful technical assistance programs, as well as relationships with US and Ukraine government officials, representatives of other international institutions and private organizations that will strengthen the business operations of UADC and affiliated companies in Ukraine.

6.4 Affiliated Leasing Company

The UADC will seek to identify a proven agricultural and food processing leasing company experienced in leasing in Central Europe or the NIS to consider as an equity and debt investment to make leasing services available to customers of participating equipment companies in Ukraine. As previously mentioned, the design team and some interested company representatives met with one European based leasing company that could be a candidate for the affiliated company. UADC does not anticipate supplying any staff for the affiliated leasing company operation. It is anticipated that through collaboration UADC will assist the leasing company when requested to facilitate conversion of barter contracts to enable lease payments to be made in currency. UADC may also enter into agent or cooperative agreements to provide additional support to enhance the capabilities of the leasing company, such as credit bureau information and other services to improve security, maintenance, monitoring or use of equipment. These arrangements are all expected to be on a fee for service basis.

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[9] The degree of collaboration with the leasing company will depend on those UADC services the leasing company needs to facilitate its operations. These range from investment only to substantial administrative services. The actual mix must be negotiated and relate to operational efficiency.

6.5 Transaction Description

There are numerous variations to the typical credit transactions that will become the principal business of UADC. The following examples illustrate two types of transactions commonly undertaken by suppliers and distributors and expected to be financed by the UADC. There are others, including suppliers extending credit directly to some farm customers. The precise terms and conditions of the UADC for financing actual transactions of suppliers or distributors, including UADC credit standards, documentation,[10] collateral and security, should be developed by the UADC management and the participating companies.

Supplier Credit Transaction

Source	***Activity***
Supplier:	1. The supplier establishes a business relationship with a Ukrainian distributor. 2. The supplier extends financing to the distributor based on its own credit criteria and assesses the distributor and its customers and determines that it meets the supplier's and the UADC's credit standards.
Distributor	1. The distributor purchases for retail sale the products of the supplier (either as seasonal stock based on past sales and projected demand or on behalf of specific customers). 2. The distributor extends credit to the farm customer for the product delivered. 3 The distributor's sales arrangement includes payment for inputs by barter contract or cash with delivery of commodity or cash payment at season's end.
Supplier:	1. The Supplier will bring its receivable[11] from the distributor to the UADC Ukraine Credit Office, including the required security (i.e. the distributor's receivable, barter contract, or other collateral), as available. 2. The Supplier will request the UADC purchase the receivable for payment based on established terms for purchasing supplier receivables.

[10] The UADC and participating companies may decide that all companies should use standardized forms for extending financing to distributors or farm customers to minimize administrative expense and facilitate developing loan pools for sale into the international financial market.

[11] The supplier will likely bring a group of receivables to a distributor or a line of credit financing a large group of distributor's receivables rather than a single receivable. This is for illustration purposes only.

	3. The Supplier will indicate to which pool it seeks to place the credit for sale to international institutions.
UADC Credit Office - Ukraine:	1. The credit office will make an independent assessment of the supplier's credit process, its credit history with the specific distributor, the customers the distributor in turn finances, and their repayment experience.[12] 2. The credit office will assess the receivables for meeting established criteria, including appropriate security, verify the supplier's receivable as acceptable credit, prepare all documentation[13], and submit the package to the UADC Finance Office with its recommendation for credit purchase.
UADC Finance Office:	1. The Finance Office receives the financing request and Ukraine office recommendation. 2. The Finance Office makes the final credit decision--accept, reject, or accept with modification. 3. The Finance Office arranges payment to the supplier at its US or European office.
Distributor:	1. At season end, the distributor collects the barter product (or, in some cases, cash) from its customer and arranges for the barter export and sale to a trading company or other entity for hard currency. 2. The distributor pays the UADC Finance Office in cash or completes the export transaction and arranges to make direct payment to the UADC Finance Office in hard currency on behalf of the supplier for the amount of the supplier credit purchased.
UADC Finance Office:	1. The Finance Office receives payment in full and closes the account record. 2. If full payment is not received, the UADC will seek collection on security, take action to prevent future credit extensions to the customers involved.

[12] For administrative efficiency, this process is likely to occur once in a comprehensive manner at the time of the first credit request with periodic reviews based on experience.

[13] Legal documentation for purchasing credits, including appropriate assignments of security, will be executed by supplier in Ukraine and then by UADC Finance Office as accepted. UADC management and participating companies are likely to develop umbrella credit agreements wherever possible to streamline the credit process.

Distributor Credit Transaction

Source	*Activity*
Distributor:	1. The distributor purchases for retail or further wholesale sale the products of a participating supplier company (either for seasonal stock based on past sales and projected demand or on behalf of specific farm customers). 2. The distributor extends credit to the farm customer for the product delivered. 3. The distributor's payment terms include payment in cash or by barter contract of commodities at season end in exchange for the inputs delivered.
Supplier or Distributor:	1. The distributor, or the supplier whose products are being sold, brings the distributor's receivable to the UADC Ukraine Credit Office, including the required security (i.e. the barter contract or other collateral), as available. 2. The Supplier or distributor (with supplier approval, unless it is a UADC shareholder) will request the UADC purchase the receivable for payment based on established terms for purchasing distributor receivables. 3. The Supplier (or distributor if it is a UADC shareholder) will indicate to which pool it seeks to place this distributor's credit for sale to international institutions.
UADC Credit Office - Ukraine:	1. The credit office will make an independent assessment of the distributor's credit process, its credit history with its customers, the experience of suppliers with this specific distributor, the customers the distributor in turn finances, and their repayment experience.[14] 2. The credit office will assess the receivables for meeting established criteria, including appropriate security, verify the distributor's receivable as acceptable credit, prepare all documentation[15], and

[14] For administrative efficiency, this process is likely to occur once in a comprehensive manner at the time of the first credit request with periodic reviews based on experience.

[15] Legal documentation for purchasing credits, including appropriate assignments of security, will be executed by distributor in Ukraine and then by UADC Finance Office as accepted. UADC management

	submit the package to the UADC Finance Office with its recommendation for credit purchase.
UADC Finance Office:	1. The Finance Office receives the financing request and Ukraine office recommendation. 2. The Finance Office makes the final credit decision--accept, reject, or accept with modification. 3. The Finance Office arranges payment to the distributor's supplier at its US or European office and the supplier reduces its outstanding credit to the distributor accordingly.
Distributor:	1. At season end, the distributor collects the barter product (or, in some cases, cash) from its customer and arranges for the barter export and sale to a trading company or other entity for hard currency. 2. The distributor pays the UADC Finance Office in cash or completes the export transaction and arranges to make direct payment to the UADC Finance Office in hard currency for the amount of credit purchased.
UADC Finance Office:	1. The Finance Office receives payment in full and closes the account record. 2. If full payment is not received, the UADC will seek collection on security, take action to prevent future credit extensions to the customers.

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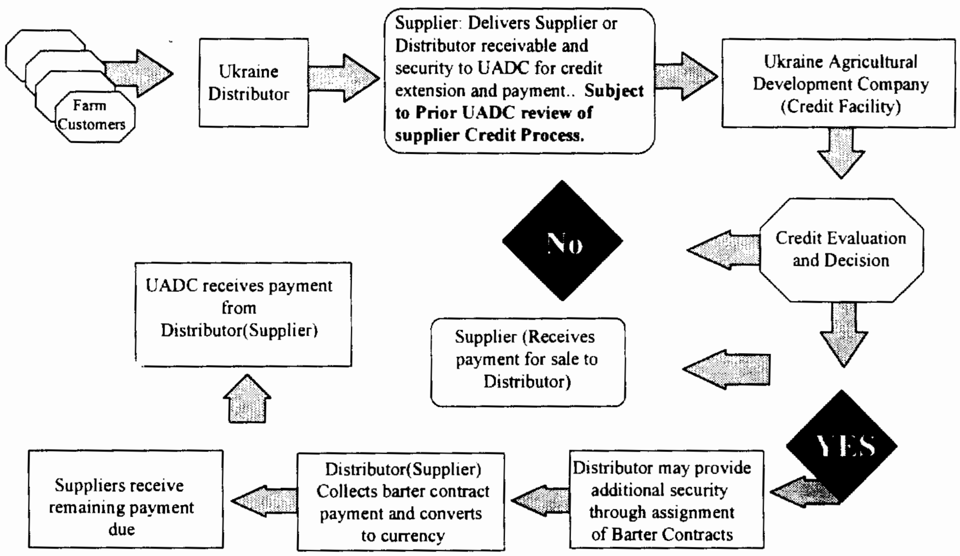
and participating companies are likely to develop umbrella credit agreements wherever possible to streamline the credit process.

UADC Transaction Summary



6.6 Pool Formation and Funding

Funding for loans may be supplied through the formation of loan pools that will utilize UADC's equity and various forms of credit enhancements to leverage the amount of loanable funds available for credit extensions. Initially this will take the form of three structures:

1. Participating Company Guaranteed Pool

2. Participating Company Non-Guaranteed Pool

3. Affiliated Leasing Company

Ultimately the objective will be to provide a series of loan pools of different risks based on varying credit enhancements of participating companies and other sources to meet the broadest range of needs for the participating companies of UADC.

The following describes in general terms the operation of each of these facilities.

The Guaranteed Pool:

The loanable funds available to participating companies in this guaranteed pool would be consist of the following:

1. UADC Equity

2. USAID Capital

3. Leveraging provided from commercial sources supported by capital and guarantees in the form of recourse or standby letters of credit from the firms participating in the pool to the commercial source of funds. Funds could take the form of borrowed funds secured by pools of loans or asset-backed securities.

The following describes a typical process for forming the guaranteed pool. Circumstances could result in substantial variations on this transaction description.

- UADC would request each participating company to indicate its expected funding requirements for the next crop year shortly after harvest in the current year and the pools in which it intended to participate;

- Participating companies would provide UADC with funding requirements, pool participation intentions, any limiting terms and conditions required by the company, and provide representatives to negotiate loan pool terms with company guarantees of authorize UADC to do so on their behalf;

- UADC would prepare by mid-autumn a UADC and participating loan pool term sheet for the guaranteed pool and submit to individual bank or a banking consortium of commercial banks and financial institutions in the US and Europe for bid;

- UADC would receive bids from commercial sources for credit lines of asset-backed security purchases for the following crop years credit activities. These bids could take several forms

  - Option One: The participating companies would guarantee payment through direct recourse or supported by a standby letter of credit to the commercial funding source, a percentage of the total funds provided by the commercial source to UADC. This would take the form of a shared risk with the commercial institution providing the funds. (For example the companies may guarantee 70-80% of the total amount at risk on a shared loss basis. i.e. of the total loss incurred the guarantor would pay 70-80% of the loss and the commercial funding source would pay the remaining loss)

    The guarantee would not be joint and several. The UADC would have no recourse to the companies based on this guarantee.

Each guarantor would be responsible for their share of any loss to this pool of a credit extension allocated to a credit extended to a customer of the participating company under the terms of the pool agreement.

Maximum loss exposure to each company is the amount of the guarantee and equity investment in UADC. A company must replenish equity to maintain access to the UADC credit facility; that is, the company must contribute additional capital to UADC for the amount of loss on its related receivables less a calculated "profit" from other loans.

•• Option Two: The participating companies would guarantee payment through direct recourse or supported by a standby letter of credit to the commercial funding source, a percentage of the **first tier loss** on any loans in the pool sold to commercial sources. Under a first tier loss, the companies would be liable for the full loss on the entire pool up to the amount guaranteed. (For example, the company would guarantee the first 15-25% of loss incurred by the credit, thereafter the commercial funding source would bear full exposure to any loss)

The guarantee would not be joint and several. The UADC would have no recourse to the companies based on this guarantee.

Each guarantor would be responsible for their share of any loss to this pool of a credit extension allocated to a credit extended to a customer of the participating company under the terms of the pool agreement.

Maximum loss exposure to each company is the amount of the guarantee and equity investment in UADC. A company must replenish equity to maintain access to the UADC credit facility.

- The design team notes that there are a number of variations or alternatives to the structure of these options that should be evaluated by UADC and its participating companies during the process of establishing debt funding for UADC.

- The CFO of UADC and the company representatives would accept the offer of one bidding financial institution or consortium and complete negotiations to obtain the funds required for the following years operations. Based on the terms and conditions established for the pool the allocation of funds and pricing will be established.

Some company representatives have suggested that the combined strength of the participating companies and UADC may produce a financing cost savings to the group that may be significantly better than what any individual company could obtain by itself. This assumption, however, is entirely speculative until tested by the UADC and the companies requesting bids from banks in the open market. An evaluation should be jointly conducted of the terms and conditions offered by any respondents.

- UADC will establish the pool for the current year indicating the credit allocation to each participating firm, terms and conditions, and rate. Responsibility for allocation of credit extensions to the pool will be given to the Pool Credit Manager. Participating companies will be required to approve each credit extension assigned to the pool.

- In the event of chargeable losses to the pool the allocation of losses will be based on the terms of the pool guarantee entered into by UADC and the participating guarantors and the commercial financial institutions funding the pool. Regarding the funding international banks, UADC would typically be exposed to pool loss first followed by the guarantors in accordance with the terms of the secondary credit enhancement.

  At the conclusion of each crop year, this process will be repeated. It is expected that as experience is developed the amount of guarantee required by participating companies will decrease and/or terms for the pool will improve. It is also likely that additional credit enhancements will be developed that will improve UADC funding ability for this pool.

  Until this process is fully tested the exact operating results and terms and conditions are at best speculative.

The Non-Guaranteed Pool:

The loanable funds available to participating companies in the non-guaranteed pool would consist of the following:

1. In year one the pool size is expected to be limited to UADC Equity

2. Leverage for year two and thereafter is expected to be based on pool performance and internally developed credit enhancements. Participating companies may also consider additional company provided credit enhancements and insurance to improve the market for the pool.

The following description illustrates a potential process for forming the non-guaranteed pool:

- The CFO may announce the funds available to this pool and any credit allocation for each participating company by the end of each calendar year. (Credit allocation is expected to be an issue for this pool only in the early years).

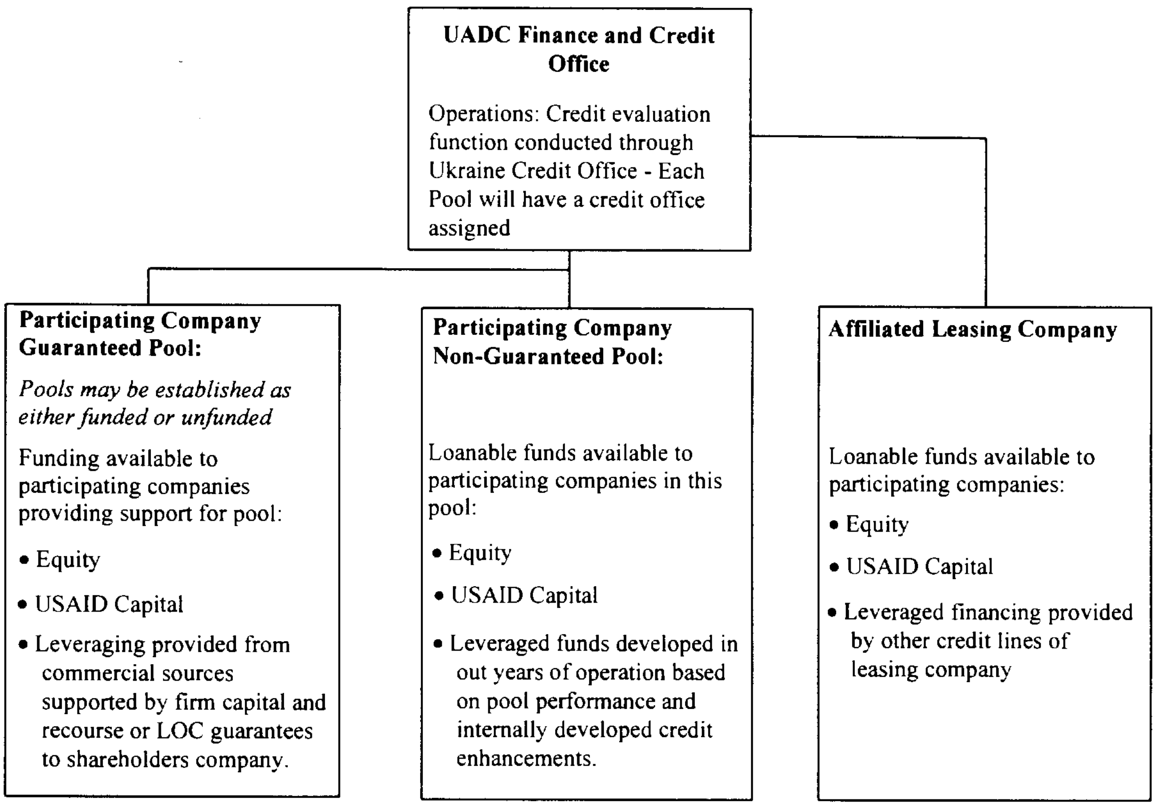
- Responsibility for allocation of credit extensions to the pool will be given to the Pool Credit Manager. Participating companies will be required to approve each extension of credit allocated to its guaranteed portion of the pool, if any, prior to closing of each credit extension.

- Maximum loss exposure is the equity investment in UADC. Companies must replenish equity to maintain access to UADC credit facility.

- At the beginning of each crop year this process would be repeated. As experience is developed, the opportunity for leveraging loanable funds for this pool would increase. In addition, the following credit enhancement may be available to this pool to facilitate leveraging.

    - Crop Insurance (Lloyds) may be used as a credit enhancement to provide a means for leveraging early in the firm's operations. (This option requires credits being secured by a barter contract from the farm customer. Additional discussions on variations of this alternative will be required by the CFO of UADC)

Loanable Fund Pooling Structure



7.0 FINANCIAL STRUCTURE OF THE UADC

The financial model for the Ukraine Agricultural Development Company (UADC) is based on assumptions described in this section. This model shows a general scenario based on the design team's ability to collect information during a limited time in the field and interviews and meetings conducted in the U.S. and Europe with agribusiness suppliers and other specialists. This projection should not preclude each investor from performing extensive due diligence.

This model reflects the structure as outlined. All amounts are presented in US dollars. There is no provision for inflation. Given that the rate of inflation in Ukraine is still quite high, it is difficult to estimate what impact inflation might have on the rate of devaluation and dollar costs of Ukrainian office operations. The model assumes a 30 percent income tax rate for demonstrative purposes, as it is not yet known where and how the UADC will be incorporated or taxed. Operating expenses have been estimated, based on information received from western companies currently engaged in business in Ukraine. This base case scenario is intended as a starting point for the UADC potential shareholders, from which they can adjust and fine-tune the model as they make decisions along the way.

7.1 Capitalization

Beginning company operations in February 1996, UADC will be capitalized with $30m. This amount consists of a reimbursable grant of $10m (interest- free), provided by USAID, and $20m of equity from the US company investors, made up of equity contributions by each company based on company size, determined by annual worldwide sales. The model also shows a subsidy from USAID to cover administrative expenses of $1.2m in year 1, $1m in year 2 and $800,000 in year 3, which has not yet been approved. For modeling purposes, it is assumed that the USAID reimbursable grant is provided in the first year and is repaid to USAID in two installments: $5m in year 3, $5m in year 4; however, the exact terms and conditions of this arrangement have not yet been finalized.

7.2 Structure

The structure of UADC is comprised of two separate pools of loanable funds and an investment of $5 million of debt and equity in a leasing company. The companies that choose to participate in the guaranteed pool will have loanable funds available through equity, USAID capital and leveraging provided from commercial sources supported by UADC capital base and recourse or LOC guarantees from their company. Although a third unfunded guaranteed pool is expected to be developed, it has been assumed that his will be part of the $100m annual increase and therefore considered one pool for modeling purposes. The companies that participate in the non-guaranteed pool have loanable funds from equity, USAID capital and leveraged funds resulting from internally developed credit enhancements and pool performance in later years of operation.

The proposed leasing company would be either a joint venture with an existing leasing firm or a wholly-owned subsidiary of UADC. A capital investment of $5m of debt and equity will be provided from UADC to the leasing company. Conservatively, it is assumed that the leasing company provides no rate of return for the first five years. Loanable funds that may be available to companies through the leasing company would be in the form of equity, and leveraged financing provided by credit lines of the leasing company.

7.3 Loans

In the model, it is assumed that through the non-guarantee pool, the UADC will loan $9m in the first year and 90 percent of available capital in subsequent years. The guaranteed pool will loan $100m the first year, with a straight line increase of $100m annually through year five. The guaranteed pool structure is based on the companies' ability to get loanable funds through collateralized asset-backed securities or commercial loans backed by their company guarantees and the UADC capital. For modeling purposes, it is assumed that all loans are made in three installments: 50 percent of the loans on March 1 for 270 days, 25 percent on June 1 for 180 days, 25 percent of August 1 for 90 days. The disbursement schedule as presented is staggered to reflect the farmers' credit needs and the anticipated delivery of inputs and equipment. At this stage, individual transaction size and number of transactions have not been projected.

The projected loan portfolio is uniform and consistent with a 6 percent spread between the cost of borrowing and the interest rate charged to the borrowers. In reality, the spread on the guaranteed line may be less than 6 percent, depending upon the cost of operations relative to this pool. Additionally, the spread for the no-guarantee line will vary in accordance with prevailing market conditions. All loans are scheduled to be fully repaid in November. Since the fiscal year ends in September, a November repayment falls in the following fiscal year. The interest charged on all loans is assumed to be 17 percent. A 5 percent loan loss provision is assumed for the non-guaranteed pool. A lower loan loss provision of 2 percent is assumed for the guaranteed pool. These estimates for loan provisions were difficult to judge because of the lack of credit history in Ukraine.

7.4 Investments

The model assumes that UADC will invest $5m debt and equity in an affiliated leasing company as a joint venture with a third party leasing firm or as a wholly-owned subsidiary of the UADC. The $5m comes from initial UADC capitalization; the model shows no return or dividends from the leasing company. The leasing company is expected to leverage capital by a 7:1 ratio. Lease payments are expected to be made through the UADC credit facility and based on annual barter contract payment agreements with farms or separately arranged by the leasing company. The operations of the leasing company are considered separate from the UADC facility; therefore, only the initial $5m investment in the leasing company is reflected in the model.

The model shows unloaned money or excess cash present in UADC deposited in interest-bearing accounts yielding at 5 percent APR from January 1 until disbursed. An additional amount of $15m is deposited in the first year for 11 months.

7.5 Leveraging of Funds

It may be possible for UADC to leverage funds through a variety of options including international funding sources, commercial banks, international securities markets, and insurance companies. As UADC will be primarily lending against barter contract agreements, UADC's ability to adequately document and structure the agreements for securitization and/or collateral has not yet been determined. Through the non-guaranteed pool, it is not anticipated that UADC will be able to leverage funds in the first year of operations. In the second year, the model shows $5m in January coming from donor agency borrowing, to be repaid in a balloon payment for a 7 year term. The debt to equity ratio by year 5 is 2.5:1. The interest on this debt is assumed to be 10 percent per year, payable every 12 months, in December, typical for international financial institution lending rates in similar countries.

The leverage possibilities are primarily driven by the fact that under the guaranteed pool the funds are collateralized by corporate guarantees. Given the limited amount of commercial credit available now in the Ukraine, it is difficult to assess the leveraging capabilities from both domestic lending as well as borrowings from abroad. The model also shows $20m in additional infusions of equity at the beginning of year 3 and 4, which will in part be used to reimburse the USAID grant.

7.6 Conclusion

As base case assumptions, the financial statements show the UADC to be profitable after year one and financially viable after five years. A review of the financial statements show a quick build up of total assets during the first year from $30m to $134m, climbing to $725.5m after five years. The guaranteed loan program becomes the principal vehicle of growth, which relies on separate shareholder guarantees and is somewhat speculative until actual loan pool sales have been negotiated. This rapid growth relies heavily upon the ability of the shareholders to assist the UADC in obtaining favorable funding for loan pools based on corporate guarantees of some percentage of the loan pool. It also strongly relies upon the UADC's ability to establish sound and effective credit standards for the loans or supplier account receivables to be discounted or purchased by the UADC.

The capital/asset ratio is projected to be 8.2% at the end of year 5. While this meets international banking standards established by the Bank for International Settlements, the recent experience of suppliers in Ukraine suggests a stronger capital ratio of 10%-25% may be more appropriate. This capital ratio assumes that UADC obtains $40m in additional capital during the five year period. If international financial institutions are unwilling to make this investment, the UADC shareholders may need to make additional contributions or obtain investment from international financial institutions, possibly those funding the guarantee loan pools.

FINANCIAL MODEL

Disclaimer

The following 6 pages present a model of the UADC's combined financial and operating information for a five year period. The model was developed to ascertain certain minimum and maximum financial parameters which must be attained to produce a financially viable operation. The financial parameters modeled include, but were not limited to, the following key elements: 1) minimum level of equity capitalization, 2) the range of feasible leverage of debt to equity capital, 3) the size, timing and nature of AID-sourced flows in and out of the organization and 4) the maximum sustainable loan loss ratio.

The model was developed for use as a dynamic tool in order to test the sensitivity of the organization to variability in key financial and operating assumptions. Accordingly, it was utilized to conduct various iterations and in no way should be viewed as a static representation of the projected financial position of the organization.

The model contains certain base case operational data prepared by the design team based on assumptions made and tested by them. While the team believes that the assumptions contained in this model are reasonable operating parameters, they are inherently subject to significant economic and competitive uncertainties which cannot be predicted accurately and are beyond the control of the team. Therefore, there can be no assurance that the results of this model will be fulfilled. Actual results will differ from those shown. The model should be considered in conjunction with the UADC design paper. This model is not a projection and does not portray anticipated results. Its presentation in this design report has the sole purpose of enabling the reader to envision the stringent financial operating parameters that must be met in order to produce a financially acceptable company.

BALANCE SHEET USD '000	Beginning B/S 2/1/1996	End Year 1 9/30/1996	End Year 2 9/30/1997	End Year 3 9/30/1998	End Year 4 9/30/1999	End Year 5 9/30/2000
Assets						
Current Assets						
Cash	30.000	1.197	7.672	19.300	35.219	54.586
Interest Receivable - G	0	9.563	19.125	28.688	38.250	47.813
Loan Loss Provision - G - Interest	0	(191)	(574)	(1.148)	(1.913)	(2.869)
Principal Receivable - G	0	100.000	200.000	300.000	400.000	500.000
Loan Loss Provision - G - Principal	0	(2,000)	(6,000)	(12,000)	(20.000)	(30.000)
Interest Receivable - NG	0	861	3.202	6.178	9.612	12.084
Loan Loss Provision - NG - Interest	0	(43)	(203)	(512)	(993)	(1.597)
Principal Receivable - NG	0	9,000	33,480	64.606	100.516	126.372
Loan Loss Provision - NG - Principal	0	(450)	(2.124)	(5.354)	(10,380)	(16.699)
Invested ST Funds	0	15,000	0	0	0	0
Total Current Assets	***30,000***	***132,936***	***254,578***	***399,757***	***550,312***	***689,690***
LT Assets						
Other Assets	0	0	0	0	0	0
Long Term Investments	0	5,000	5.000	5.000	5.000	5.000
Total LT Assets	***0***	***5,000***	***5,000***	***5,000***	***5,000***	***5,000***
Total Assets	**30,000**	**137,936**	**259,578**	**404,757**	**555,312**	**694,690**
Liabilities and Equity						
Liabilities						
Interest Payable - G	0	6,188	12,375	18,563	24,750	30,938
Commercial Borrowings - G	0	100,000	200,000	300,000	400,000	500,000
Interest Payable- Comm.- NG	0	0	792	2,946	5,685	8,845
Interest Payable - DFC - NG	0	0	500	500	500	500
Commercial Borrowings - NG	0	0	7,200	26,784	51,684	80,413
DFC Borrowings	0	0	5,000	5.000	5,000	5.000
USAID Reimbursable Grant	10.000	10.000	10.000	5.000		
Total Liabilities	***10,000***	***116,188***	***235,867***	***358,793***	***487,620***	***625,696***
Equity						
Paid in Capital	20,000	20.000	20,000	40,000	60,000	60,000
Retained Earnings	0	1,748	3,711	5,964	7,692	8,994
Total Equity	***20,000***	***21,748***	***23,711***	***45,964***	***67,692***	***68,994***
Total Liabilities and Equity	**30,000**	**137,936**	**259,578**	**404,757**	**555,312**	**694,690**
CHECK: Assets - Liabs	0	0	0	0	0	0

INCOME STATEMENT USD 000		Year 1 9/30/1996	Year 2 9/30/1997	Year 3 9/30/1998	Year 4 9/30/1999	Year 5 9/30/2000
Income						
Interest from Loans - G		9,563	19,125	28,688	38,250	47,813
Interest from Loans - NG		861	3,202	6,178	9,612	12,084
Interest on Invested Cash - NG		800	558	1,077	1,675	2,106
Total Income		**11,223**	**22,885**	**35,942**	**49,537**	**62,003**
Financing Expenses						
Interest on Commercial Debt - G		6,188	12,375	18,563	24,750	30,938
Interest on Commercial Debt - NG		0	792	2,946	5,685	8,845
Interest on DFC Financing - NG		0	500	500	500	500
Provision for Loan Loss - G- Principal		2,000	4,000	6,000	8,000	10,000
Provision for Loan Loss - NG - Principal		450	1,674	3,230	5,026	6,319
Provision for Loan Loss - G - Interest		191	383	574	765	956
Provision for Loan Loss - NG - Interest		43	160	309	481	604
Total Financing Expenses		**8,872**	**19,884**	**32,122**	**45,207**	**58,162**
Gross Margin		**2,351**	**3,001**	**3,821**	**4,330**	**3,841**
Admin Expenses						
Payroll - Ukraine office		769	882	995	1,108	1,221
Other Expenses - Ukraine		259	204	209	214	219
Payroll - Offshore		450	450	450	450	450
Other Expenses - Offshore		91	91	91	91	91
Total Admin Expenses		**1,568**	**1,626**	**1,744**	**1,862**	**1,980**
Income Before Taxes		783	1,375	2,076	2,468	1,861
Income Tax	30%	235	412	623	740	558
Net Income before subsidy		**548**	**962**	**1,453**	**1,728**	**1,302**
AID funded operating subsidy		1,200	1,000	800	0	0
Net Income after subsidy		**1,748**	**1,962**	**2,253**	**1,728**	**1,302**
Cumulative		1,748	3,711	5,964	7,692	8,994

CASH FLOW STATEMENT USD 000	Year 1 9/30/1996	Year 2 9/30/1997	Year 3 9/30/1998	Year 4 9/30/1999	Year 5 9/30/2000
CASH INFLOW					
Cash inflow from operations					
Interest from Loans -G	0	9,563	19,125	28,688	38,250
Interest from Loans - NG	0	861	3,202	6,178	9,612
Interest on Invested Cash	800	558	1,077	1,675	2,106
AID funded operating subsidy	1,200	1,000	800	0	0
Total Cash inflow from operations	**2,000**	**11,981**	**24,203**	**36,541**	**49,968**
Other Cash inflows					
USAID Reimbursable Grant Inflow	10,000	0	0	0	0
Shareholders' Equity Inflows	20,000	0	20,000	20,000	0
Return of Loan principal - G	0	100,000	200,000	300,000	400,000
Return of Loan principal - NG	0	9,000	33,480	64,606	100,516
From short term investment	0	15,000	0	0	0
New DFC Borrowings	0	5,000	0	0	0
New Commercial Borrowings - G	100,000	200,000	300,000	400,000	500,000
New Commercial Borrowings - NG	0	7,200	26,784	51,684	80,413
Total Other Cash inflows	**130,000**	**336,200**	**580,264**	**836,290**	**1,080,929**
TOTAL CASH INFLOWS	**132,000**	**348,181**	**604,467**	**872,831**	**1,130,897**
CASH OUTFLOWS					
Cash outflow - operations					
Operating Expenses	1,568	1,626	1,744	1,862	1,980
Interest - DFC borrowing	0	0	500	500	500
Interest - Commercial Borrowing -G	0	6,188	12,375	18,563	24,750
Interest - Commercial Borrowing - NG	0	0	792	2,946	5,685
Income Tax	235	412	623	740	558
Total Cash outflow - operations	**1,803**	**8,226**	**16,034**	**24,611**	**33,474**
Cash Outflow - Investments / loans					
Short Term Investment	15,000	0	0	0	0
Long Term Investment	5,000	0	0	0	0
New Loans - G	100,000	200,000	300,000	400,000	500,000
New Loans - NG	9,000	33,480	64,606	100,516	126,372
Total Cash Outflow - Investments / loans	**129,000**	**233,480**	**364,606**	**500,516**	**626,372**
Cash Outflows - Repayments					
Repayment of DFC Borrowings	0	0	0	0	0
Repayment of Commercial Borrowings -G	0	100,000	200,000	300,000	400,000
Repayment of Commercial Borrowings - NG	0	0	7,200	26,784	51,684
Repayment of USAID Grant	0	0	5,000	5,000	0
Total Cash Outflows - Repayments	**0**	**100,000**	**212,200**	**331,784**	**451,684**
TOTAL USES OF CASH	**130,803**	**341,706**	**592,840**	**856,912**	**1,111,530**
NET CASH FLOWS	**1,197**	**6,475**	**11,628**	**15,919**	**19,367**
Cumulative Cash at Beg of Period	0	1,197	7,672	19,300	35,219
Cumulative Cash at End of Period	1,197	7,672	19,300	35,219	54,586

UKRAINE AGRICULTURAL DEVT. CO. FINANCIAL PROJECTIONS BASE CASE

OPERATING EXPENSES USD '000			Year 1 9/30/1996	Year 2 9/30/1997	Year 3 9/30/1998	Year 4 9/30/1999	Year 5 9/30/2000
Ukrainian office							
Payroll							
Number:	COO (US)		1	1	1	1	1
	Manager (Ukr)		1	1	1	1	1
	Credit Officers (US)		5	6	7	8	9
	Assistants (Ukr)		5	6	7	8	9
Salary	COO (US)		120 [1]	120	120	120	120
	Manager (Ukr)		20 [2]	20	20	20	20
	Credit Officers (US)		70 [3]	70	70	70	70
	Assistants (Ukr)		8 [4]	8	8	8	8
Total	COO (US)		120	120	120	120	120
	Manager (Ukr)		20	20	20	20	20
	Credit Officers (US)		350	420	490	560	630
	Assistants (Ukr)		40	48	56	64	72
Total Payroll			530	608	686	764	842
Fringe		45%	239 [5]	274	309	344	379
Gross Payroll			***769***	***882***	***995***	***1,108***	***1,221***
Other Expenses							
Rent			42 [6]	42	42	42	42
Communications			36 [7]	36	36	36	36
Legal			75 [8]	15	15	15	15
Licenses & Local Taxes			10	10	10	10	10
Translation			10	10	10	10	10
Transportation			35	40	45	50	55
Security			36	36	36	36	36
Misc.			15	15	15	15	15
Total Other Expenses			***259***	***204***	***209***	***214***	***219***

estimate based on US equivalent salary
estimate based on information from western businesses in Kiev
estimate based on US equivalent salary
$700/month, estimate based on good local admin. asst. salary
Fringe @ 45% standard for Ukraine: for US includes COLA, post differential
$3500/month for fully equiped western-style office
$3000/month in phone bills, fax and mail
upfront legal costs in year 1 associated with start-up due diligence

OPERATING EXPENSES USD '000			Year 1 9/30/1996	Year 2 9/30/1997	Year 3 9/30/1998	Year 4 9/30/1999	Year 5 9/30/2000
Off-Shore Office							
Payroll							
Number:	CEO (US)		1	1	1	1	1
	CFO (US)		1	1	1	1	1
	Assistants (US)		0	0	0	0	0
	Assistants (Ukr)		2	2	2	2	2
Salary	CEO (US)		150	150	150	150	150
	CFO (US)		100	100	100	100	100
	Assistants		30	30	30	30	30
Total	CEO (US)		150	150	150	150	150
	CFO (US)		100	100	100	100	100
	Assistants (Ukr)		60	60	60	60	60
Total Payroll			310	310	310	310	310
Fringe		45%	140	140	140	140	140
Gross Payroll			***450***	***450***	***450***	***450***	***450***
Other Expenses							
Rent			40	40	40	40	40
Communications			36	36	36	36	36
Misc.			15	15	15	15	15
Total Other Expenses			***91***	***91***	***91***	***91***	***91***
Total Operating Expenses (Ukrainian and US combined)			**1,568**	**1,626**	**1,744**	**1,862**	**1,980**

0

CAPITAL (EQUITY + GRANT) USD 000	Year 1 9/30/1996	Year 2 9/30/1997	Year 3 9/30/1998	Year 4 9/30/1999	Year 5 9/30/2000
Beginning of year					
USAID Grant	10,000	10,000	10,000	5,000	0
Paid in Capital	20,000	20,000	20,000	40,000	60,000
Total	30,000	30,000	30,000	45,000	60,000
Movements Oct - Dec					
USAID Grant	0	0	(5,000)	(5,000)	0
Paid in Capital	0	0	20,000	20,000	0
Total	0	0	15,000	15,000	0
Available at Jan 1					
USAID	10,000	10,000	5,000	0	0
Companies	20,000	20,000	40,000	60,000	60,000
Total	30,000	30,000	45,000	60,000	60,000
Net Available					
Capital at beginning of year	30,000	30,000	45,000	60,000	60,000
Less:Invested in Leasing company	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Net	25,000	25,000	40,000	55,000	55,000

A FARM FINANCE COMPANY FOR UKRAINE

Task Order Period: October 2 - November 30, 1995

I. SUMMARY

The task order is for a rapid assessment and design of a financially self-sustaining private agricultural financial company for Ukraine, specifically targeted to provide short and medium term financing to Ukrainian farms. The design of the agricultural finance company will be closely coordinated with the design of USAID's integrated agriculture/agribusiness assistance strategy for Ukraine.

The report submitted by the Contractor will provide complete details 1) as to how to set-up and operate a special purpose agricultural finance company for Ukraine consistent with the parameters set forth in this task order; and 2) propose a program of USG assistance in facilitating the evolution of this autonomous private financial company. The assessment and design work will involve a three-week trip to Ukraine by two or three USAID-supported experts in the operation of agricultural finance institutions, and legal and regulatory aspects of establishing and operating such an institution. The resulting report will detail their findings on the start-up and development of a finance company, legal and regulatory aspects, capitalization requirements and private and public sources to meet the requirements, and appropriate administrative and operational structure of the organization.

II. BACKGROUND STATEMENT

Currently there are no functioning and affordable sources of credit for Ukrainian farmers. This lack of access to credit is one of the major constraints to the transformation and privatization of Ukraine's agriculture, agribusiness and food systems economy. It makes it all but impossible for producers to access needed farm inputs and machinery, improved Western technology, and value-added processing equipment. Fundamentally, it shuts off access to alternatives to the state system of agribusiness monopolies, discourages the creation of private farms and related enterprises, and stifles the emergence of a functioning private sector, demand driven food systems economy.

The Ukrainian banking system is not capable of providing the required credit services. In fact, much of the financing that is required (seasonal operating capital and medium-term purchase-money loans for equipment) are most efficiently provided to individual farmers and emerging enterprises through dealer and distributor networks rather than through banks.

The Bank of Ukraine is the main source of credit to the agricultural sector, including state-owned processing and storage facilities and input suppliers, as well as state and collective farms. Although in the past the BU lent to state owned enterprises to cover their losses, the current policy of the BU is to support developmental priorities and not engage in write-offs, but it will continue to provide support to loss making state owned enterprises.

Two other government institutions are involved in agricultural finance. The Government Insurance Institution is currently providing credit insurance. Although providing such insurance appears to be a profitable activity under Ukraine's current inflationary conditions, it is unlikely to remain so in the longer run. The Ministry of Agriculture and Food also has a variety of plans and programs that involve directed and subsidized credit for the agricultural sector. USAID/Kiev has extensive banking sector reform programs to provide training in accepted accounting principles, external audits, and a comprehensive systems of prudential regulation and supervision by competent government agencies to ascertain which banks are solvent and not engaging in excessive risk taking.

However, none of these institutions can meet farmers' needs for input and operating financing in the near or foreseeable future. Because the restructuring of agricultural, agro-processing, marketing and distribution enterprises and development of market driven agricultural distribution networks cannot be deferred until functioning systems become operational, **a privately owned and operated special purpose financial institution, providing short- and medium-term credit to private and privatizing Ukrainian farms for inputs and equipment, is urgently needed.**

To address this issue, USAID sponsored an agricultural conference in Kiev, July 19-20, to discuss possible financing mechanisms that will ameliorate the credit bottleneck to farmers. The participants, including USAID staff, World Bank and other donor organizations, CNFA representatives, and U.S. agribusinesses currently operating in Ukraine, reached a consensus that if the Agribusiness Service Centers and other USAID agricultural assistance initiatives are to achieve their objectives, such a mechanism should be implemented as quickly as possible. It was further agreed that it should be designed as an integral component of the emerging USAID agriculture and agribusiness strategy for Ukraine, and that although USAID and other support is needed to launch the effort, the private sector (primarily the U.S. companies marketing inputs and equipment to farmers) should take on the major responsibility for capitalizing and operating the facility.

III. A FARM FINANCE COMPANY (FFC) FOR UKRAINE

Discussions held at the USAID-sponsored conference in Kiev established the general parameters for the FFC, as follows:

The initiative will create a cost- and risk-shared financing mechanism specifically targeted to Ukrainian farms to provide them with the resources they need to take advantage of the package of goods (both consumable inputs and equipment -- including small-scale processing equipment) and services available through the Farm Service Centers (FSCs).

The FFC will be a fully functional and independent finance company capitalized by participating U.S. corporations and other financial institutions such as EBRD, IFC, the WesNIS Fund, selected international and local banks and others, and supported by an initial reimbursable grant from USAID (up to $10 million). USAID will also provide grant resources for start-up and initial administrative costs.

The impact of this program on transfer of environmentally safe technology, higher yields and efficiency for agriculture could be dramatic. Benefits would both reach upstream, as increased volumes make local manufacturing and processing feasible, and down stream, as the demand for new services develops into a maturing agricultural services economy. However, the success of the initiative depends upon several factors:

1) It must be developed along with a viable, expanding network of Farm Service Centers (FSCs) which will provide the "retail" end of the financing chain;

2) Appropriate legal approvals to operate in Ukraine must be obtained;

3) It must be open and transparent in design and operation;

4) It must be operated by a highly regarded and experienced finance executive; and

5) Steps must be taken to attempt to ensure the enforceability of contracts to the maximum extent possible under the circumstances.

<u>The Company:</u> The formation of the company is based on the idea of pooling risk and capital contributions among the owners and investors of the facility. Ultimate authority and responsibility will reside in the Board of Directors, which will be constituted from among the capital contributors.

<u>Capitalization:</u> Preliminary estimates project an initial capitalization of $30 million($10 million from USAID plus $20 million largely from the U.S. private sector) which, at an optimal 4:1 ratio, can yield a lending capacity of more than $100 million per year. This would allow the facility to adequately finance at least 1,000 farms each year at an estimated $100,000/per farm.

Loans: Terms of the loan would vary from short to medium term depending on their purpose: loans for consumable (70% of the package) would mature seasonally, while loans of depreciable equipment (30% of the package) could extend for up to four growing seasons. Participating farms will be required to make a reasonable cash down payment (15% or more of the total purchase). Next, Agricultural Service Center Operators -- who make the initial credit decisions -- and input suppliers would be responsible for 25%. Finally, the finance company would absorb the remaining 60%.

Interest Rates: While they would be priced at positive interest rates, the cost of the dollar-denominated loans to farmers would be well below what might otherwise be available on the inflationary local market. Since loans are cash flow based, it is expected that purchase money guarantees backed with the capital of the major input suppliers and international financial institutions will be available to the company at substantial discounts. If, for illustrative purposes, this were estimated to be at 9% (estimated prime rate) and adding in 2 points for administration, 3 points for insurance, and 3 points retained as a reserve against losses, financing to the farmers could be made available at around 17%. The above cost figures are for illustrative purposes only, the Contractor is expected to reassess the validity of these assumptions and make realistic accurate projections.

IV. STATEMENT OF OBJECTIVE

The objective of this task order is to facilitate the rapid design, development, and implementation of a financially self-sustaining private agricultural financial company for Ukraine through a cost- and risk-sharing mechanism of its members specifically targeted to provide short and medium term financing to Ukrainian farms.

V. TASKS, BENCHMARKS, AND DELIVERABLES

The Contractor will investigate and analyze the requirements for establishing a fully functional, free standing agricultural finance company for Ukraine. In order to accomplish this, it will assemble a team of four U.S. and 1-2 Ukrainian professionals that are highly experienced in a) start-up, operations and management of agricultural lending institution, and b) a legal aspects of establishing and operating a financial institution c) Ukrainian legal counsel to advise on Ukrainian laws and financial institutions. The field work will begin on or about October 2, 1995. Of the six work weeks, about three weeks will be spent in the field in Ukraine. The remaining three weeks will be spent in meetings and/or discussions over phone with the U.S. companies and other potential investors in Washington and/or Brussels, briefings with ENI/ED/AG, CNFA and in preparation of the final report.

In carrying out this task order, the team will: 1) coordinate their activities in Ukraine, including preparatory work in the United States, with CNFA; 2) review the rules and regulations governing establishing and operating a private financial institution; 3) meet with appropriate financial institutions (including IFC, the World Bank and EBRD), regulatory authorities and Ministries which might be involved in prudential supervision of the Ukrainian financial institutions; and 4) work with CNFA to engage and consult with appropriate private sector representatives and other donor institutions to seek advice and support for the FFC initiative.

The team will analyze the existing legal and regulatory framework for the start-up and operations of an independent financial institution and indicate what legal and organizational structure (including nationality and location of operations) will permit the facility to begin operations in a timely manner under existing laws and regulations.

The deliverable under this Task Order will be a final report (five hard copies and a computer diskette) that will include the following:

a) Description of the economic and policy framework;

b) Legal status of FFC - Examination of legal and regulatory aspects of establishing and operating the finance company including prudential supervision of the FFC;

c) Organizational and management structure - The Board of FFC Directors will consist of representatives of the private agribusiness investors and other capital investors, as appropriate. Consistent with this premise, propose an organizational structure for the FFC including senior management structure, key positions and total staff, their work requirements, salary structure and training needs.

d) Satellite offices - Discussion of the needs, if any, and parameters for the establishment of satellite offices of the FFC in Ukraine;

e) Capitalization - Working with CNFA and representatives of selected participating U.S. companies and other potential equity participants, establishment of capitalization requirements of FFC. **Secure letters of intent to participate and pledges from the U.S. companies for their cash and in-kind contributions to the FFC, and an examination of guarantees or letters of**

credit as investment options. For the USAID reimbursable grant, develop a payback schedule to turn funds over to the USAID/Kiev agro-processing Partnership Program to be established in FY96. A recommended subordination structure and hierarchy that will ensure maximum leverage of USAID and private sector funds.

f) Lending guidelines - Develop preliminary recommendations for lending guidelines for short-term/seasonal (less than six month) working capital loans for expendable agricultural inputs and medium term (3-5 years) investment credit for farm machinery and equipment including small scale processing;

g) Eligibility of Borrowers - As indicated earlier, borrowers would include farms that are either privatized or currently in the process of privatizing. There might be other forms of partnerships, farmer associations that might be considered appropriate borrowers. Briefly discuss potential qualifying criteria for borrowers;

h) Security for Loans -- Develop procedures for assessing the collateral and cash flow requirements for loans;

i) Loan making and servicing procedures - Propose basic guidelines for loan making and servicing;

j) Accounts and audit - Establish applicable accounting and audit procedures;

k) Cost of administration and financial sustainability - Provide preliminary estimates and projections of administrative costs, based on the organization structure as proposed by the Contractor. Using cash flow projections discuss when and how FFC could become a financially self-sustaining entity. With the objective of FFC achieving financial sustainability in the shortest possible time, the Contractor is expected to assess all approaches to reduce FFC's transaction costs.

l) Schedule of Lending Operations Start-up - List of principal activities and proposed timeline for the establishment of the FFC and start-up of the lending operations.

The final report will be delivered within 3-4 weeks following completion of the field work in Ukraine, i.e., by approximately November 30, 1995.

RHÔNE-POULENC

SECTEUR AGRO

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TLX 310098 F RHÔNE

John H.COSTELLO
President
The Citizens Network for
Foreign Affairs

Lyon, le January 17th, 1996

CREDIT MANAGEMENT INTERNATIONAL
96-005

Dear Sir,

We hereby confirm our decision to maintain our participation in the Ukraine Agricultural Development Company (UADC) project.

Our decision to subscribe to the UADC equity is subject to the realization of the following conditions :

1) Formal agreement from all parties including US AID organization and UADC not to put any restrictions regarding the country origin of imports on the Ukrainian distributors selected by UADC

2/ An Equity Commitment limited to US$ 500 000 for our company with the possibility of increasing the contribution in the second year,

3/ The precise definition in the forthcoming shareholder agreement of clauses regarding the increase or assignment of our equity contribution

4/ A supplier commercial risk exposure limited to the contribution in equity and to the losses generated by his own activity with his distributor.

5/ Participation tied to a minimum level of $ 20 million of supplier's commitment representing more than 10 companies.

6/ Conditions of reimbursement of the US AID loan of $ 10 million.

For all further discussion Debbie Myers is entitled to represent our Company.

If the conditions required are achieved, the final decision will be made in accordance with our internal procedure for approval by the Investment Committee.

Best regards,

G.BRAU

CASE CORPORATION
700 STATE STREET
RACINE, WI 53404 USA
TEL (414) 636-6011

December 11, 1995

John H. Costello, President
The Citizen's Network for
Foreign Affairs
1111 - 19th Street, N.W., Suite 900
Washington, D.C. 20036

Frank W. Naylor, Jr.
Ukraine Farm Finance Company Design Team
Deloitte Touche Tohmatsu
Suite 350 N
1001 Pennsylvania
Washington, D.C. 20004-2594

Re: Ukraine Agriculture Development Company

Dear Mr. Naylor:

The purpose of this non-binding letter of interest is to set forth on a preliminary basis some of the general terms and conditions upon which Case Corporation or one of its subsidiaries ("Case") would be prepared to invest capital into a U.S./Ukraine Farm Credit Company ("Credit Company").

The proposed terms and conditions of the investment are as follows:

1. Case would contribute capital to form the Credit Company in an amount equal to the average amount being invested by other companies having annual worldwide agricultural sales of $500 million USD or more, not to exceed $2 million USD (the "Investment").

2. The Investment would be made in the Non Guaranteed Pool without any standby letters of credit, guarantees, or other credit enhancements from Case unless otherwise agreed to by Case in writing.

3. The Credit Company would form an equipment leasing company, or would enter into an equipment leasing joint venture with a joint venture partner, on terms and conditions satisfactory to Case. The Leasing Company or joint venture would extend intermediate or long term financing to Ukrainian lessees of agricultural equipment ("The Leasing Company").

4. The detailed business plan including the financial statements and models for the Credit Company and the Leasing Company must be satisfactory to Case.

5. Case's willingness to make the Investment would be subject to its satisfaction with all aspects of the transaction, including without limitation, the corporate and management structure of the Credit Company and the Leasing Company; the legal, tax and regulatory environment; the credit and collection and other policies of the Credit Company and Leasing Company; and all final legal documentation.

Without limiting the foregoing, the following would be some of the specific preconditions to Case's willingness to make the Investment:

A. <u>Organizational Structure</u>

1. The Credit Company is formed with a minimum initial capitalization of $30 million USD for the sole purpose of providing short term financing for the importation of seed, chemicals, agricultural equipment, and other related agricultural items provided by Case or Investors (defined in A. 2 below) to distributors or eligible customers located in the Ukraine. The Leasing Company will extend intermediate or long term financing to Ukrainian lessees of agricultural equipment.

2. USAID would make a loan of at least $10 million USD to be used for the initial capitalization of the Credit Company and a non-reimbursable contribution of $3 million USD to be used for start up costs. The other investors in the Credit Company ("Investors"), the loan repayment terms by the Credit Company to USAID, and any conditions imposed by USAID on the $3 million contribution must be satisfactory to Case.

3. Case representatives must be involved in the decision making regarding the formation, structure, organization and management (including, but not limited to, the establishment of credit policies,

of the Credit Company and the Leasing Company). Key management and employees of the Credit Company and Leasing Company must be approved by Case.

B. Legal, Tax, and Regulatory Considerations

1. All tax legal, regulatory, and other governmental concerns relating to the transactions must be resolved in a manner satisfactory to Case.

2. The Ukrainian government and any other applicable governmental body must provide all necessary consents and assurances that the Credit and Leasing Companies will be permitted to effectively operate in accordance with their business plan.

3. All necessary exchange control and other approvals must be in place for prompt repatriation of funds to the United States.

4. The overall tax regime which will apply to the Credit Company and the Leasing Company (including tax rules applicable to equipment leases) must be satisfactory to Case.

5. Case must be satisfied that all applicable import and export tariff, sales tax and value added tax laws and other similar laws are favorable to the Credit and Leasing Companies. (For example, a transaction should not be treated as a sales transaction until title to the equipment passes to the lessee or end-user.) The export of repossessed equipment should not be subject to an export tariff.

6. Assurance that the Ukrainian legal system will effectively permit the Credit and Leasing Companies to repossess equipment following defaults by customers.

7. The Credit and Lease Companies will maintain and provide Case with access to information to satisfy Case's U.S. or other tax reporting obligations.

C. Credit Policy Considerations

1. Case Ukrainian dealers, Case distributors, and Case customers must have access to available credit lines in the Credit and Leasing Companies in an amount at least equal to Case's

Investment in the Credit Company plus a proportionate share of the Credit and Leasing Companys' leverage.

2. Any extensions of credit by the Credit or Leasing Companies must be without recourse to Case unless Case agrees otherwise in writing.

3. Creditworthiness criteria for the extension of credit to a distributor, lessee or end-user and collection procedures must be approved by Case.

4. All finance transactions must be insured against the risk that equipment cannot be repossessed following a default.

5. All extensions of credit to any customer or distribution by the Credit and the Leasing Companies must have cross-default provisions.

6. The Credit and Leasing Companies must obtain political risk insurance acceptable to Case which would cover non-payment of the debt as a result of any governmental action, including actions that would prevent currency convertibility or barter transactions, or that would impose price controls on bartered commodities or other governmental actions that could affect the ability of the Credit Company, the Leasing Company, or any lessee or end-user to repay its indebtedness.

7. The finance rates and leasing rates established by the Credit and Leasing Companies will not be higher than Ukrainian market rates.

8. Payments on leases and loans by the Credit and Leasing Companies must be U.S. dollar-denominated. The lessee or end-user shall bear all exchange risk.

D. Other Consideration

1. Case equipment eligible for financing by the Credit and Leasing Companies must be acceptable to Case (i.e. U.S. sourced versus foreign sourced).

This letter indicates Case's desire to enter into or continue discussions with you toward the possible end of making the Investment discussed above. The letter is not meant to be, nor shall it be construed as, a commitment by Case to make any investment or otherwise to extend credit. Moreover, it does not attempt to describe all other terms and conditions that would pertain to this Investment, nor do its terms suggest the specific phrasing of documentation clauses. Instead, it is intended to outline certain basic points of business understanding around which the Investment could be structured. The closing of any transaction relating to the Investment would be subject to various conditions precedent, including without limitation, the conditions discussed above. Without limiting the foregoing, Case's willingness to make any investment would be subject to further investigation, satisfaction with all final documentation and approval of the Investment by Case's senior management, board of directors, and lenders.

Case reserves the right to terminate this letter at any time.

Case Corporation

By:______________

Name: Theodore R. French

Title: Senior Vice President &
Financial Officer

Date: December 11, 1995

Approved to and Agreed By:
The Citizens' Network for
Foreign Affairs

By:______________

Title:______________

Date:______________

DowElanco
1776 Eye Street, N.W.
Suite 575
Washington, DC 20006
(202) 429-3400
FAX: (202) 429-3467

December 11, 1995

DowElanco

Mr. John H. Costello
President
The Citizens Network for Foreign Affairs
1111 - 19th Street, NW
Suite 900
Washington, DC 20036

Dear John:

This letter communicates DowElanco's willingness to consider participating as an equity partner in the Ukraine Agricultural Development Corporation. If all of the following conditions are met, DowElanco would consider committing up to $2.0 million in equity capital.

- A sufficient number of companies participating to reach the $20 million equity threshold and the consequent participation of USAID funds in the form of a five year reimbursable grant of $10 million plus a non-reimbursable grant of $3 million for operational funding.

- Access to UADC secondary financing by the equity investors proportionate to the capital commitments of the investors.

- Availability of credit information through the UADC to the participating investors with confidentiality guidelines comparable to those used by D&B.

- Sourcing guidelines no more restrictive than achieving an "overall U.S. value added" matching the share of the USAID funding via the reimbursable grant.

DowElanco would be represented in the organizing steering committee by either Gordon Brain or Sean Skinner.

Obviously, DowElanco's participation in UADC is also contingent upon formal approval by the DowElanco Board of Directors and the execution of the proper definitive agreements.

Sincerely,

Gordon Brain

Gordon H. M. Brain
Global Business
Development Manager

Du Pont de Nemours International S.A.
Middle East / Africa and Eastern / Central Europe
2 chemin du Pavillon
P.O. Box 50
CH-1218 Le Grand-Saconnex
Geneva, Switzerland
Tel. (022) 717 51 11
Fax (022) 717 61 35

DUPONT
Middle East / Africa and
Eastern / Central Europe

December 7, 1995

Mr. John H. Costello
President
The Citizens Network for Foreign Affairs
1111 19th Street, N.W. Suite 900
Washington, DC 20036

xmw TG

Dear Mr. Costello,

In response to your memorandum faxed on December 6, 1995 requesting expressions of interest from addressee companies, our position is as follows :

1) We confirm our interest in continuing to participate in the discussions related to the preliminary design of the UADC project.

2) Subject to a) formal internal review and approval by the duly authorized E.I. DuPont de Nemours & Company officers b) receiving satisfactory answers to specific structural, financial, commercial and legal questions to be addressed separately; and c) completion of all due diligence procedures, we will consider participating in the UADC project through an eventual equity investment in the range of US$ 500,000 to US$ 1,000,000.

3) We will be in a position to comment on our eventual participation (or not) in specific categories of loan pools upon receipt of specific additional data to be requested in accordance with paragraph 2 above.

4) Until such time as the conditions in paragraph 2 above have not been fully met, neither E.I. DuPont de Nemours & Company nor any of its affiliates or their representatives will participate in any actual implementation actions related to creation of UADC.

As per paragraph 2, above, we are preparing a preliminary set of questions we plan to forward to you as soon as possible. I will be in touch with you early next week to discuss the next steps.

Yours sincerely,

François Loup
Director CIS
Agricultural Products

cc. Ph. Deseulles/V.P. "AG" Europe
Ad Van Schaik/Finance Europe
J.M. Furge/Legal Europe
J. Shmorhun/AG Manager Kiev

KIEV-ATLANTIC GROUP
(Ukrainian-American-German Agribusiness Company)
 # 8 Staronavodnitskaya Suite 71-72
Kiev, 252015 Ukraine
Tel. 044-295-7275; 294-4267; 294-9068;
Fax. 044-294-9350

December 11, 1995

Mr. John Costello, President
The Citizens Network for Foreign Affairs
Washington, DC Fax 202-296-3820

Gentlemen: "UADC Conditional Letter of Intent"

As a early advocate of the need for the development of strong private farm credit facilities for Ukrainian agriculture, and as a primary potential beneficiary of such a credit facility by our model Ukraine KAU Project, we strongly support your efforts to bring the UADC effort to fruition.

The present "conditional letter of intent" is to serve as our "conditional" commitment for the minimum investment of $ 100,000 in this organization.

In accordance with our agreements with the EBRD, until the full completion of our KAU project, our American Company, Kiev-Atlantic U.S., Ltd. will be responsible for any cash shortages of our KAU Model Supply, Service and Processing Project Company, Kiev-Atlantic Ukraine. Project completion is scheduled for December 31, 1997. Therefore, any cost overruns prior to project completion must be borne by the project sponsors (Kiev-Atlantic U.S., Ltd.) unless these funds can be earned by the Project Company prior to project completion. We must therefore maintain our entire working capital for project trading activities during this period.

Considering that we already have encountered considerable project cost overruns and that Kiev-Atlantic does not have any cash reserves, we regrettably cannot commit to make this investment during the next 24 months, but, we hereby ask special consideration to be granted a "Put" on a $ 100,000 investment until early 1998 (following project completion).

Our formal conditions for making this investment are as follows:

1. That KA be allowed to make this investment at anytime up until January 31, 1998.

2. In addition to item one, the KA commitment is conditional on all of the conditions which the firm Monsanto has laid out as conditions of their investment.

With reference to our corporate procedure for approval of this investment, the below signed has the full latitude to make the required corporate approval for this amount of investment.

In the event that KA should have the funds available when the first call for investment is made, we will be proud to join all others in making their investment. If we do not have the funds available until the above prescribed time, we are pleased to inform you that we will continue to provide valuable Ukrainian farm credit related experience and insight, free of charge, to your Board of Directors at any time we can be of service.

Considering our special conditions of investment, I do not feel the need for our representative in Washington, Arthur Quinn, to be appointed to your steering committee, but, should our offer be accepted, we would appreciate being invited to attend the meetings and of being kept informed regarding their progress.

Thank you,

Very truly yours,

David D. Sweere
President & CEO

Monsanto

Monsanto Company
800 N. Lindbergh Boulevard
St. Louis, Missouri 63167
Phone: (314) 694-1000

January 23, 1996

Mr. John Costello
President, Steering Committee
UADC in Formation
c/o The Citizens Network for Foreign Affairs
1111 19th Street, N.W.
Washington, D.C. 20036

Dear Mr. Costello:

Monsanto Company has participated in and reviewed the latest results of the efforts of Citizens Network, the consultants to AID and other companies concerning the proposed creation of the "Ukraine Agricultural Development Co.", (UADC). We are in general agreement with the aims, purposes and basic design of this entity and wish to participate in the next steps necessary to create UADC.

To facilitate proceeding with this project, we would like to express our interest to proceed based on the following conditions:

Monsanto is willing to make an equity investment in UADC of up to $2 million, assuming the following critical features are met:

- The level of private sector equity commitment reaches a minimum of $20 million.
- There is minimum participation of at least 15 companies.
- USAID commits to provide a reimbursable grant of at least $10 million, to be repaid over some period of time beginning not earlier than year 3 of UADC operations.
- USAID commits to provide a non-reimbursable grant of $3 million to cover start up expenses of UADC.
- UADC operations are limited to financing/leasing of agricultural inputs and equipment for the Ukraine.

- Monsanto is represented on the initial organizing steering committee which will finalize design of UADC and, by virtue of its participation and involvement in UADC, will be assured of full voting rights and Board participation.

Final, formal authorization of the proposed investment is in process at the required senior level of Monsanto.

Monsanto is interested in participating in the Guaranteed loan pool, if and when UADC is formed and in operation.

Sincerely,

Robert A. Westoby
Director, Global Treasury Operations

/sfc

AgrEvo

A company of Hoechst and Schering

Telefax

Standort (Werk)/Location (Plant): Berlin Wedding

Von/From (Name, Abt./Name, Dept.) Robert Ungnad Region International Tenderbusiness	Telefon/Phone 030/43908-399 Telefax 030/43908-670
An/To (Name, Abt./Name, Dept.) E. Morgan Williams CNFA / CNAA Washigton	Telefon/Phone 001-202 2963920 Telefax 001-202-2963948
Gesamtzahl der Seiten (einschließlich Deckblatt)/ Total number of pages (including cover letter) 1	Datum/Date 08.12.95

Ukraine Agricultural Development Company

Reference is made to the strategy meeting held on 05.12.95 and your telefax to Dr. E. Steadman on the same subject.

We have passed on the UADC Design Document to our subsidiary in Kiev and to our finance department for their comments. Unfortunately the time remaining to meet your deadline of December 11 is too short for AgrEvo to thoroughly review the concept in order to take a decission on an important issue such as the investment of USD 0.5 - 1.5m in a special purpose company. At this point in time we therefore are not in a position to commit ourselves for participation in UADC.

We will let you know as soon as we have further evaluated the concept. Meanwhile we would appreciate it very much if you kept us informed via Dr. Steadman on the progress of UADC.

Best regards,

R. Ungnad

cc: Dr Steadman, Hoechst Celanese
Mr. H. Förstner, Hoechst AG

BASF Facsimile

Attn.: E. Morgan Williams
Company: CNFA, Washington
Fax: (001) 202 296-3948

From: Mr. Tappert
Company: BASF Aktiengesellschaft, LRV/AA
Phone: 06 21/60-9 33 82
Fax: 06 21/60-4 46 20

Date: 23.11.1995/En
Page:

Ukraine Agricultural Development Company
Your Fax to Wilfried Flagmeier, Nov 14, 1995

Thanks a lot for the information on the above project which unfortunately reached us somewhat late (Nov 21).

But, most important, it reached us. Although we cannot meet your deadline Nov 17 th we will thoroughly evaluate the project which may take until mid December.

Taking into account the investment involved, we will need a couple of days.

We can then come back to you and discuss how to proceed.

Best regards

Ralf Tappert
Tappert

cc. LRV/AA

Charles H. Cannon
Vice President and General Manager

Food Machinery Group
Avenue Louise 480 B9
1050 Brussels Belgium

Mr John H. Costello
President
The Citizens Network for Foreign Affairs
1111 19th Street, N.W., Suite 900
Washington, D.C. 20036
U.S.A.

cc: TB, EMW

Brussels, December 8, 1995

Dear Mr Costello,

Re: Ukraine Agricultural Development Company

Thank you very much for your fax of December 6, 1995.

Due to the nature of FMC's diversified businesses and the current heavy travel schedule of several decision makers, it will not be possible for us to provide you with our consensus position regarding your proposal within the deadline of December 11, 1995.

I understand that Jacqueline Renner, FMC's Project Finance Director, has already talked to you over the phone on this matter. She willl be contacting you in early January.

Yours sincerely,

Charlie

Charles H. Cannon
Vice President and General Manager

cc: James Duke - Philadelphia
Jacqueline Renner - Chicago

ZENECA

ZENECA Agrochemicals
Fernhurst Haslemere
Surrey GU27 3JE
UK

Telephone (01428) 644061
Telex 858270 ZENAGR G
Telegraphic ZENAGCHEM
Fernhurst
Fax (01428) 652922

Mr J H Costello
President
THE CITIZENS NETWORK FOR FOREIGN AFFAIRS
1111 19th Street
N W Suite 900
Washington DC 20036
U S A

Fax no . 00 1202 296 3948

DJH/mm/1/25 01428 657117 11 December 1995

Dear Mr Costello,

UKRAINE AGRICULTURAL DEVELOPMENT COMPANY ("UADC")

Zeneca wishes to remain involved in the design and concept of the proposed UADC, but is not in a position to issue a letter of intent at this time. This is primarily because of the very recent and material changes to the original proposed design, which initially make the idea look less attractive, and which need to be properly discussed and assimilated within Zeneca. However, it is obvious that much hard work that has been put in by the design team, and I would like to thank them for this.

Approval for an investment of this size and nature would have to be sought from the main board of Zeneca under the sponsorship of the Chief Financial Officer of Zeneca Agrochemicals. I envisage that Zeneca would be in a position to make a final decision on whether it wished to participate or not towards the end of January, 1996.

Yours sincerely,

D. J. Hedley.

DAVID J HEDLEY
GROUP TRADE FINANCE MANAGER

SANDOZ AGRO GMBH
Brunner Strasse 59, Objekt 59
Postfach 181
A-1235 Vienna / AUSTRIA
Sitz der Gesellschaft: Wien
Firmenbuchnummer: HRB 30.456 Handelsgericht Wien

Tel.: 43-1-86 54 617 / 43-1-86 54 647 Fax: 43-1-86 52 054 / 43-1-86 52 438 Tx: 111754 scpa a

SANDOZ

Naylor

Pls. deliver to Morgan Wi[illegible]

TELEFAX MESSAGE

DATE: *December 11, 1995* **TIME:** *14:52*

TO: ***Frank W. Naylor, Jr.***

CC:

FROM: *Alden Sutherland*

Number of pages including cover sheet: 1 **Please make copies locally , thanks!**

RE: *UADC INVOLVEMENT*

Sandoz Agro has decided not to continue its involvement in the formation of UADC at this time.

Regards,

A. Sutherland

Alden Sutherland
Sandoz Agro GMBH
Head of Finance

JOHN T. WATSON
VICE PRESIDENT
DIRECTOR OF OPERATIONS -
CIS, OCEANIA, TURKEY

cc TB, EMW

TO: John H. Costello, President
The Citizens Network for Foreign Affairs
Fax: (202) 296-3948

FROM: John T. Watson, Vice President

CC: E. Morgan Williams

DATE: December 11, 1995

RE: Ukraine Agricultural Development Company

I want to sincerely thank you for the tremendous effort and leadership that you and your CNFA team have provided on the Ukraine Agricultural Development Company project.

At the present time, Pioneer Hi-Bred International, Inc. will not participate in the formation of the UADC.

Sincerely,

John T. Watson, Vice President.
Pioneer Hi-Bred International, Inc.

CYANAMID INTERNATIONAL

1 Cyanamid Plaza
Wayne, New Jersey 07470

Fax Cover Sheet

DATE:	December 11, 1995		
TO:	John Costello Citizen Network	PHONE: FAX:	 202-296-3948
FROM:	John C. Rabby	PHONE: FAX:	201-831-4222 201-831-5819
SUBJECT:	UKRAINE AGRICULTURAL DEVELOPMENT COMPANY (UADC)		
CC:	J. Chambers R. Lombardi - CIS	B. Timofeeve - CIS G. Wychunas	

Number of pages including cover sheet: 1

Mr. Costello:

American Cyanamid has reviewed carefully the Ukraine Agricultural Development Company design report. We have also been participating in the various design meetings held to better understand the thought process behind this concept.

It is unfortunate at this time, however, that I inform you, American Cyanamid cannot participate further in this program. The risks versus the benefits does not equate to a positive position for American Cyanamid.

Cyanamid is committed to the Ukrainian Agricultural business and is staffing accordingly at our Kiev office to build a long-term future. We are also proceeding ahead with direct financing and extending credit to the dealer/large farmer levels in the Ukraine. Please note we have submitted a separate concept for a Ukrainian business focusing on extended credit to Citizen Network. Has this been reviewed yet?

American Cyanamid looks forward to working with Citizen Network in the future and we wish you well in the UADC initiative.

Regards,

John Rabby
Director of Operations
American Cyanamid Company

APPENDIX C: DISTRIBUTION LIST

American Home Products/Cyanamid
Mr. Jerry L. Chambers
Washington Representative
1726 M Street, N.W.
Suite 1001
Washington, D.C. 20036

American Home Products/Cyanamid
Mr. Richard W. Lombardi
Managing Director, CIS
ul. Agrokhimikov 9
Nemchinovska 1
143013 Moscow, Russia

BASF
Mr. Werner Besch
Regional Manager
Europalsche Staatshandelsiander
Jugoslawien
Rhein-Center, Rathausplatz 10
D-6700 Ludwigshafen, Germany

Bayer AG
Mr. Martin Petersen
Marketing Osteuropa
D-51368
Leverkusen, Germany

CASE Corporation
Mr. Leo Arteau
General Manager, Intl. Sales
700 State Street
Racine, WI 53404

Ciba-Gelgy
Mr. Benedikt Mettauer
Export Risk Manager
Group Treasury
CH-4002, Basel, Switzerland

Concord, Inc.

Mr. Thor Iverson
Vice President, Finance
2800 - 7th Avenue North
Fargo, ND 58102

Deere & Company

Mr. Dean R. Dort II
Washington Counsel
1667 K Street, N.W.
Suite 1230
Washington, D.C. 20006

Dekalb

Mr. Robert Donalson
Asst. Treasurer
3100 Sycamore Road
DeKalb, IL 60115

DMI, Inc.

Mr. William H. Schmidtgall
President
P. O. Box 65
Highway 150E
Goodfield, IL 61742-0065

DowElanco

Mr. Gordon H.M. Brain
Manager, Business Development
1776 Eye Street, N.W.
Suite 575
Washington, D.C. 20006

DuPont External Affairs

Mr. Robert M. Heine
Director, International Trade
1701 Pennsylvania Avenue, N.W.
Suite 900
Washington, D.C. 20006

FATA Hunter, Inc.

Mr. Fabrizio Alvarez de Toledo
Senior Advisor, NIS Project
Development Services
Off Forest Street
Manchester, MA 01944

FMC

Mr. James H. Duke
Group Credit Manager/Ag. Pro.
1735 Market Street
Philadelphia, PA 19103

FMC Europe N.V.

Mr. Guy Pira
European Finance Manager
Avenue Louise 480-B9
8th Floor
1050 Brussels, Belgium

Ibberson International, Inc.

Mr. Mark C. Geitzenauer
EVP/Managing Director
828 Fifth Street South
Hopkins, MN 55343-7750

Iowa Export-Import

Mr. Craig Winters
President
512 Tuttle Street
Des Moines, IA 50309-4818

Kiev-Atlantic Ukraine, Ltd.

Mr. David D. Sweere, President
byl. Staronavodnitska, 8
kb. 71-73
Kiev, 252015, Ukraine

Kiev-Atlantic U.S., Ltd.

Mr. Arthur L. Quinn
U. S. Managing Director
7979 Old Gerogetown Road
Suite 200
Bethesda, MD 20814

Monsanto

Mr. Robert A. Westoby
Director, International
800 N. Lindbergh Boulevard
St. Louis, MO 69167

Monsanto Europe S.A./N.V.

Mr. Giuseppe M. Matassi
Manager, Financial Services
The Agricultural Group
Avenue de Tervuren 270-272
1150 Brussels, Belgium

New Holland

Mr. Jack Brandt
Sales Staff Manager
500 Diller Avenue
New Holland, PA 17557-0903

Pioneer Hi-Bred Intl., Inc.

Mr. John T. Watson
Vice President
P. O. Box 316
6900 NW 62nd Avenue
Johnston, IA 50131-0316

Rhone-Poulenc

Ms. Deborah E. Myers
Manager, International Affairs
1401 Eye Street, N.W.
Suite 200
Washington, D.C. 20005

Sandoz

Mr. Alden Sutherland
Head of Finance & Controlling
Brunnar Strabe 59, Objeki 59
A-1235 Vienna, Austria

The Citizens Network for Foreign Affairs, Inc.

Mr. E. Morgan Williams
Senior Advisor
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President
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Uniroyal Chemical Limited

Mr. Marcus Meadows-Smith
District Manager, Crop Protection
Kennet House
4 Langley Quay
Slough SL3 6EH Berkshire,
England

Valmont International

Mr. E.Robert Meaney
President & COO - Intl.
P. O. Box 358
Valley, NE 68064-0538

York Manufacturing Co.

Mr. Andrew J. Cheesman
President
P. O. Box 38
6 Miles West U.S. 34
York, NE 684467

Zeneca, Inc.

Mr. Joe Virian
Customer Financial Services
1800 Concord Pike
Wilmington, DE 19850-5458

U. S. Agency for International Development
ENI/ED, SA-15,
Room 3000
Washington, D.C. 20523
Attn: Dennis Sharma

U. S. Agency for International Development
8/10 Esplanada Street, 19th Floor
252023 Kiev, Ukraine
Office of Privatization

APPENDIX D: TAXATION AND INVESTMENT IN UKRAINE

As Ukraine moves toward a free market economy, it faces numerous difficulties. However, Ukraine offers ample investment opportunities in terms of its growing consumer demand for goods and services and its skilled workforce.

Deloitte & Touche, the Deloitte Touche Tohmatsu International member firm in Ukraine, has an office in Kiev. The firm offers accounting, statutory and international auditing, management consulting, tax and legal services, as well as services that assist needs arising from the changes occurring in Ukraine, such as banking and foreign exchange services, privatization consulting, financial investigations and valuations and human resource services.

Office director: Nicolas Gerra
Auditing services.- Sergey Kostiuk, Maurice Downey
Management consulting services: Alexander Tarabukhin
Tax & legal services: Yevgen Zanoza
Telephone: +380 (44) 416 4060
Fax: +380 (44) 416 4241

Investing in Ukraine

Legal Form of Entities
Legal persons may be incorporated in Ukraine under the following legal form:

- Limited liability company,
- Closed joint stock company,
- Joint stock company,
- One single member private company,
- Additional liability company,
- Commandite partnership, and
- Full partnership (can be created as a non legal person as well).

All listed above legal persons, excluding one single member private company, should have a minimum of two members or shareholders which may be either individuals or legal entities. In order for a legal entity to qualify as a limited liability company it must, among other requirements, have an authorized capital of at least 37,500,000 UKR (about US$ 220). Joint stock companies establishing as opened or closed should have authorized capital of more than 75,000,000 UKR (US$ 445). Unlike a public (or open) joint stock company, a closed company is prohibited from inviting the public to subscribe for its shares.

Shareholding of foreign persons In general, there are no restrictions associated with the value of foreign persons' shareholding in the authorized capital of a national company, with the exception of Ukraine's banking sector, where limitations on foreign participation have been established. Foreign companies with investments in Ukraine cannot hold title to property, but in the majority of cases enjoy similar rights as companies with such a status.

Registration of a Company The table below shows the list of state bodies which are responsible for incorporation and other registrations of a company in Ukraine. The list also indicates what formal registration requirements are set up by each state body concerned. "N/A" indicates that the company is not required to get registered with a state body concerned but the latter can have control over the company's activities.

Administration Body	***Procedure***
Local (District of the City) State Administration	State registration (incorporation). The company must submit the following documents. ❑ Foundation documents: ✓ Owner's resolution about creating the new business; ✓ Statutory Agreement; and ✓ Statute (in case of partnership it is not required) The statutory documents are drawn up in the state language or in another language as provided by the Law of Ukraine "On Languages in Ukrainian SSR". ❑ Registration card (obtainable at the Administration) - 3 copies. ❑ Receipt, containing the information about payment of the registration fee (registration fee depends on the nature of activities which a company is going to carry out in Ukraine and for a wholesaler amounts to 12,600,000 URK). ❑ Copy of registration certificate of every company shareholder. A foreign legal entity hands in a document, confirming its registration in the home country (an original copy from a trading, legal or bank register, etc.). This document should be witnessed by a notary at the place of its issue, translated into Ukrainian and legalized in a consular institution in Ukraine, if not proscribed by international treaties Ukraine participates in. The above mentioned document can also be certified in the embassy of the applicant's home country in Ukraine and legalized at the Ministry of Foreign Affairs of Ukraine as well. The incorporation procedure should be completed within five working days from the date the documents are received. If all the documents mentioned above are available, the state registration body is obliged to effect state registration of the

	subject of business activity and give the applicant a certificate of incorporation

Administration Body	*Procedure*
Local (City) State Administration	Registration of a foreign investment: ❑ Special form - ":Notification about Foreign Investment" (5 copies). Registration fee about 1,000,000 UKR
Tax Inspectorate	Within days after the registration with the State Administration, a company should be registered with the relevant local Tax Inspectorate. The following documents should be submitted to a local office of the State Tax Inspectorate: ❑ Application form. ❑ Copy of the Statutory documents. ❑ Registration card.
Statistic's Committee	❑ Application form. ❑ Statutory documents (copies).
The State Department of the Defense of the Economics Against Criminal Encroachments	N/A
Tax Police	N/A
Procurator's Office	N/A
Social Security and Pension Funds	The following should be submitted within 10 days after the State Registration: ❑ Application form.
Employment Fund	The following should be submitted within 10 days after the State Registration: ❑ Application form.

Administration Body	*Procedure*
Ministries	N/A Prospectus of a [open] joint stock company should b registered by the Ministry of Finance before company incorporation.
The State Fund for Liquidation of Consequences of the Chernobyl Disaster	N/A
The State Innovation Fund	N/A
Price Inspectorate	N/A
Banks	To open a bank account, a company needs to submit the following documents: ❑ Application form (obtainable at a bank). ❑ Registration Certificate (copy). ❑ Owner's resolution about creating of the new business or (in case of partnership) Statutory Agreement. ❑ Statute (notarized copy) with the resolution of the Tax Inspectorate about registration. ❑ Notarized bank's card with specimens of signatures and company's seal (obtainable from a bank).
Customs Office	Accreditation. ❑ Application form. ❑ Statutory documents. ❑ Information Note about Foreign Investment
Sanitary Inspection	This is normally required for enterprises involved in public services, such as public catering and medical service enterprises.

Administration Body	*Procedure*
Fire Supervision Inspectorate	If necessary for a particular type of business.
The State Technology Supervision	If necessary for a particular type of business.
Consumer's Protection Fund	N/A
Labour Protection Fund	❑ Application form.
State Department of the Road Maintenance	N/A

Affiliations (branch) representative offices are not subject to state registration. The subject of business activity informs the state registration body about the creation of the above mentioned branches by introducing the necessary information into its registration card. Moreover, a company involved in trading of goods (for the scenario at hand, both retail and wholesale food products) is subject to licensing by the State Administration, which requires:

- Application form with the specification of goods.
- Statutory documents (copies).
- Registration Certificate (copy).
- Agreement on the rent of a storage space valid for at least 3 years.
- Approvals of storage facilities by the Fire Supervision Inspectorate and Sanitary Inspection.
- Other documents in accordance to the list established by the Ministry of Foreign Economy Relations and Trade.

Exchange Controls

The karbovanets (URK), the legal Ukrainian currency is not fully convertible. Residents and non-residents may hold hard currency and karbovanets accounts with authorized banks and to import and exchange currency in accordance with the procedures of the National Bank of Ukraine. Ukrainian exchange control legislation defines residents of Ukraine as:

- Individuals (Ukrainian citizens, citizens of foreign countries and persons without citizenship), including people temporarily visiting from outside Ukraine, who are domiciled in Ukraine.

- Legal entities and places of business lacking the status of a legal entity (such as branch or representative offices) located in the territory of Ukraine and carrying out their business pursuant to Ukrainian legislation.

- Diplomatic, consular, trade, and other official Ukrainian representative offices abroad that enjoy diplomatic immunity and privileges, as well as representative offices of Ukrainian enterprises and organizations abroad that do not carry out business activity.

Non residents are

- Individuals (Ukrainian citizens, citizens of foreign countries and people without citizenship), including those temporarily visiting Ukraine or domiciled outside Ukraine

- Legal entities and places of business lacking the status of a legal entity (such as branches or representative offices) located outside Ukraine that are established and carrying out their activity pursuant to the legislation of a foreign country.

- Foreign diplomatic, consular, trade and other representative offices, and international organizations and their affiliates located in Ukraine that enjoy diplomatic immunity and privileges as well as representative offices of other companies and organizations that do not carry out business activity under the laws of Ukraine (that is, offices that do not normally carry out operational activities themselves and simply refer business to the foreign entity they represent).

Legislation provides that transactions between Ukrainian legal entities must be made in Ukrainian currency only. Transactions between Ukrainian legal entities and non-residents of Ukraine can be in foreign currency. Transaction in cash on the territory of Ukraine must be only in local currency, exemptions apply to:

- duty free shops;
- payments by credit cards;
- hotels for the foreign tourists;
- ship chandlers' services;
- payments for the tickets on intentional flights, etc.;
- customs duty payments; and
- payments of non-residents for entry visa.

Ukrainian legislation requires the mandatory conversion, through authorized banks on the Interbank Currency Market of Ukraine, of 50 percent of foreign currency received by residents. However, hard currency receipts of enterprises with foreign investments from sales of products, services, or works produced by themselves are exempt. Further exemptions from the 50 percent mandatory conversion are:

- Payments in foreign currency received on the account of a Ukrainian resident acting as an agent under a contract of agency provided that those payments are transferred to the principal selling entity, which can be resident or non-resident.

- Investments in foreign currency contributed to the authorized capital of legal entities with foreign investments by foreign investors.

- Payments in foreign currency received by Ukrainian citizens (except Ukrainian sole proprietors) from non-residents of Ukraine.

- Foreign currency purchased at the Interbank Currency Market.

- Foreign currency reserves of authorized banks.

Residents and non-residents of Ukraine need an individual license from the National Bank of Ukraine for effecting currency operations, except for:

- Foreign currency which was duly brought into Ukraine at an earlier date.

- Foreign currency payments related to foreign trade transactions.

- Foreign currency payments related to credits, interest, and dividends.

- Foreign and Ukrainian currency taken out of Ukraine by residents of Ukraine (up to the limits specified by the National Bank of Ukraine).

- Repatriation of foreign investment amounts, in the case of termination of investment activity.

Bringing foreign currency into Ukraine is not subject to licensing.

Local Participation or Management Requirements
Foreign investors may own 100 percent of shares of an enterprise, and the personnel of a company may be made up entirely of foreign individuals. However, the number of expatriates within a representative office, may be subject to a quota.

Investment Incentives
Enterprises with foreign investments including joint ventures which were created before 1 January 1995 can enjoy tax holidays for up to 5 years from the date when a qualifying investment is made. A qualifying foreign investment is an investment by a foreign-owned enterprise in a Ukrainian legal entity of not less than 20 percent of the paid-in capital and complying with one of the conditions below:

- The minimum value of the investment must be at least US$50,000 if the investment is made in the form of:

- ✓ any personal or real assets (land, buildings, equipment, etc., except for consumer goods and goods for sale) as well as proprietary rights relevant thereto; or

- ✓ any intellectual property rights valued in foreign currency according to the laws (procedures) of the investor's home country or to international trade precedents.

- The minimum value of the investment must be at least US$500,000 if made in cash.

If the contribution of the foreign investor to the authorized capital is less than the equivalent of US$50,000, but more than US$10,000, enterprises with foreign investments enjoy tax holidays for one year from the date when the investment is made. A newly created business would be considered an enterprise with foreign investment if the qualifying investment is made within a calendar year from the registration date. Tax incentives become effective for the enterprise from the date when the qualifying investment is made. However, according to the Law of Ukraine "On Tax on Profit" which came into force on 1 January 1995, all the above mentioned benefits will be effective only for enterprises with foreign investments created and registered prior to 1 January 1995, during the first 5 years after the date when the investment was made.

Privatization

Privatization is an important part of the government program to improve market relations in Ukraine. The program of privatization includes privatization of the state residential fund and privatization of state enterprises and companies. Unfortunately, no provision for the privatization of land exists at the present time. Land cannot be purchased by a legal entity, only leased from the state.

Entities targeted for privatization by foreign investors are defined by the State Property Fund of Ukraine. Participation of foreign investors in the privatization process is allowed, but with limitations. For example, low priced enterprises can be purchased by foreigners only after an auction or tender for local investors, or the enterprises are otherwise offered to Ukrainians. However, the law is expected to be changed in 1995, to authorize participation of foreigners in auctions on an equal rights basis. Areas where privatization is restricted at present include power and energy production, defense industry enterprises, and units of the main state transportation organizations. By the end of 1994, only 13 percent of enterprises intended for privatization had been privatized.

Taxation of Resident Entities

Corporate Income Tax Rates. (Tax on Profit)

The rates shown in the Table are effective from 1 January 1995.

Corporate income Tax Rates	
Type of activity	**Rate (%)**
Standard rate (most activities)	30
Intermediary and action activities	45
Gambling activities	60
Profit of agricultural enterprises which are providing services for agricultural production	15

The basic rate of tax on profit is 30 percent. It is applicable for resident and non-resident entities. However, some kinds of activity (e.g., own agricultural production and processing, fishing and fish product processing, construction in the countryside) are exempted from taxation.

In addition, the profit of a Ukrainian legal entity is exempted from taxation if the Ukrainian legal entity has the following features:

- The legal entity is wholly-owned by non-residents.
- The legal entity obtains revenue and other receipts only from sources outside Ukraine.
- All settlements are made only through the Ukrainian banks.
- Management and administrative personnel are all citizens of Ukraine.
- The legal entity does not provide representative functions for foreign owners.

Taxable Income Taxable income includes a company's worldwide profits with some deductions for business expenses. Foreign income taxes may be credited against Ukrainian income taxes, but the credit is limited to the amount of income tax payable on foreign derived income. xchange gains and losses are generally included in the computation of taxable income.

The former Soviet Union's regulations requiring the straight-line method of depreciation are still valid in Ukraine. However, accelerated depreciation may be used upon the tax authorities' specific approval; approval is granted to encourage investment in new technology.

Taxation of non-resident entities

Non-resident entities with permanent establishments in Ukraine pay tax on their income received from activities in Ukraine. Non-resident entities operating a permanent establishment usually pay tax once a year.

Tax Considerations for Groups

Tax provisions regarding groups of companies do not exist. One of the parties to a group must maintain accounts for joint activity of the group. The profit obtained from the joint activity is allocated to the companies according to their agreement, and each company adds the allocated income to its separate income for tax purposes. No special provisions apply to intercompany dividends. There are no provisions regarding thin capitalization and there are no specific provisions on transfer pricing.

Corporate Assessments and Payments

The tax year corresponds to the calendar year. Resident companies must file final returns by 15 March of the year following the tax year. Taxes are assessed on a quarterly basis and preliminary payments of the estimated or forecast tax on profit are required on a monthly basis. Non-resident entities with a permanent establishment in Ukraine must file final returns by 5 February of the following year and taxation of such entities is calculated on a yearly basis.

Withholding Taxes

Basic Rates

Dividends paid to non-resident companies are subject to a withholding tax of 15%. Revenue that is obtained by a foreign legal entity from Ukraine but is not related to business activities therein, is taxed at the following rates:

- 15 percent - for revenues from dividends, interest, royalties, licenses and rent
- 6 percent - for international freight payments in favor of foreign legal entities.

These rates are applied for all foreign legal entities, if there are no other provisions provided by international tax treaties.

Rates Under Double Tax Treaties

Ukraine honors the treaties concluded by the former Soviet Union, which generally follow the Organization for Economic Cooperation and Development (OECD) model. Among these treaties are those concluded by the Council for Mutual Economic Assistance (COMECON). Signatories of these treaties also included Bulgaria, the former Czechoslovakia, Hungary, Mongolia and Romania. Treaties are in force with the countries shown in following Table, and their effect on the withholding tax rates is indicated there.

Withholding Tax Rates for Treaty Countries			
Country	**Dividend (%)**	**Interest (%)**	**Royalties (%)**
Austria	-	-	-
Belgium	15	15	-
Belarus	15	10	15
Canada	15	15	10
COMECON countries	-	-	-
Cyprus	-	-	-
Denmark	15	-	-
France	15	-	-
Finland	-	-	-
Germany	15	5	-
Italy	15	-	-
India	15	15	15
Japan	15	10	10
Malaysia	15	15	10
Netherlands	15	-	-
Norway	15	-	-
Poland*	-	-	-
Spain	15	-	5
Sweden	15	-	-
Switzerland	15	15	15
UK*	5-10[1]	-	-
USA*	5 - 15[2]	-	-
Uzbekistan	10	-	-
* Treaties were signed and ratified by Ukraine.			

[1] According to the Convention between the UK and Ukraine dividends are taxable as follows:

- ✓ 5 percent of the gross amount of the dividends if the beneficial owner is a company which controls, directly or indirectly, in the case of the United Kingdom, at least 20 percent of the voting power in the company paying the dividends, and in the case of Ukraine, at least 20 percent of the authorized capital in the company paying the dividends;
- ✓ 1 0 percent of the gross amount of the dividends in all other cases.

[2] According to the Convention between USA and Ukraine dividends are taxable as follows:

- ✓ 5 percent of the gross amount of the dividends if the non-resident beneficial owner is a company which controls, directly or indirectly, in the case of the USA, at least 10 percent of the voting power in the company paying the dividends, and in the case of Ukraine, at least 20 percent of the authorized capital in the company paying the dividends;

- ✓ 15 percent of the gross amount of the dividends in all other cases.

Taxation of Individuals.
Individuals residents of Ukraine are subject to personal income tax on their worldwide income. Non-residents are liable for tax on Ukrainian-source income only.

Treatment of Families
Married couples are assessed separately, as are children.

Personal Income Tax Rates
The rates of personal income tax are shown in the following Table. Tax rates are deductible by 50 % for income obtained in hard currency.

Personal Income Tax Rates	
Level of Taxable Income (URK per month)	**Rate Applicable to Band**
Up to 1,400,000	non taxable
1,400,000 - 7,000,000	10% on income exceeding 1,400,000
7,000,001 - 14,000,000	560,000 + 20% on income over 7,000,000
14,000,000 - 21,000,000	1,960,000 + 30% on income over 14,000,000
21,000,001 - 35,000,000	4,060,000 + 40% on income over 21,000,000
more than 35,000,000	9,660,000 + 50% on income over 35,000,000

Profit distributions (dividends, share of profits etc.) of Ukrainian tax residents are taxed at a rate of 15 percent.

Taxable Income Taxable income comprises the gross income from all sources. Personal taxable income in Ukraine is determined by reference to the residence status of the taxpayer. A person is considered to be a resident in Ukraine if he/she is present in Ukraine for more than 183 days during a tax (calendar) year. A resident is subject to Ukrainian taxation on his/her worldwide income earned during the whole year.

Exempt Income All individual taxpayers are entitled to a number of allowances. Those which are of most interest for expatriates paid for them by employer are:

- Car allowances.
- Travel allowances.
- Housing allowances.
- Pension and social insurance remittances made by the employer on behalf of the employee.

APPENDIX E: UKRAINE AGRICULTURE

With its rich soils, temperate climate and strategic location, Ukraine has been a traditional exporter of agricultural products, and an importer of such inputs as pesticides, herbicides and fertilizers. Since independence in 1990, and the collapse of the Former Soviet Union (FSU), economic conditions in Ukraine have deteriorated significantly, with corresponding effects on agricultural production and outputs. Inefficiencies, waste, losses in transport and in storage, as well as spoilage in food processing, continue to plague the sector. While the Government of Ukraine (GOU) has focused on many of the issues that need to be addressed, the timing of the implementation process within the various government agencies has been mixed. This was confirmed in a recent speech by President Kuchma, where it was stated that the key to the realization of real reform in Ukraine was in agriculture, and that in addition to endorsing farm reform, the President was also including plans to decentralize control within powerful ministries such as Agriculture. President Kuchma's continued commitment is supported by the many private initiatives currently taking place, as evidenced by the newly created farm centers, agribusiness joint ventures, and the proposed Ukraine Agricultural Development Company (UADC).

This report will not address all aspects of the agricultural sector, but rather those that are relevant to the implementation and success of the proposed UADC, which as currently designed, will concentrate its in-country activities on working with the major international input suppliers and their Ukrainian representatives, agents and distributors. As envisioned, the UADC will provide financial support designed to increase the supply and availability of imported inputs from the major agricultural input companies and equipment manufacturers. The lack or scarcity of these inputs was a major factor in contributing to the estimated 30% reduction in agricultural production rates that took place from 1990 to 1994. Current production yields continue to decline although it is also reported that some of the reduction may in practice be due to product diversion into the "gray market". The timing of the proposed UADC would seem to be especially opportune given the continuing lack of rural credit, increased need for inputs to offset declining agricultural production, and the growing number of new entrepreneurial initiatives that are looking to meet the needs and develop the many opportunities that exist.

In the proposed design of the UADC consideration has been given to the immediate need to provide the farm sector with access to seasonal crop inputs for the 1996 season as well as developing a means of providing lease financing for the acquisition of machinery and equipment.

This has been done within the framework of regulations governing banking, which currently does not allow for non-bank lending. It order to accommodate the regulations and at the same time allow for an early start-up, the UADC has been designed as an off-shore financial entity that will in essence purchase the trade receivables resulting from the sale of inputs to Ukrainian farmers and dealers. The fundamental need to provide financial support to the agricultural sector will be addressed and fulfilled.

STATUS OF THE SECTOR

Agriculture is the largest economic sector in Ukraine, accounting for 20% of all employment, 30% of Gross National Product and 28% of exports. The sector's importance is further highlighted by the fact that over 60% of urban Ukrainians family income is spent on food. Since 1990, the sector has been affected by external factors including high inflation, increased real costs of agricultural inputs, overall decline of real wages and domestic demand, and the breakdown of payment channels with FSU countries. These, combined with the continued impact of unsustainable agricultural policies inherited from the past, have contributed to the sector's declining output. Collectivized agriculture and the routine covering of enterprise losses eroded labor incentives and rewards to management for containment of costs, resulting in low levels of productivity. The cumbersome mechanisms of central planning and control resulted in monopolistic and inefficient distribution systems for agricultural inputs and outputs. With the decontrol of farm-gate prices in recent years, the uncompetitive nature of state procurement enterprises and export barriers have caused poor transmission of border prices to the farm level. The end result has been an erosion of agriculture's terms of trade and a farm economy that is largely characterized by barter transactions.

Ukraine, the FSU's bread basket with exceptionally fertile soil, has just recently announced that it expects this year's grain harvest to be the lowest in over a decade. According to the Ministry of Agriculture, the gross harvest, including corn, is expected to be 37.7 million tones this year, 6.4 million less than expected and a 17% drop from last year's harvest of 45.6 million tones. The large state-run enterprises produced a total of 35.0 million tons, down from the expected 40.7 million tons, while the small private farms showed slightly better average yields. Average yields per hectare are approximately half those in Western Europe, fertility yields of livestock are 33% lower, and feed conversion ratios are less than half of Western standards. Local reports quote experts who place the blame for the reduced yields on the government's controls on prices and trade, not with farmers or the land, since according to their assessment, yields on state farms are half those on farms participating in joint ventures with western firms. Further blame is placed on the continuing subsidies to the deficitary state farms, where the GOU has again indicated its intention to eventually transfer 60% of the land into private ownership, whereas it currently owns 93%. Addressing these problems will require land reform and massive farm restructuring, privatization and demonopolization of the agricultural input supply, marketing and processing enterprises, as well as improved linkages to international markets.

The GOU is aware of the need to accelerate the pace of change in the agricultural sector, while at the same time adhering to the guidelines of the International Monetary Fund (IMF), which are designed to reduce the rate of inflation, contain GOU spending, restore real interest rates and other measures which are necessary to encourage investment. Curtailment of capital flight and the need to provide increased liquidity to the financial community are additional priorities. While not opposed, the GOU recognizes that the transition to a market economy does imply certain measures that may result in temporary hardships, especially when dealing with redundant farm labor and over-employment in the state controlled "agro-industrial complexes". Until quite recently there was the misconception within the GOU that the problems of the agricultural system were transitory; it was felt they could be overcome through advanced technology, better management, and the maintenance of large-scale production systems and enterprises, and that they could continue to subsidize inputs during the transition. Monetary emissions by the central government to finance seasonal input supply and output marketing operations served to raise the rate of inflation and perpetuate the heavy involvement of state enterprises in agricultural marketing under ministerial direction. The combination of heightened inflation and payment delays by these state enterprises consistently eroded farm income. It should be noted that though the GOU ceased setting most agricultural output and input prices in 1992, it still maintained considerable control over prices through state contracts and state orders. Monopolistic state trading agencies exert substantial pressure on farms to sell at low prices by making these sales a condition for supply of otherwise hard-to-get inputs and credit.

While over 80% of the state and collective farms (sovkhoz and kolkhoz) have been transformed to share controlled entities, either joint stock companies or cooperatives, the presence and role of the state is still pervasive. It should be mentioned though that this has in part been ameliorated by the rapid growth of the large informal and unreported economy. Less than 2% of Ukraine's agricultural land is controlled by independent private farmers, with some 11.8% being used for household plots and gardens. Privatization of agricultural processing firms, grain elevators, input supply companies and other service entities has been largely stalled by delays in the mass privatization program. A number of newly created firms or foreign firms dealing with agricultural inputs have been established, thereby creating alternative sources of supply. In this respect it is interesting to note that in addition to US manufacturers and distributors, German, French and Dutch suppliers also seem to be entering the market. Unfortunately the number of such firms is still small and the supply of inputs limited when measured against the sector's needs, resulting in a continuing dominance by the state companies. Farmers have addressed this situation by setting up their own processing facilities and by selling bulk to merchants for export or barter, depending upon the licenses and conditions available. A number of private channels of distribution have also developed to supplement the traditional markets and retailing of Soviet times, taking advantage of the growing willingness to bypass the system.

In recognition of the need for a comprehensive agricultural reform strategy, the GOU has focused on a number of areas that require attention. These include the following:

- Private ownership of land and agricultural assets
- Elimination of state contracts and liberalization of producer prices
- Trade liberalization, including elimination of export licenses and quotas
- Creation of a commercial system for input supplies
- Development of a commodity exchange
- Modification of tax policies
- Establishment of a viable rural credit system

Donor agencies such as the US Agency for International Development (USAID) and the US Department of Agriculture (USDA) as well as the European Union and the World Bank are working closely with the GOU to assist with the reform process. However, it should be recognized that land privatization, commercialization of agricultural assets and restructuring of the public sector entities that manage the multitude of agro-industrial holdings, are not necessarily popular nor politically feasible undertakings in the current Ukrainian environment. Political expediency may very well determine the pace at which the reform programs take place. An example of this was evidenced in the attempts of the Socialist Party to declare unconstitutional President Kuchma's decree authorizing farmers to buy and sell land. While it is reported that the Supreme Rada (Parliament) has been supportive of the President's reforms in general, difficulties and delays are experienced.

The Ukrainian agriculture and agribusiness sector has the potential to lead the recovery in economic growth for the Ukrainian economy. The sector is also vital to the health and well being of the population, as emphasized by President Kuchma who has targeted enhanced agricultural productivity as a key element in the reform process. As a bellwether, agricultural growth would not only address the tenuous aspects of domestic growth, but would also assist in compressing a significant trade deficit with its former Soviet partners, which is made all the more important because of Ukraine's dependence on imported energy, of which Russia is the main supplier.

Under the FSU's interrepublic trade Ukraine was a large net exporter of practically all major temperate zone products (grain, milk, meat, sugar, vegetables), and with the exception of potatoes and fruits, Ukraine had the lowest production costs. Recent assessments have confirmed Ukraine's comparative production cost advantages within the New Independent States (NIS), suggesting that specialization would be beneficial as the country looks to increase trade with its neighboring NIS members. Ukraine's trading patterns have not changed like those of some East European countries and the Baltic states. This is in part due to the delays in implementing the necessary economic reforms which would permit it to take advantage of foreign trade and investment opportunities. Like its East European and Baltic neighbors, the need for energy imports and the inability to generate hard currency to pay for such has left Ukraine dependent on its NIS neighbors, especially Russia. Ukraine's balance of payments, particularly with the NIS, is in deficit, and has every indication of expanding. It is in recognition of this that President Kuchma has singled out agriculture as the sector with the greatest potential to provide the Ukraine with financial sustainability. The President has also indicated that in order to achieve the needed growth, the reform program must be implemented and the sector must undergo major change.

In the future it is expected that the new roles for government will be the provision of agricultural market information, policy making and sub-sectoral analysis. The dismantling of the existing bureaucratic structure of central planning and direct management of agricultural enterprises are important changes that must be made. At this juncture it is difficult to predict what the timing of the agricultural reform process will be, other than to confirm the importance the GOU has attached to it. In October 1994, the agricultural reform directions announced by President Kuchma signaled the first comprehensive reorientation of agricultural policies. Implementation of the reform measures were initiated in December 1994, and have continued albeit at a slower pace into 1995. Select appointments and efforts during the year confirm the continued commitment to move forward with the reform program, which is as indicated, designed to bring about fundamental change in the ago-industrial sector.

MAJOR AGRICULTURAL SUBSECTORS

The production of crops accounted for about 45% of gross agricultural output in the late 80's and early 90's. Livestock production accordingly contributed about 55%. These shares have changed in favor of crop production during recent years, as the decline in livestock production has been greater than in the crop subsector. It is currently estimated that crops represent in excess of 52%, with livestock production continuing to suffer greater declines due in part to the export of breeding stock. Ukraine had the reputation of being the bread basket of the FSU, with more than 80% of all agricultural land having being used for crop production. The cropping structure has not changed in recent years, with 45% of arable land being used for crop production, 33% for forage, 10% for industrial crops, and the remaining balance being used for potatoes and vegetables.

Within the crop subsector, cereals are the key crop for both livestock production and human consumption. Wheat is the major grain crop representing some 49% of all the cereals. Barley is next, accounting for 19%, followed by maize (15%), other legumes (6%), rice (5%), millet (5%), oats (3%), and buckwheat (2%).

Sugar beets and sunflowers are the most significant industrial crops: others include soybeans, rapeseed, castor oil plant and flax fiber. A number of the farm managers indicated that sugar was the most profitable crop, due in part to the fact that it is a negotiable commodity in barter agreements as well as being highly marketable as either molasses or alcohol. In many of the barter transactions that were observed, sugar and its by-products were the preferred commodity.

Potatoes, the most important food crop after grain, are also used for animal feed and as raw material for industrial products. While the recent harvests have not reflected the same general decline as cereals, yields at 13.7 tons per hectare in 1993, are low by international standards. Vegetables, with tomatoes, cucumbers, cabbage, carrots, beets, and onions accounting for most of the production, have averaged under 8.0 million tons per annum with an average yield of 15.1 tons per hectare. The absence of sweet maize, beans, and such leafy vegetables as spinach and lettuce is attributable to both cropping conditions and dietary habits.

Fruit harvests average close to 7.0 million tons per annum, with an average yield of 3.7 tons per hectare. The main fruits produced in Ukraine are seed fruits (apples and pears) which comprise 58% of total production; stone fruits (peaches, plums and cherries), 16%; grapes, which are grown mainly in the south, 23%; and berries, 2%.

Livestock production in Ukraine is exceptionally large, accounting for more than 50% of the value of gross agricultural output in the time of the FSU, as well as using two thirds of agricultural land and domestically produced grain, employing 70% of the agricultural labor force, and contributing 40% of total agricultural exports, mainly in the form of meat. Since 1990, the livestock population has declined by almost 20%. With livestock production having fallen at a far faster rate than the decline in livestock numbers, opportunities exist to introduce new breeds and improved genetics. Within the cattle industry significant focus is on dairying, which is carried out on some 10,800 State and collective farms. These own about 6.0 million cows distributed among more than 18,000 sub-farms. Beef production is handled by more than 5,000 State enterprises with an installed capacity to fatten over 8.0 million young bulls per year in about 8,000 feedlots. A number of private feedlots have been established, and are expanding at a rapid rate. Pig production is very important due to attractive prices for lard and consumer preference for fatter pigs.On some 10,000 State and collective pig farms, Ukraine produces much fatter pigs (with lean meat carcass contents of 38-45%) than Western countries (52-59%). Almost all sheep are raised on about 5,000 social sector farms with average herd sizes of about 1,200 sheep. Ukraine's goat population is relatively small and is mainly in private hands. Poultry production is based on integrated breeding and production programs, with the sector having experienced a recent shift from State enterprises to private producers.

As an addendum to this section it is of interest to note that official figures indicate that Ukrainians today consume less protein (meat, fish, eggs and dairy products) and more carbohydrates (bread and potatoes), but also less fruit and vegetables. Animal fat is popular and its continued relative low cost encourages excessive consumption. Life expectancy rates have not improved, and the effects of a weaker inadequate diet combined with water contaminants and the cold winter climate, are not expected to help.

Ukraine's forests were extensively damaged during World War II and were reduced from 40% of land area to only 12% after the war. With extensive reforestation they have recovered to more than 14% of the land area, but the country continues to be a net importer of wood. Forests are state owned although the new land code permits private ownership (cooperative and individual) of forest plots of up to 5 hectares, alleging that this is a result of a government policy emphasizing the environmental values of the forest.

RESTRUCTURING OF AGRICULTURAL ENTERPRISES

The restructuring of the agricultural sector is proceeding mainly through reorganization of collective and state farms. As indicated earlier, the extent of formal reorganization has been substantial, with over 80% of the state and collective farms having been "privatized" through the following mechanisms:

- Creation of shared ownership based on conditional land and non-land shares;
- Creation of "lease cooperatives" as independent subdivisions of existing kolkhozes and sovkhozes;
- Conversion of kolkhozes and sovkhozes into joint stock companies (JSCs); and
- Separation of individual peasant farms from the kolkhoz or sovkhoz structure.

Resulting from the above is the agricultural cooperative which is in effect a conglomerate. The continuation of land reform and farm restructuring will eventually facilitate the purchase and sale of farm land and assets. Until such changes are implemented, private, that is individual, farm ownership will be difficult given the lack of tenure and inability to obtain appropriate credit. Private farmers are thus undercapitalized and have difficulties in providing collateral. Under current legislation, private farmers may own up to 50 hectares of agricultural land and up to 100 hectares of all land. However, according to a 1993/1994 survey, less than 5% of private farmers had plots of more than 50 hectares, and more than 50% of the farms were of less than 20 hectares. Most of the land in private farms is arable, with areas under gardens, haylage and pasture being very small on average.

The agroprocessing subsector consists of more than 7,000 agro-industrial plants, of which approximately 2,250 are primary processing plants and the rest are secondary processing plants. The main products of these plants are sugar, edible oils, meat, milk and dairy products, and canned and dried fruit and vegetables. There are also potato and flax processing facilities. Secondary processing industries include bread baking, pasta making, processing of vegetable oil and the beverage industry, including the distilling of alcohol and spirits, wine making, beer brewing, as well as soft drinks and mineral water bottling. Full capacities of the industry have not been used in recent years, and outputs in most cases are constantly declining. Most of the plants are old or inefficient and could not operate under competitive conditions. Considerable changes in the structure of these industries is needed in the coming years, and should be part of the mass privatization program. In the meantime, the agroprocessing subsector continues to be dominated by the State, with some private initiatives beginning to develop in their shadow. According to several private investors it is almost easier to start afresh rather than take on the prospects of restructuring one of the State enterprises.

The food processing industry has traditionally relied upon government orders to obtain its input supplies from agricultural producers and other government enterprises to sell their output. In the current environment, many food processing operations are constrained due to lower farm supplies,[1] higher price demand from farms, and significantly under-market prices for their output from state marketing enterprises. To the extent possible, many are beginning to market their own goods outside state channels. However, few are willing to restructure their plants in an effort to compete with international firms.

The food processing bottleneck is providing a strong business opportunity for the growing number of private input distributors. A number of private, independent Ukrainian, foreign or joint venture firms have been established during the past few years to provide agricultural inputs to the sector. This nascent alternative supply source has struggled against the state firms, as well as government bureaucracy, regulation, and control. The number of such firms is still small and their capital, inventories, and distribution channels are limited relative the size and needs of the sector. Inputs are still dominated by the state companies.

[1]The lower supplies are more likely from the reluctance of farm enterprises to provide them with product at lower offered prices than lower actual production. Many farm enterprises appear to be withholding much of their harvest as able to obtain higher export or value added prices from their own or newly private processing facilities.

In order to render their inputs distribution businesses profitable, most distributors are taking the commodities in barter payment from the farm and liquidating them for hard currency. The risk of dealing in barter rather than cash is high but the rewards are also high for the enterprising. Distributors are finding it necessary to process the commodities and then sell the value added product, such as flour, molasses, or alcohol. Many are becoming adept at finding alternative routes to export commodities and in developing more processed products, avoiding government regulations, to meet their foreign customer demands. The value added processing provides much higher margins to distributors, enabling them to take on some of the additional credit risk of their farm customers.

LEGAL AND REGULATORY FRAMEWORK IN AGRICULTURE

Export license and other export restrictions

The list of exported agricultural products, which are subject to licensing, is changed by the Ukrainian government every year. Presently, according to the Resolution of the Cabinet of Ministers, #35 "On the List of Products that are Subject to Export Licensing and Quotation in 1995" dated 18 January 1995, export of food grains, including wheat, rye, barley, maize, rice, sorghum, buckwheat, oats and millet, is subject to quotation and licensing.

The ability of exporters to obtain a license is often associated with bureaucratic hassles and is determined by a number of factors. First, the Ministry of Agriculture annually sets up an export quota for particular products. Thus, a business enterprise can get the export license only within the limits of the quota. In order to get the license, potential exporters must satisfy the following requirements:

- the fulfillment of the state contract on agricultural products supplies (the majority of collective farms are participants of such contracts),
- compliance of the contract prices with the indicative prices and/or with the prices at the Ukrainian Agricultural Commodities Exchange at the time of export.

Prices on agricultural products

Currently, in order to avoid dumping trade practices the Ukrainian government determines the so-called "indicative prices" on butter, sun oil, sun-flower seeds, 3rd class wheat, flour, maize, barley, peas, and sugar; these are the lowest prices at which the products can be traded. For example, the indicative price for 1 ton of 3rd class mild wheat is US$ 140-150. In addition, according to the Resolution of the Ukrainian Parliament, #625 dated 14 August 1995, grain cannot be exported at prices lower than those fixed by the last bids at the Ukrainian Agricultural Commodities Exchange.

Setting up prices lower than the indicative prices must be authorized by the Ukrainian Ministry of Foreign Economic Relations. The exporter can obtain such authorization by submitting evidence of why it is impossible to sell the products at the indicative price (for example, because of lower quality or because of certain market conditions). Moreover, according to Ukrainian State Customs Committee procedures, in cases where the contract prices are lower than the indicative ones, customs authorization can be carried out if one of the following requirements are met:

- the contract price is confirmed by the Ukrainian Ministry of Foreign Economic Relations
- in cases where exported goods are subject to licensing the exporter has a valid export license.

Since the founding of the Ukrainian Agricultural Commodities Exchange (the Exchange), regulations for exporting agricultural products have been significantly liberalized. The peculiar thing about the operations performed through the Exchange is that licensing and quotation regimes do not apply to agricultural products that are sold to foreign buyers on the terms of spot and forward rates. Furthermore, there are no restrictions for the export of sun oil and no contract registration procedures are required. The contract has to be certified by a stamp of the Exchange and registered at customs (at the Exchange customs point) which can serve as grounds for unrestricted export of agricultural products outside Ukraine. Settlements with foreign buyers are carried out in Ukrainian karbovanets (URK). Procedures regulating purchase of the national currency by the foreign buyer are designed by the National Bank of Ukraine. Currently, it is apparent that there are only two possible ways to export agricultural products, either by a separate export agreement, including barter agreement with a producer, or through the Agricultural Exchange.

Barter agreement

Presidential Decree #84 dated 27 January 1995 gives the following definition of a barter (exchangeable) transaction. "Barter transaction is a legalized, contract cost-balanced exchange of products between a Ukrainian and foreign party without any monetary settlements." The barter agreement determines the general cost of the exported and imported products. The cost should be expressed in US dollars.

In barter transactions involving (the highly liquid) agricultural products, the exporter or importer is obliged to open an advance import deposit of 5% of the contract value with a Ukrainian bank. A bill of exchange can also serve as a "deposit." The exporter gets his advance import deposit back as soon as he presents a copy of the customs declaration, confirming the entry of imported goods into Ukraine.

In cases where the imported goods arrive later than 90 days from the fulfillment of the export part of the barter contract, the Ukrainian exporter should pay 0.3% of the contract value of undelivered imported goods for each day of delay. However, in case the import part of the contract (if the contracted goods are complex equipment, special goods, etc.) fails to be fulfilled within the 90-days term, the Presidential Decree #660 dated 26 July 1995 provides an opportunity to avoid the penalties mentioned above. By obtaining special permission from

Ukraine's Ministry of Foreign Economic Relations the local party can be allowed to prolong the terms of delivery of the imported goods. The aforementioned Decrees are issued by the government to prevent possible accumulation of hard currency by the Ukrainian exporters abroad. However, if the import part of the contract is performed before export, neither sanctions, nor advance import deposits are imposed.

Registration of barter contracts

Presidential Decree #659 dated 7 November 1994 establishes a special procedure for registration of contracts with the Ministry of Foreign Economic Relations (MFER). In particular, barter agreements on meat and milk products, groats, flour, sun-flower seeds, sugar and molasses, are subject to obligatory registration.

The registration procedure requires submission of an application, the contract, a confirmation of opening an advance import deposit with the authorized bank, and an expert conclusion on reasonability of the price (in case the MFER are unable to estimate it). According to the MFER Resolution, the procedure must be completed within 15 days after submission of the above documents. After the procedure is completed, the exporter is granted a record-card. This card together with the other documents should be presented to the customs officials.

Import value-added tax

Import value added tax has been imposed by the Law "On the 1994 State Budget." Today the tax rate is 20% of the customs price of goods, including customs duty and customs fees. The VAT is paid in URK at the exchange rate of the National Bank of Ukraine, valid at the date of submission of consignment customs declaration. For example, if the contract price of imported equipment is US $10,000, customs duty is 5%, and customs fees are 0.15%, then amount of taxes to be paid are calculated as follows.

> (10,000 + (10,000 * 0.05) + (10,000 * 0.0015))*0.20;
> VAT = US$ 2,103 or URK 372,231,000 (rate of exchange, US$ 1 : URK 177,000)

The equipment and other property imported into Ukraine as a contribution of a foreign investor to the authorized capital of an enterprise with foreign participation is exempted from the above tax. In addition, according to the Decree of the President of Ukraine dated 30 June 1995, raw materials, inputs, equipment, materials and other goods imported by the local business entities directly, as well as imported via intermediaries, for production purposes and own needs without further alienation, are exempted from the VAT at the moment of crossing the customs border. In case the above mentioned goods are used for the purposes other than the ones specified above, they are subject to VAT payments at the value which must not be lower than their customs value.

The above mentioned Decree allows to import into Ukraine any equipment, raw materials, other material and technical resources without payment of VAT, if the importer is a Ukrainian consumer of these goods (the same attributes to import, based on the contract with participation of an intermediary - commissioner, attorney) and the imported goods are intended for production and internal purposes of the importer. The same regime and requirements are applied to the import of equipment, carried inwards on the basis of a financial leasing contract. Leased equipment should serve for internal production purposes only.

APPENDIX F: UKRAINE FINANCIAL SECTOR

This report presents an assessment of Ukraine's financial sector and the implications for the creation of the proposed Ukraine Agricultural Development Company (UADC).

Since the collapse of the Former Soviet Union (FSU), Ukraine's financial sector has been beset by high inflation, negative real interest rates and a general decline in the levels of industrial and agricultural outputs. Like other former Soviet republics, Ukraine experienced a surge in prices and wages in 1991 and 1992, after decades of nearly non-existent inflation. The pace accelerated in 1992, when the prices of goods and services accounting for 60-70% of consumer expenditure, were liberalized and those prices remaining regulated were raised very substantially. Electricity rates went up 12 times for rural consumers and six times for urban customers. Official figures indicate that in 1993 yearly average inflation was 5,500%. At the beginning of 1994 prices were still rising by over 50% per month, thus plunging the country into incipient hyperinflation. Political events, and President Kuchma's election in mid year called for the introduction of a policy of economic reforms and the Government of Ukraine's (GOU) request for assistance from the international community. The reform agenda introduced in October 1994, included the acceleration of privatization, the reduction of budget deficit, and a liberalization of the economy.

While results to-date are mixed and inconclusive, significant progress has been made in bringing down the rate of inflation and restoring a degree of normalcy to the financial sector. The economy still faces major restructuring and the continuing declines in agricultural and industrial output, especially amongst the state-owned enterprises, threatens to prolong or deepen the social and economic plight of a large segment of the Ukrainian population.

STRUCTURE OF THE UKRAINIAN FINANCIAL SECTOR

Within the financial sector, the role of the National Bank of Ukraine (NBU) has evolved to where the NBU has gradually assumed the functions of a central bank. Other changes within the sector, including the emergence of new private financial institutions, provides encouragement for the further strengthening of the sector and the growth of local and foreign investment. Agricultural credits which had by tradition been provided by the specialized state-owned banks, including the Ukraine Agricultural Bank (now called Bank of Ukraine), were converted to commercial banks, albeit still state-owned, and have tended to continue the old ways of lending to state enterprises to cover their losses. Few sources of credit are available for the many new ventures that have been started, with the farm sector depending more on short term supplier credits that are often arranged by the dealers and agents of the international input manufacturers and suppliers. With the exception of a few credits provided by international lending agencies and Western joint venture partners, no term credits have been provided to the agro-industrial sector.

The diminished size, limited products and oligopolistic structure of the sector are the consequences of the distorted policies of the past few years, and the high rates of inflation. The higher real interest rates associated with a successful anti-inflation policy have already manifested a downside in the form of liquidity and other strains on a sector that is already in crisis. The excessive number of small under capitalized banks with inadequate funding sources, coupled with the emergence of numerous investment intermediaries responding to the more than

2,500 share offerings authorized by the Ministry of Finance (MOF), have shown the need for greater constraints and added discipline that the sector requires.

Key to the development of the Ukrainian financial sector is the NBU in its role as central bank and regulatory agency for bank involvement in capital markets. Following the break up of the FSU, the Ukrainian banking community was divided into four basic groups. The first three are comprised of the remnants of the former Soviet system, with the first being the NBU that was constituted out of the Gosbank in the spring of 1991. As all lending foreign exchange and deposit taking activities are deemed to be banking related, the NBU is the regulatory body that must authorize, approve and otherwise monitor and supervise all activities within the banking sector. The second group of institutions are the specialized state-owned banks , including BOU, that while having been converted to commercial bank status (corporatized), are still instruments of the GOU. Other banks in this category would include Prominvest and Ukrosotsbank. All three of these banks are large and continue to operate throughout the country as they dominate their specialized markets. The third grouping includes two state-banks (Oschadny and Eximbank) that enjoy near monopolistic status and the ability to exercise undo influence in their respective areas of specialization. In the case of Oschadny Bank (Savings Bank of Ukraine), which has more than 600 branches and 14,000 smaller scale affiliates throughout the country, one of its main functions has been to provide financial services to rural areas, including limited credit for private farmers and deposit services for the entire rural population. The forth grouping includes the more than 200 registered commercial banks that have been established over the past few years, most of which are small and under capitalized. The stronger, more successful of the private banks have gained market-share very rapidly, and are beginning to show every sign of being able to develop into full service financial institutions. Of the smaller new banks, many will close, others will be absorbed, and others may find a niche status as "finance houses" where their ability to operate may be restricted, especially in relation to the acceptance of deposits. Current banking regulations do not provide for finance companies nor financial institutions that are not looking to take deposits from the public.

In addition to the banks, both state and private, and the various investment intermediaries licensed by the MOF, the Ukrainian capital market is dominated by institutional investors. There are some 265 investment companies, funds and trust companies licensed by the State Property Fund (SPF) to invest in privatization certificates. The other intermediaries, of which there are more than 500, handle non-voucher instruments, provide brokerage services, and look to share in the market as the shares of the 8,000 state companies are transferred to private ownership. Financial conglomerates are already beginning to appear, in which a commercial bank, an insurance company, a pension fund, a trust company, and an investment fund will all be part of the same group. In the future it would be useful for the UADC to look to work with these emerging financial groups as the association would allow for a complete financial package of services to be provided.

Life insurance and pension funds are not yet significant investors, and would at this stage have little to offer the proposed UADC, although it should be noted that there are more than 500 insurance companies in Ukraine. In general terms the insurance industry's product range is limited and of poor quality, with many of the companies having difficulties meeting larger claims when they arise. The limited capital base of most insurers makes it unlikely that they have the capacity to insure credits of any significant size.

CURRENT DEVELOPMENTS WITHIN THE SECTOR

Given the situation in Ukraine in which significant levels of subsidization to enterprises is provided through the inefficient and non-transparent means of subsidized bank credits, the GOU is confronted with the dilemma of withdrawing its various interventions in the sector, without further weakening the financial markets. In general, subsidies to enterprises should be provided directly through fiscal transfers so as to reveal their full costs to the Government and the economy rather than be hidden in the form of subsidized credits channeled through banks.

As fiscal and monetary policies are further tightened in the context of the International Monetary Fund (IMF)-supported stabilization program, the structure of the financial sector will continue to evolve, with the private commercial banks continuing to grow as they take on an expanding role within the sector. With this currently in progress, the NBU is giving greater attention to the need to: enforce the minimum capital requirements on all banks; upgrade local supervision procedures; encourage all banks to undertake external audits; enforce tighter prudential rules on all banks; and close insolvent banks. The implementation of these measures will help in building investor confidence, both local and foreign, which will in turn allow the banks to expand both their equity and deposit base. Foreign bank participation in Ukraine is very limited, with one French bank maintaining a local affiliate and several others in the process of obtaining final NBU approval and authorization. Some of the private Ukrainian commercial banks are said to be looking for foreign participation's, and one or two may have been successful in attracting Western participation's.

Prevailing conditions in the financial markets are disrupted by the already mentioned system of subsidizing state enterprises through the granting of below-cost loans. This practice when combined with the high rates of inflation that existed during the period 1990 through 1994, has resulted in that the state-owned banks, especially the BOU given the size of its loan portfolio, are holding large uncollectable debts from state owned farms and enterprises. With the advent of change to a more open market economy, these loans will be written-off, resulting in large losses and decapitalization. The private commercial banks that must compete for their deposits and loanable funds, while handicapped in terms of equal access to the market place, do not face the same difficulties with their existing portfolios and have been able to select their credit risks on the basis of proper merit. This is not to say that many of the commercial banks because of poor management and credit procedures, have not also made bad loans. Given the inadequacies of the financial disclosure requirements, it is difficult to assess the financial soundness of the banking community, and it is reported that the European Bank for Reconstruction and Development (EBRD) is in the process of reviewing a number of the larger private commercial banks at this time. The purpose of the EBRD assessment is to select a limited number of local financial institutions through which EBRD credits could then re-passed to the local market.

Interest rates and other financial costs vary significantly within the financial sector, given the prevailing practice of providing subsidized credits to the state enterprises. Most local currency commercial borrowings are short term and "pegged" to the refinancing rates paid by the NBU. Hard currency borrowings are limited with costs varying according to the strength of the borrower and the guarantees provided. Rates for US dollar borrowings are reported to be in the 20-25% per annum range. Other than the farm credits provided by the state banks, the financial options for agriculture have been very limited, although it is reported that a few of the private commercial banks are beginning to be interested in making agricultural loans. The absence of regular financial services has been one of the major factors in the growth of barter as a growing method of trade.

For agriculture, a number of financial and structural developments are essential to the sector's continuing development. Key and foremost amongst these is access to affordable credit that will allow for the purchase of inputs (both local and imported) and equipment; next is the farmers ability to freely market the outputs, assisted by private processors and marketers. Third is the GOU's ability to provide a sound economic environment in which inflation rates are kept low and the currency is stable and freely convertible. President Kuchma has indicated his understanding of these requirements as the basis for a regrowth of agriculture, and in a recent speech confirmed the Government's endorsement of farm reform, including plans to decentralize control within powerful ministries such as Agriculture.

With a renewed commitment from the GOU, and the continued growth of new agricultural and agro-industrial projects, the prospects for the sector are quite positive. New sources of funding such as the private commercial banks either with their own resources or repasses from the EBRD, the Fund, and the proposed UADC, will begin to allow private entrepreneurs to consider starting or expanding agricultural projects be they in farming, processing or the many related services that are required.

PROSPECTS FOR THE UADC

For the UADC the situation is quite clear, in that if the proposed entity is to provide credit (short or medium term as outlined above) within the Ukraine, then it must be licensed as a bank, even if it had no intention of seeking deposits or other forms of local funding. The procedure for bank authorization and approval rests with the NBU; however, the timing of such a process is uncertain given the recent experience of the US Government sponsored Western NIS Enterprise Fund (the "Fund") where a similar approval was sought, and the process has taken almost a year. The Fund which has a broad mandate to provide financial support to local private enterprises through both equity and debt, had been informed that local lending authority can only be given to banks. Non-bank entities are assumed to have no legal authority to lend in Ukraine under existing legislation; therefore, the Fund has been forced to seek special authority via Presidential decree. In the UADC's case, it is deemed more appropriate to design the proposed institution as a non-Ukrainian entity that will in effect not be lending or providing loans in the Ukraine.

The proposed method of operation for the UADC will be that of an off-shore financial intermediary whose primary role will be to discount (much as in "aforfait") paper that is generated from the supply of seasonal crop inputs to Ukrainian farmers and distributors. The UADC will also participate in a leasing company, where again due to the lack of appropriate local legislation, will operate off-shore providing machinery and equipment to Ukrainian farmers and food processing industries.

Operationally the UADC will have to pay particular attention to the following: the creditworthiness of most of the farmers is questionable, and agricultural land cannot yet be used as collateral to secure loans, putting the UADC in the position of where it would have to develop its own credit information while at the same time relying on the existing experiences of the suppliers and their dealers and representatives; and the fact that there is a lack of rural banking infrastructure, which will not be an obstacle to the use of barter as a means of payment, suggests that early consideration be given to the needs that will develop as the UADC expands and looks to do the volume of business that is forecast in the financial projections. In this respect it would be appropriate for the UADC to collaborate with banking institutions that may develop a presence in the key agricultural areas. This eventual collaboration could lead to joint lending programs, collateral and security agreements and eventual participation in the UADC.

The proposed creation of the UADC comes at a very auspicious time, in that private agricultural interests are growing and there is a recognized need for both short and medium term hard currency borrowing. Local entrepreneurs and many of the more enlightened farm managers see the opportunities that exist in agriculture, and are looking to initiate or expand existing ventures. The role of the UADC could be extremely important is providing both financial and technical assistance in further developing Ukraine's incipient private agricultural and agribusiness sectors.

Terms of Reference

- **Design a private ag. finance co. for Ukraine**
  - originated from consensus reached at Kiev Ag. Conference, July '95
  - a design, not a feasibility study
- **Work with CNFA to engage private sector involvement**
- **Secure pledges from U.S. companies**

Approach

- **Client Driven**
  - Established dialogue with AID/W and USAID Ukraine
  - Established dialogue with U.S. companies
  - Ascertained & arbitrated desires through repeated contact
    - » Washington D.C., Brussels, London, Ukraine
- **Enlisted full support of CNFA**
- **Conducted field trip to Ukraine**
- **Involved Donor and Banking Community**
  - WestNis Fund, EBRD, IFC, World Bank Group, Ukrainian and International Commercial Banks

Original Assumptions

- **Needs are for short and medium term credit**
- **Direct lending for input packages envisaged**
  - potential for formal securitized lending
- **Farm Service Centers to work retail end of financing chain**
- **U.S. Companies eager to participate**

Changes from Original Premises and Rationale

- **Moved from primary to secondary lending**
  - Per companies' expressed desire
  - Purchase of receivables rather than loan generation
- **Lending needs to be character based at this stage**
  - Companies comfortable with their own character-based lending decisions
- **Incorporation of term lending via leasing affiliate**
  - least risky given Ukrainian legal environment
- **Retail end of FSCs a better fit with secondary operation**
  - Supplier ties to FSCs not a constraint under this design

Design Proposed

- **Establish UADC with objectives of providing:**

short term secondary or wholesale financing of suppliers' / distributors' input receivables to farm clientele

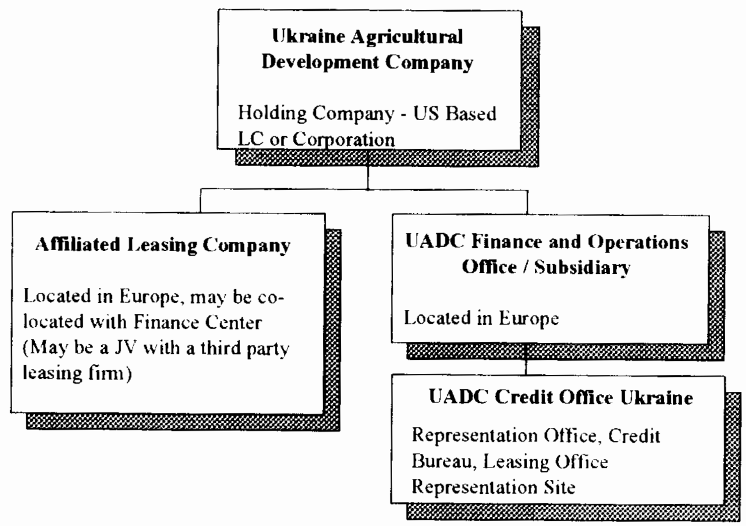
intermediate term credit directly or through an affiliated leasing company for equipment

Detailed Design Features

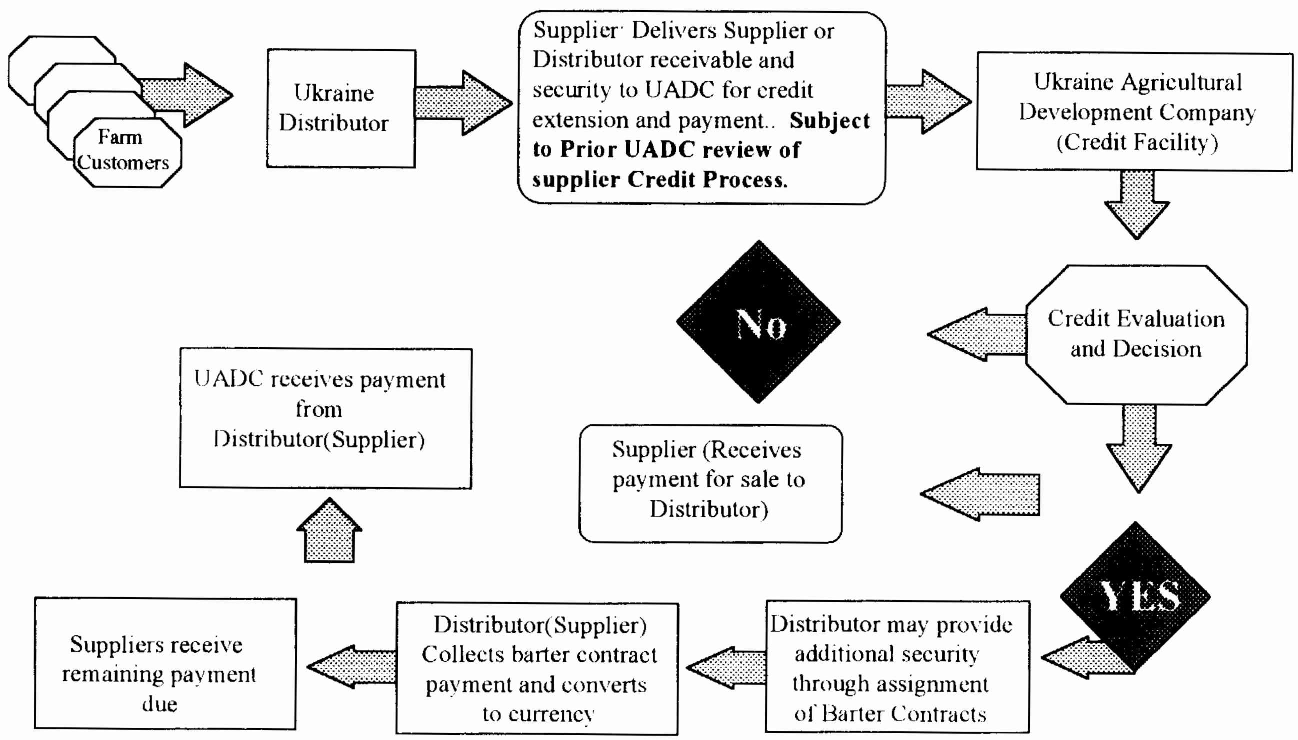
- **Shared risk structure**
  - provides self-reinforcing incentives throughout chain: suppliers, distributors, farm clientele
- **Enhanced credit risk evaluation via UADC credit bureau**
- **More potential for leverage:**
  - Pooled equity capital = increased leverage potential
  - Corporate Guaranteed Pools likely to attract Int'l banks
  - More loanable funds from World Bank Group, EBRD, other donors, West NIS Fund
- **Leasing affiliate provides tried operation & greater funding sources**

Organizational Structure

Ukraine Agricultural Development Company



UADC Transaction Summary



Deloitte Touche Tohmatsu ILA Group Ltd.

Design Concept : Fund Pooling

UADC Finance and Credit Office

Operations: Credit evaluation function conducted through Ukraine Credit Office - Each Pool will have a credit office assigned

Participating Company Guaranteed Pool:

Pools may be established as either funded or unfunded

Funding available to participating companies providing support for pool:

- Equity
- USAID Capital
- Leveraging provided from commercial sources supported by firm capital and recourse or LOC guarantees to shareholders company.

Participating Company Non-Guaranteed Pool:

Loanable funds available to participating companies in this pool:

- Equity
- USAID Capital
- Leveraged funds developed in out years of operation based on pool performance and internally developed credit enhancements.

Affiliated Leasing Company

Loanable funds available to participating companies:

- Equity
- USAID Capital
- Leveraged financing provided by other credit lines of leasing company

Leveraging Strategy

- **Incentives are to maximize leverage: cos. should vest best credit in UADC**
- **Core UADC Loan Pool: UADC Capital and Borrowed Funds Only**
- **Corporate Guaranteed Loan Pool: Shareholder companies participate as desired to provide guarantees to purchasers of loan pools**
- **Independent Credit Enhancements: Insurance, First Loss Coverage, Partial Corporate Guarantees**

Affiliated Leasing Company

- **Design anticipates formation of a Joint Venture with a leasing company in Ukraine**
- **Proposed structure involving debt & equity totaling $5 million U.S.**
- **Past leasing experience suggests potential 7:1 leverage ratio**
- **Credit Facility may enter into agent agreements with leasing co. to facilitate placement and management of equipment**

UADC Central Credit Bureau

- **Credit Information shared, good *and* bad**
  - Suppliers' customers
  - Distributors' customers
- **Strict Maintenance of Confidential information**
- **Credit checks available upon request**

Impartiality of UADC Operation

- **No shareholder or its products favored over another**
- **No Financial Advantage to Any Shareholder or Supplier**
- **Strict Maintenance of Confidential Information**
  - Shareholder Customers
  - Pricing
  - Distributor Operations
  - Customer Financial Information

Credit Allocation

- **Corporate contributions available for company sales**
-
- **All leveraging available for creditworthy sales**
-
- **Leveraging: key to enabling an end to credit allocation**

Risk Reduction

- **Leverage potential favors vesting of good credits in UADC**
- **Shareholder agreements to encourage corporate behavior in common interest**
- **Pricing to reward lower risk**
- **Risk Sharing construct:**
  - Farm clients: First 15% & Distributors / Suppliers: Next 25%
  - UADC: Final 60%
- **Political risk insurance via World Bank**
- **Benchmarks for Distributor service to be established**

Potential benefits for participating companies

- **Offers a means to expand markets at reduced risk**
- **Provides additional credit sources for suppliers**
- **Increased security: a default on one is a default on all**
- **Reduces credit granting costs for suppliers**
- **Multiplicity of parties provides combined strength, resources & suasion with Ukrainian Government**
- **Provides credit source not requiring sovereign guarantee**

Proposed Capital Structure

- **Initial Capitalization Proposal:**
- **Participating Companies** **$20 Million USD**
- **USAID Ukraine** **<u>$10 Million USD</u>**
- **<u>Total:</u>** **<u>$30 Million</u>**
  <u>USD</u>
- **Proposed Initial Use of Funds:**
- **UADC:** **$30 Million USD**
- **Ukraine Leasing Company: proposed as a JV with an existing leasing firm or as a wholly owned subsidiary. Capital committed by UADC: $ 5 Million USD**

Anticipated Administrative Requirements

USD 000	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Company Share	368	626	944	1862	1980	5780
USAID Share	1200	1000	800	0	0	3000
Total Estimated Administrative Costs - UADC	**$ 1,568**	**$ 1,626**	**$ 1,744**	**$ 1,862**	**$ 1,980**	**$ 8,780**

Solicited Capital Contributions

- **Major U.S. and Multinational Agribusiness Firms:**

  $1.0 - $2.0 Million USD

- **Mid sized U.S. and Multinational Agribusiness Firms:**

  $0.5 - 1.0 Million USD

- **Small Agribusiness Firms**

  $0.1 - 0.5 Million USD

Design Phase Achievements

- **Progress on Company Pledges**
  - Contigencies and conditionalities to be met in Phase II
- **Interim Steering Committee Formed**
  - CNFA President selected as Chairman
- **Committed participants agree to recruit more corporate commitments**
- **Full meeting set for January 25th: "Drop Dead" date for corporate commitments**
- **Final Design Report to be delivered to AID Jan. 30th**

Phase II: Next Steps

- **CNFA to take lead role**
  - Steering committee to develop final design and begin organization
- **Secure additional company commitments**
- **Firm up USG participation, terms & conditions**
  - Eg. US Sourcing requirements
- **Explore leveraging options**
  - Trip to European banking community currently underway
- **Legal preparations**
  - Articles of Incorporation & Charter
  - Shareholder Agreements on Critical Issues