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Required Report - public distribution

Date: 05/08/2013

GAIN Report Number: RSATO1305

Russian Federation

Food Processing Ingredients

Update of Food Processing Sector in Russia

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Report Highlights:

The food processing sector in Russia – which did not experience the same dramatic collapse during the crisis as most other sectors -- continues to build upon its recent growth, supported by rising disposable income, increasing real wages, declining unemployment and growing food expenditure. The European Bank for Reconstruction and Development (EBRD) recently revised upwards its economic growth forecast for Russia in 2013 from 3.3% to 3.5%.

The majority of raw materials and ingredients used by Russian food processors/manufacturers are imported. This leaves ample opportunities for U.S. exports to Russia. WTO accession in 2012 should

ease import restrictions for some products and make the overall business and regulatory climate more predictable and transparent. Among the best prospects for U.S. ingredients are: poultry products, nuts and dried fruits, flavor enhancers, colorants and preservatives. Regulatory issues currently prevent the export of dairy, pork and beef from the United States to Russia but absent those barriers these products have great potential in the Russian market.

This report presents an analysis of the food ingredients/food processing market in Russia, reviews its main trends including key players, characteristics of the main segments and prospects for development. The analysis includes the structure of exports and imports, a description of the competitive environment, and profiles of the major manufacturers and distributors of food ingredients in the Russian market.

Post:

Moscow ATO

Executive Summary:

SECTION I. MARKET SUMMARY

The Russian economy is in a period of “post-crisis” moderate growth. According to the EBRD, Russia’s economy will grow by about 3.5% in 2013, reflecting expectations of flat oil prices, still-weak external demand, rising imports, and moderating internal demand. Inflation is expected to ease to around 6%. According to RosStat, the Russian State Statistical Service, 2012 CPI inflation reached 6.6%. In 2012, food prices underpinned the largest part of the overall increase, as they were up 7.4% year on year. Some daily staples gained the most: bread - up 12%, fruits and vegetable - up 11% and meat - up 8.3%. Among non-food items, the cost of tobacco products jumped the highest – by 22.6% in 2012.

The food processing sector in Russia – which did not experience the same dramatic collapse during the crisis as most other sectors -- continues to build upon its recent growth, supported by rising disposable income, increasing real wages, declining unemployment and growing food expenditure. Over the last two years, output of the following processed foods have increased steadily: meat and offal, sausages, meat products, dry milk and cream, butter, canned milk, pasta, sugar, confectionery, frozen fruits and vegetables, and mineral water.

The majority of raw materials and ingredients used by Russian food processors/manufacturers are imported. This leaves ample opportunities for U.S. exports to Russia. WTO accession in 2012 should over time ease import restrictions for some products, such as dairy products. Among the best prospects for U.S. products are: poultry products, nuts and dried fruits, flavor enhancers, colorants and preservatives. Regulatory issues currently prevent the export of dairy, pork and beef from the United States to Russia but absent those barriers these products have great potential in the Russian market. Therefore, it is vital that U.S. exporters keep up-to-date with any changes in the market, and how those changes can affect their business.

The Russian food processing industry is poised for a rapid growth and is set to become one of the highest yielding sectors in Russia. It is also recognized as a key sector by the Government of the Russian Federation (GOR). According to Euromonitor, the Russian processed food market displayed healthy growth of 4% in volume terms and reached 967 billion Rubles in 2012.

The food processing industry in Russia is recognized by the GOR as a strategic sector which could potentially supply the entire 143 mln people of Russia with quality food products. It numbers over 30 sub-sectors contributing more than 19.3% of Russia’s economic production and employing 1.4 mln people. Russia is the largest processed food market in Europe and one of the world's largest importers of ingredients for food processing, for example Russia is the world’s largest dairy products importer in the world. According to *ID-Marketing* the number of food processing plants in Russia in 2012 was around 53,000 (including beverage and tobacco production) and the number has been growing by about 10% per annum for the last 3-4 years. The Russian food ingredients and additives markets have grown both qualitatively and quantitatively with an average annual rate of 5-15%.

In its Strategy for Development of the Russian Food Industry (see Regulatory Framework, below), the GOR assesses the food processing sector as highly attractive for investors based on the following factors:

- The food processing industry has displayed robust growth as compared to such industries as oil and gas lagging behind both of them only in profitability. For example, as compared to 2009, the production of meat increased by 15%, semi-finished meat products by 7.7%, sausage by 8.7%, fish by 1.5% (most of the Russian fish catch is processed in China, Norway, and in the Baltic sea countries), confectionary by 2.8%, fruit and vegetables by 8.4%, and pasta by 8.3%.
- Return on investments in the food processing sector is quick – within a year or two – as compared to other industries. In 2005-2010, about 905.7 billion Rubles (\$30.1 billion U.S) in local and foreign investments were made into the Russian food industry.
- The report claims that there are many factors that add to the appeal of investing in Russia, including the growth of the Russian middle class, lowering trade barriers as Russia joined the World Trade Organization (WTO), skilled labor and low labor costs.
- The Strategy says that Russia does not have any capital flow restrictions and thus is more open to foreign investment.
- Russian companies have recently taken some important steps to modify their dividend policies, thus becoming more open in many respects, including their financial reporting.

There are a number of key drivers that are expected to stimulate growth in the food processing industry in Russia over the near to medium term. The mass grocery retail industry is developing rapidly, becoming more efficient, less fragmented and more accessible to customers. Food retail industry sales are forecast to be around \$792.7 billion in 2014. Additionally, the expected rise in tourism due to the 2014 Olympic Winter Games and the 2018 Football World Cup is expected to boost food and beverage consumption in the Hotel, Restaurant and Institutional (HRI) sector.

Within the last 4-5 years Russian customers become increasingly sophisticated about their food purchases. Although income growth in the largest cities slowed down, subsidies provided by the GOR support income growth for teachers, doctors, police and the military to reach the average official income registered in Russia. Price and quality of food are more important for these consumers than brand name. This created new opportunities for packaged food market players to launch new products of high quality, but with a more flexible pricing and a lower investment into marketing.

Table 1. Sales of Packaged Food by Category: Volume 2007-2012

'000 tons	2007	2008	2009	2010	2011	2012
Baby Food	172.57	192.18	196.31	207.06	222.75	228.16
Bakery	7,905.10	7,913.21	7,977.32	8,102.37	8,003.60	7,946.59
Canned/Preserved Food	1,099.34	1,172.53	1,161.54	1,192.52	1,242.26	1,282.22
Chilled Processed Food	816.49	834.25	838.20	837.23	856.03	886.38

Confectionery	1,011.92	1,030.82	1,022.65	1,045.95	1,071.04	1,093.95
Dairy	6,782.95	6,589.68	6,649.23	6,857.61	6,913.17	7,053.65
Dried Processed Food	1,374.57	1,405.60	1,445.99	1,536.33	1,690.21	1,745.76
Frozen Processed Food	1,065.75	1,112.51	1,125.47	1,172.75	1,234.74	1,293.12
Ice Cream	298.50	281.74	276.98	309.01	278.70	290.15
Meal Replacement	0.24	0.26	0.21	0.25	0.30	0.35
Noodles	96.43	97.64	100.03	98.61	96.85	94.04
Oils and Fats	1,593.64	1,476.02	1,505.37	1,506.67	1,522.74	1,530.69
Pasta	746.28	813.67	862.49	883.19	909.69	923.34
Ready Meals	584.31	595.35	603.50	616.45	636.35	658.01
Sauces, Dressings and Condiments	911.86	928.54	924.11	936.65	951.41	968.89
Snack Bars	0.58	0.62	0.64	0.68	0.74	0.82
Soup	58.01	59.88	61.24	64.53	68.66	75.02
Spreads	53.25	54.83	53.57	57.10	57.73	58.98
Sweet and Savory Snacks	296.72	318.54	322.49	330.22	342.11	352.52
Impulse and Indulgence Products	2,537.41	2,591.97	2,591.49	2,686.13	2,731.91	2,809.82
Nutrition/Staples	16,915.62	16,634.85	16,823.60	17,232.02	17,336.83	17,457.12
Meal Solutions	4,536.91	4,704.23	4,715.23	4,821.27	4,990.60	5,164.77
Packaged Food	23,389.59	23,316.52	23,504.56	24,095.75	24,390.04	24,734.55

Source: *Euromonitor International*

Russia is among the world's fastest-growing economies in terms of domestic market size. Though in 2012 Russia's consumer purchasing power decreased, it is still four to eight times greater than in China, India and certain Eastern European countries. *RBC* forecasts Russia will become Europe's largest food consumption market by 2018. A rising level of consumer disposable income and expanding Russia-wide distribution infrastructure – supermarkets, malls, specialty food chains - pave the way for the food sector's growth rate of an average 12-15% per annum. *Ernst & Young* ranks the Russian food industry sector as second on the list of Foreign Direct Investment (FDI) projects (after the automotive sector) with 86 FDI projects implemented and 9,958 jobs created in Russia within the period of 2007-2011. More than 80% of processed foods sales and marketing projects in Russia are concentrated in the two largest cities – Moscow and St. Petersburg. The Moscow processed food market is the most high-capacity market in Russia, due to the strongest growth rate in average per capita consumption. Moscow is a primary market for premium and standard quality food products and novelties introduced by local and multinational companies.

In 2012, demand for food ingredients by the processing industry was estimated between \$1.7 billion to \$3 billion. The share of the Russian market accounts for about 9-10% of the total world market of food ingredients and the room for growth is significant compared to the European and American markets.

Table 2. The Russian Food Ingredients Market's Consumption and Rate of Growth 2006-2015

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Consumption (\$ billion)	1.7	2.0	2.3	2.0	2.1	2.3	2.6	3.0	3.4	3.9
Rate of growth (%)	n/a	15%	15%	10%	5%	10%	10%	15%	15%	15%

According to the Union of Food Ingredients of Russia, at present the Russian food processing industry uses over 20 types and about 1,000 varieties of food ingredients and additives, such as acidity regulators, sweeteners, bleachers, colorants, emulsifiers, thickeners, preservatives, nutrition fortifiers, flavors, pectins, starches, fats, stabilizers, and so on. *RBC Research* states that Russia's food ingredients market is weighted as follows: flavors (29%), preservatives (24%), colorings (19%), antioxidants (13%), food acids (6%), and cloud emulsions (2%).

The main users of ingredients are bakery, confectionery, dairy (including ice cream manufacturing), meat processors and canned and bottled food producers. Russian processors use special ingredients to:

- control the texture of the product: food phosphates, plant and animal proteins, gelling agents, thickeners, emulsifiers, stabilizers, functional and feature-rich mixture.
- enhance the organoleptic characteristics and make products more appealing and tasty: sweeteners, acidity regulators, antioxidants, flavor enhancer, flavoring, spices, herbs and their extracts, colorants.
- prolong the shelf life: preservatives, antioxidants, acidity regulators.
- accelerate the technological process.

A table below displays what portion of ingredients and additives (in %, as compared to the total volume of processed raw material) was used in food processing sectors in Russia in 2012

Table 3. 2012 Ingredients Used in Food Processing Sectors, in %.

Food Processing Sector	Food Ingredients and Additives, in %
Confectionary	56.6
Bakery	38.4
Dairy, Butter & Cheese	33.0
Soft beverages	25.2
Fats & mayonnaise	24.1
Meat processing	23.0
Ice cream	19.1
Fruit jams	18.0
Snacks & chips	16.6
Vegetables & sauces	16.4
Fish processing	14.3
Other	8.9

Despite its success, the Russian food processing industry needs to address a number of factors in order to compete against imported products:

- Access to raw materials
- Problems with recruiting qualified personnel

- Lack of experience introducing innovative products
- GOST (State Standards) being replaced by less clear Technical Regulations;
- Underdeveloped quality control and testing infrastructure;
- Underdeveloped technical infrastructure, e.g. inefficient supply chain, high transportation and inventory carrying cost;
- Inadequate warehousing space/infrastructure;
- High packaging cost;
- Cultural and regional preferences;
- High taxation;
- Lack well-developed distribution channels, logistics and “Price-Quality” balance.

These factors underlie the GOR’s efforts to increase domestic production of raw materials, namely cattle, swine, grain, vegetables and fruit. However, with few exceptions (such as flavorings which have 30% of their market segment) domestic agricultural production is hampered by highly variable weather conditions, overall inefficiencies and lack of infrastructure. All in all, in 2012 Russian food industry production was valued at 4,062 billion Rubles (\$135.4 billion), which is 2.5 times more than in 2006.

With the growth of strong multinational companies in the Russian market (Symrise, Cargill, Kraft, etc.), the competition in the food processing industry has increased. However, to tap into the vast Russian market for processed foods, efficient marketing and solid investment are necessary to bring a demand-driven production. Marketing becomes the key to drive expansion, to reduce intermediaries, and lower consumer prices.

Regulatory Framework

Russia operates a complex and often unpredictable system of import controls, including sanitary regulations, import tariffs, import quotas and other restrictions. Barriers to trade have traditionally depended on the type of product, customs clearance location, importer status and other sometimes non-transparent factors.

FAS Moscow’s Food and Agricultural Import Regulations and Standards report identifies 54 major pieces of legislation that govern food, plant, and animal health, most of which received thorough review during the past few years’ WTO accession negotiations. A few of them correspond to food additives and are listed below. The FAIRS report in full can be found here:

<http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Food%20and%20Agricultural%20Import%20Regulations%20and%20Standards%20-%20Certification%20Moscow%20Russian%20Federation%2005.02.2013.pdf>).

Major Russian SPS Measures/ Technical Regulation: CU Technical Regulation TR TS 029/2011 “Safety Requirements for Food Additives, Flavorings, and Technological Aids” – (as amended through July 20, 2012) <http://www.tsouz.ru/eeK/RSEEK/RSEEK/SEEK8/Documents/P_58.pdf>

Russian Competent Authority Regulations/ Sanitary Measures: Hygienic Requirements for Food Additives ([SanPiN 2.3.2.1293-03](#), as amended through December 23, 2010).

After almost 18 years of negotiations, Russia acceded to the WTO on August 22, 2012 and became its 155th Member. Since that time, Russia has started submitting notifications to the WTO SPS and TBT Committees. Many of these notifications are country specific, notified after implementation, and without

comment periods. Additionally, these notifications tend to refer to products that may be imported into Russia as opposed to normative safety and hygiene standards for both domestically-produced products and imported products.

The major WTO membership consequences for the food processing industry are expected to be: a boost in strategic investors’ confidence, which could lead to technological innovations in the agricultural and food sectors in terms of the ability to produce healthy functional foodstuff, frozen fruit and vegetables and alcohol-free drinks. General customs requirements and product-specific approvals are required for a wide range of products including food and beverage products. Please refer to the Customs Union Technical Regulations on Food Products Labeling FAIRS report

(<http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Customs%20Union%20Technical%20Regulations%20on%20Food%20Products%20Labeling%20Moscow%20ATO%20Russian%20Federation%2010-11-2012.pdf>) and the Opportunities for Future Growth GAIN report

(<http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Exporter%20Guide%20Moscow%20ATO%20Russian%20Federation%207-6-2012.pdf>) for more information.

Table 4. WTO Membership Import Decrease Tariff Decrease Per Ton

Product	Currently Applied Rate	WTO Final Bound Rate
Sugar	\$243 US	\$223 US
Oils and fats	9%	7.1%
Dairy products	19.8%	14.9%
Agricultural products	13.2%	10.8%
Cereals	15.1%	10.0%

In 2010, the GOR passed the “Principles of the Russian Federation State Policy in the Field of Nutrition for the Period to 2020” which is considered by many as some progress in terms of GOR support for the food processing industry including food ingredients manufacturers. The main objectives of the policy, which is still in effect, are: expansion of domestic production of basic raw materials that meet modern standards of quality and safety, the development of manufacturing food products enriched with essential components, specialized baby food, functional food products, dietary (curative and preventive) food products and dietary supplements. Also, the GOR is focusing on the development and implementation of innovative technologies in agriculture and the food industry, including biotechnology and nanotechnology, and development of healthy eating educational programs for various groups of the population. In this regard, technical regulations relating to food are expected to be adopted. It is proposed to strengthen the legal responsibility of the manufacturer for production of food products which are consistent with statutory requirements, and to improve quality control for food and raw materials produced in Russia and imported from abroad. Also, according to the document, the GOR would provide the conditions for investment in production of vitamins, enzymes for the food industry, probiotics and other food ingredients, consumer foods enriched with vitamins and minerals, as well as would prioritize development of research in the field of modern biotechnological and nanotechnological methods to obtain new sources of food and biomedical estimation of its quality and safety.

Along with the “Principles of the Russian Federation State Policy in the Field of Nutrition for the Period to 2020”, in April 2012, the GOR issued Resolution #559R Strategy for Development of the Russian

Food Industry for 2013-2020. The aim is to increase food industry production almost twofold by 2020. To do so, the GOR believes an influx of investment of 398.5-777.8 billion Rubles (\$13.3-25.9 billion U.S) will be necessary to replace obsolete equipment (some dates back to the beginning of the last century), upgrade food processing, introduce bio- and nanotechnologies, improve efficiencies in production facilities up to 85%, implement innovative engines and labor efficiency by applying IT and Enterprise Resource Planning (ERP) business management solutions. According to the 2013-2020 Development Strategy, the GOR expects construction of 64 processing plants and reconstruction of 296 existing ones. However, these investments will have to be privately funded rather than through public funding.

A key regulatory body in Russia is the Russia-Belarus-Kazakhstan Customs Union which is responsible for, among other things, producing technical regulations such as the "Safety Requirements for Food Additives, Flavorings, and Technological Aids". This regulation was accepted on July 20, 2012, and will come into force on July 1, 2013: <http://www.tsouz.ru/db/techreglam/Pages/Pishdobavki.aspx>.

Trade

The Russian food industry in general is dependent on imported food ingredients and additives. And since the Russian food processing sector still has significant room for growth, the major world producers of food ingredients are increasingly focused on servicing the market. According to *RBC Research*, Russia consumes about 8-10% of the world’s market for ingredients. Most food additives and ingredients which are used by Russian companies - approximately 86%, according to *RBC Research* - are made from imported raw materials. In 2012, imported ingredients to Russia were valued at roughly \$419.33 mln. China is the major supplier of ingredients to Russia. According to *RBC Research*, in 2012 China sold \$57.63 worth of food ingredients to Russia. The United States ranks as the 11th biggest supplier with ingredients exports to Russia worth \$11.63 mln in 2012.

Table 5. 2012 Share of Food Ingredient Imports By Country, in %

Country	%
China	15.4
Lithuania	12.5
Germany	11.2
The Netherlands	9.7
Belgium	6.7
France	6.4
Ireland	4.5
Poland	3.9
Estonia	3.2
Denmark	3.1
United States	3.1
Latvia	2.6
Finland	2.4
Italy	2.0
Ukraine	1.5
Other	12.0

Russia exports a modest amount of food processing ingredients, including glucose and maltose syrups, texturized soy protein, and icings. In 2012, exports of ingredients out of Russia were estimated roughly at \$17.85 mln.

Import Tariffs

Russia is part of a Customs Union comprised of Russia, Kazakhstan and Belarus. The Customs Union members develop regulations that are then reconciled and agreed to by all members and then applied to the three countries.

Import duties apply to many food products and generally vary between 5-30%. As part of its WTO accession agreement, Russia has committed to reducing and binding import tariffs on all agricultural goods, thereby providing more predictability on its duties. The average tariff for agricultural products will be reduced from the current 13.2% to 10.8% (please refer to <http://www.tks.ru/db/tnved/tree>).

Imports are subject to VAT, which is calculated on the customs value of the items plus customs duties and fees. In addition, import duties are assessed at the specified rates. They are assessed according to classification and are applied to the customs value of the imported goods, including shipping charges and insurance. Certain imported food and beverage products will require a certificate or declaration of conformity from the GOR as well as additional permits depending on the product (please see the latest FAIRS Report

http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Food%20and%20Agricultural%20Import%20Regulations%20and%20Standards%20-%20Certification_Moscow_Russian%20Federation_05.02.2013.pdf). Certain products, most notably beef and pork, are imported under a quota system. Russian regulations on trade and tariffs can be complex. For this reason, it is important to have a competent intermediary contact in the market.

Import and Labeling requirements and Food Additive Regulations

Labeling requirements are outlined in Federal Laws and National State Standards (GOSTs). All products exported to the Russian Federation must include relevant information about the product in the Russian language. For example, the Technical Regulations of the Russia-Kazakhstan-Belarus Customs Union on Food Product Labeling are designed to establish uniform mandatory requirements for food products labeling and intend to ensure the free movement of the food products released for circulation on the joint customs territory of the Customs Union. These requirements will come into force on July 1, 2013.

Information on General Requirements for Indication of Ingredients in Food Products Labeling can be found in the ATO report “[Customs Union Technical Regulations on Food Products Labeling Moscow ATO Russian Federation 10-11-2012](#)”. In general, the following information is required in Russian on labels:

- product name, type, grade and category (whichever are applicable);
- name, country, address of the producer, packer, exporter and importer;
- net weight, quantity or volume;
- ingredients, nutritional value (depending on the product) and additives/flavorings;
- date of processing, storage conditions and expiry date or shelf life;
- identification of regulatory or technical documents and a Conformity stamp;
- any biotechnology components or use in production.

There are mandatory requirements for safety and identification, which are outlined in Federal Law and the following regulatory documents:

- Sanitary Rules and Regulations (SanPiN; for food ingredients SanPiN 2.3.2.1293-03);
- National State Standards (GOSTs; (though since 2010 State Standards are being replaced by Technical Regulations));
- Hygienic Requirements For Foodstuff Safety and Nutrition.

Please refer to recent GAIN reports for addition information on labeling and other standards <http://gain.fas.usda.gov/Lists/Advanced%20Search/AllItems.aspx>.

Sanitary and Phytosanitary Environment

Russia’s sanitary and phytosanitary measures are regulated by the Federal Service for Veterinary and Phytosanitary Surveillance, known as Rosselkhoznadzor. Rosselkhoznadzor regulates phytosanitary quarantine zones, controls the use of pesticides and agrochemicals, oversees soil fertility issues, and regulates animal and aquatic animal health and safety. Policies on consumer protection are developed by the Federal Consumer Service Bureau (Rospotrebnadzor).

Meat imports require an Import (Veterinary) Permit. Plant imports must have an Import Quarantine Permit if the product is classified as having high phytosanitary risk. U.S. exporters may refer to the Animal and Plant Health Inspection Service or Food Safety Inspection Service websites (http://www.aphis.usda.gov/import_export/index.shtml and http://www.fsis.usda.gov/Regulations_&Policies/InternationalAffairs/index.asp, respectively) for current standards applicable to the United States. Currently, U.S. meat exports are restricted in Russia due to Russian veterinary and sanitary requirements and Russia does not allow imports of dairy and egg products from the United States pending a new certificate.

ADVANTAGES AND CHALLENGES FOR U.S. EXPORTERS

Advantages	Challenges
Demand for food processing ingredients is growing dramatically compared to the other sectors of the food processing industry.	European exporters have geographical advantage, and exporters from the Middle East offer lower prices.
Russian food processing ingredients market is widening its assortment.	Demand for premium products has not yet recovered completely from the financial crisis. Consumers have switched from imported products to cheaper brands or Russian analogs.
Russian food processing sector mostly relies on imports, 86-90% of all ingredients.	Increasing Dollar rate made prices for imported raw materials and food processing ingredients less affordable for manufacturers.
Local processors more often must meet international quality standards. They pay more attention to the quality of the ingredients they use and local ingredients often do not meet their needs.	Russian processors lack well-developed contacts with U.S. suppliers.
Russian food processing companies continue to	Russian producers of ingredients are improving

expand and modernize their production facilities. This increases their demand for high quality ingredients.	the quality of their products.
GOR has committed to spending billions on infrastructure over the next 10 years, particularly railroads and highways, which should translate to better logistics.	Distance from end-users and lack of Russian consumer demand
Russia joined the WTO in August 2012 and its trade and investment policy is converging with international standards.	Transition to WTO rules not complete leaving room for confusion at customs and clearance delays, contract disputes, and unexpected expenses.
GSM-102 program offers U.S. exporters and Russian importers an opportunity to conduct business using credit.	Cash-in-advance system of payment is still a common trade practice in Russia, due to credit risks and expenses from letter of credit.

Author Defined:

SECTION II. ROADMAP FOR MARKET ENTRY

A. Entry Strategy.

1. Distribution

Russia is the largest country in the world by landmass and has the world’s 9th largest population of over 140 million people. Though Russia is a large market for food and ingredients – it currently imports around 40% of its total food consumption - its infrastructure is underdeveloped which can lead to logistical challenges. Unlike the United States, selling directly to retailers is uncommon in Russia. A solid Russian importer, direct dealership, or distributor with fast-growing Russian company, and investment in significant marketing and promotion campaigns are the keys to success. The local partner can help you solve many problems and better understand the peculiarities of the local market.

Food distribution channels vary considerably across Russia. The population is unevenly distributed across the country, with the highest density around Moscow and St. Petersburg, and therefore with well organized distribution channels around these cities. Urban centers have the advantage of development – a big concentration of workforce and capital and proximity to consumption markets make them good locations for food processing facilities, such as bakery, confectionary, dairy, and meat processing (sausage and semi-finished products). Moscow remains the obvious first choice for a representative office in Russia where many food processing companies and representative offices of foreign and regional food companies are concentrated. It is more conventional to give one distributor exclusive buying status, but some companies use multiple distributors in order to target multiple regions successfully. New entrants to the Russian market are advised to start in Moscow and then move into the regions through a reliable distributor. If you will ship your product through St. Petersburg – and approximately 80% of U.S. food products are -- it might be worth considering St. Petersburg as a home base. It is important to select a company that has a developed distribution network in the targeted region and has been successful in the past. Having a representative office in one of major Russian cities will help you to establish valuable contacts with leading Russian food companies. Other factors to consider are storage facilities and whether the company has had successful experience in working with Western companies. Multinational companies continue to penetrate the Russian market mainly via mergers and

acquisitions. Such international players as Bonduelle Groupe SA, Mondelez International, Karl Fazer Oy, and Atria Plc benefited from Russia-based facilities.

2. Market Research

It is important to conduct thorough research on market prospects for your particular product in terms of preferences, target consumers, competition and sales channels. Exporters considering entry into the Russian market must be mindful of market access issues such as the aforementioned veterinary, phytosanitary and labeling rules and the risks associated with supply chain distances, foreign exchange fluctuations and access to credit. At the higher end of the market, competition from Europe and lack of brand awareness are issues that must be addressed by a unique product offering. Whilst expensive, targeted marketing is crucial if U.S. products are to gain brand awareness and market share. Exporters have to be committed to devoting significant time and funds to any entry strategy. ATO Russia recommends attendance at an appropriate trade show in Russia as a way to introduce your product to the market and conduct initial market research. A list of the key Russian shows relevant to food ingredients follows:

- **INGREDIENTS RUSSIA** (Moscow, March 11-14, 2014) is the only ingredient exhibition in Russia. Ingredients Russia is a key meeting point for all those involved in the Russian ingredients industry. It is an effective way to meet new and existing clients, increase brand awareness and discover the latest news from the Russian ingredients industry.
- **PRODEXPO INTERNATIONAL EXHIBITION** (Moscow, February 10-14, 2014) is the largest annual international exhibition in Russia and Eastern Europe promoting high quality foodstuffs. The exhibition promotes high-quality foodstuffs to the domestic market, giving the opportunity for foreign exporters to present their products and to make valuable contacts.
- **WORLD FOOD** (Moscow, September 16-19, 2013) is attended by serious players in the Russian food market – both well-established and those who are just planning to enter the market. World Food Moscow is an effective platform for processors or dealers. Held annually, this show attracts approximately 1,400 exhibitors from 64 countries and 26,000 trade visitors. Unlike Prodexpo, it contains seafood, fruit and vegetable pavilions.

3. Marketing

Marketing your products to the buyers and end-users is paramount. Russia's leading processing companies employ qualified personnel and use modern processing technology making them good candidates for training programs for technologists. Also, ingredients suppliers should understand that their clients are not only the food product manufacturers but also the end-users. Keeping consumers in mind along with the importer/distributor will help U.S. exporters be successful in the Russian market. However, marketing effectively can be a challenge, as one single strategy cannot be applied to all regions in Russia. It is advisable that exporters cooperate with their local business partner on how to promote their brand and product. For example, it is important to support in-store promotions with discounts (for example, buy one get one free) or gift promotions. It is also worthwhile to use relevant magazines for promotional purposes. Advertising and other marketing activities can be done through local media agencies. Of course, the best entry strategy for every new-to-market exporter depends on its unique experience, particular circumstances, and specific products. Key advertising campaigns in 2012 were targeted at enhancing brand recognition and obtaining more consumer loyalty. Major producers of

processed food boosted the image of their brands via TV commercials, street advertising and internet sites.

4. Pricing

Prices for food and food ingredients in Russia vary depending on location due to developed distribution channels, transportation costs, differences in costs of living in regions and other factors. An important aspect to pricing would be whether or not there is sufficient local supply in Russia of an analogous product.

Russia has a complex business environment with a high level of bureaucracy, ranking 112th out of 185 economies on the World Bank's 2013 list of "Ease of Doing Business". Because of Russia's complex business environment, performing due diligence such as verifying references, and credit checking are very important. It should be noted that credit reporting is a new practice in Russia, so information may be limited.

Knowledge of the Russian language or the use of an interpreter is essential even though an increasing number of Russian business people speak English, though may prefer to conduct business discussions in Russian. Business cards are important and bilingual English/Russian business cards are carried by most foreign business people in Russia

A large local market and difficulties with importing certain products has led many food processors to locate their manufacturing lines in Russia, enabling lower unit costs, future expansion to Russian remote regions and capacity for export. The Overseas Private Investment Corporation (OPIC), an organization that aims to promote American companies overseas, has been providing financing to U.S. companies for them to undertake projects in Russia, thus supporting the investment climate between the two countries. Kraft Foods was one of these pioneers.

The most well-known foreign food processors in Russia are PepsiCo, Carlsberg, Heineken, Coca-Cola, Nestle, Mondelez, and Danone. Symrise and Cargill also have production lines in Russia. These foreign food manufacturers are strengthening their positions with investments and marketing activities that overshadow local companies. The leaders in this market are focused on consolidation and expansion into regions outside of Moscow and St. Petersburg through buying regional companies shares, investing in new equipment, logistics, business solutions and marketing campaigns.

5. Packaging and Branding

Russians shop by brand and tend to choose well-known brands, but they will still switch products if prices change. Introducing innovative brands with smart packaging and sizes has been a common strategy for suppliers. At the higher end of the market, competition from Europe and lack of brand awareness are issues that must be addressed by a unique product offering.

B. Market Structure

The market is made of a diverse group of food processors who therefore require a vast array of food ingredients. The main types of food processors are:

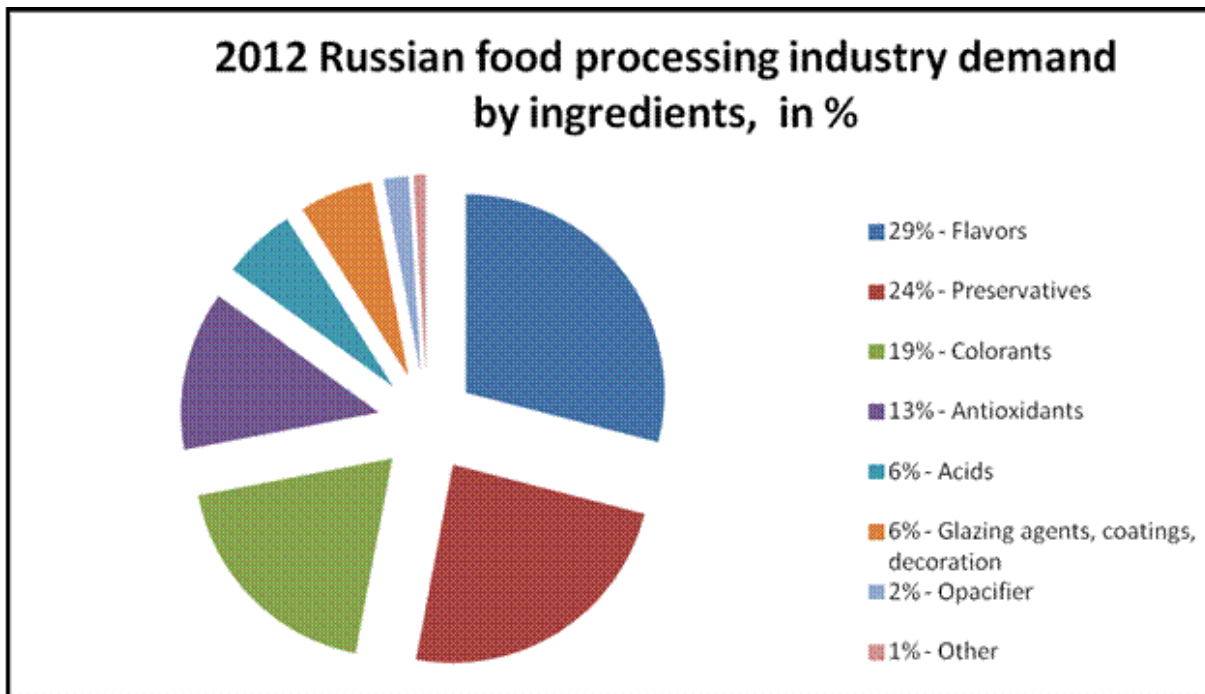
- Meat processing;
- Dairy;

- Fats;
- Bakery;
- Confectionery;
- Alcoholic / non-alcoholic beverages.

Given the wide range of products produced, the Russian food ingredients market uses over 1000 different ingredients. Most notable among these are:

- Colorants (natural and nature identical);
- Sweeteners;
- Preservatives;
- Flavors (natural and nature identical);
- Emulsifiers;
- Glazing agents, coatings, decoration;
- Opacifier;
- Acids;
- Antioxidants, etc.

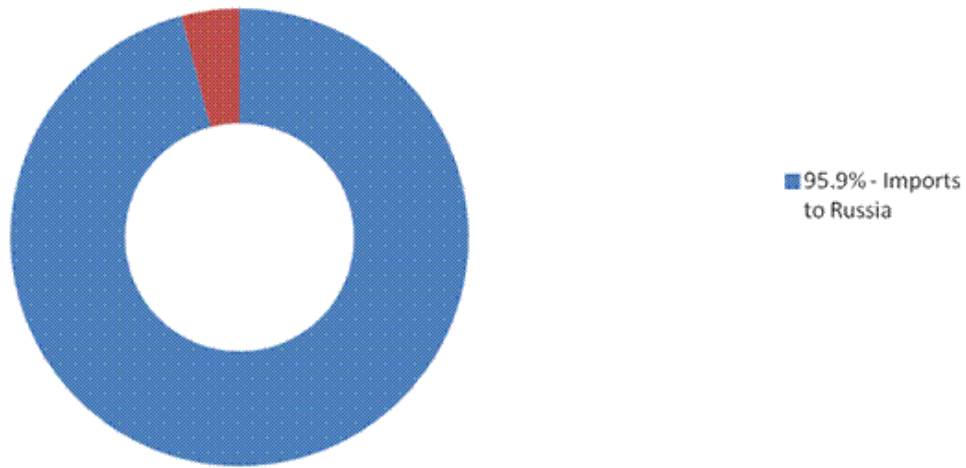
According to the Union of Food Ingredients, the food ingredients industry includes about 1,000 types of ingredients: artificial and natural flavors, vanilla, natural and artificial colors, sweeteners and intense sweeteners, emulsifiers, preservatives, etc. The chart below, from *RBC*, shows industry demand by ingredient usage.



RBC Research

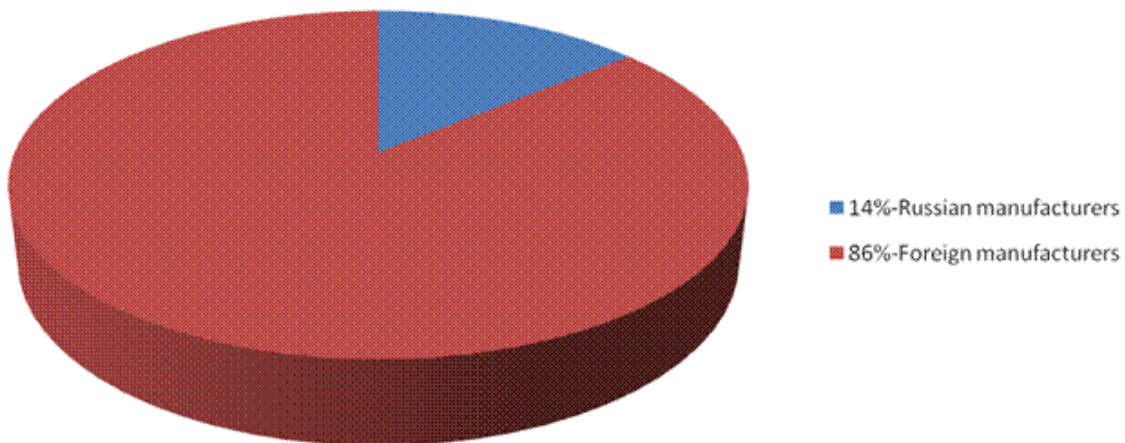
The main users of food ingredients are manufacturers with their own production lines and distribution companies that supply imported products but do not have their own production lines.

2012 Russian food processing industry ingredients import-export ratio, in %



According to *RBC* data, in 2012 there was a prevalence of foreign manufactures in the Russian market, approximately 14% of those were Russian while 86% were foreign.

Russian ingredients manufacturers vs Foreign ingredients manufacturers in 2012 in Russia, in %



Often local manufacturers distribute not only their own products, but also act as official distributors of foreign brands in Russia. Local manufacturers are not yet able to compete with foreign manufacturers and their strong marketing campaigns and promotion practices.

Below are three possible ways of working with ingredient processors in Russia:

- Supply products directly to a local food processor;
- Trade via Russian importer/broker to a local food processor; or
- Supply products via a Russian importer/wholesaler to a local food processor.

In Russia, there are a number of large food ingredients importers and distributors. One of the key market trends is concentration of the largest food importers/distributors/processors in Moscow and St. Petersburg, expanding their reach and influence into regions in some cases by absorbing small local distributors. In the past, there was one key distributor in each Russian region working with all local large processors and small wholesale companies. Increasingly, large Moscow/St. Petersburg-headquartered companies control distribution channels using their affiliates and partners in the regions.

Russian food processors prefer working through local wholesalers, as wholesalers can offer the whole range of ingredients with attractive discounts. Processors supply their products to wholesalers and also to large food retailers whose share of the market has recently grown. The demand for high quality food products despite the higher prices remains strong. This is a positive sign for foreign ingredient suppliers. A key task to solve for the exporter, along with establishing distribution channels for selling products throughout Russia, is to find an experienced and reputable customs broker who would be able to solve any problems at Customs.

C. Company Profiles

Russian food processors can be divided into the following main groups:

- Large vertically integrated holdings focused on development of their production facilities using their own raw material resources (began in the mid 90s), such as Cherkizovsky meat-processing plant, Wimm-Bill-Dann juice and dairy producer, etc.
- International manufacturers with production facilities in Moscow suburbs and other large regions of the country (started to appear in early to mid 90s), such as DANONE (France), Campina (Germany), Mars (U.S.), Kraft (U.S.), Dirol Cadbury (UK), San Interbrew (Belgium), etc. Russian holding companies with foreign capital, such as OJSC Baltika Brewery Company, KamposMos, and others.
- Regional food processing companies that started their activity under the Soviet times and successfully passed through the period of structural management and production reorganization in the second half of the 90s.
- Small regional producers/entrepreneurs most of whom produce and sell their products in the region where they are located.

The following table includes information about major food processors by category. 28 food processing companies made the list of the 400 biggest Russian companies based on sales volume in 2011. The rating was published by EXPERT Rating Agency at www.raexpert.ru.

Table 7. Major Food Processing Companies in Russia.

Company Profiles	Sales volume in 2011 in \$\$ mln.	End-Use Channels	Production Location and rank among 400 biggest Russian companies	Procurement Channels

Wimm-Bill-Dann Food Products (PepsiCo) (dairy products, fruit juices, drinking water, baby food)	5,441.1	Retail, HRI	Russia+ CIS (42)	Importers, Direct, Distributors
Baltika Brewery Company (beer, non-alcohol drinks)	3,055.3	Retail, HRI	Russia (83)	Importers, Direct, Distributors
Nestle Russia (chocolate, confectionary, coffee, drinks, cereals, ice-cream, snacks, baby food, drinking water, pet food)	2,273.9	Retail, HRI	Russia + Eurasia (101)	Importers, Direct, Distributors
Mars (confectionary, chocolate, ready soups, chewing gum, pet food)	1,939.3	Retail	Russia (116)	Importers, Distributors
YUG Rusi Group of companies	1,907.4	Retail	Russia (118)	Importers, Distributors
Coca-Cola HBC Eurasia (non-alcohol drinks)	1,745.9	Retail, HRI	Russia (137)	Importers, Direct, Distributors
Kraft Foods Rus (coffee, chocolate, confectionary, chewing gum)	1,522.0	Retail, HRI	Russia (151)	Importers, Direct, Distributors
Cherkizovo Group (beef, pork, sausage)	1,472.9	Retail, HRI	Russia (157)	Importers, Direct, Distributors
United Confectionary Manufacturers Holding (chocolate, confectionary)	1,457.1	Retail	Russia (160)	Importers, Direct, Distributors
Efko Group of Companies (oils, fats, mayonnaises, ingredients for dairy, confectionary and bakery production)	1,386.3	Retail, HRI, Processing	Russia (167)	Importers, Direct, Distributors
Sun inBev Russia (beer)	1,363.8	Retail, HRI	Russia (169)	Importers, Direct, Distributors
RusAgro Group of Companies	1,351.3	Processing	Russia (170)	Importers, Distributors
Miratorg Agropromyshlennyi (agricultural) Holding	1,309.8	Processing	Russia (178)	Importers, Distributors
Unimilk (dairy products, baby food)	1,157.1	Retail, HRI, Food Processing	Russia (197) + Ukraine + Belorussia	Importers, Direct, Distributors
Danone Industry (yogurts,	1,094.1	Retail, HRI	Russia (205)	Importers,

baby food, drinking water)				Direct, Distributors
Prodimpex-Holding	1,092.3	Retail, HRI, Processing	Russia (207)	Importers, Direct, Distributors
Heineken United Breweries	878.0	Retail, HRI	Russia (244)	Importers, Direct, Distributors
Synergy Group of Companies (alcohol, meat, poultry and dairy products)	857.9	Retail, HRI, Processing	Russia (246)	Importers, Direct, Distributors
<u>Priorskolye</u>	853.3	Processing	Russia (247)	Importers, Distributors
KDV Group (confectionary, snacks)	847.4	Retail	Russia (249)	Importers, Direct, Distributors
Orimi Trade (tea, coffee)	822.9	Retail, HRI	Russia (257)	Importers, Direct, Distributors
Efes Breweries	789.3	Retail, HRI	Russia (266)	Importers, Direct, Distributors Importers, Direct,
Ostankinskiy meat processing plant (sausages, semi prepared meat products)	758.0	Retail, HRI	Russia (282)	Importers, Distributors
Nizhegorodskiy fat and oil plant (fat-and-oil products, mayonnaises)	710.2	Retail, HRI, Processing	Russia (300)	Importers, Direct, Distributors
SABMiller Rus (beer)	692.4	Retail, HRI	Russia (309)	Importers, Direct, Distributors
<u>Sodruzhestvo-Soya</u>	659.1	Processing	Russia (320)	Importers, Distributors
Russian Alcohol Group of Companies (hard liquors, low-alcohol beverages)	607.9	Retail, HRI	Russia (342)	Importers, Direct, Distributors
<u>ASTON Agropromyshlennyi</u> (agricultural) Complex	599.8	Processing	Russia (344)	Importers, Distributors
Group of Compnies Kosmos Group	599.3	Retail, HRI, Processing	Russia (345)	Importers, Direct, Distributors
CARGILL - Efremovskiy glucose-	576.0	Retail, HRI, Processing	Russia (356)	Importers, Direct,

dextrose plant (glucose syrups, starches, fodder products)				Distributors
ROSHEN (chocolate, confectionary)	564.5	Retail, HRI	Russia (359), Ukraine, Lithuania	Importers, Direct, Distributors
VAMIN Tatarstan (cheeses, dairy, sausage, pasta and bakery products)	553.7	Retail, HRI, Processing	Russia (362)	Importers, Direct, Distributors
Solnechnye Producty (mayonnaises, fat-and-oil products)	528.1	Retail, HRI, Processing	Russia (377)	Importers, Direct, Distributors

Source: EXPERT Rating Agency.

D. Sector Trends

The food processing industry is divided into **three basic groups** based on the raw materials/ ingredients processed and by location. **Group One** is comprised of inputs that are closely tied to a production/growing region and power sources. They are often products whose processed form weighs several times less than the weight of the raw materials and they tend to have a short shelf life. The main products in this category are: fruits/ vegetables, sugar, and fish. These processors gravitate toward the production/growing region to save on logistics costs. **Group Two** utilizes semi-processed raw materials and tends to be located closer to population centers. These include processors such as: pasta, bakery, confectionary, tea, and brewery. These branches gravitate toward cities and easy access to ingredients and additives suppliers. **Group Three** can be based both in proximity to agricultural raw materials and to population centers. These include milk, meat processing, and flour.

Group One

There are 93 sugar processing plants, located mainly in southwestern areas of Russia where sugar beets are grown; more than half of them were put into operation before 1917. The processing is inefficient with significant losses of raw material, water and energy. FAS Moscow estimated production of 4.85 MMT of white beet sugar in raw value basis in 2012/13. This is 11.8% less compared to 2011/12 due to lower domestic beet production and expected lower sugar extraction. Consumption of sugar is not growing linear to production of sugar containing products as the food processing industry increases utilization of sugar substitutes. The chairman of the Russian Union of Sugar Producers has proposed to maintain the current level of rates of duty on citric acid, yeast food, and confectionery products after Russia's accession to the WTO, and to restrict the use of artificial sweeteners and high-energy glucose-fructose syrups.

The GOR forecasts building of six new sugar plants with innovative technologies and resource-saving equipment to increase domestic production of amino acids, “lemon” acid and pectin, and sugar beet molasses (high protein additive in feeds for cattle and pigs). (For more information on the Russian sugar sector please see GAIN RS1261 Sugar Semi-Annual report at [http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Sugar%20Semi-annual Moscow Russian%20Federation 10-4-2012.pdf](http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Sugar%20Semi-annual%20Moscow%20Russian%20Federation%2010-4-2012.pdf))

The roughly 300 vegetable and fruit processing companies in Russia have had steady annual growth of 10-15% during the last 3-5 years, mainly due to diversification of their juice assortment manufactured from imported concentrates. Like the sugar processors, many of these facilities also run on outdated equipment and outdated processing technologies. Due to the shortage of domestic fruits and vegetables -- due to poor climate for fruit and vegetable production in most of Russia's territory -- they rely heavily on imports. By 2020, the GOR plans to develop about 50 investment projects in this sector to dehydrate/ deep freeze fruit and vegetables, produce tomato/ vegetable/ fruit paste, puree, and jams and produce potato chips.

Today there are over 680 fish processing companies, based mainly in the Far East of Russia and in Murmansk, Kaliningrad and Astrakhan oblasts (areas). These processors do filleting, preserving, canning, salting, and deep freezing. In 2012, fish processing increased 8.7% as compared to 2011. A big percentage, more than 50-70%, of the catch is processed in China, Norway and Baltic Sea countries. The "Strategy for the Development of the Russian Food Industry Through 2020," calls for 400 processing facilities to be upgraded, with a special focus on 150 facilities in the Far Eastern District. By the end of 2020, total investment in the industry is estimated at 36.9 billion rubles, including 28.3 billion from private corporations and 8.5 billion from government subsidized loans.

Oil and fat products are manufactured at 76 big plants and 1,300 small facilities in Russia. This sector is strategically important for domestic food processors since it supplies fats and margarine to confectionary, bakery, dairy, ice cream, and animal feed producers. By 2017, the GOR forecasts the oil and fat sector to produce 3.1 mmt of sunflower seed oil, 371,000 tons of corn seed oil, by-products and oil cake - up to 5.1 mmt. FAS Moscow forecasts MY2012/13 sunflower oil production at 3.1 mmt, soybeans at 490,000 mt and rapeseed at 330,000 mt. For more on Russian oilseeds please refer to GAIN RS1222 Oilseeds and Products Annual at

http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Oilseeds%20and%20Products%20Annual%20Moscow%20Russian%20Federation_4-5-2012.pdf.

In 2011, the GOR introduced new requirements aimed at reducing misleading labeling practices. For example, a product containing more than 50% vegetable oil should not bear a name that suggests any traditionally recognized dairy product so that they would not be misleading to consumers. Prior to the new regulations GOR estimates are that around 60% of all products named to convey the notion of butter sold in Russia were not real butter but, rather, products containing a high proportion of vegetable fat.

Margarine and cooking fats, vegetable and seed oil processing is dominated by domestic manufacturers. The butter category is witnessing competition between domestic and international manufacturers, with international brands recording sales in the premium segment. Wimm-Bill-Dann and Produkty Pitania OAO continued to lead the butter category in 2012 with an 18% value share. In the end of 2010, Arla Foods Artis OOO launched an advertising campaign to support its Lurpak brand, a Danish premium brand of butter owned by a Danish Dairy Board. The campaign has thus far been deemed a success, largely due to the lack of competition in the high quality segment from Russian producers. The average price of butter is expected to rise at 2% on the average, as manufacturers are forced to improve the quality of their products through the reduced use of vegetable fat.

Flour and cereals are milled and processed by 1,500 companies including 400 small facilities. This

sector does not produce semi-prepared flour mixes for industrial or home use as is done in the United States and Europe. Grains, such as wheat, barley, oats and rye, are cultivated on more than half of Russia's arable land, and Russia is self sufficient in food quality grains (for more information on Russia's grain and feed sector please see FAS Moscow reporting including the most recent Grain and Feed Update RS1304

http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Grain%20and%20Feed%20Update_Moscow_Russian%20Federation_1-24-2013.pdf). However, processing of this grain in value added consumer products is lagging far behind the developed countries. The GOR forecasts that flour mills will build more lines to enrich flour with vitamins and minerals and for manufacturing of baking mixtures for industrial and home use.

Russian starch and syrup processors produced 492,000 tons of sugar-based products from starch (various by-products and glucose-fructose syrups) and 145,700 metric tons of starch. According to *ID Marketing research*, production of starch and maltodextrin in Russia during 2005-2012 grew rapidly with an increase of 30% However, production of dextrin – polysaccharide produced by the hydrolysis of potato or corn starch – declined 7% in 2011 and about 30% in 1Q 2012.

In the beginning of 2004, the processing of grain into starches and syrups increased by 70 percent, from 650,000 MT (including 645,000 MT of corn and 5,000 MT of wheat), to 1.1 MMT (including 910,000 MT of corn and almost 200,000 MT of wheat). The grain industry has developed new schemes for processing rye into syrups as well, but corn still remains the major source for starch and syrup production (although the share of wheat is increasing). The leader in production of starches and syrups is Cargill (58% of Russia's starch and syrup production in 2011). This growth is expected to continue as demand for sugar replacers in the food industry is growing and the price of syrup from grain in 2010 and 2011 remained 60-90 percent lower than the price of white sugar. By 2020, Russian market demand is forecast to increase as follows: starch - 320 TMT, starchy treacle - 640 TMT, glucose-fructose syrups - 180 TMT. The GOR plans to build new processing facilities in proximity to corn and wheat agricultural areas.

Group Two

Bakery is a leading sector in Russia, where bread provides over 30% of a daily nutrition. There are about 18,000 bakery companies in Russia, 50% of which are small businesses. Big bakeries are large enough to satisfy customer needs in this traditional Russian food. But a growing demand for fresh or special diet products creates a need for small bakery shops with multiple locations. The bakery sector requires equipment update, as the production lines are wearing out. Russian customers are looking for assortment varieties that can be provided by innovative technologies, new ingredients and additives for various diets, enrichment and nutrition. The current trend is for breads containing grain, nuts, dehydrated fruit/ vegetables, herbs, etc.

Pasta in Russia is produced in 300 factories with a total capacity of 1.3 mmt per annum. This amount satisfies the average annual consumption in Russia – up to 6-7 kilograms per person per annum. The major problem of this sector is shortage of local flour made of hard wheat thus they rely on imported wheat or flour.

Russian confectionary has 1,500 production facilities spread Russia-wide, including 150 large factories. Average annual production volume is 3.5 mmt. An average Russian person consumes about 20 kg of

confectionary products per year, which equals the European level of consumption. Confectionery categories have enjoyed relatively robust sales growth of about 12% over the past two years. The confectionary market in Russia is expected grow due to demand for products with special quality features.

The most popular flavors in confectionary are crème brulee, hazelnut, cappuccino, Irish cream and the leading suppliers are exporter Kim-Limited and local producers Soyuzsnab, Scorpio-Aromat. Confectionary manufacturers want flavor producers to develop a formula resistant to high temperatures, because when heated some flavors currently used disappear. To produce jam agar, pectin, natural coloring, flavoring and emulsifiers (lecithin) are used with a focus on the quality and stability of these ingredients.

Group Three

Meat processing in Russia is highly dependent on meat imports. On the average these processors use 39% beef and veal, 34% pork, 24% poultry, 3% mutton and goat meat per annum. In 2012 the sector had about 3,500 companies, including about 2,000 meat processing plants. The major goal for the sector is assortment expansion, extending the shelf life of semi-finished products, and more effective processing of secondary raw materials (skin, guts, blood, bones). The GOR expects meat processors to invest up to 16.3 billion Rubles by 2020. For more information on the cattle sector in Russia please see Gain report

http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Livestock%20and%20Products%20Semi-annual_Moscow_Russian%20Federation_3-14-2013.pdf

Milk is produced seasonally in Russia, with adequate production during the short summer season. Russia produces roughly the same amount of milk as the average person consumes per year, which is about 150 kilograms. Russia has to import about 80% of the ingredients (such as powdered milk and milk fat) for milk, cheese and butter production. Imported ingredients are supplied to the roughly 1,500 dairy processing companies. In 2012, dairy production output increased by 7-9% as compared to the previous year. Major impediments to further growth are low percent of superior quality milk, shortage of coolers for milk on farms, resource wasteful processing lines unable to produce animal feed from dehydrated whey, lactose, milk protein concentrate. GOR expects milk processing branch to invest about 47,493 billion Rubles total by 2017 into equipment update to achieve milk production up to 12 mln tons, cheese – up to 529 TMT, butter – up to 267 TMT.

New investment in the dairy sector by French firm Danone is in line with the company's objective to rapidly increase its share of the country's dairy market through acquisitions. In fact, the company's Russian division, Unimilk, announced its purchase of a Rostov-based dairy project from grain and oilseed company OAO Aston. The project was started seven years ago, but the dairy plant has not yet been built; as a result, Danone will take over the whole process. Original milk processing capacity was 600 tons per day. This comes after Danone-Unimilk increased its stakes in two local dairies, Yekaterinburgskiy Gorodskoy Molochny Zavod, based in the central city of Ekaterinburg, and Kingisepp Dairy, based in northwestern Russia. The acquisition processes were started before Danone took over Unimilk in 2010 and is part of the company's objective to take over more national brands as well as to strengthen its offering of formula milk products on the Russian market.

Production of spreads with a various formulas (margarine-based, or 50% milk fat-based, or vegetable fat-based) is a growing sub-segment of the dairy category. As noted previously, a significant amount of

spreads were being passed off as butter. Average annual spread (other than margarine-based) consumption is about 1.8 kilograms/person and is growing steadily as the product has low fat content and is enriched with micro elements. In 2011, according to *Rosstat*, the output was approximately 153,000 tons, two times more as compared to 2007.

7-10 years ago the Russian food market was not ready to accept many of the emerging food additives and ingredients. But as the food industry modernized and as consumers were exposed to processed food products through international travel, the more widely used food additives and ingredients have grown in demand, e.g. exotic spices and tropical fruit flavors.

Table 8. Full-Line Ingredients Manufacturers in Russia:

Company Name	City of location
Kombinat Khimiko-Pischevoy Aromatiki (Combinat of Chemical-for-Food Flavors)	St. Petersburg
Eco-Resource company (flavors)	St. Petersburg
Scorpio-Aromat (flavors)	Moscow
Cargill factory (flavors)	Yefremov

Consumption Trends

The Russian lifestyle is looking increasingly familiar to Americans and Europeans. There has been a notable shift in consumption towards premium class products with natural ingredients or ethnic/exotic cuisine with specific tastes, flavors and additives. Russian consumers are increasingly interested in balanced diets, healthy, functional, low calorie, and natural foods. The influence of western food habits is unmistakable in the food processing sector which is using more and more innovative technologies for food processing and modern high-tech ingredients for semi-finished products. The advent of organic/natural/bio market niche is also creating demand for so-called bio or organic ingredients and eco-friendly packaging. Urbanization has spurred demand for ready-made food or semi-prepared food and greater convenience. Such changes imply a need to diversify the food production base to match the changing consumption preferences and increase innovations in food processing

At the same time, the average consumer is still price sensitive. The *Federal State Statistics Service* states that more than 13% of the Russian population is below the subsistence minimum. Over 48% live from hand to mouth with an average annual income of about \$4,000. As a result, the food processing industry is also very price sensitive and highly motivated to use cheaper ingredients.

Despite the trends emerging in functional foods and others, numerous studies show that Russian consumers tend to prefer traditional foods and flavors. This can present a challenge to food processors that launch a new flavor or new product in the Russian market. However, as Russians travel and try new foods, their palates are expanding and there is room for carefully introducing new products into the market. A few examples of successful transitions are products such as yoghurt, muesli and low-fat alternatives to traditional Russian sour cream and cottage cheese that have been growing faster than the overall food market.

2012 saw the return of pre-crisis spending volumes. Comparatively lower inflation and unemployment and a higher GDP rate than the rest of Europe contributed to Russia's food and consumer goods sales growth in 2013 by 11% over 2011–2012, Russians spend about 1/2 of their household grocery budgets

on fresh foods, such as meat, processed food and dairy. Consumer spending in Russia increased up to 5.5 billion Rubles in the second quarter of 2012 from 5.2 billion Rubles in the first quarter of 2012 (*Federal State Statistics Service, Russia*). Over the last three years Russia witnessed a threefold growth of the Russian middle class, which is 25% of Russia’s population and nearly 40% of its workforce. According to the Ministry of Economic Development of Russia, the middle class will grow up to 37% by 2020 and up to 48% by 2030.

SECTION III. COMPETITION

The Russian market is highly differentiated: foreign ingredients manufacturers dominate mainly in Moscow and St. Petersburg food processing. In the regions, in contrast, Russian ingredients manufacturers prevail, among both small local producers, and large manufacturers operating across the country. Local food processors are becoming more and more competitive in terms of quality and consistency. This is partially due to GOR initiatives to support domestic food producers with protective measures and import quotas. Quantitative quotas and tariff rate quotas (TRQs) make imports of some products difficult and strengthen the position of domestic production of these commodities, e.g. beef, pork. The details of TRQ policy are available in GAIN reports devoted to poultry and meat products listed in “Other Market Reports” Section. According to some projections, by 2015, domestic ingredients producers will seize 45-50% of the domestic food ingredients market, due to rapidly developing domestic food industry, lower prices (as compared to imports), proximity to food processors, and close cultural and linguistic ties.

Zelyonye Linii, Milord, Technomol, Aromaros, PTI and other food ingredients manufacturers are among the leaders. According to forecasts, by 2015 Russian manufacturers will hold at least 65% of the local food ingredients market. Currently, Russia’s share in the world’s food ingredient manufacturing is not more than 4% (or in dollar value - \$16,241.5) because it lags behind the level of industrial development. The major importers of Russian ingredients are former Soviet countries such as Ukraine, Uzbekistan and Turkmenistan.

The Russian food processing market is not dominated by one or two large firms and therefore doesn’t present serious obstacles to new operators entering the industry. It is in the development stage and far from being saturated. So, for example, in Russia ingredients for the meat industry are supplied by several types of operators: direct importers such Solae, Shaller, Cargill and others; official representatives of foreign manufacturers, for example Moguntia-Interrus (Moguntia), Biofud Spice (Zaltech), Matimex (ALMI) and others; supplier agents involved in preparing complex mixes such as Aromaros-M, Milord, Vremya iK, Omega – Pischevye Technologii and others.

Table 9. Major International Suppliers of Selected Specialized Ingredients in Russia

Company Name	Country	Import Volume, in thousand tons
Roquette Freres	France	34,628.82
QINGDAO SAMIN CHEMICAL CO., LTD	China	10,169.46
QINHUANGDAO LIHUA STARCH CO. LTD.	China	6,247.84

DANISCO	Denmark	5,615.32
TD Krakhmaloproduct (Starch Product)	Ukraine	5,574. 48
LUZHOU BIO-CHEM TECHNOLOGY (LIAONING) CO.,LTD.	China	5,413.70
LIUMATRADE LTD	Great Britain	5,104.72
JILIN PROVINCE CREATE TECHNOLOGY TRADE CO.,LTD	China	4,881.99
CARGILL	USA	4,374.99
TSYATSYA on Export-Import, LTD Fuyuan'	China	3,997.43
OTHER COMPANIES	OTHER COUNTRIES	142,651.09
TOTAL		228,659.84

European food ingredient suppliers are the major competitors of U.S. exporters in the sub-sector of specialized ingredients. The leading countries are The Netherlands (9.5%), Latvia (7.8%), Germany (7.7%), Belgium (7.7%), and France (6.7). Apart from competition on price, European suppliers have an incontestable advantage over U.S. suppliers due to their proximity and lower transportation costs. However, as the Russian distribution network improves and U.S. ingredients gain a reputation here, U.S. suppliers can more easily compete with European suppliers.

SECTION IV. BEST MARKET PROSPECTS

A. Products That Have Good Sales Potential for U.S. Exporters

- Meat including pork, beef, poultry, and edible offal (please note trade restrictions, section Sanitary and Phytosanitary Environment);
- Fish and Seafood: Opportunities for ground fish and salmon, especially underutilized species, for processing;
- Tree nuts and legumes: Russia's commercial nut production is limited. Consumer demand for tree nuts is rising driven by confectionery and baking sectors feeding into a revitalized economy post-economic crisis and a trend toward healthy diets. Iran is the biggest competitor for pistachios, Turkey – for hazelnuts, Tajikistan – for walnuts. U.S. almonds and pistachios are enjoying very strong growth. Good potential for U.S. peanuts and pecans;
- Dried fruits: quality prunes, raisins, apricots and other dried fruit In spite of tough competition from Iran, Tajikistan, Afghanistan and Uzbekistan for bulk dried fruits, U.S. raisins, prunes and dried cranberries are competitive for quality retail and processing markets;
- Flavor enhancers for processed meat products;
- Natural sweeteners and colorings: Healthy eating trend conditions using natural; ingredients in food processing;
- Sugars, sweeteners and beverage bases;
- Functional soy concentrates and isolates (primarily for sausage production);
- Lactose;
- Butter, milk powder;
- Cheese for processing and HRI (subject to trade restrictions);
- Quality Textured Vegetable Protein;
- Gluten Powder;

- Dextrin and other modified starches;
- Complex ingredients including colorings, sweeteners, emulsifiers and preservatives; Seasoning/spices/flavorings;
- Frozen or soft pasteurized fruits – for yogurt and ice cream production.

B. Products Not Present in Significant Quantities but Which Have Good Sales Potential

Specialized food ingredients including carrageenan, emulsifiers, enzymes, pectin, starter cultures, and functional systems (integrated blends of emulsifiers and thickeners) are have potential in the Russian market. Certified organic/natural ingredients also are growing. Note: while many local processors are advertising “natural” or “ecologically-clean“ food and beverage products, there are no official organic standards and such claims cannot be substantiated. Draft standards are currently under review in Russia. USDA Certified Organic can be used in Russia. Kosher and halal-certified ingredients also have a notable market here as there is a sizable Jewish population with growing interest in kosher products and a large Moslem consumer base in Russia and CIS countries.

With naturalness becoming increasingly important throughout the food and soft drink industry, it is no surprise to find high levels of research and development being undertaken in the natural sweeteners category. Stevia extract is at the forefront of this trend. Stevia is not the only natural ingredient attracting attention, with a number of other plant extracts with potential sweetening applications also being researched. These developments will allow the removal of sugar and addition of new sweetening agents. The prebiotic nature of many of the major polyol varieties has become a major selling point in recent times as the potential of prebiotics as functional food ingredients is increasingly recognized.

Although the usage of natural colors and flavors is still at a relatively low level it is growing. The U.S. natural colors and flavors manufacturers have tremendous growth potential in the Russian market. For example, the beverage and confectionary segments are eager to use natural colors and flavors.

SECTION V. POST CONTACT AND FURTHER INFORMATION

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For Trade Policy/Market Access Issues, General Information on the Russian Agricultural Sector, etc:

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Other Useful Contacts

The Agricultural Trade office works with a large number of U.S. industry organizations, several of which are resident in Russia. These cooperators share the view that Russia is a promising market for food products.

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The American Chamber of Commerce is another good source for information on doing business in Russia. The Chamber has offices in Moscow and St. Petersburg

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The U.S Commercial Service has offices in Moscow, St. Petersburg, and Vladivostok. For questions regarding agricultural machinery, food processing and packaging equipment or materials, refrigeration equipment, and other industrial products, please contact:

U.S. Commercial Service

Bolshoy Devyatinskiy pereulok, 8

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<http://export.gov/russia/>

The U.S. Commercial Service office at the U.S. Embassy in Moscow assists American exporters by identifying potential partners through the Gold Key Matching Service. The program features:

- appointments (typically four per day) with prescreened Russian firms;
- background and contact information on each potential partner, such as: the size of the company; number of years in business; product or service lines; and capability to provide after-sales service;
- customized market briefing with U.S. Commercial Service staff; and,
- available market research on the relevant industry sector.

The World Bank and the U.S. Agency for International Development also maintain missions in Russia.