Chicken Run

The business strategies and impacts of poultry producer MHP in Ukraine

September 2015

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SOMO

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Amsterdam, September 2015
Colophon

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Contents

Executive summary .................................................................................................. 4

Introduction ........................................................................................................... 7
  Aim and target group ........................................................................................... 7
  Methodology and report structure ....................................................................... 8

1 Characteristics of Ukraine's agricultural sector .................................................. 10
  1.1 Government policies and incentives ............................................................. 10
  1.2 Agricultural trade with the European Union ................................................ 11
  1.3 The role of international financial institutions ............................................. 13

2 MHP company profile ......................................................................................... 16
  2.1 Basic information .......................................................................................... 16
  2.2 Corporate structure ....................................................................................... 17
  2.3 Ownership and management ........................................................................ 19
  2.4 Financial information .................................................................................... 19
    2.4.1 Key financial figures ............................................................................... 19
    2.4.2 Capital structure ...................................................................................... 21
    2.4.3 Taxes ....................................................................................................... 22
  2.5 Stakeholders ................................................................................................... 23
  2.6 Business strategies ......................................................................................... 24
    2.6.1 Competitive environment ....................................................................... 24
    2.6.2 Competitive positioning ........................................................... 25
  2.7 Use of prison labour ....................................................................................... 26

3 Adverse impacts at Vinnytsia ............................................................................. 27
  3.1 Impacts related to current operations ............................................................ 27
    3.1.1 Foul smell and manure ........................................................................... 27
    3.1.2 Traffic ..................................................................................................... 28
  3.2 Impacts related to the expansion of operations ............................................. 29
    3.2.1 Lack of access to information ................................................................. 29
    3.2.2 Undue pressure on local land owners ....................................................... 30

4 Conclusions ........................................................................................................... 33
  4.1 MHP's business strategies are aligned with the political agendas of IFIs and the EU ........................................................................................................... 33
  4.2 Vinnytsia’s scale of operations and rapid expansion lie at the heart of the adverse impacts ................................................................................................. 34
  4.3 Adverse impacts can be insufficiently mitigated due to lack of information and inspections ...................................................................................................... 35
  4.3 The Netherlands has been instrumental in the growth of MHP ....................... 35
Executive summary

Introduction

This report examines the business strategies of Myronivsky Hliboproduct (MHP), the largest private actor in Ukraine's poultry industry, and how these strategies have been shaped by the characteristics of Ukraine's agricultural sector. With a business strategy frame, it analyses the adverse impacts of the company's Vinnysia complex, the largest chicken farm in Europe. The report is partially based on the results of a fact finding mission, published simultaneously by CEE Bankwatch.

Ukraine's agricultural sector

Ukraine's agricultural sector has industrialised in recent years, and MHP exemplifies this development. The poultry sector is the most concentrated of all the meat sub-sectors in Ukraine, with two fully integrated large agribusinesses, MHP and its direct competitor Agromars, controlling almost the entire market.

Government incentives

The Ukrainian government – seen by the president of the European Bank for Reconstruction and Development (EBRD) as “the most reform-minded government that Ukraine has known” – provides a number of incentives to agribusiness companies, which the Food and Agriculture Organization (FAO) describes as ‘production and trade distorting’. As part of a series of measures to deregulate the business environment in Ukraine, the government also imposed a moratorium on all government inspections of businesses, including all environmental inspections.

Increase in trade with EU

A second notable characteristic of Ukraine’s agricultural sector is the increase in trade with the European Union. The EU has granted so-called ‘autonomous trade preferences’ to Ukraine, which remove customs duties on certain Ukrainian exports. For poultry, the quotas set in the autonomous trade preferences amount to 16,000 tonnes of chilled and 20,000 tonnes of frozen poultry meat. The Netherlands is the only European country that imports significant quantities of Ukrainian poultry.

Financing by IFIs

International financial institutions (IFIs) such as the International Finance Corporation (IFC), the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB), have provided tens of billions of euros to support the Ukrainian economy. They regard Ukraine as playing a vital role in the global food security agenda, and the agriculture sector has been one of their prime focus points.
MHP – a Ukrainian agri-industrial company

Myronivsky Hliboproduct (MHP) is owned by Yuriy Kosyuk, the fifth richest individual in Ukraine. The company is the largest poultry company in Ukraine, accounting for approximately 60% of the country’s industrially produced poultry. It owns and operates each stage of its chicken production, from growing feed grain and producing fodder to slaughtering and distribution and wholesale. The company cultivates 380,000 hectares of land and slaughters an estimated 332 million chickens each year.

Vinnytsia: largest chicken farm in Europe
The construction of MHP’s Vinnytsia facility has been done in two phases, the second of which is due to start in late 2015. With this expansion, the company aims to increase its overall production to 900,000 tonnes. The Vinnytsia complex has been constructed using technology mainly from Dutch suppliers, most of whom received export credit insurances from the Dutch export credit agency Atradius DSB.

Financiers: development banks and universities
The company is the recipient of a long list of loans issued by the IFC and other IFIs, which together total nearly € 0.5 billion. Additionally, the company has received a number of loans from commercial banks, including the large Dutch banks ING and Rabobank. The largest known bondholders include Columbia Investment Management, a wholly-owned subsidiary of Columbia University that manages the bulk of the university’s endowments.

Adverse impacts

Foul smells and heavy traffic
As the largest industrial poultry complex in Europe, MHP’s Vinnytsia facility inevitably creates a burden for nearby communities. These impacts are primarily related to the large volumes of manure produced by the facility and the increase in heavy traffic. Foul odours arise from the trucks transporting live or slaughtered animals, the rearing zones where the chickens are housed, and the heaps of manure piled in fields and at the company’s manure deposit site. Interviewees from a nearby town reported that heavy traffic has intensified since the company started operations. In particular during construction of the facilities, nearby communities experienced the impacts from heavy machinery coming through their villages. However, even after construction was completed, company trucks continued to transport manure, poultry, fodder and other materials directly through the village, thereby damaging roads, causing noise and dust pollution, and cracking the structure of roadside houses.

Undue pressure
Villagers already affected by the company’s operations, as well as those at the intended sites of expansion, claim they were given little to no information about the company’s actions and future plans. It remains unclear how local community members are informed and consulted about the company’s expansion plans and the related environmental and social risks. Local community members expressed strong concerns about pressure exerted on them by the company to lease
their land. Community members described how the most vulnerable inhabitants – elderly, single or widowed women – were targeted the most.

Conclusions

**MHP’s business strategies are aligned with the political agendas of IFIs and the EU**

With nearly €0.5 billion in financing from development banks, the company has been able to expand and vertically integrate its operations to become the largest poultry company in Ukraine. The company has furthermore benefitted from the removal of custom duties for exports to the EU. The second phase of expansion of the Vinnytsia complex primarily serves MHP’s export strategy, as the EU is the fastest growing export destination, and duty free quotas are expected to rise in the future.

**Vinnytsia’s scale and rapid expansion lie at the heart of adverse impacts**

Adverse impacts experienced by local communities are linked to the scale of the Vinnytsia complex and the company’s strategy of rapidly expanding production capacity. It can be argued that the burden for local communities is unavoidable in the vicinity of a complex where millions of chickens are reared and slaughtered every day. The undue pressure experienced by community members is clearly linked to the company’s interest in gaining access to specific plots of land.

**Adverse impacts insufficiently mitigated due to lack of information and inspections**

Community members have little to no access to relevant information concerning the environmental and social impacts of the company and its operations. With state institutions unable to inspect local impacts and local institutions unresponsive to complaints by community members, actual or potential adverse impacts can be insufficiently mitigated.

**The Netherlands has been instrumental in the growth of MHP**

As the Netherlands is a board member of both the IFC and the EBRD, it is involved in decisions to issue IFI loans to MHP. Furthermore, MHP has sourced technological equipment for the Vinnytsia complex from a range of mostly Dutch suppliers. In several cases these companies have received export credit insurances from Atradius DSB. Since the opening of the EU market for Ukrainian poultry, the Netherlands has accounted for the majority of EU imports of MHP’s products.
Introduction

Ukraine plays a key role in the future of the global agricultural sector. In the midst of the armed conflict that has been ongoing for almost two years, the Ukrainian countryside is being transformed into large and intensive industrial farming sites. Under the influence of the World Bank and the International Monetary Fund (IMF), the country is seen as playing a key role in the global food security agenda, in large part because of its highly fertile black soil. With economies of scale and modern technologies, large agribusinesses are expected to make the countryside more productive and turn Ukraine into a net exporter of food.

However, this transformation comes at a cost. First, industrial farming leads to monocultures and large scale factory farms. Standards related to the environment and animal welfare are weak and lightly enforced in Ukraine, leading to a heightened risk of adverse impacts. The export of products made under lower standards also creates competitive pressures on products required to meet higher criteria. In countries such as the Netherlands, this has already led to calls by politicians to reduce national regulations related to battery chicken farming and food safety. 1

Second, the expansion of large scale farms creates pressures on local farming communities in Ukraine. Recent years have seen a growing concentration of production within large agribusinesses, in particular in the meat production industry. These agribusinesses have been able to grab both a large market share as well as vast areas of land, including land formerly used by smallholders and family farms.

The global food security agenda has shaped the policies of governments and IFIs vis-à-vis the Ukrainian agricultural sector, and the successful agribusinesses in Ukraine have been able to align their business strategies with the political agendas of these actors. In turn, the strategic business decisions of large agribusinesses can create adverse social and environmental impacts.

Aim and target group

This report presents a case study of Myronivsky Hliboproduct (MHP), the largest private actor in Ukraine’s poultry industry. It aims to analyse the adverse impacts on communities located around the Vinnytsia complex, the company’s largest facility, by looking at the business strategies of MHP and how these have been shaped by the characteristics of Ukraine’s agricultural sector.

As such, this report is intended to inform civil society working on IFIs or the agricultural sector, policy makers in Europe and elsewhere, sustainable investors and the wider public.

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Methodology and report structure

This case study is based on a combination of desk research and a fact-finding mission in Ukraine. Information about the characteristics of Ukraine’s agricultural sector (Chapter 1) and for MHP’s company profile (Chapter 2) is derived from corporate documents and websites, research reports by international organisations and research institutes, analyst reports, investor calls, media articles, economic databases and other secondary sources.

Chapter 3 is based on the outcomes of a one-week fact-finding mission by the Center for Research on Multinational Corporations (SOMO), CEE Bankwatch, Both ENDS, the Estonian Green Movement and the Latvian Green Movement, hosted by the National Ecological Centre of Ukraine (NECU). This chapter is based on excerpts from a more extensive fact-finding mission report simultaneously published by CEE Bankwatch. Business strategy analysis has been used as a framework for interpreting the impacts described in Chapter 3, and outcomes of these analyses are discussed in Chapter 4.

For the purpose of the fact-finding mission, the team conducted interviews with local civil society, authorities and residents of three villages, and the town of Ladyzhyn. Meetings were also held in Kiev with the Ministry of Agriculture, the Ministry of Environment and Natural Resources, and representatives of the IFC and the EBRD. In addition to individual and group interviews with more than 100 people, and meetings with officials, the fact-finding mission research relied on publicly available information disclosed on the websites of MHP, EBRD, IFC and EIB.

During the course of this research, MHP demonstrated an unwillingness to communicate with civil society organisations. Prior to the fact-finding mission, several requests were made to meet MHP representatives in its Ladyzhyn and Kiev offices, and to get access to environmental information on the Vinnytsia poultry farm units.

The company asked to meet NECU prior the start of the mission. During this preparatory meeting, the MHP indicated its unwillingness to meet participants of the mission or provide any environmental information. In follow-up written communication, MHP stated that “it will be difficult to find mutually beneficial points for our cooperation; therefore MHP representatives will not meet or provide information for CSOs”.2

Attempts to meet company representatives during the fact-finding mission were ignored or dealt with in an aggressive manner. When the team asked for a meeting with company representatives at its local headquarters near the city of Ladyzhyn, security personnel forced the team to leave the company’s premises and refused it further access.

In response to a draft version of this report, MHP stated that it was unaware that the requested visits were part of a fact-finding mission and that it did not prioritise engaging with NECU because they are not listed on the website of the Ministry of Ecology and Natural Resources. In its response, it implies that it wants to exclusively engage with NGOs that cooperate with business, “and not with

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2 Email communication between MHP Head of Investor Relations and Communications Department and NECU, 19 May 2015.
more than four hundred other environmental organisations which use self-PR and groundless attacks on the companies as the forefront of their activities”\(^3\).

A draft version of the chapters of the report that discuss the factual findings (Chapters 1-3) has been sent to MHP as part of SOMO’s review procedure, in parallel with the review procedure for the fact-finding mission report by CEE Bankwatch. The company issued general comments for both drafts, which have been processed throughout this report.

\(^3\) MHP response to a draft version of this report, email received 26 August 2015.
1 Characteristics of Ukraine’s agricultural sector

As a poultry producer, MHP operates within the broader context of Ukraine’s agricultural sector. Ukraine’s agricultural sector has industrialised in recent years, and MHP exemplifies this development. This chapter describes three factors that have contributed to the expansion of large scale industrial farming in Ukraine; government policies and incentives; agricultural trade with the European Union (EU); and the strategies of IFIs. Each of these developments is seen as having shaped MHP’s business strategies, discussed in Chapter 2.

1.1 Government policies and incentives

Agriculture is one of Ukraine’s strategically important economic sectors, accounting for 12% of GDP, 31% of total goods exported and 17% of total employment.\(^4\)

Since the mid-2000s the Ukrainian meat sector has rapidly consolidated and integrated vertically, with large industrial meat companies gaining control over the entire value chain, from feed production to processing and retail.\(^5\) Meat production in Ukraine rose by as much as 39% between 2005 and 2010.\(^6\) In Ukraine, the poultry sector is the most concentrated of all meat sub-sectors, with two fully integrated large agribusinesses controlling almost the entire market.

Incentives

One of the factors leading to the industrialisation and vertical integration of the agricultural sector – and the meat sub-sector in particular – are the reforms and structural adjustments implemented by the Ukrainian government with the support of the IFIs. The Ukrainian government, which is seen as “the most reform-minded government that Ukraine has known” by the president of the European Bank for Reconstruction and Development, provides a number of incentives to agribusiness companies.\(^7\) For example, processors of milk and meat can ‘redirect’ value added tax payments directly to their suppliers instead of paying the tax to the state government.\(^8\) Furthermore, the Ukrainian government has introduced a fixed agricultural tax (FAT), which replaces 12 different types of tax and reduces

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the overall level of taxation in the agricultural sector. Other measures include interest rate subsidies and partial compensation for the costs for investments in setting up or reconstructing livestock farms. According to the Food and Agriculture Organization (FAO), this preferential taxation status of agribusiness in Ukraine has facilitated transformation of the sector and led to an increase in investments. However, the FAO also categorises government support to the agriculture sector as “production and trade distorting”.

Moratorium on inspections

As part of a series of measures to deregulate the business environment in Ukraine, the government also imposed a moratorium on all government inspections of businesses in 2014, with an extension announced a year later. This moratorium bans all state inspections apart from the State Fiscal Service and the State Financial Service, except when a specific inspection is ordered by the Cabinet of Ministers or when an enterprise requests the inspection themselves. According to the IFC, this has saved the industry millions of Euros, as agribusiness did not have to undergo an annual technical check of agricultural machinery in 2014, among other things. However, it also includes a moratorium on environmental inspections, posing a high risk that environmental violations by the private sector remain unidentified.

1.2 Agricultural trade with the European Union

A second notable characteristic of Ukraine’s agricultural sector is the increase in trade with the European Union. In late 2013, violent protests erupted in Kiev against the government of then-president Yanukovych, eventually leading to a change in government, the subsequent annexation of Crimea by Russia and the armed conflict in eastern Ukraine that continues to date. A major factor that spurred the violent protests and current conflict was the rejection by Yanukovych of an EU Association Agreement that would have opened trade and integrated Ukraine with the EU. This deal was tied to a US$ 17 billion loan package from the IMF. After the removal from power of Yanukovych, this deal was eventually accepted by the interim, pro-EU government in May 2014.

Part of this EU Association agreement is the Deep and Comprehensive Free Trade Area (DCFTA). The DCFTA aims to set out a framework for market access for Ukrainian goods and services to the EU and vice versa. It includes the “progressive removal of customs tariffs and quotas, and … an extensive harmonization of laws, norms and regulations in various trade-related sectors”.

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12 Interview with Elena Voloshina, Head of IFC Operations in Ukraine, 28 May 2015.
In May 2015, the EU announced that it will begin implementing the DCFTA on 1 January 2016.¹⁵ In the meantime, the EU has granted so-called ‘autonomous trade preferences’ to Ukraine, which remove customs duties on certain Ukrainian exports.¹⁶ These duties are partially lifted for a number of agricultural products, such as poultry, pork and beef, by setting ‘duty-free tariff rate quotas’ to limit the amount of these goods that can benefit from the trade preference. In effect, these quotas partially open the European market for Ukrainian agricultural products, as only negligible volumes are imported into the EU outside of quota arrangements.¹⁷

However, while customs duties have been lifted, other provisions of the DCFTA, such as a harmonisation of standards and regulations, have not yet been implemented. Currently, there is legislation that applies to poultry farms in Europe but not in Ukraine. Examples include “the use of antimicrobial growth promoters … meat-and-bone meal in broiler feed and the absence of environmental legislation”.¹⁸ Animal welfare, slaughter and transportation standards are also less strict, while producers in non-EU countries such as Ukraine have no costs for the disposal of manure.¹⁹

**Poultry trade**

Poultry quotas set in the autonomous trade preferences amount to 16,000 tonnes of chilled and 20,000 tonnes of frozen meat.²⁰ When looking at the actual exports of poultry meat by Ukraine, the introduction of this quota coincided with a sharp increase of exports of poultry meat to the Netherlands and other European countries (+26130% EU imports in 2014 compared to 2013).²¹

The Netherlands is the only European country that imports significant quantities of Ukrainian poultry. It accounts for approximately 12,500 tonnes of the exported chicken meat, most of which is frozen and can therefore not be sold on the fresh-food market. As discussed in the next chapter, Dutch companies and banks are heavily linked to poultry operations in Ukraine through the supply of technology, provision of corporate loans and partnering in distribution.

1.3 The role of international financial institutions

The IMF, the World Bank and the EU have provided Ukraine with large sums of capital in recent years. IFIs such as the International Finance Corporation (IFC), the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) have provided tens of billions of euros to support the Ukrainian economy.

**International Finance Corporation (IFC)**

The IFC, the private sector lending arm of the World Bank Group, has been present in Ukraine since 1993 and has invested a total of US$ 3.2 billion in 92 different projects. It recognises agriculture as one of the key sectors, as it sees it as one of the only sectors with export potential to provide foreign currency to the country. The IFC has invested over US$ 1 billion in Ukraine's agricultural sector.\(^{22}\)

The IFC provides direct financing to large agribusinesses that it claims helps Ukraine’s overall economy and the overall need for protein by exporting meat to the Middle East and Africa. It also invests in private companies in infrastructure, energy and financial markets.\(^{23}\)

Additionally, the IFC works with local banks to provide access to finance for smaller farms by training banks to set up financial products, providing technical training to farmers and by developing insurance schemes and other financial instruments. Financial products developed include a so-called ‘crop

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\(^{22}\) Interview with Elena Voloshina, Head of IFC Operations in Ukraine, 28 May 2015.

receipts’ instrument, whereby future crop harvests are used as collateral for credit provided by local banks and multinational farm input suppliers such as Bayer and Syngenta.

Finally, the IFC has set up a comprehensive advisory programme to the Ukrainian government, together with the International Bank for Reconstruction and Development (IBRD, also part of the World Bank Group), and has increased its local staff to 50 employees in recent years. This programme has a particular focus on agribusiness-related regulations. For instance, the IFC has called for the removal of mandatory certification provisions from Ukrainian law and the harmonisation of laws on pesticides, additives and flavouring. It has also pushed for a roadmap for lifting the moratorium on the sale of land in Ukraine.

Policy think thanks have criticised the IFC’s role in Ukraine. According to the Oakland Institute, the structural adjustments promoted by the IFC and other IFIs following the installation of a pro-western government will likely result in more large scale acquisitions of agricultural land by foreign companies and further corporatisation of agriculture in the country.

The inclusion of Ukraine in the IFC’s ‘Doing Business’ ranking by the World Bank is also argued to be one of the instruments used to influence reforms.

**European Bank for Reconstruction and Development (EBRD)**

Since 1996, the EBRD has invested more than € 11 billion in Ukraine in a total of 345 projects.

Since the beginning of the political upheaval in late 2013, the EBRD has stepped up its engagement in Ukraine’s agribusiness sector. In the first nine months of 2014 it signed deals for 10 projects, with a total value of US$ 194 million. It focuses its investments on energy, agriculture and the financial sector. The EBRD claims that all of its clients together employ 200,000 people in Ukraine and contribute to more than US$ 10 billion of exports each year.

In Autumn 2014, the EBRD publicly announced that 10 private agribusinesses were willing to invest in Ukraine alongside the bank as part of its Private Sector Action Plan. The EBRD noted that such investments would require changes to regulation related to taxes, import and export laws, and land sales.

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24 Interview with Elena Voloshina, Head of IFC Operations in Ukraine, 28 May 2015.
The EBRD’s strategy between 2011 and 2014 was based on a number of economic challenges it had identified in Ukraine, such as the partial realisation of Ukraine’s agricultural potential due to low productivity, limited access to finance, and uncertain land ownership and user rights.31 It points to the fact that Ukraine was not self-sufficient in the past and had virtually no agricultural exports.32 Other challenges it listed include close links between business and politics, weak governance and transparency, and poor enforcement of competition policies. In the agricultural sector, the EBRD aims to support investments along the whole value chain while specifically targeting primary producers.

For its agricultural investments, the bank states that it applies EU environmental and animal welfare standards and expects each project to either comply with these standards or be aiming to comply.33 In an interview with the authors of this report, EBRD representatives pointed out that until recently Ukraine imported poultry from countries with very low standards. Now, Ukraine has become a very competitive exporter of poultry, thereby reducing its dependency on third countries while receiving much-needed foreign currency. It argues that Ukrainian poultry companies now realise that they need to meet environmental and quality standards in order to have access to finance.

European Investment Bank (EIB)
For the period 2014-2016 the EIB has committed € 3 billion to investments in Ukraine as well as access to finance for small and medium-size enterprises (SMEs). The EIB lists a total of 25 projects on its website in the agribusiness sector, energy, water and waste management and the financial sector.34

The EIB operates in Ukraine on the basis of an external lending mandate by the EU as well as the European Neighbourhood Instrument, under which the bank manages financial measures to support EU foreign policy objectives.35 Both these instruments allow the bank to support a wide range of sectors and beneficiaries, including agribusinesses. In comparison to the EBRD and the IFC, the EIB is a relative latecomer to the agribusiness sector in Ukraine. However, the DCFTA signed between the EU and Ukraine in 2014 has given it a strong impetus to step up and support regulatory reforms and implement the aims of the DCFTA.

The EIB and Ukraine have signed a Declaration of Intent to finance projects in the agri-food sector in order to help the country benefit from opportunities offered by the DCFTA. In 2014 the bank provided € 135 million in agribusiness loans for two big companies, MHP and Astarta.

32 Interview with EBRD staff, 29 May 2015.
33 Interview with EBRD staff, 29 May 2015.
2 MHP company profile

2.1 Basic information

Myronivsky Hliboproduct (MHP) is a Ukrainian agri-industrial company, focusing on chicken meat production and the cultivation of various grains. MHP is the largest poultry company in Ukraine, accounting for approximately 60% of the country's industrially produced poultry and employing around 30,000 people. It supplies both the domestic Ukrainian market, where it sells its products primarily under its own Nasha Riaba brand, as well as a variety of export markets.

MHP has a vertically integrated business model. It owns and operates each stage of its chicken production, from growing feed grain and fodder production to egg incubation, chicken raising, slaughtering, processing, distribution and wholesale of products. The company cultivates 380,000 hectares of land, owns five chicken farms, two breeder farms, feed mills and convenience foods facilities. At any given moment, there are around 40 million broiler chickens, 2 million breeder chicks and 20 million hatching eggs in the company's facilities. With chickens reared for 44 days, the company slaughters an estimated 332 million chickens each year, producing 525,000 tonnes of chicken meat.

The company was established in 1998 as a grain trading company and began chicken production a year later at its Peremoga chicken farm. It expanded its operations in subsequent years and in 2003 became the first Ukrainian business to receive funding from the IFC for facility expansion and modernisation. After having raised capital between 2006 and 2010 by issuing various bonds and an Initial Public Offering (IPO) on the London Stock Exchange, the company commenced the construction of the Vinnytsia chicken farm in 2010, which was to become the largest chicken farm in Europe.

The construction of the Vinnytsia facility is conducted in two phases. The construction of the first phase, with a production capacity of 220,000 tonnes, started in 2012 and was completed in 2014. The construction for the second phase, which will increase the capacity of Vinnytsia to 440,000 tonnes, is planned to start late 2015. The company expects that this will be in operation in 2017.

or 2018. With this expansion, the company aims to increase its overall production to 900,000 tonnes.\(^{40}\) Most of the additional production is intended for export.\(^{41}\)

### 2.2 Corporate structure

MHP organises its business through three operating segments; *Poultry and Related Operations* integrates all functions related to the production of chicken, as well as the production and sale of chicken products, sunflower oil mixed fodder and convenience food products.\(^{42}\) The *Grain Growing* segment comprises the production and sale of grains. The *Other Agricultural Operations* segment comprises the production and sale of cooked meat, sausages, beef, milk, goose meat, foie gras, fruits and feed grains.

All the company’s operations take place in Ukraine. Until recently, the company was also active in Russia through its subsidiary Voronezh Agro Holding, where it conducted grain growing operations on 40,000 hectares of land. However, in June 2015, it announced an asset swap arrangement with Agrocultura, whereby it exchanged its Russian assets for 60,000 hectares located in Ukraine.\(^{43}\)

MHP S.A., the ultimate holding company, is registered in Luxembourg. All the bonds and shares that the company has issued are made from this Luxembourg-based entity.

Apart from its 30 operating subsidiaries in Ukraine and its holding entity in Luxembourg, the company also has a sub-holding located (with tax residency status) in Cyprus, thereby benefiting from the Double Taxation Treaty between Cyprus and Ukraine as well as European Union tax directives with respect to dividends and share sales.\(^{44}\) Additionally, the company has a sunflower oil and poultry meat trading company in the British Virgin Islands, a known tax-haven and secrecy jurisdiction, and has recently incorporated MHP B.V., a financing entity based in the Netherlands.\(^{45}\)

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\(^{44}\) MHP, Offering Memorandum for 8.25% Senior Notes due 2020, 25 March 2013, [http://www.ise.ie/debt_documents/ListingParticulars_56b582b3-8e7a-4291-a414-b248db7ac111.PDF](http://www.ise.ie/debt_documents/ListingParticulars_56b582b3-8e7a-4291-a414-b248db7ac111.pdf) p.31; MHP response to a draft version of this report, email received 26 august 2015.

Summary Corporate Structure and Financing

The following diagram summarises the corporate structure and financing arrangements of the Issuer and its subsidiaries immediately after the Offering and the Tender Offer (assuming U.S.$350 million aggregate principal amount of the Existing Notes are purchased in the Tender Offer) and the application of proceeds of the Offering as described in “Use of Proceeds”. For more information regarding the existing indebtedness of such subsidiaries, see “Description of Other Indebtedness”.

U.S.$984,767,000 aggregate principal amount of the Notes and Remaining Existing Notes

Guarantees of Notes

Proceeds Loans in a principal aggregate amount equal to the aggregate principal amount of the Notes and the Remaining Existing Notes(*)

Represents the Guarantors(**)

Other restricted subsidiaries(***)

Notes:
(1) First-ranking assignments of the Proceeds Loans (as defined below) will be in effect in favour of holders of the Notes. The interests created by these assignments will be shared with the holders of any Remaining Existing Notes.
(2) As of 31 December 2012, on a pro forma basis after giving effect to the Offering and the Tender Offer, the Guarantors would have had approximately U.S.$501.1 million of Indebtedness (other than the Guarantees and the guarantees of the Existing Notes), all of which would have consisted of bank borrowings, U.S.$50.0 million of which is secured and would be effectively senior to the Guarantees. In addition, the Group would have had U.S.$67.4 million of finance leases that would effectively rank senior to the Notes and Guarantees. See “Description of Other Indebtedness”.
(3) As of 31 December 2012, on a pro forma basis after giving effect to the Offering and the Tender Offer, the Other Restricted Subsidiaries would not have had any bank borrowings. See “Description of Other Indebtedness”.

Source: MHP Bond Prospectus*

2.3 Ownership and management

Yuriy Kosyuk is the company’s CEO, founder and majority shareholder. He features on the Forbes list of billionaires and is the fifth richest individual in Ukraine. Between July and December 2014, Kosyuk had a short spell in politics as the first deputy head of the Presidential Administration. Reportedly, his political tasks dovetailed with his business operations, as he was responsible for supporting military logistics in east Ukraine and Crimea, where a number of MHP facilities are located which were at risk of being affected by the conflict. However, only a few months into his tenure he was dismissed from his function for disagreeing with president Poroshenko’s military strategy.

Kosyuk is the majority shareholder of MHP through its 100% ownership of WTI Trading Limited, which holds more than 60% of MHP SA’s shares. The remaining shares are floated on the London Stock Exchange. The other shareholder of note is Franklin Templeton, the large US-based investment firm which holds almost 5% of the company’s shares and which is also the largest single investor in Ukrainian government bonds. Franklin Templeton started investing heavily in Ukraine in 2010 and saw the turmoil surrounding the ousting of Viktor Yanukovych as an opportunity to buy government bonds on the cheap. The investor is seen as having significant influence in Ukraine, and the company has been at the centre of recent negotiations to restructure Ukraine’s national debt.

In addition to Kosyuk, MHP’s management consists of six other executives. Non-executive director John Rich is an agribusiness consultant for the IFC, one of the company’s main funders.

2.4 Financial information

2.4.1 Key financial figures

Over recent years, MHP has been a rapidly growing business with profitable operations. Its sale volumes as well as its production volumes have steadily risen since the company went public in 2008. The company’s revenues are primarily generated by the sale of poultry (63%) and sunflower oil.
For both products, the volume of goods sold increased significantly between 2013 and 2014 (by 18% and 23% for poultry and sunflower oil respectively). For poultry, the increase in volume sold can be explained by the expansion of production at the Vinnytsia farm and increased exports to the European Union. Of the total 525,460 tonnes of poultry sold by the company in 2014, approximately 27% was exported.

In 2014, the company was affected by the devaluation of the Hryvnia – reflected both in lower revenues and net losses. While the company reports an operating profit of US$ 414 million, it suffered a net loss of US$ 412 million. This loss is primarily explained by foreign exchange losses of US$ 778 million as the Hryvnia lost 74% and 97% of its value to the Euro and the US dollar respectively.

Table 1 and Table 2 show some of MHP’s core financial figures.

**Table 1: Core financial figures in millions of US dollars**

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>1,379</td>
<td>1,496</td>
<td>1,407</td>
</tr>
<tr>
<td>Operating profit</td>
<td>415</td>
<td>272</td>
<td>381</td>
</tr>
<tr>
<td>Net profit</td>
<td>-412</td>
<td>162</td>
<td>311</td>
</tr>
<tr>
<td>Total assets</td>
<td>2,293</td>
<td>2,768</td>
<td>2,488</td>
</tr>
<tr>
<td>Total equity</td>
<td>945</td>
<td>1,249</td>
<td>1,199</td>
</tr>
</tbody>
</table>

*Source: MHP Annual Reports*

**Table 2: External revenues per segment in millions of US dollars**

<table>
<thead>
<tr>
<th>Business Segment</th>
<th>2014</th>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poultry and related operations</td>
<td>1,177</td>
<td>1,201</td>
<td>1,083</td>
</tr>
<tr>
<td>Grain</td>
<td>77</td>
<td>133</td>
<td>169</td>
</tr>
<tr>
<td>Other</td>
<td>124</td>
<td>162</td>
<td>155</td>
</tr>
</tbody>
</table>

*Source: MHP Annual Reports*

---

2.4.2 Capital structure

The company is financed 58% by debt and 42% by shareholder equity. The company paid out a total of US$ 80 million in dividends in 2014, despite a net loss for the year. It also paid out an interim dividend of US$ 50 million in April 2015.

The debt consists mostly of corporate bonds, which totaled US$ 943 million at the end of 2014. In 2010, the company issued US$ 330 million in corporate bonds at 10.25% interest and in 2013 it issued additional bonds for US$ 750 million at 8.25%. According to the latest filings, the largest known holders of these bonds include Pioneer Investments and Columbia Investment Management. The latter is a wholly-owned subsidiary of Columbia University and manages the bulk of the university’s endowments.

In June 2014, MHP signed an agreement for a loan to the amount of US$ 200 million to refinance the bonds due in 2015, at a significantly lower interest rate. This loan is syndicated by the IFC (which contributes US$ 175 million) and Dutch bank ING, which contributed US$ 25 million.

This is the latest facility in a long line of loans issued by the IFC and other IFIs, which together total nearly half a billion Euros. Since 2003, the IFC has issued a total of six additional corporate loans and facilities to MHP, with the intention of changing its corporate governance and structure, expanding existing poultry and grain growing operations and developing new facilities. The EBRD also issued a loan of US$ 100 million to MHP in 2013 for the acquisition of agricultural land and capital expenditure related to agricultural equipment. The EIB provided the company with a € 85 million loan for the construction of an integrated chicken fodder production facility as part of the Vinnytsia complex. MHP has used these loans to build two new poultry complexes, including hatcheries, rearing zones, slaughter houses, and gas, water and distribution infrastructure.

The IFIs list a range of different benefits that result from these investments, including; the improvement of animal welfare; food safety and quality; development of agricultural lands; SME inclusiveness; job creation; improved resource efficiency; and the enhancement of food security and self-sufficiency of Ukraine. All these loans are assigned a Category B, indicating that the banks assess that there are limited potential adverse impacts that are largely reversible. The EBRD reports that the company’s

57 MHP response to a draft version of this report, email received 26 August 2015.
operations do not adversely impact local communities. The IFC indicates that “land acquisition will only be done through willing seller/willing buyer negotiations”. MHP indicates that it has always complied with the requirements of the IFIs as set out in their Action Plans.

Additionally, the company has been issued a number of loans by commercial banks, including the large Dutch banks ING and Rabobank.

Table 3: MHP Capital structure, 2014

<table>
<thead>
<tr>
<th>Type of financing</th>
<th>Value (million USD)</th>
<th>Percentage of overall capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder equity</td>
<td>882</td>
<td>42%</td>
</tr>
<tr>
<td>Total debt</td>
<td>1,215</td>
<td>58%</td>
</tr>
<tr>
<td>Bonds</td>
<td>943</td>
<td>45%</td>
</tr>
<tr>
<td>Loans</td>
<td>234</td>
<td>11%</td>
</tr>
<tr>
<td>Financial lease obligations</td>
<td>39</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: MHP Annual Reports

2.4.3 Taxes

As the company operated at a loss in 2014, MHP booked a tax benefit of almost US$ 60 million. In 2013, it also booked a tax benefit of US$ 2 million, while it booked tax expenses of US$ 7.8 million in 2012.

The majority of MHP’s agricultural subsidiaries are exempt from the 18% statutory income tax and a variety of other taxes. As producers of agricultural products, these companies pay a fixed agricultural tax (FAT) instead, which is set at 0.15% of the value of the land plots used for agricultural production. In 2013, the company reported that these FAT payments were equivalent to approximately 0.1% of its 2012 net profits. As the company’s financial statements group FAT payments under the heading

61 MHP response to a draft version of this report, email received 26 August 2015.
'Other operating expenses', it remains unclear how much FAT the company paid exactly in subsequent years.

Additionally, as an agricultural company, MHP is also entitled to a VAT refund, based on the difference between the VAT the company charges on their agricultural products and the VAT it pays on items purchased for their operations. Between 2012 and 2014, the company reported significant VAT refunds of US$ 102 million, US$ 101 million and US$ 90 million respectively. In 2014, the VAT refunds constituted 19.5% of the company’s operating profits (before impairment losses). The VAT refund scheme for the agricultural sector is planned to be abandoned on 1 January 2018, although political discussions are currently ongoing to bring this forward to 1 January 2016. The company also reports on ongoing litigations with the Ukrainian tax authorities related to “disallowance of certain amounts of VAT refunds and deductible expenses”.

2.5 Stakeholders

In addition to international shareholders and financiers, MHP also has business ties to several international suppliers and clients. The company mentions the following suppliers of technological equipment and facilities, most of which come from the Netherlands:

- Nijhuis Water Technology B.V. (the Netherlands)
- Big Dutchman (Germany)
- MOBA (the Netherlands)
- VDL (the Netherlands)
- Meyn Food (the Netherlands)
- Pas Reform (the Netherlands)
- CFS (the Netherlands)
- Sprout Matador (Denmark)
- Haarslev (Denmark)
- Roxell (Belgium)
- Poultry Tech (USA)
- Buhler AG (Switzerland)

The Vinnytsia complex has been constructed using technologies from mainly Dutch suppliers. These include machinery for the hatching farm, a waste-water processing installation, slaughter lines, ventilation and water systems. The Dutch companies supplying these technologies all received export credit insurances by the Dutch export credit agency Atradius DSB.

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Additionally, this research has identified one distribution partner of MHP in the Netherlands, which is Jan Zandbergen World-Wide Quality in Meat.69

**2.6 Business strategies**

MHP operates in a business environment characterised by a growing domestic and international demand for poultry, improved access to the EU export market, and a highly consolidated and vertically integrated sector with a low threat of new entrants. The company’s strategy is geared to servicing both the domestic market as well as diversifying and expanding its export markets. In order to achieve this, the company aims to rapidly expand its poultry and grain growing operations, while keeping its production costs as low as possible. As discussed in subsequent chapters, the scale of its operations and the pace at which it is expanding can be seen as primary causes of the adverse impacts experienced by local communities.

**2.6.1 Competitive environment**

**Growing domestic demand and improved access to EU**

MHP operates both in the domestic Ukrainian poultry market, as well as on a range of export markets. In Ukraine, the average person consumes about 48.8 kilograms of meat per year.70 The level of meat consumption in Ukraine is well below the average consumption level in the EU but it is expected that this will continue to grow in the coming years. Nearly half of the consumed meat is poultry, a growing portion of which is produced industrially.

As described in Chapter 1, the European Commission has implemented a number of trade measures as part of a broader effort to integrate Ukraine’s economy with Europe’s. These measures include duty-free quotas of poultry and a few other products for import into the EU. As a result, exports of Ukrainian poultry to the EU have grown from being virtually non-existent a few years ago, to between 15,000 and 20,000 tonnes of poultry meat in 2014. While this currently constitutes approximately 10% of Ukraine’s overall exports, it is projected that the duty-free quotas will be raised in the coming years, thereby increasing Ukraine’s exports to the EU. MHP accounts for the majority of Ukraine’s poultry exports to the EU. At the same time, Ukraine’s access to the Custom Union, the trade bloc of several former soviet-countries including Russia, has been cut off since February 2014 as a result of a ban of the import of several food products.

**Highly concentrated and integrated sector, low threat of new entrants**

The Ukrainian poultry market is highly concentrated, with the four largest companies controlling approximately 86% of the market. According to the FAO, poultry is both the most technologically

The two large poultry companies, including MHP, have vertically integrated business models with control over the entire value chain of poultry production.

In its 2013 bond prospectus, MHP argues that it is difficult for new players to enter the poultry market because of the time and investment that is required for new entrants to achieve a comparable position.\footnote{MHP, Offering Memorandum for 8.25% Senior Notes due 2020, 25 March 2013, <http://www.ise.ie/debt_documents/ListingsParticulars_56b582b3-8e7a-4291-a414-b248db7acc111.PDF?v=2632015, p.114.}
New entrants would need to acquire land, which requires government licenses that would be difficult and time-consuming to obtain. Also, both MHP and its most important competitor, Agromars, have a vertically integrated business model that reduces production costs and that is difficult to replicate for new entrants. Using European business models that rely on a network of suppliers would be difficult to implement in Ukraine because of the lack of infrastructure for the hatching and rearing of chickens.

\subsection*{2.6.1 Competitive positioning}

As the largest player in Ukraine’s poultry sector, MHP positions itself by applying a number of strategies aimed at increasing the company’s sales volumes. These strategies include the rapid expansion of production facilities and diversifying export destinations.

\subsubsection*{Rapid expansion of production facilities and land bank}

Given the steady growth of demand for chicken in Ukraine and the expected increase in access to the EU export market, MHP’s strategy is to expand its production facilities in order to profit from these favorable market conditions. While MHP is already the largest poultry producer in the country, the phase 2 expansion of the Vinnytsia complex would increase the company’s chicken production from 550,000 tonnes in 2014 to 600,000 tonnes in 2015. According to its investor relations spokesperson, this additional capacity would be mostly directed to export markets.\footnote{MHP, Conference call audio recording, 29 April 2015, <http://www.mhp.com.ua/library/file/q4-and-12m-2015-var1.mp3 (25 June 2015).}

Additionally, the company aims to expand its agricultural land bank to support its vertically integrated business model. Its strategic goals include an increase in its land bank to around 450,000 hectares in 2015-2016 with the aim of stabilising the supply of fodder ingredients.\footnote{MHP, Q4 and 12M 2014 Financial results, Company presentation, 29 April 2015, <http://www.mhp.com.ua/library/file/q4-and-12m-2015-var1.pdf (18 May 2015) p.8.}
Such expansion requires leasing additional land plots, mostly from individual land owners who hold an average of two hectares. The leases that the company signs range from 5-7 years for land for cultivation to 49 years for plots on which facilities are constructed. Prices are dependent on the location of the plot and are based on prices set by the Ukrainian government.\footnote{MHP response to a draft version of this report, email received 26 August 2015.}

As recognised by the company itself, this strategy
entails a business risk of having a fragmented land bank “if it is unable to continue to lease land from its contiguous individual lessors”.76

The aggressive efforts of the company to obtain land leases from individual community members near the Vinnytsia complex, as discussed in the next chapter, can be seen as a mitigation effort to this particular risk.

**Export diversification**

MHP generates approximately 42% of its total revenues by export operations and the company accounts for approximately 85% of poultry exports from Ukraine.77 MHP has been affected by the export ban to the Custom Union, and has made an active effort to redirect its exports to other markets, including the Middle East, North Africa and the European Union.

The EU plays a key role for this business strategy, and a significant portion of the company’s expanding production volumes have been directed towards this market. Several of MHP’s facilities were pre-certified by the European Commission for imports into the EU, and the growing importance of the EU is reflected in the overall export figures for Ukraine, given the company’s dominance in the export of poultry. As reflected in the figures given in Chapter 1, most of MHP’s exports to the EU consist of frozen products that go to the Netherlands, where the company has partnered with at least one distributor.

### 2.7 Use of prison labour

During the fact-finding mission, the authors of this report were informed by several sources that the company made use of prison labour to work in the poultry facilities. According to interviewees, these workers would conduct jobs that locals were unwilling to do. Concerns were also raised that these prisoners were housed in apartments adjacent to a local school. The use of prison labour has been confirmed by MHP in response to a draft version of this report.78 It regards this as a social responsibility project, and acknowledges that prisoners are used to fill vacancies for which the company cannot find local workers. At the time of writing, questions remained outstanding with regards to the voluntary nature of the work and the pay rate for these workers.

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78 MHP response to a draft version of this report, email received 26 August 2015.
3 Adverse impacts at Vinnytsia

This chapter describes a selection of adverse impacts caused by MHP’s operations at its Vinnytsia complex, one of the company’s main poultry facilities. It is drafted on the basis of excerpts from the more extensive fact-finding mission report, to be published by Bankwatch. The fact-finding mission report documents the findings of a mission to the villages in the proximity of the Vinnytsia complex on 25-30 May 2015. In this chapter, a selection of impacts are discussed that can be directly related to the company’s business strategies.

Key findings of this mission fall into two categories:

- Adverse impacts caused by current operations
- Adverse impacts caused by the planned expansion of operations

3.1 Impacts related to current operations

As the largest industrial poultry complex in Europe, MHP’s Vinnytsia complex almost inevitably creates a burden for local communities living in its vicinity. These impacts are primarily related to the large volumes of manure produced by the facility and the increase in heavy traffic.

3.1.1 Foul smell and manure

The members of the fact-finding mission smelled foul odours caused by several of the company’s operations on various occasions. These included odours coming from trucks transporting live or slaughtered animals, the rearing zones where the chickens are housed and the heaps of manure piled up in several fields and at the company’s manure deposit site. These smells were observed both on the roads adjacent to the company’s facilities, in open fields in the region, and in the centre of the nearby village of Olyanitsa.

Villagers complained mainly about the bad smell of manure stored on or applied to agricultural fields, and about wind carrying the smell from the chicken rearing houses. Several interviewees reported that the company occasionally dumps unprocessed manure slurry on wasteland near Ulianivka village.

This was confirmed by the fact-finding team, which inspected a field that appeared to be used as an illegal dumping ground for raw manure slurry. The team documented various heaps of poultry-related, unprocessed waste that had polluted the field. While the team was inspecting the site, it witnessed a company truck entering the site with the apparent intention of dumping additional manure. When the driver of this truck became aware of the presence of the fact-finding team, he drove off to MHP’s central manure storage site. In response to a draft version of this report, the company denies that the truck carried manure, but rather that it was a tank truck filled with
water. However, it does not give a credible explanation as to why the truck was entering the same field where the team witnessed dumped manure and slurry.

All these sources contribute to a persistent stench in the area. Depending on the wind, the odour affects not only villages like Olyanitsa that are located near the existing MHP facilities, but also sites near the planned expansion of the company, such as the village of Ulianivka. There, the occasional stench contributes to the near unanimous local resistance against MHP’s expansion plans and the refusal of locals to lease their land to the company.

While illegal dumping of unprocessed manure appears to take place occasionally, the standard MHP procedure for manure management seems to be to collect the manure in a central open-air storage site where it is kept to mature for several months. After that it is applied to the fields as fertiliser at an appropriate time. The fact-finding team visited the manure storage site. The facility basically consisted of a concrete floor and sidewalls. Neither the floors nor the walls were watertight, and no roof or rainwater cover for the manure was present. In several agricultural fields, the team witnessed several piled up heaps of manure. Manure had already been applied in the fields surrounding the heaps, suggesting that leftover supplies were simply left on the field.

In response to these findings, MHP indicates that it applies manure to its own fields and that it sells organic mixture to third parties. It states that it aims to reduce the discomfort of local inhabitants by providing a ‘special memo’ to buyers of the mixture that is based on broiler chicken manure. It furthermore indicates that it adheres to and exceeds the legal sanitary protection zones for its poultry farms. It should be noted that the state-wide moratorium inhibits any inspections of such legal requirements.

3.1.2 Traffic

Interviewees from Olyanitsa reported that heavy traffic has intensified since the company started its operations. In particular during the construction of the facilities, the nearby communities experienced impacts from heavy machinery coming through their villages. However, even after the construction was completed, company trucks continued to transport manure, poultry, fodder and other materials directly through the village, thereby damaging roads, causing noise and dust pollution, and cracking roadside houses.

Local people indicated that the roads in the village were not designed for heavy trucks. Villagers in Olyanitsa who lived by the main road showed the fact-finding mission team noticeable cracks in the brick walls of their houses. They indicate that reports have been filed with the company and with the local authorities, but their complaints are not followed up because they have no documented proof of the prior condition of the buildings.

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79 MHP response to a draft version of this report, email received 26 August 2015.
Matters are made worse by the speed of passing trucks and lack of effective speed control and road safety measures, such as signs and speed bumps. To alleviate the problem, some villagers in Olyanitsa requested a lower speed limit in the village, but to date these requests have not been met.

Several interviewees indicated that before the construction of the Vinnytsia facilities, promises were made to the village of Olyanitsa that the company would build new roads to bypass the village. However, interviewees indicated that this promise was not upheld. Trucks continue to pass through the village, causing dissatisfaction among villagers. Interviewees indicated that the current situation does not reflect the infrastructure development they expected as a result of the arrival of the company.

3.2 Impacts related to the expansion of operations

Notwithstanding concrete actions such as dumping unprocessed manure or not respecting speed limits, the impacts described above are also the inevitable consequence of the sheer size of the Vinnytsia complex. It can be argued that such impacts are unavoidable for a complex where millions of chickens are reared and slaughtered on a daily basis. It is therefore to be expected that the communities around the sites where MHP plans to expand will suffer from similar problems. Additionally, these communities are already faced with a lack of adequate information and undue pressure to lease their lands.

3.2.1 Lack of access to information

People in several villages expressed concern to the fact-finding team about the lack of access to information on MHP's operations. Both villages already affected by the company's operations as well as those at intended sites of expansion claimed they were given little or no information about the company's actions and future plans. They were also generally unaware of the involvement of IFIs.

In Olyanitsa, a former village head explained how public hearings did take place, but that people were informed when it was already too late to influence the project. While villagers were informed about the company's intentions, they did not have a say in the details of the project. She believes that if the people had been asked for their consent, they would have opposed the company's plans. One land owner says that he agreed to lease his land to MHP on the understanding that it would be used as agricultural land. He was not informed that the company would construct a facility on his land until after construction had already begun. He indicated that if he had known about the company's plans beforehand, he would not have leased his land.

In Uljanovka and Bilousivka, two villages where the company intends to construct phase 2 of the Vinnytsia complex, community members expressed during group meetings that they had filed their concerns regarding the company's plans both directly with the company as well as with local and state authorities. They indicated having received no answers to their written requests for information and letters of concern. A local environmental NGO also filed a formal request for information concerning several technical and environmental documents, including information about the company's manure management system. This information was also not provided. It therefore remains
unclear how local community members are informed and consulted about the company’s expansion plans and the related environmental and social risks. MHP has indicated that information about the environmental impacts of its facilities is available on request at its local offices, but only to professional specialists.80

MHP recently published a Stakeholder Engagement Plan, as well as a complaint form on its website.81 In its Stakeholder Engagement Plan, the company recognizes village councils and local residents as being among the company’s stakeholders and describes a company-level conflict resolution mechanism. However, at none of the interviews conducted by the fact-finding team did community members indicate being aware of this mechanism or having received a response to their written enquiries.82 When asked to comment publicly, the company dismissed all complaints as “black PR”.83

IFIs that have financed MHP do provide some information on the environmental and social risks and mitigation plans. The IFC provides the most extensive information on its website, including both a summary of their environmental and social review as well as the company’s environmental and social action plan.84 However, given the communities’ lack of awareness of IFC involvement, it is highly unlikely that communities are able to find or access the relevant sections of IFC’s website. The information disclosed by the EBRD is much more limited. Whereas it mentions that an environmental, health & safety and animal welfare audit has been conducted, it has also indicated that this audit report is confidential and cannot be shared.85

3.2.2 Undue pressure on local land owners

As MHP looks to expand its poultry operations and land bank, it aims to lease additional land from local land owners in the Vinnycia region. Local community members expressed their strong concerns about the pressure they experience from the company to lease their land.

80 MHP response to a draft version of this report, email received 26 August 2015.
82 In response to a draft version of this report, the company indicates that “any person is able to handwrite a form or draft a complaint in a free form and put it in one of the boxes specially (sic.) placed for this purpose. Boxes are located not only in administrative premises of the MHP Group of Companies but also at other places available for the local population. In turn, we assure you that all complaints received will be reviewed as a must (sic.). The response to them will be adequate, constructive and without any delay,” email received 26 August 2015.
The residents of Ulianovka were worried about the plans to construct several new hen houses near their village, which they believe would be harmful to their livelihoods. Based on experiences in nearby villages, they are concerned about the drop in water levels, sanitary standards, air quality and foul smells. Land owners already expressed their unwillingness to lease their land to MHP and they also opposed the expansion of the company to their lands. However, they felt that the company was systematically pressuring them to reconsider their decision. As described, letters sent by communities to the company detailing their opposition against the construction plans were left unanswered.

Interviewees described how the company would approach land owners individually to sign the leases, rather than as a community. When individual community members refused to sign the lease, they would be approached up to four additional times. Community members described how the most vulnerable people, such as elderly single or widowed women were targeted the most. The families of the company’s workers were also among those pressured to sign the lease. No written documentation about the social and environmental impacts would be presented during these exchanges and land owners were asked to sign leases on the basis of verbal promises by representatives of the company.

However, community members did join together and, despite company workers reportedly attending community meetings and promoting the company’s plans, almost unanimously decided against leasing their land to MHP. Below are a number of quotes from community members during a group interview with the fact finding team:

“We are the children of war, the post-war generation and we know how to care for ourselves. Look at the oldest woman here. She gave her health to the land and now wants to give her land to her children. … Help us! They pressure us to sign [the land lease]. They want to put cement blocks on top of our best land – chernozem. We oppose. They send us workers to advertise the company, but what is said verbally can beforgone. Those villages who gave their land they did not understand what was coming. Now they come and tell us what [impacts] they have. Who is going to defend our rights?”

“We gathered together and decided against leasing our land. 410 people signed against, 1 was for construction. There are 50 people from the village who work for the company and they are putting pressure on these people’s families.”

“The company’s manner is rude, aggressive and brutal.”

“We want investments and development to bring us closer to civilization. But we want an investor who will not pollute our water, air and land. Already our lands are near the thermal power plant’s ash disposal site, so we do not want to be sandwiched between two environmental health hazards.”

Furthermore, interviewees expressed their disappointment with the local and state authorities. They have written several letters to authorities stating that they were against construction, including to the district administration, the district council and the prosecutor’s office. The latter redirected these requests to the department of architecture, the department of ecology and department of
agriculture. While the state authorities replied that the decision on construction would not be made without their participation, villagers did not actually believe that the state would protect their rights, mainly due to the lack of trust between the state authorities and local people.

In response, MHP denies pressuring the community members. It states that it cannot force people to lease their land, because it would damage their reputation, while it needs to build long-term relations with these communities in order to obtain access to the land it needs for its operations.
4 Conclusions

This report analyses the impacts of MHP's Vinnytsia operations by looking at the characteristics of the agribusiness sector in Ukraine and MHP's corporate strategies. It highlights those findings of the May 2015 fact-finding mission that can be explained by assessing MHP's competitive positioning. On the basis of this analysis, it comes to the following conclusions.

4.1 MHP's business strategies are aligned with the political agendas of IFIs and the EU

The company's business strategies appear to be influenced to a large extent by the agendas of its financiers. The IFC and other IFIs see Ukraine as an important actor in addressing food security issues globally through its export of wheat, sunflower oil, poultry and other products, and they see agribusinesses as playing a key role in increasing Ukraine's food production while generating foreign currency. The EBRD and the EIB have stepped up their involvement in the country in recent years in reaction to the ongoing armed conflict. With their focus on the agricultural sector, IFIs have contributed to the transformation of Ukraine's rural lands into large agribusinesses, and MHP has been one of the largest recipients of such public funds. With nearly €0.5 billion in financing from...
development banks, the company has been able to expand and vertically integrate its operations to become the largest poultry company in Ukraine. With the Vinnytsia complex in operation it now slaughters 332 million chickens annually, making it one of the largest poultry companies in Europe.

The company has furthermore benefitted from the removal of customs duties for exports to the EU. As a precursor to the imminent EU-Ukraine DCFTA, the EU has partially opened up its market to poultry and a few selected other products to licensed exporters as part of the effort to integrate Ukraine’s economy with Europe’s. These moves take place against the backdrop of the geopolitical tensions between the EU and Russia. With its vertically integrated business model, its low production costs and the devaluation of the Hryvnia, MHP is in a position to profit from the access to the EU market as it can outcompete its European rivals on price. With its access to the Custom Union cut off, the EU market is playing an increasingly important role in MHP’s export diversification strategy. The phase 2 expansion of the Vinnytsia complex primarily serves this export strategy, as the EU is the fastest growing export destination, and duty free quotas are expected to be increased.

In addition to the various government incentives and the preferential tax regime that MHP enjoys, the IFI loans and the preferential access to the EU market have paved the way for the company’s growth over the past decade. This shows how MHP has been successful in aligning its business strategies with the political agendas of the World Bank Group, the EU and other international institutions.

4.2 Vinnytsia’s scale of operations and rapid expansion lie at the heart of the adverse impacts

Adverse impacts experienced by local communities as described in Chapter 3 are linked to the scale of the Vinnytsia complex and the company’s strategy of rapidly expanding production capacity. Notwithstanding concrete actions such as dumping unprocessed manure or not respecting speed limits, impacts related to the current operations, such as the foul smells of the company’s operations and manure, as well as the increase in heavy traffic, can be regarded as the inevitable side effects of the scale of the operations at Vinnytsia. It can be argued that the burden for local communities is unavoidable in the vicinity of a complex where millions of chickens are reared and slaughtered on a daily basis. This conclusion contradicts the position of the IFIs that the project is mostly beneficial, with limited and mostly reversible potential adverse impacts.

Similarly, opposition of local communities in areas where the company plans to expand the Vinnytsia complex can be explained by the experiences of villages where the company is already active. Their understandable suspicion is triggered by stories from Olyanitsa, where community members felt they were informed too late and would probably have voted against the arrival of the company if they had known the consequences.

MHP has an interest in maintaining good community relations given their long-term presence in the area. However, the company also has a commercial interest in accessing adjacent plots of land in order to avoid the higher costs associated with a fragmented land bank. In order to lease adjacent
plots, the company has to negotiate with a significant number of individual land owners. The undue pressure experienced by the community members in Ulianovka is clearly linked with the company’s interest in gaining access to specific plots of land. While no evidence has been found that the company is breaking the law, repeat visits to people refusing to lease their land; negotiations with villagers on an individual basis; and requests that villagers sign contracts on the basis of verbal promises are all indications that the company is eager to obtain the leases without delay.

4.3 Adverse impacts can be insufficiently mitigated due to lack of information and inspections

Given the near inevitable adverse consequences of the company’s operations and the inherent conflict between the company’s commercial interests and those of villagers that object to leasing their lands, it is of importance that the rights of local communities are respected and that impacts are mitigated.

However, community members have little to no access to relevant information concerning the environmental and social impacts of the company and its operations. They are generally not aware of the involvement of IFIs, and are therefore uninformed about the requirements that come with it or the independent accountability mechanisms associated with them. Requests by local community members and NGOs for information, technical or environmental documents have remained unanswered. In response to this report, the company has admitted that it is only willing to share such documents with specialised professionals, inevitably creating an information gap for communities.

Furthermore, the moratorium on government inspections creates the risk that environmental violations remain undetected and that adverse impacts remain unmitigated. With state institutions unable to monitor local impacts, and local institutions unresponsive to complaints by community members, it can be concluded that any actual or potential adverse impacts can be insufficiently mitigated.

4.3 The Netherlands has been instrumental in the growth of MHP

Finally, it can be concluded that there are several links between MHP and The Netherlands. Dutch companies and state institutions have been instrumental in the rise of MHP through providing corporate loans, supplying technology and partnering in the distribution and sale of end products.

As the Netherlands is a board member of both the IFC and the EBRD, it is involved in the decisions to issue IFI loans to the company. Furthermore, the company has received commercial loans from the Dutch banks Rabobank and ING, with the latter taking part in the recent syndicated US$ 200 million loan by the IFC. Furthermore, MHP has sourced the technological equipment for the Vinnytsia complex from a range of mostly Dutch suppliers. Companies such as Nijhuis Water Technology and CFS Bakel have supplied the company with water filtering equipment, processing and packaging
machines and other technology. In several cases, these companies have received export credit insurances for these transactions from Atradius DSB.

Since the opening of the EU market for Ukrainian poultry, the Netherlands has also accounted for the majority of EU imports. With MHP accounting for 85% of Ukraine's overall poultry exports, it is safe to conclude that the overall export figures are a good representation of the company's export markets. This research has furthermore identified at least one Dutch distribution partner of MHP. As it exports mostly frozen chickens, it is likely that MHP products are primarily used for low-end restaurants and processed foods.
Chicken run

The business strategies and impacts of poultry producer MHP in Ukraine

With nearly half a billion in financing from development banks, Myronivsky Hliboprodukt (MHP) has been able to expand its operations to become the largest poultry company in Ukraine. The company, owned and controlled by one of the richest men in Ukraine, slaughters an estimated 332 million chickens per year to produce more than half a million tonnes of chicken meat. Its Vinnytsia complex is the largest chicken farm in Europe, and local communities suffer from foul smells from manure, transport and slaughter of chickens, increased heavy traffic that damages roads and houses, and constant pressure from the company to lease their land.

This report examines the business strategies of MHP and how these strategies have been shaped by International Financial Institutions (IFIs) and the European Union. Using a business strategy frame, it concludes that the negative consequences around the Vinnytsia complex are caused by the scale and the rapid expansion of the company and that the Netherlands has been instrumental in growing the company by providing finance, technology and an export market.