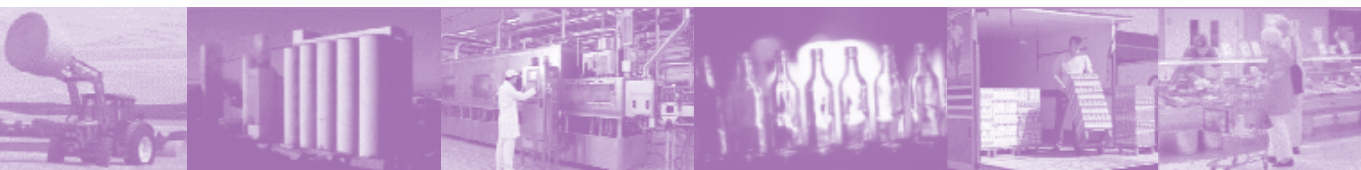


Uzbekistan



Investment Opportunities in the Agribusiness Sector

Study Supported Under the French Technical Cooperation Fund
(Ministère des Affaires Etrangères)



Food and Agriculture Organization
of the United Nations



European Bank
for Reconstruction and Development

UZBEKISTAN

INVESTMENT OPPORTUNITIES IN THE AGRIBUSINESS SECTOR

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CURRENCY EQUIVALENTS

US\$ 1 = UZS 975

US\$ 1 = EUR 0.93

ACRONYMS AND ABBREVIATIONS

AsDB	Asian Development Bank
BAS	Business Advisory Services
CASC	Central Asia Seed Corporation
CFDT	Compagnie Française pour le Développement des fibres Textiles
CIS	Commonwealth of Independent States
COPACO	Compagnie cotonnière
EBRD	European Bank for Reconstruction and Development
EUR	European euro
FAO	UN Food and Agriculture Organization
FDI	Foreign Direct Investment
FTC	Ferghana Textile Combinat
GDP	Gross Domestic Product
GNIS	Groupement National Interprofessionnel des Semences
ICGREF	Ingénieur Civil du Génie Rural, des Eaux et des Forêts
IFC	International Finance Corporation
IFIs	International Financial Institutions
IMF	International Monetary Fund
IPM	Integrated Pest Management
JBIC	Japan Bank for International Co-operation
JSC	Joint Stock Company
JV	Joint Venture
MAWR	Ministry of Agriculture and Water Resources
MFER	Ministry of Foreign Economic Relations
PET	Poly-Ethylene Terephthalate
RO	Resident Office
SME	Small and Medium Enterprise
TC	Technical Cooperation
UHT	Ultra High Temperature
US\$	United States dollar
USDA	United States Department of Agriculture
UZS	Uzbek soum
VAT	Value Added Tax
WB	World Bank

EXECUTIVE SUMMARY

(i) *The objective of this report was to identify potential areas of investment in the agribusiness sector for the EBRD. The report, written for internal use, is addressed primarily to the EBRD Agribusiness team. The report reviews the general investment climate in Uzbekistan, outlining objective constraints and recent improvements. It then offers some background on the various subsectors and proposes a series of company profiles that include individual follow up recommendations.*

General Investment Climate

(ii) *So far, the existing policy framework and the macroeconomic conditions in Uzbekistan have not been conducive to private investment. Reforms have been slower than in most other CIS countries and, as a result, foreign investment has been limited. Within the CIS, only Tajikistan has a lower stock of Foreign Direct Investment (FDI).*

(iii) ***The local currency is not freely convertible.** Currency convertibility is widely considered as the greatest obstacle to doing business in Uzbekistan. Companies have to apply to the government to convert their soums (UZS) into hard currency at the official conversion rate. This process, involving a high level of red tape, is cumbersome and disrupts normal business transactions (e.g. payments of imported raw material to suppliers or repayment of dollar-denominated loans). Hard currency can also be bought on the black market but rates are less advantageous and this is not an option for companies that want to keep transparent accounts. Since last October, however, Nestlé mentioned that they have been granted free access to hard currencies. This seems to confirm that the government is committed to a series of progressive changes in its macroeconomic policies.*

(iv) ***Foreign exchanges risks are high and restrictions are imposed on the circulation of cash.** Other implications of the government's monetary policy include the high exchange risks incurred by companies borrowing in hard currency. The liquidity of local banks in soums is reportedly limited and the latter tend to extend loans in hard currency using resources borrowed from international institutions like the World Bank, the EBRD or bilateral donors. In all cases, the foreign exchange risks are taken by the borrower. Except for companies with revenues in hard currency, foreign exchange risks are high as the monetary policy of the government typically results in abrupt devaluations of the soum.*

(v) *As part of the efforts of the government to tightly control the monetary situation, new restrictions on the circulation of cash have been imposed. Most payments to suppliers and clients have to be done by bank transfer, which in practice excludes a large section of the economic operators from conducting business according to the law. Large companies like Nestlé have no choice but to ask special exemptions to the rule if they want to operate normally.*

(vi) ***Macroeconomic reforms are under way but at a slow pace.** To sum up, the absence of convertibility of the local currency has a series of serious implications hampering private business operations. The International Monetary Fund (IMF) is leading the efforts of the international financial community to introduce macroeconomic reforms in this respect. After past failures in resolving its differences of view with the Uzbek Government, the IMF launched a staff-*

monitored programme in 2002 to tackle a series of reforms, in particular the liberalization of the foreign exchange system. The programme is under implementation. Some changes - for instance in the agricultural sector - are already visible and more results should be seen within the next harvesting season.

(vii) **Some positive measures have been introduced by the government to encourage FDI.** Joint ventures involving a foreign partner are entitled to a seven-year tax exemption if the investment project is included in the National Investment Programme. In addition, joint ventures with more than 50% of foreign ownership are exempt from taxes on reinvested profits.

(viii) *Despite the adverse investment climate, some international agribusiness companies have made the strategic decision to invest in Uzbekistan and manage to operate successfully. Having stressed the above constraints, it should be noted that some private companies, including international agribusiness firms like Nestlé or Dagrís, have decided to invest their own resources in Uzbekistan. Taking a long-term view on the export potential or the domestic market potential of the country, these companies manage to operate successfully. Such precedents tend to prove that the decision of the EBRD to invest in the agribusiness sector is a matter of putting enough effort into projects that, by nature, are more difficult to structure and/or that convey higher risks. The view taken in this report is that, to compensate the higher risks related to the adverse investment climate, stand-alone projects should be launched in co-operation with very strong partners, if possible with a track record in Uzbekistan.*

The Agricultural Sector

(ix) **Agriculture is the most important sector of the Uzbek economy.** Agriculture generates more than 30% of the GDP and employs at least 35% of the workforce. In 2001, exports of agricultural and food products represented 28% of total exports. The main agricultural regions are the Ferghana Valley, the regions of Karshi, Bukhara, Samarkand, Tashkent and the Surhandarya region (Termez).

(x) *During Soviet times, Uzbekistan's agriculture was highly specialized in cotton and wheat, with 70% of all irrigated land dedicated to cotton. In contrast, the country was dependent on imports for a large range of foodstuffs. Since independence, there has been an evolution in cropping patterns, with agricultural labour and management systems shifting to the non-state sector. Today, private farmers, excluding the "paper-privatized" co-operatives (shirkats), reportedly produce 70% of the fruit and vegetables and 90% of the livestock products, on approximately 10% of the arable land. However, the level of state involvement in the sector remains heavy and hampers the development of private farms by limiting their access to open markets, inputs and credit.*

(xi) *While most agribusiness companies are at least partly privatized (generally at 75 % and at 49% for companies producing spirits), the State maintains its command over the agricultural sector through (i) its minority shares in the agribusiness companies, (ii) a system of State Orders (goszakaz) and (iii) by controlling the procurement of key commodities.*

(xii) *Under the State Order system, which applies to crops like cotton, wheat, sugar beets, and rice, farmers are requested to grow specific crops on their land and sell part of their production to state-controlled agents at state-set prices, which are generally well below the market prices. In exchange, farmers can obtain inputs at subsidized prices.*

(xiii) **Reforms in the agricultural sector are under way.** The dismantling of the State order system is part of the priorities set in the IMF staff-monitored programme and the Ministry of Agriculture and Water Resources confirmed its commitment to progressively lead these changes to their ultimate goal. Some measures have already been passed to reduce the importance of State Orders, e.g. by decreasing the proportion of the final production that has to be sold to the State (50% for wheat and cotton, down from 75%). Furthermore, the procurement prices of these commodities are now based on regional commodity exchange prices (world price less processing, transportation and marketing costs).

(xiv) Another area of reform worth emphasizing is the full privatization of industries in non-strategic sectors, which include all agro-industries. A presidential decree was signed to this effect in January 2003. In practical terms, the decree stipulates that all the shares that the state still holds in these companies will be disposed of. The modalities of the privatization still need to be clarified but, if and when the decree is applied, the ownership structure of a lot of agribusiness companies will be clarified. Depending on how it is conducted, the privatization process might also offer investment opportunities for investors in the agrifood sector. Full privatization should also render the State Order system more and more difficult to maintain. Another effect of the privatization process will be the dismantling of the so-called "industrial associations" such as the Oil, Fat and Tobacco Association which, by holding state shares in a large number of agrifood companies, have been vehicles used by the government to maintain its grip on the sector.

(xv) Finally, the idea that certain subsectors are strategic, which was used to justify firm restrictions on imports/exports, is progressively waning. These restrictions are being removed. For the 2003 cropping season, private farmers can freely dispose of 50% of their cotton and wheat production. The cotton produced outside the State Order system can be sold to traders that have the right to export cotton through auctions.

(xvi) **Reforms are usually partial.** Across the board reforms are unlikely to be introduced by the current government at one time. The latter will have difficulty in loosening its grasp over the agriculture sector. One reason for this is that cotton, for instance, has traditionally been one of the only sources of export earnings for the State budget. This has been achieved through a system of State Orders, minimum prices paid to farmers and strict control over international trade. Vested interests of individuals close to the national and local government circles are also a strong deterrent to change. On the other hand, some aspects are playing in favour of reforms. Firstly, some government officials are realizing that paying very low prices to cotton producers is not sustainable in the long term and eventually undermines the very source of foreign earnings, especially if the government is not able to inject enough working capital to sustain production. This explains why, under certain conditions, companies are now authorized to export cotton directly, provided that they pre-finance the crop. In the context of projects financed by International Financial Institutions (IFIs), the government has also accepted the launch of more comprehensive reform packages, though on a limited geographical basis. In the four regions currently covered by the World Bank and in the region covered by the Asian Development Bank, State Orders have been dismantled altogether.

(xvii) **Specific arrangements can be negotiated with the government.** In conclusion, even if reforms are slow and strong distortions still affect the agricultural sector, some effective changes were recently introduced by the authorities, which confirm their commitment toward economic reforms. In practice, additional advantages can be negotiated with the government, on a case-by-case basis, as illustrated by the experience of Nestlé and other investors. Regional authorities can

also propose special conditions (e.g. access to land) to investors, in order to attract them in their region (e.g. Veno, Termez).

Subsector Analysis

(xviii) As mentioned earlier, the Uzbek agriculture is highly specialized. Some private operators, along with government officials, have realized the importance of diversifying from the crop patterns established during Soviet times. The efforts undertaken by the government to introduce sunflowers as an alternative source of oilseed illustrate this trend. From an investment perspective, however, it should be noted that introducing new crops can turn out to be very costly and time consuming. It typically requires the introduction and testing of new varieties and very high levels of technical assistance at the farm level. For the past two years, the French association of seed producers (GNIS) has been involved in the registration process of more than 30 different new varieties of cereals, vegetables and sunflowers. Given the efforts required to introduce new crops, the most immediate investment opportunities were identified in subsectors where Uzbekistan has traditionally been strong.

(xix) **Cotton and the textile industry offer good export prospects.** Cotton, and the downstream textile industry, offers good investment prospects. It is one of the only subsectors that have a clear export potential, which is a key element for any investment financed in hard currency. Partial reforms are under way, as mentioned earlier and further demonstrated by the special conditions granted to companies like Dagrís and the Central Asia Seed Corporation (CASC) to export cotton fibre. In the textile industry, a significant number of large investment projects, involving foreign partners from, among others, Korea, Japan and Turkey, have already materialized. Finally, a case can be made that the environmental damages usually linked to cotton should actually be ascribed to bad irrigation practices that are in no way specific to cotton. Investing in cotton with the right level of technical support can actually be an occasion to mitigate detrimental agricultural practices.

(xx) **The fruit and vegetables subsector is less subject to government control and also has tangible export prospects.** One of the advantages of the sector is a much lighter government control. State Orders do not apply and there are no restrictions on imports/exports. Interesting niches exist for products fetching high margins on export markets (e.g. pomegranate and other fruit concentrates sold to Asian and European markets; tomato concentrates, etc). A number of investments, involving foreign partners from the Netherlands (Marvel Juice), Bulgaria (Veno), and Turkey (Demir) have been successful and further investments are under consideration.

(xxi) **Investment projects targeting the domestic market might also offer good returns in the long term.** In view of the important exchange risks associated with the local currency and assuming hard currency financing, products generating high margins and/or for which competition is limited should be preferred, especially as the domestic market, with its 25 million consumers, is still characterized by a low purchasing power. The **beer sector** is expanding and, for the moment, competition in this sector is limited. Some local companies (Mehnat, Ferghana Pivo) are considering significant investments to increase their capacity and meet the domestic demand. They have a clear strategy to capture the top segment of the market by importing malt and producing higher quality beer that can compete with imported beers. In the **dairy sector**, Nestlé took in 1996 the strategic decision to invest in the Uzbek domestic market. The company also produces mineral water and baby food. Its products are in the upper category of consumer products. Although the conditions initially proposed by the EBRD were considered as

unacceptable by the company, new proposals could be made. The company is facing difficulties in procuring milk and a risk-sharing scheme similar to the one set up to finance Danone's supplying farmers in Russia could be attractive. In the **packaging sector**, the existing vacuum that characterizes Central Asian markets is a real constraint to the development of the agrifood industry and is an area where investment opportunities exist. The Uzbek government has recognized this gap and decided to give its guarantee to finance a plant producing glass bottles and glass pots in the region of Tashkent. Private investors, including foreign ones, have invested in cardboard packaging (Promcartontorg). A twist-off cap project, under consideration, would be worth exploring, given the strong demand of fruit and vegetable processors for glassware which meets international standards. The **edible oil sector** offers good investment prospects in view of the current deficit that characterizes the Uzbek market and the poor quality of the oil produced locally. While most existing crushing facilities have become obsolete, new cottonseed oil projects are worth investigating, as well as high-margin oil projects (sesame oil, pharmaceutical oils). At this stage, the **grain processing sector** remains problematic until the full removal of the State Order system. However, some small and medium size flourmills are already operating successfully and would be good targets for new SME credit schemes. Other sectors like the meat sector were not systematically investigated.

The Local Banking Sector and the International/Bilateral Financing Institutions

(xxii) *The local banks that were visited consider agricultural/agribusiness as a high potential sector. Some, like Hamkorbank and Innovation Bank, are already active in this sector, but a special mention should be made of Pakhta Bank, which used to play the most active role in agricultural financing. This bank is now almost fully privatized and remains an important player in this sector. Most banks visited offer loans in hard currency using the resources of international financing institutions or bilateral development agencies. These facilities are usually guaranteed by the government, except in the case of the International Finance Corporation (IFC). The team noted that medium size agribusiness projects (between US\$0.5 and 4 million), i.e. projects that could not be financed as stand-alone projects, have problems obtaining credit facilities from local banks. This may be due to the relatively small balance sheet of these banks and/or their prudential rules but it may also be due to the maximum thresholds that are introduced by IFIs that wish to maximize the number of final borrowers/beneficiaries. A comprehensive review of the financial sector, led by IFC, is currently under way. The FAO team did not investigate the feasibility of extending new credit lines through local intermediaries. However, the EBRD Resident Office mentioned that the Bank is considering increasing its lines to the Uzbek banks, through a wider range of intermediaries (so far, four banks have received EBRD financing).*

(xxiii) ***Some IFIs are active in the agricultural sector.*** *Should the EBRD decide to invest in the Uzbek agribusiness sector, complementarity with the interventions of other IFIs should be investigated. The IFC, for instance, has worked actively on the improvement of the legal framework for leasing, following up an earlier study financed by the EBRD. After eight months of efforts, a satisfactory framework is in place and companies like Case IH are considering returning to Uzbekistan. The EBRD might consider setting up an agricultural leasing facility, with partners like IFC and Case IH. Similarly, investing in regions where the World Bank and the Asian Development Bank are financing agricultural projects might prove easier. In the cotton sector, both CASC and Dagrís benefited from the World Bank's Cotton Subsector Improvement Project. The main active World Bank project in the agricultural sector is the Rural Enterprise Support Project.*

RECOMMENDATIONS

In view of the visits made during the field trip, the following recommendations are made:

(i) **Explore the possibility to finance selected stand-alone agribusiness projects.** Few agribusiness companies visited have investment projects that could justify stand-alone transactions. The minimum investment size considered was US\$4-5 million. Six projects could potentially qualify and are briefly described in the company profiles presented in section 3.1 of the report.

- **Dagris (cotton, cotton oil, medical cotton).** Only the project sponsored by Dagris (France) combines the key advantages of having a strong international partner and revenues in hard currency. Dagris already approached the EBRD two years ago but, at that time, the Bank was not open to financing projects in Uzbekistan. It is recommended that a new contact is established and the investment projects of Dagris are explored in more detail. Should an investment project in the cotton sector be considered, a mitigating environmental TC project might be advisable.
- **Veno Holding (cotton plant, tomato concentrate).** These projects, also targeting export markets, are worth investigating. Veno is a Bulgarian company. It is a client of one of EBRD's local bank partners in Bulgaria. In Uzbekistan, Veno is already a client of Pakhta Bank. The most immediate recommendation is to make an inquiry into Veno through EBRD's Resident Offices in Sofia and Tashkent.
- **Ferghana Textile Combinat (dying unit, spinning/knitting).** The large and successful joint ventures of the local sponsor of this project with Kabool Textiles (Korea) and Sidat (Turkey) are positive aspects. The project is targeting export markets. The creditworthiness and the assets of the sponsors could be investigated by the Resident Office in Tashkent.
- **The Kagan Edible Oil Plant** project in the Bukhara region and the **Salt Mine** in the Surhandarya region would require strategic investors. The EBRD might play a role in identifying such partners.
- **Ferghana Don Flourmill.** As mentioned earlier, until State Orders are completely removed from this sector, any large operation in the grain processing sector would be too risky.

*Although smaller in size, the projects of **Menhat** and **Ferghana Pivo** (see section 3.2) in the brewery sector should be further investigated for potential stand-alone transactions. This sector is characterized by sustained local demand growth and little competition. The creditworthiness and the assets of the shareholders/sponsors could be investigated by the Resident Office in Tashkent.*

(ii) **Strengthen the capacity of EBRD's Tashkent-based Business Advisory Services (BAS) in the agribusiness sector.** The investment projects of most companies visited are too small to justify stand-alone transactions, whatever their merits may be. Detailed information on these projects is presented in section 3.2 of this report. They include Novator, a successful local company selling mainly pistons and the only producer of plywood in Uzbekistan; the twist-off

packaging project promoted by the Fruit and Vegetables Association; and the various agribusiness projects of the Turkish group Demir.

(iii) *The EBRD's Financial Institutions (FI) team already extended SME credit lines to four local banks (NBU, Pakhta, Asaka, Uzpromstroy), while the EBRD's Resident Office in Tashkent reported that it is now considering extending new credit lines to Uzbekistan, through a wider range of financial intermediaries. Subject to further investigation by the local banks, the above projects/companies could receive indirect EBRD support under its new SME credit lines.*

(iv) *While there would be no obvious reason to set up a dedicated agribusiness credit line, the capacity of local agribusiness SMEs to identify partners and structure investment projects could be strengthened. This would facilitate their access to existing and future EBRD SME credit lines. To achieve this, it is suggested that the scope of activities of the local Business Advisory Services (BAS) team is enhanced by a dedicated agribusiness advisory TC project. Initial discussions were held with the BAS Office in Tashkent. The immediate recommendation is to further explore the idea with the Head of TAM in London and with the Official Co-financing Unit.*

(v) ***Explore the possibility of setting up an agricultural/agro-processing leasing facility.*** *The combined efforts of the EBRD and the IFC have led to the establishment of a favourable regulatory framework for leasing operations. Discussions are reportedly held between the FI team and the IFC to fund a leasing facility. Given the importance of agricultural leasing operations and the renewed interest of companies like Case IH in the Uzbek market, the Agribusiness team might consider setting up an agricultural leasing facility.*

(vi) ***Mobilize TC funds to develop a favourable regulatory framework for warehouse receipt financing and commodity exchanges.*** *For the moment, the existence of State Orders creates market distortions that would hamper the implementation of a warehouse receipt financing scheme. However, as noted before, State Orders are in the process of being removed. In view of IFC's success in promoting changes in the regulatory framework of leasing operations at a low cost and in a relatively short period of time, it is suggested that a similar exercise be launched in the area of warehouse receipt financing and commodity exchanges. It would be an occasion to promote reforms in the agricultural sector and it could eventually lead to financing opportunities for the Bank. The Ministry of Agriculture and Water Resources expressed interest in receiving information on the EBRD-sponsored Grain Warehouse Receipt Programme in Kazakhstan.*

PROPOSED FOLLOW-UP STEPS

Company	Sector	Project	Estimated amount of investment	Comments	Initial contact	Proposed f/up steps	Related sections of report
DAGRIS (France)	Cotton ginning	- Cotton ginning plant in Suhrandariya region	- to be defined	+ Projects generating revenues in hard currency + Strong shareholder + Demonstrated experience in Uzbekistan	- Meeting with local CEO in Tashkent	- Gilles Mettetal to meet Dagriss' GM at Paris HQ and discuss investment strategy	- Cotton subsector note - Dagriss and CASC company profiles
	Cotton oil processing	- Cottonseed oil processing plant in Bukhara region	- to be defined				
	Medical cotton	- Cotton fibre processing plant to produce medical cotton	- to be defined (estimate: US\$3 million)				
Ferg'onapivo Co. Ltd.	Beer	- Increase capacity of brewery - New malt plant	- brewery: US\$4.5 million (of which US\$1.9 million financed by Pakhta) - malt plant: US\$3 million	+ Strong local demand + Limited competition - Small project (high transaction cost)	- Site visit - Meeting with GM in Ferghana	- Tashkent RO to check credentials of shareholders and creditworthiness of company - Gilles Mettetal to meet GM in Tashkent in May	- Beer subsector note - Ferg'onapivo and Mehnat company profiles
Mehnat	Beer (and wine)	- Increase capacity of brewery and working capital	- US\$1 million	+ Strong local demand + Limited competition - Small project (high transaction cost)	- Site visit - Meeting with GM in Tashkent	- Tashkent RO to check credentials of shareholders and creditworthiness of company - Gilles Mettetal to meet GM in Tashkent in May	
Veno Holding (Bulgaria)	Cotton ginning	- New ginning plant in Suhrandariya region	- EUR 5 million (of which EUR 3 million of equity)	+ Company well established in Uzbekistan	- Meeting with Veno Holding CEO in Tashkent	- Tashkent and Sofia RO's to check credentials of shareholders and creditworthiness of company - Veno Holding CEO ready to come to London for meeting and/or Gilles Mettetal to meet Uzbek Representative in Tashkent in May	- Cotton and Fruit and vegetables subsector notes - Veno company profile
	Fruit & vegetable processing	- New tomato and fruit processing plant in Suhrandariya region - New canning factory	- tomato plant: EUR 2.7 million (of which 20% of equity, 30% Pakhta) - canning plant: EUR 1.5 million	+ Projects generating revenue in hard currency			

Company	Sector	Project	Estimated amount of investment	Comments	Initial contact	Proposed f/up steps	Related sections of report
Ferghana Textile Combinat	Cotton processing / textile	<ul style="list-style-type: none"> - Dyeing unit - Spinning and knitting unit - Cotton waste processing unit 	<ul style="list-style-type: none"> - Dyeing: US\$6 million (of which bank loan US\$2.5 m) - Spinning/knitting (1st phase): US\$2.5 million - Cotton waste: US\$2.5 million 	<ul style="list-style-type: none"> + Strong partnership with Kabool (Korea) and Sedat (Turkey) + Revenue in hard currency 	<ul style="list-style-type: none"> - Meetings with CEO in Tashkent and Ferghana 	<ul style="list-style-type: none"> - Tashkent RO to check credentials of shareholders and creditworthiness of company - Agribusiness team to investigate Kabool (Korea) - Gilles Mettetal to meet CEO in Tashkent in May 	<ul style="list-style-type: none"> - Cotton subsector note - Ferghana Textile Combinat company profile
Demir Group (Turkey)	Agro-processing and retailing	<ul style="list-style-type: none"> - Small oil extraction plant (safflower and sunflower) - Dry fruits and pulses conditioning - Poultry breeding - Breakfast cereals 	<ul style="list-style-type: none"> - to be defined (consolidated needs: US\$13.2 million) 	<ul style="list-style-type: none"> + Strong and active sponsor + Cautious approach + Group well established in Uzbekistan - Small projects - Operations in Uzbekistan not consolidated 	<ul style="list-style-type: none"> - Site visit - Meetings with Executive Director of Demir Uzbekistan in Tashkent 	<ul style="list-style-type: none"> - Agribusiness team to investigate Demir (Turkey) - Tashkent RO to check credentials of shareholders and creditworthiness of company - Gilles Mettetal to meet Executive Director in Tashkent in May 	<ul style="list-style-type: none"> - Demir Group company profile - Related subsector notes
Novator Group	Processing of straw and wood by-products	<ul style="list-style-type: none"> - New chipboard processing line (second-hand equipment) 	<ul style="list-style-type: none"> - US\$6.5 million 	<ul style="list-style-type: none"> + Strong local shareholders + No competition in the whole region + Low cost raw material 	<ul style="list-style-type: none"> - Plant visit - Meeting with Chairman of the Board of Directors in Tashkent 	<ul style="list-style-type: none"> - Tashkent RO to check credentials of shareholders and creditworthiness of company - Gilles Mettetal to meet Executive Director in Tashkent in May 	<ul style="list-style-type: none"> - Novator Group company profile

Company	Sector	Project	Estimated amount of investment	Comments	Initial contact	Proposed f/up steps	Related sections of report
Kagan Cotton Oil Plant	Cotton oil processing	- Complete new cotton oil extraction plant	- US\$18.6 million (of which US\$12.8 million already invested)	+ Equipment already procured, construction half completed - Existing shareholding structure not clear - Reasons for project suspension not clear	- Meeting with Plant Manager	- Agribusiness team to identify potential strategic investors - Tashkent RO to investigate shareholders and reasons for project suspension	- Edible oil subsector note - Kagan Cotton Oil Plant company profile
Khujjaikon Tuz	Salt mining	- Salt extraction and iodination for human consumption	- US\$4.2 million	+ Very good extraction conditions + Large reserves + Strategic location - Research of strategic partner not transparent (no tender)	- Site visit - Meeting with Hakim of Surhandariya region - Meeting with CEO in Tashkent	- Agribusiness team to identify other potential strategic partners; if necessary, to advise local authorities on privatization process (international tender) - Tashkent RO to investigate privatization process	- Khujjaikon Tuz company profile
Nestlé	Dairy products, baby food, mineral water	- UZB financing needed	n/a	+ Very strong partner + Strong presence in Uzbekistan	- Meeting with Financial Manager in Tashkent	- Agribusiness to reconsider offer and meet with Nestlé HQ - Gilles Mettetal to meet with Financial Manager in May in Tashkent	- Nestlé company profile
n/a	Grain Warehouse Receipts	- Develop legislative/regulatory framework	n/a	+ State Orders system to disappear progressively + Openness of MAF to work on legislative framework	- Discussions with MAWR	- Gilles Mettetal to meet with MAWR and selected local banks (Pakhta, Innovation Bank, Asaka Bank, etc.) - Agribusiness team to mobilize TC	n/a

1. INVESTMENT CLIMATE

A. General Investment Conditions

Currency Convertibility and Exchange Controls

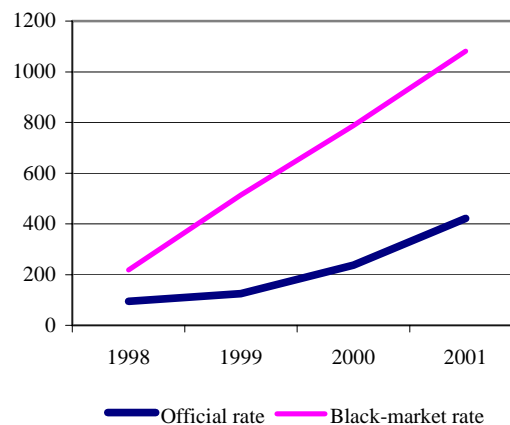
Uzbekistan held out as one of the last former communist countries to agree to an IMF stabilization programme, and from the outset has had strained relations with the Fund. The country received a stand-by loan facility in 1995, but that was suspended in 1996. In 1997, a joint Uzbek-IMF working group failed to resolve differences about the course of economic policy and finally, in 2001, the IMF decided not to replace its representative in Tashkent. Uzbekistan agreed to a staff-monitored programme in 2002, but the slow pace of economic reform has not been satisfactory to the IMF, which has refused to discuss another stand-by facility until the currency market is fully liberalized.

The difficulty in converting soum (UZS) into hard currency is most often cited as the greatest obstacle to doing business in Uzbekistan. The Government justifies its use of exchange controls as necessary for channelling the country's foreign exchange reserves into high priority sectors, but the effect is more often detrimental distortions throughout the economy.

Half of hard currency profits must be exchanged into UZS at the overvalued official rate, yet access to foreign exchange at this rate is severely restricted. Companies must apply to the Government each month in order to convert their UZS into hard currency. The burdensome and unpredictable application process makes planning production schedules challenging and companies have experienced difficulties importing necessary raw materials as well as paying debt to foreign creditors. As real interest rates on UZS accounts are negative, companies experience losses on money awaiting conversion. Hard currency can be purchased through the black market, but only at a significant premium. The restricted access to hard currency at the official rate discourages companies that must purchase inputs at the black market rate to export products, for which they would receive income at the official exchange rate.

Since 2000, the black market premium has been decreasing and, by the end of 2002, it was down to only 36%. In 2003, the black market rate became even closer to the official rate. However, this is more due to official rate devaluations and tighter monetary policy than to true liberalization.

Diagram 1:1 Evolution of the US\$/UZS Exchange rate



Taxation

According to a Presidential Decree issued on 27 March 1998, Joint Ventures (JVs) that have an authorized capital of US\$150,000 and for which the foreign investment represents at least 30% of the authorized capital are entitled to certain tax privileges:

- JVs with projects included in the National Investment Program receive a seven-year tax holiday:
 - If the JV has 50% or more foreign ownership, tax on profits for the subsequent two years is 20%;
 - If invested capital is over US\$1 million, the subsequent two-year tax rate is 16%.
- JVs of any size that export and produce at least 25% of their output for children receive a seven-year tax holiday with a 50% tax reduction after the holiday period expires.
- JVs with foreign ownership over 50% are exempt from taxes on the profits they reinvest.

Additional benefits may be available to companies that are able to negotiate their own decree.

Trade Restrictions

As part of its import substitution programme, the Uzbek Government sets quotas for foreign exchange and requires import contract registration. Although officially foreign companies and joint ventures importing capital goods with their own funds are exempt from this requirement, their local bankers often strongly recommend they register anyway.

Custom procedures are cumbersome and can take as long as four months with no priority for perishable goods. During this time, the importer is responsible for storage fees.

The following items are prohibited for export from Uzbekistan:

- Grain (wheat, rye, barley, oats, rice, corn, buckwheat);
- Bakery products;
- Flour, cereals;
- Cattle, poultry;
- Meat and meat sub-products;
- Dry milk;
- Tea feedstock, tea;
- Antiques (pictures, sculptures, etc.);
- Tanning raw materials (except non-standard).

Privatization

Privatization in Uzbekistan has been slower than in most transition countries. Small businesses were privatized almost immediately after independence, but medium-sized companies that were nominally privatized into joint stock companies are still largely under state control. Most large enterprises are still at least partially state-owned. A 1998 decree allowed the Government to block strategic decisions made by majority foreign shareholders in local firms if the Government decides that they are not in the country's interests.

However, the situation is evolving. A presidential decree, signed in January 2003, stipulates that all the shares that the state still holds in companies operating in non-strategic sectors will be disposed of. The modalities of the privatization still need to be clarified but, if and when the decree is applied, the ownership structure of a lot of agribusiness companies will be clarified.

B. Foreign Direct Investment (FDI)

Inflows and Stock of FDI

The IMF disputes the Government's accounts of FDI as their figures in the past have included foreign debt inflows and there is concern that the Government includes contractual pledges of FDI rather than actual investment flows. More reasonable figures demonstrate that Uzbekistan has had one of the lowest cumulative inflows of foreign direct investment among transition countries and there is practically no portfolio investment. The lack of reform in currency convertibility and the extensive restrictions on capital and trade have led to a decline in FDI inflows since 1997. Within the CIS, only Tajikistan has a lower stock of per capita FDI than Uzbekistan.

Table 1:1 Foreign Direct Investment

	1996	1997	1998	1999	2000
FDI Inflows (US\$ m)	55	285	140	121	73
% of GDP	0.4	1.9	0.9	0.7	0.5
US\$ per head	2	12	6	5	3
Inward FDI Stock (US\$ m)	305	590	730	851	924
% of GDP	2.2	4.0	4.9	5.0	6.8
US\$ per head	13	25	30	35	37

Source: Economist Intelligence Unit

Main Investors

The largest investors in Uzbekistan are Turkey and the United States, followed by South Korea, Indonesia, the United Kingdom, Germany and Japan. The most significant foreign investments include:

- US\$300 million: (UK/US) British-American Tobacco's project to rehabilitate the tobacco industry;
- US\$200 million: (South Korea) Daewoo's automobile plant in Andijan;
- US\$150 million: (US) Newmont Mining's gold-processing venture.

Additional large investors include:

- Case Corporation: manufacturing and servicing of cotton harvesters and tractors;
- Coca-Cola: bottling plants in Tashkent, Namangan and Samarkand;
- Texaco: producing lubricants for sale in the Uzbek market;
- Baker-Hughes: oil and gas development.

Incentives/Restrictions

Although the Uzbek Government claims a desire to attract FDI and offers various tax breaks, its restrictions on currency transactions are a strong deterrence to foreign investors. In order to convert UZS revenue into hard currency, private companies must comply with an onerous patent-licensing process. Furthermore, the Government mandates that 50% of hard currency profits be converted into UZS at the overvalued commercial bank rate. As a result, exporters must often increase prices to compensate for the loss on the currency conversion, which hurts the competitiveness of Uzbek products on world markets.

2. SECTOR ANALYSIS

A. Summary

Agriculture represents the largest sector of the Uzbek economy, generating 30% of GDP and employing 35% of the workforce. The sector is characterized by the dominance of cotton-related output and heavy state involvement. During the Soviet period, the specialization in cotton was extreme. Seventy percent of all irrigated land was dedicated to cotton, which made Uzbekistan reliant on imports of food.

After independence, agricultural labour and management systems and crop patterns had to be changed. Agricultural production was shifted to the non-state sector. Now, there are three main forms of farming: large producers – agricultural co-operatives (shirkats); medium-sized producers – farms; small producers – dekhan farms (peasant farms). Combined they produce over 98% of the agricultural products of the country.

In 1994, the Programme of Grain Independence was adopted as part of the country's import substitution strategy and now the country produces its own flour and flour products. Only a small quantity of the durum variety of wheat is imported. Rice and potatoes are also supplied by domestic production. Orchards and vineyards have been leased to private individuals and all former cattle breeding farms were privatized and sold for private use through auctions.

Uzbekistan is the second largest exporter of cotton and the crop provides 60% of the country's hard-currency export earnings (See Annex 1). There has been little reform in the agriculture sector, which has hampered growth and kept cotton farmers in a very weak position. The combination of low state-determined procurement prices and exchange rate controls results in farmers being paid only 25% of the world cotton price.

The emphasis on cotton production has been the source of major environmental problems with repercussions throughout the region. Irrigation systems are inefficient and water prices artificially low, leading to massive waste of water resources. The result has been the dramatic shrinking of the Aral Sea and a rising water table that retains harmful chemicals and renders fields unusable. These problems receive little attention from the Uzbek Government, which continues to strongly resist liberalizing water prices and instituting environmental protection regulations.

State Purchasing System

The Government of Uzbekistan is still heavily involved in the agricultural sector and maintains a system of state orders for cotton, wheat, rice, sugar beets and other crops. The state determines which crops will be grown where, provides inputs at subsidized prices and buys the crop at a state-set price, which is generally far below the market price. If farmers exceed their quota, they can sell a portion of their crop at negotiated market prices; however, if they do not meet their quota, they must sell their entire crop to the state at the below-market price.

B. Subsector Notes

Cotton

With a production of 1.015 million tonnes of lint in 2001, Uzbekistan is the world's fifth largest producer and the world's second largest exporter. Cotton is Uzbekistan's largest export, accounting for one-third of all export earnings and 60% of hard-currency earnings.

Cotton Production

Cotton Harvesting Methods. According to Government sources, not less than 341,000 tonnes of seed cotton, i.e. 9% of the total 2001 harvest target, should have been machine-picked¹ (the rest being hand-picked). It is not clear whether this target was achieved and if there was a similar target for 2002.

Seed Varieties and Seed Production. The number of varieties has been decreasing since 1992, but there are still twenty in commercial production.

Processing Plants

In 2000, a new cottonseed processing plant opened², owned by K. Soliyev Seed-growing Corporation (Uzbekistan) and Dagrís (France). The JV borrowed US\$3 million from the World Bank - under its "Cotton Sub-sector Improvement Project" - to purchase French equipment. This brought the number of seed companies established under the World Bank project to six, located in Namangan (Mirishkor, French/Uzbek), Ferghana (Ferghana Seed Corporation, Greek/Uzbek), Bukhara (French/Uzbek), Syrdarya (Central Asia Seed Corporation, USA³), Surkhandarya (Oltin-Chigit, Greek/Uzbek) and Tashkent (Hatipet, German/Uzbek). Another Greek/Uzbek joint venture is under consideration in Khorezm (no funds requested from the World Bank). The Central Asia Seed Corporation (CASC) installed American manufactured saw gins and the Bukhara Seed Corporation installed an American Lumus gin with a Kincer delinting plant. The two companies in the Ferghana Valley have small ginneries, while those in Surkhandarya and Tashkent rely on local ginneries.

Import of Inputs

Most plant protection chemicals, such as Nurem, Dalafon, Nurel, Zalon, Dentol, are imported. Over time, the utilization of these chemicals is decreasing and farmers tend to use biological methods of plant protection. However, it is difficult to estimate the extent of the trend, as statistics are scarce⁴.

¹ Source: World Bank Rural News, 15 September 2001

² See Dagrís Company Profile.

³ See CASC Company Profile

⁴ Source: USDA Report #UZ2004, 3 July, 2002

Production Statistics

Table 2:1 Production Targets for 2002/03

Region	Hectares ('000 ha)	Yield (mt/ha)	Production ('000 mt)
Ferghana	115.3	2.95	340.1
Andijan	107.6	2.88	309.9
Namangan	94.0	2.87	269.8
Tashkent	110.0	2.55	280.5
Syrdarya	115.3	2.29	264.0
Djizzak	105.5	2.37	250.0
Bukhara	128.2	3.12	400.0
Surkhandarya	120.0	3.17	380.4
Khoresm	95.0	2.95	280.3
Navoi	43.0	2.79	120.0
Samarkand	110.0	2.27	249.7
Kashkadarya	164.0	2.56	419.8
Karakalpakstan	80.0	2.33	186.4
Total	1,387.9	2.70	3,750.9

Table 2:2 FAO Production Statistics

Production (mt)	Year							
	1995	1996	1997	1998	1999	2000	2001	2002
Cotton Lint	1,265,000	1,081,000	1,080,000	1,147,000	1,021,000	1,000,000	1,015,000	1,055,000
Cottonseed	2,387,000	2,040,000	2,220,000	1,932,000	2,220,000	1,803,000	1,830,000	1,850,000
Cotton Linter	107,640	87,000	81,000	75,000	83,280	69,960	89,400	60,000
Cotton Waste	157,368	134,004	145,572	128,248	144,000	120,072	131,000	138,000

Changes in Government Cotton Policy

Exports. The Government plans to develop a market information system so that farmers can better react to market conditions⁵. Several elements indicate that Uzbekistan plans to reform the way it exports cotton. According to some sources⁶, most private sector enterprises and individuals will eventually be able to export cotton fibre through auctions. The Government is working on the mechanism for holding auctions, before issuing export licenses to individuals and enterprises. To date, Uzbek law normally forbids individuals and private enterprises from exporting cotton without using state trading enterprises. The Ministry of Foreign Economic Relations (MFER) and its divisions negotiate and oversee cotton exports. The reform of the system is part of a program of economic stabilization and structural reforms launched by Uzbekistan in co-operation with the

⁵ Source: USDA.

⁶ Source: Interfax 28 April 2002.

IMF. So far, only two companies have been able to negotiate direct cotton sales: CASC and Dagrís.

Procurement of raw material. Reportedly, Uzbekistan plans to reform the system of government contracts for cotton and grain procurement⁷. Prices under State contracts will be partly based on world prices for cotton and grain and the over-the-counter national currency exchange rate. Decisions on how much the Government will buy from growers will be based on actual rather than planned production of cotton and grain. Government purchase prices for cotton will be set by 10 August. The State will buy 30% of cotton and 25% of grain at the set price. In addition, farmers will be also required to sell to the State at contract prices 20% of the cotton produced and 25% of the grain produced. It is not clear how much this price will differ from the State set price. Farmers will be free to sell the rest of the harvest (50%) as they see fit. In any case, the changes in the Government's cotton pricing policy should mean a significant increase in earnings for thousands of cotton farmers who, for years, have been forced to sell cotton to the Government at a fraction of the world price⁸. Last year, the price offered by the Government for one kilogram of cotton was US 12-15 cents, one-fifth of the price on the world market.

Local Market and Exports

Local Market and Key Producers. All cotton lint is sold either to the Ministry of Foreign Economic Relations (MFER) for export (except in the case of Dagrís and CASC, see above) or to Uzbeklegprom, the association of joint-stock textile enterprises. The textile companies can buy from the association up to the quota that is allocated to them. They can now also buy from the ginning factories the available surplus generated by farmers outside the State order obligations. The current domestic consumption of lint is estimated at 250,000 mt and is forecast to remain almost at the same level in 2002/03. It is expected to increase gradually over the next few years as several South Korean/Uzbek and Turkish/Uzbek JV textile mills start to operate. The South Korean "Kabool Textiles" company is one of the most active foreign investors in Uzbekistan's textile industry⁹. South Korean investors have already constructed several textile mills and plan to construct additional mills in the future. These mills will mainly produce yarn for export.

In 2002¹⁰, Ok Saroi Tukimachi Ltd, a joint venture of Uzbek, Turkish, and Japanese partners, opened. The plant will process 6,110 tonnes of cotton fibre a year, producing 4,800 tonnes of yarn and 2,000 tonnes of knitted fabric for the local market as well as for export. The company was founded in 1999 with a registered capital of US\$19 million by Sado (a division of Uzbeklegprom) - 41.75%, Turkey's Byrsel - 54.85%, and Japan's Mitsubishi Corporation - 3.5%. The project was financed through a loan provided by the Japan Bank for International Co-operation (JBIC) and by the partners of the joint venture.

The Government hopes to expand the domestic consumption of cotton lint and estimates the overall capital investment required by the textile industry between now and 2005 at more than US\$1.2 billion to increase the quality and expand the range of cotton products. Official forecasts indicate that, by 2005, the production of yarn will increase by 78,850 mt, greige goods by 45 million m² and finished cloth by 65.5 million m². Currently, the total production capacity of all operating textile mills is 130,000 tonnes of yarn and 500 million m² of different fabrics.

⁷ Source: Interfax, 29 March 2002.

⁸ Source: Associated Press World report, 23 August 2002.

⁹ See Fergana Textile Kombinat Profile.

¹⁰ Source: Interfax, 11 May 2002.

Several Turkish companies have already invested in the sector¹¹:

- Asnam, in Namangam (US\$7 million)
- Papfan, Turkish/German/Japanese JV, in Aktzaray. 2002 production: 6,100 mt of cotton fibre, 4,800 mt of yarn, 2,000 mt of fabric
- Chinaz factory. 5,300 mt of cotton fibre, 2,500 mt of yarn
- Arezion Nurtop. 2,500 mt of yarn
- Hasnam Cotton Yarn. 2,500 mt of yarn
- Bestex. German/Turkish/Uzbek JV. Plant under final stage of construction. Expected production in 2003: 6,800 mt of yarn
- Sedat Textil, in Chalayan. 4,200 pieces of ready made sportswear for men

The Ferghana Textile Combinat¹² has a strategy to add as much value as possible to the raw cotton bought in the country before exporting it. Having established a successful JV with Korean partners ("Kabool Textile"), the company is actively searching for partners to co-finance a new investment project. Reportedly, this approach is strongly supported by the Government.

Export Statistics

Table 2:3 FAO Export Statistics

Cotton Lint Exports	Year						
	1995	1996	1997	1998	1999	2000	2001
Quantity (mt)	1,025,300	650,000	978,900	829,974	900,000	740,270	760,000
Value (US\$ '000)	1,798,897	1,020,000	1,580,000	1,192,000	883,700	731,000	752,000

Cotton Linter Exports	Year						
	1995	1996	1997	1998	1999	2000	2001
Quantity (mt)	82,081	60,000	70,000	65,000	60,000	50,892	24,170
Value (US\$ '000)	14,727	11,000	14,000	12,000	12,000	11,014	12,600

World Bank Subsector Cotton Improvement Project¹³

Total project value: US\$73.8 million. The World Bank Cotton Sub-sector Improvement Project supported five components: (i) the seed industry component supported the creation of private seed companies to process and market about 25,000 tonnes of planting seed produced by private seed companies in association with privatized seed farms; (ii) the cotton marketing component supported the introduction of cotton grading technology to determine the characteristics of Uzbek cotton in conformity with internationally recognized standards; (iii) the integrated pest management component provided equipment and technical assistance for the development of insect rearing and dispersal technologies that would allow the country to economically broaden biological control of cotton pests; (iv) the irrigation component provided equipment and training to introduce irrigation scheduling technology and demonstrate effective ways to reduce water use

¹¹ Source: Turkish Commercial Attaché.

¹² See Company Profile (Section 3).

¹³ See <http://www4.worldbank.org/sprojects/Project.asp?pid=P009122>

in cotton production, while improving land productivity and avoiding water-based damage to the environment; and (v) the project management and program design component helped in implementing the project.

Results. The Government is still in the process of changing its cotton grading system to approximate the U.S. system in order to eliminate a major source of contract disputes. Several years ago, the Government established the National Cotton Certification Centre (SIFAT), as part of the World Bank Project. SIFAT purchased 16 HIV labs, and installed them in each cotton-producing region. The water component of the World Bank (WB) project led to the establishment of Water Users' Associations and to the installation of flumes to measure water flow and consumption. A charge for water was also introduced in 1997. This was meant to have the effect of rationalizing irrigation practices but, reportedly, some farmers prefer to save money by reducing water use in a haphazard manner, in a way that is detrimental to the crop. According to a USDA report, most of the agricultural budget continues to be spent on irrigation but the water charge system does not work well and the irrigation network continues to deteriorate. The Integrated Pest Management (IPM) component is also completed. During project implementation, in 2002, the crop was severely damaged by trips in parts of the Tashkent region. Unfortunately, there was no outbreak of bollworm during project implementation and IPM could not be tested. On the other hand, the wet spring and protracted planting period in 2002 appeared to have favoured such an outbreak, resulting in considerable crop loss. The seed component progressed satisfactorily and the six companies financed under the project are either operational or will be operational for the 2003 planting season.

Remarks on the Environmental Impact of Cotton Cultivation in Central Asian Countries¹⁴

The blame for the important environmental damages that currently affect the region, in particular the Aral Sea should be placed not so much on cotton as on the mismanagement of land and water resources at the time of the Soviet era.

- Although it stays longer in the ground, cotton does not need more water than other crops. The main problem is that 50% of the water delivered to the former kolkhozes boundaries is lost while being distributing to the field.
- Cotton (and grapes) is less sensitive to drought than Lucerne, apricot, maize or rice.
- Land erosion cannot be attributed to cotton since it is grown in the arable flat lands.
- IPM is still hardly known in the area despite substantial efforts from the WB. The use of biological control, narrow spectrum pesticides at ultra low volume and other technologies could make the cotton growing environment harmless.
- Little defoliant is currently used because of the high price of this input. Furthermore, in the absence of harvesting machines (most of the cotton is hand picked), the need to defoliate the plant is not obvious (the rest of the plant being used for livestock feeding).

¹⁴ This section is based on a note written by Mr. Armitage, Senior Agronomist, Director of Landmarks Consultancies for the EBRD Environmental Appraisal unit. Mr. Armitage is based in Tashkent.

- If farmers receive anything like the export parity price for raw cotton at farm gate, i.e. about US\$300/mt, and achieve yields above 2.5 tm/ha, with judicious use of inputs, they could secure a gross margin from cotton of at least US\$400/ha. This is far more than for most alternative crops, except some fruits and vegetables, while markets for fruit and vegetables, except in certain cases, are much more difficult to expand (remote location from world markets, poor processing capacity).
- In such conditions (i.e. location, poor processing capacities), one can argue that the emphasis should be placed on non-perishable crops with a high value-to-weight ratio. Apart from cotton, rice is also an attractive crop for such conditions, as well as fruits and vegetables if they can be processed. Wheat is not an attractive alternative for cultivation on irrigated land.

Conclusions

- Involvement of reliable private investors, including foreign companies. Under difficult circumstances, the privatization of the cotton fibre sector is under way, with the successful entry of a number of foreign companies such as Dagrís and CASC. In the cotton textile industry, major investments are also under way, involving Asian and Turkish entrepreneurs who are mainly supplying the European markets.
- Limited exchange risks. In the agribusiness/agriculture sector, cotton is one of the few sub sectors that has obvious export opportunities. This is a key advantage for any project financed in hard currency in a country with important exchange risks.
- Opportunities to limit the environmental impact. A cotton project involving a solid partner can be an opportunity to actually decrease the environmental impact of cotton growing (better irrigation practices, IPM). If necessary, it could be accompanied by a TC project specifically tackling environmental issues. Donor funding for this sort of TC project in Central Asia should be relatively easy to identify.
- Profitability. Even under difficult business conditions, the examples of Dagrís and CASC show that new cotton projects can be profitable, even when farmers receive fair prices for their production.
- Evolving Government policies. The Government is proving increasingly open to reform with regard to its cotton policy, in particular in the context of well-designed projects.

In view of the above, the EBRD should consider cotton as one of the most promising sub sectors to identify investment opportunities in Uzbekistan, either through stand-alone projects, credit lines, or in the area of commodity exchange development.

NB: Related Company Profiles: Dagrís, CASC, Freehand Textile Kombi Nat.

Edible Oil

Edible oil is considered as a strategic sub-sector by the Uzbek Government. There is currently a large deficit of edible oil in the country and most of the local production, mainly derived from cottonseed, is of low quality. Ideally, the Government would like to reach a higher level of self-sufficiency and encourage diversification¹⁵. This has had limited results so far, although some international seed suppliers are involved in these efforts. The production of edible oil remains driven by the production of cotton.

As for other strategic commodities, the Government is imposing restrictions on imports and exports of edible oil. Private dealers are not allowed to operate in this sector on international markets.

The first oil factory was constructed in the city of Koran (Ferranti region) in 1883. Other plants were built in Kattakurgan (Samarkand) and Asaka (Andijan). During the Soviet era, these small oil factories became large oil extraction plants. Seventeen such plants were built at that time and were all designed to process only cottonseed. Since independence, some smaller facilities have started to appear.

Raw Material

Table 2:4 Availability of Raw Material

Type of raw material ¹⁶ 2001	Planted area (ha)	Average yield (tonnes/ha)	Available raw material for edible oil production (tonnes)
Cottonseed	1,450,000	1.1	1,582,000
Soya beans	2,000	0.21	400
Sunflower seeds	8,900	0.3	2,700
Safflower seeds	3,100	0.29	900
Total	1,464,000	N/A	1,586,000

Import of raw material. During Soviet times, Uzbekistan used to import 5,000,000 tonnes of soy beans. About 200,000–300,000 tonnes were processed, mainly for soy cakes used as chicken feed. Presently, only limited quantities of soy beans are still imported from the U.S. (on a loan basis) but processing soy is not considered profitable by the factories. As a consequence, there is a protein deficit in the animal feed sector in the country, as stressed by all the poultry producing plants that were visited. The main source of protein is cottonseed cake.

Production

Production capacity. The total processing capacity of the sub-sector is 3,700,000 tonnes. At best, 70-80% is still in use. According to the Oil, Fat and Tobacco Association, the production of edible oil in 2002 was 191,000 tonnes. Since most factories are not equipped with full refining lines, the

¹⁵ Some attempts are made to introduce sunflower.

¹⁶ Source: Oil, Fat and Tobacco Association, Maslojirtabakprom 2001.

oil produced does not comply with western standards. The hexane content is very high. De-colouration and deodorization are not performed. Although some factories have bottling lines, they are often of a poor standard.

Since independence, eight small and medium-size edible oil plants have been constructed. Two of them, financed through loans of the National Bank of the Republic of Uzbekistan, were built with the assistance of Deleplanque¹⁷ and Cie, which provided container-type equipment:

- El Erk Nur, located in the Djizak region, has a capacity of 20 tonnes per day (cost of the equipment: US\$500,000);
- Shakhri International, located in Shakhrisabz, has a production capacity of 25 tonnes per day (equipment cost: US\$940,000).

Prices. In 2002, the ex-factory price of cottonseed oil was approximately UZS 750-800/litre, while retail price was UZS 1,000-1,100/litre. This was high compared to the average world price of cottonseed oil (average 2002: US\$580/t, equivalent to UZS 580/litre), as evidence to the large deficit of edible oil in Uzbekistan.

Table 2:5 FAO Production Statistics

Production of oil (mt)	Year							
	1995	1996	1997	1998	1999	2000	2001	2002
Cottonseed oil	323,000	261,000	243,000	225,000	250,000	210,000	268,500	280,500
Safflower oil	2,082	3,247	3,550	3,903	4,576	4,937	3,345	3,415
Maize oil	9,000	5,400	4,140	3,744	3,600	4,248	3,240	3,060
Soya bean oil	7,056	2,700	14,670	8,892	360	9,632	9,846	7,200
Groundnuts oil	3,908	838	1,066	1,322	1,892	874	3,654	519
Linseed oil	257	122	146	146	181	85	120	102
Rapeseed oil	340	435	442	404	510	700	700	522
Total	347,638	275,738	269,011	245,409	263,118	231,476	291,406	297,208

Production of oil cakes (mt)	Year							
	1995	1996	1997	1998	1999	2000	2001	2002
Cotton seed cakes	771,420	623,500	580,500	537,500	596,840	501,380	640,700	430,000
Soya bean cakes	31,360	12,000	65,200	39,520	1,600	42,811	43,760	32,000

¹⁷ See <http://www.deleplanque.fr/fr/index.htm>

Exports and Local Market

Exports. This subsector is still considered a strategic sector. Restrictions are imposed on international trade of oil and oilseed cakes, while there is a large demand on the local market for edible and technical oils, cotton delinting waste and cake. Despite the deficit of edible oil in the country, 30,000 tonnes of cotton oil were reportedly exported in 2002.

Local consumption. Uzbekistan has a population of 25 million. The estimated per capita consumption of edible oil is 13 kg/year. In addition, it is estimated that 50-75,000 tonnes are utilized by the industry. Hence, there is a total estimated domestic demand of 375-400,000 tonnes per year.

Key Producers

Table 2:6 Key Producers

Name	Ownership	Size/Capacity (total production)	Location
Yangiyul oil factory	25% - state 75% - private	880 tonnes per day	Tashkent Region Yangiyul District
Kattakurgan oil factory	25% - state 75% - private	1,100 tonnes per day	Samarkand Region Kattakurgan Town
Asaka oil factory	25% - state 75% - private	580 tonnes per day	Andijan Region Asaka Town
Koson oil factory	52% - Oil-Fat & Tobacco Assoc. 25% State 10% Polish Impex 10% Staff 3% Invest. Funds	Official capacity: 1,200 mt/day Actual capacity: 800 mt/day (due to technical misconception)	Kashkdarya Region Koson District

Apart from a Polish investor, Polish Impex in Koson, the sector has not yet attracted any major foreign investor.

Strategy of the Uzbek Government in the Edible Oil Subsector

Development of sunflower oil. In view of the current deficit of edible oil in the country and the low quality of local production, the Uzbek Government would like to promote the production of sunflower for oil. It has plans to introduce sunflower in an area of 50,000 ha in the north of Uzbekistan (Karakalpak and Khorezm) by 2005. The damage caused by irrigation in this region is particularly important and diversification is encouraged. Farmers in the area will be exempted from state orders for cotton production.

In 2002, the Kattakurgan oil factory processed 1,076 tonnes of sunflowers. The price of locally produced sunflowers was UZS1,675,000 / tonne (US\$1,675 US\$/tonne), which is very expensive compared to the world price. These high prices were related to the very low yields obtained. In view of the costs of the raw material and the small quantities processed, sunflower oil is, for the moment, not competitive. Until the production of sunflower seed becomes more competitive, the Oil, Fat and Tobacco Association has made an agreement with Moldovan seed producers to provide seeds for the plant.

Introducing sunflower production will, in any case, require a very high level of technical assistance at the farm level.

The French Seed Producers Association, GNIS¹⁸, is in the process of registering five new varieties of sunflower in Uzbekistan. A French seed company, Deleplanque and Cie, is showing an interest in developing another specific project in this area, although they recognize that the sector is still under heavy Government control through the Oil, Fat and Tobacco Association¹⁹.

Government-supported industrial projects. The Uzbek Government is considering providing its guarantee (see Appendix to this Note) to finance the completion of an important edible oil processing project - "Uzizraprotein"- in the Bukhara region (Kagan district). Designed by an Israeli firm²⁰, the processing line was imported and paid for in 1999 for a total amount of US\$7.7 million. The plant facilities were half built for a total value of US\$5.2 million. The project was not completed due to a lack of funding.

Negotiations were recently undertaken by the current shareholders with an Uzbek/American investor but failed. The parties could not agree on the valuation of the existing assets and the capital sharing structure.

The project would be supported both by the Government through a State Guarantee and by local authorities. The Bukhara City authorities would very much favour the relocation of the activities of the existing processing plant, close to the historic centre, to the new site.

Other Potential Areas for Investment

Cottonseed cakes. During the Soviet era, Uzbekistan exported cottonseed cake to other livestock producing republics such as Lithuania and Estonia, as well as to countries such as Iran and Pakistan. Although the level of gossypol in cottonseed cakes is considered too high for feeding animals used for milk production, the high protein content makes them attractive for feeding animals used for meat production, in particular pork and chicken.

According to CASC²¹ and to the edible oil plant and poultry factories that were visited, the demand for cottonseed cakes is high, on both domestic and international markets, in particular in Iran. A few years ago, a JV²² was established to produce cattle, chicken and fish feed concentrate with a high protein content, derived mainly from cottonseed cake. Over 90% of its production is now exported.

¹⁸ See <http://www.gnis.fr/english/default.htm>

¹⁹ The Association is in charge of the sunflower development programme and does not seem to be too preoccupied by competitiveness.

²⁰ High Processing and Conveying Technology Ltd.

²¹ See CASC Company Profile.

²² Mitchell JV.

High value-added oil production. Uzbekistan produces sesame oil, but the quality and the quantities produced are not enough to sustain export markets, although the demand in neighbouring countries is high and prices are very attractive.

There is a draft plan for producing sesame oil in the Nurota district of Navoi Region with Deleplanque. Messrs Joost Heij and Sergey Moscalenko (owners of Marvel Juice and Andijon Durdonasi²³) are considering working with Deleplanque and Cie on the establishment of a plant for processing apricot, peach and plum stones, as well as grape seeds. The raw materials for this plant would come from the two Marvel Juice factories and four other factories located in the Ferghana Valley. The plant would produce pharmaceutical oils, which fetch even higher margins than sesame oil.

Conclusions

Some investment opportunities are likely to appear in this subsector, in view of:

- the structural deficit of edible oil and oilseed cakes in the country;
- the obsolescence of most existing factories;
- the high value of cottonseed oil and cakes on international markets.

Should the Government decide to release its control over the sector, some strategic investors of the edible oil industry should take a careful look at future development in:

- sunflower seed and oil production;
- the rehabilitation of the most efficient plants (Koson, Kattakurgan and Asaka);
- the construction of a new plant in the Bukhara region (“Uzizraprotein”), for which the Government is offering its guarantee;
- high value-added oil production (sesame, pharmaceutical oils).

²³ See Marvel Juice Company Profile.

Fruit Processing

Availability of Raw Materials

Uzbekistan has 207,000 ha of orchard and citrus plantations of which 143,000 ha are planted with trees of fruit-bearing age. Over 60% of the fruit production and 75%²⁴ of the vegetable production is grown by private farmers on 13% of the arable land.

Fruit production is an attractive sub-sector for newly established farmers since it can be grown on small parcels of land and provide regular incomes without having to conform to State Orders.

The following types of fruit are grown²⁵:

Table 2:7 Fruit Production in 2001

Type of fruit	Total plants of fruit bearing age (000'ha)	Actual harvest in 2001 (000'tons)	Actual yield per hectare in tons
Seed-bearing fruit (apples, pears, quinces and other seed-bearing fruit)	81.9	474.0	5.8
Stone-bearing fruit (cherries, plums, sweet cherries, apricots, peaches and other stone-bearing fruit)	51.2	287.6	5.6
Nuciferous fruit (walnuts, filberts, almonds, pistachios and other nuciferous fruit)	4.8	7.4	1.5
Sub tropical fruit (figs, persimmons, pomegranates and other subtropical fruit)	4.3	28.3	6.6
Bush berries (strawberries, raspberries, gooseberries and other bush berries)	0.6	3.1	4.8
Citrus fruit (lemons, oranges, mandarins and other citrus fruits)	0.1	1.0	9.1
Total	142.9	801.4	N/A

Taking into consideration fresh fruit consumption, post-harvest losses due to poor selection, transportation and storage means, it is assumed that only 20% of fruit grown is fit for processing. Therefore, over 160,000 tons of fruit are readily available for fruit processing industries. This is, of course, not withstanding any improvement in production, selection, storage and transportation processes.

²⁴ Statistical collection of Uzbekistan

²⁵ Source: Statistics bulletin of the Minmacroeconomstate of the Republic of Uzbekistan, Tashkent 2002.

Import of Raw Materials

All necessary ingredients for fruit processing are imported, except for the following: gelatine, slychosol, pectinaza, betanite, vitamin C, drums, aseptic bags and activated coal.

Production Statistics

Besides unprocessed fruit, fruit processors are producing different types of products, from soft juice drinks to fruit concentrates. The main products are shown below²⁶:

Table 2:8 Production of Concentrates, Purées and Juices

#	Type of product	Approx. quantity produced in 2001 (tons)
1	Apple juice concentrate	8,500
2	Apricot purée	6,000
3	Peach purée	4,000
4	Plum purée	1,500
5	Jam, etc.	500
6	Juices	6,000
7	Nectars	2,300
	Total	28,800

Exports

Processed fruits are mainly exported. It is estimated that 80%²⁷ of the production is exported to Europe and Russia, while the remaining is for local consumption.

Sector Organization and Key Producers

Fruits and Vegetables Professional Association. Founded during the Soviet era, the Association of Fruit and Vegetable Processors has 273 members, including 89 Shirkats (former Kolkhozes), 47 wineries, 20 drying companies and 67 fruit and vegetable processing factories. It is still 25% State-owned and the remaining 75% is now dispersed among its members. With the new Privatization Law, the Association expects to be fully privatized within 3 years.

The Association provides such services as:

- Financial services;
- Policy advice and lobbying at national level;
- Tax and legal advice;
- Market information and export assistance.

²⁶ Sources: data from Uzplodovoshvinprom and the Ministry of Agriculture and Water Resources.

²⁷ Source: Ministry of Agriculture and Water Resources.

This Association constitutes a good potential partner. It can help identify investment projects, help match the interests of local investors and foreign investors, act as collateral, facilitate relationships with the State Administration, etc. (See related Company Profile).

Key Producers

Table 2:9 Key Fruit Processors

#	Name	Ownership	Size (total processing capacity in 2001)
1	JV 'Marvel Juice Co. Ltd'	Uzbek – Swiss JV 25% - State-owned (Namangan branch of Uzmevasabzavot Holding) 75% - Swiss company 'Frewar Investments Ltd'	20,000 tons of apple 2,200 tons of stone-bearing fruit 500 tons of tomatoes
2	JV 'Mevalar Kamalagi'	Uzbek – Russian JV 51% - local (Shakhrisabz Canning Factory) 49% - Russian PTG 'Svyatogor'	
3	JV 'Fercom'	1% - local Ferghana Canning Factory 99% - foreign partner (Saudi Arabia)	30,000 tons of fruit
4	BER-AD Ltd ²⁸	100 % private	1 st operator in dry fruits and vegetables
5	JV Veno Food Ltd'	15% local Ishtikhon Canning Factory 85% VENO Asia	150 tons of apricots

Factories are now operating with relatively good standards and fruit production has already increased in the areas where these factories are located. There is fierce competition among the processing factories to purchase the raw material during the production season. To overcome this shortage, most factories have their own orchards (Demet of Demir Group, Marvel Juice, Veno Holding).

Conclusion

In his agronomic review, Mr Armitage²⁹ states: *“Orchards, mainly located on the poorer soils of the mountains slopes, produce potentially world-class quality fruit. The abundance of cheap labour and natural radiation can transform superb fresh fruit into dried fruit products that meet the export criteria. Together with rationalization of the cultivars under production, and improvement of the irrigation systems on permeable and erodible soils well above the level of water sources, assistance is required to promote penetration of world markets and establish quality control in growing, processing and packaging.”*

²⁸ See <http://www.ber-ad.com/index.asp>

²⁹ Mr. Armitage, director of Landmarks Consultancies, is a well-known agronomist in the region.

This sector is considered a priority by the Ministry of Agriculture and Water Resources. It contributes to helping the farmers diversifying into other crops than cotton. Furthermore, in an effort to boost the competitiveness of Uzbek exports, the Uzbek Government has decided to guarantee the construction of a new glass factory. It is interested in further investing in a “twist-off cap” production line.

Some investment opportunities are likely to appear in this sector, in view of the following:

- It is an export-oriented sector (80% of production is already exported);
- Several private companies are already successful (Marvel Juices, BER-AD, JV Mevalar Kamalagi, Veno Holding, etc.).

There are some related niches where demand is well in excess of supply on local and foreign markets and where import substitution would make sense:

- The pomegranate juice and concentrate is in high demand in Asia (prices can reach 7,000 US\$/mt);
- Glass packaging, twist-off technology;
- Dry fruits;
- Aromas and essential oils;
- High quality off-season fresh fruits.

Beer and Bottled Water

Production

The first Uzbek brewery was constructed at the end of the 19th century by a German-Belgian brewer in the Ferghana Valley (today Ferg'onapivo, see Company Profile). During the Soviet era, the beer industry expanded rapidly. After independence, there was a significant recession in local beer production but, since the mid-1990's, new breweries have appeared and some private investors have started to renovate the old facilities.

Key producers. To date, 21 breweries are operating in Uzbekistan. The most well known companies are:

- Almalikpivo
- Andijonpivo
- Bukharapivo
- JV Ziyobakhsh – Unitrading
- Rokhat Joint Stock Company
- Beshyogochpivo Joint Stock Company
- Ferg'onapivo' Joint Stock Company (see Company Profile).

Most local producers face technological problems due to the obsolescence of their facilities. Local breweries typically lack appropriate filtration and pasteurizing lines. The shelf life of bottled beer is therefore limited and storage is problematic. As a result, in the summer, local companies cannot keep up with demand.

Companies visited. Three breweries were visited:

- (a) Ferg'onapivo Co. Ltd. (see Company Profile) is the oldest brewery in Uzbekistan. It is well located in one of the most densely populated regions. The brewery also serves the needs of neighbouring countries (Kyrgyzstan and Tajikistan). Its production is 36,000 per day. In the summer, the company cannot keep up with demand and has to set sales quotas for its various wholesalers.
- (b) Menhat Winery and Brewery currently has a limited capacity of 5,000 per day. The company plans to progressively increase this to 80,000 per day (see Company Profile).
- (c) In Termez, a brand new mini brewery produces 2,000 per day of very good quality beer.

Availability of Raw Materials

Local production. The state-owned company “Uzdonmahsulot” supplies most of the local malting barley. Indicatively, the price of local malting barley is UZS 60/kg. Local barley is currently of poor quality and creates turbidity in the beer.

Under the co-operation between Demet Farm (see Demir Group Company Profile) and the French Professional Seed Association (GNIS, see <http://www.gnis.fr>), five new varieties of barley are presently being tested for registration by the local authorities. This could induce substantial changes in Uzbek malting barley production in the coming years.

There are 6 malt producers in Uzbekistan. All of them are integrated with breweries. The key malt producers are Kibray, Ferghana, and Samarkand. The largest malting facility is an old Russian tape circling aggregate with a total capacity of 5.5 tonnes of malt per day (or 7.5 – 8 tonnes of barley per day).

Imports and new projects. For high quality beers, all raw materials are imported (malt or barley, hops, wheat, and rice), mainly from Germany. Yeast is imported from various European countries. According to official figures³⁰, import of hops and malt were respectively 160 tonnes and 2,370 tonnes in 2000. In reality, imports are probably much higher.

Beer Consumption

Table 2:10 Uzbek Beer Market³¹

(000's litres)	Local production	Imports	Total consumption
1996	68,000	54,000	122,000
1997	62,000	3,000	65,000
1998	65,000	8,000	73,000
1999	50,000	94,000	144,000
2000	68,000	165,000	233,000
2001	66,000	208,000	274,000
2002 (Jan-Jun)	43,000	94,000	137,000

Competition of foreign producers. So far, local beer producers have invested relatively little in marketing and advertising, compared to German, Czech and American beer importers. As a result, for the moment, the image of Uzbek beer on the domestic market is associated with lower quality. Among local beers, locally produced beers bottled in 1.5 l PET are very popular (low price).

Conclusions

There are good investment opportunities in this sector:

- The demand for beer is strong and increasing, especially in the summer season;
- The return on investment in this sector is very fast - as quick as two years (as reported by Mehnat);
- Most facilities (breweries, malting plants) are obsolete;

³⁰ Source: FAO statistics.

³¹ Source: Data from Minmacroeconomstate of the Republic of Uzbekistan.

- Some local entrepreneurs have already started to establish their own brands (e.g. Ferg'onapivo and Mehnat).

Related Company Profiles: Mehnat, Ferg'onapivo Co. Ltd.

Packaging Sector Review

Packaging equipment and technologies in Uzbekistan are obsolete and geared mainly toward chemicals, rather than food packaging. Three main types of packaging are (or will soon be) produced locally:

Glass packaging. In order to comply with international standards and boost exports in the food processing sector, the Uzbek Government has decided to invest in a new glass factory for the production of glass jars and bottles. Situated near Tashkent, the new plant is due to start its production in 2003. It will produce over 1 billion bottles/year. Starting 2005, it will be equipped to recycle used glass.

Cardboardⁱ packaging. Situated in Angren, 130-km away from Tashkent, on a large compound of 60ha, “Promcartontorg” is the only company in Central Asia producing cardboard boxes. It has a large production potential. Designed in the 1980s with Russian technology, the plant was completed in 1991.

The company was taken over by three investors in 2002 in a move to improve the quality and quantity of cardboard cartons produced. Two of the shareholders (Heij and Moscalenko) are also owners of Marvel Juice, a joint venture producing fruit juice, purées and concentrates, and hence a heavy user of cardboard cartons. For the time being, the State still owns 25% of the company, but following the recent decree on privatization, the team of investors is planning to take over the rest of the capital.

Promcartontorg processes recycled paper and wood cellulose (supplied by Glavpap Joint Stock Company) into cardboard. The cardboard is used to manufacture various types of products.

The production capacity of the company is as follows:

- Cardboard containers – 100 thousand tons
- 3-layered wafer cardboard – 120 million m²
- Boxes from wafer cardboard – 97 million m²
- Fibrous plates – 1 million m²
- Binding (glued) cardboard – 2,000 tons

The company manufactures “secondary boxes”, i.e. the external package utilized for the transportation of various products such as bottles of wine and spirits, margarine boxes, juice, etc. It does not yet produce “primary boxes” (Tetra Pak Type), in which processed food products such as juices, purées, or milk are actually preserved.

For the time being, only 20% of the factory’s capacity is used: in 2001, production was 20 million m² of boxes, made from wafer cardboard and 300 thousand m² of fibrous plates. Investments would be required to replace the equipment, which is based on obsolete technology.

Twist-off Cap Processing Line. After the construction of the new glass factory, the next priority of the Uzbek Government is to support investment in twist-off cap technology. This would not only reduce imports of packaging material, but also facilitate sales of local food products, both on local and international markets (in particular Asia and Europe).

The Joint Stock Company “Metalloplastmass”³² has all facilities to set up a twist-off cap processing unit. The company is 25%-owned by the Fruit & Vegetable Processing Association and 75%-owned by private investors. The selected equipment supplier is a private Italian company called “Cuomo”³³. The value of the project is estimated at EUR2.51 million, for a twist-off caps production line of 400 units per minute.

³² Republic of Uzbekistan, Tashkent Region, Yangiyul town, Samarkand Street, 215 in the territory of JSC ‘Metalloplastmass’

³³ F.lli Cuomo is a private owned company located Contrada Starza dei Corvi, 34 Z.I., 84014 Nocera Inferiore (Sa), Tel: 081/5177133

Grain Milling and Related Industries

Uzbekistan has had an active grain milling industry for over 90 years. The first flourmill was constructed in 1910 in Tashkent, followed by more mills in Ferghana and other cities. There are currently 64 large flourmills and many small private flourmills in Uzbekistan.

One of the main economic strategies for Uzbekistan since its independence has been to achieve self-sufficiency in wheat. As a result, 91% of locally-consumed wheat is now grown locally, out of which 65% is supplied by state agricultural organizations and 35% by private farms. Due to dry climatic conditions, local soils and inappropriate seed selection, the quality of Uzbek wheat is much lower than the quality of Kazakh wheat.

Availability of raw materials. Raw materials used by local flourmills are:

- 99% 3rd class soft wheat
- 1% rye (only used by Ferghana Flourmill)

Table 2:11 Raw Materials used by Local Flourmills (2002)

Type of raw materials 2002	Planted (hectare)	Annual yield	
		In tons	In tons/ha
Wheat	1,216,200	4,095,300	3.4
Rye	15,200	42,380	2.8
Total	1,231,400	4,137,680	-

Import of raw materials. During Soviet times, Uzbekistan was importing large amounts of wheat from other Soviet Republics. The import substitution strategy adopted after independence in 1991 showed results. Presently, Uzbekistan imports only 9% of the wheat consumed locally (50% of which from Kazakhstan), i.e. 400,000 tons per year (of which 40,000 tons of hard wheat, the rest being 3rd class soft wheat).

Flour production. In 2002, total flour production was 3,375,000 tons (70-75% of total production capacity). The main concern of Uzbek flourmills is to produce high quality flour in order to remain competitive with Kazakh imports. Key constraints are:

- Equipment is old (latest investments were in the late 1980s);
- Flourmills are still subject to State Orders, requesting them to reach yields of 78%. Such results can only be achieved by reducing the quality of the flour;
- Due to poor agronomic performance, Uzbek wheat is of lower quality than Kazakh wheat;

There are four types of flour produced in Uzbekistan: 1st grade, 2nd grade, Uzbekistan sort, and hulled rye flour (produced only by the Ferghana Flourmill). The renovation of existing factories with new equipment could increase the output of 1st grade flour, while maintaining the required 78% flour output level. It could also increase the number of flour types produced. Since independence, Uzbekistan has worked closely with Turkey in this sector, mainly through three large JVs: “Shahri KESh” (Kashkadarya), “Alpomish” (Surkhandarya) and “Yokut” (Tashkent). The output of high quality flour has increased by an average of 25-30% since the renovation of

these factories. As a result, there is currently no flour imported in the Kashkadarya and Surkhandarya regions, and in Tashkent the quantity of imported flour has decreased substantially.

The Demet farm in the Tashkent region now produces good quality wheat flour with high yields by using new varieties of wheat from France and Israel (See the Demir Group Company Profile).

Prevailing prices in the sector are:

Table 2:12 Comparison between State and Private Prices

Wheat from State order	UZS60/kg (US\$60/t)	Flour from State Order	UZS132/kg (US\$132/t)
Wheat from private farmers	UZS80/kg (US\$80/t)	Flour from private farmers	UZS160/kg (US\$160/t)

Prices are well below world market levels: (\approx US\$130/t for wheat, and \approx US\$/500 t for flour).

Sales on international and local markets. As a result of the State's strategy to achieve self-sufficiency in wheat, flour producers have the right to export flour only in the form of ready-made confectionery products. Several joint-ventures such as Dilek Enterprise and Aylin (involving Turkish investors) have entered this sector and produce confectionery products for the local market as well as for exports to neighbouring countries.

With a population of 25 million people and a per capita consumption of 95 kg per year, annual domestic demand is estimated at 2,375,000 tons. The confectionery, bakery and food industries process an additional 1,125,000 tons per year, bringing local market demand for flour to 3.5 million tons per year, which is almost covered by local production. Uzbekistan imports only high quality flour grade from Kazakhstan to supplement local production.

Uzbekistan might be able to export flour and bakery products in the future. There is an important demand from Afghanistan, which currently imports from Kazakhstan and Russia. In this respect, investing in a new flourmill in the Termez region could make sense, given the strategic location of this region at the Afghan border and the lack of milling facilities in the area.

Key producers. Uzbekistan's five main flourmills are:

Table 2:13 Main Flourmills in Uzbekistan

Name	Ownership	Total production of flour in 2002	Other information
Ferghana Flourmill (See Company Profile)	25% - state 10% - collective 65% - private	200 tons per day	This factory operates at 33% capacity. Only factory in Uzbekistan producing hulled rye flour. Largest flourmill in Uzbekistan.
Andijan FGF	25% - state 10% - collective 65% - private	150 tons per day	This factory operates at 47% of its production capacity.
Navoi Flourmill	25% - state 10% - collective 65% - private	130 tons per day	
Turkistan AC Invest Flourmill	Turkish ownership	300 tons per day	2 mills: one in the Alpamish Termish region and one in Shehrikesh, in the Sharikand region.
Yakut Flourmill	Turkish ownership	60 tons per day	Has been in operation since 1998

Conclusion

Turkish investors have already made significant investments in the Uzbek grain milling and related industries³⁴ (pasta, cookies, etc.). Turkish investors have based their strategy on the development of the local and regional markets.

The sector is not waiting for its full privatization. Before State Orders are abolished and the privatization process is completed, the EBRD should refrain from investing in this sector, which is considered sensitive and subject to Government intervention. However, it should follow up future developments closely.

³⁴ Aybin, a large biscuit factory with Turkish capital, produces one million tons of cookies a year (of 33 different varieties).

Dairy

In Uzbekistan, consumers make a clear distinction between raw and processed milk. Raw milk is fresh milk that is sold directly by farmers or intermediaries without any thermal treatment. The bacteriological quality of raw milk is usually very poor. Processed milk (pasteurised and UHT) is both imported and produced locally. It is sold mainly in bazaars, mini-shops and supermarkets.

Production

Table 2:14 Production of Processed Milk in 2002 (in metric tons)

Region	2001	2002
Tashkent	4,900	17,000
Samarkand	7,800	9,400
Bukhara	7,100	8,800
Surkhandarya	3,300	8,300
Ferghana	5,300	6,000
Total country	59,000	81,600

The total production of processed milk is very low compared to the national demand/consumption.

Milk Consumption

The demand for milk in the Tashkent City and Oblast only is about 215,000 tons. For the whole country, the demand for milk is estimated at 1,165,000 tons, which is very low compared to the size of the population. Most of the milk consumed in Uzbekistan is raw milk or milk processed into cheese or traditional dairy products by farmers or at home.

Key Producers

Table 2:15 Main Dairy Producers

Name	Ownership
UzDutch Cheese	Milk factory 'Talisman' (Uzbek partner) – 64% CEBECO International Projects (foreign partner – Holland) – 30% ACC Business Creation (foreign partner – Holland) – 6%
Sundus Co	Turkish Investor Established in 1995 in Tashkent region Processing 15,000 t/year of milk
Nestlé	UHT Milk processing factory 100% foreign investment

Conclusion

The major constraints for investors in the dairy sector are:

- the low performance of Uzbek dairy farms (low productivity, poor quality of milk);
- the absence of milk collection systems;
- the difficult of paying milk supplies due to the new restrictions imposed on cash circulation imposed by the Uzbek Government;
- low purchasing power of Uzbek consumers, which limits the sale prospects of higher-margin dairy products.

Considering the size of the Uzbek market, Nestlé however made the strategic decision to invest in this sector. The Swiss Government is supporting Nestlé's efforts to assist local dairy farms to improve their performance, by funding a TC project in this sector. At this stage, the EBRD could consider financing Nestlé's operations before exploring other investment opportunities in this sector.

3. COMPANY/PROJECT PROFILES

A. Potential Stand-Alone Projects

Dagris	
Joint Stock Company	
Address	Office n° 121, 60A Amir Timur Street, Tashkent 700000
Tel	+998 71 132 01 37
Mobile	+998 71 187 81 22
Fax	+998 71 132 07 20
Email	leroi_uzb@sarkor.uz
Contact name	Mr Richard Leroi Représentant délégué en Ouzbékistan
HQ Address	13 rue de Monceau - 75008 Paris – France
Tel	+33 1 42 99 53 00
Fax	+33 1 42 99 53 00
Web Site	www.dagris.fr
Contact names	Mr Pierre-Henri Texier, Directeur général adjoint, Directeur du Développement et de la prospection Mr Bocchino, Directeur général
Sector/activity	Processing raw cotton into cotton fibre Seed selection for cotton and wheat
Products	Cotton fibre Cotton seeds for crushing Selected cotton and wheat seeds
Total revenues	Bukhara: US\$ 7 million Namangam: US\$ 2.5 million
Net Profit	Not specified
Employees	80
Investment projects	Cotton seed oil processing New deginning/delinting factory in Surkhandarya region One cotton processing unit in a third region
Dates of visit	31 January and 7 February 2003
Present from FAO	Mr Emmanuel Hidier, Economist Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-Up Recommendation	
<ul style="list-style-type: none"> • Good potential partner for EBRD direct involvement through credit. • Dagris to be approached in Paris to discuss future investment projects in Uzbekistan. 	

The Company

The mother company, Dagrís, previously named Compagnie Française pour le Développement des fibres Textiles (CFDT), is a joint stock company with 62% French State ownership. The remaining 38% is private capital owned by various textile companies and banks. Created in 1949, Dagrís was until recently focussing on African countries where it has built over 100 cotton processing and edible oil processing plants. Through an active and participative entrepreneurial policy, Dagrís has helped African countries to become the third largest cotton-exporting region in the world.

With cotton at the core of its business, Dagrís has developed its activities in the production of cotton seed, rural development, ginning, edible oil and soap factories, valorisation of cotton by-products and the management of cotton and oil producing companies.

With 120 employees at the Paris Headquarters, Dagrís is involved in 40 companies in 20 countries. The company employs 50 experts abroad. Dagrís' 40 industrial ventures employ over 30,000 people, and indirectly benefit 3.5 million farmers who sell their cotton to the plants.

In view of Uzbekistan's position as the fifth largest producer of cotton in the world and the second largest exporter, Dagrís launched an exploratory mission in this country in 1993. Regular contacts were maintained until 1999 when the decision to invest together with World Bank was finally made. Two joint ventures were created. The first one processes cotton fibre in two regions: Namangan (Ferghana Valley) and Bukhara. The local partner in this JV is an association of eight shirkats (former kolkhozes) producing raw cotton. The second JV produces selected cotton seed of high quality at the Mirishkor cottonseed processing plant. The K. Soliyev Seed-growing Corporation is the Uzbek partner in this JV. The two JVs are fully controlled by Dagrís.

Total investment: US\$7 million, including US\$4 million of Dagrís direct investment and US\$3 million of World Bank loan.

Main Activities

Cotton Processing

Two ginning and delinting plants are operated:

- 15,000 tonne capacity plant in Bukhara region (built in May 2000)
- 6,000 tonne capacity plant in Namangan region (built in July 2000)

Dagrís now has a full-cycle production experience in Uzbekistan, from growing to processing and exporting the fibre.

In 2002, the Namangan factory had an annual turnover of US\$2.5 million, while the Bukhara factory had a turnover of US\$7 million. Both factories were highly profitable due to favourable external conditions:

- The Liverpool index value of cotton fibre increased dramatically last year from US\$0.35 /lb (US\$400 /tonne) to US\$0.75 /lb (US\$1200 /tonne).

- The exchange rate of the Uzbek soum (UZS) to the US\$ improved from 675 to 960. As Dagrís pre-financed the crop in UZS, its net profit significantly improved.

These cumulative effects generated a 30% increase in net profits – from UZS 130,000 per tonne to UZS 400,000 per tonne in two years. Cotton production is now proving more competitive in Uzbekistan than in Africa.

Local profits are presently reinvested in the rehabilitation of infrastructures at Mirishkor village.

A new decree, applicable for the next harvest and valid for all private operators, stipulates that, if a company pre-finances cotton growers, it will be allowed to export the corresponding production. This means that Dagrís will soon be allowed to process cotton bought from other shirkats, as long as it pre-finances the crop.

Seed Processing

A seed processing plant with a capacity of 6 tonnes/hour is located in the Namangan region.

Considering the difficulty faced by local farmers in finding locally selected wheat seed, Dagrís' local partner proposed processing wheat seed as well. This proved to be a positive move, improving the profitability of operations, since the harvesting seasons of the two crops are complementary. The plant produces 200 tonnes of selected cotton seeds and 5,000 tonnes of selected wheat seed.

Business Environment

(See Cotton Sector Note, Section 2, for the general business environment prevailing in this sector)

Markets and Competition

From the beginning, the two JVs were welcomed by the Uzbek authorities. Although the two companies were controlled by Dagrís, the authorities eventually allowed them to export cotton fibre on a private basis. This was a noteworthy exception to the prevailing government monopoly over cotton fibre exports.

It took Dagrís two years to obtain an export production quota of 7,000 tonnes of cotton fibre, which enables them to pay back their loan in hard currency. These conditions are slightly different from the ones granted to their American competitor, the Central Asia Seed Corporation (CASC). CASC is authorized to export the cotton that they pre-finance.

Dagrís is now confident that the relations they have developed with local partners and local authorities put them in a good position to consider further investments (see below).

Raw Material Supply

Dagrís still does not have the right to process and sell raw cotton from outside their own production area, which is presently limited to the eight shirkats (“paper privatized” kolkhozes) belonging to their Uzbek counterpart in the JV. As mentioned earlier, this might change. Dagrís

has set up, with its local counterpart, an active programme of technical assistance, including the provision of inputs, machinery and know-how to improve the production of raw cotton.

Product Distribution and Marketing

All cotton fibre is exported through Dagrís' affiliated trading company, COPACO.

Development Strategy and New Projects

In view of the successful results of their first ventures, Dagrís is now considered as a reliable/serious partner (with a long-term view on Uzbekistan) and is regularly asked to participate in new projects. Their dealings with the local administration are much easier. The following projects are currently being contemplated:

- A new cotton processing plant in the Surhandarya region in co-operation with the World Bank (Task Manager: Mark Lundell). In March, Dagrís will conduct a full feasibility study, which will already constitute an initial investment towards establishing a new plant in the region. The size of this project will be defined in March, during the visit of Mr Clavier, Dagrís expert.
- Dagrís is also seriously considering setting up an edible oil processing plant in the Namangan region. The projected capacity of this plant has not yet been determined. This might be an investment opportunity for the EBRD, depending on the size of the plant.
- A medical cotton production plant is also an option under consideration. Medical cotton is made from a by-product of cotton delinting and, as such, has a good value-added: processing costs are low and raw material (wastes from cotton delinting) is cheap. This could be another opportunity for the EBRD. Overall estimated project size: US\$3 million.
- The company has also received an interesting proposal for a project in Shingen on the border with Kazakhstan. This however requires further investigation before the proposal is studied in detail.

As mentioned earlier, Mr Pierre-Henri Texier, Deputy General Manager of Dagrís, is sending in March one of the HQ experts, Mr Clavier, to take a careful look at the above proposals before any further action is taken. Mr Leroi suggested that Mr Adham Ergashev could assist Mr Clavier in his work. The activities of Dagrís in Uzbekistan are under the direct supervision of the company's General Manager, Mr Bocchino. The attitude of the general management towards these activities is positive, based on the demonstrated capacity of the Uzbek ventures to operate successfully and generate profits. The company seems to be ready to commit itself to a new project.

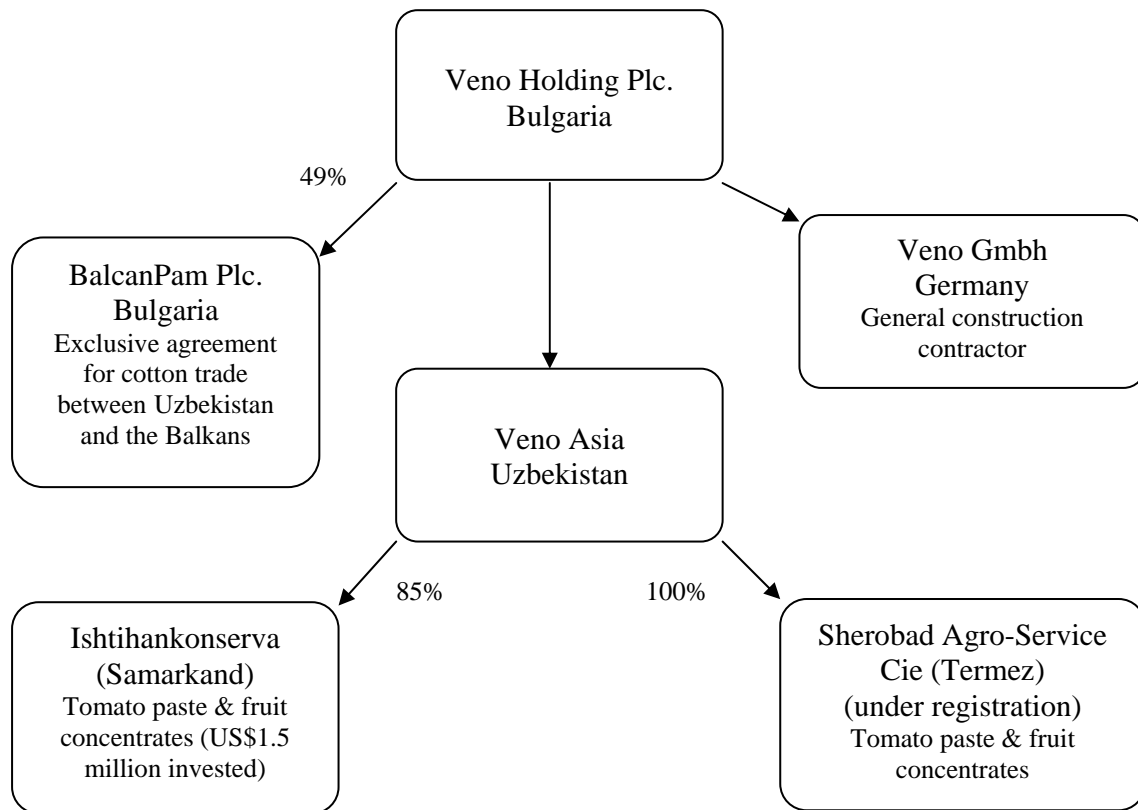
We recommend that a contact be established with Dagrís' GM or Mr Texier (ICGREF) on the occasion of EBRD's next marketing trip to Paris. Reportedly, Dagrís (including Mr Leroi) met with President Lemierre two years ago. At that time, the EBRD was very reluctant to do any kind of business in Uzbekistan. Since the general environment is showing positive signs of evolution, it might be timely for EBRD to reconsider this partnership.

Related subsector notes: Cotton, Edible Oil.

Veno	
Holding Group	
Address	83 Demokratsia Blvd Bourgas 8000 Bulgaria
Tel	+359 (56) 800 007, 800 050, 800 052
Fax	+359 (56) 800 245, 220 01
Mobile	+998 (71) 111 30 79
Email	veno@venoholding.com, veno@bse.bg
Contact name	Mr Dimo Petrov, Chairman of the Board of Directors Executive Director
Ownership	51% Mr Petrov, 49% owned by 8 other individuals
Established	1989 (in Uzbekistan)
Local representative	Mr Karimov
Sector/activity	General construction contractor (hotels, industrial plants, etc.) Cotton trade Tomato and fruit paste processing
Products	Cotton fibre (traded) Processed tomato and fruit paste
Annual turnover	EUR 21 million for Veno Holding Bulgaria EUR 5 million for Veno Gmbh EUR 1.5 million for Veno Asia
Net profit	Not specified
Employees	Not specified
Investment projects	New fruit & vegetable processing plant in Termez: EUR 2.7 million Ginning plant: EUR 5 million
Dates of visit	25 January 2003 (site visit) and 4 February 2003 in Tashkent
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-Up Recommendation	
<ul style="list-style-type: none"> • VENO was recommended by Pakhta Bank. • Veno Holding seems to have a good business track record in Uzbekistan. • Veno is already an indirect client of the EBRD in Bulgaria (through First Investment Bank). • Sofia RO to check creditworthiness of holding company. • Tashkent RO to check credentials of Uzbek shareholders. Mr Petrov, CEO, ready to come to London for a meeting. 	

The Holding Company and its Affiliates

In Uzbekistan, Veno Holding Group has been involved in cotton trading since 1989, under its JV with the Ministry of Foreign Trade (BalcanPam Plc). The other activities of the company in Uzbekistan are managed through the following affiliates:



To obtain more information on the activities of Veno in Bulgaria, please refer to the First Investment Bank (Bulgaria, see: <http://www.fibank.bg>), through which the EBRD indirectly financed one of Veno's projects.

Main Activities of Holding Company and Affiliates

Veno Holding (Bulgaria)	- 3 ginning mills, 1 flax mill
BalcanPam Plc. (Bulgaria)	- exclusive importer of Uzbek cotton to the Balkans - 6,000 mt of storage capacity (cotton) in Bourgas - partner: 51% UzInterImpex (Uzbek state-owned Cie, one of the four companies authorized to trade cotton)
Veno Asia (Uzbekistan)	- cotton trade, holding
Veno Gmbh (Germany)	- construction of Gulistan ginning mill (WB-financed project) - construction of Horezm Palace in Urgench, Uzbekistan (EUR6.5 million contract, financed by Hypovereinsbank) - construction of a hotel in Tashkent (under way)
Ishtihankonserva (Samarkand, Uzbekistan)	- tomato seeds and concentrates - apricot and apple concentrates - 100% of production exported to Europe and Russia
Sherobad Agro-Service Cie (Termez, Uzbekistan)	- company under registration - to manage new agrifood projects in the region of Termez

Production of Tomato and Fruit Juice Concentrates

This activity is currently carried out through Ishtihankonserva.

In the Samarkand region, Veno manages 350 ha of irrigated land. Veno imported a new variety of tomatoes from Russia, well adapted to the local climate and to the processing requirements. Under good agronomic practices, the yield of this variety can reach 100 mt/ha, while local varieties have an average yield of 25 mt/ha. In these conditions, 1 ha yields 15 mt of tomato paste, i.e. a turnover of US\$6,750 /ha considering that the world price of tomato paste is US\$450 / mt. For comparison, 1 ha of cotton yields 1 mt of fibre at a world price of US\$1,200.

The production period in Samarkand is from July to late October (whereas in Termez it is from June to early November). Before and after the tomato production period, the plant is processing apricot and apple purées, which are also in high demand on the European and Russian markets. The average price for fruit concentrates is US\$1,600 /mt.

Prepared in 200-kg aseptic drums, these products are exported to the Russian and European markets. Veno' products are currently being analysed by Danone Russia for potential imports.

Development Strategy and New Projects

Veno is considering investing in the following projects:

- A cotton ginning factory for fine cotton fibre (saw gin type) with a 30% higher value (US\$1,800-2,000 / mt compared to US\$1,200 / mt for raw gin type). Total project value: EUR5 million (of which EUR3 million of equity from Veno).

- Another tomato and fruit processing factory in the Surhandarya district (Termez). Processing capacity: 350 mt of tomatoes per day and 300 mt of fruits per day. Total project value: EUR2.7 million (of which 20% of equity from Veno and possibly 31% of loan from Pakhta Bank). Status of project:
 - Project approved by Governor of Surhandarya district and Vice-Premier;
 - 500 ha of irrigated land to be leased from district and region (approved);
 - Company in the process of being registered (Sherobad Agro-Service, 100% affiliate of Veno Asia);
 - Plant site with adequate utilities identified and negotiated;
 - Equipment contract negotiated with supplier;
 - Clients contacted, expressions of interest for new production;
- A fruit processing plant for pure fruit concentrates. Total project value: EUR2.1 million.
- A canning factory for fresh vegetables (green peas and sweet corn). Total project value: EUR1.5 million.

For the two first projects, a full business and marketing plan is ready. For the first project, Veno would need a quick reply as the company is targeting the next cotton season.

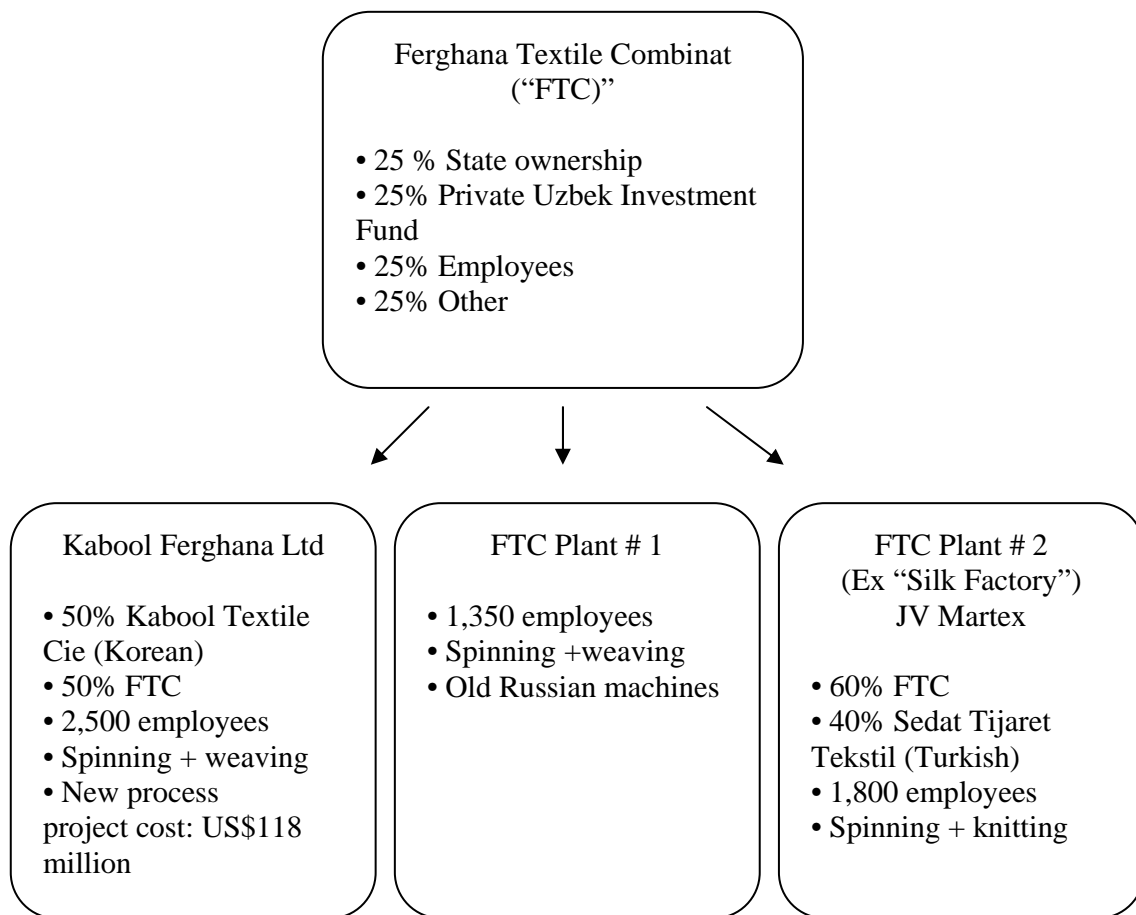
Related subsector notes: Fruit and Vegetables, Cotton.

Ferghana Textile Combinat	
Joint Stock Company	
Address	Ferghana
Tel	+998 732 33 38 81 +998 732 33 78 80
Mobile	+998 711 86 50 77
Fax	+998 732 33 30 96
Email	aoftk@vodiy.uz
Contact name	Mr Tashhodjaev Alohon Yulbarsovitch Chairman of the Board
Sector/activity	Processing cotton fibre into yarn and cotton fabrics
Products	Cotton yarn and fabrics
Annual Turnover	US\$36 million of exports (holding level)
Net Profit	Not available
Employees	1800+1350 = 3150
Investment projects	Several projects are being prepared to integrate the processing chain through to ready-made garments, in order to add as much value as possible to raw cotton
Dates of visit	1 February 2003 in Ferghana and 7 February in Tashkent
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • Potential partner for EBRD direct involvement through credit and/or equity participation. • Creditworthiness and credentials of partners (Kabool, Sedat) should be investigated. 	

The Company

The Ferghana Textile Company (“FTC”) was established in 1930. It was one of the first factories of this type in Central Asia. Mr Tashhodjaev has been the chairman of the company since 1997. He is a young manager with strong, established partnerships in various foreign countries.

Ferghana Textile is a holding company for three different factories:



Main Activities

FTC’s two main activities are spinning cotton fibre into yarn and weaving cotton into greige fabric.

Kabool Ferghana Ltd

A 50/50 Joint Venture agreement was signed in 2000 with a Korean company, Kabool Textile Co.¹, to invest a total of US\$118 million in the new factory. A US\$70 million loan was awarded by the Japan Eximbank for the equipment. The equipment is of German, Swiss and Japanese origin.

In a 110,000 m² hall provided by Ferghana Textile, Kabool Ferghana Ltd, with a processing capacity of 11,000 t of fabric from 25,000 t of cotton fibre, has been erected.

90% of the company’s production is exported. Reaching 80% of its capacity in 2002, the export turnover was US\$30 million. In 2003, production will be increased to reach 90% of the plant’s nominal capacity and 100% in 2004.

¹ See also www.kabool.co.kr

FTC Plant #1

FTC Plant #1 is equipped with ageing Russian machines which need to be modernized. FTC Plant #1 has a covered area of 75,000 m², of which only 30% is in use. There are 102 spinning machines and 784 weaving machines.

In US\$' 000	1999	2000	2001
Annual Turnover	2,057	2,598	4,641
Net Profit/loss	291	(562)	548

The plant processes:

- 6,000 t of yarn
- 20 million “E” units of fabric
- 12 million pieces of ready-made garments

FTC Plant #2

The former “Silk Factory” is located downtown in a three-storey building. It processes:

- 3,500 t of yarn
- 3,600 t of fabric
- and manufactures T-shirts (12 million units)

The company group exports mainly greige cotton. 80% of its exports are to European markets; the rest is sold to Korea and Japan. 10% of its production is sold locally for further processing.

Business Environment

(See Cotton Sector Note, Section 2, for the general business environment prevailing in this sector)

Markets and Competition

There are eight textile processing plants in the Ferghana Valley:

- Kuva Textile is planning to invest US\$25 million with the aim of producing ready-made products with an integrated processing chain: weaving, printing, cutting and sewing.
- Two plants need to be renovated: Beshariq and Fourkat.
- Kokan Textile is planning to invest in a joint venture with Marubeni: a US\$30 million credit line was recently approved for this project.

Several Turkish companies have shown interest in relocating their plants to Uzbekistan, where labour costs are still very low.

Raw Material Supply

Cotton fibre is bought from the State-owned company “Uzbeklegprom”. The Government Cotton Agency sets a quota for each buyer and imposes a contract price. For 2003, the Cotton

Commission has awarded Ferghana Textile a right to 6,000 t of cotton fibre (they will apply for 10,000 t). Kabool Ferghana JV has been awarded a quota of 25,000 t.

Cotton fibre is also purchased directly from farmers who have produced enough to be able to sell at negotiated prices. The price of raw cotton is fixed according to the Liverpool rate (US\$1,260/ton, presently), less transportation costs (US\$155/ton).

Development Strategy and New Projects

There is value added at each step of the cotton processing cycle, and the strategy is to further develop the cotton processing chain.

Product	Value equivalent of 1 ton of cotton fibre
Cotton fibre	US\$1,000
Cotton yarn	US\$1,800
Greige fabric	US\$2,500
Printed/dyed fabric	US\$4 to 5,000
Ready-made garments	US\$7 to 50,000

The objective of FTC is to reach a consolidated US\$80 million turnover in export value from the three factories.

Development Project for FTC Plant #1

- Objective: install a dyeing unit within the premises of the plant in order to produce dyed fabrics.
- 30,000 m² of industrial space are available.
- Total project value: US\$6 million, of which US\$2.5 million is a bank loan.

Development Project for FTC Plant # 2

- Objective: renovate the spinning and knitting equipment with the participation of a Turkish partner, Sedat Ticaret Tekstil.
- Total project value: approximately US\$10 million, with a first phase of US\$2.5 million for 2003/2004. The AsDB is proposing a loan in US\$, but the company would prefer a loan in EUR since they are buying European equipment and their main export market is Europe.

New Cotton Waste Processing Line

- FTC's new German processing line was also visited. It is already producing cotton for socks and towels knitted from the waste fibres of the cotton ginning factories and the other textile processing factories.
- Total value: US\$2.5 million.
- The company wishes to expand this factory with a rug tearing line for recycling old fabrics.

- Total value: US\$1 million, which would generate US\$2 million of turnover with 40 workers.

Miscellaneous

Mr Tashhodjaev is also taking an active part in a private professional association, the Union of Ferghana Valley's Light Industries, created in 1994. This association aims at developing the food processing industries of the region. Its members are Directors of local industrial companies. The association has been approached by a Taiwanese company, Green World, to export pomegranate juice concentrate, the value of which is US\$7,000/ton. The investment is estimated at US\$5 million. The association wishes to invest in this line, which should have a pay back period of 2 years.

Khujaikon Tuz (Salt Mine)	
Joint Stock Company	
Address	Surhandarya region, Sherobod district, Chorbog village
Tel	+998 (76) 222 96 84
Fax	+998 (76) 225 52 34
Email	
Contact name	Mr Nodirov Erkim General Manager
Shareholders	State - in the process of privatization
Sector/activity	Salt Extraction
Products	Salt
2002 Annual Turnover	n/a
Net Profit	n/a
Employees	n/a
Investment projects	EUR4.6 million
Date of visit	2 February 2003
Present from FAO	Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-Up Recommendation	
<ul style="list-style-type: none"> • This contact was introduced and recommended by the Regional Authorities. • Good potential investment project (very good mining conditions). • It would require a strong partner with good marketing capacities. • Value of the concession (extracting rights) to be reviewed carefully. 	

The Company

The mine was visited shortly and a brief meeting was organized with the General Manager, in the offices of the regional administration. Khujaikon Tuz is an open sky mine with proven reserves of 111 million tons of salt. It is strategically located near major railroad networks of Central Asia.

Main Activities

The company has extraction rights for part of the open sky mine (proven reserves of 44 million tons of salt). Another site situated nearby has additional proven reserves of 77 million tons. In 2002, the factory extracted and processed 47,000 tons of salt.

Business Environment

Markets and Competition

The annual local market of salt is 97,000 tons. Apart from another mine in Kazakhstan (with old extraction and processing facilities), there is no other salt mine in the whole region.

Product Distribution and Marketing

Natural markets would be Central Asia, CIS countries, Pakistan and India. Linked to the railroad network, the factory can transport its production easily to any of these destinations.

Development Strategy and New Projects

Being listed on the State Investment Programme, the development of this mine is a priority for the Regional Authorities. A Joint Venture is presently under negotiation with Spanish partners: Serra Salt Machinery¹. The investment would originate from the United States. The company wishes to invest in a new processing line to provide iodine salt to the whole region. The expected investment is of EUR4.2 million, with a production capacity of 10 mt/hr.

¹ Serra Salt Machinery
<http://www.serraprocess.com/empresas.html>
Calle Montseny 17, Poligano Industrial, Sant Mol
08799 Olerdola – Barcelona - Spain
tel: +34 93 89 23 462 Fax: +34 93 89 23 50
Email: serra@aboforum.es

Kagan Cotton Oil Plant	
Address	Kabulov Collective Farm – Kagan District Bukhara region 706380
Tel	+998 365 22 11 54
Fax	+998 365 22 624 56
Email	
Contact name	Mr Akhmedov Najmiddin Mukhiddinovich General Manager
Shareholders	Directorate of Oil Processing plant in Kagan (part of the State Association “Maslojirprom”)
Sector/activity	Cotton seed oil processing
Products	Cotton oil and cake
2002 Annual Turnover	Factory under construction (expected: US\$20 million)
Net Profit	n/a
Employees	147 expected
Investment project	Total of US\$18.6 million, of which US\$12.9 million already invested
Date of visit:	No site visit but information given by Bukhara Oil Plant and the Farmers Fund Association
Present from FAO:	Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • This contact was recommended by Pakhta Bank. • Good potential investment project to be developed with a strong foreign partner. • Shareholding structure and credential of shareholders should be checked carefully. 	

The Company

The company is 100% owned by the Directorate of Oil Processing Plants in Kagan, which itself is part of the State Association “Maslojirprom”. There is currently a large deficit of edible oil in the country and most of the local production, mainly derived from cottonseed, is of low quality. The Uzbek Government considers edible oil as a strategic sub-sector.

The project was not completed due to a lack of funding. After committing US\$12.9 million, the Directorate faced a difficult financial situation. The plant facilities were half-built (for a cost of US\$5.2 million). Most plant infrastructures were built: access roads, electricity lines, water and sewage systems were completed. Designed by an Israeli firm¹, the processing line was imported and paid for in 1999 for a total amount of US\$7.7 million. The plant site is located a few kilometres away from Kagan and Bukhara.

¹ High Processing and Conveying Technology Ltd

Main Activities

Planned production capacities are:

Cotton oil	8,250 mt/year	Cotton husk	12,980 mt/year
Food protein flour	10,000 mt/year	Cotton lint	3,500 mt/year
Fodder protein flour	11,500 mt/year		

Planned value of export sales:

Food protein flour	100% of the production	US\$2.1 million
Cotton lint	100% of the production	US\$1.2 million
Cotton oil	40% of the production	<u>US\$9.3 million</u>
		US\$12.6 million

Planned value of sales on the local market:

Cotton oil	60% of the production	US\$4.3 million
Fodder protein	100% of the production	US\$2.0 million
Cotton husk	100% of the production	<u>US\$1.2 million</u>
		US\$7.5 million

Total expected turnover US\$20.1 million

Business Environment

(See Edible Oil Note, Section 2, for more information)

Uzbekistan is producing approximately 1,850 million tons of cotton seed¹. Situated in a cotton producing area, the supply of raw material is not an issue.

Development Strategy and New Projects

The total estimated project cost is US\$18.6 million. The remaining US\$5.7 million (taking into account the US\$12.9 million already disbursed) should cover the cost of purchasing missing equipment, including transportation costs, installation, training of employees, and start-up operations.

Conclusion

Negotiations were recently undertaken by the current shareholders with an Uzbek/American investor but they failed. The parties could not agree on the valuation of existing assets and the capital sharing structure.

The project would be supported by both the Government, through a State Guarantee, and by local authorities. The Bukhara City authorities would very much favour the relocation of the activities of the existing processing plant, close to the historic centre, to the new site.

¹ FAO Statistics

Ferghana Don Flourmill	
Joint Stock Company	
Address	Uzbekistan, Ferghana town, Al Fargoniy Str., 93
Tel	+998 73 2 24 54 71
Mobile	+998 90 70 2 23 37
Fax	+998 73 2 24 59 94
Email	mmm@vodiy.uz
Contact name	Mr Mamajonov Abdusamat Muydinovich General Manager
Sector/activity	White processing Industrial bakery Pasta manufacture
Products	Assorted varieties of flour
Annual Turnover	US\$66 million worth of exports
Net Profit	UZS87 million (US\$87,000 equivalent)
Employees	698 people
Investment projects	Upgrading the flour milling plant
Date of visit	1 February 2003
Present from FAO	Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
Other persons present	Mr Dilshod Sh. Kamilov, Draco Trade and Consulting
✓ Summary Assessment/Follow-up recommendation	
<ul style="list-style-type: none"> • This contact was recommended by Pakhta Bank and Draco Trade and Consulting. • The State Orders system, which the company has to comply with, limits its profitability and its overall capacity to react to competition. • The company would first need to be fully privatised and join with a strong strategic (possibly foreign) partner. 	

The Company

Founded at the beginning of the last century, the plant is composed of:

- One large 50,000 t silo.
- Three mills.
- One pasta production unit.
- One bakery production unit.

The oldest mill is out of order. The two other milling units were built in the 1950's and the late 1970's. Their production capacities are 150 mt/day and 225 mt/day respectively.

Strategically situated in the suburbs of Ferghana City, with a storage capacity of 50,000 t, this plant is well maintained and produces 4 types of standard quality flour.

Ferghana Don is still 25% State-owned.

Main Activities

Flour Milling

With the new law allowing farmers to dispose freely of 50% of their own harvest, several small mills were recently built and, as a result, less wheat is processed by the larger mills. Therefore, current production of wheat flour has dropped to 30,000 mt, i.e. 20% of their previous “normal” pre-independence production (14,000 mt/month compared to 2,500 mt/month now).

Since Ferghana Don is still partly owned by the State, it has to comply with the State Orders system, requesting the company to reach yields of 79%. Such results can only be achieved by reducing the flour quality.

Animal Feed Processing

In 2002, production reached 15,000 mt of animal feed, i.e. 15% of the pre-independence production.

Cookies and Pasta Processing

1,500 mt of various baked products were sold in 2002.

Business Environment

Markets and Competition

Facing increasing competition from small private mills, Ferghana Don wishes to be 100% privatized and to be freed from the State Order system. They would then be able to process higher quality flour and satisfy market demand. Having comparative advantages in terms of processing capacity, they could offer competitive wheat prices to attract supplying farmers, while increasing their profitability. Given Ferghana Don’s strategic location, additional potential markets include Tajikistan and Kyrgyzstan.

The company was approached in 2002 by Turkish investors – Makina & Enerji Endüstriyel Cözümler A.S. – to create a joint venture and refurbish the milling facilities. The project did not materialize, when the Turkish company realized they could not export flour to generate revenues in hard currencies. Processed products, such as bread, could be exported but their production would require additional investments.

Raw Material Supply

Situated in the middle of Ferghana Valley, the most fertile region of Uzbekistan, the supply of raw material in terms of quantity is not an issue. A major issue remains the quality of local wheat which has a low gluten content compared to e.g. Kazakh wheat.

For next season, Ferghana Don has bought 7,000 mt of selected seed to improve the quality of wheat produced by their suppliers.

The on-going liberalization of the State Orders system will eventually drastically improve market conditions.

Product Distribution and Marketing

The company delivers its products to local bakeries in bulk or in 100-kg bags. Some farmers are also taking back their share of flour to sell it to the market.

Development Strategy and New Projects

Renovation of the Flourmill

The mission received a letter of intention from Makina & Enerji Cie indicating that this company is keen to buy 40 % of the share of Ferghana Don, renovate the milling unit and invest in a bakery for a total estimated cost of US\$3.5 to 4 million.

Conclusion

Positive aspects include:

- the strategic location of the plant both for raw material supply and market outlets;
- its large storage capacity;
- the progressive liberalization of the State Orders system;
- the possibility of exporting baked products such as cookies.

However, the company would need to be fully privatized and find a strong strategic, possibly foreign, partner.



The major mill connected to the elevator



The 50,000 t elevator



The 50,000 t elevator



The second mill



The second milling facility (to the right)



The third and largest mill

B. Smaller Projects

Novator	
Address	Southern Industrial Zone 700154 Tashkent
Tel	+ 998 (71) 258 85 42
Fax	+ 998 (71) 258 58 69 70
Email	novator2@online.ru
Contact name	Mr Alexander Matveev, Chairman of the Board of Directors Mr Farhod T. Zakirov, Director
Shareholders	100% owned by Mr Alexander Matveev
Sector/activity (of new project)	Plywood
Products (of group)	Pistons, auto/tractor machinery, enamel wire, mining and processing manganese ore, iron alloys, chipboard plates of MDS & TSP type
2002 Annual Turnover	US\$500,000 (for the plywood/chipboard activity)
Net Profit	Not specified
Employees (of new project)	64
Investment projects	New chipboard-producing line of higher capacity and quality processing of wheat straw and waste wood from pruning
Date of visit	25 January 2003 and 6 February 2003
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev , Global Facts, Local Consultant
✓ Summary Assessment/Follow-Up Recommendation	
<ul style="list-style-type: none"> • This contact was recommended by Pakhta Bank. • Good potential investment project. • Creditworthiness of shareholder to be checked by Tashkent RO. 	

The Company

This holding company is 100% owned by its chairman, Mr Matveev, who is also a member of the Uzbek parliament.

Main Activities

Pistons and Rings

The main activity of the group is the production of pistons for the Russian market. It is the only factory of this type in Central Asia. It employs over 2,000 people. It has one subsidiary in Kazakhstan, producing metal rings.

Chipboard

The chipboard production line was acquired two years ago from Russia. This second-hand production line has a capacity of 10,000 m³ of chipboard, processed from straw and glue.

Cheese

Novator has invested in a cheese production factory in the region of Tashkent: the UzDutch Cheese Company.

Business Environment (for the Chipboard Project)

Markets and Competition

Novator is the only producer of chipboard in Central Asia. The closest producer is located in Perm, Ural. The transportation cost of imported wood and wood-based products is prohibitive. The transportation cost to deliver chipboard from Ural to Uzbekistan is estimated at US\$60/mt.

Locally produced chipboard is therefore very competitive, costing US\$160/m³. The official profit margin is set at 30%, but the real figure might be much higher.

Raw Material Supply

650 kg of straw are used to produce 1 m³ of chipboard. This is bought at a very cheap, though fair, price from local farmers. The glue is a by-product from oil refineries, and although it is produced locally, the company gets it at a cheaper price from Russia.

Product Distribution and Marketing

The production was initially sold to only two wholesalers. The company cannot satisfy the demand, which they consider to be over 300,000 m³.

Development Strategy and New Projects

New Production Line

Novator would like to increase its chipboard capacity by acquiring another production line. The company has surveyed several second-hand production lines: one in Scotland with a capacity of 100,000 m³ and one in Italy with a capacity of 30,000 m³. The latter is on sale for US\$5 million

(against US\$24 million for new equipment) and is of good quality (Swedish machinery). The overall investment including equipment and installation would be US\$6.5 million.

Conclusion

Considering:

- the availability of raw material at a cheap price;
- the absence of competition in this sector in Central Asia;
- the steady demand for chipboard;
- the strong management team; and
- the financial strength of the group as a whole.

This project would be worth further analysis.

Uzplodoovoshvinprom	
Fruit and Vegetable Processing and Wine Association	
Address	6 Abay Str – 700011 Tashkent
Tel	+998 (71) 144 27 56
	+998 (71) 144 19 95
Fax	+998 (71) 256 30 12
Email	
Contact name	Mr Azimjon M. Ayupov, Chairman Mr Rustam Akbarkhodjaev, Deputy Chairman
Sector/activity	National professional association of companies operating in the fruit and vegetable processing and wine sector
Services	Financial services Policy advice and lobbying at the national level Tax and legal advice Market information and export assistance
Consolidated Turnover (of members)	UZS100 billion (US\$100 million equivalent)
Net Profit	Not specified
Employees (of association)	2,070
Investment projects (of members)	New glass factory (ongoing, to be completed in 2003) Production of twist-off caps Production of cardboard boxes for food packaging (Tetra Pack)
Dates of visit	30 January 2003 7 February 2003
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-Up Recommendation	
<ul style="list-style-type: none"> • Dynamic management. • Good entry point to access members with interesting investment projects (Mehnat, food packaging projects). 	

The Association

This association used to be the State institution responsible for the fruit and vegetable processing sector during the Soviet era. It still holds the remaining shares of the State in the sector (25 %). Under the new privatization law, the association and its members expect to be fully privatized in 3 years' time.

The association has 273 members, consisting of:

- 67 fruit and vegetable canning and processing factories;
- 47 wineries;
- 20 dry fruit processing plants;

- 89 shirkats, which manage 20,000 ha of vineyard and 20,000 ha of orchards.

Altogether, these members employ 72,000 people.

All processing plants have been partly privatized (25% still State-owned). A new presidential decree published in January 2003 calls for the total privatization of non-strategic industries. When this decree is enforced, all the members of the association will be 100% private.

Main Activities

Under its new statutes, the association is trying to shift its activities to advisory services in the following areas:

- financial services;
- policy advice and lobbying at national level;
- tax and legal advice;
- market information and export assistance.

Business Environment

Markets and Competition

The annual consolidated turnover of the association's members is over UZS100 billion (US\$100 million). Export of processed fruit & vegetables dramatically increased over the past 4 years, from US\$1.9 million in 1999 to US\$8.3 million¹ in 2002.

Processed fruits are mainly for export markets. It is estimated that 80%² of the production is exported to Europe and Russia.

Raw Material Supply

Uzbekistan has 207,000 ha of orchards and citrus plantations, of which 143,000 ha are planted with trees of fruit-bearing age. Over 60% of the fruit and 75%³ of the vegetable production is grown by private farmers on 13% of the arable land. A large variety of fruits and vegetables are grown in Uzbekistan, including apricots, peaches, grapes, melon, watermelon, dry fruits (such as walnuts, chestnuts, almonds, peanuts, pistachios, raisins, apricots, etc.), tomatoes, courgettes (zucchini) and aubergines (eggplants), citrus fruits, pomegranates, etc.

One of the major problems is the collection and storage of fresh products before processing or marketing. The quality and yields are yet to be improved to reach world standards. However, with proper technical assistance and working capital, production is rising quickly.

¹ Source: Fruit & Vegetable Processing Association

² Source: Ministry of Agriculture

³ Statistical Office of Uzbekistan

Product Distribution, Packaging and Marketing

The association's members are facing fierce competition in their traditional markets (Russia and neighbouring countries). A major constraint is the lack of packaging material for handling and marketing purposes.

In order to comply with international standards and to boost exports, the Uzbek Government has decided to support the financing of a new glass factory for the production of glass jars and bottles (through a State guarantee). Situated near Tashkent, the new plant is due to start operating in 2003. It will produce over 1 billion bottles per year. Starting from 2005, it will be equipped to recycle used glass.

For fruit and vegetable canning purposes, the association is promoting/sponsoring an investment project aiming at the production of "twist-off" caps.

Development Strategy and New Projects

Existing Projects

The Association is involved in three projects:

- Virmaory Company: US\$2.9 million for the implementation of a ketchup processing line;
- Yanis Company: US\$3.9 million for wine production;
- Gisah Company: US\$0.5 million for bottling soft drinks and mineral water.

Repayment of these loans is now almost completed and they are now keen to develop new projects.

Twist-off Cap Processing Line

After the construction of the new glass factory, the next priority of the Uzbek Government is to support investment in twist-off cap technology. This would not only reduce imports of packaging material, but also facilitate sales of local food products, both on local and international markets (in particular Asia and Europe).

The Joint Stock Company "Metalloplastmass"¹ has all facilities to set up a twist-off cap processing unit. The company is 25%-owned by the Fruit & Vegetable Processing Association and 75%-owned by private investors. The selected equipment supplier is a private Italian company called "Cuomo"². The value of the project is estimated at EUR2.51 million, for a twist-off caps production line of 400 units per minute.

¹ Republic of Uzbekistan, Tashkent Region, Yangiyul town, Samarkand Street, 215 in the territory of JSC 'Metalloplastmass'

² F.lli Cuomo is a private owned company located Contrada Starza dei Corvi, 34 Z.I., 84014 Nocera Inferiore (Sa), Tel: 081/5177133

PKL and Tetra Pack Cardboard Boxes

With the same view of reducing imports of packaging material, the Association wishes to support the construction of a plant manufacturing PKL and food cardboard boxes for local and regional processing factories.

This project is not ready for investment.

Upgrading the Most Efficient Wineries

The wineries that are members of the Association wish to upgrade their facilities to produce wine for export to Russia. This would require an estimated US\$22 million worth of investment (mainly in filtration and related equipment).

This project is not ready for investment.

Conclusion

This Association has a strong management and is committed to building up a strong fruit and vegetable processing sector. Although not fully privatized, it is an interesting potential partner since it has strong financial assets and access to information and raw materials, as well as good lobbying power within the Administration.

Ferg'onapivo¹	
Joint Stock Company	
Address	Usmonhodjaev st. 4, 712000 Ferghana
Tel	+998 732 26 64 44
Mobile	+998 711 07 03 07
Fax	+998 732 26 48 71
Email	fergonapivo@vodiy.uz
Contact name	Mr Mutalib Rahmonjonovich Karimov General Manager
Shareholders	100 % privately owned since 2000 4 major private investors, including the General Manager
Sector/activity	Beer processing
Products	Beers Soft drinks Malt
Annual turnover (2002)	UZS 7 billion (\approx US\$7 million)
Net profit	UZS 850 million (\approx US\$0.85 million)
Employees	135
Investment projects	New filtration and bottling line (under way) New beer boilers Upgrading the cooling tanks New 20 ton/day malting plant
Date of visit	1 February 2003
Present from FAO	Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • Good potential partner for EBRD direct involvement through credit and/or equity. • Check credentials of shareholders and creditworthiness of company through Tashkent RO. • Organize follow up meeting in May. 	

The Company

Founded in 1895 by a German-Belgian beer processor, Ferghana Pivo was renovated in 1980 with Russian technology. Located in the suburbs of Ferghana City, the plant is very well maintained and produces good quality beers despite its old equipment that would require modernization.

In 1995, 51% of the capital was bought by the employees and the management. It was completely privatized in 2000. In view of the good results of the company, the Privatization Agency (JKI) tried to buy back its shares in the company.

¹ This company was recommended by Pakhta Bank.

Main Activities

Malt Processing

The nominal production capacity of the malt plant is 2,000 tons/year. The local production of barley and malt does not meet the necessary quality standards and would deserve specific efforts for improvement.

Ferg'onapivo's malt production capacity is well below its own brewing needs. The company therefore purchases malt from both local producers (at UZS 300 / kg) and from Germany (at UZS 430 / kg).

Beer Production

Nominal production capacity: 20 million litres/year
Actual production: 13 million litres/year

The company has six dish boilers that are quite old but well-maintained. It also has 10 cooling tanks of 100 tons each. Three new bottling lines for both soft drinks and beer are to be installed in 2003 with a capacity of 3 x 12,000 bottles/hr (financing from Pakhta Bank, see below).

Two quality levels of beer are produced:

- a good quality beer with a price of UZS 250 / 0.5 l bottle and;
- a standard quality beer with a price of UZS 150 UZS / 0.5 l bottle.

Mineral Water and Soft Drinks Production

The company also has a natural water spring and produces mineral water in 1.25-l PET bottles. It also produces soft drinks.

Business Environment

See the beer subsector note for the general business environment prevailing in this sector.

Markets and Competition

Being the only beer factory in the Ferghana Valley, the company has access to a market of about 11 million customers. The company's markets also include densely populated areas of neighbouring countries (Kyrgyzstan and Tajikistan), which are very close to the factory (less than 50 km away).

Due to the quality/price ratio of the company's products, demand exceeds production capacity in the summer. The company has to set quotas for its wholesalers.

Raw Material Supply

As mentioned above, the company has a small malting line integrated in the factory but it is a very old facility. This malting line is processing locally-produced barley. The local variety of barley is not meeting the quality requirements that the market is now requesting. Technical assistance would be needed in this area¹. Hops are imported from Germany.

Development Strategy and New Projects

Malt Plant

Considering:

- the low quality of locally-produced malt; and
- their own consumption needs and the needs of other breweries in the country;

the company wishes to invest in a new malting production line with a 20t/day capacity (5,000 t/year). One of the first steps would be to erect a new silo.

The total value of this project is US\$3 million.

Beer Processing Plant Upgrading

Projected Investment	Value
New filtration and bottling line (under way)	US\$2.5 m
Installation of new beer boilers with cooling and storage tanks	US\$2 m

Pakhta bank has just extended a US\$1.87 m credit line to the company for the new filtration and bottling lines.

The company has not yet prepared a comprehensive business plan that would cover the overall plant renovation / company development strategy. So far, the company has adopted a step-by-step approach related to the local banks' perception of its borrowing capacity (and their own lending capacity). They would however prefer an approach that would allow them to utilize a larger credit line covering their overall development needs. The company is also considering to diversify into wine.

Conclusion

This company is very market-oriented, highly-specialized in its core operations with an efficient management and a proven track record since 1995. It could be a good investment target.

Related subsector note: beer.

¹ GNIS (<http://www.gnis.fr/english/default.htm>), already working with the Demir Group, could be involved in the registration of new barley varieties

Demir Group	
Address	26 Bukhoro Str. 700000 Tashkent
Tel	+998 (71) 133 81 48
Fax:	+998 (71) 120 65 37
Email	info@nail.uz
Contacts name	Mr Bakhtier Tukhtabaev, Executive Director Mr Shukrat A. Azizov, Manager of Agro-Sarmoya Firm
Ownership	100% Turkish family private group
Sector/activity	Agriculture, livestock breeding, grain milling, seed selection, slaughtering, agro-services
Products	Meat Animal feed Wheat flour Vegetables Selected seeds Service to farmers
Annual Turnover	UZS1 billion (US\$1 million) for Demet Farm UZS3 billion (US\$3 million) for Demir Group
Net Profit	Not specified
Employees:	375
Investment projects	4 complementary projects: - Cleaning and packing unit for pulses - Small Edible oil plant - Poultry breeding - Cereal breakfast manufacturing unit
Dates of visit	January 24 th , 2003 on site and February 8 th in Ohangaron farm
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • Dynamic and serious private enterprise. • Has a good business record in Uzbekistan • Already present in seed selection process with the French professional seed organization, GNIS. 	

The Company

The Demir group¹ has had interests in the agri-business in Uzbekistan since 1997. Demir started by acquiring “Yangi Hayat” farm, one of the oldest and largest farms in Uzbekistan. The farm covers 4,000 ha and uses modern methods of agriculture and animal breeding.

Demir has also built 2 retail supermarkets of 5,000 and 10,000 m². These MIR Supermarkets are mainly supplied by “Yangi Hayat” farm quality meat, flour and dairy products.

¹ See <http://www.demirgroup.uz/>

Main Activities

Farming and livestock breeding (1,100 hectares)

The Yengi Hayat farm is involved in breeding cattle, sheep and goats. 600 cattle are bred for meat and milk production and graze on open pastures. They are fed with fodder produced by Demir's own factory. The milk production infrastructure is currently being developed to increase milk production capacity.

As far as vegetable crops are concerned, Demir produces pulses such as chickpeas, red beans, green beans, green gram, and lentils, and other crops such as wheat, barley, sunflower and safflower.

Agro-Processing: meat, wheat flour, animal feed

The slaughterhouse, producing 240 mt of meat per year, provides Tashkent markets and restaurants with fresh meat.

Demir has also built a flour factory, with a daily production of 24 mt, and a fodder factory, with a daily production of 20 mt. In addition to this, milk is collected, processed and packaged at the Tetrapak packaging centre in Tashkent for distribution to markets.

Agro-services (3,000 hectares)

Demir provides agronomic consulting and farm support management services. Besides this, it provides mechanized services to private farmers (6 tractors and 4 combine harvesters). New machinery and equipment was financed by Demir's own funds (US\$1 million) and an IFC-sponsored leasing facility (US\$976,000).

Seed selection

The farm cultivates 36 kinds of wheat on special plots of land as part of a State-run experiment. Demir Group entered into agreements with enterprises such as the French Company Maisadour (<http://www.maisadour-semences.com/>) and began cultivating wheat and corn on these plots. In addition, super elite potato seeds purchased from Salana are cultivated as part of an ongoing, long-term cooperation project with agricultural organizations such as Salana, Norex and Selka.

Product distribution and marketing: Pulses are exported directly in bulk to Iran and Turkey. Meat is sold in Uzbekistan through the MIR supermarkets, butchers, markets and restaurants. Flour is sold on local markets. Selected seeds will also be sold on the Uzbek market. Agro-Services provides its services to private farmers in the area surrounding the Hangi Hayat farm.

Development Strategy and New Projects

Demir Group has 4 integrated projects for a total investment amount of US\$13.2 million, out of which US\$5.2 million will be a direct investment from the Demir Group and US\$8 million will come from charter funds and loans.

- Fruit & vegetable processing and conditioning: cleaning and packing unit for pulses for export; fruit and vegetable drying and packing unit;
- Edible oil processing: 10 mt of sunflower and safflower oil production per day;
- Poultry breeding, slaughtering and marketing: expected output of 100,000 chickens during the trial period, to be increased to 1 million chickens per year;
- Breakfast cereal processing line.

Demir Group is in the process of consolidating its legal structure in Uzbekistan. Demir Turkey could provide the necessary collateral for the above-mentioned investments.

Conclusion

Demir is a strong local group, well established in the country. It has both the technical resources and market outlets to support its activities.

Following a progressive and careful development policy, the group has now a proven record of sound management methods.

Mehnat Winery and Brewery¹	
Joint Open Stock Company	
Address	M. Fozilov collective farm, Tashkent District, Tashkent Region.
Tel	+998 711 18 90 64
Contact name	Mr Usmanov Alikhan Islamovich, General Manager Mr Abdurashid Vasikov, Deputy Manager Mr Erkinakar, Technical Manager
Ownership	100 % owned by the above individuals
Sector/activity	Wine, beer, juice concentrate, tomato paste
Products	Full range of dry and sweet wines, red and white, One type of beer, tomato paste and fruit juices.
Annual turnover	UZS 2.5 billion (US\$2.5 million)
Net profit	not specified
Employees	170
Investment projects	Increase the capacity of the existing brewery
Dates of visit	25 January 2003 on site and 4 February 2003 in Tashkent
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • Very good potential partner but project might be too small for direct EBRD involvement. • Check credentials of shareholders and creditworthiness of company through Tashkent RO. 	

The Company

The company was created in 1993. Mehnat currently owns 154 ha of vineyards. Since 1993, they have progressively increased their processing capacity by regularly reinvesting their profits into the company.

The Innovation Bank highly praised the management of this company, mentioning that, over the last 10 years, they have never had any repayment problems.

Main Activities

Wine Production

Mehnat owns 154 ha of vineyards in the Hungarian region but, in total, they are directly involved in the cultivation of 240 ha. In addition to their own winery, they have set up several grape

¹ This company was recommended by the Innovation Bank.

collecting and processing centres. The wine produced in these affiliated wineries is brought to the Mehnat factory for bottling.

Sixteen different types of wines, originating from various regions, are now bottled and sold under Mehnat's own brands. Wines available on the local market are generally of poor quality. Compared to Uzbek standards, Mehnat wines are known to be of good quality.

Last year, total production was 10 million litres.

In order to improve the uneven quality of grapes sold by farmers and affiliated wineries, Mehnat plans to cultivate an additional 500 ha directly and 700 ha under cultivation contracts. Altogether, they will soon cultivate 1,440 ha of vineyards.

Beer Production

The company has an installed capacity of 80,000 l per day but, until recently, only 5,000 l per day were used. This was due to the lack of working capital financing and the investment requirements for the filtration line.

A new filtration and pasteurization line was bought from KHS (Germany) (<http://www.khs-ag.com/>), which allowed industrial production to start in December 2002. Apart from water, all raw materials are bought from Germany.

Tomato Paste Production and Juice Concentrate

The company also diversified into tomato paste production and juice concentrate, in view of good market opportunities existing in this sector. One production line is located in Buloungur (Samarkand region) and a second one is under construction in the Tashkent region. The company processes tomato paste in cans and fruit juice concentrates in "bag-in-box" for export.

Product Distribution and Marketing

Mehnats brand name is well established on the wine market. The company distributes its wine and beer products through wholesalers and restaurants. 10% of their wine production is sold in bulk to Russia and Kazakhstan. For beer, the company also uses traditional distribution channels (cask beer sold in the streets).

Development Strategy and New Projects

In the wine market, Mehnats strategy is to continue to focus on quality by better controlling its grapes supplies. In the beer market, Mehnats objective is also to focus on quality and to take over within the next 3 years the market share currently controlled by Russian beer makers. To further develop its sales, the company intends to invest US\$1 million to complete its brewery processing line and cover its working capital needs before the next summer season.

To finance its development plans (new winery), Mehnat took a loan in 2002.



Beer bottling hall



Mehnats office building



Malt storage facility



Beer cooling tanks



Brewery building

Related subsector note: beer.

C. Visits with No Explicit Investment Requests

Nestlé	
Société pour l'exportation des produits Nestlé S.A. Ouzbékistan Nestlé Ouzbékistan	
Address	111 A. Buyuk Ipak Yuli Str – 700077 Tashkent
Tel	+998 71 120 46 00
Mobile	+998 71 120 46 05
Fax	+998 71 187 62 10
Email	Jacques.Vauthier@tr.nestle.com
Contact name:	Mr Jacques Vauthier
Sector/activity:	Finance and Control Manager for Central Asia and Azerbaijan Mineral water Dairy based products Marketing of imported Nestlé Products
Local Products:	UHT milk production Mineral water
Total Turnover in 2002:	US\$11-12 million (indicative)
Net Profit	Not specified
Employees:	410
Investment projects	Not mentioned
Dates of visit	30 January 2003
Present from FAO	Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> At this stage, the only possible EBRD involvement to support Nestlé's operations in Uzbekistan would be to assist the company in getting UZS from local banks. 	

The Company

Nestlé started to export to Uzbekistan in 1995. They established a representative office in Tashkent in 1996. In 1999, a presidential decree authorized a US\$30 million investment programme planned until 2005 for the construction of a dairy factory and a mineral water bottling plant. 2002 was the first year of full operation.

Main Activities

The factory is situated in Namangan. Construction started in early 2000 and was completed in January 2001. The sale of mineral water started in March 2001 and the sale of UHT milk started in April 2001. US\$25 million have been committed so far and the balance should be invested before 2006. The indicative annual turnover is US\$11-12 million. Nestlé's long-term strategy in Uzbekistan is to focus mostly on the local market (25 million consumers) and on neighbouring countries, when possible.

Business Environment

During the meeting, Mr Vauthier mentioned the main issues Nestlé faces in its day-to-day operations. Despite a difficult business environment, it should be noted that the company operates successfully in Uzbekistan.

Foreign exchange: Until last October, Nestlé experienced difficulties in buying hard currency on the official market. The situation has improved since then, as the local authorities have facilitated the sales of foreign currency to the company. A freer access to hard currencies would however greatly facilitate the overall business environment.

Import duties: An issue that still needs to be resolved with the local authorities is related to the payment of duties on imported goods. Import duties are levied on various processing and packaging materials, which add up to the final price of the product. If Nestlé purchases imported items locally, for instance aluminium foil¹, PET, or cardboard, the local importer passes on the import duties onto Nestlé. On the other hand, Nestlé cannot get these import duties refunded when exporting its finished products, which somehow reduces its competitiveness. This applies to other exporters, be they local or foreigner companies.

According to Nestlé, the Tax Department should set up an import substitution scheme to avoid the prevailing double taxation system and give longer-term tax exemption as an incentive for local manufacturers to export their products.

In addition to the above-mentioned difficulties, trade with neighbouring countries, especially Kazakhstan, is plagued by numerous informal rules that are difficult to understand in a free market economy.

Cash Management for Settlement of Business Transactions

By being very restrictive with regard to the free circulation of cash, the Government intends to reduce the black market on the exchange of hard currencies. However, by doing so, it might well end up promoting an even larger grey economy.

Payment of suppliers: According to the new restrictions imposed by the Government on the circulation of cash, companies like Nestlé are requested to pay their suppliers via bank transfers. In practice, Nestlé is buying milk from over 5,000 farmers who typically accept payments only in cash. Nestlé therefore had to request a special derogation to the new regulations to be able to pay its milk suppliers.

Other payables: Local banks use their limited cash to meet the withdrawal demands of their clients for the payment of salaries or other legally allowed cash transactions. However, these withdrawals often cannot be made on time or in sufficient amounts. This is putting a heavy burden on companies by preventing them from running their activities in a smooth fashion. This is definitely a sign of misunderstanding of actual business operations by the present Government. It should be noted, however, that Nestlé no longer faces this problem.

¹ For example, the raw material required for printed alufoil bags, i.e. aluminium, is imported (while the printing is done by a local contractor)

Product Distribution and Marketing

The restrictions imposed by the Government on the circulation of cash have serious consequences for the distribution of Nestlé's products. Under the new regulations, Nestlé's customers also have to pay their dues via bank transfer. These measures have literally killed a lot of small and medium traders/retailers in the bazaar or, at the very least, Nestlé is no longer able to deal with them directly. These small retailers, however, are highly competent in their own field and play a key role in the distribution chain from the producers/ manufacturers down to the consumers.

In these circumstances, Nestlé can only deal with relatively large wholesalers or else will need to move into the retailing business by setting up its cash-and-carry outlets or supermarkets, which are for the moment underdeveloped.

In fact, the Government, by de facto eliminating small retailers, limits its capacity to levy VAT at this level and hence reduces its revenues substantially, while its initial objective was to increase its fiscal revenues by clamping down on the grey economy.

Financing Needs and New Projects

Another constraint faced by Nestlé is related to the difficulty of borrowing money in local currency, even on a short-term basis. Uzbek banks are not liquid in UZS. They are mostly onlending the proceeds of US\$-denominated loans borrowed from international institutions, passing the exchange risks on to the borrowers.

In Nestlé's opinion, a very useful service that the EBRD could develop in Uzbekistan would be to assist local banks in setting up some sort of back-to-back credit lines allowing them to lend money in local currency while limiting their own exposure to exchange rate fluctuations. Local banks are also not in a position to accept the guarantee of Nestlé S.A. and therefore tend to ask other types of securities from the local affiliate. On the other hand, Nestlé considers that the EBRD should be in a position to accept the guarantee of Nestlé S.A. This was apparently not reflected in the offers that the EBRD made in the past. Generally speaking, the lending conditions proposed by the EBRD to finance Nestlé's activities in Uzbekistan were not considered acceptable for the following reasons:

- High level of securities (130 %);
- High interest rates (Libor + 5%);
- Nestlé S.A. guarantee not taken into consideration.

The possibility for the EBRD to provide financing in the form of equity is not favoured. It would require amendments to various decrees issued by the authorities in relation to Nestlé's investment in this country.

For the time being, Nestlé is not considering any new major investments in Uzbekistan until its access to retail distribution is improved (Nestlé depends heavily on the distribution of its products to a wide range of retail outlets).

Finally, Nestlé is setting up a TC project to improve local milk production in the area surrounding its dairy plant. The TC project will be financed by the Swiss authorities. It will include veterinary and extension services in the area of husbandry, animal feeding, and artificial insemination.

Central Asia Seed Corporation	
(CASC)	
Address	40/19 Khamza Street. Tashkent, 700049, Uzbekistan
Telephone	(+998 71) 1 33 22 79
Fax	(+ 998 71) 1 33 90 67
Email	casc@online.ru
Contact name	Mr Tommy Keith Bryant General Manager
Shareholders	Elsut International Inc.
Sector/activity	Cotton industry
Products	Cotton fibre Cotton seed
2002 Annual Turnover	N.A.
Net Profit	N.A.
Employees	383
Investment projects	None mentioned
Date of visit	
Present from FAO	Mr Emmanuel Hidier, Economist, FAO Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • None, but very informative on the cotton sector. 	

The Company

Elsut International Inc., CASC's parent company, is incorporated and operates under the law of the State of Alabama, USA.

Elsut International Inc.'s wholly-owned subsidiary, Central Asia Seed Company ("CASC"), is registered in accordance with the procedures established by Resolution No. 55 of the Cabinet of Ministers of the Republic of Uzbekistan and the Decree of the President of the Republic of Uzbekistan of November 30, 1996.

CASC operates in the regions of Bukhara and Tashkent and produces cotton fibre and cotton seed. It took the corporation until 2001 to obtain the permission to export cotton fibre. Such an exception was made possible through strong political support from American Senator Joe Preston.

Main Activities

CASC's core activity was initially cottonseed selection and production. However, since the export of cottonseed is still prohibited, the company had to adapt its strategy and get involved in the production of cotton fibre. The company also assists farmers by pre-financing their crops and providing them with technical assistance services.

Cotton Farming

CASC is working with 8 shirkat farms and 114 private farmers, which represent a total planted area of approximately 10,000 ha of cotton.

Farmers have developed different ways to improve their earnings:

- over-sowing: while in the US only 15 kg of seeds are needed to plant one hectare of cotton, Uzbek farmers use up to 85 kg/ha;
- however, “officially”, up to 350 kg/ha of seeds are used to plant one hectare. The difference is sold on the black market in nearby countries to generate additional cash for the farm;
- once harvesting is complete, the raw cotton must “mature” for one month before being processed. This is another way used by farmers to “cook the books”.

CASC participated actively in the World Bank Sub Sector Cotton Improvement Project, under which the company imported 16 modern planting machines and other machinery with the proceeds of a loan granted by the World Bank.

Cotton Ginning

The CASC ginning factory has a production capacity of 22 bales per hour, each bale weighing 230 kg. This large capacity is part of their long-term strategy to allow the ginning of the cotton production of the whole region (10,000 ha).

Cotton bales are wrapped in polybags according to international standards. To insure the quality of their products, CASC uses a saw ginning process which does not break the long fibres of the raw cotton, thus increasing the value of the cotton.

Cotton is bought at between US\$125 and US\$225/mt at the farm gate depending on the quality of the fibre. De-linted cotton was sold at up to US\$1,200 /mt in early 2003.

A ginning fee is charged for processing cotton and a 10%-commission is charged for selling the fibre. Storage and loading fees are paid by CASC.

Cottonseed Plant

Delicate ginning is done to enhance the quality of planting seeds. CASC produces high germination, top-quality, acid de-linted, chemically treated planting seed. Presently, three local varieties are produced. The capacity of the de-linting treatment plant is 2mt/hour.

Business Environment

Markets and Competition

To demonstrate its support to CASC’s project, the Government of Uzbekistan decided in 1995 to take a series of measures affecting the cotton sub-sector. Specifically, the Government agreed:

- to allow the creation of private seed companies;
- to grant 99-year leases on land used for seed companies' administration buildings, operating facilities, and ginning and seed processing plants;
- to allow seed companies to freely develop their management structure and operating style;
- to allow seed companies to operate freely in choosing seed farms for the procurement of their inputs;
- to allow seed companies to sell their products freely on the market, including the world market;
- to facilitate the timely issuance of licenses for import and export of equipment and commodities, use of currencies and accounts, and related activities and transactions for seed companies and their suppliers;
- to liberalize the prices of planting seeds and gin-run seeds;
- to substantially decrease the State order system for cotton, leading to its elimination by the start of the 1998 cropping cycle;
- to increase the procurement price for cotton and cottonseed remaining under the State order system, with world prices coming into effect at the time of the elimination of State orders;
- to allow seed companies to contract with seed farms for the production of cotton lint, which would be exempt from State orders; and
- to ensure that cotton lint not sold through the commodity exchange would benefit from an expedited 10-day procedure for obtaining an export license through the Ministry of Foreign Relations.

These concrete measures, as well as others, were stipulated in a letter signed by Deputy Prime Minister Bakhtiar A. Khamidov and sent to the World Bank in early 1995.

CASC appreciates the cooperation of the mayors of the Saykhunabad, Bayaut, and Chinaz districts, especially their practical input with regard to legal matters and existing farming structures, industry and project financing in the Republic of Uzbekistan. Their help in establishing business contacts between CASC and local farmers was invaluable.

CASC cannot yet buy raw cotton outside its own pre-financing area. During the next cotton season, this should be changed with the establishment of an auction system for the cotton remaining after the State Order is fulfilled.

Cotton Exports

CASC exported 2,000 mt of cotton fibre in 2002 and has contracts to export the remaining 3,000 mt. In order to obtain customs clearance, they have to pay a 10% "tax" on the export value, from which the transportation costs are deducted. Grading is done by SIFAT, the National Cotton Certification Centre established under the World Bank Programme.

Cottonseed exports: cottonseed and cotton cake are highly valued in the United States as animal feed for ruminants. However, since Uzbekistan has banned the export of all edible oilseeds and cakes, CASC is not yet able to operate in this sector.

Cottonseed Import

CASC imported 70 mt of new varieties of cottonseeds, which were blocked at the border by the Quarantine Authorities and destroyed due to alleged disease. This was interpreted by CASC as a move to avoid competition from foreign varieties.

Development Strategy and New Projects

No specific request was formulated for financing new projects.

Conclusion

By investing their own money in Uzbekistan, CASC took some risks which almost drove them to bankruptcy until they finally succeeded in exporting cotton fibre. This enabled them to pay back their World Bank loans, which were denominated in US\$.

They now enjoy a privileged position as one of the few foreign companies allowed to export cotton.

Marvel Juices	
Address	12 M.Tarobly str., Tashkent, 700090 , Uzbekistan
Tel	+998(71)152 71 76/77
Fax	+998(71)152 65 73
Email	joost@marvel.uz
Contact name	Mr Joost Heij, General Manager and one of the two majority shareholders.
Shareholders	Mr Joost Heij Mr Sergey Evgenievich Moscalenko, Millier Trading Gmbh
Sector/activity	Fruit juices, purées and concentrates
Products	Juices, purées and concentrates of fruits and tomatoes
2002 Annual Turnover:	N/A
Net Profit	N/A
Employees	200
Investment projects	N/A
Date of visit	26/01/03
Present from FAO:	Mr Jean-Jacques Franc de Ferrière, Agro-Industry Consultant Mr Adham Ergashev, Global Facts, Local Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • None, except for the cardboard factory investment. 	

The Company

Marvel Juice runs two factories acquired in 2001 and 2002 through the investment vehicle Frewar Investments Limited (“Frewar”). The Managing Director of Frewar is Mr Joost Heij, who previously worked for the Dutch Trade Company and ING Bank in Amsterdam. The other partner of Mr Heij is Mr Moscalenko.

The first factory was initially owned by an Uzbek/Swiss joint venture called “Marvel Juice Co Ltd”. This joint venture was 75%-owned by the foreign partner and 25%-owned by the State. In November 2001, Frewar bought all the shares of the Swiss company. The factory is located in the Namangan region, Yangikurgan District, Iskovat village.

The second factory (a canning factory) was first owned by an Uzbek/British joint venture (40% local, 60% foreign) created in 1997. It is called Andijon Agrifirm “AFA”. In 2002, Frewar bought 60% of shares of the JV from the foreign partner. The factory is located in the Andijan region, Andijon city, 33 Musaev Street.

Main Activities

Both factories produce fruit juices, fruit purées and concentrates.

Processing capacity: The first factory has a processing capacity of 10 tons of apples/hr and 3 tons of stone-bearing fruit/hr. The second factory has a processing capacity 10 tons of apple/hr and 5 tons of stone-bearing fruit/hr.

Production: Last year, the first factory processed 20,000 tons of apple, 2,200 tons of stone-bearing fruit, and 500 tons of tomatoes. It produced 2,300 tons of apple juice concentrate, 1,800 tons of purée from stone-bearing fruit and 400 tons of tomato purée. It also made 4.5 million litres of ready-to-drink juices in cardboard cartons of 1-litre and 250-gramme capacity. These were produced under the “Tip Top” brand, which is highly publicized throughout the country.

The second factory was bought at the end of last year.

With the technical assistance of foreign consultants and strong management, the production of the first factory doubled. The orchard yield tripled thanks to better agronomic practices.

Business Environment

Markets and Competition

The competition is felt more at the level of the collection of raw material than at the market level. Local demand is high for fruit juices and export demand is high for purées and concentrates.

Raw Material Supply

Both factories are situated in the Ferghana Valley, which is a very productive area for fruit and vegetables (see Fruit and Vegetable Sector review). Furthermore, with proper technical assistance, yields are increasing significantly: the orchards managed by Marvel Juices will soon supply enough necessary raw materials to both factories. While the size of the supply area is reducing, transportation costs are also decreasing.

On the other hand, the new regulation imposed this year by the Uzbek Government on cash management has introduced a major constraint for the collection of raw material.

Product Distribution and Marketing

Marvel Juice has its own marketing and distribution channels for the local market and an exclusive sales agent abroad.

Juices and nectars: 90% are sold on local markets;
 10% are sold on export markets.

Apple juice concentrates, apricot and peach purées are sold exclusively on export markets.

Development Strategy and New Projects

The second factory has to reach its full production capacity for the 2003 season.

To avoid further disruptions due to the new regulations on cash management, the company intends to cultivate its own orchards (measuring 500 ha).

As a big consumer of cardboard boxes, the company acquired 50% of the “Promcartontorg” cardboard factory (See Company Profile).

Conclusion

There are no specific investment needs for Marvel Juice for the time being. Having taken the lead in this sector, they wish to consolidate their position before taking any further action.

The most important concern for the two partners now is to upgrade the cardboard factory to obtain good quality packaging material to improve their competitiveness in the local and regional markets.

Promcartontorg	
Address	Angren, Uzbekistan
Tel	+998(71)
Fax	+998(71)
Email	
Contact name	Mr Sergey Evgenievich Moscalenko, General Manager and one of the three majority shareholders
Shareholders	27% Mr Sergey E. Moscalenko, Millier Trading Gmbh (Swiss) 23% Mr Joost Heij, Freewar Investment (UK) 20% Mr David Gaweld 25% State 5% Staff
Sector/activity	Cardboard processing
Products	Various types of cardboard for packing and packaging
2002 Annual Turnover	UZS2 billion (US\$2 million)
Net Profit	UZS150 million (US\$150,000)
Employees	1,500
Investment projects	US\$10 million
Date of visit	05/02/03
Present from FAO	Mr Jean-Jacques Franc de Ferrière, FAO - Agro-Industry Consultant
✓ Summary Assessment/Follow-up Recommendation	
<ul style="list-style-type: none"> • Key sector in the whole region. This cardboard factory should be seriously considered. 	

The Company

Situated in Angren, 130 km away from Tashkent, on a large compound of 60ha, “Promcartontorg” is the only company in Central Asia producing cardboard boxes. It has a large production potential.

Designed in the 1980s with Russian technology, the construction was finalized in 1991.

The company was taken over by three investors in 2002 in a move to improve the quality and quantity of the cardboard produced. Two of the shareholders (Heij and Moscalenko) are also owners of Marvel Juice, a joint venture producing fruit juice, purées and concentrates, and hence a heavy user of cardboard cartons.

For the time being, the State still owns 25% of the company, but following the recent decree on privatization, the team of investors is planning to take over the rest of the capital.

Main Activities

Promcartontorg processes recycled paper and wood cellulose supplied by Glavpap Joint Stock Company into cardboard. The cardboard is used to manufacture various types of products.

The production capacity of the company is as follows:

- cardboard containers – 100 thousand tons;
- 3-layered wafer cardboard – 120 million m²;
- boxes from wafer cardboard – 97 million m²;
- fibrous plates – 1 million m² (made from production wastes);
- binding (glued) cardboard – 2,000 tons.

The company manufactures “secondary boxes”, i.e. external packaging for the transportation of various products such as bottles of wine and spirits, margarine boxes, juice, etc. It does not yet produce “primary boxes” (Tetra Pak Type) in which processed food products such as juices, purées, milk, etc. are actually preserved.

For the time being, only 20% of the factory’s capacity is used: in 2001, production was 20 million m² of boxes made of wafer cardboard and 300,000 m² of fibrous plates.

Equipment is obsolete and would need to be replaced.

Business Environment

Markets and Competition

Demand is high both locally and abroad. The foreign shareholders would like to develop the company into a modern/ high-tech company oriented towards exports and producing competitive products at international standards. The company can supply regional markets - i.e. Uzbekistan, as well as Central Asian and CIS countries - with high quality cardboard containers, consumer packages, toilet paper and napkins.

So far, with poor management and old equipment, the quality/price ratio of the company’s products has been low.

Raw Material Supply

Raw materials are readily available in the area. 70% of supplies come from recycled paper and the remaining from locally-purchased wood cellulose.

In view of large surpluses of cotton by-products available in the country, the company would like to diversify into napkins and toilet paper.

Product Distribution and Marketing

This area of business needs restructuring. A marketing manager is soon to be recruited to join the new management team.

Export markets within Central Asia and the CIS will be one of the main commercial targets of the new team.

Development Strategy and New Projects

A few months after taking over the company, the new shareholders are in the process of restructuring management and recruiting new managers from Russia.

The new investors have a two-step strategy:

- recruit a new management team and run the factory as it is to the best of its capacity;
- progressive launch new product lines in the area of “primary boxes” to supply local and regional markets.

Several projects are under consideration:

- production of toilet paper and napkins with a capacity of 5-6 thousand tons per year;
- consumer containers with multicoloured print (offset print and flexoprint), made from micro corrugated board and box-type cardboard, with a capacity of 20 million m². The main raw materials used for manufacturing these containers will be recycled paper (70-75%) and wood cellulose (25-30%). The cardboard will be produced by the factory’s own cardboard processing line.

Conclusion

According to a technical audit carried out last year, the overall investment needed to renovate the factory and install new processing lines is estimated at US\$10 million over a period of 5 years.

With a strong management team, the company is bound to play a key role in the packaging industry in the region. No specific request was made with regard to potential EBRD financing/support.

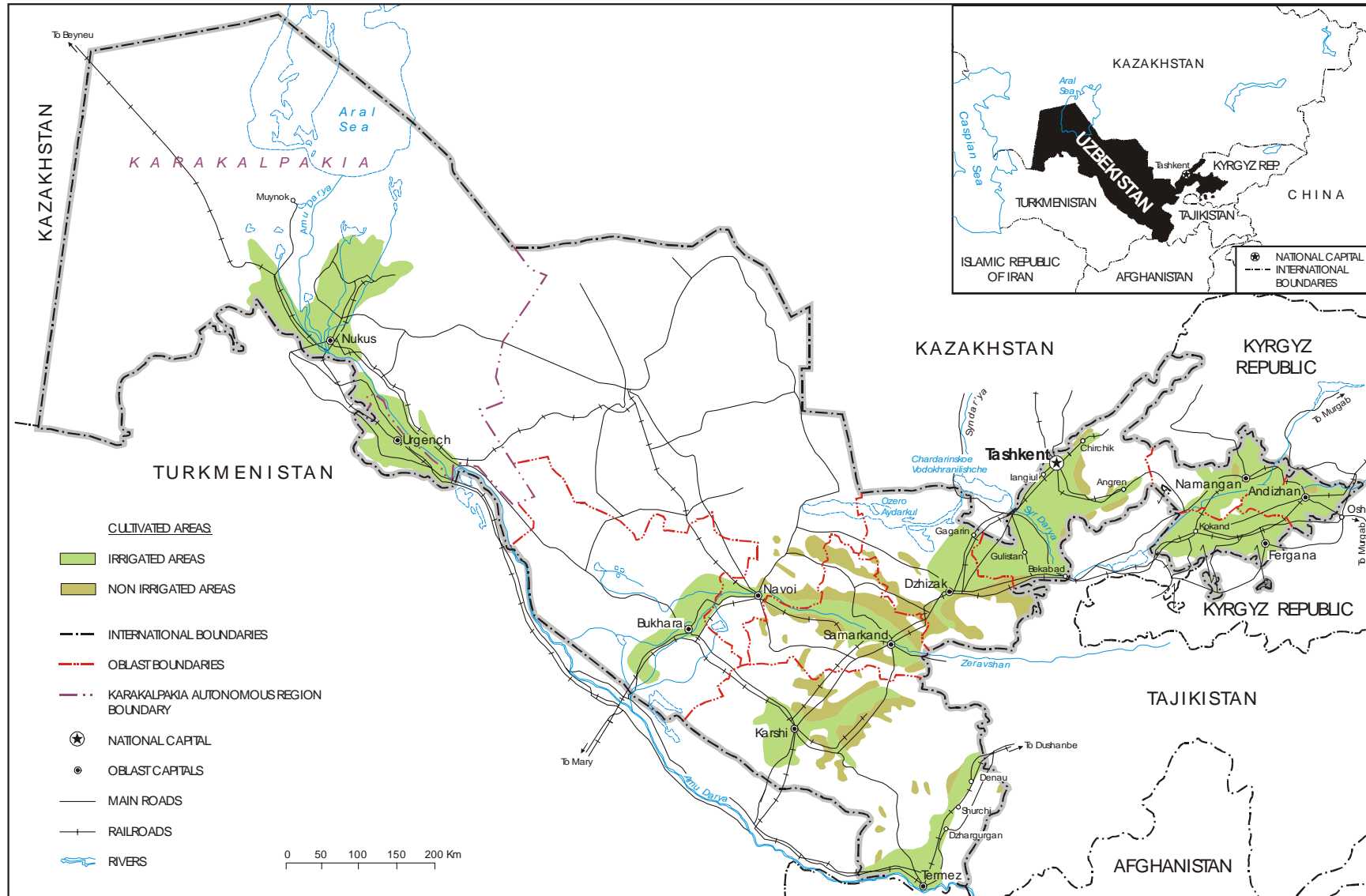
ANNEX

Maps

Administrative and Transportation Map



Main Agricultural Production Areas



Livestock Production Areas

