

Consumer Purchasing Power: Fueling Ukraine's Economy

During the past 16 months, Ukraine's electorate closed the chapter on post-Soviet transition and began a new one on parliamentary democracy. A pro-western President has been joined by a pro-business parliament elected recently to integrate Ukraine into global and European trading bodies. Investment opportunities and business growth in sectors related to a growing consumer market are driving Ukraine's emerging market economy, despite a global increase in energy prices. Horizon Capital Managing Partner **Natalie A. Jaresko** sheds light on Ukraine's hidden investment opportunities

Political risk in emerging markets is always on the mind of investors. What do you tell them after they read the latest international headlines about Ukraine?

Transitions were messy in Central and Eastern Europe during the 1990s. Current events in Ukraine show a steady political consolidation toward European democracy. Despite the political ebbs and flows making headlines, market opportunities continue to grow. The active merger and acquisition market is demonstrating that foreign investors are aware of the strength and promise of this large homogeneous market.

Statistics show GDP growing more slowly than during the height in 2004. Are opportunities still there?

One needs to look beyond GDP and closer at the growth potential in various industry sectors to get the full picture of opportunities here. While Ukraine's GDP projections show 2-3% growth in 2006, disposable income is growing at rates of 15% annually, which in turn fuels private consumption. We've been investing for more than a decade in mid-sized companies. During the past five years, our investment portfolio has witnessed per capita disposable income almost triple. This fact alone drives growth in the private equity market, particularly in segments that benefit from growing living standards such as FMCG, retail, manufacturing, financial services and media. Consumers are demanding better products and services that naturally require investments in technology, human resources, as well as marketing and distribution.

A growing appetite for consumer spending requires access to credit. How does the banking and credit sector compare with other markets?

Ukraine's banking sector is a growth leader in the Central East European region. The consumer lending market grew at a



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Cumulative Annual Growth Rate (CAGR) of 87% between 2000-2004, reaching Euro 47 per capita. This is just the beginning of a transformation expected to continue for more than a decade given Western European peers have reached levels of Euro 1,846 per capita.

Mortgage lending is similarly dynamic. Last year, Ukrainian banks tripled their mortgage portfolios resulting from the creation of a regulatory framework for mortgage lending coupled with growth in personal incomes, real estate prices, and a growing middle class.

During the past twelve months, these growth rates caught the attention of banking institutions such as Raiffaissen Bank (Austria), BNP Paribas (France), Bank Intessa (Italy), and Russia's Sberbank and Vneshtorgbank. All are now Ukrainian market players with controlling stakes in local banks. The banking sector is consolidating and we expect new innovative products for both its corporate and retail segments.

How have you taken advantage of these opportunities?

One year ago, we invested \$8.3 million and launched the International Mortgage Bank (IMB) in Kyiv. It focused on providing clients with superior customer service and innovative products. With a standardized portfolio and a transparent ownership structure, IMB attracted long-term capital and built an impressive customer base.

Recently, IMB merged with Favorit Capital, a credit intermediary focused on installment loans, in which we are also an investor. This

merger created the first pure-play consumer lending bank with a product portfolio that includes mortgages, installment loans, and more credit products anticipated soon. IMB is centrally located in Kyiv, while Favorit Capital has more than 200 points of sale nationwide.

What criteria do you consider when evaluating a prospective portfolio company?

Our investment strategy targets mid-sized companies that can become market leaders. We look at fast growing market sectors. Among them are financial services, FMCG, retail and industrial goods, to name a few. One of the keys to success are company managers who support good corporate governance practices, and have the vision and drive to become market leaders.

Can you name a few examples?

A \$7m investment was made in the Shostka Dairy, a high quality manufacturer of hard cheeses. The company increased sales by 55% in 2005 and maintained strong profitability. Another is our recent investment in Ergopack, a market leader in the manufacture and distribution of household (kitchen) disposables. This company's revenue growth ranges from 40-60% year-on-year over the past three years, as it expands its shelf space in the dynamic retail market.

What are some of the concerns facing investors in Ukraine?

The investment climate here is improving thanks to deregulation and government moves to simplify tax and customs procedures. Citizens are demanding a better lifestyle and lower prices for goods and services, which influences government policy. More needs to be done, however, to open up untapped market opportunities and encourage domestic and foreign investment throughout the economy. While privatization and breaking up state monopolies will bring competitiveness to various industry sectors, we believe small and medium business growth will remain a major opportunity for private equity investment in the near term.



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