

Overview of Ukrainian Retail

GENERAL OVERVIEW

The rapid economic growth recorded by Ukraine in recent years has boosted personal income and bolstered retail trade. Nominal GDP, at USD 81.7 bil. in 2005, has grown at a CAGR of 21.2% since 2000. Total disposable income, expected at USD 49.9 bil. in 2005, has posted 23% CAGR over the period.

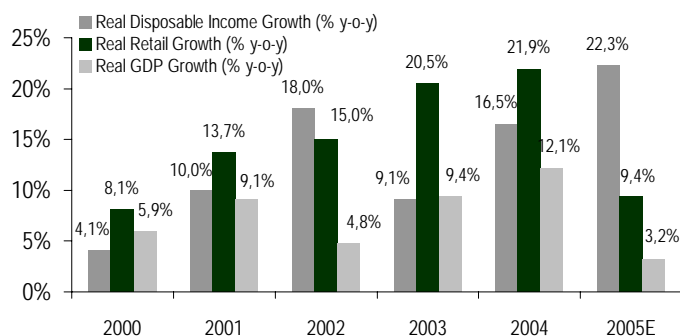
Retail trade is one of Ukraine's fastest growing sectors and the most rapidly growing retail market in Central and Eastern Europe. In 2005, total retail trade volume reached USD 31.1 bil., of which organized trade accounted for USD 18.1 bil. The retail market expanded at a CAGR of 26% from 2000-05, outpacing nominal economic growth by nearly five percentage points.

Consumer spending in Ukraine increased by 25% y-o-y, to USD 50.7 bil., in 2004, and expanded by an estimated 35%, to USD 68.5 bil., in 2005, bringing 2000-05 CAGR to 24%. As Ukrainians grew wealthier, the share of food spending, which stood at 68% of total spending in 2000, decreased to 60.2% in 2005, while non-food spending rose from 18.5% to 24.3% over the period.

Rapid economic growth boosted personal income and retail trade

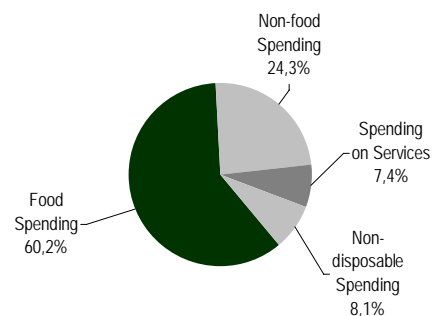
Retail trade is one of the fastest growing sectors

Spending grew at 24% CAGR in 2000-05E, with non-food expenditures rising faster



Ukraine Personal Income Structure (USD bil.)

Source: State Statistics Committee, Dragon Capital



Personal Income Structure (2005)

Source: State Statistics Committee, Dragon Capital

Ukraine shot up an impressive eight slots in A.T. Kearney's Global Retail Development Index over the past year, landing third after India and Russia in the 2005 rankings and boasting the 'Act Now' recommendation for investors interested in the sector.

A.T. Kearney urges global retailers to 'Act Now'

FOOD RETAIL

Modern retail formats, such as supermarkets, Cash & Carry stores and hypermarkets, are steadily gaining popularity in Ukraine. Yet, their share in total retail trade is still small. According to GfK-USM, the share of supermarkets in total retail trade in Ukraine increased from 3% in 2000 to approximately 12% in 1H05. The share of convenience stores rose from 18% to 25% over the period, partly thanks to the development of modern discounters such as ATB-Market. Specialized stores preserved their share at 5%. Non-organized retail has been declining, with the highest drop registered by open markets, from 52% in 2000 to 43% in 1H05.

Supermarkets are rapidly growing in cities, but their share is still small

The consolidation of Ukrainian retail market is years behind CEE countries and Russia in terms of competition. If measured by the market share of top 10 retailers, competition is strongest in Slovakia, where the top 10 retailers control 66.9% of the market, followed by the Czech Republic with 60.6%. In Romania and Bulgaria, the top ten have only 12.5% and 14.3% of the market, respectively. Russia trails them with 9.5% and Ukraine is still further behind with only 5%.

Retail market concentration in Ukraine is the lowest compared with other CEE countries

MAJOR COMPETITORS

Company	Format	2004 Sales (USD mil.)	2005E Sales (USD mil.)	No. of Stores
FOZZY Group	Hyper- and supermarkets, discounters	298	450	152
Furshet	Supermarkets	213	350	48
Metro C&C	C&C	149	330	7
ATB-Market	Economy supermarkets, discounters	178	280	122
Velyka Kyshenya	Hyper- and supermarkets	109	230	24
Intermarket	C&C, supermarkets, discounters	67	100	22
Pakko	Hyper- and supermarkets, discounters	60	90	25
Tavriya-V	Hyper- and supermarkets	58	80	5
Rewe (Billa)	Supermarkets	61	90	8
Megamarket	Supermarkets	50	75	5

Ukraine's Top 10 Grocery Retailers (end-2005E)

Source: Velyka Kyshenya, Dragon Capital

Market trends

- ▶ **Strong margin growth potential.** The sector's general gross margin grew from below 8% in 2002 to 14% in 2003 and stabilized at that level in 2004 and 2005, which is still very low by industry standards in Russia and other CEE countries. The low-margin environment presents a critical entry barrier for major international retailers considering investing in Ukraine. At the same time, it provides another area of potential growth for the sector.
- ▶ **Gradual format change.** Organized retail, which accounts for 63% of total retail trade, is growing faster than the overall market. Modern retail outlets account for less than 5% nationwide. Open-air markets still dominate in the regions.
- ▶ **Lack of appropriate locations reduces entry options for newcomers.** In 1999, Kyiv had only three supermarkets run by as many operators. In 2004, there were already 12 major operators, 75 supermarkets and 6 hypermarkets in the city. Supply of new locations in Kyiv is rapidly becoming scarce.

Major market trends

Restaurant Industry Overview

The Ukrainian restaurant business is steadily catching up with the rest of the economy. In 2005, domestic restaurants posted a turnover of USD 850 mil. (up 22.8% y-o-y in nominal terms, the highest annual growth rate since 2000). Despite last year's acceleration, the market, with a 2000-05 CAGR of 15%, is still under performing both retail growth and overall economic expansion.

As Ukrainians get wealthier, their restaurant-going habits change too. Nowadays, the most frequently cited reasons for eating out are to meet with friends, spend time with family, and get a quick meal. Ukraine's burgeoning middle class is the local restaurant market's main driving force, which explains why fast-food, with an average check of up to USD 10, is the fastest growing segment.

Restaurant industry grew by 22.8% in nominal terms in 2005

The domestic fast food industry operates in three formats:

- ▶ Traditional fast food (McDonald's, MakSmak, Mister Snack, Shvydko), characterized by high client turnover, limited food selection, and visited by low-to-middle class customers paying USD 2-4 per meal on average;
- ▶ Bistro/Counter (Domashnya Kuhnya, Puzata Hata, Chinese bistros), featuring an extensive menu (up to 150 items) served at long counters; customers pay USD 2-4 per meal on average;
- ▶ Quick & Casual (Pizza Celentano, Dva Gusya, Potato House, Pan Pizza), offering a mix of traditional and fast food meals and visited by customers with higher disposable income who pay USD 7-10 on average; this is the fastest growing of the three formats.

Competition

Fast Food Systems (FFS), the owner of Pizza Celentano and Kartoplyana Hata brands, is the market's undisputed leader in terms of the number of restaurants (112 outlets in 45 cities) thanks to a strong franchise network. The company sells regional franchises, charging a fee of 1.5% of franchisee revenues. FFS thus opened 20 outlets in 2005, and plans to launch another 15-20 in 2006, keeping up its unmatched expansion pace.

Pizza Celentano and Kartoplyana Hata, top players

Major Players

	Total outlets	Outlets in Kyiv	Number of cities covered	Number of franchisees
Pizza Chelentano	77	13	45	67
Potato House	35	6	45	33
McDonald's	52	21	16	0
Pan Pizza	18	4	5	
Dva Gusya	12	6	6	3
Shvydko	11	11	2	0

Source: Dragon Capital

Non-food Retail Overview

Ukraine's non-food retail sector is growing at a faster clip than food retail, with the overall market for household goods, cosmetics, and toiletries estimated at USD 1.2 bil. Non-food items account for 20-25% of local supermarkets' SKUs. However, these products are mainly distributed through outdoor markets, direct sales, department stores, and perfume stores.

Competition in the sector is weak, and the market itself is quite fragmented. The top two companies, Asnova Holding and Cosmo Ltd, which operate DC and Cosmo chains, respectively, account for 7% and 3% of the market respectively. Both specialize in perfume and household care products and offer similar assortment of goods and loyalty schemes. Cosmo is also expanding via franchising schemes, and it already has three outlets working under franchising agreements. Brocard follows the top two closely, with a market share of just under 2%, but specializes only in perfume. Its outlets also boast a larger area on average compared with DC and Kosmo. We expect the market to consolidate gradually in the near future.

Non-food retail is growing fast

The market is unconsolidated, competition is weak

	Sales (USD mil.) 2005	Outlets	Outlets in Kyiv
DC	84.3	93	35
Cosmo	50.0*	34	25
Brocard	42.0*	20	10

Source: Company Reports, Dragon Capital; *Dragon Capital Estimates.