The Russian Beef Market

Market Assessment and Opportunities

U.S. MEAT EXPORT FEDERATION [1]

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[1] The project was funded by US Beef Producers. Ricardo Vernazza-Paganini (USMEF Director, Central/South America & Global Strategic Coordination) and Maria Kulakhmetova (USMEF, Manager St. Petersburg and CIS countries) where responsible for the development and implementation of the project.

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Executive Summary

- During the 3-year period in which U.S. beef was banned from the Russian Federation, the Russian beef market experienced significant changes.

- In this respect, USMEF developed a project to understand the new structure of the market aiming to assist U.S. companies in the development of a successful re-entry strategy. In February 2007 USMEF performed 22 face-to-face interviews with Russian importers and retail companies.

- The U.S. liver exports will now face a more competitive scenario relative to 2003. Russia's U.S. export ban caused a dramatic change in the structure of the liver market: total imports dropped from 80,000 MT/year to an average of 36,622 MT for the 2004-2006 period. Moreover, since 2003 Russians have substituted poultry for beef livers in their diets. Per capita poultry consumption increased from 15 kg per capita/year (2003) to 20 kg per capita/year (2006). Domestic poultry production has increased by 50 percent since 2003.

- US potential in the liver market will be driven by its competitive position with respect to quality, retail certificate, shipping time and price. While quality is very similar between countries, US "retail certificate" creates an advantage relative to Argentinean and EU packing plants that are not retail-approved. The big shipping time difference between Australia or NZ (60-75 days) and the US (30-40 days) will give the US another advantage. Finally, our price analysis supports the fact that the price level of U.S. livers should be very competitive with Australian, New Zealand, Argentina and Brazilian livers as well as poultry prices in the Russian market.

- In this context, U.S. companies should be extremely careful when planning their strategies for re-entering the Russian liver market since the return of U.S. livers to the market could trigger significant distortions in prices throughout the protein complex.

- Australia is currently the number one supplier of high quality beef to the upper-end foodservice sector, followed by Argentina. However, importers identified problems with Australian beef that should help USMEF members to reposition U.S. beef. Fifty percent of the respondents cited "lack of a standardized quality" as a shortcoming of Australian beef. Another 35% mentioned that Australian beef has less marbling and tends to be less tender. U.S. companies should take this feedback into account as they are developing strategies for positioning their products in the Russian market.

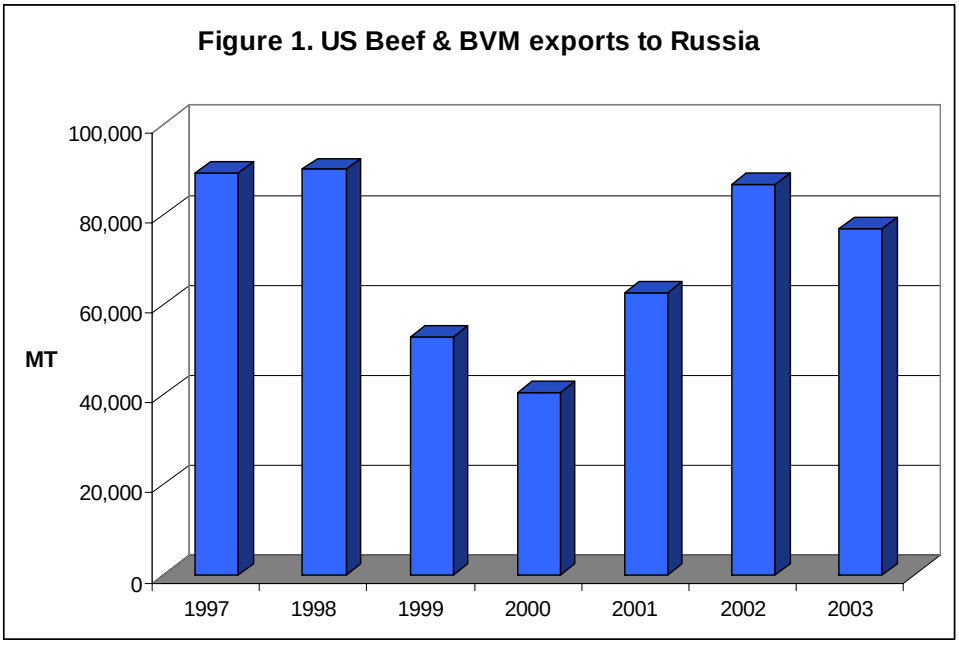
- In the medium-term U.S. companies should find good opportunities for U.S. beef in the upper-end retail sector. Modern grocery retailing has shown a dramatic growth that is expected to continue. Twenty five percent of the interviewees believe that there will be opportunities for U.S. high quality beef in this sector. Specifically, two retail chains said that once U.S. product is available they will be willing to try it.

- In the retail sector Brazil and Ireland were cited as the number one suppliers followed by Australia, NZ and Argentina. Because of the prominent position of cheaper suppliers, U.S. companies will need to develop a quality differentiation strategy, while "enhancing the price competitiveness" of U.S. beef. Educating customers about the "very high tenderness" and "quality consistency" of U.S. beef could enhance the competitiveness of U.S. beef *vis a vis* Argentina and Brazil in the upper-end retail segment. Many interviewees mentioned tenderness and quality consistent problems with Brazil and Argentina.

- Finally, in order to "enhance the price competitiveness of U.S. beef", USMEF members should consider launching new value beef cuts. This will make U.S. beef much more price competitive *vis a vis* Argentina and Brazil. On average, the prices of some of these cuts are considerably below that of US *ribeyes* and *tenderloins*.

Background

In December 2003 after the first U.S. BSE case the Russian Federation banned U.S. beef exports. In 2003 the Russian beef market was the 5th largest market for the U.S. accounting for 5.41% of total U.S. beef exports. In that same year 76,922 MT of beef and BVM were exported to Russia valued at $46 million. Frozen livers accounted for 91% of total exports (71,000 MT). U.S. exports decreased following the currency crises in 1998, to later start an upward trend until 2003 (figure 1).



On the 19th of October 2007 the Russian Federation opened its market to de-boned, bone-in and beef byproducts from cattle under 30 months of age. The U.S. will now face a different and more competitive scenario relative to 2003. The ban on U.S. beef exports caused a dramatic change in the structure and dynamics of the Russian liver market with total liver imports dropping dramatically from approximately 80,000 MT per year down to an average of 36,622 MT for the 2004-2006 period. Australia, Brazil, Argentina and New Zealand captured U.S. liver share.

On the other hand, U.S. exports of chilled and frozen beef cuts accounted for less than 1 percent of total Russian imports. In 2003 chilled and frozen beef cut exports accounted for 1,142 MT and 2,283 MT, respectively. Although, the ban did not affect the overall market for beef cuts, the high-end HRI sector of Moscow and St Petersburg was affected since U.S. high quality beef had started to successfully make inroads into white-table cloth restaurants and five-star hotels in those two cities.

In this context, USMEF developed a project to better understand the new structure and dynamics of the market in order to assist U.S. companies and USMEF with the development of a successful re-entry and expansion strategy.

The information presented in this report was obtained from a combination of primary data gathered in Russia, secondary data obtained from Russian importers, the Global Trade Atlas

dataset, and Euromonitor. Quantitative data about preferences and perceptions were collected through a questionnaire-based survey in the metropolitan cities of Moscow and St. Petersburg. During January-February 2007 USMEF staff performed face-to-face interviews with nineteen Russian importers and three interviews with retail companies. The face-to-face interviews focused on the strategy and product quality of competitor countries relative to the U.S.

Market Situation and Diagnosis

The Liver Market

1. Suppliers

Until 2003 the U.S. accounted for more than 80 percent of the import market share of livers. Immediately after the ban other countries such as Australia, New Zealand, Argentina, Brazil and the EU expanded their exports to capture the U.S. share (table 1).

Table 1. Total Russian imports of frozen livers (2003-2007*)

	2003	**2004**	**2005**	**2006**	**2007***
World	82,551	29,248	34,706	45,932	32,036
U.S.	70,163	2,451	0	0	0
Australia	5,536	9,519	16,404	15,756	8,683
NZ	496	1,023	2,797	3,533	1,582
Brazil	123	3,031	4,250	2,156	5,354
Argentina	0	0	0	13,801	8,610
France	566	4,802	5,080	4,183	1,899
Italy	635	1,583	1,685	3,436	980
Denmark	1,576	3,411	514	1,034	508
Others	5,033	6,838	4,490	2,033	4,420

* January-June 2007

2. Quality Characteristics and Preferences

In order to assess the U.S. competitive position with respect to liver quality we asked Russian customers to rate U.S. quality relative to their current suppliers (table 2). Australian and New Zealand livers were rated as the best quality followed by Argentina, U.S. and Brazil. EU livers were ranked as the lowest quality.

Table 2. Liver Quality Ranking [1]

	Australia	New Zealand	U.S.	Argentina	Brazil	EU
Importer 1	1	1	1	2	2	3
Importer 2	1	1	1			2
Importer 3	1	1	1	1	1	
Importer 4	1.5	1	1			2
Importer 5	1		2		3	
Importer 6	1		2			
Importer 7	1	2	2			
Importer 8	2		1			
Importer 9			1	1	1	
Importer 10			1			2
Importer 11	1	1	2			3
Average Score	**1.17**	**1.17**	**1.36**	**1.33**	**1.75**	**2.40**

[1] Scale: 1 = Best quality; and 3 = Worst quality

The High Quality Beef Market

1. Suppliers

The main suppliers to the HRI and retail sectors differ. As of 2007, Australia was identified as the most important supplier of high quality beef to the HRI sector, followed by Argentina and New Zealand. On the other hand, only 12.5% of the importers identified Brazil, Uruguay and the EU as suppliers of high quality beef in the HRI sector. Interestingly, the ranking of the main suppliers of high quality beef to the retail sector was very different from that of the HRI sector (table 3). Brazil and Ireland ranked in first place, and Australia, New Zealand, Argentina and Russia ranked second.

Table 3. Ranking of suppliers of high quality beef in the HRI and retail sectors.

Country	HRI Rank	Retail Rank
Australia	1st	2nd
Argentina	2nd	2nd
New Zealand	3rd	2nd
Brazil	3rd	1st
Uruguay	3rd	-
EU	4th	1st (Ireland)
Russia	-	2nd

2. Quality Characteristics and Preferences

Customers' preferences towards high quality beef vary with the distribution channel. Although upper-end restaurant owners and chefs prefer more marbling (*Prime* over *Choice* over grass-fed), they generally purchase *Choice* because of a better value. On the contrary, retailers prefer grass-fed beef because of a good balance between price and quality.

Overall, both HRI and retail customers have a preference for white fat, red light muscle color, tenderness and to a lesser extent marbling. However, regardless of the distribution channel consumers are not very knowledgeable about the attributes of high quality beef. For instance, the overwhelming majority do not understand the relationship between marbling, flavor and tenderness.

Table 4 presents a comparison of U.S., Australian, Argentina and EU quality as it is perceived by the 7 largest importers of high quality beef in Moscow and St. Petersburg.

Table 4. High Quality Beef: Quality Ranking[1]

	U.S.	Australia	Argentina	EU
Importer 1	1	2	3	4
Importer 2	1	2	-	-
Importer 3	1	1	2	-
Importer 4	1	2	2	3
Importer 5	1	1	2	-
Importer 6	1	-	-	2
Importer 7	1	2	2	-
Average Score	**1**	**1.7**	**2.2**	**3**

[1] Scale: 1 = Best quality; and 4 = Worst quality

On average, U.S. beef quality was ranked the highest, followed by Australia, Argentina and Europe. Importers mentioned that Australian and Argentina specifications are usually less standard (15% weight variation) and quality is less consistent than the U.S. Some interviewees alluded to the fact that Australian beef (sometimes) and always Argentina beef have less marbling. This has created tenderness and flavor problems. However, it is important to highlight that some of the Russian companies (importers 3 and 5) believe that Australian quality is equivalent to U.S. quality. Some Australian companies have started with a differentiation strategy to position different qualities according to different marbling levels. For example, *Nippon Meat Packers Australian* is marketing Marbling Score (MB) 2-3 beef (Table 5).

Table 5. Comparison of USDA and Australian quality grade with respect to marbling scores

Australia	U.S.	
Marbling Score	**Marbling Score**	**USDA Grade**
MB 0-1	Practically Devoid to Traces	Standard
MB 2	Slight	Select
MB3	Small to Modest	Choice^{-} and Choice^{o}
MB4	Modest	Choice^{o}
MB5	Moderate to Slightly Abundant	Choice^{+} to Prime^{-}

Source: USMEF Japan

Also, in some situations Australian and Argentina quality were rated with the same score (importers 4 and 7). Among the HRI users EU beef was consistently cited as tougher.

We were unable to asses the U.S. competitive position for the retail sector because that sector has never featured U.S. beef. Interestingly, although EU quality was consistently rated as the worst by HRI customers, Irish grass-fed beef is perceived as high quality by the retail sector and better that Brazilian beef. Retailers highlighted that Irish beef offers them a good value (good quality at a competitive price). Moreover, Irish beef is being marketed with an attractive package and presentation.

Market Prospects and Opportunities

As we highlighted before the overall structure and dynamics of the Russian beef market changed after U.S. exports were banned. As a consequence, the U.S. will face a different competitive landscape relative to 2003 when it returns to the market. The ability of the U.S. to regain market share will depend on its competitive position *vis a vis* Australia, New Zealand, Brazil, Argentina and others.

The Liver Market

U.S. potential in the liver market will be driven by its competitive position relative to other liver suppliers and relative to other substitute products such as poultry.

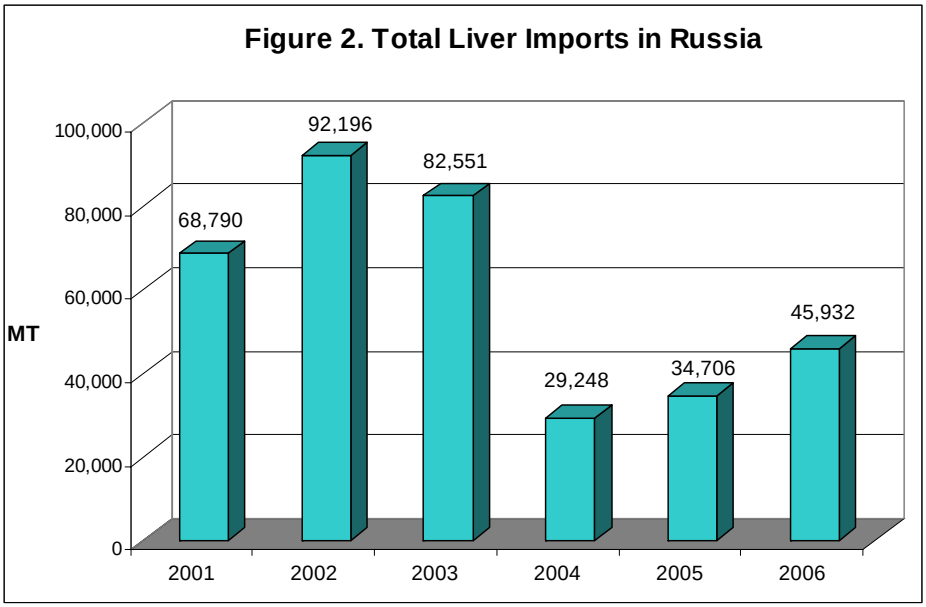
The competitive position with respect to other liver suppliers will be associated with a combination of the following four main factors: quality, retail certificate, shipping time and price. In this respect, the U.S. will offer a very competitive mix that we believe will result in a very rapid growth and recapturing of market share:

1. Quality: Although, we did not perform any statistical analysis to objectively measure the quality differences between country of origin, the qualitative information obtained from face-to-face interviews supports the fact that Australian, New Zealand, Argentina and U.S. quality are very similar, and better than Brazil and the EU. Moreover, the presentation and packaging of Australian, New Zealand, Argentina and U.S. livers is very similar (Individually Wrapped Package-IWP, clean and 1-3 pieces/box).

2. Retail certificate: One very important factor affecting importers' preference towards livers is the retail certificate. Importing and distributing livers from non-retail approved facilities is subject to very stringent regulations and cumbersome paperwork. Therefore, the majority of Russian importers are willing to pay a slightly higher price to source from retail-approved plants. In this respect, the U.S. has a competitive advantage relative to Argentina and EU packing plants since they do not have the retail certificate. All Australian and New Zealand packing plants are retail approved. Brazilian plants will most likely be approved for 2008.

3. Shipping time: Because of the nature of the world liver market (*spot maket* and low-margin business) shipping time is a very important factor affecting profitability. The big shipping time difference between Australia or New Zealand (60 to 75 days) and the U.S. (30 to 40 days) will give the U.S. a significant competitive advantage.

4. Prices: After the U.S. ban total Russian imports dropped dramatically. Annual average imports for the 2001-2003 period were 81,179 MT, while annual imports for the 2004-2006 period were barely 36,622 MT (figure 2). Between 2001 and 2006 the Organization for Economic Co-operation and Development (OECD), the Food and Agricultural Policy Research Institute (FAPRI) and the Food and Agriculture Organization of the United Nations (FAO) estimated an average drop in total beef domestic production of approximately 9.7 percent. Therefore, the decrease in total imports has also caused a decrease in the overall supply of livers.



This limited supply resulted in the fact that livers have been priced well above world market levels since December 2003 (table 6).

Table 6. Liver prices[1] (CIF, St. Petersburg) in Febraury-March 2007

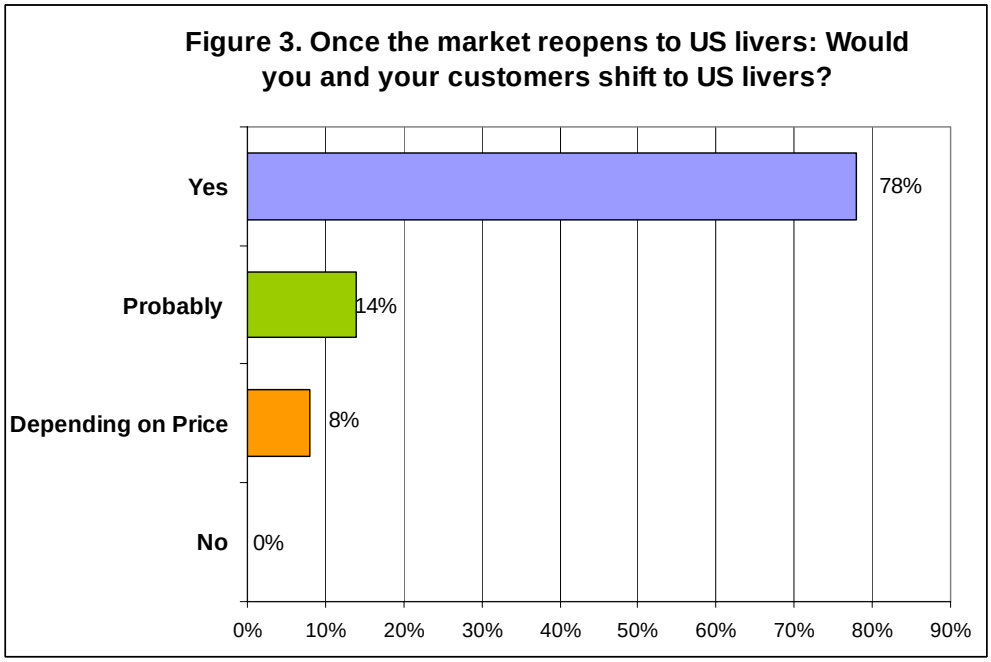
	Minimum	Average	Maximum
Australia/New Zealand[2]	$0.68 /lb	$0.725 /lb	$0.77 /lb
Argentina[2]	$0.68 /lb	$0.70 /lb	$0.72 /lb
Brazil[2]	$0.66 /lb	$0.69 /lb	$0.72 /lb
United States[3]	$0.38 /lb	$0.44 /lb	$0.50 /lb

[1] Prices correspond to cleaned IWP livers packed in 1-3 units per box.
[2] The prices for Australian, New Zealand, Argentina and Brazilian livers were provided by Russian importers in St. Petersburg.
[3] U.S. prices were estimated based on current FOB prices plus ground and ocean freight.

The price competitive position of U.S. livers relative to other suppliers will not be driven by different tariff treatments. There are no quotas for livers and all countries face a 15 percent duty. Developing countries such as Argentina, Brazil and Paraguay have a preferential access treatment that reduces the actual duty to 11.25 percent. However, as we observe

from table 6 such difference should not be enough to offset the U.S. price advantage. On average U.S. prices are 64 percent, 59 percent and 56 percent lower than prices for Australian/New Zealand, Argentina and Brazilian livers, respectively.

Finally, we asked Russian importers and retailers the following question: "Once the market reopens to U.S. livers: Would you and your customers shift to U.S. livers?" While 78 percent said "yes", 14 percent responded "probably" and 8 percent said "depending on the prices". None of the interviewees answered "no", (figure 3).



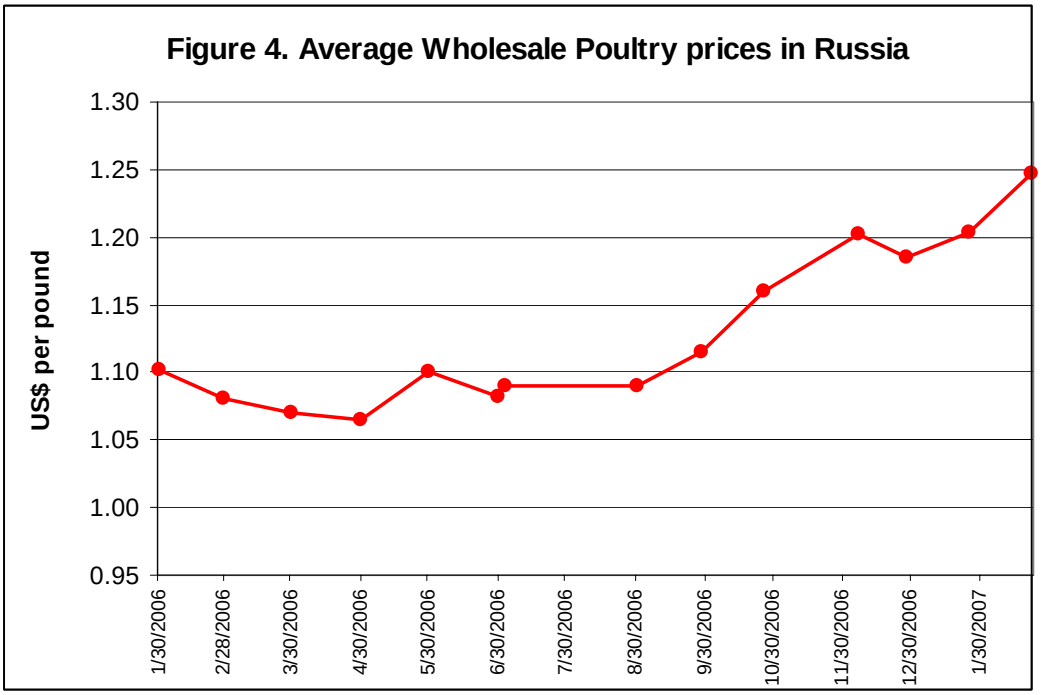
The analysis of the four aforementioned factors together with our survey strongly suggest that U.S. companies will rapidly capture a significant share of the current 45,000-50,000 MT import market.

However, another question arises: Will liver imports expand to reach 2003 levels (85,000 MT)? The uncertainty may arise from the fact that during the last four years Russians seemed to have substituted poultry for beef livers in their diets. Per capita poultry consumption increased from 15 kg per capita/year (2003) to 20 kg per capita/year (2006). Meanwhile, domestic poultry production has increased by 50 percent since 2003 (from 1 million MT in 2003 up to 1.38 million MT in 2006).

Since lower poultry prices fueled this substitution, the market size for livers could reach 2003 levels provided that U.S. liver prices become competitive. Figure 4 shows wholesale poultry prices in Russia[2]. Since January 2006 wholesale prices averaged US$ 1.13 per pound[3]. Using as a base estimate the U.S. liver prices presented in table 6 and assuming a wholesale

[2] Poultry prices were estimated by the combined average of domestic and imported frozen carcasses, frozen boneless breast and frozen leg quarters.
[3] Source: USDA-FAS GAIN Report: Russian Federation Livestock and Products, Poultry and Meat Prices, 2007.

mark-up of 15-20 percent[4], U.S. wholesale liver prices could be priced at a range of US$ 0.45 to US$ 0.60 per pound. Therefore, this information supports the view that U.S. re-entry will expand the overall market size.



The High Quality Beef Market

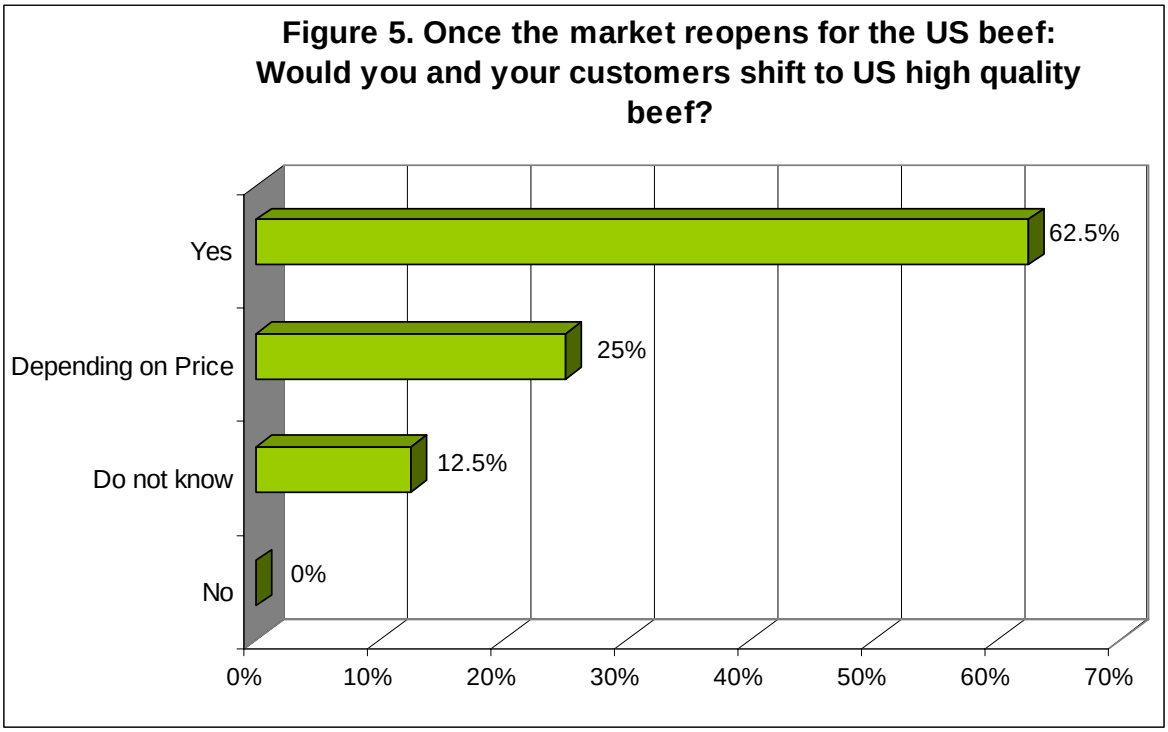
The competitive landscape for high quality beef will be more complex than the one outlined for the liver market. In this respect, a successful expansion strategy should differentiate between short-term and medium/long-term opportunities.

Short-term opportunities

U.S. companies re-entering the Russian high quality beef market will face the following scenario:

1. A high-end HRI sector mainly featuring Australian grain-fed beef,
2. A lack of knowledge and little exposure to high quality beef among the vast majority of the consumer population,
3. A positive experience with U.S. high quality beef which used to be popular among restaurant owners and chefs catering to the high-end socio-economic classes of Russia and tourists,
4. A sizeable proportion of the Russian importers willing to start featuring U.S. high quality beef. Although U.S. beef has been out of the market for more than 3 years, the majority of the importers supplying the upper-end HRI sector believe that their customers will slowly[5] shift to U.S. beef (figure 5).

[4] Source: Russian importers
[5] Between 3-12 months depending on the customer.

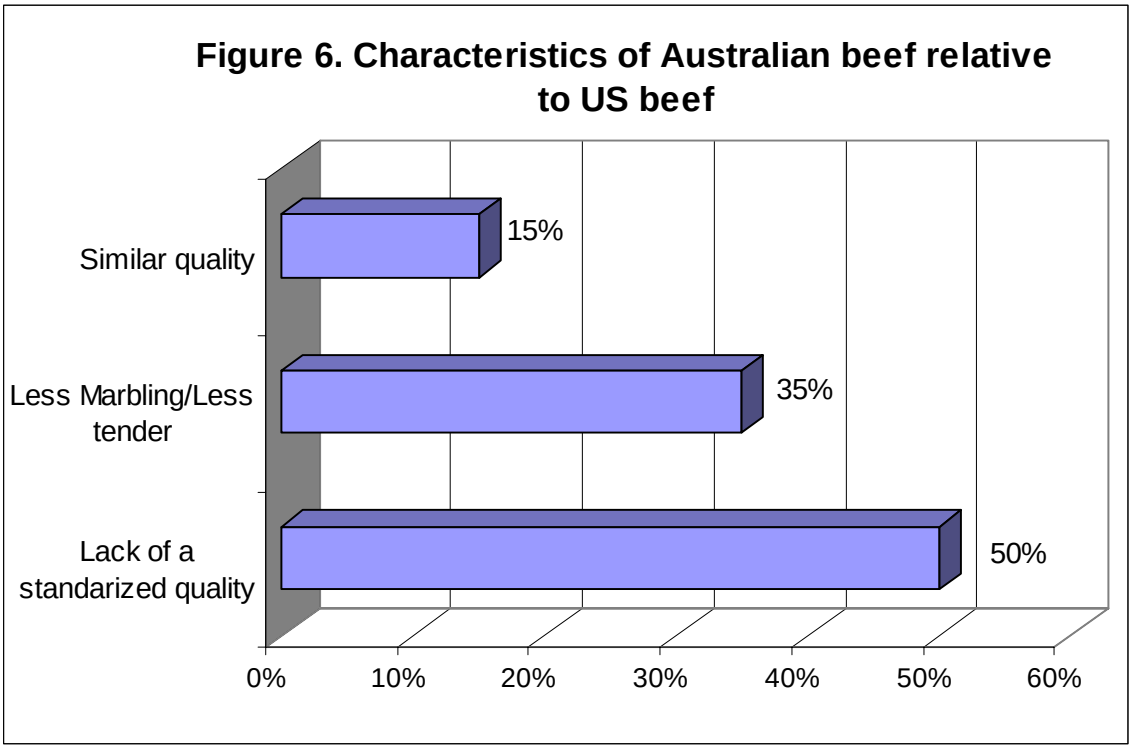


Although, a large proportion of the customers would shift to U.S. beef, many of the interviewees strongly believe that promotional efforts will be required to stimulate buying as U.S. beef re-enters the market. Moreover, there is a new generation of chefs that has never been exposed to U.S. beef.

In this context and in order to capitalize on the current situation U.S. companies should consider the following short-term move-to-the-market strategy:

- Target market size: 85 to 100 MT per month (1,020-1,200 MT per year).
- Target Consumer segment: Upper-end consumers (ABC1)
- Target Geographic region: Moscow, St. Petersburg and the Far East,
- Target Distribution channel: white-table cloth restaurants and five-star hotels.

Although Argentina and other countries are also supplying the upper-end HRI sector of Russia, Australia has mainly taken U.S. market share. Former U.S. customers got used to high marbling, very tender and grain-fed beef flavor. As a consequence, Australia naturally took U.S. share. However, importers and downstream customers have identified some problems with Australian beef that should help U.S. companies to reposition U.S. beef (figure 6). Fifty percent of the respondents cited “lack of a standardized quality” as a shortcoming of Australian beef. The “lack of a standardized quality” was associated with quality consistency and specification problems. Another 35 percent mentioned that Australian beef has less marbling and tends to be less tender than U.S. beef. Only 15 percent said that Australian quality is similar to U.S. quality.



Finally, we understand that U.S. beef prices should be competitive relative to Australia. Table 7 presents a comparative analysis of average U.S. and Australian CIF prices for the period between November 2006 and May 2007. The U.S. competitive position varies slightly with each cut. U.S. *Choice* bone-in ribeye is comparable to an Australian MB 0-1 bone-in ribeye, and 18 percent cheaper than an Australian MB 2-3 bone-in ribeye. For the case of a boneless ribeye, U.S. price advantage is even more significant with prices being 10 percent and 22 percent cheaper than Australian MB 0-1 and MB 2-3 products, respectively. Finally, while the price of U.S. and Australian MB 2-3 tenderloins are comparable, Australian MB 0-1 tenderloins are approximately 35 percent cheaper.

Table 7: Comparative Price Analysis of U.S. and Australian middle meats (average November 2006-March 2007)*

Cut Name	Country and Quality Grade	Price (CIF /lb)	Relative Value
Ribeye bone in lip-on (109E**)	Australian, MB 0-1***	5.27	100%
	Australian, MB 2-3****	6.09	115%
	U.S., Choice	5.15	97%
Ribeye boneless, lip-on (112A**)	Australia, MB 0-1	6.48	100%
	Australia, MB 2-3	7.27	112%
	U.S., Choice	5.87	90%
Tenderloin (189A**)	Australia, MB 0-1	7.73	100%
	Australia, MB 2-3	10.43	134%
	U.S., Choice	10.55	136%

*- Source: USMEF estimates based on AMS-USDA Market News Report and Russian Importers
** NAMP Classification
*** MB0-1 corresponds to USDA marbling level "Practically Devoid to Traces" (Standard grade)
**** MB2-3 corresponds to USDA marbling level "Slight to Modest" (Select, Choice^{-} and Choice^{0})

Medium and Long-term Opportunities

Accurately assessing the medium and long term scenario and opportunities for U.S. companies is certainly a more difficult task.

On the supply side, we identified a few major trends. First, the EU has lost its prominent position as the main beef supplier to Russia. While in 2004 the EU accounted for 33.9 percent of the import market share, that figured dropped down to 14.1 percent in 2006. The decrease in subsidies has created an unavoidable decrease in EU beef production. While between 1990-2004 production dropped by 18%, FAO still predict another 6% drop for the 2005-2015 period. As consequence, in July 2006 the EU agreed to give 67 percent (233,000 MT) of its 2006 Russian beef import quota to other countries.

On the other hand, we also observe a dramatic expansion of Brazil, Argentina, Paraguay and Uruguay to become main players in the Russian market (table 8). Table 8 also highlights that Australia has grown from an annual average of 1,803 MT for the 2002-2005 period up to 11,097 MT in 2006. However, it is important to note that the market is clearly segmented between low quality beef, mainly from Brazil and Argentina and to a much smaller degree the EU, and higher quality beef from Australia, Argentina, Ireland and the U.S.

Table 8. Annual Russian beef imports* (Metric Tones)

	2002	2003	2004	2005	2006	Volume change 2006 vs. 2002
Mercosur	**42,082**	**121,218**	**251,468**	**546,639**	**565,455**	**+523,373**
Brazil	27,087	90,528	147,425	300,416	259,816	+232,728
Argentina	1	22,023	84,054	191,040	151,586	+151,585
Paraguay	3,790	1,768	19,551	51,801	86,249	+82,459
Uruguay	11,203	6,900	439	3,383	67,805	+56,602
Oceania	**3,804**	**1,634**	**795**	**1,088**	**11,591**	**+7,787**
Australia	3,802	1,590	758	1,061	11,097	+7,295
NZ	2	44	37	27	494	+492
EU	**256,833**	**182,099**	**139,246**	**73,051**	**65,560**	**-191,273**
Germany	108,215	54,868	46,111	29,869	30,483	-77,732
Ireland	61,943	58,324	36,799	21,095	23,388	-38,555
Italy	23,179	21,480	21,855	7,448	5,997	-17,182
Spain	32,113	42,516	32,147	10,888	5,691	-26,421
Poland	31,383	4,911	2,335	3,751	1	-31,383
Ukraine	**129,960**	**146,258**	**79,634**	**56,683**	**2,303**	**-127,657**

* Beef muscle cuts (HS 0201 and 0202). Beef variety meats are not included.

In this context and in order to capitalize on the medium and long-term scenario U.S. companies should consider the following move-to-the-market strategy:

1) Target Consumer segment: Upper-end consumers (ABC1)
2) Target Geographic region: Moscow, St. Petersburg, and the *Regions*[6]

[6] The term *Regions* usually refers to the territory of Russia excluding the two largest metropolitan areas of Moscow and St. Petersburg

3) Target Distribution channel: upper-end foodservice and retail sectors.

1) Target Consumer segment: Because of the significant price advantage offered by Argentina and Brazil, U.S. will necessarily have to focus on the upper-end consumer segment that we expect will continue to grow. Since the 1998-economic crisis purchasing power (measured by the *gross national income per capita at purchasing power parity*) has grown by 58%[7] (from $6,500 up to $10,250).

2) Target Geographic region: As was the case until 2003 U.S. companies should continue to target Moscow and St. Petersburg. However, they should also consider expanding into the Regions, where a growing disposable income is expanding the target consumer base well beyond the population of the metropolitan areas of Moscow and Saint Petersburg. For example, as we observe from table 9 there are 14 cities in the Regions with more than 800,000 people. The total population in those 14 cities more than doubles the combined populations of Moscow and St. Petersburg. Moreover, the mining industry (oil, diamond and gold) is expanding in such areas as Siberia. As a consequence average per capita purchasing power of many cities in that area (Ekaterinburg, Novosibirsk, Vladivostok, etc.) has increased well above that of Moscow and St. Petersburg.

Table 9. Cities in Russia and number of Modern Format Shopping Centers (2005)

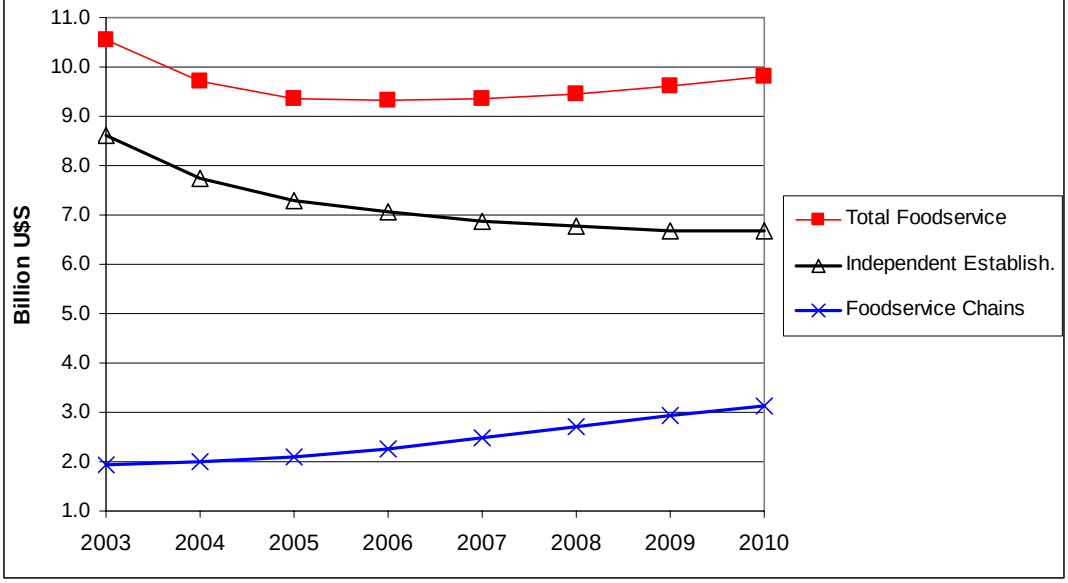
City	Population	Shopping Centers
Moscow & St. Petersburg	**15,007,578**	**90**
Moscow	10,406,578	65
Saint-Petersburg	4,601,000	25
***Regions*: Top-14 Cities**	**15,239,154**	**67**
Novosibirsk	1,405,569	6
Ekaterinburg	1,304,251	18
Nizhny Novgorod	1,297,550	6
Samara	1,151,681	6
Omsk	1,142,773	1
Kazan	1,110,022	3
Chelyabinsk	1,095,053	9
Rostov-na-Donu	1,057,958	-
Ufa	1,036,026	1
Volgograd	1,032,938	7
Perm	989,499	4
Krasnoyarsk	917,195	3
Saratov	857,961	3
Voronezh	848,751	-

3) Target Distribution channel: While total foodservice sales have shown a slight decrease in the last four years, we observed a dramatic shift from independent foodservice establishments to foodservice chains. Sales through independent establishments dropped by 18 percent and foodservice chain sales increased by 17 percent during the 2003-2006 period[8]. This trend is expected to continue and intensify. Foodservice chains sales are

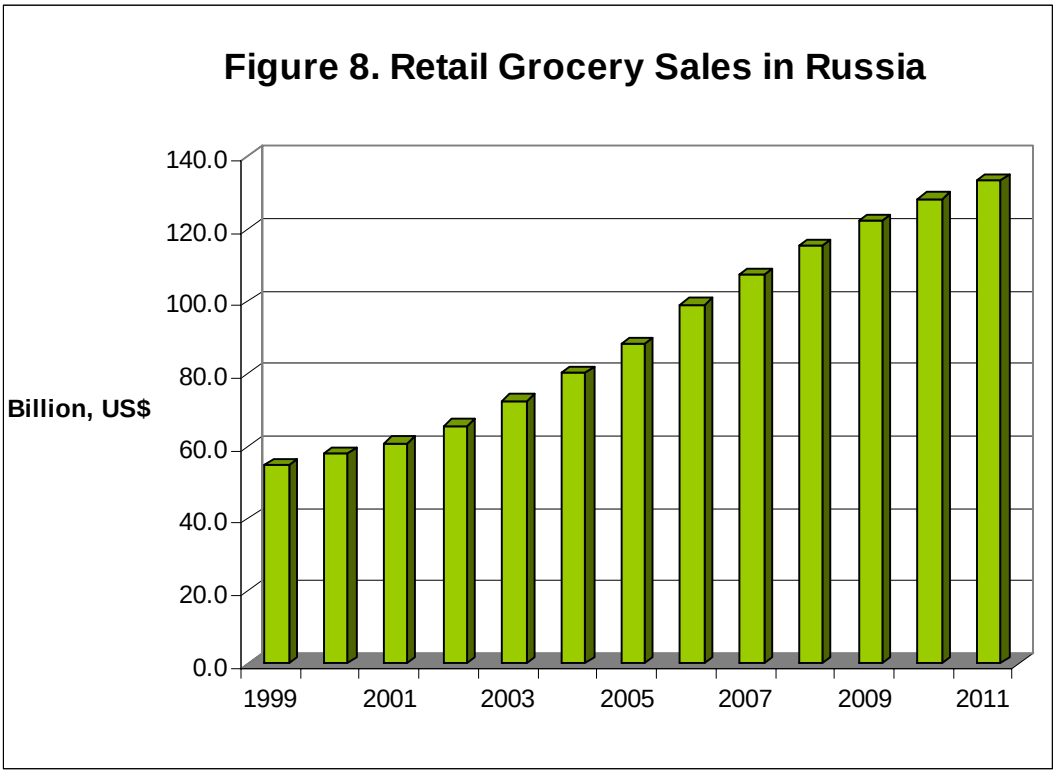
[7] Source: *The World Bank*, World Development Indicators Database.
[8] Source: *Euromonitor* International, 2007

expected to grow by 39 percent between 2006 and 2010 (figure 7). Moreover, North American-type chains sales are expected to grow by more than 10 percent.

Figure 7. Foodservice Sales in the Russian Federation



As highlighted in figure 8 grocery retailing has also shown a very dramatic growth that is expected to continue. Annual retail grocery sales increased from US$ 54.88 billion in 1999 up to almost US$ 100 billion in 2006. For the 2006-2011 period *Euromonitor* forecast another 34 percent increase to reach US$ 133 billion in annual sales in 2011.



Twenty five percent of the Russian importers that were interviewed believe that there will be opportunities for U.S. high quality beef in the modern retail sector. Moreover, specifically two retail chains (*Okey* and *Azbuka Vkusa*) said that once U.S. product is available they will be willing to try it. In this respect we understand that U.S. companies should approach the upper-end retail segment where we identified at least five up-scale retail chains as potential targets (table 10).

Table 10. Upper-end retail chains.

Retail Chain	Number of stores*	Location
Metro	24	Moscow, St. Petersburg, Yaroslavl, Kazan, Rostov-on-Don, Volgograd, Samara, Krasnodar, Nizhniy Novgorod, Ekaterinburg, Voronezh, Lipetsk, Ryazan, Tula, Tyumen and Ufa.
Azbuka Vkusa	24	Moscow and St. Petersburg,
Stockmann	5	Moscow and St. Petersburg,
Globus Gourmet	12	Moscow and St. Petersburg
Okey	26	St. Petersburg and the *Regions*

* Current and projected for 2007

Target Competitors: We understand that the competitive position of U.S. high quality beef relative to other suppliers will not be driven by the different tariff treatments. Although quotas as well as in-quota and out-of-quota duties do exist for frozen and chilled beef, high quality beef trades under a "tariff-only system". Under the *Decrees number 732* and *729 of the Russian Federation Government,* dated December 5, 2005, High Quality Beef is defined as "beef that cost over €3000/MT". This definition applies to beef imports from Oceania, South

America and the EU, among others. However, under the *Agreement between the Government of the United States and the Government of the Russian Federation on Trade in Certain Types of Poultry, Beef and Pork", June 15th, 2005* the following definition will apply to U.S. high quality beef: "Carcasses or any cuts obtained from bovine animals of less than 30 months of age which have been fed for at least 100 days on nutritionally balanced, high-energy-content rations containing not less than 70 per cent grain and comprising at least 20 pounds (9.07 kilograms) total feed per day. Beef graded "choice" or "prime" according to the United States Department of Agriculture (USDA) standards automatically meets this definition". Therefore, although, there are two different definitions for high quality beef, we believe that regardless of the Country of Origin almost all of the high quality beef will pay the same duty of 15 percent of custom value but no less than €0.15 per kilo. As is the case for livers, developing countries such as Argentina and Brazil have a preferential access treatment that reduces the duty to 11.25 percent.

In the upper-end HRI sector we continue to foresee Australia as the main competitor. On the other hand, according to table 3, the main suppliers of high quality beef to the retail sector are first Ireland and Brazil, and in second place Argentina, Australia and New Zealand. We believe that current market forces will change the competitive landscape in the next 2-5 years. According to FAO and the *Irish Food Board*, the Irish cattle herd and production have remained relatively stable for the last 10 years. However, because of an overall shortage in beef supplies in the EU, Ireland is diverting exports into that more lucrative market and away from Russia. Since 2002 Irish exports to the EU have increased by 21 percent and exports to Russia have dropped by 62 percent. If this trend continues we foresee Ireland giving up market share and as a consequence Argentina, Brazil and Australia becoming the main competitors in the high quality retail market.

Australia as a player in the retail sector could loose competitiveness because of the fact that demand for chilled beef is expanding rapidly. This has been driven by consumers preferring chilled beef because it is believed to be fresher. Industry players agreed with the fact that upper-end consumers are the ones favoring chilled beef. The extended shipping time (60 to 75 days) would place Australia and New Zealand at a disadvantage relative to the U.S., Brazil and Argentina (30 to 40 days).

The single most important competitive disadvantage of U.S. beef relative to Argentina and Brazil is and will continue to be price. In this context, U.S. companies will need to develop a quality differentiation strategy, while "enhancing the price competitiveness" of U.S. beef. In order to achieve this objective two main strategies could be devised. First, educate customers and consumers about the "very high tenderness" and "quality consistency" of U.S. beef. Many interviewees mentioned both tenderness and quality consistent problems with Brazil and Argentina. "We are now trying Brazilian tenderloins but so far we have found some quality problems", stated one of the importers.

Second, in order to "enhance the price competitiveness of U.S. beef", USMEF members should strongly consider launching new value beef cuts. This will make U.S. beef much more price competitive *vis a vis* Argentina and Brazil. The fact that the prices for some of these cuts are very competitive should open up opportunities for USMEF members[9]. (see table 11).

[9] A marketing and educational strategy aiming to position these two cuts was successfully developed in Guatemala, where US beef faced a comparable competitive scenario to the one in Russia. In

Table 11. Weekly USDA Choice prices per pound*

	5.23.07	4.23.07	3.26.07	2.29.06	1.24.06	12.27.06	Average
Ribeye	6.44	5.12	4.84	5.43	6.67	6.31	5.80
Tenderloin	9.38	8.99	9.69	12.77	11.48	10.61	10.49
Flat iron	2.40	2.18	2.37	2.39	2.36	2.50	2.37
Petit tender	2.64	2.34	2.31	2.40	2.40	2.68	2.46

* Source: USDA-AMS Market News Report.

Final Comments

The U.S. will continue to be a major player in the Russian liver market. However, the pace of U.S. export growth will be closely associated with the "Egypt factor" (relative purchasing power of Russian and Egyptian consumers) and the competitive price position of livers vis a vis poultry.

A growing economy in a country of 140-million people with growing modern retail and foodservice sectors will certainly open many opportunities. In both the short and long term we foresee the U.S. supplying almost exclusively high quality beef in both the HRI and retail upper-end segments with Australia, Argentina, Brazil and to a lesser extent Ireland as our main competitors.

We expect that the processing sector as well as the HRI and retail sectors targeting the medium and low socioeconomic classes will continue to source from Russia, Mercosur countries and to a lesser extent the EU.

Finally, we understand that more research is needed in order to better refine the medium and long term strategy for the upper-end retail sector as well as to assess the extent and dimension of the opportunities in the Regions.

Central America US middle meats are at least 100 percent more expensive than any domestic or regional products.