Key Investment Considerations for Ukrainian Agricultural Companies

Our review is addressed, principally, to Ukrainian agricultural companies that wish to attract foreign investment. However, it may also be relevant for foreign investors with interest in the Ukrainian agricultural sector.

1. Agribusiness as an area for investment

One of the most valuable natural resources of Ukraine is its very fertile 'black soil' which covers almost 44% of the country’s territory. Combined with a comparatively mild climate, this creates nearly ideal natural conditions for arable farming, as well as dairy and poultry farming. In fact, Ukraine is the world’s largest producer and exporter of sunflower oil, third largest in maize, fifth largest in barley and rapeseed and ninth in wheat. However, Ukrainian farmers experience certain difficulties, including a lack of financing. Accordingly, many producers are trying to attract investors who would bring with them not only financing, but also new technologies, experience and market opportunities.

Investors, of course, are looking for real value and need to fully understand the risks before investing.

2. Due diligence review

An investor will almost inevitably undertake a due diligence to assess the investment and potential risks.

For companies operating in the agribusiness sector, some of the most common (and most problematic) legal issues relate to:

- prior acquisitions made by the group;
- lease agreements entered into by the group;
- regulatory compliance by the group; and
- overly complex corporate group structures.

3. Risks related to prior acquisitions

Many agricultural companies have grown by conducting a series of acquisitions of their smaller competitors; quite often only undertaking a limited due diligence of the companies at the time of the acquisition.

Investors will be looking to make sure that there are no historical issues which may have an impact on any of these acquisitions. To get this comfort they will be checking even basic things like:

- whether the charter capital was fully paid up;
- whether waivers of pre-emption rights were obtained from all owners; and
- whether spousal consents were obtained.

As failure to do or obtain any of these basic and very simple things could lead to invalidation of a prior acquisition, they are a source of concern to potential investors.

Investors will want to see the evidence that these things were done or obtained. Therefore, it is very important for an agricultural company to have the documents confirming this. Where the company does not have the documents, or something like the above was not done or obtained, then sorting this out before talking to investors will mean that the process for the sale will go more smoothly and the investor’s confidence in the company and the way it runs its business will not be tarnished.

4. Risks related to lease agreements

Obviously, the main asset of an agricultural company is the land which is leased and operated by it. Given the moratorium on the sale of agricultural land, most agricultural land is still owned by private individuals and agricultural companies are required to enter into hundreds, if not thousands, of lease agreements with such individuals. In view of this, it is often cost prohibitive for an investor to go through and conduct due diligence on all of the lease agreements.

If a company has used a single (or a limited number of) template lease agreement(s) as the basis for all its leases, then this will make the due diligence process much simpler, enable an investor to undertake a more comprehensive due diligence, and thereby give the investor greater confidence in the company.

If, due to acquisitions and timing, the company has not been
able to achieve this, then an investor will most likely adopt a due diligence approach that involves reviewing all leases over land of a certain size and then conducting random sampling of the other leases. At the same time, random sampling could result in due diligence being undertaken of any lease, so the company needs to make sure that:

- lease agreements contain all the necessary essential terms and otherwise comply with Ukrainian law; and
- the lease rights are registered with the title register.

If any of these requirements are not met, this can lead to invalidation of a lease agreement and should be remedied before the investor starts its due diligence.

5. Regulatory risks

Investors will also be concerned to check that the group has complied with all regulatory requirements in Ukraine. As mentioned above, as many agricultural companies have grown through a series of acquisitions one of the most common regulatory requirements checked is compliance with Ukrainian competition law.

If a company failed to obtain prior approval of the Antimonopoly Committee of Ukraine (AMC), when it was required, then a fine in the amount of up to 5% of the total group turnover may be imposed. However, in practice such fines have been considerably less. In addition, there is a potential risk that a Ukrainian court may invalidate a transaction if prior AMC approval was required but not obtained.

Therefore, vendors should check if all the necessary clearances were obtained during the previous acquisitions and if all the members of the vendor’s group, including beneficial owners, were disclosed to the AMC. If not, then advice should be obtained about how such risks could be minimised.

6. Overly complex group structures

As noted above, many agricultural groups grow through the acquisition of small companies. As a result of this as well as tax driven issues, group structures involving 50 and even more companies are not uncommon.

In addition to the cost involved in undertaking due diligence of such a large number of companies, investors looking at a business like that will be concerned about the considerable financial and time expense required for the management of so many companies.

One of the ways to deal with this is to merge the companies together. Obviously there are legal, logistical and cost implications of doing this, such as having to re-register the land lease rights and so this will not always be feasible for every company.

If it is not possible, then undertaking simple things, like making the constitutive documents of the companies the same and having a limited number of people as directors and chief accountants, can help to make what is a very large grouping appear more cohesive.