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The Minovalov system: how to make a profit where others lose money

Banker and landowner Kirill Minovalov learned to watch over each harvester, tractor operator and agronomist via the internet. The result was 1.5 billion rubles of annual profit.

August, Orel region. In the midst of harvesting, grain harvesters slowly and methodically cruise around one of the Avangard-Agro fields. One of the harvesters suddenly stops: a bush amidst the ears of wheat blocks the way.

"What's wrong?" immediately comes the question on the combine's cell phone.

"There's a bush in the way."

"We have no bush on the map, so go ahead and do your job!" an exasperated voice commands on the phone.

The incident happened a couple of years ago, but Orel peasants still tell this anecdote, because the episode very precisely illustrates the methods of an eccentric Moscow banker who decided to take up farming.

The scale of Avangard Bank owner Kirill Minovalov's agricultural business (№166 on the Forbes list, \$600 million) is impressive: 300,000 hectares of land, about 4.5 billion rubles in revenue and 1.5 billion rubles net profit in 2012. Net profit in agribusiness is already twice that of the banking business, so now Minovalov might just as well be called a farmer. His venture in agriculture started by accident, continued "for spite," but he himself credits a large part of this success to a computer program developed under his direction. The program does not control the growth of wheat or barley but gives Minovalov the ability to control and personally monitor all company processes. "I don't want to my business to depend on something I don't know as head of the farm," he explained in an interview with Forbes.

Since 2008, financial and economic issues have haunted Russia's largest agricultural holdings. But despite all this, Avangard-Agro is doing great. However, not everything can be controlled, and Minovalov has already faced problems with no solutions.

Student Consultant

In fact, Kirill Minovalov had no intention of getting involved in agribusiness or even becoming a banker. In 1991, at the chiding of his girlfriend, he created his first business, a consulting company called Alcor. He was then a 20-year-old student at the Moscow Institute of Railway Engineers. "She got a position in MosnarBank for \$300 a month, and said that nobody would ever take me for even \$100," Minovalov told me in an interview. Initially, Alcor dealt with the registration and sale of turnkey companies, eventually expanding its activities a bit later. Minovalov proudly declared during the same interview that, "By age 23, I had already become an advisor for people - multimillionaires twice my age." And between 1993 and 1994, he helped Russian businessmen to open about 1,500 Swiss bank accounts. Minovalov calls it "international business schemes," but perhaps it is just a fancy name for plans to withdraw capital abroad. In 1994, he spent \$400,000 to create Avangard Bank, \$300,000 of which Minovalov says he borrowed from a business friend.

In the mid-1990s, Avangard was a small financial institution trying to make money in a variety of ways. However, the banker succeeded in paying off all debts within a year and a half. Avangard didn't even have a currency license until 1996: it cost about \$1 million and was initially too expensive. On January 1, 1995, the bank had only 102,000 rubles of assets (all figures prior to 1998 are given with regard to the denomination of the ruble), but after obtaining a currency license, total assets rocketed up to 120 million rubles by the end of 1996. At best, this put Avangard on the list of the 150 largest commercial banks in terms of assets.

On the eve of the financial crisis in July 1998, the bank's assets were estimated at 213 million rubles (at this point, Avangard was not even among the 200 largest Russian banks). "During the crisis, the bank appeared to be in a state of retraction, but it quickly bounced back with an influx of new customers-legal entities switching from the affected banks," says Minovalov. Thus, by January 1, 1999, total assets reached 1 billion rubles according to Central Bank data. Moreover, by July 1, 1999, they increased to 1.44 billion rubles, which made Avangard the 62nd largest bank in terms of assets. The bank statements show that assets increased due to the transfer of customer funds, including entities that deposited money and set up bank accounts. Who helped Avangard and why?

The owner of Avangard

In 1999, Avangard began a strong expansion within the Krasnoyarsk region. In June, the Bank started to handle the financial accounts for Krastsvetmet, a state enterprise which processed raw material from Norilsk Nickel into platinum, palladium and other precious metals. Krastsvetmet had been with Lanta-Bank, where Vladimir Gulidov, who had run Krastsvetmet for many years, was Chairman of the Board. But Gulidov died in a car accident in the spring of 1999. The regional administration was concerned with the subsequent fate of the plant, and so the Krastsvetmet accounts were almost immediately transferred to Avangard. Vice-Governor Svyatoslav Petrushko became the Chairman of the Board after Gulidov's death. He also developed a plan for Avangard to participate in the Krasnoyarsk Coal Company privatization, according to a source familiar with the details of this deal.

In January 2000, about 75.6% of Krasugol were offered for sale in an auction. Former Fuel and Energy Minister Sergei Generalov bought 41% of available shares, Filaret Galchev purchased about 34%, and Minovalov's company acquired the remaining 25%. Governor Lebed asserted that the trade union must participate in the management of the company as a mandatory condition for privatizing Krasugol. Thus, Avangard acted as the buyer of "economic interest." Representatives of the trade union were nominated to the Board of Directors on behalf of this shareholder. Therefore, the scheme worked - no problems arose with the union. However, the relationship between Avangard and Governor Lebed's administration did not shape up well. By 2000, Avangard had lost the Krastsvetmet accounts - the plant was transferred under Norilsk Nickel management and in 2001, the Krasugol package was sold to SUEK after a long-term conflict within the company.

"I've always had a 99% stake in the bank," says Minovalov. Other shareholders - including Rosshina, AMO ZIL, and the Magadan gold mining and processing companies - were nominally present in the authorized capital with no one holding even 1%. "During the 1990s, it didn't look good to have no-name bank shareholders, and I was also interested in having recognizable names for PR purposes," the banker explained. Only in January 2002, did Minovalov officially acknowledge that he was the owner of Avangard.

In the summer of 2004, new challenges arose for Avangard, which according to its management specialized in leasing operations. In May and June, the licenses of Sodbiznesbank and Credittrust were terminated due to money laundering accusations. The market had expected the "wave" to spread to other medium-sized banks. "At that time, investors picked up 40% of the bank's deposits and the Central Bank did not include the bank in the deposit insurance system, considering the high proportion of loans to affiliated entities makes it very risky," Minovalov told Forbes in 2008. Among these affiliates were malt houses,

i.e. plants for producing malt, germinated and dried raw material for beer production, which was then experiencing hard times. Nevertheless, Minovalov figured out how by helping each other, both troubled assets could get out of the crisis.

Promising malt

Avangard got its very first malt house accidentally: in the early 2000s, the bank issued credit for its construction to entrepreneur Vasily Tkachev. His company Amrus was one of the operators in the beer market - distributing beer and supplying glass containers to the factories. During the late 1990s, Tkachev bought a small malt house in the Tula region with a 7,000-ton capacity, so he came to Avangard with a \$35-million project to build a new modern 100,000-ton malt house. The bank provided the funding and, in 2002, the malt house was built. But, Avangard kept it. Minovalov alleges that Tkachev's company failed to comply with its commitments. According to Tkachev, the bank with its much greater financial and legal resources just took over a promising pet project.

Whatever the case, Minovalov immediately attempted to sell the malt house by making an offer to American Cargill and French Soufflet, which already owned malt houses in Russia. But these giants decided that there was nowhere for the banker to go with such an illiquid asset, so they offered very little money. Minovalov says that this kind of position by foreigners struck a deep chord: to spite them, he decided to develop the project on his own and began construction of two more malt houses in the Voronezh and Orel regions.

By 2004, Minovalov was operating two malt houses which became the basis of Russian Malt. But the brewers were in no hurry to buy his product, even at a discount prices. At a certain point the warehouses were full with € 21 million of finished product. But the banker found a way out: Avangard started offering credit to the largest beer distributors with a 14% interest rate and a two-week grace period. If the distributor could convince their suppliers to work with Russian Malt, the interest rate was cut to just under 3%. The plan succeeded. In 2006, four of the five major Russian beer producers were working with Russian Malt, SUN Inbev being the only exception, which used its own raw materials.

First barley, then money

Minovalov immediately faced a problem with raw materials for malt production: practically no malt barley was planted in Russia and the more expensive imports "ate up" almost the entire margin for the malt houses. The banker decided to convince the farmers: he started crediting the agricultural companies not in terms of cash, but barley. "For example, for 1 ton of seeds per year, our partners had to give us back 2.2 tons of crop, or 330 tons of barley per harvester. We worked with the coefficients on mutually beneficial terms - and no money," says Minovalov. Avangard bought seeds and fertilizers for farmers, and supplied them with imported equipment. From 2004 to 2005, the Bank transferred more than 100 machines to farms on lease which, for example, is comparable to the amount of state agricultural support provided to Rostov Region under the federal leasing program in 2004.

Partners easily settled with Avangard during good years when grain prices were low. But farmers would begin looking for a buyer on the side as soon as the price increased due to crop failure or market conditions. Vladimir Petrychenko, CEO of the ProZerno analytical center, explains that it's a common practice in the Russian grain market. For example, in a down year like 2010, manufacturers returned product prepayments to exporters the next day after the agreement had been signed. They said "we don't want to sell grain to you because we have a much better deal." But during good years, says Petrychenko, the buyers did exactly the same thing, low-balling prices and forcing producers to sell for a pittance.

If farmers were unwilling to pay, Avangard waged a war, using the courts to seize property and assets, mostly land. In 2005, Avangard acquired

tens of thousands of hectares in the Voronezh and Kursk regions and a small amount in the Orel region. What to do with the land? "The answer was completely obvious," says Minovalov.

"And it was to try to seed it on our own." So the company Avangard-Agro was formed: at that time he invested about 15 billion

rubles to develop it, including land and equipment costs. Malt houses were operated within the separate company Russian Malt. Minovalov affirms that both companies achieved operating profits after only the first year of operations.

A mathematical approach

Avangard-Agro in figures

Avangard-Agro
3800

fields in possession

85 ha
average field area

850
TRACTORS

390
HARVESTERS

980
CARS
including 520 lorries

≈3000
EMPLOYEES

SOURCE: AVANGARD-AGRO

"I do not run businesses that I don't understand and where I cannot control each point of its process," says Minovalov. The first year he just watched the new business, and then started counting. One grain of spring barley yields up to five stems with 20 grains on a stem. Mathematics promises the highest possible yield of barley in the amount of 120 hundredweights per hectare. So, why did the average yield within the country rank below 20 hundredweights?

Minovalov is confident in blaming the human factor. "The only true main rule in agribusiness is to follow technology. You cannot fertilize even two days later or apply chemical treatments once instead of the usual two times," he said. This happens de facto all the time. The reasons vary: farmers save, people steal in large agricultural holdings - the consequences equally affect the yields. Minovalov was definitely not the first to see the problem. But, as he says, he was the one to figure out how to minimize the influence of the human factor. For a month, he outlined all his ideas and formulas on a paper and gave it to two bank programmers. They designed a program to control the equipment. It took just a couple of weeks to install GPS-navigators on the first hundred tractors and harvesters and connect them via GPRS to a shared network.

It took people almost a year to get used to the new order. The very first day, machine operators at one enterprise in the Voronezh region broke the GPS-navigators, thus testing the resolve of the new owner. Minovalov told them that experts would come to fix the navigators, but until then the tractors would stay in the garage. Security was strictly charged with not allowing any machine out of the station with a broken device. "They made a big deal out of it," says the banker, "and began to appeal to conscience, warning there would be crop failures and losses." But Minovalov just shrugged his shoulders. "What can be done? Let there be losses, but rules must be rules."

At another farm, the machine operators went on strike, refusing to work with the GPS-control. Minovalov remained adamant, "A new team will come from a neighboring village tomorrow if you don't start working." The people eventually gave up - it was hard to find stable paid work there.

The "Minovalov system"

"During the sowing and harvesting season, I use the program up to 10 times a day and even in the evening at home," says Minovalov. His "system" captures every step of his employees in a real-time mode: sowing, fertilizing, harvesting, and machinery operations on site. Data is recorded, archived and stored. For example, the banker can see the sowing process on field № GL-7 in the Voronezh region while staying in his Moscow office. You just select "Field" from the menu, then the region and the area number - and that's it, you are ready to monitor. The archive keeps historical data on a field from the time it's connected to the system: How much

fertilizer was applied on April 7, 2008? What was the yield on August 5, 2009? How did the machine operator Ivanov follow the field on October 10, 2010? Minovalov is certainly not the only one watching the process: he has an army of inspectors.

Actually those "watchers" sitting at the monitors are mainly recruited students who follow the process online. One person from the region and one from Moscow supervise each enterprise with plots of less than 10,000 Ha, and there is one curator in the region and two in Moscow if the area is much larger. In total, there are 70 employees in Moscow and the same number within the regions. If, for example, the tractor operator enters the wrong field, his cell phone immediately rings and the screen displays "Moscow Office." The watcher must track down the problem and inquire into the reason, but its solution is the responsibility of other employees.

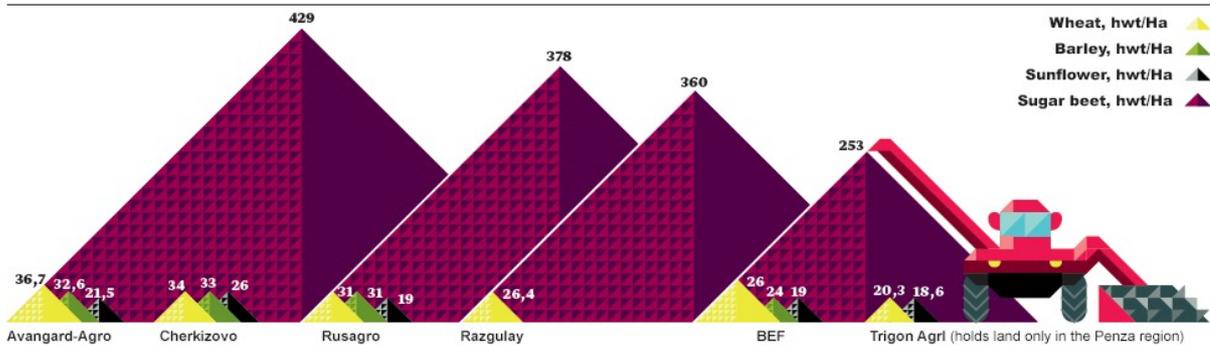
Dual control is activated on site: two people immediately arrive at the field in case of any emergency - the director of the company and an employee from a private security company. "We identify drinkers hands down," Minovalov rubs his hands. Offenders are immediately fired, but no shortages are observed. Vladimir Shimyakin, deputy head of the Avangard-Agro affiliate in Belgorod, says machine operators receive up to 50,000 rubles per month for gathering. It's fabulous money in a village where a salary of 10,000 rubles is considered superb.

The same program can be used to record the consumption of chemicals, fertilizers, machinery, spare parts and even gasoline. But the banker complains that even with such total control, where theft seems impossible, the phenomenon still exists and it's not always clear how they could do it. Three years ago, pests destroyed the crop at one of the farms a week after a chemical treatment was allegedly carried out. "We checked with the system: everything seemed OK. A storekeeper gave chemicals to an agronomist in the presence of security. The agronomist opened the package and filled a sprayer on the tractor. And the tractor went to the field and made the appropriate number of laps around the field. But we lost the harvest," says Minovalov. No one was caught in the act, but as a way to counter the phenomenon, everyone involved in this chain was fired to discourage others.

Without a doubt, electronic control has been implemented in the area most familiar to the bank - money turnover: all employees of the agricultural company, including those involved in seasonal work, are paid using Avangard bank cards. When the wages were paid in cash through the cashier, it often happened that employees did not receive their full earnings - management used to take part of the money as a "bonus."

Kolkhoz in outsourcing

Avangard bank owner Kirill Minovalov is confident that agribusiness is most effectively managed via the internet



Source: Company data, calculations Forbes

System efficiency

Avangard's experience is not a unique one. Alexei Ivanov, CEO of Agroko group and a former top manager of the Razgulay group, says that today every company has something like the system described. However, he had not seen the program himself, though the chief engineer of one of the Agroko units shared his impressions. Mr. Ivanov recognizes that all systems are configured individually and says that, "seeing is one thing, but using it is another."

According to Minovalov, Avangard-Agro yielded 1.5 billion rubles of net profit on revenue of 4.5 billion rubles in 2012. Unlike many competitors, Avangard-Agro has reported a profit for five consecutive years. The company does not publish its consolidated financial statements, but according to SPARK data, the company's total net profit off of 2.5 billion rubles in revenue from the Avangard-Agro affiliates in Belgorod, Voronezh, Kursk and Orel was 726.9 million rubles in 2011, compared with 1.6 billion rubles in revenue and 435.4 million rubles in net profit the prior year. While Black Earth Farming (a Swedish company that is a major Russian land owner and one of Avangard-Agro's main competitors) yielded \$ 7.2 million in net profit last year against revenue of \$ 229 million, the first profitable year in its seven-year history.

Minovalov's fields already have yields higher than those of his neighbors, though it is still a far cry from the 120 hundredweights per hectare figure derived mathematically. One of the regional government officials states that Avangard-Agro runs more than 100,000 hectares of land in the Orel region, and most of it is in the least fertile areas. But last year, the yield here exceeded thirty tons per hectare while neighboring fields collected no more than twenty.

The path of a landowner

Until 2009, Avangard-Agro had increased its land bank, preferring to own property rather than lease. The rental price at auction could be up to 2,000 rubles per hectare in season, so a purely mathematical approach was chosen to answer the question: what was more profitable - to rent for 2,000 rubles or to buy for 20,000 rubles? At the very beginning in 2005, the company owned only 25,000 ha. During its first four years, Avangard-Agro increased its land bank by more than five times up to 142,000 ha. It's a pretty average value compared with other major holdings: by this time Black Earth Farming held 300,000 hectares, and Razgulay owned 250,000 ha. Minovalov's competitors bought lands liberally. When the price reached 40,000 rubles per hectare in the central part of Russia in 2008, Minovalov decided to hold off on purchases, unwilling to pay so much.

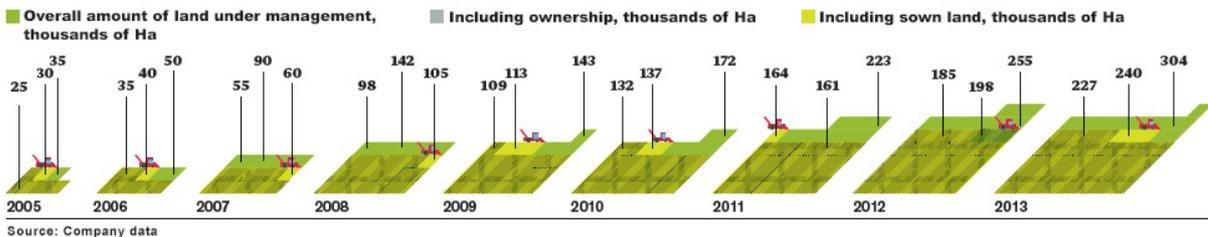
A year later, the market had completely changed. Agribusiness took a major hit in 2008: the financial crisis and overproduction were superimposed on each other. Traders were unwilling to buy grain at a price any greater than 1,500 rubles per ton compared with a direct cost of 2,200-3,000 rubles for a record crop of 108 million tons. Banks claimed credits, manufacturers could not sell their products, and many agricultural companies went bankrupt or changed owners.

Dmitry Rylko, CEO of the IKAR analytical center says that interest in land by both industrial and financial investors was significantly extinguished after the crisis. He adds that in the recent years, only Avangard-Agro has been actively buying in the market with its 300,000 hectares of land and the Miratorg agricultural holding company, the largest producer of pork (runs 316,000 ha). A Lipetsk regional administration official and a source in one of the agricultural companies told Forbes that Avangard-Agro is negotiating the purchase of land in the Lipetsk region with the distressed company Nastyusha (Igor Pinkevich, co-owner of Nastyusha, denies there have been negotiations, while Minovalov does not officially comment). Ramon administration official in Voronezh region told Forbes that Avangard-Agro is buying land the RAV-Agro Pro holding company (part of Czech PPF Group). A source close to RAV-Agro Pro confirmed that the company has already sold 9,000 hectares to Minovalov for 100 million rubles. Responding to Forbes' request, PPF Group reported negotiations to sell a

few small plots of land in the northern Voronezh region, but did not disclose any details. Other market players are suffering financial difficulties and thus cannot afford such purchases according to Rylko.

Golden fields

For 8 years, the land area held by Avangard-Agro has increased almost 10-fold.



Beer or pigs

Almost 300,000 hectares of Minovalov's land no longer serve just the needs of his malt houses. In addition to barley, Avangard-Agro grows sugar beets, wheat, and sunflowers, and now more than 60% of its sales come from third-party orders. "Our wheat can be exported duty-free to the EU with a quality bonus up to € 40 per ton," says Minovalov. He got started with wheat and other crops out of necessity: one could collect a barley crop from a field once every 3-4 years, and the rest of the time the field is sowed with other crops or "rests." Today, his malting business, which almost sank Avangard with its loans 10 years ago, consists of four malt houses in Russia and four in Germany (the banker bought them from the bankrupt company Weissheimer at the end of 2006). Russian Malt is the largest producer of raw materials in Russia for brewers, and controls more than a quarter of the market. In 2011, Russian Malt became the seventh largest producer in the world. According to SPARK, revenues for Russian Malt amounted to almost 2.5 billion rubles in 2011, with net profit of 11.7 million rubles.

Today this business faces other challenges. Ten years ago, brewers were in no hurry to buy malt from Minovalov, waiting to see what would happen to the novice in the market. But today they are doing the same thing because the Russian beer industry plunged into crisis itself, with four multinational companies representing 80% of the market. In August 2009, as part of a new anti-alcohol campaign, Russian President Dmitry Medvedev stated, "Alcoholism possesses traits of a national disaster in our country ... the fight against alcoholism can be effective only on a systematic and long-term basis." This initiative by the former president hit beer producers the worst. According to Rosstat, from 2008 to 2012, retail beer sales decreased by 16.2%, while beer production dropped by 7.2%. It was nearly a disaster for an industry where the figures had grown continuously since 1996. On January 1, 2010, excise taxes on beer were tripled and a year and a half later, beer was declared an alcoholic product, with a subsequent ban on night sales, as well as in stalls, tents and kiosks. Beer production dropped off which subsequently reduced the production of malt. Being its largest producer, Minovalov has already written concerned letters to government authorities. One of them is addressed to the Minister of Agriculture Nikolai Fyodorov (copy available to Forbes). In this letter Minovalov uses the favorite tactics of large Russian companies - scaring state authorities with the negative social consequences in rural areas: since the production capacity of Russian Malt malt houses was cut in half, "we must cut staff and acreage in response."

Minovalov is thinking up a new strategy while the authorities have not given a clear answer. One version of this strategy is "kolkhoz in outsourcing." The new idea is to become a leader in

growing crops, proposing alliances with the largest agricultural holding companies like Prodimex, Cherkizovo and Miratorg. Minovalov hopes to captivate their interests with an offer to grow grain for them on their own land, but with Avangard-Agro forces and management, using his "unique system." However, holding companies remain cool to the idea. "Inclusion of intermediaries in the chain will increase the prime cost," said Dmitry Lgovskiy, representative from Miratorg. According to Andrei Sizov, Executive Director of the SovEcon analytical center, such proposals could be attractive not to agricultural holdings, but to conditional investors who have invested money in the land and now are in despair because they don't know what to do with it. He explains, "There are no top professional management teams in Russia to prove that plots of land across hundreds of thousands of hectares can be operated effectively, thereby making a profit."

Minovalov is sure his services will be in demand, "Sooner or later the time will come when I'll be able to tell the neighbors, 'What are you worried about?! Let me grown the wheat for you, I know how.'"

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