



Fields by algorithm

Kirill Minovalov does business within the bank-malt-barley business triangle

Anton Osipov, August 2014

The article was published in the Agroinvestor journal, №8 (79), August 2014

PROFIT AS IN A BANK

It was in 2012 when Kirill Minovalov earned a net profit of 1.49 billion rubles for the fifth consecutive year from his agricultural business against revenue of 5.5 billion rubles. Agribusiness profit was double that of the banking business, as Forbes estimated. In 2013, profit from the bank was 1.744 billion rubles, but the agricultural business dropped to 1 billion rubles. This was mainly due to grain price-cutting, according to information from the Avangard-Agro press service. "Today, our agribusiness profits are nearly comparable with those of the bank, and in good years agriculture may exceed banking results. However, it all depends on market conditions."

Over the past four years, Avangard-Agro transfers about 50% of net profit to the bank in the form of dividends, which are included in its capital.

One can hardly find a large crop grower - over 200 thousands ha - that at the same is consistently profitable, let alone with continually increasing cash flow. It is absolutely impossible. But the founder of Avangard has such a business. In recent years, it has grown during the crisis, during a drought, and even through low market prices.

In an interview a few years ago, a correspondent for Agroinvestor asked Kirill Minovalov, Avangard Chairman of the Board, a question regarding the investment required for a business that has made the decision to grow high-quality malting barley.

Minovalov hesitated for a moment.

"Surely, you can't remember all of the figures," the journalist raced to the rescue. "Good, will you send them later?"

"No! I'll tell you now," retorted Minovalov, who started providing figures from memory. "We spend this much in fuel & lubricants per hectare, that much for fertilizer, plus labor cost, depreciation..."

The businessman calculated the required amount within a minute without ever once looking at a paper or using a calculator.

No wonder there is a belief among his staff that the chief can multiply four-digit numbers in his head.

Besides his great mathematical prowess, Minovalov's inherent stunning performance draws from a strength of will and a desire to meet challenges. For example, he became a banker to spite his girlfriend, and started an agricultural business in defiance of greedy foreign companies.

The beginning of career

Minovalov was born in Moscow on April 22, 1971. He earned his first money at age 13, working on a vegetable base: he wanted to save up for a scooter, but in the end never bought it. He remembers that at the time it was one of the worst things in his life. At age 15, Minovalov told his parents that he would become a millionaire. The seniors laughed. At that time he was very upset that he hadn't been born three years earlier: "perestroika" (restructuring) opened up many opportunities for self-starters, and he was still a schoolboy.

After graduating from high school No10 with an intensive study of English, Minovalov entered the Moscow Institute of Railway Transport Engineers (MIIT) for a major in computer systems engineering. The talented student was noticed, receiving higher scholarships and often being sent to academic competitions. However, over time he became an infrequent visitor in class.

One might consider it a reasonable excuse. In the early 1990s, Minovalov started working at the same time to help the family. For example, he used to bring Levi's jeans from St. Petersburg to Moscow and actually slept in trains, as Finance magazine wrote.

The 501 model jeans cost 700 rubles in the capital. But in St. Petersburg one could find them for 480 rubles. First Minovalov collected money to buy three pairs, and then started to buy 10-12.

As a result, he learned subjects before the exam and sometimes it was fun. For example, a professor once pointed out, "Hey, young man, I don't know you." Minovalov replied, "So what, I don't know you either." It turned out the professor was giving lectures that year. He had to switch classes. Minovalov stresses that he took all exams himself and never gave a bribe.

Minovalov created his first business - a company called Alcor - in 1991, two years before graduating. It happened almost by accident. His girlfriend got a job at MosnarBank with a salary of \$300/month, which was fabulous money for students at that time. Somehow, she let Minovalov know that nobody needed him for even \$100. He decided to prove her wrong and took up the registration and sale of turnkey companies.

At first, he worked 20 hours a day. He sought customers through advertisements on poles, received people in study of his mother, who worked at a state institution. A couple years later, the firm had two offices and three dozen employees thanks to the hard work and competent strategy of its founder. So Minovalov started developing his next business line - consulting.

Good knowledge of English and an analytical mind allowed him to figure out the western taxation system. So he began to help Russian businessmen to create international business - tax schemes, as well as managing finances abroad.

In 1993 and 1994, Minovalov opened about 1,500 Swiss bank accounts for Russians. There were very famous people among his clients - multimillionaires who controlled entire industries.

While observing the amount of means that passed through the banks, Minovalov created his own bank called SADR in 1994 (which was renamed Avangard in 1996). ZIL, Rosshina, and various gold mines were among its shareholders. However, in 2002, the businessman admitted that their combined share was less than 1%, as he always kept 99% of the bank individually. Other "founders" just imparted credibility.

Minovalov financed the Bank with \$100,000 of his own savings and \$300,000 of borrowed money.

Business was difficult. A currency license cost \$ 1 million and he didn't have that kind of money. The wealthy people whom Minovalov consulted were not interested in cooperating with the bank without the opportunity to work with the currency. The bank's entire staff of 8 people nestled six months in a 20-meter room, writes Credit-card.ru.

They bought the long-awaited license for currency transactions in 1996, but the bank, which rented an office on the 15th floor of the GosStandart building, had very few customers. Minovalov tried to earn money in other industries, founding transport, trade and construction firms. Then the financial crisis broke out in 1998.

Minovalov bet on the bank while choosing which businesses to save. He pledged the shares of his other companies to main customers with a promise that all assets would go to them as compensation if he did not return the money in three months. As he noted in an interview with Finance magazine, "that action attracted new customers. On learning that Avangard gave guarantees, people started transferring money from other banks."

A new stage of development began in 1999. Avangard acquired the accounts for Krastsvetmet, which processed raw materials for Norilsk Nickel. Prior to this, the company was served by Lanta-Bank where Vladimir Gulidov, former head of Krastsvetmet, was the Chairman of the Board.

After Gulidov's death in a car accident, the Deputy Governor of the Krasnoyarsk Territory, where Alexander Lebed was Governor, ran the company and the accounts were transferred to Avangard. However, relations with the administration deteriorated a year later and the bank lost those financial flows, says Forbes. But by that time Avangard was already on a sure footing.

Get to know the malt

Avangard financed projects by leasing entire businesses. The bank would own the company for the first years, but the founder ran it. The businessman would then become the sole owner if he reimbursed the Bank for all costs and paid interest. If not, the bank kept the assets and looked for a new manager, and so the process would start all over again. For example, the bank worked with a meat-processing plant in Yekaterinburg and a fish processing plant in Moscow under this scheme.

"In 2001, Vasily Tkachev, owner of Amrus, a distributor of malt and beer bottles, decided to develop a small business based on a Tula malt house with annual capacity of 7,000 tons. He drew on Avangard funds to construct another one in the Moscow region," Minovalov told Agroinvestor. According to the rules, Minovalov personally made the decision to grant credit over \$100,000. The business seemed very attractive to him.

In late 2001, malting barley was worth \$100/t, -or \$130 when considering the conversion rate (1.3 tons of barley turns into 1 ton of malt), as Secret of a Company magazine cited Minovalov's calculations. Processing added \$50-70/t. Malt market value were in the range of \$300 - \$350/t.

It turns out you could earn \$100-140/t. The market at that moment was 60% dependent on imports. Minovalov went to Europe, surveyed the performance of malt houses there, counted the cost of equipment and convinced Tkachev to build a plant not for 40,000 t/year, but 100,000 t/year as this volume would be more cost-effective. Nevertheless, something went wrong.

First, costs increased. They invested \$ 35 million in the malt house instead of \$20-25 million: barley processing and storage facilities, treatment facilities, railway reconstruction, and so on came at a high price. Minovalov claims, Tkachev lost control and could not attract customers.

Tkachev told Forbes that the bank simply took his favorite business. In 2004, Amrus even began legal proceedings against Avangard for breach of the lease agreement, but the deal fell apart.

First Minovalov decided to offer control of the malt house near Moscow to a large company. But the leadership of Groupe Soufflet and Cargill offered to buy it at a price equal to the

actual costs incurred. Hence, the bank would not only have earned nothing on the project, but would also suffer losses in the form of lost profits. The businessman resented the offer.

"[The big players] insisted that I had no other option but to sell. Well, I had no choice but to prove they were wrong," he told Agroiinvestor. So Russian Malt appeared.

Minovalov was drawn into the details of the business: he learned the Kolbach number, the required content of beta-glycan, the number of grains on a stem... He even went to Denmark to learn from the owner of a malt house. Forbes reports that the six weeks of training and six months of consultations cost him € 500,000. The banker was personally involved in developing the barley flow control scheme, if failure occurred at one site. Anyone could call him at any time.

At the same time he turned to information technologies. Each brewer uses raw material with a given specification. The more a lot of malt conforms to this, the more consumers are willing to pay for the malt. Minovalov instructed a team of bank programmers to write a program which would enable data collection on each lot of malt. The program displayed client specifications and advised on specific raw materials batches and proportions for blending. Minovalov claimed that this yielded an additional 3-5% profit.

He had already started construction on a second malt house in the Voronezh region before the first one had even been commissioned (it was only in 2003). The enterprise cost \$35 million and was launched in 2004.

A year later, with another \$35 million investment, a third plant in the Oryol region was launched. Finally, in 2011, a fourth malt house in the Kursk region began operations. In general, all of the company's plants are capable of producing up to 500,000 tons of malt per year, but they are currently only 50% utilized.

"After 10 years, our Russian malt houses have fully recovered," said the company's press service in response to a request by Agroiinvestor. The company now considers them as a division of its agricultural business, Avangard-Agro. The facilities process their own malting barley into malt.

Therefore, even with a cut in the malt price, their profitability will remain high, according to the company's press office.

Crossing the border

In late 2006, Minovalov became a hero of the business media. The Russian businessman bought a 142-year-old German company - Weissheimer group and four of its six malt houses (one was under construction).

The following year, in a conversation with RKB Daily, he summarized, "The global market for brewing malt excluding China (since no one can accurately estimate the capacity of the Chinese market) is about 16 million tons/year.

The three Russian Malt plants produce 375,000 tons in Russia, -and 245,000 tons in Germany. Accordingly, we occupy 27% of the malt market in Russia, about 14% in Germany, and 4% in the world. This means the [...] sixth place." According to the Avangard-Agro press service, the current total capacity of Avangard Malz plants in Germany is 330,000 tons of malt per year at 100 percent utilization.

Russian Malt is among the top-seven companies worldwide in terms of total plant capacity, and among the 10-12 largest companies in the world in terms of sales.

The transaction amount was not disclosed at that time, but Minovalov insisted that it was 40% lower than in the best of times - the malt business in Germany experienced extreme overproduction.

Weissheimer recorded €15/t of losses prior to the asset sale, so the company had to shut down its plants. It was too obvious for Minovalov and he reckoned that other players were also suffering negative results and, eventually, the weakest would leave the market and then raw material prices would rise.

Until then, the profit of Russian malt houses could sustain the German company, he explained to Forbes. Minovalov even refused to launch one of the plants in Germany until the margin could reach a certain level.

The banker's optimism was justified, but a little differently than he had expected. After years of stagnation, the demand for beer had grown thanks to the mild winter of 2005-2006 and the 2006 FIFA World Cup held in Germany. The quality of German raw materials had decreased due to rains during the barley harvest in August and September. Thus there was a shortage of malt and the price recovered.

Minovalov's diverse businesses are interrelated and mutually supportive. For example, in 2004, brewers reluctantly bought raw materials from the new company. About 100,000 tons of finished malt product valued at approximately € 21 million accumulated in warehouses, wrote Forbes. Then Avangard started offering loans to beer distributors with a two-week grace period.

If a distributor could convince brewers to buy raw materials from Russian Malt, it would receive a rate of interest just under 3%. The size of the loan depended on the scope of delivery. The plan worked as distributors persuaded the owners of Baltic Beverages Holding (BBH) to meet with Minovalov.

The contract was signed. As a result, four of the five largest brewers in Russia began acquiring malt from Minovalov. The only exception was SUN InBev, which had its own malt house.

Avangard gave Russian Malt either interest-free credits, or under 5% annual interest (the rate later increased, as it has been tied to the LIBOR - London Interbank Offered Rate, wrote Smart Money).

In 2007, the company firmed up and borrowed funds at 12%, although it had access to financing at under 6% in the West, said RBKdaily. Russian Malt allocated free funds in Avangard as subordinated term deposits.

MORE THAN TWO-THIRDS OF LAND IS PRIVATE

Asset status of Avangard-Agro

Thousands of hectares	2005	2006	2007	2008	2009	2010	2012	2013
Whole land	35,5	50,5	90,5	142,5	143,5	172,5	255,5	345,5
including property	25	35	55	98	109	132	198	227

SOURCE: AVANGARD-AGRO

Forced agribusiness

When Minovalov started developing malt houses, he used to spend a third of his working time on management. By his interview with Agroiinvestor in 2007, the work was well organized so that it took no more than 5% of his time to manage the business, mainly spent on strategic decision-making.

But starting up and developing another business demanded a significant portion of his attention and that was growing malting barley. Nowadays, Avangard-Agro management demands up to 50% of Minovalov's labor during the season.

Minovalov was forced to enter the agricultural business. To provide raw materials to the malt houses, Minovalov entered into forward contracts with farmers and agricultural enterprises. But he was faced with two problems at the same time: unstable quality and unreliability. Therefore, Russian Malt decided to buy European barley seeds and cultivate them at a test plot with the help of Western consultants.

Four out of fifteen breeds were selected as better suited for local conditions. Minovalov honestly deducted \$20-25/t in royalties, which was a very rare event in Russian agriculture.

The businessman gave seeds and equipment on lease to independent agricultural companies. For example, an American or Dutch harvester cost 330 tons of barley and 1 ton of seeds - or 2.2 tons of the crop. According to Forbes, during the years 2004-2005, farms took on leases for more than 100 machines. Russian Malt acquired about a third of the raw materials under such leasing schemes. The rest it endeavored to buy through forward deals.

The banker complained that farmers claimed the barley crop had failed in cases when prices were rising, and then sold the contracted volumes to those who were ready to offer the best price.

In Germany, if you sign a contract with a brewer, farmer or agricultural holding company, you can be sure that all parties will meet their obligations regardless of the circumstances, said Minovalov.

He recalled 2008, when he contracted barley in Germany for €160/t and got the entire volume at these rates, although the market value at that time had rocketed up to €350/t. But in 2009, the businessman had to pay the contractual €340/t when the market price was at €140/t. However, in Russia he was able to organize the work with only a few small-scale farmers in the Oryol region and the White Frigate agro-holding company, though the latter went bankrupt in 2009.

Avangard seized the assets of Russian enterprises through the courts when they were not able to pay for the lease. This is how the bank first acquired land in the Voronezh, Kursk and Orel regions, and in 2005, the agricultural holding company Avangard-Agro was established.

"The average crop yield in the Voronezh region [...] is 22 hwt/ha. But we have achieved 36 hwt/ha!" Minovalov summed up the year 2006 (quoted by Smart Money) and could finally focus on his own production.

Minovalov has already invested about 20 billion rubles in developing Avangard-Agro. The company's press service reported just this spring that they purchased agricultural machinery for 2 billion rubles. The company recorded an operating profit after its first year of operation.

HIGH EQUIPMENT CAPABILITY

Inventory of farming machinery in the company*

Harvesters	390
Tractors	850
Automotive equipment – including lorries	980
	520
Towed vehicles	4000

*units in 2013

SOURCE: AVANGARD-AGRO

The businessman explains the differences in yield and grain quality not by the investment volume, machine output or the quality of the seed, but in terms of the human factor.

"The only true main rule in agribusiness is to observe the technology. You cannot fertilize even two days later or apply chemicals once instead of the usual two times," he told Forbes. In fact, farmers can save on something, steal or just be too lazy to do something.

The company again was saved by high technologies: GPS-navigators were installed on the equipment, document control was transferred into electronic form, and bank programmers created a special control program.

Now from any place with internet access, one can track online the consumption of fuel and lubricants, fertilizers, agricultural chemicals, spare parts, salaries (as it turned out, it had not reached workers before) and machinery movement, or browse the archive for data gathered since the start of the system.

During the harvesting and sowing season, Minovalov uses the program more than 10 times a day from his office and from home. Of course, he is not the only one to watch everything. For example, hired students monitor the equipment operators. As soon as a machine deviates from the course or stops unexpectedly, the operator immediately gets a call from Moscow inquiring into the cause. The head of the farm along with a private security company guard will come on site in the event of any problems.

Of course, not everyone was happy with such innovations. GPS- navigators were damaged on the very first day at one of the Voronezh region sites, wrote Forbes. Then Minovalov shelved all machinery that had no tracking devices. He remained firm despite overt threats of crop failure and losses.

At another farm, machine operators refused to work under the controls. But upon hearing that people from the neighboring village would replace them, they changed their minds.

FINANCIAL STATEMENTS

Billions of rubles	2007	2008	2009	2010	2011	2012
Assets	1,5	3	5	7,1	10	13,2
Revenues	0,72	1,5	1,4	1,95	3,3	5,5
Net profit	0,1	0,6	0,18	0,4	0,7	1,5

SOURCE: AVANGARD-AGRO

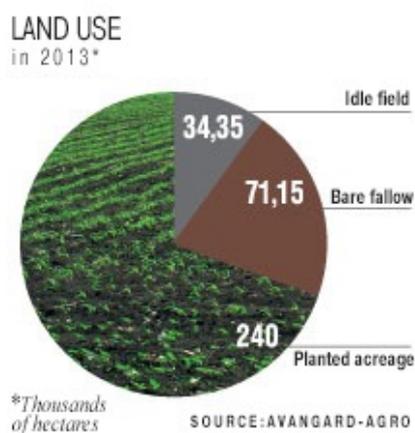
Barley basis

In 2005, Avangard-Agro had 35,500 hectares of land, 25,000 hectares of which they owned. In 2008, they had 142,500 ha, with 98,000 ha held in property. During the crisis, the company bought hardly any new lands. But then the land bank started growing unabated.

"We plan to add 15-20% per year," said Minovalov in 2009. The holding strategy is to possess more than 2/3 of the land in property. "The risks of renting and buying land are comparable," Minovalov told Agroiinvestor. "When you have 500 shareholders behind you and they are ready to defend this land with pitch forks, it is more difficult to seize it."

This year, the company continues to buy assets. In April, Avangard-Agro purchased 27,750 ha of land plus an Ostrogzhsky elevator (15,000 tons of storage in the Voronezh region) from Black Earth Farming, a Swedish public company which operates in Russia through its affiliate Agro-Invest. The transaction amount was for \$21.1 million. Avangard-Agro had to deal with other agricultural plantings so that the land would not lie fallow.

For example, last year the company allocated over 73,000 ha for wheat, 23,000 ha for sunflowers and grew sugar beets on 13,500 ha. In addition, it increased grain maize plantings. Today, agriculture accounts for about 70% of the holding company's revenue.



Basically, the company succeeds in making money on wheat, much of which is exported to European flour mills, as well as sunflower sales, and the sugar produced from sugar beets.

Previously, the holding company intended to build a sugar factory in the Voronezh region. But in November 2012, it dropped the idea. According to one version of the story, they did not find a suitable site. Another source claims it was due to the reduction of the beet share of plantings. The company also announced a project for a grain elevator in the Voronezh region, and an oil extraction plant for 2.5 billion rubles. The projects have not yet been implemented.

"Since 2012, the Russian economy has changed greatly. Expensive money does not allow investments to be recouped within a reasonable time. With the stabilization of the situation, which means the acceleration of GDP growth and reduction of the money value in the market, the company plans to return to these projects," the company's press service informed Agroiinvestor.

HARVEST

in 2013

	Thousands of tons	Hundredweight (hwt) per hectare
Barley	274	29,2
Wheat	326	44,6
Sunflower	54	23,5
Beet	604	448
Buckwheat	3,5	11
Rye	3	30
Corn	23	50
Soybean	2,7	12

SOURCE: AVANGARD-AGRO

Barley remains the core business. Last year, the agricultural company yielded almost 274,000 tons from 93,500 hectares. The crop yield was 29.2 hwt/ha, about the same as in previous years. The figures differ from Minovalov's optimistic estimates. In 2007, he argued that "only farming standards separate us from the German crop yield (50- 55 hwt/ha)". The businessman insisted that it was quite possible to achieve comparable crop yields in Russia.

In the beginning, Avangard-Agro expected to yield at least 35 hwt/ha. In 2008, they managed to reach 52 hwt/ha, but results have since decreased. Nevertheless, Forbes estimated that crop yields on Minovalov's farms are higher than those on neighboring lands. "The 10-year experience of growing barley in our natural surroundings primarily shows a strong dependence on the weather and the level of precipitation," said the company's press service. "The Central Black Earth Region only has summer barley, and it is more exposed to the spring drought."

Furthermore, there is no ability to increase the amount of fertilizer (ammonium nitrate) to improve yields, since this poses a risk to obtaining forage due to high nitrogen content in the soil."

Consequently, the holding company has reduced malting barley plantings and prefers winter wheat, which for the same cost per hectare yields 1.5 times higher crop volume.

Inna Ganenko participated in working on this article.

Location of the publication: <http://www.agroinvestor.ru/companies/article/16907-polya-po-algoritmu/full/#cut>