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A DIVESTITURE PLAN FOR THE NATIONAL FOOD AUTHORITY

REPUBLIC OF THE PHILIPPINES

REPORT BY

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CENTER FOR PRIVATIZATION
1750 New York Avenue, N.W.
Washington, D.C. 20006

Project No. 14

December 30, 1986

Prepared for the
BUREAU FOR PRIVATE ENTERPRISE
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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LIST OF ACRONYMS

ADB	Asian Development Bank
ADU	Asset Disposal Unit
AID	Agency for International Development
APMP	Agro-Processing and Marketing Project
APT	Asset Privatization Trust
BSI	Bicol Seeds, Incorporated
CFP	Center for Privatization
CRW	Central refrigerated warehouse, FTI
DBP	Development Bank of the Philippines
DCF	Discounted cash flow
FTI	Food Terminal, Incorporated
FMG	Facility Management Group, FTI
GOP	Government of the Philippines
IFC	International Finance Corporation
MINPROCOR	Mindanao Progress Corporation
NARIC	National Rice and Corn Administration, predecessor of NGA
NEDA	National Economic and Development Authority
NEI	Northern Engineering, Inc.
NFA	National Food Authority
NGA	National Grains Authority, predecessor of the NFA
NPC	National Power Corporation
NPGC	Northern Philippines Grains Complex
PAS	Public Administration Service
PCGG	Presidential Commission on Good Government

PDCP	Private Development Corporation of the Philippines
PECO	Panay Electric Company
PNB	Philippine National Bank
PNR	Philippine National Railways
RP	Republic of the Philippines
SOE	State-owned enterprise
SPGC	Southern Philippines Grains Complex
USAID	United States Agency for International Development
WACC	Weighted-average cost of capital

Currencies:

P	Peso
$	U.S. dollar
L	British pound

EXECUTIVE SUMMARY

This study was requested by the Ministry of Agriculture and Food (MAF) to analyze the peripheral activities of the National Food Authorization (NFA) to determine their potential for privatization. A peripheral operation is one defined as not directly involved in the NFA's primary mission, the stabilization of prices and supply of rice and corn.

The facilities reviewed in this study are:

- Food Terminal Incorporated, which comprises a grocery operation selling to poor consumers, and an industrial estate management business that leases out retail, wholesale and industrial space and manages several food processing operations

- Northern Philippines Grains Complex (NPGC), an operable, major ricemilling and storage operation in Isabela province

- Tabangao Unloading Terminal, an inactive, overdesigned facility for unloading imported soybeans from ships for the now-defunct Phil Asia soy processing plant

- Iloilo Thermal Generation Plant, a soon-to-be operable facility designed to provide electricity to an NFA installation by burning rice husks

- Southern Philippines Grains Complex (SPGC), an operating, large-scale ricemill and oil extraction and refinery located in Central Mindanao

- Digos Agro-Industrial Complex, a rice and corn milling and storage operation in Davao del Sur

- Bicol Seed Company, a small, underutilized ricemill located in Albay province

- The provincial kadiwas or people's markets, which are located throughout the Philippines and sell basic foodstuffs to low-income consumers.

Our major observation after analyzing these operations and making site visits is that these facilities were established or acquired at a time when NFA was a part of a political scheme in which economic rationale was subsidiary in the decision-making process. Because of this, most of these facilities are overbuilt, out-of-scale and poorly located, and thus viability may be difficult to achieve by the private sector. At present, these operations constitute a major drain on NFA resources, and this should be curtailed as soon as possible. To appreciate the burden imposed upon the NFA by the peripherals, one needs only to know that their aggregate loans outstanding equal P1.2 billion ($60 million), requiring an annual amortization of P144 million ($7.2 million).

All operating units are unprofitable showing an aggregate annual loss of P189 million ($9.45 million). These losses are likely to increase if NFA should itself operate such units such as the Northern Philippines Grains Complex or the Iloilo Power Plant. Some units are requesting immediate infusions of cash to maintain their operations at present levels. Food Terminal, Inc., for instance, wants NFA to provide it P60 million to P80 million ($3 million to $4 million) in the near-term.

Some of these operations can only be operated economically by private enterprises if they are acquired at prices low enough to promote financial viability; others may not be viable at any price, as the facilities may have difficulty running anywhere near their designed capacity. For the first group, potential financial returns, rather than book value, must be used to guide their valuation. For the second group, dissolution and sale of the assets individually may be the only prudent option.

In some cases in the first group (the NPGC is an example), care must be taken in the selection and acceptance of buyers. Because of political realities, Filipino investors are preferred to foreign. Foreign investment, however, should be welcomed in the role of complementing local investment and supplying equity in those instances where local investment is unavailable, inadequate or disinterested.

However, the massiveness of investment required and the relative scarcity of domestic capital mitigate against any overly-strict application of nationality rules. In instances where both foreign and local investors are interested, a fair procedure would be to provide a differential between local and foreign investment, i.e., all else being equal, the government could add a 10% premium to the bid of Filipino nationals (individual or corporate).

Sale of these assets will not be easy, and should not be hampered with onerous restrictions. The government needs to maximize its returns by opting for early sale at the best reasonable price offered.

We do not believe that privatization will be accomplished unless firm, decisive steps are taken in the near-term. The NFA's primary role is to stabilize the price of grains. This fully occupies the endeavors of its staff and its role should not be subverted by the divestiture of non-related activities. Additionally, the NFA should be assisted specifically in its stabilization task. By separating the two functions, the NFA and GOP can concentrate on the grain stabilization activities and more accurately estimate the funds required.

The responsibility for the sale of the NFA peripheral assets could be turned over to the newly created Asset Privatization Trust

(APT). Upon transferring the assets to the APT, the assets would be valued at realistic levels, such as those developed in Appendix B. This approach would remove responsibility from NFA for privatizing these assets. Once these assets are under the control of the APT, however, they will have to compete for priority with a large number of other government holdings, many of which will command higher attention by virtue of their size and importance to the country's economy. The physical constraints on the APT in divesting such a large number of assets will mitigate against early attention to the NFA assets, and financial losses for the government are likely to continue.

An alternative to this scenario would be for the MAF to request that the privatization of the NFA assets be assigned to the Ministry on an exception basis. Provision for such exceptions exists and is used in the case of the Philippine National Oil Company. In this case, the MAF can organize a special team for the disposal of the assets. It is important that a team knowledgeable and experienced in asset sales be assembled, and be made responsible solely for the disposal of these assets so that their early sale can be achieved. For the purpose of this discussion, we recommend that the MAF call this group the Asset Disposal Unit (ADU).

Under this arrangement, NFA would continue to have responsibility for maintenance and operation of the facilities, until such time as the ADU can arrange for their sale. The NFA would also be responsible for certain tasks for which it has a contractual obligation, such as resolution of the status of the Iloilo Power Plant loan from the U.K. government, or tasks which it has already well underway, such as shutting down the provincial Kadiwa operations. This dichotomy of responsibilities avoids unnecessary legal, financial and managerial entanglements.

Sale by the ADU needs to be consummated within a certain time period. We recommend putting each facility up for bids; if that fails, investment packaging and promotion techniques should be utilized, pursuing selected buyers. By putting each facility up for bids, the ADU will avoid criticism of insider deals or cronyism. The Minister of Agriculture and Food, the Administrator of the NFA, and a Deputy Minister of MAF should jointly approve or disapprove of each sale transaction. Beyond a certain pre-agreed date, maintenance of a facility will no longer be valid or sensible, and it may have to be scrapped.

To avoid a build-up of bureaucracy, the staff of the ADU should be limited. We recommend a core professional staff of seven, with administrative support. The core group would be composed of a unit director, a real estate lawyer, a public relations specialist, a contract administrator, an economist with finance skills, a real estate sales specialist, and a maintenance coordinator. Provided with its own funding, the ADU would depend upon outside, contracted technical assistance when needed. In particular, the sales effort would fall heavily on industrial real estate firms working for a sufficiently large commission to stimulate their strong commitment.

The ADU should also conduct a public education and awareness program to ensure acceptance of the often difficult decisions that will be needed to correct the mistakes of the past regime.

We recommend that USAID provide this unit with start-up funding so that it can hire staff and get underway. Technical assistance would also be required and is recommended to assist the Ministry in its efforts. Through a long-term technical assistance contract, USAID should provide for the costs of professional, expatriate advisors skilled in divestment. The advisors can assist in coordinating the activities of the unit; to develop complete, accurate prospectuses, including the best available financial records; to promote through advertising, brochures and other means the sale of the assets; and to assist the MAF in negotiations with prospective buyers.

The advantage to this approach is that divestment efforts dedicated solely to the NFA assets is very likely to lead to their expeditious disposal, thus relieving NFA of continuing financial losses. Also MAF and NFA could take credit for pursuing the government's privatization objectives diligently and efficiently. The risk of MAF facing greater resistance as a result of being in the forefront of the privatization process, while possible, is not great, given the relatively non-controversial nature of most NFA assets. We believe that divestiture of these operations can be accomplished within two years.

While valuations of the peripherals have not been possible in all cases, primarily because some have never operated and have no financial history, we roughly estimate that the entire lot could be worth up to P500 million ($25 million). These sales revenues should not be used to cover NFA operating costs, but, after paying sales costs and the operating cost of the ADU, should be used to reduce the outstanding liabilities that correspond to these operations.

Chapter II includes detailed divestiture strategies for each of the peripherals. The organizational arrangements and timetable for the divestiture program are included in Chapter III.

PURPOSE OF THE PROJECT AND SCOPE OF WORK

The purpose of this project was to respond to a request by Minister Ramon V. Mitra of the Ministry of Agriculture and Food (MAF) to analyze various peripheral activities of the National Food Authority (NFA) to determine their potential for privatization. A peripheral operation is one which is not directly involved in the NFA's primary mission, the stabilization of prices and supply of rice and corn.

The scope of work included the following tasks:

- Review and confirmation of the findings and recommendations concerning divestiture contained in a previous study of the NFA by the Public Administration Service (PAS) for the Asian Development Bank
- Determination of the commercial viability of each peripheral operation
- Establishment of the estimated net worth of each operation
- Establishment of a "fair price" band to guide its eventual sale
- Asset valuation for each operation assuming liquidation
- Preparation of an action plan for divestiture.

To carry out this study, an extensive background review was undertaken for each of the peripherals, and each peripheral was visited by the study team. In addition, a large number of persons in both the public and private sectors were interviewed to generate the divestiture strategies and to confirm them (see Appendix D).

Chapter I of this report discusses the posture of the Aquino administration regarding privatization and divestiture. It also discusses the PAS report recommendations and subsequent actions taken by the NFA; it identifies the incentives for the NFA to undertake divestiture now; and it presents some concepts which have proven useful in organizing successful privatization efforts in other countries.

Chapter II provides profiles of the major NFA peripheral operations in terms of background information, financial status, financial projections, valuations, constraints to privatization, social impact of privatization, types of potential investors, and strategies for divestiture. Appendix A explains our methodology for valuing the businesses. The financial projections and valuations are treated in greater detail in Appendix B.

Chapter III discusses the current financial drain of the peripheral operations on the NFA. This chapter also presents a strategic action plan for divestiture, based on immediate, near-term, and longer-term actions identified in the previous chapter.

I. INTRODUCTION

This report sets forth a divestiture plan for those operations which no longer fit within a revised and more focused mission for the National Food Authority -- the stabilization of the prices of rice and corn. It responds to the directions set for the Philippines by the Aquino administration, to the extent that privatization policy has been set forth to date. Its specific focus on NFA is particularly important because of the significance that agriculture has in the Philippine economy and the strong role that the NFA has played in that sector in recent years. It is particularly timely in that NFA has, in the past year, recognized that it needed to sharply reshape and limit its mission, and has undertaken considerable preparation for this restructuring. The change in national government has cleared the way for major policy shifts and specific implementation plans that should yield major benefits for the economy, for the government, and specifically for NFA.

1. THE AQUINO ADMINISTRATION IS PLACING A HIGH PRIORITY ON PRIVATIZATION AND THE NFA OFFERS A PRIME OPPORTUNITY TO IMPLEMENT THAT POLICY

During her campaign and in the initial months of her administration, President Aquino has consistently stated her intent to have less government involvement in the economy. In a May 1986 speech to the 19th Annual Meeting of the Board of Governors of the Asian Development Bank (ADB), President Aquino stated that "this regime means business when it says it will not meddle in private business. Government will provide the usual public services and facilities, preserve order, vindicate rights and protect liberties. But the private sector shall be the main propeller of the economy. I believe that the restoration of a genuine private enterprise economy will foster competition, productivity and efficiency. . ."

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A major challenge to this restoration is the inheritance from the prior administration of a vast public structure burdened with enormous financial liabilities. President Aquino noted in her speech to the ADB that "the previous regime accumulated 330 corporations with total liabilities in the billions of dollars. A few of these entities are profitable; most are an intolerable burden on our government budget. We plan to commence their selective rehabilitation and sale, especially those companies which cannot cover their own operational costs and are in competition with the private sector. . ."

These views are reflected in a report prepared by the Presidential Commission on Government Reorganization in June 1986. That report recommends that the government withdraw from the provision of all marketable goods and services. The report places a high priority on promotion of private initiative, of which privatization is featured as a major component.

In August 1986, President Aquino approved that Government Reorganization Plan and named an inter-ministerial committee on privatization. The committee is composed of the Ministers of Finance, Trade and Industry, and Budget, the National Economic and Development Authority General Director, and the Minister and Chairman of the Presidential Commission on Government Reorganization. This committee will formulate policies and guidelines governing privatization. In addition, the President will appoint two or three trustees to an Asset Privatization Trust (APT), which will sell off non-performing, government-owned corporations.

Other actions are noteworthy. The International Finance Corporation (IFC) worked on a scheme wherein it would acquire non-performing assets and divest them after rehabilitation. That scheme was recently abandoned by the administration, presumably because the process was envisioned as a very lengthy one.

The Asian Development Bank (ADB) is setting aside P1 million for technical assistance and is developing a window capable of lending to support privatization. The total amount of the financing to be made available has not been formalized yet.

In an interview with the finance minister, it was learned that there was great interest in the present study, as it could provide the privatization committee and the Asset Management Trust with a model and methodology for disposing of government-owned corporations and non-performing assets.

The NFA and its major subsidiary, Food Terminal, Inc., (FTI) have drawn specific attention from this administration. The NFA is the vehicle through which rice and corn price support and retail ceiling price policies are implemented. These functions are critical to the rural and agricultural sectors which are dominant in the Philippine economy and in which stability, strength and growth are of paramount importance.

In addition to that central role, the NFA has previously had a largely unlimited charter, playing an increasingly dominant role in the agricultural sector, outside of its stabilization functions. Specifically, it moved by policy and practice into monopoly positions in wheat and flour importation, and found in them a consistent source of revenues, permitting it to continue a wide range of operations without subsidy from the national government. These activities included a wide range of non-grains work, primarily to promote selective commodities and management of existing and inherited facilities and programs like FTI and the Kadiwa operations. Such non-grain operations, especially those dealing with perishables, have been costly to NFA and have diminished private sector opportunity and performance. A third growth area for NFA emerged from its inheritance of a range of businesses and facilities which had failed in private hands and were transferred to its portfolio. In almost every instance, these additions continue to be either non-performing assets or, in some cases, non-operating assets.

The task for NFA, in support of the Aquino administration's goals, is to divest itself of those activities and assets not relevant to its central mission, and to efficiently and effectively concentrate on its primary activities.

2. A 1984-85 STUDY BY THE PUBLIC ADMINISTRATION SERVICE SET THE STAGE FOR A REVISED NFA OPERATION, AND THE NFA HAS SUBSEQUENTLY TAKEN STEPS TO FOCUS ON ITS STABILIZATION MISSION

In 1984, an extensive report on the roles, organization and systems of the NFA was prepared by the Public Administration Service (PAS), a U.S.-based consulting firm. This work was carried out under a contract with the Asian Development Bank as part of the Agro-Processing and Marketing Project. The report findings and recommendations were accepted by NFA and ADB and shared with major Philippine officials, ministry representatives, and the World Bank.

To an exceptional degree, the PAS report set forth an agenda for the NFA which matches the intent and direction of the Aquino government. The report concluded that major changes were required in NFA's direction and programs, and that an appropriate framework for NFA should be constructed around several principles:

- The stabilization mission should be limited to the vital food staples of rice and corn, and the level and nature of stabilization efforts would be determined on the basis of the minimum, affordable, effective intervention. (The PAS report also recognized a minimal stabilization role in wheat, but argued for complete withdrawal from its previously held monopoly position.)

- The NFA role in other commodities should be limited to industry development and support, shifting away from NFA-owned and operated facilities. Specifically, NFA should not engage in the highly risky business of procurement, processing and distribution of perishables.

- All NFA programs and facilities should be subject to examination for relevance to mission and economic viability, and the NFA should work to divest itself of non-economic and peripheral programs or facilities.

- The PAS report then addressed a range of specifics concerning:

  - The reconstruction and more efficient organization of the systems and operation of its programs which would be retained in this limited framework

  - The current financial state of the NFA and the impact of mission changes on its financial requirements

  - Identification of peripheral programs and facilities which would be subject to divestiture planning and action.

NFA adopted and advanced the findings and recommendations of PAS and the past administration took initial steps to implement the program. For example, Executive Order 1028, signed on May 31, 1985:

- Deregulated the price of milled rice as of October 1, 1985

- Limited the NFA stabilization functions to rice and corn, and where necessary, wheat

- Directed the NFA to relinquish or transfer to another government entity or the private sector all its non-grain stabilization and trading activities, specifically identifying the Kadiwa operations and Food Terminal, Inc.

- Opened the importation of wheat and the distribution of flour and fertilizer to the private sector.

Furthermore, the NFA adopted the principles of the PAS report into its 5-year development plan. It organized itself into Task Forces and Committees to evaluate and implement the PAS recommendations. Much of the information gathered by those groups was well done and proved helpful in formulating this report.

The new administration of the NFA which came into office in March 1986 has continued to advance and support this work as part of its overall agenda for NFA. Specifically, in its first 5 months, the new administration has shut down 25 provincial Kadiwa centers and FTI has reduced its 21 Kadiwa centers and 47 satellites located in Metro Manila to 11 centers. Internal reorganization plans aim to reduce the Authority's authorized personnel complement by 30 to 35 percent -- mostly through voluntary retirement.

3. THERE ARE SEVERAL IMPORTANT INCENTIVES FOR NFA TO DIVEST ITS PERIPHERAL ACTIVITIES IN THE NEAR-TERM

As will be quantified later in this report, the losses generated by its peripheral activities and assets have had extraordinary impact on the Authority's fiscal well-being. Therefore, their divestment has vast ramifications in budget and financing terms. With the termination of its monopoly position in wheat, flour and feedgrains, NFA lost its most significant revenue source. Without regular budget support, it will not be able to support the basic organization and trading activities necessary for the grain price and supply stabilization, development and regulatory roles which remain its mission.

NFA is under substantial pressure by the administration to show tangible results from its divestiture planning and demonstrate an irrevocable commitment to proceed swiftly on that course. The analysis and recommendations in this report advance that work and remove some of the conditionality associated with future budget allocations. Indeed, divestiture of peripheral assets could provide direct relief to this financially beleaguered entity, by reducing the outflow required to keep them afloat.

Another significant incentive for the NFA and its "parent," the MAF, is compliance with the PL-480 Title I Agreement between the GOP and the U.S. government. According to Self-help Measure D of that agreement, the stabilization and trading activities should be transferred to another government entity or to the private sector. This measure focuses on the divestiture of the operations of Food Terminal, Inc., and the Kadiwas, requiring that either the government proceeds with divestiture, or it completes, by January 31, 1987, a study to guide the divestiture. The government can also satisfy the agreement if it proceeds with the divestiture without preparing a study.

4. THERE ARE SEVERAL GUIDING CONCEPTS WHICH HAVE WORKED WELL IN SUCCESSFUL PRIVATIZATION PROGRAMS IN OTHER COUNTRIES

This section introduces several concepts that have proven useful in the privatization programs in other countries, and which have been used to help establish a practical framework for divestiture of NFA's peripheral operations.

Privatization has become a pervasive force throughout the world during the past 5 years. Countries all over the world, developed countries, developing countries, and communist bloc countries alike, seem to be discovering that government-owned enterprise can be turned over to the private sector, with an improvement in the quality of goods and services, much lower costs, and an increase in the government's tax base.

The Center for Privatization (CFP) in Washington, D.C. has been contracted by the U.S. Agency for International Development to lead and coordinate privatization efforts in AID's recipient countries.

Some of the concepts which have emerged from these efforts to create successful privatization programs are as follows:

- The government must be fully committed to privatization and understand what that commitment entails in terms of the political sacrifices, capital requirements, effects upon employment, and the work and time involved in selling off assets.

- Privatization must be accompanied by an effective public awareness and education campaign.

- Privatization is best carried out by a competent staff committed to divestiture and the organization of the implementing group should be created early in the process.

- Existing employment must always be taken into account.

- Enterprises to be divested should be priced at their fair market value, and fair market value must be based on the potential profitability of the enterprises.

- Privatization programs should commence with those operations that are the easiest to divest.

- Privatization should be viewed as an opportunity to spread the wealth, generally through a broadening of ownership.

- Extensive restructuring or rehabilitation of an enterprise by the government in preparation for its eventual sale, which may actually be a delaying or holding action, is not an acceptable part of a privatization program. The key criterion to determine whether rehabilitation is acceptable, are the cost-benefits derived from the action, and the time required.

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- Likewise, management contracts or leases of assets from the government which do not eventually lead to a sale of the enterprise should not be part of a privatization program; however, long-term leases of privatized assets are acceptable.

- Privatization should involve a genuine risk of financial loss on the part of the investors, without protection or special incentives.

- Privatization must deal creatively and decisively with the problem of excess or unmanageable liabilities.

- Foreign investment should be encouraged when local sources of capital are inadequate.

These concepts are explained in greater detail below, with particular reference to the NFA operations which are candidates for privatization.

(1) <u>The Government Must Be Fully Committed To Privatization And Understand What That Commitment Entails</u>

The Aquino administration intends to privatize a large number of state-owned enterprises (SOEs); however, it is not clear that there is a full understanding on the part of the government what that entails. At the time of the preparation of this report, a proposal, drafted by the Presidential Commission on Government Reorganization advanced the immediate objective of divesting government-owned activities that can be better carried out by the private sector, thereby reducing public budget deficits. The study team appreciates the posture of the GOP, but hastens to offer some realism concerning privatization. There are obvious longer-term benefits in terms of increased employment, investment, tax revenues and the overall health of the economy. Viewed broadly beyond the scope of the immediate study for NFA, the privatization effort will involve massive amounts of capital, some dislocation of employment, and some gaps in the provision of goods and services while the private sector gears up. A well-planned, privatization program must incorporate the means to minimize such impacts and lay the foundation for increases in productivity, employment, and tax revenues in the medium-term.

One of the most critical areas to the Aquino administration is unemployment, especially in light of estimates of 3 to 5 million persons out of work. Privatized units may retain many of the existing employees, but obviously there will be some cutbacks and screening to achieve viability and greater productivity.

The administration has proposed to provide severance pay, one month's pay for every year of government service, to mitigate the dislocation effects of privatization. To effect this policy, the NFA has set aside P100 million ($5 million) for severance pay. Without further analysis, it is difficult to know whether this figure will be adequate. Furthermore, the severance payment itself may be viewed as a very small amount by retiring workers in an economy where jobs are hard to come by.

(2) Privatization Must be Accompanied By An Effective Public Awareness and Education Campaign

In a privatization program such as the one envisioned for the the NFA, not only might there be fears that the government is putting people out of work, but also that it is giving away the nation's assets. These criticisms may be voiced despite general public knowledge that most of the state-owned operations are financial losers and cost the government and taxpayers billions of pesos. A public awareness and education campaign can alleviate some of these fears and reduce political resistance to privatization.

Another role of such a campaign would be to reduce resistance to the inevitable financial losses and adjustments which must be made. Rather than being swayed by journalistic and political emotionalism that the privatization program is giving away of the nation's assets, the public can be educated on the true value, accumulated losses, effect upon external debt, etc., of the SOE. The fact that the loss has already occurred (with much of the capital in the hands of Marcos and his cronies overseas) means that many of the adjustments are primarily accounting for the actual situation. The need to price the assets at a fair market value so that the operations will be purchased and feasibility can be achieved by the new investor should also be explained. While desirability of business being in the hands of the private sector rather than the government is obvious to many, it is not always so in countries where capitalists are seen as opportunists and price gougers.

(3) Privatization Must Be Carried Out By An Implementing Body Committed To Divestiture

Privatization at this point is only a policy promulgated by the Aquino administration; therefore, procedures and organizations responsible for implementation on a broad, national scale have not been set up. This report, therefore, will make recommendations for a divestiture program to be carried out by an implementing body formed within the presently existing governmental structure. There will be considerable pressure placed upon any such group, not only by the public, but also by buyers seeking bidding information, concessions, and fire sale prices. Our plan will attempt to recognize and safeguard against such pressures, and to support a swift, efficient divestiture of operations.

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(4) <u>Existing Employment Must Always Be Taken Into Account</u>

As indicated above, existing employees may often be retained by the privatized operating entities, although the workforce in most cases, will need to be reduced or changed to achieve profitability. Private sector buyers will scrutinize carefully any requirement to retain present workers, as labor unrest, strikes, slowdowns, etc. are real issues for employers. Sometimes employees are offered an opportunity to purchase shares in the privatized firm, which can substantially reduce opposition to divestiture by employee groups. In most cases, the buyer will want to screen the employment roster carefully to winnow out problems at the start. The NFA and FTI employees currently do not have a collective bargaining agreement; nevertheless, considerable attention must be paid to easing the stress privatization can impose to avoid creating widespread (including other government-owned SOEs) employee opposition to divestiture efforts.

(5) <u>Enterprises Should Be Priced At Their Fair Market Value</u>

The NFA has records of the acquisition prices of the plant and equipment of the operations, and subsequent expenditures for expansion. The accuracy of some of these records is questionable. Also, these acquisition costs have also been adjusted upward to reflect inflation in the economy, giving what Philippine appraisers term a "sound value." The use of sound value as a surrogate for market value, however, can be misleading. Sound value does not take into consideration superadequacies (when the assets are over-built) or economic obsolescence (when there is insufficient market demand to utilize an asset at a normal operating level). <u>This report, therefore, has estimated the value of these operations at their market price primarily based on what the purchaser could earn with them under privatized ownership.</u> Even beyond that, the price may have to be discounted farther to give the investors an additional incentive -- and to attract interest in making the purchase in the first place.

(6) A Privatization Program Should Commence With The Sale Of Those Operations That Are Easiest to Divest

To be successful, this privatization program must achieve considerable early momentum. Priority, therefore, should be given to those operations in the NFA portfolio which have the best potential viability and which will be easiest to privatize. Although none of the NFA operations slated for privatization was determined to be profitable in its current condition, several have potential for being attractive to investors.

(7) Privatization Should Spread The Wealth

The past regime gained a well-deserved reputation for crony capitalism and favoritism, and any divestitures involving a continuance of this practice will hurt the program. Therefore, recommendations are made in this report to establish wealth-spreading schemes where they appear to be feasible. This does not preclude a divestment to a single buyer when it is in the best interest of the nation to do so; however, there are Philippine situations which may arouse unusual sensitivity. One such case might be where it would be inadvisable to sell a large operation, such as the NPGC in Isabela, to a single rice trader, or even a small group of them, because of the effect that the owner of such a large facility could have on the marketplace. The study team devised strategies, including buy-out opportunities for small producers and sale of blocks of stock to agencies such as the IFC, to overcome these unwelcome effects. The present limited interest in capital investment through the stock exchange and the relative size of the operations analyzed may make flotations and wide ownership difficult to achieve in the near-term.

(8) <u>Extensive Restructuring Or Rehabilitation Is Not An Acceptable Posture Unless The Cost-Benefits Are Positive And Can Be Implemented In The Short-Term</u>

In general, the study team is not recommending that the NFA invest in rehabilitation of facilities prior to their sale. Such efforts would only delay their divestiture. The team found only one case where rehabilitation is necessary, the revamping of the central refrigerated warehouse at FTI. The only other exception would be where the returns from the rehabilitation would be clear and certain and where upgrading could be done in the short-term. The benchmark prices developed herein allow for improvements to be made by private investors after the sale.

(9) <u>Management Contracts Or Leases Are Not Acceptable Unless They Lead To Sale Of The Operation</u>

As long as the operation continues to be held by the government, management contracts to run SOEs or leases of government-owned assets or operations are not recommended, unless they are for the purpose of allowing a potential investor to "try-out" an operation before committing to purchase it. In all such cases, the contract should include an option by the potential investor to purchase the facility after a limited trial period. Such contracts or leases, agreed to on a long-term basis, are acceptable, however, if the assets have been divested to private hands.

(10) <u>Privatization Involves A Genuine Risk Of Loss By The Investors</u>

There is sometimes an attempt on the part of new investors to obtain preferential treatment or protection by the government in the form of tax and tariff reductions and so on. These should be resisted, as they distort the marketplace and require the government to forego revenues over a period of several years. An operation requiring subsidy should probably not be operated at all. If any incentive is given, it should be that of lowering the sale price of the enterprise to compensate for any unusual risks.

(11) Excess Liabilities Must Be Dealt With By The GOP

SOEs typically are burdened by excess liabilities for which new investors will not want to be responsible. The GOP should anticipate that it will deliver the enterprise to the new investor free and clear of all liabilities, liens, obligations, and legal actions. If this cannot be accomplished, there must be compensating drop in the sales price. Privatization can stop the financial hemorrhaging, but it can only partially recapture the losses if the outflow has been prolonged. Liabilities to other GOP ministries and agencies should be written off. Negotiations will have to held with the private sector creditors, based on their importance as lenders, suppliers or service-providers to the privatized firm, to liquidate these payables prior to or upon sale. In the end, some liabilities may have to be assumed by the GOP.

(12) Foreign Investment Should Be Encouraged When Local Sources Of Capital Are Inadequate

Given the magnitude of the overall privatization program envisioned by the GOP, and the limited liquidity of the banking system and individuals, the NFA may want to open up privatization opportunities to foreign investors. The present 60-40 law for joint Filipino-foreign joint ventures may not be adequate to fill the capital, managerial, marketing and technology gaps expected to show up as the privatization of SOEs moves ahead but there is obviously great sensitivity surrounding this issue. Foreign investment in divested SOEs has several advantages: it brings in new capital; it can create greater competition in the bidding for these firms and assets and therefore raises their price; and it may also introduce new managerial talent, technology, and export market access to make them more profitable. In the case of the Philippines, foreign investment may facilitate a more rapid divestment process and consequently a faster economic recovery for the country. Subsequent Filipinization over a fixed period, say 30 years, can be required and would be an acceptable feature.

* * *

This chapter has been an introduction to the analysis of the peripheral operations of the NFA. Specifically, it has provided a report on the status of privatization as a part of the Aquino administration's focus on private initiative. The chapter has also served to review the renewed emphasis of the NFA upon its stabilization activities, which underscores the need for divestiture of its peripheral activities. It has set forth some concepts useful in formulating a divestiture program. The following chapter analyzes the individual peripheral operations, proposing a divestiture strategy for each one.

II. DESCRIPTION OF NFA'S PERIPHERAL OPERATIONS

This chapter discusses selected peripheral operations of the National Food Authority that, in the judgment of NFA, constitute opportunities for divestiture to the private sector. These include:

- Food Terminal, Inc. (FTI)
- NFA Kadiwas (People's Markets)
- Iloilo Thermal Electric Generation Plant
- Southern Philippines Grains Complex (SPGC)
- Agro-Processing and Marketing Project (APMP) which includes the Northern Philippines Grains Complex (NPGC)
- Tabangao Bulk Unloading and Storage Facility
- Bicol Seed Company
- Digos Agro-Industrial Complex.

Each enterprise is discussed below in terms of its historical background, fixed assets and their condition, operational status, financial status, and employment. The chapter also discusses the constraints and social impact of privatization of each enterprise. Each section concludes with a discussion of the estimated financial viability of the enterprise, the types of buyers who might potentially acquire it, and the recommended strategies for divestiture.

Each operation is distinct in terms of its operational characteristics, risks, and constraints to privatization. Therefore the approach to privatization in each case is different. The characteristics of each enterprise, its potential viability, and the exigencies surrounding each situation (what must be acted upon in the short-term and what might be postponed) lays the foundation of the strategic divestiture plan presented in Chapter III.

The geographic location of each facility is denoted in Exhibit II-1.

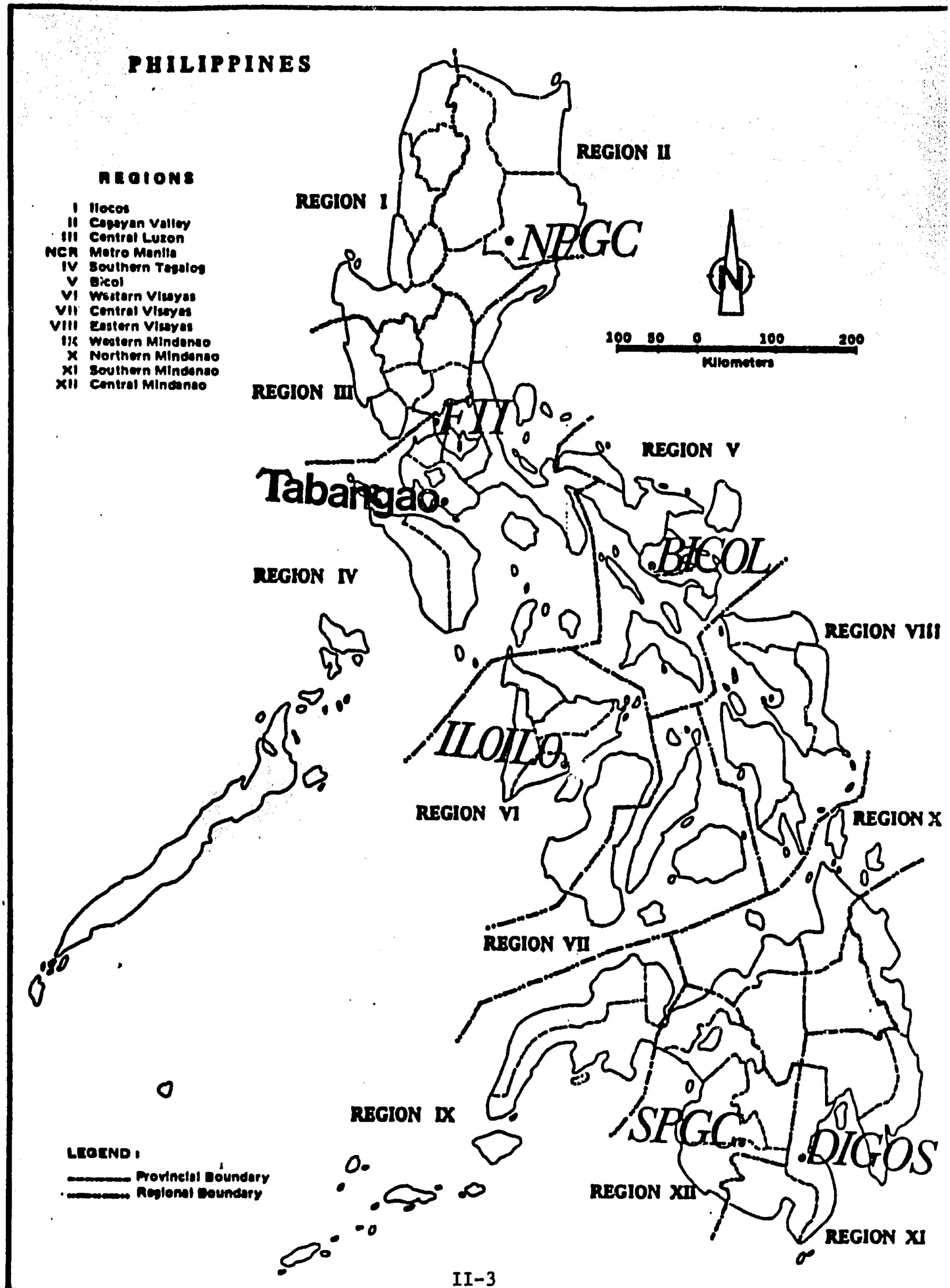
1. FOOD TERMINAL, INC. (FTI)

This section discusses FTI, a major subsidiary of the NFA, which, despite 1985 gross sales of foodstuffs of P638 million ($31.9 million) and other income, primarily rental income of P70 million ($3.5 million), incurred losses of P134 million ($6.7 million) and presently faces a severe shortage of working capital.

(1) FTI Has Been Passed From Organization To Organization, Ending Up As A Subsidiary Of The NFA

FTI was originally established as the Greater Manila Terminal Food Market in 1969 on a 120-hectare site in the Fort Bonifacio Military Reservation. FTI leases this site from the Ministry of National Defense. During its early years, FTI engaged primarily in emergency trading operations, but later went into massive food procurement and distribution. In 1974, it was renamed Food Terminal, Incorporated. FTI was managed by the Development Bank of the Philippines (DBP) until 1979 when the Human Settlements Development Corporation assumed control. The FTI was then restructured as a government-owned corporation, and transferred to the NFA in early 1981. Despite these changes, in the late 1970s and early 1980s more than 30 foreign and domestic industries were induced to build factories on land sub-leased from FTI.

EXHIBIT II-1
LOCATION OF NFA PERIPHERAL OPERATIONS



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Under the NFA, FTI's key installations were rehabilitated and new infrastructure was developed. In 1981, a nationwide system of Kadiwa centers (retail food stores) was also established, with more than 400 centers in the provinces, and 25 centers, 42 satellites, and 65 mobile stores in Metro Manila. The Kadiwa operation was part of a grand scheme to provide basic foodstuffs to the poor at below-market prices. The Kadiwas were also viewed by NFA management as a means to make FTI a viable operation.

(2) FTI's Primary Role Was Food Supply And Price Stabilization, But It Also Served The Marcos Regime As A Political Tool

FTI's strategy was to set up a marketing network for food commodities, providing facilities and services to farmers, food producers, processors, and wholesalers. Its objectives were to:

- Ensure a steady supply of quality food at reasonable prices
- Encourage production and upgrade the farmer's standard of living
- Generate employment opportunities
- Boost foreign exchange.

The current pricing policy for the Metro Manila Kadiwa stores is to:

- Set prices for basic foodstuffs and household commodities to be sold to the underprivileged at 5 percent below the prevailing market price

- And for non-basic commodities, including fruits and vegetables, at the prevailing market price.

A list of basic commodities carried by the Kadiwas is found in Appendix C of this report.

It must be noted that FTI and specifically the Kadiwas were often used for political purposes by the Marcos regime. Its vast network served as a convenient channel to voters, and FTI distributed free rice, for instance, to voters prior to the last election. It was not surprising to learn that Imelda Marcos was the Chairman of FTI, and that the Kadiwas were one of her pet projects (probably because of their political usefulness). A boycott of the stores from 1983 to 1985 reduced patronage substantially.

The name Kadiwa means oneness, togetherness or belonging in Tagalog. Because of the negative Marcos connection, NFA recently changed the stores' name to Tindahan Natin (People's Market).

(3) <u>The FTI Complex Includes Considerable Developable Land Which, If Ownership Is Transferred To FTI, Would Greatly Enhance The Ability To Divest Its Assets</u>

According to its year-end 1985 balance FTI has the following fixed assets:

Fixed Assets	Millions of Pesos	Percentage
Land and land improvements	50.0	8.8
Buildings and leasehold improvements	229.6	40.9
Furniture and equipment	281.5	50.2
Sub-total	561.1	100.0
Less: accumulated depreciation	159.8	
Net property, plant and equipment	401.3	

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A review of an appraisal made in 1985, on which these figures appear to be based, allowed the study team to see that such figures are nearly worthless when attempting to place a value on such assets. First, the 1985 appraisal is merely an updated version of a 1979 appraisal, whose figures had been multiplied by factors reflecting the cumulative inflation from 1979 to 1985. It was not known whether specific items listed in the appraisal are obsolete, inoperable, missing, or excess.

Because the appraisal of FTI is an unreliable estimate of the value of the assets, the study team has determined "fair market" value of the peripheral operations based on what the assets or operation can earn (see Appendix A).

Exhibit II-2 shows the FTI facilities, leased facilities and vacant land on the complex located just south of Metro Manila. The following assets are located on the complex:

- A spacious, three-story administrative office building.

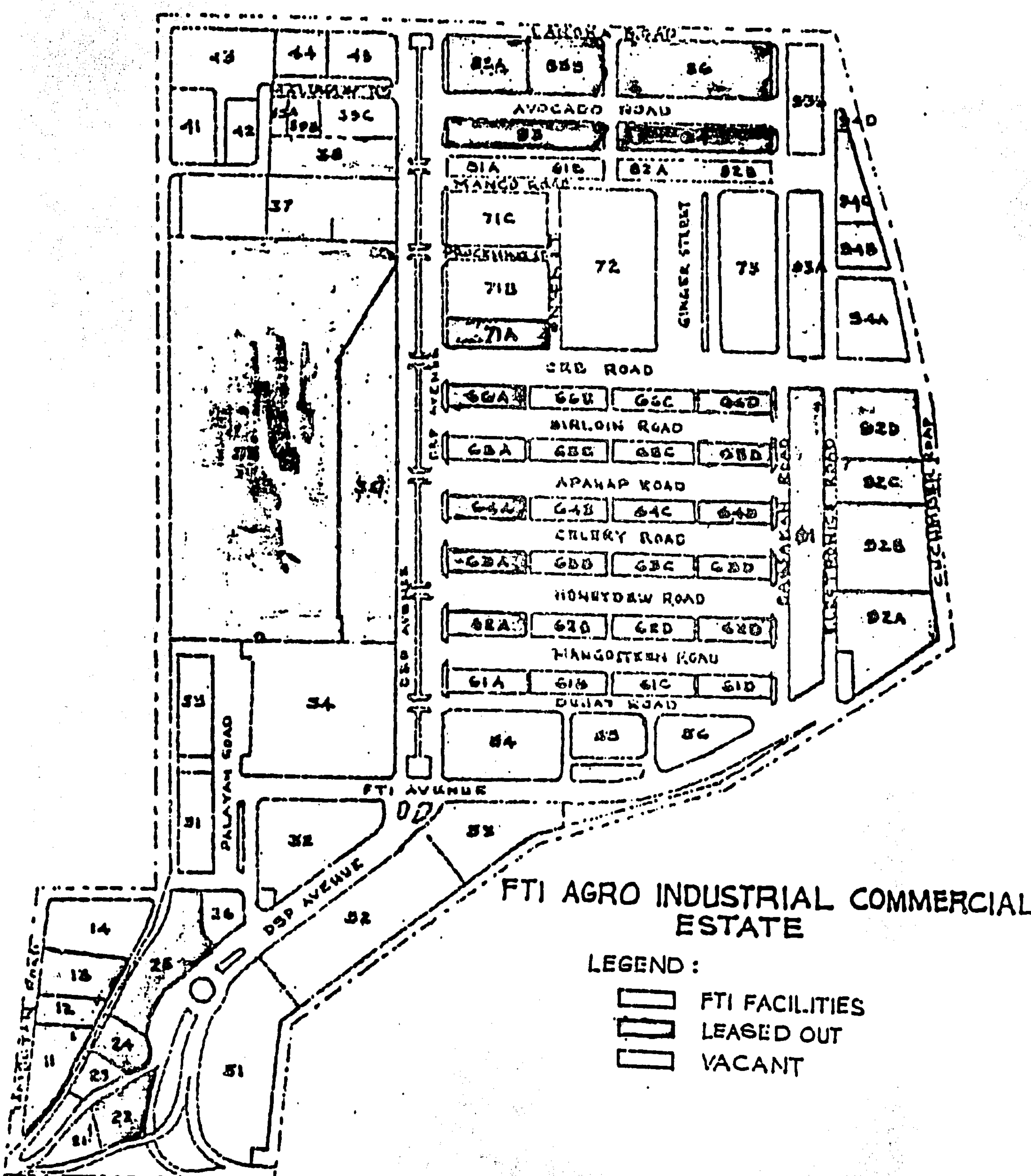
- Wholesalers' building containing six stalls, a chilling room, canteen spaces, platforms and mezzanines.

- A central refrigerated warehouse with an effective capacity of 55,000 cubic meters. The facility contains 18 rooms (28,000 cubic meters) for chilling, and eight rooms (27,000 cubic meters) for freezer storage. There are also seven blast freezers with a capacity of 1,600 cubic meters and five refrigerated processing rooms.

- A 5,944 square meter dry warehouse.

- Four retail market buildings containing 43 stalls of 42 square meters each and a commissary.

EXHIBIT II-1


FTI AGRO INDUSTRIAL COMMERCIAL ESTATE
LEGEND :
FTI FACILITIES
LEASED OUT
VACANT
AVOCADO ROAD
FTI AVENUE
DSP AVENUE
HONEYDEW ROAD
CELERY ROAD
PALAYAN ROAD
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- A slaughterhouse with a processing capacity of 160 cattle and 1,200 hogs daily on a single-shift basis.

- A small chicken-dressing plant with machinery capable of processing 1,000 birds per hour.

- Land, 550,000 square meters, on which 35 industries have built facilities. Annual rental fees range from P10 to P46 per square meter.

- Twenty-two hectares of undeveloped land, 12 of which are sub-leased to, but not used by, the Philippine National Railways for P.10 per square meter for 50 years (see lots 34 and 35 on the map of the complex). This undeveloped land is one of the most attractive sales features of the complex.

- The complex is in a prime location: just off the South Super Highway, near the airport and only 15 minutes from Makati. There are some problems due to the narrow and congested access road, but traffic congestion seems to be the norm for Metro Manila.

One of the most important assets is the central refrigerated warehouse, reportedly one of the largest such facilities in Asia. As will be noted below, it is a major user of electricity (50% of total consumption of the complex), and is in poor repair, with ill-fitting doors, refrigerant leaks, and poor lighting. Refrigeration engineers must examine the warehouse to determine the condition of the equipment, its expected life, and ways to put it to greater use, and estimate the repair costs. A number of its 26 chilling and freezing rooms are presently shut down, some because of mechanical problems, others because of a lack of users. Present utilization is 25% of the 28,000 cubic meter chilling area and 56% of the 27,000 cubic meter freezing rooms. It is estimated by FTI's Facilities Management Group (FMG), which manages the warehouse, that P5 million to P6 million will be required to rehabilitate this facility.

Semiconductor operations located in the FTI complex store perishable plastics under refrigeration and cited this facility as one of the reasons for locating in the complex, although their space requirements are small. Other users, primarily purveyors of agricultural and livestock products, now lease space on an as-needed or seasonal basis.

The chicken processing plant is utilized by three processors: one, Magnolia, a division of the San Miguel Corporation, uses it for 10 hours daily with its own crew; and two other processors, RFM and Purefoods, each use it for four hours daily using FTI crews. This processing plant is a cramped, poorly laid out facility with little dock space. The dressing line has an output of 1,000 units per hour, which is considered low by local chicken processors. It lacks adequate water for good sanitation; however, this will be resolved by a hook-up to the municipal system expected by year-end.

The slaughterhouse provides services for three meat wholesalers and the Metro Manila Kadiwa stores. The facility processes 420 hogs daily (35% utilization) and 150 cattle daily (utilization of 94%). Hog line utilization may be low because of lowered buying power in the Metro Manila area. The slaughterhouse includes office space, and a chilling room presently used as a canteen. In the sale transaction, the buyer may want to purchase additional land on which to erect larger chilling facilities. It is inconvenient to haul processed beef and pork to the central refrigerated warehouse. The slaughterhouse also has its own holding pens at the complex. Users report that the machinery at the facility is nearly worn out, and will have to be replaced. The slaughterhouse also lacks an adequate water supply for hygiene. This problem will be resolved by the extension of the municipal line to the complex.

There are several food processors currently leasing processing rooms: three shrimp exporters, a frozen mango exporter, and a snail canning operation. These are considered by FTI to be embryonic industries which operate, some of them rather intermittently, under the FTI roof until they can afford better facilities elsewhere.

Another facility in the complex is the FTI Baking Technology Center, basically a baking school, which seems to be a poor use of valuable industrial space.

Also on the premises is the Food Development and Technology Center, which inspects food exports and reportedly works with entrepreneurs to develop new food processing techniques and products. It is notable that the Center, which was financed through the ADB's Agro-Processing and Marketing Project (APMP) discussed below, recently was certified by the U.S. Food and Drug Administration as an inspection facility for selected products. This enhances Philippine quality control of processed foods exported to the U.S. market.

(4) FTI Is Organized In Five Major Departments And Employs 1,585 Persons

The departments of FTI and their number of personnel as of August 1, 1986, are as follows:

Office of the President	14
Food Development and Technology Center	60
Commission on Audit	60
Office of the General Manager	43
Corporate Services Group	392
Facilities Management Group	410
Marketing Operations Group	606
Total	1,585

The Commission on Audit (COA) is included under the Office of the President, but is really a government-mandated office of independent auditors. The Corporate Services Group is responsible for public affairs, health and safety, corporate planning, treasury, security and investigation, administration and general services, and accounting functions.

7/1

The Facilities Management Group leases out space, maintains facilities, and operates several of the processing activities (slaughterhouse, chicken processing and some other limited food processing).

The Marketing Operations Group runs the food wholesaling and retailing in Metro Manila. During a recent retrenchment, all 23 of its Kadiwa centers were closed; 11 were subsequently re-opened, but 133 employees were laid off, leaving the group with 606 employees. Each retail outlet employs about 45 employees. Most Kadiwa buildings in Metro Manila are owned by FTI, but are located on land belonging to other government agencies.

(5) FTI Continues To Require NFA Subsidies Because It Is Unprofitable And Acutely Cash-Short

Although severely constrained for cash, FTI continues to operate, amassing additional losses and payables. Its current liabilities rose P166 million ($8.4 million) during 1985. Despite rather large food sales, P638 million ($31.9 million) in 1985 and a respectable gross profit on these sales of 8.7 percent, it reported a loss of P148 million ($7.4 million). Losses in 1984 were P85.6 million ($4.3 million). Audited financial statements are included in Appendix C.

In 1985, FTI's total revenue of P127 million was composed of P56 million from food sales (44%); P46 million from estate rental (36%); and P25 million from food processing, interest and miscellaneous income (20%). However, the total revenue was completely overwhelmed by three expense items: personnel, electricity and interest, which together accounted for 35 percent of the total revenue figure.

Electricity costs are a major problem for FTI. These costs are based on a fixed, sub-station capacity rate by Meralco, the local power company. These costs are judged by FTI to be approximately four times the cost of the actual electricity consumption.1/ FTI paid Meralco nearly P50 million for electricity in 1985. Even if the problem of allocation of costs is corrected, many individual units within the FTI complex lack meters, thus a correct billing for electricity costs is impossible.

FTI has some major outstanding loans, most of which were borrowed to finance the Kadiwa operations, which will have to be dealt with in order to deliver a company free of debt to private investors. These major loans include:

	Loan Millions of Pesos	Interest Rate (12/31/85)
Philippine National Bank	100.0	39%
Land Bank of the Philippines	93.0	30%
Piso Bank	7.1	20%2/
Development Bank of the Philippines (NFA's assumption of FTI's liability in 1984)	520.6	
Total	720.7	

Interest on these loans amounted to P84 million ($4.2 million) in 1985.

1/ It is reported that when Meralco was taken from the Lopez family to be managed by Benjamin Romualdez, he sharply raised the rates to siphon off money from the government wherever possible. He also encumbered Meralco with loans to such an extent that, now that the company is back in the hands of the Lopez family, it may be difficult for them to reduce the rates.

2/ Average rate.

Based on figures provided to us by the Central Office of the NFA, FTI also owes massive payables to the NFA totalling approximately P554 million; however, reimbursement will depend upon the amount of cash generated by FTI's divestiture.

To keep going, FTI estimates that it needs a cash infusion of P60 million to P80 million from the NFA in the near-term. The amount of the NFA subsidy in 1985 was P59.5 million. Some belt-tightening is in evidence, but nothing significant in terms of reducing the overall deficits. As of May 31, 1986, FTI's sources of cash appear slim: P25 million in rent receivable and P35 million from other less-promising receivables. Another source of cash would be the large inventory of food items supposedly held by FTI Marketing. However, the size and value of the inventory has been disputed by COA which claims that the year-end figure should have been P68 million, rather than the P140 million shown on FTI's balance sheet. A physical inspection of this inventory by the study team found the frozen inventory to be nearly valueless, except possibly as animal feed. The dry goods inventory is also in poor condition, due to poor handling and storage practices, and expired goods. The main source of goods presently for sale through the remaining Kadiwas is from suppliers on 30-day terms.

(6) <u>There Are Four Major Constraints to FTI Privatization</u>

A major constraint to privatization is the large investment and diverse management talent required to purchase and manage FTI as a complex. This constraint can be addressed by breaking the complex into affordable and more manageable segments.

A second constraint is the fact that the land is presently leased from the Ministry of National Defense. This 25-year

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lease has 8 years before the option to renew for an additional 25 years can be exercised. Unquestionably, this leasehold has value, especially since the rental fee is 10 cents per square meter. However, the inability of a developer or other purchaser of individual FTI components to pledge buildings on leased land, or the leasehold itself, as collateral for additional loans under the present circumstances, greatly detracts from the attractiveness of investing here. Furthermore, since two government entities are involved, extracting the GOP from the ownership of this property is complicated. FTI should become the landowner so that individual components of the complex may be privatized. The marketing of the developable land alone could attract considerable interest by developers. At the same time, the 12 hectares presently sub-leased to the PNR is not used for any purpose. This lease needs to be abrogated so that the land can be included in the privatizable package.

A third major impediment to privatization is the large number of employees still working at FTI. While the current level of employment, 1,585, is far below its 3,500 employees in 1985, this number will be cut further as the operation is privatized. By virtue of the timing of this study, FTI may become one of the first major SOEs to be privatized, and therefore care should be taken to ensure that privatization does not become synonymous with the wholesale dismissal of employees. This retrenchment should be gradual, but completed by a certain date. In a recessionary climate with high unemployment, large dislocations of personnel may well backfire.

The fourth major constraint is the electricity charges imposed by Meralco, as described above. Discussions held with Meralco by NFA to date have been fruitless. Discussions have even been held with the NPC concerning extending a transmission line directly from the NPC to the FTI, bypassing Meralco altogether. Meralco's pricing structure discriminates against all industries. Studies are being made by the government to reduce the subsidies for certain (poor) consumers and to reduce transmission line losses in order to reduce the burden on industries. Ultimately, individual components within the complex must be metered to determine actual consumption.

Some have voiced concern that because the Kadiwas serve the low-income population, that group would be adversely affected by the closure of these stores. To measure the validity of this complaint, the study team reviewed the most recent grocery price survey performed by FTI staff and found that FTI prices were higher or equal to the prices charged by competitors on all items, except rice, poultry and beef -- items supplied by FTI itself. It was also reported that the purchase price of some Kadiwa goods was 50% higher than current retail prices. Furthermore, FTI's retrenchment earlier this year closed down stores which were competing unsuccessfully with public markets. Therefore, the economic benefits to the poor from these outlets is questionable.

In addition, the large amount of food sales by FTI, P638 million in 1985, displaced private sales. To continue this operation would be contrary to the Aquino administration's stated policy to stimulate private initiative.

(7) <u>There Are Two Types Of Potential Buyers: Users Of Specific Facilities Now Operating At The Complex And Real Estate Developers</u>

Potential purchasers include the present users of specific facilities, such as meat processors and wholesalers, poultry processors who are vertically integrated from farm-to-store, grocery operators seeking additional locations, wholesalers seeking an excellent dry warehouse, all of whom might possibly require access to the refrigerated warehouse. Potential buyers identified include Purefoods, General Milling, Vitarich, Federal Piggery, Universal Robina and RFM. Real estate management or development firms which could handle the current leasing, could lease or sell space in the refrigerated warehouse, and could develop the open tracts as office, factory or commercial space are potential purchasers for the remainder of the complex. Once the ADB window is set up, that financing would be instrumental to facilitate the purchase of these operations by such buyers.

(8) <u>The Privatization Strategy Involves Divesting Some Free-Standing Activities And Sale Of The Remaining Assets In A Block To Real Estate Developers</u>

The steps in a divestiture strategy for the FTI would be as follows:

- An Executive Order should be issued to transfer ownership of all land presently leased by the FTI to the FTI. This decree would abrogate the lease of the 120-hectare FTI complex from the Ministry of National Defense. It would further abrogate the PNR sub-lease of 12 hectares on the FTI Complex. It would transfer to FTI land owned by other government agencies on which the Kadiwa stores are located. (If this cannot be accomplished, a second-best strategy would be to lease out components on a long-term basis. The disadvantages to this approach are that the returns will be lower and will be spread out over time, and the government will still be involved.)

- The resolution of the Meralco problem may also require cabinet-level discussions and presidential action, as its discriminatory pricing policy adversely affects not just FTI, but the entire industrial sector. Once the pricing policy issues are resolved, Meralco would also be required to provide electric meters to individual operations in the complex, so that electricity is paid for on the basis of consumption, not transmission capacity.

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- Individual operations should be put up for sale starting with the most viable, which is believed to be the slaughterhouse. Next most viable would be the chicken processing plant. Because the chicken processing plant requires more space and a re-configuration of its lines to increase its output up to around 3,000 birds per hour, consideration should also be given to selling the food processing space adjacent to it, to provide for expansion and additional dock area. The market for dressed chickens is growing, making the facility an attractive buy for an expanding processor.

- The refrigerated warehouse would be set up as a "condominium" with individual rooms sold to businesses requiring refrigeration. The approach to its sale depends heavily on the assessment by refrigeration engineers recommended above. The warehouse would be managed by the real estate management/development firm, and space not sold as condominium units would be leased on an as-needed basis.

- As the Kadiwa situation requires early resolution, the dry warehouse and food stores should be put up for sale in a block with notification of the sale sent to a wide variety of wholesalers and retailers. The lease which is presently being negotiated for 3,000 square meters of dry warehouse space should permit its sale in the near future. If a block sale of the warehouse and Kadiwa outlets is impossible, they can be sold off individually.

- The recommended break-up of the FTI operation could entail the dismissal of up to 1,000 employees. The NFA should calculate at an early point the amount of severance payments required, and should request a special budgetary allocation if necessary. Staff should be dismissed gradually over the next 12 months. It is possible that the real estate management firm may want to retain a large proportion of the present Facilities Management Group to maintain the complex.

The remainder of the complex should be put up for sale to real estate developers who would:

- Manage the land leases of the industrialists who currently own buildings on the complex. It is conceivable that some Philippine corporations would want to purchase the land they presently lease from FTI. (Foreign corporations are not allowed to own land in the Philippines.)

- Manage the leasing of retail and wholesale stall space.

- Lease the present administration building for office space (The offices of the Facilities Management Group and the Baking Technology center can provide adequate office space for the firm managing the complex.)

- Develop the open 22 hectares for commercial, industrial or office use.

- Sell water to complex users based on metered consumption.

- Provide perimeter security for a fee to businesses within the complex.

- Maintain the roads and other support facilities to house the on-site staffs of the real estate developers.

(9) <u>Estimated Fair Market Prices On Existing Structures Total P82 Million To P238 Million, Depending On Resolution Of The Meralco Matter</u>

All assumptions and calculations for the valuation of the individual sub-components of FTI are included in Appendix B. Because of the impact of the high Meralco rates upon the viability of these sub-components, two sets of valuations have been formulated: one based on current Meralco charges, and one with the rates at about one-fourth their current level. FTI staff estimated that they are paying Meralco four times their actual electrical consumption. A summary of the estimated valuations, not including the undeveloped land, which will require a separate professional appraisal provided locally, are as follows:

	Valuations Based On Existing Utility Rates	Valuations Based on Reduced Utility Rates
	(Millions of Pesos)	
Slaughterhouse	3,942	13,548
Chicken processing plant	3,246	15,623
Central refrigerated warehouse	1,199	73,837
Estate management	73,308	135,833
	81,695	238,841

2. NFA KADIWAS (PEOPLE'S MARKETS)

This section discusses the provincial Kadiwa stores managed by the NFA. This is a different set of stores from the Metro Manila stores managed by the FTI, although these provincial stores were also once managed by FTI. The NFA is currently in the midst of shutting down the stores, apparently without any major social repercussions. The history of the stores and the curtailment is discussed here primarily to support NFA's actions.

(1) <u>These Stores Provided Food To The Provincial Poor At Low Prices, But In Doing So Incurred Considerable Losses And Were Used For Political Ends</u>

The first Kadiwa center was established in 1980 by the FTI to stabilize the supply and prices of basic food commodities and essential household items, and to distribute food on an emergency basis during natural calamities (and, as noted above, elections). The program was justified as a response to highly fluctuating food prices during the 1970s. In 1981, with Presidential Decree No. 1770, the National Grains Authority (NGA) was reconstituted as the National Food Authority (NFA) with expanded responsibilities to manage the FTI. It was consequently decided that the Metro Manila Kadiwas would be under FTI, and the provincial Kadiwas were to be managed by NFA.

The number of provincial Kadiwa outlets expanded rapidly, and in 1984, there were 242 with 47 satellite centers (minimarts). Some stocks for these stores were purchased centrally by NFA; others were bought directly from wholesalers by individual outlets. These outlets pursued their mandate, but the social good created was obscured by political abuse. They were also unprofitable as demonstrated below:

Sales and Losses of NFA Kadiwas
(Thousands of Pesos)

	1983	1984	1985	1986 (1st Q)
Sales	463,811	628,466	388,326	44,896
Net Loss	(35,322)	(18,301)	(47,488)	(11,286)

A recent survey also revealed that except for rice, prices in the provincial centers were at the same level or even higher than neighboring stores. Hence, a policy decision was made that only financially viable and socially desirable centers should be maintained. The NFA has cut the number of provincial Kadiwas down to 87 with 49 satellites, 41 mobile stores and 98 depots. Current employment stands at about 450 people with a monthly payroll of P950 thousand.

(2) There Have Been Some Concerns About Closing Down These Stores, But the Repercussions Seem Minimal

There has been some concern that closing down these stores would not be advisable in the current socio-economic and political situation. It is the perception on the part of the government and consumers that the private sector tends to "cartelize", colluding to raise prices and profits. Also, in some provincial areas the income levels are so low that provision of a subsidized food supply was thought to be necessary. At the provincial Kadiwas visited by the study team, however, there were almost no customers, and in several cases, the outlets appeared to be set up for the benefit of NFA employees who are provided a credit line of P1,000 per month. At sites where the Kadiwa was already closed, NFA's staff did not note major social impact from their closure.

Most land and buildings by the provincial Kadiwa centers are leased on an annual basis, except in five locations where both building and land belong to the NFA. In just one location the building was constructed on land belonging to the local government.

(3) Divestiture Has Already Begun And Could Be Completed By March 1987

A Committee on Divestment/Privatization of Kadiwa Centers and the FTI was constituted on June 11, 1986. This Committee

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recommended the closure of 64 non-viable outlets out of a total of 151 centers. The scheduled closures are as follows:

August	-	20
September	-	29
October	-	15

With this schedule, only 23 remaining provincial NFA Centers need to be closed; a task which could be accomplished by year-end, or the first quarter of 1987. "Closing-out-sales" could be readily accomplished, as procurement activities have been limited and inventories are low: inventory per store ranges from P150,000 to P200,000. The remaining Kadiwa centers on NFA land could be sold to employees' cooperatives or farm cooperatives, as has been done in Santiago, Isabela; Cabanatuan, Nueva Ecija; Bacolod, Negros Occidental; Mangagoy, Agusan del Sur; and Zamboanga City in Mindanao. All other leased centers could be phased out, with the movable assets and inventories auctioned off to competitors, or to employees' cooperatives.

The NFA building on local government land in Malolos, Bulacan, can be donated to the local government as stipulated in the initiating memorandum of agreement--and the operations closed down.

The study team supports the action taken by NFA to date and believes that complete divestiture is the correct policy to pursue. Under no circumstances should the NFA Kadiwas be transferred to FTI as prescribed in Self-Help Measure D of the P.L.-480 Agreement with the U.S. government. Self-Help Measure D, if followed, would only serve to perpetuate a losing situation, both in FTI and the provincial Kadiwas.

3. ILOILO THERMAL ELECTRIC GENERATION PLANT

In 1981, Northern Engineering, Inc. (NEI), an English engineering firm, submitted an offer to NFA to build a rice husk-fueled power plant which would be sited at the NFA milling, warehousing and regional office complex at Iloilo. The plant was to be a prototype unit which would burn three tons of rice husks per hour and produce nearly 2 mw of electric power. A portion of that output was intended to meet the power needs of the NFA facilities.

The U.K. Government supported this project with a loan whose conditions and features are detailed below. Counterpart funding was to be provided by NFA for installation and other development expenses as well as for operational costs.

Construction began in 1983. The project was delayed by a range of technical and design problems, including the need to establish an assured source of conditioned (mineral-free) water. These problems have been mostly overcome and the power plant has had two brief trial runs, the latest in July 1986. Evaluation of those test runs has established that the plant will operate within expectations. With an expansion in the conveyor system expected to be completed in September 1986, the plant will be ready to commence the initial year's industrial operation.

NFA considers the Iloilo power plant to be an appropriate candidate for divestiture, as the production and marketing of power is clearly not now within the NFA charter.

(1) The Total Loan Is P48.5 Million, But NFA Is Not Required to Begin Repayment Until The Plant Has Completed One Year's Operation

Total investment cost to date is P65.5 million, of which P48.5 million was supplied by NEI through the U.K. government loan. NFA has funded P15 million in installation costs, and has provided five trucks valued at P1.5 million, and laboratory and other equipment valued at P175,000. The assessed value of the land upon which the plant and its auxiliary facilities are situated is P146,692. The investment cost does not include already expensed items such as chemicals, gasoline and oil, personnel services, supplies and materials consumed in the construction and trial-run phases.

The U.K. loan supporting this project has the following conditions and features:

- The total loan is L1,565,699 repayable in Sterling. At a conversion rate of 31 to 1, this loan is worth P48,536,669 (approximately $2.42 million)

- The interest rate is fixed at 7 1/2% per annum, with no interest to be charged or accumulated until the end of one year's industrial operation.

- Fifteen percent of the principal is due within 14 days after completion of one year's industrial operation, with the balance due in ten equal semi-annual installments commencing six months after the end of the first year's operation. Accumulated interest is payable with each installment.

(2) <u>Projections Are Based On Assumptions Of A Privatized Operation That Sells Power Through The Local Power Company's Distribution System</u>

The major assumptions and projections regarding potential income and operating costs of the thermal plant are as follows:

- The plant will produce 2.0 mw gross, 1.78 mw net with an operating time of 24 hrs./day, 300 days per year. These figures are consistent with the design and affirmed by the trial runs.

- The selling price of electricity in the Iloilo area is estimated at P.70 per kwh, with annual increases. Electricity price projections provided by the NFA Corporate Planning Department were P1 per kwh; however, recent oil price reductions have lowered those electricity rates for the foreseeable future.

Assuming sale of 75% of its total output, the projected income is P6.7 million in the first year of operation with gradual increases to P8.8 million in the 5th year, and P12.4 million in the 10th year.

(3) The Constraints To Privatization Include The Terms Of The British Loan, And The Useful Life Of The Facility

The short amortization period for the British loan, just 7 years after the plant initiates operations, places a high cost burden on the owner in the initial years of operation. A buyer burdened by this loan would face a hefty negative cash flow from the outset. Therefore, it is recommended that NFA negotiate with the British to substantially change the terms of this loan. The study team feels that the posture of the NFA should be that the loan be converted into a grant. The British can point to the plant as a prototype, i.e., that this particular technology can provide electricity for ricemills using the by-products as fuel. Extending the amortization period of the loan is futile, as will be explained in the paragraph below.

The major constraint facing the sale of this facility is the planned extension of power from the Negros Oriental geothermal plant (112.5 mw output) to Iloilo and other parts of Panay by 1989. Even if delayed somewhat, this extension via submarine cable effectively makes the Iloilo plant redundant -- useful for stand-by operations only. The study team estimated the effective life of this plant at 5 years (see Appendix B), reducing its value to only P10.4 million ($520,000). If for some reason the Negros line were greatly delayed and this is known prior to the sale of the facility, the sale price could increase somewhat. Even under these conditions the sale price will fall far short of the acquisition cost.

NFA ricemills alone cannot adequately supply the fuel requirement of this plant. Additional husk must be procured and hauled by the prospective buyer. Roads are good and sufficient rice husk, according to an NFA study, does exist within a 10-kilometer radius. The expense projections assume hauling costs, but other acquisition costs could be incurred.

As part of any sale, contractual arrangements need to be made with NFA covering land or right-of-way use, provision of water, provision of rice husk, and provision of power for use by the NFA facilities. The projected usage figures for the NFA compound are 220 kw, or approximately 11% of the expected net energy output of the plant. The nature and value of these arrangements will affect the income and expense projections, and therefore the fair market price. Preferably, the buyer of the plant will guarantee the NFA power requirements and NFA will be compensated for the value of the water, husk and other services provided either by direct payment or by reduction in power charges. The projections and estimate of value in Appendix B are based on the assumption that such an arrangement can be worked out.

(4) <u>Positive Social Impact Will Be Created From The Operation Of This Plant</u>

This project, when operational, will generate and sustain a level of continuing employment for the existing staff and provide contract work for other individuals. It has the potential of generating associated contracts for acquiring, hauling and handling of raw materials, and provides a useful disposal of rice by-products. Finally, to the degree that the power generated can be sold for use in the surrounding community during the next 5 years, it can alleviate some power needs at a cost lower than prevailing rates.

(5) <u>There Are Two Potential Private Sector Buyers Of This Facility</u>

There are two potential buyers, both electric companies, for this plant. The first is the National Power Corporation (NPC) which has the capability to manage a thermal plant, and, in fact, operates several power barges to compensate for the lack of power generation capacity on the island. NPC is a government corporation, so such a divestiture would be an intergovernmental transfer.

A second potential buyer is the Panay Electric Company (PECO), a private utility, which also has the management capability to run the facility. In its interview with the study team, PECO expressed an interest in buying and managing the facility, if the price were reasonable. The advantage to PECO is that, by integrating the low-cost electricity generated by the Iloilo plant into its system, it could lower its overall costs of production. PECO currently generates 20% to 25% of its requirements, buying the remainder from NPC.

(6) <u>The Divestiture Strategy Should Begin With Serious Negotiations With The British Government Followed Almost Immediately By Negotiations With PECO</u>

To achieve the maximum flexibility and attractiveness of the scheme, NFA should negotiate with the British Government for conversion of the loan to a grant. Such action should commence immediately before the plant begins its initial operating year. Under no circumstances should the plant begin to operate until the status of this financing is clarified.

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NFA should also immediately open discussions with PECO to sell the facility. The fair market price developed in Appendix B (with some possible refinements) will enable PECO to operate this plant profitably for 5 years, until the submarine power line is extended from the geothermal plant in Negros Oriental.

If PECO will not buy it at any reasonable price, NPC should be approached. If NPC will not purchase it, the plant should be left in the hands of NEI and the British government.

4. SOUTHERN PHILIPPINES GRAINS COMPLEX (SPGC)

The SPGC when constructed was one of the biggest and most modern rice mills in Southeast Asia, capable of milling 25 tons per hour. The plant's utilization today is low, operating at only 38 percent of its potential output in 1985. While this modern milling facility can produce rice of export quality, the regional rice market is glutted, and SPGC has not exported rice since 1981.

(1) SPGC Was Originally A Private Milling Operation That Was Foreclosed By The DBP And Subsequently Transferred To The NFA

The Mindanao Progress Corporation (MINPROCOR), a group of private investors headed by Robert Tulio, purchased a 15-hectare site in Tacurong, Sultan Kudarat, in the early 1970s on which it erected a small ricemill. Using this property as collateral, MINPROCOR borrowed P52 million from the DBP to construct a large-scale rice milling complex which included:

- A 25 ton/hour Buhler Miag (Swiss) ricemill installed in a seven-story concrete building
- Rice husk-fueled power plant
- Eight warehouses for bulk and bag storage

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- Six storage silos with a total capacity of 5,000 tons
- Truck scale
- Concrete solar drier
- Two mechanical driers with 10 and 11-ton/hour throughput
- Rubber millhead manufacturing unit
- Ancillary buildings and housing
- A rice polishing operation located in Quezon City.

As a result of mismanagement and failure to pay its debts, MINPROCOR's loan was foreclosed in May 1977 by the DBP. By July 1977, the complex was sold to the National Grains Authority (NGA), the predecessor of the NFA, for a cost of P127 million. The NGA made a downpayment of P7 million to the DBP and agreed to amortize the loan at P4.8 million annually for 25 years.

(2) <u>The Milling Is For NFA Stabilization Stock and For Individual Farmers</u>

The SPGC serves the rice farmers of Sultan Kudarat and nearby provinces in two ways:

- It mills and stores the rice purchased from the farmers under the price stabilization program of the NFA. SPGC uses the Buhler Miag mill for this work because these procurements involve considerable quantities and because it requires at least 50 tons of rice to start up this mill due to the extensive

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ducting and complex equipment layout. SPGC as an entity does not receive direct income for milling NFA stock.

- It also custom mills for local rice farmers and traders, using the old, original coo ricemills. This milling is done at rates lower than those charged by the other millers in the area.

Because SPGC receives no income for milling NFA stock and only limited income from custom milling for private parties, it reports continued losses, as noted below.

At the time that the NGA acquired the SPGC, a rice bran oil extraction plant was partially completed. SPGC management completed it and an oil refinery and began to produce rice oil for cooking and bran meal for livestock feed. During the study team's visit, this facility was being used to refine palm oil for Kenram, a major plantation located nearby. Kenram normally markets crude palm oil, but was refining the oil for some market tests. The SPGC can refine any kind of vegetable oil.

The rice husks are manually unloaded and mechanically conveyed to the power plant, which burns the husk to produce electricity for the compound. The power plant, a 1.8 mw facility, runs 24 hours a day, year-round. SPGC previously supplied electricity to the neighboring towns. However, due to the irregular and fluctuating power supply generated, as well as the introduction of electricity supplied by a large-scale hydrothermal plant, the complex now only produces electricity for its own use. One of the justifications provided to the study team for operating this plant was the disposal of rice husks. The plant burns about five tons of husks per hour.

The complex can store up to 25,000 metric tons of palay in its warehouses and silos, adequate to store NFA-procured stocks from this and surrounding provinces.

Mechanical drying equipment is little used because the farmers who deal with SPGC use the complex's concrete drying yards to save money.

The complex also includes a 7.3 hectare demonstration farm, which has been turned over to the employees, and a small rubber manufacturing plant.

The facility in Quezon City is a rice polishing operation. It is presently used for storage and distribution of Manila area NFA employees' monthly rice allowances. Therefore it is no longer considered part of the SPGC.

There are presently 14 private mills in the region which average 1.5 metric tons output per hour. The production of the region is 7 million bags, or 350,000 metric tons, which means that the private millers have the capacity to handle roughly 20% of the palay produced in the region. SPGC operating at full capacity could handle approximately 26% of regional production.

The present strategy of the NFA is to close down procurement and milling operations in southern Mindanao, including facilities at General Santos (10 tons per hour), Kidapawan (10 tons per hour), and Digos (10 tons per hour). The Digos facility is analyzed in a section below.

(3) NFA-Provided Financial Statements Give An Incomplete Picture Of SPGC's Operations

The financial statements provided to the study team indicate severe fluctuations in sales and steadily increasing losses, as shown below:

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SPGC Sales and Losses
(Thousands of Pesos)

	1981	1982	1983	1984	1985	First 6 Months 1986
Sales	696	97	228	186	142	17
Losses	(661)	(186)	(4,001)	(7,380)	(11,470)	(2,883)

However, these figures do not accurately reflect SPGC operations, as they include no remuneration for the milling of NFA procurements. But they do include all expenses for carrying out these services. For example, if in 1983 when SPGC milled one million bags of palay, it had shown income from that milling, its annual profit would have been approximately P4 million to P5 million.

Our projections of SPGC as a private operation in Appendix B show an after-tax, cash flow break-even when plant utilization is at 26%. Utilization at the plant in the 1978-1984 period averaged 49%. If the NFA closes the operations at General Santos and Kidapawan, and even if it privatizes the operation at Digos (which could create competition for SPGC), it appears likely that a private firm could maintain adequate utilization to be profitable.

(4) <u>The Privatization Of SPGC Will Be Constrained By Its Ability To Achieve Adequate Volume, Low Prices For Cooking Oil, And Political Instability In Central Mindanao</u>

A constraint to privatizing this complex is whether private owners could purchase and mill a sufficient volume of rice to enable it to operate profitably. Within a 100-kilometer radius there will be considerable competition from private millers and other NFA milling operations.

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Another constraint, specific to its oil extraction operation, is the over-supply and low prices for cooking oil. Domestic and world prices for vegetable oil are very low and this will continue into the foreseeable future.

The strongest constraint is political instability in the area in which SPGC is located. Both the New People's Army (NPA) and the Moro National Liberation Front (MNLF) operate on Mindanao; in fact, the Tacurong site is adjacent to a Moro-occupied region. These conditions may require considerable promotion and a very attractive price to sell this complex to a private sector buyer.

(5) <u>The Privatization Strategy Must Involve Guarantees By NFA To Close Down Nearby Milling Facilities And To Use SPGC As Its Prime Contract Miller In Mindanao</u>

The NFA should study further the effects of closing down its milling facilities in General Santos and Kidapawan. Closing down these facilities may result in enough milling volume to achieve a profit at SPGC. Such a study should analyze the effects of this closure on the farmers, i.e., will they receive less for their crop due to increased transportation costs? The study should also take into consideration inter-island flows and the transportation costs related to SPGC'S inland location.

Given a satisfactory outcome of this study -- that is, that farmers will not receive markedly lower returns for their crops and that the concept of concentrating considerable milling activity at Tacurong and closing down less important NFA operations harmonizes with the overall trade flows of palay and rice -- NFA should provide guarantees to the buyer that it will:

- Use SPGC as its procuring agent for market interventions in central Mindanao

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- Pay SPGC the market price for storage of palay and milling of rice

- If feasible, shut down nearby NFA facilities to increase the volume handled at SPGC, and by other private millers.

The study team believes that the price ranges established in Appendix B (based on a range of utilization rates) are low enough that it can be afforded by a single buyer or group. As a condition for selling the facility at such a low price, the buyer should guarantee:

- To maintain all personnel that desire to continue working for one year

- To issue 20% of the stock of a newly incorporated firm to farm cooperatives in the region which can purchase their shares on a buy-out arrangement based on a portion of their palay deliveries over time, and who will have proportionate representation on the board of directors

- To submit their books to auditing annually by a reputable accounting firm, and make the results of that audit available to all shareholders

- To pay dividends out of profits to all shareholders.

NFA can move immediately to sell off the demonstration farm. The valuation of SPGC in Appendix B did not include the value of the demonstration farm, so proceeds from its sale should be considered supplemental to values indicated by the analysis of SPGC income.

5. AGRO-PROCESSING AND MARKETING PROJECT (APMP)

The APMP is a large, ADB-financed development project focused in the Cagayan Valley of Northern Luzon. Project construction is several years behind schedule. Despite the delays, the facilities completed are first-rate and are prime candidates for divestiture, especially the Northern Philippines Rice Complex (NPGC), a ricemilling and storage facility at Echague in Isabela province.

(1) The Project Has Six Components Stressing The Reduction Of Post Harvest Losses Of Rice, Fruit And Vegetables In The Luzon Region

In 1982, the NFA submitted to the Asian Development Bank (ADB) a proposal for an agro-processing and marketing project aimed at augmenting and modernizing the post-harvest infrastructure of the food crop sector. After review and acceptance of a feasibility study, the ADB approved the project valued at $52 million. In December 1982, a loan was granted to the GOP in the amount of $36 million, with a local counterpart requirement of $16 million to be provided by government. The NFA was designated as the executing agency.

At that time, the project was consistent with the government's efforts toward food self-sufficiency and supply stability. Major attention was to rice production, with the goal of reducing post-harvest losses. At the time of project approval, the government was also active in the fruits and vegetables sector. Portions of the project were aimed at reducing physical and quality losses, establishing prices of farm products, and improving the marketability of fruits and vegetables to the consumer markets.

The APMP project has six major components:

- Northern Philippines Grains Complex (NPGC) estimated at $12.5 million

- Cagayan Valley Grains Center Development Scheme estimated to cost $4.9 million

- Private Sector Modernization Scheme at $13.6 million

- Fruit and Vegetable Marketing Facilities, estimated at $3 million

- Food Technology Research and Development Center, valued at $1.4 million

- Consultancy services and study tours for Philippine officials amounting to $2.0 million.

NPGC, an integrated grains complex already mostly constructed in Echague, Isabela, is designed to mill 100,000 metric tons of palay per year to produce high quality rice and to utilize the milling by-products: rice husks as fuel to generate electricity; refined edible oil from bran; and animal feeds from bran meal.

The major elements of this complex as originally planned are to include a rice milling system involving three mills and ancillary facilities, a bran oil extraction plant and refinery, a power plant and a parboiling plant. This complex is capable of handling 5 percent (two million out of 40 million bags) of the palay cultivated in the surrounding region.

The Cagayan Valley Grains Center Development Scheme (CVGC) would establish or strengthen NFA's 24 grain centers in the Cagayan Valley by providing adequate threshing, drying, storage and transportation facilities. These grain centers are envisioned to serve as procurement satellites for palay to be processed at NPGC. More than half of the centers are now completed.

The Private Sector Modernization Scheme (PSMS) involves credit incentives, technical assistance and preferential assignment of milling contracts to stimulate modernization of 350 rice mills in selected areas of the country. Modernization is to be done primarily through the installation of rubber milling heads and other equipment to improve rice quality.

The Fruits and Vegetables Marketing Facilities (FVMF) component is designed to set up six farmer markets in the major vegetable growing areas of Luzon, strengthening two trading centers linking these markets, and opening a new wholesale market serving Metro Manila.

The Food Technology Research And Development Center (FTRDC), located on the FTI complex, focuses on perishable food items and undertakes studies on how to reduce post harvest losses, preserve quality, and improve marketing techniques. It recently has been certified by the U.S. Food and Drug Administration as an inspection site for selected exports to the U.S. It also has the goal of working with food processors to develop new products and refine existing ones. Administration of the center has been taken over by the FTI.

An amount of $2 million was set aside for a range of technical assistance, training, study tours, support services, monitoring and evaluation.

The project includes $14.7 million for contingencies, 39.7% of the estimated total cost. The ADB loan bears an interest rate of 11% and a commitment charge of 0.75% on funds drawn down. The repayment period is 20 years, with the first payment due in March 1987.

To carry out its executing agency role, NFA established an APMP office which currently employs 116 people, 47 on a regular hire basis, 69 as casual labor.

(2) <u>All Components Of The Project Have Experienced Substantial Delays</u>

Project accomplishment has substantially lagged behind the original schedules due to a wide range of factors, including major changes in international and local conditions; alteration of government policies; and planning, design and bidding problems.

The August 4, 1986, status report cites the following completion percentages:

Northern Philippine Grains Complex (NPGC)	40.16%
Cagayan Valley Grains Center Development (CVGC)	54.17%
Private Sector Modernization Scheme (PSMS)	14.78%
Fruit and Vegetable Marketing Facilities (FVMF)	56.36%

The NPGC warehouses are complete and the milling equipment is operable. The refinery equipment is on-site, uninstalled. The power plant and parboiling unit have not been ordered.

As of June 15, 1986, total drawdowns of the ADB loan were $12.3 million and local counterpart disbursements for capital outlay, operating maintenance, interest and commitment charges were P56.3 million ($2.8 million).

(3) <u>Current Issues Include Whether To Construct Subcomponents Of The NPGC As Well As A Cut-Back In Other Project Subcomponents</u>

Given this lagging implementation and changing conditions and policies, it is clear that an immediate project review needs to be conducted to determine both the current viability and continued appropriateness of the various project components. This view is shared by both government and NFA, and such a request has been formally submitted by NFA to ADB by letter dated July 31, 1986.

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In particular, the following subcomponents of the NPGC should be reviewed: parboiling plant, bran oil extraction and refining plants, feedmill and power generator. The local and international market prospects for NPGC's outputs, especially parboiled rice and rice oil, appear dim, and the operations of such plants would be unattractive to private investors and inappropriate for government operations. Should these components be deleted, the need for the planned power plant capacity should be correspondingly reduced, or possibly deleted altogether.

In view of the slow drawdown of the Private Sector Modernization Scheme funds, this component should also be reduced. At this point, only 12 applications have been accepted or funded and 66 applications are in-process. Revision of standard operating procedures may improve the loan application process. Additional loan applications may result from improved investor confidence, given a clear and consistent policy regarding the private/public sector balance in the grains sector.

In the fruits and vegetables marketing scheme, the proposed location of the wholesale market to serve Metro Manila is subject to substantial question. It might well be dropped from this particular project without prejudice to future alternatives. Further study is required.

For those facilities and assets to be completed and acquired under this project, clear intent and planning must be undertaken regarding their ultimate ownership and management. Very clearly, the NPGC was established to provide modern and efficient facilities in a region where rice production is large, and is expected to greatly increase. The satellite schemes similarly were necessary adjuncts to the main complex. But these designs were made in a setting in which NFA was to continue as the major player in the grains sector. Although NFA's stabilization mission in rice and corn will remain, its involvement will be lessened and it will not be able to fully use these new facilities in the coming years.

The most promising possibility for privatization is the NPGC, established as a private corporation. As NPGC is fully operational now utilizing purchased electricity, the NFA can take steps to privatize the complex, completing a reduced-scale generating plant, if it is feasible, in time for divestiture. Attractive options may also exist for the satellite centers, although some of these have been constructed within existing NFA facilities and, therefore, may prove difficult to privatize.

In the area of fruits and vegetables marketing facilities, it is clear that NFA is mandated to withdraw from its operational role in the non-grains sectors. It is possible that established and strengthened markets could be turned over to the respective municipalities. This strategy needs to be detailed and advanced.

(4) <u>The NFA Should Begin Now to Prepare For The Divestiture Of The NPGC And Other Divestible Sub-Components</u>

In conjunction with ADB, the NFA should review the specific components of the APMP with the objectives of:

- Eliminating or adjusting those subcomponents which do not appear to have economic validity or which fall outside the more limited mission now set for NFA

- Reducing the loan exposure in segments where implementation progress has fallen far behind schedule.

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A clear strategy for divestiture, through sale or transfer, of those assets and facilities acquired in the course of this project should then be developed. Separate strategies would be appropriate for the NPGC milling complex, the satellite centers, and the developed market centers. NPGC would likely attract interested investors from existing, well-established businesses. Because of the undesirability of a complex of this scale falling into the hands a single rice trader or trading cartel, its sale should include the sales of 20% of the shares to farm cooperatives in the region, possibly employing a buy-out plan. There are approximately 250 such cooperatives active in the region. It is recommended that procedures similar to those made in connection with SPGC be followed:

- The representation on the board of directors should be proportionate to the ownership of shares

- Board meetings should be held to discuss setting of prices for palay and payment of dividends

- The accounting records of the corporation should be audited annually, and the results of the audits should be distributed to all shareholders.

If the farm cooperative participation proves to be an acceptable option, additional protection of the cooperatives' interest could be achieved by having the NFA retain 5% ownership and a place on the board. The 5% share could be structured to give NFA a "golden share" -- in essence, veto power over abusive pricing or other practices by the new owner.

The International Finance Corporation (IFC) could perhaps be persuaded to take an equity position of, say, 40 percent in NPGC, which it would sell over time to investors. This would lend to the divestiture the prestige and approval of an internationally respected financial institution. The IFC, in discussions with the study team, indicated a willingness to consider such an arrangement.

The satellites may be excellent candidates for cooperative ventures. The markets could be viable for either municipalities, cooperatives or joint business ventures. ADB may well be interested in providing both technical assistance and credit support for the divestiture of the components, either from the existing loan or other sources. In fact, the ADB is working to set up a financing window specifically for financing privatization throughout the Philippines.

6. TABANGAO BULK UNLOADING AND STORAGE FACILITY

This installation is a large, over-designed unloading facility costing P112 million. It currently stands idle, but well-maintained, having functioned on only four occasions to unload P.L. 480 rice shipments. It is located near the city of Batangas. The facility includes a well-constructed pier, an unloader, two large warehouses, and a conveyor system. The system was specifically designed to handle only smooth grains, such as soybeans. Other grains would quickly erode the facility's metal conveyors and augers. Although it has limited use for general cargoes because of its pier width, it may offer other grain transshipping possibilities. There is considerable interest on the part of investors in buying Phil Asia, the bankrupt soybean processing plant located adjacent to the Tabangao facility, which is the major potential user of the unloading facility.

(1) The Unloading Facility Is An Expensive, Modern Installation Built Primarily To Handle Soybeans For Phil Asia

The Tabangao unloading and storage facility went under construction in 1981 and was completed in late 1985. The

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financing for the facility came from the various sources: DBP, P32.5 million; the Swiss Transfer Credit Facility, P17.2 million; NFA corporate funds amounting to P20.4 million; and a national government appropriation of P24.6 million. The total cost of the project was approximately P112 million ($5.6 million).

The purpose of the project was to enable Phil Asia to import soybeans, which would be processed into soy meal for livestock feed and soy oil for cooking. The facility can unload 500 tons of soybeans per hour and convey them to two warehouses which have a bulk capacity of 400,000 metric tons each. The pier can accommodate ships of 30,000 to 40,000 DWT, as the water depth at the pierhead is 17 meters.

Phil Asia is located directly adjacent to the unloading facilities, and, in fact, is connected by conveyor. Ironically, Phil Asia, owned by Marcos crony Roberto Sabido, went bankrupt before the unloading facility was completed. Subsequently, Phil Asia was sequestered by the PCGG.

Although the unloading facility was never used to unload soybeans, the NFA did import large quantities of the commodity which were manually unloaded and delivered to Phil Asia. According to the contract executed by Phil Asia and the NFA, Phil Asia was to have repaid the NFA in-kind with soy meal that could be sold to animal feed producers. Phil Asia did hand over some soy meal to NFA, but unfortunately, the contract did not fully bind Phil Asia to this arrangement. NFA was left holding a receivable of P70.9 million when Phil Asia went broke. NFA had also provided P150 million financing for the establishment of Phil Asia. DBP has the most exposure in Phil Asia, however, having loaned it P800 million.

There is an estimated annual domestic demand for soybean meal of 300,000 tons. The Phil Asia plant, if it were operating, could supply one-fourth of this demand. There is considerable interest by several parties to purchase the plant and the unloading facility as a unit.

(2) <u>The Unloading Facility Is Well-Maintained By An NFA Crew, But The Phil Asia Facility Is Deteriorating</u>

NFA has kept a crew posted at the unloading facility which has maintained it in excellent condition and the facility could be operated when needed. The Phil Asia plant, on the other hand, has been closed since March 1984 and would require at least 2 to 3 months to put it into operation, despite its 11-man maintenance crew. The Presidential Commission for Good Government (PCGG) currently administers Phil Asia because of the sequestration. A physical inspection of Phil Asia found the plant to be in poor condition, either due to a lack of supervision or funds, or both.

(3) <u>The Three Constraints To Privatization Are Size Of The Investment Required To Jointly Purchase The Tabangao And Phil Asia Facilities, Lack Of Clear Ownership Of The Phil Asia Facility, And The Low Market Price Of Soy Oil</u>

The major constraint to privatization of the unloading facility is that it is a specialized operation built to supply Phil Asia. The two are essentially part of the same operation and should be sold together; however, they are held by two different owners. The study team discussed the concept of a joint sale at senior levels of the DBP and the NFA. The concept of selling the two facilities together, subsequently splitting the proceeds in proportion to their respective exposures, was accepted in principle by both parties. Subsequently, DBP and NFA met to discuss this arrangement.

The sequestration by PCGG poses another constraint. Even if the DBP and NFA receive an acceptable, joint offer for the facilities, the ownership status, because of the sequestration, poses a real obstacle to the sale. PCGG should be encouraged to act quickly to determine whether Phil Asia was obtained illegally; if so, to turn title over to the DBP so the facility can be sold off.

There appear to be no difficulties in selling soymeal at a good price; however, sale of soy oil, especially in light of the recent governmental decision to allow more coconut oil extraction plants, faces low prices.

(4) There Will Be Positive Social Impact From Privatization Because The Facility Is Not Operating

A successful joint sale of the facilities could have a positive effect in the Tabangao area as the operations would employ a considerable number of persons. The increased availability of soy meal for animal feed would also have a positive impact on nutrition and prices of processed animal feeds. If MAF can stimulate more soybean production in areas which now produce such economically unviable crops as sugar cane, rural income can be raised. Increasing soybean production may be difficult because the length of day at Philippine latitudes is short.

(5) Possible Buyers Of The Facilities Include Local And Foreign Grain Dealers And Feed Millers

It appears, based on the number of visits to the facility by potential investors, that there is considerable interest in the purchase of these facilities, especially by grain dealers and feed millers. In fact, three letters of interest have been received concerning purchase of both facilities and 10 other groups have visited and discussed the facilities with DBP and NFA.

(6) <u>The Divestiture Strategy Should Involve A Joint Sale Of The Facilities And Exploration Of Other Grain Handling Possibilities</u>

Because of the high interest in these facilities, the best means to achieve the highest price for the facilities is to pursue the joint marketing strategy described above. The study team reviewed the financial records of Phil Asia to develop a fair market price for both facilities, however, the irrationality reflected in the Phil Asia statements made the valuation impossible. More study is required by a financial specialist with knowledge of that industry to determine the value of the two facilities. This should be the first step in the divestiture strategy.

Another angle should be explored. There is an idea which has been under consideration for several years, and is currently being re-studied by the National Economic and Development Authority (NEDA) for an island grain unloading terminal in Manila harbor. Study of the concept has been continued because of the congestion, inadequate unloading facilities on-shore, and long demurrage time required in the Manila harbor. One grain dealer interviewed, however, stated that the island terminal concept is not feasible because it would require double handling, double costs, and considerable commodity loss -- experience elsewhere would support this contention.

According to the engineers who designed the current unloading facility, the facility's pierhead could be widened to install the unloader on tracks, making bulk (smooth) grain unloading much easier than the stationary gantry arrangement that exists now. At the same time, the conveyors could be reconstructed to simultaneously bulk-load barges, thus enabling the facility to unload other bulk grain cargoes, destined for Metro Manila. With this adjustment in the mechanical conveyor facilities, estimated to cost $500,000, the Tabangao facility

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could be used to transship to Metro Manila thus creating a higher utilization rate and greater profitability of the Tabangao installation. This idea merits further study.

7. BICOL SEEDS, INC.

This section discusses Bicol Seeds, a small ricemilling complex which has fallen into disrepair and is little used. Privatization as an operation may prove difficult because it is located in an active insurgency zone.

(1) The Complex Was Acquired By NFA Inexpensively But Has Fallen Into Disrepair And Is Underutilized

Bicol Seeds, Inc. (BSI), was a private company founded in 1974 to provide integrated rice milling services in the province of Albay. In 1977, BSI was offered by its owner to the predecessor of the NFA, but the offer was refused because at that time there was insufficient rice production in Albay to warrant acquisition of the complex. In 1980, BSI was again offered to NFA, this time by the Private Development Corporation of the Philippines (PDCP), which had foreclosed on a loan made to the owners of BSI. A committee was formed by NFA to evaluate the feasibility of the offer, in light of an increase in provincial rice production. The committee recommended that NFA purchase the complex, at P4.5 million to 5.5 million. Notwithstanding the committee's recommendation, NFA management bought the BSI complex for P9.3 million.

The Bicol facilities include the following assets:

- Land and improvements
- Administration building
- Rural bank building
- Bulk storage bins
- Satake Ricemill with 5 ton per hour capacity

- Rice husk-fueled drier
- Hammer mill
- Flatbed driers
- Generator.

At present, the BSI complex is under the management and supervision of the NFA provincial office in Albay. The complex employs seven persons with a monthly payroll of P14,000.

The complex is deteriorated; most facilities are not utilized because of frequent mechanical breakdowns, poor maintenance, and the consequent high cost of operations. At present, the ricemill is capable of achieving only half its capacity because some of its components are broken. The warehouse suffers from water seepage which damages stocks. To restore the facilities to full operation would require an estimated P1 million.

Utilization of the ricemill for the past three years has been declining:

Utilization
(Percentage of Capacity)

	1983	1984	1985
Ricemill	69.4	10.8	0.3
Drier	0.5	1.0	4.6
Warehouse/silos	24.0	4.5	7.5

In 1984 and 1985, BSI procured only 1% and .3% respectively of Albay cultivation

(2) <u>There Are No Good Financial Records Available For This Operation</u>

Following its purchase, BSI's output, and financial and economic performance were not adequately monitored. Its financial records are lumped in with those of the NFA provincial office. Therefore, little could be learned by the study team concerning its finances.

BSI was purchased for P9.3 million, based on a P1.86 million downpayment and semi-annual payments of P840 thousand for 8 years. The outstanding balance as of March 31, 1986, was only P3.89 million.

(3) <u>There Are Some Severe Constraints To Privatization Of BSI At This Time</u>

The constraints to the sale of the complex are:

- The complex is located in an area of considerable insurgency activity and there may be reluctance on the part of local entrepreneurs to invest

- The complex, especially the ricemill and bulk storage bins, is in poor repair and will require at least P1 million to make it operational

- Its electric generator (525 KVA) is too big, hence too costly, for the feasible operation of the complex

- The location is poor, i.e., not on a main highway

- Competition is well-established; there are 15 large cono mills and a number of smaller ones in the area.

On the positive side, privatization or scrapping of the complex would not create any adverse social impact, as it is almost inactive, currently employing only seven people on a full-time basis.

(4) NFA Should Attempt to Sell Complex "As Is"--If Impossible Its Individual Components Should Be Sold Off As Spare Parts Or Scrap

NFA should first put the complex up for bids as a unit. If that fails, the complex should be broken into components and sold by public auction or scrapped. Components which could be dismantled and moved include the ricemill, the grain drier, and the electric generator. The land, the mill building, and the storage building could be sold for use as a general warehouse.

8. DIGOS AGRO-INDUSTRIAL COMPLEX

Digos is a medium-sized rice and corn milling operation that currently plays an integral but minor role in the NFA's intervention program on Mindanao. It is a modern ricemill and warehouse complex, and primarily for that reason, constitutes a good opportunity for privatization. A portion of one of its warehouses and its education building (currently leased to a Coca Cola distributor) and its demonstration farm could be sold as components separate from the complex.

(1) The Digos Complex Mills And Stores Rice And Corn And Plays A Role In NFA's Stabilization Activities In Davao Del Sur

In 1958 the National Rice and Corn Administration (NARIC), another predecessor of NFA, purchased a site near Digos on which to erect the Digos Agro-Industrial Complex, envisioned as a strategic grains storage and processing operation for Davao Del Sur and neighboring provinces. The complex began as the provincial NARIC office. Subsequently, a cornmill, mechanical drier, warehouse, power plant and so on were added component-by-component.

In the 1983-1985 period, the NFA procured at its Digos location only 1.4% of the local palay production; 2.3% of the white corn; 1.7% of the yellow corn. In September-December, DAIC will purchase about 70,000 bags of palay out of 370,000 bags produced in a 25- to 30-kilometer radius from Digos.

(2) Digos' Considerable Assets Are Underutilized

The assets of the complex include:

- Three warehouses with a 21,000 ton capacity
- Nine bulk storage silos (currently not used)
- A Satake ricemill with a 10 ton per hour capacity (1980)
- Shrader corn mill (inoperable)
- Mechanical drier
- Eleven motor vehicles; farm equipment
- Farm equipment
- 13.5 hectares of land and improvements
- Office building
- Training center.

According to an evaluation made by NFA Corporate Planning in 1986, some of the post-harvest facilities are not fully utilized and some have not been utilized for a number of years. During the field visit the study team noted that the cornmill was broken down, one warehouse was not being used, and the old wooden silos and mechanical driers were not being used and did not appear usable.

(3) <u>The Complex Had Only One Year Of Profits In The 1983-1985 Period</u>

The three-year summary of grain operations shows that 1984 was the best year for the complex in recent times:

<u>Millions of Pesos</u>

	1983	1984	1985
Sales	28.6	29.4	19.1
Cost of sales	27.9	23.9	24.6
Gross profit	.7	5.4	3.2
Less: operating expenses	3.2	3.9	4.2
Operating income loss	(2.5)	1.5	(1.0)
Plus: other income	.7	1.3	.6
Net profit (loss)	(1.8)	2.8	(.4)

(4) <u>The Digos Complex Can Be Divested As Three Components</u>

DAIC can be broken up into three units for divestiture:

- The ricemilling and storage operation
- The demonstration farm
- The warehouse and training center, which are presently leased to local Coca Cola distributor for P5 per square meter.

The modern Satake ricemill with the Triplex warehouse and a single-chamber warehouse that is not presently used should be easily saleable as a unit. The calculations of the study team result in a fair price recommendation of P44 million, based on 100% plant utilization. Potential utilization will depend upon NFA's actions in closing down other ricemilling operations on Mindanao. Therefore fair market price should be adjusted according to the level of utilization anticipated once the overall NFA strategy for Mindanao is determined (see above section on SPGC). Our calculations ions also indicate that there must be at least a 29% utilization of this plant merely to achieve an after-tax, cash flow break-even.

The 13.5-hectare demonstration farm is clearly outside the NFA mission, and the NFA central office has instructed DAIC to curtail that operation. It should be sold as soon as possible, using sealed bidding procedures.

The smallest warehouse (50,000-bag capacity) and the training center are presently leased to the local Coca Cola distributor for storage and office space. Coca Cola wants to lease these facilities on a 10-year basis. The NFA should attempt to negotiate the sale of these buildings to Coca Cola based on a comparative value analysis made in the Digos area. If that fails, NFA can lease the facilities, providing for annual increments in the rent.

* * *

This chapter has provided an in-depth description of each of the NFA's peripheral operations. It has focused on each peripheral's operational status, the constraints to privatization, and potential buyers, and has developed an individualized strategy for divestiture. With the individual divestment steps identified, we move to Chapter III, which develops a strategic plan for divestiture of these operations.

III. STRATEGIC PLAN FOR DIVESTITURE OF NFA PERIPHERAL ACTIVITIES

This chapter presents a strategic plan for divestiture of the peripheral operations of the NFA. To be sure, not enough is known concerning all of these operations; in some cases, the action recommended is that additional study be made. However, this study provides enough recommendations to establish a plan to move things ahead -- while some details can be filled in afterward.

The study team sees the criteria for setting priorities for divestiture activities as follows:

- The level of financial impact of the peripheral activities upon the NFA -- the idea is to reduce NFA's outflow due to losing propositions as soon as possible

- High priority for those actions which should be taken immediately

- Medium priority for those steps that should be carried out in the first year after initiating privatization

- Lower priority for those steps that can be delayed until the second year.

Each peripheral operation is reviewed in this chapter in terms of these criteria. The priorities established through this process form the basis for a strategic action plan.

This chapter also discusses institutional alternatives concerning how the divestitures might be physically carried out. The recommendations include physical placement of the divestiture unit within the GOP, the staffing and contract services required, and a list of required activities. The end result should provide the GOP, and specifically the MAF and NFA, with areas for discussion and decision.

The chapter begins with the discussion of the financial impact of the peripheral operations upon the NFA. It discusses in general terms the dire financial straits in which the NFA finds itself, and assesses the historic, present and future financial impact of the eight peripheral operations described in the project profiles. It also comments on certain other accounts carried on NFA books for which specific action appears warranted. In particular, attention is drawn to a substantial accounts receivable listing which includes major elements which are, or appear to be, uncollectible.

1. NFA IS SERIOUSLY UNDERCAPITALIZED BECAUSE OF NORMAL LOSSES ON ITS STABILIZATION ACTIVITIES AND CONTINUED LOSSES OF ITS PERIPHERAL OPERATIONS

NFA is in a difficult financial situation. In 1985, it had a net loss of over P458 million ($22.9 million) and its liabilities exceeded its assets by over P203 million ($10.2 million). Its net loss for the first quarter of 1986 rose to an enormous P272 million ($13.6 million).

NFA has long been seriously undercapitalized, and has been existing on borrowed funds and profit gained through grain importations, primarily wheat. In 1985, NFA's monopoly position in wheat importation was stricken and with that went its major income source. NFA has not had any significant governmental support since 1980.

There is complete consensus that NFA's earlier, extensive mission needed to be curtailed and limited to a stabilization role in the essentials of rice and corn and to certain regulatory licensing, development and support activities. Such limitations are necessary to create a climate in which the economy can grow and the private sector can develop and contribute to that growth.

The revised charter for NFA, by any measure, means that government must support, through normal budget processes, the residual functions which remain the charge of NFA. This means providing funds for the purchase of palay and corn at the determined levels of effective intervention. Consider-able pressure built over this issue during the study team's work in August 1986. In that month, P865 million was finally made available to the NFA so that it could begin its purchases of palay to be harvested starting in September. As long as the GOP wants a price stabilization program, it means absorption of storage and operational costs incurred which are not covered by the sale of rice and corn.

To the degree that successful divestiture of NFA peripheral activities takes place, the NFA burdens of debt and operational requirements will be lightened. That clears the way for the long-term financial rationalization of NFA.

2. EACH OF THE PERIPHERALS STUDIED CONSTITUTES A LIKELY PRESENT OR FUTURE DRAIN OF NFA FINANCIAL RESOURCES

This study has analyzed eight facilities and operations in order to develop a series of divestment opportunities and strategies. Each has had or has economic and financial consequences to NFA, and each will continue to consume government resources and incur liabilities as long as they remain within the NFA's portfolio. The following paragraphs provide a summarized view of each in terms of that financial impact.

(1) Food Terminal Inc.

The financial impact of FTI must be viewed from two perspectives: its own accounts and those carried by NFA as its "parent". The figures cited below represent the NFA accounts as of March 31, 1986:

Accounts Receivable from FTI	P493,511,439
Accounts Payable to FTI	(1,195,307)
Investment in FTI	553,823,888
Total	P1,048,530,634

A detailed list of the components of the accounts receivable is shown as Appendix C. The picture is painful. NFA has paid accrued interest for FTI loans due to the Land Bank of the Philippines and to the Philippine National Bank; has provided bail-out financial assistance (P64.5 million) and loans (P25 million); and has issued, procured and delivered rice, hogs, chickens and other commodities to FTI for which it has not received full payment.

The net accounts payable essentially reflects the current balance from commodities supplied by FTI to the NFA central office and to its regional offices. For these deliveries, NFA has made over P156 million in payments, so that the accounts payable figure is relatively current and small, compared to the amount owed to NFA by FTI.

The investment figure of P553 million primarily represents the loans payable to DBP in connection with the assumption of FTI's obligation in 1984. This loan is to be amortized in quarterly payments of P5.5 million over 25 years. As of March 31, 1986, payments total P33.2 million leaving a balance of P520.6 million.

To these NFA figures must be added the accounts of FTI itself. (See Appendix C)

(2) NFA Kadiwa Centers

Summary statements were available for the NFA Kadiwas from 1983 through the first quarter of 1986. Information on losses, accounts payable and receivable, and inventories as of March 31, 1986 are as follows:

- Net loss for 1983 was P35.3 million; P18.3 million in 1984; and P47.5 million for 1985. For the first quarter of 1986, operating expenses were P9.5 million, and already, a net loss of P11.3 million was recorded.

- Accounts receivable as of March 31, 1986 was P3.2 million; accounts payable was P1.2 million.

- Commodity inventories stood P52.5 million as of March 31, 1986.

NFA is aggressively closing Kadiwas throughout the provinces, and thus by year-end 1986 or first quarter 1987, these operations should cease to constitute a drain upon NFA's resources.

(3) Iloilo Thermal Generating Plant

As detailed in the project profile, NFA invested over P15 million in this plant. In addition, it spent nearly P10 million in salaries, chemicals, gas and oil, various supplies and other costs to bring the plant up to the point where it will operate.

The P48 million loan from U.K. does not become payable until after the first year of industrial operation. As was noted in the profile, this loan carries a 7 1/2% interest rate and a short amortization period of six years. This is a future obligation not yet carried on NFA accounts. The study team recommends that the loan be converted to a grant by the U.K. government.

(4) Southern Philippines Grains Complex (SPGC)

NFA accounts for 1981-1985 show total losses from SPGC operations of P25.3 million. A special exercise provided a P & L statement and balance sheet for the first quarter of 1986, showing an operating loss of P2.9 million with current liabilities of P134 million. The major liability is the 25-year DBP loan, payable in P4.8 million annual installments. The balance on that loan as of March 31, 1986 was P91.2 million.

(5) Agro-Processing and Marketing Project

The APMP is a project in process which was estimated to cost US$52 million, of which $36 million is to be provided through an 11% ADB loan. Amortization of this loan will begin on March 1, 1987, and extend over 20 years. Total obligations incurred against the loan are $12.3 million to date, and local counterpart disbursements of P56.2 million. This project should be scaled back, which would have the immediate financial consequence of reducing the commitment charge of 0.75% on the unwithdrawn amount, and the short-term effect of reducing the amortization payments. As in the case of the Iloilo plant, the financial burden of this project has yet to be felt by NFA.

(6) Tabangao Bulk Unloading and Storage Facility

This facility includes two major obligations:

- A DBP loan for P32.5 million payable in semi-annual installments of P3.6 million over a ten-year period.

- A Swiss Transfer Credit Facility loan for P17.2 million, payable in installments P1.2 million over a 10-year period. Current balance is P22,012,685

Minor maintenance expenses will continue to be incurred by NFA until the facility is sold; these should be continued.

(7). Bicol Seeds

The Bicol Seeds facilities carry an obligation to the Private Development Corporation of the Philippines (PDCP) of P9 million payable in semi-annual installments of P840,548 over eight years. The loan balance as of March 31, 1986, was P3.9 million. The study team was unable to determine whether the complex was profitable during recent years, but based on low utilization we suspect it could not be profitable.

(8) Digos Complex

The 1983-85 profit and loss statements for the complex showed a 1983 loss of $1.8 million; a 1984 profit of P2.8 million; and a loss in 1985 of P.4 million for an average annual profit of P.2 million.

Exhibit III-1 summarizes the financial effect of the peripheral operations upon the NFA. The total loans payable equal P1.2 billion ($60.0 million). To pay off these loans, annual amortization payments of P144 million ($7.2 million) is required. Losses incurred on the operations are P189 million ($9.5 million). These losses could be even higher if the NFA were to decide to operate the Iloilo plant, components of the APMP and the Tabangao unloading facility itself. Cash requirements can be contained somewhat if the Iloilo loan from the British government can be turned into a grant, and if the scale of the APMP can be scaled downward. It is clear from the level of their annual cash requirements that FTI and the NFA must command high priority, and that, from a financial impact viewpoint, only Digos and Bicol can be delayed.

3. NFA ACCOUNTS RECEIVABLE SHOULD BE REVIEWED AND WRITTEN OFF AS APPROPRIATE

Special note should be taken of the substantial accounts receivable listed on NFA books. As of March 31, 1986, the account

A. FINANCIAL VALUATION OF A BUSINESS ENTERPRISE

APPENDIX A

FINANCIAL VALUATION OF A BUSINESS ENTERPRISE

The typical motivation of a buyer in purchasing any property, whether tangible or intangible, is the expectation of benefits of ownership subsequent to the purchase. From a theoretical point of view, the value of property is equal to the present value of all benefits of ownership subsequent to the purchase.

In the case of a business enterprise, the benefits of ownership are quantifiable as cash income. This makes a business particularly well-suited for valuation based upon the value of anticipated income (the income approach). On the other hand, there is a limitation in using the technique described below when the enterprise in question has not yet gone into operation.

In valuing a business, useful historical information is gained from financial statements. The typical financial statement consists of a balance sheet and an income statement (also known as profit and loss statement). The balance sheet shows account balances for assets, liabilities, and equity as of the date of the balance sheet. The "book" value of the assets or equity of a business are obtainable directly from the balance sheet. However, "book" values can be very misleading when considering the market value of a business.

Balance sheet data generally reflect historic costs, and adjustments based upon arbitrary accounting procedures, neither of which accurately represent market values. For example, a building may be constructed for business use, with an estimated useful life of 20 years. If it is assumed that the building has no salvage value at the end of the useful life, accounting data would normally show the book value to be the original cost less 5% for each year the building has been in service. However, it is commonly known that the market value of a building often increases over time, both as a function of inflation and of increased demand.

In estimating market value, it is necessary to consider the dynamic nature of the market. Markets behave in unpredictable ways that make the rigidly objective nature of accounting procedures incapable of representing market values on the balance sheet.

The income statement (profit and loss statement) provides the more useful data in the valuation of a business enterprise. There are two reasons that the income statement is the more relevant financial report:

- The value of an operating business arises from the ability to generate income, and not from the historical accumulations of assets

- Income statement data are substantially derived from the reporting period (e.g. month, quarter, year) so there is considerably less economic distortion of the data than in the balance sheet, which represents a cumulation of data over many accounting periods.

The first and more important reason for reliance upon the income statement for valuation is the theory upon which the market values business. Since an investor in a business is motivated by the expectation of receiving future benefits (income), he/she is indifferent to any historical events of the business, except to the degree that historical data impact future earnings. Historical income statements are often good indicators of future revenues and expenses, which are used to quantify the value of expected income.

The true motivation of the investors in a business is not the anticipation of accounting income, but rather the anticipation of cash flow. In this context, cash flow is the amount of cash that would be available for distribution to the owner(s) after all payments necessary for prudent operation of the business have been made. Cash flow can, in some cases, differ substantially from accounting income. The most common sources of differences between cash flow and income are different treatments of depreciation, capital expenditure, loan amortization, and changes in working capital.

Depreciation is a non-cash expense, used in accounting to reflect an anticipated cost of the use of plant and equipment. In analyzing cash flow, depreciation is only useful in the calculation of taxable income and income tax.

Capital expenditures are uses of cash that for accounting purposes are not considered as expenses in the period of expenditure. Instead, the price of capital purchases appears over a number of accounting periods as depreciation.

Loan amortization is a use of cash that is not considered an accounting expense (although interest payments on loans are expense items). The accounting treatment of amortization is the reduction of a liability (loan) by an offsetting reduction of an asset (cash).

Changes in working capital also represent a use/source of cash that is not reflected as an expense in accounting statements. Working capital includes such items as cash, inventory, and receivables. Net working capital is the sum of these current assets, net of current liabilities, such as short-term loans and trade credit. Most businesses require a positive net working capital which must increase with increasing business. As a result, a growing business will use cash to increase net working capital, while a shrinking business will be able to liquidate net working capital for use as a cash source.

A typical calculation of available cash flow is as follows:

$$\text{Cash flow} = NI + Depr - CE - LA - \Delta WC$$

where:

NI = After tax net income

Depr =Depreciation

C E =Capital Expenditures

L A =Loan Amortization

$\triangle$WC =Increase in Working Capital

Over long periods of time, cash flow will generally equal net income. However, the concept of "time value of money" makes the difference between cash flow and net income very important.

TIME VALUE OF MONEY

It is a generally observed phenomenon that investors prefer to receive cash sooner rather than later. To attract investment funds, the investment must have an expected yield above the amount of initial investment that is sufficient to induce the investor to forego use of funds for immediate consumption. The required returns for investments are largely determined by activity within capital markets (stock markets, bond markets, etc.). Since many alternatives exist for the investor, the investment decision is often the choice of which investment instrument, rather than the choice of a single investment or immediate consumption.

The expected rate of return consists of three elements:

- Compensation for loss of value due to inflation
- A reasonable return above inflation to attract investment on a risk-free basis

- Return on investment above the risk-free rate, to induce investors to bear the inherent risk of the investment.

Compensation for loss of inflation in the rate of return is intuitively obvious. A rational investor will not forego consumption to invest if it is expected that the total amount received from the investment will provide less real purchasing power than the current purchasing power of the amount invested. It is observed from the history of capital markets, that an additional amount above the expected rate of inflation is required to attract investment funds in risk-free investments.

The risk premium on investment is the reason many different investment rates exist in capital markets at any specific time. The concept of the risk premium arises from observed market behavior that indicates that investors are generally risk averse. Risk aversion is best described by simple example. Suppose an investor has an opportunity to invest in one of two opportunities. In opportunity "A" the investor will receive after one year, 1.2 times the initial investment (for each peso invested P1.2 would be returned) without any risk. In opportunity "B" the investor has an equal chance of receiving 0.9 or 1.5 times initial investment. In both cases A and B, the average expected annual return is 20%. However, investment B presents an element of uncertainty that is not present in A. The lack of risk in A makes it a more attractive investment, and thus preferred by investors. For opportunity B to attract funds, the price must be lowered, which will increase the expected yield above 20%. The increased yield represents the risk premium.

The example is obviously much simplified from the existing investment market. However, the investor motivation and behavior is illustrative of how risk affects required return on investments.

The time value of money is quantified by a discount rate, which is the annual rate of return required for an investment based upon

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its inherent riskiness. The present value of an expected amount of cash is the amount of investment that would yield a rate of return equal to the discount rate. The calculation of the present valuation is derived below.

Suppose P1.00 can be invested in an interest bearing deposit account at an interest rate, k (e.g. k = .10 for a 10% rate). After one year, the value (FV) of the total investment is

$$FV\ (1) = P1.00 \times (1+k)$$

The value after two and three years is as follows:

$$FV\ (2) = P1.00 \times (1+k) \times (1+k) = P1.00 \times (1+k)^2$$

$$FV\ (3) = P1.00 \times (1+k) \times (1+k) \times (1+k) = P1.00 \times (1+k)^3$$

The general formula of the future value in n years is:

$$FV\ (n) = P1.00 \times (1+k)^n$$

This equation can be generalized by substituting the P1.00 investment with the general algebraic variable, PV, representing any present amount:

$$FV(n) = PV \times (1+k)^n$$

An algebraic equivalent of this formula is:

$$PV = \frac{FV\ (n)}{(1+k)^n}$$

This is the formula used to calculate the present value of a cash amount n years in the future, FV(n), using a discount rate, k. The present value factor (PVF) is the amount used to multiply FV to calculate present value (PV). The PVF is derived from the above equation, as

$$PVF = \frac{1}{(1+k)^n}$$

CAPITAL STRUCTURE AND THE WEIGHTED AVERAGE COST OF CAPITAL

Generally, businesses are financed with a combination of debt and equity financing. The investor providing debt financing (e.g. bank loans, bonds) is entitled to receive interest and return of principal, regardless of the performance. The debt investor does not share in the benefit of superior business performance but will receive interest payments of the business unless the business performs so poorly that it is incapable of meeting contractual obligations of the debt contract (i.e., a state of technical insolvency).

The equity holder shares all the risks of the business performances, and receives benefits in cases of superior performance. Because of the riskier position of the equity holder, the expected rate of return is greater than the required rate of return on debt.

As the percentage of capital financed by debt increases, both the debt and equity of the firm become increasingly risky. The debt becomes riskier because the additional burden of debt service increases the probability that contractual obligations of the debt cannot be met. The equity becomes more risky because most of the proprietary risk of the firm becomes concentrated on a relatively smaller portion of the business capital. This effect is called leverage, because relatively higher debt levels cause small variations in business performance to cause larger variations in the value of equity.

One notable difference in debt and equity financing is the tax treatment of the investment return. Interest payments on debt are generally deductible as business expenses for national income taxes, while returns on equity, whether as dividends or retained earnings, are not tax deductible.

The after-tax cost of capital is determined by calculating a weighted average of the after-tax cost of the debt and equity. This is called the weighted average cost of capital (WACC).

The WACC formula is:

$$WACC = (1 - L) \times E + (1 - T) \times L \times B$$

Where:

L is the percentage of capital as debt

E is the required equity return

B is the required debt return

T is the income tax rate.

THE DISCOUNTED CASH FLOW MODEL

The discounted cash flow analysis is performed by a computer model, and the output shows pro-forma income and cash flow statements for the projected period of ten years. For each year, revenues, expenses and other financial data are shown as components of the total cash flow analysis. The reader is referred to DCF printouts in Appendix B. The following discussion describes the layout of the cash flow output starting from the top and working downward.

The section of the proforma statement shows all revenue items, which are summed to show total revenue. The expense categories are divided into cash expenses and non-cash expenses (depreciation). Since depreciation is not a use of cash, this amount must be added back to income in the cash flow calculation. Explicitly separating depreciation from cash expenses helps to clarify this treatment. Cash expenses are added to non-cash expenses to calculate total expenses.

Net income before tax is calculated by subtracting total expenses from total revenue. Income tax is calculated by applying the income tax rate to income before tax. The amount of tax is subtracted from income before tax to yield after income.

The listing of non-taxable cash source (uses) shows cash flow items that do not appear on an accounting income statement. These items are listed so that a positive number indicates a cash source, while a negative number indicates a cash use. The sum of non-taxable cash items is then calculated.

The cash flow section of the output recapitulates the net income, non-cash expense, and non-taxable cash items. These items are added to calculate the net cash flow. This is the projected amount of cash to be available for distribution.

As shown earlier, the present value factor formula is:

$$PVF = \frac{1}{(1+k)^n}$$

This formula assumes the cash flow is received at the end of the period. However, in a real business situation, cash flow occurs throughout the year. For this reason, more accurate results are obtained by discounting from the middle of the period. This is accomplished by the following formula:

$$PVF = \frac{1}{(1+k)^{n-0.5}}$$

This is the formula used to calculate the present value factor in the DCF model. The present value of cash flow is determined as the product of cash flow and present value factor.

In the value conclusion section, the present value of the 10-year cash flow is the sum of each year's present value. The value of all cash flows after the tenth year (residual) is estimated by multiplying a specified residual multiple by the net cash flow of the tenth year. The present value of the residual is calculated by discounting the result over the ten year projection period. The final value conclusion is the sum of the present value of a 10-year cash flow, plus the present value of the residual.

THE DEBT-FREE CASH FLOW MODEL

Discounted Cash Flow (DCF) analyses are performed on a debt-free basis. The use of the weighted-average cost of capital as the discount rate implicitly considers the cost of debt, as well as equity in valuing the firm. The debt-free model is believed to provide the best insight into the value of NFA operating assets because it calculates the value of all income producing assets, without regard for the existing capital structure.

Disregarding the existing capital structure in the analysis is justified for several reasons. First, much of the debt burden on operating units is the result of an arbitrary accounting allocation of debt that was incurred for purposes unrelated to the business of the operating unit.

The second reason for valuing business enterprises using the debt-free cash flow model is related to the theory of financing businesses. The operations and generation of business income should be independent of the financial structuring of the firm. While the availability and cost of capital are relevant in making operating decisions, such as when to purchase equipment, the form of the capital source (e.g., debt or equity) should be of no relevance. This means that an investor in an operating business enterprise should be able to purchase the business with any combination of cash and assumed liabilities, and then proceed to alter the capital structure for optimal financial performance.

The result of the debt-free cash flow analysis is the expected total price an investor would pay, deducting the assumption of debt. It is noted that when assumed debt has an interest rate different from the prevailing market rate, the market value of the debt is different from the face value. In such a case, the price paid is the sum of cash plus the market value of the debt assumed.

The alternative to the debt-free model of DCF is valuing the equity of the business enterprise with a debt- burdened cash flow analysis. In such analysis, interest is recognized as an expense, amortization is included as a cash use, and new debt is included as a cash source. The equity rate of return is used as the discount rate, instead of the WACC. The resulting equity value plus the market value of initial debt is the total value of the business enterprise. Functionally, the two differ in the fact that the debt-burdened model considers a specific schedule of debt, while the debt-free model assumes that the firm will maintain a capital structure consistent with the assumptions made in the derivation of the WACC.

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B. VALUATION OF NFA PERIPHERAL OPERATIONS

VALUATION OF CENTRAL REFRIGERATED WAREHOUSE

The valuation of the Central Refrigerated Warehouse (CRW) is based upon projections derived from historical revenues. Although the form of ownership and use of CRW in the future may be different (e.g., sale or rental of specific areas of the warehouse) it is believed that the inherent value of CRW is indicated by current use and revenues.

Valuations have been conducted under two sets of assumptions, differing in their treatment of electric power costs. Power costs are currently very high, and have a major impact on the profitability of CRW, since a refrigerated warehouse is a major power user.

The relatively poor condition of the CRW facility is noted as a significant factor in the valuation. It appears that substantial ongoing maintenance is required to keep the warehouse in operating condition (some areas are currently not in operating condition). In the present condition, the useful life of the facility is assumed to be short. As such, it is assumed that a private investor would immediately improve the condition of the warehouse. Cost of such improvements are estimated at P6 million. After the improvements are made, the CRW is projected to have a useful life of 10 years.

The DCF analysis is based upon the assumption that repairs have been made and the warehouse is in good working order. Therefore, DCF value is the value of the warehouse in good condition. The estimated cost of repairs is subtracted from the DCF value to yield the concluded value of the CRW in the present condition. It is noted that no discount is applied to the estimated cost of repairs because it is assumed that the repairs represent an immediate cash outlay.

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The revenue generated from cold warehousing is projected as P25 million in 1987. This represents a small increase over current revenue based upon inflation and a small increase in use as a result of the improved condition of the facility. Revenue is projected to grow at the long-term inflation rate.

Personnel expenses are assumed to be a percentage of warehousing revenue. In the first five months of 1987, this expense represented about 12% of revenue. However, according to management, this reflected substantial overstaffing. The employment level is being reduced, and for the DCF projections, personnel is projected as 6% of revenue.

In the DCF scenario which assumes the existing power rate structure, a light and power expense of P19 million is projected. This is an amount consistent with historical 1986 expenses. In the reduced power scenario, an expense of P4.75 million was projected for 1987. In both cases, the light and power expense is projected to grow at the long-term inflation rate.

The projected general and administrative expense allows for the cost of services that are currently provided centrally by FTI. This expense is projected as 3% of revenue. Facility repair and maintenance is projected as 2% of revenue, and other cash expenses are projected as 5% of revenue.

Depreciation is calculated assuming an initial depreciable basis of 80% of the concluded value of the business operation (before deducting immediate repairs). The initial basis is depreciated over 10 years using the straight-line method. Depreciation of new assets, based upon capital expenditures, is calculated as 100% of investment depreciated over five years using the straight-line method.

In addition to the immediate required investment and routine maintenance, an allowance is made for new capital expenditures. This amount is calculated as 1% of revenue.

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Other assumptions used in the analysis are as follows:

Long-term inflation	7% annually
Income tax rate	35%
Amount of capital as debt	75%
Cost of debt	19%
Cost of equity	26%
Net working capital	4% of revenue

Since the estimated useful life of CRW is only 10 years, the residual value after the tenth year is considered negligible (however, there will be some land value). As such all value is assumed to arise from cash flow of the ten-year projection. Value conclusions are as follows:

For existing power rates:

DCF Value	P7,199,000
Less: Improvement Cost	(6,000,000)
Concluded Value	1,199,000

For reduced power rates:

DCF Value	P79,837,000
Less: Improvement Cost	(6,000,000)
Concluded Value	P73,837,000

The concluded value for the scenario using existing power rates is very small, considering the amount of revenue generated. In fact, the approximate nature of the DCF analysis must allow for sufficient error such that it cannot be stated conclusively that there is any value at all, given current electricity rates.

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DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
CENTRAL REFRIGERATED WAREHOUSE
ASSUMING EXISTING UTILITIES RATE STRUCTURE
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
WAREHOUSING REVENUE	25,000	26,750	28,623	30,626	32,770	35,064	37,518	40,145	42,955	45,961
TOTAL REVENUE	25,000	26,750	28,623	30,626	32,770	35,064	37,518	40,145	42,955	45,961
CASH EXPENSE ITEMS										
PERSONNEL	1,500	1,605	1,717	1,838	1,966	2,104	2,251	2,409	2,577	2,758
LIGHT AND POWER	19,000	20,330	21,753	23,276	24,905	26,648	28,514	30,510	32,646	34,931
GEN. & ADMIN.	750	803	859	919	983	1,052	1,126	1,204	1,289	1,379
FACILITY REPAIR & MAINT.	500	535	572	613	655	701	750	803	859	919
OTHER CASH EXPENSES	1,250	1,338	1,431	1,531	1,638	1,753	1,876	2,007	2,148	2,298
TOTAL CASH EXPENSES	23,000	24,610	26,333	28,176	30,148	32,259	34,517	36,933	39,518	42,285
NON-CASH EXPENSE ITEMS										
DEPRECIATION	626	679	737	798	863	934	959	985	1,014	1,045
TOTAL NON-CASH EXPENSES	626	679	737	798	863	934	959	985	1,014	1,045
TOTAL EXPENSES	23,626	25,289	27,069	28,974	31,012	33,192	35,475	37,918	40,532	43,329
NET INCOME										
NET INCOME BEFORE TAX	1,374	1,461	1,553	1,652	1,758	1,871	2,043	2,226	2,422	2,632
INCOME TAX	481	511	544	578	615	655	715	779	848	921
AFTER TAX INCOME	893	949	1,010	1,074	1,143	1,216	1,328	1,447	1,574	1,711
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(1,000)	(70)	(75)	(80)	(86)	(92)	(98)	(105)	(112)	(120)
CAPITAL EXPENDITURES	(250)	(268)	(286)	(306)	(328)	(351)	(375)	(401)	(430)	(460)
TOTAL NON-TAXABLE CASH	(1,250)	(338)	(361)	(386)	(413)	(442)	(473)	(506)	(542)	(580)
CASH FLOW										
AFTER TAX INCOME	893	949	1,010	1,074	1,143	1,216	1,328	1,447	1,574	1,711
NON-CASH EXPENSE ADDBACK	626	679	737	798	863	934	959	985	1,014	1,045
TOTAL NON-TAXABLE CASH	(1,250)	(338)	(361)	(386)	(413)	(442)	(473)	(506)	(542)	(580)
NET CASH FLOW	269	1,291	1,385	1,485	1,593	1,708	1,813	1,926	2,047	2,176
PRESENT VALUE FACTOR	0.929	0.803	0.694	0.599	0.518	0.447	0.386	0.334	0.288	0.249
P.V. OF CASH FLOW	250	1,037	961	890	824	763	700	643	590	542

VALUE CONCLUSIONS

P.V. OF 10 YR. CASH FLOW	7,199
IMMEDIATE REPAIRS	(6,000)
CONCLUDED VALUE	1,199

DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
CENTRAL REFRIGERATED WAREHOUSE
ASSUMING REDUCED UTILITIES RATES
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
WAREHOUSING REVENUE	25,000	26,750	28,623	30,626	32,770	35,064	37,518	40,145	42,955	45,961
TOTAL REVENUE	25,000	26,750	28,623	30,626	32,770	35,064	37,518	40,145	42,955	45,961
CASH EXPENSE ITEMS										
PERSONNEL	1,500	1,605	1,717	1,838	1,966	2,104	2,251	2,409	2,577	2,758
LIGHT AND POWER	4,750	5,083	5,438	5,819	6,226	6,662	7,128	7,627	8,161	8,733
GEN. & ADMIN.	750	803	859	919	983	1,052	1,126	1,204	1,289	1,379
FACILITY REPAIR & MAINT.	500	535	572	613	655	701	750	803	859	919
OTHER CASH EXPENSES	1,250	1,338	1,431	1,531	1,638	1,753	1,876	2,007	2,148	2,298
TOTAL CASH EXPENSES	8,750	9,363	10,018	10,719	11,469	12,272	13,131	14,051	15,034	16,087
NON-CASH EXPENSE ITEMS										
DEPRECIATION	6,437	6,490	6,548	6,609	6,674	6,745	6,770	6,796	6,825	6,856
TOTAL NON-CASH EXPENSES	6,437	6,490	6,548	6,609	6,674	6,745	6,770	6,796	6,825	6,856
TOTAL EXPENSES	15,187	15,853	16,566	17,328	18,144	19,017	19,901	20,847	21,859	22,942
NET INCOME										
NET INCOME BEFORE TAX	9,813	10,897	12,057	13,298	14,626	16,047	17,617	19,298	21,095	23,019
INCOME TAX	3,435	3,814	4,220	4,654	5,119	5,616	6,166	6,754	7,383	8,057
AFTER TAX INCOME	6,379	7,083	7,837	8,644	9,507	10,430	11,451	12,543	13,712	14,962
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(1,000)	(70)	(75)	(80)	(86)	(92)	(98)	(105)	(112)	(120)
CAPITAL EXPENDITURES	(250)	(268)	(286)	(306)	(328)	(351)	(375)	(401)	(430)	(460)
TOTAL NON-TAXABLE CASH	(1,250)	(338)	(361)	(386)	(413)	(442)	(473)	(506)	(542)	(580)
CASH FLOW										
AFTER TAX INCOME	6,379	7,083	7,837	8,644	9,507	10,430	11,451	12,543	13,712	14,962
NON-CASH EXPENSE ADDBACK	6,437	6,490	6,548	6,609	6,674	6,745	6,770	6,796	6,825	6,856
TOTAL NON-TAXABLE CASH	(1,250)	(338)	(361)	(386)	(413)	(442)	(473)	(506)	(542)	(580)
NET CASH FLOW	11,565	13,236	14,024	14,866	15,768	16,733	17,747	18,833	19,995	21,238
PRESENT VALUE FACTOR	0.929	0.803	0.694	0.599	0.518	0.447	0.386	0.334	0.288	0.249
P.V. OF CASH FLOW	10,749	10,627	9,726	8,907	8,161	7,481	6,854	6,283	5,762	5,287

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VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	79,837
IMMEDIATE REPAIRS	(6,000)
CONCLUDED VALUE	73,837

VALUATION OF ESTATE MANAGEMENT OPERATION

Historical income and expense data were examined to project revenue and income of the Estate Management Operation (EMO). It is assumed that EMO will expand in scope as a result of changes in the restructuring of FTI as recommended within this report. In particular, additional property would be operated by EMO for the following reasons:

- Termination of Kadiwa operations will make storage space available for rent or sale
- Termination of most food processing and manufacturing operations at FTI would provide rentable space
- Reductions in staff at the FTI complex could provide surplus office space that can be rented
- Market rents could be collected for the food laboratory facilities and the baking technology center.

The scope of the present investigation did not allow a detailed analysis of the financial impact of this expansion of EMO. For purposes of the DCF analysis, it is assumed that the net effect will be to increase building/facilities income by 20%.

It must be noted that the DCF analysis only considers value of income-producing property. As such, the vacant, developable land at the FTI complex is not included. The total value of EMO would be determined by adding the market value of developable land to the concluded DCF value for the EMO.

As discussed elsewhere in this report, the FTI complex is burdened with extraordinarily high electric power costs. Prudent management of the complex requires that all possible measures be taken to achieve a substantial reduction in power costs. However, it is not clear whether the owner of the complex (private or government) would be able to effect such a reduction. For this reason, DCF analyses were conducted using two scenarios: one assuming the existing power rate structure, and the other assuming a 75% reduction in rates.

Based upon 1986 revenue data, and assuming growth at the long-term inflation rate, building/facilities rental revenue of P24.8 million is expected from existing operations for the first year projected; with an additional 20% to allow for expanded operations, 1987 revenue was projected at P29.8 million. Based upon historical data, land rental revenue is projected at P3.3 million for 1987. Both of these amounts are projected to grow at the long-term rate of inflation.

Since the direct labor involved in property management is much greater for operating facilities than for land rental, the cost of labor was examined as a function of building/facilities income. In the first five months of 1986, personnel expenses were about 18.7% of building/facilities income. FTI is in the process of reducing non-essential employment, and it is believed that a private sector owner could operate with personnel expenses equal to 12% of building/facilities income, which is how this amount is calculated in the DCF analysis.

Electric power costs of EMO are currently allocated at a rate of about P12.5 million per year. Considering typical inflation, it is reasonable to expect this amount to grow to P1.3 million in 1987, which is the amount projected in the DCF analysis assuming the existing power rate structure. In the reduced power cost scenario, the 1987 power cost is reduced by three-fourths (P3.25 million). In both cases, the power expense is assumed to grow at the indicated long-term rate of inflation.

General and administrative expenses are included in lieu of central management services now provided by FTI for EMO. These expenses are projected as 3% of total revenue.

Facility repair and maintenance expenses, and other cash expenses are each projected as a percentage of total revenue. Facility repair and maintenance are projected as 2% of revenue, and other cash expenses are projected as 8% of total revenue.

Depreciation is calculated assuming an initial depreciable basis of 80% of the concluded value of the business operation. The initial basis is depreciated over 15 years using the straight-line method. Depreciation of new assets, based upon capital expenditures, is calculated as 100% of investment depreciated over 10 years using the straight-line method.

In addition to routine repair and maintenance, an allowance is made for capital expenditure. This allowance is projected as 1% of total revenue.

Other general assumptions used for the DCF analysis of EMO are:

Long-term inflation rate	7% annually
Income tax rate	35%
Residual value after 10 years	4 times tenth year cash flow
Capital financed by debt	75%
Cost of debt	18%
Cost of equity	25%
Net working capital	4% of revenue

The residual multiple of four is quite low for most businesses. However, it is observed that the aging facilities of EMO will eventually require substantial improvement and upgrading. It is assumed for this analysis, that costs of such improvement will gradually reduce cash flow, thus lowering value.

The assumed capital structure and costs of capital were used to calculate a WACC of 15%, which was used to discount cash flow. The concluded values are as follows:

Scenario	Value
Existing power rates	P 73,308,000
Reduced power rates	P135,833,000

As previously stated, the total value of EMO would be the sum of the DCF value, above, plus the market value of the developable land. It will be necessary to have property appraisers place a value on the developable land.

DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
ESTATE MANAGEMENT OPERATION
ASSUMING EXISTING UTILITIES RATE STRUCTURE
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
BUILDING/FACILITIES INC.	29,760	31,843	34,072	36,457	39,009	41,740	44,662	47,788	51,133	54,713
LAND RENTAL INCOME	3,300	3,531	3,778	4,043	4,326	4,628	4,952	5,299	5,670	6,067
TOTAL REVENUE	33,060	35,374	37,850	40,500	43,335	46,368	49,614	53,087	56,803	60,779
CASH EXPENSE ITEMS										
PERSONNEL	3,571	3,821	4,089	4,375	4,681	5,009	5,359	5,735	6,136	6,566
LIGHT AND POWER	13,000	13,910	14,884	15,926	17,040	18,233	19,509	20,875	22,336	23,900
GEN. & ADMIN.	992	1,061	1,136	1,215	1,300	1,391	1,488	1,[illegible]93	1,704	1,823
FACILITY REPAIR & MAINT.	661	707	757	810	867	927	992	1,062	1,136	1,216
OTHER CASH EXPENSES	2,645	2,830	3,028	3,240	3,467	3,709	3,969	4,247	4,544	4,862
TOTAL CASH EXPENSES	20,869	22,330	23,893	25,565	27,355	29,270	31,319	33,511	35,857	38,367
NON-CASH EXPENSE ITEMS										
DEPRECIATION	3,943	3,978	4,016	4,057	4,100	4,146	4,196	4,249	4,306	4,367
TOTAL NON-CASH EXPENSES	3,943	3,978	4,016	4,057	4,100	4,146	4,196	4,249	4,306	4,367
TOTAL EXPENSES	24,812	26,308	27,909	29,622	31,455	33,416	35,515	37,760	40,163	42,733
NET INCOME										
NET INCOME BEFORE TAX	8,248	9,066	9,941	10,878	11,880	12,952	14,100	15,327	16,641	18,046
INCOME TAX	2,887	3,173	3,480	3,807	4,158	4,533	4,935	5,365	5,824	6,316
AFTER TAX INCOME	5,361	5,893	6,462	7,071	7,722	8,419	9,165	9,963	10,816	11,730
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(1,322)	(93)	(99)	(106)	(113)	(121)	(130)	(139)	(149)	(159)
CAPITAL EXPENDITURES	(331)	(354)	(379)	(405)	(433)	(464)	(496)	(531)	(568)	(608)
TOTAL NON-TAXABLE CASH	(1,653)	(446)	(478)	(511)	(547)	(585)	(626)	(670)	(717)	(767)
CASH FLOW										
AFTER TAX INCOME	5,361	5,893	6,462	7,071	7,722	8,419	9,165	9,963	10,816	11,730
NON-CASH EXPENSE ADDBACK	3,943	3,978	4,016	4,057	4,100	4,146	4,196	4,249	4,306	4,367
TOTAL NON-TAXABLE CASH	(1,653)	(446)	(478)	(511)	(547)	(585)	(626)	(670)	(717)	(767)
NET CASH FLOW	7,651	9,425	10,000	10,616	11,275	11,980	12,735	13,542	14,405	15,330
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	7,134	7,640	7,048	6,504	6,006	5,548	5,127	4,740	4,383	4,055

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VALUE CONCLUSIONS

P.V. OF 10 YR. CASH FLOW	58,183
P.V. OF RESIDUAL	15,124
CONCLUDED VALUE	73,308

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DISCOUNTED CASH FLOW ANALYSIS
OF
FOJD TERMINAL INC.
ESTATE MANAGEMENT OPERATION
ASSUMING REDUCED UTILITIES RATES
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
BUILDING/FACILITIES INC.	29,760	31,843	34,072	36,457	39,009	41,740	44,662	47,788	51,133	54,713
LAND RENTAL INCOME	3,300	3,531	3,778	4,043	4,326	4,628	4,952	5,299	5,670	6,067
TOTAL REVENUE	33,060	35,374	37,850	40,500	43,335	46,368	49,614	53,087	56,803	60,779
CASH EXPENSE ITEMS										
PERSONNEL	3,571	3,821	4,089	4,375	4,681	5,009	5,359	5,735	6,136	6,566
LIGHT AND POWER	3,250	3,478	3,721	3,981	4,260	4,558	4,877	5,219	5,584	5,975
GEN. & ADMIN.	992	1,061	1,136	1,215	1,300	1,391	1,488	1,593	1,704	1,823
FACILITY REPAIR & MAINT.	661	707	757	810	867	927	992	1,062	1,136	1,216
OTHER CASH EXPENSES	2,645	2,830	3,028	3,240	3,467	3,709	3,969	4,247	4,544	4,862
TOTAL CASH EXPENSES	11,119	11,897	12,730	13,621	14,575	15,595	16,687	17,855	19,105	20,442
NON-CASH EXPENSE ITEMS										
DEPRECIATION	7,277	7,313	7,351	7,391	7,435	7,481	7,531	7,584	7,640	7,701
TOTAL NON-CASH EXPENSES	7,277	7,313	7,351	7,391	7,435	7,481	7,531	7,584	7,640	7,701
TOTAL EXPENSES	18,396	19,210	20,081	21,012	22,009	23,076	24,217	25,438	26,745	28,143
NET INCOME										
NET INCOME BEFORE TAX	14,664	16,164	17,770	19,487	21,326	23,292	25,397	27,649	30,058	32,636
INCOME TAX	5,132	5,657	6,219	6,821	7,464	8,152	8,889	9,677	10,520	11,423
AFTER TAX INCOME	9,531	10,507	11,550	12,667	13,862	15,140	16,508	17,972	19,538	21,214
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(1,322)	(93)	(99)	(106)	(113)	(121)	(130)	(139)	(149)	(159)
CAPITAL EXPENDITURES	(331)	(354)	(379)	(405)	(433)	(464)	(496)	(531)	(568)	(608)
TOTAL NON-TAXABLE CASH	(1,653)	(446)	(47[illegible])	(511)	(547)	(585)	(626)	(670)	(717)	(767)
CASH FLOW										
AFTER TAX INCOME	9,531	10,507	11,550	12,667	13,862	15,140	16,508	17,972	19,538	21,214
NON-CASH EXPENSE ADDBACK	7,277	7,313	7,351	7,391	7,435	7,481	7,531	7,584	7,640	7,701
TOTAL NON-TAXABLE CASH	(1,653)	(446)	(478)	(511)	(547)	(585)	(626)	(670)	(717)	(767)
NET CASH FLOW	15,156	17,373	18,423	19,547	20,749	22,036	23,413	24,886	26,462	28,148
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	14,131	14,083	12,983	11,976	11,052	10,204	9,425	8,710	8,052	7,446

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VALUE CONCLUSIONS

P.V. OF 10 YR. CASH FLOW	108,062
P.V. OF RESIDUAL	27,771
CONCLUDED VALUE	135,833

VALUATION OF THE FTI SLAUGHTERHOUSE

The slaughterhouse is a fully operational business unit. Cattle slaughtering is currently operating at near-capacity, while some excess capacity exists for hog slaughtering. Capacity could be expanded for both operations with additional capital investment.

The slaughterhouse provides services to the livestock owner, but does not buy or sell any product. Revenue is generated by collecting standard slaughtering fees. Miscellaneous revenue is generated from such activities as special livestock handling and rental of surplus holding pens. For 1987, slaughterhouse revenue is projected at P4 million, and miscellaneous revenue is projected at P1.2 million. Both revenue items are projected to grow at the long-term rate of inflation.

Personnel costs are projected as a percentage of slaughterhouse revenue. Since slaughterhouse operations are labor-intensive, a relatively large percentage of revenue goes for labor costs. In the DCF analysis, this expense is projected as 25% of slaughterhouse revenue.

Because of the high electric power costs at the FTI complex, two valuation scenarios were analyzed; one assuming the existing level of power costs, and the other assuming a substantial reduction of power cost. Under existing rates, 1987 expenses of P1.93 million are projected. For the reduced rate scenario, half of that amount (P483,000) is projected. In both cases, the power expense is projected to grow annually at the long-term inflation rate.

Expenses for repairs and maintenance of equipment and facilities are projected in the DCF as 3% of total revenue. General and administrative expenses are also recognized that allow for the cost of services currently provided by FTI. General and administrative expenses are projected as 3% of slaughterhouse revenue.

Review of slaughterhouse expense statements indicates that other expenses, including supplies, services, motor vehicle expenses, and miscellaneous expenses, represent approximately 35% of slaughterhouse revenue. These expenses are projected accordingly in the DCF analysis.

Depreciation is calculated assuming an initial depreciable basis of 80% of the concluded value of the business operation. The initial basis is depreciated over 12 years using the straight-line method. Depreciation of new assets, based upon capital expenditures, is calculated as 100% of investment depreciated over 5 years using the straight-line method.

Other assumptions used in the analysis are as follows:

Long-term inflation rate	7% per annum
Income tax rate	35%
Residual value after 10 years	4 times tenth year cash flow
Amount of capital as debt	75%
Cost of debt	18%
Cost of equity	25%
Net working capital	0

Because the slaughterhouse operates on a cash-on-delivery basis, it carries virtually no accounts receivable. It also carries no inventory, so relatively few current assets are required to operate the business. These observations justify the assumption of zero net working capital.

The assumed capital structure and costs of capital were used to calculate a WACC of 15.0%, which was used as the discount rate. The concluded values from the DCF analysis were P3.9 million with existing power rates, and P13.5 million with reduced power rates.

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DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
SLAUGHTER HOUSE OPERATIONS
ASSUMING EXISTING UTILITIES RATE STRUCTURE
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
SLAUGHTERHOUSE REVENUE	4,000	4,280	4,580	4,900	5,243	5,610	6,003	6,423	6,873	7,354
MISCELLANEOUS REVENUE	1,200	1,284	1,374	1,470	1,573	1,683	1,801	1,927	2,062	2,206
TOTAL REVENUE	5,200	5,564	5,953	6,370	6,816	7,293	7,804	8,350	8,935	9,560
CASH EXPENSE ITEMS										
PERSONNEL	1,000	1,070	1,145	1,225	1,311	1,403	1,501	1,606	1,718	1,838
LIGHT AND POWER	1,930	2,065	2,210	2,364	2,530	2,707	2,896	3,099	3,316	3,548
REPAIRS & MAINT.	156	167	179	191	204	219	234	251	268	287
GEN. & ADMIN.	120	128	137	147	157	168	180	193	206	221
OTHER CASH EXPENSES	1,400	1,498	1,603	1,715	1,835	1,964	2,101	2,248	2,405	2,574
TOTAL CASH EXPENSES	4,606	4,928	5,273	5,643	6,038	6,460	6,912	7,396	7,914	8,468
NON-CASH EXPENSE ITEMS										
DEPRECIATION	263	263	263	263	263	263	263	263	263	263
TOTAL NON-CASH EXPENSES	263	263	263	263	263	263	263	263	263	263
TOTAL EXPENSES	4,869	5,191	5,536	5,905	6,300	6,723	7,175	7,659	8,177	8,731
NET INCOME										
NET INCOME BEFORE TAX	331	373	417	465	516	570	629	691	758	829
INCOME TAX	116	130	146	163	181	200	220	242	265	290
AFTER TAX INCOME	215	242	271	302	335	371	409	449	493	539
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	0	0	0	0	0	0	0	0	0	0
CAPITAL EXPENDITURES	0	0	0	0	0	0	0	0	0	0
TOTAL NON-TAXABLE CASH	0	0	0	0	0	0	0	0	0	0
CASH FLOW										
AFTER TAX INCOME	215	242	271	302	335	371	409	449	493	539
NON-CASH EXPENSE ADDBACK	263	263	263	263	263	263	263	263	263	263
TOTAL NON-TAXABLE CASH	0	0	0	0	0	0	0	0	0	0
NET CASH FLOW	478	505	534	565	598	634	671	712	755	802
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	446	409	376	346	319	293	270	249	230	212

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VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	3,151
P.V. OF RESIDUAL	791
CONCLUDED VALUE	3,942

DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
SLAUGHTER HOUSE OPERATIONS
SSUMING REDUCED UTILITIES COSTS
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE	----	----	----	----	----	----	----	----	----	----
SLAUGHTERHOUSE REVENUE	4,000	4,280	4,580	4,900	5,243	5,610	6,003	6,423	6,873	7,354
MISCELLANEOUS REVENUE	1,200	1,284	1,374	1,470	1,573	1,683	1,801	1,927	2,062	2,206
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TOTAL REVENUE	5,200	5,564	5,953	6,370	6,816	7,293	7,804	8,350	8,935	9,560
CASH EXPENSE ITEMS										
PERSONNEL	1,000	1,070	1,145	1,225	1,311	1,403	1,501	1,606	1,718	1,838
LIGHT AND POWER	483	516	552	591	632	677	724	775	829	887
REPAIRS & MAINT.	156	167	179	191	204	219	234	251	268	287
GEN. & ADMIN.	120	128	137	147	157	168	180	193	206	221
OTHER CASH EXPENSES	1,400	1,498	1,603	1,715	1,835	1,964	2,101	2,248	2,405	2,574
	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
TOTAL CASH EXPENSES	3,159	3,380	3,616	3,869	4,140	4,430	4,740	5,072	5,427	5,807
NON-CASH EXPENSE ITEMS										
DEPRECIATION	903	903	903	903	903	903	903	903	903	903
	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
TOTAL NON-CASH EXPENSES	903	903	903	903	903	903	903	903	903	903
TOTAL EXPENSES	4,062	4,283	4,519	4,773	5,043	5,333	5,643	5,975	6,330	6,710
NET INCOME										
NET INCOME BEFORE TAX	1,138	1,281	1,434	1,598	1,773	1,960	2,161	2,375	2,604	2,850
INCOME TAX	398	448	502	559	620	686	756	831	912	997
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AFTER TAX INCOME	740	833	932	1,039	1,152	1,274	1,404	1,544	1,693	1,852
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	0	0	0	0	0	0	0	0	0	0
CAPITAL EXPENDITURES	0	0	0	0	0	0	0	0	0	0
	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
TOTAL NON-TAXABLE CASH	0	0	0	0	0	0	0	0	0	0
CASH FLOW										
AFTER TAX INCOME	740	833	932	1,039	1,152	1,274	1,404	1,544	1,693	1,852
NON-CASH EXPENSE ADDBACK	903	903	903	903	903	903	903	903	903	903
TOTAL NON-TAXABLE CASH	0	0	0	0	0	0	0	0	0	0
	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
NET CASH FLOW	1,643	1,736	1,835	1,942	2,056	2,177	2,308	2,447	2,596	2,756
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	1,532	1,407	1,293	1,190	1,095	1,008	929	856	790	729

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VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	10,830
P.V. OF RESIDUAL	2,719

CONCLUDED VALUE	13,548

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VALUATION OF THE FIT CHICKEN DRESSING PLANT

Discussion with individuals knowledgeable about the chicken industry indicate that all major chicken processors have integrated operations, in which they control raising, processing, and distribution of chicken -- processing alone is not considered a viable operation. It appears, therefore, that the most likely investors in the FTI chicken facility would be someone interested in buying the operation for integration with other operations. Possibilities are an integrated firm seeking more capacity, or a relatively large grower seeking to integrate processing and distribution into his operation.

The DCF analysis is based upon an assumed constant annual output of 3,000,000 kilos of dressed birds (approx 1 kilo per bird). This estimate is based upon the 1,000 kilo per hour production rate observed in the plant, extended over a 60 hour work week for 50 weeks per year.

The current revenue from the dressing operation is approximately P2.00 per kg. (dress weight). This amount is assumed to grow at the expected rate of inflation. Production costs are projected for both low power cost and high power cost scenarios. For the low power cost scenario, utilities are projected as 10% of revenue. In the high cost scenario, utilities are projected as 40% of revenue. In both cases, labor costs and other costs are projected as 40% and 10% of revenues, respectively.

A capital expenditure of 1% of total revenue is projected to allow for investment in equipment for the existing operations. Routine maintenance costs are included in the production costs.

Depreciation is calculated assuming an initial depreciable basis of 80% of the concluded value of the business operation. The initial basis is depreciated over 10 years using the straight-line method. Depreciation of new assets, based upon capital expenditures, is calculated as 100% of investment depreciated over 5 years using the straight-line method.

Other assumptions used in the analysis are as follows:

Long-term inflation rate	7% annually
Income tax rate	35%
Residual value after 10 years	4 times tenth year cash flow
Capital financed by debt	75%
Cost of debt	18%
Cost of equity	25%
Net working capital	4% of revenue

Based upon these assumptions, a WACC of 15% was calculated, and used for the discount rate. As a result of the discounted cash flow analysis, the value of the chicken dressing operation is estimated as P3.2 million at high electricity rates, and P15.6 million if the electricity rates are reduced.

DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
CHICKEN DRESSING FACILITY
HIGH UTILITIES COST ASSUMPTIONS
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
OUTPUT (1,000 KILOS)	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
UNIT REVENUE (PESOS)	2.00	2.14	2.29	2.45	2.62	2.81	3.00	3.21	3.44	3.68
TOTAL REVENUE	6,000	6,420	6,869	7,350	7,865	8,415	9,004	9,635	10,309	11,031
CASH EXPENSE ITEMS										
LABOR	2,400	2,568	2,748	2,940	3,146	3,366	3,602	3,854	4,124	4,412
UTILITIES	2,400	2,568	2,748	2,940	3,146	3,366	3,602	3,854	4,124	4,412
OTHER COSTS	600	642	687	735	786	842	900	963	1,031	1,103
TOTAL CASH EXPENSES	5,400	5,778	6,182	6,615	7,078	7,574	8,104	8,671	9,278	9,928
NON-CASH EXPENSE ITEMS										
DEPRECIATION	272	285	298	313	329	346	352	358	365	372
TOTAL NON-CASH EXPENSES	272	285	298	313	329	346	352	358	365	372
TOTAL EXPENSES	5,672	6,063	6,481	6,928	7,407	7,919	8,455	9,029	9,643	10,300
NET INCOME										
NET INCOME BEFORE TAX	328	357	389	422	458	496	549	606	666	731
INCOME TAX	115	125	136	148	160	174	192	212	233	256
AFTER TAX INCOME	213	232	253	274	298	322	357	394	433	475
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(240)	(17)	(18)	(19)	(21)	(22)	(24)	(25)	(27)	(29)
CAPITAL EXPENDITURES	(60)	(64)	(69)	(74)	(79)	(84)	(90)	(96)	(103)	(110)
TOTAL NON-TAXABLE CASH	(300)	(81)	(87)	(93)	(99)	(106)	(114)	(122)	(130)	(139)
CASH FLOW										
AFTER TAX INCOME	213	232	253	274	298	322	357	394	433	475
NON-CASH EXPENSE ADDBACK	272	285	298	313	329	346	352	358	365	372
TOTAL NON-TAXABLE CASH	(300)	(81)	(87)	(93)	(99)	(106)	(114)	(122)	(130)	(139)
NET CASH FLOW	185	436	464	495	527	562	595	630	668	708
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	173	353	327	303	281	260	239	220	203	187

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VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	2,547
P.V. OF RESIDUAL	699
CONCLUDED VALUE	3,246

DISCOUNTED CASH FLOW ANALYSIS
OF
FOOD TERMINAL INC.
CHICKEN DRESSING FACILITY
LOW UTILITIES COST ASSUMPTIONS
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
REVENUE										
OUTPUT (1,000 KILOS)	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
UNIT REVENUE (PESOS)	2.00	2.14	2.29	2.45	2.62	2.81	3.00	3.21	3.44	3.68
TOTAL REVENUE	6,000	6,420	6,869	7,350	7,865	8,415	9,004	9,635	10,309	11,031
CASH EXPENSE ITEMS										
LABOR	2,400	2,568	2,748	2,940	3,146	3,366	3,602	3,854	4,124	4,412
UTILITIES	600	642	687	735	786	842	900	963	1,031	1,103
OTHER COSTS	600	642	687	735	786	842	900	963	1,031	1,103
TOTAL CASH EXPENSES	3,600	3,852	4,122	4,410	4,719	5,049	5,403	5,781	6,185	6,618
NON-CASH EXPENSE ITEMS										
DEPRECIATION	1,262	1,275	1,288	1,303	1,319	1,336	1,342	1,348	1,355	1,362
TOTAL NON-CASH EXPENSES	1,262	1,275	1,288	1,303	1,319	1,336	1,342	1,348	1,355	1,362
TOTAL EXPENSES	4,862	5,127	5,410	5,713	6,038	6,385	6,744	7,129	7,540	7,981
NET INCOME										
NET INCOME BEFORE TAX	1,138	1,293	1,459	1,637	1,827	2,030	2,260	2,506	2,769	3,050
INCOME TAX	398	453	511	573	639	711	791	877	969	1,067
AFTER TAX INCOME	740	841	949	1,064	1,188	1,320	1,469	1,629	1,800	1,982
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(240)	(17)	(18)	(19)	(21)	(22)	(24)	(25)	(27)	(29)
CAPITAL EXPENDITURES	(60)	(64)	(69)	(74)	(79)	(84)	(90)	(96)	(103)	(110)
TOTAL NON-TAXABLE CASH	(300)	(81)	(87)	(93)	(99)	(106)	(114)	(122)	(130)	(139)
CASH FLOW										
AFTER TAX INCOME	740	841	949	1,064	1,188	1,320	1,469	1,629	1,800	1,982
NON-CASH EXPENSE ADDBACK	1,262	1,275	1,288	1,303	1,319	1,336	1,342	1,348	1,355	1,362
TOTAL NON-TAXABLE CASH	(300)	(81)	(87)	(93)	(99)	(106)	(114)	(122)	(130)	(139)
NET CASH FLOW	1,702	2,034	2,150	2,274	2,407	2,549	2,697	2,855	3,025	3,206
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	1,587	1,649	1,515	1,393	1,282	1,180	1,086	999	920	848

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VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	12,461
P.V. OF RESIDUAL	3,163
CONCLUDED VALUE	15,623

VALUATION OF THE ILOILO POWER PLANT

The Iloilo power plant has not yet been put into service as an income-producing entity. As such, there is no operating history upon which financial projections can be based. This fact makes investment in the plant riskier than for an operating plant. To reflect this risk, relatively high investment rates are selected: 20% for debt, and 27% for equity. Because debt could be secured by fixed assets, a high level of debt may be possible. However, the risk involved in startup of a new plant, plus the inherent shortness of useful life of the plant, would cause a lender concern for the ability of the plant to service the debt. For this reason, 60% financing is assumed. The WACC is calculated as follows:

$$\text{WACC} = (1-L) \times E = (1-T) \times L \times B$$

$$= (0.4 \times 0.27) = (1-0.35) \times 0.6 \times 0.20$$

$$= 0.186 \text{ or } 18.6\%$$

The WACC of 18.6% is used as the discount rate in the DCF analysis.

The projections established for operating expenses of the plant, which were provided by the NFA Corporate Planning Department, are believed to be reasonable and relatively precise. However, the projections of utilization of the plant's generating capacity, and therefore the revenue, are highly questionable. It is accepted that the plant can operate 300 days each year. It is certain, however, that there will not be demand for 100% of the generating capacity of the plant. This is partly due to the cycles of power demand throughout a day and the seasonal differences in power use. It is necessary for power utilities to maintain generating capacity to meet peak demands, so in non-peak demand periods there is excess capacity. It is assumed that utilization would be 75% of capacity.

Perhaps the most important assumptions concern the probable useful life of the plant. Because of the extension of the submarine power cable from Negros whose projected completion is 1989, calculations were made assuming the useful life of this facility to be 5 years (giving the NPC a couple years of leeway in completing their cable project) and 10 years.

Basic assumptions of the analysis are as follows:

Annual growth rate in power cost	1.64%
Annual growth rate of expenses	4.30%
Income tax rate	35.00%
Residual value after 10th year	None
Depreciable basis	Approx 80% of Concluded Value
Net working capital	0
Initial net working capital	0

The gross generating capacity is fixed at approximately 2 megawatts. Internal power uses of 220 kilowatts leaves a net capacity of 1.78 megawatts. Based upon 7,200 hours of operation (300 days), a net salable 12 million kw hours of electrical energy could be available for sale. With a utilization factor of 75%, the billable capacity is 9.6 million kwh.

The price of one kilowatt hour is projected as P.70 in the first year, and is estimated to grow each year at the stated growth rate. The gross revenue is the product of billable capacity and price per kwh.

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Expenses were estimated for fuel, chemicals, husk handling, insurance, repairs and maintenance, and personnel services for the first year as shown on the printout. Each expense item was projected to grow at the stated annual growth rate of expenses.

The power plant operating as an independent entity would need general services such as accounting and business management. This is reflected in a general and administrative expense, calculated as 1.5% of gross revenue.

The estimates of depreciation are calculated assuming an initial depreciable basis of 80% of the concluded value of the operation, under the two assumptions concerning useful life of the asset, using the straight-line method.

Capital expenditures are expected to be small; as such, they were assumed negligible for this analysis.

The value conclusions of the DCF analysis are as follows:

Five-year useful life	P10,397,000
Ten-year useful life	P16,144,000

It is apparent that the value of the future income of the Iloilo plant does not support a calculated value equal to the cost of construction. In fact, the value is lower than the face value of the loan from the United Kingdom. Given that debt-free assumptions have been used reach the above values, the analysis suggests that if the buyer assumes the U.K. loan of P48.5 million, NFA would have to pay the buyer to take the facility off their hands. This means that the loan is unworkable, and that the U.K. government should be requested to convert the loan into a grant.

ILOILO POWER PLANT
5 YEAR OPERATION
(1,000'S OF PESOS)

REVENUE	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
GROSS CAPACITY (KW)	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
LESS : INTERNAL USE	220	220	220	220	220	220	220	220	220	220
NET : CAPACITY (KW)	1,780	1,780	1,780	1,780	1,780	1,780	1,780	1,780	1,780	1,780
HOURS OF OPERATION	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200
NET CAPACITY MW HRS.	12,816	12,816	12,816	12,816	12,816	12,816	12,816	12,816	12,816	12,816
UTILIZATION FACTOR	75.00%	75.00%	75.00%	75.00%	75.00%	0.00%	0.00%	0.00%	0.00%	0.00%
BILLABLE CAPACITY	9,612	9,612	9,612	9,612	9,612	0	0	0	0	0
PRICE PER KW HR.	0.70	0.75	0.80	0.86	0.92	0.98	1.05	1.12	1.20	1.29
GROSS REVENUE	6,728	7,199	7,703	8,243	8,820	0	0	0	0	0
CASH EXPENSES										
FUEL	1,045	1,118	1,196	1,280	1,370	0	0	0	0	0
CHEMICALS	989	1,058	1,132	1,212	1,296	0	0	0	0	0
HUSK HANDLING	66	70	75	80	86	0	0	0	0	0
INSURANCE	581	621	665	711	761	0	0	0	0	0
REPAIRS & MAINTENANCE	204	218	234	250	267	0	0	0	0	0
PERSONNEL	474	508	543	581	622	0	0	0	0	0
GEN. & ADMI.	101	108	115	123	132	0	0	0	0	0
CASH EXP. SUB TOTAL	3,459	3,702	3,961	4,238	4,535	0	0	0	0	0
NON CASH EXPENSES										
DEPRECIATION	1,664	1,664	1,664	1,664	1,664	0	0	0	0	0
TOTAL EXPENSES	5,123	5,365	5,624	5,902	6,198	0	0	0	0	0
NET INC. BEF. TAX	1,605	1,834	2,079	2,341	2,621	0	0	0	0	0
INCOME TAX	562	642	728	819	917	0	0	0	0	0
NET INC. AFTER TAX	1,043	1,192	1,351	1,522	1,704	0	0	0	0	0
NON TAXABLE CASH SOURCES (USES)										
WORKING CAPITAL CHANGES	0	0	0	0	0	0	0	0	0	0
CASH FLOW										
NET INC. AFTER TAX	1,043	1,192	1,351	1,522	1,704	0	0	0	0	0
NON CASH EXP. SUB TOTAL	1,664	1,664	1,664	1,664	1,664	0	0	0	0	0
NON TAXABLE CASH ITEMS	0	0	0	0	0	0	0	0	0	0
NET CASH FLOW	2,707	2,856	3,015	3,185	3,367	0	0	0	0	0
PRESENT VALUE FACTOR	0.9265	0.7953	0.6826	0.5859	0.5030	0.4317	0.3706	0.3181	0.2730	0.2344
P.V. OF CASH FLOW	2,508	2,271	2,058	1,866	1,694	0	0	0	0	0

VALUE CONCLUSIONS	
P.V. 10 YEAR CASH FLOW	10,397
P.V. OF RESIDUAL	0
TOTAL PRESENT VALUE	10,397

ILOILO POWER PLANT
10 YEAR OPERATION
(1,000'S OF PESOS)

REVENUE	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
GROSS CAPACITY (KW)	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
LESS : INTERNAL USE	220	220	220	220	220	220	220	220	220	220
NET : CAPACITY (KW)	1,780	1,780	1,780	1,780	1,780	1,780	1,780	1,780	1,780	1,780
HOURS OF OPERATION	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200	7,200
NET CAPACITY MW HRS.	12,816	12,816	12,816	12,816	12,816	12,816	12,816	12,816	12,816	12,816
UTILIZATION FACTOR	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%
BILLABLE CAPACITY	9,612	9,612	9,612	9,612	9,612	9,612	9,612	9,612	9,612	9,612
PRICE PER KW HR.	0.70	0.75	0.80	0.86	0.92	0.98	1.05	1.12	1.20	1.29
GROSS REVENUE	6,728	7,199	7,703	8,243	8,820	9,437	10,098	10,804	11,561	12,370
CASH EXPENSES										
FUEL	1,045	1,118	1,196	1,280	1,370	1,466	1,568	1,678	1,795	1,921
CHEMICALS	989	1,058	1,132	1,212	1,296	1,387	1,484	1,588	1,699	1,818
HUSK HANDLING	66	70	75	80	86	92	99	106	113	121
INSURANCE	581	621	665	711	761	814	871	932	998	1,068
REPAIRS & MAINTENANCE	204	218	234	250	267	286	306	328	350	375
PERSONNEL	474	508	543	581	622	665	712	762	815	872
GEN. & ADMI.	101	108	115	123	132	141	151	162	173	185
CASH EXP. SUB TOTAL	3,459	3,702	3,961	4,238	4,535	4,852	5,192	5,555	5,944	6,360
NON CASH EXPENSES										
DEPRECIATION	1,292	1,292	1,292	1,292	1,292	1,292	1,292	1,292	1,292	1,292
TOTAL EXPENSES	4,751	4,993	5,252	5,530	5,826	6,144	6,483	6,847	7,236	7,652
NET INC. BEF. TAX	1,977	2,206	2,451	2,713	2,993	3,293	3,614	3,958	4,325	4,718
INCOME TAX	692	772	858	950	1,048	1,153	1,265	1,3[illegible]	1,514	1,651
NET INC. AFTER TAX	1,285	1,434	1,593	1,763	1,946	2,141	2,349	2,572	2,811	3,067
NON TAXABLE CASH SOURCES (USES)										
WORKING CAPITAL CHANGES	0	0	0	0	0	0	0	0	0	0
CASH FLOW										
NET INC. AFTER TAX	1,285	1,434	1,593	1,763	1,946	2,141	2,349	2,572	2,811	3,067
NON CASH EXP. SUB TOTAL	1,292	1,292	1,292	1,292	1,292	1,292	1,292	1,292	1,292	1,292
NON TAXABLE CASH ITEMS	0	0	0	0	0	0	0	0	0	0
NET CASH FLOW	2,577	2,726	2,885	3,055	3,237	3,432	3,641	3,864	4,103	4,358
PRESENT VALUE FACTOR	0.9265	0.7953	0.6826	0.5859	0.5030	0.4317	0.3706	0.3181	0.2730	0.2344
P.V. OF CASH FLOW	2,387	2,168	1,969	1,790	1,628	1,482	1,349	1,229	1,120	1,021

VALUE CONCLUSIONS	
P.V. 10 YEAR CASH FLOW	16,144
P.V. OF RESIDUAL	0
TOTAL PRESENT VALUE	16,144

VALUATION ANALYSIS OF SPGC

The Southern Philippines Grains Complex (SPGC) is an under-utilized facility which is currently not economically viable. However, it has not sought business in the open market, so its utilization has been solely dependent upon the purchasing activity of the NFA. Recent financial statements reflect large operating expenses even though utilization has been low.

The present study cannot conclude a market position that SPGC will achieve after privatization. As such, the DCF analysis has been conducted using a varying range of utilization factors. A utilization of 100% has been arbitrarily defined as 70 hours of production weekly for 50 weeks per year. It is clearly possible for the facility to operate at a utilization rate higher that 100%.

The results of the valuation calculations, for various utilization rates, are plotted on Figure B-1. The resulting plot shows the value-relation to utilization to be approximately linear, but with differing slopes in the positive and negative value ranges. The different slopes are a result of different treatments of taxes and depreciation. Specifically, negative taxes and depreciable bases are not allowed in the DCF model.

The hourly capacity of the milling operation is 500 bags (50 kilo) of rice per hour. Revenues are to be generated by custom milling (25%) and procurement for milling and wholesaling (75%). The value of custom milling services is projected as P10.40 per bag and the value of procurement milling is P13 per bag in 1987. These amounts are projected to grow annually at the long-term rate of inflation. Other important revenue is derived from rice bran sales. Total revenues are projected based upon the 100% level of utilization for the DCF printout shown.

A difficulty in projecting expenses for this analysis arises when estimating how expenses vary with revenue. It is generally assumed, for analysis, that all direct cost items are a fixed, variable, or linear function of revenue, with both fixed and variable components. Recent financial statements give an indication of cost levels, but are not very helpful in indicating the breakdown of fixed and variable components of costs. There are two specific reasons that historical information is not particularly useful. First, as a government operation, SPGC appears hesitant to reduce employment and other operating costs in times of low business activity, as would be dictated by sound business practice. Also, the large amount of inflation that occurred in 1984 limits the current relevance of any financial data prior to 1985. Using recent financial statements and best judgement, the cost items were projected as follows:

Personnel Expenses :	P1,800,000 fixed, plus 5% of Total Revenue
Contract Services :	P600,000 fixed, plus 5% of Total Revenue
Repairs & Maintenance :	P1,400,000 fixed
Transportation :	P500,000 fixed, plus 10% of Total Revenue
Utilities :	P150,000 fixed, plus 5% of Total Revenue
Other Cash Expenses :	P800,000 fixed

In all cases, the fixed part of the expense item is projected to grow annually at the long-term inflation rate.

Depreciation is calculated assuming an initial depreciable basis of 80% of the concluded value of the business operation. However, when the concluded value is negative, the initial basis is set at zero. The initial basis is depreciated over 15 years using the straight-line method. Depreciation of new assets, based upon capital expenditures, is calculated as 100% of investment depreciated over 7 years using the straight-line method.

Other assumptions used in the analysis are as follows:

Long term inflation rate	7% annually
Income Tax Rate	35% but 0% when income 0
Residual Value after 10 years	5 times the tenth year cash flow
Amount of Capital as debt	75%
Cost of debt	18%
Cost of Equity	25%
Net Working Capital	2% of total revenue

Using the assumed capital structure and costs of capital, a WACC of 15.0% was calculated. This was used as the discount rate in the DCF analysis. The results of the DCF calculations are plotted on figure B-1.

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Given the assumptions above, the valuation of the complex at 100% utilization is P137.5 million. The valuation at various levels of utilization is as follows:

Utilization	Value (Thousand of Pesos)
0%	(48,024)
10%	(24,521)
20%	(1,024)
30%	16,323
40%	33,634
50%	50,945
60%	68,256
70%	85,567
80%	102,878
90%	120,189
100%	137,500
110%	154,811
120%	172,122

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REVENUE PROJECTIONS
OF
SOUTHERN PHILIPPINES GRAINS COMPLEX
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
TOTAL REVENUE	31,456	33,658	36,014	38,535	41,233	44,119	47,207	50,512	54,048	57,831
CASH EXPENSE ITEMS										
PERSONNEL	3,373	3,609	3,862	4,132	4,421	4,731	5,062	5,416	5,795	6,201
CONTRACT SERVICES	915	979	1,047	1,120	1,199	1,283	1,373	1,469	1,571	1,681
REPAIRS & MAINTENANCE	1,400	1,498	1,603	1,715	1,835	1,964	2,101	2,248	2,405	2,574
TRANSPORTATION	2,073	2,218	2,373	2,539	2,717	2,907	3,111	3,328	3,561	3,811
UTILITIES	1,723	1,843	1,972	2,111	2,258	2,416	2,585	2,766	2,960	3,167
OTHER CASH EXPENSES	800	856	916	980	1,049	1,122	1,201	1,285	1,373	1,471
TOTAL CASH EXPENSES	10,283	11,003	11,773	12,597	13,479	14,422	15,432	16,512	17,668	18,905
NON-CASH EXPENSE ITEMS										
DEPRECIATION	7,423	7,519	7,622	7,732	7,850	7,976	8,111	8,255	8,320	8,389
TOTAL NON-CASH EXPENSES	7,423	7,519	7,622	7,732	7,850	7,976	8,111	8,255	8,320	8,389
TOTAL EXPENSES	17,706	18,522	19,395	20,329	21,329	22,399	23,543	24,768	25,988	27,294
NET INCOME										
NET INCOME BEFORE TAX	13,750	15,136	16,619	18,206	19,904	21,720	23,664	25,744	28,060	30,537
INCOME TAX	4,813	5,298	5,817	6,372	6,966	7,602	8,282	9,010	9,821	10,688
AFTER TAX INCOME	8,938	9,838	10,802	11,834	12,937	14,118	15,382	16,734	18,239	19,849
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(629)	(44)	(47)	(50)	(54)	(58)	(62)	(66)	(71)	(76)
CAPITAL EXPENDITURES	(629)	(673)	(720)	(771)	(825)	(882)	(944)	(1,010)	(1,081)	(1,157)
TOTAL NON-TAXABLE CASH	(1,258)	(717)	(767)	(821)	(879)	(940)	(1,006)	(1,076)	(1,152)	(1,232)
CASH FLOW										
AFTER TAX INCOME	8,938	9,838	10,802	11,834	12,937	14,118	15,382	16,734	18,239	19,849
NON-CASH EXPENSE ADDBACK	7,423	7,519	7,622	7,732	7,850	7,976	8,111	8,255	8,320	8,389
TOTAL NON-TAXABLE CASH	(1,258)	(717)	(767)	(821)	(879)	(940)	(1,006)	(1,076)	(1,152)	(1,232)
NET CASH FLOW	15,102	16,641	17,657	18,745	19,909	21,154	22,487	23,913	25,407	27,006
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	14,082	13,489	12,443	11,484	10,604	9,796	9,053	8,369	7,731	7,144

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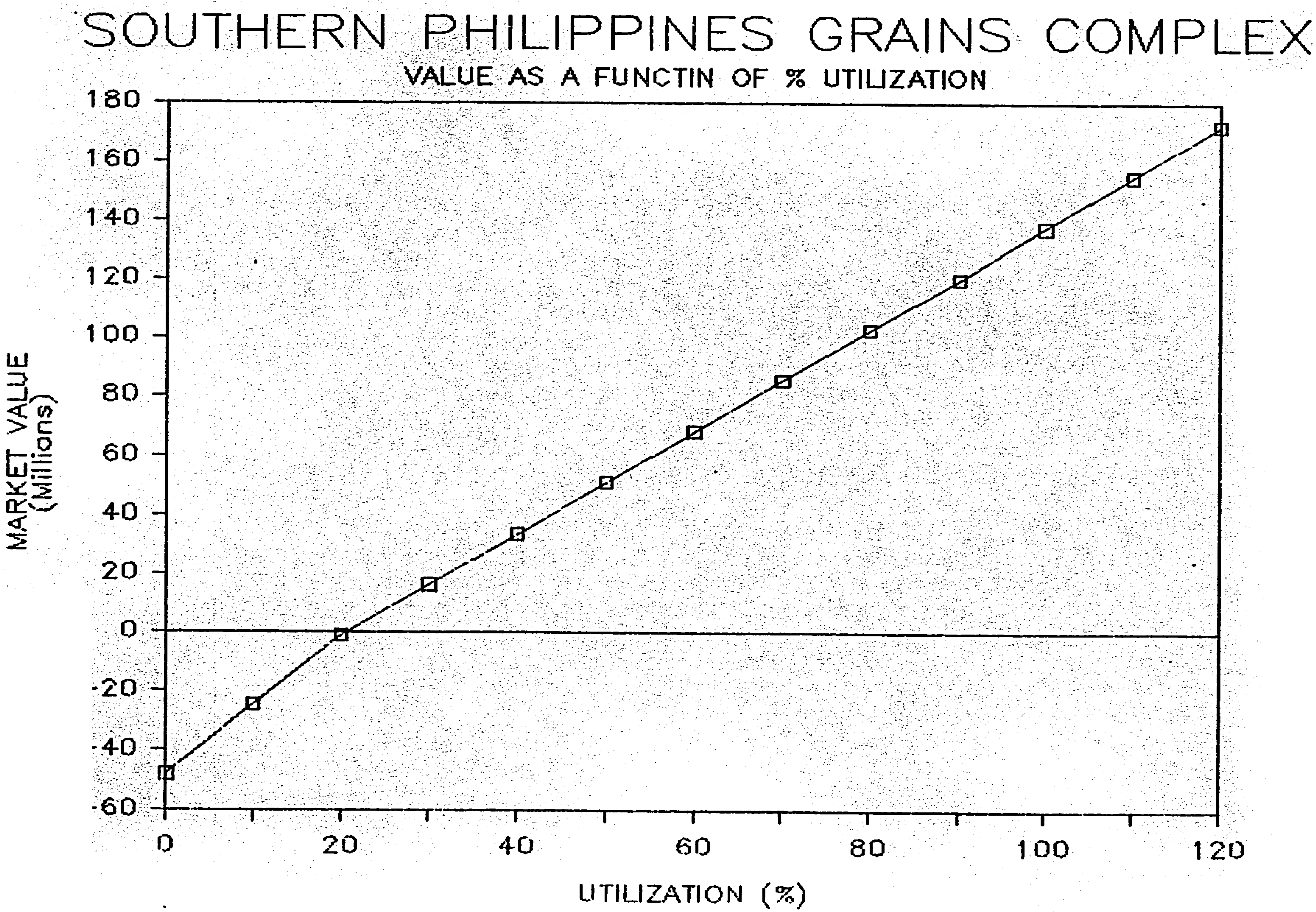
VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	104,195
P.V. OF RESIDUAL	33,305
CONCLUDED VALUE	137,500

REVENUE PROJECTIONS
OF
SOUTHERN PHILIPPINES GRAINS COMPLEX
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
MILLING CAPACITY (BAGS)	1,750,000	1,750,000	1,750,000	1,750,000	1,750,000	1,750,000	1,750,000	1,750,000	1,750,000	1,750,000
% UTILIZATION	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
CUSTOM OPER. (BAGS)	437,500	437,500	437,500	437,500	437,500	437,500	437,500	437,500	437,500	437,500
REVENUE PER BAG (PESOS)	10.40	11.13	11.91	12.74	13.63	14.59	15.61	16.70	17.87	19.12
CUSTOM REVENUE	4,550	4,869	5,209	5,574	5,964	6,382	6,828	7,306	7,818	8,365
PROCMNT. OPER. (BAGS)	1,312,500	1,312,500	1,312,500	1,312,500	1,312,500	1,312,500	1,312,500	1,312,500	1,312,500	1,312,500
REVENUE PER BAG (PESOS)	13.00	13.91	14.88	15.93	17.04	18.23	19.51	20.88	22.34	23.90
PROCMNT. REVENUE	17,063	18,257	19,535	20,902	22,365	23,931	25,606	27,399	29,317	31,369
BRAN MEAL SALES REVENUE	9,844	10,533	11,270	12,059	12,903	13,806	14,773	15,807	16,913	18,097
TOTAL REVENUE	31,456	33,658	36,014	38,535	41,233	44,119	47,207	50,512	54,048	57,831

EXHIBIT B-1


SOUTHERN PHILIPPINES GRAINS COMPLEX
VALUE AS A FUNCTIN OF % UTILIZATION
MARKET VALUE
(Millions)
180
160
140
120
100
80
60
40
20
0
-20
-40
-60
0
20
40
60
80
100
120
UTILIZATION (%)

VALUATION ANALYSIS OF DIGOS AGRO-INDUSTRIAL COMPLEX

The Digos Agro-Industrial Complex (DAIC) is an under-utilized facility which is currently not an economically viable entity. However, it has not sought business in the open market, so its utilization has been solely dependent upon the amount of purchasing activity of the NFA. Recent financial statements reflect substantial operating expenses despite low utilization.

Non-grain trading operations have been terminated as of this date, and the demonstration farm operations are being terminated. As such, the valuation analysis deals only with grain operations. More specifically, the analysis assumes only rice milling activity, since the corn milling facility is currently inoperable, and its market demand is questionable.

It should be noted that the demonstration farm represents an excess asset not required to carry out grain activities. It can be sold without detracting from the business enterprise of DAIC. Also the presently leased warehouse and education building could be sold. The total value of the complex is the DCF value estimate plus the market value of the demonstration farm and the warehouse and building presently leased to Coca Cola.

The present study cannot conclude a market position that DAIC will achieve after privatization. As such, the DCF analysis has been conducted using a varying range of utilization factors. A 100% utilization has been arbitrarily established as 70 hours of production weekly for 50 week per year. It is clearly possible for the facility to operate at a utilization rate higher that 100%.

The results of the valuation calculations for various utilization assumptions are plotted on Figure B-2. The resulting plot shows the value relation to utilization to be approximately

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linear, but with differing slopes in the positive and negative value ranges. The different slopes are a result of different treatments of taxes and depreciation. Specifically, negative taxes and depreciable bases are not allowed in the DCF model.

The hourly capacity of the milling operation is 200 bags (50 kilo) of rice per hour. Revenue is generated from custom milling, procurement and milling of rice, and rice bran sales. The value of milling services is projected as P11.25 per bag for custom milling and P11.50 for bag for procurement milling in 1987. These amounts are projected to grow annually at the long-term inflation rate. Total revenues are projected based upon a 100% level of utilization for the DCF printout shown.

A difficulty in projecting expenses for this analysis arises when estimating how expenses vary with revenue. It is generally assumed, for analysis, that all direct cost items are fixed, variable, or a linear function of revenue with both fixed and variable components. Recent financial statements give an indication of cost levels, but are not very helpful in indicating the breakdown of fixed and variable components of costs. There are two specific reasons that historical information is not particularly useful. First, as a government operation, DAIC appears hesitant to reduce employment and other operating costs in times of low business activity, as would be dictated by sound business practice. Also, the large amount of inflation that occurred in 1984 limits the current relevance of any financial data prior to 1985. Using recent financial statements and best judgement, the cost items were projected as follows:

Personnel Expenses	:	P1,200,000 fixed, plus 5% of total revenue
Contract Services	:	P400,000 fixed, plus 1% of total revenue

Maintenance of Motor vehicles	:	P400,000 fixed
Transportation	:	P330,000 fixed, plus 10% of total revenue
Utilities	:	P100,000 fixed, plus 5% of total revenue
Other Cash Expense	:	P525,000 fixed

In all cases, the fixed part of the expense item is projected to grow annually at the long term inflation rate.

Depreciation is calculated assuming initial depreciable basis of 80% of the concluded value of the business operation. However, when the concluded value is negative, the initial bases is set at zero. The initial basis is depreciated over 15 years using the straight line method. Depreciation of new assets, based upon capital expenditures, is calculated as 100% of investment depreciated over 7 years using the straight line method.

Other assumptions used in the analysis are as follows:

Long-term inflation rate	7% annually
Income tax rate	35% but 0% when income 0
Residual value after 10 years	5 times the tenth year cash flow
Amount of capital as debt	75%
Cost of debt	18%
Cost of equity	25%

Net Working Capital	2% of total revenue

Using the assumed capital structure and costs of capital, a WACC of 15.0% was calculated. This was used as the discount rate in the DCF analysis. The results of the DCF calculations are plotted on figure B-2.

Given the assumptions above, the valuation of the complex at 100% is P44.1 million. Valuation at various levels of utilization is as follows:

Utilization	Value (Thousands of Pesos)
0%	(23,744)
10%	(15,367)
20%	(6,990)
30%	830
40%	7,065
50%	13,232
60%	19,400
70%	25,568
80%	31,736
90%	37,904
100%	44,071
110%	50,239
120%	56,407

DISCOUNTED CASH FLOW ANALYSIS
OF
DIGOS AGRO-INDUSTRIAL COMPLEX
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
TOTAL REVENUE	11,944	12,780	13,674	14,632	15,656	16,752	17,924	19,179	20,522	21,958
CASH EXPENSE ITEMS										
PERSONNEL	1,797	1,495	1,600	1,712	1,831	1,960	2,097	2,244	2,401	2,569
CONTRACT SERVICES	519	556	595	636	681	729	780	834	892	955
MAINT. OF MOTOR VEHICLES	400	428	458	490	524	561	600	642	687	735
TRANSPORTATION	1,524	1,631	1,745	1,867	1,998	2,138	2,288	2,448	2,619	2,802
UTILITIES	697	746	798	854	914	978	1,046	1,120	1,198	1,282
OTHER CASH EXPENSES	525	562	601	643	688	736	788	843	902	965
TOTAL CASH EXPENSES	5,463	5,418	5,797	6,203	6,637	7,101	7,598	8,130	8,699	9,308
NON-CASH EXPENSE ITEMS										
DEPRECIATION	2,385	2,421	2,460	2,502	2,547	2,595	2,646	2,701	2,725	2,751
TOTAL NON-CASH EXPENSES	2,385	2,421	2,460	2,502	2,547	2,595	2,646	2,701	2,725	2,751
TOTAL EXPENSES	7,848	7,839	8,257	8,705	9,184	9,696	10,244	10,831	11,425	12,060
NET INCOME										
NET INCOME BEFORE TAX	4,096	4,941	5,417	5,927	6,472	7,056	7,680	8,348	9,097	9,898
INCOME TAX	1,434	1,729	1,896	2,074	2,265	2,470	2,688	2,922	3,184	3,464
AFTER TAX INCOME	2,662	3,212	3,521	3,853	4,207	4,586	4,992	5,426	5,913	6,434
NON-TAXABLE CASH SOURCES (USES)										
CHANGES IN WRKNG CAPITAL	(239)	(17)	(18)	(19)	(20)	(22)	(23)	(25)	(27)	(29)
CAPITAL EXPENDITURES	(239)	(256)	(273)	(293)	(313)	(335)	(358)	(384)	(410)	(439)
TOTAL NON-TAXABLE CASH	(478)	(272)	(291)	(312)	(334)	(357)	(382)	(409)	(437)	(468)
CASH FLOW										
AFTER TAX INCOME	2,662	3,212	3,521	3,853	4,207	4,586	4,992	5,426	5,913	6,434
NON-CASH EXPENSE ADDBACK	2,385	2,421	2,460	2,502	2,547	2,595	2,646	2,701	2,725	2,751
TOTAL NON-TAXABLE CASH	(478)	(272)	(291)	(312)	(334)	(357)	(382)	(409)	(437)	(468)
NET CASH FLOW	4,569	5,360	5,690	6,043	6,420	6,824	7,256	7,718	8,201	8,717
PRESENT VALUE FACTOR	0.932	0.811	0.705	0.613	0.533	0.463	0.403	0.350	0.304	0.265
P.V. OF CASH FLOW	4,260	4,345	4,010	3,702	3,420	3,160	2,921	2,701	2,495	2,306

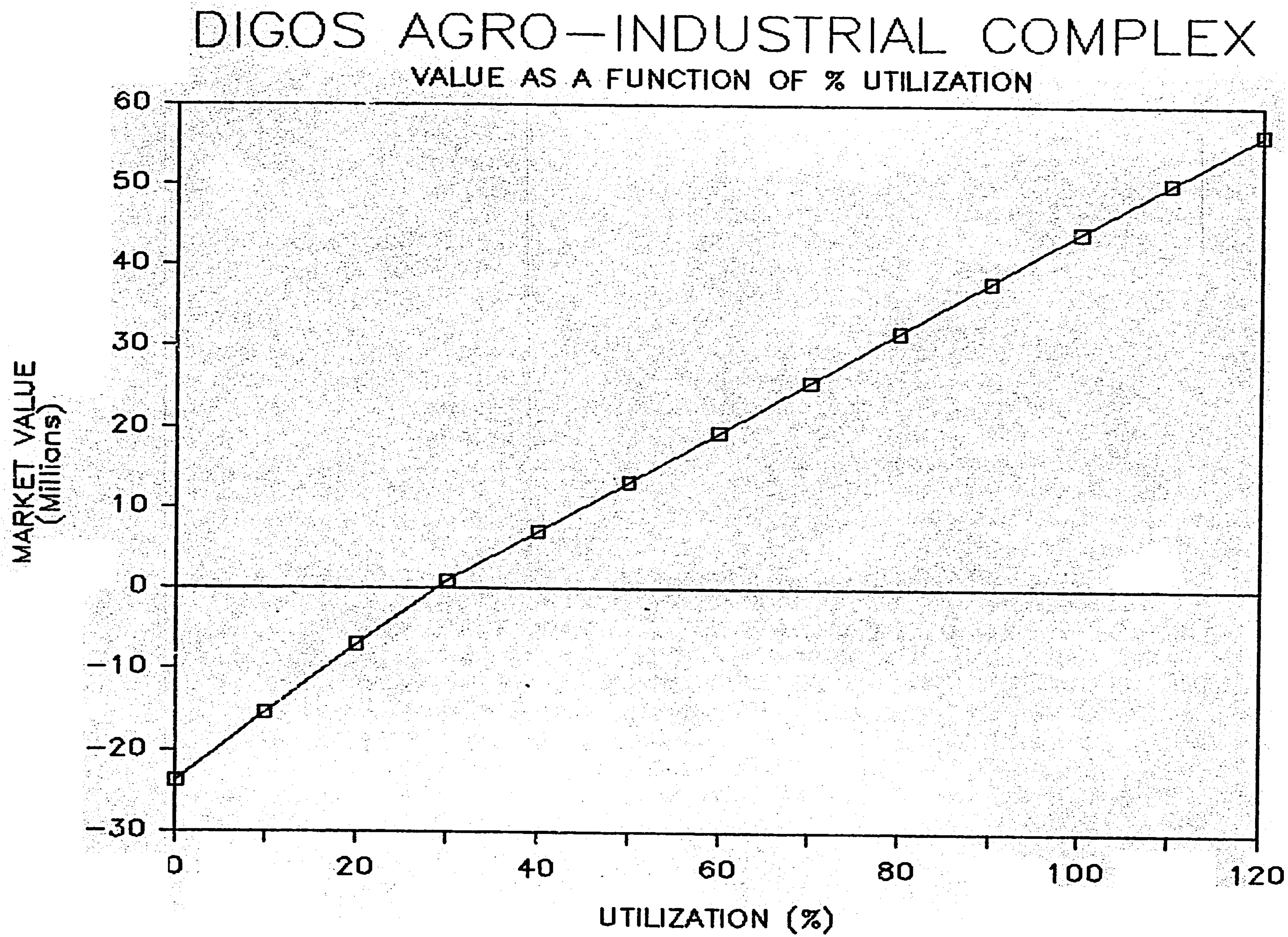
##################################

VALUE CONCLUSIONS	
P.V. OF 10 YR. CASH FLOW	33,321
P.V. OF RESIDUAL	10,751
CONCLUDED VALUE	44,071

DISCOUNTED CASH FLOW ANALYSIS
OF
DIGOS AGRO-INDUSTRIAL COMPLEX
(1,000'S OF PESOS)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
MILLING CACITY (BAGS)	700,000	700,000	700,000	700,000	700,000	700,000	700,000	700,000	700,000	700,000
% UTILIZATION	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
CUSTOM OPER. (BAGS)	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000	175,000
REVENUE PER BAG (PESOS)	11.25	12.04	12.88	13.78	14.75	15.78	16.88	18.07	19.33	20.68
CUSTOM REVENUE	1,969	2,107	2,254	2,412	2,581	2,761	2,955	3,161	3,383	3,619
PROC. OPER. (BAGS)	525,000	525,000	525,000	525,000	525,000	525,000	525,000	525,000	525,000	525,000
REVENUE PER BAG (PESOS)	11.50	12.31	13.17	14.09	15.07	16.13	17.26	18.47	19.76	21.14
PROC. REVENUE	6,038	6,460	6,912	7,396	7,914	8,468	9,061	9,695	10,374	11,100
BRAN MEAL SALES REVENUE	3,937	4,213	4,508	4,824	5,161	5,523	5,909	6,323	6,765	7,239
TOTAL REVENUE	11,944	12,780	13,674	14,632	15,656	16,752	17,924	19,179	20,522	21,958

EXHIBIT B-2


DIGOS AGRO-INDUSTRIAL COMPLEX
VALUE AS A FUNCTION OF % UTILIZATION
MARKET VALUE (Millions)
60
50
40
30
20
10
0
-10
-20
-30
0
20
40
60
80
100
120
UTILIZATION (%)

C. MISCELLANEOUS EXHIBITS CITED IN THE TEXT

APPENDIX C

SELECTED GOODS SOLD IN FTI KADIWA CENTERS

Dry Goods

- Rice
- Sardines
- Evaporated and condensed milk
- Powdered milk
- Meat loaf
- Corned beef
- Cooking oil
- Instant coffee
- Refined sugar

Wet Goods

- Pork/kasim/pigue
- Pork chops/liempc
- Beef laman
- Sirloin
- Dressed chicken
- Cabbage
- Onions
- Potatoes
- Tomatoes

Non-foods

- Bar soap
- Bath soap
- Powdered soap
- Colgate tooth paste

Republic of the Philippines
FOOD TERMINAL, INCORPORATED
CONSOLIDATED BALANCE SHEET
December 31, 1985
(With Comparative Figures for 1984)
(In Millions)

ASSETS	1985	1984	Increase (Decrease)
Current Assets			
Cash on Hand and in Bank (Schedule A)			
Cash in Bank	₱ 18.939	(₱ 9.523)	₱ 28.462
Cash on Hand	15.515	17.611	(2.096)
Total	₱ 34.454	₱ 8.088	₱ 26.366
Short-term Investments (Note 2)	₱ 26.149	₱ 21.213	₱ 4.936
Receivables			
National Government Agencies	1.719	1.053	.666
Gov't. Owned/Controlled Corp.	3.359	3.675	(.316)
Trade/Business	16.059	21.907	(5.848)
Estate Management Operation	25.662	19.668	5.994
Food Processing Operation	2.157	.795	1.362
Other Services	.548	.620	(.072)
Receivables Arising from Co. Benefits	2.213	1.897	.316
Miscellaneous Receivables (Sch. B)	51.779	49.876	1.903
Total	₱ 103.496	₱ 99.491	₱ 4.005
Less: Allowance for Doubtful Accounts (Note 3)	35.181	27.136	8.045
Net Receivables	₱ 68.315	₱ 72.355	(₱ 4.040)
Inventories			
Supplies and Materials	₱ 22.720	₱ 24.160	(₱ 1.440)
Items for Sale-Domestic	141.076	149.905	(8.829)
Items for Sale-Export	.077	.077	-
Inventories in Transit	.130	1.699	(1.569)
Miscellaneous Inventories	.843	-	.843
Total	₱ 164.846	₱ 175.841	(₱ 10.995)
Prepaid Expenses	₱ 1.140	₱ 1.387	(₱ .247)
Total Current Assets	₱ 294.904	₱ 278.884	₱ 16.020
Property, Plant and Equipment			
Land and Land Improvement	₱ 49.999	₱ 49.897	₱ .102
Building Structure and Leasehold Improvement	229.612	228.596	1.016
Furniture, Equipment and Work Animals	281.545	277.810	3.735
Total	₱ 561.156	₱ 556.303	₱ 4.853
Less: Accumulated Depreciation	159.830	140.691	19.139
Net Property, Plant and Equipment	₱ 401.[illegible]	₱ 415.612	(₱ 14.286)
Other Assets [illegible]	₱ [illegible]	₱ [illegible]	₱ [illegible]
Total Assets	₱ 702.[illegible]	₱ 70[illegible].704	₱ 2.071

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	1985	1984	Increase (Decrease)
LIABILITIES AND STOCKHOLDERS' EQUITY			
L I A B I L I T I E S			
Current Liabilities			
Payables			
National Government Agencies	₱ 1.027	₱ 1.114	(₱ .087)
Gov't. Owned/Controlled Corp. (Note 4)	391.990	242.575	149.415
Trade/Business	267.376	218.383	49.493
Miscellaneous Payables (Sch. D)	140.468	176.834	(36.366)
Total	₱ 801.261	₱ 638.906	₱ 162.455
Trust Liabilities			
National Government Agencies	₱ 7.535	₱ 7.655	(₱ .120)
Government Owned/Controlled Corp.	.580	.528	.052
Miscellaneous	2.471	.358	2.113
Total	₱ 10.586	₱ 8.541	₱ 2.045
Depository Liabilities	₱ 3.909	₱ 2.699	₱ 1.210
Miscellaneous Deferred Credits	₱ [illegible]	₱ [illegible]	₱ [illegible]
Total Current Liabilities	₱ 819.266	₱ 653.497	₱ 165.769
Long-Term Liabilities			
Advances Payable-Gov't. Owned/Controlled Corporation (Note 5)	₱ 45.858	₱ 45.858	-
Others (Note 6)	7.062	7.062	-
Total Long-Term Liabilities	₱ 52.920	₱ 52.920	-
Total Liabilities	₱ 872.186	₱ 706.417	₱ 165.769
STOCKHOLDERS' EQUITY			
Paid-Up Capital (Note 7)			
Preferred Stock-10 % Cumulative Non-Participating, par ₱10.00 authorized and issued 15 M shares	₱ 150.000	₱ 150.000	-
Common Stock-₱10.00 par, authorized and issued 35 M shares	350.000	350.000	-
Total Paid-Up Capital	₱ 500.000	₱ 500.000	-
Miscellaneous Capital	₱ 4.360	₱ 4.360	-
Retained Earnings (Deficit)			
Beginning of Year	(₱ 586.032)	(₱ 500.682)	(₱ 85.350)
Add/(Deduct) Net Income (Loss) for the year	(148.117)	(85.600)	(62.517)
Adjustment on Prior Years' Losses (Note 8)	(15.584)	.250	(15.834)
Retained Earnings (Deficit) at end of Year	(₱ 749.733)	(₱ 586.032)	(₱ 163.701)
Appraisal Surplus (Note 9)	₱ 71.322	₱ 71.322	-
Donated Surplus	₱ 4.640	₱ 4.637	₱ .003
Total Stockholders' Equity	(₱ [illegible])	(₱ 5.713)	₱ 163.698
Total Liabilities and Stockholders' Equity	₱ [illegible]	₱ 700.704	₱ 2.071

(See Accompanying Notes to Financial Statements)

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Republic of the Philippines
FOOD TERMINAL INCORPORATED
CONSOLIDATED STATEMENT OF INCOME
For the Year Ended December 31, 1985
(With Comparative Figures for 1984)
(In Millions)

	1985	1984	Increase (Decrease)
Sales	₱ 638.353	₱ 832.287	(₱ 193.934)
Cost of Sales	582.283	747.762	(165.479)
Gross Profit	₱ 56.070	₱ 84.525	(₱ 28.455)
Other Revenues			
Rent and Other Service Income			
Estate Management Income	₱ 46.223	₱ 41.180	₱ 5.043
Food Processing Income	6.581	5.253	1.328
Other Service/Rental Income	.638	.253	.385
Total	₱ 53.442	₱ 46.686	₱ 6.756
Miscellaneous			
Financial Income	₱ 8.213	₱ 9.464	(₱ 1.251)
Miscellaneous Income	9.490	17.505	(8.015)
Total	₱ 17.703	₱ 26.969	(₱ 9.266)
Total Revenues	₱ 127.215	₱ 158.180	(₱ 30.965)
Operating Expenses			
Personal Services			
Salaries and Wages	₱ 35.873	₱ 34.750	₱ 1.123
Non-Commutable Allowances	10.021	11.294	(1.273)
Insurance Premiums	3.022	3.011	.011
Overtime Pay/Meal Allowances	4.217	5.866	(1.649)
Bonus and Incentives	5.378	4.903	.475
Training and Personnel Improvement	.048	.039	.009
Consultant/Specialist Fees/Allowance	.162	.194	(.032)
Other Benefits (Appendix B_1)	14.648	13.683	.965
Total	₱ 73.369	₱ 73.740	(₱ .371)
Maintenance & Other Operating Expenses			
Travelling Expenses	₱ .478	₱ .561	(₱ .083)
Communication Services	1.338	1.507	(.169)
Repairs & Maintenance of Gov't. Facilities	.614	.376	.238
Transportation Services	.420	1.666	(1.246)
Other Services (Appendix B_2)	10.928	15.309	(4.381)
Supplies and Materials	6.772	8.661	(1.889)
Rent Expenses	2.126	2.899	(.773)
Interest Expense/Bank Charges (Note 10)	83.987	60.554	23.433
Grants, Subsidies and Donations	.427	.886	(.459)
Inventory Losses/Bad Debts	10.911	6.214	4.697
Depreciation/Amortization	19.240	18.343	.897
Water, Illumination and Power	51.781	[illegible]	[illegible]
Auditing Services	1.388	.982	[illegible]
SSS Benefits and Other Claims	1.442	.302	1.140
Maintenance of Motor Vehicles	6.814	6.965	(.151)
Taxes and Licenses	1.316	.209	1.107
Representation Expenses	.340	.877	(.537)

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	1985	1984	Increase (Decrease)
Discretionary Expense	1.069	1.282	(.213)
Awards and Indemnities	-	.001	(.001)
Miscellaneous Expense	.358	1.125	(.767)
Total	₱ 201.749	₱ 170.038	₱ 31.711
Total Operating Expense (Note 11)	₱ 275.118	₱ 243.778	₱ 31.340
Net Income (Loan) Before Extraordinary Contingent/Emergency Expenses	(₱ 147.903)	(₱ 85.598)	(₱ 62.305)
Less: Extraordinary Expenses	.214	.002	.212
Net Income (Loss)	(₱ 148.117)	(₱ 85.600)	(₱ 62.517)

(See Accompanying Notes to Financial Statements)

NATIONAL FOOD AUTHORITY
QUEZON CITY

LIST OF BIG ACCOUNTS RECEIVABLE
AS OF MARCH 31, 1986

NAME OF COMPANY	AMOUNT	REMARKS
ACCOUNTS RECEIVABLE - FTI	495,189,492.91	CASH,RICE,HOGS,CHICKEN
GOLDEN COUNTRY FARMS	134,688,298.60	ISSUES OF FEEDGRAINS/CORN & SOYBEAN MEAL ON A 30 TO 45 DAYS CREDIT, WITH THE CORRESPONDING POST-DATED CHECKS, NOT SUFFICIENTLY FUNDED. EXCLUSIVE OF INTEREST.
PHIL-ASIA FOOD INDUSTRIES	70,857,148.12	ISSUES OF IMPORTED AND LOCAL SOYBEANS TO BE PAID BY PHIL-ASIA IN KIND (SOYBEAN MEALS) A BY-PRODUCT OF PROCESSED SOYBEANS. EXCLUSIVE ON INTEREST
ECLAP (EMERGENCY CEREAL LAON ASSISTANCE PROGRAM)	129,886,227.24	LOAN ASSISTANCE TO DROUGHT STRICKEN AREAS IN 1983. TOTAL LOAN GRANTED IS 150M.
GENERAL MILLING CORPORATION	9,223,056.58	WHEAT GRAINS ISSUED TO GMC. THE AMOUNT IS THE SUBJECT OF THE ON-GOING RECONCILIATION.
FEDERAL AGRICULTURAL CORP.	7,206,773.03	ISSUANCE OF FEEDGRAINS.
KBS-RPN BROADCASTING CORP.	1,995,487.20	RICE ISSUED FOR THE ALLOWANCE OF THE CO. COVERED BY A BARTER AGREEMENT. PAYMENT SHALL BE MADE THRU OFFSETTING WITH NFA SUBSCRIPTION OF THE NEWSPAPER (DAILY EXPRESS) AND ADVERTISEMENT THRU THE NEWSPAPER AND TELEVISION.
REPUBLIC FLOUR MILLS	7,851,642.07	WHEAT GRAINS ISSUED. AMOUNT SUBJECT OF THE ON-GOING RECONCILIATION
STA. MARIA YELLOW CORN CENTER	2,134,321.38	FEEDGRAINS ISSUED. THE AMOUNT IS THE SUBJECT OF THE ON-GOING RECONCILIATION. NFA TO SUBMIT DOCUMENTS TO EVIDENCE THE STOCK ISSUE.
WELLINGTON FLOUR MILLS	2,299,870.90	WHEAT GRAINS ISSUED. FULLY PAID AS OF JULY 1986.
LIBERTY FLOUR MILLS	2,706,878.20	WHEAT GRAINS ISSUED.

LIST OF BIG ACCOUNTS RECEIVABLE
AS OF MARCH 31, 1986

NAME OF COMPANY	AMOUNT	REMARKS
MARCINS AGRI. DEVELOPMENT CORP.	2,875,500.00	FEEDGRAINS ISSUED, WITH ON-GOING FORECLOSURE PROCEEDINGS.
UNIVERSAL ROBINA CORP.	5,253,874.00	WHEAT GRAINS WITH OFFSETTING ARRANGEMENT FOR FLOUR. THE AMOUNT IS THE SUBJECT OF THE ON-GOING RECONCILIATION.
TAGUM DEVELOPMENT CORP.(TADECO)	2,280,000.00	FEEDGRAINS ISSUES BY NFA TAGUM.
ROYAL FEEDS	1,251,236.83	FEEDGRAINS
SOCIAL SECURITY SYSTEM	8,717,817.50	RICE ISSUED TO SUGAR WORKERS OF NEGROS, GUARANTEED BY THE SOCIAL SECURITY FUND, ISSUED IN 1983.
PHILSUCOM	39,809,446.18	RICE ISSUED TO SUGAR WORKERS (DISPLACED) OF NEGROS, THRU THE PHILSUCOM & MAF, ISSUED IN 1983.
METRO MANILA COMMISSION	17,487,578.33	RICE ISSUED TO VARIOUS EMPLOYEES OF THE METRO MANILA COMMISSION.
PHILIPPINE NATIONAL RED CROSS	1,299,534.25	RICE ISSUED TO DISTRESSED AREAS FROM 1983-1986.
KABATAANG BARANGAY BUREAU	2,837,768.72	RICE ISSUED PRIOR TO 1980.
MINISTRY OF SOCIAL SERVICES DEV.	11,689,070.73	RICE ISSUED FOR TYPHOON, DROUGHT & OTHER DISASTER STRICKEN AREAS.
CITY OF MANILA	2,268,593.20	RICE ISSUED TO THE VARIOUS EMPLOYEES OF THE CITY OF MANILA PRIOR TO 1980.

LIST OF BIG ACCOUNTS RECEIVABLE
AS OF MARCH 31, 1986

NAME OF COMPANY	AMOUNT	REMARKS
VARIOUS PUBLIC SCHOOLS	1,599,968.06	RICE ISSUED TO VARIOUS PUBLIC SHOOL TEACHERS.
MSSD - BUREAU OF ASSISTANCE	1,020,470.00	RICE ISSUED TO DISASTER AREAS.
PROVINCIAL DIRECTOR COORDINATING CENTER	1,615,311.65	RICE ISSUED.
OFFICE OF THE PROV'L. GOV. (VARIOUS)	1,887,904.00	RICE ISSUED TO VARIOUS GOVERNORS.
OFFICE OF THE MAYOR (VARIOUS)	1,205,692.04	RICE ISSUED TO VARIOUS MAYORS.
VARIOUS GOV'T. OFFICES IN METRO MANILA	1,001,694.70	RICE ISSUED FOR GOVERNMENT EMPLOYEES IN 1973.
SUB-TOTAL	968,140,661.42	
OTHERS	264,655,975.50	
TOTAL RECEIVABLES	1,232,796,636.92	

D. PERSONS INTERVIEWED

APPENDIX D

PERSONS INTERVIEWED

ASIAN DEVELOPMENT BANK (ADB)
P.O. BOX 789, Manila

- Bob Bakley
  Director, Country Department

- H. Leigh Durland
  Manager, Private Sector Division
  Industry and Development Banks Department

- Morimitsu Inaba
  Senior Project Economist

- Akira Tsusaka
  Director, Industry and Development Banks Department

BUHLER MIAG
2723 Pasong Tamo, Makati

- Guenter H. Lorenz
  Manager

CABINET MEMBERS, REPUBLIC OF THE PHILIPPINES

- Ramon V. Mitra
  Minister of Agriculture and Food
  MAF Building, Quezon City

- Jaime Ongpin
  Minister of Finance
  Central Bank Building

- Luis Villafuerte
  Minister and Chairman of the Presidential
  Commission of Government Reorganization
  Allied Bank Building, Makati

COMMISSION ON AUDIT (COA)
C/O NFA, Matimyas Building
E. Rodriguez Avenue, Quezon City

- Sylvia P. Montes
  Assistant Corporate Auditor

- Cornelia C. Ramos
  Corporate Auditor

DEVELOPMENT BANK OF THE PHILIPPINES (DBP)
P.O. Box 800 MCC

- Roberto D. Anonas
  Vice Chairman

- Amado Fabio
  Staff, Branches Department

- Elsa Guevarra
  Special Projects Office

FOOD TERMINAL, INC. (FTI)
Taguig, Metro Manila

- Rodolfo Ayalde
  General Manager

- Francisco Buencamino
  Department Manager, Facilities and
  Manufacturing Services

- Susan Garcia
  Director, Finance and Accounting

- Brenda Rivera
  Director, Corporate Planning

INTERNATIONAL FINANCE CORPORATION (IFC)
Central Bank Building, Manila

- Vijay K. Chaudhry
  Chief of Mission

KADIWA CENTERS
Metro Manila

- Nestor Estoesta
  Manager, Visayas Avenue, Quezon City

- Gina Gonzaga
  Accountant, La Loma, Quezon City

- Bernardino Martinez
  Manager, Tayuman, Tondo, Manila

- Lino Onate
  Manager, Paco, Manila

- Errol Renol
  Manager, Dagat-dagatan, Navotas

- Angel Vera
  Manager, Novaliches, Quezon City

KADIWA CENTERS
PROVINCES

- Wilfredo Aure
  Manager, Cavite City, KC

- Noel Carada
  Teller, Los Banos, Laguna KC

- Trinidad Medina
  Manager, Carmona. Laguna KC

- Marilyn Pasigan
  Teller, Lipa City, KC

MAGNOLIA, DIVISION OF THE SAN MIGUEL CORPORATION

- Antonio Climent

MINISTRY OF AGRICULTURE AND FOOD (MAF)
Circle Road, Quezon City

- Carlos Dominguez, Jr.
  Deputy Minister

NATIONAL DEVELOPMENT COMPANY
Sen. Gil J, Puyat Ave., Makati

- Rafael Suarez
  Group General Manager

NATIONAL FOOD AUTHORITY (NFA)
Matimyas Building, E. Rodriguez Avenue
Quezon City

Agricultural Processing and Marketing

- Teresita Leonardo
  Finance

- Fernando Miranda
  Assistant Director

- Nestor V. Zamora
  Director

Central Office

- Evangeline Anago
  Chief, Fund Management Division

- Antonio Celino
  Regional Director
  Region IV

- Erlinda dela Cruz
  Assistant Director, Accounting

- Jess Domingo
  Chief, Internal Audit

- Teodoro Jumamil
  Asst. Adm. Corporate Planning

- Magdalena Lapuz
  Director, Treasury, Fund Management

- Emil Ong
  Administrator

- Sener Reyes
  Section Chief, Internal Audit

- Greg "Jake" Tan
  Assistant Administrator, Infrastructure

Corporate Planning

Davao Office

- Esther Lontoc
  Operations Officer

- Ellen Magued
  Information Officer

- Wilfredo Royeca
  Asst. Manager
  NFA Davao

- Irma Feliciano
  Project Evaluation Officer

Digos Grains Complex

- Angel Fernandez
  Accounting Clerk

- Merlita P. Te Eng Fo
  Provincial Operations Officer

- Efren Macasinag
  Mechanic/Plant Operator

- Pedro Hernando, Jr.
  Director, Corporate Planning

- Chito Irigo
  Division Chief

- Noel Noble
  Division Chief

Iloilo Thermal Plant

- Javier Lozada
  Provincial Manager

- Jose Marie Agriam
  Provincial Information Officer

- Sidney Espina
  Plant Engineer

- Jovito D. Habaradas, Jr.
  Electrical Engineer

Management Services Directorate

- Leticia Cruz
  Assistant Director

- Edna Roldan
  Division Chief, Research

Non-grains Directorate

- Jose D. Chua
  Division Chief

- Trifona P. Datu
  Division Chief

- Erlinda B. Ferrer
  Assistant Director

- Diosdado A. Mayuga
  Section Chief

National Power Corporation
Iloilo City

- Floricel Candari
  Grid Manager, Panay Grid

- Cipriana Villalon
  Manager, Power Plant Barge 3

- Robert S. Musngi
  Division Chief

- George Pimentel
  Director, Non-grainsw Operations

Northern Philippines Grains Center (NPGC)
Echague, Isabela

- Juan L. Capitulo
  Regional Director (Region II)

- Hernan Cruzal
  Chief, Engineering Section, NPGC

- Farida Macalinao
  Provincial Manager

- Eleazar Pagalilawan
  Project Manager, NPGC

- Cesar Pagulayan
  Regional Operations Officer

- Wenceslao Sison
  Project Manager, Private Sector Modernization

Panay Electric Company, Inc. (PECO)
J.M. Basa, iloilo City

- Jose Ma. E. Cacho
  President/General Manager

Southern Philippines Grains Complex (SPGC
Tacurong, South Cotabato

- Ernesto Cotia
  Provincial Manager

- Antonio R. de la Cruz
  SPGC Manager

- Romulo Millan
  Regional Director CII, NFA

Southwestern Merchandising Corporation
35 Buendia Ave., Makati

- Ramon Torres
  President

Tabangao Loading Facility
Tabangao, Batangas

- Tomas Dizon
  Manager, Tabangao Facility

PHIL ASIA
Tabangao, Batangas

- Joseph Tan
  Plant Supervisor

PISO BANK

- Glicerio V. Sivat
  Executive Vice Psident & CEO

RFM CORPORATION
Mandaluyong, Metro Manila

Bernardo Araneta Concepcion
Assistant Vice President
Agri Business Division

TELEFUNKEN SEMICONDUCTORS (PHILS), INC.
FTI Estate, Taguig, Metro Manila

- Lutz Mannhardt
  Director and General Manager

TRIUMPH INTERNATIONAL
FTI Estate, Taguig, Metro Manila

- Al M. Escueta
  General Manager

UNIVERSAL ROBINA CORPORATION
P.O. Box 3542 Manila

- Henry L. Go
  Senior Vice-President

EXHIBIT III-1

FINANCIAL IMPACT OF NFA'S PERIPHERAL OPERATIONS
(Millions of Pesos)

Peripheral Operations	Loans Outstanding	Annual Amortization	Annual Losses	Total Annual NFA Cash Requirements	Rank
FTI	720.7	89.5	134.0	223.5	1
NFA Kadiwas	1.2	-	47.5	47.5	2
Iloilo Thermal Generating	48.5 1/	13.1 1/	2/	13.1	4
SPGC	134.0	4.8	7.3	12.1	5
APMP	246.0	30.4	2/	30.4	3
Tabangao Unloading	49.7	4.8	2/	4.8	6
Bicol Seeds	3.9	1.7	-	1.7	7
Digos			(.2)	(.2)	8
Total	1,204.0	144.3	188.8	333.1	

1/ The study team recommends that this loan be converted into a grant.

2/ NFA may have additional cash requirements due to losses, unless operation is privatized.

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receivable totaled over P1.2 billion (distinct from the loans payable figure referred to above), nearly 40% of which is attributable to FTI.

Many of these receivables are clearly uncollectible. Many of the intergovernmental accounts are very old. Several of the business accounts are with companies either no longer operating or in dire financial straits.

The NFA should aggressively pursue these receivables with a goal of keeping receivables current up to 30 days and to apply short-term borrowing rates to receivables more than 30 days. It should further seriously mount an effort to write off uncollectibles. The project team recognizes the slow process required to do so as well as the legal limitations existing at this time, but believes that the earliest cleansing of accounts is essential to achieving a fresh start for NFA.

4. THE PRIVATIZATION OF THE NFA PERIPHERALS CAN PROBABLY BE ACCOMPLISHED IN TWO YEARS

While it is difficult to predict at this point how long it will take to divest this set of operations, our experience would indicate that, given a strong commitment to the task and fairly stable economic and political conditions, it could require only about 2 years.

This section lists the tasks for privatizing these operations identified in Chapter II. The tasks have been broken into those requiring immediate attention, those which will be first year activities, and those which will be addressed in year two. Subjective estimates have been made for how long these tasks would take. Lastly, we have identified the skills required to carry out the tasks, as a guide for the types of personnel and technical assistance required for the privatization.

(1) <u>The Privatization Of The NFA Peripherals Should Be Undertaken By A Unit Especially Set Up For Asset Disposal</u>

Because of the exigencies of the NFA to carry out what the study team considers to be a relatively gigantic chore of price and supply stabilization of rice and grains, we believe that the responsibility for the sale of most of the peripheral units must be passed to an Asset Disposal Unit (ADU) specifically designed to handle the legal problems, additional appraisals, refinement of evaluations, and preparation of prospectuses to bring about their sale.

Consideration was given to the alternatives open for placement of these units within the GOP bureaucracy. One obvious possibility is the Asset Privatization Trust (APT) to be set up to dispose of non-performing assets on a government-wide basis. This idea was rejected for now because of the possible, substantial delays of setting up an entity of such over-riding importance to the overall privatization effort. Additionally, the NFA assets would have to compete for priority with a large number of other government holdings, many of which will command higher attention by virtue of their size and importance to the country's economy. The physical constraints on the APT in handling such a large number of assets will mitigate against early attention to the NFA assets.

Consideration was also given to the National Development Corporation, which is attempting (so far without success) to privatize some of its corporations, and the IFC, whose government-wide privatization scheme was turned down by the GOP.

For the purpose of ease of transferring the operations and for maintenance of the line of authority necessary to tie up financial and administrative loose ends efficiently, the study team recommends placement of the unit under the MAF, with responsibility given to the Deputy Minister level (see Exhibit III-2). This will require setting up a special office which has its own budget for operations and a limited number of staff members. Once privatization of the NFA peripherals is completed, this staff can be transferred to the Asset Privatization Trust (APT), or other locations in the GOP where disposal of government-owned assets is taking place.

(2) <u>There Are Several Tasks Requiring Immediate Attention</u>

The following tasks require immediate attention:

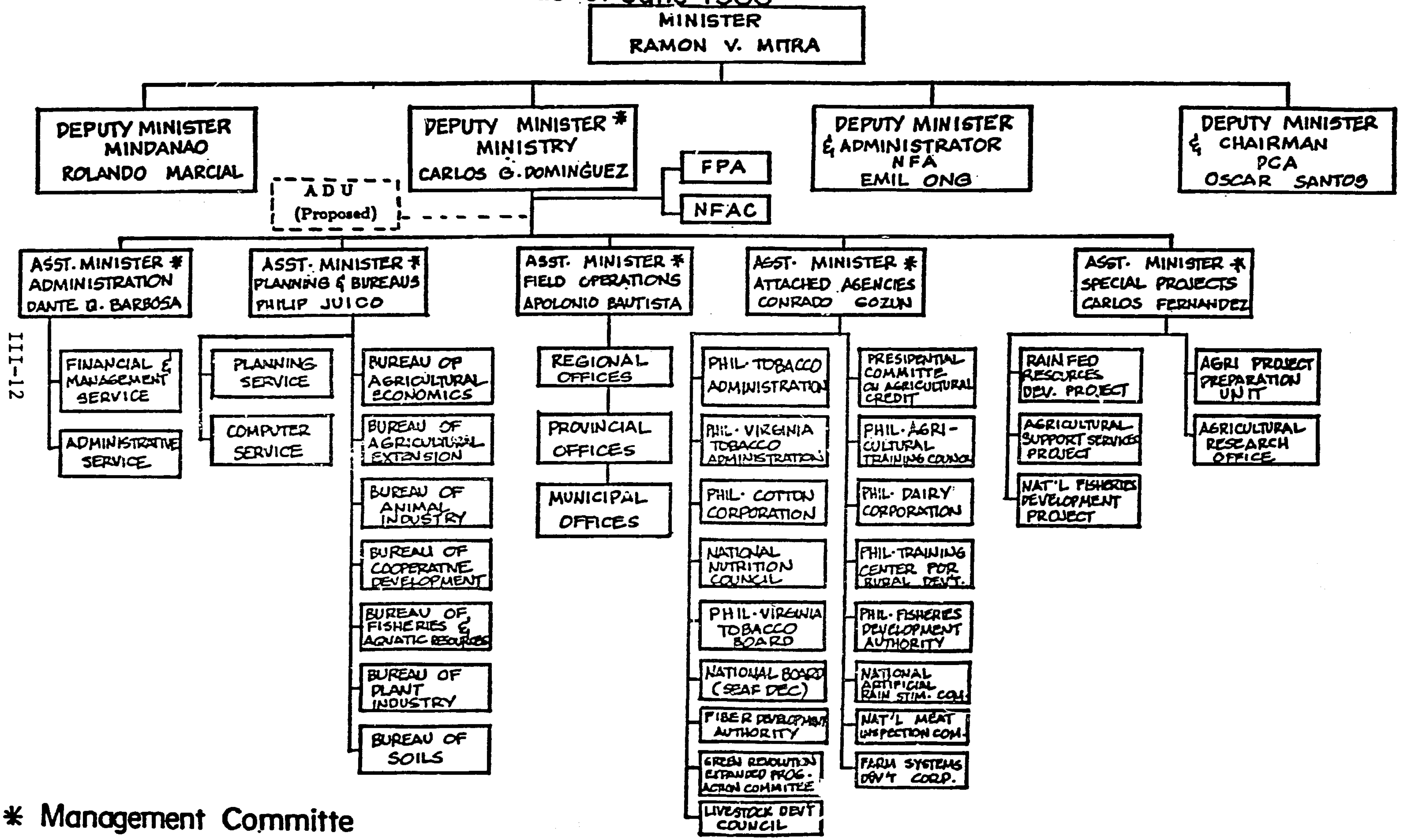
- <u>Closing down the Metro Manila and NFA Kadiwas</u>. Because of the continuing negative financial situation created by these operations as indicated in the financial analysis above, these operations should be phased out by March 1987. The NFA should take responsibility for finishing up this close-out operation. Estimates need to be made now concerning severance pay requirements.

- <u>Meralco billing problem</u>. Because of the high charges made by Meralco and the negative effects upon the privatization of FTI (not to mention the negative drag of these charges upon the entire industrial sector), the ADU should call upon the Minister of Agriculture and Food to bring this issue up for cabinet-level action at the earliest possible moment. NEDA is also studying the problem and may have useful supporting information.

- <u>Transfer of property leased by FTI</u>. To enhance the possibilities of privatizing FTI, the land it occupies in the Fort Bonifacio Military Reservation and the land on which its Kadiwa centers are located should be transferred to FTI. The staff of the ADU

EXHIBIT III-2

Ministry of Agriculture and Food as of June 1986



* Management Committe

should research this and pass it to the Minister for resolution by Executive Order. At the same time, the PNR lease of FTI land should be abrogated.

- Negotiate a grant with the U.K. government. The NFA should immediately re-negotiate the loan agreement related to the Iloilo thermal electric generation plant. The ADU, in efforts coordinated with the NFA, should move to sell the facility to either PECO or NPC. If no sale can be made, the facility should be left in the hands of the U.K. government.

- Negotiate with the ADB on the APMP. The NFA should negotiate the scaling down of this project, as discussed above.

- Negotiate a marketing strategy for Tabangao with the DBP. Given the level of interest in this facility, it may become the first operation sold. Therefore, the ADU should move quickly to formalize a joint marketing strategy and market price for the Tabangao facility and Phil Asia.

These tasks and others to be carried out in years one and two are listed in Exhibit III-3.

(3) The ADU Will Require Specialized Staffing.

Some special skills are required that are not likely to be found in either the NFA or the MAF. The specialties are:

- Real estate law
- Appraisal and valuation
- Investment promotion and packaging
- Public relations

EXHIBIT III-3

ANALYSIS OF TASKS FOR PRIVATIZATION OF NFA PERIPHERALS

	REQUIRES IMMEDIATE ATTENTION	YEAR 1 ACTIVITY	YEAR 2 ACTIVITY	DURATION (MONTHS)	SKILLS REQUIRED	RESPONSIBILITY
FTI						
1. ESTIMATE TOTAL SEVERANCE PAY REQUIREMENTS	**			1	ADMINISTRATION	NFA
2. CLOSE DOWN METRO MANILA KADIWAS OVER NEXT 6 MONTHS	**			6	LEGAL; MANAGEMENT	NFA
3. RESOLVE MERALCO BILLING PROBLEM	**			2	ECONOMICS; LEGAL	ADU
4. TRANSFER MINISTRY OF NATIONAL DEFENSE PROPERTY AND KADIWA PROPERTY*	** **			1	LEGAL	ADU
5. ABROGATE PNR LEASE WITH FTI				1	LEGAL	ADU
6. SELL SLAUGHTER HOUSE		**		2-4	INVESTMENT PACKAGING AND PROMOTION	ADU
7. SELL CHICKEN PROCESSING PLANT		**		2-4	INVESTMENT PACKAGING AND PROMOTION	ADU
8. REFRIGERATION ENGINEERS EVALUATE CENTRAL REFRIGERATED WAREHOUSE		**		1	CONTRACT ADMINISTRATION	ADU
9. SELL FOOD STORE SITES AND DRY WAREHOUSE		**		6-12		ADU
10. REPAIR CENTRAL REFRIGERATED WAREHOUSE		**		3	CONTRACT ADMINISTRATION	ADU
11. APPRAISE UNDEVELOPED LAND			**	1	CONTRACT ADMINISTRATION	ADU
12. SELL REMAINDER OF THE COMPLEX			**	6-24	INVESTMENT PACKAGING AND PROMOTION	ADU
NFA KADIWAS						
1. ESTIMATE TOTAL SEVERANCE PAY REQUIREMENTS	**			1	ADMINISTRATION	NFA
2. CLOSE OUT OPERATIONS	**	**		6	LEGAL; MANAGEMENT	NFA
ILOILO THERMAL GENERATION						
1. NEGOTIATE TERMS OF U.K. LOAN	**			1	ADMINISTRATION, LEGAL	NFA
2. NEGOTIATE SALE TO PECO				2	LEGAL; INVESTMENT PACKAGING	ADU
SPGC						
1. STUDY RICE PROCUREMENT STRATEGY FOR MINDANAO	**	**		3	NFA ADMINISTRATION; ECONOMICS	NFA
2. DETERMINE FARM COOPERATIVE INTEREST IN PARTICIPATION		**		1-2	MANAGEMENT FARM COOPERATIVES	ADU
3. SELL DEMONSTRATION FARM		**		3-4	REAL ESTATE; LEGAL	ADU
4. SELL COMPLEX		**	**	12-20	INVESTMENT PACKAGING AND PROMOTION	ADU

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EXHIBIT III-3 (cont.)

ANALYSIS OF TASKS FOR PRIVATIZATION OF NFA PERIPHERALS

	REQUIRES IMMEDIATE ATTENTION	YEAR 1 ACTIVITY	YEAR 2 ACTIVITY	DURATION (MONTHS)	SKILLS REQUIRED	RESPON BILIT
APMP						
1. NEGOTIATE WITH ADB TO REDUCE PROJECT	**			1	NFA ADMINISTRATION	NFA
2. NEGOTIATE EQUITY PARTICIPATION		**		1	LEGAL; INVESTMENT PACKAGING	ADU
3. DETERMINE FARM COOPERATIVE PARTICIPATION		**		1-2	INVESTMENT PACKAGING; FARM COOPERATIVE	ADU
4. SELL OFF COMPLEX		**	**	8-20	INVESTMENT PACKAGING AND PROMOTION	ADU
5. DIVEST FRUIT AND VEGETABLE MARKETING FACILITIES			**	6	INVESTMENT PACKAGING AND PROMOTION; FARM COOPERATIVE	ADU
TABANGAO						
1. BRING SOY PROCESSING FINANCE SPECIALIST TO ASSIST IN JOINT VALUATION OF PHIL ASIA AND TABANGAO	**			1	Valuation	ADU
2. NEGOTIATE JOINT SALE STRATEGY WITH DBP	**			1	LEGAL; INVESTMENT PACKAGING	ADU
3. STUDY FEASIBILITY OF TRANSSHIPPING GRAINS BOUND FOR MANILA		**		3	ECONOMICS	ADU
3. SELL COMPLEX WITH PHIL ASIA		**		24	INVESTMENT PROMOTION	ADU
BICOL						
1. SELL COMPLEX AS UNIT, IF NOT, SELL BY COMPONENTS			**	6-24	INVESTMENT PROMOTION AND PACKAGING	ADU
DIGOS						
1. IN CONNECTION WITH SPGC, STUDY RICE COMPONENT STRATEGY FOR MINDANAO		**		3	ADMINISTRATION; ECONOMICS	NFA
2. SELL DEMONSTRATION FARM		**		3-4	INVESTMENT PROMOTION; LEGAL	ADU
3. SELL OR LEASE WAREHOUSE AND TRAINING CENTER TO COCA COLA		**		1	INVESTMENT PROMOTION	ADU
4. DEPENDING ON MINDANO STABILIZATION STRATEGY, SELL RICEMILLING AND STORAGE OPERATION			**	12-24	INVESTMENT PROMOTION AND PACKAGING	ADU

The study team is hesitant to recommend hiring many additional new staff and the creation of a new bureaucracy. Therefore, we recommend a small core staff for the Asset Disposal Unit comprised of the following:

- One unit director
- One lawyer, with consider experience in real estate law.
- One public relations specialist
- One contract administrator to handle contracting with appraisers, lawyers (as needed), refrigeration engineers and other specialists
- One economist to work on Meralco issue, assist with the Mindanao procurement strategy, and to refine valuations as additional financial information becomes available
- One sales specialist who can package deals, develop investment promotion strategies and deal with real estate firms working for commission, and investment banking firms in case a flotation is required
- One maintenance coordinator, to work with NFA to assure that maintenance is kept up on the units until the time of sale.

The MAF should provide staff assistance to make contact with farm cooperatives in the Cagayan Valley and Central Mindanao to determine their interest in participating in the purchase of SPGC and NPGC. In the event substantial interest exists, MAF staff members should be assigned to provide liaison to the cooperatives, and to assist in facilitating the sale of these operations.

The study team also recommends that expatriate advisors be placed in this unit to assure that:

- Clear communication and coordination exist between the MAF, NFA and other appropriate agencies

- Sales materials including prospectuses, photos, maps, surveys, financial information are made available to buyers and that advertising and brochures are developed.

- Valuations of operations are refined and used in accepting or rejecting offers

- Operations are marketed aggressively

- Negotiations proceed in an orderly fashion.

USAID can provide the ADU with start-up funding so that it can hire staff and get underway. It can also fund a long-term technical assistance contract to provide the costs of professional, expatratiate advisors.

5. <u>POTENTIAL PROCEEDS COULD RANGE UP TO P500 MILLION AND SHOULD BE USED TO SUPPORT THE ADU AND PAY OFF EXISTING LIABILITIES</u>

As noted above, several valuations could not be completed at this time (Tabangao, NPGC, other components of APMP, and Bicol), primarily because of insufficient financial data. However, given the valuations of the peripheral operations that could be completed, and assigning subjective estimates to some of the more significant assets (such as NPGC, Tabangao and the undeveloped land at FTI), it is conceivable that the sales proceeds could total as much as P500 million. Exhibit III-4 lists these valuations.

A caveat regarding these valuations must be made. Given the information and assumptions employed, some valuations made in

EXHIBIT III-4

ESTIMATED VALUATIONS OF
NFA PERIPHERAL OPERATIONS
(Thousands of Pesos)

Operations	Valuations Low[1/]	Valuations High[2/]
Food Terminal, Inc.		
Slaughterhouse	3,942	13,548
Chicken processing	3,246	5,623
Central refrigerated warehouse	1,199	73,837
Estate management	73,308	135,833
Developable land	NV	NV
Kadiwa buildings	NV	NV
NFA Kadiwas	-	-
Iloilo Thermal Plant	10,397	16,144
SPGC	50,945	85,567
Demonstration farm	NV	NV
APMP		
NPGC	NV	NV
Fruit & vegetable marketing facilities	NV	NV
Tabangao Unloading Facility	NV	NV
Digos Agro-Industrial Complex	7,065	19,400
Warehouse & Education building	NV	NV
Demonstration farm		
Bicol Seed	NV	NV
Totals	150,102	359,952

NV--value not determined

1/ FTI sub-components valued according to existing and reduced utility rates; Iloilo valued according to 5-year and 10-year useful lives; SPGC is valued at 50% utilization, Digos is valued at 40% utilization.

2/ SPGC is valued based on 70% utilization; Digos is valued based on 60% utilization.

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Appendix B may fall somewhat wide of true fair market value. However, the ADU can refine these valuations, following the methodology explained in Appendix A, as new information becomes available. For instance, additional information may be generated either through the work of industry-specific specialists or more current or accurate financial figures provided by the NFA finance unit.

The ADU, having sold the assets at their fair market value, will pay any costs relating to the sale such as sales commissions or fees. The two-year operation of the ADU would also be self-financing, with external assistance necessary for start-up costs only. The net proceeds should be used then, not for NFA operations, but to reduce NFA's outstanding liabilities. Debts to foreign and private lenders should take precedence over those to other GOP agencies; these former debts will not disappear, and their payment will increase the creditworthiness of the GOP.