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CONSULTANCY REPORT ON THE PRIVATIZATION AND REHABILITATION OF EDIBLE OIL MILLS IN UGANDA

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ACRONYMS

AID	Agency for International Development
ACDI	Agricultural Cooperative Development International
CAAS	Cooperative Agriculture & Agribusiness Support Project
DAPCB	Departed Asians Property Custodian Board
EOSIL	Edible Oils & Soap Industry, Ltd.
ESOP	Employee Stock Option Plan
GOU	Government of Uganda
LMB	Lint Marketing Board
UCA	Uganda Cooperative Alliance
UNEX	Union Export Services

EXECUTIVE SUMMARY

The government of Uganda (GOU) has the stated objective to achieve self-sufficiency in edible oils production in the near-term and to reenter the export market, in which it participated in the 1960s, to save and generate foreign exchange. Nearly all oil mills are either obsolete, operating at a fraction of capacity or non-operational, or defunct. Many had been expropriated from expelled Asians and allowed to go to seed. Only two are new, one owned by a cooperative. It has been determined that one additional new plant is needed for near-term self-sufficiency.

FINDINGS

Initially, this project encompassed privatizing EOSIL, a state-owned company operating four oil mills, through acquisition by UCA, the cooperative umbrella organization, on behalf of its members. However, title to the mills themselves, which were expropriated from and are being claimed by previously expelled Asians, are in contention. Consequently, acquisition of these assets are not recommended until the title issue is resolved. The scope of work was then amended to identify opportunities for UCA and others to participate in the rehabilitation of the edible oils industry and recommend a process for accomplishing this.

Some options for launching a new or rehabilitated oil mill venture are:

- Negotiate with the previous owner of the best of the EOSIL plants to relinquish all claims and, in return for compensation, obtain clear title for UCA, with the agreement of the GOU.

- A relatively large mill has recently been returned to a previously departed Asian, who plans to rehabilitate it. Negotiate for its acquisition, either fully or in joint venture. He is interested in seeing proposals.

- Build an entirely new oil mill.

- Attract a foreign investor with experience in edible oils to form a joint venture.

- In combination with one of the foregoing, acquire equity and management control in the existing new mill owned by a cooperative, through provision of expansion capital. A soap factory could be added.

CONCLUSIONS AND RECOMMENDATIONS

It is recommended that a trust be established and funded by grants from either AID alone, or in combination with an ACDI/UCA PL 480 Monetization grant, to provide venture capital for starting up one or more oil mill ventures. The Uganda office of an international commercial bank would be trustee. To acquire the needed local currency funds, the trustee would negotiate with the GOU the conversion of Ugandan foreign commercial debt purchased by the trust into local currency, thus leveraging the availability of funds. Other grant funds would be used to cover hard currency needed for imported machinery and equipment. If a debt swap cannot be implemented expeditiously, the local currency component would be supplied from an ACDI/UCA PL 480 Monetization grant.

The trust would provide the equity capital of a new limited liability company in which it would initially hold all the shares, except those pertaining to a partner in the case of a joint venture. It would finance working capital and fund an experienced oil mills general manager who would manage the company until local management has been trained to take over. Reflows from the sale of shares and repayment of loans plus interest would be used to finance additional projects.

The trust would be established for a given life, after which it would be dissolved. The fund balance attributable to AID grants would be given to the GOU for private sector development programs, while that attributable to a PL 480 Monetization grant would be used for cooperative development.

Concurrently with the establishment of the trust, a small technical unit consisting of a technical advisor and secretary should be formed and funded by a grant to manage the venture from inception through start-up.

Once the plant is fully operational and the company generates satisfactory profits, the trust would begin distributing shares. It is recommended that employees be provided about 20 to 25% of the shares through an Employee Stock Ownership Plan. Further, that UCA be given about 30% of the shares as a grant, to provide UCA with a continuing source of income. The remaining shares could be sold to the oil seed supplying cooperatives, using part of proceeds from the sale of seeds as payment. In view of the poor track record of cooperatives in management, it is recommended that their share ownership be structured so they cannot achieve management control. This can be accomplished by limiting them to a minority holding, or alternatively, issuing them a separate class of non-voting stock.

CONSULTANCY REPORT ON THE PRIVATIZATION AND REHABILITATION OF OIL MILLS IN UGANDA

INTRODUCTION

Only a small fraction of Uganda's edible oils demand is satisfied through domestic production. The bulk is imported at a considerable drain on foreign exchange. Uganda was a sizable exporter of edible oils and oil cake in the 1960s. Oil seed production was decimated as the result of civil wars and strife. Oil mills were expropriated from expelled Asians and given no maintenance and repair. Consequently, most are defunct or obsolete and operating at a fraction of capacity. Two new mills have been built and started up in recent years. One, a large modern facility combined with a soap factory is owned and operated by Asians who are Ugandan citizens. It is reportedly operating at 85% of capacity. The other is smaller, about one quarter the capacity, does not have a soap factory and was built and is operated by a co-operative at a small fraction of capacity, apparently because of lack of management expertise and working capital. These two plants are the only ones in the country capable of producing export quality edible oil.

The government of Uganda (GOU) has a stated objective of achieving self-sufficiency in edible oils in the near-term and reentering the export market. It has been determined that one additional large modern oil mill is urgently needed in Uganda to meet this objective.

SCOPE OF WORK

The original scope of work was to recommend to ACDI, the AID Mission and the Uganda Cooperative Alliance (UCA) a process for privatizing the Edible Oils and Soap Industry Ltd.(EOSIL) and the Lint Marketing Board (LMB). More specifically, the recommendation was to include:

- privatization options
- valuation options including use of debt equity swaps
- a reorganization plan for both EOSIL and LMB
- structure of EOSIL

METHODOLOGY USED

The methodology used in developing this report was three-pronged:

- a great deal of previous work had been done on the edible oils industry. Thus, several reports were read. Among others, these included:

  * Strategy for Development of Uganda Oilseed Processing by Bunker, Perry et al.

  * Uganda Agricultural Sector Review Agricultural Cooperatives by Bunker

  * The Report of the Task Force Committee on Edible Oil Industry in Uganda by Task Force Committee chaired by Ochieng

  * Oilseed Production and Processing Sector Analysis CAAS Project by Enger and Burgess

  * Restructuring of the Lint Marketing Board GOU Agricultural Policy Committee

- a number of interviews were held with senior government officials in the pertinent ministries and agencies, bank managers, UCA's lawyer, advisor to the Departed Asians Property Custodian Board, USAID and US Embassy personnel, general managers of EOSIL and LMB, and general secretaries of UCA and the Chamber of Commerce and Industry. (Appendix 1)

- visits to the following oil mills:

  * The four oil mills operated by EOSIL, two in Mbale on contiguous properties, one in Jinja, the preferred location for a new or rehabilitated mill, and one in a suburb of Kampala.

  * The OK Oil Mill in Jinja, a relatively large mill which can be rehabilitated and which has recently been returned to the previous owner, Vijay Kotecha, an Asian with Ugandan citizenship.

  * The Mukwano Industries plant in Kampala, recently completed and by far the largest and most modern plant in Uganda. It is owned by Asians with Ugandan citizenship and includes a soap factory, plastic packaging and carton making plants. The visit also included a fruitful interview with the Executive Director, Alykhan Karmali, a Harvard MBA, and son of the founder.

* The South Bukedi Cooperative Union plant in Tororo. This plant is owned and operated by a cooperative. The decorticator is used, all other equipment is relatively new.

FINDINGS

Oil Mills

The fixed assets of four oil mills operated by EOSIL and one operated by LMB are owned by Asians who were effectively expelled and dispossessed. The properties are administered by the Departed Asians Property Custodian Board (DAPCB). A 1982 Act provided that it was not in the national interest to return these properties to the departed Asians, who should be given compensation instead. The Asians have not been compensated and are claiming return of the properties.

The AID funded advisor to the DAPCB says he believes the 1982 Act is unconstitutional and that therefore DAPCB does not hold legal title to the properties. He says this view is supported by legal counsel to the DAPCB. The UCA external counsel holds that the constitution is sufficiently open-ended to permit conflicting laws under certain circumstances, and that the 1982 Act could be deemed valid. However, it, in turn, could easily be overturned by new laws. Thus, he feels there is considerable political risk in purchasing these properties from the DAPCB. A further consideration is the pressure by the World Bank and the British government on the GOU to return such properties to the previous owners as a condition for concessionary loans. Under these circumstances, it cannot be recommended that the privatization of the oil mill assets operated by EOSIL and LMB be pursued until their legal status has been clarified.

Lint Marketing Board

LMB is not privatizable in the normal sense of the word. Rather, it should be liquidated. Plans are well advanced to restructure the LMB along the same lines as the recently restructured Coffee Marketing Board. Along with the liberalization of cotton exports, the LMB is to be down-sized into two bodies, a regulatory agency and a marketing entity. The latter will be structured as a stock corporation, with all shares initially owned by the state. Later, shares will be offered to the private sector.

In contrast to the Coffee Marketing Board which owns a large and costly central processing and storage unit, LMB owns no processing facilities. Cotton ginning is in private hands.

A government regulatory body is superfluous. The industry can self-regulate itself through an association similar to Union Export Services(UNEX) or by UNEX itself, a directorate within UCA which, in turn, is owned by the district and national co-operative unions in Uganda. The critical quality control, treatment and reflow of cotton seed for planting by farmers should be coordinated with the Ministry of Agriculture and its research stations. Export licenses need not be regulated.

Exporters should simply register. Export statistics are maintained by the Bank of Uganda. It is recommended that UCA and industry associations lobby extensively for the dissolution of the government regulatory function.

Once cotton exports are liberalized, and exporters establish their own marketing organizations, again perhaps coordinated by UNEX or a similar agency, the activities of the government marketing entity would rapidly diminish. The GOU should be made aware of this probability, and should be encouraged to treat the marketing entity as an interim measure at most, to be liquidated when the industry has established its own marketing vehicles.

LMB owns considerable real estate. It is recommended that its holdings in office buildings and houses both in Uganda and in Mombasa be transferred to the Public Enterprises Secretariat for privatization along with the other enterprises to be privatized by this agency. Seed stores are planned to be sold to co-operatives. Railway warehouses and warehouses in Mombasa can also be sold to the co-operative sector.

REVISED SCOPE OF WORK

Based on the foregoing, it was concluded that EOSIL and LMB are not privatizable. It was consequently agreed that the scope of work be amended as follows:

- identify opportunities for UCA and others to participate in the rehabilitation of the edible oils industry and recommend a process for accomplishing this
- recommend valuation options in the case of existing plants
- recommend the structure of a new oil mills venture

CONCLUSIONS AND RECOMMENDATIONS

Assumptions

This report does not pretend to judge the economic merits of investment in a new or rehabilitated oil mill in Uganda. Consequently, the following basic assumptions are made:

- a new or rehabilitated oil mill will stimulate farmers to grow sufficient additional oilseeds to keep the plant operating at or near capacity

- the plant will be able to produce edible oils at a cost competitive with imports

- an experienced oil mill general manager will be available to manage the plant who will be delegated full operational and financial authority and responsibility

- the investment will largely be equity financed to ensure economic viability and an attractive return to shareholders

Options

Some options for launching a new or rehabilitated oil mill venture in Uganda are:

- The EOSIL plant at Jinja is the best of the EOSIL plants from the point of view of both location and quality. It has a soap plant and a tin manufacturing plant. Negotiations could be undertaken with the previous owner, absent from Uganda, to relinquish all claims and, in agreement with the DAPCB, to transfer clear title in return for compensation.

- The OK Oil Mill in Jinja appears to be in somewhat better condition than the EOSIL mill. A meeting was held with the owner, to whom the plant was recently returned by the DAPCB. He said he plans to rehabilitate the plant, but is open to proposals, including the outright sale of the plant or a joint venture with participation by the non-cooperative private sector. He would not associate himself with the cooperative movement because of its bad track record in poor management and corruption.

- Finance the construction and operation of an entirely new oil mill, potentially utilizing repaired used expellers, of which there is a surplus in Uganda.

- Attract a foreign investor with experience in edible oils production to invest in a joint venture plant, and provide management expertise.

- In conjunction with one of the foregoing, acquire equity participation in the new South Bukedi Cooperative Union plant in Tororo through provision of expansion and working capital and management expertise, in order to increase capacity, improve its performance and convert it into a viable operation. The addition of a soap factory could be considered. While this plant is virtually new, it only operates sporadically and already appears poorly maintained. Problems appear to be poor management, shortage of working capital and oil seed supply.

The quickest way to get a venture under way would undoubtedly be to build an entirely new mill from the ground up. It would also be the most expensive, but would provide a modern state-of-the-art facility capable of producing export quality oil. The machinery and equipment alone of the large oil mill at the Mukwano plant, not counting land and buildings, reportedly cost about $4 million. It has been estimated that it would cost about $1.1 million to rehabilitate the Jinja plant operated by EOSIL, a much smaller plant, exclusive of the purchase cost of the current plant. In addition to a new venture or the rehabilitation of an existing plant, the South Bukedi plant could be expanded quite rapidly, if the cooperative were willing to convert the operation into a stock company and permit others to acquire management control.

Valuation of Assets

Neither EOSIL nor the OK Oil Mill in Jinja are going concerns. They are operating at a fraction of capacity with completely run-down machines and rudimentary processes. They provide no return on investment and cannot even cover depreciation on plant and equipment. Consequently, their valuation should basically be liquidation value. Land is generally held in lease-hold and would be valued at whatever new lease-terms were obtainable. Buildings would be valued by an appraiser using depreciated replacement value as a guide. Most machines and equipment would be valued as scrap, with the possible exception of expellers. These can be repaired and would then retain several years of life. However, since there is a surplus of expellers in Uganda in the many obsolete and defunct oil mills without any prospective use, their value should probably lie somewhere between their depreciated replacement value, less cost of repairs, and scrap value.

Fiduciary Trust

It is recommended that a trust be established and funded by grants from either AID alone, or in combination with the ACDI/UCA PL 480 Monetization program, to provide venture capital for starting up one or more oil mill ventures. The trust would be held in the Uganda office of an international commercial bank, with that bank as trustee with fiduciary responsibilities. The trustee would carry out its functions under the terms of agreements with AID and/or ACDI and act on the basis of clear instructions contained in these documents, thus making most of its responsibilities automatic and routine.

The trust would provide funds for the equity capital of a new limited liability company in which the trust would initially hold all the shares, except those pertaining to a partner in the case of a joint venture. The shares would subsequently be distributed as described in the following section, including to employees through an Employee Stock Ownership Plan(ESOP). The trust would provide loans to this company for working capital and would finance the ESOP. The overall debt to equity ratio of the company should be low to ensure the economic viability of the venture. The trust would also fund an experienced edible oil mills general manager who would manage the company until local management has been trained to take over. In effect the functions of the trust would be similar to those of a merchant bank. A significant advantage of this type of arrangement is that the final decision on share distribution can be deferred until the venture is a going concern.

To acquire the local currency requirements for funding the venture, the trustee would negotiate with the GOU the conversion of Ugandan foreign commercial debt purchased by the trust with AID grant funds into local currency. This will increase the availability of funds. At least one official has expressed interest in such a swap. Other grant funds would be used to cover the hard currency needed for importing machinery and equipment. If a debt swap cannot be implemented expeditiously, a ACDI/UCA PL 480 Monetization grant would be used for the local currency component, so as not to delay the proposed venture.

The following example illustrates how the trust could leverage grants into funding an oil mill venture through a debt equity swap:

<u>Funding of Limited Liability Company</u>	
Fixed Assets(assumed)	$3.0 million
Working Capital(assumed)	$1.0
Funds Required	$4.0
Hard Currency for Equipment	$1.3
Local Currency needs	$2.7
<u>Debt Swap</u>	
Buy Foreign Commercial Debt	$0.75
Face Value of Debt	$3.0
GOU Transaction Fee-assume 10%	$0.3
Local currency obtained	$2.7
<u>Grants Needed</u>	
Hard Currency for Equipment	$1.3
Cost of Foreign Debt	$0.75
Total Grants	$2.05

In the foregoing example, $2.05 million in grants are leveraged into $4.0 million to fund the equity capital and finance the working capital of a new oil mill company. If a debt for equity swap is not used, $2.7 million of PL 480 Monetization funds would be needed, including $1.7 in grant funds and $1.0 million in credits to finance working capital, in addition to the $1.3 million hard currency grant.

Reflows into the trust from the sale of shares and repayment of loans plus interest could be used to fund additional ventures. The trust would be established for a given life, say 15 years, after which it would be dissolved. The fund balance attributable to AID dollar grants would be given to the GOU for private sector development programs, while any portion attributable to the ACDI/UCA Monetization grants would be used for cooperative development programs. The proposed debt swap is very advantageous to Uganda in that the foreign debt is purchased with grant funds and the local currency proceeds from the swap, plus interest generated on these funds, are effectively returned to the GOU upon dissolution of the trust.

It would be highly desirable to negotiate with the GOU that the trust be exempt from income tax on interest received on loans and on dividends on shares while they are held by the trust. Tax-free status would enable the trust to make loans at lower interest rates than would otherwise be possible.

Concurrently with the establishment of the trust, a small technical unit consisting of a technical advisor and secretary should be formed and funded by a grant. The technical advisor would participate in all phases of the venture, from evaluation of options, through plant design and acquisition, company formation, staffing and start-up. He could become the first mill manager or continue as advisor for a second venture. He would initially be responsible to ACDI.

Structure of New Venture

The structure of a limited liability company is recommended to provide for flexibility in the distribution of shares. It would use funds from the trust to acquire and rehabilitate an existing plant, build a new plant or participate in a joint venture. Once the plant is fully operational and the company is generating satisfactory profits, the trust would begin to distribute shares. In order to provide long-term incentives for good performance, it is strongly recommended that employees be provided shares through an ESOP or a similar plan.

In a typical ESOP, the employees form an association which borrows the funds to purchase the shares to be allocated to employees, using company assets as collateral. The association repays the loan plus interest using dividends on its shares supplemented by contributions from the company out of before-tax profits to make up the difference. As loan repayments are made, the shares actually paid for are distributed to employees, usually in proportion to salary to recognize each employee's

level of contribution to the company. In the proposed venture, the trust would simply finance the shares sold to the employee association.

Assuming that remaining shares are to be allocated to the cooperative movement, it is recommended that UCA be given shares in grant form, in order to provide UCA with a continuing source of income once donor-assistance ceases. The granting of shares to UCA would not be discriminatory, since UCA is effectively owned by the majority of Uganda's productive population.

Shares could then be sold to oil seed supplying cooperatives. In view of their limited membership, it would be discriminatory to grant them the shares. They should therefore pay for them. Part of their proceeds from the sale of oil seeds to the plant can be used for this purpose. In view of the poor track record of cooperatives in management, it is recommended that their share ownership be structured so that they cannot achieve management control of the company, at least over the foreseeable future. This can be accomplished by limiting them to a minority holding, or alternatively, if they are to be allocated a majority of the shares, they would be issued a separate class of non-voting stock.

A suggested distribution of shares which would give UCA together with the employees management control of the company could be:

Employees	25%
UCA	30%
Supplying cooperatives	45%

An alternative to the foregoing distribution of shares would be to provide for participation by the non-cooperative private sector in one or more oil mill ventures. As mentioned previously, the decision on the actual distribution of shares can be deferred until after the company is operational.

APPENDIX 1

PERSONS INTERVIEWED

Charles Kabuga
General Secretary
Uganda Cooperative Alliance

Sam Rutega
General Manager
Uganda Development Corporation
Ministry of Industry

Mrs. Busulwa
Permanent Secretary
Ministry of Commerce, Cooperatives & Marketing

E. Busingye
Commissioner for Marketing
Ministry of Commerce, Cooperatives & Marketing

Sam Fred Kagoye
Chief Policy Economist
Ministry of Commerce, Cooperatives & Marketing

James Obbo
General Manager
Lint Marketing Board

Eusepio Katorogo
General Manager
EOSIL

Dr. J. B. Byamugisha
Advocate
External Lawyer to UCA

Emanuel Wakhweya
Director
Public Enterprises Secretariat
Ministry of Finance

John Kazoora
National Revolutionary Council
Personal Advisor to President Museveni

Luther Morris
Economic/Commercial Counselor
U. S. Embassy

Jennifer Underwood
Economic/Commercial ~~Counselor~~ Advisor
U.S. Embassy

Stephen Ryner
Deputy Mission Director
USAID

Holly Wise
Chief, General Development Office
USAID

Gary L. Bayer
Chief, Agriculture and Natural Resources
USAID

Duane Eriksmoen
Project Manager
CASS Project
USAID

Lennart Berring
General Manager
Cooperative Bank

G.L. Thomas
Managing Director
Barclay's Bank

Peter T. Dowse
Manager, Internal Controls
Standard Chartered Bank

Chukwuma Obidegwu
Resident Economist
The World Bank

James E. McCoy, Jr.
Advisor
Departed Asians Property Custodian Board

Erisa O. Ochieng
Director
Export Policy Analysis and Development
Ministry of Planning and Economic Development

George Rujojo
Secretary General
Uganda National Chamber of Commerce and Industry

Vijay Kotecha
Owner
OK Oil Mill, Jinja
Residence: Fairway Hotel
Kampala

Alykhan Karmali
Executive Director
Mukwano Industries (U) Ltd.

Olle Otteby
General Manager
Union Export Services
Uganda Cooperative Alliance