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STUDY ON THE FINANCIAL
CONDITION OF
CENTRAL AZUCARERA
TEMPISQUE, S.A.

DRAFT

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International Development

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COOPERS & LYBRAND

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CENTRAL AZUCARERA TEMPISQUE, S.A.
(CATSA)

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I. INTRODUCTION

This report presents our analysis of historical financial performance of Central Azucarera Tempisque, S.A. (CATSA).

Besides this Introduction, the report consists of two major sections as briefly described below.

Section II presents an overview of the sugar industry including a discussion of worldwide trends as well as market characteristics in Costa Rica. This section also describes the company and its business and presents information on its history, organization and other relevant marketing and production characteristics.

Section III includes our analysis of CATSA's financial performance for years beginning with 1980 through 1983. The analysis is divided into three major areas, viz. revenue and cost trends, operations and liquidity. This section also presents our conclusions and recommendations for improving financial performance in the future.

In January 1984, a foreign creditor initiated bankrupcy proceedings against CATSA. Since then, the management has been unwilling to provide us with the basic forecasts of operations and other data required to draw up financial projections for the period following fiscal year 1983. We are therefore unable to express an opinion on the prospects for the future performance of CATSA.

II. OVERVIEW OF THE INDUSTRY AND THE COMPANY

A. THE SUGAR INDUSTRY

1. Worldwide Industry Trends

Sugar is an international commodity, a basic food produced and used throughout the world. Generally speaking, the world's developing tropical nations are net exporters of sugar while developed industrial countries are net importers. Due to its role as a commodity tied to the world food and agricultural economy, the volumes of production and consumption and the price of sugar are volatile.

Through the mid- and late-1970's world sugar consumption increased at an average of 3.6% per year. From 1980 to the present, the average rate of growth of sugar consumption slowed down to about 2% per year, due to worldwide economic difficulties and the increasing use of other sweeteners.

Sugar Consumption (Raw Equivalent)
Million Metric Tons

	1981 [1]	1982 [1]	1983 [2]	1984 [3]
United States	8.9mmt	8 5mmt	8.2mmt	7.9mmt
Brazil	6.0	5.8	6.2	6.3
Mexico	3.2	3.5	3.4	3.5
	18.1	17.8	17.8	17.7
Rest of the World	70.4	71.6	74.2	76.2
World Total	88.5mmt	89.4mmt	92.0mmt	93.9mmt

1. Actual
2. Estimate
3. Forecast

Source: U.S. Department of Agriculture

Consumption by the major sugar consumers of the western hemisphere is decreasing, as shown above.

While the growth of worldwide consumption has declined, sugar production in 1982 increased to a record high of 100.6 million metric tons. Estimates for 1983 call for an even higher production volume. As a result, world sugar stocks have climbed steadily since 1980, reaching a record level of 37 million metric tons in 1983.

As expected under such supply and demand conditions, world prices have declined steadily since 1980. In 1982 sugar reached its lowest price since the late 1960's.

Raw Sugar World Price(1)
U.S. Cents/Kilogram

	1960	1970	1980	1981	1982	1983 (2)
In Current Dollars	6.92	8.11	63.20	37.40	18.56	16.66
In Constant 1982 Dollars	23.54	23.99	58.90	36.63	18.56	-

(1) 1960 price is New York Contract Number 4, fas Cuba. 1970 and later prices are International Sugar Council "World" daily price, fob and stowed Caribbean ports.

(2) January to June.

Source: The International Bank for Reconstruction and Development, 1983.

From 1960 to 1982, the world price of raw sugar (in constant 1982 dollars) fluctuated between a low of 12.51 cents per kilo in 1966 and a high of 108.80 cents per kilo in 1974.

World production and consumption of sugar are expected to be generally in balance in 1984. This implies a sharp reduction in output after the high volumes of production of the preceding two years. Cane sugar, which accounts for about 64% of world centrifugal sugar production, has been affected by poor growing conditions in several major producer countries. This will contribute to lower output, as will a reduction in the area cultivated.

The high level of sugar stocks built up over several years will tend to keep the price down in the near future. Price projection beyond the near term is generally not undertaken due to the volatility of the market for that commodity. However, no significant recovery of sugar prices is expected and present market conditions are likely to continue.

Sugar consumption is expected to grow slowly, based on population growth and a recovering world economy. The composition of world consumption will continue to shift because of the growing popularity of substitutes in the U.S. and the increasing per-capita use of sugar in other nations. However, a growing consumer interest in low-sugar products has been developing. Some food manufacturers are increasing production and promotion of unsweetened and lower sugar content products (soft drinks, cereals and baked goods, for example). The development of aspartame and other low-calorie sugar substitutes supports this trend. In addition, the use of high-fructose corn syrup and other sugar alternatives, particularly corn-based products, is expanding.

2. The Costa Rican Domestic and Export Markets

Costa Rica's sugar millers pulled out of a three-year decline that began in 1980, and produced about 200,000 metric tons of sugar in 1983. In 1984, output is expected to reach a new high level of 220,000 metric tons (mt). The country's output represents 11%-12% of the total production of Central America.

Sugar Production
in Thousands of Metric Tons
1981-1984 Crop Years

	1981	1982	1983	1984
Costa Rica	189mt	182mt	200mt	220mt
Rest of C.A.	1332	1543	1565	1574
Regional Total	1521mt	1725mt	1765mt	1794mt

Note: 1981-1983, actual data. 1984, estimated data.

Source: United States Department of Agriculture, 1983.

The increase in Costa Rican production is attributed to favorable weather conditions, better cane yields per hectare, and improvements in the efficiency of processing operations.

In addition, molasses is produced as a by-product of the sugar industry. In 1983 about 73,000 mt were produced and consumed domestically. For 1984, molasses production is expected to increase to 81,000 mt with a small amount being exported to the United States.

The nation's sugar milling and processing industry consists of 24 enterprises. The largest of these milled 336,100 metric tons of sugarcane during 1983, producing about 32,000 metric tons of sugar. Producers typically handle both sugarcane cultivated in their own fields and cane from neighboring growers. Thousands of small growers cultivate sugarcane.

The total land area under sugarcane cultivation is about 37,000 hectares. While this area has been relatively stable since 1980, the overall yield improved from 59 metric tons of cane per hectare in 1980 to 62 mt per hectare in 1983. It is expected to increase further to almost 68 mt per hectare in 1984.

Sugar produced in Costa Rica totaled 200,000 metric tons in 1983; an additional 4,000 mt were imported. This supplied all of the domestic consumption, which totaled 130,000 mt. The remaining 74,000 mt, or 35% of production, were exported. In 1984 it is expected that about 140,000 mt will be consumed internally and 80,000 mt will be exported. Export sugar is processed to its raw form; sugar for domestic consumption is refined. All of Costa Rica's export sugar is sold to the U.S.

Costa Rica qualifies as an eligible beneficiary country for the U.S. Generalized System of Preferences (GSP). The GSP, which was established under the Trade Act of 1974, provides duty-free treatment for imports of various commodities from developing countries. Sugar was included in the GSP in 1976.

The U.S. established quotas for imports of certain types of sugar in 1982. Under this system Costa Rica's 1983 quota (October 1982 through September 1983) was 42,000 short tons of raw sugar; for 1984 Costa Rica's quota increased to 61,035 short tons when Nicaragua's quota was reduced and reallocated to other countries. By December 1983, before the 1984 harvest, Costa Rica had already filled about 50% of its 1984 quota since it had exceeded its 1983 quota by about 30,000 short tons.

Tne Sugar Cane Agriculture Industrial League (LAICA) purchases all sugar produced in Costa Rica. LAICA is a non-profit corporation which handles transportation, storage, distribution, domestic sales and exports of sugar, molasses and other sugar by-products. The corporation was created by public law in 1965, and was restructured in 1971 with the purpose of maintaining order and stability in the industry. LAICA's board is composed of eight directors: three from the organization of sugarcane growers', three from the organization of sugar producers and two from the government.

LAICA acts as a clearinghouse for all sugar sales. The organization assigns annual production quotas for refined and raw sugar to each producer. An estimate is made of total national (domestic and export) revenues to be earned from sugar during a crop year, and producers are paid weekly during the harvest for sugar delivered to LAICA facilities at a rate based on this estimate. At the end of each crop year, LAICA calculates actual revenues and final prices for raw and refined sugar, then settles the balance of revenues to the producers.

The domestic price of sugar is established by the government. During the 1983 crop year the consumer price for refined sugar was 21 colones (or about 50 cents U.S.) per kilo. Of the retail price, 62.5% was to go to the producers. The price to be paid by sugar producers to the growers for the cane purchased is also set and is paid to the grower at the time the cane is delivered.

B. THE COMPANY

1. CATSA Background

Central Azucarera Tempisque S.A., CATSA, is the fourth largest Costa Rican sugar producer (in terms of the volume of sugar produced in 1982 and 1983). Its fields, sugar processing facilities, alcohol distillery, and some of its offices are located near Liberia in the province of Guanacaste. CATSA's headquarters offices are located in San Jose.

CATSA's sugar operations were inaugurated in 1978. An alcohol distillery was later constructed to produce gasohol for the domestic market. The gasohol plant was both inaugurated and closed in January 1980, when it was found that production of export sugar would be more profitable for the limited quantity of CATSA's sugarcane available.

During 1983, CATSA milled about 192,000 metric tons of cane and produced about 17,000 metric tons of raw sugar. The quantities of sugar produced during the 1980 to 1983 crop years were as follows, according to company and LAICA data:

	1980	1981	1982	1983
Metric Tons of Raw Sugar	6,878	21,857	16,760	17,075

The sugar yield achieved by CATSA in 1983, of 89 kilos per ton of cane, was close to the average yield for all Costa Rican producers during that year. This was an improvement over prior years when CATSA's sugar yield was substantially lower than the average for all producers. In addition, about 10,000 metric tons of molasses was produced, or 54 kilos per ton of cane. There was no alcohol production during the year.

Presently, the majority shareholder is CODESA, the industrial development corporation of the Costa Rican government. The company is headed by an executive president who reports to the board of directors. There appears to be some instability at the senior level of management as evidenced by the number of different executive presidents who have headed CATSA. During the period of this review, the president resigned and an effort was in progress to recruit a new president. A series of conversations between one candidate and the board of directors had not resulted in an agreement.

Operations are directed by department managers for agriculture, industry, finance and administration. The agricultural manager is responsible for the fields, cultivation and harvest of the cane, irrigation systems and agricultural statistics. The industrial manager directs sugar production operations, laboratory analysis, electricity production, a mechanical department and repair shop, and is responsible for the distillery.

Several options for change in ownership of CATSA have been considered by CODESA and the national legislature. In 1982, it was suggested that the company be sold to a group of sugarcane growers. The following year a proposal was made by LAICA to acquire the facilities and a purchase inquiry was made by a private company from the U.S., according to news reports.

In late 1983, it was announced that CATSA will be converted into a cooperative of sugar industry workers during 1984. The terms and price of this transaction were not revealed at the time of this study. However, steps were being taken to proceed with the transaction. This included expropriation of privately-owned agricultural lands near CATSA, to be replanted in sugarcane, with the goal of improving CATSA's profitability through higher utilization of production capacity.

A recent action by a creditor brought into question CATSA's future viability. In January 1984, the Brazilian firm Dedini Metalurgia S.A. petitioned the court for payment of $495,000 through bankruptcy proceedings. It it expected that this action will be nullified by the court and settled by the parties.

As a result of the bankruptcy proceedings, CATSA's management was unwilling to provide additional financial information for this review, including data necessary for the preparation of financial projections. The historical financial analysis which follows is based on information which had been provided prior to that time or was obtained through other sources.

2. Review of the Production Process

The production process begins with cultivation and harvesting of the sugarcane, normally occuring from December to February. The cane generally has a productive life between six and seven harvests, generating one crop per year. As the cane ages its yield declines from the first crop peak of about 85 tons per hectare. Several weeks prior to harvest, irrigation is reduced in order to raise the cane's sucrose content.

During the 1982/1983 harvest a total of 120,600 tons of cane were produced by CATSA's fields according to LAICA records. This was a yield of about 52 tons per hectare from the 2,300 hectares of CATSA's land which were in cultivation. An additional 71,854 tons were sold to CATSA by neighboring growers. In 1984, CATSA expects to plant and harvest 1,200 additional hectares of cane. New irrigation systems have already been completed.

Presently, CATSA has two products: raw sugar, and molasses. Molasses is produced from low quality cane and is used for animal feed. In 1983 sugar accounted for 96% of revenues and molasses for the remaining 4%. The total sugar production of CATSA is sold to LAICA and exported. During the harvest, CATSA transports the raw sugar immediately upon production to the LAICA wharf at Punta Morales for shipment to the United States.

Sugarcane is processed into raw sugar before it is refined. The first step is milling, or producing a juice from the cane. This must be done within a few hours of the time that the cane is cut in order to retain the sugar content. The juice is then processed into raw sugar. During the harvest, the plant is operating 24 hours per day.

The pressed sugarcane pulp, a by-product of the milling process, is used to produce energy for CATSA. It is burned to produce steam, which drives the turbines for the mills and an electricity generator. This results in direct savings in the amount of electricity and petroleum which would otherwise have to be purchased. Savings were estimated at more than $400,000 per year.

According to management, milling equipment at CATSA has a capacity of 7,500 tons per day, originally designed to supply both the distillery and sugar production. The processing plant has a capacity of 4,500 tons per day. During 1983 CATSA milled and processed about 2,400 tons per day, utilizing, 53% of the processing capacity.

In 1985, when 1,200 additional hectares are expected to be harvested, about 60% of the processing capacity will be used. A rough calculation indicates that it would require 4,800 hectares under cultivation yielding an average of 75 tons of sugarcane per hectare, to utilize 100% of the plant's processing capacity. For 100% utilization of the total capacity (sugar <u>and</u> alcohol production), 8,000 hectares of cane would be required.

III. HISTORICAL ANALYSIS OF FINANCIAL PERFORMANCE

A. SUMMARY OF FINDINGS

The purpose of this review is to analyze CATSA's operating performance and financial condition for the period 1980 to 1983, in order to understand why certain results have occurred and to identify areas of strength and weakness.

The analysis was performed using Coopers & Lybrand's Effective Analytical Review (CLEAR) computer model. CATSA's financial data were obtained from its externally audited financial statements and through interviews with management. As described in the Appendix, these data were translated into U.S. dollars at appropriate rates of exchange for the different types of assets, liabilities, income and expenses. This was in order to present the financial condition and operating results from year to year in a more comparable manner than is shown by the accounts in local currency (the loss of purchasing power of the latter during the period 1980-1983 having been much more severe than that of the U.S. dollar).

The purpose of this analysis was to detect historical relationships and trends. Three performance areas were analyzed: revenues and costs, operations and liquidity. The various causes of changed performance within these areas were identified, and their relative importance was assessed. Major findings discussed in the following sections are summarized hereunder.

As shown by the Comparative Income Statement (Exhibit III-1) CATSA made net losses during each of the four years reviewed and gross losses during the first three. The results were as follows:

U.S. Dollars in Thousands

	1980	1981	1982	1983
Total Revenues	2,510	7,707	4,419	6,577
Gross Profit (Loss)	(5,390)	(1,195)	(922)	905
Operating Profit (Loss)	(6,969)	(2,288)	(1,464)	113
(Net Loss)	(11,431)	(3,992)	(3,036)	(3,175)

The operating results improved steadily from an operating loss of $7.0 million in 1980, to an operating profit of $113,000, or about 2% of revenues in 1983. Net losses were reduced from nearly $4 million in 1981 to $3,175 million in 1983.

Revenues varied greatly from year to year. Fluctuations in sugar yields, volumes of production and prices all contributed to the revenue variations. This situation indicates the critical role of management in controlling operating costs under conditions of fluctuating price levels and production volumes. Government control of domestic sugar price and the LAICA clearinghouse system of reimbursement for sugar production put some factors beyond management's control. However, other Costa Rican sugar producers of similar size have generated profits throughout this period, so it is clear that profitability is possible under this regime.

Operating expenses were reduced during the period from a high level of $1.6 million in 1980 to about $0.8 million in 1983 - a favorable change. From 1981 to 1983 operating expenses remained at the same ratio of 12% to 14% of sales revenue.

Though CATSA's capital structure contains a reasonable proportion of debt, interest expense was unusually high. This occurred due to Costa Rica's domestic financial situation. Standard lending rates of the banking system were around 28% in 1983. CATSA has not received preferential treatment in terms of interest rates. In 1983 interest expense soared to $3.5 million, or more than half of that year's sales revenue.

By the end of 1983 the company's liquidity had become a cause for concern; instead of generating cash, the business had absorbed $4.5 million. If this situation continues in 1984, CATSA will have to convert assets or raise more money to service its existing debt.

Another problem for CATSA has been an insufficient supply of its basic raw material: sugarcane, resulting in a large underutilization of production capacity. Sugar processing operations ran at about 53% of capacity in 1983 and the distillery was totally idle. The distillery, which has not produced since its year of inauguration, 1980, represents a large capital investment which produces no return and is an object of expenditure.

B. REVENUES AND COSTS ANALYSIS

1. Revenue Trends

CATSA's sales are seasonal. As described earlier, the cane is cut and processed and the sugar is delivered to LAICA soon after the harvest. Payments are received from January through September, at the time of delivery of the sugar and when revenue liquidations are calculated and distributed by LAICA. In fiscal year 1982, 69% of the revenues were received during the harvest months; in 1983 this proportion increased to 96%. There are practically no sales from June through December.

Operating revenues translated into U.S. dollar equivalents give a more consistent picture of sales activity over the 1980-1983 period than the values in colones. Sales revenue in dollar terms fluctuated widely from year to year with no overall trend. In 1980, sales revenue was at its lowest point of the period, $2.4 million; the highest level, $7.6 million was reached in 1981. Sales revenues totaled $4.3 million and $6.1 million in 1982 and 1983, respectively.

The volume of sugar produced increased considerably in 1981 as compared with the preceding year. According to LAICA records, CATSA's sales were about 21,857 metric tons, greater by more than 300% than in 1980. In 1982 and 1983 sales were 16,761 and 16,900 metric tons, respectively.

In addition to sales revenues, miscellaneous other income, principally from inventory adjustments, commercial discounts, and leasing of land and equipment, totaled about $100,000 in 1983.

2. Cost Trends

An improving trend in cost of sales occurred from 1980 to 1983. In 1983 a profit at the gross level was made for the first time during the period reviewed: Cost of sales totaled $5.2 million or 85% of the sales revenue, generating a gross profit of about $900,000. This was an improvement from previous years when the cost of sales had been 325%, 116% and 121% of sales revenue, in fiscal years 1980, 1981 and 1982, respectively.

Cost of sales consists of three categories of costs: direct materials, manufacturing overhead and direct labor. The improvement in gross margin in 1983 was primarily due to a reduction in the cost of direct materials. This is the largest component, representing 52%-66% of the total cost of sales. While sales revenue increased by about $1.8 million or 40% in 1983, direct materials cost decreased by about $700,000 or 20%. These savings may have been achieved through a higher sugar yield per ton of cane, due either to a higher sucrose content of the cane or to improved efficiency of the mill.

Manufacturing overhead accounts for 32%-37% of total cost. This includes expenses such as salaries of operations managers, repairs and maintenance, and depreciation. In 1983, a change in accounting methods reallocated part of this to other operating expense categories. Therefore it appears that manufacturing overhead increased at a much slower rate than sales revenue. The change in accounting treatment is responsible for part of the change in gross margin in 1983.

The smallest component of cost of sales is direct labor which was about 3% of the total from 1980 through 1982. However, in 1983 this item increased to 11% of the cost of sales, a growth of more than $400,000 over the preceding year. No explanation for this increase was available; it is most likely also due to a change in accounting treatment.

In addition to cost of production, several other expense categories are included in arriving at net profit. For CATSA, these were other operating costs, miscellaneous expenses, interest expense, exchange differences and accounting adjustments.

The other operating costs consist of administrative salaries, office expenses, selling expenses, and computer service costs. From 1981 to 1983 operating costs remained fairly stable at 12% to 14% of sales revenue. In 1983 those costs were $792,000.

Miscellaneous expenses, such as amortization of pre-operating expenses, totaled $563,000 in 1983.

The income statement in U.S. dollar equivalents includes exchange adjustments resulting from fluctuations in the value of the colon, which increased the loss for 1980 and 1982, and reduced the losses for 1981 and 1983.

Interest expense has had a major impact on CATSA's financial results, and ranged from $746,000 in 1981 to $3,545,000 in 1983. Without this charge in 1983, CATSA would have made a net profit of $370,000 instead of a net loss of $3,175,000.

C. OPERATIONS ANALYSIS

The focal point of operations analysis is the ratio of net income to equity, usually referred to as return on equity. This ratio provides a measure of the efficiency with which management employs resources invested and earnings retained in the business, to produce growth of the enterprise and a return for equity investors.

1. Return on Equity

CATSA's return on equity was negative throughout the period reviewed. From 1981 through 1983, the annual net loss was $3 to $4 million equivalent, representing a negative rate of return on equity of 6% to 7%: Instead of generating a return, CATSA was actually eroding its equity base through its operating losses.

Equity was increased in 1981 by converting part of the debt to CODESA. This generated no additional cash for CATSA, but it alleviated the burden of future interest expense and principal repayment obligations. However, CATSA's common equity, which totaled $52.6 million at the end of 1981, was reduced by about $3 million in both 1982 and 1983 as a result of the net losses in those years.

During the period reviewed, the main factors which affected the rate of return on equity were asset utilization and changes in profitability.

2. Asset Utilization

CATSA's asset-turnover, as measured by revenues compared to total assets, was .11 times or 11% of the total value of the assets in 1983. This is a very low level of asset utilization, but it is an improvement over the 8% turnover experienced in 1982. Part of the low utilization level is attributable to the distillery, which had a book value of $25.5 million in 1983 but produced no revenues. If the distillery is excluded from total assets, CATSA's asset turnover in 1983 was 17%. This is still a low level of asset utilization in comparison with the level achieved by another Costa Rican sugar processor of similar capacity.

A major problem for CATSA was the lack of sufficient raw materials to utilize full operating capacity: the company used only 53% of its sugar production capacity in 1983.

The net book-value of fixed assets represents about 90% to 94% of CATSA's total assets. In 1983 this figure was 91%; or 85%, excluding the distillery. During the period reviewed there were no significant capital additions.

At the close of the 1982 and 1983 fiscal years CATSA had about 9% to 10% of its annual sales outstanding as trade accounts receivable. This represented about $590,000 in 1983. In addition, there was a non-trade account receivable of $1.3 million outstanding.

In relation to sales, the 1983 year-end trade accounts receivable level was equal to that of the preceding year and the inventory level had decreased. This contributed to the improvement in asset utilization during 1983 as compared with 1982; this is partially offset, however, by increases in other assets such, as prepaid expenses, advances to third parties, and guarantee deposits.

3. Profitability

Profitability, or the ratio of net income to total revenues, shows management's efficiency in controlling expenses and the cost of production while maximizing revenues. CATSA's profitability was negative throughout the period. However, there was a slight improvement in 1983: the percentage of the net loss to total revenue went down to 46% instead of 69% and 52% in 1982 and 1981, respectively. The net loss translated into dollars which amounted to nearly $4 million in fiscal year 1981 and was reduced to little over $3 million in 1982 and 1983. From a $1.2 million gross loss in 1981, CATSA made a gross profit of $905,000 in 1983.

From 1981 to 1983, the improvement of the profitability ratio was due principally to the diminishing direct-materials cost in the cost of production.

Interest expense is a major factor having an adverse effect on CATSA's profitability. In fiscal year 1981, interest expense amounted to $2.283 million. In FY 1982, it dropped to $0.746 million as a result of a conversion of debt to CODESA into equity at the end of September 1981. However, in 1983 interest expense rose again to $3.454 million on account of new long-term debt to CODESA (of $4.0 million), additional short-term bank debt (of about $2.4 million at interest rates of 26% to 28%), other long-term debt, (of $1.0 million at 26%). The interest charges in FY 1983 amounted to more than one half of that year's sales revenue.

In summary, CATSA's ability to generate net profits depends essentially upon control of production costs and interest expense. Controlling costs under conditions of fluctuating volumes production is a task that will require constant attention on the part of management. Some improvement was made in 1983. Reduction of the interest burden can be achieved either by renegotiating interest rates with CATSA's lenders or by changing CATSA's capital structure.

4. Leverage (of shareholders' equity)

This leverage as measured by the ratio of assets to equity, shows the number of times equity has been multiplied through the use of borrowings and other credits, for investment in income-producing assets.

In 1983 CATSA's leverage increased from 1.2/1 to 1.5/1, due to an increase in total assets of $9.6 million (principally as a result of the revaluation of the fixed assets and of an increase in accounts receivable) and to a decrease in equity of $3.1 million. This higher leverage ratio was funded by new debt and by revaluation of existing debt as explained earlier.

D. LIQUIDITY ANALYSIS

In order to determine the degree to which CATSA can meet its short-term obligations through the generation of cash or the conversion of assets into cash, we have examined: cash generated by CATSA during the year, debt service coverage, leverage, and asset liquidity.

1. Cash From Business

In both 1982 and 1983 CATSA was confronted with liquidity problems caused by a company's inability to generate cash from operations. During 1983, the business absorbed $4.5 million instead of generating cash. This resulted from a $2.5 million cash-basis net loss from operations, $1.1 million in new deferred charges (new sugarcane planted during the year), and other items. At the end of 1983 a small positive working capital balance existed. In 1982, the business produced cash but, at year-end current liabilities exceeded current assets. During the last three years reviewed, only in 1981 did CATSA have a viable liquidity position.

2. Debt Service Coverage

The debt service coverage position is a serious cause for concern. At the end of fiscal year 1983, CATSA expected to make principal payments of $1 million on its long-term debt during 1984. Actually, CATSA will have to convert assets into cash or borrow more money in order to complete these payments if operations cannot be more profitable.

The new debt structure obtained by the company in 1983 was beneficial to its liquidity position. About 90% of the new debt was long-term debt so CATSA's obligation to service the debt was deferred for future periods.

3. Leverage (in relation to liquidity)

During fiscal years ending September 1980 through 1983, bank debt represented a modest 2.2% to 6.5% of total assets indicating that lenders had a large margin of safety. If debt from CODESA is included in the calculation of leverage, borrowings represented 11% to 12% of total assets in 1981 and 1982, and 30% in 1983. This would be a reasonable level of debt for a profitable entity utilizing most of its operating capacity.

However, CATSA has not been profitable over the last four years and part of its assets are the closed-down distillery. Exclusion of the distillery from total assets brings the leverage calculation to 48%. This would probably be considered an insufficient margin of safety for a new bank loan, unless the lender could obtain a secured position with priority over the company's debt to CODESA.

The increases in short-term and long-term debt during 1983 fairly matched the growths in current and non-current assets. The increase of $2 million in short-term debt roughly corresponded with the growth of $1.5 million in current assets. The increment of $11.6 million in long-term borrowings was accompanied by an $8 million increase in non-current assets.

4. Asset Liquidity

In 1983, total borrowings (including CODESA) were increased by $19.6 million. The short-term portion of CATSA's debt increased from 28% of current assets in 1982, to 69% of current assets in 1983; the long-term portion increased from 10% to 27% of non-current assets. Thus, the decline in liquidity included both current and non-current assets, but affected the current position more severely.

The current ratio (of current assets to current liabilities), declined from 2.5/1 in 1980 to 1/1 in 1983 (after recovering from a low point of 0.9 in 1982). The "quick" or "acid" ratio, calculated as the ratio of liquid assets to current liabilities, improved in 1983 but only up to 0.6/1. Both of these ratios were too low to provide an acceptable margin of security for short-term creditors. They indicate an illiquid current position.

E. CONCLUSIONS AND RECOMMENDATIONS

Although net losses occurred throughout the period reviewed, CATSA's financial performance was showing signs of improvement. Profits were produced at the gross and operating margins during 1983. As the domestic economic situation improves, reducing the rate of inflation and the cost of debt, CATSA's financial position should continue to improve.

The problem of underutilized production capacity may take time to correct. The project currently underway to bring 1,200 additional hectares of CATSA's land into production should produce results in the 1985 fiscal year. As discussed in the section describing CATSA's background, additional land gained through expropriation could be cultivated for sugarcane. A rough estimate indicates that the additional supply of cane could be sufficient for a full utilization of CATSA's sugar production capacity.

However, there would still be an insufficient amount of cane to supply both the sugar and alcohol operations. One option is to move the distillery to an area with a sufficient surplus of cane. The site should be in a region producing the most suitable quality of cane for alcohol.

This project could be undertaken by CATSA itself or the distillery could be sold. The sale would generate cash which could be used to reduce the debt and interest expense, and to increase its supply of cane, thereby improving the profitability of CATSA's main line of business: sugar production. Sale of the distillery would allow CATSA to concentrate its management and funds on production of export sugar.

The sugar industry is, by nature, volatile: prices vary widely from one year to the next as the supply of sugar on world markets is affected by weather conditions and domestic regulations. In order to be profitable in this environment, management must be skilled in controlling operating costs with fluctuating production volumes, as well as in the technical aspects of producing sugar.

The fact that CATSA was not profitable during the period reviewed suggests that management should develop a more streamlined operation. Areas which merit particular attention include elimination of unnecessary operating costs, reduction of overstaffing, control of trade and other accounts receivable, and the elimination of unprofitable investments.

A longer-term outlook on the part of management, in its decisions and administrative actions, could also contribute to more profitable results. This would imply greater stability of personnel at the upper-management level, more of a "private enterprise orientation", and greater independence from the political sector.

In addition, an accurate and complete record of operating costs is necessary in order for managers to exercise proper control over operations. An improved cost accounting and information system would be needed for that purpose. The responsibility for each operating area should be clearly defined and assigned to a manager, who would be given the authority to completely control that area.

Moreover, historical financial statements appear to have been inconsistent and unrealiable: in 1982, CATSA's external auditors would not express an opinion on the statements. A misstatement of accounts can be compounded over time, so that values shown for assets and liabilities or for changes during a period are no longer meaningful for an understanding of the company's financial position. An independent review and restatement of past results and of the present financial condition would be useful to management and other interested parties.

Exhibit III-1

CENTRAL AZUCARERA TEMPISQUE, S.A.

COMPARATIVE INCOME STATEMENT

(in Thousands of U.S. Dollars Equivalent)

	FY1980	FY1981	FY1982	FY1983
Net sales	2398	7646	4349	6139
Cost of sales	(7788)	(8841)	(5271)	(5234)
Gross profit (loss)	(5390)	(1195)	(922)	905
Operating expenses	(1579)	(1093)	(542)	(792)
Operating profit (loss)	(6969)	(2288)	(1464)	113
Other income	112	61	70	438
Other expenses	(1155)	(910)	(303)	(563)
Net exchange differences	(251)	1428	(593)	382
Interest expense	(3168)	(2283)	(746)	(3545)
Net income (loss)	(11,431)	(3992)	(3036)	(3175)

CENTRAL AZUCARERA TEMPISQUE, S.A.

Comparative Statement of Financial Condition as of September 30, 1980, 1981, 1982 and 1983 (In thousands of U.S. dollar equivalents)

Description		9/30/80	9/30/81	9/30/82	9/30/83
Current Assets					
Cash and cash equivalent		213	149	20	243
Trade accounts receivable		828	245	296	594
Other accounts receivable		134	73	41	1,264
Inventories		4,735	2,648	1,685	1,302
Other current assets		258	31	108	359
Total current assets		6,168	3,146	2,250	3,762
Less: Current Liabilities					
Start-term borrowings		-	-	-	1,592
Current maturities of L-T debt		997	785	639	1,004
Trade accounts payable		736	934	783	543
Accrued expenses		552	331	442	247
Other current liabilities		192	39	666	282
Total current liabilities		2,477	2,089	2,530	3,668
NET CURRENT ASSETS/ LIABILITIES	(A)	3,691	1,057	(280)	94
Other assets:					
Property, plant and equipment		56,427	63,202	63,837	71,418
Less: accumulated depreciation		5,097	7,845	10,887	11,582
Net book value		51,330	55,357	52,950	59,836
Other non-current assets		1,969	161	108	269
Deferred charges		4,854	2,564	1,068	2,155
Total - other assets	(B)	58,153	58,082	54,126	62,260
Total	(A) + (B) = (C)	61,844	59,139	53,846	62,354
Deduct: Long-term liabilities:					
Borrowings		1,265	775	605	1,666
Due to CODESA		27,354	5,741	4,782	15,362
Other long-term liabilities		9	-	19	-
Total long-term liabilities	(D)	28,628	6,516	5,406	17,028
TOTAL NET ASSETS	(C) - (D) = (E)	33,217	52,623	48,440	45,325
Shareholders' equity					
Share capital		1,163	1,163	1,163	1,163
Capital surplus		47,452	61,762	61,762	61,762
Exchange adjustments		3,423	12,511	11,364	11,424
Accumulated losses		(7,390)	(18,821)	(22,813)	(25,849)
Current year loss		(11,431)	(3,992)	(3,036)	(3,175)
		33,217	52,623	48,440	45,325

APPENDIX I

PROCEDURES FOLLOWED FOR THE TRANSLATION OF THE ACCOUNTS AND PROJECTIONS INTO U.S. DOLLAR EQUIVALENTS

For the purpose of this study, the accounts for the fiscal years ended September 30, 1980 through 1983 were translated into U.S. dollar equivalents as explained hereunder:-

- Monetary Assets and Liabilities measured in Colones were translated into U.S.Dollars at fiscal year-end rates, viz.:-

  .. at Sept. 30, 1980 - US$1.00 = ₡10.25
  .. at Sept. 30, 1981 - US$1.00 = ₡18.86
  .. at Sept. 30, 1982 - US$1.00 = ₡40.15
  .. at Setp. 30, 1983 - US$1.00 = ₡42.35

- Monetary Assets and Liabilities measured in U.S. dollars were taken up at their true dollar values, regardless of their local currency equivalents in the accounts.

- The Costs in Colones of Property, Plant and Equipment acquired prior to fiscal year ended September 30, 1980 were translated into U.S. dollars at the rate ruling at September 30, 1980 (viz. US$1.00 = ₡10.25).

- Costs of Property, Plant and Equipment in U.S. dollars were taken up at their historical dollar values regardless of their local currency equivalent in the accounts.

- Depreciation and Amortization charges were calculated in U.S. dollars by applying to the costs in dollars or dollar equivalents the same annual rates of depreciation or amortization as in the accounts in local currency.

- All other items of expenses and charges and all revenues were translated into U.S. dollars at the yearly average rates of exchange, viz.:-

  for FY80 - US$1.00 = ₡ 8.60
  for FY81 - US$1.00 = ₡16.02
  for FY82 - US$1.00 = ₡36.84
  for FY83 - US$1.00 = ₡40.75

- The Value in Colones of the Shareholders' Equity at the beginning of fiscal year 1980 was translated into U.S. dollars at the rate ruling on September 30, 1979 (viz. US$1.00 = ₡8.60). Net losses for fiscal years 1980 through 1983 were deducted from Equity for the dollar values obtained by translating revenues, expenses and charges as indicated above.

As a result of using the different rates of exchange as explained above, the total dollar equivalents of the assets exceeded the sum of the dollar equivalents of the liabilities and of the equity; the difference was compensated by adding an exchange adjustment to the dollar equivalent of the equity. Such adjustment may be considered as tantamount to a revaluation of the fixed assets on account of the deterioration of the purchasing power of the local currency. Consequently the accounts in dollar equivalents as presented and discussed in this report present a more realistic view of the Company's financial condition and of the results of its operations than the original accounts in local currency. (No attempt has been made, however, to incorporate into the value of the equity any further adjustment to compensate for the lesser but not insignificant deterioration of the purchasing power of the U.S. dollar during the same period, 1980 through 1983.)

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