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**BOSNIA-HERZEGOVINA**

# PILOT TEST CASE TRIAL ANALYSIS:

## MILKOS (SARAJEVO)

USAID FOSTERING AN INVESTMENT AND LENDER-FRIENDLY  
ENVIRONMENT (FILE)

Contract #PCE-I-00-98-00015-00, Task Order #821 of the GBTI IQC

**18 February 2004**

This publication was produced for review by the United States Agency for International Development.  
It was prepared by Chemonics International Inc.

Submitted to:  
U.S. Agency for International Development

Submitted by:  
Chemonics International, Inc.  
Emerging Markets Group, Ltd.  
National Center for State Courts

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development of the United States Government.

**USAID FOSTERING AN INVESTMENT AND LENDER-FRIENDLY ENVIRONMENT (FILE)**

**BIH NEW BANKRUPTCY AND LIQUIDATION LAWS**

**Program for Bankruptcy Pilot Cases**

**PILOT TEST CASE TRIAL ANALYSIS**

**MILKOS**  
**(Sarajevo RS)**

**INTRODUCTION**

MILKOS is the dairy company located in Sarajevo. Historically this Company was the largest dairy serving not only the Sarajevo region, but located in the whole of Bosnia and Herzegovina.

In 2002 MILKOS employed 189 workers and produced: Pasteurized milk, Yogurt, Kefir, Sour Cream, Ice Cream, Cottage Cheese and Butter. At the end of 2002 the Company ceased operations after experiencing 5 years of operational losses. The result was a negative net worth of 4,496,625 KM as of the end of 2002. As of May 22, 2003, liabilities reportedly exceeded 8,070,709 KM.

The Company has the necessary equipment to restart its operations on a large scale. The reputation of the Company's products has been and remains good. The Cantonal government would like to see its operations restarted and appears willing to take over the Company's obligations towards the state. There reportedly is at least one foreign investor seriously interested in a revival of the Company's operations.

However, most of its production facilities, including its machinery and equipment, are subject to liens in favor of bank creditors and an unrelated public company (the Sarajevo Tobacco Company). The practicality of reviving operations in the face of these secured interests calls for further investigation.

Because of its financial problems, the Company is undeniably a candidate for bankruptcy — most likely a liquidation with a quick auction sale of all of its assets — although a “financial reorganization” also could be a solution for its problems. MILKOS would be a good choice as a Pilot Case in either context, although there are questions about the political will to sell the company in a bankruptcy proceeding, unresolved liabilities towards the workers, and issues left behind from the privatization process.

Specifically, the Strategic Privatization Project team yielded the following relevant information:

- MILKOS's total liabilities exceed the nominal value of its total assets more than 2 times;

- MILKOS’s current financial problems are irresolvable out of court because of the number of creditors involved and the magnitude of its debt towards them;
- There is an interest on the part of foreign investors to restart MILKOS’ operations.

In order to make a definitive decision about MILKOS as a potential “Pilot Case” more information is needed. FILE team members should meet with all relevant sources of information to develop a more a more firm analysis.

### **APPLICATION OF THE SELECTION CRITERIA**

#### The First Twelve Screening Criteria.

The first three Criteria ask whether the case would be significant and positive enough to reinforce our training plans, provide a good learning experience, and have a significant impact towards advancing our overall goal of initiating a fully-implemented bankruptcy system in BiH.

Specifically, the Criteria are:

1. Would the process of adjudicating the proposed case serve as a good example, which would reinforce our training plans and other implementation activities?
2. Specifically, consider whether the *process* would provide a good learning experience, which would benefit, especially, the trustees, bankers, and business professionals involved.
3. Would an adjudication of the proposed case ultimately have a *significant* and positive enough impact to help build confidence in and encourage a broad implementation of the bankruptcy system?

MILKOS would be a big case, which would have significant impact not only for the Sarajevo Canton, but also for Bosnia and Herzegovina. The company used to provide a significant number of jobs for the local community, both directly and indirectly. These jobs should come back into existence if the assets of the company are sold and redeployed.

At the same time to the extent the system is ready to handle it (capable trustees, courts, judges, attorneys, etc., all in place, trained and certified) the process of adjudicating MILKOS in bankruptcy would reinforce our other training. If done well, with a good result, and not too many mishaps, it also could be one which would be described as a “good example.”

However, there quite likely would be numerous demands made by the interested parties, most notably the employee group, and the representatives and attorneys of these parties, all of whom would be advocating diverse, perhaps even irreconcilable, interests. Given the size of the company, the magnitude of the claims against it, and the divergent interests, concerted action towards an orderly bankruptcy resolution

might not occur. The judge might be forced to make difficult rulings that would be certain displease someone. On the whole, however, MILKOS could be classified as a case that could be cited as a good example of how a bankruptcy should be processed in the new, modern system.

Accordingly, the application of these first three Criteria to MILKOS yields a positive result. So far, we can only say that MILKOS might be a good choice for a Pilot Case but it might not be because of other factors (political, social).

The Fourth Criterion asks whether MILKOS can be a “government/government” Privatization, where it is a government owned company (“SOE”) where the *controlling* creditor interests are also government held debts. In this case the controlling creditor interests are not government held debts, but rather debt owed to banks, suppliers and employees. Accordingly, government decision-makers cannot be expected to provide controlling direction to the bankruptcy proceedings and this factor disfavors selecting MILKOS as a Pilot Case.

The Fifth Criterion provides a critical, objective financial test, asking simply whether there are sufficient assets (liquid or realizable at reasonable market values) to pay the costs of the proceedings, pay the priority and secured creditors, and still allow for the payment of a dividend or other consideration to the general creditors. For MILKOS this is a close question.

Total liabilities are now in the vicinity of 14.75 Million KM.

Inventories are valued at only 0.47 Million KM, and receivables at a paltry 1.51 Million KM. The fixed assets are booked at 4.47 Million KM. Thus, if one could take the fixed assets at “book,” one would suppose that enough assets would be available to meet bankruptcy adjudication costs pay some liabilities, too. However, the market value of the Company’s fixed assets is not known, now, to any degree of certainty. Further, an adjudication of MILKOS would constitute a fairly large, complex proceeding. Accordingly, there is some risk that the proceeding itself would be expensive in terms of fees.

The application of this Criterion to MILKOS, on this “first look” basis, is simply inconclusive.

Criteria Six through Eight ask one to consider the possibility of “streamlining” the case and its likely time constraints. Those that can be “streamlined,” e.g., where pre-packaged Plans are feasible, clearly have an advantage over other cases that may be unavoidably or unexpectedly contentious or time-consuming.

Specifically these Criteria ask:

6. Can the case be adjudicated under a pre-packaged Plan?
7. If a pre-packaged Plan is impracticable, are deadlines/time schedules flexible and favorable?
8. Irrespective of whether or not a pre-packaged Plan is feasible, it is necessary to consider whether the proceedings can be executed in a timely and efficient manner so that a final adjudication and asset or dividend distribution and/or Plan consummation can be accomplished within six to 18 months.

The application of these Criteria appears to favor the selection of MILKOS as a Pilot Case.

A pre-packaged Plan seems highly probable because of investor interest and the already started negotiations with different creditor groups. However, the problem of the workers demands may have no easy solution. If it is known that most of the employees would have future employment, this factor would provide a good “trade off” for worker cooperation. Nevertheless, current worker opposition could delay the whole of the process.

For another thing, deadlines and time schedules may be problematic right from the start. Currently there is no one that would like to take the responsibility to initiate the bankruptcy procedure. The Company's creditors are most likely to step in first, but their reaction in time is still uncertain. The New Bankruptcy Laws have very rigid, short deadlines. Once initiated the bankruptcy proceeding could meet all time-schedules and deadlines in the adjudication process if MILKOS were a Pilot Case, excluding possible delays when negotiating with the workers.

The Ninth Criterion only asks whether the debtor Company meets an appropriate insolvency test, so that a bankruptcy filing is legally appropriate. Clearly, MILKOS meets this test. Its current ratio of current assets to current liabilities is a mere 0.22, and might have dropped in half since the end of May last year. It belongs in bankruptcy.

The Tenth Criterion focuses on an issue which could be a critical stumbling block for MILKOS, that is whether debts owed to former or redundant workers for wages are likely to be a significant obstacle to an orderly liquidation or a reorganization, given not only the amounts owed, but also the ages, attitudes and sophistication of the workers and their representatives. More information about the workers should be gathered before reaching a firm conclusion on this issue. Perhaps their reemployment and future employment prospects in the aftermath of a liquidation can be presented in a favorable light. However, on first look, this Criterion seems to be inconclusive for choosing MILKOS as a Pilot Case.

The Eleventh Criterion asks whether the debtor company's assets are heavily liened and whether or not it can service its secured obligations. MILKOS has borrowed 3.63 Million KM secured by a mortgage on some of its real property and collateral on some its equipment. These loans constitute almost one third of MILKOS's debt.

MILKOS’s net cash flow from operations is negative – since 1998 until it shut down its operations in 2002. The liabilities of the Company exceed its equity by 8.07 million KM. At this rate MILKOS clearly cannot service its secured debt. This means that in a bankruptcy liquidation, the secured creditors are likely to take control on some of its assets in short order, preventing an orderly liquidation and leaving nothing for general creditors.

Further evaluation under this Criterion may be appropriate, but it appears to be a factor which weighs at “fist look” 30% against the selection of MILKOS as a Pilot Case.

The Twelfth Criterion is subjective. It asks whether an adjudication of the Company would present other unavoidably sensitive complications. In this respect, the fact that MILKOS has such a significant presence in the regional economy of Sarajevo appears to constitute a “sensitive complication” which would burden the proceedings. This, too, could weigh against selecting MILKOS as a Pilot Case.

### CONCLUSION

Further diligence and a more subjective examination of MILKOS in light of the Criteria discussed is necessary before one can reach a firm conclusion as to whether or not MILKOS could be a good Pilot Case. However, on the information available to us at this time the more likely conclusion is that MILKOS is probably a good candidate for our Bankruptcy Pilot Case Program. With USAID’s agreement, FILE will begin to undertake additional diligence.

#### **Is MILKOS a good candidate for the Bankruptcy Pilot Case Program?**

Criterion to be evaluated	Degree at which the Case meet the Criterion					Score points
	Does not meet at all	Does not meet	Neither meets nor does not meet	Meets	Completely meets	
1				X		+1
2				X		+1
3				X		+1
4		X				-1
5			X			0
6				X		+1
7				X		+1
8				X		+1
9					X	+2
10			X			0
11				X		+1
12			X			0
<i>Case Total Score</i>						+8