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Agricultural Cooperative Development International

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FOOD SYSTEMS RESTRUCTURING PROJECT (FSRP) KAZAKSTAN

Cooperative Agreement # CCN-0006-A-00-3072-00

ANNUAL PROGRAM PERFORMANCE REPORT

APRIL 1995-MARCH 1996

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FSRP/KAZAKSTAN -- ANNUAL PROGRAM PERFORMANCE REPORT
April 1995 - March 1996

I SUMMARY

Continuing progress has been made in assisting Koch Supplies in forming a joint venture between Central Asian/American Enterprise Fund, a local dairy processor, and five dairy farms. The joint venture calls for investment in the dairy farms, building a new medium-scale dairy plant in Chilik, Kazakstan, upgrading local dairy processors equipment, and upgrading retail dairy sales shops in the city of Almaty, Kazakstan. Equity in the form of cash from Koch and CAAEF and assets contributed by the local partners, were to be supported by debt capital. When the project started, the only viable source of debt capital was the EBRD Apex Loan Program in Kazakstan. After over six months of intense negotiation with EBRD representatives in Almaty and their corresponding commercial banks, it was concluded that this program was not viable for borrowers who were not stockholders in the commercial banks. The International Finance Corporation, the project financing arm of the World Bank, was contacted, and they enthusiastically expressed an interest in evaluating the loan request. Though the delay in obtaining the debt capital is frustrating for the principals, and presents a risk in keeping all parties engaged, the IFC financing package would strengthen the project because of lower interest rates and a larger available loan.

During the development of the dairy project, ACDI has observed that many policy issues in regard to restructuring agriculture could be addressed and solved. The lesson learned was that when actual foreign investment was in the offering, government officials were eager to streamline registration process, reevaluate tax policy, privatize assets to be pledged to the JV, and revise applicable laws. More specifically, Koch and ACDI led the privatization process of five state and collective farms into production cooperatives. This activity was funded under the FSRP. Input was made to government officials on the new drafting of the production cooperative law, a value-added-tax waiver on the proposed capital equipment was obtained, and consideration is being given to eliminate the VAT altogether for foreign investment in the form of capital equipment. The problem of excessive energy hookup fees for new plants was identified and some consideration was received.

Utilizing the methodology first used on the Koch dairy project, another project was initiated in the fruit and vegetable industry in Southern Kazakstan. Incidentally, that methodology was strongly endorsed by the USAID evaluation team in April, 1995. ACDI contracted with Statco Engineering, a turn-key plant food processing plant designer/builder located in California and Washington states. A team of seven persons, four consultants and three potentially interested investors, developed a modernization strategy for the fruit and vegetable industry in the South Kazakstan Oblast. That activity was conducted in May/June, and in September another subgrant was awarded to Statco Engineering for the purpose of developing a full-scale business plan for a potential joint venture between Alma fruit and vegetable plant near Chimkent, Statco, an enterprise fund, and a number of fruit and vegetable growing

farms in the area surrounding the Alma plant. This project is also of significant size and will require debt capital. The same policy issues are being addressed as in the dairy project. This activity began in November and the business plan is targeted to be complete by June 1, 1996.

ACDI assisted Koch Supplies in developing a joint venture with a partner in Akmola, Kazakstan, to build a small scale meat plant. This project was smaller in financial terms and maybe funded as early as May, 1996. Koch and ACDI are collaborating to design a subgrant proposal for an FSRP-funded training program for meat plant employees with emphasis on management systems.

ACDI assisted RJR Nabisco, a confectionary plant in Chimkent, Kazakstan, in developing a subgrant proposal for an FSRP-funded training program for plant employees, with emphasis on sales. Because of shortage of FSRP funds, this proposal is being held in abeyance until USAID obligates the remaining \$2 million of authorized funds for FSRP.

ACDI recruited an outstanding team to initiate another project in the vegetable oil industry. Methodology was to be the same as the dairy project but because of shortage of FSRP funds, this activity was canceled.

II. MAJOR ACTIVITIES OVER THE PAST YEAR

A Koch Supplies Dairy Project

Beginning in April, Koch continued its negotiations with funding agencies to finance the project. Both the EBRD and CAAEF had given soft commitments, but details still needed to be worked out. Meanwhile, an FSRP activity was initiated to assist in the privatization of the nine dairy farms involved in that project. The proposed business structure would be a production cooperative. The dairy facilities, livestock, and crop and forage-growing land would make up the dairy farm and would be broken away from the parent farm and operated as a private entity. Initially, there were nine farms. This privatization activity aimed to have a broad based impact locally, and as a model for agriculture, nationally.

ACDI developed a training program which utilized low-cost dairy farmer volunteers and paid processing and marketing consultants.

Throughout the third quarter of 1995, the dairy project was scaled down because of the inability to raise the planned \$12 million in capital. However, efforts are underway to obtain \$10 million. The results of the scaled down version were eliminating the cheese-making line and the resulting need for additional working capital and modernizing only five farms instead of the planned nine farms. The beginning total number of milking cows was to be approximately 2500, and the dairy product mix was

fluid milk, sweetened condensed milk, cream, half & half, yogurt, ice cream, and cream
Financially, the scaled down version results in an increase in rates of return

Also throughout the third quarter, Koch continued to negotiate conditions with funding agencies and governmental organizations which are required for full and proper financing for the project. In September, the Central Asian-American Enterprise Fund (CAAEF) committed \$3 million of equity funding with the condition that European Bank for Reconstruction and Development (EBRD) provide \$5.9 million debt capital. The EBRD Apex Unit and the Senior Banker in Almaty approved the loan. However, because EBRD loans their funds to the National Bank of Kazakhstan who in turn loans funds to a variety of local banks, the local bank is the credit risk taker.

Several issues still needed to be resolved with the governmental agencies. The two major items are the electrical hookup fees for the new dairy plant and the Value Added Taxes (VAT) for the incoming equipment and building. Both issues have serious financial impact and without acceptable resolutions the project is in jeopardy. The Governor of the Oblast, Mr. Uzbekov, gave Koch assurances that these issues can be resolved positively.

One of the conditions of the CAAEF and EBRD to fund the dairy project was the approval of the training subgrant under the FSRP for which Koch is eligible. Therefore, the training program was designed and submitted for approval. It calls for a series of volunteers and paid consultants to spend short term assignments on site in Kazakhstan. The proposed amount of the subgrant was \$700,000.

During the last quarter of 1995, financing for the proposed project continued to be sought. The local Kazkommertsbank refused to fund the project for a number of reasons with the principal stated reason, shortage of collateral. The history of Kazakhstan's agriculture led the banks to be very conservative on agribusiness loans. They refused to accept traditional agricultural assets such as dairy cows, facilities, equipment, or land as collateral. They favored assets in the city of Almaty such as hotels or office buildings. This lack of confidence in the agriculture sector put the entire Food Systems Restructuring Project in jeopardy, because most all high impact projects would need borrowed capital.

Koch and ACDI worked with the Center Bank, another bank qualified under the EBRD Apex Loan Program. They proved to be more straightforward to work with, but they have the same collateral issues as the previous bank. To solve that problem, ACDI with the suggestion of the Almaty Oblast Governor, persuaded the local milk company, Zhiger, to join the Joint Venture as a partner, and, in return, offered a substantial amount of their equipment/plant assets in the city of Almaty as collateral. During this time though, ACDI was informed by Koch that this would be the final attempt to bring the project to fruition. The Board of Directors began to lose interest and may abandon the project and Kazakhstan as a place to do business if this project is not approved.

Through much work, many of the peripheral policy issues were solved during the development of the enterprise. An exception in the VAT has been received and subsequently, the Government began to reconsider VAT on capital goods when they represent investment. Five farms or portions of farms have been privatized into production cooperatives, and during the privatization activity, ACDI had some impact on the new Decree on Cooperative Law. A suitable electrical hookup fee has also been negotiated, and environmental issues were also addressed. A \$700,000 subgrant was approved, contingent upon project startup, and the training program for the dairy farmers and workers was developed.

In the first quarter of 1996, and the last year of the project, with the advice of the European Bank for Reconstruction and Development (EBRD), and the EBRD Apex Unit, Koch and ACDI have prepared business plans, loan documentation, and solved policy issues such as privatization of dairy farms. ACDI, TDA, and Koch spent nearly \$1 million in time and expenses to bring the project to the point of receiving funding through the EBRD Apex Program. The Project was guided to the three banks which have been qualified by EBRD to make Apex loans, only to have two of the banks reject the project because they did not prefer agriculture loans, did not value the collateral at market value, and wanted to conserve their borrowing funds for their stockholders. One bank, CenterBank, approved the loan but does not qualify under the EBRD Tranche B to accept the requested \$6 million loan because they have inadequate capital. Therefore, Koch abandoned the EBRD Apex Program as a viable source of borrowed capital for agriculture loans.

Fortunately, however, the International Finance Corporation, the project financing arm of the World Bank, is becoming more aggressive in this market, and have committed to processing the Koch dairy project loan application. In many ways, an IFC loan strengthens the project. It can be larger, and allows for working capital needed to finance the feed crop input supplies. Cheese making capabilities can be added, and retail outlet facilities upgraded. IFC also desires a strong and more active local partner with a higher ownership ratio than was originally planned. Accommodating this feature would require a change in the training and technology/management transfer program which was to be funded by the FSRP subgrant of \$700,000. An additional benefit of the IFC program is the cost of the money is 10% per annum rather than the EBRD 15% rate.

However, considerable work is required by Koch to "repackage" the business plan along IFC requirements. They have requested using approximately \$50,000 out of the ACDI training subgrant for expenses. ACDI and USAID concur with this request and have forwarded it for approval. IFC has indicated a 4-month process to accomplish the due diligence needed to approve the loan. All the principals are in agreement that if the project is not essentially funded by August, 1996, the project will be abandoned.

B Chimkent Fruit and Vegetable Modernization

In late May 1995, a team of four consultants and three persons from Monroe Machinery/Statco and Valley Tractor assembled by ACDI traveled to Chimkent, South Kazakhstan, to develop a modernization strategy for the fruit and vegetable industry for that Oblast. Major activity centered around the Alma Fruit and Vegetable Processing plant located in the Sairamski Raion and the nearby orchard farms. This plant had been identified as an excellent investment opportunity by the ACDI field staff in late 1993. The team concurred that this is an outstanding investment opportunity and completed a report that describes the modernization strategy, the future action plan to implement the strategy, identification of potential investors, and a preliminary business plan for the Alma plant.

In the third quarter of 1995, Monroe Machinery, a subsidiary of Statco Engineering, whose General Manager, Larry Gruendike, was a member of the team which developed the modernization strategy, expressed serious interest in developing a full scale business plan for the Alma Fruit & Vegetable Plant located in the Sairamski Raion of the Chimkent Region. The business plan development was funded partially by Statco Engineering and the USAID/ACDI FSRP. Statco expressed sincere interest in investing in some sort of a joint venture with Alma and the supplying farms.

In the last quarter of 1995, Statco Engineering fielded a team of 5 persons, led by Larry Gruendike, and began the development of a full scale business plan for a potential Joint Venture with the Alma Fruit and Vegetable Plant near Chimkent. The plant has state-of-the-art tomato paste and apple juice concentrate lines and a new can making line. They lack adequate packaging and further processing lines to make consumer products from the paste and concentrate. They also have a serious shortage of working capital and their balance sheet is questionable as to the enterprise's viability. Statco's intention was to complete the business plan once Alma has resolved certain balance sheet issues they have with the State.

An ancillary project to support the Statco study is the privatization of orchard and vegetable farms which supply the Alma Plant. ACDI, using local legal consultants, engaged in this effort and are investigating various financing schemes which may provide the necessary funding to begin the process of rehabilitating the orchards. ACDI took a very comprehensive approach to agribusiness formation as was done with the Koch Dairy Project.

In the first quarter of 1996, and the last year of the project, the initial work accomplished by the Statco Engineering team resulted in a protocol. This document committed the Alma Fruit and Vegetable plant management to complete the privatization of the facility and resolve the debt issue on a state-of-the-art tomato paste making line. Once those issues were resolved, Statco would proceed with the completion of a full-scale business plan.

Progress has been slow. The State owned 30% of the shares of the Alma Joint Stock company and have disposed of 15%. Now, it is in the process of disposing the balance. However, no progress has been made in resolving the issue of the debt on the tomato paste line. Because the State was involved in the original purchase, which includes a sovereign guarantee, Alma management can not resolve this issue. Therefore, Statco is now in the final stages of completing the business plan which may provide a solution to this problem.

In February, Statco sent representatives to Chimkent to determine the capital needs at the farm level which will be required to assure adequate supply of raw materials. One of those representatives was Herold Peebles from Wilbur-Ellis, a large agronomy company in the Pacific Northwest, and a possible investor-supplier for this project. The team conducted three apple tree pruning clinics, attended by approximately 150 farmers and farm workers.

The Alma Fruit and Vegetable business plan is in the final stages of completion by Statco Engineering. The project is developing into a possible joint venture with Statco and others taking an equity position with Alma. Following the comprehensive approach used on the dairy project, Statco has determined that investments will have to be made at the farm level as well as at the plant to assure a reliable source of quality and quantity of raw fruits and vegetables.

C RJR/Kabisco Confectionery Technical Assistance & Troubleshooting Subgrant

In the second quarter of 1995, ACDI met with RJR local executives in Chimkent to develop a subgrant proposal whereby the FSRP will fund sales and management training and a short-term assignment for a food technologist/consultant specializing in confectioneries. The estimated proposed subgrant was for approximately \$235,000. RJR purchased the plant in September, 1994. RJR is committed to keeping the plant operating. One large cost saving measure has been to reduce work force substantially, from 1200 down to less than 500. Currently, it is one of the few processing firms in Kazakstan that is paying its workers in currency. Though RJR has made other efficiency moves, the plant still continues to drop in production. ACDI and RJR local executives believed the FSRP funded program would be the stimulus to improve sales, products, and management proficiency, thereby improving the company's financial condition and preparing its work force for increased sales.

In the third quarter, because of budget constraints, the application for this project was held in abeyance until the USAID/ACDI FSRP remaining unobligated funds of \$2 million are obligated.

D. East Kazakstan Sunflower Oil Industry Modernization

During the second quarter of 1995, ACDI identified the Ust-Kamenogorsk sunflower oil plant as a possible investment opportunity for U S agribusiness. A group of consultants were hired to evaluate the sunflower oil industry in Kazakstan, develop a modernization strategy, and prepare a business plan for the oil plant if it is deemed feasible to modernize. The team's anticipated arrival is approximately mid-August and the assessment would last three weeks. ACDI obtained approvals and commitments from TAGAM (The quasi-government organization which manages the State's 30% ownership in the sunflower oil plant), East Kazakstan Regional Administration, and the Sunflower Oil Plant management, to conduct and facilitate the study team's activities. Activities will include assessing the condition and requirements to increase the production of sunflower seeds, assess the vegetable oil consumer market, evaluate the feasibility to modernize the sunflower oil production plant, evaluate management and ownership of the plant, coordinate with the Canola oil seed growing project officials in the Kochatau Region, prepare a business plan for the modernization of the sunflower oil plant, and conduct a 4-hour seminar for local industry people at the end of the study period.

In the third quarter, after assembling a team of consultants, potential investors, equipment manufacturers, and agricultural input suppliers to develop a modernization strategy and business plan for the oil plant in Ust-Kamenogorsk, the project was held in abeyance because of budget constraints.

Fortunately, in the first quarter of 1996, ACDI has furnished background information to Pepe International, one of the original team members from the postponed project. Pepe representatives have continued exploration of the project and now have requested ACDI to assist them in developing the project further, and locating potential investors and sources of financing.

E Privatization of Dairy Farms

In the second quarter of 1995, ACDI assembled a team to develop and implement a privatization plan for nine dairy farms which were to be the suppliers to the Koch dairy plant. Because Koch downsized the project, six farms were chosen, five to be included in the project and one to act as a backup. The guidelines for choice were the farm has a major dairy enterprise (at least 300 milking cows), farm could dedicate sufficient feed production land to the dairy farm, and if the farm was diversified they would agree to split the dairy cows, facilities, and feed production land away from the mother farm and form a production cooperative. The status of the privatization activity is that two dairy production cooperatives have been registered, drafts of the formation documents have been prepared for the four remaining farms, and the State Property Committee has just approved the privatization plan for the four farms. By mid-October the four farms submitted their registration papers to the Minister of Justice and by end of October all six farms will be registered as production cooperatives.

F Koch Supplies Meat Project

Working with Koch Supplies and Central Asian/American Enterprise Fund on the dairy project, ACDI was able to assist Koch in developing another project to build a meat plant. Background information was furnished to Koch on the proposed partner, Tsesna, a large multi-business firm located in the proposed capital city of Akmola, and an introductory meeting was facilitated. ACDI previously met with representatives of this company in June, 1994, when meetings were arranged for the USDA Trade and Investment Mission Evaluation team.

The proposed project will be a joint stock company with ownerships of Tsesna 41.7%, CAAEF 41.7%, and Koch 16.6%. Equity contributions will be Tsesna \$300,000 cash and \$200,000 in-kind, CAAEF \$500,000 cash, and Koch \$100,000 cash and \$100,000 in-kind. Additionally, CAAEF will provide a \$1.5 million term loan. Using the 2.5 to 1 investment to grant ratio, Koch will apply for a training subgrant of approximately \$180,000, under the USAID/ACDI-FSRP.

The plant will produce semi-finished and packaged fresh cuts of beef and pork. The target market will be medium to high income consumer groups in and around Akmola, which is estimated at 42,000 people. Tsesna will retail the products out of their own retail stores and other outlets. Anticipated production of the finished product will be nearly 40 metric tons per month. The financial projections showing ROI growing from 27.1% in year one to 48.9% in year six.

This project has excellent replication possibilities because of the preference of meat in the Kazakstani diet.

G Developed Technology Resources Dairy Project

FSRP staff has collaborated with DTR officials as they prepared a subgrant request for their remaining subgrant funds. This proposal requests funds to purchase an accounting software package and a communication system for their distribution trucks, as well as accounting training.

ACDI has assumed oversight responsibility for the Developed Technology Resources dairy project for Tri-Valley Growers. Currently, collaboration is underway with DTR local and U.S. representatives on a subgrant application for the remaining funds. These funds are anticipated to be used for upgrading accounting and distribution communication systems.

H Member Trade Mission

ACDI efforts to recruit a member trade and investment mission for Kazakstan in the summer/fall of 1996 was unsuccessful. It is apparent that the methodology used in the Koch dairy project is the most effective manner to attract foreign investment to this problematic region. In short, a well-developed business approach has to be designed to create sufficient interest before U.S. agribusinesses will consider spending the time to explore investment opportunities in Central Asia.

II ACTIVITIES PLANNED FOR NEXT YEAR

Presently, ACDI has adequate funds to provide the dairy project joint venture with a training grant, complete the business plan for the fruit and vegetable project, and maintain an office presence in Central Asia until approximately September, 1996. If funding is not forthcoming from USAID, these will be the only activities possible.

However, if the remaining \$2 million of authorized funds will be obligated, ACDI anticipates the following activities:

- A** Provide Koch with continued assistance as they repackage their dairy project along IFC lines, implement the pre-approved dairy training subgrant proposal, and provide oversight of the training program until May, 1997.
- B** Provide Statco with continued assistance as they develop a business plan for a fruit and vegetable joint venture in South Kazakstan. Collaborate with Statco representatives to design an FSRP training subgrant proposal for the joint venture, if it is formed. Implement and provide oversight for that training activity until May, 1997.
- C** Provide Koch continued assistance as they develop the JV for a meat plant in Akmola. Collaborate with Koch representatives to design an FSRP training subgrant proposal for the joint venture, if it is formed. Implement and provide oversight for that training activity until May, 1997.
- D** Seek approval of the RJR subgrant proposal, and maintain oversight of the training activities until May, 1997.
- E** Revive and fund the vegetable oil project activity planned last year. This activity would entail developing a modernization strategy and business plan for the upgrading of an existing sunflower oil plant in East Kazakstan, and possible construction of a canola oil plant in the Kochetau region in north central Kazakstan.

IV ADDITIONAL OBSERVATIONS & COMMENTS

Failure to obligate the \$2 million of authorized funds for FSRP is seriously hampering ACDI's efforts to complete its objectives Presently the funds available will only allow the completion of the dairy milk project with Koch Though this project is considered by all the principals as excellent and badly needed in the Republic of Kazakstan, the shortage of viable debt capital providers to the area has caused severe delays However, a new and more aggressive financier, IFC, is now active in the region IFC has funded many agriculture projects throughout the world and has expressed a strong interest in funding the Koch dairy project We should know by early summer whether or not this project will be completed or abandoned

However, to hinge the continuance of USAID further funding of FSRP in Central Asia on this one project is questionable. The FSRP is a agribusiness formation project and in this region these projects take time and all will not succeed ACDI has developed a credibility in the region and respectfully urges USAID to provide the remaining authorized funds so that other planned projects can go forward The Republic of Kazakstan as well as U S agribusinesses will benefit

ATTACHMENT 1

FOOD SYSTEMS RESTUCTURING PROJECT

ADMINISTRATIVE DATA AND
EXPENDITURES THROUGH MARCH 31, 1996

Line Item	Obligated Budget	Posted to Date	Unliquidated
Salaries - HQ	140,000	88,945 84	51,054 16
Salaries - Expatriate	285,000	241,037 98	43,962 02
Salaries - Local	90,000	52,996 17	37,003 83
Post Differential	71,263	64,003 40	7,259 60
Payroll Added Costs	121,350	105,058 01	16,291 99
Allowances	95,000	82,737 49	12,262 51
Travel/Per Diem	220,069	158,591 11	61,477 89
Consultants	265,000	228,681 91	36,318 09
Equipment/Commodities	54,400	54,390 79	9 21
Other Direct Costs -NIS	165,390	120,664 05	44,725 95
Other Direct Costs - HQ	35,000	30,365 52	4,634 48
Indirect Costs	564,545	449,254 85	115,290 15
Subgrant - Koch Supplies	93,449	93,549 02	(100 02)
Subgrant - Koch Dairy Project	700,000	0	700,000 00
Subgrant - Monroe	5,500	6,001 91	(501 91)
Subgrant - Valley Tractor	11,000	10,542 61	457 39
Subgrant - Statco	187,730	110,080 55	77,649 45
Subgrant - DTR	55,304	0	55,304 00
Subgrant - other	0	0	0
In-kind Organizational Support	1,448,491	66,770 00	1,381,721 00
Total	\$4,608,491	\$1,963,671 21	\$2,644,819 79

ADMINISTRATIVE DATA

Country	KAZAKSTAN
Implementing Agency	AGENCY FOR INTERNATIONAL DEVELOPMENT
Contractor	AGRICULTURAL COOPERATIVE DEVELOPMENT INTERNATIONAL 50 F Street, N W , Suite 1100 Washington, D C 20001 Phone (202) 638-4661
Period of This Report	April 1995 - March 1996
AID Project Officer	MARK SMITH
Original Authorization	Cooperative Agreement CCN-0006-A-00-3072-00 dated MAY 6, 1993
Estimated Completion	MARCH 31, 1997
Life of Project	\$5,000,000
