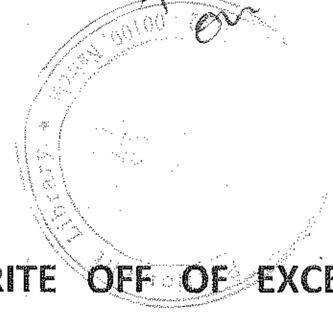
REPUBLIC OF KENYA

MINISTRY OF FINANCE



SESSIONAL PAPER NO. 12 OF 2012 ON WRITE OFF OF EXCESS GOVERNMENT OF KENYA DEBT OWED BY THE PUBLIC SECTOR OWNED SUGAR COMPANIES

1. The following information is laid before the National Assembly for consideration and approval.

2. Kenya's sugar sub-sector which supports over six million Kenyans and has a critical role in achieving Vision 2030 objectives is likely to collapse when the COMESA sugar safeguards lapse, in view of the sector's inability to compete effectively with sugar from other countries, unless radical urgent reforms are put in place to facilitate rehabilitation and expansion necessary to make the industry competitive. Problems currently affecting the sector's competitiveness adversely include:

   (a) Low productivity which is traceable to the whole cane and sugar production chain. This results in a vicious circle since the factories are unable to reinvest and operate efficiently and farmers are not paid on time making it difficult for them to invest adequately at farm level. It also results in poor factory maintenance and breakdowns at factory level and low quality sugar cane at farm level, culminating in poor sucrose content and recovery and low incomes for farmers.

(b) Poor state of infrastructure which contributes significantly to the high transport costs, currently accounting for up to 40% of cane production costs.

(c) Un-economical land sizes with farm units of two (2) to three (3) acres which restricts mechanization and makes it difficult to enjoy economies of scale enjoyed by many sugar producers as nearly 90% of sugar in the world is grown on large sugar plantations.

(d) Variable and low yields due to over-dependence on rain-fed sugarcane.

(e) Poor post-harvest management owing to delays in cane harvesting and milling, cane spillage and low processing efficiencies resulting in cane and sucrose losses as high as 50%.

(f) Weak research-extension-farmer linkages resulting in low adoption of modern technologies and continued planting of low yield cane varieties.

(g) Inadequate funding of the industry which manifests itself in obsolete factory mills, inefficient operations and delayed payments to farmers.

(h) Low crushing time efficiency (time in a year when factory is operating) due to use of very old machinery and equipment and in some cases shortage of sugar cane to be crashed.

(i) Policy inadequacies such as the price control regime with regard to which price adjustments were not always made on time to cushion the companies from increasing costs of production and financing without due regard to appropriate

leverage ratios and ability of the factories to service the debt.

(j) Poor Management of the Sugar Industry particularly in the areas of employment and procurement of uncompetitive goods and services. In many cases appointments for senior management were made without due regard to merit, qualifications, experience and appropriate skills in leadership.

(k) Over-employment and corresponding high wage bills that erode the resources that could have been utilized to reinvest in the factories to reduce financial stress for the companies.

(l) High levels of debt mainly attributed to the nature of financing most of which was in the form of debt, mismanagement, competition from imports, loss making operations and related liquidity problems which made it difficult to repay the debt and failed projects that left the companies (especially Nzoia Sugar Company) with huge debt burden without corresponding assets. The amounts owed to the Kenya Government and the Kenya Sugar Board are indicated in the table attached as Appendix 1 to this Paper.

(m) Involvement of sugar factories in non-core activities such as running of big football clubs and schools.

3. In its meeting held on 14th October 2010 the Cabinet considered recommendations submitted to it by the Deputy Prime Minister & Minister for Finance and the Minister for Agriculture on the measures necessary to make the sugar companies competitive by 2012 and approved the following recommendations:

(i) Expediting of the privatization of the five sugar companies to facilitate rehabilitation and expansion with a view to enhancing competitiveness of the industry prior to lapsing of the Common Market for Eastern and Southern Africa (COMESA) sugar safeguards in line with Government commitments in 2008 when the COMESA safeguards were extended that it would:

(a) Adopt a privatization plan and grant the necessary approval for the privatization of all remaining publicly owned sugar mills by November 2008;
(b) Undertake verifiable steps towards the privatization of the publicly owned mills by November 2009; and
(c) Adopt an energy policy aimed at promoting co-generation and other forms of bio-fuel energy production that will contribute to making the sugar sector more competitive.

(ii) Creation of financially viable sugar companies, able to access adequate cane, considering minimum viable size of area of 29,914 hectares required to supply cane to one factory. The minimum land size was arrived at by taking into account the breakeven crushing factory capacity required per annum, the average cane yield per hectare, cane maturity period and the planted cane area required to break even. Nzoia and South Nyanza Sugar Company which have a cane growing area of 49,862 hectares and 31,415 hectares, respectively to be retained as they are, Chemelil Sugar Company and Muhoroni Sugar Company which have cane growing areas of 18,437 hectares and 22,134 hectares, respectively to be merged to form one company with a total cane growing area of 40,571 hectares and decisions on the Miwani Sugar Company to be made once on-going court cases are determined.

(iii) Restructuring of the sugar Companies balance sheets as follows:

(a) Out of the total Kshs.41, 825,786,485 owed to GOK and Kenya Sugar Board by the five sugar companies, as at 31st March & 30th June 2009, Kshs.33,780,465,838, be written off as at that date to clear excess debt from the books of the companies with excess debt (debt in excess of assets) i.e. Nzoia Sugar Company, Muhoroni Sugar Company and Miwani Sugar Company. The Kshs.33.8 billion to be written off to be divided proportionally between GOK and Sugar Board based on the respective amounts owed.

(b) That out of the remaining Kshs.8,045,320,647 after the debt write off to clear the excess debt, as at 31st March and 30th June 2009, an additional Kshs.5,952,000,000, equivalent to the asset value of plant and machinery, be written off to facilitate reconstruction of the sugar mills (new plant and equipment) if entire change in existing technology is necessary to enhance the sector's competitiveness.

(c) That all the remaining GOK debt in Nzoia Sugar Company, as at 30th June 2009 and in SONY Sugar Company and Chemelil Sugar Company as at 31st March 2009 be converted to equity to reduce the debt burden to the companies. Liquidity in the companies to be created through issuing of new shares whose proceeds will be retained by the companies.

(d) That when converting the GOK loans to equity, at the time of conversion, the value of shares held by the

other existing shareholders remain as it was prior to write off of the GOK and Sugar Board debt.

(e) The remaining Sugar Board debt as at 31st March and 30th June 2009 be repaid once adequate liquidity has been created in the sugar companies and the payments to staff and the farmers have been concluded.

(f) All surplus funds attributed to GOK ownership, after payment of farmers and employees to be remitted to the Exchequer.

(g) Write off of tax penalties and interest estimated at Kshs. 4.0 billion as at 30th June 2009 and any additional interest and penalties that have accrued since then.

(iv) Regulation of Factory Zones to ensure financial viability and future sustainability of the sugar companies by clearly defining each factory zone prior to inviting final bids for the privatization transactions and ensuring that the zones are respected by all stakeholders.

(v) Formation of an Outgrowers and Employees Investment Trust through which the farmers and employees will buy all the shares set aside for them. The farmers and employees will be allowed to trade the shares among themselves.

(vi) Write off of land rates and related penalties amounting to Kshs 117,884,303 as at 30th June 2009 and additional rates and related penalties that have accrued since then to enable Nzoia Sugar Company to obtain title deeds for its nucleus estate.

(vii) Sale of 51% shareholding of each of the sugar companies to a strategic partner/s. This takes into account the fact that the farmers are unlikely to be able to pay for their shares at the time of sale and that the law prohibits sale of shares on credit hence the shares reserved for farmers will remain under Government warehousing. It also takes into account the fact that, any sale to the strategic partner that is less than 51% is likely to maintain the company as a state corporation making it difficult to attract a strategic partner.

(viii) Sale of 24% of the shares to Outgrowers and Employees Trust with a further 6% shareholding reserved for the Trust if the Government decides to sale its remaining shares at a later date. As the farmers are unlikely to mobilize adequate resources to buy the allotted shares immediately, the shares will continue to be held for them by the Government and released as and when the Trust is ready to buy. In this respect, a moratorium of three years is recommended during which the Trust will be able to buy the shares at the price at which they were sold to the strategic partner. After the moratorium period, the shares will be sold to the Trust at market price that will reflect the market valuation of the shares of the rehabilitated companies.

(ix) Retention by the Government of 25% of the sugar companies' shareholding which it may decide to sell later through an Initial Public Offer (IPO) or any other method determined at the time of sale to meet the sugar industry's and the country's strategic objectives. In a future sale, part of this shareholding will be reserved for farmers, depending on their ability to buy and the needs of the companies.

(x) Amendment of the Sugar Act to repeal the clause which requires that the Outgrowers should hold 51% of a privatized sugar company shareholding as well as appoint

51% of directors of the privatised companies. This provision could only be realistic if farmers were able to raise funds to purchase 51% of the current shareholding of the company and also mobilize at least 51% of the resources required for the rehabilitation and expansion of the factories. Investors are unlikely to invest the amount of resources required in the sugar companies unless they have control over the operational management decisions.

4. The National Assembly is requested to note the recommendations approved by the Cabinet to enhance the viability of the sugar companies and ensure their continued viability and to approve the write-off of the Government and Sugar Fund loans as follows:

   (i) Write off of Kshs. 1,536,783,331 and Kshs.1,400,221,630 due from Miwani Sugar Company to GOK and the Sugar Fund (as at 31st March 2009), respectively;

   (ii) Write off of Kshs. 6,103,989,745 and Kshs.2,048,226,132 due from Muhoroni Sugar Company to GOK and the Sugar Fund (as at 31st March 2009), respectively;

   (iii) Write off of Kshs.21,782,366,530 and Kshs.908,878,470 due from Nzoia Sugar Company Limited to GOK and the Sugar Fund (as at 30th June 2009), respectively;

   (iv) Write off of additional Kshs.5,952,000,000 as at 30th June 2009 to facilitate reconstruction of the sugar mills (new plant and equipment) if entire change in existing technology is necessary to enhance the sector's competitiveness as indicated below. This excludes Miwani and Muhoroni Sugar Companies as all the GOK

and Sugar Board debt would be written off as at 31st March and 30th June 2009 to clear the excess debt.

(a) Nzoia Sugar Company: Kshs. 3,052,000,000

(b) South Nyanza Sugar Company Limited: Kshs. 1,600,000,000; and

(c) Chemelil Sugar Company Limited: Kshs. 1,300,000,000

HON. NJERU GITHAE, EGH, MP
MINISTER FOR FINANCE

Appendix 1

(i) Kenya Government and Kenya Sugar Board Debts

Actual Debt	GoK Debt	KSB debt	Total
Miwani	1,536,783,331	1,400,221,630	**2,937,004,961**
Muhoroni	6,103,989,745	2,048,226,132	**8,152,215,877**
Nzoia	27,300,186,971	1,139,111,865	**28,439,298,836**
SONY	558,723,228	641,198,443	**1,199,921,671**
Chemelil	-	1,097,345,140	**1,097,345,140**
TOTAL	**35,499,683,275**	**6,326,103,210**	**41,825,786,485**

(ii) Excess Debt proposed for write off based on proportions of GoK and KSB debts

KShs '000s	GoK Debt (kshs.'000)	KSB debt(kshs.'000)	TOTAL(kshs.'000)
Miwani	1,536,783	1,400,222	2,937,005 (Total amount written off)
Muhoroni	6,103,990	2,048,226	8,152,216 (Total amount written off)
Nzoia	21,782,367	908,878	22,691,245
TOTAL	**29,423,140**	**4,357,326**	**33,780,466**