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By Hon Chris
Okeno on
20/12/2012
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KENYA NATIONAL ASSEMBLY

TENTH PARLIAMENT – FOURTH SESSION

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REPORT
OF THE

DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE
ON
PRIVATIZATION PROPOSALS OF THE FIVE PUBLIC SECTOR
OWNED/CONTROLLED SUGAR COMPANIES, THREE KENYA TOURIST
DEVELOPMENT CORPORATION (KTDC) OWNED HOTELS AND KENYA
WINE AGENCIES LIMITED (KWAL).

Clerks Chambers,
Parliament Buildings,
NAIROBI.

December, 2012

PREFACE

Mr. Speaker Sir,

The Finance, Planning & Trade is one of the Departmental Committees established under Standing Order 198 whose functions are:-

- a) to investigate, inquire into, and report on all matters relating to the mandate, management, activities, administration, operations and estimates of the assigned Ministries and Departments;
- b) to Study the programme and policy objectives on Ministries and Departments and the effectiveness of the implementation;
- c) to Study and review all legislation referred to it;
- d) to study, assess and analyze the relative success of the Ministries and departments as measured by the results obtained as compared with their stated objectives;
- e) to investigate and enquire into all matters relating to the assigned Ministries and departments as they may deem necessary, and as may be referred to them by the House or a Minister; and
- f) to make reports and recommendations to the House as often as possible, including recommendation of proposed legislation.

The subjects falling within the purview of the Departmental Committee on Finance, Planning and Trade are:-

- Public finance, Banking and Industry
- Insurance
- Population planning and National development
- Trade, Tourism promotion and Management
- Commerce and industry

Mr. Speaker Sir,

The membership of the Committee comprise of the following:-

- i. The Hon. Chrysanthus Okemo, M.P- **Chairman**
- ii. The Hon. (Prof) Phillip Kaloki, M.P- **Vice-Chairman**
- iii. The Hon. Jakoyo Midiwo, M.P
- iv. The Hon. Musikari Kombo, M.P
- v. The Hon. Lucas Chepkitony, M.P

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- vi. The Hon. Lenny Kivuti, M.P
- vii. The Hon. Nelson Gaichuhie, M.P
- viii. The Hon. Ntoitha M'Mithirau, M.P
- ix. The Hon. Ahmed Shabbir, M.P
- x. The Hon. Nkoidila Ole Larkas, M.P
- xi. The Hon. Sammy Mwaita, M.P

Mr. Speaker Sir,

On Wednesday, 29th November 2012, the Minister for Finance, the Hon. Robinson Githae , EGH, M.P. presented privatization proposals for different state owned entities to the Committee for approval as required under section 23(2) of the Privatization Act. These entities include:

- five sugar companies (Nzoia Sugar Company, South Nyanza Sugar Company, Chemelil sugar Company and both Miwani and Muhoroni Sugar Companies which are under receiverships);
- three hotel companies including the International Hotels Kenya Limited which owns the Intercontinental Hotel, the Kenya Hotel Properties which owns the Hilton and the Mountain Lodge Limited; and
- Kenya Wine Agencies Limited

Mr. Speaker Sir,

These privatization proposals had been approved by the cabinet in the year 2010 and first presented before the Committee in January 2011. At the time of first presentation of these proposals to the Committee by the Former Minister of Finance, the term of the privatization Commission had long expired. Therefore, the Committee could not proceed to consider the proposals in absence of the privatization commission.

As you may recall, the new privatization Commission was approved by the House in September 2012 and subsequently gazetted by the Minister for Finance in November 2012. This has therefore allowed the Committee to have a legally mandated institution to engage in so far as the presented privatization proposals are concerned.

Mr. Speaker Sir,

In arriving at its conclusion, the Committee examined the reports of the privatization proposals as presented by the Minister for Finance against the criteria set out in section 24 of the Privatization Act. While approving the privatization proposals of the Kenya Wine Agencies limited and the three international Hotels, the Committee further recommends that the privatization proposals of the sugar companies be postponed to such a time that all legislations affecting the Agricultural Sector (Sugar) and the County Governments have been passed.

Mr. Speaker,

On behalf of the departmental Committee on Finance, Planning & Trade, I have the honour and pleasure, to present the Committee's report and recommendations on Privatization proposals of the five Public Sector owned/controlled sugar companies, three hotels and Kenya Wine Agencies for the house's consideration and adoption. May I take this opportunity to thank all Members of the Committee for their input and valuable contributions during the deliberations of the matter.

Thank You

Hon. Chrysanthus Okemo, EGH, MP,
Chairman,
Departmental Committee of Finance, Planning & Trade

Signed:.....

Date:.....19/12/2012

EXECUTIVE SUMMARY

1. The Minister for Finance presented to the Committee reports of the privatization proposals and related restructuring measures approved by the Cabinet for consideration pursuant to section 23 of the privatization Act of 2005. These reports were:-
 - five sugar companies (Nzoia Sugar Company, South Nyanza Sugar Company, Chemelil sugar Company and both Miwani and Muhoroni Sugar Companies which are under receiverships);
 - three hotel companies including the International Hotels Kenya Limited which owns the Intercontinental Hotel, the Kenya Hotel Properties which owns the Hilton and the Mountain Lodge Limited; and
 - Kenya Wine Agencies Limited
2. In approving each of the detailed proposals the Cabinet considered the information submitted to it in line with Section 24 of the Privatization Act that includes:-
 - the purpose of the establishment and existence of each of the companies;
 - the extent to which the purpose of establishing each of the companies has been met including inadequacies in meeting that purpose;
 - the rights and other entitlements and resources that have been provided to meet the purpose;
 - recommendations for continuing to meet the purpose;
 - the financial position of each of the companies;
 - the recommended method of privatization;
 - the cost of implementing the proposed privatization;
 - recommendations for dealing with the employees directly affected by the proposed privatization, including any benefits they might be owed;
 - the benefits to be gained from the proposed privatization;
 - a work plan for the proposed privatization;
 - information regarding any written law, the repeal, amendment or enactment of which will be necessary for the proposed privatization to be carried out; and

- proposals on how Kenyans are to be encouraged to participate in the Transaction.
3. Prior to preparation of the detailed proposals, the inaugural privatization Commission had hired services of financial, legal, technical, valuation and other experts through open competitive procurement processes who carried out detailed due diligence work and assisted the Commission in analyzing the best options that meet the needs of each of the companies and the sectors as well as the desired national objectives outlined under Section 18(2) of the of the privatization Act.
 4. Each of the companies under discussion requires urgent intervention and may not be able to survive for a longer period. For instance,
 - The sugar companies continue to labour under excess debt and are unable to invest and compete with sugar imports from COMESA region and other countries, making it difficult for them to survive once the tariff and quota protection that constitute the COMESA safeguards are removed. The COMESA safeguards which expired in March 2012 but were extended for a further period of two years to protect the companies from collapsing sought to provide the companies with more time to rehabilitate and modernize their factories to make them more competitive before the safeguards expire. The latest extension which is likely to be the last was granted on account of progress made as the Government had approved the privatization of the sugar companies in October 2010. Kenya has almost lost one year since the two years extension was granted hence the need to expedite the privatization to avoid collapsing of the companies which would affect the livelihood of the Kenyans in the sugar growing areas adversely.
 - While noting the urgent measures needed to save these sugar companies, the Committee recommends that privatization proposals of the sugar companies be postponed to such a time that all legislations affecting the Agricultural Sector (Sugar) and the County Governments have been passed.

- The three hotels approved for privatization have deteriorated beyond the standards set by the brands under which they operate, creating doubt on the continued operation under the same brands which would lead to significant loss of international brands that have over the years contributed significantly to the country's tourism industry and business traveling the country.
 - Recently, Kenya Wine Agencies went to court to prevent Distel of South Africa whose products account for about 75% of KWAL's business from transferring their products to their local subsidiary on account of delayed privatization that would have Distel participate more actively in KWAL's business as shareholders.
5. The preparatory work on these transactions was prioritized by the Privatization Commission in 2008 and 2009 to allow for necessary intervention. In the absence of the intervention, the performance of these institutions continues to deteriorate and their future is exposed to many uncertainties.
6. The Committee therefore concurs with the Cabinet and recommends that the House approves Privatization Proposals of the five Public Sector owned/controlled sugar companies, Kenya wine Agencies Limited and the three Hotels contained in the privatization reports.

PRIVATIZATION PROPOSALS OF THE PUBLIC SECTOR OWNED/CONTROLLED SUGAR COMPANIES.

1. The inaugural privatization programme under the Privatization Act 2005, which consists of the list of Government enterprises to be considered for privatization, was approved by the Cabinet in December 2008 and subsequently gazetted by the Minister for Finance on 14th August 2009.
2. Under the Privatization Act 2005, following the approval of the list, the Privatization Commission was required to prepare a detailed privatization proposal for each enterprise on the list for consideration and approval by the Cabinet. Section 24 of the Act requires that among other things, each specific proposal should set out the objective of establishing the asset, its performance and how the service being provided by the asset will continue to be met; the financial position of the asset; the recommended method of privatization and timetable for implementing the transaction; the laws if any required to be amended, repealed or enacted to facilitate implementation of the transaction; recommendations for dealing with employees directly affected by the proposed transaction; the benefits to be gained from the privatised transaction; and how Kenyans are going to be encouraged to participate in the transaction.
3. At its meeting held on 14th October 2010, Cabinet considered and approved the detailed proposals (**annex 2**) on the privatization of the remaining Government owned/controlled sugar companies, which the Minister for Finance had submitted to the Cabinet jointly with the Minister for Agriculture.
4. Approval was in this connection granted for privatization of Chemelil Sugar Company Ltd, South Nyanza Sugar Company Ltd, Nzoia Sugar Company Ltd, Miwani Sugar Company Ltd (In-Receivership) and Muhoroni Sugar Company Ltd (In- Receivership).
5. The approved sugar companies for privatization have been facing the following challenges:
 - a. High production cost
 - b. Mismanagement
 - c. Heavy indebtedness (a total of Khs. **59,009,884,485** as at December, 2010)

- d. Weak research extension
- e. Variable and low yield
- f. Poor infrastructure and
- g. Inadequate funding among others

6. To address the above challenges, the Cabinet approved detailed measures that were to be done on these sugar Companies (**Annex 2**). Which included among others:

- (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 February 2012.
- (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.

Proposed Merging of Existing Sugar Zones to realize the required land size

Factory	Assumed Total Area Available before merger	Assumed Total Area Available after merger
Chemelil Sugar Company	18,437	40,571
Muhoroni Sugar Company	22134	
Miwani Sugar Company	9,143	9,143
Nzoia Sugar Company	49,862	49,862
Sony Sugar Company	31,415	31,415
Total	130,991	130,991

(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, Kshs.33,780,465,838, to be written off 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, 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, SONY Sugar Company and Chemelil Sugar Company 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 to 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 currently estimated at Kshs. 4.0 billion.

- (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 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 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. The required resources to acquire the shares of the companies and also to rehabilitate and modernize them are as follows:

Required amounts to buy and rehabilitate the factories

Kshs Billions	Existing Assets*	Rehabilitation	Expansion	Agriculture	Total
Chemelil	3.6	0	6.1	0.7	10.4
Muhoroni	3.3	0	4.6	0.6	8.5
Miwani	1.8	0	0	0	1.8
Nzoia	6.1	0.9	14.6	1.4	23
SONY	4.5	0.9	8.6	0.7	14.7
Total	19.3	1.8	33.9	3.4	58.4

- (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 privatized companies. If the Act remained, farmers would not raise the amount required.
- (xi) While noting the urgent measures needed to save these sugar companies, the Committee recommends that privatization proposals of the sugar companies be postponed to such a time that all legislations affecting the Agricultural Sector (Sugar) and the County Governments have been passed.

PRIVATIZATION PROPOSALS FOR SHARES HELD BY THE INDUSTRIAL DEVELOPMENT COMPANY (ICDC) IN THE KENYA WINE AGENCIES LIMITED

Background Information

The Company, whose name was changed to KWA Holdings E.A. Limited in 1999, was established in 1969 as a joint venture company between the ICDC and private sector investors and is jointly owned by ICDC (72.65%), Centum Investment Company Limited (26.43%) and other investors (0.92%).

Its business initially involved bottling and distribution of wines from a number of overseas principals under license. Over the years, the Company has grown and diversified its operations to include homegrown brand (papaya wine); establishment of stations for papaya juice, honey and grape production; launch of additional local brands (Hunters Choice whisky, Simba cane and Kibao vodka); establishment of Diplomatic Duty Free Shops; and establishment of duty free outlets in Rwanda and at Jomo Kenyatta and Moi International Airports among other operations.

KWAL and Distell company of South Africa have a contractual relationship is governed by a Production, bottling and distributorship agreement which provides for exclusive distributorship rights for twenty six (26%) Distell products and production rights for which KWAL pays Distell a royalty per litre of the products sold (currently at US\$1.10 per litre). The agreement also allows KWAL to distribute the products covered by the agreement in Uganda, Rwanda and Burundi.

In September this year, Distell issued a notice to withdraw its products from KWAL. This was forestalled through negotiations with the Government through which Distell extended the distributorship agreement up to February 2012 or until negotiations are concluded, if the negotiations will have started by then.

KWAL's survival is also threatened by the very nature of the global wines and spirits markets whereby large players transcend continents specializing in wines or spirits; and its limited success in developing own brands. Its local brands, for example account for around 25% of its sales while its initiative to promote use of local materials has not

yielded significant contribution. Marigat processing factory was closed in 2004 due to inadequate supply of fruits while Yatta Vineyards Limited which has a total acreage of 250 acres has only 30 acres under grapes and has been unable to breakeven over the years.

KWAL continues to depend on Distell's brands such that the withdrawal of Distell's brands would lead to immediate loss of 70% of KWAL's business, hence the need for KWAL to negotiate long-term arrangements with Distell for the continued production, bottling and distributorship for its products.

Privatization proposal

On 17TH November 2011, the Cabinet considered a detailed privatization proposal (ANNEX 3) prepared by the Privatization Commission, which the then Minister for Finance jointly submitted with the Minister for Trade, and approved privatization of shares held by the Industrial and Commercial Development Company (ICDC) as follows:

- (i) Phase 1: Sale of 26% shareholding to Distell through a market driven process where Distell will sign a long term supply agreement with KWAL for the company to have exclusive rights for sale of Distell products in Kenya and the region. Sale of 4% shareholding to KWAL employees at a market driven price through an Employee Share Ownership Plan (ESOP).
- (ii) Phase 2: Sale of the balance of the ICDC shares to be done within 2 to 4 years once value of the remaining shares has improved. This is to be done through institutional investor(s), public tender or initial public offer.

These urgent measures are needed to save the Company from collapsing.

PRIVATIZATION PROPOSALS FOR THE KENYA TOURISM DEVELOPMENT CORPORATION (KTDC) SHARES IN INTERNATIONAL HOTELS LIMITED, KENYA HOTELS PROPERTIES LIMITED AND MOUNTAIN LODGE LIMITED

Background Information

1. The Government has in the past played an active investment role in the tourism sector through the Kenya Tourist Development Corporation (KTDC), a wholly owned Government Development Finance Institution (DFI) through which (in partnership with other investors and also through loans) the Government made significant investments in the sector. In the first phase of the privatization programme the Government divested from some of these investments including Sirikwa Hotels (21%), Tea Hotel – Kericho (60%), Panafric Hotel (31%) , Robinson Baobao Hotel (10%), Embu Hotel (29%), Lion Hill Camp (30%), Milimani Hotel (49.12%) and Homa Bay Hotel Ltd. (99%).
2. The remaining KTDC investments include ownership of 63% of the Kenya Safari Lodges and Hotels Limited (KSLH) which owns Mombasa Beach Hotel, Voi Safari Lodge and Ngulia safari Lodge; 40.57% of the International Hotels (K) Limited which owns Hilton Hotel; 33.83% of Kenya Hotel Properties Limited which owns the InterContinental Hotel; 98% of the Kabarnet Hotel in Kabarnet Town; 95.4% of Sunset Hotel, Kisumu; 80% of the Golf Hotel in Kakamega Town; 39.11% of Mountain Lodge which is located in Mt. Kenya National Park; 72% of Mount Elgon Lodge, next to Mt. Elgon National Park; 5.64% of the Ark Limited which owns the Aberdare Country Club and the Ark Tree Lodge in the Aberdare National Park; 42% of the Buffalo Springs Lodges with regard to which there is a dispute following Isiolo County Council's failure to renew the land lease when it expired in December 2007, after which the Council leased the land and hotel to a private entrepreneur; and 9% of the Maralal Safari Lodge located in Isiolo District in the Maralal Game Sanctuary.
3. While the hotels managed by the internationally recognized hotel chains including the Hilton, the Intercontinental and the Serena Group Lodge have remained mainly in good condition, providing high quality services, this is not the same for the KTDC majority owned and managed hotels most of which have been run down over the years and continue to struggle financially as they try to maintain their clientele by

offering lower charges than competing hotels while attempting to provide similar services.

Privatization proposals

4. At its meeting held on 18th August 2011, the Cabinet considered and approved the privatization proposals (annex 4) of the three hotel companies.
5. Approval was granted for sale of KTDC's shareholding in the International Hotels Limited (Hilton):40.57%; the Kenya Hotels Properties Limited (Inter Continental Hotel): 33.83% and the Mountain Lodge Limited: 39.11% to existing shareholders through pre-emptive rights, with the shares sold at a price to be determined after independent valuation of these hotels. This decision recognizes the rights of the other shareholders in line with Section 28 of the Privatization Act which requires that all privatizations be conducted in an open and competitive way, subject to any pre-existing legal rights.
6. Details of the three hotels approved for privatization by the Cabinet are as follows:-
 - **International Hotels Kenya Limited – Hilton Hotel:** Hilton Hotel is owned by the International Hotels Kenya Limited (IHL) which is jointly owned by the Hilton Group of Hotels (59.42%) and KTDC (40.57%). It has 287 rooms: 45 twins, 186 doubles, 7 suites, 22 pool rooms and 27 executive rooms. There has been no major refurbishment on the property since 1996 hence the hotel is generally worn out. Included in the Property plant and equipment as at 30th June 2009 are assets with cost of Kshs.1,023,032,000 that are fully depreciated.
 - **Kenya Hotels Properties Limited – Hotel Inter Continental:** Located in Nairobi City Centre, the hotel is owned by the Kenya Hotels Properties Limited which is owned by KTDC (33.83%) and other shareholders that include Intercontinental Hotels Corporation Limited (33.83%), Sovereign Trust Ltd (19.38%), DBK (12.99%) and others with less than 1% (Joshua Kulei, Roger Kacou, and Ahmed Jibril). The rooms in the hotel consist of, presidential suite; deluxe rooms- 91 queen rooms; 39 twin rooms; 47 king rooms; 2 executive suites; 29 extended king rooms; 5 junior suites; 131

superior rooms; 20 standard rooms and 24 twin rooms. In total, the hotel has 389 rooms. In addition, there is an apartment for the General Manager, Resident Manager, Crew Lounge and club lounge bringing the total hotel rooms to 423 rooms. The level of current borrowing is very high vis a vis non-current borrowing. Similarly, the current ratio has been increasing over time. High level of current borrowing implies that the business may have difficulties servicing its short term obligations.

- **Mountain Lodge limited:** The hotel was established in 1967 and is located in Mt. Kenya National Park on lease from KWS which will expire on 30th June 2036. It is owned by KTDC 39.11%; TPS (Serena) 29.91%; and 13 other individual shareholders own a total of 30.98%.

Rationale for privatization

7. The three properties are overdue for major refurbishment which, due to the current financial leverage can only be financed through equity injection. While awaiting privatization, KTDC has over a number of years, convinced the other shareholders to keep the refurbishment on hold as a result of its fears that its shareholding would be diluted to insignificant proportions, prior to privatization, given that it does not have adequate resources to contribute its share of the additional equity investment. The partners in each of these investments have of late indicated that they cannot wait longer as the hotels have deteriorated far below their international brand standards.
8. In order to exploit the growth opportunity in the tourism sector, one of the challenges that will be addressed is increased hotel/bed capacity. With the recent increase in tourist arrivals, the bed occupancy levels during the peak season are close to full capacity (92 per cent). As a result, hotels and lodges are struggling to cope with rapid growth in demand due to limited investment in tourist accommodation in the last decade. As a lead investor in hotels, KTDC would utilize privatization proceeds to participate in further developments through equity and debt financing.

9. The privatization of the hotels would also contribute to the Vision 2030 goals through mobilization of resources to enable KTDC to rehabilitate and modernize its existing facilities. This would increase their bed capacity, upgrade their facilities and ensure competitiveness and financial sustainability.

10. As fully branded hotels with majority private sector control, the participation, contribution and control of KTDC as a development finance institution remains minimal. In addition, continued shareholding by KTDC in these hotels is not consistent with its mandate as a development finance institution with regard to which it is supposed to invest in new development projects and divest from them when they mature so as to release the funds to invest in new ones. This takes into account the fact that the capacity which is already developed continues to serve the country's need while its absence from the development arena slows down growth.

COMMITTEE'S RECOMMENDATIONS

The committee recommends that:

- a. Pursuant to section 23(2) of the privatization Act, the House approves this report on the privatization proposals of the following entities:-
 - I. Three Hotel Companies (International Hotels Kenya Limited, the Kenya Hotel properties Limited and the Mountain Lodge Limited); and
 - II. The Kenya Wine Agencies Limited (KWAL)

- b. The privatization proposals for the five public owned/controlled sugar companies (Nzoia, South Nyanza, Chemilil, Miwani and Mohoroni Sugar Companies) should be postponed till such a time when all legislation affecting the Agricultural Sector (sugar) and the County Governments have been put in place.

MINUTES OF THE FORTY FIRST SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON WEDNESDAY 19TH DECEMBER, 2012 IN THE COMMITTEE ROOM, 5TH FLOOR, CONTINENTAL BUILDING AT 10.30 A.M.

PRESENT

Hon Chrysanthus Okemo, EGH, M.P. (Chairman)
Hon. (Prof.) Philip Kaloki, M.P. (Vice Chairman)
Hon. Ntoitha M'Mithiaru, M.P.
Hon. Nelson Gaichuhie, M.P.
Hon. Ahmed Shakeel Shabbir, M.P.
Hon. Sammy Mwaita, M.P.

ABSENT WITH APOLOGIES

Hon. Lenny Kivuti, M.P.
Hon. Nkoidila Ole Lankas, M.P.
Hon. Jakoyo Midiwo MGH, MP.
Hon. Musikari Kombo, EGH, M.P.
Hon. Lucas Chepkitony, M.P.

INATTENDANCE

KENYA NATIONAL ASSEMBLY

Mr. Evans Oanda - Third Clerk assistant
Mr. Denis Dindi - Office Attendant

MIN.NO. 168/2012: CONFIRMATION OF MINUTES

Minutes of the thirty seventh sitting of the Committee held Wednesday 28th November, 2012 were confirmed by the Members present as a true recording after being proposed by Hon. Ahmed Shakeel Shabbir, MP and seconded by Hon. (Prof.) Philip Kaloki, MP.

Minutes of the fortieth sitting of the Committee held Thursday 13th December, 2012 were confirmed by the Members present as a true recording after being proposed by Hon. Nelson Gaichuhie, MP and seconded by Hon. Ntoitha M'Mithiaru, MP.

MIN.NO. 169/2012: ADOPTION OF THE COMMITTEE REPORT ON VETTING OF MR. FRANCIS WANGO'MBE KARIUKI

(NOMINEE) AS A DIRECTOR GENERAL IN THE
COMPETITION AUTHORITY OF KENYA.

The Committee unanimously adopted the report and asked the secretariat to prepare it for tabling.

MIN.NO. 170/2012: ADOPTION OF THE COMMITTEE REPORT ON
PRIVATIZATION PROPOSALS OF THE FIVE PUBLIC
SECTOR OWNED/CONTROLLED SUGAR
COMPANIES, THREE KENYA TOURISM
DEVELOPMENT CORPORATION (KTDC) OWNED
HOTELS AND KENYA WINE AGENCIES LIMITED
(KWAL).

The Committee unanimously adopted the report and asked the secretariat to prepare it for tabling.

MIN.NO. 171/2012: ADJOURNMENT

There being no other business, the Chairman adjourned the meeting at 11.30 A.M.

Signed.....
(Chairman)

Date.....
19/12/2012

MINUTES OF THE THIRTY SEVENTH SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON WEDNESDAY 28TH NOVEMBER, 2012 IN THE COMMITTEE ROOM, 2ND FLOOR, CONTINENTAL BUILDING AT 10.30 A.M.

PRESENT

Hon Chrysanthus Okemo, EGH, M.P. (Chairman)
Hon. (Prof.) Philip Kaloki, M.P. (Vice Chairman)
Hon. Ahmed Shakeel Shabbir, M.P.

ABSENT WITH APOLOGIES

Hon. Lenny Kivuti, M.P.
Hon. Nkoidila Ole Lankas, M.P.
Hon. Musikari Kombo, EGH, M.P.
Hon. Nelson Gaichuhie, M.P.
Hon. Lucas Chepkitony, M.P.
Hon. Ntoitha M'Mithiaru, M.P.
Hon. Jakoyo Midiwo MGH, MP.
Hon. Sammy Mwaita, M.P.

INATTENDANCE

MINISTRY OF FINANCE

Hon. Robinson Githae, EGH, M.P. Minister
Esther Koimet - Investment secretary
Solomon Kilungu - CEO (Privatization Commission)
Wyclife Etemesi - CFO (privatization Commission)
David Galuhia - Privatization Commission

KENYA NATIONAL ASSEMBLY

Mr. Evans Oanda - Third Clerk assistant
Mr. Denis Dindi - Office Attendant

MIN.NO. 156/2012: PRIVATIZATION PROPOSALS FOR PUBLIC OWNED/CONTROLLED SUGAR COMPANIES, THREE HOTEL COMPANIES AND KENYA WINE AGENCIES LIMITED (KWAL)

The Minister informed the Committee as follows:

1. He had detailed privatization proposals approved by the Cabinet for nine investments in the Privatization Programme. The reports were submitted by his predecessor at the Ministry of Finance to the Committee in line with the requirement under Section 23(2) of the Privatization Act that the

Minister shall present a report on the privatization proposals approved by the Cabinet to the relevant committee of Parliament.

2. These reports are with respect to the privatization strategies and related restructuring measures approved by the Cabinet for:
 - five sugar companies (Nzoia Sugar Company, South Nyanza Sugar Company, Chemelil sugar Company and both Miwani and Muhoroni Sugar Companies which are under receiverships);
 - three hotel companies including the International Hotels Kenya Limited which owns the Hilton Hotel, the Kenya Hotel Properties which owns the intercontinental and the Mountain Lodge Limited; and
 - Kenya Wine Agencies Limited
3. In approving each of the detailed proposals, the Cabinet considered the information submitted to it in line with Section 24 of the Privatization Act that includes:-
 - the purpose of the establishment and existence of each of the companies;
 - the extent to which the purpose of establishing each of the companies has been met including inadequacies in meeting that purpose;
 - the rights and other entitlements and resources that have been provided to meet the purpose;
 - recommendations for continuing to meet the purpose;
 - the financial position of each of the companies;
 - the recommended method of privatization;
 - the cost of implementing the proposed privatization;
 - recommendations for dealing with the employees directly affected by the proposed privatization, including any benefits they might be owed;
 - the benefits to be gained from the proposed privatization;
 - a work plan for the proposed privatization;

- information regarding any written law, the repeal, amendment or enactment of which will be necessary for the proposed privatization to be carried out; and
 - proposals on how Kenyans are to be encouraged to participate in the Transaction.
4. Prior to preparation of the detailed proposals, the Commission hired services of financial, legal, technical, valuation and other experts through open competitive procurement processes who carried out detailed due diligence work and assisted the Commission in analyzing the best options that meet the needs of each of the companies and the sectors as well as the desired national objectives outlined under Section 18(2) of the Act.
5. Each of the companies under discussion require urgent intervention and may not be able to survive for a longer period.
- The sugar companies continue to labour under excessive excess debt and are unable to invest and compete with sugar imports from COMESA region and other countries, making it difficult for them to survive once the tariff and quota protection that constitute the COMESA safeguards are removed. The COMESA safeguards which expired in March 2012 but were extended for a further period of two years to protect the companies from collapsing sought to provide the companies with more time to rehabilitate and modernize their factories to make them more competitive before the safeguards expire. The latest extension which is likely to be the last was granted on account of progress made as the Government had approved the privatization of the sugar companies in October 2010. Kenya has almost lost one year since the two years extension was granted hence the need to expedite the privatization to avoid collapsing of the companies which would affect the livelihood of the Kenyans in the sugar growing areas adversely.
 - The three hotels approved for privatization have deteriorated beyond the standards set by the brands under which they operate, creating doubt on the continued operation under the same brands which would lead to significant loss of international brands that have over the years contributed significantly to the country's tourism industry and business traveling the country.
 - Recently Kenya Wine Agencies went to court to prevent Distel of South Africa whose products account for about 75% of KWAL's business from transferring their products to their local subsidiary

on account of delayed privatization that would have Distel participate more actively in KWAL's business as shareholders.

6. The preparatory work on these transactions was prioritized by the Commission in 2008 and 2009 to allow for necessary intervention. In the absence of the intervention, the performance of these institutions continues to deteriorate and their future is exposed to many uncertainties.
7. Some of these strategies and restructuring measures were approved and submitted as early as 2010 and 2011 for parliamentary approval after due diligence findings had been done. If any material change in the same are identified, the Ministry will go back to the Cabinet and also come to the Committee to and report appropriately.
8. An update of the due diligence work carried out earlier will be undertaken as an input to the valuation that is required under the law and that the remaining activities will be carried out strictly under the process entrenched in the Privatization Act, enacted by Parliament in 2005 which was operationalized in 2008.

MIN.NO. 157/2012:

ADJOURNMENT

There being no other business, the Chairman adjourned the meeting at 12.04 P.M.

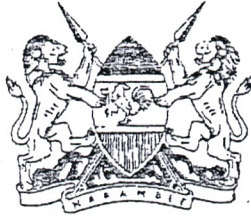
Signed.....
(Chairman)

Date.....

Annex

REPUBLIC OF KENYA

MINISTRY OF FINANCE



**REPORT BY THE MINISTER FOR FINANCE, TO THE FINANCE,
ADMINISTRATION AND PLANNING COMMITTEE OF
PARLIAMENT ON THE APPROVED DETAILED PRIVATIZATION
PROPOSAL FOR THE PUBLIC SECTOR OWNED/CONTROLLED
SUGAR COMPANIES (Nzoia Sugar Company, South Nyanza Sugar
Company, Chemelil Sugar Company, Muhoroni Sugar Company
and Miwani Sugar Company)**

NOVEMBER 2010

Sugar Companies indebtedness

Details	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
Sub - Total	35,499,683,275	6,326,103,210	41,825,786,485
Tax Arrears			10,851,078,000
Other Creditors			6,333,020,000
Total			59,009,884,485

- (v) Lapsing of the COMESA sugar safeguards would leave the sector in insurmountable difficulties:

When COMESA member states launched the Free Trade Area (FTA) on 31st October 2000, Kenya expressed concerns that her sugar sector would not be able to compete against sugar from other COMESA FTA countries and applied for protection of the sector by way of a safeguard under Article 61 of the COMESA Treaty. The safeguards were granted and extended a number of times. By February 2008, the sector was still not able to compete effectively because necessary measures had not been taken to improve its competitiveness. Kenya therefore requested for further extension of the safeguards. Under both the COMESA FTA and the World Trade Organization (WTO) the maximum protection period for industries is 10 years. In this connection, Kenya was granted the maximum period possible under both trade arrangements. The safeguards were then designed to lapse in March 2012

COMESA Sugar Safeguards

Year	Size of Quota, <i>in metric tones</i>	Tariff rate on above-quota imports, %
2008/09	220,000	100
2009/10	260,000	70
2010/11	300,000	40
2011/12	340,000	10
1st March 2012	No quota	0

Under this arrangement, Kenya committed itself to:-

- (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.
- (vi) Limited resources from the Exchequer which have in the past been availed in small amounts, only providing short term solutions.

The implication of the lapsing of the safeguards in 2012 is that the public sector owned sugar companies may not survive unless urgent and radical reforms are undertaken.

5. We urgently need to take measures that will effectively address problems currently affecting the sector's performance, competitiveness and sustainability adversely. The problems 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.

III. APPROVED RECOMMENDATIONS

6. Measures proposed in the detailed proposal that have been approved by the Cabinet to deal with these problems include:
 - (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 February 2012.
 - (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. (Investors interested in either Chemelil or Muhoroni Sugar Companies will be required to bid for both. This will facilitate an ownership arrangement that allows for the two factories/zones merging).

Proposed Merging of Existing Sugar Zones

Factory	Assumed Total Area Available before merger	Assumed Total Area Available after merger
Chemelil Sugar Company	18,437	40,571
Muhoroni Sugar Company	22,134	
Miwani Sugar Company	9,143	9,143
Nzoia Sugar Company	49,862	49,862
Sony Sugar Company	31,415	31,415
Total	130,991	130,991

(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, Kshs.33,780,465,838, to be written off 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, 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

shares on credit hence the shares reserved for farmers will remain under Government warehousing. It also takes into account 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. The required resources to acquire the shares of the companies and also to rehabilitate and modernize them are as follows:

Required amounts to buy and rehabilitate the factories

Kshs Billions	Existing Assets*	Rehabilitation	Expansion	Agriculture	Total
Chemelil	3.6	0	6.1	07	10.4
Muhoroni	3.3	0	4.6	0.6	8.5
Miwani	1.8	0	0	0	1.8
Nzoia	6.1	0.9	14.6	1.4	23
SONY	4.5	0.9	8.6	0.7	14.7
Total	19.3	1.8	33.9	3.4	58.4

- (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 privatized companies. This provision would work well only if the 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.

IV. THE NATIONAL BENEFITS ACCRUING FROM THE PROPOSED PRIVATIZATION

7. The benefits to be accrued from the proposed privatization include:

- (i) Increased efficiency in the sector through private sector participation and introduction of new technologies.
- (ii) Improved competitiveness and increased sugar production to meet the domestic demand, saving Kenya substantial foreign exchange used in importing sugar.
- (iii) Improved performance of the sector will in turn increase incomes and improve standard of living for the population that relies on sugar cane as the main source of livelihood.
- (iv) A diversified Sugar Cane Industry that would expand to include co-generation and power alcohol production. Co-generated power could be fed into the National grid increasing the country's power supply and reducing the dependency on hydro-electricity. This may reduce the cost of power in the country and the general cost of doing business in Kenya. Power alcohol could be used to blend petrol or diesel resulting in reduced importation of petroleum products, saving Kenya foreign exchange.
- (v) Reduce the future reliance on public sector financing through participation of Strategic Investors who will provide future funding for the Companies. This

will enable the Companies to raise additional capital to support projected expansion and modernization, which in turn will create employment.

(vi) Raise resources to support the Government's budget through remission of surplus funds to the Treasury. The value of the Government shareholding is also expected to improve as the companies turn around.

(vii) Privatization of the sector and associated regulatory reforms will improve the business environment in Kenya by reducing conflicts between the public sector's regulatory and commercial roles.

V. TIME TABLE FOR IMPLEMENTING THE TRANSACTION AND DEALING WITH EMPLOYEES

8. The implementation of the privatization is expected to be completed within five to six months of clearance by Parliament as follows:

Implementation Timetable

Task	Expected Dates
Announcement of approved transaction	December
Prequalification of bidders - Request for Expressions of interest	December/January
Submission of Sessional Paper on write off of excess debt and amendments to Acts of Parliament to the Parliament	December- March
Completion of prequalification of bidders	January/February
Request for bids	March
Completion of Sale and Signing of Transaction Agreements with a strategic investor	April/May

Annex 3



REPUBLIC OF KENYA

**PRESENTATION TO THE FINANCE,
PLANNING AND TRADE COMMITTEE OF
PARLIAMENT BY THE DEPUTY PRIME
MINISTER AND MINISTER FOR FINANCE ON
PRIVATIZATION OF THE KENYA WINE
AGENCIES LIMITED (KWAL)**

DECEMBER 2011

1. Section 23(2) of the Privatization Act requires that I present before this Committee a report on the privatization proposals approved by the Cabinet.

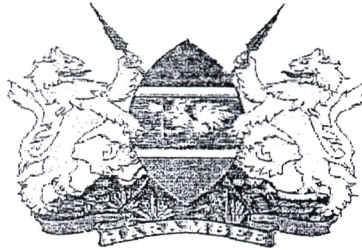
It is in this regard that I am presenting to you today a report on the approved detailed privatization proposal on KWAL which was approved by the Cabinet at its meeting held on 17th November 2011.

At that meeting, the Cabinet considered a detailed privatization proposal prepared by the Privatization Commission, which I jointly submitted with the Minister for Trade, and approved privatization of shares held by the Industrial and Commercial Development Company (ICDC) as follows:

- (i) Phase 1: Sale of 26% shareholding to Distell through a market driven process where Distell will sign a long term supply agreement with KWAL for the company to have exclusive rights for sale of Distell products in Kenya and the region.
- (ii) Still under phase 1, sale of 4% shareholding to KWAL employees at a market driven price through an Employee Share Ownership Plan (ESOP).
- (iii) Phase 2: Sale of the balance of the ICDC shares to be done within 2 to 4 years once value of the remaining shares has improved. This is to be done through

Annex 4

**REPUBLIC OF KENYA
OFFICE OF THE DEPUTY PRIME MINISTER AND
MINISTRY OF FINANCE**



**REPORT BY THE DEPUTY PRIME MINISTER AND
MINISTER FOR FINANCE, HON. UHURU KENYATTA,
EGH, MP., TO THE FINANCE, PLANNING AND TRADE
COMMITTEE ON THE APPROVED DETAILED
PRIVATIZATION PROPOSAL FOR THREE KENYA
TOURIST DEVELOPMENT CORPORATION (KTDC)
OWNED HOTELS**

AUGUST 2011

INTRODUCTION

1. The inaugural privatization programme under the Privatization Act 2005, which consists of the list of Government enterprises to be considered for privatization, was approved by the Cabinet in December 2008. Subsequently, I gazetted the list on 14th August 2009.
2. Under the Privatization Act 2005, following the approval of the list, the Privatization Commission is required to prepare a detailed privatization proposal for each enterprise on the list for consideration and approval by the Cabinet. Section 24 of the Act requires that among other things, each specific proposal should set out the objective of establishing the asset, its performance and how the service being provided by the asset will continue to be met; the financial position of the asset; the recommended method of privatization and timetable for implementing the transaction; the laws if any required to be amended, repealed or enacted to facilitate implementation of the transaction; recommendations for dealing with employees directly affected by the proposed transaction; the benefits to be gained from the privatization transaction; and how Kenyans will be encouraged to participate in the transaction.

3. At its meeting held on 18th August 2011, the Cabinet considered and approved the privatization of three hotel companies recommended for privatization in a detailed privatization proposal prepared by the Privatization Commission, which I submitted to the Cabinet jointly with the Minister for Tourism. Approval was in this connection granted for the privatization of Kenya Tourist Development Corporation's shares in the International Hotels Kenya Limited (Hilton Hotel, Nairobi); , Kenya Hotels Properties Limited (Intercontinental Hotel, Nairobi); and Mountain Lodge Limited.

4. Under Section 23(2) of the Privatization Act 2005, I am required to present to the relevant Committee of Parliament (Finance, Planning and Trade Committee) a report on the specific privatization proposals approved by the Cabinet. While the timing of the presentation is not indicated in the Act, I consider it necessary to present the report at an early stage so that, the Committee is adequately briefed as we commence the implementation stage.

BACKGROUND INFORMATION

5. Under Vision 2030, which is Kenya's strategy for accelerating transformation of the country into a rapidly industrialized middle income nation by 2030, tourism has been identified as one of the six priority sectors that promise to raise GDP growth rate to the region of 10 percent. This strategy is

premised on the existing potential and the current contribution of the sector to the economy with regard to which tourism currently accounts for close to 10 percent of the country's GDP and 9 per cent of total formal employment and remains the country's leading earner of foreign exchange.

6. A major target of the strategy is to attain the top ten long-haul destination status by addressing constraints facing the sector and implementing strategic projects to improve the quality and breadth of the tourism offerings and creating an environment where tourists spent more per visit. Some of the constraints to be addressed include both real and perceived insecurity, poor roads in key resorts and inadequate availability of high quality facilities and services as only 18 percent of Kenyan hotels are in 4 – 5 star categories which is significantly lower than the average of 40 percent in competing long-haul destinations such as South Africa.
7. Some of the flagship projects and development initiatives that have been identified under Vision 2030 to achieve these goals are as follows:-
 - (a) Attracting new investments as well as new hotels with emphasis on 4 – 5 star hotels;
 - (b) Construction of two resort cities;
 - (c) Promoting Kenya as an international tourist destination with a unique coastline;

- (d) Development of segments along the coast that are currently underutilized with expansion and improvement of quality in the existing projects;
- (e) Improving the quality of premium safari parks and opening resorts in underutilized parks;
- (f) Increasing conference and business tourism through investment in existing hotels facilities and upgrading of facilities;
- (g) Nurturing and expanding high value niche products such as cultural tourism, eco-tourism and sports tourism;
- (h) Developing eco-tourism sites in Kakamega forest, Ruma National Park, Mt. Elgon and Mt. Kenya regions;
- (i) Facilitating water based tourism by developing additional bed capacity at lake Victoria and Ruma National Park;
- (j) Exploiting underutilized parks by increasing safari bed-nights by at least 50%; and
- (k) Tripling the number of bed-nights in nascent niche nights.

8. In order to achieve these goals, the Government will work with the private sector which is expected to provide most of the additional bed capacity by investing and operating tourism related businesses while the Government will mainly

provide the infrastructure, security, promotional and developmental services.

9. In the past, the Government played an active investment role in the sector through the Kenya Tourist Development Corporation (KTDC), a wholly owned Government Development Finance Institution (DFI) through which (in partnership with other investors and also through loans) the Government made significant investments in the sector. In the first phase of the privatization programme the Government divested from some of these investments including Sirikwa Hotels (21%), Tea Hotel – Kericho (60%), Panafric Hotel (31%) , Robinson Baobao Hotel (10%), Embu Hotel (29%), Lion Hill Camp (30%), Milimani Hotel (49.12%) and Horna Bay Hotel Ltd. (99%).

10. The remaining KTDC investments include ownership of 63% of the Kenya Safari Lodges and Hotels Limited (KSLH) which owns Mombasa Beach Hotel, Voi Safari Lodge and Ngulia safari Lodge; 40.57% of the International Hotels (K) Limited which owns Hilton Hotel; 33.83% of Kenya Hotel Properties Limited which owns the InterContinental Hotel; 98% of the Kabarnet Hotel in Kabarnet Town; 95.4% of Sunset Hotel, Kisumu; 80% of the Golf Hotel in Kakamega Town; 39.11% of Mountain Lodge which is located in Mt. Kenya National Park; 72% of Mount Elgon Lodge, next to Mt. Elgon National Park; 5.64% of the Ark Limited which owns the

Aberdare Country Club and the Ark Tree Lodge in the Aberdare National Park; 42% of the Buffalo Springs Lodges with regard to which there is a dispute following Isiolo County Council's failure to renew the land lease when it expired in December 2007, after which the Council leased the land and hotel to a private entrepreneur; and 9% of the Maralal Safari Lodge located in Isiolo District in the Maralal Game Sanctuary.

11. The direct participation in investments in the hotels, through KTDC is part of the country's deliberate initiatives to accelerate development and improve the standards of living of its people. Through these investments, the country sought to achieve the following objectives:

- (a) To invest in strategic projects on new tourist circuits where private enterprises were unwilling to underwrite the risks.
- (b) To support the Kenyanization programme by ensuring that through the Government, Kenyans were able to own and manage enterprises to the extent possible. At that time it was considered that no enough Kenyans had the resources and skills to undertake the risk of starting enterprises. Under this policy, the Government was also to take a share of equity in most sound new hotel projects and to insist on local participation in most projects even those undertaken primarily by foreigners.

(c) To complement private sector initiatives.

12. While the hotels managed by the internationally recognized hotel chains including the Hilton, the Intercontinental and the Serena Group Lodge have remained mainly in good condition, providing high quality services, this is not the same for the KTDC majority owned and managed hotels most of which have been run down over the years and continue to struggle financially as they try to maintain their clientele by offering lower charges than competing hotels while attempting to provide similar services. Partly the poor performance is attributed to:-

- Inability to complete all the facilities that were required to support the western circuit leading to poor hotel occupancy in the hotels in the region;
- Poor management following the collapse of the African Tours and Hotels which was managing the KTDC hotels.
- Inability of KTDC and the Government to sustain continuous flow of funds into the hotels as most of the funds injected into the hotels are eroded through losses.

13. Details of the three hotels approved for privatization by the Cabinet are as follows:-

- **International Hotels Kenya Limited – Hilton Hotel:**

Hilton Hotel is owned by the International Hotels Kenya Limited (IHL) which is jointly owned by the Hilton Group of Hotels (59.42%) and KTDC (40.57%). The hotel, which is build on a freehold land is leased to the Hilton Group and is build on a lend parcel next to Parliament building which has a lease expiring on 31st December 2019. The hotel has 287 rooms: 45 twins, 186 doubles, 7 suites, 22 pool rooms and 27 executive rooms. There has been no major refurbishment on the property since 1996 hence the hotel is generally worn out. Included in the Property plant and equipment as at 30th June 2009 are assets with cost of Kshs.1,023,032,000 that are fully depreciated.

- **Kenya Hotels Properties Limited – Hotel Inter**

Continental: Located in Nairobi City Centre, the hotel is owned by the Kenya Hotels Properties Limited which is owned by KTDC (33.83%) and other shareholders that include Intercontinental Hotels Corporation Limited (33.83%), Sovereign Trust Ltd (19.38%), DBK (12.99%) and others with less than 1% (Joshua Kulei, Roger Kacou, and Ahmed Jibril). The hotel was built in 1969 with additions in 1978, 1985 and 1990. The hotel is leased to

the InterContinental Hotels Corporation Limited (IHC). The land on which it stands has a 99 years lease from 15th April 1967. The rooms in the hotel consist of, presidential suite; deluxe rooms- 91 queen rooms; 39 twin rooms; 47 king rooms; 2 executive suites; 29 extended king rooms; 5 junior suites; 131 superior rooms; 20 standard rooms and 24 twin rooms. In total, the hotel has 389 rooms. In addition, there is an apartment for the General Manager, Resident Manager, Crew Lounge and club lounge bringing the total hotel rooms to 423 rooms. The level of current borrowing is very high vis a vis non-current borrowing. Similarly, the current ratio has been increasing over time. High level of current borrowing implies that the business may have difficulties servicing its short term obligations.

- **Mountain Lodge limited:** The hotel was established in 1967 and is located in Mt. Kenya National Park on lease from KWS which will expire on 30th June 2036. It is owned by KTDC 39.11%; TPS (Serena) 29.91%; and 13 other individual shareholders own a total of 30.98% as follows: Eliud Matu Wamae (8.26%), Josephine Michuki (7.29%), Karen Enterprises (5.91%), Arifu Holdings Limited (2.19%), Scotlink Limited (1.74%), Joyce Gathoni Wamae (1.38%), Jerusha Ruitiara (1.22%), Kikagi Limited (0.76%), Rachel Wangui Maranga (0.61%), Doris Wairimu Maranga (0.61%), Janet Mary Clarke (0.54%),

Benjamin Gethi (0.28%) and Waruhiu Itote (0.19%). Mountain Lodge has 42 rooms and is managed by TPS Serena.

RATIONALE FOR PRIVATIZATION

14. The three properties are overdue for major refurbishment which, due to the current financial leverage can only be financed through equity injection. While awaiting privatization, KTDC has over a number of years, convinced the other shareholders to keep the refurbishment on hold as a result of its fears that its shareholding would be diluted to insignificant proportions, prior to privatization, given that it does not have adequate resources to contribute its share of the additional equity investment. The partners in each of these investments have of late indicated that they cannot wait longer as the hotels have deteriorated far below their international brand standards.

15. In order to exploit the growth opportunity in the tourism sector, one of the challenges that will be addressed is increased hotel/bed capacity. With the recent increase in tourist arrivals, the bed occupancy levels during the peak season are close to full capacity (92 per cent). As a result, hotels and lodges are struggling to cope with rapid growth in demand due to limited investment in tourist accommodation in the last decade. As a lead investor in hotels, KTDC would

utilize privatization proceeds to participate in further developments through equity and debt financing.

16. The privatization of the hotels would also contribute to the Vision 2030 goals through mobilization of resources to enable KTDC to rehabilitate and modernize its existing facilities. This would increase their bed capacity, upgrade their facilities and ensure competitiveness and financial sustainability.

17. As fully branded hotels with majority private sector control, the participation, contribution and control of KTDC as a development finance institution remains minimal. In addition, continued shareholding by KTDC in these hotels is not consistent with its mandate as a development finance institution with regard to which it is supposed to invest in new development projects and divest from them when they mature so as to release the funds to invest in new ones. This takes into account the fact that the capacity which is already developed continues to serve the country's need while its absence from the development arena slows down growth.

18. At its meeting held on 18th August 2011, the Cabinet approved the sale of KTDC's shareholding in the International Hotels Limited (Hilton):40.57%; the Kenya Hotels Properties Limited (Inter Continental Hotel): 33.83% and the Mountain Lodge Limited: 39.11% to existing shareholders

through pre-emptive rights , with the shares sold at a price to be determined after independent valuation of these hotels. This decision recognizes the rights of the other shareholders in line with Section 28 of the Privatization Act which requires that all privatizations be conducted in an open and competitive way, subject to any pre-existing legal rights.

THE NATIONAL BENEFITS ACCRUING FROM THE PROPOSED PRIVATIZATION

19. The benefits to the economy will accrue directly from the sector as well as other sectors of the economy due to many linkages that Tourism Industry has with the other sectors. The specific benefits:

- Mobilization of long term capital to finance capacity expansion and modernization of the hotels' facilities;
- Increased tourist arrivals and earnings following the increase in bed capacity, the improvement in the facilities and services provided and diversification of town products;
- Creation of employment in the Tourism sector and other sectors of the economy;
- Increase in foreign exchange earnings;
- Continued placement of the three hotels under professional management enhancing both their quality of service and value to the shareholders;

- Recouping of KTDC's investment prior to further dilution by the other shareholders;
- Releasing of funds invested by KTDC in mature investments to enable it to invest in new development projects in line with its development finance mandate.

TIMETABLE FOR IMPLEMENTING THE TRANSACTION

20. The implementation of the privatization is expected to be completed in the next three to six months as follows:

Task	Expected Dates
Presentation to the Committee on Finance, Planning and Trade	September 2011
Announcement of approved transaction	September 2011
Business valuation of the hotels and other preparations for negotiations	October 2011/November 2011
Negotiations	November/December 2011
Completion of negotiations and signing of necessary agreements	December 2011/January 2012.

REPUBLIC OF KENYA

MINISTRY OF FINANCE



INTRODUCTORY REMARKS BY THE MINISTER FOR FINANCE - HON. NJERU GITHAE, EGH, MP TO THE FINANCE, PLANNING AND TRADE COMMITTEE OF PARLIAMENT ON REPORTS ON DETAILED PRIVATIZATION PROPOSALS APPROVED BY THE CABINET

1. Mr. Chairman: Before this committee we have three reports on detailed privatization proposals approved by the Cabinet for nine investments in the Privatization Programme. The reports were submitted by my predecessor at the Ministry of Finance for presentation to the Committee in line with the requirement under Section 23(2) of the Privatization Act that the Minister shall present a report on the privatization proposals approved by the Cabinet to the relevant committee of Parliament.
2. These reports Mr. Chairman are with respect to the privatization strategies and related restructuring measures approved by the Cabinet for:
 - five sugar companies (Nzoia Sugar Company, South Nyanza Sugar Company, Chemelil sugar Company and both Miwani and Muhoroni Sugar Companies which are under receiverships);

- three hotel companies including the International Hotels Kenya Limited which owns the Hilton Hotel, the Kenya Hotel Properties which owns the Hilton and the Mountain Lodge Limited; and
- Kenya Wine Agencies Limited

3. In approving each of the detailed proposals Mr. Chairman the Cabinet considered the information submitted to it in line with Section 24 of the Privatization Act that includes:-

- the purpose of the establishment and existence of each of the companies;
- the extent to which the purpose of establishing each of the companies has been met including inadequacies in meeting that purpose;
- the rights and other entitlements and resources that have been provided to meet the purpose;
- recommendations for continuing to meet the purpose;
- the financial position of each of the companies;
- the recommended method of privatization;
- the cost of implementing the proposed privatization;
- recommendations for dealing with the employees directly affected by the proposed privatization, including any benefits they might be owed;
- the benefits to be gained from the proposed privatization;
- a work plan for the proposed privatization;

- information regarding any written law, the repeal, amendment or enactment of which will be necessary for the proposed privatization to be carried out; and
 - proposals on how Kenyans are to be encouraged to participate in the Transaction.
4. Prior to preparation of the detailed proposals Mr. Chairman, the Commission hired services of financial, legal, technical, valuation and other experts through open competitive procurement processes who carried out detailed due diligence work and assisted the Commission in analyzing the best options that meet the needs of each of the companies and the sectors as well as the desired national objectives outlined under Section 18(2) of the Act.
5. As you will note from the presentations Mr. Chairman each of the companies under discussion require urgent intervention and may not be able to survive for a longer period.
- The sugar companies continue to labour under excessive excess debt and are unable to invest and competewith sugar imports from COMESA region and other countries, making it difficult for them to survive once the tariff and quota protection that constitute the COMESA safeguards are removed. The COMESA safeguards which expired in March 2012 but were extended for a further period of two years to protect the companies from collapsing sought to provide the companies with more time to rehabilitate and modernize

their factories to make them more competitive before the safeguards expire. The latest extension Mr. Chairman, which is likely to be the last, was granted on account of progress made as the Government had approved the privatization of the sugar companies in October 2010. We have almost lost one year since the two years extension was granted hence the need to expedite the privatization to avoid collapsing of the companies which would affect the livelihood of the Kenyans in the sugar growing areas adversely.

- The three hotels approved for privatization have deteriorated beyond the standards set by the brands under which they operate, creating doubt on the continued operation under the same brands which would lead to significant loss of international brands that have over the years contributed significantly to the country's tourism industry and business travel in the country.
- Recently you would have also noted court cases whereby the Kenya Wine Agencies went to court to prevent Distel of South Africa whose products account for about 75% of KWAL's business from transferring their products to their local subsidiary on account of delayed privatization that would have Distel participate more actively in KWAL's business as shareholders.

6. Chairman the preparatory work on these transactions was prioritized by the Commission in 2008 and 2009 to allow for

necessary intervention. In the absence of the intervention, the performance of these institutions continues to deteriorate and their future is exposed to many uncertainties.

7. We note Mr. Chairman that some of these strategies and restructuring measures were approved and submitted as early as 2010 and 2011 and assure this Committee that the due diligence findings that led to the policy recommendations and decisions before you remain the same. If any material change in the same are identified, we will go back to the Cabinet and also come to this Committee as necessary.

8. As we make each of the presentations, we further wish to assure this Committee that following approval, an update of the due diligence work carried out earlier will be undertaken as an input to the valuation that is required under the law and that the remaining activities will be carried out strictly under the process entrenched in the Privatization Act, enacted by Parliament in 2005 which was operationalized in 2008.