Summary of the Operation Performance Evaluation Review (February 2009)

The project

The European Bank for Reconstruction and Development’s (EBRD) Board approved the first loan operations for the company in June 2004. Prior to agreeing this loan operation, the Bank’s agribusiness team had been in dialogue with the company regarding strategy and the development of a possible Bank engagement. The facility totalled €12.4 million, of which two-thirds were allocated for capital expenditure. The remaining portion was earmarked for short-term financing; in this case, the purchase of sunflower seeds.

The upgrading focused on the company’s edible oil business. Following the sale of the sunflower oil business, both the Bank’s long-term loan and the working capital facility were repaid. In November 2005 the Bank’s Board approved new loan facilities totalling US$ 26 million (€20 million). US$ 16 million (€12.3 million) of this was allocated as a long-term loan for capital expenditure and US$ 10 million (€7.7 million) as a working capital facility.

Project rationale and relevance

The Bank viewed this operation as an excellent opportunity to work with a leading local food processing and production company. The company was seen as having the potential to develop from an entrepreneurial into an industrial enterprise. It had the unique opportunity to become a leading food products company in the region. This was expected to benefit local vegetable growers (backward linkages) through reliable and long-term purchasing arrangements.

Further perceived benefits included:

- increased competition through marketing its branded and high quality products in the local market
- strong demonstration effect through the company’s adoption of international accounting standards, clear contracting rules with local suppliers and highest international hygiene standards for production.

Project relevance is rated High. The project fits well with the Bank’s country strategy and is in line with the Agribusiness Operations Policy, whose first objective states: “to continue to finance the downstream food and drink sectors as an effective means to support upstream primary production.”

Achievement of objectives

Competitive position (Achieved)

The objective was to increase product ranges and maintain (or increase) market shares in the various product categories. The company has substantially increased the product range and continues to seek innovative packaging, which is seen as essential for maintaining and improving market share. In 2006 the company’s market share for ketchup was 26 per cent, which is just behind the market leader. For cooking sauces the company achieved 33 per cent and for tomato paste, its market share reached 48 per cent.

The latest figures for 2008 show that the market share for ketchup has increased to 29 per cent, for cooking sauces to 40 per cent and for tomato paste to 49 per cent in a market that has grown
in value during the past three years. The company is also diversifying into branded pasta combined with cooking sauces.

Financial performance (Achieved)

The objective was to increase sales levels and improve earnings before interest, tax, depreciation and amortisation (EBITDA) margins through product mix and expanded production facilities. The entrepreneurial approach by the founders has led to a continuation of changes and upgrades in the production facilities. This has increased capacity and, at times, made comparisons on a year-to-year basis more difficult to interpret. The main goal was to increase efficiency at all levels and to comprehensively modernise all facilities.

The new modern warehouse has been operating since June 2007 and has led to substantial efficiency gains and the possibility of staff reductions. The financial performance, especially during 2008, has substantially improved compared to 2007. At present the company is concentrating on further improving marketing efforts to maintain and improve market shares and margins.

Overall assessment

The Successful overall performance rating is based on the Evaluation Department’s (EvD) internal methodology, which takes into account transition impact, achievement of objectives, environmental impact, company and project performance, Bank handling of the project and investment performance.

Transition impact at the level of the industry and the economy as a whole can be described as follows: The company has achieved a good demonstration effect as it represents a successful restructuring of a formerly state-owned production unit. Strong impacts on the regional economy were achieved through actively cultivated backward linkages to local tomato suppliers. These linkages supported the production of increasing quantities of higher quality tomatoes through the use of international standards and technology.

The company increased cooperation with its key farmers by providing them technical assistance and support in order to enable them to improve standards of production with appropriate seedlings, planting, cultivation with drip irrigation systems and mechanical harvesting technology. As a strong competitor in the local market, the company has contributed to, among other things, product innovation and packaging innovation in the local food distribution market. Both competition and market expansion are rated as Excellent.

The company has established a dialogue with relevant authorities regarding sector framework. It has also contributed to skills transfer and training. EvD is of the view that the Bank could also have supported some of the broader framework development efforts with a well-targeted technical cooperation (TC) operation. The overall transition impact rating is Good.

In terms of new standards for business conduct, the company introduced:

- high standards for internal decision-making
- international accounting standards
- state-of-the-art management information systems.

Standards for business conduct are rated Good.
The environmental performance of the company is rated *Good*, and the extent of environmental change is rated as *Substantial*.

The project’s financial performance is rated *Satisfactory*. The project objectives have essentially been met and fulfilment of objectives is rated as *Satisfactory* at this stage. Assuming a continuation of the positive recent trends, it can be projected that, with a longer observation period, this rating could be improved to *Good*.

Bank handling is rated *Satisfactory*/*Good*. Whilst the banking team has continuously supported the company’s requirements, EvD is of the view that some further Bank efforts would have been desirable. These could have taken the form of a TC operation assisting the company in improving the efficiency of its main tomato producers. Such operations could have extended to wider framework improvements of the tomato-growing sector.

Investment performance is rated as *Satisfactory* due to the relatively moderate size of the loan facility and substantial staff monitoring and support requirements over an extended period of time.

**Bank handling**

The sponsors felt that the Bank’s team was generally supportive at crucial times in the company’s development. The company expressed the view that, at times, the performance reporting requirements seemed excessive and could have been complemented by more forward looking initiatives. The sponsor also indicated that at no time did the Bank’s team offer to facilitate a TC operation, which could have supported and increased the technical extension services to local tomato farmers.

The company had the impression that the EBRD financed the efficiency improvements but did not fully believe in seeing positive results in due course. This was particularly evident in the autumn of 2007 when most construction activities were completed and the company was inviting various potential equity investors for discussions.

The sponsor regretted the Bank’s wish to exit the loan at a time when the original majority shareholder had successfully been replaced by two experienced locally active equity funds. The change of majority ownership was an appropriate time to review the client relationship and consider profitability as well as additionality and transition impact of the Bank. Based on this review the decision was reached to terminate this loan operation.

**Main OPER issues and lessons learned**

*Equity versus loan operation with emerging local entrepreneurial company*

At the time of the first loan operation by the EBRD, the Bank was not ready to consider an equity stake given the entrepreneurial nature of the business. However, at the time of the equity placement in late 2007, the Bank could have considered a participation in the growing company. If not directly through the agribusiness team, such an engagement could have been realised through a private equity fund with Bank participation.

This could have ensured a more entrepreneurial involvement of the Bank’s nominee. It could also have guaranteed more regular active contact with the management team. The agribusiness team expressed concern with limited team resources in operations where time-intensive support
of an entrepreneurial group is required and where a continuous involvement through a board representative may be more appropriate.

**Lesson**
Monitoring costs may be a concern in small loan operations to an entrepreneurial food processing company. The selection of debt or equity product may need to consider the required monitoring resources and costs in addition to credit risk. Supporting an entrepreneurial local agribusiness company may be more effective by using an EBRD-supported equity/venture capital fund to ensure higher participation in business development through a nominee director in the board. This would require an equity stake, or a sub-debt involvement, and an appropriate mechanism to continue participating when the investment achieves returns.

**Strengthening of local primary production may require substantial funding**

Such strengthening should not rely on the company’s own resources but efforts should be made to assist in framework improvement for the broader sector. Over the last two years tomato production changed fundamentally from a traditionally manual production to a modern agro-industrial approach with around 100 hectares of cultivation per farmer as a minimum size.

In 2008 the company expected 100,000 tons of fresh tomatoes to be delivered. Due to rain patterns and shortages in soil preparation (no capacity with old tractors to achieve proper deep soil preparation and levelling), the actual deliveries amounted to only 35,000 tons. In order to increase security of supply and to provide an example of state of the art farming practices, the company decided to grow about 15 per cent of its tomato requirements on leased land of 1,200 hectares. The intention is to cultivate some 300 hectares annually using crop rotation and to establish benchmarks for productivity.

The initiative to grow its own tomatoes also demonstrates the importance of establishing a fully controlled and transparent benchmark to other growers. The transition from hand-harvested tomatoes to mechanical harvesting during the past three years has been an additional challenge for the tomato industry in the region. From the perspective of cost and yield, mechanical harvesting is a necessity but it requires an evenly ripe crop.

EvD is of the view that the agribusiness team missed an opportunity to get involved in backward linkages and the removal of obstacles/entry barriers in efficient tomato production. Agro-industrial type tomato farming (compared to earlier outdated handpicked tomato farming) is a very sophisticated industry that requires, among other things, special attention to:

- seedlings preparation
- land preparation with heavy tractors that are equipped with a Global Positioning System (GPS) and that are capable of deep ripping
- utilisation of drip irrigation (either over ground or below surface)
- mechanical planting of seedlings
- spraying
- mechanical harvesting.

This requires substantial management skills, know-how and capital.

**Lesson**
Processors of agricultural products may need Bank support for enhancing backward linkages. Technical assistance operations could facilitate the introduction of state-of-the-art technology and farming practices to primary production. This is triggered by the processor striving to reach
international productivity benchmarks at all levels, including at the level of its farmers supplying tomatoes and at the level of the tomato growing industry at large. Transition impact could be enhanced even further if such operations could be directed at a broader group of farmers and involve various processors.

**EBRD exit during significant improvements versus longer-term engagement to secure increased transition impact**

When the majority shareholder exited, the Bank’s agribusiness team decided to ask for immediate repayment of the loan. This decision was based on a loan provision that allowed for the termination of the loan in case of changes of majority shareholder. The decision seems to have been based on various assumptions. It was presumed, amongst other things, that the majority shareholder provided not just an equity investment but also a degree of safety to the EBRD through its involvement with senior management.

Other factors influencing the decision to terminate included the slower than expected progress of margin improvements during 2007 and the relatively limited size of the Bank facility. The EBRD’s exit forced the company to dedicate substantial efforts to secure an alternative loan provider prior to closing a new shareholder agreement. The new shareholders are private equity funds with substantial experience and reputation in the region. They also provide support via a board representative with comprehensive experience in consumer product marketing.

The Bank’s team felt inadequately informed about the replacement of the majority shareholder. It was told only after the negotiations with the new majority shareholders had been completed. The co-founders of the company think that information was provided as soon as it was viable during the negotiation stage. They also feel that the Bank’s dissatisfaction with the levels of communication put huge pressure on the company because refinancing became a “conditions precedent” in the sales and purchase agreement of the majority stake.

The company expressed an interest in exploring possible future business opportunities, especially linked to the requirements of the association of farmers and possibly other major tomato growers in the region. This may provide an opportunity for broadening the Bank’s support to encompass the important upgrading of the region’s tomato production industry.

**Lesson**

Lasting transition impact on an agricultural sub-sector may require a sequence of operations. Initial processor focus may need to be broadened in subsequent stages in order to have a lasting transition impact on the wider agricultural sub-sector (in this case, the tomato growing industry). A longer-term Bank engagement may be crucial in a fast changing industry since processor-induced changes in primary farming take time and require substantial working capital. Wider sector improvements could further enhance transition impacts.