



# Report and Recommendation of the President to the Board of Directors

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Project Number: 48901  
August 2014

Proposed Compulsory Convertible Debentures  
Investment, Loans, and Administration of Loans  
Akay Flavours & Aromatics Pvt Ltd  
SpiceRich Seasonings Pvt Ltd  
Akay Flavours & Aromatics (Cambodia) Pvt Ltd  
Spice Value Chain Development Project  
(India and Cambodia)

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Asian Development Bank



## CURRENCY EQUIVALENTS

(as of 14 June 2014)

|               |   |                        |
|---------------|---|------------------------|
| Currency unit | – | Indian rupee/s (Re/Rs) |
| Re1.00        | = | \$0.01695              |
| \$1.00        | = | Rs59.0                 |

## ABBREVIATIONS

|      |   |  |
|------|---|--|
| ADB  | – | Asian Development Bank                     |
| CCD  | – | compulsory convertible debenture           |
| CPS  | – | country partnership strategy               |
| ESMS | – | environmental and social management system |
| IEE  | – | initial environmental examination          |
| IPO  | – | initial public offering                    |
| PPCR | – | Pilot Program for Climate Resilience       |

## NOTES

- (i) The financial year (FY) of Akay Flavours & Aromatics Pvt Ltd and its affiliates ends on 31 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2014 ends on 31 March 2014.
- (ii) In this report, "\$" refers to US dollars.

|                         |   |
|-------------------------|---|
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## PROJECT AT A GLANCE

|  |   |  |                             |
|--|---|--|-----------------------------|
| <b>1. Basic Data</b>   |   | <b>Project Number:</b> 48901-014       |                             |
| <b>Project Name</b>  | Spice Value Chain Development   | <b>Department /Division</b>            | PSOD/PSIF1, PSOD/PSIF2      |
| <b>Country</b>   | REG   |  |                             |
| <b>2. Sector</b>   |   | <b>Subsector(s)</b>                    |                             |
| ✓ Agriculture, natural resources and rural development   | Agricultural production   | <b>ADB Financing (\$ million)</b>      |                             |
|  | Agro-industry, marketing, and trade   |  | 3.10                        |
|  |   | <b>Total</b>                           | <b>13.40</b>                |
|  |   |  | <b>16.50</b>                |
| <b>3. Strategic Agenda</b>   |   | <b>Climate Change Information</b>      |                             |
| Inclusive economic growth (IEG)  | Pillar 2: Access to economic opportunities, including jobs, made more inclusive | Adaptation (\$ million)                | 3.10                        |
| Environmentally sustainable growth (ESG)   | Eco-efficiency<br>Global and regional transboundary environmental concerns      | Climate Change impact on the Project   | Medium                      |
| <b>4. Drivers of Change</b>  |   | <b>Gender Equity and Mainstreaming</b> |                             |
| Knowledge solutions (KNS)  | Application and use of new knowledge solutions in key operational areas         | Effective gender mainstreaming (EGM)   | ✓                           |
| Partnerships (PAR)   | Commercial cofinancing<br>Private Sector<br>South-South partner                 |  |                             |
| Private sector development (PSD)   | Promotion of private sector investment  |  |                             |
| <b>5. Poverty Targeting</b>  |   | <b>Location Impact</b>                 |                             |
| Project directly targets poverty   | No  | Rural                                  | High                        |
|  |   | Urban                                  | Low                         |
| <b>6. Nonsovereign Operation Risk Rating</b>   |   |  |                             |
| <b>Obligor Name</b>  |   | <b>Implied Project Rating</b>          | <b>Final Project Rating</b> |
| Akay Flavours & Aromatics Private Limited  |   | NSO8                                   | NSO8                        |
| <b>7. Safeguard Categorization</b> <b>Environment:</b> B <b>Involuntary Resettlement:</b> C <b>Indigenous Peoples:</b> C |   |  |                             |
| <b>8. Financing</b>  |   |  |                             |
| <b>Modality and Sources</b>  |   | <b>Amount (\$ million)</b>             |                             |
| <b>ADB</b>   |   | <b>16.50</b>                           |                             |
| Nonsovereign LIBOR Based Loan: Ordinary capital resources  |   | 6.50                                   |                             |
| Nonsovereign Debt Security: Ordinary capital resources   |   | 10.00                                  |                             |
| <b>B-Loans</b>   |   | <b>0.00</b>                            |                             |
| None   |   | 0.00                                   |                             |
| <b>Official Cofinancing<sup>a</sup></b>  |   | <b>11.40</b>                           |                             |
| Local Commercial Banks   |   | 6.40                                   |                             |
| Strategic Climate Fund - PPCR  |   | 5.00                                   |                             |
| <b>Others<sup>b</sup></b>  |   | <b>1.10</b>                            |                             |
| <b>Total</b>   |   | <b>29.00</b>                           |                             |
| <b>9. Effective Development Cooperation</b>  |   |  |                             |
| Use of country procurement systems   |   | No                                     |                             |
| Use of country public financial management systems   |   | No                                     |                             |

<sup>a</sup> Concessional financing from external sources.

<sup>b</sup> Derived by deducting ADB financing, B Loans and Official Cofinancing from Project Total Cost.





## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed compulsory convertible debentures (CCD) investment of up to the equivalent of \$10,000,000 in Indian rupees to Akay Flavours & Aromatics Pvt Ltd; (ii) a proposed loan of up to \$1,500,000 to Akay Flavours & Aromatics Pvt Ltd; (iii) a proposed loan of up to \$2,000,000 to SpiceRich Seasonings Pvt Ltd; (iv) a proposed loan of up to \$3,000,000 to Akay Flavours & Aromatics (Cambodia) Pvt Ltd; and (v) proposed administration of loans of up to \$5,000,000, to be provided by the Asian Development Bank (ADB) Strategic Climate Fund,<sup>1</sup> to Akay Flavours & Aromatics (Cambodia) Pvt Ltd or a partner financial institution to be identified, for the Spice Value Chain Development Project in India and Cambodia.<sup>2</sup>

## II. THE PROJECT

### A. Project Identification and Description

#### 1. Project Identification

2. Akay Flavours & Aromatics Pvt Ltd (Akay Flavours) and its affiliates (together with Akay Flavours, Akay), a leading high-value spice producer and exporter from India, approached ADB in November 2013 to seek financial support for its expansion plans in India and Cambodia. Akay was found suitable for ADB assistance based on its solid operational and financial history, its experience working with smallholder farmers as contract farmers, and its commitment to comply with ADB's safeguard policies. Akay's proposed project will help address significant challenges in the agriculture sector in India and Cambodia by supporting the inclusion of smallholder farmers in the global spice value chain and thereby helping to lift them out of poverty, promoting climate-resilient farming technologies, and fostering regional cooperation between ADB's developing member countries.

3. Agricultural development is a key to eradicating poverty and creating conditions for sustainable and equitable growth in Asia, because more than 60% of the region's inhabitants rely on agriculture for their livelihoods (including 50% in India and 60% in Cambodia).<sup>3</sup> Agricultural investment has proven to be one of the most effective and lowest-cost strategies for reducing poverty and hunger;<sup>4</sup> investment to improve the efficiency of agricultural inputs—including land, water, power, and fertilizer—is also one of the most cost-effective climate change adaptation investments, with important climate change mitigation benefits.<sup>5</sup>

4. The private sector is expected to play a key role in developing the agriculture sector in ADB's developing member countries. In 2012, ADB's Independent Evaluation Department recommended that agriculture interventions be more market oriented through support to physical and institutional links to markets and agribusiness.<sup>6</sup> Through contract farming, agribusiness companies can link smallholder farmers to global markets, and at the same time promote farming technologies that are resilient to the potential future impacts of climate change.

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<sup>1</sup> Under the Pilot Program for Climate Resilience financed by the Strategic Climate Fund.

<sup>2</sup> Proposed CCD investment and loans will be provided in two phases.

<sup>3</sup> ADB. 2013. *Country Partnership Strategy: India, 2013–2017*. Manila; and ADB. 2011. *Country Partnership Strategy: Cambodia, 2011–2013*. Manila.

<sup>4</sup> Food and Agriculture Organization of the United Nations. 2012. *State of Food Insecurity in the World*. Rome.

<sup>5</sup> D. Lobell et al. 2013. *Climate Adaptation as Mitigation: The Case of Agricultural Investments*. Bristol.

<sup>6</sup> ADB. 2012. *2012 Annual Evaluation Review*. Manila.

5. India is the leading producer, consumer, and exporter of spices in the world, and produces 28% of the world's spices.<sup>7</sup> Historically a bulk spice commodity supplier, India is now becoming an exporter of high-value spice products to cater to changes in global demand. High-value spice segments include oleoresins, seasonings, sterilized spices, and nutraceuticals.<sup>8</sup> Demand for these products is expected to continue to grow at about 10% per year.<sup>9</sup> At the same time, spice farming in India remains dominated by smallholder farmers. This creates a challenge for high-value spice exporters, which need to ensure quality and reliability of supply. Most spices are channeled through unorganized intermediaries, and only a few companies such as Akay have been able to work directly with farmers to secure procurement of raw materials.<sup>10</sup>

6. Agriculture in Cambodia is also dominated by smallholder farmers. Rice farming still absorbs 90% of total cultivated land, albeit typically for subsistence farming, with very low yields.<sup>11</sup> There is a strong need to diversify agriculture, especially towards higher-value cash crops, including spices. Most Cambodian farmers lack experience in spice farming and access to productivity-enhancing inputs, such as seeds, irrigation, and other agricultural technologies; therefore, experienced and responsible agribusiness developers are needed to partner with smallholder farmers to take full advantage of the potential for high-value spice farming.

## 2. Project Design

7. The project will support Akay's investments across the spice value chain, from climate-resilient and inclusive farming models to processing and export of high-value spice products. The project will be developed in two phases. In phase 1, starting in FY2015 and with a total project cost of up to \$10.4 million, Akay will invest in the following subprojects:

- (i) **Sterilized spices (India).** In response to the global demand for sterilized ground spices, Akay has commissioned a new steam sterilization plant in Kerala. The company now needs to invest permanent working capital of up to \$3.5 million to expand production. This new business will help increase the quantity of spices sourced from contract farmers in India. Akay has been engaged in contract farming with approximately 3,000 chili farmers in Karnataka and Andhra Pradesh. Akay trains farmers in integrated crop management to improve both crop quality and yields, and then guarantees to purchase their produce. As of FY2014, Akay meets 35% of its raw material needs through contract farming.
- (ii) **Nutraceuticals (India).** Akay has been developing spice-based products that provide health benefits. The company has already filed six patents in India and three in the United States. To support the sales of both generic and patented nutraceuticals, the company will invest up to \$3.8 million to expand research and development activities and its existing nutraceuticals production plant in Kerala.
- (iii) **Organic farming (Cambodia).** With the objective of diversifying Akay's raw material supply base, Akay's sponsors purchased 717 hectares of underutilized farmland in the Battambang Province in FY2009 to build a model organic farm.<sup>12</sup> Investment of up to \$3.1 million is needed on the farm to (i) increase the capacity of rainwater harvesting infrastructure, (ii) introduce drip irrigation systems, (iii)

<sup>7</sup> Chili, turmeric, and cumin are the key spices being exported.

<sup>8</sup> Oleoresins are liquid preparations of resins and oils, obtained by extraction from plants. Oleoresins are used for processed food flavoring and coloring. Nutraceuticals are products derived from food that provide health benefits.

<sup>9</sup> Bharat Book Bureau. 2013. *India Spices Market Outlook to FY2018*. Mumbai.

<sup>10</sup> Rabobank. 2013. *Decoding Spices: India Emerging as a Global Processing Hub of Spices*. Mumbai (entire para.).

<sup>11</sup> ADB. 2011. *Country Partnership Strategy: Cambodia, 2011–2013*. Manila.

<sup>12</sup> World Bank and United Nations Conference on Trade and Development. 2014. *The Practice of Responsible Investment Principles in Larger-Scale Agricultural Investments*. Washington, DC. Box 6.1: "An Environmentally Sustainable Business Model" is about Akay's model farm (p. 43).

expand organic black pepper cultivation, and (iv) fund working capital. The farm is expected to meet 10% of Akay's total raw material needs by FY2018.

8. Phase 2 will begin after 31 March 2015, subject to satisfactory performance in Phase 1 implementation and ADB's Investment Committee endorsement. The total phase 2 project cost will be \$18.6 million, with Akay investing in the following subprojects:

- (i) **Seasonings (India).** Akay will invest up to \$5.4 million to develop a processing plant and a marketing and distribution network for seasonings products. Akay's seasonings products will primarily serve Indian clients. The new seasonings business along with the growth of other segments will support the expansion of contract farming in India to at least 6,000 farmers in FY2018, who are expected to provide 60% of Akay's total raw material needs during the same year.
- (ii) **Oleoresins (Cambodia).** Akay plans to develop an oleoresin extraction plant in Cambodia to process spices locally for export. The plant will be located in a special economic zone in either Phnom Penh or Sihanoukville. The plant's cost will be up to \$8.2 million. Raw spices will primarily be sourced from Akay's model farm in Battambang and from new contract farmers located around the farm.
- (iii) **Climate-resilient contract farming (Cambodia).** A concessional loan from the ADB Strategic Climate Fund is being sought to support implementation of the contract farming model in Cambodia.<sup>13</sup> Under a proposed credit facility of up to \$4.0 million, ADB will administer a loan to Akay, or a partner financial institution to be identified, and funds will be onlent to contract farmers around the farm to invest in climate-resilient farming technologies, including rainwater harvesting infrastructure and drip irrigation equipment.<sup>14</sup> The Strategic Climate Fund will also lend up to \$1.0 million to Akay to support similar investments on the model farm, which will be the training ground for the spice farmers. Akay is expected to reach out to 2,000 smallholder farmers by FY2018.

### 3. The Sponsor

9. Since its establishment in 1993, Akay has grown to one of the top five exporters of spice oleoresins in the world. It is headquartered in Cochin, Kerala and operates five processing plants in India with total capacity of 42,000 tons of raw material per year. It has a distribution network in 70 countries. Akay primarily exports to the United States, Europe, and the People's Republic of China. Exports constitute over 90% of its revenues.<sup>15</sup> The company has been consistently profitable over the past 3 years.

10. Akay is majority-owned by Alex Koshy, a Kerala-born entrepreneur. A. Koshy is not involved in the day-to-day management of the company, and Akay is run by a qualified management team led by the managing director (Balu Maliakel), who holds a doctorate in synthetic organic chemistry and has more than 20 years of experience in the spice industry. Akay's core values center on social development, job creation, gender empowerment, and sustainability, as it engages with a large number of low-income farmers. It has enabled a village

<sup>13</sup> Pilot Program for Climate Resilience Concept Note (accessible from the list of linked documents in Appendix 2)

<sup>14</sup> Farms in the Battambang region are typically rain fed for 7–8 months a year, with irrigation used during the 4–5 month dry season. Using drip irrigation from harvested rainwater, farmers will be able to irrigate throughout the year without extracting water from rivers, lakes, or groundwater reserves. This will deliver better crop yields, while protecting against future potential impacts of climate change (mainly drought-induced crop failures).

<sup>15</sup> All of Akay's products meet global quality standards and comply with relevant regulations. The company follows strong internal control and quality assurance procedures. Its products are compliant with the International Organization for Standardization ISO 9001:2000 standards, and Hazard Analysis and Critical Control Point certification from the British Standards Institution.

of about 8,000 people in Karnataka to become self-sufficient by promoting contract farming and building a spice extraction plant to create local employment. In Cambodia, Akay employs local villagers on the model farm (30 on a permanent basis, and 200 seasonally), and has rehabilitated a 50-kilometer section of a poorly maintained public road that provides improved access for the local population (footnote 12).

## **B. Development Impact, Outcome, and Outputs**

### **1. Impacts**

11. The project will help sustain high value-added agriculture growth in India and Cambodia. In India, the government targets an increase in the annual real growth rate of horticulture production (including spices) from 4.7% in FY2008–FY2013 to 5.0% in FY2013–FY2018.<sup>16</sup> In Cambodia, the project will contribute to an increase in the proportion of the agricultural gross domestic product that comes from non-rice crops (including spices), from 50% in FY2012 to 65% in FY2020. The project will promote regional integration, trade, and investment, particularly spice exports from India and Cambodia to the rest of Asia, and foreign direct investment in Cambodia from the rest of Asia.

12. The project will also contribute to rural poverty reduction by including farmers in the global spice value chain. A socioeconomic survey of a sample of Akay's chili contract farmers in India found they earn 10% more per acre on average than other farmers. As a result, their per capita income has increased from \$0.75 per day to \$1.31 per day (a 75% increase) in Karnataka over a 10-year engagement with Akay, and from \$0.53 per day to \$0.61 per day (a 15% increase) in Andhra Pradesh after 1 year of engagement. A similar income growth rate among Battambang farmers in Cambodia will result in incomes rising from \$1.17 per day to \$1.35 per day, above the extreme poverty line of \$1.25 per day.<sup>17</sup> As such, the project is expected to directly contribute to a reduction in rural poverty (as nationally defined) from 26.1% in FY2010 to 21.1% in FY2020 in Karnataka, from 21.1% in FY2010 to 16.1% in FY2020 in Andhra Pradesh (and Telangana), and from 20.0% in FY2010 to 15.0% in FY2020 in Cambodia.

### **2. Outcome**

13. The project's expected outcome will be the increased production of value-added spice products, with raw materials sustainably sourced from an increased number of smallholder farmers in India and Cambodia. The project is expected to benefit at least 5,000 contract farmers in India and Cambodia by FY2018, and at least 50% of them are expected to be women (footnote 2).

### **3. Outputs**

14. The outputs of the project are (i) the successful completion of phase 1 investments by 31 March 2016, and (ii) the successful completion of phase 2 investments by 31 March 2017.<sup>18</sup>

<sup>16</sup> Government of India, Planning Commission. 2013. *Twelfth Five Year Plan, 2012–2017*. New Delhi.

<sup>17</sup> Poverty Impact Assessment and Gender Impact Assessment (Dalberg Study) (accessible from the list of linked documents in Appendix 2). The study was conducted under ADB's Regional and Sustainable Development Department-managed umbrella technical assistance for inclusive business: ADB. 2013. *Technical Assistance for Inclusive Business Support*. Manila (TA 8550-REG). A similar survey will be conducted following project implementation to confirm the project's poverty reduction impact.

<sup>18</sup> The design and monitoring framework is in Appendix 1.

## C. Alignment with ADB Strategy and Operations

### 1. Consistency with Strategy 2020 and Country Strategy

15. The Midterm Review of Strategy 2020 emphasizes food security and agricultural productivity, since food security is essential for poverty reduction, and investment in agriculture will directly support food security. Agricultural investment will also boost rural employment as the agriculture sector remains a large absorber of the labor force. Further, the project is consistent with a number of other focus areas and themes highlighted in the Midterm Review of Strategy 2020 including supporting inclusive business, narrowing gender gaps, and scaling up support to climate adaptation.<sup>19</sup> The project is also aligned with the relevant ADB country partnership strategies (CPSs). Job creation, environmental sustainability, and regional connectivity are major thrusts of the India CPS, 2013–2017,<sup>20</sup> while the current Cambodia CPS, 2011–2013 calls for “enhanced agricultural productivity and diversification.”<sup>21</sup>

### 2. Consistency with Sector Strategy and Relevant ADB Operations

16. The project is fully aligned with ADB’s agriculture sector strategy. In particular, the Operational Plan for Sustainable Food Security, 2009 recommends an expanded partnership with the private sector in order to attract more direct investments in agribusinesses. The project also addresses the operational plan’s objective of enhancing synergy and value addition in the linkages along the food and agriculture value chains. Improved linkages along value chains enhance productivity, employment opportunities, exports and regional trade, but also food security for the poor in both rural and urban areas.<sup>22</sup> The project will complement ADB’s sovereign assistance to agribusiness infrastructure and value chains in India and Cambodia.<sup>23</sup>

## D. Project Cost and Financing Plan

17. The total project cost (phases 1 and 2) will be approximately \$29.0 million and will be financed through the proposed \$16.5 million assistance from ADB, \$5.0 million assistance from the ADB Strategic Climate Fund, \$6.4 million from commercial banks, and \$1.1 million from Akay’s internally generated cash, as summarized in tables 1 and 2.

<sup>19</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>20</sup> ADB. 2013. *Country Partnership Strategy: India, 2013–2017*. Manila.

<sup>21</sup> ADB. 2011. *Country Partnership Strategy: Cambodia, 2011–2013*. Manila. The draft of the forthcoming Cambodia CPS goes further by targeting specific outcomes in terms of agricultural productivity, diversification, and commercialization through value chains and linkages. The project will directly contribute to all of these outcomes.

<sup>22</sup> ADB. 2009. *Operational Plan for Sustainable Food Security in Asia and the Pacific*. Manila.

<sup>23</sup> In India, ADB’s South Asia Department is supporting investments in market infrastructure for high-value crops, including spices. ADB’s Southeast Asia Department is preparing a project on climate-friendly agribusiness value chain development in the Greater Mekong Subregion, and synergies with the project will be explored during project implementation. The Southeast Asia Department is also exploring the possibility of allocating technical assistance funds to support training of farmers on the Akay model farm.

**Table 1: Project Cost Summary**

| Item  | Amount<br>(Rs million) | Amount<br>(\$ million) | Share<br>(%) |
|---|------------------------|------------------------|--------------|
| Fixed assets  | 584.1                  | 9.9                    | 34.1         |
| Contingency   | 76.7                   | 1.3                    | 4.5          |
| Marketing and research and development expenditures | 159.3                  | 2.7                    | 9.3          |
| Working capital                                     | 654.9                  | 11.1                   | 38.3         |
| Credit facility to contract farmers                 | 236.0                  | 4.0                    | 13.8         |
| <b>Total</b>  | <b>1,711.0</b>         | <b>29.0</b>            | <b>100.0</b> |

Sources: Akay Flavours & Aromatics Pvt Ltd, and Asian Development Bank estimates.

**Table 2: Financing Plan**

| Item                                     | Amount<br>(Rs million) | Amount<br>(\$ million) | Share<br>(%) |
|--|------------------------|------------------------|--------------|
| Loans                                    |                        |                        |              |
| Asian Development Bank (ADB)             | 383.5                  | 6.5                    | 22.4         |
| Commercial banks (working capital loans) | 377.6                  | 6.4                    | 22.1         |
| ADB Strategic Climate Fund <sup>a</sup>  | 295.0                  | 5.0                    | 17.2         |
| Compulsory convertible debentures        |                        |                        |              |
| Asian Development Bank                   | 590.0                  | 10.0                   | 34.5         |
| Equity                                   |                        |                        |              |
| Akay (internally generated cash)         | 64.9                   | 1.1                    | 3.8          |
| <b>Total</b>                             | <b>1,711.0</b>         | <b>29.0</b>            | <b>100.0</b> |

<sup>a</sup> Under the Pilot Program for Climate Resilience financed by the Strategic Climate Fund, administered by ADB.

Sources: Akay Flavours & Aromatics Pvt Ltd, and Asian Development Bank estimates.

## E. Implementation Arrangements

18. Table 3 summarizes the implementation arrangements.

**Table 3: Summary of Implementation Arrangements**

| Aspects                   | Arrangements   |
|---------------------------|--|
| Regulatory framework      | The regulatory requirements in India include a license to conduct operations in the spice sector for organized companies. There is no specific regulatory framework for the spice sector in Cambodia, but Akay will need to meet all statutory requirements to establish a foreign-owned entity. |
| Management                | Akay is led by a team of experienced managers, who have experience in the spice and agriculture sectors and hold doctorate and master's degrees in the relevant fields.  |
| Implementation period     | The project will be implemented over a 3-year period. Phase 1 will be implemented in FY2015–FY2016. Phase 2 will be implemented in FY2016–FY2017.  |
| Construction arrangements | The goods and services required for the project will be procured based on transparent and competitive bidding processes from suppliers in ADB's member countries.  |
| Operations arrangements   | The project will rely on Akay for its successful operation and maintenance. Akay successfully operates similar spice processing facilities. In Cambodia, Akay's subsidiary will enter into a long-term land lease agreement with the sponsor company that owns the 717 ha of farm land.          |
| Supply arrangements       | Akay sources raw materials through three channels: own-farm production (1%), contract farming (35%), and open trade market (64%). It aims to increase the proportion of its own-farm production to 10% and contract farming to 60% by FY2018.  |
| Performance monitoring    | Akay will report on key performance indicators, including the output and outcome indicators identified in the design and monitoring framework in Appendix 1, on a semiannual basis.  |

ADB = Asian Development Bank, FY = financial year, ha = hectare.

Source: Akay Flavours & Aromatics Pvt Ltd.

## F. Unique Features

19. The project promotes inclusive and climate-resilient agricultural value chains. The contract farming model will benefit smallholder farmers through increased income-generating

potential from growing high-value crops. The innovative drip irrigation and rainwater harvesting systems will increase farmers' income security by reducing the risk from drought. The project is also a very good example of direct cooperation between developing countries through the transfer of knowledge in high-value spice farming and processing from India to Cambodia. It is ADB's first nonsovereign climate adaptation project and first regional agribusiness project.

### III. THE PROPOSED ADB ASSISTANCE

#### A. The Assistance

20. ADB will subscribe to CCDs in Akay Flavours in Indian rupees, in an amount up to the equivalent of \$6.0 million for phase 1 and \$4.0 million for phase 2. The instrument has been structured to address Akay's capital needs. It provides growth capital with limited debt service obligations in the short term, while the asset base is being expanded. At the same time, it will enable ADB to share in the benefits from a potential initial public offering (IPO) or a potential strategic sale.

21. ADB will also provide senior secured US dollar-denominated loans to Akay. To support phase 1, ADB will lend up to \$1.5 million to Akay Flavours to fund the nutraceuticals plant expansion in India. For phase 2, ADB will lend (i) up to \$2.0 million to SpiceRich Seasonings—a 100% subsidiary of Akay Flavours—to fund the seasonings plant in India; and (ii) up to \$3.0 million to Akay Flavours & Aromatics (Cambodia)—a subsidiary of Akay Flavours, which is to be incorporated—to fund the oleoresin extraction plant in Cambodia.

22. Finally, ADB will administer loans from the ADB Strategic Climate Fund to Akay Flavours for (i) investing in rainwater harvesting and drip irrigation infrastructure on the model farm (\$1 million), and (ii) setting up a credit facility for contract farmers to invest in similar climate-resilient farming technologies (\$4 million). These loans will rank *pari passu* with ADB's loans. The loan of up to \$4 million for the credit facility may also be provided to a partner financial institution, with Akay sharing some of the contract farmers' credit risk through first-loss guarantee, for example. The final structure of the credit facility for contract farmers will be endorsed by ADB's Investment Committee and the Pilot Program for Climate Resilience (PPCR) subcommittee, following the approval of the ADB Board of Directors sought herein.<sup>24</sup>

#### B. Value Added by ADB Assistance

23. ADB assistance will support the development of a uniquely inclusive business model of including low-income farmers in the global spice value chain and providing them with additional income and climate-resilient farming technologies. ADB assistance will help demonstrate the sustainability of this business model and ensure its replicability. To ensure a successful implementation of the project, ADB will provide long-term financing and growth capital, which is extremely scarce in Cambodia, and not readily available in this sector in India. ADB will also mobilize concessional funds through the ADB Strategic Climate Fund to provide financing to Akay's contract farmers in Cambodia, who have limited access to commercial finance.

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<sup>24</sup> The PPCR subcommittee (<https://climateinvestmentfunds.org/cif/node/65>) has already approved the Pilot Program for Climate Resilience Concept Note for the project (accessible from the list of linked documents in Appendix 2).

## IV. POLICY COMPLIANCE

### A. Safeguards and Social Dimensions

31. The financing of the project is considered as corporate finance in accordance with ADB's Safeguard Policy Statement (2009). The subprojects are classified as category B for the environment, which are likely to have low to medium environmental impacts and risks during construction and operation. An initial environmental examination (IEE) has been prepared for the identified subprojects.<sup>25</sup> The project is classified as category C for involuntary resettlement and indigenous peoples. All subprojects will be located on the land owned or leased by Akay. The land in India and Cambodia has been acquired through negotiated settlement. The compensation was consistent with ADB's Safeguard Policy Statement requirements and there are no pending grievances, as confirmed by the social compliance audit. No subproject will entail further land acquisition resulting in involuntary resettlement or impacts on indigenous peoples communities. All existing lands to be used for subprojects using ADB funds are free of any encumbrances, including the 717 hectares of farmland in Cambodia. The project is categorized as effective gender mainstreaming.<sup>26</sup> Akay will comply with the national labor laws and take measures to comply with the relevant international core labor standards.

32. Akay will adopt an environmental and social management system (ESMS) satisfactory to ADB before ADB's first disbursement. To ensure adequate implementation of its ESMS and of the environmental management plan included in the IEE, Akay has agreed to establish a safety committee with representatives from all plants, and to train its management and environmental and social team. Akay is committed to enhancing its current procedures and will submit semiannual monitoring reports to ADB on implementation of its ESMS and environmental management plan, including corrective actions.

### B. Anticorruption Policy

33. Akay was advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the finance and investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

### C. Investment Limitations

34. The proposed CCD investment and loans are within the medium-term, country, industry, and group exposure limits for nonsovereign investments. The proposed loans are within the single obligor limit for loans. However, ADB's proposed CCD investment in Akay Flavours & Aromatics will represent up to 50% of the company's net worth, which breaches the equity investment limit. Furthermore, the combined total amount of ADB's proposed CCD investment and its proposed loans also breaches the aggregate financing limit.<sup>27</sup> As a result, waivers are

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<sup>25</sup> The IEE of the Cambodia oleoresin extraction plant will be updated following ADB Board approval in accordance with the agreed environmental and social management system since the subproject location has not been finalized.

<sup>26</sup> A gender action plan has been prepared to (i) increase women's participation in new contract farming in Cambodia and India, (ii) improve facilities and opportunities for women farmers engaged in Akay farms, (iii) enhance capacity of Akay to target and train women farmers and workers, (iv) improve women's financial inclusion and management, and (v) improve monitoring and reporting on gender issues.

<sup>27</sup> ADB. 2009. *Review of the Asian Development Bank's Exposure Limits on Nonsovereign Operations*. Manila. The Board policy establishes a single obligor limit for equity investments such that equity investments shall not exceed the lower of (i) \$75 million and (ii) an amount equal to 25% of the net worth of the investee company. As for the



sought for both the single obligor limit and the aggregate financing limit. It should be noted that in the event of conversion of the CCD, ADB's shareholding would be less than 25% of the shares of the company and ADB would not hold a controlling stake in the company. It would also not be the single largest shareholder in the company.

#### **D. Assurances**

35. Consistent with the Agreement Establishing the Asian Development Bank, the Government of India and the Government of Cambodia will be requested to confirm that they have no objection to the proposed assistance to Akay. ADB will enter into suitable finance and investment documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board of Directors.

#### **V. RECOMMENDATION**

36. I am satisfied that the proposed assistance would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the compulsory convertible debentures investment of up to the equivalent of \$10,000,000 in Indian rupees to Akay Flavours & Aromatics Pvt Ltd;
- (ii) the loan of up to \$1,500,000 to Akay Flavours & Aromatics Pvt Ltd;
- (iii) the loan of up to \$2,000,000 to SpiceRich Seasonings Pvt Ltd;
- (iv) the loan of up to \$3,000,000 to Akay Flavours & Aromatics (Cambodia) Pvt Ltd; and
- (v) administration of loans of up to \$5,000,000 to be provided by the ADB Strategic Climate Fund to Akay Flavours & Aromatics (Cambodia) Pvt Ltd or a partner financial institution to be identified for the Spice Value Chain Development Project in India and Cambodia

from ADB's ordinary capital resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

37. I also recommend that the Board approve the waiver of the single exposure limit for equity investment and the aggregate financing limit as specified in para. 34.

Takehiko Nakao  
President

14 August 2014

## DESIGN AND MONITORING FRAMEWORK

| Design Summary   | Performance Targets and/or Indicators with Baselines  | Data Sources and/or Reporting Mechanisms   | Assumptions and Risks  |
|--|---|--|--|
| <p><b>Impacts</b><br/>High value-added agriculture growth sustained in India and Cambodia</p> <p>Regional integration, trade, and investment promoted</p> <p>Rural poverty reduced</p>     | <p>Horticulture production growth rate in India increased to 5.0% per year (in real terms) during FY2013–FY2020, from 4.7% per year during FY2007–FY2012</p> <p>Proportion of agricultural gross domestic product in Cambodia from non-rice crops rises from 50% in FY2012 to 65% in FY2020</p> <p>Value of spice exports from India to the rest of Asia increases from \$1.1 billion in FY2013 to at least \$3.0 billion in FY2020<sup>a</sup></p> <p>Foreign direct investment from Asia to Cambodia increases from \$0.8 billion per year during FY2009–FY2012 to \$2.0 billion per year during FY2017–FY2020</p> <p>Rural poverty in Karnataka<sup>b</sup> reduced from 24.5% in FY2012 to 19.5% in FY2020<sup>c</sup></p> <p>Rural poverty in Andhra Pradesh and Telangana reduced from 11.0% in FY2012 to 6.0% in FY2020<sup>c</sup></p> <p>Rural poverty in Cambodia reduced from 20.0% in 2010 to 15.0% in 2020<sup>d</sup></p> | <p>Government of India, Planning Commission</p> <p>Government of Cambodia</p> <p>Spices Board of India</p> <p>Council for the Development of Cambodia; World Bank database</p> <p>Government of India, Planning Commission</p> <p>Government of India, Planning Commission</p> <p>Government of Cambodia</p> | <p><b>Assumptions</b><br/>Governments' commitment to priorities identified in national plans and ADB country partnership strategies</p> <p>Continued trade liberalization</p> <p>Government targets remain consistent beyond the period of the current plans</p> |
| <p><b>Outcome</b><br/>Increased production of value-added spice products, with raw materials sustainably sourced from an increased number of smallholder farmers in India and Cambodia</p> | <p>Sales by Akay Flavours &amp; Aromatics and its affiliates (Akay) of value-added spice products from India increase from \$26.7 million in FY2014 to at least \$60.0 million in FY2018</p> <p>Direct contribution (corporate tax) to government revenue in India increases from \$0.4 million in FY2014 to \$2.0 million in FY2018</p> <p>Number of Akay contract farmers in India increases from 3,000 in FY2014 to 6,000 in FY2018,</p>   | <p>Akay's reporting to ADB</p>   | <p><b>Assumption</b><br/>Companies operate according to business plan</p> <p><b>Risks</b><br/>Market risks</p> <p>Raw material supply risks</p> <p>Operation risks</p>   |

| Design Summary  | Performance Targets and/or Indicators with Baselines  | Data Sources and/or Reporting Mechanisms | Assumptions and Risks   |
|---|---|--|---|
|   | <p>including at least 50% women</p> <p>Akay's sales of value-added spice products from Cambodia increase from zero in FY2014 to at least \$20.0 million in FY2018</p> <p>Direct contribution (corporate tax) to government revenue in Cambodia increases from zero in FY2014 to \$0.6 million in FY2018</p> <p>Number of Akay contract farmers in Cambodia increases from zero in FY2014 to 2,000 in FY2018, including at least 50% women</p> <p>Number of microloans to contract farmers in Cambodia increases from zero in FY2014 to 1,000 in FY2020, covering 2,000 ha with drip irrigation in total, and building rainwater harvesting ponds of 1,000 m<sup>3</sup> on average</p>                                    |  |   |
| <p><b>Outputs</b></p> <p>1. Phase 1 investment projects successfully completed</p> <p>2. Phase 2 investment projects successfully completed</p> | <p>Sterilized spice plant in India with capacity of 10,000 tpy year fully operational by 31 March 2015</p> <p>Capacity of nutraceuticals plant in India increased from 600 to 3,000 tpy by 31 March 2016</p> <p>Area under drip irrigation on the Cambodia model farm reaches 250 ha by 31 March 2016</p> <p>Capacity of rainwater harvesting ponds on the Cambodia model farm reaches 100,000 m<sup>3</sup> by 31 March 2016</p> <p>Infrastructure and equipment for 10 ha of black pepper cultivation on the Cambodia model farm in place by 31 March 2016</p> <p>Seasonings plant in India with capacity of 2,500 tpy commissioned by 31 March 2017</p> <p>Number of Akay employees in India increases from 250 in</p> | <p>Akay's reporting to ADB</p>           | <p><b>Assumption</b><br/>Contractors deliver as per contracts</p> <p><b>Risk</b><br/>Delay and cost overrun</p> |

| Design Summary | Performance Targets and/or Indicators with Baselines   | Data Sources and/or Reporting Mechanisms | Assumptions and Risks |
|----------------|--|--|-----------------------|
|                | <p>FY2014 to at least 300 in FY2017</p> <p>Spice extraction plant in Cambodia with capacity of 3,000 tpy commissioned by 31 March 2017</p> <p>Area under drip irrigation on the Cambodia model farm reaches 500 ha by 31 March 2017</p> <p>Capacity of rainwater harvesting ponds on the Cambodia model farm reaches 200,000 m<sup>3</sup> by 31 March 2017</p> <p>Infrastructure and equipment for 40 ha of black pepper cultivation on the Cambodia model farm in place by 31 March 2017</p> <p>Number of Akay farm employees in Cambodia increases from 230 in FY2014 to at least 260 in FY2017; at least 70% are women</p> |  |                       |

|  |   |
|--|---|
| <p><b>Activities with Milestones</b></p> <p>1. Phase 1 financial close achieved by 30 December 2014</p> <p>2. Phase 2 financial close achieved by 30 December 2015</p> | <p><b>Inputs</b></p> <p><b>Senior loans:</b><br/>ADB: \$6.5 million<br/>Commercial banks: \$6.4 million<br/>ADB Strategic Climate Fund: \$5.0 million</p> <p><b>Compulsory convertible debentures:</b><br/>ADB: \$10.0 million</p> <p><b>Equity:</b><br/>Internal accruals: \$1.1 million</p> |
|--|---|

ADB = Asian Development Bank, FY = financial year, ha = hectare, m<sup>3</sup> = cubic meter, tpy = tons per year.

<sup>a</sup> India's spice exports to the rest of Asia have grown by 21% a year (in nominal terms, in US dollars) during FY2009–FY2013; conservatively, the deal team has assumed a growth rate of 15% until FY2020.

<sup>b</sup> Contract farmers are only located in the Bellary, Gulberga, and Raichur districts of Karnataka and the Khammam district of Telangana (formerly part of Andhra Pradesh). However, due to the lack of any reliable official district-level poverty statistics, state-level data is used as the indicator instead.

<sup>c</sup> Assuming a 5.0 percentage point decrease, which is half of the Twelfth Five-Year Plan's national target for poverty reduction ("head-count ratio of consumption poverty to be reduced by 10 percentage points over the preceding estimates by the end of the Twelfth Five-Year Plan"), given that rural poverty in Karnataka and Andhra Pradesh (and Telangana) is already significantly lower than for India as a whole (25.7% in FY2012).

<sup>d</sup> The Government of Cambodia aims to reduce the poverty rate by at least 1 percentage point every year. Reduction of rural poverty from 20% to 15% in 8 years is thus a conservative assumption.

Sources: Akay Flavours & Aromatics Pvt Ltd; and Asian Development Bank estimates.

**LIST OF LINKED DOCUMENTS**

<http://adb.org/Documents/RRPs/?id=48901-014-3>

1. Initial Environmental Examination

**Supplementary Documents**

2. Pilot Program for Climate Resilience Concept Note
3. Poverty Impact Assessment and Gender Impact Assessment