Cellular Services Company

Summary of the Operation Performance Evaluation Review (January 2005)

THE PROJECT

In July 1997, the Bank approved a facility for a mobile telephone company that contained the following three instruments:

- A senior loan in the form of an A/B loan of up to US$ 180 million, consisting of an A loan of up to US$ 115 million and a B loan of up to US$ 70 million.
- Quasi-equity in the form of a subordinated debt instrument of US$ 10 million to be subscribed by the Bank. The quasi-equity was prepaid in October 2002 as part of the third Bank operation.
- A risk management facility permitting the company to enter into hedging transactions with the Bank up to an exposure equal to the lesser of US$ 25 million and US$ 115 million, less the final amount of the A loan.

As a result of the higher than anticipated demand for cellular services, the company decided to accelerate and expand the construction of its Global System for Mobile communications (GSM) network. In May 1998, the Bank approved an increase in the senior syndicated loans as follows: an increase in the A loan of up to US$ 11 million, and an increase in the B loan of up to US$ 19 million.

The growth in subscribers continued to outstrip original projections. In November 1998, the Bank approved a second operation, increasing the syndicated loans by US$ 105 million. This included an increase in the A loan of up to US$ 30 million for the Bank's own account.

In July 2002, the Bank approved a third operation. The Bank refinanced the company's existing debt. It also increased the amount of financing by lead arranging a US$ 300 million senior loan facility, including an A loan of US$ 120 million and a B loan of US$ 95 million.

The proceeds of the first two Bank operations were used to construct and operate a GSM network in the country. The third Bank operation was used to upgrade the physical network and to acquire a Universal Mobile Telecommunications System (UMTS) licence. In addition, it released the ECA political and commercial risk guarantee and consolidated all of the company's loan facilities into a single financing package.

PROJECT RATIONALE

The principal shareholder and sponsor of the company had identified opportunities to expand its telecommunications operations in emerging markets. It had been awarded a GSM licence in the country of operation and in one other.

By July 1997, the date of the first loan to the company, the Bank had already participated in several cellular projects. All of these clients had enjoyed tremendous commercial success and had consistently outperformed their original business plans. The Bank's rationale was the desire to support a project that would provide an essential service for the country. The project would also make a direct contribution to private sector development, thereby having a demonstration effect on the wider economy.

ACHIEVEMENT OF OBJECTIVES

To develop a GSM network in accordance with the licence
The company's licence requirements incorporate the coverage and quality targets of its tendered business plan. Demand has exceeded all initial projections, and the company has been able to raise the necessary funds to expand the network to meet it. This means that fulfilling the licence requirements has never been an issue.

To improve access to telecommunications
The expansion of GSM services has far exceeded all estimates. Mobile penetration surpassed the penetration of fixed line phones this year, and the total number of subscribers in the country by the end of 2003 was approximately six million. The company has just under 50 per cent of this market. This corresponds to a total cellular penetration of about 30 percent in the country. The company's network covers approximately 97 per cent of the population, and about 85 per cent of the country geographically.

The country's telecoms market was fully liberalised at the beginning of January 2003. This has further boosted telecommunications services, particularly to the business sector. The company has implemented an integrated services strategy, enabling it to offer advanced telecommunications services. The company is also one of the largest internet service providers in the country.

To increase competition in voice communications services
The success of the two major GSM operators increased competition during the construction of the network. There is, however, a risk that their success will put the two smaller operators out of business, resulting in less competition in the sector. This risk would be reduced by introducing a strong regulatory framework that could encourage the emergence of virtual service providers, thereby increasing competition. The company's new integrated services strategy will, for the first time, offer an alternative service to large business customers. The market has responded very positively, and the company has picked up some very large business clients. The turnover of the company and its competitor is expected to exceed that of the partly government-owned operator over the next five years.

To facilitate economic activity and contribute to infrastructure development
The company launched its services in early 1997. It has continuously expanded its network and had met all its coverage requirements after two years. The company entered into roaming agreements with a large number of international GSM operators, enabling foreign visitors to continue to use their mobiles while in the country. This substantially contributed to the country's economic activity and improved efficiency in business transactions. The company has invested just under US$ 900 million[1] in the country since its launch. GSM networks are highly capital intensive and contain substantial elements of imported technology. They also involve local site construction, including access to roads and power supplies. Local contractors have carried out most of this work, and so have greatly benefited from the increased investment in the country.

OVERALL ASSESSMENT

The Bank's project evaluation department (PED) has carried out its own independent review of the project's performance. With particular emphasis on the project's future prospects, the PED concluded that the project's overall performance could be rated *Successful*. This assessment is based on the PED's internal rating methodology, which takes into account the achievement of

[1] All capital expenditure since inception.

objectives, transition impact, environmental impact, company project performance and profit contribution.

Bank handling was rated *Excellent,* contributing to the successful delivery of the largest syndicated loans at that time to the company. The high level of competition between the two GSM operators has kept management highly focused on maintaining market position and building additional services. The company's profitability has therefore been rated *Excellent*. The PED rated the Bank's investment performance and profit contribution as *Excellent,* due to the size of the transactions and the repeat business.

TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

The first two transactions with the company were approved before the Bank had its ex-ante rating methodology in place. From a retrospective perspective, OCE rated the first two transactions on a par with all other private sector projects in the mobile sector. This rating tends to be generally *Good,* as the competition argument is strong, and the risk is dependent on the country context and the regulatory risk. For the country, the ex-ante rating of the first project was *Good/Medium.*

The incremental transition impact of successive projects, particularly if the main use of proceeds is refinancing, tends to be lower. The ex-ante rating of the third transaction was *Satisfactory/Medium.* Since the start of the project, the OCE has continued to monitor it via the transition impact monitoring reviews. Based on these, the rating has been upgraded to *Satisfactory/Low,* as the commercial success of the project has lowered its risk rating.

The PED rated the project's short-term transition impact as *Excellent.* Due to the early stage of the liberalised market, the limited number of players and the relatively limited regulatory experience, there are still risks and therefore the transition impact over the longer term was rated *Good.* The PED attached a stronger weighting to the future impact potential, given the nature and evolution of telecoms markets, and therefore rated the overall transition impact as *Good.*

The Bank's additionality was rated as *Verified at Large.* This was the largest syndicated loan structured for a new company at a time when the commercial banks had a limited appetite for medium to long-term exposure.

BANK HANDLING

The client is happy with the Bank's role even though the covenants were seen as too tight for the company to be successful after its initial launch. The company felt it took too long for the covenants to be relaxed in order to do business. The Bank's involvement and its due diligence gave the project credibility in the eyes of the financial markets and the participants in the syndication. It also helped build credibility with the government, and with suppliers.

The Bank was the arranger of the syndicated loan and was actively involved in the loan's structuring and documentation. There was extensive monitoring of the company, and the Bank monitored the initial system build-up and subsequent operating phase very closely. Bank handling was therefore rated *Excellent.*

MAIN ISSUES AND LESSONS LEARNED

Project finance must be structured efficiently, even with large international sponsors. Developing a strong, self-contained project finance structure is essential, especially in cyclical industries where support from the main sponsor may change over time. Covenants restricting distribution during the crucial build-up phase are particularly useful, especially when sponsors may not want to inject new money due to difficulties in their key markets. This has proved to be a useful tool in telecoms sector transactions.

Training and promoting local managers plays a crucial part in building a successful company. Training and promoting local managers from the outset can enhance the success of a company, resulting in a highly motivated workforce and a creative working environment. This will also enhance the company's image in the local market. Encouraging senior managers to take an active part in the local community can further strengthen this image.

Sector policy dialogue must not be ignored, even when the transaction is already successful. It is important for the Bank to continue a close sector dialogue with the government. This is particularly the case when the government has a stake in both a fixed line and a mobile operator, and when the Bank's market influence is likely to be greater. The Bank's key aim should be to provide assistance to ensure a properly functioning telecommunications sector. The Bank should use bilateral funds for technical cooperation (TC) to pay for consultants as required.

The Bank, as a development finance institution, should pay more attention to the provision of universal service. The World Bank group, like many bilateral development agencies, is active in this area by contributing to the development of efficient delivery mechanisms. The Bank should include a statement outlining its position on universal service in its next update of the Telecommunications, Informatics and Media Operations Policy (BDS99-13). The Bank should consider trustee roles in universal service funds to ensure transparency. The Bank could also use some TC funding to strengthen the regulator, in particular to promote strong universal service funds.

The Bank should closely monitor the development of UMTS in its countries of operations, and maintain a dialogue on the viability of these services. In countries where voice is the predominant service, the business plan for UMTS and its viability will be dramatically different from the experience of newly launched services in western Europe. By engaging in an active dialogue, the Bank could promote the sharing of information on the viability of these services in low transition countries.