Summary of the Operation Performance Evaluation Review March 2004

THE PROJECT

The project has a conventional (non-concession-type) structure and consists of the design, finance, construction and operation of a new air cargo terminal. The total cost of the project was US$ 12.74 million. Of this, US$ 2 million was equity, raised in proportion to percentage shareholdings. The EBRD provided US$ 8 million of senior debt (50 per cent of which was syndicated to the B lender). The foreign and local sponsors provided subordinated debt of US$ 2.74 million. This financing is regarded as highly leveraged.

Pre-dating the Bank's involvement, a special purpose company (the "Company") was established in July 1997. The Company is owned by three shareholders: the strategic sponsors, a foreign and a local enterprise with long-standing sector experience, and another local investor company with multi-sector portfolio exposure which includes the construction industry. The shareholdings are, respectively, 40 per cent, 40 per cent and 20 per cent.

PROJECT RATIONALE

The old cargo terminal, which consisted of 10-year-old cramped, obsolete warehouses, was badly equipped. Its location was a problem, with no direct access to the apron, meaning that air cargo had to be trucked on inadequate public roads from the airport to the warehouses. Security was compromised, and so was safety whenever dangerous cargo had to be transported.

Achievement of objectives

Objectives at appraisal	PED evaluation comments
To stimulate foreign investment in a privately run company	Although this was achieved, the right deal concept may not have been applied.
To build a new, modern cargo terminal, meeting international standards	This was achieved.
To promote market efficiency and to facilitate trade	This was achieved. Reducing the dwell time from 10 to five days (with a planned further reduction) reduces the transaction costs in trade. The Company appears to have good relations with customs, so the planned reduction in dwell time is feasible. The appraisal target dwell time is less than five days.
For the Company to be financially viable	There are signs that the Company is developing into a viable business. It is too early to judge whether it will achieve the 21 per cent return on investment outlined in the appraisal document. Debt service and repayment appears unlikely to be a future problem.

OVERALL ASSESSMENT

The Bank's Project Evaluation Department (PED) rates the investment operation as *Successful* overall. The financial performance of the project and the company were both rated as *Good*. The project company has exceeded forecast figures in spite of implementation delays, and the Bank is expected to reduce its interest rates, which will further strengthen the Company's financial position. The project's profit contribution to the Bank was rated *Marginal*, in spite of acceptable margins. This mainly reflects the relatively small size of the project (US$ 8 million of senior debt, with 50 per cent syndicated) that can hardly carry the costs of the Bank.

The project's transition impact was rated *Satisfactory*, although it would have been considerably greater if the Bank had become involved at the project conception stage. This would have enabled the Bank to discuss the unbundling of functions (the separation of infrastructure and operation), the organising of operations through concessions, introducing a competitive tender process and other more transition-oriented features. Instead, the Bank came on board after the deal was done, leaving it with the more conventional role of financier. The main transition impacts occurred in the areas of technology, know-how and skills transfer, and market expansion.

The Bank's additionality was rated *Verified in Part*. This is due to the fact that the Bank agreed to step back from a number of previously agreed arrangements, after credible claims by the strategic sponsor that alternative financing options were available.

The investment project was generally in compliance with the Bank's prevailing country strategy, sector policy, environmental and procurement rules. Environmental performance was rated as *Good* and environmental change was rated as *Some*. Bank handling was rated as *Marginal*.

TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

PED broadly concurred with the Office of the Chief Economist's ex-ante assessment and rated the overall transition impact as *Satisfactory,* with low to medium risks for the future. On the company level, the main transition impacts were attributed to the areas of technology and know-how transfer, as well as business conduct, while the impact on the macro level was mainly in the areas of market expansion, market frameworks and demonstration effects.

The assessment of the Bank's additionality takes into account the fact that the project was developed during the Russian crisis (late 1998 and early 1999). The crisis increased the political risk of the project, rendering project financing very difficult without the Bank's involvement. However, by the beginning of 2000 when the Bank's loan was approved, the PED judged that the additionality factor had decreased. According to project files, the foreign project sponsor caused several changes in previously agreed arrangements, saying that alternative financing options were available. This triggered various re-processing activities within the Bank. This "accommodating" processing approach (giving away of Bank positions) reduced the Bank's additionality, which was rated *Verified in Part*.

Bank handling

Procurement. PED raised concern over the Bank's due diligence process, with regard to the handling of intelligence received by the Bank linking the construction company to one of the airport company's shareholders. The Bank should have ensured that construction procurement was conducted by the company in a manner that meets both the Bank's procurement rules and the spirit of those rules.

The quality of project documentation. In the procurement file the information on the procurement of the construction contract is worryingly 'patchy'. Not only are incomplete project files of genuine concern to the Bank, this deficiency also significantly hampered the project's evaluation. It was not possible to ascertain whether the awarding of the construction contract was subjected to a truly competitive process. Although there is a list of bidders, there is no evidence that the Bank took a view on this issue on the basis of documented information from the company and by assessing the best value for money.

The project's leadership. The turnover of operation leaders during the project's development stage may have contributed to the apparent poor dissemination of crucial information and the patchiness of information on the construction procurement process. PED learned that, before this evaluation, operation leadership changed hands more than four times. Each change, unavoidably, results in some loss of corporate and project memory. During this time, the company management staff, including the chief executive officer, also changed, exacerbating the problem. Complete and informative project files, as highlighted above, would mitigate information gaps.

MAIN OPER ISSUES AND LESSONS LEARNED

'Design additionality' is a key strategic determinant for the Bank. When the Bank is presented with a 'done' deal, the Bank should consider and propose alternative approaches that would promote a greater transition impact. If additionality is a strong factor, there is a high probability that its proposal would be accepted.

Rigorous due diligence should not be compromised. Where there is prior knowledge of an undisclosed link between one of the shareholders and a project construction company, the Bank should apply its procurement rules more stringently. There are two reasons for this approach. First, to ensure the best value for money, which affects the project economics. Second, to minimise the risk to the project, whenever the role of a stakeholder and its commitment to the investment may be in doubt.

Bank teams must anticipate potential problems with project start-ups. More serious efforts have to be made to anticipate, well in advance, potential problems with operation start-ups. This notably includes the capacity to implement the project (including the availability of sufficient qualified staff, necessary permits, and liquidity to cope with delays). In short, timely forward planning is essential.