THE PROJECT

In May 2001, the EBRD took an indirect 5.8 per cent equity interest in the Company, at an aggregate cost of US$ 27.4 million. In October 2004, the Bank invested €25 million in a high-yield eurobond issued by the Company. The EBRD is currently in the process of exiting both investments as the Company’s immediate parent is being taken over. The Company was set up in 1999 by a foreign sponsor to successfully bid for a global system for mobile communication (GSM) licence offered by the host country. The sponsor had invested in another foreign operation, with which the Bank has a lending relationship.

PROJECT RATIONALE

The rationale for the equity investment was to achieve transition impact through: i) the expansion of the telecommunications network and the fostering of innovative and advanced services; ii) the promotion of competition and stimulation of customer choice in the country and iii) the floating of the Company or its parent company on the stock exchange. The Bank’s additionality was primarily based on helping a telecoms company raise equity in the financial markets. Regarding the eurobond investment, the project rationale reiterated the goals set above, the achievement of which required a consolidation of the Company’s funding capacity, particularly if it were to bid for a universal mobile telecommunications system (UMTS) licence.

ACHIEVEMENT OF OBJECTIVES

The Bank’s Evaluation Department (EvD) identified four main objectives to be fulfilled through the equity and eurobond investment: the expansion of the Company’s network; the promotion of competition in the country’s mobile communications services market and the facilitation of entry of a new international mobile operator into the market; the floatation of the Company’s shares on the stock exchange; and access for a private non-financial company of the host country to the international capital markets via a eurobond issue. All major objectives of the operations have been either achieved or over achieved. The fulfilment of objectives has therefore been assigned an Excellent rating.

OVERALL ASSESSMENT

The Bank’s investment in the Company, through equity and debt, fulfilled its objectives, achieving a Good rating for transition impact. The Bank’s additionality was verified in both investments, though it could be argued that the equity raising might have been possible without the Bank’s participation. Conversely, the launching of the eurobond would have been more questionable without the Bank’s firm backing.

The project’s financial performance improved consistently through the life of the Bank’s investments, as the Company increased its market penetration and up-scaled its clientele. The quality of its management, market positioning and the low acquisition cost of the third and, most likely, last third generation licence in the country would necessarily make it quite an attractive target for a global player. The acquisition of the Company’s immediate parent removed the financial weaknesses in the Company and turned the Bank’s investments into a slightly more profitable proposition than could have been anticipated shortly beforehand.
The appropriate identification of the project, highly professional follow up of the Company and significant contribution of the Bank to the Company’s financial rescue should have contributed to a higher rating for bank handling than the assigned Satisfactory. However, a special exception was made regarding the presentation of the eurobond to the Board and on the sharing of its economics with financial partners in the private sector. Nonetheless, EvD has assigned a Successful rating to the project’s overall performance.

**TRANSITION IMPACT AND THE BANK'S ADDITIONALITY**

When the equity investment was approved, transition impact was rated Satisfactory by the Bank’s Office of the Chief Economist (OCE). Objectives highlighted by OCE were competition and market expansion. OCE noted in its monitoring report that these objectives were fulfilled faster than expected. When the eurobond transaction was presented to the Board for approval, a Good rating for transition impact was assigned by OCE. EvD has rated the project’s overall transition impact Good, based on the accomplishments achieved during the life of the project and the solid long-term prospects under the new sponsor. The demonstration effect from the launching of the high-yield bond, however, has been undermined by its early prepayment.

The sponsor brought in experienced management and a large number of expatriates at the commencement of the operations. The Company’s achievements have had, in addition, a great impact on competition, a direct beneficial effect on the telecoms sector in the country. Increased competition has encouraged greater efficiency, lower pricing, innovative marketing and customer service. The entry of the Company as a third operator has stimulated unexpected market growth. By making mobile communication services available to the lower end of the market at increasingly lower prices and stimulating competition, the project has had a positive impact on the economy as a whole.

The successful launching of the first high-yield eurobond in the country’s market for a non-financial institution has positively contributed to the development of the country’s capital markets. The Company is in compliance with all relevant national and local environmental health and safety regulations.

The Bank’s additionality in the initially contemplated IPO would most likely have been verified in all respects, given the sudden downturn of telecoms, media and technology stocks in the financial markets during 2000. It is however less clear that the same degree of additionality can be claimed when the operation was converted into a “pre-IPO” private placement. The total capital increase was reduced from US$ 150 million to US$ 130 million (13.3 per cent) but the Bank’s commitment was reduced by a significantly higher proportion, from US$ 40 million to US$ 25 million (37.5 per cent).

**BANK HANDLING**

The selection of the project was good. The team had worked with the sponsor on an earlier project and was well positioned to assess their capability of successfully meeting the challenges of an investment in a more competitive environment. The Bank was not a leader in the structuring of neither the equity nor the bond transaction. On the equity side, the Bank had an observer seat on the Board of Directors of the Company. This position was fulfilled consistently and the Company is very appreciative of the Bank’s contribution through its regular contacts. The team’s risk appreciation proved to be correct. Presentations of the Company’s financial situation could have put more emphasis on its high leverage and warnings should have been issued regarding the inadequacy of the debt maturity structure and CAPEX commitments in relation to EBITDA generation.
The acquisition of the Company’s immediate parent met the Bank’s initial target economic internal rate of return (ERR) although foreign exchange (FX) fluctuations provide a distorted reading of this achievement. The overall Bank investment performance has been boosted by the exceptional and unanticipated pre-payment fee on the eurobond. In most respects, bank handling was commendable and deserves a high rating. EvD is, however, concerned that the handling of the eurobond transaction by the team left a lot to be desired and raises significant issues regarding the Bank’s qualifications to engage in such transactions. The bank handling rating assigned by EvD was therefore downgraded to Satisfactory.

MAIN OPER ISSUES AND LESSONS LEARNED

The value of a mobile operator is strongly correlated to its long-term competitiveness in its market. Even though the full potential of the third generation technology would presently benefit only a fraction of the market, no operator can run the risk that better quality services provided by its competitors may not be available from itself. While the decision to opt for the UMTS licence could be deferred, missing it altogether would have hampered the Company’s marketability. Securing such a licence would add value through scarcity as the size of the market makes it highly unlikely that more tender be organised.

In leveraged situations, the Bank must be particularly vigilant to assess its client’s ability to meet debt service while making the necessary investments to remain competitive. An early warning of concern in this respect could have induced a more proactive role of the Bank in the debt restructuring. The motivation, beyond the Bank’s equity protection, would have been to devise a strategy to optimise the Bank’s positioning in the new debt structure if an increase in exposure must be envisaged.

The Bank is short of non-investment grade fixed income in-house capabilities. It is a challenge for the Bank to seek and obtain a fair remuneration for the crucial role it plays as “anchor investor”. In this case, its risk appetite is rewarded at the same level as any other “non-anchor” investor while arrangers are getting visibility (league table) and substantial upfront remuneration for professional structuring and placement skills without taking any credit risk. It is important for the Bank, each time it finds itself in such a position to evaluate how much is “left on the table” of the arrangers and size up the opportunity cost of its additionality in this particular market.

The Bank should find ways to share in the bond economics when it is an essential contributor to its realisation. As a major financial institution, the Bank should not find itself in the position of a “stuffee” on grounds that it’s presence in the fixed income market is purely opportunistic. One way around the absence of dedicated capital market fixed income activity could be agreeing on an upfront fee sharing with co-arrangers irrespective of the Bank’s final take in the issue. This could be based on the sheer acceptance of “anchor investor” position possibly coupled with a co-arranger position in the credit facility. The Bank’s additionality would remain intact through the anchor position in the bond issue that no other commercial bank would have any interest in.

The true performance of a project must be appreciated on the basis of the ERR calculated in the currency of the investment. This does not however reflect the Bank’s financial performance of the investment as it did assume a foreign exchange risk which may not have been covered. It is important to consider alternatives to the present situation. Two options are available: 1) The investment is funded in its original currency provided it is freely traded, and the cost of funding will vary with the evolution of interest rates over the unknown period of investment. 2) The investment is hedged over a hypothetical holding period and the cost of
hedging is incorporated in the expected ERR at approval but this would not protect the Bank against FX risk should the equity exit occur at a different time than was initially targeted.