

# **Food Packaging Project**

## **Summary of the Operation Performance Evaluation Review (OPER)**

### **March 2005**

#### **THE PROJECT**

On 22 October 2002, the EBRD's Board approved a €12.5 million, five year multi-currency revolving credit facility to the Company, a wholly owned incorporated subsidiary of the sponsor. The loan was to finance the development and expansion of the Company's food packaging business at its plant near Moscow, together with the development of regional production facilities. The sponsor is a multinational company that is a world leader in the consumer packaging sector. It employs 16,000 people in 35 countries. It is financially strong, conservatively leveraged with a total debt to worth ratio of 1.07. Its competitors in Russia are mainly local firms, together with some large, highly diversified international packaging companies.

#### **PROJECT RATIONALE**

- To strengthen the Company's position as an important link between food processors, retailers and consumers. The Company's locally produced, high-quality packaging would enable local food producers to meet the demands of leading domestic and international retailers.
- To provide Russian consumers with more choice and better quality of food packaging. The investment in moulded fibre equipment would meet fundamental requirements for the packaging of basic foods.
- To meet western product and manufacturing standards throughout the value chain. This includes the areas of raw material procurement, production and distribution, along with hygiene standards, product innovation and customer standards.
- To demonstrate a way of providing local currency financing to the Russian food sector for an operation with domestic revenues.

#### **ACHIEVEMENT OF OBJECTIVES**

The Company has trebled its production over the last four years. However, despite this, none of its planned geographical expansion has taken place. This is partly due to the effects of a warehouse fire in 2001, and partly due to the group's conservative approach to new investment.

The investment in a two line, moulded fibre machine is now complete and when the Bank's Project Evaluation Department (PED) visited the site it was a few days from commissioning.

The Company remains an important foreign investor in Russia's food packaging industry. In the face of growing local competition it has increased its market share with local food processors. It has also set standards in the areas of technical expertise, environmental performance and corporate governance. It has finished installing - albeit six months late - its moulded fibre equipment. However, the Company has yet to implement a strategy to extend its presence in the country and the region. PED assigned a **Good** rating to the project's overall achievement of objectives, reflecting the Bank's success in providing working capital financing in local currency.

#### **OVERALL ASSESSMENT**

PED rated the project's overall performance as **Successful**. The project's financial performance remained **Marginal**, partly due to the 2001 warehouse fire, and partly due to the longer than anticipated delays incurred in obtaining insurance settlements. However, this is relatively neutral for the Bank; from the point of view of credit, it is covered by the sponsor's guarantee, and on sustainability the company is showing positive signs of a financial recovery, along with adequate competitiveness in a market where it is the sole foreign investor.

PED gave a **Good** rating to the project's overall transition impact, company performance and the fulfilment of objectives. The relatively modest size of the investment, the size of the operation itself and the Bank's ambiguous prioritisation of objectives at Board approval are the main reasons why these ratings are not higher. PED noted that throughout this transaction the cooperation between Banking and Treasury proved highly effective, with benefits on both sides. This resulted in a **Good** rating for bank handling, although this rating was hampered by the Banking Team's vague determination of objectives.

The project's environmental performance was rated **Excellent**, with the extent of environmental change only rated **Some** due to the modest size of the project. The Bank's additionality was rated **Verified at Large**. The project's investment performance-/profit contribution was rated **Marginal**, primarily due to its modest size and partial use, which preclude a significant net profit contribution. The Bank's return on this transaction was nevertheless higher than forecast at Board approval, due to the profitability of local currency funding.

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

PED rated the project's overall transition impact as **Good**. Short term verified impact and longer term potential impact were also rated **Good**, with risk to transition impact rated **Low**. PED was particularly impressed by the high standards of corporate governance and business conduct achieved by the Company in a competitive environment where a number of smaller local businesses were not subject to similar constraints. The demonstration effect is very positive in terms of setting standards in technologically advanced products, and promoting environmentally conscious management. The company has placed a strong emphasis on recycling its own waste as well as waste paper.

The sponsor requested local currency short term financing from the Bank. The Banking Team had cautioned the Board that it was not certain the Bank could deliver such financing competitively. It has turned out to be increasingly successful, both for the Company and for the Bank. However, the additionality rating primarily takes into account the situation at Board approval.

The Company argued that the EBRD's involvement increases recognition for the business it finances, and would help to clear bureaucratic hurdles, particularly outside the capital. While these aspects were not emphasised in the approval document, they must have contributed to the sponsor's decision to accept the Bank's less attractive terms and conditions, as well as a pricing higher than that available from commercial banks. Although additionality has been amply verified and is increasingly affirmed by the current success of local currency financing, PED regarded its status at the time of approval as only **Verified at Large**.

## **BANK HANDLING**

The Banking Team identified a good project and targeted an investment that fits very well with the Bank's regional and sector strategies. The Bank was reassured on credit risk and the danger to its reputation by the sponsor's technological standing in international markets, its excellent track record on environmental policies and corporate governance and its credit standing. PED felt the Bank's performance was highly commendable in the areas of policy compliance, project selection, appraisal quality, risk identification and mitigation and client relationship. However, at the Board approval stage the team should have been more explicit in prioritising the Bank's objectives. PED assigned a **Good** rating to the Bank's performance, taking into consideration the very positive outcome of local currency funding.

## **LESSONS LEARNED**

**It is important that the sponsor has a strong commitment to the environment, together with good business ethics.** In project finance operations, the Bank always requires high credit standards from its clients to secure the value of the Bank's investments. However, in respect of transition impact, this may need to be further enhanced by the client's high standards in respect of the environment and business ethics. A responsible company culture can have a demonstration effect on the entire sector, and the importance of this should not be underestimated.

**The Bank's mandate can justify working capital financing.** Short term working capital facilities may allow the Bank to fulfil important objectives, such as moving transition forward by pioneering more mature, short term local currency lending practices in a domestic market. The banking team should not shy away from suggesting such a short term transaction.

**Local currency financing in highly volatile domestic markets can make a strong contribution to the Bank's additionality.** When financing a project with the unconditional guarantee of its sponsor, the Bank provides an element of political protection through its preferred creditor status. This may result in a premium in the pricing of its facilities. In order to justify such a premium, sponsors are looking for the Bank's ability to bring benefits specific to its knowledge and expertise in domestic matters.

**Local currency credit lines should be used to optimum effect.** In managing scarce resources, it is important for Treasury to use the different departments within Banking. Similarly, through new products or market enhancement, Treasury operations can be critical to furthering the transition impact of Banking projects.