Mobile Telephone Company

Summary of the Operation Performance Evaluation Review (March 2005)

THE PROJECT

The Bank approved three facilities for the Company as detailed below:

In July 1999, the Bank approved a long-term debt facility of €32 million, in parallel with an Export Credit Agency-backed syndicated loan and a loan from another investment bank. The €120 million total package was to enable the company to construct and operate the country's second national Global System for Mobile communications (GSM) network.

In April 2001, the Bank approved a loan to the Company of up to €10 million for the Bank's own account, as an extension of the existing €22.4 million Bank loan. The second loan was granted to the Company after its excellent performance, which significantly exceeded the assumptions of the Bank's original forecasts. The Company attracted a much higher number of subscribers than predicted, became the market leader and achieved positive earnings before interest, tax, depreciation and amortisation. The resulting additional financing requirements were met with additional equity financing, internally generated cash and an extension of the existing debt facilities.

In December 2002, the Bank approved a third loan for the Company. This amounted to €45 million, provided as a tranche under a €150 million corporate syndicated loan. This syndicated loan replaced the original 1999 project finance parallel loan facility in which the Bank had participated. This third loan was to enable the Company to further develop and operate its GSM network, and to launch a fixed line service in competition with the incumbent telecom operator.

PROJECT RATIONALE

When the first operation with the Company was approved in July 1999, the Bank had already participated in several cellular transactions in Eastern Europe. All of these clients had enjoyed tremendous commercial success and had consistently outperformed their original business plans. The Bank wanted to support a project that would result in the country having a second national GSM network. The project would also make a direct contribution to private sector development and have a demonstration effect on the wider economy. The main rationale for the Bank's involvement was the fact that the project was seen as an important step towards the reform and liberalisation of the country's telecommunications sector.

ACHIEVEMENT OF OBJECTIVES

The project's objectives were:

- To provide essential, efficient, reliable and user-oriented services. These were underdeveloped in the country at the time. This was achieved.
- To promote the successful reform and liberalisation of the country's telecommunications sector. This was the aim of the first two operations, but it was not achieved.
- To introduce competition into the telecoms market in general, and the mobile market in particular. This was achieved.

OVERALL ASSESSMENT

Based on its independent review of the project, the Bank's Project Evaluation Department (PED) concluded that its overall performance could be rated as *Successful.* This assessment was based on the PED's internal rating methodology, which takes into account the achievement of objectives, transition impact, environmental impact, company and project performance, and profit contribution. The keen competition between the two GSM operators has kept management highly focused on maintaining the Company's market position and providing innovative service packages, while achieving *Excellent* profitability. The Bank's financial performance was rated *Good* due to the size of the transactions and the repeat business involved.

TRANSITION IMPACT AND BANK'S ADDITIONALITY

The first operation with the Company was approved before the Bank had its ex-ante rating methodology in place. The second operation in April 2001 was rated *Good* by the Bank's Office of the Chief Economist (OCE) for its transition impact potential, with *Medium* impact risk. The third operation in December 2002 was rated *Satisfactory* for transition potential, with *Low* risk. The incremental transition impact of follow-on projects tends to be lower, particularly if the main use of proceeds is refinancing. The OCE's low rating should be evaluated in this context. Since the last Board approval, the OCE has continued to monitor the project through the transition impact monitoring reviews and its original rating has been maintained. The PED rated the project's overall transition impact as *Good* for the verified short-term impact. The longer-term transition impact potential was rated *Satisfactory*, with *Medium* risk.

The PED believed that additionality was already weak in the first operation and was diminishing with each new loan. This is mainly due to the strong commercial and operational performance of the Company, and the fact that its principal shareholder was also performing well. Therefore, additionality was rated as *Verified Only in Part*.

BANK HANDLING

The client was reasonably pleased with the Bank's role but felt that the banking team representing the entire bank syndicate had been difficult to deal with. In particular, the client was disappointed with the lack of understanding of the realities facing a start-up mobile operator. The Company was also unhappy about the stringent reporting requirements, particularly for the first operation. As an example, the financial staff mentioned that they could not see the point in having to provide details on all their outstanding purchasing agreements. They were pleased, however, that they managed to relax the reporting requirements for the subsequent operations. Indeed, they claimed this was one of the objectives of the two refinancing operations, in addition to lowering their financing costs.

The Bank acted as lead co-arranger on these operations. It took a leading role in the due diligence process and contributed its knowledge of the local market and the country's economy. The due diligence was facilitated by reports from a specialised telecoms consulting company. The Bank was also instrumental in structuring the initial operation by negotiating a significant up-front equity contribution from the owners. Thanks to the resulting good debt/equity ratio, the Company managed to cover a large portion of its increasing capital expenditure requirements from internal cash generation, and its rapid growth was not hampered by financial constraints.
Bank handling was rated *Good.*

MAIN ISSUES AND LESSONS

Appropriate reporting requirements must be put in place to enable credit risk monitoring. The operation leader needs to allocate sufficient time before loan signing to structure an appropriate reporting system with the company. The Bank's credit department needs to receive at least quarterly information on the credit risk from the date of loan signing. Both the operation leader and the company need to review whether the internal management information systems provide all the relevant data, or whether additional information needs to be provided. Typically, reporting requirements may be more extensive during the implementation of the project and may sometimes be adjusted after start-up.

There is the risk of creating a duopoly market in the telecoms sector. In this case, there are strong signs that the two GSM operators are creating a protected duopoly market. This is not unusual in situations with almost equal market shares. However, it is more serious in this country, as approaching market saturation leaves very little room for a third mobile operator. By being aware of this trend, and considering the Bank's large exposure in the mobile sector, the Bank might be able to influence the main players in the right direction.

A long-term approach can help the reform and liberalisation process in emerging economies. In order to successfully restructure a state owned telecommunications sector it is important to develop an appropriate and independent regulatory framework in parallel with the privatisation process. Even in highly industrialised countries, developing a strong and independent regulator has taken many years. This Bank project helped in moving the sector along the "transition event line", but the lack of progress on the regulatory side poses a major threat towards establishing an efficient sector with a level playing field for all competitors. The Bank should recognise this fact and take a long-term approach to its telecoms operations. In this case, there might be a good opportunity for the Bank to support a third mobile operator. This might well increase mobile competition, as the Bank would be able to support the regulatory agency in its efforts to regulate the incumbent mobile operators.

The objectives of Bank projects should be measurable. Objectives included in board documents should be defined in such a way that they are measurable. This would also ensure that more care is taken in establishing and agreeing the objectives with the clients. A dialogue on measurable objectives between the Bank and the client would increase the understanding of the Bank's role as a development finance institution. Measurable objectives would also facilitate the ex-post discussion of the performance rating.

Establishing sector transition event lines could be a way of consolidating the achievements in the sector. Objectives change over time in line with the process of sector reform in the Bank's countries. The focus is initially on service growth, while the regulatory aspects become increasingly important when the sector develops. In a fully privatised sector, the universal access provision would become a high priority. This is less relevant for Bank operations in countries that are at the early stages of reform. The Bank's Telecommunications, Informatics and Media Operations Policy (BDS99-13) is very general and gives no guidance on what type of projects the Bank should focus on at any given time. The use of a sector "transition event line" is a good way of helping to select a project for a particular country.

An early focus on local staff development is crucial for long-term operating success. The introduction of new telecommunications services may initially require an appropriate element of expatriate staff and technology transfer. However, it is important from the outset to develop, motivate and promote highly qualified local staff in order to achieve long-term operating success.