Glass manufacturing company

Summary of the Operation Performance Evaluation Review
January 2006

THE PROJECT

The Company is a closed joint stock company and a leader in the manufacture of premium-quality glass containers. In 1998, the Bank acquired 37.5 per cent of the already privatised Company, jointly with a sponsor (38.2 per cent). The former owner was unable to carry out the required engineering and to develop the Company into a leading manufacturer.

The Bank had a put option on the sponsor which could be exercised in case of non-completion of the rehabilitation project, or if the sponsor's financial situation deteriorated. (Financial deterioration was defined as a decline of its share value on the local stock exchange below a minimum threshold.) The sponsor subsequently ran into financial difficulties and although the situation at the Company was improving, completion was delayed and the sponsor's share value went below the put option trigger point.

Under a two stage transaction completed in February 2002, the Bank agreed to release the sponsor from its put obligation following the transfer of all the sponsor's outstanding Company shares to the Bank and transfer of the sponsor's claims to the Company under receivables and its shareholder loan. In February 2000, the Bank's equity was fully provisioned. The Bank's ownership of the Company increased to 79.71 per cent.

In March 2003, the Board approved a 5 year loan to the Company as part of an investment plan to acquire and install a second furnace and forming line, thereby increasing the Company's daily capacity. Part of the loan proceeds was earmarked to repay the Bank for the shareholder loan transferred from the sponsor under the Mutual Release Agreement of February 2002. It benefited from an improved political and economic climate as well as a brighter outlook for the Company. The Bank completed the sale of its equity in September 2005, while its term loan was prepaid simultaneously through a short-term facility. The Bank's return on its equity investment, over its almost eight-year holding period is substantially in line with the targeted level at approval in December 1997, evidencing a spectacular recovery from a 100 per cent provisioning level five years earlier.

PROJECT RATIONALE

The aim of the initial project, in 1998, was to establish the country's leading and most modern glass container production facility, thus setting an example of quality and performance standards to the country's industry. The collapse of the sponsor prior to the project's completion made the Bank a majority shareholder in the Company. The local minority partner lacked both financial resources and technical expertise to support the project. The protection of the Bank's equity became the primary objective of the 2003 operation. While the new project rationale was challenging from a risk management standpoint, it was compatible with the objective of building a highly competitive glass packaging facility in accordance with international business and industry practice. It would also facilitate a buy-out of the Bank's equity from a new Western sponsor.

ACHIEVEMENT OF OBJECTIVES

Two main objectives were set, in line with the above rationale. First, the retention and protection of the Company's leading position in the market and secondly, enhancement of the chances of recovery for the Bank by making the Company an attractive proposition for purchasers. This was done through the completion of the second furnace construction and implementation of related equipment. The 2003 investment programme was completed ahead of time and within budget. With the implementation of the narrow neck press and blow (NNPB) technology, the Company has become the leader in the upmarket flint glass segment of the glass packaging industry. It has achieved 15 per cent market share overall, while its major competitors have also added production capacity in a buoyant market. The structuring of the loan allowed for an immediate partial recovery of the Bank's equity investment. The successful implementation of the investment programme, combined with the ability to retain and enhance an already strong management team, allowed the Bank to seek competitive bids from international strategic investors.

OVERALL ASSESSMENT

The Evaluation Department (EvD) has assigned a *Highly Successful* rating for the project's overall performance. The spectacular recovery of the Bank's investment value was obtained through *Excellent* Bank handling while securing highest ratings in achievement of objectives and transition impact. The environmental performance of the project was assigned a *Good* rating with a *Substantial* extent of environmental change. The successful sale of the Bank's equity was made possible due to the *Excellent* financial performance of the Company. The Bank's investment performance (an EvD concept) was impacted by the prepayment of the loan. This is however of little significance in comparison with the earlier impairment of the Bank's investment.

TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

EvD rated this project's transition impact potential as *Excellent*. Almost every checklist indicator scored a top rating with a special mention for the demonstration effect of supporting a financially weakened project on grounds of the quality of its management and high governance standards. The Company has reached a higher profitability level than its competition through specialisation in flint glass products. The Company has had a significant influence on its competitors who are systematically attempting to replicate its production processes and adjust their marketing strategy according to the standards set by the Company.

Improvements in the quality of glass packaging has had a direct impact on the food and beverage industry through increased reliability and better marketability of its products. The Company's influence in this respect is particularly significant with liquor bottling plants. As it meets international standards which are required for this sector to be able to export, the benefits to the host country's economy come from import substitution and increased export competitiveness for the liquor sector through cost reduction in the packaging component.

The Environmental Action Plan (EAP) was updated with the aim of bringing both the existing and new production sites in compliance with EU and international industry standards. Identified environmental issues were addressed partly by the modernisation and the second furnace expansion programme and partly by the implementation of the EAP. The Bank provided equity and long-term financing which were clearly unavailable when each operation was approved. By doing so, it helped other financial institutions get into the Company's banking picture which would not have been possible without the Bank's initial involvement. The Bank's additionality was therefore *Verified in all respects*.

BANK HANDLING

The Bank demonstrated superior skills in turning around an impaired situation through complex negotiations with a failing sponsor and good credit judgement in a challenging context. None of the Bank's initial objectives were compromised in the process of working out its exposure. In fact, the transition impact resulting, in particular, from the demonstration effect of the Bank's investments (including the so far unprecedented repayment of a sovereign guaranteed loan) has scored the highest rating. The overall profitability for the Bank ended up satisfactory when compared with projected returns at successive approval stages, but spectacular in the context of where it stood four years ago. Throughout, the Bank enjoyed an excellent relationship with its client and furthered its existing good relationship with the strategic investor. EvD therefore assigns an *Excellent* rating to Bank handling

MAIN OPER ISSUES AND LESSONS LEARNED

Lesson: The Bank should regard management expertise as the most sensitive issue in respect of risks associated with foreign sponsors. While the financial strength of a foreign sponsor is important in order to balance out the respective contributions of the Bank and its equity partner, the latter's contribution in terms of sustainable management at the local level is critical. This is one aspect which would be most difficult for the Bank to deal with in case of withdrawal of the foreign sponsor for any reason. With a reliable management team in place, the Bank has in turn more flexibility to decide on the appropriateness of its on-going financial support of the local venture.

Lesson: Strategic investors look to the growth potential of their targets to justify an acquisition. The market valuation of a company is not based only on profit and leverage. The valuation method based on an EBITDA multiple would typically incorporate a higher multiple to reflect sizeable market share, including positioning in the high value segment of the market. This was indeed what took place in this project when the winning bid in the successful second round of equity sale was based on a higher EBITDA multiple than had been contemplated, based on prevailing market indicators.

Lesson: Adhesion of key managers to the search for a new strategic investor is a prerequisite to its success. The dedication of management to seek maximum value out of a sale to a new strategic investor would typically be dampened by the uncertainty regarding the new shareholder's strategy and management. The incentive package may not therefore be limited to performance indicators, and should be based on actual proceeds from the equity sale. This requires that the Bank, as a shareholder, contributes such financial incentives out of its own return since they may not be treated as corporate compensation.

Lesson: Positive impact on a client's corporate governance would typically bring about strong evidence of the Bank's additionality. In a political and economic environment where corporate governance is often neglected, the sheer presence of the Bank as a shareholder in a company, may significantly enhance its ability to attract foreign financial institutions as lenders. While committing term financing in a market where such a resource is scarce could be sufficient to show the Bank's additionality, a lot more is achieved when foreign commercial banks are motivated to start a lending relationship alongside the Bank due to confidence built through its action on the client's corporate governance.

Recommendation: The Bank should select an IRR calculation methodology that would be

consistently applied for all equity exits. If the IRR terminology is to be maintained, the methodology should disregard cost of fund. To the extent that, irrespective of the initial currency of investment and exit, the calculation is based on historically EURO translated cash flows, it is helpful to also provide an indication of the IRR in the original currency of the investment. While not necessarily representing the Bank's investment performance, the currency of investment approach allows for a more accurate assessment of the project economic performance.