SUMMARY OF THE OPERATION PERFORMANCE EVALUATION REVIEW

1. The project

The subject of this Operation Performance Evaluation Review (OPER) is a private sector investment that involved a Bank loan to a limited liability company. The loan was made parallel to an equivalent investment by another international financial institution (IFI) and was intended for the rehabilitation and expansion of an existing cement factory. The old plant was a wet-process plant that had not been in use for some time. Rehabilitation included extending grinding operations, conversion to a dry-process plant and expansion.

The project is the second investment made by the European Bank for Reconstruction and Development (EBRD) in the sector in this country. Both investments were done with the same sponsor. In the late 1990s the sponsor acquired the majority stake in a similar cement factory and associated facilities from the government.

There were no competing bids – few, if any, international investors were willing to make large investments in the country. After obtaining ownership, the sponsor's strategy was to update the plant and double production. At the time, more than 80 per cent of national demand was met by imports. The factory acquired under the previous project was the only in-country source.

Later, the sponsor in consortium with foreign investors acquired another factory. This purchase also happened through a public auction in which they were the only bidder. It is surprising that the Bank did not assist and engage with government even though this acquisition represented the country's largest privatisation to date. Given the perceived high levels of corruption in the country, multiple bids would have provided a better market signal.

While the lack of competition for the first factory is somehow explicable, the absence of competition for the subsequently acquired plant is less obvious. This may perhaps be attributed to the country's current stage of development and the fact that it remains a relatively small market. The second plant is located close to both the capital and the country's major seaport. The sponsor's rationale for acquiring this plant was premised on

- recognition of growing demand
- prospects of import substitution
- good brand name
- ideal location of the plant given the availability of raw material and logistics
- competitive cost of production.

The sponsor approached IFIs for a loan to finance the construction of a new production line. A number of other financial institutions provided additional parallel financing while the sponsor itself made an equity investment into the project.

Whereas both factories acquired by the sponsor are separate subsidiary companies, the purchase of the second plant shifted the sponsor's strategy away from its earlier project. The EBRD loan for the first plant was cancelled. The plant continues to operate as a smaller facility targeting the local region and cross-boarder trade. In abandoning the first deal, the sponsor and the country lost potential environmental gains that had previously been negotiated with the EBRD.

2. Strategy

The sponsor's strategy was to increase its national market share from slightly above 50 per cent to above 65 per cent by 2008 through substituting imports and increasing local production. Exports to the neighbouring countries (by land or sea) could have also been considered but growth in local demand meant that the sponsor lacked the excess capacity to export significant quantities.

The strategy has been implemented effectively, and the sponsor is the dominant player in the market. However, competition is emerging. This development can be attributed to the currently huge demand facilitated by remittances from overseas guest workers as well as by the availability of credit. Given the growing credit crisis, one could anticipate an increasingly competitive national market. However, the project will continue to have the advantage of being the low-cost in-country producer.

3. Project rationale

This project comprised a sensible investment opportunity because demand for local production had not been met. On completion, the plant became a low-cost producer. The lack of supplies was a constraint to growth. Having invested in the first factory at a critical time, the sponsor established itself as the dominant local player.

Furthermore, the second plant was one of the largest privatisations to have taken place in the country. Finally, promotion of local production and plant modernisation enabled significant energy efficiency and environmental pollution gains.

4. Overall assessment

The project is rated "Successful" overall. The project is the outcome of the privatisation of an old government-owned plant and its transformation into a new, modern dry-process plant. This is now fully owned and operated by the private sector. The sponsor has captured significant market share, making it the leader in its sector.

Local production effectively displaces imports, resulting in a competitive advantage and direct financial benefits to consumers. Transition impact is rated "Good". The project has performed well financially and project/company financial performance is rated "Good".

Environmental performance is rated "Satisfactory", and environmental change is rated "Substantial". While there are significant benefits to local production, occupation health and safety as well as housekeeping issues remain a concern. The project is close to compliance with European Union (EU) environmental standards. Additionality is "Verified in all respects".

It is unlikely that the client could have obtained sufficient funds to fully implement the project without access to the longer-term financing provided by the EBRD and other IFIs. Finally, Bank handling is rated "Good". The team has worked hard with the sponsor to implement the project on schedule. The EBRD has built a strong relationship with the sponsor, and the sponsor has approached the EBRD for the follow-on project.

Completion and turnaround of the plant and establishing leadership position in the industry (Fully Achieved)

At the time of acquisition, the plant was a limited use facility. The sponsor first increased its storage and operating capacity. The company, with the assistance of the lenders via the loan, successfully managed the reconstruction of the plant, built a new power station and reactivated some facilities. The plant operated at 65 per cent of its design capacity in the first year of full operation.

Setting of corporate governance standards (Fully Achieved)
The sponsor has brought in an experienced international Western management team to oversee the contractor activities and, subsequently, the operations of the plant. In addition, the contractor also introduced a highly experienced team, as demonstrated by their performance. Further, the sponsor and the new management team have introduced International Financial Reporting Standards (IFRS) accounting and reporting.

Improving energy efficiency at the plant and reducing its dependency on the national grid (not rated as this is a performance criterion, not an objective)
The older plant was shut down and a new dry-process plant was built in the same location, making use of some of the older facilities. The construction of a captive power plant adjacent to the new plant would also lead to greater efficiency than continuing to rely upon the national grid. However, it is not clear if the new plant is more efficient although it demonstrates a critical advantage by reducing line losses and avoiding shutdowns.

Company transition impact
Through the acquisition, the plant and the associated facilities successfully moved from government control to private ownership. While this occurred prior to the EBRD’s support for this project, the EBRD was already engaged with this sponsor via the earlier project. The sponsor brought to the project an excellent international management team, established international management practices, installed a management information system and introduced international tendering for key equipment.

The sponsor developed a roll-out plan that increased operational profitability. Although the plant operated at a loss in 2005 due to the high cost of clinker, it was profitable by the end of 2006. The new plant offered the sponsor a better position for servicing the primary national market as the only in-country producer. In addition, it provided better access to the port, where the company operates its own bulk loading and unloading facilities.

Industry transition impact
At the time the sponsor purchased the first plant, the probability of investments by international developers in the national market was uncertain. However, by the time the sponsor acquired the second plant, the market was already expanding. This plant as well as major foreign exchange investment in the new line demonstrated that large foreign investment operations in the country could be profitable.

From the government’s perspective, privatisation of the plants has proven successful as both plants remain operational. Also, the second plant has gone through a major expansion. The government has since auctioned off other quarries, and the market is experiencing further growth. Whereas the sponsor still has a competitive advantage, it will be interesting to see how the market develops as some of the larger global companies enter the country’s market.

Transition impact on the economy as a whole
The country has been experiencing a building boom. Cement is a key construction commodity, and demand is expected to continue to grow. Further, experience in the region shows that

construction accelerates as countries become EU candidates, which further increases the demand for cement.

Without local production of cement, construction costs would be more expensive. Thus, this project has made a significant contribution to the growth of the national economy. Further, the willingness of a foreign investor to make such a large single investment has had a major demonstration effect for the private sector. However, it remains unclear how long the current building boom will continue, particularly given the growing global credit crisis.

Environmental impact
In the Evaluation Department's (EvD) opinion, the plant is essentially performing to EU standards. The kiln is in compliance with Best Available Techniques (BAT) principles under the EU Integrated Pollution Prevention and Control (IPPC) Directive. The plant is working to obtain International Organisation for Standardisation (ISO) 14001 certification.

Furthermore, it is implementing an agreed environmental action plan (EAP) that will bring the company into full compliance. It is noteworthy that the annual environmental reports submitted by the plant management were of excellent quality. With better project monitoring and support from the EBRD, the company should fully achieve EU standards.

- *Environmental performance rating ("Satisfactory")*
  The company is generally on schedule with implementing the EAP (except for health and safety and wastewater). It is very close to meeting EU standards but without additional support, investments and training, the company is unlikely to achieve this goal. The EBRD should work to ensure that the new plant fully achieves compliance with EU standards.

- *Environmental change rating ("Substantial")*
  The client successfully modernised the plant, which resulted in a significant reduction in emissions.

Sector policies
Cement is covered under the Bank's general industry approach. While cement is a key commodity for the construction sector, the Bank does not have a strategy for this sector, even though the Bank has several projects that support construction material suppliers. A better understanding of the supply of construction commodities could enhance the role of the Bank in supporting the region's construction boom.

Additionality
This project represented the largest single foreign direct investment in the country. Few, if any, major private banks were willing to make such large long-term investments. The sponsor approached the EBRD and other IFIs, partly because of the longer terms available but also because of the political risk coverage provided. At the time, the country risk rating was quite low. Additionality is therefore rated "Verified in all respects".

Bank handling
The expanded monitoring report (XMR) rates Bank handling as "Excellent". The Banking team has done an excellent job in working with this sponsor and with the other IFI team in developing and monitoring this project. This is demonstrated by the sponsor's desire to continue the relationship in moving forward with the next project.

However, EvD is of the opinion that the team missed the opportunity to

- take an equity position in this project
- bring in a major international bank via syndication
- raise the possibility of carbon trading, which lost the environmental gains already negotiated in connection with the earlier project.

Therefore, Bank handling is downgraded to "Good", which is still a very positive outcome.

5. Key issues and lessons learned

Strong sponsors are those that recognise market opportunities and are willing to take the risk
This sponsor understood the market from its role as a bulk cement importer and operator of a previously privatised plant. They saw the growing demand for cement as a result of the local construction boom. The sponsor brought in an international management team and bought a new production line that meets EU and World Bank standards.

The EBRD should operate at arms length from clients when investing in new privatisations
The EBRD should develop its own sector intelligence and be willing to engage with government on the privatisation agenda. Existing Bank clients in transition countries, which are willing to invest in a sector, represent excellent sources of data and intelligence on national conditions, capacities and situations.

Nevertheless, the Bank should build its own knowledge to stay at arms length from its clients in new privatisation deals. Where major privatisations are anticipated, the Bank could further promote its transition objective by early engagement with the government to ensure a fair, open and fully competitive process independent from its existing client.

In cement projects involving conversion from wet-process to dry-process, carbon emission trading is an opportunity that should be investigated
Cement plant conversions from wet-process to dry-process offer 40 per cent efficiency gains in terms of greenhouse gas emissions and are obvious carbon trading opportunities. The Banking team should consider carbon emission trading in all cement plant rehabilitation projects and carry out cost benefit analysis to test whether such conversions are financially viable.