Loan and equity operation to an outdoor advertising company

Summary of the Operation Performance Evaluation Review

January 2008

THE PROJECT

In 2005 the EBRD's Board of Directors approved an initial operation, which included a loan facility of up to US$ 18 million (including a B loan of US$ 3 million) and an investment of up to US$ 5 million for a maximum of 20 per cent equity. The purpose of these investments was to finance the expansion of outdoor advertising installations by acquiring other companies in this sector and by expanding the existing business.

Shortly afterwards, the Bank introduced a private equity fund that subsequently became a new strategic shareholder with an investment of US$ 25 million. Due to this strengthened shareholder base, an operational growth significantly ahead of the original projections and a successful implementation of the acquisitions programme, a second Bank operation was agreed. The Bank's Board of Directors approved this second operation in 2006 with the following elements.

- An A/B loan of up to US$ 60 million (of which up to US$ 30 million was for the Bank's own account). This loan would refinance the earlier loan.
- A convertible loan of up to US$ 15 million.
- A contingent equity operation of up to US$ 10 million (in addition to the earlier equity investment under the first operation).

PROJECT RATIONALE

The Bank's main rationale was the desire to actively support the consolidation and modernisation of the outdoor advertising sector in the country. The Bank wished to support the consolidation of the outdoor advertising industry and contribute to more competition in the sector. The Bank also saw its role as highly additional since a locally owned advertising company with essentially local currency revenues could not easily obtain medium-term debt financing at the time of Board approval. While the Bank is providing attractive debt financing to an emerging company, the equity investment will ensure a participation in the lucrative upside of this business at the time of an IPO.

ACHIEVEMENT OF OBJECTIVES

Four main project objectives were outlined, which have all been achieved in full. The first was to grow the proprietary network of advertising platforms and to obtain most revenue from own displays. The second was to grow by acquiring solid anchor companies in regional markets where the group has little or no presence. The third was to further develop the proprietary IT platform, which allows the group to service both large national and smaller regional companies cost-effectively. Finally, EBITDA margins were to be improved towards the range of 30-40 per cent in line with that of other outdoor operators.

OVERALL ASSESSMENT

On the basis of its independent review of the operation's performance to date, the Evaluation Department (EvD) assigned a *Successful* performance rating. The transition impact is rated *Good.* The financial performance of the company has improved and is now in the range of top performers in this sector. It bought 16 regional companies and has, as a result, increased its market share from 3.1 per cent to 10.4 per cent within a year. The Bank was able to offer longer-term financing and attract commercial banks as B loan participants. EvD rated the Bank's additionality as *Verified at large*. EvD rated the company's financial performance as *Good***.** The main project objective to acquire smaller regional advertising companies and to catch up with market leaders has been achieved. EvD rated the fulfilment of objectives as *Good,* bank handling as *Good* and the Bank's investment performance as *Good.*

TRANSITION IMPACT AND THE EBRD'S ADDITIONALITY

The ex ante rating given by the EBRD's Office of the Chief Economist (OCE) of transition impact potential at the time of Board Approval was *Good*. Transition impact risk was rated as *High*. The high risk rating can be attributed to the nature of the business, which is dependent to some extent on meeting municipal authority requirements. At Board submission, the main argument outlined for the Bank's involvement was the support of a strong second player with the business focus to consolidate small regional advertising companies. Ultimately, this would lead to increased competition in this sector at the national level. It is also expected that the fast growth of this country supported by international investors would have a high demonstration effect. EvD rated the transition impact on the sector as *Good.*

In the first operation, additionality was higher than in the second operation. The 2005 Board document describes the project as highly additional given the following additionality dimensions: no term loans have been available to advertising companies in this country, other than to the market leader; commercial banks are unwilling to provide substantial long-term financing to companies that focus on the domestic market and generate rouble revenues; the Bank's preferred creditor status provides comfort to B loan participants; and through representation on the company's Board, the Bank will be able to monitor corporate governance standards, which have been improving and will continue to improve. Shortly after the first Bank operation, the private equity fund became a strategic shareholder with an equity stake of 40.6 per cent. Subsequently, the Bank's additionality in this project was lower.

BANK HANDLING

The company expressed that it was very pleased with EBRD's motivation and professionalism. It was clearly helpful that the Bank had already provided financing to the industry leader and was familiar with the industry.

The EBRD had contact with the company's founder for some time and subsequent to the first operation was able to introduce a large investor who nominated three members to the company's Board and dedicated substantial resources to the company. This joint investment position made it possible to achieve a strong impact without tying down more substantial resources from the EBRD. The EBRD director for corporate equity is a member of the company's Board and also the head of the audit committee of the Board. While the Bank has been able to support remaining shareholder efforts, the role of the Bank in the Board became less crucial after three members were nominated. However, the reputation and honest broker role of the Bank continued to facilitate agreements between local and foreign investors. Bank handling is rated as *Good.*

MAIN OPER ISSUES AND LESSONS LEARNED

Co-investment with a specialised private equity vehicle is essential in a fast turnaround and expansion scenario. Working with a strong business founder in a fast expansion strategy requires substantial resources also from the equity investor representatives. For the Bank, it is clearly an advantage if a well-known private equity investor with similar targets participates in the same company. Through its equity participation limits and staff constraints, the Bank alone could not have been as effective in influencing a fast growing company with an IPO target. Furthermore, the Bank can consider reducing exposure of Board membership at an earlier point in time.

Updating of sector and sub-sector strategies with a transition focus. The regular updating of sector strategies is important to provide the EBRD's Board of Directors a framework for the focus of future transactions. The lending focus (volume targets and transition impact targets) for the different areas of Bank operation is important and needs to be spelled out more clearly in sector strategies. For instance, in a future strategy for the telecoms sector, more clarity on the targeted transition impact when dealing with outdoor advertising installation projects is important.

Transparency in the authorisation process with municipalities. Large and efficiently organised advertising companies can support the trend to more transparency when obtaining advertising permits. This is particularly important when dealing with many regions and smaller cities. The Bank needs to assess and mitigate potential reputational risk issues in connection with loan and equity operations in sectors with a high degree of dependence on decisions by municipalities. This is particularly important where the Bank also has a representative on the company's Board.