Summary of the Operation Performance Evaluation Review
Review evaluation of a hypermarket chain
January 2009

The project

Modern retail formats such as hypermarkets entered eastern Europe in the late 1990s and unlocked a large and latent demand. They have met consumers' needs and wants while significantly raising the consumer utility. This regional project, which was approved by the European Bank for Reconstruction and Development (EBRD) in 2003, aimed to support the store rollout of a large hypermarket chain in the target countries. The operations were carried out and considered completed in 2007.

Operation A
A large syndication was arranged, and a total of €160 million was raised, including parallel loans. The A and B loans were intended to refinance six existing stores and to finance the construction of three new stores.

Supported by growing consumer spending, hypermarkets developed quickly in this country, particularly through international retail players. Together with conventional small shops, modern shop formats have intensified the competition in 2004, right after this operation started. In 2006 the government's tight fiscal measures reduced consumer spending. This halted the growth of the retail market in real terms. Since the market was saturated with many players, the store revised its rollout plan and built only one new store under the syndicated finance.

Operation B
The investment was smaller and simpler in this second country. A total of €70 million of A and B loans was fully disbursed in 2004. Three stores were already built by 2007 and the strong sales growth was mainly supported by the rapid growth of the retail market itself. The client group decided not to use the Bank financing for further store rollouts.

Project rationale

Guided by an optimistic prospect for emerging markets, a substantial syndication of a retail project finance was arranged. At appraisal, the hypermarket in the first country showed a positive economic outlook. The urge to capture market opportunities in the target region seemed strong, and the Bank's strategy and geographical coverage were sought after. The Bank's experience and achievements in investing in medium-sized retailers in the region represented additional deciding factors.

The Bank's capacity and capabilities of arranging large-scale financing for the region was also important. The EBRD had several reasons for the project:

- an established sponsor in the retail market
- co-arranger status for a large prestigious syndication
- good outlook in the country in 2004
- projected transition impact through the introduction of a modern retail format.

Most importantly, the project was expected to provide the Bank with an opportunity to exert significant transition impact at a regional scale in the emerging retail markets.

Achievement of objectives

The objectives of this regional operation, which were set at appraisal, comprised:

- meeting customer demand by achieving a timely store rollout plan with better geographical coverage
- strengthening the competitive position and realising economies of scale thereby reducing retail trading margins.

The OPER team considers the fulfilment of the objectives as *Satisfactory*.

Overall assessment

This regional project is assessed as *Successful* despite a partly successful operation in one country, unrealised rollout of two stores in the other and cancelled operations elsewhere. The objectives were mainly based on the store rollout and their partial achievement is considered just *Satisfactory* tending towards *Marginal*.

Given the verified transition impact concerning the stimulation of competition, the transition impact is assessed as *Good*. This rating is based on higher quality and better hygiene standards for goods and services in comparison with conventional small local stores. It is also based on the positive demonstration effects generated by a successful investment in the retail sector.

It remains, however, exposed to *Medium* risks. It should be noted that the transition impact diminished during the implementation as a result of amending the lending structure in Operation B.

Environmental performance is considered *Satisfactory* with *Some* changes made by the project. The project structure made a stable repayment source available, which is rated *Satisfactory*. In contrast, credit risks are taken at the aggregate level of stores whose performance has stagnated in one country and risen in another.

The Bank's additionality was derived from various areas including the Bank's capacity to arrange a large syndication. This is *Verified at Large.* The Bank functioned as the syndication agent for one country and has performed long-term tasks in an adequate manner. Bank handling is considered *Good*.

Transition impact and the Bank's additionality

High transition impact potential constituted a strong rationale for the project. The transition impact monitoring system (TIMS) has constantly rated transition potential as *Good* with *High* risks for the regional operation. Transition objectives encompassed two areas:

- market expansion through forward and backward linkages
- demonstration effect of the investment in terms of good industry practices and a high corporate standard.

Hypermarkets have significantly changed consumer utility and behaviours by providing better quality goods, wider range of products, higher hygiene standards and ancillary services, such as consumer credits. The project hypermarket chain is particularly regarded as a "niche player" that seeks to offer higher quality goods and services in spacious environments.

The OPER team considers that the overall transition impact is *Good* based on the verified short-term impact. It shows a high potential for further transition depending on the future performance of the project.

The risks anticipated by TIMS at appraisal have actually emerged during the operations in these countries. While the operations have stabilised in one country, they remain volatile in the other. Therefore, the risks associated with high transition potential are assessed as *Medium*.

Bank handling

Bank handling is considered *Good*. The operation team fared well in coordinating with the retail group and attending to the matters at hand. Within the syndication, participant banks appreciated the Bank staff and valued the relationship.

The syndications for Operation A required time-consuming administration, which included:

- contact with the participant banks
- producing documentation work for signing and amendments
- request for consents to waivers
- thorough monitoring of covenants.

Therefore large amounts of resources, time and efforts had to be allocated to properly deal with them. The relevant Bank staff should be commended.

Main OPER issues and lessons learned

Change of lending structure could result in a diminishing transition impact. This project was presented to the Board as a limited recourse project finance sponsored by a Western retail company. During the investment implementation, the lending structure was found too rigid for the fast-moving and competitive retail businesses in the emerging markets. Consequently, it was modified by removing restrictions inherent to project financing. This diminished certain transition effects, made the investment similar to corporate finance to a Western company and weakened the Bank's position.

The Bank's agency capacity for limited recourse financing needs to be assessed prior to the investment. This was the first time the client and the operation team had experienced a large syndication for limited recourse financing. All contract parties had to deal with an unexpectedly heavy workload during investment implementation.

The planned project financing would need to be examined and estimated carefully against the Banking team's handling capacity and anticipated workload and costs. In this respect, the establishment of a syndicated loan administration team in the EBRD's Operation Administration Unit is an important initiative.

Financing the store rollout of a hypermarket business in the country of operations involves much uncertainty, particularly when the retail market is untapped. In this case, the project assumed a project finance structure which required a rigid cost control. It did not suit the fast-moving retail market and deprived the client of flexibility. It eventually led the investment to relax the lending structure. The financing structure needs to fit the nature of markets and businesses involved. Unnecessarily complicated project structures for projects in a fast-moving market would create excessive costs to the project's stakeholders.

Analyses of various market drivers and sector-specific systematic risks are necessary to see the downside of the project performance. One of the major market drivers for the retail sector is consumer spending and consumer behaviours. A project involving modern retail formats often involves a property investment, which requires a certain lead time (until store opening).During this time major market drivers could be easily affected by the regulatory environment. Analyses of various risk elements, including macroeconomic and regulatory factors, help highlight proliferating risks in the emerging market. In this project the sector-specific risks reduced the number of planned hypermarkets.