SUMMARY OF THE OPERATION PERFORMANCE EVALUATION REVIEW

The project
The purpose of this operation was to finance greenfield construction and the start-up of a company. The operation was structured as two facilities, both comprising loans with a five-year amortisation period. The operation’s financing plan anticipated up to €35 million of funding and a working capital facility of €3 million to be provided locally (later increased to €5 million and then to €8 million). Construction began in August 2004, ahead of approval of the Bank’s facility. Commercial production started almost on schedule in September 2005.

Project rationale
The operation was intended to support a significant greenfield investment in the country and represented the first major foreign greenfield investment since the regime change in 2000. The project was to deliver a world-class manufacturing facility under the sponsorship of one of the world’s three leading companies in the sector. The domestically high profile nature of this project made it an effective test case for both, the streamlined investment process introduced after 2000 and the investment incentives regime. The latter was designed as a “pilot” project around the investment.

The project’s commercial rationale was underpinned by an expectation that markets in this sector and in the region would follow the experience of the most advanced transition countries. A key feature of this expectation was the assumption that rising per capita incomes would lead to higher consumption.

Achievement of objectives
The project had three core objectives:

- to establish a successful greenfield business
- to demonstrate a functioning investment environment for foreign direct investors
- to establish a recycling model.

Achievement of objectives is rated “Good”.

Overall assessment
This operation is rated as “Successful” due to having fulfilled most of its objectives while having an overall transition impact rating of “Good”. Furthermore, the project, in time, has every potential of becoming a commercial success and thereby fully achieving all objectives. The strength of the sponsor, who has a Europe-wide sales and manufacturing strategy, has been critical in absorbing the impact of a slower than anticipated uptake of the product in the target region.

This operation provides “Good” demonstration effects at both the corporate and wider economy levels, although this has yet to be translated into increasing interest from other greenfield foreign investors. The operation provides new market opportunities and has proven that both the investment and the incentive frameworks function. Transition impact is therefore “Good” but remains vulnerable to political and economic instability and to the weak financial performance of the company.

Environmental performance of the plant has been rated as “Satisfactory” based on the company’s self-certification of environmental compliance. There is no reason to doubt this, although data that verify the extent to which the company has complied with local or EU standards, as stipulated in the contract with the Bank, have not been provided. On the whole, the company is fulfilling its
obligations to introduce a national recycling and education programme. Environmental change is therefore rated as “Substantial”.

**Transition impact and additionality**
Verified transition impact (TI) is rated as “Good”. The potential that this rating will be maintained is assessed to be “Good”. There is, however, a “Medium” level of risk on account of the poor financial outcome to date and uncertain political and economic environment.

**Overall transition impact**
At the corporate level this operation has contributed to the establishment of a manufacturing business working at world-class standards. “Satisfactory” skills transfer has taken place and “Good” demonstration effects achieved (with the potential for “Excellent” demonstration effects if the medium-term commercial outcome is positive). In terms of the wider economy, the operation is contributing to new downstream product developments as well as to an entirely new business activity in contract filling.

Despite the lengthy time-frame that is likely to be needed to achieve the commercial potential of this operation, EvD assigned a transition impact rating of “Good” to this operation. However, the TI rating carries a “Medium” level risk rating due to the commercial uncertainty.

**Company impact**
This operation has contributed to the establishment of a world-class operation and the transfer of corporate best practice to its subsidiary. Strategic and technical objectives of the sponsor have been met and so have the operation objectives of the Bank. Local and international management in this company are very satisfied with the overall investment process in this country and with the high technical performance achieved.

**Industry impact**
Indications to date are that it will take some years before the sector has fully explored the commercial opportunities presented by this company. In support of market development, the company and its European parent company are working with existing and potential clients to introduce or expand filling capacity. Significant technical assistance is also being provided to a local investor who is establishing a greenfield contract filling business.

The business will fill on a contract basis for smaller beverage manufacturers for whom it is not commercially or strategically viable to establish their own filling line. Contract filling is an entirely new activity in the country and opens up the possibility of new packaging solutions and related aspects, such as niche marketing and brand development, to smaller drinks producers.

Opportunities for backward linkages in this project were limited. The main material is imported. Some skills transfer has taken place as service providers incorporated the company’s service requirements into their basic service offering to all clients. These include records and data management and health and safety features, such as using visibility jackets in goods yards.

**Impact on the economy as a whole**
This operation was integral to the establishment of a tax-based investment incentives regime in line with best practice standards. The project also provided a pilot study of an international investor successfully navigating streamlined administrative procedures that had been developed over several years. Investment agencies attribute a better understanding of inward investor and multi-national investor requirements to their experience of working with this company. Local authorities too were given additional impetus to tailor investment assistance in order to attract investors.
This company remains a flagship investor for the country. It demonstrates a functioning investment process and incentives regime. The company is active in the wider business community and hosts visits by local businesses that are interested in high-volume manufacturing practice. It is also an advocate of the country’s investment environment, providing information to international investors researching the country’s investment climate.

**Environmental impact**

Environmental performance of the project is rated “Satisfactory” and the extent of environmental change “Substantial”. The company has applied its own rigorous internal standards of health and safety. As a high speed, high throughput manufacturing business, stoppages or other disruption through accident and injury are a major commercial risk. Therefore, they are given a high priority in factory operating procedures and employee training.

The environmental risks of this business are relatively low (screened B/0) and mainly relate to lacquer residues in airborne emissions and waterborne particulates. Water is drawn from the municipal supply and waste water is discharged into a local river.

The company has been self-certifying compliance with all local environmental requirements. The Bank is not aware of any concerns of the local authority regarding environmental compliance. However, no data have been provided to the Bank that could substantiate whether the company is complying with the European Union (EU) environmental standards to which it had committed.

Notwithstanding the business’s low risk in terms of environmental impact, satisfactory environmental performance belies important gaps in environmental reporting to the Bank. In accordance with the Bank’s Environmental Policy, this operation was covenanted in the loan documentation to adhere to EU environmental standards.

In the Board’s question and answer session it was recognised that EU standard would require the installation of an incinerator for airborne emissions (vegetable and organic compounds). However, this was not required for compliance with local standards. As explained in the responses to the question and answer session, an incinerator was not considered commercially viable by the company on a single production line.

It was therefore intended to control environmental emissions through the use of water-based lacquers and appropriate manufacturing techniques. However, no appropriate reporting framework was put in place with the borrower to monitor environmental compliance.

Following prompts by EvD, some effort was made to obtain further data (June 2007) but, following notice of prepayment, it is unlikely that the Bank will be able to ascertain the degree to which this factory was compliant with its environmental obligations to the Bank. While the risks attached to the absence of data are likely to be minimal, it underlines the necessity of establishing adequate reporting parameters at an early stage of an operation regardless of who the sponsor is.

**Country strategy and sector policies**

The period between preparation and signing of this operation also saw the preparation of the country’s strategies (2002 and 2004). The operation was fully compliant with both strategies. In addition, the operation represented a pioneer greenfield investment that contributed to maintaining momentum in “reform of the administrative and regulatory framework governing the establishment and operation of private business”.
**Additionality**

Additionality is rated “Verified at Large”. The EBRD’s participation clearly complemented the investment by providing reassurance to the sponsor at a time of great uncertainty in the country. However, judging by the terms that the sponsor granted for this financing, it is not obvious that the sponsor recognised the value of the Bank’s additionality. Information on comparative terms and pricing is ambiguous, as discussed in the following paragraph.

**Bank handling**

Bank handling is rated as “Good”. The inherent commercial risks of this project were correctly identified, particularly the uncertain market development scenario. Market risks were substituted for corporate risk through the parent guaranty. Credit raised the absence of covenants at the local and parent levels as well as the weak position of the Bank in comparison with a sponsor of limited (but improving) strength (rated BB+ by Standard & Poor’s).

The operation has proceeded relatively smoothly in a timely and successful manner thanks to a responsible and committed sponsor. The level of involvement and attention paid by Banking was largely in keeping with the risks and issues presented by this operation. In the few areas where the company has not properly met its reporting obligations, the Bank has been in a weak position to press the issue on account of the parent guaranty and the prepayment policy adopted by the sponsor.

Shortcomings in reporting should not be taken as an indication of evasiveness or lack of transparency on the part of the borrower. More likely, it is a result of the company’s management having limited practical experience of the reporting requirements of multi-donor banks (MDBs) despite the presence of a parent company guaranty. The issues identified have not detracted from the otherwise “Good” bank handling of this operation.

**Key issues and lessons learned**

Where political risk cover is core to additionality, participation by the Bank in local financing may help align the interests of all key stakeholders. Where the primary contribution of the Bank to an operation is reassurance and stability in an environment of political risk, the Bank should consider participating in a local financing tranche. Where Bank participation happens entirely via a parent structure and there is no participation in local funding, other stakeholders, particularly government, may assume that the Bank is relying on external credit support and is otherwise ambivalent to policy decisions that might affect the wellbeing of the local operation.

The Bank must insist on being provided with the local reporting information agreed at the outset. Obtaining adequate reporting information, irrespective of the quality of the sponsor or guarantor, is one of the basic ways in which the Bank can protect its interests, particularly if there are few other covenants. Continuing an operation without obtaining adequate reporting could suggest to the borrower that compliance is not important. It could also compromise the Bank’s ability to respond to adverse developments.

The strategic integration of a project within the sponsor’s wider international business may mitigate some of the commercial risks posed by marginal or risky projects. In some cases strong sponsors with a broad international base may be able to absorb surplus capacity of an underperforming local venture within their international business. This can also provide the Bank-financed operation with enough time to correct an underperforming business plan. The team could assess such support as a part-mitigation of high-risk market development plans.
Insistence on full support from the sponsor is wholly appropriate in the right circumstances. Where a project finance structure is unsuited to the underlying commercial relationships and risks, it is perfectly reasonable for the Bank to seek full support from the sponsor for the project, extending to full coverage of any principal or interest liability to the Bank.