The Project
In 2008 the Board of Directors approved a senior secured loan (a part of which has been subsequently syndicated to a commercial bank) to an agricultural product processing company (hereinafter referred to as the “Company”). The EBRD loan was fully disbursed in 2008. In 2010 the Company acquired an additional share in another company (the “NewCo”) through a debt-for-shares swap and now holds over half of its shares.

Project rationale
Half of the Bank’s loan was designated to finance the “modernisation” programme of one of the Company’s plants (Tranche 1) and another to finance the acquisition of the NewCo (Tranche 2), together referred to as the “Project”.

Achievement of objectives
The purchase of equipment, financed by the loan proceeds, and their installation at the plant, were only carried out during the spring and summer of 2009. As a result, when preparing this report, the evaluation team (the “Team”) took into account the results *planned* by the Company to be achieved during 2010 (as long as these assumptions seemed reasonable). On this basis, the overall achievement of objectives is rated as *Satisfactory.*

Modernisation, energy efficiency improvement and increase of competitive position: *Partially achieved*. Until the summer of 2010 only two operational benchmarks – energy reduction in processing and farmers pre-financing – have been met. Benchmarks relating to productivity improvements, (that is, increase in daily processing capacity, extension of the plant’s operating days, increase in production yield per hectare and production increase or operating cost reduction set at approval) have not yet been met, although in most cases some modest improvements have been achieved.

Support privatisation of the NewCo by financing its acquisition: *Partially achieved.* The Team views this objective as *Partially achieved* as it appears that the Company succeeded mainly due to the availability of acquisition financing from the Bank, despite offering a tender price of over a quarter below the competing bidder. However, based on the discussions with the sector market experts, the Team understands that in hindsight the decision to select the Company rather than the competing bidder may have been justified as it proved to be better managed and dynamic, and therefore in a better position to lead the country’s sector consolidation.

Moreover, this acquisition enabled the Company to attain a close-to-monopolistic position in the country’s market. Despite the evidence that the Company takes some advantage of such a position, this has a relatively minor impact as this county’s market is more liberal than that of the European Union’s.

Overall assessment
The Project is rated overall as ***Partly Successful***, mainly due to *Satisfactory* achievement of objectives, *Satisfactory* overall transition impact, and a *Satisfactory* rating for environmental impact. The rating takes account of the *Marginal* short-term impact of the Project on competition in the domestic market and *Marginal* demonstration effect due to the provision of funds to a single bidder prior to the public tender. The financial performance of the Project is rated *Satisfactory* due to indications of improvement achieved in 2010 and positive medium-term prospects after the NewCo’s full integration into the Company’s structure in the coming years. The Bank’s loan performance is rated as *Satisfactory* due to the relatively low margin and the Company’s breach of most of the financial covenants, which increase the Bank’s risk.

Overall environmental and social impact is rated as *Satisfactory,* comprising a *Satisfactory* rating for environmental performance, mainly due to environmental issues and a rating for environmental change of *Some to Substantial* due to the positive impact of energy efficiency-related investments in one of the Company’s plants. Bank handling is rated as *Satisfactory*. A questionable mode of handling provision of privatisation financing, failure to secure environmental improvements, as well as incorrect or over-ambitious benchmarks and assumptions set/made at appraisal are counter-balanced by excellent post-disbursement handling by the Bank, particularly during the 2009 crisis.

Transition impact and additionality

Overall transition impact. The overall transition impact is rated *Satisfactory*, with *Medium* risk to the potential transition impact and *Good* long-term Transition Impact (TI) potential, reflecting the fact that, although most of the transition impact benchmarks are currently not met, a reasonable prospect exists that some of these benchmarks will eventually be met within the next two years. While the privatisation has indeed taken place, the demonstration effect from that privatisation process was rather negative, as the benefits of increased private sector participation have been eroded by the timing of its financing by the Bank.

Company impact. The loan has made a positive impact on the Company through investments in equipment, people and organisations. At the beginning of 2009, when it became clear that the high level of inventories and debt may put a serious strain on the Company, particularly in view of deteriorating market conditions, the Company's close cooperation with the Bank had a positive transition impact in terms of the skills transfer to the Company's financial management. Faced with this challenge, the Bank took decisive action, agreeing with the Company a financial restructuring plan leading to the reduction of debt and inventories.

Industry impact and impact on the economy as a whole. One of the key objectives of this Project was to support the region's economy, which depends mainly on agriculture and is less developed than the rest of the country. The Project fulfilled this objective. As part of the service to farmers, but also to ensure that the quality of the produce at harvest meets the specifications of the processing plant, the Company employs a team of agronomists, including several university professors. They deliver workshops and provide the growers with *ad hoc* consultations during the growing season. The agronomist teams receive regular training. On this basis, market expansion is rated *Excellent*, while skills transfer is rated *Good*, with *Excellent* long-term potential, in expectation of the growers meeting the ambitious yield targets in the medium term.

Competition. The Team agrees with the Office of the Chief Economist's general assessment that through financing the acquisition of NewCo, the Bank supported monopolisation of the domestic market by the Company. However, the Team believes that its negative impact is short term and relatively limited due to: (i) the country of operations market being relatively deregulated; (ii) the country's imminent accession to the European Union, which will ensure full competition among all EU producers in this sector; (iii) the retail market in the country being already dominated by another company whose subsidiaries are also the Company's largest suppliers of raw products. Therefore it would be difficult for the Company to try to take advantage of its monopolistic position. In the Team's opinion, the positive impact of the industry consolidation (expected in the longer term) outweighs the short-term negative impact on domestic competition. Thus short-term competition is rated as *Marginal* (rather than *Negative*) and longer term impact potential is rated *Good*.

Demonstration effects of privatisation financing. The increase of private ownership through successful privatisation of the NewCo, and the expected improvement of its operating and financial performance by the management of the Company, create a strongly positive transition impact, particularly in terms of its long-term potential. However, the short-term verified demonstration effect is rated as *Marginal* due to a negative impact created by the provision of financing by the Bank before the public tender was completed.

Energy efficiency. A major contribution of the Bank's due diligence efforts was to conduct an energy efficiency audit. However it turned out that the Company's management was not familiar with the Consultants' report on energy efficiency. If the Operation Leader is not fully engaged in the process, then it is likely that the topic will be dropped. The Team recommends that the Energy Efficiency and Climate Change (E2C2) team has a continuing monitoring role in all projects with strong energy efficiency components.

Environmental and social impact. The overall Environmental and Social Impact is rated *Satisfactory* based on separate ratings for environmental performance (*Marginal*) and environmental change (*Some to Substantial*). The project was categorised B/1 under the 2003 Environmental Policy and an Environmental Action Plan was prepared, however it only focused on modernisation of the Company's existing plant and did not take into account the NewCo's plant. The key issue for both plants was wastewater treatment. The City and the Company are in the process of requesting EU grant financing for the wastewater treatment plant, however this process is likely to take a long time.

Environmental performance: The expectation of the Board is that the Bank's projects are structured to meet EU standards in a reasonable and defined time. Given that the national deadline for meeting such standards by this country of operations is due in the next couple of years, the Team considers delay in meeting such standards by the Project reasonable. Based on meeting EU Best Available Techniques in Integrated Pollution Prevention and Control standards and the positive energy efficiency components, the Team would rate environmental performance as *Good.* However, as one of the plants was not included in the EAP, and will not meet wastewater standards until 2020, overall environmental performance is downgraded to *Marginal*.

Environmental change: As the expected carbon trading and use of bio fuels did not materialise, energy efficiency gains related to them are not quantifiable, while the wastewater issue will remain unresolved. The Team rates the extent of environmental change as *Some to Substantial* based on achieved reduction in gas usage and based on reasonable expectations for future, more substantial change.

Country strategy and sector policies. The Project complies with the country and sector policies. The country strategy pointed to the existence of certain barriers to foreign investment, which are associated with the dominance (market and political) of local industries by family-owned companies, particularly in food retail and agribusiness sectors. The absence of international companies from participation in the tender may be viewed as the confirmation of this trend.

Additionality. The additionality rating for the project is *Verified at large*. The country of operations is an advanced transition country, with a well developed banking system. However, the Company was attracted to the Bank's financing not only due to the favourable terms of the loan but also valued highly the "seal of approval" associated with it.

Bank handling

Bank handling is rated as *Satisfactory*. Setting (in some cases) unrealistic performance benchmarks, leaves ample scope for improvement. Basing extremely optimistic financial projections on the country's EU accession date resulted in the Project's substantial under performance versus such projections and breach of nearly all financial covenants. On the other hand, the Bank played a positive role by ensuring the prominence of energy efficiency components in the Company's investment programme through arranging an energy audit. The Bank was also instrumental in developing and ensuring implementation of the financial restructuring of the Company during the financial crisis.

Comments on the approach to privatisation financing: Another bidder's offer was financially superior to that of the Company's. However, the Company's arranged privatisation finance from the Bank before the tender and the country's Privatisation Fund's officials confirmed that availability of this financing played a key role in selecting the Company as a winning bidder, despite its lower price offer. The Bank should rather make known to all potential bidders its interest in financing the tender's winner. This has been achieved in the past through a letter to the tender-organising authority expressing the Bank's interest in financing the project, which such an authority then attached to the tender package. Such an approach ensures a fair competition and that the bids are assessed primarily based on the price offered. At the same time it enables the Bank to provide support to the privatisation or concession award processes while remaining neutral.

Environmental bank handling. The second tranche provided financing for the acquisition of a new plant, however no due diligence was undertaken on this plant, no EAP was prepared, and there was no environmental conditionality attached to the second tranche. For these reasons, environmental bank handling is rated as *Marginal.*

Key issues and lessons learned

Lesson: The Bank should remain neutral before and during public privatisation tenders. The Bank should communicate its interest in financing the *Project*, rather than any particular bidder and offer such financing on a non-exclusive basis to any (qualified) winning bidder *after* the tender process has been completed.

Lesson: Whenever feasible, all specific components of the investment programme, which are to be financed by the Bank's loan (including corporate loans) should be agreed with the Client in advance and presented in the Board Report. The operating teams should avoid vague or general statements describing the investments in the Board reports, approval memos and legal documents as "modernisation", "regeneration", "plant improvement", "energy efficiency investments", and so on. External technical consultants should be used to identify or at least verify scope, costs and benefits of the proposed investment programmes' components.

Lesson: Ensure that environmental conditionality is applied to all assets to be financed by the Bank, also those to be acquired in the future (for example, following a privatisation process, which the Bank is to finance). Where appropriate, the Bank should engage with the government before the tender, ensuring that bringing the assets to be privatised to environmental compliance is part of the privatisation tender's requirements.

Lesson: Exercise due care and diligence in selecting the most relevant transition impact objectives and setting realistic values and timeframes for their achievement. Such transition impact objectives should be *logically linked* to specific, well-defined measures of the investment programme (see the third lesson above) to be implemented under the project.

Lesson: Avoid making extreme, optimistic financial assumptions, based solely on political processes outcome or the timing of which is highly uncertain. Had the Operating Team made more realistic assumptions, perhaps it would have been possible to structure the loan differently (with a slightly longer grace period or tenor and/or lower overall amount, for example spreading the "modernisation" programme over time, phasing the programme and the loan, and so on). This could have helped avoid financial stress and breach of covenants.