THE PROJECT

In 2008, the EBRD's Board of Directors approved a loan to a company (the "Company"), consisting of an A-loan for the account of the Bank and a B-loan for the account of participants. The loan would be guaranteed by an existing client of the Bank. The operation was to enable the Company to finance the expansion of its retail network further into the regions. The Company was the largest retailer in its market in the country. The Sponsor was a large privately owned business, comprising the telecommunications, technology, insurance, real estate, retail and hospitality sectors. The Bank has a long-standing relationship with the Sponsor.

The B-loan was successfully syndicated. In 2009 and 2010, the project was affected by the financial crisis and the expansion programme was suspended. In 2010, one of the banks from the country of operations took a share in the Company through the purchase of an additional share issue in a private placement. The Company prepaid the EBRD loan in full the same month.

PROJECT RATIONALE

From the point of view of the Sponsor, the Company was an undeveloped asset ripe for expansion. Based on the existing brand recognition, the strategy was to create the largest and most efficient retail network across this country of operations. The EBRD's rationale for the investment was to support the development of the organised retail market in the sector, which accounted for only 20 per cent of goods sold. The project was intended to improve efficiency, price transparency, standards of customer service and the quality and safety standards of goods.

OVERALL ASSESSMENT – PARTLY SUCCESSFUL

CATEGORY	RATING	COMMENT
Fulfilment of objectives	●●●○○○	The physical objectives of the project were as follows: (i) Regional expansion: approximately doubling the number of stores in regional cities. ***Partly achieved*.** (ii) Development of logistics: opening of new regional logistics centres. ***Partly achieved*.** (iii) Commercial success: measured specifically through sales volumes and profitability. ***Partly achieved.*** The impact of the financial crisis had a negative effect on expansion plans and commercial success. In 2008, the Company approximately achieved its target for opening new stores, but in 2009 the total number of stores declined. The strategy was changed in the light of new economic conditions and the total number of stores by 2011 is now unlikely to reach more than 65 per cent of original projections. The Company abandoned its plan to open new regional logistics centres and instead rented space in a new, modern logistics centre. Improvements were made to logistics, but further changes are needed. The Company's sales volumes were affected by the crisis, but the main impact on profitability was through the decline in the value of the local currency. Overall, fulfilment of objectives is rated ***Marginal***.
Transition impact	●●●●○○	The expansion of the Company into the regions has undoubtedly had an important impact on the sector. The arrival of a well-known chain store in the regions has moved the goalposts for local stores and the informal retail

		sector. It also serves as a demonstration that the market has the capacity to support a chain on this scale, focused on relatively up-market goods. However, the Company has yet to demonstrate that it can work on this scale while retaining an acceptable level of profitability. The link between the EBRD's project and transition impact is not always clear. The EBRD achieves credit for encouraging the Company to improve its linkages to local suppliers, but other aspects of transition impact were intended to arise from the ongoing expansion. The EBRD did not closely monitor the achievement of the business plan objectives associated with transition impact. The curtailment of the expansion programme from 2009 and the change to plans for development of a regional logistics network have reduced the impact of the project. Nevertheless, the expansion achieved so far has established a platform for further progress. The Sponsor has remained supportive, while the crisis itself pushed the Company to make necessary improvements to its business practices to adjust to a new commercial environment. There is a lot more to do on logistics, but the Company is making efforts to address the problem. Transition impact achieved to date is ***Marginal*** but potential remains ***Satisfactory*** with ***High*** attendant risk. Overall, transition impact is rated ***Satisfactory***.
Environmental impact	●●●●○○	The Company's business model for its stores is based on leasing space in shopping centres, which limits the Company's direct influence over the environmental impact of its activities. The Company operates to the local environmental and health and safety regulatory requirements. Environmental performance is rated ***Satisfactory*** with ***Some*** environmental change.
Additionality	■■■■	Additionality is rated ***Verified in all respects***. The Company approached the EBRD because it found that long-term financing at affordable terms with the necessary long grace period was not available to it.
Bank handling	●●●●○○	Overall, the quality of appraisal and implementation would point towards a rating of Good. However, the loss of focus in structuring and monitoring the physical and transition objectives of the project leads the Evaluation team to apply a rating of ***Satisfactory*** overall. Appraisal was adequate and duly recognised the risks attached to the unproven business concept and the rapid expansion strategy. However, without documented project performance requirements, the leverage of the EBRD was reduced. The lack of engagement on controlling use of proceeds allowed the project to switch from being expansion finance to permanent working capital. In the environmental field, the Environmental and Social Summary focused on the stores and did not mention the logistics centre or the supply network, which the Evaluation team would regard as raising more obvious environmental issues: fuel consumption,

		disruption to local roads, packaging and health and safety issues, including road traffic accidents. The Evaluation team agrees that C/1 was an appropriate screening.
Investment performance	●●●●○○	The Bank's investment performance is rated ***Satisfactory***.

General	●●●○○○ Marginal	**Additionality**
●●●●●● Excellent	●●○○○○ Unsatisfactory	■■■■ Verified in all respects
●●●●●○ Good	●○○○○○ Highly Unsatisfactory	■■■□ Verified at large
●●●●○○ Satisfactory		■■□□ Verified only in part
		■□□□ Not verified

KEY OPER ISSUES AND LESSONS LEARNED

Project and transition objectives set out in the Board report should be reflected throughout the transaction cycle, from approval, to monitoring to *ex-post* evaluation. Where the Board approves a project with specific objectives, the Bank needs to ensure that these objectives are incorporated into the structure of the project in such a way that they can be monitored and the Company held to account for their achievement. This means including clear covenants or conditions precedent in the loan agreement. The Bank's control over the use of funds can be enhanced by arranging the disbursements in tranches, with later tranches conditional on the achievement of specified milestones. If the project rather consists of corporate financing without a clear project base, this should be made clear to the Board at approval, or mid term if warranted.

The EBRD should be very wary of adding to an existing mismatch with further foreign currency lending. There is often a demand from clients for loans in foreign currency rather than local currency, because of the difference in nominal interest rates. Where the client's main revenue stream is in local currency, and especially if it already has significant costs or borrowing in foreign currency, the EBRD should be very wary of adding to the existing mismatch. The Bank should strongly encourage such clients to take local currency loans where the Bank is able to offer them, and to match the currencies of their earnings and costs where possible throughout their activities. At the very least, the Bank should review, discuss and evaluate the client's risk management process, including hedging policies.

Client sustainability and sponsor guarantees. A sponsor guarantee gives extra comfort to the Bank in the case of a downturn, especially when the client is engaged in risky or cyclical industries. However, the Bank should assure itself as far as possible that the client's business is sustainable on its own terms, with the sponsor guarantee only an emergency back-up. Over-reliance on a sponsor guarantee is not conducive to sound banking nor to transition impact through the development of sustainable private enterprises.

A full sponsor guarantee may dull response to project issues that endanger transition impact. Guarantees from financially strong sponsors reduce internal pressure to monitor and increase resistance to monitoring by the borrower. In the meantime, problems that endanger project completion and transition objectives may be ignored or go undetected.