

STRATEGY FOR HUNGARY 1994-95

SUMMARY

SYNOPSIS

The EBRD's principal operational objectives in Hungary are as follows:

- continue to focus on the private sector, offering a wide variety of financial instruments on a non-recourse basis, to increase its equity commitments and to continue its product development;
- play a major catalytic role in every area where a private-public partnership makes the financing commercially viable;
- limit sovereign lending activity to the specific areas that are critical for the overall development of the economy, and where the country needs the EBRD's involvement;
- continue to focus on the development of physical infrastructure (transport, telecoms, utility), and be involved in the privatisation of these sectors and the financing of concession-type and BOT projects;
- focus on the development of the financial system and offer different products, including equity, credit line, trade facilities and other instruments.

This document is based on the EBRD's Strategy for Hungary, approved on 15 November 1994, which is for official use only.

STRATEGY

1 PROMOTION OF THE PRIVATE SECTOR

1.1 Privatisation of the major state-owned enterprises

The EBRD is actively collaborating with the Hungarian government and its advisers in their efforts to privatise the country's major enterprises.

The Bank is intensifying efforts to help the privatisation process through bridge-to-privatisation financing. There are, however, only a few companies that can be realistically considered for such intervention. These transactions are large in size, time consuming and risky; therefore the Bank, in most cases, must team up with strategic investors, or finance the restructuring of these enterprises, after the privatisation has been completed.

1.2 Active restructuring of state-owned companies

The role of the EBRD's Special Restructuring Programme (SRP) could be to deliver both equity and management/turnaround assistance to a selected group of SMEs from the portfolios of the local banks that are also participating in the Debtor Consolidation Programme (DCP), and so to add value to the financial restructuring initiated by the government and banks. The EBRD is working with Hungarian banks to determine their compatibility to become partners in an SRP.

The Bank will also continue to work on a case-by-case basis on the restructuring of large, strategically important, state-owned companies.

1.3 Financing private Hungarian companies and foreign joint ventures

The Bank is considering competitive products that will provide effective financing for increasingly sophisticated privately owned companies in Hungary. Possible new financial instruments and approaches include:

- forint-denominated medium-term instruments using the proceeds of the Bank's local bond issues. The instrument is to be tailored to the specific needs of medium-sized joint ventures that cannot yet tap the local capital market;
- partial underwriting of initial public offerings on the Budapest Stock Exchange;
- various guarantee and swap instruments;
- senior or subordinated debt financing with terms and conditions adapted to the needs and credit risk of an increasingly sophisticated clientele;
- longer maturity and quick decision making;
- various instruments involving local financial institutions.

Should the above strategy prove successful with foreign joint ventures, the Bank will also consider applying this approach to financing local Hungarian entrepreneurs.

The EBRD is currently analysing the investment programmes of several Hungarian-owned companies for possible Bank investment.

2 DEVELOPMENT OF THE FINANCIAL SECTOR

The Bank gives the highest priority to the financial sector, particularly to privatisations and the provision of long-term funding to Hungarian banks in order to allow them to offer medium-term and long-term debt instruments to their clients, as well as participating in equity funds to provide the much-needed capital. Two factors affecting the EBRD's operational environment are the Bank Consolidation Programme and the government's bank privatisation strategy.

Concerning SMEs, it is clear that the Bank can reach these primarily through financial intermediaries. However, it has to overcome the problems experienced to date with some of the financial instruments (such as CEALs) it has used in this area: to date only the agricultural restructuring lines have been successful in reaching small entrepreneurs.

Another area which needs to be addressed is the development of East-East relations through new trade financing instruments.

The Bank will consider the following for banking and financial institutions:

- continue to be involved in bank privatisations; after reviewing Hungarian government's bank privatisation strategy, the EBRD will define how it can assist in its implementation;
- provide long-term financing (credit lines, stand-by instruments);
- equity investment in specialised financial institutions including an investment bank and a medium-sized commercial bank, and in investment funds;
- trade financing instruments, including regional efforts, together with the Bank's local partners, particularly to promote inter-regional trade;
- development of the capital markets, with different instruments, e.g. underwriting, and municipal bonds;
- local currency funding;
- broadening of the funding base of various Hungarian institutions on the international money markets.

The issue of the development of SME operations could be made more attractive, and the risks undertaken made more acceptable to the counterpart local financial institutions, by provisions such as:

- risk sharing through guarantee programmes, and co-financing schemes;
- local currency loans, and/or utilising the guarantee mechanisms to support medium or long-term lending in local currency;
- higher flexibility in the utilisation and administration of the funds (streamlining of documentation);
- financial and other incentives for efficient but timely utilisation of the funds committed;
- including local currency in multi-currency options for loans and sub-loans, along with interest rate, currency swaps and hedging possibilities.

3 FINANCING OF CRITICAL INFRASTRUCTURE

The Bank has had considerable success in financing significant infrastructure projects in Hungary (e.g. M1-M15, MO, HTC loan and equity, Budapest Public Transport).

In future, emphasis will continue to be given to infrastructure projects financed on a commercial basis. The emerging appetite of the financial sector to provide long-term financing for well-structured, viable infrastructure projects, and the increased reluctance and inability of the government to provide sovereign guarantees, can be successfully combined to structure projects as private/public partnerships.

The only area where it is clear today that financing should be provided on a sovereign basis is restructuring of the railway sector.

3.1 Telecommunications

The Bank will continue to play a catalytic role by mobilising foreign investments to MATAV, local telephone operators and other telecommunications companies. The Bank would consider playing a catalytic role in the next phase of MATAV's privatisation (IPO).

3.2 Transport

The Bank will:

- cooperate closely with the relevant government agencies in reviewing the transport strategy and in planning their investment programme in the transport sector; it will support this effort through technical cooperation projects;
- focus resources on projects to be financed on a commercial basis or through private/public partnerships;
- work with other international financial institutions whenever appropriate.

3.3 Energy and natural resources

Most of the natural resources in the country are currently already under development and no major greenfield investment is being anticipated, with the exception of a few combined cycle Independent Power Producers (IPPs).

To date the Bank has brought one project to its final stages in the energy sector, a corporate financing of the state oil company MOL, to fund the development of the Zsana underground gas storage facility.

The Bank is also actively pursuing independent power projects with several interested sponsors.

Priority for EBRD financing will be given to three areas:

- privatisation of regional gas distribution companies;
- electric power generation and distribution, privatisation of MVM Rt. (the national electricity company) and financing of independent power producers;
- privatisation and capital investment financing of MOL Rt. (the national oil company).

4 FINANCING MUNICIPAL SECTOR PROJECTS

The Bank's overall strategy is to:

- focus on private concessions or BOT projects in the water, sewage, solid waste, transport and energy areas of municipal services;
- continue working with the Municipality of Budapest through the privatisation of municipal utility services and BOT projects;
- begin working with other cities, including Debrecen, Miskolc, Szeged and Pécs, with the focus on BOT opportunities;
- work out new techniques for municipal/infrastructure financing (e.g. municipal banks, specialised financial institutions and municipal bonds).

5 OTHER INITIATIVES

5.1 Property and tourism

The EBRD considers the tourism sector to be one of the key foreign currency generators in Hungary, and is therefore ready to provide financing to the private sector initiatives as well as further development of Pannonia.

Due to the relative maturity of the Budapest office market, the Bank will carefully review its involvement in commercial office projects. The Bank will focus its support on the development of warehouse and distribution facilities and will also consider projects in the retail sector.

5.2 Agribusiness

The Bank will:

- focus on investing in integrated food processing companies, with production and processing capabilities;
- continue to finance private farmers with the extension of the Agricultural Restructuring Programme;
- participate in the coming privatisation of the state-owned farms, provided the land issue is resolved;
- offer a wide variety of financing options to already privatised companies.

COOPERATION WITH OTHER IFIs

World Bank/IFC

The EBRD has worked closely on, and provided co-financing with the World Bank and IFC for, the Budapest Public Transport project, HTC equity investment, Budapest Orbital Motorway and Westel Telecoms project. The EBRD currently hopes to co-finance the MOL gas storage project and the MAV rail restructuring project, as well as other telecoms projects such as UTS and HTC Loan Syndication with these institutions.

European Union

Several technical cooperation projects were financed under the Bangkok Agreement with the European Commission, such as the Budapest Wholesale Market and the Danube River Basin Development Programme.

European Investment Bank

The EIB has worked closely on, and provided co-financing with EBRD and the World Bank for the Hungarian Telecommunications Company.

European Bank for Reconstruction and Development

Headquarters

One Exchange Square
London EC2A 2EH
United Kingdom
Tel: +44 171 338 6000
Fax: +44 171 338 6100
Telex: 8812161 EBRD L G
Swift: EBRD GB2L

Hungary

Rakoczi ut 42
1072 Budapest
Hungary
Tel: +36 1 266 6000
Fax: +36 1 266 6003