Lenders of first resort

01/12/2003

With the anxiety among foreign investors triggered by the arrest of Mikhail Khodorkovsky of Yukos at the end of October, it is arguable that the role of the multilaterals in providing a lead to foreign capital into Russia is now more important than at anytime since the Russian crisis of 1998. But beyond lender comfort - and being there when the going gets really tough - what do the multilaterals actually bring to the deals they transact in Russia that could not be achieved more efficiently through the commercial market? In a word -term.

While the private market is increasingly comfortable to take on short-term, well priced, and generally secured, loans to the better Russian corporates, it remains unwilling to look beyond the five year horizon in all but exceptional cases. The demand side however is looking for much longer term finance.

"Over recent years Russian deals have been dominated by pre-export financings but with tenors of up to a maximum of five years this is still not long enough for companies which need to invest in infrastructure," says Elena Ivanova, director in the syndications department, at ING.

The development of both the country as a whole and many Russian companies has reached a level where much larger capex is needed to ensure growth than can be provided via pre-export financings which have normally been used to fund working capital and capex. "We see growing demand from Russian companies that want to expand their operations," says Edward Nassim, director for central and eastern Europe, at the IFC.

Having benefited from the devaluation from the 1998 crisis, many Russian companies are beginning to expand. "These companies need capital and their sources of finance are limited," says Nassim. "A few can raise money internationally but it is very few. The rest have to raise funds locally and these are only available as short term borrowings and the local equity market is limited. Therefore they have to rely on multilaterals for their long term needs of equity and debt."

This is a view willingly echoed by the commercial sector. "Russian companies are moving into an expanded capital expenditure mode," says Steve Fisher, managing director and head of corporate finance for Russia/CIS, at Citigroup in Moscow. "And many projects need longer repayment terms than are available in the commercial market. Multilaterals are providing a critical additional tenor to the market. Institutions such as the EBRD play a key role in providing the longer term funds than the commercial market is comfortable with. There is solid commercial risk appetite in the three to five year range. But with the multilaterals deals can go out to seven to 10 years which is important for many projects' repayment profiles."

There is, however, an argument that if the multilaterals were not involved in Russia, that the commercial banks would have to step up and provide their valued Russian clients with the longer term money they require. Few bankers accept that multilaterals are a maturity shield behind which they can hide in Russia. "I do not think that the presence of multilaterals is holding back the development of longer term lending by the commercial sector," says Ivanova at ING. "Commercial banks simply will not lend that far out, so the multilaterals are performing a vital role in allowing Russian borrowers to access longer term financing."

Creditworthiness

Of course the deals themselves need to be commercially viable for this to mean anything. And their commercial risk performance is compelling enough for the private market to want to continue to be involved in their deals. The EBRD points to its track record of not losing any money of an investment in Russia beyond the banking sector, where all lenders were hit, since the 1998 crisis. "The commercial banks value our credit quality leadership," says Lorenz Jorgensen, director of syndications, at the EBRD in London.

What all this means in terms of the pricing Russian borrowers have to pay on these deals is hard to fathom. "How multilateral involvement really impacts on a deal's pricing is difficult to tell," says Peter Kennedy, General Manager, Standard Bank London. There are no comparable commercial facilities to benchmark the pricing of these deals but there does not seem to be any criticism in the market of the pricing set for A/B loan facilities.

This is probably just as well, given that the market helps set them. "Under the A/B loan system, the multilateral works with the commercial banks to determine the pricing for commercial portion," says Ivanova at ING. "We feel that the pricing on these deals is reasonable."

Slow or cautious?

The familiar complaint of commercial bankers against multilaterals wherever they operate is their perceived slowness in closing transactions. This charge is levelled at those active in Russia where some bankers say they are very slow to move a deal to close. So slow, in fact, that there are opportunities for nimble operators to take advantage of this. "If we hear early that a multilaterals such as the EBRD or IFC is preparing to finance a project or company in Russia, we sometimes nip in and offer a short term bridge financing to the borrower," explains one banker. "We will structure the pricing so it ratchets over time, and given the inevitable pace of the multilateral we are always in there for longer than the borrower anticipates earning an increasingly attractive return."

While relative slowness is probably a valid criticism it is a diminishing one. "There was a feeling in the past that these institutions were too slow for commercial banks' timeframes," says Ivanova at ING. "But now we see that they are much quicker, although we recognise that by their nature they have various internal processes which do take some time."

Another, and more significant, charge brought against multilaterals in Eastern Europe has been that of competing directly against commercial banks for mandates.

Some bankers complain of unseemly competition from multilaterals in markets such as Hungary, Poland and the Czech Republic. This is probably not yet the case in Russia and given the scale of the country and its corporates, there is likely to be plenty to keep both the multilaterals and private sector busy. "We are not trying to carve out a role for ourselves where commercial banks feel comfortable," says Jorgensen at the EBRD. "If they are comfortable doing certain types of deals then we will move on."

Deep into Russia

Beyond providing longer term finance to the familiar Russian borrowers, there is clearly a distinct role for multilaterals further down the Russian corporate credit spectrum. "Five years ago we were concentrating on what are called the top-tier Russian companies," says Jorgensen at the EBRD. "Now it is much less necessary for us to lend directly to these companies and we are more focused on those companies which do not have solely large export earning capabilities."

It is these transactions which highlight the value multilaterals bring to Russia and distinguishes them from the commercial sector. "We are moving deep into Russia, financing companies which would simply not be touched by Western banks alone," says Istvan Ipper, deputy director of Russia team, at the EBRD. "Companies such as TransNefteProdukt where we recently led a $75 million 6.5 year loan for a business which earns Roubles only. The market does not provide these types of funds to these companies, but with our leadership it can happen."

The multilaterals are also helping to finance relatively unattractive sectors and projects which are unlikely to enthuse many commercial bankers such as some environmental deals.

The NIB has focused on this sector and much of its financing for these types of projects comes from the Environmental Investment Facility which stands at Eu300 million and is targeted at specific areas in North-west Russia. The facility gives the banks greater flexibility in financing projects which serve to meet the facility's overriding environmental objectives. However, the NIB is also preparing to widen its activities. "The bank is in discussions to broaden the scope of its work in

Russia," says Martin Relander, vice president, responsible for lending in Central and Eastern Europe, at the NIB in Helsinki. "By the end of the year we expect to make a decision on what projects beyond pure environmental ones the bank will look to finance."

This will also involve a re-assesment of their lending criteria. "Our credit policy has always been very cautious in Russia," say Relander. "But we are looking beyond sovereign and municipal deals and hope to work more with corporates as well. We have for example recently lent around $30 million for over 10 years to a Norilsk Nickel smelter in the Murmansk region." The total $93 million of financing is split roughly equally between the NIB's contribution, Norilsk equity and grants mainly from the Norwegian government, but also from Sweden. The purpose of the financing is to reduce air pollution from the smelter, sited close to the Finnish and Norwegian borders, by 90%.

Building the Russian banks

Another prong of the multilaterals efforts to put ensure their eventual redundancy in Russia involves their efforts to develop the local banking system. The vast majority of Russian banks cannot lend long term funds due to the fact that deposits in Russia are so short term, nor is there much confidence between the banks to support a meaningful inter-bank market. The IFC has a clear strategy of helping to mobilise the Russian banking sector itself so that in the future these banks will be able to provide some of the longer term financing Russian corporates need. Miga is also active in the Russian financial institution sector, with local banks with foreign ownership. "We have provided a number of guarantees for international banks' subsidiaries in Russia," says Ileana Boza, regional manager, underwriting at Miga in Washington.. "These subsidiaries need access to long term capital and this is made via holding company loans which are then guaranteed by us."

Miga's transaction include a $5.7 million five-year guarantee to Austria's Raiffeisenverband Salzburg for its $6 million shareholder loan to OOO Raiffeisen Leasing.

Another approach to this is suggested by the recent cooperation agreement signed by Vneshtorgbank and the US based financial adviser Taylor DeJongh. The two firms will work together in structuring and financing capital markets, trade and pre-export transactions for Russian companies in the energy and industrial sectors.

Towards transparency

The third element of the multilaterals' strategy in Russia is to improve the standards of corporate governance and transparency among potential borrowers there. Without these improvements the likelihood of Russian corporates accessing other forms of finance would be limited. Evidence of this is the fact that export credit agencies are increasingly looking to originate deals in Russia. "The activity levels of ECAs has greatly increased over the past two years," says Fisher at Citigroup. "Now there is often one ECA a week coming to Moscow looking for transactions." Russia's country ratings have improved enough for ECAs to now compete powerfully against multilateral lending - it is now classified as category 4 in OECD Consensus rates.

This is yielding noteworthy transactions. In October, for example, BNP Paribas and Citigroup closed a $131 million European ECA financing for Aeroflot's purchase of four Airbus narrow-bodied jets. "This was the first asset backed guaranteed financing facility for aircraft in Russia using European ECAs," says Fisher. "We hope to use the same structure next year for a further four aircraft."

It may be too early to be sure, but Russia might have come to the stage where other forms of finance beyond multilaterals are now competitive. "ECAs represent the most attractive long term financing option for Russian companies now," says Fisher at Citigroup. "With the subsidised nature of their financing ECAs are often cheaper than syndicated loans through multilaterals."