# The show must go on

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?Everything has stopped in Russia,? says a project financier. ?It is becoming increasingly difficult to open credit lines for Russian projects, even with the support of multilaterals.? The mood at the European Bank for Reconstruction and Development (EBRD) reflects this trend.

The EBRD made a net loss of Ecu261.2 million ($308.5 million) in 1998. But there are strong differentiations in growth perspectives between different parts of the region, and Steven Kaempfer, vice-president of finance, says that the bank will not abandon Russia or any other country of the region despite these losses.

?In signing 96 projects for a total of Ecu2.4 billion in 1998, the bank continued its strong contribution to the transition in central and eastern Europe and the CIS,? says Kaempfer. ?The events in Russia in August and their consequences affected credit quality in a number of the bank's investments and, as a result, required significant additional provisions by the end of the year. The Bank is strongly capitalized and its portfolio is prudently provisioned.? But how has the EBRD's strategy changed since August 1998 and what has been the new role of the new president, Horst Kohler, appointed in September 1998?

**Russian roulette**

As Kaempfer says, in Russia ?it is not business as usual?. The August 1998 devaluation and the country's default on $40 billion-worth of ruble bonds have hit those involved in Russia. The EBRD has had some challenges. Kamaz, a truck factory based in Tatarstan autonomous region of the Russian Federation is having some difficulties repaying its creditors, which include the EBRD. ?We are pursuing a resolution of the company's financial situation,? says Kaempfer, who declined to comment on whether the bank is taking legal action against the company.

But Russia remains an important country for the EBRD in terms of size and significance for the region as a whole. Officials at the EBRD said in a statement that it ?took an active role in policy dialogue and technical assistance activities, while focusing on asset protection through involvement in debt recovery and in debt restructuring activities.? Kaempfer points out that the EBRD is a preferred creditor and its obligations throughout the region are being honored ?with the exception of a few problems with commercial repayment problems?. Kaempfer stresses that the banks operates on a project-by-project basis and pays close attention to the economic viability of single projects. According to Kaempfer, the percentage of loans that have been written off is ?very little, less that Ecu35 million throughout the region?. The president of the EBRD, Horst Köhler, confirms this view. ?The first panic is over and life has to go on no matter what the circumstance,? he says in a statement.

The EBRD has been working on two new projects in Russia since the beginning of 1999. The UK's InterMatrix is developing the Nizhfarm project. The EBRD has bought 25% of shares in the company for $10 million. In Soviet time Nizhfarm was the largest producer of medical ointments and candles. The joint investment programme of the Bank and Nizhfarm is supposed to last five years. By 2003 the complete modernization of production is planned to be carried out.

The EBRD has also created the Russia Microfinance Bank (RMB), a specialized institution devoted to lending to micro and small enterprises. It will be established on the basis of a re-organization of the Russian Project Finance Bank, which has never been operational. The RMB will support the development of the Russian financial sector by operating as a best practice institution committed to the principles of complete transparency and strong corporate governance, according to a statement released by the EBRD. The bank is stepping in with its own capital at risk and not just with a loan, which Kohler considers a ?clear signal of confidence for the Russian banking system?.

In its effort to promote non-recourse finance in Russia, the EBRD has also recently published an English-Russian Project Finance Glossary in February 1999.

**Making up for lost ground**

Among the most interesting projects being developed is the Chirag early oil scheme in Azerbaijan. The project, undertaken by affiliates of 11 international oil companies and the State Oil Company of the Azerbaijan Republic (Socar), includes the refurbishment of an existing offshore platform, drilling wells, building subsea pipelines as well as installing terminals in Azerbaijan and Georgia and repairing and completing two exisitng oil pipelines. The project is the first part of the development of the Chirag, Azeri and Deepwater Guneishli field complex, expected to cost $10-12 billion, making it one of the largest projects in the world (see Project Finance, September 1998, p.28).

?The kind of long-term financing that the EBRD and the International Finance Corporation provided has not been previously made available to the region,? says Kevin Bortz, deputy director of the EBRD's natural resources team. ?The commitment of the EBRD and IFC will send a positive signal about financing projects in the region.?

The EBRD and the IFC will each provide financing of up to $200 million towards the Chirag project, of which up to $100 million will be syndicated. The facility will be provided by five separate loans by the EBRD and IFC to BP Amoco, Exxon, Lukoil, Turkiye Petrolleri and Union Oil Company. Citibank, Dresdner and SG are co-arrangers and each takes $25 million at syndication.

**A refocused strategy**

Since the Asian crisis, the EBRD has reviewed its portfolio. ?The results of this review were quite encouraging. The bulk of the projects is viable and we have our portfolio under control,? says Kohler. In the long term, the bank has revised its operational priorities. Kohler, who has been president since September 1998, says: ?Coping with the crisis is not why I came here. I said to the EU finance ministers that I would be prepared to start in September. This was decided in June, but then the August crisis happened and I was very disappointed.? ?I want our activities to be more strategy-driven and more than just an opportunistic way of investing.?

According to Kohler, the most important issues to be addressed in the countries of the region, especially in central Asia, are those of infrastructure development. For example, there are increasing talks about the reconstruction of the ancient silk route. Kohler is nor certain how this will be financed, but he adds: ?We want to use the whole range of financing?. Kohler says that the banks has learned from its experience with the M1 financing in Hungary, where a totally privately financed deal lead to the construction of a highway that very few people use because fees are too high. ?We can't finance only one way,? he says, adding that private-public partnerships have to be used as well. The most important challenge that the EBRD has to face is being able to balance high and low risk projects in its portfolio in order to ?take on higher risks for projects in lower and medium-advanced countries?, he says. ?We have to square the circle with any particular project.?

**Working with the EBRD**

The EBRD has often been criticized in the past for being slow. Is this criticism fair? And what do project financiers think about the EBRD? One source criticizes the legal size of EBRD deals. ?Once the internal lawyers get involved, the ?business people' lose control over the transaction and there are endless discussions on legal issues,? says a source. This is something that does not happen in commercial banks.? Christopher Clement Davies, a partner at Vinson & Elkins in London, disagrees. ?My impression is that the bank wants to find workable solutions to problems as quickly it can and it is impatient about lawyers taking a very purist approach,? he says.

One banker wha has worked on a B-loan recently, says that there is not always something in these deals for the commercial banks. The EBRD should open up mandating, letting more banks come in as co-arrangers. The source suggests the creation of C-tranches, a topic that is being discussed between the IFC and a lobbying group. ?It would make sense for one of the big German banks to bring this issue up, especially because there is a German chairman now,? says a banker.

Another source complains that even though the EBRD is a profit-making, it does not have neough staff with commercial bank experience. According to the source, some of the EBRD employees behave as if the bank were a development bank. During negotiations on a B-loan, some of the commercial bankers involved wondered ?whether the EBRD was working to represent the bank or the client,? says the source. ?In some cases the client has won at the expenses of the bank. But maybe this is a bit unfair.?

The EBRD has fewer staff than the IFC, where ?a lot of people are involved in each project, dealing with issues such as insurance, the environment and dealing separately with each problem. According to Jean Patrick Marquet, vice-president of mining finance at Credit Lyonnais, this can be an advantage in some circumstances, as it means that each person is involved much more deeply in each transaction. ?Once a person has been appointed to work on a project the person will be 100% dedicated to that transaction, so the EBRD can react more quickly to opportunities,? he says.

But for those who chose to work with the bank, there are advantages. ?The EBRD is obviously an important player in the region. It has evolved and its approach has become more refined. Much of the criticism of the early years was due to the bank's slowness. But the bank is now much more focused on problem-solving?, says Marquet.

Many bankers involved in central and eastern Europe admit they are now fairly keen to work with the EBRD. According to Marquet, in central Asia projects cannot go on without the EBRD and the IFC under the present market conditions. According to Marquet, the crisis has widely extended the EBRD's and IFC's role in these markets. Even with political risk insurance it is difficult to go into these markets,? he says.

Marquet worked on a deal when the financila crisi blew up in Russia. The participating banks were about to launch syndication. ?There were a couple of weeks during which we were very uncomfortable,? says Marquet. ?The EBRD was also very uncomfortable. Then the transaction turned out to be very good. It turned out to be a very good incentive for the banks involved in syndication to do a very good country appraisal.?

Working in Hungary, the Czech republic or Poland is one thing, says a banker. Another is working in Romania, Bulgaria, Uzbekistan or Russia. Ada Pagano, regional head of project finance at the Royal Bank of Canada in London has worked with the EBRD on a project in Poland. She defines her experience with the Poland team as ?superior? and ?above average?.

Pagano points out that the project she worked on was a very difficult deal, with a Canadian corporate going into an emerging market for the first time. But the EBRD team played an invaluable role, having a very high knowledge of local customs and legislations. ?Whenever they needed to play hard they did so and they let me protect my relationship with the client,? she says. Having no affiliation with any corporate, they often take up the tough roles in negotiating a project, while letting the banks protect their relationship with their client.

Marquet admits that when Crédit Lyonnais was originally approached by the EBRD for a project, he feared that the EBRD was a ?heavy? institution. But he says that working with the EBRD has been a good experience for his bank. Crédit Lyonnais has worked with the EBRD on the Slovalko deal, funded in November 1998, which involved a $36.2 million bridge facility, taken out by a $126.2 million long-term financing ? split between a $40 million EBRD A-loan and an $86 million B-loan arranged by Crédit Lyonnais, Dresdner, SG and Rothschild.