

SUMMARY PROJECT FICHE

1. Basic Information

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| 1.1 | Désirée Number: | BG 0002.02 |
| 1.2 | Title: | FURTHER SUPPORT FOR BULGARIAN
POST-PRIVATISATION FUND |
| 1.3 | Sector: | Private sector development |
| 1.4 | Location: | Bulgaria |

2. Objectives

2.1 Wider Objective

To contribute to private sector development in Bulgaria.

2.2 Immediate Objective

To improve the performance of selected Bulgarian private enterprises by providing them with long-term equity finance and know-how, through the EU-EBRD Bulgarian Post-Privatisation Fund (BPPF).

2.3 Accession Partnership and NPAA priority

The Accession Partnership includes the following priorities under the economic criteria:

- Short-term priority: Promote competitiveness through market-based enterprise restructuring; take measures to improve the business environment and stimulate domestic and inward investment.
- Medium-term priority: Improve competitiveness through market-based restructuring, including small and medium-sized enterprises.

The NPAA elaborates on these priorities for economic and enterprise sector reform and promotion of SMEs.

3. Description

3.1 Background and justification

One of the most important barriers to private sector development in Bulgaria is the lack of long-term finance and risk capital available to enterprises on appropriate terms, and a lack of modern management advisory services. The BPPF responds to these needs by providing a source of long-term equity capital, enhanced by technical assistance to improve the management of the enterprises in which it invests.

The BPPF is an equity instrument that targets new private sector and recently privatised medium-sized enterprises that typically do not have a foreign partner, but are fundamentally sound and able to grow and improve their performance. The BPPF expects to invest in an estimated 12-15 such companies, each with between 50 and 500 employees and annual sales of at least 2.5 million euro. The BPPF provides the management of enterprises in which it has invested with significant consultancy advisory services.

The BPPF was set up in 1998 as a closed-end fund of ten years duration. It is capitalised with 30 million euro of equity funds from the European Bank for Reconstruction and Development (EBRD), which has overall responsibility for the BPPF, and a further 10 million euro from the Fund Manager that manages the BPPF. The European Commission agreed to provide up to 15 million euro from Bulgaria's 1997-2000 Phare National Programmes.

Phare funding is used to cover (i) the operating expenses of the Fund Manager, (ii) pre-investment expenses on due diligence of enterprises and preparation of business plans, (iii) post-investment consultancy advice to the enterprises in which the BPPF has invested, and (iv) EBRD's own management fee. Phare grant finance makes it possible for the BPPF to invest in enterprises that could not normally be reached, because they would be too risky, expensive to research or need management assistance.

The conditions for Phare support of the BPPF are set out in a Technical Cooperation Funds (TCF) Agreement signed in May 1998 between the Commission and EBRD. The BPPF is managed as a commercial venture capital fund by Europa Capital Management Holdings Ltd, an independent asset management house that serves as Fund Manager to the BPPF. The Fund Manager was selected and contracted in compliance with standard Phare procedures in December 1997. The BPPF is based in Bulgaria and aims to achieve a commercial rate of return.

Phare funding is programmed on an annual basis, depending on the amount actually utilised and forecast spending needs for the immediate future. Phare has so far provided the BPPF with 1.5 million euro under the 1997 National Programme (BG 9704) and 3.5 million euro under the 1998 National Programme (BG 9805). There was no need for an allocation from the 1999 National Programme. 1.5 million euro will be provided under the 2000 National Programme. Any subsequent allocation would require modification of the TCF Agreement.

3.2 Linked activities

The EBRD and the Commission established in 1999 the SME Finance Facility for small and medium-sized enterprises operating in ten countries of central and eastern Europe. The Facility will support the growth and development of private sector SMEs by mobilising long-term investment capital and by its institution building impact on participating financial intermediaries. The Facility will consist of two windows, one for equity and one for loans. Bulgaria will be covered initially through the loan window: the first two banks will be signed up in the first quarter of 2000. Further banks will be included in the Facility at a later stage, together with the development of the equity window. The Facility will complement the activities of the BPPF.

3.3 Outputs

The BPPF's deal pipeline has taken somewhat longer to establish than initially envisaged, and this is reflected in lower than expected use of Phare funds. Nevertheless, the BPPF has so far investigated more than 250 companies and currently the active deal pipeline includes 15 companies.

As of March 2000, the BPPF had made three investments and the Investment Committee of the BPPF had approved two further deals:

- The first investment of the BPPF is 1.43 million euro in Pobeda, a leading Bulgarian biscuits and sweets producer. The BPPF is committed to invest an additional 1.9 million euro over the next two years if additional equity in Pobeda is needed.
- Orbitel is the largest private internet company in Bulgaria and is the second enterprise in which BPPF has invested. The investment is 952,380 euro of common equity.
- The third investment of the Fund is in Medika, a producer of medical dressings and generic pharmaceuticals. The size is 1.9 million euro in equity and convertible loan.
- The fourth investment approved by the Investment Committee is in Damianitza, a midsize winery. The equity investment will be 680,000 euro.
- The fifth investment approved by the Investment Committee is in Babylon L, a pharmaceutical distribution company. The equity investment will be 860,000 euro.

In addition to the above mentioned investments, the current deal pipeline is strong and the Fund Manager and EBRD are confident that at least four investments will be made in year 2000 and five or six investments in year 2001. The current budget is based on the assumption that the Fund Manager will make 9 to 10 investments in years 2000 and 2001.

3.4 Inputs

The Phare funding is used to cover (i) the operating expenses of the Fund Manager, (ii) pre-investment expenses on due diligence of enterprises and preparation of business plans, (iii) post-investment consultancy advice to the enterprises in which the BPPF has invested, and (iv) EBRD's own management fee.

4. Institutional Framework

The institutional framework is governed by the TCF Agreement between EBRD and the Commission, and a separate Fund Management Agreement between EBRD and the Fund Manager. EBRD has overall responsibility for the management of the BPPF while the Fund Manager is responsible for the day-to-day operation and management of the BPPF.

The BPPF has two governance and decision-making bodies. A Supervisory Board, on which the Commission is represented, provides overall supervision of the BPPF's activities, decides policy and agrees the budget. The Investment Committee, on which the Commission is not represented, takes investment and divestment decisions on the basis of the Fund Manager's recommendations. EBRD has a veto power in this Committee.

EBRD keeps the Government of Bulgaria regularly informed of the BPPF's activities.

5. Detailed Budget

EBRD has supplied the Commission with detailed information showing the use of Phare funds since the BPPF was established in 1998, and forecast use of Phare funds to the end of the year 2002. The Phare funds committed under the 1997 and 1998 National Programmes are forecast to be fully utilised sometime during by 2001. The BPPF is expected to require additional Phare funding of 1.5 million euro to meet eligible expenditures during the rest of 2001 and 2002. These additional funds will therefore be provided under the Phare 2000 National Programme.

	Phare support (million euro)			National Cofinancing	IFI	TOTAL
	Investment Support	Institution Building	Total Phare (=I+IB)			
Total	1.500	-	1.500	*	*	1.500

* See section 11.2 below.

6. Implementation Arrangements

The BPPF is run as a managed account of the EBRD, under which arrangement the EBRD makes direct equity investments in Bulgarian companies with these investments being managed on its behalf by the Fund Manager. Tendering and sub-contracting the technical assistance funded by Phare under this project is the responsibility of EBRD.

As with previous Phare support for the BPPF under the 1997 and 1998 National Programmes, Phare funds provided under the 2000 National Programme will be transferred from the Commission direct to EBRD, under the arrangements set out in the TCF Agreement. Funds will not flow via the National Fund in Bulgaria.

7. Implementation Schedule

The project commenced in May 1998 and has a ten-year duration. The project is currently using Phare funds provided under the 1997 and 1998 National Programmes. The funds provided under the 2000 National Programme will be disbursed to EBRD in 2001 for use during 2001 and 2002.

8. Equal Opportunity

The BPPF is an equal opportunity employer.

9. Environment

The Agreement establishing the EBRD requires the EBRD and any investment funds of the EBRD to promote in the full range of its activities, environmentally sound and sustainable development. Environmental assessment and impact studies are undertaken by the BPPF as an essential part of the due diligence process and reported to the Investment Committee when an investment is put forward for approval.

10. Rates of Return

Although EBRD's hurdle rate is set at 8%, the BPPF is looking to achieve higher than average return on investment by carefully selecting enterprises with high growth potential and strengthening their management and operations. The target is to achieve an internal rate of return of 20% or higher over the life of the BPPF.

11. Investment Criteria

11.1 Catalytic effect

Phare grant finance makes it possible for the BPPF to invest in enterprises that could not normally be reached by a foreign venture capital fund, because the enterprises would be too risky, expensive to research or need management assistance to achieve their potential. The BPPF's activities will contribute to more rapid development of the private sector.

11.2 Co-financing

EBRD committed equity funding of 30 million euro, with co-investment from the Fund Manager of 10 million euro, when the BPPF was established in 1998. These funds will remain committed throughout the entire ten-year life of the project. Phare funding is committed on an annual basis, according to need. No new co-financing is required for successive Phare allocations.

11.3 Additionality

Phare was the only available source of grant funds on the scale required, when the project was launched in 1998.

11.4 Project readiness and size

The project is ongoing and has been effective since May 1998.

11.5 Sustainability

The BPPF will aim to sell its stakes in Bulgarian enterprises as going concerns to other strategic investors.

11.6 Compliance with state aids provisions

There are no state aids associated with the operation and investments of the BPPF. Although the Government of Bulgaria is kept informed of the activities of the BPPF, it has no role in its operations.

11.7 Contribution to National Development Plan

The promotion of SMEs features prominently in the preliminary NDP. SMEs are identified as a key development priority at both the national and regional level.

12. Conditionality and Sequencing

The Bulgarian Government will remain committed to its privatisation programme. It will pursue a policy of transparency in the privatisation process and refrain from introducing measures that hamper the development and operation of private sector enterprises. The Government will refrain from exercising political pressure or otherwise interfere in the operation of the BPPF.

ANNEXES TO PROJECT FICHE

1. Logical framework matrix in standard format
2. Implementation schedule
3. Contracting and disbursement schedule
4. Reference to feasibility and pre-feasibility studies.

Annex 1

LOGFRAME PLANNING MATRIX FOR Further support for Bulgarian Post-Privatisation Fund			Contracting period expires: 31 December 2002	Disbursement period expires: 31 December 2003
			Total Budget: EUR 1.5 million	Phare contribution: EUR 1.5 million
	Indicators of Achievement	How, When and By Whom Indicators Will Be Measured	Assumptions	
Wider Objective <ul style="list-style-type: none"> To contribute to private sector development in Bulgaria 	<ul style="list-style-type: none"> Increased share of the private sector in GDP of Bulgaria 	<ul style="list-style-type: none"> Bulgarian National Statistics EBRD Transition Reports 	<ul style="list-style-type: none"> Economic and political stability in Bulgaria Continued process in privatisation & liberalisation 	
Immediate Objective <ul style="list-style-type: none"> To improve the performance of selected Bulgarian private enterprises by providing them with long-term equity finance and know-how 	<ul style="list-style-type: none"> Measurable improvement in enterprise shareholder value Enterprises invested in are sold as going concerns at end of BPPF life BPPF achieves target rate of return 	<ul style="list-style-type: none"> Regular EBRD reports to Commission on BPPF activities BPPF Steering Committee and Investment Committee records 	<ul style="list-style-type: none"> Enterprises respond to consultancy advice Stability of markets in which enterprises operate Sufficient exit opportunities 	
Results <ul style="list-style-type: none"> Equity investments made in selected enterprises Management advice provided to selected enterprises. 	<ul style="list-style-type: none"> Steady flow of due diligence reports leading to regular investments BPPF fully invested within ten-year period. Consultancy services sub-contracted and provided after investments made 	<ul style="list-style-type: none"> Regular EBRD reports to Commission on BPPF activities BPPF Steering Committee and Investment Committee records 	<ul style="list-style-type: none"> Sufficient investment opportunities Availability of suitable consultancy expertise Fund Manager performs well 	
Activities <ul style="list-style-type: none"> BPPF established Equity and grant funds committed Fund Manager recruited 	<ul style="list-style-type: none"> TCF and FM Agreements signed Fund Manager commences work 	<ul style="list-style-type: none"> Regular EBRD reports to Commission on BPPF activities BPPF Steering Committee and Investment Committee records 	<ul style="list-style-type: none"> EBRD & EC approval of project & funding Will be able to identify a suitable Fund Manager willing to provide cofinancing 	

ANNEX 2: IMPLEMENTATION CHART

The project commenced in May 1998 and has a ten-year duration.

ANNEX 3: CONTRACTING AND DISBURSEMENT SCHEDULE

There will be no new contract between the Commission and EBRD governing the additional Phare support provided under the Phare 2000 National Programme. The TCF Agreement between EBRD and the Commission will continue to govern the management and use of Phare funds.

The additional Phare funds will be disbursed to EBRD when the funds are required by the BPPF, at which time EBRD will make a formal request in writing to the Commission, in accordance with the TCF Agreement. It is estimated that disbursement will take place in two equal tranches in the second quarters of 2001 and 2002.

ANNEX 4: FEASIBILITY AND PRE-FEASIBILITY STUDIES

Prior to establishing the BPPF, significant work was undertaken to identify the potential deal flow. An initial investment pipeline was developed through assessments by an enterprise screening team led by a consultant as well as enterprise screening carried out by the Fund Manager.