Issue

20

MARCH 2013

Twentieth Issue

INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

IAFEI Quarterly

The electronic professional journal of IAFEI
(International Association of Financial Executives Institutes)

March 21, 2013, www.iafei.org

Table of Contents

Please turn over

Luxemburg, Article: **IFRS 13, Or When Counterparty Risk Hits Your Bottom Line,** by **Francois Masquelier,** Chairman **ATEL,** Luxemburg Association of Corporate Treasurers, from **Le Magazin du Trésorerier, Treasurer Magazine,** No. 80, Jan/ Feb/ Mar 2013**, ATEL**

Russia, Article: **Russia`s Campaign Against Off-Shoring. Half-Hearted At Best.** by **Bernd Hones**, *from **CFO INSIGHT** magazine, Spring 2013*

South Korea, Country Report: **South Korea, Lessons For Global Development,** The “ miracle “ of South Korea`s rise and what it means for other emerging market economies, By **Payden & Rygel**, Los Angeles, California, USA, January 2013, Point of View, Our Perspective on Issues Affecting Global Financial Markets

Spain, Article: **Iberdrola, Plenty Of Choice,** Spanish energy Group Iberdrola faced a difficult challenge when it tried to refinance € 1 billion facility, so it offered its banks menu-style options. From **The Treasurer,** March 2013**, ACT**, UK

USA, Interview: **IFC, International Finance Corporation, “ It´s Not About The Money “ Interview** with Nena Stoiljkovic, Vice President of the IFC, a member of the World Bank Group and the largest global development institution focused exclusively on the private sector. Interviewed by **Armin Häberle,** *from **CFO INSIGHT** magazine, Spring 2013*

IAFEI News

Letter of the Editor **March 21, 2013**

Dear Financial Executive,

You receive the **IAFEI Quarterly XX th Issue**.

This is another issue of the **IAFEI Quarterly**, the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes.

This journal, other than the IAFEI Website, is the internal ongoing information tool of our association,

> destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the national IAFEI member institutes.

This issue again offers a broad range of articles on financial subjects, which merit the reader´s attention.

The article on **South Korea : Lessons For Global Development,** continues our series of country reports. It is a highlight of this issue.

Once again:

I repeat our ongoing invitation to IAFEI member institutes, and to their members, to send us articles for inclusion in future IAFEI Quarterlies, and to also send to us your suggestions for improvements.

With best personal regards

Helmut Schnabel

Helmut Schnabel

Euro break-up: back to 1999 !

Bruno Colmant, Ph.D., CFA, FRM Guest professor at the Luxembourg School of Finance President of the CFA Belgian Society, member of the CFA Institute Capital Market Committee.

Ever since November 2009, the European political message is based on the intangibility of the euro. The president of the ECB has even claimed its irreversibility.. Day after day, the European economies are diverging increasingly and the Euro is falling to pieces. If a monetary readjustment was to be authorised, it would lead to a dramatic devaluation of the majority of the European currencies with respect to the reinstalled Deutsche Mark.

A monetary change becomes plausible when we make an inventory of the bias that affect real interest rates, which have become negative for some countries. Firstly, the countries from the South of the Eurozone were - thanks to the German benchmark - able to borrow under lucrative conditions that masked their solvency's reality. It is in this way that Greek public debts attained peaks that the drachma would not have allowed. Indeed, foreign moneylenders would have demanded a risk premium destined to protect itself against change risks. Next, by means of a waterfall effect, the interest rates of the peripheral countries remained too low, leading to asset bubbles. This is typically the case for Spain where the real estate bubble would have never occurred if the interest rates of the Spanish State would not have been deflated by the introduction of the Euro. Lastly, this low interest rate policy has allowed the European States to reinforce their weight in economy at a reduced cost. Indeed, these States have seen their loan rates lightened and their budgetary indiscipline cleared of annoying high interest rates, which they would normally have been imposed by the financial markets.

But if the creation of the euro has compromised interest rates, its rescue generates an even more profound foible, for the ECB has to adopt extremely expansionist monetary politics. Mechanically, the euro is at the basis of numerous bubbles that all end up exploding. The next explosion will undoubtedly be that of a bond bubble in the Northern European countries.

Is there a way of escaping from monetary recession? Of course and one should hope so for the European project comes with the moral values of ideal politics. However, so as to prevent monetary recession, monetisation (i.e. permanent discounts) of the weak countries' public debt within ECB, as well as an increase of the inflation objectives of this institution should be accepted.

In his last publication (soon to be translated in French), Paul Krugman confirms, such as all other renowned Nobel prize winners in Economics, that inflation is the exit way of a homogenous Eurozone. Even the IMF henceforth pleads for even more flexible monetary politics. Consequently, they all plead for choosing the path of monetary creation and a much weaker euro. The objectives to return to budgetary balance should also be halted, to say the least of the Southern European economies, which are already suffocating under austerity. Moreover, a true fiscal and budgetary union should be formulated. However, monetary and political authorities are not too keen on these sovereignty transfers for it's a federal vision of Europe that prevails.

For the countries that will be expelled or that will choose to break up their monetary rooting, the rupture will be extremely chaotic. Yet, the outline of this operation is discernible. Like a drastic devaluation, it will demand change controls, urgent bank rescues, price and salary freezing so as to prevent (hyper) inflationist phenomena, restricted movement of capital and the support of international institutions, such as the IMF. Monetary conversion will first be realised with transferred money,

followed by coins and bank notes. Inevitable social unrest will also have to be appeased for monetary repudiation does not come with a regime change.

Hereunder, I will sum up some landmarks of this monetary metamorphosis that, once again, nobody wants but that could be imposed.

Firstly, there wouldn't exist two euros, but a euro-mark, geographically focused on the Ruhr region and peripheral currencies with managed floating. One could imagine a return to the Drachma, the Lira, the Peseta and the Escudo. With these currencies, a system in which currencies were allowed to vary from each other within a narrow band should immediately be reinstalled, comparable to the Snake in the Tunnel (1974-1978) or the European Monetary System (or EMS from 1979 to 1999) so as to stabilise intra-community trade and inflation. In other words, leaving currencies should have to evolve towards a central rate system, of which the euro-mark will be the reference axis, coupled with fluctuation margins. Moreover, the Eurozone has already returned to the EMS with sovereign spreads that replace fluctuation margins and devaluations that are being transformed in defaults.

The problem would lay in the formation of the exchange rates of these new currencies. The inhabitants of the leaving countries would indeed receive a certain amount of the national currency instead of euros for their belongings. The euro would thus not be replaced by a currency basket. This would also be applied to the active accounts that these residents have abroad. The exchange rate of this new currency will be depreciated by 20%-30%, even more in the case of Greece, with respect to 1999. However, fixing an exchange rate is complex: leaving countries would be divided between the wish for an excessively depreciated exchange rate (to stimulate their export) and a credibility constraint (to prevent that their new currency impedes them to access foreign capital markets).

The advantage of monetary secession is that it renounces these debts. The existing debts and claims of a country that steps out of the Eurozone (and that we suppose are dominated in euros) thus have to be converted in the new national currency. Consequently, an initial exchange rate should be formulated, followed by the recognition that the debts of the leaving country - denominated in euros- are converted, with a loss, into the new currency. The same goes for the debts of the leaving country, which will lead to a loss for foreign creditors. The Greek example is illustrative in this respect. Believing that foreign debts and claims - denominated in euros - of a country that is stepping out would keep a parity with respect to its exchange value in euros would of course be totally naive.

So as to minimise the losses of foreign creditors, the debts of a leaving country should, as far as possible, be domestic, i.e. being financed by national creditors. A simplified example illustrates this situation. If a country's sovereign debt is integrally held by foreign creditors and is converted by the authorities in a national currency depreciated by 30%, this will lead to a loss of 30% that is being charged to foreign creditors. If this very same debt is 80% domestic, this only comes with a global loss for foreign creditors of 20% times 30%, this is 6%. This is exactly what the ECB has been working on over the past eight months, with the help of the banks of the weak countries. The ECB loans have essentially been used by the Spanish and Italian banks to buy back the public debts of their country.

So as to minimise the losses of monetary secession, it's better to have a weaker euro so as to alleviate the impact of having to let go of certain currencies as well as to temper the inevitable revaluation of the euro-mark, which will have become a strong currency, and will thus be penalised in terms of foreign competitiveness. Singularly, a weaker euro also reduces the probability of a country having to let go such as Italy or Spain.

Will we escape from this threatening scenario ? The next few months will tell, but the absence of political ambition for a reorganised European structure does not rule out the issue. This would, undoubtedly, be bad news for the euro and good news for the countries that would leave the zone, knowing that - with a strong euro - the only economic perspectives that would be imposed on them would be unemployment, austerity and the contraction of their GNP. Besides, the last report of the IMF is very explicit. So as to save the Eurozone, budgetary reflation, as well as more flexible monetary politics have to be accepted.

–*Bruno Colmant*,

Bruno is a partner with Roland Berger Strategy Consultants. started his career with the accounting firm Arthur Andersen. He occupied several management positions at Sofina and the brokerage house Dewaay. In 1996, he joined ING where he held the position of Chief Auditor before advancing to the position of CEO of ING Luxembourg between 2002 and 2004. He then joined the Executive Committee and the Board of Directors of ING Belgium as CFO.
In 2006, he served as Chief of Staff of the Minister of Finance for a year, before heading the Brussels Stock Exchange as CEO. He also became a member of the Executive Committee of the New York Stock Exchange. Subsequently, he was called by Fortis Holding (Ageas) to solve the legacy issues of the Fortis break-up in the capacity of Deputy CEO. He retains an advisory position at Ageas.
A recognized expert in corporate and market finance, stock exchange processing, risk management, financial accounting and taxation, Bruno has a sound experience with banking and insurance mechanisms. He currently chairs the Belgian CFA Society and is a member of the Federal Economic Council. He teaches Advanced Finance at Vlerick Business School, Solvay, ICHEC and UCL, and has authored more than forty finance books.

MAPLE MAGIC

LAST YEAR, NATIONAL GRID ISSUED TWO BONDS IN CANADA, RAISING OVER $1BN. WE DISCUSS THE DEALS WITH THE KEY PARTICIPANTS

In September 2012, British utility company National Grid issued the largest-ever corporate maple bond at CAD$750m. The bond had a 2.73% coupon and a maturity date of 20 September 2017. Two months later, it followed this with a further CAD$400m issue. This time, the bond had a 2.90% coupon and a maturity date of 26 November 2019.

The maple market denotes a foreign-domiciled company issuing in the Canadian market to Canadian investors. Over the past few years, this market has continued to grow as Canadian investors have shown a significant appetite for diversification, and it has become an important part of many international funding programmes.

The key learnings from the National Grid deals were discussed at a recent roundtable conference between *The Treasurer*, National Grid and its lead dealers, RBC Capital Markets and TD Securities. The participants in the discussion were: Malcolm Cooper, director of tax and treasury, National Grid (MC); Kwok Liu, head of capital markets, National Grid (KL); Felix Fletcher, vice president, RBC Capital Markets (FF); and Patrick Scace, managing director, TD Securities (PS).

_TT_: What made National Grid come to the Canadian market when it has no Canadian assets?

MC: Our treasury has always pursued funding opportunities away from its core funding markets in the UK and US in order to benefit from investor diversification and competitive pricing in other markets.

We have funded in many currencies such as Australian dollars, Hong Kong dollars, Japanese yen and even Slovakian koruna and Romanian leu. We have flexibility as to what currency is actually issued, as long as the rate looks attractive when swapped to sterling or dollars. It is important for us to diversify our investor base away from the UK since we are one of the largest corporate issuers of sterling bonds.

FF: Although these deals were a competitive source of funding compared with sterling, I think an equally important point is that you don't want to be reliant on just one market. During the eurozone crisis, we saw corporates that were reliant on the euro market struggling to fund.

PS: National Grid also noticed that 2012 was a record year for corporate maple issuance volume, with a number of new issuers entering the market. It was also already familiar with the market as it issued CAD$200m of holding company (holdco) bonds in June 2006 and has a very good understanding of the issuance process.

_TT_: What were the most positive aspects of the 2012 transactions?

KL: The amounts that we achieved were the main positive of the transactions. We were stunned by the size that we achieved – CAD$750m and CAD$400m, at attractive coupons. Only a few years ago, a maple bond of CAD$200m-$300m would >

It is important for us to diversify our investor base away from the UK since we are one of the largest corporate issuers of sterling bonds

have been a good result. We hope the Canadian market will develop into a genuine core funding option for us.

FF: If Patrick and I are honest, at the start of the roadshow in September, we did not expect to get a size of CAD$750m. We were confident of a successful transaction, but for this to be the largest corporate maple bond ever was a pleasant surprise.

PS: The main takeaway I have is that the transactions clearly demonstrate the value of face-to-face investor meetings. National Grid has always prided itself on keeping investors up to date and it has been very diligent in Canada. The roadshow it did the week prior to launching its first CAD$750m tranche included meetings in Toronto, Montreal and Winnipeg, and involved 45 investors. I think this was a key driver for the success of the deal.

***TT*: Why do you think the deals were so successful?**

MC: We have always had good demand globally, especially for our regulated operating entities due to the regulated nature of our business. The markets in Canada were very strong and investors were keen on investing in a name such as ours.

PS: The UK regulatory model is also very similar to what is used in Canada and so the domestic investors are familiar and comfortable with the structure.

FF: National Grid, particularly at the operating company level, has always performed well in all capital markets and generally trades tighter than its peers.

PS: The Canadian investors certainly saw value in the deals compared with similar domestic utilities. These companies typically trade very tight and so investors saw this as an opportunity to buy bonds with a similar risk profile, but with extra yield.

FF: It was a win-win for both the issuer and the investor – that is rare these days. The issuer was borrowing money at an attractive rate compared with other markets available to them and the investor achieved a better yield than similarly rated domestic Canadian utilities provide.

***TT*: How important was the cross-currency swap back into sterling?**

KL: When we compare our funding opportunities across the different markets available to us, we look at the spread to sterling Libor. The currency basis is therefore extremely important to us when deciding which market to fund in. We monitored the cross-currency basis from Canada to sterling Libor very closely in the weeks and months prior to launching the deal. A sharp move against us on this basis could have scuppered the deal altogether.

A small number of Canadian banks also dominate this market and it is important to employ banks that know the market and investors well

FF: The cross-currency swap also had an important bearing on the maturity options for the bond. Longer than seven years ramps up the risk and capital charge for the banks as swap counterparty. That, in turn, increases the credit charges, which National Grid obviously wanted to avoid.

PS: The maturity constraint caused by the cross-currency swap was less relevant on these first two issues as the core demand was for the five- to seven-year terms. Domestic borrowers have access to maturities as far out as 100 years, but investors still generally prefer 10 years and under for maple issuers. This may change in the future as investors become more comfortable with international borrowers, but the swap constraints will impact longer-term borrowers.

ABOUT THE MAPLE BOND MARKET

The maple bond market is a term used to indicate Canadian dollar-denominated bonds that are sold in Canada by foreign financial institutions and companies. They allow domestic Canadian investors to invest in foreign companies without being exposed to the risk of currency exchange fluctuations. The market has grown significantly since the elimination in 2005 of the Canadian foreign property rule, which specified that no more than 30% of the assets held in tax deferred retirement savings accounts be foreign property. Over CAD$5.5bn was raised on the maple bond market in 2012.

***TT*: Were there any lessons learned that could help other corporates looking to fund in Canada?**

MC: We found the level of sophistication among Canadian investors to be very high. They had certainly done their homework on us when we went to see them and we were impressed by the quality of the questions they asked.

A small number of Canadian banks also dominate this market and it is important to employ banks that know the market and investors well, and are able to provide secondary market support. RBC Capital Markets and TD Securities specifically have done a tremendous job in helping to set up the programme and assist international issuers to access the Canadian market.

FF: National Grid had the advantage of being quite well known to the Canadian investor base, as many of the larger funds have bought their credit in sterling, euros and US dollars. Other corporates may not have that luxury and so I would encourage them to educate investors on their credit as thoroughly as possible. National Grid also focused on issuing into demand, which at the time was greatest in the five-year term. This resulted in a very strong issue, which in turn helped drive support for a follow-on seven-year issue.

PS: One of the advantages of the Canadian market is the relative ease of documentation. European issuers can simply use their euro medium-term note programme as the base document and add a Canadian 'wrap', which is a simple, short document with specific terms and conditions relevant to Canadian investors. While this is a straightforward process, I would always recommend starting the legal documentation work as early as possible. Another advantage is the ease and speed of marketing. In Canada, a company is able to meet the entire investor base over a two-day period, as most investors are concentrated in Toronto and Montreal.

I also think Canadian investors continue to look for diversification, and issuers such as National Grid that have a good credit story and strong cash flows are enjoying the most support. Any borrower with global appeal and funding transparency should view the Canadian market as a potential funding opportunity.

Any borrower with global appeal and funding transparency should view the Canadian market as a potential funding opportunity

ABOUT NATIONAL GRID

◆ International electricity and gas company National Grid is one of the largest investor-owned energy companies in the world.

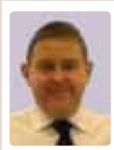
◆ It is primarily listed on the London Stock Exchange and is a constituent of the FTSE 100 index. It also has a secondary listing on the New York Stock Exchange. National Grid provides energy to millions of customers across the UK and Northeast US.

◆ In the UK, it owns the electricity transmission system in England and Wales, and operates the system in Great Britain. National Grid also owns and operates the gas transmission system in Great Britain, as well as four of the eight gas distribution networks.

◆ In 2006/7, National Grid bought US gas distributor and electricity producer KeySpan and Rhode Island-based New England Gas Company. These acquisitions doubled the size of National Grid's existing American subsidiary.

◆ National Grid's revenues for the 2011/12 financial year were £13.8bn.

ABOUT THE PARTICIPANTS



Malcolm Cooper is director of tax and treasury, National Grid

Kwok Liu is head of capital markets, National Grid

Felix Fletcher is vice president, RBC Capital Markets

Patrick Scace is managing director, TD Securities

FUNDING FALLEN ANGELS

As traditional bank financing fades away, new sources of funding are becoming available to CFOs across Europe. High-yield investors, in particular, are taking an interest in companies they had shunned before. But with choice comes complexity, so structuring a company's financials is becoming increasingly complicated.

High-yield investors do not typically invest in industrial companies; but investment patterns are changing rapidly.

By Armin Häberle

When Ciech, a Polish chemical company with annual turnover of PLN 4.4 billion (EUR 1.1bn), refinanced its bank debt with an international high-yield bond at the end of last year, it was widely recognised as emblematic of a major trend. High-yield bonds have become wildly popular. Companies across western Europe, and even in emerging Europe, can benefit from this as high-yield spreads over government debt have compressed to multi-year lows.

According to the Institute of International Finance (IIF), European high-yield spreads currently stand at just above 500 basis points, down from 1,000 at the beginning of 2012. The IIF does not want to call it a bubble, but writes that the spread compression "has raised the question of whether credit risk is being under-priced again, as in the period prior to the 2007-09 financial crisis." But the frenzy in the high-yield markets continues. According to data from Thomson Reuters, the volume of international bonds issued by European companies in the first six weeks of the year was down 19 percent compared to the same period last year – but up by 55 percent in the high-yield market.

As a chemicals company, Ciech would not normally be considered interesting by international high-yield investors. Traditionally, they look for high-tech companies, telecoms and the like. But European high-yield markets no longer behave like they used to. "Before 2009, high-yield in Europe was used predominantly by private equity investors as subordinate elements of a larger financing structure," says Fabio Diminich of Clifford Chance, an international law firm that advised Ciech on the deal. "Today, more companies use the high-yield market and for bigger parts of their overall capital structure. It now often makes up a big chunk of the senior debt."

» A growing range of funding options exists for European CFOs, but high-yield bonds cannot save the day for everyone.«

The local bond that Ciech issued, worth PLN 320 million, was due to mature in December 2012 and the company prepared to refinance it with another local bond the summer before. But early on, it became apparent that as investors were showing heightened interest in European high-yield bonds, CFO Andrzej Kopec could do more than just refinance the local bond. It turned out he could also replace the best part of its bank credit facility with a euro-denominated high-yield bond.

This came in handy as banks were increasingly sceptical about lending to Ciech after years of poor performance. The company listed on the Warsaw Stock Exchange has production sites throughout Poland and abroad, but its business has come under pressure in recent years. It reported negative net profits in 2011 and 2012 and completed a restructuring exercise in 2011, including an equity injection of PLN 400 million used for deleveraging. The high leverage, still 4.3 times its Ebitda today, is the legacy of debt-financed acquisitions carried out in 2006 and 2007 as well as investments made in 2008 that were financed by short-term loans.

The question marks regarding Ciech's business are reflected in Standard & Poor's preliminary long-term credit rating of "B", which was assigned just before the bond issuance. The agency considers Ciech's business profile "weak", and its leverage and financial risk profile "aggressive". Pressures

recently eased a slightly with Ciech's successful sale of its subsidiary Zachem to Germany's chemicals giant BASF. But the divestment process is far from over.

Placing a high-yield bond may very well be the best option in such a situation. Many of the companies now issuing high-yield debt constitute what are referred to as "fallen angels." Fallen angels are companies that faced unexpected refinancing problems in the financial crisis when they suffered from unexpected funding problems – either because of falling revenues and deteriorating credit ratings or because partner banks were no longer able to provide credit. This closed off a large number of funding options, even if the companies as such were basically sound. Now that international high-yield investors have become interested in the companies, fallen angels' refinancing options look much better again.

But even in the current environment, pricing high-yields is tricky, especially for first-time issuers. For issuers headquartered in emerging Europe, investors still expect a slight regional premium. In Ciech's case, the uncertainty about its ongoing restructuring and the fact that the company was relatively close to the local bond refinancing deadline when it priced the high-yield bond "certainly did not help," says one person close to the deal. So, despite the global trend towards spread compression, Ciech is paying a hefty 9.5 percent coupon on its bond. "This is not exactly cheap," says Magdalena Komaracka, analyst at Erste Securities Polska. "Most corporate notes issuers in the Polish markets can expect to pay 150 to 200 basis points less than that."

Getting complicated

But tapping this market also means CFOs are forced to put up with a lot of extra complexity. Ciech replaced a pretty straightforward bank facility with an international high-yield bond amended by a revolving credit facility, and included the local zloty-denominated bond in the overall structure. To appease banks, the PLN 100 million revolving credit facility holds a super senior status, placing it above the bonds in case of a default. Still, the amount is significantly less than what the banks were used to before, and they also had to accept a much softer covenants package that follows the bond structure.

"A bond, particularly a bond plus loan structure, might be a slightly bigger task to set up and implement than a pure loan package, but once it is in place, typical bond incurrence-based covenants arguably provide more operational flexibility for CFOs," says Loren Richards, also of Clifford Chance. Compare this to Ciech's former credit agreement which, apart from covenants regarding leverage, gearing ratio, coverage ratio and cash levels, also included provisions requiring proceeds from asset disposals or any cash above a certain threshold after Q4 2013 to be used for repayment.

But there are limits on the high-yield market, too. The minimum size of an international issuance is EUR 150 million. And if a CFO needs a more complex structure, the size of the additional funding elements will depend on the high-yield paper. "If you want to put a revolving credit facility on top, for example, it should not exceed 25 percent of the total volume of the deal," says Mr Diminich. "Most revolvers make up between 10 and 15 percent – increasingly with super seniority in the capital structure. Companies that need more working capital might find other funding structures more appropriate."

While there is an ever-increasing range of funding options out there for European CFOs, high-yield bonds cannot save the day for everyone. «

armin.haeberle@cfo-insight.com

"WE HAVE TO AVOID MISTAKES IN M&A"

In May, Joachim Müller will have been CFO of Bilfinger for four years. During this time, the listed company based in Mannheim has used an impressive M&A agenda to transform itself from a construction company into a service provider. The 53-year-old discusses his role as the CFO in the group's transition, and management's ability to bear the burden.

By Marc-Christian Ollrog

// Mr Müller, when you became CFO in 2009, construction still accounted for 60 percent of Bilfinger's total business. This year, this figure should be well under 20 percent. You've sold the Australian construction segment and are continuing to develop Bilfinger into a service provider. How far along are you in the process?

The groundwork for the transformation was laid in as early as 2002. But there's no question that the sale of Valemus Australia accelerated the process. We're neither at the beginning nor at the end, but somewhere in between.

// Since the launch of the BEST strategy programme some 15 months ago, we've seen 22 mostly smaller acquisitions. You invested roughly EUR 700 million in enterprise value and acquired nearly EUR 1 billion worth of turnover. Will we see a larger deal from you soon?

Hold on. Neo Structo, Tebodin, WestCon and Johnson Screens were all quite sizeable acquisitions. We will continue working on smaller niche acquisitions, but will also aim for larger deals at the same time. The plan is to increase Bilfinger's output volume by roughly EUR 3 billion, to between EUR 11 billion and EUR 12 billion, by 2016, both organically and through acquisitions.

// This year it should be around EUR 8.4 billion. That means you only have two-and-a-half years left to make up EUR 3 billion in output.

» The companies we acquire must earn their cost of capital within the first year of consolidation.«

A third of this growth will occur organically, while we want to achieve the other two-thirds through acquisitions. Compared to 2011, net profitability should almost double by 2016. This also means that in our M&A strategy, fit is more important than size. Our M&A targets have to fit into our overall corporate strategy as well as those of our respective divisions. In this respect, different segments have different requirements. Tebodin, for example, was really a lucky break, because it allowed us to acquire almost 1,400 engineers while strengthening our presence in very important markets such as the Middle East, Vietnam, Russia and China at the same time.

// You still have around EUR 850 million in cash that you could spend. How do you ensure that you don't pay too much?

In the current economic environment, we typically pay multiples of between 7 times and 9 times Ebitda and would only be prepared to move towards a double-digit multiple under really exceptional circumstances.

More generally speaking, we have, in fact, very clear requirements for our targets. We will not buy any restructuring cases and we always try to retain the local management of the company. The price we are willing to pay is also affected by the requirement that acquired companies must earn their cost of capital within the first year of consolidation. And they must, of course, make a positive contribution to group profit.

Bilfinger

The CFO...

Joachim Müller began his career as an auditor with Arthur Andersen. In 1997, the trained economist joined Software AG, where he served as chief financial officer during the company's IPO. From there, he became the CFO and COO of SAP SI, where he held international and commercial management positions at SAP AG, most recently as vice president of corporate finance at the SAP Group. In November 2008, Mr Müller was appointed to Bilfinger's executive board and as the company's CFO.

// In a corporate strategy based on M&A, failed transactions represent perhaps the single greatest risk to a company. How do you deal with that when conducting due diligence processes?

We work with a structured due diligence checklist, according to which we assign grades of A, B and C to our potential targets based on their respective enterprise values. Projects with A-rated targets are always managed centrally at headquarters; C-rated targets have values below EUR 10 million and are managed at the divisional level, with close supervision from specialists at headquarters. B-rated targets are somewhere in between. A standardised process tasks those with the relevant expertise with taking care of certain projects. The checklist has thus become a living document. We involve internal as well as external consultants, especially lawyers and auditors, in the entire process...

// ...but you completed the Johnson Screens takeover without an investment bank.

Much to the chagrin of the banks. But seriously, what do you need an investment bank for? Mainly to find targets and to manage expectations between buyers and sellers. Of course we hired an investment bank when we sold Valemus. But this isn't necessary when the target approaches us directly. CEO Roland Koch and I both personally immerse ourselves in the deals and both of us have the expertise to value a business.

// Let's come back to the topic of risk management during acquisitions.

There's no doubt that an acquisition always bears an inherent risk – and we have EUR 1.7 billion worth of goodwill on our balance sheet. We, therefore, have to avoid mistakes or write-downs. That's why we regularly turn down transactions that seem too expensive, or too risky. These risks can stem from almost anything – the region a target operates in, the quality of management or from compliance issues.

// As the CFO, you specifically are responsible for M&A, which was »

»What do you need an investment bank for? To find targets and manage expectations. But when a target approaches us directly, we have enough expertise to value a business ourselves.«

» dubbed management's "load-bearing axle" by CEO Roland Koch. What does this mean?

At headquarters, six employees work exclusively with M&A. For the due diligence, however, specialist departments at headquarters as well as of divisional departments are involved with all their experience. They all deal with two or three projects in parallel. This can sometimes be a stretch and calls for competent and hard-working employees.

// How do you approach post-merger integration (PMI)? After all, one out of two acquisitions ends up failing along the way.

Both the integration agenda and team are already clear by the time of the acquisition. We get to work on PMI immediately after closing and start by setting up a steering committee. The project leader always comes from the operating business. In addition, the committee includes a commercial manager and the relevant IT manager. It is of paramount importance that we have access to the target's internal figures from day one. We allow ourselves about three months to integrate a new entity into group reporting, and full integration can take up to one year.

Of course, we're not just talking about numbers here, but about real people. About 10,000 new employees have joined us over the past 15 months. Integration of corporate cultures is a very important aspect for us during PMI. We want to truly bring the new employees "on board" to ensure they start identifying with Bilfinger. Here, little things such as a welcome letter from the new company go a long way.

// As is the case in many companies, purchasing, corporate projects and IT also belong to your job description. As a former SAP employee, you certainly know how to handle these types of projects.

We've just refined our corporate management information system. It includes a uniform controlling and reporting system which enables headquarters as well as divisions to share the same database, with varying degrees of administrative rights, of course. Divisions can thus access their own data, but not that of headquarters. The new system will be activated on 1 April.

// How has the finance department's headcount changed since 2009?

Bottom line: it hasn't changed at all. Don't forget that our output volume fell due to our sale of international construction activities. We have many new, young employees in the areas of M&A, corporate projects and investment management. In accounting, on the other hand, we tend to have people with lots of experience. If we include the roughly 150 employees we have in IT and purchasing, then there are approximately 230 people in the relevant departments at headquarters.

// Let's talk about Bilfinger's financing strategy. At the end of 2012, S&P rated your company at BBB+, and you issued a bond with the same rating. Which figures are most important to you?

We've discussed the topic of ratings over and over again and have decided to approach the topic after the sale of Valemus is complete. This is because scaling back our construction business will greatly improve our basis for a good rating. Moreover, a good rating will give us easier access to the money market, as evidenced by the bond we issued with a 2.375 percent coupon.

For our purposes, we've defined the following critical figures that we monitor very closely: first, our gearing should be no more than 40 percent. Second, the dynamic debt-to-Ebitda ratio should be under 2.5. On top of that, we are adding cashflow protection of over 40 percent as a key ratio. And finally, we have to take into account the seasonal fluctuations in working capital, which are typical in our industry and which in our case amounted to EUR 400 million in the past year. We take these metrics very seriously and closely monitor their development each quarter.

// When Bilfinger hired Roland Koch in 2011, it was a big surprise. As a former politician, he was not only foreign to the sector but to the entire industry. How has your role as CFO changed as a result?

Not noticeably. At Bilfinger, the board always sees itself as a team. Roland Koch very quickly and very intensively involved himself in the pertinent issues – including the financial figures. During the first few months, before he had operational control, he did a great deal of travelling and got a very good big-picture understanding of the company. «

marc-christian.ollrog@finance-magazin.de

...and the company

Bilfinger is a listed company based in Mannheim, Germany, with 2012 annual revenues of EUR 8.4 billion. With its current 65,000 employees, it is pursuing a strategy of transformation, from a construction company to an engineering and services group. On the basis of this strategic trajectory, output volume is planned to grow by about 50 percent to between EUR 11 and 12 billion by 2016 and net profit to double to about EUR 400 million.

DEALS OF THE YEAR AWARDS 2012

Bonds category and overall Deals of the Year Awards winner

SCHAEFFLER

GERMAN ENGINEERING AT ITS BEST

LAST YEAR, SCHAEFFLER LAUNCHED ONE OF THE LARGEST BONDS OF ITS KIND, DESPITE HAVING A NON-INVESTMENT-GRADE BALANCE SHEET

Klaus Rosenfeld
Schaeffler CFO

SCHAEFFLER

Schaeffler has been described as "German engineering at its best". It makes specialist bearings and other metal components for the automotive industry and other industrial applications, and Schaeffler products are found in vehicles, aircraft and manufacturing plants all over the world.

But while in engineering terms, this €10.7bn revenue, privately owned group doesn't put a foot wrong, its attempt in the midst of the 2008 financial crisis to take control of rival Continental resulted in shareholders tendering more shares than Schaeffler had wanted to buy. That left it with a 90% stake and more than €10bn of debt, provided by just four banks and due for repayment in mid-2013. It was a significant exposure risk for both sides. Refinancing in the capital markets was necessary, but Schaeffler was an almost completely unknown name to bond investors, especially in the US.

In February last year, the group launched a €1bn four-tranche offering as part of an €8bn refinancing package that increased the number of its banks to eight, and later to 11. Being regarded as a cyclical, European auto industry business would not have been a good thing in the middle of the euro crisis. But the success of Schaeffler's roadshows in Europe and the US shone through. "This is a company that's totally different to what you think it is," says head of investor relations Christoph Beumelburg.

"When we started explaining to them, they immediately got it." Having been convinced about Schaeffler's global reach and high-margin, quality engineering, investor demand was so great that the bond offering was doubled to €2bn. Schaeffler wound up offering the largest debut dual-currency, high-yield bond since the financial crisis started.

Deal highlights

Issuer:
Schaeffler
Amount:
€2bn equivalent
Structure:
Four-tranche, senior-secured, high-yield bond
Rating:
B1 (Moody's)/ B (Standard & Poor's)
Currency/tenor:
€/5yr; €/7yr; $/5yr; $/7yr
Interest rate:
7.75%; 8.75%; 7.75%; 8.5%

Schaeffler also had the confidence to agree to the bonds ranking *pari passu* with the loans, giving full 'one euro, one vote' enforcement voting rights. Market support for Schaeffler in the wake of this deal allowed it to return to the high-yield market for another €326m in July, while in December Schaeffler's banks agreed to more flexible covenant and repayment terms for €5.6bn of debt.

"We are in a much, much better position," says Beumelburg. "We must have done something right."

50
Schaeffler operates in more than 50 countries across six continents

15.8%
EBIT margin in 2011

1,832
number of patent registrations in 2011

€10.7bn
group revenue in 2011

40
number of R&D centres worldwide

6,500
new jobs created in 2011

What the judges said

"In a strong list of entries, Schaeffler stands out. Two or three years ago, it wouldn't have been able to do this deal. It has done a lot of work to prepare for it."

DEALS OF THE YEAR AWARDS 2012

European treasury team of the year category winner

LINDE

TERRIFIC TEAMWORK

THE TREASURY FUNCTION OF GERMAN INDUSTRIAL GASES PRODUCER LINDE IS AGILE AND INNOVATIVE WHEN IT COMES TO MANAGING RISK

The Linde treasury team: its members come from a range of backgrounds

THE LINDE GROUP

The crowning glory of 2012 for German industrial gases group Linde was its $4.6bn acquisition of the US listed healthcare company Lincare, and the financing package surrounding that. The move doubled Linde's exposure to the US market and doubled its healthcare sales. The treasury approach to this deal was typical of Linde's style: be cautious, and yet, at the same time, opportunistic and innovative. Although these attributes don't always sit well together, in Linde's case the group remains sharp and agile, so that it can take risk out at every opportunity.

Little over a week after announcing the takeover last July, Linde was already able to repay €1.4bn of its acquisition finance facility thanks to an equity issue via an accelerated book-build, which increased the number of shares in issue by 7.5%. But at that early stage, the company had neither shareholder approval nor anti-trust authorities approval for the takeover. "We wanted to show to the market that we really care about our rating, we really care about risk," says Sven Schneider, head of group treasury. "Even if the deal were to fail, we considered the risk of being over-capitalised to be a smaller risk than being exposed to market turmoil on the equity side."

In September, Linde sought to pay down another large slice of the debt finance through a €1bn eight-year bond. Again, the company managed to play a win-win situation: at the time, the euro was facing a serious crisis, with much commentary suggesting that one or more countries would have to leave the euro. As pressure mounted on the European Central Bank (ECB), Linde – which had been upgraded from A- to a very healthy single A in March 2012 – got its issue away with a coupon of just 1.75%. The next day, ECB president Mario Draghi announced plans for a new policy of open-market transactions – a step that went a long way to take pressure off the euro. "If he had not made such a bold statement, then you are much better off having €1bn on your balance sheet because the euro crisis would have been even worse," Schneider recalls. "And we thought that if he does [make a major announcement], then maybe investors would go back to the periphery" – which could have made it more difficult for conservative Linde to raise money.

MARC GEIGER

A few weeks later, Linde demonstrated its skill at grabbing 'super-opportunistic' openings when some banks suggested that the Norwegian krone market was ripe for being tapped. A five-year, NOK2bn issue (around $350m) was the result, paying down yet more of the Lincare facilities.

Linde has a relatively small team of 30 in treasury, worldwide. In particular, the capital markets side has just two people (or three, if Schneider counts himself). "That explains in part why we are quite proud of our achievements," he says. "On the other hand, we were nearly dead at the end of last year!"

Linde's business model involves it producing, operating and selling locally, which reduces FX risk. And it's been expanding in emerging markets in recent years, with more than half of its capex going into such high-growth markets.

These, however, can create challenging financing and 'trapped cash' problems. Clearly, investment financing in Venezuela or Vietnam is not the same as in Spain. This is one reason why Schneider opened a regional treasury in Singapore in 2012 (another one of the team's achievements in the past 12 months).

Schneider believes that the team benefits from having members from a range of backgrounds. "It also helps to have international team members, especially for a truly global company like Linde."

What the judges said

"This was a typically excellent corporate finance deal in a complex process, with very good investor relations management. A really good set of work by a small team."

INTERVIEW

Mr Jimmy Doyle or all the sides of the treasury function

Jimmy Doyle joined a few months ago a big consultancy company in Dublin after 25 years spent in the corporate and banking treasury sectors. He has been also very active in the world of Treasurers' Association first as a founder member and former President of the IACT and then for EACT and IGTA. More than anybody else, he has experienced all the sides of treasury function and is able to draw the future of treasury in a difficult economic context.

Why have you decided to join PwC Dublin?

Why PwC? I was honoured to have been asked to join PwC's Corporate Treasury Services team in Dublin. Through my work with EACT I had been aware for some time of the high regard in which PwC is held by the corporate treasury community across Europe. Sebastian di Paola who leads PwC's treasury consultancy team in Europe has been a great friend to EACT over the years and has worked very closely with Francois Masquelier in preparing the various EACT submissions to the Accounting Standards body on how they affect day to day treasury management decisions particularly in the area of hedge accounting.

Why Dublin? I think this is a very exciting time for the treasury profession and the financial services industry here. Obviously Ireland has had to face serious challenges since the collapse of Lehman Brothers and the onset of the financial crisis in 2007. Despite our economic woes we have responded well to the crisis and the austerity measures introduced by the government have made Ireland much more cost competitive versus other European centres. This has led to much greater interest in FDI into Ireland which in turn, of course, helps economic recovery. Quite a number of large multinationals see Ireland a good place to set up their global treasury centres.

How do you see the treasury function in Ireland and more generally in the PIIGS countries? I guess it should be even tougher in some cases?

Irish corporate treasurers compare very favorably with their European counterparts. There is quite a degree of sophistication in the treasury management of Irish companies. This is, in no small way, due to the educational efforts of IACT. The Association's graduate diploma course in Dublin City University has produced approximately 350 graduates since it began in 1997 and this has provided Ireland with a good stock of well educated treasury specialists. In addition many of Ireland's treasurers take the UK ACT's professional exams.

What are in your view the major challenges for corporate treasurers in Ireland first and in Europe in the coming three years?

Firstly, I don't think that the challenges in Ireland

> There is quite a degree of sophistication in the treasury management of Irish companies.

are that much different from those throughout Europe. There are perhaps a few subtle differences such as assessing counterparty risk for placing funds in Irish banks and in the availability of credit from those banks. However, the breadth of the single market and the ease of flow of funds across that market mean that strong Irish companies can look to foreign banks to forge borrowing and deposit relationships. As with the rest of Europe it is the SME sector that finds it difficult to get credit no matter where the company is situated.
The main challenges are,
Refinancing existing credit and seeking new lines of credit
Cash and working capital management
Regulatory changes (EMIR, SEPA, Basel III, MiFiD)
Developments and changes in accounting standards
Risk management – Counterparty, Commodity, Treasury, Pension
Threats to Euro
Keeping up to speed on technology / systems
Maintaining good governance, policies and procedures

We can easily imagine that some of these challenges will imply recourse to external resources and help? Do you agree?

Of course I can only agree with that given my new position! Joking aside however, that is precisely why I have been drawn to this role in PwC. I know the pressure and strains that corporate treasurers are under just trying to manage the day to day running of their treasuries, providing the business with liquidity, protection from financial risk and support for expansion. A lot of treasurers just don't have time to step back and look at the bigger picture. This is where the use of external specialists can be of immense support to the treasurer when confronting the challenges mentioned above.

How do you see the role of corporate treasury associations in this difficult economic environment, when treasurers are facing many challenges?

On a national level Associations must continue to ensure that their members are kept up to speed with developments in all aspects of treasury management. They must strive to provide education for new entrants into the profession, either directly themselves or through partnership with Universities or other national treasury associations. They must also provide forums for debate and networking among members and they must also lobby their national authorities to ensure that any changes in regulation and legislation take into account treasurers' concerns about the effect of such changes on their businesses and on the real economy. On this last point, national associations must continue to support the work of the EACT who can then co-ordinate the voice of corporate treasurers throughout Europe when confronting the authorities in Brussels, ECB and elsewhere on these same issues.

With your long experience in finance and in treasury, what piece of advice would you give to our young readers and young treasurers to develop and build their career path?

Mention of long experience, young readers and young treasurers makes me seem very old in this relatively young profession. Maybe wisdom comes with grey hairs! I would certainly encourage young treasurers to try and keep up to date on all aspects of professional development. Make sure that you are aware of what is happening in the markets, in the legislative and regulatory environment and continue to educate yourself. Also remember that a company's treasury is only there to serve the business and not an entity in itself. It is easy to get taken in by the glamour of being the person who is always entertained by banks and suppliers of treasury support and forget that your job only exists because there is a business there in the first place. Finally, participate actively in your national association, network with your peers and enjoy yourself while doing so.

IFRS 13, or when counterparty risk hits your bottom line

IFRS 13 "Fair Value Measurement" will come into effect from January 2013. It will require us to take into account counterparty and credit risk, part of non-performance risk, in the revaluation of financial hedging instruments. Some important questions need to be addressed, such as: How do we calculate this risk? What reports will have to be provided and disclosed? And finally how to simulate the potential impacts on the income statement? If we think only about IFRS 9 we are forgetting another standard applicable in the very near future...

The counterparty risk was not taken into account when revaluing financial instruments

IFRS 13, the one we forgot?

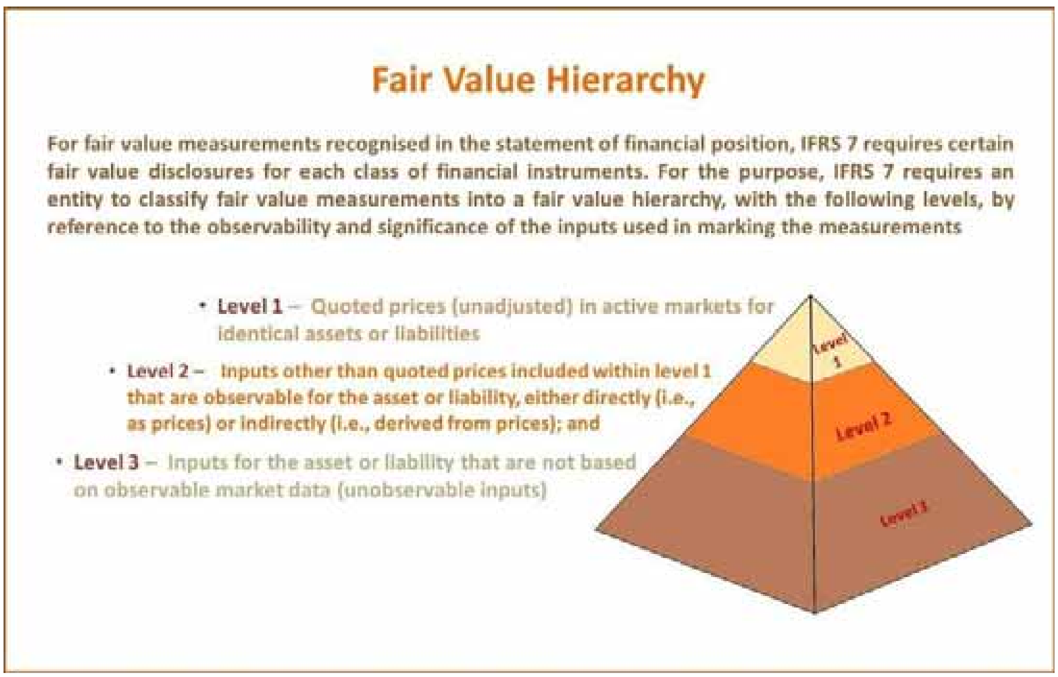
Through focusing on the future IFRS 9 (which will not become effective until January 2015), we might almost forget IFRS 13 coming into force, and one of its major impacts on treasurers (yet another one). Treasurers sometimes focus on certain problems, such as OTC derivatives and the risk of being required to post cash as collateral, to the point of forgetting others. They are so obsessed with certain measures that they see as unfair (rightly) that they forget the mandatory aspect of reporting to ESMA via trade repositories. This latter measure will nevertheless come into force as of 2013. It seems to us that we should first focus on current priorities and ensure we can fulfil our obligations as soon as they come into force. IFRS 13 is the next on our list of reports to be provided, to comply with all the new accounting regulations and standards. This accounting standard demands a minimum of thought to assess the scope of information to be provided, how to produce it and extract it from the computer systems and finally to understand the potential impact on the company's balance sheet and income statement. This is a good time to carry out an evaluation of this type, so as to be ready for that hour. IFRS 13 was published in November 2006 (that long ago). It is largely inspired by its US cousin SFAS 157 in the measurement principles that it adopts.

Dealing in financial instruments

When we deal in OTC type financial instruments for hedging purposes, for example, in IFRS we have to revalue them at every accounting period close. But what is the "fair" value of such an instrument? The "fair value" is the financial and mathematical value calculated by the difference between the NPV (Net Present Value) of the instrument and the NPV of a perceived identical and opposite contract that cancels it out. In short it is the difference between the first instrument and the instrument that needs to be traded to unwind the deal, discounted to present value. Any Treasury Management System (TMS) worthy of the name should do that with no problem. However, this "fair" value – estimated on the basis of market data (mark-to-market) – does not take account of counterparty risk or counterparty default. If the counterparty defaults you will not receive delivery of the currency or commodity or interest rate that was the subject of the original deal. The idea was therefore additionally to incorporate the concept of the risk of default of the other contracting party. This risk was not taken into account when revaluing the financial instrument portfolio. For 12 years (for the IAS 39 pioneers), treasurers have been revaluing their financial instruments in a partial and ultimately incomplete manner. IFRS 13 is intended to put that right. "Risk-free" interest rates or yield curves are taken as the basis for assessing whether the present value of the instrument is positive (an asset) or negative (a liability). To this value we would therefore apply a CVA (Credit Value Adjustment), depressing the instrument's value for counterparty risk and conversely we would reduce (because it is negative) the negative value of a liability to recognise and record our own credit risk (Debit Value Adjustment).

Measurement at "fair value"

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This is an exit price. Fair value takes into account the characteristics of an asset or liability. IFRS 13 takes up the much-heralded hierarchy of data to be used in measuring fair value. The IASB has set down three input levels in its hierarchy. The data to be used must be that which a market participant would itself take into consideration. The techniques used must also be noted in the disclosures and annual reports.



Methodology to be applied

Turning to the methodology to be applied, we have to ensure that we can gather all the necessary information and apply the appropriate calculations and simulations to it. The financial literature, as is often the case with new accounting standards, is somewhat laconic. So we have to make up our own religion, testing it with the external auditors. That is no easy job. We therefore suggest the following approach:

1. *Identify the type of ISDA agreement signed and who it is signed with to understand any payment netting agreements (generally for a single currency and a single transaction).*
2. *Identify whether any CSA (Credit Support Annex) type agreements exist, requiring collateral to be posted which would have the effect of removing all counterparty risk.*

There may be other types of agreement which would further reduce counterparty risk and its potential impact.

3. *We must check the technical capabilities of the software application being used (in general the TMS itself) or another peripheral application such as REVAL or consider whether some auxiliary facility could carry out the calculations or provide the financial data. Depending on the methods adopted, which may be very sophisticated or based on probabilities – as in financial organisations for example – we have to equip ourselves with more or less powerful software applications.*
4. *When the method and the software able to provide the data have been decided upon, in principle we have to export the data to spread sheets to apply the calculations for measuring the impacts that might potentially reduce the theoretical mark-to-market value.*
5. *We could then run simulations or stress tests, using assumptions of sharp counterparty deterioration.*
6. *We would then have to produce special reports for audit purposes and for disclosure in the annual report. Here again, we are in uncharted territory.*

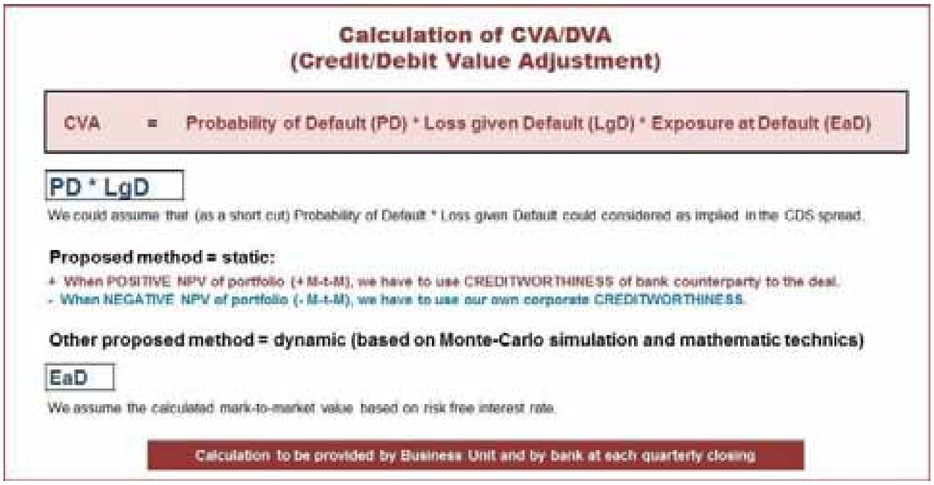
A subject that is more complex than it seems.

IFRS 13, a subject that is more complex than it seems at first glance. An impact study and prior tests are a must. Depending on the volumes, the number of portfolio transactions, and the types of hedges used (e.g. interest rate, FX, commodities, equity, etc) and the complexity of the derivatives being dealt in, these calculations can be relatively unwieldy, especially if we do not have an IT application that is suitable and able to export to spreadsheets. Even with a sophisticated TMS, you have to extract the data, format it and add what is needed for line by line calculations, to produce the required reports.

The effectiveness test may be impacted by this CVA/DVA adjustment. We therefore need to estimate it, simulate it and understand it to anticipate any potential ineffectiveness that might affect the P&L and the hedge accounting strategy.

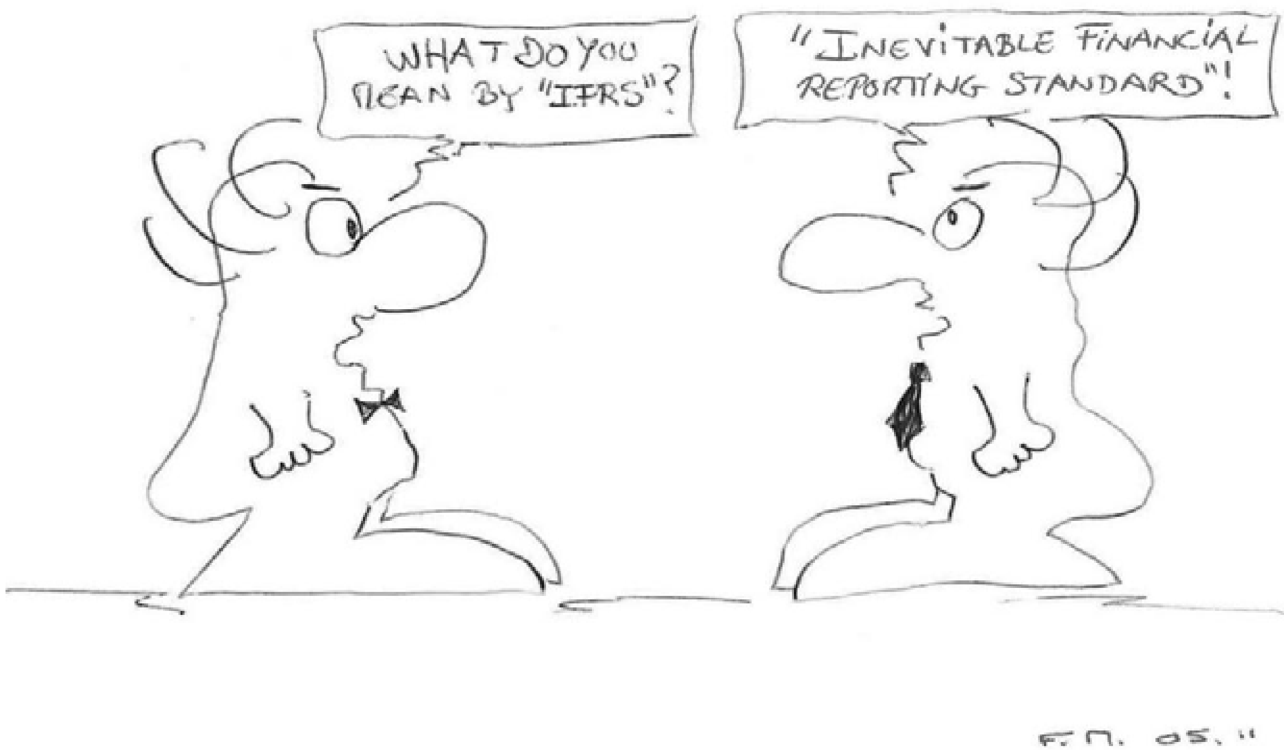
As so often, the complexity arises from the lack of clarity in the standards and the lack of practical examples and comparisons. With the new measures, you always have to start with a relatively clean sheet and the pioneers have to forge the approach and produce the documents without detailed existing guidelines. We also have to try to keep the approach we adopt simple, to keep down the time that needs to be devoted to this new accounting requirement.

Suggested methodology



Other types of approach of course exist, sometimes more complex or more mathematical, but not necessarily more correct or accurate for that. Any approach, whatever it may be, must be approved in advance by the independent auditors. The sophistication of the transactions and the software used, together with the size of the transactions, may justify use of more specific or more complex methods.

Credit risk based on their CDS levels can be calculated easily. We can work on an averaging basis or by period (the latter approach being more painstaking). If we use a detailed approach, line by line, applying the impact of credit risk (as a plus or minus depending on the NPV) we will arrive at a combined overall result that can be recognised in the accounting records.



COUNTERPARTY CREDIT RISK BASED ON CDS

Banks #	CDS 1Y	CDS 2-3Y	CDS >3Y	etc..		average
Bk1	90	125	150			XXX
Bk2	130	150	170			YYY
Bk3	112	123	146			ZZZ
etc…	…	…	…			…
						3,00%
Corporate own CDS						
CORP	75	95	130			1,20%

Proportionate Gross Fair Value Approach

we propose this method although there are some others

POSITIVE M-t-M

Trade / OTC #	M-t-M in m €	**Scaling in %**	**CVA allocation** assuming 60 as CVA	**Adjusted NPV**
Deal 1	1250	62,50%	37,5	1212,5
Deal 2	-1000	-50,00%	-30	-970
Deal 3	-750	-37,50%	-22,5	-727,5
Deal 4	2500	125,00%	75	2425
NET	**2000**		**60**	**1940**

NEGATIVE M-t-M

Trade / OTC #	M-t-M in m €	**Scaling in %**	**CVA allocation** assuming 60 as CVA	**Adjusted NPV**
Deal 1	1000	-66,67%	12	1012
Deal 2	-2500	166,67%	-30	-2530
Deal 3	-900	60,00%	-10,8	-910,8
Deal 4	900	-60,00%	10,8	910,8
NET	**-1500**		**-18**	**-1518**

In the two examples given, we have calculated the negative impact on the discounted (NPV) portfolios, whether positive or negative, in valuing them at the date of the accounts close in question. The method is simple and quite easy to use. However, it comes as no surprise that almost no treasury software publisher has proactively offered solutions and anticipated the needs of its users. But here they have a wonderful opportunity to demonstrate the quality and power of their software. These reports will be built up a little by little, as users demand them, over time. Once again, the pioneers are to a certain extent suffering from a lack of support and vision. It is up to them to devise an appropriate report suited to their treasury work environment. We also note there is no requirement for comparatives in the first year. This should make the treasurers' jobs easier. If they are well organised and have been able to test the report before its implementation date, we may even see them providing comparatives for the 2012 year end.

In this counterparty risk valuation aspect, IFRS 13 is not as complex as it might be. It is simply a constraint and one more report to be disclosed. The new valuation, however, is even more "fair" than the one that preceded it, through incorporating (more or less satisfactorily) this concept of bilateral counterparty risk. We have to sing IFRS 13's praises once again for at least providing early clarification of what needs to be done and stating which measurement techniques need to be adopted, depending on the specific circumstances. Life in IFRS accounting is a long river, which is far from being calm. What we have to do now, therefore, is to comply with this new requirement.

François Masquelier, Chairman ATEL Twitter: *@FrancoisMasquel*

HALF-HEARTED AT BEST

Year after year, Russian firms and private citizens transfer billions of roubles into foreign accounts. This is hardly due to steep tax rates. Rather, it stems from a lack of trust in the country's economic and political stability. President Vladimir Putin wants to stem this outflow of capital, but his prospects for success are slim.

By Bernd Hones

Russia has long been suffering from a capital drain. Capital is being relocated outside of Russia in astronomical amounts. Experts from the Higher School of Economics in Moscow believe this figure topped USD 80 billion (EUR 60bn) last year, making capital outflows for 2012 the same as the year before. Officials under central bank chairman Sergei Ignatyev categorised 40 percent of these to be dubious in nature. But it is not just about illegal transfers. Nine out of every 10 business deals made by large Russian corporations – including state-owned companies – are closed in jurisdictions beyond the reach of Russian tax legislation. Tax havens such as Cyprus, the Virgin Islands or Cayman Islands have long been a thorn in the side of the Russian government, and President Vladimir Putin is no longer willing to tolerate it. "We need comprehensive measures to prevent the offshoring of our economy," he claimed in December 2012.

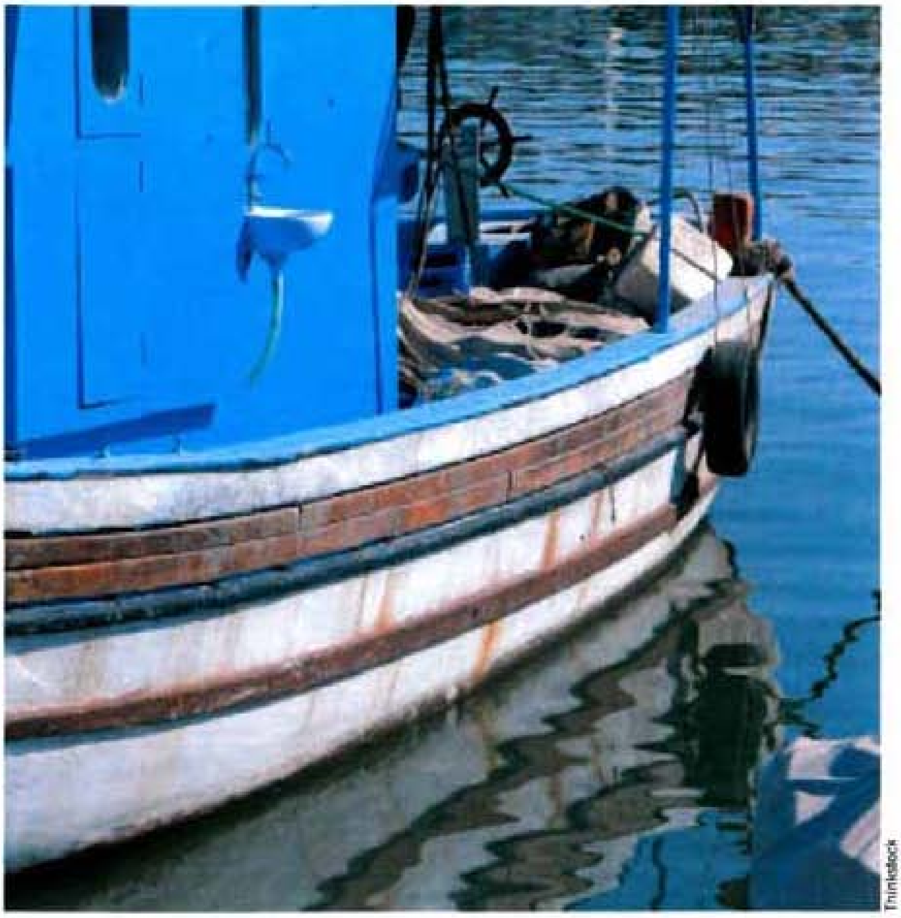
Questionable capital outflows can be mostly attributed to cleverly designed transfer pricing schemes or excessive service fees. This is made possible by groups of letterbox companies that resell goods and services to each other. Prices are set so that the highest margins are first generated in tax havens, where profits and dividends are taxed minimally, if at all. "This is how Russia loses all sorts of tax revenues," says Patrick Pohlit, a lawyer and tax adviser at consulting firm Rödl and Partner. This happens despite the relatively moderate tax rates in Russia. Corporate profits are taxed at a rate of 20 percent. An additional withholding tax of between zero and 15 percent is applied to dividend payouts.

From subsidiaries to headquarters

From the Russian perspective, the drain of the country's assets is an even sorer subject. Russian companies no longer just set up subsidiaries in tax havens across the globe. Many are now moving their headquarters there too. According to the Russian business journal Expert, 23 of the 50 largest privately owned Russian companies are managed with an offshore structure. Whether power plants, harbours, airports or telecoms networks – anything can be run through an overseas headquarters these days. In addition to the exchequer, international companies that want to settle in Russia are also suffering from this transformation as they must compete with local providers while not being able to benefit from similar tax evasion schemes. The Russian financial elite have argued about how to overcome capital flight for a long time. Former Minister of Economic Development Elvira Nabiullina is campaigning to abolish the dividend tax. Her hope is that successfully removing the tax would motivate Russia's wealthy to keep their assets in the country. On the other hand, hardliners are calling for the nationalisation of Russian assets whose owners are not prepared to repatriate them.

» Today, 23 of the 50 largest privately owned Russian companies are managed with an offshore structure.«

Simply put: neither plan will catch on. For the central bank and the finance ministry, neither a restriction of capital and currency flows nor expropriation come into question, especially considering the signal this would send to international investors. Instead, the central bank and the ministry want to increase transparency when it comes to doing business with those offshore havens that have been blacklisted by them. Since 2012, it has been mandatory to report deals with these countries worth more than RUB 60 million (EUR 1m). What is more, the sale of natural resources counts as business that must be re-



This could well be the headquarters of a major Russian company registered in Cyprus.

ported in any case. The government is trying to prevent coal, petroleum and ore from being sold at lower prices to offshore locations, from where they could then be resold to end customers at international market prices.

This very strategy allegedly helped mining and steel company Mechel, for example, save up to USD 4 billion in taxes over the past few years. In 2008, Mechel sold steel to its Swiss subsidiary at RUB 1100 per tonne. At the time, the market price in Russia was RUB 4100. The Federal Antimonopoly Service of Russia imposed a fine on the steel company amounting to a mere 5 percent of its annual turnover; totalling EUR 32 million. The outcome was much worse for shareholders, however, who had to live with a share price that slumped by 33 percent as Mechel's long-term business outlook soured considerably.

Tightening up

Today, companies headquartered in Russia are also required to disclose interest they earn on foreign bank accounts. Since mid-February 2012, firms violating this law face the prospect of stiff penalties. Beginning in October 2013, the Russian Central Bank will also increase the required documentation for the purchase and sale of property and commodities as well as for rental and leasing contracts.

In addition to internal reforms, Russia is looking directly to the tax havens for help. In accordance with OECD standards, Russia and Cyprus signed an amended double tax agreement into force on 1 January 2013, thus removing Cyprus from Russia's blacklist. As a result, Russian tax investigators will now receive information on a multitude of businesses from their Cypriot colleagues. In the future this will also include information on corporate structures. All necessary information about limited liability companies registered in Cyprus should be disclosed by 2015 – even if the equity in these companies comes from other tax havens.

Information like this is certainly pertinent for Russian tax investigators but also to federal prosecutors. It is well known that corrupt public officials have been laundering money through escrow accounts held in the Virgin Islands or other offshore domiciles. In such scenarios, lawyers or specialist companies emerge as the brokers which remain unrecognised because of convoluted and nested structures.

Indeed, tax havens attract the attentions of even those businessmen who have earned their money fairly. "Many business owners foster a deep mistrust of the rouble, as well as the country's political and economic stability," says Mr Pohlit. Many flee from the perpetual danger of losing control of their personal assets after a transition of power in the homeland. "Companies aren't fleeing from tax rates, they're fleeing from the system," says Mikhail Delyagin, director of the Moscow-based Institute for Globalisation.

Nonetheless, the capabilities of investigators still do not suffice for putting an end to tax evaders, says Mr Pohlit. This has actually been confirmed by the treaty with Cyprus. Russian tax authorities can only request information if concrete suspicion exists. The agreement does not allow for random samples. Also, reports can only be as detailed as the information the Cypriot authorities themselves have access to. For many offshore companies, however, very little information exists in the first place. The big question is: how seriously are Russian tax investigators taking the hunt for tax evaders? State-run companies profit from the system, and all too often, public officials do as well. «

editor@cfo-insight.com

South Korea,

Country Report: ***South Korea: Lessons For Global Development***

By **Payden & Rygel**, Los Angeles, California, USA, January 2013, Point of View, Our Perspective on Issues Affecting Global Financial Markets

The rapid economic growth of so-called "emerging markets" is the most important feature of the world economic landscape since the dawn of the 21st century.

This story alone explains the ascension of billions of people from abject poverty to relative prosperity and accounts for most of the growth in the total size of the global economy from $42 trillion in 2000 to $75 trillion today.[1]

Despite a doubling in world population since 1955, the absolute number of poverty-stricken humans on earth is lower today than in the 1950s. In percentage terms, humans in poverty tumbled from nearly 40% of the world population to less than 18% by 2010. So dramatic has been the transformation that, in some cases, it is no longer responsible or fair for investors to label certain countries "emerging" or "developing"—they have more than emerged.

South Korea is the example par excellence. Though Korean products surround us—Samsung, Kia, and Hyundai—few people *think* about South Korea.[2] Still fewer think of South Korea as a developed economy. Yet, as we discuss below, Korea's economic rise is remarkable and holds lessons for China and other economies supposedly still "emerging."

KOREA: "THE IMPOSSIBLE COUNTRY"

According to Kim Dong-jin, the long-time advisor to President Park Chung-hee, South Korea was "the poorest, most impossible country on the planet." In fact, in 1960, after the Korean War, South Korea had a per capita gross domestic product (GDP) in 2005 inflation-adjusted US dollars of less than $100, making it one of the poorest countries on Earth. A third of the population wandered homeless and the government relied on steady doses of foreign aid (mostly from the United States) to make ends meet.

Today, by contrast, the average South Korean lives 26 years longer and the per capita GDP is over $27,000, making it one of the wealthiest countries on Earth.

A MIRACLE OR A "PRIORITY ON PRODUCTION"?

Korea's rise is nothing short of a miracle. *Or is it*? According to economists, three factors drive long-run economic growth. The first factor is population. More people means a greater quantity of goods and services that can be produced. Second, the stock of capital (equipment and facilities that people use to produce "stuff") holds important consequences for growth. More equipment and technology increase productivity. Third, and finally, the *techniques* of production, such as higher-yielding crops, faster computers, and more efficient management, facilitate and encourage long-term increases in output.

These three factors are well and good in theory—but they needlessly complicate the story. Instead, the heart of economic success lies with producing stuff for the world. With a relatively small domestic market, for South Korea, exports were the key. In short, economic growth in Korea is "virtually synonymous with" export growth.[3]

The upward march began in the 1950s with exports of everything: tungsten, iron ore, raw silk, seaweed, fish and rice. In the 1960s, Korea increased exports of all kinds of consumer products—from footwear to children's toys. In the 1970s, attention shifted from consumer goods exports to capital-intensive activities, like shipbuilding.

As a share of GDP, South Korea's exports rose from near zero after the Korean War to 30% by the late 1980s. Then Korea's exports surged again to nearly 45% of GDP prior to the most recent crisis in 2007. Exports went from $100 million in 1964 to $10 billion in 1977 to $548 billion in 2012. As a consequence, from the

1960s to the mid-1990s, annual economic growth averaged 9%.

The typical retelling of this success story focuses on the *chaebol* led growth: the Korean conglomerates with access to cheap funding powered export-led growth.[4] One need only peruse the Kospi-100 stock index, comprised of the largest Korean firms (similar to the Dow Jones Industrial Average) to find the much-vaunted *chaebol* firms. For example, Samsung, the biggest conglomerate, accounts for 20% of South Korean exports. But this angle is overemphasized: cheap funding alone is not sufficient to power an economy to world class status. While fewer than 10 firms outside the original *chaebol* club claim annual revenues in excess of $1 trillion won ($900 million), the firms that do, do so by out competing on the innovation front (mostly technology and internet-related companies). Producing for global consumers with high valued added exports remains the recipe for success.

HEY, WHO YOU CALLIN' EMERGIN'?

South Korea has triumphed. Today it ranks as the 12th largest economy on earth, nipping at the heels of Spain and Mexico for entrance into the global top ten economic powers. On a per capita GDP basis, South Korea is now in 11th place, just behind Japan—yes, Japan—at number ten.

As a result, we think South Korea deserves to be in a different club (***see at end of article attachment, Table***). In fact, we challenge readers to take a moment and ***view at end of article attachment Table*****:** on the basis of the criteria listed, which would seem to be the developed market and which would be the so-called "emerging market" country?

When judging the relative "emergence" of an economy, the most commonly-used metric is per capita GDP. On this basis the US beats South Korea $43,000 to $27,000 in inflation-adjusted 2005 dollars. But, on a wide variety of other metrics, from years of education, to life expectancy, to literacy—and even the ease in establishing (or liquidating!) a business, South Korea fares better than the United States. The country also outpaces much of the developed world in infrastructure and internet connectivity.

Yet the myth persists. Barclays, which publishes fixed-income indices used by investors worldwide, reiterated in November 2012 that South Korea remains in the "Emerging Market (EM) Bond Index because [it includes] countries that bond investors generally classify as EM."[5]

LESSONS FOR GLOBAL DEVELOPMENT

From 2001 to 2007 Korea's growth rate slumped to an annual average of just 4.7%. Analysts lamented policy "mistakes" and cheap labor producers (e.g., China) for competition. However a little perspective should provide investors more appropriate guideposts for thinking about the future of the world economy.

Lesson #1: A growth slowdown is *not* remarkable based on modern economic history. If history is any guide, for rapidly-developing countries, a slowdown seems inevitable. In fact, once a country's purchasing power parity (PPP)-adjusted per capita GDP hits $14,000 (or, to treat the data with benign skepticism somewhere between $10,000 and $20,000),GDP growth slows. After breaching the per capita GDP threshold for the first time, no advanced economy returned to above a 4% annual growth rate for any extended period of time (***see at end of article attachment , Graph***).[6]

Is this the fate awaiting China? Most likely. China's PPP-adjusted per capita GDP is approximately $9,000, suggesting its potential growth rate should slow from double-digits to the 7-7.5% range.

Why do rapid-growth economies slow? Just as with the lesson of South Korea, imitation is easier than innovation. Fast growing economies absorb, use and implement ideas and technologies already tested in the developed world—but at some point this absorption reaches saturation.

Lesson #2: The epic rural to urban worker migration boosts labor productivity while keeping a lid on wages—a boon to manufacturing and production sectors that export goods. But, this reaches a limit. In almost every fast-growing economy (South Korea included), there is a limit to the shift from agricultural workforce to manufacturing. In 1960, the population of Seoul was 2.4 million. Seoul today: 10 million in the city and 24 million in the broader metropolitan area—nearly 50% of the country's population. This rapid rise in urbanization, from 20% in the 1950s to over 80% in cities today is faster and more impressive than China's current miracle. Further, urbanization seems to slow once it reaches 75% of a country's total population. According to United Nations data, China will reach the 75% threshold in 2040, so there may be some room to run in China's long-term economic expansion.

Lesson #3: Most countries see manufacturing start to decline just before manufacturing jobs reach 30% of the total labor force. South Korea had reached 30% of its labor force in manufacturing by 1990, with the manufacturing share on the decline ever since, replaced by a rise in the services sector. A decline in manufacturing as a share of GDP and employment accompany economic maturity not economic decline. Investors should be wary of explanations that a country is “losing its competitive edge."

Lesson #4: Despite the impact of the *chaebol* on economic development, the large firms are true global competitors, not insulated domestic producers. Samsung, Hyundai, LG all produce for the world, where the best products win. Entrepreneurship and innovation hold the key to the future: can Korea compete on the global stage? Can China? According to the US Patent and Trademark Office (PTO), in 2011, Korea ranks #6 on the global patent filings, trailing only the United States, Japan, Germany, Taiwan, the United Kingdom and France.[7] Developed-world aspirants should take note and investors should watch these metrics.

THERE ARE NO MIRACLES

Economic growth is no “*miracle*”—we can explain and understand its causes. The South Korean experience tells investors that no country should be ruled out of possible development in the years ahead—even from a lowly starting point of $100 per capita GDP, a vast army of homeless citizens and dismal prospects.

However, once rapid development occurs, investors should recognize the emphasis on continued high rates of annual growth as unrealistic. Pessimism with regard to Korean growth is misplaced. Averaging nearly 5% annualized before the financial crisis outbreak in 2007, South Korean growth registered at nearly double the pace of developed world growth—still a stellar achievement. Further, a skilled and well-educated workforce, a collection of world class and world-leading businesses hold promise for the future.

What’s more, a growth slowdown is inevitable for some areas of the high-flying growth regions in the developing world—but this does not mean the most remarkable story of economic transformation is over.

It means investors must continually reassess what “emerging” means.

SOURCES:

1 Barry Eichengreen, Donghyun Park, Kwanho Shin, “Growth Slowdowns Redux: New Evidence on The Middle Income Trap,” NBER Working Paper 18673, January 2013.

2 Daniel Tudor, “Korea: The Impossible Country”

3 Barry Eichengreen, Dwight H. Perkin, Kwanho Shin, “From Miracle to Maturity the Growth of the Korean Economy,” Cambridge: Harvard University Press, 2012.

4 Lee, Hong Yung. "South Korea in 1992: A Turning Point in Democratization.

" Asian Survey (1993): 32-42.

5 “Barclays Announces Changes to Its Benchmark Fixed Income Indices,”

5 November 2012.

6 Barry Eichengreen, Dwight H. Perkins and Kwanho Shin, “From Miracle to Maturity: The Growth of the Korean Economy,” Cambridge: Harvard University Press, 2012.

7 U.S. Patent Office.

2 Attachments, Table/ Graph, see next page

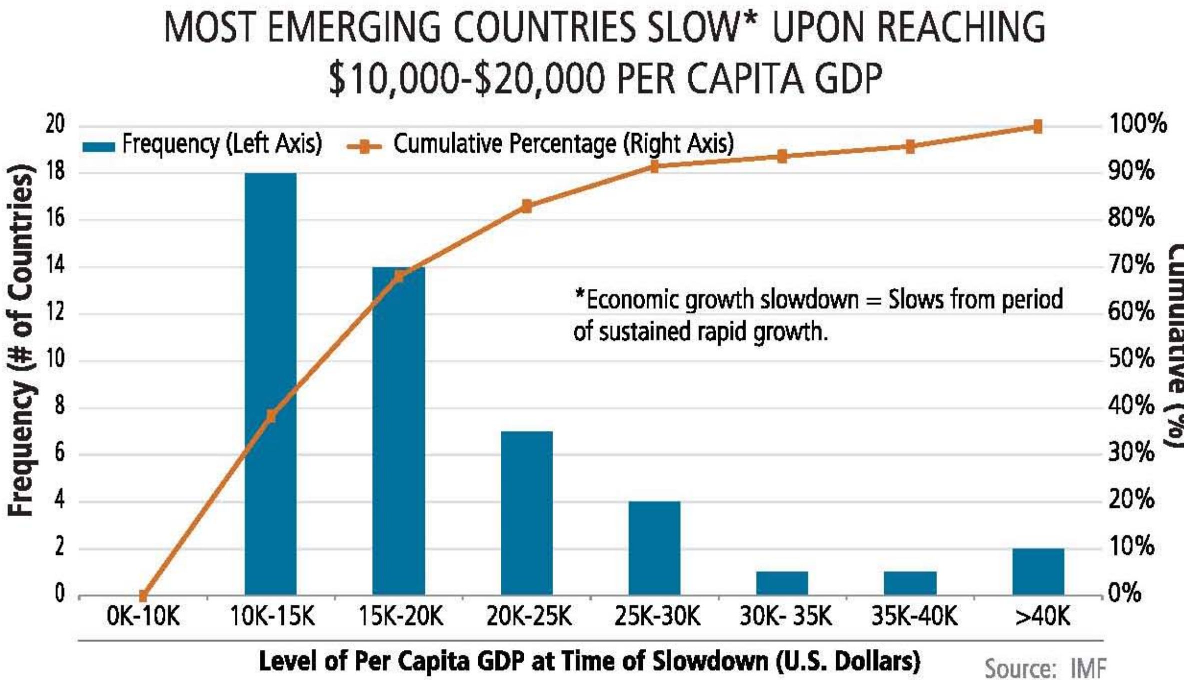
HEY! WHO YOU CALLIN' EMERGIN'?

Identify the Emerging Market Country

COUNTRY A		COUNTRY B
78.2	LIFE EXPECTANCY AT BIRTH, TOTAL (YEARS)	80.8
75.9	LIFE EXPECTANCY AT BIRTH, MALE (YEARS)	77.4
80.7	LIFE EXPECTANCY AT BIRTH, FEMALE (YEARS)	84.3
6.4	MORTALITY RATE, INFANT (PER 1,000 LIVE BIRTHS)	4.1
6	SECONDARY EDUCATION, DURATION (YEARS)	6
100	IMPROVED WATER SOURCE, URBAN (% OF URBAN POPULATION WITH ACCESS)	100
29	FIXED BROADBAND INTERNET SUBSCRIBERS (PER 100 PEOPLE)	37
1,563	SECURE INTERNET SERVERS (PER 1 MILLION PEOPLE)	2,496
106	MOBILE CELLULAR SUBSCRIPTIONS (PER 100 PEOPLE)	109
78	INTERNET USERS (PER 100 PEOPLE)	81
370	TIME REQUIRED TO ENFORCE A CONTRACT (DAYS)	230
1.5	TIME TO RESOLVE INSOLVENCY (YEARS)	1.5
-10.1	CASH SURPLUS/DEFICIT (% OF GDP)	1.7

Source: World Bank World Development Indicators

Answer: Country A is the U.S. with per capita GDP of $42,486. Country B is South Korea with per capita of GDP of $27,541.


MOST EMERGING COUNTRIES SLOW* UPON REACHING
$10,000-$20,000 PER CAPITA GDP
Frequency (Left Axis)
Cumulative Percentage (Right Axis)
*Economic growth slowdown = Slows from period of sustained rapid growth.
Frequency (# of Countries)
Cumulative (%)
20
18
16
14
12
10
8
6
4
2
0
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
0K-10K
10K-15K
15K-20K
20K-25K
25K-30K
30K- 35K
35K-40K
>40K
Level of Per Capita GDP at Time of Slowdown (U.S. Dollars)
Source: IMF

DEALS OF THE YEAR 2012 AWARDS

European loans above £750m category winner
IBERDROLA

PLENTY OF CHOICE

SPANISH ENERGY GROUP IBERDROLA FACED A DIFFICULT CHALLENGE WHEN IT TRIED TO REFINANCE A €1BN FACILITY, SO IT OFFERED ITS BANKS MENU-STYLE OPTIONS

Iberdrola director of finance and treasury Jesús Martinez Perez: "Our philosophy is we work with the banks"

IBERDROLA

With the euro crisis, one of the critical risks faced by lenders was the 'redenomination risk' that they might lend euros, say, but later be repaid after a euro break-up in a devaluing national currency, such as new drachmas or pesetas. Keen to refinance and reduce a €1.2bn facility, Iberdrola conducted what one banker described as a "thoughtful" pre-screening process to get a good understanding of what the critical needs were for lenders. What emerged was that different lenders had very different needs.

Jesús Martínez Perez, director of finance and treasury, had not seen such divergent interests before. It would have been easy to conclude that it's not possible to please everyone, and to proceed with the refinancing using a smaller banking group. And that probably would have been possible. But it ran contrary to Iberdrola's preferred working relationship with its core banks.

"We had the possibility to close the transaction with fewer banks or to try to be flexible and try to include all our core banks," says Martínez Perez. "Our philosophy is we work with the banks."

The solution, then, was to offer lenders a menu. Two issues stood out: the governing law for the lending and the type of facility. Each lender could decide whether to opt for an English law or Spanish law contract.

There was no clause in the documentation that dealt specifically with what would happen if the euro broke up. "We didn't have any position as to whether it was better to use Spanish or English law," Martinez Perez says. But most banks assumed that English law would protect them better in the worst-case scenario.

Lenders could choose to join the €536m three-year term loan, or the €464m five-year RCF. Ultimately, 70% of loan providers and 80% of credit line providers opted to be covered by English law.

Not only did this deal structure mean that Iberdrola had almost all the banks it wanted to include, it also meant that it paid a lot less than it might have had to. There is no doubt that Iberdrola, though itself an investment-grade asset, is being "penalised because we are a Spanish company, even though we have 45% [of revenue] outside of Spain," Martinez Perez argues. But, as one banker spells out, Iberdrola's menu-driven financing structure "notably increased appetite and enabled competitive pricing when compared with similar transactions".

Deal highlights

Issuer:
Iberdrola
Amount:
€1bn syndicated facility
Structure:
€536m three-year term loan; €464m five-year RCF
Rating (at time of deal):
Baa1 (Moody's); BBB+ (Standard & Poor's); BBB+ (Fitch)

What the judges said

"An investment-grade Spanish corporate offered a novel option to attract international lenders. Well researched and executed."

Highly commended
SCHAEFFLER

Schaeffler's €8bn refinancing package was one of the largest transactions of its type last year, and helped this German engineering company diversify its funding sources. A mix of around €5bn (equivalent) in term loans (euros and dollars, three to five years), a €1bn RCF (three years) and a €2bn bridge to bond improved Schaeffler's balance sheet structure, pushed out tenors and introduced the privately owned company to the capital markets. Banks were attracted to the deal, with the banking group doubling to eight banks, before later being joined by another three. Schaeffler's management team conducted an extensive marketing effort on both sides of the Atlantic to ensure the success of this deal.

IT'S NOT ABOUT THE MONEY

Nena Stoiljkovic is the vice president of the International Finance Corporation (IFC), a member of the World Bank Group and the largest global development institution focused exclusively on the private sector. Leading the global business advisory services department, she sees some major shifts in global financial markets, is concerned about protectionist trends around the world and would like to work more with major companies from developed markets.

By Armin Häberle

// Ms Stoiljkovic, there are quite a few international financial institutions (IFIs) out there. What is IFC's role today?

I think the key feature of IFC is that it is the only global development institution that focuses exclusively on the private sector. There are a number of regional players like the European Bank for Reconstruction and Development (EBRD), the African Development Bank and so on, but IFC is the only one that is active worldwide. That means we can draw from our experiences in a wide range of contexts such as the Latin American crisis, the Asian crisis and so on and adapt our work accordingly. The way we are set up is also unique in that we have three distinct units. There is typical funding, advisory services – which help us to actually deliver on a strategy rather than just fund it – and, the most recent addition, IFC Asset Management Company, a wholly owned subsidiary which invests directly in equity and is often funded by sovereign wealth funds.

// Don't you see a danger of many IFIs' work overlapping too much?

I believe there is enough work for us all to do, so we do not really overlap. The greatest potential overlaps are in middle-income countries where there is very little left for IFIs to do. In such instances, we collaborate closely on very large transactions such as financing airports or other major infrastructure projects, sometimes worth more than USD 1 billion. These are usually so large that no IFI could either finance or even syndicate the necessary funds alone.

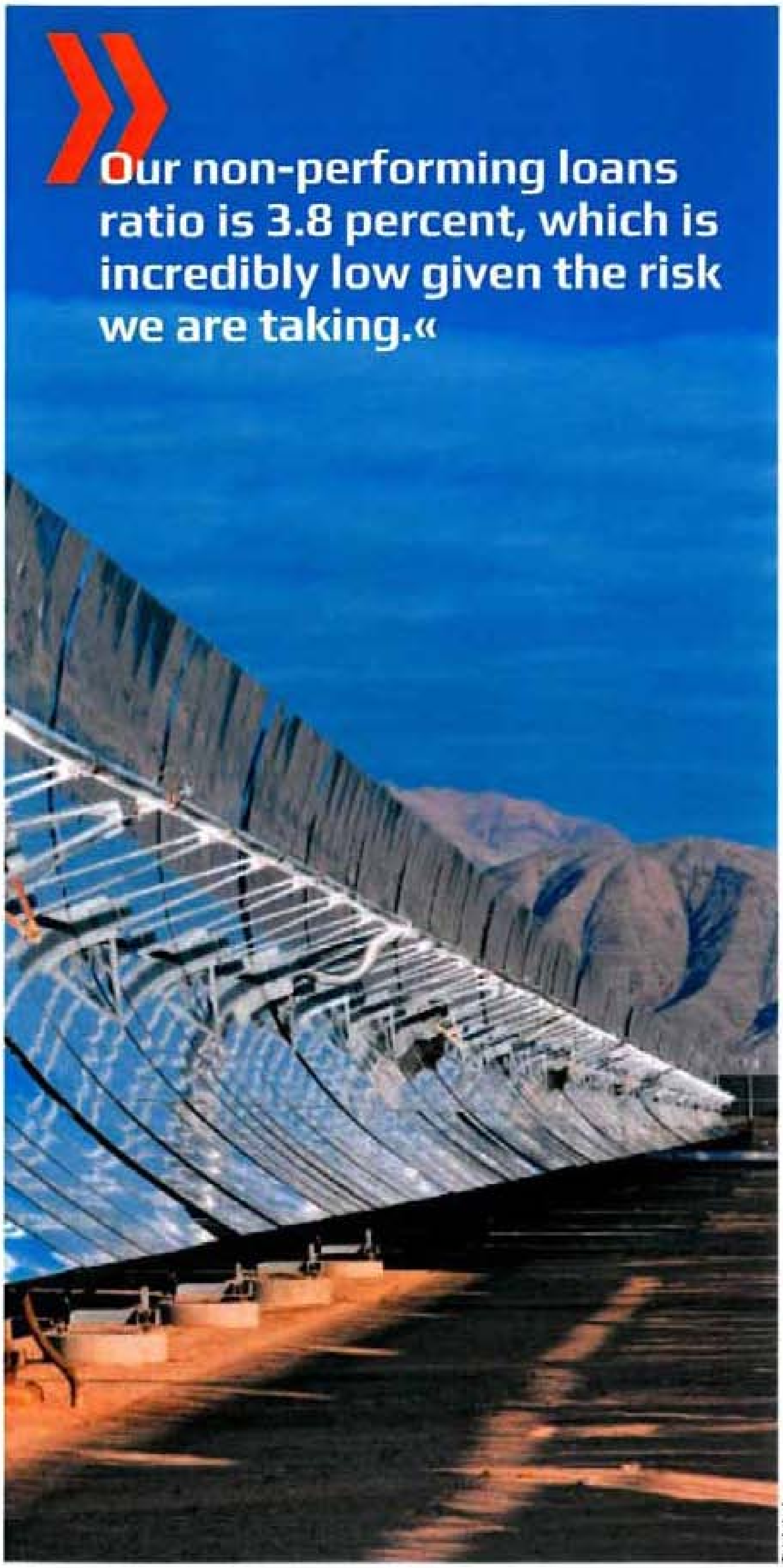
// How much of your work is through commercial partner banks, and how much is directly with companies?

Roughly 55 percent of our business is with financial institutions and 45 percent with non-financial ones. In fact, we like to work directly with big companies and would like to expand this business further. We work with them to help extend our reach into parts of frontier countries where we cannot find suitable local clients.

// And what's in it for the client?

I don't think people normally work with us just for the money. An IFC loan is sometimes more expensive than a loan from a commercial bank. Due to our structure and our limited range of products, we cannot offer loans at the same rates as commercial banks, which can cross-sell to clients and thereby reduce the rates for a specific credit line. IFC

»Our non-performing loans ratio is 3.8 percent, which is incredibly low given the risk we are taking.«



Thinkstock

The IFC funds and advises on many renewable energy projects in emerging markets. One example is the 500 Megawatt Ouarzazate Concentrated Solar Power Project in Morocco.

can only offer one particular loan tied to one particular product...

// ...so you need to offer the companies something else instead.

Indeed. That includes our experience in frontier markets around the world and our access to local knowledge. And there are other benefits such as IFC acting as a kind of "stamp of approval" for the social and environmental standards of an investment project, for example.

// Is there a limit to your involvement?

We do not cover more than 50 percent of the project value for expansion projects and not more than 25 percent for a greenfield investment. In terms of loan sizes, for smaller transactions in the range of USD 20 million, we often provide the loans directly; for larger loans, we syndicate. Quite often we also do this in parallel with commercial banks. But there is no absolute limit to our involvement. If there is a big project, we can also go in with USD 100 million or more.

// Where do the large companies you work with come from?

Most of them come from developed markets and want to invest in developing markets. But I am actually quite happy and im- »

The IFC...

IFC, as a member of the World Bank Group, shares its mission to reduce global poverty. IFC's purpose is to create opportunities for people to escape poverty and improve their lives by mobilising other sources of finance for private enterprise development, promoting open and competitive markets in developing countries and supporting companies and other private sector partners where there are gaps. To achieve this, IFC offers development-impact solutions through firm-level interventions such as direct investments, advisory services and the IFC Asset Management Company, but also by promoting global collective action and by strengthening governance and standard-setting in countries and regions.

...and its Vice President

Nena Stoiljkovic is IFC's vice president for business advisory services and a member of its management team. She leads more than 1,000 advisory services employees in 84 offices across 66 countries, and heads IFC's work to set standards in sustainability. A native of Serbia, Ms Stoiljkovic became vice president in September 2011. Ms Stoijkovic joined IFC in 1995 as an investment officer and has since worked in Asia, the Middle East, North Africa, Southern Europe and Central Asia. Prior to joining IFC, she worked as a consultant at the Economic Institute of Belgrade. She holds an MBA from the London Business School.

» pressed by how our relations with players from middle-income countries have developed in recent years as well. We now do a lot of business with major companies in Brazil, China and Turkey. They usually have no problems raising funds in their home markets but in collaborating with IFC, what they are looking for is our experience in other developing markets. This is all part of a big trend of the "South-South" investment flows that are becoming more and more important on a global scale and which we also want to encourage.

// Can you give an example?

Back in 2008, we extended corporate loans to Enerji SA to finance the first phase of its investment programme in western and southern Turkey. Now, that was a domestic project within Turkey, so not a South-South investment strictly speaking , but it might give you an idea of how we structure such deals. The total project cost was estimated at USD 2 billion, of which IFC contributed USD 825 million. We did this through a combination of two separate IFC loans totalling USD 225 million and a euro loan equivalent to USD 600 million on the accounts of the participating commercial banks, mainly Turkey's Akbank and Germany's West LB.

// Do you also support companies from emerging markets that invest in developed markets?

No, usually not. We once supported an investment in Portugal, but that was a big deal for us and certainly out of the ordinary.

// But a deal of the Enerji SA size is still exceptional?

Deals of that size are still a relatively small part of our business portfolio, indeed. But we are trying to open new relationships with large and medium-sized companies from both developed and emerging markets. Before the crisis, when I worked in Turkey, we started developing our business with second-tier, medium-sized companies. That was a risky thing to do, but it worked and many of them are now major companies. And this is also how we like to see a market develop.

// Given the risky projects and markets you engage and work in, do you have a high number of projects that fail?

Our non-performing loans (NPL) ratio is around 3.8 percent, which is incredibly low given the risk we are taking, as you correctly point out. After all, more than half of our projects, by number not volume, are in extremely poor countries. The good NPL ratio is really due to our very thorough process of approving projects and our risk management.

» Many western banks have pulled out of non-core markets, so we look for more local and regional players to work with.«

// Many banks in developed markets are struggling these days. Does that change the way you work with them?

The way in which we work with our partner banks is constantly evolving. We use their networks to expand our reach in frontier countries, but stop working with them once they have developed beyond a certain point. So, for example, we no longer work with banks in many emerging European countries. But your implication is correct. Many western banks have pulled out of non-core markets due to the crisis, which means we have to look for more local and regional players to work with.

// Do they meet your corporate governance standards?

In many cases, yes. You would be surprised to see how many well-run institutions you can find in Africa or Russia, for example. But in many cases, we also bring in our business advisory services and help the banks improve their corporate governance and environmental and social standards, before we work with them as a multiplier for our lending activities. That is also part of our wider objective of developing financial markets. For instance, in response to the crisis, we have set up a trade finance programme. This is not only a tool to support trade in times when commercial trade finance dries up, but it is also a good low-risk, short-term product that we now use to enter new and underdeveloped markets. It helps us establish relationships with banks that we have not worked with before and assess their quality before we move into more complex and long-term transactions with them.

// Is there any plan to wind this programme down again now that private sector trade finance has recovered somewhat?

No. We find this programme still extremely valuable in many countries in Africa, for example, where there is no crisis but there is often a lack of established financial markets to offer trade finance.

// In light of the crisis, there are many international players that now say a certain element of capital controls and protectionism might actually not be that bad. What is your perspective on this?

Such broad, regulatory issues are really the realm of the International Monetary Fund and the World Bank. We, as IFC, like to promote competition in each market. From a macroeconomic perspective, some form of protection might be advisable to promote stability, and we usually follow the IMF and the World Bank in their assessments. But on the micro-level that we work on, we only fund companies that are internationally competitive. They don't need to be internationally active yet, but we only work with companies that we deem to be viable in a competitive market environment. «

armin.haeberle@cfo-insight.com

IAFEI News March 21, 2013

Newly Created IAFEI Working Committees, starting 2013:

- *IFRS Committee* - Liaison IAFEI Executive Committee Member - IAFEI Treasurer, Emilio Pagani, Italy

- *International Tax Committee* - Liaison IAFEI Executive Committee Member - IAFEI Chairman, Luis Ortiz Hidalgo, Mexico

- *International Treasury Committee* - Liaison IAFEI Executive Committee Member – IAFEI Area President Asia, Nguyen Ngoc Bach, Vietnam. Name of committee may be revised to expand coverage.

- *International Observatory of Management Control Committee* - liaison IAFEI Executive Committee Member - IAFEI Area President Europe, Middle East, Africa, Armand Angeli. Frédéric Doche from French IAFEI Member Institute DFCG will be the Technical Leader.

43rd IAFEI World Congress, Warsaw, Poland, October 15 to 17 , 2013

Hosting IAFEI member institute will be FINEXA, the Financial Executives Institute of Poland, in cooperation with Financial Gates GmbH, Germany/ CFO-Insight magazine

44th IAFEI World Congress 2014, Manila, The Philippines

Hosting IAFEI member institute will be the Financial Executives Institute of the Philippines, FINEX. The exact date has not yet been determined.

45th IAFEI World Congress, 2015, Milan, Italy

Hosting IAFEI member institute will be the Financial Executives Institute of Italy, ANDAF. The exact date has not yet been determined.