**Rajiristan: Ferracorp, Limited**

***Introduction***

1. Rajiv Shah, a Senior Evaluation Officer in the World Bank Group’s Independent Evaluation Group (“IEG”), was putting the finishing touches on a draft evaluative note (“EvNote”) in connection with an XPSR completed for an A Loan to Ferracorp, Limited (“Ferracorp” or “the Company”) in the country of Rajiristan.
2. Ferracorp, a leading exporter of high-grade processed iron ore to China, was an important company in the Rana family-owned industrial group (“the Group”) of companies. The Rana Group, a second-tier (in terms of wealth and business prominence) family conglomerate in the country, was closely held by the family, which had a 99% stake in the equity with three generations of family members involved in the management of the Group’s companies.

***The IFC Loan***

1. Rajiv was somewhat surprised that the IFC A Loan (“the Loan”) of US$33 million, committed in mid-2007, although specifically targeted to supporting the Company’s plans to expand its existing 110 MW capacity in wind-power generation by an additional 37 MW to cost US$47 million, had nonetheless been structured and booked as a corporate loan. The remaining US$10 million of project cost was to be funded through the Company’s internal accruals. At the time of IFC’s commitment, the Company’s wind-power portfolio was one of the largest in the country and was motivated by the Government’s policies and regulations which encouraged the development of non-conventional energy sources. The Company, which was highly profitable at appraisal because of its successful iron ore exports and prevailing high international iron ore prices, nonetheless wanted to diversify its revenue stream, hence the focus on wind-power expansion.
2. The Loan was priced at a 1.0% front-end fee and a 1.6% spread over 3-month LIBOR with a tenor of six years, including four years grace and was repayable in two installments falling due on June 15, 2012 and June 15, 2013. Locally, bank financing available to the Company carried tenors under 5 years with limited grace periods and significantly higher interest rates. IFC’s yield on the Loan was about 4.5%, after taking into account commitment charges on the undisbursed portion until cancellation.

***Covenant Breaches***

1. IFC disbursed US$16.2 million of the A Loan in July 2007. However, the Company failed repeatedly to comply with the required conditions relating to the environmental and social action plan (“ESAP”) and IFC’s requirement of a comprehensive mining reserve audit in connection with affiliated mines against national regulatory requirements. Despite several attempts by IFC to get the Company to resolve the problem, the Company did not implement the ESAP and was deficient with respect to the mining audit.
2. More serious, however, was the Company’s unilateral action in another area. In 2008, without prior IFC consent, the Company provided a corporate guarantee on a bridge loan to one of its affiliated companies engaged in the shipping business. It rationalized this move, after the fact, as one of a shift in its revenue-diversification strategy from a focus primarily on non-conventional energy production (as previously agreed with IFC) to one giving greater prominence to shipping and logistics. This action, combined with the aforementioned non-compliance issues, led IFC to cancel the undisbursed portion of the loan of US$16.8 million.

***Company Problems and Developments***

1. Despite the aforementioned covenant breaches, the wind-generation project was built under budget and was generating revenues at the time of evaluation. But the Company’s overall profitably had slipped into the red (the FRR for the project dropping as low as negative 12.9% in real US Dollar terms) as a consequence of a ban on iron-ore mining, which reverberated widely throughout the Company’s operations, including forcing its DSCR below the covenanted 1.2. It also was adversely affected by the steady depreciation of the Rajiristan Currency Unit (“RCU”) by almost 10% per annum throughout the evaluation period.
2. The Company produced and annual “independently-assured corporate-sustainability” report to satisfy government requirements and which also partially met IFC E&S requirements. The report covered the Company’s main iron ore mine, its export-oriented business units and the wind-power projects. However, it failed to cover the Company’s associated mines and processing facilities, hence constituting an important shortfall in meeting the E&S requirements agreed with IFC. While the Company’s weakened financial position undoubtedly played a role in contributing to this shortfall, the tendency for sponsors and management executives (who for the most part were family members) to “play their cards close to the chest” may also have been responsible for the resulting impasse with respect to IFC portfolio supervision efforts. In any event, the resulting deficiencies in E&S efforts (specifically, the Company’s failure to implement the ESAP) as well as serious blind spots regarding measurement and performance indicators covering the Company’s entire operations represented significant operational and reputational risk to IFC, carrying possible legal liability. Nonetheless, the Company serviced all interest and principal payments on time.

***Questions***

1. What is your opinion of the merits and shortcomings of the Company’s stated shift in revenue-diversification strategy?
2. Regarding the Project (Loan) structure, what are the issues with respect to:
   1. Measuring the success of the Project versus the Loan?
   2. E&S risk?
   3. Borrower/Sponsor character?
3. Regarding distributional (wealth and income) effects and contribution to Development Outcome, what do you think should be a minimal set of information requirements? (Think in terms of what you **need** to know as distinct from what you might **like** to know.)
4. From the information provided, in what ways is this Loan more like an equity investment than more typical IFC loans?
5. Can you quickly identify a few key things IFC should require of a borrower/sponsor as conditions precedent to qualify for them to receive: (a) a corporate loan from IFC; and (b) an IFC equity investment?
6. Although not necessarily mutually exclusive, from the information provided, what might be the main reason for the Company to have serviced the IFC Loan despite its problems:
   1. The Sponsor had a strong sense of “honor” as regards servicing its debts
   2. The Sponsor feared an adverse credit rating in the local market
   3. The Sponsor feared further depreciation of the RCU and its prospective impact on debt servicing
   4. The Sponsor knew that IFC terms and conditions were likely the most favorable available
7. From the list of reasons in 6 above, what might be your second likely reason?