

Environmental Action Programme Support Project  
Contract DHR-0039-C-00-5034-0  
United States Agency for International Development

ANALYSIS OF PENDING LOAN GUARANTEES BY  
THE CZECH STATE FUND FOR THE ENVIRONMENT,  
WITH RECOMMENDATIONS

Submitted to:  
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Prepared for:  
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December 1996

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Prepared by:  
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## EXECUTIVE SUMMARY

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The Czech Ministry of the Environment, operating through the Czech State Fund for the Environment (SFZP), provides financing to municipalities and businesses in support of investments that improve the environment. Most financing is provided in the form of grants and subsidized loans. These grants and loans are extended directly by the Fund to the municipalities and businesses undertaking the improvement project.

The Ministry and the SFZP have recently taken a keen interest in exploring the use of loan guarantees to extend financial support. Under such an arrangement, a loan is extended by a commercial financial institution, not directly by the Fund. The Fund provides the commercial lender a guarantee of the borrower's repayment obligation. To maintain the desired incentive and ensure that loans were affordable, the Fund concurrently would provide a subsidy to the borrower. These guarantees would supplement the Fund's current reliance on direct loans and possibly eclipse them in the years ahead.

The Environmental Action Programme Support (EAPS) project, an initiative of the U.S. Agency for International Development (USAID), has provided several studies to the Ministry and the SFZP on the nature, advantages, and risks of loan guarantees as a means of stimulating environmental investments.<sup>1</sup> These studies have advised that a carefully structured program of guarantees would promote environmental amelioration and the sound financing of environmental investments. Such a program would stimulate additional funding for environmental projects, forge a collaborative relationship between the Fund and commercial lenders, and combine the incentive of subsidies with the healthy discipline of commercial prudence. Through these studies, the EAPS work has strongly endorsed the introduction of guarantees into the SFZP tool kit.

This report analyzes six transactions that the Ministry and the Fund are currently contemplating. While EAPS has reported favorably on the programmatic use of loan guarantees, in this study we conclude that most of the six transactions in particular are unattractive. This finding does not alter EAPS' view on the value of loan guarantees in general, nor should it dampen the enthusiasm of proponents of the instrument in the Ministry or the Fund. Instead, it underlines the need to subject the use of guarantees to the controls of a thoughtful policy and rigorous procedures and to approach each transaction with care.

Five of the six applicants reviewed lack one or more fundamental ingredients required for evaluation—business plans, historical financial data, financial projections, financing plans, and market analyses. Absent such basic information, the Ministry and the SFZP cannot proceed without taking on substantial risk. Further, the sketchy information presented in most cases indicates serious flaws in the proposed investments that would not be rectified by more information. Only the Povodi Vltavy project, which is governmentally owned, appears to present a reasonable credit risk. Even here, however, the SFZP should conduct additional analyses and qualify its guarantee to protect the interests of the government and the environment.

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<sup>1</sup> See Developing a Loan Guarantee Programme for The Czech State Fund for the Environment: Review, Background, and Recommendations; Analysis of the Proposed SFZP Guarantee for the Benefit of ECO GAIA, a.s., with Recommendations.

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**SECTION I**

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**INTRODUCTION**

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**SECTION I  
INTRODUCTION**

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The Ministry of the Environment and the Czech State Fund for the Environment (SFZP) have asked USAID, acting through the Environmental Action Programme Support project, to assess six applications to the SFZP for its guarantee of loans from commercial sources for environmental investments. By separate resolutions (see Annex A) issued by the Minister of the Environment between October 1995 and April 1996, the government has made a contingent offer to guarantee loans to these projects. The applications are summarized in Table I-1 below.

**Table I-1. Resolutions Offering Loan Guarantees**

Company	Industry	Project Cost (Kc millions)	Amount of Guarantee (Kc millions)	Type of Guarantee
<i>Povodi Vltavy a.s.</i>	Hydroelectric	326.0	163.0	Installments during construction and testing
<i>Stredisko likvidace odpadu Oslavany a.s.</i>	Industrial incineration	2,236.0	200.0	Unspecified
<i>REVEX plast, v.o.s.</i>	Recycling plastic waste	20.2	20.2	Unspecified
<i>SJUKO s.r.o.</i>	Hydroelectric	25.1	17.5	Installments during construction and testing
<i>CATRIN market s.r.o.</i>	Manufacturer of filling materials	35.0	35.0	Installments for seven years; then balance of loan
<i>Ekochab s.r.o.</i>	Natural gas production	70.3	42.0	Installments for term of loan

In a separate report, EAPS prepared a detailed analysis on a proposed guarantee in favor of ECO GAIA.<sup>1</sup> Because that analysis posed questions and recommendations that could be applied to virtually any credit application, there will be no attempt to duplicate those questions here. However, the analytical framework developed in the ECO GAIA case will be continued in the examination of the six projects.

The information provided in most of the six applications is limited and varies considerably as shown in Table I-2. Business plans are generally of limited value. Historical financial information is minimal. Cash flow projections often are presented without accompanying

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<sup>1</sup> Analysis of the Proposed SFZP Guarantee for the Benefit of ECO GAIA, a.s., with Recommendations.

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assumptions. Only the Oslavany project presents a serious and professional approach to business planning.

**Table I-2. Information Available for Analysis of the Proposed Guarantees**

	Financial Statements			Financial Projections	Business Plan	Market Studies	Loan Commitment
	Submitted	Current	Audited				
<i>Povodi Vltavy a.s.</i>	Yes	12/31/95	No	None	None	None	Yes, possibly stale
<i>Stredisko likvidace odpadu Oslavany a.s.</i>	Yes	12/31/95	No	Yes	Strong	None	None
<i>REVEK plast, v.o.s.</i>	Yes	12/31/95	No	Yes	Limited	None	None
<i>SJUKO s.r.o.</i>	Yes	12/31/94	No	None	None	None	None
<i>CATRIN market s.r.o.</i>	Yes	12/31/94	No	Yes	Limited	None	None
<i>Ekochab s.r.o.</i>	No	n/a	n/a	None	Limited	None	None

Only the Povodi Vltavy application has received a contingent financing approval. It is thus impractical to determine the debt service capability of the other applicants as financing terms have yet to be determined. The SFZP should consider applications for its guarantee only after detailed financing agreements have been arranged by the respective borrowers.

Of the six cases examined in this report, only Povodi Vltavy appears to have the components to suggest a reasonable credit risk owing to its 100 percent ownership by the Ministry of the Environment. If the company were to become privatized, its access to additional capital would likely become more difficult and thus diminish its creditworthiness.

The absence of a proven operating record, sufficient capital, and detailed business plans should disqualify the remaining applicants from consideration for the SFZP guarantee. As stated in the ECO GAIA report, SFZP incurs considerable risk by issuing guarantees for projects with a high credit risk. Except for the Vltavy project, the remaining guarantees represent a total exposure of Kc 291 million (approximately \$11 million). This is an extremely large risk exposure on top of the excessively high risk exposure of Kc 710 million (\$27 million) that would be created with the approval of the ECO GAIA guarantee.

Analysis of the six cases and ECO GAIA also raises questions about the type of borrowers the SFZP may wish to support. The projects evaluated in this report and ECO GAIA are commercial enterprises. The risk elements of the commercial sector in the Czech Republic are high in today's transitional economy. This outlook should improve over time as commercial

entities build capital and provide evidence of strong cash flow and proven management skills. Meanwhile, the municipal sector is more stable and generally represents a lower credit risk. Accordingly, it may benefit the SFZP to focus its financial support on the municipal sector and limit or eliminate support for commercial enterprise projects.

This report presents an overview of each project, reviews the positive and negative elements of each, and offers recommendations for steps the SFZP may wish to pursue in each case.

**SECTION II**

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**POVODI VLTAVY a.s.**

## H. Evaluation

The positive elements of this application include the following:

- 100 percent ownership of the company by the Ministry of the Environment
- Strong capital base and apparent access to capital, if needed, from the Ministry
- Apparent qualified management with experience in the industry

The negative elements of this application include the following:

- Limited operating history, with no evidence of historic cash flow sufficient to amortize the proposed debt
- Financing terms from the Austrian bank that appear to commit the SFZP to a longer term than authorized in the ministerial resolution
- No business plan to support the cash flow forecast

## I. Recommendations

The SFZP should continue to support this project with its guarantee. As a condition to its guarantee, the SFZP should obtain an agreement with the Ministry of the Environment, the authorized officers of the borrower, and the financing source specifying the following:

- No change in ownership of the borrower will be permitted without the prior written consent of the SFZP.
- All capital stock of the borrower and the hydroelectric plant to be constructed will be pledged as collateral to the guarantee.
- The bank will provide a warranty to the SFZP that it will fulfill all the duties and responsibilities similar to those described in the ECO GAIA report and the Guarantee report presented by this consultancy to the SFZP in August 1996.
- The loan to be guaranteed should be senior to all other borrowings.
- The lender must absorb a material loss (to be specified) before the guarantee is activated.
- Other standard protections should be built into the agreements.

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**SECTION II**  
**POVODI VLTAVY a.s.**

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**A. Background**

The Povodi Vltavy guarantee is in support of financing for the construction of a hydroelectric plant using the hydropower potential of the Vltava river. The ministerial resolution authorizing the SFZP guarantee was originally issued on December 13, 1995, and reissued on May 15, 1996. The guarantee is in the amount of Kc 163 million (approximately \$6.27 million), or 50 percent of the anticipated financing of Kc 326 million. In addition, the resolution authorizes partial payment of the estimated interest up to Kc 30 million. Ten percent is the maximum interest rate subsidy allowed by the resolution. The ministerial resolution also stipulates the guarantee is provided only during the construction and start-up phase of the project. When the power plant begins permanent operation, the guarantee will expire.

Bank financing is apparently being arranged with Reiffeisenlandesbank Oberosterrreich 1, 4020 Linz, Austria, as suggested in correspondence to former Minister of the Environment Ing. Frantisek Benda. The bank, in its November 14, 1995, letter to former Minister Benda, presented a different understanding of the credit guarantees from that stipulated in the ministerial resolution. However, only the November letter and not the supporting credit agreements were available for this analysis. The most significant variance between the ministerial resolution and the bank letter is the duration of the SFZP guarantee. The bank credit agreement calls for the SFZP guarantee to remain in effect until March 31, 2010, a significant departure from the resolution limit to the guarantee through the construction period.

The details of the full credit agreements should be reviewed to determine if they are in compliance with the terms of the ministerial resolution.

**B. Profile of the Borrower**

The borrower is a joint stock company founded on January 1, 1994. Its offices are located in the city of Prague at Holeckova 8, 150 24. The company's primary activities are directed to the management and protection of surface and underground waters.

The company, founded by former Minister of the Environment Benda, is 100 percent owned by the Ministry of the Environment. There is one registered share with a nominal value of Kc 5.54 billion (approximately \$213 million). Because of Ministry ownership and its financial support, the complexion of the credit risk is changed considerably.

Given the 100 percent ownership of Povodi Vltavy by the Ministry, the SFZP, as an agency of the Ministry, is in effect providing a guarantee for the benefit of its parent. No business plan was presented for our analysis, perhaps due to the ownership issue. As a result, there is limited information on which to base a meaningful credit evaluation.

**C. Purpose of the Financing**

The proposed financing is to provide funding for the construction of a new hydroelectric power plant. While no business plan was provided, the technical plan submitted to the SFZP was

highly detailed, suggesting that considerable attention has been paid to the technical and economic feasibility of this project.

File information does not indicate whether the project meets the SFZP criteria for support. This question should be looked into by the SFZP.

**D. Economic, Political, Industry, and Company Dynamics**

The plan to move from the current reliance on fossil fuel-burning power generators to a hydroelectric power general system might receive wide acceptance because of the environmental benefit. However, the conversion may also raise questions related to zoning and potential litigation. The Ministry of the Environment, by virtue of its ownership, is in the best position to judge the risk in these areas.

**E. Financial Condition**

The balance sheet as of December 31, 1995, indicates total assets of Kc 5,888,259,000 and equity of Kc 5,675,359. The assets are primarily land and buildings, including construction in progress. There is a modest amount of normal trade liabilities that are covered by a more-than-sufficient amount of cash and accounts receivable. As a result, the company enjoys a satisfactory liquidity position as of December 31, 1995. While the balance sheet is acceptable, by now it is out of date and should be replaced with a more recent statement for evaluation.

No significant income has been produced by the company to date, making analysis of the profit and loss statement impractical at this time. With no indication of the repayment terms of the proposed financing, analysis of debt service capabilities is also not possible at this time.

**F. Collateral**

In view of the Ministry's ownership interest in the borrower and the agency relationship between the SFZP and the Ministry, the appropriate collateral is to make an assignment of all Povodi Vltavy capital stock along with the hydroelectric plant to be built.

Normally, a guarantee from the company owner would be an appropriate form of support to the SFZP. In this case, it may be requested as an additional form of security for this short-term loan. However, an awkward condition exists when the Minister of the Environment is the same authority who would approve the SFZP guarantee and at the same time be responsible for any loan losses in the SFZP. The Ministry must resolve where, in the event of default, the losses should appear—on SFZP books or directly on the books of the Ministry.

**G. Primary and Secondary Sources of Repayment**

The lack of long-term operating performance by the borrower makes it difficult to evaluate the debt service capacity of this company. In addition, the evaluation of repayment sources would not be useful at present because the debt terms are not known. Once financing terms are defined, the cash flow forecast should be reviewed to establish whether the projected cash flow is adequate to service the proposed debt.

It is possible that the secondary source of repayment could come from additional capital infused by the Ministry of the Environment.

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**SECTION III**

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**STREDISKO likvidace odpadu OSLAVANY, a.s.**

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**SECTION III**  
**STREDISKO likvidace odpadu OSLAVANY, a.s.**

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**A. Background**

The Oslavany project is to construct and operate a large industrial waste incineration plant in the Southern Moravia region of the Czech Republic. This project has been in development since 1990 and has been progressing slowly. The incineration plant investment is projected to be Kc 2.23 billion, or approximately \$86 million. The former Minister of the Environment issued a resolution to guarantee on October 19, 1995, and to expire on December 31, 1996. The amount of the guarantee is Kc 200 million, or 9 percent of the project financing. The resolution does not specify the term or limits of the guarantee. The borrower has subsequently petitioned the SFZP, in an undated letter, to increase its guarantee to Kc 1 billion and keep it in force until 2006. There is no file information indicating the SFZP reaction to this request.

**B. Profile of the Borrower**

This joint stock company, located at Oslavany, Nadrazni 9, was registered in the District Court Brno-venkov on December 30, 1991. The basic equity of the company was Kc 47.9 million, increased as of June 29, 1995, to Kc 53.6 million. Following are the largest shareholders of the company and their percent ownership:

Teplarny Brno, a.s.	39.75%
Moravostav Brno, a.s.	31.34%
Kralovopolska, a.s.	12.54%
EKOENGINEERING Brno, s.r.o.	12.58%
Six minority investors	3.79%

The company has prepared an excellent business plan, with detailed information on project benefits and risks. The company plans to operate a large regional waste incineration facility in the small (4,500 inhabitants) town of Oslavany, the site of coal mines and a power station. The company plans to use heat produced from the waste combustion in the district heating system.

**C. Purpose of the Financing**

All project costs, land acquisition, demolition of existing facilities, and plant construction, including design studies, financing costs, and other soft costs are to be financed from the proposed loan. Although this is 100 percent financing, the SFZP is being asked to guarantee only a small portion of the project. Financing has yet to be arranged, and file material suggests the company is considering a variety of financing approaches.

The nature and size of this waste incineration power generation facility make it well suited for project financing. Major financing sources contemplated for the project include an export bank loan from the country of origin for the foreign supplier of the technology, and foreign development banks—EBRD, IFC, EIB, and a consortium of Czech banks and foreign commercial banks. Various guarantee schemes also have been considered.

#### **D. Evaluation**

The positive elements of this application include the following:

- A thoughtful and well-prepared business plan that recognizes the risks and benefits of the project, and that realistically assesses the hurdles to arranging a suitable financing package
- Apparent broad-based regional support
- Investors who have been willing to contribute additional capital when called upon in the past

The negative elements of this application include the following:

- No operating history to support the cash flow projections
- Financing plan still being developed
- Limited equity in relation to substantial proposed debt

#### **E. Recommendations**

A review of the business plan and supporting cash flow projections indicates this ambitious project must first arrange for a single lead lender to prepare the total financing proposal. At that time, the SFZP should be invited into the discussions to determine its interest in providing any type of financial support; e.g., grant, loan, or a partial guarantee. The issuance of the SFZP resolution was premature. A more appropriate signal to the borrower would be for the SFZP to issue a simple expression-of-interest letter. Such a letter would not specify a firm amount or term for a guarantee.

The SFZP should not renew this guarantee resolution but may wish to pursue other methods of support for the project. This support should be offered only after an overall financing proposal has been committed to by a lead bank in a project financing consortium. Under no circumstances should the SFZP agree to increase its guarantee to Kc 1 billion as requested by project applicants.

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**SECTION IV**

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**REVEX plast, v.o.s.**

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**SECTION IV**  
**REVEX plast, v.o.s.**

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**A. Background**

Revex plast, v.o.s., located in the vicinity of Ostrava near the Polish border, has been operating a plant for recycling waste plastic materials since 1995. The capacity of the existing plant is 450 tons of processed plastic material annually. Revex wishes to increase that capacity to 1,500 tons to cover the demand for processing plastic waste in Northern Moravia.

The current Minister of the Environment, Ing. Skalicky, has issued a resolution to offer an SFZP guarantee in the amount of Kc 20,155,000 (approximately \$775,000). This resolution is dated in 1996 but does not specify a day and month. The application for the guarantee was submitted to the SFZP on June 18, 1996. However, the resolution has an expiration date of five months from date of issue. The guarantee is for 100 percent of the proposed project investment. No bank financing has been arranged, and no limitations on the term of the guarantee are stated in the resolution.

**B. Profile of the Borrower**

Revex, located at Opava 6, 17 listopadu 35, was founded as a general partnership on February 28, 1995. The two partners are Alena Vecerova with a 95 percent interest, and Alena Stehikova with the remaining 5 percent interest. Ms. Stehikova has no professional work experience. The partners have authorized JUDr. Jaroslav Vecera of the Charles University Law Faculty to negotiate this guarantee on their behalf.

The company, in operation for slightly more than one year, is proposing to more than triple its production capacity. Based on only one year of operation, this decision is not supported by a detailed business plan and market survey.

**C. Purpose of the Financing**

The financing is expected to be used for the construction of a new processing plant to process up to 1,500 tons annually of plastic waste products, acquire new technology of foreign manufacture, and to purchase the necessary raw material (plastic waste) to process.

**D. Economic, Political, Industry, and Company Dynamics**

The business plan submitted by this firm offers no commentary on competitive factors within the industry or what impact varying economic and political factors would have on the business.

**E. Financial Condition**

Revex had Kc 7,434,000 (\$293,000) in total assets as of December 31, 1995. The majority of the assets were invested in buildings and equipment. The current assets of Kc 1,813,000 consist mostly of accounts receivable of Kc 1,747,000. No information is offered on the composition or aging of those accounts receivable. Revex had a nominal cash position of Kc

66,000. The assets were supported primarily with bank debt (Kc 6,796,000) and accounts payable from suppliers and relatives. The company had a negative net worth of Kc -146,000.

The first year of operations generated sales of Kc 2,415,000 (\$93,000) and a net loss of Kc 146,000 (\$5,600). The limited information available precludes observations about sales and assets, assets and equity, debt and equity, and debt service and cash flow.

Cash flow projections to the year 2002 appear ambitious and not reflective of first-year performance.

#### **F. Collateral**

The only collateral evident for this project would be the plastic processing plant to be constructed and the current plant in operation. As special-purpose facilities, neither would be desirable as primary collateral. The liquidation value of the combined facilities would probably be insufficient to satisfy outstanding bank debt or the SFZP realized guarantee.

#### **G. Primary and Secondary Sources of Repayment**

The company's first-year operating loss and deficit net worth make it highly unlikely that repayment can come from Revex cash flow. The secondary repayment source, which would have to come from liquidation of collateral, is equally dubious. Accordingly, the prospect for repayment of the proposed debt in full is highly unlikely.

#### **H. Evaluation**

There are no positive elements of this application.

The negative elements of this application include the following:

- The experience of the partners is limited. No evidence exists of the managerial skills needed to run a larger enterprise.
- The business plan is weak, revealing the partners' limited management skills.
- Revex has a negative net worth and is wholly dependent on external financing to support its operations.
- The first year of operations reflected modest sales and generated a net operating loss. This performance does not support construction of a new plant to increase productive capacity.
- The potential collateral is a highly specialized processing plant that would have limited value in liquidation.
- There is no evidence of either a primary or secondary source of repayment.

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**I. Recommendations**

The Revex application is weak and should not be supported at this time. If the company can generate profitable sales growth and significantly improve its capital over the next three years, it may merit becoming a candidate for support in the future.

**SECTION V**

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**SJUKO spol s.r.o.**

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**SECTION V**  
**SJUKO spol s.r.o.**

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**A. Background**

Sjuko spol s.r.o. submitted an application to the SFZP for financial support on August 2, 1994, for the construction and operation of a small hydroelectric plant located in the Eastern Czech Republic. A revised application was presented on April 15, 1995. On December 13, 1995, former Minister of the Environment Benda authorized a guarantee of the SFZP of up to Kc 17.5 million (\$675,000), representing 69.7 percent of the Kc 25,113,000 project financing. This guarantee is available only for construction through the testing phase of project start-up. Investors are scheduled to contribute Kc 7,613,000 to project funding over three years. Bank financing has not yet been arranged for this project. Negotiations apparently have been initiated with several Czech banks as well as foreign institutions. The company has also indicated the intent to solicit the Czech Moravian Development and Guarantee Bank for a partial interest rate subsidy.

**B. Profile of the Borrower**

Sjuko, as a limited liability company, was formed on April 29, 1993. The company is located at Prerov, Fugnerova 7, 750 000, and has four partners with an initial equity of Kc 150,000. The primary business activity will be operation of a small power plant. The project is designed to replace the current brown coal-fired power plant and to reduce attendant pollutants.

The company reports that it has arranged a contract with SME Ostrava to purchase the electricity generated by the new hydroelectric plant. That contract was not available for review. In addition, no information was available to assess the financial strength of SME Ostrava and its future need for power. As a result, it was not possible to determine the degree to which the SME contract enhances the borrower's creditworthiness.

**C. Purpose of the Financing**

The financing is to provide funding for the construction of a small hydroelectric plant. The December 31, 1994, financial statement reflects accounts payable of nearly Kc 1 million. The SFZP should verify that loan proceeds will be used for new construction expenses and not for paying existing debts.

The SFZP should verify that the purpose of the financing meets SFZP's eligibility criteria.

**D. Economic, Political, Industry, and Company Dynamics**

Little information was submitted with this application. Without a business plan, the impact of local political and economic conditions is difficult to assess. Sjuko may be vulnerable to competition from larger, low-cost power sources should alternative power generators come on line in the future. With no real operating performance to measure, Sjuko management is untested.

**E. Financial Condition**

The most recent financial statement on file is for the period ending December 31, 1994. At that time, total assets of Kc 1,433,800 were invested primarily in fixed assets. The capital

position had declined to Kc 124,300. Short-term liabilities totaled Kc 1 million. There was no meaningful income or expense activity.

The company has a limited capital base and a modest amount of liquid assets. Because it has yet to operate the plant, no comment is offered on the income statement.

#### **F. Collateral**

If this project is financed, the only available collateral would be the plant to be built. Assignment of the contract with SME Ostrava as collateral also would be appropriate. Czech law now does not recognize the perfection of a collateral interest in a "movable" asset such as the Ostrava contract. Even so, having the assignment would be appropriate in case the law is changed.

#### **G. Primary and Secondary Sources of Repayment**

It is speculative at this time to comment on potential sources of repayment as no substantive information was submitted by the applicant. Accordingly, there is no evidence for either a primary or secondary source of repayment.

#### **H. Evaluation**

The positive elements of this application include the following:

- The reported contract with SME Ostrava to buy all the power output of the proposed plant is valuable. The inability to examine that contract reduces its value within this analysis.

The negative elements of this application include the following:

- Limited financial information
- No business plan on which to evaluate management's recognition of project risks
- Limited equity in relation to a substantial amount of debt
- No suitable liquid collateral
- No evidence for source of repayment

#### **I. Recommendations**

Despite the apparent environmental benefit from this project, it is an excessively risky project because of the limited amount of investor capital, the absence of a business plan, and illiquid collateral. Accordingly, the SFZP should withdraw its support of its guarantee until substantial equity is provided by the investors and a formal bank financing proposal has been secured by the borrower.

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**SECTION VI**

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**CATRIN market s.r.o.**

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**SECTION VI**  
**CATRIN market s.r.o.**

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**A. Background**

Catrin market s.r.o., based in Prague, plans to manufacture polystyrene insulation products from recycled polystyrene, building debris, crushed ceramics, and concrete detrius. On March 27, 1996, former Minister of the Environment Benda approved a resolution to have the SFZP guarantee a bank loan of up to Kc 35 million (\$1,344,000), or support of the total Kc 35 million for a term of seven years to permit Catrin to launch production of insulation fillers. The company has not yet obtained approved bank financing for this new production.

**B. Profile of the Borrower**

Catrin was formed as a limited liability company on November 25, 1992, with offices at Tiskarska 10, Praha 10. The two partners, Alena Bastyrova and Miroslav Fric, contributed Kc 51,000 and Kc 49,000, respectively, as the company's initial capitalization. Since its inception, the company has been engaged as a caterer, a copy center, and a wholesale distributor of consumer goods, mostly consumer electronics. The partners are seeking to expand their consumer operation into a network of retail outlets.

Moving ahead in an entrepreneurial spirit, the management nows seek to enter into the manufacture and sale of recycled plastic products. Recognizing the seasonality of insulation, the company is also considering the manufacture of spiral staircases, single-purpose diamond tools, and auto seats for disabled drivers.

**C. Purpose of the Financing**

According to the Catrin business plan submitted on September 21, 1995, Kc 20 million would be used to purchase real estate, Kc 5 million to purchase processing technology, and Kc 8 million to purchase recycled plastic waste.

**D. Economic, Political, Industry, and Company Dynamics**

The proposed end product, polystyrene insulation, has been manufactured on world markets for at least 15 years. Both the raw material and end product are greatly influenced by shifts in consumer demand for housing and insulation. The current shortage of residential housing stock in the Prague metropolitan market suggests a strong demand for residential building products into the foreseeable future.

The Catrin business plan, while noting a range of influences facing the new operation, provides little analysis of those elements. Generally, the business plan fails to recognize the cost of inventory and the effect of possible slow-turning accounts receivable. The integration of a new manufacturing process into the existing distribution and service lines of business—wholesale of consumer electronics and catering—is not covered at all.

## **E. Financial Condition**

As with most of the cases examined, the applicants rely heavily on their cash flow forecasts to justify the proposed debt. The Catrin balance sheet as of December 31, 1995, reveals limited equity of Kc 371,000 (\$14,000) against total debt of Kc 29 million (\$1,146,000). The assets are primarily inventory and accounts receivable. No information is supplied for analyzing the quality and liquidity of those assets. Warehouse space is rented.

The income statement, a mixture of wholesale and catering activities, is not relevant to the new venture. The only conclusion to be drawn from the income statement is that the company has shown a nominal profit of Kc 125,000.

Generally, the Catrin financial condition is weak and should not be subjected to additional debt at this time.

## **F. Collateral**

Catrin's collateral options are unattractive. Because much of the loan proceeds are dedicated to the purchase of land and raw material inventory, the SFZP will likely have a guarantee that is secured by land. The technology to be acquired may have some market value, but its specific use and design limit its marketability. If the consumer electronics inventory is free of prior liens, it might also be considered as supplemental collateral even though it is classified as a "movable" asset.

## **G. Primary and Secondary Sources of Repayment**

The primary source of repayment for this loan should be cash flow from the new manufacturing process. Because the company has no direct experience in this new line of business, the adequacy of its cash flow is uncertain.

The secondary source of repayment is also dubious. Collateral values appear to be deficient in liquidation. One repayment option might be liquidation of the consumer electronics distribution business. However, with the manufacturing unit in a distressed financial condition, the other businesses would be strained because of their limited capital, liquidity, and earnings potential.

## **H. Evaluation**

The positive elements of this application include the following:

- The principals have some business experience and a strong entrepreneurial attitude as evidenced by their understanding of the business planning process.

The negative elements of this application include the following:

- The potential bank loan and the SFZP guarantee would represent virtually 100 percent of the project cost, including the purchase of raw material inventory.
- Management has some experience in the sale of consumer electronics and catering, but none in the manufacture of waste plastic reprocessing.

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- The existing business has limited capital, liquidity, and earnings, and could be a financial and managerial drain on a successful new venture.
- Besides ambitious cash flow projections, there is no evidence of strong primary or secondary sources of repayment.
- The project appears to have limited environmental benefit when compared to other environmental problems in the Czech Republic.

## I. Recommendations

This is the weakest of all the applications reviewed. Even the environmental benefit to be derived from this project is suspect. If this new processing plant were not built, the waste plastic could easily be sold to other processors in the Central European market. Accordingly, the guarantee resolution should be left to expire and should not be fulfilled.

**SECTION VII**

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**EKOCHAB, s.r.o.**

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**SECTION VII**  
**EKOCHAB, s.r.o.**

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**A. Background**

The Ekochab project is proposed to degas the municipal TKO Praha Dolni Chabry dump and to produce natural biogas. The total project is anticipated to cost Kc 70,340,000 (\$2,709,000), of which the SFZP is expected to provide its guarantee for Kc 42 million (\$1,615,000). The loan guarantee has no stated maturity and is conditioned on the terms of the approved bank financing. The resolution was issued in 1996, with no day or month specified on the face of the resolution, by former Minister of the Environment Benda.

The municipal refuse tip is located in the northern suburban area of Prague and is nearby residential housing. The dump was in operation between 1985 and 1993. Due to the migration of gas and consequent risk of explosion, emergency pumping off and provisional incineration of gases was begun in 1991. Ekochab has been engaged in the emergency pumping off and burning of the tip gas at Dolni Chabri since March 1995.

**B. Evaluation**

No background or historical financial information was supplied for analysis. The only information presented was a modest business plan that included a thorough analysis of the technical aspects of the project. Alternative investment approaches and financing schemes were also presented.

**C. Recommendations**

The SFZP should not support this project with its guarantee due to lack of information on the equity base, composition of assets and liabilities, historical operating performance, and potential collateral. If the company can supply information that portrays a favorable financial condition, then the SFZP may wish to continue its support of this application.

ANNEX A

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**RESOLUTIONS FOR GUARANTEES (TRANSLATION)**



**RESOLUTION**  
No. 00699541

on providing support from the State Fund for the Environment of the Czech Republic

According to §1, article 5, law No. 388/91 Coll.  
on the State Fund for the Environment of the Czech Republic

I approve: A loan guarantee in the amount of Kc 200,000,000 (the base for setting the support is Kc 2,236,000,000)  
For a project: Incinerating plant for industrial waste Oslavany  
Realized in: 1994-1997  
For an applicant: Stredisko likvidace odpadu Oslavany a.s., Nadrazni 9

Under the following basic conditions:

The total amount of the support set by a % share of the base for setting the support stated in this resolution is a maximum and it will be specified based on the selection of the supplier carried out in accordance with law 199/94 Coll. and concluded supplier's agreements. Potential increase of the specified budgeted costs (above the base for setting the support) is covered by the applicant from his own sources, when decreasing the base for setting the support the % share remains unchanged.

The project will be realized in accordance with the approved documentation and in accordance with legal regulations on the waste disposal industry: law No. 17/92 Coll. on the environment, law No. 238/91 Coll. on waste, law 309/91 Coll. on the protection of the environment, and the resolution of the Government of the Czech Republic No. 513/92 Coll. on details of waste disposal.

While operating the installed equipment, the emission limits will be met in accordance with the regulation of the Federal Committee for the Environment dated June 23, 1992, which amends the regulation of the Federal Committee for the Environment dated October 1, 1991, of law No. 309/91 Coll. on the protection against pollutants.

The applicant will select a supplier in accordance with law 199/94 Coll. on public orders.

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**RESOLUTION**

No. 05729647

on providing support from the State Fund for the Environment of the Czech Republic

According to §1, article 5, law No. 388/1991 Coll. on the State Fund for the Environment  
of the Czech Republic

I approve: A loan guarantee in the amount of Kc 20,155,000, e.g. (100% of the base)  
for setting the support in the amount of Kc 20,155,000  
For a project: Plastic waste liquidation plant  
Realized in: 1996-1997  
For an applicant: REVEX plast, v.o.s., 17. listopadu 35, Opava 746 01

Under the following conditions:

- The total amount of the support set by a % share of the base for setting the support stated in this resolution is a maximum and it will be specified based on selection of a supplier carried out in accordance with law No. 199/94 Coll. and concluded supplier's agreements. Potential increase of the specified budgeted costs (above the base for setting the support) is covered by the applicant from his own sources. When decreasing the base for setting the support the % share remains unchanged.
- The project will be realized in accordance with submitted documentation.
- The loan guarantee is provided for individual loan and interest rate payments only, excluding sanctions because of the failure to meet a loan agreement.
- To conclude a written contract between the fund and the applicant it is necessary to submit all the documents mentioned in Appendix No. 3a of the Directive of the Ministry of the Environment of the Czech Republic on providing funds from the Czech State Fund for the Environment.
- The applicant will ensure that the amount of processed waste is increased at least 1,100 t/year.

*Based on this resolution, the Office of the Fund and the realizator under §5, article 3 letter f) of the Statute of the SFZP will conclude a contract which will also include other conditions for providing the support. If the contract is not concluded within five months after the date of the issuance of this resolution, the fund has a right to withdraw from it, by which the validity of this resolution terminates.*

**RESOLUTION**

No. 08689427

on providing support from the State Fund for the Environment of the Czech Republic

According to §1, article 5, law No. 388/91 Coll.  
on the State Fund for the Environment of the Czech Republic

I approve: A loan guarantee in the amount of Kc 17,500,000 (69.7% of the base) (the base for setting the support is Kc 25,113,000)  
For a project: Weir Troubky-R. Smolka, MVE, weir of the river Becva  
Realized in: 1993-1996  
For an applicant: SJUKO s.r.o., Fugnerova 7, Prerov 750 02

Under the following basic conditions:

The total amount of the support set by a % share of the base for setting the support stated in this resolution is a maximum and it will be specified based on the selection of the supplier carried out in accordance with law 199/94 Coll. and concluded supplier's agreements. Potential increase of the specified budgeted costs (above the base for setting the support) is covered by the applicant from his own sources, when decreasing the base for setting the support the % share remains unchanged.

The project will be realized in accordance with the approved documentation.

The applicant will select a supplier in accordance with law No. 199/94 Coll. on public orders.

The applicant will meet the conditions stated in the Resolution on permit to deal with waters and to build water supply related works issued by the region authority in Prerov, department of the environment, dated January 2, 1995, under the Ref. No. ZP/Vod.6000/94-235/1-R-Hk.

Prior to signing a contract with the Fund, the applicant will submit a loan agreement with the financing bank.

SFZP will provide a loan guarantee only during the time of construction until the test operation starts, when the investor undertakes all the obligations given by the loan agreement.

*Based on this resolution, the Office of the Fund and the realizator under the §5, article 3 letter f) of the Statute of the SFZP will conclude a contract which will also include other conditions for providing the support. If the contract is not concluded within five months after the date of the issuance of this resolution, the Fund has a right to withdraw from it, by which the validity of this resolution terminates.*

**RESOLUTION**

No. 01299627

on providing support from the State Fund for the Environment of the Czech Republic

According to §1, article 5, law No. 388/91 Coll.  
on the State Fund for the Environment of the Czech Republic

I approve: A loan guarantee in the amount of Kc 35,000,000, e.g., 97.7% of the base for setting the support, which is Kc 35,000,000  
For a project: Realization of the production of expanding filling materials and products  
Realized in: 1996  
For an applicant: CATRIN market, s.r.o., Tiskarska 10, 108 28 Praha 10-Malesice

Under the following basic conditions:

The total amount of the support set by a % share of the base for setting the support stated in this resolution is a maximum and it will be specified based on the selection of the supplier carried out in accordance with law 199/94 Coll. and concluded supplier's agreements. Potential increase of the specified budgeted costs (above the base for setting the support) is covered by the applicant from his own sources, when decreasing the base for setting the support the % share remains unchanged.

The project will be realized in accordance with the approved documentation.

To conclude a contract between the Fund and the applicant, the applicant will submit concluded contracts on loan and/or leasing with bodies providing other sources of financing.

The applicant will select a supplier in accordance with law No. 199/94 Coll. on public orders.

To conclude a written contract between the Fund and the applicant, it is necessary to submit the documents mentioned in Appendix No. 3a of the Directive of the Ministry of the Environment of the Czech Republic on funding from the SFZP.

- The production program will be primarily using otherwise non-workable waste materials and recyclates, only in case of demonstrable shortage of such materials alternative raw materials will be used.
- The guarantee of SFZP will be provided for the annuities of the loan, including interest rates for the maximum period of seven years. The time limit will be specified based on the loan contract with the financing bank.

*Based on this resolution, the Office of the Fund and the realizator under the §5, article 3 letter f) of the Statute of the SFZP will conclude a contract which will also include other conditions for providing the support. If the contract is not concluded within five months after the date of the issuance of this resolution, the Fund has a right to withdraw from it, by which the validity of this resolution terminates.*

**RESOLUTION**

No. 03069641

on providing support from the State Fund for the Environment of the Czech Republic

According to §1, article 5, law No. 388/91 Coll.  
on the State Fund for the Environment of the Czech Republic

I approve: A loan guarantee in the amount of Kc 42,000,00, e.g., 60% of the base for setting the support, which is Kc 70,340,000  
For a project: Degassing of dump TKO Praha Dolni Chabry and production of treated natural gas/biogas  
Realized in: 1996  
For an applicant: Ekochab, s.r.o. Praha 8 Dolni Chabry, 184 00

Under the following basic conditions:

The total amount of the support set by a % share of the base for setting the support stated in this resolution is a maximum and it will be specified based on the selection of the supplier carried out in accordance with law 199/94 Coll. and concluded supplier's agreements. Potential increase of the specified budgeted costs (above the base for setting the support) is covered by the applicant from his own sources, when decreasing the base for setting the support the % share remains unchanged.

The project will be realized in accordance with the approved documentation.

The applicant will select a supplier in accordance to law No. 199/94 Coll. on public orders.

To conclude a written contract between the Fund and the applicant, it is necessary to submit the documents mentioned in Appendix No. 3a of the Directive of the Ministry of the Environment of the Czech Republic on funding from the SFZP.

The loan guarantee will be provided for the annuity of the loan, until the realization of the approval decision.

The realization of the measure will reduce the emission load of the hydrocarbons from the dump by 6,000 t/year by 2006.

*Based on this resolution, the Office of the Fund and the realizator under the §5, article 3 letter f) of the Statute of the SFZP will conclude a contract which will also include other conditions for providing the support. If the contract is not concluded within five months after the date of the issuance of this resolution, the Fund has a right to withdraw from it, by which the validity of this resolution terminates.*