



October 2006

Managing Corporate Debt

From Risk Management Perspective

Podravka case study

**Euromoney Conference
Dubrovnik**

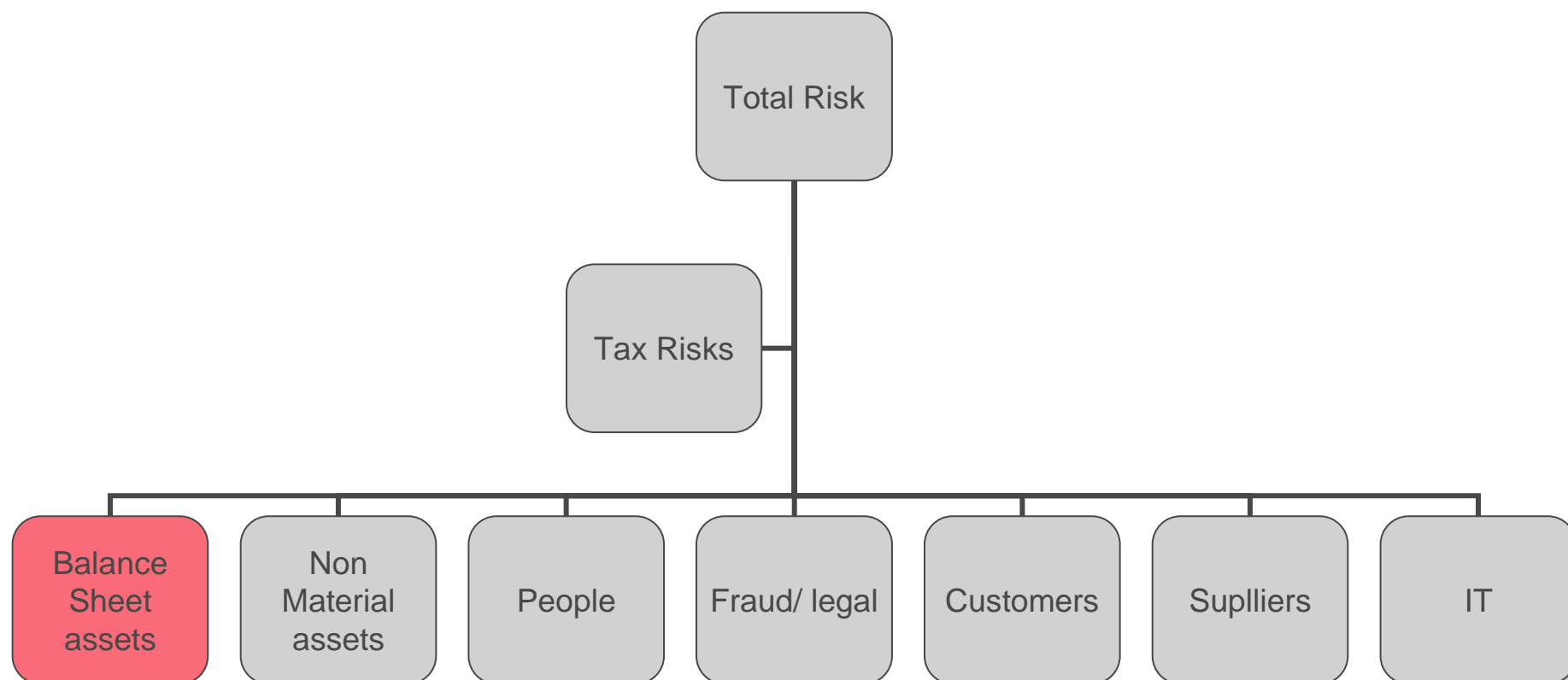
Euromoney Conference 2006

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AGENDA

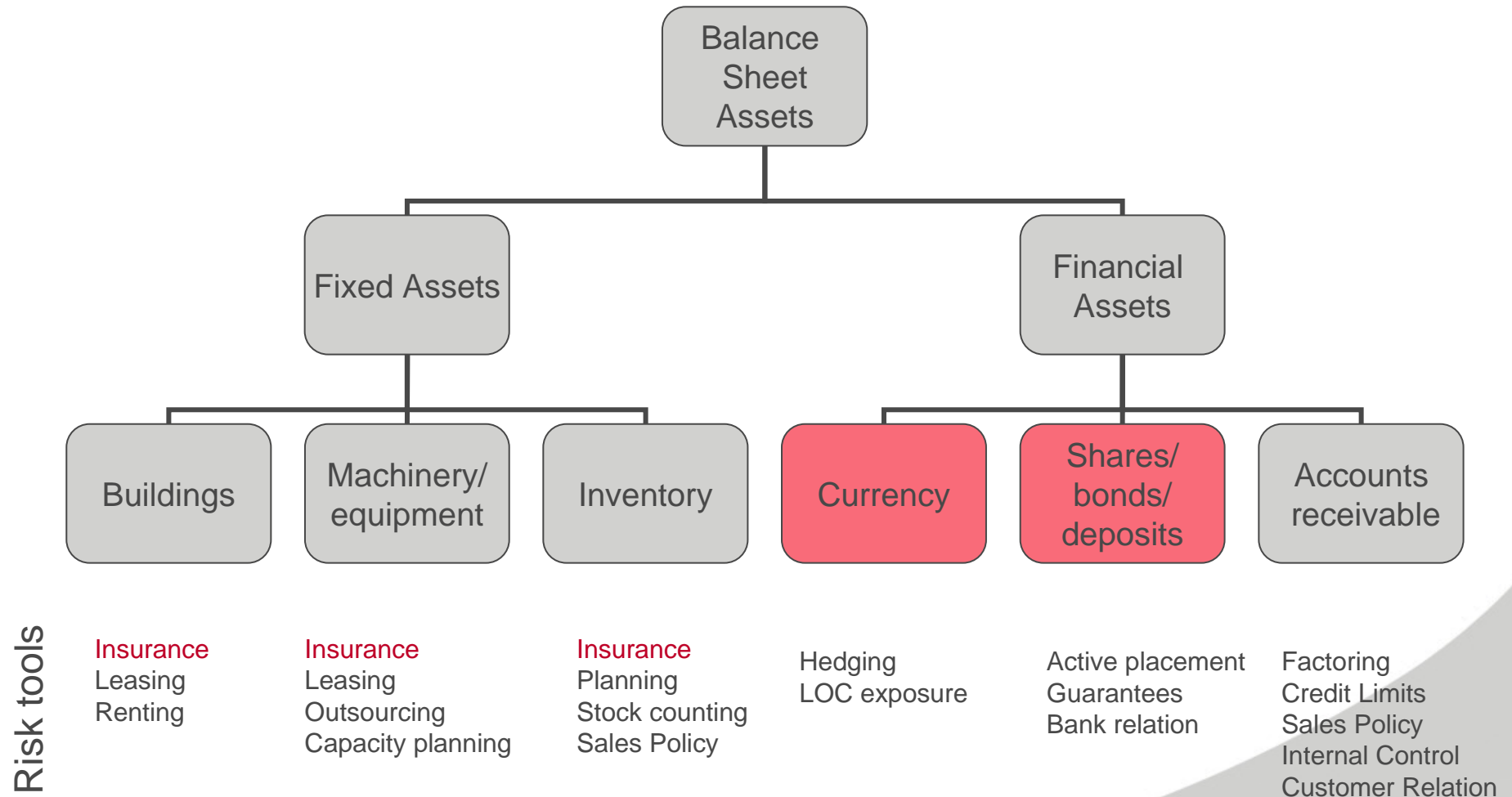
- 1 Debt structure- which type of risk?
- 2 Podravka situation
- 3 Ideas on reducing risks
- 4 Implementation

DEBT STRUCTURE- WHICH TYPE OF RISK?



Debt structure and its risks are part of Balance Sheet related risks

Balance Sheet Asset risks Finance



Debt – which type of risk identified

- **Currency related**
 - In which currency will we have risks and why?
- **Liquidity related**
 - Duration time of the debt – does it matter and why?
- **Collateral related**
 - Which type of debt needs which type of collaterals – does it matter from the risk perspective?

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CREDIT SITUATION ANALYSIS

Q4 2005

in thousand HRK

Type of credit	31/12/2004	Avg Interest 31/12/2004	31/12/2005	Avg Interest 31/12/2005/	Portion 31/12/2004	Portion 31/12/2005
Long Term	602,471	4.16%	486,950	4.16%	64.60%	59.60%
Bonds	207,123	5.00%	199,142	5.00%	22.21%	24.38%
Short term	122,997	5.23%	130,856	4.24%	13.19%	16.02%
Total	932,591	4.50%	816,948	4.37%	100.0%	100.0%

Expiry date:

2006 – HRK 200 mln

2007 – HRK 383 mln

Currency structure of total debt:

70% EUR

20% HRK

10% other local

What were the issues?

- Expiry dates - big portion of the debts were due to expire within the next 24 months
- Very high EUR related debts
- The debts in total were going down – what future needs did we have?
- Currency exposure – could we minimize it?
- Interest rates – movement in which direction?

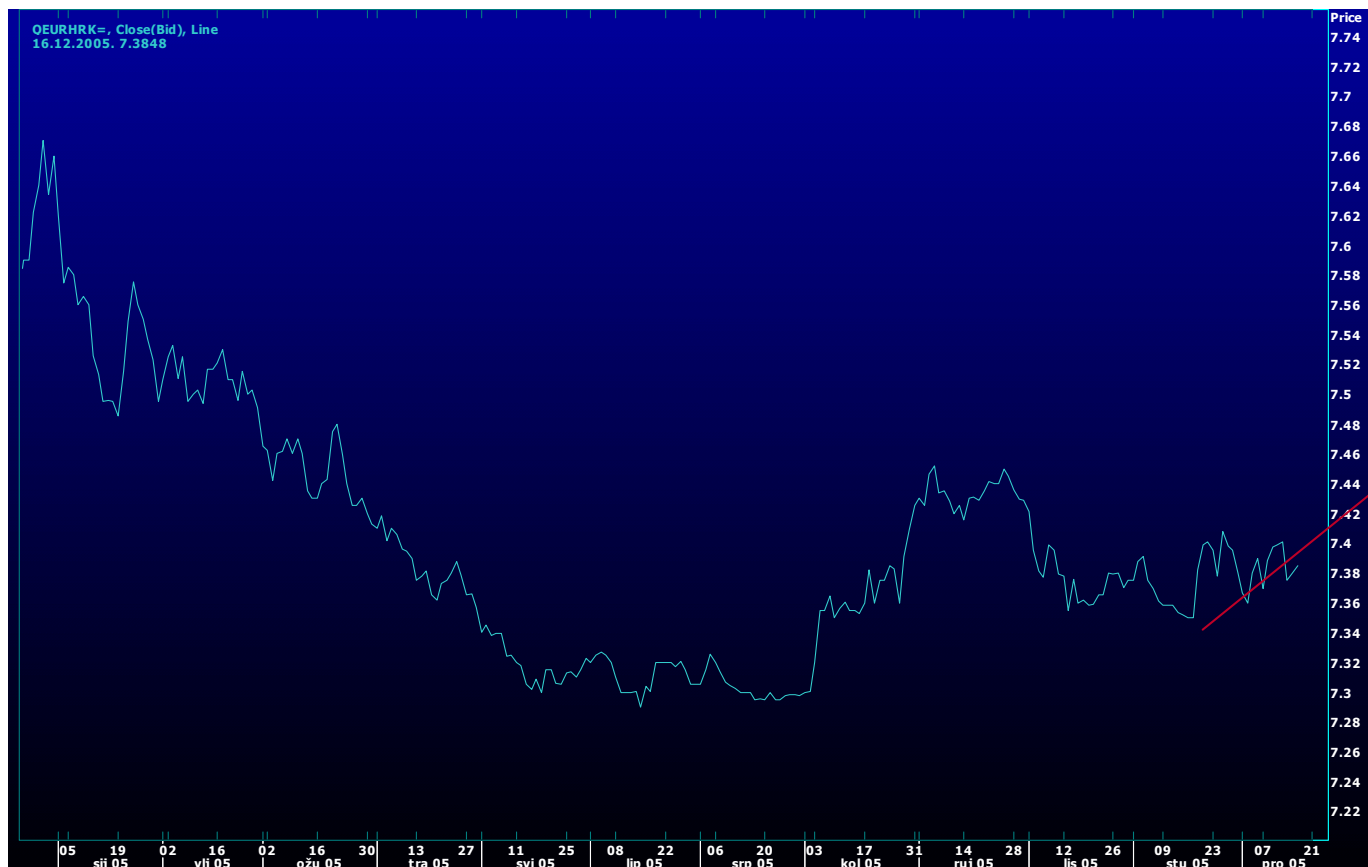
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What to do?

- Meetings with banks to scan the credit possibilities
 - Loans
 - Bonds
 - Other
- Analysis on currency movements
- Internal strategic discussion on credit needs in the future
- Interest rates analysis

Movement EUR/HRK in 2005



Forecast
Q4 2006

If EUR/HRK
7.50 =>
impact on
Podravka
- HRK 10
mln

Forecast EUR/KN 31/12/2006 by banks

PBZ	7.55
RBA	7.45
ZABA	7.45 – 7.50

6 mnth EURIBOR in 2005 in upward movement



Forecast EURIBOR end 2006

1 year Forecast => Min Fin T-Bill – 4.75%

PBZ/Intessa 2.80% - 3.00%

ZABA/Hvb Unicredito 3.00%

RBA 3.00%

Movements USD & EUR LIBOR in the period 1999 – 2005

Expected EURIBOR movement 3.00% to 3.50% - will move Podravka's variable credit costs from 4.30% to 4.80%



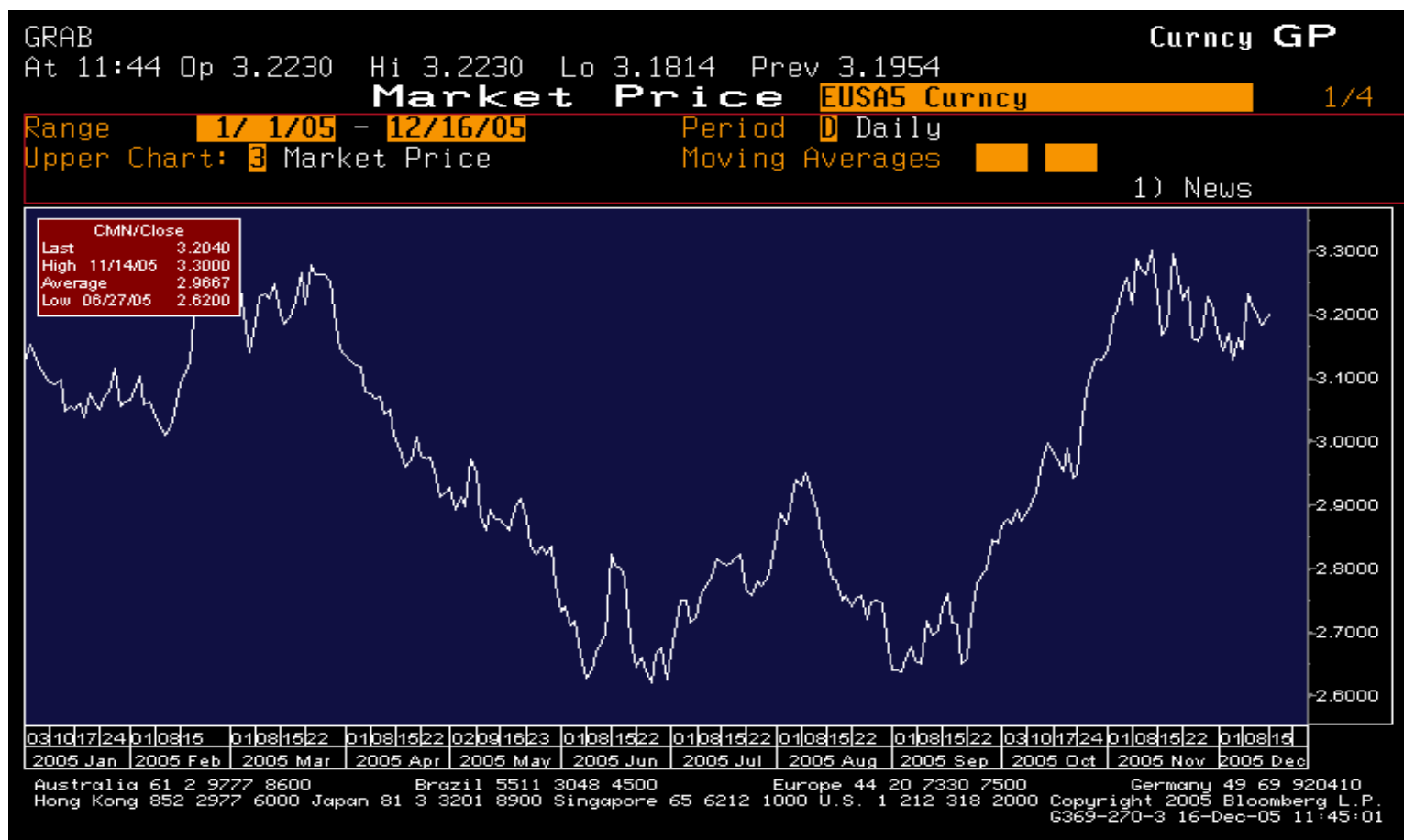
USD LIBOR increase in 2005 1.00% - 4.50%

EUR LIBOR increase in 2005 2.00 – 2.25%

Will EUR once again follow USD??

5 year movement in SWAP 2005 interest rate

Interest on 5 year EUR syndicated credit will be about 4.50% (3.00% + 1.30 margin) => 0.30 - 0.50% less than target interest on HRK bonds



Which answers?

- Credit possibilities
 - Market for HRK bonds opens up as investors look for HRK
 - All types of loans available
- Currency movements
 - HRK-EUR favourable situation at hand and expected to stay during first half year of 2006
- Interest rates
 - HRK interest rates still low and expected to stay low until early summer
 - EUR rates to increase and align towards USD levels with early spring/summer 2006
- Internal needs
 - Should free cash be available for investment
- The market was interested in HRK papers

Analysis made - Scenarios on what to do?

	STATUS QUO	Bond – EUR 50 mln or EUR credit	Bond – HRK 375 mln	Short term credits – EUR 50 mln
Currency rate costs	HRK 10 mln	HRK 10 mln	HRK 4.5 mln (buy back costs)	HRK 6.0 – 10 mln
Expiry dates	2006 – HRK 200 mln 2007 – HRK 383 mln	2006 – HRK 200 mln 2007 – HRK 28 mln	2006 – HRK 200 mln 2007 – HRK 28 mln	2006 – HRK 200 mln 2007 – HRK 383 mln
Interest cost - variable	HRK 2 mln (380x0.6%)	HRK 1 – 2 mln	HRK 1 – 2 mln	+ 1.5 + 2.5
Interest cost - fixed	0	HRK 0 – 1 mln	HRK 0 – 1 mln	0

Proposals from Finance - Go for HRK 5 year bond and buy back the EUR bonds that expire 2007

- Costs
 - Higher than normal credits but acceptable
- Interests
 - Wanted fixed as we expected increase in rates in the future HRK rates
 - Spread towards EUR continuously low
- Currency risk
 - Exploit the favourable EUR/HRK rate and convert EUR risks to HRK
- Liquidity/Maturity
 - With 375 MHRK bullet bond we move the 27 MEUR -2007 issue in time and can refinance other credits to get business cash flows free for investments
- Collaterals
 - With bonds no asset collaterals needed so we could free cash from assets if we should sell them
- Marketing
 - We could be the first on the market with HRK bond and that we expect would give positive publicity and favourable pricing

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Implementation

- Management Board approval (December 2005)
- Signed mandate letters with 3 banks with clearly defined targets which was important for us related to (January 2006)
 - Targeted buy back volumes
 - Targeted interest rates
- Secure the paper work (March - April 2006 - but had to be adopted due to HANFA requests –not Q3 2005 but full year 2006 figures)
- Road show to explain the existing bond holders about the new issue and to new bond holders about the potential they should expect (April 2006)
- Discussions with SDA about the logic of the procedures – first time HRK bond and also first time a premature buy back of old bonds (April 2006)
- Investment day with presentation of the terms (May 2006)
- Closure of the bond (May 2006)

Results

- Target date was April but it became delayed to Mid May mainly due to the request to have full year audit report instead as planned Q3 financial report in the prospect – HANFA rules
- Costs to HANFA increase from 50 KHRK to 350 KHRK under new price list
- The whole issue was sold without problem – interest rate 5.125% slightly above targeted 5%
- Buy back of 99% of old bonds – targeted 75-90%
- We were the first on the market with HRK bonds
- Currency exposure drastically reduced
- Fixed interest rates 5 years ahead
- The future business cash flows free for investments as maturity of big part of credit moved to 2011