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April 28, 2004

Streamlined Procedure
Closing Date: Friday, May 7, 2004

FROM: Vice President and Corporate Secretary

Philippines

Proposed Investment in Manila Water Company

1. Attached is a project summary for an investment by IFC in the form of an "A" loan of up to US$30 million equivalent for the account of IFC and an equity investment of up to US$15 million equivalent in Manila Water Company.

2. This project was first reported to the Board as a New Item in the February 2004 Monthly Operations Report (IFC/SecM2004-0023). The ERS and SPI for the project were sent to the InfoShop on March 30, 2004.

3. In the absence of a request from a Director (to be notified to the Vice President and Corporate Secretary by the close of business on **May 7, 2004**) for the project to be discussed in the Board, IFC management will be authorized to proceed with the proposed investment.

4. Questions on this document should be referred to Ms. Larrea (Ext. 85813) or Mr. Sheng (Ext. 33679).

Distribution:

Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC and MIGA

International Finance Corporation

Project Summary

Vice President:	Assaad J. Jabre
Industry Director:	Francisco Tourreilles
Regional Director:	Javed Hamid
Industry Manager:	Usha Rao-Monari
Project Team:	
Investment Officers:	Joan Midthun Larrea / Michael Lin Sheng
Relationship Officer:	Jesse Ang
Regional Representative:	Vipul Bhagat
Engineer:	Ahmed Shaukat
Lawyer:	Caroline Kahn
Credit Officer:	Eduardo Abello
Environmental and Social Specialist:	Stephen Bailey
Economist:	Mario Marchesini/Peter Law
Insurance Officer:	Jan Mumenthaler
Team Assistant:	Katherine de Vera

Country:	*Project:*	*Date:*
Philippines	Manila Water Company II (MWC II) Project No. 22621	April 26, 2004

Exchange Rate:

US$1.0 = 56.33 Philippine Pesos ("PHP") as of March 1, 2004

Project Description and Concept:

The Project comprises a corporate loan of up to US$30 million equivalent to and an equity investment of up to US$15 million equivalent in Manila Water Company, Inc. ("MWCI" or the "Company"), to finance its 2004-2007 business plan (the "Business Plan") and support its planned initial public offering to be launched in 2005 (the "IPO").

The Business Plan is estimated at US$292 million equivalent. It will focus on non-revenue water ("NRW") reduction, pipeline extensions and network improvements, expansion into new areas within MWCI's concession area (including underserved poor neighborhoods in urban areas and customers in peri-urban areas beyond the existing network), development of deepwells, and development of sanitation services. The Business Plan also includes the financing of concession fees paid by MWCI to the conceding authority, the Metropolitan Waterworks and Sewerage System ("MWSS") to cover a portion of MWSS's debt to multilaterals (including IBRD).

In recognition of the growing partnership between IFC and MWCI, the Company has asked IFC to lend its support to the Company's planned IPO. The IPO has been in planning since 1999, when MWCI registered its first profits. If successful, it would represent a major success story not only for the Philippines' strategy of opening up its infrastructure sector to private participation but also to the water sector as a whole. MWCI and its shareholders believe that IFC's entry as a shareholder before the flotation would be important because of the alignment of interests between IFC and MWCI on sustainability issues, the value that IFC provides on corporate governance issues, and the signal of quality that IFC's presence would send to the market.

MWCI is the water and wastewater concessionaire for the Metro Manila East service area, serving approximately five million people. MWCI's concession was awarded as part of the privatization of MWSS launched in 1997 to address chronic problems in the Metro Manila water system, including low pressure, intermittent supply and NRW estimated at 60 percent, the highest in the region. The privatization, in which IFC's then Corporate Financial Services Department acted as the adviser, divided MWSS' operations into East and West service zones. Concessions for the two zones were awarded on the basis of international competitive tenders. MWCI was awarded the East Zone and the award for the West Zone was granted to Maynilad Water Services, Inc. ("Maynilad"), a consortium consisting of Benpres of the Philippines and Suez Environment of France (formerly Suez Lyonnaise des Eaux).

The concession for the East Zone is a 25-year lease of right, with MWSS as lessor and MWCI as lessee, giving MWCI the right to manage, operate, repair, decommission and refurbish MWSS's water supply and sewerage facilities, including the right to bill and collect for water and wastewater services. Since taking over, MWCI has made significant improvements in operations, turning the water utility from a loss making entity into an efficient and profitable private enterprise. In particular, it has been able to expand coverage at a higher than historical rate, achieve significant improvements in water quality and availability, apply innovative approaches to sewerage and sanitation expansion, achieve significant reductions in NRW and improve other key operational efficiency parameters. MWCI has also implemented an internationally-acclaimed approach to providing services to lower income neighborhoods – known as the "Tubig Para Sa Barangay" ("TPSB" or "Water for the Poor") program.

Proposed IFC Investment:

This is a proposed second IFC investment in MWCI, consisting of an IFC corporate loan of up to US$30 million equivalent and an equity investment of up to US$15 million equivalent in advance of MWCI's planned IPO in 2005. The proposed IFC loan consists of a regular tranche of up to US$20 million and a standby tranche of up to US$10 million, both with maturities up to 2018. On the equity investment, IFC will have the right to put its shares to MWCI in the absence of an IPO satisfactory to IFC.

World Bank Group Strategy and IFC's Role:

The World Bank/IFC 2003-2005 Country Assistance Strategy ("CAS") for the Philippines is intended to support the Government of Philippines's ("GOP") own national economic agenda, documented in the 1999-2004 Medium Term Development Plan ("MTDP"). Both the CAS and the MTDP identify increasing the supply of potable water as an objective. IBRD has committed through the CAS to support the efficient provision of basic services such as water supply and sanitation. The CAS foresees a most likely IBRD lending program of about $1.1 billion over the three-year period of FY2003-05, including three to four public sector investment operations a year and two adjustment operations, provided that the policy reforms and portfolio management measures proceed as planned. IBRD's activities include a series of investments in wastewater in the Metro Manila area. The IFC strategy includes the support of viable projects and strengthening of regulatory frameworks necessary to enhance internal competition in infrastructure sectors.

The IFC investments in MWCI will support a company that has gained a good track record as a low cost service provider, operating in the context of a regulated concession. As such, MWCI has established itself as a benchmark for an efficiently run water utility in the region. IFC's assistance to MWCI builds upon the earlier IFC privatization advisory work by supporting a concessionaire who has demonstrated the efficiencies and client responsiveness that a private sector operator can introduce to the provision of water services. IFC's support to this successful private water concessionaire sends a positive signal to the market and to other governments considering water privatizations.

In addition to debt, the sponsors believe that completing an equity financing with IFC would substantially enhance the attractiveness of the Company in its efforts to undertake the IPO in 2005. MWCI sees a partnership with IFC as a means to strengthen its sustainability and corporate governance efforts towards the IPO, after which the Company will be entering a stage characterized by more visibility and accountability to a broader range of stakeholders.

Economic Considerations and Development Impact:

Country context

Despite lackluster exports and sluggish investment, GDP grew by 4.5% in the Philippines in 2003, driven by a robust agriculture sector and strong overseas workers' remittances. Average inflation for the year was comfortably below the range targeted by the government, and allowed the Central Bank to hold interest rates steady. However, the budget deficit remained large in 2003 at an estimated 4.6% of GDP, whereas consolidated public sector debt hovers around 120% of GDP. Concerns over the fiscal deficit and rising debt levels prompted Moody's to downgrade the government's foreign and local debt ratings in January 2004. These concerns, taken together with the uncertainty surrounding the forthcoming elections, have resulted in a sharp decline in the exchange rate which has underperformed the weakening dollar and dropped to record lows in excess of PHP 56:US$1.

Development Impact

The project will support MWCI's 2004-2007 capital expenditure program, with the main objectives including reduction of NRW, expansion of services to include underserved poor neighborhoods in urban and peri-urban areas beyond the existing network, and improvement in the availability and quality of water supply through network upgrade and pipeline extensions. The economic rate of return of the project is estimated at 20%, based on the investment program's incremental benefits and costs. The program's benefits include the cost savings, notably in water treatment costs, owing to the expected reduction in technical losses and the net welfare gain resulting from the planned expansion in service coverage to low income neighborhoods.

The project will have a particularly beneficial impact for poorer communities, where, under its TPSB program, MWCI will expand the access of piped water to lower income households at an affordable price. The program has benefited some 600,000 consumers since its inception in 1998, and will be substantially expanded under the IFC project to connect many more poor households. Service expansion to low-income neighborhoods directly contributes to poverty reduction, as consumers have to cope with lack of access by buying expensive inferior substitutes to network access. Private vendors sell water at a price as high as PHP100 per cubic meter in areas where the utility's network does not reach, approximately 10 times higher than MWCI's tariffs. The program also fosters a sense of community responsibility for the water system, in that MWCI helps the neighborhoods form water cooperatives to manage their own water supply. These neighborhood associations allow poor families to share the cost and use of meters, receive a regular supply of fully treated, safe drinking water, and police against illegal connections. Although difficult to quantify, the planned expansion of the TPSB program is also expected to contribute to lowering the occurrence of waterborne diseases, which are often found in communities reliant on sub-standard or contaminated water supplies. Finally, further improvements in service reliability resulting from the investment program would benefit all consumers, as it would reduce the need to spend resources on back-up arrangements, such as water storage facilities.

Going forward, IFC will monitor the Project's development impact by tracking: (i) the number of urban poor with access to improved water supply and sanitation services, (ii) the reduction in NRW, and (iii) the performance and efficiency gains as shown by indicators reported to the regulator.

Sponsors and Ownership Structure:

MWCI's current shareholding structure is shown in the following table:

MWCI's Shareholding Structure

Shareholders	Ownership
Ayala Corp.	51.1%
United Utilities B.V.	19.9%
BPI Capital	11.4%
Mitsubishi Corp.	11.4%
Employees	6.3%
Total	100.0%

Ayala Corporation is the largest shareholder with equity interests of 51.1% (including an indirect shareholding of 8.5% through a special purpose vehicle). Ayala Corporation is one of the oldest business conglomerates in the Philippines with operations in real estate, electronics, utilities, the automotive sector, banking, insurance, telecommunications, transportation, and food. For the first half of 2003, Ayala Corporation reported US$258 million in revenues and US$26 million in net income. Ayala Corporation effectively controls day-to-day operations of MWCI.

Bank of Philippines Islands Capital Corporation ("BPI Capital"), also a Philippine company, owns 11.4% equity interest in MWCI. BPI Capital is the merchant banking arm of Bank of the Philippine Islands ("BPI"), the country's second-largest financial institution. Ayala holds a 47% controlling equity share in BPI.

United Utilities B.V. (the Netherlands) ("UUBV") holds a direct 19.9% equity interest in MWCI. UUBV is a subsidiary of United Utilities ("UU"). UU, a listed UK company, provides water, sewerage, energy and electricity services to over 28 million people worldwide. Preliminary results for the year ending March 2003 show revenues of US$3 billion and net income of US$429 million.

Mitsubishi Corporation (Japan) ("Mitsubishi") is an 11.4% shareholder. Mitsubishi is a trading company and investor in more than 600 companies dealing in chemicals, information systems, metals, fuels, machinery, foods, textiles and general merchandise. Mitsubishi's consolidated revenues and net income for the year ending March 2003 were US$109 billion and US$444 million respectively.

MWCI has instituted an Employee Stock Ownership Program under which employees will acquire 6.3% of the equity.

Operating and Financial Performance

In the first six-and-a-half years of operational life, MWCI has made significant improvements on both efficiency and service grounds since taking over, as shown in the table below.

MWCI Key Operational Parameters

	1997	1998	1999	2000	2001	2002	2003
NRW	58%	49%	51%	51%	53%	54%	52%(a)
Billed Volume (MLD(c))	440	515	613	683	733	747	756 (b)
Households Connected ('000)	325	340	390	409	428	441	515
Population Served (millions)	3.00	3.10	3.60	3.76	3.96	4.05	4.70
Continuity of Supply	26%	NA	NA	NA	55%	83%	83%
Employee/1000 Connections	6.30	5.10	4.75	3.80	3.60	3.20	2.90

Notes: (a) : MWCI reported 50.7% NRW in December 2003. 52% is the yearly average NRW for 2003.
(b) : Yearly average. The billed volume as of end of December 2003 was 767 MLD.
(c) : MLD stands for "million liter per day".

Despite the combined effects of the Asian financial crisis in 1997, a severe drought caused by El Niño in 1998, and an uncertain regulatory environment, the Company became profitable within two years after taking over the concession. Since then, its performance has improved steadily year on year, with revenues growing by 20% and net income by 85% per year on average in U.S.

dollar terms. In 2003 alone, net income more than doubled that of 2002. The following table summarizes MWCI's financial performance between 1997 and 2003:

MWCI Key Financial Parameters
US$ Millions

	1997	1998	1999	2000	2001	2002	2003
Revenues	14.0	24.2	33.4	32.4	32.5	51.9	69.5
EBITDA*	(1.2)	(1.4)	6.9	6.3	6.0	19.9	36.1
Net Income	(1.3)	(1.6)	2.5	2.8	3.5	10.7	21.2
Total Assets	50.3	61.8	85.2	102.1	113.5	152.8	182.8
Long-term Debt	-	-	20.5	41.4	46.9	71.0	85.1
Equity	34.3	50.4	53.3	49.6	48.7	54.0	67.0
Long Term Debt/Equity Ratio	N/A	N/A	0.4	0.8	1.0	1.3	1.3
Long Term DSCR	N/A	N/A	N/A	3.8	2.1	5.1	3.7

Note: * EBITDA stands for earnings before interest, taxes, depreciation and amortization.

Financial Projections:

The financial projections for the years 2003 to 2019 are summarized in the table below. MWCI's financial performance is robust over the projection period, with revenues, EBITDA and net income rising steadily, reflecting a combination of increased coverage, tariff increases and increased consumption. Net income is projected to decline in 2006 due to the expiration of a tax holiday in that year, but builds up steadily again thereafter. The minimum Debt Service Coverage Ratio (DSCR) is 1.3 in 2007.

MWCI Summary Base Case Financial Projections for Selected Years 2003-2019
US$ millions

	2003	2004	2005	2006	2007	2010	2013	2016	2019
Gross Revenues	69.5	70.0	93.0	100.4	104.5	145.8	167.5	217.6	263.1
EBITDA	36.1	38.5	59.7	65.3	69.1	105.2	123.2	168.9	209.1
Net Income	21.2	24.5	37.6	28.9	28.3	45.1	50.2	74.6	90.9
Total Assets	182.8	217.0	294.7	326.4	364.4	468.2	475.2	438.8	418.2
Long Term Debt	85.1	115.3	106.0	113.8	132.3	129.9	96.2	48.1	6.6
Equity	67.0	78.9	109.4	130.6	149.6	245.2	238.4	232.3	229.6
Long Term Debt/Equity Ratio	1.3	1.4	0.6	0.6	0.6	0.4	0.3	0.2	0.0
Long Term DSCR	3.7	2.9	2.4	1.4	1.3	2.0	2.6	4.3	6.3

Environmental and Social Considerations:

This is a category B project according to IFC's environmental and social review procedure. MWCI has presented plans to address the major environmental and social issues associated with the project that relate to sustainability of water resources and potable water quality, wastewater management and water quality impacts, sludge management, land acquisition and resettlement and community development, and has demonstrated that the proposed project substantially complies with applicable Philippine laws and regulations and World Bank requirements. The Company also continues to make progress on implementing the agreed Environmental and Social Action Plan for the original investment. Appropriate internal policies and procedures are being followed, and a number of new initiatives that demonstrate environmental and social responsibility are being developed.

Sustainability of Water Resources

Additional water to meet the obligations of the concession will come from redistribution of the allocations from the existing sources, provision of new sources outside the present catchment areas by constructing new groundwater wells and new water treatment plants, and the continuing reduction in non-revenue water.

Wastewater Management

Supported by funding from the World Bank and the Asian Development Bank, the sanitation strategy for Metro Manila and the MWCI concession is to radically expand the septage management program in concert with the rehabilitation and new construction of small conventional sewage treatment plants serving medium and high-rise housing establishments. Following this strategy, MWCI will expand its sanitation services so that all cities and municipalities in the concession area will be 100% covered with either sewerage and/or sanitation.

To help conserve clean water resources, MWCI is exploring the potential for re-use of treated effluent for irrigation purposes within the city. The Company is proposing that the effluent be transported by municipal tanker trucks to irrigate landscaped areas in the Makati area.

Resettlement

Owing to its obligations to expand water and sanitation services by constructing new pipelines, MWCI occasionally has been faced with having to temporarily or permanently displace residents or businesses from construction rights-of-way. Given the complexities (i.e., time and resource demands) involved in relocating legal and illegal residents, the company tries to avoid using occupied land wherever possible. As part of the upcoming "Right-of-Way" scheme planned for 2004, MWCI proposes to relocate some 1,200 squatter households from pipeline rights-of-way. In future years, MWCI expects more relocations to be needed as further capital programs are implemented. IFC, therefore, has asked that MWCI adopt a more comprehensive "Framework for Resettlement" based on IFC's Operational Directive 4.30, Involuntary Resettlement.

Issues and Risks:

Macroeconomic and Country Risks

The Company has already gained an outstanding track record in operating the business successfully under the Concession. Despite this, going forward the Company is susceptible to significant macroeconomic and country risks. The economic outlook for the Philippines remains clouded by the uncertainty surrounding the forthcoming presidential and parliamentary elections. The high level of public sector debt, the weakening peso, and low business confidence are all areas of concern.

Raw Water Availability

Until such time as alternative sources are developed, MWCI is relying on the Angat Dam/La Mesa reservoir system, which lies to the northeast of Manila, for 1,600 million liter per day ("MLD"), which represents 97% of its raw water supply. While the supply from Angat is sufficient for the short to medium term and is considered secure, there are events (drought, change in dam ownership, physical deterioration and earthquakes) that in the extreme could threaten this source. Outside of such dire circumstances, however, given the political and social sensitivity associated with providing water to Metro Manila, it is unlikely that the supply of raw water to MWCI would be reduced. Future raw water projects to be undertaken by MWSS that would benefit the MWCI concession are expected to include the Wawa Dam, the Angat Optimization and the Laiban Dam. The first two are expected to be operational by 2006 and 2008 respectively, while Laiban is expected to be operational in 2013. MWCI anticipates receiving 1,150 MLD of additional volume from these projects. In the interim, MWC1's NRW reduction program mitigates the risk of limited raw water availability.

Regulatory Risk

MWCI is substantially susceptible to regulatory risks. Its concession is regulated by the MWSS Regulatory Office ("MWSS-RO"), formed as part of the privatization of MWSS. MWSS-RO is not a fully independent entity and this weakness could result in overt political intervention against MWCI's interests or poor management of future rounds of scheduled rate rebasings. In addition, the Metro Manila West Concession is not operating successfully and is in the process of reverting to MWSS' control, introducing additional risks and uncertainties for MWCI.

MIS | International Finance Corporation | As Of: 03/31/2004

(Updated Monthly)

Statement of IFC's Committed and Outstanding Portfolio

Amounts in US Dollar Millions

Country: Philippines

Approval Fiscal Year	Institution Short Name	Loan Cmtd-IFC	Equity Cmtd-IFC	QL+QE Cmtd-IFC	All Cmtd-Part	Loan Out-IFC	Equity Out-IFC	QL+QE Out-IFC	All Out-Part
2001	AEI	1.00	0	0	0	0.75	0	0	0
2001/2002	APW Trade	0	1.00	0.69	0	0	1.00	0.69	0
2003	Alaska Milk	0	0.62	0	0	0	0.62	0	0
1996	All Asia Growth	0	0.00	0	0	0	0.00	0	0
1996	AllAsiaVen Mgmt	0	0.00	0	0	0	0.00	0	0
2000	Asian Hospital	7.00	0	0	0	5.00	0	0	0
2002	Banco de Oro	0	0	20.00	0	0	0	20.00	0
1997	Bataan P/E	26.28	0	8.36	102.83	26.28	0	8.36	102.83
1998	Drysdale Food	9.96	0	0	5.87	9.96	0	0	5.87
2002	Eastwood	20.00	0	0	0	20.00	0	0	0
2001	Filinvest	22.00	0	0	0	16.00	0	0	0
1998	H&Q PV-III	0	5.76	0	0	0	5.76	0	0
1989	H&QPV-I	0	0.59	0	0	0	0.59	0	0
1993	H&QPV-II	0	1.11	0	0	0	1.11	0	0
2000	MFI MEP	0	0.12	0	0	0	0.12	0	0
2001	MNTC	46.00	0	0	0	29.98	0	0	0
2003	MWC	33.99	0	0	0	0	0	0	0
1970/1972/2000	Mariwasa	11.91	0	3.12	0	11.91	0	3.12	0
1993	Mindanao Power	0	4.26	0	0	0	4.26	0	0
1993	Mirant Pagbilao	18.00	10.00	0	0	18.00	10.00	0	0
2002	PSMT Philippines	12.50	0	0	0	10.20	0	0	0
1992	Pilipinas Shell	0	1.56	0	0	0	1.56	0	0
2000	PlantersBank	0	0	8.71	0	0	0	8.71	0
1998	Pryce Gases	13.00	0	0	5.00	13.00	0	0	5.00
2000	SME.COM	0	0.00	0	0	0	0.00	0	0
2000	STRADCOM	11.99	0	8.00	0	9.59	0	8.00	0
2003	SVI	0	4.00	0	0	0	2.00	0	0
1995	Sual Power	23.73	17.50	0	83.27	23.73	17.50	0	83.27
1992	Union Cement	0	5.63	0	0	0	5.63	0	0
1994	Walden Mgmt	0	0.05	0	0	0	0.05	0	0
1994	Walden Ventures	0	0.83	0	0	0	0.83	0	0
Total Portfolio:		257.37	53.02	48.88	196.96	194.41	51.02	48.88	196.96

"IFC's Lender of Record (LOR) exposure to a country is defined as the sum of disbursed IFC loans for its own account (including quasi-equity loans) and syndicated loans under the B-loan program. IFC's LOR exposure in the Philippines as of the end of March 2004, was US$423.5 million and is equivalent to 0.8% of the Philippines's total long-term external debt."