Report of the Board of Directors

Mission and strategy

Finnfund, formally the Finnish Fund for Industrial Cooperation Ltd, is a development finance company in which the Finnish government has a majority holding; it belongs to the administrative sector of the Ministry for Foreign Affairs and has a special development policy mission. The mission of the company is to promote economic and social development in target countries by providing financing for private sector projects involving Finnish interests. Finnfund provides long-term risk capital to complement funding obtained from the financial markets, and operates on a self-supporting basis. Finnfund targets financing at low-income and lower-middle-income developing countries, builds bridges between Finnish expertise and development needs, and augments the developmental impacts of investments catalysed by Finnfund.

In 2014, Finnfund focused on balanced growth and risk management. In a situation where long-term equity investments in proportion to the company's assets were growing as a result of decisions made, the project preparation focus has shifted to financing in the form of loans with a quicker turnaround. Besides investments requiring active participation, projects were sought that would allow better risk diversification and cost-efficiency through cooperation between financing providers. Regardless of Finnfund's role in any given project, the key requirement is the generation of a positive development impact in the target countries.

Funding and investments

The volume of financing activities continued to grow on the previous year, and cooperation with the business sector intensified, with Finnish companies participating in several projects as technology suppliers or partners. Most of Finnfund's funding was allocated to projects with excellent development impact potential and a positive effect on climate change, particularly in the renewable energy and forestry sectors.

In 2014, 23 new financing decisions (20 in 2013) were made in 25 projects, amounting to a total of EUR 115 million (EUR 90 million). Both the number of projects and their average size grew from the previous year. Calculated in euros, growth on the previous year can be regarded as considerable.

The targeting of financing decisions made in 2014 at various income levels is shown in the table below.

Income level	number	%	EUR million	%
Least development countries	7	30	41.9	36
Low-income countries	2	9	6.9	6
Lower-middle-income countries	8	35	38.6	33
Upper-middle-income countries	5	22	26.0	23
Russia	1	4	2.0	2
Total	**23**	**100**	**115.4**	**100**

Most of the 16 (9) financing decisions were for investment loans, which accounted for three quarters of the value of decisions in euros. This trend was intentional and reflects the current situation, in which the amount of Finnfund's equity is beginning to limit its opportunities to make equity investments. According to Finnfund's risk management principles, equity investments must be covered from Finnfund's shareholders' equity.

Eight (9) of the projects that were approved were equity investments or mezzanine financing that, when calculated according to their value in euros, accounted for just 16 per cent whereas the year before they represented more than half of all commitments made. The number of fund investment decisions decreased as planned, and only one was made compared to two the year before.

Both in terms of the number and value of the financing decisions made, Africa was the leading continent with 11 (7) decisions representing 49 per cent (60 per cent) of the total value in euros. Asia was next with 7 (9) decisions. The value of decisions was lower for Asia than Africa: 16 per cent (20 per cent) of the total value in euros. Similarly to last year, China was the most popular individual country, with three (four) financing decisions of relatively low monetary value allocated to the country.

One decision was allocated to Jordan, exceptionally for three different projects.

The volume of disbursements grew to EUR 73 million from EUR 34 million, representing a historic high for Finnfund. In addition to the previous year's disbursements, projects for which a decision was made in 2014 were also included.

Of this amount, EUR 37 million (EUR 23 million) was allocated to low-income countries or the least developed countries, EUR 16 million (EUR 7 million) to lower-middle income countries, EUR 13 million (EUR 2 million) to upper-middle income countries, and EUR 7 million (EUR 1.5 million) to Russia.

Finnfund is actively involved in European Financing Partners (EFP), founded in 2004 as a joint financing venture of European development finance institutions and the European Investment Bank (EIB), and in the Interact Climate Change Facility (ICCF) founded by the same actors and the French development funding provider AFD in 2011. ICCF invests in projects aimed at curbing climate change, such as renewable energy and energy efficiency. In 2014, a decision was made to commit additional funding to the ICCF. This decision was conditional on the transfer of the company's domicile away from Luxembourg, which does not currently meet the OECD criteria on tax transparency.

At the end of 2014, undisbursed commitments totalled EUR 146 million (EUR 97 million). In addition, EUR 75 million (EUR 81 million) were tied up in investment decisions that had not yet progressed to the agreement stage.

Development and priorities

The most significant development project in 2014 involved putting Finnfund's financing policy into a documented format and having this document approved by the Board of Directors. The financing policy now includes all existing written instructions and guidelines, as well as established practices and procedures not previously presented in a single written document.

To facilitate long-term planning, a financial model was created for Finnfund, in order to enable future portfolio development and profitability simulation by simply changing some default assumptions. This model was used in the preparation of the budget for 2015.

The Environmental and Social Policy was documented into an environmental handbook, which provides information which is supplementary to the existing financing process description.

Co-operation with other members of the European Development Finance Institutions (EDFI) continued as in earlier years, through both concrete projects and the sharing and harmonisation of operating methods. Since the summer of 2014, Finnfund's CEO Jaakko Kangasniemi has been acting as the Chairman of the EDFI.

At the beginning of 2014, additional facilities were provided to Finnfund in the property where the company has had its premises since 2007.

Determined measures were taken in 2014 to develop the company's administration, particularly human resources. The 360 Degree Feedback tool was used to conduct an assessment of management and supervisory work in the second half. This assessment's results will be used in personnel, supervisory and managerial development projects. The performance management and incentive scheme covering the entire personnel was revised. The revised system and new practices will be adopted in 2015.

The Finnpartnership programme

Finnfund administers a business partnership programme called Finnpartnership. Launched in June 2006, this is financed by the Ministry for Foreign Affairs. Continuance of the programme depends on the competitive tendering process to be organised in 2015.

Finnpartnership provides advisory services and business partnership support for the planning, development and implementation of commercially viable projects carried out by Finnish companies and other Finnish actors targeting developing countries; for technology and solution pilot projects; and for education and training.

Finnpartnership provides a matchmaking service for companies in developing countries, helping them to find Finnish business partners. The matchmaking service has also been used by Finnish companies that are seeking business partners in developing countries.

In 2014, a total of 113 (121) business partnership support applications were processed. Of these, 90 (96) applications were approved. Total support granted amounted to EUR 4.3 million (EUR 3.5 million).

Business partnership support was paid out to 54 (80) projects, totalling EUR 1.0 million (EUR 1.3 million).

In 2014, the matchmaking service received 222 (245) business initiatives from companies in developing countries.

Risk management

The Finnfund Board of Directors confirms the company’s risk management principles and instruments. The company’s management is responsible for the practical implementation of risk management on the basis of the guidelines confirmed by the Board of Directors. The company guidelines on asset and risk management were assessed during 2014, but no material changes were made to the risk management principles.

Owing to the nature of its activities, the company is exposed to greater than average risks. Risk management includes risk identification, hedging, and reporting to the company's administrative bodies.

The risk classification system developed by Finnfund and in use since 2005 is a key instrument in the assessment and monitoring of project risks. A risk assessment is conducted on all projects in the Finnfund investment portfolio at least once a year, and more often if necessary, if it is estimated that the risk level has changed.

On 8 October 2012, the Ministry for Foreign Affairs decided on the introduction of special risk financing to share investment risks between Finnfund and the Finnish government. Special risk financing is provided on the basis of a loss compensation commitment adopted by the government on 20 September 2012, whereby the government undertakes to compensate Finnfund for a maximum of 60 per cent of credit losses and investment losses in projects covered by special risk financing during the validity of the commitment. The loss compensation commitment and the related Ministry for Foreign Affairs decision are valid until 31 December 2015.

The decision to enter a particular project under special risk financing is made by the Finnfund Board of Directors. In order to be eligible for special risk financing, a project must have extremely high developmental impact potential and be aimed at a low-income or lower-middle income country; it must also be too risky to otherwise qualify for Finnfund financing.

In 2014, the Board of Directors decided to enter 3 (6) projects under special risk financing. The aggregate value of the decisions is EUR 2.7 million (EUR 41.8 million). The government is responsible for EUR 1.4 million (EUR 21.3 million), or 53 per cent (51 per cent) of the investment risk associated with decisions made in 2014. By the end of 2014, decisions with a value of EUR 50.2 million (EUR 47.5 million) had been made for projects under special risk financing. The government answers for EUR 25.1 million (EUR 23.7 million), or 50 per cent (50 per cent) of the risks involved in these decisions. The loss compensation ceiling is EUR 50 million, and a maximum of EUR 5 million in compensation may be applied for in any given year.

The objective with regard to interest and exchange rate risks is to identify and hedge against any risks. Since the company's investments are targeted at developing countries and are often made in the local currency, managing exchange rate risks is exceptionally challenging. The objective is to cover the interest and exchange rate risks associated with lending fully and over the entire investment period. Managing exchange rate risks associated with equity and fund investments is more complicated. Here, the objective, on a case-by-case basis, is to cover currency positions that are certain or at least likely, and that can be hedged at a reasonable cost in relation to the benefits gained.

In order to manage its liquidity risk, Finnfund maintains liquidity that is adequate in view of the anticipated volume of disbursements. Finnfund has a committed credit facility of EUR 50 million at Nordea Bank, non-committed facilities in other Nordic banks, and a commercial paper programme totalling EUR 100 million set up in 2010, which were not in use at the end of 2014.

The refinancing risk associated with borrowing is managed by maintaining a sufficiently extensive group of financiers and a versatile range of instruments. An additional aim is that at least half of the borrowing should be long-term financing. At the end of the year under review, the average time to maturity of interest-bearing debt was 3.5 years.

Finnfund maintains a continuous capacity for identifying, controlling, and combating data security risks.

Financial result and balance sheet

In 2014, Finnfund made a profit of approximately EUR 2.4 million (approximately EUR 2.7 million). The result fell slightly short of last year, but clearly exceeded budget.

The operational result is shown in the table below. Income from financing activities stood at EUR 11.1 million (EUR 11.9 million) and the result before value adjustment items, sales and taxes was EUR 4.3 (EUR 5.7 million).

No exits from projects occurred during the reporting period. The administrative-expenses increased over the year before, but they came in under budget.

Operational result, EUR 1,000	2014	2013	Change EUR	Change %
Financial income	12,929	13,558	-629	-4.6
Financial expenses	-1,802	-1,643	-159	9,7
Income from financing activities	**11,127**	**11,915**	**-788**	**-6.6**
Other operating income	1,612	1,558	54	3.5
Administrative expenses, depriciation and other expenses	-8,419	-7,797	-622	8.0
Result before value adjustment items, sales and taxes	**4,320**	**5,676**	**-1,356**	**-23.9**
Value adjustment items and sales	-1,877	-2,945	1,068	-36.3
Income taxes	-35	-29	-6	20.7
Net profit	**2,408**	**2,702**	**-294**	**-10.9**

Income

Dividend income was EUR 0.3 million (EUR 1.6 million). The dramatic drop in dividend income could be attributed to the discontinuation of dividend payment in one of the project companies.

Interest income from investment loans came to EUR 5.6 million (EUR 6.4 million), and other interest income was EUR 0.5 million (EUR 0.6 million). Interest income totalled EUR 6.1 million (EUR 7.0 million). Other interest income consisted primarily of interest income from liquid assets, and this increase was due to the increase in liquidity.

Other income from long-term investment amounted to EUR 5.1 million (EUR 3.8 million), consisting of gains from fund investments. Similar to the previous year, no capital gains from sales were recognised as income.

Other financial income without foreign exchange gains, at EUR 1.4 million (EUR 1.3 million), mainly consisted of arrangement fees, commitment fees, and other financing fees.

Investment income before taxes totalled EUR 12.8 million (EUR 13.6 million).

Foreign exchange gains amounted to EUR 11.0 million (EUR 5.0 million) and losses to EUR 11.0 million (EUR 5.0 million).

Other operating income amounted to EUR 1.6 million (EUR 1.6 million) and this comprises fees received for the administration of the Finnpartnership programme and other income from fees and charges.

Impairment losses

New recognised individual impairment losses amounted to EUR 6.7 million (EUR 9.1 million), representing around 2.3 per cent (3.6 per cent) of the balance sheet value of investment assets at the end of the year under review.

Reversals of previously recognised individual impairment losses amounted to EUR 5.4 million in 2014 (EUR 12.8 million).

The net effect of impairments on financial performance was approximately EUR 1.4 million (EUR 3.7 million).

Expenses

Interest expenses were EUR 0.7 million and remained nearly unchanged from the previous year (EUR 0.8 million). Interest expenses were incurred through borrowing in US dollars, which is used to refinance Finnfund investment loans denominated in US dollars, and through euro-denominated commercial papers issued in 2013 and the bond issued in autumn 2013.

Other financial expenses were EUR 0.8 million (EUR 0.8 million), including management fees of EUR 0.6 million (EUR 0.5 million) associated with fund investments. These fees were incurred for funds whose investment period has ended.

Investment and sales losses amounted to EUR 0.6 million (EUR 6.6 million), which is attributable to previously recognised individual impairment losses.

Administrative expenses totalled EUR 8.4 million (EUR 7.8 million). The increase in expenses consists of several items, the most significant ones being higher personnel and premises costs and increased use of external services.

Taxes recorded in the profit and loss account, totalling EUR 0.04 million (EUR 0.03 million), consist of stamp duties and withholding tax paid in investee countries.

Balance sheet

The balance sheet total stood at EUR 317.2 million (EUR 311.0 million) as at the end of the year under review.

The balance sheet value of investment assets was EUR 294.0 million (EUR 250.0 million) at the end of the year under review. Investment assets grew by about 18 per cent during the year under review, following the disbursement of many of the investment decisions and commitments made in the second half of 2013.

Loans (including subordinated loans and other mezzanine instruments) accounted for EUR 129.2 million or 44 per cent (114.5 million, 46 per cent), equity investments for EUR 86.8 million or 30 per cent (64.4 million, 26 per cent), and fund investments for EUR 77.5 million or 26 per cent (71 million, 28 per cent) of investment assets.

Liquidity stood at about EUR 19 million (EUR 55.1 million) at the end of the year, showing a decrease of approximately 66 per cent on the previous year-end. Liquidity decreased because the assets generated by the EUR 50 million bond issued in 2013 have now been invested in projects. The liquid assets are invested in domestic money-market instruments in accordance with the asset and risk management guidelines.

At the end of the financial period, the company’s equity (share capital and retained earnings) totalled EUR 235.7 million (EUR 215.3 million) or 74 per cent of the balance sheet total (69 per cent).

In 2014, the company executed one share issue. In the share issue, a maximum of 114,939 new shares were offered to existing shareholders in proportion to their existing holdings, at the issue price of EUR 170 per share. The subscription period was from 17 April to 6 June 2014. As a result of the share issue, the share capital was increased by EUR 18,025,440 with the Finnish government accounting for EUR 17,999,940 and the Confederation of Finnish Industries EK for EUR 25,500. A total of 106,032 new shares were issued pursuant to the issue decision. Finnvera plc did not subscribe to any of the new shares it was offered.

At the end of the financial period, the company’s registered share capital stood at EUR 156,989,220 and 923,466 shares, with the Finnish government holding 858,896 shares (93 per cent), Finnvera plc 63,349 shares (6.9 per cent), and the Confederation of Finnish Industries EK 1,221 shares (0.1 per cent).

The company's shares have no nominal value. The equivalent value of a share in bookkeeping is EUR 170. The company has one share class. A minimum of 51 per cent of the company shares must be under the direct ownership and control of the Finnish government at all times. The company does not distribute its funds in dividends or in payments from its unrestricted equity fund; nor does it acquire or redeem its own shares.

At the end of the year under review, the company's long-term interest-bearing debt stood at EUR 72.0 million (EUR 74.0 million) and short-term interest-bearing debt at EUR 4.7 million (EUR 20.0 million), totalling EUR 76.7 million (EUR 94.0 million). Long-term interest-bearing debt includes the EUR 50 million bond issued in autumn 2013. In other respects, the interest-bearing liabilities are mainly denominated in US dollars, used to refinance Finnfund investment loans denominated in US dollars.

Long-term debt as a percentage of all financing liabilities increased during the period under review with the reversal of short-term debt to about 93.9 per cent at the year-end. Financing liabilities decreased by some 18 per cent on the previous year.

Guarantee commitments totalled EUR 0 million (EUR 0.08 million) at the end of 2014.

Key figures

	2014	2013	2012
Financial income, EUR million	23.5	18.5	20.0
Net profit, EUR million	2.4	2.7	1.2
Return on equity, %	1.1	1.3	0.6
Equity ratio, %	74.3	69.2	64.8

Formulae:

$$\text{Return on equity} = \frac{\text{Result before extraordinary items – taxes}}{\text{Equity}} \times 100\ \%$$

$$\text{Equity ratio} = \frac{\text{Equity}}{\text{Balance sheet total – advances received}} \times 100\ \%$$

Administration and personnel

In 2014, the Supervisory Board met five times, the Board of Directors met 12 times, and the Audit Committee of the Board of Directors met five times.

The Annual General Meeting, held on 17 April 2014, addressed the matters listed in Article 11 of the Articles of Association and decided to increase the company's share capital.

The following members were elected at the Annual General Meeting to the Supervisory Board for the period 2014−2017: Kalle Hyötynen, Vice Chairman; Seppo Kallio, Director; Riitta Myller, Member of Parliament; and Anne-Mari Virolainen, Member of Parliament.

Members of the Board of Directors elected at the Annual General Meeting:

Ritva Laukkanen, Partner, as Chair
Kari Alanko, Deputy Director General, as Vice Chair
Tuukka Andersén, Director of Finance
Pekka Hukka, Counsellor
Tuuli Juurikkala, Special Adviser
Pirita Mikkanen, Partner
Markus Pietikäinen, Vice President
Tuula Ylhäinen, CFO

The members of the Board of Directors do not have deputy members.

The Board of Directors has an audit committee, with the following members since 22 April 2014:

Markus Pietikäinen, Vice President, Chair
Tuukka Andersén, Director of Finance
Tuuli Juurikkala, Special Advisor

The company's auditors are PricewaterhouseCoopers Oy, authorised public accountants, with Juha Wahlroos APA as the principal auditor.

The company CEO is Jaakko Kangasniemi PhD (Agricultural Economics).

During the year under review, the company employed an average of 51 people (2011: 49). At year-end, the number of employees in contractual employment was 54 (51), of whom 52 (47) worked full-time. Of the 52 employees, 38 were women and 16 were men.

Total wages and salaries paid to personnel in 2012-2014 were as follows:

	2014	2013	2012
Average number of personnel	51	49	49
Total wages and salaries, EUR 1,000	4,121	3,840	3,636

The final accounts include a provision for incentive bonuses earned in 2014, amounting to 7.1 per cent of payroll expenses (6.7 per cent). Incentives are partly based on meeting performance targets at company and function level, and partly based on individual performance.

Outlook for 2015

In accordance with the guidelines specified in the State Ownership Policy, Finnfund aims to improve the positive developmental impacts of its financing and to focus primarily on low-income and lower-middle-income developing countries. Finnfund will intensify its co-operation with Finnish enterprises in these countries in particular. As before, priority will be assigned to projects where Finnish know-how and competence is used to curb climate change, to improve environmental conditions, and to improve the living conditions of poor people. Due to Finnfund's equity limitations, capital investments will be made cautiously and focus in project preparation will remain in investments in the form of loans.

The amount of new investment decisions is estimated to remain at approximately the same level as in 2014, while investment assets are expected to show sustained growth.

Liquidity is expected to remain good in 2015. The central government budget for 2015 includes a EUR 10 million appropriation for an increase in the share capital of Finnfund in 2015. Company liquidity will be further enhanced by the bonds issued in 2013. It is estimated that the terms for Finnfund borrowing will remain reasonable.

The special risk financing approved by the Ministry for Foreign Affairs in 2012, effective until the end of 2015, improves Finnfund's chances of financing projects with a high level of financial risk but which have significant developmental impacts if successful.

The outlook for 2015 is positive. The company's financial performance will be crucially affected by how the estimated value of its investment assets changes during the financial period and whether any profitable exits from projects occur. Although these tend to be difficult to predict, one significant exit which was anticipated to occur in 2014 but which was delayed is expected to materialise this year. Thanks to this exit and the repayments expected on fund investments, the forecast for financial performance is positive.

The administration of the Finnpartnership programme will continue as before, until the close of the contract period at the end of 2015.

Proposal of the Board of Directors for the distribution of profit

The company recorded a profit of EUR 2,408,430.64 in 2014. The Board of Directors proposes that the profit be transferred to the retained earnings account and set aside for disposal in accordance with Article 2 of the Articles of Association.