REPUBLIC OF LEBANON
MINISTRY OF FINANCE

Brief Note on Exchange Transaction

Exchange of bonds due 2005

- The Ministry of Finance has successfully concluded the voluntary Eurobond exchange transaction, in which it **offered to exchange** any and all of its issued and outstanding:
  - U.S. $1,000,000,000 10.250% notes due 2005,
  - U.S. $850,000,000 9.375% notes due 2005, and
  - U.S. $450,000,000 8.750% notes due 2005

- The exchange was offered for:
  - an **equivalent principal amount** of notes maturing in 2010 and 2012 (or a combination); and
  - a cash payment for the **premium over par**[1] and **accrued interest** on the 2005 notes.

- Approximately **55% of the US$ 2,163,995,000 original outstanding Eurobonds** were exchanged into two new notes, representing the **highest level of participation** among similar exchange transactions of comparable sovereigns.

- The exchange transaction amounted to **US$1,186,532,000**. Additionally, **US$353,468,000** of **new cash subscriptions** were raised during the transaction. The **total transaction** amounted to **US$1,540,000,000**, or around 8% of GDP[2] for 2004.

- The success of the transaction and high participation rate of investors reflects Lebanon's **dedicated investor base** and **ample liquidity** resulting from increased deposits.

- The new issues were **priced aggressively** relative to Lebanon's outstanding yield curve.
  - For the exchange, the new issues were priced at 4 and 26 basis points tighter to Lebanon's outstanding curve for the 2010 and 2012 bonds, respectively.

- The exchange transaction helped **balance the public debt maturity structure**, and **lengthen the foreign debt profile**.

- **Financing needs** for 2005 were reduced by the amount of the exchange transaction, and the new issued cash subscriptions provided additional support to meet financing needs for 2004.

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[1] Consisting of the difference between the market price of the bonds and their par value.
[2] GDP for 2004 is estimated at $19,513,000,000.

I. Results:

- Total original outstanding Eurobonds due in 2005: **US$ 2,163,995,000**
- Total exchanged into new notes maturing in 2010 and 2012: **US$ 1,186,532,000**
- Participation rate: **54.83%**
- New cash subscriptions: **US$ 353,468,000**
- Total transaction: **US$ 1,540,000,000**.

The table below summarizes the results of the exchange transaction, combined with the new cash subscriptions accepted.

Table 1. Combined Results of Exchange and New Subscriptions

	Original Notes			New Notes	
Original Notes	**Outstanding Pre-transaction**	**Amount Exchanged**	**Outstanding Following Exchange**	**Series 30 due March 5 2010**	**Series 31 due Sept 7 2012**
10.25%, due March 5, 2005	$900,000,000	$413,658,000	$486,342,000	$374,034,000	$39,624,000
9.375%, due June 30, 2005	$847,000,000	$495,099,000	$351,901,000	$455,194,000	$39,905,000
8.75%, due September 21, 2005	$416,995,000	$277,775,000	$139,220,000	$240,254,000	$37,521,000
Total Exchange	**$2,163,995,000**	**$1,186,532,000**	**$977,463,000**	**$1,069,482,000**	**$117,050,000**
Total New Cash Subscriptions				$195,518,000	$157,950,000
Size of New Notes				**$1,265,000,000**	**$275,000,000**
Total Size of New Notes				**$1,540,000,000**	

Source: Ministry of Finance, Citigroup Global Markets, Morgan Stanley & Co. International.

- Accrued interest & premium on original notes: **$75,558,807**.

The table below details the accrued interest and premium due to the exchange participants.

Table 6. Accrued Interest & Premium on Original Notes

Original Notes	**Accrued Interest 1/**	**Premium**	**Total**
10.25%, due March 5, 2005	$235,555	$12,409,740	**$12,645,295**
9.375%, due June 30, 2005	$8,639,446	$19,803,960	**$28,442,406**
8.75%, due September 21, 2005	$23,360,106	$11,111,000	**$34,471,106**
Total	**$32,234,107**	**$43,324,700**	**$75,558,807**

Notes: 1. On September 7. 2004. Source: Ministry of Finance, Citigroup Global Markets, Morgan Stanley & Co. International.

II. Participation:

- The 55% participation rate registered during the exchange transaction represented the **highest level of participation among similar exchange transactions** of comparable sovereigns.

- The participation rate achieved compares to participation rates ranging **between 12% and 44%** for transactions of comparable sovereigns (for the periods of 1999-2004).

The following table compares the participation rate of the exchange transaction with those of similar sovereign exchange transactions which took place in 2003-2004.

Table 2. Comparable Exchange Results from Transactions Conducted in 2003-2004

Sovereign	Date	Exchange Structure	New Securities	Offering Period	Total Eligible	Total Participation	(%)
Brazil	Jul-03	Fixed Ratio	2011 & 2024 - B	5 business days	$9,479 mm	$1,288 mm	14%
Philippines	Feb-04	Reverse Dutch Auction	2015	5 business days	$4,939 mm	$1,594 mm	32%
Mexico	Apr-04	Fixed Ratio	2014 & 2033	4 business days	$6,800 mm	$3,005 mm	44%
Lebanon	**Aug-04**	**Fixed Ratio**	**2010 & 2012**	**5 business days**	**$2,164 mm**	**$1,186 mm**	**55%**

Source: Morgan Stanley & Co. International

- Amongst the three outstanding notes offered for exchange, investors participated more heavily in exchanging the longer dated maturity (September 2005 bond), to **capitalize on the cash premium and accrued interest payment**. The table below details the participation ratios for each of the exchanged bonds.

Table 3. Breakdown of Participation Rates for the Notes due in 2005

Original Notes	Outstanding Pre-transaction	Amount Exchanged	Ratio
10.25%, due March 5, 2005	$900,000,000	$413,658,000	46.0%
9.375%, due June 30, 2005	$847,000,000	$495,099,000	58.5%
8.75%, due September 21, 2005	$416,995,000	$277,775,000	66.6%
Total Exchange	**$2,163,995,000**	**$1,186,532,000**	**54.83%**

Source: Ministry of Finance, Citigroup Global Markets, Morgan Stanley & Co. International.

III. Price Information:

- On August 25, 2004, the minimum **yield-to-maturity** rates for the new bonds, as well as the **cash premium** to be paid as part of the exchange transaction were indicated. The cash premium consisted of the difference between the market price and the par value of the bonds.

The following tables detail the yields-to maturity and premium cash amounts announced as part of the exchange transaction.

Table 4. Cash Premium on Original Notes for Exchange (per $1,000 principal amount)

Original Notes	Cash Premium
10.25%, due March 5, 2005	**$30**
9.375%, due June 30, 2005	**$40**
8.75%, due September 21, 2005	**$40**

Notes: 1/ Cash premiums consist of difference between the market price of the old bonds (as announced on the price announcement day), and par.
Source: Ministry of Finance, Citigroup Global Markets, Morgan Stanley & Co. International.

Table 5. Yields-to-Maturity on New Notes

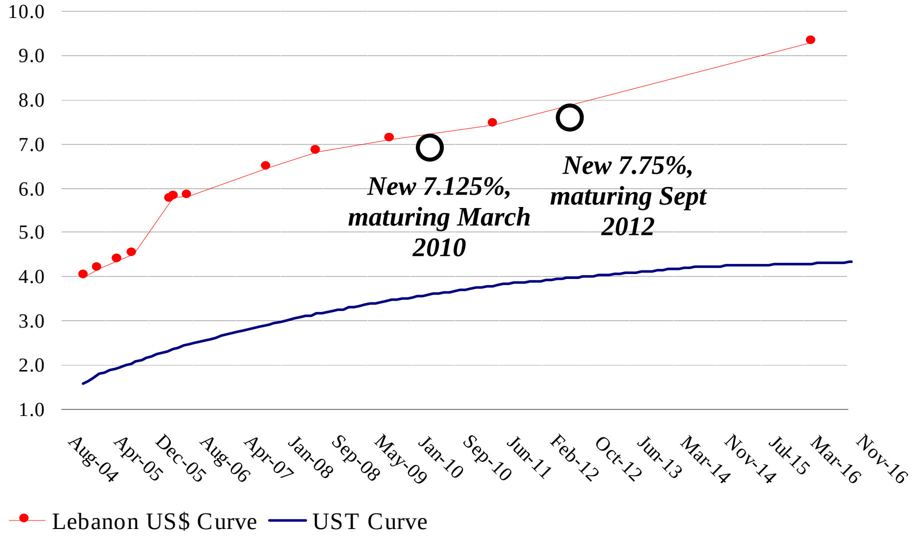
New Notes	Yield-to-Maturity
Series 30 due March 5, 2010	7.125%
Series 31 due September 7, 2012	7.750%

Source: Ministry of Finance, Citigroup Global Markets, Morgan Stanley & Co. International.

- On August 27, 2004, the yields of the bonds were affirmed to be **7.125%** per year for the bond maturing in 2010, and **7.750%** per year for the exchanged bonds maturing in 2012.

- Relative to the outstanding Lebanese yield curve, the **new bonds were priced aggressively**, as demonstrated in the graph below:

Graph 1. Yield Curve on Outstanding Lebanese Eurobonds



Source: Ministry of Finance, Citigroup Global Markets, Morgan Stanley & Co. International.

- With the new issue spread over interpolated US Treasury curve at 356 basis points and 389 basis points for the new notes maturing in 2010 and 2012, respectively (356 basis points and 377 basis points spread at par), the new issues were priced **4 and 26 basis points tighter to Lebanon's outstanding curve for the exchange.**

IV. The Exchange Process:

- The exchange process, which was opened for **5 business days**, commenced on August 23, 2004, and expired on August 27, 2004. Price information regarding the exchange transaction was announced on August 25, 2004. The exchange date, constituting the settlement date, is scheduled for September 7, 2004.

- **Description of the Exchange Transaction**: As part of the active debt management strategy of the Ministry of Finance, and in an effort to lengthen and smoothen Lebanon's debt maturity profile, holders of the outstanding U.S. $1,000,000,000 10.250% notes due 2005, U.S. $850,000,000 9.375% notes due 2005 and U.S. $450,000,000 8.750% notes due 2005 were offered to exchange any or all of their notes for the following:

    1. A **like principal amount** (par for par) of either a) Series 30 notes maturing on March 5, 2010, b) Series 31 notes maturing on September 7, 2012, c) or a combination of the two new bonds.

    2. A **yield to maturity for each series of new notes**. The yield-to-maturity for the Series 30 exchanged notes (maturing in 2010) is 7.125%, and the yield-to-maturity for the Series 31 exchanged notes (maturing in 2012) is 7.750%. (described in the "Pricing" section)

    3. A **cash premium amount** (consisting of the difference between the market price of the existing bonds and par) offered for each of the original notes maturing in 2005 (described in the "Pricing" section)

    4. **Accrued and unpaid interest on original notes**, from and including the last date on which interest on the relevant notes has been paid, but excluding the exchange settlement date (September 7, 2004).

- **Listing on Beirut Stock Exchange:** In addition to being listed on the Luxembourg Stock Exchange, the new notes issued will be listed on the Beirut Stock Exchange. Also, notes which were not exchanged will continue to be listed as they were prior to the exchange.

V. Effect on Government Finances:

- In line with the Ministry of Finance's debt management strategy, the exchange transaction resulted in a **smoother near term public debt maturity structure**, and allowed the government to **lengthen the profile of the public debt**.

- **Financing needs for 2005** were reduced by the amount of the exchange transaction, equal to $1,186,532,000, and the new issued cash subscriptions, equal to

$353,468,000, provided additional support to meet financing needs of the Government. As a percentage of GDP[3], the **exchange transaction constituted around 6% of GDP**, while the new **cash subscriptions constituted around 2% of GDP**.

VI. Transparency & Conformity to International Best Practice:

- The Ministry of Finance made every effort to ensure, throughout the transaction process, transparency and conformity with international best practices.
- To commence the transaction, **notices were published** in the Financial Times[4], the Luxembourg Wort, four leading Lebanese newspapers (in Arabic, English, and French), the Ministry of Finance's website, and in various television announcements.
- Press notices **announcing the pricing** (August 25, 2004), **expiration** (August 27, 2004), and **results** (August 31, 2004, and September 2, 2004) of the exchange transaction were also released on international wires and local wires, respectively.
- Additionally, in cooperation with the Beirut Stock Exchange, the Ministry of Finance and the lead managers of the transaction, Citigroup Global Markets and Morgan Stanley & Co. International, held a **public meeting for all investors at the Beirut Stock Exchange**, to discuss exchange transaction mechanics and generally clarify the process of the exchange transaction.

[3] GDP for 2004 is estimated at $19,513,000,000.
[4] The Exchange offer was not open to US persons or persons residing in the US.