

**MANAGEMENT RESPONSE TO THE PROJECT PERFORMANCE EVALUATION REPORT  
FOR THE SBI DFHI LIMITED IN INDIA  
(Investment 7122-IND)**

On 10 February 2006, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

**A. Overall Assessment**

1. In general, Management finds the paper well prepared and very comprehensive in the evaluation of the project and its implementation. The report provides an excellent analysis of the growth of the Government Securities Market in India over the last 10 years and the role that the investee company played in promoting the accompanying capital market reforms. Management response focuses primarily on the overall assessment and the lessons learned.

2. Management notes that the PPER rates the overall project as satisfactory. While we can agree with this overall rating of the project, we would have wished for OED to place more emphasis on the fact that ADB's assistance, through its Private Sector Operations Department (PSOD), to the establishment of the leading primary dealer company in the country contributed significantly to the development of the Government securities market. As stated in various parts of the report, this project is a fine example of ADB's private sector operations supporting broader policy dialogue undertaken by the public sector of ADB. The investment in SBI DFHI Limited serves as a prime model for the successful collaboration between the private and public sector side of ADB, whereby its public sector side helped develop an enabling environment for the target sector and PSOD then tested the robustness and market-friendliness of these policy measures by participating in an actual transaction. Clearly, the outcome of ADB's support to the Government's reform program was highly successful as evidenced by the growth and turnover of the Government securities market over the last ten years. We believe this positive achievement should have been reflected in a higher rating with respect to the project's development outcome.

**B. Lessons Learned**

3. Management notes that a number of the lessons learned focus mainly on the fact that PSOD was not able to exit this investment as originally envisioned through a public offering within 4 years from the date of the investment. To address this issue, OED recommends that PSOD's equity investments require a workable and viable exit mechanism. In particular, it is suggested that PSOD should not solely rely on an IPO and needs, therefore, to implement other divestment modalities such as a put option to the sponsor or majority shareholder. In this respect, PSOD agrees that an IPO is not always the best exit option as it might be difficult to achieve in view of the illiquid and underdeveloped state of many capital markets in ADB's developing member countries. The emerging markets in the region continue to remain somewhat volatile and unpredictable, and it is not unusual for a planned IPO to be postponed for one or

even several years until favorable circumstances exist which support a successful public listing.

4. However, it should also be emphasized at this point that a put option is not always commercial or legally viable, and in most cases would provide for a price that is substantially lower than the market value of the shares. A put option against other shareholders may result in consolidation issues for that shareholder and a put option against the company itself may not always be easily enforceable, depending on legal and regulatory framework in the relevant country. Furthermore, ADB would take credit risk on the counterparty to the put option, which may not financially be able to comply with terms of the put. It is, therefore, essential that PSOD be given the autonomy to structure a workable and viable exit mechanism suitable to the type of investment and the particular characteristics and circumstances of each project.

5. In connection with the exit issue, it should also be highlighted that the project has been highly successful in terms of the company's financial position, profitability, quality of management and risk control systems. SBI DFHI has been profitable from its start and has always paid a dividend to ADB—with the exception of FY2005. As of December 2005, the company has almost returned ADB's investment of \$4.19 million through dividend payments amounting to \$4 million so far. The total net asset value of ADB's shares in the company is currently valued at \$10.2 million which will translate to an FIRR of roughly 18% assuming ADB would divest on 31 March 2006. This is certainly an excellent return on ADB's investment.

6. ADB continues to incorporate the lessons learned from its past investments by improving transaction structures in order to allow for timely exits. In this regard, PSOD has been able to negotiate put options in a number of its recent equity investments<sup>1</sup> and will consider put options in relation to equity investments going forward.

### **C. Conclusion**

7. Management agrees with the overall rating of the project and the report's conclusion that the investment in SBI DFHI Limited contributed to the establishment of a primary dealer system in India which, in turn, supported the development of the Government securities market. Management notes OED's comments regarding the desirability of a put option, but it also wishes to highlight that the investment was timely and complementary to ADB's public sector operations and was highly successful in terms of the achieved and further expected financial return to ADB.

8. In line with the report's recommended follow-up actions, PSOD has initiated discussions with the company and the SBI Group, its majority shareholder, regarding the sale of ADB's shares.

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<sup>1</sup> A put option is in place in the following investments: MON-7197: Trade and Development Bank of Mongolia; AFG-7199: Afghanistan International Bank; PRC-7200: Credit Oriented Group; PRC-7219: Bank of China, Ltd.