SUMMARY OF OPERATION EVALUATION

An Information and Communication Technology Company

January 2013

EBRD EVALUATION DEPARTMENT

European Bank for Reconstruction and Development

The Evaluation Department (EvD) at the EBRD evaluates the performance of the Bank's completed projects and programmes relative to objectives in order to perform two critical functions: reinforcing institutional accountability for the achievement of results; and, providing objective analysis and relevant findings to inform operational choices and to improve performance over time. EvD reports directly to the Board of Directors, and is independent from the Bank's Management. Whilst EvD considers Management's views in preparing its evaluations, it makes the final decisions about the content of its reports.

This report has been prepared by EvD and is circulated under the authority of the Chief Evaluator. The views expressed herein do not necessarily reflect those of EBRD Management or its Board of Directors. Responsible members of the relevant Operations team were invited to comment on this report prior to internal publication. Any comments received will have been considered and incorporated at the discretion of EvD.

This report was prepared by Hiromi Sakurai, Principal Evaluation Manager, of the EBRD Evaluation department.

One Exchange Square

London EC2A 2JN

United Kingdom

Web site: www.ebrd.com

Contents

Executive summary

The Bank ("EBRD") approved an equity investment and a loan for an information and communication technology company (the Client). The client acquired a majority stake in a number of local market leaders and was planning an initial public offering ("IPO") on the Stock Exchange. However, the planned IPO was cancelled due to the post-crisis market conditions. The EBRD considered the client to be a promising, high-calibre company with the potential to increase competition and consolidate the ICT market. The IPO complied with the EBRD's transition objectives and appeared to be worth supporting. Through private placement, the EBRD purchased a minority stake in the client. All shares were later floated on the stock exchange. The EBRD's equity proceeds were used to complete the client's consolidation and to acquire new affiliates in two of the Bank's regions. The loan was signed but not used.

The EBRD's transition impact monitoring system ("TIMS") showed captured transition impact for this project to result not only from the EBRD's intervention but rather from the normal course of corporate actions and activities. Transition impact included higher corporate standards, regional integration and enhanced competition in the region. While most of the expected transition impact has emerged, transition potential is still high in the ICT market of one of the targeted regions, the client's multicultural business model in the countries of operations, distinct from large blue-chip multinationals, is unique, and encouraging for small and medium-sized software developers.

The client's business model and its regional development in the countries of operations could have represented a good case for EBRD support; a legitimate question remains as to the extent of the EBRD's additionality.

The report considered that the EBRD's additionality derived mainly from the transition impact attributable to the Bank's involvement, and its value-added in financial and design and functionality terms. The evaluation found that, in the absence of EBRD financing, the client's transition and financial opportunity cost would have been low, therefore limited additionality is verified. The same results could have been achieved even if the EBRD had left the project to other hands in the market.

Given the thrust of positive transition impact, this operation is rated overall *Successful*, despite some issues on additionality and the slim investment return at the current estimate.

Table 1: EvD ratings summary

Overall performance (Highly successful, successful, partly successful, unsuccessful)	Successful
Project relevance	
Additionality (Fully verified, largely verified, partly verified, not verified)	Partly verified
Project effectiveness	
Achievement of operation objectives (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Company/Project financial performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Satisfactory/ Marginal

Project efficiency	
Bank handling (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Project impact and sustainability	
Transition impact (Excellent, good, satisfactory, marginal, unsatisfactory, negative)	Good
Environmental and social performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Satisfactory

1. Overall Assessment

The EBRD's equity investment in an emerging ICT company was used to complete a series of technology acquisitions and *Good* performance is assessed in fulfilment of the objectives. As a result of the investment, the client extended acquisitions to an additional country, strengthened regional integration, and advanced market consolidation in the ICT sector. The transition impact at corporate level was realised via the transfer of skills and know-how, and higher corporate standards within the group's companies. Overall, transition impact is assessed as *Good*. The social and environmental impact is *Satisfactory*. Company financials are considered *Satisfactory*. The EBRD's return on equity is likely to underperform the forecast at appraisal unless future acquisitions capture strongly performing companies. The return on investment is therefore assessed as *Marginal* at this stage. Additionality was *Partly verified* from the viewpoint of the EBRD's value added, such as transition impact solely attributable to the EBRD's involvement. The EBRD's loan was not used, which suggests that financial additionality was likely below what had been initially expected. Bank handling is assessed as *Good* from the deal origination to monitoring and the support to the client. The overall assessment is *Successful*.

2. Effectiveness

Table 2: Effectiveness ratings

	EvD
Achievement of objectives (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Company financial performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Satisfactory
Project financial performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	[Enter Text]

2.1. Achievement of objectives

- Operational and financial performance measured (i) against the EBRD's forecast; (ii) the development of the equity fair value; and (iii) the stock market quotation after flotation.
    - The comparison with the appraisal forecast has little meaning since the client conducted more acquisitions than planned. Increased efficiency via the consolidation of the group has yet to be achieved, as some financial indicators show little

improvement. Since the purchase by EBRD, the market price of the stock has declined for macro and micro reasons.

- Future geographical and market expansion of the client by acquisition and organic growth.
  - Geographical expansion was overachieved, and included countries outside the appraisal targets. The client also acquired new business segments. Technological convergence has progressed. It enhanced synergetic effects with the originally targeted areas such as business intelligence development and installation services.
- Strengthening the client's corporate governance and practice via the implementation of the environmental and social policy
  - Little has been done in environmental and social policy. ICT companies generate insignificant ecological footprints and the EBRD's concern at appraisal related mainly to social, gender and ethnic minority issues. The client took time to deal appropriately with the social aspect and monitoring and it has become more engaged over time. Corporate governance was adequately established at appraisal, in line with the parent company.

2.2. Company financial performance

Since the crisis, corporates have tended to avoid large investments in IT systems, opting instead for local solutions as a less expensive alternative, which is what the client offers as its main services. However, the dynamic turnover increase has slowed down, due partly to the downturn in the euro-peripheral economies. The EBRD's equity injection significantly reduced indebtedness while the client's assets have grown considerably following acquisitions. The client has good liquidity owing to the majority of its customers being reputable companies in the regions. Stable profitability, high solvency and adequate liquidity resulted in satisfactory financials.

3. Efficiency

Table 3: Efficiency ratings

	EvD
Bank handling (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Bank investment performance (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Marginal

3.1. Bank handling

Bank handling included deal origination, product selection, structuring and monitoring. Still exposed to risks associated with ICT, emerging markets as well as the stock performance, the structure of the operation was masterly, and included an adequate exit strategy. The report addressed the fact that, for a first-time ICT client a loan might have been more conducive to transition than equity; it also noted the team's endeavours during implementation to enhance the EBRD's value-added. The extent to which the EBRD could promote the investee's businesses is unclear under the current banking operations guidelines and manuals. In this operation, the client needed to develop business networks in the EBRD's regions. However, if the EBRD lends excessive support to a particular investee in a market where private sector financing is dominant, it could discriminate against other private sector players on a level playing field. Where to draw the line and which criteria to apply are matters for banking management, and the principles would need to be made clear to bankers, who would subsequently be guided by them, and consider effective ways to support the investee companies.

3.2. Project Financial Performance (Investment Performance)

The stock performance has been disappointing. In addition to weak trading, the value has continued to decline and at one point, the price broke the nominal value and the outlook was weak. The client's stock suffered mainly from illiquidity and weak trading, due to the limited number of shares floated and the bearish stock market sentiment.

Based on the current performance of the client and its stock, the EBRD is unlikely to achieve expected returns unless lucrative acquisitions occur in the future.

4. Impact and sustainability

Table 4: Ratings of transition, environmental and social impacts

	EvD
Overall transition impact (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Good
Environmental and social impact (Excellent, good, satisfactory, marginal, unsatisfactory, highly unsatisfactory)	Satisfactory

4.1. Overall transition impact

The Project improved the business practice standards of the acquired companies from a domestic to a more regional or international level. Upgrading corporate practice was particularly significant in the region and similar findings were noted during EvD's Telecommunication Sector Review. Skill and knowledge transfers across group companies were realised and are on-going activities in technological consolidation and product development. The client's management board is drawn from a number of EBRD countries of operation and the client adopts a matrix approach using horizontal – product or service-based - working groups on an equal footing across the countries. This differs from the large ICT multinationals that apply their standard practice unilaterally across all subsidiaries. Competing with them and strengthening the market leader position, the client is a good example in the countries of operations, demonstrating how a regional company can become competitive. The message it has emitted is clear in a region where myriad small domestic ICT companies strive for growth. Given the transition impact realised at corporate level, the market expansion and consolidation, and demonstration effects, the report endorses the "*Good*" rating in the latest TIMS and the "*Low*" risk associated with future transition.

4.2. Environmental and social impact

Insignificant environmental impact perceived at appraisal. The client provided the EBRD with environmental and social reports twice after a long delay owing to the absence of staff with suitable knowledge. The EBRD's value-added might have been expanded had it persuaded the client to fully comply with the EU environmental and social directives. The client's environmental and social performance is assessed as *Satisfactory* and the Project has made "*Some"* changes to the client, especially its awareness of environmental and social issues.

5. Findings

5.1. Market demand as the primary rationale of an Initial public offering

Corporate stock should be listed as a response to potential market demand. In this project, the client company undertook an IPO to complete acquisitions. The IPO was intended to provide the minority shareholders of the acquired companies with a fair opportunity to sell their shares. It was thus a critical part of the group consolidation process. Otherwise there was no strong rationale for listing the stock since the parent company was a blue-chip corporate also listed in the same stock exchange market. Trading of the stock was weak and the price declined significantly, leaving the EBRD as a loser in the transaction. The client company had already been operating at a high standard; it gained little for better corporate governance and practice from the IPO and might consider delisting.

An IPO is commonly believed to generate transition impact, and therefore to suit the EBRD's operation strategy. However not all IPOs result in the outcome that the EBRD generally expects.

5.2. Project identification in the ICT sector

Private sector players are dominant in the ICT market and make it highly competitive. There would be little chance for the EBRD to introduce better corporate standards to ICT companies, as the market itself encourages corporates to adopt better standards and practices. This makes it challenging for the EBRD to identify clients and originate ICT projects in the advanced transition countries.

Such features allowed this ICT project to deliver a tangible transition impact from the client's normal course of business but it generated little value-added for the EBRD, thus additionality was weak. Therefore, when identifying a new ICT project, the project design should reflect how to maximise transition impact not only from the client's corporate activities (for example acquisitions, higher corporate practice for all subsidiaries and so forth) but also that which must be clearly attributable to the EBRD and would not have been achieved without the project (for example social safeguard policy and practice).

5.3. EBRD value-added and the transition impact potential must be high

An ICT investment is riskier if it is equity and in an emerging market, but the investment terms and conditions should be market-based because financing is not necessarily scarce. It exposes the EBRD's return on investment to various risks. In addition, the EBRD's mandate requires a sufficient justification for the investment using public finance, meaning that the EBRD value-added and the transition impact potential of the project must be high. Fulfilling all of these factors is a challenge, which characterises the EBRD's ICT projects.

The EBRD is generally tolerant of a low investment return if there is high EBRD-induced transition impact. However, this project struggled, combining a poorly performing investment with little EBRD value-added, which could make it similar to a failed commercial investment. In order to avoid such a lose-lose outcome, each requirement should be met severally and respectively, without one compensating one for the other.