International Finance Corporation
World Bank Group

A Frontier Markets Case Study

What are the Risks in Frontier Markets Private Equity & How do You Mitigate Them?

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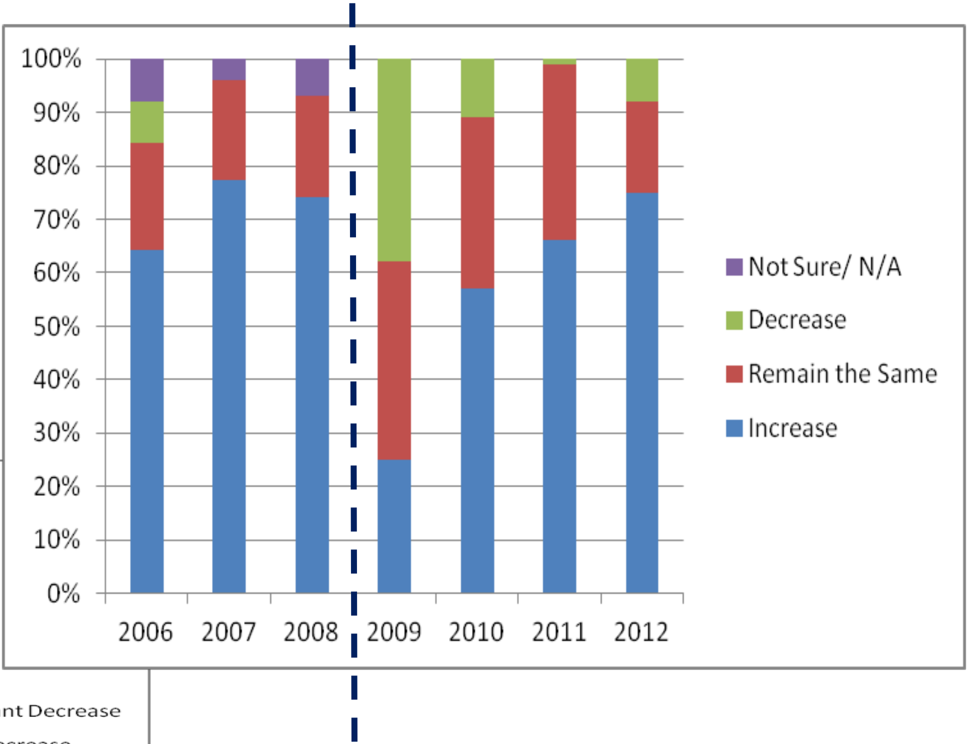
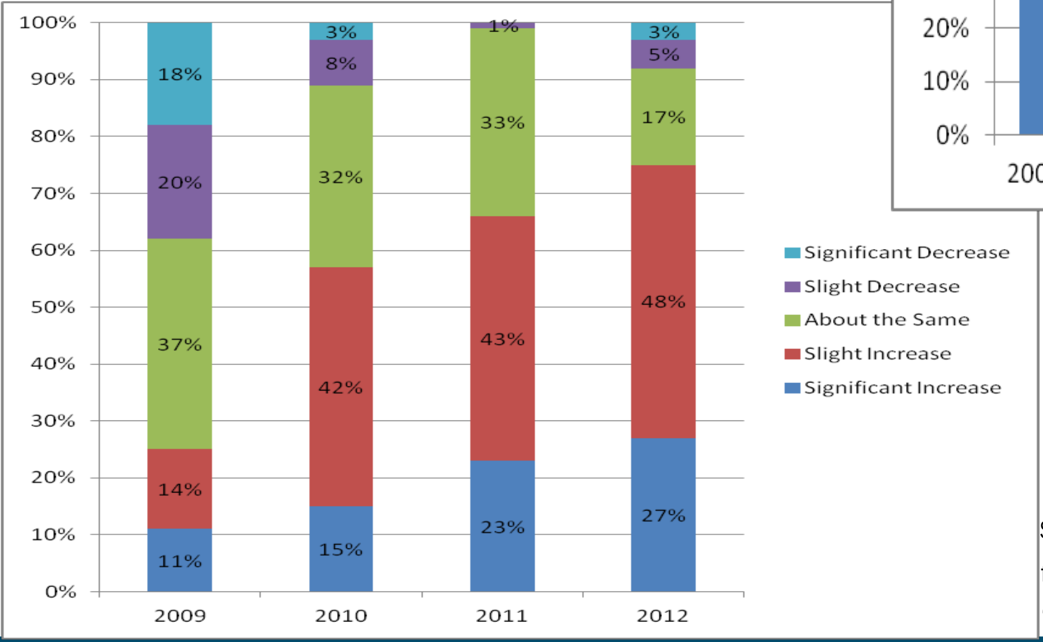
SUPER RETURN
Emerging Markets 2012

Geneva June 25-28th

Investors Have Strong Intentions to Increase Exposure to EM PE

Strongly rising intentions to increase allocations to Emerging Markets within PE portfolios make the discussion of Risk Management very relevant





Source: EMPEA surveys. Between 2008/2009 format of Question changes from "Expected change in EM commitments as a % of PE Portfolio " to "expect to increase/decrease in new commitments to EM PE"

Outline

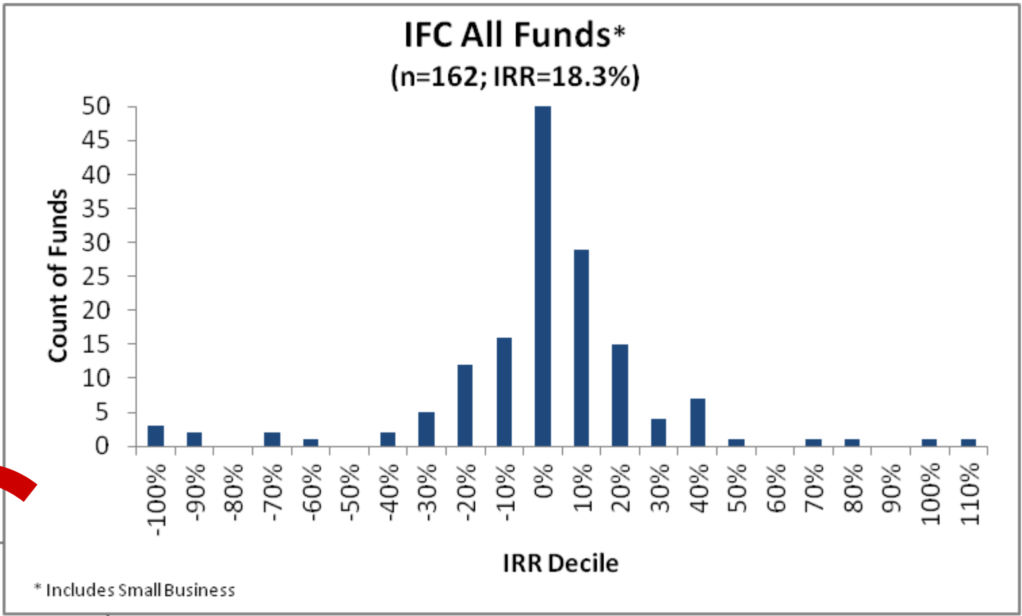
- **IFC's Experience**
  - **Select your Investment Space** - not all types of funds are equal
  - **Maintain Discipline**
  - **Global Diversification** – allows a bottom-up approach
- **Selecting Successful Emerging Market Funds**
  - **Risks Favoring EM PE**
  - **Early Mover Advantage** – use a different diligence template
  - **Risks Which Are Elevated in EM PE** - and how to mitigate them
  - **EM PE = Growth Equity = Jobs**
  - **E&S Standards are a Good Thing**

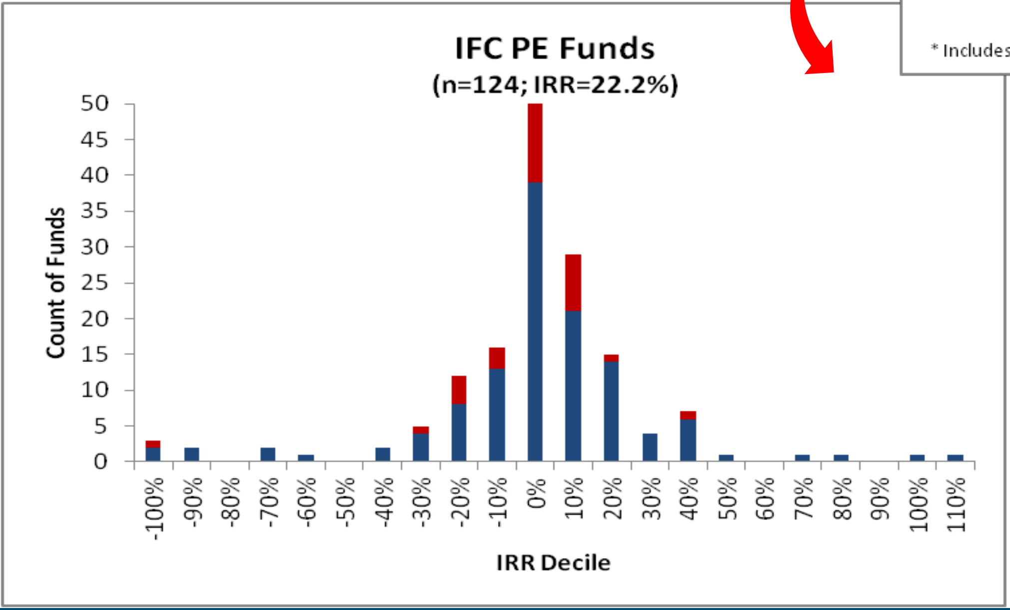
IFC’s Experience

Choose Your Investment Space

Not all investment spaces are equally attractive.

In IFC's Funds portfolio, the Growth Equity space has been the most consistently attractive.





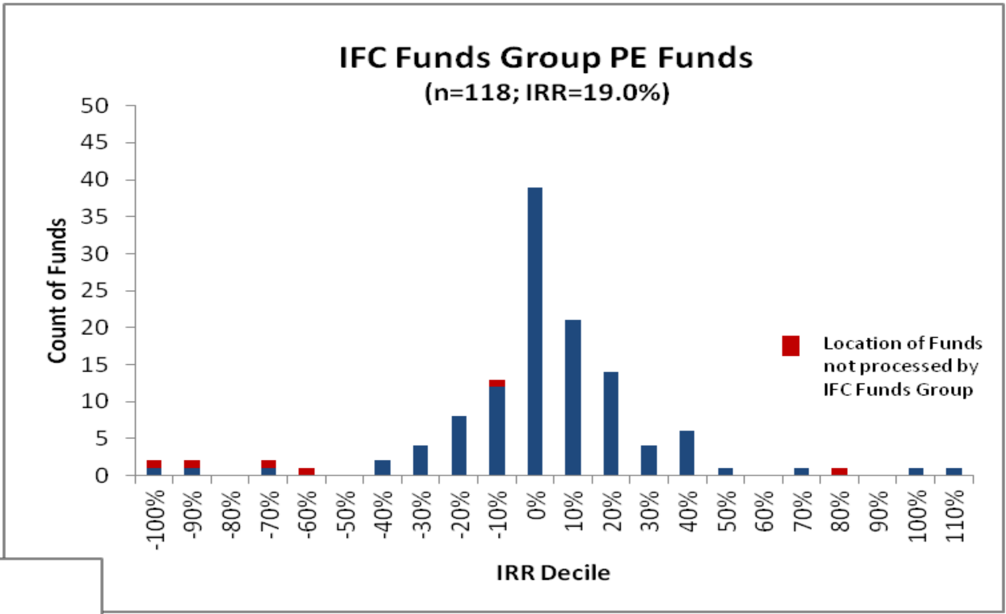
Over 2000-2011 IFC's commitments to Funds in the Growth Equity Space, targeting fast growing MidCap and SME companies, were:

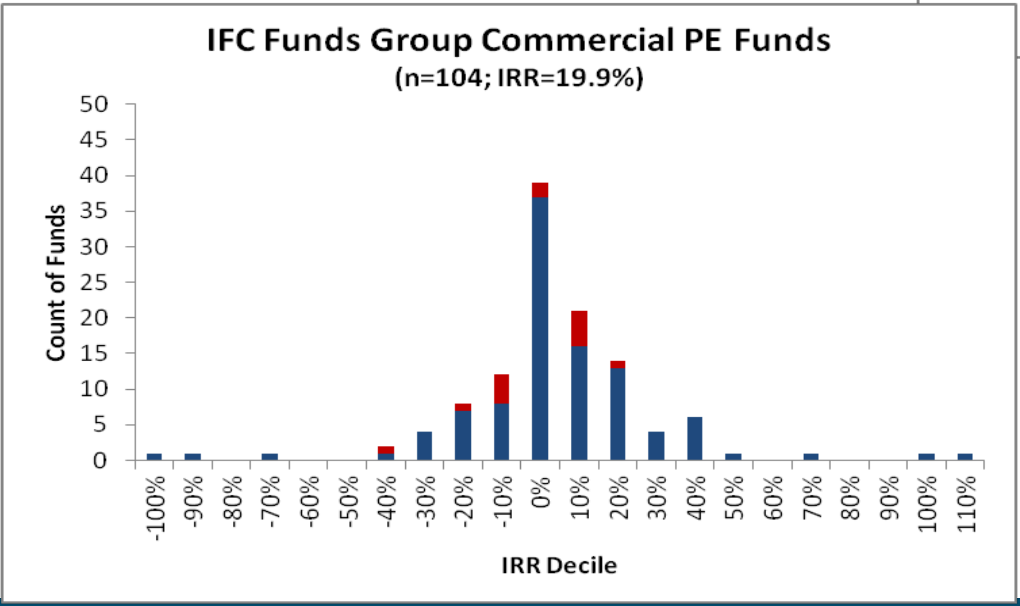
- **- 50% of commitments by number**
- **- 51% of commitments by amount committed**

As of June 2011 the IRR on these funds was 22%

Maintain Discipline

IFC established a dedicated Funds Group in 2000. The difference in the dispersion of returns of funds processed within and outside this group speaks to the importance of a disciplined approach to fund selection.



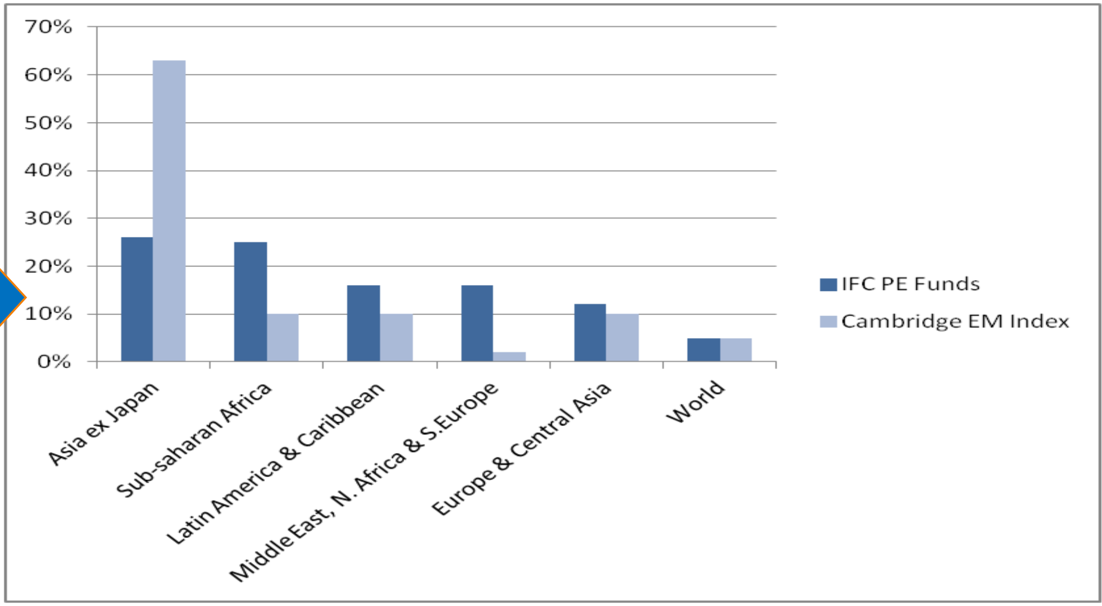


IFC will back projects for catalytic or impact reasons as long as the business model can at least cover our cost of capital. The expected return on these funds may make them less relevant for an Institutional investor.

Take Advantage of the Broad Opportunity

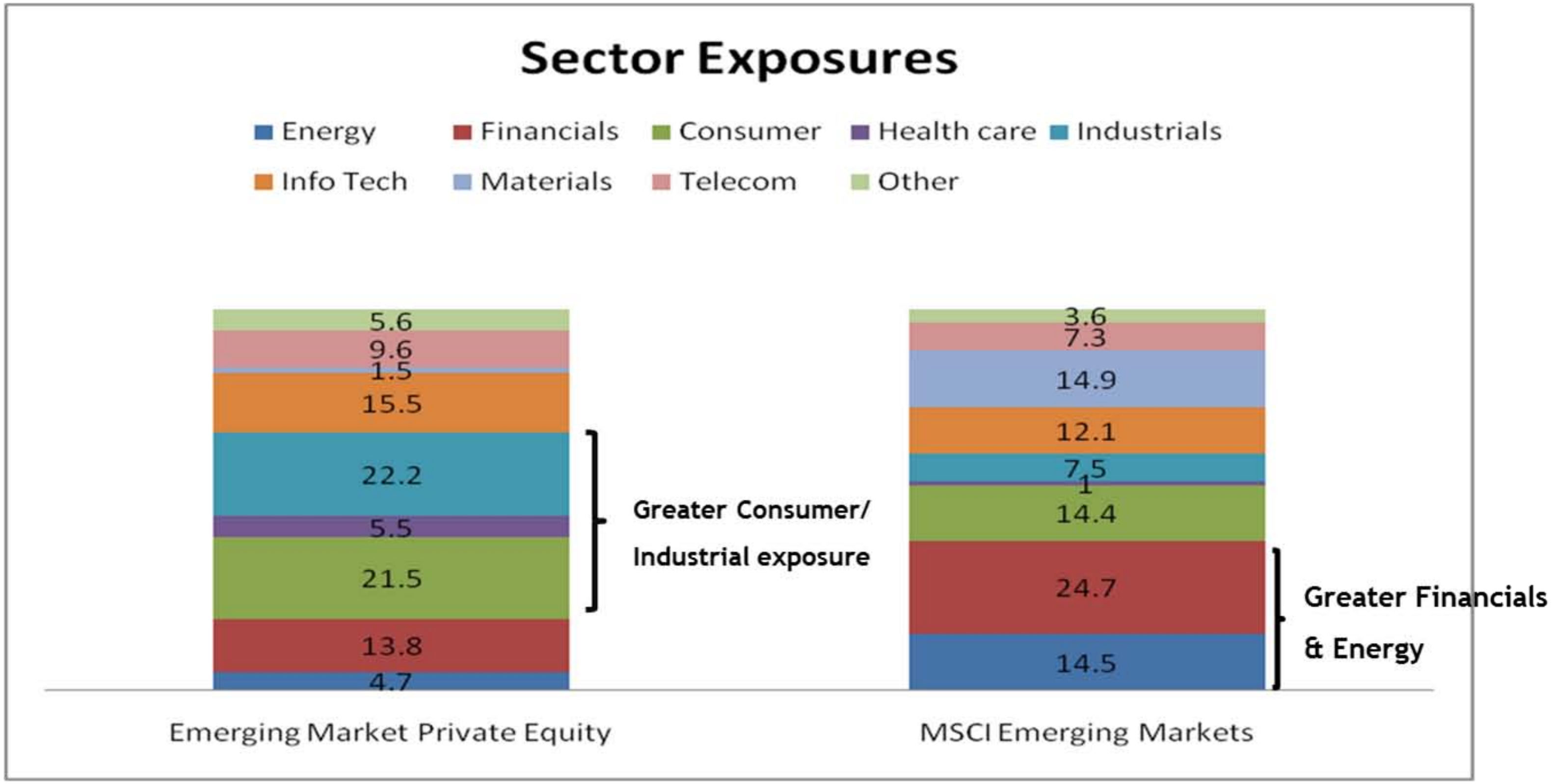
IRR from Jan '00 to	June 30 2011
IFC: Private Equity Funds *	22.20%
IFC: All Funds **	18.30%
Cambridge EM PE Top Quartile ***	19.80%
Cambridge Asia EM PE Top Quartile ***	21.70%
Cambridge US PE Top Quartile ***	17.40%

IFC has out-performed the Emerging Market Index with a much more geographically diversified exposure.



* Includes: Agribusiness, Cleantech, Midcap, Mining, SME, VC and Healthcare Funds
** Includes: Agribusiness, Cleantech, Midcap, Mining, Small business, SME, VC, Healthcare, Debt, Forestry, Infrastructure, Listed, Real Estate, Secondary Funds
*** All PE Fund types excluding Forestry, Infrastructure, Real Estate, and Secondary Funds

More Exposure to Consumer Growth than Public Markets



PE provides access to sectors under-represented in public markets

Source: Cambridge Associates

Managing Risk in the Selection of EM Funds

Aspects of Risk Favoring Emerging Markets

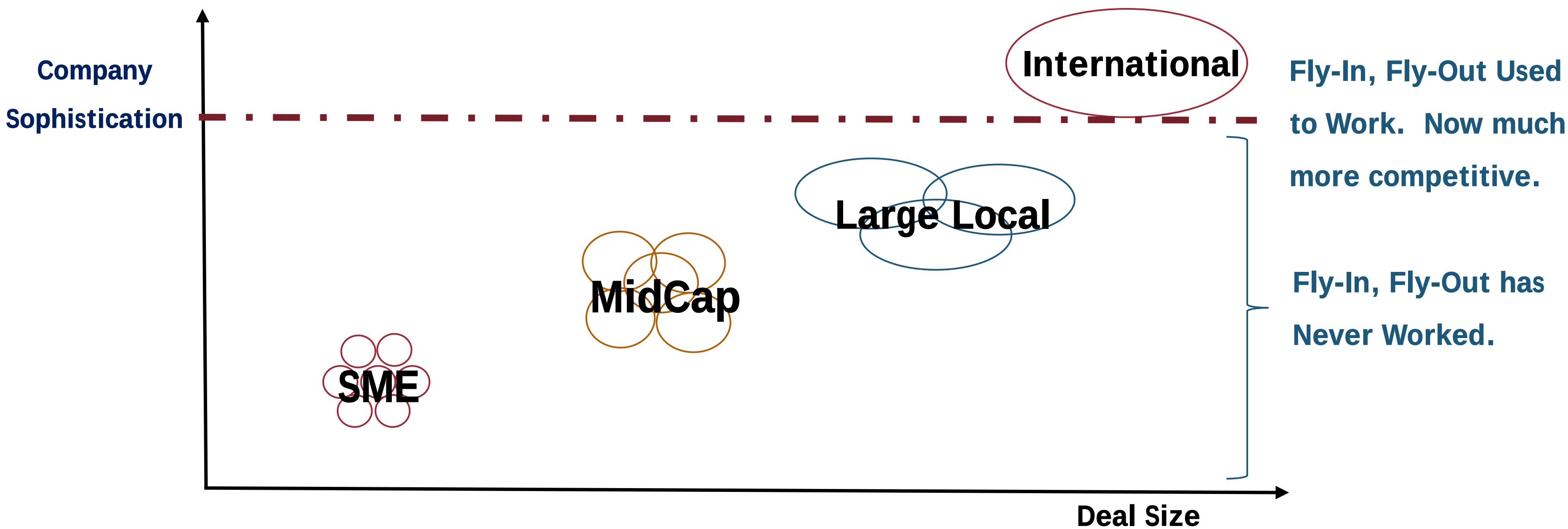
(1) EM PE provides diversification within the PE Portfolio

Cambridge Associates LLC. Correlation of indices as of December 31, 2011	All Funds Net to LP	Top Quartile Net to LP
Correlation US and EM Private Equity 2000-2011	**0.5705**	**0.5295**

Source: Cambridge Associates

Aspects of Risk Favoring Emerging Markets

(2) *Localization* has de-risked private equity in emerging markets somewhat



Access, reputation checking, due diligence, management, acquiring talent, acquiring leverage **All are Highly Local**

Aspects of Risk Favoring Emerging Markets

(3) Considerably *less leverage* - more resilient to macro and cyclical shocks

Companies in IFC-Invested Funds		
	Median	**Average**
Annual Revenue Growth*	19.50%	37.80%
Debt-to-Equity Ratio **	0.33	0.74
US Comparable ***		2.1

Higher growth and lower leverage makes the source of risk in EM PE less cyclical and more operational

Sample: 2009 * 527 companies in IFC-invested funds with holding time of at least one year ** 604 companies in IFC-invested funds, not including financial services

*** Dow Jones

First Time Fund Risk is Lower Than Expected

IRR from 2000 to June 30th 2011	
IFC All Funds	18.3%
1st Time Funds	24.0%
Non-1st Time Funds	11.1%

Early Mover Advantage reduces risk on 1st Time funds in Emerging Markets

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Aspects of Risk Elevated in Emerging Markets

Minority Positions	Can be mitigated through selection of GPs with the right skills to operate locally
Weak Contract Enforcement	
Operating Risk	
Small Companies	Does not affect returns except at very small sizes
Macro/Political	Diversification

Manager Skill Set is Key to Risk Management

	IRR as of March 2009 (simple average %)	Development Impact Score Highly Suc = 3 HighlyUn S = -1	1st Time Funds %	IDA % (<$1000 GDP per capita)	Average Deal Quality Score Max = 1 Min = 0
Top 10%	**46.6%**	**2.10**	**53%**	**27%**	**0.97**
Bottom 10%	**-38.3%**	**0.14**	**53%**	**13%**	**0.17**

The Same

More Top 10% in the Frontier

IFC's experience is that the differentiating factor in fund quality is the *Manager's skill set*

Sample: 150 Funds in IFC portfolio (invested pre- and post- 2000) as of March 2009, excluding those in the J-curve

GP Experience - Required Skills Depend on Model

Return Driver	Source of profit	Skill Required
Arbitrage	Pricing multiple differential between private market and public/M&A markets	Investment or Merchant Banking Consultancy
Leverage	Leverage a company with stable earnings	Investment Banking
Earnings growth	Increase earnings through expansion or acquisition.	Corporate Operations, Entrepreneurial, Consulting
Margin expansion	Increased profits via improved efficiency or shifting product to higher margin niche.	Corporate Operations, Entrepreneurial, Consulting
Improved transparency and governance	Earnings attract a higher price, as buyers feel more informed and protected.	Corporate Operations, Entrepreneurial, Consulting
Multiple expansion due to growth or profits	Earnings of company attract a higher price / earnings multiple	Private Equity – acquire based on what you can sell

Successful Partnership Reduces Risk

- **Partnership reduces risk where the legal system does not easily support enforcement**
- **Partnership comes from <u>high value-add</u>**
- **High Value-Add is also needed to**

  - Access transactions

  - Influence company direction

  - Influence Exit
- **High Value-Add = active advice and hand-holding**

  based on own experience

  ≠ sitting on the Board as a general sounding board

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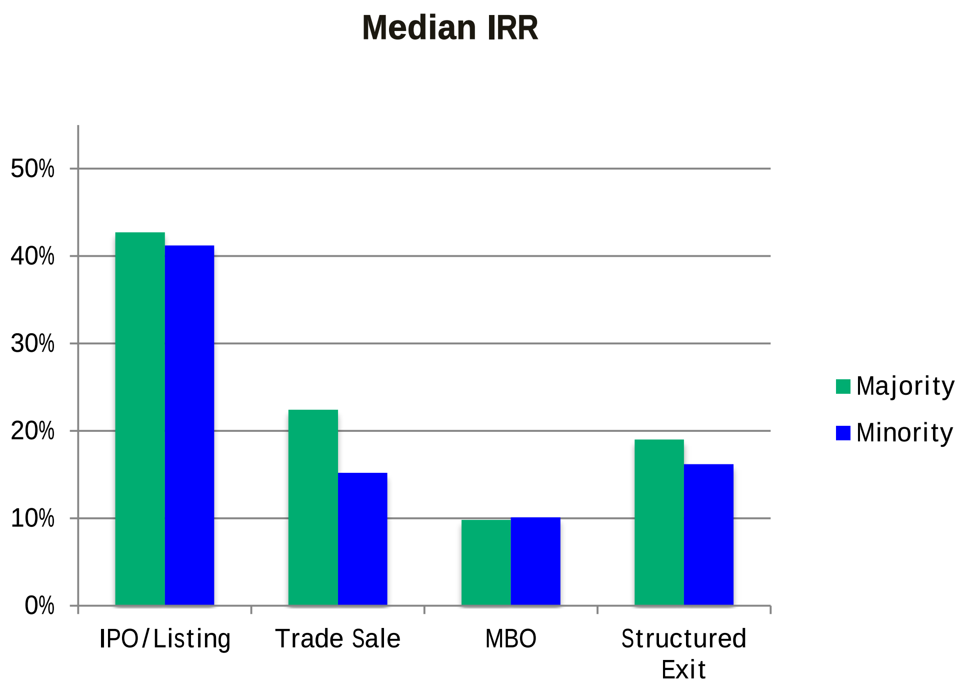
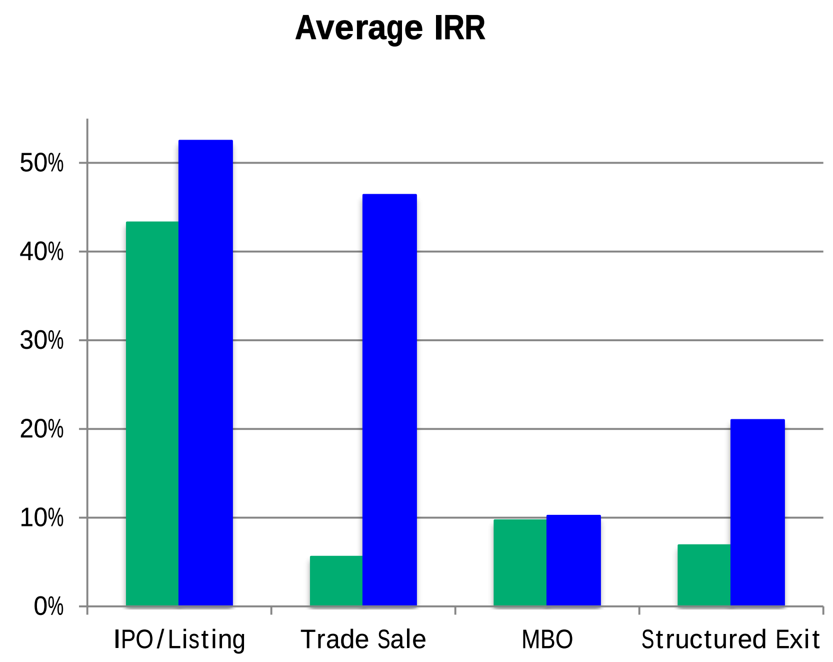
Partnership has lead to Good Performance from Minority Positions

Minority positions (blue) have performed well in all forms of exit,

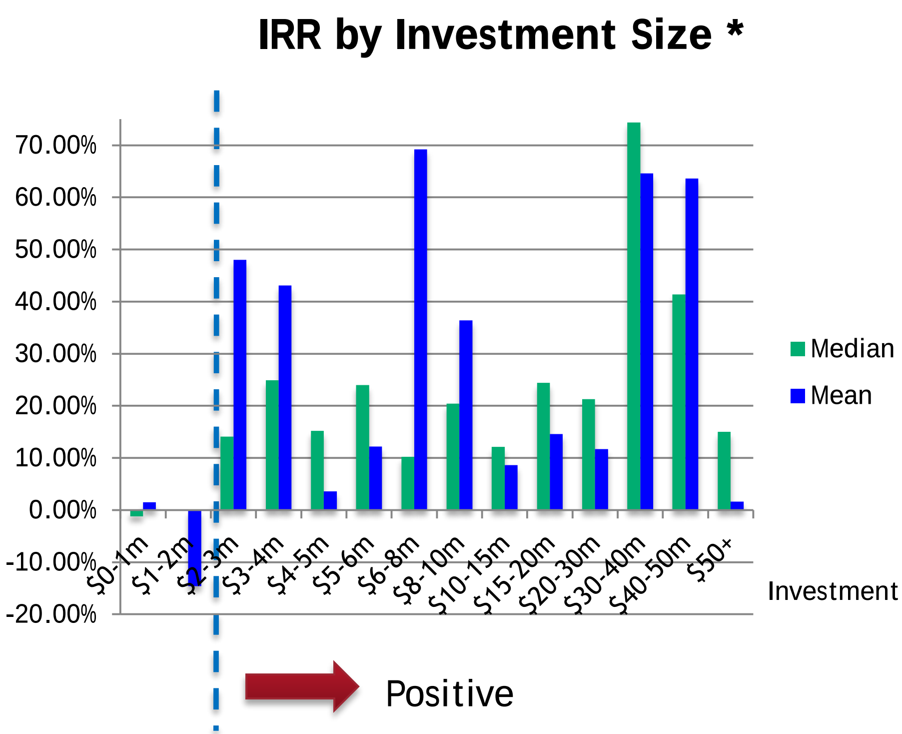
indicating that the risks associated with minority positions can be managed effectively.

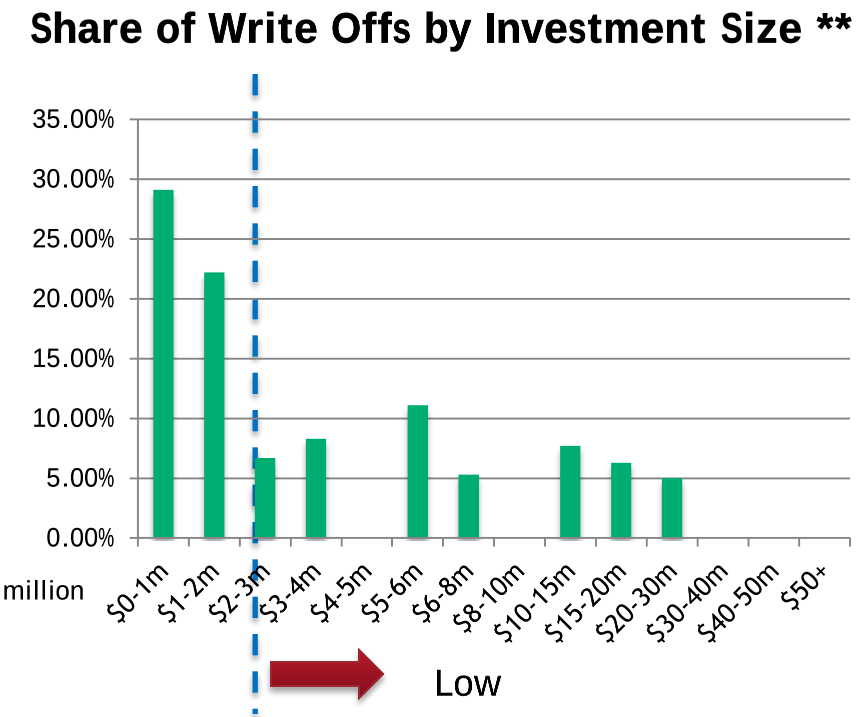




•Sample: 2009 Exits of 61 majority positions and 251 minority positions from IFC invested funds

Smaller Companies Are NOT Too Risky





Experience in deals as small as $2 million has been positive, suggesting that smaller companies are less risky than commonly perceived.

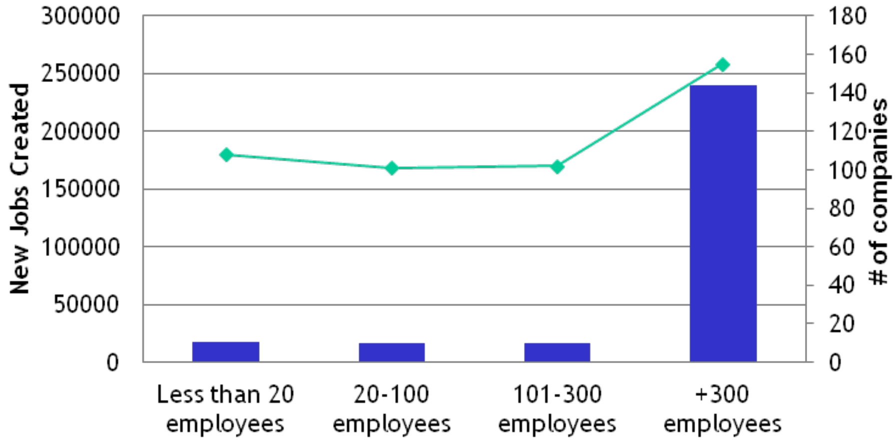
Sample: 2009 * 313 exits from IFC invested funds ** 323 exits from IFC invested funds

Differences: EM and Developed Market PE

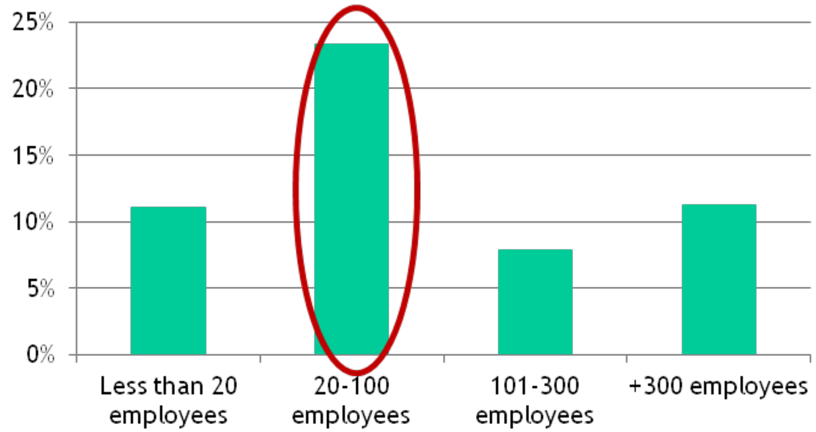
EM PE difference to US/EU PE	Scale Impact	Risk Impact	Risk Mitigation
Return driven by growth rather than leverage	Lower leverage reduces the number of companies suitable for acquisition	Less subject to macro and cyclical risk than LBO. Higher execution /operational risk	Select GP able to manage operational risks
Mostly minority positions	Lower investment per transaction	Implementation of value/exit plan requires cooperation of majority. Shareholders agreement may be difficult to enforce. Exit may be difficult.	Select GP with the skills required to become viewed by the majority as a partner. IFC's experience is that ability to form a strong relationship achieves cooperation and mitigates enforcement risks. IFC experience is that minority exits compare favorably to control exits.
Weak Contract enforcement	Limits the range of people a GP can work with, limiting deal flow.	Enforcement of shareholders agreement can be difficult.	Select GP with the skills required to become viewed by the majority as a partner. IFC's experience is that ability to form a strong relationship achieves cooperation and mitigates enforcement risks.
Smaller Companies	Smaller transaction sizes.	Potentially longer time to scale to size required to exit. Smaller companies may be more vulnerable to macro shocks.	In IFC's experience transaction sizes have to become quite small before there is a noticeable increase in negative outcomes.
Exits: Limited IPO, less liquid stock exchanges, less M&A activity	Limits capital willing to enter the market to that with less time sensitivity and more tolerance for illiquidity.	Less developed capital markets reduce exit opportunities. Can be either trapped or need to give up some return to secure an exit.	IFC's experience is that while returns on IPO are higher, trade sales provide good returns. GP needs to be aware of volatility in the exit window and be prepared to opportunistically exit even if it appears premature. LPs need to be aware of the greater difficulty of exiting listed stocks and ensure alignment of interest with the GP on distributions in kind.
Availability of experienced GPs	Not possible to crystalize the PE opportunity without a competent GP.	Huge return quartile gaps in PE. Lack of experience greatly increases risk.	IFC returns from 1st time funds have been surprisingly good – in excess of 20% net. There appears to be an early mover advantage. Still, not for the faint of heart.

Due to Growth Focus, PE in EM Creates Jobs and Supports SMEs

An analysis of investments made by 64 PE funds between 2000 and 2010



Job Creation (net)



% Job Growth (net)CAGR

291,000 net new jobs created by 466 portfolio companies.

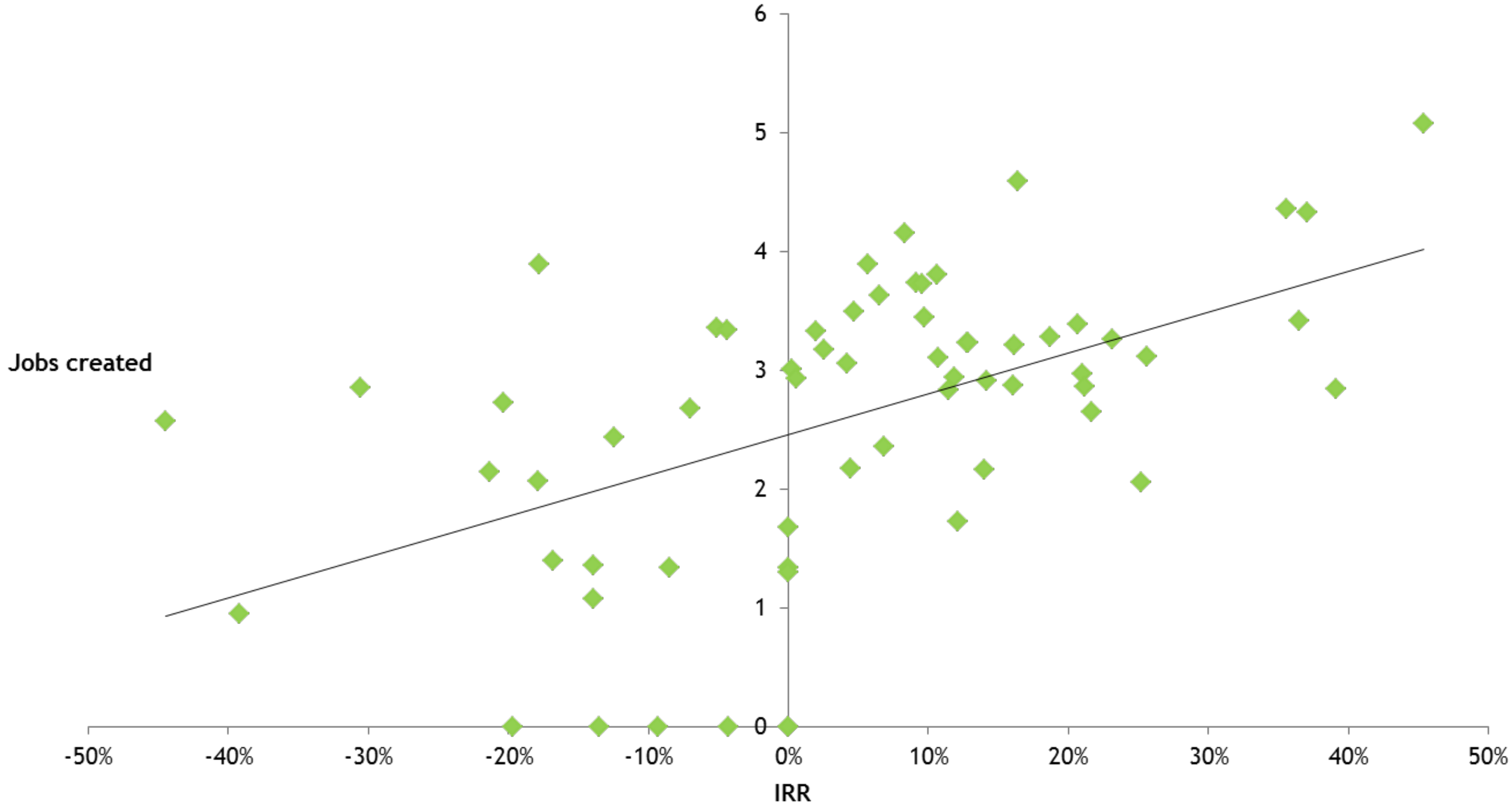
Larger companies create more jobs.

14.7% growth in jobs across the sample.

Smaller companies grew faster at 18%.

Fastest job growth in companies with 20-100 employees.

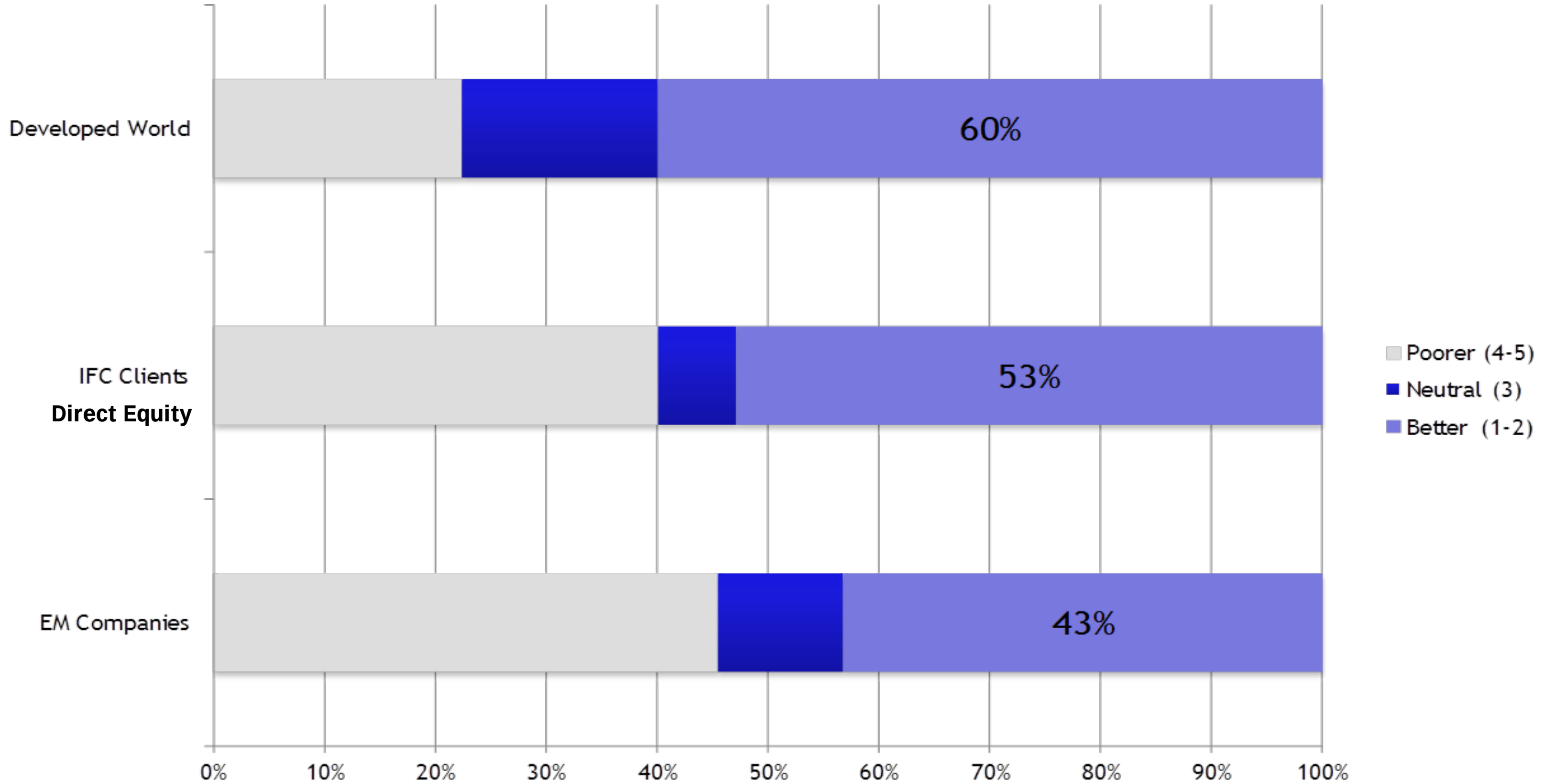
Correlation Between Job Creation and Performance



Three of the five top performing funds were also in the top five job creators

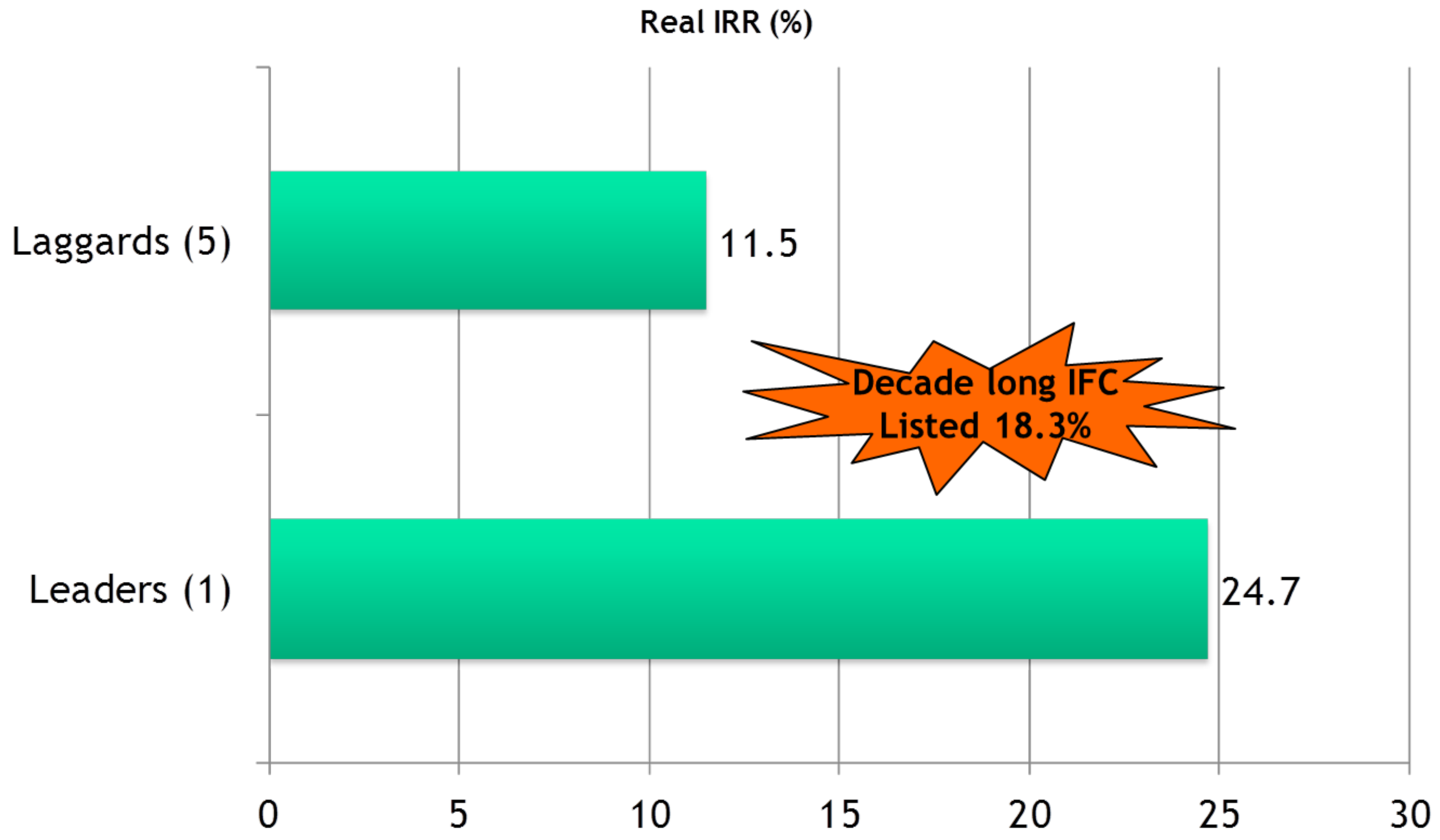
Environmental, Social & Governance Protections Have a High Correlation with Good Business

IFC Actively Seeks to Invest in Companies with Better ESG Performance



Based on EIRIS data collection and "PS sustainability" rating. Developed world consists of 2558 companies. 378 EM Companies are drawn mostly from MSCI Emerging Market Index constituents and chosen for sector and regional propensity.

Improved ESG Performance Delivers Alpha for IFC Direct Equity Investments



“PS sustainability” rating applied to IFC clients. Real IRR aggregating cashflows of equity investments in leader and laggard category (30% rated as either a leader or laggard of 134 listed equity clients).

Thank You

For further information on IFC's experience investing in emerging market private equity please see our website http://www.ifc.org/funds under the publications tab