Emerging Market Equity:

Private Equity, Public Equity, Risks & Opportunities

David Wilton, Chief Investment Officer, Manager Global Private Equity, IFC

The 2nd Annual OECD - WPC
World Pensions and Investments Forum 2012
Paris - 9 February
EM PE Returns Have Caught Up and Passed US/EU

<table>
<thead>
<tr>
<th>Period</th>
<th>US Private Equity Index</th>
<th>W. Europe Private Equity Index</th>
<th>Emerging Markets VC &amp; PE Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 Years</td>
<td>6.6</td>
<td>1.1</td>
<td>11.2</td>
</tr>
<tr>
<td>5 Years</td>
<td>10</td>
<td>11.3</td>
<td>15.5</td>
</tr>
<tr>
<td>10 Years</td>
<td>11.4</td>
<td>19.3</td>
<td>12.1</td>
</tr>
<tr>
<td>15 Years</td>
<td>12.5</td>
<td>18.8</td>
<td>9.7</td>
</tr>
</tbody>
</table>

Returns on EM PE have exceeded those on US PE over 10 years and both US & EU PE over 5 & 3 years.

A disproportionate number of EM funds are in the top half and top quartile of the Global PE Universe for vintage years from 2004.

Source: Cambridge Associates
Today, A Very Broad Opportunity
Clear Gains From Diversification in EM PE

<table>
<thead>
<tr>
<th></th>
<th>IRR from Jan '00 to ....</th>
<th>Jun 30 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFC: Private Equity Funds*</td>
<td>22.2%</td>
<td></td>
</tr>
<tr>
<td>IFC: All Funds**</td>
<td>18.5%</td>
<td></td>
</tr>
<tr>
<td>Cambridge EM PE Top Quartile***</td>
<td>19.8%</td>
<td></td>
</tr>
<tr>
<td>Cambridge Asia EM PE Top Quartile***</td>
<td>21.7%</td>
<td></td>
</tr>
<tr>
<td>Cambridge US PE Top Quartile***</td>
<td>17.4%</td>
<td></td>
</tr>
</tbody>
</table>

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

* Includes: Agribusiness, Cleantech, Midcap, Mining, Pharma, SME, VC and Healthcare Funds

** Includes: Agribusiness, Cleantech, Midcap, Mining, Pharma, SME, VC, Healthcare, Debt, Forestry, Infrastructure, Listed, Real Estate, Secondary Funds

*** All PE Fund types excluding Forestry, Infrastructure, Real Estate, and Secondary Funds
EM Private vs EM Public Equity

<table>
<thead>
<tr>
<th>IRR from Jan '00 to ....</th>
<th>Jun 30 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFC: Private Equity Funds*</td>
<td>22.2%</td>
</tr>
<tr>
<td>IFC: All Funds**</td>
<td>18.5%</td>
</tr>
<tr>
<td>MSCI EM (IFC PE Fund Cashflows)****</td>
<td>12.8%</td>
</tr>
<tr>
<td>MSCI World (IFC PE Fund Cashflows) ****</td>
<td>3.30%</td>
</tr>
</tbody>
</table>

EM PE has also outperformed Public Equity in both Emerging & Developed Markets

* Includes: Agribusiness, Cleantech, Midcap, Mining, Pharma, SME, VC and Healthcare Funds
** Includes: Agribusiness, Cleantech, Midcap, Mining, Pharma, SME, VC, Healthcare, Debt, Forestry, Infrastructure, Listed, Real Estate, Secondary Funds
**** Identical cashflow stream converted into cumulative MSCI shares; valued as the new terminal value (on 6/30/11) for the series of cashflows
Sector Exposure: EM Private vs EM Public Equity

PE provides access to sectors under-represented in public markets

Source: Cambridge Associates
To Summarize So Far ........

Emerging Market Private Equity is an Opportunity that has Come of Age ..... 

- Relative to Private Equity in Developed Markets
- Relative to Public Equity in Emerging Markets

So why do we all not have much more exposure?
The “CNN Moment” Effect
The Issues: #1 Scale

The Opportunity is very broad, but it is not deep in many places

Investors with a large minimum commitment amount are:
- limited in geographic scope
- must exercise care to not flood markets

Investors with a modest minimum commitment size can build a well diversified & high-potential portfolio
Even in the BRICs, fundraising as a percentage of GDP is low in EMs compared to the US, indicating much more room to grow.

Source: EMPEA
Real Constraints on Expansion of the Opportunity

- Requires continued GDP Growth
- Requires continued growth in availability of control/influence positions that PE needs
- Banking Systems & Debt Capital Markets need to develop to increase access to leverage
- Ability to enforce contracts needs to improve to widen circle of people with whom one can do business
1) *Localization* has de-risked private equity in emerging markets somewhat.

- Access, reputation checking, due diligence, management, acquiring talent, acquiring leverage are all highly local.

- Fly-In, Fly-Out has never worked. Now much more competitive.

- Fly-In, Fly-Out used to work. Now much more competitive.
The Issues: #2 Risk
Aspects of Risk Favoring Emerging Markets

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

<table>
<thead>
<tr>
<th>Companies in IFC-Invested Funds</th>
<th>Median</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Revenue Growth*</td>
<td>19.50%</td>
<td>37.80%</td>
</tr>
<tr>
<td>Debt-to-Equity Ratio **</td>
<td>0.33</td>
<td>0.74</td>
</tr>
<tr>
<td>US Comparable ***</td>
<td></td>
<td>2.1</td>
</tr>
</tbody>
</table>

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
Drivers of Return in Private Equity

A PE fund can achieve the same IRR through any of four basic strategies: leverage, multiple expansion, growth and efficiency.

Most funds use a blend of the four.

In EMs IRR is mostly driven by growth & efficiency

<table>
<thead>
<tr>
<th>Strategy</th>
<th>IRR</th>
<th>Equity</th>
<th>Cash out by Dividend, Stock Purchase etc</th>
<th>P/E at Entry</th>
<th>P/E at Exit</th>
<th>Revenue Growth p.a</th>
<th>Margin Improves from 5% to x%</th>
<th>Holding Period Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leverage</td>
<td>25%</td>
<td>30%</td>
<td>55%</td>
<td>6</td>
<td>6</td>
<td>0%</td>
<td>5%</td>
<td>5</td>
</tr>
<tr>
<td>Multiple Expansion</td>
<td>25%</td>
<td>75%</td>
<td>10%</td>
<td>6</td>
<td>14</td>
<td>0%</td>
<td>5%</td>
<td>5</td>
</tr>
<tr>
<td>Growth</td>
<td>25%</td>
<td>75%</td>
<td>10%</td>
<td>6</td>
<td>6</td>
<td>20%</td>
<td>5%</td>
<td>5</td>
</tr>
<tr>
<td>Efficiency</td>
<td>25%</td>
<td>75%</td>
<td>85%</td>
<td>6</td>
<td>6</td>
<td>0%</td>
<td>30%</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: IFC model
# Jobs - An Advantage of a Growth Equity Model

<table>
<thead>
<tr>
<th>All Companies *</th>
<th>Median</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Rate of Job Growth</td>
<td>11.90%</td>
<td>22.30%</td>
</tr>
<tr>
<td>Comparable Regional Job Growth</td>
<td>2-3%</td>
<td></td>
</tr>
</tbody>
</table>

Source: * Companies in Funds backed by IFC in early 2009
## The Issues: #2 Risk

Aspects of Risk **Elevated** in Emerging Markets

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

Does not affect returns except at very small sizes
Manager Skill Set is Key to Risk Management

<table>
<thead>
<tr>
<th></th>
<th>IRR as of March 2009 (simple average %)</th>
<th>Development Impact Score</th>
<th>1st Time Funds %</th>
<th>IDA % (&lt;$1000 GDP per capita)</th>
<th>Average Deal Quality Score</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Top 10%</strong></td>
<td>46.6%</td>
<td>2.10</td>
<td>53%</td>
<td>27%</td>
<td>0.97</td>
</tr>
<tr>
<td><strong>Bottom 10%</strong></td>
<td>-38.3%</td>
<td>0.14</td>
<td>53%</td>
<td>13%</td>
<td>0.17</td>
</tr>
</tbody>
</table>

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

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

• Partnership reduces risk where the legal system does not easily support enforcement

• Partnership comes from high value-add

• 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
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.

- Median IRR
- Average IRR

Sample: Exits of 61 majority positions and 251 minority positions from IFC invested funds
First Time Fund Risk is Lower Than Expected

<table>
<thead>
<tr>
<th>IRR from 2000 to June 30th 2011</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>IFC all Funds</td>
<td>18.5%</td>
</tr>
<tr>
<td>1st Time Funds</td>
<td>21.0%</td>
</tr>
<tr>
<td>Non-1st Time Funds</td>
<td>14.0%</td>
</tr>
</tbody>
</table>

Early Mover Advantage reduces risk on 1st Time funds in Emerging Markets
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: * 313 exits from IFC invested funds ** 323 exits from IFC invested funds
<table>
<thead>
<tr>
<th>EM PE difference to US/EU PE</th>
<th>Scale Impact</th>
<th>Risk Impact</th>
<th>Risk Mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return driven by growth rather than leverage</td>
<td>Lower leverage reduces the number of companies suitable for acquisition</td>
<td>Less subject to macro and cyclical risk than LBO. Higher execution/operational risk</td>
<td>Select GP able to manage operational risks</td>
</tr>
<tr>
<td>Mostly minority positions</td>
<td>Lower investment per transaction</td>
<td>Implementation of value/exit plan requires cooperation of majority. Shareholders agreement may be difficult to enforce. Exit may be difficult.</td>
<td>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.</td>
</tr>
<tr>
<td>Weak Contract enforcement</td>
<td>Limits the range of people a GP can work with, limiting deal flow.</td>
<td>Enforcement of shareholders agreement can be difficult.</td>
<td>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.</td>
</tr>
<tr>
<td>Smaller Companies</td>
<td>Smaller transaction sizes.</td>
<td>Potentially longer time to scale to size required to exit. Smaller companies may be more vulnerable to macro shocks.</td>
<td>In IFC’s experience transaction sizes have to become quite small before there is a noticeable increase in negative outcomes.</td>
</tr>
<tr>
<td>Exits: Limited IPO, less liquid stock exchanges, less M&amp;A activity</td>
<td>Limits capital willing to enter the market to that with less time sensitivity and more tolerance for illiquidity.</td>
<td>Less developed capital markets reduce exit opportunities. Can be either trapped or need to give up some return to secure an exit.</td>
<td>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.</td>
</tr>
<tr>
<td>Availability of experienced GPs</td>
<td>Not possible to crystallize the PE opportunity without a competent GP.</td>
<td>Huge return quartile gaps in PE. Lack of experience greatly increases risk.</td>
<td>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.</td>
</tr>
</tbody>
</table>
Possible future changes:

• Increased competition
  = risk profile of 1st time funds increases

• Increased deal flow via greater access to leverage
  = expansion of key GP skill set
  = increasing risk profile

• Increased local funding, LP comfort with local GPs
  = less syndication available for Foreign GPs
Summary

• Attractive returns relative to both Private Equity in Developed Markets and Public Equity

• Different Sector Exposure & Return Model
  = Diversification Potential

• Risks - some in favor of EM PE, others can be mitigated

• Scale - broad opportunity for investors with a modest minimum commitment size
  - larger investors need to be careful to not flood markets

• Growth focus provides development benefits
Annex
What Has Caused the Opportunity to Grow?

The significant expansion of the private equity opportunity in emerging markets since 2000 has been driven by an increase in the availability of control positions or minority positions with control-like rights.

This has had two main causes:

1. The shift to more market-based economies since 1990
2. Lowering of barriers to trade and capital flows since 2000
Shift to More Market-Based Economies

Measures of conditions for private business have improved across a wide range of emerging markets since the 1990s, leading to an increase in the number of companies of interest to PE.

The scale of the improvement in conditions for private business in EMs since 1990 is significant.

Source: Fraser Institute, Economic Freedom of the World (EFW) Index
Increased Openness Creates PE Deal Flow

Emerging markets have opened their trade and capital accounts since 2000, increasing both opportunities to expand and competition in domestic markets.

This creates more situations where sale of equity with influence over the business is seen as desirable by owners in order to attract the capital or the skills needed to expand, to compete, or to increase focus on core business by sale of non-core business.

Exports + Imports as a Percentage of GDP

Increase Over Period
86% China
110% India
41% Brazil
Drivers of the Expanding Opportunity

Building Blocks to Achieve Maximum Potential in PE

Motives to Sell
- Market Based Economy
  - 1990s
- Open Economy
  - 2000s

Structural Factors
- Governance, Transparency, Legal System, Taxation
  - Coming Soon?
- Bank Lending and Debt Capital Market
  - Coming Soon?
- Stock Exchange Liquidity
  - Coming Soon?

Scale
- Size of the Economy
- Scalability
- Larger Economy, larger ability to scale PE

- Increased Supply of Interesting Companies:
  Entrepreneurial activity increases. Companies emerge of the right size, growth, management quality to be interesting to PE

- Increased Motivation to Sell:
  Competitor pressure to meet international efficiency standards. Ability to expand offshore. Spurs deal flow – sale of non-core, help with offshore expansion, help with improving operations to meet competition.

- Increased Opportunity through Trust:
  Ability to contract at a distance with strangers widens pool of partners. Due diligence easier, easier to partner with strangers. Owners tax neutral between company and portfolio wealth, removes a barrier to sale.

- Opportunity Expands to Lower Growth Companies:
  Deal flow expands: slower growth companies become viable targets for PE

- Liquidity and potential returns enhanced:
  Exit window improves; generally better exit multiples from listing. Better returns stimulate deal flow.

Size enables some countries to scale without all blocks in place

India, China pre-2000. High GDP growth, little proper deal flow for PE

India, China, Colombia, Brazil, Turkey, etc

Chile, New Zealand

China, India, Brazil, USA, EU
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