Table of Contents/
Introductory Note • 2

Expert Takeaways: Value Creation & Corporate Governance in Emerging Markets Private Equity • 3
Five important observations from the groundbreaking Privcap thought-leadership video series

Q&A With Jeffrey Bunder, Ernst & Young • 6

Community and Gold in the Congo • 7
How a private equity firm created value via housing and schools

Q1 2012
Developing Value

Private equity in the emerging markets is private equity at its most powerful—nowhere is the basic private equity toolkit more in need and more in demand.

In the most mature private equity markets of North America and Western Europe, private equity firms are taking great pains to highlight sector-specific operating resources they can bring to their portfolio companies. By contrast, in the emerging markets, especially in the “frontier” markets beyond the BRICs, general partners are finding that fundamental business practices and corporate governance systems can have transformative effects on the operations and on the value of their portfolio companies.

Such is the analysis of the three experts who participated in the recent Privcap thought-leadership series, “Value Creation & Corporate Governance in Emerging Markets Private Equity.” This fascinating conversation included Jeffrey Bunder, Global Private Equity Leader of Ernst & Young, David Creighton, Founder, President & CEO of Cordiant Capital, and Robert Petty, Managing Principal & Co-Founder of Clearwater Capital Partners. These private equity veterans have witnessed and indeed driven value creation in private businesses based in developing markets.

This Privcap Briefing is designed to summarize key observations made during the video series, as well as deliver a bonus feature article that we think you will find interesting. Privcap, with its partner Ernst & Young, sees value creation as among the most important topics in private equity generally, and as private equity becomes more influential in the developing world, it will behoove private equity market participants to be able to chart and communicate the value created by this powerful model for business building.

Enjoy the Briefing,
David Snow
Private equity is well suited for emerging markets

Private equity, with its long-term investment horizons, embrace of risk and volatility, and focus on adding value, is especially well suited for growing businesses in the emerging markets, where value creation requires not only capital, but expertise and time. The private equity model only works if portfolio companies are improved and “cleaned up” in preparation for the next step, be that a business expansion, an IPO, or a trade sale. Emerging markets are dominated by family-owned businesses, and these companies are often in need of basic improvements, such as professionally run finance departments. They need board members who can guide the business in new directions. They need disciplined leaders well versed in international business standards and best practices. Private equity’s ability to align interests between the provider of the capital and the recipient company executives is a powerful model for accomplishing these goals. “That transition period, call it the 4- to 8-year evolution, to then become a public company, transitioned from a family, from a manager to an owner, and the finance department from data to information... that is the goal and the success stories [of emerging market private equity],” argues Robert Petty, Managing Principal and Co-founder of Clearwater Capital.

Minority stakes require true partnerships

Many private equity deals done in the emerging markets involve the challenges and opportunities unique to minority stakes. Since even the largest emerging market companies tend to be family-owned, an outright sale is a rare event. Those investors that agree to take minority stakes also agree to less control than is seen in traditional buyout deals. The relationship of trust that minority stakes require starts at the diligence stage, when requests for more information are best asked for with sensitivity, not demanded. Minority investors must be especially prudent when choosing families and managers with whom they’ll rely on to create and execute important growth initiatives. Much like matchmaking, the right fit can make or break a deal. “There has to be that sort of chemistry with the management team that ultimately respects the different culture but captures the enhanced management model that PE offers its investment culture,” says Jeffrey Bunder, Global Private Equity Leader at Ernst & Young. “From a private equity perspective, it’s trying to figure out how you can be as local as possible but still essentially stick to your values.”

Governance often begins with cash control

“Corporate governance” is a term that is often used as a key to improving unsophisticated businesses. But
actually implementing better corporate governance is anything but a quick fix. Still, corporate governance initiatives remain key value drivers for emerging market investing. Such initiatives can begin with questions about who’s on the board and how often it meets to who controls the bank accounts and how money is distributed. Indeed, control of cash is very often the first issue that private equity sponsors must address with their new partners. “There are quite a number of companies that we’ve looked at... where the original founder still controls a substantial bank account,” notes Petty. “One guy and all the keys to the kingdom.” It is “still something very real and very personal for a founder to give up.”

**Increasingly, business owners ‘get’ private equity**

Although they may take a little convincing at first, many serious emerging market entrepreneurs and owner/operators recognize the opportunity private equity offers their businesses. “What they all of a sudden understand is that if they tidy themselves up, they can value their company at not just one time cash flow, but...”

Private equity increasingly is enjoying a reputation for helping companies in the emerging markets prepare for an initial public offering. David Creighton of Cordiant Capital noted that Chinese companies in particular are eager for Western private equity involvement prior to going public. “There are a number of companies that we have worked with where they figure that by engaging with groups like us, that’s going to give some sort of seal of Western approval and that’s going to create some value when they go to an IPO,” he said. “They are looking for anything to be able to create that slightly higher multiple when they actually go to the market.”

Agreeing, Robert Petty of Clearwater Capital, noted that even non-Western investors like Chinese private equity firms and sovereign wealth funds can add the pre-IPO stamp of approval. “It’s not just Western Capital, it’s also local capital, increasingly in some of these markets is a phenomenon worth mentioning and watching,” he said. “They also care about the corporate governance point when you talk about the large world-class sovereign wealth funds, whether they’re Asian or not.”

In private equity, risk is rewarded most often when risk is carefully calculated. Nowhere is that more true than the emerging markets. “From a private equity standpoint, investing in the emerging markets comes with quite a bit of risk,” says Jeffrey Bunder, Global Private Equity Leader of Ernst & Young.

Emerging markets often come with risks that aren’t even considered in the West. David Creighton of Cordiant Capital learned this when the local Chinese government suddenly diverted the water supply away from several of the firm’s portfolio companies. “We looked at the whole selection of potential risks that would be coming out of there, but we didn’t think of water,” Creighton said. “We just said— that’s a given. We won’t do that again.”

Creighton added: “Usually a lot of the businesses are kind of sausage factories. You go and just check and see what the inputs are and what the outputs are, and make sure that you have access to all those things. But you don’t often think about the fact that water is one of the inputs, and you should.”
at a multiple. That’s where you’re able to get them motivated,” says David Creighton, President & CEO of Cordiant Capital. It can be a difficult decision to suddenly take advice from a foreign newcomer. But private equity can make the difference between business-as-usual—with the potential to be left behind in their fast-growing economies—and a transformation from family operation into an efficient, well-oiled, profitable enterprise.

Seeming ‘Western’ does not equate good governance

Although the suite of best practices that private equity firms try to apply to emerging markets companies can reasonably be described as emanating from the most developed Western markets, it is a mistake for an investor to think that a management team’s fluency in English and familiarity with Western practices means that good corporate governance will be easier to establish. “Don’t confuse the fact that a professional can speak English with the fact that they know how to run a business in the emerging markets,” says Bunder. “And I think a lot of funds have sort of fallen into that trap in particular.” As Petty points out, fluency in local language, law and currency issues is paramount, and this local fluency trumps comfort with Western culture every time.

Personalities Matter

It should come as no surprise that interpersonal relationships are important in making private equity deals work in the emerging markets. The challenge of operating in these markets can sometimes come in the form of cultural clashes as well as the fact that private equity firms with minority stakes do not have the same options as they would in a majority position. All this puts an even higher premium on smooth relations. “I, as a Western male, am often not necessarily the right person to be sitting on the board,” says Robert Petty of Clearwater Capital. “Leading a transaction means building an interpersonal relationship with the founder of a business or the son of the founder of the business or some senior person on that board who is driving that.”

David Creighton of Cordiant Capital adds: “If you cannot connect, what I will do is I’ll step aside and get one of the other guys in the operation to see whether they connect. And if you go through the whole operation and there’s no seeing eye-to-eye on very basic things, about just partnering... then you really just shouldn’t pursue” the deal.

“There has to be that sort of chemistry with the management team that it ultimately is of a different culture,” adds Jeffrey Bunder of Ernst & Young.
Expert Q&A
with Jeffrey Bunder
Ernst & Young

What do private equity investors need to know about adding value to emerging markets companies?

> For a lot of private equity firms, emerging markets companies present PE firms with an opportunity to improve corporate governance—similar to how PE worked with companies in developed markets when the industry started. These are practices like establishing a board that meets regularly, any sort of audit committee or compensation committee, and a real corporate structure around business. These are not necessarily present in a lot of the emerging markets.

So from a private equity investor standpoint, corporate governance is high on the agenda in terms of what they need to institute in a lot of these businesses to add value—outside of the United States and Europe and in particular in the emerging markets—including the BRIC countries as well as some of the frontier markets that recently have seen a lot more private equity investment.

What can Ernst & Young do to help improve the corporate governance of portfolio companies in emerging markets?

> I think it starts with an audit. There are some companies out there, even sizable family-owned businesses, that don’t have an annual audit. So for starters, that would be our number one recommendation. Then from there, it’s really helping the business sort out its financial reporting, its finance department, taking information and creating financial reporting to then provide information to its key stakeholders.

What is your approach to helping investors manage risk?

> From a private equity standpoint, investing in the emerging markets comes with quite a bit of risk. We have local teams devoted to conducting due diligence on targets and they tend to know where the pitfalls are in the businesses that private equity investors are looking at. Years ago, it was difficult to conduct diligence in many of these locations. A lot of it was a fly-in exercise. We’ve evolved to a point now where we have local teams across the emerging markets that are experienced and have completed numerous diligence assignments for private equity sponsors.

There is a standard amount of work that gets done that is pretty similar to what we do in the developed markets. But then there are always some avenues to pursue in local markets that wouldn’t necessarily be obvious to private equity investors. That’s the value of our local teams. They understand the culture and how business is done and know where to turn over the rocks—looking for both risks and opportunity.

For more information, please contact Jeffrey Bunder at jeffrey.bunder@ey.com • ey.com/privateequity
Community & Gold in the Congo

How a private equity firm created value via housing and schools

PRIVATE EQUITY CAN BE FOUND AT WORK IN ALMOST every corner of the world, be it yuan-denominated funds installing corporate governance in China, board-seat activism in family-owned Indian companies, or bridge investments in pre-IPO Brazilian shoe companies. The work of the private equity investor should be to create value, and this can be accomplished via many methods.

But companies in the least developed, poorest regions of the world often face extreme barriers to prosperity absent from more developed markets, including civil war, corrupt governments, drug addiction and sexual violence. Not all private equity firms view these problems as deal breakers. In the case of Cordiant Capital’s experience with Banro Corporation, poverty and dysfunction present an opportunity to participate in something the firm calls “enlightened investing.”

Banro Corporation mines gold in the Democratic Republic of Congo, a country ravaged by malnutrition, extreme poverty and two recent wars, the second of which was the world’s deadliest conflict since World War II. Banro had been public since 2000, and upon discovery of gold near the city of Bukavu, decided to construct a Phase One mine the following year. Despite the region’s instability for foreign businesses, Montreal-based emerging markets specialist Cordiant Capital invested $13 million into the company over two transactions in the form of a PIPE deal.

At first, the going wasn’t easy for Banro. Democratic Republic of Congo’s mining industry had been corrupt and the local workforce, which had operated as solo artisan miners without permits, was not welcoming of the competition. “The old way of doing mining across Africa was you go in and have a couple of glasses of Johnny Walker scotch with the mining ministry, slide the envelope under the table and all of a sudden you have yourselves a concession,” said David Creighton, Presi-
dent, CEO and Founder of Cordiant Capital. That method didn’t do much for the country, the local people, or the economy. Employee well-being and safety wasn’t a concern, the local economies gained nothing, and once the mine was stripped of its precious metals, the companies departed.

Banro tried a different approach. On the advice of Cordiant Capital, the company created a foundation to support the community around the Bukavu mine. Banro Foundation secured the cooperation of a Congolese non-government organization (NGO) and, more impressively, CARE Canada, a humanitarian organization which had never before worked with a private equity firm. Banro Foundation immediately appointed local citizens to recommend development projects for the foundation to support. Since its creation in 2007, the foundation has completed 40 such projects related to education, health and social infrastructure for the communities surrounding Banro’s mine. A school serving 600 children was constructed. A health center serving several thousand villagers was built. A program to reintegrate former child artisanal miners provided counseling and skills training. Those displaced by the building of the mine have been compensated and resettled.

Meanwhile, Banro Corporation hired 3,000 local workers for its mines. The company sent miners on trips to mines in Ghana and emphasized professional development to its employees. Since entering the region, the company has experienced a mere 1.3 percent employee turnover rate, which Creighton says is a sign of the company’s positive effect on the community and has contributed to the mine’s overall success. Creighton says the deal is proof that corporate social responsibility and positive ROI need not be mutually exclusive. “People are beginning to wake up and recognize that by engaging with the community, though it might cost you a little bit to do it, ends up making projects much stronger,” he said. But more importantly, community involvement mitigates risks. By building a strong community that views the mines as a positive force, “Your risks are lower and your ability to do something that’s good is substantially higher,” Creighton said.

When Banro Corporation leaves the region, Banro Foundation will separate itself from the company and continue operations. “The whole idea [of the foundation] is to leave something that will exist on its own long after the mine is gone,” Creighton said. “Banro will leave a lasting presence within the region that will continue to endow a lot of these schools and social infrastructure projects.” The Banro deal is not the only time Cordiant Capital has used social responsibility to alleviate investment risks in comparatively dangerous regions. In 2006, the firm backed an investment in Eleme Petrochemical, a Nigerian polyethylene and polypropylene plant previously owned by the government. The region was rife with kidnappings and sabotage, making security the deal’s biggest risk. Cordiant decided to mitigate risk by engaging with the surrounding community—it awarded equity in the new entity to local people, employees and those displaced by the building of the plant in the late 1980s. “It was the best insurance plan you could ever get,” Creighton said. “The local people had an interest in protecting the plant because it’s theirs. Then once they start to receive dividend checks, it makes them more independent and financially in control. They now benefit from the plant’s existence, so they’ll protect it.” Cordiant still holds its investment in Eleme, which has yet to experience any issues with security while other multinational players have backed out of the region, Creighton noted. “People say to us, ‘How can you do business there? It’s a horrible place to do business.’” Creighton said. “I say, ‘Well that’s what you think.”
What does it take to become a leader in a rapid growth market? Learn from someone who already is.

If you want to build your business in new markets, you've a lot to gain from working with trusted local advisors. Ernst & Young has been working with private equity in rapid growth markets for over 10 years. We can give you key insights into how leading businesses are forging relationships with local partners. So you have what you need to achieve success. Find out more at ey.com/privateequity

See More | Growth
About Privcap

Private capital has a new channel for thought leadership: Privcap.

Privcap is a producer of, and destination for, high-quality content for participants in the global private capital markets. Through videos, podcasts, articles and supporting content, Privcap delivers valuable context for private capital investment, allowing investors to make better decisions and achieve greater success in the private capital asset classes.

Privcap's digital content is universally accessible to all who register, and highly navigable. Our goal is to produce the kinds of quality exchanges of intelligence that market participants expect from seminars and conferences, and to make these available online in a compelling and evergreen digital format.

Our signature video programs feature talk-show style, panel conversations and interviews. To learn more about how to use and benefit from Privcap content, and access our exciting forward calendar, log on to www.privcap.com

Contacts

Editorial
David Snow / dsnow@privcap.com

Sponsorships and Sales
Gill Torren / gtorren@privcap.com

www.privcap.com