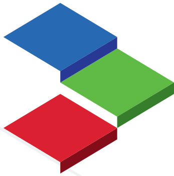

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Independent Evaluation of Bank Group Equity Investments

Summary Evaluation Report

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AFRICAN DEVELOPMENT BANK GROUP

October 2015

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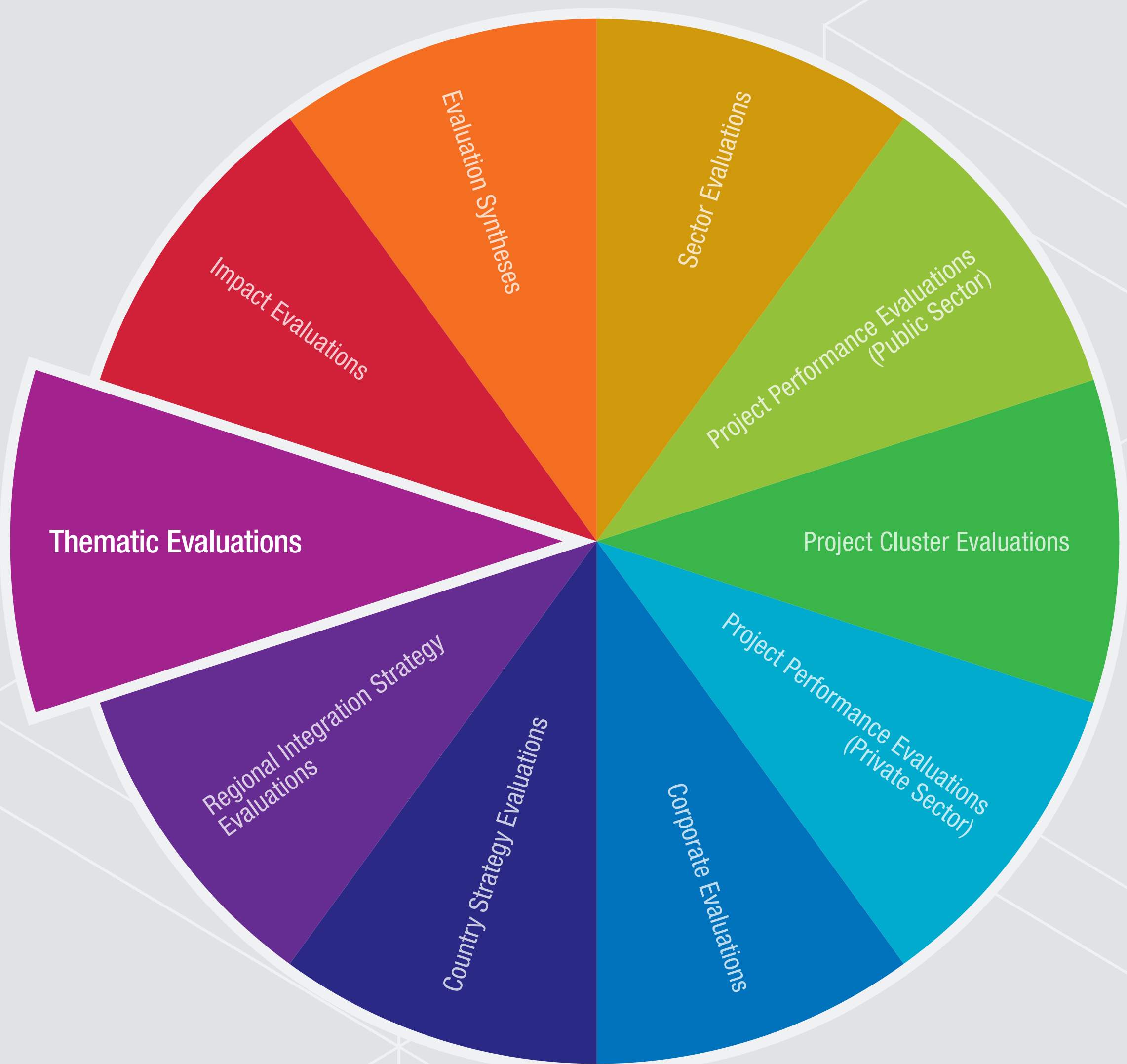

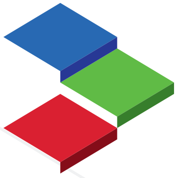

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Task manager	**Hadizatou Sidikou**, Principal Evaluation Officer, IDEV
Team member	**Elsa de Morais Sarmento**, Former Principal Evaluation Officer, IDEV
Consultants	**LP Analyst**, LP Cambridge Associates LLC
External peer reviewer	**Nicholas Burke**
Knowledge management officer	**Felicia Avwontom**, Principal Knowledge Management Officer, IDEV **Kobena T. Hanson**, Consultant, IDEV
Other assistance / contributions provided by	**Henda Ayari**, Team Assistant, IDEV.1
Special thanks to	**Norad** – the Norwegian Agency for Development Cooperation
Division manager	**Rafika Amira**, Division Manager, IDEV.1 **Mohamed Manai**, Former Division Manager, IDEV.1
Evaluator-General	**Rakesh Nangia**

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IDEV Thematic Evaluation, October 2015

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The overarching objective of the African Development Bank Group is to spur sustainable economic development and social progress in its regional member countries (RMCs), thus contributing to poverty reduction. The Bank Group achieves this objective by mobilizing and allocating resources for investment in RMCs and providing policy advice and technical assistance to support development efforts.

About Independent Development Evaluation (IDEV)

The mission of Independent Development Evaluation at the AfDB is to enhance the development effectiveness of the institution in its regional member countries through independent and instrumental evaluations and partnerships for sharing knowledge.

Independent Development Evaluation (IDEV)
African Development Bank Group

Avenue Joseph Anoma, 01 BP 1387, Abidjan 01, Côte d'Ivoire

Phone: +225 20 26 20 41

Fax: +225 20 21 31 00

E-mail: idevhelpdesk@afdb.org

idev.afdb.org

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Contents

Acknowledgements ii
Abbreviations & Acronyms v
Glossary vi
Executive Summary 1
Management Response 5

Introduction 13

Background 13

Africa's Economic Growth 13
Private Equity in Africa 14

Evaluation Approach 17

Evaluation Rationale, Purpose and Scope 17
Evaluation Issues, Questions and Methodology 17
Limitations 18

Evaluation Findings 21

Relevance: Alignment with the Bank's Strategy and Priorities 21
Performance of Bank's Equity Investments 24
Financial Performance 24
Effectiveness 32
Risk Management 36

Conclusions and Recommendations 45

Annexes 49

Annex A: Methodology 50
Endnotes 52

Contents

List of Figures

Figure 1	Africa's Economic Output	13
Figure 2	Limited Partner's planned changes to their emerging market PE investments over next two years	14
Figure 3	Africa Fundraising Totals, 2008-H1 2014	15
Figure 4	Number and Aggregate Value of Private Equity-Backed Buynot Deals in Africa Q1 2009-Q3 2014	16
Figure 5	Regional diversification, Fund Investee Cost Basis	22
Figure 6	Figures in UA Millions as of December 31, 2013	25
Figure 7	J-curve	26
Figure 8	Proportion of Fund Commitment by Stage	27
Figure 9	Fund Commitments by Strategy	27
Figure 10	South Africa Infrastructure Fund	28
Figure 11	Pan-American Infrastructure Development Fund	29
Figure 12	Growth Analysis	39
Figure 13	Holding Values, fund portfolio	39
Figure 14	Disbursement Pace Analysis; Exposure	40
Figure 15	Strategy Drift Analysis by Exposure	41
Figure 16	AfDB Fund Cash Flow Projections	42

List of Tables

Table 1	AfDB Equity Portfolio as of 31 December 2013	17
Table 2	Fund Investee Cost Basis, by Alignment (UA millions)	21
Table 3	Fund Investee Cost Basis, by Country Fragility (UA millions)	23
Table 4	Fund Investee Cost Basis, by Size of Enterprise	23
Table 5	AfDB Direct Investment Portfolio	32
Table 6	Job Creation	33
Table 7	Job Creation for Women	33
Table 8	Tax Revenue Generation	34
Table 9	EMP Added	35
Table 10	Weighted-Average Portfolio Risk Rating, using Bank capital account information and risk ratings	37
Table 11	Changes in risk rating, by sub-portfolio	37
Table 12	Capital Loss Ratio details	38
Table 13	Capital at Risk figures, in UA millions	38
Table 14	Country Risk, Total Portfolio	40
Table 15	Disbursement Pace Analysis, by stage of fund; Exposure figures in UA Million	41

List of Boxes

Box 1	The case of South Africa? Where is Additionality?	35

Abbreviations & Acronyms

ADOA	Additionality and Development Outcomes Assessments
AfDB	African Development Bank
AVCA	African Private Equity and Venture Capital Association
BTOR	Back to Office Report
BPOPF	Botswana Public Officers Pension Fund
BRICS	Brazil, Russia, India, China and South Africa
CA	Cambridge Associates
CDC	CDC Group Plc
CDG	Center for Global Development
CPIA	Country Policy and Institutional Assessment Index
DFI	Development Finance Institution
DO	Development Outcomes
EMPEA	Emerging Market Private Equity Association
EMP	Environmental Mitigation Plans
ESG	Environmental, Social and Governance
EY	Ernst & Young
EPPF	Eskom Pension and Provident Fund
EIB	European Investment Bank
ESR	Expanded Supervision Report
FMO	Netherlands Development Finance Company
GEPF	Government Employees Pension Fund
GIPF	Government Institutions Pension Fund
GDP	Gross Domestic Product
IPO	Initial Public Offering
IFC	International Finance Corporation
IMF	International Monetary Fund
LP	Limited Partner
ME	Micro Enterprises
MSME	Micro, Small and Medium-Sized Enterprises
MFI	Microfinance Institutions
MIC	Middle-Income Countries
MSCI	Morgan Stanley Capital Investment
NAV	Net Asset Value
NPV	Net Present Value
NSO	Non Sovereign Operations
PE	Private Equity
PSO	Private Sector Operations
PSR	Project Status Report
RMC	Regional Member Country
SME	Small and Medium-Sized Enterprises
PROPARCO	Society for Promotion and Participation for Economic Cooperation
TVPI	Total Value to Paid-In

Glossary

Capital distribution	Returns received by an investor in a private equity fund. The capital distribution is the income and capital realized from investments less expenses and liabilities. Once a limited partner has had their cost of investment returned, further distributions are actual profit. The partnership agreement determines the timing of distributions to the limited partner and how profits are divided among the limited and general partners.
Exit	The means by which a fund can realize its investment in a company – including by an initial public offering, a trade sale, a sale to another private equity firm or a company buy-back. An investment may also be structured with a provision for a put option or be self-liquidating (e.g., mining investments).
Hurdle Rate	Minimum return distributed to the limited partners until such time as the general partner is eligible to deduct **carried interest**. The preferred return ensures that the general partner shares in the profits of the partnership only after investments have performed well.
Internal rate of return (IRR)	Most commonly cited performance benchmark for private equity investments. In simple terms, IRR is a time-weighted return expressed as a percentage. It is the discount rate which, when applied to the time series of cash drawdowns (money invested) and distributions (money returned from investments) and the current value of unrealized investments, results in a net present value of zero.
Leveraged buy-out (LBO)	The acquisition of a company using debt and equity finance. The term leverage implies that more debt than equity is used to finance the purchase, e.g. 90% debt to 10% equity. Normally, the assets of the company being acquired are put up as collateral to secure the debt.
Private Equity Fund	A private equity fund typically makes investments in unlisted companies using the capital raised from limited partners. The fund is raised and managed by investment professionals of a private equity firm (the general partner or fund manager).
Quartile	One fourth of the data points in a data set. Often, private equity investors are measured by the results of their investments during a particular period of time. Institutional investors often prefer to invest in private equity funds that demonstrate consistent results over time and that place in the upper quartile of the investment results for all funds.

Secondary market	The market for secondary buy-outs. Not to be confused with secondaries.
Secondary PE Market	The market for a private equity (PE) fund or direct investment stakes is relatively illiquid, but transaction volume has increased significantly in recent years.
Venture capital	The term given to investments in early-stage companies/start-ups: a segment of the private equity industry that focuses on investing in new companies with expected high growth rates.
Vintage year	The year that a private equity fund stops accepting new investors and begins to make investments on their behalf. Sometimes defined as the year when the private equity fund had its first close or makes its first investment.

Executive Summary

Introduction and Evaluation Approach

This report presents the findings of an evaluation of the Bank Group's Equity Investments. This evaluation was conducted in order to inform Bank's decisions on the future use of equity investments by identifying lessons and potential areas for improvement. As such, the purpose of the evaluation is two-fold: 1) assess the relevance and performance of the Bank's equity investments; and 2) identify lessons, recommendations and areas for improvement.

The evaluation covers the combined fund and direct investments in the equity portfolio, which represent capital commitments of UA 740M and disbursements of UA 475M (64%) of capital commitments.

Several data collection methods were used. These included a literature review on the latest trends and issues related to equity investments in Africa, a thorough portfolio and program review to assess trends, measure risk, and complete bottom-up cash flow projections to support pacing and liquidity analysis, a survey of all fund managers, field visits to a sample of projects to collect development outcomes (DO) indicators, a financial database sourced from quarterly and audited financial statements of the funds partnership, and a benchmarking analysis comparing the Bank's portfolio with a customized private equity fund focused on Africa and with relevant benchmarks of public market securities.

Evaluation Findings

Relevance: Alignment with the Bank's Strategy and Priorities

Relevance was rated satisfactory. The majority of the Bank's equity investments (both private equity and direct investments) are aligned with its industrial objectives and priorities. In addition, the investments adequately support regional diversification, regional integration, Micro Enterprises, Small and Medium Enterprises (MSMEs), and fragile states to a lesser extent (for equity funds).

Equity investments were assessed in terms of their alignment with the Bank's key sectors, regional diversification, regional integration, support of MSME[1] and fragile states:

- Industry analysis for the fund portfolio shows adequate alignment between actual funds investee cost basis and the Bank's priorities, particularly with regard to infrastructure. However, a sizeable proportion (14%) of the funds are not clearly aligned with Bank priorities. In addition, all direct investees are financial institutions, which directly supports the Bank's strategy of developing soft infrastructure.

- The equity funds have invested capital in companies across 35 countries, demonstrating a high level of regional diversification. Pan-African funds, the largest category, represents companies that operate across several countries. However, a substantial proportion of the investments (25%) was concentrated in only two countries – Nigeria and South Africa. With respect to direct investments, regional diversification is adequate, with investees headquartered in 12 countries.

Three companies headquartered in Nigeria have received 29% of disbursements, followed by four companies in Kenya with 19% of disbursements. In addition, many direct investees operate and have branches in several countries, further diversifying the portfolio.

- The Bank's equity investments in infrastructure and in a high number of countries are likely to promote regional integration. In addition, the direct investments portfolio is well aligned with the Bank's priorities of promoting regional economic integration. Twelve investees have operations in multiple countries, representing 89% of the disbursed capital. Some of these companies specifically seek to increase African trade, while others are financial institutions operating in several regions.

- Actual fund investee cost-basis is adequately aligned with the Bank's objectives of supporting MSMEs. Approximately 34% of the capital has been invested in MSMEs while 52% has been invested in Large Enterprises (LE). This is due in part to the fact that larger enterprises naturally require larger equity investments compared to MSMEs. Investee companies included 462 MSMEs (with an approximate average investment of UA 216,000) and 52 large enterprises (with an average investment of UA 2.9 million). With respect to the direct investments portfolio, 15 of the 19 investees (representing 60% of disbursed capital) are MFIs and DFIs, which would be expected to benefit MSMEs. On the other hand, MSMEs comprise only a small portion of direct investees. This is to be expected, as a large portfolio of small direct investments would be resource-intensive.

- Only 10% (UA 27 million) of the total fund investee cost-basis has been invested in companies operating in fragile states. This is unsurprising as fragile states are less attractive to many private equity managers given that they often have less-developed institutional frameworks, weaker governance, and experience social conflict. However, considering the Bank's low-income country and fragile states country limits for the private sector, this breakdown achieved via funds is higher than the overall private sector department financing.[2] Seven of the direct investees (22% of all disbursed capital) are headquartered in fragile states, and another four are known to have branches in fragile states (38% of disbursed capital); a substantial proportion of disbursements goes directly to investees operating in fragile states.

Performance: Financial Performance and Effectiveness

Overall, the performance of the Bank's equity investments has been rated moderately satisfactory*, based on the assessment of financial performance and the effectiveness of equity investments. Financial performance was rated* satisfactory *as the majority of mature funds are in the first quartile compared to their benchmarks. Results for more recent funds were mixed, but the majority were lagging behind their benchmarks. It is too early, however, to make a definitive judgement on the more recent funds, which are still at early stages of the J-curve. Effectiveness (i.e., outcomes' achievement) was rated as* moderately unsatisfactory *because: 1) a substantial proportion of funds were behind in their plans or did not meet their targets on two key outcomes (job creation and tax revenues) and, 2) there was a lack of reliable outcomes data, particularly on direct investments. That said, it is still too early to make a final assessment of these results and the Bank has sufficient time to catch up on its targets.*

Financial Performance

Since 2007, the Bank has experienced a rapid consumption of risk capital, leaving only a modest proportion (38%) of the 15% limit to be used until 2020.

Fund investments are immature, and several years away from liquidity: 1) more than half of the commitments are at an early stage (fundraising and investment); 2) the majority of funds have inception dates later than 2008, and 3) the weighted average age of underlying companies is lower than the typical private equity company holding periods.

Compared to their vintage year benchmarks (both the general universe and Custom Benchmark for Africa), the majority of mature growth funds performed well. However, the eight private equity funds (2008 and 2009 vintages) all had total value multiples that trailed the pooled averages of the broader universe of emerging markets funds. The picture is slightly better when compared to the Custom Benchmark for Africa, where two of the eight are ahead of their comparators. Most of the value of funds from 2008 vintage onwards is held in unrealized investments.

Investments in key sectors such as Information Technology (IRR: 37.1%), Financial Services (IRR: 14.2%), Manufacturing (IRR 19.5%), and Transportation (IRR: 10.4%) had the strongest performance. Health Care (IRR: 23.9%) and Industrial (IRR: 35.5%), which accounted for a small amount of capital, also had strong performance. Consumer/Retail (IRR: 5.4%), Energy: Upstream/Royalty (IRR: 5.4%), Construction (IRR: 0.3%), and Timber (IRR: 1.8%) lagged with modest rates of return.

Effectiveness

The Bank's funds are generally lagging behind their targets for job creation, and a sizeable proportion of committed capital did not meet its Tax Revenue Generation targets:

- ***Early results data are partial but indicate that the majority of the Bank's equity funds are either behind their plan or missing their job creation targets.*** Only 19% of the evaluated committed capital was invested in funds considered ahead of plan, while the remaining capital was committed to funds considered behind plan (53%) or that have failed to meet the targeted outcomes (28%). While results data for job creation for women are more positive than the overall job creation numbers, they are still far behind target. About 57% of the evaluated committed capital was invested in funds considered on or ahead of plan in terms of job creation for women, while the remaining capital (43%) was committed to funds considered behind plan.

- ***While the majority of evaluated committed capital was on plan to meet their targets for tax revenue generation, a sizeable proportion of evaluated committed capital did not meet its targets.*** About 65% of the evaluated committed capital was invested in funds considered on or ahead of plan in terms of annual tax revenue generation, while the remaining capital was committed to funds considered behind plan (12%) or that did not achieve their targets (23%).

On the positive side, the Bank's equity funds performed well with respect to environmental plans. The majority of capital is invested in companies that either had or had added environmental mitigation plans (EMPs). About 31% of the evaluated company cost-basis was invested in companies that had added EMPs post-investment. An additional 27% of the capital was in companies that already had EMPs in place at the time of investment. About 13% of the capital was invested in companies that have not yet added EMP plans, but these may be in industries that are not expected to have negative environmental impacts and therefore may not require such plans.

The Bank has played a catalytic role in mobilizing additional resources for private equity, particularly in sub-Saharan Africa. However, the level of the Bank's additionality is limited in Middle-income countries such as South Africa, which has the potential of raising sufficient funds without Bank assistance. Moreover, as a limited partner and adviser, the Bank may be missing an opportunity to play an active role

in the management of equity funds and influence investment decisions.

Risk Management

The overall risk rating of the equity portfolio has not changed on a weighted-average basis. However, subsequent to enhanced models, the fund portfolio's risk rating was downgraded slightly from 5+ to 5. By contrast, the direct investment portfolio was upgraded from 5+ to 4+. Over 80% of investments by value have experienced a change in ratings since appraisal, indicating a significant change in the Bank's understanding of each investment's risk profile since appraisal.

It is important to maintain a consistent commitment pace and not over- or under-invest in certain vintage years. The inconsistent commitments to the asset class year-to-year make reliable cash flow forecasting even more critical, as it is an important aspect of effective private equity portfolio management. As indicated above, the Bank has set an equity limit of 15% for the portfolio calculated based on total risk capital[3]. As a result of significant investments made during 2008, and to a lesser extent, in 2010 and 2011, the risk capital utilization rate is quickly approaching this limit. In response to concerns among internal and external stakeholders alike, the Bank has dramatically reduced the overall pace of its commitment year-over-year since 2011. A better understanding of expected future capital calls and distributions for fund investments is critical to the future commitment and active portfolio management decision-making process.

The scope of the evaluation study did not include assessing the adequacy of the Bank's risk methodology. However, a number of stakeholders have raised some noteworthy concerns to the Bank's risk methodology and its application.

Recommendations

Recommendation 1: Continue investments in private equity funds and further strengthen portfolio oversight and management.

Recommendation 2: Develop and implement a multi-pronged investment strategy that would allow for an approach that responds to the Bank's diverse priorities and strategic objectives, by for example, establishing two investment streams: 1) a core portfolio that would focus on making larger investments supporting established fund managers with proven track records and a history of making investments that align with the Bank's priorities and, 2) a second higher-risk sub-portfolio that would focus on making smaller investments supporting first-time managers with strategic objectives related to fragile states or SME focus.

Recommendation 3: Review the risk capital limit of 15% risk and/or develop and implement an effective exit strategy for some of the older investments to free up capital.

Recommendation 4: Conduct a detailed, rigorous cash flow projection exercise.

Recommendation 5: Review the Bank's Risk Management methodology in light of concerns raised by several stakeholders.

Recommendation 6: Develop and implement a results-based management strategy to ensure 1) a streamlined, strengthened monitoring system of equity investments and, 2) a rigorous development outcomes tracking system.

Management Response

Management welcomes IDEV's evaluation of AfDB's private equity portfolio, which presents a fairly positive view of the Bank's interventions. The evaluation is timely, as Management is reviewing some of the Bank's systems for building and managing the portfolio. The portfolio has reached a level of maturity that allows a number of conclusions to be drawn on its performance. These conclusions will inform the Management Framework for Equity that is currently being prepared. Overall, Management agrees with most of the findings and recommendations of the evaluation, while providing clarifications on issues where it has reservations.

Introduction

Management notes with satisfaction that the evaluation emphasises the importance of equity investing as an engine of economic growth and development.[4] Equity remains the foundation of project financing and enterprise growth. This is because most African enterprises and projects are under capitalised and struggle to attract the volume of financing they need. The Bank's equity investment strategy has evolved with the needs and capacities of the market. Historically, the Bank invested directly in financial institutions to help build the African financial sector, notably national and regional Development Finance Institutions (DFIs). In the late 1990s, it began deploying equity through third-party managed funds. In doing so, it sought two objectives: i) to better target the capitalisation of the real economy including the infrastructure sectors, and ii) to spur the emergence of an African equity management industry. This is why Management is encouraged by the finding that the Bank has positively contributed to the development of the African private equity industry. From 2007 to date, the Bank has partnered with other Development Finance Institutions and commercial investors, committing capital in 37 active funds.

By deploying equity through third-party-managed funds, the Bank aims to make best use of their dedicated management teams. These bring invaluable technical and corporate governance know-how and help connect entrepreneurs to industry networks. In addition, working with pooled capital vehicles, enables the Bank to:

- Leverage the transactional capabilities of fund management teams to execute, grow and exit investments;
- Increase the number of enterprises reached, and;
- Mutualise the risks and transactional costs of equity investing into numerous portfolio companies with co-investors and fund managers.

In conclusion, Management agrees with the evaluation finding that the private equity industry needs sustained support to:

- Enable new managers and enterprises to emerge, and;
- Allow more experienced managers to establish the necessary track record to mobilise African and global institutional and commercial investors beyond DFI financing.

Strategic Alignment

Management welcomes IDEV's finding that the portfolio is aligned with the Bank's strategies

and priorities. Indeed, like all NSOs, equity investments are systematically selected on the basis of their alignment with the Bank's development strategies and priorities. One noteworthy feature of the equity portfolio is the particularly high number of investee companies supporting medium and small enterprises, fragile countries and regional projects. Another strategic objective of the equity portfolio is to contribute to the diversification of the Bank's overall portfolio. In implementing this strategy, Management is mindful that it needs to consolidate the Bank's exposures in more mature markets. This is consistent with the Bank's strategy to attract commercial and institutional investors that have less appetite for risk than DFIs. This also enables the Bank to continue growing prudently its higher-risk exposures in more frontier markets and with less experienced teams.

Oversight and Management

Management agrees that strengthening the oversight and management of the equity portfolio will help create financial and development value. To this end, Management is preparing a Management Framework for Equity to guide future portfolio construction and management. The Framework will define how the Bank exercises its oversight and fiduciary function as shareholder in funds and corporate entities. Management is also implementing FrontInvest—a specialised equity management software used by other DFIs. The software will provide a platform for tracking cash flows, financial data on investee companies, and development outcomes.

Adopting a Segmented Strategy

Management fully adheres to the recommendation to adopt a segmented approach to equity investing by combining large tickets with experienced teams and smaller tickets in more frontier markets/sectors and with first-time teams. This approach, to be elaborated in the Management Framework for Equity, will enable the Bank to leverage more effectively equity instruments towards its different priorities and strategic objectives. The Bank's investments in 37 active funds strike an equal balance between first-time and established teams. The Bank can now further develop its base portfolio with more experienced teams and with strategies aligned with the Bank's priorities. Maintaining this strong base allows the Bank to support (cross-subsidise) investments in more difficult regions and continue investing in new teams, increasing management and investment capacity on the continent.

Equity Risk Capital Adequacy

Management is carefully considering IDEV's recommendation to increase the equity risk capital ceiling from 15% to 20%. While scaling up the deployment of equity instruments—in line with peer DFI practices and market demand—may indeed require raising this ceiling, at least three arguments warrant prudence:

First, the Bank's current equity risk capital utilisation rate is well within prudential ceilings; and its equity portfolio continues to progress towards the upside of the J-curve. At end-Q2 2015, the cumulative equity risk capital utilisation level stood at 10.29%, or 68% of the limit (of 15% of NSO risk capital).

Second, at the current pace of annual approvals (UA 80-100 million), the equity portfolio will remain below the 15% ceiling as the investment strategy builds in a rolling over of equity capital. Indeed, 75% of the portfolio is made up of funds that have a built-in exit timeline. And half of committed capital is deployed through funds that are already in the divesting stage, in line with the self-liquidating nature of funds. The total capital returned to the Bank at end-June 2015 amounted to 27% of disbursed capital. Capital reflows from the funds are expected to gain momentum from 2017-18. Direct investments in financial intermediaries have mostly been buy-and-hold assets. Hence, more recent direct investments have specific exit structuring conditionality at entry.

Third, Management believes that the ceiling cannot be increased without reviewing the other ceilings set in the Capital Adequacy Framework for NSOs and sovereign operations. For example, an increase in the equity limit to 20% of total risk capital would reduce the risk capital available for sovereign and non-sovereign operations.

For all of these reasons, Management views an increase in the equity limit as an option of last resort that is not justified under current conditions. Other exposure management measures should precede a limit increase, including the continued optimisation of risk methodology and risk capital charges for equity investments; a measure currently performed in the implementation of the capital adequacy framework.

Management disagrees with the need to systematically pursue early portfolio exits to release equity headroom. This is because market soundings on secondary opportunities show that net asset values would be heavily discounted (given the early-stage nature of the portfolio). As the portfolio matures and market appetite for African assets grows, further opportunities may arise on more favourable terms. However, as equity investments contribute to the Bank's financial sustainability, Management will approach these opportunities with caution. Indeed, indiscriminately discounting portfolio assets would erode shareholder value.

Cash Flow Projection Exercise

Management agrees that a detailed and rigorous cash flow projection exercise is both necessary and timely. The most mature funds have reached the end of their investment period and are fully invested. Fund managers are updating cash flow projections to reflect actual investments, for each investee company. These actions provide the basis of a robust portfolio-wide cash flow projection exercise.

The Private Sector Operations Department (OPSD),[5] Financial Risk Management Department (FFMA) and Group Chief Risk Department (GCRD) have initiated a review of the financial projections for the equity portfolio as a whole, to reflect expected cash deployment and returns on the basis of actual figures, rather than (conservative) assumptions. This exercise will become an ongoing feature of the Bankwide financial projections review, and periodic updates will be included in the annual equity portfolio status report to the Board of Directors.

Risk Management Methodology

Management notes that the evaluation did not specifically consider the adequacy of the Bank's risk methodology for equity. Management is currently reviewing the methodology for risk rating at inception and throughout the life of equity investments. It also maintains an ongoing rating review to ensure that the ratings are at all times an adequate reflection of the portfolio.

Currency risk, diversification risk and managers' execution risks are embedded in the high-risk rating assigned to equity investments. The Bank carries out periodic reviews of the equity methodology, notably as regards the risk capital charges applied to different equity instruments. For example, acting on the findings of a review of the Bank's risk capital management framework, the Bank reduced the amount of risk capital charges applicable to equity transactions from 100% to 85% for unlisted equity. Other opportunities to review risk capital charges are emerging as the portfolio matures. A better understanding of portfolio dynamics, in particular portfolio gains and losses over time, will further inform proposals to optimise the risk capital charges used for equity. Continued optimisation of the Bank's risk capital management framework is, therefore, regarded as an important management tool as market demand for equity-like instruments grows.

Results-Based Management Strategy

Management agrees that the equity portfolio is still maturing and many development results are still in the making. It also agrees that results reporting must be systematically implemented. The immaturity of the portfolio at the time of the evaluation—2013—together with the fact that results were consolidated against ex-ante measurement indicators applied only since August 2009[6], accounts largely for the scarcity of information. Therefore, Management views findings pertaining to the development effectiveness of the portfolio as premature.

Moreover, Management does not agree with the conclusion that the ADOA indicators are inadequate. The ADOA Framework—the foundation of a results-based management system—is consistent with the best practice standards for development results indicators for private sector investment operations, laid out by the International Financial Institutions Harmonization Group (the Bank is one of the Group's 25 members). The ADOA assessment for private equity funds takes into consideration the outcomes expected from the fund and from investees. As the portfolio continues to develop and deploy, the OPSD monitoring team is collecting and compiling information on the ADOA indicators for tracking development outcomes.

Fund managers' use of a development outcomes tracking system is becoming a standard source of the Bank's additionality in equity funds. The challenge is to apply these monitoring systems during project implementation, and to ensure that reporting on development outcomes becomes as standard as the adoption of environmental and social impact management systems in projects.

Management recognises that development results tracking in respect of direct equity investments will require further attention. With its direct equity investments, the Bank typically supports clients' corporate-wide capital expansion plans. This type of intervention is not well suited to the identification of specific development targets, particularly for financial institutions that have a systemic/wholesale (rather than project- or company-level) role. Thus it is difficult to identify and quantify the development outcomes that are associated specifically with the Bank's equity contribution. The current reporting framework restricts the measurement of outcomes—for example, changes in the number, size and tenor of loans offered—to the financial institution (excluding outcomes at the level of the financial institution's clients).

To strengthen results monitoring and Bankwide reporting, Management has prioritised streamlining and standardising equity reporting systems to cover all aspects, including tracking development outcomes. As capital continues to be deployed in investee companies, results data are being systematically collected and compiled.

The evaluation's finding that the Bank's equity funds investment has contributed to the implementation of improved environmental and social safeguards provides further reassurance. In addition, although the evaluation does not explicitly consider this point, Management notes that the implementation of corporate governance good practice standards is a key driver of enterprise value creation for fund managers. Implementing the necessary accounting, financial management, employment conditions, reporting, decision-making and shareholder oversight systems not only improves the financial performance of the investee company, but is also seen as a precondition to achieve exit on attractive terms. To this end, fund management teams typically mobilise dedicated transaction support capacity to implement environmental, social and governance good practice standards in investee companies, particularly the small and medium enterprises. Beyond the Bank's own reporting system, the most experienced fund managers systematically generate proprietary annual development outcomes reports, highlighting investee company-level results.

Conclusion

The evaluation provides valuable recommendations, many of which are in line with recent Management actions. The Bank is already preparing documents that respond to the recommendations:

- The Revised Non-Sovereign Operations (NSO) Policy, with provisions superseding the 1995 Equity Policy (distributed on 3 July 2015 for CODE discussion);
- The first Annual Management Equity Status Report; and;
- A Management Framework for Equity Portfolio Construction and Management, which is intended to formally integrate the lessons from the last 10 years of equity investing and inform the strategic direction of the PSD and FSD Strategies.

MANAGEMENT ACTION RECORD	
Recommendation	**Management's Response**
Recommendation 1: Further strengthen oversight	
Continue investments in private equity funds and further strengthen the oversight and management of the portfolio.	**AGREED.** Equity instruments will remain a significant tool among the Bank's financial instruments. To ensure that further growth of the equity portfolio helps create financial and development value for the Bank, Management will give specific attention to defining and implementing systems for deploying and managing the equity portfolio. Management actions include the following: **Actions:** ▌ **COSP** to revise the Non-Sovereign Operations (NSO) Policy, with provisions superseding the 1995 Equity Policy, for presentation to CODE by **Q4 2015**. ▌ **OPSD** to complete a Management Framework for Equity Portfolio Construction and Management (with input from OFSD, GCRD, EDRE, GECL, ONEC), to be adopted by OPSCOM by **Q1 2016**. ▌ **OPSD** to update the Private Equity Manual for clearance by OPSCOM by **Q1 2016**. ▌ **OPSD**, with support of CIMM, to implement the private equity management and monitoring software, which will go live by **Q4 2015**.
Recommendation 2: Develop and implement a multipronged investment strategy	
Develop and implement a multipronged investment strategy that would allow for an approach that respond to the Bank's diverse priorities and strategic objectives, by, for example, establishing two investment streams: (1) a core portfolio, which would focus on making larger investments supporting established fund managers with proven track records and a history of making investments that align with the Bank's priorities and; 2) a second higher-risk sub-portfolio, which would focus on making smaller investments supporting first time managers with strategic objectives related to fragile states or SME focus.	**AGREED.** The Bank is developing a Management Framework for Equity that is based on the recommended multipronged approach. The aim is to maintain a balanced rating of the portfolio and an adequate return on capital with experienced management teams while ensuring adequate deployment of capital in frontier/transition markets/sectors where the ratings and returns are more challenging, using first-time teams. **Actions:** ▌ **OPSD** to complete a Management Framework for Equity Portfolio Construction and Management (with input from OFSD, GCRD, EDRE, GECL, ONEC), to be adopted by OPSCOM by **Q1 2016**.

MANAGEMENT ACTION RECORD	
Recommendation	**Management's Response**
Recommendation 3: Actively manage headroom: Increase the 15% limit and develop an effective exit strategy	
Review the risk capital limit of 15% risk and/or develop and implement an effective exit strategy for some of the older investments to free up capital.	**AGREED IN PART.** The Bank's current equity risk capital utilisation is well within prudential ceilings and the pace of capital recycling is increasing. This increased availability of capital alone should enable the operating divisions to sustain business volumes at current levels. All new direct equity investments feature explicit and implementable exit strategies. In parallel, Management continues to optimize risk methodology and risk capital charges for equity investments. Management therefore views an increase in the equity limit as an option of last resort that is not justified under current conditions as it would have a significant effect on other business lines. As regards early portfolio exits through secondary sales, Management's view is that, unless a rapid growth of the Bank's equity portfolio poses the immediate risk of prudential ceiling breach, such exits should be considered only when pricing valuations adequately compensate the Bank for the economic cost of equity risk capital. Nevertheless, OPSD's ongoing monitoring of the portfolio will continue to include assessing opportunities for exits, partial exits and early exits **Actions:** ▌ **COSP** to present the revised NSO Policy to CODE by **Q4 2015** that will supersede the 1995 Equity Policy. ▌ **GCRD** to implement the 4-stage model for equity risk ratings, to better calibrate risk capital utilisation relative to the position of each investment in its life-cycle by **Q4 2015**. ▌ **GCRD** to continue linking the risk capital consumption of each equity investment to the risk rating of the investment as part of its implementation of the Economic Capital Adequacy Framework.
Recommendation 4: Conduct a detailed cash flow projection exercise	
The Bank should complete a detailed "bottom-up" cash flow projection exercise. While this analysis was completed in the Cash Flow Projection Analysis section of the report, several data limitations affected its overall reliability. If the Bank can organise the required documents and data to mitigate these limitations, it can enhance the overall usefulness of these projections in making portfolio-level decisions.	**AGREED.** As the most mature funds have reached the end of the investment period and are fully invested, fund managers are submitting cash flow projections for each investee company. These projections can be aggregated and used for the Bank's bottom-up cash flow projection exercise. Of course, such an exercise can be performed only with funds that are close to reaching or that have reached the end of the investment period, as the most recently committed funds have yet to make investments. **Actions:** ▌ **OPSD, FFMA** and **GCRD** are jointly reviewing financial projections. Updates will be included in the Bankwide financial projections review and in the annual equity portfolio status reports that OPSD will distribute to the Board of Directors by **Q4 2015**.

MANAGEMENT ACTION RECORD	
Recommendation	**Management's Response**
Recommendation 5: Review the Bank's risk management methodology	
Review the Bank's Risk Management methodology in light of concerns raised by a number of stakeholders.	**AGREED IN PART.** Management notes that the evaluation does not specifically consider the adequacy of the Bank's risk management methodology for equity. Nevertheless, with a maturing portfolio, opportunities are emerging to consider actual portfolio dynamics, notably portfolio gains and losses over time, to optimise the risk capital charges used for equity. Continuous risk capital methodology optimisation is an integral part of implementing the Bank's Capital Adequacy Framework. **Actions:** ▌ **GCRD** to implement the 4-stage model for equity risk ratings, to better calibrate risk capital utilisation relative to the position of each investment in its life-cycle by **Q4 2015**.
Recommendation 6: Strengthen development outcomes tracking system	
The Bank should develop and implement a results-based management strategy.	**AGREED IN PART.** Management views findings pertaining to the development effectiveness of the portfolio as premature as the equity portfolio is still maturing and as many development results are still in the making. Management disagrees with the statements about the inadequacy of the ADOA indicators as the ADOA Framework actually specifies the indicators to be used in the ex-ante assessment of equity investments, consistent with best practice standards. The ADOA assessment for private equity funds takes into consideration outcomes expected from both the fund and investees. ADOA reporting tables are also part of legal documentation and are collected annually with updated supervision report templates. Nonetheless, Management concurs that defining and monitoring the development results of direct equity investments will require further attention. Moreover, to further consolidate results monitoring and Bankwide reporting, Management has given priority to streamlining and standardising reporting systems. Associated measures under implementation are the review of the equity manual and the deployment of FrontInvest software. **Actions:** ▌ **OPSD**, with the support of CIMM, to implement the private equity management and monitoring software, which will go live by **end-2015**.

Introduction

This report presents the findings of an independent, evidence-based evaluation of the relevance and performance of the Bank Group's equity investments. The evaluation is timely for informing the Bank's decisions on their future use.

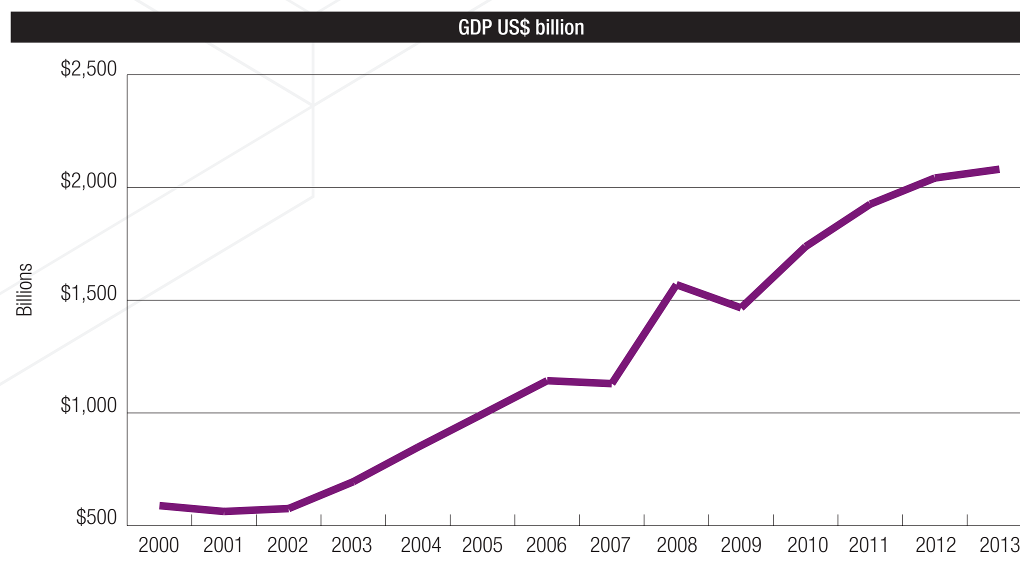
Background

Africa's Economic Growth

Africa, and specifically the Sub-Saharan region, continues to exhibit consistently strong growth. According to the International Monetary Fund (IMF), Africa's total economic output has grown steadily year-over-year, with Sub-Saharan Africa acting as an important contributor.

The World Bank growth forecast for Sub-Saharan Africa remains positive, despite some recent setbacks, with Gross Domestic Product (GDP) forecast to rise to 5.2% in 2015-2016 and 5.3% in 2017, up from 4.6% in 2014.

Figure 1: Africa's Economic Output



Source: AfDB ESTA Database

An IDEV Thematic Evaluation

Private Equity in Africa

Over the past several years, the challenging global macro-economic environment has increased demand for investments in Africa as investors have fled lower interest rates and slower growth environments in the U.S. and Europe.

Despite slowing growth in some African countries, the Africa growth narrative overall continues to sustain demand for private equity opportunities among institutional investors and global private equity firms. In an April 2014 survey[7] conducted by Emerging Market Private Equity Association (EMPEA), Sub-Saharan Africa was perceived to be the third most attractive emerging market; 37% of respondents were planning to begin or to expand private equity investment activities in the region over the next two years versus 1% who were expected to decrease or stop investing. In the 2013 EMPEA survey, Sub-Saharan Africa had ranked as the most attractive emerging market ahead of Southeast Asia and Latin America (excluding Brazil), which are now ranked higher. However, Sub-Saharan Africa continues to be perceived more favorably than other BRICS (Brazil, Russia, India, China and South Africa). In addition, an increasing number of large, global private equity firms are showing interest in the region.

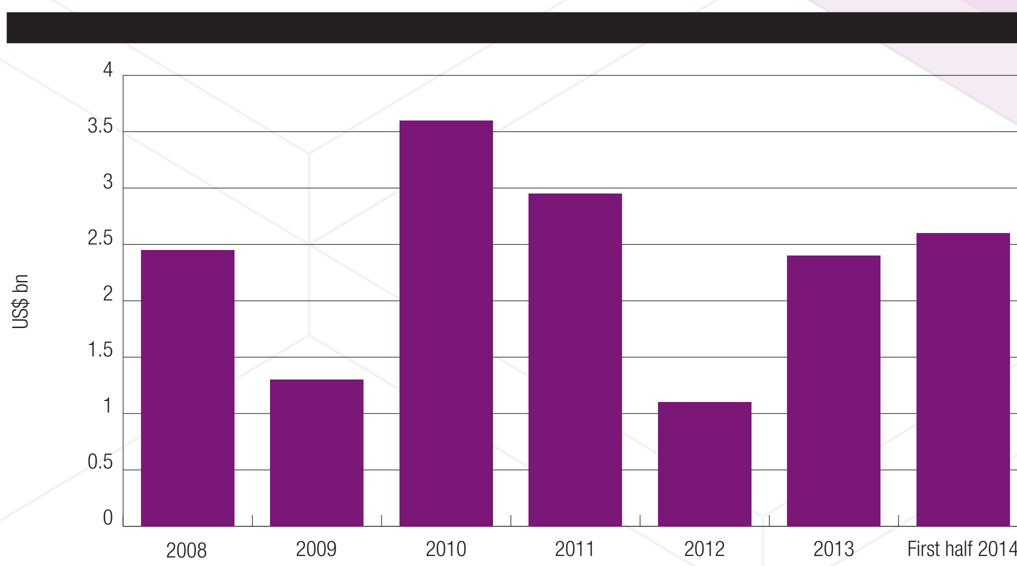
This higher demand and positive outlook for African opportunities has helped fuel a more robust environment for private equity fundraising. Private Equity International's (PEI) Research and Analytics Division reports that, in the first half of 2014, Africa-focused funds closed on nearly $2.6 billion in capital, more than for all 2013. On an annualized basis, the figure is likely to exceed the record $3.6 billion raised in 2010.

The increase in African private equity can be largely attributed to development finance institutions (DFIs), including the AFDB, IFC, EIB, CDC, FMO, PROPARCO,

Figure 2: Limited Partner's planned changes to their emerging market PE investments over next two years

Source: EMPEA

Figure 3: Africa Fundraising Totals, 2008-first half 2014



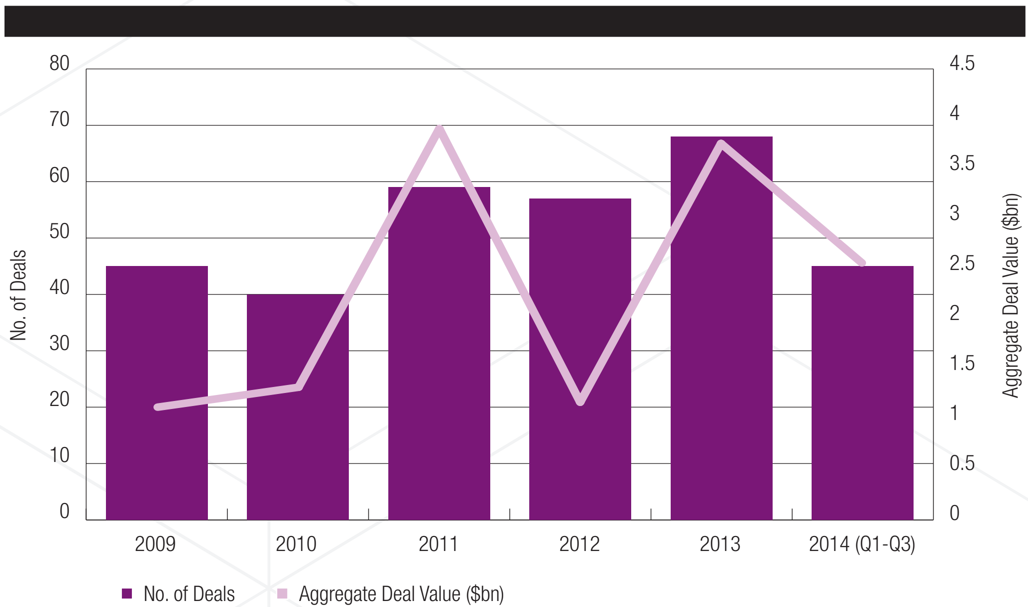
Source: PEI

and other groups who pioneered investments across a diverse set of managers and paved the way for more traditional return-driven institutional investors. While private equity participation levels from global and local programs have been sporadic to date, several African pension fund investors are increasing their commitments to African investment opportunities outside of South Africa. The Commonwealth Secretariat and the Bank[8] recently estimated that as much as $29 billion may be available for private equity investment within the African pension systems of the 10 countries included as part of its review. Were this amount actually deployed, it could effectively double the size of the industry.

The increase in capital committed to private equity funds has led to increases in both the number and aggregate value of deals. According to Preqin[9], since 2011, an average of 61 deals with an average aggregate deal value of $3.1 billion have been completed annually, an increase of 44% in the annual number of deals and 154% in the annual average value compared to the 2009-2010 period. Since 2007, these private equity deals have spanned a wide range of industries led by Energy and Utilities (19%), Consumer and Retail (19%), Business Services (19%), Telecoms and Media (15%), and Materials (13%).[10]

An uncertain exit environment is just one of many perceived risks considered by potential private equity investors in Africa, resulting in higher expected returns for investors. According to EMPEA's April 2014 survey, prospective investors (55% of respondents answered affirmatively) cited the "limited number of established fund managers" as the number one deterrent for investing in Sub-Sahara African private equity, followed by "political risk" (53%), "scale of opportunity to invest is too small" (45%) and "weak environments" (32%). Other notable concerns were "historical performance" (26%) and "challenging regulatory and tax issues" (24%)[11].

Figure 4: Number and Aggregate Value of Private Equity-Backed Buynot Deals in Africa Q1 2009-Q3 2014



Source: Preqin

Evaluation Approach

Evaluation Rationale, Purpose, and Scope

This evaluation was conducted in order to inform Bank's decisions on the future use of equity investments by identifying lessons and potential areas for improvement. As such, the purpose of the evaluation is two-fold: 1) assess the relevance and performance of the Bank's equity investments; and 2) identify lessons, recommendations and areas for improvement.

The evaluation covers the combined fund and direct investments in the equity portfolio, which represent capital commitments of UA 740 million and disbursements of UA 475 million (64%) of capital commitments. The underlying fund sub-portfolio consists of 31 core fund investments representing capital commitments of UA 537 million and disbursements of UA 333 million (62%) of capital commitments, while the underlying direct sub-portfolio consists of 19 direct equity investments representing capital commitments of UA 202 million and disbursements of UA 141 million (70%) of capital commitments[12].

Evaluation Issues, Questions and Methodology

The evaluation addressed the following issues:

- **Relevance –** this issue focuses on the extent of the Bank's equity investment alignment with the Bank's strategy and priorities.

- **Performance –** this issue addresses a number of questions including the financial performance of the Bank's equity investments, the extent to which development outcomes have been achieved and the extent to which the Bank's contribution has led to value additions/benefits.

- **Risk Management –** the issue examines changes in the risk profile of investments and the potential impact on the Bank's risk profile.

Multiple lines of evidence were used to address the evaluation issues and questions. Data collection methods included:

- Literature review of latest trends and issues related to equity investments in Africa.

- Thorough data, portfolio and program review to assess trends, measure risk, and complete bottom-up cash flow projections to support pacing and liquidity analysis.

Table 1: AfDB equity portfolio as of 31 December 2013

Investment Type	#	Commitments	Disbursed	Callable	Distributed	Current Value
Fund	31	537.0	333.2	203.8	61.4	290.2
Direct	19	202.5	141.4	61.1	0.0	184.5
Total	**50**	**739.5**	**474.6**	**264.9**	**61.4**	**474.7**

- Survey of all fund managers.
- Field visits to a sample of projects to collect DO indicators.
- High quality financial database sourced from quarterly and audited financial statements of fund partnerships.
- Benchmarking analysis comparing the Bank's portfolio with a customized private equity fund focused on Africa.

The analysis also provides comparisons to relevant benchmarks of public market securities using the "modified Public Markets Equivalent" (mPME) methodology[13] (see Annexes).

Limitations

- **Immaturity of the Bank's Portfolio:** The Bank's portfolio is relatively young, making any conclusions regarding performance, and particularly the achievement of outcomes, preliminary. Only five of the growth equity funds (and none of the buyout or venture capital funds) have inception dates prior to 2008 while the remaining funds have not yet had at least six years. Therefore, quartile performance comparisons for the less mature funds may not be solid enough to be meaningful.
- **Lack of results data:** Given that the current additionality and development outcomes assessment (ADOA) framework has only been in place since 2009, the anticipated development outcome (DO) data against which to compare actual outcomes is not available for the more mature funds in the portfolio. A standardized process was undertaken to assess each DO. As an initial step, ADOA memos[14] were reviewed to extract anticipated metrics. Actual DO information collected from fund managers by Cambridge Associates (CA) was then reviewed, however, the information was only available for a subset of funds. To enhance the overall quality of the analysis, additional data was pulled from managers' reports, back to office reports (BTORs) and project status reports (PSRs). The analysis could therefore only be conducted on a relatively small sample of funds.
- **Inconsistent quality of fund reporting and lack of cash-flow history data:** Generally, the managers provided adequate insights into the funds and underlying investee companies through quarterly reporting, but the overall quality of fund reporting and fund reporting quarters were inconsistent across managers. Finally, the Bank did not provide an adequate historical cash flow history for the funds, which could have an impact on fund waterfalls. As manager calls to review the funds and underlying investee companies were not included as part of the scope, they were not used to refine the accuracy of the cash flow projections.

An IDEV Thematic Evaluation

Evaluation Findings

Relevance: Alignment with the Bank's Strategy and Priorities

*Overall, relevance was rated **satisfactory**. The Bank's private equity investments are well aligned with its industry objectives, as more than 80% of investee cost basis are in industries that the Bank supports. Both hard and soft infrastructure companies are well represented, followed by natural resources and agriculture companies. With respect to fragility, while the fund is not heavily invested in fragile states, the exposure achieved indirectly exceeds the overall private sector department financing. Direct investments are also aligned with Bank priorities including developing soft infrastructure, diversification, fragility, and regional integration.*

Alignment of Indirect Investments with the Bank's Strategic Priorities

The evaluation team examined the 291[15] realized and unrealized investee companies across 24 fund managers and 31 distinct funds. The relevant information was retrieved directly from the most recently available fund financial reports provided by the fund manager[16]. For each fund investee, the Bank's pro-rata cost and value were determined, and investee attributes were assessed against the Bank's strategy. The results analysis showed the proportion of invested capital that has gone towards investees aligned with the Bank's strategy.

While the majority of investments are adequately aligned with the Bank's priority sectors, a sizeable proportion (14%) of investments have no clear alignment with Bank priorities.

The industry analysis for the fund portfolio reflects a high degree of alignment between actual fund investee cost basis and the stated objectives, particularly with regards to infrastructure. Specifically, 81% (UA 236 million) has been invested

Table 2: Fund Investee Cost Basis, by Alignment (UA millions)

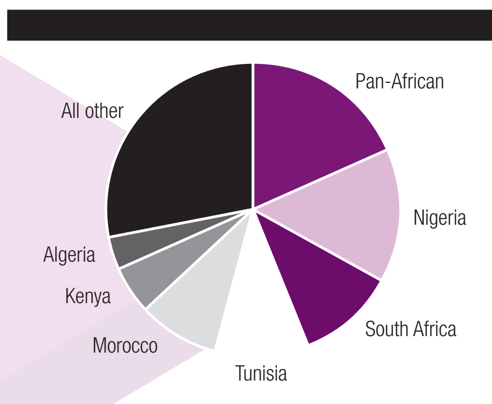
	Hard infra.	Soft infra.	Natural Resources		Agriculture		No Clear Alignment	Total
			Direct	Secondary	Direct	Secondary		
General	25.7	40.2	34.0	1.6	13.1	2.9	15.9	133.3
Infrastructure	51.3	0.0	5.3	–	1.6	1.2	0.9	60.3
SMEs	6.6	3.2	3.7	–	2.9	2.4	22.2	41.0
Agribusiness	–	–	9.0	1.1	10.9	5.4	1.4	27.8
Financial Services	–	17.2	–	–	–	–	–	17.2
Healthcare	–	5.5	–	–	–	–	0.3	5.8
Other	4.4	0.1	–	0.7	0.6	–	–	5.9
Total	**88.0**	**66.3**	**52.0**	**3.4**	**29.2**	**11.8**	**40.6**	**291.4**

in companies that are directly aligned with the stated objectives. An additional 5% (UA 15 million) of investees have secondary alignment. The remaining 14% had no clear alignment. Table 2 outlines additional details.

The highest investment of UA 88 million (30% of cost basis) went to hard infrastructure, followed by soft infrastructure at UA 66 million (23%), natural resources at UA 55 million (19%), and agriculture at UA 41 million (14%). Notably, funds focused on small and medium-sized enterprises (SMEs), which are aligned with the Bank's SME related strategic objectives, contained the majority of investee cost basis with no clear alignment with Bank industry objectives. Examples of such companies in these industries with "No Clear Alignment" include hotels, tour operators, and media companies. While companies in these industries certainly do not harm African development, they do not clearly align with the Bank's current objectives.

While the analysis demonstrates a high level of regional diversification, one quarter of equity investments are concentrated in only two countries: Nigeria and South Africa.

Figure 5: Regional diversification, Fund Investee Cost Basis



The funds have invested capital in companies in 35 countries, demonstrating a high level of regional diversification. The largest category of countries, Pan-African, represents companies operating across several countries. However, about one quarter of all equity investments is invested in only two countries – Nigeria and South Africa, the two largest economies on the continent.

While the fund is not heavily invested in fragile states (as would be expected), the exposure achieved indirectly exceeds the overall private sector department financing.

Of the total of UA 291 million in total fund investee cost basis, only 10% (UA 27 million) has been invested in companies operating in Core or Moderated fragile states. Approximately 83% (UA 242.5 million) are invested in non-fragile states. An additional 7% (UA 21 million) are considered to be Unknown as the companies are generally described as having a pan-African focus. This is a conservative estimate as the operations of these pan-African companies could prove to benefit fragile states as well.

Core fragile regions received a total of UA 22 million (7% of investee cost basis), which included Côte d'Ivoire at UA 11 million (4%), Togo at UA 5 million (2%) and Democratic Republic of Congo at UA 3 million (1%). Moderated fragile regions received a total of UA 6 million (2%).

These results are unsurprising. Fragile states are less attractive to many private equity managers because they often have less-developed institutional frameworks, weaker governance, and social conflict. However, considering the Bank's LIC and fragile states country limits for the private sector, the breakdown achieved via funds is actually much higher than the overall private sector department financing, which suggests that the fund portfolio is actually quite supportive of fragile states.[17]

Table 3: Fund Investee Cost Basis by Country Fragility (UA millions)

	Core Fragile				Moderated Fragile	Not Fragile	Various / Unknown	Total
	Côte d'Ivoire	Togo	DRC	Other				
General	6.6	–	0.9	1.4	5.8	103.8	13.9	132.4
Infrastructure	3.1	–	0.1	–	–	49.9	7.1	60.3
SMEs	0.6	–	–	–	–	41.4	–	42.0
Agribusiness	0.5	–	2.1	1.4	0.4	23.2	–	27.8
Financial Services	–	4.6	–	–	–	12.6	–	17.2
Healthcare	–	0.2	–	–	–	5.7	–	5.8
Other	–	–	–	–	–	5.9	–	5.9
Total	**10.8**	**4.8**	**3.2**	**2.8**	**6.2**	**242.5**	**21.1**	**291.4**

The Bank's equity investments in infrastructure in a large number of countries are likely to promote regional integration.

The industry analysis above reveals that 53% of investee cost is in hard and soft infrastructure companies, which is likely to promote integration. The diversification analysis above indicates that almost 20% of investments was made in Pan-African countries, which is also likely to promote regional integration.

The analysis demonstrates an adequate degree of alignment between actual fund investee cost basis and the stated objectives of supporting MSMEs[18]

Approximately 34% of capital has been invested in MSMEs and 52% in large enterprises, which naturally require larger equity investments proportionately than MSMEs. The analysis confirms that the investee companies consist of 462 MSMEs (approximate average investment of UA 216,000) and 52 large enterprises (average investment of UA 2.9 million).

Alignment of Direct Investments with the Bank's Strategic priorities

Nineteen direct investees were analyzed for their strategic alignment:

Table 4: Fund Investee Cost Basis, by Size of Enterprise

Strategy	# Funds	Micro Enterprises	Small Enterprises	Medium Enterprises	Large Enterprises	Debt	Not Available	Total	% MSME
Agribusiness	3	2.6	12.3	5.3	7.0	0.5	–	27.8	73%
Infrastructure	5	0.0	1.8	9.2	23.8	0.8	24.6	60.3	18%
SMEs	4	–	19.7	13.7	7.7	–	–	41.0	81%
General	13	0.0	9.2	16.0	97.2	10.8	–	133.3	19%
Financial Services	1	–	–	–	17.2	–	–	17.2	0%
Healthcare	2	–	4.1	1.1	–	0.6	–	5.8	90%
Energy	1	0.0	1.2	2.7	–	1.1	–	5.1	78%
Mining	1	0.0	0.7	–	–	–	–	0.7	100%
Total	**30**	**2.8**	**49.0**	**48.1**	**153.0**	**13.9**	**24.6**	**291.3**	**34%**

- All direct investees are financial institutions that directly support the Bank's strategy of developing soft infrastructure.
- Portfolio diversification is adequate. Investees are headquartered in 12 countries. Three companies headquartered in Nigeria have received 29% of disbursements, followed by four companies in Kenya with 19% of the disbursements. In addition, many direct investees operate and have branches in multiple countries, diversifying the portfolio even further.
- Seven investees (22% of disbursed capital) are headquartered in fragile states, and an additional four are known to have branches in fragile states (38% of disbursed capital), showing that a meaningful portion of disbursements goes to investees operating in fragile states.
- The portfolio is well aligned with the Bank's priorities of promoting regional economic integration. Twelve investees have operations in multiple countries, representing 89% of disbursed capital. Some companies specifically seek to increase African trade, while others are financial institutions operating in multiple regions.
- Only a small portion of direct investees are MSMEs, which is reasonable as a large portfolio of small direct investments would be resource-intensive. Nevertheless, 15 of the 19 investees (60% of disbursed capital) are MFIs and DFIs, which would be expected to benefit MSMEs.

Performance of Bank Equity Investments

*Overall, the performance of the Bank's equity investments has been rated as **moderately satisfactory**. Financial performance was rated satisfactory with the mature funds being at the lead (first quartile) compared to their benchmarks. For more recent funds, the results were mixed, but the majority were lagging behind their benchmarks. However, it is too early to make a definitive judgement on the more recent funds as they are still at the early stages of the J-curve. The achievement of development outcomes was rated as **moderately unsatisfactory** because: 1) a substantial proportion of funds were behind plans or did not meet their targets on two key outcomes (job creation and tax revenues), and 2) there was a lack of reliable outcomes data particularly on direct investments.*

Financial Performance

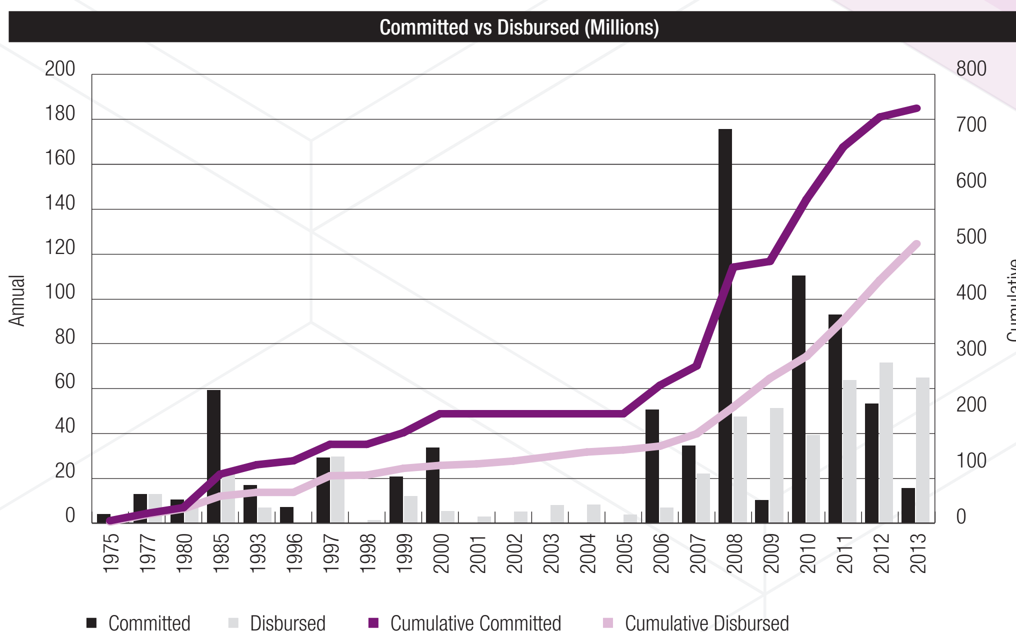
The financial performance of the equity investments was rated as satisfactory. The mature growth equity funds have performed well, with three out of five in the first quartile. The less mature funds had mixed results, but were generally lagging behind their benchmarks for financial performance. Rapid consumption of risk capital coupled with immature funds has led to an over- or under-investment in certain vintage years.

The Bank's Equity Portfolio

Overview

The Bank has experienced a rapid consumption of risk capital since 2007 leaving only a modest proportion (38%) of the 15% limit to be utilized until 2020.

Figure 6: Figures in UA Millions as of December 31, 2013



The Bank's equity investment portfolio has recorded significant growth since 2006. Commitments between 2006 and 2013 total almost 3 times the commitments made between 1975 and 2000. Cumulative commitments reached UA 740 million at the end of 2013. Several factors drive the increased use of equity investments: 1) they can mobilize and catalyze incremental financing into projects that can lead to development benefits; 2) they are believed to be an effective instrument to finance SMEs and microfinance institutions and; 3) they can improve corporate governance consistent with international standards. However, Bank statutes limit the use of this instrument to 15% of the Bank's total risk capital (paid-in capital and reserves). The growth since 2007 has resulted in a risk capital utilization rate of 9.32% (or 62% of the limit) as of September 2014 versus the limit of 15% to be used over the planning horizon of 2020. The Bank's limit is lower than the IFC limit, which is set at 100% of its net worth for disbursed equity and quasi-equity investments (net of reserves).

The direct investment portfolio, by contrast, has had a more consistent investment pace, with approximately 8% of total commitments (in UA millions) made in the late 1970s, 35% of commitments in the 1980s, 33% in the 1990s, and 24% between 2000 and 2013.

As of March 31, 2014, the Bank had committed $726.6 million to the 29 funds, of which $437.9 million had been drawn down ("paid-in"). Unfunded commitments totaled $290.3 million. The Bank had received total distributions of $184.2 million from these funds, representing 42.1% of paid-in capital. The majority of the portfolio value is currently unrealized, with a total net asset value of $426.6 million.

Fund investments are several years from liquidity. The Bank's portfolio is immature: 1) more than half of the commitments are at early stage (fundraising and investment); 2) the majority of funds have inception dates after 2008, and 3) a weighted average age of underlying companies is lower than the typical private equity company holding periods.

Private equity funds have a three-stage investment life cycle:

- ***Years 0-2: Fundraising Stage.*** The fund manager is raising capital and typically closing on capital commitments in several phases. Once the first capital close has occurred, the manager typically begins collecting management fees and making investments.

- ***Years 3- 6: Investment Period.*** The fund manager is actively seeking new investments and calling down capital. Management fees continue to be drawn.

- ***Years 7+: Divestment Period.*** The fund is fully invested, and the manager is focused on harvesting investments. The typical holding period for each investment is about 4-6 years. Traditional private equity funds typically have a 10-year life with an option, which is frequently exercised, to extend. Some strategies, such as infrastructure, have an even longer initial fund life of between 15 and 20 years. During the divestment period, management fees are typically drawn at a lower rate.

Eighteen funds are currently in the Investment Period, and one is in the Fundraising Stage. With 56% of all fund commitments in these early stages, the portfolio is immature. However, by December 2014, the 2008 and 2009 vintage funds will transition from the Investment to the Divestment Period[10], resulting in an even distribution of the number of funds at each of these two stages.

The Bank's fund commitments are primarily in what can be broadly categorized as growth equity funds ($467 million), with additional substantial

Figure 7: J-curve

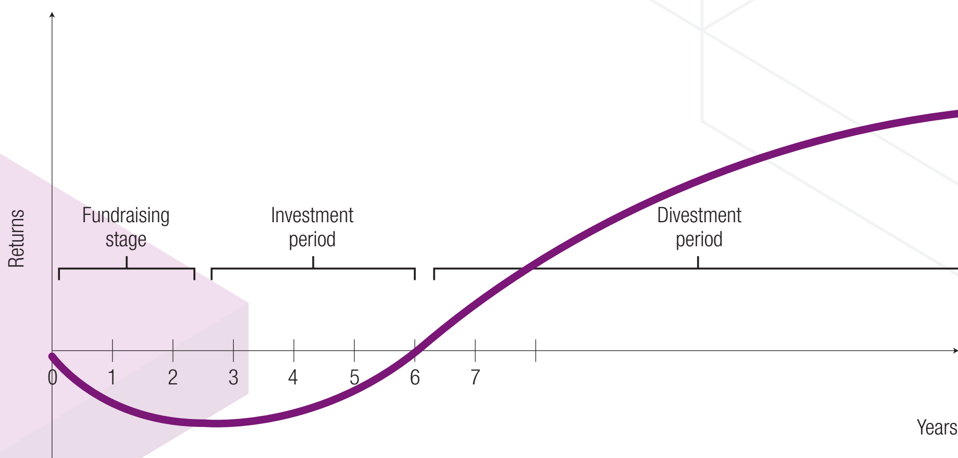
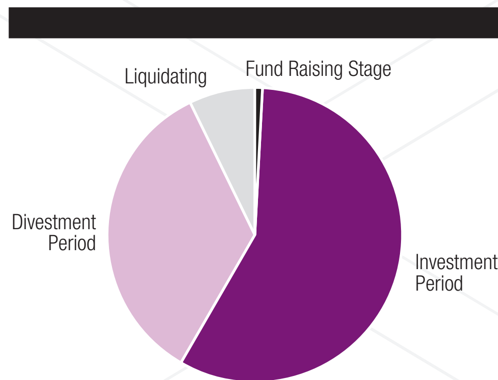


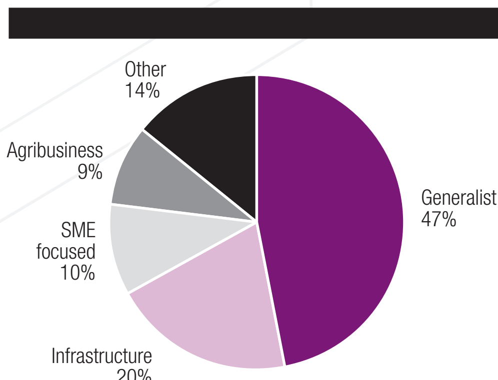
Figure 8: Proportion of Fund Commitment by Stage



commitments to buyouts ($95 million) and infrastructure funds ($109 million). A smaller amount of capital has been committed to venture capital ($35 million) and timber ($20 million) funds. Within the growth equity funds, generalist managers invest across multiple sectors, and several specialist managers focus on narrower sectors such as healthcare and agribusiness.

The breakdown by strategy is as follows (see figure 9):

Figure 9: Fund Commitments by Strategy



- 13 Generalist funds (47% of fund commitments);
- 5 Infrastructure funds (20%);
- 4 SME-focused funds (10%);
- 3 Agribusiness funds (9%); and
- 4 other (14%).

By vintage year, nine vintage 2008 funds represented 29% of all fund commitments, followed by six vintage 2010 funds (21%) and six vintage 2011 funds (15%).

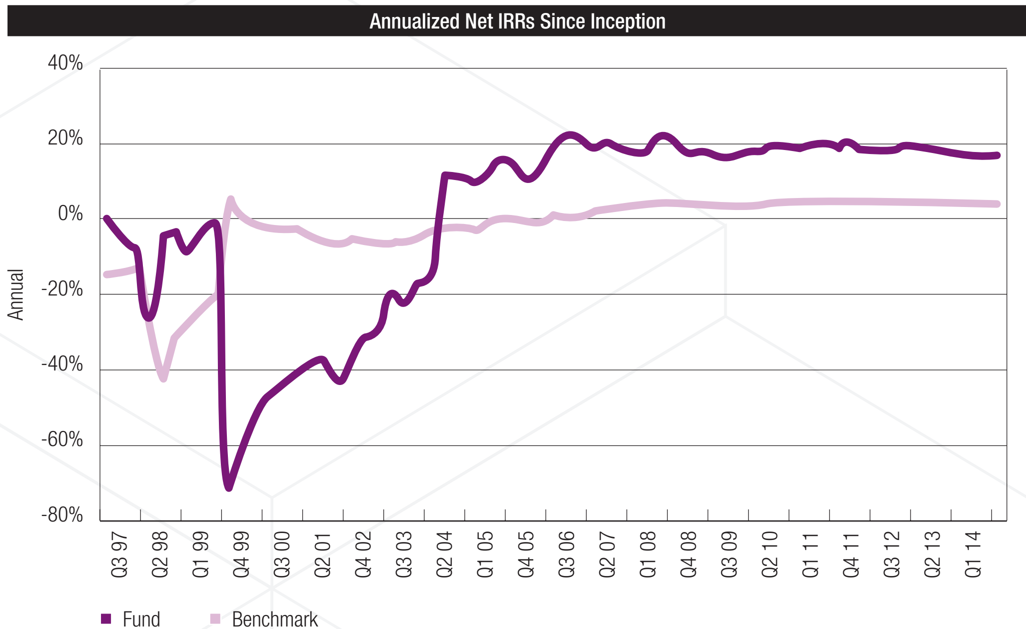
To complement this analysis, the evaluation team also examined the average maturity of the underlying companies as an indicator of overall fund maturity. The majority of the investments in the 210 unrealized underlying portfolio companies are still relatively young, with a weighted average age of 3.1 years, lower than the typical private equity company holding periods, which vary between 4 and 6 years. The 31 funds in the portfolio are therefore several years from liquidity.

Financial Performance of Bank's Portfolio: Private Equity Investments

Benchmarking against Emerging Market Funds and Custom Benchmark for Africa

While mature growth funds generally performed well compared to vintage year benchmarks (both the general universe and Custom Benchmark for Africa), the eight private equity funds (2008 and 2009 vintages) all had total value multiples that trailed the pooled averages of the broader universe of emerging markets funds. The picture is slightly better when compared to the Custom Benchmark for Africa, with two of the eight ahead of their comparators. Unrealized investments comprise most of the value of funds of 2008 vintage onwards.

Figure 10: South Africa Infrastructure Fund



While mature growth equity funds have performed well (three of the five are in the top quartile), the performance of the Bank's five mature growth equity funds has been quite good when compared to vintage year benchmarks for the broader universe of emerging markets private equity and venture capital funds of the same vintage years. Three of the five funds ranked in the top quartile globally versus other emerging markets funds (by IRR), and another was in the second quartile. The sole fund that was below median is a healthcare focused fund that ranked in the third quartile. None of the growth equity funds from 1998 to 2007 were in the bottom quartile.

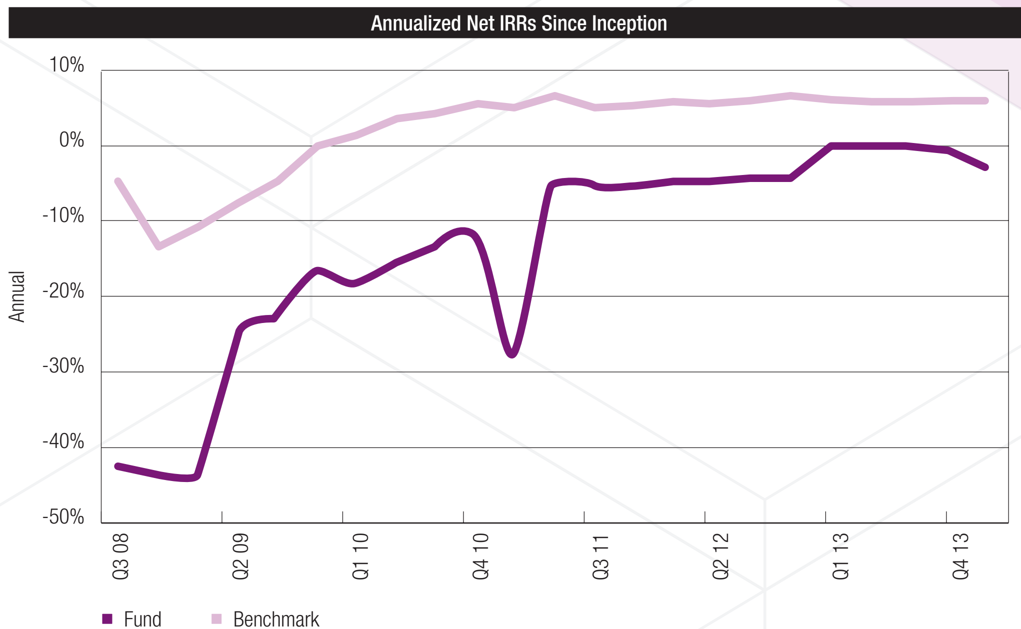
It was challenging to rank the performance of the infrastructure funds in the Bank performance, because of the small number of peers in the Cambridge Associates database for the relevant years. A South African infrastructure fund from the 1996 vintage has performed very well, with a total-value/paid-in multiple of 4.3, which is far greater than the average of other emerging markets infrastructure funds from that period.

On the other hand, a fund created by the AfDB and major investors from the continent (2007 vintage) to invest in infrastructure projects has not performed well, and ranks in the bottom quartile versus the small group of emerging markets peer infrastructure funds.

The vast majority ($148.7 million) of the distributions to date ($184.2 million) were made by two growth equity funds respectively from the 1998 and 2005 vintages managed by a single manager, and one infrastructure fund from the 1996 vintage. These three funds also accounted for the majority of total value creation to date in the Bank portfolio ($141.1 million of $172.9 million).

As indicated above, the majority of the portfolio was committed to funds of 2008 or more recent vintage years, all of which remain relatively immature, making

Figure 11: Pan-American Infrastructure Development Fund



interim performance rankings less meaningful than those for mature funds. Most of these funds have yet to distribute more than 0.15 times their called capital, with most of the value still held in unrealized investments. This low level of distributions, however, is not out of line with broader emerging markets averages, which for funds of the 2008, 2009, and 2010 vintage years, were only 0.19, 0.10, and 0.06, respectively.

The interim performance rankings for the eight growth equity, buyout, and venture capital funds of the 2008 and 2009 vintages were distributed across the second (two growth equity and one venture capital), third (three growth equity), and fourth (three growth equity) quartiles, with no funds of these vintages currently ranked in the top quartile (all versus the IRRs for the broader emerging markets universe).[19] The three growth equity funds (two in the fourth quartile and one in third quartile), buyout (one in second quartile), and venture capital fund (one in first quartile) of the 2010 vintage were distributed across all four quartiles. These rankings should be considered even more preliminary than those of the 2008 and 2009 funds, as only one of the 2010 funds has made any meaningful distributions.

In addition to comparing the performance of the funds to the broad universe of emerging markets funds, the evaluation team developed a custom benchmark of 56 Africa-focused private equity and venture capital funds. For most of the vintage years in which the Bank made commitments, the Total Value to Paid In (TVPI) multiples for the custom benchmark of Africa funds trailed those of the broader emerging markets universe. (The exceptions were the 1998 and 2009 vintage years, in which the Africa funds performed better.) Because of the relatively small sample sizes in many of the vintage years, comparisons in some cases are simply not available, or can be heavily influenced by the performance of a single fund. In

other vintage years where there are a larger number of funds, comparisons can also be affected if the Bank itself invested in a large proportion of the funds in the benchmark (as is the case for the 2008 vintage year).

When compared to the custom benchmark of Africa-focused funds, three of the five mature growth funds had outperformed on the basis of total value multiples (when compared to the vintage year pooled averages). A fourth fund had a TVPI multiple of over 2.0, although that result trailed the returns for both the broad emerging markets universe and the custom Africa index for that year (1998). The eight more recent private equity funds of the 2008 and 2009 vintages all had total value multiples that trailed the pooled averages of the broader universe of emerging markets funds for those two years. When compared to the custom Africa benchmark, two of the eight funds were ahead of the African peer group, with multiples around 1.3. There was a high degree of overlap between the two groups in the 2008 vintage, which included the two outperformers. Two of the eight B funds of these two vintages, incorporated in Ghana and South Africa, were tracking at a multiple of 0.9 or less.

Benchmarking against Public Stocks

The majority (four out of five) of the mature growth equity funds performed better than MSCI Emerging Markets Index. However, only two of the four funds outperformed the MSCI Emerging Frontier Africa Index. The more recent equity funds generally lagged both the broad emerging markets stock index and the African public markets index. Three funds were ahead of the African stock index's performance.

Of the five mature growth equity funds in the portfolio, four outperformed the MSCI Emerging Markets Index, based on total value multiples. The MSCI Emerging Frontier Africa Index did not have a long enough history to compare one of the five funds, but two of the remaining four mature growth equity funds outperformed that index, and two underperformed it slightly. Of the less mature 2008, 2009, and 2010 private equity funds, only three were ahead of the African stock index's performance.

The following section outlines the results of the Bank's private investment returns to the returns that an investor could have achieved by investing in public stocks. The evaluation team used Cambridge Associates' Modified Public Market Equivalent (mPME) methodology to carry out this analysis. This approach assumes that an investor has invested in public stocks at the same time and in the same magnitude as the capital is drawn down by the private investment fund. As assets in the private investment fund are sold and capital is returned to the Bank, a proportionate amount of the stocks is assumed to have been sold. Any public market return series can be used for such comparisons. For the portfolio, we selected the MSCI Emerging Markets Index and the MSCI Emerging Frontier Africa Index. The former has a longer track record and covers the broad emerging markets universe of public stocks whereas the latter has a shorter track record and is focused on Africa.

Of the five mature growth equity funds in the portfolio, four outperformed the MSCI Emerging Markets Index, based on total value multiples. The MSCI Emerging Frontier Africa Index did not have a long enough history to compare one of the five funds, but two of the four mature growth equity funds outperformed that index, and two slightly underperformed. Of the less mature 2008, 2009, and 2010 private equity funds, only three were ahead of the African stock index's performance (using total value multiples). The mature infrastructure fund of the 1996 vintage was well ahead of the MSCI Emerging Markets Index, whereas all the more recent infrastructure funds and the housing fund were well behind both the broad emerging markets stock index and the African public markets index.

Company-level Exposures and Performance

Investments in key sectors such as Information Technology (IRR: 37.1%), Financial Services (IRR: 14.2%), Manufacturing (IRR 19.5%), and Transportation (IRR: 10.4%) had the strongest performance. Health Care (IRR: 23.9%) and Industrial (IRR: 35.5%), which accounted for a small amount of capital, also had strong performance. Consumer/Retail (IRR: 5.4%), Energy: Upstream/Royalty (IRR: 5.4%), Construction (IRR: 0.3%), and Timber (IRR: 1.8%) lagged, showing only modest rates of return.

Company-level cash flows were obtained from the majority of the private equity managers, making it possible to analyze the exposure and performance of individual company-level investments of $347 million. Based on this data (which omits the infrastructure funds, Grofin, and two of the growth equity funds), the Bank's largest sector exposures have been in Financial Services, Information Technology, and Consumer/Retail, which accounted for 41.5% of the Bank's exposure since inception, and 42.6% of current remaining market value. Financial Services has been the largest exposure, representing 20.5% of the current portfolio. The next five largest sectors were Energy (Upstream/Royalty), Manufacturing, Construction/Related Services, Timber, and Transportation, which together accounted for another 35.5% of the since-inception exposure and 30% of current market value. The remaining eight sectors were each less than 5% of since-inception exposure and, in aggregate, represented 23% of since-inception exposure.

Information Technology investments had the strongest performance as a sector, with an annualized return of 37.1%. Of the other sectors with large exposures, the remaining best performers were Financial Services (14.2%), Manufacturing (19.5%), and Transportation (10.4%). A smaller amount of capital had been committed to two other sectors that also had performed well: Health Care (23.9%) and Industrial (35.5%). Sectors with more modest returns included Consumer/Retail (5.4%), Energy: Upstream/Royalty (5.4%), Construction (0.3%), and Timber (1.8%). Smaller sectors with poor returns included Mining (-15.6%) and Software (-6.7%). Notably, none of the ten largest sectors (by since-inception exposure) had a negative return, and only two sectors overall had negative returns lower than -0.5%.

In terms of stage of investment, over half of the capital that was tracked on a company-level basis was invested in expansion stage transactions (50.3%). The second largest exposure was to Equity LBO (14.7%) and early stage (10.6%) transactions. Expansion-stage transactions had an overall return of 11.7%, ahead of Equity LBO (4.7%) and early stage (8.9%). Start-up investments had generated a 36.6% return, but on a relatively smaller amount of capital. Seed stage, which represented only 1% of since inception exposure, had the highest annualized return, 59.1%.

The portfolio was well diversified by underlying holdings. Large individual holdings investment between 10 to 21 million or 3 to 6% of the tracked company-level investments.

Financial Performance of Bank's Portfolio: Direct Investments

The portfolio has total commitments of UA 203 million of which UA 141 million (70%) has been disbursed, leaving UA 61 million (30%) of remaining callable capital. To date, none of the direct investments have been exited and no significant capital has been returned to the Bank in the form of distributions, although there have been some dividends. The current value of the investments of UA 184 million yields a current multiple of 17[20] of invested capital of approximately 1.30x for the direct portfolio.

The direct investment portfolio can be further analyzed by examining direct commitments by strategy and investment year. By strategy, nine DFIs received UA 138 million (68%), followed by three Insurance Companies (14%), one Commercial Bank

Table 5: AfDB direct investment portfolio

Investment Type	#	Commitments	Disbursed	Callable	Distributed	Current Value
Direct	19	202,5	141,4	61,1	0,0	184,5

(14%) and six MFIs (4%). By investment year, the first direct investment commitments were made in the 1970s and totaled UA 17 million (8%). The 1980s and 1990s included UA 70 million (35%) and UA 67 million (33%) of commitments, respectively. While there were no commitments in the first part of the 2000s, UA 49 million (24%) was committed between 2007 and 2013. Annual commitments since 2008 have lower average committed amounts of closer to UA 5 million per direct investment.

Effectiveness

The effectiveness of the Bank's equity investments is rated as moderately unsatisfactory. The Bank's funds are generally behind targets in terms of job creation and a sizeable proportion of committed capital did not meet its Tax Revenue Generation targets. However, the weighted average mid-point timing expectation for achieving job creation metrics is a couple of years away (mid-2017), so these funds still have time to meet their anticipated targets. The Bank's equity funds performed well with respect to environmental plans: the majority of capital is invested in companies that either had or added EMPs. The lack of development outcomes data on a significant number of funds as well as on direct investments limited the comprehensiveness of this analysis.

Development Outcomes Achievement

The purpose of the analysis was to quantitatively assess the ex-ante development outcomes (DO) relative to current outcomes and determine whether funds have achieved them. The ADOA approach explores a wide range of expected DOs, many of which are difficult to quantify. A subset of quantifiable metrics was selected for this analysis, including Job Creation, Job Creation for Women, Annual Tax Revenues Generated, and Environmental Mitigation Plans (EMPs) Implemented. Eight funds (34% of exposure) are excluded from this analysis, as no ex-ante DO score was available. Fifteen funds (42% of exposure) had not yet had a post-investment DO assessment. Only eight funds (24% of exposure) had both ex-ante and post-investment DO scores available.

The funds that were approved for investment were anticipated to have relatively strong DO ex-ante. A score of Excellent was assigned to four funds (14% of commitments), while five funds (13%) received a score of Very Good and 14 funds (40%) received a score of Good. Overall, the post-investment assessment of the eight funds (with post-investment assessment) was the same as the ex-ante assessment, indicating that the review team believed the original objectives could still be achieved. However, the following analysis indicates that the Bank is behind plans or is missing its targets on some of the key development outcomes.

Table 6: Job Creation

	Fund Information		Quality of Metric		Jobs Created		
	# Funds	Commit. in UA M	% of Companies Reporting	WA Age of Inv.	Anticipated	Actual	% Target Achieved
Ahead of Plan	2	23	82%	2.3 yrs	2,000	6,099	305%
On Plan	–	–	–	–	–	–	
Behind Plan	5	63	70%	2.8 yrs	24,670	3,666	15%
Did not Meet	1	34	82%	5.3 yrs	32,000	5,117	16%
Sub-Total of Evaluated	**8**	**120**	**77%**	**3.6 yrs**	**58,670**	**14,882**	**25%**
Sub-Total of Not Evaluated	**23**	**417**	**47%**	**2.7 yrs**	**76,488**	**22,525**	**NA**
Total	**31**	**537**	**56%**	**3.0 yrs**	**135,158**	**37,407**	

Job Creation

Early results data, though partial, indicate that the majority Bank's equity funds examined are either behind plan or missing their job creation targets.

Only 19% of the evaluated committed capital was invested in funds that are considered ahead of plan, while the remaining capital was committed to funds that are considered behind plan (53%) or have failed to meet their targeted outcomes (28%).

One fund, created over 5,000 jobs, but significantly missed its target of 32,000 jobs by 2010. A total of 135,000 jobs is expected to be created in aggregate for the eight evaluated funds. To date, only about 37,400 have been reported, representing less than 28% of the initial target. While this figure is low, it is based on reporting by only half of the companies with a weighted-average life of only three years.

Job Creation for Women[21]

Even though results data for job creation for women are more positive than the overall job creation numbers, they are still far behind their targets

57% of the evaluated committed capital was invested in funds that are considered on or ahead of plan in terms of job creation for women, while the remaining capital (43%) was committed to funds that are considered behind plan. The creation of 14,312 jobs for women in aggregate for six evaluated funds

Table 7: Job Creation for Women

	Fund Information		Quality of Metric		Jobs Created / Held by Women		
	# Funds	Commit. in UA M	% Reporting	WA Age of Inv.	Anticipated	Actual	% Target Achieved
Ahead of Plan	2	29	47%	3.2 yrs	1,310	1,410	108%
On Plan	1	20	20%	2.1 yrs	57	49	86%
Behind Plan	3	37	96	2.5 yrs	9,483	147	2%
Did not Meet	–	–	–	–	–	–	
Sub-Total of Evaluated	**6**	**86**	**65%**	**2.6 yrs**	**10,850**	**1,606**	**15%**
Sub-Total of Not Evaluated	**25**	**451**	**30%**	**3.1 yrs**	**14,313**	**3,776**	**NA**
Total	**31**	**537**	**37%**	**3.0 yrs**	**25,163**	**5,382**	

Table 8: Tax Revenue Generation

	Fund Information		Quality of Metric		Annual Tax Revenues		
	# Funds	Commit. in UA M	% of Companies Reporting	WA Age of Inv.	Anticipated	Actual in UA M	% Target Achieved
Ahead of Plan	1	6	82%	1.9 yrs	N/A	5.9	N/A
On Plan	7	89	81%	2.2 yrs	N/A	148.2	N/A
Behind Plan	1	17	95%	2.4 yrs	N/A	0.4	N/A
Did not Meet	1	34	82%	5.3 yrs	N/A	137.2	N/A
Sub-Total of Evaluated	**10**	**146**	**83%**	**3.1 yrs**	**N/A**	**291.7**	**N/A**
Sub-Total of Not Evaluated	**21**	**391**	**26%**	**2.9 yrs**	**N/A**	**38.9**	**N/A**
Total	**31**	**537**	**46%**	**3.0 yrs**	**N/A**	**330.6**	

is expected. To date, only 3,776 jobs, or about 26% of the initial target, have been created.

The two funds considered ahead of plan are slightly ahead of target and still relatively immature. The funds that are considered to be behind plan are significantly behind, although the investees are still also relatively immature.

Annual Tax Revenues Generated

While the majority of evaluated committed capital was on plan to meet targets for tax revenue generation, a sizeable proportion of evaluated committed capital (23%) did not meet its targets.

About 65% of the evaluated committed capital was invested in funds that are considered on or ahead of plan in terms of annual tax revenue generation, while the remaining capital was committed to funds that are considered behind plan (12%) or did not achieve their targets (23%).

The one fund considered ahead of plan had an anticipated DO of $8 million annually by 2018 and generated approximately $8.7 million in the most recent period. By contrast, another fund significantly missed its target. It was anticipated to generate $1B USD in tax revenues annually by 2010, but only reported about $200 million. In aggregate, UA 331 million of tax revenues were generated in the last reported period, representing figures from 46% of the investees by total cost.

Environmental Mitigation Plans[22]

The majority of capital was invested in companies that either had or added EMPs.

About 31% of the evaluated company cost basis was invested in companies that added EMPs post-investment. An additional 27% of capital was invested in companies with EMPs already in place at the time of investment. About 13% of capital was invested in companies that have not yet added EMP plans, but these may be in industries that are not expected to have negative environmental impacts and may not require such plans. In addition, this category has the lowest weighted-average life of the groupings at only two years. The highest weighted-average age of analyzed investments is in the Added Plans category, a positive sign indicating that more companies could add EMPs as the investments mature and the manager has time to add value.

Table 9: Environmental Mitigation Plans Added

	Cost Basis in UA M	% of Companies Analyzed	WA Age of Inv.
Added Plans	41	14%	4.8 yrs
Had Plans Already	35	12%	2.6 yrs
Have Not Added Plans	17	6%	2.0 yrs
Unknown	38	13%	3.7 yrs
Sub-Total of Evaluated	**130**	**45%**	**3.9 yrs**
No Data	161	55%	3.1 yrs
Sub-Total of Not Evaluated	**161**	**55%**	**N/A**
Total	**291**	**100%**	**3.0 yrs**

Additionality and Bank's Role

The Bank has played a catalytic role in mobilizing additional resources for private equity particularly in sub-Saharan Africa. However, the level of the Bank's additionality is limited in middle-income countries, such as South Africa, which have potential of raising sufficient funds without the Bank's assistance. Moreover, the Bank's role as a limited partner restricts its capacity to influence investment decisions.

Despite growing global investor interest and a vibrant private capital ecosystem, fund managers raised a concern about fundraising in Africa, which remains a challenge for reluctant non-African investors with a low-risk appetite for Africa. As a result, DFIs play a key role in private sector development through capital flows. DFIs, including the Bank, played a counter-cyclical role during the financial crisis when it was difficult to raise money on traditional capital markets. Private equity investments fill a gap in Africa that other sources of financing do not meet.

To date, the Bank has invested more than UA 800 million in equity investments with 37 funds covering several countries. Most fund managers confirmed that the Bank is a key partner that has played a catalytic role in mobilizing additional resources for the African Private Equity industry, especially in sub-Saharan countries. There is a consensus that the Bank's presence as an investor provides a valuable seal of approval for equity fund managers, which helps them to raise capital from other investors.

Box 1: The case of South Africa? Where is Additionality?

Private equity thrives in markets with business-oriented market economies, with strong rule-of-law and openness to international competition and investment. Therefore, private equity funds, as expected, are concentrated in the high growth, relatively liberal market economies such as Nigeria and South Africa. As indicated above, the Bank's portfolio is highly concentrated in these MIC countries, with South Africa ranking highest, which are less in need of additional capital for development. Interviewees expressed concern that the Bank has been too conservative and unwilling to find prudent ways to invest in funds located in fragile states, lower-income member countries, and in first-time fund managers who may be the most willing to take risks in underserved areas. For example, the first PE investment was done in 1996 in South Africa where the Bank was the only non-South-African investor. In this case, other DFIs or other LPs did not follow the Bank's presence, making the Bank's additionality limited. Some fund managers reported that funds in South Africa that failed to get investment from the Bank were still able to raise funds without it. South Africa holds immense potential as a leading economy on the continent. It offers a wide range of opportunities in every economic sector with a high potential to attract investments. The Bank's equity investments in South Africa have not, therefore, always demonstrated additionality.

Furthermore, MDB and DFI investment in private equity has arguably provided funds where private sector banks and capital markets may misperceive the risk of investment. However, this catalytic role may be of limited value to countries less in need of additional capital, such as South Africa (Box 1).

While the Bank has played a catalytic role, in terms of challenging the fund managers' decisions, the Bank is a passive partner in fund management as a Limited Partner (LP) in a PE fund. General partners play the major role in investment and risk management, whereas LPs have limited rights to participate in day-to-day operations. The Bank usually takes a seat on the Fund's advisory committee and can participate in quarterly Board meetings. As an LP and advisor, the Bank cannot play a meaningful role in making investment decisions and may be missing an opportunity to be a fully active partner in the PE fund.

Risk Management

The evaluation team assessed the Bank's risk from a variety of perspectives in order to make a comprehensive assessment: 1) the Bank's risk rating methodology, which is a multi-dimensional approach that assigns a rating to each investment based on performance, management team, investment strategy, country and political risk, and "other" criteria, and assigns weightings to each factor based on the fund's position in the lifecycle; 2) 'best practices' portfolio metrics based on data at the investee company level; 3) manager execution risk, and 4) projected cash flows for the fund portfolio. Additional areas of potential risk to the Bank (such as operational risk and reputational risk) were beyond the scope of this evaluation.

The scope of evaluation study did not include assessing the adequacy of the Bank's risk methodology. However, a number of stakeholders have raised some noteworthy concerns with respect to:

- the appropriateness of the methodology to assess: 1) the currency risk associated with private equity funds denominated in USD, for instance and; 2) the risk profile of the direct investments, which may benefit from sovereign support;
- the appropriateness of a default-probability based rating system in measuring the risk of equity investments;
- whether there is a need to adjust risk ratings as funds mature and enter different stages of their life cycle and;
- whether the rating methodology is applied consistently across investments.

Risk Profile Changes: Bank Risk Rating Methodology

The overall risk rating of the equity portfolio has not changed on a weighted-average basis. However, using enhanced models, the fund portfolio's risk rating has been downgraded slightly from 5+ to 5. On the other hand, the direct investment portfolio has been upgraded from 5+ to 4+. Over 80% of investments by value have experienced a change in ratings since appraisal, indicating a significant change in the Bank's understanding of each investment's risk profile since appraisal.

The first analysis compared the commitment-weighted average risk rating of the fund and direct portfolios at the time of commitment[23] to the current exposure-weighted average risk rating of the fund and direct portfolios. Table shows how the weighted average portfolio risk rating has changed since the initial assessment of each investment[24].

In 2011, the risk model was upgraded. A significantly smaller portion of the portfolio is now classified as Moderate Risk and a larger portion of the portfolio is now considered Very Low Risk/Low Risk (driven by the direct equity investments). However, this is offset by an increased exposure to the High Risk/Very High Risk classifications. The weighted-average risk

Table 10: Weighted-Average Portfolio Risk Rating, using Bank capital account information and risk ratings

	Rating at Appraisal (Based on Commitments)						WA Portfolio Rating
	Very Low Risk	Low Risk	Moderate Risk	High Risk	Very High Risk	NA	
Funds	0%	0%	75%	25%	0%	0%	5+
Directs	6%	25%	33%	31%	0%	4%	5+
Total	**2%**	**7%**	**64%**	**26%**	**0%**	**1%**	**5+**

	Current Rating (Based on Exposure)						WA Portfolio Rating
	Very Low Risk	Low Risk	Moderate Risk	High Risk	Very High Risk	NA	
Funds	0%	5%	53%	39%	3%	0%	5
Directs	23%	21%	43%	13%	0%	0%	4+
Total	**8%**	**11%**	**50%**	**30%**	**2%**	**0%**	**5+**

rating of the fund portfolio increased slightly from 5+ to 5, while the direct portfolio rating decreased from 5 to 4+. The overall risk profile of the portfolio remains at 5+. The overall moderate rating of the equity portfolio is driven mainly by a few equity investments in financial institutions with relatively solid credit profiles.

The second analysis calculates the change in ratings since appraisal for each investment. Investments were classified[25] by the degree of change (table 11). Only 19% of the portfolio experienced no change while 23% of the portfolio experienced a significant change in rating: 15% of the portfolio was upgraded significantly and 8% was downgraded significantly.

The high degree of change indicates a significant post-appraisal change in the Bank's understanding of the risk profile of the investments. This may be attributable in part to the fact that the risk team has a better understanding of the risks associated with PE as it became more familiar with the intricacies of the asset class. Both funds and directs experienced many similar upgrades and downgrades, which is why the overall portfolio rating did not change.

Risk Analysis Based on Best Practice Metrics

This section presents an analysis of the Bank's risk based on best-practice metrics, including: capital loss, capital at risk, and diversification and portfolio health.[26]

The overall **capital loss** ratio for the portfolio is relatively high at 12.6%. This is not surprising given

Table 11: Changes in risk rating, by sub-portfolio

	Significant Upgrade		Upgrade		No Change		Downgrade		Significant Downgrade		N/A	
	#	Exposure	#	Exposure	#	Exposure	#	Exposure	#	Exposure	#	Exposure
Fund	1	5%	9	27%	9	26%	10	34%	2	8%	–	–
Direct	3	35%	5	12%	1	4%	5	38%	1	9%	4	2%
Total	**4**	**15%**	**14**	**22%**	**10**	**19%**	**15**	**36%**	**3**	**8%**	**4**	**1%**

Table 12: Capital Loss Ratio details

	Realized		Unrealized		Total	
	# of Deals	Loss of Capital	# of Deals	Loss of Capital	# of Deals	Loss of Capital
Funds	37	12.3%	254	12.3%	291	12.3%
Directs	–	NA	19	13.2%	19	13.2%
Total	**37**	**12.3%**	**273**	**12.7%**	**310**	**12.6%**

the risk profile of emerging market investments. The fund portfolio shows a slightly lower total capital loss ratio than the direct portfolio. The 37 realized investee companies in the fund portfolio generated a capital loss ratio of 12.3% (see table 12).

The **net capital exposure** is quite high, although it should decrease quickly if no new fund commitments are made and the underlying investees mature. However, if the program begins making new fund commitments, the net capital exposure may increase, depending on their pace.

The total value of the underlying holdings (fund investee and direct investment value) indicates a relatively low excess value coverage ratio of 67%, although this provides enough headroom to indicate that a loss of invested capital is unlikely for the portfolio. Again, the direct sub-portfolio has a much riskier profile than the fund investment portfolio. The net capital exposure of the direct portfolio is high because there have been no meaningful realizations to date.

Portfolio Diversification

The top ten holdings across the total equity portfolio represent 37% of the exposure. This is quite high, driven mainly by the Bank's direct investments. In fact, the five largest holdings in the total portfolio are direct investments that account for 25% of the total portfolio value. While the fund portfolio serves to mitigate this concentration, it is also quite concentrated. A typical portfolio of funds might have a "top-ten" concentration level of 20% versus 27% for the Bank.

At the investee level, the portfolio is well diversified by region with exposure to 35 countries. The largest exposures are to Nigeria (18%), Kenya (12%), and South Africa (11%). Mauritius is also heavily represented, although this probably includes companies domiciled in Mauritius with operations elsewhere.

The direct portfolio has its highest concentration in Nigeria, Kenya, and Burundi, while the fund portfolio has greater exposure to South Africa, Nigeria, and

Table 13: Capital at Risk figures, in UA millions

	Cost Basis	Realizations	Net Capital Exposure	Current Value	Excess Value	Excess Value Coverage
Funds	279.0	124.3	154.7	310.2	155.5	101%
Directs	141.4	0.0	141.4	184.5	43.2	31%
Total	**420.4**	**124.3**	**296.1**	**494.7**	**198.7**	**67%**

Kenya. The largest exposure in the fund portfolio is to companies whose region is labeled “Various” (Pan-African focus).

The largest exposures in the fund portfolio are to the financials (50%), industrials (12%) and materials (9%) sectors. Within the financial sector, the largest fund investee concentration is in regional banks, followed by property and casualty insurance. The direct investments are split between banking and insurance companies.

Total Portfolio: Growth Analysis

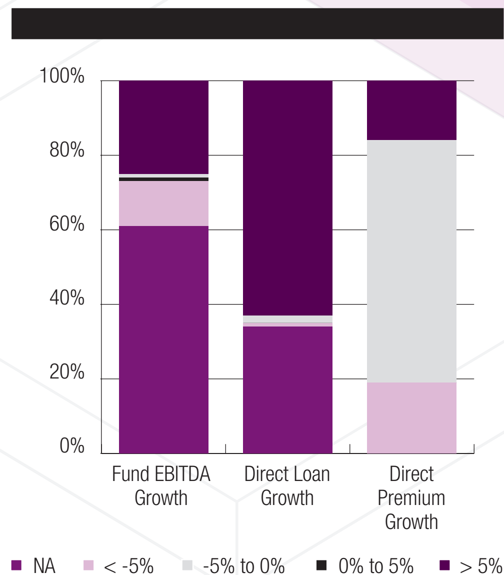
Figure 12 shows the historical EBITDA growth for unrealized fund investees[27] and historical loan and premium growth for unrealized direct bank and insurance investees[28], respectively.

The majority of fund investees with available data report positive EBITDA growth. Similarly, the direct banking investees report aggregate loan growth, and the insurance investees generally are posting premium growth. While these are all positive indicators of overall portfolio health, the data is not available for a significant portion of the fund investees.

Fund Portfolio: Holding Values Analysis. *Figure 13 shows current holding values for the unrealized fund investees.*

The majority of value in the fund portfolio is invested in underlying investee portfolio companies held above a 1x multiple of capital. In fact, 25% of portfolio company value is in 25 investee companies that are held above a 2.5x multiple of capital. The current value of investee companies held below 1x makes up only 6% (55 companies) of remaining portfolio company value.

Figure 12: Growth Analysis



Country Risk

The overall regional risk assessment for the portfolio falls within the very low risk to moderate risk range. The direct portfolio has more exposure to moderate

Figure 13: Holding Values, fund portfolio

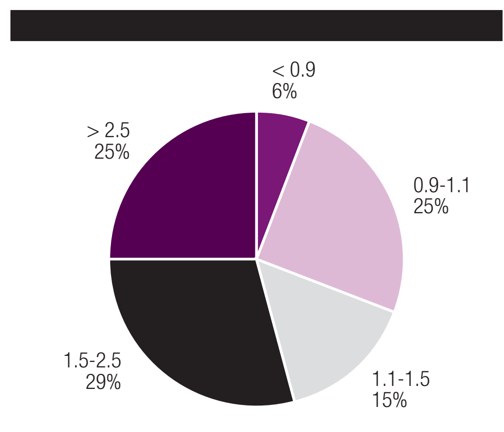


Table 14: Country Risk, Total Portfolio

	Very Low Risk	Low Risk	Moderate	High Risk	Very High Risk
Funds	28%	17%	18%	1%	0%
Directs	15%	9%	12%	0%	0%
Total	**43%**	**27%**	**30%**	**1%**	**0%**

risk regions due to the nature of the DFIs and MFIs. The fund portfolio has a high concentration in very low risk regions, which is not surprising given the more risk-averse strategies employed by private equity fund managers.

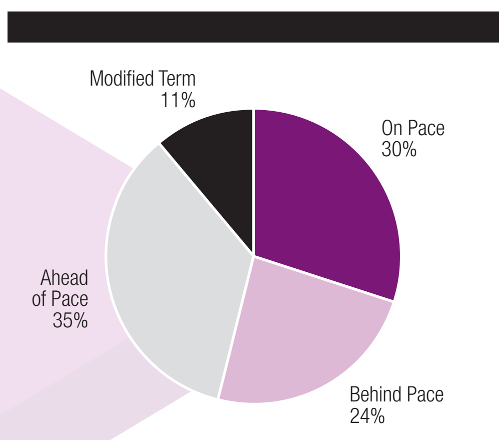
Fund Manager Execution Risk

This section examines investment pace and a subset of funds to determine whether or not the actual fund investees are consistent with the manager's stated strategy at the time of fund selection.

Investment Pace

Using historical fund cash flows provided by the Bank, the analysis calculated the percent disbursed[29] for each fund and compared it to typical disbursement rates[30]. For the funds that are still in the investment period, the percent disbursed was calculated as of year-end 2013. For the funds that are no longer in the investment period, the percent disbursed was calculated as of the final date of the investment period. Each fund was then categorized as On Pace, Behind Pace, Ahead of Pace or Modified Term[31].

Figure 14: Disbursement Pace Analysis; Exposure



A total of 12 funds (59% by exposure) that were in the investment period at December 2013 were classified as either Behind Pace or Ahead of Pace. While these funds should be closely monitored, it is important to note that the Behind Pace funds are still relatively young and the Ahead of Pace funds are all near the end of the investment period.

The pacing issues of the two Modified Term funds have already been addressed by the fund managers and approved by the fund investors, with one being in dissolution, and the other one having its investment period extended by one year.

Table 15 shows the number, the weighted-average life (as of the date of first close), and the portfolio exposure of the funds for each pacing classification.

The median percent disbursed of the ten post-investment period funds was 80%, which is consistent with expectation. However, two of these were legally modified during the investment period because they were behind pace. The investment period of the first one was extended by one year and that of second one was cut short and commitments were reduced.

Table 15: Disbursement Pace Analysis, by stage of fund; Exposure figures in UA Million

	On Pace			Behind Pace			Ahead of Pace			Modified Term			Total		
	#	WA Life	Exp.	#	WA Life	Exp.	#	WA Life	Exp.	#	WA Life	Exp.	#	WA Life	Exp.
Investment Period	7	3.4 yrs	91.7	5	2.4 yrs	74.8	7	4.5 yrs	107.7	2	4.3 yrs	34.9	21	3.6 yrs	309.2
Post Investment Period	5	8.8 yrs	101.2	1	5.5 yrs	8.7	2	7.5 yrs	39.8	2	5.6 yrs	35.0	10	7.8 yrs	184.8
Total	**12**	**6.2 yrs**	**193.0**	**6**	**2.7 yrs**	**83.5**	**9**	**5.3 yrs**	**147.6**	**4**	**5.0 yrs**	**69.9**	**31**	**4.6 yrs**	**494.0**

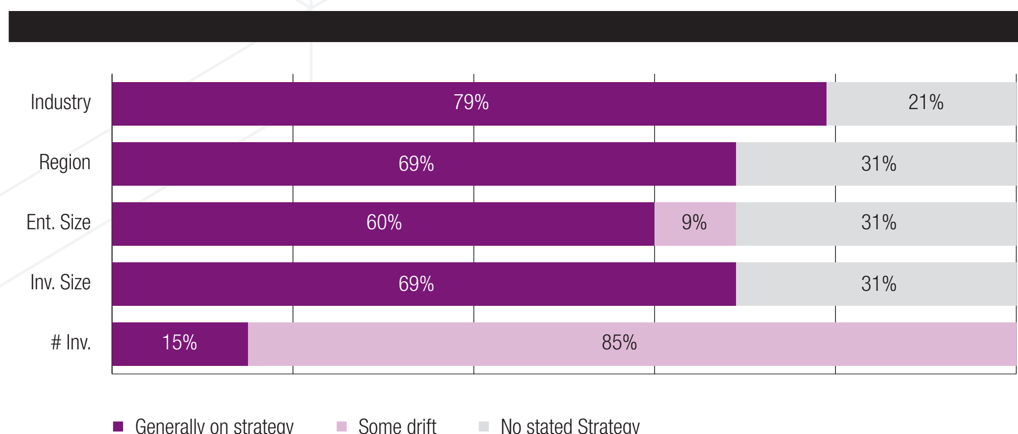
While investment pace is not necessarily a reliable standalone risk metric, it can indicate potential issues about a manager's deal-making process. For instance, an unusually fast pace of capital deployment could indicate less rigorous investment standards, while a particularly slow pace of investment could indicate that the manager is struggling to source or close on deal flow. Both situations could result in a manager making investment decisions that are off strategy or that possess less attractive risk/return profiles. For managers with slower investment paces, it is particularly important to monitor the pace towards the end of the investment period as management teams feel pressure to deploy capital.

Investment Strategy Drift

This analysis reviews a sample of eight funds (20% of exposure) where both an investment memo and adequate fund investee data were available. Each of these eight funds was assessed to determine whether its investees are consistent with the fund's original stated strategy. The evaluated components of investment strategy include Industry, Region, Enterprise Size, Investment Size (amount invested in each investment), and Number of Investments (figure 15).

The evaluated funds were generally found to be "on strategy" in the areas of Industry, Region, and

Figure 15: Strategy Drift Analysis by Exposure



Investment Size. One fund had strayed somewhat from the stated target enterprise size, though the investment was not grossly out of line.

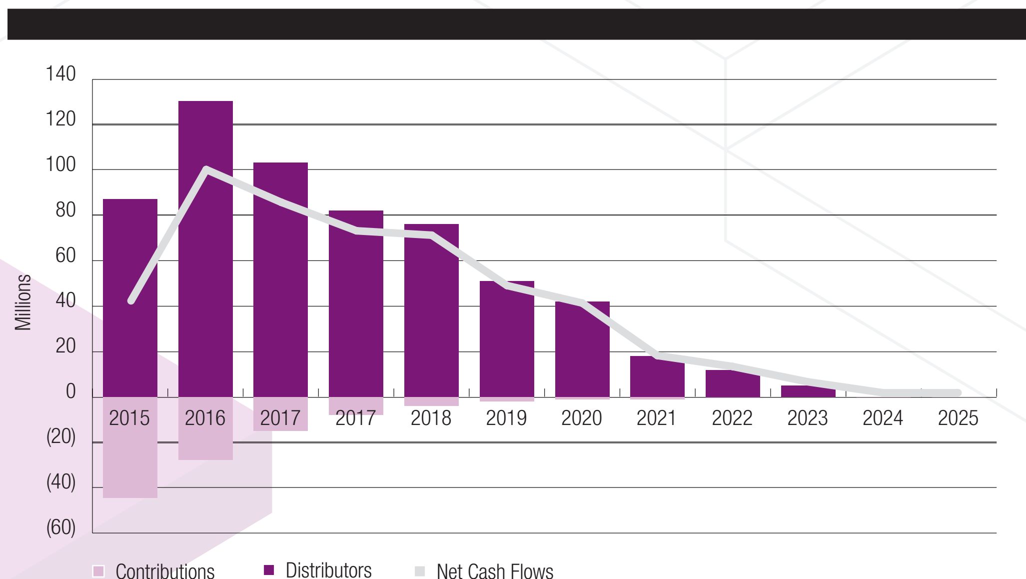
Six funds are not on track to make the expected number of investments, resulting in increased risk because of reduced diversification, which also diminishes the potential development outcomes that the manager can achieve. Not surprisingly, four of these six funds missed their fundraising targets. While strategy drift is not a risk that can be completely eliminated, robust fund monitoring and governance terms can serve to mitigate it, as potential drift can be identified and addressed promptly.

Projected Cash Flows

It is important to maintain a consistent commitment pace and not over- or under-invest in certain vintage years. Inconsistent commitments to the asset class year-to-year make reliable cash flow forecasting even more critical, as it is an important aspect of effective private equity portfolio management.

As indicated above, the Bank has set an equity limit of 15% for the portfolio, calculated on the basis of total risk capital[32]. As a result of significant investments made during 2008 and to a lesser extent 2010 and 2011, the risk capital utilization rate is quickly approaching this limit. In response to concerns among both internal and external stakeholders, the Bank has dramatically reduced the overall pace of its commitment year-over-year since 2011. A better understanding of expected future capital calls and distributions for fund investments is critical to the future commitment and active portfolio management decision-making process. The cash flow projections are subject to several limitations[33] and as a result, should be considered 'high level' despite the robust methodology employed. Figure 16 reflects forward projected contributions, distributions and net cash flows by year for the for the fund portfolio.

Figure 16: AfDB Fund Cash Flow Projections



The portfolio is expected to generate net distributions going forward, largely based on increased expected exit activity associated with investments made in the 2008-2011 timeframe and the slowing pace of capital calls, a direct result of the Bank's reduction of recent commitment activity. Distributions are expected to increase dramatically from UA 87 million in 2015 to UA 130 million in 2016 and then begin to steadily decrease starting in 2017. Capital calls are expected to decrease from UA 45 million in 2015 to UA 28 million in 2016 and UA 15 million in 2017. Net distributions are expected to increase to UA 42 million in 2015 to UA 102 million in 2016 before slowing down in 2017. Over the next three years, the analysis projects total net distributions of UA 231 million assuming no new commitments are added or current investments are sold in the secondary market.

Conclusions and Recommendations

Investment Strategy and Portfolio Management

The evaluation demonstrated that the equity investments are aligned with the Bank's strategic priorities. However, by their nature, fund investments focus on higher return and lower risk countries and consequently limit benefits to fragile states and MSMEs.

The evaluation also concluded that the financial performance of the equity investments, particularly for mature funds, is **satisfactory**. The low effectiveness rating is mainly due to the immaturity of the portfolio and the lack of comprehensive outcome data. The evaluation also concluded that fund investment helps diversify the Bank's investment strategy, as exposure is currently heavily weighted towards the direct portfolio. Furthermore, fund investment is considered an attractive way to access private markets, because it is less risky than direct investment. Investors' ability to leverage manager expertise is particularly important when investing in a market as broad and diverse as Africa. However, fund investment involves the risk of relinquishing control. To mitigate this risk, the Bank needs to ensure a rigorous due-diligence process focused on quantitative, qualitative, and operational reviews, the negotiation of strong governance terms, and robust ongoing monitoring to identify issues early.

Recommendation 1: Continue investments in private equity funds and further strengthen portfolio oversight and management. The Bank could consider the following options:

- **Pursue a Portfolio Sale:** The secondary market for private equity offers several paths to liquidity, including a partial straight or structured sale of select fund and direct investments or selling a strip of a broader portfolio. The Bank has previously had exchanges with multiple prospective buyers but the bids have not generally been attractive. As a result, should the Bank determine that a full or partial sale of the portfolio is desirable for reasons of either risk capital constraints or for strategic reasons, a fully or partially advised sale process is recommended to create additional pricing tension through a competitive bidding process. As a preliminary step, a detailed segmentation analysis could be completed to determine the projected performance for each asset and resulting range of estimated values that could be achieved in a sale process. Given the immaturity of the portfolio, it is likely that many of the investments would trade at a discount to current net asset values, but these discounts could be at least partially offset by strong strategic interest in an exclusively Africa-focused portfolio.

- **Maintain Management In-house:** the Bank can continue to manage the portfolio, including future investment decisions and monitoring responsibilities. By keeping management in-house, the Bank can retain and develop institutional knowledge and build expertise while maintaining full control of the portfolio. However, the Bank would need to dedicate and/or hire the appropriate internal resources to effectively manage and monitor the portfolio.

- **Fully Outsource Portfolio Management:** the Bank could also fully outsource portfolio management, including future investment decisions and monitoring responsibilities. Potential managers could include funds and full-service consultants. This option would allow the Bank to benefit from outside expertise, and would significantly reduce the administrative burden of managing the portfolio. This would likely be an expensive option, however, and require a full comparison versus the Bank's current costs of

running the program. Full outsourcing could potentially impede the Bank's ability to develop its own internal expertise and cause it to lose a measure of control over the ultimate direction of the portfolio.

- **Partially Outsourcing Portfolio Management:** the Bank could choose to maintain full discretion over its future investment decisions but outsource some of the administrative and monitoring responsibilities. This option would allow the Bank to maintain institutional knowledge and control of the portfolio while freeing up internal resources to focus on the most critical components of the investment process. As in the fully outsourced portfolio management option, this would require an evaluation of proposed costs versus cost savings.

Recommendation 2: Develop and implement a multi-pronged investment strategy that would allow for an approach that responds to the Bank's diverse priorities and strategic objectives, by for example establishing two investment streams: 1) a core portfolio, which would focus on making larger investments supporting established fund managers with proven track records and a history of making investments that align with the Bank's priorities and, 2) a second higher-risk sub-portfolio, which would focus on making smaller investments supporting first-time managers with strategic objectives related to fragile states or with a SME focus.

Risk Management

The evaluation concluded that there is only a modest proportion (about 38%) of the 15% limit to be utilized by 2020 due to a rapid consumption of the risk capital and the immaturity (i.e. years away from liquidity) of the portfolio. It also highlighted the importance of maintaining a consistent commitment pace and not over- or under-invest in certain vintage years. Inconsistent commitments to the asset class year-to-year make it even more critical to have reliable cash flow forecasting, which is an important aspect of effective private equity portfolio management.

A number of stakeholders have raised some noteworthy concerns with respect to the Bank's risk methodology and its application (this was not within the purview of this evaluation).

Recommendation 3: Review the risk capital limit of 15% and/or develop and implement an effective exit strategy for some of the older investments to free up capital.

Recommendation 4: Conduct a detailed cash flow projection exercise.

The Bank should complete a detailed 'bottom-up' cash flow projection exercise. This analysis was completed in the Cash Flow Projection Analysis section of the report, but it was subject to several data limitations impacting overall reliability. If the Bank can organize the required documents and data to mitigate these limitations, it can enhance the overall usefulness of these projections in making portfolio-level decisions.

Recommendation 5: Review the Bank's Risk Management methodology in light of concerns raised by a number of stakeholders.

Monitoring and Outcome Tracking

The evaluation notes some major limitations in the Bank's monitoring and outcome-tracking system of equity investments, particularly direct investments. The assessment of effectiveness was hampered by the lack of outcome data. Furthermore, the measures identified in the ADOA documents are inadequate and do not allow for a proper assessment or effectiveness.

Recommendation 6: Develop and implement a results-based management strategy to ensure:

- A streamlined, strengthened investment-monitoring system: The Bank is currently implementing an information system (E-Front), which should improve its ability to track basic portfolio data and cash flows. However, for the system to be effective, the Bank needs to develop internal processes that ensure consistency in the entry and use of the data. In addition, the system can capture investee-level metrics including development outcomes. Furthermore, it is important to ensure that fund and portfolio-level reporting provides concise, credible, and relevant reports that can inform decision-making and lead to potential improvements. They can focus for example on tracking performance (at the output and outcome levels) and risk.
- Review the DO metrics to ensure that credible and relevant information on outcomes achievement is captured in a consistent manner, which will allow for a rigorous assessment of effectiveness. For instance, in 2005, IFC launched its Development Outcome Tracking System ("DOTS"), which measures the development effectiveness of both its investment and advisory services. Under DOTS, metrics must be relevant, able to be aggregated, time-bound and targeted, and easy to track. Not all of the Bank's current metrics meet these guidelines. For instance, the ADOA documents that were reviewed revealed that anticipated tax revenues are sometimes stated annually, cumulatively, or as a net present value figure across the funds, making it difficult to aggregate the figures across the portfolio. The Bank should capture general metrics, sector-specific metrics and fund-level metrics.

LUANDA
Novo Redondo
LOBITO BAY
DAR ES SALAAM

Annexes

Annex A — Methodology

Evaluation Issues and Questions

The evaluation was focused on three key evaluation issues/questions.

Evaluation Issue #1: Relevance

- Does the equity investments portfolio fit with the current institutional priorities as per the Bank's Ten-year Strategy (i.e., growth of bankable SMEs, reducing the infrastructure financing gap, growth with reduced carbon emissions and financial inclusion)?

Evaluation Issue #2: Performance

- **Financial performance:** Have the investments in the portfolio achieved their projected financial results? Are those results likely to continue and/or improve?
- **Development Outcomes:** Have the intended DO of the Bank's equity investments been achieved? Are the achievements consistent with the expectations at the time of investment?
- **Additionality:** Is there evidence that the Bank's participation has led to value additions/ benefits?

Evaluation Issue #3: Risk Management

Has the risk profile of the investments changed over the investment period? What is the potential impact of the changes on the Bank's risk profile?

Data Collection Methods

A mix of quantitative and qualitative methods with a multi-pronged approach was employed to assess the portfolio. Data collection methods included:

1. A literature review to examine the latest trends and issues related to equity investments in Africa.
2. A thorough data, portfolio and program review to assess trends, measure risk, and complete bottom-up cash flow projections to support pacing and liquidity analysis. A variety of data sources were used for the analysis including the Bank's internal risk policy documents[1], system-produced year-end 2013 capital account information for fund and direct investments historical fund cash flow data, and fund financial statements and quarterly reports for investee funds.
3. A survey of all fund managers to collect their views.

1 *PE Rating Model Upgrade 2013*, and *June 30 2014 FFMA Credit Risk Ratings Status Report*

4. Field visits to a sample of projects to collect DO indicators.

5. A high quality financial database sourced from quarterly and audited financial statements of the funds partnership to calculate funds' performance using standard metrics such as IRR and multiples of capital such as Total Value to Paid-In (TV/PI) and Distributed to Paid-In (D/PI) ratios. For both the fund-level "net" returns and the company-level "gross" returns, the approach aggregates and compares funds with similar time periods. At the fund level, this approach was used to aggregate and compare funds formed in the same years versus other peers formed in the same vintage year groups.[2]

6. A benchmarking analysis comparing the Bank's portfolio with a customized private equity fund focused on Africa. The analysis also provides comparisons to relevant benchmarks of public market securities using the "modified Public Markets Equivalent" (mPME) methodology[3].

Rating Scale

Rating	Rationale
Highly Satisfactory	Overwhelming prevalence of positive aspects, with virtually no flaws
Satisfactory	Marked prevalence of positive aspects, clearly outweighing negative aspects
Moderately Satisfactory	Prevalence of positive aspects, albeit with some negative aspects
Moderately Unsatisfactory	Prevalence of negative aspects, only partly compensated by positive aspects
Unsatisfactory	Marked prevalence of negative aspects, clearly outweighing positive aspects
Highly Unsatisfactory	Overwhelming prevalence of negative aspects, with very few positive aspects

2 Using vintage-year comparisons is important to help control for the "J-curve effect" in which private equity funds typically follow a similar pattern of early negative returns for at least several years before the portfolio begins showing positive returns. Vintage year comparisons also help control for the effects of investments made during different environments over time.

3 This methodology allows for more accurate comparisons between returns generated by private investments and those of public market indices, which are usually reported using a Time-Weighted Return (TWR) methodology that treats the returns from each time period equally.

Endnotes

1. MEs and SMEs are typically defined based on the number of employees and either the amount of revenues or value of balance sheet assets. The definition can vary by country. As this information was not available for many of the underlying fund investee companies, the implied equity value of the companies was estimated and used as a proxy to categorize each investee company as Micro (equity value less than UA 1 million), Small (equity value between UA 1-10 million, Medium (equity value between UA 10- 25 million) and Large (equity value greater than UA 25 million)
2. Per PE Unit
3. Defined as paid-in capital plus reserves
4. This confirms the Bank's underlying premise for equity investing, as reflected in its successive private sector development, non-sovereign operations (NSO), and equity strategies and policies.
5. More specifically, the Portfolio Management Division of OPSD.
6. Time when the revised Additionality and Development Outcomes Assessment (ADOA) Framework took effect.
7. http://empea.org/research/surveys/2014-global-limited-partners-survey
8. http://assets.thecommonwealth.org/assetbankcommonwealth/action/viewDownloadFile?CSRF= jfNCat5Y0XnOaTP6SWgA&returnUrl= viewSearchItem%3findex%3d0%261%3d1&id=22972
9. Database focused on alternative assets. See www.preqin.com
10. Preqin
11. EMPEA, LP Survey 2014
12. While there is callable capital related to the direct investments, it is not anticipated that the capital will be called.
13. This methodology allows for more accurate comparisons between returns generated by private investments and those of public market indices, which are usually reported using a "Time-Weighted Return" methodology that treats the returns from each period equally.
14. ADOA memos not available for fund investments prior to 2009. Anticipated DOs available for 23 of 31 fund investments (66% of invested capital).
15. Figure excludes a microfinance-focused fund with 347 investee companies at June 2014.

16. For the fund investments, the data relied on a combination of 2013 year-end reports and Q1 and Q2 2014 quarterly reports. For the direct investments, the 2013 or 2012 annual reports were reviewed.

17. Per PE Unit

18. MEs and SMEs are typically defined on the basis of the number of employees and revenues or value of balance sheet assets. The definition can vary by country. As this information was not available for many of the underlying fund investee companies, the implied equity value of the companies was estimated and used as a proxy to categorize each investee company as micro (equity value less than UA 1 million), small (equity value between UA 1-10 million), medium (equity value between UA 10-25 million) and large (equity value greater than UA 25 million).

19. An African fund was omitted from these rankings because its strategy is substantially different from the other private equity funds.

20. Current multiple calculation: (Current Value + Distributed) / Disbursed

21. Information regarding the anticipated and current job creation metrics for women was available for 6 of the 31 funds (16% of capital commitments).

22. Information regarding the creation of EMPs post-investment was available for 9 of 31 fund investments (28% of capital commitments).

23. The at-appraisal rating reflects the anticipated risk level of the investment at commitment, using updated methodology developed in 2011. The risk rating methodology was not utilized before 2001, so the at-appraisal rating of the older direct investments reflects the rating assigned in 2001.

24. The At Appraisal bar shows commitment-weighted risk assessments of the portfolio using risk rating assigned to each investment at appraisal. Current bar shows exposure-weighted risk assessment of the portfolio using exposure information as of December 2013 and risk ratings as of June 2014. Exposure is calculated as uncalled capital plus current value. The exposure at the time of investment is equal to the commitment amount.

25. Significant Upgrade: Rating increase of more than 5 places; Upgrade: Rating increase of between 1-5 places; No Change: no change in the rating; Downgrade: Rating decline between 1-5 places; Significant Downgrade: Rating decline of more than 5 places.

26. Metrics related to the fund portfolio are based on the ownership of each of the funds' investee companies in order to provide a granular and accurate level of monitoring. The figures used were extracted directly from the fund managers' most recent financial statements and reports (ranging from Q3 2013 to Q2 2014 figures). Metrics related to the direct investees rely on cost and value data provided by the Bank as of year-end 2013.

27. Information available for approximately 40% of fund unrealized portfolio company value.

28. Information available for approximately 66% of the direct equity portfolio current value.

29. Percent disbursed is calculated as disbursed capital divided by committed capital.

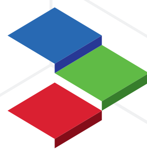
30. Managers typically invest approximately 80% of committed capital during the investment period, reserving the remaining 20% for follow-on investments, fees and expenses.

31. On Pace: Calculated percent disbursed was no less than 85% of expectation, and may exceed expectation; Behind Pace: Calculated percent disbursed was less than 85% of expectation; Modified Term funds had been behind plan, and this was addressed with a structural modification to fund terms or commitments.

32. Defined as paid-in capital plus reserves.

33. While the managers generally provided adequate transparency into the funds and underlying investee companies through quarterly reporting, the overall quality of fund reporting and fund reporting quarters were not consistent across all managers. Finally, no adequate historical cash flow history for the funds was provided by the Bank, which could have an impact on fund waterfalls. Manager calls to review the funds and underlying investee companies were not included as part of the scope and therefore not used to refine the accuracy of the cash flow projections.

An IDEV Thematic Evaluation



IDEV

Independent Development Evaluation

African Development Bank

An IDEV **Thematic Evaluation**

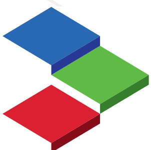
About this Evaluation

This assessment summarizes the findings from an evaluation of the African Development Bank Group's Equity Investments. The evaluation triangulates data from a number of sources, including but not limited to a portfolio and program review, a survey of all fund managers, field visits to targeted projects, a review of quarterly and audited financial statements of the funds partnership, and a benchmarking analysis. The portfolio assessed comprised both combined funds and direct investments in the equity portfolio. The assessment confirmed that the equity investments are aligned with the Bank's strategic priorities; although by their nature, fund investments focus on higher return and lower risk countries, and therefore benefits to fragile states and micro, small and medium enterprises are limited.

About the African Development Bank Group (AfDB)

The overarching objective of the African Development Bank Group is to spur sustainable economic development and social progress in its regional member countries (RMCs), thus contributing to poverty reduction. The Bank Group achieves this objective by mobilizing and allocating resources for investment in RMCs; and providing policy advice and technical assistance to support development efforts.

The mission of **Independent Development Evaluation (IDEV)** is to enhance the development effectiveness of AfDB initiatives in its regional member countries through independent and instrumental evaluations and partnerships for sharing knowledge.



IDEV

Independent Development Evaluation
African Development Bank

Avenue Joseph Anoma, 01 BP 1387, Abidjan 01, Côte d'Ivoire
Phone: +225 20 26 20 41 • Fax: +225 20 21 31 00
Email: idevhelpdesk@afdb.org

idev.afdb.org

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