ADB

Extended Annual Review Report

Project Number: 36914
Investment Number: 7184
November 2012

Equity Investment
ASEAN-China Investment Fund (formerly ASEAN-PRC SME Investment Fund)
(Regional)

In accordance with ADB's Public Communications Policy 2011, this abbreviated version of the extended annual review report excludes information that is subject to exceptions to disclosure set forth in paragraph 97.

Asian Development Bank

CURRENCY EQUIVALENTS

Currency Unit – US dollar ($)

ABBREVIATIONS

ACIF	–	ASEAN-China Investment Fund
ADB	–	Asian Development Bank
ASEAN	–	Association of South East Asian Nations
CDB	–	China Development Bank
ESG	–	environmental, social, and corporate governance
IPO	–	initial public offering
IRR	–	internal rate of return
PRC	–	People's Republic of China
SECO	–	Swiss State Secretariat for Economic Affairs
SMEs	–	small and medium-sized enterprises
UOB	–	United Overseas Bank

NOTE

In this report, “$” refers to US dollars.

Vice President	L. Venkatachalam, Private Sector and Cofinancing
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BASIC DATA
ASEAN-China Investment Fund
(Investment No. 7184)

Key Project Data	**As per ADB Investment Documents** ($ million)	**Actual** ($ million)
Total project cost (fund size)	125.0	76.0
ADB investment:	15.0	15.0
Equity:		
Committed	15.0	15.0
Disbursed		13.4
Returned		20.1

Key Dates	**Expected**	**Actual**
Concept clearance approval	August 2002	12 August 2002
Fact-finding mission	January 2003	29 January 2003
Board approval	April 2003	15 April 2003
Equity effectiveness	January 2004	January 2004
First disbursement	January 2004	29 January 2004

Financial and Economic Internal Rates of Return (%)	**Appraisal**	**XARR**
Net financial internal rate of return	13.0	34.1

Project Administration and Monitoring	**No. of Missions**	**No. of Person-Days**
Fact-finding	1	2
Appraisal, negotiation, promotion	1	7
Extended annual review mission	1	2

ADB = Asian Development Bank.

EXECUTIVE SUMMARY

In April 2003, the Board of Directors of the Asian Development Bank (ADB) approved an investment of up to $15.0 million in the ASEAN-China Investment Fund (ACIF, or “the Fund”). The Fund was formed at a time when the Association of South East Asian Nations (ASEAN) region was accelerating implementation of the ASEAN Free Trade Area agreement while actively pursuing regional cooperation and economic integration with various Asian countries, and foremost with the People’s Republic of China (PRC). It was envisaged at the time that small and medium-sized enterprises (SMEs) that could benefit significantly from the free trade area lacked access to the necessary capital (especially in the immediate years following the Asian financial crisis), management skills, corporate governance expertise, and technical skills to fully capitalize on this emerging opportunity.

ACIF was structured as a close-ended private equity vehicle with a fund life of 8 years and an option to extend the term for up to 2 years. The general partner of the Fund, UOB Capital Partners, was partly owned by UOB Global Capital LLC and Westmount Asset Management, Inc. The general partner then entered an investment advisory agreement with UOB’s wholly owned venture capital affiliate, UOB Venture Management Private Limited (the investment advisor), and the two entities formed the Fund’s management team.

The Fund eventually raised $76.0 million, making ADB’s $15.0 million stake approximately 19.75% of total commitments. Other prominent investors’ contributions to the Fund included a $15.0 million commitment from the Swiss government’s State Secretariat for Economic Affairs (SECO), a $10.0 million commitment from Singapore-listed banking group United Overseas Bank Limited (UOB Group), and $15.0 million from the China Development Bank (CDB). The Fund eventually invested a total of $55.1 million into 15 companies during its investment period, which is equivalent to 72.5% of the Fund’s total committed capital.

In terms of private sector development, ACIF made a substantial positive impact through its life, both at the fund level (through proof-of-concept and its ability to draw more capital to the region) and also at the level of investee companies (where the Fund’s investment and role (i) enhanced governance, management, environmental and social safeguard practices, and (ii) created a leveraging or multiplier effect as a result of the capital mobilized through a comparatively large listing). On this basis, the investment is rated *excellent* on private sector development-related parameters.

ACIF has exited 11 of the 15 investee companies, at an average multiple on cost of 2.6 times and an internal rate of return (IRR) ranging from 7.8% to 845.4%. As of 30 September 2012, the Fund has realized $111.6 million from disposal of assets, and received $2.8 million of dividend income, therefore returning approximately $114.4 million to investors; the remaining fair value of underlying investments is approximately $4.7 million. With its share in the investment, ADB disbursed $13.6 million through capital calls, received $20.1 million in distributions, and holds $1.4 million in the net asset value of the Fund’s remaining assets. Overall fund performance yielded an IRR of 34.1%. Given the business success of ACIF, the project is rated *excellent*.

ACIF was approved shortly after the adoption of ADB’s Environmental Policy (2002), but before the introduction of ADB’s current Safeguard Policy Statement (2009). Investors at the time, and particularly SECO, emphasized their strong desire to implement environmental, social, and corporate governance (ESG) policies into the Fund’s investment processes, but a comprehensive framework did not exist at the time. Therefore, the investment advisor designed and implemented its own ESG framework into its due diligence process, relying on World Bank and ADB environmental and social safeguard policies, ESG training from ADB and International Finance Corporation, and external training seminars on ESG compliance. On aspects relating to environmental, social, health, and safety, the Fund is rated *excellent*.

The Fund's private placement memorandum stated a target net IRR to investors of 13.0%. The Fund's net IRR of 34.1%, as of 30 September 2012, exceeds this target by more than 21 percentage points. As per the evaluation guidelines, this qualifies it for an *excellent* rating. Moreover, when compared to the benchmark for comparable funds of similar focus and vintage, AICF's net return of 34.1%, as of 30 September 2012, far exceeds the Cambridge Associates median IRR benchmark of 7.3% for Asian private equity funds of 2004 vintage. The Fund is therefore rated *excellent* in terms of ADB's investment profitability.

Over the course of the Fund's economic life, the $55.0 million ACIF deployed across 15 companies helped generate more than 9,700 new jobs (net), mobilized an additional $72.2 million of co-investment capital from other investors, and tapped over $700.0 million in new funding raised from capital markets. In addition, ACIF's presence as an active investor in these SMEs also resulted in over $151.8 million of additional debt being raised by these companies. Additional economic benefits are seen in the enhanced economic activity related to the additional revenues and/or sales generated and the subsequent taxes paid. While these assessments are subjective, they clearly substantiate an *excellent* rating for economic sustainability.

ADB's presence was critical to both the initial design and the closing of the Fund. In addition to its role in identifying a credible fund manager, ADB provided the core funding commitment necessary to facilitate ACIF's formation and motivate other investors to make comparable capital contributions. The Fund's concept papers show that SECO made clear its investment was contingent upon ADB's participation as an investor. The policy and regulatory changes required to pave the way for CDB's investment were substantially facilitated by ADB.

Following the investment, ADB was represented on the Fund's advisory board and was tasked with resolving any conflict of interest issues to arise and to provide any additional guidance to the Fund as required. In this capacity, ADB played a relatively passive oversight role once the Fund was in operation, raising relevant questions from time to time in accordance with its fiduciary obligations. No specific outcomes related to fund profitability, effectiveness in managing the investee companies, or enhancement of those companies' competencies and operating standards, can be ascribed to ADB. The overall assessment of ADB's work quality and its additionality are both rated *satisfactory*.

Overall, ACIF is rated *highly successful*. The rating is driven by (i) the Fund's development impact and outcome, and specifically the direct benefit of ACIF at the investee-company level and the large multiplier effect of bringing in new capital to the SME segment; (ii) ADB's value addition, specifically at the Fund's initial stages; and (iii) the Fund's overall strong financial performance and economic development impact.

I. THE PROJECT

A. Project Background

1. In April 2003, the Asian Development Bank (ADB) approved an investment of up to $15.0 million in the ASEAN-China Investment Fund[1] (ACIF, ACIF I, or “the Fund”). In January 2004, ADB completed the documentation, and subsequently it invested $13.4 million of its $15.0 million commitment to the Fund.

2. The Fund was formed at a time when the Association of South East Asian Nations (ASEAN) region was accelerating implementation of the ASEAN Free Trade Area agreement while actively pursuing regional cooperation and economic integration with various Asian countries, foremost with the People’s Republic of China (PRC). It was envisaged at the time that small and medium-sized enterprises (SMEs) which could benefit significantly from the free trade area lacked access to the necessary capital, management skills, corporate governance expertise, and technical skills to fully capitalize on this emerging opportunity.

3. It was with this premise that ACIF was launched, with the goal of providing export-oriented SME investee companies both risk capital and knowledge transfer in order to maximize their growth opportunities, and, in that process, to foster regional integration through trade. The Swiss government’s development agency, the State Secretariat for Economic Affairs (SECO), originated the concept of establishing a fund to facilitate this intervention, and it approached ADB regarding execution of the project.[2]

B. Key Project Features

4. Similar to other funds, ACIF was structured as a close-ended private equity vehicle registered in the Cayman Islands. It had a fund life of 8 years, and an option to extend the term for up to 2 years. The Fund’s initial target size was $125.0 million, but it eventually closed at $76.0 million, making ADB’s $15.0 million stake approximately 19.75% of total commitments. Other prominent investors’ contributions to the Fund included a $15.0 million commitment from SECO, a $10.0 million commitment from Singapore-listed banking group United Overseas Bank Limited (UOB Group), and $15.0 million from the China Development Bank (CDB).

5. The Fund’s investment period was 5 years, during which time ACIF would make equity and quasi-equity investments into SMEs operating in the ASEAN–PRC region, specifically targeting unlisted, well-managed companies, with attractive growth prospects in domestic and overseas markets, that would benefit from increased economic and trade cooperation in the region, and with leading trading partners like the PRC.

6. From an investment strategy standpoint, the Fund aimed to build a balanced portfolio of investments, with an emphasis on sectors that were well positioned (at the time) in terms of competitiveness and growth prospects. Such sectors were grouped into what was described in the investment proposal as “growth clusters.” Examples of these priority growth clusters are provided in Table 1 below.

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[1] Previously referred to in ADB Board documents as ASEAN-PRC SME Investment Fund.

[2] SECO is now the Swiss Investment Fund for Emerging Markets, or SIFEM, but will be referred to in this report by its original name at the time of ADB’s investment.

Table 1: Priority Sectors or "Growth Clusters"

Cluster Type	Business Sectors
Support Industry	Electronic components, automotive parts, packaging and distribution
Service Industry	Health care, tourism, transport and logistics
Mainstream ("old economy")	Food and beverages, light manufacturing, consumer goods
Technology-related	Information technology services, software, medical technology, biotechnology, and environmental technologies

7. Moreover, the Fund was unique in that it was among the first of ADB-promoted regional funds to include a number of target countries like the Philippines and Indonesia—geographic areas typically not covered by other country-specific SME-focused funds (which have focused on markets like Thailand and Viet Nam). Expanding the geographic scope of the Fund's investment market was, at that time, a key differentiating factor that furthered the regional integration objectives set out in the ASEAN Free Trade Area agreement.

8. The general partner of the Fund, UOB Capital Partners, was incorporated in the State of Delaware, and is owned in part (70%) by a UOB subsidiary, UOB Global Capital LLC, and in part (30%) by Westmount Asset Management, Inc. The general partner then entered into an investment advisory agreement with UOB's wholly owned venture capital affiliate, UOB Venture Management Private Limited (the investment advisor), and the two entities formed the Fund's management team, with the former executing investment decisions and the latter carrying out structuring and performance-monitoring roles.

C. Progress Highlights

9. The Fund's first close was in January 2004, with total commitments of approximately $61.0 million raised from five investors. The Fund had its final close in June 2005 with CDB committing $15.0 million, bringing the Fund's total size to approximately $76.0 million. ADB's share, which was originally envisaged to be 12% of the total fund size, eventually rose to about 20% upon final closing of the Fund. While this nominal increase may appear unexceptional, this represented a significant decision as the commitments of SECO and CDB were tied to ADB's contribution. Given that the Fund was unable to mobilize the anticipated level of capital, further shortfalls in contributions from key investors could potentially have diminished the investment advisor's ability to make meaningful investments.

10. The Fund invested a total of $55.1 million in 15 companies during its investment period, which ended in April 2008. That was equivalent to 72.5% of the Fund's total committed capital. As of 30 September 2012, the Fund has realized $111.6 million from disposal of assets and received $2.8 million in dividend income; the remaining fair value of underlying investments is approximately $4.7 million. For its part, ADB disbursed $13.6 million through capital calls, received $20.1 million in distributions, and holds $1.4 million in the net asset value of the Fund's remaining assets. Overall fund performance yielded an IRR of 34.1% as of 30 September 2012.

11. The current portfolio, as of 30 September 2012, consists of four companies that are in the process of being divested. Three of these have been listed on public exchanges, but minimum holding-period restrictions and stock market volatility have contributed to delays in the divestment schedule. The fourth and final investee is being written off as a total loss, and while there is some small prospect of recovery, those losses are fully provisioned.

II. EVALUATION

A. Project Rationale and Objectives

12. The rationale for ADB's investment in the Fund was principally to catalyze the first private equity fund specifically targeting investments in SMEs on an ASEAN-wide basis while also aligning its strategy with the regional growth being stimulated by the ASEAN–PRC Free Trade Area. ADB played a critical role in mobilizing capital from other investors, most of whom were first-time investors in these markets. These investors were extremely hesitant and highlighted substantial concerns about investing in the ASEAN region, particularly after the 1997 Asian financial crisis. ADB's intervention in the early capital-raising stages specifically paved the way for CDB, which made the first overseas private equity investment of any PRC entity. CDB's commitment to ACIF is discussed in greater detail in the following section.

13. From a capital-demand viewpoint, ACIF helped bridge the post-crisis financing gap wherein even many intrinsically sound SMEs faced significant difficulties in raising funds from banks in the region. Moreover, it was envisaged at the time that ADB's participation in the Fund would increase its own knowledge of practical impediments facing SMEs, which subsequently could be reflected in ADB's policy dialogues with the concerned governments. ACIF was the first regional fund, which fact differentiated this initiative from the earlier country-specific funds ADB had developed.

B. Development Impact

1. Private Sector Development

14. From a private sector development perspective, ACIF is considered successful as it (i) brought in new and first-time investors to the ASEAN region, specifically in the turbulent post-crisis period; (ii) established linkages between SMEs and local capital markets by deploying initial public offerings (IPOs) and stock-listings as the dominant exit route for its investments; (iii) provided demonstration value, both at the fund formation level and from an investment discipline standpoint; and (iv) successfully initiated regulatory and policy changes that established a new investment approach for PRC-based entities.

15. **Demonstration effect.** ACIF took a disciplined investment approach by consistently structuring transactions to capture the upside of an investment while also including downside protection. This was achieved using convertible loans with prices set at a discount to valuation at IPO or a guaranteed interest rate in the absence of an IPO. While it certainly did not pioneer this approach, the investment advisor's successful execution of this strategy has provided demonstration value to the market. From the broader standpoint of the Fund's strategy, ACIF targeted SMEs that were larger, both from ownership and business-model perspectives, and these were amenable to capital market listings via IPO.[3] The fact that ACIF was able to screen a large pool of opportunities fitting this theme and to deploy its committed capital into sound investments at a relatively quick pace demonstrated a clear need for equity in a post-crisis

[3] As against the more conventional approach in which the private equity fund sells its investment either back to the sponsor of the SME or to another business-related entity (like a buyer or supplier to the SME), ACIF's approach brought in much higher upside potential (through public listing). Given ACIF's small fund size and single-exposure limits, however, this also raised the challenge of bringing in other investors through a co-investment arrangement.

environment. This subsequently catalyzed the launch of other funds with similar investment theses and provided sound justification for the launch of ACIF's successor, ACIF II.[4]

16. **Policy changes.** As a direct result of efforts by the fund manager and subsequent consultation with ADB, CDB became the first PRC-based entity to receive regulatory approval for investing offshore into the private equity asset class, a precedent-setting move that continues to have long-lasting impact on the industry and in the PRC. This was a significant development, as it demonstrated PRC's position not only as a key destination for foreign capital but also as a contributor to overseas investments fostering regional development.[5] For instance, in the decade following its ACIF investment, CDB now maintains an entire division dedicated to private equity investing, a move which has allowed the institution to diversify its investment portfolio and share its experiences with its peers.

17. From the perspective of the Fund's investee companies, ACIF can be considered one of ADB's more successful initiatives in supporting SMEs within its developing member countries. The Fund's managers played a key role in guiding 11 of 15 of investee companies (73% of the ACIF portfolio) to IPOs, which not only opens new avenues to SMEs for raising capital, but also helps capital markets development by widening the profile of listed entities. The public listing process involves i) educating SME owners on the IPO process, ii) strengthening their corporate governance and management practices, iii) implementing international accounting standards, iv) engaging international auditing services and expanding disclosure standards, and v) establishing environmental and social safeguards policies and practices as an integral part of their operations. On the back of ACIF's initial investment of approximately $55.0 million, portfolio companies were able to raise approximately $713.0 million from public markets through IPOs.

18. The fund manager also improved operations at firm level by holding a board seat in all but three investee companies, enhancing company earnings through introducing new business partners, improving investees' working capital structures, providing access to new or better financing structures, and establishing superior tax planning for investees. Through these efforts (for instance, listing in local markets) investees have had some additional demonstration effect with respect to other SMEs in related sectors and geographic areas. Moreover, the Fund contributed nonfinancial improvements to investee companies. In one instance, at Hung Vuong Joint Stock Co. Ltd. in Viet Nam, the company increased employee count by over 400% (from 1,328 employees prior to investment to 6,767 at divestment, thus creating 5,439 net jobs).

19. ACIF has made a substantial positive impact, both at the fund level (through proof-of-concept and its ability to draw more capital to the region) and also at the investee-company level (where the Fund's investment and role (i) enhanced governance, management, as well as environmental and social safeguard practices; and (ii) created a leveraging or multiplier-effect as a result of capital mobilized through a comparatively large volume of stock market listings). On this basis, the investment is rated *excellent* on private sector development-related parameters.

[4] ACIF II was launched at the height of the global financial crisis, yet it successfully mobilized $149.1 million in capital commitments from investors (including a $24.9 million commitment from ADB), and deployed about 40% of its capital in underlying investments.

[5] This trend of fostering overseas investments by PRC-based entities continues. In October 2012, PRC regulators announced that domestic insurance companies can invest in offshore private equity funds, thus providing further proof that the sector continues to mature (stemming from CDB's original investment into ACIF in 2005) and establishing a new source of capital targeting regional growth opportunities.

2. Business Success

20. The Fund invested $55.1 million into 15 portfolio companies (summarized in Appendix 2). It has exited 11 of the 15 investments, at an average multiple on cost of 2.6 times (2.6x) and with internal rates of return (IRR) ranging from 7.8% to 845.4%. The Fund has returned approximately $106.8 million to investors. The fair value of the remaining investments is $11.8 million, which the general partner expects to harvest by the end of the Fund's life.

21. Several factors contributed to ACIF's exceptional performance, but the key drivers can be seen in the investment advisor's ability to (i) benefit from its linkages to UOB Bank's diverse SME-focused operations in the region; (ii) mobilize substantial co-investment capital to ensure that, despite its size being smaller than anticipated, the Fund was able to maintain its investment mandate; (iii) deploy capital very rapidly (as opposed to similar funds that missed prime investment opportunities due to various delays); and (iv) target SME companies that were strongly placed for IPO-linked exits as opposed to relying on trade sales.

22. Given the business success of ACIF, the project is rated *excellent*.

3. Environmental, Social, Health, and Safety Performance

23. ACIF was approved shortly after the adoption of ADB's Environment Policy (2002) but before the introduction of ADB's current Safeguard Policy Statement (2009). Investors at the time, and particularly SECO, emphasized their strong desire to implement environmental, social, and corporate governance (ESG) policies into the Fund's investment processes, but a comprehensive framework did not exist at the time. Therefore, the general partner designed and implemented its own ESG framework into its due diligence process, relying on World Bank and ADB environmental and social safeguard policies (including screening for potential involuntary resettlement and/or impacts on indigenous peoples), ESG training from ADB and International Finance Corporation, and external training seminars on ESG compliance.

24. The investment advisor noted that every company it evaluated exhibited some noncompliance with local laws on ESG-related matters. Therefore, the investment advisor's approach was to devise a plan to identify concrete steps for achieving ESG compliance as well as other areas of improvement. This action plan, which was based on technical and feasibility studies by consultants engaged by the investment advisor, laid out specific measures required for attaining compliance, their total costs, and the time required for construction and/or completion. The action plan became a part of a roadmap to an eventual IPO. Investee company owners were generally aligned with achieving ESG compliance as a step toward growing their businesses and raising public capital. The investment advisor noted that an investment did not push through whenever it became apparent during the course of due diligence that an owner was not serious about taking the necessary steps to achieving compliance.

25. As a result, the investment advisor evidently turned down several opportunities that presented strong financial upside and development impact potential but lacked compliance on matters of ESG.[6] The most significant contribution in ACIF's ESG compliance work has been that the investment advisor team translated the broad compliance objective into a very

[6] In one instance, the Fund turned down an opportunity to invest equity into a fisheries company where 50% of revenues were derived from shark fins. The company could not establish an environmentally friendly approach to sustaining its operations.

transparent, well-structured, and efficiently scheduled investment and operational plan, and it even included the related capital costs as a part of its investment proposal.

26. On aspects relating to environmental, social, health, and safety, the Fund is rated *excellent*.

C. ADB Investment Profitability and Economic Sustainability

27. The Fund invested $55.1 million into 15 portfolio companies in Indonesia, Malaysia, PRC, Thailand, and Viet Nam. The Fund's private placement memorandum stated a target net IRR to investors of 13.0%. Its net IRR of 34.1% as of 30 September 2012 exceeds this target by more than 21 percentage points. As per the evaluation guidelines, this qualifies it for an *excellent* rating. Moreover, AICF's net returns of 34.1% far exceed the Cambridge Associates median IRR benchmark of 7.3% for Asian private equity funds of 2004 vintage. The Fund is therefore rated *excellent* in terms of ADB's investment profitability.

28. In order to estimate the economic return from the investment, the financial internal rate of return is used as a reference point, and subjective parameters are deployed to make this assessment. This analysis is limited to portfolio level, and is not being done at the company level for each investee in the Fund portfolio. Over the course of the Fund's economic life, the $55.0 million ACIF deployed across 15 companies helped generate approximately 9,700 new jobs (net), mobilized an additional $72.2 million of co-investment capital from other investors, and helped in raising more than $700.0 million in new funding from the capital markets.[7] In addition, ACIF's presence as an active investor in these SME entities resulted in approximately $151.8 million of additional debt being raised by these companies (see Appendix Table A2.4 for details). Additional economic benefits are seen in the enhanced economic activity related to the additional revenues and/or sales generated and subsequent taxes paid. While these assessments are subjective, they clearly substantiate an *excellen*t rating for economic sustainability.

D. ADB Work Quality

29. **Screening, appraisal, and structuring.** ADB was originally approached by SECO in 2001 with the broad concept of establishing a regional private equity fund to support SMEs development. Additional high-level discussions took place between the Swiss Governor of the Bank and ADB's President at the time, Mr. Tadao Chino. SECO conducted initial feasibility analysis of the concept, which included an assessment of potential managers for the fund. It initially agreed to retain the private equity arm of the Suez Group of France as fund manager.

30. Before committing to the Fund, however, Suez chose to exit the private equity business in emerging markets altogether in the aftermath of the Asian crisis. ADB and SECO were left with a viable concept and capital commitments but no fund manager. ADB evidently took the initiative from that point, and in 2002 the working group approached the UOB Group to assess its interest in managing the Fund through its affiliated private equity entity, UOB Global Partners, given that the institution was based in Asia and had the support of a financial institution with significant penetration into the SMEs sector. The UOB Group expressed keen interest in executing this mandate on behalf of investors, namely ADB and SECO, and it also elected to join in the Fund with a substantial commitment of $10 million. This gesture was

[7] Figures provided for net jobs creation and debt raised are based on the best information available. In some instances, this information was not tracked, and therefore these figures could be even higher (or lower).

considered a strong alignment of interests, which, relative to the Fund's size, is greater than the normal proportionate commitments made by a general partner.

31. The Fund was structured generally in accordance with prudent risk mitigation principles and best practices for investment fund operations. It included the requisite investment ceilings and restrictions needed to achieve a diversified portfolio.[8] The relevant clauses protecting shareholders were also incorporated into the Fund's legal documents. ADB was involved in drafting some parts of the legal documents, which ensured that its development goal of providing SMEs with access to financing as well as knowledge of international best practices in ESG areas was included. Overall, ADB performed in line with its operating strategies, policies, and standards existing at the time of the investment.

32. **Monitoring and supervision.** ADB was represented on the advisory board of the Fund. It was tasked with resolving any conflict-of-interest issues that arose and to provide any additional guidance to the Fund, as required. The Fund held annual advisory board meetings, which were attended in person by ADB, along with additional meetings as required. The investment advisor noted that while ADB was instrumental in the formation of ACIF, it played a relatively passive oversight role once the Fund was in operation and raised relevant questions from time to time in accordance with its fiduciary obligations. While there have been some delays in the exits being implemented by the investment advisor, more diligent monitoring could potentially have helped identify these issues at an early stage.

33. **Role and contribution.** ADB's role, as confirmed by the fund manager, was crucial during the Fund's conceptualization and development. In addition to ADB's role in identifying a credible fund manager (as described in para. 30), ADB provided the core funding commitment necessary to facilitate the formation of ACIF and to motivate other investors to make comparable capital contributions.

34. The overall assessment of ADB's work quality is rated *satisfactory*.

E. ADB's Additionality

35. ADB's presence was critical to both the initial design and the closing of the Fund. According to the Fund's concept papers, SECO made it clear that its investment was contingent upon ADB's participation as an investor. During the initial closing, ADB's investment was critical in the Fund's ability to raise capital from other investors, particularly in Asia's post-crisis environment. The policy and regulatory changes required to pave the way for CDB's investment were substantially facilitated by ADB. Subsequent to the closing of the Fund, ADB played the requisite fiduciary role of a fund investor, participating in advisory board meetings as needed and providing passive oversight. No specific outcomes related to fund profitability, effectiveness in managing the investee companies, or enhancement of their competencies and operating standards can be ascribed to ADB. ADB also contributed as a significant investor in the follow-on fund, ACIF II. Overall, ADB's additionality is rated *satisfactory*.

F. Overall Evaluation

36. Overall, ACIF is rated *highly successful*. The rating is driven by (i) the Fund's development impact and outcome, and specifically ACIF's direct benefit at the investee-

[8] The Fund subsequently made one amendment to the investment restrictions to allow a greater proportion of the commitment capital to be allocated to PRC, from 50% to 65%.

company level and the large multiplier effect of bringing in new capital to the SME segment; (ii) ADB's value addition, specifically at the Fund's initial stages; and (iii) the Fund's overall strong financial performance and economic development impact.

Table 2: Evaluation of the ASEAN-China Investment Fund

Indicator/Rating	Unsatisfactory	Less Than Satisfactory	Satisfactory	Excellent
Development Impact				
Private sector development				X
Business success				X
Economic sustainability				X
Environment, social, health, and safety performance				X
ADB Investment Profitability				X
ADB Work Quality			X	
ADB Additionality			X	
	Unsuccessful	**Partly successful**	**Successful**	**Highly successful**
Overall Rating				**X**

ADB = Asian Development Bank, ASEAN =Association of South East Asian Nations.

III. ISSUES, LESSONS, AND RECOMMENDED FOLLOW-UP ACTIONS

A. Issues and Lessons

37. **Investment platform.** ACIF benefited extensively from its linkages to the UOB Group, as the investment advisor was able to tap into that bank's vast network in the region and its specialization in SME banking. UOB contributed significantly to ACIF deal flow and provided value-added services such as corporate banking, trade financing, investment advisory, and IPO-related groundwork support, among others.[9] While the benefits of these linkages are evident, current regulatory trends have resulted in an increasing number of commercial banks either substantially winding down or exiting completely from their fund-management activities in the area of private equity.[10] This presents an issue of finding alternate arrangements for maintaining the linkages between banks and private equity funds within the scope of permissible regulatory boundaries, and specifically for sectors like SME financing.

38. **Value of ESG.** ACIF's case also strongly demonstrates the direct impact of ESG compliance on the financial returns and growth prospects of private sector enterprises, which have traditionally viewed these aspects as unrecoverable social costs of business and investment. By meeting ESG standards, several of the fund's investee companies improved their cost structure and efficiency, enhanced profitability, attracted a wider investor and lender-base, and bolstered their prospects for IPO and capital-market listing. ACIF has also demonstrated the benefits of translating ESG compliance into a clear action plan, which specifies the scope of investment, costs, technology, timeframe, and schedule of completion. This brings in the required level of clarity and commitment from the SME owners/sponsors and helps to link the costs and benefits.

[9] Of 500 deals screened by the Fund, nearly 30% were internal referrals from the UOB Group. It is also important to highlight that all the transactions between UOB Bank and AICF were done wholly on an arm's-length basis, and there is no evidence of preferential considerations having been made.

[10] "Current regulatory trends" refers to the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, and within this law, Title VI or the Improvements to Regulation of Bank and Savings Association Holding Company and Depository Institutions (also known as the "Volker Rule"), which limits financial institutions' ownership of hedge funds and private equity funds (considered speculative investments) to no more than 3% of their Tier 1 capital. The Dodd–Frank legislation, in its entirety, can be found at http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

39. **Entry and exit discipline.** Some of the other operational lessons emanating from this extended review relate to (i) monitoring the exit process of all investments, irrespective of a fund's financial performance, as delayed exits tend to undermine the overall returns of the fund and extending the holding period often results in only marginal improvements; (ii) recognizing that entry-level valuations are very critical, specifically when a fund's exit is structured as a discount to future improvements in the investment value; and (iii) realizing that funds raising less capital than originally anticipated can still make meaningful investments if they can structure their investment strategies around a co-investment model, thus ensuring integrity of a fund's original investment mandate.[11]

B. Recommended Follow-Up Actions

40. None are recommended.

[11] In private equity, managers may seek co-investors—for specific transactions—to facilitate larger transactions without compromising on agreed-upon investment restrictions (such as limits on individual transaction sizes). Co-investors tend to be (but are not exclusively) existing investors in the private equity fund itself, who, in return for their additional equity capital, benefit by having the option to increase their exposure to particularly attractive investment opportunities while not having to pay additional management or performance fees that are associated with their main investment (i.e., capital commitment) to the fund vehicle itself.

PRIVATE SECTOR DEVELOPMENT INDICATORS AND RATINGS: PRIVATE EQUITY FUNDS

Indicator	Ratings[a]				Justifications/Annotations
	Impact to Date	**Potential Impact (Sustainability) and Risk to its Realization**		**Combined Rating**	**Impact to Date**
1. Beyond Intermediary and Investee Company Impacts	Impact[b]	Impact[b]	Risk[c]	Rating	
1.1 **Private sector expansion and institutional impact** 1.1.1 Contributes to pioneering or materially increasing the private sector's share and role in the economy 1.1.2 Contributes to institutional development by: • improving the supply of risk capital in the market; • demonstrating the merits of private equity funds to the public, firms, banks, and others; • bringing liquidity to local stock exchanges with IPOs; • helping a private equity industry take root and become more efficient along with maturing capital markets; and • increasing private equity expertise via migration of fund manager staff to other funds, etc.	4			4	The Fund materially increased the private sector's share and role in the economy by investing $55.1 million in equity into companies in a post-crisis environment when risk capital was scarce and in high demand from small and medium-sized enterprises. The Fund's investee companies raised approximately $713 million from the public markets, bringing liquidity to local stock exchanges and demonstrating the merits of private equity funds as a source of value.
1.2. **Competition.** Contributes to new competitive pressures in key investee markets and/or in the financial sector for risk capital and finance	3			3	The Fund's presence led to competitive pressures in investee markets as evidenced by (i) bidding situations in some markets, and (ii) increased valuation of assets over time.
1.3. **Innovation.** Helps introduce effective new products, services, and new technologies, as well as replicable new business strategies in investee companies, or in the way the fund operates, thereby supporting reform and transformation of business sectors, industries, and/or maturing financial markets (item 2.2)	4			4	The Fund was an early pioneer in structuring investments both to capture upside and limit downside through convertible loans with prices set at a discount to valuation at IPO or a guaranteed interest rate in the absence of an IPO.
1.4. **Linkages.** Relative to size of investments, adds notable upstream or downstream link effects to investee and/or financial markets for growth	3			3	The Fund's impressive IPO track record will have had significant linkage effects for related companies, both upstream and downstream, that are seeking to tap public markets but require necessary improvements to governance and/or accounting standards to achieve an IPO.
1.5. **Catalytic element.** Catalytic finance, or contributes to wider improved	3			3	The Fund was catalytic from a capital markets standpoint, as it

Indicator	Ratings[a]				Justifications/Annotations
	Impact to Date	**Potential Impact (Sustainability) and Risk to its Realization**		**Combined Rating**	**Impact to Date**
debt or risk capital supply from local and foreign investors to investees and to local financial sectors generally					mobilized funds from foreign investors and new investors who had never before invested in the private equity asset class (i.e., CDB).
1.6. **Affected laws, frameworks, regulation.** Contributes to improved legal and regulatory private business or sector frameworks, or to improved financial sector regulation, such as by observed lobby activity. Fund manager reports on significant dialogue affecting reform.	4			4	The Fund instigated regulatory reform in PRC that led to CDB becoming the first entity in that country to receive approval to invest in offshore private equity. This reform has since been expanded (in 2012) to include PRC-based insurance companies.
1.7. **Wider demonstration of new standards.** Complies with good standards, and sets replicable new standards in, among others, corporate governance; transparency; stakeholder relations; environmental, social, health, and safety measures; and energy conservation. It demonstrates standards of governance and improved transparency, including as a result of preparing investee companies for listing on stock markets (item 2.2)	4			4	The Fund adheres to good ESG standards and sets a strong example that is replicable in other funds. In the absence of ADB's environmental and social management system (2009) framework at the time the Fund was launched, the manager developed and implemented a comprehensive framework to address ESG matters.
2. Direct Intermediary and Investee Company Impacts with Wider Potential					
2.1. **Skills with demonstration and wider dissemination potential** Through achievements in new managerial strategic and operating skills, contributes to successful investee enterprises with potential for more widespread demonstration and replication Achievements in developing skills in private equity deal structuring, instruments, and new ways to invest can be applied by fund staff in follow-on funds, or when joining new private equity groups, banks, or other financing.	4			4	The Fund contributed to successful investee enterprises as evidenced by the large number of companies brought to IPO status, which has widespread demonstration value. The pioneered innovative methods of deal structuring to limit downside protection have now been replicated across the industry and in ACIF's follow-on fund, ACIF II.
2.2. **Demonstration and new standard-setting potential**					
Demonstrates new ways of operating businesses and competing, along with investee performance that is comparable with relevant best industry benchmarks and standards	3			3	The Fund introduced international best practices in ESG and accounting standards.
As evident in set standards in corporate governance and stakeholder relations	4			4	The Fund appointed a chief financial officer whenever possible.
Overall Private Sector Development Rating	4			4	

ACIF = ASEAN-China Investment Fund; ADB = Asian Development Bank; CDB = China Development Bank; ESG = environmental, social, and corporate governance; IPO = initial public offering; PRC = People's Republic of China.

[a] The combined rating weighs future impact and risk to its sustainable realization.

[b] Excellent (4), satisfactory (3), partly satisfactory (2), unsatisfactory (1).The rating is not an arithmetic mean of the individual indicator ratings, and these have no fixed weights. It considers already manifest actual impact (positive or negative) and the potential for impact as well as risk to its realization.

[c] Risk: low (4), modest (3), medium (2), high (1).

ASEAN-CHINA INVESTMENT FUND SUMMARY OF INVESTMENTS

Table A2.1: Quantitative Investment Summary of the ASEAN-China Investment Fund[This information was deemed confidential according to exception no. 97(iv) and 97(v) of ADB's Public Communications Policy.]

Table A2.2: Qualitative Investment Summary of the ASEAN-China Investment Fund

Company	Country	Industry	Investment Stage	Exit Strategy
AA Group Holdings	Malaysia	Industrials/electric & electrical equipment	Expansion	IPO & open market sales[a]
China Energy Ltd.	PRC	Oil & gas/alternative energy	Expansion	IPO & open market sales[a]
China Great Well Holdings Ltd.	PRC	Basic materials/mining-related	Expansion	
Enviro Energy Ltd.	Thailand	Oil & gas/alternative energy	Startup & expansion	Open market sales[a]
Consciencefood Holding Pte. Ltd.	Indonesia	Consumer goods/food producers	Expansion	IPO & open market sales
Hung Vuong Joint Stock Co. Ltd.	Viet Nam	Consumer goods/food producers	Expansion	IPO & open market sales
Jiangxi Kangli Medilog Pte. Ltd.	PRC	Healthcare/healthcare equipment & services	Expansion	Trade sale
China Precision Technology Ltd.	PRC	Industrials/electric & electrical equipment	Expansion	IPO & open market sales
China XLX Fertilizer Ltd.	PRC	Manufacturing/chemical & fertilizer	Expansion	IPO
Mermaid Maritime Ltd.	Thailand	Oil & gas/marine	Expansion	Trade sale
Petrojaya Ltd.	Malaysia	Oil & gas/transport	Mezzanine	Redemption
Sports Asia Pte. Ltd	PRC	Consumer goods/personal goods	Expansion	Redemption
Sunvic Chemical Holdings Ltd.	PRC	Basic materials/mining-related	Expansion	IPO & open market sales
Unionmet (Singapore) Ltd.	PRC	Basic materials/industrial metals & mining-related	Expansion	IPO & open market sales
Yangzijiang Shipbuilding (Holdings) Ltd.	PRC	Industrials/industrial transportation	Expansion	IPO & open market sales

IPO = initial public offering, PRC = People's Republic of China.
[a]Planned but not executed as of writing this report.
Source: Fund documents.

Table A2.3: Development Impact Summary of the ASEAN-China Investment Fund
[This information was deemed confidential according to exception no. 97(iv) and 97(v) of ADB's Public Communications Policy.]

Table A2.4: Selection of Certifications; Awards; and Description of Environmental, Social, and Corporate Governance Enhancements
[This information was deemed confidential according to exception no. 97(iv) and 97(v) of ADB's Public Communications Policy.]

Figure A2.1: Geographic Breakdown of ASEAN-China Investment Fund Portfolio
(Source: Fund documents)

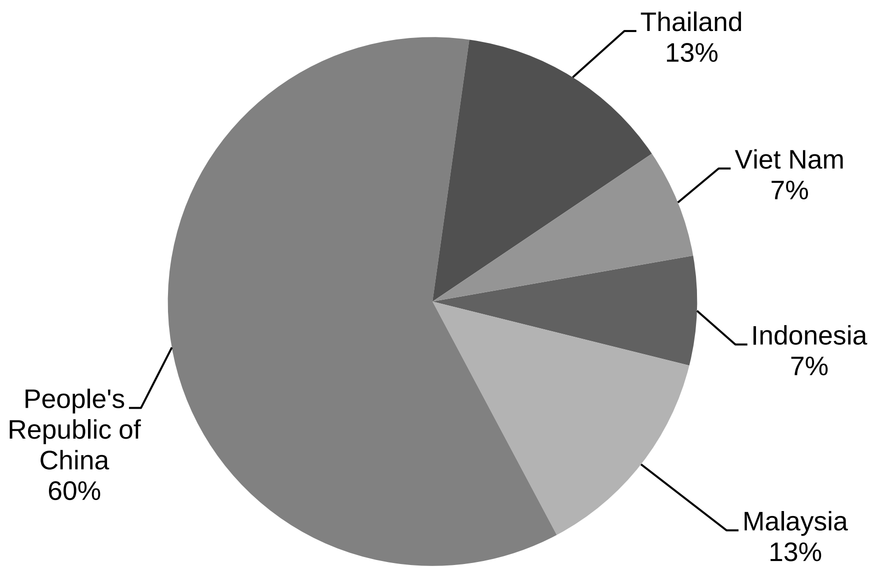

Figure A2.2: Industry Breakdown of ASEAN-China Investment Fund Portfolio
(Source: Fund documents)