Georgia Regional Development Fund Evaluation Report

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ABBREVIATIONS

DR	Development Return
GDP	Gross Domestic Product
GoG	Government of Georgia
GRDF	Georgia Regional Development Fund LLC
IPEV	International Private Equity & Venture Capital Valuation Guidelines
IPG	Investment Policy Guidelines
MCA	Millennium Challenge Account Georgia
MCC	Millennium Challenge Corporation
MCG	Millennium Challenge Georgia Fund
MSME	Micro, Small and Medium Enterprises
PC	Portfolio Company (GRDF Investee)
PE	Private Equity
SEAF	Small Enterprise Assistance Funds, GRDF Fund Manager
SME	Small and Medium Enterprises
TA	Technical Assistance
USD	United States Dollar
VAT	Value Added Tax

EXECUTIVE SUMMARY

The Georgia Regional Development Fund (GRDF) was created against the backdrop of high unemployment and a credit-constrained financial sector in Georgia. Despite improving economic growth in the lead-up to the GRDF, Georgia's economy was overly dependent on Tbilisi-based businesses. Furthermore, the lack of infrastructure and poor access to finance combined with the limited capacity of Small and Medium Enterprises (SMEs) in the regions resulted in uneven growth and persistent unemployment. GRDF was, thus, created to cater to regional SMEs with the hope of catalyzing development and growth outside of Tbilisi. The dependency of most regions on the agriculture sector led MCC to design the GRDF to focus on agribusinesses and tourism. To that end, several investment restrictions were included in the Investment Policy Guidelines with the intent of ensuring funds were made available to SMEs in the regions outside of Tbilisi and in the target sectors.

GRDF was structured as an independently operated, regionally focused private equity fund initially capitalized with USD 30 million in grant money from MCC and managed by an independent fund manager. The fund's investment policy entailed several restrictions to steer investments towards the target sectors outside of Tbilisi. In addition to the USD 30 million in committed capital, a USD 2 million technical assistance (TA) facility was made available to fund capacity building projects for potential Investees. The fund manager, the Small Enterprise Assistance Fund (SEAF), was chosen through a public tender process to serve as the Board of Director's investment agent — sourcing, originating, and monitoring GRDF investments and technical assistance projects. The Board assumed the role of the investment committee. GRDF was given a 10-year term, consisting of a 5-year investment period and 5-year wind-down period with proceeds from investments to be transferred into a trust to benefit the Government of Georgia.

The methodology used for this independent evaluation builds on the standard due diligence approach for private equity funds and analyzes GRDF's interventions around three dimensions: Project Design, Institutional Framework, and Outcomes. The goal of the performance evaluation is to understand the validity of the program logic and its assumptions (Project Design), the degree to which the institutional setup affected change (Institutional Framework), and the outcome results and lessons learnt (Outcomes). The evaluation methodology involved document review, in-depth financial analysis, stakeholder interviews and in-depth case studies. The companies selected for the case studies represent a cross-section of the portfolio in terms of financial and development performance and provide a rich source of information, from which to draw conclusions and lessons learnt. A cross-sectional analysis of the portfolio was also undertaken to reveal commonalities of failed companies and correlations between performance and sectors, financing instruments, and the external environment.

GRDF's development performance was mixed. By design, the development return was calculated as weighted average of annual changes in the wages paid, revenues generated, taxes paid, and local purchases of supply goods by GRDF Investees. This measure, however, is fraught with several shortcomings. The indicator was calculated on a yearly basis and thus did not consider the cumulative development impact. Failed companies still show a non-negative development return, despite job losses. Attribution is sometimes also a significant problem. For example, the growth in the four development return indicators for Foodmart, a GRDF Investee, is distorted by its acquisition of a large competitor. The calculations may also be distorted by diverging accounting practices across the companies. At the same time, GRDF investments did help create transformative Georgian companies, including in the telecommunications, grocery retail, poultry production, and construction sectors.

Most GRDF Investees performed poorly from a financial perspective. GRDF financed relatively small enterprises with minimal, if any, operational history and no prior experience managing debt obligations. The debt accepted on balance sheets represented the largest source of capital and, to service such high debt loads, the Investees had to grow at high rates. This left very little room for error in terms of realizing what were consistently overly optimistic growth numbers and margins of improvement. These performance problems were exacerbated by the volatile Georgian business environment and by several external shocks, most notably, the financial crisis of 2007-2008 and the Russian incursion into Georgia in 2008 (the "Russo-Georgian War"). The poor finances of companies have drastically reduced exit prospects for the underlying GRDF investments. The pressure to liquidate has left GRDF with little option other than to sell positions at high discounts. While the exact modalities are still being finalized, expectations of additional realized proceeds are low.

Companies that have become insolvent (i.e. "failed companies") following GRDF's intervention were among the earliest investments and consisted of a construction and furnishing business and several agribusinesses. SEAF's due diligence analysis assumed the continuation of favorable economic trends leading to overestimated revenue potential. Overconfidence in the ability of two of these businesses to quickly improve, led to additional investments and subsequently higher losses. A combination of over-optimism in growth, poor risk mitigation strategies, inadequate monitoring mechanisms, late recognition in business difficulties, and debt-heavy financing instruments exacerbated risks. These companies are no longer operating and their assets, largely factories and real estate, are subject to liquidation in early 2017. However, seniority of other creditors, tax penalties, and associated liquidation fees will likely result in minimal residual proceeds for GRDF.

Overall investment returns are short of expectations and remaining unrealized investments are soon to be auctioned off. From the USD 30 million in committed capital, GRDF has invested a total of USD 32 million over the life of its term. It has realized USD 24.5 million from investments, reinvesting USD 2 million from early reflows and paying just over USD 10 million in management and operational expenses. USD 6.9 million have already been distributed to the service agency and a further USD 6.0 million can be expected from investments recently liquidated and eventual liquidation of remaining assets. The Gross Internal Rate of Return for the entire fund is -5.92% and the Net Internal Rate of Return, which includes the effects of expenses, is -14.22%.

Unique design elements contributed to this mixed GRDF performance. The primary objective set for the fund was to maximize development impact with only a second consideration for financial returns. GRDF adopted a loose concept of development impact which was used as a component of bonus eligibility for the fund manager. GRDF's "carried interest hurdle rate" was set at a low threshold of 70%—implying that financial sustainability was not a core objective. Such a set-up is quite unusual in comparison to typical private equity funds—including those set-up by other Development Finance Institutions (DFIs)—and had implications on the decision-making process, stakeholder relationships, and eventual outcomes from investment activities. The compensation structure did not incentivize the fund manager towards achieving financially sustainable outcomes. Rather, it awarded short-term gains without regard for post-investment period outcomes. The imposition of several investment restrictions on business size (< USD 5 million in revenues), sector (51% in agriculture and tourism) etc. made it more challenging to ensure the financial viability of the Investees.

The Board underperformed as an investment committee. In its role as the investment committee, the Board was ultimately responsible for investment decisions. Investments were not thoroughly reviewed in the detail and depth that would be expected from a conventional fund investment committee. This aspect is related to financial accountability. Investment discussions were predominately focused on financing structures. Few of the proposed deals were rejected—even after risks were correctly highlighted. Lack of local presence, limited time, and limited knowledge of the Georgian market led to an overreliance on SEAF, who consistently put a positive spin on outcomes. Post-investment decisions also reflect this overreliance. MCC and MCA Georgia did not effectively leverage their roles in overseeing the activities of the GRDF, particularly during the early years of implementation. MCC representatives regularly attended Board meetings, but failed to identify and address these governance shortcomings at GRDF.

Several factors contributed to the poor fund manager performance, especially a mix of investment restrictions, inexperience and lack of local context knowledge, a challenging operating environment and a reliance on debt instruments to assume equity risks. Against a backdrop of a challenging operating environment and restrictive investment policy guidelines, SEAF encountered difficulties in sourcing and originating investments. SEAF's due diligence process was only narrowly applied—relying on the portfolio companies' management input and data. Despite a challenging environment, the fund manager consistently presented an over-optimistic assessment of investments and assumed higher growth or reversion to high-growth periods, which in turn made rapid disbursement possible with limited accountability in case of failure in subsequent years. Using debt to assume equity risk was another fateful strategy imposed by the design of GRDF. Monitoring of investments in general was not as robust as it should have been, given the maturity level of SMEs and inexperience of operating in Georgia. The failure rate of agribusiness investments also points to inexperience in this sector.

Overall, GRDF was an innovative structure which offers many valuable lessons for future MCC programs. GRDF investments have helped create 3-4 transformational companies in Georgia with significant positive externalities. This confirms that private equity (PE) is well suited to provide patient capital and can be a market friendly way of providing grants to countries. However, a PE fund must be operated as a commercial venture, i.e., on financially sustainable terms. Similarly, the initial project due diligence should be done by PE professionals with requisite experience in investments to ensure proposed investment policy guidelines are realistic. While shielding the fund from political interference is essential, it is important to strike the right balance between this goal and the need for local ownership—ensuring a strong public-private partnership. Private equity requires flexibility and long-term commitment, whereas MCC compacts had a five-year fixed implementation period. MCC should therefore consider a holding structure versus a fund for similar ventures going forward. Expanding the role and size of the TA facility would also help improve business viability and build SME capacity.

1. GRDF BACKGROUND & PROJECT LOGIC

1.1 ECONOMIC & FINANCIAL SECTOR CONTEXT

The first decade of Georgia's transition following independence was characterized by economic stagnation and political uncertainty. The fall of the Soviet Union presented both opportunities and challenges for Georgia in creating a new government and economic system. Like other transition countries, Georgia's economy suffered in the years after independence. It experienced several years of negative Gross Domestic Product (GDP) growth, hyperinflation and persistently high unemployment. GDP growth averaged -26% between 1991 and 1994, inflation averaged 5,715%, and unemployment averaged 13% over the same period.[1] The country was also plagued by political uncertainty because of civil war and rampant corruption—further depressing economic performance. In response to this, the Government of Georgia instituted a series of reforms between 1994 and 1998 designed to establish the institutional capacity to construct a market economy. These reforms brought about temporary stabilization but the East Asian financial crisis in 1998 revealed the inadequacy of reforms. Market mechanisms were poor and administrative interference into market institutions was high—preventing the development of an efficient private sector[2].

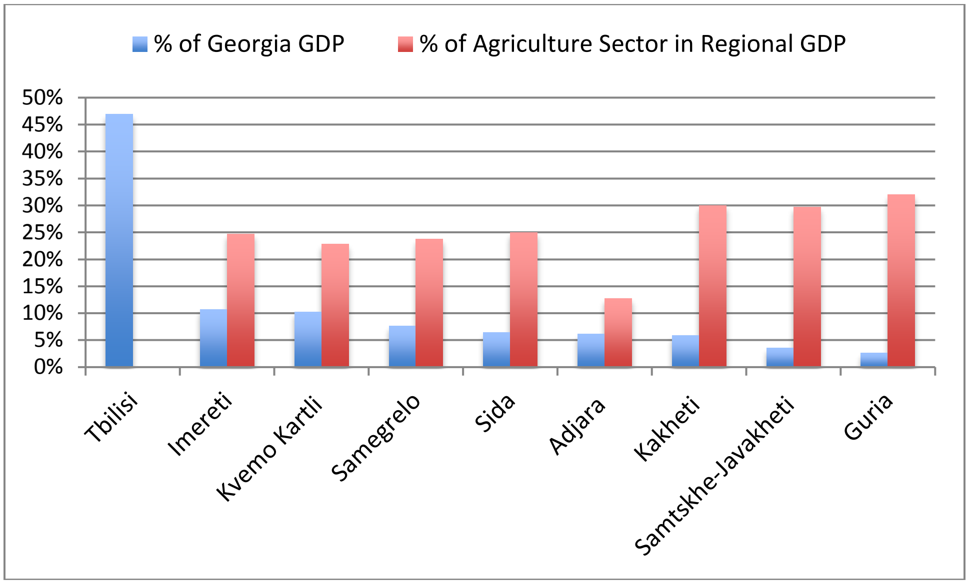
Growth-supportive reforms implemented after the "Rose Revolution" improved the business environment and lifted overall GDP. Mounting public discontent led to the "Rose Revolution" in 2003 which overthrew the government and led to dramatic political and economic reforms. Liberalization and deregulation were the focus of these reforms as the government attempted to create a business-friendly private sector and improve the governance of the public sector. A key initiative of the then-Saakashvili administration was the 2004-2005 Privatization Program that led to the privatization of over 1,800 state-owned entities and public assets. The program helped spur economic growth, which was a robust 9.6% in 2005 and 9.4% in 2006.

Despite the burst of economic growth, unemployment remained high, inequality worsened, and the regional distribution of GDP remained uneven. Growth was concentrated in less labor-intensive sectors that had a limited impact on unemployment, which continued to rise from 12% in 1996 to 14% in 2006. Labor-intensive sectors such as agriculture, which represented around 50% of employment, did not experience significant growth. The share of agriculture in the Georgian GDP, which was 34% in 1996, continued to decrease towards 12.8% in 2006. The decline in agriculture was felt particularly hard in the rural areas where agriculture was an important source of income. Meanwhile, GDP

[1] World Bank World Development Indicators
[2] World Bank (2002); Transition: The First 10 Years

was concentrated around Tbilisi and surrounding areas as the non-Tbilisi regions depended on the agriculture sector.[3]

Figure 1: Regional Structure of GDP



Source: GeoStat

With a small, underdeveloped financial sector dominated by a handful of commercial banks, the limited credit available naturally flowed towards Tbilisi. Bank credit penetration in the country was low prior to GRDF's creation in 2006. Credit to GDP stood at below 20% in 2006[4]. Furthermore, credit was mainly concentrated among businesses and individuals in Tbilisi—representing over 80% of total lending in the country. Credit was concentrated in the most productive regions and sectors, reflecting the dynamics of the economy and risk profiles of borrowers. Banks did not have the risk appetite nor the capital necessary to lend outside of Tbilisi. For the few borrowers that did qualify, collateral requirements often exceeded 100% of the value of the loan and interest rates hovered around 20% for USD denominated loans.

GRDF was one of the several projects under the MCC-Georgia Compact designed to help improve regional growth dynamics and employment. Project due diligence cited low productivity, employment, and poor investment as the causes for low regional growth. It recognized the importance of agriculture in supporting regional economies and potential growth in other sectors, such as tourism. Underdevelopment, it concluded, was a result of several growth constraints faced by SMEs—the most prominent constraints included access to finance, infrastructure bottlenecks, poor operating environment, and structural challenges.

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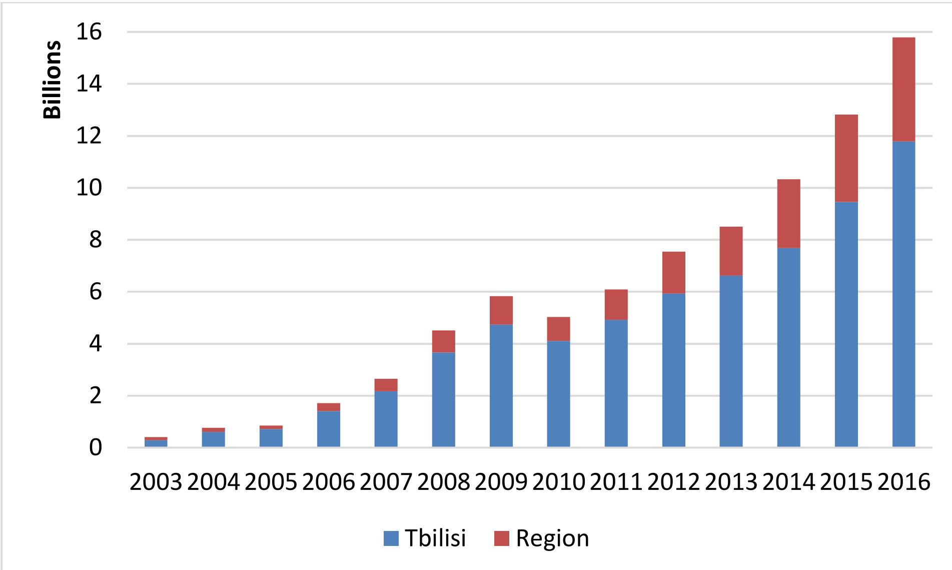
[3] National Bank of Georgia, Economic Statistics

[4] National Bank of Georgia

Figure 2: Outstanding Loans for Tbilisi vs. Regions



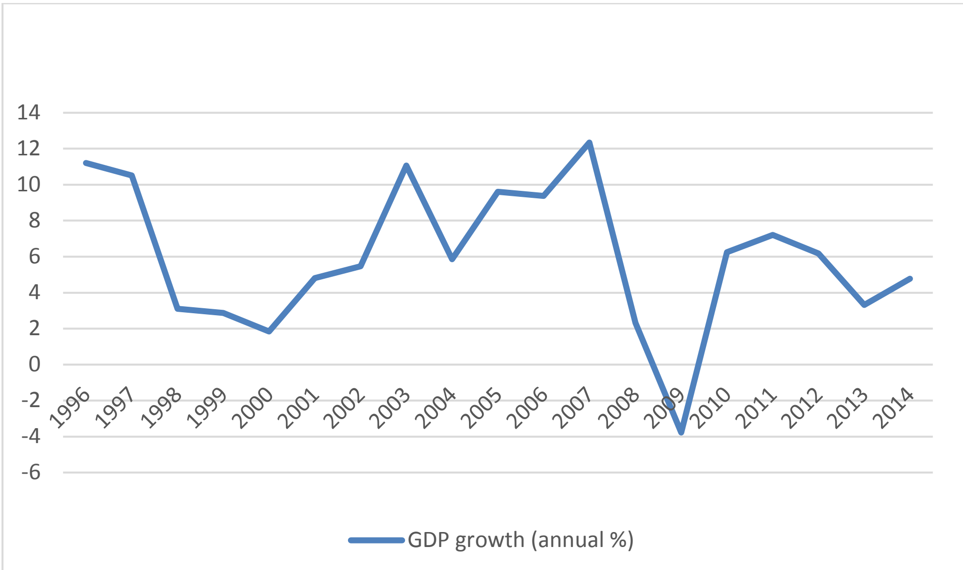
Source: National Bank of Georgia.

A confluence of internal and external factors led to erratic economic growth in Georgia soon after the start of the GRDF investment period. A decrease in capital inflows from international financial markets and a contraction in demand and reduced commodity prices resulted in a sharp decline in export revenues.[5] In the post-crisis environment, military hostilities and political tensions were additional factors strengthening the contraction of GDP in 2009.[6] Deteriorating relations with Russia closed off a significant chunk of revenues—from exports, remittances, and tourism—and weighed on the economy in the ensuing years.

No sector was immune from the overall downturn in the economy between 2007 and 2009; there was improvement across the Board in the ensuing years along with growth in lending. The banking sector grew and evolved between 2003 and 2015. The total outstanding loans as a percentage of GDP has increased significantly over the last decade. Recent total outstanding loans as percentage of GDP is approximately 45%. Of late, bank loans to the construction and hotels & restaurants sectors as a percentage of loan portfolios have grown several percentage points.

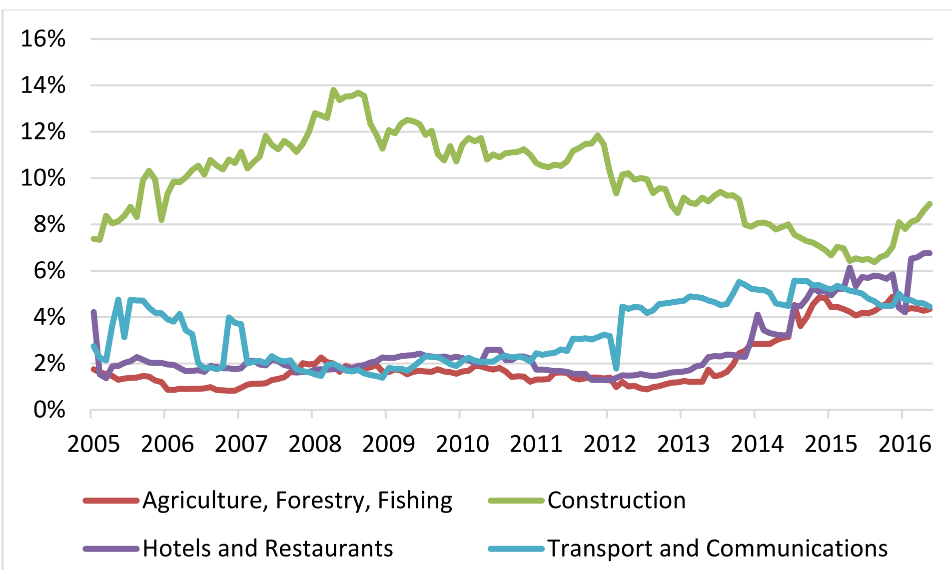
[5] National Bank of Georgia (2008), Annual Report
[6] National Bank of Georgia (2009), Annual Report

Figure 3: Annual GDP Growth (%)



Source: World Development Indicators

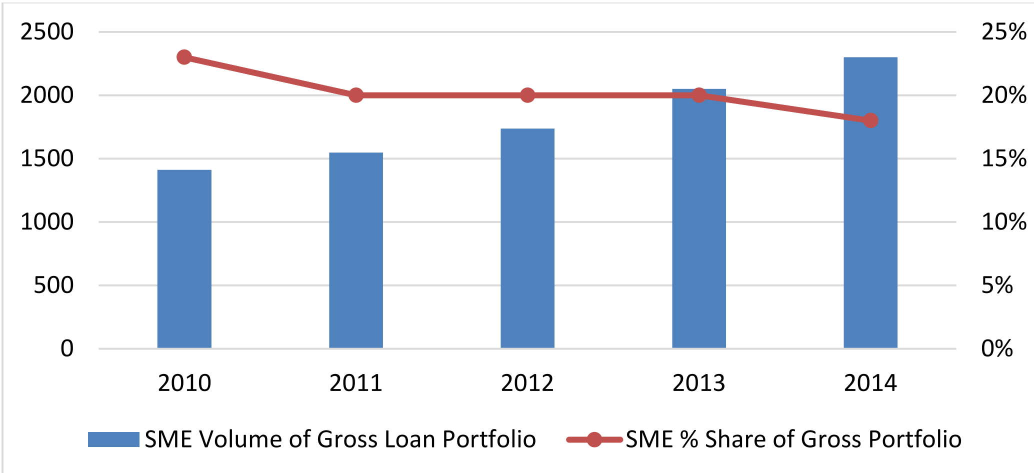
Figure 4: Loans by Sector (% of Outstanding Loans) [7]



Source: National Bank of Georgia.

[7] The percentage of "Other" is depicted on the right axis, whereas the remaining sectors are depicted on the left axis.

Figure 5: **SME Volume and Share of Gross Loan Portfolio (GEL Million/ %)** [8]



Source: National Bank of Georgia, Annual Reports

Compared to international standards, the SME sector in Georgia remains small and underdeveloped. SMEs account for approximately 94% of all registered firms in Georgia. Despite this, in 2014, gross loans to SMEs accounted for no more than 18% of the total gross loan portfolio. Moreover, the share of SMEs loans as percentage of GDP was no more than 8%—significantly lower than the regional average of 21% for Europe and Central Asia and 16% for middle income countries. [9] Since 2010, the amount of outstanding loans to SMEs has increased. Despite this, SMEs percentage share of total gross loan portfolio experienced decline. SME overall credit penetration has been constrained due to low innovation, poor skills match, low technological preparedness, weak infrastructure, underdeveloped value chain and local suppliers market.

[8] Excluding interbank loans and growth reported without the exchange rate effect.
[9] The World Bank Group – Georgia Partnership Snapshot Program (2015)

1.2 Project Logic

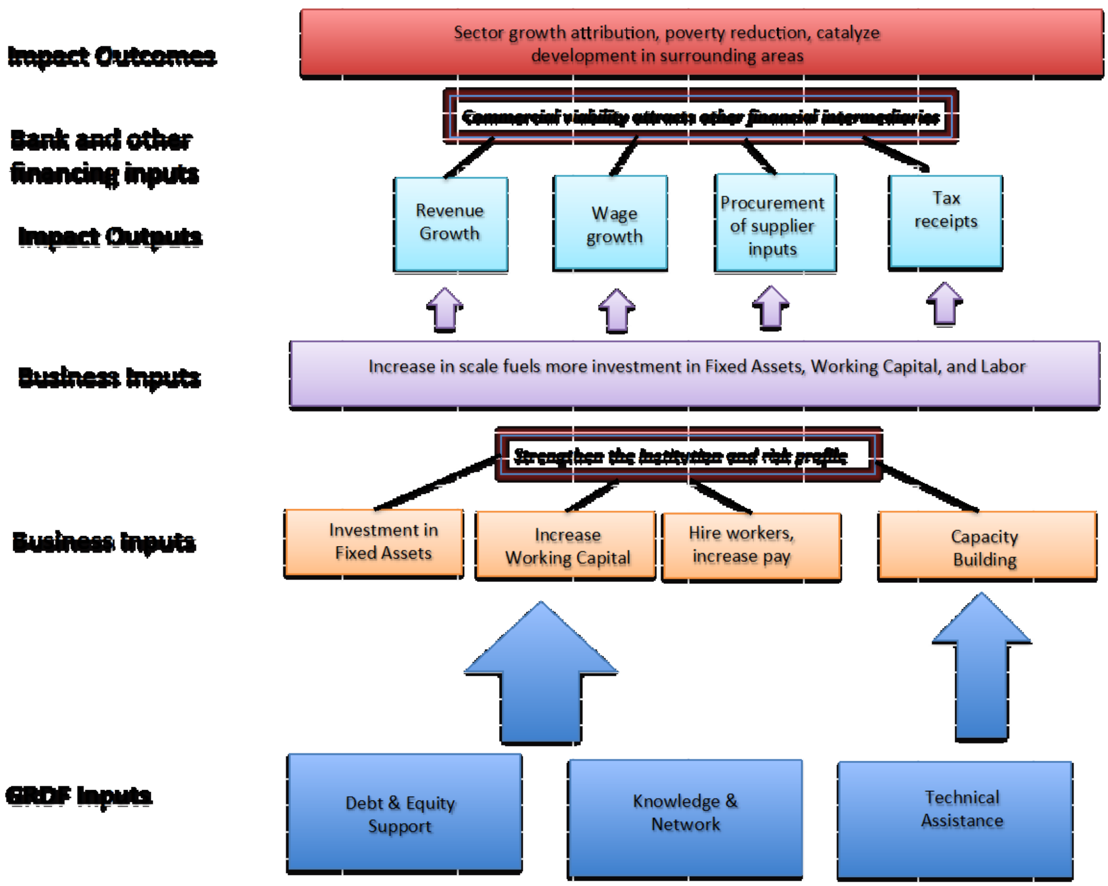
GRDF was established by the MCC and the Georgian government in 2006 to catalyze SME development in regions outside of Tbilisi. GRDF was one of the activities under the Enterprise Development Project—one of several projects included in the first Georgia Compact which aimed to improve the business environment in the regions outside of Tbilisi and the livelihoods of the economically disadvantaged. The primary objective of GRDF, as stated in the Operating Agreement, was to "maximize development impact, as well as to earn reasonable and positive financial returns from investments in SMEs in agribusiness, tourism and other sectors, primarily outside of Tbilisi." Per the GRDF Fund Management Agreement, the fund would be considered successful if it achieves this primary objective.

GRDF was intended to have direct and indirect spill-over effects. The following were included among the intended spill-over effects: 1) promotion of sustainable business activities that encourage the flow of additional private capital into Investees and, by example, into other Georgian SMEs 2) demonstration of successful mechanisms for deploying technical assistance funds under the TA facility to complement investment and 3) development of the Georgian management capacity at the level of Investees and fund management through business support to investors and training for local employees of the fund manager.

While not explicitly defined, a theory of change for GRDF can be deduced from the founding documents and the Georgia Compact. GRDF was designed to support the Georgian agriculture and tourism sectors—as these were sectors that could catalyze wider growth and development throughout the country. Specifically, the investment objective states that the Fund shall "provide long-term risk capital and technical assistance to SMEs, primarily in the regions outside of Tbilisi, and to identify legal and policy reforms needed to improve the investment environment." GRDF was thus designed to fill a perceived funding gap for SMEs in rural regions by extending a combination of financial support via debt and equity investments and technical assistance.

This theory of change reflects the precepts of academic literature on regional development. It focuses on factors such as entrepreneurial ability and capital instead of resource endowment to make the local production processes more competitive. An extensive review of the literature suggests that entrepreneurship contributes to employment and income growth by creating innovation and competition. However, the effect of entrepreneurship on growth seems to depend on other economic factors such as personal characteristics of entrepreneurs, skills and knowledge of entrepreneurs, entrepreneurial culture as well as the role of institutions and policies. A comprehensive review of theoretical and empirical literature on entrepreneurship and economic growth can be found in Carree and Thurik (2003)[10].

Figure 6: Theory of change underpinning GRDF and Compact



Samila and Sorenson (2011)[11] found that an increase in the local supply of venture capital positively affects (i) the number of firm starts, (ii) employment, and (iii) aggregate income. The estimated magnitudes of the effects imply that venture capital stimulates the creation of more firms than it directly funds through the knowledge transfer channel and capital supply. However, such results have shown to be more robust in developed markets where operating environments are generally thought to be more conducive to catalyzing and stimulating growth. Similarly, the empirical evidence for extrapolating these local outcomes to the economy is inconclusive. It is quite possible, for example, that venture capital (VC) firms simply select the more promising startups and

[10] Carree, M. A., & Thurik, A. R. (2003). The impact of entrepreneurship on economic growth. In *Handbook of entrepreneurship research* (pp. 437-471). Springer US.
[11] Samila, S. & Sorenson, O. (2011). Venture Capital, Entrepreneurship, and Economic Growth. *Review of Economics and Statistics*, February 2011, Vol. 93, No. 1, Pages 338-349, MIT press.

substitute for other sources of financing that those ventures would have received had venture capital not been available.

Differences in economic, legal and cultural systems are some of the more significant idiosyncratic factors affecting the impact of private equity & venture capital on economic growth. As Divakaran, McGinnis and Shariff point out, despite the growth prospects for private equity and venture capital in emerging markets, structural issues continue to limit the expansion of these asset classes. A direct correlation exists between the regulatory environment for alternative investments and the size and vibrancy of the industry in each country. Developing nations that seek to build robust PE and VC sectors must implement structural reforms in the regulatory and legal systems to make the market attractive to financial investors.

Audretsch (2007)[12] shows that entrepreneurship capital in the form of knowledge capital also increases output. The empirical estimation suggests that regions with more entrepreneurship capital have higher levels of output. Similarly, Audretsch et al (2008)[13] show that knowledge creation alone is not enough for regional economic growth. Economic performance is also determined by the ability and the willingness of innovative entrepreneurs to develop new products based on new knowledge. In other words, knowledge spill-over is not enough and positive economic growth depends on regional entrepreneurship capital. They defined regional entrepreneurship capital as the capacity of a region to not only encourage entrepreneurs but to support them as they start and grow their business.

Martinez-Vazquez and McNab (2003)[14] emphasized the impact of fiscal decentralization on economic growth, economic efficiency, income redistribution and macroeconomic stability. They show that funds spent at the regional or subnational level, rather than the national level, can lead to increased individual welfare as local and regional governments better understand the needs and preferences of their regions. Moreover, when funds are spent at the regional level a budget can yield larger and better quality of output at lower costs leading to greater producer efficiency. If fiscal decentralization results in greater producer efficiency, the increased quality output can result in increased income and, subsequently, growth. They do note, however, that empirical evidence on the relationship between decentralization and economic growth has demonstrated mixed results.

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[12] Audretsch, D. B. (2007). Entrepreneurship capital and economic growth. *Oxford Review of Economic Policy*, *23*(1), 63-78.

[13] Audretsch, D. B., Bönte, W., & Keilbach, M. (2008). Entrepreneurship capital and its impact on knowledge diffusion and economic performance. *Journal of business venturing*, *23*(6), 687-698.

[14] Martinez-Vazquez, J., & McNab, R. M. (2003). Fiscal decentralization and economic growth. *World development*, *31*(9), 1597-1616.

A recent report by the Commission on Growth and Development (2010)[15] states that a balanced economy with a dynamic and innovative private sector supported by government investments in public goods, effective regulation and redistribution to protect the vulnerable segment is a formula for a successful economy. The role of the government is crucial because limited public investment and over-regulation or high level of public investment without government regulation can negatively impact growth. Policymakers, therefore, must be cautious when formulating policies regarding public investment and growth[16].

Latest academic work puts an even greater emphasis on "endogenous growth" and "increasing returns due to economies of scale and/or of learning". At the regional or local level, entrepreneurial ability and capital are more important than resource endowment in making the regional production processes more competitive. As highlighted by Capello (2011)[17], this reflects the abandonment of the notion that regional development consists solely of the allocation of resources among regions—which was quintessential to older regional development theories. Instead, regional development must be conceived as stemming from local productive capacity, competitiveness, and innovativeness.

1.3 FUND STRUCTURE

GRDF was initiated with USD 30 million in investment capital, USD 2 million add-on TA facility and the Investment Policy Guidelines which established priority criteria for certain types of investments in line with the ultimate objectives of the fund, as illustrated in the Theory of Change. To promote investments in less-developed regions, at least 80% of the invested capital was reserved for businesses outside Tbilisi. At least 51% of the capital was to be allocated to investments in agribusiness and tourism, with agribusiness investment comprising at least 33% of the portfolio overall. It was, however, expected that GRDF would fund about 20 portfolio companies. Each company would be funded based on its needs and no single company could receive more than USD 3 million. The consideration of portfolio companies was to be based on both projected investment returns and development returns, as described in Table 1 below.

The fund manager and the Board of directors served as the primary agents to invest on behalf of Millennium Challenge Georgia. The GRDF was formed as Delaware Limited Liability Company with Millennium Challenge Georgia (MCG) serving as sole member and whose interest in the GRDF was to be liquidated and transferred to charitable trust in Georgia by the termination date of April 17, 2016. MCG was endowed with limited powers concerning GRDF's operations and oversight. The Board was given exclusive and complete

[15] Commission on Growth and Development. (2010). Post-Crisis Growth in Developing Countries.
[16] Commission on Growth and Development. (2008). The Growth Report.
[17] Capello, R. (2011). Location, Regional Growth and Local Development Theories. *Aestimum*, 1-25.

authority and discretion to manage the operations and affairs of GRDF. The fund manager, Small Enterprise Assistance Funds (SEAF), was responsible for aiding the GRDF investment program by providing investment services and additional capacity building measures as stipulated in the Fund Management Agreement. MCC served as an intermediary among the stakeholders with limited authority to consent over major decisions and agreements.

GRDF was designed with a dual focus of maximizing development return while achieving a "reasonable" and positive financial return. According to various stakeholders, few funds at the time incorporated such a non-financial perspective in investment decisions. Development return, defined as a combination of annual changes in four indicators relating to wages, revenue, taxes, and supplier purchases was envisioned to be an essential component in the GRDF investment decision-making process. These indicators were tracked throughout the life of the fund. Indeed, the founding documents state that the primary objective of GRDF is to maximize development impact. However, there seemed to have been conflation between financial and development returns during the initial investment stages. The Board subsequently concluded that prioritizing financial returns would lead to positive development externalities.

Table 1: GRDF Fund Profile

Committed Capital	**USD 30 million**
Add-on Technical Assistance Facility	USD 2 million
Fund Manager	Small Enterprise Assistance Fund (SEAF)
Compensation	3% of Committed Capital during Investment Period; 3% of Invested Assets at Cost thereafter
Horizon	10-year term (December 2006 – April 2016)
Number of investments	-Target of 20 companies
Investment Period	-Investments must be made before April 7, 2011 unless it is considered a follow-On Investments (up to 18 months after April 7, 2011) or had been previously approved by the Board but not disbursed
Return Objective	-Maximize development impact with a "reasonable" and positive financial return
Development Return	An annual metric used for Bonus compensation and fund reporting. Equal to the sum of annual percentage changes in four categories divided by four. Categories include: • Increase in Gross Revenues • Increase in Aggregate Wages Paid • Increase in Taxes Paid • Increase in Cost of Goods Sold (proxy for purchases from local suppliers)
Size of Investments	Not to exceed USD 3 million inclusive of potential follow-on investment; maximum initial investment of USD 2 million
Key Restrictions	
• At least 80% of the capital must be invested in businesses whose principal place of business is located outside of Tbilisi • At least 51% of capital must be invested in agribusiness or tourism • At least 33% of capital must be invested in agribusiness	

- At least 85% of capital must be invested in Existing Businesses that have completed at least one full fiscal year of operations
- The Fund may invest up to 15% of capital in “Start-Up Businesses”
- Up to 33% of capital may be invested as equity
- An investment must exceed 25% of the total capital of the Investee

1.4 KEY EVENTS

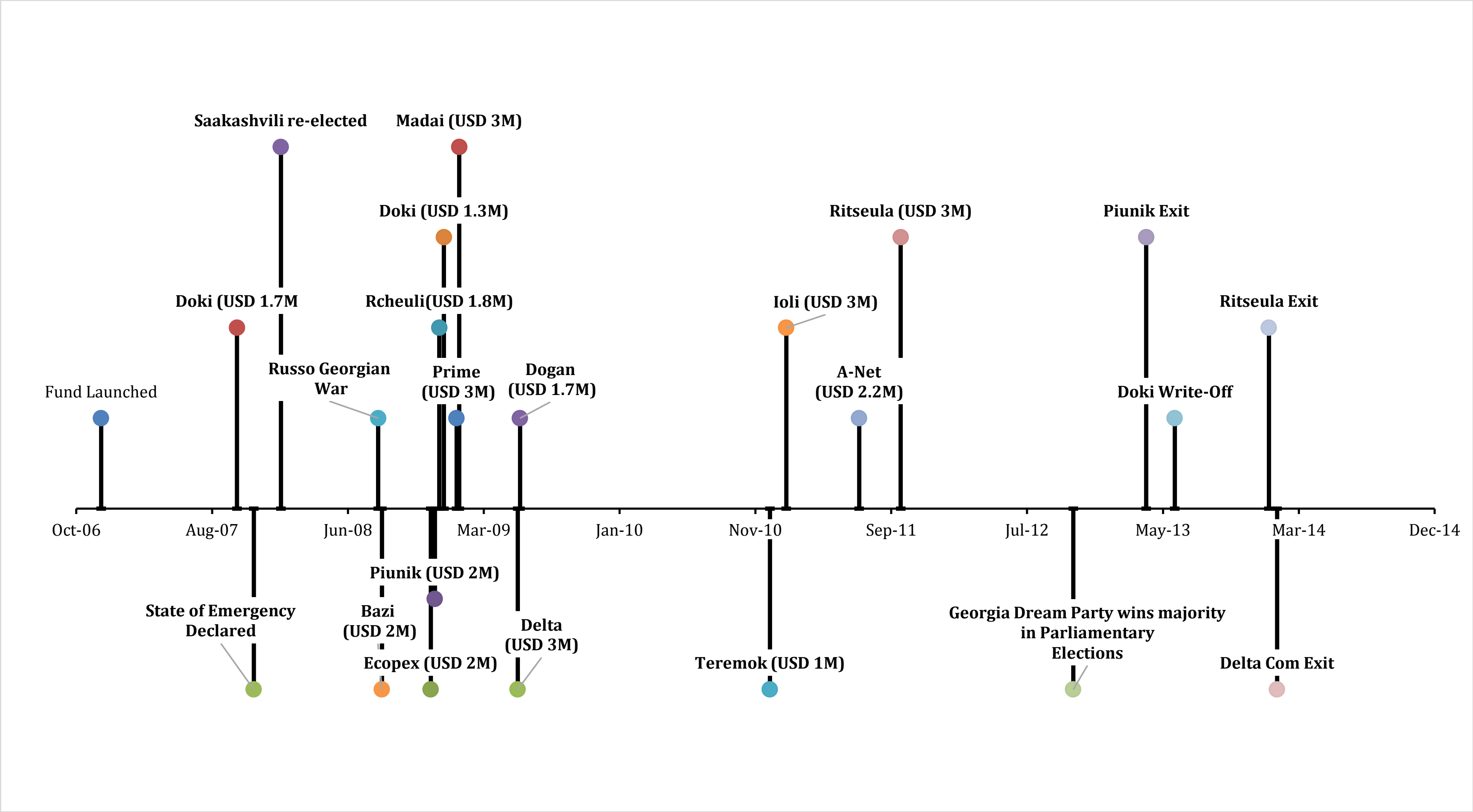
The figure below shows a timeline of GRDF's major activities including when investments were made into enterprises and when these investments were exited or written off. The timeline also makes note of key events in Georgia's recent history that may have had an impact on the performance of GRDF's portfolio.

The first of these was the state of emergency declared by President Saakashvili November 2007 in response to increasingly violent anti-government protests. These were initially sparked by the arrest of an opposing politician, but spread to encompass backlash against a variety of government actions. The protests eventually led to Saakashvili calling for early elections—which the incumbent would go on to win amidst allegations of fraud in 2008.

The next event on the timeline is the Russo-Georgian War declared by Russia after accusing Georgia of aggression toward South Ossetia. Fighting ensued in August of 2008, with Russian and Georgian forces both withdrawing from South Ossetia after 9 days. In the aftermath, Russia encouraged South Ossetia and Abkhazia, both within Georgian territory, to declare their independence. Despite the short duration of the conflict, hundreds of thousands of people were displaced and hundreds of civilian casualties were reported. The tourism industry suffered as did consumer and business confidence. GRDF made most of its investments shortly after the war.

The political environment in the aftermath of the Russo-Georgian war remained unstable and was a major encumbrance on the local business environment. Dissatisfaction with the then ruling party of Saakashvili continued to grow. In 2009, Tbilisi was overcome by 3 months of protests related to the mistreatment of prisoners. In 2011, several election reforms were made which would be put into practice the following year. These saw the defeat of Saakashvili's United National Movement Party, which had taken power after the Rose Revolution, by the newly formed Georgian Dream Party.

Figure 7:Key Events During GRDF Implementation

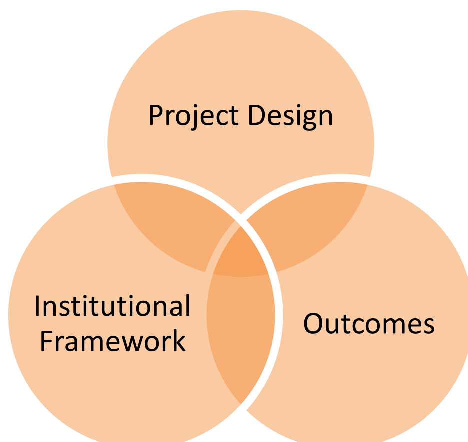


2. EVALUATION DESIGN

2.1 Evaluation Approach

This Evaluation analyzes GRDF's interventions around three dimensions: Project Design, Institutional Framework, and Outcomes. The goal of the performance evaluation is to understand the validity of the program logic and its assumptions (Project Design), the degree to which the institutional setup affected change (Institutional Framework) and the outcome results and lessons learnt (Outcomes). A qualitative-based performance attribution analysis can then be mapped around these dimensions and be further broken down into subcomponents.

Figure 8: Evaluation Framework



This evaluation approach is based upon a standard due diligence process for private equity funds. The characteristics of private equity funds present certain challenges to performance analysis. Private equity investing aims to capitalize on the specificity of a few privately held companies—leading to high idiosyncratic risk concentration and limits comparative analysis across both public and private equity funds. Many of the characteristics that facilitate performance analysis for public equity funds are absent in private equity including liquidity, observable prices, and valuation of underlying assets, comparable peer groups, and accessible indices. Typical fund performance analysis depends, in a large part, on identifying an applicable benchmark to compare returns and conduct performance attribution analysis which deconstructs differences in returns into "attributes." Identifying or constructing relevant benchmarks for private equity funds is a highly complex exercise in developed markets and further complicated in emerging markets.

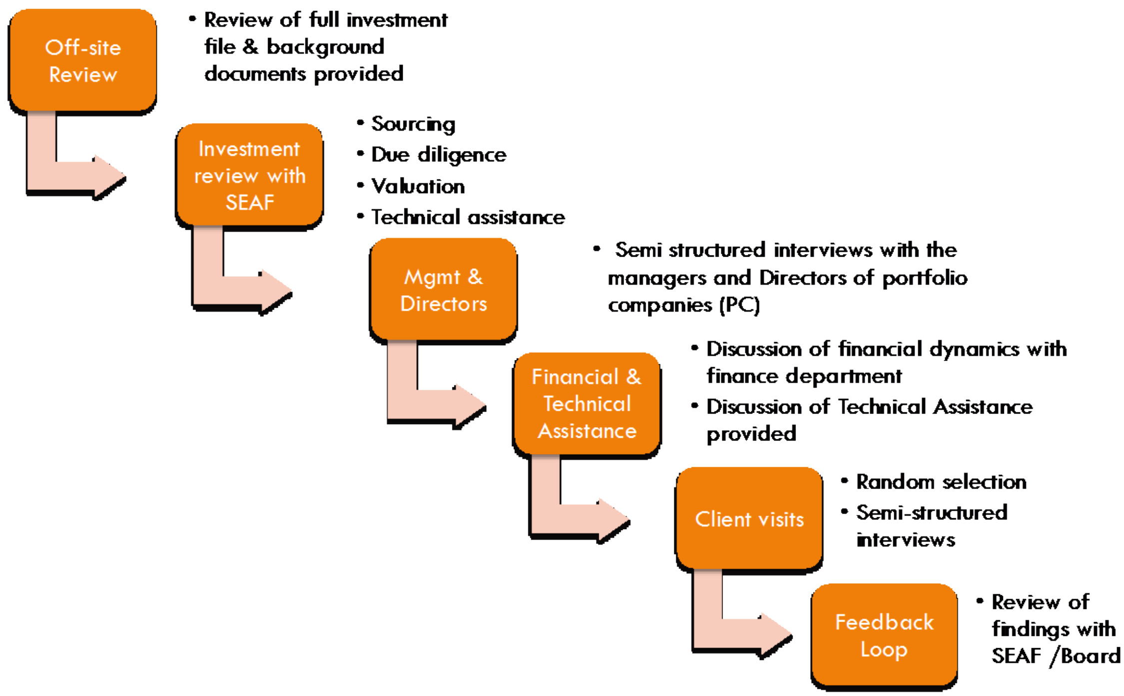
The evaluation of the project design examines the validity of the roject logic and how elements of the GRDF structure reinforce or contradict the logic. The project logic (or Theory of Change) is deduced from the original project due diligence and origination documents and assessed against a brief literature review. The evaluation then proceeds to assess GRDF structures in relation to the project logic. The GRDF was unique in many aspects. The Investment Policy Guidelines (IPG) established a narrow corridor of investable SMEs that may have been theoretically sound but difficult to apply in practice. Other design elements associated with the specific private equity model utilized, the governance structure, and unusual compensation terms also have implications on the decision-making process and eventual outcomes. The evaluation of the project design seeks to understand and assess these factors and their interrelationships within the context of the project logic.

This evaluation also analyzes and assesses the processes within the GRDF Institutional Framework and the principal-agent relationship dynamics that explain to what extent the framework acted as a limiting or enhancing factor in achieving the expected objectives. Key factors in this context are the assessment of the Board performance and SEAF's management performance. The analysis involves an assessment of the robustness of the investment process, including, among others, investment sourcing, due diligence, monitoring, and exit. Essential to this analysis is learning how the decision-making process worked in practice, the flow of information from one level to the next and understanding how well interests were aligned among the various stakeholders. The evaluation also includes an assessment of other stakeholders' performance and level of engagement.

The evaluation of the outcomes focuses on quantitative and qualitative performance at both the fund and Investee levels. Performance at both levels is correlated but nuanced and understanding the driving factors behind the eventual outcomes is critical. For example, the Investee may have eventually gone bust but the investment structure or a management decision may have either mitigated or exacerbated the loss. Document reviews, in-depth financial analysis, stakeholder interviews, and in-depth case studies serve as the basis for determining these factors. An extra level of scrutiny needs to be applied when evaluating any PE fund that still holds unrealized investments as is the case in the GRDF. Understanding the methods utilized to value them and potential for realization involves a fair degree of subjectivity. Nevertheless, this evaluation provides an opinion underpinned by objective analysis.

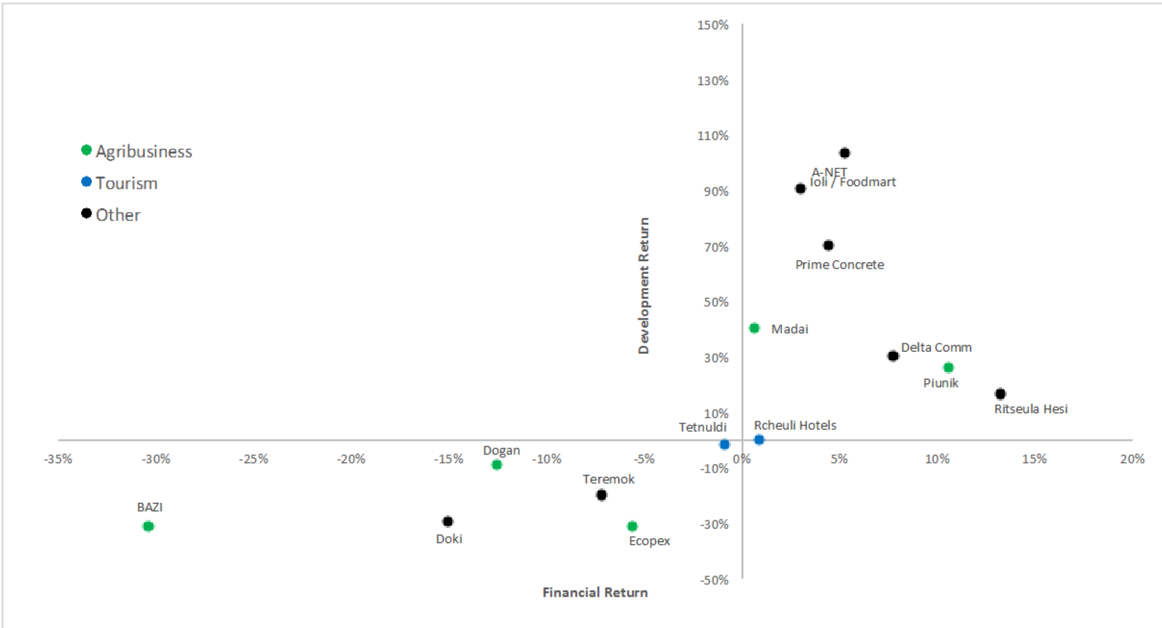
In-depth case studies were carried out for Foodmart, Piunik, Prime Concrete, and Teremok. These companies help illustrate the factors behind success or failure—considering varying types of GRDF intervention. These companies represent a cross-section of the portfolio in terms of financial and development performance and provide a rich source of information from which to draw conclusions and lessons learnt. Additionally, since case studies on all entities is not financially feasible, this approach maximizes the explanatory power of the performance evaluation.

Figure 9: **Indicative Case Study Implementation Process**



The four companies selected for the case studies are of the dual return of the GRDF investment portfolio and offer direct observational analysis. For selection purposes, all portfolio companies were mapped across a two-dimensional coordinate system with financial return on the ordinate and development return on the abscissa to illustrate the mix of performance (see Figure 8). The portfolio companies are grouped into four categories: 1) high financial return, high development return; 2) high financial return, low development return; 3) high development return, low financial return; and 4) low development return and low financial return. Further, only companies that are still a going concern were contemplated for the sake of evaluability. As a result, Prime Concrete (category 1), Piunik (category 2), Foodmart (category 3), and Teremok (category 4), were selected as proposed candidates for the case studies.

Figure 10: Portfolio Company Performance Mapping



2.3 Evaluation Questions

The evaluation questions can be divided into four components as per evaluation framework and outlined in Table 2.

Table 2: Research Questions

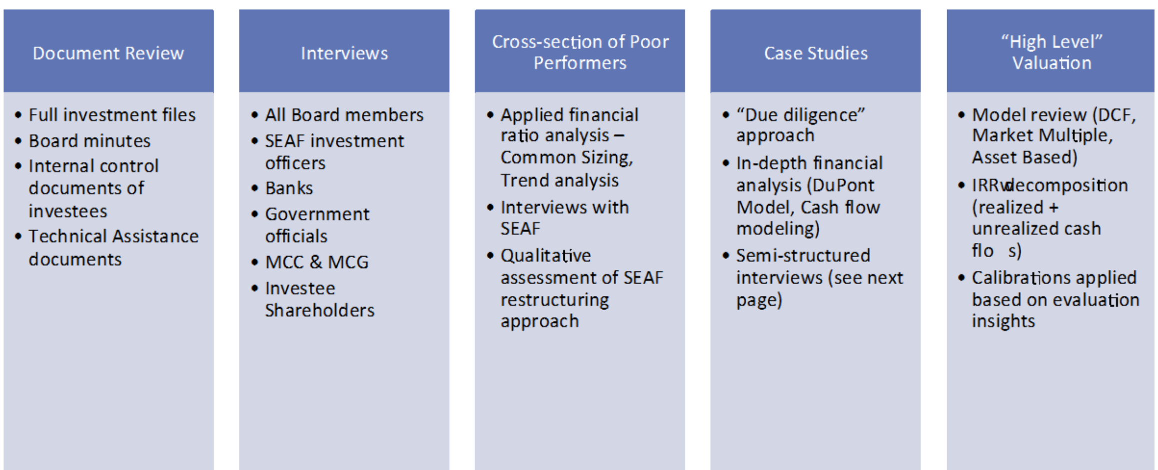
Evaluation Component	Research Questions
Relevance	• *Did GRDF meet its stated objectives? Were GRDF's stated objectives clear and actionable? Was the concept of "development impacts/returns" implementable?* • *What were the key challenges? Does the GRDF definition of "development impacts/returns" meet current industry standards for measurement in impact investing?* • *In what ways did the mandate to pursue development returns change SEAF's management of GRDF? Was SEAF able to report on development returns? Was reporting on development returns verifiable?*
Effectiveness	• *What factors explain the success of the relatively more successful/profitable firms (e.g. internal competencies, industry/market factors, GRDF technical/financial support, etc.)?* • *What factors were most predictive of a successful "exit" of a GRDF investment?* • *What barriers/challenges explain any underperformance noted in GRDF*

Evaluation Component	Research Questions
	portfolio firms (e.g. internal problems, changes in market forces, government interventions/changes, weak entrepreneurial skills, weak accounting practices, etc.)? • *Will GRDF be able to (or was it able to) liquidate all its assets successfully? How were exits managed and what lessons learnt came out of that process, for better and for worse? Were all exits managed appropriately and transparently? What challenges existed? For any investments where assets were not (or are not likely to be) liquidated, has resolution been reached with the government regarding next steps?* • *What were some indirect effects of GRDF investments? For example, did GRDF investments allow the beneficiaries to more easily access other forms of financing? Was GRDF debt leveraged into more senior debt? Has GRDF created any positive externalities in the Georgian economy?* • *overall, why were so many GRDF portfolio companies unable to fully service their debt and to what extent was this due to moral hazard, weak enforcement, or force majeure?* • *How was technical assistance funds employed by SEAF? Did these funds allow for efficiency/profitability/other gains in portfolio SMEs' operations?* • *What has been the experience of beneficiary companies with these financial products?* • *Is there evidence of government interference in the operations of the portfolio companies? If so, was government interference in line with that of comparable Georgian companies?*
Additionality	• *To what extent has the GRDF investment been essential for the SMEs' development, and for their access to finance?* • *Did GRDF provide financing that wouldn't have been accessible otherwise? Did GRDF provide better terms to portfolio firms (e.g. rates, collateral requirements, etc.) than they would have been able to acquire elsewhere?* • *How was the targeting of portfolio investments done? In what ways do portfolio firms have higher potential for development returns than other potential SME investments in Georgia?* • *Did SEAF receive better or an increased number of applications for loans from SMEs?*
Attribution	• *In what ways can the end results of portfolio companies be attributed to the GRDF intervention?* • *What role did subsequent company financing outside of GRDF play in end results?*

2.4 Evaluation Methodology

The Evaluation Methodology is based on the due diligence framework followed by institutional investors valuations to evaluate private equity funds. The typical due diligence review approach for private equity funds consists of document reviews and fund manager interviews to assess the fund's governance structure, performance, operational procedures, investment process, and valuation procedures. "High Level" valuations are applied in instances where an investment has yet to be exited. These revised valuations are subjective and in most instances, assume a higher liquidity discount based on the need to liquidate by the end of 2016. In addition, a cross-sectional analysis of "Failed Companies" was completed to determine what, if any, lessons could be learnt from their failures—including the identification of systemic problems in the investment process or insurmountable challenges in the operating environment.

Figure 11: Proposed Evaluation Methodology



Failed companies offer limited sources of information from which to reconstruct the past and to derive useful lessons. Nevertheless, a document review and notes from discussions held with SEAF, the Board, and shareholders of the failed companies during the scoping missions provided a high-level understanding of the constraints and challenges that ultimately led to failure. The different cases were contrasted to identify potential patterns and key success factors. Whenever possible, the A2F team considered how similar companies in the same field performed and how, in general, that sector of economy performed during the GRDF investment period.

3. ASSESSMENT OF PROJECT OUTCOMES

3.1 GRDF DEVELOPMENT PERFORMANCE

GRDF explicitly defined its concept of development return as a weighted average of four growth indicators. Development returns are derived from annual percentage changes in revenue, wages paid, cost of goods sold, and taxes paid for each Investee. Development returns were explicitly incorporated as a component of annual bonus eligibility for the fund manager during the investment period and have been reported in GRDF quarterly and annual reports. This concept has many shortcomings. The most prominent conceptual shortcomings would be that cumulative impacts are not measured and that the results are not intuitive. For example, Bazi is no longer operating yet the indicator suggests a positive evolution of wages and tax contribution.

The reported development "impact" of GRDF has therefore to be taken with caution. Over the GRDF intervention period, it could be said that GRDF's investments contributed to over GEL 66 million in wages, GEL 44 million in taxes, and supported just over 2,400 jobs. This suggests that despite several failed investments, the GRDF interventions have had positive effects on economic growth in the form of paid wages and taxes and realized proceeds from debt and equity investments. But this does not account for the loss of wages, taxes, and employment from companies no longer in operation. Similarly, the measure for development return only shows the state of Investees at one point in time and implicitly attributes these period changes to the GRDF intervention. For example, the growth in the four development return indicators for Foodmart, a GRDF Investee, is distorted by its acquisition of a large competitor. The calculations may also be distorted by diverging accounting practices across the companies.

Notwithstanding, some GRDF investments turned out to be "transformational". Prior to A-Net, Fiber-to-the-Home (FTTH) delivery in rural areas of the Adjara region required government subsidies. GRDF investment in A-Net made the delivery of FTTH in the Adjara region of Georgia to 8,000 retail customers possible without subsidies. During the GRDF investment period, A-Net employed 75 people and paid GEL 3 million in salaries and taxes. In Q4 2016 A-Net along with Delta Comm, another successful GRDF investment, was sold to Magticom, the largest telecommunication company of Georgia. Magticom is investing USD 120 million for further rural development of FTTH originally initiated by A-Net and Delta Comm. A-Net, as part of Magticom is expected to increase penetration to 20,000 over the next 5 years. Other examples of "transformational" investments were done in poultry, concrete production, fishing (see case studies).

Several GRDF Investees were subsequently able to attract private financing. The largest recipient of outside private capital has been Foodmart which has attracted over USD 30 million from reinvestment from existing shareholders, from the Netherlands

Development Bank (FMO), and from the SEAF-managed Caucasus Growth Fund (CGF). Delta Comm successfully refinanced the GRDF debt and attracted additional capital, part of which came from CGF as well. The GRDF A-Net investment was eventually exited through a buy-out from Delta Comm. Both companies have now been bought out by a major telecommunications firm. Ritseula and Piunik could refinance their GRDF debt from local banks, with Piunik benefiting from a subsidized government funding program. While the GRDF investments in Foodmart, Prime Concrete, and Madai have been short of expectations, those companies are likely to continue to improve operations and attract additional capital after GRDF. Despite the failure of Ecopex, Doki, and Dogan, their remaining assets consisting of factories and an orchard are still salvageable and likely to be utilized by future companies.

Table 3: Annual Development Returns by Investee Company (FY 2008-15)

Company	Indicator	2008	2009	2010	2011	2012	2013	2014	2015
A-NET	*Actual Revenue Growth*				100%	157%	53%	62%	39%
	Actual Wage Growth				100%	190%	15%	44%	11%
	Tax Growth				100%	139%	-2%	76%	52%
	Local Purchases Growth				100%	48%	501%	17%	17%
	Actual Weighted Average DR				100%	133%	142%	50%	30%
BAZI	*Actual Revenue Growth*	67%	-45%	-3%	-38%	-53%	-65%	-97%	-100%
	Actual Wage Growth	23%	100%	-28%	386%	255%	-82%	-100%	0%
	Tax Growth	56%	92%	-15%	-23%	114%	-73%	-72%	0%
	Local Purchases Growth	92%	-47%	-11%	-37%	-58%	-76%	-98%	-100%
	Actual Weighted Average DR	59%	25%	-14%	72%	65%	-74%	-92%	-50%
Delta Comm	*Actual Revenue Growth*		11%	49%	35%	3%	-9%		
	Actual Wage Growth		100%	38%	-8%	67%	-26%		
	Tax Growth		100%	35%	95%	25%	-15%		
	Local Purchases Growth		16%	74%	-18%	24%	37%		
	Actual Weighted Average DR		57%	49%	26%	30%	-3%		
Dogan	*Actual Revenue Growth*		-14%	-26%	32%	-23%	-33%		
	Actual Wage Growth		100%	-10%	58%	-66%	-24%		
	Tax Growth		-4%	-4%	22%	-47%	5%		
	Local Purchases Growth		-10%	-24%	30%	-17%	-50%		
	Actual Weighted Average DR		18%	-16%	36%	-38%	-25%		

Company	Indicator	2008	2009	2010	2011	2012	2013	2014	2015
Doki	*Actual Revenue Growth*	34%	-31%	-35%	-32%	-76%			
	Actual Wage Growth	83%	-48%	6%	-30%	-71%			
	Tax Growth	-28%	-43%	9%	-15%	-69%			
	Local Purchases Growth	88%	-47%	-29%	-24%	-68%			
	Actual Weighted Average DR	44%	-42%	-12%	-25%	-71%			
Ecopex	*Actual Revenue Growth*		100%	16%	-1%	-72%	-98%	46%	507%
	Actual Wage Growth		100%	159%	-57%	-92%	-100%	0%	0%
	Tax Growth		100%	70%	-41%	-57%	-30%	5%	76%
	Local Purchases Growth		100%	32%	-20%	-63%	-98%	-98%	203%
	Actual Weighted Average DR		100%	69%	-30%	-71%	-82%	-12%	197%
Ioli / Foodmart	*Actual Revenue Growth*				70%	90%	-17%	287%	33%
	Actual Wage Growth				200%	61%	-48%	348%	38%
	Tax Growth				193%	120%	18%	29%	47%
	Local Purchases Growth				148%	102%	-31%	276%	110%
	Actual Weighted Average DR				153%	94%	-20%	235%	57%
Madai	*Actual Revenue Growth*		100%	110%	-55%	-45%	452%	9%	67%
	Actual Wage Growth		100%	126%	-13%	-57%	767%	-20%	25%
	Tax Growth		100%	134%	11%	17%	64%	-9%	-13%
	Local Purchases Growth		100%	45%	-56%	-75%	109%	126%	111%
	Actual Weighted Average DR		100%	104%	-28%	-40%	348%	26%	47%
Piunik	*Actual Revenue Growth*		100%	23%	-63%	86%			
	Actual Wage Growth		100%	62%	53%	18%			
	Tax Growth		27%	29%	-40%	55%			
	Local Purchases Growth		100%	13%	-61%	31%			
	Actual Weighted Average DR		82%	32%	-28%	48%			
Prime Concrete	*Actual Revenue Growth*		100%	333%	-37%	85%	-42%	435%	-47%
	Actual Wage Growth		100%	48%	2%	86%	-8%	220%	-1%
	Tax Growth		100%	189%	-37%	147%	-49%	543%	-29%
	Local Purchases Growth		100%	188%	-17%	151%	-61%	296%	-35%
	Actual Weighted Average DR		100%	189%	-22%	117%	-40%	374%	-28%

Company	Indicator	2008	2009	2010	2011	2012	2013	2014	2015
Rcheuli Hotels	*Actual Revenue Growth*	23%	48%	38%	13%	4%	3%	-57%	24%
	Actual Wage Growth	47%	100%	-8%	14%	-16%	50%	-37%	-14%
	Tax Growth	-29%	74%	17%	35%	-3%	-10%	-54%	28%
	Local Purchases Growth	57%	47%	40%	9%	-61%	-25%	8%	21%
	Actual Weighted Average DR	18%	67%	22%	18%	-19%	4%	-35%	15%
Ritseula Hesi	*Actual Revenue Growth*				-3%	12%	68%		
	Actual Wage Growth				4%	-14%	19%		
	Tax Growth				9%	13%	49%		
	Local Purchases Growth				7%	-55%	-12%		
	Actual Weighted Average DR				4%	-11%	31%		
Teremok	*Actual Revenue Growth*				18%	-8%	-48%	-43%	-51%
	Actual Wage Growth				44%	-21%	-72%	-40%	-86%
	Tax Growth				102%	-30%	-54%	-70%	-75%
	Local Purchases Growth				207%	-7%	-53%	-12%	-26%
	Actual Weighted Average DR				93%	-17%	-57%	-41%	-60%
Tetnuldi	*Actual Revenue Growth*		100%	100%	193%	-75%	-8%	-21%	25%
	Actual Wage Growth		100%	2%	-40%	-80%	-95%	36%	0%
	Tax Growth		100%	23%	64%	-63%	-21%	-15%	12%
	Local Purchases Growth		32%	1016%	17%	-90%	-87%	-100%	0%
	Actual Weighted Average DR		83%	285%	58%	-77%	-53%	-25%	9%

3.2 GRDF Financial Performance

3.2.1 Portfolio Companies

GRDF investment performance has been rather mixed, with SEAF unable to exit many investments within the five-year wind-down window, and several investments underperforming despite operationally sound or improving underlying companies. Investments in companies that eventually became insolvent were the worst performing—including Bazi, Doki, Ecopex, and Dogan. Failure of two of these companies, Bazi and Doki, were particularly damaging to returns as they were given follow-on investments. Surprisingly, Foodmart, one of the leaders in the grocery retail space and a company that has attracted the most additional outside capital, is likely to lead to a -20.6% Internal Rate of Return. Investments in similarly improving companies have also not performed as expected such as Prime Concrete (-0.1%) and Madai (1.3%). Returns were depressed by a mix of tax assessments, financial investigations and the GRDF exit cut-off date.

Table 4: Portfolio Performance Summary (in USD unless otherwise noted, as of Q4 2016)

						From draft report	
	Investment	Cash Proceeds	Unrealized	TOTAL	Gross IRR	*SEAF IRR*	*A2F IRR*
A-NET	2,200,000	2,780,205	-	2,780,205	7.7%	*0.5%*	*-3.9%*
BAZI	2,480,003	23,993	-	23,993	-52.6%	*-24.9%*	*-55.4%*
Delta Comm	3,000,000	4,221,862	-	4,221,862	13.8%	*13.8%*	*13.8%*
Dogan	700,000	262,210	-	262,210	-19.1%	*-16.7%*	*-20.1%*
Doki	3,000,000	615,955	-	615,955	-33.6%	*-33.5%*	*-33.5%*
Ecopex	2,120,849	931,283	400,000	1,331,283	-7.8%	*-8.0%*	*-8.1%*
Foodmart	3,000,000	468,983	500,000	968,894	-20.4%	*-5.9%*	*-5.9%*
Madai	3,000,000	3,171,655	-	3,171,655	1.3%	*-3.9%*	*-15.9%*
Piunik	2,000,000	3,094,815	-	3,094,815	19.3%	*19.3%*	*19.3%*
Prime Concrete	3,000,000	2,987,468	-	2,987,468	-0.1%	*2.5%*	*2.5%*
Rcheuli Hotels	1,800,000	170,808	-	170,808	-35.5%	*-2.1%*	*-13.6%*
Ritseula Hesi	3,000,000	3,967,242	-	3,967,242	16.2%	*16.2%*	*16.2%*
Teremok	1,000,000	220,529	300,000	520,529	-12.1%	*-20.6%*	*-30.0%*
Tetnuldi	1,900,000	1,564,505	-	1,564,505	-4.2%	*-2.9%*	*-8.8%*
TOTAL	**32,200,852**	**24,481,548**	**1,200,000**	**25,681,548**	**-5.9%**	***-3.5%***	***-6.1%***

Notably, all but two of GRDF Portfolio Companies (i.e., Investees) ran into financial difficulties and subsequently fell behind on GRDF debt servicing payments. These financial difficulties each have their own roots in business operations. Still, the high debt loads and repayment schedules of GRDF debt did not inhibited the ability of these businesses to get back on track. GRDF debt represented the largest source of capital for most Investees. To service such high debt loads, the Investees had to grow at high rates—leaving little room for error in terms of realizing what were overoptimistic expected growth numbers and margin improvement.

To date, USD 24.5 million has been realized from a total of USD 32.2 million invested capital. Investees with a reported fair market value (FMV) represent investments that have yet to be exited. Excluding Foodmart and Rcheuli, these companies are insolvent and are planned for liquidation where remaining assets will be auctioned off to potential investors. Reported FMVs are based on SEAF valuation methods. Notably, only Foodmart maintains an equity investment valuation as part reported unrealized FMV while remaining unrealized assets of other Investees consist entirely of impaired debt positions. SEAF valuation methods and summary of provisions are provided below. The Adjusted FMVs are A2F adjusted numbers derived from agreed upon settlements and/or expected net liquidation proceeds indicated from the Q3 2016 report and latest correspondence. Details on the adjustments applied are also summarized in Table 5. The resulting adjustment equates to a reduction of unrealized FMV from USD 3.7 million to USD 1.2 million—USD 2.5 million less than reported FMV. The expected Gross IRR therefore falls from -3.5% to -5.91%.

SEAF values equity positions in accordance with the guidelines established by the International Private Equity and Venture Capital Association and values debt positions by utilizing an internal rating system called SEAL Loan Risk Rating System (SLRS). As investments are not readily marketable, valuations include varying degrees of subjectivity but still draw on market–based measures of risk and return. The most common equity valuation method applied by SEAF has been a mix of comparable multiples and discounted cash flow. The remaining equity position in Foodmart is valued as a weighted average of these two methods. For debt valuations, SEAF attempts to measure the "Probability of Default" and the "Projected Loss Given Default" based on typical credit risk metrics—e.g. capital adequacy, asset quality, liquidity—and supporting collateral. Both methods are theoretically sound. However, based on A2F experience, adjustments were applied to instances where the liquidation proceeds will be lower than assumed or too low to satisfy existing liabilities.

Most Investees began accumulating payment arrears shortly after the initial investment, as growth was lower than projections due to a range of factors. GRDF Investees fell behind on debt payments early on—quickly accumulating accrued interest and penalty fees. Several Investees were highly exposed to external shocks in commodity prices and regional conflicts as was the case for the hotel investments (Rcheuli, Tetnuldi), construction (Doki), and agribusinesses (Dogan, Ecopex, Bazi). Many of those same investments were also made at the peak of a favorable macroeconomic trend—real estate prices, tourism boom, construction boom, low agriculture input prices—which would reverse course quickly thereafter. In addition to these external shocks, GRDF investments also proved vulnerable to misuse of funds by shareholders, overlooked irregularities in the financial statements, which led to tax penalties and contagion from affiliated businesses or relationships. In other instances, the business plan was not robust or poorly executed (Teremok, Ecopex).

Table 5: A2F Adjustments to Existing Unrealized Assets (USD)

Company	Instrument	Reported FMV*	SEAF Valuation	A2F Adjusted FMV	A2F rationale
Bazi	Equity	0	Fully provisioned	0	
Bazi	Debt	219,588	90.6% provision taken on USD 2,292,751 debt investment. SEAF maintains that remaining amount is realizable prior to liquidation.	0	On-going tax issues with Revenue Service and non-GRDF shareholder; likely to proceed to liquidation with limited proceeds accruing to tax authority
Dogan	Debt	30,808		0	Assume liquidation price of remaining assets is not above procedural costs, fees, and other secured creditors
Ecopex	Equity	0	Fully provisioned	0	
Ecopex	Debt	288,717	72% provision against remaining USD 1,039,181	400,000	Based on identification of a potential buyer that is currently conducting due diligence
Foodmart	Equity	333,443	50% weight to valuation based on the latest FMO investment; 50% weight to DCF valuation	0	

Foodmart	Debt	1,184,715	50.7% provision against remaining USD 2,404,569 debt	500,000	Based on the latest proposed settlement agreement by SEAF to the Board of USD 500k. The deal was rejected. Assume USD 500k will be realized at auction.
Rcheuli Hotels	Equity	0	Fully provisioned	0	
Rcheuli Hotels	Debt	1,355,310	4.5% provision against USD 1,419,250 remaining debt position. GRDF holds mortgages on four properties as collateral	0	Existence of lien on by national authorities limits marketing ability. Assume liquidation at a much lower price and proceeds applied to tax payables and bank loan with TBC.
Teremok	Equity	0	Fully provisioned	0	
Teremok	Debt	300,000	Based on negotiated exit terms	300,000	

*Q3 2016 GRDF report.

Table 6: Cumulative Principal, Interest and Fees in Arrears (USD, as of Q3 2016)

Investee	Initial Investment Date	First Non-payment	2009	2010	2011	2012	2013	2016
Doki	09/30/07	2009 Q1	489,973	780,751	1,832,946	2,921,065	2,921,065	2,921,065
Tetnuldi	04/12/08	2010 Q1	-	260,960	579,138	1,153,314	2,139,026	3,408,253
Ecopex	12/15/08	2010 Q2	-	374,766	937,489	1,565,345	1,869,789	2,071,041
Rcheuli Hotels	12/15/08	2010 Q3	-	198,754	671,585	1,133,830	1,674,528	2,676,438
Prime Concrete	01/27/09	2010 Q1	-	-	454,019	1,594,898	3,220,373	4,183,606
Madai	02/02/09	2010 Q3	-	333,640	1,137,357	2,108,617	2,927,862	2,710,668
Dogan	06/16/09	2010 Q1	-	53,927	272,251	494,337	748,204	1,325,043
Bazi	08/15/09	2009 Q1	275,053	1,174,340	2,061,329	2,776,698	3,501,471	4,303,451
Delta Comm	11/06/09	2012 Q4	-	-	-	101,656	718,549	-
Teremok	12/24/10	2011 Q4	-	-	23,808	214,045	479,426	838,732
Foodmart	01/25/11	2012 Q4	-	-	-	347,837	1,880,134	5,795,222

A-NET	05/08/11	2013 Q4	-	-	-	-	89,875	

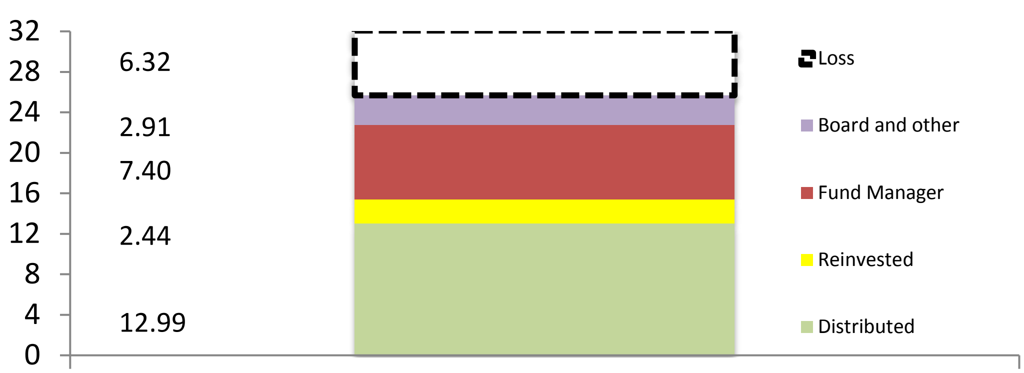
3.2.2 Overall Fund Financials

Including A2F adjusted USD 1.2 million in unrealized investments, GRDF will have returned USD 25.2 million out of USD 30 million in committed capital. From this amount, GRDF will have paid USD 7.4 million in fund management expenses and another USD 2.9 million in operating expenses, which includes Board compensation. Additionally, USD 2.4 million was reinvested from early cash inflows during the investment period. The Fund's losses total approximately USD 6.3 million. A breakdown on the distribution of the cash proceeds is illustrated in Figure 12. To date, USD 11.8 million has been distributed to investors (i.e. the Service Agency) with a further USD 1.2 million expected from recently realized investments and pending asset sales. This equates to 43% distributed as a percent of paid-in capital. The Net IRR, which is derived after deducting the USD 10 million in management and operating expenses, results in -14.22% return. Gross and Net IRRs are calculated by A2F assuming equal annual payments of realized investments and repayment of unrealized investments as of the end of 2016. Full calculations and methodologies are detailed in the Annex.

Table 7: Overall Fund Financial Performance

Updated Report			Remaining Investments		Total Value	
	Paid in Capital	Distributed to Investors	per SEAF	per Adjustments	per SEAF	per Adjustments
USD	30,000,000	11,797,997	1,200,000	1,200,000	12,997,997	12,997,997
Net IRR						***-14.22%***

Figure 12: Overall Performance in USD million (estimates for Loss and Distributed)



Investments in the priority sectors of agribusiness and tourism were among the worst performing in the GRDF portfolio. The Investees in agribusiness and tourism suffered during the 2007-2009 period mirroring the trend in economic growth of those sectors. The Russo-Georgian war directly hit hotels due to proximity to the incursion, especially in the case of Tetnuldi, and there was a drop Russian tourism. Political uncertainty also dampened consumer confidence, which was already depressed by the global financial crisis. The agribusinesses proved to be quite vulnerable to external headwinds as their business models depended largely on regional and international trade and on commodity prices. These Investees were also highly levered with limited room to navigate business disruptions and as negative circumstances arose these triggered breaches in covenants to senior creditors--leaving the GRDF in a disadvantaged position due to the subordination of GRDF debt and equity stakes. Hotels also faced headwinds themselves with Rcheuli forced to abandon a hotel and Tetnuldi falling behind on debt payments. Their financial difficulties sparked additional problems—political, tax and financial reporting.

Investments made prior to 2009 were most affected by external shocks whereas subsequent investments were selected in a more opportunistic way—in less vulnerable sectors. Later stage Investees were from the food retail, restaurants, telecommunications, and energy sectors. Factors affecting their operations were more nuanced. Telecommunications (A-Net, Delta Comm) represented a growth sector and the selected companies were well positioned to benefit from the GoG plans to invest in telecommunication infrastructure. Food retail (Foodmart) benefited from the overall surge in food retail sales yet it did encounter several difficulties. Teremok, the restaurant sector investment, became embroiled in internal disputes after demand failed to materialize at new locations. For details on Foodmart and Teremok, see section 3.4 Case Studies. Finally, energy (Ritseula Hesi) was a straightforward and simple loan structure for a government funded renewable energy project.

Equity investments have underperformed and none have been successfully exited. The most successful investments to date have been debt oriented in the form of term loans or mezzanine finance and these three—Delta Comm, Piunik, and Ritseula Hesi—are the only ones that have been fully exited with Gross IRRs of 13.8%, 19.3%, and 16.1%, respectively. Unrealized equity stakes in Foodmart are planned to be bundled with the remaining GRDF debt position and placed into liquidation. All other equity investments have been reduced to zero, as the corresponding debt position is senior to any equity position.

Follow-on investments were particularly damaging to the GRDF performance– exemplifying general overconfidence and lack of prudency by both SEAF and the Board. Approximately USD 3.2 million in aggregate was disbursed as follow-on investment in Prime Concrete (USD 1 million), Bazi (USD 500k), Doki (USD 1.3 million), and Tetnuldi (USD 400k) to meet alleged working capital needs due operational losses. The Board approved the follow-on investments after review of financial risks despite the weak development rationale. Concern over Doki's high expenditures, poor inventory management, and potential use of funds reduce senior debt from other creditors was noted in the Board minutes. Following the investment, the poor inventory management was not resolved and there was a noted reduction debt owed to other creditors. The Bazi and Tetnuldi follow-on investments were also primarily for working capital needs that arose from the misuse of funds, low revenues and cost overruns. Frustrations with the limited time provided to review and assess the Bazi follow-on investment decision were also indicated in Board minutes; however, the investment was still approved. The only follow-on investment that appears to have been a value enhancer was the one approved for Prime Concrete. Notably, the funds for this follow-on went towards infrastructure improvement to assets to reduce costs.

3.3 Review of Failed Investments

An analysis of the failed portfolio companies (Bazi, Doki, Dogan and Ecopex) reveals some common factors presented below:

- **The due diligence review prior to the investment relied on very optimistic company-provided growth projections which failed to materialize.** In the case of Doki, a high-end furniture retailer, the construction industry had been growing at a remarkable trend prior to investment and growth figures were derived from the latest trends in the sector. Following the construction downturn in 2009 through 2010, SEAF expected a resumption of those trends that never materialized. It was assumed that Doki's pronounced inventory management problem would quickly be resolved—a failed assumption. For Ecopex, a hazelnut agribusiness, there was an optimistic assumption on sourcing cheaper and stable supplies from its own orchard. In other instances, factories for tomato and apple concentrate producer Bazi and for animal feed producer Dogan were never fully utilized. Additionally, expected synergies such as Bazi's locally sourced apples were not realized. Optimistic growth projections were also based upon existing financial statements, which, in several cases, were assessed as inaccurate by third-party audits.

- **GRDF did not implement robust project monitoring mechanisms and was too slow to react when Investees encountered difficulties.** To be clear, it is unlikely that any specific action taken by SEAF would have saved these companies. However, several actions could have reduced the impact of failure on the GRDF investment. In particular, tranched disbursements of GRDF capital based on proof of payment or project completion—as commonly used by commercial banks—would have limited the ability for management to misuse funds or alter the agreed strategies to engage in unforeseen activities that led to cost overruns and/or operational losses. Similarly, early action by SEAF to assume leadership of the company or realize guarantees would have achieved a better outcome for GRDF compared to other lenders, which were often repaid at GRDF's expense—notwithstanding the fact, they held senior debt. For instance, shortly after the follow-on investment in Doki, the existing senior lender was fully repaid and the GRDF position in Doki was subsequently written-off.

- **Interestingly, three of the four failed Investees are from the agribusiness sector.** Bazi, Dogan, and Ecopex were agribusinesses involved in food canning/concentrate (Bazi), animal feed (Dogan), and hazelnut production (Ecopex). Agribusinesses are highly exposed to seasonality, particularly in inventory, which arises from demand and supply rates of raw materials. Their viability depends on robust inventory management, consistency and stability of supplies and demand for their product more so than other SMEs due to seasonality. Changes in demand and supply rarely move in tandem and are a product of internal and external factors, which can quickly become distorted amidst market turbulence—as is the case with most commodities. These companies were vulnerable to such changes and did not have enough risk mitigation strategies to lessen the blow from adverse movements in the market.

- **The risks from agricultural activities were particularly exacerbated following the GRDF investment for two main reasons: 1) predominance of debt left them highly leveraged, especially when combined with existing creditors; 2) expected servicing ratios were inflated since investments took place when one of the key profit drivers—either a low-cost input or high priced product—were already at high levels.** When adverse price movements struck operations quickly deteriorated without enough room on their balance sheet to keep them afloat even with SEAF's engagement.

3.4 Case Studies

The following four GRDF Investees were selected for detailed case studies: FoodMart, Teremok, Piunik, and Prime Concrete. Case Studies give an introspective view on the GRDF intervention from the investment process down to the actual business itself, including the rationale behind key operational decisions, relationship dynamics, and understand how SEAF and PC management affected change. In doing so, the GRDF intervention was also assessed in terms of additionality, effectiveness, attribution, and relevance.

The financial investment performance of the four Investees have fallen well short of expectations, save for the investment in Piunik, with the forced cut-off date depressing returns for Foodmart and Prime Concrete. Piunik was successfully exited with an Internal Rate of Return of just over 19%. Teremok's returns were negatively affected by poor expansion strategy, internal shareholder bickering, and a lawsuit that halted operations in several locations. Both Foodmart and Prime Concrete experienced financial turbulence throughout the GRDF investment with dramatic improvement in operations materializing at the tail-end of the GRDF investment term. Exit opportunities had improved for both companies. However, the cut-off deadline imposed upon GRDF (despite the option for two 1-year extensions), has led SEAF to settle with Prime Concrete's shareholders for a small positive return and a last-ditch effort to settle the position in Foodmart which was ultimately rejected by the GRDF Board and will now go to auction. It is unlikely that a positive financial return will be realized from the Foodmart position.

Table 8: Investment Performance Summary (USD unless otherwise noted)

Portfolio Company	Instrument Type	Initial Investment Date	Invested Capital	Realized Proceeds	Unrealized FMV *	A2F Adjusted FMV*	Gross IRR	Adjusted Gross IRR
Foodmart	Common Shares	01/25/11	93,750	1,875	333,443	-	26.4%	-59.9%
Foodmart	Mezzanine	01/25/11	2,906,250	467,019	1,184,715	500,000	-11.9%	-19.9%
Foodmart	Blended		3,000,000	468,894	1,518,158	500,000	-5.7%	-20.4%
Piunik	Mezzanine	01/12/08	2,000,000	3,095,136	-		19.3%	19.3%
Prime Concrete	Common Shares	01/27/09	110,000	2,200	-		-49.8%	-49.8%
Prime Concrete	Mezzanine	01/27/09	2,890,000	2,985,268	-		0.8%	0.8%
Prime Concrete	Blended		3,000,000	2,987,468	-		-0.1%	-0.1%
Teremok	Common Shares	12/24/10	350,000	7,000	-		-59.3%	none
Teremok	Mezzanine	12/24/10	650,000	213,529	300,000		-4.62%	-4.62%
Teremok	Blended		1,000,000	220,529	300,000	300,000	-12.1%	-12.2%

Piunik is a side venture formed by shareholders of existing agribusinesses that focused on hatching egg importing. It sought GRDF financing to vertically integrate into local production of hatching eggs and working capital to support other business lines that included animal feed, day-old chicks and consumer eggs. GRDF invested USD 2 million in participatory debt in 2009. The demand for hatching eggs exceeded expectations leading to a pivot in strategy—focusing more resources on local production to reduce dependency on imports. This pivot in strategy proved to be quite opportune as demand continued to accelerate and the higher margins allowed Piunik to fund expansion and pay back GRDF from internal cash flows. Approximately one year before GRDF debt maturity, Piunik refinanced the GRDF debt through a government subsidized loan program and continues to be a successful agribusiness.

Prime Concrete is a concrete and construction services provider in Western Georgia. Shareholders of similar operating businesses based in and near Tbilisi formed the company. These shareholders sought to take advantage of the Georgian government's plans to develop the Poti port and surrounding areas. They formed Poti-based Prime Concrete and requested USD 2 million GRDF capital in 2009 to procure necessary equipment and upgrade facilities. Prime Concrete's customer base was to be highly concentrated in the firm that bought and planned to develop the Poti port. Prime did not realize the sales originally projected as government and port projects were significantly delayed until 2014. The GRDF Board and SEAF recognized the potential and capability of

Prime’s management and took a very patient investor stance, even recommitting with a USD 1 million follow-on investment to improve cost management. Prime is now realizing its growth potential as several projects have been awarded to the company and it has built a solid, high-quality brand as the leading concrete producer in western Georgia.

Teremok was a loosely organized network of quick-service dining restaurant franchise with a Slavic-based menu. Several locations were in operation in the Tbilisi area but separately owned prior to the GRDF investment. They were organized into an official legal entity to qualify for GRDF investment and presented a regional expansion plan consisting of several restaurant openings throughout Georgia. They received USD 1 million in debt and equity capital in 2010 for renovations and working capital needs. Revenues, which never lived up to expectations, served as the impetus behind internal shareholder disputes and poorly managed partnerships. These would escalate and lead to deterioration in the restaurant’s operations. A lawsuit between an amusement park that management collaborated with and the shareholders was decided in Teremok’s favor. Proceeds from the settlement will go towards repaying a portion of the GRDF loan but, yet, the investment is one of the worst performing in the portfolio.

Foodmart is one of the largest grocery market chains in Georgia. Foodmart was created through a merger between Ioli and Populi. GRDF originally invested in Ioli in 2011 to finance the expansion of the Ioli grocery chain. Ioli management sought to expedite expansion and development plans in 2012 by acquiring its main competitor at the time, Populi—a chain that was known to be under financial difficulties. SEAF sought capital from another SEAF-managed fund, the Caucuses Growth Fund (CGF), to finance this acquisition. Post-acquisition, there were significant roadblocks in supplier negotiations that limited revenues, hurt costs, and reduced liquidity. Both grocery chains would need active involvement by SEAF and additional investment from the CGF to keep afloat in 2013. In 2014, Ioli restructured into a new entity, Foodmart to circumvent supplier issues and resume growth. Foodmart would later partner with international brand-name, SPAR. The company has improved dramatically in terms of revenue and margins and has garnered the interest of other international investors.

These companies were recently formed entities financed by individuals with ownership interests in other businesses. The companies were financed by the original owners and therefore had some access to capital. Discussions with management indicate that they were primarily interested in debt capital, fearing dilution of their own shares and loss of control from equity financing. Indeed, when SEAF tried to negotiate for higher equity stakes, the shareholders of Piunik, Prime Concrete, and Foodmart all rebuffed the proposal. Traditional bank credit was either not readily available or the terms and conditions were too constraining for investment they sought. Interviews revealed bank financing required well over 100% collateral coverage and rates were too high. GRDF debt capital was considered additional since the requirements were lower—around 80% coverage—and used royalties instead of high fixed interest rates.

The experiences of the companies illustrate the GRDF "patient capital" approach. In all cases, the GRDF has been shown to be a supportive partner in helping businesses expand in the regions—either through strategizing with management or treating debt as de facto equity. When businesses encountered financial difficulties the GRDF stance favored not recalling loans or exercising options that would lead to liquidation. These options were effectively treated as a "last resort". This was clearly seen in Foodmart and Prime Concrete. In the case of Piunik, the change in business strategy, while turning out to be quite prudent, was still high risk. The size of the GRDF debt relative to Piunik revenues escalated following the exit from the imports business. While the margins did improve, the volumes decreased and initially reduced repayment capacity.

All the companies depended on the GRDF investment to fund expansion into the regions and there have been some positive externalities on the overall Georgian economy. The GRDF investment affected local development in the case of Piunik by essentially contributing to the development of the poultry and egg-hatching sector in Georgia by increasing regional self-sustainability. GRDF's investment in Prime facilitated the local production of concrete and construction services—improving infrastructure in Georgia. The opening of new Teremok restaurants increased access to quality and affordable venue options for lower to middle-income households. With Teremok's business expansion, local value chains improved as required goods and services were locally sourced. By investing in Foodmart, SEAF has facilitated the rapid expansion of the small chain into one of the largest grocery retailers in Georgia. GRDF also contributed to the development of the modern retail sector in Georgia by introducing modern retail practices through the Foodmart/SPAR franchise deal. The chain employs over 1,430 people and operates 57 stores in Tbilisi and other regions.

SEAF was consistently over optimistic on projections for growth and operational improvement of all companies. In most cases, it was change in strategy by company management that altered the course of the business or led to unforeseen costs. Piunik focused on local production, Teremok partnered with an amusement park, Ioli (before becoming Foodmart) accelerated store openings, and Prime Concrete focused on smaller projects while waiting for larger projects to materialize. Yet, even after such changes, SEAF would present the Board with optimistic scenarios or expectations and perhaps overconfidence in its ability to steer the companies towards profitability and growth. In Prime, there was a consistent view that projects would materialize sooner rather than later. In Foodmart, there was a consistent view that negotiations with suppliers and working capital management would improve. In Teremok, there was a consistent view that revenues would grow.

According to interviews with shareholders, the GRDF financed technical assistance projects were highly regarded. The TA projects on financial management and enterprise risk management systems were all highly praised by management. In most instances, the results of the TA were eye opening for management as it gave them a detailed and analytical view of their own business that was previously opaque and subjective. Following the TA in these areas, they could make better decisions and better grasp the profit-cost centers of their businesses. It also facilitated better record keeping for auditing and tax reporting purposes.

Individual cases are discussed in detail in the Annex.

3.5 Technical Assistance

GRDF interventions typically involved technical assistance and was clearly additional in this respect. The technical assistance projects brought Investees out of the dark and aided them in formalizing their businesses and adopting international standards related to financial accounting, product quality, and safety and training certifications such as ISO. The GRDF intervention also acclimated SMEs to international investment managers and corresponding expectations. Almost all non-GRDF shareholders viewed SEAF as a trusted partner and appreciated the hands-off approach to managing their business (despite the obvious benefit from a more hands-on approach).

Needs were assessed on an individual basis. The USD 2 million Technical Facility was managed in much the same way as the USD 30 million investment facility whereby SEAF proposed projects along with cost share agreements with Investees to the Board for approval. Approximately 49% of technical assistance funds were allocated to projects in the areas of enterprise resource planning (ERP), enterprise risk, financial management, accounting, auditing, and reporting across multiple companies as seen in Table 9. Interviews with non-GRDF shareholders of all Investees, in addition to top line managers of Investees interviewed in the context of the case confirmed that these projects were among the most desired, needed, and appreciated as their respective operations were noticeably enhanced afterwards. The projects funded by the technical assistance allowed business managers to understand the drivers of their business and aided in strategy planning. The projects also vastly improved financial reporting and transparency.

Table 9: Overall TA funding by GRDF Investee (USD)

Company	TA Facility	Investee Contribution	% Of total TA Facility
Doki	157,447	74,186	8.2%
Rcheuli	82,311	32,719	4.3%
Tetnuldi	34,098	12,958	1.8%
Delta Comm	127,652	20,730	6.6%
Piunik	103,776	34,592	5.4%

Ecopex	57,727	14,917	3.0%
Dogan	31,185	6,881	1.6%
Prime Concrete	27,903	2,884	1.4%
Bazi	21,883		1.1%
Madai			0.0%
Multiple*	945,040	42,143	49.0%
Teremok	161,506		8.4%
A-Net	111,350		5.8%
Ioli (Foodmart)	57,200	7,800	3.0%
FX difference**	7,687		0.4%
Total	1,926,765	249,810	

*Projects applied across multiple Investees. **Loss on conversion to GEL.

The technical assistance was provided only to Investees (i.e. post-investment). Given the problems with tax authorities afterwards, such technical assistance projects would have greatly benefited the potential Investee pre-investment. Indeed, the substantial improvement in financial accuracy would have likely led to more precise investment forecasts and/or lead SEAF and the Board to conclude that an investment was not worth the risks. The choice to only fund technical assistance projects post-investment was a collective one taken by SEAF and the Board. As most of the technical assistance projects were allocated to financial reporting, auditing, and management, in part to formalize the businesses and obtain a more accurate picture of past and present finances, it was only after such assistance when it was revealed that several Investees had irregular finances or needed to restate past earnings.

4. ASSESSMENT OF PROJECT DESIGN

4.1 SUSTAINABILITY

Today, sustainability is widely regarded as a key prerequisite of direct interventions in development finance to improve market supply. The rationale is that only financially self-sustainable interventions can guarantee a lasting improvement in terms of access to finance. Institution building is at the center of this "financial system approach" which evolved as a key lesson from the failure of previous supply-driven interventions, especially in agricultural finance. Dale Adams, Douglas Graham and Robert Vogel of Ohio State University as well as J. D. Von Pischke of the World Bank have written extensively about the failure of these policies. There are also discussed at length in the 1989 World Development Report.

GRDF, in contrast, was not designed with financial sustainability as a primary objective. Clause 3.3.a of the Fund Management Agreement explicitly states, "The Fund Manager will use reasonable best efforts to identify and present to the Board suitable investments that meet the Investment Policy Guideline… While financial returns on each investment will be considered…, <u>the principal purpose of the fund is to have significant developmental impact on SMEs</u> in agribusiness, tourism, and other industries in Georgia in areas outside of Tbilisi". In the same spirit, the fund has only a "Developmental Return Hurdle Rate" and no financial hurdle rate. Instead, it has a Bonus Hurdle Rate of 70% of projected revenues. In other words, the fund manager needs to ensure that only 70% of projected revenues are collected to qualify for a performance bonus, i.e., independently of costs and/or the fund's overall profitability. Such a set-up is quite unusual in comparison to the typical private equity funds, including those set-up by other DFIs, and had implications on the decision-making process, stakeholder relationships, and eventual outcomes from investment activities.

GRDF structure mirrored that of a "blind trust"[18] on behalf of the Government of Georgia (GoG) which had very limited means of influence in the actions taken by the fund's agents. GoG had only an observer status on the Board (through MCG) and had no authority on those parties entrusted with making investment decisions. This led to resentment and tensions in the interaction with GRDF. General apprehension over the use of capital and perceived lack of monitoring or control was evident in the discussions held during the evaluation process. These tensions escalated as the financial performance of GRDF investments worsened. Minutes from Board meetings, in which the GoG would have a non-voting observational seat, indicate that there were disagreements over the merits of some investments and delays in disbursements or release of funds that required signatures from the MCG representatives. The contentious relationship would escalate at various times.

[18] Blind Trusts are generally used when the initiator wishes to keep the beneficiary unaware of the specific assets in the trust, such as to avoid conflict of interest between the beneficiary and the investments.

GRDF Board assumed the role of investment committee, which is rather unusual. A separate investment committee comprised of representatives from the General Partner (GP) and Limited Partners (LPs) as well as independent members is the most common feature of investment funds, including those set-up by DFIs. This committee meets as often as necessary to carry out in-depth reviews and decide on investment proposals. The GRDF Board members instead primarily resided outside of Georgia and would meet on a quarterly basis to review investments. No subcommittees were formed to ensure sufficient time and analytical rigor were applied to investment decisions, in addition to typical duties associated with Boards. The entirety of the support function rested on the fund manager. As minutes indicate, the review of projects did not meet the standards of analysis and quality control typically seen in the private equity industry.

GRDF was exposed to significant currency risk and the depreciation of the GEL has had a substantial negative impact on fund performance. The GRDF is a USD denominated fund and the use of the USD had both indirect and direct impacts on performance. Indirect effects are difficult to quantity but are associated with debt investments. Portfolio Companies, or Investees, had to service USD denominated debt with GEL-based earnings. The GEL has gradually depreciated against the USD over the investment horizon. Therefore, Portfolio Companies with GRDF debt positions have seen an increase in their exposure and higher servicing costs over the period that have contributed to lower net earnings, lower cash flows, and negatively impacted the value of both debt and equity positions. Meanwhile, equity investments, which were converted from USD to GEL at the initial investment date, are directly exposed to exchange rate fluctuations as their eventual conversion back to USD must be made at the time of exit. The average exchange rate during the investment period was 1.66 GEL per USD and the current rate is 2.3 GEL per USD representing a 28% decline.

4.2 Compensation Structure & Incentive Environment

The annual bonus incentivized short-term performance over long-term value creation. The annual bonus incentivized quick payback of capital, lump-sum disbursements, and investments in recently created SMEs, all of which would raise risks to GRDF portfolio companies and associated investments. Annual bonuses themselves are not commonly utilized in PE funds. The bonus payment was intended to incentivize SEAF to meet the financial and development objectives of the GRDF. SEAF was entitled to a maximum USD 250,000 annual bonus payment for Fiscal Years two through five (2008-2011). This would represent approximately 25% of total compensation for the year. The bonus payment was tied to Development Returns (DR), cash inflows by Investees, and capital disbursements. The bonus payment itself would be funded by cash inflows from debt amortization. The structure also favored lump-sum disbursements rather than a tranched structure (to be discussed in 3.3 Review of Failed Investments.) Finally, the Development Return was based on percentage changes and favored recently created, unproven SMEs since they naturally have a slow base from which to grow. Altogether, the structure is likely to have contributed to highly leveraged deals and bulk disbursements.

Figure 13: Bonus Calculation Formula

Bonus Payment = Total Bonus Points (converted to %) x [Actual Cash Inflows – Projected Cash Inflows]

Total Bonus Points:
1. Development Return Bonus Points = [Actual DR / Projected DR] – Hurdle Rate
2. Cash Inflow Bonus Points = [Actual inflow / Projected inflow] – Hurdle Rate
3. Capital Invested Bonus Points = [Actual invested / projected invested] – Hurdle Rate

Development Return (DR) = % change in revenue*(W) + % change in taxes paid (W) + % change in wages paid*(W) + % change in local purchases*(W) where W equals Weighting

SEAF's compensation package considered additional expenses associated with capacity building. It was generally understood that a market competitive fee structure would have to be adopted to attract a competent and experienced fund manager who was expected to spend considerable time sourcing investments and building the management capacity of Investees for the GRDF. The due diligence concluded that the relative immaturity of the target markets would necessitate extra time and efforts in this regard. Additionally, the fund manager was expected to build local fund management capacity. An extensive benchmarking analysis was carried out using a variety of similarly focused or sized investment funds to arrive at the 3% of assets under management annual fee during the five-year investment period and the 3% of invested assets using cost basis thereafter.

There were several unusual terms included in the compensation structure. Typically, a fund manager must collect more than 100% of invested capital, i.e., secure a minimum profit to investors (7-8%) to be eligible for the carried interest. In the GRDF case, the fund manager was only required to secure 70% of the invested capital to qualify for 2% carried interest. This bonus payment was increased to 25% of proceeds realized if the fund manager recovers 100% of the invested capital. Another feature of the compensation was the "claw-in" versus the commonly seen "claw-back" provision. In other words, the fund manager could still qualify for Bonus if he was able to meet the 70% hurdle for individual investments while still failing to meet the hurdle rate in the aggregate. Typically, the investors are the ones allowed to recoup "lost income" until the hurdle rate is met for the entire portfolio.

Consequently, the carried interest, which is typically a large sum that encourages fund managers to strive for long-term value creation and returns, did not have its usual weight in compensation for GRDF given the magnitude of the annual fund management fees and annual bonuses. This low hurdle rate suggests that the originators expected significant challenges in recouping capital. All these structural elements may have also contributed to this by encouraging more short-term thinking by the management, possibly excessive risk-taking and, obviously, less focus on securing positive financial outcomes. For instance, this may be one of the factors behind the very risky practice of bulk disbursements of loan proceeds after approval.

The incentive environment built into GRDF was misaligned and financial accountability was not engrained in the fund structure. At the governance level, the Board members had full decision power, but did not have adequate "skin in the game". To their credit, Board members quickly recognized the need for greater focus on GRDF profitability, and acted to adjust the strategic guidelines of the funds accordingly (perhaps in contradiction to the Fund Management Agreement). At the same time however, there seems to have been an overreliance on the fund manager and insufficient questioning of clearly overoptimistic projections and earnings scenarios. Similarly, the narrative of a widespread conspiracy by "political forces" seemed to be accepted as main rationale for the failure of several investments, as indicated in the Board minutes and interviews with SEAF and Board members. However, in several instances, this supposed interference came amid the backdrop of poor financial records and/or suspicious activity by non-GRDF shareholders.

It should be noted that the bonus component was overall difficult to implement in practice creating tension between SEAF and the Board. A considerable amount of time and effort was spent on calculating the projections from which SEAF would be measured and the subsequent measurement of results. The DR was particularly burdensome given the number of exclusions and specifics on the dates from which to start the projections. For example, the projected and actual DR was not to be calculated for Investees during a bonus year if SEAF had not yet disbursed the funds and excluded businesses considered as Start-Ups. In addition, there was confusion over whether the actual disbursement or investment decision should be used in calculating the invested capital benchmark. The confusion surrounding the bonus payment led to several proposals by SEAF to amend the structure, accompanied by lengthy calculations. The Board subsequently devoted significant time to the issue. Eventually, the Board simplified the structure to focus on disbursements and used a subjective assessment of SEAF performance with respect to development impact.

The prevalance of lump-sum disbursements and amortized mezzanine structures seems to correlate with the incentives to disburse capital and maximize cash inflows. However, it appears to be the intent of the Board to favor a quick pace of capital drawdowns, given the pressure to invest all of the commited capital, and their preferance for downside protection and capital preservation inclined SEAF to structure amortized debt structures. It should be noted that investments made early on in the investment period contained a larger equity component than those that followed.

Interestingly, the potential problems with the incentive environment were discussed at length in the Interim Activity Review dated September 2010. An Interim Activity Review, commissioned by MCC and shared with the Board and with SEAF, was conducted in late 2010 to critique the objectives, operation, and management of GRDF and recommend changes to the design and operation of investment funds. This report specifically makes the following recommendation to GRDF: "Omit any bonus incentives to increase the pace of investment beyond the pace that professional fund managers feel comfortable investing. If the pace is unsatisfactory and unjustified, then the Board should consider a change in management as the best option. Similarly, omit incentives that can in any way distract the fund manager from the final goals of the Fund, such as incentivizing short term cash flows (i.e. in the bonus), as opposed to long term capital increases in the value of the fund (i.e. in the carried interest)." No apparent follow-up on these issues was made neither by the Board, nor by MCC.

4.4 Development Return Concept

The original Economic Rate of Return (ERR) derived from the project due diligence (PDD) prior to GRDF implementation failed to account for the viability and uncertainty of the operating environment of investment proposals encountered during the project due diligence process. Furthermore, the ERR of 26 percent was likely inflated given the ambitious assumptions in net profits that in turn drives wages paid, taxes paid, and payments to local suppliers. The definition was assumed conservative since it ignored potential benefits to competitors, local communities, suppliers of related products, financial institutions, or other parties and spillover effects.

The Development Return (DR) calculation that formed part of the bonus evaluation was well intended but complicated in practice and short-term oriented. Development Returns (DR) were calculated off weighted averages of annual percentage changes in four variables consisting of growth in wages paid, growth in taxes paid, growth in revenues, and growth in local purchases. These variables were difficult to project and measure. Large annual percentage changes would not necessarily correlate to large increases in the actual numbers. Indeed, it was often the case the baseline established for these percentages were rather low as most portfolio companies were recently created prior to the GRDF investment. The DR was also an annual figure rather than a cumulative one. In many instances, the high positive DR during the early stages of an investment would show an opposite trend by the end of the investment. Crucially, there was no emphasis on the lasting development impact or sustainable outcome since the DR was only used during the five-year investment period.

The role and importance of agriculture highlighted in the project due diligence (PDD) for the development of the regions of Georgia suggests that GRDF should have been implemented after the Agriculture Development Activity (ADA) had been in operation

for a while. The PDD emphasized that one of the main constraints to growth, particularly in the regions of Georgia, was the underdevelopment of the agriculture sector. The main constraint to agribusiness development, as cited in the PDD, was a lack of development and capacity in the primary market, which has direct consequences on the viability of businesses in the secondary market, one of the key markets GRDF was supposed to target. The primary market provides raw materials and inputs for the secondary market that depends on reliable supplies and quality. The driver for the creation of the Agribusiness Development Activity, launched shortly before the GRDF, was to address this market via Technical Assistance projects. Giving the ADA a significant lead-time to first address the primary agriculture market prior to creating GRDF would likely have improved the viability of potential investment projects in the secondary market and therefore probability of success. Under this framework, it is conceivable that the envisioned synergies between the two would have been more fully realized.

The creation and pursuit of a private equity fund is usually the result of the fund manager's prior due diligence and pipeline development in the target market. The due diligence performed prior to GRDF was conducted by a party unaffiliated with either the fund manager or the Board. The calculation of the ERR for the project was very subjective and relied on investment proposals drawn from Georgian entrepreneurs during the scoping phase of the project. Such proposals did not undergo thorough due diligence to arrive at realistic rates of return nor did they account for the risks. Indeed, investment professionals were not utilized to undertake a formal survey of demand for GRDF. Initial planning and pipeline development was therefore insufficient, which slowed disbursements and consumed significant time in the Investment Period. Due diligence carried out prior to creating a fund helps identify appropriate staffing needs to fit the context, identifies and addresses potential legal issues, builds a pipeline and market awareness for the fund among potential Investees. GRDF faced challenges with respect to all the above and is largely the reason why it was unable to close on a deal until late 2007.

4.5 Investment Policy

GRDF funds financed high-risk projects involving new business operations and/or rapid expansion plans (e.g. Prime Concrete land purchase and factory construction, Tetnuldi hotel construction). While all non-GRDF shareholders interviewed indicated that other sources of capital, primarily bank loans, were unavailable or too expensive at the time of investment, there were discrepancies in several instances (see Case Studies). Investees were owned by people who had side businesses or had recently formed the entity to qualify for GRDF investment. This entity itself did not qualify for a bank loan as the operation did not have sufficient history nor collateral to do so. However, given the backgrounds of many non-GRDF shareholders and involvement in other businesses (e.g. Rcheuli owners involved in CenterPoint construction; Piunik was a spin-off of two agribusinesses; Prime Concrete's owners were already managing a similar business in

Tbilisi; Dogan’s owner subsequently operated another company after filing for insolvency), it is difficult to fathom that financing could not have been obtained if the project sponsor did not truly believe in the project thereby leveraging existing assets in those side businesses.

The Investment Policy Guidelines (IPG) encouraged GRDF to take such equity risks with debt instruments. Mezzanine finance is more attuned to the business needs of late-stage, mature firms in expansion phases. Mezzanine finance candidates are typically cash flow positive and have been in operation for several years. The due diligence did highlight the relative underdevelopment of agribusinesses due to a mix of underdeveloped primary markets, financial literacy, business acumen, and poor infrastructure. The due diligence highlighted the use of targeted equity investments to *“catalyze growth in agriculture/food processing and tourism along the agricultural value chain and in tourism infrastructure.”* As such, it could be assumed that most of the businesses from which the due diligence draws conclusions are in nascent markets and would require the kind of financing suited for high growth start-up like firms that have yet to achieve positive cash flows and/or profitability.

The mezzanine financing structure favored in the IPG does not consider the unique financing needs and risks of SMEs. Mezzanine finance in this instance is not the most optimal solution for a variety of reasons. It requires higher accuracy in forecasts, given the high debt loads it puts on Investees and potential for delinquency from even the slightest deviations from projections. It requires intensive monitoring for the reason stated above and because of common SME characteristics such as lack of financial and business transparency, informal reporting mechanisms, particularly acute in the agriculture sector, and the principal/agent problem. The principal/agent problem is assumed because of the lack of equity participation and, therefore, control of business operations. Business owners can act differently than was initially agreed to and change strategies. This was also a common occurrence in GRDF. Mezzanine finance therefore is largely a hands-off approach to investment management. This is not the ideal mechanism for early stage SMEs in developing countries as was the case in Georgia.

The combination of these restrictions along with the financial return objective run counter to or limit the development impact objective. Aside from the “existing business” criteria, several other eligibility requirements, including annual revenue limits and regional and sectoral focuses had a marked impact on SEAF’s ability to find suitable investments. The eventual outcomes suggest that the imposition of a high-expected return using debt instruments only served to elevate risks of chosen SMEs particularly in the agribusiness sector. These risks would materialize into a financial and operational crisis for several of the agribusinesses in the portfolio. The unique characteristics of SMEs in the agriculture sector and importance cited in the PDD suggests GRDF should have been structured to specifically target agribusinesses with capacity building measures and supportive capital structures, thereby assuming a lower return. This also would have been more aligned with the development objectives.

5. ASSESSMENT OF PROJECT INSTITUTIONAL FRAMEWORK

5.1 BOARD PERFORMANCE

The Board clearly believed in the development story underpinning GRDF and acted in good faith. Interviews with several Board members and review of the Board meeting minutes confirm that the investment decisions were carried out under the best intentions developmentally and financially. From a development standpoint, it is evident that during the early years of the investment period, the Board encouraged the submission of investment proposals for SMEs in the agribusiness or tourism sectors and in the regions. Members were cognizant of the publicity surrounding the GRDF and anxious to show that the GRDF monies were being allocated to the target areas. For example, during several of the early proposal discussions, the Board emphasized that it wanted to see more potential deals from the target sectors or regions. After the first investment in Doki, which did not fit within the target sector or region, the Board indicated that the GRDF should wait to publicize the investment until an agribusiness commitment was in place.

At the same time, the Board took a pragmatic view of potential deals and did not outright reject proposals that did not fit within the sector or regional criteria. The Board grew dissatisfied with the pace of investments, partly in response to pressure from MCG, and expressed concern about pipeline development. The Board felt that SEAF was not fully appreciating the context of the GRDF, noting that the investment restrictions would necessitate focused and extra efforts to source viable deals, deal with the informality of many businesses, and rectify misconceptions about the purpose of the fund. Repeatedly during the investment period, the Board would criticize the lack of deals in the pipeline as well as the slow process in developing local fund management capabilities indicating that staffing could be an issue in deal sourcing. References to MCG expectations that all committed capital be drawn down within the five-year window were also made during discussions.

The Board struggled with the need to balance financial and development returns and subsequent financing structures. Some members felt that pricing should reflect the higher risk profile of SMEs while others felt that providing financing on commercially available terms would suffice considering the development objective. This would also lead to disagreement over the use of equity and debt structures as well as whether the two should be viewed as a blended investment or separate discrete investments. This is perplexing considering the interrelationship between the two and the fact that GRDF equity would stand to benefit under more supportive GRDF debt financing terms in the same company. The matter was not definitively resolved until well into the investment period. The matter of pricing would continue to be a prominent theme during Board meetings. A suggested corridor was later generally accepted to expedite investment decision making per the following: Senior debt at 14-16% IRR (not offered by the Fund);

Mezzanine at 17-22% IRR; and Equity at greater than 22% IRR. While the rates suggested are appropriate and acceptable in terms of commercially focused funds, such high benchmarks should have been problematic for SEAF to meet for the GRDF, particularly considering an IPG that both parties thought to be too restrictive.

The Board's insistence on high-priced debt instruments likely exacerbated investment risks to GRDF. High-expected returns within the confines of the IPG only served to steer GRDF towards projects with higher risk or outside of the intended targets. The imposition of high cost debt was one reason why so many Portfolio Companies struggled to service GRDF investments. All investments had to grow at very high rates to service the financing terms negotiated with GRDF. The shareholders of Portfolio Companies clearly seem to have been aware of these risks ex ante. Many the portfolio companies in fact turned out to be affiliated to larger, established ventures, but were structured as new companies possibly to shield them from potential consequences of risky (debt-fueled) expansion plans into unfamiliar areas under optimistic growth assumptions.

As a result, all deals presented were high risk. According to the minutes of Board meetings, there were frequent discussions on pricing and expected returns of investments as well as the prominent risks to the deals such as supplier or customer concentrations, market potential, and capability of management. These risks would become a reality for many of the portfolio companies. The Board, however, took an approach that focused on higher pricing of investments, personal guarantees, options, and collateral to mitigate these risks and eventually approve some of the riskiest projects rather than reject them.

The Board, as the investment committee, did not really act like one when compared to those seen in typical investment funds. This is partly the result of the design. No one on the investment committee had direct ownership in the GRDF. The split roles, encompassing both the typical roles of a Board and those of an investment committee is also problematic. A review of the minutes and discussions with Board members indicate that time was a factor. The Board mostly met on a quarterly basis whereas a typical investment committee is called ad hoc whenever an investment decision needs to be reviewed. Additionally, most members were not located in Georgia and few were connected to or had a deep understanding of the market context. The Board was entirely dependent on SEAF for the in-depth analysis of investments that would otherwise be carried out by a separate investment committee as seen in other private equity funds. The Board therefore generally went along with SEAF's recommendations and only pushed back on the terms later.

MCC and MCG did not effectively leverage their roles in overseeing the activities of the GRDF. MCC and MCG were effectively GRDF bystanders, while their role in management were quite limited, there appears to be have been inadequate follow-up when problems arose, either at the portfolio performance level, SEAF-Board level, or at the relationship with government and local stakeholders level. MCC representatives regularly attended Board meetings, but failed to identify and address these governance shortcomings at GRDF It is unclear for example what follow-up actions were taken when activity monitoring reports or other M&E reports, including quarterly updates, showed underperformance. The conclusions and suggestions from the Interim Report, many of which are similarly included in this report, were also not utilized. This is a critical point since MCC served as key intermediary between the project and the Government of Georgia.

5.2 Fund Manager Performance

The IPG placed constraints on SEAF in relation to the sourcing and origination of investments. The IPG was designed with SMEs and target sectors in mind; however, SEAF struggled to find eligible SMEs that fit within the confines established in the IPG, with some of the most limiting factors consisting of revenue size restriction, the requirement to place 80% of investments outside of Tbilisi, the equity exposure limit, and the requirement that 85% of capital be invested in existing businesses. The constraints eliminated many value chain businesses from consideration (revenue requirement), limited development impact by excluding new businesses that could build market infrastructure (equity and existing business requirement), and exacerbated the scarcity of viable SMEs (outside Tbilisi requirement). The Board proposed changes to the IPG in 2008, including loosening the revenue size restriction and increasing the cap on equity as a proportion of the portfolio, but these were never approved.

SEAF's sourcing strategy during the first few years of the investment period did not fit the GRDF context. Pipeline development is a labor-intensive process as deal origination involves sifting through dozens of potential investments to select the best prospects. According to the minutes and discussions with SEAF, SEAF relied too heavily on the initial marketing done by the Government of Georgia and MCC in the run-up to and after the GRDF's closing, relying on businesses to approach them. Compounding the difficulty of the Georgian context was the presence of confusion regarding the grant funding, with many applications if the GRDF was a subsidized finance entity most of which were subsequently deemed unviable. SEAF, and to some extent the Board, waited for opportunities to appear, opting initially for a "standard approach of working through business networks", rather than to utilize a more formalized process of recruiting third party consultants to help source deals. The level of interaction with the ADA was also not fully integrated in the deal origination strategy even though that was articulated in the formation documents and reiterated at Board meetings.

Notwithstanding the difficult business environment, SEAF's investment process shows a gradual maturation and understanding of the context after early difficulties. SEAF relied on a team unfamiliar with the Georgian context to build the local fund management team and spearhead the investment process. Their methods assumed a standard approach to deal sourcing that led to slow pipeline development and disbursements. The inexperience of the investment team in dealing with the highly uncertain environment and target sectors was borne out in the performance of early investments. An improving operating environment and more opportunistic approach to investment deals led to better performance in those investments made in 2010 and 2011.

There were clear differences in opinion between SEAF and the Board over the role of GRDF and how to structure investments. Insistence by the Board on "risk premiums" and downside protection was a significant roadblock when combined with the IPG. It is unclear what role the incentive scheme had on financial structures. Early investments had a significant equity position suggesting a long-term view in value creation. Disbursements did accelerate and the portfolio did tilt towards amortized debt structures following a decision to have bonus payments linked to cash outflows and inflows. However, accelerating investments was the stated goal.

SEAF's due diligence process was applied narrowly, relying largely on portfolio companies' management input and data. SEAF's due diligence did hit all the right areas as far as describing the market positioning, management experience, and business plans but the investment rationale at times was lost in the details. Additionally, the due diligence approach was very much focused on views and plans of the portfolio companies' management. This narrow approach was inadequate for the Georgian SME context given the unreliable nature of financials and business statistics and moral hazard. Many investments lacked a complete investigation and analytical process that assessed market dynamics, verified financials, distribution channels, and certified contracts. Crucially, a recurrent shortcoming was insufficient due diligence on the management of portfolio companies, their other business ventures as well as personal finances to understand real motivations and potential conflicts of interest. This was a recurring theme among Investees.

The financial models used to assess investment opportunities were detailed and showed an understanding of the key drivers of the business but were ultimately driven by overly optimistic growth assumptions. It is important to note that while growth and cost assumptions underlying the financial models were very much informed by PC management and usually optimistic, the models themselves were robust, boiling down to the unit economics of each business. Profit and cost centers were thoughtfully accounted for and modeled, flowing into the overall business model and built with sensitivity analysis capabilities. For example, Prime Concrete's financial model included a cost breakdown for each grade of concrete supplied based on several raw material inputs. Sales were also detailed, using market-based prices associated with volumes of certain types of concrete sold. Figures derived from the model show comfortable margins by the time principal repayments and royalties kicked in. Debt service ratios, which measured the company's ability to generate enough cash to cover interest expense, fees, and principal repayments, were above the minimum acceptable criteria.

Nine out of fourteen companies that obtained GRDF financing were the result of recent partnerships formed by shareholders of existing businesses, which created a legal entity to qualify for investment. Few of the portfolio companies that received GRDF financing had an established operating history. In these new companies, the shareholders, often the same as management, proposed a business plan that required significant start-up costs, including acquisition of fixed assets like property, plant, and equipment, along with working capital needs. As such, SEAF's assessment of the investment was dependent on highly speculative project plans by newly formed management of early stage SMEs. This scenario compounds the difficulty in ascertaining an accurate picture of the probable evolution of the company's market position, sales, costs, capital structure, operations, and shareholding structure. Furthermore, the use of mezzanine finance as opposed to equity implied a more "passive" role in fund management with minimal controls over portfolio companies.

A number of GRDF's investments changed their business strategy following the GRDF investment. Even among the more "successful" portfolio companies, the projections were off because of the change in business strategy. Piunik, for example, changed course after the first year when realizing the profitability and growth of a segment that had relatively little impact on original projections. Ioli (before becoming Foodmart) accelerated store openings beyond the original plans. Ecopex targeted a different orchard. Tetnuldi decided to upgrade hotel furnishings beyond original plans. Teremok partnered with an amusement park to expand.

Investments lacked adequate mechanisms to mitigate such risks to GRDF. In most instances, the capital disbursements to portfolio companies were done in lump sum based on stated purposes without establishing tracking capabilities, which made it difficult to verify the purpose for the use of the funds. For example, in the case of Bazi, money was used by a shareholder to purchase more inferior equipment than was stipulated in the contract that went undetected for several reporting periods. Financial reporting at the portfolio companies also suffered from poor systems or knowledge gaps leaving the PC, SEAF, or both, vulnerable to fraudulent activities or cost overruns. The types of mechanisms that would have mitigated such risks include on-site monitoring of projects with project-completion based disbursements, required joint-signatures on major expenditures, and stricter covenants. Yet, even in cases where there were joint-signatures, proof of payment or receipts from portfolio companies were not usually requested or verified.

Monitoring of investments in general was not as robust as it should have been given the maturity level of SMEs and inexperience of operating in Georgia. Investment monitoring was the Achilles heel of the GRDF as several problems that materialized either should have been caught earlier or triggered an immediate action when it became a noticeable problem. Without the mechanisms in place to alert the fund manager to changes in the business, a closer and more frequent reporting schedule and site visits should have been followed. The lack of ownership control usually limits monitoring powers but, in most instances, GRDF financing represented the majority of capital contributed to the company and should have been used as leverage in obtaining equity-like voting rights and oversight. Still, in cases where this was indeed in place, SEAF largely went along with PC management plans that led to cost overruns or change in strategies. Notably, SEAF did so after seeking approval from the GRDF Board.

All but two of the Investees that received GRDF debt were unable to service the investment at some point, yet few were subject to GRDF seizure of assets or liquidation. This result, in combination with SEAF's due diligence analysis, suggests that SEAF, along with the Board, followed a "patient capital" approach regardless of the instrument used. When troubles escalated, both the Board and SEAF favored a "development" approach, as the actions taken during crisis periods show a reluctance to liquidate and exercise protection options (even in cases of fraud). All investment deals were adequately protected against downside risk but these safeguards were not enforced during turmoil. SEAF consistently opted for a "patient capital" approach instead, which however was in line with the Fund Management Agreement. The latter required a development impact perspective first and financial returns second. Nevertheless, SEAF appears to have been overly confident in its ability to right the ship. When SEAF did actively get involved there was improvement in the portfolio companies but it was too late in several cases.

Interestingly, investments approved after 2009 have fared better as whole compared to those made in the early stages suggesting a gradual improvement in SEAF's investment process and operating environment. Indeed, 82% of investments made prior to 2009 are "non-operating" or considered poor performers while 81% of invested capital post-2009 are considered better performing investments**.** While the performance of each company has its own unique story this statistic does at least point to an improvement of pre-investment due diligence and better investment management decisions by both the Board and SEAF.

SEAF's valuations were comprehensive and methodical, in line with best practices. Models utilized for equity valuations were justifiable, consistently applied, and altered only if changes in the underlying business necessitated as per the International Private Equity and Venture Capital Valuation (IPEV) guidelines. The value of debt securities was first reported at cost and then provisioned according to SEAF's proprietary internal rating model using commonly accepted credit risk criteria. Equity valuations, multiples or discounted cash flow analysis rely on forecasted values of revenue and costs to arrive at a free cash flow or Earnings Before Interest Taxes and Depreciation and Amortization (EBITDA) figure. The debt-rating model was based on analyst's views of the business environment, collateral values, and other risks, which would correspond to a range of discounts to apply to the cost of the debt. Notably, the debt model was inherently historical-looking as opposed to the equity model. This was a source of confusion at various points particularly when the change in values of debt and equity diverged prompting criticism from the Board. While not intuitive, a deeper analysis shows that this phenomenon was explained by the nuances of each financial instrument, such as the presence of collateral or options, and is defensible.

Projections were derived from a high degree of guesswork due to the context of the targeted SMEs. SEAF had a very challenging task in projecting financials and arriving at accurate valuations because of the nature and operating environment of SMEs. SEAF relied on the validity of PC reported financial statements that turned out to be less than accurate in several cases. At the same time, it was carrying out technical assistance projects in the areas of Enterprise Risk Management and Financial Accounting and Management to improve the transparency validity and quality of the financials post-investment. Aside from the typical business uncertainty, an added layer of risk came in from the uncertain operating environment. Many portfolio companies did express difficulties arising from the changing political landscape in the country in addition to external factors such as commodity prices and changes in regional trade. These variables had to be accounted for in projections, most of which involved a lot of subjectivity and required a much-nuanced view given the specificity of the SMEs. Based on the outcomes, it would appear that this subjectivity was not applied conservatively enough.

All investment deals were highly leveraged and required optimistic growth assumptions, thereby exacerbating investment. All the GRDF investments consisted of a majority debt with market interest rates, amortization (meaning that significant chunks of principal had to be repaid throughout the investment term), and carried a royalty (a percentage of revenues were allocated to GRDF). In most instances, the GRDF investment was the only source of outside financing for the SME and it was the SME's first experience with managing a debt obligation. The high leverage and limited experience of business managers in managing debt created a small margin of error as the business plans associated with investments required high growth rates to service the GRDF investment. In several instances, PC management tailored their business plans to qualify for GRDF financing knowing that growth needed to be high enough to service mezzanine finance and be accepted. Young or high growth SMEs need to generate enough internal cash flows to fund working capital needs associated with growth. Under these financing structures, and in addition to the high uncertainty of sales and margin forecasts for such enterprises, SMEs are particularly higher risk.

The early difficulties encountered from initial investments, most of which were in the target sectors and included a larger equity component, caused a shift in investment strategy. About 43.5% of the invested capital has been in agribusiness or tourism, below the target allocation of 60%, and all took place before 2010. Excluding Piunik, none of the agribusinesses are currently operable. Tourism was made up entirely of hotels, which did not perform well but underlying collateral in the form of real estate limited risk to the downside. Most of the financing structures during the early period also included a significant equity component typically ranging from 10 to 20%; however, this is understated since it excludes the subsequent conversions of mezzanine debt to equity. Excluding the large equity stake taken in A-Net in 2011, equity financing became a scarcer financing option as the years passed. Towards the end of the investment period, SEAF took a more pragmatic approach by securing investments in businesses that it was more comfortable with, reflecting experience (as in the case of Foodmart) and opportunity for larger financial and development impact (A-Net, Prime, Delta Comm). Perhaps unsurprisingly these turned out to be among the better performing investments.

Building from the experience of GRDF and investment potential of Georgia, SEAF was able to raise more than USD 44 million between 2010 and 2011 from international institutional investors to launch the Caucasus Growth Fund (CGF), a regionally focused private equity fund targeting SME investments in Georgia, Armenia, and Azerbaijan. SEAF marketed the potential of SME investments in Georgia and its knowledge and management experience of the local context from GRDF to raise capital from the European Bank of Reconstruction and Development, the Netherlands Development Bank (FMO), the International Finance Corporation (IFC), and the Black Sea Trade Development Bank. Interestingly, the design and structure of CGF serves as a prime example of the typical fund set-up referenced in this report which contrast with the GRDF. CGF is managed by SEAF and has a Board like GRDF. However, CGF has a separate investment committee with representatives from the investor base playing an integral role. Additionally, SEAF is an investor itself (SEAF committed 3% of the total) with no annual bonus. Decision makers therefore have “skin in the game” and an incentive to ensure long-term investment viability.

6. SUMMARY OF FINDINGS & LESSONS FOR FUTURE PROGRAMS

The GRDF was a pioneering initiative to promote regional development that, despite the many failed investments, helped spark the creation of several transformative companies. Piunik, for example, was able to reduce Georgia's dependency on imports for hatching eggs. It has continued to grow by expanding local production and services and contributes to the positive development of the surrounding area. Delta Comm is a truly transformative business, connecting rural and urban areas alike, playing a leading role in fiber optic infrastructure development of the country and providing ancillary services. Prime Concrete is now a leading Georgian-owned concrete producer in Western Georgia that can compete successfully with international players. Indeed, of the four large tenders by APM Terminal, the owner of the Poti Port, Prime Concrete has won three of them. Foodmart, despite all the headaches, has been able to attract international capital and partners and has tremendous potential to be the leading grocery chain in the country. For those investments that struggled, it is not the GRDF concept itself but rather the design and implementation that contributed to poor outcomes.

The fundamental problems encountered by GRDF stem primarily from structural issues with the design as well as inadequate performance of the Board and the fund manager on key aspects. The absence of a clear financial sustainability objective has hindered the potential success of investments. Investment decision makers did not have enough financial accountability. That, along with the compensation structure, worked against establishing a lasting impact on portfolio companies and hindered investment performance. The imposition of several other constraints in the form of investment restrictions only exacerbated these issues and increased the risk of investments. Similarly, the Board acted in good faith, believing in the underlying development story but underperformed in its role as an investment committee. SEAF's performance was possibly affected by an incentive environment that implicitly rewarded short-term gains and unfamiliarity with the Georgian context, albeit this latter aspect gradually improved over time.

Going forward, the main lessons learnt for improving the chances in realizing the strengths and potential impacts offered by PE model for meeting development finance objectives would be:

- **Financial institutions are better positioned to meet development objectives by prioritizing a financial sustainability objective.** Inconsistencies in what constitutes development impact and the balancing of development and financial impact were prevalent in the GRDF. According to the due diligence book, it was stated that GRDF would be grounded on a non-commercial vision in which the "goal is to maximize developmental impact". Yet, in the same document, it was noted, "the investments will be made on a commercial basis and a return to the fund will be expected." At the same time, GRDF was expected to catalyze other investments, particularly from the private sector. Targeting financial sustainability by taking a long-term view on value creation and providing supportive capital structures would increase the chances of sustaining viable businesses thereby ensuring a lasting impact. Additionally, incentive structures would also be aligned with the long-term view in contrast to short-term gains.

- **A PE fund is suited to the patient capital approach and can be a market friendly way of providing grants to countries.** It encourages market mechanisms to allocate resources in the most efficient way. However, the PE fund should be run and managed like a PE fund. Critically, engaging with the PE fund manager during the project due diligence process and during talks with the relevant stakeholders will enhance the ramp-up period and mitigate agency issues.

- **Clarity, visibility, and incorporating local ownership are critical to ensuring a strong public-private partnership.** MCC went out of its way to prevent any perceived connections between GRDF and the government of Georgia, the sole de facto owner of the interests and the key partner of the Compact. While it is understandable that the MCC position was to shield the GRDF from potential political interference, the lack of ownership by the GoG and a lack of accountability by agents entrusted to carry out the GRDF objective only served to fuel misconceptions, distrust, and animosity among the stakeholders. A perfect solution to this problem does not exist. Yet, greater involvement at the high-level strategic level, constant dialogue and more proactive relationship management would have helped nurture and build the sense of a public-private partnership.

- **The initial project due diligence should be done by professionals with the requisite experience in investments who is ideally the expected fund manager.** Pipeline development for an investment fund is typically the result of market due diligence undertaken by the fund manager. Investment deal sourcing and origination is a time and labor-intensive process. Prior to fund formation, most PE fund managers have already homed in on potential investments, have established networks in the target market, and are well informed on the market prospects. Notably, this was not the case for the GRDF. Potential Investees were estimated by highly subjective means without detailed due diligence. This problem was further exacerbated since the ERR was based on these findings and the highly restrictive investment guidelines were informed by those same findings. It is little wonder then that the GRDF got off to a slow start and encountered early difficulties in developing a robust pipeline of viable investments. PE fund manager engagement prior to fund creation is therefore critical and will serve to better define expectations.

- **Private equity requires flexibility and a long-term commitment, whereas MCC compacts have five years fixed implementation period.** Like GRDF, many private equity funds have a defined time limit, usually lasting from 7-10 years, consisting of an investment period followed by wind-down period. GRDF would have benefitted from the onset from clear mechanism to transfer ownership at the end of the Compact and ensure an orderly winding down of the investments without timing pressure to liquidate. A holding structure versus a fund should be considered for similar ventures going forward.

- **Expanding the role and size of the Technical Assistance Facility would help improve business viability and build SME capacity.** The TA has been praised by all managers and shareholders interviewed. All expressed their gratitude and highly praised the TA projects that went towards building financial management and accounting capacity and knowledge. The implementation of Enterprise Risk Management was also given high marks by interviewees with many admitting that their own knowledge of their business dramatically improved following the projects. In general, the TA was a significant value enhancer and improved business acumen. However, TA was only applied to Investees despite the option to expend on potential Investees. Expanding the role and size of the TA facility would improve viability of potential businesses and should be applied to both potential and accepted investment deals.

- **Potential synergies between Compact components were not adequately exploited.** The driver for the creation of the Agribusiness Development Activity, launched shortly before the GRDF, was to address the primary market via Technical Assistance projects. The main constraint to agribusiness development was a lack of development and capacity in the primary market, which has direct consequences on the viability of businesses in the secondary market, one of the key markets GRDF was supposed to target. Giving the ADA a significant lead-time to first address the primary agriculture market prior to creating GRDF would likely have improved the viability of potential investment projects in the secondary market and therefore probability of success. Under this framework, it is conceivable that the envisioned synergies between the two would have been more fully realized.

ANNEXES

ANNEX 1: GRDF INCOME STATEMENTS 2007 –2016 Q3 (USD)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	Q3 2016	Cumulative
Interest income & penalty fees	20,764	195,382	1,541,303	1,253,970	1,203,997	987,765	876,510	78,022	19,259	40	6,177,012
Recovery of bad debt	-	-	-	-	114,507	19,336	-	-	-	-	133,843
Royalty	3,270	65,227	298,559	239,842	238,368	160,251	43,814	21,569	20,865	-	1,091,765
Other	12,000	143,656	508,467	130,365	362,853	22,384	13,179	83,913	11	2,105	1,278,933
Management fees	969,041	900,000	900,000	900,000	774,289	841,382	768,309	599,789	507,588	121,583	7,403,562
Fund expenses	249,011	471,289	456,357	208,538	448,446	283,810	185,076	172,608	200,849	117,125	2,910,234
Performance bonus	-	250,000	250,000	-	150,000	150,000	-	-	-	-	800,000
Board	157,609	127,766	119,249	125,893	107,220	101,617	105,730	92,642	91,446	46,903	1,076,075
Professional & legal	43,962	48,369	50,080	39,015	121,008	62,198	68,866	69,630	86,511	62,213	651,852
Other	47,440	45,154	37,028	43,630	70,218	-30,005	10,480	10,336	22,892	5,955	263,128
Organization expenses	99,595	-	-	-	-	-	-	-	-	-	99,595
Bad debt expense	-	-	26,185	253,452	38,971	19,007	-	-	-	-	337,615
FX transaction gains/(loss)	88	221	1,068	-13,347	-5,089	-12,147	-10,913	-27,567	-8,546	-60	-76,292
Gross profit	-1,281,525	-966,803	966,855	248,840	652,930	33,390	-30,795	-616,460	-676,848	-236,622	-1,907,038
Unrealized gains/(loss)	-	-352,306	-1,535,158	-3,335,368	461,725	-4,038,388	2,372,872	-1,032,056	-1,194,987	-	-8,653,666
Realized gains/(loss)	-	-	-	-	-	-2,966,667	-	-	-	631,097	-2,355,570

Net income	(1,281,525)	(1,319,109)	(568,303)	(3,086,528)	1,114,655	(6,971,665)	2,342,077	(1,648,516)	(1,871,835)	394,475	(12,896,269)
Debt instruments	1,700,000	9,735,088	17,061,687	13,644,289	21,655,268	17,185,692	12,517,462	9,413,506	7,894,188	6,404,977	6,404,977
Equity securities	-	1,363,689	2,188,279	362,276	2,076,046	1,733,299	2,102,015	2,714,171	1,743,134	2,033,443	2,033,443
Other	36,125	325,821	1,414,755	4,540,867	1,161,863	1,222,910	2,357,809	729,229	260,005	1,801,285	1,801,285
Total Assets	1,736,125	11,424,598	20,664,721	18,547,432	24,893,690	20,141,901	16,977,286	12,856,906	9,897,327	10,239,705	10,239,705
Total liabilities	71,310	327,849	282,488	28,666	34,500	30,145	34,930	39,390	53,440	38,907	38,907
Member capital	1,664,812	11,096,749	20,382,233	18,518,766	24,859,190	20,111,756	16,942,356	12,817,516	9,843,887	10,200,797	10,200,797
Contributions	2,946,337	10,751,046	9,853,787	1,223,061	5,225,769	-	-	-	-	-	30,000,000
Distributions	-	-	-	-	-	742,436	2,544,810	2,476,324	1,101,794	37,571	6,902,935

Source: GRDF annual report

ANNEX 2: DEVELOPMENT RETURN CALCULATIONS AND NOMINAL FIGURES FOR PORTFOLIO COMPANIES

Company	Indicator	2008	2009	2010	2011	2012	2013	2014	2015	Years	Aggregate
A-NET	*Actual Revenue Growth*				100%	157%	53%	62%	39%	5	**82%**
	Actual Wage Growth				100%	190%	15%	44%	11%	5	**72%**
	Tax Growth				100%	139%	-2%	76%	52%	5	**73%**
	Local Purchases Growth				100%	48%	501%	17%	17%	5	**137%**
	Actual Weighted Average DR				100%	133%	142%	50%	30%	5	**91%**
BAZI	*Actual Revenue Growth*	67%	-45%	-3%	-38%	-53%	-65%	-97%	-100%	8	**-42%**
	Actual Wage Growth	23%	100%	-28%	386%	255%	-82%	-100%	0%	8	**69%**
	Tax Growth	56%	92%	-15%	-23%	114%	-73%	-72%	0%	8	**10%**
	Local Purchases Growth	92%	-47%	-11%	-37%	-58%	-76%	-98%	-100%	8	**-42%**
	Actual Weighted Average DR	59%	25%	-14%	72%	65%	-74%	-92%	-50%	8	**-1%**
Delta Comm	*Actual Revenue Growth*		11%	49%	35%	3%	-9%			5	**18%**
	Actual Wage Growth		100%	38%	-8%	67%	-26%			5	**34%**
	Tax Growth		100%	35%	95%	25%	-15%			5	**48%**
	Local Purchases Growth		16%	74%	-18%	24%	37%			5	**27%**
	Actual Weighted Average DR		57%	49%	26%	30%	-3%			5	**18%**
Dogan	*Actual Revenue Growth*		-14%	-26%	32%	-23%	-33%			5	**-13%**
	Actual Wage Growth		100%	-10%	58%	-66%	-24%			5	**12%**
	Tax Growth		-4%	-4%	22%	-47%	5%			5	**-6%**
	Local Purchases Growth		-10%	-24%	30%	-17%	-50%			5	**-14%**
	Actual Weighted Average DR		18%	-16%	36%	-38%	-25%			5	**-5%**
Doki	*Actual Revenue Growth*	34%	-31%	-35%	-32%	-76%				5	**-28%**
	Actual Wage Growth	83%	-48%	6%	-30%	-71%				5	**-12%**
	Tax Growth	-28%	-43%	9%	-15%	-69%				5	**-29%**

	Local Purchases Growth	88%	-47%	-29%	-24%	-68%				5	**-16%**
	Actual Weighted Average DR	44%	-42%	-12%	-25%	-71%				5	**-21%**
Ecopex	*Actual Revenue Growth*		100%	16%	-1%	-72%	-98%	46%	507%	7	**71%**
	Actual Wage Growth		100%	159%	-57%	-92%	-100%	0%	0%	7	**1%**
	Tax Growth		100%	70%	-41%	-57%	-30%	5%	76%	7	**18%**
	Local Purchases Growth		100%	32%	-20%	-63%	-98%	-98%	203%	7	**8%**
	Actual Weighted Average DR		100%	69%	-30%	-71%	-82%	-12%	197%	7	**24%**
Ioli / Foodmart	*Actual Revenue Growth*				70%	90%	-17%	287%	33%	5	**93%**
	Actual Wage Growth				200%	61%	-48%	348%	38%	5	**120%**
	Tax Growth				193%	120%	18%	29%	47%	5	**81%**
	Local Purchases Growth				148%	102%	-31%	276%	110%	5	**121%**
	Actual Weighted Average DR				153%	94%	-20%	235%	57%	5	**104%**
Madai	*Actual Revenue Growth*		100%	110%	-55%	-45%	452%	9%	67%	7	**91%**
	Actual Wage Growth		100%	126%	-13%	-57%	767%	-20%	25%	7	**133%**
	Tax Growth		100%	134%	11%	17%	64%	-9%	-13%	7	**43%**
	Local Purchases Growth		100%	45%	-56%	-75%	109%	126%	111%	7	**51%**
	Actual Weighted Average DR		100%	104%	-28%	-40%	348%	26%	47%	7	**80%**
Piunik	*Actual Revenue Growth*		100%	23%	-63%	86%				4	**37%**
	Actual Wage Growth		100%	62%	53%	18%				4	**58%**
	Tax Growth		27%	29%	-40%	55%				4	**18%**
	Local Purchases Growth		100%	13%	-61%	31%				4	**21%**
	Actual Weighted Average DR		82%	32%	-28%	48%				4	**34%**
Prime Concrete	*Actual Revenue Growth*		100%	333%	-37%	85%	-42%	435%	-47%	7	**118%**
	Actual Wage Growth		100%	48%	2%	86%	-8%	220%	-1%	7	**64%**
	Tax Growth		100%	189%	-37%	147%	-49%	543%	-29%	7	**123%**
	Local Purchases Growth		100%	188%	-17%	151%	-61%	296%	-35%	7	**89%**

	Actual Weighted Average DR		100%	189%	-22%	117%	-40%	374%	-28%	7	**99%**
Rcheuli Hotels	*Actual Revenue Growth*	23%	48%	38%	13%	4%	3%	-57%	24%	8	**12%**
	Actual Wage Growth	47%	100%	-8%	14%	-16%	50%	-37%	-14%	8	**17%**
	Tax Growth	-29%	74%	17%	35%	-3%	-10%	-54%	28%	8	**7%**
	Local Purchases Growth	57%	47%	40%	9%	-61%	-25%	8%	21%	8	**12%**
	Actual Weighted Average DR	18%	67%	22%	18%	-19%	4%	-35%	15%	8	**11%**
Ritseula Hesi	*Actual Revenue Growth*				-3%	12%	68%			3	**26%**
	Actual Wage Growth				4%	-14%	19%			3	**3%**
	Tax Growth				9%	13%	49%			3	**24%**
	Local Purchases Growth				7%	-55%	-12%			3	**-20%**
	Actual Weighted Average DR				4%	-11%	31%			3	**8%**
Teremok	*Actual Revenue Growth*				18%	-8%	-48%	-43%	-51%	5	**-26%**
	Actual Wage Growth				44%	-21%	-72%	-40%	-86%	5	**-35%**
	Tax Growth				102%	-30%	-54%	-70%	-75%	5	**-25%**
	Local Purchases Growth				207%	-7%	-53%	-12%	-26%	5	**22%**
	Actual Weighted Average DR				93%	-17%	-57%	-41%	-60%	5	**-16%**
Tetnuldi	*Actual Revenue Growth*		100%	100%	193%	-75%	-8%	-21%	25%	7	**45%**
	Actual Wage Growth		100%	2%	-40%	-80%	-95%	36%	0%	7	**-11%**
	Tax Growth		100%	23%	64%	-63%	-21%	-15%	12%	7	**14%**
	Local Purchases Growth		32%	1016%	17%	-90%	-87%	-100%	0%	7	**113%**
	Actual Weighted Average DR		83%	285%	58%	-77%	-53%	-25%	9%	7	**40%**

**Source: SEAF, aggregate calculations done by A2F.*

Company	Indicator	2007	2008	New 2008*	2009	New 2009*	2010	New 2010*	2011	New 2011*	2012	New 2012*	2013	New 2013*	2014	New 2014*	2015
A-NET	*Revenue Growth*							-	226,822	302,429	776,126	776,126	1,188,740	1,188,740	1,926,968	1,926,968	2,671,424
	Wage Growth							-	64,123	85,497	248,003	248,003	285,172	286,699	412,610	412,610	459,902
	Tax Growth							-	46,977	62,636	149,924	159,518	157,104	157,104	276,094	276,094	420,641
	Local Purchases Growth							-	64,820	86,427	127,789	127,789	767,864	767,864	898,820	898,820	1,047,657
	Weighted Average DR																
BAZI	*Revenue Growth*	840,625	1,401,455	1,418,961	785,142	1,312,187	1,272,538	1,317,490	815,599	815,599	383,524	383,524	134,426	134,426	4,447	4,447	-
	Wage Growth	46,155	56,644	-	20,646	34,288	24,750	24,750	120,278	120,278	427,123	427,123	76,215	76,215	-	-	-
	Tax Growth	179,943	280,203	36,639	70,415	117,678	99,695	105,955	81,286	81,286	174,024	172,683	47,059	47,059	12,977	12,977	12,963
	Local Purchases Growth	371,008	713,747	941,118	497,440	866,420	768,773	920,442	576,075	576,075	244,717	244,717	58,695	58,695	1,063	1,063	-
	Weighted Average DR																
Delta Comm	*Revenue Growth*			6,074,823	6,761,304	11,305,467	16,854,746	16,854,746	22,797,321	22,797,321	23,526,785	23,526,785	21,387,047				
	Wage Growth			332,982	822,218	1,373,106	1,891,991	1,891,991	1,738,648	1,738,648	2,905,985	2,905,985	2,138,738				
	Tax Growth			116,816	526,783	939,230	1,267,878	1,592,325	3,102,708	2,871,319	3,586,560	3,586,560	3,059,575				
	Local Purchases Growth			276,728	319,651	534,517	929,226	837,817	684,418	684,418	849,563	849,563	1,159,976				
	Weighted Average DR																

Dogan	*Revenue Growth*			1,738,594	1,491,787	2,495,498	1,836,215	1,836,215	2,421,931	2,421,931	1,863,733	1,863,733	1,248,753				
	Wage Growth			28,354	112,309	187,786	168,850	168,850	267,565	267,565	91,410	91,410	69,061				
	Tax Growth			84,273	80,541	134,801	129,455	129,000	154,185	154,185	81,807	78,723	82,770				
	Local Purchases Growth			1,174,281	1,054,361	1,762,012	1,341,534	1,363,860	1,778,074	1,778,074	1,477,452	1,477,452	744,284				
	Weighted Average DR																
Doki	*Revenue Growth*	4,029,969	5,381,183	5,353,733	3,679,061	6,147,001	3,989,257	3,989,257	2,709,313	2,709,313	645,847						
	Wage Growth	354,277	647,479	563,795	292,136	487,790	517,109	528,387	371,336	371,336	109,520						
	Tax Growth	812,255	582,419	727,999	416,409	701,060	761,948	757,909	623,329	623,329	194,441						
	Local Purchases Growth	289,171	544,655	544,655	317,595	521,664	370,448	388,650	296,134	296,134	94,909						
	Weighted Average DR																
Ecopex	*Revenue Growth*			-	809,605	1,358,783	1,570,968	1,570,968	1,547,466	1,547,466	432,367	432,367	7,432	7,432	10,840	10,840	65,837
	Wage Growth			3,532	44,818	75,079	194,341	194,341	83,777	83,777	6,570	6,570	-	-	-	-	-
	Tax Growth			4,230	17,829	38,020	64,576	75,438	42,835	42,835	18,581	16,703	11,746	11,746	12,361	12,361	21,766
	Local Purchases Growth			-	665,153	1,116,353	1,468,210	1,480,276	1,181,126	1,181,126	438,582	438,582	7,401	7,401	130	130	393
	Weighted Average DR												2				
Ioli / Foodmart	*Revenue Growth*							6,812,962	11,560,597	11,560,597	22,013,514	22,013,514	18,316,744	18,316,744	70,933,956	70,933,956	93,997,445
	Wage Growth							450,327	1,351,604	1,351,604	2,180,022	2,180,022	1,139,252	1,139,252	5,105,187	5,105,187	7,067,766

	Tax Growth							230,588	684,790	684,790	1,508,798	1,510,872	1,780,629	1,780,629	2,291,729	2,291,729	3,374,944
	Local Purchases Growth							1,667,937	4,140,402	4,140,402	8,371,336	8,371,336	5,740,403	5,740,403	21,572,691	21,572,691	45,311,762
	Weighted Average DR												10,774,555				
Madai	*Revenue Growth*			424,266	1,073,210	1,796,252	3,772,280	3,772,280	1,705,836	1,705,836	939,319	939,319	5,182,242	5,182,242	5,631,287	5,631,287	9,396,221
	Wage Growth			31,804	144,698	242,458	549,102	549,102	479,614	479,614	204,588	204,588	1,774,232	974,232	776,687	776,687	967,299
	Tax Growth			69,418	147,407	246,810	578,256	580,019	681,701	681,701	795,936	795,936	1,305,914	1,105,914	1,011,700	1,011,700	884,962
	Local Purchases Growth			235,501	550,969	1,011,812	1,469,871	1,721,251	762,311	762,311	194,370	194,370	406,387	406,387	918,034	918,034	1,934,977
	Weighted Average DR																
Piunik	*Revenue Growth*			1,458,403	3,956,861	6,613,656	8,158,862	8,158,862	3,044,069	3,044,069	5,670,416						
	Wage Growth			8,839	34,358	57,432	92,776	92,776	141,834	141,834	167,883						
	Tax Growth			162,536	206,258	346,246	445,743	450,796	265,706	265,706	411,882						
	Local Purchases Growth			25,152	616,126	1,029,184	1,160,353	1,101,018	431,893	431,893	566,160						
	Weighted Average DR																
Prime Concrete	*Revenue Growth*			-	861,660	1,444,593	6,249,758	6,249,758	3,943,685	3,943,685	7,302,881	7,302,881	4,214,779	4,214,779	22,567,729	22,620,585	11,900,868
	Wage Growth			-	148,857	248,963	367,948	367,948	375,500	375,500	696,917	696,917	638,925	638,925	2,046,093	1,817,508	1,801,430
	Tax Growth			-	91,185	152,667	441,272	451,814	295,554	295,554	729,011	731,984	374,122	374,122	2,405,811	2,218,513	1,576,339

	Local Purchases Growth			-	152,528	247,856	714,645	686,777	568,858	568,858	1,429,792	1,003,030	392,724	392,724	1,555,966	1,417,998	916,221
	Weighted Average DR																
Rcheuli Hotels	*Revenue Growth*	444,040	548,338	333,437	494,046	824,978	1,140,998	1,140,998	1,289,278	1,289,278	1,340,457	1,340,457	1,375,072	1,375,072	587,233	587,233	729,035
	Wage Growth	92,362	135,902	54,822	222,844	372,388	341,856	342,748	391,652	391,652	329,060	329,060	492,794	492,794	308,766	308,766	265,606
	Tax Growth	110,587	85,757	64,905	112,725	188,281	220,382	228,878	307,061	307,061	298,151	295,592	265,247	265,247	120,983	120,983	154,612
	Local Purchases Growth	69,315	160,776	76,007	111,543	338,006	472,684	472,684	513,537	513,537	200,171	200,171	150,830	150,830	163,356	163,356	198,175
	Weighted Average DR																
Ritseula Hesi	*Revenue Growth*							1,745,468	1,688,213	1,688,213	1,896,538	1,930,158	3,233,879				
	Wage Growth							190,847	198,937	198,937	170,619	170,619	202,903				
	Tax Growth							82,511	86,358	86,358	97,417	188,054	280,569				
	Local Purchases Growth							1,052,498	1,126,599	1,126,599	507,495	507,495	448,156				
	Weighted Average DR																
Teremok	*Revenue Growth*							1,287,162	1,515,470	1,516,256	1,397,392	1,397,392	723,705	723,705	412,450	412,450	202,213
	Wage Growth							316,224	454,273	454,273	359,000	359,000	98,869	98,869	58,955	58,955	8,012
	Tax Growth							132,906	273,109	273,109	190,364	190,570	88,241	88,241	26,702	26,702	6,582
	Local Purchases Growth							230,998	708,788	708,788	659,612	659,612	309,811	309,811	273,993	273,993	203,889

	Weighted Average DR																
Tetnuldi	*Revenue Growth*			-	-	-	311,455	311,455	912,004	912,004	232,006	232,006	213,037	213,037	167,730	167,730	209,663
	Wage Growth			32,717	186,071	310,757	317,334	317,334	189,146	189,146	38,384	38,384	1,769	1,769	2,400	2,400	2,400
	Tax Growth			12,691	56,965	95,138	117,211	140,318	219,628	219,628	80,461	79,122	62,879	62,879	53,266	53,266	59,765
	Local Purchases Growth			2,786	3,673	6,177	68,940	95,598	111,565	111,565	11,509	11,509	1,540	1,540	-	-	
	Weighted Average DR																

**Based on tax filings. Prior annuals were first calculated based on Financial Statements.*

ANNEX 3: INTERNAL RATE OF RETURN CALCULATIONS

A3.1 Based on A2F-adjusted remaining unrealized assets (USD)

A-NET	Initial Investment	Total Realized	Unrealized Fair Value
A-NET Equity	1,500,000	1,742,949	0
A-NET Loan	700,000	1,037,256	
A-NET Integrated	2,200,000	2,780,205	

A-NET Equity

Period	Cash Flow
05/07/11	-1,500,000
05/07/12	322,934
05/07/13	322,934
05/07/14	322,934
05/07/15	322,934
09/30/16	451,211
12/31/16	0
XIRR	4.81%

A-NET Loan

Period	Cash Flow
05/08/11	-700,000
05/08/12	192,282
05/08/13	192,282
05/08/14	192,282
05/08/15	192,282
09/30/16	268,127
12/31/16	0
XIRR	13.56%

A-NET Integrated

Period	Cash Flow
05/07/11	-2,200,000
05/07/12	515,216.72
05/07/13	515,216.72
05/07/14	515,216.72
05/07/15	515,216.72
09/30/16	719,338.13
12/31/16	0
XIRR	7.69%

Bazi	Initial Investment	Total Realized	Unrealized Fair Value
Bazi Equity	187,252	2,478	0
Bazi Loan	2,292,751	21,515	0
Bazi Integrated	2,480,003	23,993	

Bazi Equity

Period	Cash Flow
08/15/08	-187,252
08/15/09	305
08/15/10	305
08/15/11	305
08/15/12	305
08/15/13	305
08/15/14	305
08/15/15	305
09/30/16	343
12/31/16	
XIRR	-50.51%

Bazi Loan

Period	Cash Flow
08/15/08	-2,292,751
08/15/09	2,648
08/15/10	2,648
08/15/11	2,648
08/15/12	2,648
08/15/13	2,648
08/15/14	2,648
08/15/15	2,648
09/30/16	2,979
12/31/16	0
XIRR	-52.80%

Bazi Integrated

Period	Cash Flow
08/15/08	-2,480,003
08/15/09	2,953
08/15/10	2,953
08/15/11	2,953
08/15/12	2,953
08/15/13	2,953
08/15/14	2,953
08/15/15	2,953
09/30/16	3,322
12/31/16	0
XIRR	-52.60%

Delta Comm	Initial Investment	Total Realized	Unrealized Fair Value
Delta Loan	3,000,000	4,221,862	0

Delta Loan

Period	**Cash Flow**
12/31/09	-3,000,000
12/31/10	900000
12/31/11	900000
12/31/12	845000
12/31/13	1,576,862

XIRR	13.78%

Dogan	Initial Investment	Total Realized	Unrealized Fair Value
Dogan Loan	700,000	262,210	0

Dogan Loan

Period	**Cash Flow**
06/16/09	-700,000
06/16/10	35,974
06/16/11	35,974
06/16/12	35,974
06/16/13	35,974
06/16/14	35,974
06/16/15	35,974
09/30/16	46,366
12/31/16	-
XIRR	-19.07%

Doki	Initial Investment	Total Realized	Unrealized Fair Value
Doki Equity	600,000	13,987	0
Doki Loan	2,400,000	601,968	0
Doki Integrated	3,000,000	615,955	0

Doki Equity

Period	**Cash Flow**
09/30/07	-600,000
09/30/08	2,433
09/30/09	2,433
09/30/10	2,433
09/30/11	2,433
09/30/12	2,433
06/30/13	1,824
XIRR	-58.19%

Doki Loan

Period	**Cash Flow**
09/30/07	-2,400,000
09/30/08	104,690
09/30/09	104,690
09/30/10	104,690
09/30/11	104,690
09/30/12	104,690
06/30/13	78,518
XIRR	-30.41%

Doki Integrated

Period	**Cash Flow**
09/30/07	-3,000,000
09/30/08	107,122.61
09/30/09	107,122.61
09/30/10	107,122.61
09/30/11	107,122.61
09/30/12	107,122.61
06/30/13	80,341.96
XIRR	-33.59%

Ecopex	Initial Investment	Total Realized	Unrealized Fair Value
Ecopex Equity	470,849	9,946	0
Ecopex Loan	1,650,000	921,337	400,000
Ecopex Integrated	2,120,849	931,283	

Ecopex Equity

Period	**Cash Flow**
12/15/08	-470,849
12/15/09	1,276
12/15/10	1,276
12/15/11	1,276
12/15/12	1,276
12/15/13	1,276
12/15/14	1,276
12/15/15	1,276
09/30/16	1,011
12/31/16	0
XIRR	-48.84%

Ecopex Loan

Period	**Cash Flow**
12/15/08	-1,650,000
12/15/09	118,246
12/15/10	118,246
12/15/11	118,246
12/15/12	118,246
12/15/13	118,246
12/15/14	118,246
12/15/15	118,246
09/30/16	93,612
12/31/16	400,000
XIRR	-3.88%

Ecopex Integrated

Period	**Cash Flow**
12/15/08	-2,120,849
12/15/09	119,523
12/15/10	119,523
12/15/11	119,523
12/15/12	119,523
12/15/13	119,523
12/15/14	119,523
12/15/15	119,523
09/30/16	94,622
12/31/16	400,000
XIRR	-7.80%

Foodmart	Initial Investment	Total Realized	Unrealized Fair Value
Foodmart Equity	93,750	1,875	0
Foodmart Loan	2,906,250	467,108	500,000
Foodmart Integrated	3,000,000	468,983	500,000

Foodmart Equity

Period	Cash Flow
01/25/11	-93,750
01/25/12	330
01/25/13	330
01/25/14	330
01/25/15	330
01/25/16	330
09/30/16	225
12/31/16	-
XIRR	-59.94%

Foodmart Loan

Period	Cash Flow
01/25/11	-2,906,250
01/25/12	82,229
01/25/13	82,229
01/25/14	82,229
01/25/15	82,229
01/25/16	82,229
09/30/16	55,962
12/31/16	500,000
XIRR	-19.91%

Foodmart Integrated

Period	Cash Flow
01/25/11	-3,000,000
01/25/12	82,559
01/25/13	82,559
01/25/14	82,559
01/25/15	82,559
01/25/16	82,559
09/30/16	56,186
12/31/16	500,000
XIRR	-20.37%

Madai	Initial Investment	Total Realized	Unrealized Fair Value
Madai Equity	500,000	34,719	0
Madai Loan	2,500,000	3,136,936	0
Madai Integrated	3,000,000	3,171,655	0

Madai Equity

Period	**Cash Flow**
02/02/09	-500,000
02/02/10	4,532
02/02/11	4,532
02/02/12	4,532
02/02/13	4,532
02/02/14	4,532
02/02/15	4,532
02/02/16	4,532
09/30/16	2,996
12/31/16	0
XIRR	-39.18%

Madai Loan

Period	**Cash Flow**
02/02/09	-2,500,000
02/02/10	409,462
02/02/11	409,462
02/02/12	409,462
02/02/13	409,462
02/02/14	409,462
02/02/15	409,462
02/02/16	409,462
09/30/16	270,700
12/31/16	-
XIRR	5.57%

Madai Integrated

Period	**Cash Flow**
02/02/09	-3,000,000
02/02/10	413,994
02/02/11	413,994
02/02/12	413,994
02/02/13	413,994
02/02/14	413,994
02/02/15	413,994
02/02/16	413,994
09/30/16	273,696
12/31/16	0
XIRR	1.31%

Piunik	Initial Investment	Total Realized	Unrealized Fair Value
Piunik Loan	2,000,000	3,094,815	0

Piunik Loan

Period	**Cash Flow**
12/01/08	-2,000,000
12/01/09	713,000
12/01/10	755,000
12/01/11	800,000
12/01/12	600,000
03/19/13	226,815
XIRR	19.34%

Prime	Initial Investment	Total Realized	Unrealized Fair Value
Prime Equity	110,000	2,200	0
Prime Loan	2,890,000	2,985,268	0
Prime Integrated	3,000,000	2,987,468	0

Prime Equity

Period	Cash Flow
01/27/09	-110,000
01/27/10	287
01/27/11	287
01/27/12	287
01/27/13	287
01/27/14	287
01/27/15	287
01/27/16	287
09/30/16	193
12/31/16	0
XIRR	-49.82%

Prime Loan

Period	Cash Flow
01/27/09	-2,890,000
01/27/10	388,960
01/27/11	388,960
01/27/12	388,960
01/27/13	388,960
01/27/14	388,960
01/27/15	388,960
01/27/16	388,960
09/30/16	262,548
12/31/16	-
XIRR	0.76%

Prime Integrated

Period	Cash Flow
01/27/09	-3,000,000
01/27/10	389,247
01/27/11	389,247
01/27/12	389,247
01/27/13	389,247
01/27/14	389,247
01/27/15	389,247
01/27/16	389,247
09/30/16	262,741
12/31/16	0
XIRR	-0.10%

Rcheuli Hotels	Initial Investment	Total Realized	Unrealized Fair Value
Rcheuli Equity	380,750	10,019	0
Rcheuli Loan	1,419,250	160,789	0
Rcheuli Integrated	1,800,000	170,808	0

Rcheuli Equity

Period	**Cash Flow**
12/15/08	-380,750
12/15/09	1,286
12/15/10	1,286
12/15/11	1,286
12/15/12	1,286
12/15/13	1,286
12/15/14	1,286
12/15/15	1,286
09/30/16	1,018
12/31/16	0
XIRR	-47.14%

Rcheuli Loan

Period	**Cash Flow**
12/15/08	-1,419,250
12/15/09	20,636
12/15/10	20,636
12/15/11	20,636
12/15/12	20,636
12/15/13	20,636
12/15/14	20,636
12/15/15	20,636
09/30/16	16,337
12/31/16	-
XIRR	-33.62%

Rcheuli Integrated

Period	**Cash Flow**
12/15/08	-1,800,000
12/15/09	21,922
12/15/10	21,922
12/15/11	21,922
12/15/12	21,922
12/15/13	21,922
12/15/14	21,922
12/15/15	21,922
09/30/16	17,355
12/31/16	0
XIRR	-35.50%

Ritseula Hesi	Initial Investment	Total Realized	Unrealized Fair Value
Ritseula Loan	3,000,000	3,967,242	0

Ritseula Loan

Period	**Cash Flow**
10/05/11	-3,000,000
10/05/12	945,000
10/05/13	1,070,000
12/31/13	1,952,242
XIRR	16.19%

Teremok	Initial Investment	Total Realized	Unrealized Fair Value
Teremok Equity	350,000	7,000	0
Teremok Loan	650,000	213,529	300,000
Teremok Integrated	1,000,000	220,529	300,000

Teremok Equity

Period	**Cash Flow**
12/24/10	-350,000
12/24/11	1,214
12/24/12	1,214
12/24/13	1,214
12/24/14	1,214
12/24/15	1,214
09/30/16	931
12/31/16	-
XIRR	-59.33%

Teremok Loan

Period	**Cash Flow**
12/24/10	-650,000
12/24/11	37,028
12/24/12	37,028
12/24/13	37,028
12/24/14	37,028
12/24/15	37,028
09/30/16	28,388
12/31/16	300,000
XIRR	-4.62%

Teremok Integrated

Period	**Cash Flow**
12/24/10	-1,000,000
12/24/11	38,242
12/24/12	38,242
12/24/13	38,242
12/24/14	38,242
12/24/15	38,242
09/30/16	29,319
12/31/16	300,000
XIRR	-12.09%

Tetnuldi	Initial Investment	Total Realized	Unrealized Fair Value
Tetnuldi Loan	1,900,000	1,564,505	0

Tetnuldi Loan

Period	**Cash Flow**
12/04/08	-1,900,000
12/04/09	200,008
12/04/10	200,008
12/04/11	200,008
12/04/12	200,008
12/04/13	200,008
12/04/14	200,008
12/04/15	200,008
09/30/16	164,451
12/31/16	0
XIRR	-4.22%

	GRDF Loan		
	Net Cash flow	Cash Inflow	Cash Outflow
12/31/07	-2,400,000	0	-2,400,000
12/31/08	-9,157,311	104,690	-9,262,001
12/31/09	-7,930,772	1,159,228.31	-9,090,000
12/31/10	2,285,625	2,935,625	-650,000
12/31/11	-3,588,597	3,017,653	-6,606,250
12/31/12	3,982,164	3,982,164.22	
12/31/13	6,391,911	6,391,911	
12/31/14	1,487,474	1,487,474	
12/31/15	1,487,474	1,487,474	
09/30/16	2,090,121	2,090,121	
12/31/16	1,200,000	1,200,000	
Total	**-4,151,911**	**23,856,340**	**-28,008,251**
IRR	-4.32%		

	GRDF Equity		
	Net Cash flow	Cash Inflow	Cash Outflow
12/31/07	-600,000		-600,000
12/31/08	-1,036,418	2,433	-1,038,851
12/31/09	-604,700	5,299.86	-610,000
12/31/10	-339,882	10,118	-350,000
12/31/11	-1,582,418	11,332	-1,593,750
12/31/12	334,597	334,596.75	
12/31/13	333,989	333,989	
12/31/14	332,164	332,164	
12/31/15	332,164	332,164	
09/30/16	463,076	463,076	
12/31/16	0	-	
Total	**-2,367,428**	**1,825,173**	**-4,192,601**
IRR	-16.26%		

	GRDF Blended				
	Net Cash flow	Net Cash flow for Net IRR	Cash Inflow	Cash Outflow	Mgmt. fees
12/31/07	-3,000,000	-4,218,052	0	-3,000,000	1,218,052
12/31/08	-10,193,729	-11,565,018	107,123	-10,300,852	1,371,289
12/31/09	-8,535,472	-9,891,829	1,164,528	-9,700,000	1,356,357
12/31/10	1,945,743	837,205	2,945,743	-1,000,000	1,108,538
12/31/11	-5,171,015	-6,393,750	3,028,985	-8,200,000	1,222,735
12/31/12	4,316,761	3,191,569	4,316,761		1,125,192
12/31/13	6,725,899	5,772,514	6,725,899		953,385
12/31/14	1,819,638	1,047,241	1,819,638		772,397
12/31/15	1,819,638	1,111,201	1,819,638		708,437
09/30/16	2,553,197	2,248,208	2,553,197		304,989
12/31/16	1,200,000	1,200,000	1,200,000		
Total	**-6,519,339**		**25,681,513**	**-32,200,852**	**10,141,371**
IRR	-5.92%				
Net IRR	-14.22%				

ANNEX 4: DETAILED CASE STUDIES

A4.1. PIUNIK

a) Company Background & Performance

Piunik Georgia LLC (Piunik) is poultry focused agribusiness in the Kaspi region. Piunik was established in 2008 as a spin-off of the poultry business lines of two existing agribusinesses, Lego Ltd. and West Gold Ltd that had been operating since 2002. A shareholder from each of these companies formed a partnership to take sole ownership of this spin-off hoping to realize the potential for growth in the hatching eggs import business.

Importing hatching eggs and day-old chicks was a core business of Piunik. It had been importing hatching eggs and day-old chicks from a company in Armenia, owned by a Piunik shareholder, to sell in Georgia since 2002. The import business was well established and Piunik had a strong customer base for its high-quality products in Georgia. However, management sought to increase capacity and limit supply concentration risks by growing local production.

The company sought to expand into local production of hatching eggs, consumer eggs, day-old chicks, and animal feed. This vertical integration would allow Piunik to reduce its dependence on imports from a single supplier and improve profit margins—for hatching eggs, the margin was expected to increase from 25 to 35%. At the time of investment, Piunik had the capacity to produce 6,400 eggs per day and 3 tons of animal feed per hour. The company had purchased an existing chicken farm in Noste within the Kaspi region and planned to modernize it to meet European sanitary standards and to increase annual production capacity to up to 3 million hatching eggs, 1 million day-old chicks, 4.5 million consumer eggs, and 14,400 tons of animal feed. It needed financing for farm equipment, hens, and working capital to upgrade its facilities.

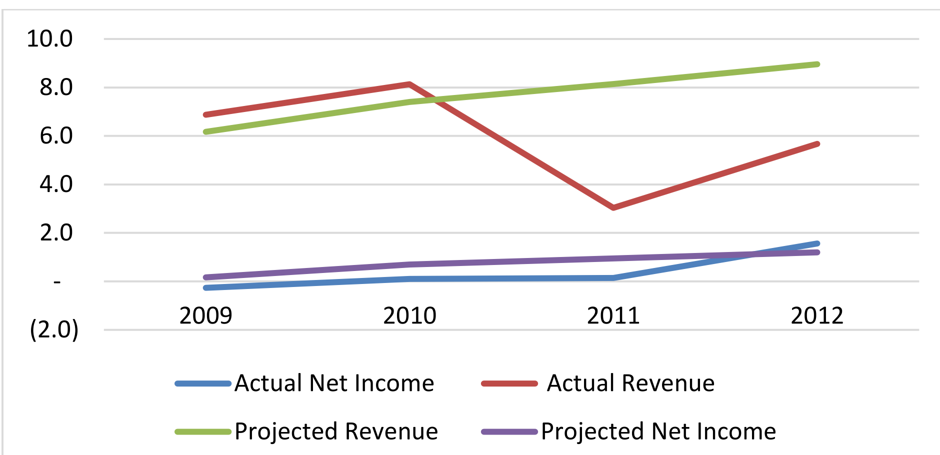
Piunik received USD 2,000,000 (GEL 2.8 million) participatory debt from in December 2008. The total size of the project was estimated USD 2,600,000. The company shareholders had already financed about 23% of the cost—amounting to USD 600,000. GRDF financed the remaining 77% of the cost—amounting to USD 2,000,000. The GRDF investment was to be used to finance the development of a local poultry and feed mill facility. The major share of the investment was planned to be spent on plant facility development and purchasing equipment.

Following GRDF investment, Piunik created a stable local base to produce hatching eggs, and laying and broiler chicken varieties to supply to local distributors. The investment increased company's ability to hire and train new staff—which in turn increased employment and wages. Upon opening its farm, the management brought in an Armenian poultry technical expert on a one-year contract to train local staff. Following GRDF investment, Piunik experienced substantial revenue growth in the first two years**.** Revenues reached GEL 6.8 million in 2009 and 8.1 million in 2010, representing 110% and 109% of projected numbers, respectively. Demand growth was significant in the first two years. Piunik's farm was initially designed to contain 9,000 egg-laying hens; however, higher demand for locally produced eggs led to an increased capacity of 15,000. In addition, the import business continued contributing to company's revenue.

Higher demand for locally produced eggs led to higher costs than planned—weakening net margins 2009. Higher costs resulted from increased demand for locally produced eggs—requiring the increase in the number of hens to 15,000 from 9,000. This had a significant cost impact in two ways: 1) limited local production at the time required higher number of expensive imports, and 2) higher costs associated with increasing the number of hens. The Company started local production of hatching eggs at the end of April 2009, but the farm had not yet started running at full capacity.

Early indications from the higher demand led management to change strategy and invest in another farm to increase the number of egg-laying chickens. Some of the GRDF funds were diverted towards this new farm purchase. SEAF and management agreed to the change in strategy as the investment would have positive implications and improved margins by the end of 2010 when the company could ramp up production and increased import substitution. Indeed, Piunik's revenues and margins were increasing primarily due to the egg-hatching business.

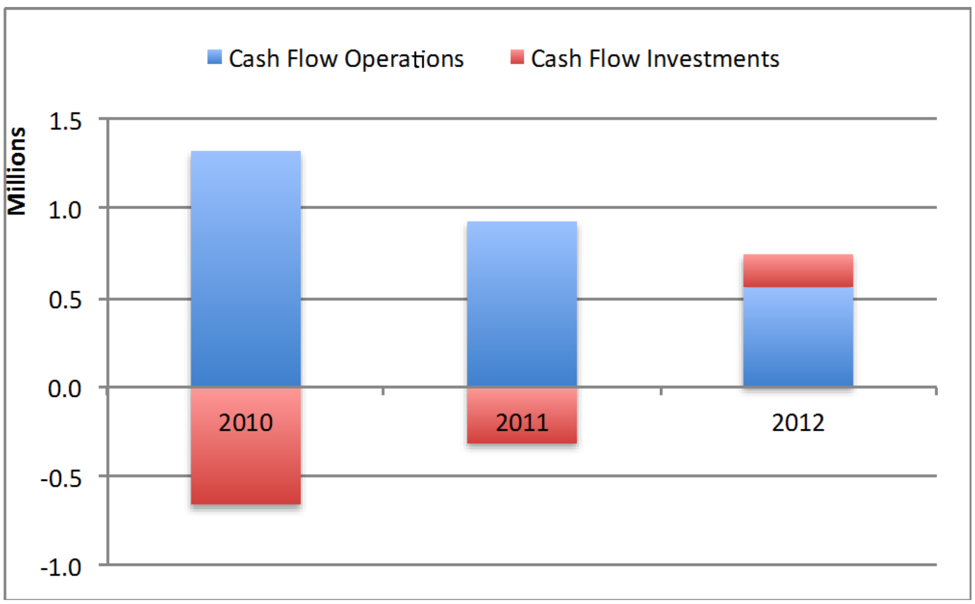
Figure 14: Actual vs. Projected Revenue and Net Income (GEL millions)



Piunik wanted to refinance the GRDF loan as soon as 2010. Piunik was offered a refinancing proposal by TBC bank with a 6-year term loan at an annual rate of 13%. The price of the bank's loan was significantly lower than GRDF's cost since there was no royalty. However, the GRDF Board denied the request as prepayment of the loan was not permitted without a 50% penalty on the outstanding principal amount as per the investment agreement. SEAF had recommended waiving these exit terms and the penalty was substantially reduced. The divestment proposal of USD 1,538,322 was approved by the Board in September 2010. However, the amount and timing of its execution was at the fund manager's discretion. Findings from the field revealed that SEAF did not want Piunik to exit but rather preferred to continue to work with them as it was a promising investment with attractive earning potential.

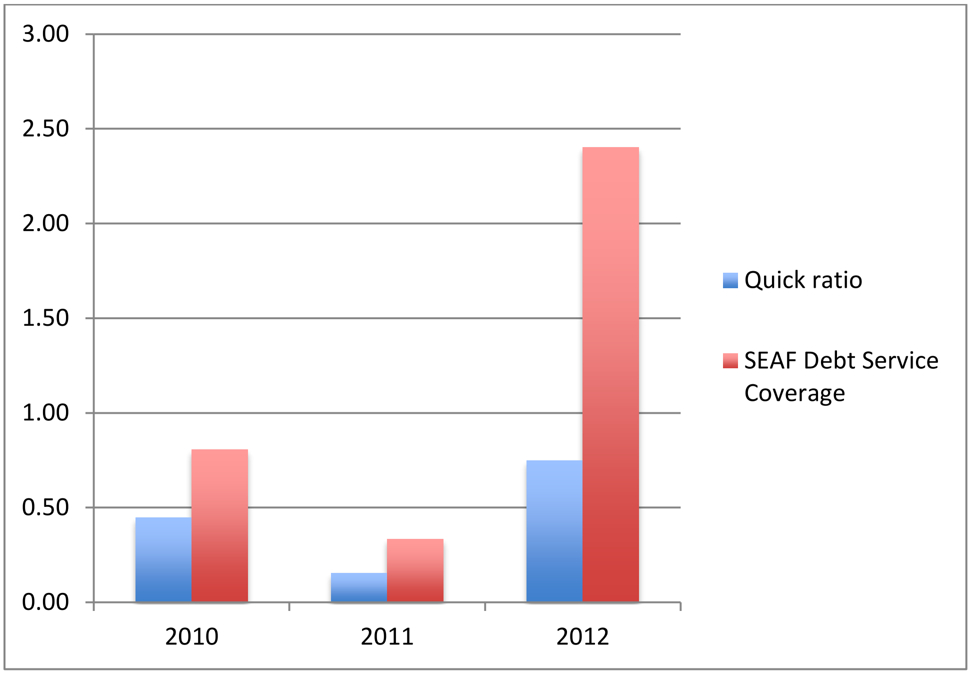
Investments in 2010 and 2011 were financed by internal cash flows. The company continued to renovate additional farms to grow the local production business given the robust demand for the product. By this time, it was clear that the production of local hatching eggs was a winning proposition. Therefore, in 2011 the company opened another poultry plant financed by internal cash flows. Cash flows from operations would continue to be reinvested throughout.

Figure 15: Cash Flows from Operations and Capital Expenditures (USD millions)



Higher working capital needs from expansion and high debt servicing requirements threatened liquidity. While the change in strategy was, a positive development given the accelerating growth of locally produced hatching eggs, farm expansion required capital expenditures and financing of working capital needs. Additionally, the high debt servicing requirements exposed Piunik to high liquidity risks as the royalty fee and principal repayments ate into cash flow from operations. Management, however, remained convinced that the farm and poultry plant investments would pay-off and that the decline in liquidity would be temporary as capacity and capacity utilization increased.

Figure 16: Key Liquidity Indicators



Robust local production substantially decreased reliance on imports and the business evolved. Imports represented over 50% of sales but were a lower margin business line compared to local production. Piunik's farm was originally designed to have 9,000 egg-laying hens; by May 2011, due to increased demand for locally produced eggs, the company had increased the number of hens to 32,000. This allowed it to exit the imports business. The business had evolved to serve larger clients and starting from second half of 2011, Piunik added incubation services as an offering to its customers instead of only selling hatching eggs.

Piunik continued to improve net margins in 2012 and reinvest in the business. There was still unmet demand and, by February 2012, it had renovated a fifth farm to add an additional 18,000 hens. Lower revenue volumes resulting in lower cash flows meant that a greater percentage of cash flows were being consumed by interest and debt payments on the GRDF loan. In 2012, Piunik expressed to SEAF an interest in refinancing with a low-cost loan advertised by the Government of Georgia. The Government of Georgia had recently initiated a low interest rate loan program for agribusinesses. The GRDF Board accepted the exit terms, subject to a smaller prepayment fee—resulting in an IRR of 21.5%.

Piunik has been a transformative business. The company received "Mercury Award" from the Ministry of Economics and Sustainable Development for introducing a new business in the country. With increased capacity over the years, the company has been able to reduce costs and increase net income. During discussions, the CEO revealed that chicken production cost has been reduced by nearly 50% since the GRDF investment. The company has already started exporting its products to Azerbaijan and Armenia and it plans to increase exports over the next few years.

b) Review of Investment Process

i. Pre-Investment Phase

Piunik appeared in the pipeline as a referral from the Agriculture Development Activity (ADA). Prior to the end of ADA activity, ADA and SEAF shared information on potential investment and grants and on agribusiness research reports. ADA referred Piunik as a potential Investee. In 2008, the company approached SEAF for financing the business expansion.

The due diligence process was thorough and informed by SEAF's agriculture consultant. Site visits to the proposed farm gave SEAF a clear idea of what kind of asset the money would support. Conversations with management and their prior experience in the poultry business, which were highly valued, and recent figures from the limited operational history were the basis for detailed cost structures. A stable supply source and existing relationships were also positively highlighted. As the initial plan was to expand existing business lines, growth projections were extrapolated from recent data and growth for the new hatching egg local production business was modest. Projections were conservative as debt servicing was based on the original plan of vertical integration to cut costs of the existing business lines. The expansion of local hatching eggs was seen as a low risk growth opportunity from which the royalty would provide additional returns.

The proposed financing structure fit the initial cash flows of the business and there was sufficient room to let it evolve over time. SEAF proposed a participatory loan with a fixed interest rate and royalty component. This structure worked well in the initial years. The evolution of the business would differ from the initial plans involving additional investment from internal sources. Careful strategy planning enabled Piunik to meet debt-servicing capacity. Therefore, the financing structure seems to have been appropriate. Furthermore, given the high leverage in the deal, several safeguards including a substantial contribution from shareholders, guarantees on personal property, and collateral were designed to mitigate potential losses. The structured participatory loan was projected to generate an IRR of 23.9%

The Board's investment proposal discussion was primarily focused on increasing the expected returns by including an equity stake. The Board's review homed in on adding an equity component given the perceived importance of a promising agribusiness investment and boosting returns. This was ultimately rejected by Piunik shareholders, which opted for debt and insisted on organic growth driven by internal cash flow generation. Despite this, the Board decided to proceed with the investment given the agribusiness is a priority for GRDF. However, the Board insisted that the interest rate be increased as a compensation—from 12% to 13%—and subsequently the projected IRR increased from 23.9% to 25.1%.

ii. Post-Investment Phase

SEAF proposed several technical assistance (TA) projects for Piunik, which improved the risk profile of the company and built management capacity in the areas of business planning and forecasts. Piunik's business, as most agribusinesses, was characterized by opaque financial reporting and operating data. The TA provided the company with the necessary tools to track business performance and most importantly, company finances. The Enterprise Resource Planning (ERP) system and financial management TA projects significantly improved Piunik's planning and financial management capabilities. Moreover, the ERP was tailored to Piunik's business needs and the business modules were configured.

SEAF proposed various other TA services for Piunik to improve financial accountability and transparency. These proposals were developed for multiple companies. Piunik was included in some of the TA services such as:

- Improvement of Financial Management, Accounting & Reporting (2009)
- Financial Accountability and Transparency Assessment TA (2010)
- Managerial Accounting Consultancy TA (2010)
- Tax Consultancy TA (2010)
- Financial Audit TA (2010)

Table 10: Technical Assistance Provided (USD)

Type	Facility Cost	Cost Share	Cost Share %
ERP Implementation	103,776	34,592	25%
Marketing Consultancy	4,384	-	N/A

SEAF was an active participant in company strategy and monitoring. Together with SEAF, management made the decision to change strategy and focus on local production of hatching eggs. Furthermore, the implementation of the ERP system and financial management systems dramatically improved business intelligence and reporting. This facilitated the frequent monitoring of the company position. While the Piunik Board was less formal, this was not atypical for this type of business.

SEAF exited the company in Q1 2013—one year earlier than planned. SEAF had negotiated an exit with a return of 20.76% that was subsequently rejected by the Board over a disagreement with penalty fees (as the Board wanted SEAF to renegotiate with a higher fee). Those negotiations failed and the delay in accepting the original offer led to a slightly lower 19.3%. The exit came about without much SEAF involvement as Piunik was approached by a local bank that offered government-subsidized loans in the sector.

c) Assessment of GRDF Contribution

i. Additionality

Piunik had limited options to finance the planned expansion and GRDF offered less stringent collateral and the backing of a prominent international investor. The current CEO of Piunik revealed that he tried to obtain loans from other banks before he was exposed to GRDF but Georgian banks were reluctant to provide loans. The banks also required high collateral or guarantees. Sometimes, he was asked to provide collateral property of USD 10 million for a USD 2 million loan, which the company was unable to provide. Piunik management indicated that other options included internal cash flows which would have resulted in a relatively slower growth process.

Management indicated that they saw SEAF as a partner even if interaction was less formal. Despite being a loan, SEAF was an active participant in company strategy and monitoring in the initial phase and worked with the management to fine tune the business strategy and operations. The decision to focus on local production of hatching eggs was a joint decision of both SEAF and Piunik. SEAF's contribution was mainly confined to financial and technical assistance; however, working together increased partnership between the two.

The technical assistance provided by GRDF was also viewed as a value enhancer that was unavailable from other potential funders. During the Interview, the Piunik CEO revealed that the technical assistance components were very useful for company's business. The ERP system, for example, helped the company manage its day-to-day operation efficiently. It also helped in tracking the company's performance on a regular basis.

ii. Effectiveness

The financing provided by SEAF was very effective even though liquidity was an issue after the change in strategy. Structuring and projections were accurate in the initial years and provided enough room for the company to evolve in the short term. Refinancing, however, was needed for the company to maintain liquidity. Management indicated that GRDF would have been even better if they did not have to pay the 1.9% royalty off top-line revenue. This, in combination with the interest rate, was considered high and was a burden on cash flows, which were relied upon to fund further expansion.

The exit effectiveness of GRDF investment is questionable because the fund exited the company several years before the original maturity date. However, it is to be noted that the bank approached the company once it was established by the GRDF investment. SEAF realized that management was a good partner and that rolling over GRDF debt or keeping it in place would not be in the best interest of the company and could potentially sour the relationship—therefore it facilitated the refinancing with the bank.

The fund exited the company on March 19, 2013 with IRR of 19.3%. The company still needed time and financing to maintain business growth. SEAF debt was amortized, meaning large principal repayments were done on a yearly basis. It therefore sought longer-term stable financing. Piunik took advantage of the low interest rate program initiated by the Government of Georgia for agribusinesses and was able to refinance GRDF debt with a 3% loan.

GRDF investment made the company self-reliant. The company was able to rely on internal cash flows to further invest in facilities and grow production. The company was able to use cash flow to further expand as revenue and profits increased. It started providing incubation services for its customers. Management did indicate that GRDF would have been even better if they did not have to pay such a high interest rate or the 1.9% royalty.

iii. Attribution

GRDF's financial support and technical assistance provided the necessary support for management to excel and take advantage of business opportunities when they arose. The eventual success of Piunik is mostly due to management's ability to adapt to the market and ascertain the needs of their customers. However, SEAF strategy consultations, marketing assistance, and management system upgrades helped Piunik become a more formally managed business. The flexibility in operations permitted and promoted by SEAF and the loan financing structure were definite advantages. Management noted that the financing they received from GRDF was adequate and appropriate for the needs of their businesses.

The success of Piunik was based on idiosyncratic factors rather than any secular trend in the industry. Macroeconomic indicators show that domestic production of poultry meat declined from 12.9 thousand tons in 2008 to 11.7 thousand tons in 2012. To meet the unmet demand, imports increased from 36.9 thousand tons in 2008 to 45.5 thousand tons in 2012. During this period, Piunik's local production of chicken meat increased—defying the overall macroeconomic trend allowing the substitution of all imports by local poultry production.

Table 11: Supply of Poultry Meat in the Country ('000 Tons)

Year	Domestic Production	Imports	Total Supply	Share of Domestic Production (%)	Share of Imports (%)	Self-Sufficiency Ratio (%)
2008	12.9	36.9	49.8	25.9	74.1	26
2009	12.4	39.1	51.5	24.1	75.9	24
2010	11.6	40.8	52.4	22.1	77.9	22
2011	12,0	45.4	57.4	20.9	79.1	21
2012	11.7	45.5	57.2	20.5	79.5	21
2013	10.1	44.6	54.7	18.5	81.5	18
2014	15.2	47.0	62.2	24.4	75.6	25
2015	19.1	42.7	61.8	30.9	69.1	31

Source: Agriculture of Georgia, GEOSTAT

iv. Relevance

The Piunik investment was highly relevant to the GRDF objectives and it embodied all the aspects that MCC had highlighted in creating GRDF. Piunik is the ideal company as defined in the Operating Agreement—an agribusiness involved in the secondary market, a SME with operating history established outside of the developed areas of Tbilisi in a business line, which could have a substantial development impact while achieving a high financial return of 19.3% IRR.

Piunik had an overwhelmingly positive weighted average development return. Annual increases in the company's revenue, wages, taxes, and local purchases were remarkable. Piunik had an annual average development return of 34% from 2009 through 2012. Notably, the overall development return was driven primarily by wage growth resulting from increased employment and wages. The shift in business strategy led to less revenue volumes in 2011 and subsequently negative growth for that year. However, this turned out to be more profitable and sustainable, and ensuing years show a recovery in the development return indicators.

The development impact can be observed by the replacement of imports in favor of local Georgian production and capacity building in the sector. There was no farm in Georgia producing breeding chickens during the investment period. Companies and private households were importing hatching eggs and day-old chicks from large enterprises and third party sellers, including Piunik. The company replaced imported eggs with local production—improving self-sufficiency. It also contributed to the development of local expertise, bringing in an Armenian poultry expert for more than a year to train local staff and bringing industry experts from Israel to provide trainings to farmers on poultry vaccination practices.

Table 12: Breakdown of Development Returns

	2009	2010	2011	2012
Actual Revenue Growth	100%	23%	-63%	86%
Actual Wage Growth	100%	62%	53%	18%
Tax Growth	27%	29%	-40%	55%
Local Purchases Growth	100%	13%	-61%	31%
Development Return	82%	32%	-28%	48%
Projected	**21%**	**21%**	**21%**	**21%**

A4.2. Teremok

a) Company Background & GRDF Performance

Teremok Group Ltd (Teremok) was a chain of quick-service Slavic restaurants. The first restaurant opened in 2006 as a family pancake house, which quickly built a strong customer base. There were six restaurants in Tbilisi at the time of investment operating under the Teremok trademark. The business, registered under the ownership of two different individuals, was managed by a single management group. Each restaurant was operating as a separate legal entity and, to maintain consistency, all the restaurants shared a similar design and operating style. After the GRDF investment, shareholders established a Limited Liability Company with a chain of affiliated restaurants and planned to expand further into the region—consolidating the existing restaurant operations under the ownership of one umbrella company.

Teremok sought funding from GRDF to finance the opening of six new restaurants outside Tbilisi. Management's experience revealed that Teremok's expansion resulted in increased brand awareness and attracted more customers to existing locations. Further expansion into the region and positive macroeconomic conditions including the stabilized economy and expected tourism growth in the country was expected to accelerate Teremok's revenue growth. The management expected to benefit from the demand for their products by increasing their customer base through expansion into new locations.

In December 2010, the GRDF approved a USD 650,000 loan and a USD 350,000 equity investment. GRDF capital was to help finance the acquisition of fixed assets and working capital needed for the expansion. The new company planned to use GRDF funds to acquire the necessary fixed assets for expansion into the Bakuriani, Gudauri, Kobuleti, Batumi, Kutaisi and Telavi regions. The funds were to be used for building renovations, the purchase of furniture and equipment and to finance working capital.

However, a delay in the investment disbursement led to change in the expansion plan. Legal due diligence and pre-condition fulfillment such as registration of necessary information within the public registry took longer than expected. As a result, Teremok received the initial investment in March 2011 instead of January. Teremok began the construction of its planned locations in Q2 2011. The delay in the investment disbursement resulted in the cancellation of two locations expected to operate seasonally and construction delays in full-year locations. Initial expansion plans were not achieved and though management sought to replace seasonal locations by forming a partnership with Aqua park to operate in three of their locations during Q2 and Q3 of 2011, the limited expansion adversely affected the first year of expected revenue and income growth.

The Aqua park partnership was not thoroughly planned nor supported by all shareholders. While the partnership was approved, some shareholders expressed reservations. The proposing shareholder had an existing professional relationship with

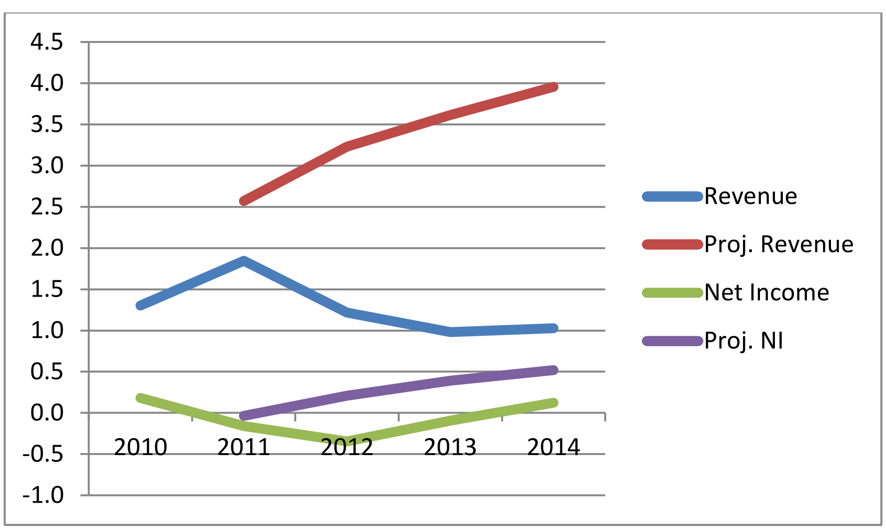
Aqua park; it was this shareholder that introduced the Aqua park proposal to Teremok's management. Aqua park was a reputable recreational park and had an established customer base, which Teremok sought to capitalize on to increase potential revenues.

Lack of demand and delays in location openings led to substantially lower sales. Revenues came in much lower than expected. Two newly opened locations (e.g. Gldani Meria, Lilo) took longer than anticipated to reach sales targets. Sales were predominately dependent on existing locations in 2011 even though there were 10 locations operating by the end of 2011. Furthermore, costs escalated due to marketing expenses, new staff recruitment, and increases in rents.

Low sales volume quickly led to arrears on the GRDF investment. Projections were off by the first year. Instead of the GEL 2.5 million expected in 2011 only 1.8 million was realized. Many of the new restaurants underperformed resulting in low sales and revenues. Teremok subsequently failed to service the GRDF investment with plans to restart once locations reached higher utilization. Revised projections were slashed and SEAF expected payments to restart by the end of 2012.

Frequent changes in management in the first year prevented stability in finances and operations. Management changed 3 times between 2011 and 2012. Targets were not met and the company was not able to generate enough cash flow. It took a short-term loan from a bank in 2012 to pay salaries and other creditors. Limited cash flows were diverted to pay outstanding liabilities—e.g. construction payments, employee payments and suppliers—resulting in a 2012 revenue far below those generated prior to investment.

Figure 17: Actual vs. Projected Revenue and Net Income (GEL millions)



Teremok's managing shareholder left the company in the middle of 2012. Poor performance led other shareholders to begin to question management over the misuse of funds and expectations—causing the managing shareholder to leave the company. This incident resulted in a misunderstanding among the shareholders and divided the non-GRDF shareholders in two, further limiting communication among them. Subsequently, each shareholder group tried managing operations independently. Lack of consensus among the shareholders on the business strategy worsened operations. SEAF was asked to mediate and oversee operational spending. SEAF recommended that shareholders with financial background oversee finances and shareholders with operational management experience oversee operations. This, however, did not resolve the misunderstandings.

The Aqua park relationship grew tense in 2013 as expected revenues failed to materialize. The restaurant's plan at Aqua park did not turn out as expected. A dispute with Aqua park over the breach of contract erupted into formal legal proceedings—halting operations at the location. The dispute stemmed from an unexpected fire in the building where Teremok had already spent USD 250,000 for renovations. Aqua park did not want to continue with Teremok—resulting in a breach of contract—and declined to pay for expenses Teremok incurred for opening a new restaurant. The lawsuit added to company woes and further contraction. In February 2014, Teremok applied to the court for a USD 400,000 payment—the advance payment to Aqua park of USD 150,000 and Batumi location construction expenses totaling USD 250,000.

New management struggled to generate enough cash flows to service debt and maintain working capital needs. Closures accelerated between 2013 and 2015 as three locations were closed in 2013 and 2014. New management considered closing two additional locations in 2015. Any cash flows generated were allocated to reducing accrued liabilities—suppliers and salaries. The company experienced a decrease of 41% in revenues in 2015 over the previous year. Only two locations have been operating since late 2015.

The GRDF investment exit has been realized through a shareholder settlement. The Board recently approved a Teremok settlement agreement on USD 480,000 in June 2016; with the amount payable in three tranches by the end of September 30th, 2016. The settlement agreement was signed in July and first two tranches in amount of USD 180,000 were paid by non-GRDF shareholders. Repayment of the third tranche has been delayed but is anticipated in Q4 2016 in the amount of USD 300,000.

Table 13: Evolution of Teremok's GRDF Payments in Arrears

Year	Overdue Balance USD	Number of Days Over Due	Reason and strategy for Recovery

2011	USD 23,808– – Interest/Fees	1 to 92 days	The Company was approximately 90 days late on payments. Given the delays in completion of the BATUMI location, the planned opening in Bakuriani, longer than anticipated time needed for newly opened locations (e.g. GLDANI, Meria) to attract customers and reach targeted results, and relatively low operational Q4 for restaurant operations, the shareholders concentrated cash flows to accommodating growing working capital and opening needs. The repayment was planned once the new locations would pick up sales and once the Aqua-park and Batumi locations were opened in 3rd-4th quarter.
2012	USD 111,342 – Interest/Fees USD 102,703 – Principal	1 to 452 days	The Company was in transition for most of the year, with new management stepping in Q4 2012. While some of the issues are clarified/streamlined (calculation of liabilities, legal due diligence performed, cases won/solved), the Company had limited free cash flow, with all the efforts mobilized towards opening the Bakuriani winter location in Q1 2013 and repayment of accrued liabilities to suppliers/employees. As such, no repayments were made to GRDF in Q4 2012. To repay all operational liabilities and outstanding payment to GRDF, the Company is considering the sale of its restaurant located in Batumi. With the sale, Teremok, as the renter, could benefit USD 400,000.
2013	USD 194,289.52 – Interest/Fees USD 285,136.01 – Principal	1 to 823 days	The company had limited available cash flow, with all efforts mobilized towards sustaining operations and the repayment of accrued liabilities to suppliers/employees. The fund manager planned to propose a TEREMOK Loan Restructuring plan to the GRDF Board during the May 16th in person meeting. The plan had been designed to give the company more time to concentrate on the repayment to suppliers and the recovery of operations.
2014	USD 262,395.30 – Interest/Fees USD 467,568.01 – Principal	1 to 1,188 days	The Company's cash flow is not sufficient to cover GRDF liabilities due. Therefore, SEAF proposed a divestment proposal that includes the equity exit at cost and the loan write down to USD 250,000. The respective divestment proposal was sent to the Board on March 31st, 2015.
2015	325,723.75 – Interest/Fees USD 650,000 – Principal	1 to 1,553 days	The potential for TEREMOK's business to repay the GRDF loan was low; therefore, there had been a discussion on settlement with Non-GRDF shareholders. The summary was provided under the qualitative strategy sheet, with the Settlement Proposal presented during the March 2016 Board Meeting. The Board suggested SEAF negotiate a precise repayment schedule with Non-GRDF shareholders in light of the latest liquidation discussions.

Source: GRDF annual reports

b) Review of Investment Process

i. Pre-Investment Phase

SEAF sourced the Teremok deal based on its actual experience of dining in the restaurant. Some of the SEAF staff were regular customers of Teremok and they were aware of its growing business. Discussions were the result of SEAF approaching management to discuss a potential partnership. Teremok management wanted to partner with SEAF given the perceived advantages of GRDF investment, which included a higher profile from having an international investor.

Due diligence was based on subjective rather than actual market analysis. SEAF heavily relied on the management's subjective perspective of demand, supply, and other market factors, such as existing competitors in the new locations. No empirical market analysis was carried out and the Teremok investment officer had no requisite experience in the sector or in this type of due diligence analysis. This resulted in poor subjective based market analysis. Moreover, future performance was extrapolated from past sales, revenues, and profitability from existing restaurants—it was believed that the new restaurants in new locations would perform as well as those in the existing locations. However, the restaurants in the new locations did not perform as expected.

Due diligence was too optimistic on the quick transition and replication of Teremok's operational efficiency through economies of scale. Six restaurants were operating before the GRDF investment. The synergies from the economies of scale were overestimated and did not account for typical growing pains. While Teremok had established a supply chain for all the planned restaurants, management likely overestimated their ability to quickly procure locations, train staff, and develop a strong customer base.

Not enough focus and consideration was given to expansion risks. The execution of the project largely depended on the managerial capability of the company—identification of new locations, construction and opening of new restaurants as planned, and recruiting new staff. Even with a knowledgeable and experienced management team, the additional responsibilities of business expansion posed a risk. It was believed that management's direct experience in site selection would mitigate the expansion risks associated with it. Management assumed that temporary relocation of existing staff to a new location would mitigate the risk of staff recruitment.

Demand was assumed based on subjective assessment by Teremok management. Teremok's business concept and menu would be new to the selected locations and the demand for its product was unknown. Failure to attract demand would have adverse effects on the business. Teremok's brand awareness and affordable prices were expected to minimize the risks of market acceptance.

The investment structure was atypical compared to SEAF's other investments given the higher equity to debt mix. The fund manager proposed a total USD 1,000,000 investment—combining a USD 650,000 loan with a USD 350,000 equity investment. Equity financing was offered as SEAF saw the ability to negotiate a favorable ownership percentage along with providing the company with the necessary buffer during expansion phase.

SEAF utilized both Discounted Cash Flow (DCF) analysis and Market Multiple Analysis to arrive at the USD 1 million (1.8 million GEL) valuation of Teremok to negotiate a 35% share ownership. The Market Multiple Analysis was based on a similar restaurant in Ukraine with an 8.4x multiple applied to Teremok's 2009 EBITDA. DCF assumed a growth in revenues from GEL 1.3 million in 2010 to GEL 4.2 million in 2015. These figures were too optimistic and led to overvaluation. The choice of multiple was also not very comparable. To ensure a "fixed return" SEAF negotiated a put option available after 2014 and a mandatory redemption at end of 2015. The put option was to guarantee at least a 22% IRR return. All non-GRDF shares were also pledged.

A 10% giveback on the equity ownership was to incentivize management. SEAF negotiated a 45% ownership stake with 10% giveback to management dependent on certain financial goals including revenue projections, margins, and dividend payments. Concerning dividend payments, SEAF negotiated a mandatory 80% dividend payout ratio commencing end of year 2012. Dividends are paid out to shareholders out of profits. Teremok was not able to turn a profit with non-payment of debt service and therefore never paid out dividends.

ii. Post-Investment Phase

High growth rates were based on a smooth transition towards regional expansion, the realization of demand potential envisioned by management, and high capacity utilization. The large jump in sales in 2011 was expected from high winter volumes in Bakuriani and Gudauri and the opening of four additional locations. The 26% sales projected for 2012 stemmed from a full year of operation after establishing all new restaurants. From 2013 to 2015, sales would grow from stabilized operations in all Teremok restaurants. This stabilized rate was the result of SEAF's projections that were based on Teremok's daily sales experience in Tbilisi and SEAF's observations of restaurant operations in two GRDF financed hotels (Rcheuli and Tetnuldi).

Revenue projections were rather ambitious given the lack of market analysis and were mostly driven by management expectations. Indeed, the projections appear to have extrapolated the results from established locations to the new sites despite being in untested regions. The market conditions, including expected demand for and supply of Teremok's products, in the new locations were not known. Furthermore, management had little knowledge of existing, well-established competitors in the new locations. Even if competitors were known, the potential threat from them was undervalued given the subjective expectations and implied overconfidence in their own products.

Technical assistance (TA) projects improved Teremok's management system and increased staff skills. A Restaurant Management System Deployment TA helped Teremok organize front and back-office management with accurate and up to date reporting—promoting efficient analysis of financial information. This TA automated business processes resulting in increased efficiency in decision making through accurate reporting and analysis. Furthermore, a Staff Training TA was provided to train Teremok staff in food and beverage service techniques, food preparation, food handlings, dining room services and safety and sanitation. The TA increased employee's skills and ensured consistency in all the Teremok restaurants.

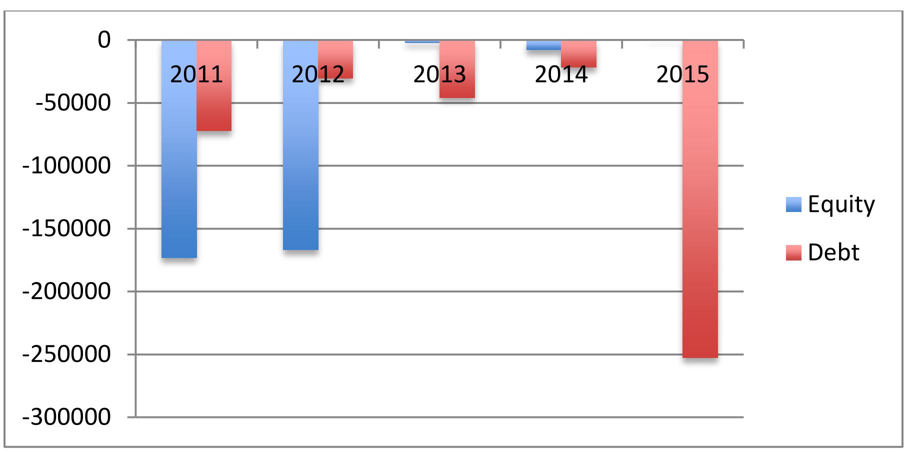
In addition, SEAF proposed various other TA services for Teremok to improve financial accountability and transparency. These proposals were developed for multiple purposes:

- ISO Consulting (March 2011)
- Brand Consulting (March 2011)
- Improvement of Financial Management, Accounting & Reporting
- Financial Accountability and Transparency Assessment TA
- Managerial Accounting Consultancy TA

Table 14: Technical Assistance Projects Financed by the Technical Assistance Facility

Type	Facility Cost	Cost Share	Cost Share %
Staff Training	USD 56,000	-	0%
Restaurant Management System Implementation	USD 55,800	USD 6,200	10%
ISO Consultancy	USD 20,460	USD 1,540	7%
Marketing Consultancy	USD 29,246	-	0%
Total	USD 161,506	USD 7740	

Figure 18: Change in Equity and Debt Fair Market Valuations (USD)



Valuations were consistently written down and by 2014 were dependent on potential Aqua park court outcomes. Revised revenue figures led to lower valuations and higher provisioning on the GRDF debt. The Aqua park case and resulting court claim became the basis of valuation in 2014. A tentative agreement had been reached with Teremok shareholders to voluntarily pay USD 600,000. A higher discount was needed to monetize the court claim and in late 2016 this figure was reduced to USD 480,000. The final tranche of the payment, in the amount of USD 300,000 is anticipated in Q4 2016.

c) Assessment of GRDF Contribution

i. Additionality

Teremok did not have access to debt or equity from banks or financial institutions. Interviews with Teremok's management revealed that banks in Georgia were hesitant to fund the company and that terms offered did not fit the business expansion needs**.** The short grace period offered was inadequate for the time needed to invest in the business and get enough returns to begin repayment of the loans. The shareholders also mentioned that before GRDF, capital needs were financed capital needs from their own savings or other internal sources. The GRDF investment was a practical solution to obtain financing. Furthermore, GRDF's mix of equity and debt was viewed as a way to improve the risk profile of the company. Management also indicated that the financial service they received from GRDF was adequate and appropriate for the needs of their business.

Technical assistance provided the company with a better financial management system. Interviews with TA providers revealed that Teremok did not have an adequate system in place to monitor the restaurant business. With the completion of the Restaurant Management System Deployment TA, Teremok started integrating data into the new system. Interviews with management revealed that the Restaurant Management System Deployment TA automated and centralized the business management systems and organized business operations.

Technical assistance also helped Teremok in increasing staff skills in operational as well as financial management. The current management revealed that the staff-training component increased staff efficiency by developing their knowledge on service offering. The Staff Training TA was cited as the most useful TA for their business improvement and was highly appreciated. Moreover, the financial consultant pointed out that Teremok's financial reporting function was not proper and it did not have audited financial reports. The employees knew only simplest accounting and lacked adequate knowledge on reporting methodologies. Teremok also received TA, which improved its managerial accounting and financial reporting practices.

ii. Effectiveness

GRDF was not very effective in Teremok. Demand never materialized according to expectations and internal disputes affected operations. The consolidation of managers into the new company may have been completed hastily and without adequate understanding of existing relationships or networks—resulting in misunderstandings between the shareholders. These misunderstandings caused operational and financial mismanagement, which ultimately led to negative growth.

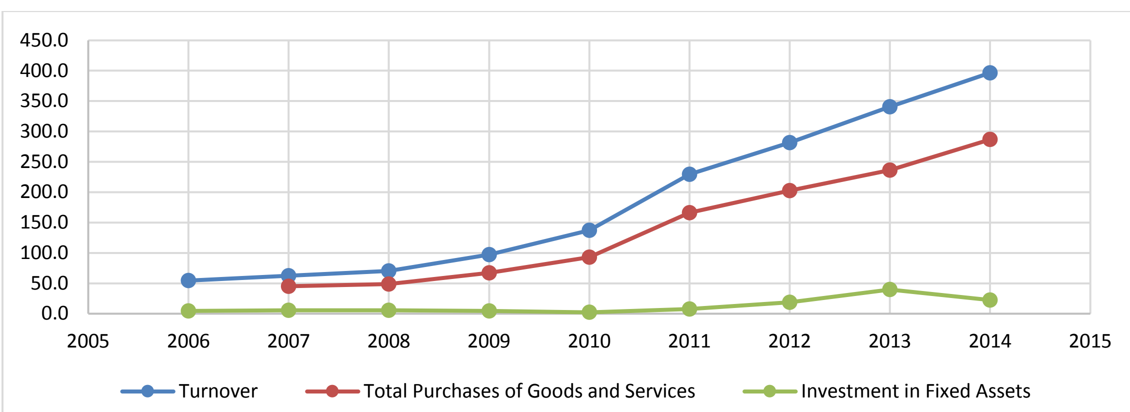
SEAF's involvement in strategy and management were not commensurate with the 35% ownership. SEAF was not involved in strategy and management until it was requested to mediate the internal shareholder dispute and reconcile the groups. Despite restructuring and new plans, the financial situation continued to deteriorate and led to yearly downward revisions to revenues and debt servicing capacity. Valuations of debt and equity holdings were lowered year after year. More involvement from SEAF might have eased the financial burden.

iii. Attribution

Teremok fell short of achieving growth after GRDF investment in variance to the macroeconomic trend. The company was growing before GRDF investment. From its inception in 2006 until 2009, the company expanded from one restaurant to six restaurants with increased revenues and net income. Following GRDF investment, the company started with growth initially, but failed to achieve lasting growth. During the same period, however, the restaurant sector grew. The number of restaurants increased from 738 in 2010 to 2,070 in 2014. Restaurants' turnover increased from 137.5 million GEL in 2010 to 396.6 million GEL in 2010. Total purchases of goods and services as well as investment in fixed assets substantially increased during the same period.

SEAF, Teremok's management repeatedly blamed subdued economic activity in Georgia as a factor affecting demand and sales resulting in the low performance of the company. Both argued that the economic slowdown affected the local population's purchasing power, which further contracted demand for their products. The macroeconomic indicators, however, show that even if the economy had downturns in 2012, the restaurant sector was least affected. Overall, the restaurants sector was performing well in terms of turnover, investment, employment, and establishments. Furthermore, one of the non-GRDF shareholders revealed that during the expansion of Teremok, 5 new Ukrainian restaurants opened in some of the planned locations and the company could not handle the competition.

Figure 19: Turnover, Purchases, and Investment in Restaurants (in Million GEL)



Source: GeoSTAT

iv. Relevance

The restaurant sector is not very relevant to the GRDF project logic and only after the unexpected change in strategy to partner with Aqua park could it be considered to have tourism-related aspects. The restaurant sector is very competitive in Tbilisi and surrounding regions. There are restaurants, bars, and cafes operating in these regions. Many restaurants offer quality and affordable food. It is therefore difficult to see the relevance of the Teremok investment other than the fact that it planned to expand outside of Tbilisi. It was only after management partnered with Aqua park, a recreational water park, could the investment be somewhat related to the tourism sector.

A4.3. Prime Concrete

a) Company Background & GRDF Performance

Prime Concrete LLC (Prime) is a concrete production, transportation and pumping services provider based in Poti, in the Western Region of Georgia. Prime was founded in November 2008, one month prior to GRDF's approval of the investment proposal. The owners of three Tbilisi-based businesses created prime: ECE Georgia, CPS Georgia, and Prime Management Company. The ownership structure of these three companies overlapped with that of Prime. The owners of Prime had extensive expertise in concrete production in the capital region. They created Prime as a vertically integrated business that would serve the construction market in the area surrounding Poti.

The shareholders identified unmet demand and business expansion opportunities in Poti, one of the largest port cities on the Black Sea Coast. Due to the growing cargo transportation industry and increased turnover, the Government of Georgia believed the Poti Sea Port had development potential for international trade between Europe, Georgia, Armenia and Azerbaijan. In April 2008, the Government signed a contract with RAKIA, a UAE-based international investor, to develop a Free Industrial Zone requiring major infrastructure work. The land plot had an extension of more than 300 hectares and investments of more than USD 400 million were expected.

RAKIA's vision was to develop a world-class infrastructure designed to make the Poti Free Industrial Zone a global hub in the region. Prime shareholders identified a demand, as there was no local modern production facility that could consistently supply the large volume of concrete needed to develop the infrastructure. Prior to the GRDF investment, a series of negotiations with RAKIA were held. In a letter of intent between the two parties it was outlined that Prime would supply 25% of the RAKIA's required concrete over the course of the project. In the first year, this corresponded to approximately 40,000 cubic meters of concrete and more than GEL 6 million.

Prime received USD 2 million from GRDF in February 2009 to setup the location. The total cost of the project was estimated at USD 2,582,090 with shareholders contributing the difference. GRDF's funding enabled Prime to set up the business and buy the equipment necessary to initiate the concrete production. GRDF was aware of the importance of RAKIA to the business plan. With more than 50% of revenues projected to originate from RAKIA, the investment was highly dependent upon the success of the infrastructure projects in the Free Industrial Zone. However, several potential gains from future prospective development outweighed the potential threats associated with the reliance upon a single customer.

Delays in the construction of the Free Industrial Zone (FIZ) reduced Prime's revenue potential soon after initial disbursement. A change in RAKIA management led to the cancellation of tenders, including projects initially designated to Prime Concrete. As a result, revenue was significantly reduced and by the end of the year were GEL 1,429,255—88% below the projections. Prime was able to sign several contracts for smaller infrastructure projects, which permitted them to remain current on the GRDF payments and led to increased brand awareness in the market.

A loan rescheduling was proposed in 2010 as delays continued. The rescheduling was sought to secure the working capital needed for the newly signed contracts. These contracts were considerably smaller than initially envisioned and ongoing delays with the Port development were wearing on Prime's ability to meet GRDF investment payments. Prime continued to develop other sales channels. Despite the Board's concern about project development plans the rescheduling was accepted. Prime repaid the overdue balance by the end of the year.

A follow-on investment in 2011 was aimed at reducing costs and expanding business lines. The follow-on investment of USD 1 million had been proposed by the owners to expand into the quarry business. The expansion was expected to increase margins and sales revenues and diversify and improve the position of the business. The follow-on investment was a result of a change in Prime's market strategy. To remain competitive and reduce reliance upon a single contract and customer, Prime desired to offer more diversified services within the construction sector. The diversification of products and services offered were considered important for future growth and expansion of the business. The changes in strategy were supported by SEAF.

Prime again fell behind on GRDF investment payments in 2011 as low revenues from a subdued construction market, expenditures related to the start-up of the quarry business and expansion opportunities decreased cash flows. By the end of December 2011, Prime had accumulated an overdue balance of USD 222,724 in interest and fees and USD 231,295 in principal. Low activity in the construction market in Q1 and Q2 and the need for current cash flow in relation to the set-up of the quarry business were initial factors contributing to the delay. Furthermore, all the company's working capital was directed towards the purchase and set-up of a new factory in Anaklia to take advantage of the government's plans to develop the area.

A change in Poti port ownership revitalized hopes of the FIZ and Port projects. APM Terminal bought the port in 2012. Development was stalled due to political uncertainties in the country. Anaklia projects had also been delayed as the government's vision for Anaklia changed. SEAF considered the option to sell Prime's assets but thought it would damage the company.

Prime's financial performance dramatically improved when FIZ development began in earnest in 2013. In 2014, EBITDA reached GEL 4,547,272 and the net income of the company was positive for the first time since operations were launched with GEL 2,310,298. Prime's actual revenue reached historical levels with GEL 22,612,985. The revenues were mainly driven from APM terminal construction projects in Poti and a sewage system in Anaklia. Prime repaid principal to GRDF for GEL 435,676. In 2015, success continued but GEL depreciation against the USD and payments on accrued interest and royalties on the GRDF loan led to a negative net income of GEL 1,840,938, despite a positive EBITDA of GEL 1,223,760.

The improvement in Prime Concrete's financial position has attracted potential strategic investors. Prime Concrete continues to sign new contracts totaling USD 14 million in 2016. Upgrades to fixed assets, capacity building projects, vertical integration, and investment in personnel and brand name via ISO certifications and management training programs have helped the company build a strong name recognition in the sector. Outside investors are in advanced talks with the company to bring additional capital and refinance the GRDF position of USD 2 million.

b) Review of Investment Process

i. Pre-Investment Phase

Management's competency, experience, and vision were seen as key drivers for potential success. The management of Prime was considered a team of talented industry experts with more than 10 years of experience. In addition, the owners had previously provided insightful guidance to factories in Tbilisi on efficient production and recipes for high quality concrete mixture. During on-site visits shareholders confirmed that Prime reached out to SEAF with their business plan to obtain financing.

SEAF correctly identified the key drivers to success for the company but the relationships with potential customers should have been better understood. Prime had only a signed Letter of Intent with RAKIA Georgia, the owner and developer of the Poti Free Industrial Zone. Prime expected a revenue of USD 88 million over four years as RAKIA'S main concrete supplier, which would account for more than 50% of Prime's forecasted annual sales. Prime had also signed three other letters of intent with other companies. In-depth discussions with these customers and understanding of the relationship along with the pursuit of a more tangible agreement should have been pursued. The Board determined that customer concentration risk was low since the government would penalize RAKIA if they did not meet the two-year development timeline.

The financing structure was not the most prudent despite downside protections. Loan repayments would be significantly impacted should a major customer cancel any contracts as RAKIA did. The initial GRDF investment of USD 2 million consisted of a USD 1.91 million participatory loan and USD 90,000 in exchange for a 5% ownership with guaranteed management buyout. Collateral was estimated by SEAF at 85% of the loan investment. In addition, the loan was also secured by 100% of the shares in the company and personal guarantees of USD 2 million provided by the shareholders. Therefore, while it was a highly speculative deal with guaranteed payments in arrears if a customer canceled a contract, the underlying collateral, which included top-grade equipment, and guarantees from shareholders with other business interests would potentially limit losses.

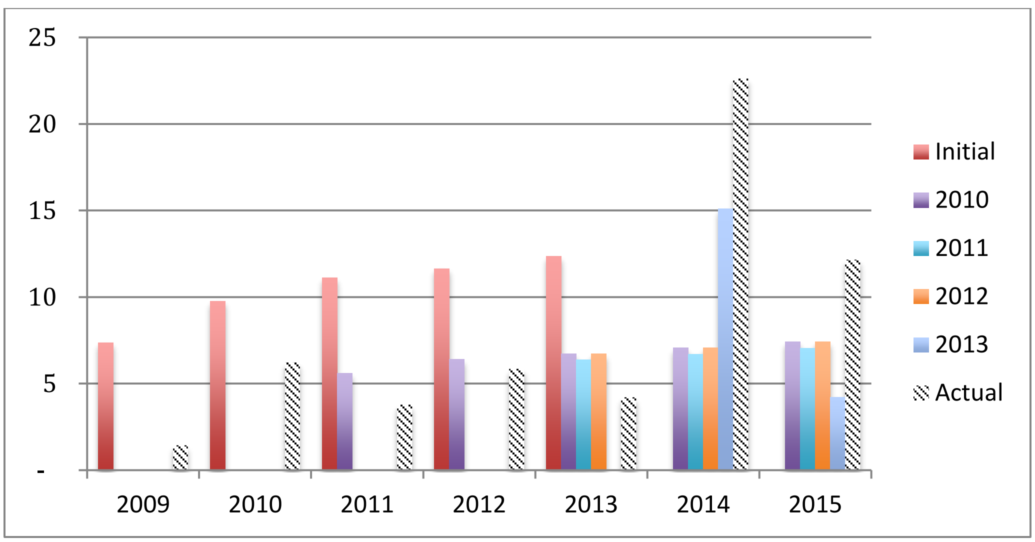
Awaiting the actual signing of a contract or reaching a conditional agreement with RAKIA would have been more prudent.

Projections were too optimistic and even overshot revenue potential in the worst-case scenario. SEAF modeled a worst-case scenario that assumed RAKIA would not start any activity in Poti. In that case, SEAF estimated that the company would still be able to service the loan with an average Debt Service Coverage Ratio (DSCR)[19] of 1.55. However, when the worst-case scenario did materialize, Prime quickly fell back in GRDF payments and was unable to service the GRDF debt.

ii. Post-Investment Phase

Changes in annual projections and related valuations underscore the difficulty SEAF encountered in determining the timing of planned projects. Prime's revenues were entirely dependent on the realization of planned development projects by the government and the Poti Port owners. The projections were essentially best guess estimates along with the underlying valuations on investments and show significant volatility. While projections show over-estimations in the early stages of the investment this trend has reversed over the last several years.

Figure 20: Accuracy of Revenue Forecasts (GEL million)



Prudent steps were taken over the course of the investment to improve the business until larger projects materialized. According to management interviews, SEAF was a good partner in terms of supporting Prime during the difficult years and both worked together to position the company to take advantage of the eventual development of the Port. These included several TA projections aimed at improving financial and risk management capacity, and internally funded management-led trainings in local personnel.

[19] The Debt Service Coverage Ratio compares a company's net operating income to its debts service obligations (i.e., interest, principal and lease payments) in a given period (typically a year).

Management also recognized the value of perceptions of safety and quality among international business partners and spent internal funds on International Organization for Standardization (ISO) certifications.

GRDF USD 1 million follow-on investment was a value-enhancing decision. In 2011, SEAF and Prime Concrete management sought to steer the company towards quarry operations. This would allow the company to vertically integrate, opening additional business lines and reducing input costs. A USD 1 million follow-on investment was used to construct and equip a stone crushing factory and purchase an excavator, a loader and dump trucks for quarry operations. A decrease in the Cost of Goods Sold (COGS) was seen shortly thereafter, improving margins. Going forward, Prime was able to substitute costly supplier provided concrete materials with its own production.

The patient capital stance was in the best interest of both Prime Concrete and the GRDF. Despite early non-payment of the GRDF investment, there was a clear belief from SEAF and the Board that Prime possessed long-term value. As such, the GRDF re-committed in the form of the follow-on investment and essentially took an equity investor stance as opposed to recalling the loan and seizing collateral. One deciding factor was confidence in Prime's management and a "Westernized" approach to doing business by focusing on price and quality. The GRDF believed that when projects did eventually begin, the company would be well positioned to reap the rewards and payback the investment.

In 2015, the GRDF and Prime reached a USD 1.5 million settlement on the existing debt principal of USD 1,219,000 and interest and fees of USD 2,964,605 leading to a positive Gross IRR of 2.8%. Total realized proceeds from the Prime Concrete debt and equity investment sum to USD 3,360,239.

c) Assessment of GRDF Contribution

i. Additionality

As a newly formed company, Prime Concrete lacked sufficient collateral and was therefore unable to obtain financing from Georgian commercial banks. Banks consider the construction business as particularly risky with high interest rates as a result. Therefore, the financial resources received from GRDF have been crucial for the overall operation of the company. In interviews, Prime indicated that the cost of capital was high, due to the royalty fee, but there were no other options available at the time. Prime would have been unable to start the business without the financial support.

The GRDF worked with banks to secure the necessary guarantees on Prime's assets to free up working capital. From the interviews, this advantage was identified as an important factor contributing to Prime's enhanced performance. To proceed with projects, significant cash outflows are needed and banks require guarantees to provide the cash. The GRDF worked with banks to reduce their seniority on certain assets to free up this capital.

Prime considers SEAF to be a good partner giving the company flexibility to evolve by supporting management strategy decisions. SEAF gave management the space and freedom to operate and evolve. SEAF trusted management to build value and improve the business. This partnership has been highly valued and appreciated. SEAF was also considered helpful in terms of connecting Prime with companies providing technical components, such as the quality management system ISO.

The technical assistance component helped the company improve internal processes and accounting. Technical assistance contributed towards high quality auditing; the ERP implementation has also had a crucial impact on the company's performance. Prime expressed that the overall the consultancies received had been essential in improving internal processes as well as the efficiency of the company.

Table 15: Technical Assistance

Type	Total TA Cost	Cost Share	Cost Share %
Technical Consultancy	USD 10,009	USD 1,009	10%
Environmental Impact Assessment	USD 7,279	USD 1,876	26%
Prime Quarry Technical Consultancy	USD 15,000	USD 1,500	10%
ERP Implementation	USD 106,878	USD 0	0%
Managerial Accounting Consultancy	USD 37,500	-	
Improvement of Financial Management, Accounting and Reporting	USD 8,750	-	N/A

Stakeholders interviewed indicated that Prime Concrete's management developed a different mindset in line with international standards. The operations were in line with strict safety regulations and the company is perceived as offering transparent competitive prices. SEAF pointed out that the company has accumulated significant construction experience, enabling the company to take on projects beyond regional borders.

ii. Effectiveness

The GRDF investment and subsequent "patient" capital stance has been effective. The GRDF provided majority debt financing. When Prime encountered financial difficulties, the GRDF continued to believe in management and the development story—opting to take an equity investor approach rather than recall the loan. The debt provided to Prime was effectively de facto equity.

iii. Attribution

GRDF attribution is moderate, mostly derived from flexibility in terms of capital repayment and the technical assistance provided. SEAF and the Board were patient, awaiting the market situation to improve in the Western Region of Georgia. With expanding development opportunities in Poti, and smaller contracts set up, SEAF was flexible in terms of rescheduling the repayment of the loan. Although exit and liquidation was a potential option early on, predictions of the market and future growth turned out to be valid assumptions and future profitability materialized. Furthermore, technical assistance improved internal processes of the company substantially. The ERP implementation and the financial management consultancies have built capacity in this area.

Prime's management praised the technical assistance as an important factor of success to the company. The technical assistance contributed towards high quality auditing. BDO, an international auditing firm, was selected to carry out a financial audit every year, whereas a tax audit is carried out every second year. The implementation of the ERP has also made a large impact on the company and has been crucial to being ISO certified (2013). Prime is currently working towards upgrading ISO certifications. In 2015, Prime hired a Health and Safety Manager, showing that they are committed and concerned about health and safety at work. Among others, heavy equipment operators are trained to fulfill the health and safety framework. Prior to hiring the Health and Safety Manager an external company was responsible for training the staff. Prime found all the above consultancies particularly helpful. The targeted objectives were met and Prime is considered one of the most transparent companies in GRDF's portfolio.

Prime's management capabilities were the most crucial factors driving success of the company. The build-up of experience in initial years where Prime took on smaller contracts improved their operating capabilities substantially. In addition, technical assistance, as mentioned, improved internal processes. As SEAF was not involved in any strategic development of the business, Prime's management capabilities are perceived as the core reason for the operational success and continuous growth of the company. The management was crucial when opportunities finally arose, enabling the company to seize large contract. As a result, financial and technical assistance are the main components attributable to SEAF and GRDF interventions.

Prime's growth has been largely driven by the expansion of Poti Free Industrial Zone. The strategic changes carried out in 2011 were emphasized as crucial for the continuous growth and development of Prime. Diversification, vertical integration and expansion into the construction services sector and quarry operations proved essential for the increasing sales volume of Prime. However, the eventual development of the port had the largest attribution effect among anything else. As it is evident that APM's construction in Poti Sea Port has had a remarkable impact on Prime's financial position over the last three years.

iv. Relevance

While not a target sector, Prime Concrete is a very relevant investment, contributing to regional employment and becoming a leading producer of concrete in the region. Insights from interviews emphasized the development of the local skillset and growth in employment. Prime started out with 30 employees. By mid-2016, the number of employees had increased to approximately 230. Prime encountered a skill shortage in the area and devoted money and efforts to build capacity within the workforce. Prime provided training in equipment use, safety procedures, financial accounting, and other programs that have been key to ensuring high quality, efficient operations. The concrete factory itself is the leading concrete company in the region and is highly regarded by its largest customer, APM Terminal for their “western” approach to business.

Table 16: Development Returns

	2009	2010	2011	2012	2013	2014	2015
Revenue Growth	100%	333%	-37%	85%	-42%	435%	-47%
Wage Growth	100%	48%	2%	86%	-8%	220%	-1%
Tax Growth	100%	189%	-37%	147%	-49%	543%	-29%
Local Purchases Growth	100%	188%	-17%	151%	-61%	296%	-35%
Weighted DR	100%	189%	-22%	117%	-40%	374%	-28%

Development returns are now overwhelmingly positive on the back of revenue growth. Development Returns have fluctuated according to revenue growth. Notably, wage growth has been robust and indicative of Prime’s investment in personnel and commitment towards local labor force capacity building. Vertical integration contributed to lower costs of purchases.

A4.4. FOODMART

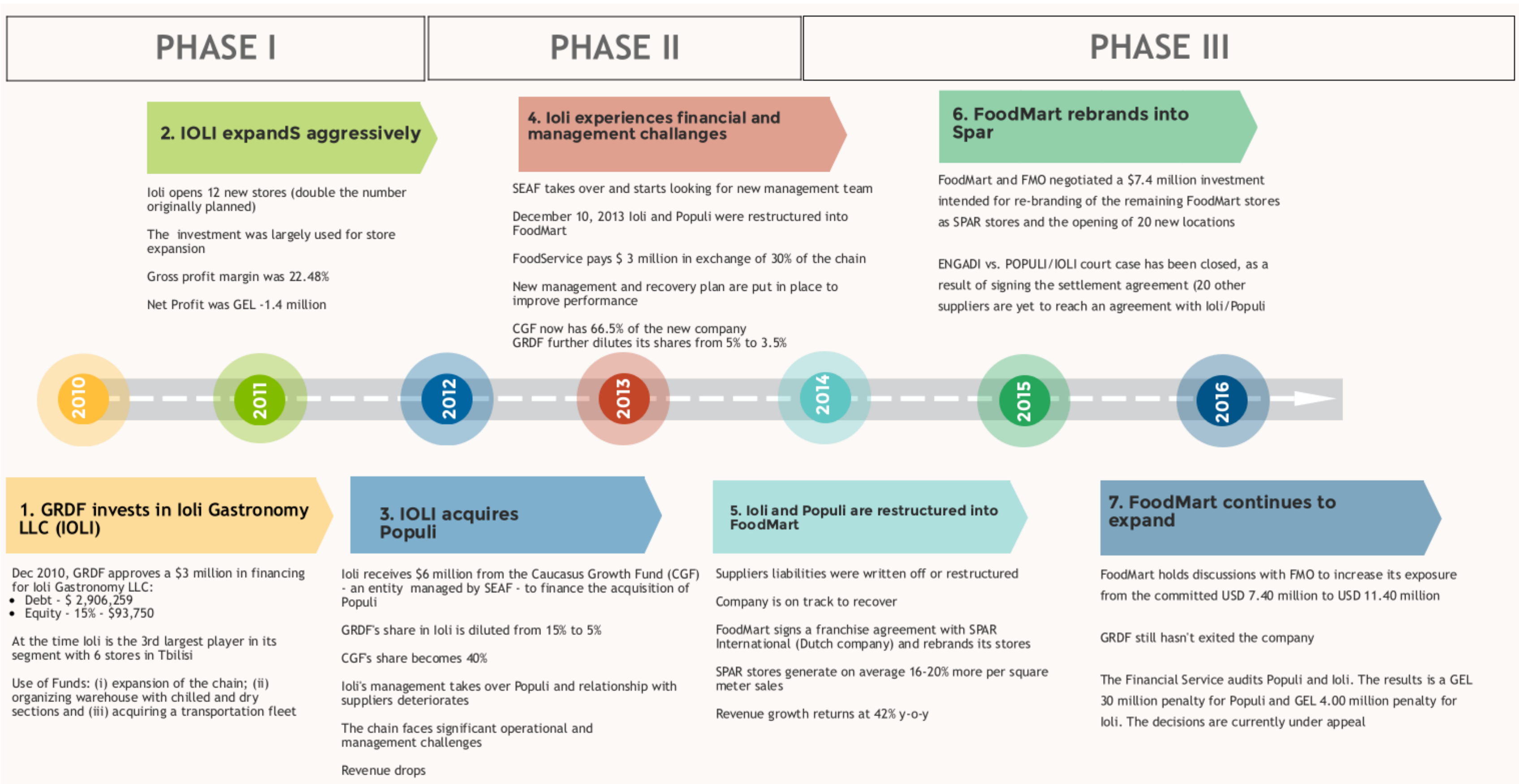
a) Company Background & GRDF Performance

i. Company Background

Foodmart JSC (Foodmart) is one the largest convenience store chains in Georgia, operating small express stores. In 2015, Foodmart's market share was 26% of the total food retail market in Georgia, a significant increase from 1.9% in 2009. Foodmart's product base includes groceries, fresh food and other everyday essentials. Since GRDF's initial investment in 2011, when the store operated under the Ioli brand, the chain has experienced periods of turbulence pre- and post-acquisition of a large but struggling competitor, Populi. While legacy issues and financial support both remain challenges in the near-term, Foodmart has continued to evolve—partnering with SPAR International, an international European grocery chain, through a master franchise agreement. Foodmart executives envision full SPAR rebranding of existing Foodmart locations over the next two years in addition to continued expansion. As of 2015, the chain operated 57 stores and employed 1,428 people.

Foodmart's investment and history consisted of three phases (See figure below): i) GRDF initial investment into Ioli; ii) the Ioli-Populi merger, and iii) the restructuring of Ioli and Populi's assets into the new entity Foodmart.

Figure 21: Foodmart Intervention Timeline



ii. Phase I: Initial Investment

Ioli Gastronomy LLC (Ioli) was a small supermarket chain at the time of GRDF investment, with six stores in Tbilisi. It was the third-largest chain in its segment of smaller, express-format stores. The supermarket chain was started in 2009 as an add-on to the existing Ioli brand. The Ioli food production company was one of the largest in Georgia, offering 500 products including meat and ice cream. The company started with stores offering only Ioli products, and then expanded to a broader range of offerings. The new Ioli stores benefitted from the company's existing brand recognition, and Ioli experienced dynamic growth.

In 2010, a group led by an international investor bought out the founder of the Ioli brand name and sought GRDF assistance to help turn the chain into a national network. Investors approached SEAF, who was intrigued by the prospects of the chain's growth—given both SEAF's and the investor's experience in grocery store investments in Eastern Europe. The initial expansion plan entailed a gradual build-out of stores at six per year and improvement in logistics to improve sales and control costs. GRDF contributed USD 3 million with the Board waving the USD 2 million initial limit. The long-term business plan put forth envisioned 36 stores in operation by the end of the investment period. It was noted that Ioli management had much higher ambitions of opening a store every 45 days as opposed to the 60 days' assumption as stated in the investment memorandum.

The investment was approved despite noted high leverage and expansion risks. It was noted that the deal involved "excessive leverage" as the chain was a loss-making business at the time of investment. The Board also noted that the success of the expansion plan rested on the ability of the company to generate sufficient cash flows to both service the loan and fund store openings. However, SEAF emphasized the position and commitment of non-GRDF shareholders to fund working capital needs and stick to the growth plans to improve efficiency and become operationally sustainable by 2012. The investment was also among the last deals approved prior to the end of the investment period. The prospect of developing a national grocery chain was also looked upon favorably. The Board subsequently approved USD 3 million investment.

A delay in the disbursement of GRDF funds led to corresponding delays in new store openings that weighed on earnings during the first half of the year. Ioli nevertheless opened eight new convenience stores in 2011 versus the six initially planned, with sales increasing monthly as additional stores became operational. Revenue growth followed additional store openings yet, annual sales for 2011 were slightly below projections, which were based on only six store openings. Revenue per store would continue to come in below projections through the next year.

The lead shareholder purchased additional shares from other shareholders, accumulating an additional 35% on top of his 50% share between September and October 2011. He was able to negotiate the purchase of other non-GRDF shareholder's interests in Ioli in late 2011. With a controlling share, he was able to persuade management to essentially double down on the expansion plan—believing a larger market position would pay-off in the medium term. Furthermore, he sought to bring his own management team with experience in the grocery retail chains of the Baltic. Remaining owners of the company, including SEAF on behalf of GRDF, approved the change. He claimed such purchases were funded by his other business interests outside of the country. No additional background investigation was done by SEAF nor was it requested by the GRDF Board upon learning of his acquisitions, which effectively removed Georgian partners from the shareholding structure. Notably, initial plans had envisioned a simultaneous exit by the Georgian shareholders and the GRDF.

Figure 22: Projected versus Actual performance Ioli

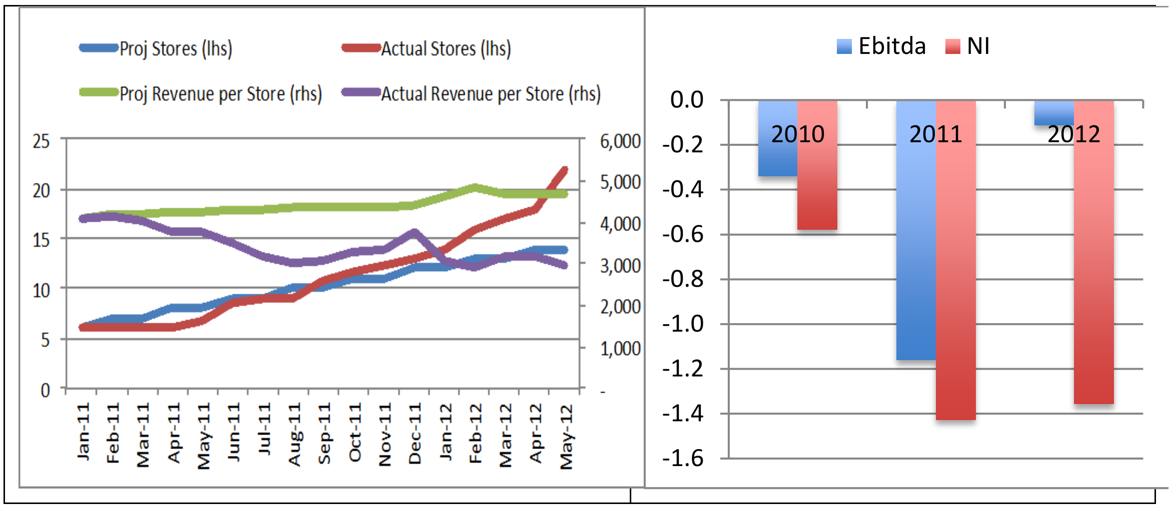
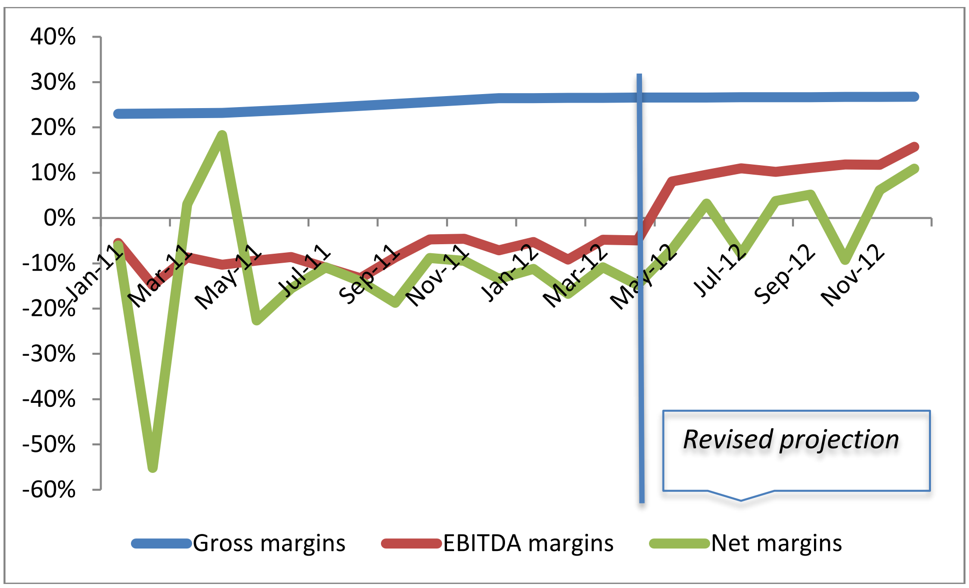


Table 17: Shareholder's position Ioli

	Beginning of 2011	End of 2011
GRDF	15%	15%
Lead Shareholder	49.5%	85%
Georgian shareholder 1	17%	
Georgian shareholder 2	8.5%	
Georgian shareholder 3	10%	

Following the change in shareholding structure, the lead shareholder assumed the CEO position and led the implementation of a more aggressive expansion plan despite accumulating monthly losses. Towards the end of 2011, as revenues were not meeting expectations and net margins were being squeezed by increased overhead costs, the new CEO chose to accelerate store openings to gain a larger footprint in what was perceived to be an increasingly competitive market. The viability of the expansion strategy was dependent on the assumption that margins would dramatically improve. From the initial GEL 5.43 million disbursed in February 2011, approximately GEL 1.49 million and GEL 1.45 million were consumed by losses from Cash Flows from Operations (CFO) and Cash Flows from Investing (CFI) activities respectively. Nevertheless, Ioli went ahead with the more aggressive plan to open stores.

Figure 23: Profitability Analysis



ii. Phase II: The Ioli/Populi Merger

In the beginning of 2012, shareholders of Populi—the largest grocery chain in Georgia with 46 stores—approached Ioli to explore interest in an acquisition. It was widely known that Populi was under distress due to financial obligations with suppliers and its major creditor, the Bank of Georgia (BoG). Populi financed its operations largely through an increase in payables to its suppliers. Populi was also subject to a fine of USD 1.1 million in 2010 by the Revenue Service following an audit of the company's financials. Given the financial situation, SEAF and non-GRDF shareholders believed an attractive price could be negotiated for Populi's assets and that there were significant synergies to realize from such an acquisition—including a centralized distribution system, supplier contract negotiations and management improvements. SEAF was able to negotiate the initial asking price from USD 12 million to approximately USD 7 million. During the pre-investment process, SEAF supported the acquisition, stressing experience with supermarkets in Eastern Europe and the Middle East—Romania, Macedonia, Serbia and Afghanistan—and expressing a strong belief that Ioli/Populi would be a great success.

In June 2012, SEAF proposed to the Board an acquisition of Populi by Ioli—to be financed by two other SEAF-managed funds, the Caucasus Growth Fund (CGF) and the OPIC-financed Small Debt Facility (SSDF). SEAF sought USD 9 million to be invested in Ioli Gastronomy from CGF and SSDF. The potential investment consisted of USD 4 million equity and USD 2 million debt capital from CGF and USD 3 million debt capital from SSDF. The investment would allow the company to acquire Populi. The due diligence process took place in the preceding three weeks, relying on external auditors for asset valuations, discussions with suppliers--most of whom were suppliers to Ioli—and market analysis. SEAF utilized its own Discounted Cash Flow (DCF) model to arrive at an estimated value of USD 7.7 million for Populi, or 1.1x the negotiated sale price.

The Board, expressing apprehension, requested additional details surrounding the expected synergies, source of funds for working capital needs, debt-servicing capacity, the proposed dilution in GRDF ownership and expected returns. Noting that several factors would have to fall in place for success in delivering value to shareholders, the Board was concerned about additional capital needed for expansion needs, seniority of collateral and how the USD 2 million expected from the SSDF would first need to clear OPIC due diligence process. SEAF, however, was confident such funds would materialize from the SSDF and included a GRDF seniority listing on collateral. Projections also provided reasonable assurances that the extra debt from CGF and SSDF would be manageable post-acquisition.

Table 18: Expected Returns

	IRR	Money multiple*	Blended IRR	Blended x Money
GRDF Loan	24.50%	1.9	31.50%	2.3
GRDF Equity	103%	15.08		
CGF Loan	21%	2.19	29%	3.1
CGF Equity	31.70%	3.53		

*Source: Ioli Follow-on memorandum. *Investment Cash Outlay / Cash Inflow.*

GRDF dilution was a hotly debated discussion topic. The additional investment into Ioli would reduce GRDF ownership from 15% to 5%. CGF would obtain a 40% share following its equity injection and the lead shareholder would be diluted from 85% to 55%. However, the expected returns for GRDF would be higher since agreeing to dilution would bring much needed additional funds from CGF to finance the acquisition. The GRDF dilution should have been closer to 10% based on acquisition modeling. However, it was determined that the expected returns for CGF would be significantly lower and that larger discounts should be applied to recent transactions—as they were seen to include a substantial control premium. SEAF argued that the GRDF investment would be significantly improved with the dilution and investment from CGF. The Board agreed to the terms laid out by SEAF and approved the investment.

The USD 3 million in financing sought from OPIC was denied and CGF came in to plug the gap. Despite extensive due diligence on Populi--including a review by Deloitte and a thorough credit review undertaken by SEAF to ensure acceptability by OPIC credit underwriters—the due diligence failed to detect prior soured OPIC-Populi arrangements. After past negotiations with OPIC, Populi cancelled the debt facility and never compensated OPIC for associated fees and OPIC declined to finance Populi after this. Details of the past relationship were revealed to SEAF only after initial OPIC approved and the final OPIC investment committee review. SEAF then sought the required funds from CGF.

Following the merger, the lead shareholder met with suppliers using the company's market position as leverage to demand much more favorable terms. Before notifying other shareholders, the lead shareholder attempted to renegotiate terms with suppliers and distributors, based on a presumed higher bargaining power following the increased market share of Ioli. As indicated during the discussions with SEAF, the goal was to lower the distributors' profit margins closer to the European average of 7-8% from the 30-35% profit margin prevalent in Georgia at the time. This led to a strained relationship with suppliers and resulted in suppliers boycotting the chain and removing their products from both Ioli and Populi. According to the interviews only some 20 distributors out of 200 continued to supply their products to the chain. Suppliers also demanded immediate payment for outstanding payables, which strained the company's finances. By the end of 2012, Ioli was behind on payments to GRDF.

SEAF became aware in Q1 2013 of a previously undisclosed company-shareholder loan and quickly moved to oust the shareholder from the company. As the new ERP system was implemented, it gave a comprehensive overview of both Ioli and Populi performance data and financials. SEAF was able to detect a suspicious increase in receivables in Populi. Upon further investigation, SEAF identified an undisclosed company loan of approximately USD 1.8 million taken out by the lead shareholder from Populi accounts between September 2012 and February 2013, which according to interviews were in connection to share purchases. The undisclosed loan severely weakened the company's working capital position likely served as the impetus behind strained relationships with suppliers and creditors. SEAF essentially had two options: 1) liquidation or 2) management takeover in an effort to revitalize and stabilize the company. Given the amount of financial and human capital at stake—the company employed approximately 1,000 people—after conferring with the respective Boards of GRDF and CGF, SEAF opted for the latter.

An agreement was made to waive the indebtedness for the lead shareholder's shares in return for his ouster. Accordingly, in February 2013, an agreement was made to waive the debt to the company by decreasing the debt obligation to CGF. CGF would simultaneously increase its equity position by an amount consistent with the ownership interest—the difference to be financed in installments. Notably, the ownership transfer was completed based on a revised valuation of USD 6.725 million for Ioli —a valuation considerably lower than the valuation at the time of the merger due to the deteriorating finances of the company. CGF now assumed 95% ownership of the company.

SEAF took control of Ioli operations, deploying extra resources at its own expense in an effort to save the firm from bankruptcy. As Ioli entered crisis mode, SEAF took a very active management role—overseeing finances and operations and bringing in personnel from other managed funds. In an effort to stabilize cash flows throughout the year, negotiations, restoration of supplier confidence and cost control measures—including 20 large and unprofitable store closures—took priority over growth. This strategy led to gradual improvement in EBITDA, from GEL -1.0 million in February 2013 to GEL -576 thousand by October 2013. Actual revenue, however, dropped 43% in 2013 as indicated in the figure below. At the same time, SEAF was actively looking for a new management company and potential exits via third party buyout. During this time, SEAF also initiated talks with international supermarket SPAR for a potential franchise deal. By the end of 2013, intransigence from suppliers on payment terms had depleted inventory levels and the creation of a new entity was proposed as potential solution to supplier problems.

iii. Phase III: Foodmart

Foodmart JSC (Foodmart) was created to circumvent stalled supplier negotiations and the new company acquired all assets of Ioli/Populi. Foodmart was envisaged to assuage supplier reluctance to serve Ioli and Populi due to continued distrust and to essentially force suppliers to accept new terms. By creating this entity, accumulated payables were paid off over time by January 2016. Most suppliers subsequently accepted a 30% cut on outstanding payables and committed to supply Foodmart. The new entity took over Ioli/Populi assets and most corresponding liabilities—supplier credits, CGF, and GRDF debt were subject to a cut. The GRDF Board raised concern with the additional USD 10 million investment to make the turnaround strategy a success; however, SEAF indicated that they were able to secure a USD 7 million commitment to Foodmart from Food Service, one of the largest distribution companies in Georgia.

The Board approved the restructuring—paving the way for Foodmart's acquisition of Ioli and Populi assets—totaling GEL 36.1 million and financed through a mix of liability transfers and cash. Board approval was contingent on (a) transfer of the assets and part of Ioli liabilities to the new company "Foodmart" LLC; (b) transfer of a cut GRDF loan to "Foodmart" LLC under the same terms as in Ioli and with first security interest in all assets being contributed by Ioli to "Foodmart" LLC; (c) one to one exchange of GRDF's shareholding position in Ioli for the shares in Foodmart until further dilution with new money. Notably, the Bank of Georgia was fully repaid in cash along with GEL 6 million of the GEL 10 million in supplier payables. Financing of the acquisition was primarily sourced through USD 4 million in equity capital by Food Service, which also contributed another USD 3 million in debt capital for working capital needs. Food Service acquired a 30% share in the new entity and diluted GRDF to 3.5% shareholding and CGF to 66.5%—a pre-money valuation of approximately USD 9.33 million. The improvement in valuation for the GRDF stake improved from USD 330k (5% share) to USD 646k (3.5% share).

Table 19: Foodmart post-restructuring position (GEL million)

	Populi	Ioli	Total		Foodmart
Assets	56.0	22.8	78.8		36.1
Liabilities					
GRDF CGF	13.2	15.0	28.2		12.0
BOG	13.2		13.2		13.2
Other	10.6	5.7	16.3		10.1
Populi receivable from Foodmart	0.8		0.8		0.8
Total	**37.7**	**20.7**	**58.4**		**36.1**
Equity	**18.3**	**2.1**	**20.4**		
Purchase price	***32.1***	***4***	***36.1***		

Foodmart, backed by new management and additional working capital, began a new development stage. Revenues and efficiency ratios of the company started to recover and all rebates and cash-back from the suppliers were being returned to the company. In 2014, SEAF was able to negotiate a franchise agreement, on behalf of Foodmart, with the well-known European company, SPAR International—a Dutch multinational chain with stores in 42 countries. It is expected over the coming years that Foodmart stores will be rebranded to SPAR.

In 2014, the Georgian retail sector was hit by currency depreciation and knock-on effects from Russia's poor economy. These developments led to a decline in consumer expenditures, affecting revenues. Increases in rent further affected the financial performance of Foodmart as traditionally they had rented retail space usually located in busy urban areas. With the increased volatility of the GEL, property owners requested that rents be paid in US dollars compounding the moderate financial performance of the chain.

SPAR rebranding has resulted positive gains in terms of sales per square meters, as rebranded stores had higher customer traffic than comparable Foodmart stores. Given recent positive developments, Foodmart negotiated a USD 7.4 million investment from the Netherlands Development Finance Company (FMO) in 2015—intended for rebranding of the remaining Foodmart stores to SPAR in addition to open opening 20 new locations.

SEAF is working to refinance the GRDF loan and to raise additional investment for the development of the chain.

Notable improvement in working capital management followed the restructuring. Operating efficiency, as indicated by days outstanding ratios for accounts receivables, inventory, and accounts payables in Table 20, improved in the years following the restructuring of Ioli's and Populi's assets and liabilities into Foodmart. The dramatic reduction in accounts payables can be attributed to repayments to suppliers. Yet, sizeable balances in both payables and inventory remain, as negotiations with suppliers on amounts due continue and stores struggle to liquidate accumulated inventory. A high turnover rate is indicative of efficient inventory management—resulting in higher gross margins. A good rule of thumb for supermarkets is between 20 to 40 days. A higher number of days could be concerning because it could mean that the chain operator is only turning inventory once every 5-6 weeks, on average. For a rough comparison, the Global Industry Average is also provided in the table to show that Foodmart is still a way off in terms off in terms of achieving operating efficiency.

Table 20: Selected Performance Indicators

Days Outstanding	2013	2014	2015	Global Industry Average (2015)
Accounts Receivables	16.19	5.96	3.40	6.89
Inventory	44.48	42.61	56.07	18.97
Accounts Payables	101.63	41.34	60.17	10.66

Source: Morning Star, industry data for accounts payable and days outstanding is from WholeFoods. Days Outstanding (DO) indicates how many days it takes a company to turn receivables into cash (Receivables DO), inventory into sales (Receivables DO), and payables into cash outflows (Payables DO).

Foodmart closed 2015 with nearly GEL 90 million in revenue generation and with a positive EBITDA of GEL 639,333.17. The performance was driven by improved sales per location and operational efficiencies—e.g., decreased rental fees, overhead costs and better payment terms with suppliers. The company continued rebranding stores and is now currently operating with 20 SPAR branded stores. As reported in the annual statements, SPAR stores generate on average 16-20% more per square meter sales than prior to rebranding. Over the next two years, rebranding of all existing stores Foodmart stores will be completed and 24 new stores will be opened.

The GRDF investment is likely to show negative Gross IRR. The GRDF investment has recouped approximately USD 500k in realized proceeds from the original USD 3 million. The GRDF debt was subject to a cut of around USD 500k when Ioli interests were transferred to Foodmart. With the 2016 exit deadline imposed on the GRDF, improvement in the valuation of the equity investment is not likely to make up for the loss since the valuation methods include DCF and Comparable Multiples typically based off EBITDA. The blended IRR on both the debt and equity GRDF positions is therefore expected to be around -6%.

b) Review of Investment Process

i. Pre-Investment Phase

The initial Ioli deal was sourced from GRDF marketing and public knowledge; additional rounds of financing were exclusively the result of SEAF's network. The lead project promoter approached GRDF directly for possible financing solutions to the planned expansion and SEAF's involvement in sourcing the original deal was relatively passive. SEAF was effective in promoting the project to additional investors, namely CGF—another fund managed by SEAF but led by a different shareholder profile and objective. SEAF was successful in sourcing further investment in Ioli and reaching through its network to secure the capital needed to help Ioli, later Foodmart, expand.

The due diligence process prior to the first investment was perhaps the most thorough analysis conducted of all GRDF investments in the portfolio. Extensive interviews with management and suppliers were carried out to understand the dynamics of the Georgian grocery chain market while leveraging SEAF's prior experience in the sector in Eastern Europe. The market analysis was comprehensive and aided in part by a recently commissioned Ioli financed market assessment by a market research consultancy. The cost structure and terms underlying working capital conditions were thoughtfully integrated into the financial projections and analysis. The investment strengths were convincing and it was believed at the time that the lead shareholder would be a reliable and valuable partner in the chain's development. Furthermore, as opposed to several other instances in which SEAF had assumed optimistic growth forecasts, SEAF acted prudently by providing much more conservative growth and margin improvement targets versus what Ioli management had envisioned.

SEAF negotiated an attractive entry price to obtain 15% ownership. SEAF's entry price into Ioli implied a valuation of USD 625,000—determined by a mix of discounted cash flow analysis and market multiples analysis—and equaled around half the value implied by recent purchases by the lead shareholder. GRDF's entry diluted the lead shareholder's 58% share to 49.5%. Furthermore, SEAF negotiated anti-dilution and blocking rights on future changes to the shareholding structure along with a put option—an instrument that bound Ioli management to repurchase GRDF shares at a guaranteed price—should SEAF choose to exercise it any time after December 31, 2012. Crucially, changes to key management, strategies, and financing of Ioli required 100% Ioli Board approval, in which SEAF held a seat. The exit planned a strategic sale to a third party, from which SEAF and the lead shareholder both thought to leverage their existing networks among the international supermarket chains to facilitate a buyout.

Following the initial investment, there were gaps in the due diligence process. Ioli management did not respect Initial growth plans and the company pursued a more aggressive and riskier expansion strategies with revenues falling behind schedule. The aggressive share purchases by the lead shareholder, which required shareholder approval, should have raised some concerns that were not adequately investigated. While ascertaining shareholder motives is difficult, there would ideally have been a proof of funds or tracking of the source of funds for the acquisitions, especially after considering the high price paid for shares.

Several failed attempts by other investors to improve Populi's position should have been given more weight in the due diligence process. Populi was a bigger business than Ioli, but was operating at a loss. The expected synergies and period for realizing synergies appear to have been too ambitious considering the recent experience of the slower than expected process in margin and revenue growth at Ioli. The quick transition assumed in the acquisition plan undersold the potential difficulties in turning Populi around. Prior unsuccessful experience of past management at Populi should have called for assumptions that were more prudent.

The collective due diligence process may have been subject to overconfidence by company management and SEAF. SEAF and management had extensive prior experience in developing grocery retail chains in the Baltic and Eastern Europe. These facts were prominent in the investment memorandums and Board meetings. The due diligence is likely to have been swayed by these successes with the intention of replicating past formulas for success. As such, the Georgian context was not adequately addressed—particularly on the Populi acquisition—as the lead shareholder, had already bought out most the Georgian shareholders and brought in his own management group.

The initial financing structure of the GRDF investment was not tailored to the nature of the grocery business and projections were too optimistic given the nascent stage of development. Ioli had existed for just over a year with full operations and, while it showed tremendous growth and potential, it had accumulated losses and was expected to continue do so until 2012. Projections for a positive EBITDA only after year of the investment were unrealistic. Grocery chains at this stage of development need financial support in the form of equity to fund working capital needs as they expand. The debt package offered was restrictive in freeing up the necessary cash flows to expand. Even under the revenue projections, the margin of safety was low for the deal. It was also management's clearly stated goal to expand at a more rapid pace than the six stores per annum assumed in the memorandum. To do so would require additional working capital financing. Indeed, despite growing revenues in the first year more or less according to plan, free cash flows were limited due to royalty and interest payments to SEAF and the necessary "growing pains" of a young company.

The Board required multiple iterations with SEAF regarding the follow-up investments in Ioli. During Foodmart's development, the shares of GRDF were diluted twice from 15% to 5% after the Populi/Ioli merger and finally from 5% to 3.5% following the restructuring of the chain to Foodmart. With the proposed merger with Populi, the Board and SEAF had multiple discussions regarding the dilution of shares, which essentially breeched the investment memorandum, in which GRDF declared to protect the value and liquidity of its investment through anti-dilution rights. There were numerous discussions at Board meetings concerned with valuation and the dilution of GRDF shares from the initial 15%

stake to 3.5% following investment by the SEAF-managed CGF to acquire majority stakes in Populi. Terms of the deal were complex and required multiple iterations before the final Board approval. The discussions culminated in the approval of the merger in 2012, diluting the GRDF shares to 5%. The fund's ownership interest was converted to a 3.5% stake with the restructuring of the chain into Foodmart.

ii. Post-Investment Phase

GRDF provided much needed and effective technical assistance in the following areas: Human Resource Management (HRM), Implementation of Client Relationship Management (CRM) and Merchandise Planning Solution, Tax Advisory, Financial Audit, and managerial accounting. The total year-to-date GRDF TA facility cost is USD 292,021 consisting of IT improvement, business integration, client relationship management, and merchandise planning solutions. These were critical to effectively manage store operations and improve business intelligence. Significant improvements, such as ISO certification started after the restructuring in 2014. Foodmart started implementing ISO 22000 (a food safety management system) for its production facility, which was upgraded and relocated to Food Service's new distribution center in Q3 of 2014. Furthermore, the Company deployed external consultancy to institutionalize a formal Environmental and Social Management System. These activities are likely to bring the Company's operations up to par with international standards (e.g., ISO 22000 and IFC/EBRD requirements on ESMS).

A more cautious approach should have been applied towards the acceleration of the store expansion strategy. A large portion of the GRDF funds was redirected towards the aggressive expansion of the chain. The approved upgrade and expansion of the warehouse and distribution center never materialized—only minor improvements were made to Ioli's existing facilities. As a result, 70% of the USD 3 million went into the opening of twelve new locations in 2011 rather than the six initially approved by the Board. The change in strategy coincided with the increased share position of the lead shareholder, who aggressively bought out other shareholders and brought in his own management team to operate the chain.

The aggressive acquisition of shares by the lead shareholder should have raised concerns over change in governance. These purchases required GRDF approval yet, no large concerns were raised or adequately investigated. While ascertaining shareholder motives is difficult, there would ideally have been a proof of funds or tracking of the source of funds for the acquisitions, especially after considering the high price paid for shares. The lead shareholder's position increased to 85% equity stake at the end of 2011 from 49.5% at the beginning of the same year. It also seems that SEAF was overly confident in his skills and experience in grocery retail, which explains the limited supervision exercised by the fund manager. Consequently, SEAF overlooked important governance issues and misconduct, which resulted in a non-disclosed loan and the fall out with suppliers causing the chain severe financial and operational challenges.

The involvement of CGF in Foodmart raises concerns regarding objectivity and potential conflict of interest. SEAF approached the GRDF Board in the period following the Ioli/Populi merger with a proposal to restructure the GRDF debt position into equity as it was also proposing a conversion of the CGF debt to the CGF Board. It was believed that a formal conversion would allow Ioli to renegotiate an outstanding loan with the Bank of Georgia. However, two issues are worth highlighting here. First, as was noted by the Board, the emphasis of short-term improvements in operations and margins following the SEAF takeover masked that fact that Ioli was still a loss-making enterprise. It was also noted that CGF had a large stake in Ioli and that the two fund's objectives were not aligned. The Board therefore opted to take a more prudent stance like the Bank of Georgia until further improvement in the company's profile. The second issue is the dramatic improvement in valuation within just a few months. The CGF conversion just a few months earlier assumed a USD 6.7 million valuation while the proposal for the GRDF conversion was based on a USD 10 million valuation. The purchasing power of GRDF debt conversion had therefore been substantially reduced.

Foodmart showed overwhelmingly positive DR performance, except in 2013. All development return indicators, except revenues, grew at a higher rate than projected in 2011. The following year, 2012, was a year of improvements in revenues, wages, taxes, and local purchases—all of which exceeded projections. The highest increase was marked by the tax and local purchases indicators, which exceeded projections by some 40% and 30% respectively. In 2013, the company showed negative returns overall, except for the tax payment indicator. The underwhelming performance throughout 2013 was a result of the investment and operational challenges faced by the company during the merger with Populi and the management transition period, which affected the DR quantitative data. Further, there was an evident discrepancy between the projected and actual DR. The actual weighted average DR of Foodmart is 91% and significantly exceeds the initially projected 21.9% DR as well as the performance marked by the other portfolio companies.

Table 21: Actual Development Returns

	2011	2012	2013	2014	2015
Actual Annual Revenue Growth	70%	84%	-17%	287%	33%
Actual Wage Growth	200%	61%	-48%	348%	38%
Actual Tax Growth	193%	120%	18%	29%	47%
Actual Local Purchases Growth	148%	102%	-31%	276%	110%
Actual Weighted Average DR	153%	94%	-20%	235%	57%

As of Q3 2016, the outstanding amount of SEAF's debt investment in Ioli is USD 501,681 and USD 2,404,569 in Foodmart. SEAF has elected to take a 100% provision applied to the debt outstanding in Ioli resulting in a debt carrying value of USD 0. FoodMart's unrealized debt value is USD 1,382,229 based on a 50.7% provision applied to the accrued principal and interest. Debt provisioning is based on several credit risk criteria that determine the probability of default and loss given default, according to SEAF's internal rating system. These criteria are commonly accepted risk indicators and the underlying methodology appears sound.

The equity position is valued at USD 333,443 or 3.5% of the total company value of USD 6,335,418. The equity valuation is based on a combination of Discounted Cash Flow (DCF) method and a recent valuation undertaken for the investment by The Netherlands Development Bank (FMO). Notably, the valuations implied by the DCF model are like those implied by recent transaction. This valuation approach is therefore considered best practice and suitable for this investment.

Nevertheless, a recently negotiated settlement with non-GRDF shareholders and SEAF (on behalf of GRDF) was rejected by the Board of GRDF. SEAF and the local shareholders of Foodmart have exhausted refinancing options with local banks. Banks are unwilling to lend due to lack of a successful track-record in generating positive cash-flows, coupled with recent investigations by the Financial Police and a pending tax audit from the Revenue Service arising from the transfer of assets to Foodmart. SEAF recently proposed a USD 500,000 settlement amount to the Board, which was rejected. To this end, the GRDF debt position is likely to be sold at auction and the equity investment written-down in its entirety.

c) Assessment of GRDF Contribution

i. Additionality

At the time of GRDF's investment, Ioli was the third largest grocery chain in the growing grocery retail market in Georgia and financing could have been sourced from other financial institutions. The chain was off to a good start and likely would have received financing without help from GRDF.

In terms of synergies, SEAF was able to utilize its large network of partners in Europe and facilitated the chain's franchise deal with SPAR. The knowledge and grocery retail experience from SEAF's similar investments in Serbia and Poland was only applied to Foodmart after SEAF took over management of the chain in 2013. The current management of Foodmart indicated that they saw SEAF as a partner who played a major role in reviving the chain in 2014.

ii. Effectiveness

GRDF's effectiveness improved in the later stages of the investment. The period leading up to the Ioli/Populi merger was marked by limited corporate governance and supervision on the side of SEAF (on behalf of GRDF) which led to: i) cash flow issues following the aggressive openings of new stores; and ii) the overconfidence in the integrity, capabilities and vision of the lead shareholder. The consequences of this oversight almost bankrupted the chain following the merger with Populi. SEAF assumed management of the company, on behalf of GRDF and CGF, including day-to-day operations and finances in an effort to save the struggling chain. Their role in reviving the chain was vital, not only by reconciling with suppliers but also by bringing in a new management team and an international franchise partner, which revitalized the company.

The structure of the investment was inappropriate for the business risks. The structure of the Ioli deal, which largely came in the form of debt, restricted the operational capacity of the business. Grocery chains at this stage of development require financial support in the form of equity to fund working capital needs as they expand. The debt package offered was restrictive in freeing up the necessary cash flows to fund expansion. The cash flow was further restricted by the pace of expansion in the first year of the investment—requiring additional working capital financing. Indeed, despite growing revenues in the first year according to plan, free cash flows were limited due to royalty and interest payments to GRDF and the necessary "growing pains" of such a young company.

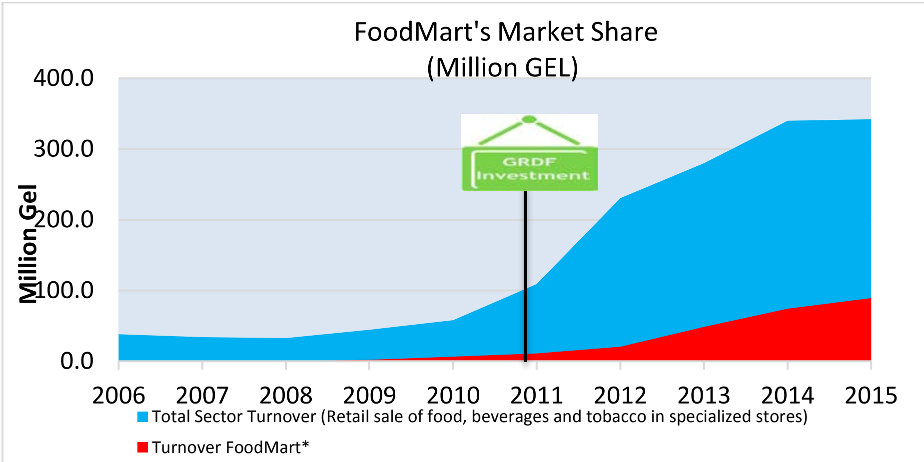
SEAF, on behalf of GRDF, was effective in attracting additional capital to Ioli. Ioli has attracted close to USD 30 million in capital since 2011. A large portion has come from SEAF-managed funds and SEAF networks, including CGF and Food Service. Notably, each of these sources of capital have their own investment decision-making process and SEAF has proven ability to influence other financiers of the potential in Foodmart.

TA was considered effective, with SEAF facilitating much-needed upgrades of the ERP system. Discussions with SEAF and Foodmart's **management** pointed to efficiency gains in customer service, marketing and sales after the franchise deal with SPAR—as the franchise provided marketing and operational training. These trainings included an introduction to marketing and sale techniques such as upselling which, according to Foodmart's management, are already providing results. SPAR encouraged changes in store layout and the allocation of shelf space, which has led to an upsurge in sales in recent months.

iii. Attribution

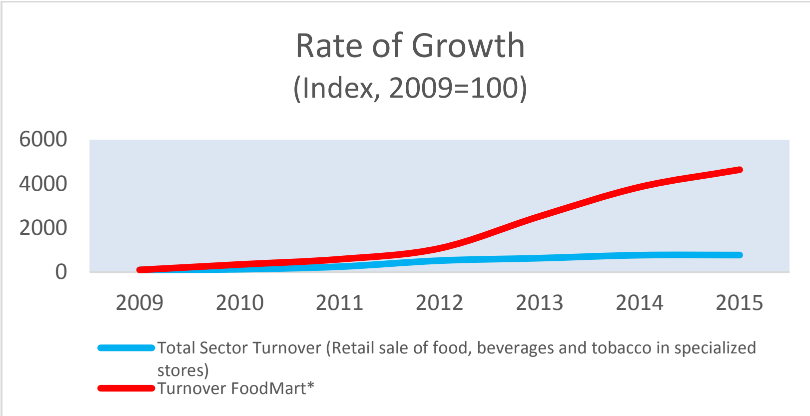
When looking at Foodmart's market capitalization today, the Ioli investment can be considered a success because it has significantly increased the market share following GRDF's involvement. The figure below provides an overview of the evolution of Foodmart in terms of turnover relative to the evolution of the subsector. As of 2015, Foodmart's market share constitutes 26% of the total food retail market in Georgia, a significant increase from 1.9% in 2009 - the pre-investment year.

Figure 24: Market Capitalization Foodmart



Source: GeoStat, 2016

Figure 25: Foodmart Rate of Growth



Source: GeoStat, 2016

Attribution could be difficult to assert due to a lack of counterfactual. While one can argue that given the rapid rate of growth and potential of the grocery retail sector, the chain would have developed with or without GRDF, the growth rate of Foodmart, as depicted by the figure above significantly outpaces that of the grocery retail industry. Growth particularly picks up after Ioli acquires Populi, an investment financed by GRDF and CGF. Despite increased revenues, Foodmart has been experiencing cash flow issues and has gradually become significantly overleveraged, reporting a net loss every year. With the SPAR franchise agreement and new management, Foodmart is on track to be net positive for the first time in FY 2016.

iv. Relevance

The investment was not fully relevant to the GRDF objectives as Ioli operated in the retail sector, which was poised to expand rapidly following the prohibition of street grocery sale (Box 1). Furthermore, the business was operating in Tbilisi where the market was already becoming saturated with Ioli being the third largest player at the time. GRDF's decision to invest in Ioli was then viewed as a relatively easy investment, which would generate good financial and development returns.

The investment has generated positive development returns. The projected development return for FoodMart was 21.9%, while the actual weighted return has been 104% over the investment term. The company now operates 57 stores in Tbilisi and other regions in Georgia and targets middle-income households; therefore, Georgian customers benefited from increased access to diversified products and a range in prices at the company stores. Moreover, the company directly contributed to the local economy in the form of taxes; and has indirectly contributed to employment in the retail value chain through backward linkages and increased local sourcing of goods and services from local suppliers; (iv) the project facilitated the transfer of modern retail and management techniques to local employees through the SPAR franchise deal.

Table 22: Headcount and number of stores

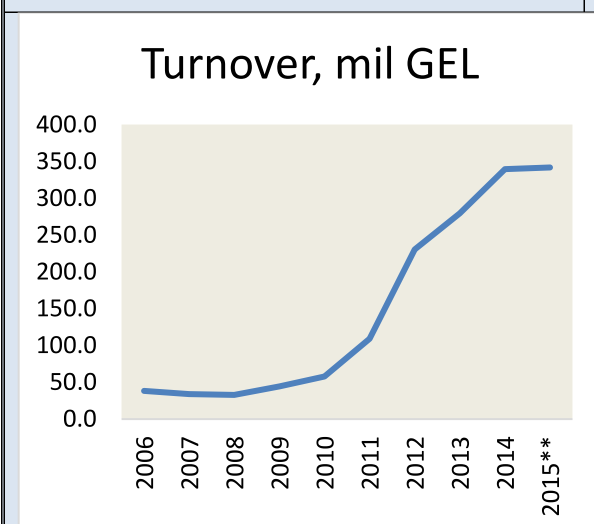
Year	2010	2011	2012	2013	2014	2015
# of Stores	6	18	67	49	48	57
# of Employees	153	281	1408	780	1131	1428

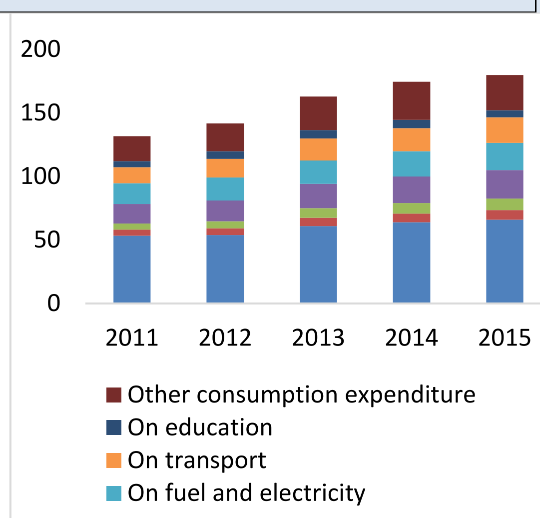
Box 1: The Evolution of the Retail Sector in Georgia

Economic growth, increase in consumer incomes, improvement in the investment climate and the emergence of modern retail trade formats have been the major driving force behind the rise of the retail sector. This is evident from the trend in annual retail turnover that has grown exponentially from GEL 38.2 million in 2006 to GEL 342.1 million in 2015. Average monthly food expenditure per capita has also increased by close to 23 percent between 2011 and 2015. The share of spending on food in per capita terms, however, has declined relative to total cash spending per capita from 40.5 percent in 2011 to 36.7 percent in 2015.

Figure 26: Retail Trade and Consumption Expenditure

Retail sale of food, beverages and tobacco in specialized stores, Annual Turnover (GEL million)	Average Monthly Cash Consumption Expenditure per Capita (GEL)





Source: GeoStat, 2016

Annex 5: GRDF Investee Companies Due Diligence Questionnaire (Guide)

A. GRDF investment process

a. Please describe how you heard about GRDF and how the initial contact was made.
b. What was your main motivation in obtaining financing? What was your experience with financing prior to GRDF?
c. Were you happy with the financing options presented to you by GRDF? If you could change certain aspects what would those be?
d. During the due diligence process, were there any challenges or problems highlighted by the GRDF team? Did you maintain audited financials? How were business statistics, including production and financials verified?
e. How long was the due diligence process? Were you presented with options?
f. Did you have a say in the choice of financing? Did you prefer a different type of financing? What other options were there for financing instead of GRDF?
g. Aside from financing, how would you characterize your relationship with GRDF? In what other ways did they help the business?

B. Business Evolution since GRDF investment

a. What are some of the internal and external events that affected your company? Please describe those events and how it impacted the company?
b. What has been your relationship with local and national authorities? Would you say that this is typical for the sector?
c. How did revenue and profit compare to initial projections? At what point did these fall short / exceed forecasts? What happened specifically that led to this variance?
d. Please describe demand for products. What do you believe is the comparative advantage of your company? How do you differentiate products? Which segments represent your biggest target clientele? How has the profile of your customer evolved since GRDF intervention? Did GRDF advise on product mix and business strategy?
e. Does your company have a Board? Did it have a Board prior to the GRDF intervention? Please describe the change in structure after GRDF intervention and GRDF's specific contribution.
f. What licenses or certificates did you acquire after the GRDF intervention? How did GRDF help in obtaining these?
g. Please describe the circumstances under the restructuring / re-investment / divestment including communicated rationale by GRDF and your response. What did the finances of the company look like during the restructuring / re-investment / divestment.
h. Please describe any significant upgrades to your company's assets and how those were financed? What was GRDF's role?
i. What kind of supplier agreements did the company have in place pre and post GRDF intervention? Were the terms improved because of GRDF or increased purchasing power?

C. Company's E&S framework

a. What was the company's experience with reporting on environmental and social indicators pre GRDF?

b. What is the current framework for E&S? What do you report and how do you verify?
c. What are the company's key objectives going forward for E&S? Does E&S form part of the company's value proposition?

D. Evolution of funding structure

a. What would you identify as the most significant cost and profit centers of the company pre and post GRDF?
b. What was the shareholder and liability composition pre GRDF? What is it now? How do the terms and conditions compare?
c. Why were you able (or not able) to obtain additional financing?
d. How do you generate working capital?
e. Has the risk profile of your company increased or decreased since the GRDF intervention? How has this affected financing options to your business?

E. Key challenges and success factors

a. What were your main competitors pre GRDF? Who else has entered the market since? How do you view the competition and why do you think they have entered the market?
b. What is the regulatory environment like pre and post GRDF? Have there been any significant changes in regulations during the intervention and has that helped or hurt the business in your view?
c. How has the relationship with the government evolved during the intervention? Were there any instances where you felt the company was singled out by local or national authorities?
d. What caused the change in demand for your products?
e. How did the regional, national, or international economic situation specifically affect demand or costs for your business?
f. Is your business seasonal? How did you mitigate risks from seasonality?

F. What kinds of technical assistance were provided by GRDF and in what areas? In your view, were these helpful to the business? Did you want or feel the need for this technical assistance?

What have been the 3 main benefits and 3 main opportunities for improvement in the GRDF intervention?

ANNEX 6: INFORMED CONSENT STATEMENT FOR INTERVIEWS

Interviewer name	

To be read to respondent: *Good morning/afternoon/evening. My name is …………… from A2F Consulting, a US-based company focused on financial sector development issues in emerging markets. We have been retained by the Millennium Challenge Corporation (MCC) to evaluate the Georgia Regional Development Fund (GRDF) investment in …… . We have identified you as a stakeholder that may possess relevant information from your experience in working with/at ……..*

Any information you provide that can identify you will be kept strictly confidential by the parties conducting this study. No direct quotes will be taken from these discussions. Our intent is to understand your experience while working with/at …. during the years of GRDF investment. The result of these discussions will be summarized in our study.

Your participation is entirely voluntary; you may skip any questions that you do not wish to answer. Do you have any questions about the research study? If you have questions or concerns after we are finished, please contact {Interviewer} at A2F Consulting LLC.

Do you agree to participate?

If so, let's begin…

Date of interview (ddmmyy)							
Time of interview (24hr clock)							

Corresponding Portfolio Company:

1. Teremok
2. FoodMart
3. Piunik
4. Prime Concrete

What language would you prefer to be interviewed in?

English	1	Russian	2	Georgian	3

If respondent cannot communicate in any of the above languages, CLOSE INTERVIEW.