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ACAP PARTNERS AFGHANISTAN RENEWAL FINAL REPORT

Report for RAMP-CLIN 0003-JO# 39-ACAP

RAMP/ACAP
JUNE 2006

Final Program Report of Activities for the

Rebuilding Agricultural Markets in Afghanistan Program (RAMP)

AFGHANISTAN RENEWAL FUND

Grant Agreement No. RAMP-0003-39

28 July 2006

Acap Partners

EXECUTIVE SUMMARY[1]

- RAMP/Chemonics contributed at total of $3,800,000 as a grant to the Afghanistan Renewal Fund, the country's first venture capital fund, managed by Acap Partners.
- The purpose of RAMP/Chemonics' participation was to increase the amount of financing available to small- and medium-sized enterprises operating in Afghanistan along the agribusiness value chain
- RAMP/Chemonic's participation was critical to the establishment of the Fund which generated $16,500,000 in additional investment from a range of investors, including high-net worth private investors, development finance institutions and the Fund Manager. The total size of the Fund is $20,300,000 as per the establishment date in January 2006. The objective of the Fund is to reach $40,000,000 by 2007.
- RAMP/Chemonics' grant was invested in the Fund through the Acap Development Trust under provisions that enable the RAMP contribution to be returned to the Trust if the Fund is successful and then to be 'recycled' into new Funds in Afghanistan. The grant was used as a revolving fund of 'permanent capital' providing financing to SMEs, not as an equity contribution.
- The Fund has an investment period of three to four years and a life of up to 10 years. 20% of the Fund's investments are targeted to enterprises along the agribusiness value chain.
- As of 11 July 2006, the Fund had investigated 164 investment opportunities, including 30% in agribusiness. It is currently working on 20 'deal prospects'. Assuming a typical venture capital ratio of one investment per 100 deal opportunities Acap expects to make a first investment by the end of 2006.

1. BACKGROUND AND PURPOSE

The RAMP/Chemonics prime contract, which is the umbrella instrument that overarches this Grant, calls for aggressive programs to expand financial service delivery. As a step toward expansion of access to financing, a Request for Proposal was published by

[1] This Final Report on the RAMP contribution to the Afghanistan Renewal Fund was prepared in accordance with the requirements of 22 CFR 226.51(d) as specified in the grant agreement. §226.51 of 22 CFR 226.51(d) sets out the following requirements for monitoring and reporting program performance.

(d) Performance reports shall generally contain, for each award, brief information on each of the following:
   (1) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both. Whenever appropriate and the output of programs or projects can be readily quantified, such quantitative data should be related to cost data for computation of unit costs.
   (2) Reasons why established goals were not met, if appropriate.
   (3) Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

RAMP/Chemonics to solicit firms to create financial institutions to meet the financing demands of enterprises involved in the agricultural sector. Through this competitive process, Acap Partners was chosen to establish the Afghanistan Renewal Fund ("the Fund"), a venture capital fund that will invest in small- and medium-sized enterprises (SMEs) operating in Afghanistan.

RAMP/Chemonics took a decision to contribute a total of $3.8 million to the Fund, subject to mutually agreed conditions. The primary aim of RAMP/Chemonics' participation in the Fund was to provide agribusinesses with a sustainable financial entity that will survive beyond the life of the RAMP program.

RAMP's participation in the Fund was in the form of a $3.8 million grant to capitalize the Fund. Acap will invest $200,000 of its own capital, as a cost share, to the Fund. Acap was expected to seek contributions from other investors such that the Fund's total capitalization was to exceed $16 million.

Description of Proposed Program

The Afghanistan Renewal Fund ("the Fund") was designed to create a finance delivery mechanism to fulfill the unmet financing needs of small and medium enterprises (SMEs) in Afghanistan.

Closed January 2006, the Fund expected to invest in approximately 8 to 12 enterprises over the three-year investment period, with each investment ranging in size from $0.5 million to $5.0 million in capitalization. The Fund aims to invest 20% in enterprises along the agribusiness value chain. These enterprises will include the kinds of enterprises receiving support through other RAMP-funded projects.

The Fund was to be managed by Acap Partners ("Acap).

Project Duration

The Fund will exist for no more than 10 years from the date it is established. Although the initial program is intended to last two years, based upon the projected duration of the USAID/RAMP program, RAMP/Chemonics' contributions to the Fund will continue to be deployed beyond that date. Deployments beyond that date will be monitored solely by Acap, assuming the Fund remains under its purview as a result of a to-be-determined decision by the Annual Investors Meeting. The Annual Investors Meeting meets once per year and is expected to convene for the first time in late 2006 (specific date to be agreed with investors).

Projects to be funded

The Fund will make investments in small- and medium-sized enterprises in Afghanistan in line with its investment policy and guidelines, which have been developed in cooperation with the USAID/RAMP program. The USAID/RAMP-Fin technical team will assist Acap in identifying agricultural projects that will be considered for investment by the Fund's Investment Committee.

Eligible use of proceeds

RAMP/Chemonics' contribution to the Fund was intended to be used to attract additional 3rd party capital contributions to the Fund, in an effort to increase the overall financing available to SMEs operating in Afghanistan. Use of any proceeds gained after the end of the Grant Program period will be determined by the Trustees of Acap Development Trust who will ensure that such proceeds will be used in line with provisions laid out in the Trust Deed of the Acap Development Trust which was developed in cooperation with RAMP.

Geographical Coverage

Acap's local office will be in Kabul. However, the Fund may invest in enterprises operating anywhere within Afghanistan, including regions where other RAMP-funded activities/projects (e.g., Kunduz-Baghlan region, Kandahar-Helmand region) are underway.

2. PROJECT OBJECTIVES AND RESULTS

The purpose of the Afghanistan Renewal Fund is to generate market-based returns for investors by financing SMEs in Afghanistan and, in doing so, to contribute to the regeneration of Afghanistan's private sector. The purpose of RAMP/Chemonics' participation is to increase the amount of financing available to small- and medium-sized enterprises operating in Afghanistan along the agribusiness value chain. There is currently very limited financing available to SMEs in Afghanistan, especially for agro-businesses. Making venture capital financing available to eligible businesses in Afghanistan will stimulate the creation and growth of value-added businesses along the agribusiness value chain, which will translate into new jobs created.

Review of objectives and results achieved:

Objective	**Result**
1. Establishment of a venture capital fund with a capitalization of initially $20,000,000	As of 30 June 2006, Acap Partners succeeded in attracting $16,500,000 in capital contributions additional to RAMP's contribution bringing the Fund to a total capitalization at first closing of $20,300,000
2. Invest in 8-12 small- and medium sized enterprises in the three-year investment period between 2006 and 2009.	As of 30 July 2006, the Fund has made no investments. However, the Fund Manager reviewed over 170 potential investment

	opportunities, including 30% along the agribusiness value chain (see review of the Fund's investment pipeline below). Assuming a typical investment rate of 1% of investigated deals, the Fund Manager expects to make one or two investments by the end of 2006

3. INVESTMENT PIPELINE

Overview of the deal pipeline

Acap investigated 164 investment opportunities as of 30 June 2006 of which 30% were in the Agribusiness sector:

Deals by Industry	No.	%
Agribusiness	50	30%
Construction materials	25	15%
Construction	19	12%
Energy	11	7%
Transportation, shipping, & logistics	9	5%
Consumer packaged goods	8	5%
Telecommunications & information technology	8	5%
Healthcare	6	4%
Lodging & food services	6	4%
Metals & mining	6	4%
Services	6	4%
Textiles & apparel	6	4%
Media	3	2%
Printing & publishing	1	1%
Total	164	100%

Of the 164 investment opportunities identified, more than half were eliminated because the investment sponsor failed to respond to requests for further information. 17% were rejected because the business did not have the minimum requirements associated with a sustainable investment opportunity; they often constituted start-up operations by entrepreneurs with no prior experience in the industry, no proven track record of operational or management skills. Just under 4% of deals were rejected because they did not make investment sense to the Fund, typically because deal sponsors were not willing to put their own capital at risk (contributing land does not constitute exposure to down-side risk).

Deals by Deal Stage	No.	%
Pre-prospect	27	16.5%
Prospect	12	7.3%
Preliminary IC Approved	0	0.0%

Final IC Approved	0	0.0%
Invested	0	0.0%
Exited Deal	0	0.0%
Lapsed - Business Thesis	28	17.1%
Lapsed – Investment Thesis	6	3.7%
Lapsed - Sponsor Withdrawal	91	55.5%
Total	164	100%

Current investment prospects

Pre-prospects

Pre-prospects are potential investment opportunities where a first meeting has taken place but where insufficient information exists to determine whether an investment will be likely.

Deal Number	*Business Description*	*Acap investment (US$ mil)*	*Revenues This Year (US$ mil)*	*Profit after tax This Year (US$ mil)*
136	Sugar production	5	NA	NA
137	Tomato sauce processing	2	NA	NA
138	Private health clinic in Heart	2	NA	0.012
139	PVC gas production	5	NA	NA
140	Rokhan stones mine	1	NA	NA
141	Dry cleaning business	NA	NA	NA
143	Land development on lake	NA	NA	NA
144	Upscale health club	NA	NA	NA
146	Consumer packaged goods	NA	NA	NA
147	Dried fruits export	NA	3.5	NA
151	Gem mining and processing	NA	NA	NA
152	Carpet processing facility	NA	NA	NA
153	Live/work/play compounds	NA	NA	NA
154	Flour mill	0.578	NA	NA
155	Flour mill	0.45	NA	NA
156	Carpet cutting/washing facility	0.08	NA	NA
157	Dairy processing plant	0.3	NA	NA
158	Garment factory	0.58	NA	NA
159	Edible oil production	0.185	NA	NA
160	Flour mill, biscuit, marble	1.5	NA	NA
161	Residential apts construction	1	NA	NA
162	Road construction	4.5	NA	NA
163	Apt & materials factory completion	0.5	NA	NA
164	Aluminum product factory	1.5	0.5	0.1

Prospects
Prospects are potential investment opportunities where sufficient information is available to determine that, at face value, the business could be a possible investment.

Deal Number	*Business Description*	*Acap investment (US$m)*	*Revenues This Year (US$m)*	*PAT This Year (US$m)*
5	LPG repackaging & distribution	5	NA	NA
113	Generic tablet production	NA	0	0
115	One stop building material shop	4.8	0	0
116	Low-cost housing	1	NA	NA
120	Dairy farm and processing plant	5	NA	NA
121	Water bottling plant	5	NA	NA
127	Carpet cleaning & processing	0.8	0.255	0.016
128	Farm (grain, cattle, orchards...)	0.8	0.11	0.021
129	Building construction	0.8	0.686	0.0228
132	Equipment financing under $.5m	5	NA	NA
133	Marble factory	1.89	NA	NA
134	Oil drilling and distribution	5	50	NA

Subsequent stages of the investment process include 'preliminary investment committee approval', 'due diligence', and 'investment approval'. None of the investment prospects have yet reached that stage.

4. PARTNERS AND COUNTERPART INSTITUTIONS

The strategy in identifying creditworthy clients was to coordinate directly with RAMP and RAMP Implementing Partners, the business advisory services of FI, and other financial institutional partners of RAMP. Most of these institutions were instrumental in developing a pipeline of quality projects for the FI portfolio.

Additionally, FI worked closely with many other organizations during the past thirteen months. Some were also funded by USAID and other international donor programs along with several private Afghan registered companies. Examples of these coordinated interventions are listed below:

RAMP
The USAID/RAMP-Fin technical team assisted Acap in identifying agricultural projects that were considered for investment by the Fund's investment committee.

On The Frontier (OTF):
OTF provided helpful information on the dried fruits and nuts sector and the carpet sector and introduced Acap to possible buyers of Afghan dried fruits and nuts in the UK.

USAID Afghanistan Economic Department:
USAID liaised closely with Acap providing insight into market developments in the

agribusiness and other sector.

AICC
The Afghan International Chamber of Commerce held regular networking events that provided opportunities for Acap to identify new investment prospects.

Afghanistan International Bank (AIB)

AIB's lending capacity is complementary to the Fund providing loans below the Fund's minimum investment size of $500,000. AIB and Acap referred potential investee companies to each other based on the respective amount of required capital.

Afghan Finance Company (AFC)

AFC provides leasing products and services to agribusinesses. It is expected that some of the companies currently financing equipment leases through AFC will grow and later be considered for investment by the Fund.

5. CHALLENGES ENCOUNTERED

Challenges Acap encountered over the past 18 months can be divided into two categories: a) challenges in the establishment of the Fund, and b) challenges in investing in Afghan small- and medium sized enterprises

1) Challenges in the establishment of the Fund

a) Afghanistan continues to be a challenging environment for outside investors despite the relatively high GDP growth the country has experienced. Consequently, significant time was invested in bringing potential investors to Afghanistan for due diligence visits to get a first-hand understanding of the environment.

    - The judicial system does not provide adequate protection for investors.
    - There is continued uncertainty about the Afghan investment law. For example, during the establishment of the Fund international accounting firms were unable to advise investors whether they would have to pay 20%, 40% or 60% in tax on profits achieved by the Fund's investee companies.
    - Security continues to be a concern for investors in three main aspects: a) as a direct threat to the Fund's physical assets in investee companies; b) as a cause for a slow-down in the general economic environment with subsequent loss of revenues; c) as a limit to the Fund Manager's ability to travel to the location of investee companies and to monitor and assist these companies.

b) Bringing a range of different investors into the Fund requires all parties involved to move out of their comfort zone of standard operating modes. The effect of this was a delay in the timing of the Fund establishment.

- The creation of the Afghanistan Renewal Fund is the first joint investment Fund in the history of two major institutions, the Asian Development Bank and OPIC. Bringing two institutions with different operating procedures and legal requirements together into one fund agreement took considerable time during the legal negotiations.
- Private investors in the Fund, in turn, continue to be suspicious of the burden of operating processes of development finance institutions, particularly in an environment that is not conducive to standard operating procedures. Consequently, significant time was spent on achieving compromises between the expectations of private investors to have flexible operating rules, based on general principles and the detail- and procedure-focused approach of some of the institutional investors.
- The ability of the Fund to bring DFIs, donors, and private investors into one fund agreement is in itself a tribute to the determination by all parties involved to adapt their working approaches to the special circumstances of Afghanistan.

2) Challenges in investing in Afghan small- and medium sized enterprises

- Afghan entrepreneurs, much like in other developing countries, lack an understanding of the need for investors to examine credible business plans before investing
- There is little understanding among SMEs of what constitutes a robust and detailed business plan; instead it is often viewed merely as a high-level marketing document.
- While Afghan businessmen often have decades of experience as traders there are few who have the operational, management, financial skills to run production plants or more complex service businesses. Some are aware of this deficiency and are keen to hire skilled personnel from abroad.
- Many entrepreneurs lack basic professional skills such as delivering requested information on time and with accuracy
- Other challenges include: lack of financial transparency among SMEs, lack of profitability of SMEs, higher concentration of trade enterprises and few service and production industry enterprises with greater expansion potential for job creation.

LESSONS LEARNED

- In post-conflict countries, with an ongoing security problem, outside private investors would not invest at such an early stage without the capital contributions from donors such as RAMP to enhance the likely risk-return profile of their investment

- Afghan investee companies require substantial hands-on-support in terms of development of business plans, management support and general professionalisation. This is expensive and requires technical assistance such as the $1.5 million provided by USAID to support business development activities by the Fund Manager.

- International donors need to encourage the governments of post-conflict countries to establish predictable, simple policies and laws that enable the private sector to operate effectively, to grow, and consequently to provide employment for people and tax income for the government.

- Identifying investment opportunities in the agribusiness sector faces similar difficulties as investing in other sectors. At the production end, the industry is very fragmented and it is hard to find local partners that have the scale and capability to grow. Higher up the value chain, local partners often lack the skills and experience to run e.g. processing facilities efficiently and professionally.

- Aid programs in support of small- and medium sized enterprises should put greater emphasis on assisting and investing in good managers rather than in equipment. We observed several instances, in which donors or well-meaning NGOs had put in place equipment and provided business development support to entrepreneurs who did not have a track-record in running successful businesses in the relevant industry and who lacked interest and incentives to grow the business. Donors and NGOs should put much greater emphasis on identifying the best possible businessmen and management teams to partner with and to put incentive structures in place that truly align the local partner with the success of the business. Contributing land and e.g. 50% of the deal sponsor's time is not enough. Without competent deal sponsors whose interest are aligned with the success of the business, venture capital funds also cannot invest in projects previously supported by donors, no matter their value in assets.