GRYPHON
EMERGING MARKETS

Why is it hard to raise PE funds for Emerging Markets Economy?

BIA INVESTMENT FORUM

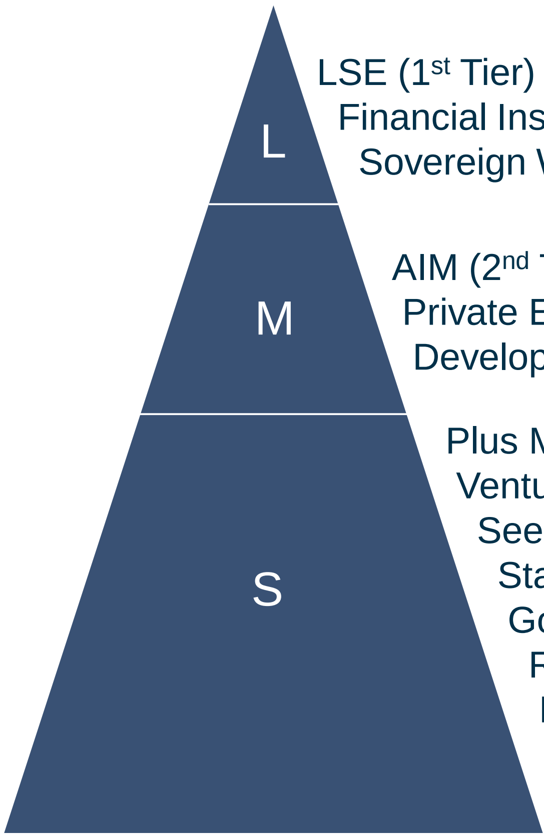
May 2018

Emerging Market Deal Flow

Owner-managed enterprises, management teams and individuals eager to develop business concepts in their home markets.	
Situations	**Needs**
▪ The owner of an existing business seeking to expand domestically or internationally by organic growth or acquisition	▪ Development capital injections of between $10m and $250m.
▪ An individual with an ambitious plan to develop a business opportunity.	▪ Assistance in evolving a strategic plan that will be credible with investors and partners.
▪ An entrepreneur seeking to buy a business, perhaps in a privatisation programme or from a larger group.	▪ Advice on enterprise structuring to optimise profitability and protect the business franchise.
▪ A management team seeking backing to enter an underexploited market sector.	▪ Help in identifying, approaching and negotiating with investors and strategic partners in the EU, USA, Middle East and Asia.
• Governments seeking to develop specific segments of their national economies	• Access to industry knowledge and financial expertise remote from local market

Private Sector Equity Financing Channels

UK

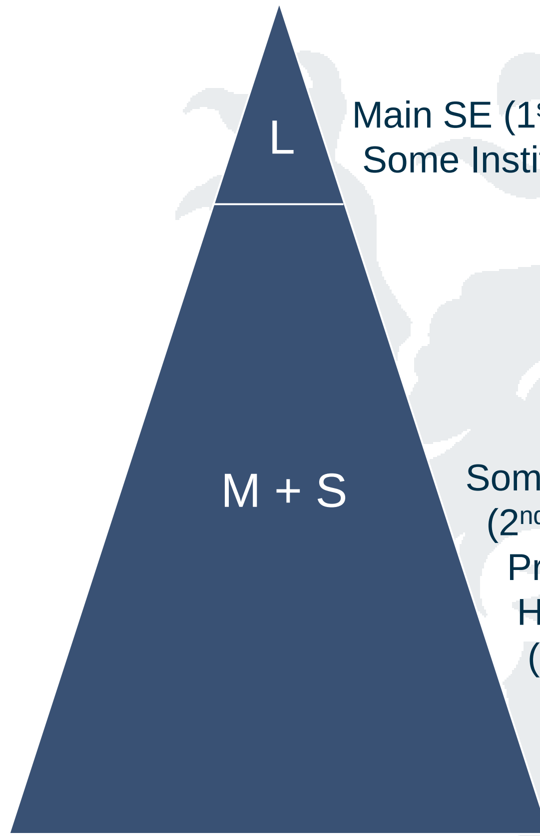


LSE (1st Tier)
Financial Institutions
Sovereign Wealth Funds

AIM (2nd Tier)
Private Equity Funds
Development Capital Funds

Plus Markets (3rd Tier)
Venture Capital Funds
Seed Capital Funds
Start-Up Capital
Government Funds
Regional Development Funds
Business Angel Network
Family Offices
HNW Investors

CEEMEA



Main SE (1st Tier)
Some Institutions

Some OTC Markets (2nd Tier)
Private Equity Funds
HNW Investors (Oligarchs)

Market Position

Statistics	Countries	Markets
Population:	460mn	420mn
Population under 25:	29%	39%
GDP per Capita ($):	29,250	12,170
GDP growth 2009-12:	-1%	4-8%
DC/VC funds Invested ($):	80bn	10bn

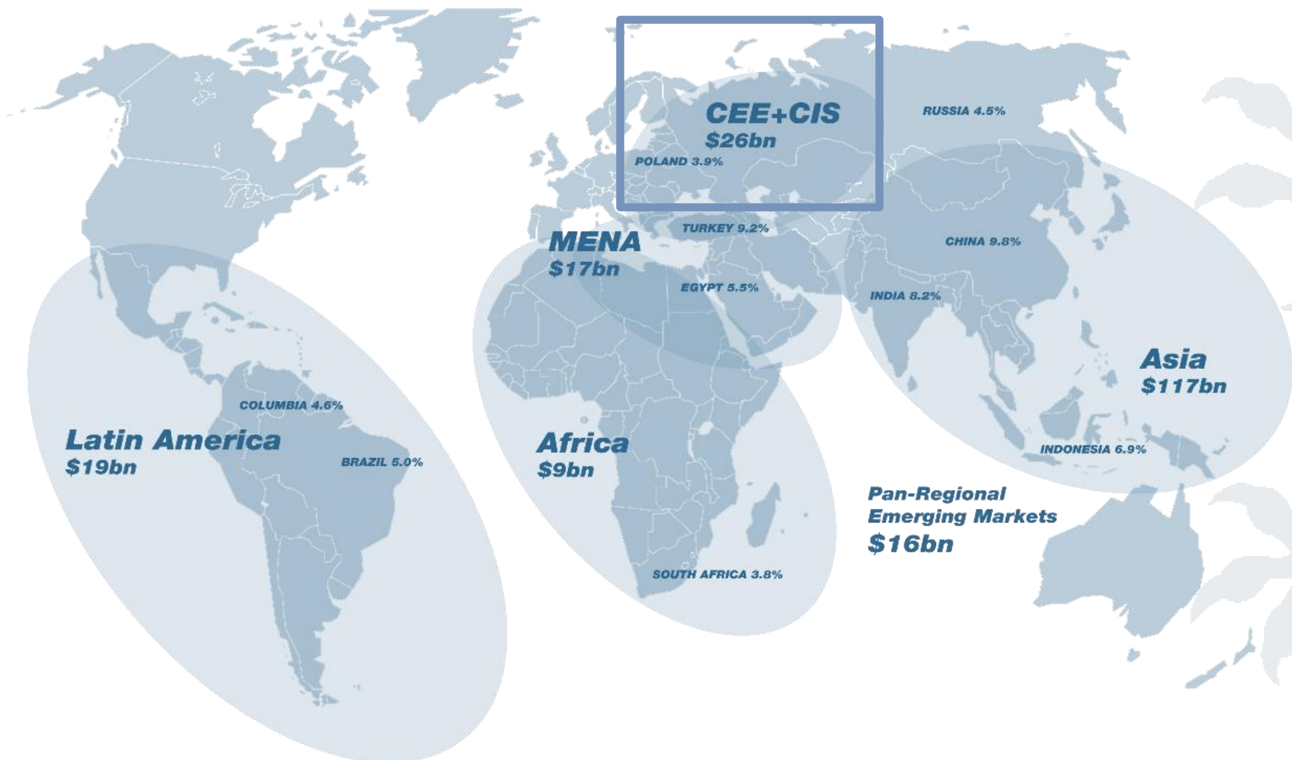
Target Emerging Markets
Demographic advantage
Superior growth prospects
Emerging structural stability

Timing
Low valuation
Distressed Assets

Alternatives to Private Equity
Inefficient capital markets = fewer IPOs
Banking crisis = reduced lending capacity

New Sources of Capital
Sovereign Wealth Funds
Islamic Finance
Geographic Re-allocation

Emerging Markets Private Equity



Private equity

- AUM/GDP = 10% vs. EU
- Total AUM = 3% vs. EU
- 105 vehicles
- Average GP = $250mn
- 10x control stakes/fund
- Avg. company = $50mn

Source: Greenpark Capital

Why is it hard to raise PE funds?

The Structural Fix

- The normal GP/LP structure is a 10 year life with a 3 year drawdown. Compare that to hedge funds with quarterly liquidity or mutual funds with daily liquidity
- Think about it:
  - When you sign up to a private equity fund commitment, you are signing a piece of paper that says that in the next 3 years, the manager can call on your money to invest in whatever he likes
  - You will then be relying upon him and his team to stay in place for 10 years until the businesses are sold and you generate a return
- **If you are an LP, you are going to be very careful**
- Fact: a statistically insignificant number of first time funds are raised on a PowerPoint and a clever team
- Fact: the leading placement agents wont normally take on first time funds

Real world realities

- LPs want to see a team that has worked together for a long time with a track record of sticking out rough patches – for this reason most first time funds fail
- They want to see the management team with their personal wealth on the line
- In a first time fund, don’t start until you have a cornerstone putting up at least half the money.
- Fundraising is long and vague – LPs want to see if you are still there in 6 months or a year.
- Diligence is extensive. The PowerPoint and IM is only the start.

Private Equity Facts

Datapoints

- The CEE region is served by approximately 105 separate GPs.
- These GPs are managing $25bn with an overwhelming orientation towards control (>51%) positions in unquoted businesses.
- This means that the average equity ticket in the region is $25mn and the average pre-money equity valuation at entry is $25mn.
- This AUM represents less than 10% of the AUM relative to GDP vs. the EU and less than 3% in absolute terms.

Why?

- Western PE funds generate 30% of their returns from cheap leverage. Take that away and they don't work: when a juicy IRR of 30% becomes a less than stellar 20%, why bother?
- PE funds are investing in micro-cap companies vulnerable to external shocks, which cannot attract multiple expansion in a 3-5 year timeframe and which are hard to exit. The big exception? IT – the big winners have almost all been in technology (which don't need debt).
- Shortage of dealflow means they all chase the same deals and overpay – the GP/LP structure creates huge investment pressure
- The dirty secret: the money is all in the fees, not the carried interest.
- Another dirty secret: placement agents rarely help (at the start).

Private Equity Risk Exposures

Entry Timing & Pricing

1. Investment period of 3 years
2. Betting the cycle will be favourable to that deployment horizon
3. Competing head to head with locals

Management

Betting that management will work out after short relationship.

Diligence & Governance

1. Reliance on legal and accounting reports.
2. Betting that legal protections will be effective.

SME Risks

The normal array of SME risks.

Exit Timing

1. Divestment period of 5 years
2. CG IRR optimised in that period
3. Betting the company sale can be effected in line with the M&A cycle.

Multiple Expansion

1. Exponential ME available at market leadership and EBITDA > $25mn
2. This may conflict with management exit timing – i.e. it takes longer.
3. Leverage unlikely to add to IRR.

Capital Gain Orientation

1. “All or nothing” exposure to capital gain, which may conflict with management.
2. Can be weak in the face of additional equity requirements.

Primacy of the Owner-Manager

Commitment to Governance

Is the owner committed to sharing information and decision-making? Does his general behaviour give confidence?

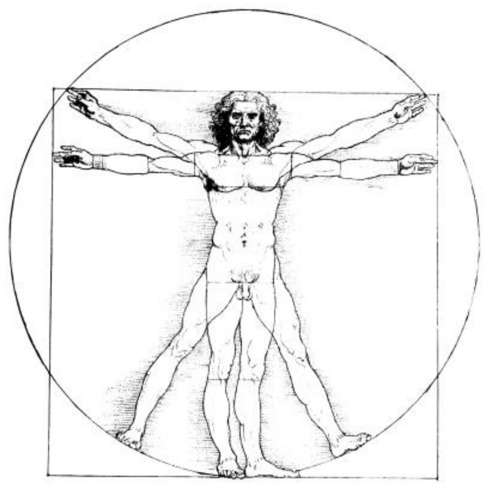
Compelling strategy

Is the owner proposing a compelling investment strategy which, if successful, can generate demonstrable value?

Accounting

Is there a genuine willingness to move to transparent accounting standards, even if there is a short term profit impact?

Out of over 500 transactions reviewed, success stories scored over 50%. Under 50%, the deal failed to price.



A high score day one is unrealistic – but an agreed path to improvement is essential.

Resources

Is the owner prepared to be sufficiently well-capitalised to withstand the inevitable shocks that will occur?

Visibility

Is the owner the most visible actor in his sector? Foreign investors will inevitably seek out the most visible player.

The Market

Is the company in a segment supported by growth (consumer) or destroyed by it (low cost manufacturing)?

Implementation

European Investment Models
Making Prudent Investments

European Investment Company Model

Why they exist

- Founded when capital markets were thin/non-existent, channelling capital and expertise.
- Focus on return in all aspects – use of income to minimise NAV discount
- Listed conduits for institutional capital combined with "active ownership" which means adding value to investees in finance, strategy, cross border M&A, corporate governance.
- All these are areas where CEEMEA companies expect superior Western knowledge.

Examples of Investment Companies

- Ratos AB – Sweden
- Industrivarden AB – Sweden
- Groupe Bruxelles Lambert SA – Belgium
- Ackermans & van Haaren SA - Belgium

Source: Gryphon analysis

Active Ownership Model vs. Private Equity

Holding Companies/Conglomerates

+ professionalised, process-oriented exercise of ownership
+ cohesive and continually developed management culture
+ consistent use of benchmarks and best practices
+ often great success in build-up phases
+ resilient to business climate through spread of risk

- lack of exit strategy (leads to rigid structures and diminishing returns)
- long-term approach becomes an alibi for indifferent ownership and failure to make demands
- one size fits all – same method of approach and/or model pushed out in widely different businesses
- empire building (which does not stop in time)

Private Equity Model

+ structured and systematized ownership
+ impatient ownership
+ active and demanding ownership
+ considerable transaction expertise
+ leading-edge financial expertise
+ successful use of incentive programmes

- lack of industrial expertise and focus
- short-term approach and transaction orientation
- major focus on financial engineering skills which results in high risk taking
- lack of responsibility

Source: Ratos AB reserach

In Quotes

- **Ratos AB**

  "Expertise in transactions and financing is essential in our business. This is, however, an area mastered by most private equity companies and where the opportunities for long-term and sustained value creation are limited. The common denominator for owner companies that have been successful over time is active ownership where most of the value creation takes place through industrial development."

- **Industrivarden AB**

  "We are a long-term industrial developer of listed Nordic companies. Enduring value is a result of many small steps and can only be built up over time. Based on substantial ownership and positions of trust, Industrivärden contributes to the growth in value of its portfolio companies through long-term active ownership"

- **Groupe Bruxelles Lambert SA**

  "GBL strives to develop a portfolio of investments focusing on a small number of industrial companies that are leaders on their markets, in which it can play its role as a long-term professional shareholder. This portfolio is meant to evolve over time depending on the companies' development and market opportunities. GBL invests and disinvests according to its objectives of value creation and of maintaining a solid financial structure."

- **Ackermans & van Haaren SA**

  "Positioning as an independent and diversified group, led by an experienced, multidisciplinary management team, based upon a healthy financial structure to support the growth ambitions of the participations. A long term perspective, with clear objectives agreed upon with the participations. A proactive shareholder, with involvement in selecting senior management and defining long-term strategy, in permanent dialogue with management, monitoring and control of strategic focus, operational and financial discipline and giving active support to management for specific operational and strategic projects."

Source: annual reports

How to create a fund that gets raised?

Four directions:

- Commit to the long haul with a dedicated team and invest into exhaustive preparation (with industry focus)
- Joint venture the product with a brand name GP that can “push a button” to raise capital (top names only need apply)
- Cornerstone half the equity
- Raise against a portfolio

Foreign Investor: Competitive Advantages

Natural Advantages

1. Cost of capital. Most emerging market local debt is priced between 10% and 18% (if available) – equity at 5x Ebitda (if available)
2. Ability to control the timing of the investment with the cycle. You sit in London
3. Sophistication in capital, management and strategy.
4. Desirability. A Western partner is often preferred as an added political protection.
5. Flexibility in choice and structure of the investment.

Manage Risk

1. Use capital advantage - buy into "good businesses at a fair price". Why compete in the bargain basement? Target EM metrics.
2. Create options to invest – then wait for the crisis (if possible). Put the volatility on your side, not against you.
3. Focus on relationship diligence rather than control. Control can come later.
4. Deploy Western skills. The short commodity is management support.
5. Build a stake a step at a time. Why risk more capital than you have to?

Representative Investment Transactions

Penoplex is the market leader in polystyrene insulation in the CIS, with a 40% market share in XPS and a 30% share in other products. It is the leading XPS manufacturer in Europe. The Company owns 7 state of the art plants in Russia and is owned by its founder and Gazprombank.

Saran is the market leader in international content aggregation in Turkey and Central Asian markets, with a dominant position in entertainment (representing 4 of the 7 Hollywood majors) and foreign sports (representing up to 80% of international football and other sports in Turkey

enter air is the leading charter airline in CEE. Started 5 years' ago and profitable from day one, the company operates 14 737s from hubs in Poland, France and the UK. It has a dominant market share in excess of 60% on the Polish charter market and is owned by its founders.

Pachin is the leading decorative coatings manufacturer in North Africa, with a 40% share of the Egyptian paints market. The company is listed by controlled by a syndicate including the Egyptian government, Banque Misr, the employees and Ashmore.

Malbi is a chocolate producer in Ukraine. The company is successfully competing with world leaders (Nestle, Kraft) on Ukrainian market in medium – high segments in consumer chocolate with around 12-15% and a leader in industrial chocolate and chocolate products with 70% of the market.

ITI: Private Equity to IPO

Valuation: €2.5bn
Total Assets: >€950mn
Industries: Media

Pre-1995	– food manufacturing and video import (Hitachi)
	– joint ventures in advertising, other media
1995	– private equity pre-IPO capital raising: $11mn
	– obtains regional TV licence with CME
1998	– private placement – using Luxembourg structure: $36mn
	– expands TV (=TVN), multiplex (Multikino)
	– JV for game shows - SBS Broadcasting buys out CME
2001	– acquisition of O-Net - #1 internet portal
2003	– eliminates bank debt: high yield bond issue of €235mn used to buy out SBS, refinance debt and add TVN24 + thematic channels
2004-6	– IPO of TVN on GPW – shares triple in value – secondary offerings
2008	– #1 media group in Central Europe with a market value of ~€2.5bn

- Success through industry focus, structure, commitment to quality
- Always partnering with the best in the industry: Chio, McCann, Endemol
- Intelligent use of the capital markets – use all available financing sources at various stages: bank debt, bonds, joint venture partners, private equity, IPO

Five Lessons from ITI

1. Believe in your own sector. Relentless focus on media-related opportunities for growth by generic expansion and by acquisition.
2. Avoid dilution by creating high but credible valuations – and then deliver the performance.
3. Use a staged process for acquisitions where necessary. Be prepared to take a minority holding in the first instance.
4. Adopt flexible approach to capital structure. Be prepared to dilute if essential to support the business, – but then reduce the dilutive effect by being ready to buy back shares from partners willing to sell.
5. Use all financing avenues at your disposal. Don't rush too early to the public markets. Private equity and strategic partnerships can make sense if managed properly.
6. Communicate a clear theme: "#1 media group in Poland"

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