

## Information Note: Armenian SME Fund

*April 2016*

### 1. INTRODUCTION

The EBRD is considering an investment in a private equity fund (the “**Fund**”) to be focused on Armenia and supported by the European Union. EBRD is interested in speaking with any prospective fund managers who are willing and able to establish and manage a private equity fund focused on investing in Armenia in accordance with the guidelines set out in this document.

EBRD will decide at its sole discretion whether to proceed with the potential project. If the potential project proceeds, the manager of the private equity fund (the “**Fund Manager**”) would be required to invest in small and medium-sized enterprises (“**SMEs**”) in Armenia. EBRD and the European Union would together consider investing up to ~USD 15 million in the Fund. The Fund Manager would be required to (i) invest its own capital in the Fund, and (ii) raise at least an additional USD 10 - 15 million of capital from third party investors.

The European Union contribution to the Fund would be provided from the Neighbourhood Investment Facility and will provide an element of downside protection to other investors, thus facilitating the mobilisation of required external financing.

The Fund should be invested in a diversified portfolio of 8 – 12 investments in Armenian SMEs over an investment period of 5 years. All investments are expected to be fully realised within the 10-year life of the Fund.

An indicative summary of expected key terms and conditions for the Fund are provided in **Annex A**.

### 2. ACTIONS EXPECTED OF THE FUND MANAGER

The Fund Manager would be required to market, establish and manage the Fund, with specific responsibilities to include:

- Developing an investment strategy to address the specific Armenian opportunity set and market challenges;
- Establishing an appropriately qualified team to implement the investment strategy;
- Approaching potential investors and attracting third party capital to the Fund;
- Selecting entities in appropriate jurisdictions to act as the Fund and the Fund Manager and formulating an appropriate fund structure which would facilitate external investment through the Fund in Armenian SMEs in a transparent and tax efficient manner;
- Establishing required Fund legal entities;
- Negotiating key terms and conditions and full legal documentation for the Fund;
- Sourcing and executing investments with attractive risk return profiles with the objective of achieving long-term capital appreciation for the Fund investors;

- Ensuring compliance of the Fund and its investments with applicable laws / regulations and best practice Environmental, Social and Governance standards;
- Managing investments of the Fund, including hands-on involvement such as board representation;
- Realising investments of the Fund and returning proceeds to investors;
- Reporting to investors on the financial and operational progress of the Fund.

### **3. INVESTMENT PROPOSALS**

Whilst a specific template is not provided, any prospective fund managers should prepare for EBRD written materials in the English language which outline their credentials and cover all aspects of information outlined in **Annex B**.

Any interested parties should send such materials via email to **ArmeniaSME@ebrd.com** by **June 5 2016**.

### **4. MINIMUM REQUIREMENTS**

The EBRD will review and assess all materials it receives and decide, at its sole discretion which, if any, prospective fund managers it would like to shortlist for further in depth due diligence. Specific minimum requirements for the Fund Manager include:

- Senior dedicated team based in Armenia, with relevant skills and experience to implement the Fund;
- Relevant investment experience gained in Armenia and/or internationally;
- Coherent investment strategy, adapted to the specifics of the local market, and including strategies as to how investment opportunities will be generated, how value will be created within portfolio companies and how investments of the Fund will be realised;
- Indicative pipeline of potential investment opportunities for the Fund;
- Ability and willingness to commit its own capital to the Fund;
- Strategy to identify additional investors in the Fund;
- Strong alignment of interest with investors and an absence of conflicts;
- A proposed Fund structure which facilitates external investment in Armenian SMEs; and
- Commitment to implementing highest standards of (i) corporate governance, (ii) environmental (iii) accounting & reporting and (iii) integrity and anti-money laundering procedures.

EBRD may decide, at its sole discretion, to delay or not proceed with the potential investment. Any commitment by the EBRD will be conditional on the negotiation and execution of appropriate legal documentation.

### **5. ANNEXES**

Annex A: Indicative summary of terms and conditions

Annex B: Project Description Guidance

## ANNEX A: Indicative summary of terms and conditions

Fund	The Fund should be established as an independent entity in a jurisdiction which is acceptable to its investors and offers an established and well-tested legal regime for private equity funds. The Fund's proposed investment structure should facilitate external investment in Armenian SMEs in a transparent and tax efficient manner.
Fund Manager	The Fund Manager should be established as an independent entity. The management team should own and operate the Fund Manager.
Minimum fund size	USD 25 – 30 million, including, in addition to the commitments of EBRD and the European Union, at least USD 10-15 million of commitments from reputable third party investors approved by EBRD.
Fund life	The Fund shall be a closed-end fund with a finite life of 10 years from the date of its first closing.
Investment period	New investments may be made for a period of 5 years from the date of the first closing of the Fund.
Investment Strategy	The Fund will invest in small and medium-sized private sector enterprises in Armenia. The investment restrictions for the Fund shall include, amongst others: <ul style="list-style-type: none"> <li>- The Fund will not invest in enterprises engaged in (i) arms manufacturing or other military-related activities, (ii) manufacture of tobacco products or hard spirits, or (iii) operation of casinos or other gambling facilities.</li> <li>- The Fund will not invest in listed securities.</li> <li>- The Fund will not engage in speculative investment activities such as real estate, commodities, commodity contracts and forward currency contracts.</li> </ul>
Portfolio Diversification	The Fund will not invest more than [15%] of total commitments in a single portfolio company.
Exit strategy	The Fund Manager will be required to realise underlying investments, distribute the proceeds to investors in cash and liquidate the Fund.
Investor Protections	The Fund Manager may be removed and / or the Fund may be terminated at any time by investors representing a specified majority of the capital of the Fund.
Key Persons	"Key Persons" will need to be dedicated to the Fund or otherwise have a defined minimum time commitment. In the case of a departure or insufficient time commitment from a Key Person, the Fund may be suspended or terminated.
Environmental, Social and Governance	The Fund shall comply with Performance Requirements 2, 4 and 9 related to the EBRD's Environmental and Social Policy and shall implement the EBRD's Integrity Due Diligence and Monitoring Guidelines for Private Equity Funds when managing the Fund and its investments.
Key economic terms	<u>Management fees</u> : the Fund Manager will receive a management fee to cover the expenses incurred in operating the Fund. The appropriate management fee will be agreed based on the operating budget provided by Applicants. <u>Carried interest</u> : the Fund Manager will be entitled to retain a [20%] share of the Fund profits assuming it returns the entire capital of the Fund (including the contribution of the EU) and meets a minimum net return for investors [of 8% per annum].
Investment Committee	An Investment Committee will be formed by the Fund Manager to approve all investments and divestments of the Fund. The Investment Committee should primarily be comprised of representatives of the Fund Manager but may also include independent members.

Advisory Committee	An Advisory Committee will be formed of representatives of significant investors in the Fund (including EBRD and the European Union) and will review and approve potential conflicts of interest, portfolio company valuations and certain other consents or approvals which will be defined in the legal documentation of the Fund.
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## **ANNEX B: Project Description Guidance**

Materials which are prepared and shared with EBRD should take into consideration the indicative summary of terms and conditions provided in Annex A and include (but not be limited to) the information highlighted below.

### **B1. Market Opportunity**

- Overview of target market segment;
- Depth of opportunity set;
- Demonstration of why targeted segment represents an attractive investment opportunity;
- Explanation of the macro and micro economic and other drivers that underpin the opportunity;
- Risks / barriers relevant to the market segment and its impact on the investment opportunity set;
- Envisaged competition and/or co-operation with other market players;
- Overview of private equity landscape and the challenges / opportunities for private equity in the country

### **B2. Investment Strategy**

- Overview of proposed strategy including how it fits within the economic and social context of the country;
- Appropriate fund size to execute the strategy;
- Overview of industry sectors which are expected to present particular opportunities for the Fund;
- Development stage of investment opportunities;
- Envisaged financial instruments (equity, quasi-equity) to be utilised and stakes to be acquired;
- Competitive positioning of strategy vis a vis other finance providers;
- Target number of investments, deployment rate and portfolio composition;
- Expected holding period of investments;
- Expected exit route for investments;
- Target / expected returns and how they will be generated;
- Indicative investment pipeline including, for each opportunity: name, sector, transaction type, indicative commitment, indicative stake, source of opportunity, indicative value creation plan, and potential exit route;
- Challenges related to implementing strategy;

### **B3. Investment Processes**

- Expected source(s) of deal flow;
- Overview of investment process from origination to signing;
- Overall strategy and key focal points of due diligence;
- Expected use of third party advisors;
- Post-investment management of portfolio companies, including approach to monitoring, value-creation, and involvement in governance bodies;
- Anticipated involvement in strategy, finance and/or operations of investee companies;

- Proposed approach to corporate governance and financial transparency in investee companies of the Fund;

#### **B4. Fundraising Strategy**

- Proposed commitment by the Fund Manager;
- Feasible fundraising target for the Fund;
- Potential investors in the Fund and strategy to approach them;
- Expected timing for achieving required additional investment and beginning operations;

#### **B5. Investment Team**

- Full details of each member of the proposed management team, to include (i) time dedication to the Fund, (ii) Detailed CV, (iii) prior experience and connections within target market segment, (iv) investment track record (including investee name, transaction type, sector, geography, key areas of responsibilities, invested amount, date of investment and exit, realised or unrealised value), (v) current / previous salary, and (vi) three references;
- Details of prior personal and professional relationships between team members;
- Respective responsibilities of each team member in the management of the Fund;
- Competitive advantage of proposed management team;
- Details of any previous and / or existing business activities engaged in by any management team members which could generate conflicts of interests with the Fund or otherwise place time demands on the team members;

#### **B6. Fund's organisation & structure**

- Proposed domiciliation and legal form of Fund and Fund Manager and a description of how the Fund will make its investments demonstrating that the Fund would be an attractive vehicle for external investors wishing to pool their investment in SMEs in the country;
- Details on the proposed shareholder base / ownership of the Fund Manager and distribution of carried interest;
- Operational budget for the Fund Manager, to include details of proposed remuneration of all investment professionals;
- Proposed Investment Committee membership and voting mechanics;
- Details of any other proposed boards / advisors the Fund will have, including how individuals on such boards will contribute to the Fund (including time and financial commitment) and how they will be compensated;
- Independence of the management team, notably as regards investment decisions.