



Completion Report

Project Number: 30707
Investment Numbers: 7131/7132-REG
January 2006

REG: Equity Investments in Lombard Asian Private Investment Company LDC and Lombard/APIC Management LDC

In accordance with ADB's public communications policy (PCP, 2005), this completion report excludes information referred to in paragraph 126 of the PCP.

Asian Development Bank

ABBREVIATIONS

ACGA	–	Asian Corporate Governance Association
CalPERS	–	California Public Employees' Pension System
DMC	–	developing member country
LAPIC	–	Lombard Asian Private Investment Company LDC
Lombard/APIC	–	Lombard/APIC Management LDC
PCR	–	project completion report
LPP	–	Lombard/Pacific Partners LP

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. This project completion report (PCR) relates to the Asian Development Bank's (ADB's) equity investments in Lombard Asian Private Investment Company LDC (LAPIC, or the Fund) and Lombard/APIC Management LDC (Lombard/APIC, or the Fund Manager).¹

2. Overall, the Project is rated excellent, as shown in the table below.²

Evaluation of Lombard Asian Private Investment Company and Lombard/APIC Management LDC

Item	Unsatisfactory	Partly Unsatisfactory	Satisfactory	Excellent
Development Outcome				<input checked="" type="checkbox"/>
Business Performance				X
Economic Sustainability			X	
Living Standards				X
Private Sector Development				X
Environmental Performance			X	
Enabling Environment				X
ADB's Investment Profitability			<input checked="" type="checkbox"/>	
Return on Equity			X	
ADB's Effectiveness				<input checked="" type="checkbox"/>
Screening, Appraisal, and Structuring				X
Supervision and Administration				X
Role and Contribution				X

ADB = Asian Development Bank, APIC = Asian Private Investment Company, LDC = limited duration company.

Note: The check marks contained in boxes represent the overall rating for each main heading in the table.

Source: Asian Development Bank.

II. SUMMARY

A. Project Description

3. LAPIC is a \$252.5 million investment fund that had its financial closing on 14 April 1997. It was formed at a time when the Asian financial crisis posed serious challenges to the Philippines, Republic of Korea, Thailand, and other Asian economies. The intent was to build a diversified investment portfolio consisting primarily of direct, long-term capital investments in emerging markets in the Asia and Pacific region, specifically the developing member countries (DMCs) of ADB.

¹ On 4 days in November 2005, a field mission met with key staff of LAPIC in Hong Kong, China and held discussions with key management officials of two of the Fund's investee companies in Thailand.

² This PCR is part of a sample of PCRs independently reviewed by the Operations Evaluation Department. The review has validated the methodology used and the rating given.

4. The California Public Employees' Retirement System (CalPERS) made a \$225 million commitment to LAPIC representing 90% of all class B shareholder commitments.. On 5 December 1996, ADB committed \$25 million (10% of class B shareholder commitments).³ LAPIC's investment period expired on 13 May 2003 and drawdowns are now being made only to pay for the management fees and any needed follow-on investments in investee companies. ADB also invested \$0.25 million for a 5% stake in the Lombard/APIC Management Company, the manager of the Fund. The shareholders' interests in the Fund and the management company are reflected in the participation of ADB and LPP representatives on the boards of directors of LAPIC and Lombard/APIC.

5. As of 30 June 2005, LAPIC had invested \$178.6 million in 11 companies in the DMCs. Of this amount, \$146.3 million, or 82%, was invested in the economies most affected by the Asian financial crisis of 1997. LAPIC set a positive example through company restructuring, proactive representation on the boards of investee companies, and promotion of good corporate governance. In particular, good corporate governance helped create value for LAPIC's investee companies and provided investors with examples of successful investments, in the process attracting capital back into the region and improving the region's capital markets after the Asian financial crisis.

B. Rationale of the Project

6. ADB's participation in LAPIC and Lombard/APIC Management Company was justified on several grounds. It would

- (i) mobilize funds from alternative sources;
- (ii) allow ADB to associate with and attract capital from pension funds like CalPERS;
- (iii) mobilize equity funds from domestic and international investors;
- (iv) contribute to the development of the capital markets since many of the investee companies would eventually be listed on stock exchanges;
- (v) conform to ADB's strategy of resource mobilization and capital market development; and
- (vi) allow ADB to be better informed and gain in-depth knowledge about the Fund Manager's performance and issues affecting the Fund's portfolio companies.

C. What Would Have Happened Without This Project

7. Other funds were reluctant to invest in DMCs in late 1997. These funds could not respond in time to reallocate capital and ease the effects of the crisis. The creation of LAPIC in 1997 provided value-added assistance to its investee companies in the development of corporate governance, financial reporting, strategic planning, and due diligence and analysis of acquisitions.

³ Class A and C shares are held by the Fund Manager.

8. LAPIC also helped establish the Asian Corporate Governance Association (ACGA), an international, nonprofit promoter of good governance practices. Without LAPIC's support and the models provided by its investments, the "good corporate governance" message might not have been so widely disseminated.

III. PROJECT EVALUATION

A. Development Outcome

1. Business Performance

9. The main drivers of LAPIC's success have been high-quality underwriting, involvement in key activities and strategies of investee companies, and extensive resources of capital and relationships, including access to ADB's personnel, policies, and relationships. LAPIC has deployed capital efficiently, given the state of the macro environment and the financial health of its remaining investments.

10. LAPIC's investment strategy involves consideration of a broad range of attractive investment opportunities diversified by economy and business sector, with certain limitations. Overall, the Fund seeks to produce an appropriate risk-adjusted return for investors while providing investment exposure to a range of economies and dynamic industries and promoting high standards of corporate governance, labor practices, and environmental management.

11. As of 30 June 2005, LAPIC had invested \$178.6 million in 11 companies in five countries in the region. Industry-wise, LAPIC's investment portfolio was concentrated in food processing (26%), financial services (24%), and manufacturing (18%). LAPIC's capital supported seven companies in the expansion phase, two restructuring investments, and two start-up or early-stage companies.

12. LAPIC's investment strategy underwent several adjustments to reflect the impact of the 1997 crisis. The crisis created opportunities to invest in operationally healthy but financially distressed businesses essential to Asian economies. LAPIC therefore invested in companies that were restructuring. Learning from its early investment experience (LAPIC had invested in an Internet company and an early-stage investment, both of which were not successful investments), LAPIC recognized that its strengths were in ongoing business in the financial services, consumer products, and basic manufacturing industries, and avoided high-tech, Internet, and early-stage companies, which carry increased risks and are driven by different dynamics.

13. As of 30 June 2005, LAPIC had invested \$178.6 million (70.7% of its committed capital), of which 98.8% had been returned to shareholders through divestment proceeds and through dividends.^{4*} Ten (partial and full) divestments have been made, with six divestments giving positive returns, because of timely divestments and the higher valuation of the shares in the market, while the remaining four were made at a loss. LAPIC's current strategy is to continue to add value to existing portfolio companies and to plan and execute appropriate and timely exits. It expects to return more than the capital invested by the end of its term. The Fund Manager does not foresee any event that would threaten the viability of any individual investments and thus endanger the realization of benefits that may still be achieved.

⁴ As of February, 2006, LAPIC had returned all of ADB's invested capital, while still holding all or part of four portfolio investments.

2. Economic Sustainability

14. LAPIC's contribution to economic sustainability is rated satisfactory. Eight of the 11 portfolio companies are economically viable, and some of these have grown or have sustained substantial success.

15. LAPIC's impact on the Asia and Pacific region is evidenced by the following:

- (i) LAPIC's successful investment program, included in several international studies on Asian private equity performance, helped demonstrate the viability of private equity investing in Asia and is therefore partly responsible for attracting significant amounts of foreign capital to the region.
- (ii) The successful financial rehabilitation of one company in the Republic of Korea, which was on the verge of liquidation, is a particularly good example of the positive impact of the Fund on the region's economy. Through LAPIC's investment, coupled with capital from other investors, a major financial institution was rescued, a good model of corporate governance relevant to Korean companies was established, and hundreds of jobs were saved.
- (iii) LAPIC is considered profitable for its investors, and the rate of return substantially exceeds that earned in the region's public equity markets over the same period.

3. Living Standards

16. LAPIC's contribution to improved living standards is rated excellent. It helped in the growth of eight companies and created jobs in at least six DMCs. LAPIC's investee companies have reportedly created thousands of new jobs since the Fund invested in those companies. In addition, the profitability of LAPIC's investee companies has helped increase government tax revenue. There has been no negative impact from LAPIC's presence in these companies.

4. Private Sector Development

17. LAPIC's impact on private sector development is rated excellent. LAPIC's catalytic role has been substantial, as the Fund's investors and the Fund itself have been highly visible and most of the investments have been successful. The investments created substantial employment opportunities in both the People's Republic of China and Viet Nam. LAPIC contributed in the following areas:

- (i) **Catalytic role.** LAPIC has attracted other private equity investors to Asia because of its visible success and the manner in which the success was achieved. LAPIC mobilized from three to four times its total capital by attracting co-investors in equity positions and enabling bank financing to take place.
- (ii) **Impact on the region's financial market development.** LAPIC's investments in three financial institutions in the Philippines, Republic of Korea, and Thailand contributed to the growth of financial services companies. In particular, the improved performance of Lombard's financial sector investee company in the Republic of Korea, including the introduction of innovative investment products,

risk control, and good corporate governance, set an excellent model for financial institutions throughout the region.

- (iii) **New products.** LAPIC's investment in companies in the manufacturing and food processing sector has contributed to developing new product lines.
- (iv) **Improved disclosure standards.** LAPIC's presence on the boards of the portfolio companies allowed the Fund to encourage improvements in accounting standards and overall financial disclosure.
- (v) **Development of management skills and employee training.** LAPIC provided advice on general corporate finance, treasury, and investor relations to some investee companies. It also provided training in valuation methods and acquisition process management to the senior management of an investee company.

5. Corporate Governance

18. The Fund Manager believes that, apart from earning profits exceeding public market benchmarks and demonstrating that private equity investments in the DMCs can succeed in mobilizing funds for investment, the promotion of sound corporate governance is one of its greatest accomplishments. LAPIC encouraged its portfolio companies to improve corporate governance and adhere to high-quality standards. Two of Lombard's portfolio companies in Thailand and the Republic of Korea, for example, have received many awards for good corporate governance, and have been recognized by analysts as top companies in their regions and sectors. The Fund Manager strongly believes that good corporate governance enhances shareholder value. One of the few private equity fund managers that develop and make active use of their corporate governance guidelines, Lombard/APIC periodically reviews and improves these guidelines. In 1999, Lombard helped establish ACGA, a nonprofit organization, which now has over 50 corporate and institutional members dedicated to the implementation of effective corporate governance throughout Asia. LAPIC itself is governed by a board of directors that meets at least once a year and follows best practices in the conduct of its business and the transparency of its operations. The members of its investment committee meet regularly to decide on investments and disposition, and sign resolutions (which to date have always been unanimous) adopting their decisions. Detailed quarterly reports are made available to board members and shareholders. All staff members are trained in best practices in corporate governance and encouraged to participate in forums and seminars on the subject.

6. Compliance with Environmental Standards

19. The Fund's compliance with applicable environmental requirements is rated satisfactory. LAPIC invested only in companies that complied with ADB's environmental guidelines and all related local government regulations. It did not invest in "environmentally sensitive" sectors and industries such as infrastructure and mining. The Fund Manager was provided with ADB's requirements in this area and ensures that staff members are familiar with and understand the policies. LAPIC's own environmental policy and guidelines conform to ADB's policy.

7. Enabling Environment

20. LAPIC's contribution to the enabling environment is rated excellent. LAPIC has induced material net improvement in the environment by demonstrating that private equity investors can

make significant profits through socially and environmentally responsible investments in DMCs over sustained periods of time. The Fund has brought out the benefits of sound corporate governance to investors and investee companies. It exerted a significant and positive impact on the enabling environment for improved corporate governance in Asia by forming and continuing to provide financial and in-kind support to ACGA and its independent research, advocacy, and education activities. ACGA believes in the long-term development of Asian economies and capital markets.

21. LAPIC has mobilized capital for the region from other sources like CalPERS, and has catalyzed other investors for the region in other Lombard funds like the Thailand Equity Fund and for future funds like Lombard Asia III.

B. Outcome of ADB's Investment

22. The overall performance rating for ADB's investment in LAPIC and Lombard/APIC, as well as the return, is satisfactory.

C. ADB's Effectiveness

23. On the basis of the following findings, the effectiveness of ADB is rated excellent.

1. Screening, Appraisal, and Structuring of the Project

24. ADB had several meetings and discussions with CalPERS on ADB's participation in the Fund. The proposed investment in LAPIC received good support from ADB's Board of Directors. The Board considered the Fund to be well designed, quite attractive, and truly demonstrative of ADB's capacity to mobilize investment capital by performing a catalytic role among private investors and pension funds from developed countries. The Fund served as a good model for a vehicle to attract pension funds. Its structure adequately addressed the crucial issues of management and control.

25. ADB's performance in screening, appraisal, and structuring is therefore rated excellent.

2. Supervision and Administration

26. ADB's supervision and administration of LAPIC has been very consistent and is rated excellent. ADB has interacted regularly with the Fund Manager, both on the boards of LAPIC and Lombard/APIC, which have had meetings in Manila, and through frequent e-mail and telephone communications and periodic visits to the Fund Manager and the investee companies. In all cases, ADB has reacted promptly and efficiently. ADB staff members regularly prepare an annual review of LAPIC.

27. There have been occasional changes in the ADB representatives on the boards and in the staff in charge of supervising ADB's involvement in the Fund, but the changes have had no negative effect on the Fund itself or on the relationship with the Fund Manager.

IV. REASONS FOR SIGNIFICANT VARIATIONS FROM BOARD REPORT ASSUMPTIONS

28. There were no significant variations from expectations in the stated rationale and benefits set forth in the report and recommendation of the President. LAPIC could not meet its

target fund size of \$500 million, owing in part to the Asian financial crisis and the lack of awareness of opportunities among the global investor community. However, this large fund-size target was set in 1996, when LAPIC was considered by ADB for investment, shortly before the Asian financial crisis. The Fund's objective was to attract significant amounts of capital from major pension fund investors. However, only CalPERS invested in LAPIC. It should be noted, though, that it is not easy to attract conservative pension funds into Asia. That is why ADB, through its Private Sector Operations Department, should continue its catalytic work in mobilizing funds for private equity investments in its DMCs. Furthermore, ADB's location in the Philippines makes it very difficult to maintain continuous contact with pension funds and institutional investors from developed countries.

V. LESSONS LEARNED FROM LAPIC

29. On the basis of the evaluation discussed in the previous sections of this report, the following lessons learned would assist ADB in considering future funds:

A. Positive Experiences

43. As it was the case in LAPIC, the selection criteria should include careful consideration of a Fund Manager with an excellent track record, a good reputation, and wide experience in managing funds in Asia.

44. ADB was proactively involved in the structuring of LAPIC from the beginning. This is critically important for any new Fund in order to gain from ADB's experience and ensure its success. The Fund should have a good concept and a well-designed structure, and be realistic in its objectives and expected benefits.

45. ADB's hands-on role in corporate governance through participation on the board of the fund and the Fund Manager where ADB is an investor was highly successful in LAPIC and should be maintained in new funds.

46. To attract pension funds to invest, ADB should systematically build relationships with pension funds in Asia and donor countries at ADB's annual meeting and other events. ADB should also consider establishing a training program for investment professionals of local institutional investors like pension funds to familiarize these institutions with investing in private equity funds and achieving a better diversification of their investment portfolio.

B. Negative Experiences

47. As a result of Lombard's problems in finding additional investors in 1997, ADB learned that it is important for ADB and the Fund Manager to devote more time and resources to marketing the fund to attract investors and achieve the targeted fund size.

VI. CONCLUSION

49. The overall performance rating of evaluation standards covered by this PCR is excellent. ADB's involvement in the fund was highly catalytic. The establishment of LAPIC may have triggered an increase in both private equity and venture capital investments in the Asia and Pacific region. LAPIC made some mistakes by investing in early-stage companies and sectors where it lacked the necessary know-how and experience, but it learned from these mistakes and was quick to adopt new strategies. The Fund Manager identified the risks associated with

each of its investments and tried to address the industry risks, investment concentration risks, and other risks through diversification by economy and business sector, with certain limitations.

50. LAPIC has strong fundamentals and is managed by a competent fund management team. Through LAPIC's equity investment and the Fund Manager's proactive role, LAPIC has made a significant contribution to its investee companies, particularly in two of its most successful investments in Thailand and the Republic of Korea. LAPIC has placed a strong emphasis on corporate governance and supported activities in this area.

51. ADB does not really need to participate in the fund management company to gain a better insight into the affairs of the fund and therefore monitor the project more closely and effectively. The same can be accomplished through active participation in the various supervisory or advisory committees and bodies of the fund.