CASE STUDY

ELEVAR EQUITY: UNITUS EQUITY FUND AND ELEVAR EQUITY FUND II

November 2013

IMPACT INVESTING 2.0

ORGANIZATION HEADQUARTERS	U.S.: San Francisco, California, and Seattle, Washington India: Bangalore
YEAR FOUNDED / LAUNCHED	Unitus Equity Fund L.P. (UEF): 2006 Elevar Equity II, L.P. (EE II): 2008
LEADERSHIP	**Maya Chorengel,** Co-Founder, Managing Director **Sandeep Farias,** Co-Founder, Managing Director **Johanna Posada,** Co-Founder, Managing Director **Chris Brookfield,** Co-Founder, Managing Director
DESCRIPTION OF PRIMARY ASSET CLASS	Private equity
FUND SIZE	In UEF: $24 million In EE II: $70 million Total: $94 million
GEOGRAPHIC FOCUS	India and Latin America
SECTOR FOCUS	UEF: Microfinance EE II: Financial services (microfinance, SME finance, mortgages, payments), housing, healthcare
SUMMARY OF IMPACT AREAS	UEF: To support the growth of high potential MFIs serving the poor and to increase the visibility of microfinance as a viable investment category among private sector. EE II: To deliver essential services to disconnected communities underserved by global networks
FINANCIAL PERFORMANCE	UEF: 21% realized IRR, net to LPs EE II: N/A
SOCIAL PERFORMANCE	16 companies introduced over 12 essential services to 11 million households

Cathy Clark and Ben Thornley were the lead authors of this case. This case study is part of The Impact Investor, a research partnership between InSight at Pacific Community Ventures, CASE at Duke University and ImpactAssets from 2012-2013. The Impact Investor project team was co-led by Cathy Clark, Jed Emerson and Ben Thornley. More in-depth impact investing fund case studies, practitioner blogs, videos from expert convenings, as well as project reports, are available at: http://bit.ly/impinv and at the twitter hashtag #impinv2.

INTRODUCTION

Building on its partners' deep roots in microfinance lending, Elevar Equity has built a set of funds that are accomplishing what many might think would be an impossible task – using equity investments to build early-stage, high-growth, scalable businesses for underserved customers in Bottom of the Pyramid (BoP) markets. And they are achieving market-rate returns doing so. Over its seven-year history, with $94 million of committed capital under management, Elevar Equity's thesis-based equity investing strategy has focused on generating outstanding investment returns by connecting underserved communities to global networks.

Elevar's story contains many unique elements. First, Elevar's first managed fund, Unitus Equity Fund (UEF), was promoted from within a nonprofit called Unitus. Second, the Elevar partners each brought an average of over 15 years of investing and emerging markets experience, including an average of over eight years of microfinance/impact investment experience. The team's deep understanding of microfinance has enabled a thematic approach to identifying customer needs in adjacent services, such as financial services, payment networks, and rural healthcare. The team has proven experience in investing in scalable enterprises through successive capital rounds, acquisitions and IPOs, and attracting additional capital from upstream investors. Third, Elevar was part of one of the biggest financial wins in the microfinance space through its investment in the Indian microfinance institution SKS Microfinance, which had an initial public offering (IPO) in 2010.

> "It's much easier to socialize a commercial person, than to commercialize a social person. We've made an explicit choice to build our team and portfolio this way."
>
> – SANDEEP FARIAS, CO-FOUNDER AND MANAGING DIRECTOR, ELEVAR EQUITY

The fund has also had some failures and the partners have worked to explicitly put the lessons of both success and failure into their current practice. Much of the progression of Elevar from its first fund, UEF, to its second fund, Elevar Equity II (EE II), is based on leveraging its understanding of client needs and its core expertise in distribution models in microfinance. Elevar has been able to slowly widen its circle of influence to a new set of finance-related industries, new sets of investors who are more mainstream than impact-focused, and new geographic areas.

EE II is also unique in that its small team of partners is geographically dispersed: some partners are based in India to be close to portfolio companies, and some are in the U.S. in order to access other investors and travel more easily to Latin America. The team culture, perhaps as a necessity, is very strong, built on many years of a core set of partners working together and a shared knowledge of living and working in the markets their companies serve. This culture was evident in interviews with limited partners (LPs) and portfolio company CEOs. And the impacts are far-reaching: Elevar's first fund, focusing mostly on microfinance, has served over 10 million BoP borrowers or clients with loans at the MFIs worth over $1 billion. Over 97 percent of these borrowers were women. Elevar's second fund, which is still being invested, has a broader set of businesses, which collectively serve over one million borrowers or clients. Together the funds have crowded in over $3.7 billion in debt and $500 million in equity in follow-on rounds to its investments.

As of September 2013, UEF had achieved a net IRR to LPs of 21.4 percent; investments in EE II had averaged 155 percent revenue growth from Q4 2011 to Q4 2012. The funds together had invested in 16 early- to growth-stage companies serving close to 11 million households in Asia and Latin America through services such as microcredit, savings accounts, rural healthcare, home improvement loans, convenient payment access, small business credit, migrant (housing) services, and information services.

ORIGINS

Three of the four eventual partners at Elevar had worked together at Unitus, a nonprofit that provided capital and expertise to microfinance institutions in developing countries from 2000 to 2010, with staff and field offices in Bangalore, India, and Nairobi, Kenya. Back in the mid-2000's, according to Elevar partner Johanna Posada, Unitus was trying to figure out why MFIs tended to taper off at about 2,000 clients. Many of the MFIs started to become financially sustainable at that size and yet a lot of them did not grow further.

Posada, who had a background in economics and corporate finance, joined Unitus in 2004 and started working on debt as a possible solution, establishing relationships between MFIs and commercial banks so they could start to access the capital market. "It was an initial relationship, so we were structuring the deals with 1:1 guarantee." At that point Maya Chorengel, a former private equity investor, was at the Dignity Fund, also working in debt, and met Posada through a board member of Unitus. She and Posada started working on many deals together. Sandeep Farias, a lawyer by training, had stepped in to found Unitus' operations in India shortly before Posada joined, and Chris Brookfield, with a background in venture capital, came onto the Unitus team in 2006.

Around 2004 or 2005, according to Posada, "We decided to put together an equity fund, which is a bit different from the other funds that were already in the market. There were a few examples of microfinance equity funds but they were betting on very mature institutions and were mostly working in Latin America. We wanted to do a venture capital approach, backing high-risk, high-potential entities. One of the risks was transforming many of the MFIs from nonprofit to for-profit entities. We were the first equity the companies would have on the books. The other new approach was our goal for LPs. We said this was an investable asset class, let's attract private investors looking for socially responsible investments, looking for both financial return and social return." That first fund, UEF, closed at $24 million. The first LP investor was Omidyar Network (ON), with a $5 million equity program-related investment (PRI), their first PRI, in 2006. There were 97 other smaller investors, and it took the team about a year to get to their first close.

UEF was a pioneer in the space and was raised at a unique time. Timing, Posada insists, was on their side. "The market was different then. There was no financial crisis. The equity market was doing well. Microfinance was a sexy new idea. Our first close for that fund was 2006 and our final close was 2007." During that same year, the Mexican MFI Compartamos went public, the first public offering for any microfinance institution, and Muhammad Yunus won the Nobel Prize. "While no one had a track record investing equity in microfinance, there was definitely a lot of excitement around the idea," Posada added.

UEF, with Brookfield and Posada as its managers, was created within and promoted by Unitus. It was structured with mainstream venture fund terms, such as a 2.5 percent management fee and a 20 percent carry structure. The general partner (GP) of that first fund, Unitus Investment Management (UIM), was set up as a subsidiary of the nonprofit. According to Posada, once the fund was invested and operating, they began to explore the possibility of creating an independent commercial investment practice focused on the space. "We invested across seven companies, mostly in India, but also Mexico and Brazil. By the end of 2007—and we invested quickly—when we saw that we had committed quite a bit of the fund, Chris and I started the conversation with Sandeep and Maya on whether we could create an impact investment practice under a true partnership-based model with the managers of the fund aligned as investors and fiduciaries. We saw potential and wanted to have more flexibility to attract and retain talent."

The Elevar founders negotiated with Unitus to create a new entity, completely independent from Unitus, which could continue to manage UEF as well as market a new fund. The team was supported by many of the existing LPs, including Omidyar Network. The new Elevar team entered into a sub-management agreement with UIM, which remained the GP of UEF. This was an arms-length agreement which stated that Elevar would oversee day-to-day management of UEF for a fee and incentives tied to the success of that fund; investment decisions were still to be presented to and taken by the UEF investment committee, which was in place from day one (and which included members of Unitus and other LPs).

In 2008, Elevar Equity was formed. The team went out and raised another $70 million in 2008 and 2009 for Elevar Equity II (EE II). By then, UEF had seven investments, five in India and two in Latin America, and one exit with a 10 percent gross return on the investment. EE II was also structured with mainstream venture fund terms with regards to management fee and carry. The first $40 million for EE II came from ON and an emerging markets investor, Legatum Ventures. Eliza Erikson, Director of Investments at ON, said the main value proposition for anchoring the fund's LP pool was the mix of "seasoned, robust fund managers" and a focus on early-stage business model creation and growth in BoP markets. Posada explained, "We got a few other institutional investors and some of the high net worth individuals from the first fund. Then the financial crisis hit, and raising the additional $20 million was harder." The second fund's investment focus included microfinance, but had broadened to address other financial and adjacent services for disconnected communities. According to Sandeep Farias, "We saw that microfinance was reaching its peak in India and we decided to move on to other ancillary businesses, all within the financial context, but in related industries like affordable housing and mobile services." This started to form the investment thesis for the second fund. In 2009, after making a few investments, and given the volatility of the global financial markets, the partners paused and went back to the drawing board to refine their understanding of customer needs and build their thesis around new services beyond microfinance.

Around the same time, in late 2010, the Unitus nonprofit decided to reformulate its operations. A 2010 press release quoted Joseph Grenny, the nonprofit's board chair at the time, describing the Unitus' decision to shift focus: "[The] capital markets have embraced microfinance… with additional providers entering the marketplace at an aggressive clip. We now feel that there is greater need for our capital and energy in other areas… aligned with our overarching mission of alleviating poverty through opportunity." Today, the nonprofit operates as Unitus Labs and functions as part of a larger group of Unitus entities. Since 2010, Unitus Labs has focused on impact investing and has to date incubated and spun out two new commercial funds targeting this space.

THE FUNDS

FOCUSED THESIS: SERVING DISCONNECTED YET COHESIVE COMMUNITIES.

The thesis of the Elevar funds is based on recognizing disconnected communities as an undervalued asset and investment opportunity. Elevar works to identify entrepreneurs and new business models that meet the unique needs of these communities and connects them to global networks.

The basics of the approach are built on years of experience in microfinance investing. There, according to the fund team, the misconception is that the poor cannot save and are not willing to make purchases for long-term value, like education or property. But the poor, Farias points out, pay for a lot of services; they simply get them at a very low quality and with very high transaction

FIGURE 1. ELEVAR EQUITY MARKET DATA,
From Elevar Presentation, April 2013

# of SMEs in Emerging Markets **400+ million**	SMEs Credit Gap in Emerging Markets **$2.1-$2.5 trillion**
Migrants estimated worldwide **215 million**	Remittances to Emerging Markets **406 billion (2012e)**
Unmet housing units need in India and Latin America **56 million**	Market for small home-improvement loans **$331 billion**

costs. For example, families in India may not often have title to the property they own, but they've been living in the same home for generations. Elevar looks at underserved communities that are cohesive because they have other factors that connect them, such as migrant communities with strong social ties.

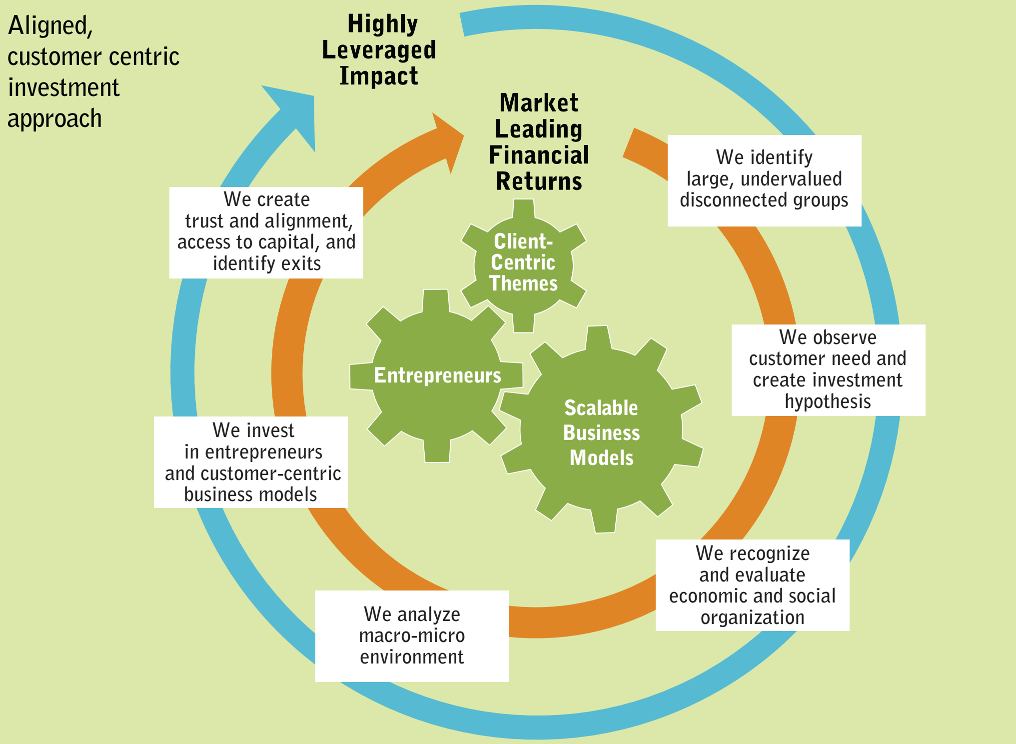
In UEF, Elevar focused on equity investments in MFIs and understanding how to get the unit economics right at the lowest field level and then scaling them up. But many of the MFIs, says Posada, were not structured or incentivized to create new products, so when opportunities emerged for financially-related products outside of the realm of straight microfinance loans, the MFIs were not able to act on market opportunities. In the second fund, EE II, Elevar has focused mostly on financial adjacencies, other kinds of financial products that have the same broad customer base. These have included financial services such as mortgage services, small and medium enterprise finance, brokerage services for immigrants, and payment platforms; the distribution techniques of microfinance can be applied to these and other financial inclusion-oriented services focused on cohesive but disconnected communities.

THE ELEVAR METHOD: MEETING CUSTOMER NEEDS TO BUILD SUSTAINABLE AND SCALABLE BASIC SERVICES

The Elevar "Method," shown in Figure 2, is to carefully identify a set of underserved groups and then work on the ground to create an investment hypothesis around the kinds of services that can be provided to these communities through commercially sustainable business models. Elevar does this in close connection to the entrepreneurs, often working in the field with the entrepreneurs to better understand their customers' needs. Elevar then brainstorms with the entrepreneurs as they seek the best business models to serve the needs of customers in a financially viable, scalable manner, providing inputs based on Elevar's experience with low income communities and the organizational structures and distribution models that can serve them successfully.

Glocal, for example, is an investment from the second fund that runs low-cost hospitals in areas of rural India where there is poor infrastructure. The founder spent a lot of time working in rural areas and collecting data. He discovered that there were 42 conditions (e.g. snake bites, giving birth) that appeared repeatedly in these communities and made up about 95 percent of the conditions for which people sought treatment. He architected a hospital that treats only those conditions and has set up referral networks for other conditions with other hospitals. This customized approach to consumer needs has reduced the capital expenditure required to set up each hospital in his network by over 50 percent, allowing for a business model that can provide healthcare at affordable price points and generate a profit.

FIGURE 2. ELEVAR METHOD



Elevar's team has emphasized understanding customer needs at the lowest level on the ground, and working to build successful distribution models at that level. Farias explained, "The most important part of the ecosystem is when somebody down the line of a company, let's say a field officer or a customer officer, interacts with the customer; that's where most of the magic happens. On top of that, you have all the layers of the organization up to the CEO of the company that we've invested into, and then another level of abstraction between the company leadership and us. We said what was very important was that we needed to get underneath all these layers and understand the customer base. It's very important to think of them as customers, not as beneficiaries. And once you get the unit model set correctly, then you can grow very quickly, because the number of people who need your services is very large. That's the Elevar method."

When asked about the incentives to move up market once customer demand is proven, Posada responded, "None of our companies has moved up market because their success is based on building a distribution model that gets it right for the target customer group." She also commented, "The other thing that makes this work is that we are focusing on very traditional systems. We are taking no technology risk, only investing where the client has already expressed a need and is currently accessing a service in a suboptimal way. Our special sauce is not product innovation, but innovation and rigor in delivery. We will walk through every number and every assumption to determine whether the unit model that is closest to the end consumer can be profitable."

UNIT ECONOMICS: A DISCIPLINED INVESTMENT STRATEGY

The fund's investment strategy builds on a focus on unit economics as well. "We invest specifically for that learning on unit economics," said Posada. "For example, if there is a branch structure, we'll ask how long will it take you to get to break-even at each new branch and then we'll fund enough to learn whether that can happen. We actually make sure the company is somewhat starved for capital at the beginning so they are focused on proving their model and won't grow too quickly too soon." Added Farias, "We generally ask companies to focus for the first 18 to 24 months in getting the unit economics right and understanding the time and investment it takes for each new unit to become profitable. The first investment is often $1.5 million or less. Then, when that is done, we'll invest in growth and work to scale out the innovation."

Farias said the rigor in this method actually came from one of the team's early failures. The investment was in a firm that was rolling out rural business centers in several states in India. "What was amazing about that deal was that we subsequently learned was that while the company was profitable, the unit economics of the individual kiosks didn't really exist in the field -- there was a 80/20 rule, and beyond the first 20 percent, there was a problem. As we started to scale, fundamentally we scaled the problem. It just fell like a pack of cards." This profitable company then faced cash problems and had to wind down its operations. Key lessons included:

1. **BEING PRUDENT ON INVESTMENT SIZE,** actoring in fund size, company stage and impact on valuation.
2. **PROVING UNIT ECONOMICS AND TRANCHING EXPANSION,** especially when still proving the viability and scalability of the business. The company's funding need was tied to a large-scale rollout of rural business centers (RBCs) in several states in India, based on signed government contracts (regardless of financial performance of those RBCs). The company sought equity funding in addition to debt financing for the rollout and when the financial crisis hit, debt funding did not materialize. The company used its equity funding to finance the rollout of RBCs, quickly burning through cash. Though they had proof points of unit economics and operating/ financial sustainability at certain RBCs, a critical number had not achieved profitability.
3. **RECOGNIZING RISK IN RELYING ON GOVERNMENT AGENCIES FOR REVENUES** as it faced problems with the quality and recovery of receivables.

SELECTING ENTREPRENEURS: TWO KNOCKOUT CRITERIA

The partners reported that they had worked in the second fund to identify and locate potential investment opportunities based largely on the quality of the entrepreneurs. Execution skill, professional maturity and the ability to take decisive action are more important that global recognition or awards for being a visionary. The team realized going forward it should insist on proven experience at the CEO and other senior management level and engage two very deliberate "knockout" criteria.

The first criterion is based on commercial experience in managing large organizations. Entrepreneurs leading EE II portfolio companies are seasoned, long-term professionals averaging approximately 20 years of prior professional experience, and most have held C-level positions in their prior careers in large companies such as Citigroup, ICICI Bank, Banco Santander, Reliance, GE Capital, HSBC and McKinsey & Company. Elevar considers this group to be experts at management and execution in their markets. According to Farias:

"It's much easier to socialize a commercial person than to commercialize a social person. It's quite a controversial statement because of the word socialize. Based on our track record, we are capable of both, but we make an explicit choice to focus on one. With all of our backgrounds through the first fund and at Unitus, we actually worked with a bunch of social guys to commercialize. I, for example, did a lot of work in helping the MFIs transform from nonprofits to for-profits. We've taken organizations through that journey. But what we realized was, if we have to back successful companies, the entrepreneur needs to be able to build large organizations. And to build large organizations, this is not a 24 year old who's never had a job, and it's not like building an Internet company. You are going to have thousands of people working for the organization and you need someone who has real experience in building them, from within a multinational or a large corporation."

The second knockout criterion is someone who has embraced the right mindset for understanding target customer markets at a deep level. Adds Farias, "How can they understand the customer if they don't go out and spend time in the field? Are they comfortable working in a non-air-conditioned environment in India? I'm not saying don't have an air conditioner in the office. But I'm saying, are you comfortable going to the ground, rolling up your sleeves, doing the work and meeting with the customers? We ask to go into the field with potential CEOs and meet some customers, and then while they talk to the customers, we watch them. Are they going to sit in their car and go two feet in or are they actually walking in and spending time talking to people? That is critical. I wouldn't invest otherwise."

TEAM DYNAMICS AND CULTURE: DISPERSED YET CULTURALLY UNIFIED TEAM

Elevar is comprised of four Managing Directors, Maya Chorengel, Sandeep Farias, Johanna Posada, and Chris Brookfield, who collectively have over 60 years of experience in professional venture and private equity investing, law, corporate finance and impact investing. They and the broader Elevar team come from diverse nationalities and ethnic backgrounds. Most importantly, Chorengel notes, all the partners have lived and worked in the markets they are investing in, and the partners have known each other and been working together in different capacities for an average of seven years. Team members have previous work experience in India, Peru, Mexico, Spain, Brazil, Hong Kong, China, the Philippines, Indonesia, Singapore, South Korea, the U.K. and the U.S. and have made investments (at Elevar and previously) in over 10 countries. Collectively, the Elevar team has executed over 100 transactions across many of these markets.

Taylor Jordan, Managing Director of the advisory firm Imprint Capital, pointed out the team's strengths, and also mentioned that the geographic dispersion of their small team (with bases in Bangalore, San Francisco and Seattle) was a red flag in the initial due diligence his firm performed for some potential LPs. "We spent a lot of time watching how they solve problems and we saw they were very open and transparent, with high integrity and you can tell they are a tightly knit group that communicates easily." Portfolio company entrepreneurs also noted the unusually forthright style of this team. Gino Picasso, CEO of GlobalKasNet said the team has been "a pleasure from the get-go" and that when Elevar invested in his company alongside Accion, what set both groups apart from other investors was their deep knowledge base. He added, "The real test of a relationship is when something doesn't go right. We had an issue a while back and despite the fact that I have been a telecom exec for more than 30 years, it was the most difficult phone call I've ever made in my career, because basically we were victims of fraud. My first calls were to Maya Chorengel and Monica Brand of Accion and they helped me manage the crisis, right there with us the whole time, helping me communicate the problem, interact with various stakeholders, and execute on a plan. Having a board that has complete transparency is a real privilege."

Farias said hiring other team members for the funds is a key component of their success. “We recruit in different locations, and the associates are ultimately working with the dispersed team. We are very demanding and blunt with each other. We are also not a deal shop and we have to recruit carefully for people who understand the implications of that; it’s a small team. But yes, our culture is defined and seems even to be understood enough so we get pushback when we stray outside of it. I had a team member last week pull me aside and say there were a few things I said in the team meetings that were not consistent with our culture. I took that very seriously.”

THE INVESTMENTS

Elevar is responsible for a number of firsts in the microfinance investing industry. At its launch, UEF was one of the few, and likely the first microfinance-focused equity fund that was fully funded by private, non-governmental investors (i.e., there were no development finance investors in the fund). The first fund invested primarily in commercially established MFIs from 2006 to 2008 totaling $17.8 million in invested capital. As of 2013, those MFIs have served over 10 million clients, up from approximately 550,000 served at the time of the initial investment. The second fund did one follow-on investment into a company from the first fund, and has invested in 10 more companies. In 14 of 16 portfolio companies to date, Elevar’s capital was the first institutional capital in the portfolio company. In four companies, Elevar played a formative role in identifying client needs and defining the initial business plans alongside the founding management teams of such companies. In eight financial services companies, UEF and EE II invested in multiple stages of financing as the portfolio companies progressed from start-ups to serving in excess of seven million clients with aggregate gross loan portfolios in excess of $630 million, as of December 31, 2012. Through September 2013, for nine companies out of the total portfolio, UEF and EE II had invested in up to four subsequent rounds of financing for each company. Finally, the Elevar investment team had managed two exits, and was extensively involved in one of them, the IPO of SKS. See Table 1 and Figure 3 for an overview of UEF and EE II.

FUND 1: UNITUS EQUITY FUND (UEF)

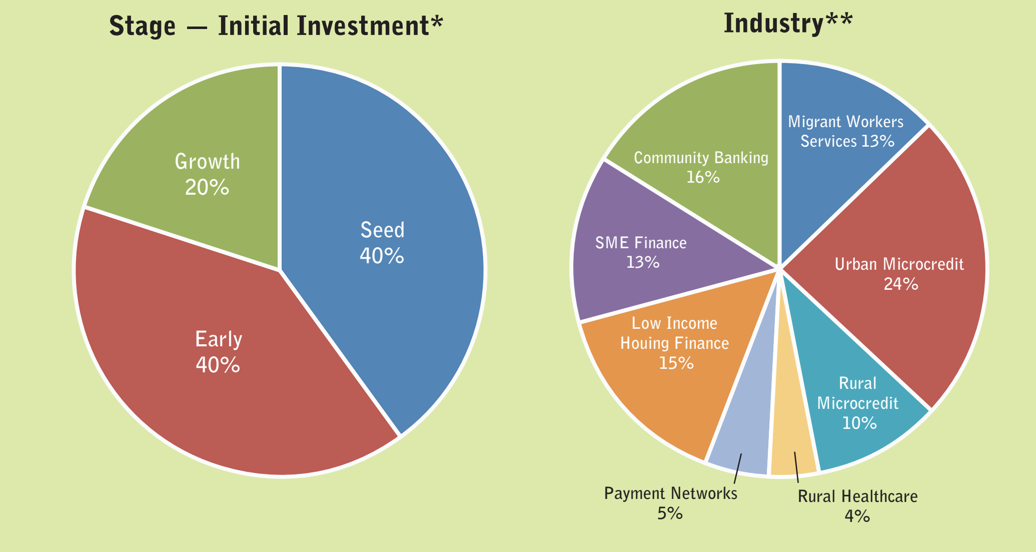
The first investment theme, applied by Elevar from 2006 to 2008, was that microfinance could be sustainably operated within a commercial framework. Since 2006, UEF has invested in six MFIs, four in India and two in Latin America (Mexico and Brazil). UEF also has an investment in one company providing agricultural supply chain services to rural Indians. For these seven investments, UEF executed seven initial rounds and eleven follow-on rounds of financing. Adopting a venture capital approach, UEF invested in younger, growth-oriented MFIs that had recently transformed from nonprofit to regulated financial institutions, or in start-ups with innovative business models intended to spur growth and efficiency. In keeping with its goal of encouraging the development of a commercial equity market for MFIs, UEF was among the first microfinance-focused equity funds to seek and welcome co-investments directly into the MFI from mainstream commercial investors (such as Sequoia Capital), signaling to the broader capital markets that the microfinance industry has long-term viability and offers an attractive risk-return profile. UEF was the initial fund investor in SKS, which achieved an IPO on the Mumbai Stock Exchange in August 2010, becoming the first publicly traded microfinance non-banking financial company in India. The company went public only four and a half years after receiving equity financing from UEF and a few individual investors to incorporate a for-profit non-banking financial company.

FUND 2: ELEVAR EQUITY II (EE II)

EE II was one of the first commercial efforts to push beyond microfinance investing to focus on other essential services to the microfinance customer base. To date, EE II has invested in ten portfolio companies operating in multiple industry sectors, such as financial services and other essential services focused on large disconnected communities. Seven portfolio companies are based in India, one company is based in Peru, one company is domiciled in the U.S. but focuses primarily on Peru, and one company is headquartered in Spain and has operations in Europe, the U.S., Colombia, Peru, Bolivia and Ecuador. Among the investments are several pioneers: the first finance company exclusively focused on credit to rural and semi-urban micro and small enterprises in India; the fastest growing and largest independent, multibank payment network in Peru; one of the first housing finance companies providing new mortgages and home improvement loans in urban/peri-urban India; the first comprehensive, rural hospital chain in India; and the first formal housing provider to low income migrants in India. As of September 30, 2013, EE II has invested $32 million of capital in these ten portfolio companies.

	EE FUND I — 2006	EE FUND II — 2008
Fund Size	$24 million	$70 million
Invested Capital	$18 million	$32 million
Portfolio Companies	7 companies	10 companies
Realizations	$41 million	N/A
Company total Revenue — 2012	$135 million	$70 million
Realized IRR, net to LPs	21%	N/A
Geography	India, Mexico, Brazil	India, Peru, Europe/U.S./ Latin America

FIGURE 3. INDUSTRY AND STAGE



* Fund II — Based on number of companies at intial Elevar entry

** Fund II — Based on fair market value as of December 31, 2012

INVESTMENT PROFILE: VISTAAR

Vistaar Finance (www.vistaarlfi.com) is a financial services firm focused on lending to the micro and small businesses segment in India. According to the Indian government's ministry statistics, only 5 percent of the 26 million small- to medium-sized enterprises have access to institutional finance. By offering affordable finance, Vistaar helps these businesses to scale up their operations and enter mainstream financial markets. Vistaar's loans range from INR 30,000 ($500) to INR 2.5 million ($4,000), at an average interest rate of 24-25 percent. The company differentiates itself from microfinance institutions by lending money exclusively to small businesses on the back of property as collateral and on an individual basis. It does not extend loans for personal consumption.

Vistaar targets businesses such as small shops, small manufacturing units (e.g. flour mills), services (e.g. small restaurants, garages, workshops), power/auto loom textile manufacturers, dairy, kirana (mom-and-pop retail), and home-based industries. Other players have focused either on segments which are eligible for loans from banks or on segments that are close to the base of the pyramid with smaller ticket sizes and have therefore found it difficult to scale. Lending to this segment can also be a challenge owing to insufficient proof of income documentation and challenges in property title verification. Through a deep understanding of borrowers' businesses, household expenses and commitments, and collateral issues, Vistaar has developed a unique credit methodology that addresses these issues in an innovative manner. As the requirements of financing for different businesses, geographies and target customers vary significantly in this demographic segment, there is a need for a more customized approach to product offerings. Vistaar focuses on this opportunity by providing customized products aligned to the needs of the small businesses on three key dimensions – loan size, tenor, and security.

GUARDIANS OF THE VALUE PROPOSITION

According to Ramakrishna Nishtala, Vistaar's founder, "Elevar's team was very clear from the beginning about the kind of business in which they wanted to invest. Other investors settled back after hearing our presentation, but Chris and Sandeep met with us in 2009 and got excited. We initially tried a model that focused on much lower ticket sizes, but after a year, we realized that market was saturated with existing microfinance offerings. We sat down with Elevar, one of our two initial investors, and explored a set of other potential sectors in which to target loans. Together, we studied cost and revenue drivers, cash flows and other factors, and did many customer visits. We ended up decided on seven segments on which to focus." Fast forward a year and the company raised a second round of financing, in the amount of $2 million from Elevar and Silicon Valley Bank. By 2012, the company had raised another $8 million, adding two more investors, Omidyar Network and Lok Capital.

Elevar's principals did more than help the company reinvent the company's business model. They have also served as "guardians of the value proposition," according to Nishtala. "They are open-minded about new ideas and at the same time, keep us from getting distracted. They have deep knowledge about other markets which they can bring to discussions about ours, and they are experienced in implementation details, like collateral and credit structures."

SCALE AND IMPACT

The scaling plan is focused on the unit economics at the branch level. As of June 2013, the company had disbursed $33 million in loans to over 30,000 micro and small enterprises and had been profitable since August 2012. Nishtala said he aims to have every branch serve at least 800 borrowers within two years of starting operations. The company's overall plans have them operating over 150 branches over the next two years, which would represent about 120,000 borrowers.

According to Nishtala, Vistaar's social impact is inextricably interwoven into the company's customer segmentation. Their target segments are completely deprived of capital, so the impact of including them in the financial system is relatively easy to track. By creating proprietary credit underwriting models for six verticals (dairy, textiles, small convenience stores, other small shops, foodservice, and brickmaking) to date, they have cracked the code to address financing for livelihoods representing 56 percent of the total micro/small/medium industry sector in India, by credit demand. The company tracks the customer segment in terms of size of business, the kinds of sources they get capital from before and after their loan, and the number of first time loans they access from mainstream banking sources. The firm also tracks employment from their lending, the number of jobs supported (approximately 61,000 as of December 2012), and the percentage of women who are applicants or co-applicants (82 percent as of December 2012). In addition, 97 percent of their customers are taking business loans from the finance sector for the first time.

They have integrated a number of field-leading consumer protection components into the model to ensure that customers do not become over-indebted; the firm practices very strong customer transparency. "That is one of the things the Omidyar Network helped us with," said Nishtala. "We used their contacts and resources to prepare a video for new borrowers that explains loan terms clearly, and explains other important concepts, like what a credit bureau is."

LOOKING AHEAD

Nishtala said the company was exploring multiple exit options. "An IPO is attractive because we would get to retain the uniqueness of what we are trying to execute." In addition, he believes the company at scale will be a very attractive acquisition for a larger bank.

FINANCIAL AND SOCIAL PERFORMANCE

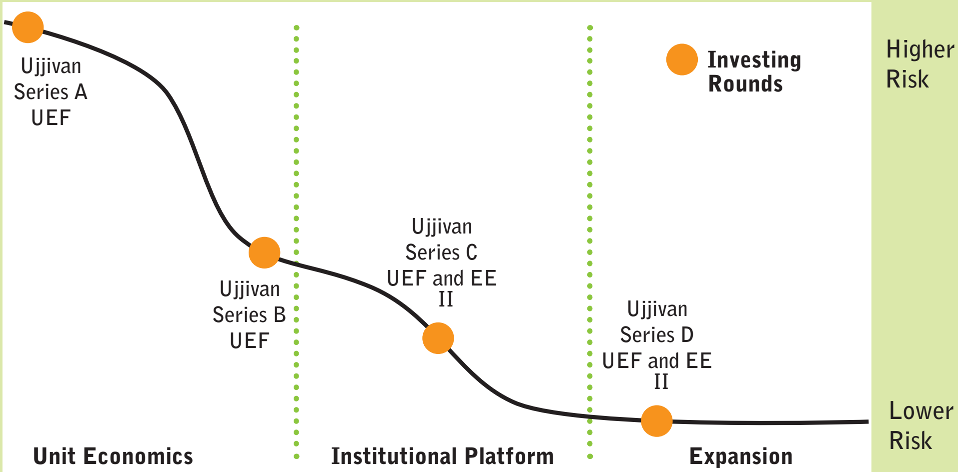
As explained above, the Fund seeks to invest in large-scale, client-focused platforms. Once profit is generated at the unit level, the effort shifts to institution building, replication, and expansion. Scaling from hundreds of clients to thousands or millions of clients is a significant challenge. That said, the majority of UEF companies are operating at scale. Furthermore, six EE II companies have successfully proven out their unit economics, and two of them are operating at scale. Figure 4, below, shows graphically the progress of portolio company Ujjivan, a microfinance provider in India, from unit economics to institution building to expansion mode, from the date of its first investment as a start-up by UEF in 2006 through subsequent rounds of financing with participation from UEF and EE II. The most recent financing round was completed in 2012.

EXITS: REALIZED RETURNS AND OTHER MEASURES OF FINANCIAL GROWTH

To date, UEF has achieved multiple exit events involving two of its portfolio companies. As of September 30, 2013, UEF had realized $40.7 million, its blended net IRR to LPs (realized after fees and carried interest) was 21.4 percent, and its blended net IRR to LPs (realized and unrealized) calculated on cash invested into the portfolio companies was 28 percent.[1] Through this date, the value of UEF's realized proceeds and residual fair market value was 2.1 times total called capital of $21.6 million.

[1] IRR is calculated as XIRR, using capital funded by limited partners at the time of each capital call as outflows, and inflows of capital when they actually occurred (for Finsol and SKS exit events) or as of September 30, 2013, assuming exit at the then market price calculated by taking the actual valuations (price per share) paid on the companies' last equity round or the public market pricing for the company net of management fees, fund operating expenses and allocation of general partner carry cost.

FIGURE 4. SCALABLE BUSINESS MODELS



Unit Economics

- Client-centric: essential products/services in high-demand.
- Purpose built distribution, product/services, operations for target segment.
- Iterative pilots/design focusing on unit economics.
- Metrics and milestones with risk tolerant capital.

Institutional Platform

- Replicable operating units.
- Processes, people, and platforms for sustained growth.
- Governance, controls, risk management, information systems.
- Highly-aligned, patient investors and capital.

Expansion

- Long term relationship with clients.
- High volume, low margin and profitable business.
- Continued innovation on product and focus on lowering costs.
- High growth capital and access to capital markets (debt + equity).

As of December 31, 2012, the EE II portfolio companies had averaged 78 percent cumulative annual asset growth since initial investment by EE II. In aggregate, by December 31, 2012 the fund's portfolio companies had mobilized over $4 billion in capital (over $500 million in equity and over $3.7 billion in debt) post-investment by UEF and EE II. Co-investors in UEF and EE II portfolio companies have included both impact investors like the Michael and Susan Dell Foundation and Accion, as well as commercial investors like Sequoia Capital, Silicon Valley Bank India Capital Partners, Helion Venture Partners, WestBridge Capital, and Wolfensohn Capital Partners. In terms of attracting additional capital to the sector, each dollar of initial equity invested by Elevar has been followed by an additional $89 in third party debt or equity capital. Elevar has attracted significant additional investment and provided a pathway so that their portfolio companies can continue to secure capital from mainstream capital markets.

In addition to realized and unrealized economic gains, the UEF portfolio has achieved strong growth at the client level, wide geographic coverage and a leading market position. Measured from investment inception to year-end 2012, UEF's portfolio MFIs have grown their collective client base from approximately 234,000 to seven million, a cumulative annual growth rate of approximately 58 percent. This compares to a comparable annual growth rate for MFIs reporting to the Microfinance Information Exchange of four percent.[2] The UEF portfolio, as of December 31, 2012, owned a collective gross loan portfolio of nearly $634 million. Its Indian portfolio companies have among the broadest geographic coverage in the country compared with the microfinance portfolios of other impact investors. The more diverse EE II portfolio counted over 1.2 million customers as of December 31, 2012 for its companies serving individuals and small businesses in India, Peru and from the Andean region of Latin America. Importantly, the range of services provided by this portfolio have extended beyond microfinance to cover other financial services, payments infrastructure, housing and healthcare.

[2] Microfinance Information Exchange, Inc., http://www.mixmarket.org/crossmarket-analysis-report/download. Note that data is calculated as of December 31, 2011 as more current industry data for the period ending December 31, 2012 is not available.

SKS MICROFINANCE: LESSONS FROM A HIGH-PROFILE IPO

One of Elevar's exits was from the IPO of SKS Microfinance. This was a highly controversial event for the field of microfinance in India, since many industry critics point to the visibility, success and enormous wealth created from this IPO as a complicating factor to the microfinance crisis in the Indian state of Andhra Pradesh in 2010, which threatened the entire microfinance industry in India.[3] Elevar's team believes the experience revealed several important lessons for them and for others in the field of impact investing:

1. CHOOSE THE RIGHT CO-INVESTORS. Given the small size of UEF, the team recognized the need for a deeper pocket and a local and strategic investor in SKS, as the company had had an aggressive growth profile and path to IPO. It also recognized the importance of choosing long-term, patient co-investors that clearly understand the balance between profitability and returns vs. client-focused and long-term community value creation

2. PORTFOLIO ALLOCATION DECISIONS NEED TO BE DYNAMIC. The allocation of the fund's capital at the appropriate time was a decisive factor in the optimization of the funds' IRRs. It is important to have larger reserves for each company than UEF had put aside. Specifically, in SKS's C round, Elevar's managers went back to the UEF LPs and requested approval to waive the 20 percent allocation cap for any one investment under the Limited Partner Agreement. Having received approval, they were able to defend their pro rata in the Series C round, an internal round priced at a relatively low valuation, which ultimately resulted in a higher return on investment for the fund.

3. FOCUSING ON LIQUIDITY IS AN ART. In late 2008, influenced by general market conditions as well as specific, indicative signs of an over-heating Indian MFI market and over-indebtedness in Andra Pradesh, Elevar entered into a private sale of a portion (about one-third) of its ownership in SKS, even with knowledge and clear indication of a near-future IPO which promised a much higher valuation. This was done to exhibit the fund's ability to generate liquidity and returns while still supporting and maintaining an important ownership interest in the company.

Furthermore, Elevar's recommendation at the IPO was that the GP accept "promoter" status, though it implied risk, in order to be able to sell shares on the public offering and obtain liquidity. In India, for a company to go public, there needs to be a clear identification of the promoters of the company (usually the founder or their affiliates). The promoters also need to own a minimum of 20 percent ownership in the company shares. For SKS, no one had close to that level, so Elevar (along with a couple of other investors) stepped into that status to help make the transaction happen. As a promoter, there are additional limitations on selling your stake following the transaction, and additional transaction documentation requirements. In exchange for accepting "promoter" status, Elevar and the other investors who accepted that status negotiated the ability to sell previously owned shares at the IPO price at the time of the IPO. For Elevar, which was a Series A investor in SKS, this guaranteed a solid return for the investment, and thus shored up returns for UEF. According to Chorengel, she has not heard of another instance where investors stepped into the role of a promoter during an Indian IPO.

4. EYE ON REGULATION. Elevar believes it is important to not underestimate the regulatory and political risks present in many of the countries in which they invest.

[3] See http://www.cgap.org/publications/andhra-pradesh-2010

IMPACT ASSESSMENT: STRATEGICALLY ALIGNED WITH THE FUND THESIS

Elevar's impact thesis relates to the belief that many communities are underserved (for many reasons, including poverty, discrimination, and distance), which is an impediment to development. These communities often contain thriving informal sectors in which a variety of services are being demanded and offered, though generally at low quality and high prices. Elevar works to invest in companies that deliver products and services to these communities in ways that develop a thriving market, where the company can both scale to millions of customers and retain its own financial sustainability. This ensures that its products and services can simultaneously maintain quality and reach. The overall thesis, then, is one of financial and economic inclusion, and Elevar's impact metrics are tightly intertwined with financial and operational metrics.

To validate impact, the funds concentrate on five core themes: customer demographics, customer financial strength, product/service quality, scale, and capital leverage. These directly relate to metrics the fund collects, as seen in Table 2.

TABLE 2: ELEVAR'S CORE THEMES

THEME	QUESTION	SUB-QUESTIONS	SAMPLE INDICATIVE METRICS
Customer Demographics	Is the business centered on the target customer?	Percentage of customers who do not otherwise have access to services/are unable to afford services at currently available price points Percentage of customers who are in target demographic based on income level or some other measure	• Significant percentage of customers without credit score/records • Average income of borrowers within targets • Significant number of RSBY insurance customers[4] • Number of underserved districts in which hospitals or bank/MFI branches have been set up • Significant number of customers with no prior banking relationship
Customer Financial Strength	Does the product/service help strengthen the customer's balance sheet?	Does it help reduce expenses/ increase income? Does it help build a long term asset?	• Reduction in borrowing, rental, transaction cost compared to status quo • Increase in value of asset (such as a building in housing) • Improvement in health (long term asset creation)
Product/Service Quality (as measured by Customer Satisfaction)	Does the business offer significant improvement in quality/reduction in price as compared to the current alternatives? Is the customer satisfied?	Customer satisfaction as compared to next best alternative? Demand for and uptake of products/ services?	• Increase in average tenure and occupancy levels at hostels • Increase in word of mouth customer referrals • Increase in staff productivity (ease of customer acquisition)
Scale	Is the business able to scale and cater to large, unmet customer demand?	Volume – number of customers? Value of products sold? Presence – in terms of locations covered / number of units set up?	• Increase in number of loans disbursed • Increase in number of hospital beds or patients treated • Increase in number of customers with better homes • Increase in number of homes sold to migrant workers
Capital Leverage	Are our investments attracting capital to this space?	How much debt/equity capital has the company raised?	• For every dollar invested, how much is raised • Mix of commercial vs. social sources of capital

[4] RSBY is a state insurance scheme for Below Poverty line patients, administered by private insurers.

While Elevar tracks extensive impact metrics for each company in its portfolio, it concentrates on several key performance indicators for each company, which are a blend of operational outputs and social impact outputs: a Community metric, a Business Model metric, and a Scale metric. Whenever possible, these metrics attempt to include status quo figures so that the companies are comparing results to what existed prior to their intervention.

As an example, portfolio company GlobalKasNet LLC (GKN) is the fastest-growing, independent, multibank payment network in Peru, offering transaction, processing and settlement services to low income urban and rural clients of banks, MFIs, and commercial wholesalers. GKN empowers its agents – typically carefully selected small shop owners or merchants – with training and technology to perform all the functions of a bank teller or ATM, providing greater convenience and accessibility to end clients. GKN reports increases and decreases in three key performance indicators to Elevar, as seen in Table 3

TABLE 3: KEY PERFORMANCE INDICATORS FOR GKN

METRIC TYPE	METRIC	DESCRIPTION	Actual percentage increase reported from Dec 2011 to June 2012
COMMUNITY	Number of active agents	This reflects the reach of GKN's services. More agents equal more access points for the Peruvian population to access financial services.	+17%
BUSINESS MODEL	Number of quarterly transactions per active agents	This metric shows the acceptance of GKN's banking correspondent agents by the under-banked adult population in Peru.	+25%
SCALE	Number of transactions per quarter	This metric shows the depth of use. An increased number of transactions means people are using agents for a variety of services, including making deposits, withdrawals, utility payments, loan payments, to open new accounts, etc.	+46%

From December 2011 to January 2012, the highest average increases in key performance metrics across the fund's portfolio were in the Scale metrics, which measure depth of use. On average, Business Model metrics were mostly steady-state, and Community metrics increased, but only slightly. This is consistent with the fact that most of the fund's portfolio companies are now approaching the stage of scaling growth (after achieving unit economics and institution building) and shows they are scaling more through depth of service than through breadth of access points, on average. More importantly, it shows that customers, when given access to these core financial and health services, are using them more and more frequently. In terms of demographic data about customers, Elevar has seen that more than 97 percent of the borrowers through the companies in the UEF's MFI portfolio are women. Elevar has not performed or commissioned any third party studies of impact on customers, but is confident based on these metrics that the services its portfolio companies provide are bringing high quality services to the under-banked, and bringing them into the mainstream for financial products.

CONCLUSION

Elevar's experience shows the power of a targeted investment thesis entering underserved markets at the right time. Moving from its roots as a subsidiary of a nonprofit, Elevar's two funds have taken a highly disciplined investment approach, concentrating on scalable distribution models in BoP markets and working to engage private investors, both as LPs and as co-investors, in driving these services to scale. Elevar continues to believe it can apply its expertise and knowledge from these markets to investments in new companies in other geographies with similarly underserved markets. The fund expects to extend this investing experience into additional geographies in its third fund and to conceptualize approximately one new investment theme per year.

POSTSCRIPT

The Elevar team believes that impact investing is in its early days, and that despite the increasing interest in the field, more concrete evidence of success – both in terms of financial return and impact – is necessary for the industry to solidify. Yet, the team also believes their investment method has concrete proof points and is a basis for confidence about the field as a whole. According to Chorengel, "We see impact investing as one of the pillars of the future of capitalism. At the core, our investment hypothesis is that underserved communities are an enormously undervalued investment opportunity and that the market, and often government, has failed these vibrant, though informal, communities thus far. We see opportunity, vibrancy and entrepreneurs where others see poverty, slums and rural disconnection. We can unleash fundamental value by providing access, lowering transaction costs, and increasing household wealth. Our work is capitalism at its best." Elevar continues to pursue its goal of democratizing the provision of essential services to underserved communities and, as of November 2013, was on track to raise a third equity fund following the investment themes and geographic scope of EE II.

APPENDIX: ELEVAR PORTFOLIO COMPANIES, AS OF SEPTEMBER 30, 2013

COMPANY	DATE FOUNDED	DESCRIPTION
SKS Microfinance	1998	A publicly listed microfinance institution with a pan-India presence.
Credex	2002	Targets low-income borrowers through individual productive loans in the poor urban and semi-urban areas and village banking in the rural areas of Mexico.
MokshaYug Access	2005	A rural supply chain management company in India that builds market linkages between rural communities and larger commercial markets with a focus on dairy.
Finsol Brazil	2006	A microfinance institution reaching the vast number of micro-entrepreneurs living in the outskirts of cities around Northeast Brazil.
Grama Vidiyal Microfinance	1993	One of the largest microfinance institutions in Tamil Nadu providing small loans to women without access to formal credit.
Swadhaar FinServe	2008	Focuses on providing microfinance services to the economically active poor in the city of Mumbai and other urban areas.
Ujjivan	2006	One of the most respected and the leading urban-focused microfinance institution in India.
Madura Microfinance	2005	A highly efficient, low cost, customer focused microfinance institution that serves economically active, rural women in Tamil Nadu.
Comat	1996	Provides access to essential information and e-governance services through 800 rural business centers in India.
Vistaar Finance	2010	Specializes exclusively in providing credit to rural and semi-urban small businesses.
GloblalKasNet	2007	The fastest-growing, independent, multibank payment network in Peru offering transaction, processing and settlement services to low income urban and rural clients of banks, microfinance institutions and commercial wholesalers.
Shubham Housing Finance	2010	Provides home improvement and new home loans to low income individuals and families in urban and semi-urban India.
Caja Rural Los Andes	1997	A profitable, deposit-taking, regulated bank that caters to the needs of the rural community in the southeast Andean region of Peru.
Glocal Healthcare	2010	Provides quality, affordable, patient-centric healthcare services to rural India.
Union Andina	2005	Enables Latin American migrants in the U.S. and Europe to purchase a home in their country of origin, by offering migrant workers access to qualified real estate developers' inventory as well as mortgage financing solutions.
Aarusha Homes	2007	Provides safe, well-priced, high value rental housing solutions to low income migrants in urban India.