

Another Quantum Leap in Microfinance: Preparing for Future Growth through Consolidation

Hosted by the EFSE Development Facility



Shaping and leveraging the new reality



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Another Quantum Leap in Microfinance: *Preparing for Future Growth through Consolidation*



Introduction

Definition

- Market consolidation happens when two or more companies join to form an entirely new company.

$$A+B=C$$

- Consolidation is brought about through a **merger or acquisition** process (**M&A**). Often these terms are used interchangeably.

Objectives of the session

- Understand mergers & acquisitions as part of corporate life
- Be better equipped for approaching merger discussions
- Be aware of critical success factors and potential challenges
- Be sensitive to integration challenges, especially to the need to provide the right incentives to all parties
- Be aware of potential regulatory issues

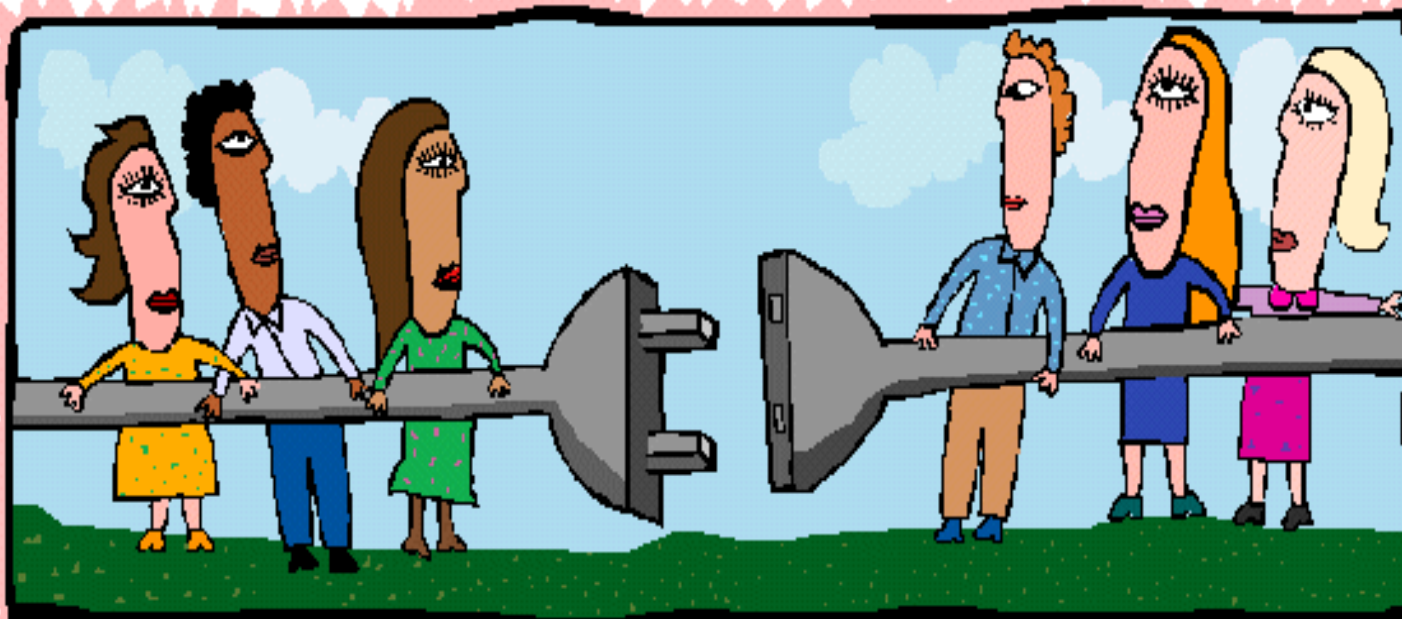
Ground Rules

- Share your personal experience
- Every question is worth asking
- One conversation at the time
- Help us stay on track and on schedule
- Fun is allowed



The Business Case for M&As

Creating value through mergers



\$1.2 Trillion spent on global M&A in 1st half of 2010

M&A's are Part of Corporate Life

30,000 mergers annually in recent years

=

80
transactions
a day

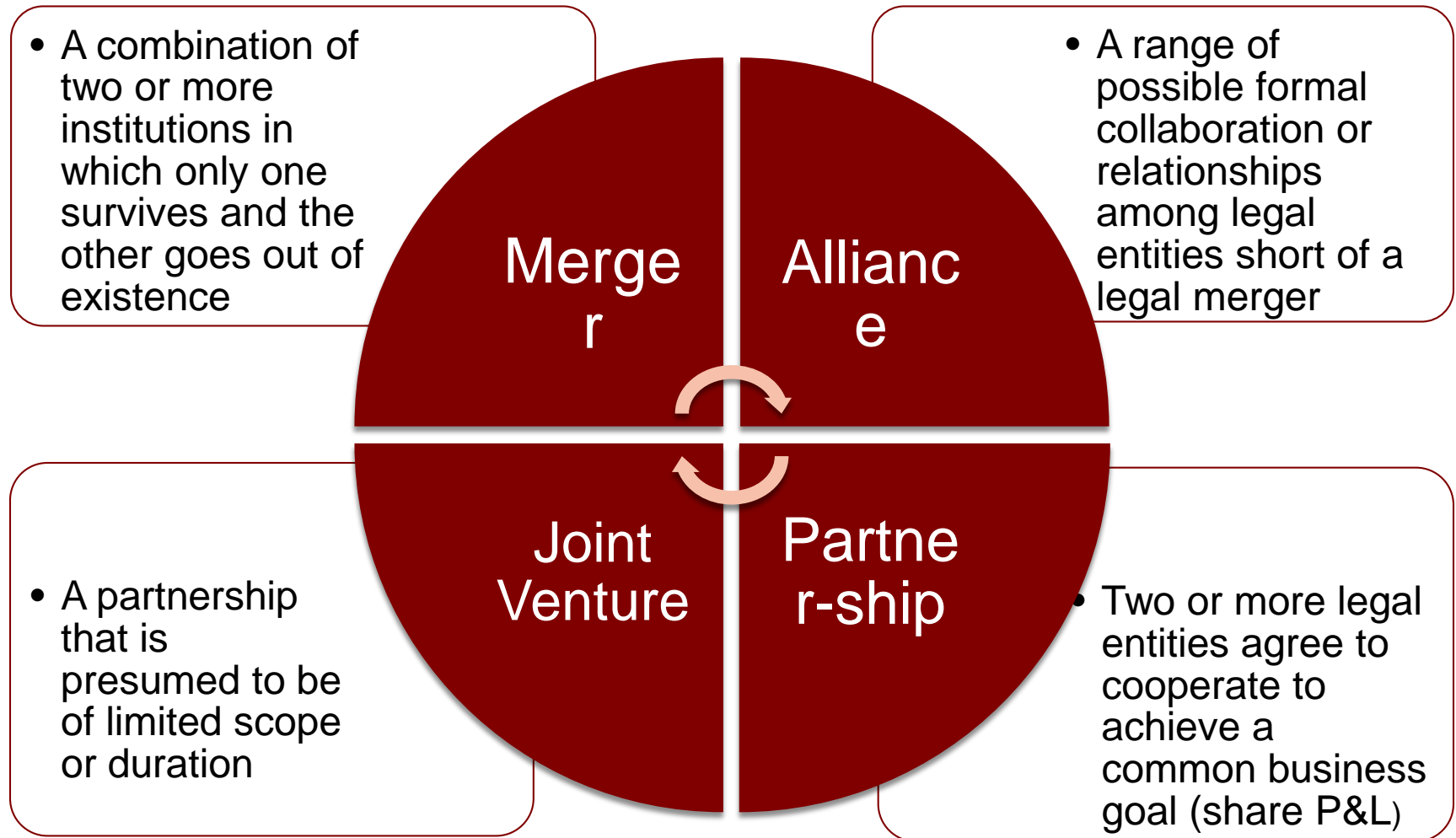


\$2 Trillion every year

Companies pay more frequently in cash than stocks. In 2010, 66% of US merger transactions were paid in cash, compared to 54% in 2009

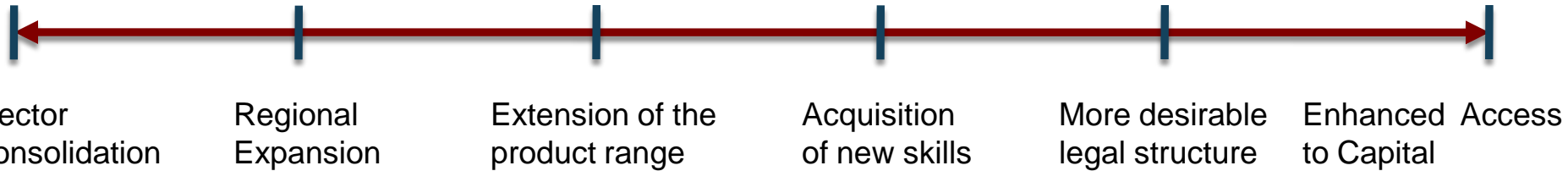


Typology



Business Logic & Key Drivers

What are your company's strategic objectives?



Stylized Facts

Study after study puts the failure rate of M&As btw 70–90 %

83% of mergers failed to unlock value (KMPG, 1999)

Every second merger fails to achieve desired results (Oliver Wyman, 2008)

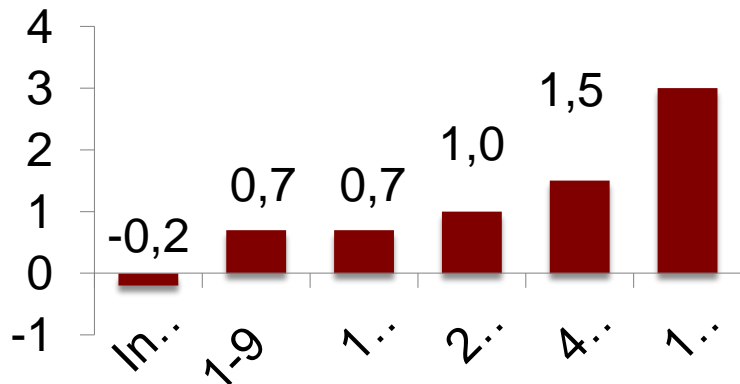
70% of US mergers in 1995-2001 failed to create meaningful shareholder value (Bain)

Bain found some evidence of a **positive trend during economic downturns**: US mergers right after 2001-2002 almost tripled the shareholder returns than mergers in 1996-2000

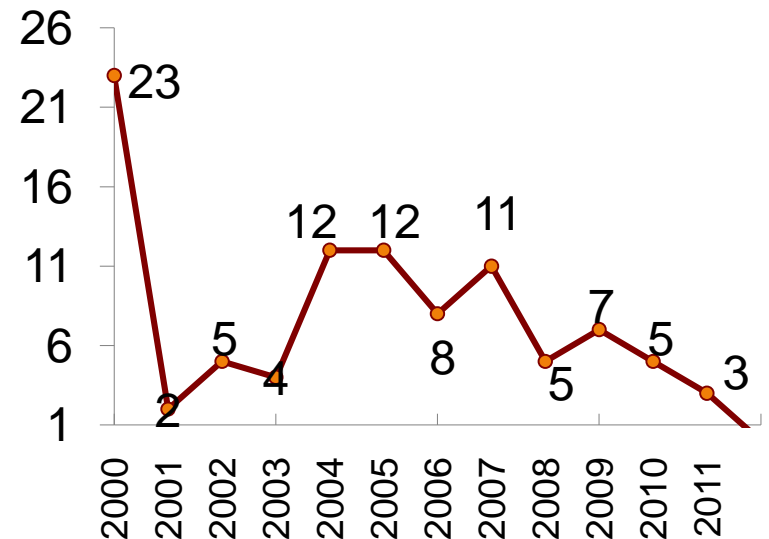
In 1995, about 50% of U.S. mergers underperformed their industry index. In 2005, the figure was about 30%

Frequent acquirers outperform in the long term

Annual excess return (%)
(1987-2006)



CISCO's Acquisitions



One of the world's best serial acquirers, over the past 14 yrs it has averaged 26% annual revenue growth

Examples of Corporate Mergers

- ❑ United/Continental (2011) – **Honeymoon?**
- ❑ Microsoft/Skype (2011) – **Overpaid?**
- ❑ Wells Fargo/ Wachovia (2008) – **A blissful acquisition?**
- ❑ HP/Compaq (2001) – **Synergies at last!!..**
- ❑ AOL/Time Warner (2000) – **The biggest mistake in corporate history**
- ❑ Daimler/Chrysler (1998) – **Where did the synergies go?**
- ❑ Exxon-Mobil (1998) – **Archetype of successful merger**

Star Alliance - - An Alternative Model

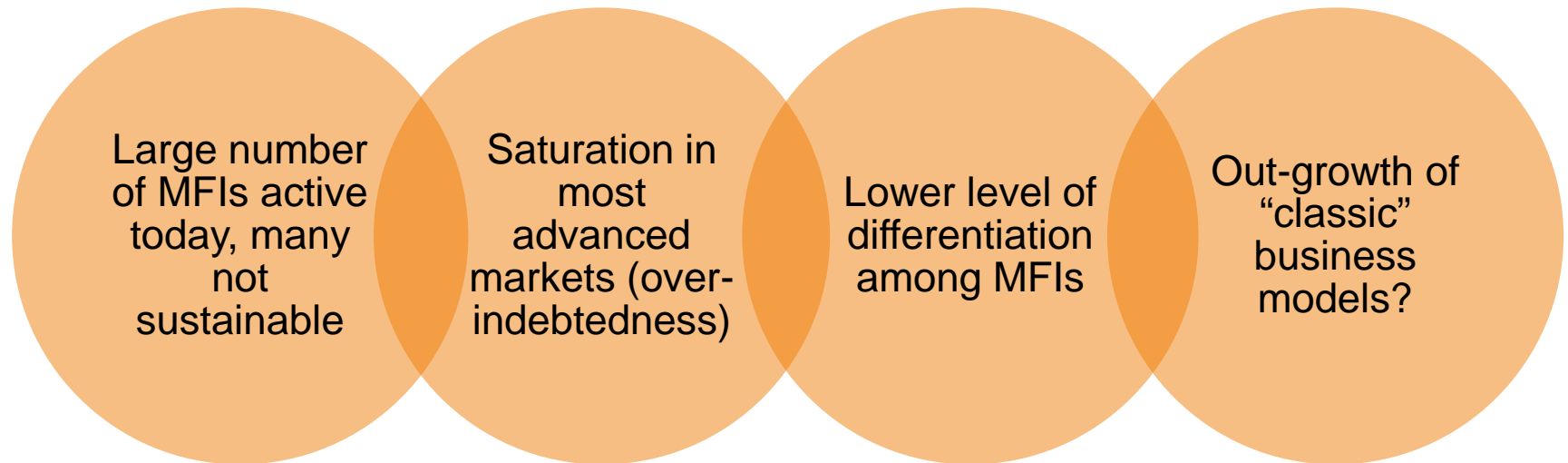
- Alliance of 27 airline companies
- Goal is to expand their geographic network in the most efficient way
- A single ticket, one major frequent flyer plan, shared lounges, coordinated schedules, consistent quality
- Built an internationally-recognized brand but individual airlines kept their own brands
- Individual airlines remain independent companies
- Hostile takeovers on fellow members prohibited



What is specific to Microfinance?



The Market Perspective

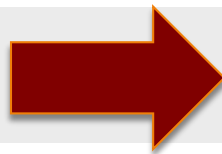




Ownership and Governance

- Not-for-profit tend to have unclear ownership structures – Who really are the organization's owners?
- Often management exercises almost total control on the MFI operations – does that make them the owners?
- How to treat the capital grants given to the MFI?
- How to align interest between the MFIs and management?

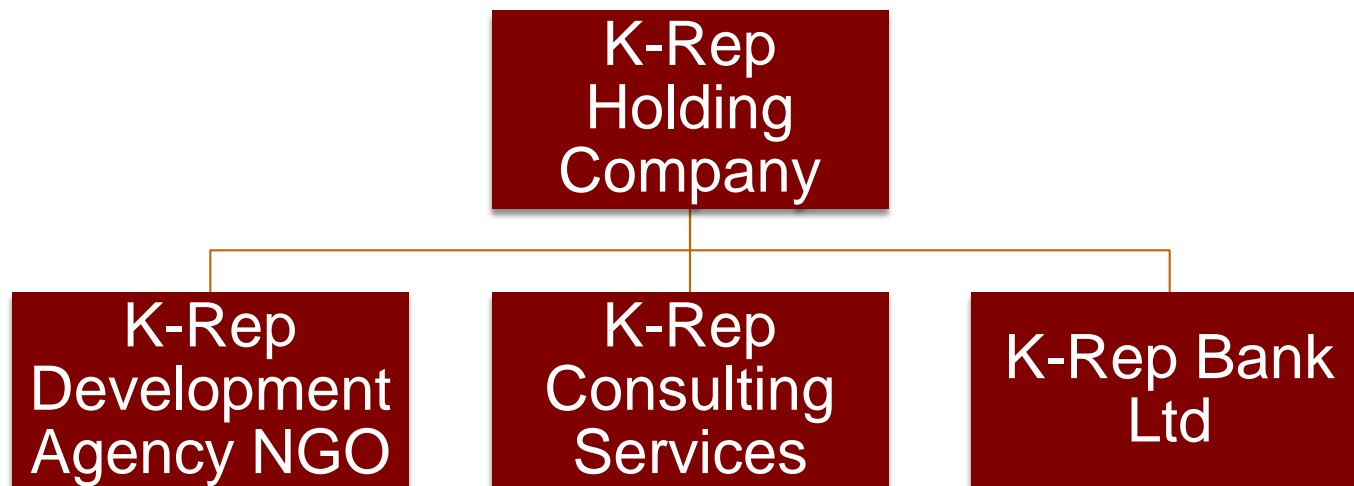
Ownership & governance
is often unclear



M&A as imperfect channel
to growth & sustainability

How to value Sweat Equity?

- Recognizing the value of “sweat equity” is critical
- Management’s leverage not to be underestimated
- The example of K-Rep and its ESOP

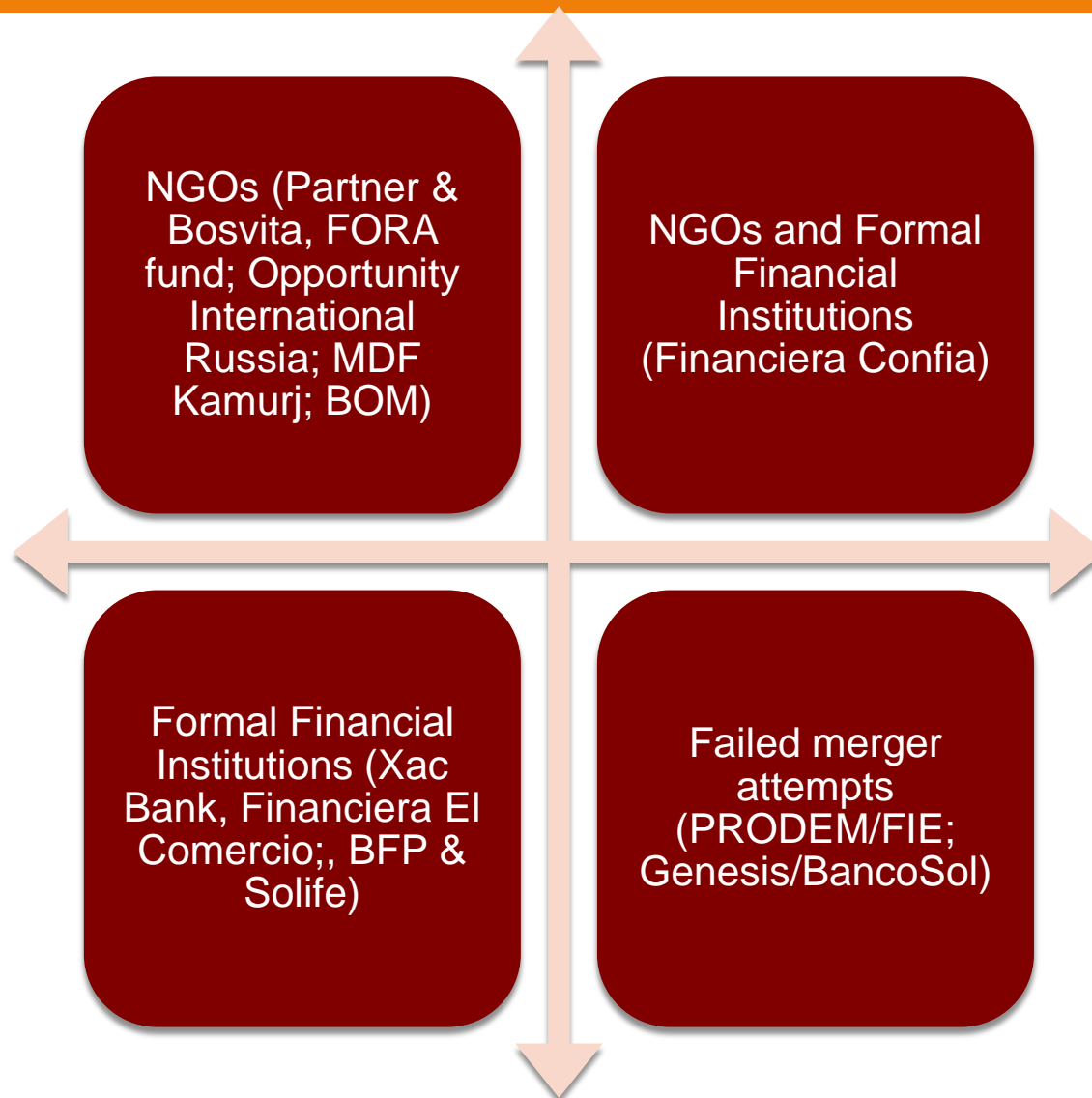




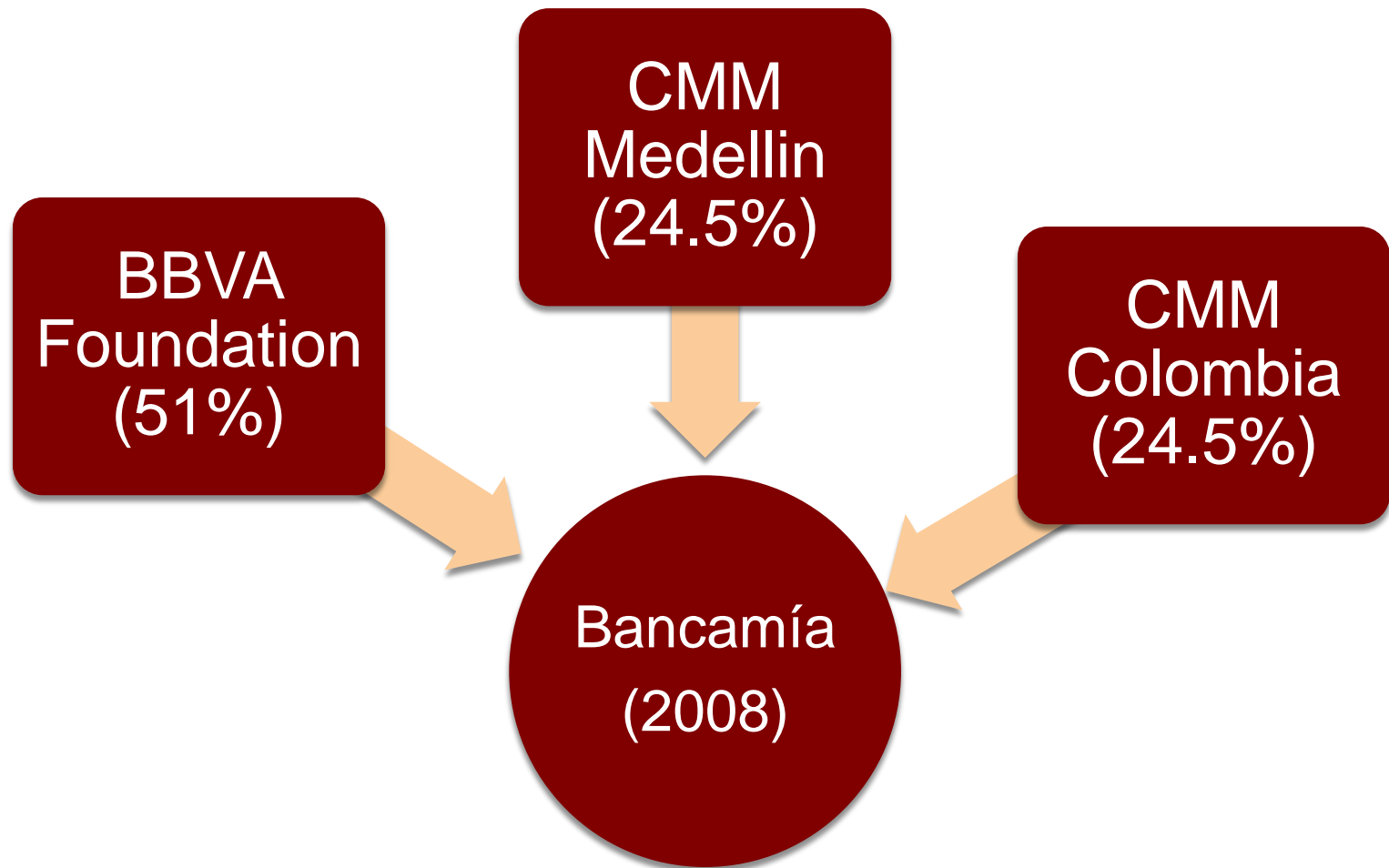
Regulation

- ❑ In most countries, regulation is untested or inadequate for mergers of microfinance players
- ❑ M&As can lead to change of legal status with more stringent regulatory requirements (e.g., capital adequacy, profile of Board members, etc.)
- ❑ Beware of potential implications for the tax regime
- ❑ Regulation can sometimes create a misalignment of interests and incentives between the MFIs and management

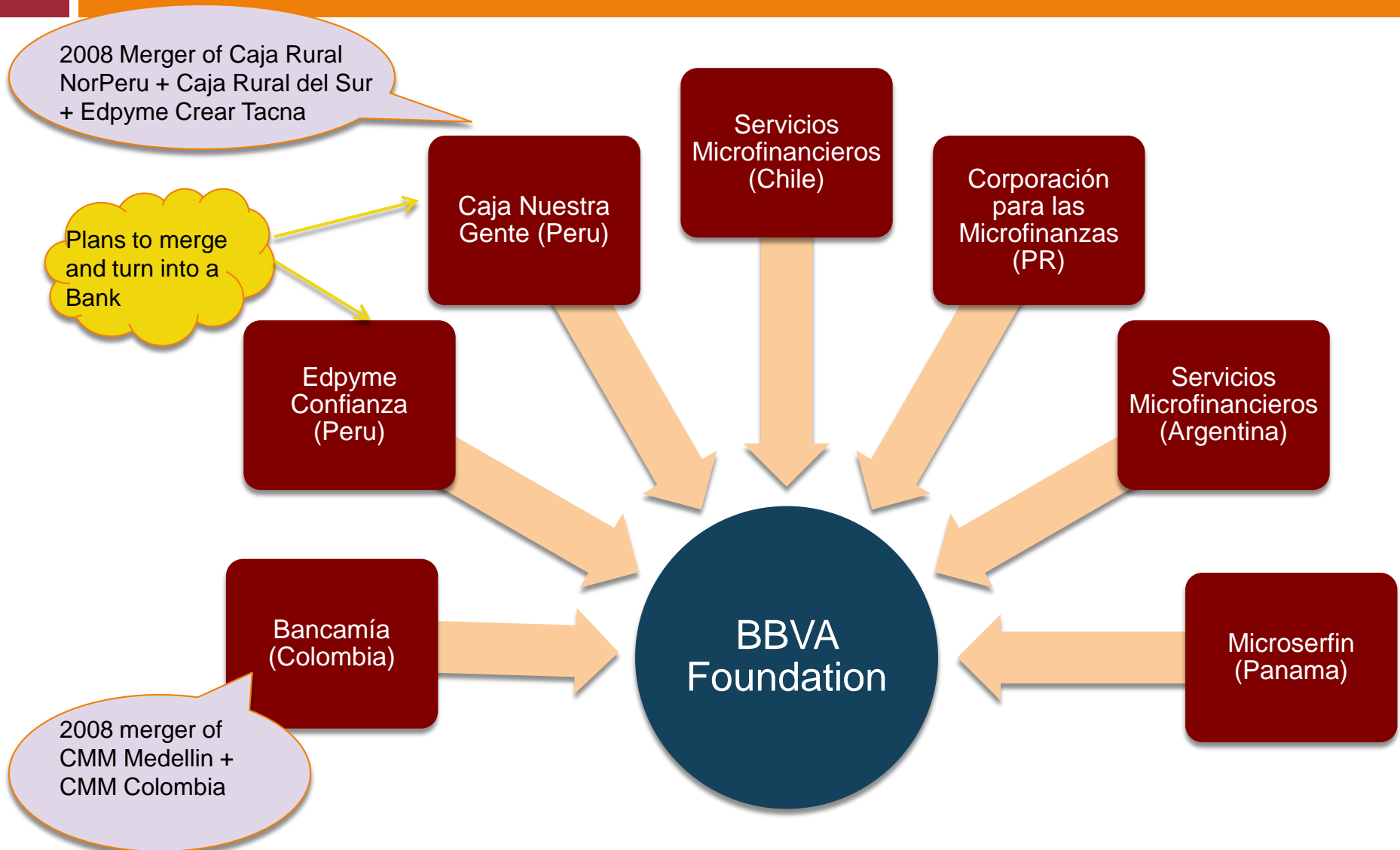
Some MF mergers and consolidations



Joint Venture

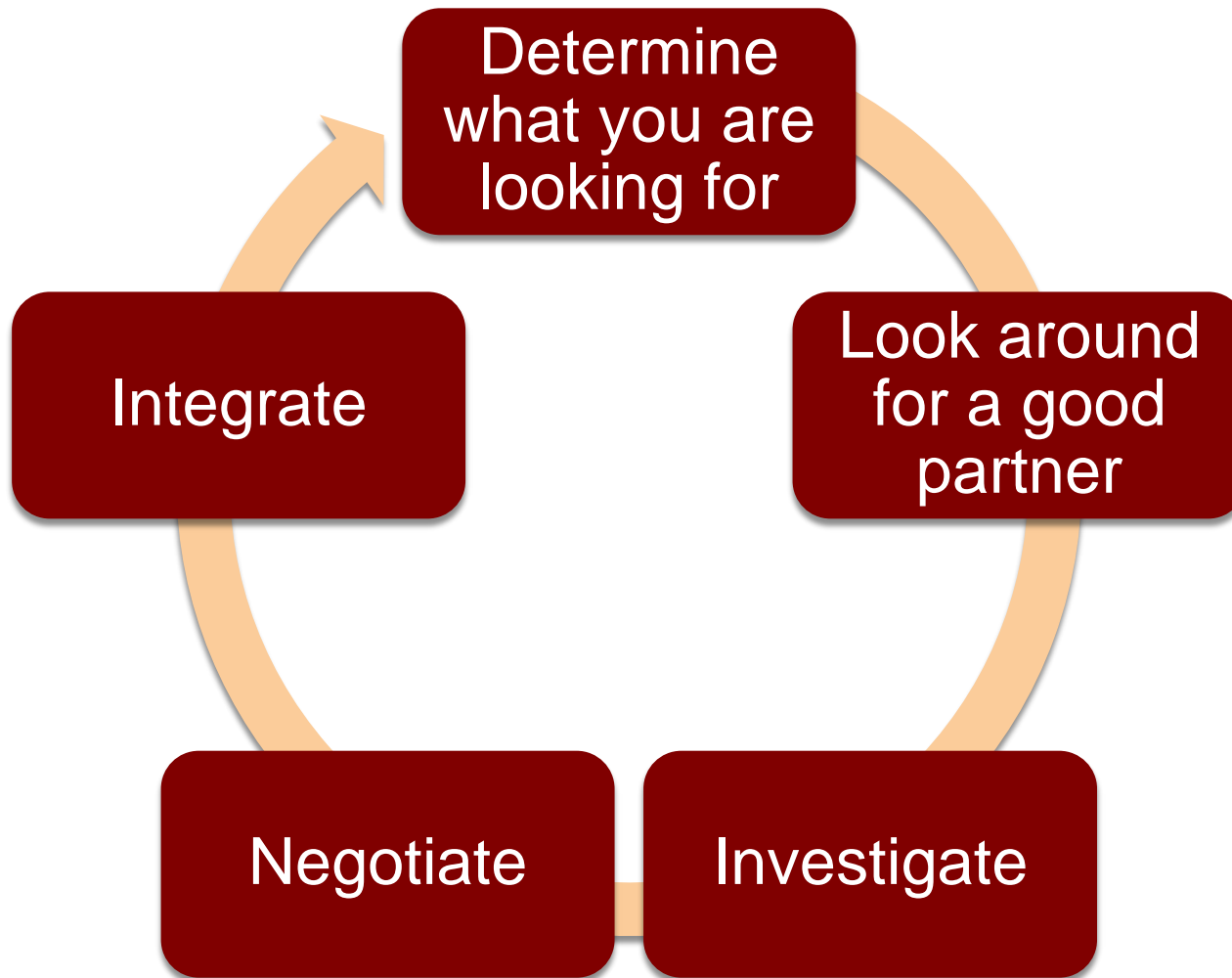


BBVA Foundation Alliance Network



Key Issues to be considered

M&A Stages



DEFINE WHAT YOU ARE LOOKING FOR?



First take a closer look at yourself

- Understand your institution's strategic position and your value proposition
- Do a detailed SWOT analysis to identify areas for improvement
- Determine your needs and ways of addressing them internally
- Determine what requirements you are looking for in another organization
- Consider hiring external advisor for this process

LOOK AROUND FOR A GOOD PARTNER



Finding the Perfect Match

Assessing the strategic fit and real synergies

- Think about what you want
- Due diligence in financial and human capital areas: does it match what I am looking for?
- Do you share common goals and principles?
- Do you have complementary skills?

What counts for a good match?

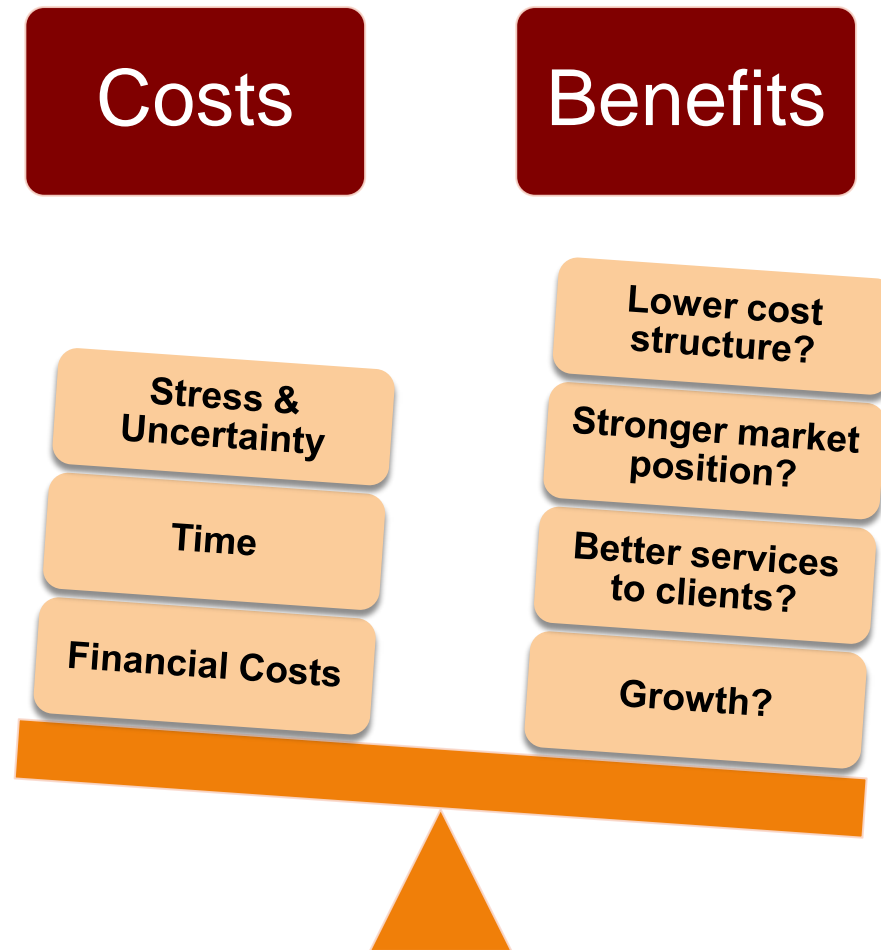
- Mutual need
- Shared Vision
- Mutual trust
- Commitment

INVESTIGATE





Is it worth it?





Non-financial Due Diligence

Mergers depend on people!

- Cultural integration may require restructuring the organization, redesigning compensation and incentives, rethinking decision and authority rights
- Are both organizations willing to adapt their practices?
- Stress and uncertainty about job security

WHO's going to get the TOP JOBS?

NEGOTIATE



What is the right price for the deal?

- MFIs can't be valued as traditional banks
- Scarcity of information on microfinance valuation
- Transaction size and net income growth are key drivers of valuations
- Ultimately, the right price depends on what purpose the merger will serve

Valuation: In Theory

Two broad approaches:

- Asset based (with a multiple)
- Earnings based (with a multiple) (with adjustments for expected merger synergies, and merger costs)

Valuation: In Theory

Example: Earnings-based valuation:

	2014+ Perpetuity		Local Currency		Share-holding	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Dec-11	Dec-12	Growing perpetuity
	Disc.Rate	Growth	NPV	NPV(\$k)													Dec-13
Base Case	15.0%	10.0%	30,756	\$12,815	\$10,465	(255)	(192)	(101)	(48)	(20)	(1)	26	53	78	547	1,802	44,149
Pessimistic	20.0%	10.0%	14,232	\$5,930	\$4,843	(255)	(192)	(101)	(48)	(20)	(1)	26	53	78	547	1,802	22,075
V. Pessimistic	25.0%	10.0%	8,824	\$3,677	\$3,003	(255)	(192)	(101)	(48)	(20)	(1)	26	53	78	547	1,802	14,716

Example: Asset-based valuation:

Exit valuation (assuming exit at end of projection period)	Dec-13
Book value at end of period	8,014
Exit Multiple	2.0 x
Exit PE (on trailing earnings)	7.3 x
Valuation at end of period	16,029
Valuation at end of period (in US\$ thousands)	\$6,412
Shareholding at the end	82%
Valuation at end of period (US\$k) (Shareholding)	\$5,236

Valuation discounted back to PV	Disc.Rate	Share-holding
Base Case	15.0%	\$3,482
Pessimistic	20.0%	\$3,076
V. Pessimistic	25.0%	\$2,730

Microfinance Valuations by Region

	Median Historical P/E				Median Historical P/BV			
	2005	2006	2007	2008	2005	2006	2007	2008
Africa	5.6	6.2	17.1	11.8	0.9	1.2	1.6	1.7
Asia	NA	NA	NA	6.0	1.7	2.0	7.0	2.4
ECA	9.3	8.6	13.8	9.3	1.8	1.3	1.0	2.0
LAC	NA	6.7	5.6	7.8	1.4	1.2	1.1	1.2

Valuation: In Practice (Not a Science)

Ultimately a Negotiation: with imperfections all-around:

- What are the strategic objectives of each side?
- How much does each side need the transaction? What if nothing happens?
- Are you negotiating with only one buyer / seller? Or is it a more competitive bidding process?
- Who are the key decision makers (shareholders, management)? (are you negotiating with both?)
- If an NGO - what will happen to the proceeds?
- What does each side want? (Max price? Job security? Legacy?)

INTEGRATION

How do you make it work?



Not an Easy Task

Challenges

- Overestimation of synergies
- Inadequate due diligence
- Poor post-merger integration
- Poor leadership
- Conflicting corporate cultures

Key Ingredients for Success

- Define key added value and set clear priorities for integration
- Meticulous planning and execution
- A compelling vision that all stakeholders understand and embrace
- A fast and focused transition

Post-Merger Integration in 3 steps

Preparation

Form a competent integration team

Define strategic direction and targets of new company

Identify & plan changes in HR, procurement, products, processes

Operational Integration

Implement details of the integration plan

Eliminate product redundancies, select the right people, communicate to customers

Achieve short-term financial and market goals

Strategic Integration

Focus on achieving new strategy to ensure competitive positioning in the market

Monitor progress and adjust strategic goals as needed

Planning the “morning after”

- Integration planning starts during due diligence
- Don't lose sight of why you picked your partner – appreciate value and uniqueness
- Decide the desired level of integration, plan meticulously but act quickly
- Select a trusted and respected outside broker to facilitate negotiations and change management
- Clear leadership – a single skilled person in charge
- Communicate, Communicate, Communicate – beat the grapevine!

Key Change Management Aspects

- First things First - “Do I still have a job?”
- Performance, morale and productivity usually go down as staff are worried about their futures
- Most qualified people may leave if uncertain
- Ensure a focus on customers – don’t lose sight of the market by looking-inward
- Give management and staff the right incentives to support the merger



EFSE Annual Meeting 2011

Lunch
12:30 – 14:00



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