



# Report and Recommendation of the President to the Board of Directors

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Project Number: 49274-001  
October 2015

## Proposed Equity Investment Creador III L.P.

This is an abbreviated version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank



## ABBREVIATIONS

ADB	–	Asian Development Bank
DMC	–	developing member country
ESMS	–	environmental and social management system
IPO	–	initial public offering
IRR	–	internal rate of return
SMEs	–	small and medium-sized enterprises

## NOTE

In this report, “\$” refers to US dollars.

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## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed equity investment of up to \$45,000,000 in the Creador III L.P.

## II. THE FUND

### A. Investment Identification and Description

2. **Description.** Creador III L.P., a Mauritius registered limited partnership, is a closed-end private equity fund with a target capitalization of \$450 million. The general partner will be Creador Management III Limited, a Mauritius registered company.

3. The general partner will enter into investment advisory agreements with advisors selected by the general partner to provide investment advice and other administrative support in connection with the fund (collectively the investment advisor). The general partner will establish an advisory board comprising representatives of the limited partners selected by the general partner. The advisory board will provide advice and counsel as requested by the general partner in connection with the fund's investments, potential conflicts of interest, and other fund matters. It is expected that ADB will have the right to appoint a member to the advisory board. The fund, the general partner and the investment advisor are collectively referred to as Creador.

4. **Investment identification.** As part of its market-mapping exercise of private equity fund investment opportunities within the developing member countries (DMCs) of the Asian Development Bank (ADB), ADB identified Creador as a high potential private equity firm investing in middle-market companies in South and Southeast Asia. In June 2014, ADB initiated dialogue with Creador and since then has followed the firm's platform with increasing interest as Creador operates in geographic regions and sectors that align with ADB's mandate. ADB was also attracted to Creador's record of generating attractive co-investment opportunities for its limited partners, particularly in underserved markets in Southeast Asia that ADB is keen to support.

5. Creador follows a middle-market-focused, multi sector investment strategy that fits well with ADB's criteria for private equity fund investments. In Indonesia and Malaysia, Creador was one of the early firms to set up a private equity fund and, thereby, has been able to position itself as one of the leading private equity fund managers by leveraging its sizable local teams to identify attractive investment opportunities before other investors enter the market. In India, Creador targets middle-market companies, a niche segment for private equity funds, as this is a market that is increasingly dominated by larger private equity funds pursuing large buyout opportunities. Importantly, Creador's middle-market focus offers significant development impact potential through investments across multiple DMCs, including India, Indonesia, Malaysia, the Philippines, and Sri Lanka. Given Creador's competitive advantage in terms of performance record, regional reach (including a sizeable regional platform with local teams and a dedicated platform for operations), access to direct proprietary deal flow, and investor base, ADB considers Creador III to be a high-quality investment opportunity for ADB's private equity portfolio.

### B. Business Overview and Strategy

6. The fund will make equity and equity-linked investments in middle-market companies that cater primarily to middle-income segments in South and Southeast Asia, including India, Indonesia, Malaysia, the Philippines, and Sri Lanka. Within these segments Creador III will

concentrate on three broad investment themes: (i) financial services (e.g., banks and finance companies); (ii) consumer goods and services (e.g., health care and education); and (iii) business services (e.g., business-to-business services, outsourcing, payment processing, and logistics).

7. Creador III aims to provide growth capital to leading established middle-market companies with high growth prospects and the potential to gain or consolidate significant market share in their respective industries. The fund proposes to target more than 10 equity investments of approximately \$10 million or more each, while investing no more than 20% of its committed capital into any one asset. The fund will generally seek to become a minority partner in investee companies and anticipates holding the investments for 3–5 years to allow the assets to be divested in an orderly manner.

### C. Ownership, Management, and Governance

8. **Ownership.** The fund is organized in Mauritius as a limited partnership that will comprise strategic investors, foundations, family offices, and other institutional investors. The Global Forum on Transparency and Exchange of Information for Tax Purposes has categorized Mauritius as largely compliant with internationally agreed tax standards.<sup>1</sup> The fund holds a tax residency certificate issued by the Mauritius revenue authorities, and its investments are expected to benefit from India–Mauritius double taxation treaty arrangements in line with market practice for similar funds investing in India.

9. ADB’s review of the fund does not give ADB cause to believe that it has been established or is being used for cross-border tax evasion, money laundering, or terrorism financing in the jurisdictions involved in the investment.

10. **Management.** The fund will be managed by the general partner. Creador is led by its chief executive officer and founder, Brahma Vasudevan, formerly of ChrysCapital, one of the largest private equity firms in India. In 2011, B. Vasudevan left ChrysCapital to start Creador in his home country of Malaysia. The Creador III management team also includes two senior managing directors, Cyril Noerhadi and Anand Narayan; managing director Kevin Loh; executive director Lim Sze Mei; and four directors: Stefanus Ade Hadiwidjaja, Amit Dabas, Akash Jain, and Wong Pau Min. The broader investment team comprises more than 32 investment professionals across four offices—Chennai, Jakarta, Kuala Lumpur, and Manila (the most recently opened). Creador’s 9-member dedicated management team for operations, Creador+, supports the investment team. The team members help portfolio companies develop and implement strategies to improve growth and profitability.

11. **General partner contribution.** The general partner’s contribution was financed by each of the general partner’s shareholders, including the chief executive officer and members of the senior management team. This provides for strong alignment of the interests of the general partner with the limited partners.

12. **Governance structure.** The general partner typically conducts a three-stage investment process: (i) investment screening of each potential portfolio company’s operations, products, market opportunity, and valuation against the fund’s mandate and strategy; (ii) deal structuring

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<sup>1</sup> Organisation for Economic Co-operation and Development. Global Forum on Transparency and Exchange of Information for Tax Purposes. <http://www.oecd.org/tax/transparency/exchange-of-information-on-request/peer-review>. Other jurisdictions categorized as largely compliant include Germany, the Netherlands, the United Kingdom, and the United States.

and due diligence; and (iii) preparation of investment proposals for presentation to the fund's investment committee.

13. The investment advisor is responsible for scanning the market to identify investment opportunities. Once a deal is identified as an opportunity, the investment advisor conducts a preliminary assessment of the market and the specific target company, and prepares a detailed investment memorandum to be presented to the general partner.

14. Once accepted, the general partner refers the investment opportunity to the investment committee. The committee reviews all prospective opportunities at weekly meetings. Once committee approval is received, the general partner prepares an initial term sheet, which typically identifies a period of exclusivity that may vary depending on the nature of the opportunity but will generally range from 45 to 120 days.

15. Once the term sheet is executed by the general partner and the target company, the general partner conducts a rigorous due diligence process with the assistance of the investment advisor. In parallel, the general partner engages legal counsel to complete the documentation. The general partner then presents the findings of the due diligence to the investment committee for final approval. Once the final investment committee approval is received, the general partner submits the investment documentation to the board of the general partner for final approval and execution, completion of other formalities, and the funding process.

### III. THE PROPOSED ADB ASSISTANCE

#### A. The Assistance

16. ADB will provide an equity investment of up to \$45,000,000 in Creador III L.P., not to exceed 25% of the fund's total capital commitments and not resulting in ADB being the single largest investor in the fund.

#### B. Financial Analysis of Expected Returns and Assumptions

17. Overall returns for the fund are expected to be strong, in line with return expectations for Creador's first two funds.

#### C. Implementation Arrangements

18. **Exit strategy.** The fund has a 10-year term from initial closing, with two options to extend for a maximum of one year each. The fund's exits will likely come from trade sales and initial public offerings (IPOs). Trade sales will involve finding buyers among global strategic investors keen to expand their presence in high-growth emerging economies. IPOs are also envisioned to provide liquidity for the fund's minority investment positions where the sponsors plan to remain invested for the long term.

19. **Reporting arrangements.** The general partner will provide ADB with (i) quarterly unaudited reports; and (ii) audited annual reports, including financial statements, a fund overview, and an overview of the portfolio with brief information on each portfolio company's performance and valuation. ADB will review this information and follow up with the general partner if more information or clarification is needed. If the information received from the general

partner raises issues that could impair the value of ADB's investment in the fund, ADB could decide to put the fund on a watch list for more frequent review and closer attention.

20. The general partner will be required to adopt an environmental and social management system (ESMS) acceptable to ADB prior to its first disbursement, and to report annually on environmental and social safeguard issues and development effectiveness indicators. ADB will monitor the receipt and quality of the ESMS reports, and offer guidance should the general partner require clarification of ADB's safeguard requirements.

#### **D. Value Added by ADB Assistance**

21. **Catalyze private sector investment.** Asian mainstream investors have traditionally focused on larger regional funds and/or country-specific funds, and have limited interest in investing in smaller, regional funds, particularly in Southeast Asia. The middle market is also a specialized segment within the private equity asset class, with limited distribution and visibility among institutional investors. ADB's participation in the fund is, therefore, expected to raise the visibility of the capital needs in the fund's targeted core sectors and market segments. ADB's intervention is expected to catalyze both institutional and non-institutional participation in private equity funds investing in middle market companies in South and Southeast Asian markets where private equity fund activity is still in nascent stages.

22. **Raise standards.** ADB is expected to be the first multilateral partner in Creador's funds, and is expected to encourage the general partner to ensure that its investee companies comply with the highest environment and social safeguard standards, and to report on development indicators. ADB's role, along with other members of the fund's advisory board, will be to assist in providing oversight on important governance matters that are critical for companies to demonstrate as they seek additional sources of growth capital from institutional and/or individual investors.

#### **E. Risks**

23. **Deal sourcing.** The proposed investment has a strong rationale, the realization of which, however, depends on the development of a larger deal pipeline for Creador III. Given that Creador I is 100% deployed and Creador II is 79% deployed to date, there is confidence that Creador III will also be able to successfully deploy capital across target markets given Creador's deep local presence in India, Indonesia, and Malaysia. Regardless, ADB expects submission of an expanded transaction pipeline from Creador before financial close.

24. **Fund raising.** Comfort is taken from the fact that Creador has successfully raised two funds in the recent past – \$130 million for Creador I (2011) and \$331 million for Creador II (2014) and is confident of reaching its target size of \$450 million for Creador III by final close. To the extent Creador III is unable to reach its target fund size of \$450 million, ADB will seek to cap its commitment to Creador III at the lower of 10% of committed capital and \$45 million.

25. **Fund track record.** Creador funds have a relatively untested track record. The Creador team completed two successful exits (from India and Malaysia) out of 17 investments under Creador I and II within 2–3 years from investment date. While this is promising, Creador I and II are relatively young vintages in markets that have experienced steady positive growth in real gross domestic product. The team takes comfort from the fact that the sensitivity analysis undertaken on underlying investments in Creador I and II demonstrates that entry multiples for investees have a buffer for downside risks.



26. **Key person risk.** The market for experienced investment professionals in Southeast Asia is highly competitive, and the loss of one or more senior professionals from either the general partner or the portfolio companies may adversely impact the performance of the fund. The general partner's current investment team has a long history of working together, and discussions indicate the risk of members leaving this group is low. The due diligence confirmed that carried interest compensation is adequately distributed among Creador's senior investment team, which would help Creador retain its investment staff for the long term. To help mitigate the risk of key professionals leaving portfolio companies, Creador can leverage its extensive local professional network developed since its establishment in 2011 in Southeast Asia to assist in recruiting professionals to fill key positions if necessary.

27. **Exit risk.** The fund expects to exit investments through trade sales and IPOs. As mentioned earlier, Creador has a relatively limited track record of realizing exits, having fully exited only two investments. Prior to committing to investments, Creador's investment team is required to identify time frames for an exit and multiple exit strategies. To further mitigate exit risks, prospects are monitored continually for all investments, and portfolio companies' relevant metrics are tracked (e.g., financial, operating, and market positions) to help optimize exit opportunities.

28. **Foreign exchange risk.** Contributions and distributions to and from the fund will be denominated in US dollars, while investments may be made in currencies other than the US dollar. Therefore, investments may be adversely affected by fluctuations in foreign exchange rates, changes in monetary policy, and foreign exchange control regulations. The fund does not intend to reduce foreign exchange risk through hedging or other financial derivative instruments due to prohibitively high costs in the relevant markets. To cushion its returns against exchange rate impacts, Creador aims to use natural hedges (e.g., targeting portfolio companies with foreign currency earnings) and structure deals with downside protection from foreign exchange movements whenever possible.

29. **Legal, tax, and regulatory risks.** Many private sector laws and regulations in the target markets are at an early stage of development, and may not provide adequate protection of the fund's rights as a shareholder in the event of disputes. The administration of laws and regulations by the governments in target countries may be inconsistent. In some countries, legal frameworks are vague and subject to interpretation. The extensive experience of the fund's management team and its advisory board in India, Indonesia and Malaysia, drawn from previous professional experience and existing Creador transactions, provides comfort that investee companies are top industry players that are aware of regulatory risks. Creador's locally-based teams are also expected to provide market intelligence to senior management of investee companies on decisions impacting continued investment or exits to mitigate regulatory risks.

#### IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

##### A. Development Impact, Outcome, and Outputs

30. **Impact.** The impact will be increased private equity funding in the Asian middle-market segment. The fund's success is expected to catalyze additional private equity funding in ADB DMCs, which is measured by the increase in private equity funding in Asia.

31. **Outcome.** The investment will demonstrate the financial sustainability of private equity investments in the Asian middle-market segment. The provision of finance through the private

equity modality to middle-market companies and small and medium-sized enterprises (SMEs) in the target sectors and geographic areas is expected to enhance risk-adjusted financial returns. The fund estimates that at least 75% of its portfolio companies will target increased availability of capital to middle-market companies. At the conclusion of the project, the fund will exit 100% of its investment portfolio at a minimum IRR of 8%. As indirect and qualitative measures, the fund also expects to improve the corporate governance and transparency of its investee companies wherever possible, and to contribute to increased job creation and tax revenue for host countries.

32. **Outputs.** A private equity fund will be established with a target size of \$450 million focused on the middle-income segment and three main investment themes: (i) financial services, (ii) consumer goods and services, and (iii) business services. The fund aims to mobilize capital from a diversified base of Asian and western institutional investors and invest in companies across South and Southeast Asia, including in India, Indonesia, Malaysia, the Philippines, and Sri Lanka. The fund reached its first close of approximately \$207 million in July 2015, and will be considered successful if it commences fund operations by the first quarter of 2016 and deploys its capital within the proposed 5-year investment period.

## B. Alignment with ADB Strategy and Operations

33. **Consistency with ADB strategy and country strategy.** The proposed investment in the fund aligns well with ADB's Strategy 2020, which seeks to promote inclusive growth.<sup>2</sup> Accordingly, the fund intends to invest in financial services by increasing the capacity of financial intermediaries to expand lending to middle market companies and low- and middle-income consumers, which is essential to ensure sustainable private-sector-led growth. The fund plans to invest in health-care businesses, including those that support delivery of more cost-effective health services and goods. In addition, the fund proposes to participate in secondary and tertiary education institutes, thereby helping to improve access to and quality of skills development in target markets to reduce skills shortages. These targeted investments are consistent with Creador's prior funds, Creador I and Creador II, wherein several investments align with the first pillar of the strategic framework on inclusive economic growth. These include (i) an affordable housing company in India, (ii) a tertiary education center that aims to improve the quality of health-care professional skills (medical and pharmacy) in Malaysia, and (iii) a housing finance company in India focusing on underpenetrated nonmetropolitan areas. Finally, the fund supports ADB's vision of expanding its partnerships with a diverse group of stakeholders to maximize returns as well as the development impact potential of its investments.

34. **Consistency with sector strategy and relevant ADB operations.** The fund's investment goals strongly align with ADB strategies for encouraging the development of private sector middle market companies (including SMEs), removing barriers to financing for such companies, and promoting social and inclusive growth.<sup>3</sup> Furthermore, the fund's investments are consistent with ADB's plan for finance sector operations, which prioritizes the need to enhance access to finance for middle market companies as part of the finance sector development agenda, and the need to support the three key pillars of the real economy: households, SMEs,

<sup>2</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

<sup>3</sup> S. Shinozaki. 2012. A New Regime of SME Finance in Emerging Asia: Empowering Growth-Oriented SMEs to Build Resilient National Economies. *ADB Working Paper Series on Regional Economic Integration*. No. 104. Manila: ADB; ADB. 2014. *SME Development: Government Procurement and Inclusive Growth*. Manila; ADB. 2014. *Asia Small and Medium-Sized Enterprise Finance Monitor 2013*. Manila; and ADB. 2014. *Capital Market Financing for SMEs: A Growing Need in Emerging Asia*. Manila.

and infrastructure.<sup>4</sup> The fund's exit strategy includes IPOs and trade sales, which are expected to contribute to the development of local capital markets in the investee countries.

35. **Lessons from previous operations.** ADB has accumulated several lessons from managing its legacy private equity fund portfolio. These include reducing exposure to (i) first-time, small funds; (ii) single country funds; and (iii) emerging fund managers without an exit track record. Consequently, ADB made a deliberate choice in selecting a fund manager with a large regional fund mandate. ADB views this fund as an opportunity to increase its portfolio exposure to Southeast Asian markets, financial services, and more recent fund vintages. While recognizing that Creador is relatively new in the Asian private equity market, ADB takes comfort from the significant track record of B. Vasudevan, Creador's chief executive officer. At his previous firm ChrysCapital, a leading growth capital private equity firm focused on India, B. Vasudevan was one of three senior managing partners responsible for investing over \$2 billion in more than 45 investments over multiple economic and market cycles. He also successfully helped ChrysCapital raise five successive funds, growing its assets under management from \$64 million to \$2 billion with vintages ranging from 1999 to 2007.

## V. POLICY COMPLIANCE

### A. Safeguards and Social Dimensions

36. In compliance with ADB's Safeguard Policy Statement (2009), ADB's equity investment is classified category FI, based on potential impacts on the environment, involuntary resettlement, and indigenous peoples. The fund will exclude from ADB financing any investment rated category A under ADB's Safeguard Policy Statement. The proposed investment's potential environmental and social impacts, the risks associated with the fund's existing and/or likely future portfolio, and its commitment and capacity strengthening for environmental and social management were assessed. The operations of the fund are not expected to have significant impacts on involuntary resettlement and indigenous peoples. In the unlikely event of any involuntary resettlement and indigenous peoples' impacts, the ESMS will provide guidance on matters pertaining to due diligence and corrective actions. The fund will apply ADB's prohibited investment activities list and ensure that investments using ADB funds are compliant with applicable national laws and regulations. The fund's ESMS will be updated by enhancing the screening and due diligence process, and including ADB's environmental and social safeguards classification, and monitoring and reporting requirements.<sup>5</sup> ADB has also discussed the possibility of its safeguard team providing periodic environmental and social safeguard training to the relevant Creador personnel to strengthen the fund's environmental and social safeguards capabilities. The ESMS will be updated to meet ADB requirements before the first disbursement. The training would include ADB's screening process, project categorization system, knowledge sharing on local and national environment and social laws and regulations, and environmental issues associated with the fund's pipeline.<sup>6</sup>

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<sup>4</sup> ADB. 2011. *Financial Sector Operational Plan*. Manila.

<sup>5</sup> A corrective action plan will be required to be implemented for subprojects if gaps are identified during the due diligence. Creador's strategy is to take minority stakes with board seats in investee companies to allow them to work with management in implementing necessary operational and environment, social and governance improvements (e.g., Corrective Action Plans).

<sup>6</sup> Details of the safeguard and social dimensions and recommended improvements to the ESMS, which have been agreed with the fund, are in the Financial Intermediary: Environmental and Social Management System (accessible in the list of linked documents in Appendix 2).

37. No specific gender measures are integrated into the project design, thus it is classified as no gender elements. The operations of the fund are not expected to cause any specific cultural or social impacts or exclude any socioeconomic group, including women, from benefits. The fund will comply with national labor laws and, pursuant to ADB's Social Protection Strategy, will take measures to comply with the internationally recognized core labor standards.<sup>7</sup> The fund will report regularly to ADB on (i) its compliance with such laws, and (ii) the measures taken. Information disclosure and consultation with affected people will be conducted in accordance with applicable ADB requirements.

#### **B. Anticorruption Policy**

38. The fund, the general partner, and the investment advisor were advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism; and remedies for ADB in the event of noncompliance.

#### **C. Investment Limitations**

39. The proposed equity investment is within the medium-term, country, industry, group, and single investment exposure limits for non-sovereign investments.

#### **D. Assurances**

40. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),<sup>8</sup> ADB will proceed with the proposed assistance upon establishing that the governments of the member countries of ADB where the fund will invest have no objection to the proposed assistance to the Creador III L.P.. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the ADB Board of Directors.

### **VI. RECOMMENDATION**

41. I am satisfied that the proposed equity investment would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the equity investment of up to \$45,000,000 in the Creador III L.P. from ADB's ordinary capital resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao  
President

October 2015

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<sup>7</sup> ADB. 2003. *Social Protection Strategy*. Manila (adopted in 2001).

<sup>8</sup> ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

## DESIGN AND MONITORING FRAMEWORK

<b>Impact the Project is Aligned with</b> Private equity funding in the Asian middle-market segment increased <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Outcome</b> Financial sustainability of private equity investments in the Asian middle-market segment demonstrated	a. Fund yield of at least 8% in aggregate internal rate of return achieved by 2021 (2014 baseline: not applicable) b. At least 75% of the portfolio companies will target SMEs by 2021 (2014 baseline: not applicable)	a. General partner's quarterly and annual reports on the fund b. Investee companies' annual reports and audited financial statements	The unsuccessful exit from investments adversely affects returns. Investments are adversely affected by fluctuations in foreign exchange rates and changes to monetary policy and foreign exchange control regulations.
<b>Outputs</b> 1. Creador III is established  2. Capital is invested	1a. The fund is launched with \$450 million in aggregate limited partner commitments by Q3 2016 (2014 baseline: not applicable) 2a. The fund's committed capital is deployed among approximately 12 portfolio companies by 2020. (2014 baseline: not applicable)	a. General partner's quarterly and annual reports on the fund	Investment pipeline is weaker than expected. Fund manager is unable to execute on intended pipeline opportunities. Competition from other investors reduces attractiveness of investment opportunities.
<b>Key Activities with Milestones</b> <b>1. Creador III is established</b> 1.1 Execute ADB's legal documentation by Q1 2016. 1.2 The fund establishes an ADB-approved environmental and social management system framework by Q1 2016. 1.3 The fund establishes an independent advisory committee (with ADB representation) by Q1 2016 1.4 ADB and other investors invest in the fund by final closing in Q3 2016. <b>2. Capital is invested</b> 2.1 The fund promotes itself in the market (approximately 2015–2016). 2.2 The fund sources, screens, and invests in companies (2015–2020).			
<b>Inputs</b> Asian Development Bank: Up to \$45 million (equity) Other cofinanciers: \$405 million			
<b>Assumptions for Partner Financing</b> Not applicable.			

ADB = Asian Development Bank, Q = quarter, SMEs = small and medium-sized enterprises.

<sup>a</sup> Defined by project.

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=49274-001-3>

1. Sector Overview
2. Ownership, Management, and Governance
3. Details of Implementation Arrangements
4. Contribution to the ADB Results Framework
5. Financial Analysis
6. Country Economic Indicators
7. Summary Poverty Reduction and Social Strategy
8. Safeguards and Social Dimensions Summary
9. Financial Intermediary: Environmental and Social Management System