1. Summary

The Soros Economic Development Fund ("SEDF") undertakes investments, principally in countries that are transitioning to democracy, to bring about meaningful economic development. SEDF defines development to include the creation of jobs which permit a family to live above the poverty level and contribute to family cash income and the improvement of access to affordable services for poor and low-income persons as well as to other marginalized populations. In this regard, SEDF believes that the exclusion of populations from economic activity creates as much of a marginalized class as any other form of exclusion from society.

SEDF defines its geographic focus to include West Africa (from Cameroon through Senegal but excluding the Gambia and Guinea Bissau), Southern and East Africa from South Africa to Kenya (but excluding for the moment Uganda and South Sudan), the West Bank of Palestine excluding Gaza and South Asia including India and Burma. Although SEDF may enter other countries it will only be with the specific agreement of its Investment Committee which serves as its governance body.

SEDF's predominant focus has been to invest in **financial services**, **agriculture** writ large (meaning from agricultural input to table) and the **system of distribution of goods and services ("logistics")**.

Investment in **financial services** has been important because the creation of financial institutions in turn permits these institutions to fund the start-up and growth of small and medium sized enterprises ("SME") which generate jobs, income and services. In a sense, this type of investment is tantamount to building the field. As an example, we own 20% of a leading bank in **Sierra Leone** and have therefore been able to direct them to do more SME lending and have helped to attract external investment by Development Finance Institutions which further builds SME creation.

In 2014-2017 we will continue to look for opportunities where we can generate value by creating both institutions and financial products and expect to invest in expanding banking and leasing in our core geographic areas, particularly **Zimbabwe**, **Ghana, Liberia** and possibly **Burma**.

An SEDF priority is to structure new debt investment vehicles which use dependable deferred revenues as sources for repayment. We are trying to assist the OSF Education Program to examine the feasibility of creating debt instruments to finance affordable education. While we cannot do this on our own, our role will be to mobilize partners, underwrite the costs of legal and capital markets research and to lead at least one of this type of financing.

Investment in **agriculture** has been a principal emphasis of SEDF, although we have focused more intensely on value-added services than on primary growing. As an example, we believe that a critical bottleneck to agriculture in Sub-Saharan countries is a persistent shortage of quality seeds. As a result we have invested in a holding company which allocates 35% of its investment to seed development and replication companies and the remainder to agricultural SME's. We have also been in discussions with cutting edge providers of biological growth enhancement products that increases plant yield with the intent of co-financing the development of a marketing channel for Africa. A secondary benefit of this is to help protect plants from the stresses of climate change. In general, all of SEDF's focus on agriculture relates closely to improving productivity either by increasing yields or reducing waste.

We are also closely focused on improving access to markets by trying to build intermediaries that permit small and medium sized farmers to meet the needs of large buyers, in order to both increase income for farmers and to meet the challenges of providing food to metropolitan areas.

Inextricably linked to this is investment in improving **logistics**. We have invested in improved port handling and warehousing **in Tanzania** in order to reduce the cost of moving inputs to the interior and to increase the efficiency of moving product to exports. We will invest in a logistics skill building company in India which will aim to train and provide jobs for blue collar workers in warehousing logistics such as forklifts, long haul trucking and pick and pack for agricultural produce. We will look at opportunities to extend key logistic infrastructure such as cold chains that can be used for food as well as for medicines and other perishables. We are considering an investment in a small hybrid electricity solution for situations where uninterruptable power is critical and for factories, farms and offices that are off the grid.

2. Program Context

SEDF's fundamental objective is to promote economic inclusion of disadvantaged populations by expanding employment and income generating opportunities for poor and low-income persons and also by expanding their access to fundamental goods and services. We believe that this strengthens Open Societies, particularly in post conflict countries and those which are undergoing a transition from undemocratic governance to democratic governance. We also strongly believe, as Paul Collier's research has shown, that the introduction of democratic change in the absence of improving family incomes actually increases the risks of political violence. Thus, the overarching objective of the SEDF Program is to help grow businesses that provide employment and important goods and services to our target population, as well as to establish infrastructure which will reinforce and multiply this growth.

While the concept of support to the field is not one that SEDF would normally define, it may be useful to consider this as somewhat analogous to building developmental infrastructure such as financial institutions, capital funds and capital market participants that can continue to independently invest in growth and development. Once founded, banks and investment funds, with proper controls and governance, become reinforcing entities as their mission is to find and grow profitable businesses. To some degree, the field is founded by SEDF's investment, and then may require modest support but will develop its own strategies for growth.

History of the Program

The history of SEDF has closely tracked the program context above. SEDF initially worked in Central and Eastern Europe ("CEE") in support of strengthening transitional economies by developing financial institutions that would in turn strengthen small and medium-sized enterprises. Decision making for investment activity was, by design, isolated from the national foundations because of the different skill sets required and the fear that by involving national foundations in decision making, this could create a moral hazard.

Following the accession of most CEE states to the European Union, SEDF refocused its efforts in other geographic areas of interest to OSF, primarily Sub-Saharan Africa, and maintained its emphasis on post conflict countries and those undergoing a transition to democratic rule. This included OSF's historic engagement with **South Africa's** housing program which was transferred to SEDF and new engagements with **Sierra Leone**, **Liberia**, **Kenya, Tanzania and Zimbabwe and indirectly through funds in Malawi, Mozambique, and Ghana**. SEDF also expanded its work to **India**, seeking to demonstrate that investment focused on the bottom of the economic pyramid could yield substantial economic and social returns. We also expanded our presence in **Haiti** and entered the **West Bank of Palestine**, both of which qualify as post conflict states and **Mexico** as a learning experience for transferrable concepts.

In this transition, SEDF also expanded its thematic focus from principally financial services to a mix of financial services, agriculture and logistics. This expansion reflects the significantly less developed environments of Africa, Asia and the Middle East in comparison to CEE, the greater role of agriculture in the economies of these regions, the relative absence of small and medium sized enterprises and established industries that could serve as economic generators, and the implicit need to establish industrial segments that can generate large numbers of jobs that accommodate lower levels of formal education. As SEDF has pursued these new priorities, it has become apparent, particularly in Africa that investments are often cross border, and that while our focus may initiate in a transition country the impact of the investment will affect several surrounding nations.

SEDF has, since inception, utilized several measures of success. The simplest has been profitability and sustainable cash flow. In terms of social performance we have measured first the number of jobs generated and then utilized a conservative multiplier to estimate the number of people affected. We have also measured improvement in access to goods and services which is where we have had the greatest impact. We intend to refine the measure that we use to estimate the multiplier effect of jobs created and to measure the implied subsidy that we offer in pricing short and longer term debt in comparison to local rates. As a result of a self-assessment undertaken several years ago, we have become convinced that while financially successful we have sometimes failed to have a broad enough reach to justify many of the investments. As a result we have shifted our focus to investments that are scalable, replicable or disruptive.

3. Fealty to Fields and Places

SEDF's principal "field" is that of impact investing. Typically we do not invest in other impact investors but we invest alongside other like-minded impact investors and make a significant effort to bring other investors to the geographies and strategies that are important to us. As an example, we have worked for the past year to try to draw additional family offices to co-invest with us in the impact portfolio, largely because we believe it is good for the field. Also, SEDF has taken an industry lead in innovating new structures for our investment vehicles. Our mixed performance experience and desire for greater transparency has encouraged us to move away from typical fund structures. In West Africa, SEDF led the restructuring of two small equity funds into Injaro Agricultural Capital, a holding company structure. Aspada, our second investment in India, is also a holding company structure. It is unique to the Indian market and aims to attract other impact investors to identify, pursue and complete bottom of the pyramid investments. In the period 2014-2017, we will create similar structures in East and Southern Africa.

Our experience across our portfolio has shown that we will be required to play a more active role in the mentoring of our investee entrepreneurs, much as we have done in Palestine and India. As a result, we may begin to support existing technical service groups or build new ones for this purpose.

We will also allocate small amounts of grant funding to document our efforts and disseminate them as one version of a useful practices guide. Included in this effort will be a focus on improving transparency of both financial and social results- SEDF is one of the few impact investment groups that freely disclose both financial and social results . We will also assess the demand for a standards setting group, but are inherently skeptical of the demand in view of the large number of actors in this area.

Our expectation of each type of managed impact investment structure is as follows:

1. To identify investments that are consistent with the overall objective of building sustainable businesses that generate meaningful numbers of jobs and income and/or provide goods and services to our target population.
2. To achieve financial self-sufficiency and at the end of the investment period to return capital plus an agreed minimum earnings rate.

4. Program Concepts and Initiatives

An important part of SEDF's 2014-2017 strategy is to continue to selectively invest in and strengthen businesses that in turn generate employment, income and access to goods and services for our target population. Our current target population is those below $12/day, which includes the poor and near poor. We aim to generate employment in the typical blue collar fields such as transportation, logistics and service industries such as hospitality. We will also continue to move from isolated investments which may be good in their own right but lack reach and significance to investments that are **scalable** or **replicable** or to those which have a potentially **disruptive effect** on markets.

We believe that an example of a scalable investment is our investment in a farm to fuel and food model that replaces the use of charcoal as a cooking fuel. This is being piloted in **Mozambique**, however the principal justification for the investment is the potential, if successful, to roll this business out more broadly, either directly by the Company or via a franchise basis, to a large number of African cities. This would most likely require a 5-10 year period but has the potential to create thousands of jobs, improve incomes of thousands of smallholder farmers, provide a meaningful contribution to food security, impact positively on the health of the families using the cleaner fuel, and remove over 2 million tons of carbon emissions annually while reducing deforestation.

An example of a disruptive approach is a potential investment that we are assessing with a prominent venture fund to bring to the African market a synthetically produced protein product which holds the promise of ending protein deficiency and its long-term health effects such as stunting. This shift to investments of far broader reach and potential benefit is perhaps the most important overall change in strategy that SEDF is undertaking; however the increase in reach also increases the relative risk of the investment and consequently the possibility of loss.

Within the overall construct of SEDF's priorities of developing financial services, agriculture and logistics, our principal focus is to identify and address important bottlenecks that prevent economic progress. This may require direct investment but will also require identifying areas in which advocacy can play an important role in changing the manner in which governments regulate these thematic areas. As examples, the Central Bank of Burma's policy requiring all debt to be less than a year in tenure and fully collateralized makes it impossible to use debt to develop small businesses or agriculture. The policy of each individual government in Africa requiring new registration of seed stock, sometimes taking up to two years, severely hampers agricultural development. In both cases, concerted advocacy by OSF's advocacy staff together with SEDF staff and SEDF clients would be of assistance.

Specific programs within SEDF's 2014-2017 strategy include developing agriculture, logistics and financial services in priority geographies of post conflict and emerging **Africa**, **India** and **Burma**. Initiatives are as follows:

Agriculture and Logistics

1. Improve agricultural productivity at the grower level by making improved inputs more readily available to farmers, particularly in markets where working capital is not generally available and where distribution channels are not well developed. To accomplish this SEDF will consider the following areas for investment:
    a. Expand the existing program of investment in seed replication companies with an emphasis on higher yield and fortified nutrition seed in order to improve both the absolute quality of production and the nutritional value of production. It should be noted that while seed replication is crucial to drive agricultural success, it is a low margin, working capital intensive and high risk business that may require partial grant support to fully justify the investment. This will be done in close contact with AGRA which is the pre-eminent public organization in Africa working on seed development and distribution and will also require a significant scale up to expand the number of demonstration plots per country. In turn, this will require SEDF to either utilize its own funds as grant funds, or to solicit donors including seed companies to underwrite the costs of these scale-ups. This program, initiated in 2013 in West Africa will intensify in 2014 but realistically will require three to four years before it shows significant impact. We expect the principal focus to initially be on West Africa, a region significantly underserved even vis-à-vis its peers of East and Southern Africa, and then move to East and Southern Africa, as additional participants are attracted to the field.
    b. Improve access of farmers, particularly small holders, to newly developed biologic agricultural inputs by building a distribution channel and entering co-ventures with suppliers. This will permit improved yields and as importantly, experimentation in protecting crops from drought and temperature stress. This will be accomplished through a co-venture with a Norwegian Company and by

the possible contribution of an ownership interest in the company from Soros Fund Management to SEDF.

c. Expand existing programs of strengthening cooperative extension services (through blended funding of investment and grant capital) in order to improve the level of agricultural training and consultation available to smallholder farmers by working with other participants including national governments, multi-lateral and bi-lateral donors and philanthropies. National government advocacy activities and coordination with local foundations will be critical to this effort. One example of this is the OSF-SEDF supported BRAC West Africa initiative in **Sierra Leone** and **Liberia**.

2. Improve agricultural and pastoral profitability by investing in a range of projects that individually represent attractive paybacks but create improved selling and operating margin opportunities for growers and pastoralists.
    a. Identify opportunities for value added processing including milling, cold storage, canning and abattoirs.
    b. Link growers and processors with wholesale or retail markets by strengthening cooperatives, forming private-public trading companies and/or storage depots.
    c. Reduce waste by introducing storage solutions that reduce insect and mold in cereals and other dry products from 20% to near zero by marketing and financing Grain Pro, a manufacturer and marketer of storage solutions.
    d. Lower the costs of importing inputs and foods to interior locations by investing in logistic capacity more broadly, including port handling companies, storage warehouses and agricultural distributor businesses.
    e. Identify and continue to support technology and communications platforms that can reduce the information asymmetry in the agricultural sector, with a particular focus on empowering small holder farmers with the relevant market data to receive higher prices for their commodities.

Financial Services

SEDF’s fundamental strategy for 2014-2017 is to continue to invest in innovative financial services that can facilitate growth through SME development and improved financial security for disadvantaged and marginalized populations, as well as address other financial gaps facing our target population and geographies. Specific projects within this category include the following:

1. Expanding SEDF's investments in livestock and equipment leasing now based in **Kenya** to other parts of Africa either through partnerships with existing financial institutions or the creation of new leasing companies.
2. Establishing or helping to expand SME financial institutions in underserved transitional markets including **Zimbabwe**, **Burma** and possibly in our selected countries.
3. Broadly extending the availability of debt for SME use in **India** by structuring new permitted companies such as a debt only vehicle, recently allowed by Indian regulators.
4. Continuing to identify new forms of insurance that specifically benefit our target clients such as crop and health insurance together with the Leap Frog Fund our investee, although we will not participate in their new $300 million fund, as our investment would no longer be catalytic nor be required for success.

In a somewhat different vein, SEDF has been asked by several OSF programs to advise on, or participate in working with thematic programs on innovative financing programs. As an example, SEDF has had ongoing discussions with the Education Support Program "ESP" regarding how to increase or introduce the availability of debt financing for private affordable education. One country where we believe there is strong potential for piloting a debt vehicle for financing private schools is **Pakistan**. We would work with ESP to develop this initiative. In 2014, we will budget a small amount for development work and will more fully engage with the ESP working group, including its consultant the Innovative Finance Foundation.

SEDF is also beginning to evaluate financial investment opportunities in the Gulf for financial products that can benefit medium to long-term migrants. These opportunities may include mobile based health and insurance schemes, or home country savings and credit programs which are designed to both aid transitions to home country and to permit migrants to put their capital to work in their home country. The one area in which we do not plan to work is in remittance payments because the field is crowded and dominated by Western Union and because of our conviction that to succeed one requires a ubiquitous physical network that can only be built over a long period of time at significant cost. We will move forward with this work only if we can determine that there is interest on the part of the Migration Program.

<u>Other New Areas of Focus</u>

SEDF will continue to pursue its plan to enter the **Burma** market, focusing on the same core areas of financial services, logistics and agriculture in order to demonstrate positive progress within the country and to help attract other impact investors. SEDF will pursue establishing a commercial English Language translation business and a large scale English Language education program potentially with the British Council as a core partner and in close coordination with the OSF Burma Program as well as with several other programs including Scholarships, Information and Education. There are precedents for both of these initiatives in OSF's earlier work in CEE and we will research approaches that worked well and perhaps connect with actors that were helpful at that time. DFID has also suggested that we jointly pursue a project to establish a training center to teach larger companies how to conduct business transparently and with appropriate controls. Their hope is that this can be used to convert marginally tainted "oligarchs" to adopt new practices. We think that this is an interesting concept for near term concentration, and will coordinate this with the new Transparency Program led by Julie McCarthy.

<u>What We Will Discontinue</u>

SEDF will continue to exit its CEE investments and will no longer maintain Budapest based staff, instead shifting this capacity to the Making the Most Program. To the degree that we continue to try to structure a financing vehicle for Roma and other CEE marginalized communities, which to date has been highly challenging on a number of levels, we will do so using New York based staff together with local consultants. We believe that developing a sustainable financial system that targets this customer base requires the deep involvement of the EU structural funds and financial deposits and of European financing agencies including the European Investment Fund ("EIF"), the European Investment Bank ("EIB") and the European Bank for Reconstruction and Development ("EBRD"). If we are unable to secure a meaningful commitment from these organizations, we will most likely conclude that this project is not feasible and withdraw.

We will also continue to refrain from developing new investments in **Haiti** where we have two performing investments and one non-performing investment. We do not anticipate re-engaging in the market unless there is a clear shift in the willingness of the government to engage deeply and to enforce an acceptable level of transparency.

5. Contributions to Shared Frameworks

SEDF intends to be active in Shared Frameworks, particularly in the initial project related to Food Security in the context of Climate Change. Several of our ongoing core projects are incorporated within Goal 2 of the Food Security strategy and will be completed within the normal context of our work. Participating in the shared framework, however, will require us to develop an effective way to communicate plans and progress to other colleagues working alongside of us. We also plan to investigate two other areas that could potentially form the basis for a shared framework. The first, as discussed above, relates to developing financial services for migrants, with the express intents of both improving their security while out of their home country, for example, by developing a local health insurance product that ties back to their home country and by also improving their financial security upon return to their home country by insuring that they have savings and credit. We will seek close cooperation with the Migration Program and the Public Health Program. A second area may relate to introducing investment support of US Programs place based initiatives, but will depend upon a variety of factors including revising the overall charter of SEDF to include domestic work. We believe that our expertise in housing finance, financial services and innovative financial structuring could make this an attractive area for exploration.

6. Other Significant Collaborations

We plan to more fully develop our relationships with DFID/CDC, USAID, EIF/EIB and KFW in the next three years. Each of these organizations plays important roles in the investment space that we occupy. Each has its own bureaucratic peculiarities that make interaction difficult. With DFID and USAID, we will participate in the broader OSF relationship and continue to develop our own geographic specific relationships. With EIF/EIB, we would request assistance from the Brussels office to understand EIF/EIB priorities and to be guided and introduced to the proper people for discussion.

We also will place an emphasis on finding and cultivating the right relationships with potential aid/impact investors in China such as the China Investment Corporation, in order to bring them into the investment mix in Africa. We have had preliminary discussions with Martyn Davies of Frontier Advisors and would hope to involve our China Program as well as others (for example, Baifong Schell and Tony Elemelu through his UBA relationships) to reach the proper parties. We believe that this is a multi-year effort but one well worth undertaking.

SEDF will begin formulating a country risk assessment mechanism which will include risk scoring from our OSF colleagues in-country. As per normal we will continue consultation with foundations regarding individual investee profiles and reputations as well as entry in to new countries within their geographic remit. All government level or ministerial meetings are conducted in consultation with the local OSF offices.

7. Internal Organizational Plans

SEDF is in the process of reorganizing and strengthening its Analyst and Investment Officer positions. Newly recruited analysts will be required to have excellent modeling skills, and be credit trained by a bank or other financial institution. Newly recruited Investment Officers will be expected to have been active in emerging market investing with successful histories of multiple transactions. SEDF is also carefully evaluating locations such as Johannesburg, Accra and India where new hires will be deployed in order to get as close to the investment environment as possible. We are also engaging key board members in the interview and selection process. When SEDF makes a substantial commitment to Burma, it will require supplementing its staff with an Asia based Investment Officer, most likely in 2014. SEDF is also assessing its requirements to strengthen senior management oversight which may include the addition of a Chief Investment Officer. For existing staff, SEDF, with guidance from the OSF Human Resource Department, will expand its efforts to offer skills and professional development opportunities. We must also address the issue of compensation in order to insure that we are competitive with other first tier impact investment groups and with the broader investment industry from which we draw candidates.

Financial Implications

SEDF has aggregate assets of approximately $225 million of which approximately $100 million is already committed to investments and we expect additional 2013 commitments of $40M. In each of 2014 and 2015 we anticipate new commitments of $50 million. During the same period 2013-2015 we expect repayments of loans or liquidations of investments of about $20M million and we expect earnings (estimated conservatively at 5%) of about $18 million in the 2013-2015 period. During the same period we anticipate operating expenses of about $13 million reflecting an increase in staffing and operations. Therefore at year-end 2015 we estimate having committed substantially all of our liquid assets. As a result, we are in discussions with senior management and George Soros regarding a recapitalization. If this is not forthcoming we will revise our investment program to more slowly allocate resources, and we would curtail our planned expansion and try to accelerate our exits from investments in order to enhance liquidity.

It should be noted that in 2014 SEDF will not draw funds from the OSF operating budget but will continue to be self-funding. We have not, therefore, reduced spending by 25% but can do so upon direction and would then reduce new investment as well.