

Case Study: KZ Noir Ltd. (Rwanda)

KZ Noir's Story

In early 2011, the Rwandan coffee sector was suffering from mismanagement, volatile coffee prices and lack of access to financing, along with lagging productivity due to fragmented local production. At the time, there was little commercial appetite within Rwanda for investing in distressed coffee companies. However, Kaizen Venture Partners (KVP), which focuses on special situations in Sub-Saharan Africa, saw an opportunity to consolidate several struggling coffee producers, support their working capital needs through a difficult market, and boost profitability through improved internal reporting and increased capacity utilization.

KVP also believed that Rwandan coffee was among the world's best in terms of quality; with the right marketing and branding, it believed the companies' coffee could command a premium and reach many more international customers through expanded buyer relationships.



At the same time, KVP saw the potential to impact the lives of hundreds of processing employees and thousands of farmers by growing employment in Rwanda's poor rural areas in a sustainable way. Indirect effects on the country's broader economy could also be appreciable, since coffee typically accounts for about one-third of Rwanda's export income.

KVP approached Gilbert Gatali—a locally based manager with experience in sustainable agriculture in East Africa and knowledge of Rwanda's coffee industry—to work as managing director should KVP complete an acquisition. Following the first acquisition, Gatali became the Managing Director of KZ Noir, KVP's Kigali-based holding company, and assisted KVP in its acquisition of two additional coffee processing companies.

The Role Played by Private Equity

Prior to investment, the most pressing concern among KZ Noir's new subsidiaries was solvency; the Rwandan coffee industry as a whole was in distress and all three companies, unable to extend their credit lines due to lack of collateral, were facing the possibility of bankruptcy. KVP helped the companies to restructure their long- and short-term bank debt, and built relationships with local banks and impact investors, such as Root Capital, to improve KZ Noir's access to working capital. Remaining gaps in working capital requirements were filled through shareholder loans.

KVP also focused on the companies' cost structure, which includes raw materials that follow export prices at a lag, and thus can result in volatile margins. Gatali and his team accelerated

internal reporting of raw material costs in relation to international coffee prices to improve sourcing decision-making. Consolidated under KZ Noir's umbrella, the investee companies were also able to reduce costs by pooling back office functions (including accounting and quality control) as well as purchasing inputs in larger quantities. On the revenue side, KZ Noir began hedging output prices—uncommon among Rwandan coffee processors—through futures contracts and put options with Falcon Commodities, a U.K.-based coffee importing and trading house.

With KVP's guidance, the investee companies shifted away from the volume-first approach that their previous shareholders had pursued and began to focus more on quality. Following acquisition, the companies achieved higher price differentials for their specialty coffee, a reflection ▶

The Company

Essentials

Company: KZ Noir Ltd.

Country: Rwanda

Sector: Agribusiness

Business focus: Coffee processing

Size: US\$4.1 million in revenue (2012)

GP: Kaizen Venture Partners (KVP), a private equity investment firm focused on special situations in Sub-Saharan Africa (www.kaizenventurepartners.com)

Date of investment: 2011

Investment: KVP acquired a 75% stake in Socor Ltd., 65% stake in Caferwa Ltd. and 80% stake in Karengera Coffee Ltd. through its Rwandan holding company, KZ Noir Ltd.

Impact Highlights

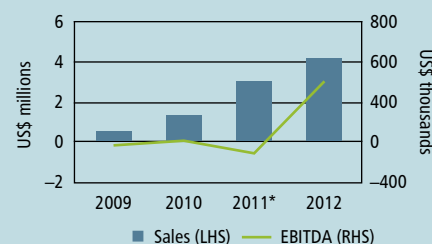
KVP consolidated three distressed coffee processing companies, restructured their debt (enabling them to avoid bankruptcy) and provided working capital financing through equity injections, shareholder loans and third-party financing

Under KVP's leadership, investee companies increased production volumes and widened operating margins through new management expertise, improvements in raw material sourcing and quality control, tighter internal controls and hedging of raw materials prices

With KVP's assistance, investee companies have worked to increase coffee farmers' yields through training in agronomy best practices coupled with both organic and non-organic fertilizer distribution

Financial Performance

Portfolio Companies' Sales and EBITDA



*KVP acquired the portfolio companies in early 2011.

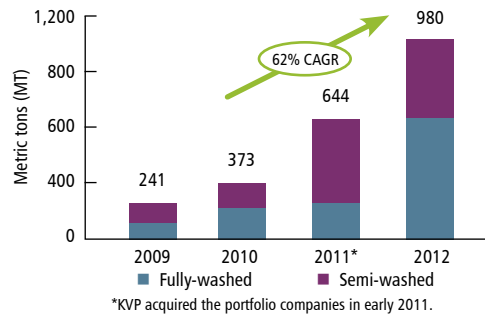
The Company View

“When I decided to get into coffee, I was looking for something that would have a social impact. Kaizen’s investment allowed management and me to pursue things like fair trade certification, as well as pay attention to the firms’ environmental impact and how we treat our farmers and staff. Kaizen believed in these measures and helped support them.”

Gilbert Gatali, Managing Director, KZ Noir



Increased Coffee Production Volumes



“We source raw materials from over 10,000 farmers, which is a big part of our social impact. We support farmers by buying their coffee cherries, but we also train them in agronomy best practices, which increases yields and farmer income, and also builds farmer loyalty. A lot of farmers have a choice in where to sell their coffee cherries, and so by building those relationships we’re also helping to ensure our supply.”
Sean Nowak, Senior Associate, Kaizen Venture Partners

► of rising output quality. KZ Noir has also been recognized in national coffee competitions; in the past two years, two subsidiaries have placed among the international winners of Rwanda’s Cup of Excellence award for the first time.

In order to build up its subsidiaries’ customer base, KZ Noir’s management traveled abroad to promote their brands at international trade shows in the United States, South Korea and Ethiopia. These efforts significantly expanded buyer relationships, securing new export partners as far away as Japan and Australia. With KVP’s guidance, the companies’ partners have grown to comprise top international coffee roasters, including Peet’s Coffee and Tea and Whole Foods’s

coffee sourcing subsidiary, as well as some of the world’s largest commodities trading houses such as Olam and Louis Dreyfus. In 2012, KZ Noir sold about half of its specialty coffee to Starbucks, and is now considering branding single-origin coffee from specific coffee washing stations to international customers as its volumes increase.

Under their new management, the investee companies’ sales increased at a CAGR of 73% from 2010 to 2012, and 2012 earnings before interest, tax, depreciation and amortization rose to more than US\$500,000 after averaging a loss over the previous three years.

Beyond the Bottom Line

In turning KZ Noir’s subsidiaries around, KVP has focused on its impact on local communities. It is now pursuing several internationally recognized certifications, including Fair Trade, Rainforest Alliance and Starbucks’s C.A.F.E. certification. In preparation for these certifications, KVP has launched several initiatives to enhance the positive social and environmental impact of its investment.

KVP engaged Technoserve, a technical assistance NGO, to enhance sustainability at KZ Noir’s washing stations and to train KZ Noir employees in agronomy techniques. Staff have subsequently worked with hundreds of coffee cherry suppliers, teaching farmers best practices in land maintenance, fertilizer application, tree pruning and other areas. In addition to raising farmers’ yields and incomes, this initiative has boosted loyalty among farmers who have a choice of whom to sell to, helping to ensure KZ Noir’s supply.



KVP’s involvement has also benefited relatively disadvantaged populations within Rwanda. Most of the subsidiaries’ 1,300 full-time and seasonal staff are women, and many skilled jobs—including plant managers—are based in the country’s poorer Western Province, providing a valuable opportunity for quality employment outside of the capital.

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