

June 9, 2008



Private Equity Funds Turn Toward Cambodia

As Vietnam's overheated economy teeters on the brink of crisis, its neighbor Cambodia is being labeled the next frontier market for private equity.

That should be good news for a country that's normally only in the headlines for its bloody past, but it also raises an important question: Can foreign investment flourish in a state notorious for corruption, weak laws and business secrecy?

While finding suitable targets in Cambodia may be difficult enough, private equity buyers are also certain to face challenges when they try to exit years from now. "This really is a frontier market," said Chris Leahy, a Singapore-based managing director at risk consultant Kroll Inc.

In a sure sign Cambodia has arrived on the global investment map, finance luminaries Marc Faber and Jim Rogers have poured praise on the country's investment prospects. "Cambodia offers an enormous potential for future capital gains," Mr. Faber wrote in a recent newsletter for acolyte investors. Messrs. Faber and Rogers are advising some of the private equity firms that will pour upwards of \$500 million into Cambodia from already completed and continuing fund raising.

Last month, 22 mainly U.S. fund managers met in Siem Reap, Cambodia's base for temple tourism, to assess the opportunities.

They aren't the first. Malaysian interests have been active in the country for years and South Koreans are already investing in banking and property, including a \$2 billion satellite city on the outskirts of the capital Phnom Penh.

The expatriate business community in Cambodia has long railed against negative perceptions of the country. One refrain: 'Cambodia is more than a pile of skulls' - a reference to Phnom Penh's gut-wrenching "killing fields" museum. Some 1.7 million people, a fifth of the population, were killed during the communist Khmer Rouge's reign of terror from 1975 to 1979. Special attention was paid to exterminating the educated. Three decades later, the consequences continue to ripple through the country; a lack of skilled people hampers efforts to lift millions out of grinding poverty.

Another legacy of that era, corruption, is well documented. Berlin-based Transparency International ranked Cambodia the 14th most corrupt out of 179 nations in its 2007 study.

It is also difficult to enforce legal rights and business contracts. “There are issues in Indonesia or Philippines enforcing rights but it’s much harder in Cambodia,” said Kroll’s Mr. Leahy. “A creditor needs more than 400 days to get a claim enforced, and that’s assuming the court decides to side with a foreign creditor’s claim,” he said, citing a World Bank report.

Given the perception that large-scale business activities require an unsavory accommodation with powerful figures in the government, staying small may be the key to success for private equity investors.

“We want the small- and medium-sized investments below the political radar screen,” said Douglas Clayton, a managing partner of Leopard Asia, which is raising \$100 million for its Cambodia fund. Leopard’s fund opened for subscription in April and has so far raised \$11 million. It’s targeting investments between \$5 million and \$15 million, with a preference for minority stakes and a willingness to start businesses from scratch.

Mr. Douglas said the group sees opportunities in food processing, the garments industry, agribusiness and property. Its first deal is a minority stake in a 250-unit condominium in Siem Reap. The projected return for the fund’s \$2.5 million investment in the condo is 60%, well above its target for returns of 25%.

But finding enough suitable opportunities to absorb several hundred million dollars of private equity capital is another issue facing investors. The challenge is finding companies with accounting and management standards that approach international norms, said Peter Brimble, managing director of the Cambodia Emerald Fund, which is aiming to raise \$100 million after splitting from Leopard late last year.

The money can be absorbed if the economy continues to grow strongly and the government continues to improve transparency and legal standards, Mr. Brimble said. “As we dig deeper into this country and connect with the entrepreneurial class we are finding a lot of opportunities,” he said.

“Five hundred million dollars is really just a few golf courses and hotels. A lot more could be absorbed,” said Douglas Broderick, the U.N. Development Program’s resident representative in Cambodia.

–Stephen Wright in Bangkok