Cambodia's growl too quiet to be Asia's next tiger yet

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By Lawrence White

The country is looking to the future under a pro-investment government. Foreign banks, private equity funds and manufacturers are interested, but there's no guaranteed alpha on the Mekong. Lawrence White reports.

The cost of doing business

DRIVE NORTH OUT of Phnom Penh for 10 minutes or so and you'll reach a flat stretch of dark yellow sand where the southernmost shore of Pong Peay lake used to be. At first it doesn't look like much: children play in the remaining streets of the shanty town, rickety stalls sell drinks to a handful of Khmer idling on parked motorbikes. Then comes the sign: a huge arch proclaiming "New History is COMING" straddles the dirt road, and in the background cranes tower over half-built apartment blocks that dominate the flat land around them. A new city is being built.

Funded by Korean banks and built by Korea's Hanil Engineering, Camko City – the name is a conflation of Cambodia and Korea – will offer apartments, houses, villas, a hospital, a school and a business district to house Cambodia's new stock exchange. The latter, a joint venture with the Korean Stock Exchange, is to open in September 2009.

Back in Phnom Penh, Korean construction firm GS continues work on the new $1 billion, 52-storey IFC building that will tower over the city's low skyline when it is completed in 2012. Perhaps some of the private equity firms that have been sniffing around Cambodia in the past 12 months will settle there: for the moment the lack of A-grade office space in the city forces them to look elsewhere, and two of the most prominent funds, Leopard Cambodia and Cambodia Emerald, are for the moment lodged in converted colonial villas.

Interest in this country of 14 million people has been quietly building for a few years but in the past 12 months there has been an explosion of foreign direct investment. One fund manager estimates that the rate of FDI has more than tripled. The country has attracted brotherly sympathy, financial aid and the help of a bewildering number of NGOs and charities since it emerged gasping from the brutality of

Khmer Rouge rule. Now, though, some of Asia's emerged and emerging countries are making investments driven by financial as much as filial concerns and the country is changing rapidly.

"Years ago when we started looking at this place, people thought we were crazy," says Doug Clayton, managing partner at Leopard Capital. "But in the last six months other people seem to have realized that we might be on to something." The fund launched in April with $15 million of seed capital, and Clayton says that sum will all be invested within the next month or two as the firm moves on to a second round of financing and a final target size of $100 million. Although Cambodia's economy at the moment is poorly diversified, with clothing accounting for 80% of exports, Clayton says that project ideas are pitched to him almost every day and the challenge is to pick the ones that have been properly thought through and have the best chance of being properly executed.

New world order

Investment in emerging Asia has in the past often come from the US and Europe, so it's perhaps a sign of the new world order in financial markets that Cambodia is very much an intra-Asian project. In addition to the heavy involvement of Korean firms in the real estate sector, there are lots of projects developing the country's physical and financial infrastructure sponsored and managed by Asian institutions. The Japanese development banks have built bridges and roads; Thais have invested in power; and a Kazakh bank, Advanced Bank of Asia, has invested heavily in telecoms.

Ruslan Zhukeyev, chief executive of Advanced Bank of Asia (whose largest shareholder is Kazakh investment bank Visor), explains one of the most appealing reasons for investing in Cambodia: "We are the largest GSM operator in Nepal, and built our brand there from scratch until it was one of the largest companies in the country. We began looking around for similar opportunities in Asia and came to Cambodia in 2006. It's one of the easiest markets to get into in the region because there are very few entry barriers: if you have an idea, you can come here and start a business, without difficult visa issues, in a dollarized economy where capital flows are not as tightly regulated."

Of course, pegging your economy's fortunes to those of the dollar is not without its risks: in recent months the Cambodian authorities have been waging the same battle against inflation as their counterparts across the region without access to some of the same countermeasures. The National Bank has raised capital reserve requirements for banks from 8% to 16%, draining liquidity from the system and attempting to slow the country's accelerating credit growth. The authorities work closely with the IMF, and while bank chief executives were initially upset at the measures, most privately describe the National Bank's actions as sensible and well-advised.

Still, inflation is a real threat. The government had yet to disclose the latest CPI figures, in itself a cause for alarm and dismay among some market participants urging greater transparency from the authorities. However, the present rate of inflation is believed by most to be between 25% and 30%. An informal *Euromoney* poll of taxi and moto drivers in Phnom Penh supports the view of a local paper that the price of rice has doubled in the past 12 months, making life difficult for some.

While the government can and does argue that much of this inflation is driven by external factors affecting most of Asia, there are also issues unique to Cambodia. This is a small market, and there's a real worry that the sudden flurry of interest from foreign investors is driving price increases and distorting land values. Who will populate the towering new financial centres and gleaming villas?

"We have almost sold out the first phase of Camko City's development," says Duk-Kon Kim, vice-president at World City, the special purpose company set up by Korean shareholders to build the new city.

"We have only 55 units remaining from over 1,000 built during the first phase," he says, adding that it is his company's aim to sell as many of these to locals as possible. Still, many of the units in this first of three phases were sold to Korean real estate funds, and many in Phnom Penh fear that an over-zealous response by capital-rich Korean construction firms to the perceived need for quality real estate is creating a bubble. The Camko City project also attracted much negative publicity in its early stages for the ecological cost of filling in the lake and displacing local residents. The sale and lease of large swathes of the country's coast has raised similar issues across the nation. Developers in Cambodia face extensive public relations issues that could become more problematic still.

"Some of the real estate projects you're seeing spring up around town are pure speculation," says a foreign investor yet to spend any capital in the country. "They are projects that have been started on the expectation that land values will rise and stay high. We've already seen a few developments pulled, and although I think the country as a whole is very exciting, that is one sector that could be headed for trouble."

In October last year a Russian businessman, Alexander Trofimov, was arrested on charges of sexually abusing underage girls in Cambodia. Trofimov was the chair of a company that had bought a 99-year lease on Koh Pos (Snake Island) off the coast of Cambodia, and the sorry tale bought further negative attention to the activities of foreign investors in the country, many of whom were blamed for displacing and disrupting local lives. Nonetheless foreign investment continues to grow, and is beginning to demonstrate some benefits to a country that desperately needs outside capital.

"Banks here can lend only 20% of their capital to a single customer," says Stephen Higgins, chief executive of ANZ Royal Bank, "and even for the larger ones here that's not going to be much above $10 million or so. So any big project probably has to get offshore funding."

Room for more

The country's accelerating net domestic credit growth, which doubled to 70% in the 2007 financial year, according to the National Bank of Cambodia, means there's plenty of space for the increasing number of small banks entering the market. The country's top four banks, which include Australian-owned ANZ Royal and Acleda, the former microcredit lender turned top domestic bank, have a 70% market share between them, while smaller lenders proliferate. Some consolidation will be inevitable when this rate of growth slows. For now, though, Cambodia's ratio of credit to GDP is around 25% when the figure for the rest of the region is nearer 100%.

The sector most in need of investment and credit is Cambodia's potentially lucrative agricultural industry. Given rising prices for rice, this fertile country with its young workforce could benefit enormously but for the moment most producers are, according to the World Bank, "small, informal and serving local middlemen", while the lack of technological investment means most of what they farm is exported to Thailand, where value is added before the product is re-imported. There is a huge demand for financing to develop the roads, factories and mills that will support this industry. Investment could also help tackle Cambodia's extraordinarily high electricity prices, a factor that many think is the key restraint on industrial growth.

The World Bank concluded in 2004 that "there is scope for the private sector to bridge the financing gap, but the most essential role for the private sector and market forces is to ensure that efficient choices are made in delivery and management of services".

Enter the banks and private equity firms, which are hoping to do just that. Camko Bank, financed largely by the same shareholders that are backing the Camko City project, subsists for the moment on fees it wins for advising on that project and aims to expand its lending as opportunities develop.

"The government here is very open to foreign investment," says Moo-Kyung "Mike" Kang, the Korean president and chief executive of Camko Bank. "But it's difficult to find good counterparties here, so for the moment we want to make our own clients by introducing the market to Korean investors."

To call Cambodia the next Asian Tiger is obviously ambitious: the country's GDP is nearing just $7 billion and its population is small. Some participants in the Cambodian market are calling it the next Vietnam, by which they mean the next Asian country to experience accelerated growth and rapid modernization with the assistance of foreign investment.

"I'm more of a conservative," says Kang, "I can't say that Cambodia will follow the Vietnam story. Domestic demand is slow because there's a small population and very little industry. If oil production takes off, as has been rumoured, then perhaps we could have the liquidity needed to speed things up, but you can't compare too much to Vietnam where you had large domestic demand and a good light manufacturing industry already in place."

Still, the investors are coming. Peter Brimble and Brad Gordon formed Cambodia Emerald after a falling out with their former partner, Doug Clayton, at Leopard Cambodia over issues he had with a non-business-related non-disclosure issue. Gordon and Brimble are now targeting an initial fund size of $100 million, and see the country as a land of huge untapped resources. Brimble estimates that "roughly 80% of arable land is not used, and there's a mix of big and small holdings available unlike in the rest of this region, and a tremendous base of workers from the garment sector."

At a higher level, education is a problem that he and most of his counterparts at other firms cite. Naturally for a developing country whose recent rulers deliberately persecuted academics and turned schools into torture camps, Cambodia's workforce is largely untrained. The return of educated Cambodians who fled the Khmer Rouge regime is helping but workers in high-skill industries such as financial services are in short supply.

Further opportunities

That creates yet more opportunities for foreign firms and investors to help out, says Marvin Yeo, managing partner at Cambodia Investment and Development Fund, whose advisers include legendary commodities investor Jim Rogers, contrarian investor Marc Faber and the former head of AIG Asset Management, Bob Ash.

"Right now, Cambodian companies are debt free," says Yeo. "We can help them create value by finding the right capital structure." As a former head of syndicate at the Asian Development Bank, Yeo says his experience with and contacts in the development industry are helpful in using capital markets solutions to generate growth for Cambodian firms.

It has been said of Vietnam that its greatest asset is its young people, and whether the much smaller Cambodia will follow that country's recent development or not, the same could clearly be said of the Khmer population. Many are indeed so young that they think much more of the possibilities of the future than the traumas of the past. "Do we go to killing fields now?" asks a young moto driver matter of factly after a visit to the Tuol Sleng genocide museum. "Or maybe Russian market so you can buy something nice?"

Clearly wherever Cambodia is going must be better than where it has been recently. While neighbours Thailand and Vietnam seem to be showing little interest, the rest of Asia seems to have taken Cambodia under its wing. While many are motivated by profit as much as concern, in a sense, it doesn't matter so long as there is growth.

"In 2006 Cambodia co-chaired the Asean +3 council with Korea, and it was then that their government approached the Korean government about this project," says Sung-Hee Hong, executive director at Korean exchange KRX who is in charge of the Cambodian stock exchange project. "We don't expect to make any profit from this project, at least not for a decade or so, but we view it as critical both for itself and for the success of other similar projects we are running in places like Mongolia and Laos."

Caveats abound in Cambodia, from the perils of corruption to the untrained workforce, from inflation to high power costs. But there is also opportunity. On a late night cruise down the Mekong after dinner at a restaurant he has just invested in, a new arrival in Cambodia says: "I turned down quite a senior job at an investment bank in New York to come here. There's so much potential in getting this young people out of the fields, into better jobs, building the infrastructure. At a certain point in any country's development you hit a wall but in Cambodia there's just so much easy growth to come."