

Chris Mayer of *Capital & Crisis* reports on Cambodia

Greetings From Phnom Penh, Cambodia

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Dear *Capital & Crisis* Reader,

Phnom Penh is a thriving city of 2 million people at the confluence of the Tonle Sap, Bassac and Mekong rivers in Cambodia. It's a long way from the EU debt crisis. Out on the frontiers of investing, it's hard not to come to the conclusion that the greater long-term upside is in markets like this one, rather than the aging markets of the West.

Historically, travelers often describe Phnom Penh as a pretty French colonial town. It was once known as the "Pearl of Asia." Keyes Beech's description in a 1971 book is typical: "Phnom Penh is a lovely city of stately homes, broad, tree-lined avenues and golden upswept-roofed pagodas... It is a leisurely city with not too many cars..."

These descriptions do not ring true today, as there are swarms of cars, tuk-tuks and motorcycles that manage to navigate crowded intersections, often without the benefit of traffic lights. But the golden upswept-roofed pagodas are still here, architectural marvels of their own, as is the royal palace.

Even so, there are still some of the bones of the French colonial era. I stayed, for example, at the Raffles Hotel Le Royal (for a mere \$120 per night, I might add!). It dates from 1929 and oozes old-world charm. The hotel is a majestic presence, with its French vanilla-colored exterior and immaculate grounds shaded by palm, bamboo and rain trees.

You may be thinking, "But what about the Khmer Rouge?" There are no visible stains of that dark period, which closed 33 years ago. I did visit the famous Tuol Sleng museum. Pol Pot and his minions converted the former secondary school into a prison, known as S-21. It was the largest in Cambodia. Of the some 14,000 people held here (and some estimates put the number as high as 20,000), only seven people survived. Yes, seven.

One of the survivors was there the day I visited. He was a little old man, seated behind a desk under an awning, sipping at a fruit drink through a straw and taking pictures with tourists. I wondered what the man must've felt sitting in a place that was such a hell 30-odd years ago.

Hell is what it must've been. Vietnamese soldiers found it in 1978, when Vietnam invaded Cambodia and toppled Pol Pot's regime. They took pictures of what they found. And those pictures hang on stark walls in the prison. Dead and mangled bodies on steel bed frames, blood-splattered floors and implements of torture scattered about and hung on walls. My stomach turned, standing there in the same rooms in which such awful deeds took place.

There are also hundreds of pictures of the victims, with sad, worried eyes staring back at the camera, as the Khmer Rouge documented what they did here. You can

peruse the tiny cells and see the pile of clothes from the victims, asked to strip before interrogations. S-21 is an overpowering portrait of evil. It's a terrible, somber place.

On the other hand, I also thought about how resilient people are. The ability and determination to rebuild always astonishes. You'd never know any of these awful things happened tooling around Phnom Penh today. The people I met in restaurants and shops were warm and friendly -- and also young. (The median age is only 21 years old.) They are not interested in Pol Pot anymore than American youths today are interested in the Vietnam War. They want good jobs and mobile phones and cars and the things we take for granted. They want a better life.

This is contrary to what many mainstream journalists want you to believe. I read Joel Brinkley's new book, for instance, *Cambodia's Curse: The Modern History of a Troubled Land*. He writes, "Cambodians by and large are a dour people... In fact, it was quite rare to see Cambodians laugh at all. Given their desperate situation, they seldom even smiled." Well, I don't know what Cambodia Brinkley visited, but it's not the same one I'm in now.

There is a definite energy here, a good vibe. The restaurants and bars are hopping at night. There are a number of scaffolds on buildings being renovated or cranes atop new ones. There are old French colonial buildings being restored as hotels, restaurants, apartments and more.

Foreigners do all these renovations, so I'm told. Perhaps because restoring old buildings is something done by rich cultures after certain other needs are met. The prices of real estate are high, and the renovations are not particularly rewarding financially. In Cambodia, there are lots of other needs and better uses of capital. Let me highlight one that deals with a favorite theme: farmland.

I met with the chief investment officer of Leopard Capital, Scott Lewis, in a little Mediterranean bistro called Ocean Restaurant tucked down a quiet side street in Boeung Keng Kang. (Leopard Capital is a private equity group with a \$34 million fund in Cambodia.)

Scott ran through the appeal of the idea. The big picture, if you've been reading this letter, you well know. We're going to need to produce more food to feed a growing and increasingly affluent global population that's eating more-complex diets. The land to do that has to come from somewhere. Cambodia is one of those land banks.

Land is cheap, available and of pretty good quality. You can get a 20-year concession for only \$400 a hectare. Rubber prices are favorable, so the business is attractive. So much so that it's attracting Malaysians and Indonesians, who produce a lot of rubber but are running out of space in their homelands.

There is also lots of room to modernize agriculture here -- to use better seeds, irrigation and fertilizers to boost yields. There is also an acute need for better storage and drying facilities, milling and processing plants. These would allow Cambodians to capture more of the value of their crops, instead of shipping them elsewhere for processing.

This reminds me of what happened in Saskatchewan. About 10 years ago, Saskatchewanian farmers shipped their crops out to be cleaned and processed by someone else. But entrepreneurs got wise to the opportunity, and now processing is a good business up there. Maybe the same will happen in Cambodia.

Scott laid out the basic economics of acquiring farmland. You buy the hectares for \$400 a pop. You have to invest about \$3,500 per hectare to get it to production. So let's say you're all-in for \$4,000 per hectare. Meanwhile, producing rubber plantations go for \$15,000-20,000 in Cambodia and pay a 9-10% yield. So that's a four-bagger -- with yield, too. Sounds like a winner, right?

Ah, but there is a catch. Land is sensitive everywhere. I have been at this long enough to know. It's true in Saskatchewan, and it's true in Brazil. I have firsthand experience with both. Nowhere is it easy for foreigners to start gobbling up farmland.

So the catch is that it can take a long time to get approvals. Leopard's been working on it for over a year, but is very close now. And when you start to factor in the time value of money and other expenses occurred along the way, the deal does not look quite as sweet.

But at some point, the land will get to production, because the economic incentives are so great. It's just a matter of time. Still, it illustrates, in a tangible way, that what sounds great from a macro perspective can be tough to implement in a micro way.

One other point: Cambodia is not as isolated from the rest of the world as you might think.

Cambodia suffered in the 2008 crisis. Tourism is important here, about 15% of the economy. And the only significant export is from the garment industry, whose biggest customer is U.S. consumers. The biggest investor in the country is China.

In truth, there are few places to hide in the world today when the big economies get sick. But again, long term, the upside is out on the frontiers.