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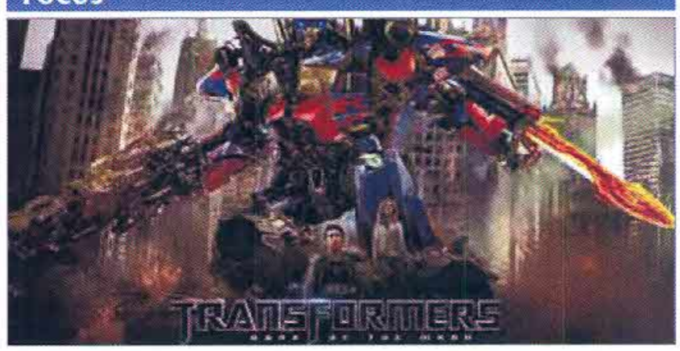

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Investing around Asia's edges

Private equity deal flow in Mongolia, Cambodia and Laos has gone from zero to a steady trickle. When can the region's frontier markets turn this potential into real momentum?

ASKED TO DEFINE A "FRONTIER" private equity firm's investment rationale, Douglas Clayton, founder of Cambodia-based Leopard Capital, says: "Risks tend to be as overrated in many frontier markets, as they are underestimated in developed economies. This is because analysts in developed countries rate the risks, and are uneasy with anything unfamiliar."

Yet the appetite for assets in these unknown areas – chiefly Mongolia, Cambodia and Laos – is growing. Investment has gathered pace over the last five years, hitting a perhaps deceptively high peak of $1.3 billion in 2009 when China Investment Corp. (CIC) launched itself at Mongolia's mining sector.

Still, transactions have risen from zero to a steady trickle and fundraising efforts assumed a new vigor in 2011, with five single-country vehicles entering the market targeting $325 million between them. One explanation put forward for the renewed interest is that the difficulties in the developed world combined with a stutter among the BRIC economies has made investors more willing to take a punt where there is less competition.

These frontier markets share a common selling point: natural resources, including untapped mineral reserves, oil and gas, renewable energy potential and agricultural opportunities. There is also an enormous need for infrastructure in part to accommodate populations that are becoming more prosperous, albeit from a low base.

While risks remain, more experienced GPs in these countries have managed to gather momentum. Speaking on Cambodia, Maya Ballard-Downs of DFDL Mekong, says, "Although the market may not be totally transparent, the funds have generally established a presence with staff who bring local knowledge and connections with them."

Leading first round deals in frontier markets

Investee	Amount (US$m)	Stake (%)	Industry	Date	Investor
Cambodia Fiber Optic (Cambodia)	50.0	–	Telecom	Mar-11	China-ASEAN Investment Cooperation Fund
Lung Ming Investment Holdings (Mongolia)	20.0	–	Metals	Jun-07	Clarity Partners
Moly World (Mongolia)	10.0	20.00	Metals	Jun-11	Origo Partners
ACLEDA Bank (Cambodia)	5.0	–	Banking	Mar-10	Leopard Capital
CamGSM (Cambodia)	5.0	–	Telecom	Dec-09	Leopard Capital
Kincora (Mongolia)	3.0	25.00	Metals	Sep-10	Origo Partners
Electricite Du Laos-Generation Public (Laos)	2.7	2.32	Utilities	Jan-11	Leopard Capital
Vientiane Commercial Bank (Laos)	2.1	10.00	Financial services	Apr-07	IFC
Cambodia Plantations (Cambodia)	1.8	–	Forestry	Jun-09	Leopard Capital
Bumbat Consolidated (Mongolia)	1.0	11.30	Mining	Jun-10	Origo Partners

Source: AVCJ Research

A Mongolian story

The principal driver of the frontier markets' rising numbers is Mongolia. Investment reached $23.7 million in 2007, before shooting up to $300 million in 2008 and then $1.3 billion in 2009. Cambodia's surge came later as $10.1 million in 2009 and $5 million in 2010 became $50 million a year later. Laos is less developed, with $12 million in PE deals over four years.

Mongolia's bumper 2009 came as a result of three transactions in the space of two months. CIC committed $500 million to SouthGobi Energy Resources, $700 million to Iron Mining International and then another $100 million to SouthGobi alongside Temasek Holdings – two PIPE deals and one pre-IPO investment. This pace couldn't be sustained in 2010 and 2011 but early stage and growth capital deals in the mining sector continue such as Origo Partners' investments in Moly World and Kincora. Leopard has been similarly active in Cambodia.

Mongolia's population numbers just 2.7 million and 80% of them are engaged in herding. Yet the country is rich in copper, gold, coal and rare earths. Foreign direct investment was as high as $1.7 billion in 2010, up from $372.5 million in 2007, and year-on-year export growth is over 50%. As a result, GDP growth reached 6.1% in 2010 and 10% in 2011, according to the Asian Development Bank (ADB), making Mongolia the fastest growing economy in the region.

Origo, which is currently investing out of a $100 million fund raised in 2007, has backed four mining sector companies made four mining sector investments since mid 2010 and last year announced a joint venture with Trafigura. Chris Rynning, Origo's CEO, expects the partnership to augment his firm's financial and sector expertise as well as potentially opening the door to larger ticket deals.

"Our on-the-ground presence means we are

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in a strong position to create value by applying our exploration and engineering skills and equipment to all stages of project development," Rynning says.

He believes opportunities are being created by high interest rates, which have made it more difficult for domestic companies to raise funds. This also presents a challenge for Origo's portfolio companies and the private equity firm has responded by sticking to its core interests in the natural resources sphere, principally copper and coal.

By contrast, Mongolia Opportunities Partners, which has received commitments from the likes of the International Finance Corp. (IFC) and the European Bank for Reconstruction & Development for its latest fund, approaches the resources sector indirectly, targeting service providers and infrastructure. It told *AVCJ* last year that it had 30-40 targets in mind, including some in financial services. Sources close to the fund say a debut investment is now imminent.

"Our focus on non-mining opportunities here is not only because our development finance institution (DFI) investors don't want us doing mining deals," says Mandar Jayawant, the private equity firm's managing director. "We also think that these opportunities offer a better risk-reward profile, especially for a fund of our size."

Although Origo did list Kincora in Toronto last year and claims to have other IPOs in the pipeline, the reality for the Mongolia-focused funds is that trade sales are the most likely exit. The burgeoning number of regional strategic investors – whether from China, Japan or Korea – now flooding into the country, support this strategy.

Winning over LPs

Proximity to China is a key selling point for these PE firms – in Indochina as well as Mongolia – when making their case to LPs. Interest in frontier funds has grown but it remains difficult for a first-time GP in a far-flung location to secure commitments. According to AVCJ Research, of the 11 single-country frontier funds launched since 2007, only five have reached a final close.

Origo's Rynning doesn't see this as much of an obstacle, noting that "good companies can always raise capital, if the price is right."

Fundraising for Mongolia Opportunities Partners has taken a much more circuitous route, however. The founders have strong DFI backgrounds and this has influenced their approach to private equity. Jayawant worked at the ADB until about four years ago and Marvin Yeo was one of his colleagues. They paired up to launch Frontier Investment & Development Partners (FIDP fund) in 2008, with a view to targeting Southeast Asia and Mongolia.

"We'd seen the big gap between opportunities in those markets and the international investment community, and within the latter [between the purely commercial players and] the developmental finance community," Yeo recalls. "We set our business up to bridge these different groups."

A Cambodia-focused fund was to be anchored by a Swiss private bank, with a new Mongolia fund primed for launch as soon as the Cambodia vehicle achieved a first close. However, the onset of the global financial crisis saw the Swiss bank pull back. Deciding to re-roll the dice, Jayawant and Yeo accelerated their activity in

Mongolia Opportunties Partners' LPs are not keen on direct investments in the mining industry

Myanmar: Asia's next frontier market?

To see a pariah state, isolated for half a century, transforming into a putative investment icon in a matter of months is nothing short of miraculous. But that's how a growing number of frontier investors now see Myanmar, the former Burma, once described back in the 1940s as the richest country east of Suez.

"Myanmar is one of the remaining jewels of the frontier space, with a potential 10x catch-up story once the reforms are anchored," says Douglas Clayton, CEO of Cambodia-based Leopard Capital.

Decades of iron-fisted military dictatorship and massive economic mismanagement left the country locked in a bizarre time warp as its neighbors achieved historic prosperity. But over the past year or so, President Thein Sein's regime appears to have eased its grip, releasing political prisoners, reaching out to the West, and talking of economic reforms. It is said that these moves are in part driven by concerns that growing Chinese influence could become pervasive.

The parallel market exchange rate of the kyat has appreciated by about 32% in nominal effective terms since the end of the 2010 fiscal year, primarily due to large foreign investment inflows. The IMF is projecting GDP growth of 5.5-6% in 2012, up from 3.6% in 2008. Inflation is expected to pick up as the recent decline in food prices phases out.

The progress has prospective international investors salivating. "George Soros has just been there. Bill Gates is about to go. And I can see Myanmar becoming the most exciting country in the region over the next five years," enthuses one. "Would-be investors are already flooding in. You can't get a hotel room in Yangon right now."

Maya Ballard-Downs of DFDL Mekong in Cambodia confirms that there is increasing interest among Indochina-focused offshore funds in Myanmar.

Their enthusiasm isn't hard to understand. Myanmar boasts a largely untapped treasure trove of natural resources, including oil and gas, minerals and timber, as well as equally impressive renewable energy, agricultural and fisheries potential. And while it is next door to tourist mecca Thailand, its beaches are almost deserted. In the long term, the 60 million population is seen as an emerging consumer market.

The downsides are a lack of foreign investment protection and incentives, plus an artificially overvalued currency. Economic sanctions may well be lifted, but there remains there is also a risk that the government will perform an about face.

It seems almost inevitable that the economic dynamism of Southeast Asia will in some way spill over Myanmar's borders. Clayton sees the first wave of investment focusing on hard assets like real estate, hotels and natural resource concessions. "But as reforms take root, that will broaden to include financial services, telecommunications, electricity, local consumer products and labor-intensive export manufacturing," he tells *AVCJ*. "Most of the early opportunities will be for greenfield projects, however."