Forbes

Opportunistic Private Equity, Leopard Capital In Asia's Frontier Markets

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By Jon Springer

Ken Stevens has been working in market research and investments for 23 years in Southeast Asia. Previously head of research and an investment banker at CLSA Securities in Thailand, he cofounded Leopard Capital in 2007 to be a premier global private equity company in frontier markets. He has a range of expertise in financial management, project design, service businesses and property construction and management.

In this interview we focus on Leopard's strategy for identifying quality private equity investment environments, and investment opportunities in private equity and real estate assets in emerging Asia. We also discuss themes to watch in Asia's growth story going forward. Countries specifically addressed in particular questions include Cambodia, Sri Lanka, Myanmar, Mongolia, Vietnam and Bangladesh.

Jon Springer: Leopard Capital is often early or first-movers investing in private equity in the countries where you work. How do you identify countries to start working in and what sectors you go into?

Ken Stevens: The main factors that we look for are first, what is the competitive environment for funding and what access do companies have to capital. We prefer to operate in countries where companies have very limited access to long-term development capital. The second factor we look at is the openness of a given country to foreign investment. The main question is whether foreign investors can get a fair deal in those countries: will foreigners have some recourse through the legal system or other means to get a fair shake if things go bad? Thirdly, we look at the quality of the potentially investable companies. Are there groups that would make good partners? Are there groups that understand how foreign direct investment, private equity and other types of foreign investment work? Do these groups have a long-term focus?

Are these groups trying to develop the next blue chip companies? Are they looking to build a business empire that will exist long beyond the current owners into future generations or are they just looking to make a quick buck? Thus far in all the frontier countries we operate, we have found many good partners in which to invest.

Macro factors such as GDP growth, the level of interest rates, et cetera are less important in our decision to invest in a given country. It's great when you find a country that's growing at 10% per annum like Cambodia when first we entered there or a country like Laos that is very far off the radar but has been booming much to everyone's surprise. However, the macro drivers really don't dictate the investments. If you can't find companies that you can work with, if you can't find good partners, if you can't find the groups that understand the need to properly align interests, which is really the cornerstone of all private equity investments, then you're not going to benefit from the potential double-digit growth that is taking place.

Investors are concerned about several other issues in frontier markets such as corporate governance, transparency, whether the financials of companies are clean. These matters are all important but those are not the priority factors that we consider. Those types of issues can certainly be improved and those are amongst the tasks that our local partners ask us to come in and help them with.

In a nutshell, we look for environments where we can be competitive in providing long-term capital. We prefer countries and industries where there are no huge, dominant groups that are going to be the 800-pound gorillas that basically do as they please. Foreigners need to have the opportunity to get a just and fair deal when things go wrong. Partner selection is paramount, if you can find a company with good business lines and good potential down the road, then we think we have a good chance of success in these risky and volatile markets.

Springer: Do you have a particular philosophy in how you select the business sectors Leopard Capital invests in for each country?

Stevens: In general, we're an opportunistic investor and we're agnostic to the type of sectors in which we can invest. In frontier markets, some sectors stand out such as: financial services; consumer goods and services; hotel and tourism; selected property segments; power, which is going to grow at two or three times the GDP multiple; manufacturing and export driven industries. Also, other industries such as renewable energy and agriculture are interesting because there is a lot of support from the development banks and international community to go into frontier markets and assist in the development of these sectors.

Springer: What are the rewards of being an early mover investing in a country?

Stevens: The most important benefit of being an early mover is it allows you tie up with the best partners in any given country. Secondly, you will probably get a better deal and better prices for assets. As the first institution that local businessmen meet, you'll probably negotiate a better deal than, for example, in a country like Vietnam where there are a lot of funds with a lot of money chasing after a limited number of deals. In places such as Cambodia and Laos where we've been operating for many years, we were the first fund or foreign institution which allows you to work with companies, develop good relationships and improve companies and corporate governance in an investor friendly way. The third factor which also is important is that you get a say in the development of the capital markets of these countries: you may be an advisor to the stock market or may get good access to high level ministers in the government which allows you to provide input on how they can continue with reforms. Lastly, the strategy to establish the best deals by selecting the best partners is the key. We often come across opportunities that are fantastic and are not going to last too long. If you are there early, you can identify the best deals and you can help business groups by being their first investor and helping them become the future blue chip groups from the early days.

Springer: And the risks of being an early mover investing in a country?

Stevens: The cons of being the first mover is that timing is often tricky in these frontier markets. There are no really good benchmarks as to tell you when they will take off and when you can actually mobilize funding or see substantial performance in your investments. Vietnam serves as a very good point for this. The first groups that entered into Vietnam got into Vietnam several years too early and it took time for their investments to materialize.

So firstly, if you're in too early you run the risk of underperformance or that you won't really tap capital markets as timely as you would like to. Secondly, the policy conditions that establish the frameworks of these markets may not be ready for institutional investment, private equity or professional development of property. In this case, you may have the best intentions and best opportunities but you may not get optimal returns. For example, you may have the chance to take a stake in an attractive company, but unfortunately there is no clear exit as strategic investors are not yet aware of opportunities in this country. In that case you most likely won't do the investment. Another example might be that the banking sector or the capital markets aren't ready to support your deals with credit or follow on funding.

Third, you have great volatility in all these countries. You may invest in a country that has been growing at double digit GDP growth for 4 or 5 years just in time for the downtick when there's a recession or pause for a breather before the next leg up. Often the government will launch a reform in a way that you had not expected and which could impact an existing investment. For example, Myanmar's reforms have been better than almost anyone has expected but often their government makes very bold decisions which can negatively impact the recent investments in their country.

Finally, there are a lot of local business groups who don't understand private equity or simply don't want to operate in a transparent way. These business groups aren't ready to professionalize their company or take on professional investors. In frontier markets, you sometimes have to kiss a lot of frogs before you find a prince.

Springer: **Cambodia** is a country where Leopard Capital had early success as the first private equity firm on the ground. Your fund there has some real estate near Angor Wat. How are the capital and real estate markets in Cambodia maturing?

Stevens: Before we decided to engage Cambodia as our first frontier market fund, we looked at all the countries of the region, including all the newly emerging ASEAN countries, all the former Soviet bloc countries in Asia, Bangladesh, Sri Lanka, Papua New Guinea, and other countries that were under the Asian frontier mandate. Cambodia was very compelling to us. Firstly, we met some very attractive companies, partners we really wanted to work with. Secondly, the economy was booming. Third, it was a reasonable extension of Thailand and Vietnam, two countries that we know very well. A lot of our existing corporate friends were looking to move into Cambodia. Lastly, the investment policies that were being launched were the best in the region: allowing foreigners to be up to 100% owners in any sector except property ownership, some very good guarantees against expropriation, currency matters and the like. So, Cambodia was getting its reforms and FDI off to a very good start and that's why we chose it.

Regarding the real estate market in Cambodia. There have been some very profound changes in Cambodia in the seven years we have been operating there. Initially I would characterize the property sector as 'build and they will buy'. Most of the early projects were not professionally done, they really didn't understand the market, but there was a view that there was such a shortage of supply and so many new investors coming in, so much pent-up buying, that the attitude was to just build something and enjoy the boom in prices. For a while that happened, you had land prices going up 4 and 5 times in a few years. You had land values and unit prices well in excess of Bangkok and other regional cities.

What happened from late 2008/2009 – the recession – is that property companies had to take a breather and they had to improve their developments to be regional class or better. Now when you look at new projects that are going up in Cambodia, you will find very well established and well regarded architects. You're going to find management groups like CBRE, Savills and many

others who are involved early in these projects and helping to make them regional class. You're also finding a lot of regional brands that are now starting to develop some very good projects, people like Ciputra from Indonesia, Hong Kong Land and other regional groups. The transition from very basic and very outdated concepts when we arrived seven years ago to today where you have modern thematic regional-standard professionally driven projects is a big difference.
Secondly, the financial sector and the support for the property sector have improved tremendously. You see now the emergence of consumer friendly mortgages, although they are still not up to regional or global standards. Project financing and property funding has improved dramatically now that the banks really understand the needs of developers. Several very good regional and international groups are becoming major players in Cambodia such asMaybank, ANZ and others. The banks are stepping up and providing very professional financial support to the property sector and other business projects.

Regarding private equity within Cambodia: local businesses now understand better how private equity works. There are groups now that want to engage private equity through us, regional sources or global sources. They now see the benefit of long-term relationships with funding institutions.

Lastly, we found no shortage of good deals in Cambodia. When we first started in Cambodia, several investors were wary that we wouldn't find enough attractive projects and good partners. They feared everyone was too connected to the ruling party or to entrenched and unsavory business interests. However, we were able to find in the middle-sized category decent growth companies and promising projects in which to invest. A lot of those same fears are being mentioned for Myanmar and some of the other new markets. So, we think Cambodia and Laos are good examples that frontier markets do have good potential partners and favorable investment opportunities.

Springer: **Sri Lanka** is a country where Leopard Capital tried to raise money for a fund in 2010 without success. There are some interesting developments there including new ports and 500 acres of ocean to be reclaimed and landfilled to form a new mini-city next to the port of Colombo. Is Sri Lanka's market primed for investment today better than in 2010?
Stevens: In hindsight, our timing for Sri Lanka was very good. The funding was very difficult, getting limited partners (LPs) to come into a fund was difficult at the time because it was shortly after the Sri Lankan Civil War had ended. There were many investors who didn't know Sri Lanka too well, they only knew it from the civil war. Had we got funding then, I think the fund would have been very successful.

Currently, there's a lot investment going on in Sri Lanka including both corporate and institutional investment and not just the big infrastructure projects. Hotels are booming in Sri Lanka. A lot of groups that we are friendly with and work with in the ASEAN region have been going to Sri Lanka to set up major hotels on the beach, in the interior and in the capital of Colombo. Many of these projects in Colombo are renovations of existing properties which are a bit outdated, but beautiful properties that need refurbishment.

There will be investment in mini-cities and new port areas. We refer to those as the 'big picture, bright light' projects. These projects are more difficult to fund however as they need big government contracts or the involvement of huge investment consortiums. We prefer to look for opportunities that are a bit smaller in size or that work more directly with private sector companies.

Moreover in Sri Lanka, there's a great pool of companies that are lean and mean because they survived 26 years of civil war. There are supermarket chains that are better than almost anything in the region. There are hotel brands that once the war ended began expanding in Sri Lanka and in other countries as well. We find in places like Luang Prabang, Laos some fantastic Sri Lankan developers who are doing some of the best projects there.

The Sri Lankan companies are regionally competitive, they have been starved from capital for a long time and now they are really taking advantage of the economic climate. They are taking up the opportunity to tie up with some very strong partners and launch very good deals. So, for private equity and finding good growth companies, the opportunities are very good in Sri Lanka.

Springer: When I was in Sri Lanka in fall of 2012 I met a number of good people, including two very helpful and informative businessmen who had worked with Leopard Capital in 2010.

Stevens: You know, in many countries we go to, there is this expectation amongst investors that you will mostly meet Shyster businessmen who just want to make a buck. When you go to Sri Lanka, you meet very well educated, very well spoken, very smart people. It is very easy to get to like them and establish a bond with them. It is a very well developed business environment.

Springer: Among frontier market specialists, **Myanmar** has been the hot country investors are interested in the potential of recently. There are some established players in the real estate market there, most notably Serge Pun ofYoma Strategic Holdings. Is Myanmar's real estate market priced right for the growth global real estate investors seek?

Stevens: Yoma is a good example of a company with first mover advantage. They also benefit from being in the right place at the right time. Many people don't know that they have successful developments that pre-date their Myanmar experience in both Bangkok and Hong Kong where Serge Pun was an early investor in property. He really cut his teeth in these countries. He learned how to do developments and then when Myanmar got started he was able to show people the type of professional quality projects that he could do. Also, if you can compete with the Thais and the Hong Kong Chinese in their own countries, it is a great vote of credibility that you can pioneer property development in your own country.

The view of the foreign investors and institutional community on property is a bit misleading. They tend to focus on stories of properties that are being sold at auctions for outrageous prices or they tend to get misled by looking at these megaprojects going up in cities. People are too focused on the massive projects and the boondoggle ego projects.

We find that there are a number of potentially good property partners in Myanmar that want to become over time the next big blue chip developers: construction companies that want to learn by tying up with a foreign group like us and foreign developers to have the capability to do bigger projects in the future. We also have hotels that aspire to become the equivalent of the Dusit Thanigroup in Thailand which in my 23 years in Thailand have gone from 3 properties to being an international, luxury brand. So with some of these groups in Myanmar you can get favorable deals for land. You bring in the capital and expertise, they will provide land at attractive leases.

It is really a tale of two cities, the big projects that are being sold by one-off landowners who are looking to make a quick buck, and then you have other deals that serve the long-term strategy of a other groups: initially they want to develop one property, build a brand, and ultimately have that be their primary business. So, there are good opportunities in Myanmar. But unfortunately some investors merely go to a local hotel lobby, hear a local mogul bragging that their property is worth $10,000 per square meter and the first thing they want to do is get on the first plane out of there.

A real challenge in Myanmar is that it’s expensive to build properties. Second, it is almost impossible to get local funding by the banks. You have to be very careful to scrutinize the returns. On the cost side, there aren’t a lot of large contracting groups that can build modern properties as they don’t have the proper assets and equipment. It is the only country in Asia with a booming property market and almost no cranes in the sky. Almost everything is still done by hand with little bricks. While there are some adequate building materials produced in country, most construction materials have to be imported. Many groups have to turn to Thai, Vietnamese and Chinese contractors to come in and build the buildings. The input of local professionals is often minimal and most property projects use a Thai or Vietnamese architect, a Thai or Vietnamese project manager, and an expatriate consultant or property manager. Thus, these are very expensive projects to do and an additional drag on returns is the lack of leverage in funding. We say when you invest in Myanmar you have to BYOB: bring your own bank.

Due to a dearth of supply, rental prices are good, selling prices for condos are favorable and room rates for hotels are through the roof. A good serviced apartment that a western or North Asian executive would live in are going for $4,000 to $5,000 per month. In Thailand, it would be half that rate. There's such a shortage that the existing service agencies don't even keep a waiting list, as there's no availability for three years.

There are only two professional office buildings. In those you pay $100 to $120 per square meter which is 3 to 4 times the rate of Bangkok or double the rate in Ho Chi Minh City.

Some projects are feasible despite their high development costs because the revenue generation is so very high. At this point, the main strategy is to build properties that foreign businessmen, investors and tourists will cater to. Clearly, the numbers for tourism and business arrivals are improving. But there are some groups that are developing housing and other properties for locals and over time that will be the dominant market. But, right now, the quick buck is to make serviced apartments, four-star hotels and office space that foreigners will snap up and lock into long-term leases.

Springer: With a stock market that went up 121% in 2010, investing in**Mongolia** was a hot commodity whose star has faded in recent years due to the government's ever changing regulations and declining natural resource prices. Is the country once nicknamed Minegolia for its vast natural resource potential at China's doorstep on Leopard Capital's radar?

Stevens: Mongolia is a place we hope to invest in at some point, but people have to understand it is somewhat different from most of the other frontier markets in which we're involved. Their overall system of government and economy is quite different being an ex-Soviet-bloc country compared to some of the more free-market and pro-business environments in ASEAN and the Mekong region. You have to understand what priorities are different, how their governing structure is different and the fact that sometimes they will focus on a more socialist agenda that is merged into a fairly vibrant capitalist system. Secondly, because of the resource focus their development cycle and industrial focus is a bit different and narrower than what we look at in several other countries.

We think Mongolia has a bright future because of the resources. One has to understand the resource cycle and the Mongolian way of doing business before you can productively engage there.

Springer: **Vietnam** has had a rough few years. Recent news suggests the country's capital markets and real estate market are ready to turnaround. Does Leopard foresee an uptick in Vietnam's property market on the horizon?
Stevens: For us, the disadvantage of Vietnam is that there are a lot of existing private equity groups and other institutional funds. There tends to be very keen competition for existing deals.

The private equity and institutional investor community has had very good successes in Vietnam over time. Some of the established private equity names there are now investing in Cambodia and even Myanmar.

Regarding the property market in Vietnam, in Ho Chi Minh City they are still digesting a glut of supply from the earlier boom. In our view, that glut hasn't fully worked its way out.

At the same time, there's a lot of new concepts and new types of development that are finally starting to move forward in Vietnam: proper shopping malls, modern mixed use units, modern office towers and things of this type. Vietnam is starting to have some projects that are very professional and built to regional standards.

Places like Hanoi and the other outlying cities have shown very steady growth. They have been getting a lot attention as they were not quite as overbuilt as Ho Chi Minh. Of course, the tourism numbers into Vietnam are progressing quite well. Some of the tourist destinations such as Danang and Hue are commensurately starting do well.

For Vietnam in general, there are a lot of institutions with a very positive view on the stock market and other types of investments. Mark Mobius of Templeton is very bullish on Vietnam, as is investment guru Marc Faber.

What really needs to be seen is if the worst of the banking sector weakness is over with and if the policies implemented by the government to address issues in the banking sector will work. If we see signs of that in 2014, I think that will be a green light for private equity and other types of investment to once again take off in Vietnam.

Springer: Among all the opportunities in Asia, Leopard Capital is currently raising funds to be the second private equity fund in **Bangladesh**(Brummer & Partners was first). The international news cycle out of Bangladesh is usually negative. With an anchor investment of $15 million by the International Finance Corporation, the investment arm of the World Bank for your impending Bangladesh fund, is Leopard Capital still positive that Bangladesh is a good place to position itself?

Stevens: What we like most about Bangladesh is that there are very strong companies there and potentially good partners for private equity investments. When you look at the Bangladesh corporates, many of them are regionally competitive. They could survive if they were in Singapore, India, Thailand or anywhere else, which is rare for frontier markets. You have very well run, very large corporations that are into their third or fourth generation of company ownership. Some have not operated as family businesses for quite some time. When we engage companies there, we are looking at growth opportunities that are very developed that are looking to get capital to expand and improve their businesses.

The property market in Bangladesh is a very difficult market and we're not looking at property opportunities there. Land is very expensive and it's very hard to acquire land within the capital of Dhaka. There's not a lot of space and a lot of property lots are small. A lot of the new hotels and developments there have to go into outlying areas. I think Bangladesh is very interesting for private equity but less so for property.

Another factor with Bangladesh is that the growth of local financial institutions, local banks who are investing, has become very sophisticated over the period that we have been looking there. It is a bit different from some of these other countries where the banks really aren't good and don't provide good support to their clients. You have some very good local players in Bangladesh. There are pools of money – whether its corporate or wealthy individuals – who are funding private equity deals on their own.

The political volatility is very high. We expect that to continue. In Bangladesh, timing your entry and timing your investments is very important.

In the way of sectors, there probably has been too much emphasis on garments and other types of low-end export production. A lot of groups we talk to are looking to expand their production of other services. Over time, it looks like Bangladesh is on a good track to broaden its manufacturing base and its export base which will be a very big positive for the country. There are a lot of positives in Bangladesh.

Springer: Across Asian emerging and frontier markets Leopard Capital is at the forefront of compelling growth stories. Are there common themes you find in the growth stories of these countries that you can see unfolding from the capital markets to the real estate market?
Stevens: The most notable improvement is that the capital markets and the companies are becoming increasingly sophisticated. For example, if you see the Laos Stock Exchange you say, "wow, this is really well done." Or, in Cambodia, where they have some of the best mobile phone systems in the world; they leapfrogged landlines and went directly to 3G and 4G digital communications. Likewise, in our countries you now find company owners who understand foreign investment and private equity a lot better that they did before.

Secondly, quality of management in these countries has become much better. In some of them, the entrepreneurs are now third or fourth generation. In places such as Vietnam, Cambodia and even Myanmar, you meet business people who are sophisticated, who have been educated overseas. These people give you a much better feeling that they will be better partners and that they will understand the needs of foreign institutions than say Thailand 23 years ago when I first arrived here.

Local institutions in all these countries and their banks, sometimes sovereign funds in these countries as well, now do private equity. The competition for good private equity deals is going up. The quality of the companies and the entrepreneurs and businesses is getting better. Some of the financial reporting is still a little suspect. The transparency and the corporate governance still needs to improve to catch up with regional levels.

Lastly, in many of the ASEAN countries, and even places like Bangladesh and elsewhere, we're seeing an increased involvement of regional players: investment banks, commercial banks and operating groups. Singapore, Malaysia, Thailand and Vietnam are often at the forefront of investment in these countries. It is no longer the case where China and Japan lead, and then all the ASEAN countries come piling in after them. Very often we find that the Singapore and Malay groups are the first on the ground in these countries.

The bigger projects and deals will usually be dominated by North Asians or sometimes the West. But I can say on the mid-cap companies and some of the more progressive businesses, it is ASEAN businesses driving the way. To this, ASEAN brings with them the funding, their bank relationships and their brands. When you go to Myanmar, you see a lot of Singapore brands that I've never seen in Thailand or Cambodia.

Regarding the ASEAN integration story and the cross-border investment story that is becoming a major thematic economic driver, we are currently launching a Mekong Fund to capitalize on this newly emerging trend. The fund will invest in Cambodia, Laos, Thailand, Vietnam and Myanmar. One of the reasons we're doing this is because we're finding a lot of our contacts in various countries are pursuing business across borders as companies move from being nationally successful to becoming more regionally minded. Those are the trends we are seeing today.

Mr. Stevens along with other real estate professionals from across Asia can be met at the Boomtown Investment Summit in Hong Kong on the 26th of March this year. For information on attending this event contact Beacon Events.