

Special Report:



Funds survey 2009



A game of two halves

Nicholas Watson in Prague

The past year for funds investing in Central and Eastern Europe has been, to borrow footballing terminology, a game of two halves.

Looking at the table of funds at the end of this article, the year from June 30 in 2008 to June 30 in 2009, *bne's* chosen ranking period, has been an almost uniformly miserable one, with the vast majority of funds finding themselves firmly in the minus column. However, while the whole year may have been a difficult one, the second half has been quite different to the first half.

That's hardly surprising – the full year encompasses the period immediately after Lehman Brothers went bust in September 2008 and markets around the world went into freefall, wiping out trillions of dollars of wealth and leading some to predict financial Armageddon. That, of course, didn't happen and the subsequent recovery – while still fragile, patchy and overshadowed by a forbidding sense that the markets are getting ahead of themselves – has lifted stock markets to levels that were hard to imagine just a few months ago when investors stared day after day at screens of red. "I think it has now become clear that those doomsday scenarios were clearly exaggerated and have not come true. It all looks brighter

than in October and November when markets priced in complete economic collapse or at least a 1930s-style depression," says Angelika Millendorfer, head of equities emerging markets at Raiffeisen Capital Management.

A glance at the numbers shows just how far and fast the recovery on some markets, particularly Russia, has happened: Pioneer Investment's Russia Stock fund was down 55% for the year, but up 78% year to date, and Swedbank's Central Asia Equity Fund was down 65% on the year, but up 50% year to date. Even funds centred on countries still regarded as particularly vulnerable have improved markedly: Dragon Capital's Ukraine Virgin Fund was down 44% on the year, but up 3% so far this year and East Capital's Baltic Fund is up 1% year to date after being down 50% over the year.

But the pace of that rebound has left some portfolio managers feeling uneasy. "On the equity side, it's been very quick and very fast, so our opinion is we might see a correction in equities. It's been too fast and not justified by fundamentals," reckons Peter Svoboda, former fund manager of Erste Sparinvest's Bond Danubia fund and now responsible for Erste's overall fund business in CEE.

Bond funds have also rebounded, though in a less dramatic way. Svoboda explains that the key driver for the recovery in bond funds – Erste's Bond Danubia fund is down 10.29% on the year but up 5.24% year to date – has been carry trades, as financing in dollar and euro has been very advantageous. "Spread wise, we are still at really high levels so portfolio gains have mainly come from carry trades," he says.

That should change as spreads narrow over the course of the year. It's becoming increasingly clear that the region will avoid a sovereign default and the Eurobond markets are open for emerging European issuers. Both Hungary and Lithuania have successfully got away Eurobonds recently, two of the region's most dodgy credits, and more issues are expected over the coming months from Turkey, Romania, Russia and Bulgaria, amongst others. "Overall, I'm positive on the sovereign bond side – Hungarian and Polish, and I'm not even reluctant to buy Baltic ones, it's a great opportunity to be present in the sovereign bonds of the Baltics," says Svoboda, explaining that the comparison between Latvia and Argentina is a spurious one, given that the former is in the EU – "a shield of prosperity" – and the latter has had a history of defaults.

Downsized

Another thing that jumps out from this year's fund list is how much less assets the funds have under management now, the victims of waves of redemptions, forced or otherwise. Some funds have even closed. Swedbank's Russian Equity Fund, for example, had only €27.5m under management as of the end of June compared with €112.4m a year earlier. "It was not a good time to be in Russia, it was hit particularly hard. A lot of margin calls went out to strategic and other investors who had bought a lot on margin – this was really forced selling at incredibly low prices," says Millendorfer.

Even so, portfolio managers report that redemptions from March and April have certainly slowed and even reversed in some cases as the huge rally on Asian markets plays itself out and concerns grow that the torrent of money flowing into that region is fuelling asset-price bubbles; most Asian countries have seen gains of around 50% or more in their stock markets since the start of the year. According to the latest data from EPFR Global, which tracks country and sector asset allocation data for a broad range of global and emerging market equity and fixed-income funds, emerging markets have seen inflows of \$32bn this year, outpacing developed markets.

Going into July, bigger was better for many emerging markets fund managers as money began to concentrate on the BRIC (Brazil, Russia, India and China) markets: net purchases of Russian, Indian and Chinese equity by EPFR Global-tracked equity funds hit 18-, 15- and 13-month highs, respectively. These four markets currently account for 44.95% of the average Global Emerging Market Equity Funds portfolio. On the bond side, EPFR reports that emerging market bond funds lifted their Indonesian, South African and Polish allocations to new record highs during June, largely at the expense of Latin America.

Even so, for most of the region the money flowing in is still in relatively small amounts and the buying selective. "After solid outflows for a few quarters, by the end of the first quarter that process slowed and even stopped. Then

in the second some bargain-hunting investors again started to put money in the market and in the mutual funds. Currently, we are seeing slow process of return of the investors and modest inflows, which might be accelerated by the current [Bulgarian] stock market rally that took place in the end of July and the first weeks of August," says Ivailo Penev, a portfolio manager for ELANA Fund Management in Sofia.

Svoboda declares that the redemption wave we saw in the months through to March and April is over. "I would say that by April, redemptions had slowed quite significantly. We saw some redemptions through March and into April, but money is slowly popping in again, especially crossover money – not necessarily new money from the region, but mainly crossover money from institutions."

Further indications that things have turned is the performance this year of the Vienna Stock Exchange, which Andras Szalkai, a portfolio manager for East Capital, describes as a proxy for many international investors who are interested in the region. Toward the end of August, the leading ATX Index was up almost 40% since the start of the year.

Retrospective

Svoboda probably speaks for most fund managers when he says, "I have been in the job for 10 years and this has been my worst year."

Most are predicting a better year to come, especially now that Germany (and France) have reported that their

"We saw some redemptions through March and into April, but money is slowly popping in again, especially crossover money"

economies already emerged from year-long recessions in the second quarter. "A lot depends on Germany, it's the most important player here. If export industries rebound because of a recovery in Germany, then we will come out of the crisis sooner," says East Capital's

Szalkai. Even so, no one is seriously expecting a return to the pre-crisis heady economic growth of 6%-plus anytime soon as the region copes with swollen budget deficits, squishy corporate profits, rising unemployment and weak consumer spending.

In terms of where funds are putting money, the first half of the year has definitely been all about banks, surprising on the one hand because it was this sector that the genesis of all the problems, but perhaps not so surprising since it also fell first and hardest. In the second quarter, Deutsche Bank said its universe of banks in Czech Republic, Poland and Hungary delivered 11% quarter-on-quarter aggregate net profit growth in the second quarter, beating its forecast by 23%. "The expectation-beating financial performance was mostly driven by low provisioning – so far only FX options and consumer lending witnessed a significant increase in risk costs, with both corporate lending and mortgages not showing any material deterioration," the bank said.

Another place where banks have been particularly strong is Turkey, which not coincidentally was the focus of the winner of the *bne* 2009 best equity fund, given that three of the top holdings in East Capital's Turkey fund are banks: Garanti Bankasi, Vakifbank and Halkbank. Turkey, a firm favourite of emerging markets guru Mark Mobius of Franklin Templeton for many years, has finally rewarded its long-suffering supporters with a relatively firm performance during this crisis. "It's been prone

to crises in the past and surprisingly weathered the storm much better than others, because the leverage in the system was that much lower. Banks were not leveraged so much because interest rates were so high, and this served it well in the current crisis," says Millendorfer. ●

CEE and CIS funds

Fund manager	Name of fund	Type of fund	Geographic allocation	Size	Return 1 year (to June 30)	Return YTD (June 30)	Return since Inception	Total expense ratio
Compass Asset Management	Kazakh Compass Fund	Equity	CIS	\$50.74m	n.p.	3.20%	minus 36.6%	0.70%
Compass Asset Management	Tau Capital	Equity	CIS	\$136.4m	n.p.	4.30%	minus 42.8%	0.20%
Dragon Capital	Orange Opportunity Fund	Equity	Ukraine	n.p.	minus 79.48%	minus 6.41%	minus 49.21% since 2005	n.p.
Dragon Capital	Ukraine Virgin Fund	Equity	Ukraine	n.p.	minus 44.36%	3.13%	minus 29.11% since 2007	n.p.
Dragon Capital	Eastern European Recovery Fund	Equity	Ukraine	n.p.	n.a.	20.77%	20.77% since June 2009	n.p.
DWS Investment	DWS Osteurope	Equity	CEE	EUR203.4m	minus 49.6%	n.p.	233.60%	1.76%
DWS Investment	DWS Russia	Equity	Russia	EUR323.3m	minus 73.8%	n.p.	16.70%	2.06%
DWS Investment	DWS Turkey	Equity	Turkey	EUR47.3m	minus 13.4%	n.p.	14.90%	1.76%
DWS Investment	DWS Europe Convergence Equities	Equity	CEE	EUR29m	minus 56.2%	n.p.	minus 24.9%	1.76%
East Capital	East Capital Eastern European Fund	Equity	CIS, CEE	EUR385m	minus 40.4%	38.70%	174.8% since 2002	2.50%
East Capital	East Capital Russian Fund	Equity	Russia and CIS	EUR715m	minus 48.5%	53.60%	733.1% since 1998	2.50%
East Capital	East Capital Balkan Fund	Equity	Southeastern Europe	EUR115m	minus 39.7%	17.30%	33.3% since 2004	2.50%
East Capital	East Capital Baltic Fund	Equity	Baltics	EUR37m	minus 49.6%	1.07%	240.1% since 1998	2.50%
East Capital	East Capital Turkey Fund	Equity	Turkey	EUR116.5	9.9%	41.28%	minus 33.2% since 2006	2.50%
ELANA Fund Management	ELANA Eurofund	Bond	Bulgaria	EUR0.21m	0.6%	minus 0.06%	6.01%	5.74%
ELANA Fund Management	ELANA Money Market Fund	Money market	Bulgaria and Greece	EUR8m	7.4%	3.56%	7.50%	0.81%
ELANA Fund Management	ELANA Balanced EUR Fund	Balanced	Bulgaria; Greece; Russia; Kazakhstan	EUR 4.9 m	minus 40.7%	minus 5.35%	minus 1.0%	1.90%
ELANA Fund Management	ELANA Balanced USD Fund	Balanced	Bulgaria; Greece; Russia; Kazakhstan	\$9.2m	minus 33.6%	minus 5.00%	1.56%	1.77%
ELANA Fund Management	ELANA High Yield Fund	Equity	Bulgaria; Greece; Russia; Romania; Kazakhstan	EUR 2.4 m	minus 53.2%	minus 8.89%	minus 3.1%	2.53%
Erste Sparinvest	ESPA Cash Forint	Bond	Hungary	EUR8.4m	minus 9.2%	0.54%	14.12% since 22/11/04	0.98%
Erste Sparinvest	ESPA Stock New-Europe Active	Equity	Central Europe	EUR3.98m	minus 49.87%	4.22%	minus 42.41% since 2006	2.35%
Erste Sparinvest	ESPA Bond Danubia	Bond	CEE	EUR473.21m	minus 10.29%	5.24%	94.4% since 1/07/1997	0.78%

Fund manager	Name of fund	Type of fund	Geographic allocation
Erste Sparinvest	ESPA Stock Russia	Equity	Russia and CIS
Erste Sparinvest	ESPA Stock Europe-Emerging	Equity	CEE
Franklin Templeton Investments	Templeton Eastern Europe Fund	Equity	CEE/CIS
GILD Property Asset Management	EEREIF	Real Estate	CEE
HEXAM Capital	HEXAM Emerging Europe Fund	Equity	CEE/CIS
ING Investment Management	ING (L) Emerging Europe	Equity	CEE
ING Investment Management	ING Russia Fund	Equity	Russia
ING Investment Management	ING Czech Equity	Equity	CEE
JPMorgan Asset Management	JPMF Eastern Europe Equity A - EUR	Equity	CEE
Limestone	Eastern Europe Real Estate Equities	Real Estate Equity	CEE
Parex Asset Management	Parex Ukrainian Equity Fund	Equity	Ukraine
Parex Asset Management	Parex Eastern European Balanced fund	Balanced	CIS and Latvia
Parex Asset Management	Parex Russian Equity fund	Equity	Russia
Parex Asset Management	Parex Eastern European Bond fund	Bond	Russia, CIS and Baltics
Parex Asset Management	Parex Baltic Real Estate Fund II	Real Estate	Baltics
Pharos Financial Group	Pharos Russia Fund	Equity	Russia and CIS
Pharos Financial Group	Pharos Gas Investment Fund	Equity	Russia and CIS
Pharos Financial Group	Pharos Small Cap Fund	Equity	Russia and CIS
Pioneer Investments	Emerging Europe and Mediterranean Equity	Equity	CEE
Pioneer Investments	Russia Stock	Equity	Russia
Pioneer Investments	Eastern Europe Stock	Equity	CEE
Pioneer Investments	South Eastern Europe Stock	Equity	Southeast Europe
Pioneer Investments	Central and Eastern Europe Bond	Bond	CEE
Prosperity Capital Management	Russian Prosperity Fund	Equity	Russia and CIS
Prosperity Capital Management	Prosperity Quest Fund	Equity	Russia and CIS
Prosperity Capital Management	Prosperity Cub Fund	Equity	Russia and CIS
Prosperity Capital Management	Russian Prosperity Fund 'Euro A'	Equity	Russia and CIS
Raiffeisen Capital Management	Raiffeisen Russia Equities	Equity	Russia and CIS

Size	Return 1 year (to June 30)	Return YTD (June 30)	Return since Inception	Total expense ratio
EUR13.99m	minus 53.70%	63.48%	minus 53.00% since 1/08/2007	2.15%
EUR99.6m	minus 59.64%	21.80%	33.54% since 1990	1.95%
EUR499.5m	minus 26.90%	n.p.	209.00% (10 years)	n.p.
EUR47.3m	n.p.	minus 22.17%	n.p.	n.p.
EUR13.7m	minus 45.7%	61.90%	minus 37.40%	1.43%
EUR100.79m	minus 53.6%	27.12%	20.75% (5 years)	n.p.
\$277.6m	minus 56.26%	56.27%	n.p.	2.07%
EUR7.3m	minus 28.82%	8.89%	n.p.	n.p.
EUR582.1 m	minus 41.67	66.08%	129.77%	0.45%
EUR2.16m	1.2%	1.40%	fund opened June 2009	n.p.
EUR 0.475m	minus 82.75%	minus 4.85%	minus 67.52%	n.p.
EUR13.4m	minus 17.03%	34.03%	2.47%	n.p.
\$7.1m	minus 52.48%	72.40%	7.87%	2.00%
\$19.8m	minus 12.33%	41.86%	3.43%	1.50%
EUR18.1m	minus 47.04%	minus 43.89%	minus 12.34%	n.p.
n.p.	minus 9.6%	24.70%	n.p.	n.p.
n.p.	minus 31.4%	1.00%	n.p.	n.p.
n.p.	minus 30.8%	30.90%	n.p.	n.p.
EUR359.1m	minus 45.6%	34.40%	85.26%	2.06%
EUR35.2m	minus 54.6%	77.90%	101.67%	2.22%
EUR53.8m	minus 51.70%	36.00%	104.84%	2.23%
EUR7.3m	minus 24.8%	25.70%	minus 24.3%	2.22%
EUR88.4m	minus 5.80%	2.20%	82.99%	1.12%
n.p.	minus 54.7%	77.80%	882.40%	n.p.
n.p.	minus 61.1%	39.00%	1989.10%	n.p.
n.p.	minus 47.2%	79.50%	1663.30%	n.p.
n.p.	minus 51.5%	64.40%	295.50%	n.p.
EUR11.65m	minus 59.39%	74.12%	minus 52.61%	2.49%

Fund manager	Name of fund	Type of fund	Geographic allocation
Raiffeisen Capital Management	Raiffeisen Eastern European Bonds	Bond	CEE
Raiffeisen Capital Management	Raiffeisen Eastern European Equities	Equity	CEE
Renaissance Investment Management	UIF Renaissance Shares	Equity	Russia
Renaissance Investment Management	UIF Perspective	Equity	Russia
Renaissance Investment Management	UIF Balanced	Balanced	Russia
Renaissance Investment Management	UIF Bonds	Bonds	Russia
Renaissance Investment Management	Renaissance-Nedvizhimost	Real Estate	Russia
Swedbank Investeerimisfondid	Swedbank Central Asia Equity Fund	Equity	CIS
Swedbank Investeerimisfondid	Swedbank Eastern Europe Bond Fund	Bond	CEE
Swedbank Investeerimisfondid	Swedbank Eastern Europe Equity Fund	Equity	CEE
Swedbank Investeerimisfondid	Swedbank Eastern Europe Real Estate Equity Fund	Real Estate equity	CEE
Swedbank Investeerimisfondid	Swedbank Russian Equity Fund	Equity	Russia and CIS

n.p. = not provided

And the winners are...



bne's second annual survey of funds investing in our region spanned what one portfolio manager described as "the worst year in my life." However, there are obviously many investors who are still firm believers in the emerging market story, as money has begun flowing back into funds investing in the region and the stock and bond markets are once again rising.

Our survey lists many of the funds with a significant proportion of their assets invested in Central, Eastern and Southeast Europe, as well as the Caucasus and Central Asia. We asked fund managers working with the region to submit their funds and mixed all different types of funds together on the basis of which are making the biggest returns. We chose the winners based on the simple criterion of best performance in the year from June 30, 2008 to June 30, 2009.

East Capital's **East Capital Turkish Fund** is the clear winner in the equity category of our survey this year, managing to make its investors not only a positive return in the second half of the year – many funds achieved that – but also one of the very, very few that posted a positive return for the whole year with a hefty 9.9%. "The Turkish market proved to be very resilient for a number of reasons," says East Capital partner Jacob Grapengiesser, who, together with analysts Emre Akcakmak and Adrian Pop, runs the fund. Turkish companies and especially the banks were better prepared than most, and hence were able to react quickly to new circumstances. The banking sector is well capitalized and could tackle the downturn in the economy without recapitalisations, and massive interest rate cuts also benefited the banks. Many other businesses have strong families as the main owners – this proved to be a successful recipe, as most of them had experienced a deep crisis previously and had a conservative approach to leverage.

Size	Return 1 year (to June 30)	Return YTD (June 30)	Return since Inception	Total expense ratio
EUR72.16m	minus 9.38%	minus 2.61%	6.80%	1.10%
EUR373.91m	minus 47.01%	37.17%	7.36%	2.15%
\$17.7m	minus 32.8%	81.60%	18.41%	n.p.
\$5.7m	minus 47.6%	80.70%	15.20%	n.p.
\$11.0m	minus 23.3%	45.30%	23.40%	n.p.
\$19.1m	minus 4.1%	16.50%	34.80%	n.p.
\$55.7m	minus 13.3%	minus 10.20%	24.4%	n.p.
EUR7.8m	minus 64.6%	50.30%	minus 68.7%	n.p.
EUR12.6m	minus 13.35%	minus 2.49%	minus 6.65%	n.p.
EUR22.3m	minus 63.3%	11.20%	minus 34.6%	n.p.
EUR10.4m	minus 70.2%	32.90%	minus 69.5%	n.p.
EUR27.5m	minus 63.1%	53.80%	minus 21.4%	n.p.



The Sofia-based ELANA Fund Management's **ELANA Money Market Fund** wrapped up 2008 as the fund with the highest return on the Bulgarian market and now takes *bne's* award for the best money market/fund income fund with a return of 7.4%. "The fund's performance is a combination of a couple of factors that played out as good as we expected them to," says Ivailo Penev, portfolio manager of ELANA Fund Management. "First of all, the fund started near the peak of our local stock market at the end of 2007 and as the market started falling, it attracted many investors in relatively short time. The high [net asset value] allowed us to negotiate better rates on deposit deals, and also the high demand for financing through the money market lead to high repo rates, which also boosted the performance."



After years of boom in the region's real estate markets, this year was a bust, and it was all real estate funds could do to limit the losses. The fund that held up best during this tricky year has been Renaissance Investment Management's **Renaissance-Nedvizhimost Fund**. "The Renaissance-Nedvizhimost is up 24.4% since its launch at the end of 2006, and we are proud to have outpaced the competition over the most difficult period on the Russian real estate market in the last decade. Our commitment to delivering consistently excellent results throughout the cycle has now been recognized," says Ekaterina Konstantinova, managing director and head of Real Estate Group, Renaissance Investment Management. "To take advantage of the current downturn across the sector, in the next few months we will launch a new fund that will acquire trophy real estate assets at extremely attractive prices."

Vadim Grib sets up Ukraine's first distressed fund

Graham Stack
in Kyiv

Vadim Grib's TEKT investment group, with 14 years on the market one of Ukraine's oldest, is marking the seismic downgrade of Ukraine's economic reality by putting its asset management funds up for sale in August and switching its focus to a private equity fund for distressed assets, Ukraine's first distressed asset fund.

While TEKT is not the first company to quit the moribund Ukrainian stock market, it's the first to go the whole hog and open a private equity fund for distressed assets. "I've always been more interested in investing in specific projects rather than finance, and I focus on a company's profitability instead of capitalization," says Grib, chairman and owner of TEKT.

Grib is one of Ukraine's most colourful, even controversial, investment figures, who once caused outrage by admitting on national TV to having offered half a million dollars to a regional official to help buy a stake in a company. Speaking 11 years to the day from the Russian economic collapse of 1998, he recalls that, "the 1998 crash confirmed my approach – in 1994 I lost a lot of money in banks, and in 1998 I lost nothing, and made use of the chance to make some very profitable acquisitions. And this is what I intend to do now."

Distressed and depressed

According to Grib, TEKT Private Equity Fund I is looking to take controlling stakes in distressed companies that are either crisis-proof or likely to respond quickest to the start of an economic

recovery. "Our approach is very simple: we are mainly interested in companies with stable operating revenues, but crippled by a heavy debt burden," he says. The surging amount of non-performing loans in Ukraine "opens significant opportunities for distressed assets funds. We can offer companies capital instead of debts."

Grib is planning a small, but highly profitable, closed-end distressed assets fund. For each of the around 10 holdings, Grib specifies a minimal annualized return of 45% and a target of 100%. Grib says he generally exits projects within 18 months after a 150% annual return. TEKT will only buy controlling stakes in companies, with each deal in the region of €1.5m-8m. The fund's target volume is UAH500m (€43m).

Grib's distressed asset fund differs in crucial aspects from worldwide equivalents. In Ukraine, there is no legal framework for a key worldwide investment technique – buying companies' debts off banks at a discount. On the other hand, loopholes in Ukraine's legislation let TEKT pay out on exited projects immediately, without waiting for the fund to close after its four-year term expires. This fits with Grib's project-focused approach. He says he prefers to talk with potential investors about projects rather than about the fund's overall strategy and profit algorithm. "You just end up talking hot air about abstract concepts and philosophy when the crucial thing is implementation," says Grib, who is not known for mincing his words. "In general, inves-



Vadim Grib

tors here know me and my reputation of at least 50% annualized returns."

He also admits he is not particularly interested in foreign investors who will require detailed explication of the fund's technology. "There are plenty of resources in Ukraine for investment, so foreign investors are not a priority at the moment." Grib says it took him only one week to raise the fund's UAH500m and that with only talking to 20% of the people on his list. "25% of the money is mine, and the rest belongs to private individual investors," he says.

Grib lists companies that are niche monopolists as primary acquisition targets. "No land or real estate," he says. "Also no agriculture – there is simply not the institutional framework."

In contrast to most private equity funds, Grib's fund will settle for nothing less than a controlling stake in any of the companies. "This has simply always been my philosophy never to trust anyone. Ukraine suffers from bad corporate governance, and without a controlling stake you will find your investment may be worthless."

Ukraine's media have often accused Grib of "raiding," and indeed some list him as Ukraine's number-one raider. Grib is having none of it. "One man's investor is another man's raider. I simply buy first, and then insist on my rights. Obviously in the case of a hostile takeover, it is easy for the losing side to cry 'raider', but I have never used blackmail or illicit methods." ●

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Best regards,





Poland a lynchpin of emerging European funds

Jan Cienski
in Warsaw

The Warsaw Stock Exchange was one of the world's worst performers this winter when the global economic crisis was laying waste to emerging markets worldwide and hitting Central and Eastern Europe particularly hard. But that didn't stop Lindsay Cooper and Damian Bird, representatives of Singapore-based Arisaig Partners, from travelling to Warsaw a few months ago to check out the investment prospects for Poland.

"We are a small fund essentially focused on consumer goods companies, but we think there is an awful lot of growth potential in markets like these," says Cooper. "You can't call yourself an emerging markets fund without Central and Eastern Europe, and Poland is the lynchpin of that."

They are not alone. After its depth-plumbing lows six months ago, the Warsaw Stock Exchange's blue-chip WIG20

index has jumped almost 60%, and those kinds of returns are making both domestic and foreign funds sit up and take notice. As risk aversion fades, funds are becoming more concerned about making profits again and not simply

"You can't call yourself an emerging markets fund without Central and Eastern Europe"

preventing losses. "We're seeing foreign investors start to come back," says Annie Krasinska, an analyst with Wood & Company, a Prague-based brokerage with a large presence in Warsaw. "In the early stages of the recovery in March and April, investors were mostly moving into blue chips because they had cash burning a hole in their pockets, but they were

most concerned about being in fairly liquid investments. Now, as the recovery continues, we're seeing them beginning to move into mid-caps as well."

Morgan Stanley, the US investment bank, recently upgraded its assessment of the WSE, noting that the bourse had good prospects because it had rebounded less than other developing markets, and added that the overall condition of the Polish economy – which looks to be one of the only EU countries to avoid a recession this year – made Polish stocks a decent investment.

Pension pillars

The Warsaw Stock Exchange has cemented its position as a regional leader during the crisis, overtaking its rival in Vienna in terms of trading volumes and market capitalisation – with trading in the first seven months of the year coming in at about €2bn more than in Vienna. "We have been the first in the region to come out of the crisis," Ludwik Sobolewski, the head of the WSE, told the *Rzeczpospolita* newspaper in a recent interview. "From February and March of this year, we have been the fastest exchange in the region to make up the previous falls, which took place in 2008. No more bad things will happen to us, under the condition that there is no unexpected black news from the world economy."

The backbone of the Warsaw exchange are domestic pension funds, which can only invest 5% of their assets outside

of the country – something for which Poland is being investigated by the European Commission. The funds, which are part of the reformed pension system, can invest a maximum of 40% of their assets in stocks. During the depths of the crisis, they had limited their stock holdings to only about 22% of their portfolios, but as the market

has revived they are jumping back in, hoping to make up for last year's lacklustre results – where they lost PLN1.4bn (€340m). The funds have a guaranteed source of income from Polish workers – raking in PLN20.5bn last year – for a combined total of PLN139bn in assets.

The crisis also prompted many clients to bail out of investment funds. From the end of the bull market in October 2007, funds saw clients pull out more than PLN31bn as they sought to protect themselves from the downturn. The recovery has been halting – with the three months to July seeing an inflow of funds – although the scale of the revival is still small, with a total of PLN1.3bn in inflows over those three months.

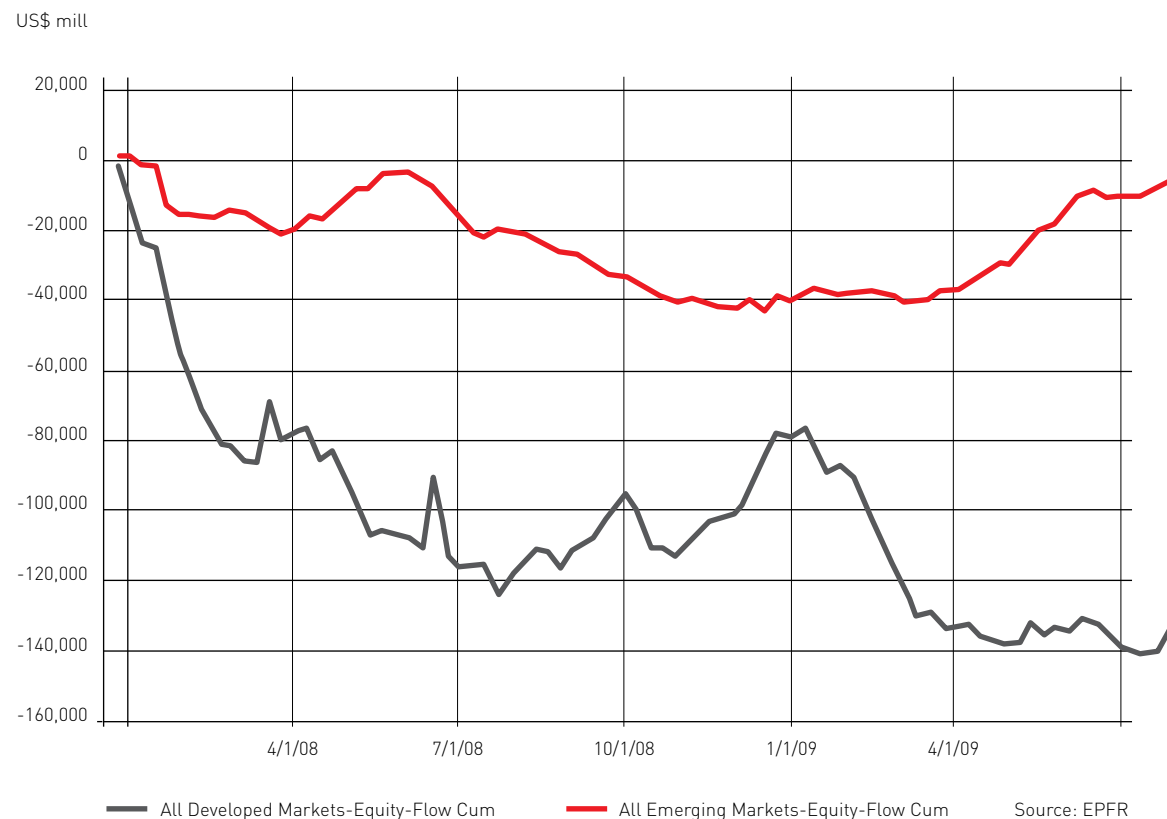
Private equity funds are also showing some signs of recovery. In 2008, private equity and venture capital funds invested €628m, only 8% less than in record-breaking 2007, but it proved to

be a lot more difficult to attract new investors. The funds acquired €2.5bn in funds for new investments in 2008, about 40% less than had flowed in a year earlier.

However, the private equity market is beginning to revive, according to new study by Deloitte, the accounting and advisory firm. In a survey of funds active in the region, Deloitte found that only 19% of private equity fund managers expected a continued falling market (compared to 80% six months ago), with 65% expecting the next half year to be relatively stable. Almost half the respondents said they were looking for new deals.

Although funds have amassed more than €4bn to spend in Central Europe, they invested only about €100m in the last half year, says Oliver Murphy of Deloitte, adding that the increase in optimism shows the market is at or near bottom, and that the expected recovery is near. ●

Cumulative weekly equity inflows. EM vs Developed Funds. 2008-YTD09



Foreign investors remain sceptical about Kazakhstan

Clare Nuttall
in Almaty

Kazakhstan-focused funds suffered big losses over the past year. But even with stock prices now rebounding, it's proving difficult to attract international investors, who remain sceptical about the country's prospects.

The autumn of 2008 saw the Kazakhstan Stock Exchange's index, the KASE Index, fall to under a quarter of its value at the start of the year. Internationally listed companies, mainly in the banking and commodities sectors, also saw their values plummet.

During this period, Kazakhstan-focused funds with flexibility in their asset allocation were best placed to weather the crisis. Atul Patel, CEO of Compass Asset Management, says the firm's funds – Kazakh Compass Fund and Tau Capital – didn't lose as much value as the KASE or Russian stock market indices, because about 25% of their portfolio was short various stocks, with further holdings in cash and private equity. "In the first part of 2009, we maintained a defensive position because we did not believe in the rally when it happened. A significant percentage of our portfolio was flat – for example, we had around 30% invested in private equity, which does not move at all," Patel says. "We were suspicious of the recent rally, and we see a lot more value in special situations and private equity than in public equities. Our strategy will be to look for attractive private equity investments. We plan to do one or two before the end of this year."

By contrast, Seven Rivers Capital, which manages the Hanwha Kazakhstan Fund,

a South Korea-based retail investment fund investing in Kazakhstan, Central Asia and Russia, saw a much sharper fall in the value of the fund because it had less flexibility. "We started investing in summer 2007. Since then, our losses have been quite big, because we did not have the right to sell our stocks and hold the funds in cash, which many other funds did at this time. All we could do was decrease the stock portion of the fund to 70%," says Seven Rivers Capital's deputy chairman, Sergey Plissak.

Commodity connected

The rally on global markets so far this year, including Kazakhstan's, has allowed funds to improve their positions. As of August 19, the KASE Index had risen 41.8% since the beginning of the year, and was up 20.5% in the month to mid-August. By June, Compass had seen a 3.2% rise in its Kazakh Compass Fund and a 4.3% increase in the Tau Capital fund since the start of the year. Plissak forecasts that the Hanwha Kazakhstan Fund will perform better in the second half of 2009 than the first half.

However, Compass' Patel points out that the recovery of the KASE is not a good indicator of the strength of the Kazakhstan economy, because it's driven by natural resource companies

KazMunaiGas E&P and Eurasia Natural Resources Corporation, and reflects commodity prices rather than conditions on the domestic market. "The decline is bottoming out, but economic improvements are not as great as the market is anticipating. The markets may pull back from where they are now. The increase, especially in large liquid stocks, is not justified under current conditions," he says.

While long-term macroeconomic forecasts for the country remain positive, fund managers say that interest from foreign investors in the country remains low. "It is still hard to drum up interest in Kazakhstan," sighs Patel. "The first wave of the recovery in emerging markets involved the areas investors felt very comfortable with, such as China, India, Brazil and Vietnam - all of which are much more developed than Kazakhstan. They are still concerned about the banking sector, as are we. However, the longer oil stays at \$60-70 per barrel, the more confidence will return."

Many of Seven Rivers Capital's investors decided to withdraw their money due to the crisis, and in particular in the run-up to the February devaluation of the tenge, which has considerably decreased the firm's assets under management. Plissak agrees that interest in Kazakhstan-focused funds has not yet returned to pre-crisis levels, but he's positive about future prospects. "I believe that at least this year, and probably next year as well, private individuals will not be interested in investing in investment funds," he says. "However, I do believe that we will be able to attract money back from the international investors who invested in our funds before the crisis. We are looking in particular at South Korea where we have good partners, but other countries too." ●

"The decline is bottoming out, but economic improvements are not as great as the market is anticipating"

Private equity in CEE down but certainly not out

Matthew Day
in Warsaw

Gather a crowd of private equity people together in Central and Eastern Europe (CEE) and smiles are thin on the ground. The champagne confidence that once dominated a sector enjoying heady growth has gone, replaced by the sobering realisation that it faces a hard slog with casualties along the way.

At a July conference on the state of the CEE private equity market held in Warsaw one expert started his presentation with a slide of a gravestone bearing the stark motif, "R.I.P. the Good Times"; hardly surprising, given that worldwide, according to research by the mergers and acquisition department of the monitoring company ISI DealWatch, buyout and venture capital activity in emerging markets fell by over 40% in the first half of 2009 to 276 deals, while deal values slumped by 60% to €7.47bn.

In the first half of 2009, CEE deal volumes and their value fell by around 50% in comparison to the same period last year. Poland, one of the region's biggest markets, saw a "dramatic drop in the number of deals done," Dealwatch's Jakub Siekierzynski said in a presentation at the conference.

Marcin Hejka, senior director for strategic investments in CEE at Intel Capital, points out that the factors that once drove growth in the region have disappeared. "The good times came courtesy of massive amounts of cheap debt, rising profitability across all industries, escalating asset prices and allocation of

funds from all players," he says. "Now all these factors are going in the opposite direction."

With the private equity market in the doldrums, Hejka believes that, "we're about to face a major shake-up, many funds will go out of business."

Debt disappears

In particular, the problem of raising money has become acute. "It's pretty ugly out there," says Robin Hubbard, director of CB Richard Ellis. "You don't want to be raising money. Twelve to 24 months is a very realistic timetable to raise funds. You need an 'X-factor' to get money, as the criteria is so high amongst investors."

All this comes, he explains, as a remarkable turnaround from a couple of years ago, when "investors lowered their standards and couldn't say 'no'," and raising capital took as little as a month. Experts point out that investors have taken to sitting on their cash and still have little incentive to part with it.

To make matters more complicated for private equity funds trying to raise capital for the region is that the neatly holistic concept of CEE as a region may no longer exist. The global recession has affected economies across the region to such varying degrees that it has become almost impossible to address the region as a whole. With Latvia's economy seen crashing about 16% this year, but Poland still expected to post marginal growth, CEE private equity companies have had to adopt an every-country-

for-itself approach as they adjust to the new economic realities. This has raised the need for funds to have boots on the ground in various countries in order to understand just where the pitfalls, and opportunities, lie.

Chuck into this the difficulty that experts now have when it comes to mapping out the economic future, and the continued currency fluctuations, the situation leaves little to smile about for the industry.

Pick and choose

Despite all this, there could be some light at the end of the tunnel. Figures from ISI DealWatch show that Russia and Poland remained attractive destinations for buyout and venture capital developments in the first half of 2009, occupying third and fourth place on the global list with 30 and 20 deals done respectively. Experts point to predictions showing higher GDP growth potential in emerging markets than in the established G7 economies, which should attract the attention of investors. And attention is a good thing, as it appears money is still out there. At a spring conference on CEE private equity, Michael Tojner of Global Equity Partners Beteiligungs-Management claimed that some \$3bn to \$4bn in "dry powder" – money committed but not yet accessed – was ready for investment opportunities in CEE.

Others in the sector are keen to stress that private equity has the advantage in being elastic and flexible, and so should adapt to the new economic landscape quicker than other industries. The days of large leveraged buyouts in CEE, for example, may have become a thing of the past as funds, governed by a greater sense of caution, invest in smaller firms carrying no more debt than they can pay off. But with a conservative approach, and operating in a market that is not only expected to rebound well but also remain under-penetrated by the private equity sector, Hejka struck an optimistic note at the Warsaw conference. "The long-term future is good," he said at the end of a presentation. "The market will be smaller, but the survivors should do well." ●