

TRUSTING

The Independent Financial Advisor

Direct investment An Attractive Strategy for Returns

In the increasingly diversified investment landscape, how can one approach emerging markets beyond the classic forms offered by the official markets?

Is the solution in direct investment, and if so, how?

I am writing this article while in Istanbul where PRI has been active since 1999. Turkey is just one of several examples of developing economies that attract relatively little foreign direct investment, compared to the opportunities that it offers. It has a population of almost 70 million and world-class companies in dynamic Export, Construction and Tourism sectors. It has not yet reached FDI of \$2bn per year. It has opportunities that can absorb multiples of that. However, very few of its companies have experience dealing with foreign investors and lenders. And most foreign investors have no idea, or the wrong idea of the opportunities the country offers and its culture. As usual, a bridge is needed.

NEWS OF THE DAY

Since the fall of the Soviet Union, and even a few years earlier, volatility and crises have become a global phenomenon. We are linked to each other's problems by satellite TV and waves of money going in and out of markets as a reaction to the news of the day. The largest crises have hit the largest and most "stable" economies. Almost \$1trillion in equity disappeared from the US during the years of the Savings and Loan crisis which followed the Tax Law change of 1986. While the more recent dot-com, Enron and other corporate revelations crises were of much smaller proportions, they were clear reminders that "political stability" does not guarantee transparency and safe investment.

Within the next few years we are likely to experience another major crisis in the US, which will impact on many other economies. The unprecedented debt and trade deficit situations are worrisome, at a minimum. The problem of the virtual disappearance of the

mid-sized industrial sector by 2006 is very real and will not be solved by the next President.

In the 90s and early 00s, we lived through economic earthquakes in Mexico, South East Asia, Japan, Russia and Central Europe, Turkey and Argentina. We will continue to experience major peaks and valleys. We are creating them by pushing and pulling vast sums of capital, in and out of Markets.

"Political stability" does not guarantee transparency and safe investment

On the front page of the October 14 issue of the Financial Times the main headline read: "Emerging market borrowing boom. Bond issuance of 270bn Euros breaks last year's record with two months to run. Institutions seek refuge from poor returns elsewhere. Warning of risk in oil price. The amounts are not really impressive, when we look at the actual size of the "Emerging Markets" and their needs, but the statistic points to the making of yet another wave driven greatly by the eagerness to achieve better returns.

TO ELIMINATE SOME OF THE MYTHS

The time is right to eliminate some of the myths and to prepare Investors and their representatives to diversify and get involved in direct investment opportunities in Emerging Economies. There are many small and medium size (often large, by local standards) quality companies and projects in countries outside of North America and Western Europe.

They present as good, if not better, opportunities for investors than the stock markets where they have been playing.

Direct Investment in Emerging Markets offers IFAs and Private Bankers diversification from the usual target markets and instruments. From time to time clients are interested in becoming involved in a certain country that seems interesting and promising. The challenge is to be ready with the right relationships, on the ground to be able to participate in the opportunities.

The question is how to choose where to go and how to get involved in a productive and profitable way.

How do you take your clients there? What are some of the obstacles that need to be overcome?

You will choose the country or region depending on the profile of your clients and the distance that your resources allow you to travel. Distance and lack of local know-how are the main obstacles to safe direct investment. Finding compatible and experienced local associates in the country of choice is critical for success.

ESTABLISH YOUR NETWORK

Co-Investors: From our experience, the Investor who is new to a market benefits from co-investing in a well structured transaction, where a local Investor, say a Fund with a local presence, is interested as well. It is easier to do due diligence on someone else's due diligence than to do your own. In all countries where opportunities exist, there are International funds that have local infrastructure. Among their concerns, when they consider Investment proposals, are returns and exit. Yours are likely to be the same.

Due Diligence Required:

Review of Comprehensive Information about the Project, outlining:

- Uses of Funds
- Target Markets and Rationale
- Management and Organizational Structure
- Marketing and Sales Strategy
- Manufacturing Process and Equipment
- Advantages of Geographic Positioning
- Financial Projections and Valuation

The International Finance Corporation of the World Bank also has local or Regional offices in most countries worth considering. They are being approached by many companies looking for Investors. They do thorough due diligence. Some of the projects that they turn down are actually worth looking at through more entrepreneurial eyes. Pay them a visit in Paris and get a reference to their country manager. EBRD and EIB are also active in the same markets and sometimes co-invest with the IFC. The most interesting to your clients may be the Investment Funds established by private organizations, which are more flexible than the multilaterals.

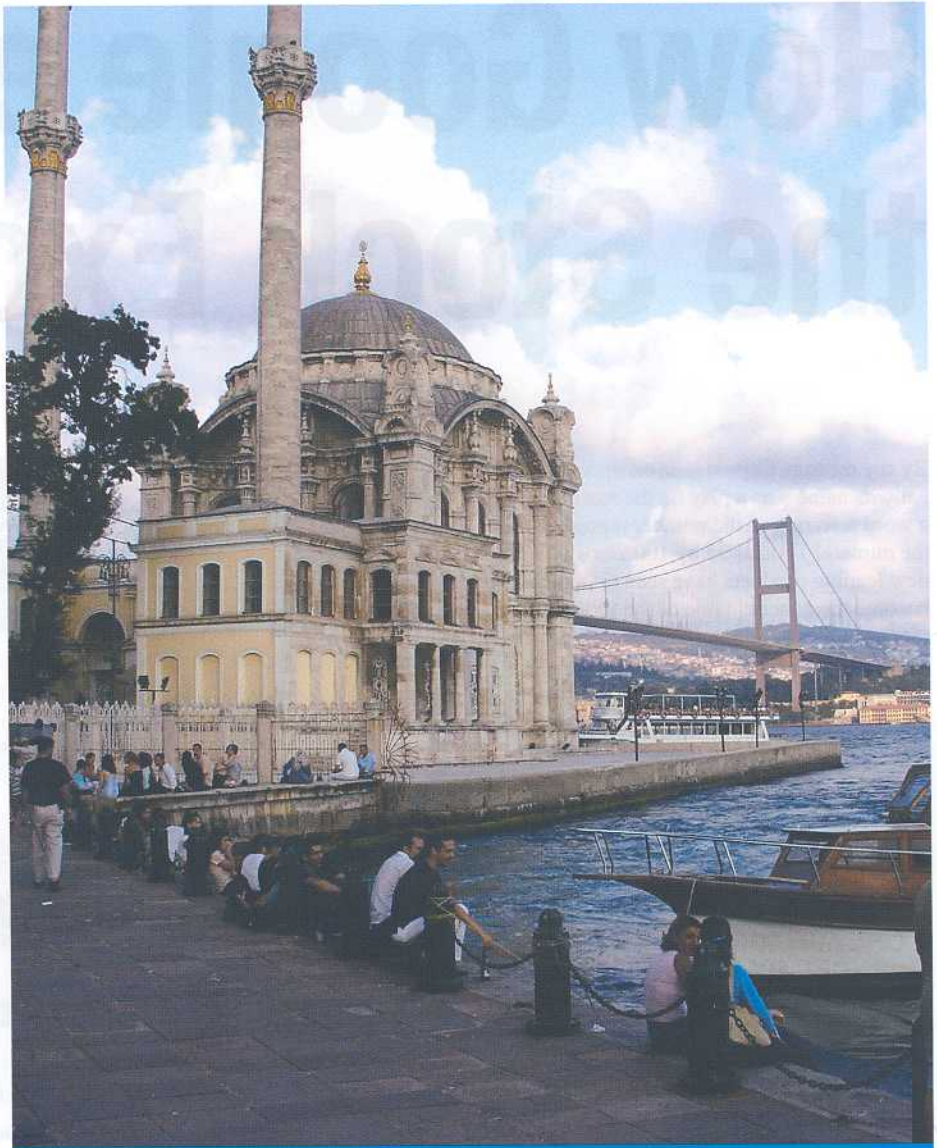
Lawyers: Contact a law firm that has solid experience working with International Banks and Investors. They would be eager to answer your initial questions, especially if they are a well established local firm.

Banks: There are always Banks that stand out from the crowd. They are either top quality Domestic Banks or International Banks with domestic presence. They have senior executives responsible for international relationships. They are always prepared to meet and share their knowledge. Since they live in the country, they are often cautious about their recommendations.

Travel: Go to the country. Be a tourist for a couple of days. Feel the people. There is nothing like the reality on the ground. It beats analysts' and country reports, or at least it complements them nicely.

SIGNIFICANTLY HIGH RETURNS

In the early stages of your involvement in a country, you may want to focus on the world of Exporters that have demonstrated that they



have the capacity and quality standards that satisfy international customers. The professionals that you will be contacting will know who is who and will be able to comment on the credibility of the companies.

All the above assumes that you wish to be proactive so that you become a sort of "specialist" in certain markets. If you prefer to be reactive to opportunities that come to you, identify the people that you will need to be associated with and let them know what type of opportunities you are interested in seeing. Do it in writing and be as specific as possible.

THE RISKS CAN BE QUANTIFIED

Direct investing is an opportunity to offer your clients a truly innovative asset class, apart from simply diversifying into "Emerging Market" stock funds, which are often

mature local blue chip firms with minimal growth opportunities. This is a play on convergence with the developed markets, rather than looking for the potential of a superior business model, or sustainable low-cost manufacturing advantages, or unique local products that will be in demand from import markets worldwide.

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PRI Project Development LLC, a 10-year old New York based firm that develops projects for its clients in "Emerging Markets", obtains Strategic Partners, Equity and Debt financing for their implementation.