Early Bird
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Sri Lanka focused PE fund bullish on post-war stability

June 26, 2009 (LBO) - Singapore-based Calamander group is the first to launch a Sri Lanka focused fund after the end of a 30-year war in the island, but the firm has worked behind the scenes for two years to be the first kid on the block.

The Sri Lanka Private Equity Fund is an early bird, coming barely a month after the island's government said a war with Tamil Tiger separatists was at an end with its top leadership eliminated. Sri Lanka's listed stocks are up 60 percent from the beginning of the year though despite disappointing earnings, largely on the bullishness of investors who have ground knowledge of the country.

It is also no accident that the Calamander group hit the ground running to become the first to open a fund on the country.

On the ground

"We were waiting for two years for the end of the war essentially," says director Mafaz Ishaq.

"We were establishing ourselves on the ground looking at companies and their financials."

"It is not a transparent market we are looking at."

Private equity deals in unlisted firms, requires an intimate knowledge of a firm and sometimes management input to make a deal bring returns with a successful exit.

Ishaq, a Calamander director who is working on the fund, is Sri Lankan born. He says about 40 million dollars of potential investments have been identified.

He understands Sri Lanka's industry, having worked with perhaps the islands most successful rubber based firm, the solid tyre firm Solideal-Loadstar as well as Holcim, a Swiss cement firm that has consolidated its position in the island.

Commodity/manufacturing play

Calamander has been looking at industries that process and add valued to, tea, coconut and rubber, the island's traditional commodity exports - and ceramics.

"Sri Lanka has a very prominent place in soft commodities," says Ishaq. "Tea, rubber and coconut. Rubber's position has diminished over time. In coconut, it is an innovative producer."

Commodities are going up again, fired by loose monetary policy from the US Federal Reserve, despite lower demand.

"Because of the nature of the commodities being a global business, this is de-risking from Sri Lanka," says Ishaq.

"We are bullish not only on Sri Lanka; we are also bullish on commodities."

Solideal-Loadstar the island's biggest rubber consumer even imported some rubber to feed its hungry plants, before the commodity and economic bubble burst last year.

Ishaq says Calamader is looking at tea factories, "a couple of trading companies", in coconuts players that "doing innovative things".

Calamander is also looking at ceramics. The country's tile producers are operating under the protection of high import duties, which means their export competitiveness, will diminish over time as they lose out to more efficient players.

Even their local captive market may be endangered in the future when public awareness of how ordinary Sri Lankans are punished by high duties may sway change trade policies, taking away super profits.

"What we are looking at is slightly different [from tiles]," says Ishaq. "Though the broader sector looks protected, there are niche players that we are interested in."

Competitiveness

He points to the success of the Japanese firm Noritake which has a large production unit in Sri Lanka. A part of the success of such firms is their brand and marketing strength.

Calamander is looking at companies that have a distribution and marketing edge as well as the potential.

"We are looking at companies that have established marketing capabilities," says Ishaq.

"In tea there is a lot of opportunity for branding."

In pure export manufacturing, the success of post-war Sri Lanka depends on its ability to contain domestic costs.

Both Germany and Japan, two global export powerhouses, managed to grow their industrial base – and keep unions happy and wages in check – by keeping inflation low.

After the gold standard ended in floating exchange rates in 1971-73, both Japan and Germany conquered inflation early. Other 'industrial' countries wallowed in stagflation and labour unrest until the early 1980s.

"The first thing for us is the economy," says Ishaq. "We understand the underlying macro-situation."

"I think the central bank is committed to maintaining an even keel on inflation.

"Our prediction for inflation is around 5.0 percent in 2012."

In the past 30 years, authorities in other dollar pegged nations, including Bank Negara in Malaysia, the Peoples' Bank of China, the Monetary Authority off Singapore and the Hong Kong's currency board has vastly outperformed the Sri Lanka Central Bank.

This year it had managed to keep inflation low despite weak fiscal policy.

Prospects

Fiscal policy has been Sri Lanka's undoing even in the past, when there was no war, though the war worsened an already bad situation where populist spending takes precedence over long-term investment.

Unlike the East Asian Tigers the government runs a current account deficit on the budget and is a net dis-saver taking away private sector saving that could have pushed growth up.

There are signs that this year's current account deficit of the budget would set a fresh record, indicating that the central bank would have to be extremely vigilant on inflation, unless external flows comes in to ease the pressure.

There are signs that it is happening.

The end of the war has changed the outlook for the country. Already hedge funds, which have bigger appetite for risk - and can also run away quickly – have put 190 million dollars in the government treasuries, according to the Central bank.

Calamander is hoping to raise more that 50 million US dollars from high net worth Asian and people who are interested in India and understands the South Asian region.

"There is tremendous interest in sri lanka," says Ishaq. "People want a vehicle in which to invest in the country in ways in which they understand."

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