



Photo: Alexei Kudikov

Julian Kozerski, Principal, RP Capital Group, and Anatoli Kaminov, Principal, RP Capital Group explain why the investment thesis of their fund is not being exploited by the current private equity and hedge fund universe

How was the team for this investment group brought together?

Julian Kozerski: The Group was founded in September 2004 by Rafael Berber and Petr Kellner. Rafael was formerly the Global Head of the Equity-Linked Products Group at Merrill Lynch and was at the forefront of developing Merrill's European emerging markets business. His partner, Petr Kellner, is the founder and majority owner of PPF Group, the largest privately owned financial services group in the Czech Republic. PPF has interests in insurance, media and consumer finance in Eastern Europe and Russia.

The team has been brought together to create a diverse pool of skills. For example, Anatoli comes from a management consulting and equity research background; I am from the capital markets and derivatives side of the business; we have people who are experts in private transactions, fixed-income, equity and credit derivatives and trading.

What is distinctive about the fund?

JK: We cover the full spectrum of what you would expect from an investment bank. In fact, we take what we believe is a unique 'merchant banking approach' to the investment process. By structuring transactions and syndicating some of our deals we are very well positioned to exploit the characteristics of a hybrid fund, which has a significant private equity-like element to its investment portfolio. At the same time, we possess all the attributes of a traditional fund – with a liquid trading portfolio, comprising equities, currencies, fixed-income, commodities and OTC derivatives.

The percentage breakdown in terms of current NAV is roughly 60% in privately negotiated less-liquid investments and 40% in the liquid trading portfolio. There is also an overlap between the various portfolios. We may have structured positions which have the characteristics of equity, but because of their nature, sit within the less liquid investment portfolio.

Our focus is on Eastern Europe, the Middle East and Africa (EEMEA), with certain specific country emphasis – Russia being an obvious example. If we see value in a specific name, we use portfolio construction techniques to understand whether fundamentally a name has viability in the portfolio, but there will be shift of allocation not only in and out of specific sectors but out of countries.

However, clearly there are core investment themes. We are believers in Russia over the long term. In terms of the other aspects of the portfolio – we don't tend to use much leverage, but what leverage we do use is not necessarily explicit - it is typically in the form of some derivative component.

Given the less liquid investments in the portfolio, there is a natural long-bias. However, we try to mitigate this through the prudent use of correlated liquid positions.

All of our investments in the less-liquid portfolio have to meet certain crite-

ria: we don't ordinarily take a controlling stake in a company from a percentage ownership point of view but in all cases without exception we have to believe in and trust the management team. Alternatively, we might create a venture and bring in outside partners, with whom we typically would have a long standing and nurtured relationship.

Anatoli Kaminov: One of the unusual aspects of our fund is that we have a three year lock up for investors, which allows us to be flexible and to get into less liquid investments. For a typical hedge fund, it is quite unusual but fits perfectly into our investment philosophy.

Why do you believe that your investment thesis is not exploited by the current private equity and hedge fund universe?

AK: Firstly, because we operate in a manner similar to the way a merchant bank would operate. We can offer products and we can tailor, create and structure a particular instrument to suit a particular situation, while participating in the investment. That gives us a competitive advantage. Furthermore, we are flexible enough to stay in some less liquid investments for up to 36 months (or even beyond, in some specific cases). As a result, as barriers to entry are much higher for others in these types of situations, we should benefit from higher returns.

JK: The breadth of the skill-set is also very critical. The EEMEA region is multi-faceted. To exploit the full range of opportunities that are out there, we need to have a full set of skills in the group. We are not afraid to roll up our sleeves. For a lot of hedge funds in the region, there is a lot of hot money that comes in, when emerging markets are doing well, and then goes out, when exuberance gets ahead of itself. We are long-term believers in the region. Most of our net-worth is tied up in the business. Clearly, we are aligned with our investors.

More importantly than that, we are not just going to sit behind a desk and expect deals to come in. We use our network and leverage that network most efficiently and are on the road a lot of the time chasing deals. It is a hands-on commitment and very much about going out and sourcing opportunities.

AK: We are also not an opportunistic hedge fund in the sense that all of us have many years experience in the region.

JK: As a result, we also believe that we have a good understanding of the risks as well. Most of us experienced the 1998 crisis professionally and learnt valuable lessons.

As I mentioned before, with the approach that we have taken by using the liquid portfolio as a means of hedging some of our exposure, we hope to mitigate much of the risk that is involved with having a long-bias in the less liquid portfolio.

You are also looking at projects in the agriculture sector. What is the logic behind this venture?

AK: This is consistent with what Julian has outlined. This is an example of a less liquid project. Russia's new land code became effective in January 2004 and completely changed the agricultural landscape.

It is now possible to legally acquire long lease rights to arable land in Russia. Previously, legal barriers existed. Since the code was approved by Parliament, it is still quite difficult for small farmers to get their land properly surveyed and registered. Barriers to entry remain high. Therefore, prices for land are low – even in the context of emerging markets. In Russia, top quality arable land can be purchased for \$250-400 per hectare. If you go back and use Poland as a benchmark, in 1991 the cost was about \$300 per hectare and it is now about €3500.

When we looked at the opportunity to create an agricultural venture in Russia, the key factor for us was not the potential for land appreciation (which would come as a bonus) but whether we could invest in a professionally managed stand-alone venture that could generate sufficient cash flow to deliver our targeted returns.

Land yields remain low as a result of inadequate investments in technology and poor expertise. We asked ourselves the question, 'can we find a partner who has the ability to manage farms properly?' We put together a team of professionals who have extensive experience in

not only managing farms but also trading crops.

I think that we have put all the necessary elements together. We are coming into the venture with a team of experienced international partners and we think that together we can make it happen. We are starting from a small base but intend to grow the hectareage to achieve economies of scales.

The idea is to make the venture profitable in the next two to three years, and exit either via a trade sale to a strategic investor or through an IPO.

This is quite an unusual investment for a hedge fund, but it is in line with our overall philosophy. We pursue less liquid transactions when we are able to partner with experienced professionals.

What is your general assessment of Russia's ongoing economic development?

JK: Russia is very susceptible to a decline in the commodity cycle because the economy has such a bias towards that sector. There is also some nervousness amongst the corporates. Clearly, the biggest political risk is the question of what is going to happen 'post Putin'. However, we are comfortable with the investments that we have made and, to the extent that you can be, we have mitigated some of the more obvious risks.

Alternatively, you could have set up a fund that is only Russia-focused...

JK: You need to have diversification, and there are many good opportunities to invest in outside of Russia with potentially less risk.

AK: Also in Russia we try to stay away from regulated industries - we try to get exposure to consumer growth. We try to be prudent. We know the region and the country well enough to know that it pays to be prudent.

JK: We think that there are too many people who just don't get it on the outside.

AK: We are not a hedge fund that plays with Russia and emerging markets. We are professionals, who have been involved in this business for many years and we are making investments with our eyes wide open and our finger on the pulse of the market. 