February 23, 1998 12:00 AM

MANAGERS FLOCK TO CENTRAL, EASTERN EUROPE

By Theresa Agovino

TWEET SHARE SHARE EMAIL REPRINTS PRINT

Money managers are trying to raise up to $2 billion for Central and Eastern European private equity funds.

Relative economic and political stability, sky-high stock market prices, company restructurings and proven exit strategies have created a good environment for launching private equity funds in Central and Eastern Europe, managers said.

London-based Baring Central European Investments and Vienna-based European Direct Capital Management are raising money for new private equity funds that will invest in the entire region.

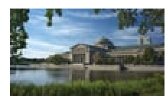
Meanwhile, East Fund Management Vienna just closed a $60 million private equity fund that will invest solely in the Czech Republic, and Budapest-based Antra Kft. is drawing up plans to raise $50 million for a new Hungarian fund.

These funds soon will have more competition for investor dollars. Budapest-based Rona & Co. Ltd. plans to raise between $80 million and $120 million for the Second Hungary Venture Fund, which will be the sponsor's second Hungarian private equity fund.

RECOMMENDED FOR YOU

Money manager DC assets shift over time

Read the print edition of P&I


Citadel's Ken Griffin gives $125 million to Chicago museum; name will change


Sponsored Content: The Institutional Investor's Guide to Active Thematic Global Equities

Pricoa Capital Group, a unit of Prudential Insurance Co. of America, Newark, N.J., has formed Argus Capital Group in London. The new unit is expected to invest up to $200 million in Central and Eastern European private equity. A Prudential spokesman declined to comment on any fund-raising efforts.

Zurich Centre Investments Inc., the New York City-based private equity group of The Zurich Group, also is considering launching a private equity fund.

Infrastructure investments also are receiving attention. New York-based Scudder Kemper Investments Inc., another Zurich Group unit, is in the early stages of creating a private equity fund of up to $1 billion that will invest in infrastructure projects in Eastern Europe as well as in Russia, the Commonwealth of Independent States and the Balkans.

"The region is changing dramatically. It needs power plants, roads, airports, ports. It will have to turn to the private sector because (the governments) don't have money to build them," said J. Scott Swensen, managing director of Scudder Kemper Investments Inc.

"There is real investor interest now," said Gyuri Karady, managing director of the Baring Central Europe Fund. He hopes to raise $250 million by this summer for the fund. Baring Private Equity Partners, the fund's manager and a division of ING Groep, already has seeded the fund with $25 million.

"The more advanced economies like (those in) Hungary and Poland are practically western, while the countries further east like Bulgaria are making progress," he said.

But it might take persuasion to interest U.S. pension funds in participation in these funds.

Anthony Hoberman, senior vice president at Alliance Capital Management LP, New York, said many U.S. pension funds have resisted investing in Eastern European private equity funds because there is no track record of success.

"U.S. pension funds did a lot of fact-finding trips to Eastern Europe. There was a lot of teasing by pension funds and not a lot of investing," Mr. Hoberman said. "What attracts pension fund money to new areas is conspicuous success, but at this stage the successes are still few and far between. People may be making money quietly, but there still isn't a sufficient pattern to form a track record."

Diversification benefits

Still, managers argue, Central European private equity funds offer good diversification from Asia's reeling markets. Managers said Central and Eastern Europe lack Asia's property boom/bust scenario, and balance of payments in the region are not out of whack.

Mr. Karady said private equities offer a greater opportunity than the more crowded field of Eastern Europe stock-market investments. "There are already several funds that invest in publicly traded companies," he said.

Some observers note that investing in public companies poses difficulties. For example, prices of Hungarian stocks have risen dramatically over the past two years, making good value hard to find. In local currency terms, the Budapest Stock Exchange index soared 155% in 1996 and 86.4% last year.

Meanwhile, lackluster corporate results have curtailed investor interest in Polish stocks. And the Prague Stock Exchange remains poorly regulated.

Eastern European private equity funds can offer substantial returns. Last year, Rona & Co.'s First Hungary Fund's net asset value increased 50% to $215 million. The fund has seen its assets rise an average of 20% a year in each of the past three years, said Michael Carter, the fund's manager.

Mr. Carter said some Eastern European countries, such as Hungary and Poland, will enjoy above-average growth rates for the next several years. While expected to join the European Union in the next few years, such countries still will enjoy the advantages of inexpensive skilled labor, he said.

Funds offer expertise

Mr. Karady said the Baring fund will not specialize in particular industries and the allocation among the countries has yet to be decided.

He thinks a majority of the money will be invested in Poland and Romania because, with 40 million people and 25 million people respectively, they represent the largest markets. Mr. Karady is not especially concerned with the current squabbling between the government's two major coalition partners in Romania.

The situation in Romania "is a zig-zag. They take two steps forward and one back," Mr. Karady said. "But the Communists are out and they (government officials) are moving in the right direction."

Mr. Karady said the fund will seek large minority stakes in companies, with most investments between $20 million and $30 million.

The fund already has made its first investment, pouring $7 million in Allami Nyomada, a profitable Hungarian printing company with $25 million in revenue.

Despite high prevailing prices, the managers of these new funds said there are private companies that can offer excellent returns. State Street Global Alliance Managing Director John Snow said that while on the surface the private companies might not appear inexpensive, the financing and management expertise his fund can provide will mean returns can soar.

"The overall market is not priced at a very low level, but there are still companies that are enormously undervalued," Mr. Snow said. "There are a lot of businesses that have been privatized, but the companies' assets have been organized to make the most of those assets."

Timing is right

State Street owns 60% of Vienna-based European Direct Capital Management, which is trying to raise between $200 million and $300 million by the summer to invest in companies primarily in Hungary, Poland, Slovakia and the Czech Republic. The remainder of the firm is owned by a group of investors in the region.

State Street officials waited until they could find talented professionals with local knowledge before launching a fund, Mr. Snow said. The timing is right for such a fund because a substantial amount of privatization in the region has been completed. Now some original investors are rethinking their purchases and might be anxious to sell, he said.

Moreover, companies that were sold to local management might be in need of additional financing. The fund will invest between $15 million and $40 million in a company, Mr. Snow said. A majority stake isn't required, but management participation is a prerequisite if the fund is to invest.

Some experts contend the best buys might be in the Czech Republic because the country is facing an economic crisis. The privatization process there was an incestuous system that now is falling apart.

Czech companies were privatized by selling shares to investment funds that were partially controlled by leading Czech banks. The same banks kept lending money to the newly privatized companies, but were reluctant to restructure overstaffed and inefficient companies.

Now, the banks are buckling under the bad debt and the companies still need cash but none is available because the financial institutions have stopped making loans.

This scenario creates a buyers' paradise, said Roland Haas, managing director of the East Fund Management Vienna, a joint venture between New York City-based Alliance Capital and Vienna-based CA IB Investment Bank.

The company just closed a $60 million fund that will specialize in restructuring companies in the Czech Republic. Mr. Haas said the fund will make investments of $3 million to $8 million that will buy either majority stakes or management control. He is open to all kinds of companies but wants them to be profitable at an operational level.

"This is more or less a financial crisis in the Czech Republic. This is an ideal situation for investment," Mr. Haas said. "The situation is such that we'll be able to negotiate good deals. I think we'll see a huge deal flow."

Hungary is safe

Hungary is not in a financial crisis, but Tom Howells, managing director of Antra Kft., said there still are opportunities to buy into companies as their owners rethink strategies stemming from the early stages of privatization.

While Hungary might not offer bargain-basement prices, its companies are less expensive than those in Western Europe and its economic and political stances probably are the sturdiest in the region.

"Hungary is a safe place to invest money," Mr. Howells said. "It has Eastern European growth combined with safety."

What's more, he said, there are proven exit strategies for Hungarian companies in venture capital firms. Two of the firms in Euroventures Hungary BV, the $20 million venture capital fund Mr. Howells manages, were floated on stock exchanges -- one on the NASDAQ, the other on the Vienna Exchange.