

# EVEN NORTH KOREA

Frontier market investors have arrived in countries under sanctions and embargoes, such as Iran and Cuba, even those without stock markets, such as North Korea and Myanmar. Stefanie Eschenbacher investigates the investment opportunities.



**NORTH KOREA IS** investable, and this time it is not just a hoax by a US website – *The Onion* once declared the North Korean supreme leader Kim Jong Un “the sexiest man alive” (and China’s *People’s Daily* fell for it).

Mongolian oil company HBOil recently established ties with the most isolated and secretive country of all, and is now trying to entice foreign investors.

Meanwhile, Myanmar revealed plans to open a stock exchange following nearly half a century of military rule. Stocks that give exposure to Myanmar but are listed in third-countries, such as Singapore and Thailand, are already trading on high valuations.

Iran, however, appears to top the list of desired investments, despite its uncertain future and decades of sanctions that have

crippled the country. Ramin Rabii, the managing director at Turquoise Partners, which is based in Tehran, manages almost all foreign investments in the Tehran Stock Exchange. “Iran is the most misperceived country in the world,” Rabii says. “The potential, once sanctions are lifted, is enormous.”

The Tehran Stock Exchange is large and liquid, with a market

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**COMMUNIST CAPITAL:**  
There are ethical and reputational concerns when it comes to countries like North Korea.

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capitalisation of \$145 billion, including the junior market. Rabii says interest from European, Asian and even American investors has increased since reformist Hassan Rouhani was elected president last year. "We are hopeful about the negotiations that are going on," Rabii says.

"On both the US and the Iranian side, there is a genuine will to get to some sort of resolution."

Investing in Iran is legal, even under current sanctions, except for US investors. Turquoise Partners has no US investors, and the fund is not marketed to them.

"We have a strict sanctions compliance policy, which means we do not invest in any company that is under European Union or United Nations sanctions," Rabii says. There are practical challenges, too.

Sending money back and fourth is difficult: investors need to get clearance from their local treasury once it exceeds a certain amount, and they cannot use any bank channels. Deutsche Bank, Standard Chartered and BNP Paribas have recently come under fire for allegedly violating sanctions and embargoes.

Most of the money Turquoise Partners currently manages on behalf of its 90 investors was raised between 2005 and 2010 when there were no European Union sanctions.

"Today, raising funds is difficult for us, not necessarily for legal reasons, but for practicality," he adds. "Iran itself is, in terms of sophistication and regulation, not a frontier market."

Rabii says the most compelling investment opportunities are in natural resources – Iran is estimated to have the largest combined resources of oil and gas – as well as in minerals and consumer sectors. There are large mining and metal-producing companies, such as Chadormalu and Gol-E-Gohar that produce

iron ore, and Khuzestan Steel and NICIC, which produce steel and copper, respectively.

#### **IRAN FUND**

Known for the Iraq fund it launched four years ago, FMG, which is headquartered in Malta, has also explored the possibility of an Iran fund. Henrik Kahm, an investment analyst, and his colleagues even travelled to Iran.

"The market is solid, and we see interesting companies that are attractively valued, but that is for a reason," Kahm says. "The opportunity in Iran is due to the fact that it has issues with foreign exchange and sanctions, and the second those issues disappear the market may rebate."

FMG already had to overcome challenges when it launched its FMG Iraq fund – the only depositary in the country is the Iraq Depositary Centre.

This means the fund could not be set up as Ucits. It is domiciled in Bermuda.

Iraq is once again engulfed in a

#### **» WE ARE ALSO LOOKING AT MYANMAR, BUT ANYTHING RELATED TO MYANMAR IS EXPENSIVE. «**

*Karine Hirn, East Capital*

civil war, but Kahm says the fund has seen few outflows. Extremist group Islamic State has seized large swathes of territory in Iraq and Syria over the past couple of months, prompting another US military intervention.

"We have probably seen the worst on the stock market on a year-to-date basis and do not expect the situation to deteriorate, but if it does deteriorate, we will face outflows," he says.

The FMG Iraq fund has core positions in blue chip companies, such as the Bank of Baghdad, Gulf

Commercial Bank and Baghdad Soft Drinks. Kahm says these companies have managed to grow top and bottom line, despite tough market conditions.

"Iraq has actually been one of the main beneficiaries of the increased interest in frontier markets over the past couple of years," he says.

Hong Kong-based Asia Frontier Capital, which pursues several frontier markets in the region, including Iraq, has also sent staff to Iran.

Thomas Hugger, the chief executive officer, dropped plans to invest, but says he would like to do so as soon as the sanctions are lifted. Meanwhile, he has his eyes set on off-benchmark investments, such as Nepal and Bhutan.

The Nepal Stock Exchange is comparatively large and liquid, while the Royal Securities Exchange of Bhutan is small, but home to what Hugger says are attractively valued companies. Neither of the markets is currently open to foreigners.

"These markets are less correlated, and there are no foreigners," he adds.

Investing in stocks listed in third countries is common among frontier market investors. Asia Frontier Capital invests in the Maldives via Aitken Spence Hotel Holdings, listed on the Colombo Stock Exchange in Sri Lanka.

It also invests in three of the companies listed on the Port Moresby Stock Exchange in Papua New Guinea – BSP Bank, Credit Corp, and City Pharmacy – and one listed in Australia that derives its revenues from doing business in Papua New Guinea.

Yoma Strategic Holdings and Interra Resources are, among others, listed in Singapore, but give exposure to Myanmar.

Hugger says all of the countries Asia Frontier Capital invests in are challenging; with the exception of Cambodia, every one has

restrictions on either foreign ownership or repatriation.

Asia Frontier Capital needs a tax adviser for its investments in Bangladesh and Pakistan because both countries charge capital gains tax, although in Bangladesh the tax applies only to foreign investors. In other countries, there are issues with custody.

"In the smaller countries we either use local custodians, like in Bangladesh, or we own the stocks directly at the central depository," Hugger says.

"In Iraq, Cambodia and Laos, there are no foreign custodians at all, which means that our large competitors cannot invest there."

Hugger says the Mongolian oil trading and processing company HBOil, which recently took an indirect 20% stake in the Sungri refinery in North Korea, has caught his attention.

Former communist Mongolia has had diplomatic relations with North Korea for years, and now seeks to power its mining-led boom. The investment comes as North Korea's diplomatic relations with its most important ally China are cooling.

Aminex, which is listed on the London Stock Exchange, got involved in a North Korean exploration programme a decade ago, but withdrew in 2012.

Ulaanbaatar-based HBOil is now trying to entice foreign investors, but Hugger, who recently returned from a trip to Mongolia, says he is not yet convinced.

"We are still doing our research and especially due diligence on the company," he adds.

Karine Hirn, head of Asia, East Capital, says besides reputational risks, there are ethical concerns when it comes to investing in countries such as North Korea.

"When I visited North Korea, it was my holiday," she says.

"I did not want the trip to be seen as East Capital looking to invest there."

East Capital decided to broaden the mandate of its Luxembourg-domiciled, Ucits IV-compliant East Capital Emerging Asia Fund to include a number of new markets, such as Vietnam, Sri Lanka, Bangladesh, Pakistan, Laos, Cambodia and Myanmar.

Both lawyers and custodians were sceptical of Hirn's plans – while the lawyers were mainly concerned with Myanmar, the custodians objected to Cambodia and Laos.

The Cambodia Securities Exchange in Phnom Penh recently saw its second listing while only

### **» WE BOUGHT THE INVESTMENT BECAUSE OF THE CASH VALUE IN THE BANK, BUT THE COMPANY HAS A CLAIM ON CONFISCATED PROPERTY IN CUBA. «**

*Thomas J. Herzfeld, Thomas J. Herzfeld Advisors*

three stocks are listed on the Lao Securities Exchange.

The exchanges are among the smallest in the world – but the Seychelles Securities Exchange, which launched two years ago, has no listed companies. All three do have Facebook pages, however.

Hirn also recently went on a trip to Bangladesh to explore opportunities there, but this has not materialised because no custody is in place.

East Capital, which is based in Stockholm, was involved in opening up custody in Serbia, and Hirn says the Serbian authorities were eventually pleased to see long-term institutional foreign money coming into the market.

"Part of the reason why things are so complicated is because local regulators do not always understand what the intentions of foreign investors are," she says.

While acknowledging the pressure custodians are under, Hirn says she likes to remind them

during every board meeting of her ambitions.

"Bangladesh is the most cumbersome market we have tried to enter so far," she adds.

"We are also looking at Myanmar, but anything related to Myanmar is expensive – people are excited about it."

Daiwa Securities Group and the Tokyo Stock Exchange agreed back in 2012 to help set up the exchange, after Myanmar had started to open up. The stock exchange in Yangon is scheduled to open in October next year.

Myanmar already has an over-the-counter bourse, the Myanmar Securities Exchange Counter, with two stocks, but most are listed in third-countries.

### **CUBAN REVOLUTION**

East Capital invests in a cement company, Lucky Cement, and a power company, Hub Power, in Pakistan, an increasingly popular country. Hugger says Asia Frontier Capital sold well-performing consumer stocks in Pakistan because they became too expensive amid increased interest from larger investors.

The Havana Stock Exchange closed more than 40 years ago during the Cuban Revolution – the closest thing the country has to a trading floor is the thriving black market in La Cueva.

Thomas J. Herzfeld, the founder of Thomas J. Herzfeld Advisors, is based in Florida and invests in Cuba, circumventing the US embargo through a variety of legal investment strategies.

The Herzfeld Caribbean Basin Fund is invested throughout the Caribbean Basin in companies Herzfeld expects to benefit from Cuba, regardless of whether the US embargo is lifted, such as cruise ship operators and property businesses.

A US-domiciled closed-end fund, it also holds several direct investments, including





defaulted sovereign debt of Cuba, sometimes referred to as Cuban 77s because of their maturity date of 1977, or Batista bonds. Herzfeld says he owns a small issue of those bonds, the only sovereign debt that is still outstanding.

"We value these bonds at zero, but they have 14 years of coupons attached to them, and if bonds and interests are paid, it will be a gain for our portfolio," he adds.

Under US law, the embargo against Cuba can be lifted if it settles with businesses that were seized by the government of Fidel Castro in 1960. Herzfeld holds shares of Cuban Electric, a US company that ran the electricity in Cuba until its plants were seized; he bought the shares just before

trading was suspended.

"We bought the investment because of the cash value in the bank, but the company has a claim on confiscated property in Cuba." The third direct investment is a penny stock, Fuego Enterprises, which publishes a magazine on Cuba that is distributed on charter flights. In addition, it has licences from the Cuban treasury department for business in the country. "It is our most speculative investment," Herzfeld says.

Much of his strategy will depend on how relationships between the US and Cuba proceed.

"The embargo will likely be lifted during president Obama's term in office, he has said he would like to see this

happen," Herzfeld says. Other triggers could be the release of imprisoned Alan Gross, a US government subcontractor, accused of spying, or the death of Fidel Castro's.

"The opposition to lifting the embargo comes mainly from the Cuban exile community in south Florida, but the hardliners are ageing and a lot of the emerging leaders of this community are softening their stance."

There appears to be no limit to investment ideas, only of ways to realise them. Mark Mobius, executive chairman, Templeton Emerging Markets Group, made headlines four years ago when he expressed interest in Palestine, but this has not materialised. 

# FRIENDS IN NORTH KOREA?

» **NORTH KOREA OPENING UP ITS OIL AND GAS RESERVES AT A TIME WHEN ITS NEIGHBOURS ARE HUNGRY FOR MORE ENERGY COULD CHANGE THE FATE OF THE MOST ISOLATED COUNTRY IN THE WORLD.** «

**REMEMBER WHEN WE** all had a laugh at the expense of North Korean supreme leader Kim Jong-un after US satirical website *The Onion* declared him "sexiest man alive"?

The *People's Daily* in China made it all the funnier when it ran a 55-page photo spread of him that went viral.

There was other news coming out of North Korea in recent weeks that could have gone viral, at least in financial circles, but somehow it did not. Mongolian oil trading and processing company HBOil, based in Ulaanbaatar, took an indirect 20% stake in the Sungri refinery in North Korea. HBOil is not the first company to attempt that: Aminex, listed on the London Stock Exchange, tried this a decade ago, but withdrew from a North Korean exploration programme in 2012.

Edison Investment Research warned as far back as 2006 that "North Korea's strained relations with the outside world could deter potential farm-in partners", but HBOil now appears to be using the exposure to North Korea as a marketing argument.

Whether investors are ready is another question. Thomas Hugger, the chief executive officer of Asia Frontier Capital, says he is not convinced.

Hugger, a frontier market investor whose portfolios feature countries as exotic as Papua New Guinea, the Maldives and Bangladesh, recently returned from a trip to Mongolia.

"We are still doing our research and especially due diligence on the company," he says of HBOil.

North Korea opening up its oil and gas reserves at a time when its neighbours are hungry for more energy could change the fate of the most isolated country in the world. Even Gazprom, the world's largest extractor of natural gas, has expressed interest in North Korea in the past.

Karine Hirn, the head of Asia at East Capital, says besides reputational risks, there are ethical concerns when it comes to investing in countries like North Korea.

"When I visited North Korea, it was my holiday," she says. "I did not want the trip to be seen as East Capital looking to invest there."

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