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20% Return Expected for 'Direct Investment Fund'

By The Moscow Times

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The fund will target non-oil and gas sectors, including food production. **Igor Tabakov**

WASHINGTON / NEW YORK — Russia's planned $10 billion private equity fund will be mostly funded by foreign capital, lured by targeted returns of up to 20 percent from investing in industries such as technology and pharmaceuticals, a senior official said.

Energy-rich Russia hopes that the fund will help diversify its $1.3 trillion economy away from the hydrocarbons sector, which contributes more than a fifth of the country's gross domestic product.

Russia hopes that the fund will also improve foreign capital inflows, held back by a poor view of the country among some investors. It aims to attract cash-rich sovereign wealth funds and international private equity funds.

Foreign investors are expected to contribute the lion's share of the capital into the fund, which will seek to make investments of between $100 million and $150 million, said Vladimir Dmitriyev, head of Vneshekonombank, the state-run bank put in charge of establishing the fund.

"For each ruble put into the fund, co-investors will put in five rubles," Dmitriyev told journalists in Washington at the International Monetary Fund and World Bank spring meetings on Sunday.

In recent weeks, Russian government officials have been conducting an unofficial roadshow for the fund, to be called The Direct Investment Fund, in Europe and the United States.

The fund will be launched in June, with Russia committing $2 billion every year over the next five years, Dmitriyev said. It hopes to attract some $60 billion.

The return on investment should be on par with the 20 percent that private equity firms typically seek, according to Dmitriyev's predictions.

"We expect that [return on investment] will be no lower than 15 percent," Dmitriyev told journalists on the sidelines of the meetings.

"As a whole, on average, it should be about 20 percent. This is what's attractive to investors with whom we've already talked."

However, the lucrative energy sector will be excluded from the investment criteria for the fund, which could make it less appealing, a Western investor said on condition of anonymity.

Dmitriyev said oil and gas projects would be "categorically" excluded from the fund, unless they clearly were connected to the development of new technologies, for example.

Instead, Russian government officials have been targeting investors willing to put their money in Russia's high-tech, food production, pharmaceuticals and electricity sectors.

Investors have been cautious about putting their money in Russia, partly due to corruption and what some see as a lack of consistent rule of law. They are waiting for President Dmitry Medvedev to deliver on promises to fight graft and red tape.

"The perception is that the best deals get to go to the oligarchs, and because the oligarchs have a fair amount of money, there isn't so much need for Western private equity capital," Carlyle Group's co-founder David Rubenstein said in September.

While Carlyle Group is cautious, rival TPG Capital has ventured into Russia with a stake in Russian hypermarket chain Lenta and in VTB bank.

Dmitriyev said the government's participation in the fund provided a safety net.

"It's attractive for investors ... that the state together with them carries the risks and shares the risks," he said.

That could be attractive to cautious investors. The Russians "appear to be hoping to recover their reputation in the capital markets" by offering a group of high-profile private equity firms low-risk, high-return opportunities that they hope will attract others to follow on less advantageous, "more normal terms," Lord Mark Malloch-Brown, chairman of global affairs at business advisory firm FTI Consulting, said recently.

In March, Prime Minister Vladimir Putin ordered his officials to step up work on attracting foreign capital, which last year came to $33 billion, according to the Economic Development Ministry.

"Russia has taken a course to promote modernization and innovative development. Foreign investments play a special role in this process," Medvedev said at a breakfast with Hong Kong and Russian business leaders over the weekend.

"There are two types of investors that we actually almost don't have," Deputy Economic Development Minister Stanislav Voskresensky said in Washington.

"First is private equity funds, second is sovereign wealth funds from Arabic countries and Asian countries. Why? Because they don't see that kind of interest in Russia, both political and financial, to invest."

Voskresensky said the government hoped to create a success story that would serve as a model for future initiatives. "It is to bring newcomers," he said. "It's not to substitute foreign direct investment into Russia."

A new equity fund is being created to promote investment in companies deemed likely to benefit from political stability expected after the election period, Vedomosti reported.

Arbat Capital Management is starting the New Kremlin Fund to help wealthy investors from Russia, Kazakhstan and Ukraine select targets that will prosper due to the proper mix of politics and economics. "You need to know well the companies and the politicians in order to pick the right investments," said Arbat managing director Yulia Bushayeva. The fund is expected to be functional, with a $150 million initial investment, by August.

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