PEI Alternative Insight
PE ASIA
FOR THE ASIAN PRIVATE EQUITY MARKETS

# An LP-free zone?

**Still recovering from decades of civil war, Sri Lanka has attracted some private equity interest but firms have found it hard to rally LP support for the country.**

posted - 07 May 2012 06:15 GMT
updated - 07 May 2012 06:28 GMT

Sri Lanka's golden sandy beaches lie not 50 kilometres from India's closest point, but the distance between the two countries' private equity markets is vast.

Two years after the end of a 30-year civil war, Sri Lanka is expected to have 6.5 percent real GDP growth for 2012 and a more stable economic environment for its 20.8 million population, according to the IMF. Its proximity and commercial connections to India position the small economy well for growth. Yet firms are finding LPs wary of Sri Lankan private equity funds.

Sev Vettivetpillai, chief executive of emerging markets specialist Aureos Capital and also a native Sri Lankan, said: "Post-war, the Sri Lankan market has suffered considerably in terms of lack of investment. The traditional investors in Sri Lanka like [UK development finance institution] CDC and [Dutch development bank] FMO have decided not to invest in the near future because they aren't happy with the governance and the human rights issues."

Risks also include volatility in the market, explains Vettivetpillai. In March, Sri Lanka's currency depreciated by 18 percent against the US dollar. "That kind of depreciation in one go impacts returns. We've been saying the [Sri Lankan] rupee has been overvalued for two years and the government kept it at that level for obvious reasons. These kinds of decisions are the ones that keep private equity investors like us away from the market."

Sources have said global players like The Blackstone Group and Warburg Pincus have been scoping out the landscape, but haven't yet done any deals. A number of smaller firms have in recent years been trying to raise Sri Lanka-focused funds, but haven't had much luck.

Leopard Capital in 2009 made an unsuccessful attempt to raise a Sri Lanka-focused vehicle. "We were unable to uncover sufficient investor interest at the time and suspended the project," says Douglas Clayton, founder of Leopard. But he adds he still believes in Sri Lanka's opportunities.

Singapore-based Calamander Group likewise launched a fund in 2009 after the long war ended and hopes ran high, but could not attract enough investor interest. Calamander now invests in Sri Lanka on a proprietary basis, says Mafaz Ishak, director. He believes tourism is a key sector and the firm has invested in Unawatuna Beach Resort while the beaches there recover from a devastating tsunami in 2004.

One native GP is now giving fundraising another try. Indika Hettiarachchi was Aureos' managing partner for Sri Lanka before moving on to launch a $50 million fund for the country. He insists opportunities are rife, telling PE Asia, "Based on my actual experience and assessment of the market trends, it is possible to target minimum 23 percent IRR in US dollar terms."

His fundraising efforts are at the proposal stage as he tries to secure a local anchor investor. "We do not want to approach foreign investors until we have a firm anchor and we are particular about getting the right [one]," he explains.

He could be in luck. Investment firm LR Global recently secured a $10 million (or 20 percent of the total fund) investment in its Sri Lankan-focused fund from the International Finance Corporation, proving that there is some LP interest in the country.

Despite the fact that GPs see promise, an approach that mitigates risk in Sri Lanka may appeal more to LPs. Aureos' Vettivetpillai admits, "I would not invest in Sri Lanka alone. I would put my capital across three markets – India, Sri Lanka and Bangladesh. Sri Lanka alone would be too risky."