



Trip to Bangladesh and Sri Lanka

By Ning Ma

On February 9, 2015, I left for a trip to Bangladesh and Sri Lanka. The timing was interesting as Sri Lanka had just concluded a peaceful presidential election on January 8, while Bangladesh was embroiled in the chaos of road blockades and strikes called by the opposition party.

	Bangladesh	Sri Lanka
GDP Growth 2015 est	6.0%	6.9%
Inflation	6.3%	3.8%
Population (mil)	166	22
People/km sq	1,275	338
% Literate	59%	91%
% Literate Female	55%	90%
% under age 15	32%	25%
Life expectancy	70.65	76.35
% Urban	34%	18%
GDP/ cap (PPP)	\$3,400	\$10,400
% Unemployed	5%	4%
Land (km sq)	130,168	64,630
GDP % Agriculture	15%	10%
GDP % Industry	27%	33%
GDP % Services	58%	57%

Source: CIA Factbook



Bangladesh

We have been investing in Bangladesh since 2006. This is a country with a population of more than 166 million and a land size slightly smaller than Iowa, USA. It is the world's eighth-most populous country and among the world's most densely populated countries. Despite several rounds of salary increases, labor costs in Bangladesh are still among the cheapest in this region. Pakistan may be at the similar level, but its safety and security issues are a big concern to many international producers. Not surprisingly, Bangladesh is the world's second-largest ready-made garments exporter after China. The industry contributes significantly to the GDP and employs about 4.1 million people. With China's labor costs rising, Bangladesh has become increasingly more attractive to global apparel



Source: CIA Factbook

manufacturers. The country grows at about 6% annually with an inflation rate of 6.3%. One would assume this is an economy set to take off; unfortunately, there have always been political and regulatory obstacles. This time is no exception.

A few weeks before my trip, I was warned by the local broker that all my meetings would have to be constrained to the Gulshan district due to safety concerns as a result of the widespread violence across Bangladesh stirred up by the opposition party – the Bangladesh Nationalist Party (BNP). The BNP started an extended campaign of social unrest following the anniversary of last year’s disputed election. Transport blockade and national strike were called across the country.



http://www.bpedia.org/maps/MD_0145E.GIF

The problem is deeply rooted and there is no easy solution. Bangladesh suffers from a dysfunctional two-party system. For years, the two parties have alternated in office. As much as it looks like a democratic system, the reality is it is a political system where winner takes all. At this point, most BNP leaders are imprisoned, exiled or in hiding. The incumbent party – the Awami League - has done everything to secure its power and make it impossible for the BNP to replace it. We are looking at a situation now where one party has everything to lose while the other has nothing to lose. Perhaps one of the management teams I met in Bangladesh summed it up best: “Democracy has come to us a bit earlier than we can accept it.”

Sadly, the battle between the two parties is at a great cost to the country. According to Stratfor, the economic cost of the unrest could be around \$10 billion. Bear in mind, the country’s GDP is only about \$150 billion. GDP growth for 2015 was cut from 6.3% to 6% by the IMF. The industries hit the hardest are retail, distribution and agriculture. The negative impact will likely spill over to the banking sector as credit quality will deteriorate. During my meetings, all the management teams shared concerns over the political instability. Meanwhile, they all showed confidence about surviving the difficulties. Indeed, the business sector has demonstrated some resilience to politically-led economic disruption in the past. However, as the stand-off drags on, the business environment is only going to become tougher and tougher. The MSCI Bangladesh Index has declined by about 8.5% YTD. Average daily volume was down 40% YoY since the blockade started (according to Exotix 3/11/15).



Source: FMAM, FactSet



Ice cream from Golden Harvest

Thanks to the blockade (ironically), traffic had never been easier in Dhaka. I was able to do 12 meetings in 2 days, compared to 3 meetings in 1 day on my last visit. There was a good variety of industries: banking, food, textile, cement, telecom, and energy. With everything going on in this country, the stocks are surprisingly not cheap, especially in the consumer sector. As a result, I didn't find interesting new ideas on this trip. At this point, we are closely following the macro development in the country, market valuations, and our holdings.



Sri Lanka

The last time I was in Sri Lanka was at the end of 2010, not long after the country's civil war ended. The country was full of optimism. The then president –Mahinda Rajapaksa - was praised for his effort to end the war and his policies to develop the economy. The stock market went up by 96% in 2010. Fast forward four years to Sri Lanka's election on January 8, 2015: to everyone's surprise, Maithripala Sirisena who used to be the Minister of Health and General Secretary of Rajapaksa's administration was chosen to be the opposition's common candidate and won. Shortly after his victory, there was a one-off 25% "super gain" tax announced on companies with profit before tax over LKR2 billion. There were also concerns that the new government would not be very friendly to China, a key foreign direct investor in Sri Lanka. The market didn't take either of these developments very well.



Source: CIA Factbook

Five weeks after the election result was announced, I arrived in Colombo with questions and concerns surrounding potential policy changes. To my surprise, the election result is actually being viewed quite positively by people both domestically and internationally. Markets have rebounded and stabilized following an initial sell-off. Although there is a certain degree of uncertainty on economic policies going forward, the new president appears to be moving the country along the path of transparency and democracy.

I think we should give credit to former President Rajapaksa for bringing an end to the almost 30 years of conflict in the country. However, during his presidency, he vastly over-expanded his powers. For example, one of former president Rajapaksa's brothers was the Minister of Defense, another was the Minister of Economic Development, and a third was the Speaker of the Parliament. Additionally, he amended the constitution to abolish the term limits for the president. The system had endorsed nepotism. With the new president in the office, we expect to see a more balanced approach towards foreign policies and reforms for anti-corruption and better governance. The two issues that have been discussed and debated the most are:

1. Constitutional reforms to scale back the president's power and create better governance: A.) Reinstating a parliamentary system of government. B.) Reintroducing the two-term limit on presidency. C.) Establishing independent commissions and institutions such as Elections, Public Services, Police, Audit Service, Human rights, Investigate Allegations of Bribery and Corruption, Finance, etc. D.) Ensuring people's right to information. These reforms will lead Sri Lanka to a better political culture. However, we have to keep an eye on the actual implementation.
2. The prior government developed a very close relationship with China. It received significant financial support and infrastructure financing from China. These projects include an airport, a port at Hambantota, a coal power plant, a port city and more. On the one hand, these investments helped with the improvement of the infrastructure of the country and boosted economic growth. On the other hand, the procurement process has not been transparent. There were allegations that the former government awarded non-bid contracts and paid inflated prices. The new government is interested in more transparent procedures and opening up its markets to more diversified investors, such as India and Malaysia. It is reviewing all investment projects signed by the former government. As a result, lots of Chinese-backed projects are on hold. One example is the \$1.4 billion port city project. I believe the new government is committed to reducing corruption and building interest from the other foreign investors. Meanwhile, I think the government is pragmatic and will continue to want to maintain a good relationship with China. It appears that the investigations against corrupted practices are mostly focusing on the project contractors.

The road to a true democracy and a balanced foreign policy will be bumpy. The process can be slow, just like the resolution of the previous war. The government's populist policies can be obstacles to economic development. According to IMF, the country's GDP growth is expected to slow from 7.4% in 2014 to 6.5% in 2015 due to budget cut, slowing construction activity and uncertain policy environment. I expect short-term uncertainties. However, I am cautiously optimistic from a long-term perspective.



Elephant resting in water in Sigiriya



I think Sri Lanka is heading in the right direction. The strengthening of the rule of law and cutting corruption will gain more confidence from investors and attract more investment. The populist policies, to some extent, will increase domestic consumption. We are hoping to see more private investments, compared to the pure public-investment-driven economy of the past. Tourism still has lots of potential, but Sri Lanka needs better infrastructure in place. The country targets two million tourists in 2015 and 2.5 million by 2016.

I met 12 companies in two days. Most of the management teams are very impressive with good knowledge of their businesses. The banking sector expects a pick-up in private activities and has mostly reduced its exposure to gold pawning loans. As is common in Asia, many

companies in Sri Lanka tend to expand their businesses and become conglomerates. The management likes this strategy, because they think "diversification is to protect them from the ups and downs of the business world." What we found is often a lack of focus and poor use of capital. However, if you look around, you can find conglomerates that are streamlining business operations to focus on specific economic sectors. Overall, I am confident our holdings reflect some of the best business practices in Sri Lanka.

Overall, it was a very productive trip, and most of my meetings were impressive and informative. As fundamental stock pickers, I am pleased to see that most of the management teams are competent and the businesses are solid. However, I have to admit that these two countries are currently overwhelmed by political uncertainties, particularly in Bangladesh. The business environment in Bangladesh is very challenging, while Sri Lanka seems to be heading in the right direction, but with risks of slower-than-expected implementation or setbacks. We continue to closely monitor the developments in both markets.

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