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Opalesque Roundtable Series '14

RUSSIA

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Editor's Note

"There is not much correlation between FT headlines and returns you get on the ground in Russia"

Russia is a very large market, with a population of over 143 million people. It is the ninth largest consumer market in the world, and by 2020 it will be first in Europe and the fourth largest in the world. On the investment side, performance of Central and Eastern Europe (CEE) and Russia funds have beaten other emerging markets, developed markets and the S&P 500 according to statistics from EMPEA and Cambridge Associates.

However, given the recent developments, Russia is definitely not the first choice for conservative global investors today. Increased uncertainty and political risk make Russian markets unattractive, but on the flip side those factors bring opportunities for hedge fund managers who are able to take advantage of volatility, and long term investors. The country is in a contradictory environment where people who were invested in Russia for years are getting out, and some new investors are trying to put fresh capital to work following the classic mantra of buying when there is blood on the streets, looking for liquid and high-yield assets. Russia has become rather heavily undervalued - as it has been for years - but now "it's really screaming". But, the future returns and future of the financial markets as a whole depend very much on politics. Still, this doesn't keep large pools of assets, some of them family offices with a couple of hundred million dollars from around the globe, including America and Asia, taking on a contrarian view and go bottom fishing in Russia. Capital is very scarce, so they face much less competition and many choices.

Russia and Alternative Investments: Unlocking domestic capital

The current regulation does not allow local institutions such as insurance companies or pension funds to invest directly in hedge funds or alternative investments, including private equity. The main audience for hedge funds in Russia are qualified high-net-worth individuals and family offices. And it looks like these investors' perception about alternative investments is changing.

The days when long-only was the winning strategy in the Russian market are over. Historically, Russian investors associated actively managed strategies with enormous returns and excessive risk. Today the most sophisticated investors and their advisors consider alternative investments a source of diversification and portfolio risk reduction. They are also becoming more realistic about returns.

If we look for example at the U.S., the private equity industry only took off when the required legislation was introduced in the 70's. With Western Capital becoming more scarce, Russia is taking the first steps to upgrade their market structure. Of course, this is a long term game, and it has to start with education. In September, leading local GPs established the Russian Private Equity Council with an industry-wide initiative to lobby for legislation to unlock local institutional LP money, to enable it to participate in private equity, real estate and other alternative asset classes. In the current environment, when many Western investors are leaving the market, this is becoming more important than ever.

On the private side, 85% or 90% of private banking assets in the U.S. for example are invested into some form of liquid securities, while that percentage in Russia is maybe 5% or 10% maximum. The growth potential is staggering.

Surge in educational initiatives

September 2014 marked the 20th anniversary of Private Equity in Russia. At the VI Russian Private Equity Congress, most of the market players announced their plans to continue investing in line with their strategies. The National Alternative Investment Management Association (NAIMA), a non-profit partnership representing alternative investment firms and service providers committed to the growth of long-term capital in Russia. has teamed up with Moscow School of Management SKOLKOVO and launched an inaugural Private Equity and Venture Capital course for Executive MBA students and alumni led by Columbia Business School Professor Laura Resnikoff. Other initiatives are the Venture Academy with Lawrence Wright, or the Moscow Hedge Fund Managers Club, a professional association aimed to bring global industry standards to local hedge fund community, communicate hedge fund concepts to local investors and facilitate local industry development. The CAIA Association is also active in Moscow and offers certification exams.

The Opalesque 2014 Russia Roundtable took place September 22nd in Moscow with:

1. Stephen Lewis, Director of European Business Development, Maples Funds Services
2. Alexei Klaptsov, Director, SPRING Group
4. Christian Putz, Portfolio Manager, Kazimir Partners
5. Dmitry Malykhin, Chief Investment Adviser, Da Vinci CIS Opportunities Fund
6. Dmitry Schuetzle, Managing Director, VIY Management
7. Gregory Klumov, Portfolio Manager, SBD Global

8. Nadya Nesterova, Head of Investor Relations, VIY Management, Co-Head of Information Policy & Market Statistics committee, National Alternative Investment Management Association (NAIMA)
9. Olga Kokareva, Advisory Board Member, Moscow Hedge Fund Managers Club

The group also discussed:

* What are some of the recommended ways to invest in Russia?
* How has corporate governance developed since 2008?
* What new products are Russia-based managers working on?
* Opportunities in Russian CDS, fixed income, and currency: Ruble one of the most attractive carry currencies

Enjoy!

Matthias Knab
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Participant Profiles

(LEFT TO RIGHT)

Christian Putz, Olga Kokareva, Dmitry Schuetzle, Nadya Nesterova, Matthias Knab

Dmitry Malykhin, Stephen Lewis, Gregory Klumov

Missing on group photo: Alexey Klaptsov

Introduction

Dmitry Malykhin
DV Advisers

My name is Dmitry Malykhin, I represent a company called DV Advisers. We advise on one single hedge fund, which is called Da Vinci CIS Opportunities Fund.

Nadya Nesterova
VIY Management (VIYM)

My name is Nadya Nesterova. I am Head of Investor Relations with VIY Management (VIYM), an independent partnership dedicated solely to private equity services for international investors with private equity growth capital and real estate investment strategies in Greater Europe, with a focus on the emerging economies of Russia and other CIS markets. We are headquartered in London, with offices in Luxembourg, Moscow and St. Petersburg. Our funds are domiciled in Luxembourg and their underlying investments and co-investment platforms are represented by 15+ projects in such countries as Austria, Italy, Switzerland and the most economically vibrant Russian regions from Kaliningrad to Vladivostok.

I am also co-head of the Information Policy & Market Statistics committee with National Alternative Investment Management Association (NAIMA), a non-profit partnership representing alternative investment firms and service providers committed to the growth of long-term capital in Russia. Our flagship project is an industry-wide effort aimed at: raising awareness for Private Equity and other alternative investments among asset allocators, regulators and entrepreneurs; creating a more favorable legal environment for direct investments; promoting Russian private equity in the global LP/GP community; and also setting professional standards for the further development of this market.

Olga Kokareva
Moscow Hedge Fund Managers Club

My name is Olga Kokareva. I am a member of advisory board of Moscow Hedge Fund Managers Club, a professional association aimed to bring global industry standards to the local hedge fund community, communicate hedge fund concepts to local investors and facilitate local industry development.

I am also a member of Charter Alternative Investment Analyst (CAIA) Association and I lead-manage alternative investment education initiative organized by National Alternative Investment Management Association (NAIMA) and Moscow Hedge Fund Managers Club (MHFMC) in collaboration with CAIA Association.

Dmitry Schuetzle
VIY Management (VIYM)

My name is Dmitry Schuetzle. I am Managing Director at VIYM and our scope of activities has been briefly outlined by Nadya, therefore I'll just share a few words on my background with the firm.

I have particular expertise in finance, industrial production and retail. Currently the portfolios of VIY Growth and VIY Greater Europe Hospitality funds, which have co-investment platforms, have more than USD 500 million assets under management. I also serve on the Boards of two of our portfolio companies - Syktyvkar Tissue Group and SPZ Group, representing the interests of VIYM investors.

Prior to joining VIYM, I served as an asset manager in the Financial Corporation URALSIB where I had broad responsibility for a diversified portfolio of more than USD1 billion in AUM. Before that I was the General Director of URALSIB Leasing Company and also held several other senior management positions for such companies as Dialog Optim Bank and Rossiyskiy Credit Bank. I also served as Chairman of the Board of Directors for the National Factoring Company and of the Deshoulieres Group, and in addition I was a member of the Board of Directors of the Imperial Porcelain Plant.

Alexey Klaptsov
Specialised Research and Investment Group (SPRING)

My name is Alexei Klaptsov from Specialised Research and Investment Group, also known as SPRING. The firm was established in 2004, so ten years ago. We manage various funds which invest in publicly-traded companies and in private companies as well. Currently we have about US$ 500 million under management, and I am a portfolio manager of this company.

Christian Putz
Kazimir Partners

My name is Christian Putz. I am a long/short equity portfolio manager working for Kazimir Partners. The company was founded in 2002 and the long/short equity fund has one of the longest and best track records in Russia. In the past years Kazimir Partners launched a total return bond fund and acquired a major international asset manager. Currently our AuM are approximately one billion USD and the offered investment products range from Russia to Eastern Europe, frontier markets, Nigeria, Sub-Saharan equity funds.

I am originally from Austria and I moved to Russia in 2009. Before that, I was working for Man Investments in Switzerland and London. Currently my focus is on developing a global long/short hedge fund product. Better investment opportunities can be exploited with a broader geographic mandate and investors' interest in Russia-focused products is subdued.

Stephen Lewis
European Business Development for Maples Fund Services

Stephen Lewis, Director of European Business Development for Maples Fund Services, which is a part of the Maples group and includes Maples and Calder, the world's largest offshore law firm.

We also have a fiduciary arm, Maples Fiduciary, which provides directorships and corporate secretarial services.

As mentioned, I work for Maples Fund Services, our fund administration business line, which is celebrating its 10 year anniversary next year. Since commencing operations in 2005, we now have offices in nine key financial locations including Boston, the Cayman Islands, Dublin, Dubai, Hong Kong, Luxembourg, New York, Montreal and Singapore.

Gregory Klumov
SBD Global Fund

My name is Gregory Klumov. I manage portfolio for SBD Global Fund, which is a captive hedge fund, with an absolute return mandate. We invest across different strategies; long/short equity, derivatives, private equity, and venture capital.

We also have a fund of global hedge funds product. We don't invest in Russia but rather aim to diversify for our shareholders out of Russia. Before my current role, I managed a portfolio for Everest Asset Management, which was a long/short global emerging markets hedge fund.

Matthias Knab What is the situation you are currently facing as Russia based alternative investment managers or investors? Also, can you share with us what your own clients, so the end investors, are doing?

Gregory Klumov: Unfortunately, the local investors are very pessimistic about us, the alternative investment providers. The reason is that 90% of the industry has had negative track records for the last couple years, primarily because most of the funds were focused on the local stock market. The result is that the most popular "alternatives" products here are dollar denominated capital protected notes, issued by state-owned banks and real estate, sometimes levered.

A new demand trend that has picked up recently lies in a traditional asset – Fixed Income. The whole asset class experienced a sell off after the political events we witnessed, so a lot of private banks are pushing clients to replace CDs with Eurobonds issued by the same institution, because the yield on the latter is higher, plus they are liquid.

While for the more risky assets, investors prefer structured notes, where principal loss is limited to 0-10% (zero coupon bonds, for example) with the cashflow stream invested into call options on assets like U.S. stock indices, gold or some ETF.

If we zoom out the most recent trends of last few years, we'll see that local investors are actually just waking up to the alternatives asset class. I can think of several reasons to explain the gap. First, the private equity business was generating healthy double digit returns for the last 10-15 years and most of the capital owners were reinvesting their profits.

Second, there is a big gap in financial education across the country as everybody was going through, literally, battlefield experience learning finance and capital markets here in Russia. And last but not the least, legal framework and infrastructure was not ready to securitize assets and protect investors in the way it is happening in some other emerging markets, saying nothing about the developed ones. If you look at the US, for example, 85% or 90% of private banking assets are invested into some form of securities, while this percentage in Russia is maybe 5% or 10% at maximum. So while we definitely have very low base to grow from, there are still a lot of obstacles for the industry to take off.

Nadya Nesterova: We are in the long-term asset class, private equity and real estate, therefore our investor base is more fundamental value driven and dedicated to our investment strategies and markets.

As for our PE allocation to the selected emerging economies of Eastern Europe, and Russia in particular, there are of course not too many new investors these days on the market. We currently work mostly with those international investors who have already gained positive co-investment experience with us in various geographies, some of whom have been with us since our first generation of Luxembourg-based funds.

Here we are talking primarily about capital preservation and value creation for the long-term lock-up period, and our investors are more focused on fundamentals with a ten-year horizon and longer. That said, we can look at secondary opportunities and shorter co-investment periods on a deal-by-deal basis. If we look at the performance of the market on a 10-year basis, returns for CEE and Russia funds have beaten other emerging markets, developed markets and the S&P 500 according to statistics from EMPEA and Cambridge Associates. And if we look at EBRD, the European Bank for Reconstruction and Development, they have been very active in Russia for the last decade irrespective of the economic turmoil, and they have supported a lot of Russia-focused GPs, first-time funds and direct investments. They have also tended to consider Russia to be one of the worst perceived and best performing markets, although the current political crisis is forcing them to take a step back from the market for now.

We have seen some headlines in the press about large players such as Blackstone leaving the Russian market. But while for the second consecutive year non-BRIC markets remain the most popular, our seemingly out-of-favor economies, including Russia, can still present positive investment opportunities for LPs with a contrarian view. You have VIYM as a mid-market player with a dedicated international investor base, as well as such peers as BVCP, Russia Partners and Elbrus, who have also raised new funds in the last couple of years. We all still have considerable dry powder to invest and the timing seems to be right, with entry valuations continuing to fall still today.

Last week we celebrated the 20th anniversary of PE in Russia at the VI Russian Private Equity Congress and most of the market players announced their plans to continue investing in line with their strategies. VIYM also continues to invest via funds and co-investment platforms.

To give you some recent examples, last month we announced an investment into French Kiss, a leading producer and distributor in Russia's fast-growing premium chocolate and confectionary market, in order to finance the company's investment program up to 2017. The Company has 15 boutique stores in Moscow, and 18 franchises in key regions across Russia. Our Family Doctor medical services company opened its fourth clinic in Moscow last month and we'll finance their further investment program through 2018. Our Syktyvkar Tissue Group (STG) investment project represents one of the largest paper tissue manufacturers in Russia and the CIS, ranks first in Russian base paper production with a 15% market share and is rated among the top-3 Russian tissue product manufacturers with a 7% market share. Last Friday STG launched a new, technologically-advanced production unit in the Yaroslavl region, with the unit meeting the best international standards. This new production facility represents the largest investment project envisaged in STG's development strategy to 2015. The total investment in this facility is estimated at some USD 100 million and it was completed within just two years from our entry in September 2012.

But of course in the mid-term the situation is a bit more complicated on the LP side and some of the leading internationals, who advise the largest pension funds in Europe or the US, or who even joined our advisory board of the National Alternative Investment Management Association a couple of years ago such as AlpInvest or Adams Street Partners. They do have to admit that due to the current political situation, it has become more difficult for them to make any new investments with new GPs. And in some cases, such as with the EBRD, it has become impossible to consider new investments at this time.

So, we know that some players have been forced to leave the market or limit themselves to prior commitments. But for the dedicated investors with a contrarian view, now is the ideal time to be investing.

Dmitry Schuetzle: The last six months in Russia have been turbulent, however not so much from an economic perspective but rather from a political perspective. For private equity, for example, the past six months have not had much of an impact. It's not enough time to feel impact, given that we pursue long-term strategies and the investment process alone can take several months to execute. So for us, the market fundamentals don't look bad at all, which is why we continue active deal sourcing and are pleased that we have enough funds to continue investing for the next couple of years. So now is a time of great opportunity for us, not least because we don't seem to have so many competitors these days.

Christian Putz Dima, for the private equity deals do you only provide equity or do you as well help in getting financing deals from banks etc.?

Dmitry Schuetzle We provide equity financing, but usually in some of the larger deals we can attract not only a co-investor but a financial partner, typically a local bank, which provides debt financing.

Nadya already mentioned that just last Friday one of our investee companies, a leading tissue paper production company in Russia and the CIS, launched a major new production facility, effectively increasing the company's total production capacity by more than 50%. The investment size was around USD 100 million, which is much higher than our average ticket size, which typically ranges from around USD 5-15 million per deal. In such cases we work closely with like-minded local debt providers.

Christian Putz Can you explain how easy or difficult it is to get financing for private equity deals in the current economic environment.

Dmitry Schuetzle It's not that easy to say. In fact for the last few months, we haven't found it to be too difficult. Of course, the political situation could start to make things more challenging in the future, but for now the main thing that we are seeing is an increase in interest rates. And looking ahead, I have a hard time seeing debt finance in Russia drying up completely regardless of the political situation.

Alexey Klaptsov What sectors do you invest?

Dmitry Schuetzle We invest in different sectors. We have a very strong track record of investing in hospitality real estate. For example we helped to bring the iconic Four Seasons brand to Russia. We are also investing actively in mid-market hotels across Russia. And we have hotels with the leading local and international brands in Austria, in Davos, in Umbria and so on.

Our other strategy is private equity growth capital investments. through investments like the tissue producer we mentioned. We have also invested in a rice producer here in Russia, in a chain of private healthcare clinics, and a leading premium chocolate producer. Currently, we have more than 15 projects in our portfolios.

Nadya Nesterova: Regarding debt availability on the market, most of our projects involve secured debt financing. In Russia we work with the largest state banks such as Sberbank and VTB as well as private banks such as Uralsib and Bank of Moscow. In Western Europe we work with Raiffeisen, Commerzbank, and we are also seeing interest from various Chinese institutions to step in as debt providers on our markets, including some state-owned giants with a mandate to support outbound investments, such as Sino Sure.

So we might see some debt and equity financing substitution from Asia, initially through public-private partnerships, but then in the private segment as well.

Olga Kokareva: From the hedge funds perspective, the investors landscape in Russia is slightly different than that for private equity. The current regulation does not allow local institutions such as insurance companies or pension funds to invest directly in hedge funds. The main audience for hedge funds here are qualified high-net-worth individuals and family offices. And it looks like these investors' perception about alternative investments is changing.

The days when long-only was the winning strategy in the Russian market are over. Recent political and economic developments made Russian investors rethink the concept of risk. Even fixed-income instruments or government-related banks deposits are not considered completely safe investments anymore. Now, more investors actually started

to ask themselves, *"What happens if?"*

Historically Russian investors associated actively managed strategies with enormous returns and excessive risk. Today the most sophisticated investors and their advisors consider alternative investments a source of diversification and portfolio risk reduction. They are also becoming more realistic about returns.

Of course, those investors are still very few in total, and therefore the demand is far from optimal. But we see increasing interest in education, investors want to know more about opportunities in alternative investment space.

That said, Russian private investors tend to invest in what they can understand and trust. They realize that apart from market risk with alternative investments they should also care about operational, liquidity and strategy complexity risks.

Stephen Lewis: I just want to add an optimistic note because we have a more global view in terms of our investors and external investors' perceptions on this particular market. Earlier in the year, non-Russian investors took the view that the market was going to be tough when the Crimean issues arose. We have seen a fall in the AUM of several funds, but the market has recovered and is nearly at the level it was prior to the market downturn. The redemptions and recovery were primarily in funds with external investors.

We have also seen an increase in the number of new Russian funds, asset classes and structures. This growth has been fueled by Russian investors looking to diversify their portfolio and spread their risk. We administer a variety of Cayman structures and have seen a great deal of interest in Irish structures. The asset classes range from the traditional global equity and fixed income, through real assets, private equity and real estate, to various hedge fund strategies.

Matthias Knab Let's add more color and details regarding the respective environments of your individual strategies. For example, Dmitry can you share with us what you see in the CIS region?

Dmitry Malykhin: As you said, our fund has in it CIS abbreviation but the CIS markets other than Russia are really, really pretty small. Luckily, we didn't invest in Ukraine much. That's good.

I think that what we saw this year happening in Russia, we can add CIS to that story, also because Russia has a quite lot influence over CIS as you may guess. So we have seen that the future returns and future of the financial markets as a whole depends very much on politics. While this may sound like very banal, nevertheless it's really true and what we experience.

Just after Crimea, just about one month after that in April or May when we saw some steps of Mr. Putin towards the West, a lot of people had also just started to look for Russian assets. They were asking whether it's a good time to invest or not, because Russia is now rather heavily undervalued - as it has been for years - but now it's really screaming. Just about two months after that, after the final round or the western sanctions and after very recent "Sistema" affair, which is still developing, I think this is just another sign how much the markets depend on politics.

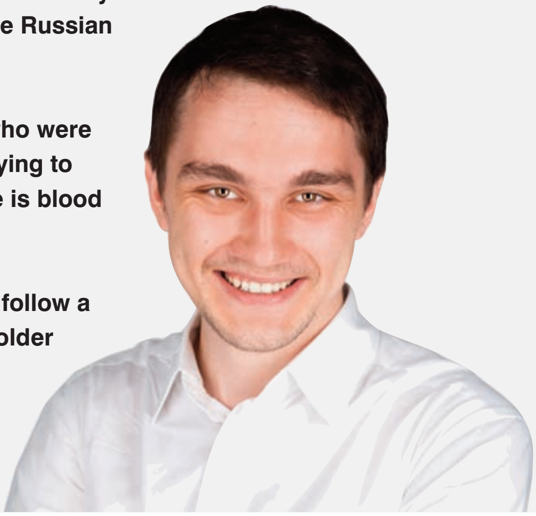
So probably we and the investors have to just be prepared for what may come next, and is difficult to estimate. If the situation turns, if we see some indications for that, we will have a great time to invest.

Now, I looked at the transcript of the Opalesque Russia Roundtable from 2008, and there were a lot of bulls there and I remember myself being one in November 2008. Our timing and our positions were right then, but for now, I am not sure - we may have this situation for years. But maybe now it will turn around quickly, but we should be prepared for both scenarios.

Gregory Klumov: We also see that some investors are trying to bottom fish in Russia.

Over the last few years, I have been doing some extensive traveling, attending a number of hedge fund conferences looking for managers to invest into. I met a significant number of foreign family offices that approached me as a Russian individual asking for an efficient way to buy some Russian exposure. We were even thinking about creating an offshore product with local Russian treasury debt before it started clearing like corporate Eurobonds.

Those were fairly large pools of assets, family offices with a couple of hundred million dollars from around the globe including America and Asia. Obviously, they have never had invested in Russia, and now they feel valuations are attractive and want to put a couple of million dollars to work – maybe just 1% or 2% of their assets – in Russia. But as I said, that inflow is being negated by the outflow of people who were invested here for number of years. In some cases those investors have been exposed to Russia since the beginning of early 1990s, they were adding to their exposure in 2008, but then over the last couple of years they were bleeding out either in part of in whole, just because theycouldn't bear mark to market losses any more. If you talk to them, they will tell you they are fed up with the Russian government, inefficient legal system or the Russian corruption.



So in general we have a sort of contradictory environment where people who were invested in Russia for years are getting out and some new investors are trying to put fresh capital to work following the classic mantra of buying when there is blood on the streets and looking for liquid and high-yield assets here.

Again, I am kind of watching this from the outside, as for our own fund we follow a completely different strategy as we strive to basically diversify our shareholder out of Russia by investing in hedge funds, private and public equity companies in the U.S. and Europe. However, we also have a separate team that manages our Russian exposure. They invest in second and third-tier companies for the dividend streams.

Matthias Knab What do you recommend those family offices that are looking at Russia now?

Gregory Klumov: Russian treasury debt. It yields almost 10% now, in Rubles, is very liquid and undervalued versus other emerging markets debt.

Most of those family offices are pretty conservative, they wouldn't dig for some third-tier companies to put themselves at risk to deal with the company management, possibly facing corporate governance issues like Pharmstandard -

google it if you have not heard about it - where the shareholder extorted some assets out of the company, and minorities couldn't do a thing about it.

One famous hedge fund manager said that in emerging markets you have to invest in debt because this is something thats well-regarded and is usually paid off. With EM equity, particularly Russian SOEs, investors don't own the income statement but the balance sheet. The income statement is owned by government officials and oligarchs, who control the entity, while minorities just own the balance sheet and end up with restructured debt, at most, when s*** hits the fan.

Olga Kokareva: Russia is definitely not the first choice for conservative global investors today. Increased uncertainty and political risk make Russian market unattractive, but on the flip side those factors bring opportunities for hedge fund managers who are able to take advantage of volatility. There are less risk averse and more opportunistic investors out there and they might be willing to consider getting in the emerging market play beyond investment grade debt.

My advice to those investors would be to really focus on manager sourcing. Careful manager selection becomes much more important in today's environment than it was back in the mid 2000s.

The key is to find the manager who knows the local market, who is in a position to ensure downside protection and get out of risky exposure as quickly and efficiently as possible if something goes wrong. And also it's critical to explicitly understand how exactly the strategy works and more importantly in what circumstances it stops working.

Christian Putz: It is difficult to account for political uncertainties in a fundamental bottom-up investment approach. As a consequence, our firm, along with other Russian asset managers decided to go global and offer products with a broader geographic focus than just Russia or CIS.

This strategic change has been reinforced by the fact that global investors have subdued interest in Russia and local investors want to diversify away from Russia. And a global mandate allows me as a portfolio manager to find really great businesses which meet my investment criteria for the long book.

Coming back to the Russian stock market, it is hard to be bullish even if you disregard political uncertainties. Commodities play the crucial role, with approximately 60% of the Russian equity market being represented by oil and gas companies. In simple terms the underlying drivers for oil and gas companies are the oil price, production growth and the lifting costs. All of them do not look great. If you take a one or two year view, the risk/return characteristics for the Russian oil and gas sector are unattractive. The oil price will probably stay at the current levels or maybe decrease given the shale oil boom and low global economic growth. Production growth is almost non-existent and can even turn negative due to the recent sanctions. In short there is no significant growth driver, while the production and lifting costs are increasing. The weak Ruble is only partly offsetting those increasing costs. Hence the low valuations reflect unattractive fundamentals and not really buying opportunities.

Before the financial crisis in 2008 the fundamentals were quite different, with the oil price increasing from $30 to almost $150 and annual production growth reaching 10-20%, Russia offered significant growth.

Alexey Klaptsov: Right, if Russia is considered as a big oil company, yes, it is probably not the place to be in. But luckily, Russia has also other sectors which are not so connected to oil. The problem with Russia is that Russian GDP has been decelerating for the last three years. In my view, consumption is really the place to look at. That is also why investors try to invest in retail, in real estate, or in medical or health-related businesses that are all private as of now.

But we have come to the point where internal consumption cannot support GDP growth anymore, just because real income does not grow. The only thing which can boost GDP up is investment, and the big obstacle for that is cost of capital. In Russia, cost of capital is very, very high, it's more than 10%. Now, it is very difficult to find good projects which could be profitable if you have to borrow at 10%. It is impossible if you have to pay 15%. It means that Russia will not be successful if companies can only operate at this relatively high cost of capital. But if an investor is able to raise capital at relatively low levels, investments in Russia will work. So probably going forward, in Russia we will only see those investors who have an opportunity to secure capital, and all others will leave.

That's what we see. I don't know who raised the capital in publicly-traded companies this year - I think only a few firms, Russia-dedicated firms or funds. Probably many other companies have lost investors this year because of low GDP growth and the political tensions. But having said that, the best time to invest in Russia is when everybody is bearish. You should be quite brave to be in Russia.

Matthias Knab Specifically, what do you recommend?

Alexey Klaptsov: We recommend to invest in specific companies, we are not saying simply that someone should "go to Russia or to China". Effectively, you should invest in a specific person. A well-known example is Magnit, the Russian retailer set up by Sergey Galitsky. In case of private equity, you should also invest in specific projects. For example, we invest in Russian utility projects which in some cases can generate high return, but it's very, very specific and it's difficult to replicate. So it means that only highly dedicated investors are able to generate profit but other investors probably will be neutral in the best case.

Christian Putz: It is hard to sell the Russian equity market as a long-term investment case. No one will probably buy into an investment pitch which says, "You should invest in Russia because in 10 years there will be a great diversified economy, there will be safe regulation and your return on investment will be outstanding."

But I also think that there are different investment strategies, and in some cases the investment strategy of a Russia-focused manager has a very low correlation with the performance of the Russian equity market. For example, I am quite convinced that you can run certain trading and quant strategies in Russia and generate significant returns for your investors despite the Russian market being in a downward trend since March 2011.

Dmitry Schuetzle: **I think we shouldn't write off Russia completely. It is a very large market, with a population of over 143 million people. Russia is the ninth largest consumer market in the world, and by 2020 it will be first in Europe and the fourth largest in the world. I don't think investors can ignore those facts.**

So for private equity here in Russia, consumption is one of the main drivers. Otherwise you really need to find the right sector, for example in the current market environment you want to find non-cyclical industries which can be resilient even in challenging times. As an example, not a single one of our portfolio companies is performing badly this year, despite the general environment.

So, Russia is a very large market, but it's still an emerging market and therefore still offers a lot of opportunities, particularly for private equity.

Alexey Klaptsov Russia is still undeveloped, you can find lots of sectors where Russia is extremely inefficient and where investors can make money on this inefficiency. The problem is, as we pointed out, the cost of capital. As long as cost of capital is that high, it's very difficult to find projects that work at those levels. Any increase by 1% decrease the number of eligible projects significantly.

Dmitry Schuetzle You are right that in a market that is underdeveloped such as Russia, there is opportunity. In terms of capital, our experience is that if you look outside of Russia into the global economy, you see that there is still plenty of money looking for such opportunities. Eventually, the current troubles will come to an end and more of this money will find its way into Russia.

Stephen Lewis: **I agree Russia presents a multitude of private equity opportunities, although there are the attendant risks of investing in long–term assets.**

If there is one asset class where we have seen more funds established and growing levels of interest, it is in private equity over last 12-18 months. Much of that activity has been in the venture capital end of the market, although there seems to be growing interest in infrastructure projects and associated funds.

Nadya Nesterova: **May I add that this is getting more vital especially when there is the risk of Russia being isolated. Olga mentioned that we still lack domestic institutional money – local insurance companies and pension funds cannot invest into alternatives at all including private equity. If we look for example at the U.S., they introduced this legislation and unlocked institutional LP market back in the 70's which improved the regulatory environment and gave a boost to the private equity industry. Even a 5% allocation among pension funds can significantly improve the market.**

But we are making progress in Russia too. For instance last week, leading local GPs established the Russian Private Equity Council with an industry-wide initiative to lobby for legislation to unlock local institutional LP money, to enable it to participate in private equity, real estate and other alternative asset classes. In the current environment, when many Western investors are leaving the market, this is becoming more important than ever. Asia is still a bit hesitant and they don't have a comparable asset base like the West, although they have a strategic interest in some sectors in Russia. But it's going to take some time before Asia, and maybe the Middle East, become a meaningful source of capital for Russian companies. The substitution of Western capital won't happen quickly.

Matthias Knab Tell us more about the different stakeholders, the different asset pools you are trying to bring together for this initiative?

Nadya Nesterova: We are addressing public and private pension schemes and insurance companies. So for example, the National Alternative Investment Management Association ("NAIMA") via its Russian Private Equity Initiative has already arranged series of roundtables where we brought international and local players to exchange ideas on different types of asset allocations, and on the potential role of private equity, real estate and other alternatives as part of their diversification.

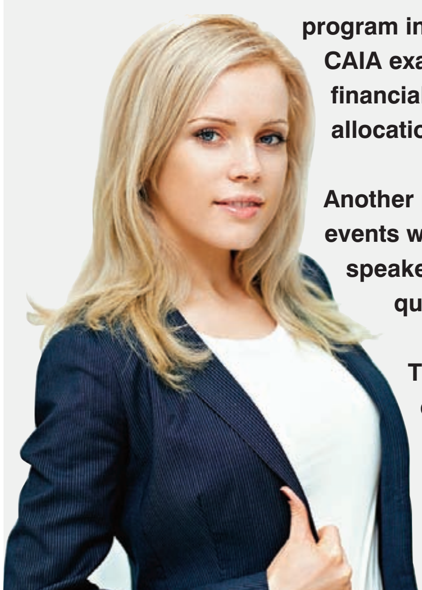
Although this will require a serious effort at both government and industry levels as it's not an easy task and there are no fast solutions.

Matthias Knab What is the level of education within that investor base? Is there an understanding about alternative investments strategies and asset classes? Where do you need to start this education?

Olga Kokareva: This is a great question because in fact, the lack of education and awareness is the main problem about internal demand for alternative investments in Russia. Even professional wealth advisors and institutional allocators' staff oftentimes do not possess sufficient knowledge in the area alternative investments to efficiently assist their clients in adding alternative exposure to the portfolio.

At the same time there are quite a few alternative investment teams in Moscow with focused expertise, globally recognized certifications, years of practical experience and global community exposure. And those are the best people to ask about alternatives.

So earlier this year NAIMA and Moscow Hedge Fund Manager Club have decided to join forces to create the industry initiative for raising awareness on alternatives among Russian financial community. This summer we have organized an event in collaboration with CAIA Association where we announced our plans to launch the first educational program in Moscow focusing entirely on alternative investments. The program may serve as CAIA exam preparation for Moscow based candidates, but its ultimate purpose will be to help financial professionals dive deeper in alternative investments to enhance their asset allocation skills.



Another project our associations are working on is the regular educational and networking events where alternative investment professionals get the opportunity to listen to guest speakers' presentations, discuss particular alternative strategies, learn new concepts, ask questions, argue and share ideas.

The more investors and advisors know about alternative investments, the more competitive the industry will become. It may sound counterintuitive but that is in the interests of market participants because alternative investments is a global industry, and there should not be an "emerging market naivety discount". Investors have to demand global quality services and transparency, and the local industry should only consist of talented managers who are able to compete on a global level.

Gregory Klumov: **Large macro funds all have sizable books of credit derivatives in Russia. Companies like Brevan Howard, Bridgewater, etc., all trade Russian credit-default swaps, Russian fixed income, and Russian currency. As a matter of fact, Ruble is one of the most attractive carry currencies adjusted by volatility and size of the market.**

Also, you can do arbitrage by buying government-issued Eurobond and sovereign CDS. This spread is around 150 basis points right now. One reason for that is that the local investors underestimate and don't understand the opportunities available in the derivatives and the global macro space while foreign investors are not hedging their books enough. Another reason is possibly that it is hard to open a true prime brokerage account with big global institution. You would need a very good track record of personnel and shareholders to establish this relationship in order to get access to cheap funding.

But once you have all that, you can get funding at maybe LIBOR plus 40, 50 basis points and then you could trade these Russia-exposed derivatives, the stuff that Russian people inside the country cannot do. As for the education, there are still big gaps as you mentioned in terms of understanding how financial markets work, even basics like what is equity, what is fixed income, what are credit derivative and things like that, but we are seeing some progress. I have another example of Russian education gap in alternatives. While I worked at Everest, I was raising money for a hedge fund that was trading global equities with a simple, fundamental value approach: define couple big trends, identify a basket of exposed global equities, analyze them to death and put capital to work. But people were not ready at all for global investing. They didn't understand the point why to buy, say American, Philippine or Indonesian equities, because local politicians announced on state TV that Gazprom will have market cap of 1 trillion dollars, so everybody was obsessed with that.

But now, having lost decent chunks of capital, people are looking at different asset classes, besides local equity market. They are learning their way through some press, journals and magazines. As a matter of fact, some private banks are expanding their product offerings in alternatives asset class to start educating clients how regular high net worth individual can diversify their portfolios out of Russian risk or at least add some uncorrelated performance components to it.

So, things are slowly progressing, and maybe it will take 10 to 20 years, and hopefully with the help of our government, it will be shorter. As a consequence of the current tensions and sanctions, there is also a certain rush of Russian capital flowing back to the domestic market which was previously was managed offshore. I think its safe to assume that a part of this capital is looking for attractive investment opportunities.

Stephen Lewis

Most of the education we see in the market is through the fund sales process. There are some very talented fund managers and sales people developing innovative products in the market and they are working hard to get their message across especially for some of the hedge fund strategies. Many of the investors that we meet are sophisticated and understand the risks and are looking for exposure to those risks, they are also well advised.

One question I have is on controlled foreign corporations (CFCs), what impact do you think this will have on Russian managers and investors?

Nadya Nesterova

So far, we haven't seen any impact on our operations. But we are paying close attention to this. The National Alternative Investment Management Association is preparing a consolidated industry view on this legislative initiative.

Also, as I mentioned, the creation of the Russian Private Equity Council was announced – an initiative to advocate for the interests of private equity as one of its primary purposes. The Council was initiated by 10 leading GPs on the market.

So we believe this will be an effective platform for NAIMA to be part of the discussion. We know that our fellow association members such as PWC as an example are already working with the government on this issue.

Nadya Nesterova: Coming back to the question of education. As Olga mentioned, we are bringing CAIA to Russia, which is an important development, not least with this year being the 20th anniversary of Russian Private Equity. And the Emerging Market Private Equity Association (EMPEA), celebrating its 10th anniversary, also plays an important role with their first visit to Russia this year.

In July 2012 NAIMA and Moscow School of Management SKOLKOVO launched an inaugural Private Equity and Venture Capital course for Executive MBA students and alumni led by Columbia Business School Professor Laura Resnikoff. In 2013 NAIMA continued the effort with two specialized courses: on Private Equity Growth Capital with Andreas Angelopoulos, Executive Director of Private Equity Institute from Oxford's SAID BS, and launched the Venture Academy with Lawrence Wright. Almost 100 professionals passed through the course in 2012 and 2013. We strive to bring the best lecturers from all over the world and "blend" it with practitioners from Russia's investment arena. Russian PE and advisory firms' executives from BVCP, iTech, VIYM, Baker Botts shared their experience. This year we have a top-ranked professional from Asia – Kwek Ping Yong (CEO, Inventis Investment Holdings). He is widely recognised for his track records globally as one of the pioneers in Private Equity investment in China.

This initiative will grow at a later stage in the creation of the PE Center as a multi-disciplinary research and education platform specializing in the study of private equity and venture capital in Russia.

Lack of reliable qualitative and quantitative data represents a critical impediment for development of the Russian alternative investment industry. In association with Thomson Reuters, NAIMA plans to launch the first industry survey focused on performance measurement. This will allow Russian GPs benchmark their returns against peers and significantly contribute to increasing transparency of the market. In addition to that the Association will create a database of local institutional investors tracking their deal and fund activity. Leveraging on its close relationships with international media groups, investment consultants and associations, NAIMA will act as a principal information interface between local firms and global markets.

Matthias Knab You have a really great scheme worked out to help particularly the build out of the private equity industry in Russia. You mentioned transparency, and along with transparency, corporate governance is always important and a hot topic when it comes to emerging or underdeveloped markets. How did you see corporate governance developing since say our last Russia Roundtable in 2008?

Christian Putz: Well, I moved to Moscow in 2009, so I cannot really compare with the pre financial crisis period. But having the recent corporate governance incidents in mind, it is hard to talk about improving standards. Minority investors suffered severe losses.

Everyone associates Russia with corruption, but the reality is that there are many other emerging markets which have the same or even worse levels of corruption and corporate governance. Obviously this does not mean that one should not fight corruption in Russia or that corruption is not an issue in Russia. However, corruption is not just a Russia specific phenomenon but reality for countries which are at a certain development phase. As an investor in Russia, Brazil, China etc. you have to accept this reality and only invest if the expected returns are attractive enough taking low corporate governance standards into account.

Nadya Nesterova: If you look at the figures, Russia's business climate has made notable strides over the past year, climbing up 19 positions in the World Bank's Doing Business 2014 ranking. Russia keeps now the first place among BRIC countries, it is 4 places above China in the global list.

So it shows that considerable progress has been made. Of course one can't overlook the impact of the current political situation, and no doubt this has an effect on the perceived business climate. But if you get beyond the current politics, headlines and noise, you see that the underlying analysis and figures are positive, and significantly improved from where they have been previously.

Stephen Lewis

To attract foreign investment it is going to be necessary to accept the required levels of corporate governance. As other markets have matured, they have educated the managers and investors to the point where the use of a Board of Directors with the necessary independence has become the norm. Our clients here in Russia have certainly accepted that point putting the necessary boards in place with the appropriate documentation.

Dmitry Schuetzle: From our point of view we see a huge improvement in the corporate governance culture in Russia, because right now we can at least say that every entrepreneur we meet to talk on a potential deal has heard about the institute of a Board of Directors, and so on. Five years ago that would not have been the case. Now it's not a problem and every one of our shareholder agreements includes policies on BoDs and corporate governance more broadly. Today, all of our investee companies have properly functioning Boards of Directors.

Matthias Knab

Is this done via shareholder agreements or different share classes?

Nadya Nesterova

Shareholder agreements.

Matthias Knab

I wonder why? What is the benefit versus having different share classes? In the U.S., for example, it is more common to use different share classes to segregate different rights and aspects.

Dmitry Schuetzle

From our point of view, shareholder agreements are more common and easier. You are right with your observation regarding the U.S., because there they often do different capital raising rounds, but typically it's much simpler in our deals where there is basically one main founder, the entrepreneur, and VIYM representing financial investors.

Alexey Klaptsov: Coming back to corporate governance, I would think that corporate governance in Russia actually became better, much better than it used to be in 2009 or 2010.

Let me give you two examples. The TNK-BP case actually questions corporate governance in British Petroleum, because you know that Rosneft was not obligated to buy out, but it would be obligated if TNK-BP did not vote for loans given to Rosneft, and Rosneft would have to vote for these loans. So it's more a question to BP rather than to Rosneft in this particular case. In my view, the real question here is if British companies have good corporate governance?

If you look at Protek as a second example, I think this is a totally different story, because Protek and Russian Sea, these two companies actually misled investors, and that was why they declined significantly. I believe that happened in 2010.

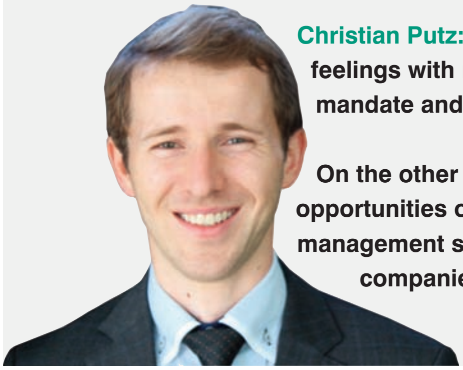
Last year we had an absolutely different situation with Tinkoff when the main shareholder provided full information and he did not mislead investors, but investors made up a story and they invested in the company, which was different than it is.

Christian Putz: I agree that TCS is a different story but I would not say that that investors made up a story. The story was heavily pushed by the sell side and some of the brokerage firms might have had a certain conflict of interest given that they had private equity investments in TCS.

Alexey Klaptsov: Right, but still, while the situation is not pleasant, it's much better than in 2010.

And also, what I would like to mention is that the current market is different than it used to be, because Russia has a problem with capital during last three or four years. As a result, now it's clear that we have different types of companies in Russia: some which are traded at very high valuations and others which nobody wants to buy. That situation has been forcing the majority shareholders to the conclusion: if they would like to see a high valuation, they have to be more pleasant to minority shareholders.

Almost all companies started paying dividends, whereas five years ago, before crisis, Russian companies tended not to pay dividends. Now, even companies in a high growth mode like Magnit are paying some dividends because they understand that investors would like to see dividends. They would like to see a simple story, transparency, a good cash flow, and with that a good performance, which is a big step forward compared to where things were a few years ago.



Christian Putz: As a general remark I would like say that most investors probably have bad feelings with respect to Russian corporate governance given that they have a long only mandate and might have incurred significant losses.

On the other side, for a long/short fund manager, bad corporate governance can offer great opportunities on the short side. Is there a better short than a badly managed company, with management stealing assets, especially in this environment where the economy is slowing and companies with high debt levels have issues refinancing their debt?

Dmitry Malykhin: I am not that sure that corporate governance has improved much since 2008. In my opinion, it hasn't.

Second, when it comes to companies starting to pay dividends, you could also argue that maybe the majority owners of these companies are afraid and now try go get some money out of the company and replace that with say debt finance, if they can. So, I think we have to look at this phenomenon case by case, and I am not sure that the big

dividends, which in fact got bigger for some of the private companies, can generally be seen as a sign of significantly better corporate governance.

Third, I would like to look at the bigger picture, and the bigger picture or the deeper question is why should corporate governance should get better at all? Before the very recent events, we would have said "because we want more people to invest and do well in the markets", but let me also point her to the famous huge poster on the wall of a house somewhere in the center of Moscow that said "there are things more important than the stock market", you get my point?
I am not saying that something which happened yesterday will have a profound effect in the 10 years going forward, but view this as a negative process which started, I don't know when, maybe in 2011... And as a result, the process of improving corporate governance, improving substance of the stock market, requires more than technicalities. In my view, the very substance of the corporate governance has no stimulus to evolve, except for several companies.

Alexey Klaptsov Can you explain further what you mean by "substance" in that respect?

Dmitry Malykhin: That means for example having the right Board of Directors' protocols. Let me give you an example with Rosneft. Maybe they did everything according to the legal requirements, but they still may not have followed good corporate governance. Following a good corporate governance not just by form, but by the substance, would have meant in Rosneft's case to buy out minorities at a fair price, which would have been about two times higher than what it was.

Alexey Klaptsov At the end of the day, even in Western countries, we know that people follow rules for various different reasons and one of those reasons is law. If they can be punished, they will try to avoid to break law.

I have been on the market for nine years now, and again, because in the current environment it is so hard to get capital, people have to play fairly, because if you don't, you tend to become bankrupt or you got in trouble and got caught by Interpol.

Christian Putz I think all of us have different examples of bad corporate governance in mind. We need to differentiate incidents which involve private company owners versus those where you are dealing with state companies. It obviously might be difficult to enforce your rights with the latter.

Alexey Klaptsov: The best company from the perspective of a Western investor is privately owned, so no state-controlled company, where you deal with one majority shareholder who meets with people, ideally he also acts as a manager to the company, a company with a good story and which at some point will start paying dividends. If it's a state controlled company, I can see some international investors do not want to invest.

But coming back to Rosneft for a moment, which is a good example, but we should also acknowledge that Rosneft could in fact do what they did because it was allowed by a Western Company called BP. It was actually BP who wanted to get a good price, in the end BP did not play a fair game.

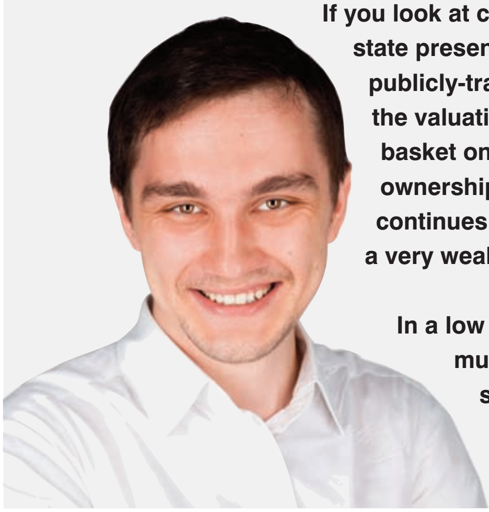
Christian Putz I suppose, this is what Dmitry Malykhin meant with form versus substance.

Alexey Klaptsov Correct, and what I find really awful here is that in fact a Western Company behaved like this, showing the worst corporate governance.

Christian Putz I think this is getting quite philosophical. Both cases are not very good, right? So justifying bad corporate governance by saying another side has bad corporate governance as well is probably not helpful.

Let's keep in mind that we are having this discussion because we are asking ourselves what should improve in Russia so that this country becomes more attractive for investors? Saying that BP is not better than Rosneft, will not increase Rosneft's attractiveness for investors.

Gregory Klumov: I will add to Christian's point. Bad governance, like corruption, is not just a Russian phenomenon, but a global issue.



If you look at countries that export energy, I believe that out of 22, 17 or 18 have significant state presence or state ownership in the sector. As a proxy for those, you can look at publicly-traded equities in China with and without state ownership, and you will see that the valuation gap has widened significantly in the last couple of years. Just make a basket on Bloomberg of state-owned enterprises in China and the ones without state ownership, both Hong Kong and A-shares. You will see how large that gap is and that it continues to widen. So this not just a Russian phenomenon, but a global phenomenon of a very weak economic recovery and slow GDP growth.

In a low growth environment, efficiency and growth is something that gets a premium multiple. If you are competitive and efficient, your valuation is higher. This, I suppose, is the primary reason for the multiple premiums, enjoyed by efficiently run, growing companies like Magnit, VIPShop and others.

Alexey Klaptsov: Coming back to investing in Russia, I believe we as well as foreign investors are aware that political risks are quite significant in Russia, so we can spend time to find good companies etc., but all our good work can be destroyed by one political decision. However, when that risk will be mitigated, this will push the markets to very high levels.

Olga Kokareva: What is important to understand is that investing with Russian alternative manager is not the same as taking pure passive exposure on Russia. As we all know, in alternative investments dispersion of results among different managers is much greater compared to passive investments, and thus management team talent and edge play a critical role.

The industry is still emerging in Russia but there are some talented managers here worth looking at. However, overall country risk obviously does negatively impact alternative investment teams with local operations and makes them much less attractive for global investors. Those Russian managers looking to raise capital globally should probably also look at improving their setup structure to minimize potential operational risk.

Dmitry Malykhin: We have spoken with a lot of foreign investors over the last five years. We typically find that the perceived risks regarding investing in Russian companies is much lower for investors who are present on the market already, compared to those investors who are just entering the economy. Of course, the view on the Russian market and local businesses is better from the inside than from the outside.

There is no point trying to play down the tensions we are facing at the moment. These are changing times without a doubt. But challenging times usually come with a lot of opportunities. And as some of prominent investors say, there is not much correlation between FT headlines and returns you get on the ground in Russia (Henry Potter, Partner at Alpha Associates and chairman of EMPEA CEE/CIS council).

Matthias Knab Who of you has launched or is working on a new product?

Dmitry Malykhin: At Da Vinci we thought about what can we offer to investors which is may not be so much Russia-related, but what can still offer good alpha. One of the global trends among investors has been the greater use of index products, be them bonds, stocks or other asset classes. One of the issue index players face is that they have to adhere to the rule of the index and to adjust their holdings to the index.

We found out that it is very interesting to forecast index changes and invest ahead of those passive participants, and that is what we are developing now in the emerging market space. It works well in Russia for us, but of course the balancing events are limited in number if you are looking just at one market. So we have started to include more markets, and believe it is a very promising product.

Christian Putz: Given the current low attractiveness of the Russian equity market for long only investors, we started to expand our product range and the mandate of certain funds. For example we added Turkey and Poland to the mandate of our l/s equity fund. Now we are working on a global l/s equity product which is interesting for both international and local Russian investors.

Stephen Lewis: As a service provider, we obviously sit in the background. It is very interesting listening to everybody here because we offer fund and fiduciary services to meet established and new fund requirements. So clearly the topics covered today have been very interesting and insightful.

In Europe, my challenges have been primarily focused on regulatory legislation and changes to taxation, all of which are either impacting this market now or will in the future. We have spent 2013 developing our regulatory reporting service to incorporate Annex IV reporting for AIFMD, Form PF, EMIR, OPERA, Form CPO-PQR and FATCA solutions. The new offering alleviates much of the onerous data management and technology requirements for investor advisors, and provides an interactive solution for investment managers to populate and file regulatory reports.

If the industry is going to make Russian funds more accessible to the global market and to global investors, it would be wise to think carefully about where you plan on basing and structuring those investments. Cayman funds are still the most popular in the U.S. and Europe where 60% to 70% of hedge funds are still registered in Cayman. Ireland is making inroads and has now captured 10% of the European Hedge Fund market with its AIFMD ready approach.

Investor sentiment has been steadily improving throughout Europe and we are seeing more fund managers planning to come to market in 2015 than we have in 2014 and 2013 put together. I think this is the case in Russia as I'm seeing increased interest in the funds that we service from Russian Investors. We have been able to position our complete service set; legal, fiduciary and fund servicing for those new and existing customers in Dublin and Cayman.

Olga Kokareva: I would like to submit a new product idea which I think would be of a great value, particularly for the Russian hedge fund industry.

Among the most common reasons why hedge fund managers tend to lose prospects when presenting their funds are failure to communicate how the strategy works and lack of transparency on portfolio construction. The solution to that would be a managed account platform built as a combination of prime broker, database, incubation and capital introduction services. Instead of sending an investor just another pitchbook, new managers could demonstrate their results online using standardized tools including attribution analysis, risk profile, stress tests and more. Platform based settlement and reporting would mitigate operational risk.

The platform would be a one-stop-shop for local investors looking to allocate to hedge funds. Those managers demonstrating the required track record would become eligible for the cap intro team to offer their assistance in raising capital. The platform would profit from prime brokerage business rather than charging managers for each allocation, so it would benefit from selecting strong teams with viable strategies.

Not only would such a platform help investors to better assess hedge fund strategies but also it would help managers build a verifiable track record and a robust case for global prospects including institutional investors.