

# I was already invested two years before the “Orange Revolution”

*Smart Investor in an interview with Stefan Laxhuber, expert investor for Eastern Europe and derivatives advisor about the political argy-bargy in the Ukraine, the Russian influence on the country and the strength of the Ukrainian economy*

**Smart Investor:** Mr. Laxhuber please tell me how you discovered a market like the Ukraine?

**Stefan Laxhuber:** First of all part of my job was to make business in Eastern Europe including travelling a lot in this area and establishing subsidiaries for my employer. 1998 – in the year of the Russian Crisis – I spotted the possibility to buy assets there for really cheap prices. You could for instance watch how the Baltic countries, which heavily suffered from the Russian Crisis, suddenly dynamically recovered. This was a hot potatoe at that time. Mutual funds which were invested in Eastern Europe at that time all had suffered badly. German or English research was not available at all. And that is how I got involved into these markets – first part-time and then on a regular base.

**Smart Investor:** Could you just roughly describe your investment approach?

**Laxhuber:** I would be exaggerating to compare my approach with the value strategy of Warren Buffett. But conceptionally it goes along those lines. I usually do not invest in companies that only have a growth story to offer. I am a value investor strongly based on fundamentals. You always got to be aware of the intrinsic risks. In Eastern Europe these are usually political risks in combination with the fundamentals and valuation ratios. Especially the data of the not so well known markets in Eastern Europe are simply unbeatable.

**Smart Investor:** You are known as somebody to be the very first in certain Emerging Markets. What about the Ukraine? Are



Laxhuber is still a first mover in eastern european stock markets

you invested there at the moment? Do you currently increase your investments or do you reduce them?

**Laxhuber:** Good question. I am invested there since longer. We got in there two years before the Orange Revolution. Six or seven months ago we reduced some investments while others were increased. We redeployed capital within the Ukrainian segment. Now we are about to add on some positions, because we regard the Ukraine as a promising market. Although I want point out the long term perspective, on the short term I am a little bit more sceptical.



Stefan Laxhuber

**Smart Investor:** What are the reasons for your scepticism?

**Laxhuber:** Surely the political argy-bargy. But I do not tell you anything new. We have had problems in the past 12 months, past 12 weeks and past 12 days. This can scare off potential investors. On the other hand: I have just read a correct statement on Ukrainian stock market. “Ukraine is a bullet-proofed market.” Freely translated: The market has been recently bombed out. But it recovered very well. I like this, because it means that an array of bad news is already priced in. It cannot deteriorate much more. On the contrary, investors for example are still not aware of the first positive legislative steps which have taken place in favour of the stock markets. According to Kostolany – that is just the right time to enter the market, although there might be some setbacks you have to sustain for a while. In the moment I would not regard the Ukraine as a trend market. On the short term I still expect a rebound.

**Smart Investor:** What could cause a rebound?

**Laxhuber:** Politics! Just to show a good example – the prime minister Yanukovich palms himself off as a populist. In this part he made sure that the electricity and gas prices for private households were reduced by 20%. But in reality energy has not become cheaper. So finally somebody has to pay for it – maybe



Laxhuber visited the Ukraine a lot of times – and hit on some interesting investments

the industrial sector. For instance the energy-related sector may be suffering. On the mid term this is counter productive for the economy, but on the other hand it delivers more near-term votes – i. e. a political success. This is only one of a lot of examples.

**Smart Investor:** Why is Russia threatening to reduce the shipment of gas to the Ukraine?

**Laxhuber:** There was a to and fro between the two countries. Russia has been brutally increasing the gas prices for its former satellite states to world market levels. Unfortunately the Ukraine was totally struck.

**Smart Investor:** Maybe Russia's real intend is to stop the democratic revolution?

**Laxhuber:** I see this dangerous possibility in the Eastern Ukraine, because the country is still divided in two parts. While the Western Ukraine is clearly focused on the Western World, the East of the country is definitely still influenced by Russia. This could cause more tensions. Also speculations continue on whether the country may divide in the future. I don't think it's realistic, but politics in this country will be blocked from this issue for a while. In the moment you cannot take the Ukraine for an exemplar for reforms. I also have to state, that the developments up to now have considerably undermined the confidence of the economy – but not so much of the population. This of course makes it difficult to execute radical reforms.

**Smart Investor:** Recently the economy came heavily under pressure?

**Laxhuber:** That is right. 2004 the economy was growing at 12% a year – a year later only at 2,6%. For the first six months of this year the growth rate is up to an official estimate of 5,5%. For the whole year the estimations are at 6,6% growth rate. I myself think it will range at least around 7%.

**Smart Investor:** Where do you see the strength of the Ukrainian economy?

**Laxhuber:** You mean, where I would invest now. And I must state: consumption, consumption and consumption again! Just look at the boom in the consumer sector in Russia. There is a real shift from the cheap to the luxury segment. You can see it at the revenue per square meter. In our certificate we are heavily invested in retail, partly in private equity. One of them, the Retail Group Velyka Kyshenya, will float at the London Stock exchange in 2007. That is happening in the background of strongly growing personal income. Inflation and tax adjusted they grew at 19% in the first nine months of 2006 – notably without the money which has been paid outside of the statistics. That is why the profits of the retail companies are virtually exploding. There we overweigh this sector heavily.

**Smart Investor:** Which other sectors do you like?

**Laxhuber:** Producers of coke are very interesting. Neither China nor India have sufficient coke. In order to produce steel they have to import this commodity. The Ukraine has huge resources of coal and has many coke producing companies. However, none of them is listed at the German stock exchange. I also see promising producers of pipelines, for example Nizhnodniprovs'k Pipe Rolling Works (NPR) or Dnipropetrovsk Tube Works. As to oil it looks like that the Ukraine – the company Ukrnafta – has resources, but not enough for exports to the world markets. Ukrnafta is indeed 50% dominated by the state but by far not valued at the fair price. However, the state might retreat only at significantly higher prices. For a major rise in the price the company needs restructuring by the state. Only then they will achieve a higher price.



Harbour of Tallinn – Estland was one of the first picks in eastern europe of Stefan Laxhuber

**Smart Investor:** Which would be your three standard investments?

**Laxhuber:** Ukrnafta is a long term investment – also the already mentioned NPR or the two electricity companies Dniproenergo and Centrenergo.

**Smart Investor:** In which country do you invest besides the Ukraine?

**Laxhuber:** We are well invested in Georgia. But the market has already rallied pretty well. Uzbekistan with 26 million inhabitants, a well working agriculture, and its

resources of oil and gas is also very promising. There is a political risk, because the country lacks high foreign estimation. But because of the political tensions, people don't wait and are simply entrepreneurial. I like that. We have also funds in Armenia and Moldavia, but the markets there are more illiquid.

**Smart Investor:** Where will be the Ukraine in five years?

**Laxhuber:** Western Ukraine belongs to Europe – there is no doubt about it. But it will be critical what will happen in the East of the Ukraine. If the Western world fails to integrate the East, then they might actually separate. Therefore we invest in companies having their business mainly in Western Ukraine.

**Smart Investor:** Thank you very much for the interview.

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