Sarona Asset Management Seeks to Do Well by Doing Good in Latin American Private Equity

By Dan Weil

Sarona Asset Management aims to make money in Latin America's private equity market by doing good. That means it also wants to help with economic development and protect the environment.

The firm has about 40 percent of its $200 million under management invested in Latin America through several funds.

Sarona, a subsidiary of MEDA (Mennonite Economic Development Associates) Investments, is based in Waterloo, Ontario, Canada. Its first private equity investment in Latin America came 57 years ago: Sarona Dairy in Paraguay.

The latest Sarona fund is Sarona Frontier Markets Fund, a fund of funds that started up this year with $12 million to invest in emerging markets. The fund will likely grow to $250 million within a few years, Gerhard Pries, Sarona's president, told VELA in an interview.

Sarona's investors consist primarily of high net worth individuals, family offices and family foundations. A few pension funds and insurance companies also participate. Most of Sarona's investors are American.

The firm focuses on small and medium-size enterprises (SMEs). There are three main reasons, Pries says. First, the SME sector will almost certainly grow more quickly than large cap companies in emerging markets during coming years. Second, it's the sector of the economy that creates most of the jobs, which fits well with Sarona's social goals. And finally, "It's a sector that we know better and is less crowded than large cap," Pries said.

As the market grows, more and more exits from SMES will be available through trade sales and IPOs, he points out. Sarona has invested in Mexico, Peru, Ecuador, Paraguay, Haiti and throughout Central America. Its investments have gone into a range of industries including agriculture, financial services, housing and renewable energy.

The firm generally allocates between $2 million and $20 million to each of its investments.

In its new fund of funds, Sarona just put money into IGNIA, a Mexico-based private equity firm that invests in companies serving Latin America's non-wealthy population.

A fund of funds is a good way to initiate investors in emerging markets, including Latin America, Pries says. "They hear about these markets but have no way to participate," he said.

"It's almost impossible for any investor, even pension funds and insurance companies, to run around the world and find the best small private equity funds to create a portfolio for themselves." So the Frontier Markets Fund can provide instant global diversification, including Latin America.

Sarona also helps the managers of funds designed to have a positive social impact in addition to strong

Venture Equity Latin America
Published by WorldTrade Executive,
A Part of Thomson Reuters
P.O. Box 761 – 2250 Main St. Suite 100
Concord, MA 01742
Tel: 1-978-287-0301 Fax: 1-978-287-0302

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returns, Pries says. That's because public development agencies account for most of the capital in these funds.

"Fund managers are really looking for private capital," he said. "We follow in the agencies' footsteps and create opportunities for private investors to participate as well."

Pries discussed several of the individual companies in which Sarona has invested. One is Codip, which is the largest starch producer in Paraguay, accounting for about 75 percent of local consumption. "What's most interesting is that it gets all of its feedstock supplies from small farmers, so it supports 3,000 farmers," he said.

Codip exports to Chile, Brazil and Argentina and is looking at other markets as well. It's quite profitable, Pries says. Sarona originated its equity position about 12 years ago and now has a controlling, albeit minority, stake.

Another Paraguay investment for Sarona is DIRSSA, a high-end charcoal maker that exports to Europe, mostly Germany.

The company is environmentally friendly in that its charcoal is made out of dead wood that would otherwise be a potential fire hazard. DIRSSA also employs 900 local workers to pick the wood, giving them higher pay than alternative jobs, Pries says.

"It's probably the most profitable company in our portfolio, though it's small, with annual sales of about $1.6 million," he said. The company's return on net book value more than doubled to $277 a share last year from $126 in 2008.

Sarona has invested in several microfinance companies. It's interested because microfinance represents a key vehicle for small entrepreneurs to obtain capital.

"We see great inefficiencies at this micro level," Pries said. "If you bring capital, you can increase efficiency." At the same time investors are helping to move families and communities out of poverty.

And exits are available to large commercial banks, which smell profits in microfinance, Pries says. "In Peru we have sold to Banco del Credito del Peru and BBVA at nice multiples."

As for Sarona's investment philosophy, "We take a macro view of world," Pries said. "We try to fit our investment strategy into that view."

So Sarona starts with the idea of investing in developing country SMEs that help the middle and lower classes and don't hurt the environment.

"With the middle class growing quickly throughout the developing world, that means more demand for protein and commodities," Pries said. "It means a shortage of housing in almost every Latin American country and upward pressure on real estate prices."

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So it's a matter of discerning the trends and investing in them, he says. "You may have off years and managers who don't succeed, but if you invest in those broad trends, you have a good chance to outperform," Pries said.

And what have been the most difficult obstacles for Sarona while investing in Latin American private equity?

"We ask two things of host governments," Pries said. "First, that they provide policy stability. And second we need reliability of contract law. If we have those things, we can assess the rest of the risks. But if there's not a reliable judiciary and contract law, if disputes aren't settled in any legal way, but by who you know or who you pay off, then there's a problem."

Occasionally those requirements haven't been met in Latin America, he says.

Governance also can be a problem. "That's either because our partner may be a family business that hasn't had investors before or the government structure isn't as developed as elsewhere," Pries said. "But it's not insurmountable. It's just a challenge we have to know."