

DEG Horizons

Our business is developing.



GERMAN ENTERPRISES

are increasingly investing in countries outside Europe to open up new markets. DEG has been at their side in developing nations and transition countries for over 45 years. In 2007 alone, DEG contributed EUR 128 million for this purpose.

EDITORIAL

The process of globalisation is gaining force – that has been obvious over recent years. “Emerging markets” are playing an ever more important role. One indicator: in 2007, the flow of capital from emerging countries to industrialised nations markedly exceeded the – likewise high – investment moving in the opposite direction, into the emerging markets. It remains to be seen whether this role reversal can be maintained in the face of what may prove to be a worldwide economic slowdown.

What enterprises need to take into account when they invest in foreign countries and establish locations abroad, and the elementary role played by infrastructure in a country's development – these are just two of the subjects discussed in this edition.

The DEG editorial team wishes you pleasant reading

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IN BRIEF

A successful business year in 2007: **EUR 1.2 billion** in **new business**, a portfolio that has grown to **EUR 3.6 billion**, and an annual net profit of EUR 117 million were key figures in DEG's annual statement of accounts. 2008 also got off to a promising start, with finance totalling EUR 290 million being approved just **in the first quarter**.

On the 30th of April 2008, **Johannes-Jürgen Bernsen**, a member of the DEG Board of Management since 2001, **retired** after 32 years of working for the institution. His special areas of responsibility were Portfolio and Risk Management. He was succeeded on the 1st of May by **new member of the Board of Management Philipp Kreutz**, who has been with DEG since 2005 and was most recently responsible for Finance/Controlling as Head of Division. As board member, Kreutz will be responsible for some new business as well as for departments with a cross-sectional function. The other members of the Board of Management are Dr Michael Bornmann and Dr Winfried Polte (Chairman).

The quality of DEG's new business was remarkably high in development terms: the grade of 2.3 was the best result achieved since rating was introduced six years ago.

FOCUS

INVESTING ABROAD: EXPERIENCE NEEDED.



DEG is able to provide enterprises with finance for pre-investment or investment-tied measures, e.g. from the PPP programme, provided these are used to achieve developmentally sustainable outcomes.

Internationalisation is essential for many medium-sized German enterprises if they are to remain viable. For over 40 years, the policy of moving abroad has proved a tried and tested recipe, allowing enterprises to adapt to changing market and cost structures. But where it initially targeted industrialised countries in Europe or the USA, the focus has now shifted to include developing and transition countries.

Since the 1960s, DEG has supported German enterprises as they opened up these countries. It is possible to identify particular "waves of investment" during that time. In the 1970s for example, the institution financed many subsidiaries in Brazil, especially in the engineering industry, and in North Africa, in the textile sector. Following the collapse of the Soviet Union, there were new start-ups in member states of the Visegrad Group, in the automobile supply sector and in engineering; at the same time, there was a growing interest in China. Today, enterprises are mainly looking at Russia and China, increasingly at India, and at Mexico, from where they can supply the US market direct.

For medium-sized enterprises, setting up a manufacturing base a long way from their home market – and especially in developing and transition countries – represents a major challenge. From the experience DEG has gained from co-financing more than 360 subsidiaries, the following points are important for success:

Market assessment: The enterprise must carry out its own analysis of market conditions. The barriers to market entry are often higher than expected. Manufacturing capacity should be gradually adjusted to meet demand, provided this is possible both technically and in terms of costs.

Joint venture or subsidiary: These days, the trend favours setting up subsidiaries, since joint ventures often involve more imponderables. With a joint venture, the local partner must have sufficient financial resources, be of good standing, and

have strong marketing capabilities. Both partners should be pursuing largely similar interests. It is advisable to make contractual arrangements in case one of the partners fails to meet agreed commitments.

Financial and human resources: The finance needed for a foreign commitment often exceeds the original budget. There must be enough financial leeway. Also, qualified staff from Germany will have to be deployed, at least initially, and compensatory measures will be necessary at the domestic base. In the case of new start-ups, the management should include some experienced members of staff from the parent company. They will need skills and cultural training to prepare them for their new assignment. Fostering loyalty towards the business in a sustainable way will help to reduce staff turnover, which is widespread in dynamic developing countries.

Adequate finance: With loan finance, sufficiently long grace periods are important to avoid liquidity problems during the set-up phase. Overly short repayment times are often a problem. The means required to finance current assets are also often underestimated. Another aspect is choosing the right currency: if at all possible, the loan currency should match the currency of later receipts, e.g. from exports. So to reduce risk, it is advisable to involve a bank with a proven track record of investing in developing countries.

DEG provides the necessary comprehensive advice and offers suitable long-term finance. In the case of loans, it generally uses the borrower's capital assets in the developing country as collateral security; this avoids having recourse to the parent company's balance sheet. Businesses are able to benefit from specific aspects of DEG's experience to ensure that their foreign investment is a success.

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FINANCING

INFRASTRUCTURE: THE BACKBONE OF DEVELOPMENT.



Power failures, inadequate communications, sub-standard transport routes: in countries undergoing development, the infrastructure is often outdated and certainly unable to cope with rapid growth – with the result that both the economy and households are badly served. However, many countries feel unable to shoulder the necessary investment on their own. One possible solution is cooperating with private enterprises.

A good example is mobile telephony. It has allowed many countries to make the leap into a new age of communications. Today, thanks to modern technology, broad sections of the population in Asia, Latin America and Africa are able to exchange ideas and gain information quickly even across great distances. Private sector providers boost competition, which has a positive effect on services and costs. Add to that the development of small trade involving telephone-based services. Telecommunications is an industry in which DEG has been involved for years; the institution has co-financed many “green-field projects” in Africa and Asia. As a hands-on investor, DEG is a long-term partner for these enterprises. It offers advice during the planning stage,

provides equity capital, mezzanine finance or loans, depending on the individual project, and undertakes the arrangement of larger tranches. DEG's current mobile telephony portfolio totals more than EUR 200 million. Most recently, it has co-financed projects in Tanzania, Ghana und Cambodia.

Another priority is investments that promote climate protection, use renewable energy and ensure energy-efficient production – an especially relevant subject all over the world, given the huge increase in energy needs and the threat to the environment. Over the past two years, DEG has provided more than EUR 140 million for, among other things, hydro-electric power plants in Uganda, Brazil and Eastern Europe. Working with project developers, it has also taken a stake in enterprises in order to share know-how and invest in promising markets. DEG plans to expand its involvement in climate protection even further in 2008.

The most recent example of infrastructure finance is a long-term loan of more than EUR 14 million for a seawater desalination plant in Chennai. This will significantly improve the water supply in India's fourth-largest city. DEG is the sole international provider of finance for the project, which is being implemented by an Indian-Spanish joint venture and is due to start operating in 2008. As the first plant in private ownership with a capacity of more than 100 million litres a day, the project will serve as a model for others.

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Widespread: telephone-based services offered by small traders.

JOINT ENVIRONMENTAL STANDARDS FOR EUROPEAN DEVELOPMENT FINANCE PROVIDERS.

EDFI stands for “European Development Finance Institutions”. The group includes DEG along with 17 other finance providers which support the private sector in developing countries. In total, their portfolio amounts to more than EUR 15 billion. EDFI is committed to jointly launching and supporting environmentally sustainable investment. The adoption of common standards is designed to promote this aim. Accordingly, EDFI members have come to an understanding about shared environmental and social requirements: as well as deciding on a joint definition of environmental and social categories

and an exclusion list of projects which must not be co-financed, members have harmonised their requirements in respect of project reviews and minimum contractual obligations. National requirements in the investment countries formed the basis, while internationally recognised environmental and social standards like those of the World Bank Group and the International Labor Organization (ILO) provided a benchmark. This gives the clients of EDFI members clear guidelines about the environmental and social requirements generally attached to any finance.



NEWS

WORMWOOD AGAINST MALARIA.



Training in Uganda: farmers are given information about the proper way to cultivate the medicinal herb.

A substance that forms the basis of highly effective and inexpensive anti-malaria drugs can be extracted from "artemisia annua", commonly known as Sweet Annie or Chinese Wormwood. In traditional Chinese medicine, this type of wormwood has been in use for centuries as a healing herb, while in Asia, artemisinin has been used as an active substance against malaria since the 1970s. The World Health Organization WHO also promotes and recommends compounds based on this substance, specifically in respect of the regions where the malaria pathogens are already resistant to conventional drugs. For Africa in particular, where millions of people contract the disease and death rates remain high, combating malaria is enormously important.

Originally, the plant was only grown commercially in the Far East. But some years ago, a com-

pany in Kenya began cultivating the plants and using them to produce artemisinin as the basis for anti-malaria drugs. Today, around 4,000 small farmers in Kenya, Tanzania and Uganda grow sweet wormwood for Botanical Extracts EPZ Ltd., receive training from the company and earn a regular income. The wormwood is then processed at the main production plant in Kenya. The client is Novartis, a pharmaceutical company that also co-financed the setting-up of the plant. DEG has now provided the enterprise with EUR 3.2 million in the form of a subordinated long-term loan. Together with other investors – IFC, which is a member of the World Bank Group, Acumen Fund, and Industrial Promotion Services Kenya Ltd. (IPSK) – DEG is ensuring that the enterprise's financial needs are met and it will be able to invest in expansion.

DEG

- DEG has been financing and structuring the investments of private companies in developing and emerging market countries for more than 45 years.
- DEG invests in profitable projects that contribute to sustainable development in all sectors of the economy, from agribusiness and infrastructure to manufacturing and services. We also focus on the development of the financial sector in order to facilitate reliable access to capital locally.
- Our aim is to establish and expand private enterprise structures in developing and transition countries, and thus create the basis for sustainable economic growth and a lasting improvement in the living conditions of the local population.

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