

NEWS FROM AFRICA

FUTURE IS GREEN FOR SOUTH AFRICA'S CAPE REGION.

The fynbos ('fine bush'), the evergreen flora of the Cape region of South Africa, is continually being lost and numerous species are threatened. Thanks to a project initiated by the German family Lutzeyer, the fynbos is now facing a "green future", as are unemployed from the region. The Lutzeyers have established the Green Futures College for fynbos gardeners on their private Grootbos Nature Reserve. The project is co-financed by DEG within the scope of the Public Private Partnership Programme. Cikizwa Plum (photo) is one of the first attendees. Together with 11 fellow students she is taking a one-year Green Futures training course that covers everything about the fynbos, including maintaining it and laying out gardens. In addition, the syllabus includes biology, mathematics, English and business skills. Once the students have successfully

completed the course, they will receive support in looking for a job as gardeners. A 1000-hectare fynbos landscape with 450 species has been re-established at the Grootbos Nature Reserve, which lies about 200 kilometres south-east of Cape Town. The Lutzeyers run an eco-lodge there, with 30 comfortable rooms. More information on Green Futures is available at: [www.greenfutures.co.za](http://www.greenfutures.co.za).



MOZAL – MOZAMBIQUE'S INDUSTRIAL HOPE.

The Mozal aluminium smelter is proof that one can also successfully carry out industrial projects in southern Africa. The plant was constructed in record time and went into production in the autumn of 2000 after only five year's construction. Phase Two of the smelter has now been completed. In future, Mozal will be producing more than 500,000 tonnes of aluminium a year, especially for the Japanese and European markets. The USA-based Project Management Institute chose

Mozal as its "2001 Project of the Year". DEG co-financed this facility, which forms Mozambique's industrial core. It represents employment and income for about 800 Mozambicans and their families. The aluminium smelter has improved the country's trade balance by USD 380 million. It is a symbol of hope in Mozambique, a country where peace only came ten years ago following a bitter civil war.

WHO SAID IT?

"There's no such thing as a free lunch."

- a) Ludwig Erhard (1897-1977), Minister of Economics in the Federal Republic of Germany's first cabinet and the father of the "economic miracle"
- b) Paul Bocuse (b. 1926), French master chef, who is also regarded as being both a brilliant and businesslike restaurant proprietor
- c) Milton Friedman (b. 1912), American economist and winner of the 1976 Nobel Prize for Economics

Answer:  
 Three possibilities but only one was the right answer: "There's No Such Thing as a Free Lunch" was actually the title of a book (published in 1975) by Nobel laureate Friedman – a confirmed monetarist with a tendency to make punchy statements. Friedman argues that national economies have to earn what they spend.

DEG

- DEG has been financing and structuring the investments of private companies in developing and transition countries for 40 years.
- DEG invests in profitable projects that contribute to sustainable development in all sectors of the economy, from agriculture to infrastructure and manufacturing to services. We also focus on investments in local money markets in order to facilitate reliable access to capital locally.
- So far, we have worked together with more than 1,050 companies. By providing 5 billion euros of finance, we have achieved a total investment of 34 billion euros.
- 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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# DEG Horizons

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## SUSTAINABILITY

is certainly a word one can use to describe an Egyptian producer of herbal medicines, a company that is also very active in supporting social and cultural activities. SEKEM, a long-standing DEG partner, has been honoured repeatedly for its efforts.

EDITORIAL

Yet another year is coming to a close. The weeks and months seem to have just flown by, and sometimes we all wish we had more time. Indeed, time now seems to have become something very precious, particularly in the fast-moving world in which we live. We'd like to invite you to buck this modern trend and take a little time out for a closer look at this latest issue of Horizons.

The current issue shows Latin America's many facets and discusses what prospects the region has to offer investors, who now have the support of a recently opened local DEG office in Mexico City. We continue our series on the various forms of financing with an article on mezzanine finance and related benefits. You can also read about two markedly different projects in Africa and about investments by medium-sized businesses in China.

The DEG Horizons editorial team wishes you pleasant reading.

IN BRIEF

International honours for the Egyptian SEKEM Group, which produces medicines and foodstuffs using biodynamic farming methods: the company, which is co-financed by DEG, has received the 2003 Right Livelihood Award, better known as the **Alternative Nobel Prize**. The jury paid tribute to **SEKEM** as the "business model for the 21st century in which commercial success is integrated with and promotes the social and cultural development of society". Earlier, in August this year, the Schwab Foundation had honoured SEKEM's chairman, Dr Ibrahim Abouleish, as one of its "Outstanding Social Entrepreneurs for 2004". DEG also regards SEKEM as a living example of how compatible profitability and sustainability really can be.

The eastern expansion of the EU is not far off and investments in the EU's new neighbours have become very popular. In **Poland**, DEG recently agreed to provide a loan to a young company from the packaging sector that will enable it to finance its expansion. The tendency for companies to get involved in eastern Europe is continuing: German companies are also rediscovering **Russia**. DEG has provided a long-term loan to Bericap GmbH & Co., a medium-sized German company, to set up a production facility in south-western Russia. The company, which is based in Buddenheim near Mainz, operates at 14 locations and employs 1,800 people worldwide. It produces closures for the most varied range of containers, which are sold in over 70 countries.





## COUNTRY FOCUS

### LATIN AMERICA – A CONTINENT IN MOTION.

It is not only from an investor's point of view that Latin America is a multi-faceted place bustling with activity. Companies that become actively involved here pose the widest possible range of questions regarding the choice of location, markets for their goods and any risks involved. The countries of Latin America differ so markedly from each other that one can hardly generalise. However, 2002 was certainly a relatively difficult year for the whole of the continent, due mainly to the Argentine crisis and its effect on the other countries.

By comparison, 2003 is proving to be a more positive year with Latin America's total GNP expected to increase by 1.5%, compared with a decline of 0.6% last year. One needs to be cautious and bear in mind that changes here often happen very quickly. The rapid development in Brazil in recent months is a good example. Argentina is another; after a decline of 10.9% last year, the country is top of the country rankings this year, with a 5.5% increase in GDP being predicted for the whole of 2003. It appears that the situation there has at least stabilised.

Even Uruguay, which was previously regarded as being a "model" country, suffered due to the Argentine crisis turbulent times in 2002, mainly as a result of external factors. However, it now looks as if the country is making every effort to deal with the crisis quickly. This year, for the first time, DEG agreed to provide investment finance there. It has awarded long-term loans to a leading paper manufacturer and a rice producer. In doing so, DEG is consciously supporting reliable local companies that would otherwise be unable to raise funds on the capital market because of the country risk involved. An example is Saman, Uruguay's largest rice exporter and one of its major currency earners, which trades with countries

such as Brazil, Peru and Iran. The finance from DEG will allow the company to fund its trading as well as to carry out planned essential investments.

The economic situation in other Latin American countries, such as Mexico, is basically stable. DEG has been active here for a good many years. It first got involved in Mexico in 1966 and since then has invested over 220 million euros in about 60 projects by private companies. Its current Mexico portfolio stands at about 50 million euros, spread over 16 projects. DEG believes that traditionally there are interesting prospects for investments in processing industries, including house building for families on low incomes and in the whole of the supply industry; these need to be expanded intersectorally in order to replace imports with home-produced goods in future.

DEG's new local office in Mexico City started doing business recently; it will look after the needs of clients and partners locally. The opening of what is DEG's second office on the continent after São Paulo only serves to emphasise that Latin America is an important partner region for DEG – even in difficult times.

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## PARTNERS AND PROJECTS

### CHINA – SUBSIDIARIES ARE IN.

WTO entry, a huge domestic market with increasing consumer demand, sustained high levels of economic growth and favourable location and production costs are turning China into a magnet for foreign capital. In 2003, the People's Republic topped the list of the world's most attractive locations for inward investment, with more than USD 53 billion of foreign direct investments. China is an enormously important market for medium-sized companies like Ludwig Krohne GmbH & Co. KG of Duisburg, Germany. It is where the company is currently enjoying its highest growth rates – double-digit growth for its core products.

Krohne, a world leader in the field of flow-measurement technology, opened its first sales office in Hong Kong in 1977 and in Beijing in 1986. High import duties were mainly the reason for imported products being substituted by locally produced ones. Until the beginning of the 90s, it was only possible to manufacture locally by establishing a Sino-German joint venture. Krohne set up its first joint venture in Shanghai in 1986; others followed in Chengde, near Beijing, and Wenzhou. Today, Krohne is the market leader in China.

Although joint ventures offer benefits, such as being able to call on the partner's knowledge of the local market, there are also possible risks, including those related to management decisions. In addition, joint ventures are only allowed to do business with their own products. This aspect adversely affects the further expansion of many joint ventures. There is thus a trend now towards setting up subsidiaries. In 2002, Krohne established a wholly owned subsidiary, Krohne Measurement Technology Shanghai Co. Ltd. DEG co-financed planned investments with a long-term loan.

DEG has been supporting companies like Krohne in the "Middle Kingdom" since the mid-80s. Its current China portfolio totals over 120 million euros. The benefits of DEG financing are clear: the amount, term and form can be tailored flexibly to meet the needs of the investment. Collateral security is usually in the form of fixed assets in the investment country. In addition to being able to rely on DEG's extensive knowledge of the market, clients can also benefit from dealing with experienced staff who speak the language and understand the local mentality as well as having an office in Beijing that will support them whenever necessary.

## FINANCING

### MEZZANINE FINANCE: OFFERING BENEFITS BETWEEN LOAN AND EQUITY CAPITAL.

If you ask an architect, he'll tell you straight away what the word "mezzanine" means; it describes a storey between two other storeys in a building, usually between the ground and first floors. The term "mezzanine finance" has been derived from the architectural term to describe a mixed form of finance in between simple loan capital and a classical bank loan. It can involve, amongst others, a loan with equity features, a loan with a conversion option or even preference shares.

There are various possible scenarios where mezzanine capital makes sense; for example, if a young company with a positive cash flow and very promising business prospects has too few assets, and is thus unlikely to obtain a normal loan from a bank because it cannot provide collateral. Mezzanine capital can be a good solution when a company is planning to reassess its strategy; it is also worth considering when a successful business wants to raise capital for expansion and strengthen its equity capital without changing or adding to its shareholder structure.

For rating purposes, mezzanine finance is classed as equity capital, which is particularly important for medium-sized companies as it gives them greater flexibility. An added benefit is that such types of

finance can be tailored to a company's specific needs. With subordinated loans, the subordination can be wide ranging or only apply to specific criteria; as far as liability is concerned, mezzanine finance can be defined as "quasi equity". And it can thus serve to balance out the different interests of the providers of equity and loan capital.

The provider of mezzanine capital considers himself to be a long-term partner whose objectives are in keeping with the company's own corporate policy. He is convinced that a business idea is feasible and is willing to invest in a company on the basis of its anticipated positive development. He consciously undertakes a higher risk for a certain time. In return, he receives a fixed return and a share in the company's success.

A current example of mezzanine finance provided by DEG is a loan with equity features, which enabled via a leveraged buyout a Croatian group of companies to acquire a local manufacturer of skin-care agents and cosmetic products, and then invest in the necessary modernisation of the company. DEG's decision to provide mezzanine capital led to an Austrian commercial bank also participating in the financing and providing the rest of the funding required.