



## **Interview with Michael Hokenson, Co-founder and Managing Director of Minlam Asset Management LLC**

*EurekaHedge*

Minlam Asset Management LLC is a New York-based investment firm providing financial solutions for emerging markets. Minlam creates and manages financial products to address the increasing number of commercial opportunities in microfinance. Microfinance is the provision of diverse financial services to low-income entrepreneurs. Microfinance investments have a successful track record and represent an attractive investment opportunity with compelling social benefits for the four billion people that constitute the Base of the Economic Pyramid (BOP).

Minlam's team of professionals combines macroeconomic expertise with fundamental investment analysis to deliver local currency capital to microfinance institutions (MFIs) around the world. Minlam utilises a global strategy to provide microfinance institutions with innovative customised local currency products. Our firm performs detailed investment analysis to identify strong, sustainable microfinance partners. Minlam builds lasting relationships with our partners to support their long-term success and growth.

In the fall of 2007, Minlam launched a fund aimed at expanding loan portfolios and purchasing securities of financial institutions that serve low-income demographics in emerging markets. The investment activity includes funding MFIs and other entities which provide financial services such as working capital loans, mortgages, insurance products and credit cards to low-income communities in emerging markets.

### **1. How would you characterise the investment/management style that governs the Minlam Microfinance Fund? What is the overall proposition to investors?**

The Minlam Microfinance Fund is a synthesis between global macro and special situations investment styles. The global macro component deploys capital across a diversified set of emerging market securities and special situations based on fundamental views on country and currency performance. The special situations component refers to local currency loans to MFIs that Minlam's investment team directly originates, evaluates, structures and monitors. MFIs are a diverse set of entities that operate in local markets and provide financial services to low-income communities.

In our view, the value proposition to investors is exposure to a unique portfolio composed of local currency loans at attractive yields to creditworthy MFIs. The high historical repayment rates of MFIs to lenders and the investment consensus on outperforming emerging markets make our fund an attractive asset. In addition, there are many positive social externalities linked to the practice of microfinance which is appealing to socially-motivated investors.

### **2. What are the key drivers behind the development and growth of the microfinance industry as a whole? At the same time, how is your fund positioned to take advantage of these factors and how does it differ from other microfinance products?**

The key driver behind the growth is the effectiveness of the microfinance strategy in unsaturated markets. Over three billion people worldwide are potential recipients of microfinance services. Today, the industry has reached approximately 100 million persons and has an asset base of approximately US\$22 billion. Top performing MFIs have an average Portfolio-at-Risk > 30 days less than 5%. That's an incredible achievement given the difficult operating conditions. The market for the working capital loan, the flagship product of microfinance, has been estimated to be over US\$250 billion. MFIs are growing at impressive rates to meet this demand and are in need of additional debt and equity capital to do so.



The main point of differentiation for our fund is our ability to lend in local currencies on a global basis. The majority of international funding available for MFIs has been delivered in dollars or used expensive swap and other structuring mechanisms to deliver local currencies. These practices have delivered money market-like returns to investors and, in some cases, created foreign exchange risk for MFIs. As MFIs grow, many intend to become regulated institutions which may mean that their open FX positions must stay within certain limits, creating a favourable environment for our local currency loan product.

**3. *What are the key challenges and opportunities associated with investing in MFIs? How have these institutions evolved in recent years?***

The broad opportunity is that microfinance is an expanding market, one that will absorb billions of dollars in funding over the coming years. It is also a practice that uses a commercially-based solution to an entrenched social problem, which makes microfinance quite compelling. The key challenge is that investment options in these institutions are not readily accessible. It requires networks, relationships and understanding of local markets. Thus, since we possess these capabilities, this forms part of the advantage for the Minlam Microfinance Fund.

Over the past few years, MFIs have become more professional and commercially oriented to access their funding through savings and/or capital markets. Initially, the majority of the funding came from subsidised sources of capital. These sources, however, are not sufficient to meet the growth needs.

**4. *Can you elaborate on the various emerging markets that the fund invests in? With such a focus on emerging markets, how does the fund manage and control the accompanying currency and country exposures?***

We maintain a global outlook with exposures to traditional and frontier emerging markets. At the moment, we are most interested in countries with strong balance of payments and currencies under pressure to appreciate. Our currency and country exposures are actively managed through diversification and the use of currency forwards and credit default swaps.

**5. *How liquid is a typical allocation and what is the expected holding period for such an investment?***

A loan to an MFI is between 12 and 36 months and is generally not liquid. Our portfolio maintains 15-20% in liquid securities.

**6. *In terms of the due diligence process as it relates to MFIs, what is the approach used by the team to source, develop and monetise these opportunities?***

Within countries selected by the macro process, we will perform credit analysis of potential MFI investments. Deals are sourced primarily through our extensive network. Each potential MFI loan candidate passes through a detailed due diligence process to assess its past performance and credit risk. Our credit analysis team looks for a high level of professionalism and transparency within management, a commercial focus, and the potential for significant and healthy growth.

The performance assessment reviews past financial statements and operational quantitative information. An evaluation of MFI performance utilises traditional credit analysis and considers debt service coverage ratios, leverage and return on equity. The credit risk assessment is focused on future outlook by analysing strategy and governance, people and organisation, products and services, outstanding debt, and control and compliance systems.



**7. Investors might perceive microfinance as another ethical product, how is the fund positioned in this respect? How does the fund's social impact component fit into a traditional ethical portfolio?**

Microfinance has long been associated with social impacts such as poverty alleviation, the promotion of gender equality and improved health and education levels. Minlam incorporates and monitors social criteria when evaluating MFIs such as the percentage of female borrowers and the average loan size as measured against per capita income.

Due to the absolute return potential and low correlation of the product, we feel the Minlam Microfinance Fund is a valuable addition to institutional portfolios. Ethical portfolios that have focused on exclusionary screening practices now have a progressive and commercially-oriented investment opportunity with our fund.

**8. On the other hand, the Minlam offshore fund is principally defined as a hedge fund. In this regard, how would its fixed income/macro strategy fit into an alternative portfolio considering its risk-return profile?**

We believe we are an attractive option for fixed income/macro strategies that seek local currency exposure in asset classes exhibiting low correlation.

**9. The fund seeks growth potential as well as low correlation – whilst microfinance has been characterised as having money-market qualities. What is the fund's payoff profile and to what extent is leverage used to optimise returns?**

The steady, low volatility money market quality of microfinance funds was due to the dollarised nature of the debt market. Little pricing differential existed between various MFI credits and countries regardless of relative risk. We believe local currency loan denomination and a rational pricing scheme – components of the Minlam Microfinance Fund – will yield superior financial results.

Leverage is not used with this particular fund. It cannot exceed 100% of the master fund's NAV and is primarily used for hedging and diversification purposes.

**10. What has been the performance since the launch of the product in 2007? What would be a valid benchmark to compare this track record?**

Since October 2007, the fund has returned 1.8% and has been positive every month net of all fees and expenses. The HFRI Hedge Fund Index is down -0.7% for the same time period. While the EurekaHedge Hedge Fund Index was up 1% during the same period; the Fixed Income component shed 1.4%.

**11. Being a relatively new fund, what types of institutions comprise the fund's investor base? What type of risk-profile is the fund best suited for?**

Our investor base is institutional with participation from fund-of-funds, endowments and family offices. We believe our risk profile is appropriately suited for pensions, endowments and family offices. We intend to raise capital for the fund approximately once a year as we alternate between phases of AUM expansion and allocation.

**12. What are your thoughts on the growth prospects for Microfinance and what other products would you foresee developing in this market?**

We believe microfinance has a very attractive future for investors and clients alike. The demand from investors for new asset classes with attractive return-risk profiles is ever present. The demand for microfinance services from the BOP is also very tangible.



We believe microfinance will expand its offering into home loan products, savings and insurance. Accordingly there will be investment vehicles that address every aspect of the industry from structured debt to venture capital.

We also feel that it will be important for MFIs to remain focused on using financial services as a tool to increase the incomes and improve the livelihoods of their clients thus creating a virtuous cycle between our fund and their clients.

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