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Commodity investor interviews: INOKS Capital calls for a more institutional approach

Helen Castell

Senior Reporter 16 December 2015 Add comment

The well-publicised capital constraints facing traditional trade banks at present has seen many retreat from commodity finance's riskier regions and made them even less able to lend to smaller players. However, specialist commodity investors and trade finance funds are stepping in to plug the gap.

In our new interview series we speak to three of the most active commodity investors in Africa, Asia and Latin America to find out what else is fuelling their growth and whether this new funding landscape is here to stay.

INOKS Capital

INOKS Capital is an independently owned alternative investment house based in Geneva. Since 2004, it has provided commodity structured trade finance to agricultural, energy and metals producers, processors, importers and exporters in Africa, South-East Asia, Eastern Europe and Latin America. Over the last three years it has also offered businesses in these value chains mezzanine debt equity conversion and early-stage private equity.

In part three of our interview series, TXF's Helen Castell talks to INOKS Capital chief executive Nabil Marc Abdul-Massih about the importance of regulation and his concern that some trade finance investors don't understand the risks.

Trade & Export Finance (TXF): *Who do you finance and what would be a typical transaction?*

Nabil Marc Abdul-Massih (NMAM): Historically, INOKS has focused on providing capital to SMEs, two thirds of which are in the agricultural sector and a third in energy and metals.

We now also fund mature and major players, including some of the top five names in cocoa, soy beans, grain and cotton, but SMEs still represent over two-thirds of our business.

We finance readily tradable commodities value chains, for example, the production of rice for local consumption or export, the purchase and processing of sunflower seeds or soya beans into seed oil, or cotton production, ginning and export.

Whether we do it in the short term with commodity structured trade finance (CSTF), in the medium term with mezzanine debt equity conversion or in the long term with early-stage private equity, we are in the business of providing capital to successful companies that need capital to grow.

Transaction sizes range from $1 million to around $7.5 million or $8 million for SMEs, and from $6.5 million to $15 million or $20 million for mature businesses. For major businesses, we start at $20 million, with the biggest at $35 million.

TXF: *What's driving growth for you?*

NMAM: Banks pulling out is definitely one reason why we're now able to provide capital to much more mature players, but our growth is not solely driven by the Basel III story.

Many of the players we fund would be able to access bank finance, but not the kind of capital we can offer them. Ours is bespoke, can be off balance sheet and offers companies more flexibility. There is however more demand from the segment that banks can supply.

In most emerging markets, it has historically been easier to access capital the closer you are to the consumer versus the earlier on you are in the value chain. Regulation facing banks also means SMEs in particular are under-funded.

That said, just because a value chain or company is in need of capital, that's no reason for us to fund it. We're not suitcase bankers.

TXF: *Who do you compete with?*

NMAM: If, like us, you take a diversified approach, you end up competing with the whole world. You compete with peers in trade finance, in mezzanine and in early-stage private equity. You compete with local banks and with multinational trading houses that extend credit to their suppliers or offtakers.

The market is so large however that we never have to fight for revenue – there's a lot of room out there. Competitors would find it difficult to corner us on SMEs, on majors, on mezzanine or on early-stage private equity, because we service all of them.

TXF: *How are you different to your peers?*

NMAM: We have a strong private equity mind-set and a more diversified approach to addressing companies' liquidity requirements. Trade finance is just one tool we use to provide them with short-term capital. Because we may also offer a company mezzanine or early-stage private equity, we need to validate that the company is P&L positive and is sustainable. It's not just about extracting financing costs from a buy and sell contract.

Another strength is our large team of 20 people. The CSTF we do involves a lot of in-house work that requires considerable resources. We do the sourcing, due diligence, investment, risk management and divestments ourselves.

Also, we don't provide capital to speculators – companies we finance need to be involved in production, processing or multiple segments in their value chain.

The regulatory burden for us, in terms of know your client (KYC) compliance, is at least equivalent to that of a bank.

We passed a major milestone in September when we were granted FINMA (Swiss Financial Market Supervisory Authority) authorisation as an asset manager of collective investment schemes. It was a very costly process and took us five years.

FINMA provides prudential supervision and is considered slightly more stringent than other regulators.

TXF: *What's your approach to risk management?*

NMAM: We're very risk averse but we benefit from what we call risk-perception arbitrage.

If, for example, a non-specialised lender finances grain exports out of Louisiana, it might consider that less risky than financing the same business out of South Africa, and its pricing will reflect that.

However, the operational risks are essentially the same. It's a question of how well you know the value chain and the environment and how well equipped you are to identify those risks so as to mitigate them.

To begin with, our team gives us a level of know-how that a bank would find difficult to replicate. Everyone has been a physical commodity trader, logistician, collateral manager, insurer, futures trader or commodities financier. We then use risk mitigants or risk-transfer tools that are available on the market.

This means we are able to offer capital at an opportunity cost that remains attractive and still generate alpha.

TXF: *Who are your investors?*

NMAM: Ninety-eight percent of our investors are institutional players – pension funds, banks, national development agencies. We have the great honour, for example, of handling a bespoke vehicle for the Swiss Investment Fund for Emerging Markets (SIFEM).

This is a big change from when we started, when most of our investors were fund of funds. Although we had a strong impact investing model, our investors then couldn't care less about whether we traded tangible assets or engaged in impact investing – they just wanted no volatility, no leverage, no correlation and a substantial yield.

We continue to deliver that – we have historically returned 10.7% net back to our investors, which is quite superior considering we don't use leverage, and our annual volatility is just 1.3%.

However, the alternative industry crisis of 2008 and 2009 changed our focus and with it our investor base. We embarked on a strong institutionalisation drive, determining to become more a value player for the long term and to drop any short-term profit, hedge-fund attitude.

TXF: *Is trade finance becoming better understood by investors?*

NMAM: No, that's not really changing at all. Although trade finance as an uncorrelated yield generator, a diversifier, is now fairly well known by investors, we believe that many fund managers aren't educating them sufficiently.

Some over-simplify the language, which can seduce investors into believing trade finance is risk-free and a pure spread play arbitrage. This is not true. There are risks involved with trade finance and certain levels of correlation.

Another concern is that trade finance has become over-commoditised. You can't put receivables discounting, agricultural supply chain finance and pre-export financing in the same basket. They don't have the same risks or returns.

Unfortunately, the investment community is always eager to invest dollars. So sometimes they take short cuts and believe they understand trade finance before they do.

There is a risk that the democratisation of trade finance as an asset class will attract more money and more non-qualified investors to it. That may result in losses.

One opportunity however is that as the asset class attracts more attention, established institutional managers will come in and set up teams. That would help make the marketplace more mature and the asset class more secure and institutional. We would welcome that.

TXF: *What next for INOKS?*

NMAM: Over the next five years, we want to at least double or triple our assets under management, which are around $500 million today. But we are more interested in quality than quantity. We are not cash hungry. We want to continue delivering institutional-grade, specialised, professional and superior services. And if that means staying where we are, we will.

COMMENTS (1)

Vaibhavi Thakkar, Blend Financial Services Limited 21 December 2015

This is quite interesting. Could you please direct us to the official we could talk to at Inoks on global opportunities we have ? Tx

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