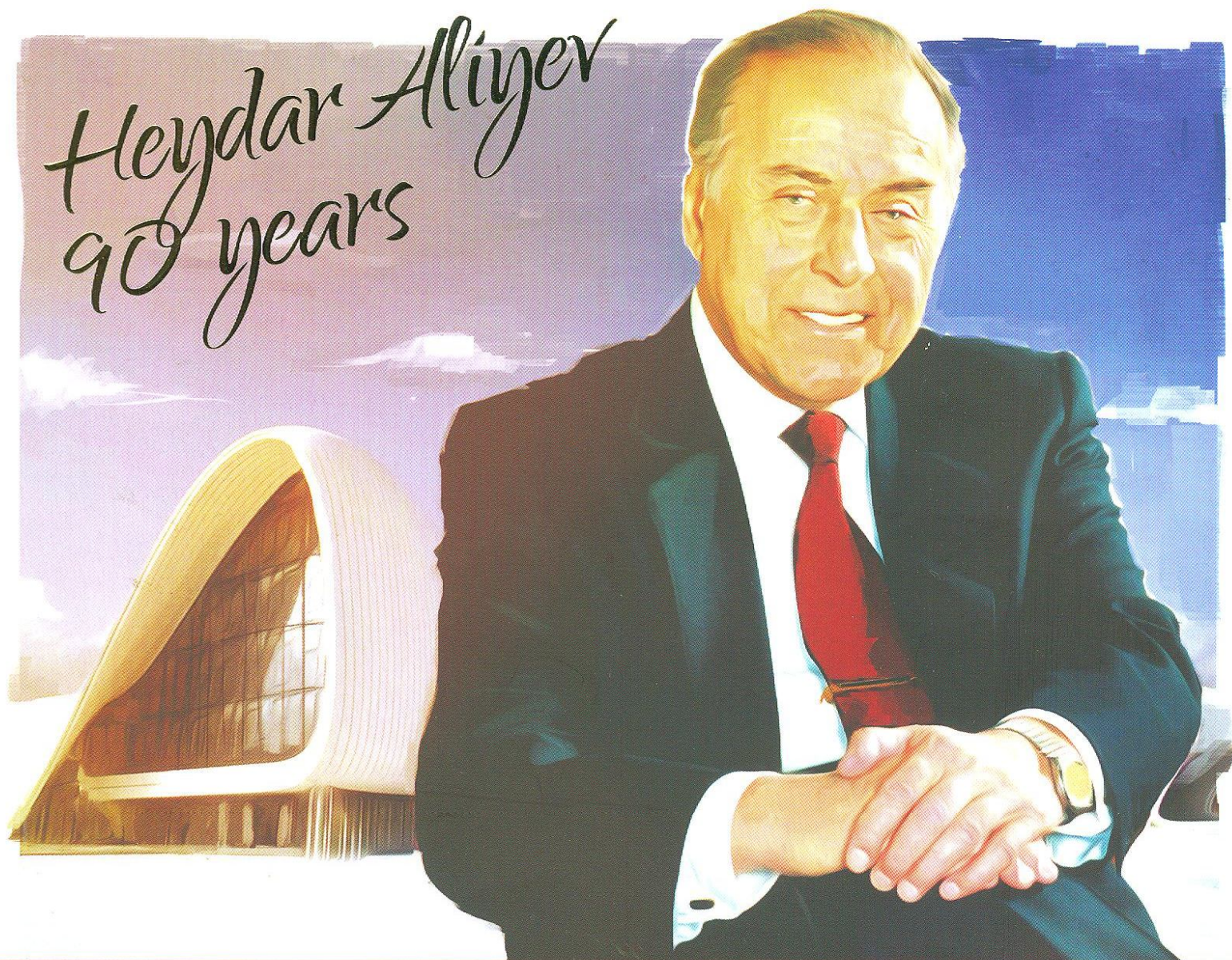


Year in Review | Diplomacy & Politics | Economy | Finance | Energy | Industry & Mining | ICT
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Azerbaijan2013

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*Heydar Aliyev
90 years*



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ISBN 978-1-908180-12-4



INTERVIEW

Shahmar Movsumov



The New Asset Mix

TBY talks to *Shahmar Movsumov*, Executive Director of the **State Oil Fund of the Republic of Azerbaijan (SOFAZ)**, on the fund's growing and diversifying investment portfolio and its contribution to the evolution of wealth and development in Azerbaijan.

TBY Could you describe the scope of the activities that the State Oil Fund of the Republic of Azerbaijan (SOFAZ) is active in?

SHAHMAR MOVSUMOV President Heydar Aliyev established SOFAZ back in 1999 as an integral part of the government's oil strategy. The first stage of this strategy involved the development of oil and gas fields in cooperation with major foreign oil and gas corporations. The second stage was focused on establishing multiple oil and gas transportation routes connecting Azerbaijan with major international markets. The third stage of the strategy involved the establishment of SOFAZ, with the main purpose to maintain transparent and prudent management of the country's oil and gas revenues. One of SOFAZ's main objectives is the preservation of macroeconomic stability by insulating the economy from oil revenue volatility, decreasing dependence on hydrocarbons, and stimulating the development of the non-oil sector. The second objective is to ensure intergenerational equality with regard to the country's oil wealth. Non-renewable natural resources are converted into a diversified portfolio of international financial assets, which generates perpetual income for current and future generations. The investment portfolio is only invested in assets outside of Azerbaijan, and until 2012 it was

mostly allocated to fixed-income securities denominated in three major international currencies. In 2012, we diversified into new markets by adding exposure to new asset classes, namely gold, real estate and equities, and different currencies. The third objective is allocating resources for funding major socioeconomic projects. For instance, we have completed financing the state's share in the Baku-Tbilisi-Ceyhan (BTC) pipeline construction project. Currently, we are financing the construction of the Baku-Tbilisi-Kars (BTK) railroad and the construction of the settlement for refugees and internally displaced persons who were forced to flee their native lands as a result of Armenia-Azerbaijan, Nagorno-Karabakh conflict. Furthermore, we are funding the "State Program on the Education of Azerbaijani Youth Abroad from 2007-2015," which provides full scholarships to Azerbaijani students studying in leading international universities. In 2013, we are starting a number of new projects in cooperation with the State Oil Company of Azerbaijan Republic (SOCAR)—we will begin funding the Trans-Anatolian Pipeline (TANAP) project, which is an integral part of the Southern Gas Corridor and will allow the transit of gas to Europe.

What would you say were some of your major achievements in 2012?

I would say that 2012 was a milestone year for SOFAZ. We modified our investment strategy to include several new asset classes and started building a diversified, multi-asset class portfolio, thus enhancing the expected return of our investments. Our conservative, risk-cautious investment strategy served us well in the past, enabling the fund to avoid incurring losses during the turbulent years of the global financial crisis or a low-yield environment, and prevailing in the financial markets in the post-crisis period, which substantially limited its performance. As in every new beginning, each one of these new instruments has brought its challenges. However, the capacity we have built over the years, from both a human resources and infrastructure point of view, has enabled us to successfully overcome those obstacles.

SOFAZ has recently made some high-profile real estate acquisitions in Paris and London. What led you to make these decisions regarding the purchase of real estate?

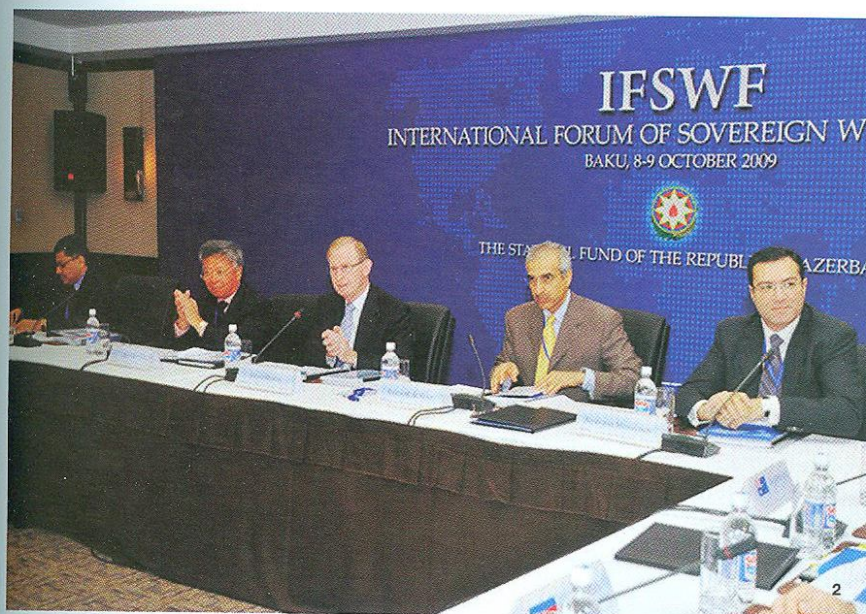
According to SOFAZ's current investment

BIOGRAPHY

Shahmar Movsumov is a graduate of the International Economic Relations Faculty of Moscow State Institute of International Relations, and has a Master's in Public Administration from the John F. Kennedy School of Government at Harvard University. After graduation, he worked for an extensive period from 1995 to 2005 at the National Bank of Azerbaijan Republic, becoming its General Director in 2005, before moving to the State Oil Fund of the Republic of Azerbaijan (SOFAZ) as Executive Director in 2006. Since 2006, he has also served as Chairman of the Government Commission on the Extractive Industries Transparency Initiative.

1 Shahmar Movsumov, Executive Director of SOFAZ

2 Shahmar Movsumov (right) at the International Forum of Sovereign Wealth Funds in Baku in 2009



SOFAZ in numbers

Assets

\$34 billion

Employees

100

Proportion of portfolio in fixed-income instruments

85%

guidelines, up to 5% of its investment portfolio may be allocated to real estate. Our current investment strategy with regard to this asset class is aimed at building a globally diversified portfolio comprised of core assets in key cities around the globe. All of the potential investments are thoroughly analyzed along several parameters, such as price, location, quality, current tenants, and development potential. The highest-scoring properties are acquired.

Are you involved in any projects in Azerbaijan to improve state infrastructure?

Only large-scale projects of national significance are financed by SOFAZ. Over 2013, in addition to the projects I mentioned earlier, we will start funding a fiber-to-the-home project aimed at providing broadband internet access to every house in the country. This project has significant potential for moving forward the telecommunications sector in Azerbaijan.

How much of SOFAZ's portfolio is in gold, and what made you decide to acquire that asset?

In accordance with our current investment policy, up to 5% of our investment portfolio may be allocated to gold. We started our investments in this asset class in February 2012 and acquired around 15 tons of gold by the end of the year. In 2013, we are planning to increase our gold holdings to 30 tons, and we have already started transporting it to Azerbaijan. As an asset class, gold has several unique characteristics that makes it attractive for investors. In the long run, gold is considered to act as an effective

instrument for hedging inflation and currency risks. Moreover, gold offers protection from heightened volatility in financial markets during economic downturns as it is negatively correlated to both equity and fixed income.

How would you characterize the evolution of Azerbaijan's investment climate over the last decade?

I recently attended a farewell dinner for one of the ambassadors who spent roughly 10 years here. In his words he said, "I came to one country and I am leaving a totally different country." During his 10 years here, Azerbaijan has absolutely transformed itself into a new country. Wide-ranging economic reforms implemented by the government have resulted in notable progress to improve regulatory efficiency and encourage domestic economic diversification, especially in the areas of agriculture, tourism, and ICT. The government invested in the development and modernization of the country's infrastructure, laying the foundation for private sector investments in the country. Azerbaijan has enjoyed measurable success in diversifying its economy outside of the energy sector, with the non-oil portion of the economy growing significantly.

What further strategies do you have for 2013?

Overall, 2012 was marked by the fund entering public equities, real estate, and gold markets. At the same time, we have added new currencies to our investment portfolio—the Australian dollar, the Rus-

sian ruble, and the Turkish lira. In 2013, we will continue building up our exposure to these asset classes and further diversify our investment portfolio. We are planning to increase our exposure to equities, both public and private. We will also strengthen our position in real estate. At the moment, we are exploring new regions for attractive investment opportunities in real estate.

What are your medium-term plans for SOFAZ?

Over the next few years, we plan to expand institutionally and professionally. We are looking forward to further increasing our allocation to equities and alternative assets. These financial instruments are expected to perform better than fixed income in the long-term perspective. This is in line with the long-term investor nature of the fund. On a separate note, we have always managed the majority of our assets in-house. That way, we are able to gain valuable experience and a deeper understanding of those markets. During the initial stages of our investments in the new asset classes, we decided to employ the know-how and expertise of the largest players in those markets. For instance, our public equity portfolios are currently being managed externally. However, we are planning on gradually increasing the fund's involvement in the management of those assets, while keeping an eye on cost efficiency. In the meantime, we will be building the internal capacity necessary for efficient in-house management by investing heavily in staff training and developing necessary systems and practices. ●