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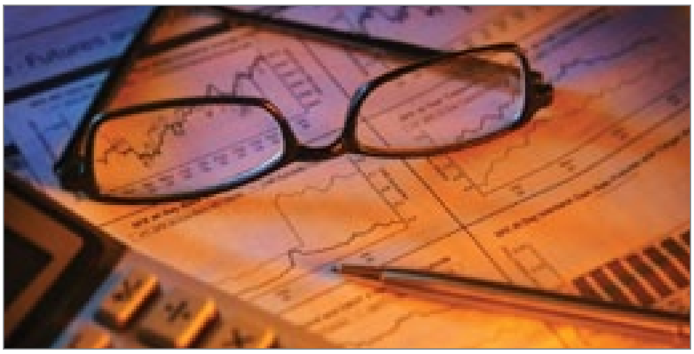

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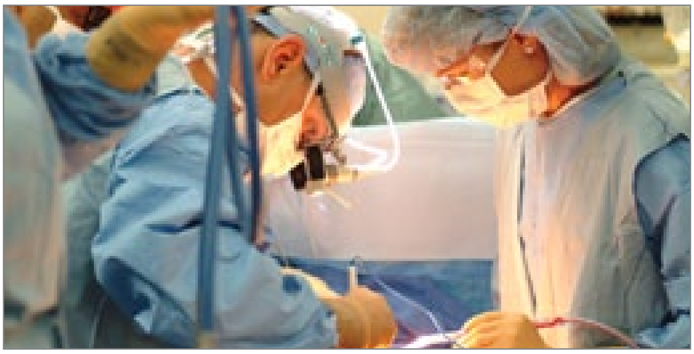

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EDITOR'S VIEWPOINT

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The revolving door

EMPLOYING PEOPLE IN CHINA IS AN illuminating experience. Job notices provoke a barrage of resumes crammed with work experience. After the customary 30-second scan, you are forced to blink and re-read, asking yourself, "How is it possible for candidate X to have been employed at so many different places in such a short period of time?"

And, in some cases, it's not possible at all. On closer inspection, candidates have worked at two or more places simultaneously – and at none for more than six months.

When asked at interview why they haven't remained anywhere for a sustained period of time, there is a uniform response: "I'm talented, I was head-hunted." The more likely explanation is that these people are molecules bouncing around in a highly competitive recruitment market that – late 2008 and early 2009 excepted – is perennially bubbling over. Where you have strong economic growth or volatility, job volatility inevitably follows.

For China-focused private equity firms, identifying and then retaining talented staff is a major challenge. This is particularly the case for mid-level associate positions. Addressing recruitment issues properly might require a PE firm to review its corporate culture and compensation structure.

Chinese LPs are in a similar bind, as evidenced by the revolving door at China Investment Corporation (CIC) in the first half of 2012. The resignations of James Ieong and Daniel Hu, managing director and director in the sovereign wealth fund's private equity department, in May, came on the heels of Collin Lau quitting as European PE head just four months after being reassigned from the real estate division. Lau's replacement in that department, Patrick Wu, departed earlier in the year.

Most land on their feet in the private sector. Ieong is now working for Queensland Investment Corporation while two private equity executives that left CIC in 2011, Jingping Guo and Xiaowei Zheng, reportedly ended up at China International Capital Corp. (CICC) and CITIC Private Equity, respectively.

For some of these investment professionals, 2011-2012 signaled the end of three-year contracts with CIC. These were signed around the time of the global financial crisis when there was a lot less job security in the financial services industry. Come renewal time, the investment professionals – their rolodexes brimming over from fierce networking in China's state sector as well as in its PE community – found they could earn more money elsewhere.

It is difficult for CIC to address this issue given that staff are essentially government employees and therefore paid notoriously low salaries compared to their peers, according to numerous industry sources. Rethinking the compensation structure would require high-level government approval and the implications of such a precedent-setting move are enough to make even broadminded policymakers gulp.

The frustration for CIC is that high turnover in key positions makes it harder to develop sophisticated investment practices. Two recent anecdotes put this into perspective.

CIC picked up the bulk of $3.9 billion equity that supported Alibaba Group's $7.6 billion partial buyback of a stake in itself held by Yahoo. Three PE firms also participated, CITIC Capital, CDB Capital and Boyu Capital, with the latter involved from an early stage as an advisor to CIC. One industry participant familiar with the transaction adds that Boyu was instrumental in negotiating the terms of behalf of the sovereign fund.

"Particularly when they are negotiating with domestic guys, CIC is too bossy and talks often break down," he says. "So they needed an intermediary."

Staff turnover also means that fund managers approaching CIC as a prospective LP find themselves starting from scratch with a new group of executives every few months. One GP recalls dealing with 3-4 different teams from the sovereign wealth fund over a two-year period. By contrast, other large Asian LPs, including relative newcomers to private equity such as Malaysia's Employees Provident Fund, are said to be more consistent.

When CIC was set up, the Chinese government pointed to Temasek Holdings as a model to which it could aspire. Unfortunately the Singaporean approach to public servant compensation – it pays among the highest rates in the world and expects loyalty in return – is perhaps the hardest aspect to replicate.

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NEWS

GLOBAL

Terra Firma, CDB to launch infrastructure fund

UK-based Terra Firma and China Development Bank (CDB) are reportedly planning to launch a $3-5 billion energy infrastructure fund. CDB will market the new fund in China, although most LPs are expected to hail from the US and Europe. It will invest in global opportunities in renewable energy infrastructure projects and companies.

Costa joins Developing Markets Capital Partners

Developing Markets Capital Partners (DMC), a PE firm launched by three ex-Goldman Sachs executives, has hired Ken Costa, former chairman of Lazard's international arm as a partner. Costa is the fifth partner to join DMC. He will work alongside Philippe Costeletos, who previously headed up TPG Capital's European unit.

ADIA hires new head of principal investments

Abu Dhabi Investment Authority (ADIA) has appointed Colm Lanigan as head of principal investments in its private equities department. He is responsible for the identification, execution and management of direct investments into private companies.

Greenpark promotes Damien Green to CIO

Greenpark Capital has promoted Damien Green to CIO. He joined the firm in 2001 and was previously an investment director, serving on the secondary specialist's executive team and investment committee. Green will lead the investment team and participate in the sourcing, evaluation and execution of transactions.

ASIA PACIFIC

Intel Capital invests in five Asian companies

Intel Capital, the venture capital arm of Intel Corp, has invested $40 million in 10 companies, half of which are from China, India, South Korea and Taiwan. Its newest round of Asia investments include South Asia's Hungama.com; Taiwan-based integrated circuit design house FocalTech; South Korea's social game developer LIFO Interactive; and two Chinese companies - mobile advertising provider UUCun and 3D game developer Transmension.

SCPE re-invests in PepsiCo's South Asia bottler

Standard Chartered Private Equity (SCPE) has invested a further INR1.7 billion ($32 million) in Varun Beverages (VBIL), the largest bottler for PepsiCo in South Asia. The cash injection follows SCPE's INR2.5 billion purchase of a reported 5% stake in the firm in July 2011, as part of a deal intended to support the company's expansion in India as well as in Morocco, Nepal and Sri Lanka.

VBIL is engaged in bottling, distributing and marketing beverages sold under trademarks owned by PepsiCo. It is owned by RJ Corp, which comprises diversified business interests spanning beverages, fast food restaurants, ice creams and dairy products, breweries, education, healthcare and hospitality.

AUSTRALASIA

Billabong says TPG talks continue despite concerns

Billabong said that buyout negotiations with TPG Capital are continuing despite the private equity firm and its advisors raising some due diligence concerns. It was earlier reported that TPG was poised to walk away from the A$694 million ($709 million) deal, prompting the surfwear company's stock to plunge 20%.

Founder of Australia's Seek plans PE platform

Paul Bassat, co-founder of Australian job search site Seek, is looking to set up a private equity platform with Tony Holt, who recently left his position as a senior managing director with Macquarie Group in Hong Kong. They will look for opportunities in the technology, internet and media spaces.

Next-backed Hirepool in talks to buy HireQuip

Hirepool, the New Zealand rental equipment specialist owned by Australian private equity firm Next Capital, is reportedly in exclusive talks to purchase its indebted rival, HireQuip, which is owned by Sydney-based Tasman Capital. The acquisition would allow HireQuip to pay off most of a A$115 million ($117 million) from Westpac that is due to mature this year.

GREATER CHINA

Cathay Fortune offers $848m for Discovery Metals

Cathay Fortune Corp, a private equity firm founded by Chinese billionaire Yu Yong, has made an A$830 million ($848 million) takeover bid for Australian copper producer Discovery Metals. China Development Bank (CDB) is supporting the proposed deal. Cathay Fortune, already holds 13.7% of Discovery and has offered to pay A$1.70 per share for the remainder.

Morgan Stanley supports Feihe MBO bid

Morgan Stanley Private Equity Asia (MSPEA) has teamed up with the chairman and CEO of Feihe International to make a buyout offer for the US-listed Chinese company. The chairman and an MPSEA affiliate are willing to pay $7.40 per share for all outstanding shares they don't already own. The transaction values Feihe, a leading infant formula producer, at $146 million.

Loeb & Loeb launches Hong Kong office

Loeb & Loeb has launched its second Asia office in Hong Kong, having opened in Beijing three years ago. The law firm's Hong Kong operations will run in conjunction with local player Pang & Co. Benny Pang, managing partner at Pang & Co, will join Loeb & Loeb's capital markets department as a partner.

MoFo hires ex-A&O PE specialist Jeremy Hunt

Morrison & Foerster has recruited Jeremy Hunt as a partner in its Hong Kong-based corporate practice. Hunt joins after 24 years at Allen & Overy, where he worked on numerous private equity transactions involving the likes of The Carlyle Group, Temasek Holdings and Capital International.

NORTH ASIA

Japan's GPIF considers alternative investments

Japan's Government Pension Investment Fund (GPIF), which has $1.38 trillion under management, is considering diversifying into alternative assets. A GPIF executive told AVCJ that a consultation project began in September and is expected to conclude next year.

Oaktree exits aircraft leasing firm to Mitsubishi

Oaktree Capital Group has sold aircraft leasing firm Jackson Square Aviation to Japan's Mitsubishi UFJ Lease & Finance Co. for JPY100 billion ($1.3 billion). The deal, which involves the sale of Jackson Square's parent JSA International Holdings, will be completed in December, and will add around 70 planes to Tokyo-based Mitsubishi UFJ's commercial-aircraft fleet.

SOUTH ASIA

Blackstone commits $100m to International Tractors

The Blackstone Group has committed $100 million for a 12.5% stake in India's International Tractors (ITL). The capital will be used to expand production and pursue overseas acquisitions. Akhil Gupta, chairman of Blackstone India, said that rising labor costs are leading to increased mechanization in the farming industry.

IUVP rebrands as Kalaari Capital, closes $150m fund

The founders of Indo US Venture Partners (IUVP) have established a new VC firm, Kalaari Capital, and raised a $150 million India fund. Vani Kola, managing director at Kalaari, said the rebranding exercise is expected to bring in fresh ideas and focus on the Indian market.

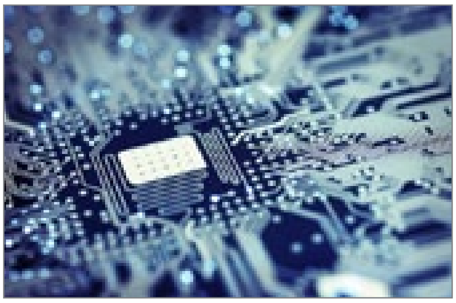
Nalanda Capital makes 2x return on Shree Cement

Nalanda Capital has sold a 1.61% stake in Shree Cement for INR2.13 billion ($40.9 million) through a bulk deal on the Bombay Stock Exchange. The partial exit generated a money multiple of 2x. Nalanda Capital invested in the cement producer between June and September last year, when the firm's shares were trading at half of the current level.

Carlyle, Unison-backed Covalent avoids default

Covalent, the Japanese semiconductor materials manufacturer owned by The Carlyle Group and Unison Capital, has averted a debt default by agreeing to buy back securities from its bondholders.

The bondholders have approved the company's proposal involving a combination of buying back the outstanding bonds and extending their maturity in return for higher coupons. Covalent said in July that it had insufficient cash reserves to repay JPY54.3 billion ($679 million) in bonds due to mature in February. Two months later the company offered to buy back the bonds at a price of JPY76 against the face value of JPY100.



Carlyle and Unison acquired Covalent from Toshiba Corp. in 2006. The deal valued the asset at JPY91 billion and the debt financing amounted to JPY65 billion..

Info Edge acquires Accel-backed Toostep

Accel Partners India has exited its stake in Toostep Consultancy after the networking and recruitment company was acquired by Info Edge, India's leading online classified advertising player. The VC firm first invested in Toostep in 2008.

3i's Nikhil Gahrotra joins BanyanTree

Banyan Tree Finance has poached Nikhil Gahrotra from 3i Group, where he was working as associate director. He joins the mid-market PE firm as a director. Gahrotra has more than nine years of experience in the financial services industry, of which the last seven years were spent focusing on private equity in India.

Fulcrum reaps 10x from Casa Grande exit

Fulcrum Venture India has reaped a money multiple of 10x from its investment in Indian real estate company Casa Grande. Fulcrum sold its stake back to the firm's founders for INR500 million ($9.6 million), having invested just INR48 million in Casa Grande in 2004. The money multiple equates to an IRR of 54%.

VenturEast hires ex-DFJ partner to run seed fund

VenturEast has hired Sateesh Andra, formerly a partner at Draper Fisher Jurvestan, to head up its seed-stage technology fund. His remit is to create a Silicon Valley-like incubation ecosystem and help companies tap into global venture funding.

SOUTHEAST ASIA

Baring-backed Courts Asia targets $112m IPO

Baring Private Equity Asia portfolio company Courts Asia has launched its Singapore IPO with a view to raising S$137 million ($112 million). The electronics and furniture retailer is offering 178 million shares, of which 60 million are new shares, at a price of S$0.77 apiece, the top end of the indicative price range.

CVC considers Matahari share sale

CVC Capital Partners has reportedly asked bankers to advise on selling Matahari Department Store, the Indonesian retailer it acquired two years ago for INR7.2 trillion ($616.3 million). It remains the largest ever PE investment in a consumer business in the country.

Yishan creates JVs to tap Indonesia real estate

Yishan Capital Partners has formed two strategic joint ventures to improve its penetration of the Indonesia market. The first, JV with Colliers International, will look for opportunities in the retail property sector. The second, run in partnership with Jakarta-based Rodamas Group and focus on logistics parks and other industrial properties.

TPG hires Credit Suisse's Francis Woo

TPG Capital has hired Francis Woo as a principal for its Southeast Asia team. He was previously director and co-head of corporate finance for Southeast Asia at Credit Suisse. Woo will focus primarily on deal sourcing and execution.

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More than ticking boxes

Corrupt deals, agreements with the dishonest and lackluster returns can all be avoided by doing sufficient due diligence on a GP. But advisers say LPs in Asia still aren't doing enough

HOW MANY PRIVATE EQUITY professionals does it take to change a light bulb?

a) A syndicate of 10 private equity firms, 100 investment bankers and 100 lawyers

b) Not applicable. My deals never fail and my light bulbs never fail

c) Don't know. But the LPs pay for our light bulbs somewhere in the numbers.

Why did the PE executive cross the road? Why is your firm targeting an IPO despite claiming that a company benefits from private ownership?

All of these questions should be put to private equity managers before an LP decides to invest with them, argues Veryan Allen, adviser to high-net-worth individuals, family offices and pension funds, who specializes in emerging and frontier markets.

There's little doubt that Allen – who made the observations on his blog – was writing in jest. However, the subject of fund-level due diligence is something investors shouldn't take lightly.

"For proper due diligence – particularly in emerging markets – you really have to drill down to the portfolio company level to understand the true value-add the GP brings to the portfolio management team – the CEO and CFO," explains Richard Tan, Hong Kong-based senior private markets consultant at Towers Watson, a major gatekeeper to institutional investors like pension funds.

"You need to make sure that the downside protections are examined carefully and are enshrined if possible in the legal documentation."

Doug Coulter, head of Asia Pacific private equity at LGT Capital Partners, goes one step further. "There are a number of portfolios where you have mediocre companies, no exits and GPs who haven't raised any more money or aren't going to raise any more money," he says. "Maybe if people had done better due diligence, qualitative and quantitative, before committing capital, they wouldn't be in these positions."

Surface skimming

Anecdotal evidence suggests that the due diligence conducted by many LPs active in Asia is still insufficient. Yet given the dominance of minority deals in the region, which means the investor has less influence over the portfolio company, choosing the right GP is arguably more important here than anywhere else. Numerous LPs, particularly smaller firms located in far-flung locations, have been known to make do with merely skimming the surface of a private equity firm's investment thesis or just having a conversation with a couple of its senior professionals.

The problem with this approach is that few firms have skeletons in their closets that can be exposed with a peripheral glance. According to Violet Ho, head of the Beijing office for Kroll, the private intelligence agency, LPs investing in China should be concerned that various investigations and background checks on private equity firms have revealed unscrupulous behavior.

"Some founders of GPs, who made their money as entrepreneurs, have gone on to present investment opportunities to their funds without revealing previous personal involvement in these companies," Ho tells *AVCJ*. "Then they tell their family or friends that they can achieve a valuation for the company that's higher than what it's worth. They do it because they get some sort of personal pay-off when they secure and finish the transaction."

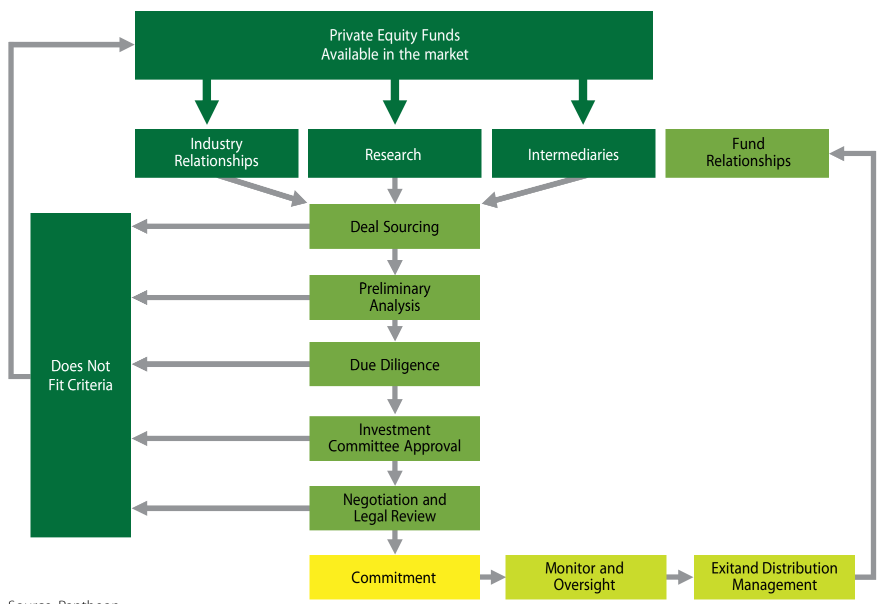
Another source is aware of an LP that invested with a firm, only to discover the main manager of the fund had lied about his educational background. Ironically, the returns from the fund were healthy, and so the LP continued to invest in any case, but the situation nevertheless acts as a cautionary tale for those investors that believe they can take GPs at face value.

Challenges at sea

Potential corruption, physical distance between an LP and a prospective GP, and the size of the LP's team aren't the only challenges that present themselves during the due diligence process. Investors need to adopt a two-tiered approach to their analysis of a PE firm – examining both the fund manager and the underlying portfolio companies – but the companies aren't always entirely willing to participate. Furthermore, many Asian companies aren't properly or credibly audited, so getting high-quality financial information can be difficult.

"Portfolio companies don't always understand what's happening," says Ian O'Donnell,a partner in the venture capital practice at US and China-

The typical due diligence process



Source: Pantheon

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Diligence: USD vs RMB

It seems counterintuitive that a fund would ask for an investment from an LP and then fail to provide enough information about itself. However, such circumstances aren't unheard of in Asia, especially in China, where a discrepancy has been noticed between the level of data provided by renminbi- and US dollar-denominated funds.

Offshore funds that raise in both currencies simultaneously typically share information based on a template established over years of experience in LP reporting. It's unusual for renminbi funds raised by Chinese GPs to have this depth of background, so many of them fall down on this point. The exception tends to be firms that recruit external advisers to assist with English language-versions of the PPM and due diligence materials or even with creating an LP reporting template.

"They will without doubt improve over the course of time, but some of the Chinese GPs that are thinking of raising for the first time may not be that equipped at the early stages of their fund life," says Richard Tan, Hong Kong-based senior private markets consultant at gatekeeper Towers Watson.

Not all LPs see this lack of familiarity with due diligence and reporting procedures as a disadvantage in any case. Some take it as a given that in cases where PE firms have perhaps only raised one prior fund in a relatively kind market the ability to pre-package due diligence and create a robust data room for investors will not be as advanced. LPs can use this to their benefit, though.

"If you have a truly local team that's fluent in Mandarin and has done due diligence on dozens of managers, it's in your DNA to meet directly with the management teams of companies who might not speak English to check if the lights are on on Friday night, that they're running multiple shifts, and actually need the capex that they're expressing," says Alex Wilmerding, principal with global fund investor Pantheon's Asian investment team.

"It's natural to sift through the accounts and diligence information that is only provided in the local language."

focused law firm Cooley. "It can be difficult to ask them to deal with 30-40 calls from LPs. One solution is to bring some standardization into the process, which funds are trying to do because it avoids having LPs contact their companies too many times."

First-timers

The bulk of institutional investors already use a standardized questionnaire as part of due diligence – although Towers Watson's Tan emphasizes that this doesn't capture the nuances of the contrasting emerging markets across Asia and that investors ought to make further inquiries to obtain the necessary level of detail.

This is even more important in the case of first-time funds. According to data from Prequin, at 46% of the total, "Asia and rest of the world" account for the largest proportion of private equity vehicles raised by first-time managers, which globally are targeting an aggregate of $72 billion at present.

Though around half of all Asia-focused LPs are thought to have a policy prohibiting investment with new managers, the remaining 50% have their work cut out to make sense of a firm that has yet to build up a track record. First-time fund managers rarely have their documentation and investment procedures honed to the same standard as more experienced counterparts, so LPs are obliged to conduct research on a more informal basis. If the individuals behind the fund made investments before the formation of the GP, investors can accumulate valuable information by talking to people who invested alongside them.

Global fund-of-funds manager Pantheon rarely takes this chance though, and will only invest in a first-time fund if it is a spin-out from a larger institution or has a pre-existing relationship of 2-3 years with the firm.

Among funds that do have predecessors, a strong track record remains one of the top three criteria for LPs. Perhaps surprisingly, though, this doesn't mean that it's game over for firms with one or two catastrophic deals in their wake. On the contrary, LPs may view past blow-ups as a positive, arguing that they don't want their capital to be used as the tuition fees for the GP to learn on the job. If a team can take past experiences and apply what was learnt intelligently in future transactions, it generally isn't a problem.

"If a company goes bankrupt, though, then something's seriously wrong," says a partner at a global fund-of-funds. "It's a pretty big mistake if something goes bust 2-3 years after your investment, so we would take that seriously. We would prefer the loss ratio of the overall fund to be under 20%."

Affinity Equity Partners lost its principal when Australian Colorado Group went under last year, but this $298 million buyout is unlikely to cast a shadow over the GP as it enters the market with its fourth fund, targeting $3.5 billion. The prospects for Advantage Partners, however, are uncertain. The Japanese private equity firm acquired Tokyo Star Bank for $2.2 billion in 2007 – by far the GP's largest investment – only to see it fall into the hands of creditors four years later after failing to meet debt payments.

An element of track record that appears to generate disagreement among LPs is the need for consistency of strategy. On the one hand, the consensus is that if it's marketed correctly, and there are good reasons for the change, a shift in direction is justifiable. An example would be a fund manager that decided to move away from investing in healthcare in China because it deemed the margins insufficiently high to continue to operate in the space. Provided the decision was explained in adequate detail, many LPs would accept it.

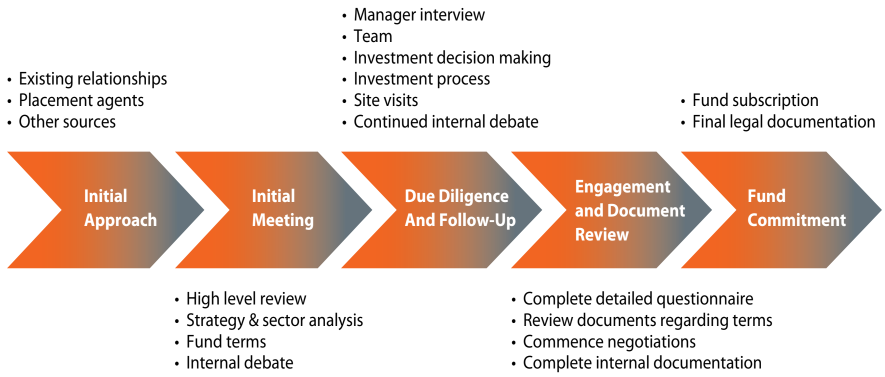
On the other hand, despite the need for flexibility in the rapidly changing Asian market, there is the argument that a lack of consistency renders a track record useless and may cause an investor to question a GP's judgment. "In general, we prefer people to be consistent in terms of strategies where they've made money in the past," is how one LP puts it.

> "Some founders of GPs have gone on to present investment opportunities to their funds without revealing previous personal involvement in these companies"
>
> – Violet Ho

Team equality

Another prime consideration when conducting due diligence is the quality of a GP's team and a cohesive decision-making structure. What LPs

Institutional investors would typically adopt the following steps when pursuing private equity fund commitments



Source: Towers Watson

don't like to see are situations in which one or two fund managers drive the entire investment process. If a fund says it has 4-5 managing partners, they want to see equanimity in terms of remuneration between those individuals. An exception to this are so-called "personality funds," where much of the marketing revolves around a particular person. Hony Capital and Primavera Capital, run by John Zhao and Fred Hu, respectively, arguably fall into this category.

In such scenarios, investors typically view it as defensible if the most prominent individual(s) earn 60% of the carried interest, due to the benefits these quasi-celebrities confer on the fund when convincing entrepreneurs to take capital, for example.

"I don't think anyone wants a firm that is just driven by one individual, so you can't be happy about that, but you have to play with the cards you're dealt and in China you can't always find those solid teams of people who are just carving themselves out of a firm or a bank," adds Ben Wootliff, who heads the Hong Kong office of the business risk consulting firm Control Risks Group.

Others point out that in China, in particular, the media frenzy surrounding private equity and venture capital means that it's very difficult for anyone who has encountered success in this field to remain low-profile, even if they wanted to.

Thus on balance LPs appear willing to accept the disproportionate number of entities in Asia riding on the backs of high-profile individuals for a while longer. What has changed with regards to due diligence on firms is that – although many LPs in Asia still have a way to go to bring background checks up to the global standard – they are spending longer on their investigations than ever before.

Even firms with prominent figureheads face more sophisticated and relevant lines of questioning than in the past.

"Before, it tended to be that when we were asked to look at a firm, we were asked to look at the founder," says Kroll's Ho. "Now a lot of LPs are asking questions about the whole deal team – their composition, their stability, do they get along? They're asking a lot more about the culture and values of the firm, which is a very positive sign."

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The bottom falls out of RMB fundraising

Third-quarter analysis: China US dollar funds attract more capital than renminbi vehicles; trade sales and secondary buyouts continue to gather pace; positive early signs for China buyouts

1) Renminbi funds stutter amidst flight to quality

Have the wheels fallen off renminbi-denominated fundraising? It would appear so. According to provisional data from AVCJ Research, between July and September, nine local currency vehicles achieved some kind of close, compared to 27 in the previous quarter and 50 during the same period a year ago. Total funds raised have now fallen during three consecutive quarters: from $8.2 billion in January-March to $6.4 billion in April-June and now $1.4 billion in July-September.

To put the scale of demise into perspective, US dollar-denominated fundraising in China exceeded renminbi fundraising in the third quarter. This turns on its head a trend that had been gathering pace over the last two years.

In the first half of 2011, renminbi vehicles accounted for 54% of China fundraising, rising to 80% in the following six-month period and 82% in the six months after that. The renminbi portion of fundraising region-wide increased from 33% to 57% to 65%. In the third quarter of 2012, the share of national and regional totals fell to 44% and 13%, respectively.

It would be tempting to tie this poor performance to wider macroeconomic weakness – Chinese GDP expanded 7.6% in the second quarter, its slowest pace in three years, on the back of weakening exports and lower investment growth – but are investors only now pulling back from private equity or did this in fact start happening several months ago?

The reality is that renminbi fundraising has been underpinned by large, state-backed vehicles for more than a year. With the exception of Hony Capital Fund V, the four largest funds reaching a close in the first half 2012 throughout Asia were government-linked. Such vehicles are conspicuous by their absence from the list of the top 10 funds raised between July and September. The CICC Jia Tai Private Equity Fund is the only renminbi vehicle among them.

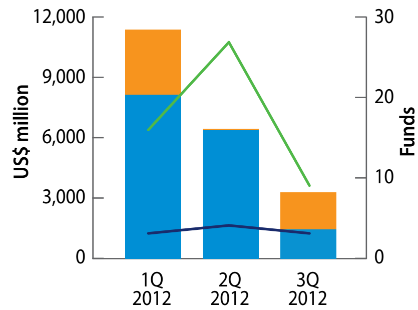
There are two other China funds in the list: PAG Asia I (final close) and FountainVest China Growth Fund II (first close). Between them they accounted for most of the $1.8 billion that went into US dollar vehicles in the third quarter, a marked improvement on the previous three months, even though the number of funds fell by one, to four.

It reflects a trend apparent across the region. Private equity fundraising in Asia reached $10.8 billion during the period, the lowest level in two years. But the $2.5 billion quarter-on-quarter fall in capital raised is far less dramatic than the decline in the number of vehicles attracting capital – 33, down from 67 in the second quarter.

What the numbers suggest is that investors are committing less but focusing on a smaller number of funds – entirely in keeping with the "flight to quality" mantra we highlighted three months ago. The four largest funds came from PAG, Bain Capital, Asia Alternatives and FountainVest, all of which can point to senior executives with credibility and experience in the market.

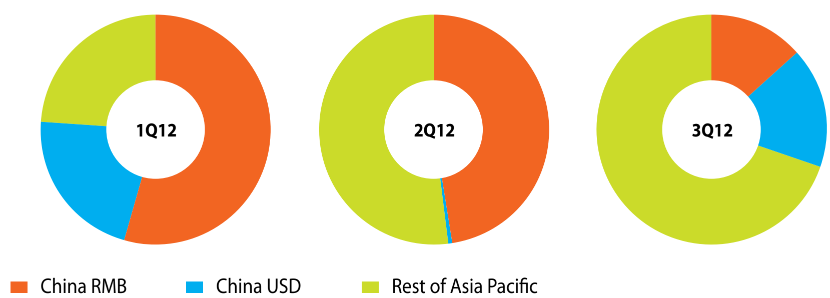
Three more – Kerogen Capital, Clearwater Capital Partners and The Longreach Group – achieved final closes during the quarter. Although each one came in under target, they did better than most. They can also point to particular areas of expertise – energy, distress and Japanese corporate carve-outs, respectively – that might appeal to LPs looking for differentiation and a strong investment narrative.

China RMB vs USD fundraising



Source: AVCJ research

China share of Asia fundraising by quarter



Source: AVCJ research

2) Trade sales, IPOs gain momentum. Can it last?

Trade sale exits and private equity-backed IPOs have rebounded, with July-September quarter numbers building on the momentum of the previous quarter. The question is: can this run be sustained? We are more optimistic about trade sales than IPOs.

First, the public markets. Private equity-backed offerings generated $14.2 billion in the third quarter, comfortably more than the $8.8 billion and $2.9 billion seen in the previous two quarters. However, the number of issues is largely unchanged: 41 in January-March, 47 in April-June, and 42 in July-September. Clearly, a few bumper IPOs are pushing the needle.

For that we can thank the robust Bursa Malaysia, where Khazanah Nasional-owned IHH Healthcare weighed in with a $2 billion offering, and Enterprise Turnaround Initiative Corporation, which completed the restructuring of Japan Airlines. The latter culminated in an IPO that accounted for more than half the total raised in Asia as a whole. Clearly, we are unlikely to see one of these per quarter, so expect the IPO data to correct in the final three months of the year.

As for trade sales, $19.9 billion was transacted in the third quarter, compared to $15.6 billion in April-June and a paltry $5.3 billion in January-March. The most notable exits concerned investments made during the boom period of 2006-2007, when Japan and Australia in particular saw a host of highly leveraged transactions.

These assets are now due for sale or refinancing and, given the weak capital markets and tighter lending policies from buyout financiers, strategic buyers are waiting to pounce. Country Road picked up Australian fashion retailer Witchery Group from Gresham Private Equity for $180 million, while Advantage Partners agreed to exit Rex Holdings to rival restaurant chain Colowide for around $175 million.

As for secondary buyouts, Permira acquired Japanese sushi chain Akindo Sushiro for $1 billion, generating a stellar return for local GP Unison Capital, and now plans to support the company's expansion into new markets in Asia. In Australia, Quadrant Private Equity completed an innovative quasi-secondary investment in Super A-Mart and Barbeques Galore. The PE firm put in $136 million and secured a new financing package, taking just under 60% in the combined entity and allowing Ironbridge, which led the original buyouts of the companies, to roll over its equity stake, while Government of Singapore Investment Corporation (GIC) exited.

These represent interesting themes and financial logic suggests they will become more prominent, but we made a similar prediction this time last year and exit activity went into a six-month decline. The nature of these investments and health of the underlying assets means sales tend to come in fits and starts.

3) China's emerging buyout movement

The argument for ever larger China-focused private equity funds is largely predicated on expectations that the nature of investment opportunities will evolve. Through a combination of take-privates of Chinese companies listed overseas, state-owned enterprises in need of restructuring and entrepreneurs looking to exit their businesses or seeking help to expand them overseas, industry participants are optimistic about buyouts.

Several of these driving factors aren't going to bear fruit immediately, but third-quarter deal activity gives an indication what is to come.

The take-private movement reached new heights as the chairman of NASDAQ-listed Focus Media joined forces with The Carlyle Group, CDH Investments, China Everbright, CITIC Capital Partners and FountainVest Partners and put in a buyout offer that values the company at $3.5 billion. Since 2010, 39 take-private deals for Chinese companies trading on US bourses have been announced, completed or terminated and PE investors are involved in four of the 14 completed deals and six of the 20 that are ongoing. Focus Media, however, is by the largest and highest-profile effort.

Not to be outdone, TPG Capital completed the acquisition of packaging firm HCP Holdings for approximately $500 million. It is, for now, the largest ever leveraged buyout of a Chinese company. In this case, the private equity firm secured control from the family that founded the business in Taiwan more than 50 years ago but felt they had taken it as far as they could.

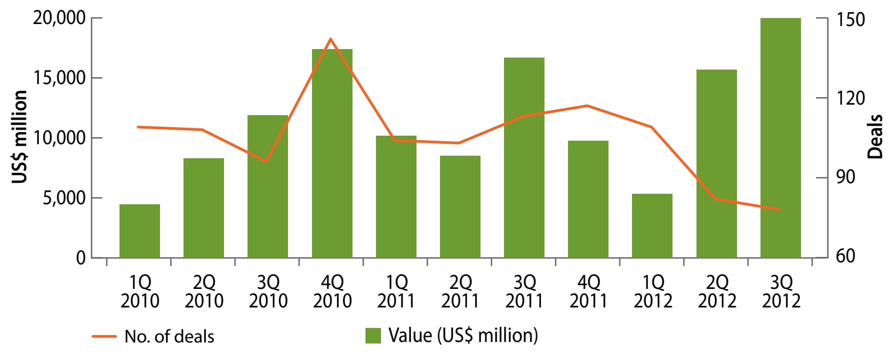
These deals helped the buyout share of total transaction value in Asia reach $6.5 billion and retain its lead over the growth segment. Despite recording a quarter-on-quarter increase, activity in the growth space remains on a longer downward trend as China-focused investors scale back on pre-IPO deals. China deal value came to $8.4 billion for July-September, nearly twice the previous quarter's figure, but the number of transactions fell, suggesting a shift to larger cap investments, including buyouts.

Private equity investment in Asia as a whole came to $16.1 billion, down slightly on the previous quarter, although some transactions have yet to be disclosed. After China, South Korea saw the greatest spike in activity, with deal value hitting $2.7 billion, up 45% quarter-on-quarter and more than 500% year-on-year.

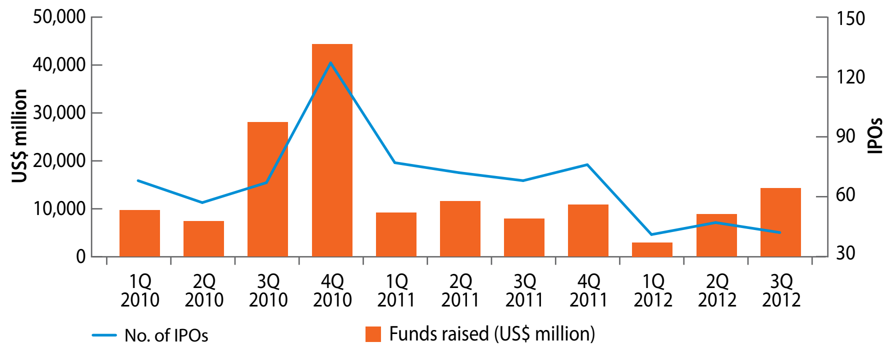
The latest state-linked divestment in Kyobo Life, which saw Affinity Equity Partners, Baring Private Equity Asia, IMM Private Equity and Government of Singapore Investment Corporation (GIC) pay $1 billion for a 24% stake in the company helped. So too did MBK Partners $1 billion investment in Woongjin Coway, although the prospects for this deal are unclear because the parent company filed for bankruptcy post-announcement but pre-closure.

To receive a full set of data and analysis on private equity activity in Asia Pacific during the third quarter of 2012, please contact AVCJResearch@incisivemedia.com

Trade sale and secondary exits



Private equity-backed IPOs



Source: AVCJ Research

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- Lexington Partners
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- MFC Foundation
- Mitsubishi Corporation (China)
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Carlyle in second-largest India exit of the year

THE CARLYLE GROUP'S $830 MILLION exit from Indian mortgage lender Housing Development Finance Corp. (HDFC) represents the private equity firm's largest divestment in Asia this year. It is also a welcome boost for investors keen to see India address its dubious reputation for PE exits.

Already this year, General Atlantic and Oak Hill Capital Partners have sold their 30% stake in business process outsourcing firm Genpact to Bain Capital for $1 billion, while Temasek Holdings and Warburg Pincus completed sell-downs of ICICI Bank and Kotak Mahindra Bank, respectively.

HDFC: 2x return for Carlyle

Carlyle was also involved in that flurry of financial sector activity in February, jettisoning one quarter of what was then a 5.2% holding in HDFC via the public market and raising $270 million. On that occasion, the shares were priced at INR676.90-697.85. The PE firm secured its full exit through block trades priced at INR760-781 per share, although a source familiar with the situation tells *AVCJ* that the transaction slipped towards the lower end of the range, representing a 3.4% discount on Thursday's closing price of INR789.05.

Carlyle's involvement with HDFC can be traced back to 2007, when it purchased 15.25 million new shares through a preferential allotment for INR26 billion ($533 million). In August 2010, the shares were split 1:5. During the five-year holding period, the mortgage lender's net profit increased 70% to INR41 billion in the most recent financial year.

"The investment was channeled through Carlyle Asia Partners II five years ago at INR346 apiece. The exit – including the February's sale – therefore represents a money multiple of around 2x," the source says. "This has been one of the largest and most successful private equity investments performed by Carlyle in India."

The exit came one day after India's benchmark Sensex Index hit a 15-month high in response to the Indian government announcing a series of reforms designed to attract more foreign direct investments in the insurance and pension sector. Carlyle's shares were picked by 40-50 investors, most of them long-term overseas institutional players.

"Following the announcement, financial institutions have gained a bit of confidence and once again started to invest in the market," says Vikram Utamsingh, executive director and head of private equity at KPMG India. "Private equity players can make good use of this opportunity to sell their stakes as the market moves up, if this continues for some time."

As of the first week of October, four of the five largest India exits this year came via open-market sales of minority stakes. Given this context, Utamsingh is not optimistic for investors seeking to offload larger interests.

"If you hold a small stake in a public company, you can exit through the market when it moves up even for a short while. If you hold a larger stake, say 10% or more, it's difficult," Utamsingh says. "The general exit environment in India, and the IPO market in particular, is still very tough."

Actis supports Sri Lanka hospital consolidation

FOR ASIRI HOSPITAL HOLDINGS (AHH) IN Sri Lanka, read India's Sterling Hospitals in India. Actis, which has acquired a $32 million equity stake in the Sri Lankan healthcare operator, found itself looking at a similar market dynamic when it first invested in Sterling six years ago.

"Sri Lanka is like India in that higher per capital GDP means consumers are looking for better quality services," J.M. Trivedi, head of South Asia at Actis, tells *AVCJ*. "A large portion of the population is served by government-owned hospitals, and the standards are relatively good, but the middle-to-affluent classes prefer private treatment. Asiri is serving this clientele."

India remains an attractive market for investors in private healthcare: despite rising disposable incomes, the country's healthcare expenditure to GDP ratio is barely 4%, well short of the 9% global average, yet private sector receives $3 out of every $4 spent. Sri Lanka, though smaller, is even further back on the development track and faces the same imbalance between demand and supply.

"The private hospital market is growing at more than 20% year-on-year, much faster than wider industry," says Trivedi. "Government hospitals aren't able to meet rising healthcare needs and so the private sector steps in."

When Actis invested in Sterling it was a one-hospital brand. Over the past six years, the company has grown to seven multi-specialty facilities with more than 1,000 beds. The development model for AHH is almost identical: scale up and drive operational efficiencies and economies of scale.


Private care: Big in Colombo

The first step is consolidating the company's existing assets – including Asiri Hospital, Asiri Surgical Hospital, Asiri Hospital Matara and The Central – und Colombo-listed AHH. Of Actis' $32 million investment, $17.2 million was transacted through a private placement of shares, amounting to a 19.09% stake in the firm, while the remainder was used to buy a 10% interest from existing shareholders.

According to a regulatory filing, the private placement alone took Actis' overall stake to 25.5%. This is because the PE firm invested in another Asiri subsidiary in August, which owned a portion of the assets now being consolidated under AHH.

Ashok Pathirage, founder and CEO of the Asiri group, remains the largest overall shareholder, owning a 51% interest through his conglomerate, Softlogic.

Actis' capital will also be used to further the company's expansion plans. AHH currently has 600 beds and a 30% market share in Colombo – rising to 40% for diagnostics – and wants to take the brand nationwide. Actis plans to remain involved for the long haul, recognizing that hospitals are a capital intensive business and so AHH might require additional funding beyond the standard 3-5 year investment period.

"We are looking at five years or more," says Trivedi. "In five years time AHH should be one of the largest and most active hospital chains in Sri Lanka."

Longreach eyes corporate carve-outs

AFTER MORE THAN 800 DAYS IN THE market, Longreach Capital Partners 2 reached a final close on September 30. It has been a challenging process that required the target corpus to be scaled back from $750 million to $400 million – but the fund is also largest independent Japan-focused private equity vehicle raised since the global financial crisis.

While Unison Capital Partners III, which closed in August 2009, managed to accumulate A$1.8 billion, the bulk of its commitments came prior to the fallout from the Lehman Brothers bankruptcy. It also predates the full effects of the hangover that followed Japan's 2006-2007 leveraged buyout boom.

"We did face some collateral damage from things that went on in Japan that had nothing to do with our portfolio," Mark Chiba (pictured), group chairman and partner at The Longreach Group, tells *AVCJ*.

"We have strong conviction that our particular niche in Japan is exciting and differentiated, but general market sentiment has been poor. While it has turned a bit in the last few months, it's still a challenge to attract capital for a Japan strategy."

A number of North American institutions that backed Longreach Capital Partners 1 – a $1 billion vehicle that closed in 2006 – have since retreated from the asset class. According to market sources in the LP community, several US endowments and foundations did re-up, while new entrants include several sovereign wealth funds, including Korea Investment Corporation (KIC), Japan's Pension Fund Association and Pavilion Capital, the North Asia arm of Temasek Holdings.


Longreach's Mark Chiba

Though unable to comment on the specifics of his investor roster, Chiba admits that there is a strong appetite for co-investment among some of the LPs. "We realistically have around $700 million in capital to deploy in total, with LPs co-investing on top of the fund size."

Noting that the tough fundraising environment has sucked a lot of the buy-side capital out of the market, Chiba expects to see relatively less competition for assets. Longreach's perceived sweet spot remains corporate carve-outs along the lines of Sanyo Electric Logistics, which was purchased from Sanyo for about $200 million in 2010 and sold to Mitsui-Soko for $300 million earlier this year. Longreach generated a 2.3x return.

Typical targets fall in the category below struggling giants like Renesas, the semiconductor manufacturer that was subject to a takeover bid from KKR – typically non-core assets with an enterprise valuation of $200-400 million, which translates into an equity check of $80-200 million, depending on leverage.

"As industrial Japan reconfigures, attractive businesses become available, but these are not easily accessible deals," Chiba says. "They come through long-term relationships and advisory-type origination. You have to be tied to a multi-year strategy to understand what is there and execute it. Sanyo Electric Logistics was a good example of that approach."