The public face of private equity

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Anything is possible...

There are many barriers to liquidity in private equity: complexity, transaction size, deadlines, disparate assets, confidentiality, alignment, tax, shareholder sensitivities – the list goes on.

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Asian PE – the show that never stops

IT IS BUT A FEW DAYS BEFORE THE 2012
AVCJ Private Equity & Venture Forum – indeed you may find yourself reading this at the event itself. I am pleased to note that despite the beating private equity has taken in certain markets, our conference is proceeding very well and it is poised to be another great event with the venue at full capacity.

More importantly, for the GPs in the room, the number of LPs in attendance has not only increased but has also diversified considerably to include more family offices and investors from overseas. This is another sign that institutions are increasingly more interested in private equity as an investment strategy that can deliver alpha in their portfolios.

Since its launch, the wvw Forum has always been a bellwether for the Asian private equity industry, offering snapshots of the past and glimpses of the future. This year’s event will be no exception as our high level speakers explore a number of the key issues chosen because of their relevance to the majority of delegates.

One topic I expect to hear much about – from the panels and from the floor during the question and answer sessions that follow – is the role of Asia in the global portfolio. Many institutional investors from North America and Europe are still underweight on emerging markets and want to boost their exposure to GPs in this part of the world. But what is the best way to do it – fund-of-funds, gatekeepers, regional buyout vehicles or country-specific funds? It all depends on individual LP’s comfort and experience with the managers in Asia.

Let me stress here and now that the feedback from events channeled to my colleagues and myself is one of the most significant factors in shaping the following year’s conference agenda. We want the audience and industry to have a say in the content, so if you have any thoughts on this, please share them.

One question we get asked a lot is what is the difference between the AVCJ Forum and other events? For starters, AVCJ has been around for 25 years and one of the main reasons for this is our willingness to engage with the industry and create a better product, year after year. We thank you for your continued participation.

Allen Lee
Publisher
Asian Venture Capital Journal
**AUSTRALASIA**

**Verde targets $52m venture fund**

Australian venture capital firm Verde is seeking to raise A$50 million ($52 million) for a fund that will focus on bringing technology to market. It will concentrate on innovations in the medical, defense and technology sectors. The government will provide administrative support to the vehicle worth up to A$200,000 per year over five years. Capital will be sourced from private and institutional investors in Australia and overseas.

**Ten Network, CHAMP PE agree Eye sale**

CHAMP Private Equity’s portfolio company oOh!media has agreed to pay A$13 million ($11.7 million) for Eye Corp, Ten Network Holdings’ outdoor advertising business. Last week it downsized its original offer of A$145 million to A$110 million.

**Quay Partners appoints Australia manager**

John Zaknic has joined Quay Partners as an investment manager in Sydney. The appointment is one of a series of senior hires as the Australian fund-of-funds and advisory firm builds its newly established infrastructure team. Matthew McPhee will lead Quay Partners’ infrastructure initiative in Boston and is joined by Nancy Mangraviti as legal advisor.

**Allegro Funds leads MBO of Australia’s Hasty Services**

Allegro Funds has completed a management buyout of Australian industrial services group Hasty Services, months after its parent company, Lazard-backed Hasty Group, went into administration. The buyout, realized sees the mid-market investor pick up all three Hasty Services group companies: Hasty Services and Spectrum Fire & Security in Australia - each of which had receivers and managers appointed to them back in May - and Cowley Services in New Zealand.

**Fundraising rebounds with foreign investor support**

The fiscal year ended June 2012 was reportedly the best fundraising year for the Australian private equity and venture capital industry since 2007-2008, with more than A$3.3 billion ($3.4 billion) raised by 21 funds. According to the Australian Private Equity and Venture Capital Association (AVCAL)/Ernst & Young 2012 Yearbook, the amount raised constitutes a 59% up on the previous year’s figure. Commitments from overseas investors represented more than half the total amount raised.

**CIC buys stake in Heathrow Airport Holdings**

China investment Corporation (CIC) has bought a 10% stake in Heathrow Airport Holdings from Spanish builder Ferrovial and other investors for GBP450 million ($725 million). Ferrovial sold its 5.72% stake in the airport’s parent FGP Topco to Stable Investment Corporation, a wholly owned subsidiary of CIC, for GBP257.4 million. As part of the transaction, and at the same price per share, Stable acquired another 4.28% from other shareholders for GBP192.6 million.

Following the deal Ferrovial will continue to be an industrial partner in Heathrow with a reduced 33.65% stake. Government of Singapore Investment Corporation (GIC) and Alinda will also remain shareholders in FGP Topco.

“We will continue to work with the new shareholders and with existing shareholders to ensure that Heathrow Airport Holdings retains its position as one of the best infrastructure assets in the world,” said Inigo Meiras, CEO of Ferrovial, in a statement.

**CDIB to set up a private equity fund in China**

Taipei-based China Development Industrial Bank (CDIB), the investment banking unit of China Development Financial Holding, has teamed up with China’s state-owned Jiangsu High-Tech Investment Group to set up a RMB8 billion ($321 million) PE fund. The fund will invest exclusively in Jiangsu province.

**AXA Private Equity opens Beijing office**

AXA Private Equity has opened an office in Beijing as part of efforts to boost its exposure in north Asia as it seeks to raise $500-600 million for a third regional fund. With AXA Capital Asia II now 80% deployed, the firm reached a first close of $300 million for its successor vehicle in September. As with previous funds, 70% of the corpus will be committed to Asian GPs while the remainder is channelled into direct investments.

**PE investors inject $50m into Huaxia Dairy**

Olympus Capital has led a group of investors including California Technology Ventures, Herostar Holdings and Grand River Capital in committing $50 million stake in Chinese milk producer Huaxia Dairy Farm. The deal follows a $45 million investment in Huaxia last year by another Olympus-led group, which included European dairy producer Mueller Milch Management. Olympus put in $30 million, while Mueller Milch pledged $10 million and existing investors committed $2 million.

**Insurers get green light for foreign PE**

The China Insurance Regulatory Commission (CIRC) has issued the long-awaited regulation on overseas investments made by domestic insurers, including commitments to private equity funds. Qualified insurance companies are now permitted to invest in 25 developed economies and 20 emerging markets.

**ClearVue leads $20m round for beauty brand**

Lumi, a leading nutritional beauty products firm in China, has raised RMB120 million ($20 million) of Series B funding led by ClearVue Partners. Fidelity, JAFCO and Capvent also participated in the round, along with existing shareholder, DCM. William Chen, managing partner of ClearVue, will join Lumi’s board of directors.
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China Everbright-Macquarie fund in debut deal
The Greater China Infrastructure Fund, a $1.5 billion vehicle jointly launched by Macquarie Group and China Everbright, has made its first investments in two Chinese companies. The fund, which is in its second tranche of fundraising, invested $100 million to become the second-largest shareholder in Zhejiang Wan Environment Protection. The other investment was in a Shenyang-based water supply project.

Bravia Capital in talks with Spice Jet
Hong Kong-based Bravia Capital, which focuses on investment in the transportation and logistics sector, is in talks to invest in Indian budget airline SpiceJet. SpiceJet will use the capital to purchase aircrafts. The company is planning to take delivery of six Boeing planes next year.

CyberAgent invests in Taiwan start-up
CyberAgent Ventures has invested $500,000 in Polydice, the Taiwanese start-up behind recipe-themed social network iCook.tw for a 15-20% stake. It is CyberAgent’s first investment in a Taiwanese company since it opened its Taipei office last year. The investment was made via the IT-focused CA-JAIC China Internet Fund II.

Paul Hastings opens Seoul Office
Paul Hastings has opened an office in Seoul, its 20th location globally. It follows a number of international law firms in setting up a presence in South Korea. Jong-Han Kim will lead the new office and Daniel Kim will be head up the corporate practice. Several other lawyers will also relocate to Seoul.

SOUTH ASIA

Sequoia India invests in pathology chain
Sequoia Capital has invested INR400 million ($7.5 million) in Indian pathology services provider Suburban Diagnostic for a 30% stake. The company will use the funds to expand its network and upgrade equipment at its existing centers.

Carlyle to buy Diversey Japan
The Carlyle Group has agreed to by Japanese sanitation business Diversey Japan from the Sealed Air Corporation for JPY30 billion ($377 million). Diversey is one of the leading providers of sanitation and hygiene products to institutional customers in the Japanese market. The company recorded approximately $321 million for the year ended September 2012.

The transaction is expected to be completed by the end of this year. The sale of Diversey Japan comes a year after Sealed Air, known for its Bubble Wrap brand, bought Diversey Holdings in a $4.3 billion deal to expand into commercial cleaning and sanitation. The investment comes via Carlyle Japan Partners II, which received JPY121.5 billion ($1.9 billion) in commitments in 2006, making it the largest Japan-focused vehicle ever raised, although the corpus was subsequently reduced to JPY165.6 billion.

Fidelity backs Triviton Healthcare
Fidelity Growth Partners India has invested INR4 billion ($74.4 million) in medical technology firm Triviton Healthcare. The funding will be used to make lateral acquisitions in Europe and the US as well as to improve the Chennai-headquartered company’s distribution network in Southeast Asia, the Middle East and Africa. The investment facilitates the partial exit of Headland Capital Partners and ePlanet Ventures.

SOUTH EAST ASIA

Ekuinas acquires Malaysian shipping services provider
Ekuinas, the Malaysian sovereign wealth fund, has completed a MYR220.9 million ($72.3 million) buyout of OMNI Petromartitime, a company that provides offshore support vessels to the oil and gas industry. Ekuinas acquired an 82.5% stake in OMNI for MYR150.9 million and injected MYR70 million of additional capital to pay down debt and support expansion plans.

KV Asia reaches first close of more than $100m
KV Asia Capital has reached a first close on its debut fund of over $100 million. The full target is $250 million, which will be deployed in Southeast Asia, with Indonesia expected to feature prominently. According to market sources, LPs participating in the first close include Adams Street Partners, Hermes GPE and Morgan Stanley.

Silk Road expects three Myanmar deals by year end
Silk Road Management expects to complete three investments in Myanmar by the end of the year, marking the Southeast Asian nation’s first private equity deals in about 20 years. The investments will be made via Silk Road’s Myanmar Human Capital Fund, which closed in September at $25 million.

SE Asian PE deals to rebound in 2013
Southeast Asia’s PE investments will to pick up next year as the region’s improving economic outlook attracts new funds, said Sebastien Lamy, a partner at Bain & Co. He projects transactions across the region in 2012 to match last year’s $5.3 billion or fall short. “Deal-making in the region will pick up in 2013 or 2014,” he says.
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Global and local players are in the market trying to raise new regional and country vehicles. The former can rely on institutional relationships and IR might to get the job done. The latter face a resources squeeze.

![Asian private equity fundraising](image)

**ASKED WHETHER HE IS RELIEVED THAT**

Bain Capital closed its Asia fund ahead of the competition, Jim Hildebrandt, a Hong Kong-based managing director with the firm, hesitates before opting for a diplomatic answer. “Fundraising is difficult at present – it is a really competitive market. The best funds are getting the capital they need for follow-on funds, but others are not. A lot less money is being raised now than 5-6 years ago, and it’s a lot more aligned to the opportunities out there.”

Bain Asia Fund II reached a final close of $2.3 billion in July, roughly halfway between the initial target and the hard cap, after about one year in the market. The vehicle is more than twice the size of its predecessor, raised in late 2006.

A host of global and regional buyout players are still in the market looking to raise sizeable vehicles, some of which are substantially larger than those raised in the previous cycle. Should KKR, TPG Capital, The Carlyle Group, Affinity Equity Partners, MBK Partners and RRI Capital all meet their targets, nearly $25 billion in capital would be added to the Asia pool.

**Pushing the limit**

It could be argued that this is commensurate with the size of the Asia opportunity. X.D. Yang, managing director and co-head of Carlyle Asia Partners, observes that private equity still only accounts for a small portion of Chinese companies’ capital needs given the country’s GDP stands at $7 trillion. Other industry participants talk up the potential for greater deal volume – and larger ticket sizes – coming out of Southeast Asia, Japan and South Korea than has been the case in recent years.

Nevertheless, the question remains: Are these firms trying to raise too much capital for Asia? ‘One could confidently say that too much money is being raised,’ says Doug Coulter, head of Asian private equity at LGT Capital Partners. ‘If all that capital does get raised, on top of all the dry powder in a market that really isn’t that deep, how do you deploy it? Returns will fall and investors will be disappointed.’

Asia’s mid-market GPs present a different set of investment opportunities but they also face a starkly different fundraising reality. When the global buyout firms raise Asia vehicles they leverage pre-existing relationships with large European and North American institutions. Even if they find fewer doors are being opened to them these firms have the resources to go and knock on hundreds more. “They have 50-strong investor relations teams that do nothing but raise capital on a global basis,” says Mounir Guen, CEO of placement agent MVisio. “These teams work the market incessantly.”

This is a strong competitive advantage at a time when the fundraising environment is challenging. Asia-focused PE funds have attracted $40.7 billion in capital so far this year, compared to $66.9 billion for 2011 as a whole. Interestingly, the number of funds that have received commitments stands at 181, by some distance the lowest number seen in seven years. As a result, average fund size has jumped to $224.9 million in 2012, up from $160 million the previous year. It implies that LPs are focusing on a smaller number of managers, so competition for allocations is intensifying.

“You find people traveling a lot more to the US and Europe and focusing on investor relations even during the investment period of a fund,” says Sebastiaan van den Berg, Hong Kong-based managing director at HarbourVest Partners. “GPs need to find a balance between time spent on client services and time spent investing.”

This is a pertinent issue for all GPs that operate with relatively small teams, and feeds through to more fundamental questions concerning the viability of their business models. It is estimated that an Asian manager needs to have about $1 billion under management – ideally not spread over too many similar funds – to generate the fees required to support an IR team and related resources. If the GP has a pan-Asia focus and maintains investment teams in several cities, budgets are even more stretched.

It is therefore important that time spent on the fundraising trail is used efficiently, targeting LPs who might feasibly commit to the kind of vehicle being marketed, but not everyone grasps this. “A lot of GPs spend months barking up the wrong tree,” says Vincent Ng, a partner at placement agent Atlantic-Pacific Capital. “They lose momentum and people start asking why they have been in the market for so long.”

LPs have ready-made strategies for less proven managers who might stumble during the process. In order to avoid being locked into a fund that is seeking $500 million but is stuck on less than half that, an LP might attach conditions to the agreement, allowing the capital commitment to be withdrawn if a first close isn’t achieved at a certain level.

Concessions aside, though, there is one key area in which an Asian GP can stand out from the crowd in the eyes of institutional investors: complete some exits.

“A lot of capital has been put to work in Asia but before committing more investors will want to see some real cash-on-cash returns,” says van den Berg. “The only market that has shown it can deliver returns and liquidity consistently is Australia. In emerging markets GPs want to hold on too long. There is a belief that companies will simply continue to grow at 30-40% per annum.”

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**A divided market**

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Causeway Bay, Hong Kong
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 m +852 6208 7686

Singapore
80 Raffles Place
#42-01 UOB Plaza
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Shanghai
Room 4105 Jin Mao Tower
88 Century Boulevard
Shanghai, PRC, 200121
 t +86 21 3865 8121
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Seoul
20th Floor, Kukdong Bldg
60-1, Chungmuro 3-ga
Jung-gu, Seoul 100-705
 t +82 2 2260 2788
 m +82 19 267 2788

Mumbai
302 Dalal House
Nariman Point
Mumbai 400021
 t +91 22 6656 0588
 m +91 99 8718 9275

Tokyo
Bancho Kaikan
12-1 Gobancho Chiyoda-Ku
Tokyo 102-0076
 t +81 3 3237 5897
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Bagging a sovereign

Led by a clutch of sovereign wealth funds, Asia’s emerging LPs are looking to boost their alternatives exposure. Fund managers in search of allocations must find out what makes these institutions tick.

THE GREAT AND THE GOOD OF THE institutional investment world gathered in Quebec in 2010 to look at ways in which they could collaborate. Disintermediation was inevitably a key theme: How could these institutions cut out the middlemen in order to reduce fee expenditure and focus on direct deals tailored to their long-term horizons rather than a seven-year fund cycle?

China Investment Corporation (CIC), Beijing’s $409 billion sovereign wealth fund, was in attendance and the executives liked what they heard. “CIC subsequently set up its own round table with a view to uniting LPs – the ultimate capital providers, not fund-of-funds – and talking about new ideas and investment products.”

There was a very strong response,” says one industry participant who attended the meetings. “Gradually, more and more LPs are thinking about how they can work together.”

Infrastructure is the classic example of where a large institutional investor – perhaps an Asian sovereign fund with a relatively young alternative program, limited short-term liabilities and lots of liquidity – would seek to commit capital for long periods. However, real estate, up-size private equity deals and venture capital, particularly in the context of new energy, are also cited as areas of interest.

CIC doubled its exposure to “long-term holdings,” understood to include private equity and direct investments and hedge funds, in 2011 to 31% as it extended its investment horizon from five to 10 years. Direct transactions in the last 12 months are dominated by energy and infrastructure plays, such as France’s GDF Suez and Thames Water Utilities and Heathrow Airport Holdings. However, it also acquired a $2 billion interest stake in Alibaba Group in support of the firm’s repurchase of a stake in itself from Yahoo.

Strategic imperatives

This change in strategy on the part of Asian sovereign wealth funds has been long anticipated and the motivations widely analyzed. But what does it mean for GPs that see these institutions as potential fund investors? They will certainly have to alter the way in which they approach the likes of CIC, Korea Investment Corporation (KIC), Malaysia’s Employees Provident Fund, Temasek Holdings and Government of Singapore Investment Corp. (GIC), but it doesn’t mean they can’t do business with them.

“These large institutional investors are starting to do more on their own, in order to reduce overall costs and capture more premium, but they still need good partners. They can’t do everything on their own” says Scott Kalb, former chief investment officer at KIC who now runs his own institutional investment consultancy, KLTI Advisors. “The watchword for GPs is partnership. –It’s not just about returns, it’s about working together.”

CIC’s Alibaba deal is instructive in this respect. The sovereign fund had been in negotiations with the e-commerce platform for more than a year about participating in the $7.6 billion Yahoo buyback, partly due to uncertainty about the timing of the transaction. The equity portion came out at $3.9 billion and, after CIC took its cut, the remainder was divided up between Boyu Capital, CITIC Capital and CDB Capital as well as existing investors Silver Lake, DST and Temasek.

It was a fairly typical club deal with no shortage of interest from the private equity community. However, Boyu was involved from the outset, advising CIC and helping facilitate the transaction. “Boyu was instrumental in negotiating the terms on behalf of CIC,” says one source familiar with both the sovereign fund and this deal. “Particularly when negotiating with domestic guys, CIC is too bossy and talks often break down. So they needed an intermediary.”

Put simply, Boyu got a piece of the action thanks to its familiarity with CIC and by delivering a value-added service that few in the market could realistically provide. It is a strategy that other GPs would do well to emulate with any of Asia’s emerging LPs, but it requires an understanding of how these institutions operate.

Motivating factors

Two thirds of sovereign wealth funds in existence today globally weren’t around 10 years ago, so their alternatives programs are still immature. The desire for exposure to the asset class arises from a need to counterbalance much weightier public equities holdings. Stock market investors pay an embedded premium that reflects the liquidity of such assets offer; an institution happy to hold on to assets for decades see no reason for paying this premium across its portfolio.

While alternatives offer better returns, these come with a higher price tag in the form of management and performance fees and other costs, which can alter the risk-adjusted return profile of the investment. Kalb preaches a disciplined approach – a 750-basis point premium might easily be whittled down to 250 without proper cost controls – and careful manager selection.

“With public markets you can diversify managers without much portfolio construction risk, but in the alternatives space, the disparity in performance between first and fourth quartile managers is enormous. If you diversify too much it can undermine performance,” he says. “Poor program construction is not easily fixed because of the length of commitments. If you have 300 managers and want to get it down to 75, it could take 10-15 years.”

The real danger is when sovereign funds stipulate that alternatives must account for a certain portion of overall assets and managers respond by allocating to a growing number of GPs as the capital at their disposal increases.

Doug Coulter, head of Asian private equity at LGT Capital Advisors, observes that the biggest mistake is trying to build an investment platform too quickly. “A new CIO comes in and says we need to increase PE exposure and next thing you know they have put lots of money into the worst vintage funds in the market,” Coulter says. He adds that certain institutions have learned from the rash direct commitments that characterized...
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their early days and have since focused on expanding organically and slowly.

It is worth noting that managers are under enormous pressure to put capital to work once an investment platform is set up. When Kalb arrived at KIC in 2009 private equity activity was virtually zero and he had to create an entire alternatives program. In just under three years, KIC invested about $10 billion on a committed capital basis across a broad spectrum of alternatives.

With this in mind, he stresses the need for nascent Asian LPs to target private equity firms that are capable of scaling up in terms of fund size and infrastructure. These institutions have to deploy considerable amounts of capital each year and so a $50 million allocation to a mid-market manager isn’t going to move the needle. Furthermore, if that allocation is going into a fund with a corpus of $200 million, sizeable co-investment opportunities might also be limited.

**Going smaller**

Other industry participants have a different take. “We are seeing some of the Asian sovereign funds make smaller commitments and become more nimble,” says Sebastiaan van den Berg, managing director at HabourVest Partners in Hong Kong. “They started their investment programs making big commitments to buyout funds and now they are looking to go lower, using fund-of-funds but also going in directly.”

The source familiar with CIC’s strategy confirms that a shift is underway from global to regional to country managers, ostensibly to get closer to expertise in individual markets. In some cases, a sovereign fund will take a stake in the GP in addition to anchoring the fund, but there is no hard and fast rule. “It’s not just about saving fees and carry but getting a better variety of investment options that are most customizable and suit the sovereign fund’s needs,” the source says. “Direct investment has always been a focus.”

In this sense, even though LPs are keen on pursuing direct investment opportunities, total allocations to GPs are unlikely to decrease. Rather, they might be redistributed to focus on different funds based on issues such as the size and nature of co-investment opportunities.

Some sovereign funds are already set up for this. Temasek’s North Asia subsidiary Pavilion Capital is known for backing smaller regional GPs. It goes without saying that co-investment opportunities should feature prominently in any pitch a mid-market Asian GP makes to one of the region’s sovereign wealth funds. According to one placement agent, a US or European GP is unlikely to get a face-to-face meeting with a large Asian LP unless their fund is $3.5 billion or more and therefore classified as large cap in global terms. Anyone beneath this threshold is referred to gatekeepers who advise the LP on asset allocation in developed markets. Asian allocations, however, are handled in house.

But it isn’t as simple as setting up a single meeting and sharing the investment pipeline. These LPs want to establish real partnerships with managers and making the breakthrough requires persistence. One GP recalls the origination process taking 12-18 months from the first discussion to closing the document. During this period, the GP met with the prospective Asian investor six times and the investor made two site visits to conduct due diligence.

Indeed, it is advisable to establish relationships well before the official fundraising process begins. “Approaching people from a fundraising perspective alone is not as fruitful as it used to be,” says Vincent Ng, a partner at placement agent Atlantic-Pacific Capital. “A lot of Asian LPs want to build relationships early on – not when you need the money but when you don’t need the money.”

To build familiarity, fund managers will talk LPs through their portfolios, explaining the good times and the bad, and also put forward co-investment opportunities. Although some institutions split up the primary and co-investment functions, in many cases it is the same group of people running the business for a particular geography. Therefore they might be responsive to this kind of value-add.

KLTIs Kalb stresses that co-investment shouldn’t come with a fee attached. His view is that GPs in general must be prepared to give more ground on upfront and hidden costs, including the introduction of hurdles so that investors aren’t paying performance fees on beta.

**Share the knowledge**

When dealing with Asian LPs that have less experience with the asset class or limited resources, GPs are also expected to offer training, information and even technology. Ng says that placement agents go in and try to act as a conduit, sharing market knowledge – even if they are in the process of marketing a buyout fund, they will offer views on the venture capital environment if the LP expresses an interest in the area. Broadly speaking, fund managers can do much the same.

“If you help them think through concepts and follow the learning curve,” they will see you as transparent and as a good source of information – and you find that the next time they are in your city they ask to come by the office and meet the team,” he says. “As a GP you are not going to identify your main competitors during these meetings, although some of the more confident managers have been known to do this.”

How far a GP is willing to go in the name of generating goodwill and potential fund commitments – from sovereign wealth funds and other large institutions is ultimately a function of the fundraising environment. It reflects the wider GP-LP power dynamic and the negotiations that take place on fees and terms and conditions: a manager in demand can give less away.

However, Kalb sees it as part of a much-needed realignment of interest. “GPs have forgotten that the private equity industry was not created so that PE professionals could become rich; it was created to help LPs diversify their portfolios and invest in illiquid asset classes to generate greater returns for their constituents,” he says. “This business is all about GPs helping LPs to be better at investing.”
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In Volcker’s shadow

With the Volcker Rule and Basel III compliance forcing US financial institutions to pull back from private equity, some Asian GPs are in a state of flux. New fundraising strategies are required.

“THERE IS DEFINITELY AN EXTINCTION event underway” confides one Asian GP. Not long ago this manager had to completely reconstruct his LP base after the US financial institutions that had previously been such enthusiastic investors were unable to re-up for a new vehicle. Private equity firms globally are facing a new fundraising reality in the light of recent regulatory reforms. Casualties are expected.

“After the global financial crisis, banks started looking at illiquid assets in a different way and private equity became a bit harder to stomach,” he continues. “Dodd Frank has been the nail in the coffin in terms of making it prohibitively difficult for banks to be strong in the assets class.”

The Dodd-Frank Wall Street Reform and Consumer Protection Act, to give the legislation its full name, was signed into law in 2010 and represents the most significant redrawing of US financial regulation since the Great Depression. The general idea is prevent banking system collapse and a key tenet of the policy is restricting balance sheet exposure to alternative assets.

For private equity, the key section is the Volcker Rule, which came into effect in July. It prohibits any banking entity from engaging in proprietary trading or acquiring, or retaining, any kind of ownership interest in a private equity fund or hedge fund. More specifically, the rule imposes a 3% cap on the amount of tier-one capital banks can invest in such vehicles. They are also unable to account for more than 3% of any single fund.

Factor in the increased capital adequacy requirements imposed on large financial institutions under the Basel III standards, and banks’ alternatives ambitions have been more or less neutered. GPs in need of primary capital find their options are limited.

Taking the strain

Asia-focused private equity firms feel the impact in different ways. The global buyout funds, busy raising their latest regional vehicles, have sufficiently large investor bases that they can manage the fallout by targeting LP classes more aggressively. Some smaller funds might not have any US financial institutions on the roster at all.

Two mid-market GPs that reached final closes in recent months despite upheaval in their LP bases are Indonesia’s Saratoga Capital and The Longreach Group. A US financial institution was one of three anchor investors in Saratoga’s $150 million second fund, which closed in 2009. When the GP returned to the market late last year, the LP was unable to participate, citing the Volcker Rule. Riding on a wave of interest in Indonesian managers, Saratoga still accumulated $600 million in a matter of months.

Longreach, reliant on a larger number of US financial institutions in its previous vehicle and seeking to raise capital for the currently unfeasible Japanese market, faced a much tougher proposition. The fundraising period lasted two years and the initial target of $750 million was scaled back to $400 million.

According to Preqin, banks account for 6% of LPs globally. Among US LPs that proportion is lower – 1% compared to 2% in 2008. Though the percentage change is small, the impact on Asian

To put the shift into perspective, 3% of the cumulative tier-one asset pool of the largest banks in the US is estimated at between $2 billion and $5 billion.

“In light of this change GPs have turned to new sources of funds such as sovereign wealth funds, insurance companies and private banking clients” says Phill Smith, a partner at law firm Mayer Brown. “Furthermore, some GPs have turned away from collective investment schemes completely and now focus on tailor-made managed accounts for large institutional investors.”

Rebuilding job

Longreach didn’t have to do anything as extreme as abandoning limited partnership model, but the LP base required significant recalibration. According to market sources, 70% of the capital committed to the GP’s $1 billion debut fund, raised between 2004 and 2006, came from US-based investors. Japanese LPs accounted for the rest of the corpus.

In the recently-closed second fund, the US portion plunged to around one third, Japan’s share stayed more or less the same, and a final third came from Asia ex-Japan investors. Sovereign wealth funds from South Korea, Singapore and Malaysia are thought to feature prominently in the final portion.

In Asia, where banks have typically formed a much larger chunk of the LP base by number of institutions, there have been some significant changes over the past four years. In 2008, 20% of
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LPs were banks; by 2012 the share had fallen to 15%. Government agencies now account for 10% of the region’s LPs, up from 7% in 2008. Pension funds are unchanged on 4%. The changes suggest that not only US banks are seeing their private equity investments curtailed by the Volcker rule.

“The Volcker Rule will affect non-US financial Institutions,” confirms Jay Baris, a partner at Morrison Foerster in New York. “To what extent is still not clear – the rules have been proposed but not yet finalized, but it could affect their ability to remain in the business”.

The rule states that Asian banks, or any foreign banking organization with US subsidiaries, are prevented from proprietary trading in a similar way to US banks. The only banking groups exempted are those that conduct their business solely outside the US on the provision that no ownership interest in a fund is offered or sold in the US. As a result, Asian banks are forced to choose between maintaining a US presence and holding on to a private equity portfolio in their own countries.

“You have to make a decision on whether you want to promote business development in the US, and cooperation between the two countries, or focus on your domestic development – currently the legislation is unclear,” says Mounir Guen, CEO of placement agent MVision. “It captures you under its guidelines the same way as if you are a US domestic entity. So you are put in a position where you have to decide what is most important to you.”

The legislation has already attracted criticisms from Asian institutions who believe they have been unduly constrained. Earlier this year the Association of Banks in Singapore submitted a position paper to US authorities, requesting an exemption from rule.

A new world

With the prospect of a smaller pool of international banks willing or able to commit to private equity, both GPs large and small must adapt to a new climate. Some anticipate a trend towards investments in larger, more established GPs. Where the larger banks were once more willing to take a risk in backing smaller private equity firms, it is doubtful whether more risk-averse LPs – government agencies or fund-of-funds, for example – would be willing to invest in a manager without a solid track record.

It is suggested that younger, more independent firms might differentiate themselves by focusing on more contrarian markets. In this way they might be able to offer LPs a kind of exposure they can’t get elsewhere and at the same time avoid like-for-like comparisons to more experienced counterparts.

“Smart managers will always come up with ways and new strategies to attract investors,” says Lorna Chen, a Hong Kong-based partner with Shearman & Sterling. “I wouldn’t think that small GPs will become extinct because of the Volcker Rule and compliance burdens.”

However, it remains to be seen where these managers are prepared to draw the line. According to anecdotal evidence, a number of smaller GPs have agreed to give up stakes in themselves in return for a sovereign wealth funds providing seed capital to vehicles that otherwise might not be raised.

“I think as a result of regulation, smaller firms will be more desperate and willing to do things they may not want to do, such as sell equity in themselves,” says one Asia-focused GP.
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The aspiration angle

L Capital Asia, a private equity firm sponsored by LVMH, the world’s largest luxury goods company, was set up in 2008 and closed its first fund in 2010. Managing Partner Ravi Thakran tells AVCJ what makes the firm different.

Q: L Capital Europe was created in 2001. What was behind the decision to come to Asia?
A: Prior to 2000, LVMH was present in Asia but it was primarily focused on Japan, Korea, Taiwan and a few other cities like Hong Kong and Singapore. It was only from 2000 that the group really focused on emerging Asia and it is now the largest region in the world, accounting for more than 40% of total revenue this year. By 2010, with our brands on the top in almost every sector we deal in, it was the perfect time to start the kind of platform we have. L Capital Asia differs from most private equity firms in that we are focused on certain sectors in which we have a deep knowledge. We bring a very granular value-add to portfolio companies, drawing on our own expertise and relying on LVMH’s resources for additional help.

Q: What is the nature of the relationship between L Capital Asia and LVMH?
A: We are a subsidiary of the listed company but we work at arm’s length from it, operating as an independent platform. LVMH is focused on luxury while L Capital Asia is focused on the layers below that – the aspirational, affordable and alternative segments. While LVMH looks at large global assets, we look at regional national companies and smaller ticket sizes. L Capital Asia has a lot of knowledge and LVMH is interested in that – our portfolio companies are in tier two, tier three and tier four cities, LVMH isn’t there today but it may be there tomorrow. Having said that, we are sensitive to our portfolio companies’ confidentiality issues and we never share information with LVMH beyond what is shared with other LPs. LVMH contributed less than 10% of our fund and as a sponsor they do receive a share of the carried interest.

Q: What is the makeup of your overall LP base?
A: We have a diversified portfolio of LPs – large investment banks, pension funds, private banks, family offices and various players that are in similar businesses to us in Asia Pacific. We tell them, “Domestic consumption and the emergence of Asia’s middle class is a renaissance-like revolution.” It is one of the biggest engines for global growth and we offer access to the best companies catering to that market.

Q: L Capital Asia’s $650 million debut fund was raised in 2010. How much is deployed and are you thinking about a successor vehicle?
A: About 70% of the fund will most likely be committed by the end of the year. Half has been deployed in China, 20% in India and the rest in Southeast Asia. We plan to start looking at a successor vehicle early next year.

Q: You have invested in 11 companies in the region. Have these been predominantly minority deals?
A: We typically look for minority stakes because we believe the entrepreneur should remain in the driving seat. In China a lot of company owners are first generation – they are hungry to grow, don’t want to give up control, but are willing to give a minority stake to a partner like us. Having said that, we are not opposed to taking majority interests.

Q: The portfolio includes two Indian fashion companies, Genesis Luxury and Fabindia. What are you doing with them?
A: Genesis sells own-brand products and also represents foreign brands. We are helping them to expand the portfolio with better quality brands – for example, we recently acquired the exclusive India rights for Armani. We are also taking them into new segments, having obtained distribution licenses for 16-17 beauty brands. Then there is recruitment, helping the company negotiate better rental and media contracts, improving supply chains and inventory management, and contributing to own-brand designs. Fabindia sources ethnic products with contemporary designs from 50,000 artisans across India and sells them to urban customers. We are helping with store and product design but also looking at international expansion.

Q: How big can these companies become?
A: In five years Genesis should be more than four times its current size and we want to take the company public. L Capital Asia only invested just over a year ago but we have already been approached by two of the largest listed companies in India about selling the asset.

Q: What is your approach for portfolio companies in more developed markets, such as Emperor Watch & Jewelry?
A: When we invested it was primarily a Hong Kong company but we are trying to get them entrenched in China and Southeast Asia. We have turned it into a more robust company overall. If you look at the 1881 store in Hong Kong it is number one in the world for sales of Rolex and Patek Philippe. Similarly, we have helped them to source diamonds directly from diamond polishers in India, which means better prices and product selection. They used to go via a broker in Hong Kong who was buying from Antwerp. We are also helping them create a jade-inspired jewelry collection. Chinese women tend to favor jade above diamonds but we have yet to see a really contemporary, beautifully-designed range of jade jewelry.
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A good citizen

Private equity globally is under more scrutiny from more directions than ever before, placing a higher value on good branding and reputation. Does the asset class also suffer from the same profile problem in Asia?

DAVID RUBENSTEIN SELLING LEMONADE,
Bill Conway working in call center and Daniel D’Aniello serving up donuts: these were the “what-might-have-been” snapshots offered by The Carlyle Group’s founders in their 2011 Christmas video. It was entertaining – private equity jargon reeled off to the bemusement of the man or woman in the street – but it had a secondary purpose: reminding viewers that these industry titans are ordinary guys trying to build extraordinary businesses.

KKR has also engaged in visual storytelling, albeit less seasonal and more serious: Its website features a three-minute video produced by the Private Equity Growth Capital Council earlier this year in which KKR professionals demonstrate “value-add in action” at portfolio company Rockwood Holdings. The professionals conduct on-site analysis at the US-based chemical company and the screen ultimately cuts to Rockwood’s CEO, who says, “The private equity partner has been great for us.”

Both KKR and Carlyle are now listed companies so they must devote more time and resources to profile management. Yet in the last 12 months they and other private equity firms have come under even closer public scrutiny. As soon as Mitt Romney launched his bid for the Republican presidential nomination political rivals began devising ways to milk the industry’s intermittent failures and cutthroat reputation for all it was worth.

The image of PE in Europe is little better, with politicians in Germany and the UK lambasting critics of the perceived damage created by leveraged buyouts. Almost half of LPs interviewed for the latest edition of Coller Capital’s global private equity barometer consider the general reputation of PE as bad; only one in 10 said the asset class is seen as a good thing – dropping to one in 20 among European investors.

“Private equity is certainly a nice target for criticism and industry participants haven’t seen brand building as particularly important while it’s actually very necessary,” Markus Ableitinger, managing director of Asia investment management at Capital Dynamics, tells AVCJ. “We are certainly aware of whether or not a private equity house has a positive brand image because these are usually successful firms that aren’t shy about having their names mentioned in public.”

While it is clear that private equity needs to improve its public profile in the West, the asset class is considerably less demonized in Asia, where transactions have traditionally focused on growth capital rather than leveraged buyouts. And then in some less developed countries, private equity is simply unknown.

“The biggest challenge concerning PE’s public image is the lack of awareness of the asset class itself. As such, many potential portfolio companies don’t even think about it as a vehicle for capital,” says Steven Okun, director of public affairs of KKR Asia Pacific. “This provides an opportunity for us to create a full picture – not something you can find in the US where everyone already has an image of private equity in one way or another.”

Going mainstream

Although Asia is still a relatively young player in global private equity, it is edging nearer to the mainstream, at which point Asian governments and top-tier domestic financial institutions will pay more attention to it. A broader public profile driven by media coverage and increased regulation will inevitably follow.

Certain government agencies in the region are already trying to promote the asset class, the sophistication of their efforts dependent on respective knowledge and experience. China’s National Social Security Fund announced in September that it had committed RMB22.6 billion ($3.6 billion) to 16 venture capital and private equity funds to enhance investment returns; a Senate enquiry in Australia also concluded that private equity is good for the economy; Korea and Singapore – both aggressive technological innovators – are encouraging investment into start-ups through venture capital funds.

“The speed at which PE has gone from obscurity to household name in China surprised everyone,” says Yichen Zhang, CEO of CITIC Capital. “The asset class is probably better known in China than in the US. And it’s generally a positive view: if you ask the top college graduates what they want to be, it’s still investment banking and private equity. A lot of the private equity executives in China have almost rock-star status.”

Following the lead of their Western counterparts, large financial institutions in Asia are transforming into multi-strategy asset managers in order to appeal to a broader base of investors. China Life, for example, has won approval to launch a subsidiary to invest in private equity, while domestic brokerages China International Capital Corporation and CITIC Securities appear to be moving into new asset classes as fast as the regulations will allow.

In India, private equity subsidiaries have been established by local financial services giants such as Infrastructure Leasing & Financial Services (IL&FS), Infrastructure Development Finance Company (IDFC) and ICICI Bank. Feeding into the general investment enthusiasm, most of the country’s business newspapers now have a specific private equity beat intended to inform
Outbound Private Equity Investment by State-Owned Enterprises in China

Alex Chen is Managing Partner of Silver Star Global Capital, a financial advisory company which focuses on private equity, investment management, and financing services for emerging enterprises in Greater China. Mr. Chen was previously Partner of Greenbridge Capital, also a financial advisory company focused on China. From 2004 to 2005, he worked for Zero2ipo as Managing Director. He helped to found the China Venture Capital Association in 2003 and acted as the Deputy Secretary-in-Chief of the organization until 2004. From 1997 to 2003, he founded two famous business magazines in China: CEO&CIO and Digital Fortune. During his financial advisor career, Mr. Chen has helped about 50 companies in China raise money from PE/VC firms, for a total of about US$ 1 billion. Mr. Chen is an expert on the PE/VC industry in China and has vast relationships in this industry. He graduated from Peking University with Bachelors and Masters degrees.

Why are state-owned enterprises (SOEs) looking to invest overseas, when the Chinese market and consumer base is still growing?

Most sectors in China are faced with lack of effective demand and serious overcapacity problems, so SOEs have intrinsic motivation for global expansion and investment. Chinese government policy tries to guide appropriate SOEs into becoming leading global enterprises through overseas mergers and acquisitions.

How can private equity firms assist SOEs in their quest to expand overseas?

Screening targets and joining investment negotiations; helping SOEs create international and professional teams internally; identifying external intermediary agencies for transaction purposes; assisting with communications – on a political and policy level as well as a social and cultural level – in the target country; contributing to the planning and implementation of post-investment management strategies.

Which sectors and geographies do you think are most likely to be targeted by SOEs when investing overseas, and why?

Firstly, natural resources. The first choices for mergers and acquisitions are regions that are rich in oil, coal, iron and other mineral resources, notably Africa, Australia and Canada. These non-renewable resources are important strategic materials for China’s further economic development, but the country itself is unable to supply them domestically.

Secondly, telecom assets in Asia and Africa. On one hand, China’s telecom operators have tremendous financial strength; on the other hand, the corresponding countries need to improve their telecom infrastructure but financial or technological limitations preclude them from using independent contractors or operators.

Thirdly, commercial banks, investment banks and financial services institutions in the US, Europe and other developed countries. China’s state-owned financial institutions want to accumulate experience in operating and managing financial assets via mergers and acquisitions, as well as expanding their businesses globally.

Fourthly, transportation infrastructure in Africa, Asia and South America, including railways, highways, airports and seaports. China has huge excess capacity in these areas and requires a global market to help digest it.

Finally, commercial real estate, including the hotel and services industries in the US and Europe, because Chinese players want to learn how to meet the evolving needs of domestic customers.

Do you see this trend accelerating or decelerating over the next 3-5 years?

This trend will accelerate in the next 3–5 years. China’s SOEs have sufficient liquidity and the inherent impulse to invest.

What has the overall performance been so far for outbound private equity investment from China?

We are still at a very early stage, and there is a lack of understanding of market conditions as well as the impact of the global economic downturn. Another reason is time concerns. Private equity investment is illiquid and long-term, so investors must wait to see the full effects.
Here to stay: Building stable GP platforms

“I attended a conference recently at which people asked the LPs there what they worry about the most. The answer is clearly when their GPs make the front page – unexpectedly and not for good reasons,” says Vincent Huang, a partner at global fund-of-funds manager Pantheon. “I am sure there are fund managers that are increasingly aware of this but public image traditionally hasn’t been a top priority of most GPs.”

Since the global financial crisis, private equity has been forced into a more closely regulated and scrutinized space. LPs are certainly becoming more selective in their investments and there is less tolerance for everything from bad returns to bad image. The rush to invest in China and India funds has been replaced by caution. There is no more easy money for first-time funds. Alignment of interest, sustainable business models and stable teams are high priorities.

Some GPs are certainly aware of that. Hony Capital’s CEO John Zhao, for example, tells AVCJ that, from the outset, he was focused on “building an institution that would last forever.”

Simon Pillar, co-founder of Pacific Equity Partners (PEP), adds that his company has also been conscious of the need to building a long-lasting franchise rather than a GP that disbands after just one or two funds. “The firm’s name does not reflect the founders and we always set out to establish a brand that doesn’t rely on any one or small group of individuals,” Pillar explains.

“We have over the years institutionalized what we do. We hope this means we have learnt from mistakes and improved the way we do business.”

GPs that exude stability and longevity are a source of comfort for LPs. However, Markus Ableitinger, head of investment management for Asia at Capital Dynamics, argues that a strong brand doesn’t necessarily mean a private equity firm will stay in business for 20 years. Ultimately, GPs are judged on their track records.

“There is a saying at Sequoia Capital: ‘You’re only as good as your next investment,”’ Ableitinger says. “As tough as it may sound, a business model is only as good as the last deal. When you screw up 2–3 deals you are in danger, regardless of the status of your brand or the public or industry awareness of your company.”

and educate the public about the asset class.

“Five years ago, there was very little media coverage concerning private equity and people did not fully comprehend the industry or recognize anyone working in it,” Archana Hingorani, CEO of IL&FS Investment Managers, says. “But today, in stark contrast, PE-related news and transactions dominate the headlines.”

The emergence of private equity in the public domain demands a response from industry participants. Ignore the issue and the void in the news flow will soon be filled by uninformed, perhaps overly negative, coverage; be proactive and there is the opportunity to influence the public view. It is especially important when approaching potential investor companies – whose management may not be too familiar with the asset class – in markets where there are competing sources of capital.

This explains why the likes of KKR and Carlyle are employing more public relations executives in local markets. Even some local GPs that have yet to spend large amounts on media campaigns are beginning to take active roles in the media and at industry events.

“As we are better known, we are more mindful of our public profile than before,” John Zhao, CEO of Hony Capital, tells AVCJ. “But we have always been very careful. Even when we were nobody, we were serious about building and protecting our reputation, especially in emerging markets like China.”

Adding value
A positive brand, however, doesn’t come simply out of words. A private equity player can only publicize its success if it is genuinely bringing value to investors and portfolio companies. In this context, first-hand accounts from entrepreneurs who have received private equity funding and expertise, and benefited from the experience, are worth their weight in gold. Word spreads throughout their business networks and suddenly other entrepreneurs are more willing to listen to proposals.

In order to draw more attention to its value-add strategy, KKR teamed up with the Emerging Markets Private Equity Association (EMPEA) to produce in-depth articles on the role of private equity in two of its portfolio companies. First, Jiuling Deng, chairman of Modern Dairy, emphasizes KKR as a true partner that “works alongside us at every stage of Modern Dairy’s development.” Then Yucheng Lin, CEO of UEL, explains how he was able to “leverage KKR’s global resources, extensive operational and financial expertise and take advantage of their China team’s local experience and track record of success.”

“To get the message out effectively, it is better not to talk about yourself, but to have others providing testimonials. This generates greater credibility for the work you have done together,” says KKR’s Okun.

The Australian Private Equity and Venture Capital Association takes a similar approach in its media outreach efforts. Roundtable discussions are arranged featuring a private equity executive and the CEO of a portfolio company. The CEO takes the lead, explaining why he chose this particular PE partner and what has been gained from the experience.

International angle
For foreign private equity firms operating in Asia, perhaps the most significant element of value-add is access to their global networks. In practical terms, this might involve identifying new customers and suppliers, making introductions to potential development partners, or bringing in executives who have faced and overcome similar business challenges in other markets.

“When private equity players talk about branding in Asia, they increasingly understand that companies in the region don’t lack money but are clamoring for access to international markets and industry know-how,” says Richard Barton, a specialist in strategic communications. “For any international firm wishing to be a credible player in the region, these are the things they need to demonstrate.”

Apart from promoting individual success in supporting portfolio companies as a means of generating new investment opportunities, industry participants would like to see collaborative efforts aimed at shoring up the general reputation of the asset class. There is a sense that private equity in Asia is working to a deadline – act now and consolidate the industry’s standing and this could preempt any negative publicity that might otherwise have politicians clamoring for tighter regulation.

“As regulatory authorities globally have been more attentive to potential risks attached to all financial products – plus the fact that they don’t really understand private equity – communication is important,” David Pierce, CEO of Squadron Capital, tells AVCJ. “This is especially true when private equity in Asia has mainly been about growing small and medium-sized enterprises, which is exactly what policy makers are looking for.”

Around the region: Private equity’s public face

Private equity is more entrenched and better understood in some Asian markets than others. What do the various stakeholders—entrepreneurs, government, media, public—make of the asset class?

AUSTRALIA

Katherine Woodthorpe, CEO, Australian Private Equity & Venture Capital Association

THREE TO FOUR TIMES A YEAR, A GROUP of journalists from an Australian newspaper sit down with a private equity executive and the CEO of one of his portfolio companies. The PE executive does very little of the talking, leaving it to the CEO to explain why he brought in private equity and what it’s like working for them.

This is one of the Australian Private Equity & Venture Capital Association’s (AVCAL) roundtables intended to improve media relations with the industry. “It is very frank and because the CEO is at the coal face, rather than a manager behind the scenes, they get a good response from the media,” says Katherine Woodthorpe, CEO of AVCAL.

The public face of private equity in Australia has been tarnished in recent years. Although the Cooper Review placed the fees paid to PE managers under the spotlight—prompting a minority of investors to reconsider their allocations to the asset class—the fallout from some of the leveraged buyouts that took place prior to the global financial crisis has been much more damaging for the industry’s profile.

In the last few weeks, embattled media giant Nine Entertainment underwent a debt restructuring that saw CVC Capital Partners lose all of the AS $1.8 billion in equity it pumped into the company through several highly leveraged transactions between 2006 and 2008. Details of the protracted negotiations were leaked to the press, fueling a public perception of private equity that doesn’t reflect the reality.

“They think everything is highly leveraged buyouts—people don’t understand the shades of gray that the industry comes in,” Woodthorpe says. “One of the problems is that these deals involved brand name, but the vast majority of transactions are smaller companies that no one has heard of because they make shipping containers or construction site toilets.”

CHINA

James Wang, partner, Han Kun Law Offices, Beijing

PRIVATE EQUITY IS A BROAD TERM—it might be used to refer to leveraged buyouts, pre-IPO financing, growth equity, venture capital, or perhaps all of the above. While in more mature markets such as the US and Europe, the leveraged buyout is a dominant force, with transaction sizes that dwarf the likes of venture capital, China is still very much a small-cap play. There are none of the negative connotations tied to leveraged buyouts because such deals don’t exist. As such, private equity’s public image differs from elsewhere.

In the West, the media is all too willing to brand private equity investors as locusts who acquire undervalued companies, sack workers and strip out and sell off assets to pay down the debt. The general public in China is largely oblivious to this kind of critique. At the same time, though, no consistent views are expressed—by the public or in the media—towards the asset class. Most people don’t understand it as a function of asset allocation.

This is an important point because, regardless of the fact that they don’t fully understand PE, people are investing in it. Among those who participate, there is a general preference to bet only areas with which they are familiar. An entrepreneur who has made his fortune in the technology sector, for example, is more likely to invest in funds targeting that sector—or even set up his own fund targeting that space.

The channels through which individuals participate in such vehicles are as informal as their grasp of the asset class might suggest. A group of like-minded entrepreneurs might be entrust capital to an acquaintance with some VC experience. The GP and LP roles, so clearly defined in Western private equity, are blurred; little if anything is set out in contract form.

In some extreme cases, these “investor clubs” reach a significant scale, at which point operations do become more professional. Yunfeng Capital, which was set up by David Yu and Jack Ma, founders of Focus Media and Alibaba Group, respectively, has a partner roster that reads like a who’s who of CEOs who have...
taken Chinese tech companies public in the US. The collective experience, resources, expertise and connections of these individuals makes for a powerful deal-sourcing tool.

High net worth individuals who don’t belong to these clubs are typically approached by placement agents regarding PE commitments. Shanghai-based wealth management firm Noah is a case in point. It has established a wide network of wealthy clients and succeeded in raising capital for a number of funds.

However, the fundraising environment is a lot more challenging this year compared to the past two years. This is partly attributable to the sharp drop in public market valuations in China, which makes it more difficult for private equity and venture capital firms to exit their investments at short order and for high multiples.

For many high net worth individuals that committed capital in more bullish times, the asset class has suddenly become much less attractive. They lose interest and default on capital calls. In this context, it’s fair to say the public face of private equity in China isn’t as rosy as it once was.

INDIA

Vikram Utamsingh, head of transactions and restructuring for KPMG India

A POSITIVE DEVELOPMENT IN INDIA’S private equity environment since the global financial crisis has been a better understanding and a stronger appreciation for the asset class. Business owners have begun to see private equity not only as just another source of capital but more as a partner for growth.

The weak primary market coupled with high interest rates over the past three years has meant that Indian firms have had to look at alternate sources of capital for their expansion plans. As a result, not only have better deals flowed to PE investors, but also entrepreneurs have become more appreciative of the value that a private equity firm brings along with its investment.

Our research indicates that more than 12 companies that raised money from private equity between November 2010 and April 2012 initially got regulatory approval for IPOs but subsequently changed their plans. For example, an ATM outsourcing and system integration company raised $33 million from TPG Capital in June 2011. An energy company received about $45 million from an international infrastructure fund, having recognized that this partner has a strong local knowledge of the industry as well as a global network of contacts and experience.

Large Indian business groups that previously would not have partnered with private equity firms are now approaching investors to support expansion in the overseas markets. The Tata Group and Mahindra & Mahindra group have each partnered with PE firms on specific opportunities.

KPMG research based on interviews with business owners has shown that PE investors are also playing a more active role in their portfolio companies despite being minority shareholders. They can attract management talent, help develop new business models, improve corporate governance and identify new partners and customers. In addition, PE firms are increasingly hiring specialists to add value to these companies.

As for the general public’s view of private equity, it is quite different. This is because the Indian media only focus on deals and the challenges the industry faces in terms of exits and returns. Also, the regulators continue to have a difficult time distinguishing this asset class from financial institutional investors who target short-term public market deals. The recently issued Alternative Investment Fund (AIF) regulations impose unnecessary restrictions on fundraising and fund management.

The industry is responding and has formed working groups under the Indian Venture Capital Association and the Confederation of Indian Industry to interact with different regulators. This approach seems to be working. However, the general public perception is a much more difficult challenge to overcome.

JAPAN

Joji Takeuchi, CEO and co-founder, Brighttrust PE Japan

VENTURE FUNDS? “GOOD GUYS,” HEDGE funds? “Greedy and scary” Buyout funds? “What do they do? Are they vulture funds?” This is what I think the “uninformed” public would say if asked about “funds.” But, for most people, it is hard to distinguish between so many different types of funds and understand exactly what they do.

Broadly speaking, I believe the public image of private equity has improved significantly in the last 10 years. The Shinsei Bank bailout in 1999-2000 painted a negative picture of the asset class due to the specific circumstances of the deal. In mid-2000s, Murakami Fund, an aggressive activist hedge fund, challenged public tolerance levels of “greed-driven capitalism.”

In between them, a lot of corporate restructuring and turnarounds were executed by local private equity funds. Many involved well-known domestic companies such as Kanebo and Daiichi. As a result, the public image of private equity improved and it established itself in the Japanese economy and society. Nonetheless, “funds” still has negative connotations when used in conjunction with corporate acquisitions. Small- and medium-sized enterprises (SMEs): SMEs account for more than 75% of Japanese buyouts, but a number of these companies still decline to meet with private equity firms, possibly due to the vulture image. Getting access to these deals is critical for GPs. While foreign investors inevitably find it tough, captive funds can leverage their ties to well-known institutions.

Large companies: Most large listed firms are happy to buy portfolio companies from Japanese and non-Japanese private equity players. Many will also sell subsidiaries to these same players. Problems only arise when PE investors try to acquire these firms in their entirety or make “difficult” requests, such management changes.

Investors: In the past 10 years, I have not met a single professional in the private equity department of a Japanese institution who said, “I do not like PE.” Many have become fans of the asset class but regulatory developments in recent years – notably Basel III solvency requirements – mean this enthusiasm can no longer be replicated at the institutional level.

Government: The most earnest supporter of private equity – on a domestic level – is the Ministry of Economy, Trade & Industry (METI). It wants to see the industry develop and has supported numerous initiatives to promote foreign investments into Japanese PE funds. These include the 2009 tax reform that substantially eliminated tax liability for foreign investors in Japanese limited partnerships.

Politicians: The perception of private equity among politicians varies depending on the individual’s knowledge. It would be fair to say the
Affinity Equity Partners is an independently owned private equity fund manager and currently advises and manages over US$4 billion of funds and assets, making it one of the largest independent financial sponsors in this region. The Affinity team has executed transactions for values aggregating US$12 billion.

**Primo Group Holdings Pty Ltd**
- **Lead Investor**
- Leveraged buyout of Australia's largest meat processor
- **October 2011**

**Beijing Leader & Harvest Electric Technologies**
- **Lead Investor**
- Buyout of the leading manufacturer of energy-saving electrical equipment in China
- **October 2009**

**Pulmuone Foods Co, Ltd**
- **Sole Investor**
- Investment in the leading fresh food provider in Korea
- **September 2011**

**Tegel Foods Ltd**
- **Lead Investor**
- Leveraged buyout of New Zealand's largest poultry producer
- **May 2011**

**Oriental Brewery Co Ltd**
- **Joint Lead Investor**
- Leveraged buyout of the second largest brewery in South Korea
- **July 2009**

**United Test and Assembly Center Ltd**
- **Joint Lead Investor**
- Leveraged buyout of a leading independent semiconductor test and assembly service provider listed on the Singapore Exchange
- **November 2007**

**The FaceShop Korea**
- **Sole Investor**
- Leveraged buyout of a leading cosmetics company in Korea
- **October 2005**

**Loscam Limited**
- **Sole Investor**
- Leveraged buyout of a leading returnable packaging hire company in Australia
- **August 2005**

**Himart Co Ltd**
- **Lead Investor**
- Leveraged buyout of Korea's largest consumer electronics retailer
- **April 2005**

**Haitai Confectionery & Foods Co Ltd, Korea**
- **Joint Lead Investor**
- Leveraged buyout of the second largest confectionery company in Korea
- **September 2001**

**Sime Diamond Leasing (Singapore) Pte Ltd**
- **Sole Investor**
- First buyout cum leveraged recapitalisation of a financial institution in Singapore by a financial sponsor
- **March 2001**

**NS Electronics Bangkok Ltd**
- **Sole Investor**
- Largest financial restructuring and recapitalisation buyout in Thailand by a financial sponsor
- **February 2000**

**Mando Corporation**
- **Co-Investor**
- Leveraged buyout of Korea's dominant auto parts company
- **December 1999**

**Mando Climate Control Corp**
- **Lead Investor**
- First leveraged buyout in Korea by financial sponsors
- **October 1999**

**MK Electron Co Ltd**
- **Sole Investor**
- First buyout of a Korean non-financial institution by an international financial sponsor
- **May 1999**

**Kyobo Life Insurance**
- **Lead Investor**
- Investment in the third largest life insurer in Korea
- **September 2012**

**PT Mitra Pinasthika Mustika**
- **Lead Investor**
- Investment in the leading consumer automotive services group in Indonesia
- **September 2012**

**Korea Digital Satellite Broadcasting**
- **Sole Investor**
- Investment in Korea's only digital satellite TV broadcaster
- **August 2007**

**The FaceShop Korea**
- **Sole Investor**
- Leveraged buyout of a leading cosmetics company in Korea
- **October 2005**

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**MK Electron Co Ltd**
- **Sole Investor**
- First buyout of a Korean non-financial institution by an international financial sponsor
- **May 1999**
depth of understanding is quite modest.

*Media:* The mainstream media’s stance on private equity also varies. The less transparent the fund, the more susceptible it is to criticism. There is also the expectation that private funds should play a major role in energizing Japanese economy.

**SOUTH KOREA**

*Sunny Yi & Wonpyo Choi,* partners, Bain & Company’s Seoul office

**WHILE THE MEMORY OF PRIVATE EQUITY’S tumultuous early years still lingers in Korea, public sentiment seems to have turned a corner. Foreign PE investors entered the country during the tough days of the Asian financial crisis and funds’ healthy returns were met with strong resentment by a nation struggling with massive unemployment.**

Some deals, like Newbridge Capital’s acquisition and turnaround of Korea First Bank, were viewed more for the dramatic returns reaped by foreign investors than for the significant improvements made to the business. Others, like Lone Star’s purchase of Korea Exchange Bank, ended in scandal and fueled a continuing controversy about the wisdom of foreigners buying assets in financial services and other sensitive industries.

While a degree of sensitivity remains, it is softening. And there are signs that Koreans as the government offers more vocal support and as more companies, investors and individuals feel its positive effects. It’s only been eight years since the government allowed local PE funds to operate.

Among Korea’s business leaders, those who have used private equity as a vehicle for growth or capability building tend to be more positive than those who have not. Doosan wisely relied on PE to carve out its non-core businesses and de-leverage its capital structure. Fila bought Acushnet, a leading golf brand, with the help of PE investors. Many owners of mid-cap companies are now using PE as tools for growth capital or to cash-out. Some are working with global or regional funds to expand overseas.

Actions speak louder than words, so each successful PE deal in Korea serves to quiet the skepticism that once raged so strongly.

Private equity still has its share of detractors. For example, conflicts frequently arise when PE funds take board seats and exercise their rights – angering owners who are accustomed to making all the important decisions themselves. There is also resistance when funds structure deals to gain favorable downside protection. And because many PE players lack years of experience working with major firms, they also lack the insights and knowledge that helps improve companies.

However, such challenges are now being balanced – and outweighed – by visible evidence that PE has much to contribute to Korea’s economy. The government and regulators are positive towards the asset class provided deals don’t involve over-leveraging, massive restructuring or leakage of core technology.

The days of bottom-feeding are giving way to tangible portfolio value creation. PE funds are becoming more actively involved in management and operations, upgrading portfolio companies’ management infrastructure to make them more scalable, finding new customers, suppliers and partners. These are not only requirements for private equity to flourish, but also the best way to improve the industry’s once notorious image.

**SOUTHEAST ASIA**

*Dean Collins,* partner, O’Melveny & Myers, Singapore

**GAUGING PERCEPTIONS OF PRIVATE equity amongst the public and various stakeholders in Southeast Asia is challenging for a number of reasons, most obviously because its constituent countries do not think as one. Cultural, social, lingual and economic disparities confound generalizations.**

At one end of the scale sits Singapore: modern, transparent, user-friendly regulation and making a concerted effort to attract more foreign private equity firms. Public views on the asset class are generally positive because the government is pushing all the right buttons.

Myanmar is at the other end of scale. “Some governments haven’t addressed their minds to private equity yet,” says Dean Collins, a Singapore-based partner with O’Melveny & Myers. “Myanmar has just passed new rules on foreign investment. It’s not about PE; it’s about recognizing this is a poor country that needs foreign capital. They are not discriminating between PE and corporations.”

Looking at the region as a whole, economies are not as penetrated by PE as elsewhere in Asia.

“For years, there were only four local GPs in Indonesia – plus a few international guys above them looking for deals – and now there are 5-6,” says Collins. “In Thailand there are only two established private equity firms, and although Vietnam saw a sharp increase in GPs a few years ago, most have since faded to the margins.”

Given the growth-oriented nature of many transactions, together with the strong consumer sector focus in countries such as Indonesia, wherever the public and business communities actually have reasonably informed views on private equity, they tend to be positive.

Collins cites Indonesian movie theater chain Blitz Megaplex as an example. The entrepreneur who started the business wouldn’t have been able to do so without support from local GP Quvat Management. From a pure consumer point of view, before Blitz came along, Indonesia only had one movie theater chain, so there is a sense that PE has made a positive contribution.

“What you don’t have yet in Southeast Asia are the millionaires you find in China who got rich thanks to private equity-backed IPOs,” Collins adds. “People are influenced by their friends and contacts – if one person received PE capital then the others want investment as well – but there aren’t a lot of stories about this guy or that guy getting his money from CDH Investments.”

There are, however, a couple of private equity professionals who enjoy a reasonably high public profile. Gita Wirjawan, founder of Ancora Capital, is now Indonesia’s trade minister, while Sandiaga Uno, co-founder of Saratoga Capital, is a regular contributor to local media.

Last month, Uno used his column in the Jakarta Post to criticize media coverage of tensions between Indonesian family conglomerate Bakrie Group and UK financier Nathaniel Rothschild, who together control Bumi, an Indonesian coal producer. The public response was, to say the least, mixed.

It serves as a reminder that Southeast Asia is characterized by an asset ownership model under which a lot of power lies in the hands of a few families. Private equity firms need to do business with these families and so the public perception of one will inevitably rub off on the public perception of the other.
Shearman & Sterling has an established presence with a 139-year legacy. It is one of the world’s leading international law firms known for its expertise in virtually every area of law relating to commercial and financial activity, from advice on investment funds, capital markets, corporate/mergers and acquisitions, project development and finance transactions through to representation in international arbitration and litigation.

With a long-standing commitment to Asia for more than 30 years, we offer a sophisticated approach to deliver innovative and integrated strategic, tactical and technical advice to our clients. Our core practice areas include:

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- Asset Management
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- Direct Investment
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- Intellectual Property
- Litigation
- Mergers & Acquisitions
- Private Equity
- Privatizations
- Project Development & Finance
- Regulatory & Compliance
Reputation matters

John Lewis, chief investment officer at Unitas Capital, talks to AVCJ about the importance of reputation in Asia from fundraising through post-deal value-add to exiting portfolio companies to multinational buyers

Q: How conscious are you of the Unitas Capital brand?
A: We continually try to build up our reputation and the strength of our brand through the investments we make and the clarity of our strategy, as well as the way we interact with management partners and LPs. If we are creating a distinct value proposition that attracts potential portfolio companies, resulting in good deals and good returns, the value proposition will be clear to LPs. So what we say to the two groups is very similar.

Q: In terms of what LPs require of Unitas, how important are environment, health and safety (EHS) issues?
A: Universally, increased attention is being paid to compliance and people are particularly sensitive about emerging markets because these issues get plenty of coverage. Take for example the issues surrounding Chinese companies listed in the US. We are very careful and have strict compliance procedures in place at all our companies. We haven’t seen a huge change in terms of LPs asking for lots of documentation but I wouldn’t be surprised if that trend developed.

Q: To what extent is EHS a priority when exiting investments to multinationals?
A: Strategic investors have made China a top priority and they are looking for acquisitions for market entry or expansion. However, they do get nervous about systems and compliance, and the risk of ending up in a very messy situation. One thing we can do is ensure the portfolio company is very clean.

Q: What kind of post-close conditions do strategic investors seek to impose?
A: It varies. There are European-style transactions where there is no recourse for the buyer and it’s similar to buying a public company. On the other hand, you have US-style acquisitions where there are more covenants and undertakings on the part of the seller and more recourse for the buyer. Depending on competitive dynamics in the deal and other factors, a private equity seller might accept some recourse but it would typically be very limited. And in no event would the buyer be able to recover more than the sellers’ proceeds. There have been situations in the US, for example, where a huge environmental liability emerged and the buyer has gone after the seller for more than they paid.

Q: What about the brand and reputation in a fundraising context? Your current vehicle closed in 2008, so presumably you are thinking about returning to the market…
A: We haven’t finalized timing for our next fund. We still have capital left in our current fund and our focus is on investment, but, yes, we will enter the market in the not too distant future. We feel our particular niche – being a leading Asian franchise in the industrial and consumer-outdoor clothing maker NEPA and Chinese restaurant chain Babela’s. What are your operating partners doing with these companies?
A: With NEPA, the focus in particular is helping them expand overseas. Korea is the second-largest outdoor apparel market in the world and the company has developed lines with great design and performance characteristics. We think its products will have appeal in foreign markets, starting with China. Eugene Suh, who leads our consumer and retail business, and Jay Lee, who was formerly CEO of Buy The Way and before that was at Yum Brands and PepsiCo, are in charge of that investment. With Babela’s, there is a good brand and platform but a whole range of operational improvements are required, ranging from procurement to restaurant design to what’s on the menu. Gene and Jay are also working on that alongside Jim Tsao, who also comes from an operating background and leads our overall efforts in China.

Q: Where do you see the most investment potential right now?
A: Public market valuations have come down in China but you still don’t see a lot of entrepreneurs willing to sell controlling stakes to PE investors. However, we are seeing more deal flow in emerging privately-owned consumer and retail businesses and cross-border industrial. We own four companies that were originally based outside of Asia but have a big presence in the region. Our focus is on globalizing them and helping them expand in Asia.

“We have a powerful value creation model that is unique in the middle market in Asia”
With leadership in the private equity sector moving from country specific to global markets, we encourage private equity companies to look for talent beyond borders. AIMS has been at the forefront of conducting global, multi-country and local searches. Our experience across all five continents has allowed us to build an extensive network with a diversified talent pool which extends beyond borders and cultures. Our 400 consultants and over 100 offices in 80 countries enable us to search locally and truly globally.

We believe in being creative in our search, by giving priority to understanding our client's brand, target group, company culture, company structure, lifestyle and philosophy. We use non-traditional channels to look exclusively for those outstanding professionals who can combine a unique mix of financial knowledge, business leadership and managerial skills and have the vision to be attracted by great growth opportunities and new challenges.

AIMS industry teams and specialists’ combined knowledge and experience allows us to understand the dynamics and trends of each industry's job market. We provide our clients with savvy insight and advise during and after their talent search processes. Our track record is cemented by the strong relationships we have built over the years with our clients.
Sustainable alpha

Increasing numbers of PE firms are upping their commitment to environmental and social governance issues at future and existing portfolio companies. What’s their motive?

THE PLANNED $8.9 BILLION EXPANSION

of a petrochemical plant in the eastern Chinese city of Ningbo provoked a wave of protests by residents last month. They were concerned about plans to produce the industrial chemical paraxylene at the facility, which could cause untold damage to the local environment and health. After three days of demonstrations, the local government announced that the project would not go ahead.

This scenario has been repeated time and again in China in recent years. It is symptomatic of a growing awareness of environment and sustainability issues globally, and is reflected by the increasing number of private equity firms putting environmental and social governance (ESG) higher up the agenda. A recent PricewaterhouseCoopers survey into the responsible investment practices of 17 PE houses found that 94% of firms believe that ESG activities can create value at their portfolio companies.

“People nowadays are more aware of bribery and corruption issues, governance problems in companies, worker participation and exploitation issues, and environmental issues such as reduction in carbon footprint and fuel economies,” says Claire Wilkinson, general counsel at placement agent MVision and chair of the European Venture Capital Association’s Responsible Investment Working Group.

Compliance isn’t enough

For those firms investing in China, compliance is a key issue. While many local companies may have undergone environmental impact assessments (EIAs) – to determine the impact a proposed project may have on the environment – and obtained the necessary permits, on numerous occasions permit requirements have not been implemented, meaning investors find themselves liable to pay large sums to bring projects up to the mark.

According to James M. Pearson, CEO of Pacific Risk Advisors, which conducts environmental and social (E&S) due diligence on behalf of investors, firms that are only interested in being compliant – as opposed to wanting to back firms with superior ESG records – are setting their standards too low.

“If you’re not in compliance, you’re breaking the law, so those people who are really happy because they’re compliant are at the bottom of the bottom,” he tells AVCJ. “They should be saying they’re better than compliance, which would mean they are able to identify a lot of operational improvements staring them in the face. I’ve never gone to a factory that’s been 100% in compliance anyway – I’ve always found something regulatory-wise, whether it’s the environment or health and safety.”

Labor issues are also a cause for concern among GPs. The biggest issue – in China, in particular – is that often potential targets have not paid for social insurance for their workers, despite this being required by law. A firm investing into such a company needs to be aware of this, to ensure back-pay is provided and that all future employees have appropriate healthcare and accident coverage. In some cases, a lack of insurance might be cause enough to walk away from a deal.

“If you’ve got 100 workers and for the last 10 years they’ve been exposed to some toxic chemical, they may be coming back ill and you’re liable to be sued,” points out Pacific Risk’s Pearson.

Compliance and labor issues are nothing new among Asian companies, though. What’s changing is the recognition from investors of the importance of these issues, and risk management is a prime motivator. China Investment Corp-backed China-ASEAN Investment Cooperation Fund (CAF), which invests in infrastructure, energy and natural resources in Southeast Asia and China, views E&S due diligence as just another method for analyzing the capacity of an investee company’s management.

“If a potential investee company does not have a sound grasp of ESG management or the willingness to improve, this can be a symptom of greater issues at hand,” explains Dean Robinson, an associate at CAF. “By helping an investee company improve its ESG performance, this in turn can help minimize risks and improve value.”

It’s also not merely the reputation of the individual company that is at stake, either, but the brand of the fund as a whole. No GP wants to have an entity in their portfolio that constitutes an environmental reputational risk. This doesn’t mean that an investment won’t take place if a negative ESG factor is highlighted in pre-deal screening. It simply means the investment manager will take on that project well-informed of the risks and aware of the value that can be added by instituting new procedures or mitigating downsides.

LP preference

LP expectations constitute another significant driver for PE firms to focus on ESG. According to Coller Capital’s latest global private equity barometer, the majority of European (70%) and Asia-Pacific (59%) LPs monitor – or expect to start monitoring – GPs’ ESG policies, and most industry participants believe this will grow in coming years. Some investors still pay little attention to ESG issues, however, with Coller’s survey...
black and white answers 1,000 shades of grey

THE SWEET SPOT

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noting that only a quarter of North American LPs monitor ESG strategies.

“There are exceptions of course with some notable US public pension plans being very active in this,” says MVision’s Wilkinson. “I think this is societal. The end investors are expecting good returns from their fiduciaries and maybe in North America, consumers haven’t yet moved towards demanding that those returns are also based on sustainable investment criteria.”

Other motivations for a robust approach to ESG include the potential cost-savings for the PE firm. KKR and Doughty Hanson are among a handful of investors that have attempted to quantify the financial impact of their environmental activities in monetary terms. KKR, for example, claims that thanks to being part of its Green Portfolio Program, investee company Oriental Brewery has saved $5.3 million and avoided generating 40,000 metric tons of greenhouse gas (GHG) emissions. Collectively, the 23 portfolio companies that have taken part in the scheme have achieved more than $365 million in financial impact and avoided 810,000 metric tons of GHG emissions, 2.2 million tons of waste, and 300 million liters of water.

“Cost-savings are what makes the program sustainable over a long period of time. If it’s done the right way, this program should go on forever,” says Steve Okun, director of Asia-Pacific public affairs. “If it makes business sense to do something – and you can have an environmental impact – why wouldn’t you do it?”

Exit gains
A related advantage is the benefit the GP sees on exit. The notion of “sustainable alpha” – creating a difference in value at the exit point through focusing on sustainability risk – is one that is gaining traction. Not only is it advisable to have reputable E&S procedures in case the company decides the pursue a listing – the Hong Kong Stock Exchange has just introduced new ESG reporting requirements and other exchanges have their own stipulations – but firms going down the secondary or trade sale route should also be considering the impact ESG can have.

“You can harp on about how compliance is expensive and takes time but the smart GPs get it,” says Vikram Raju, senior global funds specialist for the International Finance Corporation (IFC). “If you have two equal companies – one with ESG standards and the other without – the company with ESG standards can command a better multiple. If you don’t have this, it definitely dents your valuations.”

The potential magnitude of E&S disasters and pressure from investors, particularly IFC and Asian Development Bank, mean it’s a foregone conclusion that the PE industry’s response to ESG will evolve rapidly. What form this evolution will – and should – take is a matter for debate.

“At the operational level, PE investor leaders in ESG integration like Robeco Private Equity will help push the industry to move past a tendency to focus on one or two ESG issues (such as corruption or water) and take a more holistic, engaging approach with the GP,” says David Doré, research manager at AsIA, an organization that promotes sustainable finance and responsible investment in Asia. “We would expect an even greater awareness that ESG integration, such as focusing on employee satisfaction thereby lowering sick leaves and increasing productivity, is not in conflict with value creation and operational efficiency.”

As demands from society and LPs rise, those firms that develop in-house capabilities to tackle ESG may be in a much stronger position than those that do not. The more forward-looking firms will see this as an opportunity rather than a challenge.

Global PE firms’ ESG policies for Asia

CVC Capital Partners
“Our ESG policy in Asia is consistent with our global policy. As a responsible investor, CVC is committed to the effective management of ESG issues, which it believes should be an integral part of the overall investment process. All deal teams are therefore required to consider the sustainability implications (both risks and opportunities) of acquiring a target, and to formally document their evaluation in the team’s investment papers. In order to assist the team, a comprehensive online ‘Sustainability Toolkit’ covering 11 industry sectors is available to provide guidance and help teams identify relevant ESG issues on each deal.”

TPG Capital
“TPG’s commitment to sustainability in Asia supports the firm’s long-standing consideration of environmental, health and safety practices in due diligence, investment decisions and operations. Our focus on sustainability enables us to make better investment decisions and achieve greater results for investors, portfolio companies and stakeholders. TPG’s sustainability commitment ensures that sustainability practices are implemented and that measurable results are achieved in our companies and our operations. We incorporate sustainability considerations into our investment diligence and decisions and strive for greater transparency and governance from our companies.”

KKR
“In 2009, we became signatories of the United Nations-backed Principles for Responsible Investment, in part to give us a platform to engage with our investors and peers on managing ESG issues. In addition, we partner directly with a number of LPs to help define and prioritize our ESG-related efforts as well as to learn from their experiences, including through our ‘ESG round tables’, which we started holding in some cities in 2010.”

Bain Capital
“ESG principles are at the core of Bain Capital’s value-added investment approach. We encourage our employees, worldwide, to give back to the communities in which they live and work, to help the businesses that we collaborate with to be environmentally efficient and to help ensure that the management teams with which we partner operate with the highest standards of integrity.”

The Carlyle Group
“Carlyle employs ESG principles to create long-term value for our investors. We are integrating responsible investment guidelines into our investment decision-making process for controlling, corporate buyouts across our portfolios. We can work with our portfolio companies to facilitate their evaluation of the ESG issues associated with their businesses. As a result of our encouragement, more than 60 Carlyle portfolio companies – representing more than 90% of Carlyle-controlled companies – reviewed their operations in accordance with the Private Equity Growth Capital Council guidelines corporate social responsibility in 2011.”
Risk Capital Advisors (RCA) is the market leader in advising on and negotiating transaction insurance and alternative risk transfer solutions. With a wealth of experience across Asia Pacific and an impressive track record of closing transactions, the RCA team provides knowledgeable and commercial advice on a range of transaction risk strategies and solutions.

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- Tax
- Litigation
- Prospectus Liability
- Environmental
- Contingent Liabilities
The privatization play

Take-private transactions have created headlines in a climate of low public market valuations. Companies are being targeted in Australia, Japan and the US, but a bid doesn’t necessarily result in a deal

IN THE TWO YEARS SINCE CHAMP PRIVATE

Equity closed its third buyout fund, the Australian GP has completed five deals, two of them take-privates. The most recent, Gerard Lighting Group, departed the domestic bourse last month to join earlier acquisition oOhMedia, an outdoor advertising company, in the CHAMP portfolio.

Australia has traditionally offered rich pickings for private equity firms chasing take-privates and 2012 is no exception. Pacific Equity Partners (PEP) acquired cleaning and catering contractor Spotless Group in April while TPG Capital has been engaged in the on-again, off-again pursuit of struggling surfwear manufacturer Billabong.

On the other side of the world, take-private transactions of US-listed Chinese companies reached a new high in August as Focus Media received a $3.5 billion offer from a PE consortium. Japan has also been busy, with Advantage Partners buying home builder Yasuagi Unison Capital moving for auto parts maker Ashii Tec.

Despite this recent activity, Asian private equity-backed take-private transactions in 2012 account for just a fraction of the volume transacted five years ago. As of October, $1.8 billion had been committed across seven transactions; during the liquidity boom of 2006-2007, when buyouts of all kinds grew exponentially, there were more than 40 take-privates collectively worth $31 billion.

The tougher debt financing environment is partly responsible for the disparity, but the greatest challenge is rooted in the willingness of founders and majority shareholders to take part in such transactions.

“Take-privates are a more viable option for existing shareholders to pursue an exit,” Tatsuo Kawasaki, a founding partner at Unison Capital, tells AV/CJ.

“But going private does create a little bit of a shock to the company and you need to explain to management and shareholders why it makes sense in this environment.”

Timid investors

The public market malaise that facilitates take-private deals is long-standing. While Australia’s benchmark S&P/ASX 200 Index is trading at two-thirds of its pre-global financial crisis level, Japan’s Nikkei 225 and Hong Kong’s Hang Seng Index are down 50% and 30%, respectively. In this climate, investor expectations have weakened to the point that they are open to offers of immediate or guaranteed liquidity.

“If you think back to our attempted takeover of Flight Center in early 2007, there was a sense that the market was inexorably rising,” Tim Sims, founder and managing director of PEP, tells AV/CJ.

“PE had expressed its interest, and shareholders were able to tell them to go away in the expectation that three months later the market would reward them with a higher share price.”

The best examples – in an Australian context – of how perceptions have changed are investment group Perpetual and Billabong. In both cases, take-private offers were spurned and the share prices subsequently tanked.

KKR bid for Perpetual in October 2010, offering A$38-540 a share for a total consideration of A$1.75 billion. Months of limited engagement followed as the target company repeatedly insisted the offer was too low. When KKR eventually walked away, Perpetual’s share price plunged 50%.

In February, TPG was prepared to pay A$841 million for Billabong – or A$3.30 per share, up from a previous offer of A$3 – only for the company’s board to demand at least A$4 per share. As the company’s commercial difficulties became more apparent, its stock began to slide and TPG returned with a A$694 million offer. The board reluctantly opened its books to the private equity firm. TPG withdrew its offer in October after concerns emerged during due diligence.

Billabong is now trading below A$1.

Fearful that weak public markets could further undermine the personal worth they have tied up in their companies, founders and shareholders in several markets are – theoretically – more open to a private equity solution. Some company chairmen actively court prospective investors, offering access to assets at cheap valuations.

“A lot of top-tier US-listed China companies, for example, are now trading at a high single-digit, whereas if you source a private business in China, you need to pay something like 12-15x the forward price-to-earnings (P/E) ratio,” Donald Yang, managing partner and CIO at Abax Global Capital, explains. “When you look at the quality of corporate governance, internal controls, and financial management, the advantage clearly goes to the listed companies.”

For many mid-cap Chinese companies, the main reason they went public in the US in the first place was to raise funds. However, ever since financial irregularities were uncovered at a number of Chinese firms that listed in America via reverse mergers this function has ceased to be valid. Chairmen are paying the additional compliance costs of maintaining US listing and all the while market capitalizations are shrinking.

While not all take-private deals are sponsored by private equity investors, Honson To, head of private equity at KPMG Asia Pacific, suggests that PE firms can provide financial and restructuring expertise to these companies, in addition to capital. Their mere presence can also boost a Chinese issuer’s credibility. “Market participants

![Take-private transactions in Asia since 2005](image_url)
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are eagerly observing the growing trend of take-private transactions and any potential first-mover advantage, although it remains to be seen if such companies can be successfully relisted in a few years’ time,” he says.

Maurice Hoo, global leader of Orrick’s M&A and private equity practice group, agrees that PE players who understand the valuation differential between markets are playing a vital role.

“Almost all of these take-private transactions are aimed at going private in the US and then going public in Hong Kong, where the companies should expect to fetch a higher valuation,” he says. “This is due to not only an absence of negative publicity, but also an investment public that should understand the company and its business in China much better than in the US.”

Inaccessible debt
While low valuations and relatively higher listing costs can present a compelling case for going private, Australia and Japan, which between them account for 60% of Asia’s PE-backed privatizations since 2005, aren’t seeing anything like the activity of 2006-2007.

Debt financing is a key issue. Banks in both countries are still willing to sponsor leveraged buyouts; but there are fewer participants than before and the debt portion of deals is less generous. In Australia, for example, European banks have more or less completely exited the syndication market and the four major local lenders focus on smaller deals. Private equity firms must therefore rely on US and strong Asian banks for support.

“The deal debt margins and the gearing ratios have changed considerably from the peak of the boom to the current position in Australia,” says Mark Malinas, co-head of private equity at law firm Allen. “Debt-to-equity ratios of around 4x were common in 2006-2007 and you could get a margin of 2-2.5% over the bank bill swap rate; now you have gearing ratios of around 2x and a margin at around 4-4.5%.”

With less debt financing available, private equity players have shifted towards smaller and mid-market deals. Last year, the average PE-backed take-private deal in Australia and Japan came to $252 million and $116 million, respectively; it was $1.7 billion and $604 million in 2007. Another option is setting up club deals, but that may mean a longer and more complicated execution process.

Take-privates for US-listed Chinese companies are on the opposite trajectory, although it’s worth noting that debt financing, while available, is limited. Deal flow was negligible in 2006-2007, but 45 transactions have been announced in 2010-2012, 16 of them involving private equity.

However an announcement is no guarantee of a closure: only four of these PE-backed deals have been completed as of October, data from AVCJ Research and Roth Capital Partners show.

Abax Global Capital’s buyout of Fushi Copperweld is expected to close in the fourth quarter, two years after the offer was first submitted. The private equity firm has one successful take-private to its name – Harbin Electric – but this took one year to transact.

Game of chicken
The long execution process suggests that, when calculating the premium to be offered to shareholders, private equity firms and company management should take into account the possible price fluctuations and the changing valuation expectations from shareholders.

Just in the last week, a $1.7 billion take-private bid submitted by CVC Capital Partners and the Malaysian state of Johor for the country’s two main KFC fast food franchisees met with opposition from investors one year after the deal was announced. They claimed that the offer came so long ago that the price no longer represents the company’s true value.

So there are two issues to consider when dealing with shareholders. First, they may lose interest during a protracted deal process. Second, many company owners in Asia – usually the first-generation founders – are not fond of delisting for prestige reasons and often loathe to give up sizeable portions of equity.

“You also need to remember to treat minority shareholders fairly because often a number of them unhappy with the price,” says Unison’s Kawasaki. “I think it has become clear over the last decade that they may eventually speak out. For people like us, these considerations are very important and we must make sure a transaction is valid from all angles.”

In addition, Ken Chen, a Shanghai-based director at L.E.K. Consulting, suggests that China take-privates in particular have been a seller-led game in the last couple of years, given that there is more capital than good companies. A lot of funds raised in the last couple of years are still in the process of use up their dry powder before returning the capital to LPs.

“Private equity players don’t want to come across as too desperate during negotiations because it will be made known to everyone in the public market,” says Chen. “Both sides have pride and it’s like the game of chicken. When the founder turns down the offer, why should we come back to you?”

Should each of the China take-privates announced in 2012 actually close, the region-wide figure would balloon by $6.3 billion. But compared to the boom market in 2006-2007 when asset prices were rising steeply, the current economic outlook is more difficult to predict. PE players are certainly aware of the uncertainties and skeptical about paying high price.

In the face of a valuation expectation gap between buyers and sellers, Christopher Kelly, a partner at Linklaters, says private equity players should emphasize how they can add value to target companies rather than just focusing on geographic arbitrage obtained through buying US-listed Asia assets and relisting them in Hong Kong.

“Most Asia targets are looking beyond the cash that PE houses bring to the table. What they want is some level of expertise for future growth,” Kelly says. “Certain private equity houses are now pursuing a ‘buy-and-build’ strategy – you purchase the asset, take it private and build the platform by buying complementary assets. The resulting business should be worth more than the sum of the parts and the value created can be realised via an IPO or trade sale.”

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**Leading Asia take-private deals since 2005**

<table>
<thead>
<tr>
<th>Target company</th>
<th>Investor</th>
<th>Amount (US$m)</th>
<th>Date</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investa Property Group</td>
<td>Morgan Stanley Real Estate</td>
<td>5,400</td>
<td>May-07</td>
<td>Australia</td>
</tr>
<tr>
<td>Macquarie Communications Infrastructure Group</td>
<td>CPRB</td>
<td>5,300</td>
<td>Mar-09</td>
<td>Australia</td>
</tr>
<tr>
<td>Chartered Semiconductor Manufacturing</td>
<td>Advanced Technology Investment Company</td>
<td>3,000</td>
<td>Sep-09</td>
<td>Singapore</td>
</tr>
<tr>
<td>Shin Corp</td>
<td>Siam Commercial Bank, Temasek</td>
<td>4,600</td>
<td>Jan-06</td>
<td>Thailand</td>
</tr>
<tr>
<td>Intal Group</td>
<td>Canada Pension Plan Investment Board</td>
<td>3,000</td>
<td>Aug-10</td>
<td>Australia</td>
</tr>
<tr>
<td>Skylink</td>
<td>AIG, CVC, Nomura</td>
<td>3,000</td>
<td>Jun-06</td>
<td>Japan</td>
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<tr>
<td>Healthscope</td>
<td>Carlyle, TPG</td>
<td>2,400</td>
<td>Jul-10</td>
<td>Australia</td>
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<tr>
<td>Parkovoy</td>
<td>Khazanah Nasional</td>
<td>2,400</td>
<td>Aug-10</td>
<td>Singapore</td>
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<tr>
<td>The Tokyo Star Bank</td>
<td>Advantage Partners, Coller Capital, Lehman Brothers</td>
<td>2,200</td>
<td>Dec-07</td>
<td>Japan</td>
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<tr>
<td>DCA Group</td>
<td>CVC</td>
<td>2,000</td>
<td>Sep-06</td>
<td>Australia</td>
</tr>
</tbody>
</table>

Source: AVCJ Research
Partnering Innovation since 2004

Machinery
Materials
Energy
China take-private deals

Since 2005, China has accounted for just 4.5% of PE-led privatizations in Asia by value. With 11 deals in the pipeline involving Chinese companies listed in the US, this share could rise to 13.6% - provided they all close. It is not unusual for these stocks to trade at a discount to the offer price post-announcement. This is largely due to uncertainty about the deal getting done. Given all the regulatory, legal, tax and due diligence considerations, transactions can take months to close, and some fall apart along the way.

Pending PE-backed privatizations of US-listed Chinese companies

<table>
<thead>
<tr>
<th>Target</th>
<th>Investor</th>
<th>Announced</th>
<th>Value (US$m)</th>
<th>Pending</th>
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<tbody>
<tr>
<td>Fushi Copperweld</td>
<td>Abax Global Capital</td>
<td>Nov-10</td>
<td>363.8</td>
<td>723</td>
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<tr>
<td>ChinaCast Education Corp</td>
<td>Undisclosed</td>
<td>Nov-11</td>
<td>343.1</td>
<td>362</td>
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<tr>
<td>AsianInfo-Linkage</td>
<td>CITIC Capital</td>
<td>Jan-12</td>
<td>941.8</td>
<td>296</td>
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<tr>
<td>China Transinfo Technology</td>
<td>SAIF Partners</td>
<td>Feb-12</td>
<td>146.6</td>
<td>264</td>
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<tr>
<td>ShangPharm</td>
<td>TPG Capital</td>
<td>Jul-12</td>
<td>177.7</td>
<td>128</td>
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<tr>
<td>Focus Media</td>
<td>The Carlyle Group/FountainVest Partners/CITIC Capital/CDH Investments/China Everbright</td>
<td>Aug-12</td>
<td>3,565.4</td>
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<td>LJ International</td>
<td>FountainVest Partners</td>
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<td>7 Days Group</td>
<td>The Carlyle Group/Sequoia Capital</td>
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<td>3SBio</td>
<td>CITIC Private Equity</td>
<td>Sep-12</td>
<td>331.0</td>
<td>62</td>
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<tr>
<td>Feihe International</td>
<td>Morgan Stanley Private Equity Asia</td>
<td>Oct-12</td>
<td>146.0</td>
<td>39</td>
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<tr>
<td>Yongye International</td>
<td>Morgan Stanley Private Equity Asia/Abax Global Capital</td>
<td>Oct-12</td>
<td>330.0</td>
<td>27</td>
</tr>
</tbody>
</table>

Time lag between deal announcement and completion

Source: AVCJ Research

The Chinese share of PE-backed take-private activity in Asia

Source: AVCJ Research

Harbin Electric
Funtalk China
China Fire & Security
Chemspec International

Source: AVCJ Research
Change management

Martin Mok, a Hong Kong-based partner at EQT Partners Asia, talks to AVCJ about what slowing economic growth and slowing public markets mean for private equity investors in China.

Q: EQT Greater China II is a 2005 vintage fund. Are you now looking for exits?
A: The fund made nine investments to date, one of those, LBX Pharmacies, filed in February with the Shanghai Stock Exchange. The IPO market has been slowing down but we are hopeful of approval by next year. We have had tripled EBITDA during the four-year ownership period are just waiting for the environment to improve for a liquidity event.

Q: What have you done to boost the company’s earnings?
A: When EQT first went into the deal, LBX’s gross margin was in the 22% range – for a retailer that’s not really good enough and the reason was not enough high margin products were being sold. The company changed its procurement structure so now over 40% of its products are now in the high-margin category, up from 20%. Gross margins have since risen from 22% to 35%. The other major innovation involved store format. LBX went to visit market leaders in the UK, the Philippines and Japan. After rolling out a second-generation store, the company hired a leading Japanese pharmacy to come in to build five flagship outlets for us. As a result, LBX has managed to branch out into a whole new customer demographic with a third-generation store format that attracts younger customers.

Q: When are the IPO markets struggling what can you do to develop other exit channels?
A: Fortunately, only two of EQT’s portfolio companies are targeting IPOs and the market for trade sales is still quite strong. It is impossible to predict the market but if you look at the Shanghai Stock Exchange, China hasn’t been this cheap for well over 10 years. There is moderately slow growth but when the market is trading at its lowest in decades you have to believe it is not going to get much worse. And I believe the whole thing is turning a corner.

Q: What can you do to insulate portfolio companies against slowing macro growth in China?
A: We invest in cyclically neutral companies, such as LBX Pharmacies and Qinyuan Bakery, which have seen EBITDA increase 25% and 50%, respectively, so far this year. Hong Kong’s Japan Home Centre has also seen EBITDA jump by 12% despite Hong Kong’s GDP being revised down to 1-2%. The key is we were a little bit gun-shy during the 2006-2007 global liquidity boom when everyone else was investing in mining and real estate. Some did well and got out quick but others didn’t.

Q: What impact is slow growth in China having on the investment environment?
A: Anyone heavily exposed to the commodities market, real estate or the banking sector is suffering. I spoke to some of the top Chinese private equity firms recently and asked, if they were add together all the profits from their portfolio companies so far this year, would it be growing or shrinking. At least two said it would be shrinking. Earnings for companies in the Shenzhen Composite Index are down 11% and industrial profits in China are falling across the board. What does that mean for private equity? Fortunately for us, EBITDA across all our companies in third quarter is up 3.2% year-on-year.

Q: What impact is this changing environment having on how GPs’ investment strategies?
A: It is having a deep impact. People are realizing that it’s not about investing in anything that seems to be growing or heading for an IPO. Instead they have to be careful in selecting businesses with good cash flow, stability and neutrality to the cycle. Companies involved in pharmaceutical retail, baked goods and household products – like LBX, Qinyuan and Japan Home Centre – can be improved by better management and industrial benchmarking. These are all the hallmarks of traditional private equity when it started in the US and Europe, something China has moved away from in recent years with the boom in pre-IPO investment. However, the country will likely return to these fundamentals.

Q: A number of PE firms are taking advantage of weak public market valuations by doing take-private deals – and in June EQT did this with Singapore-listed China Healthcare. What are your plans for the company?
A: China Healthcare has done very well to date. This is because of operating leverage and the nursing homes increasing utilization rates to 95% while simultaneously increasing prices. The company has also ramped up home care and training services, so all the business engines are humming. EQT brought in co-investors and together we have a 49% stake while the founder holds the rest. The business plan is based upon improving existing nursing home services and building more centers. According to the Singapore government, by 2030 one fifth of the city’s population will be 65 or over and, given the depth of local wealth, people will be able to afford nursing homes. The aim is to build more centers as the government gives out more licenses and they have just announced 10 more will be issued. China Healthcare also has a center in Malaysia and a second opening by 2013. The company will continue to grow in Malaysia, which has similar dynamics to Singapore in the form of an ageing, affluent population.

“If you look at the Shanghai Stock Exchange, China hasn’t been this cheap in over 10 years”
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