AVCJ
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PRE-CONFERENCE ISSUE | AVCJ PRIVATE EQUITY AND VENTURE CAPITAL FORUM INDONESIA 2013

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# Tougher this time

**A NUMBER OF PE EXECUTIVES – OLD** enough to have seen several cycles – have commented on how difficult the fundraising environment is at present. "I thought my last fundraising [in 2004] was very difficult. Now that I am raising my current fund, the past experience almost seemed easy," the senior partner of a regional buyout fund observed during a recent meeting. Different versions of this incident are recounted by other GPs as they take a timeout from the fundraising trail.

The numbers appear to confirm this story. Although LPs still need to find a place to park their capital and Asia remains an attractive growth market, provisional data from AVCJ Research shows that regional fundraising is a comparatively anemic $2.8 billion so far this year – and half of that comes from Affinity Equity Partners' first close. Around $9.8 billion had been raised by the same point in 2012, but it's worth noting that much of it went into renminbi-denominated vehicles.

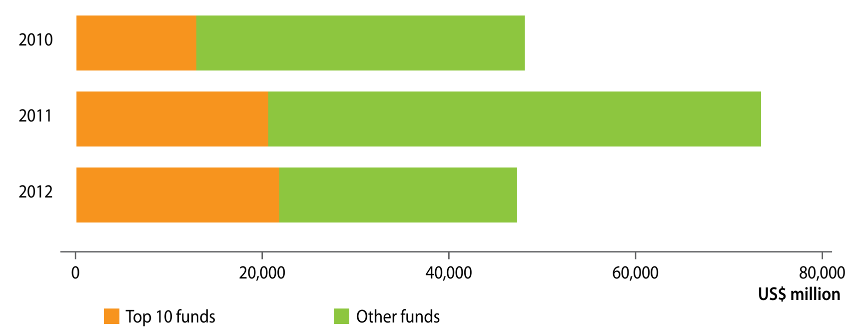
The fundraising world can be divided into "haves" and "have nots." What we have seen over the last few years is a small number of large GPs accounting for an ever larger share of the overall pie. In 2010, the 10 largest funds attracted 27% of total capital committed to Asia. In 2011, it rose a touch to 28%, but this was a bumper year for fundraising. In 2012, when overall fundraising was similar to the 2010 level, the top 10 GPs took a startling 46% of the pool.

There are some well-documented trends at work here. Institutional investors are looking to consolidate their GP relationships, committing more capital to a smaller number of players; and they are backing stable teams known for delivering consistent returns. Bear in mind that the 2013 figure doesn't yet include the $3 billion from KKR's expected second and final close on its $6 billion second Asian fund.

Other funds have been lagging a bit behind, but this is not unique to Asia. Permira's recent announcement that it was reducing the fundraising target for its latest global fund from EUR6.5 billion ($8.5 billion) to EUR4-5billion may be a harbinger of things to come. Indeed, a number of firms have lowered the lofty standards set in the previous cycle before the global financial crisis.

I've also met with a number of LPs in the past few weeks. They claim to be busier than ever before, given that GPs are trying harder to build relationships with a view to securing commitments. While the larger players are focused on issues outside of primary commitments, such as increasing their co-investment levels and reducing fees, the smaller and more entrepreneurial fund-of-funds are looking more closely at country and/or sector-specialist GPs. The big funds are "getting too big," they say.

**Asia private equity fundraising**

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# NEWS

## ASIA PACIFIC

### New York State Common backs RRJ Capital

New York State Common Retirement Fund (NYSCRF) has committed $300 million to RRJ Capital. The Hong Kong-based GP has reportedly raised $3.5 billion for its second fund, having originally targeted up to $5 billion. Other LPs are understood to include China Investment Corporation (CIC), Temasek Holdings and Texas County & District Retirement System.

## AUSTRALASIA

### PE firms eye larger deals - AVCJ forum

Private equity investors expect to see more large-cap deals in Australia as the liquidity boom in the US provides increased capacity for debt financing. "If you can access the US market that opens up more opportunities than we have seen in recent years because we can do larger financing and larger deals," Justin Reizes, managing director at KKR Australia, told the AVCJ Australia & New Zealand Forum. Simon Moore, managing director at The Carlyle Group, added that the retail note market has also become more accessible.

### Anacacia set for 5x return from Home Appliances

Anacacia Capital has agreed to sell its controlling stake in Australian cooking products supplier Home Appliances to McPherson's for A$22 million. The PE firm is expected to secure a 5x money multiple and an IRR of more than 90% once the deal closes by the end of March.

### PE-backed Blue Star entities pick up assets from Geon

Blue Star's Australia and New Zealand entities, which are now run by two separate private equity-backed management groups, have agreed to buy assets from struggling rival printing company Geon. The sales came after KKR and Allegro Funds have placed Geon into administration with a view to buying certain parts of the business out of receivership.

### Firms tap US high-yield market for record sums

Australian companies have raised a record $6.2 billion in high-yield debt via the US markets in the last five months. This includes about $700 million in Term Loan B financing obtained by hedge funds Apollo Global and Oaktree Management to support the restructuring of Nine Entertainment after creditors assumed control from CVC Capital Partners.

### Affinity reaches $1.5b first close on Fund IV

Affinity Equity Partners has reached a first close of $1.5 billion on its fourth fund, having spent only about five months in the market. The vehicle has a hard cap of $3.5 billion.

About 20 LPs, most of them existing investors, participated in the first close, according to sources familiar with the situation. The LP base is broad, taking in pension funds, sovereign wealth funds, fund-of-funds and family offices, among others. MVision is serving as placement agent.

Investors that have disclosed involvement include Washington State Investment Board, which put in $300 million, three times its commitment to Affinity's third fund, and Maine Public Employees' Retirement System, which has committed $30 million.

Affinity Asia Pacific Fund III took about four months to reach a final close of $2.8 billion in 2007. The LP base features the likes of California Public Employees' Retirement System (CalPERS) and California State Teachers' Retirement System (CalSTRS). The fundraising environment in Asia is tightening, with $18.98 billion raised in the second half of 2012, according to AVCJ Research. Only $46.8 billion was raised for the year in full, down 35.8% on 2011.

## GREATER CHINA

### Texas County, Oregon commit to CDH Fund V

CDH has secured commitments for its fifth fund from both Texas County & District Retirement System (TCDRS) and Oregon Investment Council. The US pension funds agreed to invest $50 million and $75 million, respectively, in the vehicle, which launched in September 2012 and has a target of $2 billion. The Chinese GP reached a first close of $1 billion in February.

### MGPA acquires Shanghai office building

MGPA has acquired J-Tower, a newly completed Grade A office building in Shanghai's Jiading district for RMB263.5 million ($42 million). The deal marks MGPA's second China investment from MGPA Asia Fund III, a real-estate vehicle with a total capital of $3.9 billion.

### Hony supports $505m take-private of Simcere

Hony Capital is backing a $505 million management buyout of Chinese drug developer Simcere Pharmaceutical Group. New Good Management, a vehicle controlled by Simcere chairman Jinsheng Ren, and Hony-owned Assure Ahead Investments have offered to pay $9.56 per share in cash for all outstanding shares. New Good owned 36% of Simcere as of February 2013. The company's 2011 annual report shows that Hony held a 17% stake

## NORTH ASIA

### Cerberus to boost stake in Japan's Seibu

Cerberus Capital Management wants to raise its stake in Japanese railways and property group Seibu Holdings by around 4% as the company plans to re-list. Cerberus has already paid over JPY100 billion ($1.04 billion) to become Seibu's biggest shareholder and hopes to buy more shares from other owners via a public tender.

### Calls for limit on Japan's government-backed funds

KKR, The Carlyle Croup and Bain Capital are part of a group of private equity firms urging the Japanese government to rein in its state-backed funds. The Japan Private Equity Association (JPEA) says that government-funded entities, such as Innovation Network of Japan (INCJ) are squeezing out opportunities for private capital.

### Vogo-backed Tong Yang Life eyes IDG South Korea unit

Vogo Capital-backed Tong Yang Life Insurance is considering purchasing ING Group's South Korean insurance unit. In a regulatory filing, Tong Yang Life said it was reviewing whether to buy the asset, but didn't outline plans as to how it would fund the acquisition.

## Fidelity Growth Japan leads Metaps series B round

Fidelity Growth Partners Japan has led a JPY1 billion ($10 million) Series B round of investment in Metaps, a Tokyo-based mobile software developer. Existing investors have also taken part in the round. The funding would be used to secure more talent and expand the Metaps service across the region.

## Mitsubishi unit seeks $750m for shipping PE fund

MC Asset Management Holdings, a unit of Japanese conglomerate Mitsubishi, is seeking to raise a $750 million fund that will take advantage of depressed prices in the shipping industry. The MC Seamax Shipping Opportunities Fund will acquire and manage up to 35 container ships for lease to liner companies.

# SOUTH ASIA

## Fung Capital to invest in JV with India's Future Group

Fung Capital, the private equity arm of the family owners of Li & Fung Group, will invest in a wholesale joint venture with India's Future Group. Fung Capital is expected to hold at least a 26% stake in the venture with Future Group founder Kishore Biyani owning the remainder.

## Eredene to exit India's Ocean Sparkle

Indian infrastructure investor Eredene Capital will exit its stake in Ocean Sparkle (OSL), a Hyderabad-based port operations company. Eredene currently holds a 6.65% stake in OSL, purchased in 2010 for GBP7.3 million ($10.8 million). The company generated pre-tax profits of INR563 million ($10 million) for the year ended March 2012.

## KKR closes in on Alliance Tire buyout

KKR is said to be in the final stages of acquiring an 80% stake in Indian tire maker Alliance Tire Group. The deal values the company at $600 million and it will see KKR buy Warburg Pincus' entire 70% interest in the company as well as shares from other minority stockholders.

## Temasek commits $24m to Indian oncology chain

Temasek Holdings has invested INR1.3 billion ($24 million) in Indian cancer care hospital chain Healthcare Global Enterprises (HCG). The deal facilitates the exit of Evolvence India Life Sciences Fund, a vehicle managed by 3 Logi Capital.

## Future Generali sells 22.5% stake to IITL

Industrial Investment Trust (IITL) will acquire a 22.5% stake in the life insurance unit of India's Pantaloon Retail, Future Generali India Life Insurance (FGLI). Post transaction, Future Group will hold a 52% stake in FGL.

## TPG buys Australian poultry producer Inghams

TPG Capital overcame several rival private equity and strategic bidders to acquire Australian poultry firm Inghams Enterprises. The family-owned company didn't confirm the financial details, although it has been reported that the deal valued Inghams at A$1 billion ($1 billion), with TPG paying A$880 million, including a small cash earn-out.

Blackstone was said to be among those that submitted final offers for the company, which is responsible for one in three chickens sold in Australia. The private equity bidders were looking at tapping the US markets for deal financing as the wave of cheap credit that has supported large North American buyouts in recent months filters through to Asia.

Bob Ingham, the sole shareholder in Inghams, put the firm up for sale last summer. The asking price was around A$1.5 billion but prospective buyers were unwilling to pay so much. An IPO was also considered but it failed to get off the ground due to poor market conditions.

## CX Partners to close India Transaction Solutions deal

CX Partners is near to completing its acquisition of a 75% stake in the Indian ATM unit of Australia's Transaction Solutions International (TSI) for $22 million. CX Partners is expected to invest the entire $22 million in several tranches, committing around $14.6 million initially.

## WestBridge exits India's Interactive Avenues to IPG

WestBridge Capital has exited its investment in India Interactive Avenues, a digital marketing company, to New York media firm IPG Mediabrands. The original investment was made through WestBridge Ventures II in 2007 when it was part of Sequoia Capital. Interactive Avenues will become part of IPG's digital services arm, Mediabands Audience Platform (MAP).

## India's Grameen Koota raises $9.6m from VCs

Grameen Financial Serivces (GFS), also known as Grameen Koota, has raised INR532 million ($9.6 million) from Creation Investments, Incofin Investment Management and MicroVentures in its third round of funding. GFS is a registered non-banking financial company (NBFC) engaged in the microfinance sector..

# SOUTHEAST ASIA

## CVC-backed Matahari launches $1.3b offering

CVC Capital Partners and its local partner are eeking up to $1.36 billion through a partial exit from Indonesian retailer Matahari Department Store. The deal values Matahari at $3.4 billion. A CVC subsidiary and Multipolar, a vehicle owned by the Riady family's Lippo Group, are offering 1.167 billion shares priced at INR10,000-11,250 apiece. Cornerstone investors have agreed to cover $435 million of the offering.

## TPG, Northstar approached for BTPN stake

Mitsubishi UFJ, and Sumitomo Mitsui are said to be among the suitors approaching TPG Capital and Northstar Pacific Partners with a view to acquiring their stake in Indonesia's Bank Tabungan Pensiunan Nasional (BTPN). The PE firms' five-year lock up expires next week. Based on current prices, they are are expected to make at least a 6x return on the investment.

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- StepStone Group
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- FLAG Squadron Asia Limited
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# New territory, new talent

## Indonesia has become a priority for global and regional PE firms looking to source deals in a high-growth market. The first step is finding the right people, and it's not easy

**AT FIRST GLANCE, THE SUPPLY OF** educated international professionals in Indonesia has never been better. A country brimming with growth and opportunity, many of the most talented among its 5.3 million strong diaspora are looking to return home and stake a claim for their slice of the success story. It is hoped that some of them might fill out the ranks of the next generation of domestic private equity talent.

"With all this talk of prosperity, I think there are a lot of talented Indonesians overseas, whether in Australia, the US or Europe, seeing all this wealth being created and thinking, 'We should be a part of that,'" says Karam Butalia, executive chairman of KV Asia Capital.

While the country's private equity industry is still young it is gaining rapid prominence in the region. According to AVCJ research, of the 22 Indonesia-focused funds that have been launched over last decade, 13 were set up in the last two years alone. Meanwhile, on the investment side, Indonesia accounted for 17% of deals closed in Southeast Asia last year, up from just 6% in 2008.

### A mixed bag

However, for many industry participants it has not been plain sailing. A handful of local private equity firms have prospered, cleaning up during the early days of the commodities boom and raising new funds on the basis of those deals.

Two global players also stand out: CVC Capital Partners entered the region early and has completed two sizeable Indonesia deals, with a partial exit from one of them – Matahari Department Store – expected to generate the lion's share of $1.36 billion; TPG Capital formed an alliance with Northstar Pacific Partners, serving as an LP in its initial funds and then entering into a cross-share arrangement with the local GP while continuing to co-invest with it.

The Carlyle Group and Affinity Equity Partners have found deal sourcing more difficult.

Carlyle went through several Southeast Asia executives over several years before finally securing its debut Indonesia deal, buying a 25% stake in telecom tower operator Solusi Tunas Pratama for $100 million last autumn. Affinity opened an office in Jakarta in four years ago but also had to wait until 2012 before investing $100 million in auto services group Mitra Pinasthika Majesty.

Whether a firm thrives or fails in the Indonesia can to a large extent depend on the quality of people it has on the ground and how well they know the terrain. The likes of KKR, Bain Capital, Warburg Pincus and The Blackstone Group are expected to become more active in the country and are looking to hire local dealmakers. But there is no consensus among industry professionals as to availability of this talent.

"The general feeling is that the market is very thin," says Michael Di Cicco, a partner with Heidrick & Struggles in Singapore. "If you want someone to lead investing, then you are typically looking at an Indonesian candidate who has worked in the country for a long time, is Western-educated and has a history of successful investments. But those people are very hard to find."

There is no one-size-fits-all approach for Indonesia and a GP's talent shopping list can vary widely depending on what position they want to fill.

At junior level, for example, it can particularly difficult to identify candidates with global-standard M&A skills and knowledge. "The key issues are finding people with an international perspective, excellent English, and strong, relevant sector experience combined with the technical skill-sets required for analysis," says Charles Yong managing director at executive search firm Korn Ferry in Jakarta.

He adds that most fail to hit the mark because Indonesian bankers are more often used for client coverage support rather than technical execution, which is typically handled by a regional headquarters in Singapore.

When executive search firms seek to fill these roles, candidates are usually sourced from places like investment banks where many will have the technical skills required for M&A transactions. In-house corporate finance teams at major Indonesian conglomerates are another rich source of talent. Once these options are exhausted, head hunters go to management consulting firms where employees have strategic analysis skills and an ability to understand operational improvement, turn-around strategy and business process improvement.

### How deep is the pool?

At senior level, the hunt can be more complex. The kinds of individuals in demand are those with additional high-level corporate and government connections. No matter how qualified or experienced they may be, many returnees lack the deep knowledge and on-the-ground relationships to tap into the local business community effectively to source the opportunities.

> "The promise of being part of the pioneering team does attract a certain group of people that don't just want to be part of a global firm's Fund IV; they want a sense of ownership that comes with being part of a first-time fund" – Jag Dhaliwall

Hendrik Susanto, managing director at Ancora Capital, remarks that in Indonesia it is simply not enough just to build your team out with those who have worked or studied abroad. Especially when it comes to developing operational expertise, in country with over 300 ethnic groups and 742 different languages and dialects, local knowhow is vital.

"You need to mix your team up with people who might have been educated locally and built their career entirely in-country," says Susanto. "Only with this combination can you leverage local experience and bring the strength of people with international background too."

Ancora focuses in Indonesia's mid-market

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buy-out space and relies on deep local knowledge to generate deal flow. In addition to technical skills, recruits must be able to operate in the country in a cultural context, and this includes speaking the local language. Susanto notes that the local firms are mostly staffed by Indonesians and the global and regional firms are looking for locals as they build out operations in the country.

Seniority is also important. In a country where title and age are respected, GPs need an industry veteran with credibility that can open doors.

"I think a lot of mid-market companies are still skeptical about private equity, as there isn't a track record in the country yet," says Mark Thornton, managing director at Indonesia Private Equity Consultants (IPEC). "So when they see a young guy turn in a suit with a spreadsheet, they don't believe that he can add value."

## Fly in, fly out

In some cases, global firms might approach the market in a slightly different way. Yes, they need the industry veteran with a great rolodex to act as a rainmaker, but if Indonesia is treated as a fly in, fly out market – expected to generate a few large-ticket deals that might be heavily intermediated – then an entire local support team isn't necessary.

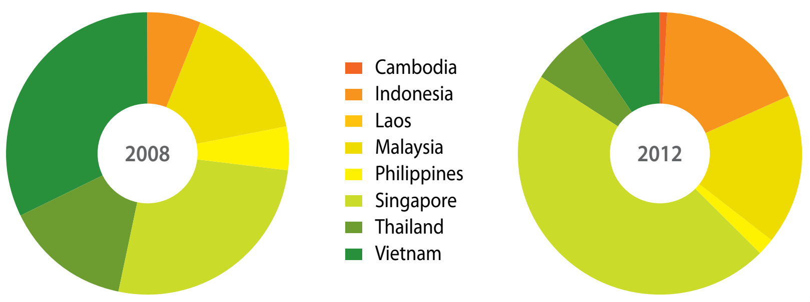
*AVCJ* last year that the firm likely would have located no more than 4-5 people in Indonesia had it decided to go in alone; the alliance with Northstar means it has access to a team of more than 20 investment professionals with strong local networks.

For many, finding the right people is just the first part of the battle; the next hurdle is offering sufficient incentives to get them on your team. GPs are competing for talent in Indonesia not only with one another but also with the investment banks, particularly the global players, which can pay professionals in Indonesia almost in-line with Singapore. The base salaries might be far higher than those offered to junior recruits at PE firms.

"Private equity firms are seeing increasing competition for talent from local corporates, newly arriving multinational corporations and management consultancies," explains Korn Ferry's Yong. "Alongside that is the trend for many well-educated Indonesians to work for family-owned enterprises. It all adds to the challenge of finding and securing talent."

Many GPs also recognize the best candidates are looking at more than just a remuneration package. Given that carried interest can take 3-10 years to crystallize, team dynamics, management style and connectivity with senior leaders play a

### Southeast Asian PE investment by country




Source: AVCJ Reasearch

"That's why they might be happy initially with just one senior managing director and then, as and when that person sources a deal for them, the execution can be imported from the offices in Singapore or Hong Kong," says Susanto. "It is a lot easier for a global firm with a large team of professionals."

However, as Indonesia becomes a more important investment destination, private equity firms recognize that they need local talent, whether it is on the ground or based out of a regional office in Singapore. The other option is the TPG approach of teaming up with a local partner. A source familiar with the TPG told

key role for recruits who appreciate they are in for the long haul.

"From a candidate's perspective, ideally the GP will be into its third or fourth fund, with a record of exits and a team on the ground with very low turnover," explains Jag Dhaliwall, managing director with executive search firm Principle Partners in Singapore.

This ideal scenario is somewhat hard to find in Indonesia, where only two local GPs, Northstar and Saratoga Capital, have raised third funds. First-time funds only have the reputation of their founders to trade on, although it could be argued that entrepreneurial young professionals might recognize value of getting in at the beginning. Dhaliwall notes that the typical Indonesian candidate is far less risk averse than his Singaporean counterpart, who is attracted by the prospect of joining a well-established firm.

"What first time funds can offer is the long-term vision that it could be the next big pan-Asian fund in 5-10 years," he adds. "So the promise of being part of the pioneering team does attract a certain group of people that don't just want to be part of a global firm's Fund IV; they want a sense of ownership that comes with being part of a first-time fund."

## Plenty of takers

It seems that those least concerned about the availability of talent are the well-established local PE firms such as Saratoga, which already has a team of 20-plus Indonesian private equity professionals. Devin Wirawan, an investment manager at Saratoga and a member of its HR committee, recognizes the challenges involved in finding talent, but says the firm receives around 50 applications a week from potential candidates via its website.

"We have an entrenched relationship with the business community; most of them are people who we have dealt with in the past," he explains.

KV Asia claims to be in a similar position. While the firm was only set up in 2010 and is still raising its first fund, Butalia's career in Indonesia stretches back to the 1980s when he worked as an investment banker with Citibank. He says the firm has had little trouble hiring staff because he was able to leverage his own connections in the country. For example, the head of the Indonesia office is former colleague from Citibank.

"I think when people say it is difficult, they are coming at it fresh, they haven't been around long enough," says Butalia, who describes Indonesia as being in the second cycle of optimism following a close to 10-year period when the Asian financial crisis wiped the country off international investors' radar. "I think the idea that finding talent is difficult is something of a myth. In the early days, before the crisis, we had some of the most talented people in our Citibank office and they went on to achieve big things."

Heidrick & Struggle's Di Cicco reflects that GPs will have to invest identifying the best candidates in Indonesia, regardless of the specific requirements. Like any other market, he recommends digging under the surface for a talent.

"It is far better scenario for a GP or a portfolio company to spend the time and money in finding somebody who has already been through that learning curve and doesn't need to go and make mistakes on your watch," Di Cicco explains.

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# Frontier fortunes

Veronica Lukito, co-founder and managing director of Ancora Capital, discusses Indonesian growth, hype and myriad challenges in capitalizing on Asia's latest success story

**Q: What do you think are the biggest challenges facing PE investors in Indonesia right now?**

**A:** In Indonesia there are a lot of challenges with regards to infrastructure or rather the lack of investment in that sector. One of the main issues is that there is a lot of overlap with regards to the policies that are in place and a lack of detailed regulation and implementing of regulation. This has especially been the case with those regulations which have recently been revised, such as the mining law. Dealing with bureaucracy and policy-making certainly is still a key challenge for most investors. That is why it is important for foreign players to work with local investors who understand the terrain much better and are able to navigate any issues that may arise. The last challenge is in finding skilled labor. Despite the large population, the skill sets available are still fairly limited in particular in industries.

**Q: So which sectors are you excited about at the moment?**

**A:** In the consumer sector there is nothing really new, the reason being that everything is in growth-mode right now. If you are talking about well-established, scaled players, there is only a handful and they have been transacted in the last three to four years. All the other opportunities are in much smaller-sized companies. I expect in the next three to five years these companies will become sizeable, so the consumer sector will remain very attractive.

**Q: Do you anticipate valuations in Indonesia will remains as high as they have been?**

**A:** I think the issue of valuations depends on kind of deals we are talking about. We have traditionally been performing well in capital markets among our peers – our current price-to-earnings (P/E) ratio is probably around 15 to 16. Larger-sized transactions will follow capital markets trends

but that is less the case with smaller sized transactions. I would say that, with what went on in Europe last year, there has been a rebalancing of people's expectations. A lot of Indonesians, in terms of investment sentiment, are driven by and large by commodities. With the correction in commodity prices in the past year, people understand that valuations will not perpetually escalate and so I think expectations are more realistic. Yet, there are always going to be business people who expect off the chart. numbers.

**Q: How sustainable do you think the current hype over Indonesia is?**

**A:** Indonesia has been in the limelight in the last year-and-a-half and that has had an effect on other countries in the region too, with Myanmar, in particular, becoming flavor of the month. In the private equity industry, as far as I understand, people who had been successful in China and then tried to get into India and failed are now looking to Indonesia. Having said that, the

> "With the correction in commodity prices in the past year, people understand that valuations will not perpetually escalate and so I think expectations are more realistic"

kind of money that has been raised in the last two years is nowhere near what was raised in India. Maybe it is because people are cautious and that is good for the PE market. I hope ourselves and the other incumbents can provide leadership to the guys coming in. With that, I think the Indonesian private equity industry will be sustainable and can generate the kind of value-add that is expected.

**Q: What is the extent of the competition for deals in Indonesia's mid-market?**

**A:** In our space I would say the pie is still large enough. If you are talking about large-size deals there is lot more competition out there simply because the supply of those transactions is limited. Sectors like energy and infrastructure are crowded by large players competing with sovereign wealth funds, large multinational corporations, state owned companies. In our space the pie is still very large.

**Q: Looking at the wider region, there has been a lot of talk recently about greater ASEAN integration. What do you think will this mean for Indonesian PE?**

**A:** Economically, Indonesia depends a lot on neighbors like Singapore and Malaysia. There is great reliance on our labor force. So far we have not been a major exporter as a country and we hope that will develop in the next five to ten years. We need to overcome internal hurdles before we address the issue of integration but I think integration is positive in terms of the economic flows between countries.

**Q: What is your outlook for Indonesia?**

**A:** Indonesia's growth trajectory is tracking upwards. There is an election coming next year, what does that mean for our market? Probably not that much, but in terms of exits it could have some impact. Some people might think this year will not be the best time to sell so they will wait until things settle down on the election side so they can get a better valuation. Other than that, the exit market remains to be predominately trade sales.

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# Reality check

## Few Indonesia-focused GPs that sprung up in recent years have made headway. It points to a still immature local market and recognition amongst LPs that they can get exposure to the country in other ways

**IF ANYONE ENCAPSULATES THE** Indonesian fundraising fervor it is C. Christopher Holm. In late 2011, it emerged that the former investment banker with Bank of America Merrill Lynch was seeking $1 billion in commitments from LPs for what would have been the largest-ever dedicated Indonesia vehicle.

"The idea evolved over the course of social dinners in Jakarta," he told *AVCJ* last year. "We originally planned close to $500-600 million, but when we talked to people we know well, who would be potential LPs, the appetite was so strong." Holm planned to focus fundraising efforts on local high net worth individuals, and he gave himself one year to accumulate the capital.

*AVCJ* hasn't been able to reconnect with Holm. Emails have gone unanswered, mobile phone numbers are no longer valid, and the contact number for the merchant banking operation – Yawadwipa Companies – set up to run the fund leads to an entirely different firm. It would appear that Holm has either decided to operate off the radar (perhaps a wise move if the he has managed to secure local family money) or abandoned its capital-raising plans. If it's the latter, then he is not alone.

### Big ambitions

A desire for Indonesian exposure, prompted in part by the success of a few early movers, saw a host of prospective GPs emerge in 2011. They included Falcon House Partners, Capsquare Asia Partners, Forte Capital, Fairways Capital, Mahanusa and Antara Capital. Only two have gathered any real momentum: Capsquare recently reached a final close of $75 million on its fund while Falcon House is said to be nearing completion of its $200 million vehicle.

Of the others, Mahanusa and Yawadwipa are status unknown; Antara began pitching LPs for a $150 million fund, generating some interest, but is nowhere near a close; and Forte and Fairways never got started, having recognized the tide was against first-time funds and returned to deal-by-deal advisory and investment work. They may return once conditions become easier and track records have been established.

"For all the talk about money coming in, a lot of it is coming in via regional players," says Doug Coulter, partner and head of Asian PE at LGT Capital Partners. "Although people may be very bullish on Indonesia, it's still hard to raise a first-time fund; not impossible, but it won't be easy and it will take time. A lot of it is about the story and some of these stories were not compelling."

While the raw potential for private equity in Indonesia is plain to see – the country has a nominal GDP of around $800 billion and a stock market capitalization of $400 billion, yet there is only about $5 billion in PE assets under management – weak fundraising numbers betray the lack of depth and experience in the market.

**Largest Indonesia PE funds**

| Name | Vintage | US$m |
|---|---|---|
| Northstar Equity Partners III | 2010 | 820 |
| Saratoga Asia III | 2011 | 600 |
| Quvat Capital Partners II | 2008 | 350 |
| Northstar Equity Partners II | 2010 | 285 |
| Saratoga Asia II | 2006 | 152 |
| Quvat Capital Partners | 2006 | 150 |
| Ancora Opportunities Fund | 2008 | 150 |
| Northstar Equity Partners | 2007 | 110 |

Source: AVCJ Research

According to AVCJ Research, fundraising has reached $150 million or more five times in the last six years, chiefly helped by three of the better established domestic GPs, Northstar Pacific Partners, Quvat Management and Saratoga Capital. The 2011 numbers were swelled by Northstar raised $820 million on its third fund; last year it was Saratoga's turn, as the GP closed Fund III at $600 million.

The speed and size of these fundraises speaks volumes for their status as big fish in a small pond. Northstar claims it has yet to make any formal decisions on a fourth fund but LPs expect the private equity firm to come to market no later than 2014. Apparently there is a commitment not to exceed $1 billion, the implication being that a larger target could be reached if so desired.

### Going regional

As for the regional players, most of the large pan-Asian funds are looking to do more in Indonesia and hiring aggressively to support these efforts. Then there are sub-regional operators focusing largely or exclusively on Southeast Asia.

Navis Capital Partners is the best known, but the likes of Creador and KV Asia – the former closed its fund at $132 million, the latter is about halfway towards its $200 million target – have emerged, with Indonesia expected to feature prominently. Singapore-based Southern Capital, meanwhile, is said to be progressing steadily towards a regional vehicle of up to $400 million.

"There is a lot of appeal in the country's fundamentals although it's a relatively new market and track records are thin," says Jie Gong, executive director at Morgan Stanley Alternative Investment Partners. "A number of GPs are attracting capital so it's no longer an underpenetrated market. With this conundrum, we think going through sub-regional [Southeast Asian] funds is a good way to do it. They have flexibility in their allocations to Indonesia and less pressure to stretch themselves in any given country. There's also the ability to execute on cross-border expansion into Indonesia, for Singapore or Malaysia based companies."

Indeed, Brahmal Vasudevan, CEO of Creador, recalls from the fundraising trail that the less opportunistic LPs – typically pension funds and endowments – were conscious of the merits of a regional blind pool as opposed to one devoted to Indonesia alone.

This doesn't preclude country-focused managers, but it puts the challenges they face in context. Most of the larger LPs wouldn't look twice at a first-time fund where the manager has no previous PE investment experience. Beyond that, the team must be able to display domain expertise and operational skills. If local GPs can't meet these criteria then investors will seek Indonesia exposure via other channels.

While fundraising efforts will no doubt continue, the major change Coulter expects in the next year or so concerns regional players.

"My sense is that we will see a bunch of firms both big and small that have an interest in Indonesia opening up in Jakarta in addition to Singapore," he says. "Players that have a regional strategy and talk about Indonesia as an important market must have a Jakarta office to appear credible."

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# It's who you know

## Although not overrun with GPs, Indonesia's mid-market is difficult to penetrate. Access to local networks through which deals can be sourced is a good first step. After that, it's entrepreneur management

**GARUDA INDONESIA WANTS TO MORE** than double the size of its fleet to around 200 planes – and it needs people to fly them. In addition to placing several sizeable aircraft orders with Airbus, the flag carrier is looking to hire new pilots and keep its existing staff flight ready, which means there is no shortage of demand for places at local flight schools. Factor in the rapid expansion plans of Indonesia's emerging budget carriers and the proxy for the country's consumption story becomes clear.

"Nobody thinks about aviation – it's obscure and esoteric," says Tom Lembong, CEO and managing partner of domestic GP Quvat Management. "But there has been a boom in budget airlines and the pilots have to do a certain number of hours in a simulator to retain their certification. They need access to flight schools and simulator providers."

Investing around the edges of Indonesia's consumer sector has become a prevalent theme as competition for deals has grown. Away from the large-cap deals that have attracted regional and global buyout funds, the country's mid-market may be populated by fewer GPs but there is still competition for deals.

The commodities boom has created a generation of ultra-wealthy families. The latest Cap Gemini-RBC Asia Pacific Wealth Report estimates Indonesia had 32,000 high net worth individuals (HNWI) – defined as those with investable assets in excess of $1 million – in 2011, a fraction of markets like China and India yet the country's HNWI population grew faster than any other in the region across 2010 and 2011.

Lembong says these families are increasingly behaving like VC investors, committing up to $50 million to deals. However, they are seen as fad-oriented, hence Quvat's interest in the obscure. "If you are in areas that are more contrarian, you don't see them," he says. "Most rich families seek comfort in crowds; they do what everyone else is doing, like palm oil plantations and coal-mining."

### Underpenetrated, impenetrable

Indonesia's mid-market – with the consumer sector front and center – is widely seen as a sweet spot, and it is growing. According to AVCJ Research, transactions of $60 million or less amounted to $118.7 million in 2012, the highest level on record and nearly six times the figure for 2006. Yet the number of disclosed investments in this segment remains relatively small and anecdotal evidence suggests deal flow is patchy. It is fairly typical of a nascent private equity market and some industry participants question whether the mid-cap or large-cap spaces can deliver on their promise, at least in the near term.

"A lot of people see from a macro perspective that Indonesia has a lot of potential but the micro reality is more challenging," says Mark Thornton, managing director of Indonesia Private Equity Consultants (IPEC), who left his position as head of Southeast Asia at 3i in 2011 to search for independent opportunities in Indonesia. "You can put together a robust investment strategy and raise capital, but in reality you can only deploy a certain amount each year. While there is huge potential, near-term visibility on deals is limited."

This view isn't shared by all and Thornton admits that more established GPs with track records and substantial teams on the ground are better equipped to address the challenges of the mid-market. These typically come in three forms: identifying companies that are fast growing and investable without the support of databases; making inroads with owners and management to the point they are comfortable selling equity to outside investors; and reaching a mutually acceptable entry valuation.

The ease with which GPs surmount these obstacles depends on numerous factors, but most can be traced back to the strength of local networks.

According to Brahmal Vasudevan, CEO of Creador, which recently closed its debut Indonesia, Malaysia and India-focused fund at $132 million, his team has met with around 300 companies in the past 12 months, completing two deals while another 7-8 are at various stages of development.

"We would normally expect to talk to 150-200 companies a year, enter into 10-12 formal discussions, and close 2-3 deals," he says. "It could be about two years in between the first meeting and an investment being made. We cultivate relationships that might result in deal flow."

Much of this time is spent educating entrepreneurs on what private equity can bring. While there might be a basic understanding of the asset class among local business owners, it is often tinged with suspicion – that they are giving away a slice of their growth rather than bringing in a partner that could accelerate and sustain expansion.

According to Vasudevan, mid-market companies are trading at a 30% discount to their larger counterparts and if an entrepreneur has never previously considered PE backing this might actually make the valuation process easier because there is no competition for the deal.

Certainly, once entrepreneurs become savvier as to the premium private equity investors might pay, their valuation expectations rise. Thornton recalls working with a company that planned to list on London's AIM bourse but failed to get its offering away due to deteriorating market sentiment. The entrepreneur needed $20 million in capital and a good offer was received on reasonable terms. However, the terms were deemed not reasonable enough and the entrepreneur simply decided to wait until he could find a better deal.

> "You can put together a robust investment strategy and raise capital, but in reality you can only deploy a certain amount each year" – Mark Thornton

Possible alternatives range from equity provided by rival PE firms and bank financing to local family offices and mezzanine debt providers. If a company is growing at 25% per year in revenue terms, the owners might see little point in giving up equity when they can get debt financing and rely on the proceeds of rapid expansion to pay down the senior, regardless of the high interest rates and onerous covenants.

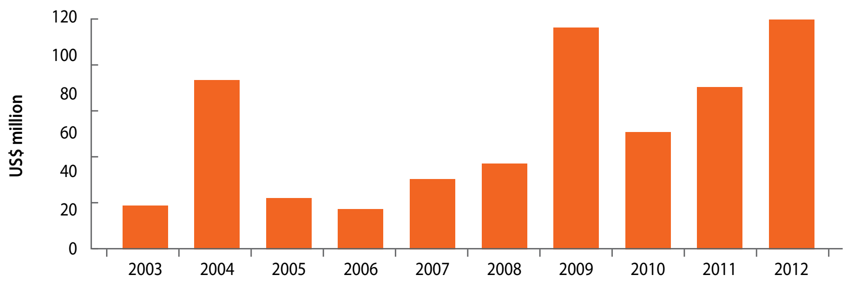
Some industry participants go so far as to suggest that the traditional blind pool private equity growth capital model just might not be appropriate for Indonesia. Wouldn't it be better to manage a $100 million special account for an

LP with a special situations mandate that permits investment regardless of capital structure? While there are merits to having this kind of flexibility – some local PE firms offer debt solutions in addition to equity – the broader issue is how the asset class presents itself as a long-term value proposition.

### Who you gonna call?

In this context, the ability to call on the services of people who are already familiar with target companies and can make the requisite introductions and kick-start the private equity education process is invaluable.

Indonesia's private equity middle market




Source: AVCJ Research

Note: Middle market is defined as deals below $60 million

These individuals might come from investment banking, consulting or audit backgrounds and have worked with the companies before. For example, Cyril Noerhadi, Creador's senior managing director, was previously CEO of the Jakarta Stock Exchange, a partner at PricewaterhouseCoopers, and then CFO of oil company Medco Energi. Brian O'Connor, founding partner at Falcon House Partners Indonesia Fund 1, was head of Indonesia at Lehman Brothers before rising to Asia Pacific COO, while his colleague Samir Soota previously worked at KPMG and Quvat.

Most private equity firms active in the country, if they aren't brand names in their own right, are staffed by people with extensive deal-making experience in the country. Even then, it takes time and effort to develop relationships with a view to generating PE deal flow, and there is no guarantee of success.

Teezar Firmansyah, a partner at Antara Capital Partners, notes that Indonesia's cultural diversity presents another complicating factor – there are more than 300 ethnic groups, and although Javanese account for more than 40% of the population, different groups require different treatment. "If you have the money and expertise, that's great, but you also need to know the person," Firmansyah says. "I closed a deal within one month because I understood the entrepreneur's background as well as his business model. If you don't understand the people it could take one year or longer."

With CVC Capital Partners preparing to make a lucrative partial exit from Matahari Department Store, Indonesia's fourth-largest retail brand, it is hoped that this deal will serve as a poster child for the positive effect of private equity, and its impact will trickle down to the mid-market.

But there are already a number of success stories within the mid-market itself of companies that were once quite raw – with imperfect bookkeeping, tax compliance and management systems – becoming industry champions.

The obvious example is Alfamart, which sits above Matahari in the Indonesian retail rankings, sharing a convenience store duopoly with Indomaret. Northstar Pacific Partners led a consortium to take a significant minority stake in Alfamart in 2007, supporting the original co-founder's purchase of the business from Philip Morris, which had picked it up as part of a wider acquisition and was keen to divest.

Three years later, the private equity firm exited for a reported 5x return. Alfamart now has a market capitalization of around $2.5 billion and the co-founder, Djoko Susanto, is worth more than $1 billion.

"At the mid-market end the check sizes are smaller and so the target companies are less established, but when they do succeed the results can be quite spectacular," says Quvat's Lembong. "In our experience, the number one factor is the caliber of the local partner and manager. There have been time when we have judged badly on the local partner and, even with a strong investment thesis, the outcome has been mediocre. In other situations, we got the investment thesis wrong but the local partner was so formidable the outcome was okay."

As long as Indonesia's consumer sector continues to produce stars like Alfamart it will also see a fair number of companies that suck in private equity capital and sink without a trace. Lembong compares it to project finance in terms of the execution risk involved – an entrepreneur might want to double his business in size, predominantly through green field developments – and the amount of close attention required.

### Positive developments

Yet there are already signs that the sector is maturing, creating opportunities for private equity in terms of investments and exits. Firstly, a new generation of entrepreneurs is emerging. Typically in their 30s and 40s and educated overseas, these people are running family businesses in a less straight-laced fashion than their forbears. There is an acceptance that a private equity partner can help expand companies, either organically through the introduction of better systems or inorganically via lateral acquisitions. The family may no longer own 100% but they might own 70% of a much larger business.

Secondly, for those investors that are able to identify, partner with and develop mid-market firms, potential exit channels are widening. In addition to IPO and trade sale options, other PE investors are increasingly keen buyers.

Indeed, this lies at the heart of Capsquare Asia Partners' investment thesis. The GP, which recently closed its debut fund at $75 million, deliberately took a step away from the competition and entered early-stage private equity. It deploys $10-15 million per transaction – mostly for control positions, unlike the bulk of the mid-market – and the goal is to improve transparency, governance and management so that portfolio companies are attractive to other PE firms or strategic investors.

"There are very interesting business models out there that wouldn't satisfy later-stage PE mandates," says IPEC's Thornton. "These companies might take a year or two longer to mature but everybody realizes it's a market where investments are difficult to buy and if you can make a business easier to buy you can extract a premium for that."

Much the same applies higher up the food chain. Vasudevan of Creador, which has a fund nearly twice the size of Capsquare's vehicle, notes that three or four global private equity firms have expressed an interest in portfolio companies.

"We seek to add scale and institutionalize family-owned mid-market companies and aim to make them attractive to regional and global funds to add to our exit alternatives," Falcon House's O'Connor. "In Southeast Asia, secondaries will likely be an important theme in the coming years."

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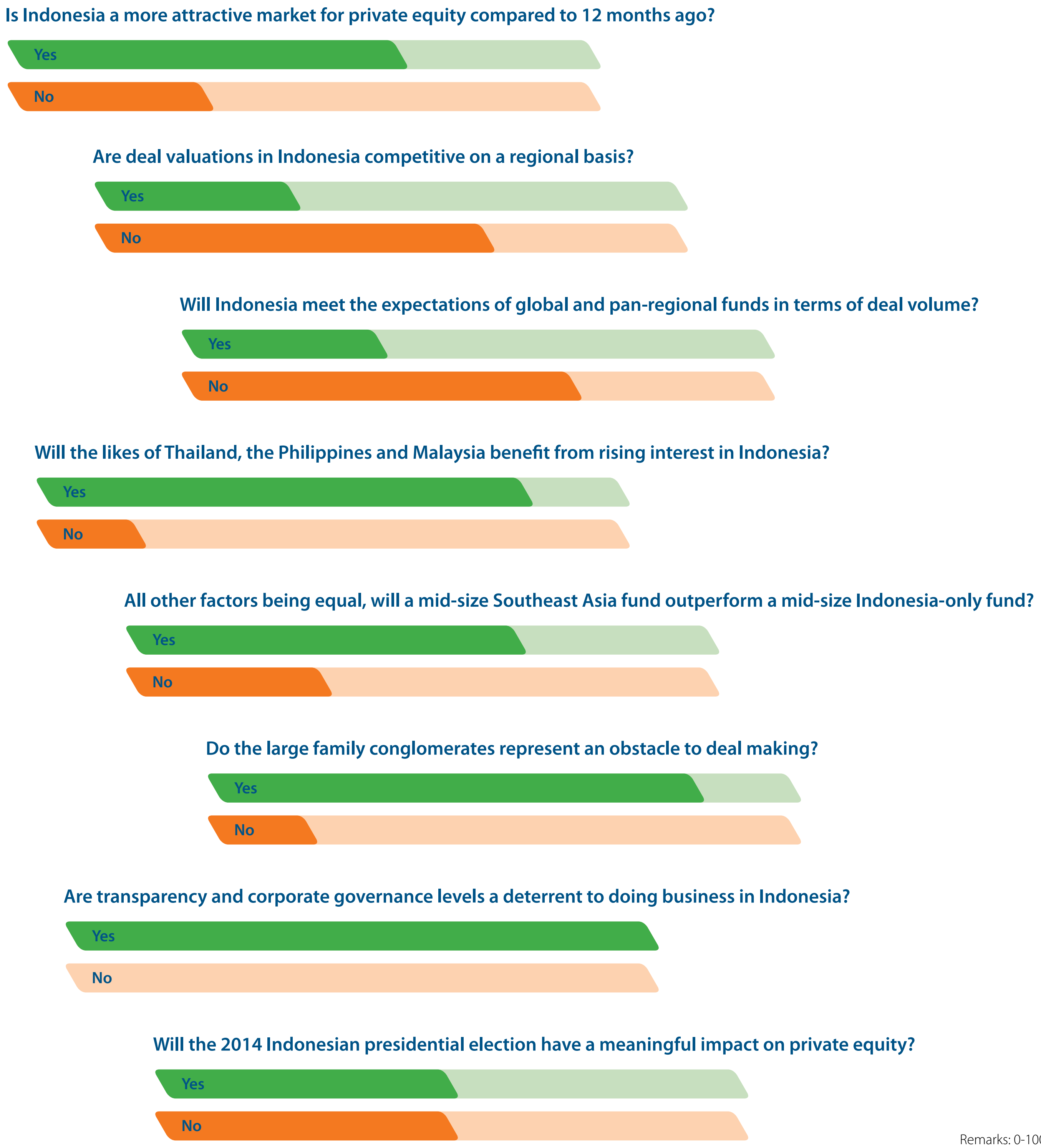
# Taking the temperature

AVCJ conducted an online poll of its readers to assess attitudes towards Indonesia as an investment location. Here are the results...

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