Chasing momentum

With Asian private equity maturing and GPs raising their game, experts tell Carmela Mendoza where the real opportunities and challenges lie in the years to come

PHOTOGRAPHY BY GARRIGE HO

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On a typically humid September day in Hong Kong, four industry veterans gather to discuss the opportunities stemming from China's developing buyout market, and the overall private equity environment in the region. On one point, they are in agreement: investors have a lot more choice.

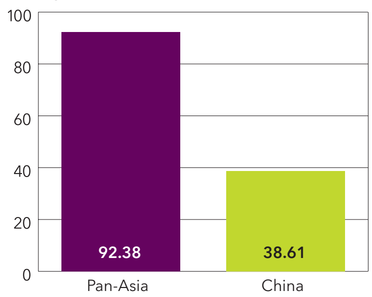
The industry is maturing: fundraising focused on the region has more than doubled in the first six months of 2017 compared with the same period a year ago, according to *PEI* data. Forty-three funds closed on $22.6 billion, compared with 27 funds collecting $9.6 billion last year. Managers are also raising ever-larger funds, such as KKR's $9.3 billion Asian Fund III, the biggest pan-Asia private equity fund so far.

BIG AND BOLD

There is more capital for pan-Asia funds than China-focused, but the latter has a larger average target

Number of funds in market, including those with no target

Total target size ($bn)



Average target size

$277m
Pan-Asia

$390m
China

Source: Private Equity International

And that pace shows no signs of slowing. Close to 150 Asia-Pacific focused funds targeting $44 billion were in market at the end of H1, and a further 40 China-focused funds eyeing $16.5 billion, *PEI* data show.

"When you look at the number of global firms that are entering the market and looking to raise capital, specifically for Asia, to me it's saying that people are looking to add more Asia into their global allocations," Hemal Mirani, managing director for HarbourVest Partners, says. "Increasing interest in Asia has been driven by the attractiveness of the opportunity, diversification, or because of lower pricing in this part of the world."

Chris Lerner, head of Asia for Eaton Partners, agrees: "KKR's success with its third pan-Asia fund is a great achievement and a positive for Asia private equity but it is also indicative of a global trend we are seeing – bigger asset managers raising larger amounts of capital and correspondingly, in many cases, larger pensions consolidating the number of general partner relationships."

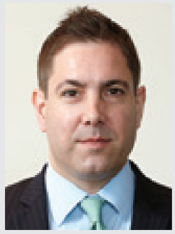
Big names raising mega-funds to invest in Asia is not good news for everyone. Gavin Anderson, a partner at Debevoise & Plimpton, points out the headlines do not tell the whole story. "There are some GPs that are not finding it as easy as you might think from the headlines, and that's partly because some of the larger funds are hoovering up allocations which might have gone elsewhere."

The general trend of LPs taking longer to do due diligence and getting to know managers is also affecting fundraising. "If you are not one of the big names that's instantly familiar then maybe you are not raising as quickly as you hoped you might," he adds.

With huge amounts of capital pouring into Asia in huge funds, the question »

MEET THE ROUNDTABLE

GAVIN ANDERSON
Partner
Debevoise & Plimpton
Anderson is a member of the firm's global investment management/funds group and advises sponsors and investors on a variety of issues, including fund formation, co-investment and carried interest arrangements. He has acted for clients including Baring Private Equity Asia, CDH Investments and HarbourVest.



CHRIS LERNER
Global partner and head of Asia
Eaton Partners
Lerner leads Eaton's origination and execution of fundraises, secondaries and strategic advisory. He has more than 18 years of experience in private markets investments and investment banking, with over $15 billion in completed transactions. Prior to joining Eaton, he was managing partner for Mercer Street Capital.

HEMAL MIRANI
Managing director
HarbourVest Partners
Mirani oversees the firm's investments and investor relations across the Asia-Pacific region. She joined HarbourVest in 1997 and spent 11 years developing relationships with Asian private equity managers and investors across the region. She rejoined HarbourVest after six years with CVC Capital Partners in Hong Kong, where she was head of investor relations in Asia and chief administrative officer.

MIRANDA TANG
Managing director for private equity
CLSA Capital Partners
Tang heads up the firm's pan-Asia growth funds. She has over 25 years of experience in corporate planning and equity investment in Asia and the US. Tang has private equity expertise in China, India, Indonesia, South Korea, Taiwan and Vietnam. She began her career at EY and worked with the Century City Group in the US and Hong Kong.

» on everyone's lips is: where should the mega-funds hunt?

Lerner observes GPs are more focused on developed Asia – Japan, Korea and Australia – because these markets offer more sizeable deals with the opportunity for control. Cross-border buyouts with an Asia angle are also on the rise. He adds that pan-Asia funds do venture into the region's developing economies but via select, opportunistic entries into newer frontier markets or through club deals, because of the competitive dynamic and limited opportunities at that cheque size.

Indonesia, for example, has attracted interest from pan-Asia players in the last year. A group of investors including KKR, Warburg Pincus, Farallon Capital and Capital Group Private Markets participated in a funding round of more than $550 million for Indonesian motorcycle hailing app GO-JEK. Vietnam is another example. As its urbanisation accelerates, the country has seen global players enter the retail space.

Miranda Tang, managing director for private equity at pan-Asia firm CLSA Capital Partners, recalls that when her firm started in the mid-1990s, only small funds existed. "Large global players came and didn't know where to get the deals. Now the landscape has allowed firms to invest in a wide range of deals," she says.

Mirani notes that the beauty of Asia is the variety of markets – different markets are active at different times and investors are not forced to invest in only one. "There is an opportunity and the ability to be able to allocate when the opportunity is ripe. To the extent that you are seeing more capital flow into Asia, this is a net positive for the region."

Pan-Asia firms are, however, not the only ones benefiting from this era of superabundant capital in Asia. Lerner says: "The fact that larger, branded Asia funds have done well in terms of fundraising and performance may well signal a turning point

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>
> **Miranda Tang**

where the industry will see more of the rest of the field benefit.

"In the interim, GPs are grinding it out: figuring out what exactly is their DNA, what exactly is their competitive edge, honing in on that and getting more refined. Expect them to come back stronger."

A MARKET LIKE CHINA

All participants agree that even with headwinds, such as slower GDP growth and volatility in equity markets, Chinese private equity has matured in the last two decades and is now firmly established as the largest market for the asset class in Asia.

From 2008-16, the China market (including Hong Kong) raised a total of $532 billion, maintaining its dominance in the Asian private equity and venture capital industry, according to a PwC report.

"One thing about the China fund landscape is that we're seeing a generational shift," says Lerner, who is based in Eaton's Shanghai office. "I think that's a bit indicative of how that market started, with whom it started, and where the largest piece of the pie of the opportunity set lies. From a fundraising point of view there are a lot of options right now."

This generational shift also prompts specialisation, Mirani says.

"Healthcare is a sector that's seen as having an incredible amount of interest at the moment, and a place where we will probably see more sector-focused funds come in. Five years from now we will be talking about something else."

Lerner adds: "It's a market that should be deep and should become increasingly deep. There are visible areas both in productivity and consumption where the market opportunity is huge and the universe of investable companies is growing."

Lerner expects to see more industry shake-outs, turnover of market leaders and consolidation, which creates opportunities for private equity. "This is the second »

> ***The days of Chinese copper producers trying to buy Hollywood studios are probably over for the moment***
>
> **Gavin Anderson**

> *GPs are grinding it out: figuring out what exactly is their DNA, what exactly is their competitive edge, honing in on that and getting more refined*
>
> Chris Lerner

» largest economy. We still have so far to go and will continue to see so much more change. You won't find that anywhere else in the world."

Mirani notes China is the only market in Asia where LPs can invest in a broad range of strategies, such as venture, growth and buyout opportunities.

From a manager's perspective, Tang makes three observations. First, an increase in the breadth and depth of deals in China. "With China's 'BAT' trio of internet giants – Baidu, Alibaba and Tencent – we see a lot of the corporate development in play, which has a larger strategic role in the development of smaller sub-segments and companies. These corporate investment arms will definitely expedite the growth of early stage companies."

Secondly, regulations are more relaxed in some of the newer industries such as advanced manufacturing and financial technology. "Amongst and between industries there aren't a lot of boundaries – as long as your creativity carries you, there can be a multitude of results," she notes. Lastly, Tang says the China market sees crossovers between industries, as well as a lot of amalgamation in terms of resources and knowledge, which could result in a completely new model that may not be applicable elsewhere. "It's a very interesting market, especially with fintech, peer-to-peer platforms, artificial intelligence and digital wallet, among others."

China is also seeing a rise in control buyouts as companies warm up to the private equity value proposition.

"It will be interesting to see the emergence of more buyout funds in China and where that goes because if you have control then you have more potential to influence portfolio companies," Anderson says.

"It all makes sense that this is where China is heading, that's very much the direction it has gone in the US and elsewhere for the buyout fund model. Some sponsors

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Hemal Mirani

in Asia have these operational partners and teams that can now go in and improve companies. That's a good thing."

However, Lerner is quick to point out the industry is changing rapidly. The challenge, he says, is knowing where those companies are playing, where buyouts are available and whether that is where you want to be taking control.

"Buyout as a concept, taking control and the ability to add value, to create distributions is attractive. When we are talking China, however, I would just argue that the level of difficulty is a bit higher and just because it is a buyout does not necessarily make it an attractive investment," he explains. "One has to ask: why am I being offered control and is the company that is willing to hand it over one I want to own? Also, once you come in as a control investor to a domestic company and the CEO is not going to stay involved, the level of difficulty jumps up another notch because typically the whole success of these companies has been built around their founder."

"In China if your whole strategy is 100 percent concentrated on buyouts that may be tough, not because of the number of opportunities but because of the quality of those opportunities," he cautions.

OUTWARD BOUND

The participants agree Beijing's capital controls in the last year have slowed down outbound investments, hitting private equity.

"If you are a domestic Chinese investor trying to commit to an offshore private equity fund, using onshore capital, that's a problem in terms of getting approvals. That is real and difficult," Anderson says. "If you are an offshore private equity fund trying to invest into China we've heard anecdotally that's become a little easier recently on a case by case basis in certain areas to get the necessary approvals. They are trying to restrict capital coming out; capital coming in is generally less of a concern."

TECH RISING

In 2016, internet, technology, media and telecommunications companies in Asia-Pacific attracted $42 billion, or 45 percent of total investment value, according to Bain & Co. Internet accounted for more than a third, with active deals in India and China.

"If you think you are buying into the next Alibaba or Tencent, it doesn't matter if you pay two times more than it's worth because you're going to make a lot of money anyway," Anderson says. "Tech may be more prone to exuberance compared to other industries because you have at least in theory that sort of potential."

And those big players are having an effect: "It's fascinating when you see BAT [Baidu, Alibaba and Tencent] go to South-East Asia and India today," says Mirani. "That will have a tremendous influence in terms of how quickly those markets develop, as well as the business models that come into place."

These giants are also dipping their toes into the asset management space. In August, Baidu teamed up with China Life, the country's largest insurer by assets, to launch a $1 billion private equity fund to back global internet and technology companies with "significant association with China". ■

***Open sesame**: where Alibaba and its peers go, others will soon follow*

Source: Thomas Lombard (Creative Commons)

» He adds: "Deal certainty is what makes it very difficult. If you are a Chinese company trying to do something offshore that's politically backed, such as investments relating to the Belt and Road Initiative – then you may be okay. But the days of Chinese copper producers trying to buy Hollywood studios are probably over for the moment."

Lerner notes the most obvious knock-on effect of currency controls has been the rosy fundraising environment for the yuan, with the obvious beneficiary being local private equity shops. He also observes an increase of private equity consortium buyout deals with A-share listed companies or those based in mainland China that are listed on the Shanghai or Shenzhen stock exchanges. "The dollar amount that onshore companies can take on is restricted. But it's also just created an interesting dynamic of the role of private equity in helping to facilitate change and the ability for managers to get some kind of credibility with these A-share listed companies when they want to take their money offshore."

Lerner adds that the industry is also seeing the development of more so-called M&A funds – essentially offshore acquisition funds – focused on directed industries that relate to manufacturing and industry upgrading. He adds the proliferation of these vehicles has no doubt slowed but they still exist, often in size and with government support, where the mandate includes direct investments in sectors or areas that are deemed important to the development of the overall economy and initiatives such as Made in China 2025 or One Belt One Road.

And when it comes to HarbourVest, Mirani says the firm is looking to get exposure to China, and that hasn't changed. "We'll continue to be active in the market there. Regulations seem to have made an impact more on outbound transactions, but we will definitely maintain levels of activity in terms of continued investment in China."

From an operational angle, Tang notes CLSA has seen some slowdown in terms of process and procedure with money going in and money coming out. "We haven't seen major problems thus far in terms of the recent capital controls, perhaps our deals are smaller and not in the prohibited category that would trigger questions on security or national interest."

Anderson adds private equity practitioners have also seen a lot more sensitivity – not necessarily deals that have actually gone to Committee on Foreign Investment in the United States and been blocked – from advisors and sellers towards Chinese buyers. "Even offshore funds with a connection to China may be asked to justify why CFIUS is not going to be a problem." ■