PRIVATE EQUITY international

Multiple use PDF

Second Floor
Sycamore House
Sycamore Street
London EC1Y OSG
Tel: +44 (0)20 7566 5444
Fax: +44 (0)20 7566 5455

The macro factor

Fundraising is booming for Asia-focused private equity funds, but limited partners around the world are still anxious about macroeconomic risk in the region. They should be more worried about GP risk. David Snow *reports.*

Elvis Presley sang that fools rush in. What he should have added is that if the fools stick around long enough, they'll eventually find true love. So goes the song of private equity in Asia, where old heartbreaks are finally beginning to give way to that magic feeling of investment success.

Across Asia, private equity franchises that made it through the privations of the late-1990s Asian contagion and remained active investors are now reaping heady rewards. This applies to general partners as well as to limited partners, the latter having generally gotten burned on overly optimistic Asia fund commitments made a decade ago.

As evidenced by a surge in follow-on fundraisings and new fund launches, the limited partners that have more often associated Asia private equity with poor performance now have renewed appetites to gain exposure to a crucial and growing engine of the world economy. Limited partners in North America, Europe and, increasingly, Asia, that have not previously invested in Asia are seeking professional help to get there, whether in the form of consulting work or fund of funds commitments.

It certainly helps that the perceived "smart money" of the institutional investment world is high on Asian funds. A private equity consultant notes that Cambridge Associates, an influential advisor to many US endowments and foundations, is "telling people they have to have exposure to China," the consultant says.

Enthusiasm for China, India and, to lesser degrees, for much of the rest of the Pacific Rim countries, is driven largely by the compelling macroeconomic and demographic pictures being painted of the region. "Limited partners are doing their own internal BRIC reports and saying, 'Hey, stuff's happening, gotta be there,'" says the consultant.

Increasingly, investors also sense that a corner has been turned in the capital markets of formerly infrastructure-challenged economies like China and India.

Previously, the Asian private equity opportunity simply couldn't compete with Western private equity markets out of LP fears of opportunity cost. "Because of the immaturity of the capital markets in Asia, private equity firms ended up making more growth capital deals, and the return profile was just not as attractive as what you'd get from buyouts in the US," says Mounir Guen, the chief executive officer of global placement agent MVision.

But about 18 months ago, says Guen, there was something of a "seismic shift" in investor perceptions of Asia. "Investors can see a trend now of the [Asian] markets being properly nurtured and grown by the regulators, by the governments and by the financiers."

The perception shift on capital-markets facilitation has been quick with regard to mature economies like Australia and Japan. But established LPs are increasingly warming to the pro-investment progressions of China and India, economies without long histories of free-market capitalism, let alone enabling capital markets.

LPs made their bullish outlook manifest in 2005 by voting with their capital commitments. Private equity fundraising in Asia last year, which totaled roughly $17 billion, nearly matched the amounts raised in 1999, according to *Asia Private Equity Review*. (Figures were still short of the 2000 take).

The past year has seen the launch of larger, follow-on funds from established Asia general partners, as well as fundraising efforts from new groups. According to an analysis of an internal fund database maintained by placement agent Probitas Partners, the amount of capital targeted by GPs on the fundraising trail rose roughly 25 percent in the past year. In April 2005, Probitas counted 88 Asia- and Pacific Rim-focused private equity and special situation funds targeting a total of $39.5 billion in capital commitments. The same database in March 2006 logged 137 Asia- and Pacific-Rim focused private equity and special situation funds targeting a total of $49.6 billion.

IT'S THE ECONOMY

Not since the world woke up to the possibilities of the Internet have institutional investors been as captivated by a topic as they are by the growth of Asia, particularly China and India.

It's hard to attend any conference, board meeting or cocktail party today without hearing some new superlative on the topic. The private equity leaders with bets on the region have themselves been enthusiastic promoters of the potential of Asia.

At the recent Milken Institute Global Conference in Los Angeles, a free-market forum affiliated with Michael Milken's think tank, Carlyle co-founder David Rubenstein shared a "global overview" lunch panel with Czech Republic president Vaclav Klaus and Nobel laureate economist Gary Becker, and much of the discussion centered on China. Rubenstein said the dramatic growth of the world economy had placed its participants "in the docket of history." He noted that China and India were key drivers of this change, thanks largely to their governments' recent moves to deregulate the economy. "China got out of the way of China," Rubenstein said, noting similar progress in India.

"The vibrancy of the Chinese economy is staggering," he added.

Endorsements like this have done much to put LPs in the mood to commit to the region. Michael Hoffmann, a partner with San Francisco-based Probitas Partners, describes the recent investor interest in China as an "intellectual rush" to the region. Indeed, according to a recent survey from the Emerging Markets Private Equity Association (see chart), a conceptual buy-in to the Asia proposition is currently dwarfing the actual dollars committed to the region.

MVision's Guen, who is currently in the market with an Asia-focused buyout fund, EQT Greater China, says he has noticed a keen interest among limited partners in understanding the macroeconomic landscape of China and India, where country risk is perceived to be higher. "It's the first question they ask," says Guen. "They want to know the fundamentals that allow a private equity group to make money, and then they get comfortable with the team. Some are a bit hesitant on China because they want to know the politics better."

Guen says his firm has instituted a policy of always including in PPMs that target non-US, non-European countries an extensive appendix that provides country analysis.

Certainly institutional limited partners, who face tough questions from investment board members and "headline risk" from the press when foreign adventures go awry, should understand the markets in which they invest. What is less certain is how much a deep knowledge of macroeconomic risks and opportunities will enhance private equity returns.

The real risk in Asia, according to Guen, Hoffman and many established GPs in the region, is that private equity talent is extremely scarce. It is already a well established observation of the more mature markets in the US and Europe that truly good GPs are hard to find. In Asia this scarcity is far more acute, given the relative youth of the asset class there. "There isn't a very deep bench of talent," says Hoffmann. "Almost any LP who is investing there today is making a bet on the future viability and stability of a given GP. Given the spate of recent high-profile departures to competitors at a number of funds, this is a legitimate concern."

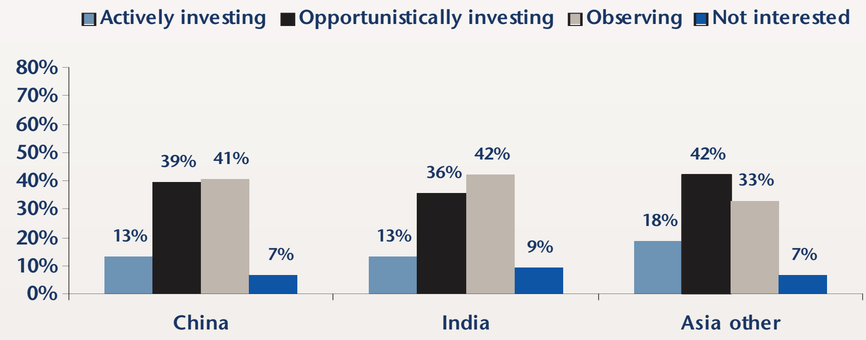
A buyout GP in Tokyo, speaking off the record, said he was aware of several executive search efforts under way in Japan, all of them assignments from Western private equity firms looking for teams of locals to head up a Japanese private equity franchise. One major firm was recently told by a prominent Tokyo headhunter to "get in line" behind an assignment from an earlier private equity client, the GP said.

That said, limited partners today face a plethora of choices in Asia-focused private equity funds, all of which play up the economic vibrancy of the region. Fewer of these groups have significant experience in building and exiting businesses through cycles. The LPs who do best in Asia will chalk their success up to good fund managers, not economic statistics. ■

READY FOR ACTION

According to a recent survey of more than 300 institutional investors, a vast majority are either observing or opportunistically investing in China, India and the rest of Asia. The survey, released earlier this year and conducted from November 2005 to February 2006, was conducted by Liberty Global Partners for the Emerging Markets Private Equity Association (EMPEA). Broadly, 65 percent of limited partners said they expected over the next five years to increase their commitments to emerging markets as a percentage of their total commitments to the private equity asset class. When a similar survey was conducted in 2004, just 45 percent of respondents said they planned to increase their exposures to emerging markets private equity. The survey does not include Japan, Australia and New Zealand.

"Describe your current strategy regarding private equity and venture capital in Asia?"*



* *Asia ex-Japan, Australia, New Zealand*

Source: EMPEA