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Asian private equity: Tentative steps forward

*Capital is flocking to safer hands as regulatory and geopolitical headwinds threaten market sentiment towards PE in the region,
writes Alex Lynn*

Asia's private equity story has until recently largely been one of expansion. New managers have set up shop, Western firms have planted flags and underexposed investors have built portfolios. In a post-covid landscape, however, growth has become more concentrated, tempered by a degree of caution.

Perhaps nowhere is this more evident than in Asia's fundraising scene. The average fund size has soared in recent years as capital flocks to brand names and large vehicles. The average funds raised for Asia-Pacific in 2019 and 2020, respectively, were \$386 million and \$379 million versus just \$294 million and \$321 million in 2017 and 2018, according to *PEI* data. In H1 2021, this figure climbed to \$481 million.

"It's easier to go with people you know or people whose names you recognise, and of course with the uncertainty of covid, geopolitics and everything else at the moment, it's sort of understandable," says Gavin Anderson, a Hong Kong-based partner at Debevoise & Plimpton.

"People may not want to be a hero in this particular environment at this particular moment in Asia. In terms of how that then flows through to fundraising, there are big funds with very strong track records that are being raised pretty quickly, and they have a lot of leverage because there is capital out there and it has to go somewhere."

Notable fund closes from 2020 include Baring Asia Private Equity Fund VII and MBK Partners V, which each raised \$6.5 billion, and CVC Capital Partners Asia Pacific V, which collected

\$4.5 billion. This year, KKR broke the regional fundraising record with its \$15 billion Asian Fund IV.

Despite these headline figures, fundraising in Asia has been on the decline since 2018. Managers raised \$82.4 billion that year, followed by \$73 billion in 2019 and \$52.4 billion in 2020, albeit during a pandemic. About \$36 billion was raised in the first half of 2021, on track to finish below 2018's peak.

"There's a tremendous amount of capital out there now seeing negative interest rates or very low rates and looking for a better home, and so you might think this must be a good fundraising environment," says Kyle Shaw, founder of ShawKwei Partners. "But, is this now really a good fundraising environment for Asia-Pacific? Maybe not. A lot of those investor funds instead

might be going to places like Europe and North America because of certain complications here in Asia on the geopolitical front. Plus, with the current travel restrictions, it's hard for potential LPs to come out to Asia and kick the tires of the funds."

Chinese venture capital is a partial exception to the rule. Fundraising is on track for an exceptional year, although capital is flocking to larger funds as it is in other Asian markets. Chinese firms raised \$6.6 billion over 15 funds in the first half of 2021, exceeding the \$4.4 billion across 17 funds for the entirety of 2020 and \$6.2 billion over 25 funds in 2019, according to PEI data. If the momentum continues in the second half of this year, fundraising levels may approach the \$13.8 billion collected in 2011.

Sino-US tensions

Though the pandemic has played a critical role in Asia's broader fundraising slump, geopolitical uncertainty must also shoulder some of the blame. Chinese GPs, in particular, have been anticipating a tougher fundraising environment due to the threat of regulatory intervention among US public institutions.

That dynamic has already played out in the public markets. Last year, President Trump ordered the Federal Retirement Thrift Investment Board, a US government agency that oversees about \$760 billion, to halt plans to back an index containing Chinese stocks because of national security concerns.

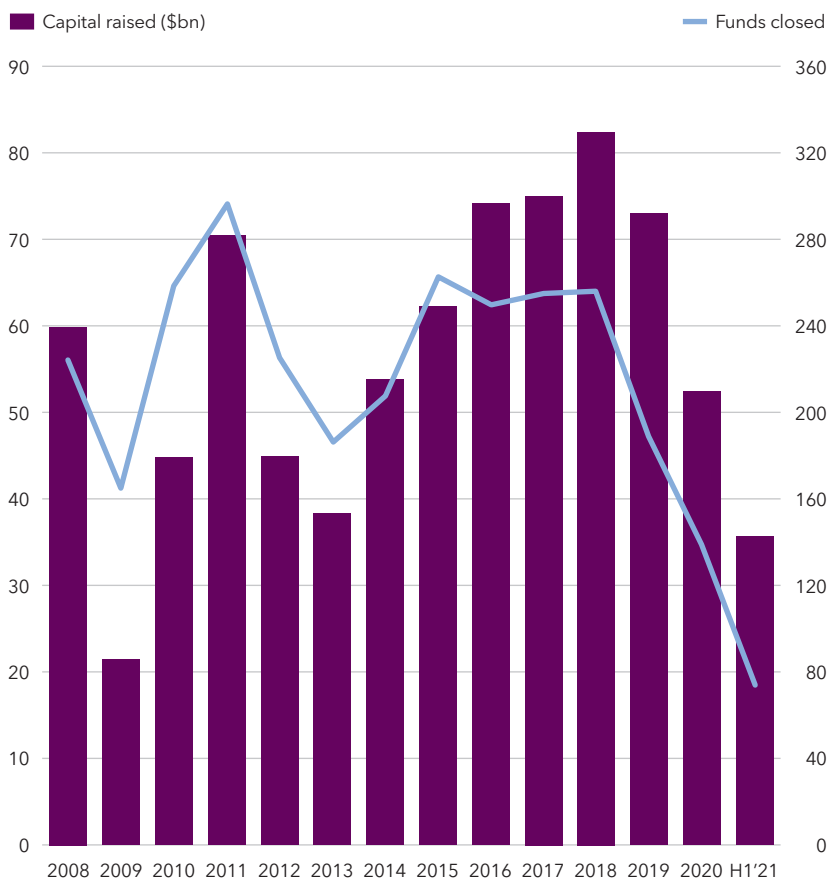
The US Department of State later warned university endowments to divest from Chinese stocks lest enhanced listing standards spark a wave of de-listings from US exchanges.

"Depending on what type of organisation you are, your constituents, investment committee or board will have a pretty disparate view on how they want to access – or if they want continue to have exposure to – China,"

"It feels like there's just been a torrent of co-investments coming through"

GAVIN ANDERSON
Debevoise & Plimpton

The number of funds closed in Asia has plummeted in recent years, as capital floods to familiar names and larger vehicles



Source: PEI



Gavin Anderson

Partner, Debevoise & Plimpton

Based in Hong Kong, Gavin Anderson is a member of the firm's investment funds and investment management group, advising sponsors and investors on issues including fund formation, co-investment, fund restructurings and carried interest arrangements.

Doug Coulter

Partner and head of private equity for Asia-Pacific, LGT Capital Partners

Doug Coulter joined the firm in 2007 and has more than 20 years' experience in private equity and investment banking.



Jonathan English

Managing director and head of Asia private equity, Portfolio Advisors

Jonathan English joined Portfolio Advisors in 2007 and has more than 20 years' experience in the asset class. He is primarily engaged in sourcing, evaluating and recommending investment opportunities in Asia private equity primary funds, secondary transactions and co-investments.

Kyle Shaw

Founder and managing partner, ShawKwei & Partners

Kyle Shaw is the founder and managing partner of ShawKwei & Partners, a private equity investment firm established in 1998. ShawKwei & Partners invests in Asia, Europe and the US and has offices in Hong Kong, Singapore and Shanghai. Shaw's private equity experience before ShawKwei & Partners includes managing Asian private equity businesses for Security Pacific National Bank and then the Tudor Group.



Zhan Yang

Principal, Collier Capital

Zhan Yang is an investment principal responsible for origination and execution, based in Hong Kong. Prior to joining Collier Capital in 2016, Zhan was a director at BlackRock Private Equity Partners. Previously, he worked at Swiss Re Private Equity Partners and Adveq Management in Zurich, Beijing and Hong Kong.



Kelvin Yap

Managing director,
HarbourVest Partners

Kelvin Yap joined the firm in 2006 and is a member of its global co-investment group leadership. Based in Singapore, he leads the firm's co-investment activities in Asia-Pacific.



“There’s quite a lot of dry powder on the sidelines for Asian secondaries, but we have no doubt that the asset class is going to go strong”

DOUG COULTER
LGT Capital Partners

says Jonathan English, a Hong Kong-based managing director at Portfolio Advisors.

“It really is on a case-by-case basis, depending on the internal policies of a particular organisation and how they’re reviewing the geopolitical risk,” English adds.

“At the end of the day, people are commercially minded and obviously returns can drive and influence decision-making. It may be a challenge psychologically on how best to balance the varying views.”

Chinese private equity was dealt another blow in late July by the US Securities and Exchange Commission. The SEC said it would start requiring Chinese companies hoping to raise money in the US to disclose their legal structures and the risk of China’s government interfering in their business.

Besides the political climate, enhanced scrutiny around Chinese listings has been driven in part by specific instances of questionable book-keeping. US-listed Luckin Coffee, one of Chinese private equity’s banner success stories, was delisted last year following an accounting scandal relating to alleged fraudulent revenue figures. US-listed TAL Education was probed

for sales fraud and others were accused of similar issues.

US IPOs have traditionally been a popular exit route for Chinese companies, which may now favour Chinese bourses.

“If you look at countries like the US, which has been a huge exit opportunity for listing Chinese companies, then I think that’s probably not going to be a realistic exit strategy to pin your hopes on,” Shaw says. “Instead, you’re probably looking at potential listings in Shanghai, Shenzhen and Hong Kong, which may not be as attractive when finally exiting the investment.”

While a less hospitable environment could be bad news for some managers, it could represent an opportunity in the country’s vast yuan-denominated private equity market. Data from Schrod-er Adveq and advisory firm Zero2IPO put yuan fundraising at the equivalent of \$163 billion in 2019, compared with just \$22 billion from international investors.

“Events over the past few weeks [in July] have shown a lot more uncertainty on exits for Chinese assets outside of China,” says Kelvin Yap, a Singapore-based managing director at HarbourVest Partners. “If you can’t really

exit outside anymore because there’s going to be a lot more regulatory scrutiny there, then you’re going to be exiting on the inside. So it’s a matter of how you can react to that development. Invest inside and exit inside.”

Secondaries

International investors can access yuan-denominated private equity via the Qualified Foreign Limited Partnership pilot programme. Launched in 2010, the scheme enables certain foreign managers to invest onshore in yuan with capital raised offshore, albeit subject to strict quotas and high barriers to authorisation.

“That’s the enabler,” Yap says. “QFLP has been around for some time, but it’s a matter of the size of the quotas and the regulatory regime being a lot more straightforward for people to tap into. Because that’s the window.”

The yuan-denominated secondaries market in particular may benefit from greater capital inflows, with domestic buyers few and far between. The opportunity set should be large, given that Chinese private equity funds tend to have four- to five-year terms and can be left with significant amounts of unrealised capital at the end of their lives.

“For investors sitting on the sidelines or least slowing down their deployment pace into Asian private equity, secondaries provide an opportunity for them to re-engage”

JONATHAN ENGLISH
Portfolio Advisors

APAC deal value hit a record last year, while exits continued to decline (\$bn)



Source: Bain & Co; AVCJ

“If you look at the market, there’s very little capital available to do RMB secondaries transactions and provide liquidity into the ecosystem,” says Zhan Yang, an investment principal at Collier Capital. “If you’re asking whether there are opportunities, the answer is yes. LPs are interested, but they want to learn more to see what the opportunity looks like and the size of the opportunity.”

Secondaries buyers have become increasingly active across Asia-Pacific more broadly during the pandemic and are expected to have a strong 2021 due in part to fundraising delays, rising demand in China for US dollar commitments and a backlog of transactions that were disrupted by the pandemic.

“We closed a fairly big continuation fund for a Southeast Asia manager in July and they also closed their main fund around the same time,” Anderson says. “Now, in a normal year we’d just be closing their flagship fundraise, so the fact that there was a continuation fund going on at the same time I think was very much a sign of the times.”

Secondaries in Asia has been on the up for some time.

“Just thinking back to Hong Kong-based private equity conferences that took place five to 10 years ago, you could walk into the one secondaries panel that they would always have on the last day at four o’clock, and there’d be nobody there,” notes Doug Coulter, partner and head of private equity for Asia-Pacific at LGT Capital Partners.

“If you look today, Asia is probably still only between 5 to 10 percent of global secondary volume, but if you talk to anybody in the industry in terms of their projections, they’ve got that number headed up towards probably 15 percent or even 20 percent of global volume in the medium term. There’s quite a lot of dry powder on the sidelines for Asian secondaries, we have no doubt that the asset class is going to grow strongly.”

Sponsors in particular are helping drive secondaries deals in the region. “We’re seeing a proliferation of GP-led

opportunities in Asia,” Yang says. “It’s a situation similar to the primary market, whereby the good deals are hot because everybody’s chasing them, and the not-so-good ones – or at least ones that aren’t perceived as good – are not receiving a lot of interest.”

In May, TR Capital, one of Asia’s biggest direct secondaries firms, became the latest to use China’s qualified limited partnership scheme in a GP-led restructuring. The Hong Kong-headquartered firm co-led a process that involved transferring six healthcare assets from three funds managed by China’s Huagai Capital into an 800 million-yuan (\$123.5 million; €104.9 million) continuation fund.

The same month, Hamilton Lane and Collier Capital co-led a fund restructuring of healthcare assets owned by Beijing-based Legend Capital. Last year, HarbourVest and LGT backed a \$600 million-plus yuan-to-dollar restructuring involving Chinese manager IDG Capital, according to *Secondaries Investor*.

“For investors sitting on the sidelines or least slowing down their deployment pace into Asian private equity, secondaries provide an opportunity for them to re-engage,” English notes.

“If you take away some of the duration and liquidity risk witnessed historically in their Asian PE portfolios, a secondary strategy is a way to recalibrate, access backdated vintage-year diversification and have a really interesting opportunity to restart and refocus their Asian PE programme.”

Dealmaking

Like much of the world, dealmaking in Asia has recovered from a lull in the first half of last year. Deal value hit a record \$185 billion in 2020, up 19 percent from the prior year and 23 percent more than the previous five-year average, according to Bain & Co. Some \$97 billion was deployed in China, a 42 percent increase from 2019 and 22 percent higher than the previous five-year average.

“It is absolutely a friendly dealmaking environment,” Shaw says. “There

are many companies interested in either raising money for growth, or with shareholders wanting to sell out and change their lifestyle, or deciding to restructure by spinning off assets, and so I think there are a lot of opportunities out there in terms of compelling valuations.”

With a rise in dealmaking comes an increase in the number of co-investment opportunities for LPs.

“It feels like there’s just been a torrent of co-investments coming through,” Anderson says.

“I think at least some managers may have had anxiety about whether they were going to have enough capital, so there may be an element of making sure that there’s sufficient margin of safety rather than using up all of their fund. In an environment where people may be concerned about fundraising, the importance of keeping the LPs

“If you look at the US, which has been a huge exit opportunity for listing Chinese companies, then that’s probably not going to be a realistic exit strategy to pin your hopes on”

KYLE SHAW
ShawKwei & Partners

happy is another aspect to it as well.”

Some markets have been more active than others when it comes to co-investing, with the region’s comparative isolation an obstacle for Western participants without a local presence, Coulter says. That said, the pandemic has created opportunities, as well as challenges, in particular sectors.

“For example, in Australia, Japan and China, even though those have been mostly closed markets, they’re large enough to be able to support potentially very interesting deals in domestic tourism,” Coulter adds.

“Tech and sectors related broadly to domestic consumption, such as

“We’re seeing a proliferation of GP-led opportunities in Asia”

ZHAN YANG
Coller Capital

India: Big players contribute to rising deal value

While China grapples with regulatory uncertainty, India has been raking in private equity capital

Deal value in India rose to \$38 billion last year, up 64 percent over the prior five-year period, according to Bain & Co. Growth was buoyed by 10 private equity investments totalling almost \$10 billion in technology multinational Jio Platforms and seven investments in Reliance Retail.

The market has attracted some of private equity’s biggest names. Carlyle Group completed at least three deals in 2020 alone, including buying a 74 percent stake in healthcare business SeQuent Scientific for a reported 15.87 billion rupees (\$215 million; €180 million) and a 20 percent stake in Piramal Pharma for 35.23 billion rupees. KKR, PAG, TPG and Warburg Pincus also made multiple investments.

“It certainly feels like there’s quite a lot of India activity going on,” says Gavin Anderson of Debevoise & Plimpton. “There’s not an infinite number of large Indian GPs that can absorb a decent amount of capital. Compared to the number of China GPs out there, it just feels like there’s not quite as many, especially once you get outside the venture space. I think a lot of it probably is done through pan-regional funds to a greater extent.”

It isn’t just mega-firms that are drawn to India. “India will continue to be an increasingly large part of the strategic proposition in the portfolio of companies in which we consider investing,” says Kyle Shaw of ShawKwei & Partners.

“India has a meaningful role right now for people like us looking for alternative sites for advanced

manufacturing and services. India is probably not just a single source investment location, but it could be part of a European, US or Southeast Asian company that’s looking to expand into an area where access to abundant labour and a reliable supply chain is easily available.”

Sceptical investors

Still, investors may require some convincing before fully warming to India, a market that has sometimes disappointed those expecting steady distributions.

“The real risk that investors have experienced historically when underwriting Indian secondary opportunities is duration,” says Jonathan English of Portfolio Advisors. “You may be caught in stalled liquidity situations, depending on the capital markets or scalability of those assets, and need to strike a balance when analysing Indian LP stakes on the secondaries market. Hopefully it’s a multiple-line-item portfolio with greater diversification to help de-risk some of that uncertainty on the hold period for those assets.”

Others see opportunity in India’s underwhelming past. “Disappointing outcomes actually fits really nicely as a recipe for our secondary investment strategy,” says Kelvin Yap of HarbourVest Partners. “When you have a counterparty who says, ‘I just want to get out of this position,’ it can make for a great trade depending on whether you price it correctly, what the assets are and how diversified the basket is.”

healthcare, especially in emerging Asia, China and India, have become incredibly crowded trades. For some ‘market-leading’ companies, we see sky-high valuations, so it’s a question of risk and how much you want to lean into very highly priced deals in those covid-friendly sectors.”

HarbourVest is taking advantage of market conditions in Asia. The firm launched a Singapore bureau in June, with Yap relocating from Hong Kong to assist the build-out.

“China was first in and first out of the initial covid-19 wave,” Yap notes. “There was the opportunity to rotate into cyclical sectors quickly when there were still really good deals to be had. We closed a number of those type of opportunities focused more on retail and travel where you could buy at a very attractive multiple, but underwrite the risk of a resurgence in cases and then a repeat of the economy being shot for a period of time. There are lots of opportunities around the entire region. It all depends on underwriting

a given pathway to recovery for the economy you are investing in.”

Exits

While dealmaking warmed up, exits in Asia slumped last year as firms globally waited for better times to sell portfolio companies. The region saw \$70 billion-worth of exits in 2020, down from \$92 billion the previous year and less than half the \$161 billion recorded in 2018, per Bain & Co.

For those that did seek an exit, initial public offerings were the preferred route. Listings accounted for 60 percent of exits by value in Asia last year, almost double the prior five-year average. China accounted for 86 percent of the region’s listings, with the majority launched by healthcare and tech companies.

Activity was driven in part by Chinese companies listed on US exchanges opting to conduct secondary listings in Hong Kong: Alibaba did so in 2019, followed by Chinese gaming company NetEase Inc and e-commerce giant

JD.com last year. The introduction of Shanghai’s STAR Market for high-tech companies in 2019 expanded the IPO routes available for domestic firms.

Still, a broader decline in exits has sparked fears in some quarters of exacerbating a perceived comparative lack of distributions among Asian GPs relative to their peers in Europe and the US. Capital contributions continued to outweigh distributions last year. The value of companies held in PE portfolios, or unrealised value, rose 33 percent to \$1 trillion.

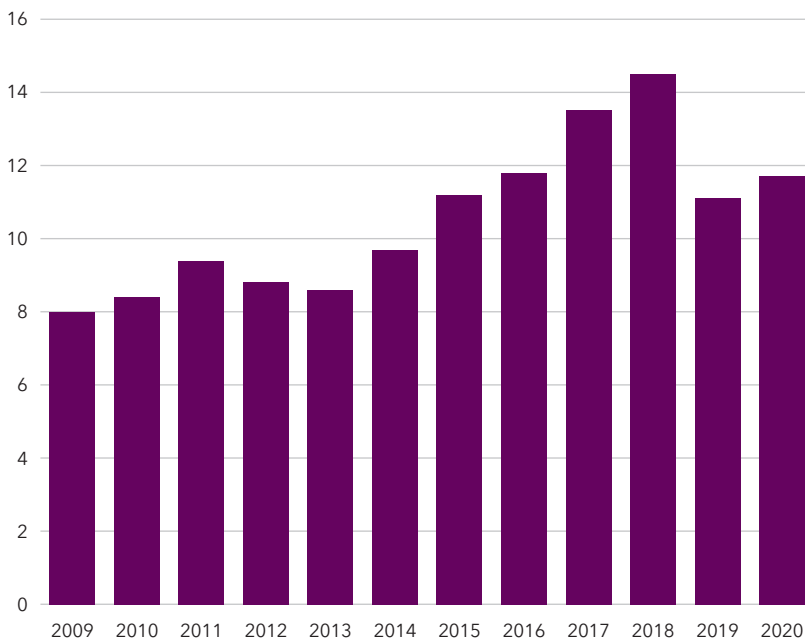
“It ultimately comes down to a GP-by-GP analysis but, let’s face it, there are a lot of managers in APAC who have very low DPIs on a relative basis,” Coulter says. “Also, with all the money crowding into venture, particularly in China and India, there’s probably going to be a lot of very unhappy LPs over the next five to 10 years except for those in the very top-tier names. It’s the same thing in the US – if you’re in the top VCs, you’re happy, and if you’re not, you may not be so happy. China is probably going to unfold in exactly the same way.”

Asian private equity firms seem to be waking up to the need to distribute capital to LPs.

“During the last cycle, the broader Asian GP community has come to understand the importance of DPI to the global LP community, not only for their current fund, but for the successor,” English notes. “GPs have matured and are more sophisticated on when to pull the trigger and may not be as wedded to an underlying asset as they may have been historically. To take money off the table, they utilise a multitude of levers on creating liquidity, either through recapitalisations or selling down partial shares, in order to deliver liquidity back into the LPs’ hands and crystallise carry for themselves.”

There is some debate around whether Asia’s perceived lack of distributions relative to the West is as serious as investors have been led to believe. HarbourVest, for example, has

There were bargains to be had in APAC during the pandemic, with PE multiples remaining at lower levels than previous years (Median EV/EBITDA multiple)



Source: Bain & Co; S&P Capital IQ

“There are lots of opportunities around the entire region. It all depends on underwriting a given pathway to recovery for the economy you are investing in”

KELVIN YAP
HarbourVest Partners

analysed investment statistics across its portfolio globally to ascertain whether Asia lags Europe and the US in terms of liquidity, Yap says. It found that buy-outs, venture and growth strategies all had similar liquidity profiles regardless of region. However, within venture and growth strategies, North American and European funds in the portfolio were approximately 70 percent exited by number of deals versus just under 50 percent for Asia.

“This is fundamentally driven by the significant growth of venture and growth assets in Asia relative to a much smaller base a couple of fund cycles ago, rather than longer average investment holding periods in Asia,” Yap notes. “The Asia portfolio is just younger on a weighted average basis.”

This hasn’t stopped Asian GPs from running single-asset transactions to generate liquidity for investors without sacrificing their own exposure to a treasured asset.

“We have seen more single-asset GP-led transactions in the secondaries market in the first half of this year; they represent 25 percent of the entire

market, so it’s obviously becoming a very large exit route for GPs,” Collier’s Yang says. “The secondaries market is global, but here you have a lot of local flavours. In Asia, GPs have learned how to best make use of the secondaries market to manage their own portfolios and create liquidity for their LPs.”

Though investor concerns over liquidity have, to some extent, been addressed, the looming spectre of regulatory actions in China may give potential LPs additional pause for thought.

In November, Ant Financial’s highly anticipated, and potentially record-breaking, listing in Shanghai and Hong Kong was pulled as a result of a regulatory crackdown on the company’s lending business. Just days after Chinese ride-hailing company Didi’s \$4 billion market debut in June, China’s government removed it from app stores, alleging Didi violated data security rules.

Perhaps most damaging for private equity was Beijing’s decision in July to ban private tutoring companies from making a profit through teaching core school subjects and raising capital. The sector had attracted billions of private

equity and venture capital dollars during the pandemic.

“There are lots of discussions around the new regulations in the education sector in China,” Yang says. “That creates noise or uncertainties for some investors, although I believe in Beijing a lot of investors anticipated that changes were going to happen.”

The Hang Seng Tech Index, which represents the 30 largest tech stocks in Hong Kong, dropped more than 10 percent following the education announcement. As of early August, the index was down more than 30 percent from a record high in February.

Some private firms active in this sector appear to have dodged a bullet.

“We have a manager in our portfolio that completely liquidated their position in an ed-tech company earlier this year,” Coulter says. “It came over a weekend very suddenly, not in a way that Western investors are used to regulatory change happening. If you were local on the ground, you kind of saw this coming but if you were several thousand miles away this came as a complete shock.” ■