

THE CHANGING INVESTMENT LANDSCAPE IN ASIA

- Alexandre Schmitz, Capstone Partners



Now that the Asian private equity market has begun to mature, what impact has that had on the industry?

After the euphoria of the early days of the Asian private equity industry, where strong performance was achieved by following pre-IPO/momentum-driven strategies, institutional LPs have been disappointed by managers that were unable to return cash-on-cash money to their investors. Over recent years, the Asian private equity market has matured, with more GPs focusing on a hands-on investment approach rather than being passive stock-pickers. In that context, sector specialization has emerged as a better alternative to country focus. More than ever, healthcare, business services and consumer strategies offer the best value-creation prospects, particularly companies that rely on asset-light and tech-enabled business models.

At the same time, in a region which remains dominated by minority stake investments, secondary transactions have demonstrated a better ability to generate good cash-on-cash returns, particularly for portfolio companies relying on a technology-driven strategy. By buying existing shares or combining a secondary and a primary investment in a firm that has been backed for several years by venture capital investors, a GP can simultaneously reduce the intrinsic risk of the transaction and its holding period.

Last but not least, in the regions open to majority transactions (Japan, Australia and to a lesser extent in Southeast Asia), buyout strategies continue to attract the interest of institutional investors. These transactions in Asia-Pacific rely on growth (organic or buy-&-build strategies) and on operational excellence. In that context, Australia continues to be considered the most attractive buyout market, particularly in the small to mid-market segment where prices remain reasonable.

Two-thirds of private equity funds closed in 2017 used a placement agent, the

largest proportion over the past decade. From your perspective, how has the way that GPs raise capital changed over recent years?

In Asia, there was a period when capital was abundant, especially in China. Due to the supportive IPO market at that time, the returns were strong and opportunities for growth investing were numerous. As market conditions shifted, GPs found it more difficult to raise capital on their own and started turning to placement agents to boost the odds of success for their fundraise. In addition to making the appropriate introductions to LPs at the right time, the placement agent can help the GP to be ready for fundraising in due time. This includes document preparation, loading the data room and preparing for diligence requests. Regarding documentation, it is important to focus on compliance with respect to each country, and a registered placement agent can work alongside legal counsel to determine the best course for fundraising. In a world where regulation constraints are increasingly complex to manage, partnering with a service provider with global vision and a local presence in the main LP markets is key.

Our data shows that Asia-focused private equity funds are much more likely to appoint a placement agent that is based in North America rather than Asia. In your opinion, what is the appeal for Asian private equity funds to use international placement agents over local firms?

When you look at the typical composition of the LP base of Asian GPs that have been able to grow over time, you clearly see the combination of three sources of funding: (i) Asian investors, (ii) international investors with a presence in Asia (mainly funds of funds and pension funds) and (iii) international investors without a presence in the region (mainly North America-based endowments and family offices). With increased interest from international investors, an Asian GP may determine that the best way to access these non-Asian

investors is through a North America-based placement agent. In many cases, you find that North America-based placements agents will also have an office in Asia, which truly gives the GP the best of both worlds: a local presence as well as the deep reach into LPs that may be harder to access.

Have you seen many changes in LP appetite in Asia?

In addition to an increasing appetite for sector-focused, hands-on managers, the main evolution we have seen in recent years is the renewed interest for the mid-market segment. While the most successful managers have substantially increased the size of their funds, the most sophisticated LPs in both Asia and the West aim to rebalance part of their allocation to fund managers operating in the \$300mn to \$1.5bn range, not just in multibillion-dollar funds. Furthermore, there is an increasing interest to support managers that have demonstrated a consistent ability to offer quality co-investments. In that context, several international investors have opened offices in the region and/or reinforced their local teams for greater efficiency in executing a direct investment strategy alongside their fund allocation.

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