OPTIMISM AND OPPORTUNITIES SEEN IN ASIA-PACIFIC

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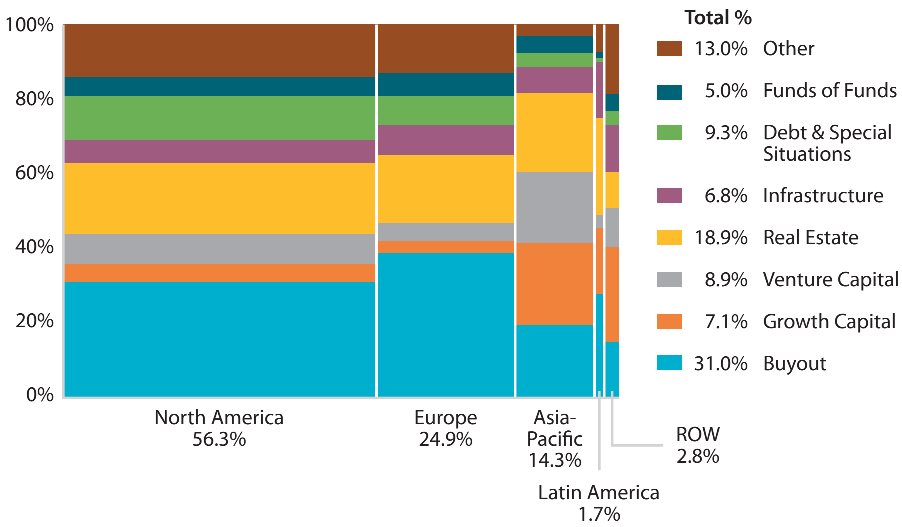
CURRENT STATE OF THE PRIVATE MARKET INDUSTRY IN ASIA-PACIFIC

As illustrated by Fig. 1, funds focused on the Asia-Pacific region represent 14% of the $5.9tn raised over the last decade. Across this time period, the majority of the Asia-Pacific-focused funds are fairly evenly split between buyout, growth, venture capital and real estate strategies.

Following the GFC, the amount of capital raised for closed-end funds focused on the Asia-Pacific region rebounded more quickly than for funds focused on the West. At the end of 2011, 23% of the money raised globally was dedicated to investment in the region and, as seen in Fig. 2, it was the second largest destination for deploying money, after North America and before Europe. Over the last two years, North America and Europe have recovered to their pre-2008 levels while the Asia-Pacific region has decreased from its 2014 peak in absolute terms. The most recent figures show that the amount raised during the last 12 months by funds focused on Asia-Pacific ($70bn at the end of June 2017) was 24% below the peak at the end of 2014 ($93bn), and is now less than 10% of the amount raised globally.

The two main drivers of this negative trend are the decreasing amount of capital raised by Japan-based managers and the limited number of international managers raising money to be deployed in the Asia-Pacific region since the end of 2014. Over the last few months, more than 10 Japanese buyout funds have been closed in a row. Furthermore, the recent close of KKR Asia III at $9.3bn and the anticipated raises of several other global private equity houses imply a potential reversal of this decline.

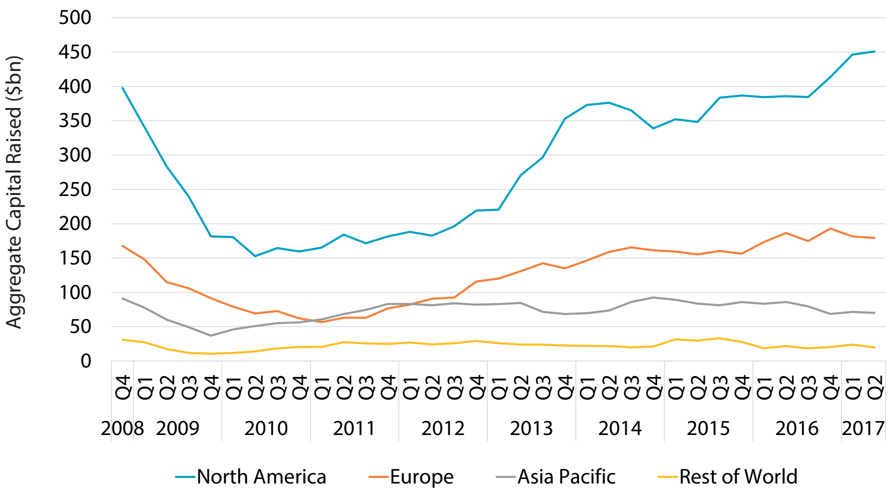
Fig. 1: Aggregate Capital Raised Globally by Closed-End Private Capital Funds, 2007 - 2016



Source: Preqin, Capstone Analysis

Legend: "ROW" = Rest of the World = Africa, Israel and Middle East. "Other" = Co-Investment Multi-Manager, Secondaries, Direct Secondaries, Natural Resources, Special Situations, Timber and Turnaround

Fig. 2: Aggregate Capital Raised by Closed-End Private Capital Funds, 2008 - 2017 (Rolling Total for Previous 12 Months)



Source: Preqin, Capstone Analysis

ASIA-PACIFIC FUND PERFORMANCE COMPARED TO OTHER REGIONS

Historically, funds dedicated to the Asia-Pacific region have performed well compared to their Western peers. This is particularly the case for venture capital funds in China and buyout funds in Australia which generated the best performance at a global level in their respective segments. For the region as a whole, the return premium to invest in private rather than listed markets has been higher in Asia-Pacific than in North America or Europe.

Nevertheless, international investors remain cautious with their allocations for investment outside the West. The two main issues for global investors active in the region are a greater divergence between the top quartile and poor performers, and a relatively low realization rate of the value created. Indeed, too many funds, which have reached the end of their investment period, are characterized by DPI below 50%, particularly the ones exposed to China and India.

While it seems that there is no material premium to investing in Asia rather than in the West, it is important to note that the nature of the performance differs compared to the West. In Europe, over 80% of the funds dedicated to private equity investment have been raised for leverage buyouts, while the bulk of the funds focused on the emerging Asia region target venture capital or growth capital investments. Moreover, the few managers utilizing a control strategy typically only rely on moderate financial engineering. As a result, in addition to the multiple expansion, most of the value created is driven by growth rather than financial leverage. Buying minority stakes in growing companies with the hope of a listing also implies longer than average holding periods. In China, for example, private equity managers have invested in more than 10,000 companies, while only about 250 IPOs are transacted on a yearly basis. Going forward, more trade sales and secondary transactions will be needed.

APPETITE OF GLOBAL LPs FOR PRIVATE INVESTMENTS IN ASIA-PACIFIC

Given the disparity of the performance between top-quartile and lower-quartile funds, manager selection is even more important in Asia than in North America and Europe. Therefore, investors continue to favour GPs that have demonstrated their ability to return capital and that have built a repeatable successful business model. A few years ago, pre-IPO strategies allowed managers to generate value without implementing operational changes in the portfolio companies. Today, operating management skills and an ability to negotiate satisfactory corporate governance (in particular regarding exit rights) are a must to convince investors to make a commitment. Alongside large pan-regional GPs that have imported best practices from the West, local managers that have developed a sector expertise should continue to attract LP interest.

Overall, there will continue to be two different types of global investors in the region. The first type is the international investor that has set up operations in Asia and is committed to allocating to Asia as a diversification play. The second type is the "fly-in" investor that is only looking to invest in opportunities where they believe they can take advantage of the reasonable valuations and attractive growth prospects to achieve premium returns that will compensate them for currency and emerging markets risk. Circumstantial evidence would suggest that the quantity and interest levels of these international "fly-in" investors should continue to increase as attendance at the large Asia regional conferences has also increased over the last several years. As the market matures, we are likely to see continued strong support from local investors augmented by the "fly-in" investors becoming a larger percentage of the committed capital.

BEST PRIVATE EQUITY OPPORTUNITIES IN ASIA-PACIFIC

Only a few countries in Asia-Pacific can be characterized as having a mature private equity industry that is dominated by buyout funds, namely Australia, Japan and, to some extent, Korea. Due to limited competition for quality companies with an enterprise value below $200mn and a large ecosystem in that segment, Australia appears to offer the most attractive mid-market buyout funds on a global level. Compared to North America or Europe, over 95% of transactions are primary deals in Australia. Furthermore, compared to the Japanese market, Australia is characterized by sound macroeconomic growth prospects.

In emerging Asia, secondary managers are expected to continue to deliver above-average performance when adjusted for risk. By nature, buying into a fund entering its harvesting period or into a company owned for several years by another private equity investor reduces the intrinsic risk of an investment. It also significantly reduces the expected holding period before a liquidity event is likely to occur.

In addition, managers that have built a franchise and shown the ability to add value to companies in sectors such as technology, healthcare or education seem to be well placed to raise funds in the future. We also believe that the infrastructure and credit spaces will provide interesting investment opportunities. However, if the underlying markets are expected to grow significantly in the foreseeable future, the main issue in those two segments is the limited number of managers that have demonstrated a consistent track record.

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