Hamilton Lane Research

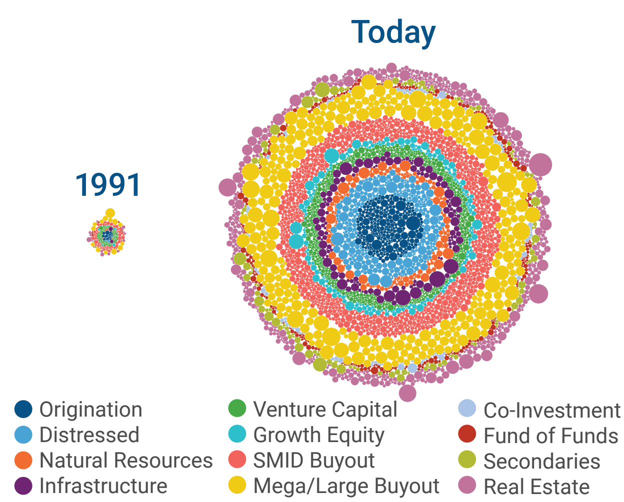
PRIVATE MARKETS IN ASIA: A COUNTRY-BY-COUNTRY GUIDE

By Mingchen Xia, Managing Director and Shannon Chow, Principal

Sometimes, particularly on lazy, slow summer afternoons (do those exist? Let's pretend for a moment they do), we at Hamilton Lane like to kick up our feet and reminisce. We hearken back to our founding, in the year 1991, and fondly recall just how remarkably different the asset class and landscape was back then. "Private equity" really just meant "buyout" and there were just a smattering of funds to choose from – quite a different picture than today.

The proliferation of funds and strategies available to LPs today is one of the biggest and more notable changes in the asset class over the last several years, and while we could spend hours and days detailing this evolution (and in fact, we do – check out our Market Overview), one specific area that has been attracting an increasing amount of LP attention recently is the private markets landscape in Asia.

In fact, given the complexities and nuances of the Asian private markets, we will be tackling this topic in a series of white papers, beginning by framing and introducing the market (the "What"). We'll then explore some of the reasons for the uptick in LP interest in Asia (the "Why") and finish up with – you guessed it – the "How."



Source: Hamilton Lane Date (July 2019)

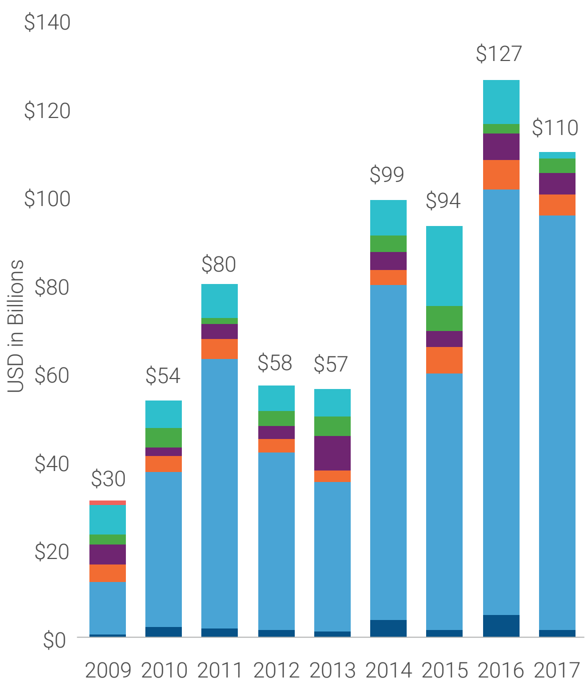
What exactly *is* the private markets landscape in Asia?

Just like its cultures, cuisines and languages, Asia's private market landscape is very large and diverse, with enormous regional variations. There are five key regions: China, India, North Asia (Japan and Korea), South East Asia ("SEA") and Australia.

The Asian market has experienced drastic growth in terms of private market maturity as well as LP appetite. And we expect this trend may continue, albeit gradually. Fundraising activity in Asia, however, tells a less nuanced story, increasing by more than three times, from $30 billion in 2009 to $110 billion in 2017. China represents the majority of fundraising activities in Asia, while SEA, India and Japan also saw meaningful increases.

Amount of PE Funds Raised

By Country



Source: AVCJ December 2017. Excludes real estate & global funds and includes funds raised in all currencies.

In term of private equity investment size, China is the largest market and represents the majority of PE investments (about 50 - 60%) in Asia. Other countries represent the remaining 40% - 50% of PE investments in the region.

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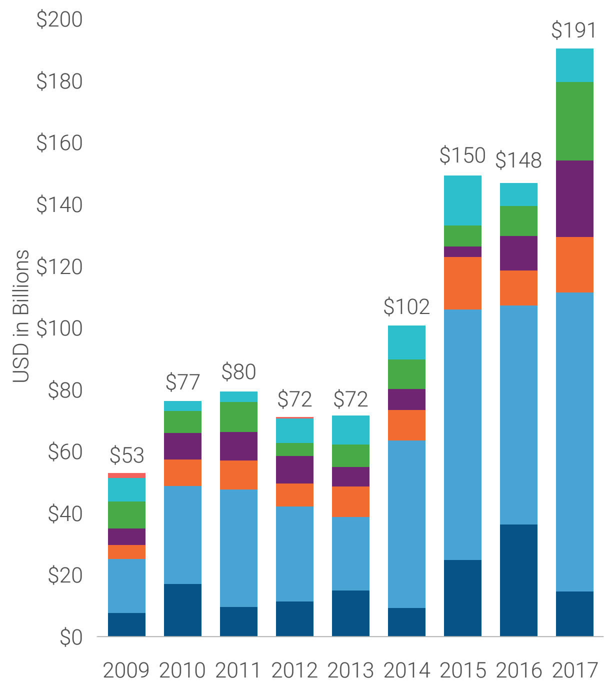
PE Investments

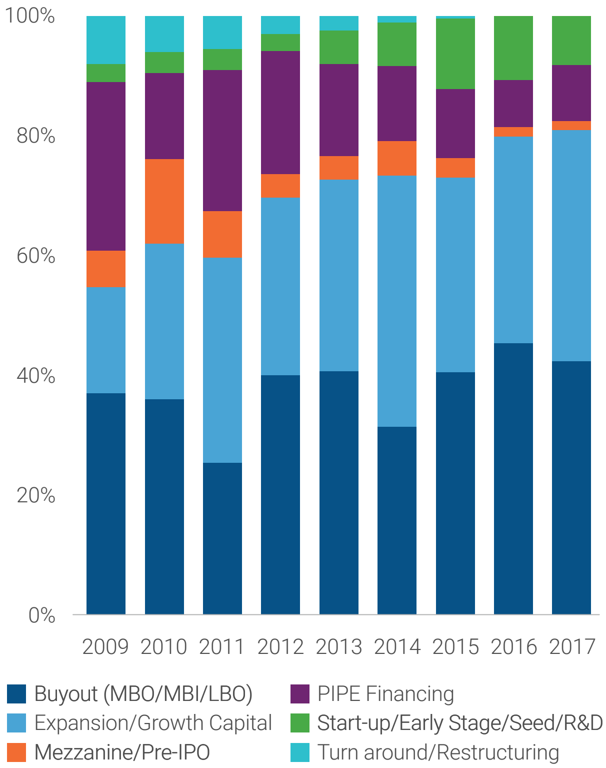
By Country



Source: AVCJ December 2017. Excludes real estate & global funds and includes funds raised in all currencies.

When it comes to investment strategies in Asia, buyout, growth equity and venture capital tend to dominate. Buyout is mainly in developed Asia (i.e. Japan, South Korea and Australia), while growth and VC are mainly in developing Asia (i.e. China, India and Southeast Asia). Compared to the U.S. and Europe, growth and VC comprise a larger portion of the Asian market because of the faster-growing economies there.

PE Investments by Strategy
By Value



- **There is a significant increase in growth strategy**
- **Buyout has remained the widely utilized strategy by investment amount throughout the period**
- **Other strategies including mezzanine, pre-IPO, PIPE and turnaround / restructuring have continued to become less prevalent**

Source: AVCJ December 2017. Excludes real estate & global funds and includes funds raised in all currencies.

These days, a typical global PE portfolio tends to have approximately 5% to 10% allocation to Asia. If we think about Asia's market size as a proportion of the global market, according to the IMF's 2018 World Economic Outlook[1], Asia is forecasted to represent just over 34% of global GDP in 2019, and is forecasted to represent 63% of total global GDP growth in 2019.[2] Without a doubt, Asia is a powerful growth engine with a lot of room to run, and if you ask us, compared to its size of economy, LPs' allocations to Asia are generally underweighted. In fact, we believe that in the next five to 10 years, Asia's private markets could potentially be similar or equivalent to that of Europe.

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Key trends driving Asia's private markets

We know it's tempting, but don't take our bold prediction at face value. There are a number of market trends that informed our view. And, while Asia is a diverse market with huge regional variations, in general, a couple of similar themes emerge:

General Partner Maturity & Cycle Experience — Many mature GPs have experienced multiple economic cycles and successfully managed multiple funds.

Competition – Asia is comprised of a variety of GP types — global, regional and local players are competing for deals, talent, and LP capital. In China, onshore RMB funds add one more layer of competition, driven by the abundant domestic liquidity and active and sizable stock market.

Differentiation & Specialization of strategy – The confluence of GP maturity and competition in turn drive strategy differentiation and specialization. There are GPs specialized by sector (e.g. healthcare, consumer, early-stage technology, industrial-focused funds, etc.); by theme (e.g. buyout, secondary, credit, etc.) or operational expertise (e.g. domain knowledge, business strategy, etc.). This depth and breadth of options provides more flexibility and optionality around portfolio construction.

Increase of buyout investments in developing markets (China, India and SE Asia) – Growth is still a main theme, but we see the growth of buyout investments, driven by slowdown of GDP growth, structural changes (e.g. transition from an investment and export-led economy to a consumption-driven one, privatization of State-owned-enterprises and de-regulation, etc.) and demographic challenges (ageing population and succession issue), where GPs can really take control and create value.

Investment themes by market

As noted, the private markets landscape in Asia varies widely by country, so join us on a whirlwind tour of the region...

China

China's GDP ranks No.1 in Asia which in 2018 was over $13 trillion which clocked in at a 6.4% increase year-on-year in the March quarter of 2019.[3] Though the Chinese economy growth rate has slowed down, it still ranks No. 2 globally, and is no slouch.

The main strategies in Chinese private market are growth equity, venture capital and buyout.

Growth Equity – High-growth sectors are TMT, Healthcare and Education, driven by the theme of domestic consumption upgrade.

Venture Capital – The VC market here is comprised mostly of early-stage tech startups with multiple rounds of financing, including companies like Didi, Meituan, Xiaomi and the likes.

Buyout – Historically, buyout actually was not a mainstream strategy in China, given that China has been such a high-growth economy. This seems to be changing, though, with some traditional industries, such as manufacturing and industrials, are experiencing a slowdown of late, while corporates have faced economic and succession issues, with many aging entrepreneurs choosing to sell their family businesses when their children opt not to take over the reins. As a result, buyout opportunities are gradually increasing and GPs are developing their skillsets around value enhancement by cutting costs and improving operational efficiency by adopting new technologies, transforming the business model and optimizing business processes.

Another differentiation for China is the increasing capability of technological innovation. In the last 10 years we have seen a good deal of unique innovation here, including mobile payment, 5G and artificial intelligence (AI), especially the application of AI within facial recognition, robotics etc.

We believe China will remain one of the most important markets in Asia. Macro-economic challenges such as the trade war with the U.S., present a short-term challenge, but we do not expect the trade war to have too much of a direct impact on China's private markets.

India

Let's move on to India. This is Asia's third-largest economy, and is actively catching up to China, though it recently grew at a slower-than-expected rate of 5.8% in Q1 2019[3], compared with 6.4% in China.

The characteristics of India's private markets are similar to those of China, with an increase in buyout deals in recent years, but the strategy is more growth-oriented. India's is a highly leveraged economy, with a high concentration of non-performing loans ("NPL"). The Insolvency and Bankruptcy Code, India's first consolidated bankruptcy law, was passed in 2016 to curb the NPL issue. As a result, many business owners and conglomerates needed to sell their companies/subsidiaries (mainly non-core assets) to cover their debt, which in turn has led to a surge in buyout and private debt investment opportunities.

The other key development affecting the private market landscape in India was the implementation in July 2017 of a comprehensive governmental tax overhaul called the Goods and Services Tax (GST). The GST streamlined the country's indirect taxation system to a unified domestic system of indirect taxes and has had a positive impact on the economy and various subsectors, making it easier to invest in different states within India.

Japan and South Korea

We now turn to Japan and South Korea, which are mature and developed markets with relatively low GDP growth rates. On an annual basis, the Japanese economy grew 2.2% while the South Korean economy advanced 1.7% in the first quarter of 2019.[3] Investment opportunities are mainly buyouts and the sectors are diversified. There are many small-to-medium enterprises in these two countries. Most of the mid-market buyout transactions are proprietary situations (e.g. non-auction and bilateral negotiation), where the entry valuations are relatively reasonable and there is room for value creation, as the companies tend to be undermanaged. Trade sales are the most common exit strategy in these markets, which is different from China, where GPs rely mainly on IPO markets for exit.

In Japan, corporate carve-out deals are on the rise, due in part to many large Japanese companies or conglomerates like Toshiba, Hitachi, Panasonic, Sony and Fujitsu with hundreds or even thousands of subsidiaries. These firms are focusing on their core business and carve out non-core businesses or subsidiaries.

Similarly, in Korea, many chaebols, which are large industrial conglomerates that are run and controlled by a South Korean owner or family (examples include Samsung, LG, Hyundai, SK and Lotte), own businesses with many subsidiaries in which they may sell majority shares but hold a minority interest. This in turn creates buyout opportunities.

Another theme here, similar to China, is that of aging entrepreneurs struggling to find a proper successor and thus turning to the buyout market as their succession plan.

South East Asia

Indonesia, Vietnam, Singapore, Malaysia and the Philippines are some of the key countries in SEA. In total, this region has a population of approximately 662 million, with Indonesia comprising the largest portion of the market, with a population of about 269 million.[4] The economic growth story here is relatively slower than in China or India.

Growth equity and buyout are the main strategies in SEA. Buyout opportunities are slightly more robust than in China or India, as some SEA countries such as Singapore, are relatively mature. Because each country in SEA is small, generally they aren't big enough to support country-focused funds. Most GPs here are regional players, though there are some small country-focused funds in Indonesia.

SEA tends to be considered as a single emerging market, but the countries in the region are not homogenous. As a result, a company that thrives in one South East Asian country may not do well when rolled out to another. On the flip side, this is another area with a lot of opportunity for GPs to add value. For example, there is a significant amount of capital from Chinese GPs or strategic investors flowing into South East Asia, particularly within technology and VC. The experienced capital can help local companies expand to other SEA markets.

Australia[5]

Last but not least...

The economy of Australia is smaller than that of Korea and Japan and is primarily driven by domestic consumption, and the key sectors here are in the traditional sectors such as healthcare, education, business services and consumer products and brands (e.g. Australia dairy is very well-known). Australian GPs today are less commodity- and natural resource-focused and instead focus more on consumer-related areas. Many small and medium-sized enterprises in Australia are still local and less sophisticated in international markets, which in turn creates opportunity for GPs to help them navigate and grow in overseas markets, particularly SEA and China. Australia is a typical buyout market, with many large corporate carve-out opportunities such as MSC Australia. Take-privates is another common strategy in the Australian market.

Conclusion

Congratulations, you've made it to the end of this whirlwind tour of Asia's private markets. Hopefully, we've conveyed the complex and varied landscape and some of the key current dynamics affecting this market. While we don't like to generalize (especially in this market) it's safe to say that the private markets in Asia are sizeable and have grown rapidly over the last several years. This is already an important region within the global privates market landscape, and we believe it is now simply too important to ignore. Given its variety in strategies and geographies — and again, without over-generalizing — we believe that the market can present attractive investment opportunities to ex-Asia LPs and can be an important component of a well-diversified and balanced portfolio.

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Endnotes

[1] Source: IMF's 2018 World Economic Outlook: Challenges to Steady Growth https://www.imf.org/en/Publications/WEO/Issues/2018/09/24/world-economic-outlook-october-2018#Full%20Report

[2] Source: https://www.visualcapitalist.com/economies-global-growth-2019/

[3] Source: Trading Economics

[4] Source: Worldometers

[5] New Zealand is included

Disclosures

As of July 31, 2019