NAVIS CAPITAL

Path of most resistance

Navis Capital is one of the biggest private equity firms focused on Southeast Asia, with $3 billion in assets under management. The Navis team came out of The Boston Consulting Group and as former management consultants, they have shaped a specific investment strategy for the region. Nicholas Bloy, co-managing partner, explains

What sectors are you focused on in Southeast Asia?

We don't focus on particular sectors. But we know what we avoid. We avoid government-controlled industries – too much cronyism involved. We don't like tech or startups because you don't need to take the associated risk to get good growth in Southeast Asia. There's good organic growth in very prosaic industries. To us, the key is to diversify and avoid a single sector focus.

In each of our funds, we are trying to create the most well-constructed portfolio of maybe 14-15 different companies. We're trying to avoid correlation in these portfolios. We think about portfolio construction in a sophisticated way, similar to hedge funds who think about their overall net or aggregate exposure. Is the portfolio across multiple uncorrelated countries, industries, mixed between export and domestic markets, and spread over a few years to avoid vintage concentration? Black swans are everywhere in emerging markets and when they come, you must have a portfolio that can handle it. You must never allow a single deal to be so big that if it blows up, it will blow up the whole fund. Ensuring the right mix of deal sizes, and number of deals in a portolio adds time and complexity to private equity management. This is an example of a line of most resistance, but it's worthwhile.

Navis favors control buyouts. Aren't they particularly hard to do in Asia, where families running businesses don't want to give up control?

Of course control deals are hard. Minority deals are everywhere and easy to do. But control deals are our only focus because we think they have a superior risk/return profile. We've done over 50 such investments since we started the firm. The universe of opportunity for control deals is quite a bit smaller than that for minority deals. But there are many logical reasons why control can become available in good companies. It can occur with generational change in a family where the next generation has no interest in the business. In many of our deals, we've seen that a great entrepreneur is in his 60s with sons or daughters abroad studying or married, or just disinterested. He has nobody to leave the business to. We can become helpful in managing the transition to longterm professional management. Those situations happen less frequently than an inter-generational transfer, but there's an enormous number and diversity of

Bloy: sculpting a portfolio

family-owned businesses in Asia. Many family businesses in Asia become multi-business holding companies. One area of a holding company requires cash that could be generated from another part, and that might lead to a sale. Control deals also arise from public companies that may not be family controlled, but which can be taken private. Also, multinationals can be a source of control deals, when an overseas subsidiary falls out of strategic favor. Although on average it's harder to find and manage a control deal, it doesn't mean there isn't a very attractive smaller universe of such deals to be done.

How does Navis structure deals in an environment like Thailand where political risk, credit constraints and a lack of exit options are big hurdles?

I don't draw a sharp distinction between political risk in Southeast Asia and in other economies. I don't see any difference in the political risk profile of Southeast Asia vs China or India. As for credit constraints, that doesn't worry us much because we almost never use leverage. We have a risk-averse approach with our portfolio companies. When we control them, we want them to have the strongest balance sheets in their industry. Certainly in private equity the temptation is to put in as much leverage as possible to juice equity returns. We don't believe in that in emerging markets. It's a feasible strategy, but a superior strategy in a risky growth environment is to put in no debt and start with a strong balance sheet. That allows us to grow the company aggressively.

One reason we always focus on control is because we've never believed that it's easy to exit to the public markets. On average, it's very hard to exit a minority position. With a control deal, we can pass on control to a strategic buyer. Out of 50 deals we've done, we've exited about 20 and none through IPOs. We sell our companies to strategic buyers and their appetite for acquiring a business in a country is not a function of what's going on in that country's capital markets.

Navis recently sold its Dunkin' Donuts and Au Bon Pain business in Thailand for about 2.5 times its initial investment. What were the operational challenges in growing that business?

The previous owners were a Thai family business group. They had fingers in many pies including real estate and other asset-intensive businesses. As a group, they were a bit cash-strapped. That was the catalyst for deciding to sell the food retail business. They had been under-investing in it, taking cash out and using it elsewhere in the group – all quite logical, but to the detriment of the food business. When we took over, the business had been starved of capital for a number of years. We wanted to grow the brands quickly because we felt they were under-penetrated. We made fairly basic investments that should've been done over the prior years – refurbishing entire stores, rebuilding central kitchens, fixing logistics systems that fed the stores. So reinvigorating the business that had been running on empty for the prior three years was the first big challenge. Next, we used a site selection model that looks at different locations from a number of parameters and is predictive in terms of what economics and revenues will be at a particular location. Once that was done, it was a more straightforward matter of rolling out more stores. We doubled the store network during our ownership.

Where in Southeast Asia does Navis have the most investments?

We're well spread around Southeast Asia. We've been investing there for over 12 years and as a region it represents about 70 percent of our aggregate invested capital. We have invested in all the major economies – Singapore, Malaysia, Thailand, Indonesia, Vietnam, Philippines.

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Indonesia is generating a lot of interest, but we think it's overhyped. Just focusing on Indonesia totally misses the point of what's going on in Southeast Asia overall. There's been creation of a free trade zone – AFTA. A very material political and economic process has been underway for a number of years that is creating a tariff-free trading area like NAFTA or the EU. In the last couple years, tariffs on 90 percent of all goods and services among the Southeast Asian countries have come down to zero percent. By 2014, it will be zero on almost everything.

The opportunity is to invest in a national champion in one of those countries and take it cross border. Southeast Asia has 600 million people in aggregate. Cross-border growth and M&A is a much more powerful and longer-running value-creation phenomenon than what is going on in any single country – but few people know how to do it. As a private equity firm, you need multiple offices with local staff to really execute well. It's hard work, but in many different industries, in going from national to regional champion, there is a lot of value to be created. AFTA will offer opportunity for the next 20-30 years. ■

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