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Private equity deals picking up steam

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Value of deals in Malaysia comprised 50% of South-East Asia's total last year

EVERY investing asset class has its defining deal.

In the world of private equity (PE), its defining deal has got to be United States-based Kohlberg Kravis Roberts & Co's (KKR) takeover of RJR Nabisco in 1988 for US$31.3bil (RM97.03mil). That was the largest leverage buyout in history for the next 17 years.

RJR Nabisco was formed in 1985 by the merger of Nabisco Brands and RJ Reynolds Tobacco Company. Nabisco was a producer of food products such as *Oreo* cookies, *Ritz* crackers, *Del Monte* fruit and vegetables and *Snickers* chocolate. RJ produced *Winston*, *Camel* and *Salem* cigarettes. No link there between food and fags.

KKR made a hostile takeover bid of RJR Nabisco. During the ferocious battle that followed, the board along with KKR and other bidders progressively increased their bids to outdo each other. KKR subsequently won with its bid of US$31.1bil.

Due to tobacco legislation, RJ Reynolds was subsequently spun out of RJR Nabisco. Today, Nabisco is owned by Kraft Foods. The RJR Nabisco leverage buyout was considered as the unsurpassed example of corporate greed.

Time magazine featured RJR Nabisco president and CEO Ross Johnson on the cover of their December 1988 issue with the headline, *"*A Game of Greed: This man could pocket US$100mil from the largest corporate takeover in history. Has the buyout craze gone too far?*"*

Subsequently, the events were chronicled in the book, *Barbarians at the Gate: The Fall of RJR Nabisco* and later made into a television movie starring James Garner.

Fast food offer: CVC Capital Partners Asia teamed up with Johor Corp and EPF in a RM5.12bil buyout offer for KFC and QSR last year.

The emergence of private equity

Twenty-four years have since passed and the continued excitement in the PE landscape is becoming all too obvious. The appetite for risk is as strong. With internal rate of returns of about 25% per year, who wouldn't want to be in this lucrative business?

It is this appetite and interest which is nurturing new trends in the PE world.

For one, Asia Pacific is now becoming an increasingly attractive destination for private equity firms. The rise of Asian consumerism, coupled with the availability of diverse and attractive companies, have made Asia a hotspot for private equity fund managers.

Leverage buyout deals such as RJR Nabisco, while still being done, are executed on a much more conservative basis in Asia.

The phrase "private equity" which started catching on in the 90s is perhaps a makeover from the taboo leverage buyout term of the 80s.

Private equity today is more about value adding the operations and growth of a target company rather than simply leveraging on financial creativity to suss up numbers.

For the uninitiated, a private equity firm differs from a venture capitalist.

While a venture capitalist invests in an emerging company or a start-up, private equity firms invest in companies which are already in operation.

Typically, a private equity firm will raise pools of capital or private equity funds to acquire equity ownership in companies.

These are usually controlling or substantial minority positions. The private equity will then help the company grow and improve over a period of time. Its objective is to generate favourable returns for its investors over a certain duration. Finally, it exits the company either through an initial public offering (IPO) or through the divestment of its stake to a strategic shareholder.

Asia's share of global private equity investments has doubled to 21% in the past four years and that figure should continue to rise, according to McKinsey in its latest report.

McKinsey points out that the dramatic rise in Asia's private equity volumes could signal a global shift in deal flows, with the industry in Europe and the United States still subdued in the face of debt worries and weak employment data.

“There has been changes in private equity investing trend since the 2008 financial crisis. In the last three years, because of what has happened in the US and Europe, a lot of Asian businessmen are more open to private equity firms coming in to take up stakes, sometimes majority stakes,” says Asiasons Capital Ltd founder and managing director Datuk Jared Lim.

Clockwise from right: Asiasons’ Datuk Jared Lim, Ekuinas’ Abdul Rahman Ahmad, CIMB’s Darawati Hussein, Navis Capital’s Tan Chow Yin and Goldis’ Colin Ng.

“I just came back from the United States. There are many private equity investors who want to hear the South-East Asia story. Many of these investors have yet to craft a SEA strategy and now want to have a focus in this part of the world,” says Lim.

Private equity investments for Asia in 2011 hit US$65bil (RM201.5bil), up 63% from a year earlier. China continued its dominance, capturing 45% of the region's private equity investments.

“While that may be so, Asia's share of global gross domestic product (GDP) (on a purchasing power parity basis) is approaching 40%. As such, the share of private equity deals as a percentage of GDP and as a percentage of total mergers and acquisition is still very small, especially in South-East Asia, compared to more developed economies," says Navis Capital partner Tan Chow Yin.

He adds that there are interesting and suitable private equity deals in Asia.

"As businesses mature and the entrepreneurs get older, succession planning may become an issue. The entrepreneur may also not have the appetite to pursue more aggressive growth outside of his comfort zone. He may not want to sell the business entirely to a strategic investor because there could still be room for growth and untapped potential. An experienced private equity firm with the right skill-set and domain knowledge can then be a very natural partner. The private equity firm could be an active partner and bring in regional experience," says Tan.

"Going for an initial public offering (IPO) is no longer the only option. A lot of the small and medium industries, especially those that make a net profit of RM30mil and less, realise that by going for an IPO, they may not necessarily be getting good valuations," says Ekuinas chief Datuk Abdul Rahman.

Tan says that at the small and medium enterprise (SME) level, companies need to question whether the IPO market is right for them.

"In many instances, these SMEs should not be listed. First of all, they get very little coverage from analysts and then there is hardly liquidity in the trading of their stock. They may derive some prestige and other brand benefits from being listed, but their shareholders are largely passive. In contrast, Navis expects to be an active investor," says Tan.

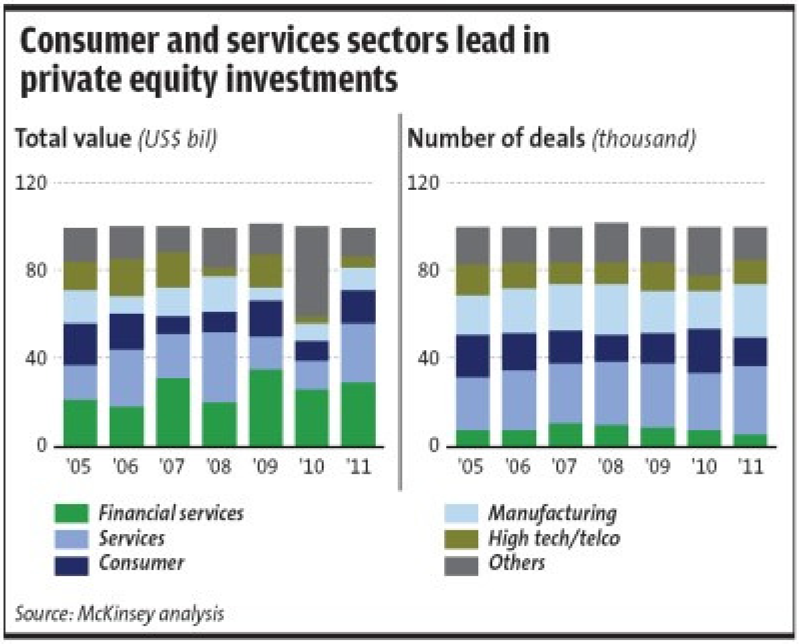
Lim agrees: "If the owner has no exit strategy and plans to make the company a family heirloom, then a listing is fine. However, if he intends to eventually exit his investment, an IPO may not be the greatest option especially if there are liquidity issues,"

Tan says that he sees a shift in the investing paradigm.

"Interestingly, on the Singapore Stock Exchange, there were only five IPOs in the first quarter of this year compared with six delistings. This may happen in Malaysia too. Capital is not scarce today. Liquidity or dry powder' is substantial. We are competing for deals with entrepreneurs, family offices, foreign strategics and foreign PEs, financial institutions, even government-linked entities. We must know what value we bring and how to find alignment with the entrepreneurs we back," he says.

CIMB Private Equity chief executive officer Darawati Hussain says there will be more interest in Malaysia, especially with larger deals happening.

"We are seeing a shift from government funding to private sector funding. People are beginning to realise that absolute returns from private equity is more lucrative. We can do 500 basis points better than capital markets. And PE firms are very aligned with investor interest. This is starting to perk the interest of the foreign players, as we are starting to see," says Darawati.



Rising interest in Malaysia

In 2011, Malaysia overtook Singapore and became South-East Asia's top investment destination. Private equity funds invested US$3.6bil (RM11.16bil) across 14 deals, a level that represents 50% of South-East Asia's total deal value.

Nonetheless, total invested funds in PE is only 1.6% out of a fund size of some RM400bil in Malaysia.

"If you were to compare the private equity penetration as a percentage of GDP of Malaysia versus other countries like Singapore or the US, it is actually quite low," says Darawati.

That rising interest in Malaysia is becoming evident.

UK-based CVC Capital Partners teamed up with Johor Corp and the Employees Provident Fund (EPF) in a US$1.65bil (RM5.12bil) buyout offer for Malaysia's fast food operators KFC and QSR. This made it one of the largest private equity deals in South-East Asia in 2011.

Another highly-publicised deal was Mitsui of Japan, which took up a 30% stake in IHH Healthcare for US$1bil (RM3.02bil). Khazanah Nasional Bhd owns the remaining 70%.

Come July 25, IHH Healthcare is offering 2.23 billion shares under its dual listing on Bursa Malaysia and the Singapore Exchange.

"I believe deal-making has always been quite active in Malaysia given our robust and rather diverse economy. Many people I know have made interesting, profitable private investments in the past. However, there are certainly more institutional-type professional PE players today than say 5 to 10 years ago," says Tan.

Certainly, the growth in the PE industry has been fuelled by a supportive government, in the form of government-linked investors like Ekuiti Nasional Bhd (Ekuinas), Khazanah Nasional Bhd and the EPF.

In 2011 alone, Khazanah invested about US$1.9bil (RM5.89bil) in 13 transactions and realised about US$660mil (RM2.05bil) in eight divestments.

The Government has, through the Securities Commission, established the Malaysian Venture Capital Development Council which is tasked to look into this specific issue of developing a more vibrant industry.

The birth of Ekuinas is the strongest signal that the Government sees potential in the PE industry. Ekuinas is Malaysia's PE fund management company established in 2009 to create next-generation leading companies, while promoting equitable and sustainable bumiputra economic participation.

With a total endowment of RM5bil to be provided by the Government, RM1.1bil has so far been disbursed. A further RM500mil-RM600mil will be given out this year.

The region's top deals in 2011 offer a snapshot of the landscape

Target	Investor	Deal size (US$mil)	Industry	Country
Skylark	Bain Capital	2,072	Services	Japan
KFC Holdings	CVC Capital Partners; Johor Corp	1,649	Consumer	Malaysia
Alibaba Group	DST Advisors; Silver Lake; Temasek Holdings; Yunfeng Capital; undisclosed investors	1,600	Services	China
MYOB	Bain Capital	1,253	High tech/telecom	Australia
Grand China Air	Hangzhou Jiuzhi Investment Management; Zhejiang Longsheng Group	1,232	Transport	China
360buy.com/JingDong Online	DST Advisors; Tiger Global Management; undisclosed investors	1,000	Services	China
New China Life Insurance	AXA PE; CICC Investment Management; CITIC PE; Hony Capital	984	Financial services	China
Tsubaki Nakashima	Carlyle	807	Manufacturing	Japan
Television Broadcast	Charles Chan Kwok Keung; Madam Cher Wang; Providence Equity Partners	806	High tech/telecom	Hong Kong
Valad Property Group	Blackstone	753	Financial services	Australia

Source: McKinsey analysis

"The scramble to invest in South-East Asia, coupled with the presence of more and richer PE funds has increased competition in the region. The natural consequences is a scarcity of high quality target companies and higher asset prices," Ekuinas says in its annual report.

For 2012, the largest PE deal so far has to be the buyout of SEG International Bhd (SEGi) by Navis Capital Investment Ltd and SEGi group managing director Datuk Seri Clement Hii on April 25 for about RM1.19bil. For Navis, this is its biggest deal in Malaysia so far,

Navis and Hii have made a general offer to privatise SEGi at RM1.714 per share and 1.214 per outstanding warrant. They intend to turn SEGi into a regional education player.

The privatisation offer has presently lapsed and it would appear that SEGi will continue as a listed entity.

Meanwhile, respondents to a 2011 Bain & Co survey of PE in South-East Asia cited the difficulty of finding attractive companies to invest in and the inflated price expectations of sellers as two of the biggest constraints on the industry going forward.

Also, the survey indicates returns are being squeezed in the region.

“The percentage of PE exits that earned a negative return increased slightly over the past year as those that realised an outsized multiple of more than three times investment dropped,” says the survey.

While the sector is improving, there are certain issues which still needs addressing.

Tan says policy improvements and secular trends that are good for the economy are also conducive for PE.

“We are excited about the Afta (Asian Free Trade Area) implementation and continued liberalisation of local ownership criteria in various sectors of the economy. Other shareholding restrictions should also be removed with harmonisation of rules for both public and PE investments,” says Tan.

Darawati adds that currently the outsourcing of funds for PE firms, while growing, was still relatively small.

“We are still not seeing the private sector doing it yet. Many still don't see PE as a choice asset class. For the sector to grow and become more sophisticated, we need more funds coming in,” says Darawati.

Abdul Rahman says that if there are any lessons from the West to be learnt, it is that leverage buyouts are risky and over-leveraging can bring about severe consequences.

“From the big boys in the West, we can also learn about creating operational values, not just financial value. This can be done through productivity, financial discipline and better strategies,” says Abdul Rahman.

Industry trends by McKinsey

PE deal value was up 40% last year, reflecting a rebound in the sector after a protracted downturn during the global financial crisis, according to a report by global management consultants McKinsey & Co.

Last year the total value of PE investments in Asia-Pacific reached US$65bil (RM201.5bil), a total not seen since 2008.

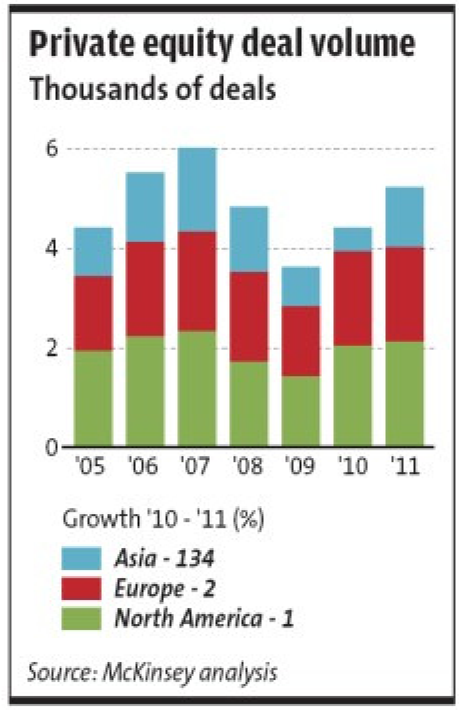
The number of deals in Asia rose from around 500 in 2010 to over 1,200 in 2011, representing a 134% growth rate. Although Asia is still down almost 30% by volume compared with before the global crisis which began in 2008, 2011 might mark a deeper shift in global deal flows toward the region.

Asia Pacific now accounts for 21% of global PE activity by value, bringing it closer to its 28% share of global GDP. The average deal size fell from US$150mil (RM465mil) in 2010 to US$90mil (RM270.3mil) in 2011.

However, McKinsey's research also shows that smaller deals are driving much of the industry's growth. So while deal volume doubled in 2011, the average deal size was substantially smaller than in the previous year.

One of the most striking changes in 2011 identified by McKinsey's research was the proliferation of smaller transactions.

The number of Asian deals valued at less than US$100mil (RM303mil) more than doubled. The larger deals those valued at more than US$500mil (RM1.5bil) that garner the most attention, demonstrated much less impressive growth, rising from 16 deals in 2010, to just 24 in 2011, well below the 37 large deals recorded in 2007, it says.



McKinseys says deal volumes in South-East Asia increased 39% last year, fuelled by a doubling of deals in Indonesia and a 67% rise in Vietnam. Of the recorded deals, almost half of the volume was in expansion-stage investments. But from a value perspective, the buyout stage was more prominent, accounting for about 52% of the total value compared with expansion's mere 12%.

By valuation, South-East Asia's 2011 performance was unique the region was the only major one in Asia, other than Japan, where deal values grew faster than deal volumes, with the average deal size increasing by 33%.

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