

VIDEO SERIES

Briefing



Investing in Southeast Asia

Experts discuss how positive trends make the region attractive, the impact of the economic slowdown in China, and deal flow.



Paul Kang
Headland Capital Partners



Michael Rogers
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Investing in Southeast Asia

Key Findings

1. Southeast Asia's potential for PE is driven by a range of positive trends
2. The slowdown in China has impacted Southeast Asia in various ways
3. There are compelling areas for deals in Southeast Asian countries
4. Deal flow in the region is diverse—and deals are getting bigger
5. PE is finding a variety of exit opportunities in the region

The Panelists



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→ CONTINUES ON NEXT PAGE

1 SOUTHEAST ASIA'S POTENTIAL FOR PE IS DRIVEN BY A RANGE OF POSITIVE TRENDS.

Early in 2015, an EY report on private equity in Southeast Asia called the region “one of the few growth hot spots” in the year ahead. Why is it on the front burner? There are a number of reasons. Demographically, Southeast Asia is getting younger, the middle class is expanding, and consumers are spending more. Cities are swelling rapidly, and infrastructure investment is rising.

Economically, Southeast Asian nations are transitioning from communist, nontraditional, or limited systems of capitalism to pure capitalism, a shift that portends even greater promise for the region, considering that it’s already a \$1.5T combined economy, on par with India.

Underlying these macro trends, there is a growing attitude among local company shareholders that private equity is a good thing. “You’ve had a generational shift within many of these economies,” says Paul Kang, a senior partner at Headland Capital Partners. “Businesses founded in the ’80s and ’90s have reached a certain stage of maturity, and people running those companies are asking, ‘What’s next?’ Added to that, you have a new generation who have studied abroad and may want to do something different. There’s not necessarily a hang-up about keeping the business in the family.”

Michael Rogers of EY notes that a significant amount of manufacturing is now exiting China for Southeast Asia. With higher wages and other costs moving up the value chain in China, multinationals are moving down the map to countries like Indonesia, Vietnam, Cambodia, and Myanmar, where wages are often up to a third lower than in China’s manufacturing centers.

“We’ve seen in Latin America, for example, that countries in the Pacific Alliance have broken down trade barriers,” Kang adds. “I see something similar on the horizon in Southeast Asia. Overall, if you look at the size, the scale, and the consumer interest of the population, you see a very attractive market.”



Indonesia Emerging

Paul Kang
Headland Capital Partners

The Indonesian economy has gained momentum of late, bringing to life the country’s nascent private equity market. So what are some of the features that make Indonesia a distinct private equity opportunity?

“It has a population of over 200M, and it’s the largest core of the Southeast region,” Kang says. “The population is relatively young. Infrastructure is somewhat underdeveloped. Those elements lead to the proposition that inward investment should earn a pretty good return.”

In terms of emerging sectors for PE investors, he points to consumer goods, healthcare, and education as the most promising. “There are sectors where we think you’ll see above-average growth,” he says.

However, he quickly adds, finding good deals in those sectors could pose a challenge. “Healthcare as a macro opportunity is very interesting, but the healthcare space isn’t all that deep,” he says. “So if you’re looking for investable businesses of scale, there aren’t many opportunities.”

Kang notes that healthcare deals in Indonesia come with restrictions on foreign ownership that can make acquisitions tricky for PE investors.

→ CONTINUES ON NEXT PAGE



Inherent Advantages

Mike Rogers
EY

The fledgling Indonesian private equity market has a number of inherent advantages that set it apart from other emerging regions. Perhaps the largest is Indonesia's already established expertise in the consumer packaged-goods space, which is always a popular area of investment among PE practitioners. "The food and beverage arena is something that Indonesia is known for and has been an attractive entrance point for a lot of private equity into that market," Rogers says.

He adds that Indonesia benefits from its strategic geographic position in the market and the country's long history of conducting trade and commerce with other nations in the region. "Indonesians are known to be good traders, international traders," Rogers says. "Those are concepts that private equity looks for. PE likes to grow the geographic footprint of its investments, and folks in Indonesia are known for having that skill set and that trading mindset."

2 THE SLOWDOWN IN CHINA HAS IMPACTED SOUTHEAST ASIA IN VARIOUS WAYS.

The economies of Southeast Asia are heavily influenced by their neighbor to the north. China has now eclipsed the U.S. and become its largest trading partner. But the slowdown in China's economy is weighing in various ways on different sectors of the economies of Southeast Asia.

"If you look carefully at capital flows and trade flows between the nations, a lot of what's being exported from Southeast Asia to China is actually resource-related, whether it's energy or soft commodities," says Wen Tan, a partner at FLAG Capital Management. "So the slowdown in China impacts various Southeast Asian countries in different ways. In some cases it is quite noticeable." For example, China's slumping demand for energy has hit particularly hard in Indonesia, the world's largest exporter of coal.

Set energy aside, though, and the slowdown in China has likely had less impact on Southeast Asia's overall growth than recent capital flows and the strong U.S. dollar, Kang observes. "And that's going to continue with QE tapering. That's potentially a cloud on the horizon with respect to Southeast Asian consumer expenditures and inflationary pressures within those economies. We've already seen currencies throughout the region depreciate significantly over the last 18 to 24 months."

3 THERE ARE COMPELLING AREAS FOR DEALS IN SOUTHEAST ASIAN COUNTRIES.

Southeast Asia is a large and diverse place, but there are investments whose appeal spans the region. Education is one. "If you look at where Asians are driven to spend, it's an aspirational space," Kang says. "It's sending their kids to schools with the view, ultimately, to have their children educated abroad. In that respect, the education sector—particularly the private education sector—is a very interesting opportunity. We've made a couple of investments, and they're doing very well."

Tan advises PE professionals interested in Southeast Asia to investigate the "consumer upgrade" sector, a broad category encompassing industries including education,

→ CONTINUES ON NEXT PAGE



Picking PE Winners

Wen Tan
FLAG Capital Management

Indonesia may one day be Asia's next economic powerhouse, but it still has a distance to travel—at least in terms of private equity investing. Of course, that's not a bad thing for investors who want to get in early.

"Unlike many of the other markets within the region, there's really a very shallow pool of investable GPs in Indonesia," Tan says. "But from an LP perspective, that actually makes it attractive, given the relative lack of competition."

In particular, Wen says, he sees opportunity to back private equity players that will one day emerge as industry leaders. So what does he look for in GPs, and how does he know who will ultimately succeed?

"From the point of view of most LPs, you wouldn't necessarily back a startup manager," he says. "That manager needs to have a verifiable track record within an Indonesian context. So really what the LP community is dependent upon are spinouts of individuals from some of the more established local Indonesian GPs or the Indonesian teams of pan-regional GPs."

bring in the bigger global private equity houses. On the one hand, there's more competition, greater liquidity driving valuations upwards. On the other hand, it's a validation of the opportunity."

5 PE IS FINDING A VARIETY OF EXIT OPPORTUNITIES IN THE REGION.

There is no greater stimulant for private equity than a healthy flow of rewarding exits. Private equity in Southeast Asia over the past 10 years has been more buyout-focused than in China and India, and this has meant that, despite the global weakness in public markets globally, there has been an avenue for exits in Southeast Asia. "Distributions have not been too bad in the overall context of emerging-market private equity," Tan says, "especially for funds that have a large buyout component."

As private equity in the region matures, exit opportunities are multiplying. A decade ago, most exits were driven by sales to strategic buyers or other financial buyers. Now, with increasing capital market liquidity, dividend recaps are a possibility. Exits via IPO, which have been challenging in the past, are getting easier.

"Where you have increasing liquidity chasing up valuations, we'll start seeing more and more secondaries," Kang says, "private equity owners selling to other private equity firms. With respect to liquidity alternatives in Southeast Asia, it's a pretty healthy environment right now."

Rogers adds that, while he's heard individual investors wish for more exits, the data shows an upward trend in exits from many of the countries in the region. "If you look at the actual information, you'll get yourself more comfortable that there has been a nice track record of exits in Southeast Asia." ■

Expert Q&A

With Michael Rogers,
Global Deputy Sector Leader,
Private Equity,
EY



How does EY support its emerging markets clients?

Rogers: We bring the firm's full scope of resources to bear from a tax perspective, an advisory perspective, and a transaction perspective. In many cases, we might provide the assurance relationship as well. So it's really our job to follow the footprint of our bigger clients, all the way down to the smallest local funds where we can add significant value.

We've been focusing on emerging markets private equity for some time now and it really comes in three different buckets. What we like to do is support those funds that are in these markets directly that are growing and thriving and raising capital. There's a whole suite of skills and support that we can provide those funds.

Then we like to support the pan-regional funds as well. And there are more and more of those. We're seeing those bucketed in Southeast Asia, in Latin America, and also in Eastern Europe. Some folks are just focused on those markets, and so we will reach across borders and support those investments that might touch multiple jurisdictions and multiple countries

And lastly, we try and follow our large global clients around the world. So even though some of these funds might be based in London or New York or San Francisco or in Singapore, they might have an interest in doing deals in any market that we could name around the world. ■

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About Privcap Media

Privcap is a digital media company that produces events and thought-leadership content for the global private capital markets. Privcap Media offers communications services to market participants.

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