

China heads rising private equity investor interest in emerging markets

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Foreign players are staying on the sidelines in both China and India, giving local companies the opportunity to conclude more deals in their stead, say fund managers.

By Ruth David

Emerging market economies might be getting more risky in the global economic downturn, but private equity investors plan to invest more into them, according to results from the EMPEA/Collier Capital Emerging Markets Private Equity Survey.

The survey, published on April 6, elicited responses from 156 investors across the globe. Around 77% of the respondents expect emerging market private equity investments to offer annual net returns of over 16% in the next three to five years, compared with just 43% of respondents expecting such returns in the market as a whole.

China continues to be considered the most attractive emerging market among respondents, followed by Brazil, which moved up to second spot from fourth place in last year's survey. India and Central and Eastern Europe both fell one notch, to third and fourth places respectively.

"Investors recognise that emerging economies are the only ones still growing, and they also know that, since private equity deals in emerging markets don't rely on debt, the collapse of the global leveraged finance markets won't impede deal flow," said Sarah Alexander, president of the Emerging Markets Private Equity Association (EMPEA).

Last year, 210 private equity firms focused on investments in emerging markets raised US\$66.5 billion in fresh capital, 12% up from US\$59 billion raised in 2007, EMPEA found.

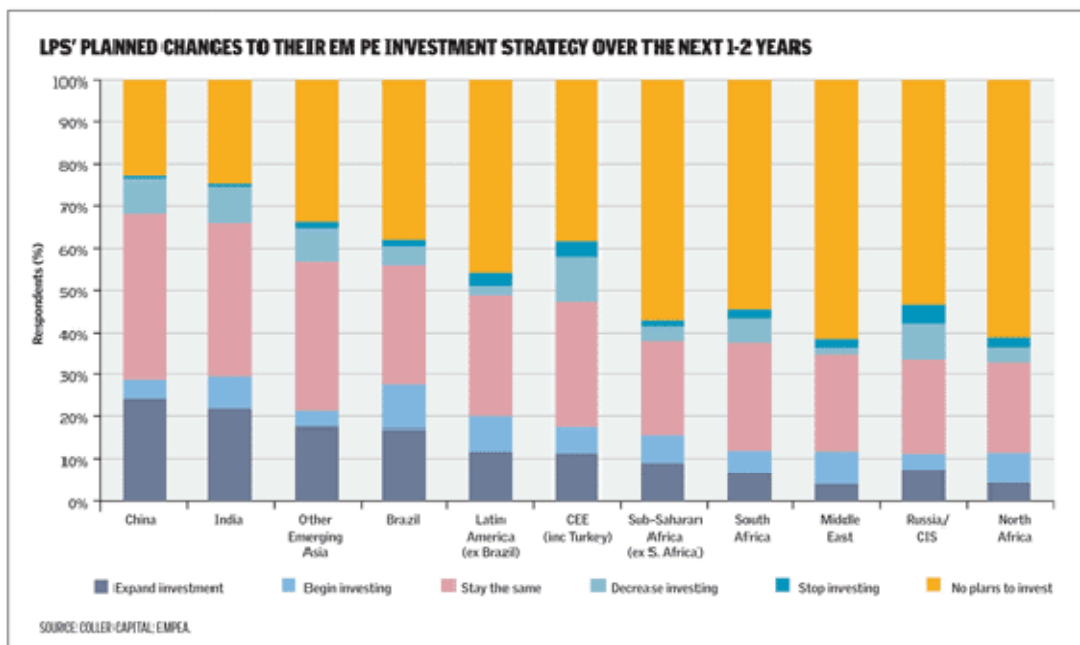
Investor annual return expectations from investments into emerging markets remain at around 25%, with investors typically looking at an investment time frame of between three and five years. But valuations are down and competition from global bank private equity divisions and hedge funds has decreased from the levels of last year, said Supratim Basu, managing partner at Frontline Strategy.

The study found that 62% of limited partnerships invested in emerging markets plan to maintain or increase their new commitments in 2009. The 38% who expect to reduce their new commitments cite cash constraints and over-allocation to private equity as the key reasons.

While investors are keen on emerging markets, the survey discovered that the risk premium required to conduct buyouts in these markets relative to developed markets had risen to 7.2% in 2009, compared to 6.7% in 2008. The only emerging economy whose perceived risk premium had dropped from last year was Brazil.

Private equity investors away from the survey estimate that the risk premium for India has risen in particular, from around 7%-8% last year to 12%-13% currently.

“Equity risk premiums in India had come down substantially in 2007-08, now they’re back up with a vengeance,” said Basu.



China deal slowdown

Despite the confidence of the survey’s respondents in opportunities in China, private equity deal activity in the country has slowed down.

“Valuations are down in China but funds are still taking two to three times longer than they did last year to make decisions on deals,” Richard Lim, managing director at GSR Ventures, told asiamoney.com.

“There is still growth in the space but competition for deals is now more domestic. At the beginning of last year there were a bunch of US funds that had set up offices and were trying to make investments. We’re not seeing that this year,” he said.

“If private equity investments this year hold at 2008 levels, it will be a successful year,” added Jesse Parker, managing director at Dragonvest Partners. “The number of deals done this year will be greater, though the value of overall investments could be the same or lower.

“This year is a very big investment opportunity for us. Valuations are reasonable and the investment direction is pretty clear. Sectors led by [the Chinese] government initiatives especially will accelerate pretty quickly,” Parker added, pointing to his fund’s interest in clean technology companies that stand to gain from the state’s infrastructure-related spending in China.

A key trend in China, and to an extent India, is the emergence of domestic private equity funds. In 2008, domestic venture capital funds accounted for 270 deals in China, compared to the 296 from their foreign counterparts, according to market research firm Zero2IPO Group.