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# The Asian elephant in the room

*China's private equity slowdown is causing both LPs and GPs to rethink their approach to the Asia-Pacific region, writes [Alex Lynn](#)*

Shifting appetites for Chinese private equity are helping to reshape the look and feel of Asia-Pacific private markets. It is within this context that four industry experts came together in early August to discuss the region's future.

APAC funds closed on \$16 billion in the first half of 2023, around one-third of the \$44 billion collected by European funds and less than half of the \$37 billion raised by APAC funds in H1 2022, according to *Private Equity International* data. Only 57 APAC funds reached a final close in the first half, putting 2023 on track to finish well below the 266 closed throughout 2022.

"In the mid to late 2010s, Asia was approaching 25 percent to 30 percent of global private equity," says Doug Coulter, partner and head of private equity Asia-Pacific at LGT Capital Partners. "However, the investment landscape has changed substantially, not least because of higher interest

rates in the US, or the occurrence of economic factors like the denominator effect.

"There is also the question mark on China, by far the largest private equity market in Asia. In fact, for probably a majority of Western LPs, 'Asian private equity' has effectively meant 'Chinese private equity' during the past decade. Some LPs at least are calling into question whether excellent returns at scale are achievable in the current Chinese market environment... Hence, from a risk/reward perspective, it might be more attractive for them to keep their money closer to home and invest in treasury bonds or US mid-market buy-outs. All of these things are conspiring to make life more difficult for Asian GPs."

China's private equity market has faced a confluence of headwinds in recent years, including a regulatory crackdown in 2021, deteriorating geopolitical tensions with the West and travel disruption from the pandemic. "All those negative elements have

come together as really a perfect storm around China," notes Mingchen Xia, managing director and co-head of Asia investments at Hamilton Lane.

"Some investors wanted to deploy more in the non-China parts of Asia, but if you ask LPs from different markets, the answer can be very different. Typically, a lot of US-based LPs feel more cautious and reluctant on China, but many Asia-based LPs, European LPs and, more recently, Middle East LPs are trying to actually deploy more capital to this region."

These factors have contributed to a dramatic slowdown in China fundraising. Funds headquartered in mainland China and Hong Kong raised just \$8.2 billion in the first half of 2023, on track to fall well short of the \$28.2 billion raised throughout 2022 and \$51.3 billion raised in 2021, according to *PEI* data.

"Our general sense is that it's the international sponsors that still have traction in the course of fundraising," says Shawn Yang, a partner at Debevoise &



### **Heath Zarin**

Founder, chairman and CEO, EmergeVest

Heath Zarin began his career as a fund formation lawyer with Schulte Roth & Zabel, before joining DLJ Merchant Banking. He relocated to Hong Kong in 2006 to set up Credit Suisse's Asian private equity business, before leaving to form Emergent Investment Group. In 2010, Zarin joined HSBC in Hong Kong, before creating EmergeVest in 2013.

### **Doug Coulter**

Partner and head of private equity Asia-Pacific,  
LGT Capital Partners

Doug Coulter heads the private equity Asia-Pacific team for LGT Capital Partners. Prior to joining the firm in 2007, he was a senior investment officer for the International Finance Corporation, based in Hong Kong and Washington. Coulter previously worked at Nomura Securities and was a lawyer at Fasken Martineau DuMoulin.



### **Mingchen Xia**

Managing director and co-head of Asia investments,  
Hamilton Lane

Based in Hong Kong, Mingchen Xia has responsibility for primary and secondaries investments. Prior to joining Hamilton Lane in 2014, Mingchen was a senior fund manager at Tokio Marine Asset Management in Japan, where he was responsible for private equity fund investment globally. Previously, he worked at Mitsubishi UFJ Securities and Mizuho Securities.



### **Shawn Yang**

Partner, Debevoise & Plimpton

Shawn Yang is part of Debevoise & Plimpton's investment management group and is based in Hong Kong. He focuses on private equity fund formation and secondaries. Yang has represented clients including Baring Private Equity Asia, KKR, Clayton, Dubilier & Rice, Ontario Teachers' Pension Plan and HarbourVest.



Plimpton. “That said, even for certain international clients, there’s a regulatory overlay: people have been talking about reverse CFIUS [Committee on Foreign Investment in the United States] for many months now, and there’s a general angst as to what that might ultimately look like. Even if you weren’t purely China-focused but had significant exposure to China and one of your sources of money was US pension plans, people are wary as to what that might look like.”

This is not to say China funds aren’t getting raised full stop. Notable examples this year include Primavera Capital Fund IV, which raised \$4.1 billion against a \$4 billion target, and Nexus Point Partners II, which closed on \$600 million against an unknown target.

“We are raising a few China-focused funds at the moment and have seen successful closings – though perhaps not at the size of past years – so, even in a down market, there are outperformers,” Yang adds. “What helps to raise money in this environment is a proven track record – not only in terms of IRR, but an ability to demonstrate that you’re able to return capital.”

### Analysing risk

For some participants in Asia-Pacific – be it LP or GP – this uncertainty may feel like familiar territory.

“There seems to be a recurring cycle of asking whether China and the US are decoupling from each other, and why we should invest in Asia or take exposure to this particular market at any moment of time,” notes Heath Zarin, founder, chairman and CEO at EmergeVest.

“Right now, the pendulum has certainly swung towards ‘Why should we take China risk?’ and ‘Are we being compensated enough for that risk?’, compared to ‘What can we do in markets that are perceived to be safer?’. That gets to the question of persistence of investment success and whether strategies that have been successful

in driving returns and generating value during this last cycle will continue to be successful or appropriate for the time period that we’re in right now.”

Some alternatives managers have attempted to cater to shifting LP appetites by offering the ability to opt out from China exposure. Hong Kong real estate firm Gaw Capital Partners, for example, created a separate sleeve in its seventh flagship vehicle for North American investors that did not want exposure to that market, affiliate title *PERE* reported in January.

Yang says: “We do have conversations with sponsors on how to answer that question from LPs who have

expressed the view that ‘We don’t want any exposure to China’, or ‘Do a sidecar for us’. That might be one approach.

“Agreeing to unilateral excuse rights may show less conviction in a strategy that you’ve been following for a very long time and could be difficult to administer. Where practical, we try to steer the conversation towards investment restrictions and providing the sponsor with a bit more room to take a disciplined approach towards China. There is, however, more room in the context of sidecars, as that tends to be catered to a specific client/bespoke investment strategy.”

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**HEATH ZARIN**  
EmergeVest

Other GPs have attempted to navigate LP concerns by rebranding themselves as pan-regional or even global players, with some establishing a presence in Singapore to that end. “One of the themes that we’ve seen in the past few years is sponsors pivoting away from China or going out with a China-plus-one strategy,” Yang adds, “although we also have seen sponsors lean into it, doubling down on their ability to outperform in a tough environment despite the issues.”

LP reception to this dynamic appears to be mixed, Coulter notes. “I think for many market participants, it lacks credibility when a GP that has done 100 percent of its deals in China, or for a pan-regional manager where China has been a big part of the investment thesis, suddenly changes the strategy to cross-border China or tries

to build capabilities in other Asian markets where they have perhaps not been active or less successful historically.

“It does not mean the new strategy is not going to be successful going forward, but investors certainly should proceed with caution. If Western LPs are rather less interested in Chinese or Asian markets today, it would make more sense for GPs to raise smaller funds and keep doing what they are good at. Time will tell whether the caution of investors with regard to China might well be a short-term phenomenon.”

Of course, some GPs and LPs retain conviction in Chinese private equity, says Xia. “This environment provides a good opportunity to test GPs to see if they have the capability to navigate this very volatile and difficult time. Some of

the mediocre GPs have already faced a lot of difficulties in raising their next funds, and they may disappear – it’s a process of natural selection. Because the overall market has slowed down a lot and not as many good GPs are coming back to market, naturally our investment pace has slowed down a lot as well in China. We still want to keep a relationship with strong GPs, so will try to re-up with those GPs even in this environment, if we can.”

EmergeVest, for its part, spies opportunities relating to China’s shifting geopolitical role, says Zarin. “When we’re having conversations with our LPs... we do get a lot of questions about China risk: how it will impact our existing portfolio and how it informs our investment strategy going forward. We continue to be optimistic and bullish on China over the medium term.

“We are an industry-focused GP: one of our... sectors of interest [is] supply chain and logistics, and China is the second-largest market in the world for that sector. So we continue to believe that it’s a very attractive investable market, combined also with the fact that, as

### Second chances

#### Asia-Pacific's stagnant secondaries market still holds promise for the future

In addition to the wider private markets slowdown in the region, APAC's secondaries markets have been quieter of late. APAC accounted for just 6 percent of global GP-led deployment in H1 2023, according to PJT Park Hill. APAC asset activity – defined as any LP selling APAC positions, or an APAC GP-led – fell to \$6 billion in 2022, down from \$7 billion in 2021, according to Greenhill.

“While Asia has always been a relatively small, though fast-growing, part of global secondaries volume, we are not likely to see growth this year,” says Coulter. “Most of the investment committees signing off on Asian deals are based in the US and Western Europe, and many do not have offices in Asia to properly assess the assets that are on the market.

“Therefore, in the current environment, they often shy away from the potential regulatory, currency and geopolitical risks that are involved in such transactions. Ultimately, I think current demand is less than the supply of deals. That said, for LPs... that have large, local teams across Asia, the next few months could end up offering very interesting opportunities on the secondaries side.”

As with global markets, LP-leds have been more prevalent this year than GP-leds, says Yang. “More of our time is spent on LP portfolio sales rather than continuation funds. There were a number of continuation funds in the market about a year ago, and our sense is that there's been a bit of a pause as investors are becoming more discerning. On the LP portfolio side, we're seeing a number of sales being driven by regulatory restrictions forcing certain institutions to sell off fund interests.”

This isn't to say that GP-leds won't resume at scale, Zarin notes. “There's a backlog of opportunities that will be coming to market in the GP-led space, although it'll probably be testing the market in a much more quiet way to avoid the risks around broken deals or unsuccessful processes.”

Secondaries remains an intriguing opportunity set within China. US dollars represent just a small portion of China's domestic private equity market, which in recent years has seen RMB-denominated fundraising and investment activity rocket. Hamilton Lane, for its part, launched a dedicated RMB secondaries strategy earlier this year via China's Qualified Foreign Limited Partnership programme.

“The goal of our RMB secondaries strategy is to use this as a tool to get access to this market and then explore the opportunities to raise an RMB fund from domestic LPs,” Xia says.

“LP interest deals are still very dominant on the RMB side – last year, we saw two or three GP-led transactions, but they were very small and, to be frank, the quality of the GP has been pretty mixed. If you are talking to some government funds or [state-owned enterprise]-related funds, their attitude on pricing and discounts can be very different: sometimes they are very sensitive because they will have to explain that discount to the government or their parent company, etc. On the other hand, if the seller is a real estate developer and they really need liquidity, the discount could be 50 percent.”

supply chains and logistics shift, there's greater growth in the rest of Asia as a 'de-risking' of China.”

#### One market's loss

Though by far APAC's largest market, China is by no means the only option. Indeed, increased caution towards the country means some LPs and GPs are looking elsewhere in the region.

“The temperature of the raising market has differed across Asia-Pacific,” says Xia. “Some markets like Japan, Korea [and] Australia have attracted more capital, or at least interest, than before. Those markets have made up some of the loss in China, but because China is so big, we've still seen a very dramatic drop in Asia-Pacific on an aggregate basis.”

BPEA EQT's Baring Asia Private Equity Fund VIII was last year's largest APAC fund close, at \$11.2 billion. The next largest were FountainVest Capital Partners Fund IV on \$2.8 billion, Qiming Venture Partners USD Fund VIII on \$2.5 billion, and Australia's BGH Capital II on \$2.5 billion.

Zarin says: “Interest in some more developed markets like Australia and Japan might be higher because it's probably a little bit easier to plot the dots and see that strategies that have been successful previously will continue to be successful, whereas there are much bigger questions around China in that way.”

Australia in particular appears to be attracting interest, says Coulter. “Australia is a pretty interesting hunting ground. It has a relatively decent number of small mid-market buyout shops, and one thing a lot of them have in common is that they have been pretty good about velocity of capital, selling companies, quickly distributing cash back to LPs and generating good DPI.”

India is also often touted as an alternative destination for private capital due to its economic trajectory bearing similarities to that of China.

“India is a \$4 trillion economy, while China is an \$18 trillion economy, so you may think that alternative asset managers should not have too much capital on the ground in India,” Coulter adds. “However, unlike many of our competitors, we have always been overweight [to] India, averaging around 20 percent India in our last five Asia funds. We took this call a number of years ago, following a significant devaluation of the rupee against the dollar, as it looked like a good opportunity to put more money to work in India. And interestingly, our returns in India have been as good as they have been in China.”

Other GPs appear to concur. India’s share of Asia-Pacific’s private equity deal value grew to 23 percent in 2022, compared with a 17 percent average in

the previous five years, according to Bain & Co’s *Asia-Pacific Private Equity Report 2023*. Meanwhile, China’s share dropped from 46 percent to 31 percent in 2022.

India is not alone in benefiting from shifting geographical appetites, says Zarin. “The main beneficiaries of de-risking supply chains that some perceive may be overly dependent on China are Southeast Asia and the Indian subcontinent. If you’re in the apparel or soft goods space, then Bangladesh and the India subcontinent are benefiting by far; for broader types of goods, like electronics and footwear, Vietnam, Thailand and Cambodia would all benefit from that.”

However, looking further afield in APAC is not without its challenges, Coulter notes. “China is by far the

largest economy and the largest private equity market in Asia. Hence, whether you are a GP or an LP, it is hard to make your numbers work without China, because the reality is that while India, Australia, Japan and Southeast Asia have some great managers and nice dealflow on the direct side, they are much smaller, much more shallow markets relative to China.”

Hamilton Lane, for its part, is cautiously optimistic about the potential opportunity set, Xia says. “Historically, our Asian exposure has been very China heavy, but now we’re trying to build a more balanced portfolio in Asia by adding more buyout exposure, including across Japan, Korea and Australia, and more selectively also looking at India and Southeast Asia.

“The headline numbers sometimes look lower than some of the high-performing China VC or growth funds in history, but if you calculate the risk you are taking and the volatility on the VC/growth side, on a risk-adjusted basis, we still think the buyout funds in Asia make a lot of sense for our portfolio. The downside is that the number of investable or good managers is still relatively smaller in China, so you have to be very careful: a common issue with those managers is the wide gap between gross and net IRR.”

#### Driving deals

Like many of its global peers, China’s private equity and venture capital market had previously been extremely hot when it comes to valuations, says LGT’s Coulter. “In 2020 and 2021, there were some pretty excessive multiples and managers overpaying for deals, which is what some players in the industry are worried about.”

One consequence of APAC’s fundraising slowdown on the US dollar side is less competition for assets. “We believe it’s really a good time to make new investments at a relatively reasonable valuation,” Xia says. “When the consumer market was hot two or

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LGT Capital Partners

three years ago, valuations were high as money flooded into the sector, but a few years later many companies are struggling. However, good companies have survived and are now raising the next round, either at a much more reasonable valuation, or the valuation itself may not come down, but the underlying operational performance has grown.”

EmergeVest is among those snapping up assets across the region, Zarin says. “Even during boom times, we systematically have made acquisitions below 8x EBITDA, and in the last 18

months we’ve done four add-on acquisitions for [logistics business] EV Cargo – all below that level.

“There’s an additional factor in global supply chain and logistics at the moment, which is we’ve been through such a period of disruption that there are probably more small businesses available for sale than has been the case for quite some time. And we see that particularly being the case across continental Europe [and] also across key markets in Asia.”

That said, global dealmaking in 2023 has been hindered by a tightening

of debt markets, Zarin adds. “Rising interest rates are having an impact on M&A within leveraged buyout-type strategies, including our own, where cost of capital has gone up. There’s a less mature leveraged finance market in Asia for mid-market businesses, but we have benefited in that our platforms also have a linkage with Europe, and so we’ve been able to secure financing in Europe to help drive our strategy.

“The next phase of this higher interest rate environment is that many corporates need to reevaluate their strategy and decide who they are and who they want to be for the next 10 years. As a result, there’ll be many bull market bets or bull market positions that will need to be unwound, and so we’re expecting to see a pretty big opportunity for buyouts in Asia arising from corporate restructuring.”

Debevoise’s Yang notes that APAC funds may wish to be tactical with their deployment, considering the challenge in raising fresh capital this year. “For the sponsors that have dry powder and are in a very good position to deploy capital, we’re seeing more co-investments. Strategically, that’s very smart because you’re doubling down on your LP relationships, bringing down the management fee rate across the portfolio and you’re also slowing down the deployment rate to your next fund.” ■