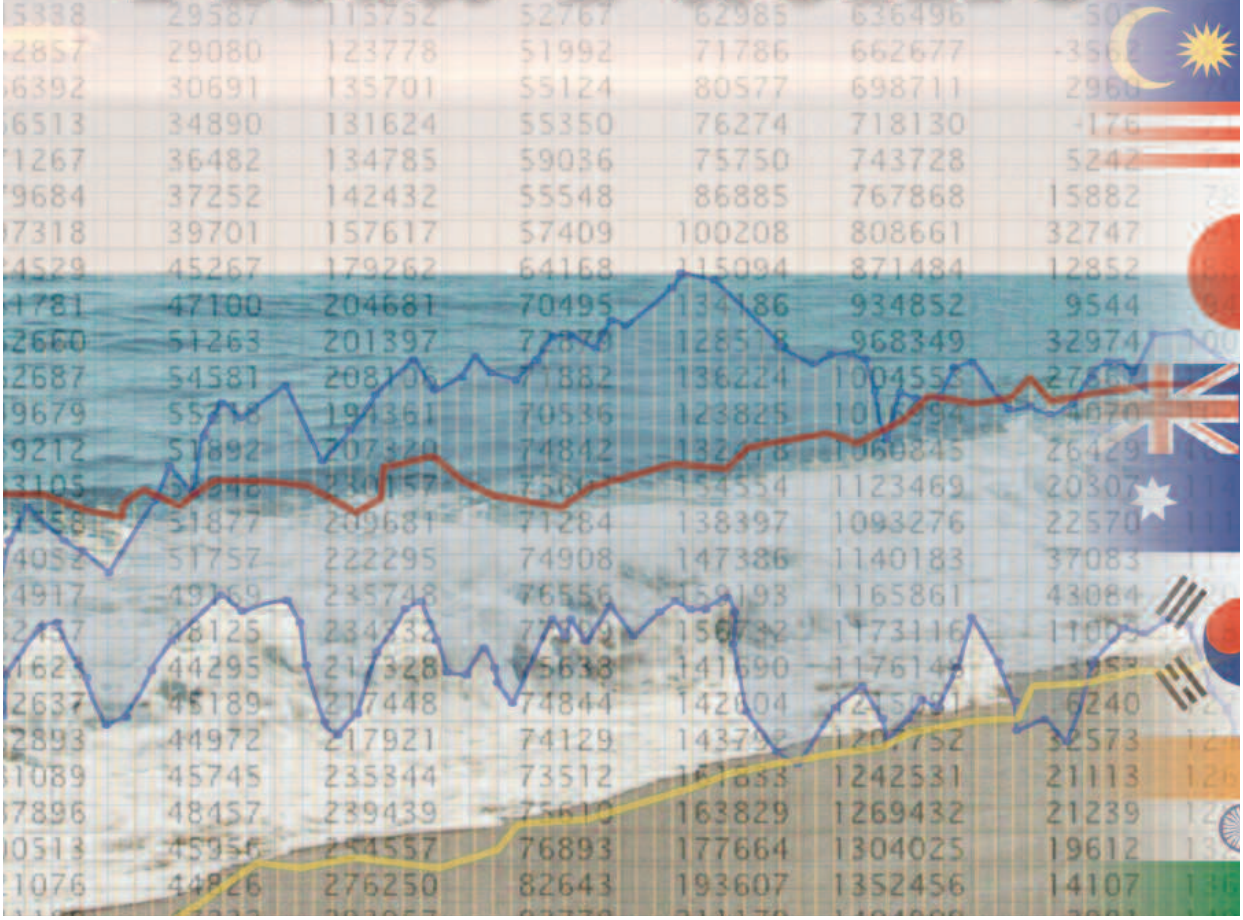
EYES ON WORLD MARKETS

Asia Pacific



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Southeast Asia
Lures Private Equity

By Laura Dodge

While South Korea, China, and Australia have seen some of this year's biggest mergers and acquisitions, Southeast Asia's market has been inching quietly, if slowly, ahead. Eight years post-crisis, some of Southeast Asia's most developed economies are stuck with the same stumbling blocks investors have faced for years: overseas Chinese family-controlled businesses closed to outside investors; unreliable and at times opaque regulatory environments; and political risk. Yet there are signs that things are changing, and private equity, in particular, is poised to pounce.

First, the bad news. Political issues in countries like Indonesia, Malaysia, and the Philippines increase the risk of mergers and acquisitions. Indonesia, for example, is racked with Christian-Muslim tensions, separatist movements in two provinces and, in the first week of October, public outrage at the reduction of government fuel subsidies and bombings in Bali.

Malaysia's "relentlessly average" GDP growth and slowing exports, according to a recent UBS Securities report, put something of a damper on the investment climate. Leverage and capitalization rules there also make large M&A transactions difficult. Thailand, meanwhile, remains a largely insular business community despite an influx of private equity since 1997.

For the private equity funds flowing into Asia, the lack of buyout opportunities in Indonesia, Malaysia, and Thailand can be a deterrent, since "private equity wants its feet on the board—it wants control," as Nicholas Bloy, founder and partner of Navis Capital Partners, puts it (see p.13). Private equity, he says, is a very demanding form of capital, and the Asian M&A market has been driven by institutions wanting to invest in buyouts. Most successful buyout stories have been in markets like South Korea and Japan, with foreign buyout firms acquiring distressed assets and turning them around. Comparable examples in Southeast Asia are harder to come by in part because the regulatory and political environments make buyouts more difficult.

"The problem in those [Southeast Asian] markets is definitely one of control," according to Dennis Melka, the Singapore-based partner at venture capital firm Mass Market Ventures.

The market for buyouts in Southeast Asia is made more difficult by the ever-present overseas-Chinese family business. "You have very established, very shrewd family groups that have been doing business there a long time," says Melka. "Sometimes these families can spot an opportunity well before the private equity guy gets off his plane from Hong Kong or New York."

Keith Johnson, the head of Linklaters M&A practice in Hong Kong, agrees. "Most Southeast Asian companies are tightly family controlled," he said. "A lot of intra-regional M&A is small-scale, family-to-family. What will be interesting is if the PE [private equity] guys get in on that."

Meanwhile, international investors face competition from local giants like Temasek Holdings, the investment arm of Singapore's government, and its counterpart in Malaysia, Khazanah Nasional Bhd, both of which have been actively acquiring Indonesian assets. Khazanah's recently acquisition of controlling shares in Bank Lippo comes on the heels of the acquisition by Singapore's second largest lender, United Overseas Bank, or UOB, of PT Bank Buana.

Despite these challenges, money is flooding the region: between $8 and $12 billion in private equity funds was raised in the first half of the year, versus $6.5 billion for all of 2004. This suggests that either Asia offers great opportunities, or, perhaps, that too much money is chasing too few deals.

Bloy believes that while there may be a short-term risk of a deal shortage, "Asia is the next frontier." With the ongoing restructuring of the region's financial sector, private equity investors are hoping they can repeat their success in South Korea, where global buyout firms acquired, restructured and sold off distressed companies—with great returns.

With many such strategic opportunities already taken up in South Korea and Japan, capital is now scouring Southeast Asian countries for similar prospects. Singapore may be ripe for this kind of M&A activity. Says Crispin Rapinet, the Asia managing partner at Lovells, "In Singapore, M&A volume has been much smaller than in Japan or China, despite the government issuing an edict encouraging government run companies to divest themselves of their non-core assets."

In terms of private equity flows, Johnson reckons that Asia is where the United Kingdom was five years ago, and growing fast. "The number of people on the ground is building up, and it's happening on a weekly basis," says Johnson. Private equity accounted for 0.05 percent of the GDP of the 10 members of the Association of Southeast Asian Nations (ASEAN) in 2004, compared with 0.77 percent of the GDP of the European Union, according to Bloy.

This low base of funds, combined with a rising demand for capital, increases the region's allure for buyouts and other types of M&A. The Indonesian government, for example, is encouraging private investment in public infrastructure projects. Bank Indonesia has announced the consolidation of the country's more than 130 banks. Accordingly, private equity invested in Indonesia has jumped by more than 10 times in the first half of this year compared to the same period last year, to $564 million, according to *Asian Venture Capital Journal*.

Colin Banfield, head of non-Japan M&A at Credit Suisse First Boston, says that while sociopolitical risk is higher in Indonesia, the country offers investors in corporates some handsome assets. Temasek has acquired stakes in Bank Internasional Indonesia and Bank Danamon Indonesia Tbk, whose credit ratings have subsequently gone up. Perhaps the best indication of renewed interest in the country's large corporates was Philip Morris International's $5 billion offer for cigarette company Hanjaya Mandala Sampoerna Tbk.

Consolidation in telecommunications and resources is also driving M&A activity across the region. ASEAN's 10 member countries control 40 percent of the oil and gas resources in the Asia-Pacific region, and the hunger for resources is spurring investment in these and related industries, such as marine transportation and exploration. "The resources sector has been extremely active," says Johnson, "and it's not just oil. There's a need for steel, aluminum, and other minerals."

It's the growing consumer base that may offer the best, untapped potential. The post-Asian crisis economic rebound has led to a concomitant rise of a middle class with money to spend. As a combined entity, ASEAN's consumer market is roughly the size of China's coastal markets, with much of the market concentrated in the "ASEAN 6" of Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand, and while it may not produce the same kind of starry-eyed gaze investors get when they think of the China market, Southeast Asia offers high-return investment opportunities with less risk.

The high household savings rates add to the region's allure. "The rise of the Asian consumer is undeniable and unstoppable," says Bloy of Navis Capital. According to *Asian Venture Capital Journal*, investments in the retail and wholesale industries took up the best portion of the investment pie in the first half of 2005, with almost 21 percent of inward-bound private equity. Given the recent downturn in U.S. consumer sentiment and the persistently high savings rates of Asian consumers, the ASEAN frontier is looking even greener.

Navis Capital Partners

In some circles, they are known as "the diaper guys." It was the firm's 2001 purchase of the Southeast Asian diaper business of Drypers Corp. that put Navis Capital Partners on the map.

Navis, one of Asia's more successful homespun private equity firms, set up in Kuala Lumpur in 1998, at a time when private equity deals in Asia had largely been discredited. "The real idea came up on a boat in Turkey," says Nicholas Bloy, one of the three founders of Navis. "After interminable games of Scrabble, thoughts turned to careers and we realized that there was never going to be a better time than now to do private equity—on our own."

Bloy and his partners Richard Foyston and Rodney Muse had been working at The Boston Consulting Group in Asia since from the mid-1980s right up until the crisis, when the contagious effects of the currency crisis in Thailand spread to most of the rest of Asia. "All the incumbents in private equity had been discredited," says Bloy. This, he suggests, created a window of opportunity for a new type of private equity investor. "This was a great opportunity for a certain type of entrepreneur."

Until the 1997 crisis, private equity in the region had driven corporate expansion primarily through investment in minority equity stakes. Given the region's need, post-crisis, for capital to fuel restructuring and consolidation, private equity would have to take controlling stakes if it was going to play a role in the region's turnaround. That would be Navis' strategy—the question was, how would the firm raise the funds to do it?

Lacking a track record in investment banking, the Navis partners had a difficult time raising their first fund. "It is near nigh impossible to raise your first fund if you don't have an investment track record," says Bloy. The men did have strong backers among their former colleagues at BCG. Moreover, by 1998, overseas investors, fueled in part by the tech boom, were ready to reinvest in Asia. BCG partners, Bank Boston, and Swiss Re put their money in the fund, and Dutch investment group HAL Investments BV became a 25 percent shareholder and major capital provider. Their first fund, Navis I, got off the ground with $70 million—not much for a buyout firm, but enough to furnish investment in some of the small-to-medium size enterprises that fall under the radar of some bigger funds.

That's when the firm got into diapers. Navis' purchase of Drypers, Southeast Asia's largest diaper manufacturer, was its first investment, and one of its most successful. In 2001, Drypers' parent company was bankrupt, and its Asian subsidiary was making a loss. Navis sold the business last year to the tune of $90 million.

Consumer businesses have been a staple of the Navis funds ever since. "You're seeing increasingly brand-conscious, freely spending Asian consumers," Bloy states. "Retail sales in the U.S. and Europe may have hit a brick wall, but Asia has a long way to go."

Some investments that have paid off include the KFC franchise in Hong Kong and an Indian airline catering business. Navis also gained control of the Australian coffee chain, Dome, which is now expanding west to India and the Middle East, and the Asia Pacific franchise of Europcar International. Bloy says it is his firm's Asia expertise that enables them to drive Australian and European business expansion in the region. "Australia has a pretty mature private equity environment. But private equity firms there don't have the wherewithal to add value to companies outside of Australia. And now there's a set of companies that have maxed out their businesses in Australia and New Zealand, and that need to grow by addressing markets in Asia."

It hasn't always been smooth sailing for Navis. By the time the company built its second fund in 2001, the investment climate had fizzled as a result of the bursting of the tech bubble in the United States. Last year's Asian bird flu crisis also took a bite out of one of their more profitable investments, the world's third-largest duck processor, Bangkok Ranch. Bangkok Ranch's principal export markets in Europe and Japan banned raw exports.

Ever resilient, Navis directed the Ranch to shift to processing and exporting of cooked duck products, which, it turns out, are now resulting in record levels of profitability. "It's probably going to be our most successful investment to date when we exit," says Bloy. "You don't want to be a one-hit wonder."