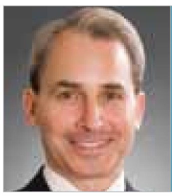
On the surface of it, 2009 was a year that was heavy on the bad and the ugly and light on the good. But when *PEI Asia* asked industry professionals for their

The good, the bad, and the ugly

Luis Miranda, president and chief executive officer, IDFC Private Equity, Mumbai

The good, the bad and the ugly in 2009:
The good part is that the mood is better today than a year back. I have learnt a new phrase - "cautiously non-pessimistic"! That describes the mood today. I recall reading a research paper around a year back that argues that down cycles have become shorter over the past 500 years because of global cooperation. This seems to be the case. The bad part is that valuations have gone through the roof – in India it's as if the crisis never happened and it was just a bad dream that we all had. The excesses of the past seem to be back with listed investors willing to pay ridiculous valuations ignoring execution and market risks.

Changes for 2010:
GPs will continue to be cautious. I see LPs coming back into emerging markets, mainly because this is where the growth is. China and India will lead the way together with Brazil. But LPs will be more discerning – looking at team stability and track record (and, more importantly, the quality of track record).



Philip Bilden, managing director, HarbourVest, Hong Kong

The good, the bad and the ugly in 2009:
Volatile public markets and a global economic downturn caused a decline in valuations and private equity activity throughout the first half of 2009. LPs have continued to experience portfolio allocation pressures. For GPs, Asian fundraisings and deal volume have been limited. Managers have instead focused their efforts on managing their portfolios, as many funds face some combination of operational challenges, financing/covenant issues, and lengthened exit horizons. Yet while some companies and sectors have experienced lasting impairment, others have remained resilient. Asian deals with prudent financing structures have benefited from their discipline. In recent months, we are seeing signs of greater stability in the economy. Some Asian markets, including developed countries such as Australia, as well as developing countries such as China and India, are showing economic strength that is unmatched by other regions. The public markets' revival and improving consumer confidence are good news for portfolio company growth prospects and valuations. Energy is returning to the market as GPs renew their focus on deals and explore exit opportunities. It is too soon to judge whether this will translate into a sustained recovery or premature exuberance, but there is reason to be cautiously optimistic.

Changes for 2010:
Economists vary in their forecasts for 2010, and the outlook remains uncertain. However, we believe that the market dislocation is beginning to generate attractive investment opportunities for the year ahead. The improvement in sentiment, earnings, and valuations is motivating buyers and sellers to re-engage in deal discussions. Capable managers and healthy investments should benefit from this trend. Asian banks are relatively well capitalised and able to provide mid-sized funding for new high quality assets. Mega deals, however, are expected to remain limited, causing some buyout managers who raised large 2007-vintage funds to face challenges in deploying their capital. For managers with mature companies, the recovery in the capital markets is enabling IPO exits. Asia remains an attractive destination for capital, and LPs with the capacity to invest should be well-served to maintain their Asian commitments during this vintage. The key is to remain disciplined and consistent, as the indications of recovery are still far from certain.

Joseph Ferrigno, founder and managing partner, Asia Mezzanine Capital Group, Hong Kong

The good, the bad and the ugly in 2009:
It has certainly been a year with ugly aspects for Asian private equity. In our niche sector of the industry, the demand for mezzanine capital investments of all types has been adversely affected by the higher level of uncertainty generally which has deterred new investment, including in capex, M&A events, privatisations and buyouts. A bad element for us has been the buoyant local equity markets that have caused us to lose opportunities to very good companies that were able to get an IPO done on highly attractive, and I really mean very silly, valuations. The good for our investment strategy may be that that commercial

opinions on the year's highs and lows, a surprising number of silver linings to the economic downturn were revealed.

and investment banks and hedge funds, which were highly active in providing mostly shorter-term mezzanine-type loans, mostly without equity participations, to a variety of good and bad borrowers in Asia with, frankly, often cursory due diligence and unsound legal structures, have pulled back.

Changes for 2010:

I believe that a sea change may be occurring which will generally be bad for the private equity industry during 2010 and good for mezzanine investors. With the developed world economies beginning to come out of recession, central bankers will gradually withdraw the extraordinary level of liquidity which they pumped into their systems. If history is an indicator, they will probably again get things wrong and withdraw liquidity and increase interest rates prematurely. (I am reminded of Einstein's quote: "We cannot solve our problems with the same thinking we used when we created them.") This will drive good companies and private equity sponsors to seek alternative financings sources, which will be the opportunity which people like us have been waiting for now for some time.

Joe Zhou, founder and managing partner, Keytone Ventures, Beijing

The good, the bad and the ugly in 2009:

Good: Economic recovery in China is in progress. 8.5% GDP growth in Q3, so we will be over 8% for 2009. Consumer confidence level has stabilised. Investment pace in sizable late-stage opportunities has recovered. Overseas stock markets have opened up. The Growth Enterprise Board debut in October saw some very high PE multiples.

Bad: The fundraising environment for the venture capital industry was the worst in history for the first half of 2009 and continues to be bad in the second half of 2009. Investment activities by domestic investors at the late growth/pre-IPO stage picked up significantly and drove valuations up very quickly.

Ugly: Domestic investors competing with US dollar denominated funds in cash flow positive, profitable investment opportunities, took away many deals initially targeted for offshore listing and now targeting domestic emerging market listing. The high failure rate experienced in both growth capital and venture capital portfolios. There are challenges ahead for those who do not differentiate in strategy and focus.

Changes for 2010:

The global market will likely recover in 2010, although it will probably remain volatile. China's economic growth will be strong in 2010, which will make the fundraising environment significantly improved for China focused GPs in 2010; the recently launched Growth Enterprise Board will continuously drive the investment pace of domestic investors to an all-time high in 2010; the exit window for US/HK listings will open up; US dollar denominated funds will be pressured to come up with an RMB fund strategy to capture opportunities that are not open to US dollar denominated funds; the industry (venture capital and private equity) will start to consolidate in 2010.

Abdul Hafeez Shaikh, general partner, New Silk Route Partners, Dubai

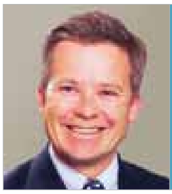
The good, the bad and the ugly in 2009:

Bad and ugly: Private equity deal activity in the MENA region dropped by about two thirds in terms of both number and value. The completed deals focused almost exclusively on defensive asset classes such as education, healthcare, utilities, and foods. Launches of new private equity funds suffered as investors preferred cash over medium-term, private equity-type commitments. Depressed and volatile markets made exits difficult.

Good: An estimated US$11 billion to $13 billion remains available to regional private equity funds, providing a ready platform for undertaking new projects; a decline in the dollar value of invested assets has resulted in more active portfolio management and value-addition by private equity funds.

Changes for 2010:

Depending on the magnitude and pace of global recovery, we will see some consolidation in the private equity industry and a reduction in the number of funds; the better managed private equity companies with committed LPs, available cash, and good project pipelines will be able to benefit from lower and more realistic valuations and potentially come out stronger.



Michael Tierney, head of leveraged finance, Asia Pacific, Credit Suisse, Melbourne

The good, the bad and the ugly in 2009:

Good: Clearly the highlight for the Australian private equity industry in 2009 was the Myer IPO, which was successfully executed in one of the most challenging years on record. This was the biggest Australian IPO since April 2007, and reflects the re-opening of the Australian IPO market. It was also the fifth largest IPO ever in Australia and the fifth largest in the world this year. It is a great outcome for the Australian Private Equity market that TPG was able to successfully manage and grow the business through the global financial crisis and exit the investment with a large multiple on their original investment.

Bad and ugly: The Australian private equity industry has outperformed offshore private equity markets on a relative basis in terms of lower default rates. The industry's performance and outlook might have been less positive had some of the mega leveraged deals mooted in 2007 succeeded.

Changes for 2010:

We will see an improvement in the Australian leverage loan market in 2010 as global credit markets continue to improve. However, this improvement is likely to lag the more dynamic global markets due to the smaller size of the local market and the lack of a developed institutional subordinated note market. We will not see a return to the stretched senior leverage levels that the senior bank lenders have provided in the past, due to the increased risk weighting on sub-investment grade loans driven by the impact of Basel II. As a result spreads on those sub investment grade loans are not likely to contract as significantly as investment grade loans. This capital and pricing discipline by the banks going forward is a positive for the industry as it will assist in the development of a more regular-way institutional subordinated note market, both on a listed and unlisted basis.

Richard Guo, partner, Fangda Partners, Beijing

The good, the bad and the ugly in 2009:

Good: Domestic capital market IPOs are proven exits. We have seen more precedents than ever before, involving both domestic fund and offshore fund investors.

Bad: Fundraising remains challenging, in particular for foreign sponsors. Regulations are still not in good shape and ambiguities remain.

Ugly: We saw several unfortunate incidents involving principals that got caught and indicted for illegal fundraising, running afoul of private placement protocol.

Changes for 2010:

We expect to see more foreign-sponsored RMB funds and an increasing echelon of qualified domestic LPs (insurance companies for instance).

Don Lam, chief executive officer and co-founder, VinaCapital, Ho Chi Minh City

The good, the bad and the ugly in 2009:

The only good thing in 2009 for private equity investors was that valuations came down to more reasonable levels. On the negative side, companies in Asia are behind the curve in improving corporate governance. We hope to see companies do better in this regard.

Changes for2010:

I do see an improved environment for deal making in 2010 and one positive change for investors will be the opportunity to negotiate stronger downside protections. The financial crisis and economic slowdown has made everyone more cautious and realistic. I don't think anyone is expecting outsized returns in the next year or two.

Shailesh Dash, co-founder, Al Masah Capital Limited, Dubai

The good, the bad and the ugly in 2009:

Good: The valuation expectations of sellers have become much more realistic, although not to the levels buyers would have wanted. There is a lot of dry powder with the private equity players in the MENA region.

Bad: Like everywhere else in the world, there were very few transactions which got completed, which means private equity players were not able to take advantage of the economic downturn to buy businesses at cheaper levels. Exits have become difficult through the public markets.

Worse: As yet I have not heard of any major private equity player closing down its operations, but it has badly affected anybody who has done leverage buyout transactions.

Changes for 2010:

The most positive aspect of 2010 will be the increased number of private equity transactions and exits through the primary issuance (public markets). With the stock markets improving, there are expectations that we might be able to see some significant exits in 2010 through the primary market. I think two things which have gained prominence in the MENA region are corporate governance and better risk management. We will increasingly see private equity firms also embracing these practices and there will certainly be improved transparency as a result.

Wen Tan, managing director, Squadron Capital, Hong Kong

The good, the bad and the ugly in 2009:

Good: The bursting of the valuation bubble of the recent years and the return to saner valuations (the valuation expectations gap between buyers and sellers notwithstanding). Charging sheep- or lemming-like into rising markets is not a sustainable investment strategy, especially if all you're doing is following the herd. Another good aspect of the past year has been the slowdown in capital inflows into private markets across the Asia Pacific region, be it through reductions in private equity fundraising or through the pullback of hedge funds and prop desks.

Bad: The sharp rebound in the public markets in recent months. Various markets are now trading at higher valuation multiples than during 2006/07, despite the weaker outlook now compared to then. A more prolonged downturn would have been more conducive to weeding out the hubristic bull market mentality. I know it's said that some investors have a short memory, but this bounceback in risk appetite is worryingly goldfish-like.

Ugly: Sheep, lemmings, goldfish… Though admittedly lemmings are endearing in a foolish sort of way as they endeavor to just go ahead and jump off a cliff with the herd instead of using their own judgment.

Changes for 2010:
I would expect a gradual pick-up in activity in the Asia Pacific private equity markets as a whole, be it in terms of fundraising, investing, or exits. The indications are that it should be a decent vintage for returns, as long as one is backing GPs who are deploying capital at a deliberate pace and who are sufficiently disciplined in terms of entry valuations and downside protections.

Enrique Cuan, managing partner, Mercury Capital Advisors, London

The good, the bad and the ugly in 2009:
The "good" is that Asia continues to benefit from strong capital inflows because it is still one of the few places in the world that offers high growth rates, short recovery cycles, inefficient markets, and powerful demographic trends. The "bad" unfortunately is that it has been difficult to translate the region's positive macro story into sustainably profitable opportunities for investors. The "ugly" will come when many of the newer fund managers start to realise that it takes much more to execute successfully than just having good financial engineering skills. Many of these groups will experience difficulties in the next market correction – which I believe may not be as far off as people think.

Changes for 2010:
Liquidity should continue to flow strongly into the region. The more established LPs will start to branch away from their core relationships and spend more time considering investments in first-time GPs, sector specific managers, country funds, and even in opportunities in some of the Asian frontier markets. A new generation of managers will begin to emerge in which the winners will win big.

Laure Wang, co-founder and managing director, Asia Alternatives, Hong Kong

The good, the bad and the ugly in 2009:
Good: In 2009, with the pendulum swinging in the opposite direction from the froth and frenzy of 2007 and the first half of 2008, one of the positive factors to come to the fore is the better alignment between GP and LP interests. Today, fund sizes are becoming more reasonable and aligned with the GP's stated strategy and experience as well as matched to the capacity of their teams. Economic terms and governance terms are also more balanced between both parties. Vintage 2009 funds will likely be better performing given heightened GP discipline and better entry valuations – when coupled with more balanced fund sizes and terms, the whole package makes this vintage look more attractive.

Bad: With the collapse of Lehman Brothers in September 2008 and the onset of the world financial crisis, many people were expecting a torrent of secondaries to become available within the Asian private equity landscape. Several firms have staffed up their secondary efforts, and global secondary players have raised large funds, with some portion of the capital to address Asia. However, from a very nascent stage, the Asian secondary market has not ballooned as many were previously expecting.

Ugly: Cracks may have always been around, but when you get a crisis, the cracks expand and become real rifts. The ugly of the crisis has been to highlight, enhance and exacerbate the cracks in various aspects of private equity – the cracks in team cohesion, the cracks in GP diligence processes, the cracks in monitoring (especially in accounting). In 2009, we have seen all aspects of these cracks become larger and lead to full-blown problems as teams have fallen apart or led to defections of key partners, as portfolio companies experience severe underperformance given rushed diligence processes during the good times of 2007 and H1 2008, and as ethics issues have come to light in cases of fraud and creative accounting.

Changes for 2010:
Although it has already been happening as an evolutionary process, 2010 will likely push the private equity industry to become even more local. The clear case is in China where there are many more country funds being raised, and even those PE firms that are regional or global are trying to further localise their China operations. In parallel, given the hype of RMB fund formation and fundraising, there will be further pressure to truly be onshore and local.

Maurice Hoo, partner, Private Equity Group, Paul Hastings Janofsky & Walker, Hong Kong

The good, the bad and the ugly in 2009:
Bad and the ugly: Private equity investors who got tempted into "momentum" investing (such as pre-IPO rounds into unproven businesses at unsustainable rates and with no meaningful security, where the only hope of any exit at all is an IPO within 12 months) got burned – and quite a few of those are still nursing their wounds.

Good: More flight to quality, and professionals getting back to basics and taking us (their legal advisers) more seriously when we analyse and discuss risks with them – they now read the legal documents and have a better idea the amount of work we put into them.

Changes for 2010:
US and European investors, especially the private equity arms of Western financial institutions, will be very conservative in making new investments. At the same time, fewer targets will qualify to come on the radar because there was an "overdraft" (or just investors being "under-critical") on targets during the boom years. Sovereign investors will strengthen their direct investment units and compete with Western GPs directly together with indigenous funds (succeeding capital markets and hedge funds as the major competitors

to international private equity a few years ago). LPs, especially Asian LPs, will seriously question – and perhaps reshape – the "market standard" GP-LP relationship beyond the 2-20.

Julian Knights, managing partner, Ironbridge, Sydney

The good, the bad and the ugly in 2009:
2009 has been a very quiet year for Australian private equity. Although some had predicted we would see a torrent of cheap acquisition opportunities, we were of the view that the very healthy state of corporate balance sheets in Australia would mean sellers would simply exit the market, We have been proved correct in this with deal volumes down 90 percent this year.

However, there have been opportunities in the mid-market, where private equity has been able to exploit overleveraged public companies or where buy-and-build deals have been possible, because entry multiples for smaller businesses have fallen much more than larger assets.

Changes for 2010:
2010 will be more like 2009 than 2006/07! We see a gradual loosening of credit markets but nothing suggests a major renewal of syndicated loans will happen in a hurry. Hopefully the IPO window remains open to facilitate exits and the all important return of capital to LPs. Trade buyers are well placed to outbid private equity for larger assets without the benefit of cheap credit. The overall economic backdrop for Australia looks positive for the next few years. Private equity is now well established in Australasia so it should benefit from these positive fundamentals.

Jeff Yao, founder and managing partner, Prax Capital Management, Shanghai

The good, the bad and the ugly in 2009:
Good: China's government intensively stimulated certain industries, such as infrastructure, healthcare and agriculture etc. Companies in such industries benefit from policy support, and grow strongly in the economic downturn, which provides private equity investors with opportunities to seek potential targets. China's domestic demand has become a major force to drive economic growth in 2009: domestic consumption continues to grow as expected, while exports remain weak. The booming property and auto markets both played a significant role in increasing domestic consumption. In rural regions, the policy of 'Home-Appliance Purchase' stimulated household demand. According to the Dept. of Commerce, the 'Home-Appliance Purchase' policy will create RMB100 billion in domestic demand. The A-share IPO re-start and the launch of GEB (Growth Enterprise Board) have eased the concerns of PE on investment exits. The global stock crisis also opened the door of PIPE deals for investors, in Q2 2009, private equity firms invested into six PIPE deals with a total value of $541 million, accounting for 29 percent of total private equity investment.

Bad: Both export-oriented and traditional commodity industries face challenges of recovery, which has affected private equity performance at various levels; target companies continued to have high expectations on PE valuations, which made negotiation more difficult; private equity firms without portfolio management capacity and/or capability are in trouble due to the longer exit period required.

Changes for 2010:
China's economy will take a further step towards recovery, and we believe more global private equity funds will be focused on China and India. The competition between RMB funds and US dollar denominated funds will certainly become fiercer in 2010. RMB funds and USD funds will not only compete for deal sourcing and valuation, but also the recruitment of investment professionals. Involvement in and value-added contributions to portfolio companies are becoming very important tasks for private equity firms to ensure the success of the investment.

Low Hang Seng, executive director and head of the private equity fund of funds business, United Overseas Bank, Singapore

The good, the bad and the ugly in 2009:
Good: The worst of the financial crisis is past. Asia has proven to be resilient and the long-term structural growth story remains intact. It has been an excellent opportunity to separate the men from the boys among our GPs. We can now separate those who know what they are doing from those who have good power point presentations, those who are only interested in AUM from those who are working towards IRR, and those who have well thought of investment strategies from those who have marketing-oriented/opportunistic investment strategies.

Bad: It's been a very difficult environment for private equity in general – operating numbers have been weak due to a poor economy and sentiment, funding sources have been closed (debt and capital markets), exits have been non-existent for much of the year. GPs have had to spend a lot of time working with their 'problem children', plus having to deal with a fundraising winter.

Ugly: Team issues, non-operating issues at investee companies (fraud, accounting irregularities).

Changes for 2010:
I believe that 2010 will be a good vintage year for Asian private equity and investors will be well rewarded in the coming years. The environment may continue to be volatile and the US and European economies may continue to be weak, but private equity is a long-term asset class and one should be investing when markets are weak and getting out when markets are strong. In many ways, things have stabilised to the point where it is possible to analyse which industries and companies one should be investing in to take advantage of the long-term structural growth opportunities in Asia. As a fund-of-funds, we feel that we now have more information to identify the managers who we believe will be top quartile performers in the coming years.

Ask the industry

Chris Heine, managing director – Asia Pacific, ICG, Hong Kong

The good, the bad and the ugly in 2009:
Ugly: Public markets collapsed losing investors billions and closing an exit route for sponsors without the expected rash of privatisations of public companies at low valuations; the banking industry had a heart attack, was bailed out by Government, cost taxpayers billions and dramatically reduced the number of banks in the leverage finance market; overleveraged companies exposed to the 'High Street', especially niche retailers, closed, costing employees their jobs; senior bank liquidity evaporated overnight for buyouts and in lieu of new deals, sponsors had to decide which portfolio companies to support and which ones to let go.

Bad: Senior leverage finance will remain at reduced levels for the foreseeable future; due to the lack of liquidity, refinancing existing portfolio companies becomes more challenging; secondary debt trades freely and sponsors have little control over who holds the debt as banks trade their portfolios to manage their asset base; existing portfolio companies and lenders are demanding more time from sponsors to work through their problems; the possibility of covenant breach turns into probability with limited liquidity to solve the problem.

Good: Greater communication with LPs; greater focus on the business improvement model (increase revenues, improve margins, take out costs, increase cash, pay down debt – 'back to basics' private equity investing); good businesses are being restructured if required; the 'recession' did not appear to last long in Asia (famous last words?); new deals have better capital structures.

Changes for 2010:
More equity-only minority investing in public companies; more equity-only buyout transactions to secure the transaction before introducing leverage; the rise of mezzanine as a capital restructuring instrument assisting sponsors to recapitalise existing portfolio companies alongside their equity; an increase in mid-market deals of US$500 million to US$1 billion with limited senior leverage appetite; a rush to exit by sponsors with portfolio companies ready to "go to market" to delever and give LPs a return; longer hold periods for new deals; a demand for yield by investors.

Richard Pyvis, executive chairman, CLSA Capital Partners, Hong Kong

The good, the bad and the ugly in 2009:
From an Asian industry perspective, the failure of some GPs to 'stick it out' through the fairly tough times of the past 18+ months. It is very disappointing to me to see "professionals" abandon their funds and their GPs when the going gets tough – not very professional, and a major negative for the industry as a whole

Changes for 2010:
We are likely to see continued tough times, but more realistic pricing, as risk assessments and liquidity across the Asian financial spectrum return to 'normal'. However, there will be many false dawns, as the North American and European financial services sectors are a long way from a normalised state.

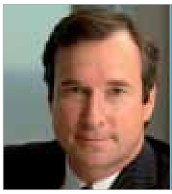
Neville Jordan, chairman, Endeavour Capital, Wellington

The good, the bad and the ugly in 2009:
Good: The New Zealand Superannuation Fund announced its intention to consider New Zealand-based fund managers for private equity funding. They released an Expressions of Interest document about three months ago and then, following a review of responses, released a formal Request for Proposal about one month ago. Successful fund managers will be selected before the end of this calendar year. Private equity fund managers are very heartened by a major institution taking this decisive action.

Bad: Other institutions remain generally risk averse towards mid-cap private equity investment, brought about by the current financial climate and a scarcity of analysts who understand the space.

Ugly: New Zealand's companies will simply migrate offshore if they cannot get local expansion capital. Sad for the economy, bad for jobs and not good for New Zealand's foreign exchange earnings.

Changes for 2010:
2010 may well bring an easing in private equity risk averseness as the New Zealand Super Fund shows the way.



Tim Sims, founder and managing director, Pacific Equity Partners, Sydney

The good, the bad and the ugly in 2009:
It has been good to be part of a resilient economy with a stable banking system that is open for business; it has been bad that the equity markets were spooked by international investors and have left vendors confused and reluctant to sell; the good news is that from this point on either more ugliness or less should provide unction for the troubled investor.

Changes for 2010:
Corporate Australia has raised fresh equity at deep discounts, profits are uncertain, dividend yield is poor, shareholders angry and Boardrooms stressed. Routine refinancing for some will be complicated while others are guilty of excess cash….this looks like an environment where the right to operate assets will be put to the test and businesses will change hands.