

REGISTER NOW!
2006 AVF JAPAN
APR 3-5, TOKYO



[Click Here](#)

**ASIAN
VENTURE CAPITAL
JOURNAL**
THE ASIAN PRIVATE EQUITY
NEWS SOURCE

Volume 19, Number 8

February 27, 2006

AVCJ Weekly

REGISTER NOW!

2006 ASIAN PRIVATE
EQUITY & VENTURE
CAPITAL FORUM — USA
THE ASIA - US
HEARTLAND BUYOUT
FORUM

MAY 15 - 17, 2006
THE PENINSULA HOTEL, CHICAGO
[Click Here](#)

REGISTER NOW!

2006 AVF
MIDDLE EAST
APR 23-25,
DUBAI

[Click Here](#)

**COVER STORY...5
NEW PERSPECTIVES ON
ASIA MEZZANINE**



MOVERS & SHAKERS



QIMING UNITES RIESCHEL AND
KUANG IN SHANGHAI...3

COVER STORY



NEW PERSPECTIVES ON ASIA
MEZZANINE...5



PARTNERS IN MEZZANINE IN ASIA...7

REGIONAL NEWS / DEAL LOG



BABCOCK & BROWN'S CASH BOX
RATTLES IRISH PHONE LINES...9

TEMASEK READY TO INVEST \$700
MILLION IN INDONESIA
PETROCHEMICALS...9



KOTAK INDIA REAL ESTATE
FUND HAS FIRST CLOSE AT
\$100 MILLION...11



IE ENTERPRISE FUND LAUNCHED
TO TAKE SINGAPOREAN FIRMS
GLOBAL...11



ORCHID ASIA GETS SPORTY IN
CHINA...13

JUST IN...



JUST IN . . . BREAKING STORIES FROM
AVCJ AND OTHER SOURCES...11

CHINA FILE



BAIN SPEAKS ON NEW HIRES, CHINA
STRATEGY...15

NEW PERSPECTIVES ON ASIA MEZZANINE

Mezzanine, classically defined as "debt that incorporates equity-based options, such as warrants, with a lower-priority debt" is still "nascent" in Asia. Associated with private equity, often following buyout funds in Western markets, it is even earlier in its development than the still-growing sponsor industry in the region. However, mezzanine in the region is already developing.

Mezzanine's characteristics and diversity

Sandwiched between debt and equity, incorporating elements of both, mezzanine has marked out its own territory by articulating certain unique characteristics and advantages.

[Stephane Delatte](#), Managing Director of the Mezzanine Fund at [CLSA](#), lists the differentiators as "flexible structures (e.g., deferred payments, holding company structures, and unsecured positions), overall lower return expectations compared to equity, and subordinated position to senior Lenders."

"We separate the mezzanine space we break into three distinct zones: there's debt-oriented, equity-oriented, and so-called balanced mezzanine," says David Bussmann, Partner at [Asia Mezzanine Capital Group](#). "The European mezzanine market is getting away from an equity component. You have a US market where generally more than 75-85% of the returns for the mezzanine players is usually from the debt components. The Asian market is evolving, and you see structures that run the gamut from highly debt-oriented to extremely equity-oriented."

"Mezzanine's intermediate position in the capital structure (in between senior secured debt and equity) justifies higher return expectations compared to senior lenders," Delatte goes on. "The equity kicker feature often allows the target to lower and/or defer interest payments, thereby providing more cash to repay its senior debt faster, or for the business to preserve cash for CAPEX expansion."



Henry Stein

"Mezzanine rates are lower than equity," notes [Henry Stein](#), Managing Director for Structured Finance at [Indus Capital](#). "They are more than senior debt, which is why I encourage companies to borrow as much senior debt as they can and then add mezzanine. That provides the lowest overall cost of capital."

"Mezz replaces part of the equity in a deal and helps investors leverage their returns," says Piers Millar, MD at Intermediate Capital Asia Pacific. "People still think of it as an alternative to senior debt: but mezzanine is a lower-risk lower-return alternative to part of the equity."



Piers Millar

Bussmann notes the proliferation of "warrantless mezzanine, which is simply a kind of subordinated debt that has no equity kicker at all. From a relatively small part of the European market six or seven years ago, this is now dominating the European market, to such an

extent that according to a Fitch Ratings survey done just recently, more than 80% of European deals done last year did not have an equity component." However, he feels that Asia balanced mezzanine, where there is generally an even split between returns expected from the equity and debt components is more appropriate for many companies. However, as Delatte notes, "ultimately, each deal or structure is different and depending on the situations, equity sponsors may prefer a full PIK/large kicker or an equity-less solution."

Mezz drivers and demand in Asia

Mezzanine's characteristics may make it attractive to private equity funds and other customers, but the demand



Joseph Ferrigno

story has not necessarily played out in Asia the same as elsewhere. Funding is one universal need, and as Delatte points out, "depending on the situations, mezzanine providers may be able to offer solutions to their clients that are overall cheaper and more flexible in nature. By bridging a funding gap, mezzanine can help to close deals that would not otherwise make commercial sense for senior

lenders or equity providers. "Mezzanine is about partnership with the major shareholders, to help them improve their returns," Millar emphasizes.

"Mezzanine allows companies and owners to pursue the same goals yet pay less for the 'raw materials,' in this case capital," says Stein. "The company raises the same amount of money yet pays less while also giving up less control."

Service providers and intermediaries can very beneficially use mezzanine to provide solutions for their clients. It is also extremely flexible."

Yet in some markets, mezzanine-type structures can serve unique local needs, such as, for instance, corporate restructuring: as in Japan. Mezzanine there can support companies that "have to be sensitive to credit rating," notes one private equity authority in Japan. "They cannot provide equity or loans, so what about mezzanine? Everybody wants to buy it."

Corporate uses of mezzanine can go further. After all, mezzanine is raised on a fund basis, and companies can reasonably see it as an alternative menu item on the Asian capital market's bill of fare.

"You can segment it into the non-buyout/non-private equity area, and the buyout/private equity area," Bussmann explains. "We think the greatest volume of opportunity with Asian firms is in the non-buyout area. Typically, European and many segments of the US mezzanine market only follow and piggy-back the buyout firms. They're providing a very specialized type of mezzanine, and depend entirely upon the buyout and private equity firms."

He goes on: "It's back to the opportunities we see in Asia. In Asia, some of the greatest opportunities are in growth capital. And we feel balanced mezzanine is a better fit often than traditional private equity, because in markets like China or India where you have entrepreneurs who prefer not to cede control of their company. At the same time, many quality mid-cap companies simply lack the access to long term debt financing that would be available in more mature economies with fully-developed banking systems."

Complicating the picture is the mezzanine-like structures often used by private equity firms themselves. "You'll frequently see that they take investments in China in a mezzanine form without actually doing mezzanine," adds Jonathan Robinson, Partner at [Asia Mezzanine Capital Group](#). "When a private equity firm goes into a public company, they're often using a mezz structure."

"Mezzanine in practice does not just compete with other 'direct' mezz as such but also with other types of capital," notes [Geoff Lee](#), Director of Investment at CLSA Private Equity's Mezzanine Fund. "In very large deals, capital market high yield becomes a viable alternative ... Having said that, traditional mezz works wonderfully when conditions are right."

"The market's just starting," says Millar. "The dramatic increase in the number and size of private equity funds in the region will drive valuations higher over the next few years and create more competition among investors, and that will push the need for more mezz."

Making mezz work in Asia

Pressure from competing forms of capital adds to the many challenges of making mezzanine work in Asia as an asset class and as an investment technique.

"Sometimes the private equity firms will use a mezzanine type instrument for their own purposes," remarks [Joseph Ferrigno](#), Managing Partner at the Asia Mezzanine Capital Group. "Generally, their intentions are very different from ours, and their value add is very different. In many cases we're complementary, and in a few cases we might be competitive, because our type of mezzanine might be a preferable way for a medium-size family company to go: to be involved with a fund to give them two or three more years before they go to a private equity fund or the public markets. But there are so many opportunities that I don't think we would be directly competitive often."

This does not mean that the Asian asset class is necessarily struggling. "Personally I have not heard of any defaults in the mezzanine space in Asia," notes Lee. "As long as our interest is paid when due and our principal isn't at risk, everything else is a sweetener."

However, mezzanine remains at least as difficult and time-consuming as mainstream private equity in the region. "It takes a lot of work to do these things, and source these transactions," says Bussmann. "You need to have very good due diligence and structuring skills. Selection is very important. The thing that you have to seek to avoid is to take an equity risk but get a debt return."

"The mezzanine market is still in its early days in Asia so the jury is still out," Delatte admits. "However there are already a few good exits made by several players."

"There are lots of mezzanine successes," concludes Stein. "I can think of many business initiatives (acquisitions, expansion, working capital, new products, refinancing) that mezzanine capital helped make possible." - PSM



Geoffrey Lee



Stephane Delatte



David Bussmann

PARTNERS IN MEZZANINE IN ASIA

[As a major global fund of funds, *Partners Group* invests in mezzanine as in many other asset classes, and is well equipped to evaluate the situation in Asia objectively. *AVCJ* spoke to *Mike Siebert*, Associate based in Singapore, about how *Partners Group* sees the market.]

AVCJ: What are *Partners Group* investments and interests in mezzanine, both in Asia and worldwide?

Siebert: We have the Euro Mezzanine Fund, where we invest exclusively in Europe. We have a global Mezzanine Fund, and that has an allocation of at least 10% in Asia. We have a number of other vehicles and structures that also invest in mezzanine vehicles. We're fairly active in Europe and the US in the co-investment side in mezzanine ... So far we've looked at a number of mezzanine funds here in Asia, though we haven't committed to any of them. We've done one co-investment in mezzanine.

AVCJ: Assuming a comfortable investment proposition comes along, will you invest in Asian mezzanine?

Siebert: We don't have a strategic imperative stopping us. Having said that, if you look at the returns, interest rates are fairly low in Asia. Senior debt is very easy to get, and you can stretch it quite far. If you look at the different markets, in Japan senior debt is just 13%. So if you're going to do mezzanine in that area, it's probably going to be 9-11%. For us to invest in something with 11%, it's not what we're paid for. It's just not attractive. And they typically don't have a whole lot of equity kickers.

AVCJ: So it's like European warrantless equity?

Siebert: Yes, but with a lower yield. In Australia, it's a little bit more attractive. But there you have the phenomenon called public notes. Pricing is around 8-12%, you have hardly any rights; it's a public debt issue. It's relatively cheap compared to mezzanine. On the negative side, though, it's not flexible. Once you have it you can't do a recap unless you repay the entire public note.

AVCJ: And the rest of the markets in this region are not yet sufficiently attractive or developed?

Siebert: Korea definitely is attractive. That would be the third attractive market. But we haven't seen a whole lot of buyouts in China and India, and as long as there aren't any buyouts, there's no need for mezzanine. Mezzanine in those markets has a different place: it can work almost like growth capital. You provide capital funds and just limit your downside. A lot of growth funds do the same thing; they do preferred equity or convertibles: it's very similar in terms of strategy.

AVCJ: Some of the funds at present see the greatest opportunities in providing capital direct to management teams and entrepreneurs, rather than providing a capital alternative to private equity firms. Do you think that is a valid way to go for the region's mezzanine funds?

Siebert: For the time being, yes. The problem that a lot of people facing in India and China, is that they have problems getting money. In China, credit's only given on an annual basis. If the government decides they want to tighten money,

they're just cut down on their credit, and you're out of cash. If you get a mezzanine provider, or any capital provider, that gives you a bit more stability and long-term flexibility. So they have a legitimate role, but they're competing against the growth guys.

It's really a question of whether you come from the equity or debt side, but in theory if you don't have anything else it will be junior to senior debt.

AVCJ: Mezz presumably will be preferred by the entrepreneur.

Siebert: It doesn't really make a difference to him. What can they bring to the table? They can bring cash, and that's what the guy wants the most.

AVCJ: What are the prospects for mezzanine in the region?

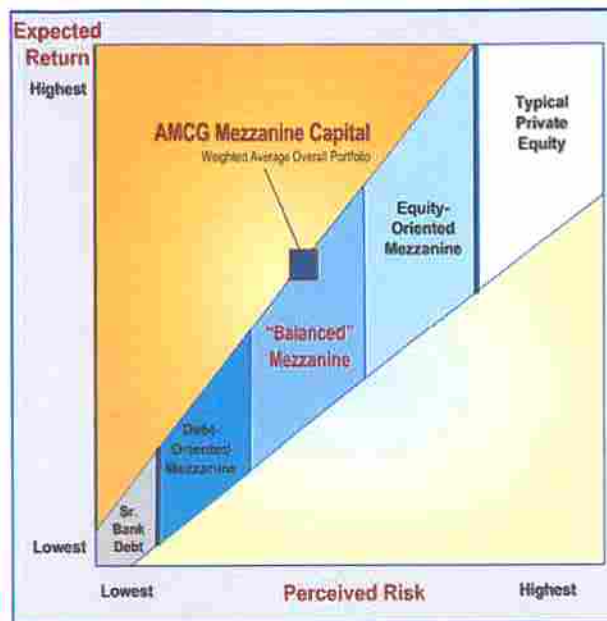
Siebert: Mezzanine will definitely play a role in Asia, and it will play more of a role going forward, but it's still very nascent. We're watching the birth of the mezzanine market as it is. There's definitely more to come, but I think it's going to be a few years before we see a full development of the market.

-PSM



Partners Group's Asia Pacific offices at UOB Plaza 1 in Singapore.

COVER STORY



Profile of expected risks and returns for mezzanine

Source: Asia Mezzanine Capital Group

Most Common	Sometimes Utilized	Rarely Utilized
<ul style="list-style-type: none"> Structurally subordinated debt with equity warrants Contractually subordinated debt with equity warrants - Typically current pay instruments - May include Pay-in-Kind/Rollup component 	<ul style="list-style-type: none"> Subordinated debt in combination with a straight equity investment, or preferred equity investment Pay-in-Kind ("PIK") Preferred (only as a small tranche of an investment package with other current return instruments) Preferred equity Convertible subordinated debt Convertible preferred equity 	<ul style="list-style-type: none"> PIKs on stand alone basis Long-term bullet maturity subordinated debt Zero coupon subordinated debt

Selected mezzanine financing instruments

Source: Asia Mezzanine Capital Group

Selected Mezzanine Investments in Asia

Investee Name	Investee Name	Amount (US\$M)	Announce Date	Investee Industry	Investors (Nationality)
GNG Networks Inc.		37.0	Jul-02	Telecommunications	Darby Asia Investors Ltd. (USA)
First Generation Holdings		35.0	Jul-03	Utilities	Darby Asia Investors Ltd. (USA)
CGV		29.1	Sep-02	Leisure/Entertainment	Intermediate Capital Asia (HKG)
Alok Industries Ltd.		23.0	Apr-04	Textile & Clothing	CLSA Mezzanine Management Ltd. (FRA)
Yellow Pages (Singapore)		18.6	Dec-03	Media	Intermediate Capital Asia (HKG)
Aqua Clara Japan, Inc.		9.4	Nov-04	Consumer Products/Services	SBI Capital Solutions Co., Ltd. (JPN)
CopperCo Ltd.		4.2	May-05	Minings & Metals	LinQ Capital Ltd. (AUS)
Tekisui Corporation		2.8	Nov-04	Financial Services	SBI Capital Solutions Co., Ltd. (JPN)
Cuppa Cup Vineyards Ltd.		0.3	Jul-98	Consumer Products/Services	Australian Mezzanine Investments Pty Ltd. (AUS)
Himart		n/a	Apr-05	Retail/Wholesale	Intermediate Capital Asia (HKG)

Source: AVCJ Group

Selected Mezzanine Fund Managers in Asia

Fund Manager	Country	Fund Names	Launch Date	Capital Under Management (US\$Million)
Archer Capital	Australia	Byvest Mezzanine Debt Fund	Jan-98	27.2
CLSA Mezzanine Management Ltd.	Singapore	MezzAsia Capital L.P.	Dec-02	n/a
Darby Asia Investors Ltd.	Hong Kong	Asian Infrastructure Mezzanine Capital Fund	Jan-98	246.0
i-cap partners limited	New Zealand	i-cap mezzanine partners limited	Apr-01	5.0
Indus Capital Advisors	Hong Kong	N/A	N/A	n/a
Intermediate Capital Asia	Hong Kong	N/A	N/A	n/a
Kendall Court Capital Partners	Singapore	Kendall Court Mezzanine (Asia) Fund I	Jun-04	35.0
SBI Capital Solutions Co., Ltd.	Japan	SBI Mezzanine Fund No.1	Aug-04	29.1

Source: AVCJ Group