EMPEA Special Report
Asian LP Sentiment Toward Private Equity

2012

EMPEA

Emerging Markets Private Equity Association

About EMPEA

The Emerging Markets Private Equity Association (EMPEA) is an independent, global membership association whose mission is to catalyze the development of private equity and venture capital industries in emerging markets. EMPEA's 300 members share the belief that private equity can provide superior returns to investors, while creating significant value for companies, economies and communities in emerging markets. Our members include the leading institutional investors and private equity and venture capital fund managers across developing and developed markets. EMPEA leverages its unparalleled global industry network to deliver authoritative intelligence, promote best practices, and provide unique networking opportunities, giving our members a competitive edge for raising funds, making good investments and managing exits to achieve superior returns.

In support of its mission, EMPEA:

- Researches, analyzes and disseminates authoritative information on emerging markets private equity;
- Convenes meetings and conferences around the world to promote information exchange between leading fund managers and institutional investors;
- Offers professional development programs to enhance knowledge transfer; and,
- Collaborates with stakeholders from across the globe.

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**As of December 2011.*

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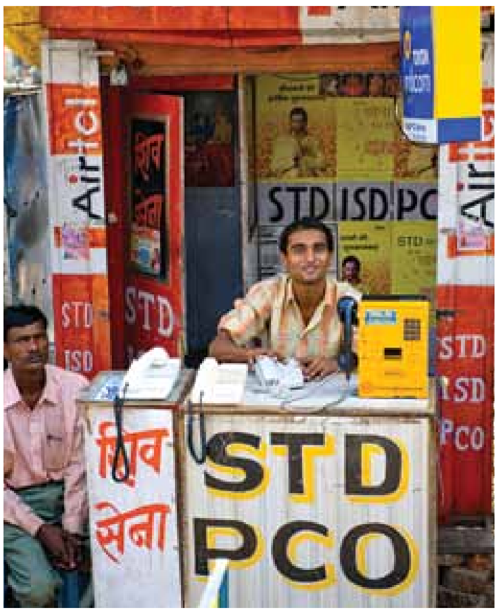

EMPEA Special Report
Asian LP Sentiment Toward Private Equity

Contents

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Methodology and Disclaimer

In the second half of 2011, EMPEA surveyed 13 of the leading limited partners (LPs) based in the Asia-Pacific region. These institutional investors are from organizations headquartered in Australia, China, Japan, South Korea and Southeast Asia and represent public and corporate pension funds, insurance companies, banks, asset managers, endowments and sovereign wealth funds. The survey participants boast collective assets under management of approximately US$1 trillion.

The LPs participated in the study through an online survey as well as in-person meetings and phone discussions. All individual survey responses are confidential.

This study was published in January 2012, based on surveys conducted between July and September 2011. The current troubles facing the eurozone may have since had an impact on LPs' viewpoints—either positively or negatively.

EMPEA is not responsible for any decision made or action taken based on information drawn from this report.

Definitions

For the purposes of this study, emerging markets (abbreviated to "EM") is defined as the private equity markets of all countries outside of the United States, Canada, Western Europe, Japan, Australia and New Zealand. Emerging Asia encompasses all of Asia excluding funds whose primary investment focus is Japan, Australia or New Zealand.

The term private equity (abbreviated to "PE") encompasses leveraged buyouts, growth capital, venture capital and mezzanine investments. By emerging markets private equity (abbreviated to "EM PE") funds, we mean PE funds that principally target investments in emerging markets.

Within Emerging Asia, this study highlights the markets of China, India and South Korea. Other Emerging Asia refers to Southeast Asia, South Asia ex-India and East Asia ex-China.

Western-focused funds refer to funds focused on North America and/or Western Europe.

We gratefully acknowledge the support of EMPEA Member First Avenue Partners.

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Sarah Alexander
President and CEO
Emerging Markets
Private Equity
Association

Dear Reader,

In the current economic environment, with fierce competition for capital, general partners (GPs) from across the globe must increasingly look for new sources of capital to complement their traditional Western LP institutional base. To address this capital diversification need, EMPEA launched an initiative in 2011 to explore sources of capital from within the emerging markets themselves. Our first report focused on *Local Pension Capital in Latin America*; now we are turning our sights toward Asia to examine whether Asian LPs will become a growing source of capital for both local and non-Asian GPs, particularly GPs in emerging economies.

Over the last five years, Asia has become a premier destination for private equity investment. Led by China, PE investment in Emerging Asia has exceeded US$129 billion since 2006, dwarfing investment in any other emerging market region. The story about the surge in Asian PE usually focuses on North American and European institutions investing in the region. The less-known story, however, is Asia's growing potential as a *source* of capital for both Asian and non-Asian private equity funds.

Our Special Report on *Asian LP Sentiment Toward Private Equity* tackles critical questions for determining the interest of Asian LPs in the private equity asset class. Some of the key questions addressed include:

- What role are Asia-based LPs currently playing in the Asia region today, and what influence will they have in the future?
- How viable are Asian institutional investors as a source of funding for emerging market-focused funds beyond Asia?
- What are the key barriers for Asian LPs as they commence or consider expanding their commitments to PE generally and EM PE more specifically?
- Which region(s) will be favored?

A key objective of this publication is to provide the industry with a better understanding of how Asia-based LPs view EM PE—in Asia and outside the region, as well as within the context of a broader portfolio inclusive of Western and global PE exposure. This study also aims to encourage greater private equity participation amongst Asia-based LPs by first delineating the primary barriers hindering investment.

We would like to thank the LPs that participated in this study and graciously shared their time and insights. Although the 13 leading institutions surveyed in this study may not be a perfectly representative sample of the entire Asia-based LP landscape, these investors collectively allocate some of the largest pools of capital in the region and their brands are among the most visible globally. EMPEA's Asia Council identified these LPs as being the *most active* or *potentially most active* investors in EM PE, including outside of Asia.

We also express thanks to EMPEA's Asia Council members, who helped identify the key Asia-based LPs and provided important introductions that allowed us to gain critical insight into these LPs' attitudes.

We hope that understanding the motivations and preferences behind these leading LPs' decisions on whether and how to allocate capital to EM PE provides insights for GPs looking to raise funds from Asia. Additionally, we hope non-Asian LPs will benefit from a greater understanding of how their peers view the asset class. Lastly, this study also provides valuable lessons for broader industry participants who are seeking to further unlock these pools of capital—a key EMPEA priority.

As always, we welcome any feedback you may have at empea@empea.net.

Sincerely,

Sarah E Alexander

Sarah Alexander
President and CEO
Emerging Markets Private Equity Association

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Executive Summary

The Emerging Markets Private Equity Association (EMPEA) recently surveyed a select group of Asia-based LPs to better understand their attitudes toward emerging markets private equity (EM PE) investing, both within Asia and outside the region. The objective of this study is to provide EMPEA members—LPs, GPs and other industry stakeholders—with a greater understanding of how Asia-based LPs view the asset class, their interests and future plans, and primary barriers that may hinder greater investment in private equity.

The findings of this study are based on data collected from 13 leading Asia-based LPs from Australia, China, Japan, South Korea and Southeast Asia. Representing public and corporate pension funds, insurance companies, banks, asset managers, endowments and sovereign wealth funds, the survey participants boast collective assets under management of approximately US$1 trillion. All of these LPs have been investing in private equity for at least two years—in most cases, much longer—and have dedicated staff focused on private equity.

LPs participating in this study were identified by EMPEA's Asia Council as being among the region's *most active* or *potentially most active* investors in EM PE. While the findings presented are not statistically representative of the entire Asian LP market, they provide a snapshot of leading Asian LP views on the asset class today and may be indicative of future trends in Asian participation as LPs across global emerging markets.

Key findings from this study include:

1 **Expected increases in Asian LP commitments to PE are driven by a search for alpha:** Asia-based LPs plan to increase the aggregate value of their commitments to private equity over the next two years, citing the potential for high returns as the greatest driver in their organizations' decision to commit capital to the asset class (page 7).

2 **There is a bias among Asian institutional investors toward Western-focused PE funds:** Asian LPs have historically heavily allocated commitments, as a percentage of their portfolio, to Western-focused funds—and Asian LPs plan to continue to allocate a significant portion of their dollars to North American and Western European-focused fund managers (page 9).

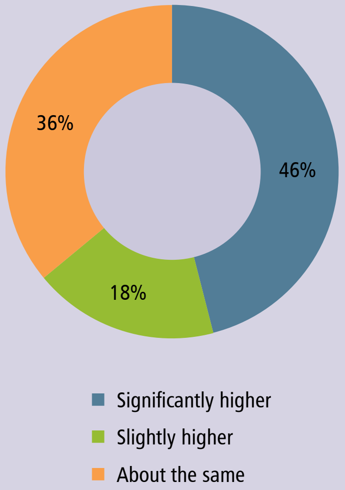
3 **Emerging markets are poised to see the highest percentage increase in *new* PE commitments from Asian LPs:** Despite being heavily weighted to Western-focused funds, Asia-based LPs will play an increasingly important role in EM PE. In addition to deepening their exposure to Emerging Asia, led by China, Asia-based LPs plan to expand their reach to other emerging markets, with Latin America ranked as the most preferred destination (page 11).

4 **Outperformance expectations are driving this increased focus on Emerging Asia and other emerging markets:** Asian LPs' average net return expectations for 2011 vintage PE funds in emerging markets exceed 16%, compared to less than 16% for funds focused on developed markets. Within Asia, net return expectations are highest for Emerging Asian economies and lowest for the developed economies of Japan and Australia (page 13).

5 **The perception of too few established GPs is inhibiting LP commitments in Emerging Asian markets:** The most frequently cited barrier to greater investment in Emerging Asian markets—particularly in Indonesia, the Philippines and Vietnam—is a concern about the limited number of established GPs and a lack of information on the asset class (page 15).

Expected Increases in Asian LP Commitments to PE are Driven by a Search for Alpha

Exhibit 1: LPs' Anticipated Level of New Commitments to PE Over the Next 2 Years Compared to the Previous 2 Years



Source: EMPEA.

Overall sentiment toward the asset class is positive, with the majority (64%) of Asia-based LPs surveyed planning to increase the aggregate value of their new private equity commitments in 2011 and 2012 in comparison to their commitments in 2009 and 2010. Just under half (46%) of the LPs anticipate "significantly" increasing commitments, with an additional 18% planning to increase commitments "slightly." None of the LPs participating in the study intend to decrease commitments.

Philip Bilden, Senior Advisor at private equity fund of funds HarbourVest (Asia) Limited, remarked, "Generally, most LPs who have already made commitments to private equity have a favorable view of the asset class to date, even if the duration of their program is short and without positive investment performance." Bilden attributes this to a much better educated LP base today than even a decade ago, when explaining the concepts of the J-curve, portfolio construction, diversification metrics, and GP selection was more challenging. He noted that "there is now an abundance of publicly available information on the asset class that has allowed practitioner LPs to gain confidence that private equity should be part of an institutional alternative asset class allocation."

The strongest motivator for Asian LPs to invest in private equity today is the potential for high returns, followed by diversification benefits. Of the LPs participating in this study, 80% cited the potential for high returns as a very important factor in currently driving their organization's decisions to commit capital to private equity, while 50% noted the same of diversification benefits.

When asked about the primary philosophy of their organization's financial goals, one LP stated that their firm is seeking to "achieve attractive returns subject to reasonable risks through maintaining a diversified portfolio." However, most LPs are focused primarily on alpha, citing guiding mantras such as "increasing the long-term return," "achieving higher returns than inflation plus," and "achieving a return of inflation plus 5% in perpetuity."

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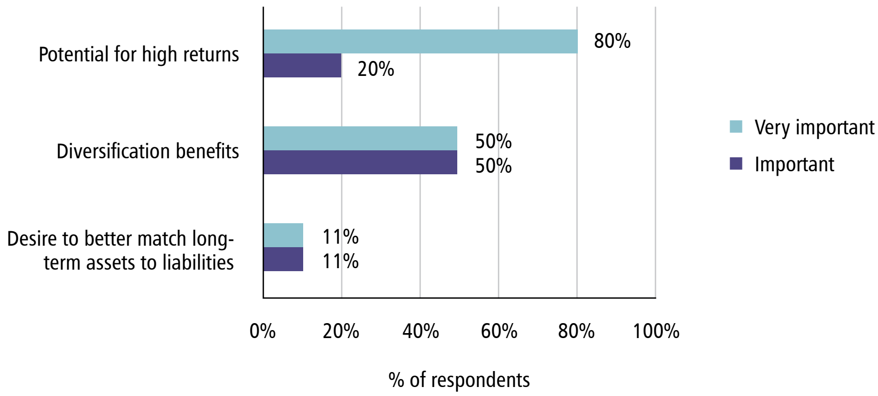
The desire to match long-term assets to liabilities (liability-driven investing) is not a key factor for most LPs in making the decision to invest in the asset class. In fact, 78% of LPs regard this as either a neutral or unimportant issue.

Exhibit 2: Drivers of LPs' Decision to Currently Commit Capital to PE

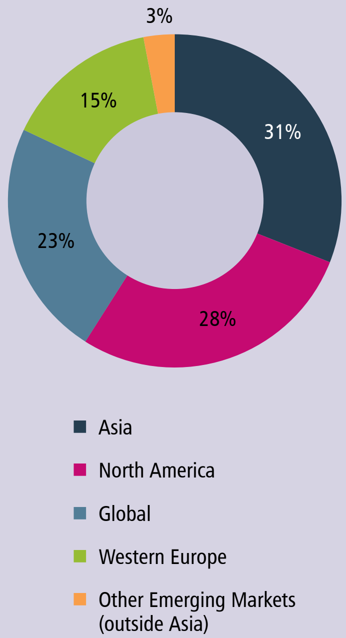


Source: EMPEA.

Most of these LPs have substantial flexibility in terms of investing in private equity. More than 80% of the LPs participating in this study have an internal allocation target with regard to what percentage of their total portfolio can be committed to private equity. Of these, 75% are not fully invested yet under their allocation target.

There is a Bias Among Asian Institutional Investors Toward Western-focused PE Funds

Exhibit 3: Global Distribution of Current Committed Capital



Source: EMPEA.

The majority of Asia-based LPs *first* invested in private equity through a global or Western-focused fund, and most of their portfolios remain heavily allocated away from Asia. Today, over 66% of the portfolios of LPs participating in this study are invested in global and Western-focused funds, versus 31% dedicated to Asia. Within Asia, China represents the largest market for committed capital, accounting for nearly 15% of the collective portfolio of the LPs surveyed.

This bias toward at least initial investment in Western Europe and the United States begs the question of whether Asia-based LPs have historically been attracted to more established private equity markets outside of Asia—which have a stronger track record and larger number of fund managers—or if they are strategically investing outside of Asia for geographical and, subsequently, risk diversification benefits.

Luis Miranda, former Chairman at India's IDFC Private Equity, noted that it is interesting that Asia-based LPs haven't invested more in Asia: "I wonder if it is because the accessible market is smaller or due to legacy reasons—in other words, Asian LPs have been investing in the West for years, so perhaps there is inertia to change? This is surprising since Asia is expected to drive global growth over the next few years."

The perceived attractiveness of North America and Western Europe as markets for committing new capital to private equity funds remains high, despite the financial challenges in the West over the last several years. North America was ranked as the most attractive market for private equity investment for Asia-based LPs, with 77% viewing the North American market as either *attractive* or *very attractive*. Western Europe tied for second place (alongside China), with 54% of participating LPs describing the market as a favorable investment destination. However, a higher proportion view Western Europe as "very attractive" than they do for China.

Jean Eric Salata, Founder and CEO of Asia-focused private equity firm Baring Private Equity Asia, commented, "I am not surprised that the

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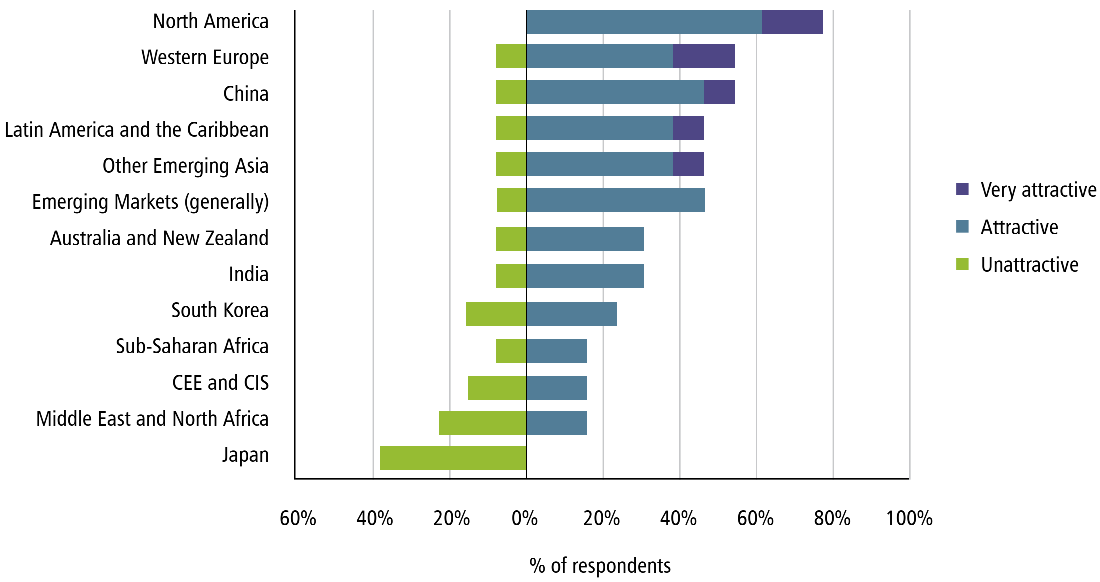
United States and Europe are where most Asia-based LPs began to build out their private equity portfolios, as these are considered developed markets and perhaps 'safer' by a generally risk averse investor base that is new to the asset class. What surprises me somewhat is that they continue to view the United States and Europe as the most attractive private equity markets."

Exhibit 4: Attractiveness of Select Markets for Committing New Capital to PE Funds



Source: EMPEA.

Brian Lim, Principal at global private equity fund investor Pantheon, agreed. "I would expect some early investors in Asian private equity—bar Australian and maybe Japanese LPs—to have been underweight in their local markets, as these were still nascent at the time and had limited opportunities for them to deploy capital effectively. However, I would have anticipated newer [commitments] to be showing higher allocations to Asia and the emerging markets," he said.

Looking forward, signs suggest that Asia-based LPs will play an increasingly important role in emerging markets private equity, not just locally but also internationally. Emerging markets as a whole ranked high on the attractiveness scale, with nearly half of LPs viewing them as either very attractive or attractive for private equity investment. In particular, China led the emerging market pack with 54% of respondents viewing it as either very attractive or attractive.

Latin America is also gaining visibility in the region, tying in terms of attractiveness for private equity investment with other Emerging Asian markets (ex. China and India). In fact, Latin America was viewed as relatively more attractive by Asia-based LPs than local markets such as Australia, India and South Korea.

> "I am not surprised that the United States and Europe are where most Asia-based LPs began to build out their private equity portfolios, as these are considered developed markets and perhaps 'safer' by a generally risk averse investor base that is new to the asset class. What surprises me somewhat is that they continue to view the United States and Europe as the most attractive private equity markets."
>
> Jean Eric Salata
> Baring Private Equity Asia

Emerging Markets are Poised to See the Highest Percentage Increase in *New* PE Commitments from Asian LPs

> "Every Board of Directors, CEO, CIO, and pension officer must consider China as a destination for all asset classes—regardless of the structural risks, regulatory changes, valuation volatility, capital imbalances, RMB competition, cases of fraud, GP instability and corporate governance opacity. The overall growth, consumption shift, industrialization, and urbanization in China are part of too great a macro event for LPs in PE programs to ignore."
>
> Philip Bilden
> HarbourVest (Asia) Ltd.

Several Asian LPs plan to translate their perception of the attractiveness of emerging markets into actual commitments. China was ranked as the market most likely to receive an increase in private equity commitments from Asia-based LPs, with 62% planning to increase their commitments to the country over the next two years.

HarbourVest's Bilden said the survey results suggesting higher future investments in China-focused funds fit with what he has seen in the market. "Every Board of Directors, CEO, CIO, and pension officer must consider China as a destination for all asset classes—regardless of the structural risks, regulatory changes, valuation volatility, capital imbalances, RMB competition, cases of fraud, GP instability and corporate governance opacity. The overall growth, consumption shift, industrialization, and urbanization in China are part of too great a macro event for LPs in PE programs to ignore. However, they dismiss or understate the risks at their fund beneficiaries' peril."

PV Wang, Partner at global fund of funds Adams Street Partners, cautioned that this large influx of capital may put stress on the Chinese GP market. "The growing allocation to Chinese private equity from LPs across the world is a challenge to the young industry there," he said.

Other Emerging Asian markets, including India, are also poised to receive an influx of private equity capital from Asian LPs, with just under half of the LPs participating in this study planning to increase their commitments to these countries. Outside the region, nearly 40% of Asia-based LPs intend to increase their commitments to Latin America and the Caribbean.

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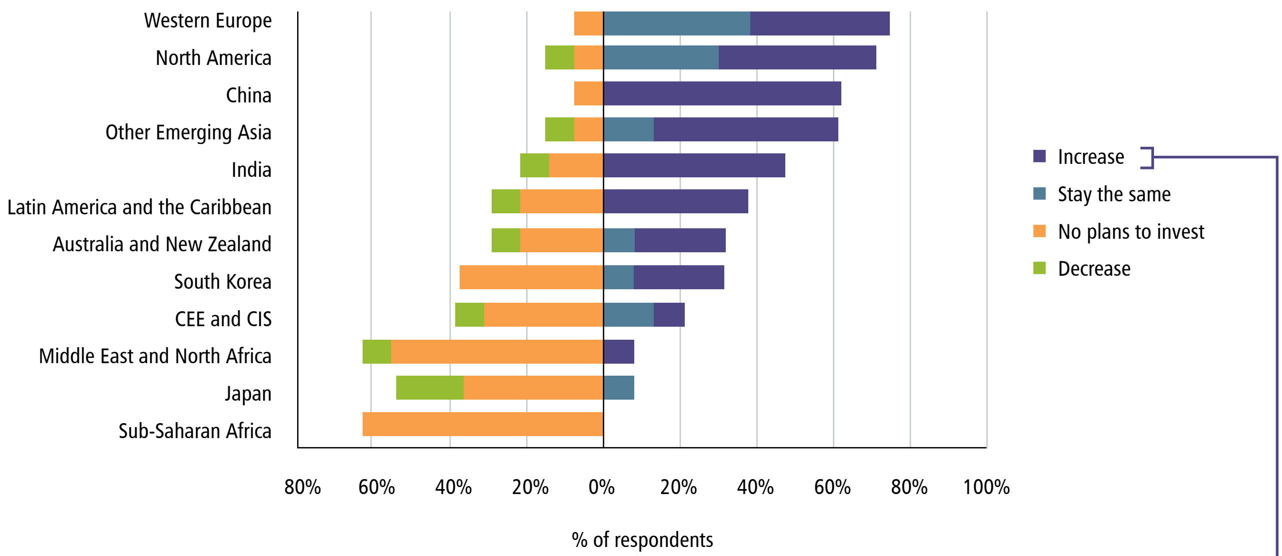
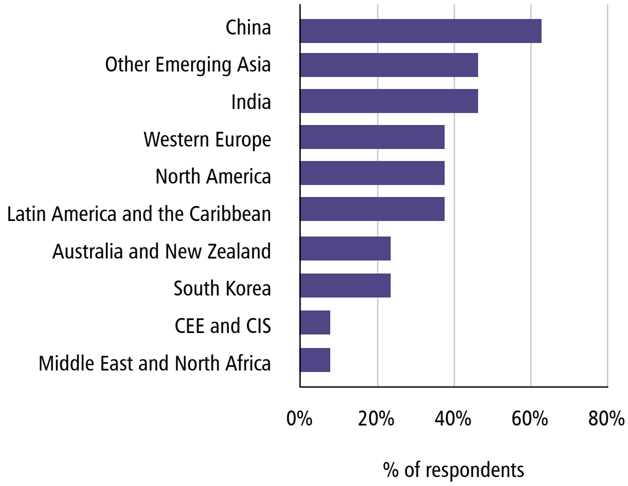
On the other side of the spectrum, Japan ranked as the least attractive market for private equity investment, followed by the Middle East and North Africa. Interest in Japan has suffered from historical difficulty of private equity investing in the country, while the focus on private equity activity in the MENA region has been impacted by political uncertainties. One LP noted that "macro factors and political instability creating headwinds" were the primary reasons it viewed both markets as unattractive.

Despite growing international fanfare around Africa, the majority of Asia-based LPs currently have no plans to invest in either Sub-Saharan Africa or the Middle East and North Africa.

Exhibit 5: Anticipated Changes to US Dollar Value of LPs' PE Fund Commitments Over the Next 2 Years



Markets Most Likely to See Increased Commitments Over the Next 2 Years



Source: EMPEA.

Outperformance Expectations are Driving an Increased Focus on Emerging Markets

Exhibit 6: Ranking of Net Return Expectations From 2011 Vintage Funds for Select Markets

Ranking	Market
1	China
2	Other Emerging Asia
3	Sub-Saharan Africa
4	Latin America and the Caribbean
5	India
6	Middle East and North Africa
7	Western Europe
8	United States
9	South Korea
10	CEE and CIS
11	Australia and New Zealand
12	Japan

Highest return expectations

Lowest return expectations

Source: EMPEA.

One of the key factors driving Asian LP interest in select emerging markets is return expectations. Net return expectations for LPs participating in the study are above 16% for emerging market-focused 2011 vintage PE funds, while they are generally below 16% for funds focused on developed markets.

China, other Emerging Asian markets, Sub-Saharan Africa, and Latin America and the Caribbean evoke the highest return expectations, while Japan, Australia and New Zealand evoke the lowest. Pantheon's Lim notes, "This is consistent with *EMPEA's Annual LP Survey*, and really shows the re-rating of private equity within the major emerging markets."

Exhibit 7 shows the distribution of net return expectations from 2011 vintage funds for a few select markets. Roughly 90% of LPs expect returns above 16% from China-focused funds, with one-third expecting net returns greater than 21%. In contrast, approximately 85% of LPs expect net returns below 10% from Japan-focused funds and just under half expect the same from funds focused on Australia and New Zealand. The market with the most mixed return expectations was Central and Eastern Europe and the Commonwealth of Independent States, where one-quarter of LPs anticipate funds focused on this region to deliver net returns of less than 10%, while one-quarter believe returns will be over 21%.

Commenting on the markets with the lowest return expectations, David Pierce, Chief Executive Officer of Squadron Capital, an investment firm that manages Asia-focused private equity funds of funds, notes,

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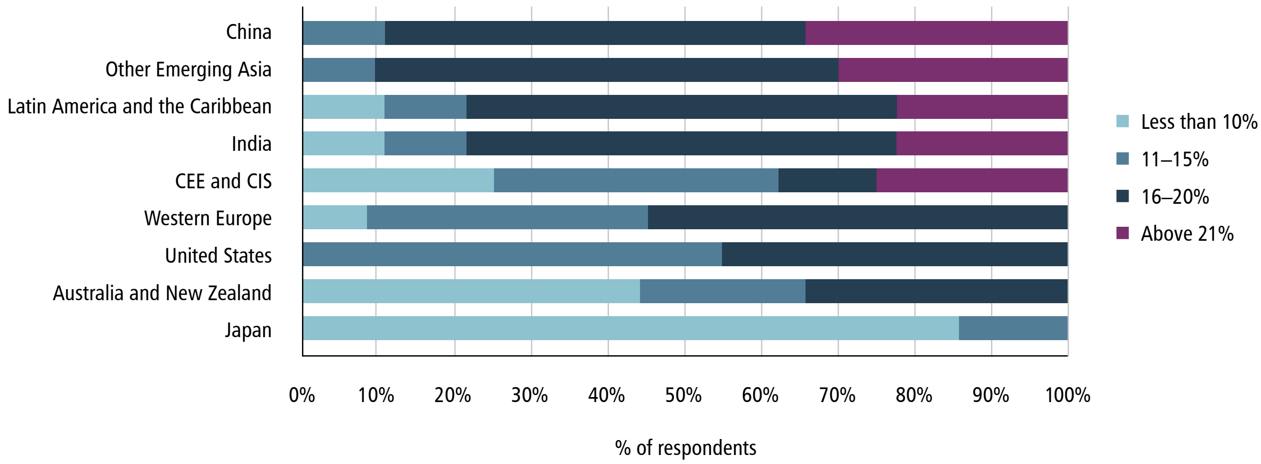
"Japanese LPs, at least up to now, have proven surprisingly willing to accept lower returns from Japanese GPs, probably due to their perception of lower risk with Japanese investments, concerns about currency appreciation and ease of communications."

Exhibit 7: Distribution of Net Return Expectations From 2011 Vintage Funds for Select Markets



Source: EMPEA.

Suyi Kim, Managing Director at Canada Pension Plan Investment Board (CPPIB) and head of the organization's Asian private equity fund investments, commented, "I am surprised to see that Asian LPs view Australia as one of the markets with the lowest expected return. If perceptions are due to some of the larger deals done in 2006–2008 struggling due to high amounts of leverage, then return expectations should not be any worse than those for the European Union and the United States. If anything, Australia has seen higher GDP growth than the European Union and the United States over the last two decades, averaging about 1% higher, thanks to its proximity to high growth Asian countries, which seem to have also benefited the private equity market."

"Japanese LPs, at least up to now, have proven surprisingly willing to accept lower returns from Japanese GPs, probably due to their perception of lower risk with Japanese investments, concerns about currency appreciation and ease of communications."

David Pierce
Squadron Capital

The Perception of Too Few Established GPs is Inhibiting LP Commitments in Emerging Asian Markets

"Whilst listed market equity exposure can be a good way of accessing growth in the emerging markets, it is not a good proxy for private equity. For instance, listed equity markets in the emerging markets often have low exposure to some of the highest growth sectors that benefit from domestic consumption, such as the retail sector. Instead of looking at listed markets as a substitute for private equity, it should be seen as a complement."

Brian Lim
Pantheon

In general, the leading factors for selecting private equity funds for Asia-based LPs are the experience/skill-set of the management team, team stability/alignment and track record. Geographical and sector strategies were the lowest ranked factors for fund selection.

When asked how their organizations deal with the uncertainties and risks of choosing a fund manager in a less developed private equity market, some replied that they take a hands-on approach. For instance, one LP stated, "We examine the experience of the managers and, if they do not have local private equity experience, we will evaluate the work they have previously done." However, most Asian LPs take a wait-and-see approach. One investor remarked, "We might have to skip opportunities in some markets," and another commented, "We wait for them to get the requisite level of experience."

In fact, a limited number of established GPs was the most frequently cited barrier to investment in select Emerging Asian markets, alongside a lack of information on the asset class. In particular, several Asia-based LPs noted Vietnam and the Philippines as markets challenged by a dearth of established GPs, while a lack of information on the asset class was a key investment deterrent for at least one LP for all markets—and Indonesia and the Philippines, in particular.

While a challenging regulatory environment was cited as an inhibitor to investing in China for some Asia-based LPs, on the whole, regulatory issues were not an overwhelming hindrance to private equity investing in most Emerging Asian markets. When one investor who did cite this as a challenge was asked what governments in these markets could do to encourage greater investment from them as an LP, the respondent commented that "greater transparency, better tax laws and

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foreign exchange regulations" would be key steps in the right direction. Another LP noted, "Government policies have been changing dramatically, but, especially in the case of China, they remain quite vague."

HarbourVest's Bilden remarked, "Many GPs have helped the region's LPs resolve structural issues arising from regulation, and Emerging Asia is not the only Asian sub-market where regulation has conspired against clear, predictable rules of investment in Asian private equity. Of note, South Korea, Japan and Australia all famously adopted unexpected tax rules on the private equity industry that threatened the practice and return profiles of GPs in those developed markets."

Exhibit 8: Factors Likely to Deter LPs From Investing in Select Asian Markets

	Already exposed via other asset classes	Challenging regulatory environment	Entry valuations too high	Lack of information on asset class	Limited number of established GPs	Political risk	Scale of opportunity too small	Weak exit environment
China	23%	23%	15%	8%	23%	23%	0%	0%
India	23%	15%	23%	8%	15%	23%	0%	0%
Indonesia	0%	15%	0%	38%	31%	23%	8%	8%
Malaysia	0%	0%	0%	20%	31%	8%	15%	0%
Philippines	0%	15%	0%	38%	38%	23%	31%	0%
South Korea	8%	0%	0%	8%	31%	8%	15%	0%
Thailand	0%	8%	0%	31%	31%	15%	23%	0%
Vietnam	0%	8%	0%	31%	38%	15%	23%	8%

Source: EMPEA.

Some of the most frequently cited challenges in China and India were exposure to these markets via other asset classes, high entry valuations (in the case of India), and political risk. Pantheon's Lim cautioned, "Whilst listed market equity exposure can be a good way of accessing growth in the emerging markets, it is not a good proxy for private equity. For instance, listed equity markets in the emerging markets often have low exposure to some of the highest growth sectors that benefit from domestic consumption, such as the retail sector. Instead of looking at listed markets as a substitute for private equity, it should be seen as a complement."

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Open to qualified LPs only
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Washington, DC

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15–16 May 2012
Washington, DC

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17 May 2012
Washington, DC

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EMPEA
Emerging Markets Private Equity Association

Founded in 2004 by a handful of visionaries at the heart of the emerging markets private equity and venture capital industry, the Emerging Markets Private Equity Association (EMPEA) is a non-profit, independent, membership organization that provides its member firms with superior intelligence through research, education and networking opportunities across the globe.

EMPEA Members receive exclusive access to authoritative information and insight into the opportunities in the emerging markets private equity and venture capital industry.

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