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CAPITAL GROUP

ASANTE CAPITAL SOLUTIONS

Asante Capital is a leading independent private equity placement and advisory group focused on partnering with best-in-class managers and limited partners in both developed and emerging markets.

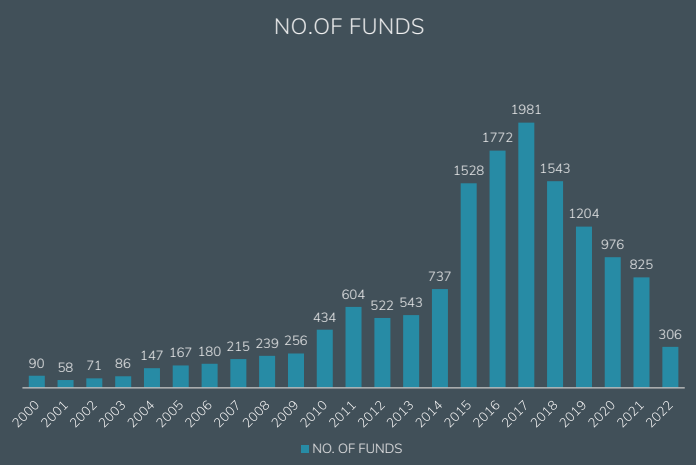
LENS ON THE ASIA-PACIFIC MARKET

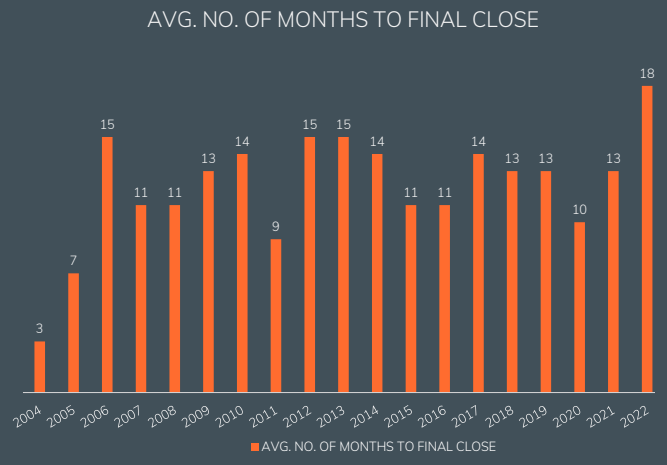
Following a decade of robust and unprecedented growth in the Asia-Pacific private equity region, 2022 brought with it a combination of challenges, ranging from the lingering effects of the COVID pandemic, global economic downturn and general macro uncertainty, casting a dark cloud over the region's private markets. The answer to what the market in 2023 will look like is multi-faceted: in this newsletter, we are putting a spotlight on the key trends we are seeing in the APAC region and assessing their impact on the fundraising landscape.

EXTENDED FUNDRAISING TIMELINES

For Asia-based managers that held a final close in 2022, it took an average of 18 months from fund launch to closing, versus an average of 13 months in 2021. It was also the longest in the past 20 years and there is obviously survivorship bias. In fact, many GPs are struggling to raise at all – only 306 private equity funds were raised in 2022, a drastic decline from 825 in the previous year. Capital raised for Asia-based GPs saw the biggest drop (c.55-60%) in the past 20 years, driven by notable risk aversion towards China, but also by a general 'reverse globalisation' trend where investors have tended to increasingly focus on domestic or geographically closer markets.

We expect this sluggish trend in the Asian market to persist through 2023. Managers who are still in the market or planning to launch a new fund in 2023 are likely going to face an extended fundraising period given the domino-effect triggered by the backlog and allocation pressures faced by LPs (many of whom are affected by the denominator-effect from plummeting valuations in public markets), a lukewarm economic growth outlook, decline in dealmaking and exits, as well as competition for capital from protracted fundraises by large-cap managers who failed to achieve their fundraise target in 2022. In summary, a reduced amount available of LP capital is being targeted by an increased number of GPs, who failed to achieve capital targets within their stipulated timeframes compounded with managers who wanted to avoid launching in 2022, but are now in need of dry powder.





While riding the current wave of the fundraising market, it is more important than ever for GPs to carefully evaluate their fundraising strategy, positioning of their investment strategy, portfolio, pipeline and ability to deliver exits ahead of a fund launch to help turn a short-term delay into a long-term growth opportunity. Proof of concept, delivery of DPI and a clear strategy differentiation are key to standing out in a saturated fundraising market.

1. Number of funds raised by Private Equity managers based in Asia
2. Average number of months to Final close based in Asia

RESHUFFLING OF ALLOCATION IN A SHIFTING APAC ENVIRONMENT

We are seeing global investors make adjustments to their allocation plans in view of market dislocations and evolving international geopolitical dynamics.

In general, consistent with fears of geopolitical tensions and uncertain market outlook, investor apprehension is evident amongst Western LPs. Unsurprisingly, escalating trade tensions and deteriorating US-China relationships have inevitably resulted in US investors reducing their allocations to China. Indeed, investor types with more conservative risk-reward profiles, such as some US state pensions, have responded to concerns over the geopolitical landscape by completely putting a pause on funding China GP relationships. The Asante Survey conducted in Q3 2022 suggests LPs will look to recalibrate their portfolios in 2023 by moving away from Asia compared to previous years – with Asia expected to experience a 15% reduction of private capital allocations while Europe and North America to benefit from an increase of 8% and 26% respectively.

Shifting investor preferences in China also provide an insightful case study of private market responses to geopolitical risks. Chinese LPs have been increasingly moving away from the US both on a voluntary and involuntary basis. Headline risks have prompted state-owned or state-backed Chinese investors that are cautious of the geopolitical sensitivity to shift their allocation away from the US. On the supply end, there have also been isolated cases of US GPs turning down Chinese capital due to perceived sensitivities.

For Chinese GPs, the reshuffling of allocation poses a more challenging fundraising environment, particularly for managers who have historically had strong support from US-based LPs. To counterbalance the diminishing appetite from US / European investors, Chinese GPs will have to reassess their ambitions for regional LP diversification, as well as adopt more creative processes in seeking capital. As such, we are seeing Chinese GPs adjusting their strategy from a purely domestic Chinese player to becoming a “China plus” or pan-regional player, as well as incorporating new sectors of focus that benefit from prevailing China policy tailwinds.

While investor sentiments towards China is due to improve, perceived market turmoil has brought about vast opportunities for managers elsewhere. Within Asia, capital has shifted away from China into two camps: developed Asia buyout strategies and venture capitals in Southeast Asia. Given diminshed appetite for Chinese venture capital, traditional buyout strategies in developed markets in Asia have seen increased levels of interest, supported by global investors that are looking to deploy into less risky asset classes regions. Within emerging markets, venture capitals in SEA and India are also benefiting from the shift of allocation with more attention and capital flowing into the region. Asante’s anecdotal evidence throughout the year firmly illustrates the effect of tightening fundraising markets due to economic and geopolitical uncertainty, whereby LPs have narrowed their investment focus in favour of established managers in more developed regions (a clear flight to perceived safety).

DIFFERENTIATION THROUGH SPECIALISATION

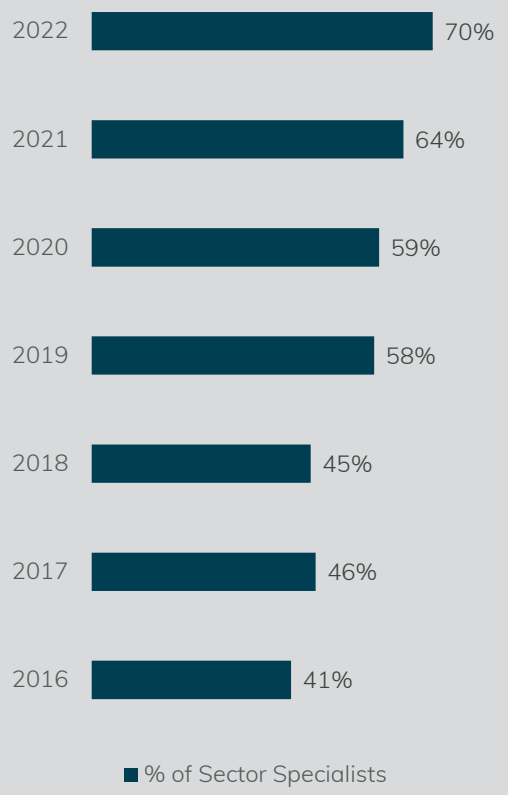
Having said the above, LPs will inevitably continue to deploy despite the fact that the bar is higher than it's ever been. As we step into 2023, sector specialisation is a major theme we expect will become ever more prevalent in the Asia-Pacific region as the market evolves.

Over the past two years, the market saw the popularisation of sectors previously perceived as more "niche", such as deep tech, biotech, mobility, artificial intelligence. This was initially driven by generalists across the region building out specialised investment capabilies in these sub-sectors, but we are now at an inflection point for many of these sub-sectors where new GPs are emerging that specialise in these areas as their core. The sector specialisation trend has also been partially driven by increasing competition with new groups emerging and hence the need to differentiate at a time when LP capital is more scarce than ever. Take China as an example, 70% of Chinese VC/Buyout GPs are sector specialists today, versus only 41% in 2016. We believe this trend is here to stay, as truly specialized GPs have an advantage over generalists given their deep network, reputation, greater understanding of fundamentals within their verticals, and a bench of experts within their ecosystem that provides them with a significant sourcing edge.

A recent example of the positive effects this brings to the fundraising process is NIO Capital, who began fundraising for their second USD Fund in late 2021, and despite full travel restrictions and less than ideal macro conditions still achieved a sizable first closing less than 4 months into the fundraise and closed at the USD 380m hard-cap in mid-2022. The manager's specialised focus on the mobility and new energy space, and the core themes of digitalisation and decarbonisation where they are a recognized first-mover in China, helped them achieve a quick second fund raise despite the negative impacts of COVID-19 and market-wide decrease in appetite in China over that period. Likewise, Potentia Capital, a middle market manager focused primarily on investments in the technology space within Australia and New Zealand, was able to achieve a single final close of its Fund II within 6 months, with LP interest almost 2x their fund target.

With the expectation that the investment landscape remains in a state of flux in 2023, allocating capital for the long term will likely remain a challenging task for market participants. Both LPs and GPs might continue to benefit from shifting towards those with a more specialized lens when looking at potential opportunities in the market.

PERCENTAGE OF CHINA VC / BUYOUT GPS WHO ARE SECTOR SPECALISTS FROM 2016-2022



Source: Preqin

1. Per a study by Cambridge Associates, the advantages of taking a specialist approach have yielded clear investment return margin on generalist strategies. Investments executed by sector specialists from 2001 to 2010 have generated a MOIC of 2.2x and IRR of 23.2%, versus investments by generalists during the same period, that have generated a MOIC and IRR of 1.9x and 17.5% respectively.

HARNESSING SECONDARIES IN TODAY'S MARKET

The resurgence of COVID-19 in Asian economies has slowed exit processes for many GPs, particularly within the venture capital space, which has historically relied on equity capital markets to generate liquidity. While trade sales continue to take up a significant share of sponsor exits, an increasing number of GPs are considering secondary solutions as an alternative exit avenue and for liquidity.

In theory, GP-led secondary transactions such as continuation vehicles or strip sales provide the GP with a path to accelerate liquidity for a fund and allow the GP to effectively "dial up" the DPI. This could prove to be a powerful fund management solution for Asian GPs. However, the transactional dynamics differ substantially from an IPO or a trade sale. It involves nuanced negotiations between the GP, existing LPs, and secondaries buyers, and these are typically facilitated by a third-party advisor. GPs should consider the commercial rationale behind a GP-led secondary solution, be it continuing the growth story of star assets or legacy fund clean-up. In today's market dynamic of flight to quality and diversity, secondary investors are focusing on assets with proven value creation, promising business outlook and a clear path to exit. The supply of assets in the market and the risk premium uplift embedded within a secondary buyer's return hurdles would likely impact pricing and terms, however quality assets with performing GPs remain marketable.

SELECT ANNOUNCED GP-LEAD SECONDARIES TRANSACTION IN ASIA PACIFIC

Announced Date	GPs	Transaction	Transaction Size
Jan 2023	Samara Capital	Fund II Multi-asset CV	USD 150m
Nov 2022	Quadrant Private Equity	Single-asset CV - MotorOne	USD 165m
Jul 2022	Hahn & Co	Single-asset CV - Ssangyong C&E	USD 1,500m
Jun 2022	L Catterton Asia	Fund III Strip Sale	USD 360m
Apr 2022	Hosen Capital	Single-asset CV - Kilcoy Global Foods	USD 280m
Jan 2022	B Capital	Fund I Strip Sale	USD 200m
Jan 2022	Bright Capital	RMB to USD Fund Restructuring	USD 82m

An increasingly relevant secondary solution in a market with tougher fundraising climate, such as the Asia-Pacific region, is the tender process. This provides optional liquidity to existing LPs that are reallocating or unlikely to be strong supporters of the GP's franchise going forward. It provides for the opportunity to bring onboard strategically relevant investors.

With the more active Secondaries investors in Asia raising / planning to raise their next dedicated funds in 2023 (to name a few: NewQuest, Bee Capital, TR Capital, and Coller Capital), we expect buyers to continue to be active and selective in terms of deal selection and structuring. Coupled with fundraising congestion and market risks, we anticipate Asian GPs to increasingly consider GP-led secondaries as a tool to catalyze fundraising, whether through the improvement of performance metrics on previous funds, through leveraging the secondary transaction to secure additional time and capital for assets, or through an outright staple commitment to the first close.

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