

BCG

REPORT

Private Equity in Southeast Asia

Increasing Success, Rising Competition



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PRIVATE EQUITY IN SOUTHEAST ASIA

INCREASING SUCCESS, RISING COMPETITION

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EXECUTIVE SUMMARY

This report surveys the dealmaking landscape in Southeast Asia, one of the world's most dynamic and fast-growing regions, providing private-equity (PE) professionals with a detailed overview of the opportunities and challenges to be found there. In addition to reviewing recent dealmaking activity and the investment theses that are driving transactions, BCG describes the unique aspects of culture, business practices, and government policy that make Southeast Asia unlike any other global marketplace.

Over the past decade, Southeast Asia has become a dealmaking hotspot, drawing an influx of PE firms from the U.S. and Europe. The fast-expanding wealth, abundant natural resources, and rapidly developing business sectors of the ten members of the Association of Southeast Asian Nations (ASEAN) make it fertile ground for investment, and many firms have already prospered there by pursuing a growth thesis.

The very popularity of that thesis, however, has intensified competition for deals and driven multiples upward. Recognizing that fact, we include a section on alternative investment theses and the overlooked opportunities that they can reveal. Gathering robust empirical data and the observations of seasoned regional experts, this is an essential guide to Southeast Asia for PE professionals, investors, and global executives.

Western PE firms have long held a mixed view of Southeast Asia, but several trends are converging to make the region a dealmaking hotspot.

- Investors have traditionally associated Southeast Asia with political and economic volatility, a legacy of events such as the 1997 currency crisis and the rioting that rocked Thailand in 2010.
- Despite these concerns, competition for deals is rising, and with good reason. With a regional population of around 611 million and a GDP of \$3.3 trillion that's growing annually at about 8 percent,

Southeast Asia is the third-largest emerging-market bloc after China and India, besting Brazil and Russia by a wide margin.

Economic, political, and demographic transformations are driving the region's strong growth.

- Economic reform has spread across the region. Restrictions on foreign ownership have been relaxed, and some governments are actively developing a PE sector. At the same time, intraregional ties are strengthening and deepening.
- Strong demand for Southeast Asia's rich endowment of natural resources, which include oil and gas, minerals, palm oil, and agro-commodities, is increasing wealth while powering the growth of adjacent industries such as logistics and transportation and oil services.
- Southeast Asia's consumer class is growing rapidly. Approximately 102 million households in the region are projected to achieve middle-class status (that is, an annual income of more than \$3,000) by 2015, up from about 75 million today. Consumer expenditures are expected to grow accordingly.
- Manufacturers are moving out of China and into Southeast Asia. As inflation erodes China's cost advantage, companies across multiple sectors are flocking to Southeast Asia, drawn by its competitive costs and its potential to serve as a hedge against new Western curbs on Chinese goods.

Southeast Asian companies have strong profits and growth prospects.

- Because there is, in general, less competition within many sectors of the Southeast Asian economy than within China and India, profit margins are correspondingly higher. As a result, despite Southeast Asia's smaller market size, profit pools are frequently as large as those in China and India—if not larger.
- Some sectors of Southeast Asia's economy are poised to expand at a rate that far outstrips the region's overall GDP growth rate. Some of the most attractive investment opportunities in the region can be found in such sectors as beauty products, dental care, life insurance, and private education, which are currently entering the rapid-expansion stage.

Asset prices in most Southeast Asian countries are relatively high.

- As measured by recent M&A transactions, acquisition prices in Indonesia have risen to 16.2 times earnings. In the Philippines, the average price-earnings ratio is nearly as high, at 15.8, while Malaysia, at 14.2, and Singapore, at 12.9, are close behind. Thailand, at 12.1, and Vietnam, at 9.8, appear relatively cheaper, primarily because of both countries' lower growth expectations and higher perceived risk.

- At least some businesses have the growth potential to justify these valuations. At prevailing prices, however, the corridor for success is narrower than in the past. Successful dealmaking increasingly depends on execution before and after closing. Best management practices will separate the winners from the also-rans.

The environment for exit transactions is improving as financial markets gain sophistication.

- PE investors have successfully exited deals in all countries and most sectors. Funds have realized their returns mainly through initial public offerings (IPOs) and trade sales, as secondary transactions are still relatively rare in Southeast Asia.
- Most IPOs have been executed on local stock exchanges. IPO outcomes depend heavily on local capital-market conditions, and historically Southeast Asia's stock markets have shown resilience in the face of economic shocks.

State-owned PE funds and family business groups are powerful forces in the dealmaking arena.

- State-owned PE funds (also called sovereign-wealth funds) enjoy several advantages, including deep knowledge of local markets and considerable political influence.
- Business groups, for their part, bring significant synergies to the table. These groups frequently have regulatory and governmental credibility that serves them well in deal negotiations.
- Like PE investors, these other players have confined most of their dealmaking to a handful of economic subsectors, and, as a result, asset prices have risen while return expectations have fallen.

Most PE firms in Southeast Asia follow a straightforward growth thesis.

- There is currently a focus on deals in food and beverages, durables, modern retail, natural resources, and technology, media, and telecommunications.
- Outside those sectors, competition for deals is less intense and deal premiums are lower. BCG believes investors should consider exploring less well-covered territory, such as business support carve-outs, roll-up and buy-and-build opportunities, and infrastructure investments.

Local knowledge confers a major strategic advantage.

- The region's unique social, political, and cultural characteristics shape the business climate. Rather than simply transfer a U.S. or European model to the region, PE firms need to understand and adapt to each country's distinct idiosyncrasies and business customs.

- Firms entering the region for the first time should expect to do smaller deals and be prepared to take minority stakes in order to accommodate family ownership groups and government-linked investors. Lead times are long, raising transaction costs.
- Pricing acquisition targets is a tricky business that relies on accurate forecasts of long-term growth. To avoid overpaying, PE firms need to ground their calculations in a deep understanding of local markets and a realistic assessment of growth trends.

A DYNAMIC REGION WHERE RISKS ABOUND

Investors often associate Southeast Asia with political, economic, and environmental turmoil. And for good reason. Heavy rains have hit Indonesia every year since 2006, causing flooding and damage. Vietnam, whose annual inflation rate since 2005 has gyrated from 7 percent to 23 percent and back down to 6 percent, could be a case study in monetary instability. In Thailand, the 2011 flooding that wiped approximately 10 percent off GDP in just three months threatened to deepen the chronic political instability in that country, which is still shaken by the 2010 riots that climaxed with the destruction by fire of Bangkok's Central Shopping Mall. As a result of such events, overseas investors have frequently taken a mixed view of the region, admiring its galloping growth and the locals' entrepreneurial zeal but remaining critical of the dearth of management talent and lamenting how close ownership, bureaucracy, and, on occasion, corruption have slowed the development of an open business climate supported by robust regulatory and legal frameworks.

Yet competition for deals is rising—clear evidence that Southeast Asia remains attractive to investors despite the challenges it presents. With a regional population of around 611 million and a GDP of \$3.3 trillion that's growing annually at about 8 percent, it is the third-largest emerging-market bloc after China and India, besting Brazil and Russia by a wide margin. (See Exhibit 1.) The Boston Consult-


























ing Group has gathered the observations of our country experts in Southeast Asia to offer private-equity (PE) professionals an overview of investment opportunities—and potential pitfalls—to be found in this dynamic but challenging region. (See the sidebar “The Makeup of Southeast Asia.”)

What's Driving the Region's Growth

Several forces are converging to drive Southeast Asia's growth. They include the following:

- *Increasing Economic Liberalization.* Economic reform has spread across the region. Indonesia is breaking down restrictions on foreign ownership, and Malaysia has actively focused on the creation of a PE sector. More recently, Myanmar appears to be embarking on a dramatic, if fitful, shift toward greater political openness and a market economy. Chastened by the 1997 Asian crisis, central banks in the region have upped their game. Monetary policy across the region has stabilized, and interest rates and currency movements, with the exception of those in Vietnam, have been relatively stable. The banks have also strengthened their management of excess capital, which was such a significant driver of the currency disruptions of 1997.

EXHIBIT 1 | Southeast Asia Is a Populous, Fast-Growing Market

	 ASEAN	 China	 India	 Brazil	 Russia
					
GDP¹ (\$billions)	3,321	11,359	4,497	2,285	2,370
World (%)	 4.2	 14.4	 5.7	 2.9	 3.0
CAGR, 2006–2011 (%)	~6.8	12.5	9.6	6.1	4.6
CAGR 2011–2016 (%)	<u>~7.9</u>	10.4	10.3	6.5	6.1
GDP per capita² (\$)	5,440	8,600	3,740	11,850	16,750
Population (millions)	611	1,320	1,202	193	142
World (%)	 ~9.5	 20.6	 18.8	 3.0	 2.2
World exports³ (%)	 ~6.9	 10.7	 1.9	 1.4	 2.9
CAGR 2006–2011 (%)	10.0	14.4	22.0	13.2	11.4
CAGR 2011–2016 (%)	10.2	11.5	13.8	8.0	5.0

Sources: Economist Intelligence Unit, BCG analysis.

¹Nominal GDP (\$ at purchasing power parity)

²GDP per capita in 2011 (\$ at purchasing power parity)

³Total exports in 2011 (FOB)

- Rising Regionalization and Intraregional Trade.** Although Southeast Asia encompasses ten very different countries, each with its own distinct business culture, economic integration is rising. Trade within the region is again on the upswing after faltering during the global financial crisis. The Association of Southeast Asian Nations (ASEAN) is formally targeting 2015 as a date to establish a common single market with a freer flow of labor and reduced tariffs.

Whether the alliance can fully implement its agenda remains an open question, but the possibility alone is already fueling rising cross-country competition in multiple sectors. A growing number of more nimble business groups, such as AirAsia, Maybank, and CIMB, are establishing footholds in multiple countries in the region.

- Rising Demand for Resources.** Southeast Asia is benefiting disproportionately from

THE MAKEUP OF SOUTHEAST ASIA

ASEAN includes ten countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Its GDP, at \$3.3 trillion, accounts for 4.2 percent of the world total and is expected to grow at a 7.9 percent compound annual growth rate from 2011 through 2016. Population, currently around 611 million, is projected to grow at a 10.2 percent compound annual growth rate from 2011 through 2016.



its rich endowment of natural resources, which include oil and gas, minerals, palm oil, and agro-commodities, among others. Strong demand is increasing wealth while powering the growth of adjacent industries such as oil services and logistics and transportation. In Indonesia, for example, the oil and gas services sector grew at a 12.3 percent compound annual rate from 2005 to 2012, tracking the rise in oil prices from about \$55 per barrel in 2005 to around \$100 per barrel today. The oil and gas sector currently accounts for 8.5 percent of Indonesia's GDP, 25 percent of budget tax and nontax revenues, \$10 billion of annual expenditures on exploration and development and production, and \$30 million per year of community development investment.

As fast as Southeast Asia's GDP is growing, its consumer class is growing even faster.

- *Urbanization and a Swelling Middle Class.* As fast as Southeast Asia's GDP is growing, its consumer class is growing even faster. Approximately 102 million households in the region are projected to achieve middle-class status (that is, an annual income of more than \$3,000) by 2015, up from about 75 million today, and consumer expenditures are expected to grow rapidly. That creates investment opportunities in industries such as organized retail, consumer products, health care, education, transportation, and telecommunications.
- *Shift of Manufacturing from China to Southeast Asia.* Manufacturing in Southeast Asia appears set to benefit from the increasing movement by companies away from China and into other markets—reversing the trend of the past 15 years, when manufacturing migrated northward from Southeast Asia to China. As inflation has eroded China's cost advantage, companies across multiple sectors are flocking to Southeast Asia, drawn by its competitive costs and its potential to

serve as a hedge against new Western curbs on Chinese goods. Northstar Group's 2012 acquisition of Multistrada, a tire manufacturer based in Indonesia, may be a recent example of this trend, occurring as it is in a sector particularly susceptible to trade disputes. Another example is Navis Capital's \$62.4 million acquisition of apparel producer King's Safetywear in 2008. King's has manufacturing plants throughout the region and is poised to gain from any manufacturing migration out of China.

An Edge in Profitability and Promise

The investing climate in Southeast Asia is also notable for the profitability and growth prospects of companies there. Because there is, in general, less competition within many sectors of the Southeast Asian economy than in China and India, profit margins are correspondingly higher. As a result, despite Southeast Asia's smaller market size, profit pools are frequently as large, if not larger. For example, Southeast Asian revenues in consumer financial services hit \$91 billion in 2010, about half of China's \$184 billion. Yet because average margins in Southeast Asia were 4 percent, versus 2 percent in China, the region's profit pool, at roughly \$3.6 billion, was virtually identical to China's. India's consumer-financial-services sector generated \$34 billion in revenues and \$700 million in total profits, at a margin comparable with China's. Consumer sectors such as tobacco and food and beverages exhibited a similar pattern.

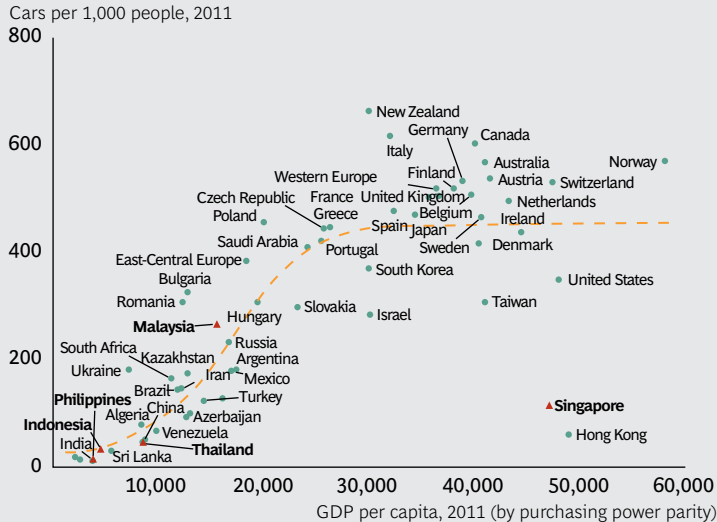
In addition, certain selected sectors of the region's economy are poised for surging growth. Historically, emerging economic subsectors hit an inflection point—the first upward slope of an S curve—when national wealth reaches a given level. (See Exhibit 2.) When wealth arrives at this tipping point, some economic subsectors expand at a rate that far outstrips the overall GDP growth rate. In Indonesia, for example, the proliferation of modern trade has propelled the mini-mart sector to a 45 percent compound annual growth rate (CAGR) from 2004 through 2007, more than three times Indonesia's overall CAGR of 14 percent. (See Exhibit 3.)

Across the region, consumer sectors such as beauty products, dental care, life insurance, and private education are in the early stages of similarly strong growth surges. Sectors such as professional services and talent management,

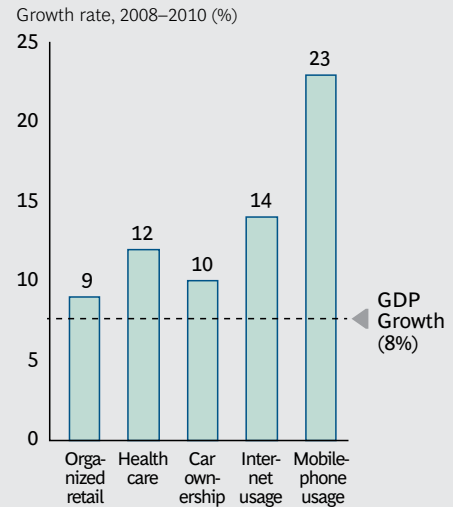
which grow as the overall economy and wealth increase, are also growing faster than GDP. We believe some of the most attractive investment opportunities in the region can be found in sectors now on the lower slopes of their S curves.

EXHIBIT 2 | Selected Economic Sectors Are Poised to Outpace GDP Growth

Many industries (such as the auto sector) are at the start of the S curve...



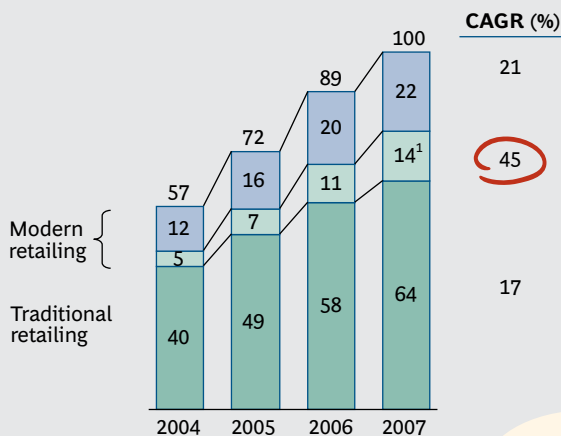
... As a result, individual sectors frequently outpace GDP growth



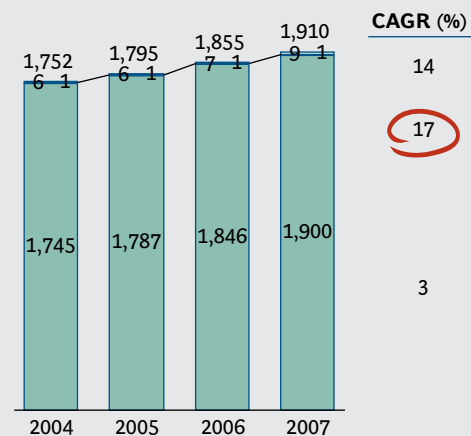
Sources: Economist Intelligence Unit; BCG analysis

EXHIBIT 3 | Mini-marts in Indonesia Grew 45 Percent (CAGR) from 2004 Through 2007

Historical retail growth in Indonesia 2004-07 (IDR trillions)



Historical retail growth in Indonesia 2004-07 (thousands of outlets)



Modern retailing has ~1% share of outlets but ~35% value share.

Sources: "Retail and Shopper Trends Asia Pacific 2008," A.C. Neilson; "Convenience Stores: Indonesia," Euromonitor.

¹Total Sales were calculated based on total share of minimart sales available, according to A.C. Neilson; mini-mart value was triangulated from Alfamart's revenues (from its IPO press release) and shares from Euromonitor.

²Modern retailing consists of hypermarkets, supermarkets, and mini-markets.

An Uneven Rise in Asset Prices

Even as Southeast Asia develops a stronger regional identity, wide country-by-country variations in deal opportunities, industry ownership, and economic structure remain. Likewise, asset prices vary significantly throughout the region. (See Exhibit 4.) As measured by recent M&A transactions, acquisition prices in Indonesia have risen to 16.2 times earnings. In the Philippines, the average price-earnings ratio is nearly as high, at 15.8, while Malaysia, at 14.2, and Singapore, at 12.9, are close behind. Thailand, at 12.1, and Vietnam, at 9.8, appear relatively cheaper, primarily because of both countries' lower growth expectations and higher perceived risk. The companies in both countries that are considered lower risks generally command higher multiples.

Although asset prices in the region may appear high, we believe that at least some businesses have the growth potential to justify these valuations. At prevailing prices, however, the corridor for success is narrower than in the past. It is more crucial than ever to pick businesses that can deliver on their promises, because economic growth alone will likely no longer assure a positive return. Successful

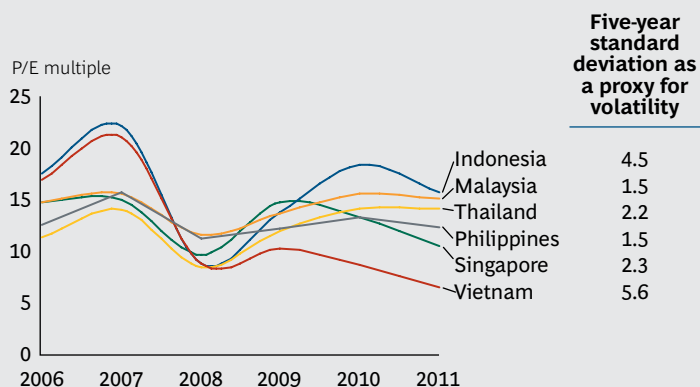
dealmaking increasingly depends on execution before and after closing. Best-management practices will separate the winners from the also-rans.

Prior to closing, winning PE players will take care to explore alternative deal mechanisms and engage in creative dealmaking in order to optimize capital structures as market and macroeconomic conditions change. After closing, management needs to deliver significant above-market growth and achieve business model extensions, improve pricing practices, and enhance the efficiency of target companies' costs and capital controls. In other words, selecting a target and consummating the transaction are just the first steps.

Savvy investors can achieve handsome returns, potentially comparable with those posted by the four top-ten Asia-Pacific funds with a focus on Southeast Asia or a mandate to invest there. Those funds and their net internal rates of return (IRR), as compiled by Preqin, a clearinghouse for data on alternative investments, are Vietnam Equity Fund, with a net IRR of 104.9 percent; Headland Asian Ventures Fund 3, with a net IRR of 94.7

EXHIBIT 4 | Deal Multiples Vary Widely Across the Region

Median price-earnings multiple for public equities¹



Median price-earnings multiples for preceded M&A transactions per country, 2006–2011



Sources: Bloomberg; Thomson OneBanker; BCG analysis.

¹Sample for each year consists of the top-100 public companies by market capitalization listed on the main local stock exchanges. The sample can be different for each year on the same stock exchange since companies' market cap changes affect the top-100 constituents.

²Equivalent to the sample size for the median calculation.

percent; BankInvest Private Equity New Markets II; with a net IRR of 71.1 percent; and Baring Asia Private Equity Fund III, with a net IRR of 66.2 percent. Only Headland is a venture fund; all the others are expansion or late-stage, growth, or balanced funds.

Where's the Exit?

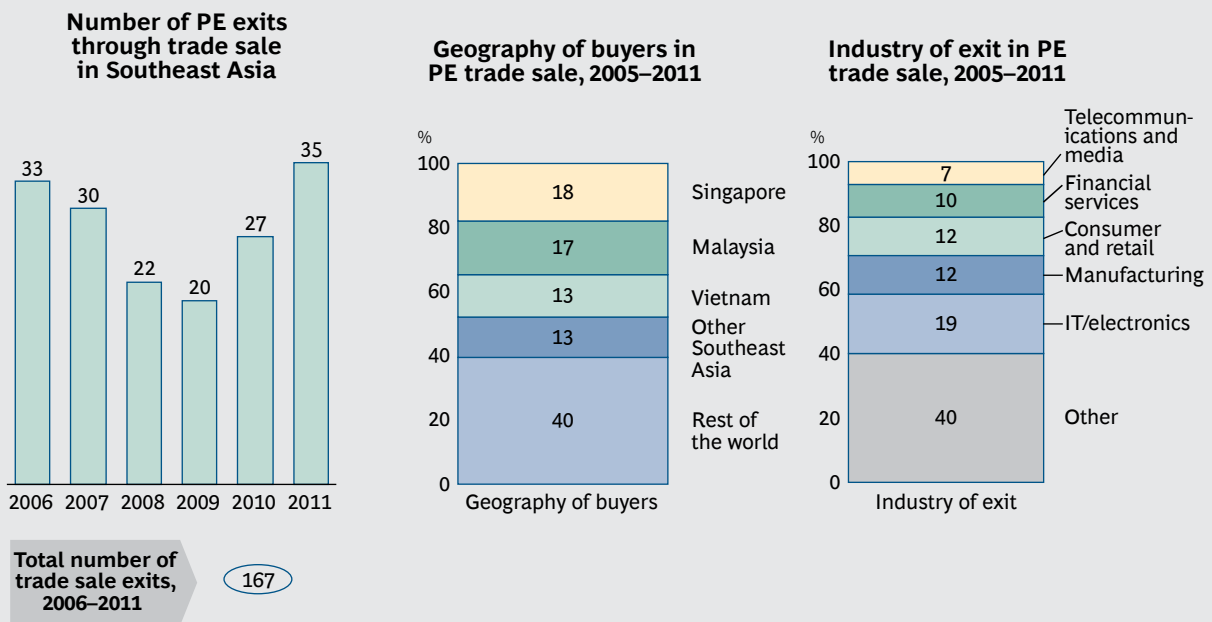
PE firms contemplating investing in Southeast Asia invariably ask if there are proven paths to follow in order to exit. The answer is a qualified yes, and the environment is improving as financial markets gain sophistication. PE investors have successfully exited deals in all countries and most sectors. Funds have realized their returns mainly through initial public offerings (IPOs) and trade sales, as secondary transactions are still relatively rare in Southeast Asia. According to *Asia Venture Capital Journal*, there were 167 exits through trade sales and 78 IPOs in Southeast Asia, compared with only 16 secondary transactions in the region. Sixty percent of trade sales occurred within the region. The remaining 40 percent was divided among acquirers in Europe, the U.S., Japan, China, India, and the United Arab Emirates. (See Exhibit 5.)

Some notable examples of trade-sale exits include TPG's sale of a stake in Parkway Holdings, a hospital operator, to Fortis Healthcare for \$685 million in 2010; TPG's 2008 sale of a stake in BankThai to CIMB, a Malaysian bank, for \$145 million; and VinaCapital's 2011 sale of a stake in Hanoi Liquor, a Vietnamese wine and spirits company, to Diageo for \$52 million in 2011. In each case, the acquirer was a strategic investor.

PE investors have also successfully exited manufacturing deals, as when CVC Capital Partners and Standard Chartered PE sold Singapore-based fastener manufacturer Infastech to Stanley Black & Decker in 2012. The two PE firms had taken equal stakes in Infastech for approximately \$420 million in 2010 and exited at \$850 million. According to sources familiar with the deal, the investment has generated a return of just under three times capital.

All these transactions are evidence that most markets in the region have passed the exit test. Potential acquirers of well-run Southeast Asian assets include not only local corporations and conglomerates but also global strategic investors. (See Exhibit 6.)

EXHIBIT 5 | Trade Sales Are the Most Common PE Exit Avenue



Sources: *Asian Venture Capital Journal* database; BCG analysis.

Note: "Rest of the world" consists of more than ten countries and regions, including the U.S., EU, Australia, China, India, and Japan. "Other" consists of 12 other industries, including utilities and infrastructure, natural resources, medical, and other services.

IPOs, the other primary exit mechanism, have occurred for the most part on local stock exchanges. PE investors completed five exit transactions in 2011, 14 in 2010, 12 in 2009, 15 in 2008, 14 in 2007, and 18 in 2006. Notable IPOs include heavy manufacturer Amtek Engineering, whose 2010 offering in Singapore raised about \$180 million for former owners CVC Capital Partners and Standard Chartered PE; and Trikomsel, a mobile-phone company, whose 2009 listing on the local stock market returned around \$100 million to Northstar Group. And many other firms have exited their investments successfully through IPOs. (See Exhibit 7.) Of course, IPO outcomes depend heavily on local capital-market conditions, and historically Southeast Asia's stock markets have shown resilience in the face of economic shocks.

Dealmaking Hot Spots

From 2005 through 2010, Southeast Asia accounted for about 18 percent, by value, of PE deals in Asia. In 2010, the value of the region's deals was about one-fourth of China's and 30 percent of India's. Deal sizes and volumes vary significantly by country: Singapore has historically led in the number and size of deals, while Thailand and Vietnam

have small and relatively underdeveloped PE markets. Indonesia is extremely active—indeed, the largest IPO in the history of the Indonesian stock market was a private-to-public deal. (See the sidebar “Saratoga: A Homegrown Home-Run Hitter.”) Malaysia has delivered mixed results. (See Exhibit 8.) But with a host of new players entering the region, Southeast Asia's share of Asia's deal pool looks set to increase.

Most dealmaking has been confined to a handful of sectors. From 2009 through 2011, technology, media, and telecommunications made up the most active sector, with \$5.5 billion in transactions; followed by consumer goods, with \$4.8 billion; financial services, with \$4.4 billion; industrials, with \$3.9 billion; and other sectors. (See Exhibit 9.) PE buyouts accounted for 54 percent of total deal value; minority PE investments made up 44 percent. The remaining 2 percent were venture investments.

Each of those sectors has seen its share of marquee deals. In Indonesia's consumer sector, CVC Capital Partners acquired Matahari Department Store in 2010 for \$616 million and has already put it up for sale at the end

EXHIBIT 6 | Trade Sale Exits Are Common Across Most Industries

Year	Country of exit	Portfolio firm	Seller	Buyer	Deal size (\$millions)
2012	Singapore	Infastech	CVC Capital, Standard Chartered PE	Stanley Black & Decker (USA)	850
2011	Malaysia	Integrated Healthcare	Khazanah Nasional	Mitsui & Co (Japan)	1,090
2011	Singapore	King's Safetywear	Navis Capital	Honeywell International (USA)	338
2010	Singapore	Parkway Holdings	TPG Capital	Fortis Healthcare (India)	685
2010	Malaysia	GS Paper & Packaging	CVC Capital	Oji Paper Co. (Japan)	311
2009	Indonesia	Adaro Energy Tbk	GIC, Goldman Sachs	Not applicable	151
2008	Indonesia	Bank Internasional Indonesia	Temasek	Maybank (Malaysia)	1,334
2008	Thailand	BankThai	TPG Capital	CIMB Group (Malaysia)	147
2007	Singapore	Unza Holdings	Actis, Standard Chartered PE	Wipro (India)	246
2007	Singapore	Asia Renal Care SEA	3i and others	Bumrungrad Hospital (Thailand)	70

Sources: Asian Venture Capital Journal database; BCG analysis.
Note: This list is not exhaustive.

EXHIBIT 7 | IPOs Remain a Viable Exit Route

Year	Country of listing	Portfolio firm	Seller	IPO market capitalization (\$millions)
2012	Indonesia	PT Toba Bara Sejahtera	Baring Private Equity Asia	\$409
2010	Singapore	Tiger Airways Holdings	Indigo Pacific Partners, Temasek	\$583
2010	Indonesia	PT Tower Bersama Infrastructure	Provident Capital Indonesia, Saratoga Capital	1,033
2010	Singapore	Amtek Engineering	CVC Capital, Standard Chartered PE	535
2009	Vietnam	Masan Group	TPG Capital, BankInvest	967
2009	U.S. (NASDAQ)	Avago Technologies	GIC, KKR Asian, Silver Lake Asia, Temasek	3,540
2009	Indonesia	PT Trikonsel Oke Tbk	Northstar Group	90
2008	Singapore	Otto Marine	Standard Chartered PE	396
2008	Indonesia	PT Adaro Energy Tbk	Citigroup, GIC, Goldman Sachs, Saratoga Capital, Temasek, and others	3,863
2007	Singapore	Mermaid Maritime PCL	Lombard Asia, Railay Capital Partners	553

Source: BCG analysis.

Note: This list is not exhaustive.

of 2012, while in 2006, Navis bought Royal Food Group, owner of the Dunkin Donuts brand in Thailand, for \$24 million. A standout high-technology deal was ATIC's 2009 purchase of Singapore's Chartered Semiconductor for \$3.9 billion. In the industrial sector, CVC Capital Partners purchased Singapore's Amtek, one of the largest independent precision metal-engineering companies in the world, for \$363 million in 2007.

A growth thesis underlay most of those deals. CVC Capital Partners' acquisition of Matahari, for example, represents a bet that

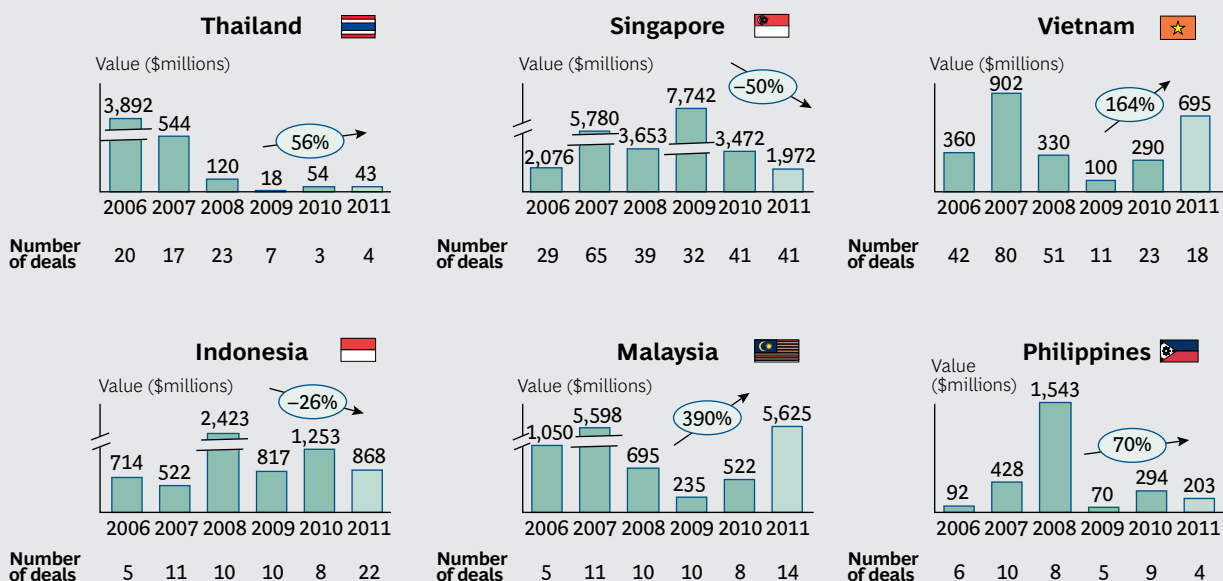
Indonesia's department-store business, predominately focused on Jakarta, can be extended to the country's growing tier 2 and tier 3 cities. KKR invested \$159 million in Vietnamese food and beverage manufacturer Masan Food to gain a slice of the sales of packaged food (mainly soy sauce and fish sauce) to Vietnam's rising urban population. And TPG Capital and Singapore's Government Investment Corporation teamed up to invest \$400 million into Indonesian miner Delta Dunia to tap into surging demand for raw materials.

SARATOGA A Homegrown Home-Run Hitter

One of the most established and successful firms on the Southeast Asia scene is Saratoga Capital, an Indonesian fund founded in 1998 that invests for growth, concentrating exclusively on natural resources, infrastructure, and consumer industries. In 2008, one of its portfolio holdings, the coal company Adaro, went public in what remains the largest IPO in

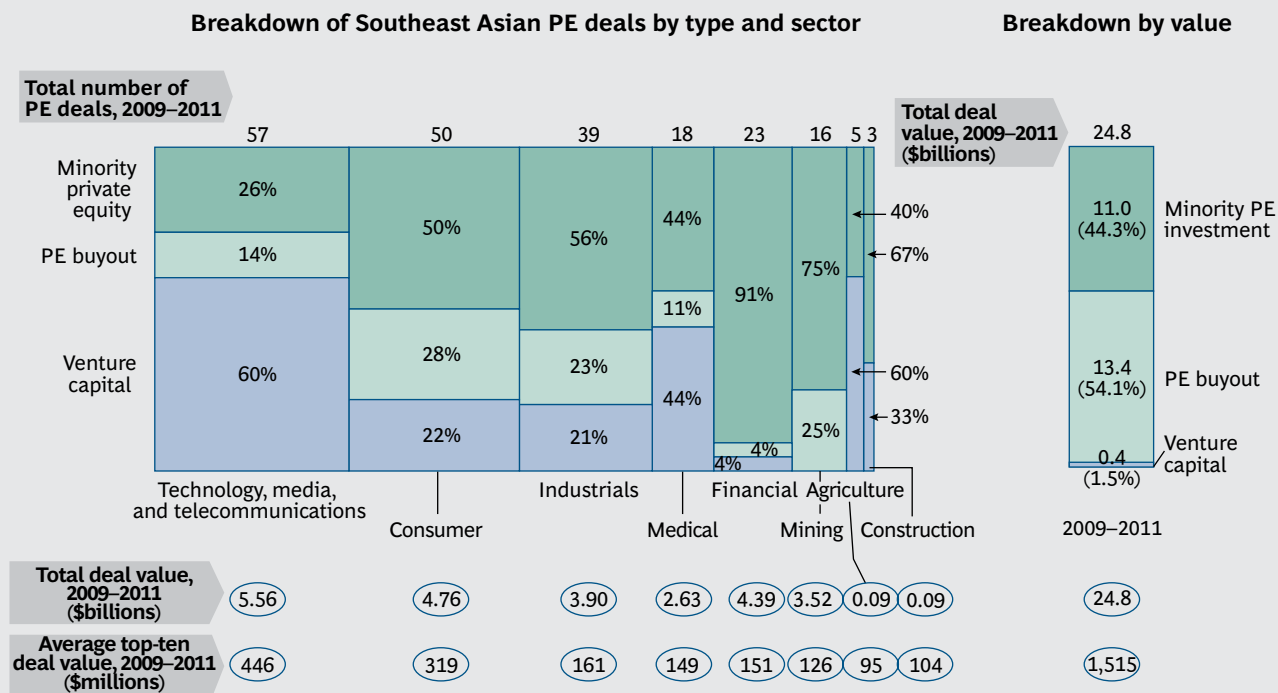
the history of Indonesia's capital markets. The offering of 35 percent of the company raised \$1.3 billion, creating a stellar payday for Saratoga, which owned 32 percent of Adaro before the IPO. It had paid only \$46 million for its original stake—acquired when Saratoga bought a predecessor to Adaro from Deutsche Bank in a closely contested distressed sale.

EXHIBIT 8 | Deal Sizes and Volumes Vary Widely by Country



Sources: Asian Venture Capital Journal database; BCG analysis.

EXHIBIT 9 | Deal volume is concentrated in a handful of sectors



Sources: Asian Venture Capital Journal database; BCG analysis.

Note: PE Buyout indicates the purchase of a majority stake/controlling stake of an entity, business units, divisions, product lines or other operations of another entity. PE investments shows the purchase of a minority stake in a private company/business or a public company. Venture capital investments refers to the purchase of a minority stake in a venture company/business (such as a technology start-up).

A BUILDUP OF CAPITAL AND COMPETITION

SEVERAL PROMINENT PE FIRMS have already established a foothold in the region and have capital at the ready. The most active among them follow country-focused or hub-and-spoke models. (See Exhibit 10.) TPG Capital, for example, operates a country model, with an office in Singapore. It also has small cross-shareholding with Northstar Group, a Southeast Asian PE group that is managed from Singapore and focuses on Indonesia. This model has enabled TPG to play actively in two local markets, closing nine deals through its Singapore office and nine deals in conjunction with Northstar. CVC Capital Partners, another active firm, follows a hub-and-spoke model, with a hub office in Singapore covering the entire region. CVC has closed 11 deals in Southeast Asia.

A Massive Capital Overhang

These firms and their rivals have committed considerable capital to the region in the past decade. From 2001 through 2011, the amount of documented capital under management in Southeast Asia has risen from \$11.7 billion to \$30.1 billion. Because the pace of dealmaking has not matched the growth in capital commitments, much of that capital remains uninvested.

Other PE-type funds, such as global funds as well as hedge funds and other less-documented capital sources, have also intensified their

focus on Southeast Asia in recent years. Their increasing presence likely accounts for much of the decline in new PE capital dedicated to the region since 2007. Like PE investors, these other players have confined most of their dealmaking to a handful of economic subsectors, and, as a result, asset prices have risen while return expectations have fallen. As we discuss later, however, significant profit opportunities remain in such sectors as business processes, private education, and new media, which most PE firms have so far overlooked because they fall outside the bounds of their growth theses.

Several prominent PE firms have already established a foothold in the region.

A Crowded Playing Field

One big difference between the PE markets in this region and those in the West is the sizable and influential presence in Southeast Asia of state-owned PE funds and family groups. (See Exhibit 11.) Both represent serious competition. Among the most active state-owned PE funds in the region are Singapore's Government Investment Corporation, Temasek (another investment arm of the Singapore government), and Khazanah

EXHIBIT 10 | Active PE Firms Follow Country or Hub-and-Spoke Models

	Investor description	Representative investment/year/country/deal value (\$)
TPG Capital	<ul style="list-style-type: none"> Specializing in incubation, start-up, post start-up, growth capital, turnaround, restructurings, buyouts, and middle-market distressed companies Southeast Asia office: Singapore 	<ol style="list-style-type: none"> 1. BFI Finance/2011/Indonesia/169 million 2. Delta Dunia Makmur/2010/Indonesia/400 million 3. Masan Group/2009/Vietnam/57 million 4. Bumiputra-Commerce/2008/Malaysia/150 million 5. BankThai/2007/Thailand/35 million 6. United Test-Assembly Center/2007/Singapore/1,429 million 7. Bank Tabungan Peniunan/2007/Indonesia/200 million 8. BankThai/2006/Thailand/84 million 9. FPT Corp/Singapore/2006/37 million
Northstar Group	<ul style="list-style-type: none"> PE and venture capital firm specializing in growth capital and buyouts Singapore-based Southeast Asia PE group with a focus on Indonesia Founded in 2003 and has small cross-shareholding with TPG Capital 	<ol style="list-style-type: none"> 1. Multistrada Arah Sarana/2011/Indonesia/78 million 2. BFI Finance/2011/Indonesia/169 million 3. Delta Dunia Petroindo/2009/Indonesia/350 million 4. Trikomsel/2009/Indonesia/20 million 5. Sumber Alfaria Trijaya/2009/Indonesia/35 million 6. Bank Tabungan Pensiunan Nasional/2007/Indonesia/200 million 7. Alfa Retailindo/2007/Indonesia/25 million
CVC Capital Partners	<ul style="list-style-type: none"> Specializes in buyout and middle-market investments Primarily invests in Asia with a focus in Japan, China, Hong Kong, Singapore, South Korea, and Australia Southeast Asia office: Singapore 	<ol style="list-style-type: none"> 1. KFC/2011/Malaysia/1,649 million 2. QSR Brands/2011/Malaysia/NA 3. Link Net/2011/Indonesia/186 million 4. First Media/2011/Indonesia/82 million 5. Rizal Bank/2011/Philippines/163 million 6. Acument/2010/Singapore/300 million 7. Matahari/2010/Indonesia/616 million 8. Magnum/2007/Malaysia/1,540 million 9. Silver Bird Group/2007/Malaysia/4 million 10. Amtek/2007/Singapore/362 million 11. Genting Sanyen/2007/Malaysia/213 million
Navis Capital	<ul style="list-style-type: none"> Specializes in direct equity investments in growth, buyouts, recapitalizations, and financial restructurings Southeast Asia offices: Singapore, Malaysia, and Thailand 	<ol style="list-style-type: none"> 1. Kinderdijk Group/2011/Malaysia/6 million 2. Eng Kong Hld/2010/Singapore/55 million 3. Bangkok Ranch/2010/Thailand/50 million 4. Alliance Cosmetics Group/2010/Malaysia/12 million 5. King's Safetywear/2008/Singapore/62 million 6. Mentor Media/2007/Singapore/142 million 7. Royal Food Group/2006/Thailand/24 million 8. Mentor Media/2006/Singapore/103 million

Sources: ThomsonONE.com Investment Banking; *Asian Venture Capital Journal*; BCG analysis.

Note: Includes only Southeast Asian deals from 2006 to the first quarter of 2012 that were captured by data providers (Thomson, AVCJ). For Navis Capital, there are only eight deals listed because the deal value of the other six was not applicable. For CVC, KFC and QSR, deals are pending shareholder approval.

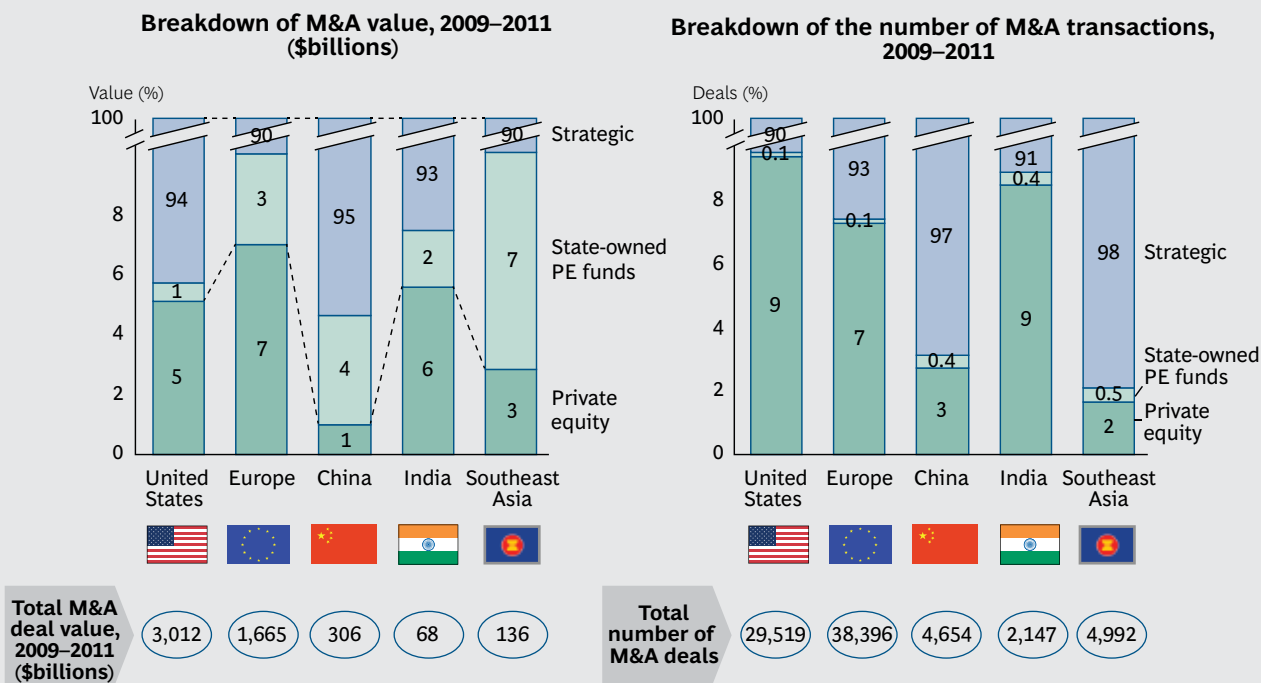
Nasional Berhad, the Malaysian government's investment vehicle.

These funds enjoy several advantages, including deep knowledge of local markets and significant political influence. The Government Investment Corporation has closed dozens of transactions since its founding, including the 2008 purchases of large stakes in Citicorp and UBS. Among Temasek's closed deals are investments in Merrill Lynch in 2008 and China Construction Bank in 2005. Khazanah Nasional Berhad, meanwhile, has completed a num-

ber of M&A deals including Parkway Health and Apollo Hospitals in 2011. Other Southeast Asian governments may well follow their lead, injecting state-owned enterprises and assets into state-owned PE funds in order to generate industrial and commercial development as well as investment returns.

Business groups represent another competitor to private equity. Quite aside from bringing significant synergies to the table, these groups frequently have considerable regulatory and governmental credibility that is ad-

EXHIBIT 11 | Competition Comes from Strategic Investors and State-Owned Funds



Sources: ThomsonONE.com Investment Banking; BCG analysis.

Note: Analysis captures three years of transaction data from January 2009 through December 2011 for all disclosed transactions from ThomsonONE.

“State-owned fund” is defined as a government-controlled investment fund that is funded with foreign reserves or commodities and participates in foreign investment activity with a long-term investment horizon according to ThomsonONE. Private equity is defined as financial sponsors that engage in PE or venture capital transactions with capital raised by investors according to ThomsonONE, which differs from *Asian Venture Capital Journal*’s definition. Strategic investors refers to private companies that engage in M&A activities for strategic reasons according to ThomsonONE.

vantageous in deal negotiations. (See the sidebar “San Miguel’s Family Values.”) For example, a rising force among business groups in the region is Vietnam’s Masan Group, which is evolving into a deal powerhouse in its home country. Following investments by TPG and BankInvest’s \$57 million investment in the conglomerate in 2009 (BankInvest purchased an additional \$13 million stake in 2010), the group has amassed a

collection of credible shareholders, including Goldman Sachs, IFC, and Dragon Capital—as well as Japanese strategic investor Food House, which in 2009 invested \$20 million in a deal that valued the entity overall at more than \$1 billion. Masan Group is currently moving beyond its core holdings in construction and food, with recent acquisitions such as the Nui Phao Mining Joint Venture for \$130 million in 2010 and Vinacafe in 2011.

SAN MIGUEL’S FAMILY VALUES

Conglomerate San Miguel Corporation, based in the Philippines, is in many ways the prototypical family group. With a market capitalization of \$6 billion, San Miguel focuses primarily on the food, beverage, and packaging products industries, but several of the 23 M&A deals it has closed range far from its core businesses. It has acquired stakes in oil refiners Esso (2011) and Petron (2010), mobile operators

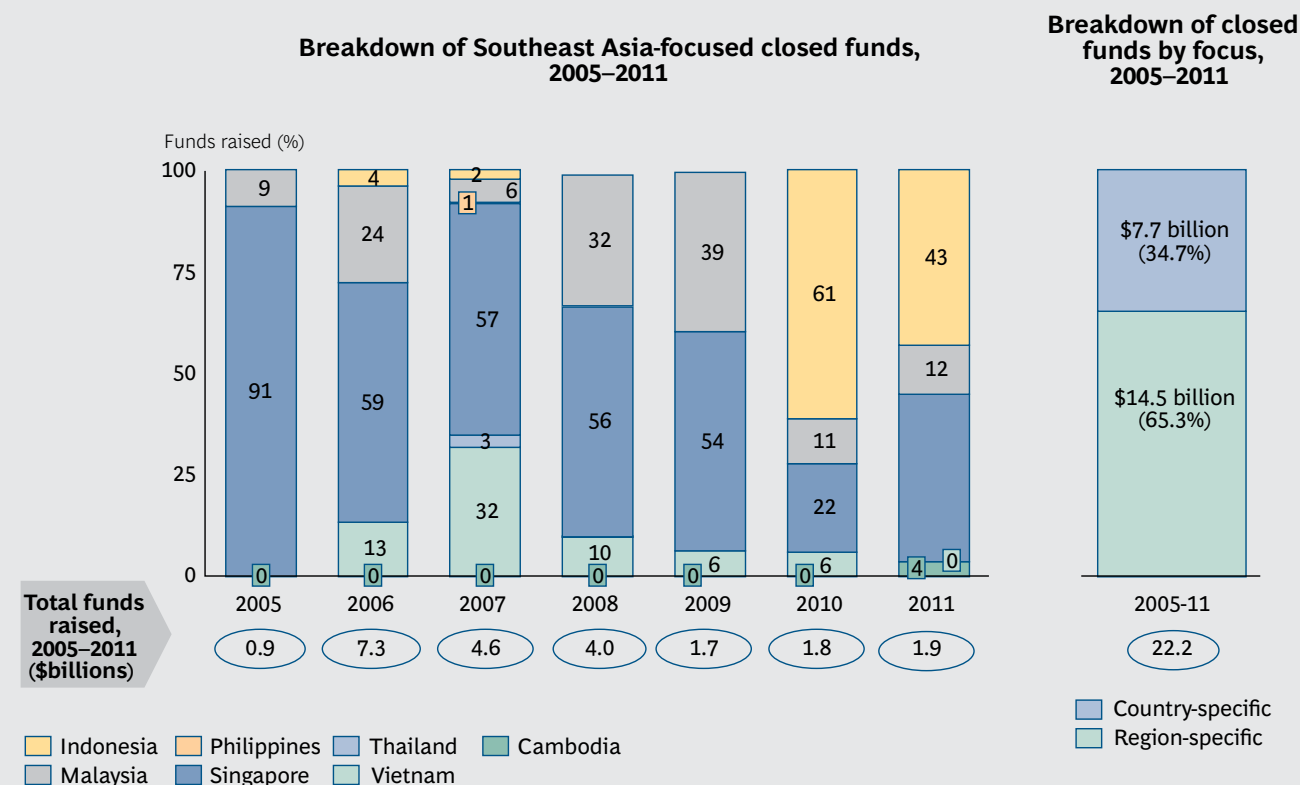
BellTel (2010) and Express Telecom (2009), and NAPOCOR-Sual Power Plant (2009). But San Miguel is not just a rival to PE firms. It’s also a potential supplier of deals. In 2011, San Miguel president Raymond Ang announced that the company is considering the sale of stakes in its power and food subsidiaries in order to raise funds for new ventures, such as more infrastructure projects.

Strategic investors are also major acquirers in Southeast Asia. The majority of these are local companies that have developed skill sets as serial acquirers. One of the strongest is Thailand's Indorama, an integrated chemical company with a \$6 billion market capitalization. It has made nine acquisitions, including TPT Petrochemicals in 2008. From February 2010, when it was publicly listed, through August 2012, Indorama's market capitalization has risen from \$1.3 billion to \$4.3 billion, and the company has delivered a total return to shareholders of 82 percent a year. In 2008, YTL, a utilities and regulated-infrastructure corporation with a \$4 billion market capitalization and operations in Malaysia, Singapore, and the U.K., acquired 54 targets, including

Power-Seraya, which generates about 30 percent of Singapore's energy needs.

PE funds new to the region are adding to the competitive mix. These funds typically set up local offices, as General Atlantic Partners, EQT, and Fortress have done in Singapore. TA Associates, meanwhile, opened a Hong Kong office with a regional mandate in 2011, and Warburg Pincus recently rededicated a professional to the region. Large firms are also upping the stakes, sometimes by innovative means. One example is TPG's share swap with Northstar, which gave TPG expertise in Indonesia. It is likely that other large funds will seek similar tie-ups. Most have set up funds expressly targeting Southeast Asia. (See Exhibit 12.)

EXHIBIT 12 | PE Firms Are Busy Raising Funds for Southeast Asia



Sources: Asian Venture Capital Journal; BCG analysis.

FINDING TOMORROW'S OPPORTUNITIES TODAY

As we mentioned previously, PE deals in Southeast Asia have usually followed a fairly simple growth-investment thesis. PE acquirers have focused on food and beverage, durables, modern retail, transportation, and technology, media, and telecommunications in order to capture spending by the up-and-coming middle class, or on natural resources, in order to capitalize on the commodities boom in local and global markets. (See the sidebar “Eight Steps to Better Dealmaking in Southeast Asia.”) With so many investors following essentially the same thesis, competition for deals in those sectors is intense and prices are high. We believe that rather than run with the herd, PE investors should consider exploring less conventional approaches, such as the following. (See Exhibit 13.)

- *Business Support Carve-Outs.* When PE funds focus on growth plays, they screen out potential carve-outs from large corporations, conglomerates, and family groups. Such carve-outs represent a significant opportunity for those wishing to leverage Southeast Asia's labor costs, which in many cases compare favorably with China's and India's. In particular, we see opportunities in carve-outs of back-office operations, support functions, and business process outsourcing (BPO). In fact, there is an opening for new BPO companies to pursue an intra-Asia outsourcing thesis, assembling operations

that can compete on cost with Indian and Chinese BPO companies.

Rather than run with the herd, PE firms should explore less conventional approaches.

Investors pursuing a BPO thesis can also find several attractive targets in the private domain, including listed companies such as the Philippines's Paxys and IPVG, Malaysia's Advanced Information Marketing and Efficient E-Solutions, and Singapore's Teckwah Industrial Corporation, all of which are already competing for global BPO contracts. Some of these companies boast double-digit EBITDA margins and are eager to expand or build their industry presence, making them attractive acquisition candidates. Others are still incurring losses after losing clients to bankruptcy in the wake of the global financial crisis and could be inviting targets for distressed investments.

- *Roll-Ups and Buy-and-Builds.* Many business sectors in Southeast Asia are relatively fragmented, offering PE investors a host of potentially suitable candidates for roll-ups, buy-and-build plays, or consolidation. In Indonesia, for

EIGHT STEPS TO BETTER DEALMAKING IN SOUTHEAST ASIA

To improve their chances of success in Southeast Asia and limit their exposure to some of the risks and intricacies of the investment market there, PE firms should keep the following eight key points in mind. Although these steps lead to higher deal costs and investment complexity, we believe that they also maximize the opportunities and returns that the region has to offer.

1. *Choose a focused model.* An investing model focused on a specific industry sector or on just one (or at most two) countries will maximize the chances of sourcing and converting the right deals. The hub-and-spoke model, although often successful in other regions, is less likely to work in Southeast Asia.
2. *Be flexible about deal terms and types.* To allow a wide enough scope for potential deals, be flexible about investment criteria such as debt ratios, including convertible debt. Be willing to accept smaller deals and minority stakes. Being flexible has proven to be of strategic value in what remains a relatively small deal market.
3. *Localize talent.* Build local offices in the region wherever possible. The ability of local talent to network and read behavioral nuances can be invaluable.
4. *Invest more in due diligence.* Allow plenty of time for due diligence, especially when creating market scenarios and mapping industry structures and value chains. Remember that these are nascent markets, and reliable sources of data are hard to find. Supplement desktop research with trips into the field to study markets firsthand.
5. *Facilitate deal flow via smart partnerships.* Consider partnerships with conglomerates or family groups seeking to institutionalize their investment capabilities. Other potential partners include local PE funds as well as banks, government-linked organizations, and state-owned wealth funds. They can facilitate access and help build up a steady deal flow.
6. *Address governance issues.* Assume that the costs of managing and overseeing your investments will be higher than in Europe or the U.S. Southeast Asian firms typically have complex governance structures, and minority owners can encounter difficulties exercising influence.
7. *Take advantage of local capital.* Consider inviting local investors into selected deals. A state-owned PE fund can provide useful insight into potential targets, not to mention political cover.
8. *Manage your expectations.* Take the long view and expect continued volatility, especially within individual countries and business sectors. Diversification can help smooth out the inevitable bumps in the road.

example, automobile finance looks very attractive. The market is fragmented, with the top-five companies controlling only about 45 percent of the market and dozens of smaller players contending for about 55 percent of the business. Obviously, no small provider of automobile financing has the scale to exploit demographic and economic trends to their full

extent, but a deep-pocketed acquirer pursuing a roll-up strategy could grow to significant scale in relatively short order. Companies such as Amanah Finance, Andalan Finance, Austindo Nusantara, Buana Finance, Clipan Finance, Swadharma Bhakti, Trihamas, and U Finance Indonesia—which together control about 10 percent of the receivables market—

EXHIBIT 13 | Beyond Today's Growth Story, New Opportunities Await

Today's focus: Rising demographics and economic megatrends

Current thesis (examples)	Current deal type (examples)
The middle class is emerging rapidly	Consumer goods, modern retail formats
Rising incomes are fueling a boom in service industries	Financial services, public transport, telcos
Economic growth boosts cyclical B2B companies	Transportation, distribution and logistics, media, telcos
Prices for the region's commodities are soaring	Natural-resources producers

Tomorrow's focus: Thinking two or three steps ahead

New opportunities thesis (examples)	New opportunities deal type (examples)
Back offices can benefit from intra-Asia outsourcing	Business support and back-office carve-outs
Go after consolidation plays in fragmented industries	Roll-ups, buy-and-builds
Some tightly regulated sectors will liberalize	Private and premium education and health care
Infrastructure urgently needs upgrading	Long-term projects with sound fundamentals and inflation protection
Rising labor costs may drive production out of China	Manufacturing, adjacent industries
Consumer demand for Internet-enabled devices is growing	High tech, new media

Sources: BCG Analysis.

could provide a solid platform for industry roll-outs. Across Southeast Asia, there are plenty of precedents for such a strategy in service industries such as tutoring, health care, insurance, and Islamic finance.

- *Participating in the Liberalization of Tightly Controlled Sectors.* As incomes rise and economic growth roars ahead, governments are gradually easing control over service sectors while maintaining a firm grip on more strategic sectors such as defense and natural resources. Malaysia, Vietnam, and Thailand, for example, have recently loosened control over health care and education, creating openings for PE deals. Indonesia, meanwhile, has raised the foreign shareholding limit in a number of industries. Once barred from any holding in a staple food plantation, foreigners can now own up to 49 percent. Ceilings in the construction sector have been lifted to 67 percent from 55 percent, and foreigners can now own up to 95 percent of a power plant.

Other governments, including Myanmar's, are likely to relax controls in the next few years. Indeed, that country may end up as the region's greatest liberalization success story. The country's breathtaking political and economic advances in recent months could soon create enormous opportuni-

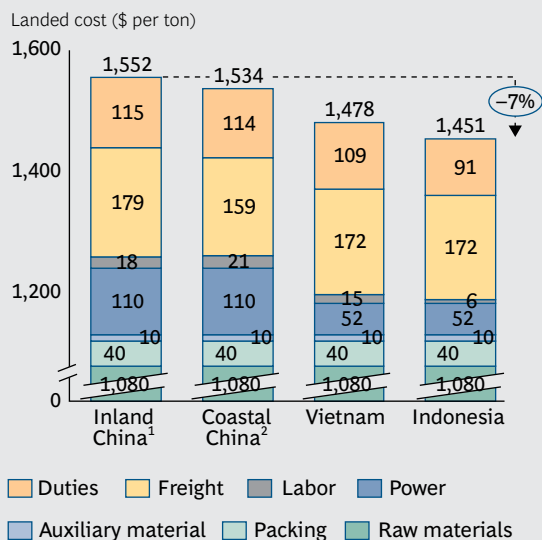
ties for PE firms armed with patience and foresight.

- *Investing in Infrastructure.* The breakneck growth of many Southeast Asian economic sectors has fueled strong demand for infrastructure assets. As automobile ownership becomes more widespread, for example, many countries have launched massive projects to build toll roads. Likewise, the growth of export industries in the region has sparked demand for new ports and transportation facilities. As export industries expand and the region's population continues to increase and urbanize, demand for new infrastructure will remain strong well into the future. Firms considering infrastructure deals, however, need to be prepared for large-scale investments with long time horizons. PE investors that lack confidence in Southeast Asia's long-term political and economic stability need not apply.
- *Riding the Diversification of Manufacturing out of China.* As we have already said, Southeast Asia's labor costs are highly competitive, and it is possible today to produce labor-intensive goods more cheaply in Indonesia or Vietnam than in China. (See Exhibit 14.) Changes in Western trade policies are likely to further enhance Southeast Asia's cost competitiveness. In this environment, PE investors

EXHIBIT 14 | Manufacturing Costs in Southeast Asia Compare Favorably with Those in China

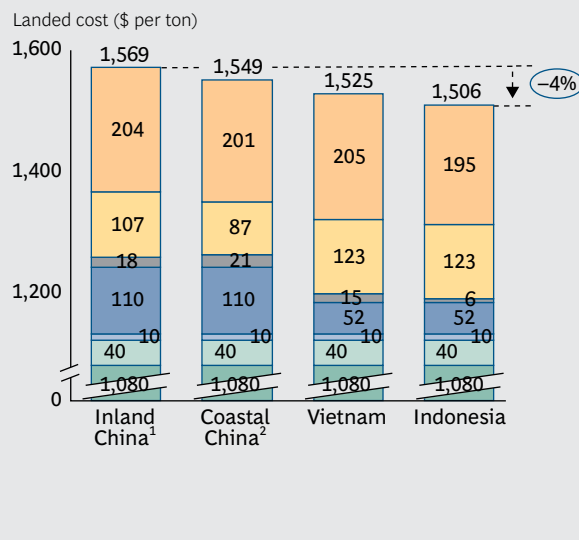
Textile landed costs to Europe show Indonesia and Vietnam are advantaged...

Comparing woven textured fabric landed cost with Italy, 2009



...which is true for landed costs to the U.S., as well

Comparing woven textured fabric landed cost with West Coast U.S., 2009



Sources: EIU, China Statistics Yearbook, China National Development and Reform Commission, International Textiles Manufacturers Association, BCG Analysis.

Note: Includes duties of 8 percent for the EU and 14.9 percent for the U.S. Raw materials, packing, and auxiliary material costs are assumed to be the same. Twenty-three tons per 40 feet, full container load. Labor wages and productivity are adjusted.

¹Includes Hunan, with barge cost of \$20 per ton to Shanghai.

²Includes Shanghai.

- will find compelling opportunities to buy and scale significant businesses. Winning PE funds will be proactive in developing investment theses around manufacturing growth and scanning for similar opportunities in other sectors in order to leverage changing trade policies and the region's competitive cost position.
- *Investing in High Tech and New Media.* To date, PE firms in Southeast Asia have paid relatively little attention to high tech and new media, engaging in only about 15 transactions in the past five years, compared with more than 300 in the U.S. and more than 500 in Europe. Yet Southeast Asia collectively has 485 million mobile-phone subscribers and an estimated 43 million smartphone users, a number that is expected to grow to 71 million by 2015. That makes the region one of the largest smartphone markets in the world and represents a significant opportunity for PE players looking to

import tested business models into new territories or create innovative ones.

- *Buying Secondaries.* As the market matures, many PE firms are seeking to exit their existing holdings with increasing urgency. The market has started to see offering memos for existing PE holdings, and we foresee a rise in secondary deals in this region and around the globe. PE firms seeking profit opportunities in secondary deals must be confident that they can outdo their rivals in driving growth and realizing operating efficiencies. Those gains are often realizable when a new owner already has assets within the same value chain, even if those assets are spread across Southeast Asia.

The opportunities listed above are just a few of the investment theses that exist as alternatives to the dominant growth thesis. These are investment opportunities that we believe have been overlooked until now.

THE STRATEGIC ADVANTAGE OF LOCAL KNOWLEDGE

NEW PE ENTRANTS IN Southeast Asia must be prepared for a dealmaking environment that is markedly different from Western markets. The region's unique social, political, and cultural characteristics shape the business climate, and rather than simply transfer a U.S. or European model to the region, PE firms need to understand and adapt to each country's distinct idiosyncrasies and business customs. Newcomers can quickly acquire local savvy by employing resources familiar with regional nuances or partnering with local players. Firms entering the region for the first time should expect the following:

- *Smaller Deals and More Minority Deals.* The deal market is still relatively small compared with Europe and the U.S., and cultural and political factors strongly influence deal structures. PE investors should be willing to take minority stakes in acquisition targets in order to accommodate family ownership groups and government-linked investors.
- *Longer Lead Times for Deals.* As is typical of markets in the early stages of their development, deals in Southeast Asia tend to be complex and have long lead times, raising aggregate transaction costs. PE firms should perform extensive due diligence to avoid pouring time and money into dead-end deals.

- *Wide Variations Between Countries.* Even though ASEAN is establishing a strong regional identity, each country within Southeast Asia has its own unique character, customs, and culture. Rather than try to cover the whole region straightaway, PE firms have a higher likelihood of success if they focus on one or two countries and cultivate a deep understanding of the business climate there.

PE firms need to understand and adapt to each country's idiosyncrasies and customs.

- *Valuation Challenges.* Pricing acquisition targets is a tricky business that relies on accurate forecasts of long-term growth. As less sophisticated participants crowd into the market, valuations can become overstretched. To avoid overpaying, PE firms must be sure to ground their calculations in a deep understanding of local markets and a realistic assessment of current growth trends. In many cases, the deals that succeed in Southeast Asia will be those based on investment insights that buck the conventional wisdom.

It is easy to see why Southeast Asia, despite numerous risks and uncertainties, has become a magnet for investment. Rapid growth, political and economic liberalization, and the emergence of a consuming middle class have proved an irresistible lure to the global investor community. But the days of easy returns are already long gone. So many firms, most pursuing a similar investment thesis, have stampeded into the market that valuations

and deal premiums have risen sharply and the corridor for success has narrowed. Success in this climate calls for deep local expertise and the boldness to venture beyond the conventional growth thesis and outside the sectors that have, until now, been the center of dealmaking activity. Success is no longer a given, but it remains well within reach of PE investors with the right stuff.

FOR FURTHER READING

The Boston Consulting Group publishes many reports and articles on private equity and value creation that may be of interest to senior executives. Recent examples include:

Strategies for Superior Value Creation: Improving the Odds

A report by The Boston Consulting Group, September 2012

How M&A Can Grow Portfolio Value: Plant & Prune

A report by The Boston Consulting Group, August 2012

How Value Patterns Work

A Perspective by The Boston Consulting Group, June 2012

Value Patterns: The Concept

A Perspective by The Boston Consulting Group, May 2012

Unlocking Growth in the Middle

A Focus by The Boston Consulting Group, May 2012

Succeeding in Uncertain Times

A Focus by The Boston Consulting Group, April 2012

The CEO as Investor

A Perspective by The Boston Consulting Group, March 2012

The 2012 Private Equity Report: Private Equity; Engaging for Growth

A report by The Boston Consulting Group, January 2012

M&A: Using Uncertainty to Your Advantage

A Focus by The Boston Consulting Group, published with UBS Investment Bank, December 2011

No Time Like the Present to Plan an IPO: Prepared Companies Will Be First in the Queue When Markets Recover

A report by The Boston Consulting Group, October 2011

The Art of Planning

A Focus by The Boston Consulting Group, April 2011

NOTE TO THE READER

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BCG's private-equity practice is a global network of experts helping leading PE firms with the full spectrum of services covering the entire PE value chain from focused due diligence assignments to transformative profit improvement programs for their portfolio companies. For further information or to learn more about the firm's capabilities in private equity, you may contact one of the authors.

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