
Trends in Asia Co-Investments: Maturing Markets and Growing Opportunities



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Over the past twenty years, the Asia private equity market has evolved to be a significant part of the global private market landscape. Adams Street has found that Asia markets have a resiliency to macro and geopolitical risks from weathering numerous market cycles and allow savvy investors to take advantage of challenging market conditions and corrections in valuations.

The development we have witnessed in Asia has created a maturing market for co-investments – and an attractive opportunity for investors. By partnering with the right local managers and leveraging GP relationships, investors can access high-quality deal flow and build a compelling risk-adjusted co-investment portfolio.

Opportunities in Asia Co-Investments

Adams Street has observed positive trends in our Asia co-investment deal flow and portfolio, and we believe that opportunities in this region are not only increasing, but also becoming more attractive in general. Given the increased maturation of the market, we believe a natural extension of the success of primary fund investments is to expand the investment strategy into pro-active co-investments alongside the right managers. New research from the Economist Intelligence Unit highlights the importance of co-investments to institutional investors, with 41% predicting that co-investments will offer the greatest private equity opportunity in 2021. The same survey of global private market investors found Asia to be the top geographic focus in 2021, with 42% of respondents indicating confidence in the region.

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– The Economist Intelligence Unit: Leveraging Opportunity in Change, 2021

We believe a significant reason for the positive sentiment toward the region is the attractive relative valuations, growth rates, and risk profiles of the opportunities, especially when compared to the US and Europe. A large number of Asia private equity deals are proprietary – particularly in emerging markets – and often enjoy a valuation discount. Many businesses benefit from relatively higher growth rates than found in the US and Europe, and their valuations look even more attractive on a growth-adjusted basis. At the same time, company debt levels are much lower in general – most of the minority growth deals in emerging markets do not use leverage. Returns therefore rely less on leverage, and the overall financial risk is much lower.

Asia private equity deal sizes have increased, resulting in a growing opportunity set of actionable co-investment transactions. Adams Street has seen founder-led companies seek large minority / majority private equity partners, MNC companies and large conglomerates carve out assets during their strategy rationalization, and companies raise capital via an M&A strategy. The opportunity set is also rife with maturing businesses that fit co-investment underwriting criteria. Many companies are cash-flow positive with lower risk of external capital funding needs. Consequently, control deals and buyout transactions have grown in Asia emerging markets (and remain common in Asia developed markets), including privatizations.

Similarly, Adams Street sees increasingly more liquidity and exit options for co-investments in Asia. Many co-investors in Asia deals are passive and rely on the lead equity sponsor to drive exits, making it important for co-investment deals to have visible liquidity routes. The development of a more robust liquidity profile is encouraging. Exit routes are more diversified, including sponsor-to-sponsor secondary transactions, IPO exits supported by strong local and overseas public markets, and increasing acquisitions from local, regional, and global strategic partners.

Finally, our strong confidence in Asia co-investments is bolstered by the prevalence of more sophisticated GPs seeking co-investment capital and solutions. GPs' track records reflect thoughtful, detailed underwriting of portfolio companies. They are also actively working with co-investors on large transaction syndications, co-underwriting bids, follow-on investments, and even secondary transactions, adding a wide variety of opportunities for co-investors in the region.

Challenges to Consider

While the Asia private equity market continues to grow and garner international interest, there are differences, which can present challenges in sourcing, selecting, and executing the best deals that investors must keep in mind.

First, investors must understand the language and cultural discrepancies. Asia is a large and highly diverse market in both language and customs. For example, a significant quantity of China GPs have co-investment materials in Chinese only, and due diligence calls are conducted in the local language. Second, Asia markets also vary significantly in policy regime, regulations, market structure, deal types, and capital market maturity. A firm understanding of cultural norms, business practices, and local regulations is key for building relationships and navigating market complications.



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With that in mind, investors may find that the Asia private equity market is not as transparent or structured compared to what they may be accustomed to in the US or Europe. In Asia, particularly emerging markets, co-investments are typically not widely syndicated, and opportunities are often based on relationship with GPs. As a result, access to high-quality GPs is key to generating co-investment deal flow.



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Factors for Successful Co-Investments in Asia

As an investor, Adams Street believes there are two critical factors for a successful co-investment program:

- (1) Access to high-quality co-investment deal flow, which relies on a strong GP network, and
- (2) A team of experienced investors to proactively select and execute on the best opportunities from the deal funnel.

In terms of deal access, we think it is important to have a local or regional team to select fund managers and build a portfolio of best-in-class private equity GPs. The team can also develop deeper relationships with this GP base to generate a large funnel of actionable co-investment opportunities. We believe having a close relationship with the GPs will ensure that vetted, high-quality opportunities rise to the top.

Regarding deal selection and execution, an on-the-ground presence is once again integral to successfully incorporating the local knowledge into the underwriting and selection process. At the same time, we believe having a global perspective is also critical to focusing on the relative risk/return profile of each opportunity. Similar to the developed US and European private equity markets, it is important across all co-investments to effectively underwrite the GP's experience as it relates to the target companies, as well as their alignment with the co-investors. Likewise, having the ability to quickly respond to opportunities, even in less formalized processes, is table stakes for a credible co-investment partner.

Looking Ahead

With strong investor sentiment toward Asia – including China standing out as the only G20 country to record positive GDP growth in 2020 – co-investments offer a bevy of opportunities for skilled investors who understand the needs and nuances of operating in this region. After many years of development, the private markets in both developed and emerging markets in Asia offer multiple types of unique transactions, further portfolio exposure, and differentiated returns. With the power of a strong local team and a deep understanding of each individual market, Adams Street foresees a great deal of growth in this region in 2021 and beyond. ■

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