Uncovering Hidden Gems: Private Equity Investing In South-East Asia

SEPTEMBER 2023

AURAGROUP

Introduction

Southeast Asia has long been touted as this decade's land of opportunity for private equity investors looking for growth. And rightly so. The economic support of a burgeoning and young population, strengthening technology infrastructure and rising urbanisation makes for an attractive investment landscape.

Each country in Southeast Asia presents its own set of characteristics and exit challenges for private equity investors. Understanding these challenges is crucial to developing value creation and effective exit strategies.

As the landscape of private equity changes in Southeast Asia, thesis and data-driven strategies, such as 'time machine' and 'back to the future', become all the more relevant. These strategies provide valuable information that helps private equity investors evaluate investment opportunities and make informed decisions.

Unlocking Future Value with a Time Machine Investment Strategy

Private equity investment activity in the region has expanded by almost 30% in the last four years to reach an estimated US$13 billion in deal value in 2022, following a pre-COVID peak of US$25bn in 2021.

With ongoing geopolitical tensions and regulatory risks in countries like China, investors seeking exposure to Asian private equity have found a market in South East Asia that has a growing commercial landscape buoyed by macroeconomic trends and more importantly is ready to receive private equity investment.

The rise of key business models in certain industries and sectors in Indonesia, Vietnam, Philippines, Thailand and Malaysia often mirrors that of China, Singapore, South Korea and India in recent history, underpinned by the very same demand-side and supply-side changes.

History May Not Repeat, But It Often Rhymes

Compare Indonesia to China. Both are highly populous Asian countries with a vast geography and a significant rural-urban divide. Mobile penetration rates are in the low 100s (read: very high) and proper banking infrastructure is only concentrated in tier 1 and tier 2 cities. Both countries have rising literacy rates, with Indonesia at 96.1% (China's 2014 levels), and growing median disposable income.

It is little coincidence that Indonesia's developments in e-commerce and FinTech reflect that of China a decade ago. Indonesian e-commerce players such as GoTo and Blibli are comparable to Chinese counterparts Didi and JD, and Indonesia's Akulaku and Ovo to China's Zhima Credit and Alipay.

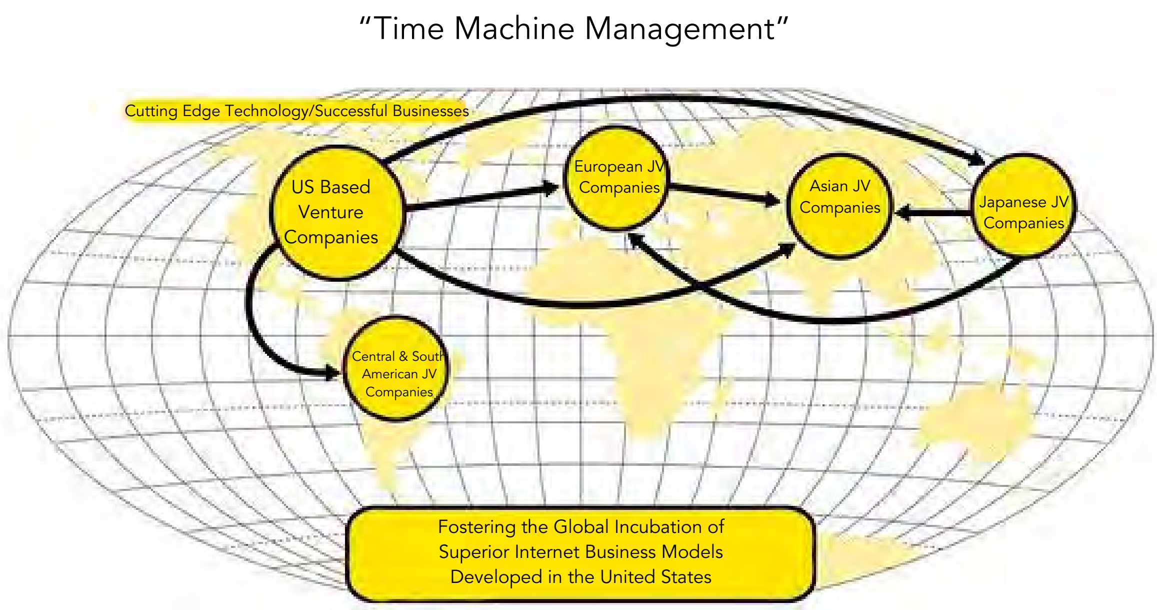
Introducing the Time-Lag Effect

The logic of this "time-lag effect" is simple: such advanced markets have already undergone the iterative process to create stronger product-market fit in response to such market characteristics, which is then translated into successful business models.

Entrepreneurs in developing markets then apply these models to their own economies that contain similar market characteristics and therefore market gaps. On a broader scale, this generally results in the development and maturing of a local market that matches that of the advanced markets with a general time lag of 5 to 15 years.

Not surprising, investors have long used the time-lag effect to formulate effective strategies. The founder of Softbank Group, Masayoshi Son, was known to have religiously followed the time-machine strategy in his business, and even made his investment in Alibaba in 2000 on the basis that China's nascency in technology and the internet was simply the beginning of the same development trajectory he witnessed in the United States.

Figure 1: Softbank's internet business extends worldwide.



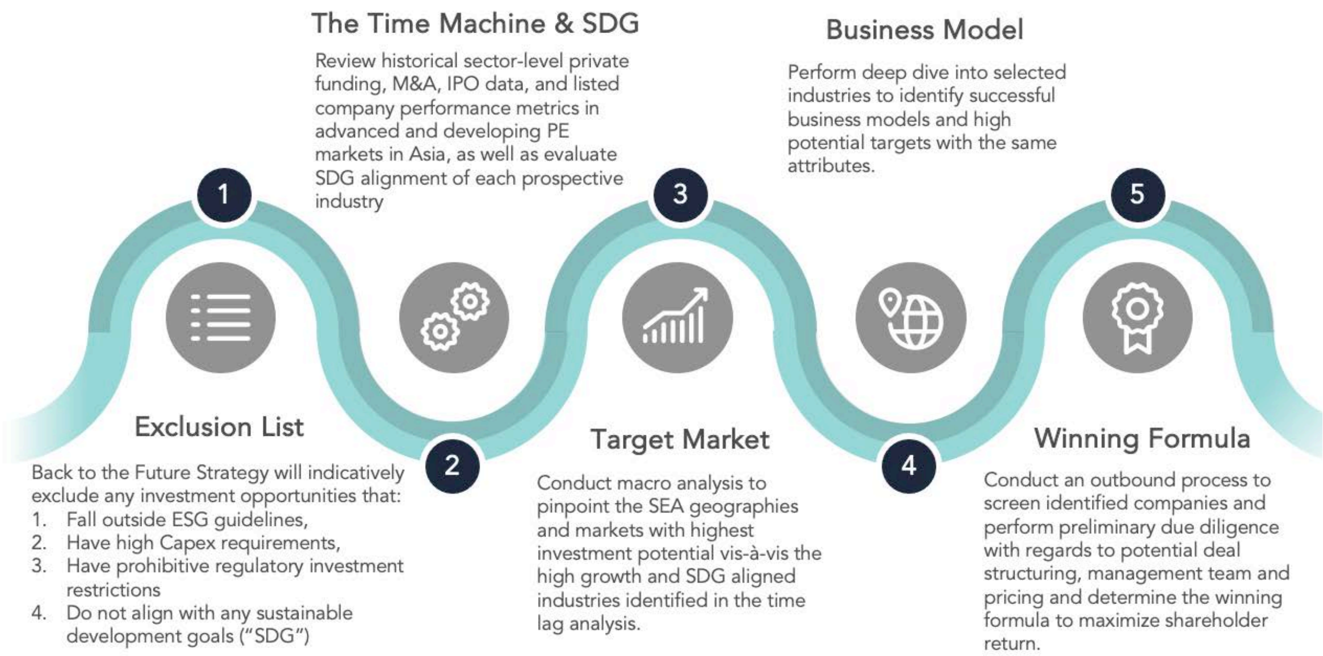
Source: Allocators Asia

Vision Plus Capital, a Chinese investment firm coincidentally established by a co-founder of Alibaba, also based its investment thesis on a new time machine theory. The company believed that the development of China's PC internet learned from the path of the United States over the past 10 years. Likewise, the development path of China's mobile internet in the next decade will be a reference for other emerging markets.

Picking Winners

When it comes to identifying opportunities. the question isn't so much if there is a time-lag effect in Southeast Asia vis-à-vis mature market benchmarks, but rather where that effect is strongest and most applicable for the requisite growth profile characteristic of private equity asset class.

Figure 2:



Source: Aura Private Equity

Data from historical market activity can be put to work in making stronger investment decisions, with the leverage from the time lag especially relevant in an early private equity market like Southeast Asia. Using private and public market transaction volume can help you identify relevant sectors that exhibit a time lag within key Asian markets.

The investible universe can then be fine-tuned by triangulating macroeconomic factors to determine optimal geographies and filtering out non-private equity-ready businesses (e.g. unprofitable, sub-scale, or unsustainable long-term unit economics). This forms the foundation of a data-driven and high-conviction time machine strategy that aims to understand what and where to invest.

Finding an Edge with a Back to the Future Strategy

As the market becomes more competitive, and data gives dealmakers the ability to drive investment opportunities and exits more objectively and efficiently, embracing a data-driven approach and advanced analytics can help investors find an edge in the market.

Taking a data-led approach in private equity deal-making offers several advantages over traditional methods. By leveraging data, investors can make more efficient and objective decisions. Data provides accurate insights into market trends, historical performance, and financial metrics, reducing reliance on subjective judgments and biases and key men or women.

Aura Private Equity's back to the future strategy is a Southeast Asian variant of time machine investing. This data-led approach utilises reference data from developed markets like Singapore, South Korea, China, and India. The data is used to identify target companies in Southeast Asia that are poised for rapid growth and economic traction, including Indonesia, Vietnam, Philippines, Thailand and Malaysia.

"By leveraging data, investors can make more eficient and objective decisions. Data provides accurate insights into market trends, historical performance and financial metrics."

A Different Approach to Identifying Similarities

When considering the reference markets of Singapore, South Korea, China, and India in relation to the target markets of Indonesia, Vietnam, Thailand, Philippines, and Malaysia, there are several non-exhaustive factors to examine for similarity.

Economic Development: Singapore and Korea are more advanced economies with developed financial markets, technology infrastructure, and high levels of urbanisation. China and India, while having certain developed regions, also have segments that are less developed, making them more comparable to the target markets.

Market Size and Population: China and India are the most populous countries globally, while Indonesia and the Philippines have the highest populations within Southeast Asia. Similarities in population size can indicate the potential for consumer-driven growth and market expansion.

Cultural Proximity: China shares some cultural similarities with Vietnam, while India has historical and cultural ties with Indonesia. These factors can influence market dynamics and business practices.

Industry Composition: Analysing industry sectors in the reference markets can help identify similarities to the target markets. For example, Singapore's strong finance and services sectors may align with Malaysia, while Korea's tech industry could be comparable to Vietnam's.

Analysing these similarities (as dissimilarities) helps investors identify potential growth patterns and adapt successful strategies to the target markets.

Navigating an Exit

While the focus of private equity investing has primarily been on identifying promising investment opportunities, the exit stage of the investment lifecycle often poses unique challenges for private equity firms.

Exit value in Southeast Asia has fallen 46% year-on-year. In the medium to short term, the exit problem will be exacerbated by increasing interest rates, re-rating of public market valuations, lack of initial public offerings (IPOs), a softening economic environment, and general uncertainty.

Leveraging Data to Inform Your Decisions

Private equity investors can leverage private funding, M&As, IPOs, and listed company data to assess the potential for successful investments in certain industries and to navigate challenges specifically in Southeast Asia, including the ability to exit.

Private Funding: Private equity investors can analyse the amount and sources of private funding received by companies in a particular industry. Higher levels of funding indicate investor confidence, strong growth prospects, and potential interest from other investors or acquirers. Private equity investors may view companies with significant funding as more attractive investment targets, as the availability of capital can support expansion plans and increase the likelihood of successful exits.

Mergers and Acquisitions: The frequency and scale of M&A activities within an industry can provide insights into exit opportunities. Private equity investors monitor M&A trends to gauge market dynamics and the level of interest from strategic buyers or other private equity firms. Industries with a history of active M&A transactions suggest a robust market for exits. Private equity investors may target companies in such industries, anticipating potential acquisition opportunities as an exit strategy.

Initial Public Offerings: Private equity investors consider the IPO market as a potential avenue for exits. They assess the performance of IPOs within a specific industry to understand investor appetite and the potential for successful public offerings. A track record of successful IPOs within an industry indicates that companies in that sector may have a greater ability to exit through this route. Private equity investors may invest in companies with IPO potential, aiming to benefit from the increased valuation and liquidity that can accompany a successful public listing.

Listed Company Data: Once a company goes public, its financial performance and other relevant data become publicly available. Private equity investors analyse the financial reports and key metrics of listed companies within a targeted industry. Positive indicators such as revenue growth, profitability, market share, and operational efficiency can suggest a higher probability of successful exits. By assessing the listed company data, private equity investors can gain insights into the potential exit opportunities within that industry.

A Complex Landscape

Using a thesis and data-led approach can help investors navigate the complex landscape. Here are five core components to consider.

1. Limited Capital Markets

One of the key challenges in exiting private equity investments in Southeast Asia is the relatively underdeveloped capital market. The region lacks deep and liquid markets, making it more difficult to find suitable buyers for portfolio companies.

The limited number of IPOs and mergers and acquisitions (M&As) means private equity investors have fewer exit options than more mature markets. IPO markets have been improving in the region, but liquidity is still a problem. Special purpose acquisition companies (SPACs) targeting Southeast Asian companies and global listings of Southeast Asian companies have also been growing.

2. Reliance on Strategic Buyers

Without robust public markets, private equity investors in Southeast Asia often rely on strategic buyers for exits. Strategic buyers, such as larger corporations in related industries, are more likely to acquire a portfolio company to expand their own business lines or gain market access. However, the challenge lies in identifying and negotiating with the right strategic buyers who perceive value in the investment and can offer an attractive exit opportunity.

Southeast Asia's attractive long-term growth fundamentals are routinely referenced in the context of rising strategic interest in the region: a population of 675m with a median age of 30; and a middle-class consumer base of 190m which is expected to double in size over the next few years. The challenges of greenfield expansion also push companies towards M&A.

3. Regulatory Hurdles

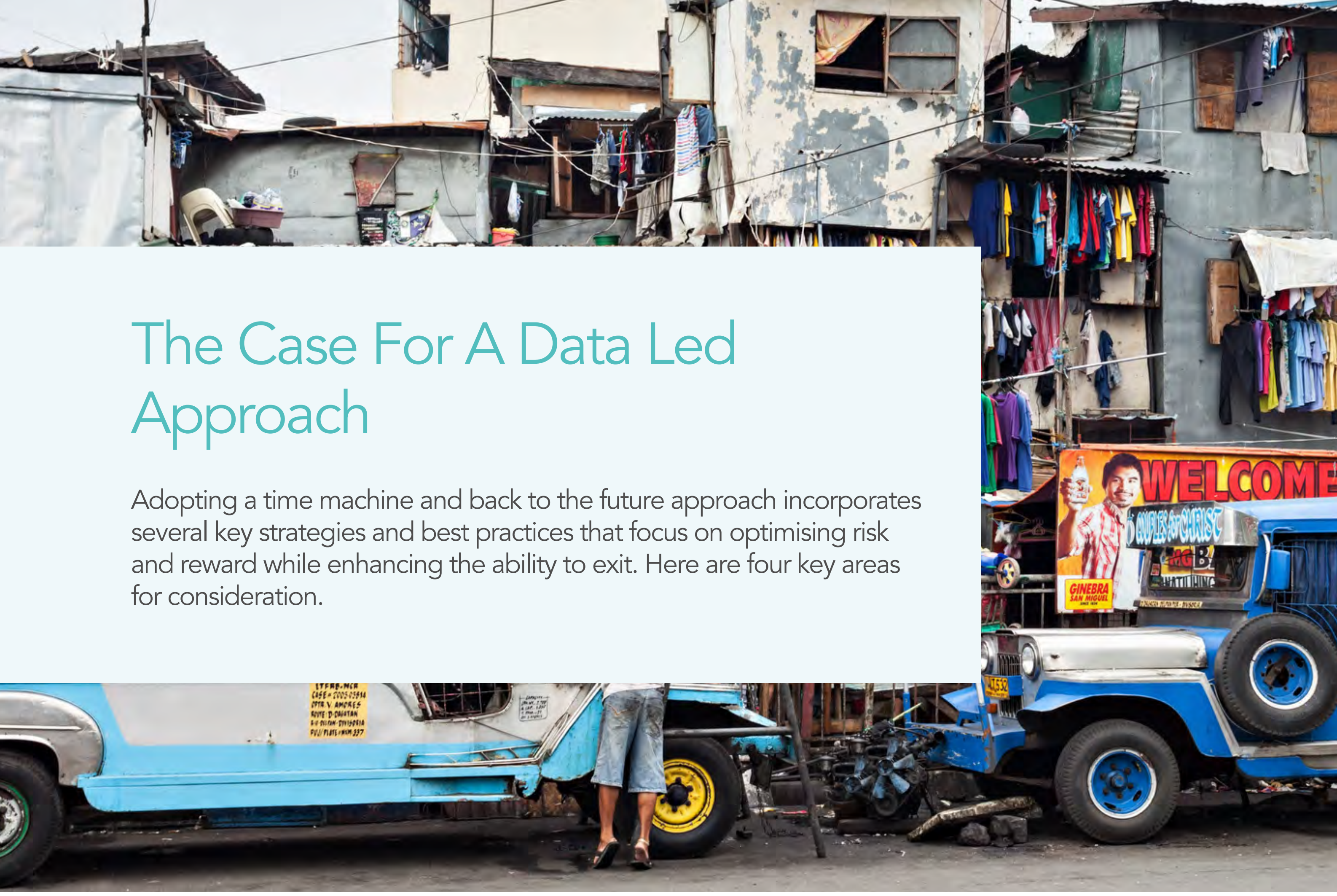
Navigating the regulatory landscape in Southeast Asia can be a complex task for private equity investors. Each country has its own unique set of regulations governing foreign investments and acquisitions, which can vary significantly regarding transparency, ease of doing business, and legal protection. Complying with these regulations and securing necessary approvals can often delay or complicate the exit process.

4. Limited Secondary Market Opportunities

Another challenge in Southeast Asia is the lack of developed secondary markets for private equity investments. Secondary transactions, where investors sell their stakes to other investors, can provide an alternative exit route. However, the limited number of institutional buyers and the relatively small scale of secondary transactions make it a less frequently utilised option in the region.

5. Focus on Capital Efficient Businesses That Can Use Leverage for Dividend Recaps or Buybacks

Another effective strategy in navigating the exit problem is to focus on capital-efficient businesses that can potentially leverage their financial position for dividend recaps or share buybacks. Such businesses can generate excess cash flow and utilise it to return capital to the private equity investor. This approach provides an additional avenue for realising value and can contribute to a more favourable exit outcome.



The Case For A Data Led Approach

Adopting a time machine and back to the future approach incorporates several key strategies and best practices that focus on optimising risk and reward while enhancing the ability to exit. Here are four key areas for consideration.

Identify Sectors with Strong Private Funding and Sponsor Activity

A thesis-led approach starts with identifying sectors that demonstrate strong private funding, sponsor activity, and positive M&A and IPO trends in more advanced reference markets. By analysing trends and market dynamics in mature markets, private equity investors can gain insights into sectors that are likely to experience growth and attract investor interest.

This proactive approach helps identify promising investment opportunities with a higher likelihood of successful exits in Southeast Asia.

Prioritise Businesses with Strong ESG Considerations and Impact

Incorporating strong environmental, social, and governance (ESG) considerations into investment decisions is becoming increasingly important in the private equity landscape. Investors should prioritise businesses that are committed to sustainable practices, ethical operations, and positive social impact. Companies with robust ESG profiles are more likely to attract strategic buyers and generate interest from socially responsible investors, thereby improving exit options and potentially enhancing investment returns.

Identify Companies with Market Leadership and Pricing Power

Investing in companies that have achieved market leadership and exhibit pricing power can significantly improve exit prospects. Businesses with strong market positions and the ability to control pricing have a competitive advantage and are more likely to attract potential buyers. Private equity investors should target companies with unique products or services, established customer bases, and a proven track record of profitability. These factors enhance the chances of a successful exit.

Utilise Structuring to Optimise Risk and Reward and Enhance Exitability

An important aspect of a thesis-led approach is employing structuring techniques to optimise risk and reward while improving the ability to exit investments. This involves carefully designing the investment structure, such as utilising convertible debt or mezzanine financing, to align with the specific characteristics of the target company and the market dynamics. Structuring investments appropriately can provide flexibility and potential exit alternatives, ensuring investors can adapt to changing market conditions and maximise exit opportunities.

Adopting a Data-Led Approach to Investing

By considering all these factors, private equity investors can make informed investment decisions and develop exit strategies tailored to specific industries. Industries with strong private funding, active M&A, a history of successful IPOs, and favourable listed company data. It can also enhance risk-reward outcomes in the realm of private equity.

Adopting a data-led approach to private equity can assist investors in making more efficient and objective decisions. It also provides investors with the ability to identify high-potential opportunities in sectors with strong growth potential, and which capture ESG considerations and impacts, market leadership and pricing power, strategic structuring and capital efficiency.

This approach enables investors to screen a more targeted pool of companies, have a deeper fundamental understanding of more relevant industries and business models, improve the chances of successful exits, and contribute to sustainable and impactful investments in the region.

INNOVATE.
SUSTAIN.
GROW.

About Us

Founded in 2009, Aura Group is an Asia Pacific-focused Funds and Wealth Management business offering innovative investment solutions to investors via a range of strategies across multiple asset classes. Choose from our suite of open-ended investment funds or our closed-ended opportunities which capitalise on current market opportunities and bespoke investments. Our asset classes include:

- Private Credit
- Cash Management
- Multi-Asset
- Venture Capital
- Private Equity
- Real Assets

We take a client-centric approach, providing tailored solutions to meet the needs of our clients and have been awarded the 'Best Wealth and Fund Management Company' and the 'Asia Pacific Client Service Excellence Award' consecutively since 2019 from the International Finance Awards.

Aura Group partners with private clients, family offices, foundations, corporates and institutions.

"We help families and institutions achieve their financial potential through innovative and sustainable investments."

Our purpose is to help entrepreneurs, families and institutions build and protect wealth over generations.

Contact Us

Calvin Ng
Managing Director

Mobile: +61 458 888 888
E: calvin.ng@aura.co
Linkedin: Calvin Ng

Shane Shi
Director

Mobile: +61 410 241 868
Email: shane.shi@aura.co
Linkedin: Shane Shi

Andrew Nai
Director

Mobile: +65 9824 6838
E: andrew.nai@aura.co
Linkedin: Andrew Nai

Nicholas Tan
Associate Director

Mobile: +65 8388 3661
Email: nicholas.tan@aura.co
Linkedin: Nicholas Tan

Christopher Chan
Senior Investment Analyst

Mobile: +65 8694 0826
E: christopher.chan@aura.co
Linkedin: Christopher Chan

Ashley Feldman
Distribution Manager

Mobile: +61 402 665 578
Email: ashley.feldman@aura.co
Linkedin: Ashley Feldman

International Finance awards

Signatory of:

PRI Principles for Responsible Investment