FrontLine Research Paper

Is the emerging Asia-Pacific region coming of age?

Assessing the level of maturity of private markets is challenging. This endeavor is even more demanding when the market in question is the combination of multiple countries. Emerging Asia-Pacific is one of these composite markets. Fund investors contemplate this geographical concept to allocate assets to private equity.

The issue with this construct is that, at times, it looks artificial. It gathers countries with variable levels of private equity activity, knowledge, experience, and development. Grouping them could lead investors to conclude a distorted image of reality.

Assessing the level of maturity of private markets in Emerging Asia-Pacific is challenging

It would be tempting to zoom in and focus on individual countries. This level granularity might add new distortions instead of reducing them. Analyses focusing on countries leave aside a significant number of pan-regional funds. Looking at individual countries would also reduce the depth of the data pool, as many countries count only a handful of dedicated active funds.

Therefore, it makes sense, to a certain extent, to lump together Greater China, India, Indonesia, and Singapore, at least for the time being, in the concept of "Emerging Asia-Pacific". This group of countries will be in the focus of this issue of FrontLine.

Funds from the region Emerging Asia-Pacific mature slowly

Assessing the maturity of a market

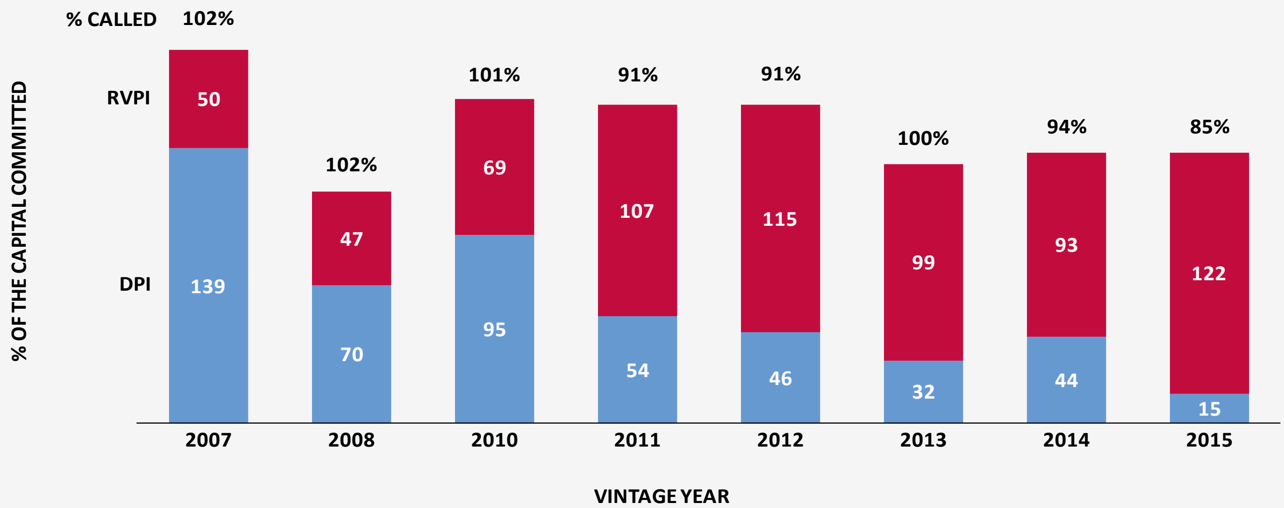
The next challenge is to choose the field of analysis. Among private market strategies, private equity comes to mind. It could be tempting to focus on venture capital, but specific analytical distortions might appear. Start-up investing can be overly sensitive to macro-economic events and economic booms and busts. Growth capital represents a significant portion of private equity investments in emerging markets. Transfer of ownership (buy-outs) plays a role as well. Looking at private equity, which combines the three strategies, as a sector of reference might help to avoid analytical distortions, even though the results will be less precise.

This analysis is possible thanks to the high-quality eFront Insight's cash-flow data, one of the few sources providing detailed and high-quality data on private equity in emerging markets. The currency of reference is the US dollar. Fund values are usually denominated in this currency in the region, and most of the fund investors can use this currency as a working instrument. Further analysis could use local currencies, but this might come with additional distortions and would not provide any meaningful improvement when it comes to analyzing the maturity of a market.

Defining the instruments of measurement

Measuring the maturity of a market can be elusive. Qualitative elements can be useful but are challenging to analyze systematically. The meaningful approach is to look at the proportion of residual value in the total value of a group of funds. This proportion is the technical maturity of funds. Figure 1 provides a perspective when funds are considered regardless of their size, and Figure 2 provides a capital-weighted average. The picture does not dramatically change from one to the other, which is good as it means that funds tend to mature reasonably homogeneously.

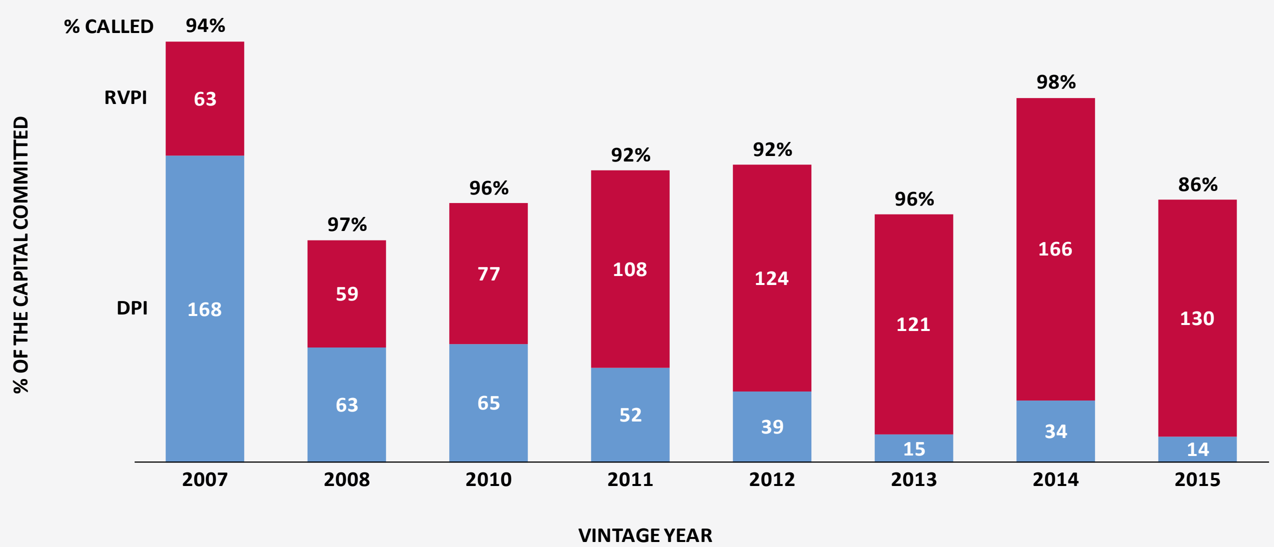
Fig. 1 – Arithmetic average value of private equity funds from Emerging APAC



Source: eFront Insight, as of Q3, 2019.

Funds from the region Emerging Asia-Pacific seem to mature slowly. The residual value of older funds remains fairly significant: it is above 50 percent for vintage years 2007 and 2008. Distributions are substantial, which means that funds have been able to realize some of their investments. How to interpret these figures?

Fig. 2 – Capital-weighted average value of private equity funds from Emerging APAC

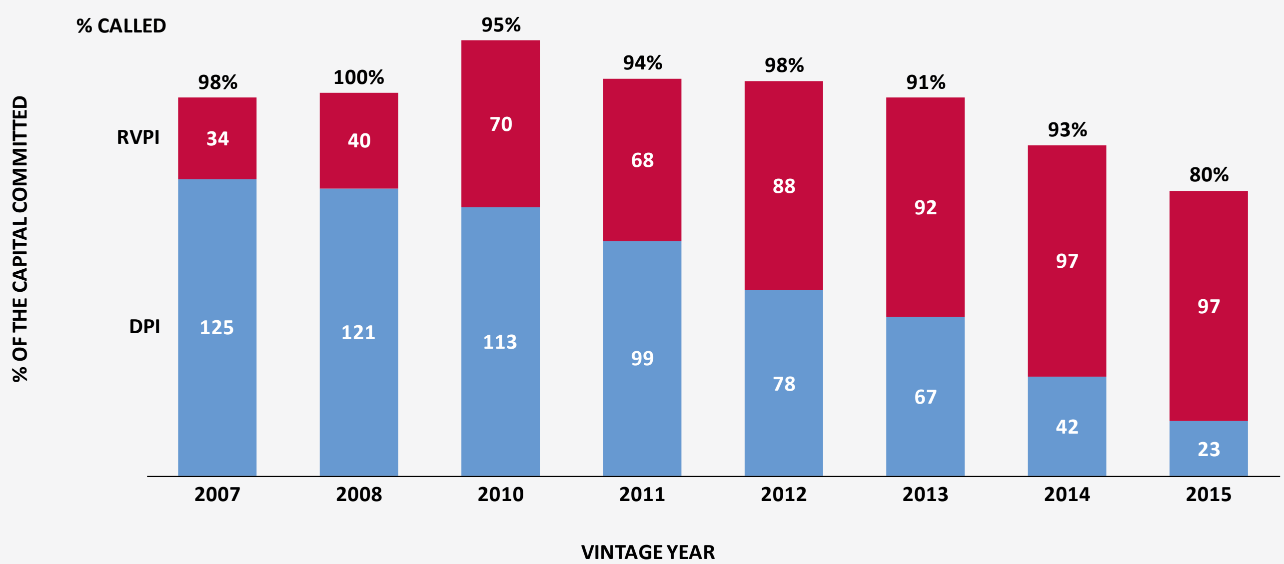


Source: eFront Insight, as of Q3, 2019.

A comparison between developed and emerging markets could help. The vintage year 2010 has a DPI of 65 percent, while its RVPI reaches 77 percent in Figure 2. A quick ratio provides a realization rate of 46 percent. Looking at Western markets, defined as Western Europe and North America (Fig. 3), the DPI reaches 113 percent, and the RVPI 70 percent. The realization rate is above 61 percent. Thus, funds from Emerging Asia-Pacific seem to require more time to mature than their Western peers. This could be attributed to a more demanding exit environment, such as higher requirements for local companies to be effectively sold or listed on the stock exchange.

Still, such comparisons have to be treated with caution, especially since the time-to-liquidity of LBO funds is shorter than for growth and venture capital funds. As Western markets include a significant proportion of LBO funds, there could be a bias. However, the comparison of Figures 2 and 3 still indicates an accelerated maturity of Western funds or a slower maturity for the ones from Asia-Pacific. This finding could hint at a lower level of maturity of Emerging Asia-Pacific when it comes to private equity. Further analysis is required to go beyond a first impression.

Fig. 3 – Capital-weighted average value of private equity funds from Western markets



Source: eFront Insight, as of Q3, 2019.

Investigating further

The next option would be to look at the capital calls and distributions of funds from Emerging Asia-Pacific. The maturity of funds is related to the cash profile of funds: as funds mature, they distribute cash. However, a perspective on capital calls and distributions by quarters shed a different light, as it highlights the dynamics of the market and matches the actual perception of fund investors. Therefore, besides the level of maturity of individual vintage years, the actual cash flows of funds provide a perspective that is closer to the heart of fund investors.

Looking at capital calls and distributions for Emerging Asia-Pacific (Fig. 4), a sequence of three periods appear. First, significant capital calls and barely any distribution until 2009. Then, distributions picked up but were systematically inferior to capital calls until 2015. It is at that time that capital calls and distributions have managed to balance each other, until now.

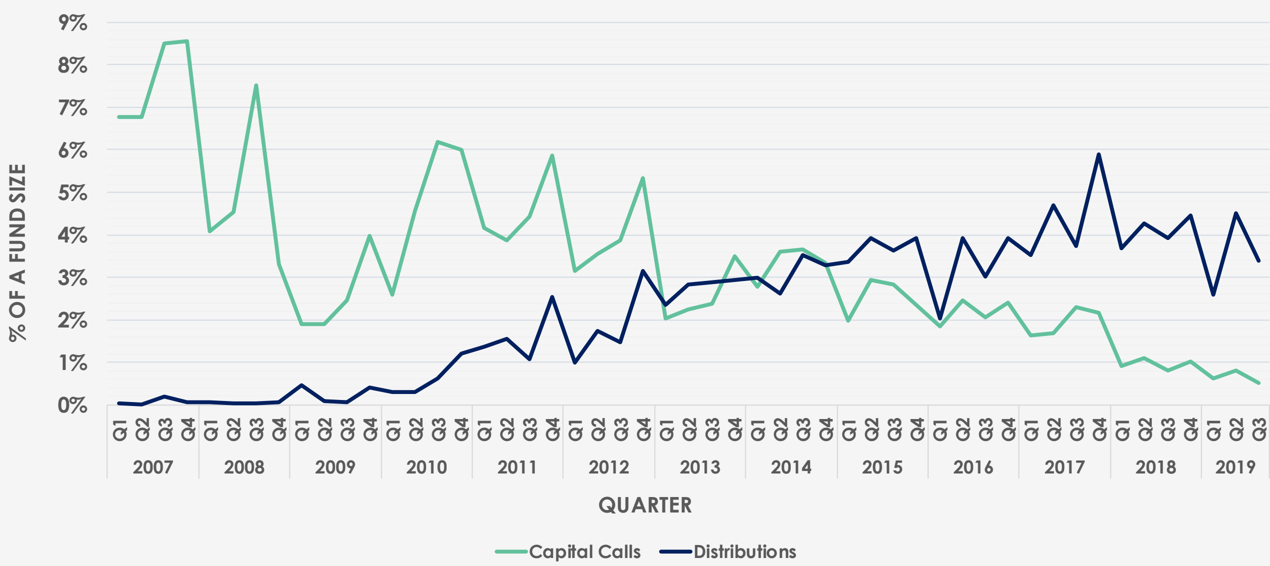
Private equity funds from the region have matured enough to reach their cruising speed

The calls and distributions of Western markets form a different picture (Fig. 5). The first episode also lasted until 2009. The second was shorter, until 2012. The third was even shorter until 2014. A fourth episode during which distributions significantly exceeded capital calls appeared after that and continues until now.

Fig. 4 – Capital calls and distributions of private equity funds from Emerging APAC

Source: eFront Insight, as of Q3, 2019.

Fig. 5 – Capital calls and distributions of private equity funds from Western markets



Source: eFront Insight, as of Q3, 2019.

The conclusion would be that indeed Emerging Asia-Pacific funds have matured along similar lines than Western funds, but took longer to do so. If private equity funds from the region Emerging Asia-Pacific have grown enough to reach their cruising speed, they have not yet reached the stage where they can land substantial net capital distributions to their investors. In that respect, if Emerging Asia-Pacific funds have matured, they are still one step behind those of developed markets.

Conclusion

How relevant are these conclusions to fund investors? The maturity of the market of private equity funds in Emerging Asia-Pacific could appear as a distant question when the quest to identify and to get access to top fund managers is so pressing. However, it is still of importance for at least two reasons.

First, many investors are looking at places where they can effectively deploy capital on a net basis, notably to avoid negative interest rates in Europe. Assuming that investors can increase their future commitments, funds of Emerging Asia-Pacific could help them deploy more capital than before. This is not the case in Western markets.

Second, as funds mature more slowly, the capital of investors is put at use for a longer time, which is also positive if investors want to avoid prolonged exposure to cash. The flip side is that this can prove to be more challenging to handle if the exit environment for Emerging Asia-Pacific funds is less favorable in the future, and investors need to collect capital back.

However, distributions from Western funds might help them overcome this issue. This strategy assumes, however, that Western funds continue to be net distributors in the future. There is no indication that this assumption will remain valid and, if so, for how long.

The region could attract investors wishing to deploy more capital on a net basis

Note

The aim of this newsletter is to provide readers with elements of analysis and understanding of the private finance universe, based only on cash-flow data collected by eFront Insight. It does not intend to draw any definitive conclusion, nor judge the performance of fund managers. By providing a guided reasoning, FrontLine hopes to contribute to the overall progress of understanding of the asset class in a short monthly format, with all the limits that this entails.

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In 2019, eFront was acquired by BlackRock and since then operates as a specialized business unit within BlackRock Solutions, alongside Aladdin Institutional and Aladdin Wealth.

About eFront Insight

eFront Insight is a sophisticated web-based analytical platform dedicated to alternative investments and combining granular, high quality investment data reported by General Partners, leading market benchmarks and other relevant sources in order to generate unique insights and facilitate investment decision making. eFront Insight is available to both General Partners to digitize data exchanges with investors and to Limited Partners to enhance decision making.

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