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Slow China IPO market limits private equity exits

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A lack of Chinese IPOs is making it difficult for private equity firms to cash out.

HONG KONG (CNNMoney)

China's stalled market for new share listings is severely limiting the ability of private equity funds to cash out their investments in the country, according to a new research report from China First Capital.

The Shenzhen-based investment bank analyzed more than 9,000 private equity and venture capital deals completed in China since 2001, and found that more than $100 billion -- much from the U.S. -- remains invested.

And of that, some $22 billion is tied up in 2,200 deals completed before 2008, meaning time is fast running out for firms to find a way of returning cash to investors over the standard 5-7 year period.

The problem? The money has nowhere to go.

Until recently, initial public offerings in Shanghai or Hong Kong were the best, and most efficient, way for private equity shops to recoup their investments. But a **drought of activity** in the IPO market has left private equity firms with no option but to park the money.

And that might not change anytime soon.

"It seems more likely than not that the golden age of Chinese IPOs, when over 350 companies were listing each year across public markets in the U.S., Hong Kong and China, is now over," the firm said in the report.

Other avenues for cashing out private equity stakes are not well developed in China.

Trade sales -- a sale through a merger or acquisition -- are extremely rare in the country. And a market for secondary sales -- a sale by one private equity company to another -- has yet to develop in earnest. That leaves investors in the unenviable position of waiting for the IPO market to recover.

"By itself, such dependence on a single exit path is risky," said Peter Fuhrman, the chairman of China First Capital. "In the current environment, with most IPO activity at a halt, it looks even more so."

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China First Capital argues that a more robust secondary market may yet develop. Private equity firms interested in buying a stake from another fund would be able to skip much of the due diligence on accounting issues that sometimes trouble Chinese companies -- as that work has already been done by the initial investor.

"In the current difficult market environment for private equity in China, secondary transactions provide a valuable way forward," the report said.

"Secondaries potentially offer some of the best risk-adjusted investment opportunities, as well as the most certain and efficient way for private equity and venture capital firms to exit investments." ■

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