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Buyout Firms Lack Exit Ramp in China

By Chao Deng
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With the door to initial public offerings in China largely shut, private-equity firms invested there are having a tough time cashing out. The alternative—selling to another buyout firm or a company looking to expand via acquisition—remains rare in a market where buyers are relatively few.

Private-equity firms are sitting on more than $130 billion of investments in China and are under pressure from investors to find an exit, Shenzhen-based advisory firm China First Capital said in a report last week.

Gary Rieschel, founder of Shanghai-based Qiming Venture Partners, said, “There needs to be a broader number of choices in buyers” in China.

Private-equity firms have generally exited their China investments through IPOs, but the number of private-equity-backed IPOs approved by mainland regulators has plummeted. Meanwhile, the Hong Kong IPO market has softened and sentiment toward Chinese companies in the U.S. has soured because of accounting scandals.

In October, the China Securities Regulatory Commission shut the IPO door completely on the mainland, halting the approval of new listings over worries that a glut of offerings would further weigh on sagging share prices. The Shanghai Composite Index was one of the world’s worst performers in 2012, sinking to a near four-year low in early December before a rally pulled the index up slightly for the year.

Analysts say they don’t expect the CSRC to approve any IPOs until at least March, when Beijing’s top lawmakers usually hold important annual planning meetings.

The regulator approved 220 IPOs of companies backed by private-equity or venture-capital firms in 2010, but that fell to 165 the following year and 97 last year, research firm China Venture said. There are now nearly 900 companies waiting to list in China, the CSRC said on its website.

Hong Kong’s market, meanwhile, has seen fewer IPOs over the past year as investors soured on new listings after several underperformed the broader market. U.S. private-equity firm Blackstone Group, which owns 20% of chemical company China National Blue Star, scrapped a planned Hong Kong listing of a unit called Bluestar Adisseo Nutrition Group in 2010 due to weak markets. It has yet to list that firm.

Carlyle Group has struggled to exit some of its deals, including two deals it made in 2007, a $20 million investment in Shanghai-based language-training firm NeWorld Education Group and a $100 million investment in Zhejiang Kaiyuan Hotel Management Co. A company spokesman said the holding periods for those investments are normal because private-equity firms usually stay invested for four to seven years. The spokesman also said Carlyle has successfully exited many deals, including the recent sale of its stake in China Pacific Insurance, which generated a profit of more than $4 billion.

In more-developed markets, private-equity firms can count on exiting their investments through sales to rival buyout firms or to companies looking to grow through strategic acquisitions. But in China, private-equity firms have sold stakes to rival firms or other companies only an average of 15 times a year over the past three years, according to data provider Dealogic.

China’s secondary buyout market—where private-equity firms sell to each other—remains immature. Among the handful of such deals, Actis Capital sold a majority stake last month in Beijing hot-pot chain Xiabu Xiabu, for which it had paid $50 million in 2008, to U.S. firm General Atlantic for an undisclosed amount.

Domestic consolidation is rare compared with the activity in developed countries. Chinese companies that are still growing quickly may prefer to hold off selling, and there are fewer big corporate domestic buyers.

“China is still a relatively fragmented economy with a disproportionately small number of large businesses relative to the size of its economy and very few national businesses,” said Vinit Bhatia, head of China private equity for Bain & Co.

When a private-equity firm does sell a Chinese portfolio company, the size of the deal tends to be small. Last year’s biggest sale was MBK Partners’ $320 million sale of a majority stake in Luye Pharma Group, which it bought in 2008. The buyer was AsiaPharm Holdings Ltd.

Usually, though, foreign private-equity firms hold only minority stakes in Chinese companies because full control is tough to get, in part for regulatory reasons. Domestic private-equity firms, meanwhile, are often content to hold minority stakes in fast-growing companies, which can offer healthy returns.

Management may not be on board when a minority investor wants to put the whole company up for sale. Chinese chairmen, who are often the founders of their businesses, prefer to remain at the helm, said Lei Fu, co-founder of Shanghai-based private-equity firm Ivy Capital.

Still, private-equity investors say they are hopeful that more buyers will emerge in China this year, even if the IPO markets stay shut.

The number of strategic Chinese buyers should increase as the government encourages consolidation across industries and as medium-size companies begin growing more rapidly with a rebound in the economy, they say.

"Five years ago we would think of multinationals…Now we think more local companies" when looking for buyers, says Huaming Gu, Shanghai-based partner at private-equity firm Baird Capital.

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