Chinese Private Equity Funds Are Taking on the World's Giants

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July 21, 2016 — 12:00 AM HKT

- PE firms from China pursue overseas deals at record pace
- One Italian target says China links are what matter most

Giuseppe Bellandi never imagined that his company, a 30-year-old maker of industrial automation components in the foothills of the Italian Alps, would end up in the hands of a private-equity fund from China.

But when the chief executive officer of Gimatic Srl realized that Asia's largest economy was key to his firm's future, and that Chinese PE executives had the expertise to help him grow there, Bellandi jumped at the chance to partner up. Last month, Gimatic turned down bids from Europe and the U.S. in favor of selling a majority stake to AGIC Capital, the PE firm founded by Chinese banker Henry Cai with backing from the nation's sovereign wealth fund.

"I was really surprised when I realized how strong Chinese private equity firms are," Bellandi said by e-mail.

China's PE industry is expanding globally at an unprecedented pace, putting firms like AGIC, Legend Capital and Golden Brick Capital in competition with European and U.S. counterparts like never before. Fueled by China's growing wealth, investor sophistication and desire to gain exposure to overseas assets, homegrown funds have taken part in at least $16.4 billion of cross-border deals so far this year, exceeding the previous annual record of $11 billion in 2012, according to Asian Venture Capital Journal.

The overseas push marks a coming of age for an industry that just a few years ago was better known for "buy-and-flip" investments in local companies already primed to go public. The approach was so pervasive that Chinese regulators asked KKR & Co.'s Henry Kravis, a private equity pioneer, to lecture domestic players on how to add more value.

This year, Chinese PE firms have participated in the $3.6 billion takeover of U.S. printer company Lexmark International Inc., the $2.75 billion purchase of Dutch chipmaker NXP Semiconductors NV's standard products unit and the $600 million acquisition of Oslo-based Opera Software ASA's web browser business. The sum of overseas transactions so far in 2016 is higher than Asian deals by foreign PE firms for the first time, according to AVCJ.

"These Chinese funds are already beginning to alter the calculus for buyout deals worldwide," said Peter Fuhrman, the chairman and CEO of China First Capital, a Shenzhen-based investment banking and advisory firm. "It's about buying companies that, once they have Chinese owners, can start making really big money selling products in China."

For a QuickTake explainer China's outbound M&A, click here.

The firepower to pull off such deals comes in part from China's growing army of high-net worth individuals, whose ranks expanded at the fastest pace worldwide last year despite the country's weakest economic growth in a quarter century, according to Capgemini SA. Rich Chinese investors are increasingly keen to diversify overseas after last year's devaluation of the yuan spurred concern of more weakness to come.

"There's a lot of domestic capital available, obviously looking for a home, and that's fueling the emergence of these funds," said Michael Thorneman, a partner at Bain & Co., a Boston-based consulting firm.

It's no coincidence that the increased focus on international deals comes amid a record overseas shopping spree by Chinese companies, who have announced about $149 billion of outbound acquisitions so far this year. In some cases, PE funds are working with Chinese corporates and financial firms to help structure the deals and amplify their buying power.

For the Lexmark purchase, Legend Capital partnered with PAG Asia Capital and Apex Technology Co., a Chinese maker of ink cartridge chips. On the $9.3 billion takeover of U.S.-listed Qihoo 360 Technology Co., Golden Brick Capital teamed up with Chinese investors including Ping An Insurance (Group) Co.

Domestic Players

"PE funds like us have very experienced teams, who can do the whole thing from deal sourcing to negotiation to due diligence to deal structure," said Parker Wang, the CEO of Beijing-based Golden Brick, which has invested about $2 billion since it opened in 2014 and also led the purchase of Opera Software's browser unit.

It hasn't always been smooth sailing. The Opera Software deal, for example, was originally supposed to be a takeover of the entire company, but suitors including Golden Brick failed to secure government approval.

Chinese funds are also becoming more active in their home market. They've been helped by a regulatory bottleneck for initial public offerings -- which encouraged companies to turn to PE firms for financing -- and the rise of China's Internet industry, a business that the government shields from foreign ownership.

Local funds participated in domestic investments worth $48 billion last year, exceeding Chinese deals by foreign PE firms by a record margin, according to AVCJ. The number of active Chinese funds, at 672 during 2013-2015, was the highest in at least five years, according to data compiled by Bain & Co.

For more on one of the latest China PE investments, click here.

Among the most high-profile firms doing domestic deals is Yunfeng Capital, founded by Alibaba Group Holding Ltd. Chairman Jack Ma. The firm has purchased stakes in Citic Securities Co. and smartphone maker Xiaomi, while also participating in offers for U.S.-listed Chinese companies such as iKang Healthcare Group Inc. and WuXi PharmaTech.

Domestic funds typically have a home-field advantage over foreign firms in identifying promising investment targets, according to William Sun, general manager of Beijing Jianguang Asset Management Co., a PE firm that focuses on the technology industry.

"We're all optimistic about China opportunities, but we probably have a better grasp of them than foreign funds," Sun said.

To be sure, overseas players aren't walking away from China. Some have partnered with domestic PE firms on consortium deals, as California-based Sequoia Capital did with Yunfeng on the WuXi PharmaTech takeover.

Growing Competition

Others have identified niches. KKR has spent about $1 billion on five food-related investments in China since 2008, betting that its global track record in the industry will help it thrive in a country that's faced several food-safety scandals in recent years.

More broadly, foreign firms may be concerned about rising valuations in China, according to Bain & Co.'s Thorneman. The average PE-backed Chinese acquisition target in 2015 had an enterprise value of about 18 times earnings before interest, taxes, depreciation and amortization, up from about 11 in 2013, according to data compiled by Bain.

"There's just more competition out there," Thorneman said. "That translates typically into higher valuations, more competitive deals, and more players pushing prices up."

Most signs point toward a bigger role for Chinese PE firms both at home and abroad. They controlled the largest portion of an estimated $128 billion cash pile in Asia-focused PE funds at the end of 2015, data compiled by Bain show.

Given that China is still growing faster than most major countries, any PE firm with the ability to help companies thrive there will have a leg up on international competitors, said Cai, the former Deutsche Bank AG investment banker who started AGIC last year and calls it an "Asian-European" PE firm. The fund, which counted Chinese insurance companies among its early investors, has offices in Beijing, Shanghai, Hong Kong and Munich.

"Few companies nowadays would care about the money or how much you pay them," Cai said. "They care if the investor can help them break into the Greater China market."

http://www.bloomberg.com/news/articles/2016-07-20/chinese-funds-that-kravis-urged-to-grow-up-are-now-kkr-rivals