

Private equity roundup – China

Private equity roundup – China is part of a series from Ernst & Young focusing on private equity activity in emerging markets.

Contacts:

Jeff Bunder

Global Private Equity Leader
jeffrey.bunder@ey.com

Philip Bass

Global Private Equity Markets Leader
philip.bass@ey.com

Michael Buxton

Asia Pacific Private Equity Leader
michael.buxton@hk.ey.com

Robert Partridge

Greater China Private Equity and
Transaction Advisory Services Leader
robert.partridge@hk.ey.com

Peter Witte

Private Equity Analyst
peter.witte@ey.com

Momentum for deal-making in China continues amid global decline

Private equity (PE) activity in China continues to strengthen with growth in PE deal activity supported by an active fund-raising environment and the availability of exit route options. Aggregate PE deal activity rose significantly in Q4 2011, in sharp contrast with global trends. Moreover, despite valuation concerns founded in increasingly robust competition for deals among local and global PE firms, deal-making continued unabated, and the aggregate number of PE deals in 2011 rose to US\$20b – an increase of 48% compared to 2010.

However, PE fund-raising lagged, declining 11% from US\$32.1b in 2010 to US\$28.5b in 2011. The second half of 2011 saw new commitments totaling US\$8.6b, just half that of the first part of the year. But limited partners (LPs) and general partners (GPs) still show significant interest in the Asia Pacific region and China, in particular, and local currency PE funds continue to expand. Renminbi (RMB) funds experienced a 28% year-on-year increase in their aggregate value to US\$11.4b in 2011.

Consistent with global trends, PE exit activity – especially IPOs – experienced a significant decline in the second half of the year. Just 4 PE-backed IPOs priced in H2 2011, compared to 33 in the second half of 2010. For the whole year, PE-backed IPOs declined by 62% in 2011, from 47 to 18. However, it is likely that PE firms will continue to favor IPO as an exit route, with Hong Kong rated as one of the top global financial centers, and China considered as the world's largest IPO market.

The continued slowdown in China's GDP growth could have a short-term effect on PE deal-making in China. But the fundamentals of the economy and the industry remain strong and the outlook for PE investing in China will remain bright.

Transactions

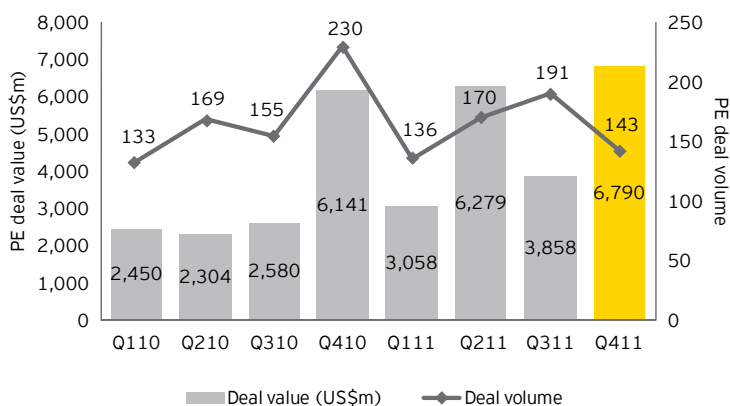
Aggregate deal value rises while volume sees marginal decrease

PE deal activity in China continues to see robust activity and growth. Aggregate PE deal value reached US\$6.8b in Q4 2011, its highest level in two years. For 2011 overall, aggregate deal value rose by 48%, from US\$13.4b to US\$20b. This increase was in contrast to global aggregate PE deal volume, which declined 19% to US\$138.1b.¹

Unlike many emerging markets like India where PE deal activity is driven by global firms, China has a number of domestic firms that make a sizeable contribution to PE deals. Domestic PE firms led investments in 8 of the top 10 PE deals in China in Q4 2011.

In terms of the aggregate volume of PE deals, Q4 2011 witnessed the second-lowest figures in 2011 with 143 PE deals. In 2011 there was a marginal decrease of 7% in aggregate PE deal volume with 640 deals, as compared to 687 deals in 2010.

Figure 1. Quarterly PE deal activity in China, 2010-11



Sources: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

Figure 2. Top 10 PE deals, Q4 2011 (by value)

Target	Investor(s)	Value (US\$m)	Announced date (2011)	Sector
Alibaba Group Holding, Ltd.	Digital Sky Technologies, Silver Lake, Temasek Holdings and Yunfeng Capital	1,600.0	1-Nov	Technology
SVA Information Industry Co., Ltd. (now known as BesTV New Media)	Wuxi Venture Capital Group, Chengdu Yuanhong Innovation Investment and others	487.3	15-Dec	Consumer products
Harbin Electric, Inc.	Abax Global Capital and an undisclosed firm	445.3	4-Nov	Diversified industrial products
Huaxin Cement Co., Ltd.	Jiangsu Winfast Investment & Development and others	282.8	8-Nov	Diversified industrial products
China Fire & Security Group, Inc.	Bain Capital	265.5	4-Nov	Other sectors
Qinghai Sunshiny Mining	Jiangsu Winfast Investment & Development and others	243.2	15-Dec	Mining and metals
Shanghai Maling Aquarius Co., Ltd.	Liuhe Capital and others	236.6	15-Dec	Consumer products
S&P Pharmaceutical Co., Ltd.	Shenzhen Baoteng Venture Capital, Jiangsu Winfast Investment & Development and others	230.5	24-Nov	Life sciences
Haitong Securities Co., Ltd.	Warburg Pincus and an undisclosed firm	222.0	1-Dec	Banking and capital markets
Suzhou Gold Mantis Construction Decoration Co., Ltd.	Greenwoods Asset Management, Shenzhen Zhongxin Lianhe Venture Capital and others	208.7	18-Nov	Real estate

Sources: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

¹ "Ernst & Young says fundamentals will finally prevail over uncertainty to get deals rolling in 2012," Ernst & Young press release, <http://www.ey.com/US/en/Newsroom/News-releases/Ernst-and-Young-says-fundamentals-will-finally-prevail-over-uncertainty-to-get-deals-rolling-in-2012>, 7 December 2011.

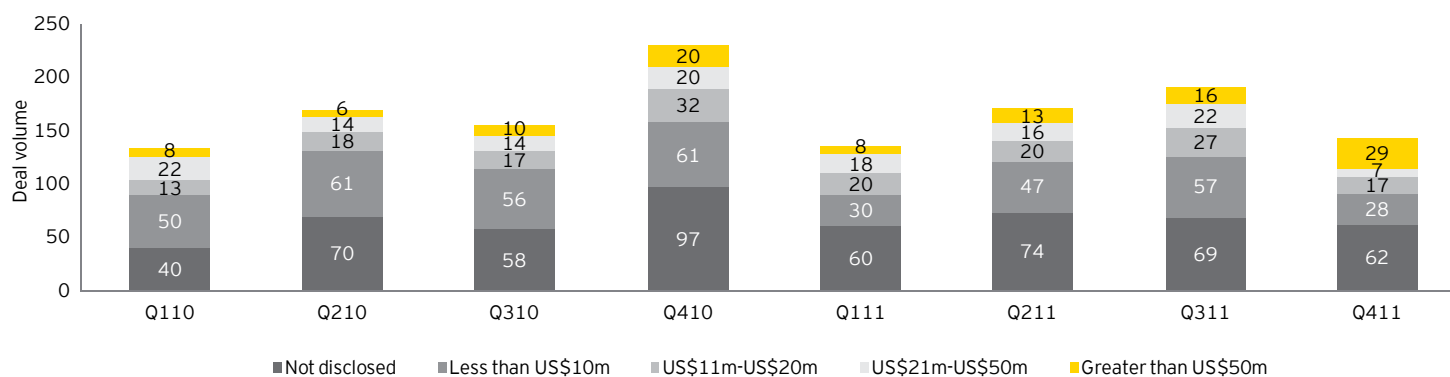
Transactions (... continued)

Large PE deals gaining momentum

The number and size of large PE deals (those with reported values higher than US\$50m) are expected to increase as Chinese companies continue to grow with the country's economy. In Q4 2011 a total of 29 PE deals with values greater than US\$50m were recorded, the highest quarterly number to date. This growth was evident year-over-year as well, with large PE deals increasing 50% from 44 in 2010 to 66 in 2011.

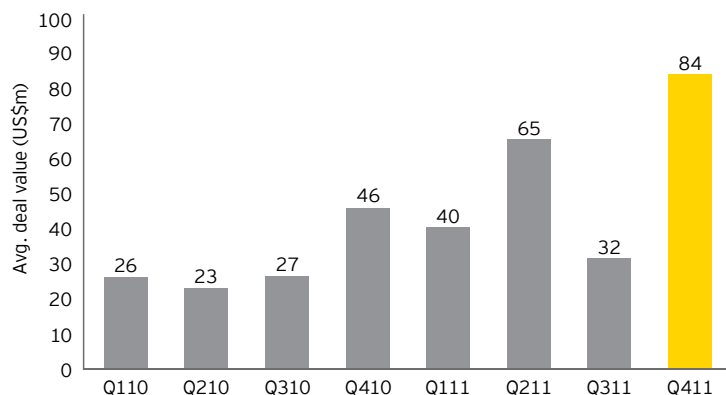
Deals of smaller value also continue to play a key role in the Chinese PE landscape. There were 28 deals with reported values of US\$10m or less, making up the second-largest category by number of transactions. However, the increasing importance of large deals can be seen in the fourth quarter's average deal value, which rose to US\$84m, twice the average value of PE deals in China as measured over the last two years (US\$42m). The median deal size was US\$20m for Q4 2011, also the highest among the last eight quarters.

Figure 3. Composite of PE deal volume by deal size



Sources: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

Figure 4. Average PE deal size by quarter, 2010-11



Sources: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

Transactions (... continued)

Technology, consumer products and diversified industrial products sectors lead PE deal activity

Technology, consumer products and diversified industrial products attracted the highest levels of PE investment in Q4 2011 in terms of both value and volume. As a group, these sectors contributed 60% of total PE deal value in China in the fourth quarter. For 2011 overall, technology, life sciences and consumer products attracted the highest level of PE investment value and as a group totaled US\$9.8b, which was 49% of the total PE deals value in 2011. Compared with 2010, technology and consumer products were among the highest PE investment value sectors, but real estate, which attracted the highest level of PE investment value in 2010 (US\$3.6b), declined by 78% to US\$0.8b in 2011.

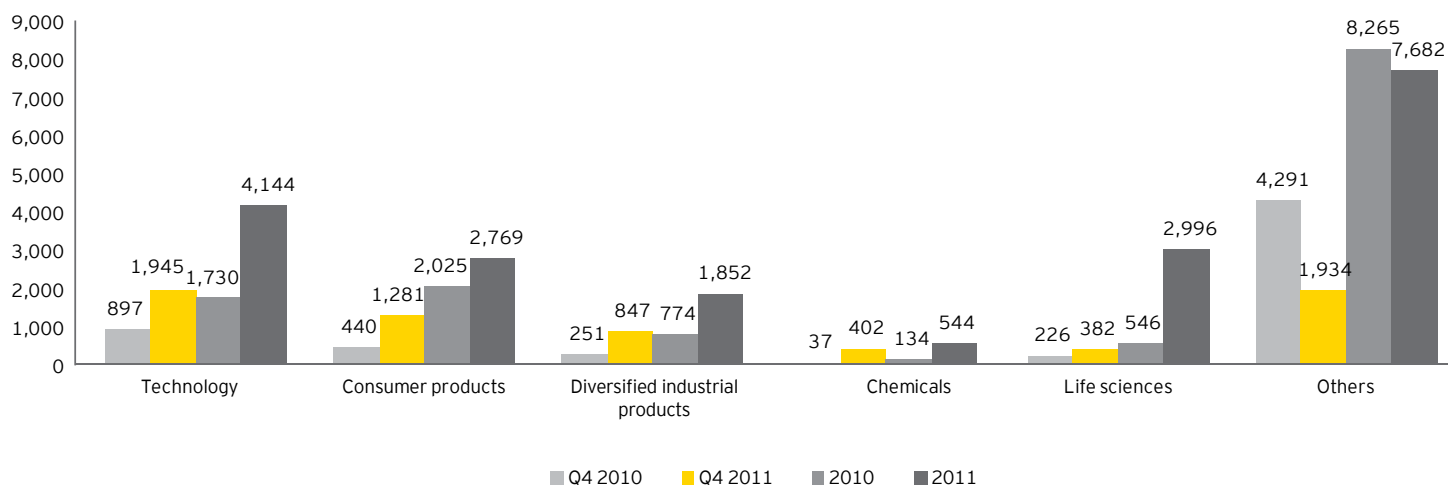
Technology accounted for 29% of overall PE deal value in Q4 2011 with an aggregate value of US\$1.9b. The sector continues to attract

the highest levels of PE investment: during 2010-2011, a total of US\$5.9b in deals involving PE firms was reported for Chinese technology companies.

Consumer products contributed 19% of Chinese PE deal value in Q4 2011 with US\$1.3b in deals. The sector was followed by diversified industrial products, which reported US\$0.8b in PE deals during the quarter. Over the past two years, Chinese consumer products companies have been involved in US\$4.8b in deals led by PE firms, while diversified industrial products firms have participated in a total of US\$2.6b PE deals.

In terms of PE deal volume, technology again led the sectors with 40 deals in Q4 2011. Consumer products companies participated in 19 deals, while diversified industrial products were involved in 18 deals. These three sectors have attracted the most number of PE deals in the past two years as well.

Figure 5. Aggregate PE deal value by sector: Q4 2010, Q4 2011, 2010 and 2011 (US\$m)

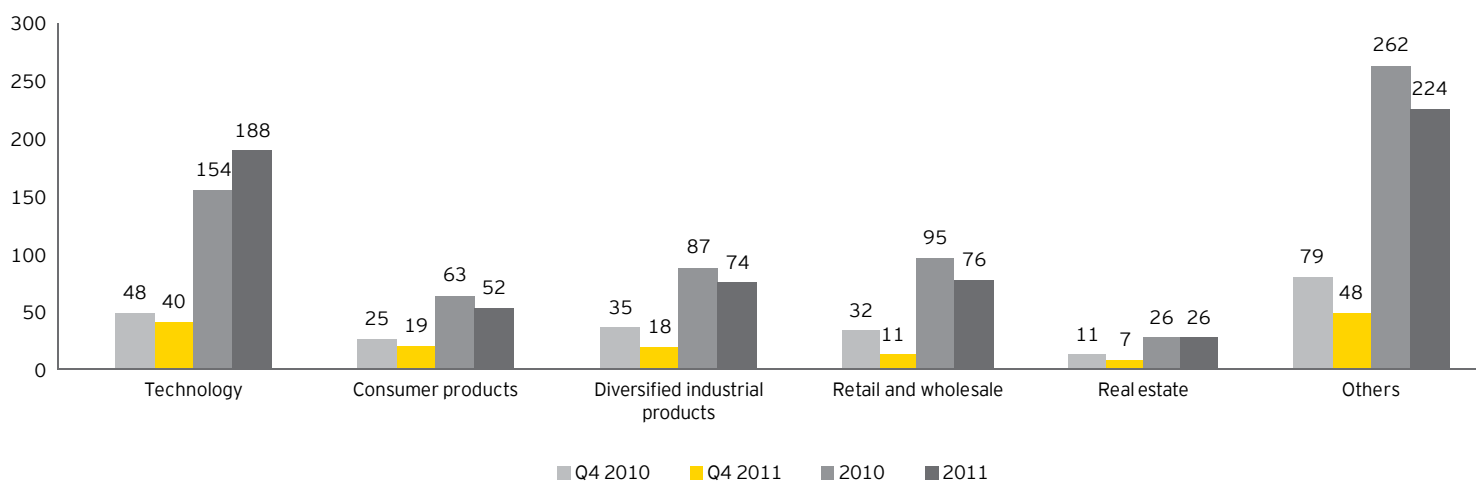


Sources: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

Note: the above graph includes the top five sectors by aggregate PE deal value in Q4 2011 and others. "Others" include the aggregate of aerospace and defense, airlines, asset management, automotive, banking and capital markets, government and public sector, insurance, media and entertainment, mining and metals, oil and gas, other sectors, power and utilities, provider care, real estate, retail and wholesale and telecommunications.

Transactions (... continued)

Figure 6. Aggregate PE deal volume by sector: Q4 2010, Q4 2011, 2010 and 2011



Sources: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

Note: the above graph includes the top five sectors by aggregate PE deal value in Q4 2011 and others. "Others" include the aggregate of aerospace and defense, airlines, asset management, automotive, banking and capital markets, government and public sector, insurance, life sciences, media and entertainment, mining and metals, oil and gas, power and utilities, provider care and telecommunications.

Technology

PE deals span a variety of sub-segments

PE deals have spanned a variety of business segments in technology, ranging from cloud computing services, social network businesses and mobile phone applications developers to smartphone and semiconductor manufacturers. The majority of these companies have generally been startups or businesses in their early stages. Over the last two years, 75% of technology PE deals with a disclosed value in China were valued at less than US\$20m.

The technology sector has had the largest number of PE deals in the last five quarters. In Q4 2011 alone, there were 40 PE deals with a total deal value of US\$1.9b. The largest Chinese PE deal in the fourth quarter was in the technology sector. Alibaba Group, a provider of

business-to-business technology services for companies selling via online marketplaces, received an investment of US\$1.6b from Digital Sky Technologies, Silver Lake, Temasek Holdings and Yunfeng Capital. Compared to the prior year, PE investments in technology rose by 139% from US\$1.7b in 2010 to US\$4.1b.

Other notable PE deals included an investment of US\$90m made in Beijing Xiaomi Technology, a manufacturer of smartphone handsets, by a consortium including Temasek Holdings, Qiming Venture Partners and IDG Capital Partners, and a US\$57.5m investment in semiconductor maker Tianshui Huatian Technology by Shanghai Dansheng VC Investment and other investors.

Transactions (... continued)

Consumer products

Rise of consumer spending power continues to provide attractive opportunities for PE

Consumer products companies in China are attracting their share of attention from PE firms. There were 19 consumer products PE deals totaling US\$1.3b in Q4 2011. The largest PE deal was an investment of US\$487m in SVA Information Industry by a group of investors including Chengdu Yuanhong Innovation Investment and Wuxi Venture Capital Group. SVA, a consumer electronics manufacturer, has since been renamed BesTV New Media. Compared to the prior year, PE investments in consumer products rose by 37% from US\$2b in 2010 to US\$2.8b.

Within consumer products, food and agriculture played a prominent role in the largest PE deals of the quarter. A consortium including Liuhe Capital invested US\$236m in Shanghai Maling Aquarius, a food processor and distributor. Fish and marine products breeder Shandong Horney Aquatic Development also received an investment of US\$174m from Liuhe Capital and other investors.

The increasing purchasing power of consumers in emerging economies such as China is expected to fuel growth for consumer products firms in these markets, which in turn has drawn interest from global PE firms. Some of the largest global PE funds have made significant investments in the consumer products sector in China over the last two years. Examples include the Carlyle Group's investment of US\$190m in China Fishery Group, an industrial fishing company, and an investment of US\$95m by Warburg Pincus in retailer China Red Star Furniture Group.

Among PE deals valued at more than US\$50m in 2010 and 2011, the Chinese consumer goods sector reports the second highest number of PE deals at 18. Chinese consumer product companies are seeking growth capital to increase the scale of their operations in order to meet rising consumer demand, and spending power, across China.

Diversified industrial products

Smaller deals dominate PE activity

The diversified industrial products sector saw 15 PE deals totaling US\$847m in Q4 2011. The largest deal was a US\$445m management buyout of Harbin Electric, a manufacturer of electric motors, led by Abax Global Capital and Tech Full Electric Co. A consortium including Ningbo Younger Investment Holding, Jiangsu Winfast Investment & Development Co. and Holchin B.V. invested US\$238m in Huaxin Cement. Paper manufacturer Guangdong Guanbao High-Tech Co. received US\$69m from Hongyuan Securities, China Gaoxin Investment Group and other investors. Compared to the prior year, PE investments in diversified industrial products rose significantly by 139% from US\$0.7b in 2010 to US\$1.9b in 2011.

PE deals of less than US\$10m dominated the diversified industrial products sector. More than half (58%) of all PE deals in the sector in Q4 2011 fell into this category. Within the sector, no single sub-segment dominated; investments were spread across a wide range of product types.

In 2010 and 2011 there were a total of 12 deals valued at US\$50m or greater, and global PE investors participated in many of these deals. Goldman Sachs and two other investors invested US\$100m in wind power equipment-maker Lianyungang Zhongfu Lianzhong Composites in 2010. Morgan Stanley's PE fund invested US\$100m in China XD Plastics, an automotive industry supplier.

Fund-raising

Fund-raising has lagged in 2011, declining by 11% from US\$32.1b in 2010 to US\$28.5b in 2011. However, funds raised in China's local currency, the renminbi, increased by 28% from 2010 to 2011, growing from US\$8.8b to US\$11.4b, indicating that local investor participation in Chinese PE is on the rise. In contrast, fundraising in India is largely dominated by global PE firms. Furthermore, significant funds are available and interest is still strong from the LPs as more than 200 funds are on the road targeting an aggregate of US\$89.5b of funds for China.²

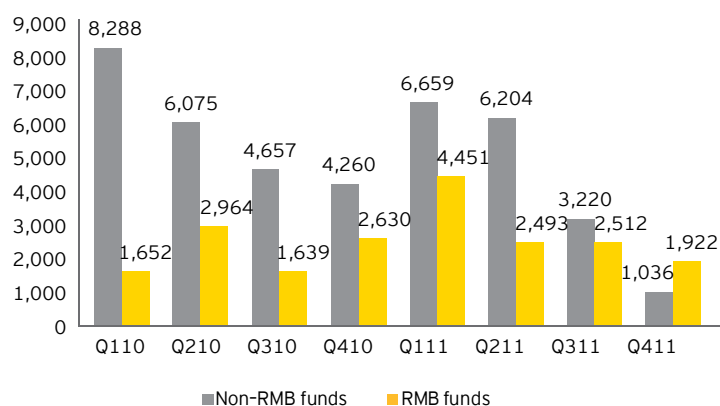
In Q4 2011 PE funds raised a total of US\$3b of funds for investment in China.³ Approximately two-thirds of the funds raised were in RMB, totaling RMB12.2b (US\$1.9b). According to the research firm Preqin, Shanghai Ruili Emerging Industries Parallel Fund, an industrial fund managed by Shanghai International Group, was the largest fund raised in the fourth quarter. The fund, which contains RMB5b and US\$300m in capital totalling approximately US\$1.1b, will target emerging industries on behalf of investors ranging from Chinese state-owned enterprises to institutional managers in the US and Europe.⁴

Another notable fund that closed in Q4 2011 was the Tianjin Junruiqi Private Equity Partnership Fund, launched with US\$518m in capital by Legend Capital Management. The fund, which is Legend's second to be denominated in RMB, aims to invest up to 20% of

its capital in early-stage companies and the remaining balance in expansion/late-stage companies.⁵

Parallel funds: renowned GPs are offering parallel funds to meet the increasing investor appetite for investing in PE in China. Offshore LPs invest in US dollar-denominated funds as they are restricted from investing in RMB funds while the local LPs seek to invest in RMB funds.

Figure 7. PE fund-raising for China, 2010-11 (US\$m)



Source: Preqin, accessed 3 January 2012

Figure 8. Top five China-focused funds by value closed in Q4 2011

Fund	Vintage	Manager	Type	Industry focus	Final fund size (RMBm)	Final fund size (US\$m)
Shanghai Ruili Emerging Industries Parallel Fund I	2011	Shanghai International Group	Buyout	Diversified	7,000	1,099
Tianjin Junruiqi Private Equity Partnership	2011	Legend Capital Management	Venture (General)	Diversified	3,300	518
White Peak Real Estate II	2010	White Peak Real Estate Investment	Real Estate	Real Estate	974	153
Hunan Richland Culture Industrial Fund I	2011	Richland Equities	Growth	Media	300	47
Richland Yangtze River Delta Technology Growth Companies Investment Fund I	2011	Richland Equities	Growth	Technology, health care, diversified	200	31

Source: Preqin, accessed 3 January 2012

2 Methodology for selecting fund-raising for China from Preqin: Fund focus – rest of world, location focus: greater China.

3 Methodology for selecting fund-raising for China from Preqin: Fund focus – rest of world, location focus: greater China.

4 Tang Zhenlong, "Shanghai International Group Establishes A Parallel Fund with RMB7B Raised in Series A Financing", <http://www.pedaily.cn/Item.aspx?id=218344>, accessed 6 January 2012.

5 "Funds in market – Tianjin Junruiqi Private Equity Partnership", Preqin, accessed 6 January 2012.

PE exits

PE exit activity declined in 2011, as it was affected by the volatility in global equity markets. Consequently, PE-backed IPOs decreased by 60%, from 47 in 2010 to 18 in 2011 while the number of secondary and trade exits decreased by 22%, from 50 in 2010 to 41 in 2011.

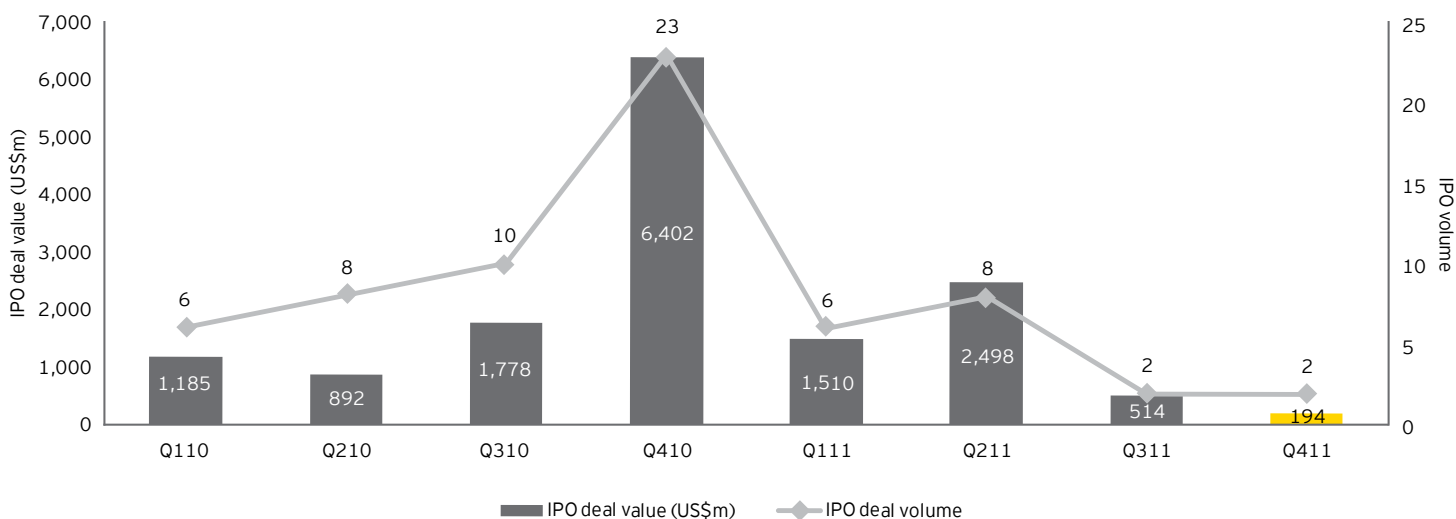
PE-backed IPOs dry up

There were only two PE-backed IPOs of Chinese companies in Q4 2011, a dramatic decline from 23 IPOs in Q4 2010. The largest PE-backed IPO in Q4 2011 was of China Tianrui Group Cement, which raised US\$124m and was backed by KKR and JP Morgan.

For 2011, the largest IPO was of Renren, which raised US\$855m in May 2011 and was backed by General Atlantic and DCM. Renren was listed on the New York Stock Exchange.

The number of PE-backed Chinese companies seeking US listings has also decreased. There were only 6 PE-backed Chinese companies that completed their US listings in 2011, as compared to 20 PE-backed Chinese companies in 2010. Governance and transparency issues, along with global stock market volatility, may be factors influencing the decisions of Chinese companies to list their stocks domestically or abroad.

Figure 9. PE-backed IPOs by quarter, 2010-11



Source: Dealogic, accessed 4 January 2012

Note: above includes only PE-backed IPOs, not venture capital-backed IPOs.

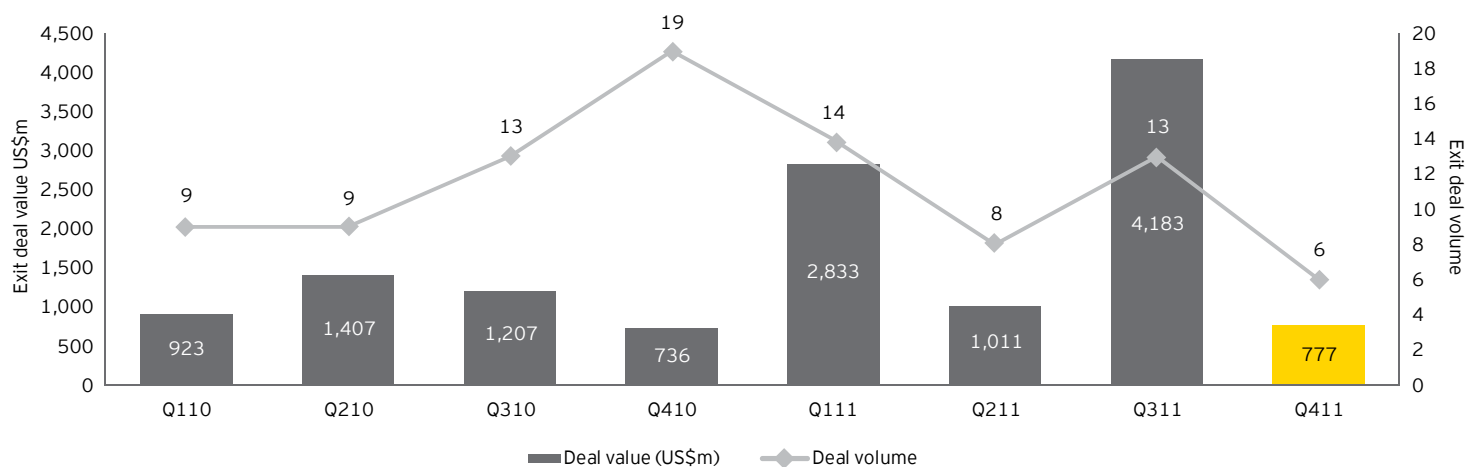
PE exits (... continued)

Trade and secondary activity slows as well

PE exits through trade or secondary sales declined significantly in Q4 2011. There were only 6 PE exits, compared to a rough average of 12 per quarter earlier in 2011 and 2010 (35 and 50 exits, respectively). Volatility in the global stock markets made it difficult to establish appropriate valuations for companies being put up for sale.

The largest PE exit in Q4 2011, was an acquisition made by Pearson of Global Education & Technology Group, a provider of test preparation services for Chinese students learning English, in a deal valued at US\$295m. Global Education & Technology was backed by India-based SAIF Partners. For 2011 overall, the largest PE exit was an acquisition by Nestle of Hsu Fu Chi International in a deal valued at US\$1.7b. Hsu Fu Chi International was backed by Baring PE.

Figure 10. Quarterly PE exits, non-IPO route, 2010-11



Source: Dealogic, accessed 4 January 2012



Outlook

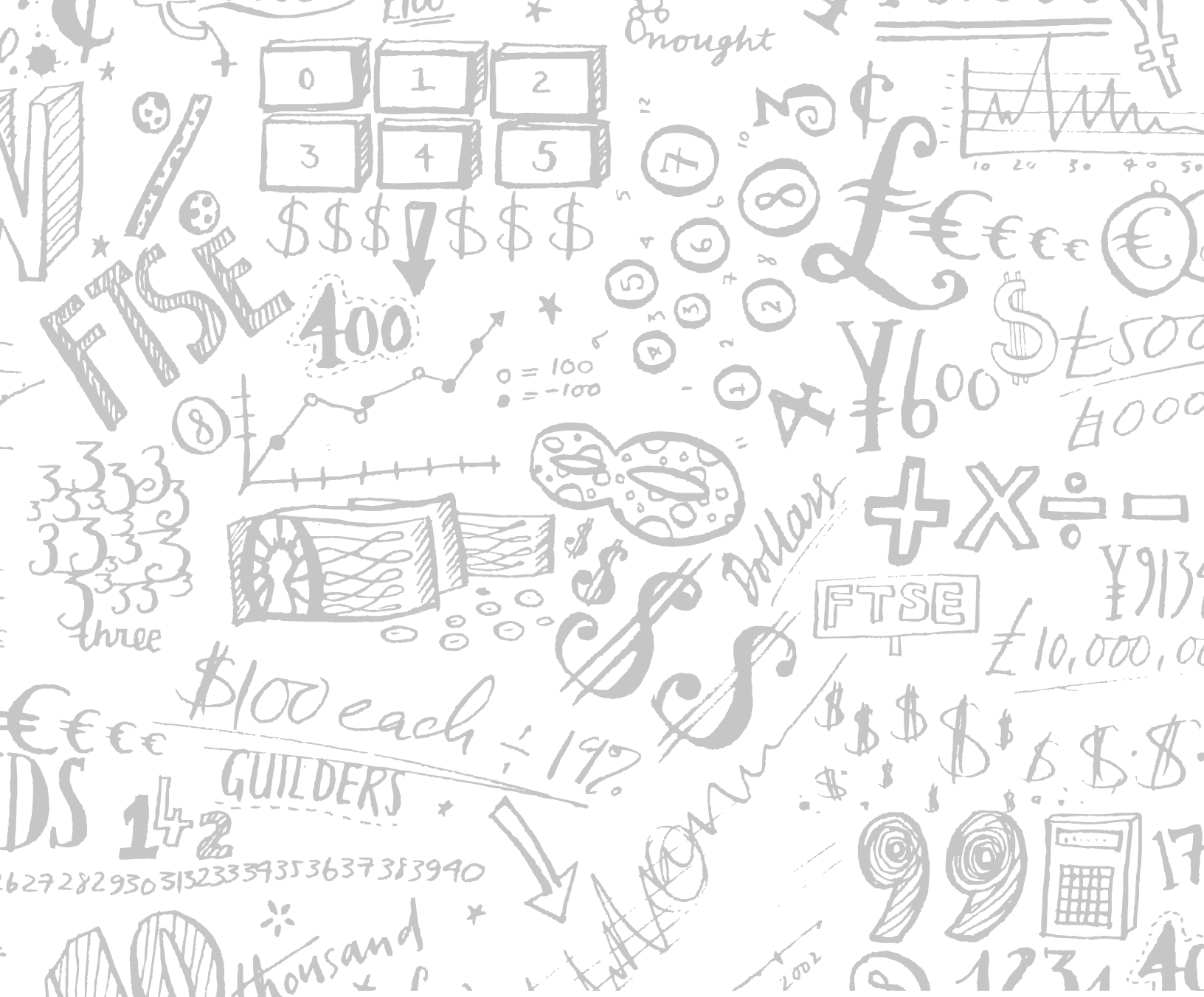
PE deal activity in China shows continued promise for 2012. A number of sectors – particularly consumer products, retail, industrial products, financial services, mining and life sciences – are expected to see strong deal activity. Cleantech and renewable energy may also attract attention from PE investors as the Chinese Government continues to provide impetus to this sector.

We expect PE fundraising in RMB to continue to grow, driven by interest from local institutional investors and high net-worth individuals and groups. Even if fund-raising is affected by the economic uncertainty in Europe and slow growth in the US, there are still significant total global funds available to invest in the region. In addition, LP and GP interest in the country and Asia Pacific region remains resolute.

Many PE firms that made investments during the boom period of 2006 through 2008 are likely to seek opportunities for exits in 2012. Alternative routes, particularly trade and secondary sales, may be pursued more aggressively, especially if equity markets remain volatile.

Of course, PE investing in China faces challenges in 2012. Investors should be sensitive to the possibility of a valuation bubble for targets as an increasing number of global and local players compete for opportunities. Chinese economic growth is expected to continue its slowdown into 2012, but the fundamentals of the economy remain strong.

While this slowdown could dampen overall PE activity in the short-term, including fund-raising and exits, we expect PE activity in China to remain robust over the long-term.



Methodology

- ▶ *Private equity roundup – China* is based on Ernst & Young's analysis of announced PE deals, as well as other PE-related news and information reported in secondary sources, Thomson ONE and Dealogic.
- ▶ Deal value is considered as per Thomson ONE. Where deal value is not available, aggregate of equity amount disclosed or equity amount estimated and debt amount, as per Thomson ONE, is considered as the PE deal value.
- ▶ We have not considered open market deals to analyze PE exits or investments. The deals have been reclassified, wherever required, based on Ernst & Young's sector-classification policy. The figures have been rounded off to the nearest whole number.

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