Private equity briefing: Southeast Asia

June 2018
This quarterly briefing offers you a roundup of the private equity and venture capital deals along with capital activities across major sectors in the quarter and trends that are shaping investment decisions today.

It distills the perspectives of our teams of subject-matter professionals in the region into pertinent insights to keep you ahead in navigating the private equity landscape.
Private equity (PE) deal value skyrocketed in 1Q18 as it marked the completion of one of the largest secondary transactions in the region thus far, Global Logistic Properties (GLP) for US$12b, along with the sale of Equis Energy for US$5b. Dry powder committed to Asia-Pacific continued its upward run, reaching a record level of US$313b by the end of 1Q18.

PE and venture capital (VC) investment value in 1Q18 increased manifold, with 19 deals being completed, valued at US$21.9b in comparison to 26 deals worth far lower at US$687m in 1Q17. Exit value too went up substantially from US$295m in 1Q17 to US$17.7b in 1Q18, mainly because the two largest buyouts completed in 1Q18 were secondary transactions.

The largest deal completed in 1Q18 was the secondary buyout of GLP by Hopu Investment Management, Nesta Investment Holdings, Hillhouse Capital Group, China Vanke Company, and Bank of China Group Investment along with the senior management executives of the firm at a staggering US$12b, which will go down as one of the major PE buyout deals completed in Asia to date. GLP is a global provider of logistics solution and is focused on creating a logistics ecosystem that utilizes the latest technology, data and service offerings to drive value for customers. We expect to see a continued trend of future deals above US$1b driven by factors such as record levels of dry powder, a growing trend of co-investing and an increasingly active group of large direct investors.

The other major transaction completed in 1Q was again a secondary buyout in which an American investment fund, Global Infrastructure Partners (GIP), took control of Equis Energy, a Singapore-based renewable energy independent power producer (IPP) firm, in a deal worth US$5b. This also supports a growing trend of secondary buy-outs in the region.

The technology sector continued to be attractive for PE and VC investments in 1Q18 as it witnessed the completion of two big ticket deals – GrabTaxi and Go-Jek at US$2.5b and US$1.5b, respectively. The technology sector will remain a high priority, steering growth in PE and VC investments in the region.

Fundraising slowed in 1Q18 in comparison to the preceding quarters as US$821m was raised in comparison to US$3.4b raised in 1Q17. However, VC fundraising, mostly with technology sector focus, witnessed an upswing from US$189m being raised in 1Q17 to US$369m in 1Q18. This may translate into an increased volume of VC-backed technology deals in near to mid term.

Note: PE and VC includes private equities, venture capitals and sovereign wealth funds (SWFs)
Note: Our analysis in this newsletter are based solely on PE and VC deals that are reported to be completed. Announced deals are not included in the analysis but are referred to where relevant in the commentary.
Exit planning: Timing the exit right

With the growing number of PE assets coming to the end of their investment life, we’re expecting exit activity to remain healthy over the next 12 months.

We are also seeing more PE determining the right time to sell 12-18 months prior to exit to allow for adequate planning. With rising valuations, the opportunistic approach to exit is no longer automatically working and PE firms are being made to work harder to justify the pricing during the exit process, even in an era of tough competition for the most attractive assets.

To optimize the sales process and maximize value, many PE firms are considering a number of ways to achieve this:

- Allow time for divestment planning: The percentage of PE funds relying on opportunistic buyers has fallen. PE funds are spending more time positioning the business for exit, with a sale strategy established well in advance.
- Leverage the power of data: Analytics can transform a deal life cycle, providing faster and higher quality data preparation and analysis, including for unstructured data sets (which are common in emerging markets), to facilitate a more focused discussion around key value drivers. This allows PEs to unlock opportunities, reduce critical risks that can be avoided earlier in the process and create a compelling and relevant value case for each potential buyer.
- Embed digital into the business strategy: Build and execute on a digital transformation theme in the business strategy of the portfolio company.

Topics to be discussed in this issue

In this issue, we will share our perspective on the medtech distribution landscape. It has been generating increasing interest from PEs in the region. With demand on the rise and a fragmented structure the device distribution industry is ripe for consolidation and a roll-up play. We discuss the opportunities and challenges that we see arising in this sector.

We will also discuss the increasing interest in environmental, social and governance (ESG) considerations when making investment decisions. Over the last few years, it has become a growing trend, particularly among PE investors, to carry out sustainable investing by considering ESG data and their impact as part of their core investment strategies. As well as there being increasing regulatory pressure for sustainability efforts, there are also a number of academic and industrial studies revealing that companies with strong sustainability performance outperform their peers, and the market in general. In this issue, we consider the key trends driving ESG as well as the value it can bring.

“First quarter of 2018 witnessed a record surge in PE investment in the region, and amid significant capital awaiting deployment, we are seeing plenty of activity this year.”
The first quarter of 2018 witnessed the completion of 19 deals through which PE and VC invested a record c.US$21.9b across the Southeast Asia region.

The deal value in 1Q18 jumped to a historic level on the back of two large-size secondary transactions being completed during the quarter – GLP for US$12b, which is among the largest deals thus far in Singapore, and Equis Energy for US$5b.

Singapore continued to be the leader among other Southeast Asian countries, contributing 90% to the aggregated deal value in 1Q18. The country witnessed 12 deals through which PE and VC invested c.US$19.8b during the quarter.

Real estate (55%) followed by energy (23%) and technology (19%) were the key sectors attracting majority of the PE and VC investments in Southeast Asia.

Figure 1: Investment activity

Figure 2: Investment activity excluding large-cap deals

Note: Analysis based on completed deals only; Small = deal value less than US$20m, mid = deal value of US$20m-500m, large = deal value more than US$500m; based on deal values disclosed
Source: Thomson One, Dealogic, S&P Capital IQ, Pitchbook and Mergermarket
**Table 1: Top investments in 1Q18**

<table>
<thead>
<tr>
<th>Investment date</th>
<th>Company</th>
<th>Country</th>
<th>Sector</th>
<th>Value (US$m)</th>
<th>Acquirer or investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-18</td>
<td>Global Logistic Properties Ltd</td>
<td>Singapore</td>
<td>Real estate</td>
<td>12,000.0</td>
<td>Hopu Investment Management, Nesta Investment Holdings, Hillhouse Capital Group, China Vanke Company, Bank of China Group Investment, Ming Z. Mei and other management</td>
</tr>
<tr>
<td>Jan-18</td>
<td>Equis Energy</td>
<td>Singapore</td>
<td>Alternative energy</td>
<td>5,000.0</td>
<td>Public Sector Pension Investment Board; Global Infrastructure Partners; China Investment Corporation</td>
</tr>
<tr>
<td>Jan-18</td>
<td>GrabTaxi Holdings Pte Ltd</td>
<td>Singapore</td>
<td>Technology</td>
<td>2,500.0</td>
<td>SoftBank, Didi Chuxing</td>
</tr>
<tr>
<td>Feb-18</td>
<td>Go-J ek Indonesia PT</td>
<td>Indonesia</td>
<td>Technology</td>
<td>1,500.0</td>
<td>Tencent, Astra International</td>
</tr>
<tr>
<td>Mar-18</td>
<td>Vietnam Technological &amp; Commercial J Joint Stock Bank - Techcombank</td>
<td>Vietnam</td>
<td>Financial services</td>
<td>370.0</td>
<td>Warburg Pincus LLC</td>
</tr>
</tbody>
</table>

Source: Thomson One, Dealogic, S&P Capital IQ, Pitchbook and Mergermarket

“With more corporate divestments expected over the next two years, this presents significant opportunity for PE players. Our Global Corporate Divestment Study 2018 highlights that 88% of Southeast Asian companies plan to divest within the next two years – twice as many as reported in 2017.”
There remains limited disclosure around PE exits in the region, with a number of deals going unreported and therefore not captured by the analysis.

1Q18 saw total exit value of US$17.7b through 9 deals completed. The total exit value for 1Q18 was the highest recorded in any quarter since 2013 due to large-cap exits.

Two large-cap exits took place in 1Q. Notably, the sale of GLP\(^1\) for US$12b by a consortium of investors led by GIC Private was the largest exit deal in the quarter. The second largest deal of the quarter was Equis Energy sale for US$5b by Equis Funds Group.

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Note: \(^1\)GLP was de-listed on 22 January 2018 from Singapore Stock Exchange. As per Pitchbook data, GIC Private, Canada Pension Plan Investment Board, BOC International (US), and Ardian sold their stakes to Hopu Investments, Nesta Investment, Hillhouse Capital, China Vanke Company, Bank of China and management.

Analysis based on completed deals only; Small = deal value less than US$20m; mid = deal value of US$20m-500m; large = deal value more than US$500m, based on deal values disclosed.

Source: Thomson One, Dealogic, S&P Capital IQ, Pitchbook and Mergermarket
### Table 2: Top exits in 1Q18

<table>
<thead>
<tr>
<th>Investment date</th>
<th>Company</th>
<th>Country</th>
<th>Sector</th>
<th>Value (US$m)</th>
<th>Sponsor</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-18</td>
<td>Global Logistic Properties Limited</td>
<td>Singapore</td>
<td>Real estate</td>
<td>12,000.0</td>
<td>GIC Private, Ardian, BOC International (US), Canada Pension Plan Investment Board</td>
<td>Secondary sale</td>
</tr>
<tr>
<td>Jan-18</td>
<td>Equis Energy</td>
<td>Singapore</td>
<td>Alternative energy</td>
<td>5,000.0</td>
<td>Equis Funds Group</td>
<td>Secondary sale</td>
</tr>
<tr>
<td>Jan-18</td>
<td>Aspion Group</td>
<td>Malaysia</td>
<td>Health care and life sciences</td>
<td>345.8</td>
<td>Southern Capital Group</td>
<td>Trade sale</td>
</tr>
<tr>
<td>Mar-18</td>
<td>Global Sports Commerce Pte Ltd</td>
<td>Singapore</td>
<td>Technology</td>
<td>80.0</td>
<td>FidelisWorld</td>
<td>Secondary sale</td>
</tr>
</tbody>
</table>

Source: Thomson One, Dealogic, S&P Capital IQ, Pitchbook and Mergermarket

“Whilst value is created throughout the PE holding period, it can be difficult to extract if initiatives aren’t fully implemented or a supportable road map is not provided to buyers.”

[Image of Geophin George]

Geophin George
Partner
Transaction Advisory Services
Ernst & Young Solutions LLP
According to Preqin, the total PE and VC dry powder committed toward Asia-Pacific has reached a record level high of c. US$313b by the end of 1Q18 from c. US$254b at the end of 2017 (2016: c. US$226b).

In 1Q18, six PE and VC funds based in Asia-Pacific with focus on Southeast Asia reached a final close raising an aggregate S$821m, which is lower compared to 10 funds closed in 1Q17 raising US$3.4b.

However, it is notable that VC fundraising witnessed an upswing from US$189m being raised in 1Q17 to US$369m in 1Q18.

Amid the record level of capital to get deployed and rising need for private capital, there exists an unprecedented need for PE and VC firms to shift focus toward investment and the deployment of this capital.

Figure 5: Fund raising activity* – Asia-Pacific domicile funds with Southeast Asia focus

Note: *Analysis includes all fund types i.e., growth, early stage or venture, real estate, infrastructure, mezzanine, special situations, etc. It includes funds that are based out in Asia-Pacific and have a mandate to invest in Southeast Asia along with other geographic regions.
Source: Preqin
We are currently witnessing a record level of dry powder in Asia. The two largest Asia-Pacific domiciled funds raised in 1Q18 with Southeast Asia as a focus region include Axiom Asia, raising US$321.5m and Apollo Southeast Asia raising US$200m. In addition to pure-play PE, there is an increasing prevalence of shadow capital as institutional investors, sovereign wealth funds (SWFs) and family offices become savvier and begin to deploy capital directly.

The quest for quality assets continues to remain as PE and VC compete with corporate acquirers to leverage the same investment opportunity. Increasingly, PE firms must be able to articulate a differentiated source of value-add above and beyond their ability to invest capital.

Table 3: Top Asia-Pacific domicile funds raised in 1Q18 – with Southeast Asia region among the location focus for investment

<table>
<thead>
<tr>
<th>Fund name</th>
<th>Closed date</th>
<th>Manager</th>
<th>Type</th>
<th>Final size (US$m)</th>
<th>Location focus</th>
<th>Industry focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Axiom Asia V</td>
<td>Mar-18</td>
<td>Axiom Asia Private Capital</td>
<td>Fund of funds</td>
<td>321.5</td>
<td>Southeast Asia, Australia, Emerging Markets, Greater China, India, Japan, South Korea</td>
<td>Diversified</td>
</tr>
<tr>
<td>Apollo Southeast Asia</td>
<td>Jan-18</td>
<td>Baidu Capital</td>
<td>Venture (general)</td>
<td>200.0</td>
<td>Southeast Asia (incl. Singapore)</td>
<td>Technology, transportation, high-tech, software, wireless</td>
</tr>
<tr>
<td>CapitaLand Vietnam Commercial Value-Added Fund</td>
<td>Mar-18</td>
<td>CapitaLand</td>
<td>Real estate</td>
<td>130.0</td>
<td>Vietnam</td>
<td>Real estate</td>
</tr>
<tr>
<td>Insignia Ventures Partners Fund I</td>
<td>Feb-18</td>
<td>Insignia Ventures Partners</td>
<td>Early stage</td>
<td>120.0</td>
<td>Southeast Asia, Far East</td>
<td>Technology</td>
</tr>
<tr>
<td>3one4 Capital Fund - Scheme II</td>
<td>Jan-18</td>
<td>3one4Capital Advisors LLP</td>
<td>Early stage</td>
<td>39.2</td>
<td>India, Singapore, US</td>
<td>Technology, media, financial services, agriculture, education and training</td>
</tr>
</tbody>
</table>

For global PE firms, real estate remains a favorite sector in Southeast Asia from potential investment perspective as reflected from the closing of a US$7b real estate fund by Blackstone in 1Q18. Top two PE funds closed, which are based outside of Asia and focused to invest in Southeast Asia among other regions, are real estate funds.

Table 4: Top non-Asia-Pacific domicile funds raised in 1Q18 – with Southeast Asia region among the location focus for investment

<table>
<thead>
<tr>
<th>Fund name</th>
<th>Closed date</th>
<th>Manager</th>
<th>Type</th>
<th>Final size (US$m)</th>
<th>Location focus</th>
<th>Industry focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blackstone Real Estate Partners Asia II</td>
<td>Mar-18</td>
<td>Blackstone Group</td>
<td>Real estate</td>
<td>7.0</td>
<td>Southeast Asia, Australasia, Australia, China, Far East, India</td>
<td>Real estate</td>
</tr>
<tr>
<td>LaSalle Asia Opportunity Fund V</td>
<td>Jan-18</td>
<td>LaSalle Investment Management</td>
<td>Real estate</td>
<td>1.2</td>
<td>Asia, Australia, China (mainland), Hong Kong, Japan, Singapore, South Korea, Taiwan</td>
<td>Real estate</td>
</tr>
</tbody>
</table>

Source: Preqin
Medtech distribution landscape has been generating increasing interest from PEs in the region. With demand on the rise and a fragmented structure, the device distribution industry is ripe for consolidation and a roll-up play, driving the interest of PEs. PEs can generate further value by focusing on value creation through in-licensing of value segment products and offering digitized solutions.

**Rising demand**

- With universal health care being advocated or practiced in limited forms across Southeast Asia and middle-class becoming more aspirational, health care standards in the region are rising. (Figure 6)
- Expansion of health care coverage has led to increased budget pressures on governments, making policy makers put an increased emphasis on screening and diagnostics and use of early stage interventions to limit treatment costs.
- These forces, have led to an increased usage of medical devices, likely to see a healthy growth of 8% to 10% across most markets with consumables, diagnostic imaging and lab devices being the biggest.

**Figure 6:** 2015 Medical device market by key product segments (US$m)

<table>
<thead>
<tr>
<th>Market</th>
<th>others</th>
<th>lab devices</th>
<th>orthopedic and prosthetics</th>
<th>dental products</th>
<th>patient aids</th>
<th>diagnostic imaging</th>
<th>consumables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>1.816</td>
<td>25-30%</td>
<td>10-15%</td>
<td>15-20%</td>
<td>5-10%</td>
<td>5-10%</td>
<td>20-25%</td>
</tr>
<tr>
<td>Thailand</td>
<td>1.397</td>
<td>20-25%</td>
<td>15-20%</td>
<td>5-10%</td>
<td>10-15%</td>
<td>15-20%</td>
<td>15-20%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>878</td>
<td>20-25%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>666</td>
<td>20-25%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
</tr>
<tr>
<td>Singapore</td>
<td>609</td>
<td>20-25%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
</tr>
<tr>
<td>Philippines</td>
<td>360</td>
<td>20-25%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
<td>15-20%</td>
</tr>
</tbody>
</table>

**Medical device market CAGR 2015-20F**

<table>
<thead>
<tr>
<th>Market</th>
<th>Malaysia</th>
<th>Thailand</th>
<th>Vietnam</th>
<th>Indonesia</th>
<th>Singapore</th>
<th>Philippines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>−9%</td>
<td>−8%</td>
<td>−16%</td>
<td>−10%</td>
<td>−12%</td>
<td>−10%</td>
</tr>
</tbody>
</table>

- The growth is largely volume driven as prices are reducing due to lower budgets and better technology enabling more productive use of assets and devices.
A fragmented value chain with strong influence of distributors

► While multinational corporation principals (manufacturers and license) have significant share of the market, the overall value chain has been traditionally disparate, with most principals accessing the markets through distributors.

► The distributor landscape itself has been very fragmented, with the largest player in some markets or categories not having more than 10% market share. Most distributors have been family run businesses of former employees of a medical device company who have been awarded a contract by their former employee, leading to significant principal and revenue concentration. Figure 7 explains the level of fragmentation across markets.

► Due to the complex purchasing landscape, challenges with cash collection and vast and difficult topography, the reliance on distributors and sub-distributors especially in developing markets of Indonesia, Philippines and Vietnam is very high.

Figure 7: Medical device distribution in Asia-Pacific – outsourcing and fragmentation levels

<table>
<thead>
<tr>
<th>Country</th>
<th>Level of outsourcing to distributors to access market</th>
<th>Fragmentation of distributors in medical device market</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Singapore)</td>
<td><img src="chart1" alt="Pie Chart" /></td>
<td><img src="chart2" alt="Pie Chart" /></td>
</tr>
<tr>
<td>(Indonesia)</td>
<td><img src="chart3" alt="Pie Chart" /></td>
<td><img src="chart4" alt="Pie Chart" /></td>
</tr>
<tr>
<td>(Philippines)</td>
<td><img src="chart5" alt="Pie Chart" /></td>
<td><img src="chart6" alt="Pie Chart" /></td>
</tr>
<tr>
<td>(Malaysia)</td>
<td><img src="chart7" alt="Pie Chart" /></td>
<td><img src="chart8" alt="Pie Chart" /></td>
</tr>
<tr>
<td>(Thailand)</td>
<td><img src="chart9" alt="Pie Chart" /></td>
<td><img src="chart10" alt="Pie Chart" /></td>
</tr>
<tr>
<td>(Vietnam)</td>
<td><img src="chart11" alt="Pie Chart" /></td>
<td><img src="chart12" alt="Pie Chart" /></td>
</tr>
</tbody>
</table>

Source: EY analysis; industry reports; company websites

= low  = high

Scale, technical capability and account management are key to win the distribution space

► Key success factors to win in the distribution space are:
  ► Wide distribution network: Large geographical coverage and multichannel presence
  ► Quality and breadth of services: Capability of the distributor to provide value added services and provide over 95% level of customer service (compliance to service level agreements). Additionally the technical understanding of products and the ability to educate hospital and account stakeholders on the clinical benefits of the product are key for newly introduced products
  ► Local market intelligence: Deep understanding of market nuances including account motivations and key account influencers
  ► Cost containment investments: Technological and operational investments to contain service costs
In order to achieve these success factors, PEs are pursuing a roll-up of various small distributors onto a regional platform. A regional platform has significant potential as principals’ value working with a regional distributor. A regional distributor enables:

- Easier market access to new markets
- Cost efficiencies – better economies of scale
- Operational and management efficiencies – a single window of interaction for various logistics (easier contract management)
- Stronger compliance – better Foreign Corrupt Practices Act (FCPA) reputation

The importance of consolidation and a wider portfolio is reflected in the deal rationale in this space (Figure 8); and unlike the Pharmaceutical sector, the region is yet to see a few dominant distributors, suggesting the potential for further deals in this space.

Figure 8: Medical device distribution transactions in Asia-Pacific (FY06-17)

Increasing possibility of disintermediation in the future as markets mature

Globally, including in Southeast Asia, hospital chains are procuring smartly, leveraging the strength of the hospital chain or forming procurement partnerships to gain scale. As these buyers increase in size, they have better leverage in the sales cycle, requiring medtechs to reconsider their existing product – centric-selling model and moving to a more customer- or account-based model.

As markets mature, the medtechs are more likely to focus on a key account management approach for their portfolio and are likely to do direct to the market. For example, in developed to semi-developed territories of Southeast Asia markets leading in-vitro diagnostics players are going direct for key accounts.
Generating sustained value through adjacencies and in-licensing

To mitigate the threat of disintermediation and generate added sustained value, distributors could consider the following levers:

► Widening the portfolio of products by including adjacencies. For example: distributors that carry an imaging or diagnostics heavy portfolio can consider a foray into patient monitoring, give the procurement synergies of the two sub-sectors

► In-licensing value segment products for specific categories. Value segment players from India and China are gaining significant share in home markets. As they look for expansion in Southeast Asia, distributors can in-license their products

► Predictive maintenance: With Internet of Things becoming pervasive, predictive maintenance in the future could be a standard practice. Distributors, with their technical knowledge of the product and deep understanding of customer requirements, can play a critical role in facilitating the last-mile solutions in sales and maintenance of products

► Additional services: Various additional services for customers or accounts can be provided by distributors. For example: hospital or laboratory furniture, IT solutions for small-scale set ups, working capital support (collections or payables tracking and monitoring)

Medtech distributor’s transformation opportunity – digital insights

As digitization and consumerism of health care increases, medtechs, tech giants, pharmaceutical players and consumer electronic majors are expected to form a complex web of digital partnerships. In Southeast Asia, the fragmented nature of health care landscape and related digital investments makes unlocking digital insights relatively more challenging. Medtech distributors, being close to the customer, with their clinical understanding are uniquely positioned to provide these insights playing the role of a potential aggregator across the platforms.

At the outset, while distributors today are not a part of the platform partnerships, it’s their very lack of participation that can be an advantage, as they can develop a flexible cross-platform solution. They can invest in technologies that can pull relevant information of clinical efficacy, device usage patterns from various platforms and run analytics, while combining with their own demand patterns. The range of possibilities are wide: from demand prediction to real-world evidence gathering

Medtech distributors and investors need to consider the following factors for an insights play:

► Business and operating model: Distributors will have to identify viable commercial models for all participants and develop internal operating models to support the commercial models

► Technology capability: Large medtechs and other ecosystem players will be keen to ensure distributors have necessary capability around data analytics and insights. Compliance and data protection measures would be of paramount importance

► Ability to understand and navigate policy landscape: Given some of the business models and data partnerships may not have a precedence, it is critical to navigate the policy landscape to reduce regulatory hurdles

Medtech distribution has great potential in Southeast Asia and is at inflection point. PEs that are able to evaluate their investments in medtech distribution both from an immediate perspective of winning through scale and a long-term lens of generating lasting value will bring structural changes to targets and portfolio companies, eventually leading to better returns.

“While disintermediation is an imminent threat and cannot be ignored, it is important to note that companies that have tried going direct, have done so with mixed results. They have not appreciated the complexity of the markets, e.g., agile and dynamic order and collection patterns.”

Abhay Bangi
EY Asean Health Transaction Leader
Partner, Ernst & Young Solutions LLP
Current trend in ESG investing

The 2015 United Nations Climate Change Conference held in Paris saw 196 countries agreeing to abide by the global pact, known as the Paris Agreement, to reduce greenhouse gas emissions. As a result, not only is there heightened regulatory pressure for sustainability efforts, there are increasing calls for institutional investors to divest from carbon-reliant companies. Thus, it has become a growing trend, particularly among PE investors, to carry out sustainable investing by considering ESG data and their impact as part of the core investment strategies.

A study by Morgan Stanley Institute for Sustainable Investing has shown that 71% of individual investors are interested in sustainable investing and 65% expect sustainable investing to become more predominant in the near future. Assets applying sustainable investing criteria has proven to grow 76% in the last two years. These results highlight that the interest in sustainable investing has seen considerable growth, particularly from women (76%) and millennials (84%).

These two groups of investors are becoming increasingly influential decision makers and rapidly looking to align their financial investment strategies with their core values.

The introduction of Sustainability Stock Exchanges initiative in 2009 has also urged stock exchanges and other financial institutions to incorporate ESG considerations into their stock indexes, listing rules and frameworks. In 2012, a new dimension was introduced and five stock exchanges became the first SSE Partner Exchange. Today, they are now joined by nearly all the major stock exchanges in the world.

The Singapore Exchange (SGX) has also made it mandatory for all listed companies to report their ESG practices from the financial year ending 31 December 2017 onwards. The SGX has gone a step further by providing model guidance to participating companies: the report should include a board statement to describe the company's sustainability actions, identify ESG factors that affect business strategies, explain their practices and performances, and set targets for future sustainability practices.

Sources: Morgan Stanley, Sustainable Signals, The individual Investor Perspective, SGX, Sustainability Stock Exchanges, United Nations
What is ESG?

**Environmental aspects**

This evaluates the environmental risks, which impacts the company and the way they manage such risks. It may focus on the mitigation hierarchy to predict, avoid and minimize the risks and influence it has on the environment. This includes the assessment on the company’s energy use, waste management as well as pollution.

**Social aspects**

Social factors help to assess a company’s business relationships. The review includes the company’s compliance to their human resource policies and procedures outlined by the manpower authorities to ensure rights and basic principles at work, including fair treatment, minimum wage, ideal work environments, non-use of child labor and non-discrimination is being adhered to.

**Governance aspects**

Governance pertains to the way a company is structured, regulated and held accountable, while taking into consideration rules, norms and actions. The corporate governance depends on many variables and motivations of a particular industry. It usually measures the roles and responsibilities of the various departments as well as the reporting lines, company structure, composition and authorities. It also evaluates if the risk management and governance is adequate and effective by assessing the escalation and communication pathway, information flow and management reporting. Companies may also come up with various codes of governance to focus on certain areas, such as sustainability.
How does ESG add value?

There is an increasing number of academic and industrial studies revealing that companies with strong sustainability performance outperform their peers, and the market in general. This has resulted in mounting interest in sustainable investing.

The following are three key reasons:

<table>
<thead>
<tr>
<th>ESG and corporate financial performance</th>
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<tbody>
<tr>
<td>• A 2015 report by Deutsche Asset &amp; Wealth Management that reviewed the results of over 2,200 studies from 1970 through 2014 and concluded that corporate financial performance is positively linked to all ESG aspects individually and when taken in combination.</td>
</tr>
<tr>
<td>• In addition, the abovementioned research has suggested that companies with strong ESG scores were positively correlated to the financial outperformance. 89% contributed to market-based outperformance while 85% contributed to accounting-based outperformance.</td>
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</table>

<table>
<thead>
<tr>
<th>ESG and risk exposure</th>
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<tbody>
<tr>
<td>• Studies have suggested that ESG may have a part to play in investors’ portfolios, which extends beyond ethical considerations, particularly for risk-adverse investors.</td>
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<tr>
<td>• Researchers shared that the higher the sustainability rating, the lower the fund’s risk profile. Companies that effectively manage material social and environmental issues can reduce their operational and reputational risks.</td>
</tr>
<tr>
<td>• AQR Capital Management has also performed a study on the risk and return implications when incorporating ESG considerations into investment strategies. The results showed that stocks with limited ESG exposure have volatility that is up to 10-15% higher than stocks with high ESG exposure. They also added that ESG scores may aid investors in forecasting future changes to estimated risks from traditional risk models.</td>
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<th>ESG and cost of capital</th>
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<tr>
<td>• A research by the University of Oxford and Arabesque Asset Management on nearly 200 studies, reports, and articles regarding sustainability has found the following:</td>
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<tr>
<td>• 90% of studies on the cost of capital show that sustainability standards lower the cost of capital of companies</td>
</tr>
<tr>
<td>• 88% of studies indicate that good ESG practices result in better operational performance</td>
</tr>
<tr>
<td>• 80% of studies show that sustainability practices are able to positively influence a company’s stock price performance.</td>
</tr>
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</table>

Falling behind

Today, companies are facing a growing pressure from stakeholders, which include regulators, employees and customers, to make a positive contribution across the ESG factors. They are not only required to do less harm, but to continuously deliver results.

Despite the increased investor demand in ESG performance disclosure, there is still a considerable number of listed companies that do not share this data publicly. With varying reasons such as the lack of internal sources and difficulty in choosing a key performance indicator from the available options, these companies risk falling behind while the current investment trend continues.

The disconnect between the sustainability and investor relations departments within an organization may mean that companies are missing out on the opportunity of collaborating with investors with mounting interest in sustainable investing. Many top investment firms have illustrated their belief that ESG factors are integral in assessing a company's quality and an important part of their investment consideration.

Further, stock exchanges have implemented regulations to encourage sustainability reporting. An example is the SGX, which has adopted a "comply or explain" approach where firms are required to provide a sustainability report, failing which they have to explain the non-compliance.

Recent scandals related to ESG issues have also drawn more attention to non-financial disclosures. Investors have also indicated that they have paid more attention to the issuer's non-financial disclosures following the scandals.

Call to action

The types of ESG information that investors seek today has evolved significantly. An EY survey conducted in 2016 noted that while surveyed investors found the company’s own annual report to be the most useful source of non-financial information for making investment decisions, the second most-useful source was an integrated report. Investors are also taking a more in-depth view of risk and potential opportunities from ESG considerations. The most important non-financial issue for investors in the survey was related to “good corporate citizenship and issuers’ policies on business ethics,” with 35% of respondents calling the issue “very important” and 57% saying that it was “important.”

Companies should be aware of the increasing need to prioritize ESG factors to better position themselves in the market and gain recognition from the investors. Media reports have noted that the Chairman and CEO of BlackRock, the world’s largest investment manager, sent a memo to the CEOs of the S&P 500 companies and Europe’s largest corporations. His message: focus more on long-term value creation rather than short-term dividend payouts; be open and transparent about growth plans; and focus on environmental, social and governance factors because they have “real and quantifiable financial impacts."

Sources: SGX, EY, Code Green, Forbes

"Companies should prioritize ESG factors to better position themselves in the market and gain recognition from the investors."
With institutional investors using non-financial information more often in their decision-making, reporters should direct their focus in the following:

- Meet your investors’ and prospective investors’ expectations
- Seize the opportunities to tell your organization’s performance story
- Address the essentials

**Meet investor expectations**

1. **Take a long-term view**
   Meet investor needs by informing them of the most material environmental, social and economic aspects that could impact your company’s ability to generate value over the longer-term—and the steps you are taking to manage them.

2. **Consider the global megatrends**
   Understand what could be shaping and disrupting your industry over the coming decades. Balance current risks with future opportunities to show investors your business model is future proof.

3. **Allocate capital and infrastructure to ESG**
   Investors agree that environmental and social aspects of performance are fundamentally important and have been overlooked for too long. Evaluate the adequacy of your allocated capital to put processes and procedures in place to address ESG issues and regulations.

**Seize the opportunities**

1. **Trust the evidence**
   Academic research now reveals that companies with strong sustainability performance outperform their peers and the market in general. Investing in understanding the opportunities of managing environmental and social risk could pay dividends.

2. **Set the agenda**
   Investors understand just how important ESG information is to the performance of your business but still largely review this information and data informally. This provides an opportunity for your company to lead the way in highlighting your understanding and management of the risks and opportunities you face.

3. **Engage your board and stakeholders**
   Engaging the board in the process early should provide the governance expected of you, and minimize the likelihood of heading in a direction inconsistent with their expectations. In addition, involve a broad cross-section of your stakeholders in determining what aspects of your business are most important and keep them informed on progress.

**Address the essentials**

1. **Materiality matters**
   Avoid being seen as “green washing” in your sustainability disclosures by applying a robust materiality process. A well-considered report should be able to articulate the environmental, economic and social risks and the opportunities most important to your stakeholders, and the ability of these risks and opportunities to impact your business now and into the future. Focusing on the positive, but ultimately less material aspects, may undermine your credibility with readers.

2. **Be transparent**
   Investment decisions are being made on the ESG performance of your business whether you report on them or not. Transparency on challenges you face, and how you are managing them, will be more beneficial than producing a report that just highlights the positive aspects of your performance. Reporting on ESG aspects should also be a challenging process. If not, you should question whether you’re actually telling investors something they don’t already know.

3. **Value third-party assurance**
   Having independent verification as part of your reporting process is important, as over two-thirds of all investors say it is very useful or essential. Coverage of material issues, data and information will add significantly to the credibility of your reporting not just with investors, but all stakeholders.
The EY PE team comprises experienced professionals focused on PE and is supported by our deep sector insights around the world.

### EY PE capabilities

**Dedicated PE experience:** dedicated teams comprising former PE operating partners, seasoned operating executives and management consultants

**Broad functional knowledge:** capabilities in PE fund structuring, portfolio audit, strategy, M&A and all core operating functions; experience in revenue enhancement, cost reduction, human capital and change management

**Deep sector experience:** primary focus in oil and gas, consumer, industrial, health care, automotive, real estate, financial services, life sciences and technology, media and telecom industries; ability to tap into sub-sector professionals

**Accelerated approach:** customized approach that is highly responsive and provides accelerated realization of benefits

**Global capabilities:** dedicated teams that have extensive cross-border experience with access to more than 30,000 consultants operating in 140 countries with deep industry and functional know-how

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### PE enterprise

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<th>Key issues and needs</th>
<th>EY solutions</th>
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<td>• Increased regulatory scrutiny</td>
<td>• Exit readiness and IPO</td>
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### Our solutions

- Management company
  - Back office modernization
  - Platform diversification
  - Risk management
  - Talent
  - Cyber
- Funds
  - Agility in an uncertain world
  - Putting dry powder to work
  - Increased regulatory scrutiny
- Portfolio companies
  - Value creation
  - IT infrastructure
  - Cyber
  - Exit readiness
- Funds
  - Deal origination
  - Integrated due diligence
- Portfolio companies
  - Value creation
  - Exit readiness and IPO
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