Private equity pulse: Asia-Pacific 2023

January 2024

Building a better working world

The slowdown in the pace of private equity (PE) activity in the Asia-Pacific region, while noteworthy, isn't indicative of a lack of opportunities or interest but rather a market recalibration. Investors remain confident as they expect the PE activity to gain momentum in 2024.

Macro challenges result in greater caution when fundraising

Attracting new funds remained a challenge for PE firms in 2023. The number of funds that closed in 2023 in the Asia-Pacific was the lowest since 2018. The decline in the number of funds closed can be attributed to a confluence of several factors, including fear of recession, shifting geopolitical dynamics, spiking interest rates amid deteriorating credit conditions and persistent inflationary pressure. These uncertainties led LPs to adopt a more cautious strategy, preferring to invest with established fund managers with proven track records. Bain Capital's Asia Fund V was the largest fund closed in 2023 with US$7.1b raised, followed by Primavera Capital Fund V (US$4b) and True Light Fund I (US$3.3b).

To facilitate fundraising, Asia-Pacific GPs are spending more time on pre-marketing during the off-peak season, utilizing co-investments and secondaries to build relationships with LPs and cultivating new pockets of capital such as retail and high-net-worth channels.

Private credit is a nascent asset class in the Asia-Pacific region, with tremendous growth potential and opportunity for investors. Tighter credit markets, constrained bank lending, a need for more flexible capital solutions and concerns around equity valuations have created a greater appetite for private credit funds in the region. While private credit fundraising witnessed a decline in 2023, in line with the global trends, attractive opportunities can be found within secured lending, mezzanine and special situations verticals. In all, 14 funds raised US$3.4b for Asia-Pacific private credit in 2023. The largest fundraising included PAG's Strategic Credit Fund raising US$1.1b and Allianz Global Investors' final close of its US$610m Asia-Pacific Secured Lending Fund in December 2023.

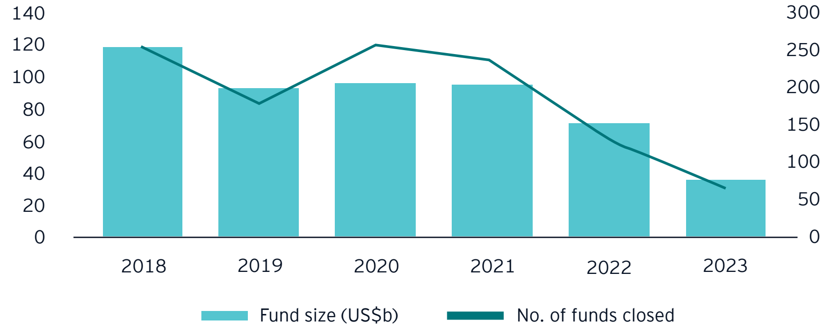
US$3.4b

was raised by 14 funds for Asia-Pacific private credit in 2023.

11%

of the overall M&A activity in the region in 2023 was accounted for by the PE deal value.

Asia-Pacific PE fundraising (2018 to 2023)



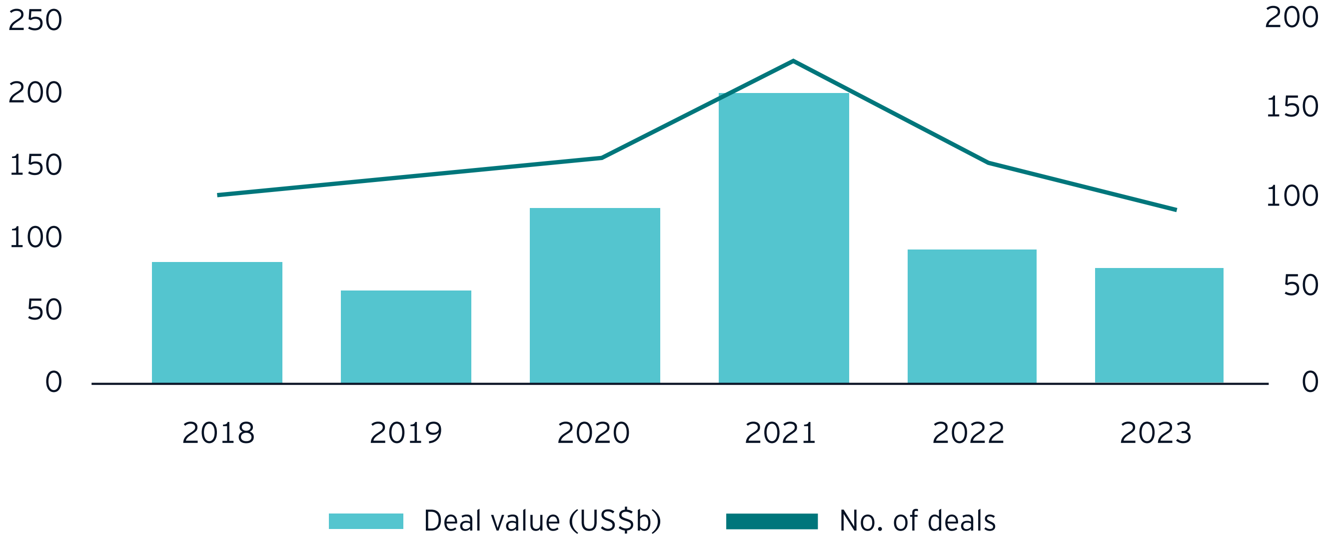
Note: Includes closed funds only

Investment activity declines

PE deal value accounted for 11% of the overall M&A activity in the region in 2023. PE investment activity in the Asia-Pacific slipped to US$79b in 2023, an outcome that was more in line with the pre-pandemic years. While macro uncertainty partially caused a slump in deal volumes, interest rates largely triggered a widening bid-ask spread in PE-led M&A. At the global level, uncertainties ranging from supply chain challenges to geopolitical tensions between key markets have added to current complexities. Additionally, a slowing Chinese economy alongside regulatory changes in Mainland China made investment activity and outcomes less predictable.

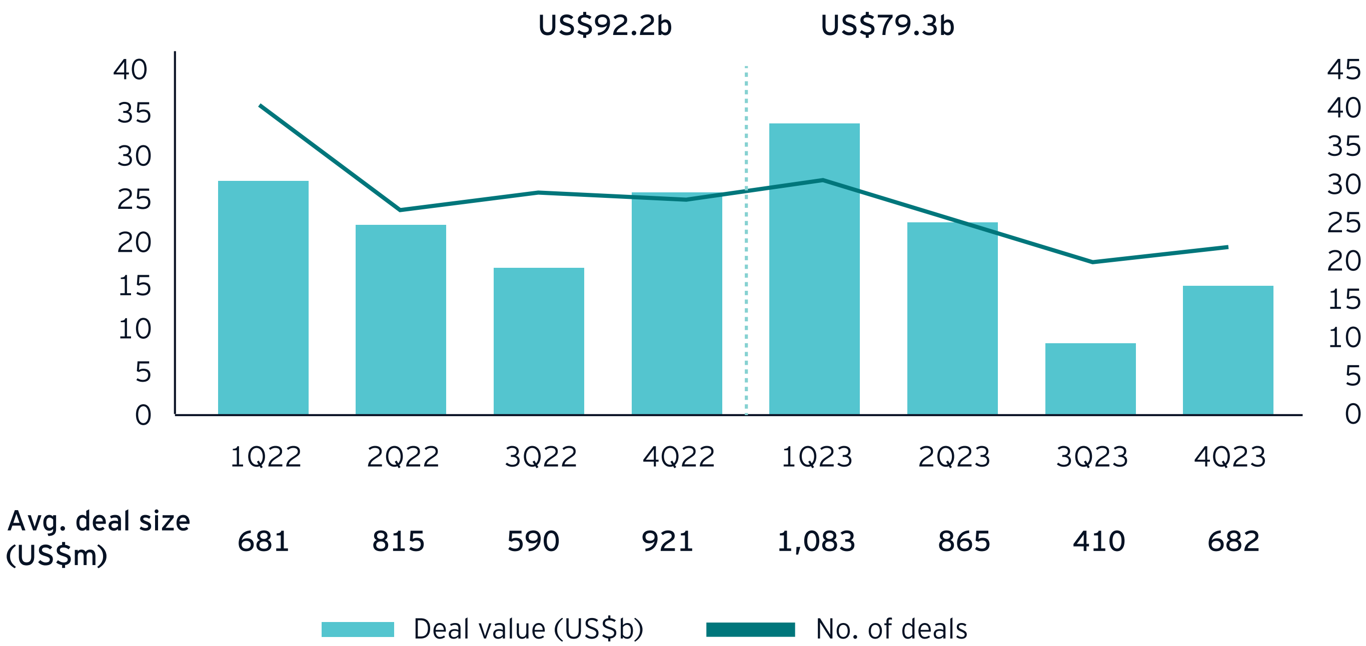
Although PE investment activity dipped in 2023 after a record year in 2021, we are already seeing a stronger deal pipeline start to take shape in the Asia-Pacific. In the fourth quarter, PE firms announced deals valued at 15b, an increase of 83% when compared to 3Q23. As firms get a greater visibility into interest rate trajectories and as macro volatility begins to recede, deal activity is expected to accelerate. Average deal size improved from US$743m in 2022 to US$801m in 2023.

Asia-Pacific PE investments (2018 to 2023)



Note: Analysis for deals valued US$100m or above

Quarter-on-quarter Asia-Pacific PE investments



Note: Analysis for deals valued US$100m or above

56%

of PE fundraising in 2023 was done by Greater China.

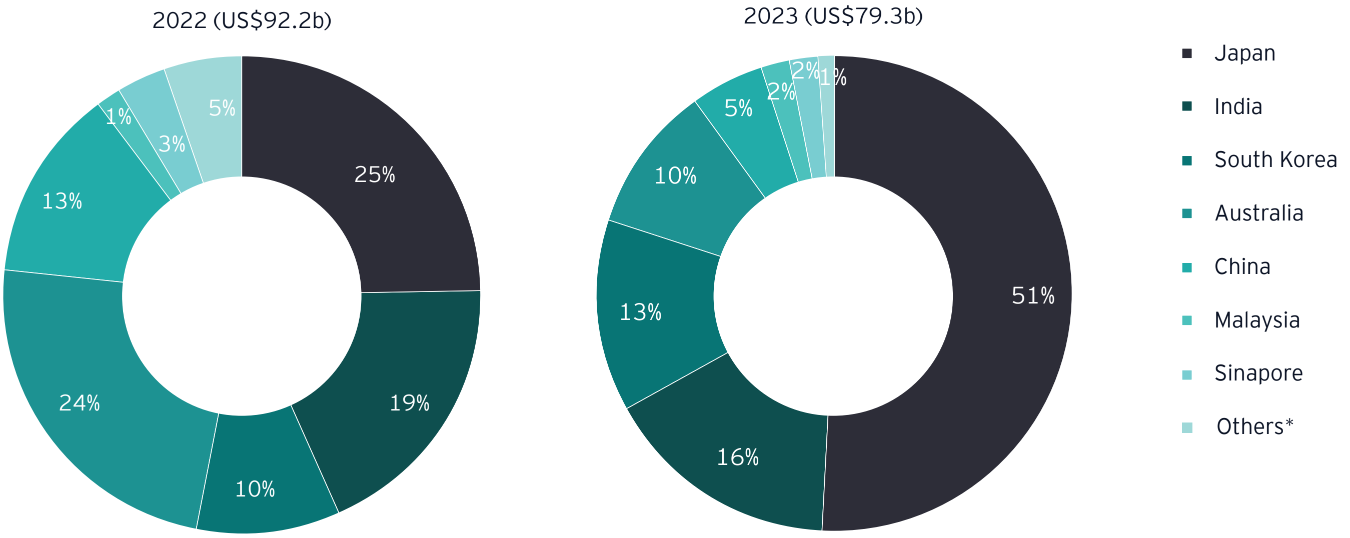
Regional opportunities: Japan and India emerged as attractive hotspots for PE investment

While Greater China accounted for roughly 56% of PE fundraising in 2023, geopolitical tensions and regulatory changes drove investors to seek diversification outside of Mainland China and explore opportunities in other Asia-Pacific countries such as Japan and India.

Japan was the largest buyout market in the Asia-Pacific, accounting for more than half of capital committed across the region. Yet top three deals made up 70% of the total for Japan, led by Toshiba, the largest announced buyout for Asia-Pacific on record at US$16b. This was followed by JIC Capital's investment in JSR Group (US$7b) and Shinko Electric Industries (US$4.7b).

India accounted for 16% of investment value and 29% of total PE deal volume in the Asia-Pacific during 2023. Given India's growing middle class and a large consumer market, it offers a wide range of investment opportunities in sectors such as technology, healthcare, renewable energy and e-commerce.

Asia-Pacific PE investments by country in US$b (2023 vs 2022)

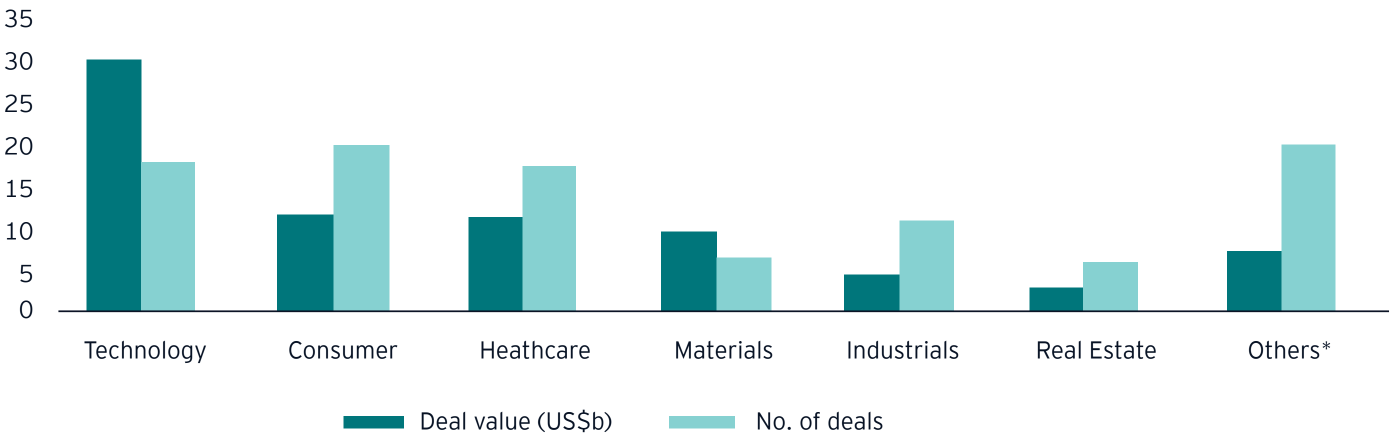


Others* include Indonesia, New Zealand, Vietnam and Guam

Note: Analysis for deals valued US$100m or above

Tech, consumer and healthcare sectors remain key sectors for PE in the Asia-Pacific

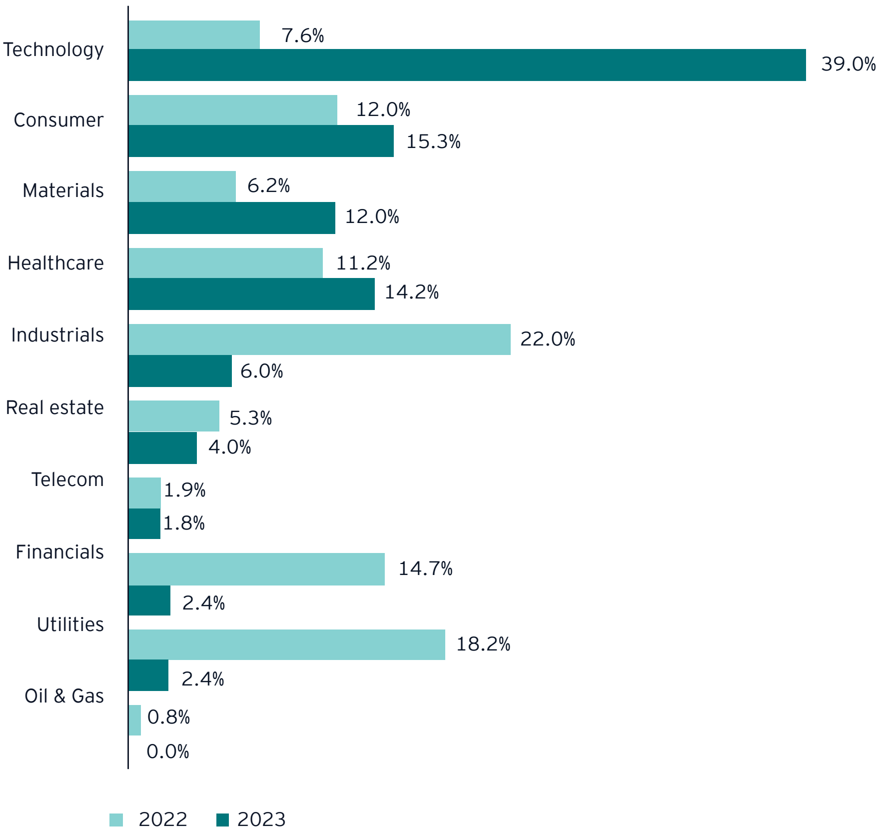
Asia-Pacific PE investments by sector in 2023



Others* include financials, utilities, retail, telecom, business services.

Note: Analysis for deals valued US$100m or above

Asia-Pacific PE investment value by sector (2023 vs 2022)



Note: Analysis for deals valued US$100m or above

In 2023, tech deals accounted for approximately one-fifth of all PE investments in the Asia-Pacific and 40% of total invested value. Apart from the Toshiba transaction, there were significant investments in digital infrastructure particularly in Japan, South Korea, Mainland China and India.

Artificial intelligence is a transformative force that is reshaping the business landscape. According to the EY CEO Outlook Pulse (October 2023), 71% of Asia-Pacific CEOs agree their organizations must act now on Generative AI to avoid giving competitors a strategic advantage, while an equal number (71%) say uncertainty around Generative AI makes it challenging to develop and implement an Artificial intelligence strategy. From an investment perspective, the revenue-generating opportunities and business models created by Artificial intelligence are still at a nascent stage. With high valuations in the space, investors in the Asia-Pacific remain cautious.

While almost a quarter (23%) of global CEOs prefer raising new capital for their Artificial intelligence investments, only 15% of Asia-Pacific CEOs share this approach. Instead, just under half (42%) of Asia-Pacific CEOs indicate they will reallocate capital from other investment budgets and a third (32%) prefer to draw from their existing technology budgets.

Despite caution around direct investments in AI, there are attractive investment opportunities within Artificial intelligence infrastructure verticals, such as chip manufacturers and data centers and their adjacencies.

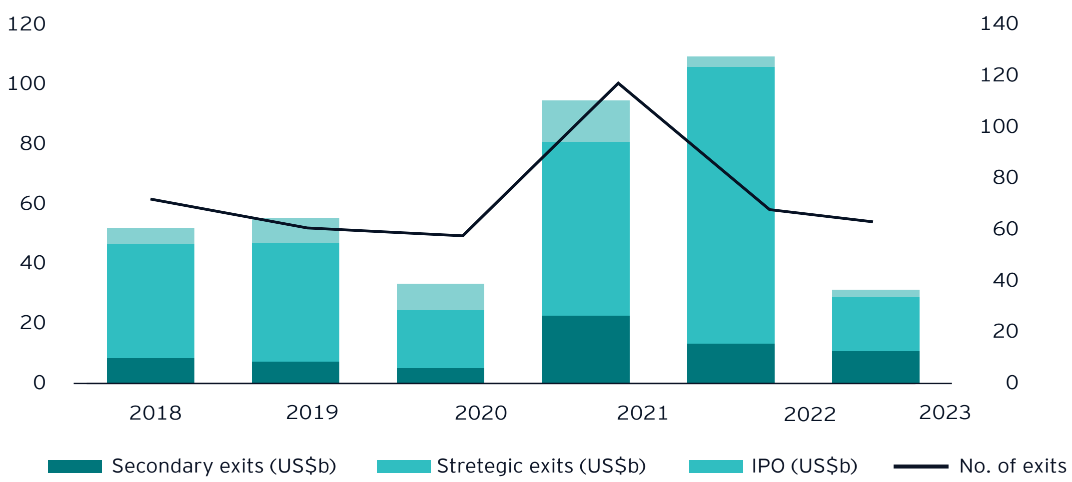
Additionally, investors in the region remain broadly positive about the prospects for innovative drugs, carbon neutrality, new materials, high-end manufacturing, digital economy and new forms of consumption. The energy transition remains a key area of focus, given Mainland China's commitment to become carbon neutral by 2060 and strong policy support for industries aligned to the energy transition.

Healthcare, similarly, offers a compelling investment thesis. The sector accounted for 14% of investment value in 2023 and 17% in terms of volume of PE deals. India, in particular, has seen a long-term rise in biopharma-related activity (for example, in generics and active pharmaceutical ingredient manufacturing), albeit with a slowdown year over year, while also seeing growth in domestic demand driven by an expanding middle class and government insurance programs. These macroeconomic dynamics, coupled with several successful exits from early investors in India, such as TPG's sale of a controlling stake in Care Hospitals to Blackstone, have propelled PE sponsors to regard India as a place to deploy healthcare capital at scale.

Exits remain challenging, investors focus on value creation

Asia-Pacific faced a challenging exit environment in 2023. This multi-front downturn was marked by lower IPO markets, fewer trade sales and cautious financial sponsors limiting options for PE firms wanting to sell. As a result, PE investors were more creative around liquidity and explored GP-led secondaries and continuation funds. In one of the largest exits during the period, Bain Capital secured a full exit for Fund IV through the sale of Japan's **Works Human Intelligence** for JPY 350b (US$2.6b). Following a competitive process, half the equity went to GIC and half was transferred to Bain's fifth fund.

Asia-Pacific PE exits (2018 to 2023)



Note: Analysis for deals valued US$100m or above

Outlook for 2024

PE participants are entering the new year with a blend of caution and ambition. There is still a significant amount of PE dry powder (US$486b as of Dec 2023) to deploy in the region. The tech revolution, powered by AI, is transforming sectors across Asia-Pacific's mix of established and emerging tech hubs, creating new investment prospects. One must not forget that Asia-Pacific is still home to some of the world's fastest growing economies with a highly aspirational and growing middle class. Businesses servicing this demand have growth ambitions and need capital.

While this will mean good investment opportunities for PE, we expect Private credit to also play a more active role in serving this demand for capital. Catalysts for the growth of Private credit include an increasing share of the debt financing in sponsor backed buyouts, customized direct lending solutions and collateral backed lending.

As PE braces for continuous change in the business landscape, investors are leaning toward ventures that can deliver both profitability and sustainability. Environmental, social and governance (ESG) factors are now key investment considerations, emphasizing responsible growth.

In terms of markets, 2024 to reflect a similar regional mix as was observed in the previous two years, with Japan and India leading the charge.

The confluence of a more challenging economic environment and a maturing industry is fostering consolidation among PE managers. Even prominent firms are now becoming targets for acquisitive peers. In May 2023, TPG invested US$2.7b to acquire Angelo Gordon, a heavyweight in real estate and private credit. Towards the end of 2022, Sweden's EQT undertook the acquisition of Baring Private Equity Asia, one of the most well-established firms in the Asia-Pacific region, marking what is likely the largest merger of its kind.

GPs are also increasingly focused on value creation in their portfolio companies. GPs are implementing operational improvements that involve streamlining processes, optimizing supply chains and enhancing productivity. GPs are also looking to continuously update their value creation approach whether it is through in house or outsourced resources.

Notes: 1 Analysis includes deals with value above US$100m Sources: Dealogic, EY analysis

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