BRIGHT SPOT

With China sputtering out of global investors' sights, buyout firms sitting atop a record amount of unused capital increasingly turned to Southeast Asia. Lawyers in Indonesia and Malaysia share what they have seen in the local private equity markets and the factors driving the growth in investor interest. **BY SARAH WONG**

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Squeezed by a persistent high-rate environment and challenging credit conditions, private equity investors ended 2023 with a disappointing record. The number of funds that closed in 2023 – 71 funds raising $35 billion of capital - dropped to the lowest point since 2018, according to an EY report.

The PE deal flow slowed last year even in Southeast Asia, which, for the first time since 2008, registered no megadeals. There were a total of 22 PE deals in Southeast Asia last year deploying $3.9 billion – down from 38 deals recorded in 2022 deploying $6.7 billion, the data showed.

The total value of the deals in 2023 and 2022 also paled in comparison to the aggregate in 2021, when Southeast Asia's PE market recorded an all-time high of $25 billion in deal value despite the COVID pandemic.

The usual suspects contributing to the market slowdown include tightened monetary policies, inflationary pressure, geopolitical uncertainty and market volatility.

On top of those, "the reduction in the number of private equity deals is possibly due to the slower pace in fundraising activities coupled with unexpected exits emanating from concerns over slower return of capital, which invariably cause lower levels of commitment to raise and establish new funds," note a team of lawyers at Malaysia law firm Zul Rafique & Partners led by corporate and M&A partner David Lee.

Even though the end might be nigh for a sluggish global dealmaking scene as blockbuster deals rejuvenate investor appetite, the lingering caution has led to a continuously muted scene in the Asia-Pacific region, where deals fell 28 per cent to $90 billion in the first quarter of this year, according to data from the London Stock Exchange Group.

However, a pick-up in activity among private equity investors is anticipated. One of the main reasons is that buyout groups have been sitting on a large amount of unused capital and have been proactively scouring for exit opportunities under investor pressure.

But, the Asia-Pacific region faced a challenging exit environment last year. In Southeast Asia, there were 13 PE-backed exits valued at $3.3 billion last year, according to EY. The exit value plunged by 58 per cent compared to 2022 levels as subpar exit conditions and valuations prompted many general partners (GPs) to put selling on hold. However, analysts believe the dealmaking momentum is expected to tick up in 2024.

FROM GLOBAL TO REGIONAL

Despite macroeconomic headwinds, Southeast Asia – with its favourable demographic trends, quickened technological advancement, and a steady rise in domestic consumption – has managed to capture the attention of global buyout heavyweights, including KKR.

For instance, the New York-listed PE group has raised a record $6.4 billion for its latest pan-Asia infrastructure fund, making 10 investments so far, including an $800 million injection for a 20 percent stake in Singapore telecoms company Singtel's data centre business.

"In our experience, countries like Indonesia, Singapore, Thailand, Malaysia, and the Philippines have garnered the most private equity interest in the region. We have also seen a rise in interest in investments in Vietnam," says Nico Mooduto, a partner at Indonesian law firm SSEK.

He notes that PE deals have become more regional than global, especially in the past two years, due to the movement of capital, talent and resources drawn into Southeast Asia. There has been a rise in interest in the Indonesian market from countries such as South Korea and India, with China and Japan remaining as hotspots for incoming PE investment.

Also, "the sheer size of Indonesia's market simply cannot be overlooked. With a population of around 270 million, and a rising middle class as well as a large, growing young population, Indonesia's immense potential continues to be a strong pull for private equity investors," adds Mooduto.

He also underscores Indonesia's robust start-up and technological environment and an improved legal infrastructure prone to international best practices as favourable conditions for global investment.

Government support also plays a critical role in stimulating PE activities in Malaysia, which is expected to gain further momentum thanks to the conducive economic outlook, stronger investor confidence, and a basket of government initiatives.

For example, "In its bid to woo foreign direct investments into Malaysia, the Malaysian government established a Malaysian Venture Capital and Private Equity Development Council that comprises representatives from both the public and private sectors to provide vision and direction as well as strategies for the development of investments by both VC and PE," explain the Zul Rafique team.

In addition, the Securities Commission Malaysia has promulgated new rules regulating the registration of VC and PE companies. As a result, the 50-investor limit on PE funds has been removed and eligible PE investors can now make a minimum investment of $52,550 into funds, the team explain.

"Collectively, the initiatives taken resulted in providing clarity and stability to investors, which in turn will boost investors' confidence," they add. "Established and mature landscape and framework are also potential factors considered by the PE players as they promote investments, protect investor rights and minimises uncertainty that will better mitigate investment risks."

GREEN NEW DEALS

In the Asia-Pacific region last year, technology continued to dominate other sectors as the largest industry in terms of PE deals and exits. And the energy and natural resources sector has clocked the only growth in terms of deal value and volume across all investment areas, according to a recent report by Bain & Company.

This has pointed to a trend that investors are increasingly betting on assets related to the energy transition due to rising focus on ESG considerations as well as the lucrative potential of energy-related investment.

The investment pattern is largely similar in Southeast Asia. In Indonesia, Mooduto. in recent years, has witnessed PE players most active in the financial services, telecommunications and technology (in particular data centres), logistics and distribution, consumer goods and services, and healthcare sectors.

"There has been a total of $3.5 billion capital movement in the consumer, telecommunications, and technology industries in the past three years. Among these investments, Carlyle Group Inc and CVC Advisers Ltd stood out," says Mooduto.

"Another sector to be on the lookout for is the mining sector, with a focus on downstream projects. It will be interesting to see how sustainability aspects, in particular ESG-related, will play a role in PE players' decision-making," he adds.

Over in Malaysia, the healthcare industry has mustered substantial investor interest as PE funds have the tendency to search for sizable consumer bases or untapped sectors with significant growth potential, according to lawyers.

"The rapid growth of corporate investment in the Malaysian private hospital sector has had a considerable impact on the health care system. Sustained economic growth, the development of new urban areas, an enlarged middle class, increase in ageing population and the inclusion of hospital insurance in salary packages have all contributed to a financially lucrative investment environment for hospital entrepreneurs," note the Zul Rafique team.

When guiding clients through transactions, the team stress the importance to keep up with market information pertinent to the industry involved in the PE deals and the strategies and objectives of the PE players.

On the other hand, Mooduto of SSEK foresees that technology is bound to play a vital role in equipping lawyers in the wake of a more robust dealmaking landscape. "Private equity investors, as one of our clients would tell us, operate at light speed," he says.

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