

IQEQ



Private equity in Asia

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This report covers private equity in Asia.



Introduction

Over the past year, marked by unprecedented developments, we witnessed notable macroeconomic shifts, including record-high inflation rates and aggressive monetary policy tightening across advanced economies.

These headwinds precipitated a global downturn, injecting significant uncertainty into markets. Private markets, in turn, faced substantial pressure, with some notable exceptions across strategies and regions.

As we progress through the second half of 2024 and into 2025, a more optimistic outlook is taking shape. Major economies are experiencing disinflationary trends and have begun entering a period of easing interest rates. Central banks, including the Federal Reserve (the Fed), the Bank of England and the European Central Bank, have already implemented at least one rate cut, marking the start of this easing cycle.

However, in contrast, the Bank of Japan raised its interest rate for the first time since 2007, with two hikes in March and July 2024. Although this move diverges from the global trend, its impact on overall asset prices should not be overstated, as markets often overreact initially to such decisions and are now showing signs of correction.

Optimism surrounding a more accommodative borrowing environment sets the stage for a potential resurgence in private market activity. However, broader uncertainty is expected to linger due to geopolitical tensions, the prospect of significant shifts in the global political order amid numerous elections in 2024, and persistent macroeconomic challenges.

Against this intricate backdrop, we've been examining how these conditions will influence the outlook for private markets in the latter half of 2024 and into 2025. Our comprehensive series of reports has scrutinised the prospects for three specific asset classes – private debt, real estate and, now, private equity – across diverse geographical regions. We provide insights into how investors can navigate current market dynamics and leverage opportunities strategically to their advantage.

Macroeconomic overview



Electoral
outcomes



Inflationary risks
due to
global supply
chain threats



Slowdown of
the Chinese
economy

Macroeconomic conditions



Monetary policy
differential with
the U.S.



Energy
transitions and
technology shifts



Geopolitical
realignment

The Asian region continued to show strong growth in Q1 2024, with initial slowdown concerns revised downward due to increasing optimism.¹ This growth is led by several countries, notably India, projected to be the fastest-growing economy among G-20 countries in 2024.²

The region's growth is primarily fuelled by strong domestic demand. With spare capacity to reach its peak, the Asian region has room for further economic expansion, including the growth of private market assets.

Inflation in most Asian economies is now within respective government target ranges. However, China remains an outlier with poor consumer price growth and bouts of deflation due to lack of domestic demand and property sector corrections. Despite this, the overall inflationary pressures are expected to dissipate, leading to a more optimistic growth outlook and favourable investment opportunities.

The political landscape is heavily influenced by elections in eight countries and ongoing geopolitical tensions, which can create supply-side risks and upward inflationary pressures. Despite these challenges, Asia's resilience reinforces its status as the fastest-growing region globally, highlighting its significance in the global economic landscape.



Overview of the private equity market

Elevated inflation in the first half of 2023 continued to put downward pressure on company operating margins. In addition, monetary policy tightening kept borrowing costs elevated for leveraged buyouts and decreased investment valuations.

Consequently, the slowdown in private equity witnessed in the second half of 2022 continued throughout 2023. Deal-making activity experienced a notable decline, with deal value and count plummeting by 60% and 35%, respectively, from their 2021 peaks.³ Buyout investments, excluding add-ons, saw their value drop to \$438 billion in 2023, a 37% decrease from the year prior and representing the lowest total since 2016.⁴

Exit activity struggled more than deal-making, with buyout-backed exits declining by 44% in 2023 compared to 2022, to \$345 billion.⁵ Increased borrowing costs led to a scenario where potential purchasers of a portfolio company would need to spend more for reduced borrowing capacity relative to EBITDA multiples, compared to the seller's initial purchase conditions. This discrepancy created a significant gap between the buying and selling price expectations for the same asset, specifically within the sponsor-to-sponsor channel.

This has resulted in buyout funds sitting on roughly 28,000 unsold companies worth \$3.2 trillion.⁶ Moreover, sellers are not only mindful of the bid-ask spread but are also selectively offering only premium assets to the market, ensuring these investments yield satisfactory returns.

Despite ongoing loosening, interest rates are projected to remain high relative to pre-pandemic levels, potentially leading to a persistence of wide bid-ask spreads and selective offerings. This situation is likely to continue obstructing exit pathways for private equity, casting uncertainty over investment returns and dampening future fundraising efforts.





Despite facing obstacles, a cautiously optimistic outlook prevails for general partners (GPs).

For one, undeployed capital worth \$3.9 trillion acts as a significant motivator. Furthermore, the slowdown in deal-making presents an upside by increasing the average age of buy-out capital. This increase implies funds are approaching the latter stages of their investment periods, encouraging companies to explore investment opportunities more promptly. This scenario harbours optimism for the asset class, signalling a likelihood of heightened investment activities in the near term.

Moreover, global private equity raised more capital in 2023 compared to the year prior, amounting to \$629 billion, signalling a positive outlook amidst lingering uncertainty and tighter monetary conditions more broadly.⁷

However, while these build-ups and anticipated rate cuts may provide some relief in unclogging exit channels, GPs will need to adopt more innovative approaches and prioritize returning capital to limited partners (LPs) to revitalise fundraising levels, particularly amidst broader macroeconomic uncertainties.

Navigating fundraising and exit strategies in Asia amidst prevailing macroeconomic conditions

Investment in private equity within the Asia-Pacific region declined to its lowest point in a decade in 2023, totalling \$147 billion. This represents a 59% decrease from its peak in 2021.⁸ Deal counts also fell below its five-year average of 1,849 to reach 1,300.⁹

Japan was only the country in the region to show some improvement on this account, recording a 183% increase in deal value above the five-year average.¹⁰

Investors' optimism towards Japan was fuelled by the persistence of low interest rates (despite the Bank of Japan's recent departure from negative interest rates) – which stood in stark contrast to the rigorous monetary tightening efforts observed in various other markets – as well as a stable regulatory framework and the availability of numerous target companies with prospects for performance enhancement. The ongoing synergy of these elements is anticipated to continue, thus presenting Japan in a favourable light. This has led investors to consider it among the top three developed markets worldwide for potential investment opportunities in the forthcoming months.

Investors are also expanding their focus from Japan to include India and Southeast Asia as promising investment destinations in Asia.

Despite the performance of their respective private equity sectors not being as pronounced as Japan's, these regions are attracting attention due to their robust growth potential, substantial consumer markets and reluctance from investors to direct capital to China amidst the mainland's struggles.

Meanwhile, fundraising activities witnessed a decline in Asia, a trend that was mirrored globally. In the Asia-Pacific area, the number of successfully closed funds plummeted to 308, the lowest figure since 2009, a stark contrast to the more than 2,000 funds that were closed in 2017.¹¹ Furthermore, the enthusiasm for initiating new funds in the Asia-Pacific region has waned, with its global fund share dropping to 9% from 23% in the past ten years.¹² This change signified a shift in investor preferences towards more established and stable markets, amidst prevailing uncertainty.

Within the Asia-Pacific region itself, the trend of declining fund closures was accompanied by a strong history of returns. Despite these shifts, the private equity sector remains robust, with a significant reserve of dry powder – \$486 billion in unallocated capital as of December 2023 – of which about a

third has been earmarked for investment for four years or longer. While this suggests a pick-up in private equity activity in the near term amidst improving economic conditions, it also underscores the pressure on GPs to deploy capital efficiently.

Regional macroeconomic turbulence adversely affected IPO markets in the region, which in turn cast a bleak outlook for exit opportunities. Exit values dropped to \$101 billion, a 26% decrease from the previous five-year average.¹³ Nevertheless, India, South Korea and Japan bucked this trend in 2023, with India's exit values climbing by 12% from the previous year, driven mainly by open market sales following a recent surge in IPOs. South Korea's exit values slightly increased in 2023 but fell 41% short of the last five-year average, while Japan's exit values saw a remarkable 144% increase from the previous year.

Yet, subdued public markets and underperforming IPOs in the rest of the region compelled GPs to explore alternative strategies, including secondary exits and the use of continuation funds to extend the investment lifecycle and protect LPs' returns against weak strategies.

The exit strategy landscape will likely remain challenging across 2024, compelling GPs to seek alternative means to facilitate liquidity. For assets held longer than expected, GPs will need to focus on operational enhancements and value creation. Nonetheless, with the substantial amounts of dry powder available to GPs and the average age of buyout capital increasing, there is an impending need to deploy these funds, potentially revitalising secondary buyout exits. Indeed, Preqin expects APAC fundraising to pick up in the years to 2029, as the anticipated challenges of bringing capital into China subside.¹⁴

In this vein, GPs must adopt innovative and flexible strategies to navigate the evolving market dynamics, accentuated by a shift in investor sentiment towards more established markets and the imperative to efficiently utilise the significant dry powder at their disposal.

To navigate these challenges, GPs should target sectors like technology, healthcare and green energy, known for their resilience and potential for stable returns. Improving operational efficiencies in portfolio companies could enhance their appeal for exits, including secondary buyouts. Furthermore, partnerships with local and international investors can open new funding avenues, and adopting ESG criteria may broaden the investor base amid a surge in demand for sustainable investments. Strategic collaborations and co-investments with institutional investors could also address fundraising hurdles and present new exit opportunities, ensuring continued return generation in a volatile market.

References

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- 3 [Bain & Company \(2024\), Global Private Equity Report 2024](#)
- 4 Ibid
- 5 Ibid
- 6 Ibid

- 7 Preqin (2024), Future of Alternatives 2029
- 8 Bain & Company (2024), Asia-Pacific Private Equity Report
- 9 Ibid
- 10 Ibid
- 11 Ibid
- 12 Ibid
- 13 Ibid
- 14 Preqin (2024), Future of Alternatives 2029

Degree of opportunity for private equity markets posed by macroeconomic conditions

Development	Degree of opportunity for asset class		
Expectations of looser monetary policy			
<p>Asia is expected to follow the lead of major central banks in the West, particularly the US, in implementing looser monetary policy, with the exception of Japan. This shift to monetary policy loosening will offer relief to the private equity asset class in two main aspects. Firstly, it will ease financing conditions, particularly beneficial for leveraged buyouts. Secondly, it will facilitate exit strategies, which is essential given the substantial volume of unsold assets in the market, providing some relief from liquidity constraints.</p>	<p>✓ HIGH</p>	<p>MEDIUM</p>	<p>LOW</p>
The rising tide of energy transition			
<p>Amidst a subdued investment landscape across various sectors, the energy and natural resources sector was the only area where deal value and volume have shown consistent growth in Asia. This surge in interest can be attributed to the increasing focus of both LPs and GPs on energy-transition-related assets. With a rising number of organisations committing to net zero emissions and regulatory frameworks incentivising sustainable practices, GPs are increasingly confident that the energy transition presents a promising avenue for investment. As the world shifts towards renewable energy and sustainable solutions, the energy and natural resources sector stands out as a potentially lucrative opportunity for private equity firms.</p>	<p>HIGH</p>	<p>✓ MEDIUM</p>	<p>LOW</p>
Healthcare sector as a lucrative investment avenue			
<p>The healthcare sector has accounted for 13% of all PE investment in the Asia-Pacific region since 2018. With significant unmet demand, rising middle-class wealth and favourable regulatory reforms, these sectors offer lucrative opportunities for PE investments. India's expertise and competitiveness in pharmaceutical manufacturing and services make it an attractive destination for PE capital deployment in this sector. Moreover, regulatory changes in the region notably in India and South Korea have been directed at reducing barriers to investment in the healthcare industry.</p>	<p>HIGH</p>	<p>✓ MEDIUM</p>	<p>LOW</p>
China real economy slowdown			
<p>China's economic slowdown and tightening regulations are causing a shift in investor sentiment in the region. This trend could have two significant implications for the broader Asian market. Firstly, the overall economic deceleration in China may lead to spill-over effects, dampening investor confidence across the region. Secondly, investors are now seeking alternative markets, viewing countries like India and Japan as potential replacements for China. India's expanding consumer base and tech-savvy workforce make it an attractive investment destination, while Japan's stable, transparent and well-regulated markets, coupled with its relatively lower interest rates, offer optimal conditions for private equity investment.</p>	<p>HIGH</p>	<p>✓ MEDIUM</p>	<p>LOW</p>



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