CAPITAL MARKETS
ASIA EQUITY

Intra-regional plays in Asia

Markus Federle, general counsel of Samena Capital, examines the burgeoning potential of Asia for private equity investors

IFLR speaks to Markus Federle, general counsel at Asia-focused private equity fund Samena Capital, which operates in India and China, sophisticated hubs such as Hong Kong and Singapore, and frontier markets such as Vietnam and Sri Lanka. Federle looks at the momentum-gathering trend of intra-regional plays in Asia's markets and the view that the region is far greater than the sum of its parts. The One Belt One Road initiative and pan-regional transactions and strategies embody this vision. But how does this work in practice and what are the stumbling blocks for private equity involvement in such a disparate region?

What is Samena Capital's structure and investment strategy?

Samena stands for 'subcontinent, Asia, Middle East and North Africa,' and that is a description of the geographical remit of our activities. Our corporate structure is an expression of our investment philosophy. Our management company is owned by the senior team together with a number of significant entrepreneurs and business leaders from the Samena region. They are actively involved in originating investment ideas, supporting portfolio companies, sharing insights and exploring opportunities for collaboration.

We currently manage approximately $1 billion in assets in three primary strategies. Our core business is private equity investing in our main markets: the Indian subcontinent, southeast Asia (including China) as well as the Middle East. In 2017 we started fundraising for our third private equity fund. We had a first closing early on in the process at $351 million and we have good traction to reach or even surpass the $700 million target for the fund.

As a complementary strategy, we pursue large standalone direct investments in companies that exhibit exceptional growth potential. In 2014, for example, we led a consortium of sovereign wealth funds and select co-investors to acquire a significant stake in RAK Ceramics, one of the leading global ceramics producers which is listed on the Abu Dhabi Stock Exchange. We also have an India Credit Fund which invests in the rapidly-evolving Indian credit market. The fund is managed by our Mumbai based team which exclusively focuses on the strategy.

What would you see as the key trends in the operating framework across Asia?

There is no uniform legal or regulatory framework and the regions across Asia are very different in terms of their history, culture, and economic development. The Middle East is grappling with the fall in oil prices and undergoing a massive transformation to diversify away from its oil dependency; meanwhile India is benefitting from the low oil price and exhibiting very strong growth under the Narendra Modi government, which is tackling overdue reforms. China has seen a slowdown in GDP but is in the process of making a change from low cost manufacturing to a world-leading domestic-driven economy in its own right. And then you have the Association of Southeast Asian Nations (Asean), which is an exciting market with 10 nations and 600 million people in very different stages of development, with Myanmar at one end of the spectrum and Singapore at the other.

The days when Asia was known for light touch regulatory regimes are long gone

A key trend is that, despite their differences, these regions are no longer seen as fragments of an Asian market but as something that is greater than the sum of its parts. China's One Belt One Road initiative (Obor) is at the forefront of this. Obor envisions three routes connecting China to Europe: one via central Asia and the Persian Gulf and Mediterranean; one through western Asia; and another through southern Asia. There are more than 60 Asian countries that have expressed interest in the Obor action plan and a number of cooperation agreements have already been signed. On the face of it, this comprises large infrastructure projects, train connections, waterways and pipelines, but underlying these is the expression of the idea that there is significant commonality and complementarity between the different markets and that increased cooperation, trade and pan-Asian activity holds significant potential.

At Samena we see this on a micro level when we speak to target companies and discuss the added value we can bring them as an investor – for example an Indian company looking to sell its products and services in the Middle East or an entrepreneur in Asean who wants to expand to the subcontinent; this is where we can open doors to enable growth. Often, these markets are not naturally connected but this is where we see a lot of potential for value enhancement through pan-Asian plays.

The other trend is a phenomenon that has to do with the fact that the Asian private equity market is rapidly maturing. GPs in the region are currently working with a record level of unspent cash and there is a wave of capital chasing deals of all sizes that has pushed valuations upwards. The old Asian private equity business model – taking a minority stake in a company, waiting for top line growth and then exiting at a premium – has come under pressure. To create significant alpha and achieve the returns we are looking for, you have to excel in two areas. First, you have to be able to source truly proprietary deal flow to identify growth companies that have attractive valuations. Second, you need to proactively create value in your portfolio companies. You have to enter these companies with a clear vision and value creation plan. I am convinced that in the long term the only successful investors will be those who have deep local networks to source the right investments at reasonable entry valuations while at the same time having the resources and capability to be an active value enhancing investor.

How do you balance the single region approach with the very diverse and specific country cultures and legal frameworks?

It is challenging. You are dealing with a patchwork of different legal systems. You have varying degrees of maturity of functioning or defunct bureaucracies and judiciaries. Hence, you have to always consider the enforcement of your rights. It is great to have a good agreement with all the contractual protections, but how will you actually go about enforcing your rights in a downside scenario. This is as much a legal question as it is a practical one. Is there a legal framework and infrastructure in the relevant jurisdiction to enforce a judgment or award? Are there public policy considerations that could impair your ability to enforce? And how would enforcement work in practice? This is – again – where deep local knowledge and understanding becomes essential which can sometimes come in the form of a local partner who is looking out for your interest on the ground.

How big a challenge is compliance for a firm such as Samena Capital?

The compliance burden for an investment manager in Asia is significant. This is due to the fact that the business requires a presence on the ground where you want to do deals. You cannot source and execute transactions remotely in a vacuum; you need to be rooted in the local markets. This means that you must have offices in multiple jurisdictions, which, of course, exposes you to different regulatory regimes. At Samena we have regulated entities in the Dubai International Financial Centre (regulated by the Dubai Financial Services Authority or DFSA); in Hong Kong (regulated by the Securities and Futures Commission); in Mauritius (regulated by the Financial Services Commission); in London (regulated by the Financial Conduct Authority); and in India (regulated by the Securities and Exchange Board of India). The days when Asia was known for light touch regulatory regimes are long gone. The DFSA for example is a very sophisticated organisation whose mission is to be at the forefront of the regulatory agenda globally. I am very much in favour of regulation for the industry. The challenge is to comply with a multitude of overlapping regulatory regimes which is time and resource intensive.

You mention Modi as a reforming leader, what is your assessment of the India private equity sector?

India's performance has been very strong. 2016 saw a major increase in deal value, up 40% from $9 billion to $13 billion. We see very strong interest in India from investors in the US, Europe and Asia. Despite a slowdown in the first quarter of 2017, the GDP forecast for the year is close to seven percent

Historically, it has been very difficult to do business in India. There are still a lot of stumbling blocks, but the Modi government has already taken some bold measures including demonetisation and the introduction of the Goods and Service Tax; they may cause temporary setbacks but in the medium to long term will have positive effects. India has also loosened the Foreign Exchange Management Act rules to make it easier for foreign investment to access the country. We think it is one of the most promising markets at the moment and for the foreseeable future. It has a great ecosystem of a stable political system, a great pool of well-educated talent and young people with a lot of drive. On the technology side, India is very much on the map globally and has the attention of the big players. If you spend some time in the business lounge of Bangalore airport you will run into a lot of Silicon Valley executives waiting to travel back to San Francisco.

What impacts, if any, are you anticipating from Brexit in the Asian markets?

The UK accounts for two to three percent of total exports for economies such as Hong Kong and Vietnam and even lower (0.2% to one percent) for most of the other Asian countries. So a significant direct adverse impact of Brexit on these economies is unlikely. However, there are number of countries like India and Japan that have important manufacturing operations in the UK (eg in the automotive sector) which are relying on continued access to the EU market. A hard Brexit with the abrupt loss of access to the EU market could therefore become an issue for Asian companies manufacturing in the UK. The more significant risk is that Brexit could lead to a further disintegration of the EU which would have far reaching implications not only for Asia but for the global economy as a whole. In a way, Brexit could also provide Asean members with some important lessons regarding regional cooperation and integration, demonstrating the gains and pitfalls of a political and economic union.

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What will a Trans-Pacific Partnership (TPP) without the United States mean for Asia?

On his recent tour of Asia President Trump made it very clear that he believes that American interests are better served through bilateral deals than multilateral trade agreements. TPP without the US is a bit like Hamlet without the prince. After all, the US has been the driving force behind its creation. In the absence of American leadership, the Trans-Pacific partners are going ahead without the US. Japan has driven the new round of talks between the remaining 11 countries working on the agreement (Japan, Australia, Canada, Mexico, Singapore, Malaysia, Vietnam, Chile, Peru, New Zealand and Brunei, labelled by Prime Minister Shinzo as Ocean's Eleven). A new deal could be announced in the first half of this year and other Asian countries such as South Korea, the Philippines and Thailand are expected to join once the deal is ratified. Even without the US, the deal would be the largest trade agreement in history. In parallel China is negotiating a potential deal with 16 Asia-Pacific countries, including Japan, India and South Korea. The hope is, of course, for a future American administration to return to TPP. In the meantime, the world and Asia are moving on.

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