

AVCJ Private Equity and Venture Capital Report **CHINA 2010**



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OVERVIEW

Attractions remain, despite stimulus concerns

The year 2009 saw one of China's best-ever relative performances versus global private equity – but as much in terms of mindshare against a background of dire results elsewhere as in fundamental value. By March that year, Blackstone Group CEO Stephen Schwarzman was pointing to the Middle Kingdom as one of the few remaining “pockets of strength” in a global economy where up to 45% of the world's wealth had been destroyed in just 18 months. At the World Economic Forum in Davos a year later, he essentially remained on message about China, stating that “China, of course, is really sort of on fire,” although warning that much of that strength came from stimulus packages. He also paid tribute to the aggressive entrepreneurial zeal of Chinese people and their government's determination to keep growth on target. It was not surprising sentiments, perhaps, given that the China Investment Corporation (CIC) is one of Blackstone's largest LPs.

Significantly, China has apparently moved to welcoming to global private equity, with some good reason. A recent European Union Chamber of Commerce in China/Bain & Company joint survey concluded that Chinese officials, entrepreneurs, management teams, and other stakeholders broadly perceive private equity as having helped drive the country's recent breakneck growth. This sentiment could change if some corporate scandals or spectacularly poor returns sour it, but overall the PRC seems likely to remain one of the more receptive destinations for the asset class in the region, in economic and even cultural terms. Even the controversy surrounding CIC's own early investment in Blackstone has ebbed as the SWF returns strong performance numbers.

Some of the policy drivers at work in the Chinese economy explain its relatively healthy performance during 2009. According to HSBC, aggregate investment spending, and especially the government-mandated stimulus packages, accounted for 53% of GDP for the full year. With such unprecedented support, China's robust showing in a difficult year is hardly surprising. And the whole plan has received high marks internationally. As Laura D'Andrea Tyson, current economic advisor to US President Barack Obama and Professor at the Haas School of Business of the University of California, Berkeley, remarks, “the stimulus package was extremely well-designed and effective. It created wonderful spillover effects for the entire region.”

Yet even with LP interest in and awareness of the PRC at unprecedented levels anecdotally, fundraising for China during 2009 showed that even a market rated among the most attractive in the world for private equity was not truly insulated from the global

FUNDRAISING AND CAPITAL UNDER MANAGEMENT

New funds grow as old LPs struggle

As already noted, 2009 saw a sharp falloff in fundraising for China, though the prime reasons for this lay outside the PRC, and had much more to do with Western LPs struggling with the denominator effect and other portfolio issues from the crisis. Furthermore the effect would have been even more marked were it not for the advent of the domestic RMB funds – quantified as part of the overall US dollar totals in the following figures.

In fact, of the US\$6.5 billion raised for China in 2009, well over US\$3.9 billion was actually RMB-denominated. Strip that component out of the figures, and only a mere US\$2.06 billion of international, US dollar-denominated investor money found a home

FIG 2.1 (US\$million)
TOTAL PRIVATE EQUITY FUNDS RAISED



Source: AVCJ Research

TOTAL PRIVATE EQUITY FUNDS RAISED (US\$ MILLION)

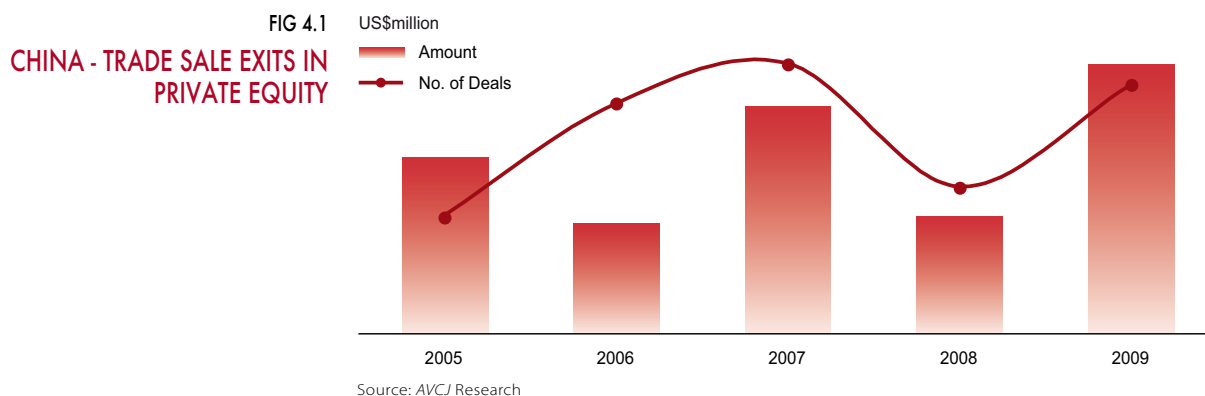
	2005	2006	2007	2008	2009	% Change 2008-2009
China	XXX	XXX	XXX	XXX	XXX	XXX
Asia	XXX	XXX	XXX	XXX	XXX	XXX
% of China Over Asia	XXX	XXX	XXX	XXX	XXX	XXX

Source: AVCJ Research

TRADE SALES AND M&A

Upside surprise as China leads Asia

As instanced already, Chinese exits were not one of the more disappointing areas for private equity investors over 2009. Trade sales in 2009 resumed a see-saw profile seen over the past five years, where a down year like 2008 or 2006 is immediately followed by an up year like 2009 or 2007.



The year's biggest exit, Goldman Sachs's almost US\$1.9 billion sale of its 0.9% stake in Industrial and Commercial Bank of China to undisclosed investors, mirrored the PIPE investment pattern already seen in dealmaking this year with Iron Mountain and Temasek's US\$4.6 billion investment for 3.6% of China Construction Bank. And the successful transaction confirms that this approach can certainly be lucrative. The other big trade sale exit of the year, TPG Capital's US\$1.675 billion sale of its 6.8% headline stake in Shenzhen Development Bank to Ping An Insurance Group, delivered a financial services success of a very different kind, as TPG achieved a good result on its original US\$149 million 2004 investment. Although the deal was still in theory awaiting regulatory approval from the China Securities Regulatory Commission as of March 2010, TPG's lucrative reward for a turnaround success story seems well-recognized and respected in the industry.

Few other trade sale exits of 2009 could match the scale or the pedigree of those two deals. The third largest trade sale of the year, CCB International Asset Management's 100% sale of Changzhou EGing Photovoltaic Technology to HaiTong Food Group for just over US\$413 million, was a decidedly domestic Chinese affair. CDH China Management and Morgan Stanley Private Equity's multiple exit from China Shanshui Cement Group – with a sale of 10% of the group to undisclosed investors in April 2009 for just over US\$128 million, followed by an almost US\$80 million stake sale in June by MSPE alone, and a further 15.3% by both for US\$377.5 million in September – also delivered a good result for two