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Q&A: China Everbright Ltd CEO sees opportunities in SE Asia

By Carol Huang | 6 March 2019

The Hong Kong-listed unit of state-owned China Everbright Group plans to boost overseas assets, first in Singapore. Meanwhile, it has turned cautious on domestic investment.

After a turbulent 2018, Chinese investors have become cautious and subdued when talking about the year ahead.

Chen Shuang, executive director and chief executive of China Everbright Limited (Everbright), shared his view on the market and his strategy after a turbulent 2018.

Everbright is an asset manager wholly owned by the state-controlled China Everbright Group. Listed on Hong Kong Stock Exchange since 1997, the company manages 60 funds and has HK$143.5 billion (US$18.3 billion) under management. With over 300 portfolio companies globally, its global investment strategy closely follows China's state policy.

Since the second half of last year, there has been constant talk of a “valuation correction”. Concerns about China’s slowing economic growth and tensions created by the US-China trade war have further amplified the volatility of China’s equity market. This has brought down valuations across the entire private equity market. Institutional investors need to be “slow and steady”.

Chen said the company will continue with its 2018 strategy of “being progressive in fundraising, cautious on new investment, and orderly and decisive when divesting”. While keeping up with the national strategies, Everbright intends to increase its focus on cross-border mergers and acquisitions, as well as its overseas portfolio, especially in Singapore. When it comes to industries, the company will continue to focus on high-end manufacturing, a sector which is supported under the nation-supported new economy.

The trade war is an important factor that will continue to affect both Chinese economic figures and investor confidence globally. Since Beijing imposed structural reform to deleverage, banks have tightened liquidity supply and decreased money supply to private equity funds both directly and indirectly. This poses new challenges for private equity market across China.

“Valuations are indeed too high,” Chen acknowledges. This is, he adds, often led by an “overestimation of the total market demand in China”. He still holds a “not so optimistic” view of the market in 2019 and suggests that investors “wait a bit” before making investment decisions.

To keep a steady ship, Everbright intends to increase its overseas asset allocation in 2019. Singapore and Southeast Asia will be one of its key target markets for overseas expansion.

Everbright had an 8% increase in total fundraising scale from January to June 2018. Its US dollar-denominated fund and the launch of multiple funds of funds with local governments in China have been key factors that have helped it buck the industry norm in 2018.

The following is the conversation that Chen Shuang had with *FinanceAsia*. This interview has been edited for brevity and clarity.

Q How would you summarise the private equity market in China last year?

A 2018 was a turbulent year. First, there is the trade war, which has a direct impact on China’s economic indicators, including exports, consumption and investment. But the greater impact is on people’s and investors' confidence. Trade war brings uncertainty to the future, which creates a crisis of confidence. It also influences people’s view about the market which leads to market volatility.

In China, the economy is currently undergoing a major structural transformation which is also impacted by the trade war. Due to deceleration of economic growth, there were some hesitations in policymaking. The overall direction is still moving toward deleveraging, but faced with an economic slowdown, some fiscal policies were dialled back last year. This includes requirements on bank reserves and fiscal controls which have gone through various phases of tightening and loosening.

As asset managers, we have faced tough challenges.

The first challenge came on the fundraising side. Previously many Chinese private equity funds were funded by bank assets. Last year, regulations changed and bank assets can no longer be invested in non-financial institutions. Banks have traditionally been a major

source of funding for many private equity funds. When the source of funding is shut off upstream, there is little liquidity downstream. So last year, the tightening of bank funding had a significant impact on the entire private equity market.

From the point of view of an investor, despite having sufficient funds at hand, the appetite to invest was also reduced in face of market volatility. This also significantly impacted the secondary market, especially in what we call the new economy sector. About 80% of newly listed companies fell below their issue price after their IPOs. And many did not even reach the valuations of their second-to-last round prior to listing. Without a doubt, companies in the new economy sector are all facing a valuation correction.

In general, last year was a winter for private equity funds. These sharp changes created by the internal and external environment had an obvious impact on the industry.

Q Has it been a tough year for Everbright as well?

A Fortunately, as a cross-border asset management company with global asset allocation and the capability to raise funds in foreign currency, Everbright is in a relatively better position to manage risk and deal with the previously mentioned issues.

Our funds in the primary market span across real estate, the new economy, healthcare, infrastructure, new energy and other sectors. Geographically, our investments are in China, the US, Europe, the Middle East, Hong Kong and Singapore. We had some bright spots on the fundraising side as well. We successfully launched multiple funds of funds in 2018 by partnering with a few local governments in China. We have also seen growth and increased traction with our US dollar denominated funds, which is one of the competitive advantages in differentiating and strengthening our leadership position.

But compared with 2018, Everbright's investment will be more cautious in 2019.

Q What's your outlook for the private equity market in 2019?

A I am not so optimistic about the market this year.

We must consider the fundamentals and see if the environment we are in has changed. For example, the current US-China trade war. It is highly likely that China and the US will reach agreements in specific areas. But the demands from each side are so different, which creates uncertainty about a final agreement. I'm not optimistic about it in the short term.

This will continue to create problems in the global market. Let's face it, China and the US are two of the largest economies in the world. The dispute will affect the flow of assets between the two and potentially limit foreign investment into China. The trade war may also lead to an adjustment of policies in China including the tightening of capital control on outflows. More importantly, the trade war will affect people's confidence in the market.

It is still unclear what the after-effects of the trade war will be for the economy and investor confidence. The IMF has predicted that China's GDP growth will slow down to 6.2% this year. Equally, there's a negative impact on the US as well.

Cross-border investment has been seriously challenged. Due to the trade row and government regulations, China's investment in the US decreased to $4.8 billion last year: only a tenth of its peak in 2016.

Secondly, China's economy has reached an inevitable adjustment period after 40 years of continuous growth. But structural adjustment itself is no easy matter. China's economic growth, for example, has relied heavily on its real estate industry. Despite the fact that house prices are already too high, local governments continue to depend on the real estate industry for revenue. No one wants to prick this bubble. After all, the sector may still provide a short-term boom when the economy is going through a downturn. You can imagine how challenging it is for China to carry out its economic structural reforms.

Q What's your strategy going to be?

A Our approach this year will be more cautious if not as conservative as in 2018. We will pretty much stay on the same course – being progressive in fundraising, cautious with new investment and decisive when divesting.

We will strengthen our overseas assets allocation. Our current mix is about 30% overseas with a balance of 70% in China. We aim to increase the overseas asset allocation to 45%, and we hope to complete this adjustment soon. Meanwhile, we would like to increase our investment overseas as well. Likewise, for fundraising, currently 20% of our funding is from overseas, we would also like to increase this ratio through the establishment of new platforms.

In terms of investments in bonds and stocks, we favour bonds for fixed return and stable income.

Q How do you intend to increase overseas investment?

A Last year we started in Singapore, and this year we will expand our Singapore platform.

We have acquired Kinergy, a semiconductor manufacturer, in Singapore. Together with a current investment platform, we aim to build up our Singapore operation as a global M&A platform. In addition, we would like to establish an asset management platform to cover South Asia and markets in the Middle East.

There's been good growth for private equity funds in Southeast Asia. They have invested in tandem with the industry, seizing opportunities in Southeast Asia as they did in China 20 years ago. That is also why we aim to set up funds in Singapore to cover the region. Recently we have been looking at potential opportunities there, specifically in the high-tech field.

Q Has the role of private equity changed in China over the years?

A The traditional way is for PE funds to invest the money and wait for assets to appreciate and then sell them. It's not the same anymore!

In addition to investing money, whether the investment team can add value to the project is crucial. Can the investment team help with reaching clients, advising on strategy and improving management and operation? These are what we call value-add. Beyond investing capital, there are many investment teams that can help projects with implementation which is essential to growing a business.

For example, Everbright invested in Terminus, an artificial intelligent-of-things (AIoT) startup that is building smart cities. This company has software and hardware and has already become a unicorn in the AIoT industry. It is itself a platform for other companies to implement their technology. When other companies, including our investees SenseTime and 4Paradigm, are looking for a platform to roll out their technologies, they will come to us and we can create the alliances that deliver the synergy. Investees want and need an ecosystem to realise their value. Previously, we invested in SenseTime and 4Paradigm, now it's the other way around: they want to participate in our investments. This is what we do to build an ecosystem spurring investees to grow and prosper together.

PE has become a dominant player in the M&A space in China which has led to the consolidation of various industries. This is different from the previous speculative form of integration. The number of pure financial investors will decrease in the future. The market will gradually eliminate PE institutions that lack the research capabilities on the industry and have a lower rate of return.

Although many PE funds found fundraising challenging last year, for leading PE funds like us and Sequoia Hillhouse Capital, the amount we raised last year was still considerable. Capital tends to gravitate toward the leading PE funds as the allocation of assets is more rational and supports the development of the industry. Although we have experienced periods of disorderly competition in the past, the market environment – rather than policy adjustments – will eventually solve the problem.

This year, the secondary market will be relatively stable as banks and financial institutions – the largest sector in the stock market – will see less fluctuation. That will, in turn, steady the primary market. Relatively speaking, 2019 will not be as bad as 2018.

The real economy, however, is not yet out of the woods, and we are still likely to see a group of enterprises exit the market. I am not optimistic about the capital markets for the foreseeable future. But we invest for a living, so we have to do it even if the market is not in good shape. This is a test of our vision and ability to make effective investments in preferred industries. This is what we will face in the next two to three years.

Q On which industries does Everbright intend to focus?

A We will continue to focus on advanced manufacturing as a part of our new economy investment strategy. We will also maintain our investments in healthcare and education.

Frankly speaking, China's demand for high-end manufacturing is still very strong because this is a fundamental industry. The combination of our previously acquired companies The Burke Porter Group (BPG) and LapMaster Wolters, as well as domestic firms, will boost development for both sides. The change is clear growth in technology, as high-tech combines with traditional industries in advanced manufacturing.

BPG used to be a small company, but we pushed for the integration of the upstream and downstream and helped this small firm enter the global market with five times growth in its EBITDA. BPG also expanded its business from chassis testing to whole car testing, 3D printing and medical equipment testing.

Investment in advanced manufacturing started in 2004 together with our first fund. Our global M&A fund also focuses on advanced manufacturing. This is a direction that I personally care about.

Apart from that, China Everbright will keep in line with national policies including "One Belt One Road" and the development of the Guangdong-Hong Kong-Macau Greater Bay Area to understand and better support China's national strategy.

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