

LPs Increase Interest in Sector-Specific Emerging Markets Funds

If 2005 will be remembered in emerging markets private equity fundraising as the year of large multi-country buyout funds, 2006 is shaping up as a year characterized in part by niche strategies and sector-specific funds.

Already this year, nearly US\$2.1bn has been raised for infrastructure funds in Korea and India, US\$400m for consumer-focused funds in India, and nearly US\$400m for Latin American power opportunities. Other niche strategy funds now in the market or recently closed include funds focused on health care, clean energy, maritime opportunities, and agribusiness.

While some of the support for these funds stems from Development Finance Institutions, a growing number of private sector LPs are coming on board. For example, five US university endowments recently backed Conduit Capital's US\$393m Latin America Power III fund. In July 2006, India's Infrastructure Leasing & Financial Services Investment Managers received US\$100m commitments from both CalPERS and Oregon State Treasury for its US\$525m infrastructure and real estate fund.

LPs making these commitments would seem to be bucking the conventional wisdom that the unpredictable deal flow and exit environments of emerging markets favor more generalist funds.

Richard Frank, CEO of Darby Overseas Investments, believes this conventional wisdom has led to a "mismatch between opportunities and capital," adding that "a great deal of capital was raised for very large buyout funds in Asia, which are not yet placing a lot of that capital."

Taking a more niche-oriented approach, Darby raised a US\$610m Korea Emerging Infrastructure Fund, a joint venture with Korea's Hana Bank, and is currently raising Darby ProBanco II, a US\$100m fund focused on financial sector opportunities in Central America.

Darby's Korean fund illustrates the way some niche funds are meeting quite specific needs of investors. The fund has an unusually long fifteen-year life and is denominated in Korean Won, characteristics that were very attractive to leading Korean institutions and to two US insurance companies looking to balance their long-term Korean assets and liabilities.

Conduit Capital's Latin Power III likewise appears to have been effective in the market in part because of its differentiated cash flow dynamics. Conduit Chairman Scott Swensen notes that the fund attracted US LPs that see a lack of diversification across large US buyout funds, which often invest together and are constrained by their size to a limited set of deals. "These LPs saw the value of a

niche sector outside of the US that generates regular, long-term, dollar-linked cash flows," he said.

Paul Rapello, Managing Director of Great Circle Capital, which manages a US\$180m maritime and transportation fund targeting the former Soviet Union, points out another reason why sector-specific funds can help an LP's portfolio. "Sector-specific funds make it easier, not more difficult, to construct a well-diversified portfolio because you know going in what sectors the fund will invest in."

Assuming that LPs can get comfortable with sector concentration in their emerging market portfolios, sector-specific funds offer the obvious advantage of greater domain expertise.

"Our fund will take majority control of power plants and run them," says Conduit Capital's Scott Swensen. "A number of us are engineers, and we've built power plants, and you need that degree of specialization to be successful."

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"Some sectors have a barrier to entry in terms of knowledge of the market and knowledge of the regulatory environment," says Sanjay Sehgal, manager of East West Capital Partners, which invests in health care companies across Asia. "Yes, LPs can get exposure [to health care] through generalist funds, but we are going to win the deals playing the value-add card, not the price card, and that should lead to better returns."

Rapello of Great Circle Capital agrees, noting that his firm competed against several generalist funds for Russian Logistic Service, a leading Russian transportation logistics company, but won the deal on the basis of their domain expertise. "People who've dedicated their careers to a certain sector are going to do a better job managing portfolio companies in that sector," he says.

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Infrastructure is clearly the sector that has attracted the most interest from LPs, which in part reflects the massive scale of the infrastructure needs in emerging markets. India, for example, requires infrastructure investments of approximately US\$150bn according to Luis Miranda, President and CEO of IDFC Private Equity, a leading Indian infrastructure GP. Support for infrastructure funds also appears to reflect a greater willingness among some LPs to back investments that involve contracting with regulatory and governmental bodies. "The risk in participating with government has gone down," says Shazaad Dalal, CEO of IL&FS Investment Managers.

Another category of sector fund that has emerged recently is the consumer-oriented fund, which arises primarily from the concentration of market opportunity, rather than from the specialization inherent in the sector. The India market has seen one consumer-focused fund close this year, the \$400m Indivision Capital Fund, managed by Future Capital Holdings. A second, the India Consumer Growth Fund, backed by Oak Investment Partners, is in the market. Both funds are responding to the huge Indian population, zooming economic growth, and a to-date extremely fragmented consumer sector.

A question that arises for GPs is which of their skill areas should reside within general funds, and which make more sense as a separate offering. In the case of the global private equity firm Actis, the decision takes into consideration firm history, LP demand, and market dynamics. With an existing general-orientation fund in Africa, the firm recently launched the Actis Africa Agribusiness Fund as a separate vehicle with backing from the CDC Group. According to Actis Partner Michael Turner, the fund will offer a distinct risk-return profile linked to the high yields and regular cash flows available from investments in timber and agricultural commodities.

It is important to note that private equity has always had a place for highly skilled generalists, and none of the managers interviewed for this article is predicting that funds that invest in African timber, Latin American power and Russian logistics will end up dominating the emerging markets private equity landscape. But for those LPs looking for managers that can leverage a distinct skill set to generate differentiated cash flows, the opportunities are growing. ●

Selected Sector Specific Funds Raised and In the Market 2005-2006

Manager	Fund Name	Sector(s)	Funds Raised	Closing Date	Country/ Region Focus
AMP Capital Investors	Infrastructure Fund of India	Infrastructure	102	June-06	India
APIDC-Venture Capital	Biotechnology Venture Fund (BVF)	Bio/Lifesci; Health Care	32.6	January-05	India
Bio Veda Capital	BioVeda Fund	Bio/Lifesciences	32	2005	Singapore, Asia
Conduit Capital Partners	Latin Power III	Energy	393	July-06	Latin America
Darby Overseas Investments, Ltd.	Korea Emerging Infrastructure Fund	Infrastructure	610	July-06	South Korea
FE Clean Energy	Global Asia Clean Energy Serv Fund	Clean Energy	65	2006	Asia
Future Capital Holdings	Indivision Capital	Consumer/Retail	400	June-06	India
Great Circle Capital LLC	The Great Circle Fund LP	Transportation	180	April-05	Russia/CIS
IDFC Private Equity	IDF II	Infrastructure	430	April-06	India
IL&FS Investment Managers	IL&FS India Realty Fund (IIRF)	Infra; RE/Housing	525	April-06	India
Macquarie Bank	Macquarie Korea Infrastructure Fund	Infrastructure	980	March-06	South Korea

Manager	Fund Name	Sector(s)	Target (US\$ mm)	Closing Date	Country/ Region Focus
Actis	Actis Africa Agribusiness Fund	Agricultural	100	n/a	Africa
Burrill & Company	China Life Sciences	Bio/Lifesci; Health Care		n/a	China
China Science and Merchants	China Energy Fund	Energy	1,250	n/a	China
CLSA Capital Partners	Clean Resources Asia	Energy/Environment		n/a	Asia
Darby Overseas Investments, Ltd.	Darby Probanco	Bnkg/Fin. Services	100	n/a	Central America
East West Capital Partners	Asia Healthcare Fund	Health Care	200	n/a	India
Gateway Fund Advisors Pvt. Ltd.	India Consumer Growth Fund	Consumer/Retail	200	n/a	India
GIC Group	21st Century Latin America Fund	Agribusiness; lifescience	100	n/a	Latin America
Global Environment Fund	Global Environment Fund III	Environment	300	n/a	Global
Injazat Capital	Injazat Shefa Healthcare Fund	Health Care	100	n/a	Middle East
JC Flowers & Co.	JC Flowers II	Bnkg/Fin. Services	6,000	n/a	Global
Swicorp	Swicorp Joussour Company Fund	Energy	500	n/a	Middle East
UOB Venture Management	UOB JAIC Venture Bio Investments	Bio/Lifesci; Health Care	20	n/a	Asia