

May – June 2008

中文 Greetings from China

During the last year, we have been spending an increasing amount of time overseas. Earlier this month, we spent a week in China meeting with more than 20 private equity groups and many other industry insiders, including investment bankers, government officials, large corporate investors and CEOs of private equity-backed companies. The primary impetus behind this trip was an on-site diligence meeting for an upcoming investment. However, we also furthered our understanding of the private equity landscape in China and added to our growing pipeline of attractive investment opportunities in the region. The trip was a tremendous success. First and foremost, we were able to confirm our preliminary diligence on the firm in question (stay tuned CleanTech Fund IV investors). In addition, we ended the week with significant interest in several other groups and actionable intelligence on regional trends that we think will positively impact all four vehicles within PEP IV.

Key Take-aways

- Despite its size and seemingly daily press coverage, China still has a relatively small, tight-knit private equity community. Nearly all of the private equity professionals in China are well acquainted with one another and tend to work together, making it very difficult for “fly over investors” to access deal flow. To be successful in China, you have to have a local presence.
- With few exceptions, private equity firms in China are all pursuing the same investment strategy: making minority growth investments at relatively low valuations from financially unsophisticated management teams and fairly quickly exiting those positions through initial public offerings at home and abroad. China clearly is more of a consumer play than a technology play. With real GDP growth approaching 12% and consumer spending increasing 13% year over year (retail sales increased 22% in May over the same period last year), private equity firms are finding low-tech (in some cases, “no-tech”) companies that are growing 20-30% per annum. Although not always the case, many private equity firms are adding little to the companies other than capital and simply riding the wave of consumer growth in China. Despite the success some groups have demonstrated with this strategy to date, we do not believe it is sustainable.
- The leveraged buyout market in China is virtually non-existent. While there are groups that are making control investments, very limited leverage is available for buyout transactions (primarily in the form of annual revolver loans). However, many of these control investments do not require leverage to generate outsized returns. The common control strategy goes as follows: purchase a state owned entity in concert with management, improve governance and incentive structures and enjoy the tailwinds of 12% real GDP growth.
- China exudes growth and is showing no signs of a slowdown. Everywhere you go there is construction in order to accommodate the rapid trend toward urbanization, capitalism and consumerism. Cranes litter the skyline. Trucks are lined up bumper to bumper for miles at all hours of the night to deliver goods to the major cities. It is truly unbelievable.
- China’s pollution problems are legendary, but you have to experience them first-hand to fully appreciate their magnitude and impact on human activity. The air is filled with smog. Much of the water is not potable. Manufacturing sites and much of the surrounding areas are contaminated with lead, mercury and other toxic substances. To its credit, the Chinese government has mobilized and has committed to addressing these issues with a zeal and unified vision that is uniquely Chinese. If you thought the CleanTech opportunities in North America and Europe were promising, China will leave you awestruck.

China’s private equity community remains in its infancy. Although we believe the near-term prospects for outsized returns in China are tremendous, changes are likely. The current environment, one in which very little value add is required to generate outsized returns, is not sustainable. In the next stage of development, look for sector specialists to emerge. Also, look for more traditional buyouts to emerge and become common place as global financial institutions broaden their activities in the region and as the western concept of secured lending finds a foothold. As with other sectors and geographies, it will become vital to find the managers in China who have tremendous deal flow, a coherent investment strategy, a strong team capable of building companies and knowledge of global capital markets in order to continue generating the tremendous returns we are seeing today.

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Investments Underway for Private Equity Partners IV

PEP IV affords investors the opportunity to access highly sought after Venture, LBO or CleanTech managers through fund of funds structures. PEP IV also offers a Direct Investment fund that is strategically positioned to invest alongside the top CleanTech managers worldwide, as well as in other proprietary CleanTech investment opportunities. Investors may allocate their capital to any of these four components.

Fund commitments are well underway:

- Venture Fund: 3 commitments have been completed, with 1 additional commitment pending committee decision
- LBO Fund: 1 commitment has been completed and several additional commitments are in advanced stages of due diligence
- CleanTech Fund: 3 commitments have been completed, with 2 additional commitments pending committee decision
- Direct Fund: 1 commitment has been completed and several additional investment opportunities are under review

To review more details on PEP IV's overall diversification strategy and commitment pipeline, [click here](#).

The next closing is scheduled for September 30. If you would like additional information about PEP IV, please contact Gretchen Postula at (612) 303-6331 or gretchen.s.postula@pic.com.

Upcoming Events

We are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming conferences:

- **September 22-23, 2008:** Scott Barrington will be speaking at the European Energy Venture Fair in Zurich, Switzerland
www.europeanenergyventurefair.com
- **October 26-29, 2008:** The 19th Annual SRI in the Rockies Conference at the Fairmont Chateau Whistler, Whistler, British Columbia
www.fairmont.com/whistler

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