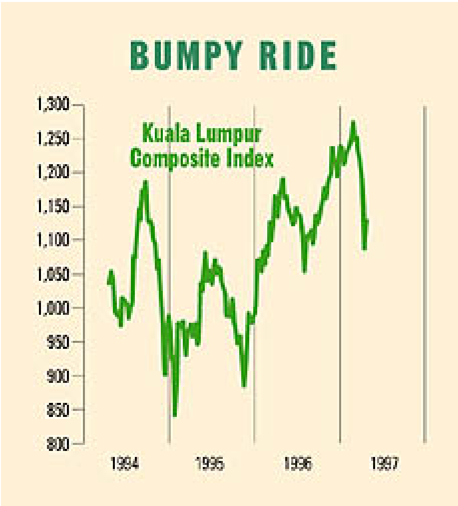
How to Avoid Market Spills

Your portfolio may benefit from private equity

THE MELTDOWN ON THE Kuala Lumpur Stock Exchange may worry some folk. But Jasim Puthucheary is not unduly concerned. That's because he leavens his stock investments with private equity stakes in companies that have yet to go public, reducing his exposure to damaging market downturns. A law graduate of the London School of Economics, Jasim is a senior associate of Australian independent financial boutique AusAsean. He manages part of the company's soon-to-be-listed $150-million AusAsean Regional Growth Fund out of Kuala Lumpur. Puthucheary recently spoke with Asiaweek Correspondent Steven K. C. Poh.

What is the main difference between investing in private equity and the stock market?

With private equity, investors take a stake early in a company's life-cycle, when it should have greater profit growth potential. But they should be aware of the risks. Since these companies have yet to list on the stock market, ready buyers may not be around if the investment turns sour. Also, the firm's earnings record may not be stable. So, we would recommend that private equity investments not exceed 10% of any given portfolio.



(Source: Datastream)

Does that make you a venture capitalist?

In a broad sense, yes. But we do not provide seed capital for start-up companies. We invest in firms that are entering the development phase of their life-cycle and require fresh capital. Typically, they are three to eight years old. We aim to manage the risks of our investment by advising on the company's development. We look for companies with an established management and track record. We are interested in firms that are expanding into new markets, introducing technology, or transferring production to lower-cost locations. We also like businesses that are expanding regionally and forming joint venture partnerships with local companies.

Would you encourage a stock market investor to look at private equity?

The main reason to consider private equity opportunities is to diversify one's portfolio and reduce exposure to stock market fluctuations. But it can be lucrative. Because an investor is entering early in a company's life, there is more upside opportunity at a cheaper price. Say the price-earnings ratio on the KLSE averages 16 times, and the price for equity in a private company is six times. The investor can exploit that difference in P/E multiples when the company goes public.

What do you look for when investing in private equity?

We aim to realize gains over the medium-term. Dividends are not a priority, though there should be some dividend income within the first two years. The hurdle rate for each investment is an internal rate of return which is at least three times the U.S. 30-year bond rate (currently over 7%). We judge new companies based on their earnings growth potential, management and competitive advantage when entering new markets. The investment must be structured to safeguard the interests of foreign investors like us. Also, it must have a clearly identifiable exit mechanism. An initial public offering is the usual mode of exit. At the time of the IPO, we generally reassess the growth potential of the company before deciding whether or not to dispose of our entire investment. In most cases, that doesn't happen. We sell enough shares to ensure capital preservation and to provide liquidity for our other investments. The remainder of the shares will be treated as unrealized profits or free equity.

What industries do you favor?

We like food and agribusiness. The sector encompasses companies that focus on farm inputs, such as chemicals, feed, fertilizers and machinery, on the one hand; and firms involved in value-added work such as distribution, marketing, processing and exporting. We also like the technology sector, especially companies working on products relevant to consumers in the region. We like the mining sector, particularly gold. We seek investments in miners with world-class technology and expertise both in Australia and the region.

Which countries in the region do you prefer?

We continually assess investment opportunities in Australia, China, India, Indonesia, Malaysia, the Philippines and Singapore.

What regional concerns affect your investment decisions?

For starters, inflation. It can severely erode investment gains by causing the local currency to fall in value. Also, the policies of governments in the region. Certain countries provide incentives and subsidies to favored companies, or enforce restrictive trade barriers. These factors can impact on the profitability of our investments. The tax implications of investing in a given country form an integral part of our evaluation process. Often, we will restructure the investment to minimize our tax burden. Political stability is another concern. In addition, the local legal system, and the protection it gives investors, is even more crucial in private equity investments than listed ones as there are fewer avenues to exit.