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Asian manufacturing provides rich pickings

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ShawKwei & Partners managing director Kyle Shaw discusses why Asia's precision manufacturing sector offers big opportunities for GP investment.

For more than 25 years ShawKwei & Partners, a Hong Kong-based private equity firm, has been investing in middle-market manufacturing and service industries in Asia.

Earlier this year, it merged its two Singapore-based precision manufacturing portfolio companies, Beyonics Technology, in which it has invested $100 million, and Singapore-listed Chosen Holdings, where it has deployed $51 million, to provide a one-stop shop. The new entity combines design and fabrication, manufacturing, toolmaking and assembly.

The firm is investing out of its Asia Value Investment Fund III, a 2010-vintage vehicle which closed on $450 million and is almost fully deployed.

Managing director Kyle Shaw talks to Private Equity International about investment trends and why Asian precision manufacturing businesses are good acquisition targets.

Q: Where are the opportunities for GPs in Asian manufacturing businesses?
A: Twenty years ago many facilities in China, Malaysia and Singapore were built on vacant lands. Today these factories are surrounded by residential neighbourhoods rather than being in an advantaged manufacturing and supply chain zone. This means there needs to be a movement of the facility to other places more appropriate. When you start talking about moving the facility, you're talking about high disruption to the workforce. When you talk about bringing in capital goods and equipment, you're also talking about a different kind of workforce, and that's just on the manufacturing side.

In addition to simply upgrading the capabilities of the company, you also need to look at institutionalising the management – everything from branding, to recruiting new staff and financial planning – these are all perfect opportunities for GPs to step in.

Lastly, one of the key things that should actually happen in Asia is consolidation. In these industries, small companies should be joining forces. However, there is no investment banking business in that middle market level to facilitate that process, nor do these companies know how to approach each other because they were former competitors. For us, that's a great opportunity to buy one of those companies, invest in its people and capabilities, and maximise its value.

Q: Any geographies or areas that ShawKwei is looking at closely?
A: We're more interested in value-added manufacturing. If you make some auto components, the precision is quite high and so are the requirements. And if you do it quite well you have a solid business because you would be part of the supply chain for BMW, Chrysler or Ford. On the other hand, if you make shoes or garments, the barriers to entry are quite low and you're always chasing cheaper labour and moving on.

In Asia, I think people think of manufacturing as very low end, a sweatshop labour kind. However, there is lot of high quality manufacturing that does take place – from medical instruments to equipment, to auto and telecommunications.

I think there are some areas which are for the future, but are not really here yet in Asia, such as aerospace, aeroplanes, oil and gas. The technology that goes into oil and gas drilling equipment is as high if not higher than aerospace. Those are areas that I think we would like to be in and serve. And I think you have a talent pool here in Asia that can do that.

Q: What are the other key investment themes in Asia?
A: One of the themes is demographics – business owners in Asia are getting older. Their children are not involved and most do not really have a succession plan. A lot of entrepreneurs started their businesses in the 1960s and '70s and they're getting to an age now where they are not that young, they need to retire and their children oftentimes do something else, work overseas, and don't want to run the business.

Another theme is factory upgrades and automation. A lot of Asian businesses have fairly old facilities and are very labour intensive, which was appropriate in the past. Over the last five years, wages in China have doubled at the lower level, and in order to be competitive going forward they have to think about adding more equipment, more capital, and more automation.

Q: Why has interest in IPO exits dropped?
A: If you go back 10 years ago, a lot of companies in Asia would say, "Well, I'd take my company public." They always thought going public was a way to exit the investment, but as we know, doing an initial public offering does not provide you an exit. If anything, it ties you more closely to the business. Another important thing is that markets today have very little appetite for small cap stocks. If you had a $100 million market-cap company 10 years ago, there was a good appetite for it and you can find bankers to do it. Today, bankers won't even talk to you if you have $100 million; they are looking for something closer to $500 million.