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2012 Survey

The Social and Economic Impact of Private Equity in China

In partnership with

BAIN & COMPANY

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FOREWORD

Private equity: what Social and Economic Value for China as a whole?

Over the past decade, the venture capital and private equity (PE) industry in China has grown in stature and influence, serving as a driving force for economic growth, job creation, innovation and entrepreneurial success.

China now is one of the leading destinations for PE capital amid continued global economic turbulence, with more than US$16 billion invested in 2011, representing 0.2% of China's GDP compared with 0.3% in Europe and 0.5% in the US.

This survey, the first of its kind, analyses the social and economic impact of the PE industry throughout China. It was launched in 2009 by the Private Equity and Strategic M&A Working Group of the European Union Chamber of Commerce in China, in partnership with Bain & Company. Our goal is to quantify the social and economic value created by PE, using a rigorous methodology and objective fact-finding. We've analysed how PE continues to deliver economic growth for Chinese companies as well as contributes to a more innovative and green economy. The analysis also provides a balanced look at areas where PE's impact has fallen short of expectations.

It's gratifying to see that the 2009 study quickly became a point of reference for the industry. It was designed as a key information tool for all PE stakeholders: government officials, financial institutions, media, industry associations, scholars, and particularly entrepreneurs and management teams. The 2012 survey applies the same methodology, providing the consistency required to identify trends. But the scope is expanded to assess environmental performance as well as the growth of small and mid-sized enterprises (SMEs) in China.

The study also provides transparency for the general public. Transparency creates trust. It is our goal to strengthen the trust people have in PE by explaining how this important industry works and detailing its contributions to China and its people. We believe the PE industry will achieve increased sustainability by highlighting PE's impact on major social indicators such as job creation, investments into R&D investments, "green economy" and China's "Go West" policies. In addition, it assesses the impact on economic performance, including revenue and profitability growth, support to SME companies, and corporate governance improvement.

At a time when China is rebalancing its economic model, with the aim of achieving more inclusive and consumption-driven growth, this survey offers a unique social and economic perspective to an industry that is too often regarded as pure financial engineering. It applies rigorous data analysis to answer the question: Private equity—What's in it for China's society as a whole?

We hope all industry participants will use these findings extensively. The European Chamber and Bain & Company are looking forward to participating in future conferences and workshops with industry stakeholders—opportunities to apply the study's unique data and analysis.

Finally, I would like to express my thanks to the European Chamber team that contributed to this survey; to its secretary general, Dirk Moens; my vice-chairs Serge Janssens de Varebeke and Fernando Vila; to all the members of the PE and M&A working group and the Chamber staff for their continuous support; and to Bain & Company and partners Michael Thorneman and Weiwen Han for producing the underlying analysis upon which this report is based.

André Loesekrug-Pietri
Chair, Private Equity and Strategic M&A Working Group
European Union Chamber of Commerce in China
March 2012

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Executive summary

This second survey on the social and economic impact of PE in China documents the role that PE investments play in the growth of Chinese companies and how those investments contribute to China's long-term economic and development goals. Since our groundbreaking survey in 2009, PE firms have continued to transfer management know-how to their portfolio businesses, build globally competitive companies, improve corporate governance, develop an innovative private sector, support development inland and foster domestic consumption. The survey's goal is to chronicle the growing impact of PE investments on China based on objective facts and figures.

PE, still a relatively new phenomenon in China, continues to develop rapidly, establishing the country as one of the world's top destinations for PE investments. With US$16 billion invested in 2011, PE in China represents more than 5% of the value of global private equity investment, a significant increase from just more than 1.5% in 2007. As with many fast-growing industries, the societal changes set in motion by new capital flows raise questions about whether PE enriches Chinese social and economic development as a whole.

To help answer those questions, the Private Equity and Strategic M&A Working Group of the European Union Chamber of Commerce in China and its survey partner, Bain & Company, examined PE's social and economic impact in China. The resulting report chronicles evolving trends, compares current findings with findings from the past survey and presents data on important social indicators, including job creation and improved salaries, research and development (R&D) spending, "green economy" and investments into inland provinces. It evaluates key measures of economic performance, including revenue and profit growth, support to small and mid-sized enterprises, tax payments and corporate governance. The study also serves as a major source of quantitative information about PE in China and contributes to a constructive debate about its current role and future development.

This second survey covers deals announced during the period from 2004 to 2008. It includes information from a panel of companies that represented 40% of the total value of PE deals valued at more than US$20 million during that period. (All compound annual growth rate comparisons are based on this group of survey participants.) The majority of the companies surveyed are small to mid-sized, with revenues of less than 10 billion RMB. We excluded deals completed after 2008 in order to track post-investment performance for a period of at least two years. The report reveals PE's social and economic contributions based on quantitative analysis of portfolio companies and 25 in-depth interviews with PE-backed company executives.

This study uses three key comparisons to gauge performance along social and economic dimensions: performance of PE-backed firms compared with publicly listed firms over a two-year period, post-PE investment; 2012 survey findings with 2009 survey results; and change in portfolio companies' performance during the two-year period following the initial investment with the next two-year period.

Key findings:

- **PE has a significant social impact on China, demonstrated by improved job opportunities and innovation.**

PE-backed firms pay higher salaries even as global economic uncertainty continues. PE-financed companies generated full-time jobs at an annual rate of 8%, on a par with the market over the period of our study—but at a slower pace than in the 2009 survey, when job growth at PE portfolio companies increased by 16%. Even so, wages are continuing to rise—the salary growth rate is 7% higher at PE portfolio companies than at listed companies, contributing to an improved standard of living for employees and spurring consumption.

PE-backed firms have increased R&D investments to incubate innovative growth. Measured as a percentage of revenue, PE-backed companies now spend almost twice as much on R&D than their publicly listed counterparts, demonstrating a sustained emphasis on innovation. PE investors work with portfolio companies to help them understand the pivotal role that innovation plays in powering growth. As Chinese companies build value, they help the nation achieve one of its public policy goals: establishing China as an innovative society.

Environmental protection grows slowly for both listed and PE-backed firms. When it comes to environmental initiatives, however, both PE-backed and publicly traded companies have opportunities to do more. For both groups, corporate commitment to environmental protection is in the early stages. Only about 40% of the companies we surveyed had released an environmental protection report detailing spending and green initiatives; even fewer disclosed their expenses for environmental protection.

"Go West." PE firms continue to support China's "Go West" policies that spur growth by encouraging investments in China's underdeveloped inland provinces, primarily in western and central China, as well as Tier-3 cities.

After a decline in 2008, investor interest rebounded. Since 2009, more than half of all PE investments have been in companies headquartered in the western region, surpassing backing for businesses located in the more affluent coastal provinces. From 2009 to 2010, deals in Tier-3 cities also grew dramatically from US$1.2 billion to US$2.8 billion.

- **PE's economic impact is notable, especially when comparing companies' financial performance.**

PE builds financial performers that generate higher profits and growth. PE-backed companies in China outperformed the market in revenue growth, rising an average of 21%—an impressive gain from just 3% in the 2009 survey. They also posted 7% higher profit growth than their publicly traded counterparts, achieving a compound annual growth rate of 21% versus 14% at listed companies.

PE investors provide critical support for smaller companies. PE firms provide critical support for this business segment, now a powerful engine of growth. Investors helped smaller companies outgrow listed competitors. The survey results show that smaller PE-funded firms tripled the revenue growth rate of comparable listed companies.

Valued PE advisers improve governance, generate higher tax payments and spur growth. The majority of executives of PE portfolio companies value the guidance provided by PE firms. They benefited from the role their PE partners play as management and financial advisers on a range of issues: strengthening corporate governance, creating more open and transparent decision-making processes and reallocating working capital to support expansion. Reflecting their stronger financial performance, PE-backed companies yielded tax payments that grew at an annual rate of 21% – slightly lower than the 28% posted in the 2009 survey – but still higher than their benchmarked peers. The result implies that PE shareholders continue to bring improved corporate governance with respect to the disclosure of taxable income. They also use their networks to provide access to customers, suppliers and distribution channels.

But PE firms received mixed reviews from some survey participants who welcome more hands-on support and increased industry operational knowledge from their investors, even after taking the company public.

PE-financed firms continue to support the expansion of China's domestic consumer goods and retail industry. Attention of PE firms continues to shift to the consumer goods and retail sector. In 2010, deals in these two sectors represented 13% of total PE deal value, a significant increase from a mere 4% in 2004. Retailers backed by PE investors booked sales growth of 59%, compared with just 19% for publicly listed retail companies – consistent with what we observed in the 2009 survey.

The social impact of PE

Social impact 1: Improved job opportunities and rising incomes

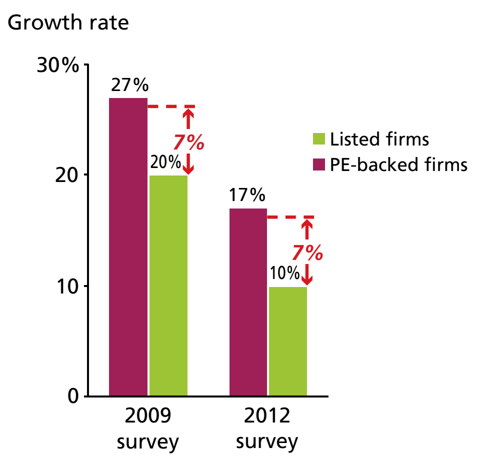
PE-backed firms are job creators, adding full-time positions at a rate of 8% annually, on par with the market. These firms also, on average, pay higher salaries and wages than their listed competitors to successfully attract more qualified employees (see Figures 1 and 2).

Figure 1: Full-time employee growth rate comparison

Note: CAGR 0-2 years after PE investment represents weighted average of CAGR ('04-'06) for '04-invested company; CAGR ('05-'07) for '05-invested company; and CAGR ('06-'08) for '06-invested company. CAGR 2-4 years after PE investment represents weighted average of CAGR ('06-'08) for '04-invested company; CAGR ('07-'09) for '05-invested company and CAGR ('08-'10) for '06-invested company. PE-backed company '04-'08, N=72; '07-'10, N=59. Listed company '04-'08, N=2,398; '09-'10, N=2,979

Source: ACVJ; CapitalIQ; Wind; Bain analysis

Figure 2: Gross salary growth comparison



Note: CAGR 0-2 years after PE investment represents weighted average of CAGR ('04-'06) for '04-invested company; CAGR ('05-'07) for '05-invested company; and CAGR ('06-'08) for '06-invested company. CAGR 2-4 years after PE investment represents weighted average of CAGR ('06-'08) for '04-invested company; CAGR ('07-'09) for '05-invested company and CAGR ('08-'10) for '06-invested company. PE-backed company '04-'08, N=72; '07-'10, N=59. Listed company '04-'08, N=2,398; '09-'10, N=2,979

Source: ACVJ; CapitalIQ; Wind; Bain analysis

The average annual base salary at PE portfolio companies is both higher and rising more quickly than at publicly listed firms. Survey participants reported that the base salary following initial PE funding is more than 51,000 RMB compared with an annual salary of approximately 41,000 RMB offered by listed peers. The gross salary growth rate also is higher—as much as 7% more than at listed firms.

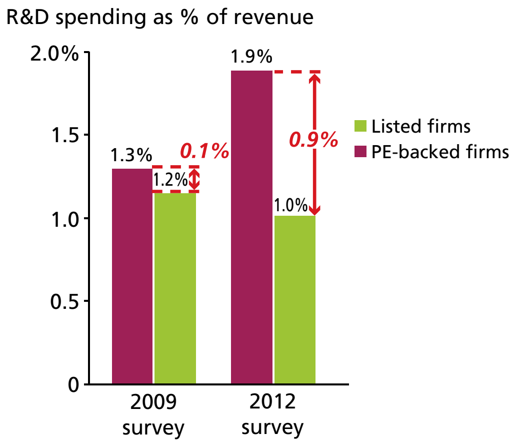
PE's impact on hiring and compensation is helping to attract quality talent, especially at the managerial level. Interviews with portfolio executives confirmed this. One executive explained, "After their investment in our company, the PE fund replaced some management-level personnel with more competent personnel found through professional headhunting firms."

Social impact 2: Increased R&D investments: Incubating innovative growth

PE-backed firms consistently stress the importance of investing in R&D to ensure sustained growth through innovation. As a percentage of revenue, the 2012 survey shows that PE portfolio companies spent twice as much as their publicly traded peers, whose R&D investments decreased by 16.6% over the same period.

PE investors help cultivate innovative enterprises and improve the effectiveness of R&D. They enhance the innovation process by offering best practices to increase the productivity of R&D investments and help set clear goals. Almost half of the companies surveyed believe their PE investors make positive contributions to R&D. Executives specifically noted that PE firms introduced them to systematic toolkits for identifying best practices and applying them companywide (see Figure 3).

Figure 3: Overall R&D spending as a percentage of revenue

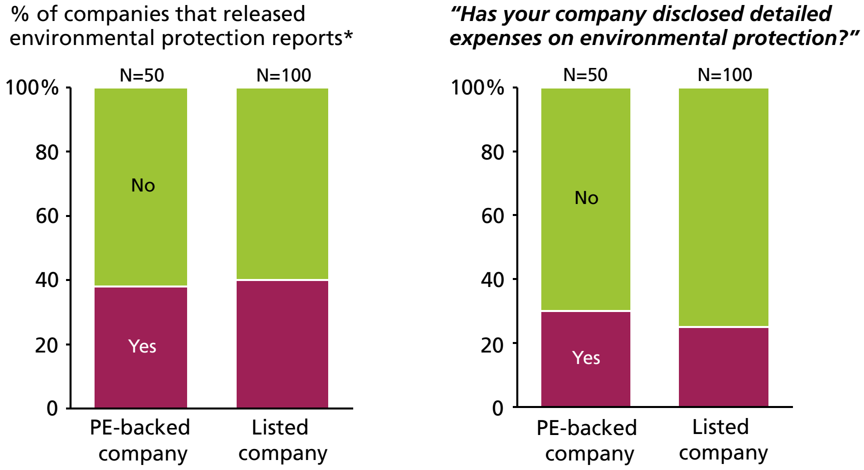


Note: CAGR 0-2 years after PE investment represents weighted average of CAGR ('04-'06) for '04-invested company; CAGR ('05-'07) for '05-invested company; and CAGR ('06-'08) for '06-invested company. CAGR 2-4 years after PE investment represents weighted average of CAGR ('06-'08) for '04-invested company; CAGR ('07-'09) for '05-invested company and CAGR ('08-'10) for '06-invested company. PE-backed company '04-'08, N=72; '07-'10, N=59. Listed company '04-'08, N=2,398; '09-'10, N=2,979
Source: ACVJ; CapitalIQ; Wind; Bain analysis

Social impact 3: Environmental protection grows slowly for both listed and PE-backed firms

When comparing environmental compliance and the growth of green initiatives, we found little difference between listed and PE-funded companies. The majority (72%) of surveyed portfolio executives say PE investors are more focused on value-added initiatives than on compliance issues. Only 28% believe that PE funding has a positive impact on environmental protection. About 40% of PE-funded and listed companies released environmental protection reports; even fewer disclosed their expenses for environmental protection (see Figure 4).

Figure 4: Green growth comparison



*The two groups of companies have the same sample mix in industry, firm size and year of IPO.
Note: Environmental protection report in the form of standalone company social responsibility report, announcement of environmental protection compliance in prospectus and description of environmental protection efforts under director's report in annual report; sample firms are A-share companies.
Source: AVCJ; CapitalIQ; Wind; company reports; Bain analysis

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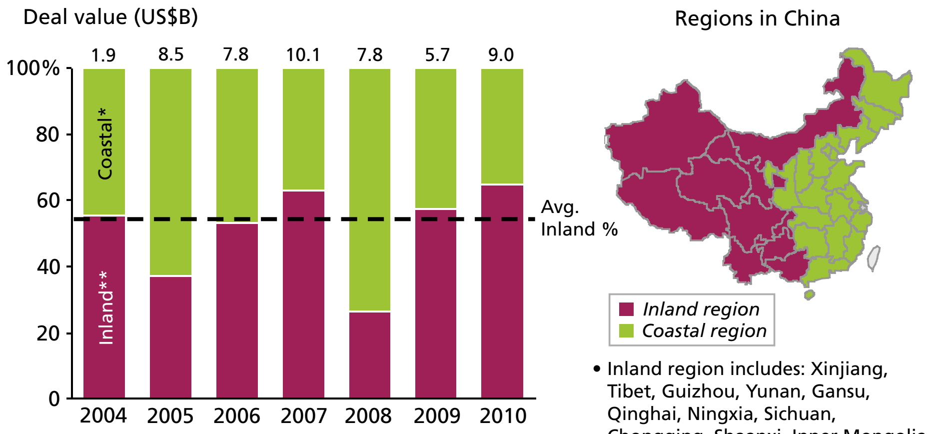
Social impact 4: Go West

PE firms continue to support China's "Go West" policies. The initiatives spur growth by encouraging investments in China's underdeveloped inland provinces, primarily western and central China, as well as Tier-3 cities.

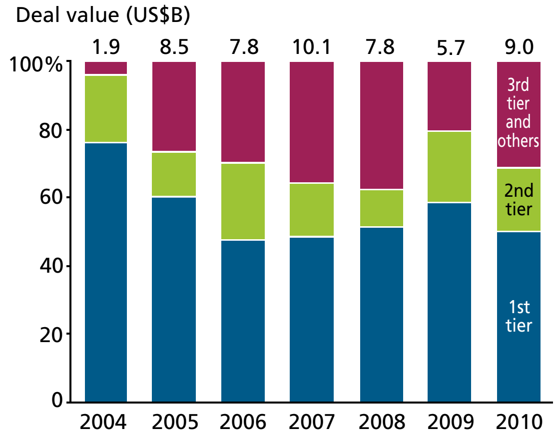
Although inland investments dropped off in 2008, PE investors' interest quickly rebounded. Since 2009, more than half of all PE investments have been in companies headquartered in western regions, surpassing the backing for businesses based in the more affluent coastal provinces. From 2009 to 2010, deals in Tier-3 cities also grew dramatically from US$1.2 billion to US$2.8 billion (see Figures 5 and 6).

Figure 5: PE investments, inland vs. coastal, in 2004–2010



*Target companies with headquarters in coastal provinces
** Xinjiang, Tibet, Guizhou, Yunan, Gansu, Qinghai, Ningxia, Sichuan, Chongqing, Shaanxi, Inner Mongolia, Guangxi

Figure 6: PE investments by city tier in 2004–2010



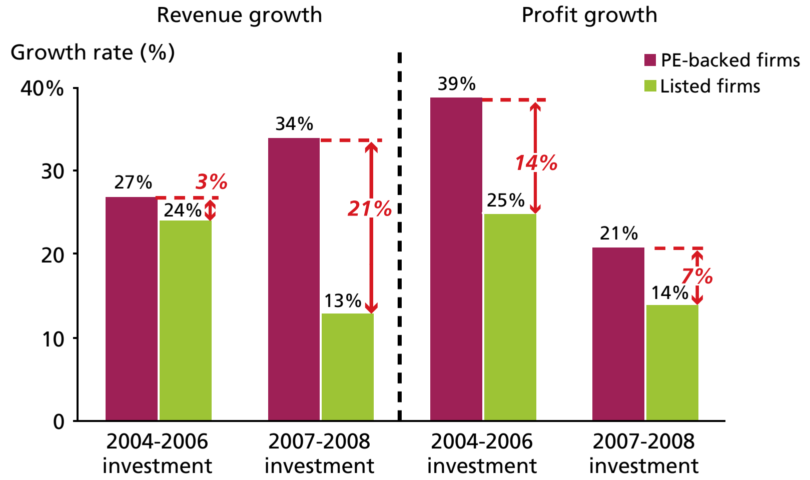
Note: Includes deals larger than US$20M with target company's headquarters location disclosed; real estate deals are excluded; financial deals excluded are megadeals of Industrial Bank, Bank of China, China Construction Bank and Bank of Communications
Source: AVCJ; Bain analysis

The economic impact of PE

Economic impact 1: PE builds financial performers: Higher profits and growth

Firms with PE backing outperformed the market when we compared them using three key economic performance indicators. PE-backed companies turned in 21% higher annual revenue growth than their publicly traded peers and 7% higher profit growth in spite of increased spending on employee compensation, R&D and taxes. In addition, fixed-asset growth by companies with PE investments outperformed listed firms by 17%. Portfolio companies accelerated growth initiatives by tapping PE capital to rapidly acquire the needed property, plants and equipment (see Figure 7).

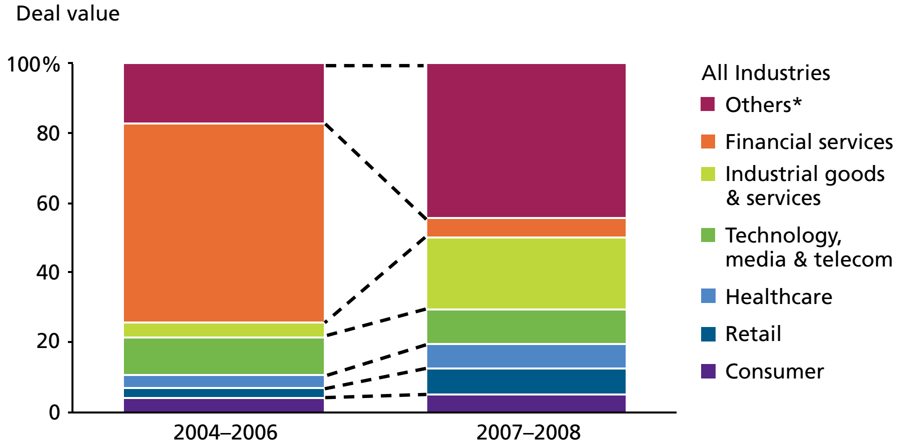
Figure 7: Revenue and profit growth comparison



Note: CAGR 0-2 years after PE investment represents weighted average of CAGR ('04-'06) for '04-invested company; CAGR ('05-'07) for '05-invested company; CAGR ('06-'08) for 2006-invested company. CAGR 2-4 years after PE investment represents weighted average of CAGR ('06-'08) for '04-invested company; CAGR ('07-'09) for '05-invested company; CAGR ('08-'10) for '06-invested company. PE-backed company '04-'08, N=72; '07-'10 N=59; Listed company '04-'08, N=2,398; '07-'10; N=2,979
Source: AVCJ; CapitalIQ; Wind; Bain analysis

Even though portfolio companies continue to generate higher profit growth than listed companies, their advantage has diminished since the 2009 study, with growth dropping by half, from 14% to 7%. This decline is partially explained by a change in the mix of PE investments. PE investors shifted more of their funding to the industrial goods and services, retail and healthcare sectors. These industries experience faster growth, but they also require larger fixed-asset investments, reducing profits (see Figure 8).

Figure 8: PE investment by industry in 2004–2008



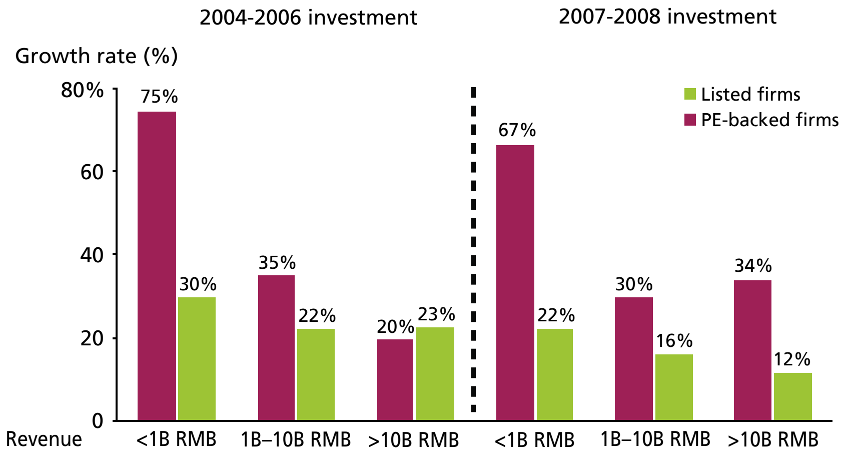
* Others includes electronics, non-financial services, mining and metals, light manufacturing, construction, agriculture/fisheries, textiles and clothing, leisure/entertainment, travel/hospitality and ecology.
Source: AVCJ; Bain analysis

Economic impact 2: PE provides critical support for smaller companies

SMEs have emerged as powerful engines of China's growth. According to a recent study by China's central bank, SMEs represent more than 90% of all companies in China and accounted for more than 60% of the country's GDP in 2010.

PE provides critical support for this business segment. Among portfolio companies, PE firms had the greatest impact on smaller companies, helping them outgrow listed competitors. The survey results show that smaller PE-funded firms tripled the revenue growth rate of comparable listed companies (see Figure 9).

Figure 9: Revenue growth by company size



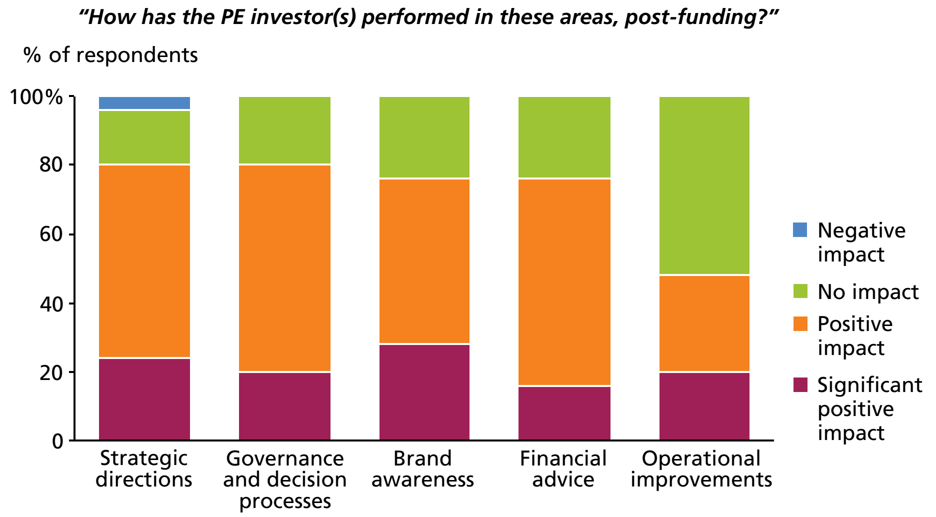
Note: PE-backed firms ('04-'06) N=72, ('07-'08) N=59. Listed firms ('04-'06) N=2,398, ('07-'08) N=2,979
Source: AVCJ; CapitalQ; Wind; Bain analysis

Economic impact 3: Valued PE advisers improve governance, generate higher tax payments and spur growth

Executives of PE portfolio companies value the guidance provided by PE firms. The overwhelming majority of interviewed executives (80%) told us they benefited from the role their PE partners play as management and financial advisers on a range of issues: strengthening corporate governance, creating more open and transparent decision-making processes and reallocating working capital to support expansion. They use their networks to provide access to customers, suppliers and distribution channels. One healthcare executive explained, "A famous fund can increase brand awareness. And foreign investment makes the firm more international."

But PE firms received mixed reviews from some survey participants who welcome more hands-on support and increased industry operational knowledge from their investors, even after taking the company public (see Figure 10).

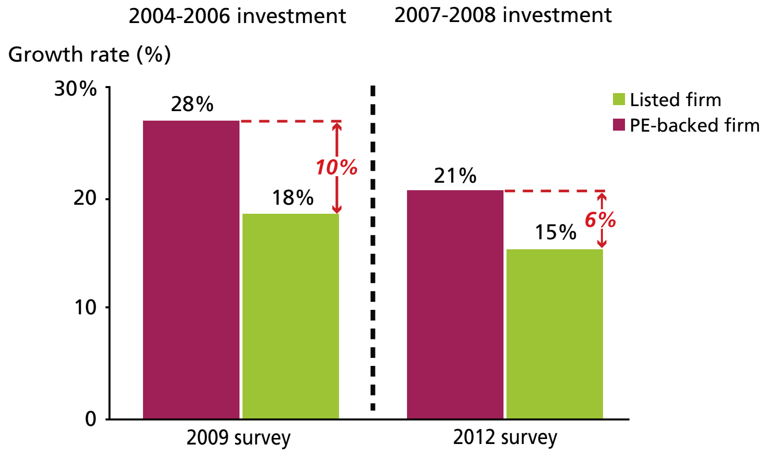
Figure 10: Survey responses to PE's economic impact



Source: Survey (N=25)

Reflecting their stronger financial performance, companies received PE investment in 2007-2008 yielded tax payments that grew at an annual rate of 21%, 6% higher than their benchmarked peers. This is slightly lower than the result in the 2009 survey, when the PE-backed companies posted 28% tax payments growth p.a. and publicly listed companies at 18%. However, PE shareholders' effort in bringing improved corporate governance with respect to the disclosure of taxable income is apparent, especially in the context that many PE-backed companies enjoy more favorable tax rates than their publicly listed counterparts (see Figure 11).

Figure 11: Tax payment comparison



Note: PE-backed company ('04-'06) N=72, ('07-'08) N=59. Listed firms ('04-'06) N=2,398, ('07-'08) N=2,979.
Source: AVCJ; CapitalIQ; Wind; Bain analysis

Economic impact 4: PE-financed firms continue to support the expansion of China's domestic consumer goods and retail industry

Attention of PE firms continues to shift to the consumer goods and retail sector. In 2010, deals in these two sectors represented 13% of total PE deal value, a significant increase from a mere 4% in 2004.

Private equity's increasing presence in the consumer goods and retail sector is having a positive impact on overall domestic consumption and sales. PE-backed consumer goods companies have booked revenue growth of 26% per annual, slightly lower than the 30% growth recorded in the 2009 survey, while their publicly listed peers saw growth at 16% and 18%, respectively. Retailers backed by PE investors booked sales growth of 59%, compared with just 19% for publicly listed retail companies — consistent with what we observed in the previous survey (see Figure 12).

Figure 12: Revenue growth by comparison

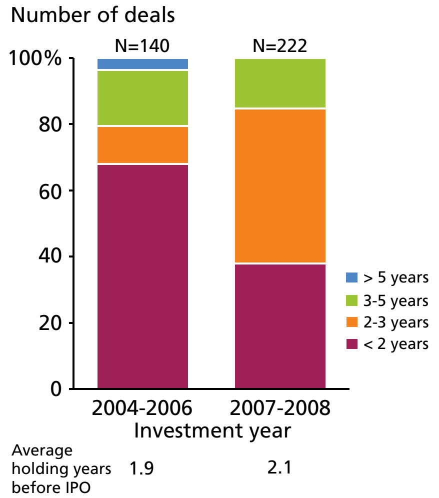
Note: CAGR 0-2 years after PE investment represents weighted average of CAGR ('04-'06) for '04-invested company; CAGR ('05-'07) for '05-invested company; and CAGR ('06-'08) for '06-invested company. CAGR 2-4 years after PE investment represents weighted average of CAGR ('06-'08) for '04-invested company; CAGR ('07-'09) for '05-invested company and CAGR ('08-'10) for '06-invested company. PE-backed company '04-'08. N=72, '07-'10, N=59 Listed company '04-'08, N=2,398, '07-'10, N=2,979.
Source: AVCJ; CapitalIQ; Wind; Bain analysis

China's PE industry: Going public within 2.1 years

PE investors tend to favor investments that quickly build value, allowing them to exit through IPOs, the most common exit channel for PE in China. PE firms turn to IPOs because China's stock market provides higher P/E multiples, making public offerings more profitable. This exit strategy is expected to continue as the China Growth Enterprise Market becomes better established. It is expected that the trend to more long holding time will increase due to more difficult IPO markets and a recognition that working with the portfolio companies is essential to build value.

Most PE firms are making mid-term investments. The majority of IPO exits take place within two years after the initial investment (see Figure 13), when companies typically outperform competitors. The data shows that PE funds exited at least 42% of the companies they had invested in between 2004 and 2008. Of these investments, they exited about 80% of their companies in China within three years of the initial investment. The time between a PE investment and an IPO averages about two years, with the market cycle having the biggest impact on timing. Comparison data in Europe and the US shows that the holding time is 4.8 years and 3.7 years, respectively.

Figure 13: PE holding year comparison



Source: AVCJ; Bain analysis

PE firms often make a portion of the shares available for sale to the public through an IPO and then divest a substantial amount of the investment after the lock-up period ends. When it comes to selling the remainder of the shares, timing varies depending on the stock's performance.

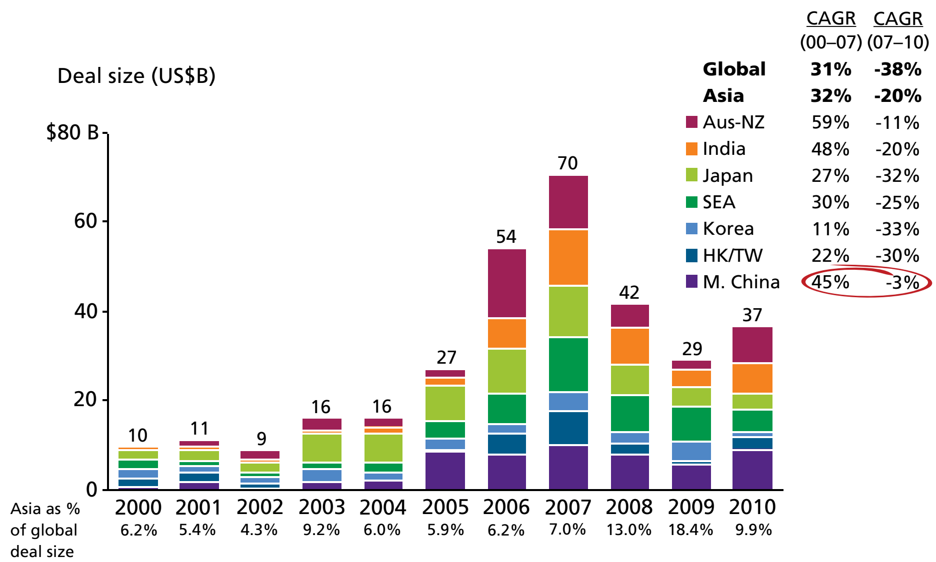
Overview of the PE industry in China

China leads Asia

China continues to be the top destination for PE investments in Asia. During the period from 2000 to the peak of the global economic expansion in 2007, PE deals in China grew at a compound annual growth rate of 45%. Yet, even as new investments slowed in 2008 due to the financial crisis, PE activity in China remained strong relative to other Asian markets. This trend continued through 2010, as deal volume topped US$9 billion—nearly double the volume in 2009. No other country has recovered as quickly. According to a recent Zero2IPO report, the total amount of PE funds raised in mainland China was US$26.4 billion in the first 11 months of 2011. China now is on a par with the mature economies in the Asia-Pacific region, such as Japan, Australia and New Zealand, as a destination for new investments.

PE investing in China is on track for continued growth over the next several years. Already PE investments in mainland China represent 0.15% of the country's gross domestic product (GDP). PE's contribution to China's GDP will increase dramatically if investments reach the levels seen in Europe and the US—0.3% and 0.6% of GDP, respectively (see Figure 14).

Figure 14: Asia annual PE deal value by destination in 2000–2010



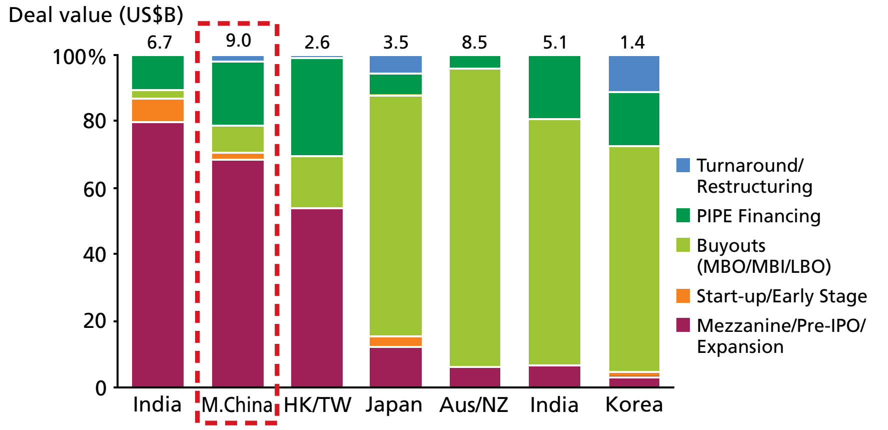
Note: Only investments with an announced deal value are included. Additional deals that have been excluded are: deals of value <US$20M; bridge loans, franchise funding and seed/R&D deals; infrastructure project finance deals, real estate, real estate investment trust and hotels & lodging property deals; mega investments in China's banking sector (Agricultural Bank of China, Industrial Bank, Bank of China, China Construction Bank and Bank of Communications)

Source: AVCJ; Bain analysis

A focus on growth capital

Compared with other countries and regions, China's PE industry shares characteristics more often associated with venture capital. The primary reason: the rapid growth of China's economy. Entrepreneurs have limited access to expansion capital needed by small and mid-sized companies and new enterprises. They turn to PE investors for growth capital to fill the breach: More than 80% of all PE investments supplied the capital needed to finance an expansion (see Figure 15).

Figure 15: 2010 Asia PE deal value by deal type

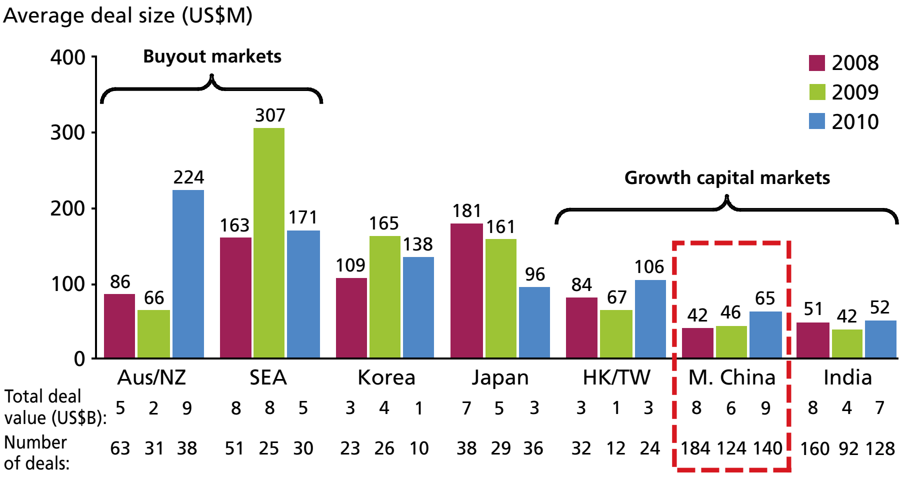


Note: Only investments with an announced deal value are included. Additional deals that have been excluded are: deals of value <US$20M; bridge loans, franchise funding and seed/R&D deals; infrastructure project finance deals, real estate, real estate investment trust and hotels & lodging property deals; mega investments in China's banking sector (Agricultural Bank of China, Industrial Bank, Bank of China, China Construction Bank and Bank of Communications)

Source: AVCJ; Bain analysis

The average size of PE deals in China is smaller than deals in other Asian countries—they averaged US$50 million from 2008 to 2010, about one-third of the size of PE deals in Japan and Korea (see Figure 16).

Figure 16: Asia PE investment average deal size in 2008–2010



Note: Only investments with an announced deal value are included. Additional deals that have been excluded are: deals of value <US$20M; bridge loans, franchise funding and seed/R&D deals; infrastructure project finance deals, real estate, real estate investment trust and hotels & lodging property deals; mega investments in China's banking sector (Agricultural Bank of China, Industrial Bank, Bank of China, China Construction Bank and Bank of Communications)
Source: AVCJ; Bain analysis

Several evolving trends could affect China's PE industry: introduction of RMB-denominated funds, closer alignment of domestic regulations with international principles, collaboration with global funds to diversify portfolios, introduction of industry best practices for both limited and general partners operating in China, and higher levels of participation by domestic institutional investors and fund-of-fund investing in PE.

PE glossary

The most common investment strategies in PE include leveraged buyouts, venture capital, growth capital and distressed investments.

Distressed investments: Distressed, or special, situations are a broad category referring to investments into financially troubled companies. Investors may acquire debt securities in anticipation of taking control of the company's equity after a corporate restructuring. Investors may also provide "rescue financing"—typically a combination of debt and equity—to companies undergoing operational or financial challenges.

Fund of fund: It is a pool of capital that invests in several PE funds. Its own investors are large institutional investors like pension funds or insurance companies. High-net-worth individuals and relatively small institutional investors participate in a fund of funds to minimise the effort and costs related to managing their portfolios.

General partner (GP): A GP is a fund manager. It takes part in the daily operations of the PE partnership and is personally responsible for its liabilities.

Growth capital: This is an equity investment made most often to acquire a minority position in a relatively mature company that is looking to expand or restructure operations, enter new markets or finance a major acquisition without ceding control of the business.

Leveraged buyout: Also called LBO or buyout, this is a strategy financial sponsors employ to acquire a majority stake in a company, business unit or business assets from the current shareholders, typically using a combination of equity and debt. The target companies involved in these transactions are typically mature and generate healthy operating cash flows.

Limited partner (LP): An LP is an investor in a fund. It has a share of ownership in a PE partnership but takes no part in managing it. LPs are liable only up to the amount of their original investment in the partnership.

Venture capital: This is an equity investment made to finance the launch, early development or expansion of a business. Venture investing is most often found in the application of new technology, new marketing concepts and new products that have yet to be proven, and it usually involves acquiring a minority stake in the business.

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Methodology

Representative panel

To develop a representative view, we surveyed mainland Chinese companies that received at least US$20 million in financing from foreign or Chinese PE funds during the period from 2004 to 2008 and tracked those companies' two- and four-year post-investment performance. We excluded deals completed after 2008 to allow us to follow performance for a minimum of two years.

We analysed data obtained from 131 PE-funded deals that took place from 2004 to 2008, making up about 40% of the total value of PE deals over US$20 million. The selected companies represent a range of industries, company sizes and geographies, with the majority from technology, media and communications, industrial goods and services and consumer segments. The survey excluded unusually large PE investments that risked biasing the results, such as megadeals involving real estate companies and China's largest financial institutions.

Benchmark selection

In our survey, we compared the 131 PE-backed companies with 2,979 publicly listed companies that have major operations in China. Of these, 2,216 companies are listed on the Shanghai and Shenzhen stock exchanges. The study also included 763 Chinese-affiliated enterprises listed on other major exchanges around the world, including exchanges in Hong Kong, Korea, Singapore, Europe and the United States. To qualify for inclusion, a company had to be headquartered in China, have China as its primary geographic location or have the words "China" or "Chinese" as part of its name or in its business description.

To better evaluate the relative performance of companies with PE investments, we developed a database to create benchmarks. This database included publicly listed firms with major operations in China, representing such industries as retail, consumer goods, industrial goods and services, healthcare, financial services, and technology, media and telecommunications. In order to perform an industry-level analysis, each listed company was assigned to one of the six industries.

Benchmark rationale

The listed companies for the benchmark sample were selected for the following reasons:

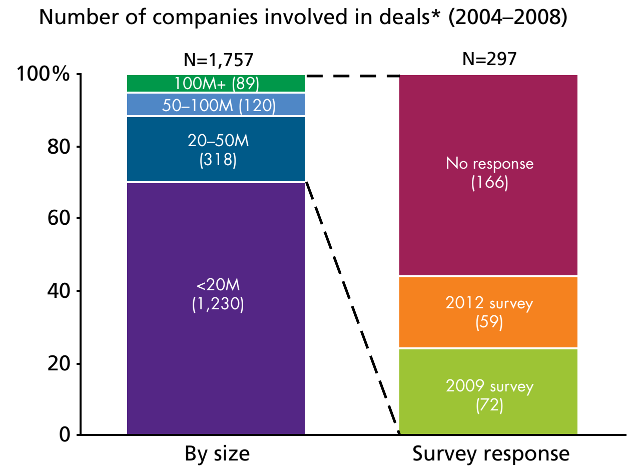
- They provide transparent data for a relatively long period (at least four years), enabling a comparison with PE-backed firms for two- and four-year periods, post-investment.
- The industry mix is similar to the PE-backed firms, avoiding a bias.
- Their performance is at a similar level to the PE-backed firms. Since portfolio companies usually outperform public companies, this factor also helps avoid sample bias.

Key comparisons

The study uses three key comparisons to gauge performance. First, we compared PE-backed firms with publicly listed companies in the two-year period, post-PE investment. Second, we analysed the differences between the 2009 and 2012 survey findings. Finally, we observed the changes in portfolio companies' performance during the first two years following the initial investment and the second two-year period.

To determine the performance of the PE-backed firms in the survey relative to the benchmark groups, we first calculated their growth using relevant metrics over the two-year period, beginning with the most recent PE investment. As a result, the performance of PE-backed companies that received their initial infusion of PE capital in 2004 was compared with that of the benchmark group for the identical two-year period, 2004 through 2006. We then calculated a company's overall performance for each metric by aggregating the results from different time periods using a weighted average of its performance over the relevant period. The 2012 survey includes companies that received PE funding in 2007 and 2008. We aggregated the results by performing a weighted average for the periods covering 2007 to 2009 and 2008 to 2010 (see Figure 17).

Figure 17: Survey participants



*Real estate deals and financial megadeals are excluded
Source: AVCJ; Bain analysis

The benchmark sample included Chinese companies with major operations in mainland China that are publicly traded on the Shanghai, Shenzhen, Hong Kong or overseas stock exchange. The nearly 3,000 listed firms serving as a benchmark represent an industry mix comparable in scope to the PE–backed firms.

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About the European Chamber

Purpose
As the independent voice of European business in China, we seek greater market access and improved operating conditions for European companies

Services
- We provide European business with an effective communication and lobbying channel to the European and Chinese authorities, business associations and media
- We ensure our key recommendations and lobbying strategies are shaped by business through our members' Working Groups
- We monitor China's compliance with the World Trade Organization and other international commitments which impact on doing business in China
- We support companies by providing a platform for the exchange of information on business and market conditions in China
- We help companies expand their networks of European and Chinese business contacts
- We promote sharing of knowledge and experience between European and Chinese business

Principles
- We are an independent, nonprofit organisation governed by our members
- We work for the benefit of European business as a whole
- We operate as a single, networked organisation across Mainland China
- We maintain close, constructive relations with the Chinese and European authorities while retaining our independence
- We seek the broadest possible representation of European business in China within our membership: large, medium and small enterprises from all business sectors and European Member States throughout China
- We operate in accordance with Chinese law and regulations
- We treat all our members, business partners and employees with fairness and integrity

General Background
The European Union Chamber of Commerce in China was originally founded by 51 member companies based in China on 19th October 2000. The rationale for the establishment of the Chamber was based on the need of the European Union and local European businesses to find a common voice for the various business sectors. Nine years after its foundation, the European Chamber now has a total of more than 1600 members in seven chapters: Beijing, Chengdu, Nanjing, Pearl River Delta (Guangzhou and Shenzhen), Shanghai, Shenyang and Tianjin. The Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China.

The European Chamber is an independent member-driven, nonprofit, fee-based organisation with a core structure of 29 Working Groups and 7 Forums representing European business in China. The Chamber is directed by a President and an Executive Committee elected each year by and from its members.

About the Private Equity and Strategic M&A Working Group

The Private Equity and Strategic Mergers & Acquisitions Working Group was established in 2008. It has since grown its membership to around 120 companies members of the European Chamber and one of its most dynamic group. It contributes every year to the Position Paper of the Chamber and launched in 2009 the first Survey on Social and Economic impact of PE in China.

Members include first and foremost PE and Venture Capital Chinese or European fund managers from funds of European origin or European professionals working for Chinese or international PE funds, as well as Heads of M&A for large European corporations. The Working Group also engages professionals working in an advisory capacity on PE and M&A related matters.

The objectives of the group are to provide a credible platform of exchange and expertise on PE and M&A related issues between members, as well as to enable an effective lobbying channel to the relevant Chinese and European governmental authorities for the long-term benefit of the European investment community in China. Its objective is to achieve a level playing field among all market participants and contribute to the sustainable growth and international recognition of the PE industry in China.

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About Bain & Company

Bain & Company is the management consulting firm that the world's business leaders come to when they want results.

Bain advises clients on strategy, operations, technology, organisation, private equity and mergers and acquisitions. We develop practical, customised insights that clients act on and transfer skills that make change stick. Founded in 1973, Bain has 47 offices in 30 countries, and our deep expertise and client roster cross every industry and economic sector. Our clients have outperformed the stock market 4 to 1.

What sets us apart

We believe a consulting firm should be more than an adviser. So we put ourselves in our clients' shoes, selling outcomes, not projects. We align our incentives with our clients by linking our fees to their results and collaborate to unlock the full potential of their business. Our Results Delivery^{SM} process builds our clients' capabilities, and our True North values mean we do the right thing for our clients, people and communities—always.

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