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Buyout Firms Look To Expand Their Companies In China

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NEW YORK—The mega buyout shops aren't the only ones taking advantage of the fastest growing market in the world.

Middle-market private-equity firms increasingly are looking at China as a place to expand their existing portfolio companies.

Here's an example. Cleveland-based Key Principal Partners, or KPP, saw that portfolio company Ampac Packaging LLC, a shopping bag maker, was losing market share to Chinese companies that could make bags 10% to 25% cheaper. So in late 2002, KPP opened a factory for Ampac in the Chinese city of Nanjing.

Because of the success of the Ampac expansion, KPP now is considering opportunities in China for nearly all of its current and potential portfolio companies.

"We now consider the risks and opportunities of expanding in China for every potential new acquisition," said KPP partner Leland Lewis, who manages the firm's Greenwich, Conn., office.

Although, in the case of Ampac, this was truly an expansion, as KPP did not close any U.S. factories, the option of moving operations there remains a possibility for other investments.

One portfolio company KPP is hoping to expand to China is its engine parts maker, a former subsidiary of Federal-Mogul Corp. (FDMLQ) based in Grand Haven, Mich., that was purchased in 2003. KPP hopes to take advantage of the growing market for engine parts in China as the number of cars and heavy-duty trucks on the road increases, Lewis said.

Other middle-market private-equity firms also are investing more in China. Blue Point Capital Partners, a Charlotte buyout shop, recently opened an office in Shanghai and is exploring expansion possibilities in the country for its U.S. portfolio companies. New America Partners, a new fund founded by Thomas Farb of Summit Partners, is raising a fund specifically to invest in U.S. companies looking to open facilities in the country.

But despite the potential rewards of investing in China, Lewis cautions that the country is still a complicated place with a relatively young business culture and legal system.

"It's a daunting task," Lewis said of going into China.

Well-known buyout firm Blackstone Group has been reluctant to follow other major private-equity firms into the region because of the complex legal and business issues. But recently, the firm said it has assembled a team of top executives to take a preliminary look at China and other Asian countries.

In a recent interview with Dow Jones, Blackstone founder Pete Peterson said the firm hasn't made any decisions about whether to invest in the region. "China is still a very complicated place with corruption and other issues," he said, echoing Lewis' comments.

One of the biggest challenges to investing in China is finding a knowledgeable financial partner to work with, Lewis said. "There isn't yet a good training ground for business professionals in China, so it's sometimes hard to find good people," he said.

KPP, which is the private-equity arm of Key Bank, got around this problem by acquiring auto-parts maker Asimco Technologies Ltd. in a $96.5 million recapitalization in February. Asimco, based in Beijing, has about 11,000 employees and 13 factories in China, and recorded annual revenue of about $350 million last year.

One of the main reasons KPP bought Asimco is because the company is run by former PaineWebber Group Inc. investment banker Jack Perkowski, who founded Asimco in China 10 years ago.

"One of the most difficult issues in expanding to China is figuring out how to do business there," Perkowski said. "That's what we've been doing for 10 years, so our expertise gives KPP an advantage when they want to expand their portfolio companies."

KPP, in fact, merged its U.S. car parts company, bought from Federal-Mogul, with Asimco, and named the U.S.-based subsidiary Asimco Camshaft Specialties.

But China isn't necessarily the best fit for every portfolio company. Circuit board maker MC Assembly, a KPP holding, considered the possibility, but eventually decided that Mexico was a better fit.

"Our investments there have really paid off, but China is not the answer to every question," Lewis said.

That is why Ampac has continued to operate in the U.S. even though it opened a factory in China. The foreign facility can make plastic shopping bags much cheaper, but it still takes about six weeks to ship the orders, while customers, usually large retailers like Nike Corp. (NKE), can't travel to China to make sure the logos and other marketing materials are printed perfectly on each bag.

Still, many private-equity firms see China as an essential market for their portfolio companies. "I can't tell you how many times a week I get calls from private equity firms that want to do business in China," Perkowski said.

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