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Shoreline To Close Second Chinese Distressed Fund This Year

San Francisco

By Shasha Dai

For years, Benjamin Fanger, co-founder of Shoreline Capital Management, has been a lonely prophet of China's coming distressed wave, with his predictions largely gone unheeded outside of the firm's circles of associates and investors.

Now, on the fund-raising trail for Shoreline's second fund, Fanger is finding a more appreciative audience.

At a time when general partners and limited partners in general are gearing up to take advantage of distressed opportunities in Europe--and to a lesser extent, in the U.S.--in the next couple years, Fanger is harping on the amount of similar opportunity in China.

While the Middle Kingdom has seen private equity activity for some time, most investors there are attracted by the country's growth as opposed to its problems. Since its 2004 inception, Shoreline has targeted nearly all kinds of distressed assets in China, from nonperforming loans on Chinese banks' balance sheets and real estate developers wanting financing to healthier businesses that have limited access to credit, and distressed borrowers unable to refinance their debt.

The firm's debut fund, the $178.2 million Shoreline China Value I LP that closed in 2008, is about equally split between nonperforming loans and special situation investments.

This time around, Shoreline is targeting $400 million for Fund II, which came to the market in June, Fanger said. After several interim closings, the new fund had reined in more than $200 million as of the end of last year.

Fund II is on track to have a final closing on more than $400 million around June, Fanger said. It has a $500 million hard cap.

"In the last 10 years, China has fueled growth by bank loans and exports. Now it has to tighten credit" or else facing worse inflation, Fanger said. "It is stuck between a rock and a hard place."

A larger average size of the typical deal opportunity Shoreline is seeing these days is one reason why Fund II's target is more than twice that of Fund I, according to Fanger. The new fund will invest in deals valued generally between $30 million and $40 million each--or as much as $50 million.

Fanger said various industry sources in China have put the estimated total amount of nonperforming loans on Chinese banks' books at anywhere between $500 billion and $2 trillion, depending on criteria of calculating those loans.

Another reason why Shoreline is raising a bigger fund this time around is the firm is expecting a heavier deal flow. The number of opportunities the firm screened increased to 1,000 in 2011 from 700 in 2010, according to Fanger.

So far, Fund II's limited partner base consists largely of family offices, endowments, foundations and pension funds. About three-quarters of the limited partners are based in North America, with the rest elsewhere in the world.

"Over the last six months, there has been a tremendous amount of headlines that reaffirmed our belief," said Fanger.

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