

Shoreline Capital Q&A: The Distressed Opportunity in China

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Among the private equity firms that invest in China, Shoreline Capital Management Ltd. has a different strategy: the four-year-old firm has [China's distressed assets](#), not growth opportunities, in mind. It seemed such a contrarian play that we caught up with Benjamin Fanger, Shoreline's co-founder and managing director, to get his take on it.



Ben Fanger (Courtesy of Shoreline Capital)

Deal Journal: Many private-equity firms view China as a growth equity story. What led to your investment thesis of focusing on distressed assets in China?

Benjamin Fanger: China presents an opportunity for value investors in a much different way than, say, the United States does right now. Even in markets with tremendous growth, such as China's, if the financial system allocates capital inefficiently, there will always be "distressed" opportunities. Projects that should get funded don't get funded, and projects that shouldn't get funded do. The result is both underpriced assets where capital is lacking and distressed debt where capital was too available.

Deal Journal: Investment banks such as Goldman Sachs Group and Merrill Lynch were among the early movers when it comes to investing in Chinese banks' nonperforming loans. In a culture where name recognition is important, how do you go about competing with larger and more established players?

Fanger: Name recognition is important only to the extent that it tells a seller we are a serious buyer. Already, Shoreline is known among distressed-asset sellers as one of the most active foreign players in China. What is far more important to sellers is bid price. And usually a foreign investor can only come to a competitive bid price when it has a local platform and experience necessary to understand the serious complexities of distressed assets in China.

Deal Journal: With the continued weakness in the credit market and the economic downturn in the U.S., Wall Street firms are grappling with their own problems and have shifted to the sell side from the buy side of distressed assets. How do you think this affect your business?

Fanger: The credit crunch in the U.S. has certainly affected China's economy as foreign demand for Chinese goods has decreased. This year's correction follows recent years when Chinese factories were built out to excess capacity and asset prices were bid up to unreasonable levels. The result of the correction is lower prices for real-estate-related assets, which we like, but longer times to exit on the same kinds of assets, which we don't. But Wall Street and the exits it provides are very far removed from the exit strategies we use in the inland provinces of China. These exits include the Chinese court system, rich local investors and restructuring borrowers. Thankfully, none of them involve IPOs in New York.

Deal Journal: China's housing market, after years of breath-taking growth, has seen excesses with increasing inventory of unsold newly-built homes. How will this affect exit opportunities for your investments of unfinished real-estate properties in China?

Fanger: Shoreline has not found residential investments that we could pull the trigger on in recent years because we worried that sooner or later the unreasonably high prices would come down. This year the pendulum is swinging back and when we see opportunities that are priced right based on cash flow, we are interested. Because of the many large developers building to excess, generally we still only look at locations where the potential supply is very constrained.

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