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EDITOR'S VIEWPOINT

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All about Korea

MORE THAN 10 YEARS AND A HOST OF bank turnarounds and corporate restructurings ago, South Korea was Asia's most active private equity market. According to AVCJ Research, $3.1 billion was deployed in the country in 2000, comfortably ahead of second-placed Japan.

Korea has yet to reclaim top spot and its chances of doing so appear slim, given the size and evolution of neighboring economies. First Japan rose to prominence in the early 2000s and by the middle of the decade China had begun its rise before the Japan-Australia pre-financial crisis leveraged buyout spike.

The last two years, however, have seen a mini resurgence. Korea was one of only two major Asian jurisdictions to see an increase in deal flow in 2012 compared to 2011. This could be repeated in 2013, with Korea PE deal investment standing at $6.9 billion in October, about $500 million short of the previous year's total.

South Korea accounted for 16% of region-wide deal value in the first three quarters – and 21% in the third quarter alone – compared to 11% for 2012 as a whole. The country's share of Asia buyouts is even more pronounced: 42% for the first three quarters, up from 13.5 % in 2012. For the first year since those heady days in 2000, Korea is a bigger buyout market than Japan, leading its neighbor by $500 million.

It is in this context that we should consider the last week's three big pieces of Korea private equity news. First, Anchor Equity Partners, a spin-out from Goldman Sachs, closed its debut fund at $500 million, adding impetus to the notion that foreign LPs have an appetite for local managers able to tap into this deal flow.

Second, Morgan Stanley Private Equity Asia (MSPEA) secured a partial exit from train manufacturer Hyundai Rotem when the company raised KRW622.4 billion ($585 million) in its IPO, the largest offering the Korea Exchange has seen in more than three years. MSPEA paid KRW161.6 billion for a 42.4% stake in Rotem in 2006, AVCJ data show; it has recouped more than 80% of the principal through the IPO and still owns nearly 25% of the company.

Third, several private equity are said to have placed bids for pieces of Woori Finance Holdings in stage two of a three-stage project aimed at jettisoning the government's majority interest in the business.

Woori is arguably the most interesting development, even though there are no guarantees that a private equity buyer will emerge triumphant, because of what it says about Korea deal flow. Although two of the three largest deals so far this year – MBK Partners' acquisitions of clothing retailer NEPA and ING Life Insurance Korea – were not driven by local conglomerates needing to divest assets, a number of the big transactions typically are.

STIC Investments led a consortium into aerospace company LIG Nex1 in February because the parent had debts that required servicing; IMM Private Equity and Mirae Asset Private Equity secured a minority stake in POSCO Specialty Steel a few months later for much the same reason. Last year, MBK Partners agreed to buy a large minority interest in water purifier manufacturer Woongjin Coway a matter of weeks before its parent filed for bankruptcy.

There will always be a place for succession planning opportunities, but one of the questions for Korean private equity is whether so far intermittent divestments become more frequent.

Affinity Equity Partners' acquisition of a majority stake in Loen Entertainment – owner of the Korean version of iTunes – from SK Telecom in July was said to be an example of a government-mandated restructuring of local conglomerates. The pressure faced by the likes of SK is not financial but political, driven by accusations that their incessant expansion is suffocating small businesses.

Will this, however, generate a flood of deal flow or a trickle, as companies are squeezed into submission by banks and regulators? And of the transactions that emerge, how many will go to genuine private equity funds rather than quasi-fund vehicles launched by state-linked institutions?

A repetition of the early 2000s isn't going to happen in the absence of severe financial distress. It will be interesting to see, though, where the deals might come from to sustain the relatively strong showing of recent years.

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NEWS

GLOBAL

Harvard appoints new private equity head

Harvard Management Company (HMC) - the investment arm of Harvard University - has appointed Lane MacDonald as its new managing director of private equity. MacDonald, who will step into the role from December, will take the lead in assessing and reshaping HMC's private equity portfolio.

AlpInvest raises $750m for Secondaries Fund V

AlpInvest Partners has closed its Secondaries Fund V (ASF V) at the hard cap of $750 million, exceeding its initial target of $500 million. The co-mingled fund was launched last year and has 18 new investors.

Yale trims private equity allocation

The Yale University endowment has trimmed its private equity allocation for the first time since 2005, although the PE remains the largest asset class in the portfolio and the weighting is still larger than that of most of its educational peers. As of July 2014, Yale will trim its PE exposure to 31% from 35% in the 2012 fiscal year target.

AUSTRALASIA

Australia's IFM changes name, opens Tokyo office

Industry Funds Management has changed its name to IFM Investors. The move comes shortly after the Australia-headquartered group consolidated its private equity and private assets divisions into one team and as it expands its presence in global markets, most recently with the addition of an office in Tokyo.

GREATER CHINA

Pactera agrees to $625m Blackstone-led take-private

Pactera Technology International has agreed to be taken private by a consortium led by The Blackstone Group that values the NASDAQ-listed Chinese tech outsourcing firm at $625 million. Existing investor GGV Capital is also participating in the bid alongside company management.

TPG to buy Fox stake in Phoenix Satellite TV

TPG Capital has agreed to buy a 12.15% stake in Chinese satellite television operator Phoenix Satellite Television Holdings from 21st Century Fox for HK$1.66 billion ($214 million). Star Entertainment Holdings, which is owned by Rupert Murdoch-controlled Fox, will sell 607 million shares in Phoenix to TPG at HK$2.73 apiece, representing a 3.5% discount to the

company's closing price on Friday. Upon completion, Star's representatives will also step down from the Phoenix board.

Phoenix launched its Chinese-language broadcast platform in 1996 with the Phoenix Chinese Channel. A movies channel followed in 1998 and the Phoenix InfoNews Channel came three years later. The company broadcasts to more than 180 countries and regions, including limited landing rights in the mainland.

The sale coincides with Murdoch's reelection as chairman of 21st Century Fox despite opposition from several shareholder groups. The media tycoon, once bullish on his prospects in China, exited New Corp's controlling stakes in three mainland television channels in 2010.

Baidu, VC-backed Qunar set for $127m NASDAQ IPO

Qunar, a Chinese travel website majority-owned by Baidu, is seeking to raise up to $127.8 million through its NASDAQ IPO. The company is also backed by GSR Ventures and GGV Capital, neither of which will sell any shares in the offering. Qunar will sell 11.11 million American Depository Shares at $9.50-11.50 apiece.

Ex-Qiming partner Hans Tung joins GGV Capital

Hans Tung, formerly managing partner at Qiming Venture Partners, has become a partner at GGV Capital. He is based in Silicon Valley but is part of a team that invests across the US and China.

Hutchison Whampoa scraps Parknshop sale plan

Hutchison Whampoa has abandoned plans to sell Hong Kong supermarket chain ParknShop, after it had reportedly attracted bids from a number of PE and strategic investors. The company said it came to the conclusion that a private market transaction would not deliver to best returns to shareholders. Instead Hutchinson will focus on expanding its business into mainland China.

RRJ invests $50m in China property developer CIFI

RRJ Capital has agreed to invest $50 million in Shanghai-headquartered real estate developer CIFI Holdings via a new share subscription. The PE firm will buy 257 million shares at HK$1.52 apiece for a 4.3% stake in CIFI. RRJ previously subscribed to $100 million in senior notes issued by CIFI.

Online marketplace 58.com targets $165m US offering

Chinese online marketplace 58.com is seeking raise up to $165 million through its NASDAQ IPO. The company's VC investors – Warburg Pincus, SAIF Partners and DCM – will not sell any of their shares in the offering. 58.com will sell 11 million American Depository Shares at $13-15 apiece.

New Horizon leads $50m round for Chukong

New Horizon Capital has led a $50 million Series D round of investment in Chukong Technologies, a Chinese mobile game developer. GGV Capital, Sequoia Capital, Steamboat Ventures and Northern Light Venture Capital also participated in the round, which brings the company's total funding to $83 million to date.

People's Daily to buy online literacy platform

People.cn, a Chinese online newspaper run by state-owned People's Daily, intends to purchase a 69.25% stake in Kanshu.com, an online book reading platform backed by Sequoia Capital, for RMB249 million ($40.8 million).

Ascendent gets Wumart stake as part of CP deal

Ascendent Capital Partners (ACP) has acquired a stake in Chinese supermarket operator Wumart Stores, as Wumart moves to acquire 36 stores from retail firm CP Lotus Corp. for HK$2.3 billion ($302 million) through a share swap. Wumart will

gain a stake of about 10% in CP Lotus - which is part-owned by a unit of Thai billionaire Dhanin Chearavanont's Charoen Pokphand Group - worth about HK$2.9 billion.

NORTH ASIA

Korea's Anchor Equity closes debut fund at $500m

Anchor Equity Partners has reached a final close on its debut South Korea-focused fund at the hard cap of $500 million. The firm – set up last year by a group that spun out from Goldman Sachs' PE unit – targets buyout, growth capital and industry consolidation opportunities.

SBI, FMO target $125m for Asia financial sector fund

Japan's SBI Holdings and the Netherlands Development Finance Company (FMO) are looking to raise as much as $125 million for their SBI-FMO Emerging Asia Financial Sector Fund. The vehicle launched last year with an initial target of $80 million but this was revised to $120-125 million following a strong investor response.

Astellas Pharma leads $45m round for Mitokyne

Astellas Pharma, a Tokyo-listed pharmaceutical firm, has led a $45 million Series A round of investment in US biotech start-up Mitokyne, alongside MPM Capital and Longwood Founders Fund. Astellas and Mitokyne are also collaborating on developing drugs that tackle mitochondria-related diseases.

Global Brain invests $3.3m in group buying site Luxa

Japanese venture capital firm Global Brain has invested JPY330 million ($3.3 million) in luxury group buying site Luxa through its KDDI Open Innovation Fund. In March, JAFCO invested JPY500 million in the business having put up the same amount back in November 2010.

Troika Resources, Canada's Bellatrix form oil JV

Bellatrix Exploration, a small Canadian oil and gas explorer, has formed a C$240 million ($231 million) joint venture with the South Korea's Troika Resources Private Equity Fund (TRPEF) - which is managed by KDB Bank, SK Energy and Samchully Asset Management - to develop oil properties in Alberta.

MSPEA-backed Hyundai Rotem in $585m Korea IPO

Hyundai Rotem, a train manufacturer backed by Morgan Stanley Private Equity Asia (MSPEA), completed the fourth-largest IPO ever executed on the Korea Exchange and the biggest in more than three years. The offering generated proceeds of KRW622.4 billion ($585 million), with MSPEA exiting more than one third of its 42.4% holding. Rotem sold 27.06 million shares at KRW23,000 apiece, the top end of its KRW17,000-23,000 per share indicative range.

Korean IPOs have struggled against weak investor sentiment in the last couple of years with no offerings of significant size since 2011. Rotem, however, appears to have timed its offering well – the Korea Composite Stock Price Index

is currently trading at around 2,050 points, its highest level since July 2011.

Rotem controls over 90% of the domestic train market and around 2% of the global market. MSPEA invested in the company in two tranches in 2006, KRW85.3 billion for a 20.7% stake and then KRW76.3 billion for a further 21.7%. Hyundai Motor held the remainder. Subsequent to the listing, MSPEA's holding dropped to 24.8%.

SOUTH ASIA

Walden to launch $100m India semiconductor fund

Walden International will launch a fund to invest in Indian semiconductor-related start-ups. It already manages a similar vehicle focused on China. The $100 million vehicle will begin investing later this year.

Silver Lake, Nexus back software platform

Silver Lake Kraftwerk has taken a minority stake in Bangalore-based Eka Software Solutions, a commodity trading and risk management software provider. Existing investor Nexus Venture Partners also participated in the funding round. This is Silver Lake's first investment in India.

Helion, Blumberg invest $1.5m in Mygola

Mygola.com, an Indian online travel planning start-up, has raised a $1.5 million Series A round led by Helion Venture Partners and including existing backer Blumberg Capital. The funding will be used to support the company's US expansion plans.

IDFC Alternatives invests $20m in Medi Assist

IDFC Alternatives has committed INR1.25 billion ($20.39 million) to Medi Assist, a Bangalore-based health benefits manager. The group has three business units: insurance benefits administration where a third-party administrator (TPA) processes claims or provides cashless facilities for health insurance policies; pharmacy benefits management; and wellness management for preventive healthcare.

SOUTHEAST ASIA

Blackstone launches Singapore office

The Blackstone Group has opened an office in Singapore, extending its footprint into Southeast Asia. Alan Miyasaki, Blackstone's senior managing director for real estate, Kishore Moorjani, managing director of the tactical opportunities team and Pithambar Gona of the private equity unit will be based in Singapore.

Northstar picks up ERA regional master franchise

Northstar Group has completed the acquisition of the Asia Pacific master franchise rights for property agency ERA from Hersing Corporation. It follows the Southeast Asia-focused GP's purchase of ERA franchise in Singapore from the same seller two months ago.

Blumont receives $200m for Discovery Metals deal

Blumont Group has received $200 million in new funding from New York-based investment firm Platinum Partners, half of which will be used to buy convertible bonds in Australian copper miner Discovery Metals, previously a target of Chinese PE group Cathay Fortune Corporation.

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On the shoulders of giants

Backing from a development finance institution can be the making of a first-time GP in a far-flung jurisdiction. Working with this kind of LP, however, comes with its own set of challenges

WHEN MONGOLIA OPPORTUNITY Partners (MOP) set out to raise its maiden fund in 2010, the challenge was two-fold. Not only did investing in Mongolia – whose chief industries are in mining and agriculture – carry with it the usual frontier market risks, putting off many potential LPs, but MOP also had no track record to speak of but for the experience of its founders.

"In Mongolia and other markets like it, no one is going to want to go in unless there's a mandate for it," says Mandar Jayawant, the PE firm's founder. "As such, development finance institutions (DFIs) are often the only ones who are going to anchor your fund."

For MOP, it was inevitable DFIs would play a significant role in the fund because Jayawant had previously acted as Asian Development Bank's (ADB) senior country economist and deputy country director for Mongolia from 2005 to 2008. He well understood the value of such partnerships and also knew what these institutions were looking for.

The fund eventually closed in June 2011 after receiving commitments from six different DFIs, including ADB, the World Bank's International Finance Corporation (IFC), German government-backed DEG, the European Bank for Reconstruction and Development (EBRD), Dutch development bank FMO and Obviam, a spin-out of the Swiss Investment Fund for Emerging Markets (SIFEM).

MOP is not the only GP to see the benefit of partnering with DFIs when mainstream LPs are reluctant to back first-time fund managers in largely unchartered geographies.

"Within the first three minutes of you walking into a meeting, a lot large LPs will say, 'By the way, we don't invest in first-time funds, but we are happy to hear your story,'" recounts one emerging markets GP. "Everyone asks you the same questions: 'How much have you raised? What are your soft commitments? Where have you reached?'"

As such, the presence of a DFI can be the difference between a successful fundraise and an unsuccessful one. They offer not only capital, networks and experience, but also a seal approval that might encourage other LPs to come in. At the same time, working with a DFI means working within the constraints of its mandate, and so the challenge for private equity firms is how they can manage the relationship as it evolves.

Faith in first-timers

According to AVCJ Research, LP commitments by DFIs in Asia have amounted to $66 billion since 2003. IFC was the most active during this period, investing just under $3.5 billion. It is followed by CDC Group and the Overseas Private Investment Corporation (OPIC) – backed by the UK and US governments, respectively – which committed $2.6 billion and $1.5 billion.

Typically, DFIs look for three things in a GP. First, an ability to generate good commercial returns consummate the DFI's own investment targets. IFC, for example, dedicates around $3 billion – or 30% – of its investment program to private equity. Around $500 million of that is LP commitments, with $200 million deployed in Asia, and the target return is close to 20%.

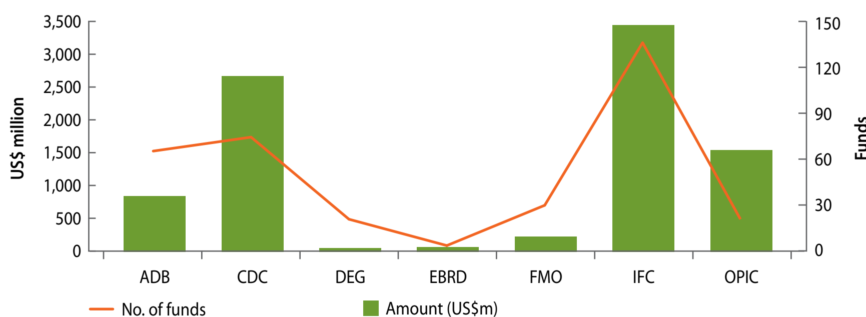
Second, a DFI often prefers GPs with strategies that fit its developmental targets. For OPIC, focal points the touch points include job creation, infrastructure improvements, environmental and social impact, corporate social responsibility initiatives and technology and knowledge transfer in the GP's home country.

Third – and helping to ensure the first two requirements are met – there is a desire to play a pivotal role in the structure of the fund and the development of a GPs investment thesis. "Often where there is a large oversubscribed fund, there is no role for IFC to play but with a small fund we are able to make a difference and shape the fund structure," explains Vikram Raju, senior global funds specialist with IFC.

This underscores the benefits to a DFI in backing a smaller vehicle, or even a first time fund. In the case of IFC, these make up for 50% of its LP commitments. Its more recent relationships include Indonesia-focused Falcon House Partners, which reached a final close of $212m on its debut fund last week after receiving an initial anchor investment of $25 million from IFC. Subsequent commitments came from OPIC, DEG and FMO.

Despite the risk involved in backing first-time funds, Raju points out that IFC has a good track record in this area, with these managers generating as much as 400 basis points of alpha.

DFI commitments to Asian private equity, 2003-2013



Source: AVCJ Research

One of the reasons these funds perform so well is that the team behind a first-time vehicle invariably spends a lot of time thinking about the opportunity set. Without legacy funds to manage, they also tend to be more focused.

However the issue remains that – unless the fund is a spin-out – it can be challenging carrying out due diligence on a team that does not have track record. Rather than the comfort of knowing a team is more than the sum of its parts, a DFI must assess the experience of individual team members and make a call on their ability to work together.

"Investing in a fund is mainly about investing the people," explains Markus Bracht, vice

president at DEG. "The integrity and in-depth experience of the GP is crucial and the alignment of interest between GP and LP is an integral part of our due diligence."

Given the role the DFI plays as an anchor investor, it is has a significant amount of leverage in ensuring alignment of interest is maintained.

Development demands

DFIs not only conform to their own investment mandate, but also to a number of global treaties regarding governance, regulation and transparency. Additionally, DFIs were among the first to endorse the Institutional Limited Partners Association's (ILPA) set of principles – launched in 2009 – that are intended to improve alignment of interest, governance and transparency in GP-LP relations.

"I would say DFIs are extremely sophisticated investors," says Abrar Mir, founder of Quadria, a GP that targets healthcare investments in South and Southeast Asia. It reached a $107 million first close on its debut fund last month, having received a $25 million commitment from IFC. "The threshold we have to cross to get a DFI over the line is extremely high, in some case higher than institutional investors."

In many cases, DFIs will often provide a list of industries GPs are restricted from investing in, such as alcohol, tobacco and gambling. In the case of MOP, one of these conditions of ADB and IFC's commitments to the fund was that it not do direct deals in mining.

One of the reasons for this is that many DFIs hesitate to give up the environmental and social custodianship of their involvement in sectors such as mining to a third party as the risks are deemed too great. ADB and IFC also needed to fulfill their mandate to help the Mongolian economy diversify beyond mining.

In any case, such restrictions can be immaterial when GPs are selected for the reason that conflicts of interest are unlikely to arise. MOP may not be able to make mining investments but as a small fund these capital intensive projects weren't really part of its original thesis.

Additional requirements DFIs place on GPs include supplementary reporting requirements that enable developmental outcomes to be measured. They may want, for example, information on a portfolio company's employment figures, with a particular interest in the number of female staff, or environmental data such as full breakdowns on emissions.

While requirements outlined by DFIs may initially appear onerous or restrictive, many GPs see the advantages of having a DFI as partner as substantially outweighing the cost.

First and foremost, the presence of a DFI on the LP roster gives confidence to other investors. MOP secured commitments from Japan's Orix Corp. and Mitsubishi Corp. prior to its final close, but only after receiving DFI money early on in the process. The same can be said of Falcon House, which closed above its $200 million target due to last-minute investments from undisclosed European institutional investors.

Another advantage GPs can leverage is a DFI's connections and experience. This is particularly valuable to a GP such as Quadria, whose specific sector focus could benefit from a DFI's network.

"Given that they have been in the market longer than most PE players, they have relationships not just at the commercial level but at the government level in many of the countries in which we operate," says Quadria's Mir. "So it is the government connection that would be useful to us."

In return, DFIs look to make investments alongside the fund managers they back. Indeed, the presence of co-investment opportunities is a large part of the reason they make commitments to the asset class in the first place.

> "When we select a fund manager our main motivation is to establish long-term and trustworthy partnerships" – Markus Bracht

There are two benefits of this kind of arrangement. First, many DFI will have offices in multiple geographies and are able to offer both on-the-ground presence and global expertise that other potential co-investor may lack. They may also be able to deploy additional capital in the form of debt and mezzanine financing to portfolio companies.

An example of this was IFC's $28 million investment last year in two Indian microfinance institutions, Equitas Microfinance and Ujjivan Financial Services. Equitas was backed by Aavishkaar Goodwell and CLSA Capital Partners, both of which had received commitments from IFC, while IFC-backed Lok Capital had been among Ujjivan's shareholders.

"We find it very useful because we are not a very large fund and with the DFIs alongside we can increase the amount of money that is actually put in the companies," say MOP's Jayawant.

"It always gives our transactions a bit of security because in these markets if you have a DFI as a shareholder your ability to solve problems is substantially greater than if you were operating by yourself."

On the other hand, given the challenges that go along with investing in certain emerging markets, DFIs are said to give more leeway as regards to management fees and carried interest. Anecdotal evidence suggests DFIs are reluctant to squeeze first time funds on fees where it would inhibit the formation of a strong team – the trade off being co-investment rights.

"When negotiating terms DFIs can be very generous with fees and carry because they understand we are a small fund and operating in markets that come high costs," says Jayawant.

Long-term relationships

Essentially, many DFIs are seeking to form relationships with the GPs they invest in with the hope of leveraging shared institutional knowledge and gaining access to future deals.

IFC, for example, was an early backer of Indonesia's Saratoga Capital, committing $35 million to Saratoga II, which held a final close at $152 million in 2009. IFC and CDC both declined to be LPs in the third fund – CDC was forced to sit out because Indonesia is no longer classified as a developing country – but IFC continues to work with its one-time investee.

Last year, it joined a Saratoga Capital-led consortium in purchasing a $112 million majority stake in Indonesian electricity producer Medco Power International.

"When we select a fund manager our main motivation is to establish long-term and trustworthy partnerships," says DEG's Bracht. "We want to cooperate with our partners to achieve our strategic goals, which are mainly the promotion of private entrepreneurship in emerging markets and the implementation of best practice social and environmental standards."

At the same time, while DFIs are looking to maintain ties with GPs they have previously backed, they are also looking to the next crop. Saratoga remains an informative example in this context. The private equity firm closed Fund III at $600 million after less than a year in the market, easily exceeding its target of $450 million. IFC, meanwhile, had moved on to Falcon House, a GP that has yet to achieve the same kind of institutional scale.

IFC's Raju describes many DFIs as having a "self-destruct button," where they will only back GPs until they become successful before putting their capital into the next generation of funds.

"As long as there is a need for us to be in a market where access to capital remains a problem and development goals need to be met, we think this is a way we can do it – by focusing on the newer, smaller funds even as the market gets more attractive," he says.

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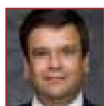
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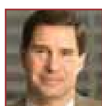
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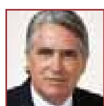
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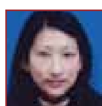
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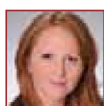
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Sink or swim

India's e-commerce sector is in the midst of consolidation. VC money continues to flow to the larger players but even they are examining their business models in a climate of higher operating costs

OF THE 193 E-COMMERCE SITES THAT were operational in India in October 2012, 89 have either shut down or merged with other retailers, essentially wilting under pressure from high operating costs.

Acquisition targets include Sequoia Capital-backed Shopo.in, an online marketplace for Indian handicraft products, which was bought earlier by online marketplace Snapdeal. The transaction was motivated by access to a network of sellers in a niche that would generate incremental value in terms of sales.

"We realized, surprisingly for us, that 95% of their sellers were not on Snapdeal," says Kunal Bahl, Snapdeal's co-founder and CEO. "It was purely incremental for our platform and we were able to offer a very 'Indian' assortment to buyers."

In another e-takeover, Flipkart acquired Letsbuy in order to deepen its catalogue of electronics products, while online babycare company Babyoye merged with competitor Hoopos in a demand acquisition play, as the companies targeted a similar customer base. Both were backed by Helion Venture Partners.

There will be more strategic acquisitions as the sector consolidates – with those that do have traction consuming those that don't, and filling gaps in their product offerings in the process.

Money continues to flow into the sector as online retailers race to scale up and achieve profitability – around $491 million has been invested in the sector this year according to AVCJ Research. One of the biggest players in the sector, Flipkart, closed a record $360 million Series E funding round to help expansion, on top of the $180 million already invested in the six-year-old company. Younger rival Snapdeal has raised $50 million from eBay and VC, bringing its funding kitty up to $177 million.

Both aspire to reach $1 billion in annual gross merchandise value (GMV) by 2015. Both claim to be already halfway there.

"The goal is to build a platform that aggregates the supply in India's largely fragmented retail sector and connects it with demand across 4,000 towns and cities," says Bahl. Only 7% of the country's $490 billion retail sector is organized and no single lifestyle brand has more than $200 million in annual sales.

Issues of scale

But scaling up has proved a challenge. Of the 137 million internet users in the country, only 25 million are online buyers, according to a report by the Internet and Mobile Association of India and KPMG. By comparison, China has 270 million active e-commerce users. Most of India's online shoppers spend INR500-2,000 ($8-33) per transaction, while only 7% purchase items worth more than INR5,000.

There are also other barriers to making money. "Typically with online retail, even before the goods leave the warehouse, the money is with the retailer," says Milan Sheth, partner at Ernst & Young. "In India that cycle is reversed."

A cash-on-delivery option, introduced to win over new customers wary of ordering online or without credit cards, accounts for a majority of sales. But 10% of dispatched merchandise is rejected on reaching its destination, and the company must still bear the delivery charge.

No retailer has managed to break-even but companies are adapting to meet the challenge. "We do believe that in the next 12-18 months some of them will get to operational profitability," says Subrata Mitra, partner at Accel Partners. His firm has backed Flipkart, among others.

Unreliable third-party logistics and supply chains add to the cost. Flipkart is part of an earlier wave of inventory-led e-commerce companies that started in 2008-2009. It was one of the first to develop its own in-house platform to handle warehousing, packaging and delivery, and needed a lot of working capital to buy inventory. It is estimated that the liquidation costs of even 15-20% excess supply can wipe out margins.

This year Flipkart switched from online retail to become a marketplace where third-party suppliers and merchants, rather than the company itself, bears the cost of inventory and storage in selling products to shoppers.

ShopClues and Snapdeal, both founded in 2011, already follow the marketplace business model. "When we started building out our business, we had the benefit of hindsight looking at the inventory-led companies – while they were growing fast, they were growing inefficiently with respect to the capital invested," says Snapdeal's Bahl.

There are three components to the marketplace fee structure – a platform fee of 5-20% of transaction value, shipping charges and payment collection charges. If a company earns a certain fee level on all transactions, as sales grow so will the total amount of absolute money being made. The main cost becomes marketing.

"If we turn back the dial on marketing we

FDI rules: The workaround

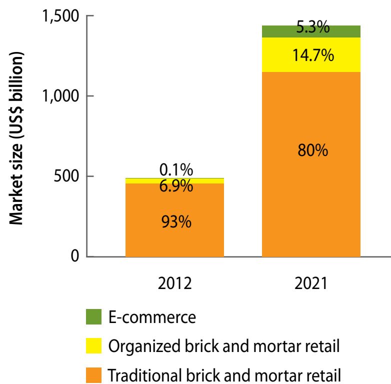
India allows 100% foreign direct investment (FDI) in online marketplaces, business-to-business e-commerce and single brand retail, and 51% foreign ownership in multi-brand brick and mortar retail. However, last year the government clarified that "retail trading in any form, by means of e-commerce, is not permissible for companies with FDI."

India's e-commerce sector has received $1.5 billion worth of investment, according to AVCJ Research, and a number of start-ups have adopted new business structures to get around the ban. "The alternative they have sought is to split the value chain into customer facing and back-end," says Milan Sheth, partner at Ernst & Young.

Business models have pivoted, with online retailers becoming marketplaces that merely provide a platform for vendors to sell to consumers. In February, Flipkart sold WS Retail Services, its front-end operations unit, to a group of Indian investors. It then set up Flipkart Holdings Singapore, an offshore entity, to own and run the technology and the back-end. A licensing agreement between the Singapore entity and its foreign investors was put in place. The company also shifted from buying and selling inventory to a marketplace model.

Snapdeal also runs its wholesale operations as part of Jasper Infotech, while its order-taking business is called Spinel Tradecom. Amazon too follows the marketplace model in India, although Amazon handles most inventory and storage itself in other parts of the world.

Indian retail market size



Source: Technopak Analysis
* Retail market size for 2021 is at nominal growth

can get profitable in one or two quarters," Bahl continues. "However, that is not the right decision for the company because if we don't invest to grow the market, then we don't grow in the long run either."

Transportation solutions

There are now delivery companies with systems tailored to work with online retailers, such as Delhivery and Ecom Express. However, even with the marketplace model, companies have developed systems to make logistics efficient.

Snapdeal, for example, intermediates all its shipments through a platform called Safe Ship, which automatically match sellers and screened, verified courier partners. It has also built a network of fulfillment centers across the country where sellers can drop off high frequency products for faster deliveries. Similarly, ShopClues has a large proportion of sellers first ship to its fulfillment center and from there packets are shipped to customers.

Snapdeal is now looking to go one step further, working on acquisition opportunities with companies that possess supply chain technologies. The firm has also entered into a commercial partnership with eBay, allowing the US company's India subsidiary to promote its products to Snapdeal's users and vice versa. EBay will also have access to the Indian retailer's logistics software and distribution network.

In part reflecting the increased focus on logistics, most e-commerce firms no longer offer free shipping to all customers, only to those that reach a minimum spend threshold.

"Right now that minimum bar is still below their average bill value," says Rahul Chowdhri, a director at Helion Venture Partners, an investor in ShopClues.com. "Soon they will start pushing that minimum bar because it doesn't make sense to encourage customers to order below the average bill value that you want."

With the larger operators in expansion and consolidation mode, VC firms are looking beyond the mainstream to verticals where consumer demand has yet to be tapped, such as healthcare and furniture. The logic is that verticals tend to be more profitable than horizontals.

"Horizontal plays are likely to achieve much bigger scale, and therefore need more funding for customer acquisition and building out infrastructure," says Accel's Mitra. "Vertical players need to be sharper in their product differentiation with better margins coming from private labels and own brands."

BabyOye, for example, already has its own branded apparel, as do a number of apparel specialists such as Accel-backed Myntra.

The biggest problem with private labels is finding out what sells – online retailers who get it wrong will be left with stacks of unsold inventory. "Once you get a good sense of what consumers want, then your own brand will start building into the revenue and start contributing to the margins" says Helion's Chowdhri.

And success in a niche could provide investors an exit through M&A.

CALL FOR PROPOSALS

Emerging Market Private Equity Managers

The Overseas Private Investment Corporation (OPIC) has launched a Global Engagement Call for Proposals.

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Falcon House's Indonesia breakthrough

WHEN TEAM BEHIND FALCON HOUSE came together three years ago they were eyeing Indonesia's underserved middle market. Drawing on local experience across corporate restructuring, PE and infrastructure, the principals thought they could make the breakthrough in a country where numerous groups have talked about raising funds but few have succeeded.

Glenn Yusuf, who ran the Indonesian Bank Restructuring Agency following the Asian financial crisis, initiated the partnership, bringing in Brian O'Connor, formerly a senior executive at Lehman Brothers, and Samir Soota, previously managing director of South and South East Asia at EMP Global.

Falcon House Fund I (FHF I), which launched in September 2011 with a target of $200 million, recently reached a final close of $212 million.

Of the first-time Indonesia-focused vehicles that have emerged since 2011 when the country returned to prominence in private equity circles, it is only the second to close. The first was Capsquare Asia Partners, which raised $82.5 million. Meanwhile, Forte Capital and Fairways Capital pulled their funds before launch, Antara Capital has stalled, and Mahanusa and Yawadwipa are status unknown.

Rupiah down: Good for GPs?

FHF I reached a $100 million first close in August last year after International Finance Corporation (IFC) came in as an anchor investor, putting in $25 million. With Overseas Private Investment Corporation, Germany's DEG and the Netherlands' FMO are also said to have made commitments, development finance institutions account for around 30% of the total corpus, according to a source familiar with the situation.

The fund reached its $200 million target back in July but became oversubscribed after receiving additional commitments from an unnamed European investor at the last minute. The rest of the capital comes from a mixture of institutional LPs, predominately US-based, including pension funds and funds-of-funds.

FHF I, which has a lifespan of 10 years a target IRR of around 25%, will provide growth capital to mid-market firms, seeking both significant minority transactions and buyout opportunities with an emphasis on the consumer sector. It is looking to make around eight investments, predominantly in the consumer sector, with a transaction sweet spot of $15-25 million.

"Indonesia has turned a corner, the fundamentals are pretty good and there is huge gap in the mid-market," the source added. "The rupiah has also weakened by 20% against the dollar, so that works to your favor if you are sitting on a lot of dry powder. Theoretically transactions have become 20% cheaper."

According to AVCJ Research, Indonesia fundraising has reached $200 million or more in five of the last six years, largely driven by the country's four longer-standing GPs – Northstar Group, Saratoga Capital, Quvat Management and Ancora Capital Management. The latter reached a final close on its second fund at $128 million last month.

IDG, CreditEase target online finance

CREDITEASE, THE LARGEST PEER-TO-PEER (P2P) lender in China, has introduced a new twist to its relationship with IDG Capital Partners. Two-and-a-half years after becoming an IDG portfolio company, CreditEase has become a principal investor in an IDG-managed microcredit fund, which will back financial services start-ups.

"CreditEase is actively looking for investment opportunities in early-stage financial innovative firms as they believe it will be the next big trend. That's also what we believed in years ago when we invested in CreditEase," says Li Feng, a tech-media-telecom-focused partner at IDG, tells *AVCJ*.

The IDG CreditEase Financial Innovation Fund recently reached a first close of $100 million. It will target internet finance technology, specifically lending, microcredit mechanisms, credit ratings, payment services and risk management enterprises in China and Silicon Valley. Each investment will be between RMB100,000 ($16,375) and RMB1 million.

CreditEase started as a P2P lending site in 2006, linking individual lenders to small-scale borrowers, typically the rural poor and urban micro-entrepreneurs. It received investment from IDG, Morgan Stanley Private Equity Asia, and existing backer KPCB in 2011.

The company has since expanded quickly and now provides a range of consultation services, including wealth management, credit rating and microcredit lending. In the context of the new fund, CreditEase is able to deliver its operational expertise to the investees chosen by IDG. "Even before setting up the fund, we had started to make co-investments, with CreditEase coming into some deals sourced by IDG," Li adds.

China SMEs: Under-funded

Online financial services are booming in China. A host of manufacturers and retailers – including Alibaba Group, JD.com and Suning – are preparing to apply for bank licenses as the government seeks to introduce more competition and services to the financial sector.

The opportunities for venture capital lie further down the spectrum. Last month the new fund made its debut investment in Hangzhou Wacai Science, a Chinese personal finance management mobile app developer. Wacai's two apps, which allow people to record their daily spending, have more than 40 million users. It follows a similar transaction by Sequoia Capital, which committed $10 million across two rounds of funding for Beijing-based personal finance management site Feibee.com.

Li foresees more deal flow coming from larger retailers as they expand payment services to cover a wider variety of products. For example, last week Sunning won approval for a subsidiary to provide payment and settlement services for online mutual fund sales.

In the first six months of this year, China had 244 million registered user of online payment systems, up 10.8% year-on-year, according to China Internet Network Information Center. Nearly one third of these users make payments via mobile devices.

Quadrant eyes aged care consolidation

QUADRANT PRIVATE EQUITY COMPLETED its exit from New Zealand retirement village operator Summerset last week but demographics remain a prominent theme in the firm's portfolio with the acquisition of Estia Health, an Australian aged-care provider.

The two investments are united by a growing demand for private sector participation to meet the needs of aging yet affluent populations. Beyond this, comparisons are not entirely fair. While Summerset offers aged-care services, three quarters of its revenue comes from retirement villages, where it is third-largest operator in New Zealand. Estia, by contrast, is a pure-play aged-care business that currently ranks no higher than sixth in an extremely fragmented Australian sector that has so far seen less integration of retirement accommodation and aged care.

"We will continue to grow the business through brownfield acquisitions and possibly some greenfield, and we will be part of the consolidation that is occurring within the sector," said Marcus Darville, a director at Quadrant. "The sector has been attracting more institutional capital and we think that will continue. There are no indigenous Australian listed companies in the space but we expect that to change as well."

The consolidation dynamic has already attracted other investors. This year Archer Capital acquired Primelife Aged Care from Lend Lease Group, while AMP Capital agreed to sell roughly half of Domain Principal Group to Singapore's G.K. Goh Holdings. Macquarie is also said to be interested in selling part of Regis Group, Australia's second-largest senior care home operator.

Aged care: Consolidation play

Quadrant has committed A$90 million ($87 million) in equity for an approximate two thirds majority stake in Estia, with the enterprise valuation said to be in the region of A$170 million. The principal seller, founder Peter Arvanitis, will retain the remaining one third and continue as CEO.

According to Darville, 60% of Australia's aged-care market is non-profit. The largest single player – either non-profit or for-profit – accounts for less than 5,000 of the 187,000 beds available in the sector as a whole, with top five players have a collective market share of 15% of the market or less. Estia manages 1,100 beds across 10 facilities.

There have been calls for greater deregulation to allow pricing differentiation and facilitate competition but so far this has only stretched to certain ancillary services, while principal accommodation and care charges are controlled. However, the government's "Living Longer Living Better" initiative, which launched last year and is expected to see A$3.7 billion invested in aged care, is seen as a positive step.

Darville believes the expansion of lump sum payments – where care recipients typically pay an accommodation bond on arrival – could prove particularly useful. "The bond is returned to the family when the resident leaves but it can be used to help pay down debt or build new facilities," he said. "It is an interesting way to grow a business."

CITIC oils Stackpole's China wheels

THE OIL PUMPS USED TO LUBRICATE engine parts and reduce friction come in two forms: fixed and variable. The first are usually oversized to handle the harshest operating conditions and therefore deliver higher average oil pressure and consume more power than required. The second allow oil flow to be adjusted to suit the engine's needs, minimizing the amount of energy required to drive the pump.

Variable displacement pumps generate a 2% fuel saving over the life of a vehicle, resulting in reduced carbon dioxide emissions. Europe has already bought into the idea, with nearly all new cars fitted out with the pumps, while in the US it's a 50-50 split between fixed and variable.

Efficient engines: Set for China

In China, only 20% of new cars have variable pumps. Increased adoption is likely to be one of numerous measures employed by the government as it seeks to reduce the amount of carbon produced per unit of economic output by about 40% on 2005 levels within seven years.

This was part of the rationale for Crestview Partners and CITIC Capital Partners' acquisition of Canada-based Stackpole International last week. "We expect to see significant growth in the pumps business during our holding period, says Boon Chew, managing director at CITIC. "The China element isn't as large as it should be today and not as large as we expect it to be in five years."

This is the 13th investment from CITIC's international funds – it is now on the third vehicle, which closed in 2011 and is 30% deployed – and the strategy follows that of its forbears: identify a Western company that is underachieving or underpenetrated in China and help realize the potential.

Stackpole is being acquired from Sterling Group and Current Capital for $512 million including debt. The two US PE firms carved out the business from Gates Corporation in 2011, after Gates' parent – UK manufacturer Tomkins – was bought by Onex Corp. and Canada Pension Plan Investment Board.

There are two business lines: variable displacement oil pumps and powdered metals, which are also used in the auto industry to manufacture lightweight components for fuel-efficient vehicles. The latter is already well established in China through a joint venture with Halle Group of Korea.

While Crestview addresses the North America and European markets that account for the bulk of Stackpole's revenues, CITIC will help the company expand operations in China on the pumps side, utilizing its local resources.

It is something CITIC has done before and expects to do again. "With any North American industrial business there is a good chance that they have a decent China component," he explains. "The key change for us was the emergence of China as an end market for businesses across multiple sectors. There are many more opportunities today, compared to 2004 when we first starting doing this."

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An active partner

Jane Rowe, senior vice president at Ontario Teachers' Pension Plan, explains the attractions of spin-out GPs in Asia and why co-investment is an important – but not the only – consideration in manager selection

TEACHERS' PRIVATE CAPITAL (TPC), THE private equity and direct investment arm of Ontario Teachers' Pension Plan (OTPP), likes backing Asia spin-outs. Of the seven GPs it backs in the region, five – PAG, MBK Partners, FountainVest Partners, Unitas Capital and Kedaara Capital – were established by PE professionals who left large firms in favor of a more independent existence. And for four out of these five, TPC has been a significant LP since their inception.

"We are always open to meeting talent that wants to do this," says Jane Rowe, senior vice president at Teachers' Private Capital and Infrastructure. "Sometimes funds have proven to be successful and they come on to our radar screen and we will invest, but if we can find the right team to back early in their partnership it has proven to be quite successful for us."

The first of these spin-outs dates back to 2005 when Michael B. Kim departed The Carlyle Group and set up MBK Partners. The firm closed its debut fund the following year at $1.56 billion, with TPC among the anchor investors. This was the largest first-time vehicle raised in the region until Weijian Shan, who moved from TPG Capital to PAG, accumulated $2.5 billion in 2011, also with TPC's support. Last month MBK closed its third North Asia-focused buyout fund at $2.7 billion.

Kedaara is the most recent addition to TPC's Asia portfolio. The Indian GP, set up by Manish Kejriwal, formerly country head of Temasek Holdings, is expected to raise upwards of $500 million for its debut vehicle.

"In India we looked at number of different groups and hadn't found one for which the chemistry felt right. When we think about the guys at Kedaara, we liked the background they brought to the table – a strong mix of local networks and Western training and skills," says Rowe. Her team met with Kedaara a dozen times before closing on the documentation and it wasn't until the sixth meeting that they felt ready to conduct deep due diligence.

Kejriwal's Temasek credentials were a plus point. FountainVest, now into its second fund, was set up by several members of Temasek's China team in 2007, with TPC again participating as an anchor investor. "The chemistry of folks coming from sovereign wealth backgrounds with strong track records has worked well for us so we appreciated that," Rowe adds.

Big spender

OTPP's total assets stood at C$129.5 billion ($126 billion) at the end of 2012, up from C$117.1 billion the previous year, with a 13% return for the 12-month period. The fund's total value has nearly doubled since 2002. TPC has deployed C$12 billion globally, split equally between fund and direct investments. This includes commitments to GPs that invest in Asia out of global funds. Asia-based GPs, meanwhile, have received C$1.5 billion and a further C$1 billion has been committed and is available to be drawn down.

Now that OTPP has an office in Hong Kong, TPC's capacity for co-investment in Asia is likely to increase. Its first co-investment in the region came in 2007 and since then opportunities have been pursued selectively, most recently alongside MBK in South Korea. OTPP's most visible direct and co-investments in Asia have been the work of its public equities and infrastructure units – such as a $300 million pre-IPO commitment to Chinese online retailer JD.com and the A$2.3 billion purchase of a 50-year lease on Sydney Desalination Plant alongside Hastings Fund Management.

While the availability of co-investment is an important consideration for TPC when making allocations, it is not a deal breaker: where there is a low probability of opportunities emerging, more emphasis is placed on projected net returns, and whether a firm can maintain its track record.

"There are two schools of thought on co-investment. We are of the co-underwriting school of thought – partnering with the GP from the very beginning on a particular opportunity and bringing in our own industry experts who have done lots of deals in that sector," says Rowe. "At the other of the spectrum are folks that have no desire to go deep into the due diligence or documentation. Maybe they go to two meetings decide they want to ride on the coattails of the GP."

The criteria for participation are fourfold: the economics must be superior to participating in a fund; TPC is able to learn about a particular geography or sector; it facilitates engagement with GPs and offers insight into operations; and it is more efficient than searching for opportunities independently, i.e. TPC only looks at the small percentage of deals that make it through a GP's due diligence.

OTPP's GP relationships in Asia

	Most recent fund (vintage)	Size (US$m)	Spin-out
FountainVest Partners	Fund II (2012)	1,350	Yes
GSR Ventures	Fund IV (2011)	350	No
Kedaara Capital	Fund I (2012)	500*	Yes
MBK Partners	Fund III (2012)	2,700	Yes
PAG	Fund I (2010)	2,500	Yes
Unison Capital	Fund III (2008)	1,440	No
Unitas Capital	Fund III (2007)	1,200	Yes

* Still fundraising
Note: Does not include global vehicles that invest in Asia
Source: AVCJ Research

Size matters?

One of the reasons that engagement and co-investment are forthcoming is TPC makes sure "the check size we bring to the table allows us to have a mature relationship," Rowe notes. Given the size of the team and the portfolio it manages, TPC would rarely commit less than C$75 million to a GP and it is typically looking to put in C$100-400 million. At the same time, OTPP's founding legislation means the group would not normally exceed 30% of the voting rights of a particular opportunity.

This seems consistent with the broader trend under which large LPs are seeking to make larger commitments to a smaller number of managers, potentially pushing sub $500 million funds outside the scope of relevance.

In the case of TPC, Rowe disagrees. "We can commit around $75 million to a $200 million fund and be a meaningful partner to that fund and the next time that fund comes up it might grow to a $400-500 million. When we think about the funds we are backing, we are in part thinking about the next three funds. We don't guarantee that we'll re-up but good teams are hard to find so we like to keep them when we find them."

PRIVATE EQUITY IN ASIA

Investment Breakdown by Country From January to October 2013

Investee Country	Amt. Invested US$m	No. of Deals	(Disc.)	No. of Investees
China (PRC)	12,183.7	451	315	445
Australia	9,876.4	66	46	64
South Korea	6,889.0	132	122	130
India	6,727.2	326	228	318
Japan	4,100.0	304	234	299
Singapore	957.8	62	49	59
New Zealand	626.6	28	22	27
Vietnam	577.0	8	6	8
Malaysia	536.1	14	10	13
Hong Kong	495.2	11	8	11
Philippines	455.0	7	6	7
Indonesia	395.6	19	4	19
Taiwan	52.0	17	12	17
Thailand	32.0	9	4	9
Mongolia	7.5	1	1	1
Myanmar (Burma)	1.0	1	1	1
Maldives	-	2	-	2
Sri Lanka	-	1	-	1

FUND-RAISING MONITOR

CLOSED FUND

Location: South Korea
Fund Name: MBK Partners III, L.P.
Closing Amount: US$2.7 billion (final close)
Launch Date: September 2012
Fund Manager/Advisor: MBK Partners Ltd.
Stage Focus: Buy-outs (MBO/MBI/LBO), Privatization, Turnaround/ Restructuring
Industry Focus: Financial services, Manufacturing - Heavy, Manufacturing - Light, Media, Medical, Retail/Wholesale, Services - Non-Financial, Telecommunications, Transportation/ Distribution
Geographical Focus: Japan, South Korea
Contact: Lee In Kyung
Phone: (82) 2-3706-8600
Email: Inkyung.Lee@mbkpartnerslp.com
Website: www.mbkpartnerslp.com
Update: MBK Partners, a private equity firm launched by Carlyle Group's former co-head of Asian buyouts Michael Kim, has reached a final close of US$2.7 billion on its third buyout fund, above its original target US$2.25 billion. MBK Partners III will follow a similar strategy to its predecessor, focusing on control transactions in North Asia, specifically in South Korea, China and Taiwan.

NEW FUNDS

Location: Australia
Fund Name: Ironbridge Fund III, L.P.
Target Amount: A$1 billion
Launch Date: September 2013
Fund Manager/Advisor: Ironbridge Capital Pty. Ltd.
Stage Focus: Buy-outs (MBO/MBI/LBO), Expansion/ Growth Capital
Industry Focus: Consumer products/services, Financial services, Medical, Retail/Wholesale, Services - Non-Financial
Geographical Focus: Australia, New Zealand
Contact: Paul Evans
Phone: (61) 2-8211-0651
Email: pevans@ironbridge.com.au
Website: www.ironbridge.com.au
Update: Ironbridge Capital is raising A$1 billion for its third fund to focus on expansion and buyout investment opportunities in Australia and New Zealand.

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