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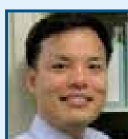

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Flights of fancy

JIANGYIN ZHONGNAN HEAVY INDUSTRIES is a Chinese steel equipment manufacturer harboring an ambition. The Shenzhen-listed company produces more than 40,000 tons per year of pipe fittings and associated paraphernalia, serving petrochemical, shipbuilding, power and oil refining customers at home and abroad. Now it wants to get into the media business.

Last month, Zhongnan Heavy announced it plans to buy Datang Brilliant Media, a TV content producer. It has also teamed up with ZEG Capital, an investment arm of property developer China Zhongzhi Enterprise Group, to raise up to RMB3 billion ($483 million) for a media-focused buyout fund. Zhongnan heavy and its parent will contribute RMB240 million between them.

They envisage the fund as an industry consolidation platform that will invest across TV production, internet media, advertising, entertainment programs and online gaming. The GP will have the option of selling portfolio companies to Zhongnan Heavy.

Zhongnan Heavy is not an isolated case. Dozens of Chinese corporations are looking to get into private equity as part of efforts to satisfy their appetite for M&A.

A strategy that was once the exclusive reserve of technology giants and their corporate venture capital units now stretches across multiple sectors. Just in the last month, Shenzhen-listed Aier Eye Hospital Group has committed to two funds with a view to driving consolidation within the ophthalmology industry.

There are all kinds of ways in: a corporate might absorb an entire private equity investment team and run it as a captive unit; or it could simply go into partnership with a manager, learning about deal sourcing and execution but without incurring heavy set-up costs.

One struggles not to be cynical when hearing of plans devised by the likes of Zhongnan Heavy. Does this company have more money than sense? It is making a giant leap into unfamiliar territory, supposedly as part of a wider business diversification initiative.

Corporate participation in private equity, as the tech sector has proved time and again, is most effective when there is a clear link between the investment strategy and the company's core business. The VC unit supports new technologies, assessing whether if pushed in certain directions they can be of benefit to the parent. This is business development, not flight of fancy.

If Aier Eye Hospital, for example, is an active LP in the funds it has backed and goes away with an understanding of M&A that can be put to good use when making parallel acquisitions on its own, then the exercise will have been worthwhile. The same might be said of Suning Commerce, an offline electronics retailer that is aggressively developing an online business.

However, where there is little strategic alignment between company and fund, there is no compelling incentive to persevere with the project. Asian corporates, often assisted by a low cost of capital, expand and contract in accordance with the prevailing economic climate: they enter new industries when it is cheap and easy to do so, and then shed non-core assets when conditions worsen.

The ultimate beneficiaries of corporates meandering haphazardly into private equity might be secondary investors. Asia's secondaries market is increasingly active, with restructurings and direct acquisitions of portfolios featuring prominently. The sellers are not necessarily conventional LPs and GPs. A corporate under pressure to divest assets might be far more incentivized to get a deal done, whether it is jettisoning a few assets or an entire portfolio with manager attached.

Look out for more secondary deal flow emanating from Chinese corporates a few years from now. It may or may not include interests held by Zhongnan Heavy.

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NEWS

ASIA PACIFIC

FLAG hires Myron Zhu as co-head of Asia

FLAG Capital has appointed Myron Zhu, previously head of J.P. Morgan's alternative investments division in the region, as partner and co-head of Asia. Zhu will lead the 15-strong team alongside Wen Tan.

L Capital Asia invests in Italian footwear maker

L Capital Asia has acquired a stake in Italian high-end footwear manufacturer Vicini, working in partnership with L Capital Management, another PE firm supported by luxury goods conglomerate LVMH. They will take a 30% stake in Vicini, owner of the Giuseppe Zanotti Design brand.

GREATER CHINA

RRJ, Temasek back warehouse developer

RRJ Capital and Temasek Holdings will invest $250 million in Chinese logistics player Shanghai Yupei Group, supporting the nationwide rollout of its warehouse network. This follows a $200 million investment last year by The Carlyle Group.

Cosmetics retailer Jumei targets $400m IPO

Sequoia Capital investee Jumei International Holding, which claims to be China's leading online retailer of beauty products, is seeking to raise up to $400 million through a NASDAQ IPO. Sequoia holds an 18.7% stake in the firm while K2 Partners has 10.3%. Ventech is also an investor.

EQT plans to exit Taiwan cable TV unit

EQT Partners intends to exit its investment in Taiwan cable TV network Gala TV (GTV) for a reported NT$6 billion ($200 million). Potential buyers include domestic industrial conglomerate Formosa Plastics Group and local financial investors, according to local media. Poa-Chuan Lin, CEO of GTV, confirmed EQT's planned sale.

PE-backed WH Group targets $5.3b in HK IPO

WH Group, the Chinese meat processing company that acquired US pork producer Smithfield Foods, is planning to raise up to $5.3 billion through a Hong Kong IPO. The company – formerly known as Shuanghui International Holdings – is selling 3.66 billion shares, of which 20% are held by existing shareholders. CDH Investments, Goldman Sachs, Temasek Holdings and New Horizon Capital could make exits.

Hony supports energy investment platform

Hony Capital will support Canada Capital Energy Corporation (CCEC), a Chinese-owned oil and gas exploration and exploitation company, as it seeks to acquire energy assets in Western Canada. The private equity firm and CCEC's majority shareholders – ZhongRong Group and Zhejiang Rongsheng Holding Group – will contribute over C$500 million ($456 million) to form a jointly-owned corporation. It is unknown how much capital each party will put in.

CCEC said it will look for exploration and exploitation opportunities in the light oil and liquids rich natural gas spaces throughout the Western Canadian Sedimentary Basin. The capital injection will support the firm's strategy "of building a highly valued and balanced portfolio through acquisitions and follow up development."

Zhejiang Rongsheng, which invested in CCEC last year, operates various businesses across petrochemical, polyester, spinning, texturing and coal chemicals in China, Europe, and the US. Last year it posted sales of more than C$10 billion. ZhongRong was established in 1992 as an investment company primarily focused on the real estate sector in China.

Consortium ups take-private bid for Yongye

A consortium supported by Morgan Stanley Private Equity Asia (MSPEA) has modified its take-private bid for Chinese nutrients company Yongye International, sweetening the deal in return for a lower shareholder approval threshold for it to go through. The new bid of $7.10 per share values the NASDAQ-listed company at approximately $360 million.

IKang Healthcare jumps 8.6% on US debut

Shares in iKang Healthcare Group climbed 8.6% on their NASDAQ trading debut following a $153 million IPO. The company sold 10.9 million shares at $14 apiece and watched them reach $17.25 before eventually closing at $15.20. NewQuest Capital Partners and GIC Private both made partial exits through the offering, while China Investment Corp. invested $40 million.

China's AutoNavi agrees to be acquired by Alibaba

AutoNavi Holdings, a Chinese digital mapping and navigation firm, has agreed to be acquired by Alibaba Group in a deal valuing the NASDAQ-listed company at $1.5 billion. Alibaba will pay $21 per share in cash for the 72% of AutoNavi it does not already own. In May, it agreed to buy a 28% stake in the company for $294 million.

Zhongnan Heavy, ZEG Capital launch media fund

Jiangyin Zhongnan Heavy Industries, a Chinese steel equipment manufacturer, and ZEG Capital, an investment arm of China Zhongzhi Enterprise Group, want to raise up to RMB3 billion ($483 million) for a media-focused buyout fund. They are targeting a first close of at least RMB1 billion.

Jack Ma invests VC-backed Wasu Media

Alibaba Group founder Jack Ma and several co-investors have agreed to buy a 20% stake in Wasu Media Holdings, a Hangzhou-based digital media operator backed by several VC firms, for RMB6.54 billion ($1.06 billion).

DCM commits $9m to China's DerbySoft

DCM has committed $9 million in a Series D round of funding for DerbySoft, a Chinese hotel technology solutions provider. Founded in 2002, DerbySoft offers IT technology solutions that connect hotels to travel agencies with online booking sites such as TripAdvisor and Ctrip.

PE-backed Digital Horizon to list via reverse merger

Beijing Digital Horizon Technology, a Chinese mobile social networking service (SNS) provider

backed by Infinity Group and other VC investors, intends to list in Shenzhen via a reverse merger. Digital Horizon will inject its assets into Hangzhou New Century Information Technology and the listed company will then buy shares from Digital Horizon's existing shareholders.

NORTH ASIA

Cerberus refuses to sell shares in Seibu IPO

Cerberus Capital Management pulled out of the Tokyo IPO of Japanese railway and hotel operator Seibu Holdings. The move came after Seibu said it would sell shares at JPY1,600-1,800 apiece – below earlier guidance of JPY2,300 a share – in response to weak public markets. Cerberus, which owns a 35.48% stake, had been expected to sell a 15.5% interest.

Jafco raises $260m for fifth global VC fund

Jafco Ventures has reached a final close on its latest global fund at $260 million for its latest global fund. The vehicle is the largest the firm has ever raised. Jafco Technology Fund V has tapped a group of over 20 new LPs. All of the capital in the previous four funds came from parent organization Jafco Japan.

Japan Industrial Partners exits Yutaka Electric

Japan Industrial Partners (JIP) has exited electrical component manufacturer Yutaka Electric to GlassOne, a manufacturer of touch screen panels for tablets and smart phones. The business was acquired by JIP in January 2006 through a carve-out from Nippon Steel Corporation. JIP paid JPY1.2 billion (then around $10.4 million) for an 85.7% stake in the company.

INCJ exits 5% stake in UK's Seajacks to Marubeni

State-backed Innovation Network Corporation of Japan (INCJ) has sold a 5% stake in UK offshore energy services provider Seajacks to its Japanese co-owner Marubeni Corporation. INCJ how holds a 45% stake in the business. INCJ and Marubeni bought Seajacks from US PE firm Riverstone Holdings in 2012, paying around $1.7 billlion.

Japan's B Dash backs photo curation site Iemo

Japanese VC firm B Dash Ventures has invested an undisclosed sum in Iemo, an interior design-focused photo site. Launched in 2013 by serial entrepreneur Mari Murata, Iemo is comparable to other more established photo curation websites such as Pinterest and Fancy.

India's Ratnakar Bank raises $55m from investors

India's Ratnakar Bank has raised INR3.28 billion ($54.6 million) from a consortium of investors, including CDC Group and Asia Capital & Advisors, in return for a minority stake. The sum includes CDC's recently disclosed investment of $28 million for a 4.8% stake, which valued the bank at INR35 billion. The round brings Ratnakar's total disclosed private funding to date to more than $230 million.

Existing investors, including World Bank investment arm International Finance Corporation (IFC) and Gaja Capital, are also revealed to have made fresh investments. There are several other existing PE backers, including Norwest Venture Partners, Beacon India Private Equity, Faering Capital and Samara Capital, but it is not known if they participated. The funding will be used to expand Ratnakar's branch network in semi-urban and rural areas of India.

The bank was founded in 1943 and

traditionally concentrated on Maharashtra, Karnataka and Goa. A new management team - led by former Bank of America executive Vishwavir Ahuja - arrived in 2010 and the lender altered its strategy to focus on lending to small and medium-sized enterprises (SMEs) across a wider geographic area.

SOUTH ASIA

India's Avendus, Zodius launch $500m tech fund

Indian financial services company Avendus Capital has partnered with PE firm Zodius Capital to launch a $500 million fund targeting technology companies. The fund, Zodius Capital II, will have a particular focus on late stage and pre-IPO investment in digital and SMAC (social, mobile, analytics and cloud) companies.

SEBI to issue crowdfunding guidelines

India's securities regulator plans to issue guidelines for crowdfunding as part of efforts to open up additional financing channels for start-ups. U.K. Sinha, chairman of the Securities and Exchange Board of India (SEBI), told an investor conference the aim is to "help young people raise capital very smoothly."

Ineda Systems raises $17m Series B round

Ineda Systems, a US and India-based developer of chip components targeting the wearable and internet of things segment, has raised a $17 million round of Series B funding led by Walden-Riverwood Ventures. Samsung Catalyst Fund, Qualcomm Ventures and IndusAge Partners also took part in the round alongside existing investor Imagination Technologies.

SOUTHEAST ASIA

Temasek opens up PE portfolio to investors

Temasek Holdings has launched a co-investment vehicle – called Astrea II – allowing six outside institutional investors exposure to its PE funds portfolio. Ardian, formerly known as Axa Private Equity, is one of the six co-investors and has been appointed general partner and manager of the vehicle. Temasek is the single largest shareholder with a 38% stake.

Mekong, CDH set for partial exits from Mobile World

Mekong Capital and CDH Investments will make partial exits from Mobile World, Vietnam's largest mobile phone retailer, when the company lists on the Ho Chi Minh exchange in June with an expected valuation of up to $280 million. The two PE firms will also sell a small portion of shares via a pre-IPO private placement in order to meet free float requirements.

Vertex leads round for taxi-booking app

Vertex Ventures, a unit of Temasek Holdings, has led a round of funding for GrabTaxi, a taxi booking app set up in Malaysia that is looking to continue its expansion into other Southeast Asian markets. The investor group comprises predominantly Malaysian investors. The round is said to be worth at least $10 million.

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Home-made remedies

Private equity firms, and the LPs, are placing greater emphasis on adding value to portfolio companies. But what is the best way of developing operational capabilities in Asia, and who should pick up the tab?

THE TYPICAL ASIAN GP IS CHANGING. In the early years, the average private equity shop might have comprised a small group of deal professionals with investment banking backgrounds. Fast forward to the present and the bankers are still there, but they are increasingly complemented by partners from broad range of disciplines: consultants, former Big Four auditors and CEOs from various industries.

This transition is largely a function of the evolving environment in which GPs operate.

They were passive investors taking minority stakes in emerging markets businesses and relying on a combination of multiples arbitrage and macroeconomic growth for returns, but there is now a sense that the low-hanging fruit has been picked. There is more competition for deals and portfolio companies face more challenging commercial conditions. Investors and investees expect PE firms to offer guidance and expertise in addition to capital.

Rumblings started among the larger players but they are now percolating through the lower tiers of the market. The onus is on operational capabilities as a means of driving growth. In this context, the need for a diverse range of talents is clear.

For GPs reassessing their approach, the question becomes how to best accommodate new blood. Building a large in-house operating division is not easy. It requires resources that are beyond some firms, while others might rely on the capabilities and experience of the existing deal team. As part of this discussion, GPs must decide what can be dealt with in-house and what should be outsourced to third parties. The challenge is identifying the most cost-effective solution and figuring out who pays for it.

"In the last five years there have been a number of cases – especially in the US and Europe – where we have had to get the EBITDA up by working the operational fundamentals of a company," says C.V. Ramachandran, managing director and head of Asia at AlixPartners, a consultancy specializing in turnarounds.

"That trend is starting to come to Asia. A case in point is India where a lot of funds in the 20007 and 2008 vintages ended up paying top dollar for assets only to see the devaluation of the rupee later. When prices start dropping, private equity needs to do something different."

Operational involvement as a means of driving returns when macroeconomic shifts – whether the global financial crisis in Europe or a capital flight and currency crisis in India – have thrown growth projections off track is one factor. Another is opportunity.

While private equity in Asia, dominated by emerging markets like China and India, remains a predominantly growth capital game, control transactions are on the rise. According to AVCJ Research, there were 199 buyouts in the region last year, the most since 2008. Minority growth deals, have declined every year since 2011, in part reflecting the lower exit multiples available through public market exits in China.

> "Our human capital organization helps us assess all the leadership teams before we go into an investment and if there are gaps in management we will go out and source the appropriate individuals" – Steve Schneider

In or out?

What has become apparent through the emergence of operational value-add models in Western markets and now in Asia is that there is no one-size-fits-all solution. A GP's approach depends on its resources, its remit and the markets in which it operates.

The global buyout firms, with their substantial resources and presence in multiple geographies, have tended to focus on in-house teams.

KKR established Capstone, its internal operations division which operates as a separate entity, in 2000 and brought it to Asia in 2008. The regional team is now 18-strong, with five professionals in Hong Kong and the rest deployed around the region.

"We decided that we wanted to go beyond the board and into the companies," Scott Bookmyer, head of KKR Capstone in Asia, told the AVCJ Forum in Hong Kong last November. "There is not one right way to do this, there is a lot of great governance and lot of great value creation that can happen outside of that, but we decided build a team with proven experienced executive."

TPG Capital took a similar approach. However, rather than build a stand-alone entity within its organization, the firm developed a network of operating partners, known as the Human Capital Team. A total of 19 team members are based in Asia, including three operating partners and 16 senior advisors.

"Our human capital organization helps us assess all the leadership teams before we go into an investment and if there are gaps in the management we will go out and source the appropriate individuals," explains Steve Schneider, a partner at TPG and head of Asia operations. "If you get the management right, and the incentives right, you end up with a pretty good outcome."

While the global buyout firms may have taken the lead in building out operational capabilities, a number of smaller GPs with narrower geographic remits have embraced the concept, albeit on a less grand scale.

Navis Capital Partners is one such example. Set up in 1998 by a group of former Boston Consulting Group executives, the firm has spent the last 16 years developing its capabilities to the point that most operating functions can now be carried out in-house. While there is no separate operations unit, Navis draws on the experience of its deal team to drive value-add.

"We are on the extreme end of in-sourcing," says Rodney Muse, the firm's co-managing partner. "Our deal teams are slightly different in composition to your average PE firm in that they have more operational experience than financial engineering experience. Part of their mandate is to go in and assist in operational improvements in general."

Lunar Capital – a consumer-focused mid-market buyout firm in China – has also found a

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way to bring about operational improvement without a dedicated in-house team. The PE firm recruits individuals with relevant expertise before making an investment and uses them during the due diligence process. They are then offered salary-plus-equity packages as CEOs of portfolio companies.

Third-party help

For the vast majority of regional and country GPs in Asia, operational capabilities come from a combination of internal and external sources. It is just not economical to provide certain specialist services, often required on an ad-hoc basis, in-house.

Unitas Capital has three deal partners and four operating partners working on every investment; one deal partner and one operating partner then assume responsibility for the business in the post-investment period. But it still uses third-party service providers. "We have a clear idea of where the opportunities are but realizing these opportunities can depend on detailed work such as data collection and significant in-depth analyses of the business," says Ajeet Singh, a partner at Unitas.

He cites the example of Hyva, a manufacturer of hydraulic cylinders and hydraulic-tipping solutions used for heavy-duty transportation equipment. Unitas acquired the business in 2011 and then hired a consultant to spend six weeks examining the company's procurement processes – what components it was buying, where they were being bought, and how many suppliers were being used globally.

"Collecting all that information requires a fair amount of time and that is where we would use a consultant because companies typically don't have that scale to collect that information in a manner through which we can devise a strategy," Singh says.

Furthermore, the extent to which a GP can rely on its in-house resource is arguably limited. Even those with substantial operational resources call in a third-party consultant when a company requires support beyond what the GP can offer. Schneider notes that TPG has been known to bring in external advisors for operational turnarounds where the skill-set needed is not one the firm would want to keep in-house full time.

In these situations, AlixPartners is often the service provider that receives the call. Ramachandran explains that is his firm is often brought in a few months or even up to two years after the initial investment when a company is not hitting is targets. And it is not necessarily smaller GPs that are in need of assistance.

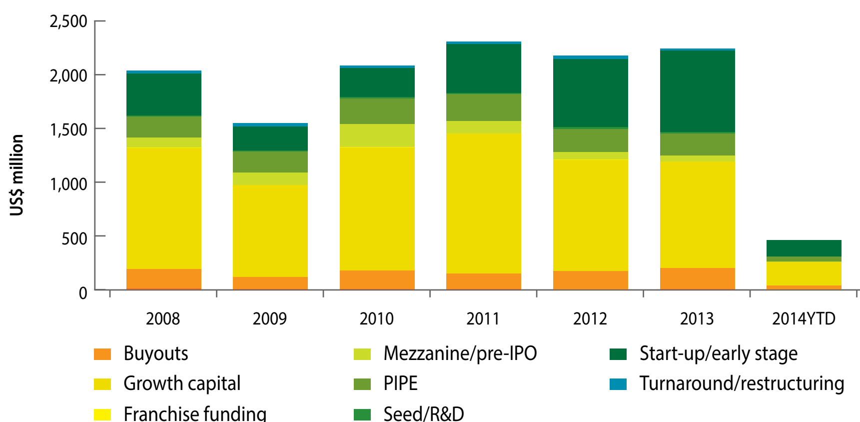
"We find there is a big segmentation by size; the smaller GP spends a lot more time getting the deal right because it doesn't have the bandwidth to fix the companies," Ramachandran says. "Whereas the bigger guys take more risks and so they need more operating help."

Nevertheless, there are still private equity firms that resolutely oppose the use of external consultants. Creador, a minority investor focused on Indonesia, Malaysia and India, recently launched its own operating unit because it doesn't believe third-parties can meet its needs. Known as Creador+, the team comprises former Boston Consulting Group employees.

"We don't believe in using external consultants for two reasons," explains Brahmal Vasudevan, founder and CEO of Creador. "First, a strategic consultant tends to be very expensive, and second, the strategy is often not implementable. We believe that whatever strategy we come in with, we have to have to make it work from an implementation standpoint, hence we believe in handling these functions internally."

This explanation offers insight into how GPs are grappling with the financial burden of investing in improved operating capabilities. An in-house team might be expensive to assemble but if it can address portfolio companies' needs quickly and effectively, does it make more sense than hiring a third-party service provider whose fresh pair of eyes might not deliver workable solutions?

Asian PE deals by financing stage



Source: AVCJ Research

Cost considerations

In the past, GPs have been able to charge for their services by charging fees to portfolio companies in addition to the standard management fees and carried interest. However, these so-called monitoring fees for management and advisory services have come under increasing scrutiny from both regulators and LPs.

Most industry participants note there has been a shift away from the practice of charging portfolio companies fees since the global financial crisis. There are two reasons for this. First, the more challenging fundraising environment of recent years has presented LPs with greater leverage in dictating terms and demanding concessions from GPs.

"It is very hard now for any GP to get away with charging substantial fees to portfolio companies that are not reimbursed back to the LPs," says one fund-of-funds LP who asked not to be named. "Few LPs are willing to tolerate that and, for ourselves, we have not committed any capital to a fund where there has not been 100% fee offset for many years."

It leaves GPs with the dilemma of being required to invest in deeper operational capabilities and receiving lower fees in return.

Second, additional pressure has come via the International Limited Partners Association (ILPA) Private Equity Principles – a set of principles intended to deliver alignment of interest, governance and transparency between GP and LPs.

The guidelines state that all fees charged to the fund or any portfolio company by an affiliate of the GP should also be disclosed. Furthermore, any transaction, monitoring, directory, advisory, exit fees and other considerations charged to a portfolio companies by the GP should accrue to the benefit of the fund.

More recently, the US Securities and Exchange Commission (SEC) has also got in on the act. The regulator has formed a dedicated group to investigate private equity firms. Its reported areas of focus are said to include the fees charged to portfolio companies.

Accordingly, GPs are increasingly steering clear of potential controversy and scrutiny. Navis, for example, claims that integral part of its business model is that is does include any charges for value-added services extended to portfolio companies.

"That is important because you do not want the management or shareholders of a portfolio company to think, 'Are these guys in it for equity appreciation or are they in it for the management fees?'" says Muse. "Any kind of fee is leakage – at a minimum it is leakage from other shareholders and at worst it is leakage from LPs. We don't do it and we are very explicit about it."

This approach has been mirrored by a number of GPs, and it is not limited to those in the buyout space – as evidenced by the launch of Creador+. Vasudevan rejected the idea that the GP would ever charge for its services.

"We decided it is an important investment for us, and that most of the value we get should be created through the carried interest," he says. "We believe that if we do the right thing the profit share is where the team will create their value and the LPs will see this as a clear differentiator."

Mixed bag

There are, however, probably almost as many ways of charging portfolio companies for operational improvement as there are models for operational improvement itself. And no approach is definitely right or wrong.

KKR's Capstone, for example, is a stand-alone entity and so fees are not charged directly by the GP. The unit will invoice portfolio companies for services, but only so far as to cover its costs. The rationale is that this is cheaper than outsourcing the function to a third-party provider.

Additionally, fees charged to a portfolio companies by third-party providers are still accepted as part of the value-add process – as was the case with Unitas and Hyva.

"These services are paid for by the portfolio company as an investment leading to improvement," says Unitas' Singh. "It is an investment that is taking cost out, so any expense the portfolio company incurs is for future profitability."

Clearly, how private equity firms deploy their resources towards achieving operational value-add depends on their specific needs. But as the example of Creador+ illustrates, more GPs are having the internal conversation, including those whose remit would not normally warrant it.

No one, it appears, is immune from broader industry sentiment. Whether investments in operational capabilities pay off for private equity firms across the strategic spectrum remains to be seen, but LPs are generally less willing to back GPs in Asia that don't these capabilities.

As one LP observes, these concerns are a natural function of a more competitive environment and concerns about the sustainability of returns. "If you are looking for a sustainable source of return, you are looking for a sustainable source of value creation, and operational value-add is it," he adds.

> **"Any kind of fee is leakage – at a minimum it is leakage from other shareholders and at worst it is leakage from LPs. We don't do it and we are very explicit about it"**
>
> – Rodney Muse

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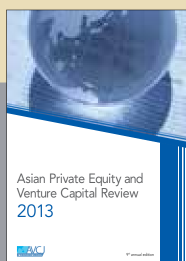

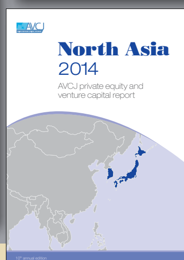

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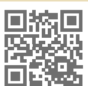

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Big fish, small fish

Country fund stars, China VCs make their mark on fundraising; the trade sale spike won't be sustained and the IPO surge may falter too; South Korean buyouts continue to create headlines

1) Fundraising: Of big fish and VCs

In a weak first quarter for private equity fundraising, few lines point upwards. Commitments to Asia-based managers reached $6.6 billion, the lowest quarterly total since the first three months of 2009. Even then, with the industry still reeling from the global financial crisis, 91 managers reached an incremental or final close. In the first quarter of 2014, there were 34 closes.

The numbers, provided by AVCJ Research, are provisional and evidence of further activity will no doubt trickle out, but they do not make for comforting reading. China and Australia are the only markets to see a quarter-on-quarter increase in capital raised. In both cases, there is an element of big fish tipping the scales.

Quadrant Private Equity is one of a handful of Australian GPs capable of raising $750 million or more and it duly closed its seventh fund – and fourth as an independent – at A$850 million ($758 million) in almost no time at all.

Meanwhile, nearly $0.90 in every $1 committed to a China fund in the first quarter went to a US dollar-denominated vehicle; and half of each $0.90 ended up in the second and final close of CDH Fund V. At $2.55 billion it is the largest China fund ever raised by an independent manager.

However, CDH is not the only interesting story behind the China data. As more capital entered US dollar funds than in any quarter since July-September 2011, the big fish was joined by several distinguished smaller fish. Only eight China venture capital funds reached a close in the first three months of 2014, well below the average of 15 for the last two years, but they raised $1.3 billion between them, the largest quarterly total in about two years.

Qiming Venture Partners and DCM led the way. The former took just a few months to accumulate $500 million for its fourth US dollar fund. The latter closed DCM VII at $330 million, above target but smaller than its predecessors in anticipation of reduced activity in the US, although China will play a more significant role.

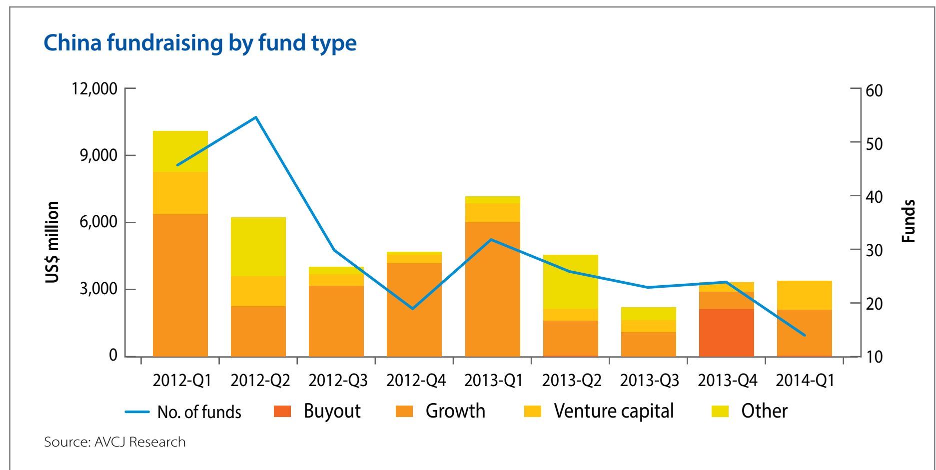
With GGV Capital expected to close its fifth US and China-focused fund at around $500 million this month – with a further $100 million from renminbi investors – and Legend Capital likely to raise $500 million for its sixth vehicle, the outlook for venture capital fundraising in 2014 seems positive.

This is largely in keeping with the global climate: distributions by North American VCs outpaced contributions for the first time in a decade in 2011 and the trend has continued over the last two years. With capital coming back to them, LPs are more likely to re-up. China-focused managers – particularly those with cross-border funds or affiliations – benefit from this positive sentiment, and that's without even factoring in the return of US IPOs and the spate of trade sales.

Another common characteristic of the US and China markets is that the leaders appear entrenched.

It is difficult to pick outright winners given most China VCs have been around for less than two decades, but the same faces continue to lead the pack. Can they be supplanted by young upstarts? The unknown factor is not US institutional money that remains the industry's lifeblood; it is arguably local high net worth individuals (HNWIs) and family offices.

When IDG Capital Partners' tech, media and telecom team spun out to form Banyan Capital, more than half the $206 million they raised for



Source: AVCJ Research

Largest PE deals, 1Q 2014

Investee	Amount (US$m)	Investor(s)
A.S. Watson & Co (Hong Kong)	5,660.3	Temasek Holdings
Global Logistic Properties China (China)	2,350.0	Bank of China; Hopu Investments; Others unnamed
Olam International (Singapore)	2,042.5	Temasek Holdings
ADT Caps (South Korea	1,920.0	The Carlyle Group
Jaiprakash Power Ventures* (India)	1,638.5	Abu Dhabi National Energy Company; PSP Investments; IDFC
Hyundai Merchant Marine* (South Korea)	1,023.0	IMM Investment
NEC Biglobe (Japan)	874.5	Japan Industrial Partners
I-Med Holdings (Australia)	493.0	EQT Partners
Shanda Games (China)	452.2	Primavera Capital
Sensis (Australia)	406.0	Platinum Equity
Sony Corp* (Japan)	393.1	Japan Industrial Partners
Beijing Sanyuan Foods (China)	328.3	Fosun

Source: AVCJ Research

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their debut fund, which closed in January, came from HNWIs. These were predominantly the founders and CEOs of Chinese companies the team had backed while at IDG.

2) Exits: Can strong trade sales, IPOs be sustained?

What a difference Asia's largest-ever trade sale makes. Deduct the $5.8 billion KKR and Affinity Equity Partners received from Anheuser-Busch InBev for South Korea's Oriental Brewery (OB) and the first quarter trade sale data look decidedly ordinary – $1.6 billion, down 75% on the previous three-month period. As it is, buoyed by OB, exits as a whole are flying high at $12.9 billion, the most since July-September 2012 when Enterprise Turnaround Initiative Corporation's exit from Japan Airlines distorted the numbers.

In the absence of a couple more large ticket transactions, the trade sale figure may moderate in the second quarter. The big question is whether IPOs will do the same.

After jumping from $3.5 billion in July-September 2013 to $9.9 billion in the subsequent quarter on the back of renewed activity in China and Australia, private equity-backed offerings have maintained an even keel. There were 53 IPOs in the first quarter of 2014, down from 73 in the previous three months, but they still generated cumulative proceeds of $9.6 billion.

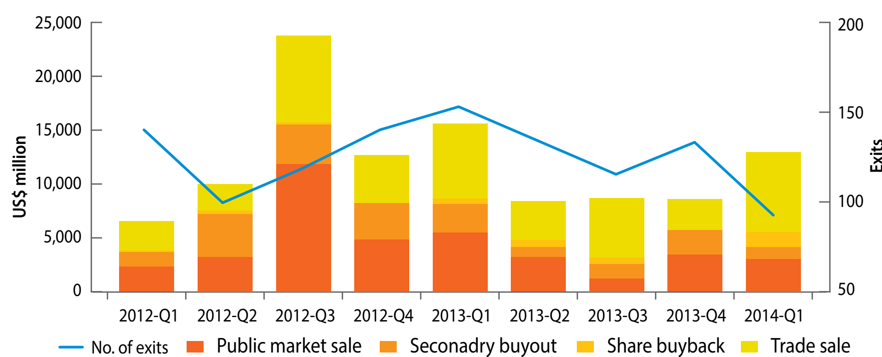
However, nearly half of these proceeds came from two offerings: Innovation Network Corporation of Japan's (INCJ) $3.3 billion listing of Japan Display, which was poorly received and continues to trail its IPO price; and a $1.1 billion float by Harbin Bank that was supported by CITIC Capital, among others, as a cornerstone investor. It also priced at the lower end of the indicative range and is currently trading below the offering level.

In short, neither of these offerings represents a liquidity event for a traditional private equity investor and both are indicative of weakness in what remains a selective market.

While the huge backlog of companies seeking to go public in the mainland should see the Shanghai and Shenzhen bourses remain busy for the foreseeable future, there has been a noticeable slowdown in Australia. Seven PE-backed offerings raised $2.2 billion between them in the last quarter of 2013, with six of these coming in December, and there was talk of a healthy pipeline stretching into 2014.

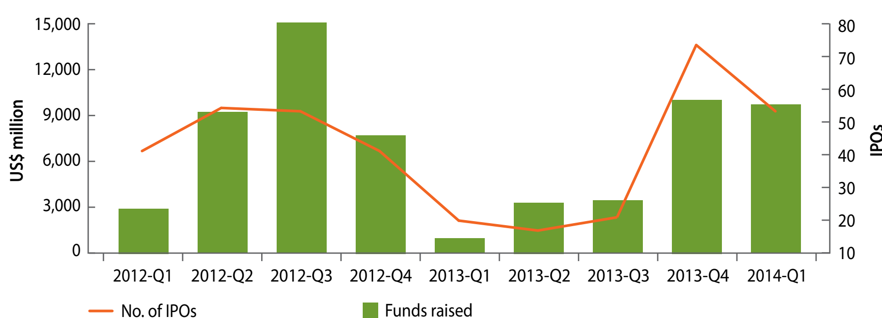
However, after the weak response to CHAMP Ventures-backed SG Fleet Holdings – following a price cut, the offering was oversubscribed, raising A$188.6 million, but the stock is currently trading at a near 10% deficit to the IPO price – other deals have been shrouded in uncertainty. Mantra Hotels and OzSale were among those to shelve offerings at the end of March and it is thought more could follow.

Asia private equity exits by type



Source: AVCJ Research

Private equity-backed IPOs



Source: AVCJ Research

3) Investment: Korea continues to impress

South Korean buyouts were one of the stories of 2013 and they have continued into the first three months of 2014. The Carlyle Group's acquisition of fire safety and security systems provider Tyco International's local unit for $1.93 billion, which was agreed in March, represents the largest PE buyout in Korea for seven years.

With two announced investments by Korean GP IMM Private Equity also among the 15 largest in Asia for January-March 2014, total PE deal flow jumped to $3.6 billion, the largest quarterly total in nearly five years. Korea accounted for 35% of the $9.9 billion channeled into buyouts region-wide during the period. This compares to a 19% share of the $25.8 billion in buyouts announced in Asia last year.

Korea may not be a particularly deep market – there were eight buyouts in the first quarter, out of 20 transactions in total. But a combination of divestments by conglomerates either in distress or under political pressure, multinational carve-outs and auctions of state-owned assets ensures that when assets do come onto the market they are of reasonable size.

Private equity investment in Asia as a whole reached $23.8 billion in the first quarter, the highest level since late 2010 when the Chinese pre-IPO machine was still purring and growth deals from that market made up the bulk of deal flow. Buyouts were up 100% quarter-on-quarter while growth deals came in at $10.9 billion, an 81% gain on the previous three months.

Obviously it wasn't all Korea. Temasek Holdings moved the needle on both the buyout and growth scales, with its $2.1 billion bid for full ownership of agricultural commodities conglomerate Olam International and $5.7 billion purchase of a 24.95% stake in Hong Kong-headquartered health and beauty retailer A.S. Watson, respectively.

Another significant transaction saw Abu Dhabi National Energy Company, PSP Investments and IDFC Alternatives pay $1.6 billion for two Indian hydropower projects sold by a subsidiary of India's debt-laden Jaypee Group.

These deals are yet another reminder of the amount of private "shadow capital" being put to work by large institutions beyond traditional PE structures, either working alongside GPs or acting independently of third-party managers.

IMAX serves as real estate proxy

THE NEW CENTURY GLOBAL CENTER, in Chengdu, Sichuan province, is the world's largest freestanding building, nearly three times the size of The Pentagon. The 1.76-million-square-meter facility includes offices, shopping malls, a Mediterranean village and an IMAX movie theater.

An estimated 150 shopping malls were due to open in China's 20 largest real estate markets last year, according to Jones Lang LaSalle. This retail-oriented construction spree – and the knock-on effect in terms of demand for multiplex tenants – is one of the reasons why FountainVest Partners teamed up with CMC Capital Partners to buy a 20% stake in movie theater operator IMAX's China business for $80 million.

IMAX: Expanding in China

However, it was not the only reason. The private equity firm had considered investing in movie theaters before but never made the leap.

"The revenue sharing and rental costs vis-à-vis the shopping mall owners have always been a key factor driving the profitability of multiplex operators," a source familiar with the transaction tells AVCJ. "IMAX is a great business given its proprietary technology and the revenue-sharing model with the movies. They share in the success but don't have to pay the additional rental."

China is the world's second-largest movie market with box office sales growing 27% year-on-year in 2013 to reach $3.6 billion, according to the Motion Picture Association of America. Greater China – including Hong Kong and Taiwan as well as the mainland – is IMAX's second-largest and fastest-growing market, accounting for approximately 19% of its $287.9 million in revenue last year.

The company opened its first theater in the mainland in 2011 and had a total of 173 in operation in Greater China as of December 2013, with an additional 239 planned for installation by 2021. Greater China accounts for 58.7% of IMAX's current global backlog. It has a partnership with Wanda Cinema Line Corporation, China's largest movie theater chain, and is working with a unit of television manufacturer TCL Corporation on develop premium home theater systems.

IMAX decided to bring in external investors in part because of how its business has evolved globally and in China. The company has gone from a straight equipment retail model to revenue-sharing model with cinema operators, whereby it defers a portion of the up-front payment for a share of box office revenues from the screens. More capital was required to sustain this approach.

"And then the media industry is growing fast but it needs navigation, so they wanted Chinese partners to grow the business with them," the source adds.

It is said that FountainVest brought in CMC to help with the navigation. The media and entertainment-focused GP has a string of state-owned sponsors and is run by Ruigang Li, former president of Shanghai Media Group, which has extensive interests in film and television production.

Lightspeed bets on financial disruption

REGULATION IS THE PRIMARY CONCERN for PE and VC firms considering investments in China's peer-to-peer (P2P) lending industry. The market opportunity has never really been in doubt. Online P2P lending platforms are a bridge between individual lenders and small-scale start-ups; they can fill the funding gap left by banks that prefer to lend to larger enterprises.

The government's concern is that P2P lenders are behaving like banks but aren't regulated, which may lead to consumers getting hurt. According to market research firm Reportstack, 71 of the at least 800 online lending platforms operating in China last year went bankrupt.

"There is still a lot of uncertainty but we feel the pure online model – where it is consumer-to-consumer – is the cleanest from a regulatory perspective and also the most scalable," says Ron Cao, managing partner at Lightspeed China Partners. "We don't touch the money, it's completely P2P. The platform provides information on risk so consumers can make their decisions."

Lightspeed invested in 99Bill, one of China's earliest online payment companies, in 2006. It took several years for the regulators to establish an approach and issue licenses. Cao sees the P2P lending following a similar evolutionary path.

With this in mind, Lightspeed led a Series B round of funding for PPDai, the largest online-only P2P platform. The round was worth tens of millions of dollars – Cao declined to be more specific – and including contributions from existing investor Sequoia Capital and wealth manager Noah Holdings. The new capital will be used for operations and the continued enhancement of the platform's online credit scoring system and IT infrastructure.

P2P lending: Regulatory issues

Founded in 2007, PPDai's service is free for lenders, while borrowers pay a commission. The company charges 2% of the borrowed amount for loans with a term less than six months, and 4% for loans with longer period. PPDai claims to differ from many practitioners by virtue of its strong risk controls. It conducts 2,000 dimensions of analysis to determine a borrower's default risk.

"They take all kinds of data, whether it's information provided by the borrowers or social media," Cao adds. "For example, they look at the borrower's Weibo account and track how often they post, what industry they are from, where they are located and how people in that geographic area have behaved in the past. All those data are crunched."

PPDai's market share is tiny – like all online P2P operators – although Celent notes that the broader P2P lending market grew from $30 million in 2009 to $940 million in 2012. It is on course to reach $7.8 billion by 2015. Consolidation is likely but Cao doesn't see it as a zero-sum game.

"They are so small compared to how big they can be – they could get to tens of millions of users," he says. "Most companies take money from one side, guarantee some sort of return and lend it to another side for a profit. That's the basic idea but there will be variations, such as companies that focus on car financing."

Vision Knight's institutional upgrade

A MARK OF A SUCCESSFUL FIRST FUND IS increasing interest from institutional investors in its successor.

Vision Knight Capital relied on commitments from high net worth individuals and family offices for 75% of the $250 million raised for its first fund in 2012. But Fund II, which last week closed at the hard cap of $550 million, is more of an institutional affair. Sovereign wealth funds, pension funds, endowments and fund-of-funds account for 70% of the corpus.

David Wei, the former CEO of Alibaba.com who co-founded Vision Knight, says the new fund was substantially oversubscribed, with more than $1 billion in prospective commitments. The GP decided against seeking to increase the hard cap, concluding that $500-$550 million was appropriate for its strategy.

US investors make up the bulk of Vision Knight's more diversified investor base, followed by Asia. However, there was still room for all LPs in Fund I to re-up in Fund II, including Jack Ma, co-founder of Alibaba Group and Wei's former boss, and Hong Kong telecom operator PCCW.

Wei stresses that Ma is investing from his own pocket, not Alibaba's. "As a private equity house, we need to be independent and keep a neutral stance from the corporate money, because corporates will have a strategic agenda and purpose for investing," he says.

The new fund will continue its predecessor's strategy of focusing on internet-related businesses, e-commerce and traditional retailers that can be transformed by e-commerce.

David Wei: Has dry powder

Since Vision Knight's approach is operations-driven, it positions itself as a PE rather than a VC investor. The firm has five consulting operational partners and one investment partner. Once a suitable target has been identified, Vision Knight will provides three months of free operational and strategic consulting to convince the entrepreneur that it can add value. This contrasts with the typical PE model of post-investment improvement.

"We're not competing with other funds. They follow the opportunity, chasing hot deals, but we are creating investment opportunity," says Wei. "Of our first 10 projects, seven weren't looking to raise capital when we invested in them."

After two-and-a-half years, Fund I is almost fully invested in those 10 companies. "The holding period for internet firms is around three years because the industry is much more volatile. For the consumer sector, we will hold longer," Wei explains.

Vision Knight has made two full exits from Fund I, online video business PPS and NetDragon Websoft's mobile app store 91 Wireless, both through trade sales to Baidu. Another portfolio company, lottery site 500.com, went public in the US last year but the PE firm has yet to sell any shares.

For Fund II, Wei expects more cross-broader transactions as Chinese tech and consumer players expand overseas. "That's why we need our global LP base – they might be able to help on cross-border deals," he adds.

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Looking overseas

Hong Kong-listed China Everbright is transforming itself from a brokerage into a multi-platform asset manager. CEO Shuang Chen explains how this will work and the role private equity is expected to play

Q: How does China Everbright transition from a broker to an asset manager?

A: We were an investment banker and broker in China and Hong Kong before 2011. We sold the Hong Kong brokerage and banking units and then re-positioned China Everbright as a macro asset management platform. Our parent company, China Everbright Group, holds a 49% interest in us; and we have two stakes in non-core businesses in China – 3.51% in Everbright Bank and 33.33% in Everbright Securities. When the opportunity arises, we will exit these stakes to our parent. This will leave China Everbright with four core businesses: primary markets, secondary markets including hedge funds, structured financing (through mezzanine funds) and aircraft leasing. We expect to grow total assets under management (AUM) by more than 30% year-on-year in these four areas.

Q: Primary markets account for the largest portion of AUM. How has Everbright developed in this space?

A: Primary markets comprises three US dollar-denominated PE funds, three renminbi venture vehicles and five sector-focused funds. While investing in early-stage companies in China is challenging, we adjusted our strategy to focus more on expansion investments and industry funds. We have recently launched new funds specializing in healthcare, new energy, advanced manufacturing and cross-border transactions.

Q: How independent are you from China Everbright Group in terms of fundraising?

A: We work independently from our parent. We [China Everbright] serve as anchor investor in the funds, although the sums committed vary. When China Everbright set up its first PE investment unit in Shenzhen in 2001, all the capital came from internal sources, but we soon realized this solution was not sustainable and started to raise capital from outside investors in 2003. The first US dollar vehicle – the $50 million Special Opportunities Fund I – received about 20% of its commitments from US investors and the rest came from our balance sheet. We are now raising the fourth US dollar fund for the Special Opportunities Fund series and the China Everbright contribution will be around 20%.

Q: What is the fundraising environment like right now?

A: Renminbi fundraising has slowed significantly since 2012. Domestic investors are less mature and target short-term profit rather than long-term returns. There are few institutional investors in China, such as the National Council for Social Security Fund (NSSF) and insurance companies, but their private equity programs are still at a nascent stage. It will take a long time to educate the market that PE is a long-term investment, rather than a short-term bet that can deliver sky-high returns. In the meantime, it is easier for us to raise funds from overseas institutional investors. Over the past few years, we have consistently attracted capital from investors including sovereign wealth funds.

> "It will take a long time to educate the market that PE is a long-term investment"

Q: China's securities regulator has assumed responsibility for domestic private equity and managers are now required to register with the Asset Management Association of China (AMAC) and disclose fund details. Is this a positive development?

A: We have registered our renminbi vehicles with AMAC. The industry should adopt a market-oriented development model, based on managers establishing investment track records and presenting their capabilities to raise capital from institutional investors. The definition of "qualified investors" and "illegal fundraising," meanwhile, is still unclear. I think this is what the regulatory should be looking at.

Q: The regulator also suspended IPOs for a year. What impact did this have on your exits?

A: We have invested in more than 80 projects to date, including real estate, and exited five last year to take the total to 71. While the domestic IPO market was closed, we diversified our exit routes. We did trade sales, such as Wasu Media Group, or made partial exits from companies ahead of public listings, such as Wufeng Agricultural. In certain cases, we exit through a promoter buy-back. Anhui Yingliu Electromechanical was in the first batch of companies to go public since IPOs resumed, listing on the Shanghai Stock Exchange in January. It was one of remaining four projects in Special Opportunities Fund I, which has generated a money multiple of more than 10x.

Q: China Everbright and Israel-based Catalyst Equity Management are currently raising a joint vehicle. What does this say about your expectations for deal flow?

A: Our PE and VC funds mainly focus on investing in China, while our hedge fund products allow Chinese investors to access offshore stock markets. We also provide structured financing for Chinese enterprises that want to acquire assets abroad. However, I am still concerned about the country's economic slowdown, given that asset valuations have been pushed so high. It is the right time for us to look for offshore investments and Israeli companies are compelling because valuations are still low. They are outstanding performers in IT, healthcare, cleantech and agriculture, areas in which China is lagging. In addition to the Israeli-focused fund, we are also looking to acquire advanced manufacturing technologies in Germany and the US.

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