AVCJ
ASIAN VENTURE CAPITAL JOURNAL
Asia's Private Equity News Source
avcj.com May 27 2014 Volume 27 Number 19

Early bird investors

Accelerators are on the rise in Asia, but fundraising challenges remain Page 7

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From China to Israel

Apax nets 6x as Bright Food buys Tnuva Page 13

EDITOR'S VIEWPOINT

tim.burroughs@incisivemedia.com

Arms race

CHINESE ONLINE RETAILER JD.COM'S US IPO was preceded by a three-year period in which it raised $1.7 billion from private equity and venture capital investors. This faith has, so far, paid off, with $1.8 billion raised through the IPO – allowing partial exits for some backers – and the company now trading at a market capitalization of $27.5 billion. Expect a spate of strategic acquisitions to follow as JD.com uses its war chest to diversify its business with a view towards long-term sustainability.

India's e-commerce giants have yet to reach the IPO phase but the arms race is already well underway. Consolidation was already a prevalent theme, with the strong typically preying upon the weak. But it has taken on a new edge with Flipkart's acquisition of fashion retailer Myntra – the very strong buying the certainly not weak, with an estimated deal size of more than $300 million.

Meanwhile, huge sums of money continue to be staked on the major players as they seek to establish scale and supporting infrastructure. According to AVCJ Research, VC and PE investors have sunk $622.6 million into Indian e-commerce so far this year, compared to $692.4 million in 2013 and $302.1 million in 2012. In 2010, it was just over $40 million. Of the total amount invested in 2014, Flipkart and rival platform Snapdeal account for 71% between them. In 2013, their share was 70%.

The competitive landscape has taken on a new twist with the arrival of Amazon, which launched its India marketplace last year and is aggressively building out its product offering.

Having switched from the inventory-led to the marketplace model, these firms are still channeling cash into marketing spend in order to defend their positions. But at the same time there is investment in quality of service, with improved logistics systems cutting delivery times and lateral acquisitions that develop domain expertise.

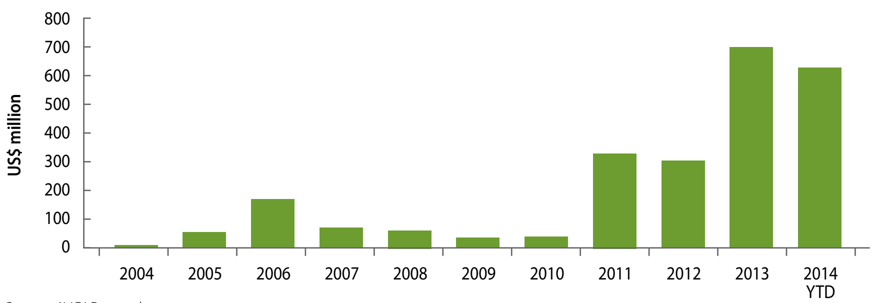
A united Flipkart and Myntra can reap economies of scale but the former will also benefit from the latter's knowledge of fashion retail. After the fundraise that following the acquisition, Flipkart said it would pursue more M&A opportunities in e-commerce as well as in technology and supply chain management. Snapdeal has also been on the acquisition trail and is expected to stay on it.

As the funding rounds get bigger, capital sources change. It was much the same with JD.com in China. Unless a VC investor is re-upping to protect an existing position in a company, it is unlikely to want to play when valuations enter multi-billion-dollar territory. There is no guarantee that the dominant players now will be equally powerful in five years' time – and in situations where a company has yet to go public there is always a risk that in aggressively building up scale ahead of an IPO it will flounder.

For early-stage players, the opportunity set has moved on, and there is talk of retail verticals rather than giant horizontals. In a China context, the buzz word is "category killers": online brand owners that are responsible for everything from product design to marketing. In India, meanwhile, there is an appreciation of the value that sits in niche segments and private labels. Success relies on a nuanced awareness of what sells, not just big marketing spend.

Tim Burroughs
Managing Editor
Asian Venture Capital Journal

PE investment in Indian e-commerce



Source: AVCJ Research

AVCJ ASIAN VENTURE CAPITAL JOURNAL

Managing Editor
Tim Burroughs (852) 3411 4909
Staff Writers
Andrew Woodman (852) 3411 4852
Winnie Liu (852) 3411 4907

Creative Director
Dicky Tang
Designers
Catherine Chau, Edith Leung,
Mansfield Hor, Tony Chow

Senior Research Manager
Helen Lee
Research Associates
Herbert Yum, Isas Chu,
Jason Chong, Kaho Mak

Circulation Manager
Sally Yip
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Prudence Lau
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Manager, Delegate Sales
Pauline Chen

Director, Business Development
Darryl Mag

Manager, Business Development
Anil Nathani, Samuel Lau

Sales Coordinator
Debbie Koo

Conference Managers
Jonathon Cohen, Sarah Doyle,
Conference Administrator
Amelie Poon
Conference Coordinator
Fiona Keung, Jovial Chung

Publishing Director
Allen Lee

Managing Director
Jonathon Whiteley

Incisive Media
Unit 1401 Devon House, Taikoo Place
979 King's Road, Quarry Bay,
Hong Kong
T. (852) 3411-4900
F. (852) 3411-4999
E. info@avcj.com
URL. avcj.com

Beijing Representative Office
No.1-2-(2)-B-A554, 1st Building,
No.66 Nanshatan,
Chaoyang District, Beijing,
People's Republic of China
T. (86) 10 5869 6203
F. (86) 10 5869 6205
E. beijing@avcj.com

incisivemedia 精銳傳媒

NEWS

ASIA PACIFIC

Canada's CPPIB doubles Asia PE exposure

Canada Pension Plan Investment Board's (CPPIB) exposure to Asian private equity more than doubled to C$4.5 billion ($4.1 billion) for the year ended March 2014. The fund made four commitments to managers in the region: $250 million and $200 million to the latest pan-Asian funds raised by CVC Capital Partners and TPG Capital, respectively; $200 million for CDH Investments' fifth China fund; and $120 million to Anchor Equity Partners' first Korean fund.

AUSTRALASIA

PEP-owned Spotless raises $919m in IPO

Shares in Pacific Equity Partners-owned cleaning and catering contractor Spotless Group opened at a 9.4% premium to the IPO price on the first day of trading in Sydney following a A$994.6 million ($919 million) offering. Spotless sold 540.5 million shares - comprising 404.5 million new shares and 136 million existing shares - at A$1.60 apiece, the bottom end of the indicative range.

Treasury Wine Estates rejects KKR buyout offer

Australia's Treasury Wine Estates (TWE) – owner of brands such as Penfolds, Rosemount Estate and Wolf Blass – has rejected a A$3.05 billion ($2.85 billion) buyout offer from KKR, saying it doesn't reflect the full value of the company.

PEP submits $1b take-private bid for SAI Global

Pacific Equity Partners (PEP) has launched a take-private bid for SAI Global that values the ASX-listed risk management and standards compliance business at up to A$1.1 billion ($1 billion). The PE firm is offering to buy all outstanding shares via a scheme of arrangement at a price range of A$5.10-5.25.

GREATER CHINA

Legend Capital closes sixth China VC fund at $500m

Chinese venture capital firm Legend Capital has reached a final close of $500 million on its sixth US dollar-denominated fund. The vehicle, LC Fund VI, spent just four months in the market, attracting five new investors, according to a source familiar with the situation.

China's JD.com jumps 10% on NASDAQ debut

Shares in PE-backed Chinese online retailer JD.com jumped nearly 10% on their first day of trading on NASDAQ following a $1.78 billion IPO. The company priced its 97.3 million American Depositary Shares at $19 apiece, above the indicative range of $16-18. The offering was said to be 15 times oversubscribed.

The stock opened at $21.75, soared as much as 20% during trading and eventually closed at $20.73.

Selling shareholders, including JD.com's founder Richard Liu, Tiger Global Management, DST Advisors, Hillhouse Capital Management and Capital Today, received about a quarter of the IPO proceeds. Tiger Global reduced its stake from 18.1% to 15.8%, while DST dropped from 9.2% to 8% and Capital Today from 7.8% to 6.8%. Two investment vehicles managed by Hillhouse Capital Management will saw their combined interest fall from 13% to 11.3%. Due to the dual shareholding structure, Liu retains control of the business despite owning a minority stake.

Founded in 2004, JD.com is seen as a Chinese version of Amazon, operating as a direct seller of goods held in its own warehouses and supported by self-delivery services. The company, formerly known as 360Buy and Jingdong.com, claims to be second-largest B2C e-commerce company in China after Alibaba Group. It has raised more than $1.7 billion in VC and PE funding in the last three years. Other investors include Kingdom Holding, an investment company controlled by Prince Alwaleed bin Talal, a Saudi Arabian billionaire, and Ontario Teachers' Pension Plan.

CVC to acquire Executive Centre from Headland

CVC Capital Partners has agreed to buy a majority stake in Hong Kong-based serviced office provider The Executive Centre (TEC) from Headland Capital Partners for an undisclosed sum. Headland will retain a minority interest in the business.

PE-backed China Auto Rental files for HK IPO

China Auto Rental has revived IPO plans that were shelved in mid-2012, although it is now aiming to go public on the Hong Kong Stock Exchange rather than NASDAQ. Warburg Pincus invested $200 million in the company in 2012 and has a 23.1% stake in the business. The following year Hertz acquired a 19% interest.

Hony, Tencent buy plots in Qianhai land auction

Hony Capital and Chinese internet giant Tencent Holdings have bought land in Shenzhen's Qianhai special economic zone for RMB2.19 billion ($351 million). Shenzhen-based Tencent won the largest piece available in the auction, paying RMB1.55 billion for a 24,947-square-meter-plot, according to an announcement. Hony bought a 15,062 square meters for RMB646 million.

Taiwan's CDIB, Govtor Capital launch $320m fund

Taiwan's CDIB Private Equity has teamed up with China's state-owned Govtor Capital to create a RMB2 billion ($320 million) private equity fund. The fund, known as Huachuang Yida Private Equity Fund, will target seven industries in eastern China, including IT, medical services, chain stores, new energy, environmental protection, new materials and advanced equipment.

China's Hopu to invest in Russian mining project

Hopu Investments has teamed up with Baikal Mining (BMC) to jointly develop a copper deposit in the eastern Russia region of Zabaikalsky, which borders China and Mongolia. The agreement allows Hopu to acquire a minority share in the Udokan project by the end of 2014.

VC-backed Xunlei files for US IPO

Xunlei, a Chinese file-sharing and download management platform backed by IDG Capital Partners, Morningside Technologies, Ceyuan Ventures and Primavera Capital, has revived plans for a US IPO. The move comes after software developer Kingsoft Corporation and mobile phone manufacturer Xiaomi invested $90 million and $300 million, respectively, in Xunlei.

China Soft, Yangquan Coal form $480m industry fund

China Soft Capital (CSC) and Yangquan Coal Industry Group have launched an industry buyout fund with a target of RMB3 billion ($480 million). The fund is expecting to hold a first close of RMB1.2 billion. It will mainly invest in coal and mining assets, especially in cleantech, advanced equipment and technology that improves energy efficiency.

Chinese group-buying site 55Tuan secures $50m

55Tuan, a Chinese group-buying site, has received $50 million in a new round of funding from existing investors, including CDH Investments and Zero2IPO Capital. The new capital will be used to expand the company's services to more major cities, develop its mobile business and optimize products and services.

China audio platform Ximalaya raises $11.5m

Ximalaya, a Chinese audio sharing platform, has raised $11.5 million in a Series A round of funding from KPCB, SIG China and Sierra Ventures. Ximalaya has a similar business model to SoundCloud – which recently received $60 million from KPCB – providing a platform for users to record and upload self-created sounds online, to be shared with friends or publicly.

NORTH ASIA

Globis leads $14m round for Japan app developer

Globis Capital Partners has led a JPY1.4 billion ($13.7 million) round of investment for Japanese mobile app developer Akatsuki. Link and Motivation, a management consulting firm, also took part in the round.

Next Capital exits massage chair maker to Asahi

Next Capital has agreed to exit its stake in Fuji Medical Instruments (Fujiiryoki), a Japanese manufacturer of massage chairs and other health-related products, to Asahi Holdings for JPY7.8 billion ($76.7 million). Asahi will acquire 81% of the business, or 242,828 shares, through its subsidiary Japan Waste Corporation.

Indian e-commerce giant Flipkart acquires Myntra

VC-backed Indian online shopping company Flipkart has acquired fashion retailer Myntra as competition intensifies in the country's e-commmerce market. Financial details were not disclosed, but it is understood that the deal - which was confirmed yesterday following weeks of speculation - is valued at around $300 million. Flipkart will buy 100% of Myntra in the largest ever Indian e-commerce transaction to date.

The acquisition gives Flipkart a stronger grip on the market as it faces competition from US giant Amazon, which launched in India last year and is now marketing aggressively. Domestic

rivals such as Snapdeal, which raised $100 million in a fresh round of funding this week, also pose a threat.

Bangalore-based Myntra launched in 2007. It sells clothes and accessories from international labels in addition to holding its own in-house brands.

The businesses share two VC investors with Flipkart: Accel Partners and Tiger Global Management, both of which took part in a $50 million round of funding for Myntra led by Premji Invest in February. The company was seeded by Erasmic Fund and Mumbai Angels in 2007, and subsequently received backing from IndoUS Advisors and IDG Ventures, as well as Accel and Tiger Global. Flipkart, which sells a broad selection of items from books to electronics, has so far raised around $540 million from VC investors.

SOUTH ASIA

India's Snapdeal raises $100m in new funding

Temasek Holdings, BlackRock, Premji Invest and Hong Kong-based investors Myriad Asset Management and Tybourne Capital Management have together invested $100 million in Jasper Infotech, the Indian e-commerce company behind Snapdeal.

WestBridge leads Series C round for Vistaar Finance

WestBridge Capital has led a INR1.6 billion ($27.4 million) Series C round for Indian non-banking financial company (NBFC) Vistaar Finance. Existing investors Elevar Equity, Omidyar Network and Saama Capital also participated in the round.

India to see rise in restructuring opportunities

India will see a sharp increase of corporate restructurings over the next 12 months, driven by corporate debt and liquidity issues, according to a PE industry survey by global business advisory firm AlixPartbers. Investments made in 2007-2008 are in particular trouble as companies face repayment issues.

SOUTHEAST ASIA

Everstone to buy Indonesia Domino's Pizza franchise

Everstone Capital, an India- and Southeast Asia-focused PE firm, has agreed to buy a 51% stake in the Indonesia franchise for Domino's Pizza from domestic retailer Mitra Adiperkasa (MAP). MAP said the decision was based on the recognition that additional strategic support is necessary to realize the growth potential of Domino's in Indonesia.

KKR in talks to buy Singapore packaging firm

KKR is in advanced talks to buy Goodpack, the world's largest manufacturer of intermediate bulk containers. The Singapore-listed company, which has a market cap of around S$1.3 billion ($1.1 billion), confirmed the talks but stressed there is no guarantee of a deal being consummated.

Indosat, SoftBank form $50m Indonesia VC fund

Indonesian mobile telecom operator Indosat and Japanese Softbank have launched a $50 million venture capital fund targeting Indonesian start-ups. The fund, SB ISAT, will be managed by a team from Indosat and Softbank. It will invest in e-commerce, digital, social media and mobile financial services.

andrew.woodman@incisivemedia.com

Backing the batch

The start-up accelerator can offer attractive opportunities for early-stage investors but the business model is still in its infancy and educating potential backers can still be challenge

"ESSENTIALLY WE ARE FARMERS," explains Meng Weng Wong, co-founder of Singapore-based accelerator Joyful Frog Digital Incubator (JFDI). "For most of venture capital's history we have been hunters, but what we are doing with accelerators now is agriculture and we are growing our own opportunities."

For Wong, having investors understand the difference between the two was essential when it came to JFDI's latest fundraise. In March, the group managed to pull in S$2.7 million ($2.1 million) from a mix of individuals and institutions. Infocomm Investments led the round, with Russia's SpinUp Partners and Silicon Valley's Fenox Venture Capital also participating. There were also contributions from several angel investors and some unnamed backers in the Philippines.

JDFI – which hopes to raise S$6 million over the next two years – is using half the capital to scale up its operations and the other half to invest in start-ups participating in its accelerator bootcamp, now in its fourth iteration. Meng explains that, just as farmers need land, tools and fertilizer, accelerators require significant capital to cover their operating costs. Fundraising – and how best to go about it – is therefore a major issue for those looking to expand.

JFDI is just one of a continuously expanding ecosystem of accelerators in Asia seeking capital with which to nurture region's start-ups. Yet the model is still very much in its infancy. The idea is that accelerators will take on a bigger role in the early-stage venture capital landscape, but with an investment approach that is so different to that of venture capital, who will back them?

Given that accelerators are new to Asia and the term itself covers broad range of businesses, there is little data available. However, numbers released by Crunchbase – a start-up-focused database operated by TechCrunch – reveals a rapid proliferation of accelerators globally. They have increased seven-fold from 27 to 170 between 2006 and 2013.

AVCJ Research's records show a parallel rise in the number of seed stage investments, classified as deals under $1 million in size, over same period. Last year $83 million was deployed across 257 transactions last year, nearly double the $48 million that went into 116 deals in 2006.

"The increase in the number of accelerators is really part of a mega trend where we are seeing more start-ups being launched globally," Rajesh Sawhney, founder of India accelerator GSF Super Angels. "It is an attractive opportunity but it works to different of economics to venture capital."

Pick your model

Accelerators broadly follow three types of business model. The first is the real estate model, which can be likened to traditional incubation. The approach tends to be more passive in nature; start-ups are offered office space in exchange for a fee or equity in the company.

The second is the development model, which comprises accelerators run by non-profit and governmental organizations with a view to growing a start-up ecosystem and stimulating the economy. The third category is the return on investment (ROI) model, where investors pool capital to back start-up accelerators and try to add-value through mentorship, networking and support services. They hope for a lucrative exit multiple at the other end.

It is this latest model that has proliferated. US accelerator Y-Combinator, set up in 2005, is widely credited with being the pioneer of this type of accelerator, although several variations have emerged in Asia in response to particular local conditions. However, the high cost of running a program ia a consistent theme.

"With most accelerators being based in city centers, there are a lot of costs related to things like office space," explains Bernard Moon, co-founder of Korean Start-up accelerator SparkLabs. "Typically, operating expenses can be anywhere up to 50-60% of the capital invested. It is not like venture capital, the money doesn't go to high salaries. Most of it just goes to the space, programming, and demo days, and the rest is for investments."

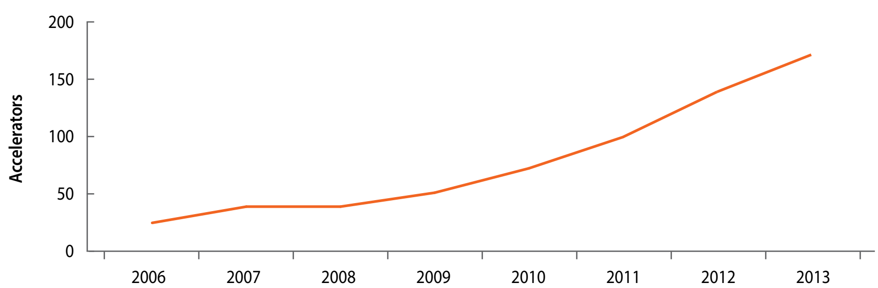
Most accelerator cycles are built around a 2-3 month program attended by batch of start-ups selected following an open application period. There are usually 2-4 programs a year.

Start-ups receive an initial five-figure injection of capital for a stake of 5-10%. The winning applications, of which there will be around 20, will normally have some kind of finished product and be between six months and one year old. After spending several weeks honing their ideas and business plans, they present to potential investors in a demo day. The most successful accelerators report that 70% of their investees go on to receive funding.

When it comes to raising capital to run the program and invest in start-ups, angel investors have historically accounted for much of the LPs base. In many cases, these will be the CEOs of VC-backed companies. In addition to providing capital, these angels usually serve as mentors to start-ups in the program, leveraging their experience and networks.

A common trade-off is that the angel, in exchange for capital and mentorship, will get early access to the company founders, a better understanding of the business, and therefore a chance to the lead on early funding rounds.

Number of accelerators globally



Source: Crunchbase

andrew.woodman@incisivemedia.com

"Sometimes you a have company that – even before the demo day – has three term sheets and it ends up raising over $1 million and is massively over-subscribed ," says JFDI's Wong. "Lots of the investors want to get in but often the only investors who can get in where those that invested in accelerator."

In many cases there is no formal agreement that underpins preferential treatment for these early backers. Angel investors may simply develop such a close working relationship with the founders during the three-month incubation period that when it comes to demo day, they already know they are going to invest, and founders are comfortable with their participation.

Further afield

But the pool of investors behind an accelerator is not limited to angels. Increasingly, institutional investors are showing an interest in backing accelerators and, in turn, accelerators have been looking to broaden their LP bases.

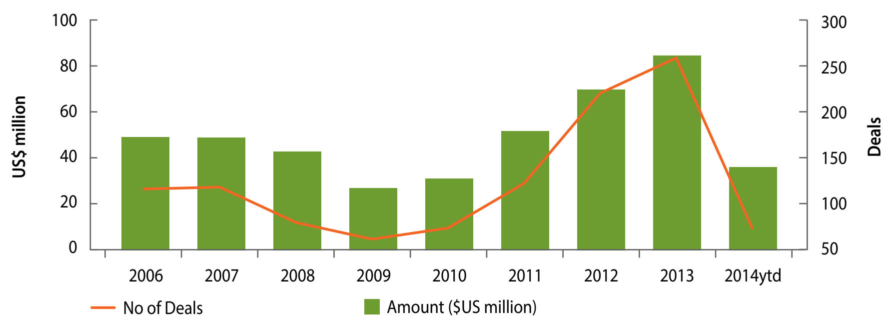
Venture capital firms have become regular backers. One or more firms will sponsor the accelerator and, in addition, investing in seed rounds for individual start-ups. There are also situations in which the accelerator is tied to a single VC, operating more like an affiliate.

This is the case with Australian accelerator Startmate which started as an independent program launched by Niki Scevak 2010 before joining with Blackbird Ventures – where Scevak is now managing director. Rick Baker, Blackbird's founder and managing director, explains that Startmate was primarily intended to support local business rather than generate returns, so it didn't make any money in the first two years before being brought under the Blackbird umbrella. The relationship has benefited both.

"It is hard for those sorts of accelerators, founded for love of it, to keep going unless they find a home within a larger fund," says Baker. "It makes it easier to keep the costs low and it is an important part of what Blackbird does and for our deal flow. It is a way to make sure we are seeing new trends and new technologies as they evolve."

Under the arrangement, Blackbird contributes around one third of the capital for each program with a group of angels – all of whom are mentors – investing the rest. Around A$50,000 ($46,000) is given to each start-up. Startmate differs from other accelerators in that overheads are kept low. Blackbird shares it resources with the accelerator, and extra expenses are shared by the VC firm and mentors when needed. When demo day comes the comes Blackbird takes part in follow-on rounds on a case-by-case basis.

Concept, seed-stage deals in Asia (<US$1 million)



Source: AVCJ Research

Chinaccelerator has similar relationship with SOS Ventures. The program was co-founded by Sean O'Sullivan and Cyril Ebersweiler, managing director and Asia investment partner, respectively, at SOS. Ebersweiler explains that Chinaccelerator had only one LP – SOS – which financed the program like a regular investment, on a per program basis. Only recently has it opened up to angels.

While a relationship with a VC firm can mean the difference between life and death for an accelerator, particularly in markets where the model is less established, it can also create problems.

Last month, Y Combinator decided change the way in which its VC partners contribute to accelerator rounds. Under the old structure, Y Combinator would invest $17,000 in every start-up accepted into the accelerator in return for a 7%. Four VC firms – Andreessen Horowitz, Khosla Ventures, General Catalyst and Maverick Capital – would then contribute another $80,000, structured as a convertible note, through a vehicle called the YC Fund. Now Y Combinator will still invest 7% but contribute $120,000. A portion of the additional capital comes from a new fund that does not include the four VC firms.

The issue with the former approach was it created a perception problem for entrepreneurs. If backers of the YC Fund didn't invest in follow-up rounds, the concern was that it would be seen as a signal that the startup in question might have problems.

VCs are not the only potential partners, though. Many accelerators have earned backing by forming partnerships with large corporates. Again, the relationship is mutually beneficial: corporates will provide capital and give start-ups access to their own resources and networks; in return they get access to talent, technology and potential acquisition targets.

"Corporates are getting into the game not so much as an ROI function but as a scouting function for new technology and innovation," explains SparkLabs' Moon. "It is an early look at what is coming through the pipeline. That is why you see these corporate accelerators programs proliferate in the US."

TechStars has launched a number of accelerators off the back of partnerships with corporates. Its partners include the likes of Nike, Microsoft, Sprint and even Barclays for a financial technology-focused program. Corporates have been equally active in Asia. JFDI – which claims to model itself on TechStars – launched the JFDI-Innov8 Bootcamp in 2012 alongside SingTel Innov8, the corporate investment arm of Singapore telecoms giant SingTel.

On the other hand, many corporates have launched their own programs without teaming up with an existing accelerator. Japanese telecoms giant KDDI is a case in point. It created KDDI Mugen Labo, which focuses on mobile app start-ups that not only provide a return but can also be a source of innovation, talent, and value-add services for KDDI to offer to mobile customers.

A new asset class

The longstanding question is whether accelerators can complete the journey from start-up to institutional platform by drawing support from pension funds and financial groups. It comes down to issues of risk and the investor's perception of what accelerators are.

"The way we put it is that accelerators are fundamentally a different animal to venture capital, we are different asset class," says JFDI's Wong. "It has been difficult for us because we run at such an early stage that two out of three investors we talk to say they are interested in dabbling in early stage but think investing in an unproven team with unproven ideas and giving them only 100 days to get their act together is way too risky."

If accelerators do manage to achieve broader acceptance among investors it will be a long time coming. In the short- to medium-term, many in the industry expect a cull of smaller accelerators, much like what has been seen in the broader the venture capital space as larger, more proven accelerators come to the fore, attracting more commitments and landing more investments.

"A lot of accelerators will likely die in the next several years. If you are working with an ROI model it is all about deal flow," says SparkLabs' Moon. "Like VC firms – where only the top ones do really well – in the US maybe the top three or five will get the best deal flow. Those are ones that will survive."

Some anticipate a similar scenario in Asia, with a handful accelerators dominating deal flow in each jurisdiction while smaller players close or restrict themselves to niche areas. Akash Bhavsar – a mentor and managing director of SkyQuest, an intellectual property-focused advisory firm that invests in accelerator-backed start-ups – believes the accelerators that are able to attract investors will be those with an international focus. The country specialists will struggle.

"It will I be difficult for them to get good deals," he says. "There have to be multinational accelerators that can help start-ups act like multinational corporations and take advantages of market access within a shorter time frame."

GSF's Sawhney is equally enthusiastic about the global approach. One of his firm's highest-profile exits came recently when Facebook acquired Little Eye Labs, which provides developers with software that allows them to monitor mobile app performance, for around $15 million. It was the US giant's first-ever India investment. GSF is also unique in that it is held across several countries. The most recent program saw start-ups spend just one month in India, followed by a month in Silicon Valley, 15 days in New York and the final 10 days in Singapore.

> **"It is hard for those sorts of accelerators, founded for love of it, to keep going unless they find a home within a larger fund"** – Rick Baker

Not everyone shares this view. After all, Asia is economically and culturally different to the US and Europe, while the large consumer bases in countries like China and India provide plenty of room for growth.

"Asia has several cultures which lead to the massive differences across the region and will complicate the task of having a pan-Asian accelerator dominate every country," says Chinacclerator's Ebersweiler. "Focusing on a growing market they understand is critical for entrepreneurs, and as such entering another Asian market early on is unlikely."

Either way, many in the industry observe that while some smaller accelerators may cease to exist, interest among investors looking beyond the ROI model will persist. For example, state-backed programs adhering to an economic development model will continue as long there is the government money to support them. JFDI's Meng notes there is already government interest in Singapore, with state-controlled giants Temasek Holdings and GIC Private attending demo days.

Again, Meng evokes the agricultural analogy. "Governments are interested in acceleration because – like agriculture – it is more predictable and defensible. It is not like venture capital, where you are basically just sending out a group of hunters."

The shortcut

JD Capital has become the first Chinese private equity firm to list on the country's over-the-counter platform. Is the New Third Board a viable exit option – for GPs or for portfolio companies?

JD CAPITAL ROSE TO PROMINENCE IN China under a different name – Jiuding Capital – as arguably the preeminent pre-IPO shop, listing companies seemingly by the dozen. It has now established itself as an early mover in another space, becoming the first Chinese PE firm to complete a public listing itself.

JD Capital's parent company – Beijing Tongchuang Jiuding Investment Management – is trading on the emerging over-the-counter (OTC) platform, known as the New Third Board. A total of 131 LPs exchanged their interests in JD's funds for interests in the GP. It is, unsurprisingly, an exit strategy: once gridlocked because underlying portfolio companies are unable to list, these LPs' fund positions suddenly became liquid.

"The key driver for the listing is to ease pressure from LPs to cash out," says Dayi Sun, managing director at China-focused fund-of-funds Jade Invest. "The GP has raised a number of renminbi funds over the last few years, which usually have a three-year fund life. LPs are now increasingly looking for exit but it's hard, given that the normal IPO process has been slowed."

Another option is to have portfolio company founders buy back positions, but this is unappetizing when valuations are low. A GP listing offers the prospect of a quick exit and a more attractive valuation. JD Capital raised RMB3.54 billion ($567 million) by selling 5.8 million shares sale at RMB610 apiece.

Other managers are expected to follow suit and take advantage of the OTC system. But the bourse's primary use to PE and VC firms is still likely to be as a mechanism for exiting portfolio companies, especially if it becomes possible to transfer to the A-share main boards or ChiNext.

However, there is no timetable for introducing such an option. And the faltering development of New Third Board over the past few years hardly inspires confidence.

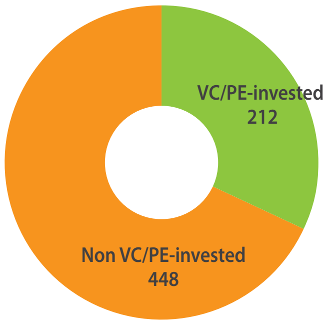
Humble beginnings

The Third Board, initially known as the share transfer system, was launched in 2001 as a pilot program enabling small- and medium-sized high-tech private enterprises in Beijing's Zhongguancun technology hub to raise funds. Two years ago the State Council allowed the program to expand into more cities, including Shanghai, Tianjin and Wuhan.

The China Securities Regulatory Commission (CSRC) introduced further reforms last year, uniting all the OTC markets and establishing the National Equity Exchange and Quotation (NEEQ), or New Third Board. The listing requirements are less stringent than for other bourses: companies must simply have a clear shareholding structure and two years of financial statements.

Despite the measures, the New Third Board is hindered by low trading volumes and inactivity.

Numbers of VC/PE-backed firms listed on New Third Board



Source: CVCA

None of the more than 40 companies on Jiangsu province's OTC market raised capital last year.

This is partly attributed to high investment thresholds. Participation is restricted to institutional investors or high-net-worth individuals with assets of RMB50 million that can be traded in listed stocks. The absence of a market maker system is also a problem; it means every transaction is based on direct negotiation between the investor and listed company.

"You could price listed companies at a sky-high price-to-earnings ratio and push the share price even higher by buying shares yourself. But no other investors are willing to pay for those shares, given that more than a half companies listed on the board have poor financial performance," says Sanshou Huang, president of domestic IPO advisory firm Heading Century.

As of the end of March, a total of 660 firms were listed on the New Third Board, doubling the number at the end of 2013, according to China Private Equity and Venture Capital Association (CVCA). Listed companies raised RMB610 million in early April, compared to RMB1 billion fundraising during 2013 as whole. Interestingly, 212 companies have previously raised capital from private equity investors.

"From a financial point of view, it's not an ideal venue for PE fund managers to exit portfolio companies if they are hoping for high returns," says Huang. "A lot of VC-backed enterprises are under pressure to exit because they agreed to a valuation adjustment mechanism with PE investors several years ago. As listing on the main board becomes more difficult, the New Third Board seems to be a visible option."

Upwardly mobile

Although the board is at a nascent stage, the government is taking steps to encourage activity. A market maker system is expected to be introduced next month and the State Council is encouraging qualified companies on the New Third Board to apply to listings on the main board, even in the absence of formal rules.

The financial disclosure requirements imposed on listing applicants already represent a stepping stone to the main board. Given that financial statements must be properly audited the documentation could be seen as a preliminary IPO prospectus.

"The role of the New Third Board is as a testing ground for how a registration-based listing system could work in practice, which is one of the government's main policy objectives," says Shoushuang Li, a senior partner at Dacheng Law Firm, who helped structure JD Capital's New Third Board listing. "Board transfer rules will eventually be launched because the State Council wants them."

JD's trading price and volume are the currently the highest ever seen on the New Third board. So far only one other manager – CSC Group – is preparing to list but others will follow if it proves beneficial to the overall franchise.

"Chinese fund sponsors could improve their visibility by listing on the board," says Serena Tan, an associate in Debevoise & Plimpton. "It will improve investor confidence as the sponsors would have to disclose certain information to the public. Transparency may then help the sponsors in future fundraisings, since investors are likely to know them better than unlisted ones."

tim.burroughs@incisivemedia.com

TPG looks up after bumpy fundraise

THE FUNDRAISING PROCESS FOR TPG ASIA VI was not smooth. More than two-and-a-half years in the market, a reduced target, changes in senior management, and churn within the China team prompting questions about the PE firm's ability to cover what is arguably its most significant geography. The finishing line was officially crossed last week, with $3.3 billion in capital commitments, less than the $4.25 billion raised for Fund V in 2008.

According to Tim Dattels, TPG Capital's Asia managing partner, who relocated to Hong Kong at the end of last year as former regional co-head Stephen Peel stepped back, the tide began to turn before the end of 2013. Fundraising accelerated after November – seen as a sign that LPs were satisfied that their calls for consolidation on the leadership side had been heeded.

The China issue was tied to the departure of Weijian Shan and Mary Ma in 2009 and 2010. Dattels accepts this was an issue in fundraising but argues that TPG's recent activity in China, plus the hiring of Steve Sun from Goldman Sachs and Jing Huang from Bain Capital, is evidence that it has been laid to rest. Three of the first five deals out of Fund VI are in China – Phoenix TV, Xinyuan Real Estate and Chindex International, although the latter has yet to close – while UT Capital was sold for 2x book value and Grand China Auto is preparing for a Hong Kong IPO.

Around $1 billion has been deployed in these initial transactions, with co-investments accounting for about one third of the total. It is estimated co-investment by a handful of large LPs on top of the main fund corpus will take the available capital to $4.5 billion. Asian, Canadian and Nordic institutions are the major contributors to the fund.

Consumer franchises, financial services and healthcare remain the primary sectors of focus, although food and agriculture may feature more prominently as well, as exemplified by the acquisition of Australian poultry producer Ingham's Enterprises. "Many press reports say too much money is chasing too few deals, but we've encountered no slowdown and had no problem finding good deals," Dattels adds.

More than 30% of the fund will likely be deployed in China, 20-30% in Australia, and the rest in Southeast Asia, India, Korea and Japan. Ben Gray, Dattels' fellow managing partner, leads investment activity in Australia while Ganen Sarvananthan has been brought in from Malaysia's Khazanah Nasional to bulk up Southeast Asia coverage. TPG also has a tie-up with Northstar Group, a long-standing source of deals in Indonesia.

TPG: Crossing the finish line

The firm recently made its debut investment in the Philippines, backing affordable housing developer 8990 Holdings, and is poised to make a breakthrough in Sri Lanka with the acquisition of a controlling stake in Union Bank of Colombo.

"Since the fourth fund we had also shown we had five deals in five different markets that have returned around 5x," Dattels says. "They were done by people at the firm today."

LPs buy into SSG's special sits story

DIRECT LENDING HAS GAINED TRACTION among PE investors in Asia who see an opportunity to meet the capital needs of small businesses that are unable to tap conventional sources of financing. SSG Capital is keen to differentiate itself from the mainstream.

"We have been very clear to our LPs that this is not just another private debt fund. Most of these deals include debt and downside protection and equity upside, but our transactions tend to be a lot more structured," says Edwin Wong, managing partner and CIO at SSG. "We are not just looking at collateral but a series of credit enhancements that make sure the downside is locked up."

These enhancements vary as widely as the nature of the deals they underpin.

While SSG does provide growth capital to companies that are overlooked by banks, its specialty is restructuring – unraveling the balance sheets of healthy companies hamstrung by shareholder disputes and either triaging distressed assets or picking up the pieces post-bankruptcy filing. Its interests may be protected by board seats and associated rights – advantages usually not afforded to typical direct lenders – taking control of a company's cash accounts, or obtaining other forms of credit support from related parties.

Based on the ramp up in SSG's fund sizes, there are sufficient enhancements to make LPs comfortable. The PE firm, which was set up by the team that used to run Lehman Brothers' Asia special situations business, closed its debut fund at around $100 million in late 2010, although capacity was boosted by co-investment. Fund II received commitments of $400 million in 2012 and now Fund III has closed at $915 million. Demand was well in excess of $1 billion.

"We had the opportunity to include some of the biggest names in the LP market, such as state pension funds from the US and sovereign wealth funds – people that would not look at a $400 million fund," says Wong. He adds that Fund II is over 100% drawn and, because most transactions are debt-based, it is has been making strong distributions.

A majority of the new vehicle is expected to be deployed in SSG's core geographies of India, China and Indonesia. India has been the most active market for Fund II but China is likely to feature more prominently in Fund III as the slowing economy leaves companies exposed.

Wong told AVCJ after raising Fund II that the process was complicated by the need to educate investors as to what special situations means in Asia. He notes that defining the opportunity set remains an issue, but receptiveness to special situations and credit strategies has improved in the last two years.

SSG: Restructuring strategy

"Investors used to be only focused on equity strategies in Asia but now that is changing" he explains. "It is a function of the slowdown in the economy and the lack of performance by many GPs on the traditional equity side. LPs are re-thinking their strategies."

Aion makes India breakthrough

THE DECISIVE VICTORY RECORDED BY new Prime Minister Narendra Modi in India's general election has removed a lingering element of uncertainty regarding economic and foreign investment policy, but it cannot save companies from their past misdeeds.

A majority of respondents in a PE industry survey by business advisory firm AlixPartners expect more corporate restructuring in India over the next 12 months. Aggressive investments made in 2007-2008 are seen as especially vulnerable.

"India's economy is slowing and the rupee has dropped more than 20% in the last year. This has created problems for local companies, including PE portfolio companies in terms of generating adequate margins from their business," said C.V. Ramachandran, AlixPartners' Asia president.

Against this backdrop of challenging commercial conditions, and weaker confidence in the growth equity model that has characterized Indian PE, Aion Capital Partners – a joint venture between Apollo Global Management and ICICI Venture – raised $825 million for its debut special situations fund. According to AVCJ Research, the vehicle launched in early 2013 and soon arrived at a $325 million first close. It then kicked on and sped past the initial target of $500 million.

It is the largest India-focused fund raised since WestBridge Crossover Fund, an evergreen vehicle without a specific investment cycle, added a further $325 million to the $525 million raised in 2011. Both could be described as contrarian but in very different ways. While WestBridge Capital has a fund structure it feels serves the needs of a PIPE deal-focused remit, the Aion approach is rooted in flexibility.

"You have a situation where private equity funds in India have been focused on just a few sectors and industries and there is a reluctance to enter businesses that might face cyclical downturns, which reduces the opportunity set," a source close to the firm tells AVCJ. "Aion wants to provide truly flexible capital, whether debt, equity or hybrid instruments."

Aion's target areas within special situations are identified as financial restructurings, recapitalizations, leveraged buyouts and promoter financings. It is thought that bespoke financing solutions developed in partnership with Aion can help companies meet their long-term capital needs. Borrowing costs remain relatively high in India and Aion expects them to remain elevated for the foreseeable future.

More than $100 million has already been invested from the fund. Disclosed deals include a commitment to Jyoti Structures, which takes on engineering projects in the power sector. The listed company wants to stabilize its business in India and increase its overseas presence, particularly in the US.


India: A vote of confidence

"What we have seen is Indian companies recognizing the benefit of being able to access a wide range of financing through the Apollo-ICICI network," the source adds. "They are a lot of different resources they can tap into."

Apax benefits from Bright Food's ambition

APAX PARTNERS' 6X RETURN ON ITS investment in Israel-based Tnuva Food Industries has been hard earned.

Tnuva was founded as an agricultural cooperative of 620 farming communities who were also the company's suppliers of raw milk and fresh produce. When they agreed to a limited auction in 2006, there were 3-4 prospective buyers. Apax won out in part because Zehavit Cohen, the firm's Israel managing partner, reached out to all the owners.

"The team went from one farm to another throughout the country and participated in their conferences, sometimes 30 people, sometimes 200 people," says a source familiar with the investment.

It took two years to complete negotiations and close the transaction. Apax took a 56% stake in Tnuva with Mivtach Shamir, a local investment firm, buying 21%. The farmers held on to the remainder. The enterprise valuation was $1.4 billion.


Tnuva: Dairy deal

Last week China's Bright Food Group agreed to buy Apax's interest in the business for around $1 billion in cash and assume responsibility for a portion of debt tied to the deal. The farmers will also exit. Apax's return comprises the cash payment from Bright Food plus dividends regularly taken out of the business during the ownership period.

"This is a great outcome for our partners and Tnuva's management, employees and other stake holders," Cohen said in a statement. "In recent years we worked prudently, together with management and employees, to transform Tnuva to a stronger company with excellent long-term prospects".

Progress was not always smooth. Tnuva is a dominant player in Israel, with revenues of ILS7.17 billion ($2 billion) in 2013 and market-leading positions across dairy products as well as a range of other fresh and frozen foods. However, Tnuva faced a challenge in 2011 when Israel's major food producers were targeted as part of protests about rising living costs. This included a consumer boycott of cottage cheese, a segment in which Tnuva has a 70% market share.

The company responded to public pressure by lowering prices and it took over a year to stabilize the business and return it to a position of strength. "They had to work on pricing, launching new products and opening new channels of communication with consumers," the source explains.

Apax opted for a dual track exit, preparing for an IPO in Tel Aviv while considering trade sale options. The introduction to Bright Food came via Israel-based employee at accounting firm BDO who was aware of the Chinese company's keenness not only to expand but also to gain access to technologies and expertise.

This is the third time a private equity firm has exited an asset to Bright Food, following the acquisition of majority stakes in Australia's Manassen Foods and UK-based Weetabix from CHAMP Private Equity and Lion Capital, respectively.

tim.burroughs@incisivemedia.com

Institutional heavyweight

Canadian Pension Plan Investment Board has established a sizeable presence in Asia and is making ever larger commitments to GPs in the region. But Mark Machin, the fund's Asia president, says it is still early days

"THERE IS A WHOLE RANGE OF DIFFERENT strategies that are completely valid and time will tell if they play out. But don't expect everybody to do what we do," says Mark Machin, Asia president at Canada Pension Plan Investment Board (CPPIB). "We have some unique structural advantages in the way we are set up, particularly the nature of the money we are managing."

In an Asian context, CPPIB was the earliest proponent of the "Canadian model," devoting more resources to its alternatives programs with a view to generating better long-term returns.

The pension fund opened its Hong Kong office in 2008 and now has approximately 50 people based there, of which 10-12 are responsible for private equity fund commitments and co-investments alongside GPs. There are also investment professionals covering real estate, private debt, relationship investing, hedge funds and long-short equities. Other functions are predominantly run out of Toronto.

As Machin suggests, CPPIB's long-dated liabilities allow a degree of flexibility that works in its favor. The pension fund will collect excess contributions until 2022 and total assets are expected to surpass C$500 billion ($458 billion) eight years after that. Of the C$219.1 billion under management, about 15% is deployed in Asia. Business in the region as a percentage of active assets committed is 40% real estate, 20% private equity, 10% infrastructure and the remainder in hedge funds and other strategies.

The pension fund's growing commitments to Asia-focused private equity managers reflects not only the region's increasing economic significance, but also this ramp up in assets.

The size factor

In 2005, CITIC Capital received a $50 million allocation for its first China fund, which had a corpus of $450 million. CPPIB is no longer able to make investments of this size. Emerging markets funds below $500 million are typically off limits, while the threshold is $750 million for developed markets vehicles. In most cases, CPPIB cannot account for more than 20% of a single fund.

"We don't want to make investments of less than $100-150 million. Globally, we are one of the largest institutional investors in PE funds, and there is a reluctance to grow the number of GP relationships to too many. We have debated lowering the bar – if you believe private equity is going to outperform public markets on a risk-adjusted basis then perhaps you should – but the conclusion is we should keep the bar high."

The pension fund's largest commitment to an Asia-focused manager was $450 million for KKR's second pan-regional vehicle, which closed at $6 billion. At the other end of the scale, Anchor Equity Partners, set up by former Goldman Sachs principal investment executives in Korea, squeezed in with a $125 million allocation to its $500 million debut fund. More recently, CPPIB has invested in the latest funds raised by China's CDH Investments and pan-regional players CVC Capital Partners and TPG Capital.

Regional funds aside, CPPIB started with China and then expanded its scope to take in Australia and India. The pension fund has been searching for an appropriate manager in Japan for a while but has yet to identify one and is now starting to look for suitable GPs in Southeast Asia as well.

While the bar has been raised in terms of fund size, the policy on co-investment has eased up. CPPIB previously only wanted to do very large deals and have a team alongside the GP from the outset. The preference for co-underwriting over passive syndication remains, but there is greater flexibility on size, with opportunities of $35 million and upwards taken into consideration.

In the last year, CPPIB has supported Baring Private Equity Asia's purchase of Hexaware Technologies and Anchor's acquisition of Korean pharmaceutical distributor Geoyoung.

Private equity is distinct from areas like infrastructure, real estate and relationship investing in that CPPIB must work with a partner. In almost all cases this will be a portfolio GP, but there is also the option of teaming up with one of a handful of "like-minded peer organizations," such as sovereign wealth funds.

CPPIB's private equity relationships in Asia

Fund	Commitment (US$m)
KKR Asia Fund II (2012)	450
KKR Asian Fund (2007)	350
TPG Asia Fund V (2007)	350
MBK Partners Fund III (2012)	300
FountainVest China Growth Capital Fund II (2012)	280
FountainVest China Growth Fund (2008)	200
MBK Partners II (2008)	200
CITIC Capital China Partners II (2009)	175
CDH Fund IV (2009)	150
Archer Capital Fund 5 (2011)	135
Anchor Equity Partners Fund I (2013)	125
Baring Asia Private Equity Fund V (2010)	100
Hony Capital Fund V (2011)	100
Multiples Private Equity Fund I (2010)	100
Hony Capital Fund 2008 (2008)	75
CITIC Capital China Partners I (2005)	50

Note: Correct as of September 2013
Source: CPPIB

Expansion plans

Subject to further analysis, CPPIB hopes to open an office in Mumbai next year – it is particularly active in real estate and infrastructure in India – and a couple more bases could be set up in Asia in due course. The general expectation is that, across all strategies, there will be an evolution from passive to direct engagement, with more people on the ground identifying opportunities.

"It is extremely early days for us," Machin says. "We are quite broadly invested in real estate and have good competence so that should keep growing. Our hedge fund portfolio will grow modestly over time. But on infrastructure we are just scratching the surface – we are pretty active in Australia, just starting in India, and not looking anywhere else right now. Private credit and relationship investing are also only just getting started. On private equity direct we have more flexibility and capacity so that will grow substantially over time."

But this does not necessarily signal a desire to become a fully-fledged direct private equity player, resulting in the disintermediation of managers. Machin places CPPIB at neither end of the passive-active spectrum.

"We spend a lot of time trying to figure out which managers will prove out over time, and we invest a huge amount of time building relationships with them and using those relationships to enhance our returns," he adds. "We are not going to move from that model."

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