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EDITOR'S VIEWPOINT

tim.burroughs@incisivemedia.com

Big beasts

AND JUST LIKE THAT, IT WAS DONE. THIS week The Carlyle Group closed its fourth Asian fund, drawing a line under a three-year process that has seen nearly all of the largest global and Asia-based private equity firms raise their first regional vehicles since before the global financial crisis.

Starting with Bain Capital Asia II, which reached a final close in July 2012, roughly one year after launch, eight firms have raised $27.2 billion between them. In addition to Bain and Carlyle, they include KKR, MBK Partners, Affinity Equity Partners, CVC Capital Partners, TPG Capital and Morgan Stanley Private Equity Asia. (PAG and RRJ Capital complete the top 10 but the former has so far only raised one fund while the latter raised its debut vehicle after the crisis. Meanwhile, Carlyle's third Asia fund and MBK's second straddle the period, but both launched several months before Lehman Brothers collapsed.)

In all but two cases the funds are larger than their predecessors. Four finished above target with two increasing their hard caps. Aggregate capital raised by the eight in this vintage is $5.3 billion larger than the last. Overall private equity fundraising by Asia-focused managers – taking into account incremental and final closes – came to $173.8 billion between 2006 and 2008; it stands at $142.6 billion for 2011-2013, and close to half of that went into renminbi-denominated funds.

There are two conclusions we can draw from this, both already well known. First, in recent years we have seen a flight to quality in Asian private equity as LPs gravitate towards a smaller number of GPs, with stand-out performers and brand names the obvious beneficiaries. Second, when individual markets are blighted by uncertainty or instability, there is comfort in a pan-regional strategy – although the leading GPs in the likes of China and India will continue to raise money.

It remains to be seen whether some of the current generation of pan-Asian funds are "too big," particularly given that LPs are seeking larger co-investment allocations alongside the funds.

As to what will occupy the fundraising landscape now the big beasts have vacated it, the answer is a mixed bag. Baring Private Equity Asia, which is understood to have increased the hard cap on its sixth pan-regional fund, looks set to cement its position in big beast territory later this year.

Beyond that, we have already witnessed a blossoming in venture capital raising – mainly for China – this year. And more is expected of the mid-market. Strip out funds with an element of government or strategic interest and there were three final closes of $2 billion or more in 2013, nothing else of $1 billion-plus and just four representatives in the $500 million to $1 billion bracket. The previous year five funds raised $1-2 billion and nine finished on $500 million to $1 billion.

As we have said many times before, it is still relatively early days for Asian private equity. Regardless of size, reputations will be made and lost, and LPs will scrutinize managers even more closely for evidence that they are worth their compensation.

Tim Burroughs
Managing Editor
Asian Venture Capital Journal

Pan-Asian fund closes

Fund	Final close	Size (US$m)	Predecessor (US$m)
Carlyle Asia Partners IV	Sep-14	3,900	2,550
Morgan Stanley Private Equity Asia IV	Jul-14	1,700	1,487
TPG Asia VI	May-14	3,300	4,250
CVC Capital Partners Asia Pacific IV	May-14	3,500	4,199
Affinity Asia Pacific Fund IV	Jan-14	3,800	2,800
MBK Partners III	Sep-13	2,700	1,600
KKR Asian Fund II	Jul-13	6,015	4,000
Bain Capital Asia Fund II	Jul-12	2,300	1,000

Source: AVCJ Research

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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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

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NEWS

ASIA PACIFIC

Rocket to form fashion e-commerce giant

German start-up incubator Rocket Internet and Investment AB Kinnevik are to consolidate five emerging market fashion e-commerce brands into a single global company with a combined valuation of EUR2.7 billion ($3.5 billion). The platforms include India's Jabong and Southeast Asia and Australia's Zalora.

H&Q leads $16.7m round for insurance SaaS firm

H&Q Asia Pacific has led a $16.7 million Series A round for US cloud insurance software provider One Inc.; Camp One Ventures and AGI Partners also took part. One Inc. provides a software-as-a-service (SaaS) product that aims to help property and casualty insurers replace their legacy core systems and increase their operational efficiency.

AUSTRALASIA

OPTrust, Catalyst consortium buys SkyBus

A PE consortium including Canada's OPTrust Private Markets Group (OPTrust PMG) and Catalyst Direct Capital Management has acquired Australian bus route operator SkyBus. The deal was valued at around A$50-100 million ($47-94 million).

GREATER CHINA

PE investors set for partial exits in Alibaba's IPO

E-commerce giant Alibaba Group is seeking to raise as much as $24 million through its US IPO. Yahoo is the biggest exiting shareholder, selling 121.7 million shares - or 4.9% - from its current 22.4% holding. China Investment Corp. (CIC), Silver Lake, CITIC Capital, Yunfeng Capital, China Development Bank, Boyu Capital and others are also planning to make partial exits.

PE-backed China Auto to raise $467m in HK IPO

Warburg Pincus-backed China Auto Rental has set terms for a Hong Kong IPO that will raise up to HK$3.62 billion ($467 million). The firm is selling 426 million new shares at HK$7.50-8.50 apiece. The IPO is set to be priced on September 11. After the IPO, Warburg Pincus' share will be diluted to 18.8% from current 23.1%.

Carlyle closes fourth Asia buyout fund at $3.9b

The Carlyle Group has reached a final close on its fourth Asian fund - Carlyle Asia Partners IV (CAP IV) - at $3.9 billion. The fund, which will make control and significant minority investments across the Asia ex-Japan region, has exceeded its original target of $3.5 billion. The vehicle launched in May 2012 and reached a first close of $1.5 billion after just under one year in the market. The fundraise took around the same amount of time as Fund III, which closed at $2.5 million.

Among Carlyle's LPs are New York State Teachers' retirement System (NYSTRS), which committed $100 million last October, and CDIB Capital International, which is understood to have put $20 million into the new vehicle having committed the same amount for Fund III.

CAP IV made its first investment in May in security services unit ADT Korea. In August, the fund invested in Ganji.com, a Chinese online and mobile-based classifieds provider. Carlyle now has $13.6 billion in assets under management in its Asia funds - including Japan - across buyout, growth, RMB and real estate strategies.

"We believe that the regional economy will continue to grow much faster than the rest of the world. Rising middle class and their demand for better products and services are key drivers of these investment opportunities," said X.D. Yang, managing director and co-head of the Carlyle Asia buyout team.

PE firms pull out of Shanda Games take-private

The Carlyle Group and FountainVest Partners have pulled out of the consortium backing a $1.9 billion bid to acquire US-listed Chinese games developer Shanda Games. Chinese online game developer Perfect World and Primavera Capital also exited the consortium. An affiliate of Orient Securities, an affiliate of Haitong Securities, and Ningxia Zhongyincashmere International Group has joined the consortium as new members.

Asian media giants form ChIna film, TV fund

Taiwan's Fubon Group, Hong Kong's Media Asia and South Korean music giant SM Entertainment have established a media-focused fund to jointly invest in Chinese film and TV production. The parties will inject an initial $20 million into the fund - Dragon Tiger Capital Partners - which has an overall target of $100-200 million.

China Exim Bank fund forms Poland wind farm JV

The China-CEE Fund, a $500 million vehicle backed by China Exim Bank that invests in Central and Eastern Europe, will partner Israel's Enlight Renewable Energy to buy a controlling interest in two Polish wind projects for up to PLN1.3 billion ($406 million). This is the fund's second investment in Polish renewable energy in two months.

China stem cell storage firm launches $813m fund

Zhongyuan Union Stem Cell Bio-engineering, a Chinese stem cell storage service operator, has partnered with China Yinhong Capital to launch an industry M&A fund with a target of RMB5 billion ($813 million). Two parties will set up an entity - Zhongyuan Investment - to focus on M&A activities, with a view to boosting its presence within the industry's supply chain.

PE invests $115m in caliper maker Guilin Guanglu

Guilin Guanglu Measuring Instrument, a Chinese electronic digital caliper maker, plans to raise RMB710 million ($115 million) from four domestic private equity firms. It will use the proceeds to support its expansion into the culture and media industry. Last year, the firm acquired a digital cable TV business unit from Zhonghui Century Media Group for RMB250 million.

Tencent pumps $70m into China healthcare site

Tencent Holdings has invested $70 million into dxy.com, a Chinese networking and information-sharing site for healthcare professionals. Founded in 2000, dxy maintains an online medical

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NEWS

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OrbiMed commits $15m to China's GC-Rise Pharma

OrbiMed has committed $15 million in Series B funding to GC-Rise Pharmaceutical, a Chinese healthcare services provider. GC-Rise, founded in 2008, focuses on healthcare for women and children.

VC-backed Xunlei to buy Kingsoft's storage business

Xunlei, a Chinese file-sharing service backed by a string of VC firms, will pay $33 million to acquire Kuaipan Personal, a personal storage business unit owned by Kingsoft Corporation. Xunlei raised $88 million in an US IPO in June. Xiaomi Ventures, an investment arm of Chinese mobile phone maker Xiaomi, and King Venture Holdings, a subsidiary of Kingsoft, are both substantial investors.

Baidu backs Finish indoor mapping start-up

Baidu has agreed to invest $10 million in IndoorAtlas, a VC-backed Finnish software developer that specializes in indoor mapping. IndoorAtlas has developed a technology that uses magnetometers in smart phones to detect anomalies in the Earth's geomagnetic field.

NORTH ASIA

Tencent invests $20m in Korea's PATI Games

China's Tencent Holdings has invested KRW20 billion ($20 million) in Korean mobile game developer PATI Games. With this investment, Tencent has reportedly become the second largest shareholder in the company with a 20% stake. Famous for mobile game titles such a "I Love Coffee" and "I Love Pasta", PATI is preparing to list on the KOSDAQ exchange.

Japanese mobility firm Whill raises $11m

The government-backed Innovation Network Corporation of Japan (INCJ) has led an $11 million Series A round for Whill, a Japanese startup which has designed a type of electronic mobility chair. Other participants in the round included: Sun Microsystems co-founder and former CEO Scott McNealy; Taiwan's Jochu Technology; NTT Docomo Ventures; and existing backers 500 startups.

Unison holds $428m first close on Fund IV

Unison Capital has reached a first close on its latest Japan buyout vehicle - Unison Capital Partners IV(F) - of JPY45 billion ($428 million), with the fund expecting a final close of JPY75 billion. The fund was launched in February this year with a target of JPY60 billion. It is smaller than the 2008 vintage Unison Capital Partners III, which scaled back its corpus in 2012 from JPY140 billion to JPY107 billion after the firm reported limited deal flow.

The new vehicle will pursue buyouts of small and mid-cap Japanese companies, including ownership successions, management buyouts, and spin-offs from large corporations. The fund will look to invest across numerous sectors, but with a particular focus on consumer-orientated businesses and upstream manufacturing.

"Japan has a very deep corporate market where good businesses change hands with relatively ease when compared with other Asian countries, but it still remains that the mega deals are harder to come by," Tatsuo Kawasaki, co-founder of Unison, told AVCJ in May. "We think the market is showing great momentum. The improvement in the macro economy is doing a lot for overall sentiment and that translates into the private equity environment well."

VCs take part in $2.1m round for Japan's Innova

Nippon Venture Capital, Draper Nexus and strategic investor Salesforce.com have together invested JPY220 million ($2.1 million) on Tokyo-based search engine optimization (SEO) and content marketing agency Innova. Through its partnership with Salesforce, Innova aims to attract more clients, while Salesforce will add Innovas' marketing solutions to its customer relationship management platform.

SOUTH ASIA

Providence in partial exit from India's Idea Cellular

Providence Equity has made a partial exit from Idea Celluar, a Indian mobile network operator promoted by Aditya Birla Group, selling a 2.3% stake - or a quarter of its previous holding - for around INR14.1 billion ($234 million) via an open market transaction. The exit from the eight-year-old investment is understood to have generated 3x money multiple, or an IRR of 15%, not counting dividends.

KKR loses India PE head

Heramb Hajarnavis, a director and leader of KKR's private equity business in India, is leaving the firm to pursue other opportunities. Based in Mumbai, Hajarnavis joined KKR in 2010, having previously spent 14 years at Goldman Sachs where he rose to managing director and co-head of private equity in India.

IFC invests in Indian food additives producer

International Finance Corporation (IFC) has invested $27.5 million in Lucid Colloids, one of the top four producers of food additive guar gum. The financing comprises compulsorily convertible debentures of $12.5 million and the balance as debt. The investment will be used to expand capacity by setting up a new guar gum plant in Gujarat, two guar splitting plants in Rajasthan, and a research and development facility.

SOUTHEAST ASIA

UOB, Orix launch $200m SE Asia mezzanine fund

Singapore-based United Overseas Bank Limited (UOB) and Japan's ORIX Corporation (ORIX) have launched a mezzanine fund providing expansion capital to mid-sized companies in Southeast Asia. UOB and ORIX are putting in an initial combined sum of US$100 million to the vehicle - the United Orient Capital Fund - with a target to raise another $100 million from institutional investors based in Asia, A joint venture between UOB and Orix will manage the fund.

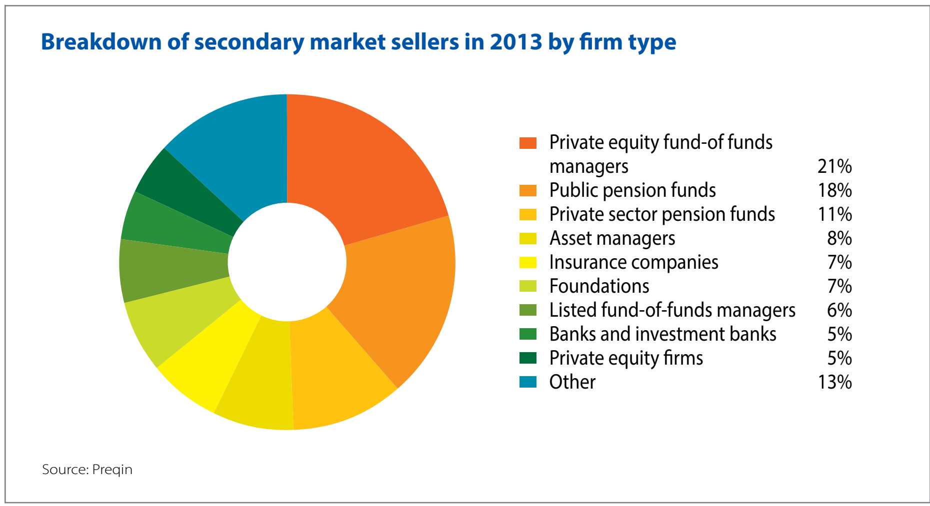
andrew.woodman@incisivemedia.com

Secondary surge

Secondary deal flow has reached record breaking levels in 2014. Regulatory reform and economic recovery have helped, but that is not the whole story – the maturing market is arguably more important

AFTER WELL OVER A YEAR IN THE MAKING, last month J.P. Morgan Chase finally entered a definitive agreement to sell about half its stake in the portfolio of its private equity arm, One Equity Partners (OEP), to secondary buyers Lexington Partners and AlpInvest Partners. The deal – involving the sale of around $2 billion out of OEP's roughly $4.5 billion in investments – is one the largest secondary transactions of 2014, a year which so far has seen around $16 billion worth of assets change hands, according to Cogent Partners.

Under the terms the transaction, J.P. Morgan is to retain ownership of about half of One Equity's nearly 30 portfolio companies, of which two are based in Asia. The rest will be spun out a new private equity firm, OEP Capital Advisors, led by existing OEP managers but independent from J.P. Morgan. The new firm will manage the portfolio being sold by the bank as well as those investments being retained.



The sale comes at a time when many banks are under regulatory pressure in Europe and the US to de-risk their portfolios by shedding private equity assets. While J.P. Morgan says the planned spin-out is not the result of these regulatory changes – it or any other bank would be unlikely to say so if it was – they are undoubtedly a contributing factor to deal flow.

"Many banks have already done some disposals and there are still quite a lot of institutions looking to shed private equity assets on their balance sheets," says Tim Flower, managing director with HarbourVest Partners in Hong Kong. "It is a very strong year in terms of deals and the level of activity is potentially going to be similar, or higher, to that of 2013, which was a record year in terms of deals done globally."

However, headline-grabbing spins-out like OEP are just part of the picture. According to Cogent, deal volume is expected to exceed $30 billion for the first time this year after more than $16 billion was transacted in the first six months of 2014. While these record-breaking figures can partly be put down to more cyclical drivers, the data also suggest that the global secondaries market is being powered by longer-term trends resulting from a maturing market.

Big beasts

To understand what has been happening this year in terms of secondary deal flow, it is useful to look back to 2013 when the industry began to see an uptick up in activity. Secondary market volume reached an equally record-breaking level of $27.5 billion, compared to $25 million for both 2011 and 2012.

What was notable about 2013 was that in the six months there were less of the mega fund portfolio sales of previous years, but rather deal flow was bolstered by increased participation from investors involved in smaller transactions, including single interest sales. According to Preqin, the largest groups selling fund interests were private equity funds-of-funds, representing 21%, while public and private sector pension funds accounted for 18% and 11%, respectively. Insurance companies, banks and investment firms made up most of the rest.

However, towards the end of the year the secondary market looked as though it might be given additional momentum with the finalization of implementation guidelines for the Volcker Rule, the regulation introduced in 2012 to put a cap on banks' private equity exposure. It was decreed that by July 2015 banks could not own more than 3% of a captive private equity program or have more than 3% of their total tier-one capital in any form of alternative asset pool.

As a result, by the start of 2014 some of the banks that had been holding off selling through most of the previous year started to come to market in anticipation of the compliance requirement. This put some of the large portfolio deals back on the table. Lexington has made a string of investments taking advantage of the banks' renewed desire to sell. In addition to the OEP deal, it has also recently bought from Citigroup the lion's share of a $1.5 billion commitment to a fund managed by midmarket buyout firm Metalmark Capital.

"With the regulatory pressure on the banks the opportunities to do large deals are there if you can provide a compelling solution," says Wilson Warren, a partner with Lexington in New York. "Our hit rate has been much higher on complicated bank transactions because they are large and they involve complex legal issues. Having a reliable, well-known counterparty is more important to those institutions than price."

Other recent examples of institutions bringing – or preparing to bring – large fund portfolios to market include Australian asset manager QIC, which was reported to have hired Cogent Partners to offload a portfolio of fund stakes valued at $1 billion. Meanwhile, Ardian is said to be planning to acquire $1 billion of fund positions owned by Singapore's state-owned investment company Temasek Holdings. One of the main motivators for these deals coming to market has been valuations.

"Pricing has been pretty frothy, and clearly

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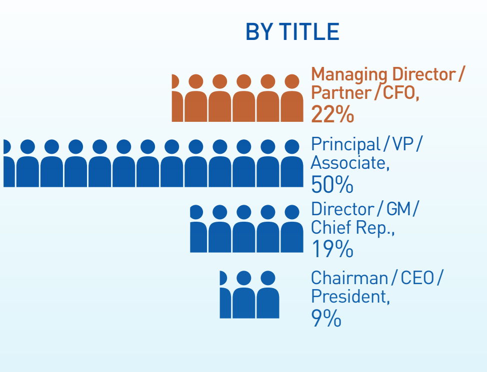
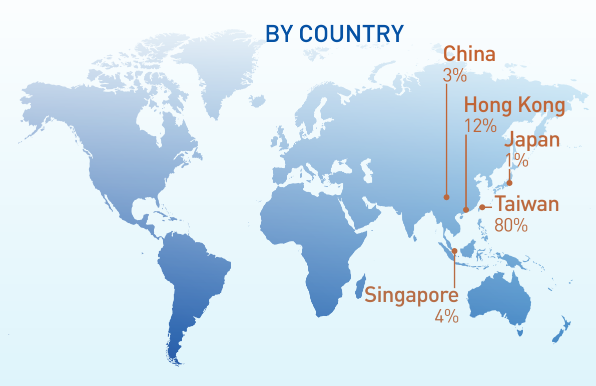
General Partners, 27%

BY TITLE



Managing Director / Partner / CFO, 22%
Principal / VP / Associate, 50%
Director / GM / Chief Rep., 19%
Chairman / CEO / President, 9%

BY COUNTRY



Registration enquiries: **Pauline Chen** T: **+852 3411 4936** E: **enquiry@avcj.com**
Sponsorship enquiries: **Darryl Mag** T: **+852 3411 4919** E: **Darryl.Mag@incisivemedia.com**

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andrew.woodman@incisivemedia.com

you want to buy assets that allow you to underwrite at a better return, so it can be a struggle," says HarbourVest's Flower. "The silver lining is that strong pricing has meant more people are exploring the market and selling. This is one of the reasons 2014 has been such a good year so far for deal flow."

Cogent's most recent study shows that the average high bid across all strategies increased to 93% of net asset value (NAV) during the first half of the year. Buyout fund pricing, meanwhile has been particularly strong, with the average high bid increasing to 100% of NAV, the first time that any strategy has priced at or above NAV since 2007. Other fund strategies also saw an uptick in pricing, with real estate and venture funds posting average high bids of 92% and 82% of NAV, respectively.

Dominik Woessner, a director with Cogent in Singapore, notes the impact this global trend has also coincided with a pick-up in activity in Asia. "In the first half of the year the secondary market in Asia was very busy, and it is shaping up to be busy is second half, and the biggest driver has been attractive pricing levels," he says. "In Asia people have come to the conclusion that these are very attractive pricing levels and have started acting on that."

Woessner adds that while in previous years Asian assets accounted for less than 5% of global transaction volume, this year he expects the figure to be in the region of 5-10%. Attractive pricing is not the only factor behind increased seller activity. Others include tougher liquidity requirements, portfolio rebalancing and the need to exit from poor- performing funds.

Liquidity opportunities

An investor survey conducted by Preqin this year offers additional insight into seller trends. According to the report, this year 39% of LPs said they used secondaries to meet liquidity requirements, an increase of 23% on the previous year. Selling fund interests as a means of rebalancing portfolios was the second most common response, though the score was down on the 42% posted in 2013. Meanwhile, the third reason – exiting poor performing funds – dropped to 21% from 29%. This seems to support the view that aside from being motivated by temporary drivers such as the Volcker Rule and high valuations, more sellers are turning to secondaries as means of managing their private equity investments.

"Everyone has something for sale and the secondary market has become an accepted solution and a necessary part of the market – one where institutions and investors alike are focused on trying to manage their portfolios more actively than ever before," says Tom Kerr, managing director and head of the secondary team at Hamilton Lane.

Another factor likely to drive increased deal activity not described above is the increased levels of secondary buyer participation in GP-led restructurings.

There are still a number of GPs managing vehicles that are close to, or past, their pre-agreed life-span with significant unrealized value remaining. LPs are unwilling to back follow-up vehicles, which means existing portfolio companies are starved of the capital needed for value generation. Caught in this capital bind, more GPs have turned to the secondary market in search of investors that can take out existing LPs that want to exit and then inject fresh capital into the fund, usually after spinning out the assets into a new vehicle.

Preqin data show that the investment potential is considerable, with these so-called "zombie funds" – defined as funds with a vintages between 2002-2007 and managed by firms that have not successfully raised capital since 2007 – number 1,049 globally with around 10% in Asia.

However, it is worth noting that such deals are notoriously difficult to transact, not least because the secondary buyer must agree a valuation with each exiting LP. Perceptions of value, often driven by the amount of pressure an LP is under to exit, can vary hugely. The new investors must also decide whether they want to retain some or all of the existing GP management team, and if not, identify a new one.

Who's buying?

While the market may have plenty of willing sellers, what is driving the buy side? Again, Preqin's recent LP survey data sheds some light on this issue. Currently, secondary buyers are predominantly made up of public pension funds, which represent 18% of the market, followed by private sector pension funds and insurance companies, on 13% and 11%, respectively.

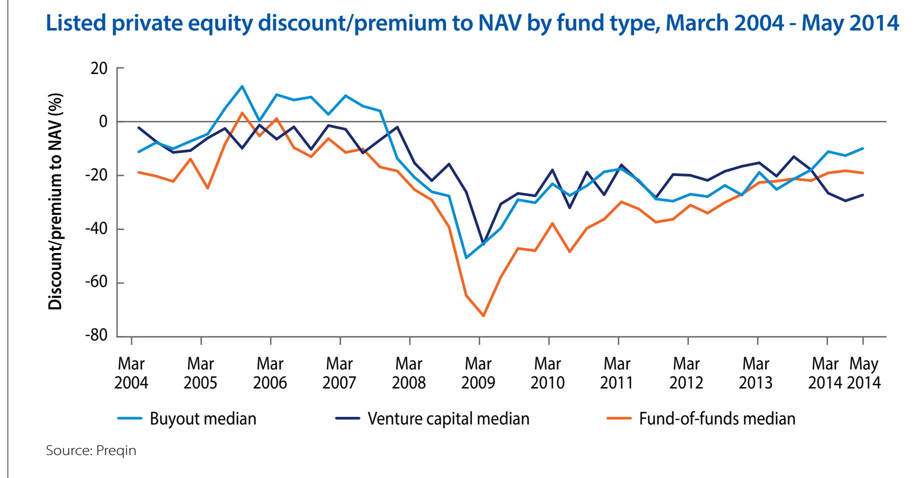
Currently over a third of these buyers cite mitigation of the j-curve effect on their portfolios as motivation – an increase from 2013, when only 17% of investors cited the same reason. There has also been an increase in the number seeking secondary investments as a means of accessing top performing managers – 31%, compared to 17% last year. As expected, there has been a substantial reduction in interest in the market due to appealing valuations (down to 33% from 67%).

Interestingly, the data reveals that an increasing number of buyers – like sellers – recognize the benefit of utilizing the secondary market to diversify and manage their private equity portfolios by vintage year, reflecting a more active and increasingly sophisticated investor universe. Lexington's Warren also makes this observation. "If you look at the turnover rate - percentage of primary market being sold into the Secondaries market - it has increased from something like 1% 20 years ago, to somewhere around 5-6% today," he says. "So there increasing adoption of liquidity in the market."

Asia, meanwhile, will still account for a small fraction of this activity, but this too will likely change as the market matures. In the short to medium term, the overall sentiment is that the combination of attractive deal opportunities, increasing need for liquidity and the fact that investors can actively managed their portfolios at attractive prices, the deal pipeline will continue to be robust.

"Over the next five-year period the market is likely to run at $30-35 billion a year. Could we have a year that reached $45 billion? Yes. Could you have a year that is $20 billion? Absolutely. It will depend on the cycle," says Warren.

Listed private equity discount/premium to NAV by fund type, March 2004 - May 2014



Source: Preqin

christie.ou@incisivemedia.com

Casual opportunity

YPX Cayman was born out of an idea for a tech-style start-up in China's casual dining space. Backed by a string of investors, the firm is making headway with Cloud 9 and preparing to launch new concepts

YUM BRANDS, THE BEHEMOTH BEHIND restaurant chains such as KFC and Pizza Hut, has more than 6,200 outlets in China; McDonald's has over 2,000. Yet these two groups' combined share of the Chinese quick service restaurant market is 7.7%. The 18 companies that make up the top 20 together account for a further 4.3% last year, according to Euromonitor International.

As many as 500 million Chinese are expected to join the country's nascent middle class over the next decade. Rising disposable incomes are already driving people to seek out a better quality dining experience – they continue to prioritize affordability, but they are willing to pay a small premium for food safety, consistency and a pleasant restaurant environment.

Four years ago, Chris Tay, a Singaporean tech entrepreneur turned casual dining expert, didn't think this consumer demand was being met. Put simply, the growth of China's economy had outpaced the development of its food industry. "Restaurant chains at that time were dominated by fast-food options like KFC and McDonald's as well as higher-end players such as Xiao Nan Guo," Tay says. "There was an empty space in between, and casual dining fell into that gap."

Hans Tung, now a partner at GGV Capital but then with Qiming Venture Partners, adds to the picture of fragmentation but also offers a hint of the payoff for investors capable of guiding a business from start-up to scale.

Like many developing markets, China is dominated by small, family-run and often inefficient restaurant businesses that nevertheless manage to scrape fringe profits in an under-regulated industry. "There were five listed dining chains in China and three had been bought out by other players," Tung observes. "In the US there are 50-plus and Japan has 16."

Concept to reality

This was the context for the creation of YPX Cayman, which operates the mainland China franchise of Taiwan-based casual dining chain Cloud 9. Last month the company received $25 million in Series D funding led by Maybank Private Equity, with participation from existing backers LionRock Capital and Ignition Capital, as well as several individual investors. YPX is now looking to introduce other restaurant franchises, capitalizing on the traction it has gained with China's growing yet still underserved casual diners.

Tung recently became a personal investor in YPX but in 2010 he was at Qiming, examining the potential for a tech-style start-up in the restaurant space. Tay was a logical partner in this endeavor. He had run IT systems for the group that licensed Dairy Queen and Yoshinoya in China, headed up Taiwan food conglomerate Tingyi Holdings' China casual dining business, and launched dairy company Yili Group's ice cream parlor chain.

"Chris has worked for a Hong Kong family, a Taiwan family and a state-owned enterprise, restructuring portfolios and taking them to the next level," says Tung. "He has a scientific, data-driven approach to the fast casual restaurant business."

With the concept and the CEO in place, it took six months to identify Cloud 9 – which has 67 stores in Taiwan – as the franchise of choice. YPX's formative days were challenging. One of the earliest outlets, located next to a railroad in Shanghai, closed down because foot traffic didn't translate into sales: people rushed by in a hurry and didn't want to spend a lot on food. Another two restaurants struggled after opening in 2011 when inflation was at its peak. YPX also once changed the Cloud 9 menu three times in the space of 15 months.

Teething troubles were unsurprising given the company was trying to bed down a concept that had yet to fully establish itself in China. Brand loyalty must be earned over time. "The most difficult thing is to convince people," says Tung. "If a restaurant chain wants to achieve scale, it takes 10 years, and maybe 13-15 years to go public. Even if there is enough capital, you need the patience, you need to build consumers' trust."

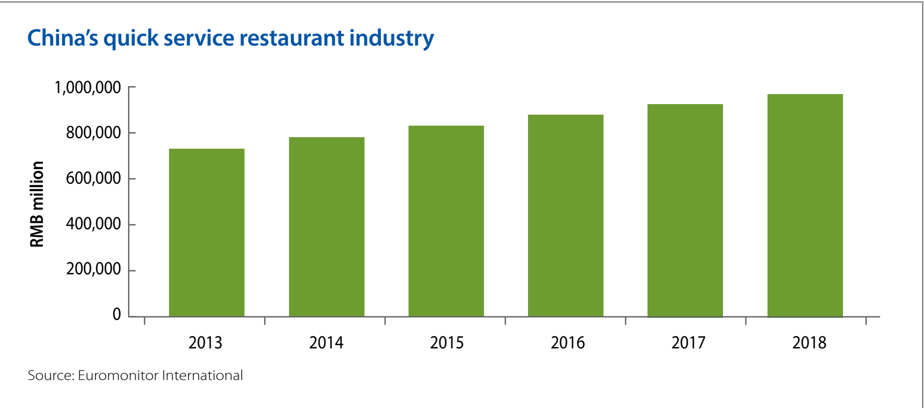
Efficiency was also critical to YPX creating a sustainable and scalable business model. Cloud 9 uses three suppliers for all its products; it develops ideas for dishes, devises recipes, and relies on these third-party providers to handle the rest. "We look at ourselves more as a brand operator and as a service provider, not as a manufacturer," Tay stresses.

The restaurant chain addressed the risk of becoming overly dependent on certain chefs by preparing complicated dishes in central kitchens. The cooking facilities in each restaurant are used for the preparation of simple dishes and re-heating, all in adherence with a standard operating procedure. This approach is intended to ensure consistency of taste and allow YPX to focus on expansion relatively unencumbered by the staff turnaround and process orientation issues that plague many restaurant businesses.

"YPX is using a very efficient IT led model of development. All of its stores are very standardized and not chef-dependent. From day one, it has been a very scalable business," says Daniel Tseung, managing director at LionRock.

The company has grown rapidly. From just one restaurant in 2010, Cloud 9's network has increased to more than 40 outlets stores covering Shanghai, Beijing, Tianjin, Hangzhou, Nanjing, Changzhou and Hefei. Sales revenue exceeded RMB100 million in 2013, with more than 3 million customers passing through the doors.

After Qiming put in an initial $5 million to get



the business started, a Series B round worth $15 million came in 2011, led by Taiwan's Hotung International. Qiming re-upped, Mitsui Global Capital entered, and several high net worth individuals (HNWIs) made contributions. A further $6.5 million came through a combination of investors exercising warrants and debt financing. LionRock led an $11.5 million Series C round in November 2012, with Qiming and Ignition also participating.

YPX's HNWI backers include the likes of Koh Boon Hwee, former chairman of DBS Bank and Singapore Airlines, and Peter Tan, former Greater China president of McDonald's and ex-Asia Pacific CEO of Burger King.

Network expansion

Of the $25 million raised last month, three quarters will be spent on expanding both YPX's network of directly-owned stores and its franchising system. It is expected that 25-30 new stores will be opened under the Cloud 9 brand next year. The overall target is 225 Cloud 9 outlets in China, comprising 100 franchise stores and 125 directly-owned stores.

YPX has only become a franchisor this year and the most frequently asked question was what would happen to its brand image. These concerns are rooted in the mixed fortunes of franchising in China due to poor monitoring, a mismatch in values between franchisors and franchisees, and unethical practices by franchisors who emphasized short-term gains over long-term brand sustainability.

"I worry about it every day," Tay says. "My strategy for establishing a proper franchise is not to have too many franchisees, but rather have a few operators opening up more stores. I select quality franchisees that have not only financial backing but also relevant management experience in food and beverage industry." By having a small number of franchisees with multiple locations, it is easier for YPX to maintain the brand's reputation.

There will also be further investment into the IT infrastructure that supports the company's franchising system. The objective is to collect and calibrate consumer data in order to identify areas in which efficiency can be improved. For example, YPX will be able to plan purchases of ingredients more accurately, speedily modify menus based on customer preferences, and shorten ordering and payment processes in the restaurants without compromising on the dining experience.

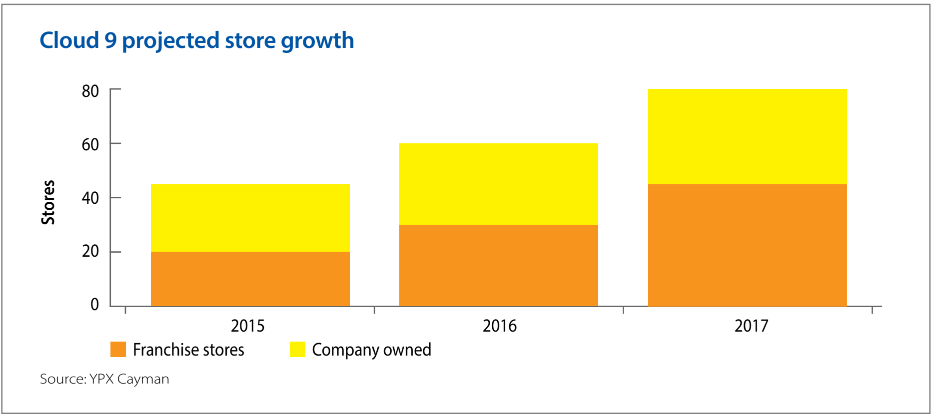
"The biggest challenge is not expansion – 25-30 stores is quite achievable," Tay adds. "The biggest challenge facing any brand in China is manpower." As such, providing the right training program is fundamental to the drive for greater efficiency. The bottleneck occurs at the operational level, with companies typically struggling to persuade the abundance of managers in big cities like Shanghai and Beijing to take up frontline roles elsewhere. YPX's non chef-dependent model is intended to minimize the impact in this area.

For any restaurant chain, the recent food safety scandal that saw McDonald's overhaul its oversight procedures after a supplier was accused of intentionally selling expired meat is a reminder of the supply chain vulnerabilities that can crop up in China. Indeed, offering consumers certainty in terms of sourcing procedures and product quality is a key driver of industry consolidation.

demand for Asian fast food cuisine. As for local competitors, YPX believes its differentiating factor is a focus on marketing, brand management and improving service quality.

"We have our own genre, those in the 18-25 age range who want to eat out but don't want to spend more than MYR40 per person," Tay says. "The menu is not that limited and changes every year." The company's investors assist in this area by supporting the implementation of international standard systems and processes.

In addition to recruiting and retaining talented staff, Keong Pneh Tee, CEO of Maybank Private Equity, sees YPX's major challenge as securing



Source: YPX Cayman

Investors in YPX are actually quite positive on the issue. Yasu Sakoh, chief representative in Beijing for Mitsui Global Capital, points out that, even as the company expands – receiving more products from a wider variety of suppliers – food safety is not a concern provided there is sufficient focus on monitoring and educating suppliers.

Koh, the former DBS chairman who now chairs property developer Far East Orchard and was among YPX's first investors, adds: "I am not worried about YPX's brand image. In any emerging market, every now and then something like this will happen. What YPX constantly emphasizes is the importance of food safety and food handling processes in our company, and I know that Chris has a lot of training programs in this area."

Competitive edge

While these efforts are integral to building consumer confidence and a credible brand image, there are now more rivals looking to do the same within the casual dining space, from Western food chains to local players. YPX responds to the challenges presented by the two groups in different ways.

In the face of competition from Western chains, the emphasis is on making the business relevant and staying up to speed on market needs. Koh stresses that beyond the realm of McDonald's and KFC there remains strong good locations. This means building strong relationship with mall landlords is especially important. However, Tan, the ex-McDonald's and Burger King executive, believes the youth and freshness of the Cloud 9 brand represents a comparative advantage – it potentially helps draw a broader demographic of customers to the mall.

Buoyed by the steady growth of Cloud 9, YPX is adding two new China franchises to its portfolio over the coming year, an American casual dining brand and a Japanese casual dining brand. "Now the competition has intensified and there are people have more choice, scaling up is not as easy as before, so we have new brands coming in," Tay explains.

In expanding its portfolio in order to increase market share, YPX is following the Yum Brands model of operating multiple brands. There are plans to enlarge the company's store footprint to include western China regions, focusing on cities such as Chengdu in Sichuan province and Kunming in Yunnan. Given the size of the untapped market within China there are no immediate plans to go overseas. Tay says it is also too early to consider exit options, although he wouldn't be surprised if the situation changed after 2017.

"Aside from an IPO, I would not discount the possibility of another private equity firm coming in and buying us out," he observes.

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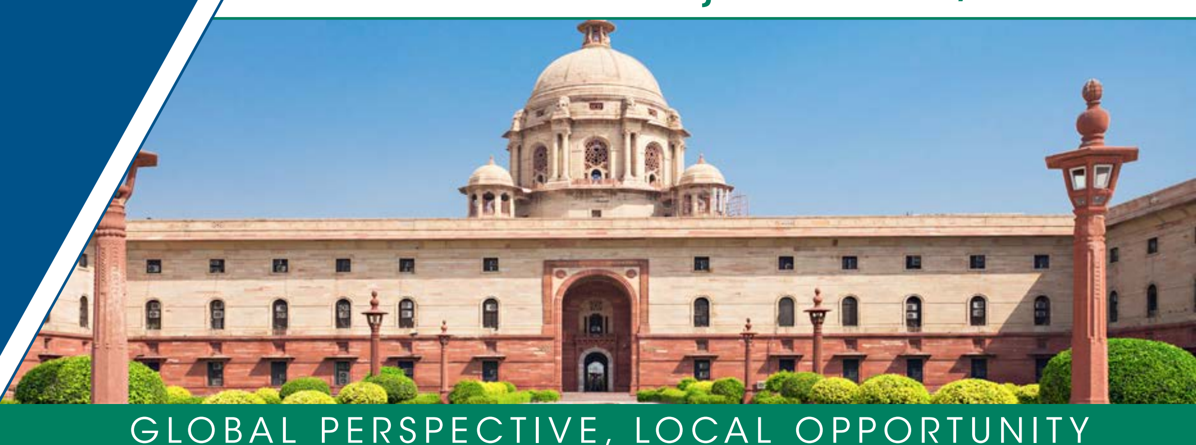

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Navis returns for Dome Coffees refill

HAVING BUILT A STRONG RELATIONSHIP with the management team at Dome Coffees Australia, Navis Capital Partners was comfortable with the notion of buying the specialty coffee and dining restaurant chain for a second time, 11 years after the first acquisition.

The Malaysia-based buyout firm's first time investment in 2003 was a management buyout worth a reported $20 million. Five years later, Navis exited to Viburnum Funds – with management once again participating – and saw a 3.5x return on its investment. Last week, the PE firm took a majority stake in Dome for an undisclosed sum. The equity commitment is said to be between $50 million and $100 million, although further capital will be provided to support expansion.

"We stayed in touch with the management team after we sold the business. They had done very well and proved to us they are both capable and trustworthy," says Nick Bloy, co-managing partner at Navis. "When Viburnum was considering an exit, management said, 'Look, we want to work with Navis again if you and Navis can agree a fair price. We don't want to do an IPO or spend time building relationships with other PE firms and strategic investors at this stage."t

As a result, the process was not competitive and took little time to complete.

Originally from Western Australia, Dome operates 110 self-owned and franchised outlets in Australia and other parts of the world, including Malaysia, the Philippines and the United Arab Emirates. Over the next five years, it will set up another 25 shops in Australia, pushing into northern parts of the country, and also enter New Zealand.

Dome Coffees: Double shot

In addition, the number of outlets in Southeast Asia – currently 32 – will nearly double and there will be 15 more shops in the Middle East. Most of Dome's less than A$200 million ($187 million) in annual revenue comes from Australia, but Bloy expects the rest of the world share to account for 50% eventually.

Styled around a Continental European bistro theme, Dome combines its own specialty coffees with a full food menu. Casual dining accounting for 70% of revenues, which means the business hinges on selling a consumer experience with a coffee concept built into it. This contrasts the likes of Starbucks where the model is based on the frequency of sales over a period of time.

As a result, Dome is in the process of creating zones for different customers in order to maximize the user experience. The principal challenge the company faces is finding store managers who understand and can execute this strategy. While Navis has traditionally exited companies to strategic buyers, Bloy sees Dome as a potential IPO candidate within five years.

"Historically, we have never targeted the IPO market, but Dome could be a very good IPO story in a five years' time - asset-light, highly cash generative with plenty of growth still to play for," adds Bloy.

VCs back Zai Lab drug development model

FEW VC FIRMS ARE KEEN TO INVEST in China's early-stage drug discovery space because the development cycle is long and risky. Taking a new drug from clinical testing to commercialization often takes 7-10 years and the success rate in China is less than 1%. But biotech start-up Zai Lab has won backing for a different strategy.

Within few months since its inception, the Shanghai-based company closed a $30 million Series A round of funding led by Qiming Venture Partners, which put $15 million on its own. KPCB, Sequoia Capital, TF Funds and TigerMed – a leading domestic contract research organization (CRO) and a Qiming portfolio company – contributed the rest.

Several other VC firms wanted in but they were squeezed out. Nisa Leung, managing partner at Qiming, attributes Zai Lab's popularity to its strong management team and a business model that makes sense.

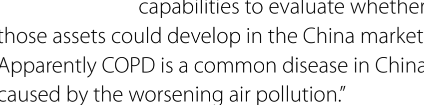
Samantha Du, Zai Lab's founder, severed as CEO of Hutchison Whampoa Group's drug R&D subsidiary Hutchinson MediPharma for more than 10 years before joining Sequoia as a healthcare venture partner. "We have been very careful about investing in early-stage drug development firms in China," Leung says. "But we have confidence in the Zai Lab team under Samantha's leadership. She is very reputable in the industry."

In recent years, many Chinese returnees have tried to develop new drugs. Although no one is close to producing the next blockbuster treatment, the biotech ecosystem is evolving, which has driven the CRO industry. These agencies provide outsourced clinical-trial services, enabling drug sponsors to save on costs, and they are getting more business from US players. With the National Institutes of Health (NIH) trimming R&D subsidies, it is increasingly difficult for US-based drug discovery firms to raising funding.

Zai Lab: Drug development

In this context, Zai Lab has a great opportunity. Du is leveraging her network to license pre-clinical findings from the West but then develops the drugs in China. Last month, the firm obtained a license from Sanofi for two novel compounds that could potentially be used to treat chronic respiratory diseases, including chronic obstructive pulmonary disease (COPD) and asthma. The compounds were discovered by Sanofi and are currently in pre-clinical stage.

"Firstly, it isn't easy to license valuable assets from a multinational firm," says Leung, explaining Zai Lab's competitive advantage. "Second, the local team must have strong capabilities to evaluate whether those assets could develop in the China market. Apparently COPD is a common disease in China caused by the worsening air pollution."



CRO TigerMed is likely to become a partner, offering clinical-trial services for Zai Lab.. Du's government relationships are also expected to make it easier for the company to obtain product licenses within China.

tim.burroughs@incisivemedia.com

Emerging giant

Malaysia's Employees Provident Fund (EPF) is a relatively new but increasingly significant part of the global PE landscape. Datuk Shahril Ridza Ridzuan, the fund's CEO, outlines the strategy

Q: As of year-end 2012, your allocation to PE was less than 1% of total assets. How has the program grown and how do you expect it to grow?

A: The EPF has been involved in emerging markets private equity funds since 2005. In the last three years we have increased our involvement in develop markets through separate account programs. We continue to make commitments to funds in both developed and emerging markets. In addition to that, we continue to seek out and invest directly in opportunities in the Malaysian buy-out space. Accordingly, the total allocation to private equity is growing and will allow us to reach our target of 2% under our strategic asset allocation.

Q: How has the private equity portfolio performed in terms of strategy and geography?

A: We are satisfied with the performance of our PE program despite the fairly short track record, particularly in the developed markets space. We have benefited from timing our entries during a period when liquidity and demand for private equity was lower than normal as a result of the last financial crises. The EPF has, however, noticed that there is a significant dispersion of performance in the emerging markets space. We believe that identifying suitable emerging market fund managers continues to be the most challenging aspect given the relative immaturity of the space and the funds operating there. Our experience has taught us to pay more attention to a private equity firm's key attributes such as track record, alignment of interests and the cohesiveness of the management team, before making any commitment.

Q: How do you see your geographical exposure developing? Are you and do you want to continue to be Malaysia and Southeast Asia heavy?

A: The EPF initially focused on Malaysia and Southeast Asia due to familiarity. In the past few years however, we have extended our private equity investments to include North Asia, Western Europe, North America and Latin America. We will continue to invest in developed markets, given the liquidity and maturity of these markets. The Malaysian market would be more of an opportunistic play, leading to opportunities for direct and co-investment deals. We believe that there is still growth in Southeast Asia, and Malaysia particularly, and will continue to work with our partners to identify clear opportunities for investment.

Q: To what extent do you use third-party advisors or managers to help with allocations?

A: The EPF's investment strategy as a whole is governed by its strategic asset allocation (SAA), which was developed in house with advice from global pension and social security consultants. In addition, we have engaged an advisor to specifically work with us on our allocations for non-publicly traded assets within the context of the SAA. For private equity fund investments, in addition to the use of LP arrangements for our entry into the typical PE fund structure, the EPF has also used fund-of-funds managers. This has been especially useful in scaling our operation in primary and secondary investments in developed markets. Obviously, for co-investment and direct deals, we employ advisors to conduct the legal, financial and commercial due diligence processes in conjunction with the funds that we partner on those transactions.

> "We are satisfied with the performance of our PE program, particularly in the developed markets space"

Q: To what extent does the QSR Brands-KFC Holdings deal, completed in partnership with Johor Corp and CVC Capital Partners, represent the kind of co-investments you are looking to do?

A: The QSR-KFC deal fulfils key criteria for the EPF's co-investment mandate – it is within our geographic mandate, the business has strong cash flows and the deal structure is a partnership between strong local investors and an experienced PE manager. The investment is also in a segment which we like, namely cash-flow driven consumer businesses with significant growth potential. Apart from that, we are actively seeking to participate in similar sizeable direct co-investment deals with our existing PE managers in Southeast Asia, Australia, and Western Europe.

Q: What do you see as the key factors that may help or hinder the development of private equity in Malaysia?

A: Private equity is already very vibrant in Malaysia with a significant number of entrepreneurs and families actively involved in business operations and investments. However, it is not in the form that is defined as PE by Western investors where a GP-LP model with primarily institutional participation exists. From our perspective, the issue is not about the industry's development but rather access for institutional investors. Malaysian businesses have had the benefit of significant access to and support from a well-developed banking sector and capital market and so they have been less reliant on alternative sources of capital. The growth in the GP-LP model has, however, been significant over the past few years. Culturally, family-run businesses have traditionally been reluctant to open up to third-party investors, but we believe this too is changing.

tim.burroughs@incisivemedia.com

National champion

Part of Ekuinas' mandate is to foster the development of a domestic private equity industry in Malaysia. Dato' Abdul Rahman Ahmad, CEO of the government-supported fund, explains its approach

Q: What is the composition of Ekuinas' private equity portfolio in terms of outsourced commitments and direct investments?

A: Ekuinas operates two investment operations simultaneously: direct investments, where we invest directly into mid-sized Malaysian companies; and the outsourced program, where we appoint third-party private equity firms to invest on our behalf. Since our inception in 2009, we have established two funds under direct investments with committed capital of MYR2 billion ($630 million) and two funds under the outsourced program with committed capital of MYR640 million. As of December 2013, we had undertaken a total cumulative investment of MYR1.8 billion across 24 companies, out of which direct investments represented nearly 90%.

Q: How has the direct investment portfolio grown since inception and how has it performed?

A: We had made 15 investments amounting to MYR1.6 billion as of year-end 2013, and facilitated total capital deployment of nearly MYR1.8 billion. The Ekuinas MYR1 billion Direct Tranche I Fund had achieved a gross portfolio return of MYR655.9 million, which translates to a gross annualized IRR of 25.5% and a net annualized IRR of 20.4%. This exceeds our stated long-term minimum targeted annualized return of 12% and our aspirational target of 20%.

Q: The outsourced investment program has committed MYR640 million across two tranches since 2012. How do you expect it to develop?

A: The MYR640 million is spread out among seven outsourced fund managers (OFMs) across two tranches. Ekuinas has allocated MYR1 billion over the long term for its outsourced programs, so there is a balance to be allocated in the future. The strategy is to expand the capital pool, given that the OFMs are required to raise at least 20% external private capital to match Ekuinas' 80% allocation. This is in line with the Malaysian government's call to increase public-private partnerships. Further, the outsourced program has been designed to be complement Ekuinas' direct investments given its focus on smaller deal size and minority growth capital, while the direct investors focus on larger deal sizes and predominantly buy-outs. At the same time, we hope that the increase in the number of more active private equity firms will broaden the opportunity for more Malaysian companies to partner with local PE firms that have the necessary network and expertise to help grow their business. This will help develop the Malaysian private equity industry as an alternative source of capital for companies.

Q: Your first direct investment – Alliance Cosmetics – was a co-investment. The disclosed investments since then appear to have been direct. Is co-investment still an important part of your strategy?

A: YYes, Alliance Cosmetics was a co-investment with Navis Capital Partners. Whilst investments undertaken thereafter by Ekuinas have been predominantly

> "Private equity firms need to be more innovative in driving investment opportunities"

independent, we have another co-investment with Shoraka Capital, a boutique Malaysian investment house, to acquire a 90% stake in Unitar Capital, the owner and operator of UNITAR International University. Co-investment with GPs remains a part of Ekuinas investment strategy and we are constantly on the lookout for opportunities to collaborate with strong private equity firms that can add value.

Q: How does Ekuinas view its role in the development of private equity in Malaysia?

A: Whilst Ekuinas is focused on meeting its commercial and social objectives, we also recognize the need to play a developmental role given private equity in Malaysia remains a relatively nascent industry. We believe this can be achieved by demonstrating that private equity investment, if successfully executed, is not only able to deliver superior returns but can also serve as a catalyst to transform companies and enhance economic productivity. At the same time, our outsourced program provides the opportunity for Malaysian private equity firms to raise capital and develop, as well as build their track record in delivering successful investments.

Q: What do you see as the key factors that may help or hinder the development of the industry?

A: The biggest challenge is the limited participation by Malaysian investment institutions in PE. Relatively few domestic groups are willing to be LPs in private equity funds, whether domestic or global. Other factors include the relatively small size of the Malaysian economy which means that attractive deals are not easy to identify. Accordingly, private equity firms need to be more innovative in driving investment opportunities and ensure they able to drive strategic and operational value creation to deliver the required returns. At the same time, Malaysian companies traditionally regard the capital markets as the first port of call for raising capital. Similar to other Asian countries, a lot of businesses are still family-owned and unfamiliar with external private investors. However, given that private equity's profile is rising as a result of successful deals and partnerships – and as public market valuations for smaller and mid-size companies recede – we believe the future of PE in Malaysia is bright.

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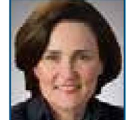

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