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Virtual goldmine?

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Last orders in Korea

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A new constituency

AS ONE GP NOW PUTS IT, SOVEREIGN wealth funds "are now the 1,000-pound gorilla in the room."

The growing importance of these investors, who are most heavily concentrated in Asia and the Middle East, to large cap vehicles has been apparent for some time. For example, in 2011, EQT closed its sixth European buyout fund at EUR4.75 billion ($6.5 billion), with more than half the capital coming from sovereign players. Asian LPs accounted for 23% of commitments – up from 5% the previous time around – as non-European investors committed the bulk of the corpus, a first for an EQT fund.

Since then we have seen large private equity firms, fund-of-funds and placement agents strategically adding to their investor relations power in the region. To be fair, sovereign funds are not their only target, but one of a breed of investors still in the process of constructing alternatives programs. Korean pension funds are just as interesting as Malaysia's Khazanah Nasional.

Another reminder of the significance of these emerging LPs came last week as Affinity Equity Partners reached a final close on its fourth pan-Asian fund at $3.8 billion.

In the GP's previous fund, a 2007 vintage vehicle, North American investors accounted for 50% of the corpus, with Europe on 36% and Asia and the Middle East trailing on 10% and 5%, respectively. Fast forward six years and Asia and the Middle East have between them emerged as the largest source of capital – the former accounts for 26% of Affinity's latest fund, while the latter's share has risen to 13%. The North American share has dropped to 38% and Europe is now on 23%.

The Volcker Rule and the Basel III regulations, which restrict financial institutions' exposure to private equity and hedge funds as well as imposing higher capital adequacy requirements, have certainly pared back North American and European firepower. Asian and Middle East investors appear to be filling the void – and although they are fewer in number they are writing bigger checks. Affinity's fourth fund is $1.1 billion larger than its third, but the number of LPs is largely unchanged.

Winning mandates from these investors requires a particular strategy. A CIO in the process of building an alternatives program is often under enormous pressure to put capital to work, which inevitably draws them to GPs capable of scaling up in terms of fund size and infrastructure. A $50 million allocation to a mid-market manager would only be considered if they came with a strong co-investment pipeline or if the GP picks the right moment – for example, the CIO might want to water down exposure to global buyout funds by backing regional and country managers.

Persistence, industry participants say, is paramount. It might take 18 months of meetings and site visits before a sovereign wealth fund agrees to commit to a fund, which means much of the initial groundwork must be done before the official fundraising process begins.

In addition to talking prospective LPs through their portfolios and putting forward co-investment opportunities, fund managers are expected to share knowledge. While longstanding investors like GIC Private don't need to be told how to do their jobs, groups that are relatively new to the asset class might appreciate assistance. This could involve offering views on certain geographies or strategies, or even the provision of training and technology.

The lengths a GP is willing to go in order to generate goodwill depends on how much it needs the money. While Affinity's fund came in oversubscribed after only a year or so in the market, Asia's depressed fundraising figures – commitments reached $41.7 billion in 2013, the lowest annual total in four years – indicate that many others are finding it tough.

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NEWS

GLOBAL

Portfolio Advisors closes secondaries fund at $910m

Portfolio Advisors has closed its second dedicated global private equity secondaries fund at $910 million. The vehicle launched in 2011 and began investing in the third quarter of 2012, focusing on direct secondary fund interests.

ASIA PACIFIC

KKR fundraiser Clifford Chiu to retire

Clifford Chiu, a leading figure in KKR's Asia fundraising efforts, will retire in June after seven years with the firm. As a partner and head of KKR's Asia Client and Partner Group, Chiu has helped raise $14.4 billion across five major markets, including capital for the firm's $6 billion second pan-regional fund.

Apollo's Kelley named CEO of City Developments

Grant Kelley, head of Apollo Global Management's Asia Pacific real estate business, has joined listed Singapore property developer City Developments as CEO. Kelley's past experience includes a stint as head of Colony Capital's Asia business.

AUSTRALASIA

Technology Crossover Ventures backs SiteMinder

Australian hotel booking start-up SiteMinder has raised $30 million in funding led by Palo Alto-based Technology Crossover Ventures. Founded in 2006, SiteMinder's cloud-based distribution products help hotels increase online revenue, streamline business processes and decrease operational costs.

GREATER CHINA

Neway jumps 32% on debut as China IPOs resume

VC-backed Neway Valve, the first newly-listed company to start trading following the year-long embargo on Chinese IPOs, saw its stock open up 32% on the Shanghai Stock Exchange. Shares in China's largest industrial valve exporter, which raised RMB1.5 billion ($248 million) in its IPO, were suspended from trading for half an hour in the morning after hitting the upper price limit.

Asia, Middle East LPs help Affinity to $3.8b close

Affinity Equity Partners has reached a final close of $3.8 billion on its fourth pan-Asian fund, with investors from Asia and the Middle East accounting for a larger share of the corpus than their North American counterparts. The fundraising process has taken approximately 15 months but the final few weeks were spent negotiating an increase in the hard cap with LPs. The GP initially limited itself to $3.5 billion but added another $300 million in response to strong demand for allocations.

Asian and Middle East investors - principally sovereign wealth funds - have become more prominent in large-cap funds globally but the rebalancing is arguably particularly stark in the case of Affinity. North American LPs remain the fund's single largest constituency but the share has fallen to 38% from around 50% in Fund III, while Europe has dropped to 23% from 36%. Asian investors accounted for 10% of Fund III but this has risen to 26% in Fund IV. The Middle East share has jumped from 5% to 13%.

The overall number of LPs has not changed much, despite the fund itself more than one third bigger than Affinity Asia Pacific Fund III, which reached a final close of $2.8 billion in 2007.

Hao Capital makes $80m partial exit from Pax

Hao Capital has made another partial exit from electronic payment systems provider Pax Technology, selling a 15.1% equity stake for around $80 million through a block trade. The PE firm has now realized $100 million on an original investment of $30 million and retains a 7.5% interest in the business worth approximately HK$312 million ($40.2 million).

SoftBank leads $120m round for Wandoujia

SoftBank Corp. has led a $120 million Series B round of funding for Wandoujia, a Chinese Android mobile app platform. Existing investors DCM and Innovation Works Development Fund (IWDF) also participated in the round. Wandoujia was among the first batch of projects incubated by Innovation Works and in 2011 received $8 million from the incubator and DCM.

Industry group announces PE registration rules

The Asset Management Association of China (AMAC), a group set up by the China Securities Regulatory Commission, has announced rules requiring domestic private equity firms to file reports within 20 days of completing fundraising, giving details of fund size and participating investors. Sunshine fund managers - who only invest in public equities - must subsequently report to AMAC every month, while PE funds are required to provide updates once a quarter.

Tencent invests in PE-backed China South City

Chinese internet company Tencent Holdings has bought a 9.9% stake in China South City Holdings, a logistics center operator that count PAG among its investors, for HK$1.5 billion ($193 million). Tencent said that it would collaborate with China South City in online and offline trade services, including e-commerce, online-to-offline retail, online payment and warehousing.

Boyu reaches $1.5b target for second China fund

Boyu Capital has reportedly raised $1.5 billion for its second China-focused fund. A final close is expected within a few weeks. TheGP received more than enough investor interest to reach its $1.5 billion target but decided against enlarging the size of the vehicle. A regulatory filing submitted last week indicated that Boyu had received $596 million from 42 investors.

MSPEA-backed Feihe buys Alf Beta Dairy

Feihe International, a Chinese infant formula and milk power producer that went private last year in a deal backed by Morgan Stanley Private Equity Asia (MSPEA), has acquired industry peer Jilin Alf Beta Dairy. The acquisition is expected to boost the company's brands and expand its distribution channels into southern China.

Matrix leads Series B round for China menstruation app

Matrix Partners China has led a $15 million Series B round of funding for Meet You, a menstruation cycle-tracking mobile app. Existing investor China Renaissance K2 Ventures is also said to have participated. The mobile app has 20 million users, with more than 2 million daily active users.

RRJ-backed China diaper maker plans HK IPO

AAB Group, a Chinese diaper maker backed by RRJ Capital, is said to be looking to raise as much as $300 million through a Hong Kong IPO in the first quarter of 2014. RRJ invested $80 million in AAB in 2011 alongside CK Life Sciences.

Sequoia invests in China Angel Group hospital

Sequoia Capital has invested in a Series B round of funding for Angel Women's and Children Hospital, a Chengdu-based hospital chain. Details of the transaction weren't disclosed but the investment was worth several hundred million renminbi. Founded in 2008, Angel operates five hospitals in Chongqing, Xi'an and Kunming.

Corruption an opportunity for SE Asia dealmakers

Corruption is pervasive in emerging markets but GPs in Southeast Asia have found ways to profit from the imperfections. Speaking at the Hong Kong Venture Capital and Private Equity Association's Asia forum, Rodney Muse, managing partner at Navis Capital Partners, listed three different dynamics to the corruption theme in Asia: cronyism, corruption and leakage.

Ridding a business of these imperfections is one of the reasons for private equity's existence in the region. "A multi-national is not going to buy a dirty business," Muse explained.

Cleansing is important to the exit thesis, whether it be an IPO or sale to a multi-national, and GPs in the region have built up capabilities to identify and eliminate corruption. While levels may vary, a common element is that "a company has four books - first for the tax office, second for the bankers, third for the owner and the fourth for the wife of the owner," said Saratoga Capital founder Sandiaga Uno. That's why the firm insists on installing CFOs in its portfolio companies.

Leakage in particular is all pervasive and distorts economics. Brian Hong, managing director at CVC Capital Partners, noted that it can be a source of opportunity. After buying one business, CVC brought in new management to plug these leakages and found that the margins for the business doubled.

NORTH ASIA

Cerberus set for exit as Seibu agrees to listing

Seibu Holdings, the Japanese conglomerate that had a bitter falling out with leading shareholder Cerberus Capital Management over a planned IPO three years ago, is expected to list in Tokyo in the first half of 2014. The PE firm is looking to exit more than half of its 35.48% holding in Seibu.

Wakabayashi Fund invests in MIT Holding

Wakabayashi Fund, a private equity firm based in Tokyo and New York, has invested in US healthcare firm MIT Holdings. The financial details of the transaction were not disclosed. Through its subsidiaries, Georgia-based MIT provides a range of healthcare-related products and services.

SOUTH ASIA

Inventus closes Fund II at $106m

Inventus Capital Partners has reached a final close on its second fund at $106 million, exceeding the $100 million target. The vehicle, which launched in December 2012, will back 20-25 companies with investments of up to $10 million.

Mayfield raises at least $86m for India fund

Mayfield has raised at least $86 million for its second India fund, which was launched a year ago. Mayfield India II has received commitments of $86 million from seven investors as of January 14. No details on the target size were disclosed.

ASK reaches first close on offshore real estate fund

ASK Group has reached a first close of $50 million on its debut offshore real estate fund. The full target for the vehicle, which will invest in middle income residential projects in Mumbai, Bangalore, the Delhi National Capital Region (NCR), Pune and Chennai, is $200 million.

Nalanda ups stake in Lovable Lingerie

Singapore-based Nalanda Capital has bought a further 3.73% stake in listed Indian undergarment maker Lovable Lingerie, taking its total holding to 8.79%. This follows the GP's investment last August, in which the Nalanda India Equity Fund increased its stake to 5.06%.

Canaan leads $5.6m round for SureWaves

Canaan Partners has led a INR350 million ($5.6 million) round of funding for SureWaves MediaTech, a Bangalore-based TV advertising platform. Existing backers Accel Partners India and India Innovation Fund (IIF) also participated.

IDG, IvyCap back FieldEZ Technologies

Bangalore-based FieldEZ Technologies has raised a first round of funding from IDG Ventures and IvyCap Ventures. The workforce management software company's mobile product helps businesses manage their field personnel.

Helion backs India language localization firm

Pune-based LinguaNext has raised a Series A round of funding from Helion Venture Partners to expand its international business. The company's software, Linguify, helps enterprises localize into multiple languages without making any changes to the application code or database.

SOUTHEAST ASIA

Boston Scientific leads round for Amaranth

Amaranth Medical, a medical device maker backed by Singapore's Bio*One Capital and Phillip Private Equity, has received a Series C round of funding from US-listed Boston Scientific. The investment is said to be substantially larger than Amaranth's $20 million Series B round.

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Betting on bitcoin

Bitcoin's emergence as a currency in Asia has atttracted mixed reactions from regulators. For VC investors there is a chance to disrupt the exisitng payment hierarchy, but they must also work with it

SOUTH KOREA'S BITCOIN ECONOMY IS a fraction of China's, but the country's largest exchange dedicated to the digital currency turned profitable in under a year of operation. Korbit was founded last July and counts over 20,000 registered users of its platform. Its success attracted the interest of Silicon Valley investors such as Tim Draper, founder of Draper Fisher Jurvetson, who led an angel round of $400,000, alongside Naval Ravikant of AngelList, SV Angel's David Lee and SecondMarket founder Barry Silbert.

Korbit's growth reflects the phenomenal rise in the digital currency's value over the course of 2013, from niche interest to moneymaker. Bitcoin prices rose from $13.60 in January to $146,000 in December. A long-only bitcoin hedge fund riding the wave returned 4,847% over 12 months.

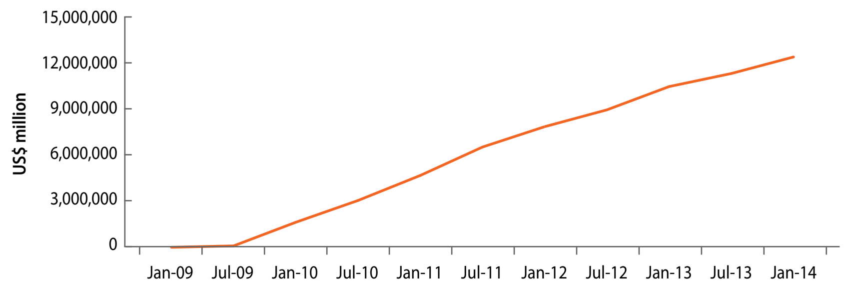
The number of bitcoin start-ups has also risen in step with its popularity as businesses spring up to target pools of emerging digital currency users. "While many of the start-ups are currently US- based, we are seeing more and more Asia-based start-ups as well," says Jeremy Liew, partner at Lightspeed Venture Partners.

One of these is the BTC China exchange which raised $5 million from Liew's firm and Lightspeed China Partners (LCP) in September. It had spent almost two years running as a part-time operation with modest revenue before the investment, but in November BTC became the world's most active exchange, driven by Chinese demand. Bitcoins in China were selling at a premium of 20% compared to foreign exchanges trading other currencies against bitcoin.

The People's Bank of China (PBoC) responded by banning financial and payment institutions from dealing with bitcoin and stressing that it cannot be used as currency in the market.

However, the global, decentralized nature of bitcoin means it can exist beyond the reach of national regulators, with users able to move their holdings to any platform in any country. Venture capital investors therefore see the digital currency as a sustainable payment channel that offers a lower cost solution than its competitors or reaches places they cannot.

Total bitcoin in circulation



Source:blockchain.info

Biggest Bitcoin Investments

Amount invested	Investor	Company	Country	Date
$25 million, Series B	Andreessen Horowitz, Union Square Ventures, Ribbit Capital	Coinbase	USA	2013, December
$9 million, Series A	General Catalyst Partners, Accel Partners, Jim Breyer	Circle Internet Financial	USA	2013, October
$5 million, Series A	Lightspeed China Partners, Lightspeed Venture Partners	BTC China	China	2013, September
$3.50 million, Seed funding	IDG Capital Partners, Core Innovation Capital, Venture 51, Camp One Ventures	Ripple Labs	USA	2013, November
$3.25 million, Seed funding	Canaan Partners, RRE Ventures, Liberty City Ventures	itBit	Singapore	2013, November

Source: AVCJ Research

Strength in numbers

Bitcoin emerged around 2009 from a software system built by an anonymous computer programmer or group of programmers using the pseudonym Satoshi Nakamoto. The decentralized digital currency relies on peer-to-peer technology – transactions are managed and money is issued collectively by the network instead of a central bank or authority.

Bitcoins are held by the owner at an address on the internet, with a transaction transferring ownership from one address to another. About every 10 minutes, a block of transactions is confirmed to a public online ledger called the block chain, which maintains a record of all transactions ever processed and ownership balances. Multiple addresses can be managed with a type of program called wallets, which are installed on a computer, mobile device or used off a website.

The technology allows direct transfers across the internet without use of a third party. However, the transactions are irreversible by design. Each bitcoin can be divided into one hundred million units, which makes it is possible to transact a fraction of a bitcoin instead of the whole.

To help it grow, the software is released open-source on the internet and runs across a network of machines called bitcoin miners. A miner is rewarded with new bitcoins for successfully confirming a transaction block.

In addition to wallets, programs being built for the bitcoin ecosystem are exchanges, which allow trading and conversion from fiat currency to bitcoins and back, and payment processors to help merchants accept bitcoins.

As such, bitcoin is not only a currency, but also a commodity and security to hold money and move it around the world. This potential to disrupt the traditional payments business has VCs excited. "The key value proposition of bitcoin is the potential for dramatically lower transaction costs using btc as a payment mechanism," says Liew.

In developing countries where the payment

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infrastructure is not as well built out, it presents an opportunity to leapfrog to the bitcoin alternative. As e-commerce takes off in Asia, the mechanism allows remote transactions in place of credit cards.

Another benefit could be to cross-border trade, where normal banking channels can take two days to get the money to suppliers and there might be currency movements over that time period. Bitcoin is quicker and costs less than Visa or PayPal.

Niki Scevak, managing director at Blackbird Ventures and investor in Melbourne-based bitcoin wallet CoinJar, sees another potential use on freelance job marketplaces. "All these people working on global marketplaces like oDesk get paid in a very high fee payment way – Western Union or PayPal and that's not even available in countries like Russia or Serbia," he says.

The technology also enables micro-payments, offering an edge over credit cards that require a $0.20-30 flat fee plus a 3% commission. App stores currently account for the majority of micro-transactions of $0.99 or less.

Rules of engagement

The decentralized nature of bitcoin is a concern for government regulators. For countries with capital controls, such as China, the digital currency is potentially a means of circumventing limits the inbound and outbound movement of money. Others might be worried from a tax, money-laundering, and funding terrorism perspective.

The risk varies according to the nature of the bitcoin platform – those dealing with fiat currency, or not. "In terms of the complexity of regulatory challenges, it ranges from virtually none in the case of a software service provider all the way to high when it comes to exchanging fiat for digital currency," explains Eddy Travia, co-founder of bitcoin start-up incubator Seedcoin.

Exchanges may need money operating or transmitter licenses depending on the country in which they are operating. Banking partners are necessary to get funds in and out of the exchange and this can become an issue in the event banks decide or are forced to break their relationships with exchanges.

Payment processing is under a much simpler regulatory environment than a bitcoin exchange. "In the US, for example, it is much easier to establish a payment processor than an exchange, which will need one money transmitter license per state," Travia adds.

A bitcoin wallet provider will not deal with any fiat currency and may not need a bank account to operate as long as its business partners pay in bitcoin or it can pay its expenses in bitcoin. The challenge is technical, mainly ensuring the wallet is secure enough to repel hackers.

In the US, where bitcoin start-ups have attracted the largest sums of venture capital investment, the Treasury has decreed that businesses must register as money services businesses and impose anti-money laundering checks on customers, just like traditional banks. Most of the 50 US states also impose their own regulations on money services businesses, so the legal process can be expensive and cumbersome.

There is no regulatory framework for bitcoin in most countries, but financial hubs such as Hong Kong and Singapore have so far shown a laissez faire attitude towards the digital currency. Asia's first bitcoin ATM is expected to start operating in Hong Kong by the end of January, making the currency more easily accessible to users.

While this has attracted start-ups,

Digital assets: The regulatory approach

CHINA

In December, the People's Bank of China issued a notice declaring bitcoin a kind of a virtual product. It does not have the legal status of a currency, and it cannot not be allowed to circulate in the market as a currency. However, bitcoin could be used online as a tool to process trading transactions, although individuals use it at their own risk.

Financial institutions and payment companies can't give pricing in bitcoin, buy and sell the virtual currency or insure bitcoin-linked products. Neither can they directly or indirectly provide any bitcoin-linked services, including helping clients register to trade bitcoin and providing clearance and settlement services.

They are also prohibited from accepting bitcoin as a payment currency, providing exchange services between it and other currencies, engaging in bitcoin deposit and mortgage services, issuing any bitcoin-related financial products, and treating it as trusts and investment funds.

HONG KONG

The Hong Kong Monetary Authority has decided that it will not regulate bitcoin because it is "a virtual commodity" not a currency. However, the Secretary for Financial Services and the Treasury, Caejer Chan Ka-keung, issued a statement, warning the public of the risks of the highly speculative commodity.

INDIA

The Reserve Bank of India has made it clear that Indian bitcoin exchanges lack the regulatory approval needed to exchange digital currencies for rupees and other national currencies. It issued a public notice warning users to stay away from digital currencies.

SINGAPORE

The Monetary Authority of Singapore has decided not to intervene in the use of bitcoin by individuals or businesses. Singapore has given guidance on how it intends to tax bitcoin transactions for businesses and merchants, covering capital gains, earnings, and sales tax on bitcoin exchanges and bitcoin-related sales.

US

Money transmission registration and licensing: The US Treasury Department's Financial Crimes Enforcement Network (FinCEN) released official guidance on the use of bitcoin in March 2013. It stated that any administrator or exchanger of bitcoins must be a registered money services business (MSB) under FinCEN's money transmitter regulations. They also need to comply with applicable state law and register with certain state regulatory agencies.

Various state regulators have followed FinCEN's example in requiring that bitcoin exchanges and service providers register and/or seek licenses on a state level as money transmitters or MSBs.

Anti-money laundering and other requirements: Digital asset service providers that qualify as MSBs are also required to implement anti-money laundering, know-your-customer and financial information reporting policies and procedures. They may also be subject to analogous requirements under similar state laws.

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entrepreneurs are asking regulators for guidelines. Hong Kong-based exchange ANX is a case in point. It went live in July last year and has 7,000 registered users – 40% from China, 30% in Hong Kong and the rest from other parts of the globe.

"We reached out to Hong Kong Monetary Authority (HKMA) and the Customs & Excise Department (CED) on whether or not we really needed a license," says Ken Lo, CEO of ANX.

The HKMA said it is not regulating the bitcoin industry for now so the ANX team got a money services operator license from the CED for remittance. In Singapore, meanwhile, itBit, an institutional-grade trading platform backed by Canaan Partners, is the process of applying for licenses locally as well as for those required in the US.

Big in China

While use of bitcoin is growing in the economy, few merchants accept it yet and the majority of transactions are speculative. That's certainly the case in China, according to Zennon Kapron, founder of research firm Kapronasia. "Buying bitcoin on BTC China was amazingly easy – you could fund and withdraw from your bank account directly or by using Tenpay, the online payment platform from Tencent, which is one of the biggest in terms of market penetration," he says. "Purchasing a bitcoin was no different than buying stock."

One factor in bitcoin's popularity in China is that a lot of the manufacturing of the bitcoin mining machines is located there and so much of the mining happens locally. Holders of these new bitcoins stand to gain from the ever-rising prices and the arbitrage occurring across various exchanges.

But the real interest started in May 2013 when CCTV, the government controlled national broadcaster, carried a documentary on bitcoin. There were about 40,000 wallet downloads in the country that month, more than in the US, Kapron explains.

Although some Chinese traders could have moved to exchanges abroad since the ban, others have found a way to work under the current set of rules. The PBoC's current position is that bitcoin can be used as an online tool for processing trade transactions, with users having to bear the risks personally.

"They have essentially legitimized it and the government has narrowed it to the field of internet and technology," says Ron Cao, founder and managing director at LCP. "The company is properly located in China and legally operating as an internet business, but a lot of other factors are unknown because it relates to payments and storing value and all that touches various government bodies."

Local exchanges must find alternative methods of moving money on and off the platforms now they are prohibited from working with financial institutions. A voucher system is currently the preferred option, whereby users buy a voucher for a certain sum in bitcoin from a platform like Paipai, go on to the exchange, type in the code and have their account credited with that amount.

It seems to be working, given trading volumes have picked up since the ban and the bitcoin price has reached mean parity with some of the foreign exchanges.

Prospects for the digital currency in China remain uncertain, but entrepreneurs are pushing forward, confident in it not going the same way as Q coins – a virtual currency for users of Tencent's QQ to make in-game purchases for their avatar and blog. The authorities responded by banning its use in the real world.

"They were centrally controlled by Tencent, so there was one entity to regulate that controlled the supply and flow of the Q coins," says Kapron. "Regardless of the Chinese regulations in place, as long as the rest of the world grows to accept bitcoin there will always be, at a minimum, a niche opportunity for bitcoin in China."

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Incremental benefits

China's securities regulator has introduced a registration-based IPO system designed to offer greater transparency. However, this does not mean an end to intervention in public markets processes

THE REOPENING OF CHINA'S IPO MARKETS has not been a smooth ride. Two weeks ago, Jiangsu Aosaikang Pharmaceutical announced plans to raise RMB4.05 billion ($669 million) through an offering that valued the company at 67x its 2012 earnings, compared to an average of 55.3x for ChiNext-listed drug manufacturers.

The IPO was aborted amid concerns not only with its size, but also with the large number of shares existing stockowners intended to sell through the offering. The China Securities Regulatory Commission (CSRC), which had already indicated that it would tighten restrictions on new listings, took note.

The agency has since conducted spot checks on 13 underwriters and 44 institutional investors involved in setting the prices for share issues, including a handful of private equity firms. When it was announced in December that the year-long embargo on IPOs would end, more than 760 companies had submitted listing applications and were awaiting approval. That number swiftly fell to 697 in the wake of the CSRC's checks.

While Aosaikang Pharmaceutical's withdrawal appears to be a victory for shareholders, it is a setback for the broader objective of replacing the registration-based approvals system with one that is more market-driven. The CSRC wants its influence to wane as the market plays a more active role in vetting listing applicants, but this was classic regulatory intervention.

"In this case, the underwriters and issuers followed the CSRC's rules of law to put original shares for sale in the IPO. However, the regulator stepped in and asked the company to suspend the IPO because of the relatively high valuation given by the market," says Leo Lou, a Shanghai-based partner at law firm Fangda Partners.

It is a contradiction to be expected of a system in transition and Lou remains positive about the measures the CSRC has put in place. However, he claims to be "cautious about what the system eventually turns out to be in the reality."

Market-oriented incentive

It is too early to make definitive statements as to whether China will adopt a disclosure-based system like the US, where investors are presented with the information and participate at their own risk, or Hong Kong's merit-based approach. Nevertheless, fund managers are generally bullish on the changes, arguing that a more transparent approvals process will give confidence to investors.

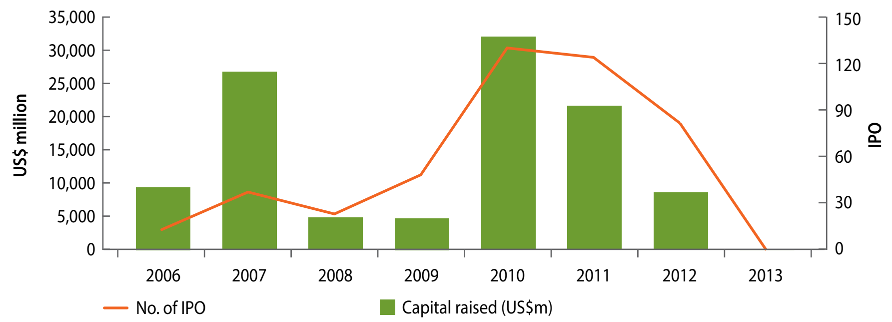
The new rules suggest the CSRC will spend less time reviewing IPO applications, although prior to the review stage companies will have to meet stricter disclosure requirements. In this way it is hoped that investors be better protected while companies with strong fundamentals are able to go public with the speed – and valuations – they deserve.

"We have one portfolio company currently in the queue for IPO approval and we do not expect any material impact on its application under the new system," says Haifeng Peng, a director at Victoria Capital. "However, it is too early to say what impact the system may have on the market as a whole. Recent events indicate there may be holes in the new rules and CSRC is still working on a lot of issues. I don't think anyone would expect a transition without hiccups."

The view among managers of renminbi-denominated funds is that going forward companies must be more marketable to investors for IPOs to get off the ground.

For example, applicants from the manufacturing sector – in which some domestic private equity funds have invested heavily in the past – may get less attention if there is no clear competitive advantage or differentiation in their business model. Investors need to see that higher profit margins can be traced back to qualities such as valuable intellectual property, strong marketing and branding, and unique product design.

PE-backed company IPOs in A-share markets



Source: AVCJ Research

> "Markets with a viable disclosure-based systems, such as the US, tend to have mature, self-policing intermediaries that perpetuate a compliance culture and perform a critical gate-keeping function for the market"
>
> – Zhang Ying

"In the past, the CSRC approval alone made the IPO companies attractive. Now, it's more important than ever that companies have a great story," says Chris Burch, advisor to the chairman at Shenzhen Capital Group.

With the regulator no longer taking the lead in assessing a listing candidate's profitability and investment value, China's institutional investors – which are themselves evolving – become the key constituency. The IPO road show is therefore vital in drumming up interest, and private equity investors may have to appear alongside portfolio companies to face questions.

"Institutional investors are getting more sophisticated. They are doing their own diligence and they're increasingly equipped to judge issuers' value and the potential risks of buying shares," says Zhang Xuan, Beijing-based counsel at O'Melveny & Myers.

Discouraging excess

The new system is perceived to be an improvement on its predecessor because it discourages excessive fundraising. Road shows that could run to a full year will be capped at three months, the idea being that CEOs will focus on running the business and only raise as much capital as they need. In addition, companies have the flexibility of deciding when they would like to go public within a 12-month window, rather than being allocated a specific date by the CSRC.

In another concession, management will be allowed to sell shares within six months of listing rather than being locked in for three years. Long lock-up periods have been criticized for failing to create an alignment of interest between company and management, with many mid-level executives unwilling to wait around.

Profitability requirements are also becoming more realistic in order to cut down on fraudulent accounting. "The former listing rules required a company to have at least three sequential years of growing profits. As every business observer knows, things don't always work out that way. So, to meet this artificial requirement, many companies resorted to creative accounting, shifting sales to other periods, sandbagging in certain years, and so on," one China-based fund manager explains.

For companies that are unable to meet CSRC criteria – usually because they don't have three years of growing profits – back-door listings have become a popular option. The phenomenon really took root during the embargo on new listings, with many PE mangers under pressure to exit investments and give back return to LPs. The regulator has responded by proposing new rules under which back-door listings would be subject to the same standards as IPOs.

Finally, the number of public listings is expected to increase, the removal of scarcity value making valuations more rational. Deloitte projects that 200-230 companies currently under review can go public in 2014, raising RMB150-170 billion between them. In 2012, the A-share market saw 154 IPOs with cumulative proceeds of RMB103.4 billion.

If the listing process falls short of accepted standards, including on pricing, the brokerages, accountants and lawyers working on the offering will be held accountable. This is the first time that the CSRC has said intermediaries should be punished. It will inevitably make these groups more careful in choosing the applicants they work with, and ultimately more professional in how they address the process.

"Markets with a viable disclosure-based systems, such as the US, tend to have mature, self-policing intermediaries that perpetuate a compliance culture and perform a critical gate-keeping function for the market," says Zhang Ying, Hong Kong-based counsel at Fangda Partners. "The rule of law is slowly taking hold in the Chinese market, but it's not quite there yet. This is clearly a step in the right direction but I don't expect the CSRC to venture far down this path until the market is ready."

The IPO reforms in detail

At the beginning of 2014, the China Securities Regulatory Commission (CSRC) resumed approvals of new share listings by firms on the Shanghai and Shenzhen bourses, ending the year-long IPO lockdown. These offerings are subject to new measures intended to shift the market from an approval-based system to a registration-based system. These changes are designed to control the "three high" problems – high prices, high price-to-earnings (P/E) ratios, and high subscription funding.

Approvals:

- The CSRC and IPO committee shall only examine IPO applications and documents according to their legality and their accordance with regulations. They won't make judgments on the issuer's profitability and investment value
- The CSRC should make decision on whether to allow a company to launch an IPO within three months
- The effective date of IPO approval has been extended to 12 months. Companies are free to issue shares any time within this period but should update their financial documents time-to-time and make sure there are no significant changes to their structures
- Companies awaiting IPO approvals are encouraged to issue corporate bonds first or secure a mix of debt and equity financing

Pricing:

- Issuing prices should be set by the issuers and underwriters. The prices should be disclosed in the IPO prospectus
- The number of inquiring investors should be between 10 and 20 for an offering of less than 400 million shares. If the offering is above 400 million shares, the number of inquiring parties should be between 20 and 40

Issuance:

- 40% of shares issued offline should first be allocated to mutual funds and social security funds
- At least 60% of the issuance should be rationed offline for offering s of less than 400 million shares. For offerings in excess of 400 million shares, at least 70% should be rationed offline
- An offline-to-online clawback mechanism will set the ratio at 20% of the total issuance, if the online subscription multiple is above 50x but less than 100x the initial allocation. If the online subscription multiple is above 100x, the clawback ratio will be set at 40% of the shares offered in the IPO
- Original shareholders that have held unrestricted shares for 36 consecutive months may sell them to the public. However, there can be no change in actual control of a company

Disclosure:

- Shareholders with at least a 5% interest in a company should disclose whether or not they intend to retain their shares after the IPO. If they plan to reduce their holding, they have to give at least three trading days' notice
- The issuer and lead underwriter should publish special risk alerts for three weeks ahead of an online subscription if the proposed P/E ratio exceeds the average of its listed peers

Supervision and punishment:

- Intermediaries may be punished for negligence. Underwriters may be barred from underwriting for 12-36 months for actions including underwriting without permission, incorrect disclosure, leaking information, engaging in unfair competition, or violating the issuance plan or the provisions of writing the investment value report
- Random inspections will be carried out on companies during book-building and road shows. If an issuer and lead underwriter are found to have used information other than what is disclosed in the prospectus, the CSRC will stop the IPO and penalize the parties involved

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Unitas completes Edwards reorientation

WHEN UNITAS CAPITAL AND CCMP Capital came across specialist vacuum products developer Edwards Group, the business was hamstrung by geography. Asia was responsible for 60% of revenues but only 30% of manufacturing activity; in Europe these figures were more or less reversed, with 10 of the company's 17 plants located in the UK.

"Edwards was technically strong but the operational focus was much less strong," says Sir Kevin Smith, the former CEO of UK-based GKN and now a partner at Unitas, who spent two years working with Edwards. "If your manufacturing footprint is fundamentally Europe-based it takes 10 weeks on a ship to get products to Asia so the flexibility to meet customer requirements was limited."

Unitas - then known as CCMP Capital Asia - and CCMP Capital agreed each committed around $150 million in equity and bought Edwards from The Linde Group in March 2007 for an enterprise valuation of EUR685 million (then $902 million). An additional EUR65 million due if the PE firms successfully developed and exited the business.

This process was duly completed last week as Sweden's Atlas Copco bought Edwards for approximately $1.6 billion, including debt. Unitas and CCMP Capital have made a 3.5x return on their investment. At the heart of the value creation story, which saw EBITDA margins increase from 14% to 22% during the ownership period, was a root and branch reorientation of Edwards' operations.


Pumped: Edwards in 3.5x exit

First, manufacturing bases were relocated. The company now has eight plants, of which only two are in the UK. Semiconductor and flat-panel display operations were shifted to Asia, primarily South Korea, while the industrial vacuum products group went to Eastern Europe.

As a result, major semiconductor customers like Samsung and SK Hynix are doing 10% more business with the company than before. Of the $595.3 million in revenues posted for 2012, 40% came from sales of products to semiconductor manufacturers and a further 20% from after-sales services to these same manufacturers.

Second, the company focused on producing just 400 key components in house and outsourced much of the rest. Smith admits that progress hasn't been perfectly smooth. Supply sourcing required improvement and then the sheer scale of new product implementation Edwards went through resulted in a few process gremlins.

However, he believes that Atlas and Edwards will benefit from the acquisition. The former has gained a semiconductor business to complement its existing industrial vacuum capabilities, while the latter has found a partner that can support its after-sales operations. "Edwards' installed base of vacuum pumps is around 800,000 and only 40% have service and support," Smith says. "It should be significantly higher and with Atlas' capabilities they can create significant momentum."

KKR, Affinity in Asia's largest-ever trade sale

ANHEUSER-BUSCH INBEV'S $5.8 BILLION buyback of South Korea's Oriental Brewery from KKR and Affinity Equity Partners is best viewed in the context of extenuating circumstances in which the original investment was made in July 2009.

First, AB InBev was a motivated seller. Eight months earlier InBev acquired Anheuser-Busch for an aggregate $52 billion, creating the world's largest brewer but also a debt burden that proved difficult to manage in the midst of the global financial crisis. A period of divestments and deleveraging ensued. The likes of CVC Capital Partners, The Blackstone Group and KPS Capital Partners also picked up assets in 2009 as divestments for the year surpassed $7 billion.


Liquid gold: Oriental Brewery

Second, KKR and Affinity were seen as reliable buyers in a climate of uncertainty. "We were not the highest bidder but the seller knew we could get a financing done," Henry Kravis, KKR's co-founder, told journalists in Hong Kong last year. "They knew we had the capital, we could speak for it, and that gave us a huge advantage. We didn't have to go out and find six partners in order to put it together."

MBK Partners was the highest bidder, according to sources familiar with the transaction, but KKR ended up agreeing a $1.8 billion deal and then sold 50% of the equity to Affinity for $400 million. It is suggested that, given the broader macroeconomic conditions, each firm was reluctant to see the bidding run to a fourth round; an equal partnership backed by a powerful financing package was preferable.

AB InBev retained the option to reacquire Oriental Brewery five years after the sale on pre-determined financial terms. These terms recognize the rapid growth the company has experienced under KKR and Affinity's ownership.

Between 2009 and 2012, beer sales in South Korea by volume grew at an annual rate of approximately 2%, with premium brands growing by 10%. The market is a virtual duopoly, controlled by Oriental Brewery and Hite Jinro. In 2009, Hite had a 57% share to its rival's 41%, but Oriental Brewery claimed number one spot in 2012 and now controls 63% of the market. EBITDA has more than doubled to an estimated KRW529 billion ($500 million) in 2013.

The PE firms provided $270 million in capital expenditure plus management and sales and marketing expertise, with KKR's Capstone operations unit spending 16 months on the ground. The personnel additions included In-soo Chang, who helped rejuvenate the sales department and was then named CEO.

While the Cass brand is the primary growth driver, Oriental Brewery reintroduced the OB Golden Lager and Cafri brands, as wall as benefiting from distribution rights for certain AB InBev products.

The buyback represents Asia's largest-ever trade sale exit by private equity investors in dollar terms, with KKR and Affinity on course for a more than 5x money multiple.

CITIC Capital finally bags AsiaInfo take-private

PRIVATE EQUITY FIRMS HAVE SUPPORTED 11 management buyouts of Chinese firms listed in the US since mid-2011. Until last week, only two of these successful transactions – Funtalk China and Focus Media – were control buyouts, where one or more PE backers emerged with the largest shareholding; in the majority of cases the chairman simply rolled over his commanding equity position into the acquisition vehicle.

AsiaInfo-Linkage has now joined this select group. A consortium led by CITIC Capital Partners completed a deal that values the telecom software provider at approximately $887 million almost two years to the day after the initial bid was tabled. To put that in perspective, six months passed in between Funtalk disclosing its take-private offer and the company de-listing. Focus Media, in which CITIC Capital also participated, was done in less than 10 months.

However, in both cases management acted in partnership with PE from the outset. CITIC Capital's approach to Asia-Info was unsolicited.

"With Focus Media deal we had discussions with the management team before we launched the bid because they were part of it," says Brian Doyle, managing partner at CITIC Capital. "The AsiaInfo process took longer because our offer was unsolicited and then they ran a full process and considered lots of different potential buyers." He adds that the regulatory review for investment in the telecom-related assets is also more stringent than for other sectors.


AsiaInfo: Data download

In the months before CITIC Capital's bid won board approval in May 2013, a string of PE firms were linked to AsiaInfo. The buyer consortium also took shape, with the addition of CITIC Private Equity and China Broadband Capital (CBC), as well as three of CITIC Capital's LPs – AlpInvest Partners, Qatar Investment Authority and Temasek Holdings.

The new equity commitment from these investors is approximately $415 million, while existing shareholders – including Edward Tian, CEO of CBC and co-founder of AsiaInfo – are rolling over equity valued at $134 million. The balance is debt financing provided by Nomura International, Bank of Taiwan, Cathay United Bank, ICBC International Capital and Maybank.

Doyle says the equity portion of the deal is relatively high because the consortium wants to use cash flows to grow the business.

He estimates China's telecom software market is growing at around 15% per year, driven by increased users and more complex usage. The rollout of the country's 4G network will accelerate this transition.

China Mobile, China Unicom and China Telecom accounted for the bulk of AsiaInfo's $547.9 million in revenue in 2012. As they develop an ever wider range of products, there will be more call for AsiaInfo's services. "It's not just more complexity around billing," Doyle adds.

"You are also getting into data analytics, working with the carriers to understand traffic and usage patterns and provide better products. It is a huge growth area."

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Big in Japan

From bust to boom, Yoshito Hori, CEO and founder of Globis Capital Management, has spent 20 years investing in Japanese VC – a story that is as much about education as it is capital

NEARLY EVERY MAJOR CITY FROM TEL Aviv to Toronto has, at some point, claimed itself the successor to Silicon Valley.

It is perhaps unsurprising, then, that in July last year Yoshito Hori, CEO and founder of Globis Capital Management and Globis University Graduate School of Management, used his blog to claim Tokyo as the next innovation hub. A record number of IPOs in 2013 plus a forthcoming close on Globis Fund IV has only strengthened his conviction.

"When you consider that the world's youngest billionaire – outside the Facebook four – is Yoshikazu Tanaka, the founder of Tokyo-based mobile social gaming company Gree, and one of the most successful female tech entrepreneurs today is Tomoko Namba, founder of web services company DeNA, you can see that something is happening in Japan," he tells AVCJ.

Tokyo, Hori argues, now has critical mass, with an ecosystem of mentors, venture capitalists and entrepreneurs making it the number one choice for start-ups. But this was not always the case.

In 1992, when Hori was a fresh graduate from Harvard Business School, early-stage VC was all but non-existent in Japan. The macro outlook had been bleak, the asset price bubble had burst and the country was at the start of its lost decade. It was against this backdrop that Hori resolved to start his first business.

"During the period after Black Monday – the days before the internet – the mood at Harvard was that everybody wanted to become an entrepreneur or at least work at a start-up or venture capital firm," says Hori. "I knew then that I wanted to start my own venture fund but I did not have the track record to raise capital, so I decided to build my track record as an entrepreneur."

Education first

Inspired by his experiences at Harvard and identifying the need for an MBA course in Japan, 30-year-old Hori launched the Globis Management School in 1992 – a year after graduation. With an initial intake of just 20 students, he invited Harvard alumni based in Japan to come to his small apartment in central Tokyo to teach classes based on the business school's traditional case studies.

But this was just one part of Hori's ambition. "The idea was to combine a business school with venture capital – and later do publishing and conferences – to create an ecosystem of people, capital and knowledge," he explains.

In 1995, after three years cutting his teeth as an entrepreneur, Hori set out to raise his first fund. Globis Fund I received commitments amounting to $5 million – four Japanese angel investors put in $1 million apiece and an additional $1 million came from the sole institutional investor, Tokyo Primary.

In an ecosystem almost entirely dominated by late-stage venture capital and pre-IPO financing,

> "At one time Gree was making $1billion in revenue with $500 million in profit. It was like printing cash"

Globis set out to be the first investor capable of demonstrating a hands-on approach to VC investing. "There really was no one who could provide management support," Hori recalls. "It was mainly financial institutions providing pre-IPO financing with no board seats and no early-stage investment."

In retrospect, he sees the establishment of Globis as part of a broader global trend which saw the Silicon Valley early-stage investment model exported to other parts of the world. Indeed, while Globis Fund I was establishing itself in Japan, Neil Rimer – a section mate of Hori's at Harvard – was in the process of breaking similar ground in Switzerland with Index Ventures.

It was not long before Hori's firm had grabbed the attention of Apax Partners, which was looking for a local partner in Japan. Globis in turn wanted access to institutional investors overseas. This resulted in the birth of Globis' second vehicle in 1999, the JPY20 billion Apax Globis Japan Fund.

"Initially, managing a joint venture fund with Apax posed us with a big challenge as the gap in experience and skill set was wide, but the tie up was quite beneficial for us." says Hori. "We had the opportunity to learn from Alan Patricof and other great people at Apax about the investment process, the due diligence process, fund management and fundraising."

By 2006, Globis was eager to be independent. Globis III – which would eventually close at JPY18 billion ($172 million) – launched just as the business school was granted university status by the government. Meanwhile, the relationship with Apax had come to an end as interests diverged; Apax began to focus more on buyouts, while Globis wanted to remain true to its VC roots. Regardless, the Apax-Globis partnership had been responsible for two of the firm's most successful investments: human resource software firm Works Applications and Gree, which went on to generate cash multiples of 50x and 100x, respectively.

Generation next

Hori says Gree – which went on to establish its own corporate VC arm – is typical of the kind of business that now proliferates in the Japanese VC ecosystem. Unlike the start-ups of 20 years ago, which predominately focused on software and services, the new generation of businesses are less capital intensive and more capable of generating high returns.

"At one time GREE was making $1billion in revenue with $500 million in profit," recalls Hori. "It was like printing cash."

While noting Japan's VC industry still has way to go when compared to that of the US, he maintains the ecosystem is getting stronger and as a result investing has become easier. For Hori, it means his ambition has only expanded.

"I started a business school to educate leaders and a VC fund to create industries; then I went into publishing and conferences to influence people," he says. "I guess the next step is to become an opinion leader and put forward my own vision for Japan's future."

SELECTED INVESTMENTS FROM OCTOBER 2013 TO DECEMBER 2013

Giant Interactive Group Inc. (ZTGame)	
Country	China (PRC)
Sector	Leisure/Entertainment
Founded	2004
Management	Yuzhu Shi, Chairman, CEO

Baring Asia Private Equity — $1,487 mln

Deal Brief
Giant Interactive Group Inc, China-based online game developers and operators, has received a preliminary non-binding proposal from Chairman Yu-zhu Shi to privatize the company for US$11.75 in cash per ordinary share, with sposonred by private equity firm Baring Asia Private Equity. The Consortium members beneficially owned, in the aggregate, approximately 47.2% of the Company's share capital on a fully enlarged basis. Based on the fully enlarged shares and the acquisition of remaining 52.8% stake, the deal is valued at $1.49 billion.

Avago Technologies Ltd.	
Country	Singapore
Sector	Computer related
Founded	1961
Management	Hock E. Tan, CEO

Silver Lake Asia — $1,000 mln

Deal Brief
Silver Lake Partners (SLP) has agreed to invest $1 billion in Avago Technologies (AVGO), a Singapore-based supplier of analog semiconductor devices, for a seven year 2% convertible note of AVGO. Under the agreement, the convertible note can be converted into AVGO's share or preferred stock with equivalent economic terms at a conversion price of $48.04 per share. The investment will be used to fund the acquisition of LSI Corporation.

Macromill, Inc.	
Country	Japan
Sector	Services - Non-Financial
Founded	2000
Management	Tetsuya Sugimoto, CEO

Bain Capital Asia — $502 mln

Deal Brief
Bain Capital, along with the existing founding management, has agreed to tender all the shares of Macromill, a Japan-listed internet marketing research firm, from Yahoo Japan and other shareholders for a cash consideration of JPY51.38 billion. Upon the investment, Macromill will be delisted from Tokyo Stock Exchange.

Korea Bulk Shipping Co., Ltd.	
Country	South Korea
Sector	Transportation/ Distribution
Founded	1949
Management	Eun-Young Choi, CEO

Hahn & Company — $377 mln

Deal Brief
Hahn & Co. has agreed to acquire a 6 million preferred shares in Korea Bulk Shipping, a South Korea-based bulk shipping company separated from debt-ridden Hanjin Shipping for Won300 billion. In addition, Hahn & Co. will subscribe a further 2 million new preferred shares in Korea Bulk Shipping for Won100 billion. After closing, Hahn & Co will hold a 76% stake in the company for a total cash consideration of Won400 billion.

SELECTED PE-BACKED IPOS FROM OCTOBER 2013 TO DECEMBER 2013

Hyundai Rotem Company	
Country	South Korea
Sector	Transportation/ Distribution
IPO Date	10/30/2013
Stock Exchange	Korea Stock Exchange
Management	Kyu-Hwan Han, Vice Chairman & CEO

Morgan Stanley Private Equity Management Korea — $586 mln

Issuer Profile
Hyundai Rotem, was founded in 1977, develops and produces railway vehicles and battle tanks. The company has 4,000 staffs, among 700 of them are researchers who focused on development of various railway vehicles. It expands its operation to 48 countries across the globe in decades.

Cover-More Group Limited	
Country	Australia
Sector	Financial services
IPO Date	12/19/2013
Stock Exchange	Australian Stock Exchanges
Management	Michele Grow, CEO

Crescent Capital Partners Management — $466 mln

Issuer Profile
Cover-More Group was established in 1986, it is engaged in the business of travel insurance. The company operates in Australia, New Zealand and the United Kingdom with employing more than 210 people in Australia. Cover-More is not an insurer, and the insurance is underwritten by Munich Re Group, one of the largest insurance groups and leading risk carriers in the world.

YuanShengTai Dairy Farm Limited	
Country	China (PRC)
Sector	Consumer products/ services
IPO Date	11/26/2013
Stock Exchange	Stock Exchange of Hong Kong - Mainboard
Management	Wenguo Fu, CEO

Ares Asia Management — $424 mln

Other VC Sharholders(s): China Securities (International) Asset; OCBC Capital Investment; VMS Investment Group.

Issuer Profile
YuanShengTai Dairy Farm is engaged in animal Husbandry and dairy products making business in China. It owns two mega-scale dairy farms, which raised 37,000 dairy cows and produced approximately 460 tonnes of raw milk per day. It's standardized farming methods have enabled them to produce raw milk of a quality that surpassed the EU milk standard.

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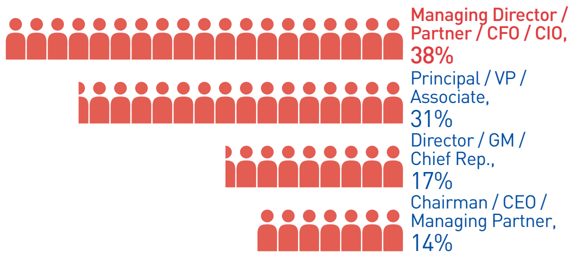

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