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EDITOR'S VIEWPOINT

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Top-up time

NORTHERN LIGHT VENTURE CAPITAL would like to have participated in the recent $50 million Series D round of funding for Daojia, but it could not. The Series C round last September wasn't possible either. As it stands, the VC firm has recorded a handsome paper gain on its Series B investment in the Chinese food-ordering platform, but the upside now appears to be limited.

"We have a very small percentage stake and the valuation of the company has grown much faster than anticipated so we didn't have the opportunity to participate in the Series C," explains Ray Yang, a managing director at the VC firm. "We would love to get more shares if we could, but we can't."

As certain companies stay under private ownership for longer periods of time and raise ever large pools of capital required to accumulate market share, what happens to the early investors? Although a degree of dilution is inevitable over time, they are sitting on potentially huge returns on what started out as relatively small bets. What, though, if they wanted to re-up and continue participating in the growth story? The problem is that doing so might go against the fund remit and exceed the maximum check size.

US venture capital firms have already found an answer – opportunity funds, which focus on later-stage investments in existing portfolio companies – and there is every reason to believe it will catch on in Asia as well. Indeed, earlier this year Indian VC Nexus Venture Partners raised a $110 million opportunity fund from its current LP base.

Nexus closed its third main fund in September 2012 at $270 million, around $50 million larger than the previous vehicle. But Snapdeal was growing even faster. Nexus and Kalaari Capital backed the e-commerce company in its infancy, providing a $12 million Series A round in early 2011. It stuck with Snapdeal through the next two rounds and then in March 2014 the company raised $133.8 million in Series D funding. This was said to be the first deal out of the opportunity fund.

A top-up vehicle is not a perfect solution. If some LPs are in both the main and opportunity funds while others have an interest in just one, it can create conflicts. Questions might also be asked about strategy drift. Investors may benefit from continued exposure to successful portfolio companies, but shouldn't Nexus be focusing on finding the next Snapdeal?

Nevertheless, the sheer size of the rounds some tech companies are now raising in Asia suggests that there will be a place for opportunity funds. AVCJ Research has records of 50 VC rounds of $100 million or more in the region, of which 33 were completed in 2013 and 2014. India's Snapdeal and Flipkart and China's JD.com and Xiaomi feature high up the rankings and multiple times in the list as a whole.

Smaller VCs can't stop DST Advisors, Tiger Global and Temasek Holdings coming in, but they might find a way to ensure these investors don't eat all of the lunch.

Tim Burroughs
Managing Editor
Asian Venture Capital Journal

Asia's largest VC funding rounds

Date	Amount (US$m)	Round	Investee
Jul-14	1,000.0	7	Flipkart
Mar-11	961.0	4	JD.com
Nov-12	682.0	5	JD.com
Jul-13	360.0	5	Flipkart
Sep-14	260.0	3	YouXinPai.com
Apr-14	250.3	1	Campaign Monitor
Dec-13	250.0	3	Lazada South East Asia
Jun-12	216.0	3	Xiaomi
May-14	210.0	6	Flipkart
Aug-14	200.0	3	Ganji.com

Source: AVCJ Research

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NEWS

AUSTRALASIA

Nuplex in asset sale talks with CHAMP PE

CHAMP Private Equity is in talks with New Zealand-based chemicals manufacturer Nuplex Industries over the potential acquisition of its distribution and plastics additives businesses. The assets that could be sold are Nuplex Specialties, which distributes raw materials, ingredients and specialty chemicals, and Masterbatch, a supplier of colors used in plastics.

Australia's Treasury Wines ends PE buyout talks

Australia's Treasury Wine Estates has ended talks with two private equity suitors, TPG Capital and a consortium comprising KKR and Rhône Capital, after deciding the offer was too low. The company said shareholders had indicated that the bid price of price of A$5.20 per share undervalued the company.

Accel, Ribbit lead $35m round for invoice app

Australia-based invoicing app Invoice2go has received $35 million in a Series A round of funding led by Accel Partners and Ribbit Capital. The company was founded in 2002 but this is its first external funding. Alongside the investment, Accel's CEO-in-residence, Greg Waldorf, has joined Invoice2Go as its new CEO.

GRATER CHINA

PE-backed apparel maker eyes $285m HK IPO

Ladies apparel maker Shanghai La Chapelle, which is backed by several PE investors, plans to raise HK$2.21 billion ($285 million) through an IPO in Hong Kong. Legend Capital holds 17.81% of the firm while Goldman Sachs owns 3.75% interest. Boxin Capital's ownership is 8.83%, while Asia Alternatives has a 0.83% stake.

Boyu joins consortium for $2.5b GLP investment

Boyu Capital and several Chinese strategic investors have joined a consortium that has committed $2.5 billion to warehouse operator Global Logistic Properties (GLP). The deal was announced in February, with Hopu Investment Management confirmed as a participant.

KKR restructures Asia leadership team

David Liu and Ming Lu have been appointed co-heads of Asia private equity at KKR as several members of the firm's leadership team across the region assume additional responsibilities. Joe Bae remains head of KKR Asia and chairman of the regional investment committee. The new management structure, which was confirmed by a KKR spokesperson, comes as the firm increases its exposure to Asia up and down the capital structure and in multiple asset classes.

Liu (pictured) and Lu, heads of KKR in China and Southeast Asia, respectively, have seen their PE remits expand to cover the entire region. Justin Reizes, who leads the firm's activities in Australia, is now also supporting the build-out of an Asia-wide energy and resources platform, while Sanjay Nayar will supplement his duties as India head with work on KKR's credit and capital markets offerings in the region.

In addition, Scott Bookmyer will leave his role as Asia head of Capstone, which works with KKR portfolio companies on operational improvements, and become the firm's chief operating officer in the region. In this capacity, he will oversee key elements of KKR's Asia business operations. Responsibility for Capstone's activities will fall to a leadership team comprising senior representatives from each geographic region within Asia.

Tiantu in $63m first close on debut US dollar fund

Chinese GP Tiantu Capital has reached a first close of $63 million on its debut US dollar-denominated fund. A final close of $100 million is targeted before the end of the year. The Tiantu China Consumer Fund I received $38 million in commitments from family offices and fund-of-funds in Asia and the US, while an additional $25 million was contributed by the GP.

KPCB leads $50m round for China video app

KPCB has led a $50 million Series C round of funding for Chinese video app Miaopai, with participation from Sina, Redpoint Ventures and StarVC, a VC firm launched by a group of Chinese celebrities. Local microblog service Sina Weibo is a strategic partner of Miaopai, which enables users to shoot up to 10 seconds of footage and then edit before sharing on Weibo.

Legend leads $50m for online finance site

Legend Capital has led a $50 million Series B round of funding for Tongbanjie, a Chinese online finance mobile app, with participation from existing investors IDG Capital Partners and China Growth Capital. The start-up plans to use the new funding to add different types of products, including insurance and credit loans, and provide self-developed investment portfolios.

Lightspeed leads round for P2P car-sharing site

Lightspeed China Partners has led a $10 million Series A round of funding for uuzuche.com, a Chinese peer-to-peer (P2P) car-sharing platform. China Renaissance K2 Ventures and angel investor Wang Gang also participated. Uuzuche currently operates in four major cities with over 10,000 car owners on the platform.

IDG invests in mobile tech player AVOS Cloud

IDG Capital Partners has invested in a Series A round of funding for AVOS Cloud, a Chinese mobile back-end as a service (BaaS) provider. Financial terms were not disclosed. AVOS Cloud was spun-off from AVOS System, a US internet company set up by YouTube founders Chad Hurley and Steve Chen, earlier this year.

Shunwei backs female social networking site

Shunwei Capital Partners has committed $10 million in Series B funding to 520guimi.com, a female-focused social networking site in China. Existing investor Lightspeed China Partners also participated. The new funding will be used to improve user experience through the addition of new features to the platform, as well as for marketing and promotions.

Alibaba invests $458m in hotel IT software firm

Alibaba Group has bought a 15% stake in Beijing Shiji Information Technology, a Chinese hospitality information technology developer, for RMB2.81 billion ($458 million). The investment is expected to allow Alibaba to develop its Taobao Travel business alongside Beijing Shiji, including hotel information management system and mobile payment solutions.

NORTH ASIA

KIC more than doubles PE exposure in 2013

Korea Investment Corporation's (KIC) private equity investments more than doubled in size to $2.6 billion over the course of 2013 as total assets increased 27% year-on-year to reach $72 billion. The sovereign wealth fund has achieved a 4.02% annualized return since its inception in 2006 but private equity - for which the investment program began in 2009 - is the worst-performing of the alternative asset classes.

SCPE backs garlic-themed restaurant in Korea

Standard Chartered Private Equity (SCPE) has led a $48 million joint investment in Mad for Garlic, a Korea-based Italian restaurant chain. There are 29 outlets in Korea and four in Singapore, the Philippines and Indonesia. The company wants to enlarge its domestic network and also enter the likes of China, Hong Kong, Vietnam and Taiwan.

Pavilion, Recruit provide Series B2 for Japan's Freee

Temasek Holdings-owned Pavilion Capital and Recruit Strategic Partners, the VC arm of Recruit Holdings, have led a Series B2 round of funding worth $6 million for Freee, a Tokyo-based provider of automated online accounting software. This follows a Series B1 round of $8 million provided by DCM and Infinity Ventures.

SOUTH ASIA

Canaan's Khanna to launch India venture debt fund

Canaan Partners managing director Rahul Khanna is to launch a INR3 billion ($49 million) debt fund aimed at supporting early-stage and established technology ventures in India. Khanna is leaving Canaan and will be involved with the new venture full-time from early next year.

Tata Capital buys minority stake in Standard Greases

India's Tata Capital is to acquire a 17.36% stake in Mumbai-based Standard Greases & Specialities for an undisclosed sum. The PE firm will subscribe to new shares in the company via the Tata Capital Growth Fund and Singapore-based Alpha TC Holdings. Each entity will hold an 8.68% stake.

Intel invests $1.5b in Tsinghua chipmakers

Intel Corporation has agreed to invest up to RMB9 billion ($1.5 billion) for a 20% stake in Tsinghua Unigroup, owner of Chinese semiconductor makers Spreadtrum Communications and RDA Microelectronics.

Tsinghua Unigroup is a unit of Tsinghua Holdings, an investment entity controlled by Beijing-based Tsinghua University. Both Spreadtrum and RDA develop mobile chipset platforms for smart phones, feature phones and other consumer electronics products, supporting 2G, 3G and 4G wireless standards. As part of the agreement, Spreadtrum will develop architecture-based system-on-chips (SoCs) jointly

with Intel, which will be marketed to domestic mobile phone-manufacturing customers from the second half of next year.

"China is now the largest consumption market for smartphones and has the largest number of Internet users in the world," said Brian Krzanich, Intel's CEO. "These agreements with Tsinghua Unigroup underscore Intel's 29-year-long history of investing in and working in China."

Last year, Tsinghua Unigroup took Spreadtrum private in a deal worth $1.7 billion. Previous investors in Spreadtrum include New Enterprise Associates and Silver Lake. Tsinghua Holdings is a state-owned company that manages the majority of Tsinghua University's commercial assets.

Tiger Global commits $30m to property portal

Tiger Global has invested $30 million in India-based property listings website CommonFloor.com, which is ultimately expected to pursue a public listing. The funding comes less than a year after Tiger Global and Accel Partners committed INR640 million ($10.5 million) to the company.

Local-language media start-up gets $16m

Sequoia Capital has led a INR1 billion ($16.4 million) round of funding for Verse Innovation, owner and operator of India-based local-language mobile platform NewsHunt. This is Verse's second round of funding and it values the seven-year-old company at nearly $150 million. Existing investors Matrix Partners India and Omidyar Network also participated.

SOUTHEAST ASIA

CVC-owned SPi to sell US healthcare business

SPi Global, a Philippines-based business process outsourcing (BPO) provider owned by CVC Capital Partners, has agreed to sell its US healthcare business to Conifer Health Solutions in a deal worth $235 million. SPi Global will retain its healthcare BPO operations in the Philippines.

Singapore supports med-tech accelerator program

Spring Seeds Capital, an investment arm of government-backed Spring Singapore, has launched an initiative that could channel up to S$60 million ($47 million) into local medical technology start-ups. The government will invest in S$30 million, with an equal sum to be raised by two new-established accelerators - Zicom MedTacc and Med Tech Alliance.

New Asia, AIF commit to Vietnam restaurant chain

New Asia Partners and AIF Capital have led a Series B round of funding worth $15 million for Huy Vietnam Group, Vietnam's largest operator of self-managed, local cuisine restaurants. Other investors include Malaysia-based Fortress Capital Asset Management and regional family offices.

VC-backed iMoney gets funding from iSelect

IMoney Group, a Malaysia-based financial comparison start-up backed by Jungle Ventures, has received approximately MYR13 million ($4 million) from iSelect, an Australia Securities Exchange-listed online comparison service. The capital will be used to accelerate growth, strengthen the management team and investment in technology.

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Parachute play

All PE investors want downside protection in China, but they prefer to use it as leverage in amicable negotiations rather than pursue full enforcement. Knowing the entrepreneur and the business is crucial

SEARCHING FOR ANALOGY THAT captures the deterioration in relations between entrepreneur and investor, Johannes Schoeter eventually settles upon two pandas paired together at a zoo with a view to procreation. No matter what is tried, the male shows no interest whatsoever in the female.

China New Enterprise Investment (CNEI), the PE firm of which Schoeter is founding partner, should have been on course for a 5x return. It held a stake in a Chinese business with strong fundamentals, an impressive product portfolio, and a long-standing and recognizable brand name. There was every reason to foresee sustained growth and ultimately an IPO exit.

The problem was the founder and majority shareholder. Not long after CNEI's investment, he became distracted by real estate opportunities, to the detriment of the main business. Various efforts were made to reengage the founder but to no avail. Eventually it was agreed that CNEI would install a new CEO but the founder, in full procrastination mode, vetoed every candidate.

With CNEI applying pressure, the founder decided he'd had enough. "We were already quite exhausted from all our efforts when he came to us and asked to buy back our shares on the strength of our put option," Schoeter recalls. "We said, 'You can buy them back but at a different price from the put option because we aren't putting to you, we are selling to you.' In the end he agreed. The put option would have given us about 1.7x but we received 2.2x."

The situation was unusual – a PE firm would typically take the initiative and tell the founder that it wanted to exercise a put option in order to exit an investment – yet it is still instructive.

While a put option is usually a highly structured piece of downside protection, its true merit is in providing leverage, not necessarily facilitating execution to the letter of the law. The threat of redeeming a position, and taking the assets held as security or finding a way to turn the screw on the founder, is part of a broader negotiation. And success rests on understanding the business and its majority owner, so the process – if there is no way of making it amicable and mutually beneficial – is at least smooth.

"Put options are not foolproof but only in extreme cases would a founder not feel pressured by the presence of these rights, so they are useful in terms of having both carrot and stick," says Bonnie Lo, partner at NewQuest Capital Partners. "If an investment goes south for whatever reason there is a way to bring everyone to the negotiating table. You might not get 100% of what the put option says, but the success rate for getting founders to buy back shares is reasonably good."

Devil in the detail

Downside protection for minority investments in China comes into effect if a portfolio company fails to meet certain performance targets or if an IPO doesn't happen within an agreed timeframe. A PE firm might seek to redeem its investment according to a formula based on interest or IRR or trigger a ratchet mechanism that increases its holding in the portfolio company.

Many investments are made in the form of subscriptions to convertible bonds or preference shares that give the private equity firm a priority claim in the event of a default. It is common for the founder to pledge his own shares in the company as security for an investment. Unsigned letters of resignation from the founder's representative board members and share transfer agreements are held in escrow and released to the investor if there is a desire to claim the security and assume control of the company.

In some cases, the founder might also offer a personal guarantee comprising onshore or offshore assets.

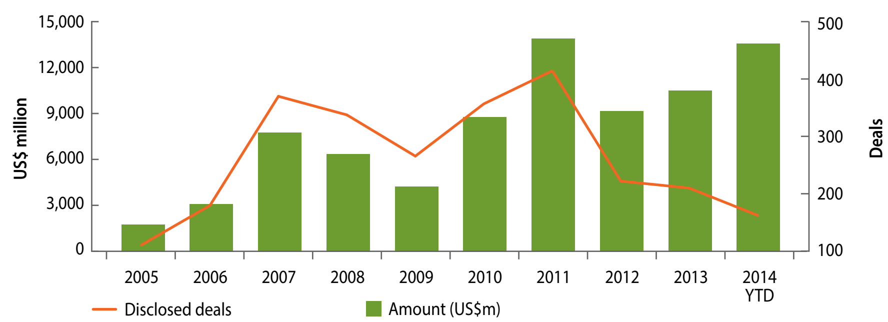
Before the global financial crisis and more recent cooling of China's domestic IPO market plenty of investors rushed in looking to flip companies into public listings. The strategy was short term and largely passive, and some paid the price for not paying enough attention to portfolio companies or the downside protection in the deals. The general view is that PE firms are now better prepared and better advised.

"In the old days, investors would come in and get a board seat and information rights," says Michael Chin, a Shanghai-based partner at Hogan Lovells. "Now they appear to be getting a lot more involved. We had a wave of PE firms that were sitting on too many portfolio companies and there were instances in which companies had gone too far down hill to turn things around because of insufficient monitoring."

All investors want an element of downside protection, but what they get is highly negotiated – maybe there is no put option at all. It is one of many variables within a deal. The decision whether or not to invest is based on the GP taking a step back, evaluating the entire situation and asking if he feels comfortable with the situation. In the absence of a put, being comfortable with the founder is also paramount.

"It comes down to a judgment call on his personality, his quality as an entrepreneur and the quality of the business," says CNEI's Schoeter. "If I were an entrepreneur negotiating with a capital provider, I would say, 'Why would I do this? We are partners, we both succeed or fail.' It

China growth capital investment



Source: AVCJ Research

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is not 100% correct because he is running the show. But it is natural for an entrepreneur, almost as a reflex, to give this response."

Indeed, not getting this response might in itself be a red flag. William Shen, senior partner at Headland Capital Partners, treats the negotiations as an additional opportunity to get a measure of the founder. If he rolls over on every point he might not be taking the prospect of redemption seriously or he has no intention of honoring it.

Degrees of comfort

The amount of leverage a private equity firm has in a redemption situation is also influenced by the structure of the investment. There are two ways in, the most common being an investment in an offshore holding company, which operates on the mainland through a wholly foreign-owned enterprise (WFOE). This structure tends to be used where the objective is an offshore IPO.

The security held by the private equity firm tends to be pledged shares in the offshore vehicle. In order to take action against a founder or company that refuses to redeem a position, it is necessary to secure a favorable ruling from a judge or arbitrator in the offshore jurisdiction of incorporation and then go to a Chinese court and make the application once again.

Even if the protection extends down another layer and there is a pledge of shares in the WFOE, enforcement is a challenge. Investors that register WFOE share securities with the State Administration of Foreign Exchange (SAFE) up front should be able enact the pledge when necessary. But there are still obstacles.

"When it comes to enforcement, although you have the legal right, when you register the transfer of equity interests in a Chinese company, the transfer of shares, the State Administration for Industry & Commerce (SAIC) would then query whether or not you could do that," says Howard Lam, a partner at Latham & Watkins. "And then the existing management in the WFOE might resist that and their cooperation is needed to file the necessary forms with the SAIC to complete the transfer of the shares."

Headland's Shen adds that a Chinese entrepreneur might just take a ruling by a Hong Kong arbitrator seriously than notice issued by a Chinese court. "It could drag on for a long time and the costs could be high," he says.

As such, Headland is generally more comfortable with the second approach, investing through a Sino-foreign joint venture. This route precludes a listing in Hong Kong or the US because there is no offshore restructuring, but it became popular with the rise of the A-share market as a public market exit option.

The private equity firm invests directly into the onshore entity, and in the event of a dispute, it can opt for for a court process or arbitration. There is no two-step process of getting mainland endorsement of an offshore ruling. Clarifying where the case is heard is important, with most investors happy to go through Beijing and Shanghai. Other locations could be deal breakers.

"We have turned down deals for the sole reason that the entrepreneur insisted on having dispute resolution in his local area," says CNEI's Schoeter. "In smaller cities, most of the entrepreneurs have connections with the local government in one way or another. They could just call the mayor or local party secretary and ask them to tell the judge not to accept the case."

> **"Put options are not foolproof but only in extreme cases would a founder not feel pressured by the presence of these rights"**
> – Bonnie Lo

A potential problem raised by Steven Tran, a Hong Kong-based partner at Hogan Lovells, is that put options can be difficult to enforce onshore. Chinese courts do not recognize specific performance – through which an individual can be compelled to comply with an obligation – in the same way as Common Law jurisdictions. An investor cannot simply go to a local court and seek a ruling against a founder by saying he gave a guarantee and has breached his obligation to pay us money.

Trigger happy?

A reluctance to pursue an action through the Chinese courts is one reason why some investors hold off on redemptions when perhaps they should act. Several industry participants say they have seen GPs accept an entrepreneur's argument for why next year will be different and then de-focus on the investment in favor of better-performing assets. They are also motivated by a desire to preserve relationships.

"They want to show they are investors that work alongside companies to solve issues rather than investors that pull the trigger at the first sign of a dispute," adds Tran. "When there is a dispute, PE investors will usually try and deal with it amicably from a commercial and a relationship perspective, and keep the dispute out of the public domain."

First of all, investor agreements can be used to make things happen without resorting to enforcement. For example, there may be clauses that prevent a company from taking certain actions – such as incurring a large amount of debt or making disposals and acquisitions – without the PE investor's approval, which offers additional leverage. Documentation allowing a change of board control at the offshore level can also be effective when used in tandem with proactive onshore tactics.

When NewQuest spun out from Bank of America Merrill Lynch, the portfolio the firm brought with it included a Chinese company where there seemed little chance of a return. But NewQuest held pre-signed letters of resignation for the founder's board representatives and share transfer documents. The founder came to the table and the PE firm negotiated a $50 million buyback – acceptable, given the circumstances.

"Everything we did was focused on the offshore part but we also sent in people to take charge of the company's chops. We also had someone dedicated to understanding the cash flow situation," Lo explains. "There were pressures we could exert."

In short, information is power – but it must be used wisely. Protection measures enshrined in the investor agreement must be underpinned by a thorough understanding of whether the company or entrepreneur has both the incentive and means to honor a redemption order.

First, it is important to look into an entrepreneur's net worth and whether he has other business interests. Second, understanding the company's debt situation can be useful. For example, there may be a lot of bank loans with cross-default clauses and refusing to redeem a PE investor's convertible bond could ultimately lead to banks foreclosing on the business. Would the founder want to risk losing everything for the sake of a $50 million settlement?

At the same time, a private equity investor must bear in mind what that $50 million means to the company. If immediate repayment would bankrupt the business then the entrepreneur is likely to resist honoring the put option regardless of the consequences. This understanding should stretch to the industry in which the company is operating. If the founder is fighting against an irrevocable industry downturn, there is no point waiting for a turnaround.

"You can put everything down on paper and he can agree it all, but you have to talk to the company and check up every day from the outset. Has the business changed? Is the entrepreneur taking money out of the business?" says Junlee Hsu, a partner at Headland.

Through this ongoing dialogue, a PE investor can make management aware that a redemption

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notice is likely to come and also provide advice as to how a company experiencing distress might generate the required funds.

A previous Headland portfolio company in Taiwan had a legal dispute with one of its largest distributors in the US. Distracted by the situation, management neglected the business and it suffered. Headland's put option wasn't due to come into effect for two years but in ahead of the deadline it starting working with management on potential solutions. This resulted in the sale of one of the core assets that gave the company sufficient financial resources to redeem the GP.

"You need to think in their shoes," adds Hsu. "You are asking for the money back but how can they get it? Can they cut costs? If that's not enough, what about selling part of the business? Sometimes entrepreneurs procrastinate – these businesses are their babies so it is difficult for them to sell. However, it is better for everyone if there the company is still there rather than bankrupt. It takes time to change their thinking."

Liang Meng, managing partner at Ascendent Capital Partners, is also an advocate of the constructive approach, regarding as in tune with his firm's strategy of sourcing deals through building advisory relationships with companies.

"A lot of conversations run along the lines of us saying, 'Let's develop this idea together and we will put in money to show we believe in the idea. If things go well, we get some equity upside. If things go really badly, just treat it as a loan and return the money plus some interest,'" he told AVCJ earlier this year.

Ascendent eschews downside protection that heavily penalizes a company, arguing that the entrepreneur might just respond by fudging the accounts. Rather, the private equity firm returns equity to the founder if growth exceeds projections and cash is returned ahead of schedule. For example, Ascendent might own 40% of a company with a 2x put option after four years and a preferred dividend stream that guarantees it covers its costs. If capital is returned earlier it may reduce its holding to 37.5%.

Same but different

The mechanisms that underpin downside protection will no doubt continue to evolve as risk perceptions and markets evolve. One clause that Headland is already trying to work into agreements is a drag-along right for a trade sale. It is a natural response to less vibrant IPO markets in China. If a company is performing sufficiently well that it doesn't trigger redemption clauses, but it can't go public at a particularly high valuation then a trade sale might be the best option for all concerned.

"Entrepreneurs are more open to it now than 3-5 years ago because the IPO market is much tougher," Shen says. "In the old days a China IPO story was worth 20x but now the market is more selective, there is no scarcity value for copy cats.."

Beyond that, the negotiating dynamics will remain largely unchanged. A GP must make a judgment call on an entrepreneur's character and ability, and whether he will have the means and motivation to honor a redemption should the need occur. Strong documentation is required but also a grasp of a company's operations and what can be done to ensure an entrepreneur's interests are aligned with those of the investor.

Access to information is crucial and it should be crafted into a clear set of guidelines that are finalized before going anywhere near the negotiating table.

"Downside protection is very useful as a pressure point to negotiate a way out of a distress situation," says Lam of Latham & Watkins. "PE investors should identify the potential exit first and consider using enforcement steps to steer towards that exit. The offshore and onshore steps will need to be coordinated. Never go into enforcement when there is less certainty as to how local authorities and courts would behave. You need to have the deal pre-packaged before implementation."

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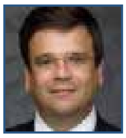

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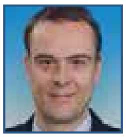

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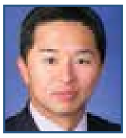

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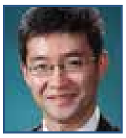

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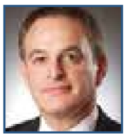

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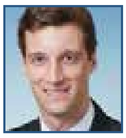

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J-Star seals first secondary exit

JAPAN HAS SEEN 61 PRIVATE EQUITY secondary exits since 2011 – more than the combined total for the 10 years before that. This surge in activity can largely be traced back to buyouts from the years leading up the global financial crisis. Investors want to exit, and with weak public markets and uncertainty among strategic players, secondaries are a welcome source of liquidity.

For J-Star, which completed its first-ever secondary exit last week, selling to another PE investor was a practical necessity. Repair business Burn Holdings was keen to retain its independence, so despite interest from a number of strategic buyers, the PE firm opted to sell its majority stake to two financial players – Shinsei Corporate Investment and Creation Capital.

Beyond that, the rationale was fairly standard. "We are a solution capital provider. When we invested the solution required was coming up with a concrete holding structure so the subsidiaries could function and to focus on improving earnings," explains Greg Hara, J-Star's president. "These have been achieved."

Burn Holdings has three subsidiaries, the largest of which is Burn Repair, a final-touch repair service used by homebuilders and construction materials manufacturers to clean up properties post-construction and pre-sale. This function was previously fulfilled by small local contractors, but as developers began to work on larger projects an opening emerged for a large-scale provider.


Burn Repair: Finishing touch

There are 30 Burn Repair outlets nationwide. It also provides post-sale services such as property inspections. Burn Holdings' other businesses, HouseBox and Spec, sell repair materials and offer interior finishing services.

J-Star acquired a majority stake in the company for around $5 million in 2011. Founder Akio Hayashi held on to a minority interest and he remains an investor under the new ownership. Burn Holdings recorded sales of JPY4.7 billion ($43 million) in 2011 and EBITDA of just under JPY200 million. Forecast sales and EBITDA for the year ending September 2014 are JPY7.4 billion and JPY500 million, respectively. Earnings growth is said to have contributed about 70% of J-Star's overall return on the investment.

The PE firm's operational contribution fell into three categories. First, it formed a holding company structure for the various subsidiaries in order to improve governance and operating efficiency. Second, headcount increased from 524 to 783 and an mentor system was used to reduce turnover. Third, steps were taken to boost profitability. "We introduced information systems and set key performance indicators," says Hara. "This was important because prior to our investment the company focused on everything, whether profitable or not. After our investment, the focus switched to the earnings contribution of different businesses."

As to what Shinsei and Creation will focus on, Burn Holdings is ultimately seen as a likely IPO candidate.

Sinarmas takes Ardent cross-border

ARDENT CAPITAL IS REGISTERED IN HONG Kong, but Bangkok remains its home. Previous investments by the VC firm have followed the same model – start in Thailand, then expand into other Southeast Asian markets. Now, though, Ardent is preparing to incubate ideas out of Indonesia as well.

Last week, the firm received $12.5 million in funding, 90% of which was provided by Indonesian conglomerate Sinarmas. It follows a $4.5 million round – Ardent's first external funding – last year.

"We realized last year that Indonesia will be a key growth market in Southeast Asia in terms of population size and investment opportunities," says Adrian Vanzyl, Ardent's CEO. "We met Sinarmas through aCommerce and we know each other well. We think that they can help us expand into the country."

ACommerce is a logistics provider launched by Ardent Labs, which operates much like a VC accelerator. In June it received $10.7 million in Series A funding led by Inspire Ventures. Sinarmas also took part.

While Ardent has a VC business that backs existing start-ups, the Labs division tests promising business ideas and seeds them with a few thousand dollars. Once the nascent company starts acquiring customers, it receives $500,000; and then a further $1-2 million before the Series A round, which includes outside investors, kicks in.


Creative zone: Ardent Labs

"We always build companies big enough to raise a scalable Series A round," says Vanzyl. "Acommerce is a good example. Its latest round was one of the largest Series A ever seen in Southeast Asia."

Ardent intends to use the same methodology to launch Indonesia-based start-ups and then help them expand into Thailand. Investments will be made across four areas: sourcing and management, fulfillment and logistics, retail, and customer acquisition. These four areas comprise what Ardent refers to as an "e-commerce stack."

With Sinarmas on board as a strategic investor, Ardent is expected to leverage the conglomerate's existing resources in industries that span agribusiness, pulp and paper, real estate, telecom and financial services. The VC firm will also open a new office in a five-floor building owned by Sinarmas and hire about 20 employees.

Ardent differs from traditional venture capital firms in that it doesn't raise funds to make investments. Rather, it operates under a holding company model, similar to Germany-based Rocket Internet. Ardent holds 100% of every company it founds and generates returns through trade sale or IPO exits. Investors in the holding company – like Sinarmas – receive proceeds based on their individual holdings.

"Compared to traditional VC firms, our model is much more capital efficient but it's also much higher risk. We make bigger bets on fewer companies, which means we really have to support and guide them to be successful," says Vanzyl.

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Back from the brink?

Moves by Japan's Nomura Asset Management and Singaporean lender OCBC to enter Chinese private equity through the Qualified Foreign Limited Partnership program are unlikely to spark a broader revival

PRIVATE EQUITY IS HARDLY NOMURA Asset Management's core business but two weeks ago the Japanese firm announced the launch of a fund in China.

Having received a license to operate under the Qualified Foreign Limited Partnership (QFLP) program, Nomura set up a 50-50 joint venture with a local fund manager Shenzhen Hua Xia Ren He Capital Management in Shenzhen's Qianhai Economic Zone.

The move comes after Singapore-based OCBC Bank launched a $100 million PE fund under the QFLP program in Shanghai earlier this year. It represents a reawakening of interest in onshore private equity funds among foreign investors following a couple of years of relative inactivity. Why is it happening?

"Public market funds in mainland China have not performed well, especially after the financial crisis. However, there is a huge growth in the private markets," says Nakano Hiroyuki, a Nomura spokesperson. "We really think PE assets could reflect the actual growth of Chinese economy. We want to launch PE fund products to high net worth individuals and capture this growth."

Broken dreams

The QFLP program was introduced in 2011, allowing foreign capital to be channeled more easily into renminbi-denominated vehicles. More than 20 private equity firms, including The Blackstone Group and The Carlyle Group, soon applied for the quotas and launched funds.

It was hoped that these vehicles would be treated as local entities, removing the bureaucracy that restricts offshore funds. Shanghai went as far as to say that local treatment would apply if less than 5% of these funds' total corpus came from overseas. However, the regulators vetoed the move – all foreign-invested funds would be treated as foreign.

"From our observation, QFLP isn't as popular as two years ago. International firms won't bother to apply for the quotas if they are still going to be treated as foreign investors," says Flora Qian, Hong Kong-based legal counsel at Fangda Law. "Fund managers may need to get Ministry of Commerce approval for every transaction, just like every other foreign investor in China."

The key point is that Nomura and OCBC are no Blackstone or Carlyle. OCBC is a bank while Nomura's core business is managing listed securities. It has been investing in China's A-share market for several years through the Qualified Foreign Institutional Investor (QFII) scheme.

The slowdown in the A-share market has seen international mutual fund managers' local joint ventures lose traction. These enterprises also have a structural failing. Foreign ownership is capped at 49% stake and this has enabled the local partner to wield more power, often pushing the foreign player into a financial advisory role.

"Global asset managers may not have much influence over how the business develops," says Ivan Shi, research director at Shanghai-based consultancy Z-ben Advisors. "Because of the weak demand for mutual fund products in recent years, a few international groups – in particular those set up in China within the last three years – are winding down their joint ventures."

> "International firms won't bother to apply for the quotas if they are still going to be treated as foreign investors"
> – Flora Qian

By comparison, the growth prospects for PE appear strong. Industry participants point to the government's pledge to restructure state-owned enterprises, which could lead to more PE deal flow, and announcements by local governments to boost internationalization of the renminbi and cross-border investments. Foreign PE firms are setting up in Qianhai and Shanghai's Free Trade Zone in anticipation of a breakthrough.

Nomura's investment banking division, Nomura Holdings, has already established another JV in the Shanghai Free Trade Zone. It will own 60% of the venture, with the rest held by two local investors. The JV cannot sell financial products directly to Chinese clients, but it can offer products and advice to the retail operation of the local partner. Hiroyuki says Nomura will look for ways in which the PE and investment banking JVs can work together.

Another factor behind the foray into PE is demand from domestic investors that want to deploy capital overseas. It has prompted several large local financial institutions to try and diversify business lines.

"There is an increasing amount of capital being allocated into alternative asset classes in Japan, such as private equity. At the same time, China is liberalizing its capital markets. If you put these two trends together, it would suggest that local fund managers like Nomura will be attracted to private equity," says Dean Moroz, Hong Kong-based legal counsel at Ashurst.

Nomura wants to raise capital from Asian high net worth individuals and sovereign wealth funds, as well as from investors in the US and Europe, but this is no easy task. Moroz cautions that mutual fund managers are hardly likely to be the first port of call for pension funds that want to invest in private equity.

Nomura says it will address this by having Shenzhen Hua Xia Ren to bring in capital from Chinese investors. The company was founded by ex-employees of China Asset Management, one of China's biggest mutual fund management firms.

As to how and where the joint venture will invest, the plan is to back late-stage private companies through the acquisition of minority and controlling stakes. There will also be PIPE deals. Nomura's Hiroyuki emphasizes the ultimate aim is to create a wider range of products for investors – in the private equity and secondary markets as well as through the construction of diversified A-share portfolio.

For OCBC, the strategy is to invest in privately-owned growth-stage companies with aspirations to list on the A-share market. Sectors such as modern agriculture, consumer, healthcare, clean and environmental technology and advanced manufacturing are of particular interest.

Each firm sees PE as part of a broader effort to develop its exposure to other financial businesses. But are industry participants are cautious as to whether this can inspire other foreign institutions to play a larger role in QFLP. After all, the Blackstone local treatment issue has yet to be resolved.

"From a commercial perspective, I don't see a lot of fund managers following suit because the program doesn't provide any significant benefits to investing in China," says Fangda's Qian.

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Going global

Malaysian pension fund KWAP is adding North America and European exposure to its Asia-heavy private equity portfolio. It is ramping up commitments from a relatively low base

RECENT PRIVATE EQUITY FUND commitments made by Kumpulan Wang Persaraan (KWAP), Malaysia's second-biggest pension fund, point to an LP in transition. Each of the nine managers it backed between 2010 and 2012 are concentrated on Asia: from Saratoga Capital and Ancora Capital in Indonesia to Advent Private Capital in Australia to the Southeast Asia-heavy offerings of Asiasons and Lombard Asia.

Last year, there was one big Asia investment – KWAP backed Affinity Equity's Partners' fourth fund, its first commitment to a large regional buyout vehicle – but the other three were far from home. Acon Equity Partners III and Stonepeak Infrastructure Fund are both North America-focused, while Nordic Capital III mainly invests in Sweden, Denmark, Finland and Norway.

"Our private equity fund program has gained momentum in terms of both geographical and fund strategy diversification in recent years," says Nik Amlizan Binti Mohamed, KWAP's CIO. "Last year we invested in four funds including a US infrastructure and a European buyout fund. As of the third quarter of this year, we have closed three funds, including one global secondaries fund. We aim for 4-5 funds per year."

The pension fund had 18 GP relationships at the end of 2013 and MYR816 million ($249 million) devoted to the asset class out of a total portfolio of MYR99.9 billion. It also had two direct private equity investments in Malaysia. Last year, the Ministry of Finance approved a new strategic asset allocation that will see KWAP's international investments rise from 10% of the portfolio to around 19%. As a result, the 1% PE allocation has jumped to 2%, with a further 1% for infrastructure. KWAP will deploy 6% in overseas equities, 5% in fixed income securities and 6% in real estate.

Based on the annual average increase in fund size over the past five years, KWAP will have MYR113.9 billion under management by the end of 2014, of which up to MYR3.4 billion could theoretically be in private equity and infrastructure.

Growing appetite

KWAP's origins lie in the Pensions Trust Fund established by the government in 1991 to cover federal pension liability. Under new legislation introduced in 2007, KWAP was incorporated and assumed responsibility for the Pensions Trust Fund. It receives contributions from 505 statutory bodies, local authorities and agencies that together have more than 160,000 members, plus additional funding from the government.

The first private equity fund investment came in 2001 but until incorporation commitments tended to be opportunistic and relatively small. In recent years, KWAP's commitment for a fund has grown from $20 million to $50 million.

Aside from picking the right managers – a challenge for all LPs, irrespective of size – KWAP faces two key pressures as it builds out its alternatives program. The first is brand recognition.

"We are still a small player in this global industry," Amlizan says. "However we believe that it is critical to build our presence in the industry in order to participate in high-performing global funds. In most cases, when top-performing GPs raise their subsequent fund, existing LPs re-up with a higher capital commitment. New LPs may not have the opportunity to invest unless they are we well known, reputable institutional investors."

The second is attracting talent capable of executing the pension fund's investment strategy. Malaysia is an immature private equity market relative to the likes of the US and this makes it difficult to recruit professionals who can source deals and funds. KWAP's alternatives department is growing fast, with nine professionals in private equity, covering both the investment and portfolio management, and others responsible for real estate, but the program is currently managed internally.

"If you are going to fast track a program you can appoint an advisor to assist in your portfolio construction and build up, but we decided to do it ourselves," Amlizan explains. "We might consider using advisors in the future to complement our in house investment program."

This team is already working on geographic and sector diversification, with co-investment seen as the next step. Some deals are already in the pipeline. Co-investment is one area of consideration when KWAP invests in a fund; another is an observer seat, which presents the team with an opportunity to learn from its partner GPs and augment internal capabilities.

As to the kind of managers KWAP is targeting, large-cap players such as Affinity appear to be the exception rather than the rule. Acon Investments and Nordic Capital, well-established mid-market players in their respective geographies, arguably serve as a better indicator of what the pension fund is looking at. In addition to offering an element of diversification to an Asia-heavy portfolio, mid-market buyouts in developed markets are seen as strong performers.

"The focus in the medium-term is more of the mid-market funds where returns have been the strongest," Amlizan says. "We aren't going to focus so much on the mega funds, although if a manager has consistently delivered well in this space then we would consider them."

KWAP private equity fund commitments, 2010-2013

Year	Fund	Geographic focus
2010	Ancora Fund II	Indonesia
	Asia Water Fund	Asia
	CIMB-TrustCapital Australia Office Fund No.1	Australia
	Tata Capital Growth Fund	India
2011	Saratoga Asia III	Indonesia
	DragonRider Opportunity Fund II	China; SE Asia
	Advent VI	Australia; New Zealand
	Templeton Strategic Emerging Market IV	Europe; SE Asia; China; India
2012	Lombard Asia IV	SE Asia
2013	Acon Equity Partners III	North America
	Affinity Asia Pacific Fund IV	Asia
	Stonepeak Infrastructure Fund	North America
	Nordic Capital VIII	Nordic region

Source: KWAP

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