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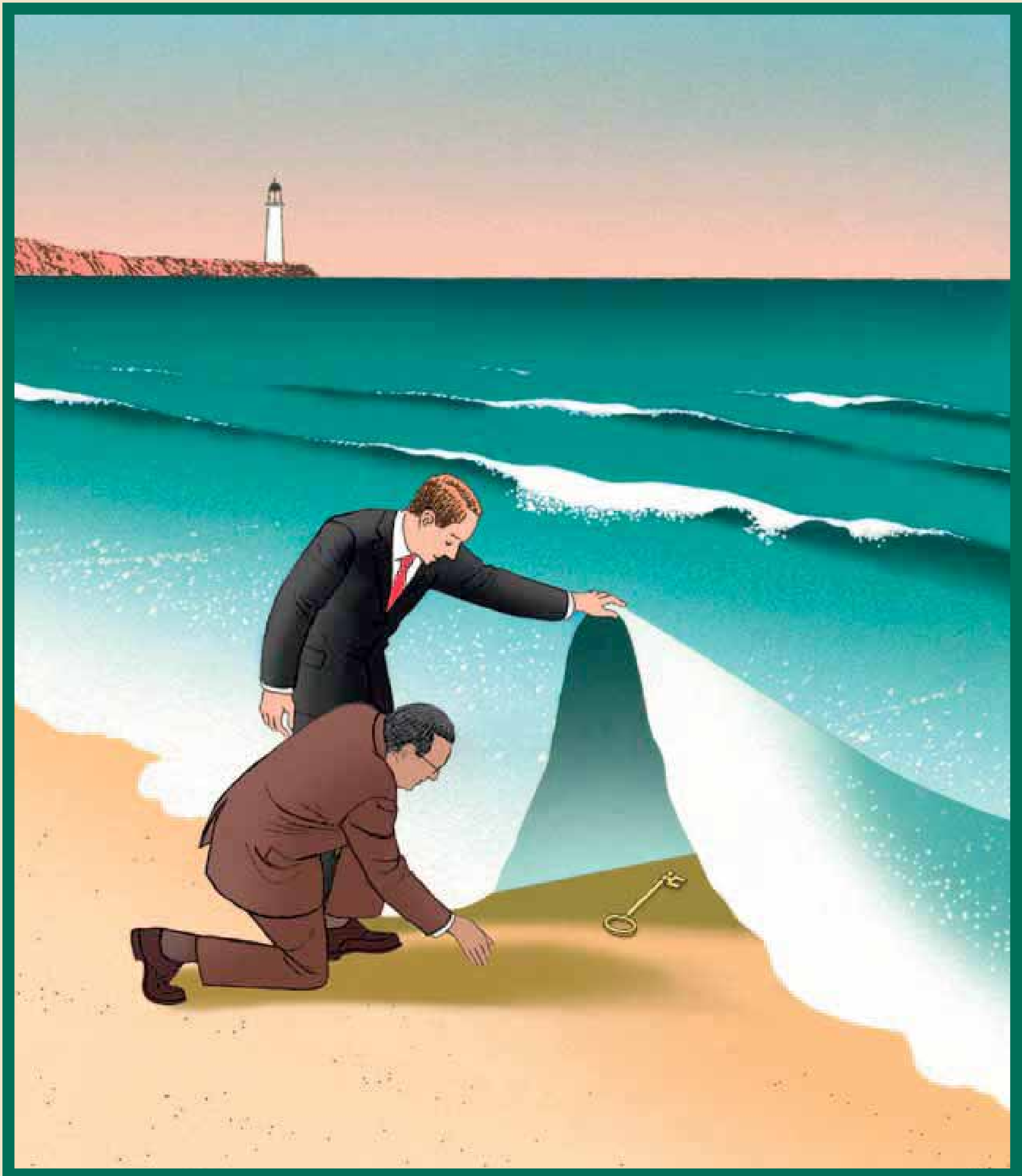

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EDITOR'S VIEWPOINT

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Trust issues

"GPS THINK LPS ARE LIARS" – IT IS A sensational designed to draw attention to an issue that is nearly as old as institutional fund management itself. Numerous past surveys and mountains of anecdotal evidence suggest that communication problems and mutual distrust pollute GP-LP relations (in many but not all cases).

The Reputational Risk in Private Equity Report, published by IAG and Thompson Taraz, which the aforementioned headline was used to promote, is no exception.

Nine in 10 GPs surveyed suspect LPs of taking meetings even though they have no intention of investing and eight in 10 said LPs are not truthful about their reasons for not investing. There is also substantial support for the notion that supposedly prospective investors request information only to benchmark other funds.

While no more than about one quarter of LPs who participated in the survey admitted to the latter two charges, a comfortable majority said they have taken meetings with fund managers despite already knowing they would not invest.

In addition, the report reveals predictable differences of opinion on the quality of fund reporting. GPs give themselves 3.9 out of 5 on reporting, overwhelmingly believe LPs are getting all the information they need; LPs give GPs 3.3 out of 5, and less than half think their information needs are met in a timely fashion.

Context is helpful here. First, this is a global survey so Asia accounts for a small portion of the GP and LP sample. Second, pension funds made up one third of LP respondents, with family offices on 18%, and insurers, endowments, banks and fund-of-funds in the low teens.

The LP breakdown is particularly important. Most of the capital going into professionally-run, US dollar-denominated funds in Asia comes from investors based outside the region. Few have any representation here and a significant proportion rely heavily on intermediaries – fund-of-funds, separately-managed accounts and other advisory relationships – when deciding which GPs to back.

As a result, the intermediary constituency in this and other emerging markets has a particularly loud voice. Not all GPs like this, and the fund-of-funds come in for particular criticism from Asia-based managers. Their alleged transgressions are legion, but here are some common sound bites: Those guys can't raise any money, they come to meetings just to collect gossip; fund-of-funds refuse to give us access to their LPs; they hound managers for allocations, pushing funds beyond the ideal size; they are aggressive on terms, I wish I could avoid doing business with them.

That said some fund-of-funds are singled out by GPs as beacons of industry respectability, untarnished by any of the criticisms listed above. It is difficult to think of a single group that is universally acclaimed. In many cases, managers will reserve praise for fund-of-funds that backed them when they were starting out and remain on the LP roster to this day.

Fund-of-funds will continue to play a role until a critical mass of international LPs is comfortable enough to enter Asia directly. Even then, they might retain mandates from mega LPs that want exposure to smaller managers but are unable to go below a certain check size. Whether the primary mode of entry in 10 years' time is still a comingled fund product remains to be seen.

Given the relative youth of Asian all LPs want to get to know managers before committing to them. This involves taking meetings when there is no chance of an allocation and requesting information that is ultimately used to benchmark managers across the region.

While some institutions may prefer obfuscation to honesty when explaining their decision not to invest, this approach doesn't help anyone. How, for example, can GPs improve their reporting capabilities and governance if LPs doesn't explain why they aren't up to scratch? Beyond that, sharing information and building relationships is part of Asia fundraising, and it applies to the region's nascent LPs just as much as nascent GPs.

At last month's AVCJ Forum I took a look at the schedule of LP meetings that an Asian PE firm had set up for the week. My eye settled upon a particular institution that is fairly new to private equity. "Really?" I asked. "You're not going to get any money from them. At least not this time around." The investor relations executive replied: "I know. It's for the fund after this one."

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NEWS

ASIA PACIFIC

Emerald Hill executive to set up China fund-of-funds

Tommy Yip, partner and head of North Asia at Emerald Hill Capital Partners, has resigned from his position. He is expected to form a new China-focused fund-of-funds with Low Kah-Fai, executive director of Eagle Asia Partners.

AUSTRALASIA

CHAMP PE-owned oOh! Media targets $141m IPO

Australian outdoor advertising company oOh! Media, which is owned by CHAMP Private Equity, plans to raise A$166 million ($141 million) through an IPO. The vast majority of the offering comprises new shares, with most of the proceeds to be used to repay debt.

Blackstone makes $150m retirement play

The Blackstone Group has invested $150 million in Australian retirement village developer National Lifestyle Villages. The company is a greenfield developer of land-lease communities for the over-45s baby boomer and early retiree demographic. It has nine communities in Western Australia and one in Victoria, comprising 1,800 residences housing about 2,700 people.

Revived vacuum retailer Godfreys set for IPO

Australian vacuum and cleaning products retailer Godfreys Group, which was acquired by Unitas Capital and Pacific Equity Partners and then taken over by creditors, is preparing to go public following a turnaround. Godfreys is seeking to raise A$77.7 million ($66.4 million), of which A$39.3 million will go to existing shareholders.

GREATER CHINA

SummitView, Shanghai launch $1.7b PE fund

SummitView Capital has partnered with the Shanghai government to launch a RMB10 billion ($1.7 billion) private equity fund, which will invest in semiconductor manufacturers. The fund is part of a strategic collaboration with China National Fund backed by the Shanghai government.

TPG exits China Grand Auto to Haitong-led group

TPG Capital will sell its stake in China Grand Automotive Services (CGA), the country's leading car dealer, to an investor group led by Haitong International Securities Group for HK$5.4 billion ($697 million).

Haitong Securities-owned Haitong International New Energy has agreed to buy into an offshore vehicle that will invest directly in China Grand Automotive Group, which in turns holds a minority interest in CGA's onshore business. Haitong will pay HK$2.1 billion for a 38.87% interest in the vehicle, while the rest of TPG's stake in CGA will be acquired by an undisclosed investor.

TPG invested up to $100 million in Xinjiang Guanggui Industry Investment's auto trade and service projects in 2006. The intention was to establish 200 "4S" stores - focusing on vehicle sales, spare parts, services and customer surveys - in China over a three-year period. China Grand Auto was launched later in 2006. The business is a joint venture with Xinjiang Guanghui and operates 402 4S dealerships across 23 provinces. Two years ago, Shanghai Future Value Investment and Shenzhen KCH Investment invested in the company for an undisclosed sum.

The company abandoned plans for a Hong Kong IPO earlier this year.

Chinese steel manufacturer invests in $163m PE fund

Guangzheng Group, a Shenzhen-listed steel manufacturer, has invested RMB20 million ($8.25 million) in a private equity fund jointly launched by a unit of Tsinghua Holdings and Harvest Capital. It has a target size of RMB1 billion.

JD Capital buys traditional Chinese medicine business

JD Capital has bought a 60% stake in Baoding Zhong Yao, a traditional Chinese medicine manufacturer. Financial terms were not disclosed but local media reported the investment size as about RMB260 million ($42 million).

Online rental site raises $22m from VCs

A group of VC investors, including Matrix Partners, SIG China, Legend Capital and China Renaissance, have invested $22 million in a Series B round of funding for Uoko.com, a Chinese online rental operator. The company focuses on rentals to young people in second-tier cities, such as Wuhan and Chengdu.

Fidelity commits $10m to medical device maker

Fidelity Growth Partners Asia and Fidelity Biosciences have committed RMB62.5 million ($10 million) to Eyebright Medical Technology, a Chinese ophthalmic medical devices manufacturer. Founded in 2010, Beijing-based Eyebright is known for making artificial lens used to treat eye conditions such as cataracts.

Ally Bridge ventures into German healthcare

Ally Bridge Group, a healthcare-focused PE firm based in Hong Kong and the US, has made its first investment in Europe, participating in a $8 million round of funding for Pieris, a Munich clinical-stage biotechnology firm. Other investors include OrbiMed Advisors, The Global Life Science Ventures, BioM Venture Capital, Gilde Europe Food & Agribusiness Fund and BayTech Venture Capital.

BVCF leads Series A for immunotherapy firm

China-focused healthcare investor BVCF has led a Series A round of funding for CARsgen, an immunotherapy firm that focuses on treating cancer. The firm has established partnerships with Shanghai Cancer Institute and Shanghai Renji Hospital to develop new treatments for liver, lung, stomach and brain cancers.

NORTH ASIA

Korean court favors Lone Star in $159m KEB tax case

Lone Star Funds is closing in on a KRW177.2 billion ($159 million) payout from the South Korea tax authorities after a court said the PE firm should be refunded taxes levied on its sale of a

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NEWS

stake in Korea Exchange Bank because capital gains taxes should be levied on the beneficiary of the proceeds of the sale. It ignored the Belgian entity through which the investment was made, and identified US-based Lone Star as one of the beneficiaries. Lone Star is protected by the South Korea-US double tax treaty.

Goldman leads $36m round for food-ordering platform

A Goldman Sachs-led consortium has invested KRW40 billion ($36 million) in Woowa Brothers Corp, owner and operator of Baedal Minjok, South Korea's leading digital food-ordering platform. The company will use the new funds to upgrade its technology, improve customer experience, and expand overseas.

Samyang joins SCPE partner in Korean packaging deal

South Korean conglomerate Samyang Corporation has emerged as Standard Chartered Private Equity's (SCPE) in the acquisition of a packaging business from Hyosung Corporation. Samyang said it would merge its packaging business with Asepsys Global, the vehicle SCPE set up to buy the Hyosung assets.

Visteon confirms PE talks over Korea divestment

US auto parts maker Visteon Corp. has confirmed it is in negotiations with Hahn & Co. over the potential sale of its South Korea-based subsidiary Halla Visteon Climate Control Corp. (HVCC). Local media earlier reported that Hahn & Co. had reached a preliminary agreement to buy Visteon's 70% stake for about KRW4 trillion ($3.6 billion).

Korea's Woori Bank sale flounders again

The South Korean government will make another attempt to sell its controlling stake in Woori Bank early next year after the latest in a string of sale processes last week because there were not enough bidders. China's Anbang Property & Casualty Insurance submitted the only offer.

SOUTH ASIA

Canada's Fairfax launches India investment unit

Fairfax Financial Holdings, which previously acquired Thomas Cook India through Fairbridge Capital, is launching a publicly-traded unit that will target investments in the country. In addition to the public offering of subordinate voting shares, the unit will receive $300 million from Fairfax Financial and $200 million from several cornerstone investors.

CVC invests $150m in Japan broadband business

CVC Capital Partners has acquired a 50% stake in enterprise-focused Japanese telecommunications carrier Arteria Networks – a unit of Japanese conglomerate Marubeni – for $150 million. The transaction will give CVC joint ownership of the business alongside Marubeni, which will continue to hold a 49% stake.

Arteria is a key operating subsidiary within Marubeni's information and communication technology (ICT) division, providing broadband connectivity and network solutions across the country. It is one of just four players in Japan with a nationwide fibre network infrastructure offering internet connectivity, leased circuits, virtual private networks, data centers and related solutions. The business specializes in providing services to medium- to large-sized corporations and condominium buildings.

Marubeni is one of the largest Japanese trading companies with businesses across various sectors. The conglomerate's ICT, finance and insurance and real estate business - of which Arteria is a part - is one of its more profitable segments. The division generated a gross trading profit of JPY44.3 billion for the six months ended September, up 16.6% year-on-year.

News Corp invests in PE-backed property platform

News Corp has paid $30 million for a 25% stake in the parent of PropTiger.com, an India-based online property marketing platform backed by SAIF Partners and Accel Partners. The platform, which was founded in 2011, has intermediated the sale of at least 10,000 properties with a combined value of over $1 billion.

PE-backed Manpasand Beverages files for IPO

Manpasand Beverages, the PE-backed drinks maker behind Mango Sip, is looking to raise as much as INR4 billion (INR64.6 million) through an India IPO. SAIF Partners first invested INR450 million in the company in 2011, and then put in another INR450 million earlier this year alongside pre-IPO investor Aditya Birla.

Nippon Life raises stake in India's Reliance Capital

Japanese insurer Nippon Life has agreed to increase its stake in India's Reliance Capital Asset Management and could end up owning 49% of the company. In the first tranche of the transaction, Nippon will pay INR6.57 billion ($108 million) for a 9% stake. This values Reliance Capital at INR73 billion.

WestBridge makes India housing finance play

WestBridge Capital Partners has invested INR980 million ($16 million) in India Aptus Value Housing Finance, an affordable housing finance company. It provides housing finance to middle-income, self-employed customers - primarily in semi-urban and rural markets - in the range of INR300,000 to INR1.5 million.

SOUTHEAST ASIA

Rakuten leads $10m Series A for PocketMath

Rakuten Ventures, a corporate VC arm of Japanese e-commerce giant Rakuten, has led a $10 million Series A round for PocketMath, a Singapore-based mobile advertising platform. Founded in 2013, PocketMath provides a self-service mobile advertising platform for any users to place ads using a real-time bidding (RTB) system.

Fin-tech accelerator launches in Singapore

Startupbootcamp FinTech, a Europe-based accelerator that focuses on financial technology, has launched an Asian program in Singapore. Startupbootcamp FinTech Asia is backed by Infocomm Investments, a subsidiary of Inofcomm Development Authority (IDA), as well as MasterCard, DBS Bank, SBT Venture Capital, Route 66 Ventures and the Monetary Authority of Singapore.

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Technology transfer

Healthcare-focused private equity firms want to take technologies from developed markets into China, leveraging rising domestic demand. It is a lucrative strategy, but not necessarily a straightforward one

THE "BRIDGE" IN ALLY BRIDGE represents just that – a private equity firm that wants to serve as a link between Chinese and global companies, bringing new healthcare technologies to the former and opening up new customer markets for the latter.

The firm, set up in 2010 by Frank Yu, was originally known as Themes Investment Partners. It targeted Chinese companies in healthcare, environmental technology and agri-business. The healthcare portfolio performed particularly well, generating an approximately 3.1x return on investments worth $60.4 million.

Forging a new path as a healthcare specialist, Yu saw the cross-border M&A angle as a means of differentiating his strategy. The rebranding as Ally Bridge soon followed in 2013. Fund I, now fully invested, backed healthcare technology start-ups in the US and helped them enter China. In June, the firm reached a second close on its second fund. For this vehicle, the one-market strategy has evolved into a fully-fledged cross-border strategy, with investments in the US and China.

"China healthcare has matured to a level where the more progressive companies are looking internationally. They want to source world-class technologies in order to address unmet needs in China and also access overseas markets," Yu explains. "Simultaneously many global companies look favorably on the continued strong growth of China's domestic healthcare sector. These are two factors generate cross-border opportunities."

In July Ally Bridge sealed a partnership between Shenzhen-based LifeTech Scientific and US-listed Medtronic to produce pacemakers and other cardiac devices for the Chinese market. LifeTech will develop the devices with Medtronic providing technical support.

Ally Bridge is not the only PE firm to recognize the potential of the cross-border healthcare investment thesis. Life sciences specialist BVCF, Fiderlity Growth Partners, Silicon Valley-based healthcare investor Essex Woodlands, and newly-formed GP Aequus Asia Capital Partners are also keen on deals of this nature. But why now?

Drivers of demand

According to Preqin, 41 Asia-focused funds that claim an interest in investing in healthcare are currently in the market, seeking to raise $24 billion between them. It runs the full gamut from large pan-regional players to small sector specialists. The total is some way off the 2005 peak, but it compares favorably with recent years. Last year 55 funds were targeting $11 billion.

AVCJ Research breaks down private equity investment in healthcare into three categories: pharmaceuticals, service providers and medical devices. While each segment has seen an uptick in activity this year, the latter two categories have generated the most interest. A total of $403 million have been committed to 12 medical devices manufacturers so far this year, the most since 2010 when $189.5 million went into 14 deals. Meanwhile, on the service provider side $554.7 million has been deployed across six deals, more than double last year's figure.

China wants to climb the value chain all along the industrial manufacturing spectrum, including healthcare, and develop technologies that can be exported overseas. At the same time, the country needs better hospitals with better equipment to meet rising domestic demand.

Healthcare expenditure – state-led and private consumption – reached to RMB3.2

Regulation: Doors opening

Medical devices

The Innovative Medical Devices Special Licensing Procedure, introduced in February, is a fast-track approval process that allows manufacturers, including those from overseas, to get their products to market in double-quick time. Qualification rests on being able to demonstrate that the medical device in question is more innovative than existing models in its category.

Jenny Yao, a partner in KPMG's healthcare consulting practice, says it is part of a wider effort by Beijing to promote locally-made medical devices, with considerable resources devoted to helping companies establish brands and improve quality.

"Not only private equity firms, but also some medical devices companies in China are trying to acquire overseas targets. The trend has emerged over the last couple of years but the market has become especially active this year," she explains.

China's medical devices market was worth an estimated RMB170 billion ($27.7 billion) in 2012, a tenfold increase on the 2001 total.

Hospitals

Another significant policy change came in August when the government announced that it would allow foreign investors to take full ownership of hospitals in seven cities and provinces, including Beijing, Tianjin and Shanghai.

The move has further opened up China's fast-growing private hospital sector, but Yao warns that investors should be aware of the variety of risks and challenges that may await them. Above all, the prospective investor must answer two questions. How is the target company going to attract high-quality doctors? And what can be done to boost patient numbers?

"I have many clients saying this is a hot area with much potential, but the more they know about this sector the more cautious they become. Some of them have even decided not to go in at all because they don't have robust solutions for all the issues," she adds.

On the recruitment side, a lot of professional doctors eschew opportunities with private hospitals because they see a clearer path to promotion in the public healthcare system. Many public hospitals also have ties to universities, and this presents teaching opportunities as well as the possibility of getting government funding for research.

Earlier this year, the government allowed doctors in public hospitals to work part-time in the private sector, but as a result of time management issues, the initiative has yet to catch on.

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trillion ($523 billion) in 2013, up 14% from 2011. Spending is expected to grow at 20% per year, driven by macroeconomic factors like urbanization and rising disposable incomes, but also by the fact that China's population is ageing.

Chronic conditions such as diabetes, cancer and respiratory disease are becoming more prevalent. China accounts for one in five of the world's population and one in three of its deaths from lung cancer. Liver cancer is the fifth most common form of cancer globally and the vast majority of sufferers are in China, yet it remains underdiagnosed and inadequately treated.

For these reasons, healthcare is a key tenet of the 12th Five-Year Plan, which covers 2011-2015. Earlier this year, the government unveiled its latest policy initiative by relaxing rules on private investment in public hospitals and also fast-tracking approvals for the sale of innovative foreign medical devices in China.

"Over the last 10 years, real estate development was one of the key drivers for GDP growth in China, but over the next 10 years it will be healthcare. There are greater internal needs around healthcare service provision, health and wellbeing, medical devices, elderly care and pharmaceutical development," says Jenny Yao, a partner in KPMG's healthcare consulting practice.

Carving a niche

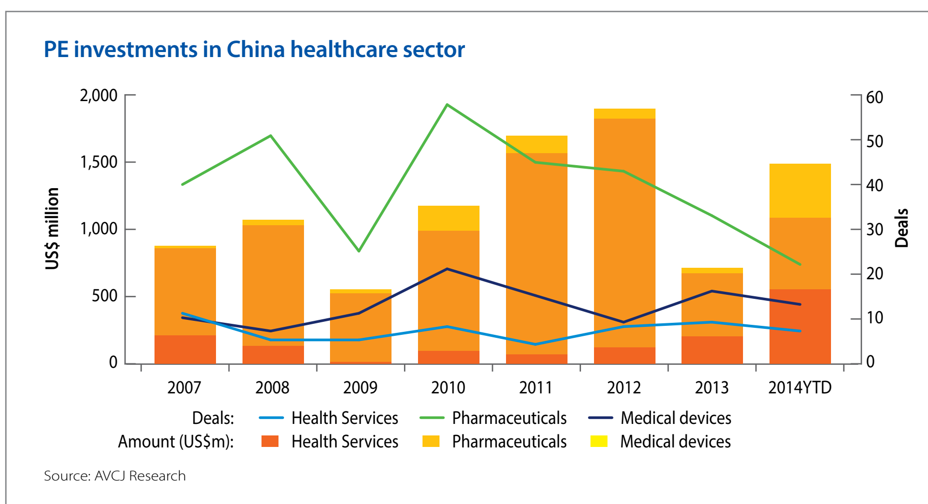
As a result of the recent reforms, the hospital space has turned into a sellers' market, with a large number of private equity and strategic investors flocking around the limited number of facilities put up for auction.

In April, a consortium led by Fosun Pharmaceutical Group and TPG Capital agreed to buy hospital operator Chindex International for $433 million, after seeing off a counter bidder, while in October Hony Capital purchased Shanghai Yangsi Hospital, the largest privately-owned hospital in the city. Hony wants to acquire 10-15 hospitals over the next three years.

With hospital deals fast-becoming a large funds' game, mid-market investors are looking for other entry points where valuations are lower. Medical devices and pharmaceuticals are obvious targets and their cross-border strategies leverage the still huge innovation gap between China and developed markets, chiefly the US.

"Healthcare investing is definitely heating up, trying to catch up with internet investing and this means valuations are rising every day," Yu told the AVCJ Hong Kong Forum in November. "We don't chase valuations by getting into crowded deals. Instead, we have our own niche, acting as an enabler of cross-border M&A to cement partnerships between Chinese and overseas healthcare companies."

PE investments in China healthcare sector



Source: AVCJ Research

Industry participants note that the valuation situation isn't just more favorable for cross-border deals than domestic hospitals; in some cases it is turned completely on its head.

Still suffering the after-effects of the 2000 biotech boom and more recent moves by the US government to reduce funding, a number of US and European companies distressed, desperately in need of capital to continue development programs. However, their technologies retain intrinsic value and this could be exploited to the full by bringing them to China.

Although biopharmaceuticals and medical devices are both present in the Ally Bridge portfolio, Yu sees investments in the latter as easier to manage given the regulatory risks. This view is echoed by Weiheng Chen of law firm Wilson Sonsini, who claims to have seen more deals in medical devices over the last two years.

Medical devices will also be a strong investment theme for Aequus, which is preparing to launch a $200 million healthcare-focused fund. The firm is looking for disruptive medical technologies that are established in the US and can be rolled out in China, and then elsewhere in Asia. Technologies used in the diagnosis or treatment of cancer and diabetes are of particular interest.

"Those products could work well in diagnostic centers and patient specialty clinics, complementing existing equipment such as CT scanners and MRI systems. The idea is that patients wouldn't have to go to 4-5 places for imaging, diagnostics and treatment; everything could be done in a single center. It is close collaboration between technology and the healthcare service delivery model," says Amit Kakar, co-founder and partner at Aequus.

The private equity firm would acquire full distribution rights for medical devices in China and then leverage its working relationships with the Chinese government to secure regulatory approvals. It would seek out joint venture partners for distribution or invest in companies that are building specialist diagnostic and disease treatment centers, and sell equipment to them.

"The application process for a license to build a large hospital is lengthy. It is also difficult to get quality doctors to work in private hospitals. And then, most importantly, it is easier to scale smaller facilities – you can open a new center within six months," Kakar adds. "We could also differentiate ourselves from regular check-up centers by focusing on diagnostics and treatment."

In this context, the steps taken to simplify approvals for overseas-developed medical devices are significant. Previously, it could take 4-5 years for a new product to be fully licensed; now, technologies deemed sufficiently innovative should be able to sweep through the process in less than two years.

However, greater access to the China market also presents market-positioning challenges for foreign companies. A multinational can roll out premium brands at high prices and see little but lucrative take-up, or team up with local players to develop affordable brands. This is the essence of the LifeTech Scientific-Medtronic partnership.

"By working with a local champion, international players can deploy their proven and innovative technologies while also leveraging local brands and distribution channels, and establishing a pricing structure that reaches a larger addressable market," says Ally Bridge's Yu.

The discovery angle

Multinational drug developers are also becoming more open-minded in licensing treatments for clinical trials in China. Again, the driver is China's scale.

According to Chinese Academy of Social Sciences, the domestic pharmaceutical was worth RMB93 billion in 2012 and it is expected

to reach RMB2.3 trillion by 2020. The earlier a company starts clinical trials and wins local approvals, the sooner it gets access to this market.

Government efforts to reduce the prices of essential drugs have made the generics space less attractive than it once was. Meanwhile, the general quality of domestic drug development has improved as waves of Chinese scientists who studied aboard return home, encouraged by increased state funding and incentives for R&D.

"More and more talents trained at world-class Western companies and institutions have returned to China to lead clinical development projects, many of which have reached global standards," says Johnathan Wang, senior managing director at OrbiMed Asia. "Global investment firms like us have also served as a bridge between East and West to facilitate cross-border partnerships. Through their networks and resources, these returnees are bringing advanced Western technologies to local companies in Asia."

They are also developing local drugs for local patients. For example, Hepatitis B is not a life-threatening condition in the US and therefore not a focus for multinationals; in China it is undertreated, with 100 million people afflicted by the disease. So not only is there domestic demand for treatments, but also a large base of patients for clinical trials. This is important given patients from different geographies have different genetic backgrounds.

Zai Lab, a clinical trials company set up by Samantha Du, former CEO of Hutchison Whampoa subsidiary Hutchinson MediPharma and a healthcare partner at Sequoia Capital, is one of a number of start-ups looking to license overseas treatments and conduct R&D in China.

The company, which is backed by Qiming Venture Partners and several other venture capital firms, recently obtained a license from Sanofi for two novel compounds that could potentially be used to treat chronic respiratory diseases, including chronic obstructive pulmonary disease (COPD) and asthma. This is a common condition in China due to worsening air pollution.

Although no one is close to producing the next blockbuster treatment, the biotech ecosystem is evolving, which is in turn driving the contract research organization (CRO) industry. These groups provide outsourced clinical-trial services, enabling drug sponsors to save on costs. They are getting more business from US players.

As success rate for new drug development is relatively low, most of the products brought into China by cross-border funds have at least reached Phase II clinical trials in the US. This minimizes the technology risk but the regulatory hurdles are still significant compared to medical devices, where companies can at least rely on improved intellectual property rights protection.

"Even if a drug candidate has been in clinical trials overseas, which means that it has been tested on humans, the developer must still gain investigational new drug (IND) approval from the China Food & Drug Administration to conduct clinical trials in China. The IND approval process typically takes 1-2 years," OrbiMed's Wang says.

It can be a daunting and time-consuming process but it is not the biggest challenge facing private equity firms when pursuing cross-border healthcare strategies. The most important consideration is whether an investment team has the skills and background to identify and source advanced technologies outside of China that can work in China. For example, Ally Bridge has 20-strong team, split between China and the US, all of whom have biotech experience.

"Having industry expertise is critical for medical devices and biotech investments," says Wilson Sonsini's Chen. "Few China-based private equity funds have actually built up professional teams to look at global disruptive technologies in areas such as life sciences. Most of local GPs are still chasing healthcare consumer players like generic drugs and hospitals."

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CITIC to build construction education business

THE EVOLUTION OF CHINA'S EDUCATION market can be divided into three periods that have, so far, delivered distinct kinds of companies. Phase one was the IPO boom of 2006-2008 when service providers focused on overseas studying and professional qualifications – such as New Oriental Education & Technology and Noah Education Holdings – went public.

Phase two started with the rise of the English training and extracurricular tutoring market in 2007 and the subsequent listings of Ambow Education and Xueda Education Group. According to Deloitte, the third phase will come to fruition from 2016, with online education providers to the fore.

Given its focus on test preparation for and vocational training in China's construction sector, Study & Share has much in common with the phase one generation. But CITIC Capital Partners, which recently acquired the company, is looking to transplant the business into phase three.

"The company is fundamentally an offline training provider but we have noticed a clear trend toward online education," says D.J. Luo, executive director at CITIC. "It is not necessarily about being purely online, but offering an offline-to-online solution. Through this model training companies can provide a more holistic and comprehensive training environment."

CITIC has not disclosed the transaction size but it is understood to be more than RMB100 million ($16.2 million). The plan is to build an online platform on top of Study & Share's network of more than 40 learning or student recruitment centers across tier-one and tier-two cities. Over the next five years, the professional qualification test market – of which the construction sector is the largest piece – will expand by 10-15%, driven by increased enforcement of certification requirements.

Test prep: Offline to online

"The demand is there," says Luo. "The macro environment is slowing and a lot of sectors are sluggish, but if you look at the education sector it has maintain double digit growth and it hasn't showed any sign of slowing down."

Luo describes the investment as a "growth buyout" deal, with Study & Share's founder retaining a significant minority stake in the business and staying involved in day-to-day management of the business. "In many cases we want to work with the founders and leverage their network experience and knowhow," he adds. "The challenge is really how to work with the fonder and develop a winning strategy and make them more successful on a national level."

The sector is also ripe for consolidation, with investment yet to match the size of the opportunity because there are so many small players that can't attract big-ticket backers. "There will be consolidation but the precondition is that the market has market leaders because if you bundle a bunch of chickens together, it doesn't make a horse," Luo says. "You need a strong player to consolidate and we can use our platform to merge with other sub-scale players."

Lazada rockets past $700m mark

"WE GO IN WITH A CERTAIN HYPOTHESIS of growth and revenue. Sometimes you're not able to guess how the market will react. If the hypothesis is not confirmed within 3-6 months then we decide to pull out."

This was the explanation given by Tito Costa, Rocket Internet's managing director for Southeast Asia, when AVCJ asked him last year about the shuttering of two smaller e-commerce ventures in the region. With more than $700 million in private equity and venture capital backing, online retailer Lazada – which was launched in 2012 – is amply resourced to deliver the critical mass Rocket Internet seeks.

Costa described Southeast Asia's internet environment as offering a unique window of opportunity: strong macro fundamentals and the freedom to establish e-commerce verticals and related infrastructure in a landscape virtually untouched by meaningful competition.

The latest chunk of capital bestowed upon Lazada so that it can stay ahead of the field comes largely from Temasek Holdings. It led a round of funding worth EUR200 million ($249 million), with participation from the likes of Kinnevik and Verlinvest. These two groups have backed several Rocket Internet ventures, including Zalora, a Southeast Asia-focused online retailer of apparel, shoes, accessories and beauty products.

The Lazada investor roster also features Tesco, Access Industries, Holtzbrinck Ventures, Summit Partners, Tengelmann Group and J.P. Morgan. Maximilian Bittner, Lazada's CEO, hailed the arrival of Temasek as recognition of the company's leading regional footprint and affirmation of its growth strategy and business potential.

E-commerce: Lazada provides

Lazada has operations in Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam, plus a sourcing center in Hong Kong. Sales on its websites and mobile applications have doubled since June thanks to the roll-out of a marketplace for third-party merchants. Marketplace sales have increased more than tenfold since January and account for around 70% of overall monthly sales. Lazada's net revenue for the 2013 calendar year came to EUR56.8 million, while the company posted a loss of EUR51.8 million.

The question now facing Lazada is what next. Southeast Asia requires a degree of localization and Rocket Internet operates under a two-tier structure comprising a regional team and and then local management in each country. Lazada benefits from the economies of scale that come from being part of a collective and it has successfully leveraged its early-mover advantage.

Competition could come from two directions. First, China's Alibaba Group, which also runs broad-based platforms, wants to become a global player and has made tentative forays into Southeast Asia. Second, there is space for numerous e-commerce verticals that focus on particular categories. It remains to be seen whether Lazada can turn its financial firepower into a marketing, customer services and logistics package that allows for long-term dominance.

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Much heat, little light

India has yet to fulfill its potential as a direct secondaries market as buyers and sellers fail to agree on valuations. A revival in investor sentiment hasn't helped matters, but patience may eventually pay off

INDIA HAS ALL THE INGREDIENTS TO become an active market for spin-outs of existing private equity portfolios by secondary investors: GPs invested a huge amount of capital between 2006 and 2008 but have yet to see a similar magnitude in exits; increasingly disillusioned LPs are clamoring for distributions and holding off on commitments to new funds until they see some.

Nevertheless, Lightbox remains an anomaly. With Kleiner Perkins Caufeild & Byers (KPCB) and Sherpalo Ventures looking to pull the plug on their India joint venture, the local team spun out. In October they announced that several secondary specialists had supported an acquisition of six existing portfolio companies, while a separate group of LPs provided $100 million for new investments.

Prashant Mehta, a partner at Lightbox, describes the fundraising process as reasonably straightforward. On the secondary side, he believes it helped that the investors knew what they were getting.

"In most cases, what happens with secondaries is you try and buy a portfolio or a company that you haven't driven," Prashant says. "We were already running the portfolio so it was more a financial transaction. There is really no difference in terms of the board, just the shareholding. It made for a smoother situation."

Anecdotal evidence suggests there is no shortage of zombie funds in India; the manager has lost interest, perhaps recognizing there will be no successor vehicle, and the LPs want to get out. There are also GPs that want to remain in business and need replacement LPs to help reinvigorate a portfolio. But secondary deal flow is not meeting expectations.

"I would love to do a deal in India right now because I think the environment is going to be better than it has been in the last four years, but the challenge is finding the right opportunities," says Tim Flower, managing director at HarbourVest Partners. "There are only a handful of high quality funds and then pricing expectations make it quite hard to find an entry point."

Crossing the void

Pricing is a longstanding gripe among secondary investors. Spinning out a portfolio can be complicated by the GP or LPs asking for valuations that secondary players see as unrealistic. In the case of Lightbox, there were only two major LPs, both of which wanted to exit, and this made negotiations easier.

Lucian Wu, a managing director at Auda, describes India a mixed bag, with GP volatility creating secondary opportunities of the traditional and the direct variety. He sees valuations as a major concern for primary players but this does not exclude a secondary angle where investors could "have a second bite of the cherry at a decent price."

The situation has arguably changed in recent months on the back of positive investor sentiment that greeted the election of Prime Minister Narendra Modi. Public markets have shot up and so have GPs' assessments of assets that 12 months earlier might have been perceived as near toxic. Portfolio companies still need to be sold but there is the possibility of tapping the public markets at a valuation that means they are no longer underwater. GPs are no longer faced with a choice between a secondary sale and continued illiquidity.

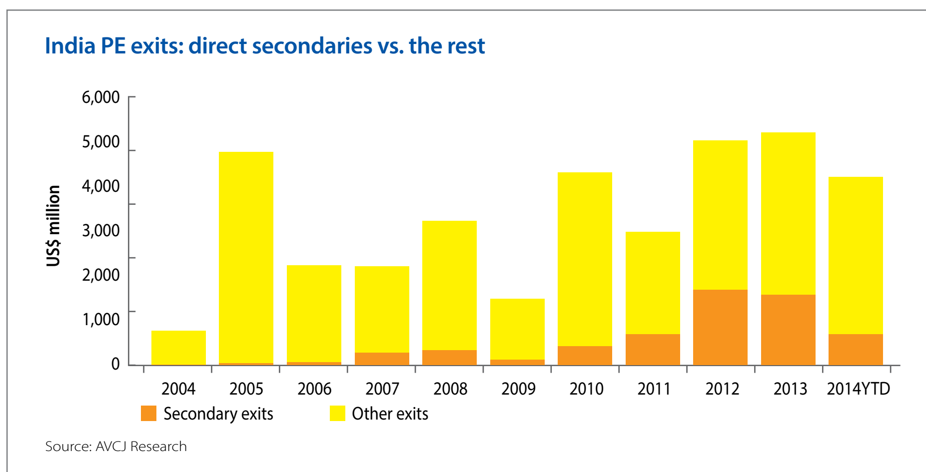
India PE exits stand at $4.2 billion so far this year, lower than the 2013 total, but a slowdown in trade sales has been in part offset by a surge in public market transactions. There has yet to be a surge in IPOs – there have been three PE-backed offerings in 2014 – but momentum is expected to gather. Of the 16 companies that have submitted draft red herring prospectuses since April, eight have private equity investors.

Secondary exits to other GPs have gained traction in recent years: annual deal flow didn't surpass $400 million until 2010, and then stormed past $1.5 billion in each of 2012 and 2013. There have around 20 transactions this year, the same as 2013, but the cumulative value has dropped by more than half to $692 million.

Amit Gupta, a partner at NewQuest Capital Partners, which specializes in direct secondary acquisitions of single assets or portfolios from GPs, is not disheartened by the changing circumstances. While he accepts that the strong public markets will reignite GPs' IPO ambitions, there are still managers who are uncomfortable playing the waiting game. They don't know if and when the market might weaken, so any liquidity is welcome.

Furthermore, some private equity firms are looking to capitalize on the more favorable investor sentiment towards India and raise fresh capital. A secondary sale could facilitate this process. "What has changed most is the hope – people think they can raise new funds so it makes sense for them to create distributions to paid-in (DPI)," Gupta says. "Pricing expectations are within a much narrower range than a year ago and we have started to receive more reverse solicitations."

Just under $2.4 billion has been raised for India-focused funds so far in 2014, bettering the full-year number for 2013, although still some way short of the 2008 peak of $9.4 billion. However, at least seven high-profile domestic GPs are either in the market or about to enter



it, seeking to commitments of around $3 billion between them. In some cases, exits are somewhat thin on the ground, so why wouldn't these GPs explore their secondary options?

According to one industry participant, these firms are conscious of the need to deliver liquidity to LPs but wary of secondary solutions. Their approach is described as opportunistic – one eye remains on the IPO market but they like to know how much they could get for assets through secondary sales.

"There are only a handful of high quality funds and then pricing expectations make it quite hard to find an entry point" – Tim Flower

State of flux

This constant state of flux bears similarities to the experiences of a number of investors who claim to have looked at Lightbox once it became apparent that KPCB and Sherpalo wanted out. They say their interest cooled as the composition of the portfolio changed.

First, Cleartrip Travel Services, operator of travel booking site Cleartrip.com, was sold to US-listed Concur Technologies, a business travel and expense management services provider. Then it was decided that mobile advertising network InMobi would remain as part of the KPCB-Sherpalo portfolio. Lightbox retains well-regarded refurbished electronics retailer Greendust, but for some this was not enough.

Avenue Capital Group has followed the same path. A handful of India portfolio companies were available, first with a management team attached and then without. The star asset was hospital operator Global Health Private. Last year, Avenue sold its minority stake in the business to The Carlyle Group for around $150 million; a secondary transaction but not one that benefited investors looking at the entire portfolio.

The PE firm saw a return on its investment of more than 4x, but the price secondary specialists were willing to pay for the remainder of the portfolio fell accordingly. While this is not a rare occurrence – for many GPs, a secondary sale is Plan B, and rightly so in some cases – it can create problems down the line.

"Part of the appeal of working with HarbourVest is we can assist with tail end portfolios. You are getting rid of the good, the bad and the ugly, but you need to keep it together. If the seller limits the portfolio to only 1-2 value drivers, the buyer's valuation is unlikely to meet seller expectations, whereas a larger portfolio offer more opportunities for upside and pricing flexibility," says HarbourVest's Flower.

Secondary investors might not be finding deals on terms they find acceptable, but at the same time the current public markets buoyancy is unlikely to last forever. The vast majority of investments awaiting exit are minority interests in companies, which means the private equity firm is not in control of its own destiny. A drop in the market may make them think once more about secondary solutions.

"There is a very large, almost completely non-crystallized opportunity in the medium term. The reality has not set in yet – people are still claiming management fees and hoping the Modi bounce will get them out of investments that really are not very good," says Doug Coulter, head of Asian private equity at LGT Capital Partners. "It might not be a tsunami but there will be an opportunity."

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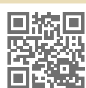
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Care in the community

A majority stake in CARE Hospitals has allowed Advent International into India's fast-growing healthcare sector. Rather than blindly pursuing expansion, the PE firm is building a business tailored to local demand

WHEN ADVENT INTERNATIONAL SELLS CARE Hospitals or takes the business public, approximately 100 doctors and other healthcare professionals will share in the wealth. All are members of the company's employee stock ownership plan (ESOP), put in place to properly incentivize staff and ensure alignment of interest with the major shareholders.

The CARE Hospitals 100 are unique in India's hospital industry through their participation in a widely-structured stock option program. This approach turns on its head a business model that tends to be founder and promoter-dominated, with highly-concentrated ownership.

"We believe we are the first healthcare company to do this in a structured fashion," says Dilip Jose, who was brought in as CARE's CEO in 2013. "The ESOP cuts across management layers, giving everyone a stake in the growth. It depends not only on a person's age or length of service, but it is also a forward-looking scheme that recognizes people who will do well in the future, as well as those who have already contributed."

This was part of a broader reorganization of that was discussed even before Advent invested. The private equity firm acquired a controlling stake in CARE for around $105 million in April 2012 following a competitive process. But when this process started, CARE's founders did not envisage selling control; rather, they were looking for new capital from a minority shareholder who would replace two existing backers.

Advent approached the situation on the back of four years spent scouring India for targets in healthcare. It met with almost every hospital chain of sufficient size to absorb at least $50 million, crossing off listed entities where there was little chance of wielding significant influence as well as less attractive geographies. CARE was among the remaining candidates, but Advent concluded that a cleaner shareholder structure was required to realize the growth potential.

"Although they had a clear vision in mind, they were not sure as to how to get there in terms of the detailed plan. We spent 2-3 months working with them on this. We explained we had the operational capabilities and we are willing partner with them, but not in a minority context," Avnish Mehra, a director at Advent, says.

"The question was then should they sell control to a PE firm or a strategic player. We said they would create more value by partnering with us today and then selling to a strategic in 4-5 years' time."

Advent bought control by taking out three investors: a high net worth individual, a family office, and Ashmore Investment Management. Over the next few months Advent acquired shares from another 100 very small investors – including some management team members – to clean up the shareholding structure.

ESOP was one of several initiatives introduced to professionalize management. When Advent invested, two of the co-founders, Dr. B. Soma Raju and Dr. N. Krishna Reddy, served as chairman and CEO, respectively. Both remain actively involved in the business, especially onthe clinical side, as chairman and vice chairman, but a management team has been built around them.

Jose, formerly head of southern India at Fortis Healthcare, was brought in and the strengthened senior team then set about reforming the two management layers below it, extending down to the unit heads within each hospital. In addition to introducing regular performance reviews, clear reporting lines and proper leadership functions in areas such as procurement and supply chain management, steps were taken to make administration more efficient.

"The head of each hospital used to be a medical person, typically a doctor doubling up as an administrator. We created a two-in-a-box structure of the doctor and a professional, full-time manager with accountability for the business," Jose explains.

Overseeing CARE is not only a board that meets once a quarter, but also an operating committee comprising key board members. This approach is taken when there is a need for rapid decision-making. The committee meets once a month and sometimes at even shorter notice. Its members include Dr. Vikram Chhatwal, the former CEO of Reliance Healthcare who is Advent's operating partner for the investment. He spends 3-6 days a month with the management team, working on a variety of projects.

Expansion story

CARE was set up in 1997 as a 100-bed facility focused on cardiac care. By the time Advent invested, the business had grown into a chain comprising 11 hospitals across seven cities, with nearly 1,600 beds and competence in cardiac care, neuroscience and natural science. It ranked fifth in India by number of beds and revenue.

Over the last two years, annual revenues have risen from $80-90 million to around $120 million, while EBITDA margins are now in the mid-teens, up from 9-10%. CARE now runs 15 hospitals across nine cities with 2,300 beds and 500-600 more expected to come online in the next 12 months. The beds added since 2012 have come through the expansion of existing hospitals and

Top PE investments in Indian hospital chains

Date	Amount (US$m)	Investee	Investor
Aug-12	180.3	Manipal Health Enterprises	India Value Fund Advisors
Nov-13	156.1	Global Health (Medanta Medicity)	The Carlyle Group
Apr-12	105.0	CARE Hospitals	Advent International
Aug-07	103.5	Apollo Hospitals Enterprises	Apax Partners
Dec-07	101.2	Narayana Hrudayalaya	AIG; J.P. Morgan
Mar-12	100.0	Vasan Healthcare	GIC Private
Jan-12	97.2	DM Healthcare	Olympus Capital
Oct-13	89.4	Apollo Hospitals Enterprises	KKR
Jun-09	85.7	SevenHills Hospital	J.P. Morgan
Jun-07	67.1	Max Healthcare	International Finance Corporation (IFC)
Feb-12	61.6	Sahyadri Hospitals	IDFC Private Equity
May-14	60.0	DM Healthcare	India Value Fund Advisors; Olympus Capital

Source: AVCJ Research

contracts under which CARE acts as a third-party facility manager.

Advent's total investment now stands at about $120 million following additional commitments to support expansion. From a return-on-capital perspective, efforts are best focused on adding beds to existing hospitals – if a facility is performing well and running close to capacity, then 50-100 beds can leverage technology and equipment already in place. In certain cases, however, acquiring hospitals or building new ones cannot be avoided.

"Greenfield takes the longest amount of time but in certain cities you need to follow this strategy because otherwise you have a mismatch of structures and styles," Mehra says. "We were lucky that when we invested in this business it already owned land in a number of cities, and land is a major barrier to building new facilities."

Jose also senses an opportunity to run more facilities on a contract basis. He observes that many stand-alone hospitals in India and the doctors who set them up are now open to handing over control to larger players that can offer economies of scale, marketing strengths and professional management. CARE currently runs two hospitals through this kind of arrangement and in each case it has an option to buy full ownership within five years at a predetermined multiple.

Four in five new beds that came online between 2002 and 2012 were provided by private hospitals looking to address the imbalance between inadequate public facilities and the rising demand for better services from a growing middle class, according to a PwC-NatHealth report.

India still has only 1.3 beds per 1,000 people, trailing China and Brazil, and these beds are spread across 55,000 hospitals. It is estimated that the country will require 650,000 new beds by 2017 at a cost of more than $26 billion, more than 50% of annual government healthcare expenditure.

Despite this compelling opportunity to expand and consolidate, CARE is not adding capacity for the sake of it. The company has five hospitals in tier-one Hyderabad, but beyond that the focus is on smaller, faster-growing cities. Mehra notes that healthcare is a very local business so it is better to concentrate on established demand bases than spread resources too thinly.

At the same time, bed capacity is becoming less significant: healthcare is shifting to an out-patient setting, which means ensuring swift turnover with the existing capacity is just as important as adding capacity. "When we invested the average length of stay was five days across the group. We have brought that down to four, which means a lot of capacity has been released," he says. "Adding bed capacity is expensive, takes a long time and isn't necessarily the best use of capital."

As such, CARE does not have a set-in-stone expansion target. Rather, the goal is to be a top three player in every city in which it has a presence. The resulting development strategy has two strands.

First, resources have been plowed into improving patient experience. This arose from customer feedback obtained by Advent during its due diligence process, which found that, while there was general satisfaction with the standard of CARE's clinical teams, some of the facilities were described as tired-looking. Areas such as food and beverage, housekeeping, IT and supply chains have been upgraded. In one case, a new out-patient building was added to a congested hospital.

> **"Greenfield takes the longest amount of time but in certain cities you need to follow this strategy because otherwise you have a mismatch of structures and styles"**
>
> – Avnish Mehra

Second, CARE has been expanding its clinical coverage. Heart disease and cancer have become the two leading causes of death in India, exposing a shortage in diagnostic and therapeutic facilities. There are only 1,050 cardiac centers nationwide capable of performing about two million angiography procedures, yet there are now more than 50 million patients suffering from coronary heart disease, the PwC-NatHealth report says. The number of cancer centers as well as PET, CT and MRI scanners is also insufficient given the rate of new diagnoses.

Already well-established in the cardiology field, CARE is busy building up expertise in sub-specialties. It recently entered into a partnership with US-based medical technology specialist Medtronic to set up heart failure clinics. At the same time, the company is branching out into oncology and diabetes and strengthening its programs in neurology, nephrology, orthopedics and organ transplants.

Overcoming obstacles

These initiatives bring their own challenges. In a country with a mere 0.65 physicians per 1,000 people, the availability of able healthcare professionals is a common concern.

"One of the major issues is the shortage of talent – managerial and clinical – particularly when you are developing niche specialties," says Jose. "Most of the talent is concentrated in major cities – Delhi, Mumbai, Bangalore, Hyderabad and Kolkata – and so it is difficult at times for us to attract people to smaller locations."

Regulation is also a potentially contentious area, with the government placing greater emphasis on cost controls. The 2014 union budget pushed forward the Modi administration's ambition "health for all," which will be rolled out in phases from April 2015 with the ultimate objective of providing universal access to drugs and diagnostic services by 2019. The estimated cost is $11.4 billion per year, and while private healthcare providers will no doubt be accommodated, the environment is uncertain.

Around 55% of CARE's business is cash-in-hand, with the remaining patients covered by some form of insurance, whether it is a private or corporate scheme or a government program. For the former, tariffs are negotiated with insurance companies; for the latter, they are mandated by the authorities. "You have to make sure pricing points are sensible," says Mehra. "Most hospitals now have to cater to at least some government-sponsored insurance schemes for below-poverty-line patients, where the price is fixed at a certain level by therapeutic area."

Less than 15% of India's population has some form of health insurance, with the penetration of private programs in the low single digits. Working from such a low base, the share of CARE's business coming from insurance customers will almost certainly increase; and then urbanization, government policy, the arrival of more foreign companies that offer healthcare cover and rising disposable incomes may accelerate uptake.

Operating a more mature business in a more mature industry will likely improve Advent's exit options, provided the business achieves its financial and strategic targets, although neither the PE firm nor CARE's management – which would participate in any upside – says it has given detailed thought to the virtues of an IPO versus a trade sale.

For his part, Jose claims to be more focused on containing the various day-to-day pressures, with human resources, pricing and cost controls top of the list. "On the softer side it is finding the right people; on the hard side it is cost management," he says. "It all filters through into how you manage effectively and deliver a profitable business."

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