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Betting on China

Regulation, volatility, and tweaks in strategy

- IPOs: Asian exchanges target tech start-ups
- Q&As: Thoma Bravo, EQT, Coller Capital
- Private wealth: Widening access to alternatives

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AVCJ Hong Kong conference issue

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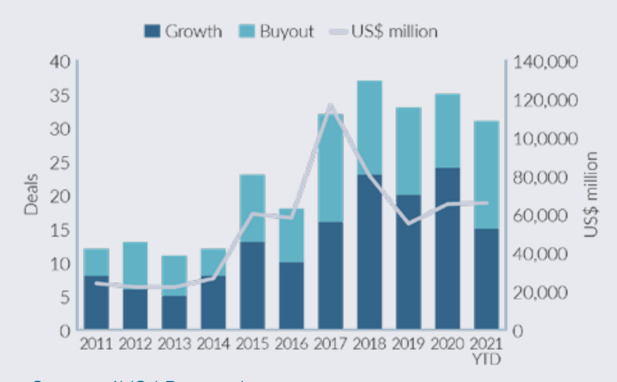
Asian Venture Capital Journal

Asia in six trends

1 Big spenders

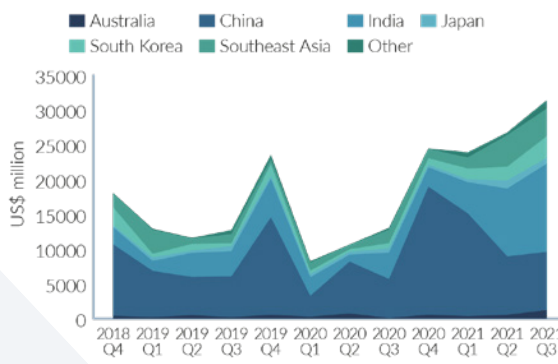
In 2017, billion-dollar-plus private equity deals stepped up a level in Asia. Previously, there were seldom more than a dozen in any given year. Over 30 were announced in 2017 and the region hasn't looked back. The emergence of big-ticket carve-out opportunities, notably in Japan, is a contributing factor, but growth-stage technology deals typically make up the largest share. Perhaps that will change in 2021. With uncertainty clouding China's technology sector, buyouts currently edging minority transactions by 16 to 15.

Asia $1b deals by type



Source: AVCJ Research

Asia early and growth-stage technology investment by geography



Source: AVCJ Research

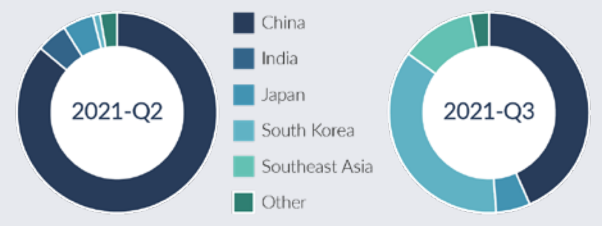
2 All eyes on India

While China has declined, India has soared. Early and growth-stage technology investment reached $12.5 billion in July-September, up from $8.1 billion in the prior quarter. For every $1 put to work in the sector in China, approximately $1.50 went into India. Three forces are at a work, two of which also account for a similar uplift in Southeast Asia: the general performance boost for technology businesses during COVID-19; clearer sightlines to liquidity as domestic IPOs emerge as an option for pre-profit businesses; and India's role as a back-end hub for global software-as-a-service (SaaS) players.

3 Riches to rags

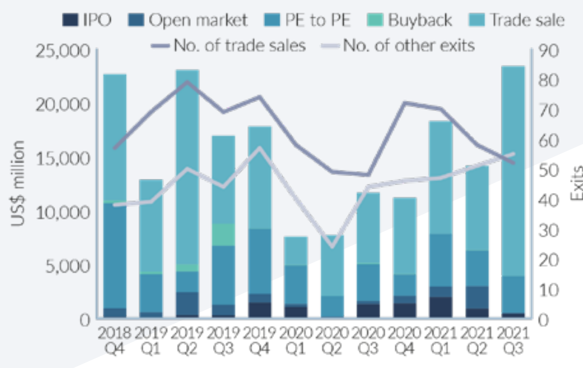
In the second quarter of 2021, 10 PE-backed Chinese businesses – primarily technology players – raised $8.9 billion through IPOs in the US. This underpinned a listings bonanza, with China accounting for 90% of the $25.2 billion raised region-wide. The US total collapsed to zero in the third quarter as the viability of offshore listings was called into question following the introduction of an additional security review for companies holding large amounts of user data. China's share of a more modest $11 billion Asian total was 49%.

Asia PE-backed IPOs - 2Q 21 vs 3Q 21



Source: AVCJ Research

Asia private equity exits by type



Source: AVCJ Research

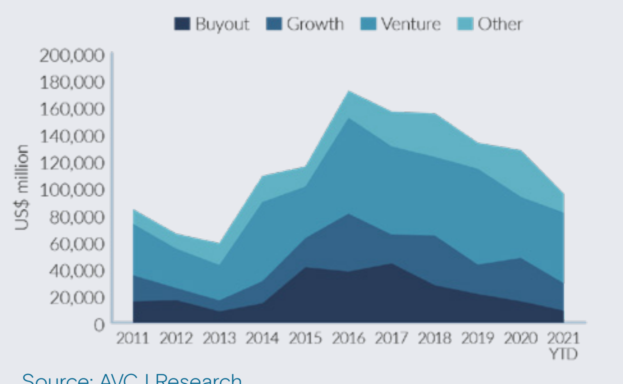
4 Waiting on trade sales

With international buyers unable to conduct in-person due diligence because of travel restrictions, and their willingness to rely on virtual channels and third parties limited, trade sales have suffered in a COVID-19 world. They plunging to $2.6 billion in the first quarter of 2020 and stayed below $10 billion thereafter. Everything changed in third quarter of 2021, with $19.5 billion in trade sales driving overall exits to $23.4 billion. However, bumper transactions involving Paidy and BillDesk point to global payments M&A boom rather than an Asia M&A revival. The other large deals all involved local buyers.

5 Buyouts bereft?

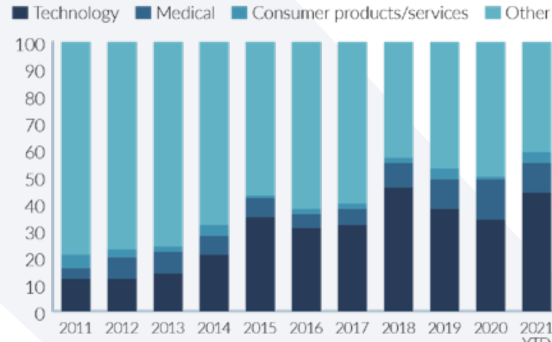
Private equity fundraising is on a roll globally – just not in Asia. Approximately $95 billion had been committed to managers focused on the region as of early November. The 12-month total for 2020 was $127.9 billion. The real drop-off has been in the buyout space, with $13.9 billion raised to date. That's largely a function of which funds are in the market. Final closes for the likes Baring Private Equity Asia, The Blackstone Group, and Hillhouse Investment before the end of the year would move the needle.

Asia private equity fundraising by strategy



Source: AVCJ Research

Asia private equity investment by sector



Source: AVCJ Research

6 Healthcare rising

The healthcare sector can claim to enjoy COVID-19 tailwinds. Not only has the pandemic exposed the need for investment in national healthcare systems – which spills over into the private sector – but the acceleration of digital consumption is a boon for telemedicine. Biotech and services are the key areas. While technology remains the most active sector for PE investors in Asia, healthcare has consolidated second place, with $31.4 billion deployed in 2020 and $24.2 billion in 2021 to date. The annual total previously hadn't surpassed $20 billion, and it was $2.8 billion as recently as 2016.

China regulation: Shock and awe

A raft of regulation, largely targeting the technology sector, has challenged business cases, thwarted exits, and spooked LPs. It is also expected to contribute to tweaks in investment strategy

"We were supposed to do another close at the end of November, but that's been delayed," one China VC manager notes. "LPs say they need to review their China strategy. Some say they will do it next month; others say by the end of the year or the first quarter of next year. Everything is a bit up in the air."

This is a typical response from the fundraising trail. Four venture capital firms told AVCJ that progress on their latest US dollar-denominated offerings has been delayed by LPs putting a hold on China commitments. Inertia extends into the private equity space, with at least one large manager extending its fundraising period, according to sources close to the situation.

The cause is regulatory uncertainty that, in the space of less than a year, has spread across the technology sector into various consumer-facing segments of China's economy. Anti-monopoly investigations targeting top internet companies, a redrawing of the commercial guidelines for private education, and a sweeping data privacy law are among the highlights.

With investment theses being questioned and paths to liquidity unclear, LPs are reluctant to pull the trigger. One placement agent observes that he hasn't seen it this bad since the global financial crisis.

"There is enormous reluctance to jump into new relationships right now. Even on the re-ups, a lot of US institutions are talking at length to their partners about whether this is a pause, or it requires some sector rotation, and some adjustment by the GP," adds Edward J. Grefenstette, president, CEO, and CIO of The Dietrich Foundation.

The foundation, which has significant

"There is enormous reluctance to jump into new relationships right now"

– Edward J. Grefenstette

China exposure, remains cautiously bullish on the country's medium to long-term prospects. Indeed, it believes the regulatory changes, when viewed as part of a cohesive social agenda, could prove beneficial.

While the continued relevance and attractiveness of China to private equity is not in dispute – even the China VC manager points to an improvement in sentiment in the last few weeks – recent developments point to potential shifts in strategy. As some sectors face regulatory headwinds, others enjoy policy tailwinds, and investors are repositioning themselves accordingly.

"This doesn't mean we won't invest, rather the level of scrutiny and the level of vetting is going to be at a much higher level," says Hans Wang, who leads the Greater China team at CVC Capital Partners, while noting that the firm's investments haven't been impacted by regulatory changes.

"In addition, we are probably going to have to pivot our sector focus and strategy, because the universe of investable sectors narrowed," says Wang.

Full court press

Industry participants stress that they were not caught off guard by the nature of the regulatory intervention, rather the speed and scale. One China-focused private equity investor highlights the number of simultaneous actions, including the decision not to rescue China Evergrande, a casualty of a drawn-out crackdown on overleveraged real estate developers.

"This is a low point when it comes to global demand for China equities, probably the lowest point in the last 10 years," he adds, a conclusion reflected in public markets. The CSI Overseas China Internet Index peaked at 14,735 points in February; it is now languishing at around 6,700.

Shares in Alibaba Group, Tencent Holdings, and Meituan – early targets for the regulators, first through Ant Group's canceled IPO, then through anti-monopoly investigations – are down 40% on their January peaks. Recent IPO darlings have also taken a hit, including those directly impacted by regulation, like short video platform Kuaishou, and those not, such as artificial intelligence (AI) chipmaker Cambricon.

In the private markets, early and growth-stage investment in the technology sector slumped from $14.8 billion in the first quarter to $8.4 billion in the second and remained at that level in the third. As recently as the final three months of 2020, it was at a record high.

Of the various regulatory interventions, two stand out in a private equity context. First, the measures targeting private education, announced in July, which effectively outlaw for-profit tuition in core school subjects and bar companies from raising capital. Dozens of PE firms were impacted through exposure to the likes of Yuanfudao and Zuoyebang.

When investors are asked to name a sector in which they were previously active but would now avoid, education is the typical answer. As for existing positions, write-offs is expected, although some companies are trying to pivot into school services or education hardware.

Exits have been complicated even for performing businesses that are not directly in the firing line. Lincoln Pan, a partner at PAG, told the AVCJ Australia Forum that investors should seek exits as quickly as possible. However, he noted that the listing or secondary sale options envisaged for a kindergarten operator PAG owns are no longer viable. A structured solution seems most likely.

"The risk in the market has fundamentally changed," Pan added. "Certainly, in the next 12-18 months, with a lack of guideposts in terms of where regulations are coming, GPs need to be extremely careful on valuations and on underwriting."

Nevertheless, several investors claim to have anticipated government intervention. They cite social problems created by the industry's rapid growth – most parents hailed the change for liberating their children from endless after-school courses – which was in turn fueled by subsidy-driven business models that prioritized market share head of long-term sustainability.

Liyong Zhou, a general manager in the VC unit of Shanghai STVC Group, a state-backed LPs, tells AVCJ he turned down several educational funds in previous years. "I was very opposed to investing in after-school training

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from day one," he says. "Off-campus training cost a lot, creates anxiety, and many excellent teachers in public schools that have been dug out by these training institutions."

Meanwhile, Jinjian Zhang, whose track record at Trustbridge Partners was based on education investments, chose to avoid the sector when he spun out to launch Vitalbridge in 2019. The warning signs were there as early as 2019, he notes, with customer acquisition costs mounting, ROI [return on investment] below 100%, yet stubbornly high valuations.

Vitalbridge also saw demographic pressure. China's birth rate has fallen for four consecutive years, reaching a 58-year low in 2020. Reversing this trend means reducing the cost of raising a child, with education and healthcare the key pressure points. "We felt that the regulation would come eventually, but we couldn't foresee when and how," says Zhang.

Didi debacle

The second regulatory intervention of note is the investigation of ride-hailing giant Didi over data privacy violations days after its US IPO in June. This laid the ground for additional approvals for certain companies seeking to list overseas.

China's Data Security Law was passed on June 10 and scheduled to come into force on September 1. Didi, as well as online job recruiter Boss Zhipin and trucking platform Manbang, listed in between these dates. Didi's IPO was extremely low-key. There was no ceremony, no speeches, and employees were forbidden to comment on the event. It suggested a degree of regulatory sensitivity.

An investigation by the Cyberspace Administration Office (CAO) soon followed, during which new user registrations were suspended. Manbang and Boss Zhipin were later also placed under review.

On July 10, the CAO issued draft measures requiring local companies holding personal information on more than one million users – Didi has 377 million – to report to relevant agencies about the data security before pursuing an IPO on an offshore exchange.

A Shanghai-based investor tells AVCJ such reviews are lengthy and involve a dozen different agencies, including the National Security Bureau. US IPOs by PE-backed Chinese start-ups have since collapsed to near zero, with several high-profile companies – such as podcasting platform Ximalaya and bike-sharing business Hellobike – abandoning listing plans.

"In terms of exits, we wouldn't be looking at anything heavily reliant on the US," says CVC's Wang. "Overall, I would describe it as very much a China-contained thesis."

Others are less equivocal about the changes. Doris Guo, a partner at Adams Street Partners, told the AVCJ China Forum that it is just another part of the listing process, not unlike an audit. She doesn't it expect the security review to "become a threshold for listing" and links the recent slowdown in IPOs to uncertainty ahead of final details being released.

Moreover, other industry participants claim that China's approach is reasonable when viewed in the context of US demands that foreign chipmakers disclose supply chain information. Taiwan's TSMC has said it is unable to share confidential information on customers.

"Even if China didn't issue the data review measures, investors should worry about future IPOs by Chinese portfolio companies. The US has strengthened supervision, and it may ask companies to disclose even more information in future. To avoid these potential risks, China has tightened rule on its side," says Fielding Chen, an economist at China Construction Bank.

Competitive dynamics

An intriguing byproduct of Didi's misfortune is the way in which prospective competitors are seeking to capitalize on it. Two ride-hailing companies, Caocao Chuxing and T3, have raised sizeable funding rounds in recent months, largely from strategic and state-backed investors. T3 has made clear that eating into Didi's market share is its goal.

While this might not be exactly how Beijing envisaged it playing out, creating a more level playing field within the technology sector is a key driver of the regulatory blitz.

The antimonopoly investigations saw fines imposed on Alibaba and Meituan for insisting that merchants use them as exclusive distributors. Another investigation resulted

> "We felt that the regulation would come eventually, but we couldn't foresee when and how"
>
> *– Jinjian Zhang*

in Tencent Music Entertainment giving up its exclusive label rights, while a Tencent-initiated merger of Huya and Douyu – China's top video game live-streaming platforms – was blocked.

One perspective is that these measures are "anti-entrepreneur" or even "anti-technology." Another is that leading technology companies have been allowed to roam too freely for too long, and that curbing their influence benefits consumers and competitors.

Alibaba and Tencent are now looking into how they can open their ecosystems to each other, allowing WeChat Pay to be used on Taobao and Alibaba services to launch WeChat mini-programs. Their recent investment in social e-commerce platform Xiaohongshu, suggests an end to the practice of taking capital from either Alibaba or Tencent, but never both.

"Recently we have seen changes in the strategic investment and M&A processes of the internet giants. They are more open-minded, no longer pursuing control and market share, more willing to create synergies and inject resources in accordance with regulations," says Daisy Cai, head of China at B Capital Group.

"In the long run, the reduction of defensive acquisitions may even result in larger private equity M&A and secondary markets."

At the same time, the notion of curbing influence has assumed specific importance with the release of draft regulations for algorithms, often used by internet platforms to recommend products. It is unclear how these rules will be implemented but a Beijing-based early-stage investor notes that artificial intelligence (AI) start-ups have suspended fundraising.

The concern is that regulators will take a heavy-handed approach and wipe out AI as an investable proposition, much as they did with large swathes of private education.

"AI is not a separate sector, it's a tool for many if not all industries. Regulators regulate data and the usage of algorithms to protect the interests of end consumers, not to hinder industrial development. AI is a key area of competition globally," says Jiawei Wu, a lawyer at Zhong Lun Law Firm.

Political angles

While China's approach to regulation may seem abrupt and arbitrary, the interventions of 2021 are connected by a single thread, which feeds into broader policy initiatives. The key themes, first outlined by President Xi Jinping, are a drive towards "common prosperity" and the "great rejuvenation of the Chinese nation."

Common prosperity is interpreted as wealth redistribution, and this is making its mark on the technology sector as companies pledge money to social causes. Steps are also being taken to improve employee welfare, with ByteDance and Tencent ending their infamous 12-hour day, six-day week, and Meituan guaranteeing a minimum wage and insurance cover for delivery staff.

In this context, reining in technology companies, curbing excesses in education, policing the use of personal information, and regulating algorithms could be seen as contributing to a society that is more equitable for consumers and a marketplace that is kinder to small and medium-sized enterprises (SMEs).

Pointing to action taken against community group-buying platforms for anti-competitive behavior, J.P. Gan, founding partner at Ince Capital Partners, observes that it wasn't the subsidy-driven business models of market leaders that upset regulators as much as who was suffering as a result. "They were burning cash and hurting SMEs, that's why the government cracked down," he says.

Indeed, parallels are readily drawn between China's agenda and that of other countries. "What they are targeting is not dissimilar to what the US and Europe are doing on data privacy and making sure businesses are doing the right thing, as well as trying to grow," says Yar-Ping ▶

Soo, a partner at Adams Street Partners. “It’s the structure of the government that’s different. Things can be done faster.”

The great rejuvenation is generally viewed as a reference to its international relations, specifically those with the US. The data privacy legislation is clearly designed to combat extra-territorial applications of other countries’ laws and control the transfer of information overseas.

However, some investors present the broader package of regulations as a response to the US and the red lines it has drawn across trade, finance, and technology. Targeting consumer internet companies may support a strategic as well as a social agenda, by encouraging investment in higher-value core technology that addresses Beijing’s desire for self-sufficiency.

“There are two types of technology company: platforms and hard-core tech providers. While hard-tech is its own barrier, platforms use scale and capital as the barrier. They try to get to critical mass as quickly as possible to become the dominant player,” explains China Construction Bank’s Chen.

Deployment plans

Private equity investors as a group haven’t abandoned the consumer internet segment – plenty of deals are getting done – rather they are highly attuned to what plays into policy initiatives across different sectors. CVC’s “China-contained thesis” includes pure domestic consumption opportunities, most likely those aimed at the broader middle class instead of the elite.

Within technology, nearly every investor is targeting domestic substitution, which is driven in part by US-China decoupling. China Renaissance is more specific, looking for areas in which local products are nearly on par with the imports they replace and may overtake them. Electric vehicles (EV) are a classic example, while also benefiting from the government’s focus on climate and sustainability.

Capital is pouring into EV value chain deals, which include batteries, semiconductors, and other components. The emphasis on hard-tech dovetails with a similar deep-tech theme, contributing to a meaningful shift from B2C to B2B. Artificial intelligence, cloud infrastructure, semiconductors, and SaaS are hot commodities.

Venture capital investors began to diversify several years ago, driven by economic rationale – B2C was increasingly characterized by large platforms and expensive business models – more than regulation. Several VCs don’t do any B2C, such as Yunqi Partners, Future Capital,

China regulation – a recent timeline

Date	Event
Nov-20	Ant Group’s A- and H-share IPO is cancelled days before launch
Dec-20	Anti-monopoly rules are released targeting community group-buying platforms, including those controlled by Pinduoduo, Alibaba, Didi, Meituan, and JD.com
Feb-21	China's State Council publishes anti-monopoly guidelines for platform internet companies
Apr-21	Alibaba Group is fined $2.78 billion for Anti-Monopoly Law violations
Jun-21	A new Data Security Law is passed
Jul-21	New user registrations on Didi are suspended - days after the company's IPO - for breaches of regulations on personal data collection
Jul-21	The Tencent Holdings-initiated merger of Huya and Douyu, China's two largest video game live-streaming platforms, is blocked
Jul-21	For-profit tutoring in core school subjects is banned as part of a range of measures targeting the private tuition space
Aug-21	China's Personal Information Protection Law is passed
Aug-21	Draft regulations limiting the use of algorithms to influence consumer choice are issued
Aug-21	Tencent Music Entertainment gives up its exclusive label rights following an anti-monopoly investigation
Oct-21	Meituan is fined $530 million for Anti-Monopoly Law violations

Source: Government agencies

Glory Ventures, and Ameba Capital. All have closed funds in recent months, despite the challenging environment.

In terms of early and growth-stage deal count, internet services – a rough proxy for consumer-facing – accounted for roughly half the China total through the middle of 2019. It then fell back and hasn't recovered. More recently, the same has happened in dollar value, as larger GPs get involved. The non-internet services share was 70% in the third quarter, up from 40% in the final quarter of 2020.

The implication is that, although overall China technology investment held steady in the third quarter, money was gravitating to new areas within the sector. Cleantech and renewable energy, which captures much of the EV value chain activity is $4.6 billion year-to-date, more than the previous four years combined.

Inevitably, it leads to concerns about valuations. "If something is not for the general good, you must be careful," says the China-focused buyout manager. "We invest in boring sectors that meet the fundamental needs of the people. Investing just because you think that's where the government wants you to invest can be problematic. People can forget about the business fundamentals." ■

Algorithms: The letter of the laws

China recorded a global first in August by issuing proposed regulations for algorithmic recommendation technology. It is part of a broader effort to limit the power – and in this case influence – of internet companies. Investors had one obvious question: What does this mean for artificial intelligence start-ups that rely on these mechanisms?

According to Jerry Ye, founder and CEO of Whale, a China-based digital marketing start-up, the crux of the issue is what data are fed into algorithms, not the algorithms themselves. Companies with solutions based on highly sensitive facial or other biological data will inevitably be severely impacted.

A Beijing-based investor with exposure to start-ups developing facial recognition software confirms that fundraising across the industry has halted amid the uncertainty. Operations, however, continue. Jiawei Wu, a lawyer at Zhong Lun Law Firm, adds that understanding the proposal is contingent on studying two further laws on data.

First, the Personal Information Protection Law (PIPL), which came into effect on November 1. It states that automated decision-making should be transparent and fair, and it should not impose unreasonable differential treatment on individuals in terms of transaction prices. This is aimed at e-commerce platforms, which leverage algorithms to market products to frequently returning customers at higher prices than those for newcomers.

In addition, individuals should be able to conveniently refuse AI-based commercial marketing. They could ask those responsible for data processing to explain the decision-making process, and ultimately refuse or opt-out of targeted advertising campaigns based on personal characteristics. This

is primarily a data security issue.

Second, the Data Security Law (DSL), which came into effect on September 1. There is a focus on establishing data are sourced legally, and it falls on investments and management teams to lead verification, says Wu. Key considerations include whether the data provider is properly and licensed, and whether disclosure would constitute a breach of contract.

While biometric data are subject to strict controls, there are legal grounds for use, such as when there are national security implications, or it helps address anti-money laundering and risk controls in financial institutions.

Algorithms are regulated simply because their misuse – deliberately or otherwise – can have serious consequences. Google and Facebook's AI engines have both mistakenly identified black people are primates, while Detroit police arrested the wrong man for shoplifting after facial recognition software picked him on security camera footage.

"Currently, details of the rules are not clear. Investors must wait and see how standards are enforced," Wu adds.

China regulation: Chaos in the community

With investor sentiment on China's technology sector cooling, community group buying platforms are battling to conserve cash. This has done little for the government's anti-monopoly drive

Pengyu He, founder and CEO of Tongcheng Life, once China's leading community group buying operator, made his last address to employees in early July in the Suzhou Arbitration Bureau. The crowd was impatient because Toncheng Life had just gone bust.

"For those who are willing to start a new business with me, I can offer you a 20% share for free. That's all I can do now. I'm sorry, brothers. I am really sorry," He said, before being pulled away by police.

Tongcheng Life is the largest bankruptcy in China's community group buying space. The company raised over $300 million in VC funding and hit a valuation of $1 billion in 2020. It ended up with debts of RMB1.3 billion ($203 million).

There have been other failures. Wuhan-based Shixianghui and Hefei-based Dailuobo, both venture capital-backed, also ceased operations this year. It comes in sharp contrast to 2020 when capital poured into the space, enabling ever-larger rounds at ever-higher valuations.

"COVID-19 led to sharp growth in community group buying revenue – people simply didn't have other choices when stores closed. But growth slowed after the pandemic came under control," says Charlie Chen, director of China Renaissance Securities, "Community group buying businesses are still loss-making; they can't continue burning cash with no new capital."

Community group buying players rely on designated individuals who coordinate activity in their neighborhoods. This involves gauging and aggregating demand, placing orders, and arranging bulk delivery. They receive a fee for their work, typically a share of the profit.

The industry is worth up to RMB1.5 trillion ▶

"Community group buying businesses are still loss-making; they can't continue burning cash with no new capital"

– Charlie Chen

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요기요

Yogiyo

Joint Lead Investor

Control buyout of one of the largest online food delivery platforms in Korea

October 2021

M-DAQ

Sole Investor

Investment in leading Singapore-based FinTech platform with global reach

August 2021

JOBKOREA

JobKorea

Sole Investor

Leveraged buyout of the largest online job portal operator in Korea

May 2021

HDBank

Sole Investor

Investment in the 5th largest privately owned bank in Vietnam (by market capitalization)

December 2020

Shinhan Financial Group

Lead Investor

Investment in the largest financial services group in Korea

September 2020

Serveone

Sole Investor

Leveraged buyout of the largest MRO company in Korea

May 2019

Scottish Pacific

Sole Investor

Leveraged buyout of Australia and New Zealand's largest independent financing provider to small and medium enterprises

December 2018

TRIMCO GROUP

Trimco Group

Lead Investor

Leveraged buyout of #1 speciality trims and labels supplier to the apparel industry

March 2018

Burger King

Sole Investor

Leveraged buyout of the exclusive operator of the Burger King franchise in Korea and Japan

April 2016
October 2017

MedicalDirector

Sole Investor

Leveraged buyout of the largest clinical and practice management software provider in Australia

May 2016

TEG Pty Ltd

Sole Investor

Leveraged buyout of Australia and New Zealand's largest ticketing and vertically-integrated live events company

July 2015

Velocity Frequent Flyer

Sole Investor

Investment in a leading Australian airline loyalty program

October 2014

Loen Entertainment Inc

Sole Investor

Leveraged buyout of the largest vertically-integrated music company in Korea

September 2013

Primo Group Holdings Pty Ltd

Lead Investor

Leveraged buyout of Australia's largest meat processor

October 2011

Beijing Leader & Harvest Electric Technologies

Lead Investor

Buyout of the leading manufacturer of energy-saving electrical equipment in China

October 2009

오비맥주(주) Oriental Brewery Company

Oriental Brewery Co Ltd

Joint Lead Investor

Leveraged buyout of the second largest brewery in Korea

July 2009

LOSCAM

Loscam Limited

Sole Investor

Leveraged buyout of a leading returnable packaging hire company in Australia

August 2005

Himart Co Ltd

Lead Investor

Leveraged buyout of Korea's largest consumer electronics retailer

April 2005

($235 billion), according to China International Capital Corporation (CICC), but it expects consolidation to reduce the competition to three or four giants. However, this outcome appears to be something regulators would rather avoid.

In December 2020, several months after the likes of Pinduoduo, Meituan, and Didi expanded into community group buying, People's Daily denounced the internet giants for "just care about the internet traffic flow regarding a few bundles of cabbage and a few kilograms of fruit."

Ten days later, anti-monopoly rules for community group buying were released, with price manipulation and unfair competition the major targets. Market leaders paid no heed. Flash deals offering four eggs for 1 fen (one one-hundredth of RMB1) proliferated. These deals were underpinned by heavy subsidies, a key tactic in customer acquisition.

Regulators responded by getting tough. In March, Meituan, Nice Tuan, Pinduoduo and Didi-owned Chengxin Youxuan were fined for "dumping products at prices below cost." Snap inspections began. In May, Nice Tuan was fined again and ordered to suspend operations for three days. "Follow the rules or we'll close you down," other platforms were told, according to an executive at one of the companies.

Intervention has long-term benefits. It helps shift the commercial emphasis from high-cash-burn for customer acquisition to supply chain management and customer retention. Investors add that it means portfolio companies are less likely to get crushed by the mega-platforms.

Nice Tuan launched a new funding round in May, seeking $1 billion at a valuation of $5 billion, according to an investor in the company. But it soon ran into a brick wall. The investigation of Didi over data privacy violations made investors gun-shy, unsure where and when regulators would strike next. Start-ups realized that fundraising would be difficult.

Chengxin Youxuan was the first to retreat, laying off 30% of its staff at the end of July, local media reported. In August, the "war subsidy" – a bonus amounting to 20% of salary, intended to encourage employees to fight for market share – was abolished. The company's coverage has been cut from 31 to nine provinces.

Nice Tuan was advised to pull back from cities where it wasn't well established and focus on core markets, says the same investor. The target valuation for the new funding round was lowered, but some existing investors still passed. Nice Tuan ended up with less than $500 million.

Still dominant

Community group buying companies are expected to incur substantial losses this year, while the path to exit remains unclear. This is bad news for PE investors, but perhaps not for the internet giants. The industry is a prime source of offline consumer data at a time when costs tied to accessing online traffic are very high. Even though these businesses are loss-making, the parent can still benefit by leveraging data to support profitable endeavors.

Chengxin Youxuan is arguably the most disadvantaged of the larger players because Didi has no e-commerce platform through which to realize synergies. "Its unit economics are the worst among the internet giant-backed platforms. Community group buying requires supply chain construction, but it has no retail genes," says a second investor.

In early June, negotiations began with JD.com and ByteDance over a potential sale, but they soon walked away. Alibaba Group's Taicaicai has taken over many of Chengxin Youxuan's suppliers and franchisees. It now ranks third in the market after Pinduoduo and Meituan.

Despite attempts to level the playing field, it appears that internet giants remain a dominant force. In addition to the top three, Xingsheng Youxuan is heavily backed by Tencent and JD.com, Nice Tuan is aligned with Alibaba, and JD.com has its own Jingxi Pinpin brand.

Investors shudder at the notion of backing another start-up in community group buying, noting that the liquidity squeeze is asking tough questions about business model sustainability.

"You could say that supervision may have shortened these start-ups' survival time because of a slowdown in investment, or it is helping small companies enjoy a level playing field," says China Renaissance's Chen. "The problem is that before small companies can fully enjoy the benefits of antitrust, their investors may have already withdrawn." ■

Q&A: Thoma Bravo's Orlando Bravo

Orlando Bravo, founder and managing partner of Thoma Bravo, which claims to be the largest PE investor in software globally, on adding value to SaaS businesses, the rise of blockchain, and opportunities in Asia

Q: How has your strategy evolved as the sector has evolved?

A: We have evolved in three ways. First, we continue to engage in radical value creation in our companies, but the tactics have changed because the industry has moved to cloud computing and SaaS [software-as-a-service]. Second, we've added many different segments. We started in applications only, and then we added infrastructure software and cybersecurity. Just with our current companies, we are twice the size of the largest independent cyber vendor in the world with almost $6 billion in revenue. Third, when we started, the software industry was relatively mature and growing faster than global GDP, but it was bounded by technology and business model. It has become a high-growth industry, and the buyouts we've done in the last five years involved market-leading companies.

Q: When did the industry reach that tipping point?

A: 2008 – that's when it became irreversible. The global financial crisis made companies cost-centric. If they could rent a piece of software for $300,000 a year, and that would take cost out of the P&L, they would do it. If that same product required spending $1 million in capex, at a time when capex budgets were being cut, they wouldn't do it. Software companies resisted change because it was painful – they had the same cost base, but they were swapping big revenue checks for rented over time. Even now, we are only 50% of the way there. Half of software is SaaS, the rest is on-premises.

"Even now, we are only 50% of the way there. Half of software is SaaS, the rest is on-premises"

Q: What has been the COVID-19 effect on the industry?

A: There's been a big step-function increase in the usability and purchasing of SaaS. The global SaaS market capitalization is $2.4 trillion, up from $75 billion in 2008, that's 30x growth. The number of companies has multiplied. A lot of these solutions were already available, it's just the open-mindedness and creativity of leaders were lagging. The pandemic has forced these leaders were forced to think differently because they had no other choice. They had to think differently about the physical world and the digital world. The second quarter of 2020 was terrible; the third was decent, the fourth was great, and we've never looked back. The pandemic has also made it more important that we buy market leaders, whether they are verticals or horizontals. In all cases, the move to winner-takes-all has accelerated.

Q: How long does it take to become a market leader?

A: About 10 years. You can become a disrupter in 24 months, but not the market leader. Younger companies might be a better fit for our growth fund, but for the buyout fund, it takes longer to establish market leadership and show stability.

Q: To what extent have the needs of companies changed?

A: They are the same. We can summarize what we do in one line: implement an analytical approach to decision making. Given these companies are high-gross-margin and have 100% recurring revenue in most cases, they don't track revenue and direct cost in each functional business area, product area, and regional area as rigorously as they should. We implement that system, so they can make better decisions in terms of investment, sales, and product management. The world hasn't changed much in software. When we started in 2000, the average publicly traded software company, post-dotcom bubble bursting, had a negative EBITDA margin of 5%. Today, it's 2%. There has been no improvement in the way these companies are fundamentally run.

Q: How is your approach to value creation differentiated?

A: We seek to make big changes in the companies we buy, but we do that with existing management teams. We come at it from the viewpoint that through our culture we can inspire people to dream about the possibilities and think differently. Sometimes it doesn't work. But that's in very few cases, and it's always after trying. People are not perfect, they may change their minds, their hearts may not be in it. That happens. But it has served us well that, when in doubt, we have stayed the course rather than making changes too quickly.

Q: Is it harder to develop that conviction in a team when communicating virtually?

A: Most of the time we don't have to make that trade-off because we have known a target company for 15 years. It's likely we have approached it many times before, have come close to buying it, have competed with it through other portfolio companies, and perhaps partnered with it. In the few times where it's only been Zoom, my experience is that if you like someone on Zoom, you like them more when you meet them in person.

Q: What is the process, in terms of internal capabilities, when entering new segments?

A: We don't come at from a top-down view and say, "We are going to do cyber, that's the future." We go one deal at a time to make sure it works. Our first cyber deal was Entrust in 2009, a 7x return. When it became clear that one would be successful, we quickly bought Tripwire, a 5x, and then SonicWall, which was almost 4x in 18 months. That set us up. It happens organically. By doing good deals, you develop a space and become good at it.

Q: What does the investment in cryptocurrency exchange FTX say about your approach to blockchain?

A: Something revolutionary that we would not have been looking at two years ago is

defi [decentralized finance]. We are not even scratching the surface of what defi is going to do to payment systems and traditional banking. Moving these crypto tokens or assets – we can't call them cryptocurrencies – or using them to store value is going to be enormous. FTX is one of those investments. We feel we are backing the most innovative exchange, certainly in derivatives and other categories, and an entrepreneur who is a visionary. Most of what we're doing is through the growth fund. Once the segment stabilizes, in terms of regulatory frameworks and business models, our private equity business will get involved.

Q: How soon will that happen?

A: In the next 24 months, much faster than people might think. We are seeing some major assets producing hundreds of millions of dollars in EBITDA in this category. It's moving quickly.

Q: Your first investment in Silicon Valley was SonicWall in 2010. To what extent are software companies you target dependent on established technology ecosystems?

A: Not at all dependent. When distributed computing really came about 25 years ago, it was supposed to lead to the democratization of locations. You build a program cheaply, distribute it, and through interconnected systems you could do it in different areas. The opposite happened. Labor and capital became more concentrated in certain economic centers, with Silicon Valley at the top. But when we started 22 years ago, all our deals were outside of Silicon Valley. The first deal was in Philadelphia; the second was in Addison, Texas; the third was in Fairfax, Virginia; the fourth was in Seattle; the fifth was in Cleveland, Ohio. Silicon Valley was more expensive, more competitive, and we were early in buyouts. The community wasn't ready for private equity; it was all venture capital. SonicWall came one-third of the way into our total timeline in software.

“My experience is that if you like someone on Zoom, you will like them more when you meet them in person”

Q: Does it matter where companies are located?

A: No. The reason it has been so concentrated in the US is there's so much opportunity. The companies were close to us as well, but now we are entering a world that is hybrid, being in the US is less relevant.

Q: How many times have you invested in businesses not headquartered in North America?

A: We've made 325 software acquisitions, but two-thirds are add-ons, and many of those are outside the US. They're in Germany, Israel, all over. From a platform company standpoint, it's more recently that we've gone outside of North America. It's interesting. There was InfoVista in France, but then our acquisitions of Sophos and Calypso, both based in the UK, closed during COVID. There's also been a bunch of investments outside of North America through our [early stage-focused] Discover fund.

Q: Where does Asia come into it?

A: We haven't done a platform in Asia, but we've done bolt-on acquisitions. Our companies sell globally, and geographical proximity to customers doesn't matter when you ship using the press of a button or you use your channel partners. North America is a feet-on-the-street market, but in Europe and Asia, we use channel partner distribution networks. Have we found a buyout in Asia of $3-10 billion? No, we have not. Have we been all over the market looking for one? No. Maybe we should be. The availability of control is an issue. Asia has been more of a venture and growth equity market.

Q: Are you seeing more sector specialist GPs? ▶

A: When you look at the size of the opportunity, there should be a lot more specialists targeting software. But at the same time, more generalists are doing these deals because software is becoming the business. If you are a generalist working in any industry, software is disrupting that industry or running the operations of companies so intimately, that's what you do.

Q: What are the barriers to entry?

A: You need to recreate a company's P&L, which means coming in operationally to build the business case as a business owner yourself. This is not like other sectors where you would buy for 12x EBITDA, finance it, hope you can do a few things, and get 18x. Sometimes you are buying zero EBITDA and you must get to $300 million just by margin improvement while enhancing growth. We started learning that when we were investing $15 million equity checks, 22 years ago. That experience gives us the conviction and wherewithal to write a $5-6 billion equity check or larger. As a new entrant, you're going to your investment committee, seeking capital on a huge scale for something that isn't there on paper. That's a big barrier.

Q: What is your view of extended hold or evergreen structures to give you longer to develop or monetize companies?

A: It's a good thing. It's an area of innovation in private equity that I think needs to move even faster for the type of assets coming into the industry. Longer duration is especially appropriate in software.

Q: Is the current pace of conventional private equity fundraising a concern?

A: It's not a concern provided the returns are good. I think it's healthy that, when you have fast deployment, the whole industry must come to market and LPs can choose the best performers. Those who don't have the numbers get weeded out much more so than when deployment is slow deployment and LPs must invest a certain amount each year. Our philosophy is the time to buy a great software company that fits our strategy is whenever we can. It's not market timing, it's not this or that. We have a way to deal with the risks of vintage year diversification. The important thing is we try never to do the next big deal until we feel the prior one is on a solid footing. ■

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Hong Kong IPOs: Winner by default

New York's loss is expected to be Hong Kong's gain as regulatory and political turbulence drives Chinese start-ups to look for alternative listing destinations – unless valuations become a sticking point

Nearly 200 companies currently have live listing applications with the Hong Kong Stock Exchange (HKEx), a record high for the bourse. Much is made of Chinese technology players, spooked by regulatory uncertainty, axing plans for US IPOs and hot footing it to the territory, yet it's unclear to what extent this is behind the rising demand.

"We are certainly seeing more interest, but I don't know if everyone is dashing to Hong Kong," notes Vivian Yiu, a capital markets partner at Morrison & Foerster. "Everyone says people are coming here, but I think most are adopting a wait-and-see approach."

Various other possible reasons are offered for the rise in applications, including an expectation that mainland Chinese regulators will start pre-vetting red-chip companies – controlled by mainland entities but incorporated overseas – seeking to list in Hong Kong. Some applicants are looking to get the jump on implementation.

But wait-and-see is an appropriate mantra. While Hong Kong is the obvious beneficiary of restricted access to US markets – real or perceived – this is not reflected in the headline numbers.

Between January and June, HKEx contributed to a surge in global IPO activity, with 46 offerings generating proceeds of HK$213.2 billion, the largest-ever first-half total. Short video platform Kuaishou Technology led the way on HK$48.3 billion, but four of the 10 largest IPOs were secondary offerings by US-listed Chinese technology companies.

Then came Didi's New York Stock Exchange (NYSE) IPO at the end of June and ensuing brouhaha as the ride-hailing giant was

> "Everyone says people are coming here, but I think most are adopting a wait-and-see approach"
>
> – *Vivian Yiu*

The Henderson, Hong Kong by Zaha Hadid Architects for Henderson Land. Render by Arqui9

targeted by regulators for violating rules on data collection. Beijing later stated that companies holding large amounts of consumer data must obtain approval to list overseas.

The intervention – coming on top of a string of others targeting the technology sector – eroded investor sentiment and closed the US listing route for all bar a handful of smaller companies operating in less sensitive areas. The Hang Seng Index dropped 15% in the third quarter and local IPO activity was muted, with HK$75.3 billion raised.

Nevertheless, Louis Lau, a partner in the capital markets advisory group at KPMG China, is optimistic about the prospects for the fourth quarter, noting that it is the traditional peak season for IPOs.

"Momentum remains strong despite the third-quarter slowdown, so 2021 might match 2020 [when nearly HK$400 billion was raised] or slightly exceed it," he says. "Not all the nearly 200 listing applicants will necessarily complete successful IPOs, but there is a big pool of companies trying. There will be activity in 2022."

One Hong Kong investment banker gives a different view, suggesting that no company of size will seek to list before March 2022. "Anyone who goes now will be asked why they are doing it, and everyone will guess the answer – because they need the money," he says.

Bigger is better

It is a matter of debate whether HKEx can, or indeed wants to, become a haven for a broad swathe of Chinese technology start-ups that would otherwise have gone public in the US. Concessions were made in 2018 to broaden the exchange's appeal – pre-revenue biotech players and companies with weighted voting rights (WVR) structures were allowed to list – but with strict conditions attached.

Hong Kong now claims to be Asia's largest biotech fundraising hub, with 33 listings by pre-revenue companies from the introduction of the reforms to June 2021. They are subject to stringent qualification requirements, including the backing of a sophisticated investor, typically a VC firm specializing in healthcare or a leading pharma player.

PE-backed technology IPOs, meanwhile, have tended to be sparse yet large. This reflects HKEx's decision to restrict the WVR exemption – as well as an exemption for pre-profit companies – to those that meet minimum standards in terms of market capitalization and revenue.

AVCJ Research has records of fewer than 20 listings by technology players with financial sponsors since WVR came into force. Xiaomi, Kuaishou, and Meituan account for about 80% of the aggregate proceeds. In the second quarter of 2021 alone, 10 China-based businesses – primarily technology players – raised $8.9 billion through IPOs in the US. The third quarter total was zero.

"If the most recent funding round was at the end of last year or beginning of this year, before the recent issues, even if the company listed today, would it get the valuation it was expecting? That is the major concern," says Maurice Hoo, a partner at Morgan Lewis, commenting on the wait-for-the-US versus proceed-with-Hong-Kong dilemma.

NYSE hasn't given up on China, emphasizing the depth and sophistication of its investor base, which can translate into healthy price premiums for companies able to tell a story that resonates with key market participants. Ample liquidity – NYSE's daily trading volume of $130-150 billion is several times that of Hong Kong – and the prestige value of a New York listing are other selling points.

"It is pretty clear companies are being steered to Hong Kong, but it's not clear what they will choose. NYSE will continue to pitch its case," says a source familiar with the exchange's thinking. The exchange declined to comment on its plans.

NYSE, like other interested parties, is in "wait-and-see mode," but it isn't sitting still. The Asia pipeline for the next two years is said to comprise about 100 companies, excluding China but including special purpose acquisition companies (SPACs).

Technology unicorns will feature prominently, with Southeast Asia and India expected to deliver up to 10 and five IPOs over the next 18 months. Meanwhile, there was a surge in inquiries from Korea following Coupang's $4.5

> "Anyone looking at a 6-12 month horizon wouldn't consider the US, but beyond that who knows"
>
> *– J.P. Gan*

billion NYSE IPO in March. It is no coincidence that the exchange's Asia business development head is relocating from Hong Kong to Singapore, the source adds.

Time's a healer?

Restoring the China-US channel involves compromise on both sides. The US Securities & Exchange Commission (SEC) responded to China's enhanced approvals for overseas IPOs by ramping up disclosure requirements for US-listed Chinese companies using variable interest entity (VIE) structures, which give foreign investors exposure to restricted sectors, including technology.

At the same time, a protracted impasse between the US Public Company Accounting Oversight Board (PCAOB) and Beijing over audit inspections of US-listed Chinese companies took on a new edge this year with the passage of legislation that could mean non-compliance results in enforced delisting. The SEC recently approved a framework for identifying which companies are implicated.

"People in the US seem pessimistic about Chinese companies listing there. Another camp believes there will be some political compromise and the issues will be worked out. Investment banks are in the latter category, but then US deals generally move faster and they make larger commissions from them," says Paul Boltz, a partner at Gibson Dunn.

J.P. Gan, founding partner of Ince Capital Partners, is among those anticipating an amicable resolution, although he claims that, as a VC, he is an optimist by nature. Gan notes that Chinese regulators have said they will continue to respect VIEs for overseas listings, while detailed guidance on data privacy has yet to emerge. With clear rules and a political thawing, IPOs will resume.

"Anyone looking at a 6-12-month horizon wouldn't consider listing in the US, but beyond that who knows," Gan says. This implies the most likely US to Hong Kong conversions will be relatively mature companies that have received several rounds of funding and perhaps have investors agitating an IPO.

Beijing Yuanxin Technology, operator of China-based online healthcare services platform Miaoshou Doctor, recently applied to list in Hong Kong. The company, which counts Ince as an investor, closed a $231 million Series F in August. Online audio platform Ximalaya abandoned its US IPO in September and filed in Hong Kong, with e-commerce player Xiaohongshu expected to take the same path.

Ximalaya is one of three China Creation Ventures (CCV) portfolio companies to kickstart Hong Kong listing processes in recent months, alongside dental clinic chain Arrail Dental and Shukun, a developer of artificial intelligence (AI) technology used in medical imaging. All have sizeable revenue or rapid revenue growth, says Wei Zhou, CCV's founding partner.

"It's like Hong Kong is in between the US and China. In the US, they are always looking for a big future, and if revenue or profit is small, that's fine. In China, they want to see cash flow and profitability. Hong Kong is in the middle," he adds. "Many Chinese companies have already achieved the threshold to list in Hong Kong. But will they choose to list there?"

There are various reasons why a business might not qualify for an IPO beyond financial performance, from incomplete business permits to exposure to countries subject to trade sanctions. Hoo of Morgan Lewis has seen potential take-private transactions collapse after PE investors realized, on studying the target's filings, that a Hong Kong relisting was unviable.

If Hong Kong and the US are both ruled out as IPO destinations, restructuring onshore to pursue a domestic listing is an option. Alternatively, a company could wait and raise more private funding. Asked about joining a round when IPO plans have been thwarted, Ince's Gan says it

depends on business quality and whether he gets a better valuation to compensate for the risk.

Marcia Ellis, a partner at Morrison Foerster, adds: “If these companies are not mature enough to be listed in Hong Kong, perhaps they should just wait. It’s not necessarily terrible. Thinking of the overall ecosystem, maybe it’s better if these companies wait for a while. Or maybe an onshore listing makes sense for them, especially if the trading multiples are strong.”

However, appetite for China’s Science & Technology Innovation Board – or Star Market – has been muted ever since Ant Group’s mainland-Hong Kong dual listing was canceled last year. Several VC investors claim that the spate of rejections across the mainland markets in the past two years has made companies reluctant to submit applications.

Adherence to process and protocol can be a challenge in Hong Kong as well, especially when accustomed to a US system based on full disclosure. Prioritizing retail investor protection, Hong Kong is proactive and paternalistic, constantly seeking to identify and neutralize potential problems.

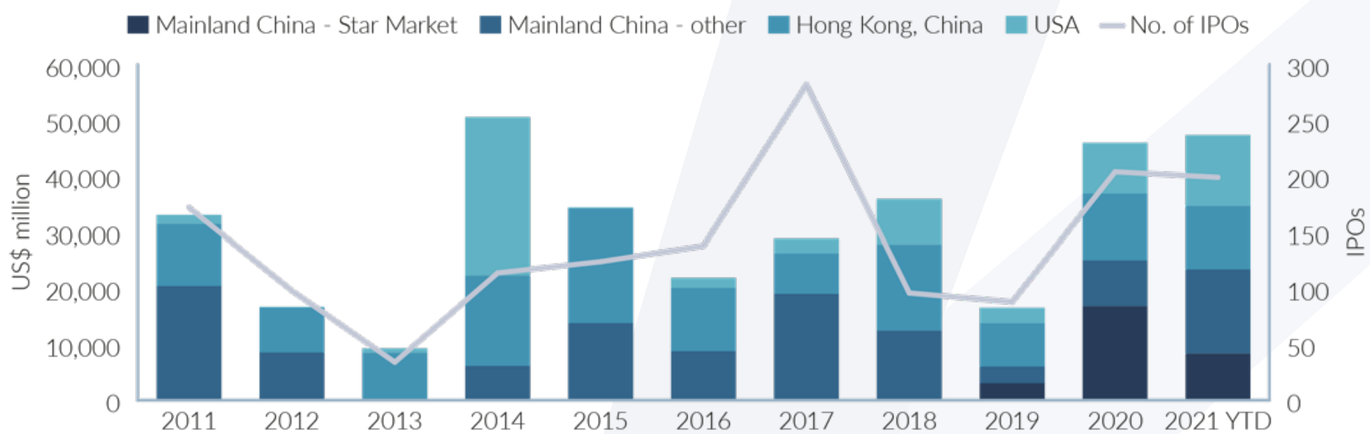
This extends to the language in IPO prospectuses, with one industry participant expressing frustration at how phrases such as “best-in-class” are nixed from documentation for pre-revenue biotech companies for being too subjective. “They don’t like technical language and they don’t like adjectives that are standard in US biotech,” he says. “They just want to dumb down the language.”

Yiu of Morrison of Foerster points to this as evidence of a general emphasis on verification among regulators and sponsors in Hong Kong. Any claim of product preeminence will be scrutinized, often resulting in a request that the issuer provides proper context and supporting expert testimony.

There is little expectation of further change to smooth the path for high-growth companies. For now, broader forces are in Hong Kong’s favor, creating tailwinds that will bring China IPOs to the exchange without additional encouragement. Should this persist, any concerns about liquidity or valuation deficits might be removed, with CCV’s Zhou noting that “money always chases good companies.”

“I can’t see them relaxing the rules – the market has a high level of retail investor participation, and it isn’t mature enough,” says Lau of KPMG. “Hong Kong may consider setting up a new board targeting professional investors only with a relatively light touch vetting process that accommodates companies with smaller market caps. Or it could revamp the GEM board because there is a lack of interest in listing there. That has been discussed.”

PE-backed China IPOs by listing jurisdiction



Source: AVCJ Research

Southeast Asia IPOs: Opportunity knocks

A breakthrough offering in Indonesia and regulatory progress in Singapore highlight Southeast Asia's growing viability as a tech IPO market. It's unclear how well this is being communicated globally

From 1990 to 2000, Indonesian tech and telecom companies – excluding fintech and media – raised 55% of their IPO proceeds in the US. Between 2001 to 2018, that fell to 0%.

The single largest factor in the drop-off is the volatility around the Asian financial crisis, although there have also been significant tax incentives for Indonesian companies to list onshore. Still, another underlying theme should not be underestimated: the nature of what it means to be a "tech" company has changed.

As the country, along with the rest of Southeast Asia, transitions from traditional industries to a more digital economy, investors will need to re-learn what makes this market tick. The best indicator that such a rediscovery may be underway came in August, when e-commerce leader Bukalapak raised an IDR21.9 trillion ($1.5 billion) through a domestic IPO.

Bukalapak is a guinea pig on a conservative exchange that eschews pre-profit companies, and its ongoing success is seen as critical to the outlook for local start-ups. This experiment in modernizing the IPO market could be seen as a microcosm of a broader ASEAN story.

The stock has ticked down 22% in the meantime, giving the company a market capitalization of IDR70 trillion and knocking it out of Jakarta's top 20, but spirits are still high. Eddy Chan, a founding partner at Indonesia's Intudo Ventures, not a Bukalapak investor, sees the decline as part of a natural learning curve and continues to track a palpable uplift in ecosystem morale.

"To see Bukalapak receive the reception it did has been extremely encouraging, and we really have to give the government and regulators

"You want your stakeholders – your customers – to have a piece of these companies and a say in their future"

– Eddy Chan

a lot of credit," he says. "They aggressively deregulated the exchange to allow for more technology listings and loosened the profitability requirements. That really rewards the consumer base for homegrown businesses. You want your stakeholders – your customers – to have a piece of these companies and a say in their future."

Chan recalls few institutional investors took him seriously when he championed IPOs as an exit option in 2017-2019. The turnaround in sentiment is palpable – reflected in Intudo's relatively swift fundraise this year and in greater confidence among portfolio company founders. Inbound inquiries from international stock exchanges and special purpose acquisition company [SPAC] sponsors are on the rise.

Sea-ing is believing

Bukalapak's story is inspirational as a proof-of-concept for Southeast Asian unicorns going public, although not necessarily on a regional exchange. Grab, PropertyGuru, and FinAccel, have all agreed to merge with US-listed SPACs. Meanwhile, GoTo has delayed a Jakarta listing to wait for regulatory changes that would provide more flexibility around founders' voting rights. The company also expects to list in the US.

There are a lot of question marks around this pending activity, not least because the incentive structure of SPACs has tended to result in disappointing post-float performances. The only other major consumer technology IPO in the region to date is Sea, a mobile internet and gaming platform that raised $884 million through a US offering in 2017. It is the largest-ever IPO by a Singapore company.

At the time, Sea's operations were limited to Southeast Asia, including Taiwan. Investors had to improvise their valuation assessments with theoretical comparables, from China's Alibaba Group to Argentina's Mercardo Libre.

"There's a misconception that it's nearly impossible to build a regional business in Southeast Asia. Sea, a $190 billion public company, is precisely that; Grab, a $40 billion soon-to-be public company, is precisely that. If it walks like a duck and quacks like a duck, sooner or later, you're going to have to call it a duck," says Nick Nash, a co-founder of Asia Partners and formerly president of Sea.

"There's nothing as credibility building as one solid case study. Sea is the best performing large-cap stock on the planet by IRR, so it's emblematic of Southeast Asia's moment. It also validates the idea of Southeast Asia continuing the IPO roadmap that China has built out. In many ways, that playbook is predictive of what's going to happen in Southeast Asia, about 10 years behind China."

A significant part of Asia Partners' brand promise to its portfolio companies involves helping list in the US. Malaysian used car marketplace Carsome, for example, plans to do that within 12 months and has fielded overtures from SPACs as part of the process. Meanwhile, RedDoorz, a pre-profit investee in the hotel booking space, is contemplating an IPO within Southeast Asia by 2023, although the exchange has yet to be decided.

While it seems likely Carsome can follow in the footsteps of Sea, the prospects for RedDoorz replicating Bukalapak's journey are less certain. And this is to say nothing of the COVID-19 challenges facing the hotel industry.

Southeast Asia's regional exchanges have recognized the value in consumer businesses during the pandemic and have, in some cases, demonstrated significant liquidity. Bourses in the Thailand and the Philippines are on track for record years in 2021 in terms of capital raised. But there is a conspicuous void in digital, new-economy models going public locally.

Profitability and size requirements are generally flagged as the main regulatory sticking points, although for the unicorn set, there is a sense that listing rules in Southeast Asia are becoming flexible enough to accommodate companies with technology growth profiles.

However, the fact that listing rules in the region come from a place of protecting small shareholders makes all the difference. The most persistent deterrent for investors is extended lock-up periods, which are imposed on newly listed companies even when their cap tables and balance sheets are strong enough to ensure they will remain a going concern for years.

"The other gap is that the key anchor public market funds – the mutual funds, pensions and sovereigns – and the bankers running the processes need to give more comfort that they ▶

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actually want these kinds of companies in the local public markets," says Yash Sankrityayan, a principal at Jungle Ventures, an investor in FinAccel and RedDooz. "That includes regulators and bankers helping start-ups navigate the compliance and administrative requirements of being a public company."

Recent developments on this front in India are hoped to bleed into Southeast Asia, especially if Bukalapak holds steady as the likes of Grab and GoTo come to fruition. This will be a process of cultural osmosis, rather than regulatory copycatting.

It is unlikely that the recent rule changes resulting in India's current IPO boom – which effectively greenlight unprofitable companies – will be rapidly adopted across ASEAN. But they could help inform less ambitious liberalizations as well as concerted government-backed attempts to get local champions over the line.

"What's happening in India recently, in addition to the evolution we've seen in the Hong Kong and Australia exchanges, is impacting regulators in Southeast Asia, mostly in a positive way. They will start a bit more conservatively in Southeast Asia, but they will be able to learn from the successes and loopholes they see in those other systems," Sankrityayan says.

Singapore's latest gambit to define guidelines and guardrails has focused on the SPAC opportunity, although it remains to be seen how much liquidity appreciation there is for assets of this kind locally. The consensus among industry professionals is that small to mid-sized companies could begin to list via SPAC in about six months, but major events the likes of Grab are not in the foreseeable future.

Hwee Ling Tay, disruptive events advisory leader for Southeast Asia and Singapore at Deloitte, observes that for companies with a track record of profitability and widely understood business models, traditional IPOs remain the ideal option. Still, for those exploring an international investment base and seeking higher valuations, listing locally will not necessarily be the best option.

In addition to the SPAC framework launched in September, Singapore government investor EDBI has established a pre-IPO fund, with an initial commitment of S$500 million ($371 million) to encourage tech companies to list locally. Furthermore, EDBI and Temasek Holdings have announced plans for a co-investment fund that will anchor IPOs. The first tranche set to amount to S$1.5 billion.

Tay also flags traction in a recent enhancement of the Grant for Equity Market Singapore program, which makes companies with a market capitalization of S$1 billion eligible to receive 70% co-funding with a cap of S$2 million. "This will help to defray the costs of listing and expedite access to the capital market," she says. "We expect this initiative to have a positive effect on the IPO landscape, but its full effect may not be apparent for some time."

Getting acquainted

Ultimately, increasing the frequency and size of regional IPOs for digital companies is mostly about improving investor familiarity with Southeast Asia and how those business models work within it. That will be a matter of explaining to global investors with long-hold philosophies the nuances of the market, where Amazon has failed to get market share, or how mobile content and social commerce enjoy different growth trajectories.

The idea is that once these investors get exposure, the awareness process accelerates: A taste of Bukalapak, for example, would open up awareness of other rising stars in Indonesia's digital ecosystem and how they fit into the local value chain. Making that work will be less about lobbying for legislative changes at home and more about marketing legwork outside the region.

"A lot of Southeast Asian exchanges historically would host delegations where cross-over funds, hedge funds or public equity mangers would learn about the exchange. Some have done a better job than others. But we need to see more education of global investors and the fact that we're starting to see some really exciting technology companies in Southeast Asia," says one investor.

"Even the New York Stock Exchange does that – traveling around the world trying to excite issuers – and they don't need to."

India IPOs:
A pleasant surprise

The lack of a reliable IPO channel is a longstanding exit obstacle for venture capital investors in India. While many still hold out hope for US listings, the domestic exchanges are proving to be the answer

Even as Paytm's valuation rose, LPs fretted about a lack of distributions. SAIF India – now known as Elevation Capital – was the digital payments provider's first institutional investor, participating in a round alongside Saama Capital in 2007. As of early 2018, the VC had built up a $1.3 billion position across three funds, while locking in realizations of $360 million, or 5x its invested cost.

But LPs wanted to see more, as several readily indicated to AVCJ over the next couple of years. They had witnessed Nexus Venture Partners resist calls to sell Snapdeal, only for the e-commerce platform to plunge in value. Saama, which made a timely exit from Snapdeal, sold its position in Paytm in 2017 at a reported valuation of $6 billion. SAIF was unwilling to let go of its winner completely.

Paytm secured $1 billion in Series G funding at a valuation of $16 billion in late 2019. Assuming this was the company's most recent private round, Elevation emerged with a 17.6% stake. And now it may have the last laugh, with Paytm set to raise INR183 billion ($2.5 billion) through a domestic IPO. Elevation is one of five investors that together will sell INR83 billion worth of shares.

A string of Indian consumer internet businesses are at various stages of the listing process, following a trail blazed by online food services platform Zomato, which went public in July and now has a market capitalization of INR1.1 trillion, more than three times the valuation of its last private round. None are profitable, having subsidized their way to market-leading positions.

Institutional investors are not wholly buying into the euphoria, instead displaying a restrained optimism befitting a community that has spent

> "The growth and digital disruption they are valuing is pretty real. The question is whether it can be sustained"
>
> *– Sunil Mishra*

years waiting for India's technology sector to deliver. Among the trickle of secondary sales and promise of US listings, domestic IPOs were not expected to be the answer.

"For a long time, it didn't seem plausible to list an unprofitable business on Indian stock exchanges – Indian equity markets historically have been very profit-focused," says Sunil Mishra, a partner at Adams Street Partners.

"If there is an appetite today, that's a good thing for everyone, but is the market mature enough to understand these businesses which could remain unprofitable for several years? The growth and digital disruption they are valuing is pretty real. The question is whether it can be sustained."

Potential tipping point

Nevertheless, there's a widespread belief that India is at a tipping point – comparable to that experienced by China seven years ago when a bumper crop of IPOs encouraged a surge in early and growth-stage technology investment. The cycle has never really stopped.

Over half of the sum invested in the sector in India over the past two decades dates from 2019 onwards. Nearly $27 billion has been deployed in 2021 to date, with the second and third-quarter totals eclipsing China. The country has seen fewer than 50 private equity-backed tech IPOs over the same two decades – China has registered six times as many – but maybe, finally, India is about to deliver.

For many investors, the key dates were 12-13 years ago, when the current batch of IPO candidates were founded. They aren't rushing to market and their cap tables have become bloated. Moreover, India now has 75 unicorns – 33 added since the start of 2021 – and the average time it takes to reach a $1 billion valuation has shrunk to seven years.

"There has been systematic pressure on Indian GPs to say when exits are going to materialize," says Karthik Reddy, co-founder of Blume Ventures. "You might get a hit here or there from a secondary sale, LPs ask when the next one is coming, and you have no idea how to predict it. Unless you put yourself on an IPO calendar, I don't think there is a definitive path to liquidity. For more than 10 years, the answer was that we were building towards exits, but no one had a plan."

Blume knows all too well that M&A is not a panacea for early-stage investors. An acquisition by a larger tech company usually delivers shares rather than cash, and a wait for someone else's IPO. Getting taken out when SoftBank or DST Global comes into a growth round is possible, but it might require a big check and founders often prioritize primary capital over facilitating secondary exits.

If something had to give, it wasn't going to be IPOs in the US. Travel start-up MakeMyTrip became a lodestar for every ambitious technology company when it listed on NASDAQ in 2010. However, years of regulatory uncertainty ensued as to when and how an India-domiciled company could follow suit.

"Earlier this year, the government was supposed to permit Indian companies to list directly in the US and many are waiting for that regulation to take shape," says Sandip Khetan, a partner at EY. "But in the meantime, they have realized that the Indian market has become more mature in understanding and rewarding technology businesses."

India's software-as-a-service (SaaS) unicorns are still expected to target the US: they tend to be domiciled in the US, have many clients in the US, and generate US dollar-denominated revenue. But a consumer internet company is in the opposite position: its brand, customers, and revenue are rooted in India. There is a logic to listing domestically – and regulators have taken steps to make doing that easier.

Reform agenda

"Change has come in three main categories: they allowed differential voting rights on founder shares; they eased rules for minimum dilution and application size for retail investors; and most importantly, they have become more accommodating on profitability track record requirements, leaving it up to the market to decide whether a loss-making company is worth backing," says Pranav Pai, founding partner and CIO at 3one4 Capital.

"All this has reduced friction for the growth-stage investors in India's tech ecosystem, allowing them to accelerate their paths to IPO." ▶

The Innovator Growth Platform (IGP) – previously known as the Institutional Trading Platform – was established as a home for VC-backed companies and sophisticated investors. Earlier this year, the Securities & Exchange Board of India (SEBI) made it more accessible for start-ups and smoothed the path for those looking to transition to the mainboard.

But the new batch of tech IPOs is going straight to the mainboard. There is a requirement that three-quarters of an offering made by an unprofitable company goes to qualified institutional buyers (QIBs) deemed sophisticated enough to understand the risks. Of the remainder, 15% is allocated to high net worth individuals (HNWIs) and 10% to retail investors. For businesses with three years of profitability – the standard threshold – the split is 50-15-35.

The retail portion of Zomato's INR93.7 billion offering was 7.5 times oversubscribed, but this pales in comparison to the other two tranches, with HNWIs and QIBs oversubscribed 33 times and 52 times, respectively. This was chiefly because 60% of the QIB pot – or INR41.9 billion – went to 186 anchor investors, including GIC, Abu Dhabi Investment Authority, and various local mutual funds and insurers.

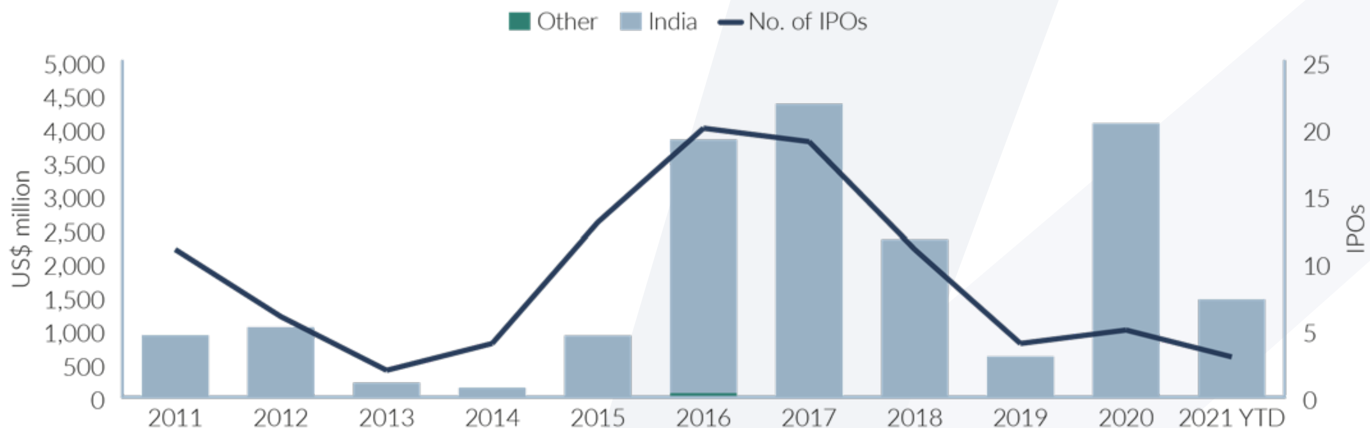
It fits a broader pattern of institutional acceptance. According to Reddy, investment banks are holding demo days for Indian technology companies that are unicorns or on the cusp of that status every three or four months. This is a response to demand from investors that recognize that the value of these businesses, might have some exposure to them in overseas markets, and want to know why they can't get the same domestically. Meanwhile, the start-ups are better prepared.

"It's not like flicking a switch and your CFO who has done Series A, B and C raises becomes a public company CFO. You spend years prepping for an IPO, making the right hires," Reddy adds. "India doesn't have a history of loss-making companies going public, so you have to sell the narrative, the path to profitability. Ringing the bell is just the beginning of the journey."

COVID-19 has played a role as well. India's strong consumer technology fundamentals are no secret: the internet economy is expected to more than double in size to $180 billion by 2025. But the pandemic reinforced the opportunity set, with the IPO candidates emerging even stronger.

These companies were being primed for listings at the tail-end of 2019. However, multiple industry participants suggest that Zomato wouldn't have been as well-received had it tested the market before COVID-19, which saw business contract and then rapidly rebound

PE-backed Indian IPOs by listing jurisdiction



Source: AVCJ Research

> “India doesn’t have a history of loss-making companies going public, so you must to sell the narrative”
>
> *– Karthik Reddy*

with better unit economics. The low-interest environment is also a factor, driving capital into higher risk, higher return assets.

A sustainable trend?

The combination of companies in need of liquidity events, domestic regulators becoming more willing to accommodate them, rising interest from institutional investors, and COVID-19 fueled fundamentals has created a series of knock-on effects. Notably, institutional vindication of these business models has encouraged participation from HNWIs and retail investors.

“By the time Zomato’s retail placement started, it was clear the institutional portion was oversubscribed, and that gave confidence to retail investors,” says Rahul Chandra, a partner at Arkam Ventures. “When I talk to HNWIs in India, they want to buy a piece of a late-stage tech company. This will be accelerated by the Zomato oversubscription because people recognize that targeting the IPO means they are going in too late. They will look for pre-IPO entry points.”

It is classic momentum-driven activity. Investor fervor spreads from the IPO anchor allocation to the IPO itself, into the secondary market and then back into the later-stage private rounds. Various domestic financial services companies have launched pre-IPO funds under their wealth management units. Family offices are also getting involved.

The surge of in growth-stage activity is a consequence of investors believing there is a clear line of sight to a liquidity event. But is this faith well-founded? The public markets may quickly lose patience with companies if losses deepen; smaller tech IPOs might fail to find favor with retail investors; or a challenging macro event could see global institutional players retreat to their home markets.

Some investors express concerns about unhealthy knock-on effects further down the chain as founders seek higher early-stage valuations based on public market signals. “If you raise a seed round at $50 million, the pressure to keep going – for revenue to catch up and the multiples to make sense – is always going to be against you,” says 3one4’s Pai. “We have to stay long-term focused and account for cycles but adapt when there is IPO fever.”

Valuation inflation is already happening to some extent. Chandra of Arkam notes that Series A rounds for in-demand start-ups have risen from $10 million to $20 million, with an increase of similar magnitude happening at the Series B. He blames it on later-stage investors pushing into earlier rounds in search of value, more than anything else. This is bearable, provided start-ups still have compelling business models and strong founders.

If the domestic technology IPO phenomenon is indeed here to stay then it will be transformative for India venture capital exits, more so than Walmart’s $16 billion acquisition of a majority stake in Flipkart in 2018. There is even the prospect of LPs calling up managers that – unlike Elevation with Paytm – sold in full via a secondary transaction and telling them they exited too early.

3one4 made an early decision to hold on to its top performers, and it remains the second or third-largest shareholder in the likes of digital bank Jupiter and fresh meat delivery platform Licious. Pai suggests that the rise of IPOs will prompt managers to alter their thinking on the merits of early liquidity and change how they align exit schedules.

Mishra of Adams Street takes a more conciliatory line, noting that investors do not control the liquidity window in an illiquid asset class. “When opportunities arise, you should weigh your options carefully. Indian venture capital has typically been low on liquidity given fewer exit avenues, so if you can deliver liquidity no one will really complain. LPs are more critical of downside than missing some upside surprises.” ■

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Diversity & Inclusion Forum

9 December 2021, Hong Kong & Online

In the past two years, the issue of diverse representation in the workforce has hit a critical juncture in the private markets industry, with the pandemic heightening the focus on the ESG considerations of GPs and their portfolio companies. While the conversation in Asia surrounding diversity and inclusion has improved, there is still much more to be done. Now in its fourth year, the AVCJ Diversity & Inclusion Forum hopes to continue to push the discussion of diversity, equity, inclusion, and culture forwards, thereby helping to generate meaningful discussion among GPs and LPs, and paving the way for future generations in the Asian private equity and venture capital industry.

4 CPD points can be claimed after attending the forum.

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- Global view: Gain insights into what global and regional GPs and LPs are doing to advance diversity and inclusion in Asia.
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- Regional insights: Hear personal stories from top women/minority led funds in Asia.
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North Asia IPOs: Welcome eruptions

A steady rhythm of small and mid-sized IPOs in North Asia is now being punctuated by globally noticeable events. Valuations are up, but Korean and Japanese investors are game

Few investors have enjoyed more exposure to Korea's booming exit market this year than Altos Ventures.

The VC firm was an early investor in e-commerce business Coupang, which raised $4.5 billion in a New York IPO in March and now has a market capitalization of $52.4 billion. It also had stakes in food delivery player Woowa Brothers, which has been acquired by Germany's Delivery Hero for about $4 billion, and social media platform Hyperconnect, which was sold to US dating giant Match Group for $1.7 billion.

Other portfolio companies like payments platform Viva Republica and online shopping player Danggeun Market are considered some of the biggest fish in the IPO pipeline. Viva, which counts Kleiner Perkins among its investors, closed a funding round in June at a valuation of $7.2 billion. Danggeun's valuation has increased 15x since 2019 to $2.7 billion as of a Series D round in August featuring DST Global.

"A lot of tech investors globally really only cared about Naver, Kakao, and maybe a couple of telecom companies that have internet assets. But now, I think we're going to see more tech companies coming out and when we have a critical mass, global investors will pay more attention," says Han Kim, a managing director of Altos.

> "I think we're going to see more tech companies coming out and when we have a critical mass, global investors will pay more attention"
>
> *– Han Kim*

"There will be fluctuations in expectations versus reality. Late-stage investors that passed on a Korean company before will take a more serious look, but Korea is not China. I just don't see a bunch of funds setting up to take advantage of this because, while it's exciting that more companies are coming up, it's going to take years."

> “They’re leaving money on the table because the underwriters are discounting the valuation too much”
>
> *– Emre Yuasa*

Kim considers the Woowa deal, agreed in December last year, as the start of the flood, while M&A activity more broadly is a major contributor to IPO market confidence. An influx of global capital (both strategic M&A and pre-IPO VC) is driving the valuations, which has triggered chain reactions in growing entrepreneur confidence and local retail investor appetite.

Recent activity for private equity-backed companies also includes game developer Krafton and Kakao Pay raising about $3.8 billion and $1.3 billion, respectively, in domestic IPOs. Hybe, the manager of K-pop band BTS, formerly called Big Hit Entertainment, raised about $840 million in a 2020 IPO and currently has a market capitalization of KRW15.2 trillion ($13 billion).

Bubble territory?

Some industry participants are wary that a bubble could be forming, especially given the fad-driven nature of some of the assets. But there is little sign of those concerns spoiling the party.

John Nahm, co-founder of Strong Ventures, a US-Korea focused firm invested in Coupang and Danggeun, is tracking these signals closely and remains generally upbeat. In a comparison of valuations (pulled on November 5), he notes that Hybe’s price-to-earnings multiple is almost 3x that of Netflix, while Krafton’s is more than twice that of ActivisionBlizzard.

“The fact that investors are giving these tech companies much higher multiples than their counterparts in the US is quite an outstanding sign of health for the Korean Exchange. We can tell our start-ups, ‘Forget the New York Stock Exchange and NASDAQ. I know it’s a bit more paperwork, but if you go public in Korea, it can actually be a better outcome,’” Nahm says.

“I wouldn’t have said that one year ago. If Coupang went public today on the Korea Exchange, it might have had an even better result [than it did in the US]. At the time, that was the best route for them to take, but one year later, the markets have changed.”

Two key factors are keeping bubble fears in check. First, although much of the domestic IPO activity is attributed to a large retail investor allocation, Korea has a relatively sophisticated and tech-savvy retail investor base. Second, IPO activity for mid-sized tech companies has paced along normally in the background, suggesting the ecosystem has sturdy foundations, regardless of greater dynamism at the top end.

The best demonstration of this viewpoint is in KOSDAQ’s often overlooked strengths in the biotech sector. Biotech typically represents 30-40% of the companies on the tech board; semiconductors is the second-place category around 15%.

The large weighting by no means indicates a low hurdle to listing. Indeed, the evaluation criteria were tightened earlier this year, with nine assessment items added to a list of 26 just for the preliminary review process. A string of surprise rejections ensued.

If this is part of an effort to raise the profile and prestige of biotech on the exchange, it appears to be working. Last month, Singaporean neurotherapeutics specialist Cerecin raised $40 million from a clutch of Korean investors, including Hana Financial Investment, which has agreed to act as the lead manager in a potential listing in Seoul in the near term.

“Within biotech, when you’re looking at different exchanges, some are more focused on pharmaceuticals, healthcare, services, or Big Pharma, but we’re looking for familiarity with innovation, which has a different risk-return,” says Charles Stacey, Cerecin’s president and CEO, adding that there has been a significant push to add foreign biotech companies to KOSDAQ.

“We would like to see analysts and bankers with capabilities around that, and we want investors and institutions that are used to that dynamic. We’re very familiar with the US and London exchanges, and we’ve seen the level of rigor with which things are done there. We’ve

seen that in Korea as well, which has given us comfort."

Structurally sub-size

Japan offers a clear contrast on this point, with decidedly low listing hurdles on its Mothers technology board resulting in a consistent stream of tiny, premature IPOs. According to the Japan External Trade Organization, less than 10% of start-ups in the US, Southeast Asia, and India are exited via IPO. In Europe, the number is 32%. In Japan, it's 67%.

The Tokyo Stock Exchange wanted it this way. With a lack of funding available from VCs, IPOs were made easier to achieve, giving start-ups at least some options for growth. As the ecosystem has developed, later-stage funding channels opened, culminating in the landmark $1.2 billion IPO for online shopping company Mercari in 2018. Since then, things have picked up.

Standout VC-backed offerings for digital companies in the meantime include accounting software provider Freee, business card management company Sansan, and perhaps most notably Taiwan's Appier, a leading advertising technology supplier that raised $271 million in April. This marked the first time since 1998 a Taiwan-based company had gone public in Tokyo and signaled the rising regional profile of the Mothers board.

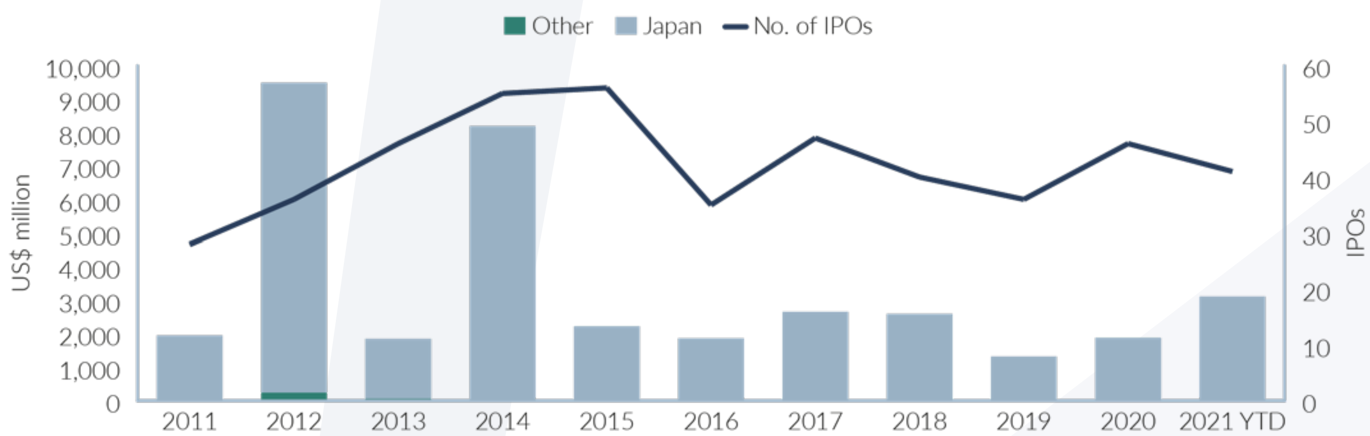
Globis Capital Partners, an early investor in Mercari, associates this activity with increased attention from global investors and a significant rise in valuations. The firm's more recent fund closed in 2019 on JPY36 billion ($320 million), twice the size of its predecessor, yet both vintages have backed the same number of companies. The effect has reached down to the early stages, with Series A rounds, which recently ranged around $20 million, now often scaling as high as $50 million.

IPO momentum has maintained Japan's attractiveness to investors, however. Globis has already notched two noteworthy IPOs this year, including human resources player Visional, which raised about $630 million on Mothers in April and now has a market capitalization around $2.8 billion. Globis is also an investor in media app SmartNews, which is currently valued at around $2 billion and exploring an IPO.

"Mercari basically shifted the ecosystem up a gear," says Emre Yuasa, a director at Globis. "VCs are able to raise bigger funds, they can invest more capital into start-ups, and entrepreneurs are going for bigger outcomes. Nowadays, a $200-300 million IPO is considered small, and rather than going IPO at that size, start-ups are deciding to raise another round and go IPO at $1 billion. The whole ecosystem is now geared toward bigger exits."

Such is the enthusiasm around IPOs, it has percolated into Japan's sizeable corporate

PE-backed Japanese IPOs by listing jurisdiction



Source: AVCJ Research

venture capital space, a logically M&A-dominated environment. As the corporate VC ecosystem has expanded, so too have the instances of start-ups straying from their original business models and finding a better product-market fit outside the domain of their sponsoring corporation.

Global Brain has corporate VC partnerships with the likes of Sony, Epson, Yamato Transport, Kirin, and JGC Group. As such, the VC has an unusually low IPO rate for Japan (only 25% of its total exits) and this ratio is expected to hold going forward. Nevertheless, public offerings are creeping conspicuously into the mix.

The firm's standout exit this year is smart security camera company Safie, which completed a $100 million IPO last month and now has a market capitalization around $1.7 billion. Safie is one of the few digital hardware players to go public; Globis-backed smart lock maker Photosynth is another. More significantly, it was the product of a corporate VC program with real estate giant Mitsui Fudosan ostensibly geared toward strategic absorption.

"We expect more IPOs from our funds, and we're adding people to our investment group to handle that," says Yuki Matsuo, a principal at Global Brain. "In our unique business model, which creates value through collaboration between start-ups and corporate VC owners, there will be more situations where corporate VCs will have wider options, including pursuit of economic return via more IPO exits such as Safie, as well as business synergies via M&A."

Growing pains

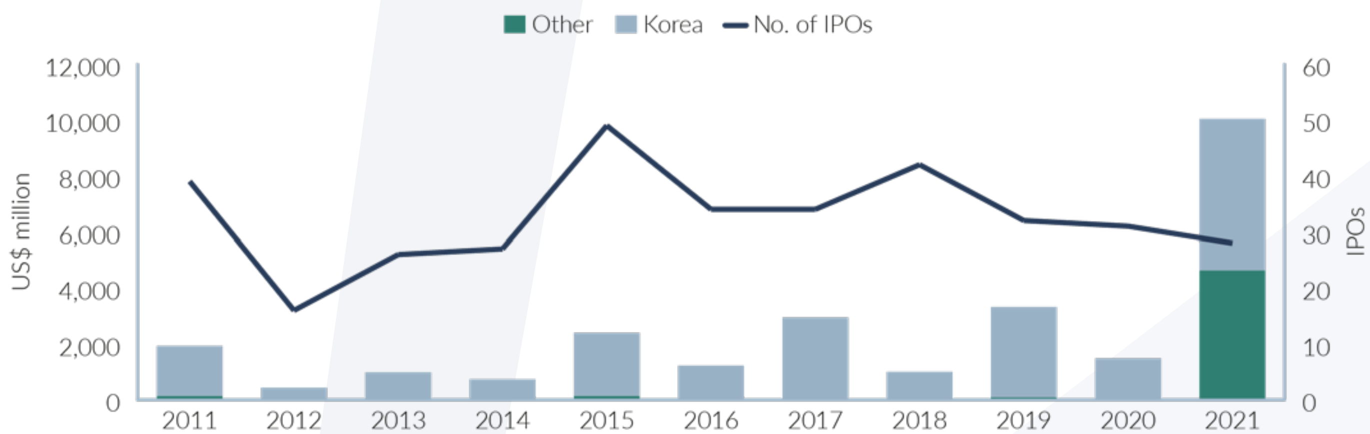
The emergence of sizable IPOs and the accompanying attention of foreign investors has been so quick, however, that many of the systemic issues facing the ecosystem remain to be ironed out. Perhaps the most important of these is a tendency for inaccurate underwriting, which results in shares popping post-IPO by 40% on average, versus 10-20% in most markets.

Indeed, this was the case for Visional, which jumped as much as 50% above its JPY5,000 listing price, which was the top of the indicative range. It was the biggest IPO on Mothers since SoftBank Group's mobile phone unit went public in December 2018.

"That 40% appreciation is taken by investors who held the shares for only one day instead of the entrepreneurs who have been working on the company for 10 years and the VCs who have been there for 5-10 years," says Globis' Yuasa.

"They're leaving money on the table because the underwriters are discounting the valuation of the companies too much. If the valuations are more accurate, there will be smaller pops, and if we see more institutional investors come in at or before the IPO, that will be a correction mechanism."

PE-backed Korean IPOs by listing jurisdiction



Source: AVCJ Research

Q&A: EQT's Andreas Aschenbrenner and Sophie Walker

In the past month, EQT has launched an impact fund with a difference and adopted science-based targets for emissions reduction. Andreas Aschenbrenner, deputy head of EQT Future, and Sophie Walker, head of sustainability for private capital, explain why

Q: How did the notion of EQT Future – a longer-dated, impact-focused fund – emerge?

Andreas Aschenbrenner: We started thinking about it around the time of EQT's IPO. We want to have a positive impact in everything we do, and when you look at ESG from an investment perspective, it is focused on not doing wrong, whereas impact is about getting a positive social outcome. To move to the next level, we needed to think what the next big strategic move could be. EQT Future is our lighthouse project, where we try to inspire the whole platform. It has several different elements. Two of the most important are tying our compensation to achieving not just financial returns but also social outcome targets, and then changing the fee model so that we only charge fees on invested capital.

Q: What makes it different from other impact funds in terms of investment mandate?

AA: It's an impact-driven fund, not just an impact fund. There are a lot of smaller funds in the impact universe with good mission statements, but their impact is limited because they focus on businesses that are still in the growth or venture phase. We want to invest in large, market-leading companies where we can transform entire industries. Our first investment is Anticimex, a pest control company. Pest control is a huge problem for society in terms of disrupting food supply, while the use of biocides damage ecosystems. Anticimex is a market leader in using preventive pest control methods that are biocide-free. If we drive this business in the right direction, helping regulators to understand the harm caused by biocide, maybe we can change

"Many of the things we are trying will be a standard in less than one or two fund generations across the EQT platform"

– Andreas Aschenbrenner

the industry. It's a large investment – EUR6 billion ($6.9 billion) in enterprise value – and achieving impact will take time.

Q: How much time do you have?

AA: For EQT's regular funds, we typically have a base case calibrated to four years. For EQT Future, we are calibrating to eight years, and I think a lot of investments will be 6-10 years. The fund life is 12+3 years, rather than 10+2 years. And the portfolio will be more concentrated, roughly 10 companies.

Q: To what extent is there likely to be crossover with EQT's other funds?

AA: We put our entire portfolio through the EQT Future deal selection framework, and we ended up with an overlap of four companies. In that case, the main fund has the right of first refusal. But it doesn't change the fact we should invest in good companies. The impact threshold and what we want to achieve, the ESG selection criteria are the same. It's just that the impact hurdle for EQT Future – supporting the three Ps, people, planet, and prosperity – is higher.

Q: How is the bar set higher?

AA: Deal selection is based on negative screening, thematic alignment, and impact potential. What we ask is: Can this company have market shaping positive impact on a large scale, and is that achievable in the timeframe we are looking at? To measure against this, we have developed a toolbox with multiple elements. The most important is the impact management framework, which has fund-level and asset-specific targets. The fund level ones follow the three Ps, and they are very measurable. On planet, it is greenhouse gas (GHG) emissions reduction, based on the Science Based Targets initiative (SBTi). On people, we try to mirror and reflect eNPS scores by improving employee wellbeing. On prosperity, we want gender diverse management teams, but not just on the executive team or non-executive team, but it covers the top 20% of earners – that is down to n-3 on the hierarchy level. These targets go across the portfolio, and we link our carry to achieving them.

The asset-specific targets should cover at least one of the three Ps. With Anticimex, we would say the reduction of biocides measured in kilos.

Sophie Walker: Additionally, what we are driving with EQT Future is the asset-specific impact assessment – defining it pre-acquisition and teasing it out properly to understand what impact change we can contribute through the toolbox and through our global size and scale. We nail down what the targets and KPIs should be and enact that through the impact acceleration plan. It is distinct from the rest of the platform, where we drive ESG core leadership against our standard expectations, but we are not putting in place really detailed "impact" acceleration plans for every investment. This is because it might not yet be appropriate to their scale, geography, and market transformation approach.

Q: Is it possible to reduce impact to standardized data points for benchmarking?

AA: You need to have it general enough to be benchmarked across the industry, so we chose GHG reduction, employee wellbeing, and gender diversity as portfolio-wide targets. The asset-specific targets are very precise and vary a lot by investment. For an oncology diagnostics lab, for example, we would measure how many years of quality life the investment has generated by helping diagnose cancer in the right way. It's very easy to have lofty targets about doing something good, but we are trying to define targets so precise we can measure outcomes.

Q: What does the adoption of Science-based targets (SBTs) say about EQT's broader ESG journey?

SW: We are moving from having voluntary requirements for portfolio companies because we could see the business case of doing that to highly mandated requirements that our LPs and regulators want us to meet. That means people will be assessing performance on all manner of ESG metrics. SBT adoption is a signal of our serious intent to drive action, but also an execution challenge because we are trying to

do it across many businesses simultaneously. We must persuade boards of the significance of the business case and then help them operationalize it. That means driving efficiency reductions in their scope-one and scope-two carbon emissions, as well as making more fundamental changes to their business model, supply chain engagement, or vehicle fleet, and engaging with customers on scope-three carbon emissions.

Q: Why is climate change EQT's top priority in ESG?

SW: There is a societally material, human species survival reason behind it. At the same time, if you forecast through what that might mean from a carbon pricing perspective, consider legislation coming down the line, and how a climate-proofed business will be a future-proofed business, it makes total financial sense for us to drive hard at climate immediately. Then there's the added benefit of it being quantifiable and easy for people to understand. There are other issues that are highly material to us as an investor. For example, on diversity, inclusion, and equality, we point to that already with the focus on gender in some of our ESG¨-linked credit facilities, and we will expand our approach to be more holistic in that area. It's in EQT Future as well, by having that ESG-linked gender diversity management target.

Q: What does SBTi compliance mean for portfolio companies in practical terms?

SW: For EQT, outside of our own operations, our SBT target is ultimately an engagement target for portfolio companies. For our portfolio companies, we don't have a set figure for annual emissions reduction; the intention for us is the cascade through the system. For our portfolio companies, they have two years from the point at which we buy them to set their GHG baseline, set their target, business case and implementation plan, and then submit their target for validation to the SBTi. Hopefully, several companies will go quicker than that. But it allows for a slow validation process by the SBTi, and it allows time to put in place a rigorous baseline for year one if there isn't one in place already.

Q: EQT is among the first private markets investors to link impact KPIs to carried interest. Was it a difficult step to take?

SW: Tying sustainability to carry as we are doing with EQT Future is cutting edge, especially the link we are making to setting and executing SBTs. But of course, it is not unusual for large, listed organizations to tie sustainability to general remuneration. In my last organization, it had been integrated with core management activities for five years, and that includes D&I targets and a sustainability bonus pool. But what we are trying to do at EQT that is bold is transform the financial services and private markets industry. This involves taking learnings from organizations that have been doing it for quite a long time and then work out how to broaden them and mainstream them in private markets.

Q: Are there plans to introduce ESG-related compensation across other strategies within the firm?

SW: It will be actively considered, and we have some specific remuneration mechanisms in place already. The EQT Future approach is important because it gives us an opportunity to learn and set the standard and think about how that might apply across the broader platform.

Q: Do you expect this to become a broader industry trend?

AA: I hope so. I think we all need to put our money where our mouth is. We are a bit of a science lab. Many of the things we are trying will be a standard in less than one or two fund generations across the EQT platform, and I expect other market participants will follow. There is enormous momentum right now. Why are we focusing on GHG emissions reductions? Because it's important for our families and for society. But it's also the largest opportunity out there. The ESG funding gap is $6 trillion a year, and half of that relates to climate. What we see with COP26 is governments and regulators trying to set standards, and the early adopters will be the ones who drive value. We want to do good and do well. ■

HNWIs & private equity: Access all areas?

The private equity industry wants more efficient and inclusive ways to raise high net worth money than private bank feeder funds. Technology, in different ways, might provide the answer

Victor Jung's explanation of why high net worth individuals (HNWIs) play a limited role in alternatives is delivered emphatically yet precisely: 10, 10, C. The two 10s represent the typical $10 million minimum investment amount and the 10-year lock-up on a fund commitment, while the C stands for capital call. Jung follows up with an account of how wealthy Asians run into this three-part obstacle.

"They might have sold assets to private equity, and they wonder why it isn't coming to them as an investment option. We pitch them, they like it, and they ask to put in $4million. When we say it's $10 million minimum, it comes as a shock – that could be their entire yearly investment budget," Jung explains.

"Then we tell them it's a 10-year lock-up and they joke, 'Some marriages last less than 10 years, and you're asking me to give $10 million to someone I barely know, and I cannot redeem?' As for capital calls, Asian HNWIs are typically cash-poor and asset-rich, a function of efficient money management. They are used to all-in and all-out. With private equity, you go all-in, but it's a drawdown mechanism, which is less straightforward, and they can risk default."

Jung is head of distributions and liquid private markets for Asia at Partners Group, where HNWIs account for 18% of the firm's total assets under management (AUM). This compares favorably with other, typically larger global GPs. The percentages for The Blackstone Group and Apollo Global Management are 15% and 8%, respectively, while KKR's 14% includes family offices.

The key, according to Jung, is Partners Group's Global Value SICAV Fund, a semi-liquid

"We often see challenges with private placement and feeder funds because they can be complex, cumbersome, expensive, and illiquid" – *Markus Egloff*

vehicle offering private equity exposure through direct deals, funds, and secondaries. The 10, 10, C does not apply: minimum commitments are $10,000; liquidity is monthly, although redemptions can be gated if there is insufficient liquidity; and investors are fully paid in.

It is one of various solutions offered to broaden access to an asset class traditionally structured to meet the needs of large-scale institutions. If rising demand – in a world where investors of all types are looking for new sources of alpha – is the primary driver, then technology is the key enabler.

In addition to listed and semi-liquid vehicles, there has been a proliferation of digital platforms that aggregate dozens of smaller fund commitments and automate reporting. Tokenization is viewed as a logical next step. While supplanting feeders established by private banks as the primary gateway is a commonly stated goal, bringing private equity to HNWIs will create alliances as well as rivalries.

"We often see challenges with private placement and feeder funds because they can be complex, cumbersome, expensive, and illiquid. Minimum investments are high, they have multiple layers of fees, and multiple parties must be at the table. These factors impact the profitability of banks engaged in distribution of private market products," says Markus Egloff, head of Asia wealth at KKR.

"Looking ahead, it's possible that something like tokenization could create an opportunity for new players in this field."

Wealth by numbers

There were 20.8 million HNWIs – defined as individuals with at least $1 million investable assets – with a combined worth $70.6 trillion at the end of 2020, according to Capgemini's latest world wealth report. In 2013, they numbered 13.7 million and controlled $52.6 trillion. Asia Pacific is home to 6.9 million HNWIs (five million live in Japan or China) with $24 trillion in assets. It overtook North America as the largest HNWI region in 2015 but ceded the place last year.

Ultra HNWIs, with more than $30 million in assets, account for 1% of the global HNWI population and about one-third of the asset pool. Their wealth is often managed through family offices, and they have the means to participate in private equity funds directly. This leaves approximately 1,900 mid-tier millionaires with $5-30 million and 18,700 "millionaires next door" with $1-5 million.

Switzerland-headquartered Pictet, which has been active in alternatives in Asia since 2015, is typical among private banks in only considering clients with at least $5 million in assets. For customized mandates, the minimum commitment is $10 million, otherwise comingled solutions are available with a starting point of EUR125,000 ($145,000). Three-quarters of clients globally have customized mandates.

Pictet is atypical in that it helps clients build their own portfolios like a fund-of-funds – last year, 20 around funds were offered to clients – rather than launch big marketing campaigns for a handful of feeders, according to Grégoire de Rham, head of alternative investments for Asia. "We don't put all the resources into one investment opportunity and we follow the life cycle of our GPs," he says.

Feeders are the lifeblood of private banks and wealth managers in alternatives. Global players routinely raise $400-500 million a time, with clients asked to put in at least $250,000. This size requirement, combined with the need to generate interest among a client base that may not be familiar with private equity, means the menu is limited to large funds from global firms.

"Some banks to annual vintage programs where they raise a fund-of-funds and invest in 5-6 mid-cap managers to give diversified exposure. Those commitments can be $20-100 million per fund and we're seeing increasing demand for such products. Single feeders range from $100 million to $1 billion at the high end. Even the regional banks start at $100 million," says Thomas Swain, a director in the private funds group at Credit Suisse.

In addition, there are often direct investment groups within private banks that source allocations to deals – typically growth rounds for in-demand start-ups – and distribute to clients.

Outside of the global firms, which have touchpoints with private banks across different ▶

strategies, the larger Asia-based fund managers have mixed views on feeders. Affinity Equity Partners and MBK Partners, for example, have never raised capital in this way; Baring Private Equity Asia (BPEA) has, with HSBC Private Bank contributing $300 million to Fund VII, which closed at $6.5 billion in 2020.

"I don't have $400 billion in AUM in multiple strategies and the need to tap every source of demand. If I can get all the money from institutions, I will. You need a different kind of fundraising team to contact aggregators and family offices," says one fund manager who hasn't taken HNWI money.

The manager gives four more reasons – echoed by several other GPs – for avoiding these investors: they lack stickiness and cannot be relied on for re-ups; they can be unstable, potentially missing capital calls; fielding questions from these investors in presentation calls "causes brain damage"; and the fees, which can include trailing fees and a slice of carried interest, are exorbitant.

HNWI accounts for less than 5% of BPEA's AUM, but the firm has noted the increasing prominence of this channel globally and is spending more time on it, cultivating several different pockets of capital, according to a source close to the situation. Moreover, HSBC received no fee from BPEA for its work on Fund VII and the same will apply to Fund VIII, which is currently in the market.

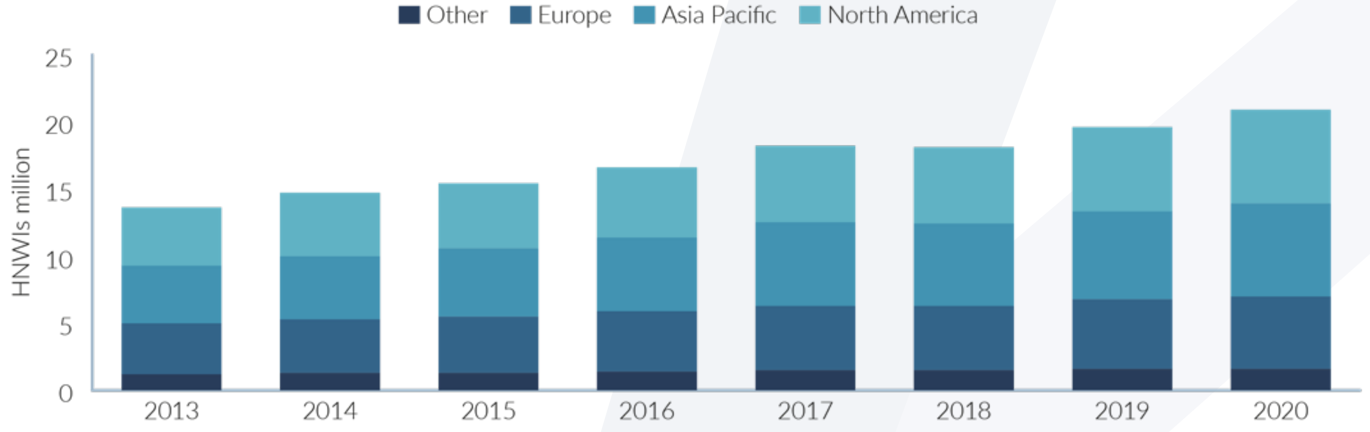
This points to a divide in the distribution model. On one hand, the likes of J.P. Morgan and Goldman Sachs commit to raising a certain amount of capital in a short period of time and charge a placement fee to the GP. On the other, HSBC and others are less explicit as to how much they expect to raise and receive no fee from the GP. Either way, HNWIs pay fees to the bank and to the manager.

Some industry participants claim the picture is more nuanced, but no one disputes the power and reach of J.P. Morgan. According to a second source, the bank used to be dogmatic in charging managers 4% of the expected total proceeds the first time it worked on a fund, falling to 3% for subsequent funds, although demand for access has weakened negotiating power industry wide.

Marketing materials for L Catterton Asia's third fund outline the fees paid by HNWI clients. A 2% origination levy was applied to commitments below $1 million, with progressive discounts applied to commitments above this threshold. All investors paid unspecified fees to cover administration and other costs, while the bank took 1% of the value of any co-investments that clients chose to pursue.

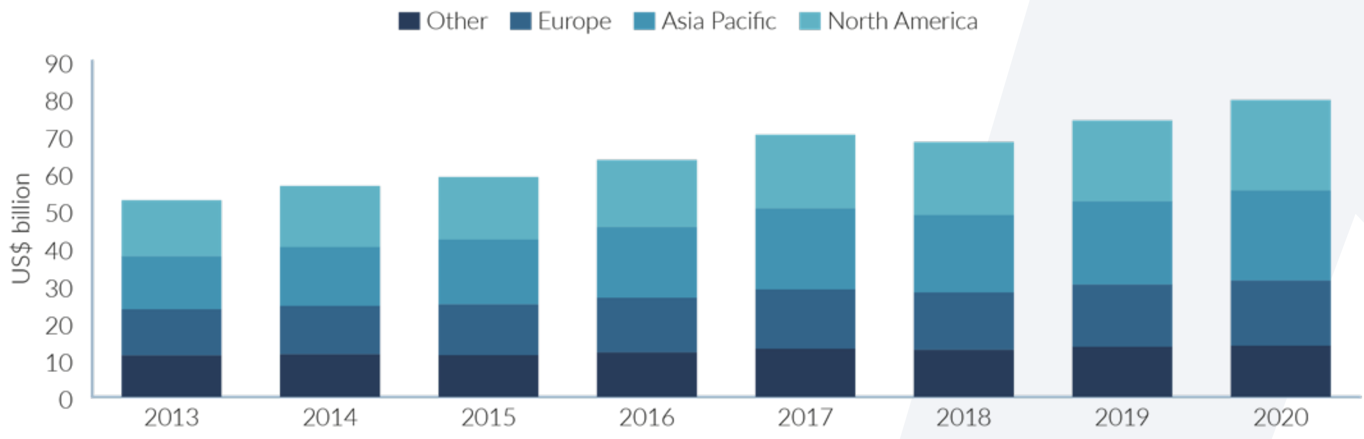
L Catterton Asia is an outlier in terms of the ▶

HNWIs by region



Source: Capgemini

HNWI wealth by region



Source: Capgemini

extent of private bank participation. J.P. Morgan clients accounted for about 50% of each of the firm's first two funds and 40% of the third, which closed at $1.45 billion in 2019. This underscores what sort of product resonates with HNWIs – L Catterton is consumer-focused and boasts ties to luxury goods conglomerate LVMH.

Yet a heavy reliance on private banks, in relative terms, brings other concerns to the surface. "The feeders don't worry about 2/20 and they never negotiate on terms. They come in big, and they won't make a fuss about key person clauses or the hard cap," the second source observes.

"They are a very convenient source of money, very GP friendly. This introduces some interesting conflicts, especially when there's an ongoing fee stream for the wealth manager associated with a fund. If a no-fault termination comes up, would they vote for it – having decided that doing so is in the best interests of underlying clients – and stop their income stream?"

Institutional LPs in the same funds ask this question. "Private banks are perceived as friendly LPs and this becomes a point of tension if, for example, a feeder is $350 million out of a $1 billion fund. Other LPs want them excluded from voting, but that doesn't work. It comes down to the voting threshold for termination and whether it can be lowered," says Justin Dolling, a partner at Kirkland & Ellis.

Access routes

It goes without saying that private equity firms would like to avoid giving up so much to private banks in fees. Technology presents a solution in the form of "white label" feeders, whereby managers create their own structures independently of private banks.

These feature in the product portfolio of iCapital Network, which serves as a technology bridge between private equity firms and HNWIs. It is the outsourcing partner, assuming responsibility for the operational and technical infrastructure – from establishing the feeder to the management of capital calls, reporting, and distributions. The company has 120 white label platforms in operation.

Private equity firms without the internal resources for HNWI distribution recognize the value of iCapital's B2B offering as well as that of B2C players like Moonfare that take alternatives – in fractional quantities – direct to the consumer. Yet these solutions do not wholly free them of costly intermediaries. While the likes of iCapital can set up and run a feeder and solve for many of the practical barriers that come with fundraising, it is still incumbent on the manager to raise the money.

"They promise a lot, but when it comes to distribution, they say, 'You've got to do that yourself, think of us as the people who set up the vehicle, onboard the client, and report to the client,'" says one Asia-based investor relations professional. "You can go after the advisors in the US if you're big enough. Otherwise, you go to the private banks, who now set up their own feeders with iCapital."

Even among the global multi-strategy managers that are big enough to target registered investment advisors (RIAs), it is an open question as to what magnitude of resources should be mobilized to this end. The dilemma was captured in the most recent round of earnings calls as Blackstone and KKR pledged to build out their private wealth exposure, while Carlyle emphasized the institutional channel.

Blackstone has invested heavily in its Private Wealth Solutions business, assembling a team of several hundred specialists that educate advisors on the role of alternatives in portfolio construction. HWNIs make up $100 billion of AUM – not far off Partners Group's total AUM. Rather than stop at the feeder level, the firm is said to identify top advisors in banks and asset managers and cultivate relationships.

KKR is equally bullish on the segment, having increased headcount from 10 to nearly 40 over the past 18 months. Co-CEO Scott Nuttall told analysts that it could triple again in the near term. HNWIs account for 10-20% of capital raised in recent years and there is a belief that it could reach 30-50% in the next several years.

Product-led evolution

The firm's US strategy has been relatively focused, prioritizing major wirehouses, wealth managers, and RIAs. A larger team – including buildouts in Asia and Europe – doesn't mean a change in approach. "I will focus on the largest players in Asia, in terms of where the money sits," Egloff says.

Rather, from a KKR perspective, democratizing access to alternatives is a function of product more than distribution channel. Open-ended products aimed at HNWIs across private equity, credit, and real estate are already an established part of the offering. The most recent addition is a fund – structured as closely as possible to a mutual fund – that can be sold directly into the US retail market.

The product is one of various '40 Act funds, so named because they are registered under the 1940 Investment Company Act. Accessible daily with quarterly redemptions, most strategies are available to all investor types, not limited to accredited investors. In the US, RIAs can simply click and buy, without the need to complete long subscription documents.

Several global GPs are already active in the space, using the '40 Act structure for interval funds, business development companies (BDCs), and real estate investment trusts (REITs). Blackstone's BREIT and BCRED – part of a shift to perpetual capital – are among the best known. Assets stood at $66.3 billion and $17.7 billion, respectively, as of September.

KKR has launched '40 Act funds across real estate, credit, and private equity. There is an emphasis on transparency and accessibility. For example, the KREST REIT offers daily reporting of net asset value, daily subscriptions via a ticker, anticipated quarterly tenders, and monthly distributions.

"These products can get fund managers that bit closer to the investment advisors and 401Ks, and for the international market, there are tax exemption frameworks that are appealing. It is a huge step forward for the industry," says Egloff.

The potential drawbacks of any semi-liquid product include liquidity mismatches and a drag on returns created by the need to hold assets in liquid form to satisfy redemptions.

Partners Group addresses this through integrated deal management. Investments are allocated across different funds, with a team of dedicated portfolio managers sitting above, calculating unfunded commitments, distributions, and ongoing liquidity on top of investment allocation. The goal is to protect existing investors and meet liquidity needs while not holding too much cash, even if that means restricting inflows via queues.

"They try to forecast cash flows from underlying assets across a range of scenarios, while working with us on the client side, asking how much is coming in this month, next month," says Jung.

"New entrants into the private markets space often do simple back-test calculations to show stellar returns on a 10-year basis, but liquidity management – or possible redemptions in the event of a financial crisis – are not considered. Liquidity management could have a significant impact on the overall return, yet it is often overlooked."

Blockchain bonanza?

Global Value SICAV Fund is offered to private banking clients of Credit Suisse and UBS and through three major wirehouses in the US. Distributors receive a portion of Partners Group's fee plus whatever they charge to clients, typically up to 3% of the commitment. Investors putting in upwards of $2 million can enter directly.

In September, a significant move was made in September towards eliminating even these barriers when the fund was tokenized by Singapore-based digital securities exchange ADDX, a first for a large global private markets firm. The product is limited to accredited investors, but the structure is designed to accommodate retail participants in the future.

Tokenization could transform the distribution, presenting a solution that is not only a fraction of the cost of a feeder fund, but also transacts faster, transfers more easily, and offers greater transparency.

"Many clients don't want to review a 160-page subscription document, but they are versant with their digital accounts. Maybe that digital account becomes a token or a unitization of a private equity fund, and a private bank serves as custodian," says Egloff of KKR. "The technology is available, and it's fairly simple. But it will take a few years to go mainstream and to gain investors' trust."

Potential speed of rollout is one of three issues raised by industry participants when presented with this version of the future. It is followed by likely breadth of adoption, given many GPs are still firmly wedded to pen and paper, and – more fundamentally – whether making private equity more attractive to HNWIs necessarily makes HNWIs more attractive to private equity.

"What do I need to do to manage that capital? And how sticky is it in a downturn? Those are the two critical questions that market leaders must answer in the next 10 years," says Juan Delgado Moreira, vice chairman at Hamilton Lane. "We haven't gone through a downturn since the HNWI boom, and so many of these structures haven't really been tested." ■

HNWIs & private equity: The road to retail

From B2C aggregation platforms to nascent blockchain-based products, solutions that bring alternatives to the mass market are gradually emerging. Providers prefer to be labeled enablers than disrupters

Artivest was arguably the first technology platform to deliver private markets exposure on a B2C basis, breaking down traditional fund commitments into smaller pieces and offering them directly to high net worth individuals (HNWIs) and other retail investors. It was acquired last year by iCapital Network, creating a dominant force in this distribution segment in North America.

There are two major HNWI pain points, one B2C and the other B2B: connecting with a broad enough universe of small-scale investors to justify participation in funds on an aggregated basis; and onboarding and managing those relationships in a cost-effective way.

ICapital has resolved the target the second, which led to Artivest's B2C operation being shuttered, and its technology repurposed. Now with $94 billion in assets, iCapital is aggressively pushing upstream to serve banks and wealth managers that serve the HNWIs.

"This is no longer just a business opportunity for them, it's also a responsibility to create access for their clients to participate in the value creation that's increasingly happening in the private markets," says Marco Bizzozero, head of international at iCapital.

"To do that at scale, with efficiency and a better client experience, you must eliminate the historical barriers between private investors and the private markets. This is achieved by partnering with a fintech company and implementing its technology platforms. In the past, this kind of outsourcing decision was mostly based on cost reductions – now it's mostly about time to market, achieving a better client experience and a responsibility."

The obstacles that stand between HNWIs and a role in the global shift toward private markets

"Getting access to the top 10% of VC funds in the US was not easy, but they were interested because their LP base is very US-centric"

– Yuri Narciss

are multifarious: regulation, liquidity and minimum threshold issues, concerns about insufficient market knowledge and data access, poor network connections, and complex or voluminous administrative paperwork for both managers and investors, just to name a few.

No one service provider could address them all. ICapital focuses on the administration part, working with wealth managers on jurisdictional compliance, reporting, capital calls, and subsequent distributions. The company sets up and manages feeder funds, but it does not aggregate HNWIs. It therefore considers itself an enabler of bank-led private markets programs rather than a disrupter.

Coaching client banks about how to properly explain private equity is essential to scaling this model by attracting more public interest, as is building a network of partner banks. ICapital entered Asia this year with regional headquarters in Hong Kong and eyes on Japan, Australia, and mainland China. A Singapore presence is already being established.

B2B vs B2C

For GPs, the B2B approach will have shortcomings in terms of opening private markets to untapped populations of HNWIs because much of that work will be left to less informed intermediaries. But the scaling advantages are manifest. For example, Germany-based Moonfare, the leading player in the B2C space, has only around EUR1 billion ($1.2 billion) in assets under management (AUM).

Still, B2C does appear more in line with the trend's democratization ideals. Yuri Narciss, a managing director at Moonfare, acknowledges the proliferation of banks with their own private markets offerings, but they are targeting the well-heeled elite. Meanwhile, access to aggregators associated with family offices is limited by personal connections and buy-in ability.

"We're talking about millionaires and billionaires there," says Narciss, making his case that there is a huge market in the lower tiers for B2C platforms. Moonfare's minimum ticket size is EUR50,000. It charges clients a one-off origination fee of 1% of the commitment and an annual trailing fee of 0.5%. This is in addition to the management fees and carried interest received by underlying managers.

Moonfare was set up in 2018 by Steffan Pauls, a former managing director of KKR, and entered Asia the following year. The company claims differentiation in a strong private equity background, which supports a quality-over-quantity thesis. It makes commitments to funds managed by The Carlyle Group, EQT, General Atlantic, and Khosla Ventures. Its first Asian fund was KKR's latest vintage in the region.

A rise in demand for this kind of service can be extrapolated from individual investors' increasing appetite for private markets in general. HNWIs, defined as having financial investable wealth of $1-50 million, allocated no more than 5% of their assets under management to alternatives in 2020. That figure that is set to reach as high as 10% in 2025, according to Morgan Stanley.

Many emerging GPs will be keen to tap this growing and increasingly accessible pool of capital via various platforms, which also represent a chance to minimize LP pushback on fees. But this approach entails some risk in the form of less discerning aggregators matchmaking poorly informed investors with unpromising funds. Meanwhile, for managers boasting oversubscribed funds, the question remains how deep into the retail space they're interested in going.

"For them, it's typically a strategic decision to diversify their investor bases, and they're obviously very conscious about their reputations and compliance, so they want to have a quality perspective to it," Narciss says. "Getting access to the top 10% of VC funds in the US was not easy, but they were interested because their LP base is very US-centric. They wanted our access to new LPs in Europe and Asia, and thought we had all the KYC [know-your-customer] compliance checks in place."

For platforms connecting with brand-name GPs, reporting is part translation, part gatekeeping. Technical information must be translated and interpreted for a retail readership, and some of it needs to be omitted to avoid public dissemination of sensitive materials. The information shared with individual LPs can be as basic as a general outlook update and the fund's net asset value.

Interestingly, the most inclusive end of the retail spectrum can have the fewest privacy complications. simply because everything is scaled down and the stakes are lower. Australia's ▶

> "It's not that hard to set up a shell vehicle and aggregate individuals. The hard part is fractionalizing"
>
> *– Oi Yee Choo*

iPartners plugs investors with gross annual income as low as A$250,000 ($185,000) into single-asset funds as small as A$500,000, with a preference for strategies where the target asset is already identified. Sectoral strengths have developed in lending businesses, healthcare, and hospitality.

"Our process is very transparent," says Mark Sherwood, director of capital markets at iPartners. "All the documents are visible, and all registered investors can click through them. If they have any questions, they can speak with an iPartners representative. All relevant information around the deal, the managers, the term sheet or anything else we think is important gets placed in the data room – and that's updated along the way."

Getting tokenized

Any conversation about using technology to streamline administration and democratize financial inclusion inevitably leads to blockchain. In theory, tokenization of a private equity fund completely erases any minimum entry barriers, makes every transaction instantaneous, and allows individual investors to buy in or sell out whenever they want, at least on the secondary market.

"Five guys in a room with a phone can be a distributor. It's not that hard to set up a shell vehicle and aggregate individuals. The hard part is fractionalizing," says Oi Yee Choo, chief commercial officer of Singapore's ADDX. "By providing an exchange, we're actually solving the pain points of individuals investing in private equity. It may not be fully liquid like a public market, but we are providing more liquidity. That's a key difference from the aggregators out there."

Founded as iStox in 2017, ADDX raised a $50 million Series A round earlier this year from the likes of Tokai Tokyo Financial Holdings, Hanwha Asset Management, and Heliconia Capital Management, a subsidiary of Temasek Holdings. In September, it tokenized an open-ended fund from Partners Group, the first such move for a major PE firm. Earlier this month, it did the same for a cryptocurrency fund from Trovio Group, a firm set up by former JP Morgan and UBS executives.

ADDX can create a feeder fund in situations where multiple capital calls will be required, but it prefers direct tokenization where possible. In a tokenization process, the company does not play the role of a single LP for individual investors, but it does provide a single distribution and reporting point. Commitments as low as $10,000 are called upfront. ADDX does not undertake a credit risk review and does not take fiduciary responsibility for the underlying investors.

This model is strongly associated with themes around the redistribution of wealth and social consciousness. Retail investment in cleantech, for example, is almost impossible to properly express without access to highly speculative private markets. Tokenization can make that happen.

There is also growing interest in this idea on the GP side, perhaps for corporate citizenship reasons. Choo notes that managers of the caliber of Partners Group have begun approaching her company this year, asking specifically about fractionalization and democratization. She expects it to be a major trend in 2022.

At the same time, however socially conscious it may be, the tokenization approach is also a buyer beware model. ADDX legitimizes it with a strong commitment to governance, undoubtedly monitored by Singapore Exchange, one of the Series A investors. But it is inevitable that less legitimate followers will move into this space, posing risks for both the retail investors and tech-driven retail access to private equity as an acceptable concept.

"There's a proliferation of digital platforms, and I'm a bit worried that some of the smaller guys trying to compete may not move up to the gold standard of governance and diligence," Choo says. "One day, one of them might crash and burn, run away with money, and put all digital platforms at risk." ■

HNWIs & private equity: Choosing channels

The swelling bank balances of Australia's high net worth individuals and family offices are an attractive target for private equity. Access is becoming increasingly formalized across the spectrum

Australia is, by one measure, the richest country in the world. Median wealth per adult is $238,070, according to Credit Suisse's 2021 global wealth report. Even in terms of mean rather than median – median favors markets with lower levels of wealth inequality – Australia still ranks fourth globally.

The number of millionaires resident in the country totaled 1.8 million in 2020; by 2025, there are expected to be more than three million. While there's no question that private equity firms are trying to tap into this growth, it is unclear how best to access Australia's affluent and to structure their exposure.

"Global GPs and allocators realize that private wealth is an important part of the market. If they are targeting family offices or individuals that can tolerate minimum commitment requirements, that's fine," says Martin Randall, head of alternatives at Crestone Wealth Management.

"But if you've got a wealthy client with $20 million in investable assets, a GP can't approach them, even with a minimum commitment as low as $1 million. That's just too much exposure to an individual GP if it's a diversified portfolio."

Crestone is among the beneficiaries of the rise of the mass affluent. Formed in 2015 through a spinout from UBS, the firm's under advisory for high net worth individual (HNWI) clients have grown tenfold to A$2.5 billion ($1.8 billion). About 11% is in alternatives – private markets, unlisted real assets, and hedge funds – against a target of 20%.

It and fellow insurgents like Koda Capital and Escala Partners are battling for market share with incumbents such as Morgan Stanley, JBWere, and Macquarie. Online platforms also ▶

> "If you've vot a wealthy client with $20 million in investable assets, a GP can't approach them, even with a minimum commitment as low as $1 million"
>
> *– Martin Randall*

form part of the landscape, as competitors or service providers to local wealth managers.

The wholesale investor segment – where target customers must have at least A$2.5 million in net assets – divides reasonably cleanly into larger family offices that go into funds directly and HNWIs that do not. And, historically, the latter have been underserved when it comes to accessing private equity.

"Australia is a bit behind the rest of the world, but the market is evolving quickly. Some clients are larger than the smallest superannuation funds and running institutional-style portfolios," says Phil Cummins, a venture partner at Greenspring Associates, which advises institutional LPs on VC exposure. "With self-managed super and personal savings, it's going to be a A$1 trillion opportunity."

Pain points

Obstacles to participation include minimum commitment levels, discomfort with illiquidity, and capital call management. Capital calls have been a pain point for years, specifically the cash drag created by drawing commitments in full upfront. Under a typical drawdown structure, no more than 70% of a commitment would be called at any one time because distributions normally begin to trickle in before the end of the investment period.

"It is cash drag on cash drag, which leads to diminished returns based on what you might otherwise get on the underlying," says one advisor, who previously addressed the problem. "We tried a three-tranche structure, with the second called when the first was 70% drawn. Sometimes, we obtained leverage, didn't have to call from the client, and could mimic the return profile of the underlying."

Australia is said to be moving towards more progressive structures. Wealth management platforms generally need an allocation of at least A$50 million to justify the administration and custodian costs of establishing a feeder vehicle that aggregates HNWIs under a single fund commitment. Randall says Crestone is now able to break down capital calls into 20% chunks.

Three years ago, the firm went a step further by establishing a A$100 million separate account with Roc Partners, a local fund-of-funds, to target Australia's middle market. Requirements included staggering capital calls over a set timeline, reducing the minimum commitment size to A$100,000, and deploying half the corpus in secondaries and co-investments to minimize the j-curve effect.

A portion of capital was called upfront, so the cash drag wasn't eliminated, but Crestone maintains that it has given clients exposure to a set of managers and assets that would have otherwise been beyond reach. A second iteration is expected to launch later this year. A similar structure was established with Brookfield Asset Management for real assets.

The net worth of Crestone clients is A$2 million to A$1 billion, with an average of A$8 million. Koda starts at A$5 million, reasoning this is the minimum required for a diversified portfolio. Not all clients, therefore, are suited to fund feeders or separate accounts. While there are local fund-of-funds that cater to HNWIs, open-ended structures are increasingly popular.

Partners Group launched a local feeder for its Global Value SICAV Fund in 2011. It is semi-liquid, with monthly applications and redemptions (although redemptions can be gated if there is insufficient liquidity). The liquidity balancer means the drag on returns remains, but the advisor argues that a net return of 11-14% compares favorably with 17-20% on a closed-end fund, given the monthly dealing dates.

Similar products have been launched by the likes of Hamilton Lane, Schroder Adveq, and

Country rankings by wealth per adult

	Median wealth	US$
1	Australia	238,070
2	Belgium	230,550
3	Hong Kong	173,770
4	New Zealand	171,620
5	Denmark	165,620
6	Switzerland	146,730
7	Netherlands	136,110
8	France	133,560
9	UK	131,520
10	Canada	125,690

Source: Credit Suisse

> "The best PE funds aren't domiciled here, so we must look globally, often at funds that primarily focus on institutional mandates" – *Paul Heath*

LGT Capital Partners. Crestone is invested in Partners Group and seeded Hamilton Lane's vehicle. Koda uses Partners Group as its core private equity offering and then creates feeders to access specialist strategies.

"We want each strategy to deliver a unique risk profile in the context of the overall client portfolio. Partners Group gives overarching exposure that covers all the risk and diversification areas, so beyond that we are looking at niche areas like healthcare rather than multi-billion-dollar raises," says Paul Heath, founding partner and CEO of Koda.

"The best private equity funds aren't domiciled here, so we must look globally, often at funds that primarily focus on institutional mandates. We spend some time knocking on doors asking to be let in."

Wealth management platforms use off-the-shelf products where they are applicable. Randall of Crestone believes semi-liquid funds will remain the go-to core offering because they deliver a combination of diversity and cost-efficiency to clients that cannot achieve the same by going direct. In addition, growth in global secondaries has facilitated more liquidity options for these funds.

"Previously, we never had funds that were in PDS [product disclosure statement] format that you could apply into with A$25,000 lots," he says. "If you can make the case for public equities, you should be able to make the case for private equity as a longstanding outperformer. The problem for things like self-managed super is they haven't been able to access it."

Super selection

Self-managed super funds exist within and outside the HNWI community – they are vehicles through which investors might access PE, alongside trust and corporate structures. There is more money in self-managed super funds than in retail super funds in Australia, the pool having grown from A$569 billion in 2015 to A$822 billion as of June. The average account balance was $637,000.

"A lot of these people have 5-10 blue chip Australian stocks and then property, they will buy a house as part of the super," says David Chan, a private equity portfolio manager at MLC, which has some self-managed super accounts come into its comingled superannuation funds.

"Private equity doesn't factor much into their thinking, although it's probably an underserved segment. It's also harder to market to. Most HNWIs have a financial advisor, but that upper tier of income earners using self-managed super do not. They just have an accountant, go to an online broker, and buy shares direct. There isn't much room to pitch other services."

Some investors opt for self-managed super to avoid traditional fee-driven asset management space. As Ken Licence, a managing director at placement agent Principle Advisory Services, puts it: every self-managed super fund wants to be treated as an individual, but every aggregator wants to treat self-managed super funds with commonality and simplicity.

Reducing costs by launching technology-enabled wrap platforms and broadening product choice within investment programs is one solution, but the watershed moment has yet to arrive. As it stands, some self-managed super money – no one is quite sure how much – filters into PE through existing wealth management channels and other aggregators, or just by chance.

"Self-managed super is a huge opportunity because it's vastly under-allocated to private equity," says Marcus Lim, a managing director at Axle Equity Partners. "We see some of that money, but you are effectively targeting an individual and they are using a self-managed super account to come in." ■

HNWIs & private equity: Hungry for tech

Demand for technology exposure among India's most affluent is intensifying. Family offices may vary in profile, experience, and mode of access, but they all want a piece of the latest hot start-up

Aarin Capital, a venture capital firm backed by proprietary capital from Infosys alumnus T.V. Mohandas Pai and Manipal Group's Ranjan Pai, committed $9 million to Byju's in 2013. The online education platform has since emerged as India's most valuable start-up, hitting $16.5 billion on closing its latest round in June. Aarin is sitting on a paper gain of more than 750x.

It is a remarkable return for a family office, yet Aarin ranks low in the Byju's cap table. Subsequent rounds have seen the likes of Sequoia Capital India, Tiger Global Management, General Atlantic, Silver Lake, and BlackRock bet big on the start-up. This evolutionary path is a familiar one. Pick any Indian unicorn and the bulk of the capital will come from offshore funds backed by international LPs.

In 2019, domestic investors accounted for 26% of all funding raised by Indian start-ups, according to a report by 256 Network, which promotes GP-LP engagement on India, and Praxis Global Alliance. This compares to 30% in Korea, 57% in China, and 84% in Japan. It is a fair reflection of the institutional investor landscape. Private equity is largely off-limits to India's larger, regulated players, so the onus falls on high net worth individuals (HNWIs) and ultra HNWIs operating at the margins.

But the report also makes a bold prediction: Indian UHNWIs will be responsible for 30% of the $100 billion that Indian start-ups are expected to raise by 2025. This will come on the back of a surge in technology sector investment, with the country's 56-strong crop of unicorns set to swell to 150.

"Over the last 18 months, that 26% figure has changed dramatically," says Dhruv Sehra,

"They are testing the water with early-stage capital, and in two or three years there will be more growth-stage capital"

– Dhruv Sehra

founder of 256 Network and previously an investment professional at Kalaari Capital. "A lot of the capital going into Indian start-ups is from India because people see monetary results. They are testing the water with early-stage capital, and in two or three years there will be more growth-stage capital. Many GPs are already raising growth-stage capital from Indian LPs to support the winners in their portfolios."

Money, meet opportunity

There is no shortage of emerging wealth in India. The country is home to approximately 350,000 HNWIs – defined as those with over $1 million in assets, including primary residence – according to a real estate consultancy Knight Frank. Moving up a level, India has around 6,900 HNWIs with $30 million-plus in assets. By 2025, these figures will be 611,500 and 11,200, respectively.

At the same time, there are abundant perceived opportunities in technology. The wealth management units of various domestic financial services firms have launched pre-IPO funds, tapping into HNWI and UHNWI demand. They include Kotak Investment Advisors, which has already surpassed the INR10 billion ($134 million) target for its vehicle. The firm, which caters to clients with more than $1 million in investable assets, has been active in the unlisted space for three or four years.

"We would explain how we saw the same categories unfold in the US and China, but most of the equivalent companies in India were not mature enough to list. There wasn't a late-stage playground for investors," says Srikanth Subramanian, Kotak's CEO for private wealth investment advisory. "In the past year, more companies are getting ready to list, so the next 5-6 years will be interesting."

Mapping the HNWI and family office landscape – and the different routes into technology – is complicated by the diversity of the participants. It is estimated there are more than 140 family offices catering to Indian UHNWIs, of which half have formal structures.

Aarin would fall into the business leader family office category, alongside Azim Premji's Premji Invest, Rishabh Mariwala's Sharrp Ventures, and Rata Tata's RNT Associates. Tech entrepreneurs such as Ritesh Agarwal of Oyo (Aroa Ventures), Kunal Bahl of Snapdeal (Titan Capital), Sachin Bansal of Flipkart (Navi), and Rajul Garg of Pine Labs (Leo Capital) form another category. Still more family offices are backed by various non-resident Indians and celebrities.

Rohan Paranjpey, an executive director for alternative investments at Waterfield Advisors, a multi-family office, highlights Flipkart achieving unicorn status as a watershed moment for family offices and technology. Some had made commitments to venture capital funds in the preceding few years, but the rise of Flipkart – and the returns created for angel investors – pushed the strategy into the mainstream. That was 2012, and interest has intensified over the ensuing years.

"Since 2015, we've seen more direct investments into large tech companies by virtue of the purchase of shares from existing employees," says Paranjpey.

"Whenever these companies give liquidity to ESOP [employee stock ownership plan] holders, they work with wealth managers in India because they think they can get better value than in the institutional market. Institutions normally want a discount when buying secondary shares."

These sentiments are echoed by other industry participants. Where once multi-family office operators would scout for opportuntities in their networks, now there is more inbound deal flow. Munish Randev, founder and CEO of Cervin Family Office, another multi-family office, typically sources opportunities from founders who reach out directly, investment banks running rounds, early-stage venture capital funds, and crowdfunding and angel platforms.

How a family office chooses to participate in the technology sector is a function of its sophistication and experience. Early movers started off with early-stage direct investments, suffered because of adverse selection, so switched to relying on VC funds to get access to the best deals and looking to co-invest alongside these managers. Other family offices have viewed the asset class from afar, reluctant to invest given their lack of industry knowledge and sourcing networks.

Both investor types are targets for Waterfield's fund-of-funds. It seems a contrarian bet, given historical sensitivity around cost and control: going through one fund to access

> “That second generation is spending more time managing wealth and directing capital into tech stocks” – *Rahul Chandra*

others involves paying a second layer of fees and offers less transparency regarding deal flow and exit outlook. But Waterfield believes it is the best way to establish relationships with managers that are generally unwilling to accommodate local LPs.

“We want to make Indian capital as attractive to high-quality funds as international capital. We can collect capital across family offices and become a large institutional LP, which may also give us access to the best co-investments,” Paranjpey says. “There are funds that are heavily oversubscribed and had never previously thought about raising from domestic family offices before making room for us.”

Even family offices that do have direct access to deal flow may opt for an outsourcing arrangement, which could mean handing over complete discretion through a fund-of-funds or relying on third-party advisors with strong due diligence capabilities. For example, technology entrepreneurs and large family offices that invest directly and through funds have tasked Cervin to work on risk management – tracking exposure and performance across different stages, sectors, and companies.

Multi-family offices have also been recruited to slice and dice deals. One family might be leading an investment, wants to bring in other family offices as co-investors, but it is reluctant to ask directly, so the multi-family office effectively runs an informal process.

Time to lead?

It remains to be seen whether the HNWI and UNWHI segment becomes significant enough to lead funding rounds on regular basis. Start-ups – and earlier investors – often prefer to have a VC in this role because it represents an endorsement for other investors. As a result, due diligence might be confirmatory rather than exploratory and there is greater confidence that pricing methodologies and deal terms meet industry standards.

To 256 Network’s Sehra, though, it is a matter of time before some – but not all – step up. “Family Offices typically go through at least one capital cycle before jumping in with both feet,” he says. “Today family offices will lead rounds because it is of strategic benefit to their existing business, especially when a company has proven its utility. But if they are doing it from a purely returns perspective, they are still quite cautious.”

Various forces could undermine the technology ambitions of India’s family offices. Adverse selection is one, depending on the mode of access. In the past, these investors have been brought in to prop up troubled companies, leading to subpar returns. A repeat of this would dent confidence.

But increased domestic exposure to start-ups is also described as an irrevocable trend. HNWI demand for Zomato’s INR93.7 billion IPO in July coursed from the pre-listing placement into the secondary market and is now being felt in the growth-stage rounds for other start-ups. The private markets portion might still be relatively small compared to contributions from foreign institutional investors, but it is being driven upwards by the exuberance of youth.

Rahul Chandra, a partner at Arkam Ventures, points to changes in India’s retail investor base, with much of the demand for new brokerage accounts coming from millennials who are consumers of technology and want to invest in it. Similarly, within family offices, the younger generations are assuming influential roles, often after being educated overseas.

“They come back from the US, and they want to have exposure to technology. They are comfortable with the notion that a company is loss-making, but ultimately the network effect and the power of the market share will start showing,” Chandra says. “That second generation is spending more time managing wealth and directing capital into tech stocks, private and public.” ■

Q&A: Coller Capital's Francois Aguerre

Francois Aguerre, head of origination at Coller Capital, on the march towards a $500 billion global secondaries market, the rise of GP-led transactions, and the implications of more permanent capital

Q: What do record deal flow and valuations in primary markets mean for secondary investors?

A: Volume is going up, and that's driven by economies growing. When I was young, a large global company would be worth $10 billion; today it is $1 trillion. So, private assets are growing, and valuations are increasing as well, which is potentially more of a cyclical effect. This is happening in North America and Europe, and we see a very similar phenomenon in Asia, although the growth equity and venture capital portion of the market is higher. Growth in secondary market volume is an inevitable consequence of primary market growth.

Q: What have you seen post-COVID-19?

A: Take 2020 out of the picture, and the level we will reach in 2021 – probably close to $100 billion – is a direct continuation of 2018 and 2019. While $100 billion looks like a big number, because 15 years ago it was $10 billion, it's still a small part of the overall industry. We have projections for $500 billion over the medium-term.

Q: GP-led deals account for an increasing share of the overall market. Will this change?

A: The GP-led market is taking over for now. I say "for now" because secondaries are a liquidity solution for participants in illiquid markets. Historically, LPs were getting used to it. Now GPs are using it prolifically. This is partly driven by intermediaries who bring tools to market participants. An intermediary advising on a $1 billion GP-led transaction will charge more in

"Take 2020 out of the picture, and the level we will reach in 2021 – close to $100 billion – is a direct continuation of 2018 and 2019"

fees than for a transaction involving a traditional LP portfolio of similar size. They are skewing the market towards GPs, but when the market dynamics change, you might see a reverse.

Q: What would lead to a reverse?

A: First, an LP transaction is a different kind of investment to a GP-led transaction – a lower multiple but higher cash velocity, greater diversification – and that leads to different portfolio composition and construction. Second, if intermediaries received the same fee regardless of transaction type, they might not have a preference. Third, some secondary capital is being used to execute single-asset transactions, but most of that capital could come from traditional investors – the sort of people who typically do co-investment. The underwriting in a single-asset continuation deal is not fundamentally different to a co-investment.

Q: Are high valuations a reason for more deal flow, on the LP side or the GP-led side?

A: LPs might say, "The market is high, I want to crystallize some returns and de-risk my investment." Equally, those LPs continue to invest in the asset class. On the GP side, I don't think the deals are driven by valuations. GPs realize that there is enough acceptance in the market for them to tweak the traditional private equity structure. The concept of holding an investment for five years and then exiting is natural for an economic cycle; it is driven by the fact that we've been working with 10-year funds for a long time. A six-year, 15-year, or evergreen fund has a different cycle. Private equity firms will continue doing GP-led transactions with performing assets for the benefit of all and themselves in particular.

Q: How many times have you seen an asset rolled over?

A: Over the last 20 years, some assets have gone through three, four, or five buyouts, one GP after another. Investors were not keen on that, but they accepted it. Now, the same GP is moving the asset from one vehicle to another. They want to hold the asset longer and offer regular liquidity options to investors, so those who want to exit can exit, and those who want to roll can roll.

Q: What role can secondary investors play in terms of permanent capital?

A: Right now, it is mainly traditional private equity vehicles, but there is a trend towards permanent capital. The secondary market could grow to $500 billion over the next 5-7 years, but no one knows what it will look like. Because we are a financial product, a liquidity tool, you should expect the market to look different from what we are today. We shouldn't be relevant to a permanent vehicle with a liquidity mechanism. However, the parts of the market that do not have those structures will continue to grow, so we will continue to be useful.

Q: In the past, some GPs have attached liquidity mechanisms to their 10-year funds...

A: Only a tiny fraction of funds used such a mechanism, typically the very large US platforms. They didn't develop because their usefulness was extremely limited. The way they work, LPs can propose a position to sell, a list of buyers puts forward a price, and the LP decides whether to transact. But LPs prefer to sell portfolios of 20-30 positions in one transaction.

Q: When assets are moved between funds managed by the same GP, what are the key negotiating points?

A: It is difficult to establish a standard. You could argue that any extra economics going to the GP takes profit away from selling LPs or take away from the returns for incoming buyers. Negotiations can be tense. Terms must not be too high, so the Advisory Committee of the selling fund can approve the transaction, and the buyers can decide to invest in this versus other opportunities.

Q: Under what circumstances would less than 100% of carried interest be rolled over into the continuation vehicle?

A: There may be carry that belongs to people who are no longer with the platform, so it won't

"We are a financial product, a liquidity tool, you should expect the market to look different from where we are today"

be invested into the continuation vehicle. Tax is another issue to take into consideration. We also see situations where GPs only want to roll over 50% because it's the first time they've got carry and they don't want to put everything back in. Alternatively, we see people who commit 100% and then want to double their exposure because they are so bullish on the company.

Q: What about terms for multi-asset GP-led transactions?

A: GPs will try to maximize value for themselves. It comes down to management fee rates, how carry is structured – multi-tier, single-tier, what kind of hurdle, and so on. Governance and legal rights are more standardized. I think there is more comfort because investors are more used to these transactions. And with performing assets, the GP doesn't have an incentive to sell cheap. It wants to crystallize a strong return and generate value from the original investment.

Q: Have you seen a step up in activity in Asia secondaries generally?

A: Intellectual property travels instantly from one part of the world to another. A few years ago, we started to see all types of transactions happening in Asia almost as soon as the innovation had happened elsewhere. The volume has been a bit more modest because the Asian market overall is smaller, but our team in Hong Kong is working on the same types of opportunities as our teams in London or New York. The only meaningful difference is the underlying assets – we see more companies or portfolios in Asia that are early stage.

Q: How do you get comfortable with valuation mark-ups on early-stage assets?

A: It's an intellectual problem. If you buy a company valued at 20x revenue, how do you make money out of that? That has nothing to do with secondaries or private equity more broadly. We are seeing massive reorganization within economies – some sectors are hit hard, others do well. Each investor must develop their own macro call.

Q: How would you respond to a portfolio with China technology exposure in the light of recent regulatory uncertainty?

A: With any situation with risk attached a firm can either walk away or only look at transactions that can be structured with downside protection. For example, if it's a portfolio of 10 companies, you need collateral. A firm might only buy 50% and the other 50% would be the collateral, or it buys 100% but where the portfolio is part of something larger, and the bigger piece as collateral.

Q: What are the next market innovations to keep an eye on?

A: We need to remain aware of the products through which investors gain access to the primary markets and develop our own solutions accordingly. For a long time, access was through 10-year private equity funds, so we would buy positions in those funds. Now, there are more SMAs [separately managed accounts] providing access, which are very different from straight commitments to funds. A lot of capital is also coming from high-net-worth channels.

Q: Can you envisage doing secondaries for impact funds?

A: I've been asked this question more often than questions about climate change-specific portfolios, but that will change – there has been a big push for climate change initiatives, more so than for impact or ESG. I can envisage providing a solution for an impact fund. It would be on a small scale because right now those strategies are raising limited amounts of capital. ■

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