AVCJ

WWW.AVCJ.COM

Buyout bonanza?

Richer sources of deal flow mean GPs remain bullish on Japan

- Japanese start-ups pursue international ambitions
- Tough fundraising conditions force GPs to improvise
- Interviews: Advantage Partners, Globis, Longreach

AVCJ Japan conference issue

Contents

EDITORIAL

Managing Editor
Tim Burroughs
tim.burroughs@iongroup.com

Associate Editor
Justin Niessner
justin.niessner@iongroup.com

Reporter
Larissa Ku
larissa.ku@iongroup.com

Design
Edith Leung,
Rana Tang

RESEARCH

Senior Research Manager
Helen Lee
helen.lee@iongroup.com

COMMERCIAL

Event Director
Jonathan Cohen
jonathan.cohen@iongroup.com

Publishing Director
Allen Lee
allen.lee@iongroup.com

Hong Kong Headquarters
25th Floor, The Center,
99 Queen's Road Central,
Hong Kong
T. (852) 2158 9769
E. subs@avcj.com
URL. avcj.com

Beijing Representative Office
Unit 07, Level 6, China Central Place Tower 2,
79 Jianguo Road, Chaoyang District,
Beijing 100025, P.R. China
T. (86) 10 5869 6203
E. CAVCJ@avcj.com

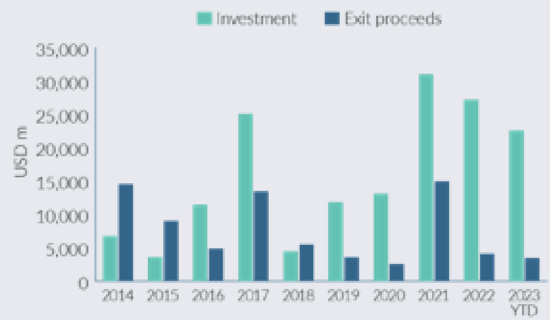
ISSN 1817-1648 Copyright © 2023
Asian Venture Capital Journal

Japan in six trends

1 Exits: An impending overhang?

Most Japanese middle-market managers have relatively lean teams and maintain reasonably concentrated portfolios. However, the dearth of exits during COVID-19 has left some holding twice as many investments as would normally be the case. It points to a broader imbalance in Japan. Nearly USD 45bn was put to work between 2015 and 2018; exits during the subsequent four-year period amounted to USD 25.3bn. GPs are under pressure to return capital – but when will this happen, through which channels, and at what valuations?

Japan investment vs exits



Source: AVCJ Research

Japan's largest PE buyouts

Investee	Date	USD m
Toshiba*	Mar-23	15,984
Toshiba Memory	Sep-17	14,712
Hitachi Metals	Apr-21	7,574
Hitachi Transport System	Apr-22	6,060
Calsonic Kansei	Nov-16	4,515
Accordia Golf	Nov-21	3,512
Evident*	Aug-22	3,108
Hitachi Kokusai Electric	Apr-17	2,951
Works Human Intelligence*	Mar-23	2,678
Takeda Consumer Healthcare	Aug-20	2,287

* Announced Source: AVCJ Research

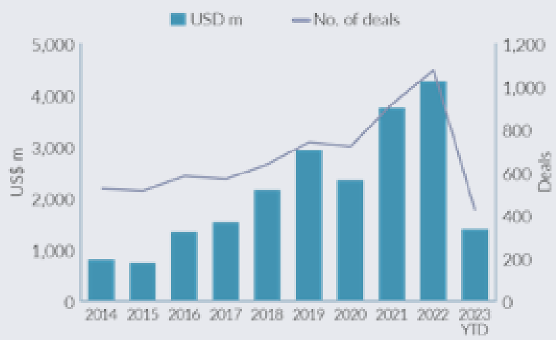
2 Carve-outs: Going even larger

Appetite for large-cap deal flow in Japan is undiminished, even though the Toshiba Corporation deal accounts for the lion's share of capital committed year-to-date and several processes appear to have slowed because sellers are unsure about pricing. Investors remain bullish on the structural trends driving activity – and unwinding corporate structures is the most prominent. Of Japan's 10 largest buyouts, seven have been announced within the last three years, and four in the last 12 months. Six of the top 10 are corporate carve-outs; Toshiba is a take-private but shares some of the same characteristics.

3 VC: Coming into bloom

Venture capital in Japan has enjoyed a seven-year upswing. Between 2016 and 2022, there has been only one year-on-year decline in investment. Consequently, the industry is larger and more mature: nearly 1,100 deals worth a combined USD 4.3bn were announced last year, up 1.8x and 3.3x on 2016. Inevitably, there has been a pullback in 2023, with USD 1.4bn committed across approximately 420 deals as of mid-June. But investors highlight a noticeable uptick in the quality of founders and business models – to the point that some start-ups are nurturing global expansion ambitions.

Venture capital investment in Japan



Source: AVCJ Research

Japan fundraising by strategy

Source: AVCJ Research

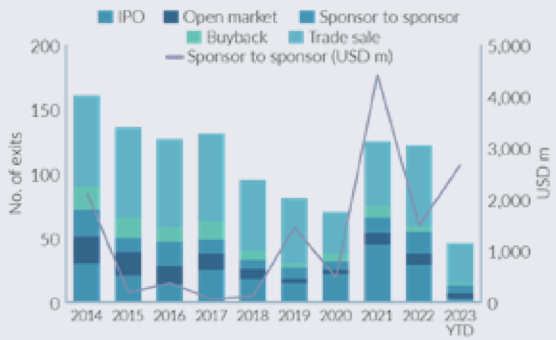
4 Fundraising: Mixed signals

Japan throws up idiosyncrasies rather trends in fundraising. Last year, more capital was raised for VC than buyout. Why? Because Japan Investment Corporation closed a bumper venture-growth fund. Buyout fundraising spikes based on which GPs are in the market. The Carlyle Group, Polaris Capital Group and Integral Corporation raised USD 3.8bn in 2020, propelling the total to a record USD 5.7bn. Rising fund sizes are worth tracking as Polaris and Advantage Partners move through the middle market, and newcomers like J-GIA and D Capital fill the space.

5 PE-to-PE: On the rise

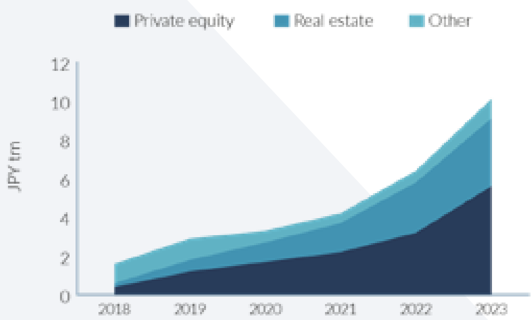
Like most markets in Asia, Japan is seeing more sponsor-to-sponsor sales. These deals are growing in number – there were 17 in 2022 against an eight-year average of 12 – but this pales in comparison to the jump in deal size. A total of USD 5.9bn was put to work in 2021 and 2022, more than the previous seven years combined. The PE-to-PE share of overall exit value was 30% in 2021 and 36% in 2022; for 2023 to date, it is 78%. Two take-aways: trade sales – especially the larger ones – have yet to bounce back; and Japan private equity is maturing, with more assets available at each level of the market.

Japan exits: sponsor to sponsor vs the rest



Source: AVCJ Research

Japan Post Bank's alternatives exposure



Source: Japan Post Bank

6 Japanese LPs: Still allocating

Japan Post Bank's strategic investment area holdings allocation – which includes private equity and real estate funds – crossed the JPY 10trn (USD 70.5bn) threshold in 2023, three years earlier than planned. In five years, PE exposure has risen from JPY 400bn to JPY 5.6trn. Japanese LPs have previously expressed frustration at shorter fundraising cycles and currency depreciation eating up their PE budgets, but many are committed to growing their allocations. Larger GPs have responded by targeting strategic relationships that bypass gatekeepers and fund allocations. Japan Post Insurance's tie-up with KKR is the latest example.

Japan buyouts: Bucking the trend

Japan remains a private equity hotspot despite muted buyout activity elsewhere in Asia. Take-private and sponsor-to-sponsor opportunities make for a more textured local market

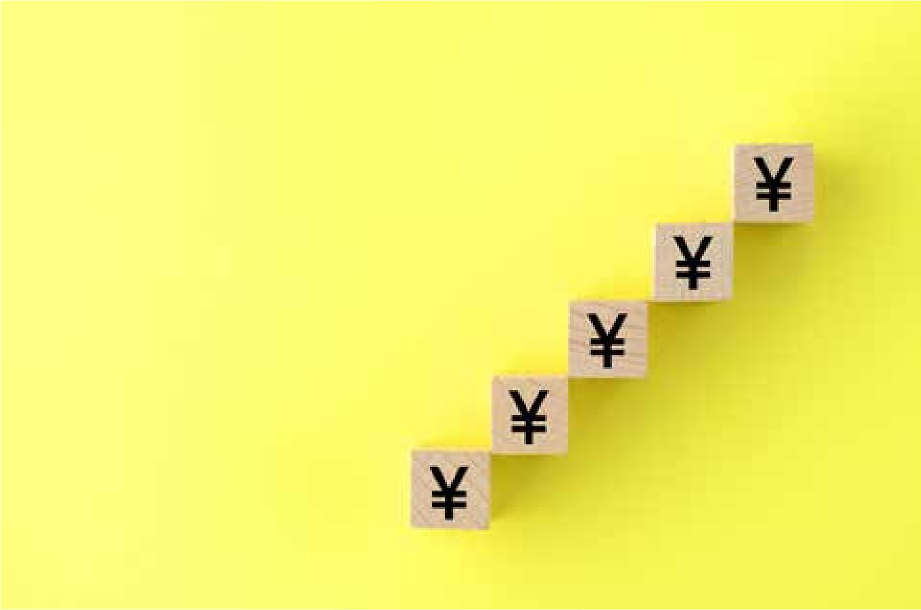
Nearly USD 20.7bn has been committed to Japan buyouts so far this year, beating the 12-month total for 2022 in less than half the time. However, 90% of the capital went to two deals: Toshiba Corporation and Works Human Intelligence, at JPY 2trn (USD 15.9) and JPY 350bn, respectively.

Japan has proved a lumpy market in recent years, with a handful of supposedly idiosyncratic buyouts underpinning headline investment numbers. Five USD 1bn-plus mega deals accounted for 70% of the buyout total in 2022, while four were responsible for 61% in 2021, according to AVCJ Research. Years of feast are interspersed with years of fallow. In 2018, no buyout crossed the USD 1bn threshold.

At the same time, Japan has confounded the sharp decline experienced region-wide from the record high of 2021. Investment in Asia – across all PE strategies – fell by more than one-third in 2022; Japan was down 12%. Toshiba casts a shadow over 2023, but the middle market is humming: 119 buyouts were announced in 2022, up from 87 in 2022; 43 have been logged in 2023 to date.

"What's changed is the relative positioning of Japan in the global markets. Previously, people appreciated fast-growing, start-up-style businesses. The way the world is shifting now, there is a recognition that growth in Japan might be slower, but it's stable and delivers attractive risk-adjusted returns," said Takanobu Hara, a partner at BPEA EQT. "You could say we are less cyclical."

This faith in Japan's innate resilience – investors point to an economy driven by a conservative, over-equitized consumer base rather than more volatile investment and export flows – dovetails with structural trends. Corporate carve-outs and



"There is a recognition that growth in Japan might be slower, but it's stable and delivers attractive risk-adjusted returns"

– *Takanobu Hara*

founder-succession remain the PE mainstays, and there are expectations of more public-to-private and sponsor-to-sponsor transactions.

Paul Ford, a Japan-based partner at KPMG, endorsed the notion of a flight to stability, whether that constitutes a pullback from emerging markets from investors in risk-off mode or a geopolitics-driven avoidance of China specifically. He recalls investors saying they have slowed down in other markets "but not in Japan, with a clear message from the mothership back home to deploy as much capital here as possible."

Representatives of most private equity firms that spoke to AVCJ claimed that deal flow is at, or close to, record levels, although feedback was mixed as to how much of this activity translates into agreed transactions. Ford is of a similar mind. His team is fully booked up with private equity work for the next six months yet notes that the first few months of the year have been relatively slow.

AVCJ Research has records of just two USD 1bn-plus buyouts – Toshiba and Works Human Intelligence – and only one in the USD 500m-USD 999m category. The five USD 1bn deals across the whole of 2022 were accompanied by four in the USD 500m-USD 999m bracket. This compares to seven in 2021 and four in 2020.

Auction angst?

Pent-up deal flow at the large end of the market includes two carve-outs apiece from Fujitsu and Mitsubishi: air conditioner manufacturer Fujitsu General and semiconductor packaging specialist Shinko Electric Industries; and Mitsubishi Chemical Group's Qualicaps capsule division and Mitsubishi Electric's automotive equipment business.

Progress on deals such as these has been sluggish because of an unbridgeable gap in seller and buyer expectations on pricing, according to sources familiar with the situation.

Toshiba moved forward only after the Japan Industrial Partners-led consortium cut the price by 16% between submitting an initial offer last September and agreeing on a deal in March. A downward revision in Toshiba's projected earnings, a fall in the value of the company's stake in flash memory business Kioxia, and reduced availability of debt financing were given as reasons.

Since the start of April, though, the Nikkei 225 Index has gained 15% and reached a record high. Fujitsu General, a listed entity in which the parent owns a minority stake, was up 25% for the year until reports emerged in April that the deal was stuck. Shinko Electric is up 69%.

"The wave of carve-outs is continuing, although at this point in the economic cycle, there can be valuation gaps between buyer and seller. Japanese companies like to price off the public markets and when they own chunks of public companies, the pricing is out there," said David Gross-Loh, a managing director at Bain Capital.

"Japan's stock market is trading at attractive levels with the depreciation of the yen and low interest rates driven by the central bank's easy money policy. This is leading to high price expectations at a time when some companies' earnings prospects are weakening with global economic pressures."

Should the deadlock break later in the year, there is appetite and capacity to complete these deals. T.J. Kono, a partner at Unison Capital, is one of several local investors claiming to see increased interest from overseas in the last 6-12 months following the end of Japan's pandemic restrictions. And, unlike Western markets, there is plenty of debt available to support leveraged transactions.

"Financing is still attractive from our perspective. Interest rates went up around 0.3% but the spread hasn't really changed. LBO financing is an important revenue source for the big banks – they want to carry on providing loans at 2%-2.5% upfront fees," said Atsushi Akaike, co-head of Japan at CVC Capital Partners.

Akaike has noted a slowdown in large-cap transactions, which is attributed to pricing for some of the carve-outs. However, CVC is working on a few founder-succession deals and a take-private.

Japan has delivered a steady stream of public-to-private opportunities in recent years, although they are often succession or carve-out deals in disguise: the founder who wants to sell a large, relatively illiquid position in a public company; the conglomerate divesting a listed subsidiary in which it holds a minority stake. GPs agree to buy these positions and launch tender offers for the rest.

Reforms introduced by the Tokyo Stock Exchange (TSE) may lead to another take-private angle. Companies that trade below book value have been told to disclose steps taken to remedy the situation and TSE is effectively encouraging shareholders to take management to task on it.

This follows a reorganisation of TSE's market segments as prime, standard, and growth, and more stringent qualification criteria for each one. For example, a place in the prime segment for an already listed company is conditional on maintaining a liquid market capitalisation of at least JPY 10bn. Newly listed companies must achieve minimum revenue and profit thresholds as well.w

"There is a recovery period, but those that still don't meet the criteria will be delisted or move into the standard section. Many institutional investors can only invest in the prime section, so companies on the outside might see their stock prices fall. They could be take-private candidates," said Tsuyoshi Yamazaki, a partner at Integral Corporation.

To some, these reforms are part of a broader tapestry that charts the modernisation of corporate Japan. Hara of BPEA EQT stresses the importance of the stewardship code and corporate governance code, as well as updated M&A guidelines that force boards to react to offers in a structured and transparent manner, including evaluations by independent committees.

TSE's recent initiatives represent another means of holding companies accountable for their performance. Toshiba is also wound into this compounding effect, given the role activist investors played in exposing poor governance, facing down management, and securing an outcome favourable to shareholders. Activists are now a feature of the Japan investment landscape.

Even if more take-private opportunities emerge – and it is expected to take several years for the impact of the reforms to be felt – they might be difficult to execute. Ford of KPMG highlights the need for strong relationships with the target's management and major shareholders if these deals are to proceed in a friendly fashion. There could also be disruptions along the way.

Asked to list the principal challenges of take-privates, Kazuhiro Yamada, head of Japan at The Carlyle Group, identified the need to pay a premium that might not be justifiable. He added activists exploiting diversified shareholder bases to oppose offers in the hope of securing a higher price, and the risk of information leaks, and subsequent stock price booms, when a parent sells a listed subsidiary.

This is largely endorsed by Bain Capital's Gross-Loh, who warned against underestimating bottom-up resistance to deals, despite a general openness to PE in Japan. "In cases where companies have distributed ownership or multiple stakeholders, creating consensus is more challenging," he said.

The Longreach Group's tender offer for Japan Systems in 2021 is a case in point. On learning that DXC Technology, the US parent of Japan Systems, had agreed to exit through the process, the Japan Systems CEO sought third-party support for a counterbid, according to a source close to the situation. He didn't get anywhere because DXC insisted it would only sell to Longreach.

Pass the parcel

T Capital Partners has never done a take-private before, but the mid-market firm is among those now meeting with CEOs about potential deals, driven in part by inbound enquiries.

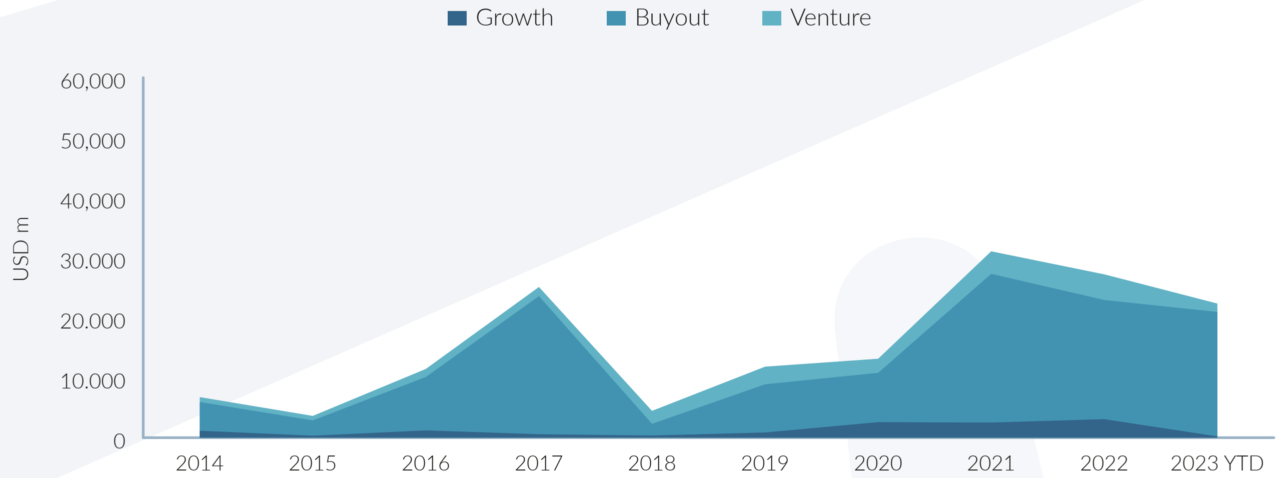
The priority, however, is securing exits. T Capital has made four investments – not including bolt-on acquisitions – since the start of 2020 but its most recent exit was before the pandemic. Koji Sasaki, the firm's managing partner, noted that the number of portfolio companies has swollen to 10 – normally it's five or six – because Japanese strategics have been selling rather than buying assets.

Unison is in the same position, having deployed nearly half its latest fund within 18 months of the final close while exits have been scarce. "Especially during COVID, when restrictions were stringent, there were very few exits, so inventory has built up. We aren't exceptional in that regard," said Kono.

Bain & Company highlighted the issue in its 2023 Japan private equity report, noting that average investment transaction value has doubled on a five-year trailing basis while exits are on the slide. Approximately 80% of deals from the 2017 ▶

"Especially during COVID, there were very few exits, so inventory has built up" – *TJ Kono*

Japan private equity investment by deal type



Source: AVCJ Research

vintage are still held in funds. Will this pressure on liquidity lead to a surge in sponsor-to-sponsor deals in the absence of other exit options?

"Normally, we would have seen more exits from 2017, 2018, and 2019, but people are sitting on them," said Jim Verbeeten, a partner at Bain & Company. "If you cannot do an IPO, a secondary becomes progressively more interesting. There are also global investors that are new to Japan and want to do something here. As a de-risked asset, a secondary can be an attractive first step."

Sponsor-to-sponsor transactions have already evolved from intermittent occurrences to become a major source of Japan deal flow. They reached USD 4.4bn in 2021, accounting for 30% of a bumper year, and remained relatively resilient as other exits dropped off thereafter. Exit proceeds amounted to USD 4.1bn in 2022 and the PE-to-PE share was 36%; for 2023 to date, it is 78% of USD 3.4bn.

This reflects not only greater willingness and resources to compete for assets but also deeper PE penetration of corporate Japan. More GPs are active at different levels of the market, creating opportunities for one manager to fulfil its investment thesis and then exit to a second manager with an agenda that is tailored to the next stage in the portfolio company's development.

It doesn't necessarily follow that businesses pass from local to global GPs. Jewellery retailer Primo Japan is onto its fourth consecutive PE owner: the three most recent are BPEA EQT (then pan-regional), Longreach (North Asia), and now Integral (local). Carlyle and CVC have both exited assets to local GPs, while various companies have travelled through the tiers of Japan's middle market.

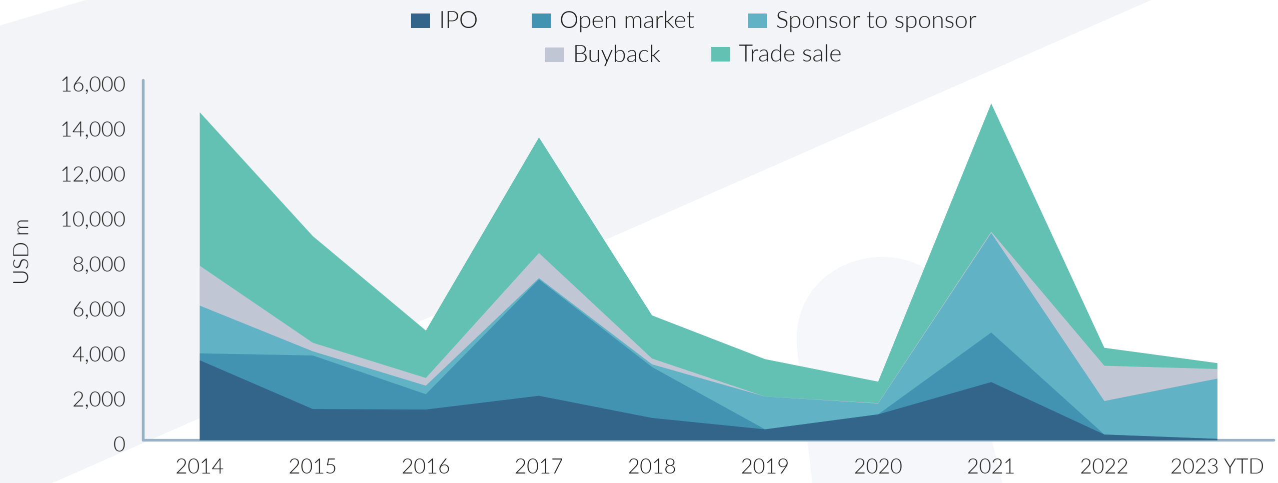
According to Koichi Tamura, an associate partner at EY, most private equity firms active in Japan have teams on the ground. As such, it's not so much about local versus global as what is the best fit. "Which house has the most value-add capability or insight into the target industry or has another portfolio company where there might be synergies? That's how they look at it," he said.

Koichi Kibata, a co-founder and partner at D Capital, which acquired snacks maker Oyatsu from Carlyle at the end of last year, emphasised fundamental differences in the investment theses. While Carlyle supported overseas expansion by Oyatsu, D Capital's agenda includes digitalisation and the rollout of protein-based snacks. The local GP positions itself as a digitalisation specialist.

Budding bona fides

Developing a business to the point where it appeals to a large-cap sponsor can be challenging in low-growth Japan. Unison's Kono noted that

Japan private equity exits by type



Source: AVCJ Research

it means tripling enterprise value on the back of a concerted transformation effort, while T Capital's Sasaki said he would anticipate a 10x return after scaling up a company to a relevant size.

A broader question is whether the management of a portfolio company wants to continue under private equity ownership. Yamada said that Carlyle holds discussions with management teams regarding the most appropriate exit route and they tend to favour an IPO or sometimes a trade sale if they want to expand their capabilities.

"We explore all options, but we work with management to meet their needs," he explained. "Some management teams don't like exits to other sponsors because they want to seek growth opportunities without a heavy debt burden."

In this context, a GP's internal resources are heavily scrutinized. They might draw on value-creation credentials to sell an expansion story to management or dip into their networks to find professionals who can augment or replace those running the target business.

Private equity investors in Japan have always struggled with a talent bottleneck at the portfolio level, while C-suite imports often fail to overcome language and culture barriers. As the asset class has become more established and proven, there is a small corps of local executives who are attuned to the PE model of relatively concentrated bursts of intense, incentive-driven transformation.

"We have brought people from past portfolio companies to help run current portfolio companies, if they are suitable and available," said Toshitaka Shimizu, an Asia-based partner at L Catterton. "Are there many of them in Japan? No. But there are cases where those who have worked with private equity firms before go from one portfolio company to another."

Akaike of CVC adds that competition for CEOs with private equity experience is fierce, so there is a need to invest in youth. In a career that spans Advantage Partners and CVC, he has worked with the CEO of massage salon chain Riraku – which has been owned by both GPs – four times.

The gradual increase in management talent, the still lumpy large-cap deal flow, and the mainstreaming of new investment themes that sit alongside carve-outs and succession are emblematic of a maturing industry. Yet the shift from explaining how PE works to demonstrating the value it brings requires some heavy lifting.

"It is necessary to do more work prior to consummating a transaction in Japan compared to Western Europe and North America. Japanese organisations tend to be more consensus-driven, so they require more convincing," said Hara of BPEA EQT. "You need to show you have the right platform and angle to be the next owner."

Fund focus : Advantage moves fast, scales up

Japan's Advantage Partners deployed Fund VI faster than expected and only some LPs wanting to delay commitments for budgetary reasons prevented a swift final close on Fund VII

Two-and-a-half years and 11 buyouts after closing its sixth Japan buyout fund, Advantage Partners returned to market last September – somewhat earlier than expected – seeking JPY 120bn (USD 879m) for Fund VII. A final close came in April at the hard cap of JPY 130bn.

"The only bottleneck for us is people. We see so many opportunities. We haven't participated in many auction processes – most of the deals are exclusive or semi-exclusive – and our win ratio has been quite high. This meant we deployed Fund VI very efficiently and effectively," said Shinichiro Kita, a senior partner responsible for the firm's buyout strategy.

Private equity activity in Japan has remained reasonably robust even as other markets have struggled. The USD 27.2bn deployed in 2022 represented a relatively small decline from the record USD 30.9bn put to work in 2021. Moreover, investment for 2023 to date stands at USD 21.7bn.

Large-cap deals – notably the USD 15bn privatisation of Toshiba Corporation announced in March – are a key contributing factor. But deal flow was strong in the middle market space occupied by Advantage: approximately 200 buyouts were announced in 2021 and 2022, and transactions of USD 1bn or more accounted for just one out of every 20.

Advantage has maintained a consistent investment pace over the past fund cycle, closing three deals in 2020 and four apiece in 2021 and 2022. There were five corporate carve-outs, three founder succession transactions, two sponsor-to-sponsor deals, and one management buyout.

Kita doesn't necessarily expect one transaction type to dominate the coming cycle. If there is a unifying theme, it's a recognition on the part of owners that they need external partners to generate growth in a typically low-growth market. A wider appreciation of the role private equity can play in this may spur sponsor-to-sponsor opportunities.

"There are a lot more private equity-owned companies in Japan compared to 10 years ago. In addition, the IPO markets are weak, so many companies are waiting for them to reopen. Some GPs need to show distributions to LPs, so they have already decided to sell to strategics or private equity," Kita said.

Meanwhile, the Tokyo Stock Exchange recently instructed listed companies with price-to-book ratios of less than 1.0 to publish detailed plans for improving performance and using capital more efficiently. With activist investors already hounding boards over perceived sub-par returns, it is suggested this measure could lead to more take-private situations – although these are seldom straightforward.

"Management teams should consider all the options, not just going private, and also how to explain their decisions to their employees and shareholders. There are a lot of complex issues around these processes. For example, activist investors are increasingly putting pressure on management teams. Sometimes this helps companies go private, and sometimes it doesn't ▶

> "The only bottleneck for us is people. We see so many opportunities" – *Shinichiro Kita*

because investors want a higher price," said Kita.

While the accelerated timing of the fundraise might be interpreted as a positive sign in terms of deal flow, it wasn't altogether convenient. First, Japan was largely closed to visitors until late 2022, which impeded on-site due diligence.

Second, the final close was delayed until April so some Japanese LPs could utilise budgets for the current financial year. Most of the capital came into a first close of JPY 100bn in December – roughly coinciding with a foreign exchange low point when the yen reached JPY 150 to the US dollar. Allocation requests from overseas LPs, when converted into yen, were much higher than when the fund launched.

"With the increase in fund size, we expected to admit more LPs than we were ultimately able to," said Kita, adding that almost all investors, foreign and domestic, were cut back. There was space for only a handful of new relationships. The foreign-domestic split remains around 50-50.

The broader picture of continued investor interest in Japan-focused funds is encouraging, but Advantage is mindful of the liquidity challenges facing many GPs region-wide. A first exit from Fund VI came in February with the sale of dentistry equipment distributor Dental Holding, and the firm is keen to further reduce its stock of existing investments, which currently stands at 24.

"When we invest, we must think carefully about who a potential buyer in three or four years would be, and what we should be doing during the investment period to generate interest among strategic investors," said Kita.

"With Dental Holding, we took a primarily catalogue-based company, increased the percentage of sales through e-commerce and introduced capabilities around digital marketing. The ultimate buyer saw significant cross-selling opportunities with the company's dental products-focused customer base." ■

Advantage Partners: Japan buyout funds

	Vintage	JPY bn
Advantage Partners MBI Fund I	1997	3
Advantage Partners MBI Fund II	2000	18
Advantage Partners MBI Fund III	2002	47
Advantage Partners IV	2006	215
Advantage Partners IV-S	2013	20
Advantage Partners V	2016	60
Advantage Partners VI	2019	85
Advantage Partners VII	2022	130

Source: AVCJ Research

Japan VC: Global appetites

The relatively recent advent of sizeable VC funds and high-profile start-ups in Japan has exposed long-simmering ambitions to be more international. This could be a breakout moment

Japan's Global Brain is finally living up to its name. The VC firm, founded in 1998, has dabbled in overseas investment since its early days but didn't enjoy much success, with most of that activity targeting other developed markets. That had clearly changed as of last month when it backed Nigeria-based automotive aftersales platform Mecho Autotech.

Global Brain is unique among Japan VC firms in that it invests via several separate accounts for local corporates, but it's not unusual for corporate strategic agendas to drive managers overseas. The GP is also deploying what is likely its largest blind pool fund to date. The vehicle launched in 2021 with a target of JPY 40bn (USD 353m), double its predecessor, and an expanded international remit.

The overall portfolio is 64% Japan, 19% Europe, 8% US, 8% Asia ex-Japan, and 1% Africa. The Mecho deal is typical of the strategy in that it combines interest in a specific growth geography with interest in a specific industrial segment. It is atypical in that it's purely a financial play with no particular LP impetus or co-development plan.

Global Brain's cross-border motivations are easy to understand. Japan represents only 3% of the global VC market, so staying at home is unpalatably limiting. Japan is not growing, and by some measures, the local market is shrinking. And the country has been a latecomer to the digital age, which has prompted the government and domestic tech sector to explore options overseas.

"We want to make early bets on specific sectors where we couldn't find the right start-up in Japan," said Ken Kajii, a general partner at Global Brain, flagging life sciences, climate tech, and crypto as potential areas of interest for overseas investment.

"We want to be at the forefront of those trends

"We try to blend the growth we see outside Japan wiht the very solid foundation Japan has created for venture"

– Akio Tanaka

by tapping into those more advanced markets. And in three to five years, those ecosystems will develop in Japan, so we want to make sure we've seen them before and already know how they work."

There is a sense that initiatives in this vein are multiplying in Japan VC, an historically insular industry where even firms with overseas bases have tended to face homeward in deal-making and lack international diversity in staff.

The earliest movers are notable exceptions. They include East Ventures, founded in 2009, and Spiral Ventures, founded in 2012 as IMJ Investment Partners; both were set up to bridge Japan and Southeast Asia and quickly set up headquarters in Singapore rather than Tokyo.

Indeed, the country's first proper VC firm, Jafco, established in 1973 as Japan Associated Finance, has invested overseas since at least 1984 with the creation of Icon Ventures, its US division. Jafco Asia put down roots in Singapore in 1990 and operates via bases in Taipei, Seoul, Beijing, Shanghai, and Bangalore.

Global Brain, for its part, opened its first overseas office in Singapore in 2013 and has since added eight more countries. The US, UK, Indonesia, and Israel have been the primary ex-Japan markets, with the latter targeted from London. Overseas could represent up to 40% of overall investment going forward.

However, even the most entrenched cross-border players have lacked the scale to be meaningfully global actors until recently. Like Global Brain, East Ventures and US-Japan specialist World Innovation Lab (WiL) both raised their largest-ever funds last year with USD 400m and USD 1bn, respectively.

Headline Asia, formerly Infinity Ventures, is taking a more inorganic approach. The Japan-based firm is the regional arm of Headline, a result of a 2021 tie-up between Infinity and its long-time collaborators, US and Europe-based E.ventures and its Brazilian affiliate Redpoint Eventures. Fund IV closed on USD 100m under the Infinity name in 2019. Fund V is currently targeting USD 200m.

Headline Asia's story is demonstrative of Japan VC's accelerating internationalisation. China was the initial overseas target in the early 2000s until shifting regulations, slowing growth, and political risk redirected much of that capital to Southeast Asia.

Less characteristically, English is the main language at the firm's Tokyo office. About 40% of the portfolio is non-Japanese, and the preference is for companies that can exploit the platform's resources in the US, Europe, and Brazil. Japan's penchant for premature IPOs – often regarded as the ecosystem's core weakness – is leveraged as a strength in the context of a global operation.

"Having Japan as a core element of our investment thesis gives us high DPI [distributions to paid-in] because we create liquidity events early on, but at the same time, we are not stuck with Japan-only exits, which might limit our upside," said Akio Tanaka, co-founder of Headline Asia. "We try to blend the growth we see outside of Japan with the very solid foundation Japan has created for venture."

Going Globis

Even firms that are not comfortable with the risk of making direct investments overseas are obliged to start considering cross-border expansion as their funds enlarge.

The essential thinking here is that pumping more money into a domestic-only Japan start-up market will not yield the unicorns required to provide a big fund with commensurate returns. As Japan VC funds begin to reach JPY 20bn-JPY 30bn with more frequency, the only viable way to achieve the necessary exit valuations is to create companies with international revenue streams.

Globis Capital Partners raised JPY 72.7bn for its seventh flagship fund in May, its largest yet, with just such a plan. The fund – which is mostly backed by local institutional investors – will invest from early to late stages, sticking to domestic start-ups but with an understanding that exiting via Tokyo IPOs will no longer move the needle.

"More and more entrepreneurs in Japan are becoming very ambitious about doing business outside of Japan, and they increasingly realise that if you over-rely on the domestic market, it's much harder to expand overseas later on," said Emre Yuasa, a general partner at Globis. "As a result, we need to develop new capabilities as a fund to help them grow into new international markets."

Globis opened a San Francisco office to help make this happen and will continue to leverage the staffing resources of its corporate training parent company, Globis Corporation, in China and Singapore. The GP also operates an executive hiring platform for portfolio companies headed by Takehiko Ono, formerly a partner at global recruiter Egon Zehnder.

These are considerable strengths considering talent sourcing will likely be the primary challenge for Japanese VC firms attempting to take portfolio companies overseas.

The ecosystem's breakout success story in this area is Mercari. The flea market app - which raised almost JPY 18bn in private funding before achieving Japan's first major technology IPO in 2018 - is credited with stoking unicorn ambitions in Japan, However, investors see danger in a false sense that its story can be easily replicated by companies with limited language skills and poor familiarity with their target market.

Mercari scored a major coup in hiring John Lagerling, formerly of Google and Facebook, as its US CEO. Lagerling happened to have lived extensively in Japan, worked for local tech giant NTT Docomo, and speaks Japanese.

"All Japanese start-ups trying to establish a business in the US are looking for someone like John Lagerling, but there are not many people like him out there," Yuasa added.

"The biggest mistake you can make is trying to hire someone who understands Japanese language and culture because you're narrowing down the talent pool too much. That's the mindset you have to change when you go overseas – you're not a Japanese start-up anymore."

The skills challenge in cross-border expansions has myriad cultural and economic dimensions, which are arguably exaggerated in the US, a significantly less relationship-driven market. Japanese start-ups that prioritise trust building by working with brand-name companies back home might be surprised to find those connections carry less weight stateside.

> "If the founder-CEO is not willing to commit and take leadership, it's hard to win" – *Gen Isayama*

More importantly, tech sector salaries in the US can appear astronomical from headquarters in Japan, especially given recent yen weakness. Even when salaries are accommodated, the discrepancy in compensation between teams can cause internal tensions. The perception is that newly hired Silicon Valley elites are drawing the same or greater wages than their superiors in Japan.

Gen Isayama, co-founder of WiL, specialises in coaching start-ups on navigating these points but has seen little progress in the past 10 years in terms of Japanese start-ups entering the US in a meaningful way. He estimates offhandedly that he gets to see around 97% of the notable start-ups in Japan but that practically none of them have what it takes to follow in Mercari's footsteps.

"If the founder-CEO is not willing to commit and take leadership, it's very hard to win. We ask questions like, 'Why do you want to go to the US? How much are you willing to spend? Are you going to move to the US?'" Isayama said.

"If you keep probing like that, half of the companies disappear, and of the half that are left, maybe 10% have a shot. I haven't seen a lot of companies in Mercari's situation, generating a lot of profit at home and therefore willing to spend, hire the right people, and give them the right compensation."

Local knowledge

Globis' flagship gambit in this cross-border corridor is news aggregation app SmartNews, which is number one in its category in Japan and has claimed annual growth of 2x-3x in the US since it entered the country in 2014. The VC firm's new San Francisco office space is leased from SmartNews, which is hoped to help with networking for other portfolio companies.

SmartNews raised a JPY 25.1bn Series F in 2021 yet remains pre-profit and is generally not considered to have the necessary economics for a routine US hiring spree. Nevertheless, around one-sixth its staff is now US-based, according to LinkedIn data, and the app is now beating CNN in terms of usage minutes per subscriber.

The approach was to tap the investor base. Social Starts, a US-based VC firm with a Japan presence and one of SmartNews' early investors, sought out one of its LPs, recruiting industry

veteran Dennis Moss, to be the company's head of executive hiring.

Moss was hired at the outset of the US push and quickly rallied his network. This involved bringing in one professional from fellow SmartNews backer Atomico Venture and Rich Jaroslovsky, founder of Online News Association, a digital journalism network founded in 1999.

"If you don't have the money to pay these outrageous recruitment fees, you basically have to lean on your VC's network. Then the first hire or two should be people who have been working in the US for 20-plus years because our networks are golden," Moss said.

"It was really through word of mouth and networks that Rich and I recruited the first 10 people into the company. If they had just put a Japanese national in, it would not have worked."

Moss added that while compensation packages in the US were significantly higher than those in Japan and most of the world, start-ups seeking top talent must pay the market rate. Sometimes it is possible to trade generous equity in place of cash, but this is a case-by-case negotiation.

The further opening of other cross-border corridors appears to be less driven by the increase in fund sizes. For example, Japan-India has emerged as a growing theme for smaller funds, many of them with corporate-influenced mandates. They include Strive Ventures, Beyond Next Ventures, and Dream Incubator.

Jafco Asia is also pushing into the subcontinent. Its latest South-Southeast Asia fund came with a renewed focus on India, including the hiring of its first in-country investment talent. For the past decade, the firm has targeted India only opportunistically; there have been six deals in the past 18 months.

Incubate Fund is another example of a GP casting a wider net without increasing fund size. While its flagship funds have ticked up to USD 250m in the latest vintage, these invest exclusively in Japan. Overseas programs are ambitious in spirit, but fund sizes are usually less than USD 10m.

Incubate's LP base has gradually shifted from corporates to financial institutions since it was founded in 2010. By 2015, the firm made its first international foray in Southeast Asia, where it has raised three funds to date. It entered India a year later and has since raised three funds. Two funds have been deployed in the US since 2019, and the first Brazil vehicle closed in 2021.

Each geography has a dedicated local investment team; there are 15 overseas staff – versus 45 in Japan – and seven overseas partners. There is also exposure to Africa via an LP investment in Samurai Incubate, an otherwise unrelated Japan-Africa specialist.

"Our approach of incubating start-ups with a founder from day one is unique in most markets," said Masahiko Homma, a co-founder of Incubate. "Even in India and Southeast Asia, there are good seed and early-stage start-ups, but not many players are helping build start-ups from scratch. That's our motivation for going international – we think our style is unique in our target markets."

Incubate's approach helps clarify the fact that although Japan has only recently emerged as a globally visible VC player, a fair amount of relatively uncelebrated legwork has been underway for several years.

The quantum of investment where Japan-based VC firms back non-Japan companies has consistently tripled or quadrupled the amount invested by Japan-based VC firms in domestic companies in the past five years, according to AVCJ Research.

However, results are exaggerated by the classification of SoftBank Investment Advisers, the manager of the SoftBank Vision Funds, as a Japanese investor. The Vision Funds contributed especially to the industry-wide spike in 2021 when they joined 137 deals, only two of which were in Japan. This accounted for about one-third of the transactions that year featuring a Japanese VC firm.

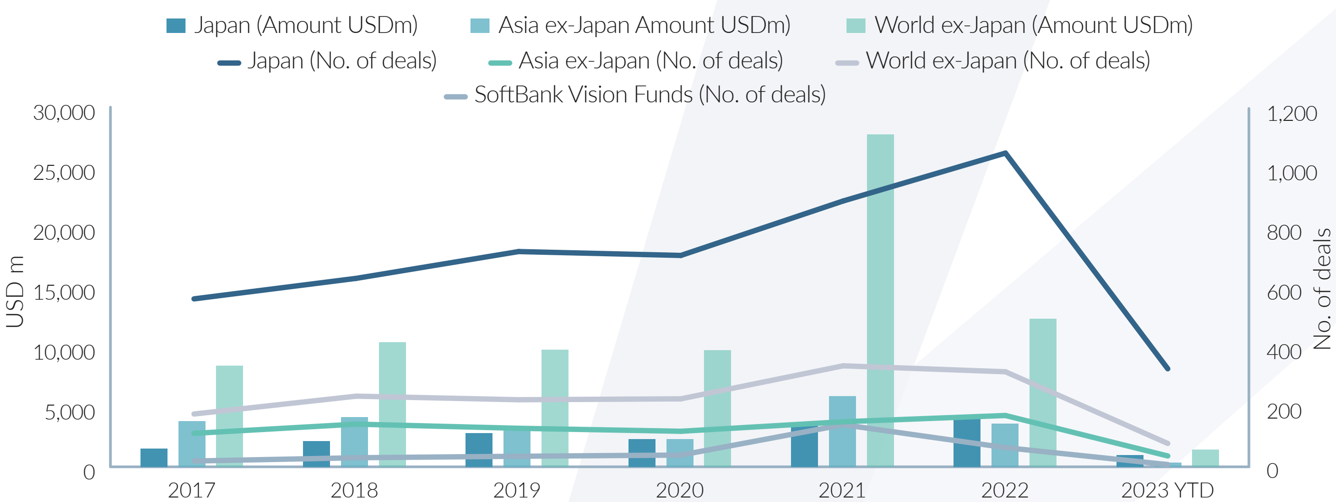
This inconspicuous pervasiveness sets the stage for the growth of Japan VC to outpace other ecosystems that are more disrupted by the current macro environment. But much will depend on the industry's ability to reconcile its conservative tendencies and embrace the opportunity.

In India, Japan VC plays are expected to benefit from warming bilateral ties and momentum in economic cooperation. In Southeast Asia, an influx of traditional Japanese financial institutions will see de-risked investment options in VC-backed companies. And in the US, the tech rout punctuated by Silicon Valley Bank's implosion could represent the most promising opening in recent memory.

"The US is going to be cold for a while, but Japan should stand on its own and not follow that US sentiment. It's time for Japan to be aggressive for once. A lot of money from the BRICS [Brazil, Russia, India, China, South Africa] is shut out of the US for geopolitical reasons., so Japan is in a pretty good space," WiL's Isayama said.

"There's also less competition domestically, with the Googles and Facebooks laying off a lot of talent. If Japanese start-ups have the resources and the guts, this is a once-in-a-decade opportunity to hire these people at a decent cost."

Deal activity with Japan VC participation



Source: AVCJ Research

Deal focus: Go aims to bring Japan's taxis up to speed

Goldman Sachs-backed taxi-hailing platform Go wants to address Japan's taxi driver shortage and bring digitalisation to an industry that remains rooted in an analogue world

When Nihon Kotsu, one of Japan's largest taxi fleet operators, and DeNA, the country's preeminent mobile gaming and e-commerce services platform, merged their taxi-hailing services in 2020 it was widely regarded as a shotgun marriage. Yet Yu Itoki, a vice president at Goldman Sachs Asset Management (GSAM) believes it has yielded significant strategic dividends.

"We've seen a lot of M&A in Japan, but this is one case where the merger created so much value. Nihon Kotsu provided the quality and know-how of taxi operations; DeNA provided the technology and digitalisation. They got the best of both worlds, and it has worked out really well," he said.

The honeymoon period for the combined business – known as Go Inc – was disrupted by the onset of COVID-19 and a downturn in demand so sharp that 30% of Japan's taxi drivers were no longer able to sustain a living and left the industry. Plans to list Go were also thrown awry, but this presented GSAM with an opportunity to invest that otherwise might not have been available.

GSAM is the sole participant in a Series D of JPY 10bn (USD 75m) that values Go at approximately USD 1bn. MUFG Bank and Sumitomo Mitsui Trust Bank also contributed JPY 4bn in debt funding.

The only other post-merger investors are both strategic players, Toyota Motor Corporation and NTT Docomo. Toyota backed Nihon Kotsu's platform, JapanTaxi, before the merger as well. Sparx Group was among the other early investors, according to AVCJ Research.

Go is now the dominant taxi-hailing app in Japan with 14m downloads and a 70% market share. It serves as a matching service, pairing passengers with vacant cars, and receiving fees from both sides. Users include members of the Nihon Kotsu fleet and independent taxi fleet operators.

Even with this market position, the company captures only about 88,000 of the approximately 840,000 taxi rides completed in Japan every year. This is because 85% of rides are initiated by passengers flagging down cars in the street.

"Our assumption is the industry will continue to undergo digital transformation," said Itoki. "More people will use smart phones to hail taxis, so the app share will rise from 15% to 30%-40%."

Japan trails its global peers on digitalisation for two reasons. First, taxis represent a small niche in a mobility sector underpinned by robust public transportation infrastructure. Second, the industry is highly regulated. Uncomfortable with the global ride-hailing phenomenon – disruption brought democratisation but also service quality issues and taxi driver job losses – the government banned it.

The likes of Uber and the Didi cannot follow their global playbooks in Japan. They are required to offer formal taxi services, which means taxis must be part of fleets not operate solo, and drivers must be full-time employees rather than members of the gig economy. Drivers undergo specific training programmes to obtain special licenses and are subject to different rules and regulations from normal car owners.

Itoki notes that Go would be cashflow-positive if it weren't spending heavily on advertising to raise awareness of taxi-hailing services. The company also faces challenges on the driver side because demand levels have rebounded to 80%-90% of pre-pandemic levels but there is

AVCJ Private Equity & Venture Forum China 2023

AVCJ by Mergermarket

5-6 September 2023
Beijing & Online

The 21st AVCJ Private Equity & Venture Forum China, returns this year on 5-6 September 2023, bringing together leading private equity fund managers, institutional investors and regional experts for two days of exclusive networking and high-level insights into the Chinese private equity and venture capital landscape.

Book before 30 JUN GET 30% OFF

Snapshots of leading LPs confirmed to attend include:

ABCI Investment Management
Abu Dhabi Investment Authority
Aceana Group
Adams Street Partners
Albourne Partners
Allianz Capital Partners
Alternative Investment Capital
Arete Capital Asia
Asia Alternatives
Asian Development Bank
Asian Infrastructure Investment Bank (AIIB)
Asset Management One
Atlas Asset Management
Aware Super
Axiom Asia
Bank of Singapore
BlackRock
BNP Paribas
Capital Dynamics
CCT Fund Management Co
CDPQ
China Great Wall AMC (International)
China Investment Corporation
China Life Private Equity Company
China Ping An Insurance Overseas
China Renaissance
Churchill Finance
CM Capital Advisors
Coller Capital
Cornes Properties
CreditEase
Cross Harbour
DBJ Investment Consulting
Development Bank of Japan
EDBI
Empire Holdings Worldwide
Fengshion Capital
Flexstone Partners
Freemont Capital
FWD Life Insurance Company
GCM Grosvenor
Golden Hill Asset Management
Goldman Sachs
Goldman Sachs Gao Hua Securities
Gopher Asset Management
Hamilton Lane
Hanwha Life Insurance
HarbourVest Investment Consulting
HarbourVest Partners
Hong Kong Monetary Authority (HKMA)
HT Capital
Huatai International Finance
International Finance Corporation
J.P. Morgan
Jebsen Capital
Jeneration Heritage
JMCR Family Office
JP Morgan Asset Management
JP Morgan Securities
KAUST
Korea Venture Investment Corp
KWAP
LionRock Capital
Manulife Investment Management
Marubeni Corporation
Mazin Lafayette Hotel Endowment Fund
MCP Asset Management
Mercer
Mitsubishi Corporation
Mitsui & Co Global Investment
Mitsui & Co
Mousse Partners
MUFG Bank
NataRock Partners
National Council for Social Security Fund
Neuberger Berman
Nippon Wealth Life Insurance
Noah Holdings
North-East Private Equity
Novel Investment Partners
Novo Holdings
Ontario Teachers' Pension Plan
Pacific Eagle Asset Management
Pathway Capital Management
Pavilion Capital
Permodalan Nasional Berhad (PNB)
Petiole Asset Management
PICC PE
Ping An Asset Management
Pioneer Generation
Portfolio Advisors
Prosnav Capital
ROC Partners
Schroders Capital
SEDCO Capital
Shanda Group
Shinhan Investment Asia
Shinhan Investment Bank
Siguler Guff
Sinochem Capital
Sofina Group
Sudarskis & Partners
Sumitomo Corporation Equity Asia
Sumitomo Mitsui Banking Corporation
Temasek
The Export-Import Bank of Korea
TKP Foundation
Tokio Marine Asset Management
Transdale Investment Corp.
Unigestion
UTM Management
Weybourne
Yonghe Investments

and many more...!



ENQUIRY

REGISTRATION: Pauline Chan
T: +852 2158 9655 E: book@avcj.com

SPONSORSHIP: Allen Lee/Lily Zhang
T: +852 2158 9634 E: sponsorship@avcj.com

2021 Forum Demographics:

560+	260+	330+	16	53+
Attendees	Limited Partners	Organizations	Geographies	Expert Speakers

Asia Series Sponsor

Knowledge Partner

Co-Sponsors

VC Legal Sponsor

Exhibitors

community.ionanalytics.com/avcj-china-2023

#avcjchina

insufficient supply. Many of the drivers that left the industry during COVID-19 were relatively old and are unlikely to come back.

Go already claims to have boosted taxi driver salaries through the accuracy of its matching algorithm. Part of the Series D proceeds will go towards recruitment and training of more drivers and putting fleets to more efficient use, for example through the rollout of taxis that only handle orders made by app.

"There are plans to offer customised mobility services that cater to customers with specific needs – such as children, pregnant women, and people who want more of a private driver or car rental service," said Itoki. "But the more imminent issue that must be addressed is having too few drivers to accommodate rising demand."

In addition to the main taxi-hailing app, Go offers a B2B platform that handles taxi fee payments and tracks employee taxi usage and an artificial intelligence-enabled service capable of detecting scenarios that might lead to traffic accidents. While the company recently announced plans to terminate its food delivery platform, initiatives like the Go Premium service are moving ahead.

The other strategic priority is energy transition. Go is already promoting the use of electric vehicles (EVs) among drivers, and it has provided an in-car emissions tracking app function aimed at passengers. The company is also looking at ways to apply its technology to charging stations.

"Charging is a bottleneck in the EV taxi transformation," said Itoki. "No one wants to charge at peak electricity hours, yet if every taxi came into charge at the same time, there wouldn't be enough stations. We want to help develop a smart energy management system that helps taxi operators decide which vehicles come back and when they are charged." ■

> "More people will use smart phones to hail taxis, so the app share will increase from 15% to 30%-40%"
>
> *– Yu Itoki*

Asia fundraising: To the grindstone

As macro uncertainties add red tape to fundraising processes and oblige some managers to operate on a deal-by-deal basis, the improvisational, survivalist nature of Asian private equity is on display

Having launched its debut fund in November 2021 with a target of AUD 300m (USD 202m), Australian private equity firm Glow Capital Partners recently confirmed a first of AUD 55m. All the capital came from personal high net worth investor contacts. The plan is to entice institutional investors by drip-feeding them co-investment opportunities.

Glow, whose main expertise is in tech-enabled consumer themes, hopes that by demonstrating its due diligence and deal sourcing rigour – while offering investors a taste of deals as well as insights into its process – LPs smelling the cusp of a new macro cycle will be persuaded over the line.

"The only way to get consideration now is to present co-investment opportunities, so we're being much more proactive on that with a view to building relationships," said Justin Ryan, co-founder of Glow, who previously spent extended stints at Quadrant Private Equity and Catalyst Investment Managers

"Some LPs won't co-invest unless they are a fund investor, but there is an emerging group of institutions that are more open-minded to just straight-out co-investing. Some just want to keep doing it deal-by-deal. Others are happy to work toward a potential fundraising down the track."

Ryan observes that LPs are generally looking for co-investment ratios of 1:1, such that every dollar of fund commitment is matched in co-investment. Three sources from around the region described ratios of 3:1 and 4:1 as increasingly commonplace expectations – and these are sometimes met.

Clean primary tickets are not unusual, but they are no longer the most common outcome in a fund commitment process, even among

"The common denominator is that at the end of the day, it's all about what you invest in"

– Denise Tse

brand-name managers. Beyond ramped-up co-investment rights and accompanying fee discounts, terms-based solutions have tended to focus on quasi-secondaries.

"We're talking to a GP about a combination of structured secondary transactions across two previous vintages, plus a co-investment deal on the fund they're raising right now. There are four components, and all combined, it's worth around USD 90m-100m, including the primary ticket," said Ricardo Felix, head of Asia at placement agent Asante Capital.

"We're seeing more transactions like this, and it's a win-win-win outcome when they work. However, given both their tailored and binary nature, the opportunity cost can also be punitive."

Compromise is king

The most creative workarounds are rapidly proliferating in the US and European markets and considered likely to come to Asia. They include net asset value (NAV) financing arrangements, whereby a lien of credit is introduced into a fund, acting like a dividend recap at the fund level. LPs receive a distribution and the portfolio is collateralised against the debt.

The idea is to create liquidity at minimal cost, but much depends on the loan-to-value ratio (LTV). Large buyout portfolios can generate meaningful distributions; growth and venture less so. Indeed, for the minority investors that dominate the Asian landscape, flexibility around fund terms is a secondary response to simply reducing the target corpus and extending the offer period.

This feeds into the still anecdotal observation that the global fundraising slowdown is forcing would-be fund managers to go into deal-by-deal mode in a more pronounced way in Asia, where 732 growth and venture funds have achieved incremental or final closes since the start of 2022 versus 53 for buyouts.

Nevertheless, the fundraising drop-off in the past two quarters reveals a trend that does not discriminate by strategy. The average quantum raised per quarter fell by around 90% in each of buyout, growth, and venture, when comparing 2022 to 2023 to date, according to AVCJ Research.

The prevailing approach in recent months has been to pool investments made on a deal-by-deal basis into a warehouse vehicle that can be proposed to LPs as a kind of seeded and therefore de-risked fund portfolio ready for an anchor investment.

Denis Tse, CEO of Singapore-based Asia-IO Partners, an affiliate of Korea's ACE Equity Partners, is a proponent of warehousing as a means of transitioning from deal-by-deal to a comingled fund in the current environment. Both Asia-IO and ACE invest on a deal-by-deal basis, but Tse declined to comment on any potential fundraising aspirations.

"The common denominator is that at the end of the day, it's all about what you invest in," he said regarding best practice for making a warehouse-to-comingled transition work.

"The good thing about the current market is that there's so much price dislocation, you can actually find good deals. If you have a collection of good opportunities and you can amass a decent size portfolio that can be warehoused, then it can be quite attractive."

There's reason to believe, however, that this strategy will be less doable in Korea than Southeast Asia, or indeed any other market in the region.

Korea is unique in that it has a deep pool of institutional LPs well-attuned to single-asset project funds. But these investors are becoming wary of the industry-wide uptick in direct secondary buyouts, not wanting to revisit companies they backed with another local manager. They are also losing their appetite for outbound investments amidst a weakening Korean won.

"In Korea, it's getting extremely hard for managers to find Korea-based equity and debt providers to finance their deal-by-deal project funds. In fact, a lot of project fund deals have gone bust since last year. Many of the new managers in Korea are not going to survive if they rely solely on a project fund strategy," said Jay Kim, founder of Orchestra Private Equity.

Ground rules

Orchestra is attempting to transition to comingled funds by leaving the country and taking a quasi-warehouse approach. The firm's last two acquisitions – KFC Korea and Japanese construction industry supplier Stack – were organised with a Singapore license at new headquarters in the city-state.

Orchestra is targeting USD 300m for its debut blind pool fund, and most of the capital is expected to be raised from global LPs, including investors in the Stack and KFC project funds. Kim acknowledges this is a tough road and said there would be "a lot" of co-investment. The global shift away from China exposure is expected to help.

There are a few rules of thumb for first-time managers in this position. First among them is that GP ownership should be the last thing brought to the negotiating table. It could take three vintages to get it back, and it will be expensive to do so.

Second, some angle around specialisation is helpful. Australia's Heal Partners closed its debut healthcare, education, and lifestyle fund last November on AUD 200m. In September, Tower Capital closed its debut blind pool fund on USD 379m, making much of its deep Singaporean roots and tight focus on the country. Only USD 55m of the corpus was earmarked for co-investment.

Furthermore, strategic repositioning may be necessary but must be done in moderation and without contradicting the idea that LPs tend to prefer that managers stick to their strengths in a downturn.

Credit funds have proven popular among private equity investors in recent months as have expansions into earlier or later stages. The latter is a trend that predates the fundraising slump, but India's Chiratae Ventures reaffirmed the idea in the doldrums of late 2022, collecting INR 7.6bn (USD 93m) for its first growth-stage fund.

The overarching challenge is that new strategies can require time to build out, perhaps longer than the market cycles to which they are responding. This is most often highlighted as a risk for China-focused managers looking to recast themselves as regional actors. There are also risks around perceptions of insincerity, especially in areas of heightened investor wariness such as greenwashing.

"We're seeing a lot of interest in impact and sustainability from regional investors. What's more, although international LPs are interested in Asian impact and sustainability, for now at least, there are very few managers with a proven track record to get those investors comfortable enough to invest," said Charles Wan, Hong Kong-based head of Asia at placement agent Rede Partners.

"While this will take time, if a manager has a viable impact and sustainability-focused asset or strategy at present, it will have a higher chance of being funded by LPs."

SMAs and beyond

Australia's Liverpool Partners – which has made a feature of its environmental, social, and governance (ESG) framework – claims to be one of those exceptions. The firm invests via a mix of separately managed accounts (SMAs) and blind pool funds, which include some of the same LPs.

Funds under management amount to about AUD 1.2bn, including an impact fund that reached a AUD 350m first close in 2021 and a generalist private equity fund set up in 2019. The latter has not yet firmed up its target but will probably seek AUD 300m-AUD 500m. The fundraising process for both blind pools is on hold, probably for the rest of the year.

The SMAs, meanwhile, benefit from the programmatic approach to investment pursued by large-format LPs. Jonathan Lim, a managing partner at Liverpool, declined to specify the number of SMAs under management but described it as "meaningful."

"We're seeing that the larger institutional investors want to allocate more into sustainability, responsible investing, and impact, but you have to be able to structure and address their needs rather than just have a cooking-cutter, conventional PE strategy," Lim said.

"In this market, you must listen more and give LPs a blend. If you have only one single

> "In this market, you must listen more and give LPs a blend. If you have only one single approach to raising capital, it will be trickier" – *Jonathan Lim*

approach to raising capital, it will be trickier, and you could get stuck."

SMAs and sidecar funds are one point of flexibility that is more amenable to the growth and venture end of the spectrum. In most instances, the investors will be government actors seeking more comfortable regulatory and tax terms. In others, they will be addressing tech-oriented strategic agendas. As GPs take on more of these vehicles, they will need to balance fundraising needs with investment orientation.

"GPs considering funds-of-one should prioritise opportunities where those LP relationships are either supplemental or strategic to the flagship mandate, as opposed to dilutive," said Sean Murphy, a fund formation partner in the Singapore office at law firm Cooley.

"Even in a difficult fundraising environment, you don't want to be in a position where you have conflicting SMA mandates, and you're trying to figure out where your attention is going to be."

Later-stage and more experienced managers are pulling different levers, including turning toward local currency vehicles as a way of buttressing their US dollar fundraising. HarbourVest Partners, which closed its latest Asia-Europe fund-of-funds last year on USD 1.6bn, has noted an increase in locally minded LPs becoming more familiar with private equity and supporting such endeavours.

Most of the action on this front is happening in China, with global managers such as L Catterton and Affirma Capital hitting first closes on their debut renminbi-denominated funds within the last six months. Meanwhile, Coller Capital recently confirmed a first close on its inaugural renminbi secondaries vehicle.

Secondaries have also proven a critical fundraising tool at the larger and more established end of the market, particularly where packages are diversified away from single-asset risk and include co-investment staples.

Dominic Goh, a managing director focused on secondaries at HarbourVest, expects to see more GP-led deals in the years to come, noting that while the transactions may take some time to organise, they're still a faster solution than a strategy pivot.

"There has been an increase in inbound enquiries and GPs asking questions about what can be done, as these transactions can be highly structured, highly bespoke," Goh said, describing LP desires to see more distributions in a period of uncertainty as a key theme in the current environment.

"And frankly, you need something like that to arrive at outcomes that all parties will accept in today's environment, where investors are asking more questions around risk, exits, and pricing. Setting up in advance to do such transactions is a big undertaking."

The hard yards

The most potent revelations of the bear market are not in the complexity of specialised vehicles, commitment terms, and fund restructurings, however. They're in the daily grind of the managers such as Glow's Ryan, who are accustomed to blind pool investing but now find themselves in a deal-by-deal world, navigating the malaise with a considerably different job description.

Martin Mok, formerly of EQT, Goldman Sachs, and CVC Capital Partners, left the latter of these firms in February 2022 to set up his own firm the following April. China-focused Azuremount Partners had significant initial commitments from two EQT LPs, but by August, the Shanghai lockdowns and general China jitters were all too much, and the investors pulled out.

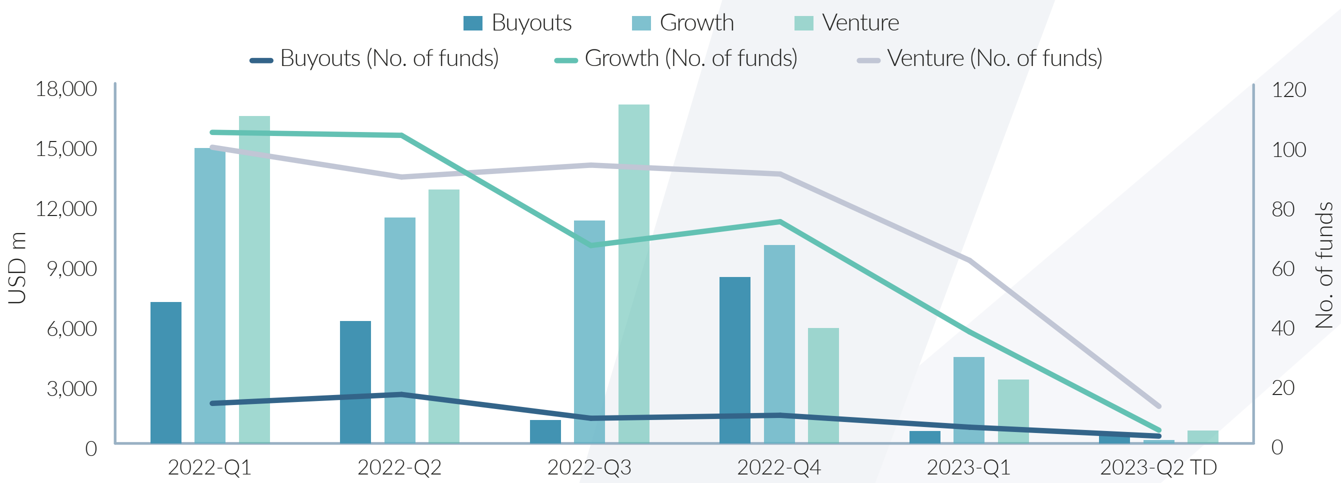
Azuremount was compelled to switch from writing USD 50m cheques in China's lower middle market – which accounts for the bulk of Mok's track record – to a VC-oriented mandate of sub-USD 10m deals.

The first investment came in January, with Azuremount leading a USD 5.7m round for brain surgery technology provider PrimaNova, which was targeting USD 4m in the raise at a USD 30m valuation. The start-up is pre-revenue and China-based – "everything people hate nowadays," Mok joked – but he was able to mobilise various ex-China and US-dollar investors from his network.

"It's not an easy life. I used to write a USD 50m cheque here and a USD 100m cheque there without relying on external parties outside the investment committee. Now you have to ask every family office and all your friends and family," Mok said.

"The advantages are you get freedom, satisfaction, a group of people who think alike, and you can really spend time on meaningful things. If I can deploy USD 20m in the first 12 months and USD 30m in the second 12 months, that's enough to cover the costs, and I think I could do it for life. I don't think I'd go back to the old days, but never say never because let's face it, the failure rate of these shops is high."

Asia-based fundraising by strategy



Source: AVCJ Research

Fund focus: Globis doubles down on Japan VC thesis

Having raised nearly twice as much for Fund VII as it did for Fund VI, Globis Capital Partners plans to back more portfolio companies through growth-stage rounds and help them realise global ambitions

Is Japan on the verge of losing its status as Asia's least known VC growth story? Shinichi Takamiya, a managing partner at Globis Capital Partners, suggests as much and perhaps the latest Globis fundraise confirms it. The JPY 72.7bn (USD 544m) vehicle is the largest pure early-stage Japan fund to date, according to AVCJ Research, and it continues a trend of increases with each vintage.

Having raised JPY 11.5bn for Fund IV in 2013, Globis moved through the gears, closing its next two funds on JPY 20bn and JPY 40bn at intervals of three years. The number of portfolio companies per fund hasn't changed much. Rather, cheque sizes are increasing and start-ups are squeezing in more private rounds before they go public.

This time around, the process wasn't straightforward. While Fund VI raced to a first and final close of JPY 40bn in 2019, Fund VII spent 18 months in the market, having launched in the final quarter of 2021. Severe corrections in global listed technology stocks hampered demand, notably from overseas LPs.

As such, the Fund VII investor base is 90% institutional and 90% Japan. This is in line with recent vintages. When Globis closed Fund III in 2006, overseas LPs put in 80% of the capital. But international appetite for Japan VC dissipated with the global financial crisis – seven years passed between Funds III and IV – and when allocations resumed the Asian portion was heavily skewed towards China.

Fund IV happened to mark the arrival of flea market app Mercari in the Globis portfolio. It went on to become Japan's first unicorn, complete a landmark IPO in 2017, and then blaze a trail into the US, where it ranks as the leading app of its kind. Takamiya estimates that nearly 40 more start-ups have achieved unicorn status, including those that crossed the USD 1bn threshold within 12 months of going public.

Japan's status as a consistent source of unicorns has driven more capital into venture. A record USD 4.3bn was deployed in 2022, AVCJ Research's records show. As recently as 2013, the annual total was barely USD 600m; it only surpassed USD 1bn for the first time in 2016, hitting USD 1.3bn.

Globis has tracked more entrepreneurs launching start-ups as well as noticeable uptick in founder quality. Takamiya observes Japan now has a reasonable number of serial entrepreneurs, while start-ups are now popular destinations for professionals who might ordinarily have picked banking or consulting.

This has contributed to bigger cheque sizes. Ten years ago, Globis was providing Series A rounds of USD 1m at valuations of USD 7m-USD 8m. Those thresholds have since risen to USD 3m-USD 5m and USD 15m-USD 20m. Moreover, Japan has managed to avoid the worst of the technology sector downturn, with plenty of capital still available for start-ups raising seed and Series A rounds.

From Fund VI onwards, Globis has raised a growth-stage sidecar as part of the overall corpus. Approximately 35% of Fund VII is expected to go into follow-on rounds for existing portfolio

> "It's a good market in terms of valuations"
>
> *– Shinichi Takamiya*

companies – and the firm expects to benefit from less frenetic competition in this space following the withdrawal of international hedge funds and late-stage technology investors.

"The growth-stage market has ramped up, mainly because of overseas money, then a bit from the Japanese government and a bit from the likes of us," said Takamiya. "Then the public market crashed and the tourist money was quick to exit. This has left a huge white space. With less money chasing the opportunity, it's a good market in terms of valuations."

The Fund VII mandate is to invest in start-ups "looking to update large industries in Japan that can be expanded globally." The idea is to take advantage of Japan's innate strengths, including mobile services (mobile internet debuted in the country 26 years ago), manufacturing (to the extent that it can be paired with modern technologies such as artificial intelligence), and deep-tech.

"A lot of basic technologies are hidden in the labs of large companies and academia, so we are seeing more spinouts. Things like deep-tech are high risk, high return, but if the technology is strong enough, you don't need to think too much about localisation – it will go across the globe in a day," said Takamiya.

Globis will support global expansion through a newly opened San Francisco office, while leveraging the on-the-ground resources of its parent, corporate training and higher education provider Globis Corporation, in Shanghai and Singapore. The firm is subleasing in San Francisco from SmartNews, a news app operator and a longstanding portfolio company.

SmartNews, which was valued at USD 2bn on closing its Series F round in 2021, has enjoyed similar international success to Mercari. The company's news reader app, which comes preinstalled on Apple devices, is the second largest in the US, and a significant minority portion of its revenue now comes from overseas. SmartNews management has agreed to mentor Globis-backed start-ups.

"One part of our thesis is dominating the Japanese market; the other is going global," said Takamiya. "In the past, companies have dominated Japan and then went overseas as the next step, but they optimised for the Japanese market so much that there was a lot of friction going overseas. We believe you need a one product fits all strategy where a product accommodates a universal need."

Q&A: The Longreach Group's Mark Chiba

Mark Chiba, group chairman of North Asia-focused The Longreach Group, on deal flow in Japan's middle market, platform acquisitions, the rise of digitalisation, and the complexities of take-privates

Q: What's deal flow like right now?

A: We've never been busier. Activity really has sprung back from the COVID impacts, and there's a lot of pent-up deal flow, certainly in the middle market. Every deal in Longreach Capital Partners 3 (LCP3) was fully exclusive or proprietary execution, and the initial opportunities we are looking at for the next fund are also exclusive. This tells me that our long-term investment in deal sourcing channels is paying off and that there are plenty of opportunities to go around. I think we will see more exit activity as well, because a lot of strategic and sponsor sellers are backed up with businesses they couldn't sell during the pandemic. Many of those businesses have grown to a scale where they are targets for larger buyers.

Q: Trade sale activity has been generally weak across Asia. Are these GPs more likely to sell to other PE firms than to strategic investors?

A: The strategics should come back, but yes, I do think there will be more sponsor-to-sponsor sales. We sold two businesses, Via Mechanics and Primo, to sponsors in 2021. We debated selling because it was a difficult time to exit – borders were closed, no one could get into Japan to conduct due diligence and none of the Japanese groups could get into markets like China. In the end, we had reasonable offers and decided it made sense to take some risk off the table. Those assets went to Japanese sponsors in part because they could execute without cross-border travel. Now that travel is back, we are seeing increasingly more cross-border deal activity.

"Will see more exit activity as well, because a lot of strategic and sponsor sellers are backed up with businesses they couldn't sell during the pandemic"

Q: What kind of exit do management teams usually prefer?

A: In most cases, they would prefer a sale to another sponsor or perhaps an IPO. A strategic buyer will be attractive if they can offer the management teams a continuation of an entrepreneurial and performance driven platform. That said, having exit flexibility is essential. We respect but can't be driven by any management team preferences; and we do ensure that those teams are financially aligned with us to capture maximum exit valuation.

Q: Are carve-outs still the dominant source of deal flow for Longreach?

A: We do a lot of mid-market corporate carve-outs, but we are seeing more founder-succession opportunities as well. And more of our deals are now bolt-on acquisitions that combine different deal types. For example, we carved out Kohikan, our coffee shop chain, from UCC Foodservice Systems in 2018 and then we bolted on Caffe Veloce, which was a founder deal, and Café de Crie, which was from Sapporo Group Foods. It's the same in business services: Japan Systems was a carve-out from DXC Technology and Blueship was a bolt-on founder-succession deal.

Q: Why are there more platform deals?

A: There are nine investments in LCPIII and six of them are platforms. We've always looked at platform building, but it's become more accessible in the last few years. Why is there so much liquidity in the bolt-on space? More founders want to sell and it's no longer controversial for corporates to sell to private equity. Also, in certain mid-market segments, industry consolidation is a major strategic and value building dynamic.

Q: Japan Systems is one of a growing number of business services deals. What's behind this?

A: It's because digitalisation catch-up is a huge secular trend in Japan. Blueship has the Japan franchise for ServiceNow, a US-based SaaS [software-as-a-service] systems integration provider. A lot of foreign companies are coming in and finding opportunities they couldn't find before, and this will lead to market consolidation. On the other side, the labour shortage in Japan will continue to tighten, so any business models driven by outsourcing or strategies that reduce labour reliance vulnerabilities – such as digitalization – are seeing strong and secular growth trends.

Q: There are also more – or expectations of more – public-to-private deals…

A: It goes back to the legitimacy of private equity as a buyer being fully established. At the same time, a lot of Japanese conglomerates spun out minority positions via IPO many years ago and it's no longer feasible for them to retain those positions, and then there are founders who hold stakes in companies that are illiquid, so they cannot exit through the public markets. There are also efforts to clean up the Tokyo Stock Exchange by removing zombie-like companies that trade below book value and are illiquid. They want to re-establish Tokyo as a more vibrant and attractive IPO destination, but it's difficult. Going public used to be the ultimate reputational halo in Japan. That's no longer the case.

Q: Can you source deals simply by working through a list of companies that trade at below book value?

A: You must have the right connections to influence founders and decision makers. Finding a target analytically is relatively easy; turning it into a deal is the hard part. You still have reluctant parties that require direct persuasion. Say the founder has died, the family has sold down part of its holding, and management is doing its own thing – there are lots of different dynamics. I think we will see more situations where small activist funds band together with foreign institutional investors and pursue take-privates. For example, an activist might have 10%-20% of a company and they've spent a year or two talking to management without getting anywhere. They could sell and take a discount, or they could approach a private equity firm or another institutional investor and invite them to launch a tender offer with their support. ■

AVCJ Private Equity & Venture Forum

by Mergermarket

13-16 November 2023 Hong Kong

Book before **25 AUG** and GET **30% OFF**

The 36th Annual AVCJ Private Equity & Venture Forum, Asia's premier private markets gathering, will take place in Hong Kong and online on 13-16 November 2023. The event, convened by ION Analytics, is comprised of 6 conferences and an awards ceremony that highlights key market opportunities, macroeconomic and strategical issues facing the private equity industry ranging from the latest investment themes and fundraising strategies to best practice ESG and DE&I. The AVCJ Forum will engage over 4,200 senior investors, advisors and regulators focused on the private markets of Asia and globally into one platform live in Hong Kong and online creating an unrivalled connected community of your peers.

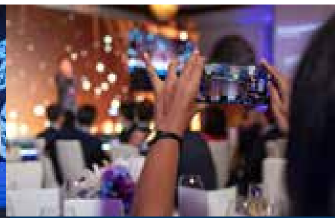
2022 AVCJ Hybrid Forum Demographics	4,250	1,050	58	1,350	168
	Senior Professionals	LPs	Geographies	In-Person Attendees	Speakers

SEE WHAT OUR DELEGATES SAID ABOUT THE AVCJ FORUM LAST YEAR:

"I think the turnout and the number of in-person participants are unparalleled. There's nothing that can replace human to human interaction and that's why it's important that AVCJ continue to hold these events going forward… It really helps to foster the private equity community across the region."
Lydia Hao, Managing Director, HarbourVest Partners (Asia)

"What's happening around the world has a big impact on how we form our investment strategies. Networking at the AVCJ Forum gives us the opportunity to meet the larger investor community from across the globe."
T.J. Kono, Partner, Unison Capital





ENQUIRY

REGISTRATION: Anil Nathani
T: +852 2158 9636 E: book@avcj.com

SPONSORSHIP: Darryl Mag
T: +852 2158 9639 E: sponsorship@avcj.com

community.ionanalytics.com/avcj-forum-2023

#AVCJForum