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ASIAN VENTURE CAPITAL JOURNAL

Asia's Private Equity News Source

avcj.com May 29 2012 Volume 25 Number 20

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EDITOR'S VIEWPOINT

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Regional funds and global LPs

ONE WEEK OUT OF EVERY MONTH, A certain Asia-based fund manager embarks on a trip that takes in three board meetings in three different countries. At each hotel, a packet of documents awaits, which must be reviewed before each meeting. Once he returns home at the end of the week, there is yet another packet containing the backlog of work that has built up in his absence – documents to sign, reports to read, phone calls to return.

The remaining three weeks in the month are comparatively less travel-heavy, but the schedule is still packed with the standard GP fare: reviewing potential and existing portfolio companies, either in person or on paper; touching base with consultants, auditors, lawyers and; and an assortment of internal meetings, covering everything from investments to compensation.

Question: "During all of this, how often must you talk to your LPs?" Answer: "All the time." It should be added that the question wasn't posed during a fundraising period.

A global buyout firm that operates a variety of vehicles across different geographies and asset classes generates sufficient fees to retain a large pool of staff. Regional and country-focused managers, who might have no more than a couple of funds underway at any one time, are run as tighter ships. Their fund sizes tend to be smaller, which means smaller ticket sizes, and their investment professionals are fewer, which means only a certain number of deals can be pursued at once. However, they have strong local networks and decisions are made within the region rather than deferred to New York or Washington.

At a time when several pan-Asian funds are either in the market or preparing to launch, it should come as no surprise that LPs' perception of these GPs differs markedly. The more interesting point that arises from the resources issue in particular is that pan-Asian fund managers' perception of LPs also differs.

There are two forces at work here. Firstly, institutional investors are less willing to write large checks than in 2007. Commitments to private equity have been cut back and one placement agent estimates that only 15 players globally have the capacity to commit $200 million or more to a single GP. Needless to say, Asian sovereign wealth funds feature prominently in that group. Secondly, the amount of information many institutional LPs require, and the frequency of disclosure, is much higher. Not all GPs have the bandwidth to cope with these demands on a large scale.

This has a polarizing effect on regional funds. The likes of TPG Capital, KKR, Bain Capital and The Carlyle Group – reportedly looking to raise around $4 billion, $6 billion, $2 billion and $3.5 billion, respectively – are able to put an executive on a plane to Europe when an LP commitment as small as $10-15 million is at stake. Smaller pan-Asian counterparts have no such luxury. By necessity, they are drawn towards larger investors, perhaps even refusing to consider commitments below $75 million.

The trend has to an extent already been borne out in the previous round of fundraising, with MBK Partners, Affinity Equity Partners and FountainVest Partners (not a regional fund, but a country-focused vehicle of scale operated by a relatively small team) opting for concentrated LP bases. We should expect more of the same. Market sources expect PAG to announce a final close on its $2.5 billion debut fund in the next couple of months. By design, the participating LPs could number less than 25; and PAG is said to have reached its $1.7 billion first close based on contributions from just a handful of investors.

Big ticket LPs may be demanding, but across the fund as a whole, they account for fewer sets of financials, fewer capital calls and far fewer phone calls.

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ISSN 1817-1648 Copyright © 2012

NEWS

GLOBAL

Franklin Templeton raises $319m property fund

Franklin Templeton has closed its latest real estate fund at $319.2 million, exceeding the initial target of $300 million. It was the first comingled fund offered by the firm to both US and European institutional investors. Franklin Templeton Real Estate Advisors began investing on behalf of the fund in February 2011 and has already committed close to half of the corpus.

ASIA PACIFIC

KKR raises one-third of $6b Asia fund

KKR has reportedly attracted commitments of $2 billion in the first round of capital raising for its new Asia fund, which has a final target of as much as $6 billion. The news comes after The Carlyle Group made initial approaches to investors regarding its $3.5 billion fourth Asia buyout fund.

AUSTRALASIA

Crest Capital acquires 51% of Australia's Questus

Crest Capital Asia has agreed to recapitalize Western Australia's Questus in exchange for a 51% stake in the investment company. Crest will provide Questus with $10 million to put towards working capital, a $20 million development loan, and a $100 million acquisition funding facility to allow it to purchase National Rental Affordability Scheme homes.

Lazard-backed Hastie enters administration

Hastie Group, the Australian engineering company backed by Lazard, has entered into voluntary administration after recapitalization talks failed. It comes after recapitalization talks failed due to "accounting irregularities" led to a profits charge of A$20 million ($19.7 million) and the subsequent resignation of two non-executive directors.

Australia's NAB pulls out of private equity

National Australia Bank is winding down its private equity unit a matter of months after the division suffered an A$25 million write-down on its investment in electronics retailer WOW Sight & Sound. The bank will make no more investments via its Integrated Capital Solutions division and existing investments will be allowed to run their course and be exited over time.

CVC to cut Formula One stake to 30% after IPO

CVC Capital Partners will reportedly reduce its shareholding in Formula One to around 30% following the motor racing business' planned IPO in Singapore, which aims to raise up to $3 billion.

The news comes shortly after CVC sold a $1.6 billion stake in the company to BlackRock, Waddell & Reed and Norges Bank Investment Management earlier this week. The price at which the 21% stake was sold set a benchmark valuation for Formula One at around $7.6 billion. The private equity firm saw its 63.4% stake cut to 42.4% through the deal.

GREATER CHINA

Jie Huang to join Cadwalader's Beijing office

Cadwalader has hired Jie Huang as special counsel in its Beijing office. Huang joins from Telstra Corp, where she was general counsel to the Australian company's China business unit. Huang has extensive experience in China's internet, media and telecommunications sectors. Her hands-on expertise includes M&A and private equity transactions.

Macy's invests $15m in China's VIPStore

Macy's, the US department store operator, has invested $15 million in VC-backed Chinese e-commerce firm VIPStore. As part of the deal, Macy's will sell private brand merchandise through omei.com, VIPStore's luxury retail site. VIPStore has already received four rounds of institutional funding from venture capital investors since it was founded in late 2009.

NORTH ASIA

TPG to invest in bankrupt apartment developer

TPG Capital has agreed to buy bankrupt Japanese apartment developer Joint Corp. alongside property consultancy Savills. The news comes after the private equity firm reportedly considered investments in two other distressed assets in Japan, Olympus Corp. and Elpida Memory. The investment is still part of a court-led rehabilitation process.

Hahn & Co. buys cement firm out of bankruptcy

Hahn & Co. fought off competition from four small strategic investors to acquire Daehan Cement for $65 million in a 100% equity deal. The unit's parent company, Daehan Group, made a name for itself in logistics and subsequently expanded into other areas. Like a number of other mid-size chaebols, Daehan overreached and the cement business went into insolvency.

SOUTH ASIA

Goldman invests in Alok Industries, CORE Education

Goldman Sachs has invested in Indian real estate asset Alok Industries and education solutions provider CORE Education & Technologies through two PIPE transactions. The US investor acquired 1.26% of Alok Industries from Nomura Singapore for INR199.5 million ($3.6 million) on the Bombay Stock Exchange. It also paid INR168.7 million for 578,000 shares in CORE Education, of which 577,000 units were offloaded by Nomura Singapore.

Reliance Infratel buyout on the rocks

Despite having signed a term sheet to buy up to 95% of Reliance Infratel for INR150-200 billion ($3-4 billion) in February, The Carlyle Group and The Blackstone Group's proposed buyout looks to be in a state of limbo as the Indian firm said the sale can only proceed following clarification from the regulatory authorities. Despite having signed a term sheet to buy up to 95% of Reliance Infratel for INR150-200 billion ($3-4 billion) in February, the Reliance management has stalled the process by waiting on regulatory guidance on issues such

as spectrum pricing and allocation.

L Capital pulls out of deal to buy India's Lilliput

L Capital has pulled out of the running to buy Lilliput Kidswear. The deal was expected to value the company at INR11 billion ($197 million), with L Capital taking an 85-90% stake, but the private equity firm was only interested in Lilliput's retail assets and didn't want the export and manufacturing divisions.

Reliance Capital backs kitchen appliance maker

Reliance Capital has acquired a 13.71% stake in Butterfly Gandhimathi Appliances for INR1 billion ($18 million) via its Reliance Alternative Investments Fund. The company, manufactures kitchen appliances under the Butterfly brand. It received orders worth INR2.85 billion for the 2011-2012 fiscal year from the Tamil Nadu government.

Warburg Pincus leads $32m round for Quikr

Warburg Pincus has led a $32 million investment round for India's largest horizontal classifieds platform, Quikr. Existing venture backers Matrix Partners India and Norwest Venture Partners (NVP) also subscribed to the round. The investors' contribution represents the fifth and largest round of funding for the firm, a subsidiary of Quikr Mauritius that counts Nokia Growth Partners and eBay among its shareholders..

Ambit Pragma raises $77m for Fund II

Indian venture capital firm Ambit Pragma has raised $77 million for its second fund. Ambit Pragma Fund II has a final target of $150 million and is expected to close by March 2013. CDC and International Finance Coporation (IFC) - both investors in Fund I - are anchoring the new vehicle. IFC, which invested $15 million in the first fund, is reportedly looking to invest up to $20 million its successor.

Xander invests $600m in real estate platform

Xander Group has channeled a $600 million investment into Indian retail real estate asset platform Virtuous Retail. Virtuous is developing a portfolio of retail, lifestyle and community centers across India, and the new capital will allow it to finance the development of these projects in cities including Bengaluru, Mumbai, Pune and Kolkata.

China Life injects $315m into CITIC PE's RMB fund

China Life Insurance has injected RMB2 billion ($315 million) into CITIC Private Equity's renminbi-denominated fund. It comes after the insurance giant invested RMB1.5 billion in Hony Capital's most recent vehicle.

CITIC Private Equity is currently raising a new renminbi-denominated fund with a target size of RMB12 billion - the successor of Mianyang High Technology Industrial Fund closed in 2010. China Life's commitment will account for a little over 16% of the total fund corpus. The vehicle is expected to be closed in June. Other investors include the National Council of Social Security Fund, financial institutions and Chinese enterprises.

KKR adds two India firms to green portfolio program

KKR India portfolio companies Bharti Infratel and Dalmia Bharat Cement are among the new additions to the private equity firm's green portfolio program. The initiative, which now covers about 30% of KKR's global portfolio, is designed to identify opportunities to improve companies' financial and environmental performance.

Everstone Capital invests in Helion-backed R&R Salons

Everstone Capital has purchased a significant stake in R&R Salons, which operates the YLG salon chain across India. The capital raised will be use for further business expansion. Everstone will initially invest INR600 million ($10.8 million), but this is likely to increase to INR1.09 billion. Jaspal Singh Sabharwal, partner at Everstone Capital, confirmed the transaction to the press. "The growing wellness and salon market led to Everstone's investment in YLG," he said. The investment will come from Everstone Capital Partners II, a $580 million vehicle closed in 2011.

Navis gets full control of restaurant chain Nirula's

Navis Capital Partners has acquired the remaining shares it did not already own in Indian restaurant chain Nirula's Corner House. Navis bought the stake held by the Delhi-based company's co-owner, Samir Kuckreja, having first acquired a majority stake for INR900 million ($19.65 million) in 2006.

Apollo, ICICI Venture near $350m on distressed fund

Apollo Global Management and ICICI Venture are close to raising $350 million to invest in Indian distressed assets. The size of vehicle is expected to reach $750 million eventually. The joint fund was launched last year and will target Indian companies that face special or distressed situations, require restructurings or are spinning off assets. Its investments will also extend to non-performing loans.

SOUTHEAST ASIA

Nanostart acquires 10% in Stella Specialty Chemicals

Nanostart Asia Pacific has acquired a 10% stake in Singapore-based Stella Specialty Chemicals and plans to increase its holding to around 23% by the beginning of next year. The investment was made through the Nanostart Singapore Early Stage Venture Fund I. The capital will be used to implement marketing concepts, build up a sales team for the Asian market and validate products and innovations to meet the needs of customers.

PE firms target $500m for Myanmar investments

Leopard Capital plans to raise a $100 million fund dedicated to Myanmar, while Cube may commit up to one third of its current $200 million vehicle in Myanmar. A $250 million joint venture fund between Dragon Capital and Frontier Investment & Development Partners is also likely to include the country in its regional portfolio.

IFC may back IPO of Khazanah's healthcare arm

International Financial Corp (IFC) is planning to invest in the proposed $1.5 billion IPO of Malaysia's Integrated Healthcare Holdings (IHH), which is owned by Khazanah Nasional. IFC's board is scheduled to make a decision on the investment by June 12.

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Keeping Asia's lights on

North American PE firms have become established oil and gas investors. Asian GPs are only just coming around to the idea, but the long-term potential is huge – provided you hire the right management

PRIVATE EQUITY FIRMS ARE INCREASINGLY comfortable getting natural resources the hard way. Last week, Warburg Pincus made its sixth investment in the Gulf of Mexico, heading up a group that committed $1.1 billion to Venari Resources, a Texas-based oil-and-gas exploration start-up. It specializes in deep-water drilling, a risky but lucrative business with no more than two wells delivering the goods for every four sunk. A few days later, a consortium led by Apollo Global Management acquired EP Energy, an unconventional resources explorer with a strong line in shale gas, for $7.15 billion.

These deals are in many respects born of technology. The pockets of oil and gas that Venari is chasing lie beneath many layers of salt and their location couldn't have been accurately identified without the assistance of seismic imaging. North American shale gas, meanwhile, has become commercially viable thanks to the development of hydraulic fracturing and horizontal drilling technologies.

For private equity in particular, better information is aligned with boldness. A clutch of players in North America – buyout firms with broad expertise as well as smaller specialists – now have more than a decade of exposure to real energy assets, and investments have performed favorably against their counterparts in the alternatives class. These firms are not venturing into the unknown (in most cases, oil majors are already present) but they are willing to go further than before.

"When you go into a new basin, there can be many years between origination and prosperity, which is a problem for private equity, but there are now emerging basins that have moved along the delineation curve and you can enter later in the cycle," says Jonathan Farber, co-founder and managing director of Lime Rock Partners. "The size of private equity funds has also grown to the point where new energy-focused vehicles are going out and raising $1 billion or more. That's what you need to do exploration."

The Asia angle

The Venari and EP Energy deals have something else in common: Asian investors. Singapore's Temasek Holdings is part of the Warburg Pincus group, while Korea National Oil Corp. is among those who joined forces with Apollo.

The link between growing Asian demand for natural resources, current commodities prices and the future commercial viability of global exploration and development projects is there for all to see. The region's national oil companies (NOCs), as well as a growing number of government-linked groups such as sovereign wealth funds, are entering the asset class, but few Asian GPs are following suit.

In addition to the longer investment horizons traditionally associated with natural resources, many firms are uncomfortable operating beyond the realm of their expertise – in terms of industry and geography. Early movers in Indonesian PE profited from direct investments in mining and oil and gas; ancillary services to the natural resources sector remain a compelling play across the region. There is little evidence, however, of Asian private equity moving further afield to marry regional demand with global resources.

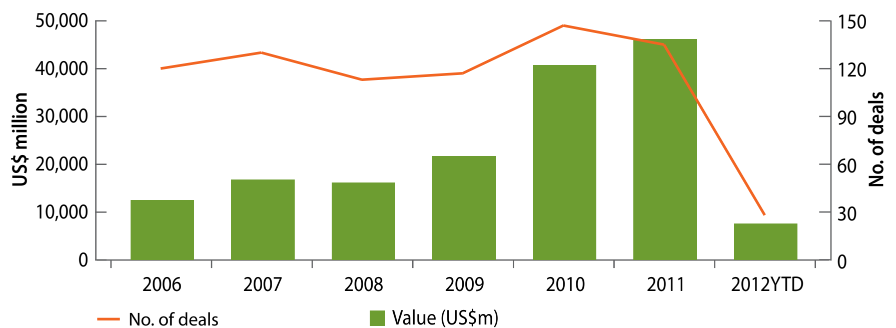
"Based on known reserves today, Asia doesn't have sufficient resources to meet its current and projected demand. As a result, the trend for sourcing investment opportunities in geographies that are further afield will continue," says Jason Cheng, co-founder and managing partner at Hong Kong-based Kerogen Capital. "Chinese private equity that is able to invest overseas has been increasingly drawn to this thesis, but it is still relatively nascent."

Kerogen might be described as the exception to the rule. Set up by former executives from J.P. Morgan's Asia energy and natural resources team who subsequently moved to Indonesia's Ancora Capital, the firm is nearing a final close on its debut fund of $1.5 billion. Its first two investments – drilling company AJ Lucas, which has exposure to European shale gas, and sub-Saharan Africa oil specialist NewAge – clearly represent assets and geographies that are of strategic importance to China. Kerogen has a strategic alliance with China National Offshore Oil Corp. (CNOOC) and is targeting a 3x return on its investments.

Several other regional private equity firms are bulking up their sector expertise, including RRJ Capital, a Singapore-based firm set up by Richard Ong, formerly of Hopu Investment Management. The firm already has something to show for its efforts, committing $485 million earlier this month to a liquefied natural gas (LNG) processing and export project operated by US firm Cheniere Energy. RRJ has also backed Frach Tech Holdings, which supplies pumping equipment to the US oil and gas industry.

Temasek invested alongside the private equity firm in each of these deals, while Korea Gas Corp. has agreed to buy from the Cheniere project.

Asia Pacific outbound oil and gas acquisitions



Source: Thomson Reuters

Growing exposure

According to Lorna Chen, a partner at Shearman & Sterling in Hong Kong, Asian exposure to global oil and gas and mining assets may be far greater than the numbers suggest.

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Many participants are aware of the political ramifications of their investments in natural resources and so operate below the radar. Rather than making direct investments in companies, these investors participate in co-investment structures that place additional corporate layers in between themselves and the assets. These co-investment structures resemble a standard private equity arrangement in that the LPs are passive investors, relying on the GP to carry out due diligence and manage the asset.

"It's a smart way of doing it because certain government-backed entities might be seen as representative of the country itself, and there are sensitivities about China, for example, buying natural resources around the world," Chen says. "These partnership structures are also very flexible in terms of raising money on a deal-by-deal basis, which is useful in large-scale natural resources projects."

The NOCs are not so secretive and a quick glance at outbound investments by the Chinese oil majors offers a clear picture of wider acquisition strategies. In the last few years, CNOOC, China National Petroleum Corp, China Petroleum and Chemical Corp. and Sinochem Corp. have targeted emerging basins in the former Soviet Union, Africa and South America, as well as unconventional assets – oil sands, shale oil and coal seam gas – in North America and Australia.

Kerogen invests with one eye on potential exits to these companies or their regional counterparts. "Energy security is increasingly a driver for many Asian NOCs and from an early stage our team has been involved in advising them on their investment strategies," says Cheng. "As a result, we believe we have a solid understanding of the strategic, commercial, operational and financial drivers influencing many of the decisions."

Energy-focused GPs from North America admit that they don't think of Asia specifically when making energy investments because demand patterns are more of a macroeconomic issue – if commodity prices rise, investors will benefit regardless of the principal drivers. However, there are two PE poster children for upstream deals in emerging basins: Kosmos Energy, a West Africa-focused oil producer backed by The Blackstone Group and Warburg Pincus, which completed a $594 million IPO in May 2011; and Cobalt Energy, a company created by Goldman Sachs, Riverstone and The Carlyle Group that has interests in the Gulf of Mexico and Africa, and raised $850 million when it went public in 2009.

Established energy investors note that there is tendency to become preoccupied with the few winners and forget the many losers. Upstream development involves a number of factors over which the GP only has so much control, particularly political risk, availability of infrastructure, and geological surprises and the impact these have on the cost of services.

"Upstream is more risky than downstream or power generation, because in these areas you get contracts with credit-worthy counterparties that support investment over time," says Lucius Taylor, vice president at ArcLight, a US-based GP that invests in assets across the energy sector. "With upstream work, you put money into a well and it either produces what you expect or it doesn't. It is more volatile and you tend to look for much higher returns."

There are several ways to minimize this risk. A number of US private equity firms stick to geographies with which they are familiar, principally onshore and offshore North American basins. There is often a reluctance to enter OECD member countries because of less certainty over legal and regulatory structures.

Allaying upstream concerns

The approach advocated by Kerogen and Standard Chartered Private Equity (SCPE) among others is to avoid early-stage assets more suited to venture capital investors, where the historical average for exploratory success is around 10%. Instead, they focus on companies that

Energy by numbers: The rise of Asia

Emerging Asian demand is the dominant energy theme of the past 10 years. The resources required by the likes of China and India to fuel rapid economic growth have sent commodities prices to record highs and seen major exporters reap massive windfalls. The rise of mineral-rich Western Australia alone is testament to the power of this theme.

In terms of oil and gas, China attracts the most attention, as its national oil companies (NOC) pursue assets in the former Soviet Union, Africa and South America, often engaging in government-to-government oil-for-loans transactions. China's oil demand is a significant factor on its own – its share of global demand is expected to reach 15.5% in 2035 from 10.5% in 2010, with imports likely to double to 12.9 million barrels per day – but non-OECD Asia is equally important.

That group of nations imported 16.3 million barrels of oil per day in 2009; by 2035 it will be 30 million, according to the International Energy Agency (IEA). A more recent trend is an increasing appetite for alternative energy assets such as oil sands, shale-based gas and coal seam gas to complement conventional reserves.

"When you look at the OECD nations, there will never be growth in oil demand at this point. We are also discovering ways of producing liquidity using horizontal drilling and fracking [hydraulic fracturing], which will increase oil and gas output," says Jonathan Farber, co-founder and managing director of US-based private equity firm Lime Rock Partners. "Consider long-term demand for oil and gas without Asian demand and it's a pretty barren scenario."

Led by NOCs from China, Korea and Thailand, outbound oil and gas acquisitions in Asia Pacific reached $46.1 billion in 2011, up from just $12.5 billion five years ago, according to Thomson Reuters.

While private equity accounts for a tiny part of global M&A in the sector, up until the global financial crisis, fund sizes were increasing. First Reserve's 2007-2008 vintage fund came to $12 billion, $4.2 billion more than the previous vehicle, while Riverstone saw its fund size more than double to $10 billion over the two periods.

For 2008, Preqin has records of final closes by 20 vehicles with a significant focus on energy (excluding cleantech) raising a total of $13.2 billion. This fell to $1.7 billion from five funds in 2011. With several of the global buyout firms – for whom the energy sector is a rich source of large-ticket transactions – looking to raise large funds for the first time since the financial crisis, investor interest is likely to increase.

Asia is still very much a poor relation of the US in terms of energy fundraising. Between 2008 and 2012, 28 US-based funds attracted capital commitments of $24.7 billion. In Europe it was just $1.9 billion, while the rest of the world – dominated by Asia – accounted for 13 funds and $4.9 billion.

have already discovered reserves and require additional capital to develop them. This might be an emerging shale player that has acquired assets and is in the process of running tests and drilling initial wells.

The capital commitment might be no more than $150 million, well below the threshold for NOCs but within the range of a $1 billion private equity fund. Co-investors are often brought in to provide further funds as the asset is developed. "There is generally more alpha to be captured in taking assets up the development curve than in acquiring stable producing assets which by definition tend to be more exposed to beta," Cheng adds.

Finally – and this is common to all energy-focused PE players, regardless of their particular targets – risk is reduced by backing management teams with which the GP is familiar. First Reserve's track record in Asia is a prime example. Its first investment in the region, Australia's Whitehaven Coal, came through a company called AMCI Capital. Two executives who spun out from AMCI then introduced the private equity firm to its next portfolio company in the country, mining services provider Calibre Global.

It was a similar process with KrisEnergy, a Southeast Asia-focused oil and gas exploration and development player that First Reserve acquired for $500 million in 2009. The team behind KrisEnergy had previously set up Pearl Energy under exactly the same business plan and the company went on to list in Singapore. The founders exited in 2008, selling to Abu Dhabi sovereign investor Mubadala, which beat First Reserve to the deal.

"When we wanted to start KrisEnergy, we went to people who had made money from Pearl or missed out on making money from it. First Reserve was in the latter category," says Richard Lorentz, the company's business development director. "They knew our business plan and they knew us. We went from initial contact in March 2009 to agreeing a deal structure within a couple of months."

Long-term gains

The benefits of familiarity with management are also felt long after the ink has dried on the contract. Operating upstream oil and gas assets requires rapid decision-making based on updates concerning the performance of different wells. Ultimately, private equity investors in control positions must pass judgment on the commercial viability of an asset: Do you stick and put in more capital, or twist and move on to something else?

"You need a management team capable of making decisions, because you can't spend all your time at the asset itself," says ArcLight's Taylor. "You are constantly trying to fill a hole because the more you produce, the smaller your reserve, so you need to drill more wells."

An investment in a start-up or early-stage oil and gas company is also an investment in the management team's ability to acquire assets in a particular geography. In addition to geological expertise, this requires a network of relationships with local governments, regulators and other operators that takes years to construct. It is no coincidence that the founders of many independent developers globally have previously served as senior regional executives for the oil majors.

KrisEnergy has been around for two-and-a-half years, during which time it has built up a portfolio of 14 exploration licenses covering Vietnam, Cambodia, Thailand and Indonesia. Given that tender and bidding processes in Southeast Asia can last 1-2 years alone, the company believes it has made rapid progress. It puts this down to the management team's long experience in the region.

"In general industrial sectors, we can manage our investments and bring in consultants if needed, but for oil and gas and mining, dedicated expertise is required," says Alastair Morrison, co-global head of SCPE. Natural resources is Standard Chartered Bank's single largest sector globally and it has considerable experience in areas such as reserve-based lending, but SCPE recently hired an executive with a natural resources background from the industry in order to provide technical expertise and assess investment opportunities.

Morrison adds that it would be difficult to function without people on the ground in the relevant geographies. He cites Nigeria, where SCPE has made an onshore gas investment, as an example. "Local knowledge is vital. There is one state that you wouldn't enter without a flak jacket, but two states down, it's fine for a guy like me to drive around in a jeep. You also know which state governors you can do business with."

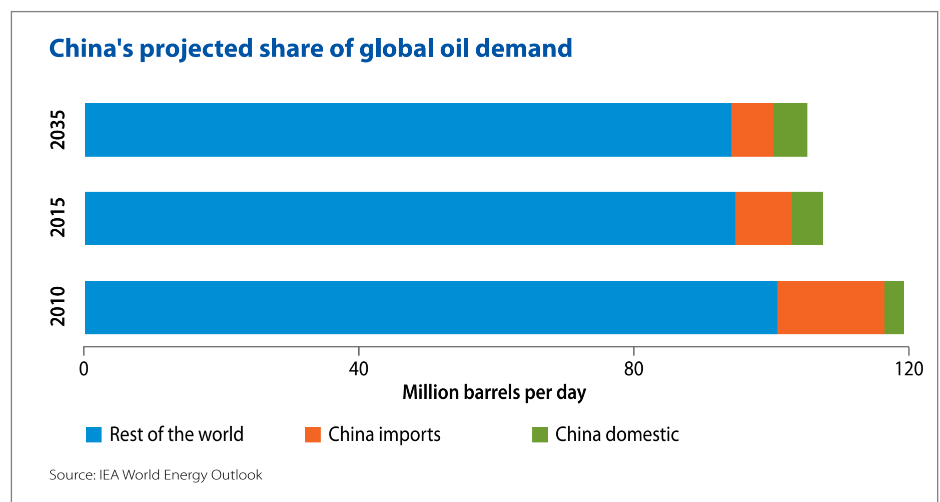
Diversification challenges

The challenges of assimilating to a variety of different operating conditions mean that relatively few private equity firms can operate effectively in multiple geographies. Discount the global firms that have considerable resources at their disposal, and most investors struggle to achieve operational excellence across more than two basins.

This explains the differing perceptions of where the major opportunities lie for private equity. Convincing cases can be made for deepwater exploration (taking advantage of new technologies in seismic imaging and remote operations), North American natural gas (leveraging the multiple arbitrage created by US LNG prices that are one fifth of global rates), European shale (less developed than in North America but full of potential) and emerging basins in non-OECD countries. Executing strategies, however, relies on recruiting people with capabilities in particular areas.

For all the interest that Asian private equity firms have shown in oil and gas, the vast majority are still in the process of building up their expertise.

"I have been approached by a plethora of private equity firms with an appetite to explore the water and stick a toe in oil and gas," says KrisEnergy's Lorentz. "A major reason for this is oil prices above $100 per barrel, but this has also generated a lot of competition. The environment has become increasingly difficult in the last 2-3 years: If you start out now with a pile of money and a blank sheet of paper, you might struggle."



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Indian family offices add to GPs' options

An increasing number of Indian PE firms are tapping local family offices for capital. Will this new wave of investors stick with the asset class in the long term?

"OUR HEAD OF BUY-SIDE IS SOMEONE who's done private equity since the 1990s in India and previously worked for an international GP. We have another team member who used to be in charge of a $400 million distressed PE fund. We understand how the cycle works, how fund investing works and so we're able to remove some of the marketing froth."

These are not the words of an executive from a global fund-off-funds; they were spoken by the founder an Indian family office. Altamount Capital is the first independent dedicated multi-family office in the country, and part of a new breed of professional operators managing investments for a growing population of high net worth individuals (HNWIs).

Families represented by the firm have backed several PE funds, including education investor Kaizen, Multiples Private Equity, agriculture-focused Goldridge, HDFC Realty and IDFC's infrastructure fund.

The way Altamount manages its clients' money – as part of a long-term allocation into asset classes including fixed income, mutual funds, private equity and real estate – is still very much the exception rather than the rule in India. The vast majority of predominantly single family offices still invest on an ad hoc basis, often relying on the advice of accountants or stockbrokers rather than executives with experience in alternative assets.

"In normal global practice, family offices typically function like any other LP," says Navin Kumar, director of fundraising and investor relations at Mumbai-based private equity firm Milestone Capital. "They don't exist in India as of now. The family office concept here is in its infancy; it's taking shape."

Investors by elimination

In spite of this, an increasing number of local PE firms have begun to turn to family offices for capital. Perhaps the primary cause is the continued strait-jacketing of the asset class' biggest potential domestic contributors. The Indian state controls all of the country's pension funds, banks and insurance companies, and thereby ensures that no more than 10% of their assets under management can be invested in equities of any kind.

Family offices – which aren't subject to this kind of government regulation – are therefore an attractive source of capital for those without the resources to focus all their fundraising efforts overseas. Add to this the simultaneous rise in the family wealth – almost 70% of the listed stocks in India are now family-owned, and the Capgemini Merrill Lynch Asia Pacific Wealth Report found that Indian HNWIs were worth $582 billion in 2010, almost double the 2008 figure – and it has a compounding effect.

> "In normal global practice, family offices typically function like any other LP. They don't exist in India as of now. The family office concept here is in its infancy" – Navin Kumar

"There is more money with families, and there are more families with money in India," says Samir Inamdar, co-founder and CEO of Bangalore-based GP Forum Synergies. "Rather than traditional old business families, there are a lot of newer families who have more money as surplus for investment, such as the proceeds from their holding in the IT company they work for."

Milestone Capital, which has raised capital from family offices for its seven private equity and real estate vehicles, was one of the firms that kick-started this trend. Back in 2008, the firm decided to attract more Indian retail households as LPs by bringing down the minimum threshold levels for subscription to its funds from $1 million to a mere INR1 million ($19,000). The bulk of its counterparts in the industry followed suit. "Obviously it gave us an advantage: each time I'd go out and bring about 3,000-6,000 investors into my fund, and four years later, we have an investor base of more than 17,000," says Kumar.

As Milestone and many other firms have since discovered, having family offices on board can be an advantage in itself. Their greater receptiveness to the concept of private equity when compared with some commercial institutions and their speedy decision-making processes are key factors in this respect.

How big an appetite?

But how interested are the family offices themselves in participating in private equity? Appetite clearly fluctuates from sector to sector, but in general, areas that fall outside the easily accessible listed space, or pose unique investment challenges, are favored when it comes to selecting a GP. Industries such as agriculture, technology and education are all subject to challenges and regulations, and so family offices often prefer to invest via an experienced private equity or venture capital firm that seek direct exposure to the assets.

Additionally, the changing nature of wealthy Indian families – from custodians of old money to groups of professionals with hands-on experience running businesses – means that family offices are increasingly prioritizing operational ability among fund managers. "What they value is operating expertise and track record," agrees Inamdar of Forum Synergies, which first raised money from Indian family offices in 2009. "That's one of the reasons our fund is very attractive for them – we bring to the table strong business leadership and an operating track record."

Indeed, some family offices have become so comfortable with running their own businesses, that the prospect of investing with a GP can be overshadowed by the lure of direct deals. The Singh brothers, for example, sold Ranbaxy to Daiichi Sankyo five years ago and have since expressed no interest in participating in private equity, instead reinvesting the billions they made from the sale in building out a hospital business and a financial services business. And the Piramal Group, run by Ajay Piramal, has even set up two of its own PE vehicles, a real estate fund and a healthcare fund.

The concern for Indian GPs is that many family offices still haven't yet decided whether they would be better off buying a property or company on their own rather than making an investment via a third-party fund. A number of the industry's current backers could be treating their fund commitments as an opportunity to learn industry best practice with a view to going it alone in the future.

Were this to happen, however, it is unlikely that GPs and family offices would end up chasing the same kinds of assets. Richa Karpe, who co-founded Altamount Capital in 2008, argues that investment strategies are sufficiently differentiated that there is little chance of direct competition. "Funds are looking at a scalable business that can create a valuation multiplier in the next four years because that's their average holding cycle," she explains. "There are some businesses that need much more patient capital and longer holding life cycles, which means PE firms can't look at them."

There are also cases in which one or other investor type would be ruled out automatically by the wishes of the promoter – one might demand a strategic investor with knowledge of education or entertainment or sport, for example, while another might want PE capital to scale up and increase the valuation. It's therefore conceivable that rather than representing even more bodies in an already crowded investor space, an influx of direct-investing families could instead offer a new potential exit to players on either side of the fence.

India PE returns snapshot

	Investment amount (US$m)	Exit amount (US$m)	Weighted IRR	Median IRR	Cash multiple	Ave. holding period (years)	SENSEX IRR
Total Sample	5,120	12,193	17.9%	7.7%	2.4x	3.4	14.4%

Note: All IRR and cash multiples are presented on a gross basis
Source: Bombay Stock Exchange, KPMG in India analysis

Skeptical views

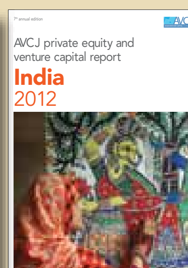
Another, broader, concern is that like LPs from other categories and geographies, Indian family offices have been starting to regard the local private equity industry with a certain amount of skepticism. The lack of vintage diversification among Indian PE funds means that the entire industry is being affected by the same macroeconomic issues and so far few vehicles have borne the fruits of great returns.

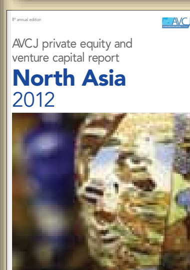
Unlike internationally, where fixed income returns are 2-3%, and listed market returns have been muted, fixed income products in India generate returns of 10-12%. As a result, some question the value of investing in an illiquid and comparably risky asset class that produces only moderately superior returns. A number of firms have attempted to reverse the widespread apprehension about returns by introducing higher hurdle rates at which the carried interest fee is taken – typically 14% rather than the industry standard of 8%.

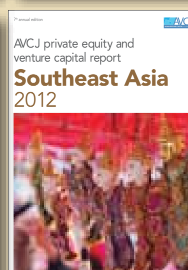
When it comes to Indian PE firms' ability to rely on fundraising from local family offices in the coming years, much will depend on the performance of existing vehicles. Indian families may be the most nascent of LP categories, but this watchful gaze trained on domestic players is what unites them with far more experienced LPs across the globe.

"The next few years is really going to be the big thing where all LPs look at GP teams to see what success they can bring," adds Karpe. "If they are successful, then people are going to give capital, there's no doubt about that."

Asia has over US$318 billion in private equity funds under management







* as of September 30, 2011. Source: AVCJ

Just where and how are these funds distributed? Read all about it in *AVCJ Private Equity and Venture Capital Report*, the annual series of regional reports by the leading source of information on Asian private equity, venture capital and M&A.

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China property firms turn to PE as lender of last resort

Tightening policies imposed on Chinese real estate developers in recent years have accelerated the appetite for alternative financing channels. It represents a massive opportunity for private equity

PERHAPS MORE THAN ANY OTHER SECTOR in China, real estate is the prisoner of policy headwinds. With few investment options and bank deposit rates that lag inflation, property investment is the default destination for many people's savings. This creates an incredibly volatile market and the government is constantly dialing up and down regulation in a bid to control prices.

The economic stimulus measures implemented in the wake of the global financial crisis including a credit boom that property developers used to rollout massive expansion plans. The ensuing hangover – best described as a relative claw-back in liquidity – continues to this day. More than a few real estate firms are turning to private equity to fill the gap.

"I expect the tight liquidity environment for Chinese developers to remain in the next few years," Stanley Ching, senior managing director and head of real estate group of CITIC Capital, tells AVCJ. "While volume of real estate market has been expanding at a rate of 20-30% every year, the growth of capital market for real estate sector is in no way comparable; this opens the window for private equity funds to support such demand-supply gap."

Chinese real estate developers have been traditionally highly-leveraged. According to HSBC, industry participants' average net gearing ratio reached more than 60% last year, up from 40% in 2009. However, a combination of macro cooling measure such as interest rate cuts and hikes in bank reserve ratios and policies specifically intended to reduce real estate lending, has denied these firms their primary source of capital. Attempts to carve out new funding channels, particularly through products issued by trust companies, have also been thwarted by regulators.

Growing distress

An obvious result of such tightening is the growing number of distressed developers. Some small- and medium-sized players have overextended themselves in recent years and are now having difficulty meeting their debt obligations, with a raft of trust products due for repayment in the coming months. Worse still, a number of these developers cannot guarantee returns from pre-sales to repay loans due to slowing property prices. According to Standard & Poor's, average housing prices are likely to drop 10% during 2012.

It is, however, an opportune time for private equity real estate funds. The likes of SoTan China Real Estate Fund, a $400 million vehicle co-managed by Tan-EU Capital and ShuiOn Construction and Materials (SOCAM) represent a much-needed alternative source of capital, so they can negotiate favorable economic terms. The fund just made its first investment last month, acquiring a 102,000 square-meter site in Tianjin's Wuqing district at a 20% discount to market value.

"The current distress has allowed us to purchase assets at attractive pricing and we are looking at discounts as much as 40%-45% in some instances," says James Buckley, executive director of fund management at Tan-Eu Capital. "The restrictions imposed by the government, coupled with tighter bank lending and narrower cross border financing channels have caused developers' balance sheet position to deteriorate. This provides good opportunities over the next 12-18 months for private equity."

While trust products are relatively short-term and more risky, the longer-term horizons of private equity encourage the development of a more mature property market in which developers can rely on consistent sources of funding to support on-going projects.

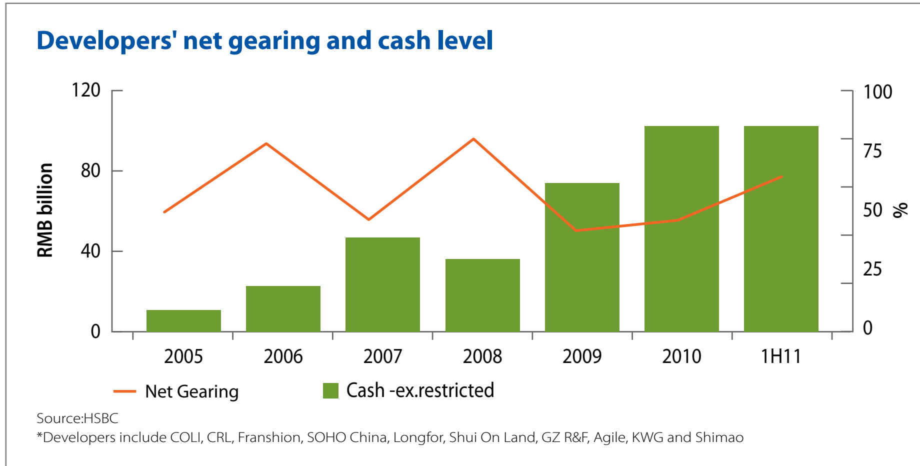
Mass participation

SOCAM is not the only Hong Kong-listed real estate company to partner with private equity funds. China Overseas Land & Investment has teamed up with Industrial and Commercial Bank of China (ICBC) to launch a $500 million vehicle targeting residential property and have reportedly raised $230 million for the new vehicle in February. The move comes after they closed their first joint-fund in 2010 at $286 million.UBS has also partnered with Gerndale, one of China's biggest developers, to establish a $100 million real estate fund.

These arrangements allow developers to leverage their balance sheets while the private equity firms– which don't always have people on-the ground – are taking advantage of their partners' local networks and expertise.

"Developers often borrowed short-term capital in the old days: they built and sold quickly before returning money to their lender within a year or two," says CITIC Capital's Ching. "The market is getting mature that they now realize the importance of long-term money in their capital structure."

More importantly, with the US and Europe



Source:HSBC
*Developers include COLI, CRL, Franshion, SOHO China, Longfor, Shui On Land, GZ R&F, Agile, KWG and Shimao

struggling, China is one of few large-scale markets globally that can be relied upon to deliver long-term positive returns. For all the recent concerns about China's slowing economic growth, urbanization and industrialization – which contribute to rising incomes – will continue to support the property demand for years to come.

According to Jones Lang LaSalle, foreign private equity investment in Chinese real estate reached $6.75 billion last year, compared to $3.95 billion in 2008 and $4.55 billion in 2007, before the global financial crisis

CITIC Capital was one of the first movers among private equity firms, making its first investments in 2005. Its first two funds – CITIC Capital China Property Fund and CITIC Capital Vanke China Property Development Fund – were fully exited, while the $400 million CITIC Capital China Real Estate Investment Fund III is also fully invested. The firm reached a first close of $250 million last November on its fourth fund, which is targeting $600 million. It will focus on retail properties.

"While residential market has witnessed more policy risks and competition, there is great potential for retail property investments because there are only a limited number of developers in this area and many cities are requiring better retail infrastructures," says Ching. He adds that there are significant opportunities in Beijing and Shanghai office properties..

Unfulfilled potential

Although private equity has been increasingly important to the local real estate market, it could be argued that the asset class can't fulfill its potential until renminbi-denominated funds grow in prominence. Noah Holdings, the Shanghai-headquartered third-party financial advisory company, is trying to make a breakthrough, seeking to raise a RMB18 billion ($2.85 billion) real estate fund from its network of high net worth individuals (HNWIs). As it stands, though, the leading PE real estate funds in China are all US dollar-denominated, according to AVCJ Research.

> "The market is getting mature, so developers now realize the importance of long-term money in their capital structure"
> – Stanley Ching

"The LP base of renminbi-denominated funds are predominantly HNWIs who are mostly aggregated by either bank or trust companies," says Rachel Renuccci-Tan, CEO of Tan-Eu Capital. "These are short-term investors eager to recover a quick return on their capital, and they would therefore find the 6-7 year fund life of a typical private equity fund too long."

Meanwhile, domestic institutional investors are still not ready for real estate private equity investments. The legal structures are in place to allow insurance companies to invest up to 10% of their assets into property sector, but the insurance regulator has yet to implement the policy. At the same time, major state investors such as the National Council for Social Security Fund (NSSF) have no plans to invest in property to the property market – unsurprising, given the sector is not favored by the central government.

"Ultimately domestic insurance companies will be the major source of long-term capital for the property market, just as in other countries they are a major owner of real estate assets. " says Michael Klibaner, head of research for Jones Lang LaSalle in China. "This is because of a natural fit for asset liability matching."

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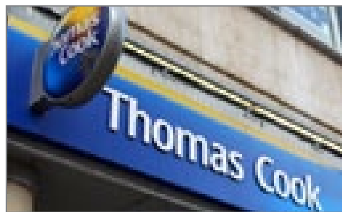
Fairbridge buys Thomas Cook India for $150m

THOMAS COOK HAS NOW SOLD ITS INDIA business twice in the space of six years. The asset was first offloaded to Dubai Financial in 2005 as a package deal including licenses to operate the brand in the Middle East, as Thomas Cook divested non-core assets to focus on Europe. Two years later, the company performed an about-face and decided to expand in emerging markets. It bought back a controlling stake in Thomas Cook India plus the Middle East business.

Now the India business has changed hands once again, though not in circumstances the parent company would wish. As India's largest integrated foreign exchange and travel services operation, with an EBITDA of INR562 million ($10.1 million) in 2011, Thomas Cook India is a cash cow – but this also made it a prime asset for sale as the parent sought to reduce its GBP1.2 billion ($1.9 billion) debt burden.



Thomas Cook is the second-largest travel firm in Europe

Fairbridge Capital, a subsidiary of Canada's Fairfax Financial Holdings, emerged the victor from an intensely competitive bidding process, paying INR50 per share – or INR8.17 billion – for a 77% stake in the company. This represents an 11% premium to the stock's trading price when the auction was announced in February.

"We take a very long-term perspective on this investment because we are not required to sell within a certain period of time," Harsha Raghavan, head of Fairbridge, tells *AVCJ*. "We see this is as a platform for long-term value creation in India."

Fairfax Financial has approximately $34 billion on its balance sheet, which offers ample dry powder for Fairbridge's India investments. This is the first capital deployed since Raghavan joined the firm last summer. A former executive at Goldman Sachs and head of India for Candover, he set up his own operation, Steer Partners, in 2009, but struggled in a difficult fundraising environment. Fairfax Financial's past investments range from pulp and paper to children's toys, and Fairbridge has a similarly wide remit.

Securing the Thomas Cook India stake meant fighting off competition from various interested parties. KKR, The Carlyle Group, Everstone Capital, Actis, TA Associates all reportedly submitted bids, as did UK foreign exchange specialist Travelex and Chinese travel group HNA. Fairbridge plans to retain the existing management team, led by CEO Madhavan Menon.

AZB & Partners and Shearman & Sterling provided legal advice to Fairbridge, while PricewaterhouseCoopers and Pioneer Investcorp served as financial advisors.

As for Thomas Cook, it has given up a foothold in one of the world's fastest-growing tourism markets in order to buy time with its creditors. The company has also agreed to sell hotels in Spain and France, but these don't boast the history of Thomas Cook India, which started out selling passages to and from the UK to maharajas and nabobs in the late 19th century.

PE giants exit AMC to Chinese investor

Dalian Wanda Group's ambitions appear to know no bounds. Last week the conglomerate completed what could be the largest ever Chinese takeover of a US company, paying $2.6 billion for AMC Entertainment. Wanda's goal is to unite AMC's movie theater chain with its own and create the world's largest theater network. It is willing to invest an additional $500 million in AMC to reinvigorate the business.

Amid these lofty ambitions, it is easy to forget that the AMC sale represented a much-needed exit for the firm's five private equity owners who had held the asset for eight years.

Back in 2004, when the US economic climate was markedly different, Apollo Global Management and J.P. Morgan's private equity unit (now known as CCMP Capital Advisors) completed a $2 billion buyout of AMC. One year later, the company merged with Loews Cineplex Entertainment, a cinema chain owned by Bain Capital, The Carlyle Group and Spectrum Equity. The three firms had bought the asset from Onex and Oaktree Capital Management in 2004 for $1.5 billion.

The merged entity became North America's second-largest cinema operator. Apollo and CCMP held 60% of the business with Bain, Carlyle and Spectrum in possession of the remaining 40%.

Although AMC is expected to turn a profit in 2012 due to stronger ticket sales, the past few years have seen a string of losses. This hampered the private equity firms' exit plans; attempts to float the business in 2008 and 2010 both floundered. With the funds approaching the end of their investment cycles, Wanda entered the fray.

Wanda is preparing to replicate AMC's business model in China

Merger talks started in July 2010 and the protracted negotiations suggest the parties originally had very different valuations in mind. The private equity investors reportedly ended up earning $500 million on the deal, which isn't much to show for an eight-year holding period, given the size of the asset.

"It's a win-win transaction; Wanda has growth objectives both within and outside China," says Eliot Merrill, a managing director at Carlyle who sits on the AMC board. "We invested for the long-term but ultimately our investors expect an exit. The fact that Wanda is a Chinese company does not concern us and they are a logical next investor in AMC."

Wanda, which has $16.7 billion in annual revenue, focuses on commercial properties, including cultural businesses, notably 86 movie theatres with a total of 730 screens. It sees the AMC acquisition as a vehicle for wider US exposure.

"We can leverage their [AMC's] experience to help replicate aspects of their operating model in high-growth markets such as China," Wanda tells *AVCJ*. "AMC can also be a platform for Wanda to eventually expand in the US in other sectors, for example in commercial property development, hotels, retail or other activities."

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Good morning Vietnam

Dragon Capital's Dominic Scriven settled in his adopted country of Vietnam when it was still a frontier market. Twenty years on, he remains active in the country's private equity and cultural communities

Most people associate the name Dominic Scriven with Vietnam because of Dragon Capital, the investment group he co-founded there in 1994. A growing contingent of followers, though, knows Scriven as the man who built one of the world's largest collections of Vietnamese propaganda art.

The collected works, known as The Dogma Collection, consist of hand-painted pictures spanning the era from 1960 to 1980. They've since been exhibited in as faraway locations as the National Gallery of Prague, but the inspiration for Scriven's archive efforts came while he was studying slightly closer to their origin, in Hanoi, during the final years of the US trade embargo on Vietnam.

"One of the things that I was very aware of when I was in Hanoi was that there wasn't a lot of color in the streets, and much of the color that did exist was political art, in the form of propaganda," he recalls. "I did some work to understand it and it became clear that nobody was really motivated to preserve it. It's art, though, and politics, and history, so I think it would be a real shame if that were lost, for both Vietnamese and international posterity."

Artistic license

Having grown up along the Welsh border as the son of a management consultant and a mother who worked in tourism, Scriven's interest in the arts first came alive during his time at Exeter University, where he studied law and sociology. There he participated in the drama society, which produced plays that included an interpretation of Ingmar Bergman's The Seventh Seal in a London park. "There was zero audience," he recalls, "which is why I didn't follow it as a career. I was worried of having no audience."

The world of fund management did strike him as a sustainable career move, however, so after graduating, he moved to London to take on the role of assistant portfolio manager for Asia ex-Japan for M&G, the company responsible for bringing the concept of unit trusts to the UK. After two years spent "shoveling sugar into people's coffee" and filing the company notes, he sought greater stimulation and decided that a move across the world to Hong Kong was the way to do it. There a 24-year-old Scriven sold and researched Asia ex-Hong Kong and Japan equities, companies and funds for brokerage

Vickers da Costa by day, but by night he embraced amateur dramatics again as a member of the Hong Kong Garrison Players, one of the city's longest-running theatre groups.

Two years on, Scriven and his colleague were recruited by Hong Kong finance corporation Sun Hung Kai, where he held the role of investment director and was responsible for raising capital for several Asia-focused mutual funds. In 1991, when his contract ended, he rejected the prospect of following his contemporaries down the MBA route, and instead embraced a burgeoning interest in Vietnam's cultural heritage by signing up to study Vietnamese in Hanoi.

Surrounded by Japanese businessmen, Asian missionaries and scholars from other Communist-sympathizing states such as Cuba and Russia, Scriven studied under a professor of Laos linguistics during a two-year stint, which was to become to the precursor to a 20-year stay in the country.

Taming the dragon

His mastering of the Vietnamese language became useful when, in 1994, he became part of the founding team of Dragon Capital. The following year Dragon launched its first vehicle, with $16 million in committed capital. Although the US embargo had by then been removed, the local investment environment remained fraught.

"There were very strong similarities with the way that Myanmar is now, because you had this

> "There were very strong similarities with the way that Myanmar is now, because you had this largely isolated political and business culture and a set of very restrictive obligations imposed from abroad"

largely isolated political and business culture and a set of very restrictive obligations imposed from abroad and then these are suddenly removed and there's a great wave of interest that washes in," he explains. "If you're not careful, though, the expectations on both sides become misaligned and people end up losing money."

For the most part that hasn't been the fate of Dragon Capital, however; on the contrary, Scriven's contribution to financial services in Vietnam was recognized by the British government in 2006, when he was made an Officer of the Order of the British Empire (OBE). The principle impetus for this award, he believes, were his efforts to promote the need for fully-developed scalable domestic institutions, rather than wholly relying on foreign investment.

Scriven may have been in Vietnam for 20 years already, but the decision to remain for the rest of his life appears to be one that's already been taken. As well as managing his art collection, he is founder and trustee of local conservation charity Wildlife At Risk and sits on the board of companies including Vietnam Dairy Products, Ho Chi Minh City Infrastructure Investment and Saigon Commercial Bank.

"This part of the world is growing," he says. "To people in Hong Kong, I think it still looks quite small, but we've become investors in Laos now, we're investors in Cambodia, and the Mekong sub-region is likely to remain the big key to what we do."

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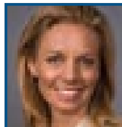
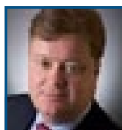


Tara Blackburn
Managing Director
HAMILTON LANE

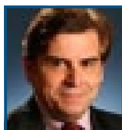
Jonathan E. Colby
Managing Director
THE CARLYLE GROUP

Jim Hildebrandt
Managing Director
BAIN CAPITAL ASIA

Peter Keehn
Global Head of Private Equity
ALLSTATE INVESTMENTS, LLC

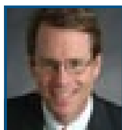


Grant Kelley
Co-head of Asia Pacific
APOLLO GLOBAL MANAGEMENT

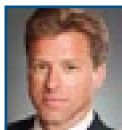


Bill Pearce
Director, Private Equity
OVERSEAS PRIVATE INVESTMENT CORPORATION (OPIC)

Robert Petty
Managing Partner & Co-Founder
CLEARWATER CAPITAL PARTNERS



Thomas Smith
Managing Director
LOMBARD INVESTMENTS INC



Scott C. Voss
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