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A new, improved AVCJ Awards

AS ASIA'S PRIVATE EQUITY MARKET DEEPENS AND BECOMES

more diversified in terms of asset class, deal size and structure, and geography, the way we assess performance has to evolve. The AVCJ Awards are and must remain limited in number – it is vital to their exclusivity and quality – but they must also accurately reflect private markets activity in the region.

We were faced with a choice: expand horizontally, adding other country awards to our existing China and India offering; or expand the flagship Asian awards vertically, to include a wider variety of fundraising and investment categories. We chose the latter approach. It is our view that the industry is not yet ready for the full array of geographical awards; as it stands, certain sub-regional markets that lack sufficient depth. We will revisit this position in time.

And so for 2014, we introduced a larger AVCJ Asia Awards. There were not categories for different geographies, but categories that acknowledged the quality work done across the region by firms of different sizes. No more would the \$400 million single-country growth fund be pitted against the multi-billion-dollar pan-regional buyout vehicle for Fundraising of the Year; separate categories were created for venture capital, mid cap (below \$1 billion) and large cap (above \$1 billion). We took the same approach for investments (venture capital; mid cap, investment size below \$100 million; large cap, above \$100 million) and liquidity events (IPO; mid cap exit, investment size on entry below \$200 million; large cap, above \$200 million).

Two things remained unchanged. First, the AVCJ Awards were limited in number; there are no plans to offer prizes across 50 categories. This was also one of several factors considered in deciding against introducing categories for service providers. Second, the judging process continues to reflect the combined views of the private equity and venture capital community, our panel of industry experts, and the AVCJ Editorial Board.

Submissions were invited throughout September and, once again, names were put forward on behalf of third parties as well as directly. Individual firms were restricted to one submission per category. All submissions had to relate to fundraising, investment and exit activity over the 12-month period ended September 30, 2014. The entries were evaluated by the AVCJ Editorial Board and a long list was created.

The judges assessed the AVCJ Editorial Board's long list and had the opportunity – if they wished – to review original submission papers and propose alternative candidates. Their collective recommendations formed the basis of the final shortlists drawn up for each category.

Voting began on September 14 and ran until October 27. The entire private equity and venture capital community was able to participate in the vote, although no more than 10 votes were accepted from employees of a single firm. The results were collated, assessed and final recommendations put forward. The PE and VC community has a 50% say in the outcome, with the judges and the AVCJ Editorial Board each accounting for 25%.

This assessment process did not apply in two categories. The Operational Value Add Award recognizes private equity-driven value creation in an

Asia-based business. It is presented at the discretion of the AVCJ Editorial Board with input from a separate expert judging panel comprising industry professionals who work on the operations side. Given the nature of the category, we were only able to consider submissions accompanied by supporting documentation.

Similarly, the AVCJ Special Achievement Award is presented at the discretion of the AVCJ Editorial Board, although as in previous years, suggestions from the private equity and venture capital community are considered and valued. It recognizes an individual who has distinguished himself or herself in facilitating the growth of the private equity and venture capital industry in Asia.

As in previous years, we are indebted to our expert judges, who made time to participate in the process. For 2014, they included representatives from:

- **Adams Street Partners**
- **Allianz Capital Partners**
- **AlpInvest Partners**
- **Asia Alternatives**
- **Capital Dynamics**
- **Hamilton Lane**
- **HarbourVest Partners**
- **LGT Capital Partners**
- **Morgan Stanley Alternative Investment Partners**
- **Pantheon**
- **Portfolio Advisors**
- **StepStone**

A separate panel was convened for the Operational Value Add Award. It included representatives from:

- **Alvarez & Marsal**
- **Cinven**
- **KPMG**
- **PwC**

The winners were announced at an invitation-only gala dinner in Hong Kong on November 10, preceding the AVCJ Forum. Many congratulations to those who took home the prizes and many thanks to everyone who participated. The number of entries was an improvement on previous years, in part due to the wider array of categories.

We will persevere in our efforts to make the AVCJ Awards relevant, appealing and reflective of the work being done throughout the asset class in Asia. With this in mind, any feedback is much appreciated.

Tim Burroughs

Managing Editor
Asian Venture Capital Journal

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“I have been coming to the AVCJ Awards dinners for many years and all we've ever won is fundraising or Special Achievement. Finally our deals speak for themselves”

– **Stuart Schonberger, CDH Investments**

“When we started we had very modest ambitions. We never thought the buyout business would grow to this size in Asia, so our success is also a testament to the whole industry and everyone who works in it”

– **K.Y. Tang, Affinity Equity Partners**





Roll of Honor

Fundraising of the Year – Venture Capital: Qiming Venture Partners IV (Qiming Venture Partners)

Fundraising of the Year – Mid Cap: Quadrant Private Equity No.4 (Quadrant Private Equity)

Fundraising of the Year – Large Cap: CVC Capital Partners Asia Pacific IV (CVC Capital Partners)

Deal of the Year – Venture Capital: Flipkart (Tiger Global/Naspers/GIC Private/Morgan Stanley Investment Management/DST Global/Accel Partners/Iconiq Capital/Sofina)

Deal of the Year – Mid Cap: IMAX China (FountainVest Partners/CMC Capital Partners)

Deal of the Year – Large Cap: Nanfu Battery (CDH Investments)

Exit of the Year – IPO: Alibaba Group (Silver Lake/China Investment Corporation/Yufeng Capital/CITIC Capital/Boyu Capital/Nepoch CapitalAsia Alternatives/Pavilion Capital/Siguler Guff)

Exit of the Year – Mid Cap: United Cinemas (Advantage Partners)

Exit of the Year – Large Cap: Oriental Brewery (Affinity Equity Partners/KKR)

VC Professional of the Year: Jixun Foo (GGV Capital)

PE Professionals of the Year: David Liu & Julian J. Wolhardt (KKR)

Operational Value Add: Oriental Brewery (Affinity Equity Partners/KKR)

Firm of the Year: Affinity Equity Partners

AVCJ Special Achievement: Victor Chu (First Eastern Investment Group)

“Japan in terms of market size and deal size has not met expectations in many ways relative to the size of the economy. But there are great deals like United Cinemas happening in the mid-market space”

– Richard Folsom, Advantage Partners



“I think we should be seen and do more in terms incorporating the social value creation and the social impact into our value matrix. When we look at projects we look at the sustainability and the social side as well as the monetary side”

– Victor Chu, First Eastern Investment Group

Anatomy of a turnaround

OPERATIONAL VALUE ADD & EXIT OF THE YEAR – LARGE CAP Affinity Equity Partners and KKR made Oriental Brewery the market leader in Korea's beer industry, then exited via Asia's largest-ever trade sale

THE FIRST TIME I.S. CHANG WAS OFFERED

the head of sales job at Oriental Brewery (OB), he turned it down. Chang was a 30-year veteran of Jinro – a soju producer that had been acquired by Hite, OB's direct competitor – having joined the company as a high school graduate. He was not inclined to move but Affinity Equity Partners and KKR, the new owners of OB, were determined to get their man.

"When we asked customers who were the best sales people in the industry, the unanimous response was Jinro. And I.S. Chang was highly recommended, not just as a sales person but as a leader," says an Affinity investment professional closely involved in the deal. "We went to see him three times in order to reassure him that we are value creators, not cost-cutters. It took 3-4 months, but eventually we convinced him to join the team."

That was January 2010, about six months after the private equity firms acquired OB from Anheuser-Busch InBev (ABI) for \$1.8 billion, including around \$1 billion in debt. They turned the longstanding number two player in South Korea's beer market into the number one, and sold the business back to ABI for \$5.8 billion earlier this year for an estimated money multiple of more than 5x.

Chang, who was named CEO of OB towards the end of the Affinity-KKR ownership period, is seen as integral to this achievement. First, appreciating the sensitivities tied to his joining OB from Hite – it is a very clubby industry with little cross-pollination between the two superpowers – Chang was patient in implementing change, ensuring people bought into his approach. Second, supported by a handful of experienced executives handpicked from Jinro, he succeeded in altering the mindset of the sales force.

"Would we have been able to find an I.S. equivalent? The alcoholic beverage industry in Korea has a long history and a strong talent base because many of these businesses were once part of larger chaebol groups," says Chung Ho Park, a director at KKR. "But for what we needed to achieve, I.S. had the right specifications – experience in leading a large sales organization at Jinro and a network in the southern region where we felt the opportunity for growth existed – to push our strategy forward."

In many respects OB bears the hallmarks of

a standard corporate carve-out, with the private equity investors leveraging the advantages of running a business unencumbered by the baggage that sometimes comes from being part of a multinational. But by Asian standards, the size and scale of the turnaround is noteworthy. OB is by some distance the region's largest-ever private equity trade sale exit.

Slumbering giant

Affinity and KKR acquired the business through a competitive process but there were fewer participants than might have been expected. A number of strategic investors, still grappling the fallout from the global financial crisis and keener on brewers in developing markets than

OB's overall share was stuck on 41%. The Cass brand retained a strong following in metropolitan Seoul and the surrounding areas, but in the south of the country OB's market share was in the teens and low 20s. Under InBev, the company launched a number of forays into the southern region, but to no avail. This was Hite's home territory.

Stephen Ko, a director at KKR, offers a US analogy, comparing the situation to St Louis-based Anheuser-Busch trying to expand into the Miller stronghold of Milwaukee. However, this did not make OB an unappealing proposition. KKR sees beer as the one of the most attractive sub-categories in packaged consumer goods globally with great margins and market dynamics.

And both Affinity and KKR recognized in OB the potential to make some real headway. Cass already had momentum, winning favor with younger drinkers; the production facilities could use additional capacity; the OB brand had strong equity and was ripe for rejuvenation. Above all, the company was the junior partner in a duopoly and had one, gaping weakness – the south. Find ways to address the market positioning and shore up the distribution network, and the balance might be redressed.

"ABI is a skilled operator of businesses and is renowned for driving operational efficiency," says Ko. "But given that Korea is a mature, lower-growth market and OB already had a strong share ABI was more focused on generating cash flow than on driving growth. The management team wanted to pursue growth opportunities, and under our ownership, we built on the strong foundation put in place by ABI, brought in new investments to areas like sales and marketing and helped OB launch its first new products in several years."

Changing the mindset

The sales team was one of the first areas the new owners focused on, with Chang's appointment a key part. The vast majority of beer sales to bars, restaurants, mom-and-pop stores and even large-format retailers in Korea are channeled through approximately 1,400 wholesalers. They wield considerable influence not just over which beers a shop stocks but also how promotions are targeted at customers.

Certain elements of the wholesaler community are partisan in nature. Former



Baker & McKenzie's Ai Ai Wong presents the Exit of the Year - Large Cap Award to C.J. Lee of Affinity (center) and KKR's Stephen Ko

the relatively mature South Korea, declined to participate.

ABI was also a highly-motivated seller. Eight months earlier InBev acquired Anheuser-Busch for an aggregate \$52 billion, creating the world's largest brewer but also a debt burden that proved difficult to manage. A period of divestments and deleveraging ensued. OB was deemed surplus to requirements, perhaps in part because the company had failed to make inroads into Hite's lead.

Established in 1933, up until the late 1980s OB was the clear leader, its eponymous brand holding a 70% market share nationwide. By the time InBev bought the business in 1998, this brand's share was on a downward spiral that would take it into the low single digits.

Even though the Cass brand was on the rise,

executives from OB or Hite might get into the wholesale business and remain loyal to their former employers. Others are more open-minded. OB's sales force simply wasn't getting out on the road and building relationships with wholesalers and as a result the company was losing a lot of goodwill.

"OB sales people were seen as number crunchers and not wholesaler-friendly. When new pubs were opening up, the owner would ask which beer they should bring in and the wholesalers would recommend Hite," says the Affinity professional. "The Jinro executives we brought in had a very different style – they were meeting people, emphasizing the personal touch, and going the extra mile. Gradually the existing sales people's mentality changed and this helped transform the sales force and the company into what it has become."

The transformation was supported by efforts to ensure data were being used properly. KKR's Park describes the process as follows: A sales rep was visiting a hypothetical, longstanding OB wholesale client that bought 700 bottles of beer each month; the challenge was how to get the order to 710 bottles.

The revised approach saw the entire wholesale market divided into clients that should be maintained, potential growth clients, and those whose business was no longer a priority. In this context, a second hypothetical wholesaler came into consideration. A Hite loyalist, he bought 10,000 bottles of beer a month, of which only 10% were OB. But doubling that share to 20% would have a far greater impact on the bottom line than persuading the first wholesaler to stretch to 710 bottles.

Another initiative targeted the incentive structure. Sales executives used to receive a bonus for hitting their monthly targets, based on how they beat those targets by. If an executive was having a poor month and unlikely to qualify for a bonus, sales used to get held over to the following month – essentially giving up the current month's target in order to improve the chances of collecting an incentive the next month. In order to encourage consistency, OB gave its people the chance to win back monthly bonuses if they met their sales targets on a cumulative basis.

"We got them to think about it in 12-month increments rather than one-month increments," says Park. "This gave the sales people more time to build relationships with potential clients."

Capstone, KKR's operations unit, was also heavily involved in the re-launch of two brands alongside a newly-appointed head of marketing. The first was Cass Light, which had previously been trialed but failed to catch on, despite the popularity of light beers in other

markets. A considerable amount was invested into the segment, including signing up several local celebrities with youth appeal to act as brand ambassadors, and the market responded positively.

The OB brand was arguably a trickier proposition given the extent of its fall. The company's previous launches had been unoriginal, with products rushed out in response to moves by Hite. With the OB brand, there was a conscious effort to reconfigure the beer in a relevant way. Cass appealed to the younger demographic so OB was positioned for the more sophisticated beer drinker in his early to mid-30s.

"We changed the taste profile and it went from being a lighter tasting beer to a fuller-

third year we started guerilla attacks – going after pockets of strength where we thought our younger brand profile would work in the southern region. That is when OB's market share began to explode in the region."

By the time Affinity and KKR exited OB, the company's market share in the south was above 40%. In August 2011, OB's overall share of Korean beer sales crossed the 50% threshold for the first time in 15 years. The lead over Hite continued to widen, reaching 67-68% in 2014.

However, it was a costly endeavor to begin with. Engaged in a battle over market share, OB wasn't in a position to increase pricing, while committing substantial resources to sales, marketing and other parts of the commercial

"The management team wanted to pursue growth opportunities, and under our ownership, we built on the strong foundation put in place by ABI, brought in new investments to areas like sales and marketing, and helped OB launch its first new products in several years"

– Stephen Ko

bodied darker beer," says KKR's Ko. "An existing product, OB Blue, emphasized the use of rice as an ingredient so we got rid of that and started using hops, stressing the lager element. It went through about 25 tests with consumers before launch."

Into the south

The brand renewal efforts helped lift customer perceptions of OB as well as internal morale. Further confidence was drawn from a push into the southern region. In consultation with management, the private equity investors devised a three-year, multi-phase strategy for a "south attack." It was based on establishing a beachhead in sales, building a distribution network and accumulating brand momentum.

With Chang and the other former Jinro sales executives on board, OB had a means of reaching out to southern wholesalers, but it was not an easy process. There remained a high level of distrust of OB in the wholesale community, and Hite was threatening to pull its products from wholesalers that decided to do business with OB as well.

"In the first year we made a 1% market share gain but we saw more distribution. In the second year it was 3% but distribution went up quite substantially with wholesalers quietly starting to reach out to us as they began to trust OB once again," the Affinity professional says. "In the

infrastructure necessary to support long-term growth. The private equity firms put \$250 million towards capital expenditure. OB also had to shed excess inventory left by ABI.

As a result, EBITDA margins went down for the first couple of years before rebounding. During the ownership period, revenue grew by 80% reaching KRW1.48 trillion (\$1.3 billion) in 2013, while EBITDA rose 109% to KRW529 billion. There was also a 63% increase in total volumes, a 141% gain in export volumes, and the number of full-time staff went up by 6% to 1,700.

ABI had an option to buy back OB five years after the sale, although a number of rival strategic investors began making inquiries as the deadline approached. The two companies maintained a close relationship while OB was under PE ownership because OB continued to distribute many of its former parent's international products. In part because of this ongoing dialogue, ABI agreed to a deal ahead of the date on which the call option could have been activated.

There were, however, plenty of questions as to how Affinity and KKR had managed to drive a turnaround that had for so long eluded ABI. "Our approach in our discussions with them was to share everything we had and make it clear that it wasn't momentary, it wasn't financial engineering, it was fundamental and sustainable improvements in performance," says Ko. ▀

Breaking new ground

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Beneficiaries of the boom

FUNDRAISING OF THE YEAR – VENTURE CAPITAL Qiming Venture Partners closed its latest fund at \$500 million this year. It wants a bigger slice of a growing Chinese internet market – but so does everyone else

HAVING BEEN ON THE CUSP OF A US

listing two years ago, Chinese online clothing retailer Vancl has experienced a painful reality check. A strategy involving expansion into a variety of categories in order to build up market share clearly failed. Vancl has now returned to its roots, selling high-quality, own brand apparel. A group of VC investors put in \$100 million this year to support the restructuring.

Rather than hang his head in shame, Vancl founder Chen Nian has become a hit on the conference circuit. "He is still giving speeches, telling people about his not so successful story," says J.P. Gan, managing partner at Qiming Venture Partners, which is still an investor in the business. "I just attended a conference and he was the last keynote speaker. His story was, 'I made a mistake but now I'm coming back,' and people loved it."

Gan sees this as evidence of venture capitalists and entrepreneurs' innate optimism. It is a quality that might see Vancl bounce back – e-commerce verticals, from travel to real estate to automobiles to apparel, are expected to prosper in the next phase of the development of China's internet industry – but also arguably contributes to a bullishness that is driving up valuations to potentially unsustainable levels.



Qiming's J.P. Gan (right) with James Lee of SAP

investors. Pittsburgh is small and also fit in well with our healthcare strategy," says Gan. "It was a relatively easy process and we didn't spend time with people we couldn't accommodate. The sentiment towards China – and China venture specifically – is still very warm."

Qiming has benefited from the stream of liquidity that lies behind this warm sentiment. Shanghai-based car rental business recently raised \$120 million through an IPO in the US and there have also been partial exits from smart

entrepreneurs' expectations, although a lot of the pressure is being exerted at the seed stage, before the traditional VCs get involved.

Qiming focuses on Series A and B rounds, taking businesses that have launched a product and developed a nascent user base to monetization and beyond. A company that might have received \$5 million in first-round funding a few years ago is now getting \$2-3 million in angel capital and then a Series A of \$10 million before it has even released a product. Qiming's typical entry point has been pushed into Series B and C territory.

"It is all about the availability of capital," says Gan. "In China over the last few years, the number of VC funds in our range has more or less stayed the same, but a lot of new funds focusing on pre-Series A have been created, often by entrepreneurs. They are deploying their own capital and raising capital from other people."

Virtuous circle

However, this same vintage of entrepreneurs – many of whom have learned their trade at Alibaba, Baidu and Tencent – is also responsible for a surge in start-ups. Seven years ago, people were starting companies on the back of three years with a multinational. Now 10-year Alibaba veterans who have managed multi-million-dollar budgets and thousands of staff are getting into the business. As a result, top-tier start-ups tend to be better run than before, with clearer ideas of what they want to be.

There are also long-term fundamentals that favor continued internet industry growth: rising internet usage, particularly via mobile devices; the adoption of more sophisticated technologies; and the migration of retail from offline to online. Gan suggests that, if Alibaba is a \$300 billion gorilla, there are 500 companies trying to grab a piece of its business – and even a 1% market share would be worth \$3 billion.

So the overall pie is growing, but aren't valuations inflating just as quickly, with capital flowing to the many rather than the few that actually deserve it?

"What can I do about it?" is Gan's response. "I am just a small participant in this huge market and the market is God. I don't like the smog in Beijing but is there something I can do about it? No. And I still go to Beijing because that is where my business activities are. There is nothing I can do about it apart from stop doing deals and retire." ▶

"The sentiment towards China – and China venture specifically – is still very warm"

– J.P. Gan

Highly successful IPOs by the likes of Alibaba Group and JD.com make everyone think they are on to a winner. "As long as the bigger companies are getting bigger and doing better no one will pay attention to the little failures," Gan adds.

Positive vibes

It was against this backdrop that Qiming – alongside a host of other VC firms – raised its latest fund. Qiming Venture Partners IV closed at \$500 million, just \$50 million larger than its 2011 vintage predecessor but heavily oversubscribed. There was space for only four new investors, notably the Massachusetts Institute of Technology (MIT) and the University of Pittsburgh Medical Center.

"We have a pretty blue-chip, endowment-heavy LP base. MIT has got to know us over the past year or so and a few of their peers are also

phone maker Xiaomi and online listings provider Dianping as strategic investors came into later rounds.

With the five-largest listed Chinese internet companies holding an estimated \$80 billion in cash on their balance sheets – with Alibaba in possession of almost \$30 billion on its own – exits to strategic players are expected to become a fixture of the industry. "All those guys are very paranoid. They see the stories about Yahoo and Sina and they know if they don't move forward, they go backward," Gan adds. "That is why they raise so much money and they don't hesitate in pulling the trigger."

At the same time, it leaves Qiming looking for deals in a market characterized by ever-larger private rounds at ever-higher valuations. The notion of becoming – or being bought by – a Baidu, Alibaba or Tencent Holdings drives up

Doctrine of discipline

FUNDRAISING OF THE YEAR – MID CAP Quadrant Private Equity raised its sixth fund in record time, resisting pressure from LPs to enlarge the corpus. The Australian GP remains resolutely middle market

THE LEADING US VENTURE CAPITAL FIRMS

do little in the way of marketing for their funds. In certain cases, fundraising means dividing up allocations among LPs that have already expressed a desire to re-up. New investors might struggle to get involved, regardless of their keenness.

Australia's Quadrant Private Equity appears to be entering this territory. Fund VI, which closed at A\$750 million (then \$746 million) in 2010, spent about six weeks in the market. Earlier this year the GP raised A\$850 million (\$758 million) for Fund VII and the process was completed in just over a month.

Marcus Darville, a partner at Quadrant, puts this speed down to several factors. First, the performance of previous funds has been good. Second, the firm is disciplined about size, working to the principal that a genuine middle market strategy for Australia and New Zealand requires a fund no larger than A\$1 billion.

Third, existing investors are loyal, with around 80% of the Fund VII covered by Fund VI investors, despite an element of churn within the Australian LP community as certain groups scale back their private equity exposure. Fourth, Quadrant keeps its terms and conditions fairly simple.

"Some existing investors put their hands up before we start fundraising so they get a lot of the work done in advance," Darville adds. "They aren't in possession of the fundraising documents, but they can come up the curve pretty quickly. A typical international investor wouldn't normally be able to tick all the boxes within four weeks."

This is the second Quadrant vehicle that has been open to international LPs. Fund VI was two thirds domestic and one third international; Fund VII is more or less a 50-50 split.

Resisting temptation

Staying disciplined on fund size can be a challenge for GPs that receive a lot of interest from prospective investors. Expanding the corpus well beyond the prescribed level means more fees but it might also necessitate a change in investment strategy in order to deploy the capital. Performance may ultimately suffer as a result.

"We pick a fund size that we think is optimal for the market. But it is also important that LPs apply a similar discipline themselves and don't turn a A\$400 million fund into an A\$800 million fund because they are all trying to get in," Darville

adds. "There have been cases in which LPs have piled in and encouraged a manager to be in a completely different investment space to that one that made them successful. That can be dangerous."

Quadrant itself has seen a few jumps in size across the vintages since the firm was founded in the mid-1990s as Westpac's private equity arm and – from 2005 – as a fully independent operator. Fund III, for example, was raised in 2001 and had a corpus of A\$125 million. It has delivered a gross IRR of 94%. Two vintages later, Quadrant was managing a A\$500 million vehicle, rising to A\$750 million for Fund VI.

The economic situation and the private equity opportunity in Australia and New Zealand have changed substantially since 2001, so A\$125

looks to keep its options open.

"We usually try and target businesses where we have a longer-term growth path – there is something in it for the next buyer. That hopefully gives you more than one exit. In our entire history we have probably exited more companies through trade sales than IPOs, but it's fair to say that, as our fund size has increased, the bulk of the assets are the right size to go public."

Middle market focus

When Quadrant makes the investments, however, the companies it targets are mostly not ready for an IPO. Residential aged care services provider Estia, for example, had 1,100 places across 10 facilities when the PE firm bought a controlling stake in the business.

"We pick a fund size that we think is optimal for the market. But it is also important that LPs apply a similar discipline themselves and don't turn a A\$400 million fund into an A\$800 million fund because they are all trying to get in"

– Marcus Darville

million is no longer appropriate. Darville gives one overriding reason for the sharp increase from Fund V to Fund VI. First, nearly every deal in Fund V had an element of LP co-investment so the size and type of transaction pursued didn't change much between the two funds.

Quadrant has realized investments quite rapidly, with Fund V now 90% exited and on course for an investment multiple of close to 3x. Thanks to an 18-month period of bullish capital markets, four of the seven companies that make up the Fund VI portfolio have been fully or partially exited.

There have been IPOs for Burson Auto Parts, APN Outdoor and Estia Health, while City Farmers was sold to Greencross in a cash-plus-stock deal. None of the three remaining investments are much more than two years old.

Although Australia's IPO market is cyclical – there have been 16 PE-backed IPOs on the domestic bourse so far this year, compared to 10 for 2010-2012 combined – Darville believes there is now sufficient momentum that a single weak offering would not derail it. That said, Quadrant

Through a series of bolt-on acquisitions, it now operates 39 facilities with approximately 3,200 places.

This is an important strategic distinction given the strong capital markets are taking away potential private equity investments at the large end of the scale as much as they are facilitating IPO exits for managers. Quadrant has completed two deals this year, which is consistent with its typical three-and-a-half year investment period per fund. Again, fund size discipline – and remaining resolutely middle market – is important.

"The larger part of the market is always a bit more erratic and then more recently it has had the added problem of the IPO market being a strong competitor," says Darville.

"We do a lot of deals with private vendors who often roll over equity with us. It helps that we have been successful building companies and taking them to IPO because these vendors are often rolling over substantial equity. They want to be comfortable that we can steer the company to a good exit." ▀

Pan-regional power

FUNDRAISING OF THE YEAR – LARGE CAP Buoyed by strong returns out of Southeast Asia and pipeline of China control deals, CVC Capital Partners defied early expectations by closing Fund IV at the hard cap

A TOTAL OF 450 INVESTOR MEETINGS, 85

road trips and a data room of 130 documents went towards the raising of CVC Capital Partners Asia Pacific IV, which closed at the hard cap of \$3.5 billion in May.

While US and European LPs account for about half the corpus, the Asian share is one third. The rise of the Asian LP is a feature of most of the pan-regional buyout funds raised in the last few years. CVC, however, can claim an extra victory. The investors in Fund IV include the Japan Bank for International Corporation (JBIC), making its first commitment to a traditional top-tier buyout fund.

"This participation can be a model that will facilitate greater coordination among PE funds, JBIC, Japanese financial institutions and Japanese companies as potential buyers for portfolio companies," Shigeki Kimura, managing executive officer at JBIC told AVCJ earlier this year.

JBIC is a distinguished addition to a fund that two years ago looked set for a difficult time in the

market, with the write-off of CVC's investment in Nine Entertainment was still fresh in the memory. There is no Australia allocation in Fund IV, which is partly why the vehicle is smaller than its predecessor. However, the PE firm has found better fortune in recent years in Southeast Asia, with deals such as Indonesia-based Matahari Department Store buoying Fund III returns. CVC acquired control of the retailer at a valuation of \$892 million in 2010 and made a sizeable partial exit in 2013 at a valuation of \$3.3 billion.

Control and joint control deals across consumer-retail, healthcare and financial services are likely to be a theme of Fund IV. Three of the last four investments from the previous fund were China buyouts. Since then CVC has bought a fast food franchise in Korea, a pan-regional serviced officer provider and a 50% interest in a Japanese broadband provider.

"With our well established presence, local networks and on-the-ground experts, CVC has a strong track record across Asia and will continue

to identify investment opportunities benefiting from increased consumer affluence and domestic demand in Greater China, South East Asia, Japan and Korea," says Steve Koltes, the private equity firm's co-founder and co-chairman. ▀



CVC's Hans Wang (right) with James Lee of SAP

Book shop to behemoth

DEAL OF THE YEAR – VENTURE CAPITAL Flipkart received \$1 billion in funding from a consortium of investors in July. It is ammunition for the arms race currently consuming India's e-commerce industry

WHEN SACHIN BANSAL AND BINNY

Bansal quit their software engineering jobs at Amazon in 2007, they wanted to set up an online bookstore. Each contributed INR200,000 (about \$3,229) to pay for a website and the following year they founded Flipkart Online Service. Seven years later, the start-up has morphed into a diversified e-commerce platform offering everything from electronics, to apparel to sporting goods. Based on the \$1 billion round raised earlier this year from a consortium led by Tiger Global Management and South African media company Naspers, Flipkart is thought to be worth about \$7 billion.

Accel Partners, ICONIQ Capital and Sofina also took part, alongside a number of investors commonly associated with later stage investments such as Singapore sovereign wealth fund GIC Private, Morgan Stanley Investment Management and DST Advisors. This latest round is a far cry the \$1 million Flipkart received from Accel just five years ago.

"The founders were outstanding, and not only knew technology but were very business savvy," Shekhar Kirani, a member of the investment team at Accel, previously told AVCJ. "We had many opportunities to interact with the team, and they would frequently come back with improved business metrics. All that got us to believe in their capability in the space."

Flipkart would go on to close six more rounds, raising an aggregate \$1.75 billion. Now with 26 million registered users making over six million daily visits and five million shipments per month, Flipkart stands toe to toe with the (unrelated) Bansals' former employer Amazon in a battle for dominance of India's fast growing e-commerce market.

Flipkart's war chest has not only helped the company rapidly scale up its operations, but also make a number of acquisitions as the industry consolidates. These have included: WeRead, a social book discovery tool bought from US-based Lulu Enterprises in 2010; digital content

platform Mallers in 2011; and Letsbuy.com, an e-commerce site backed by Accel, Helion Venture Partners and Tiger Global that was picked up for \$25 million in 2012.

In May, Flipkart completed its biggest deal yet, purchasing fashion retailer Myntra for around \$300 million in May, in a move that would give the company a much-needed advantage in the fast-growing fashion e-commerce segment. It has since moved into e-payments with the acquisition of Ngpay in August.

However, Flipkart is not the only cash rich player in its industry. The day after the \$1 billion round, Amazon pledged \$2 billion to its India operations. In October, domestic rivals Snapdeal received a \$627 million investment from SoftBank Corp, taking its total funding past \$1 billion.

It is still early days for the industry. Excluding travel services and tickets, India's e-commerce market is valued at \$3.1 billion, according to CLSA. Meanwhile, Technopak estimates the market will be worth \$56 billion by 2023. ▀



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Inside the mobile revolution

VENTURE CAPITAL PROFESSIONAL OF THE YEAR Jixun Foo, Shanghai-based managing partner at GGV Capital, recognizes concerns about heady tech valuations, but says they must be viewed in context

Q: Earlier this year GGV reached a \$622 million final close on its fifth Sino-US venture fund. How was the fundraising process compared to Fund IV?

A: This time it was a lot easier. There are several factors. First, the overall market for technology companies isn't just in recovery mode, but picking up momentum. Second, venture capital performance has been good. Through IPOs such as Alibaba Group and Qunar.com, as well as M&A activities, LPs have received cash distribution from the exits over the last 6-12 months. The final factor is our team. For example, we added Hans Tung to deepen our talent pool and I think LPs saw a lot of strength in what we are building.

Q: Valuations are also going up. To what extent has an internet bubble emerged?

A: There is a bubble in the sense that valuations have become inflated, but you have to put this into perspective. Compared to last year or the year before, valuations have definitely gone up a lot and the main reason for this is the mobile revolution. It is disrupting brick-and-mortar businesses and creating a new economy – and that is why a lot of money is pouring into the market. With that in mind, when we are looking at deals we have to ask, 'Are these companies going to be around for the long term?' and 'Is the market large enough for them to grow bigger?' If the answer to both those questions is yes, then the bubble is less of a concern. It is really about whether we are able to back the best companies at the best time.

Q: Does the speed at which technology evolves make it harder to conduct due diligence?

A: If we don't have enough time to make a proper judgment, we won't do the deal. In some situations, an entrepreneur comes to us and asks us to sign a term sheet within a week. If I don't know the industry or the founder, the chances of getting this done are very low. So I tend to back serial entrepreneurs or companies with which I am familiar. It could be that I got to know the founder when he raised seed capital, or I understand the space because I have studied it closely.

Q: In which areas do you invest most prolifically?

A: I don't think our focus is necessarily unique. By looking at areas such as travel, enterprise software and financial services, our focus isn't so different to that of other VC firms. However, we have our own knowledge and expertise in all of these verticals. For example, we have done well in mobile commerce through investments such as Meilishuo and Wish. Through these we have learned how to scale



“If we don’t have enough time to make a proper judgment, we won’t do the deal”

companies in the space. This familiarity means not only can we understand an entrepreneur's idea very quickly, but we can also help the entrepreneur develop the business. As a result, when entrepreneurs think about which VC firm is strong in a particular area, they will naturally think of GGV.

Q: How has the angel investment environment evolved in China and what does this mean for GGV?

A: The success of internet companies such as Alibaba and Tencent Holdings has made a huge impact. More people want to invest in young companies because they envisage big outcomes. In China, 50,000-100,000 technology-related start-ups will be launched this year, many by college students with new ideas. We estimate that 5,000-6,000 companies receive seed funding and only 1,000-1,500

reach the Series A stage. I think the seed capital phenomenon will remain for the next few years, given the rise in angel investors and the development of crowdfunding platforms. This partly explains the inflation in valuations because there is more capital available for start-ups. We work with some angel investors to identify potential deals – for example, we partnered with Lei Jun on YY and UCWeb. We are multi-stage but we mostly participate in A through C rounds.

Q: How does GGV address the China-US cross-border opportunity?

A: GGV started with a vision that the world is converging and this remains the case. We have a couple of portfolio companies that are cross-border by nature. Wish is a mobile shopping app developer that serves US consumers but its entire supply chain is in China. The company is helping Chinese merchants to sell goods to US consumers. Another company, sports wearable device maker Zepp, was founded by Chinese entrepreneurs and its products are manufactured in China, but its target market is the US. When convergence happens, our knowledge of the world beyond China can help start-ups scale their business.

Q: GGV invested in Southeast Asia-based taxi-booking platform GrabTaxi earlier this year. Have you added a new geography to the existing China-US footprint?

A: We are China- and US-focused but we are also thesis-driven. One thesis is that we believe in the power of mobile internet to connect customers and service providers. On-demand services and the shared economy is a big trend and it is changing a lot of businesses and consumption behavior in general. It is not geography-centric. There is a similar opportunity for mobile taxi-booking services in the US with Uber and in China with Didi Dache and Kuaidi Dache. When we looked at GrabTaxi, we liked the CEO and we recognized the demand for these services in Southeast Asia is high. So on one hand, the Uber phenomenon can happen anywhere. On the other, this is a very local business model that requires local talent. For example, GrabTaxi has to deal with day-to-day operations involving its network of drivers. Someone can't just turn up from the US or China and take over the market. ▶

There and back again

DEAL OF THE YEAR – LARGE CAP CDH Investments' acquisition of Nanfu Battery is a rare carve-out from a multinational in China, and an even rarer example of a PE firm returning to back a former portfolio company

WHEN PROCTER & GAMBLE (P&G)

announced plans to offload more than half of its brands in a bid to boost profitability, Asia's private equity community pored over the assets to see what might be carved out. Yet CDH Investments' acquisition of Chinese alkaline battery maker Fujian Nanping Nanfu Battery was not contested. The GP had history on its side.

CDH is understood to have bought P&G's entire 78.8% stake in Nanfu for close to \$600 million. It is reuniting with a management team it first backed more than 15 years ago, before the business was sold to Gillette, which was subsequently acquired by P&G. Corporate carve-outs from multinationals are a rarity in Chinese private equity; given the relative youth of the industry, a firm returning to invest in a former portfolio company is even rarer.

When CDH approached P&G this wasn't the transaction it had in mind. "The conversations started at a fairly high level with us letting P&G dictate the direction and narrowed over time, but the one category we knew we could work on relatively easily was household products," says Thomas Lanyi, a director at the PE firm. "We were aware of the ownership but we didn't go in with a specific proposal for Nanfu."

A number of potential transactions were considered, but once Nanfu – China's largest manufacturer of alkaline batteries and a top five player globally – emerged as a viable target, CDH knew it had a competitive edge. Relations between the PE firm and Nanfu management were maintained after the initial exit and they knew they could work together. This also gave P&G confidence that a deal would get done.

The beginning

The original investment in Nanfu may well have been the first-ever PE buyout of a Chinese state-owned enterprise. It was the late 1990s and the CDH team still comprised the captive private equity unit of China International Capital Corporation (CICC). They acquired a controlling interest in Nanfu alongside Morgan Stanley Private Equity Asia, with GIC Private and NIBC Asia coming in as co-investors.

Morgan Stanley was at the time a substantial shareholder in CICC and their respective PE units collaborated on several deals. GIC was also familiar with the CICC team. NIBC Asia was the Singapore office of Dutch bank NIBC's private equity arm, and it got involved through GIC.

"The best way for me to establish a network in

Asian private equity was to go and see Temasek Holdings and GIC," says Ernest Lambers, now a partner at placement agent Liberty Global Partners but then head of the NIBC Asia. "I spoke to the GIC representative in Beijing and they were looking at Nanfu. At that point there were not large pools of capital available in China so they wanted my support. We spent quite a bit of time on due diligence and this resulted in a proposal to acquire a majority interest in the company across two stages."

The second stage took place after CICC PE team spun out in 2002 and became CDH. GIC was one of four anchor investors in the new firm's \$100 million debut fund.

NIBC had also undergone change. Dutch pension funds ABP and PGGM acquired the bank and its private equity business and repurposed the latter into an independent manager for their own allocations to the asset class. In 2003 it was renamed AlpInvest Partners and Lambers was put in charge of the emerging markets private equity program. AlpInvest also backed CDH's first fund.

By the time the second stage of the Nanfu investment was completed, the company was one of the largest battery manufacturers in China, although still a fraction of its current size. Lambers was attending board meetings on a quarterly basis – the journey from the airport to the factory in Nanping city took about three hours so meetings would start in the afternoon and run into the following day – and he recalls being impressed by the management team.

"They had acquired some Japanese equipment for the manufacturing plants. They knew what was required to make a good company and they knew how to market the product," he says. "The financial investors helped in terms of marketing and expanding into other provinces. One of the differentiating factors to Duracell was that you could buy Nanfu batteries individually. With Duracell you had to buy a whole pack and that was quite a lot of money for Chinese consumers back then."

Gillette, Duracell's parent, was struggling to penetrate the Chinese market. It had to build a distribution network from scratch and it lacked lower-priced brands below the premium

Duracell product. Nanfu was therefore a logical M&A target and a deal duly happened in 2003. According to reports at the time, Nanfu had annual revenues of \$84 million.

Gillette bought out the private equity investors in full. The rest of Nanfu was – and still is – held by local government interests.

Fast forward

Nanfu now produces more than 1.2 billion batteries per year and generates annual revenues well in excess of \$300 million. Ninety percent of its business is domestic, channeled through an estimated two million points of sale running all the way from tier-one to tier-four cities. The company is estimated to account for over 70% of sales of legitimate alkaline batteries in China. It outsells local peers such as Twin Deer, GP Battery



CDH's Stuart Schonberger (right) with Guy Miller of RCA

and White Elephant, while foreign players like Duracell still focus on the premium segment and have a correspondingly small share.

Size apart, the business was an appealing corporate carve-out for three reasons. First, it had been run as a stand-alone operation within P&G – so it could be carved out quite cleanly – and the management team was staying in place. P&G had never sold an asset to a Chinese buyer before, which presented something of a challenge in terms of familiarity, but CDH addressed this by assembling a working group comprising members of its China deal team and general team members with international experience.

Second, Nanfu is fairly straightforward, cash-generative business. "It is not the kind of category where you push hundreds of millions of dollars

into R&B or capital expenditure to continuously come up with the next big thing – and that is partly why we like it,” says Lanyi. “This is a buyout transaction and we have applied some leverage, so we needed the business to have strong, stable, free cash flows and from that perspective it is extremely suitable.”

Third, the primary growth drivers of the business are reassuringly secular: rising

As with other consumer product categories, rising affluence in China is expected to see more people pay a premium for quality.

“As the consumer becomes more educated and financially capable, he will switch from carbon-zinc to alkaline batteries because the price-performance differential is favorable as long as you can afford to pay the price,” Max Hui, also a director at CDH, explains. “Nanfu has been

to last and they don’t want them to leak, so they go for trusted products.”

This may be the first time CDH has bought a business it previously owned, but the private equity firm has a record of working with management teams on multiple occasions.

There are elements of this approach in the firm’s dairy industry exposure. Over the past decade, CDH and KKR have invested in China Mengniu Dairy, China Modern Dairy and most recently Asia Dairy. This string of deals is the product of accumulated experience and industry contacts; at each stage pre-existing relationships with management teams have proved invaluable.

Another example would be Belle International, a women’s shoe retailer that CDH took public in 2007. Last year the PE firm teamed up with Belle to jointly acquire a controlling stake in apparel brand Baroque Japan and roll out the business in China.

“Teaming up with people with whom we have long-standing partnerships, whether previous portfolio companies or not, has worked well for us,” Hui says. “We will not deliberately pursue this strategy. Each investment is evaluated on a standalone basis but one of the first criteria we look at is whether we trust the people involved. People we have worked with before we can definitely trust but we are obviously open to working with new partners as well.” ▀

“Teaming up with people with whom we have long-standing partnerships, whether previous portfolio companies or not, has worked well for us”

– Max Hui

disposable incomes prompting higher demand for battery-powered electronic devices, from air conditioners to DVD players to flashlights to toys; and the shift from carbon-zinc to alkaline batteries, which are considerably more efficient.

There is a clear developed versus developing markets split in terms of product preference, with the US and Europe at least 90% alkaline, while in China the balance is tipping in favor of alkaline but not by huge margin. There is a large differential in price and an even larger differential in performance between the two battery types.

putting a lot of effort into making consumers understand that its batteries last significantly longer – we are talking 8-10 times longer – than carbon-zinc alternatives. This conversion drives growth both in volume and revenue terms.”

Lanyi adds that Nanfu’s long-term brand equity is also a function of consumer loyalty. “Ultimately it comes down to people wanting a solid product and trusting the brand,” he says. “The slogan Duracell uses in the US is ‘trusted everywhere’ and I think a similar logic applies for Nanfu’s consumers. People want these batteries

Box office mojo

DEAL OF THE YEAR – MID CAP FountainVest Partners and CMC Capital Partners are helping IMAX negotiate obstacles to expansion in China with the ultimate aim of taking the local unit public

IT TOOK “AGE OF EXTINCTION,” THE

fourth film in the Transformers series, less than a month to become China’s top-grossing movie of all time. Box office receipts came to RMB1.98 billion (\$322 million), putting the domestic cinema industry on course for another record year.

Last year, China overtook Japan to become the world’s second-largest movie market. With ticket sales growing at 30% year-on-year, some industry watchers tip it to replace the US as number one within five years. At the same time, cinema penetration remains relatively low in China and the likes of US-based IMAX Corp. want to play a role in the growth story.

IMAX was looking for local partners to help it address the tricky regulatory and business environment. Through a combination of an acquaintance with the company’s CEO and advice from LPs, Frank Tang, CEO of FountainVest Partners, put together a deal. The PE firm and CMC Capital Partners

bought a 20% stake in IMAX’s China unit for \$80 million in April.

“IMAX doesn’t make movies alone but selectively cooperates with film studios on those movies which are best fit to show on giant screens. IMAX gets a share of revenue from the studios. The company also works with operators to put IMAX screens, projectors and sound systems into cinemas,” says Tang. “Having said that, the movies which can be shown in the cinemas in China are still quite regulated.”

Only 34 foreign films are allowed into China each year, including IMAX’s 3D format. Domestic distributors keep around 50% of the box office revenue. Movies produced as Sino-foreign joint ventures, with a certain amount of domestically-produced content, are not subject to this annual quota. As former Chairman of the state-owned Shanghai Media Group, CMC founder Ruigang Li has the contacts and experience to facilitate IMAX’s interaction with regulators.

Greater China – including Hong Kong,

Taiwan as well as the mainland – is already the company’s second-largest market, accounting for 19% of its \$287.9 million in revenue last year. IMAX has about 200 screens in Greater China, with 239 more planned for installation by 2021.

It has a partnership with Wanda Cinema Line Corporation, China’s largest movie theater chain, and FountainVest will help IMAX reach out to more cinema owners as it seeks to penetrate lower tier cities.

“It is important to understand which locations to target and who to partner with,” Tang says. “IMAX can sell its equipment to cinema operators through one-off transactions, but it prefers to partner with them by supplying equipment in return for a share of the box office revenue. That means IMAX needs more capital for the latter business model.”

The private equity firm together with CMC has worked with IMAX on a roadmap for expansion in the China market. The China unit is expected to go public in the next five years. ▀

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Big beast

EXIT OF THE YEAR – IPO Alibaba Group's IPO validated Silver Lake's faith in the business. Ken Hao, a managing partner at the PE firm, expects the company to go from strength to strength, both in and outside China

ASKED IF THERE ARE ANY PRE-EXISTING

models that suggest how Alibaba Group might fare in its international expansion, Ken Hao, managing partner at Silver Lake, notes that conventional rules don't seem to apply to the Chinese e-commerce giant.

An investor in Alibaba since 2011, Silver Lake has been a "helpful ally" as the company has retained its leading position in fast-growing China market. The technology-focused private equity firm has brokered relationships between Alibaba and some of its other portfolio companies, and clearly can be an important partner as Alibaba looks to build up its business in the US and other markets. But Hao demurs

\$278.8 million off the table as part of a \$25 billion IPO – the largest ever seen – in September. Its remaining 2.2% holding was worth \$3.7 billion based on the IPO price of \$68 per share. However, Alibaba's stock opened at \$92.70 and has since gained an additional 25%, putting the Silver Lake interest at more than \$6 billion.

Overcoming uncertainty

It has been a hugely successful investment, but the PE firm disregarded its conventional rules in order to back this unconventional company. Silver Lake describes its investment approach as disciplined, valuation sensitive and control-oriented. Alibaba set two records: the highest valuation Silver Lake had ever paid for a deal in absolute terms and multiple terms; and the lowest percentage ownership.

Furthermore, Alibaba was not well understood – it had a Hong Kong-listed B2B subsidiary while the now more valuable B2C and C2C-related assets remained in private ownership – and the company had just spun out its Alipay payments business, briefly causing tensions with major shareholders Yahoo and SoftBank. And then the transaction presented to Silver Lake in 2011 was an entirely secondary

contemplation of a big Yahoo buyback but that was the strong preference for Alibaba at the time," Hao says. "The privatization and the buyback were constructive and accretive transactions, but the big bet was that Alibaba could defy the law of large numbers with its growth rate and market position, and continue to build on its success. That is clearly what has been borne out."

This has been driven by continued growth in internet usage, broadband and mobile internet penetration, and online shopping. China had 618 million internet users at the end of 2013, more than double the 2008 figure, while online spending has risen 100-fold to \$305 billion over the same period. Crucially, only about half of those internet users currently buying goods online. By 2016 Chinese online shoppers are expected to be spending \$769 billion.

Future glories

On the domestic front, new e-commerce verticals are springing up as an alternative to Alibaba's broad-based marketplace, but Hao notes that the industry is large enough to accommodate multiple players.

"It will be a while before we get to the point where for every winner there needs to be a loser and it's a zero-sum game," he explains. "That said, I don't believe that marginal companies can easily exist because Alibaba has such a powerful ecosystem that if someone is not adding true value to the e-commerce proposition then they don't need to exist. China is a uniquely valuable but hyper-competitive e-commerce market and there can be more than one company, but I do see Alibaba at the center of it all."

As such, Silver Lake is in no hurry to exit Alibaba because wants to take advantage of the company's long-term potential. But it has no immediate plans for another foray into Chinese e-commerce. The private equity firm is likely to stick with its primary strategy of investing in core technology – companies that sell technology as opposed to what Alibaba does, which is use core technology to shape an e-commerce experience.

In this sense, Silver Lake is therefore looking for the Chinese equivalent of Apple or Cisco Systems, but it will be a gradual process. "Over time in China there is going to be an ecosystem of advanced core technology companies," says Hao. "There are only a small number of players now, but it is a space we are watching. We need the right relationships with the right people at the right time." ▀



Zheng Wang (left) of Silver Lake with Baker & McKenzie's Ai Ai Wong

"The big bet was that Alibaba could defy the law of large numbers with its growth rate and market position, and continue to build on its success" – Ken Hao

from offering a view on how this might turn out.

"I cannot predict what Alibaba might do in the US, but I don't think it will be conventional," he says. "Alibaba's success in going cross-border will become more evident over the next 12 months. This is a global technology company that happens to be based in China and it was founded to be a global technology company. If Alibaba's model continues to be as scalable as it has been in the past I think they are going to prove themselves to be more global than other e-commerce companies have been in the past."

Silver Lake is understood to have invested about \$500 million in Alibaba. The PE firm took

offering: it was a liquidity event for employee shareholders and a number of early investors.

At one point this uncertainty looked set to limit the PE firm's investment in Alibaba to \$100-200 million, but it ended up committing more than that as part of a consortium that paid \$2 billion for a 5.7% stake and brought in two LPs as well. Silver Lake re-upped the following year, contributing to the \$3.9 billion equity portion of a \$7.6 billion buyback through which Alibaba picked up approximately half of Yahoo's 40% interest in the company. This followed a privatization of the Hong Kong-listed unit.

"Our first investment wasn't done in

Advantage Partners Past Investments



Reel returns

EXIT OF THE YEAR – MID CAP United Cinemas was struggling in the face of macro headwinds and low consumer confidence, but Advantage Partners' saw the bigger picture and delivered blockbuster returns

ADVANTAGE PARTNERS' INVESTMENT

in United Cinemas came at a difficult time for Japan's movie theater industry. In 2011 much of the country was still feeling the bite of the global financial crisis and the added impact of the Tohoku earthquake prompted consumers to tighten their belts further. With trips to the movies among the first items dropped from the household budget, companies like United – which had been in negotiations with Advantage at the time – were among those worst hit.

"Nobody was really sure what that it would mean for the overall industry and the economy, but for United it meant a downturn in performance for 2011," says Josh Porter managing director at the PE firm. "People didn't feel comfortable going out so much, particularly for things like movies, and were reluctant to spend money."

Advantage, which had been targeting the industry for some time before settling on United, successfully completed its acquisition in March 2012. It paid JPY3.9 billion (then \$48 million), including JPY2.6 billion in debt, to buy the business from Sumitomo Corp. Clearly, United's earnings had suffered so the first task was to get the company's balance sheet back on track while consumer demand recovered.

"The number of screens grew 40% between 2002 and 2010, so there was an oversupply situation," explains Takeshi Sasaki, the principal with Advantage who lead the transaction. "Like other cinema chains, United built its own theaters, so it was a very capital intensive business and company had accumulated a lot of debt. The financial situation wasn't good."

Recalibration process

The turnaround strategy comprised around two thirds cost management and one third revenue enhancement. The first part involved renegotiating debt with former owner Sumitomo, focusing on operational improvements, changing staff levels and managing shifts to match the needs of each theater.

The other big change was the way United would manage its assets. The company switched to an outsourcing model whereby there were no purchases of real estate or capital equipment like seating and projectors. This allowed management to concentrate on hiring the best staff, running an efficient box office and coordinating concessions.

However, in order to respond to rebounding

consumer demand, United also needed to expand its footprint and upgrade its technology. At the time of the investment the whole industry was transferring from analog to digital, so within the first six months all the old projectors in United's theaters were replaced. This eliminated the need for projectionists, delivering lower costs.

The next step was expansion. "United was the fourth-largest chain in what is really a pretty

recommendations, and announcing special menu items. The menu was also simplified.

"United Cinemas used to have a variety of menus and they tried to sell something new every season but it didn't contribute to revenue enhancement," says Sasaki. "So we eliminated the menu and instead we focused on selling a variety of popcorn, introducing various flavors like caramel and banana, strawberry and chocolate."



Advantage's Richard Folsom with Baker & McKenzie's Ai Ai Wong

Mission accomplished

These improvements, combined with a return of those movie-goers who had stayed away, saw EBITDA grown from around JPY200 million at the time of investment to JPY1.3 billion by year two, and JPY2.1 billion for the 12 months ended June. Including the Kadokawa acquisition, revenue grew 30% during the ownership period, reaching JPY19.5 billion in 2014 financial year.

More recent figures have benefited from a boom in ticket sales driven by some of this year's biggest

"United built its own theaters, so it was a very capital intensive business and the company had accumulated a lot of debt"

– Takeshi Sasaki

fragmented industry," says Porter. "So mid-way through the investment we acquired its competitor Kadokawa Cineplex, which brought the United to number three position."

The acquisition of Kadokawa – the eighth-biggest player in the market – in 2013 expanded United's footprint from 222 screens across 21 theaters to 331 screens across 36 cinemas. This also put the company ahead of rival Movix.

At the same time, Advantage addressed top line earnings by focusing on the most lucrative part of any movie theater business: the concession stand. (Most of the ticket sales revenue filters back to the movie producers.)

The private equity firm encouraged competition between movie theaters, with rewards for those that maximized concession sales. There was particular emphasis on driving popcorn sales, the highest-margin product on offer. This involved staff being more proactive – providing free samples, making

box-office hits, led by Disney's "Frozen."

"Frozen" was a big success in Japan but it was released here at the end of the fiscal year so most of the contribution to earnings came through the following quarter," Sasaki explains. "It provided an uplift this year on a pro forma basis but the buyer also acknowledged it was a one-time big hit."

The buyer was Lawson HMV Entertainment, a unit of listed convenience store giant Lawson, which had agreed to pay JPY14 billion for United, generating a 9.9x money multiple for Advantage. The sale actually came ahead of schedule but because the company was showing strong performance – and the PE firm had met the goals it set out to achieve – the timing turned out to be ideal.

"We tested the market to see what the strong interest was, recognized it was good, and so we ran a traditional sale process," says Porter. "We ended up with a buyer that is a really good fit for the business and we went forward with it." ■

An evolving thesis

PRIVATE EQUITY PROFESSIONALS OF THE YEAR David Liu and Julian Wolhardt lead KKR's Greater China private equity team, with Liu also serving as co-head of Asia PE. They look back on a busy 12 months

Q: How significant has the slowdown been in driving deal flow?

DAVID LIU: We have consistently been an active, value-oriented and operationally focused investor in China. When the capital markets are at a very low point – as they were last year for Chinese companies – we see this as an opportunity. The China slowdown has implications for how people invest and manage their portfolios. For an investor like KKR this environment presents an opportunity to further differentiate ourselves. The key is identifying interesting sectors and interesting companies run by good management teams, and working hard with them to grow the businesses.

Q: Are you more likely to be active in sectors that are clearly in difficulty, such as real estate?

DL: We prefer to invest in sectors with growth potential despite economic slowdown. Nevertheless, there are also interesting opportunities in certain sectors facing headwinds. The real estate sector is certainly experiencing tough times. There is oversupply in many areas, and speculative properties are no longer delivering the price increases people used to see. It's never easy to predict the outcome for an entire industry but it is very important when investing in China to also focus on company specifics and avoid overly generalizing. We have made some good real estate investments by partnering with best-in-class local operators at attractive locations and prices. You have to be very disciplined – smart investors get ahead of the curve by identifying attractive industries with sustainable growth even in an economic downturn.

Q: So, on a broader level, what sectors do you find interesting?

DL: Our sector preference has evolved over time. Go back 15-20 years and we were investing in companies like China Mengniu Dairy, Ping An Insurance and Belle International, but our focus has progressively shifted as the Chinese economy develops and matures. When we backed Mengniu Dairy, Chinese consumers were very focused on whether there was enough milk to drink. Today as consumers get wealthier and more sophisticated, they focus on milk quality and are willing to pay

a premium for premium-quality milk. This applies to chicken, pork and a number of businesses we are investing in across the healthcare, environment and food sectors. Twenty years ago consumers focused on basic living necessities; now they are focusing on quality of life, such as the type of water they drink and which cities have good air quality. Even though GDP growth has slowed down over the last two years, the sectors that have been impacted the most are traditional manufacturing, export-oriented companies and traditional retail. If you look at environment, healthcare, food safety and TMT, growth is quite robust.

Q: At \$530 million and \$400 million, the investments in home appliance maker Qingdao Haier and Fujian Sunner Poultry are among the largest KKR has done in China. Are deal sizes in general increasing?

DL: I think it's fair to say deal sizes in general are increasing in China – that has been the case for the last 10 years. There aren't many deals in China in the multi-hundred-million-dollar range; I would say the super majority of investments are below \$100 million. We always try to invest in market-leading businesses with long-term growth potential and operational upside. I do think that with the current downturn some leading companies are more open-minded about working with partners that can add real value to their growth. When the market was just going higher and higher, people could grow their businesses more easily. These companies have become bigger in size and so by definition it is harder for them to continue rapid growth. A downturn makes it even harder.

JULIAN WOLHARDT: Larger companies are also getting more sophisticated. Historically, all they thought about was capital, but now they are thinking beyond that. Their sophistication plays well into the context of us providing operational value-add. Companies are increasingly thinking about how to make the pie bigger and this helps us deploy

more capital through partnerships with local companies.

Q: So how do you pitch an investment to a company like Haier?

DL: If you look at Haier, they have a lot of money on the balance sheet so they want more than just capital. They want a partner with the global resources and local expertise to help them grow. It is about being a long-term, value-added partner to them. With Haier, we appreciated why it is a good, undervalued company and also identified areas in which it can further improve and grow. This is



David Liu of KKR receives the PE Professional of the Year Award from Baker & McKenzie's Dorothea Koo

tied to Haier's long-term growth strategy – where they want to grow, what are the M&A opportunities, how to better manage capital market activities and global expansion – and how our resources and knowledge could complement their existing capabilities. The deal took a year or more to complete but that is what we do.

Q: The Asia Dairy investment this year comes on the back of a successful partnership with China Modern Dairy. At what point did the Asia Dairy opportunity present itself?

JW: When we invest in one business we typically focus on growing that business; we typically do not back another company in the exact same sector. Asia Dairy is unique in that sense. We had been exiting our position in Modern Dairy and we found an interesting opportunity to create the most cutting-edge

“Twenty years ago consumers focused on basic living necessities; now they are focusing on quality of life, such as the type of water they drink and which cities have good air quality”

— David Liu

dairy farm in China. We approached Modern Dairy about doing it in partnership with them. It was really driven by us having been in the dairy industry for so many years and therefore knowing where to find the best managers, what kind of equipment to use, and how to help build best-in-class farms. Just as importantly, we have established a very good working relationship with Modern Dairy's management team over the years, so they were happy to partner with us again in Asian Dairy.

Q: On this basis, were the subsequent moves into pork with COFCO Meat and chicken with Fujian Sunner logical?

JW: Yes, the genesis of all this is food safety theme we have been actively pursuing in China. As consumers get more sophisticated, they demand high-quality food products for their family, from milk, to chicken, to pork, and so on. We will see growth in this area in years to come, and this is only the beginning. We started with success in dairy, and it was natural to move on to chicken and pork. Chicken is a particularly difficult business and I am not sure we would invest in any chicken company in China other than Sunner. Sunner is truly the exception because it is the only chicken producer in the country that is fully integrated. This is critical to ensuring food safety as they will need to control the entire supply chain to achieve such goal.

Q: Was it a similar process for the COFCO Meat deal?

JW: That deal was derived from our long-term partnership with Mengniu, which is backed by COFCO. We created a joint venture with Mengniu to invest in Modern Dairy in 2007 and ended up selling our shares to Mengniu. Based on what COFCO had seen us do with

Mengniu and Modern Dairy, as a value-added investor COFCO gave us a shot on the pork deal. We try to work with the same teams over and over to build on our trust-based relationships because when there is trust, operational improvements are easier to implement. In most cases, as a minority shareholder if you do not have that trust, it is very difficult to persuade management to adopt changes that you think are right.

DL: The reason we are able to generate good proprietary deal flow and create a competitive advantage in food safety is because we have a team with deep industry knowledge. That is going to be more important going forward when investing in China. The days of riding the easy growth wave and relying on multiple expansions to generate returns are gone. You have to know a business incredibly well and be able to add value to the entrepreneur and management team. We go in and talk about feed costs and breeding technology rather than price-to-equity multiples. Having that kind of expertise across multiple industries is important and taking an industrialist approach to investing is critical to generating sustainable proprietary deal flow and attractive returns in China going forward. ▶

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The screenshot displays the homepage of the Asian Private Equity Online Directory. The top navigation bar includes links for 'HOME', 'ABOUT', 'CONTACT', and 'LOG IN'. The main content area features several data visualizations and search functions. On the left, there is a sidebar with a 'Search' bar and links for 'Private Equity', 'Venture Capital', 'PE News', 'PE Events', and 'PE Resources'. The central part of the page contains three bar charts: 'Investment Breakdown by Industry', 'Investment Breakdown by Country', and 'Recent Private Equity Deals'. Below these charts is a section titled 'Recent Data' with a list of recent deals, such as 'AIA Group (China) Ltd. Acquires Shandong Shengtai (Shandong)' and 'AIA Group (China) Ltd. Acquires Shandong Shengtai (Shandong)'. At the bottom, there is a section titled 'New Funds & Fund Closings' with a list of recent fund closings, including 'AIA Group (China) Ltd. Acquires Shandong Shengtai (Shandong)' and 'AIA Group (China) Ltd. Acquires Shandong Shengtai (Shandong)'.

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The China pioneer

AVCJ SPECIAL ACHIEVEMENT Victor Chu's First Eastern Investment Group was among the first private equity firms to enter China. It has since carved a new niche based on Chinese outbound investment

"MY FIRST THREE PROJECTS WERE NOT

terribly successful – in fact they were disasters – and I remember my father telling me it was the best thing that could have happened," says Victor Chu, chairman of First Eastern Investment Group. "Had they been home runs I would have thought it was so easy and made much bigger mistakes."

This was the late 1980s and the China private equity model as it stands today did not exist. Chu was among the pioneers who learned through getting their fingers burnt. It involved appreciating that the risk factors were substantially different from US and European buyouts – minority investors by definition have less influence, and in China they were offered minimal legal protection.



Victor Chu (right) receives his award from AVCJ Publisher Allen Lee

"We learned that you have to be very quick in China, send in your own people, and have direct access to management and financial information"

– Victor Chu

One of First Eastern's early investments was in a manufacturer of latex gloves. They approached the deal in methodological fashion, taking time to find the right people and put proper processes in place. But the market was soon flooded by copycat manufacturers taking shortcuts.

"We learned that you have to be very quick in China, send in your own people, and have direct access to management and financial information," says Chu. "We would insist that, even as a minority investor, we had the right to appoint the deputy CEO and CFO, received all the financial

information, and had the ability to put things right if they didn't go well. We became buy-in specialists as opposed to buyout specialists."

Long-standing ties

First Eastern got into China early through a combination of Chu's professional and personal backgrounds. Through his legal practice, Chu worked on a host of corporate finance and M&A transactions for foreign investors entering the country. He was also becoming more involved in the family business, a leading Hong Kong brokerage established by his father in 1960.

This brokerage was the first to bring in a mainland Chinese investor when the Guangdong government took a 20% stake in 1986. Chu's

father wanted to train financial professionals in anticipation of the development of the country's capital markets. Each year 10 people went through the program and some of them still hold senior positions in the securities industry. Chu continued the promotion of financial services cooperation between the mainland and Hong Kong. As a member of the Hong Kong Stock Exchange's governing council, he championed the initiative that allowed mainland-incorporated companies to list on the bourse as H-shares.

was Chenming Paper, a township and village enterprise with annual production of 30,000 tons. Chenming wanted foreign capital and expertise, and First Eastern made an introduction to Japan's Marubeni Corporation, resulting in a partnership through which the company took its sourcing and sales activities overseas. Crucially, the Marubeni arrangement also turned around Chenming's cash flow position as it could get wood chips on credit.

Chenming is now the second-largest paper company in China and in the top 20 globally. Annual production stands at five million tons. It became the first company to list on the A-share, B-share and H-share markets.

An evolving strategy

When First Eastern started investing in China it used family money. The firm launched its first fund in 1992 and has raised 10 altogether, starting with evergreen vehicles and then moving to fixed-term GP-LP structures. High net worth individuals – usually personal or professional acquaintances – featured prominently in the LP base.

First Eastern's approach has now almost gone full circle, with 75% of capital deployed in the last few years being principal investment. Chu says this a good fit for the firm's strategy as it allows longer participation in projects, which is helpful for investments in areas such as renewable energy. The strategy has also become more international, a logical shift given China's increasing focus on outbound investment.

"We need to look at where we can best add value and one of the natural things was the international market," Chu says. "We have been investing internationally for a long time and China was looking for technology, branding and management to bring to the domestic market. Companies want to go overseas but you need good partners in foreign markets."

First Eastern successfully expanded into Southeast Asia, the Middle East and Europe. Chu sees Japan and North America as the geographical holes in First Eastern's investment map and steps are being taken to fill them.

"In our particular area we have little competition because we focus on the middle market, which is too big for the VC firms and too small for the big buyout firms," he adds. "In addition, we don't use debt and then because most of our money is principal capital we can commit for the long term." ▀

First Eastern has made 150 investments in China across almost every sector. Working with local government was essential and unavoidable in the early days. Chu adds it was also preferable to dealing with private companies that, though less bureaucratic than government, could be unreliable. "With the private sector, if they took the money and ran, we couldn't even find them. With the state, if an investment failed because of fraud we could always find our partner because it was part of the government," he says.

Among the firm's most successful deals

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