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EDITOR'S VIEWPOINT

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Teutonic ambitions

ANOTHER WEEK, ANOTHER CHINESE strategic acquisition of a German manufacturing asset. The most recent case involves Fusheng Industrial, Greater China's leading producer of industrial air compressors, buying its German rival ALMiG Kompresssoren.

Fusheng's rationale is simple enough: The global compressor market is expected to grow 5% over the next five years thanks to the introduction of more efficient and cleaner technologies. Not only does ALMiG present the Taiwan-headquartered manufacturer with a readymade footprint in Europe, North America and Asia, but it also represents a shortcut to specialization. ALMiG has a particular expertise in energy-efficient and oil-free industrial air compressors.

This is the thesis of Chinese outbound investment in a nutshell, at least in recent years. In the vast majority of cases, acquisitions are not iconic; they are small strategic steps intended to open up new markets and fill in technological voids. Chinese manufacturers can do scale. Now they are climbing the value chain, inorganically.

It rings true of Weichai Power's $922 million investment in Kion, a forklift truck manufacturer with a significant market share in Europe and China – Weichai is especially interested in Kion's hydraulics business; and of Sany Heavy Industry's $475.9 million acquisition of Putzmeister, where both companies are in the high-tech concrete pumps business; and even of the purported $908 billion purchase of plastics specialist KraussMaffei Technologies by an unnamed Chinese machinery group.

These particular deals show up on the AVCJ radar because private equity firms' hands are all over them. Oaktree Capital Management backed a management-led privatization of Fusheng in 2007; the Putzmeister deal was executed with assistance from CITIC Private Equity; Kion remains a portfolio company of KKR and Goldman Sachs; and KraussMaffei is owned by US-based Madison Capital.

There is clearly a role for private equity to play in bringing investors and investees together, although the aforementioned transactions indicate just how wide-ranging this role can be. For its part, Sino-European PE firm Mandarin Capital Partners plans to devote a considerable amount of its second fund to manufacturing and services companies across China and German-speaking parts of Europe.

In a number of cases, Chinese participation breathes new life and new capital into struggling European businesses, wiping out debts and potentially opening up distribution channels to fast-growing industrial customers in China. This presents another dimension to the private equity role, one that is increasingly being played by a number of China-focused GPs.

Unitas Capital's acquisition of hydraulic cylinders specialist Hyva Holdings is well known for being the instance in which a private equity firm used a high-yield bond to support a deal in Asia. But it also presented a model for several subsequent transactions involving European industrial companies.

Hyva is a Netherlands company that relies on Asia for 70% of its sales; Unitas reoriented it as an Asian company, relocating the majority of staff and operations to the region. Hyva has since expanded its product range in Asia beyond hydraulics to incorporate other equipment relevant to the fast-growing mining, infrastructure and environmental services sectors.

Unitas' portfolio now includes four industrial groups that were originally based outside of Asia but have a big presence in the region and are in the process of being globalized. Expect other GPs to add these capabilities to their investment strategies when looking at high-end German manufacturing assets.

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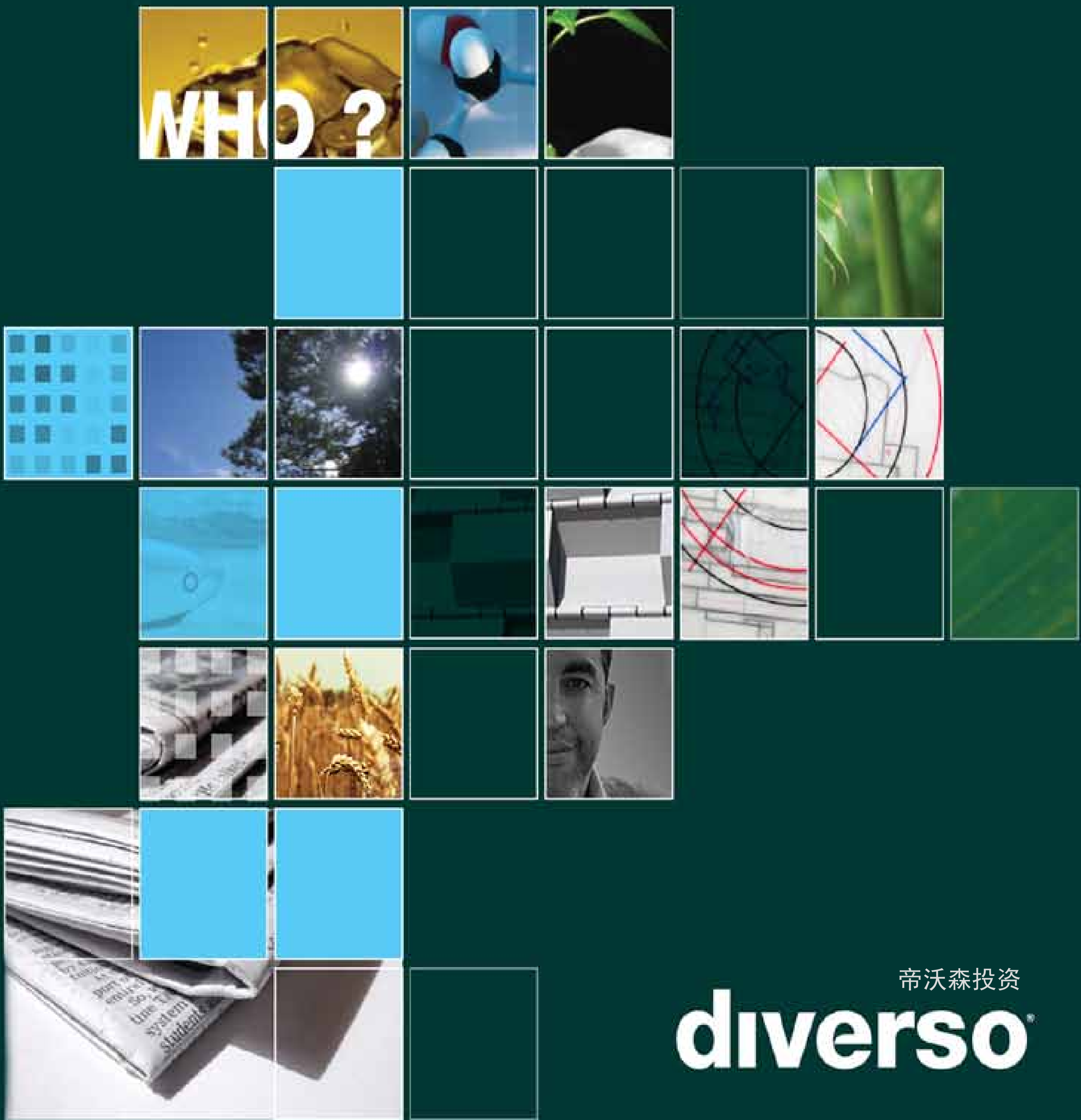

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GLOBAL

OPIC funds head Jay Koh to return to private sector

Jay Koh, head of investment funds and chief investment strategist at the Overseas Private Investment Corporation (OPIC), will leave the group at the end of November to return to the private sector. Koh has been responsible for the US government development finance institution's $2.6 billion emerging markets private equity program for nearly two years.

Hamilton Lane targets $400m fund-of-funds

Hamilton Lane is targeting $400 million for its latest fund-of-funds vehicle, with 15% of the capital earmarked for emerging markets. According to a document sent to prospective investors, Fund VIII promises a fairly even distribution between US and European buyouts, venture capital, distressed opportunities, secondaries and emerging markets.

Chrysalix network targets global cleantech deals

A new cleantech venture investor alliance, the Chrysalix Global Network (CGN), has been formed to target investment opportunities throughout the world. The alliance comprises North America's Chrysalix Energy Venture Capital, Europe's Chrysalix Sustainable Energy Technologies and Asia's Grand River Capital Chrysalix.

ASIA PACIFIC

Maine PERS commits $30m to Affinity's fourth fund

Affinity Equity Partners has secured a $30 million commitment for its fourth pan-Asia fund from the Maine Public Employees' Retirement Systems (Maine PERS). Affinity is targeting $3.5 billion for the fund, which launched in September.

Iris Capital opens offices in Tokyo and Beijing

Iris Capital has opened offices in Tokyo and Beijing as part of an international expansion which also sees the French VC firm open three offices in North America. With bases already in Europe and the Middle East, Iris said this expansion will address the growing need to internationalize its business and the demand from entrepreneurs for more global investors.

MBK reaches first close of $1.25b on Fund III

MBK Partners has reached a first close of $1.25 billion on its third buyout fund, industry sources have told AVCJ. The vehicle launched in September and has a full target of $2.25 billion. MBK declined to comment.

MBK Partners III will follow a similar strategy to its predecessor, focusing on control transactions in North Asia, specifically South Korea, China and Taiwan. The Seoul-based GP, which was set up by Michael Kim (pictured), former president of Carlyle Asia, raised $1.6 billion for its second fund, reaching a final close in 2009. The debut fund closed at $1.56 billion three years earlier.

MBK now has $5.4 billion in assets under management across the three funds. LPs in its first two vehicles are said to include the likes of Ontario Teachers' Pension Plan, Canada Pension Plan Investment Board and Temasek Holdings. As of September, Fund I had generated a realized gross IRR of 34.2% and a realized multiple of 2.9x, while Fund II had an IRR of 30.4% and a multiple of 1.8x.

AVCJ honored at Asia journalism awards

Asian Venture Capital Journal was honored at the 2012 State Street Institutional Press Awards, Asia Pacific, winning two prizes for its reporting on the PE industry. Staff writer Alvina Yuen was named journalist of the year in the investment category. Managing Editor Tim Burroughs won the equivalent award in the investor services and technology category as well as being highly commended in the investment category.

AUSTRALASIA

New Zealand's Xero raises $49m from Valar, Matrix

New Zealand-based online accounting software company Xero has raised NZ$60 million ($49 million) in new capital from US VC firms Peter Thiel-backed Valar Ventures and Matrix Capital Management. The VC firms also purchased stock worth NZ$22 million from Xero's three largest shareholders. Matrix put in NZ$58 million with Valar contributing the remainder.

GREATER CHINA

Bain raises $69.7m through Sunac sell-down

Bain Capital has raised HK$540 million ($69.67 million) by selling a portion of its shares in Sunac China Holdings, a Hong Kong-listed Chinese property developer. Bain, which invested $97 million in Sunac alongside Deutsche Bank in 2009, owned 10.01% of the company prior to this week's transaction. CDH Investments earlier sold 130 million shares in Sunac, raising $73 million.

Oaktree-backed Fusheng buys German rival

Oaktree Capital Management-backed Fusheng Industrial, Greater China's leading industrial air compressor manufacturer, has acquired its German rival ALMiG Kompressoren. ALMiG management has re-invested in the merged entity. Fusheng produces industrial compressors used in construction and manufacturing, and operates under the brands FSElliott and FSCurtis.

Zhongpin agrees PE-backed take-private

US-listed Chinese pork producer Zhongpin has agreed to a private equity-backed management buyout by its chairman and CEO, Xianfu Zhu. The deal values the company at $502 million. Zhu and his co-investors will pay $13.50 per share for the 74% of Zhongpin they don't already own. They have secured $85 million in equity financing from a PE fund, while China Development Bank will provide a $320 million loan.

China Life to support Suzhou infrastructure fund

China Life has partnered with the Suzhou government to roll out a RMB10 billion ($1.6 billion) infrastructure fund. It said to be the first PE infrastructure fund launched by a domestic insurer. China Life and Suzhou International Development Venture Capital will contribute RMB3 billion and RMB6 billion, respectively. The remainder will be raised from social funds.

Mandarin Capital opens offices in Beijing, Munich

Sino-European private equity firm Mandarin Capital Partners is opening two new offices in

Beijing and Munich, Alberto Forchielli, the firm's founding partner, told AVCJ. The Beijing office will start operations within a week under the leadership of Yani Kong, who previously worked at Nature Elements Capital.

Shanghai PE Association to launch fund-of-funds

Shanghai Private Equity Association will partner with CITIC Securities and Bank of Shanghai to establish a RMB3 billion ($482 million) fund-of-funds. The new vehicle will reach a first close of RMB500 million towards the end of the year.

NORTH ASIA

GPIF selects groups for PE feasibility study

Japan's Government Pension Investment Fund (GPIF) has chosen four companies – Capital Dynamics, local law firm Atsumi & Sakai, T&D Asset Management and Tokyo-based consultancy Brightrust PE Japan – to conduct feasibility studies for possible future investments in alternative assets, including private equity.

CITIC Captial to acquire Japan's Polymatech

CITIC Capital Partners has agreed to acquire 100% of Polymatech, a polymer parts supplier for the electronics industry, based in Fukushima. The company, which has factories in Japan, China, Malaysia and Indonesia, filed a petition for the commencement of civil rehabilitation proceedings earlier this year, after amassing liabilities of JPY20.3 billion ($247 million).

SOUTH ASIA

L Capital-backed PVR to buy Cinemax India

PVR, a cinema chain backed by L Capital, will pay INR5.43 billion ($99 million) for a majority stake in domestic rival Cinemax India. PVR will raise INR2.6 billion from L Capital and new private equity investor Multiples Alternate Asset Management (MAAM) to finance the deal. L Capital will put in INR823 million, with the rest coming from MAAM.

IFC invests $25m in Quadria healthcare fund

International Finance Corporation (IFC), the private investment arm of the World Bank, is planning to invest $25 million into Quadria Capital's $300 million private equity fund. The vehicle focuses primarily on healthcare sector assets across South and Southeast Asia.

Patni brothers buy stake in Grameen Capital India

Amit and Arihant Patni, the brothers who set up VC firm Nirvana Venture Advisors, have acquired a stake in Grameen Capital India (GCI) from its original investor IFMR Trust. GCI is a social investment bank run as a joint venture between the Grameen Foundation, Citi and IFMR. It has channeled more than INR7 billion ($127 million) into microfinance institutions.

IDFC invests $18m in Manipal Servicecorp

IDFC Alternatives has invested INR1 billion ($18million) in Manipal Servicecorp, a Manipal Group subsidiary that offers housekeeping and catering services to student hostels. This is IDFC Alternatives' second investment in the education services space and its third partnership with the Manipal Group. The investment was channeled through IDFC Private Equity Fund III.

VCs back $8m Series B round for Shubham HDFC

Accion and Saama Capital have jointly invested $4 million in India's Shubham Housing Development Finance Company. The venture capital firms join existing investors Elevar Equity and Helion Venture Capital in a second round of funding worth $8 million in total. Headquartered in Gurgaon, Shubham provides mortgages and home-improvement loans to low income families in urbans areas of India.

Lombard sells stake in Thai department store chain

Lombard Investments has exited its 10% holding in Robinson Department Store, a mid-market retailer in Thailand, for approximately $219 million. The move came shortly after the company's stock reached a near two-month high of THB65 in response to an announcement that sales were likely to grow 20% in 2012 on the back of new store openings.

Lombard affiliate Asia Investment International, which first invested in Robinson in 2009, sold 111.3 million shares at THB60.5 apiece, a 4.3% discount to Thursday's closing price, through block trades. The stock closed down nearly 7% on Friday on completion of the transaction.

Robinson was founded in 1979 by the Chirathivat family and had 27 stores, comprising 10 in the greater Bangkok area and 17 elsewhere in the country, as of September. Last year, the company said it would spend $130 million opening seven new outlets by the end of 2012, taking its total to 30.

SOUTHEAST ASIA

Ex-Carlyle Southeast Asia head joins CIMB

The former Southeast Asia head of The Carlyle Group, Anand Balasubrahmanyan, has joined Malaysia's CIMB Group, where he will have responsibility for the firm's private equity products. The hiring comes as CIMB is expanding its investment banking business after buying some Asian operations from Royal Bank of Scotland earlier this year. Balasubrahmanyan spent four-and-a-half years at Carlyle.

TriReme Medical in $18m VC funding round

Singapore-based Luminor Capital has a led a $18 million financing round in TriReme Medica, a medical device company based in Pleasanton, California and Singapore. Major existing investors and new Asian investors also participated. The proceeds will support TriReme's development of dilatation catheters and expand its commercial infrastructure worldwide.

Saratoga, Provident sell Tower Bersama shares

Saratoga Capital and Provident Capital have sold a combined 4.4% stake of Tower Bersama Infrastructure, an Indonesian telecom tower business, through a private placement that fetched as much as IDR1.2 trillion ($125 million). The 210 million shares were sold at IDR5,750 apiece, representing a 0.9% discount to the last closing price on Thursday.

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Cleantech: Moving beyond subsidies

With its reputation for lackluster returns and dependence of government support, investors have shied away from cleantech, but GPs are bullish about its ability to stand on its own feet

NICHOLAS PARKER, CO-FOUNDER OF THE Cleantech Group, and the man who claims to have first coined the term "cleantech," was equivocal in summing up the state of the sector at this year's AVCJ Forum: "The best of times and the worst of times."

Perhaps better described as an investment theme as opposed to a sector, cleantech straddles industries ranging from renewable energy to waste management. While 2011 stood out as a comparatively strong year, with cleantech accounting for 3.5% of all private equity investment in Asia, 2012 has been dismal. Investment stands as just $1 billion, less than half last year's total. There were 43 deals and their combined value made up 2% of PE investment in the region.

On the plus side, institutions like the International Finance Corporation (IFC), the World Bank's investment arm, remain upbeat about cleantech and are looking to increase their exposure.

"The future is here and the future is relatively bright for cleantech," says Nikunj Jinsi, global head of clean technology at IFC. Jinsi oversaw around $ 1.7 billion of investment in cleantech worldwide in each of the last two years and IFC wants to dedicate 20% of the $20 billion it invests globally to "climate smart" technologies.

While large multilateral institutions are highly favored as LPs, some fund managers argue that their participation is a double-edged sword. Cleantech suffers from an image problem with many investors put off by its apparent dependence on subsidies and government handouts. In this context, ties to the World Bank don't necessarily help.

"The public face of cleantech, unfortunately, is subsidies." said Christiaan Kaptein, head of private equity for Asia at Robeco. "I think bankruptcies like that of Solyndra [the solar panel manufacturers that shut down after receiving a $535 million loan from the US government] are not helping the sector's image. And then the reality is subsidies are a part of cleantech."

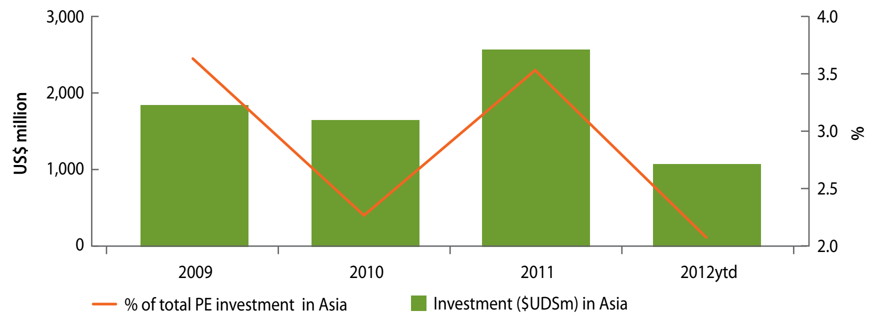
Renewable energy is the part of cleantech most closely associated with subsidies, in Asia and elsewhere. Yet global fossil fuel consumption subsidies reached $523 billion in 2011, up 30% year-on-year, compared to $88 billion in renewable subsidies.

The crux of the debate, however, isn't which sectors receive subsidies, but which sectors actually need them. According to the International Energy Agency, a combination of government incentives, falling costs, rising fossil fuel prices and, in some cases, carbon pricing, will push the renewable share of electricity generation grow from its current 20% to 31% by 2035. Have subsidies, therefore, done their job?

"Subsidies are becoming less and less needed," says Ron Mahabir, co-founder and managing director of Asia Cleantech Capital, who believes subsidies should be limited early-stage technologies. "When we started in 2006, solar modules were more than $5 plus per watt; today the average is $0.50 per watt."

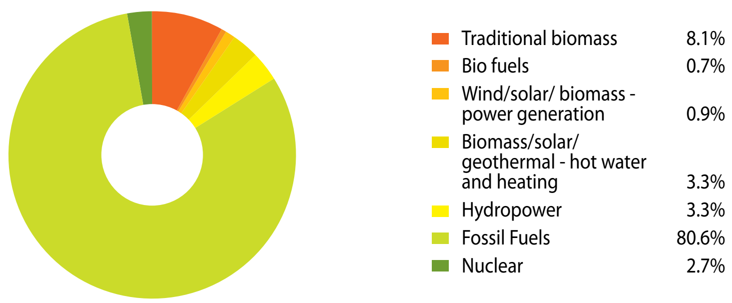
Solar power is indeed a good example of power generation becoming so efficient that governments have begun to scale back their support. China, the world's biggest solar panel producer, reduced subsidies awarded to solar projects by 21% to RMB 5.5 ($0.87) per watt. The decision was based on a 75% drop in the cost of

Private equity investment in cleantech in Asia



Source: AVCJ Research

Renewables share of global energy consumption



source: International Energy Agency

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solar panel components in the last two years.

"Over the next 10 years, we will see solar becoming even more cost effective" says Andrew Affleck, managing partner at cleantech-focused GP Armstrong Asset Management. "With the average cleantech PE fund designed over a 10-12 year period, these opportunities will be a real driver. Costs relating to equipment supply, engineering procurement practices, HR management, quality control and installation are all continuing to decline."

Affleck hopes that solar can shed the need for subsidies and thereby become a more attractive proposition for investors looking to get into the cleantech space. To put it another way, the perception problems would be defeated.

Policy support

However, government policy has been just as important as subsidies in encouraging would-be renewables investors. The combination of urbanization and industrialization has seen energy demand soar in emerging Asia in the last two decades and the pace of growth is expected to remain high. Recognizing the challenges they face in terms of sustainable development, governments have responded by setting themselves renewable energy targets.

Indonesia wants 17% of its power to come from renewable sources within 10 years, compared to the current 10%; Thailand is targeting 25% from a base of 13%, while Malaysia wants to jump from 3% to 11%. India and China have both set targets for 2020: the former wants 15% of its power to come from renewable, up from 10%, while the latter is looking to go from 8% to 15%.

Governments have introduced a variety of initiatives to facilitate private investment in cleantech, including feed-in-tariffs, which among other things provide payments to small-scale green energy producers, tax breaks for energy companies and guaranteed electricity grid access for projects.

"Governments are learning how to improve policies that put place over the last five years," says Armstrong's Affleck. "Different departments are better communicating with each other and they are learning quickly using benchmarks from Europe and North America."

Thailand was the first country in Southeast Asia to encourage investment in large-scale solar power parks and has just completed the Solarta 3MW Sai Sena Solar Park in Ayutthaya, which is seen as a model project for the region. Private equity has subsequently taken an interest, with Singapore-based GP Equis Funds Group paying $200 million for a portfolio of Thailand solar energy assets last August.

Malaysia, meanwhile, has introduced non-financial support mechanisms such as power purchase agreements between electricity providers and buyers, and by investing in infrastructure to provide grid access.

In China, hydropower has gone beyond the need for subsidies completely. The industry has played a major role in government electrification programs for rural areas, but it still represents an opportunity for the private sector because the costs of small- and medium-sized hydropower assets – typically below 100 megawatts – are relatively low.

"I would say we are an anti-subsidy business because if I look our current portfolio, our single largest investment has been in small hydro power," says Dirk Long, founder and managing director of Olympus Capital, which invested $120 million in Zhaoheng Hydropower earlier this year.

Zhaoheng, which currently owns and operates small- and medium-sized hydropower assets with a total installed capacity of over 600 MW, provides power to China's emerging provinces and survives without cash incentives. "It works because it is the lowest cost source of power and gets the lowest tariff and it happens to works very well in the rural area we operate in," Long adds.

Then and now

Some GPs draw comparisons between cleantech today and the internet sector in the wake of the 2001 tech bubble bursting. While many investors have been turned off by early losses, as technology develops there is the potential of decent returns.

Furthermore, it is hoped that with time misunderstandings of the cleantech opportunity will clear. In recent years, certain segments have suffered from chronic overcapacity problems as investors rushed in without much thought to the scope and growth potential of the companies they were backing. In this sense, the fact that many GPs have withdrawn from the sector in recent years represents an opportunity for those who have dry powder.

"You want to be investing when the sector is in distress, not when everyone is clamoring for an opportunity, driving the prices up," says Asia Cleantech Capital's Muhabir. "It is a no brainer. Since 2006 this has been by far the biggest macro economic opportunity of our lifetime."

Cleantech investors: A changing LP base?

While no LP in their right mind would put money into a sector unless they expected a decent return, those investing in cleantech are often pursuing something more than just financial gain. The question for cleantech-focused private equity firms looking to raise their next funds is can they attract capital from outside of this narrowly defined group?

Armstrong Asset Management, which focuses on renewable energy project, reached a $60 million first close on its maiden South East Asia Clean Energy Fund last May. According to Andrew Affleck, managing partner at the firm, more than 50% of funding for private equity in the space is likely to come from development finance institutions such as the International Finance Corporation, the German Development Bank and the European Investment Bank. Each has a mandate to support emerging markets and sectors connected to climate change.

For many larger institutional LPs, cleantech is still a sector to avoid. "If you were to poll a group of LPs you would most likely find that many of them would like to invest more in this sector but are put off because there aren't enough GPs they feel comfortable with," says Affleck. "A fund like ours, because we are a new team that has come together, is still seen as a new fund, regardless of our individual experience."

Ron Muhabir for Asia Cleantech Alternate adds that family offices also typically account for a large part of cleantech-focused GPs' investor bases for similar reasons to the development finance institutions. "In general in Asia, the role of family office is increasing," he says. "They understand where the world is headed, they have a longer term view, and they want to have a positive impact. Most institutional investors are thinking on an annual basis and are looking to make absolute returns."

However, Armstrong's Affleck says he is optimistic that, as larger institutions such as IFC become more active in the space, it will set a precedent other investors. "That is the objective is to make investments where there is at the time not enough capital, they set a benchmark and if successful, more private capital comes into the space and their role is reduced," he says.

Asia Awards: The winners

Firm of the Year – Bain Capital

PE Professional of the Year – Roy Kuan (CVC Capital Partners)

VC Professional of the Year – Sanjeev Aggarwal (Helion Venture Partners)

PE Deal of the Year – Tianhe Chemicals (Morgan Stanley Private Equity Asia)

VC Deal of the Year – Xiaomi (IDG Capital Partners/ Morningside Ventures/Qiming Ventures/Qualcomm Ventures/Beijing ShunWei Venture Capital/DST Advisors/Temasek Holdings)

Exit of the Year – King's Safetywear (Navis Capital Partners)

Fundraising of the Year – PAG Asia I (PAG)

Special Achievement – Lewis Rutherfurd (Inter-Asia Venture Management)

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Firm of the Year – Bain Capital

In the past 12 months, Bain Capital has raised its second Asia fund, closed sizeable deals in Japan and India, and completed a strong China exit. Jonathan Zhu, a managing director at the PE firm, looks back and forward

Q: Bain closed its second Asia fund at $2.3 billion this year. How did the process differ from the $1 billion debut regional fund?

A: Fund I reached a final close in February 2007, about 5-6 months after it was announced. The fundraising wasn't really "public" because we offered LPs in Bain Capital Fund IX a pro rata opportunity to invest. Almost all the global fund LPs subscribed to the first Asian fund. We were nearly four times oversubscribed and had to cut people back substantially. The diligence consisted of a few of us spending a week to 10 days in Boston waiting for people to come in if they were interested. This time around it was very different. The fund is larger and we have a lot of new investors. We had to do pretty extensive marketing and the whole process took about one year. The target was $2 billion, with Bain employees putting in $300 million on top of that.

Q: What are your expectations in terms of deployment?

A: We would like to deploy in four years and so far we have deployed about 20%, so we are right on pace. There have been three investments – Jupiter Shop Channel [$1.1 billion], Genpact [$1 billion] and a committed but unfunded investment in VXI, a Chinese call center operator. VXI is a smaller investment - $120 million, with $80 million in equity. Fund I took a bit longer to deploy than anticipated, primarily because of the global financial crisis. There was a 12-month period where we made no investments. In terms of total capital deployed, it was way above the limit because we have a co-investment arrangement with our sister global fund. For example, at $3.2 billion, with $1.25 billion of equity, Skylark was a very big deal and individual transactions in Fund I were capped at $85 million. As a result, all the rest went to the global fund and co-investors.The transaction size is unlikely to vary that much for Fund II, but there will be less co-investment by the global fund because the Asia vehicle is larger than before.

Q: Fund I focused on North Asia – China and Japan – but Fund II covers the entire Asia-Pacific region. What kind of deal flow is likely to come from Southeast Asia?

A: We don't think we will be doing a lot of deals

> "We want a regional platform where no market is a must-have"

in Southeast Asia. The aim is to have a truly regional platform where every market is a potential target but no market is a must-have. We always look for larger deals – due to our size and in order to be differentiated, because larger firms tend to be more complicated and harder to understand from a diligence perspective. We also have a large operating team that we send to each company to help management grow the business. That works better with larger companies.

Q: How many people are there in the operating and investment teams?

A: The operating group has 17 people, and then we have just under 60 investment professionals. When we raised the first Asia fund we had 28 people in total.

Q: Are you likely to open more offices in the region to reflect the broader geographical mandate?

A: These moves are challenging: you have the conflicting desires to be local and on the ground and also to be centralized and have a cohesive team that works together. Having teams in the three core countries – China, Japan, India – is very important. We will continue to explore the other markets, and my guess is we would probably open the next office in Southeast Asia, but there are currently no plans to do this.

Q: What changes have you seen in the China investment environment?

A: Over the last several years a couple of things have changed. Our first deals in China were $30-40 million, but now we typically invest $70-80 million as a minimum. The level of control and influence has also changed. When we raised the first Asia fund our expectation was that control isn't available in China, but we were surprised on the upside. China Fire & Security was a take-private and a control transaction; Uniview Technology was a corporate carve-out of Hewlett-Packard's China-based surveillance security business. This year we looked at 4-5 transactions where the corporate is looking to sell 100% of the business, so take-privates aren't the only type of control opportunity. Most of the take-privates we have seen so far resulted in the management team or founder retaining control with the private equity investor becoming a substantial minority shareholder.

Q: Bain exited Hipro Polymers and Casda Biomaterials to Arkema, a strategic buyer. Is this the new normal for China exits?

A: It's going to be part of the norm. Twenty years ago there was probably nothing to buy in China for these multinational strategic investors; most foreign direct investments were on a greenfield basis. In the last 10 years you have seen some Chinese businesses, manufacturing or otherwise, achieve scale, develop good management systems and good facilities, and strategic investors are interested in buying them. With Hipro and Casda, we originally bought a minority stake in Feixiang Chemicals in 2007. Feixiang decided to go into a new business, creating HiPro, and then Casda was an acquisition. We had two thirds of these businesses and the founders retained one third. Feixiang was sold to another strategic investor in 2010 and then we exited the two remaining businesses last year. In total, we returned 4x our cost.

PE Professional of the Year – Roy Kuan

CVC Capital Partners has completed five investments and two exits in the last 12 months. Managing Partner Roy Kuan, who leads the Asia team, and colleagues Francis Leung and Sigit Prasetya, discuss market trends

HONG KONG BROADBAND WAS A RARE buyout on the private equity industry's doorstep. For CVC Capital Partners, winning it was arguably the crowning achievement of a 12-month period in which the firm committed more than $1.1 billion in equity across five deals and completed two sizeable exits.

Yet groundwork for the $644 million acquisition of the internet service provider dates back years rather than months. "We had been marketing to the company for several years to do a buyout of this business," says Roy Kuan, managing partner at CVC, who led the transaction. "A deal wasn't feasible at first, but we maintained a dialogue for a long time."

The breakthrough came when City Telecom, Hong Kong Broadband's parent, decided to enter domestic television and needed capital to support these ambitions. CVC's was the logical buyer for the fiber-optic network plus a handful of international direct dialing businesses.

One curiosity is why such a large, high-profile divestment didn't end up in an auction process. "We were able to meet the seller's goals – an acceptable price and reliability in terms of deliverability," Kuan says. "There is also an ongoing relationship with the seller because Hong Kong Broadband provides services to City Telecom, so it's important to have chemistry there."

Burgeoning buyouts

While another buyout of this scale in the telecom space seems unlikely, Kuan argues that the market is conducive to such transactions in other sectors. He cites the existence of diverse corporations that may choose to focus on core business areas, the availability of debt financing, and the plentiful supply of talented executives who might consider management buyouts.

This broadening of the deal environment is already apparent in mainland China, where CVC is seeing investment opportunities emerging against a backdrop of a slowing economy, weak capital markets and tighter liquidity.

"Although China is still challenging, the situation is better now than it was 24 months ago because the public markets have slumped and people are finding it difficult to raise capital or do IPOs," says Francis Leung, CVC's managing partner and chairman for China. "Entrepreneurs are generally more receptive to PE investors than before, while in some cases entrepreneurs are aging and they are willing to sell control."

Take-private deals for overseas-listed Chinese companies are proving to be another rich source of deal flow. CVC has yet to get involved in a transaction, which is perhaps a reflection of the challenges involved. Kuan notes that winning shareholder and board approval can be difficult, especially when some independent directors shop deals around in search of alternative buyers.

CVC's two most recent investments in China, drug developer Venturepharma and ladies footwear manufacturer C.Banner International, were both significant minority deals.

in Southeast Asia, and Indonesia in particular, since 2007. Four deals have come and only one of them by auction. Nevertheless, the private equity firm is cautious about making big calls on bumper deal flow from Southeast Asia, especially when valuations are still so high.

The sub-region has delivered more in terms of exits, including the $850 million sale of Singapore-headquartered fastener manufacturer Infastech to Stanley Black & Decker in July. CVC and co-investor Standard Chartered Private Equity are said to have secured a 3x return after a holding period of just two-and-a-half years.

State Street's Dan McNicholas (left) and Roy Kuan; Sigit Prasetya (inset, top) and Francis Leung

It is Southeast Asia that claims the plaudits for creativity following the acquisition of Malaysian fast-food chains QSR Brands and KFC holdings in a joint deal worth $1.65 billion with Johor Corp. and Employees Provident Fund (EPF). Others have tried and failed to pick up the asset, which includes more than 900 KFC, Pizza Hut and RasaMas outlets across Southeast Asia.

According to Sigit Prasetya, CVC's managing partner for Southeast Asia, the bid was successful because the private equity firm partnered with Kulim Malaysia – the Johor-controlled largest shareholder in QSR and KFC – rather than buy out its interest. "Deals like this are difficult to execute and we are grateful to all parties for their support," Prasetya adds.

Forging partnerships with local business groups has underpinned much of CVC's success

The principal challenge was integration. Infastech was previously two divisions of Acument Global Technologies: one supplies nuts, bolts and screws to the Asia electronics sector; the other is a London-based rivets producer for the European auto industry. CVC consolidated the various entities into a single distribution platform, enabling the two divisions to cross-sell.

The integration process only took about six months, by which point prospective buyers were already circling. It bodes well for trade sales in Asia in general, but Kuan warns that targets must offer scarcity value, a strong brand or technology, and the ability to merge with a global platform.

"We do see more interest from strategic investors," he adds. "We have already sold two businesses to Japanese companies and there was some Japanese strategic interest in Infastech."

PE Deal of the Year – Tianhe Chemicals

Morgan Stanley Private Equity Asia had to overcome trust issues and intense competition to secure its $300 million investment in Tianhe Chemicals. Chief Investment Officer Homer Sun explains how it happened

TIANHE CHEMICALS HAD SERIOUS misgivings about doing business with private equity investors. About five years ago the Chinese specialty chemicals producer had a negative experience working with a small PE fund, not unusual for the pre-global financial crisis period of abundant liquidity when a number of hedge funds sought to enter the asset class.

"The company redeemed the fund, so they did the right thing, but the chairman formed a very cautious view towards working with private equity after that experience," says Homer Sun, chief investment officer at Morgan Stanley Private Equity Asia (MSPEA).

The chairman, Qi Wei, is responsible for establishing Tianhe's market leading positions in lubricant oil additives and specialty fluorochemicals, but remains largely focused on product development. He had brought in his brother, Xuan Wei, as a shareholder and CEO, and tasked him with sourcing the capital required to keep the Tianhe R&D machine running.

"Tianhe carefully conduted its own due diligence on the financing sources available, whether bank debt or private equity," says Sun. "This was the context for our discussions that lasted over many years with the company. My sense is that they talked to a lot of international and domestic GPs over that same timeframe."

When Sun met Xuan Wei in 2009 establishing trust was at the top of the agenda. Three years later, the private equity firm acquired a significant minority stake in Tianhe for $300 million, its largest investment to date.

Industry specialist

Tianhe was founded more than a decade ago in Jinzhou, in northeastern China's Liaoning province, where it has three manufacturing bases and more than 1,200 employees. The company's core business is lubricant oil additives, the highest value-added components of lube oil. The additives play an important chemical role in vehicle engine performance, minimizing friction, cleansing and facilitating heat dissipation.

Due to the technical barriers to entry, the global market for lubricant oil additives is dominated by four players: Lubrizol, Infineum, Afton Chemical and Chevron Oronite. Last year, Warren Buffett's Berkshire Hathaway bought Lubrizol for about $9.7 billion. Until recently, China imported about 60% of its additives because no domestic producer had the technical expertise to match the big four global firms. Tianhe is gradually changing that.

"China wants to reduce its reliance on imports in this area and having a domestic champion that has spent 20 years overcoming the technical barriers for the industry is a vital part of this strategy," Sun says. "Tianhe is not only the number one player in China but bigger than the next three players combined."

A longstanding relationship with China National Petroleum Corporation – the largest domestic petroleum refiner and owner of many of the gas stations through which lube oil is distributed – has helped Tianhe consolidate its position at home. MSPEA is now supporting the company as it moves overseas, faciltating new partnerships with global oil majors. Most of these companies don't have the capability to move upstream into additives, so they purchase lube oil components from third parties like Lubrizol.

> "The 'Made in China' stereotype used to be a plastic toy from Dongguan; now we are seeing businesses create technical barriers to entry" – Homer Sun

The other arm to Tianhe's business, specialty fluorochemicals, is already highly export-oriented. The company entered the space about eight years ago with the assistance of a group of American scientists. The technical requirements are arguably more demanding than for lubricant oil additives – as a result, gross margins are far higher – and the global market is led by DuPont, Daikin, Asahi Glass and Clariant.

Uses of fluorochemicals range from ski jacket waterproofing to fire-fighting foams. "After the BP spill in the Gulf of Mexico, companies have been engineering more effective fire-fighting foams for oil spills, and speciality fluorochemicals enable foams to better glide over the surface of the water," says Sun. "Speciality fluorochemicals are used in a diverse array of niche, lower volume markets that each command very high values."

Tianhe is already a well-established company, on course to record a net income in excess of $300 million for the current financial year. There are a number of standard improvements that can be made –corporate governance initiatives as well as financial forecasting capabilities that help the company plan production and capital expenditure – but the principal challenges are likely to come with scaling up and internationalizing the business.

Even so, Sun sees Tianhe as representing a different type of company to traditional private equity targets in China, and this speaks to a broader evolution of the market.

The first generation of private equity investment was characterized by companies that

Homer Sun (left) and RCA's Rick Glover

often stood out for their brands or distribution networks, run by entrepreneurs who tended to focus on short-term considerations. By contrast, the R&D capabilities that underpin Tianhe's value-add require long-dated and uncertain investment. Sun sees parallels with another MSPEA portfolio company, Sihuan Pharmaceuticals, where he says the board also places a premium on innovation.

"Once you start competing with Lubrizol or DuPont you are up against companies that have been doing this kind of R&D for decades. You are not going to compete in every product category, but in areas where there is strong domestic demand in China that can drive revenue and cash flow, expertise is emerging," Sun adds.

"The 'Made in China' stereotype used to be a plastic toy from Dongguan; now we are seeing businesses creating significant technical barriers to entry and stepping onto the global stage."

VC Deal of the Year – Xiaomi

The hugely successful launch of Xiaomi's smart phone, and the subsequent $216 million Series C round, justified Morningside Technologies and Qiming Venture Partners' early faith in the Chinese company

IT IS FITTING THAT THE ORIGINS OF XIAOMI can be traced back to an, admittedly extreme, example of mobile phone usage in China. Super angel Lei Jun spent 12 hours explaining his concept for a high quality but marketing-lite smart phone brand to Richard Liu, managing director at Morningside Technologies, in 2009.

"We were on the phone from 9 p.m. to 9 a.m. discussing the business model," recalls Liu. "We had to change batteries and chargers several times. We wanted to identify the next big wave and get the timing right. The Xiaomi model is interesting because of the rapid growth in the smart phone market globally."

Lei's approach stood out in two respects. First, he didn't just want to launch a new smart phone but create an ecosystem around it as well. By covering both the hardware and software angles, Xiaomi could essentially mimic the Apple approach and tie in customers on the basis of user experience. Second, Lei wanted to compete on cost. The idea was to strip out marketing and distribution expenditure by launching, promoting and selling the smart phone online.

Morningside and Qiming Venture Partners provided $10 million in seed funding in 2009 alongside the founders. They were joined by IDG Capital Partners in the $41 million Series A round in December 2010. A Series B round worth $92 million came one year later, with Beijing Shunwei Venture Capital – an investment firm backed by Lei Jun – Qualcomm Ventures and Temasek Holdings joining the existing investors.

Validation of Xiaomi's approach was provided by Yuri Milner of DST Advisors who led a $216 million third round of funding in June – valuing the company at $4 billion – with Government of Singapore Investment Corp. (GIC) also involved.

Smash hit

By this point the customers had also spoken. After focusing on R&D in the first year, Xiaomi's debut handset, the MI-ONE, launched in August 2011 with a price tag of RMB1,999 ($310), less than half the cost of smart phones with comparable specifications. There were 300,000 pre-orders in the first 34 hours. Orders for 2012 are expected to number at least six million units, with revenue likely to reach RMB10 billion.

"We would have been happy with 300,000 orders in 2012 as a whole, so everyone has been surprised by how fast it has grown," says Hans Tung, Beijing managing partner at Qiming. "Xiaomi is the fastest start-up to reach $1 billion in revenue and achieve profitability. Google did it in year six, Facebook in year seven, Amazon reached the revenue target quicker but it took nine years to achieve profitability."

Hans Tung (left), his MI-ONE phone and Baker & McKenzie's Brendan Wykes

Xiaomi's ecosystem comprises three elements: the MI-ONE smart phone series, the Android-based MIUI operating system, and instant messaging service MiTalk. This ecosystem is protected by its liberation from expensive distribution channels and high inventory costs – Xiaomi can sell its products directly while the likes of Nokia must navigate regional- and city-level distributors – and the fact that no other domestic player has replicated the model.

"Other mainstream phone companies have the hardware capability and want to do the same thing but I don't think they've made much progress," says Morningside's Liu. "You also see internet companies trying to do it but they lack the hardware capability."

There is also the Lei Jun factor. Xiaomi's founder made his name with software company Kingsoft and online bookstore Joyo before emerging as a super angel investor, seeding 20-plus companies across e-commerce, mobile and social networking. Morningside has collaborated with Lei on seven deals; Qiming on four. Tung volunteers that if anyone else had walked in and made the same pitch, they wouldn't have invested in many.

Stick or twist?

Yet, at the same time, the decision to back Xiaomi wasn't a slam dunk and it depended as much on the team Lei had assembled as on the founder himself. Morningside committed $5 million in seed funding and its total investment in the company now stands at more than $50 million. Liu notes that the ticket sizes prompted a lot of internal consideration.

According to Tung, no deal Lei presented to Qiming has been cheap, but many occasions the team has overachieved, delivering strong gains. The big question mark over Xiaomi was whether it could develop a successful smart phone without the backing of a multinational brand.

"The downside protection was that the team could do software and this was enough for us to do the Series A," Tung says. "The Series B was more complicated. The company was valued at over $100 million, MIUI was working with more than 50,000 active users, a lot of them overseas. But could they design the phone, could China have its own HTC? We didn't know for sure."

One of the clinching factors was the presence of Dr Guangping Zhou, who previously ran Motorola's R&D operation in China and had successfully designed mobile phones before.

As for the future, the company is in no hurry to go public, with Lei ruling out an IPO before 2016. There is a general desire to follow the Alibaba Group approach and build up scale while remaining a private entity, so there is no danger of capital expenditure plans being thrown of course by shifting investor sentiment.

"Xiaomi wants to get a significant market share in China, which is already the world's largest smart phone market," adds Liu. "It can also expand into other emerging markets like India, Brazil, Russia, Indonesia and eventually Africa. Xiaomi can become a global player."

Exit of the Year – King's Safetywear

NAVIS CAPITAL PARTNERS' ACQUISITION of King's Safetywear in 2008 didn't happen at an opportune time. One week after the firm completed its $62 million take-private deal and de-listed King's from the Singapore Stock Exchange, Lehman Brothers collapsed and asset prices crumbled across the board. Suddenly $62 million looked quite expensive.

However, during the three-year holding period, the industrial footwear manufacturer proved to be a standout example of Navis' investment philosophy: get in early, increase asset efficiency, penetrate new markets. When the private equity player exited King's to Honeywell International for an enterprise valuation of S$430 million ($338 million) in late 2011, it reaped an IRR of above 50%, or a 4x money multiple, well above the expected 3x.

Cost reduction was the first step. In addition to relocating production to lower-cost jurisdictions, the private equity firm sent in one of its supply chain professionals to work with the management and reduce working capital from about 43% of sales to 25%.

"On margin expansion, we switched from sourcing expensive leather uppers from Eastern Europe to less expensive alternatives from India – that alone saved about 10% of total raw materials cost per pair of shoes," Nick Bloy, co-managing partner at Navis, tells *AVCJ*.

With business growth in Southeast Asia relatively pedestrian at 7-8%, the next step was to pursue inorganic expansion. Although King's already owned German safety shoe brand Otter when Navis arrived, the PE firm took the company to another level by acquiring Oliver, the leading industrial boot brand in Australia, for a relatively low multiple.

The last step was to maximize exit value. J.P. Morgan ran the auction process and information memoranda were sent to 20 investors and the list was narrowed to three bidders within four months.

Bloy stresses that as long as Navis is a controlling investor with companies of a strong competitive position, strategic buyers – who are more eager to pay a premium – are always available whatever the broader economic or capital markets situation. The PE firm has sold six companies this year – garment label manufacturer Trimco, the Thailand franchises of Dunkin' Donuts and Au Bon Pain, India's Andromeda and Nirula's and Indonesia-based Wall Street Institute – all to strategic investors.

"I think the fact that all our exits this year were to strategic investors speaks for itself," Bloy says. "Public markets have mediocre liquidity for anything less than the biggest of IPOs, and strategic investors in general have strengthened their balance sheets since Lehman and are prepared to make acquisitions, albeit only of the best assets."

Nick Bloy (left) and KPMG's Jon Parker

Fundraising of the Year – PAG

GIVEN THE CHALLENGING FUNDRAISING environment, GPs – especially first-time fund managers – should expect the marketing process to be at best protracted and at worst impossible. The notion doesn't apply to this year's winner of the Fundraising of the Year award.

At $2.5 billion, PAG Asia I is the largest regional buyout vehicle to achieve a final close since The Carlyle Group closed its third Asia fund at $2.55 billion in 2010. It is also the first private equity fund that PAG has ever raised.

"The greatest challenge is that we are a first-time fund and many LPs have a rule not to invest in such vehicles," David Kim, partner at PAG Capital, tells *AVCJ*. "We think that LPs have become much more discerning and selective than prior to the global financial crisis."

Citi's Chris Laskowski (left) and David Kim

Nevertheless, the maiden vehicle – which launched in November 2010 – reached a first close of $1.7 billion in just seven months. At that time, PAG had already secured sufficient commitments for the entire vehicle, but didn't officially complete fundraising until June of this year because certain LPs were still finishing off due diligence and documentation.

Large institutional investors including sovereign wealth funds, pension funds and financial institutions make up more than 90% of the LP base. Market sources tell *AVCJ* that there According to market sources, there are only about 20 LPs in total.

While Weijian Shan, CEO of PAG, is well-known in private equity circles from his time at Newbridge Capital and TPG Capital, David Kim – who spent more than 14 years at Lehman Brothers – argues that the partners' track records and experiences only help a firm complete the preliminary qualifying round in a fundraising race.

"LPs are far more focused on your organization, your team, your institutionalized practices, and what differentiates you from your competitors," he explains. "We think one major advantage of our fund is that it's the best of both worlds: we combine the best practices typically found in global PE firms and the better local connectivity of country-specific funds."

While PAG Asia I has a region-wide mandate, most of the capital is likely to be deployed in China. Consumer retail, financial institutions, industrials and transportation, energy and healthcare are the areas of focus. The fund has already backed a management buyout of US-listed Funtalk China Holdings, completed the buyout of Bicon Pharmaceuticals Holdings and participated as a cornerstone investment in Haitong Securities' Hong Kong IPO.

"We focus on buyouts although we may also make strategic and structured investments without control," Kim elaborates. "Typically we invest no less than $100 million per deal, but we are able to underwrite much larger equity checks because of our LPs' co-investment capacity."

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VC Professional of the Year – Sanjeev Aggarwal

Sanjeev Aggarwal, managing partner at Helion Venture Partners, reflects on a successful fundraise, the popularity of Indian venture capital, and a portfolio that is becoming increasingly international

Q: Helion and several other Indian VC firms have raised funds this year, while domestic PE firms appear to be struggling. Why is venture popular among LPs?

A: Venture capital in India is miniscule – it is worth less than $1 billion per annum against a GDP of $1 trillion-plus. Private equity is well entrenched and well contested, but venture capital is very scarce. In the technology and consumer sectors there are lots of opportunities for non-linear returns. Concept arbitrage, which has happened in the US and China, can be brought to India. E-commerce, for example, accounts for 0.4% of overall organized retail, compared to 5-10% in China and the US. There are so many white spaces to play with, and that is attracting capital to the early stage. In the sectors we are targeting, growth rates are 13-14% per annum, twice the country's GDP growth rate. Our portfolio revenue has increased 40% in the last 12 months.

Q: Helion closed its third fund at $255 million this year, compared to $210 million for its predecessor. How has your team and approach evolved?

A: We can invest about $50 million per annum, which means 7-8 deals each of around $6 million, so $200-250 million is good for us. It gives us dry powder for four years or so before we go back to the market. One thing that has changed is we have strengthened our sector allocation process. We now focus on five core areas – mobility, e-commerce, internet, enterprise software and healthcare – and have specialists in each one. It means we develop good networks and deal flow becomes a combination of reactive inbound and proactive outbound, of top-down and bottom-up.

Q: What is the nature of Helion's ties to Silicon Valley?

A: We have a very strong partnership with Sutter Hill Ventures. In addition, about 80% of our deals are syndicated and we often find Silicon Valley firms like Foundation Capital and Charles River Venture reach out to us because they like our local knowledge and presence. There is a US dimension to our business because many companies are starting from India for India and then going global. A company might have a consumer-facing team in India but some of the engineering and development capability is in the US because there is so much talent in Silicon Valley.

Q: How many companies in Fund II are going global?

A: About 20% could be anywhere in the world, competing globally and serving multiple markets. In many cases, they already have teams in multiple continents. In Fund III, this number is going to be even higher. Most of the enterprise software companies design themselves to be global companies because our domestic industry isn't deep enough to generate a critical mass of revenue. We have 2-3 companies that have been very successful in taking their offerings global. Kirusa, which allows you to send voice SMS, started in India

and Bangladesh and has since entered a lot of countries in Africa. Then there are outsourcing companies – like legal industry-focused UnitedLex – where the talent base is India but the clients are in North America.

Q: Which portfolio companies really stand out as potential star performers?

A: We have invested a lot in online travel and one company we are very pleased with is called RedBus. Bus travel is a highly fragmented industry in India and there was no automation, but this company has become the equivalent of Makemytrip, bringing inventory online and making it available to consumers. They virtually have a monopoly position. RedBus could list offshore, but it is still some years away from achieving the critical mass that Makemytrip achieved. You need $30-40 million in annual revenue before you can consider a NASDAQ listing.

Q: How are the exits looking for Fund I?

A: It takes 6-7 years to exit in India and we still have 13-14 companies in the portfolio and a lot of exciting exits lined up. We see a lot of interest from strategic buyers – the Japanese are very active. Several of our outsourcing companies are also targets for global IT firms, but the companies serving domestic consumption are candidates for IPOs and that market is beyond our control.

Q: Some investors say Indian VC is attractive but unproven. Is this a fair assessment?

A: That's the reality. India's venture capital industry only really started in about 2006 and it takes 7-8 years to build a company with $30-40 million in revenue that can be exited for $200 million, or a 4-5x multiple. I'd say there are 15-20 venture-invested assets, several of them in our portfolio, that are in this position. But when will the exit environment improve? And when is the optimal time to exit? With some companies, you get such high operating leverage in the latter years that if you sell prematurely you aren't realizing the full value. The next 2-3 years will be very important for VC in terms of returning capital at a decent IRR.

Q: What is the competition like for deals?

A: Competition for Series A deals is fairly light. There are 3-4 firms investing consistently in this area and you can normally get in at a reasonable valuation, typically single digit. But for Series B, where the company has gained some traction and reached $10 million in annual revenue, everyone is jumping in and it becomes quite expensive, especially if the sector is hot at the time. It's not that there are too many investors, there aren't enough of these deals. The trick is to get in early and build relationships with the entrepreneurs so you aren't just competing on price.

Special Achievement – Lewis Rutherfurd

IN AVCJ'S 25TH YEAR, THE SPECIAL Achievement Award – which recognizes an individual who has distinguished himself or herself over a long period of time in developing the industry – went to a man who can claim more credit than most for getting the publication of the ground in the first place.

Lewis Rutherfurd set up Inter-Asia Venture Management in 1972 so the firm was already established by the time *AVCJ* came along in 1987. However, the industry as a whole was still in its early growth phase, and it was decided that a trade journal might provide some momentum.

Lewis Rutherfurd (left) and AVCJ's Allen Lee

"We started *AVCJ* so that firms could raise money," Rutherfurd said when accepting his award. "The target was the LPs and we were hoping they would read it and be interested in what everyone was doing. There were barely 100 participants to start with but we know from the stats how successful the industry has become."

The initial idea was that Inter-Asia would work with US-based Venture Economics to create an Asia joint venture. The VC firm was willing to contribute capital and local management and, if the business launched successfully, exit its holding to Venture Economics after a few years.

The transfer investment model had already worked well for Inter-Asia in its first fund as McDonald's and Ikea launched in Hong Kong. Asia Renal Care and Australia's Cookie Man are more recent examples.

Venture Economics, however, was not interested. Rutherfurd reached out three other Asia-focused VCs for help – Victor Fung of Prudential Asia Investments, Ta-Lin Hsu of H&Q Asia Pacific, and Lip-Bu Tan of Walden International – and together they contributed about $1 million in start-up capital. They sold the title to Dan Schwartz in 1990.

Inter-Asia is now in the process of raising its fifth fund, which has a target size of up to $75 million, and remains focused on venture opportunities. Rutherfurd notes that, from the outset, there were several fundamental differences between the US and Asian VC models – "there wasn't much technology to invest in back then, it was better to have a larger stake, and you certainly couldn't leave the entrepreneur alone" – and some still hold true.

Inter-Asia is keen on the food and beverage, healthcare and education sectors, but steers clear of technology unless it working with a partner. Transfer deals are most effective when the brand owner is investing alongside the VC firm, and this is largely because the model relies on the transfer of expertise as well as brand name.

For example, Inter-Asia set up catering company Asia Foods with Compass Group, a global specialist in the field. "Institutional catering is quite high-tech and we wouldn't have done it without someone like Compass to bring us the technology and best practices," says Rutherfurd.

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Sleight of hand

Are LPs using synthetic solutions like total return swaps to trade fund positions behind the managers' backs? Some industry participants are suspicious; others are skeptical

"YOU HAD QUITE A LOT OF POWER 10 years ago," one Asian GP says in reference to secondary sales of LP interests in funds. "Nowadays I suspect there are synthetic ways that people can run around these approval matters. It's a bit like a contract-for-difference versus owning equities. 'I am going to give you this money, I'm not buying the underlying unit, but at the end of the day there will some kind of calculation that will allocate me the capital gain.'"

It is a bleak perspective and one that the GP in question is unable to take beyond conjecture: If synthetic wraps are being used to transfer LP holdings without the requisite GP approval, the underlying manager would be the last to know.

Nevertheless, the debate represents an interesting take on GP-LP relations in the context of changes in investor makeup.

Secondaries are increasingly accepted as part of the private equity industry on a global basis – Lexington Partners estimates that deal flow will reach $30 billion in 2013, nearly double the 2008 figure – and as transactions become more commonplace they also become more sophisticated. This includes the use of total return swaps, the structure usually associated with passing the profits from an LP interest to a third party without any change in the ownership of the interest itself.

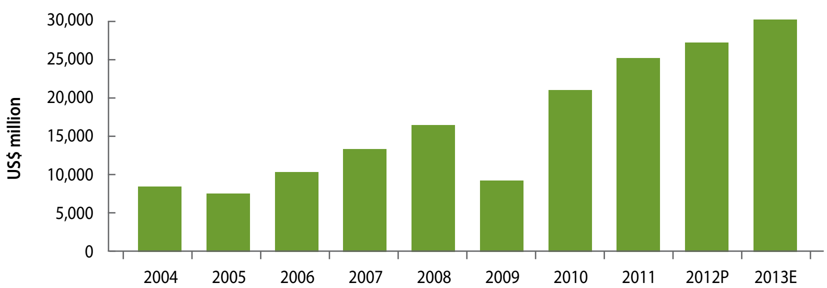
In a nascent market like Asia, where GPs' experience of secondaries ranges from comprehensive to non-existent, transactions might be simpler but they are more challenging in other respects. It isn't unknown for managers to refuse to sign off on transfers or try to exert an undue level of influence on the process.

"There are GPs in Asia that, if they find out somebody is selling, are not going to be very happy about it," says Doug Coulter, a Hong Kong-based partner with LGT Capital Partners. "But for most what matters is who is selling and who is buying. If it means upgrading the LP base – by getting a longer-term investor, a different kind of investor or an investor from a different geography – the GP could see it as a good thing."

Faced with an unyielding manager, it could be argued that total return swap is a useful means of resolving the transfer issue. Industry participants say these structures are a rarity in Asia, but LGT did come across one earlier this year.

An investor was buying a package of assets – one fund investment plus several direct investments – from an investment bank with an office in Asia. The seller received a consideration for the fund, but as far as the manager was concerned, there was no change in the LP. LGT acquired the fund interest from the investor, after the bank transaction was completed.

Global secondary market transaction volume



Source: Lexington Partners

Note: Statistics based on sales price plus unfundeds

However, a total return swap isn't necessarily used because a GP is being uncooperative: anonymity might benefit the seller because they don't want the manager to know about the sale for other commercial reasons, or perhaps they don't want information trickling through the intermediary network to rival investors.

"Sometimes the seller still wants the relationship so they are the name on the door," says Tim Flower, a principal at HarbourVest Partners in Hong Kong. "They might want to retain the GP's corporate finance business but don't want the fund interest. It's not a common occurrence but it does happen."

Another – even more hypothetical – explanation is that an overseas investor wants to acquire an LP position in a renminbi-denominated fund from a local player. Should the regulator find out about the transfer, the fund could lose the benefits available to domestic vehicles, such as access to sensitive sectors and speedy approvals, because the presence of the overseas investors means it is designated foreign.

Practical implications

Hypothetical scenarios aside, Hiro Mizuno, a partner at secondaries specialist Coller Capital, is skeptical about the size of the role total return swaps can play in private equity simply because the industry isn't ready for them.

"I was one of the first people in New York to do a total return swap with loans and at the time there was a big challenge because we had no standardized documentation," he says. "Some transactions in private equity use this technique but they are very difficult to create with PE assets for exactly the same reason. For total return swaps to become mainstream, you need standardized documentation."

Secondaries investors are not opposed to total return swaps – they provide deal flow – but there is also the issue of whether these structures are really necessary. In the vast majority of cases the LP would prefer to sell a fund interest with the GP's consent, rather than expose itself to the costs and structuring and counterparty risks that come with a total return swap.

And even in Asia, GPs are accepting that secondaries are more accepted. On the one hand, a manager who exercises a veto over a transfer is morally obliged to offer an alternative buyer and this can be time-consuming unless candidates are already standing by. On the other hand, a GP might see the benefit of allowing secondary deal flow, almost regardless of the buyer.

"Investors enter a fund knowing it is going to be illiquid but they still think it's not gong to be totally illiquid," says Mizuno. "The presence of secondary buyers encourages LPs to commit to private equity and GPs now realize this."

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MSPEA in convenience store carve-out

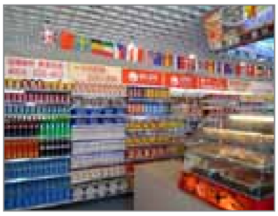
HI-24 IS EVERY BIT THE ORPHAN subsidiary. Last year the Chinese convenience store chain's parent company changed its name to China Financial Services Holdings (CFSH), confirming a strategic rethink already apparent from its acquisitive activity. Once a retail-oriented entity, the renamed and reconditioned CFSH would focus on the financial sector. Its business units specialize in credit guarantees, micro-credit, pawn shop services and financial consulting.

In this context, a private equity firm acquiring Hi-24 is not surprising. Morgan Stanley Private Equity Asia (MSPEA) has agreed to buy a majority stake in the Cayman Islands subsidiary that operates the convenience store business.

"What's interesting is that it is a control transaction for us," says Homer Sun, chief investment officer at MSPEA. "We think that the leading convenience store chain in Beijing has a lot of strategic value. It has an exceptional management team that we will continue to incentivize to drive growth."

MSPEA will take ownership of just over two million shares in the Cayman vehicle in return for settling a shareholders' loan worth RMB58.1 million ($9.3 million). The selling party is KPB Marketing, a subsidiary of CFSH, although the majority of the shares come from Siu Lam Cheung, the parent company's chairman.

The first Hi-24 store opened in Beijing in 2002 and 100 more followed over the next three years. At the same time, CFSH – then known as KPI – was developing its hypermarket interests in mainland China. Supported by investments from PAG-controlled ARC Capital Holdings and CITIC Capital in 2007, the company took a majority position in Hualian GMS Shopping Center, its Shanghai-based partner since the late 1990s. The asset was exited in 2010.



Hi-24: Beijing stalwart

By this point the Hi-24 network had expanded to 150 outlets, claiming a 30% share of the Beijing convenience store market. The plan was to double that footprint within two years and by year-end 2011 there were about 190 stores. The business was worth approximately HK$17.8 million ($2.3 million) as of June 30, with a turnover of HK$264 million and net profit of HK$8.5 million in 2011.

Regarding the nature of the transaction, Sun notes that a parent divesting a non-core asset has to consider treating management fairly – by securing a reliable new owner – as well as maximizing the sale price. MSPEA has known the management team for several years.

The near-term plan is to consolidate Hi-24's market leading position in Beijing in the face of competition from the likes of 7-Eleven and Quik, both of which operate on a national scale.

"We think there is a steady opportunity in terms of adding stores and expanding the network by 50-100% in the next few years," Sun says. "Compared to Shanghai, for example, Beijing is an underpenetrated convenience store market, so we think there is a lot of room to grow the business."

Abraaj exits Thai hospital with 3x return

OF THE 19 MILLION TOURISTS WHO visited Thailand in 2011, an estimated 500,000 traveled specifically for medical care. Although medical tourism only accounts for 0.4% of national GDP, the industry is growing at an annual rate of 16% and is expected to be worth THB100 billion by 2015.

Increased air travel, rising healthcare costs and long waiting lists in developed countries, and an aging global population are the principal reasons for patients opting to receive private treatment in emerging Asia. There is increasing demand from domestic customers as well, as household incomes rise and private health insurance penetration deepens.

Thailand: Medical tourism

The Abraaj Group has ridden this wave and now decided to lock in its gains, securing a 3x return on its investment in Bangkok-based Vejthani Hosptial as regional healthcare chain KPJ Healthcare bought the asset last week. The THB605.6 million deal, which is expected to close in the second quarter of 2013, values Vejthani at 9x forward EBITDA less net debt.

The original investment was made in 2009 by Aureos Southeast Asia Fund, a vehicle run by Aureos Capital until its acquisition by Abraaj earlier this year. The fund injected THB200 million alongside GSB Private Funds, a vehicle set up by Thailand's Government Savings Bank and managed by ING.

"We have made a number of investments in the space both in Southeast Asia and globally," Srisant Chitvaranund, a partner with Abraaj, tells AVCJ. "Vejthani was resilient during the downturn in 2009 and was well positioned to capture an increasing share of the growing medical tourism trade where Thailand has been a large beneficiary."

Vejthani Hospital, which was established in 1994, has a capacity of 500 beds and sees more than 300,000 patients per year. During its holding period, Abraaj supported numerous initiatives to transform Vejthani from a general hospital into a multi-specialty hospital. This allowed Vejthani to increase its market share in medical tourism as well as leverage domestic growth.

KPJ has a network of 12 hospitals in Malaysia and two in Indonesia, with more than 2,600 beds. Prior to the Vejthani acquisition, the company was already boosting its exposure to medical tourism, with the number of international patients increasing 40% in 2011.

KPJ will fund the acquisition through MYR54.5 million ($17.9 million) in debt and MYR6.1 million from its own reserves. According to DBS, Vejthani is expected to deliver an EBITDA of MYR32.1 million for the 2012 fiscal year, which translates to a MYR7.5 million contribution to KPJ's overall EBITDA, or 2.3% of the sum projected for the 2013 fiscal year.

Abraaj is not the only private equity to capitalize on growth in medical tourism. In January, Olympus Capital invested approximately INR5 billion ($100 million) for a minority stake in Indian hospital chain DM Healthcare. The funding will in part be used to develop Kochi, where DM is based, into a medical tourism destination.

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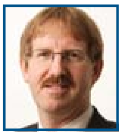

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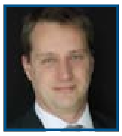

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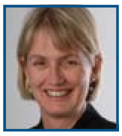

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