Down with the kids
VC success in mobile internet relies on understanding the target market

Buying big brother
Unitas backs China surveillance supplier

Whither Indian PE?
Experts share their views in AVCJ webinar
Hear from 50+ private equity leaders, including:

Keynote speaker

Thomas H. Lee
President,
LEE EQUITY PARTNERS

Senior representatives from leading investors:

- HarbourVest Partners
- Archer Capital
- Australia Post
- Australian Private Equity & Venture Capital Association
- Brookvine Pty Limited
- Cambridge Associates Ltd
- Champ Private Equity
- Coller Capital
- Funds SA
- Future Fund
- HSBC Bank Australia Limited
- Industry Funds Management
- KKR Australia Pty Limited
- KPMG Australia
- Macquarie Investment Management Private Markets
- MLC
- Navis Capital Partners
- Principle Advisory Services
- QIC
- Sunsuper Pty Ltd
- Tata Opportunities Fund
- The Carlyle Group

Book before 25 January and SAVE USD200
Register now at avcjausnz.com

Contact us
Registration: Pauline Chen T: +852 3411 4936 E: Pauline@avcj.com
Sponsorship: Darryl Mag T: +852 3411 4919 E: Darryl.Mag@incisivemedia.com
The risk factor

PROXIMITY IS REASSURING. IT SHOULDN’T be surprising that a corporate governance scandal in Asia triggers concerns among institutional investors in North America who are far removed from the information flow and first hear the news via newspaper headlines designed to grab readers’ attention. The man on the ground, meanwhile, is more likely to grasp the full context of the situation and better positioned to make a call on risk. That’s why LPs use advisors and intermediaries.

While an office in Chicago, New York or Sacramento doesn’t offer a great vantage point of Asia, neither does it favor other geographies – apart from the US and that is where the bulk of US dollar-denominated US pension fund resources will inevitably and understandably go.

For all the bullish voices we hear on Asian growth prospects, the North American LPs who participated in the AVCJ Forum in November were guarded in their optimism. Some said they couldn’t justify raising their private equity allocation to the region beyond 10% until risk factors ease and local managers build up stable teams and more substantive track records.

The general consensus was that geographies with more developed capital markets – where control transactions are available – have delivered the best returns.

Does this indicate a swing in investor sentiment as the flood of capital into Asia in recent years prices out the emerging markets premium? The winter 2012 edition of Coller Capital’s global private equity barometer appears to say as much.

The LPs who participated in the survey felt more or less the same about US and European buyouts as they did four years ago (the US has crept up a few points while Europe has retreated by a similar amount). Sentiment towards Asia Pacific GPs, however, has dropped off considerably.

Subsequent questions on risk and reward suggest why. Two thirds of LPs said private equity firms had underestimated the investment risks in India; more than half said the same was true of China. Three out four LPs expect the risk-reward equation for China is worsening; the picture for India was also negative but not to the same degree, perhaps because LPs think the situation can’t get any worse than it already is.

Given these views, it is puzzling that in the same survey 20% of respondents said they were focusing more on nascent private equity markets such as Indonesia and Vietnam than more established destinations like Australasia, Japan, South Korea, India and China. These countries present similar regulatory and political risks to China and India; indeed, in some cases they are far worse. So do the potential rewards really warrant participation?

Hiro Mizuno, a partner at Coller, observed that the 20% figure is a strong statement, but nothing more. The reality is that, of the North American institutions that account for the bulk of global private equity capital, only a tiny percentage would be bold enough to establish direct relations with Indonesian and Vietnamese GPs right now.

They may get some exposure through pan-regional funds and fund-of-funds, but even the latter, that have teams on the ground assessing opportunities, are relatively conservative. One global fund-of-funds most recent vehicle is deployed as follows: just over 25% of capital committed so far is with funds run by pan-regional players, predominantly the global buyout firms; another 25% is invested in established Australian GPs; another 25% is with China-focused vehicles; there is only one Southeast Asia fund, and it is among the smallest holdings.

There is a difference between focusing more attention on nascent markets compared to established markets – maybe an LP previously didn’t focus on Indonesia at all – and actually putting your money where your mouth is.

It will take a number of years, during which Southeast Asian GPs must build up track records and perhaps North American LPs establish offices in Asia, before the regions more emerging markets account for a meaningful slice of the pie. And there are no guarantees that early promise can be sustained over multiple cycles.

Tim Burroughs
Managing Editor
Asian Venture Capital Journal
ASIA PACIFIC

Equis closes first fund at $647m
Equis Funds Group, a pan-Asian fund manager focused on Asian energy and infrastructure, has closed its first private equity fund – Equis Asia Fund I – at $647 million, exceeding its initial target of $500 million. The fund has already made two investments: a South-East Asian solar generation platform and a hydroelectric generation platform in India.

Partners Group raises $1b for emerging markets
Partners Group has raised $1 billion for its 2011 vintage Asia Pacific and emerging markets private equity programs. In addition to Asia Pacific, the programs target investments in Latin America, Eastern Europe and Africa.

KKR raises $6b for Asia fund
KKR is said to have reached the $6 billion target for its second Asia fund. It is the largest vehicle ever raised in the region. According to Reuters, strong demand from pension funds and endowments left the fund over-subscribed. KKR reached a first close of more than $3 billion in June.

Bain hires ex-J.P. Morgan executive as senior advisor
Gaby Abdelnour has been appointed senior advisor to Bain Capital effective January 1. He retired as the Asia-Pacific chairman and CEO of J.P. Morgan in June, a position he held for the last six of his 14 years at the firm.

Templeton divests second emerging markets fund
Franklin Templeton has exited all the investments held in its second emerging markets fund, which was established in 2005 and had a corpus of $132.5 million. The vehicle has generated a net IRR of 34.3% and a money multiple of 2.1x.

AUSTRALASIA

Equity Partners buys majority stake in AHM
Equity Partners has acquired a stake of around majority stake in AHM
Equity Partners has acquired a stake of around

CHAMP exits Australian Portable Buildings
CHAMP Ventures has agreed to sell Australian Portable Buildings (APB) to two Canadian companies, Black Diamond Group and Britco, for A$72.5 million ($75.2 million). The Australian private equity firm acquired a near 80% stake in the company in February 2007 for a reported A$12 million.

Black Diamond, a North America-focused remote lodging, modular building and energy services company, will pay A$41.1 million for a 90% stake in APB’s modular rental business and 20% of its portable building manufacturing operation. Britco, a construction company that supplies Black Diamond, will take the remaining interests in each business for A$31.4 million.

CHAMP’s investment in APB was a succession planning solution as the company founder, Rick Welch, was looking to retire. The private equity firm brought in Neville Katz as CEO and gave him and his management team a stake in the business. It helped APB expand its manufacturing operations in Queensland and Western Australia, where the mining sector has a strong presence, and also set up a nationwide hire business.

70% in New Zealand camping and gardening product distributor Amalgamated Hardware Merchants (AHM). The investment came from Equity Partners Fund No. 3. The deal value was not disclosed. AHM chief executive Wayne van Diepen, and the founding Christie family, will hold the remainder of the company.

ABAX

Abax completes Fushi Copperweld take-private
Abax Global Capital has finally completed its management buyout of NASDAQ-listed Chinese wire manufacturer Fushi Copperweld more than two years after the initial bid was submitted. The transaction, staged in conjunction with Li Fu, Fushi’s chairman and CEO, and financed by China Development Bank, values the company at $364.8 million. Shareholders approved the $9.50 per share cash offer on December 11 and Fushi ceased trading on December 27.

ShangPhama board agrees to TPG-backed buyout
ShangPharma Corporation, a Chinese pharmaceutical and biotech research outsourcing firm listed on the New York Stock Exchange, has agreed to management buyout by Michael Hui, the firm’s chairman and CEO, and TPG Capital. The transaction values the company at $173 million.

Wilson Sonsini opens Beijing office
Venture capital-focused law firm Wilson Sonsini has opened an office in Beijing, enlarging a Greater China footprint that already takes in Shanghai and Hong Kong. The office is led by Kefei Li, a partner with the firm. He reports to Weihseng Chen, the China practice leader.

Focus Media agrees to $3.7b PE-backed buyout
Chinese advertising company Focus Media has agreed to a $3.7 billion management buyout backed by The Carlyle Group, FountainVest Partners, CITIC Capital, China Everbright and Fosun International. Focus Media's board approved an offer of $27.50 per share and the deal will now be put to a shareholder vote. CDH Investments was originally part of the consortium but dropped out in December.

Templeton invests in Tongda Group
Franklin Templeton has acquired a 6.3% stake in Tongda Group Holdings, a Chinese manufacturer of high-precision components used in consumer electronics products. Templeton Strategic Emerging Markets Fund IV purchased 300 million shares in Hong Kong-listed Tongda. Based on the company's closing price the day before the transaction was completed, the investment is worth HK$100.5 million ($12.9 million).

NORTH ASIA

Advantage Partners buys Sanyo’s camera business
Advantage Partners has acquired Sanyo Electric’s digital camera unit. Panasonic, which took control of its former competitor in 2009, said it chose to do business with Advantage because of the
private equity firm's strong record of investments in Japan and its expertise in improving corporate value.

**Carlyle relists Chimney, completes partial exit**
The Carlyle Group has completed a partial exit from Japanese restaurant chain Chimney having relisted the company on the Tokyo Stock Exchange three years after taking it private. The private equity firm sold holdings in the company equivalent to 53% of the total shares issued, of which about 7% was an over-allotment.

**Fortress closes second distress fund at $1.6b**
Fortress Investment Group has closed its second distress fund, Fortress Japan Opportunity Fund II, at its hard cap of JPY130 billion ($1.65 billion). The fund, which focuses on real estate-related debt and other assets in Japan, seeks to capitalize on the dynamics related to deleveraging by financial institutions and near-term debt maturities.

**Chinatrust in talks to buy Tokyo Star Bank**
Chinatrust Commercial Bank, one of Taiwan’s largest commercial banks, is reportedly in talks to acquire Tokyo Star Bank for JPY50 billion ($582 million). Tokyo Star’s shareholders – Lone Star Funds, Shinsei Bank, Crédit Agricole, Aozora Bank and others – will likely make a decision on Chinatrust’s offer early in 2013.

**Zoomlion’s PE backers exit CIFA holdings for $236m**
Chinese construction equipment maker Zoomlion has paid $236 million for equity interests held by Hony Capital, Goldman Sachs and Mandarín Capital Partners in the business unit that was used to buy Italy’s Compagnia Italiana Forme Acciaio (CIFA) in 2008. The transaction, which saw Zoomlion buy a 60% stake in the European concrete pump manufacturer for EUR163 million ($215 million) is held up as a prime example of how private equity can help corporate China make acquisitions overseas. Zoomlion said it wanted to assume control of unit, Zoomlion CIFA, in order to bolster its international development strategy and strengthen its core business. The company paid $132.5 million for a 12.77% stake held by Goldman, 8.94% owned by Mandarín Capital and 1.13% controlled by CIFA management. Hony received $103.3 million for 17.84%. Hony has been an investor in Zoomlion since 2006 and retains a 6.91% stake in the parent company. In partnership with Mandarín Capital and Goldman, it committed EUR108 million to the Chinese company’s CIFA acquisition four years ago. All three have now fully exited the subsidiary.

**Fortress closes second agri fund**
Fortress Equity Advisors is targeting $250 million for its second India agribusiness fund, more than double the $120 million raised for its debut vehicle in 2008. The larger corpus means Rabo’s typical transaction size will increase to $25 million from the current $10 million.

**Essel Group to launch private equity fund**
Essel Group, the Indian conglomerate headed by media mogul Subhash Chandra, has set up a new investment arm – Essel Financial Services – that will target private equity, infrastructure, real estate and financial services. Sumit Kumar, who was working with Beekman Helix India, has been appointed head of the private equity division.

**Lafarge in talks with PE to sell part of India business**
Lafarge is in talks with private equity and financial firms to sell 20-25% of its India unit for about $300 million. The divestment is part of a wider effort from the French cement maker to divest non-core assets and reduce debt levels to below EUR10 billion ($13 billion). KKR and Temasek Holdings are said to be among those that have been approached as potential investors.

**Abraaj exits Thai restaurant chain Hot Pot after IPO**
The Abraaj Group has exited restaurant chain Hot Pot after taking the company public on the Stock Exchange of Thailand in September. Hot Pot raised THB285.3 million ($9.3 million), in an offering that was more than three times oversubscribed. The original investment was made in 2006 by Aureos Southeast Asia Fund alongside GSB Private Funds.

**Blackstone makes real estate appointment**
The Blackstone Group has promoted India-based Tuhin Parikh to senior managing director in its real estate division. He joined the firm in 2007 and was previously a managing director.

**PE-backed Bharti Infratel completes $763m IPO**
Bharti Infratel, the Indian telecoms infrastructure subsidiary of Bharti Airtel, has raised around INR4.17 billion ($763 million) in India’s biggest IPO in two years. The offering provided an exit for Temasek Holdings, Goldman Sachs, Eton Park Capital Management and Nomura. Bharti Infratel is also backed by KKR, India Equity Partners, Axa Private Equity, Macquarie Group, Citigroup, Investment Corporation of Dubai and AIF Capital.

**Temasek invests $104m in Godrej’s agribusiness unit**
Temasek Holdings has paid INR5.72 billion ($104.5 million) for a 19.99% stake in Godrej Agrovet, an agribusiness subsidiary of Godrej Industries. The deal comprises primary and secondary tranches, with the former earmarked to support Godrej’s expansion plans and the latter facilitating the exit of existing shareholders.

**SOUTH ASIA**

**Summit invests $26m in SE Asia online retailer**
Summit Partners has invested EUR20 million ($26.4 million) in the German holding company of Southeast Asian online retailer Lazada. The capital will be used to expand the company’s product offering.

**Baird invests in Singapore’s Boston Plastics**
Baird Capital Partners Asia has invested in Singapore plastic injection molding company Boston Plastics. It acquired shares from individual investors and company management, with the latter retaining majority control of the business. Although headquartered in Singapore, Boston Plastics’ manufacturing operations are in China.

**Abraaj exits Thai restaurant chain Hot Pot after IPO**
The Abraaj Group has exited restaurant chain Hot Pot after taking the company public on the Stock Exchange of Thailand in September. Hot Pot raised THB285.3 million ($9.3 million), in an offering that was more than three times oversubscribed. The original investment was made in 2006 by Aureos Southeast Asia Fund alongside GSB Private Funds.
Creating harmony for long-term growth

SAVE up to US$400 before 8 March. Register at avcjchina.com

Reasons to attend:

- Network with 250+ industry professionals including the leading domestic and regional GPs
- Hear from 45+ of the most influential Asia focused institutional investors
- Learn how this challenging and complex market is evolving and methods for creating long-term growth

For the latest programme, please visit avcjchina.com

Contact us
Registration enquiries:
Pauline Chen
T: +852 3411 4936
E: Pauline@avcj.com

Sponsorship enquiries:
Darryl Mag
T: +852 3411 4919
E: Darryl.Mag@incisivemedia.com

Co-Sponsor
CRCI

Legal Sponsor
Cooley
The race to stay relevant

Venture capital investors targeting the mobile and social media space are only as good as their understanding of the consumer habits and technologies that underpin industry trends

WITHIN FIVE DAYS OF ITS LAUNCH AT THE end of May, Changba became the most popular free iPhone app in China. Fifteen days later it was closing in on one million downloads. Changba is in effect a mobile karaoke bar, but differs from rival apps in its social media extension: a user selects a song, sings it into his or her phone, and then shares the result with friends. Members of the Changba community can comment on other users’ songs and award virtual flowers to show their appreciation.

The app was developed by Zuitao, a Beijing-based company set up by Tony Chen, who previously co-founded travel portal Kuxun, which was sold to TripAdvisor in 2009. He spent 18 months bringing Changba to market and has claimed it could be worth $1 billion in 4-5 years.

Sequoia Capital China was sufficiently convinced by Zuitao’s success that it invested in the company in July, reportedly paying $15 million for a 20% stake. Neil Shen, founding managing partner at the venture capital firm, admits that without input from younger members of the investment team, the deal might never have happened.

“It’s difficult to imagine myself or most of my team members going to KTV more than three times a month but I checked with one of them who graduated this year and he said he loves this type of application,” Shen explained during a panel discussion at the Venture Capital Summit that formed part of the 2012 AVCJ Forum.

“Especially in the technology-media-telecom space, you need to pay a lot of attention to the younger generations. The user base could come from the 1980s and 1990s.”

The entrepreneurs themselves also tend to be on the young side and therefore have an intuitive grasp of what customers want. The classic example is Pony Ma, who started internet behemoth Tencent 10 years ago when he was in his mid-20s, Zuitao’s Chen is in his mid-30s.

Know your market

For all VC investors in Asia, success in mobile and social media essentially hinges on staying relevant. Almost every element of the market is changing rapidly, from the customers and their media preferences to the technology that underpins how content is delivered. What isn’t emerging fast enough are sustainable monetization models.

An ability to identify emerging consumption and technological trends is therefore crucial – and it comes from being in touch with developments on the ground. “We are always looking at the capital needs curve of a technology against the technology’s readiness level and trying to find the intersection between the two,” said Jonathan Glen, co-founder and managing partner at China-focused VC firm Diverso. “You need to understand demand and the dynamics of that demand.”

The situation is complicated by the fact that the evolution of more developed markets can seldom be used to plot an accurate trajectory for others due to a wealth of mitigating factors. One of the most prominent is that, while the US and Europe experienced linear progression – a PC revolution followed by an internet revolution followed by a mobile revolution – in Asia the revolutions are either happening at the same time or in a different order.

“More people in the developed world are interfacing through mobile devices but in Vietnam that has always been the case,” said Henry Nguyen, managing general partner at IDG Ventures Vietnam. “More people own mobile phones than PCs and their first contact with technology is a phone. The way you interact with it – touching it, being closer to the screen – changes the whole dynamic in terms of providing any sort of service. That means a change in the whole media market landscape.”

The practical implications are clear. How do marketers deal with the smaller screens on mobile devices for which visual display advertising is less effective? How do they take advantage of mobility – customers are on the move and could be walking past retail outlets – and the dissemination of information via social media platforms?

Vietnam is in many respects the ideal demographic Petri dish for these trends. More than two thirds of the population is 16-64 years old, and the median age is 26. Consumption has been growing at 20-24% per year for nearly a decade as, 20 years after the country introduced reforms, younger generations have unfettered access to media. And it’s all in the palm of their hand; there are 2.7 million wired broadband subscribers and 20 million 3G subscribers.

China’s development path is slightly more conventional. PCs came out before mobiles and now the PC market is slowing while mobile internet use continues to accelerate. Embryonic smart phone demand has been extraordinary, with close to 300 million users by the end of 2012, up from only 10 million in 2010.

However, even comparisons to Japan, which went through a similar PC-to-mobile transition 10 years ago, are skewed not only by the nature of technology available at the time, but also by the manner in which mobile emerged. As Shinichi Takamiya, a partner at Globis Capital Partners, noted, roughly 80% of Japan’s population now accesses the internet via mobile devices, but this wouldn’t have been possible without encouragement from the telecom operators.

“When mobile internet services were introduced in 1999 carriers played a crucial role,” Takamiya said at the AVCJ Forum. “One of the biggest things is the transaction costs. In Japan, the carrier’s take of the transaction fee is 7%; in the rest of the world it could be 50-70%. The carriers have also launched developer kits to support the content developers.”

By contrast, China’s mobile revolution has not been carrier-led; Ian Goh, a partner at Matrix Partners China, describes it as “more guerrilla.”

There are multiple standards and platforms, and the three companies that dominate the

“There are so many different operating systems for phones in China. Entrepreneurs have to be an advertising agency, deal with technology issues and be a platform themselves”

– Ian Goh
South Korea, Southeast Asia needs the same driving force; we need someone commercial advertisers,” Zhou said. “Mobile internet, it took 3721, Yahoo and Baidu to businesses becomes easier.

The uncertainty is exacerbated by the absence of leadership and proliferation of different standards, but Joe Zhou, managing partner at the VC firm invested in Beijing Momo Technology, a dating app that had 4.5 million users within eight months of its launch in 2011.

That said Xiaomi has proved it is possible to create an independent mobile phone company from scratch with limited VC funding. This was achieved by recognizing what younger generations wanted (a low-cost smart phone) and how best to tell them about it (leveraging social and viral marketing channels).

The monetization issue
Xiaomi is a classic example of a disruptive model prevailing in a fast-changing industry. The uncertainty is exacerbated by the absence of leadership and proliferation of different standards, but Joe Zhou, managing partner at Keytone Ventures, warns this dynamic will lead to far more failures than success stories among start-ups. He would like to see more leadership on the advertising side so that monetizing businesses becomes easier.

“If you look at the early stage of China’s internet, it took 3721, Yahoo and Baidu to build the distribution system to bring in the commercial advertisers,” Zhou said. “Mobile needs the same driving force; we need someone to do the dirty work. People who raised large amounts of money last year in e-commerce at high valuations, like Dianping, were able to do that because they did a lot of the dirty work that no one else wanted to do and have more sustainable models.”

There are three major monetization channels: advertising, subscriptions and transactions. Given that a paid-for content culture has yet to develop in China, Zhou sees mobile gaming as the only viable monetization strategy at present.

His dismal view on mobile advertising is shared by others. Although Beijing-based iResearch estimates that China’s mobile advertising market was worth RMB5.52 billion ($885 million) in 2012, Huang Wei, chairman of consultancy Shanghai Power Stream Mobile Media, recently argued that the actual figure is more like RMB500 million – 1.3% of overall online advertising – because 90% of the takings are commissions from app downloads. Anecdotal evidence suggests that app developers are the principal buyers of these user-acquisition services, not mainstream consumer brands.

“I invested in a mobile ad company in 2005, but it was a big fish in a very small pond and it is still trying to justify its leadership position,” added Matrix’s Goh. “It started from WAP and two years later everyone was moving to smart phones. There are so many different operating systems for phones in China. Entrepreneurs have to be an advertising agency, deal with technology issues and be a platform themselves.”

Vietnam, unsurprisingly, is even less developed. It is estimated that online ad spending as a whole might have surpassed $40 million in 2012, growing at 50% a year, but that equates to less than $0.50 per person. The mobile content and services market in Japan, meanwhile, is worth $20 billion and expanding at an annual rate of 15%. Even Android, supposedly the most difficult platform to monetize, has mobile games making $10 million each month.

Globis Takamiya argues that it is just a matter of time before monetization ramps up in less developed Asian nations, but it isn’t clear exactly how this will be realized. Monetization began in Japan with feature phones – user acquisition costs and conversion rates were low, and monthly spending was high. In the smart phone era, this has been turned on its head, with the emergence of Apple and Google as global distributors pushing up user acquisition costs.

“In Japan, the monetization problem appears to have been solved but in China it’s still an issue,” said Richard Hsu, managing director of Intel Capital China. “There are a lot of ad networks on the mobile side that are still being developed, and although people think it’s going to big, there is no evidence of traction. A lot of people using these screens but it’s a question of getting the infrastructure in place.”

Predicting the future
There are plenty of ideas as to what a mobile-enabled world will look like: wireless broadband technology will allow consumers to live in the cloud, carrying all their data – for work and leisure – with them wherever they go, and hooking up mobile devices to different display units; advertisers will find more sophisticated ways to target prospective customers individually, based on geographical location and personal preferences.

Yet it remains to be seen which business models will succeed in making the breakthrough to profitability and then whether they have the staying power as new competitors flood the market. For VC investors who spend their days identifying underserved niches of demand and disruptive technologies, keeping a finger on the consumer pulse has never been more important – and this means looking towards youth.

“Communication power will continue to grow just like computing power and that changes the way you consume information,” said IDG’s Nguyen. “That is how kids are growing up today. If you look at Twitter or Facebook, they are always getting information about what’s going on in their world. If you look at how they watch TV, they don’t watch TV; they watch YouTube videos or Netflix. It’s a whole new world in terms of communications, media and tech.”

Source: AVCJ Research

Early-stage VC investment

- China
- Japan
- South Korea
- Southeast Asia

2006 2007 2008 2009 2010 2011 2012

<table>
<thead>
<tr>
<th>Year</th>
<th>US$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>0</td>
</tr>
<tr>
<td>2007</td>
<td>20</td>
</tr>
<tr>
<td>2008</td>
<td>40</td>
</tr>
<tr>
<td>2009</td>
<td>60</td>
</tr>
<tr>
<td>2010</td>
<td>80</td>
</tr>
<tr>
<td>2011</td>
<td>200</td>
</tr>
<tr>
<td>2012</td>
<td>400</td>
</tr>
</tbody>
</table>
**Actis exits Xiabu Xiabu in secondary sale**

**IN THE PAST 12 MONTHS WE HAVE SEEN**

A 10-fold increase in secondary sales in China by value, but it is unwise to read too much into the spike: 80% of the $2.9 billion total came from Goldman Sachs selling its minority interest in Industrial and Commercial Bank of China to Temasek Holdings.

Discount this outlier, however, and the statistics are still notable for the jump in secondary buyouts specifically. Three transactions in 2012 – more than the previous three years combined – saw control pass between private third-party investors, most recently Actis’ sale of hotpot chain Xiabu Xiabu to General Atlantic.

“We expect to see more secondary exits,” says Meng Ann Lim, head of China and Southeast Asia at Actis. “Many funds are getting bigger and bigger; they started out doing growth capital but now they do more control deals. Our strategy is to invest in medium-sized businesses and grow them to a size where financial and strategic buyers are keen.”

Lim claims that so many PE and strategic players expressed an interest in Xiabu Xiabu that he lost count of the final total. The transaction size wasn’t disclosed but he describes it as one of Actis’ most successful investments in China.

The PE firm acquired a majority stake in the restaurant chain in 2008, paying $51 million. Xiabu Xiabu now has more than 300 outlets, but when Actis first identified the company there were only 40, and 60 by the time the deal closed.

“A lot of restaurant chains in China get to 30-40 stores and stay there because they don’t have professional management,” Lim says. “These chains are run by the founders and so they rely on a small number of people. After we invested in Xiabu Xiabu we helped professionalize the management team, put in place the right strategy and developed institutionalized processes.”

Part of the appeal was that these processes could be scaled up rapidly. Hotpot is a fairly standardized compared to most Chinese cuisine and the fact that the diners do the cooking themselves means a centralized kitchen can be used and there is no need for chefs at each site. Furthermore, Xiabu Xiabu offers diners individual pots instead of a communal pot at each table.

“It attracts a different kind of customer – more females than males, and more young working adults who eat out a lot but perhaps not in the big groups you usually need for hotpot,” Lim says. “Individual hotpot is also more hygienic and flexible, because you can choose your own ingredients.”

Actis’ most recent China restaurant investment, Bellagio, is unlikely to reach the scale of Xiabu Xiabu because it offers casual rather than quick service dining. However, there are commonalities: neither has ever closed a restaurant, suggesting strong repeat business; and 80% of Bellagio’s customers opt for 3-4 signature dishes, which means food standardization is less of a challenge, much like Xiabu Xiabu.

**Unitas buys controlling stake in ZTE subsidiary**

**WHEN ZTE DECIDED TO DIVEST SHENZHEN**

ZTE Netview Technology (ZNV), a subsidiary focused on power and environment monitoring and video surveillance, it wanted to act quickly. Unitas Capital was up to the task, overcoming rival bids from several financial investors and putting together a RMB1.3 billion ($208 million) deal in just one month.

“For a control transaction anywhere in the world that is fast,” John Lewis, Unitas’ chief investment officer, tells AVCJ. “We were well served by the fact that we were able to bring relevant knowledge of China and relevant industrial and operational expertise. We had a team of eight people who were able to move very quickly on the deal.”

According to ZTE, the private equity firm has agreed to take an 81% interest in ZNV, pending regulatory approval. Of this, 65% comes from ZTE directly, at a cost of RMB1 billion, with the remainder acquired from ZTE HK, a wholly-owned subsidiary. ZTE HK will retain 9% of the business, while Shenzhen Qunxian Technology, a vehicle controlled by ZNV’s management, will continue to own a 10% stake.

The company has two primary business lines: providing systems that monitor telecommunications radio base stations and internet data centers; and developing end-to-end video surveillance systems. Net profit for the nine months to September came to RMB110.6 million, compared to RMB139.7 million for 2011 as a whole.

ZNV’s major customers are the Chinese state-owned telecom operators. ZTE was already supplied telecom infrastructure equipment and the operators required mechanisms to gauge the temperature, humidity and power usage of base stations. It was a logical extension of ZTE’s business. The video surveillance unit had similar origins: the telecom operators wanted a systems supplier for municipal CCTV projects.

“We approached ZTE in 2010 about this business because it is a good fit for us,” Lewis says. “It’s an industrial business with established customer relationships in a good growth industry and with strong R&D and engineering teams and R&D depth. At the time, ZTE wasn’t interested in selling but they decided quite recently that the business was non-core and undertook a sale process towards the end of 2012.”

The sale is part of a wider divestment process by the technology firm. As ZTE noted in its 2011 annual report, the large-scale construction of broadband networks to serve the rapid rollout of mobile internet services is a challenge as much as an opportunity.

On a broader level, Lewis expects to see more of these deals due to a combination of macro factors and the general evolution of corporate China. “As growth in China slows and revenue and profit growth become more challenging, you will see more of these types of activities. They aren’t the flavor of the month – it is something that will develop over a number of years – but they are definitely growing in number.”

**DEAL OF THE WEEK**

tim.burroughs@incisivemedia.com
Relighting the fire

Investor sentiment toward Indian private equity has weakened considerably over the last year. AVCJ, supported by KPMG, hosted a webinar in December at which industry leaders assessed the various challenges.

The participants: Mark Silgardo, senior managing partner at IL&FS Investment Managers; Tushar Sachade, partner and head of private equity tax at KPMG India; Vikram Utamsigh, partner for transactions and private equity advisory at KPMG India, and Mukund Rajan, managing partner at Tata Opportunities Fund.

On dealing with LPs and expectation management

Silgardo: The idea that you can make quick money isn’t always true, especially in India where there are cycles and periods of uncertainty. Being patient is paramount to creating good value. That said, the push back from LPs comes from the fact we saw heady times in 2006-2007, a lot of capital was raised, and a lot of deals were done at high valuations, and we are feeling the backlash from that now.

Rajan: India was kind of coming back into favor and as a new fund we were getting a lot of traction in the first half of last year, soon after our first close. From July onwards, we have seen a significant drop off in investment sentiment. The big questions have really been about the market and the macro. Growth has been slowing in India, we had a whole series of governance scandals, and the government has been on the back foot in terms of certain reforms. Moving beyond the economy, there have been question marks over performance. Older funds have to defend their track records; newer funds have to explain how they have differentiated deal flow, whether they can maintain disciplined pricing, and how they can provide operational value-add.

Utamsigh: I would focus on the performance of portfolio companies and, if I’ve had a couple of exits, I would talk about where those deals came from, whether they were proprietary, and how they were successfully exited. I would also talk about portfolio companies that are coming up very soon for exit. I would also demonstrate that I have a stable team.

Utamsigh: It’s also equally important to talk about the failures. Any fund manager that says they have no dogs in their portfolio I would regard with a high degree of skepticism. So you need to talk about where you went wrong, how you tackled those situations and what you have done to turn around those companies; if you weren’t able to turn them around, what you have done to try and achieve an exit and protect capital on that investment.

On whether Indian GPs are pursuing operational value-add

Utamsigh: There is a huge question concerning operational value-add because most of the deals are growth capital investments in companies where the PE firm has a board seat and a 10-25% stake. There is debate as to whether you can provide operational value-add to companies where you are a minority shareholder. PE firms can help in terms of financial management, renegotiation of debt and obtaining working capital but it ultimately boils down to having that positive relationship with the owner.

Silgardo: I think operational value-add is more talked about than implemented on the ground. Most transactions do not involve in control and then a lot of companies are entrepreneur-owned and these people understand the business very well. The way we approach it is more from a financial and strategic perspective: adding to management and building a good structure, offering access to markets that companies can’t penetrate on their own.

Rajan: Our experience is colored by the fact that our major playground is Tata Group companies themselves, although we do have a significant allocation for opportunities outside the group. We tend to rely on the availability of expertise across different Tata companies – we can pull in capabilities that are relevant to pretty much any situation. A private equity portfolio company finds itself in. What investors like in addition to proprietary deal flow is access to operational talent. The days when you could be a smart financial investor, take a wheelbarrow down Wall Street and come back with an enormous fund, are over.

Utamsigh: The tables are turning. Promoters used to look only for money from financial investors. Now we find they are asking questions about what more a private equity firm can provide. Funds have to offer some element of differentiation.

On the implications of General Anti-Avoidance Rules (GAAR) for private equity

Sachade: The law states that any arrangement whose main purpose is tax benefit and this results in an abuse of tax laws, lacks commercial substance or is not for business purposes then that arrangement can be ignored. I don’t think anybody in the market would object to the fact that India is proposing GAAR, the problem is whether the revenue authorities implement it in a fair and just manner. The government decided to postpone implementation by one year and then it set up a high-level committee chaired by Dr. Parthasarathi Shome. The committee recommended that GAAR should be postponed.

“The days when you could be a smart financial investor, take a wheelbarrow down Wall Street and come back with an enormous fund, are over” — Mukund Rajan
by three years because the complexity of the legislation means revenue officers require a lot of training, and that there should be grandfathering of existing investments, so investments made before GAAR aren’t subject to it on exit. We expect the government to implement these recommendations and this is very positive for GAAR. What private equity players need is a certainty of structure and regulations so there aren’t prolonged negotiations on withholding tax. We are moving in the right direction.

SILGARDO: Some of the announcements that have come out previously about looking at things retrospectively spooked a lot of people. No one is opposed to a regime where there is a tax, so long as there is a policy in place that is transparent. Let’s say we exit an investment today and the tax environment were to change, then in many cases the GP would be hauled over the coals by the authorities. It’s in everybody’s interests that there is a policy in place and everyone knows where they stand.

RAJAN: Some of our funds are planned out of Singapore. The limitation of benefits were defined by the Indian government and there is a sense that in places like Singapore that are well regulated – and where the Indian government was involved in the planning of the double taxation agreement (DTA) – are relatively secure. We just hope that some of the hiccups we’ve had over the last year are resolved.

SACHADE: A lot of PE firms use Singapore and Mauritius as a hub for investments in India. The Shone committee recommends that once you opt in and get a tax certificate then GAAR shouldn’t apply. We have been working on several funds and a lot of people are still looking at Mauritius because they expect these recommendations to be implemented. However, if you look at the way the law is worded on GAAR, Singapore does make more sense as you can put operational presence there.

RAJAN: I would really like to see the government focus on letting Indian capital into private equity. There are restraints on pension funds and charitable institutions, which can’t invest in Indian private equity right now. There are also restrictions on insurance companies and banks are required to prescribe higher risk weighting for investments in private equity.

UTAMSGH: The government will need to do a lot to encourage participation, but I think it’s a very important point. To facilitate the development of private equity in India we need to have a domestic LP base that foreign LPs can turn to – they know that domestic LPs have a better understanding of the market and are better able to look after their interests. This will take time, five years, 10 years or longer. The PE industry has been quite successful in the last couple of years in coming together under the India Venture Capital Association and the Confederation of Indian Industry and making representations to the Securities and Exchange Board of India and the tax authorities.

SILGARDO: We do need a domestic LP base and apart from the fact we need government regulation, there is a lot of education to be done. We have seen domestic LPS invest in the past without really understanding the product. Equity itself is not a very well understood in India. If you look at savings and investment in general, equity forms a very small part. It’s all about developing the equity culture, not just the private equity culture. Our markets are driven by foreign investment and they will continue to be driven by foreign investment for the foreseeable future. I’m not saying we shouldn’t develop a domestic LP base but we can’t rely on it to fund a large portion of the needs of the industry.

On the outlook for investment and exits

SILGARDO: The lessons of 2006-2007 have been learnt by the industry and the euphoria is not coming back. We are looking at consolidation. The high valuation days have gone and the current period will probably be a good time for private equity deals in India. Investor sentiment in general has been poor but now it’s coming back, and so the economy will grow faster. We would like to see a more measured entry into the market. A lot of LPs coming back is not good for the industry because India can only absorb so much money each year – $17 billion is far too large and that is what we saw in the boom years.

UTAMSGH: We are seeing some positive signs at this point in time, especially in the last three months with the government talking about reforms and actually passing some reforms. We have to hold our breath and wait and see if the central bank is willing to reduce interest rates, which could see the IPO market open up. We are all hoping this will happen early in 2013. However, I don’t think the IPO market will change the face of exits; it is secondary transactions.

There is a huge base of investments – 4,000-5,000 in total – and in some cases the private equity firms are struggling; it’s not working out, but they have built the proper governance standards and the relationship between investor and promoter is positive. The larger funds that would typically want to deploy $50 million or more are looking at this base of investments and exploring buyout opportunities, especially from funds that are coming to the end of their life cycle.

RAJAN: There is a huge demand for exits and, while the public markets will be the major platform, secondaries have to be a major part of...
Turning hype into returns

Early confirmed speakers:

- **Stuart L. Dean**
  Chief Executive Officer, ASEAN, Global Growth & Operations, GENERAL ELECTRIC

- **Jon D. Lindborg**
  Country Director, Indonesia Resident Mission, ASIAN DEVELOPMENT BANK (ADB)

- **Tom Lembong**
  Co-Founder and Partner, QUVAT MANAGEMENT

- **Deepak Natarajan**
  Investment Director, SEA and ANZ, INTEL CAPITAL

- **Edward Sippel**
  Managing Director, TA ASSOCIATES

- **Yegin Chen**
  Investment Officer and Head of Private Equity, SAN DIEGO COUNTY EMPLOYEES RETIREMENT ASSOCIATION

- **Jay Park**
  Managing Director, BLACKROCK PRIVATE EQUITY PARTNERS

- **Veronica Lukito**
  Chief Executive Officer and Managing Director, ANCORA CAPITAL MANAGEMENT

- **Gary Ng**
  Managing Director, CLSA CAPITAL PARTNERS

For the latest programme, please visit [avcjindonesia.com](http://avcjindonesia.com)

**SAVE US$300 if you register before 11 Jan 2013.**

**Contact us**

**Registration enquiries:**
Pauline Chen  
T: +852 3411 4936  
E: Pauline@avcj.com

**Sponsorship enquiries:**
Darryl Mag  
T: +852 3411 4919  
E: Darryl.Mag@incisivemedia.com