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There are many barriers to liquidity in private equity: complexity, transaction size, deadlines, disparate assets, confidentiality, alignment, tax, shareholder sensitivities – the list goes on.

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Positive signs from India

THE LAST FEW YEARS HAVEN'T BEEN KIND

to Indian private equity. After a period of strong fundraising and bumper investment – a large portion of it into publicly-listed entities – the industry has largely been unable to deliver on the promise. Non-performers are already being weeded out as LPs, operating on a “I won't give you money if you can't show me money” basis, refuse to back new funds.

The question that remains with international investors is when will the consolidation be over?

A colleague's feedback from a recent research trip to India is that it's business as usual. While there hasn't really been much change in sentiment from a few months ago, many GPs are see light at the end of the tunnel. The economy maybe slow, but they are being proactive and finding new ways of creating investment opportunities. These include the use of debt instruments such as structured lending and mezzanine finance.

Although the private debt space is interesting, there has been no shortage of “traditional” deals announced recently. The more established local firms like ChrysCapital Partners, IL&FS Investment Managers and IDFC Private Equity have been active; a few more international names – Macquarie, Fidelity, Oaktree Capital Management and Goldman Sachs – are also making headlines. PIPE deals are less prevalent than before and the industry focus appears to be quite diversified, notwithstanding the spate of real estate

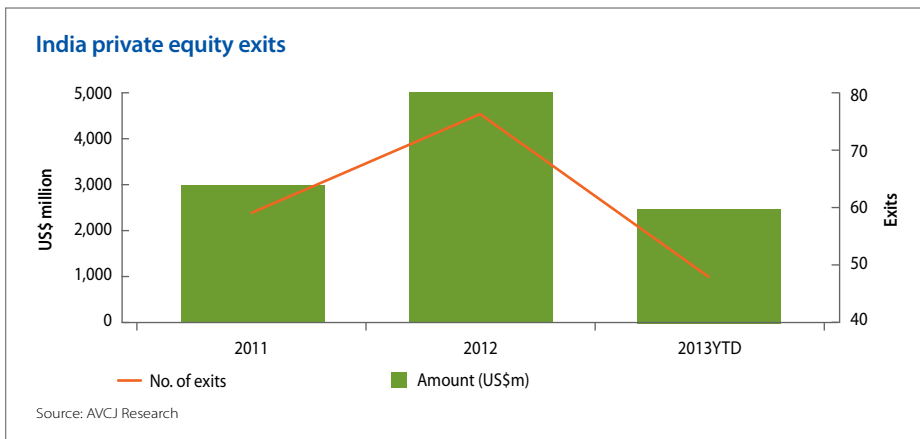
transactions announced recently.

Does this mean the global private equity industry is embracing India once again? It's too soon to say, but the numbers look promising. So far this year, AVCJ Research has records of 151 deals with a combined value of just over \$4.4 billion. That's nearly \$1 billion up on the same point last year. Investors appear to be taking bigger bets with average ticket size around \$30 million, compared to \$17 million in 2012 and \$23 million in 2011.

There are numerous possible explanations for the improvement. The Securities and Exchange Board of India's moves to alter the regulatory framework to favor dealmakers is likely having an impact, but I would highlight one other factor: exit options for portfolio companies seem to be increasing.

AVCJ Research tracked 48 exits totaling around \$2.5 billion for the year so far. The \$5 billion returned in 2012 is still some way off – and that figure was distorted by a couple of bumper deals – but the first six months of this year alone are nearly on par with the full-year 2011 stats, which saw \$2.9 billion generated from 59 exits.

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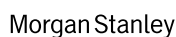
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GLOBAL

Apax reaches \$7.5b final close on latest global fund

Apax Partners has reached a EUR5.8 billion (\$7.5 billion) final close on its eighth global fund, short of the initial target of EUR9 billion. The fund is also smaller than its predecessor, which attracted commitments of EUR11.2 billion back in 2007 during the pre-global financial crisis boom. North America accounted for 43% of commitments, 25% came from Europe while Asia, Middle East and Africa accounted for 32%.

ASIA PACIFIC

SEAVI Advent Fund VI reaches \$125m first close

SEAVI Advent Private Equity, the Asian arm of Advent International, has reached a first close of \$125 million on its six fund - SEAVI Advent Equity Fund VI. Commitments came from high net worth individuals, corporate institutions and family offices, while SEAVI Advent partners put in \$10 million. The fund, which has a hard cap of \$200 million, is expected to close by the end of the year.

AlpInvest's HK secondaries head steps down

AlpInvest has confirmed that the head of its secondaries team in Hong Kong, Neal Costello, has left the company after less than a year in the role. Costello, who was a principal with AlpInvest, relocated to Hong Kong last July when the Netherlands-based fund-of-funds decided to establish a secondaries investment team in the region. Costello had joined the firm in 2003 in New York.

AUSTRALASIA

KKR-backed GenesisCare taps US debt markets

GenesisCare, a healthcare business controlled by KKR, has become the latest Australian PE-backed company to refinance its debt via the US high-yield market. GenesisCare is seeking \$245 million in first lien, senior secured Term Loan B financing, plus a revolving credit facility of A\$30 million (\$28 million). According to Standard & Poor's, GenesisCare's debt-to-EBITDA ratio will rise to around 5x following the recapitalization,

Macquarie commits \$58m to Prime Focus World

Macquarie Capital has invested \$53 million in Prime Focus World (PFW), the creative services division of India-headquartered entertainment company Prime Focus. The investment – which values the subsidiary at \$300 million – will be made in two tranches of \$38 million and \$15 million. PFW provides visual effects and animation services to major film studios, and it will use the capital to build its creative services platform and make a number of acquisitions.



Last week, Prime Focus revealed it would be opening an office in Beijing in order to tap into the growing Chinese film market. In March, the company entered a joint venture with Hong Kong private equity firm AID Partners and Zhejiang Jingqi Wenhua Chuanbo Company; at the same time, AID Partners injected \$10 million into PFW.

Standard Chartered Private Equity also invested \$70 million in Prime Focus last November, paying \$35 million for a 19.71% stake and investing an additional \$35 million through non-convertible debentures.

PFW is the world's largest provider of 2D-to-3D content conversion, visual effects and animation services. Previous projects include *The Great Gatsby*, *Star Wars: Episode One – The Phantom Menace*, *Transformers: Dark of the Moon*, *Avatar* and *Wrath of the Titans*.

assuming some of the proceeds are returned to equity holders.

Carlyle, Seven to retain ownership of Coates Hire

The Carlyle Group and Seven Group Holdings have decided against pursuing an exit from Australian equipment-leasing business Coates Hire following a strategic review. The co-owners said they remain fully committed to growing the business. Goldman Sachs was appointed last November to assess sale options, with China International Capital Corp. and Nomura assisting in China and Japan, respectively.

M.H. Carnegie, Vivant launch accelerator

M.H. Carnegie & Co has launched an A\$80 million (\$76 million) accelerator fund for emerging technology companies. It will be run in collaboration with Vivant Ventures, an Australia-based digital development specialist, providing start-ups with support and seed funding of up to A\$500,000. The vehicle has already received a commitment of A\$40 million through the Innovation Investment Fund (IFF) scheme.

GREATER CHINA

Tsinghua University unit bids for Spreadtrum

Spreadtrum Communications, a Chinese mobile chip manufacturer backed by NEA, has received a buyout offer from a unit of Tsinghua Holdings, an investment entity controlled by Beijing-based Tsinghua University. Tsinghua Unigroup is willing to pay \$28.50 in cash for all outstanding American Depository Shares - a 20% premium on the stock's previous closing price – valuing Spreadtrum at \$1.35 billion.

Yageo shareholders block private equity deal

Shareholders of Taiwanese electronic components manufacturer Yageo Corporation have blocked a \$1.65 billion private equity deal put forward by company management. Rather than seek public financing, Yageo wanted to sell up to 500 million shares to a private equity investor at NT\$10 (\$.33) apiece. This was intended to bolster operational capital and improve financial structure, while attracting long-term strategic investors.

PE-owned Dutch waste firm sells subsidiary to CKI

A Dutch waste management provider owned by CVC Capital Partners and KKR has exited its energy-from-waste (EfW) subsidiary to a consortium led by Cheung Kong Infrastructure (CKI) for EUR940 million (\$1.27 billion). CKI and parent company Cheung Kong Holdings will each take a 35% stake in AVR Afvalverwerking, with Power Assets Holdings and the Li Ka Shing Foundation owning 20% and 10%, respectively.

GSR leads restructuring round for Mirabilis Medica

China-focused GSR Ventures is leading a \$7

million restructuring round for Mirabilis Medica with a view to helping the company expand its footprint outside the US. Mirabilis Medica, which develops non-invasive treatments for uterine fibroids, wants total commitments of \$13 million. Existing investor Charter Life Sciences also participated in the financing.

NORTH ASIA

Castling gets first LP commitment, targets FoF

Castling Investment Group, a start-up alternatives investment advisory firm based in South Korea, has received its first external LP commitment – totaling \$80 million – from a local museum foundation. The capital will be placed into a separate account and deployed globally. “We want to take this commitment and go to market next year for a co-mingled fund-of-funds,” Steve J. Kim, chief investment officer at Castling, told AVCJ.

VCs provide \$4.4m round for social site Muzy

Docomo Capital and Recruit Strategic Partners – the corporate VC arms of Japan’s NTT Docomo and Recruit Holdings, respectively – have teamed up with Chinese entrepreneurs to invest \$4.4 million in micro-blogging service Muzy. The round was led by WPP with Xuyang Ren, former vice president of corporate development for Baidu, and Jianfeng Lu, former CTO of Qihoo 360, investing alongside the Japanese VCs.

SOUTH ASIA

ChrysCapital-backed Intas Pharma files for IPO

ChrysCapital Partners will exit the 10.16% stake held by Fund III in Ahmedabad-based formulations maker Intas Pharmaceuticals via an upcoming IPO. Another 6.25% stake will continue to be held by the PE firm’s fifth fund. The offering will comprise of a fresh issue of equity shares aggregating up to INR2,250 million plus 11.6 million shares held by ChrysCapital vehicle Mozart Limited.

JLL reaches first close on India real estate fund

Jones Lang LaSalle’s (JLL) Segregated Funds Group has reached a first close of INR1 billion (\$17.2 million) on its Residential Opportunities

PE backers fail to oust Intrepid board over mine

Hong Kong-based PE firm Quantum Pacific Investment has failed in its attempt to remove the directors at Australia’s Intrepid Mines after the company lost control of a key Indonesia mining asset. Quantum, which owns 5.4% of Intrepid, mounted its campaign over the Tujuh Bukit deposit, a copper and gold project in Java in which the company took an 80% stake in 2008.

The problems emerged when the seller, Indonesian firm Indo Multi Niaga, was sold to a new owner who transferred the mining license to a separate entity. This effectively dishonored the



investment agreement with Intrepid, which has spent \$100 million developing the project.

Greg Mazur, a founding partner at Quantum, said the debacle meant the shareholder group he represented had lost confidence in the board. Quantum had hoped to remove five of the seven board members and appoint four new directors to pursue a plan to win back a stake in Tujuh Bukit within nine months. However, a majority of shareholders came out in support of the board in a vote held yesterday. The board wants to win back rights to the deposit by pressing for fraud and embezzlement charges against its former Indonesian partners.

Fund I. The vehicle launched last year and has a final target of INR3 billion (\$51.2 million) It aims to invest in residential projects in seven tier-one Indian cities. Each project is expected to receive INR250-300 million in funding.

Tencent-Naspers JV ibibo buys ticketing firm redBus

Delhi-based ibibo Group has acquired venture capital-backed Indian bus ticketing company redBus.in, allowing Helion Venture Partners, Inventus Capital Partners and Seedfund to exit their investment. The financial terms of the transaction were not disclosed. Ibibo is 80%-owned by Naspers and 20% by Tencent. It already runs the travel aggregator Goibibo and B2B travel agency platform Travel Boutique Online.

Healthcare Fund invests in Wellspring clinic chain

Asian Healthcare Fund has invested in Wellspring Healthcare, which runs eight primary care clinics in Mumbai under the Healthspring Community Medical Centres brand. This is one part of a larger fundraising effort. In 2011, Wellspring raised \$3.5 million from Catamaran Ventures, Blue Cross Blue Field Venture Partners and Reliance Venture Asset Management.

Fidelity leads Series B round for Cloudbyte

Fidelity Growth Partners India has led a \$4 million Series B round of investment in Cloudbyte, a company which provides cloud-storage solutions for online applications. Existing investors Nexus Venture Partners and Kae Capital also participated. This latest round brings the total amount raised by Cloudbyte to \$6.1 million.

TriVeda Capital launches \$500m real estate vehicle

India-focused TriVeda Capital has launched a \$500 million real estate asset management platform, initially comprising five residential and mixed-used projects located in Bangalore. It plans to invest in structured property transactions in tier-one cities. Over the next several months, TriVeda also plans to raise capital for a closed-end vehicle targeting a combination of India-based and non-resident investors.

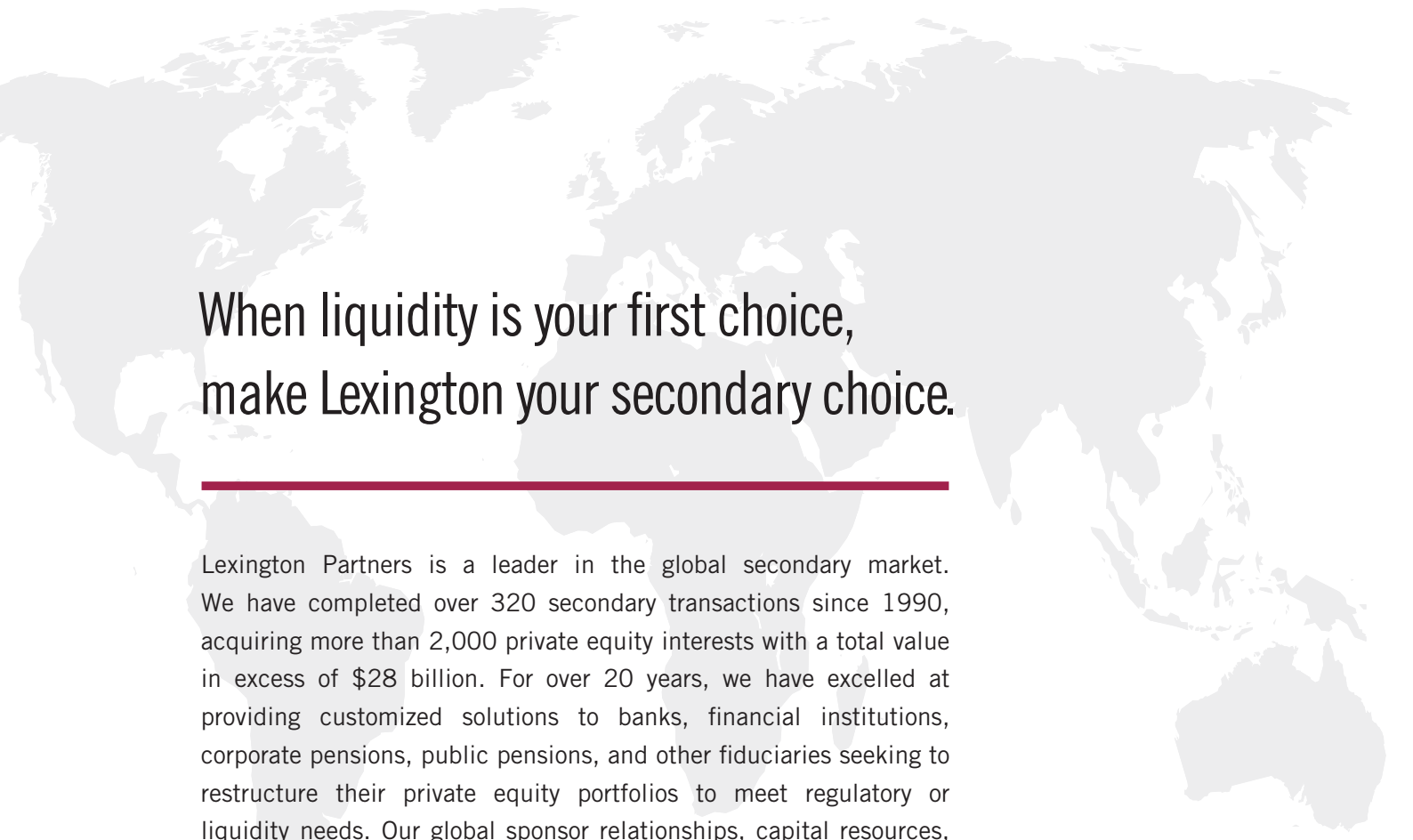

SOUTHEAST ASIA

Investors commit \$100m to retail start-up

Southeast Asian online retailer Lazada has raised \$100 million through a new round of funding led by Verlinvest, a Belgium-based investment firm set up by the founding families of Anheuser-Busch InBev. Existing investors Holtzbrinck Ventures, Kinnevik Investment, Summit Partners and Tengelmann Group also participated.

Singapore’s Temasek establishes UK presence

Temasek Holdings has set up a unit in the UK that will focus on investments in Europe. It is the Singaporean sovereign wealth fund’s 10th overseas office or affiliate. John Cryan, Temasek’s president of Europe and co-head of the portfolio and strategy group, will be one of two directors of the new unit.



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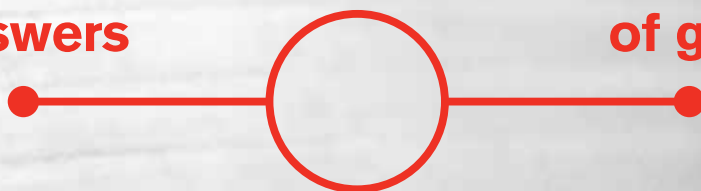
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Bespoke solutions

Reports of the death of fund-of-funds in Asia are greatly exaggerated – but all industry participants are diversifying their product offerings to meet specific client demands. Is it still primarily a scale game?

THE HOLLOWING OUT OF AUSTRALIA'S

leveraged financing market is well documented. In the wake of the global financial crisis and regulations designed to prevent its repetition, foreign banks that once accounted for a significant portion of the debt in private equity-backed deals have retreated. The likes of BOS International, Natixis and Credit Agricole have scaled back or shut their operations in the region.

Domestic banks can be relied upon to provide financing and foreign lenders still active in the market come on board as well. Then it is a case of tapping other institutions to make up the difference – and these range from traditional mezzanine providers to private markets investors to superannuation funds.

The attraction is clear: averaged leveraged margins have more than doubled since 2001 and the 5-7% returns available on first lien debt in a stable market like Australia compare favorably to other fixed income assets, even allowing for the reduced liquidity. For PE fund-of-funds managers, it is also a means of expanding along the capital structure, incorporating equity all the way up to senior debt. Several industry participants are eyeing the opportunity.

“From HarbourVest Partners’ perspective, there are push and pull factors,” according to a source at the firm with experience in the leveraged market. “We have existing relationships with institutional investors and a number of them are seeking additional products. And then we have existing relationships with the GP sponsors who face reduced liquidity and say to us, ‘Why don’t you enter the space?’”

This approach goes to the heart of the information arbitrage that underpins much of what a traditional fund-of-funds provider has to offer. But as the private debt example suggests, fund-of-funds aren’t the only product in a manager’s portfolio, nor do they satisfy every client’s demands. Rather, a manager is tasked with matching opportunities identified in the torrent of information that crosses his desk each day from GPs or other counterparties with the investment objectives of different customers.

This is a global phenomenon, but one with an Asian twist. Some LPs are becoming more familiar with a once opaque region and developing clearer ideas of what they want from it.

“They realize that making money in Asia doesn’t happen by itself, and are trying to figure out the best way to allocate capital,” says Doug Coulter, head of Asia private equity at LGT Capital Partners. “On the supply side, fund-of-funds and others are providing more structures, vehicles and strategies through which to access the region. It has become more complex but the key question is how are you going to deliver good risk-adjusted returns?”

Alive and kicking

There is an element of fee pressure at work here. On one hand, a fund-of-funds offers exposure to a basket of GPs, which may include a cluster of star managers; on the other, the extra layer of fees could eat into these returns and shift the risk-reward balance. Investors want a suite of services – featuring co-investment, secondaries, separate accounts, and so on – rather than

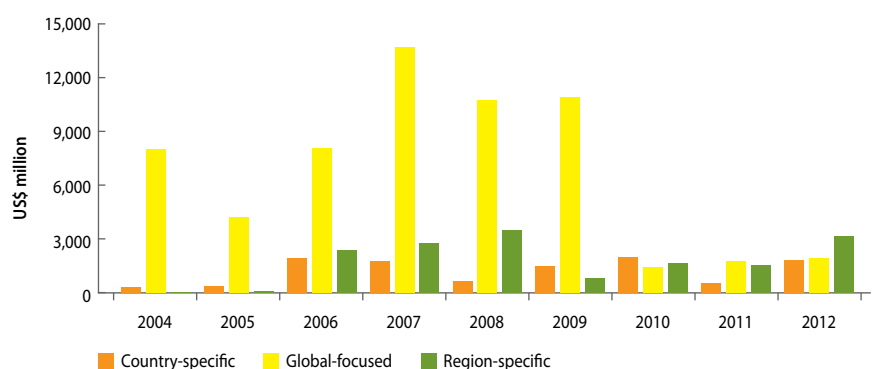
asset class matures around the world.”

The point is there are investors occupying every segment of this maturity spectrum, and for some, a fund-of-funds still makes sense.

First of all, the resources might not stretch far enough that an LP is emboldened to go solo. A team of four running a global private equity program might have sufficient bandwidth to deal with funds of a certain size directly, but anything below a certain threshold is delegated to a third party. Another category of investor, often small- to mid-size institutions, has no previous exposure to private equity whatsoever and requires support building a program that covers multiple vintages and geographies.

Second, fund-of-funds can form part of a broader strategy. Goldpoint Partners, a PE affiliate of New York Life Investments, revised its approach in 2001 after becoming dissatisfied with the returns it was getting from portfolio

Fund-of-funds with Asian exposure



Source: AVCJ Research

just plain vanilla. This may result in institutional clients graduating from fund-of-funds to advisory mandates and, in some cases, to direct commitments as their familiarity with the asset class grows. But there is no uniform approach.

“Our clients still want fund-of-funds – the model is not dead,” says Russ Steenberg, global head of BlackRock Private Equity Partners. “Growth is not as upward as it has been but there will always be a place for them. What you are seeing is more specialization as the institutional

GPs in the region. The firm made two discreet fund-of-funds commitments, one in China and one in India, to get a clearer picture of what is happening on the ground.

Ludvig Nilsson, managing director at China-focused fund-of-funds Jade Invest, claims to have a similar relationship with his largest LP, which has more than \$100 billion in global assets. “We work tightly with them, sharing information, and when we invest in a fund they often want to have a look at it as well,” Nilsson says. “They

invested with brand names before but were less than satisfied with the exposure as well as the information sharing.”

Reports vary as to the willingness of fund-of-funds to pool manager research with LPs. According to Steenburg, BlackRock is happy to make all the necessary introductions to the point that clients are able to go it alone if they so desire. Some of the local players – stand-alone Asia or China operations – are said to have been less accommodating, although everyone ultimately has to move with market demand.

There is certainly evidence of LPs shadowing fund-of-funds in the region. Much like Goldpoint, New York State Common Retirement Fund (NYSCRF) started out investing in a string of pan-Asian funds before adopting a more targeted approach. It invested \$50 million in each of Asia Alternatives’ second and third comingled vehicles and in 2011 put \$200 million into two separate accounts with the firm.

Both accounts made small commitments to Hony Capital V and NYSCRF followed up by investing \$100 million in the fund, its first direct foray into an indigenous China vehicle.

Separate offerings

Asia Alternatives’ third fund, which reached a final close last year, is in certain respects the apogee of its type in the region. The corpus is divided between \$908 million in the comingled fund and another \$600 million spread across separate accounts for a total of \$1.5 billion. The separate accounts have the same fee structure as the comingled vehicle. According to AVCJ Research, it is the largest pool of capital ever raised by an independent Asia-focused fund-of-funds.

The number of separate accounts isn’t disclosed but anecdotal evidence suggests that some investors put in far less than NYSCRF’s \$200 million. Indeed, the standard threshold for a separate account is said to be around \$100 million, but many smaller players are willing to compromise on size and fees in order to win market share.

“You offer discounts to big name clients because it helps build out business. It also makes fundraising and reporting processes easier. If someone gives you \$100 million in one go you don’t have to devote the time and energy to sourcing and looking after 20 clients who each put in \$5 million,” says one Asia-based manager. “At the same time, if someone commits \$100 million they want to be treated differently from everyone else. So a lot of it is about marketing.”

This gives rise to a couple of criticisms of fund-of-funds. First, does a smaller manager still have the resources to provide a quality service after making concessions on separate accounts? Second, is there substance behind the

marketing? “I think what LPs are finding now in Asia is what they have already found out in the West: All most managers want to do is a separate account that looks like a fund-of-funds,” notes Monte Brem, CEO of StepStone.

Needless to say, there are counterarguments. Sebastiaan van den Berg, managing director for HarbourVest Partners in Asia, believes there is a misconception surrounding separate accounts in that rising demand for such arrangements is only driven by having more influence over strategy and securing lower fees. In his experience, most separate account clients’ primary concern is often confidentiality and the need for a more tailor-made investment program.

“When we talk to an LP we don’t ask if they want a discretionary manager or an advisor, we ask how they want to relationship to work”

– Monte Brem

The level of discretion afforded to the manager also varies, depending on the mandate. “If it’s an Asian LP that wants to invest in North America you typically find the client is less specific. They aren’t knowledgeable enough to provide any meaningful direction. If it’s a US investor in Asia it’s typically the same thing,” says van den Berg. “If it’s an Asian LP with an Asian mandate, they will have views on what to do.”

However, the first criticism does hold true. Numerous industry participants didn’t pursue separate accounts to begin with, and even if they now do, a high participation threshold is set in order to keep the numbers down. An LP being told that a fund-of-funds manager already runs 15 separate accounts is akin to a high net worth individual finding out that his private banker is simultaneously handling 30 other relationships. There can also be headache in terms of allocations. If there is a great secondary deal but it’s not very big, would it still be divided up among all the clients on a pro rata basis?

The other resource issue is whether the manager has enough people and time to deal with clients individually and to a consistently high standard. While LPs’ expectations of a separate account relationship differ, it is a labor-intensive process that goes beyond just doing the investment work. In short, a much greater degree of interaction with the client is required.

Resources are likely to become even more

strained as the industry continues down its path towards greater customization. A fund-of-funds may already be sliced and diced so that primary fund exposure is accompanied by co-investment and secondaries in order to address fee and j-curve concerns, respectively. In some cases there are already teams in Asia dedicated to each of these three pillars, and the expectation is they will have to devise and manage more bespoke solutions as relationships with LPs become increasingly granular.

BlackRock bought Swiss Re’s fund-of-funds business last year in order to fill some geographic and strategic holes in its product offering, and the company is keen to expand its co-investment capabilities in Asia. As such, the division is no longer referred to as “fund-of-funds” but rather “private equity solutions.” Partners Group, which has made plain its preference for direct and co-investment and secondaries, declined to be interviewed for this article on learning that the topic was fund-of-funds.

“StepStone was founded on the concept of doing customized accounts. That comes through portfolio construction and also through how the investment process works,” says StepStone’s Brem. “When we go in and talk to an LP we don’t ask if they want a discretionary manager or an advisor, we ask how they want to relationship to work.”

The bulk of StepStone’s business is divided between advisory services for large institutions and customized accounts, but clients are now calling for real estate and infrastructure space. Comingled funds tend to be niche offerings, bringing together groups of clients under a particular strategy.

The approach seems broadly comparable to the club structures formed by private banks that enable high net worth clients to participate in a series of single-asset co-investments. According to Roger Bacon, head of managed investments for Asia at Citi Private Bank, the spike in demand for these products, globally and among Asian clients specifically, in the last five years has come at the expense of blind pools.

An off-the-shelf fund-of-funds product is unlikely to get more than a cursory look unless the manager is able to demonstrate a level of expertise and deal access that differentiates them from the rest of the market. These offerings hinge on managers being fleet of foot without neglecting due diligence.

“This a hugely complex area and there are so many ways of skinning so many cats that to try and do it in a scalable way is quite difficult,” Bacon explains. “If you do have dedicated resourcing in place then you can be more tactical and opportunistic in the way you look at individual deals and make them available to clients.”

The implication is that a fund-of-funds

provider with a broad base of resources as its disposal is better equipped to move quickly and deeply into more customized solutions. On a basic level, there is a lot of crossover in terms of the due diligence that is conducted on a primary fund-of-funds mandate and a secondaries program. In addition, creating a new product might not be economically viable without the regulatory, compliance, reporting and information infrastructure that is part and parcel of a global platform.

"At a GP level, it's an advantage being specialized; at a portfolio level, it's an advantage to have a portfolio-level perspective," says StepStone's Brem. "The LPs who work with want not only global access but also the ability to identify opportunities in Asia relative to other opportunities in the world."

Big vs. small

So where does this leave the more specialist regional players? One view is that they face the same fate as their European counterparts: overtaken or absorbed by localizing global asset managers, although it may take some years for this to happen. There have been two mergers in the past 12 months – Asia-focused Squadron Capital and US-based FLAG Capital, and then renminbi fund specialist Diligence

Capital and Europe's Capital Dynamics – but the consolidation debate still generates more heat than light.

Two more nuanced, or perhaps cynical, interpretations come from two different industry participants, a global manager and a gatekeeper, respectively: the larger Asia fund-of-funds will be sold during the next China boom; and many won't get picked up at all because they are family offices with aspirations to manage third-party capital rather than fully fledged independent managers and therefore offer little value to larger platforms.

Jade's Nilsson expects to see more mergers and notes that several fund-of-funds providers in the region have already retreated into the investment advisory space because they are unable to raise capital. Yet the trajectory he envisages for the industry is unsurprisingly different from those of global players. As institutional investors realize that Asia isn't as easy as it once appeared they will look for greater value-add and it won't necessarily come in the form of a large-scale provider.

"Back in 2006 you had IPOs left, right and center and high returns everywhere," Nilsson says. "It is only when the market begins to slow down that you come back to fundamentals and realize who has just been following the hype and who

has been taking a more fundamental approach all the way through. We feel it's great that now LPs are starting to ask the right questions."

Opinion is also divided as to the prospects for those at the larger end of the scale – the big who are only going to get bigger. Some claim that multi-product asset managers sitting on large distribution networks are out to commoditize the industry, although it is difficult to reconcile this with the resource-intensive and costly nature of the asset class. Under another scenario, asset managers will move up the value spectrum, abandoning fund-of-funds space in favor of sourcing deals directly and operating as GPs. Steenberg says that BlackRock currently has no plans to adopt a this approach, with separate accounts seen as the best fit for the firm's model.

Wherever they end up, the same push and pull factors apply: clients demanding more diversified exposure to the asset class and firms identifying in their information flow ways to create new products and boost sales.

"Fund-of-funds are just like PE firms are diversifying their offerings over time," says LGT's Coulter. "In an Asian context, how many PE firms are there with a global offering of which Asia is a part? Very few. It's no different with fund-of-funds – they have different offerings in response to the market." ▀

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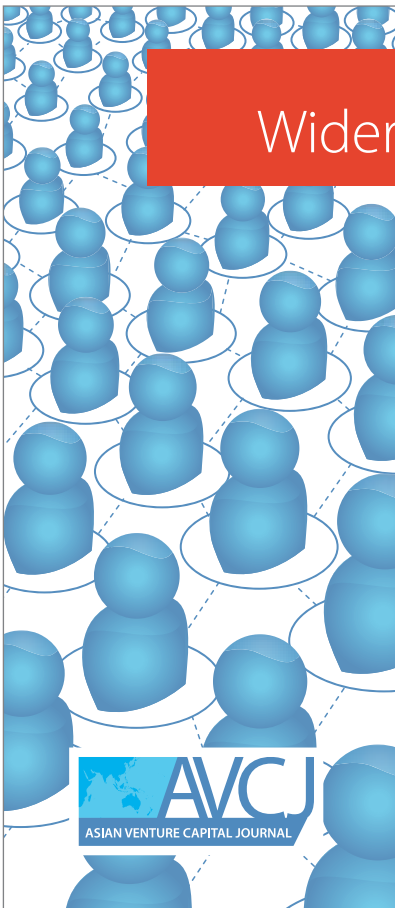
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Firm of the Year – FountainVest Partners

FountainVest took six months to raise its second fund, for which it also won the US dollar fundraising award, and then participated in China's largest-ever PE buyout. CEO Frank Tang looks back and forward

Q: The fundraising process went smoothly despite a difficult environment. What were the contributing factors?

A: We have three anchor LPs and then a number of investors in Fund I are highly reputable. The fact that they decided to re-up in Fund II was great in terms of supporting momentum. By the time we reached our first close we had already surpassed the size of Fund I and that helped quite a lot in terms of finishing it off. In addition, our increase in our fund size was seen as pretty moderate. We were about \$1 billion last time and this time it was hard capped at \$1.35 billion. Investors didn't see this as aggressive and they knew our strategy would be consistent.

Q: You have been involved in a couple of buyouts recently. Are you expecting to do more and what does this mean in terms of team size and skill sets?

A: It's limited right now, but we are seeing certain buyout situations emerging and it is likely to become a trend. In anticipation of our next phase of funds, we have been expanding the team. Our Beijing office opened about two years ago and we have been adding people across the board since then, at various levels and functions.

Q: Including the operational side...

A: We have always been looking at various ways to add value to our portfolio companies. It starts with the experienced people we recruit for these companies, depending on specific needs. We also have senior advisors engaged by the fund, and then on each project we have outside consultants. In terms of an in-house team, we are gradually building it.

Q: Can the recent spate of take-privates of US-listed Chinese companies – two of which involve FountainVest (Focus Media and LJ International) – be sustained?

A: I think it's a wave of opportunity – it became quite active last year and it will continue to be active this year. There will be a self-selection process: some entrepreneurs feel it doesn't make a whole lot of sense to continue to be listed in the West; others think that, with TMT companies, NASDAQ is a natural location because investors understand them. For

companies with variable interest entity (VIE) structures, the uncertainty surrounding these structures will discourage many from going private.

Q: To what extent are you going to the chairman/founder and pitching the idea of a take-private? Is it a difficult sell?



A: For the deals we've worked on, we have approached the founder. Becoming a public company is always more glamorous, so to de-list could be perceived as embarrassing. However, over the last two years this view has turned around, it's not necessarily a shameful thing. The decision is driven more by practical considerations. Does the valuation of the shares reflect the business fundamentals? Does being public help the company raise money through the capital markets on an ongoing basis? Does the company have an active following among analysts?

Q: Focus Media is by some distance the largest PE-backed deal of this type. Will it be topped?

A: I haven't come across any meaningfully larger companies than Focus Media that are looking to do the same thing. Most of the companies are small. Shanda was the largest to go private in the US and then there was Alibaba.com in Hong Kong. For the likes of Tencent and Baidu, they trade at fair valuations, their businesses are well understood and covered by analysts, and they have high liquidity. There is no need for them to consider going private.

Q: Investors cite two other potential sources of control deals – succession planning and

carve-outs. How much activity are you seeing in these areas?

A: Succession planning has started to emerge – there are selective first generation entrepreneurs who are now thinking about succession. As for carve-outs, we haven't seen any. There are potentially a lot of opportunities among state-owned companies but we don't

“Becoming a public company is always more glamorous, so to de-list could be perceived as embarrassing. However, over the last two years this view has turned around”

focus on that. In the future there might be carve-outs from private companies but at the moment they are growing and adding new business lines. They could reach a point where they decide to become more focused

Q: So for the time being it will remain primarily minority investments?

A: We want to enlarge our stake and influence in businesses so we are in a better position to add value, and that could include more buyouts. Generally speaking, entrepreneurs have two choices. First, they want more capital so they can become a clear leader in their sector, and that could mean their stake is diluted. Second, they can insist on holding 51% or more and basically put a stop in terms of how big they can grow.

Q: The IPO market has been difficult in the last year or so. What impact is this having on your exits?

A: The IPO market remains weak but exits are also becoming more diversified. We do see mergers, trade sales and cross-border acquisitions becoming more active. In our case of our first fund, there has been on trade sale exit to a domestic strategic buyer from the same industry. Consolidation is certainly taking place. ▀

PE deal of the year – Alibaba Group

AFTER THREE YEARS OF ON-AND-OFF

negotiations with Yahoo, Alibaba Group finally agreed to repurchase half of the US internet firm's 40% stake in itself for \$7.6 billion last September. Supported by \$5.9 billion in financing, of which \$3.9 billion was equity, it was one of the largest – and most sought-after – transactions involving a Chinese company to date.

"The size of that investment round presented an excellent opportunity for us to make a major investment," says Ken Hao, managing partner and managing director of Silver Lake.

In 2011, Silver Lake and DST Global co-led a \$1.6 billion equity investment for purchasing 5.7% employee stake in Alibaba. The two firms, plus co-investors including Temasek Holdings, raised their holdings in the buyback transaction. China Investment Corp. (CIC) led the PE portion of the deal, with Boyu Capital, CITIC Capital and CDB Capital – China Development Bank's PE arm – coming in as new investors. CIC is said to have put in \$2 billion on its own.

"Alibaba has established a close cooperative relationship with CDB," Mao Yong, executive director & CIO at CDB International tells *AVCJ*.

"We were keen to invest in the company due to its leading position in the global market, strong team and prospect for future development."

The timing of the deal was uncertain due to a combination of past tensions between the companies, the size of Yahoo's stake in Alibaba as a proportion of its own market capitalization and tax considerations in structuring the deal. This meant that CIC was ready to move much earlier than required.

"We were keen to invest in the company due to its leading position in the global market" – Mao Yong

The \$2 billion in senior debt portion of the deal was split between China Development Bank and a consortium of international banks, including ANZ, Barclays, Citi, Credit Suisse, DBS, Deutsche Bank, Mizuho and Morgan Stanley.

Once again, structuring and timing were the main challenges – Alibaba set out to finance the \$2.5 billion privatization of B2B arm Alibaba.com in parallel with the buyback but it was unclear which would come first.

"We were dealing with a large number of highly sophisticated and experienced investors and the biggest challenge was logistical – making sure everyone was moving the same direction and getting where we needed them to be," says Ken Martin, head of China Practice at Freshfields, legal advisor to Alibaba.

Yahoo has done well from its investment, having acquired the full 40% stake in 2005 for \$1 billion plus the Yahoo China business. The US firm received \$6.3 billion in cash, \$800 million in preference shares, and \$550 million in patents and licensing payments. Its remaining 20% stake is worth \$8.1 billion and Alibaba has a two-year window in which to purchase it, in case of an IPO.

The listing would be Alibaba's pay off on its efforts, with some industry participants expecting the offering to value the company at up to \$100 billion. Nothing is likely to happen before the final quarter of 2013. ▀

Exit of the Year – China Pacific Insurance

"THE TRANSACTION, THE LARGEST

private equity investment in China to date, is a testimony to the maturing investment and regulatory environment in China and to the government's commitment to financial reform," X.D. Yang, managing director and co-head of The Carlyle Group's Asian buyout group, said in 2005 when the firm invested in China Pacific Insurance.

The investee was insolvent and losing money at the time, like many institutions in China's beleaguered financial services sector. For foreign investors, there was the prospect of participating in a turnaround story, but regulatory approvals

were hard to come by. Apart from Newbridge Capital, which took a close to 18% stake plus management control of Shenzhen Development Bank in late 2004 – it could be argued that no private equity firm managed to secure itself a more influential position in the sector than Carlyle.

After three years of negotiation it agreed to inject RMB3.3 billion (then \$410 million) for a 24.98% stake in China Pacific's life insurance unit.

Getting the deal done meant putting company management through a crash course in private equity.

"We knew the company had great potential but a lot of work had to be done," Yang told *AVCJ* last year. "We spent a fair amount of time explaining what Carlyle is. That was a good process for the two sides to get to know each other and I have to give credit to China Pacific's management for recognizing that a global firm like Carlyle could make a difference to their business."

The private equity firm subsequently took its total investment China Pacific to \$740 million in 2007, converting its stake into a 19.9% interest in

the parent company following a restructuring of the various subsidiaries. The company listed in Shanghai the same year and went public Hong Kong in 2009, its turnaround complete.

Carlyle's exit was protracted, as was to be expected given the lock-up periods on its China Pacific shares. The first block trades came in December 2010 and January 2011, generating proceeds of \$2.6 billion between them. There followed three more over the next 18 months before the final portion – representing 2.2% of China Pacific's overall share capital – was sold for \$796 million.

The full proceeds top \$5 billion, making it not only by some distance the most successful investment in Carlyle's debut Asia buyout fund, but also supposedly the firm's largest-ever cash exit globally.

"Over [more than seven] years, we have worked very closely with the company, company management and other shareholders in support of transforming China Pacific into one of the best run and most successful insurance companies in China and a Fortune Global 500 company," Yang said in response to the final exit. ▀



Brian Zhou (rights) accepts on behalf of Carlyle

PE professional of the Year – Homer Sun

SOMEWHAT UNUSUALLY FOR MORGAN

Stanley Private Equity Asia's (MSPEA) China team, the last 12 months have been dominated by buyout deals. Leading Beijing convenience store chain Hi-24 was acquired last November through a corporate carve-out and then two more buyouts – take-privates of US-listed dairy producer Feihe International and crop nutrients specialist Yongye International – are pending. The Feihe deal has already won board approval.

"Hi-24 entails a classic buyout arrangement of equitizing management to better align incentives with shareholders. Management, in turn, look to us to provide a level of support to growth the business that they wouldn't have otherwise



Homer Sun (right) receives his award

received as a non-core operation of their prior parent company," says Homer Sun, MSPEA's CIO.

The private equity unit spent three years building relations with Hi-24's management before acquiring the business from China Financial Services Holding as an exclusive purchaser. It now plans to double the number of stores from 200 to 400. "Beijing has about 500 branded convenience stores, compared to Shanghai's 5,000," says Sun. "This relatively low level of penetration positions us well to drive

strategic value by expanding on what is already the largest convenience store chain in Beijing."

Sun expects to see even more buyout deals in the future – through corporate divestments, shareholders restructurings or generational changes – but they will remain fewer in number than minority transactions. As for China take-privates, these are attractive at certain points in market cycles, as MSPEA knows from experience: in 2009 Sun led the privatization of Singapore-listed Sihuan Pharmaceutical and took the company public in Hong Kong 11 months later.

Sihuan is also an example of how MSPEA has broadened its sector focus to incorporate areas such as healthcare and agriculture. Traditionally, consumer goods featured most prominently but as valuations increased with consolidation, the PE unit began to look elsewhere.

"The industries we are spending time on increasingly highlight technical barriers to entry versus more traditional branding and distribution models," Sun explains. "We are also seeing more services businesses. For example, we continue to like specialty chemicals and healthcare where we've made four investments in recent years."

Ticket sizes are increasing as companies in China mature and industries consolidate – MPSEA has invested more in the country in the last two years than during the prior six-year period or the 12 years before that. However, Sun stresses that working with quality management remains the core tenet of his investment thesis. "Forging aligned, long-term relationships with management is critical to both driving growth and to weathering business cycles," he says.

MSPEA is said to be in the process of raising its fourth pan-regional fund, which has a target of around \$1.5 billion. A first close of \$750 came towards the end of last year. Sun had no comment on the issue. ▽

RMB fundraise of the Year – CDH Investments

CDH INVESTMENTS DID NOT GET INTO

the renminbi fund space as part of the mad rush for heady exit multiples on Chinext. The private equity firm's involvement dates back to several years earlier and it owes much to China's regulators restricting offshore corporate restructurings and encouraging investors to stay onshore.

"The exit route through red-chip structures was more difficult and the China Securities Regulatory Commission (CSRC) encouraged us to use the A-share market. Then the National Council for Social Security Fund (NSSF) decided to get into the asset class and CDH and Hony Capital were the first two they picked up," Shangzhi Wu, chairman and managing partner of CDH, told *AVCJ* earlier this year.

The private equity firm launched its debut renminbi fund in 2008 and received commitments of RMB4.06 billion (\$668 million), with the NSSF putting in almost 40%. The fund was intended to be a small complement to the firm's other offerings – the previous year CDH's third US dollar fund closed at \$1.6 billion – but the NSSF's participation made it an important consideration.

Two years later, the firm returned to market with a successor vehicle – Tianjin CDH Equity Investment Fund II – and an initial target of RMB5 billion. Despite an increasingly challenging fundraising environment towards the end of the process, the fund closed at RMB8 billion last September. The NSSF's contribution was RMB3 billion.

The pension fund is now CDH's largest single LP across any of its funds – US dollar and renminbi – although the largest single group remains international institutional investors, accounting for about two thirds of the total assets under management.

As to the investment prospects for the new renminbi-denominated fund, Stuart Schonberger, managing director at CDH, notes that "China's potential for economic growth still remains very high and its economic model supports the establishment and development of world-class firms."

He cites pharmaceuticals, real estate, logistics and technology as sectors that are likely to deliver strong returns for PE investors. ▽

Firm of the Year – FountainVest Partners

PE Professional of the Year – Homer Sun (Morgan Stanley Private Equity Asia)

VC Professional of the Year – Lei Jun (Shunwei Capital Partners)

Private Equity Deal of the Year – Alibaba Group (Boyu Capital/China Investment Corp/China Development Bank Capital/CITIC Capital/DST Advisors/Silver Lake/Temasek Holdings)

Venture Capital Deal of the Year – Xiaomi (Shunwei Capital Partners/IDG Ventures/Morningside Technologies/Qiming Venture Partners/Qualcomm Ventures/Temasek Holdings/DST Advisors/GIC)

Exit of the Year – China Pacific Insurance (The Carlyle Group)

Fundraising of the Year: US dollar – FountainVest China Growth Fund II (FountainVest Partners)

Fundraising of the Year: Renminbi – Tianjin CDH Equity Investment Fund II (CDH Investments)



VC Professional of the Year – Lei Jun

Having cut his teeth with Kingsoft and enjoyed an early but short-lived high with Joyo, Lei Jun embarked on a successful career as a super angel. Mobile phone brand Xiaomi is his masterpiece, for now

TWENTY YEARS AGO, LEI JUN JOINED

Chinese software company Kingsoft and dedicated himself to developing its flagship product, WAP Office, a word processing system primed to challenge Microsoft's mid-1990s offering. It lost.

"This hit me hard. It was like someone had destroyed what we had spent years creating. Microsoft will always be our enemy," Lei said in a television interview a few years ago. He then spent 90 days in trying to WAP Office in Kingsoft stores and realized why it hadn't worked. "We focused on producing something we liked, but never researched what users preferred."

As a result, Lei lost out on the global internet boom. The late 1990s saw a legion of millionaires emerge from Silicon Valley start-ups and a few of China's nascent internet companies caught the end of the wave. For software companies, however, it was difficult to match the success of Google or Yahoo. And the Chinese equivalents of these providers had yet to emerge.

"Lei missed the first internet bubble. The likes of Tencent Holdings, Alibaba Group and Baidu were nothing more than junior start-ups when he started working at Kingsoft," says Hans Tung, Beijing managing partner at Qiming Venture Partners, who worked with Lei for several years.

But in Joyo.com, an online retailer of books, music and videos, Lei had his first success story. The company was founded in 2000, in the early stages of Chinese e-commerce, and within four years had been acquired by Amazon for \$75 million.

Going solo

Having served as Kingsoft CEO for nearly a decade, Lei stepped down in 2007 shortly after taking the company public in Hong Kong. He then embarked on a second career as an angel investor.

Lei identified three themes likely to drive the next generation of internet start-ups: e-commerce, social networking and mobile. Early targets included social networking site YY, clothing retailer Vancl, and mobile browser UCWeb. YY went public in the US last year and Vancl is expected to follow suit, while UCWeb is expected to be acquired by Alibaba.

Richard Liu, a partner at Morningside Technologies, which has backed YY since inception, notes that Lei has an innate ability to

spot companies with potential. He is also happy to hold on to portfolio companies for a long period of time and help them grow. Lei invested \$1 million in YY eight years ago and, based on the company's current valuation of \$1.5 billion, he has made a paper gain of nearly 100x. Yet he has still to exit.

"Other angel investors wouldn't have the patience to hold on to a company for such a long period," says Liu. "They usually give up and cash out in the fourth or fifth round of funding."

Another characteristic of Lei's investment approach is he only invests in industries he understands and alongside entrepreneurs that he knows well. Vancl CEO Chen Nian, for example, founded Joyo with Lei.

In total, Lei has seeded about 20 companies and he continues to support them on an institutional basis through Shunwei Capital Partners, the venture capital firm he set up in 2011.

So far, Morningside has collaborated with Lei on seven deals and Qiming on four, including Vancl. Tung volunteers that if anyone else had walked in and made the same pitch, he wouldn't have invested in many.

For all his success, Lei describes super angel investing as a hobby, not a job. However, his long-held ambition was to penetrate the mobile phone market, something that has been achieved with Xiaomi. "The creation of Xiaomi combines those three key investment themes into one product," Tung explains.

Lei's idea was to create a high quality but marketing-lite smart phone brand, and he first pitched it to Liu and Tung in 2009. "We were on the phone from 9 p.m. to 9 a.m. discussing the business model," Liu told *AVCJ* last year. "We had to change batteries and chargers several times. We wanted to identify the next big wave and getting the timing right."

Morningside and Qiming 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, Qualcomm Ventures and Temasek Holdings joining the existing investors.

Innovative approach

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.

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.

"Everyone has been surprised by how fast it has grown," Tung says. "Xiaomi is the fastest start-up to reach \$1 billion in revenue and achieve profitability. Google did in year six, Facebook in year seven, Amazon reached the revenue target quicker but it took nine years to achieve profitability."

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. However, Lei is in no hurry to take the business public and has ruled out an IPO before 2016. "What Xiaomi products have been launched now only accounted for 20% of what we discussed in the beginning," Liu says.

There are rumors of a Xiaomi Internet TV product, but all Tung will say is that the company is going international, from Greater China to Taiwan and Hong Kong, and then Southeast Asia. "Of course the US and European markets are part of the plan," he adds. "Korea has Samsung. Why can't China have its own brand reach the same level of achievement?"



Carlyle finds the right formula for Yashili

GLOW-IN-THE-DARK PORK, DUMPLINGS

with aluminum, cadmium-tainted rice, and cooking oil made from recycled sewage are just some of the horrors that have found their way onto Chinese dinner tables in recent times. It is no wonder, then, that there is an equally long list of private equity deals where investors have sought to take advantage of both a dire need for safer food in China and the willingness of a growing middle class to pay a premium for it.

Last week, The Carlyle Group joined the growing list of firms to cash in on this strategy as it agreed to exit infant formula manufacturer Yashili to China Mengniu Dairy. Mengniu is buying about 75% of the company from majority shareholders the Zhang family and CA Dairy, a vehicle owned by Carlyle Asian Partners II and its parallel co-investment entity. The private equity firm will receive HK\$3 billion (\$387 million) for its 24% holding.

Carlyle initially paid \$95.2 million for a 17.3% stake in Yashili back in September 2009. This was less than a year after China's dairy industry reached its most recent nadir. Milk had become

tainted with melamine as it passed through the fragmented supply chain, resulting in the deaths of six infants. Yashili wasn't among the main culprits but it suffered with the industry as a whole, posting a record loss of \$128 million in 2008, mainly due to product recalls and decreased sales.

Carlyle's priority was not only to ensure product safety but also to restore consumer confidence. "Carlyle has worked closely with Yashili's management team in the past several years to facilitate the company's internationalization, including setting up the Food Safety & Quality Assurance Committee (FQSAC) and supply chain initiatives in New Zealand," says Eric Zhang, managing director at Carlyle.

FQSAC was the first committee of its kind in China, headed by Robert Brackett, former director of the US Food and Drug Administration's Center for Food Safety and Applied Nutrition. On the back of the committee's efforts, among other

things, Yashili's fortunes revived and it went public in Hong Kong in 2010, raising \$348 million. Carlyle increased its stake to 24.4%.

Following the IPO, Yashili stepped up efforts to strengthen its brand, emphasizing in marketing campaigns that the raw materials for its formula were sourced from New Zealand.



Yashili: Road to recovery

In early 2012 the company introduced slogans like "Pure New Zealand, Cherish Yashili." It also committed RMB1.1 billion (\$180 million) to a new milk processing plant in Pokeno, near Auckland. The plan received regulatory approval in April.

For Mengniu, the investment means a larger share of the domestic baby-formula market, which is projected to grow by more than 70% to \$21.8 billion by 2015. It is the company's second lateral deal in a matter of weeks, following the purchase of a minority stake in China Modern Dairy, facilitating the partial exit of KKR and CDH Investments. ▀

Partners Group joins India's IT crowd

FEW INVESTORS NEED TO BE CONVINCED

of the wealth of possibilities that exist in India's IT outsourcing industry. As of last year, the sector was valued in excess \$100 billion with export revenues reaching \$69.1 billion and domestic revenues of \$31.7 billion – growing at rate of 16% and 9%, respectively.

It comes as little surprise that the sector has been prime hunting ground for VC and PE investors in recent years. At \$275 million, Partners Group's acquisition of CSS Corp, which was officially confirmed this week, represents the largest private equity buyout seen so far. The investor is understood to have taken an 80% stake in the company, with CEO T.G.

Ramesh and private equity entrepreneur Sanjay Chakravarty holding the remainder,

Like many of the larger participants in the global technology support services sector, CSS emerged during the boom in India's business process outsourcing (BPO) and knowledge

process outsourcing (KPO) industries. Established in 1996, the company provides a range of services, including mobility solutions, cloud enablement, technical support and remote infrastructure management to a blue-chip client base.

CSS now operates from 13 locations worldwide with a team of more than 5,400. The firm has revenues of \$200 million, drawing on a customer base that includes Nortel, Deutsche Bank and Motorola. It is based in the US but most of its employees and delivery centers are in India.

"CSS Corp is already a leader in the supply of specialist technological outsourcing services," says Andreas Baumann, partner and head of Singapore at Partners Group. "This is a sector in which we expect to see strong growth going forward as demand for these services increases."

For Partners Group, the plan is to shepherd the company through the next phase of

development by building out its sales capabilities and expanding its service footprint through the addition of delivery centers in new geographies. CSS is also expected to focus on its business in analytics-led customer support, mobility, virtualization and telecom services.

CSS stand out as India's largest tech support services buyout but there have been plenty of other sizeable transactions. The Blackstone Group acquired Internet Global Services in 2007 for \$200 million, selling it four years later to Serco Group for \$634 million, while last year Bain Capital paid \$1 billion for a 30% interest in Genpact. The sellers, General Atlantic and Oak Hill Capital, still own another 30%.

The CSS deal facilitates the exits of SAIF Partners, Goldman Sachs and Sierra Ventures, which prior to the transaction owned 70% of the company. SAIF's first investment came in 2006, when it paid \$22.5 million for Baring Private Equity Partners India's interest in the business. Goldman Sachs arrived the following year, leading a \$25 million round that included Sierra and SAIF. ▀



CSS Corp: Global player

India secondaries: Plan B?

India's PE industry is expected to see an increase in secondary deals as funds approach maturity and GPs look for alternatives to difficult public market exits. But is the talking translating into transactions?

WHEN ASIA GROWTH CAPITAL ADVISORS

(AGCA) acquired a portfolio of assets from its former parent Credit Suisse, the company received a new lease of life. Backed by a new set of LPs ready to commit capital, if a portfolio company needed additional support AGCA could now do follow-on investments. The transaction was also tipped to fuel investors' interest in secondary deals where existing backers are unable or unwilling to continue.

HarbourVest Partners was the lead investor in that transaction. Since the deal was completed in February, Tim Flower, a principal at the firm, has received plenty of inbound communication about portfolios that might be for sale. Such deals could account for the 10-20% of HarbourVest's nearly \$6 billion in secondary-focused funds that has been earmarked for Asia.

"There is a lot of activity. We are talking to several people, advisors as well as GPs," Flower says. He is currently working on two India deals – one to acquire the sub-portfolio of a seasoned fund manager and another for a virgin fund's portfolio of high-growth businesses.

Big opportunity, little action

The opportunity certainly is there. Between 2006 and 2008, more than \$23 billion was raised by Indian GPs, mostly for funds in the \$100-200 million range. Portfolios acquired during these boom years are maturing and the slowdown in IPOs is expected to prompt an increase in secondary direct and fund deals. And yet, Flower says he is not aware of many deals being done at all.

High valuations are often to blame for faltering sales. Many of these investments were made at a time when entry valuations were sky high, but since then the rupee has depreciated and lowered the value of portfolios. Companies may have grown but perhaps not as aggressively as originally projected.

"In some situations investors aren't willing to bite the bullet around a realistic valuation. It's not that they're selling the assets to somebody else; they're just not selling the assets," Flower says. "For better GPs we see an adverse selection in terms of the companies they're looking to sell, and that brings the valuation issue back on the table. We are happy to take a portfolio that includes assets that aren't that exciting, but if it's a collection

of underperforming assets then as much as I understand why a GP is looking to sell, we have no interest in acquiring."

In situations where a GP is sitting on a maturing portfolio of un-exited assets, frustrating incumbent LPs to distraction, a secondary investor is a useful antidote. The assets and management team into a new entity and allowing the frustrated LPs to cut their losses. However, not only must the assets be worth having, but the LPs must be willing to cede control at an acceptable price. When buying from

"In some situations investors aren't willing to bite the bullet around a realistic valuation"

– Tim Flower

a pool of investors, there are often differences in terms of need for liquidity and valuation expectations.

Doug Coulter, head of Asia private equity at LGT Capital Partners, says there are deals to be done but they are extremely resource-intensive. "As an LP you look at them and they might be interesting, but you need to balance that against the fact they take a long time to transact. You can spend a year working on it and the seller just changes their mind."

When there is no consensus, the compromise position might be single-asset sales, which bring liquidity to LPs and might give GPs the exit momentum required to drum interest in a new fund. These don't appeal to the likes of HarbourVest and LGT – they like portfolios, ideally with managers attached – but GP-to-GP deals are possible, and in some cases, actively sought.

NewQuest Capital Partners, which spun out from Bank of America Merrill Lynch two years ago, is a ready-made GP platform dedicated to secondary assets. It has a \$400 million fund and \$100 million in dry powder.

According to Amit Gupta, NewQuest's COO and head of India business, single asset deals fall into two categories: where companies are growing and need another round of primary

capital, or where the primary and secondary are clubbed in a stapled deal, giving the investor an exit.

Seasoned GPs could also find value in secondary deals – they might be investing from their fourth fund but still have a few assets left from the first fund. "They want to fully realize the old fund as they generally have already returned enough money to the investors," Gupta says. "They want to rationalize the investments and manage their team's bandwidth effectively."

On the portfolio deal side, a change in strategy is one reason investors want to exit, such as with financial institutions where banks are readdressing their strategy on holding assets in Asia.

Contrary to HarbourVest, Gupta says that pricing expectations, once far apart, are now closing. These sentiments are echoed by Akshat Shukla, Paul Capital's regional representative for sourcing secondary transactions. But he notes that the relationship with a company promoter and his willingness to enter into a secondary deal is an important factor. This is particularly the case with minority investments that were done with a view to pursuing an IPO.

GP to GP

While the number of PE exits has declined over the last few years, secondary sales between GPs have shown significant growth, rising from \$122 million in 2009 to \$1.6 billion in 2012. According to KPMG, in 2011, there were 19 such secondary deals in India out of the total 84 exits. This compares to 25 out of 94 exits the previous year.

GPs say they do not see much difference between selling to another PE fund or a strategic investor. Secondary GP deals are a focus for AGCA right now, with Soma Ghosal Dhar, partner and CEO, noting that "sellers are motivated, and reasonable, and at the end of the day you are talking to counterparts who understand valuation as well as you do."

Flower is hopeful that secondary portfolio transactions will eventually become as commonplace in India as in developed markets, but this will take time. "Frequently with these transactions when we eventually complete the deal it's at the second or third attempt because it takes the shareholders a little time to get their heads around what their objective is." ▀

Getting active in Asia

New Zealand Superannuation Fund's private equity program is only five years old but the fund is gearing up to make larger commitments to international managers. CIO Fiona Mackenzie explains the strategy

WHEN NEW ZEALAND SUPERANNUATION

Fund (NZ Super) published its first performance and portfolio update back in 2006, domestic private equity investments represented just NZ\$17 million – or 0.17% – of its NZ\$10 billion of assets under management. The fund had yet to make any allocations to the asset class overseas.

Over the last six years, the situation has gradually changed. As of April this year, NZ Super – which was set up by the government in an effort to smooth the tax burden arising from costs of superannuation – had NZ\$22.5 billion in assets. Nearly two thirds of this is in global and domestic equities, followed by 10% in fixed income. Private equity and other private markets receive 2% apiece.

However, the proportion of the fund which is allocated to private equity is not necessarily fixed as NZ Super operates under an opportunistic investment framework introduced in 2011.

“We no longer have a target allocation to private equity as an asset class; we think of private equity as a way to access underlying

allows the fund to make investments outside its framework when markets diverge sharply from underlying fundamentals. The approach has gained wider appeal among sovereign funds looking to move away from a passive indexed portfolio to one that is actively managed and increasingly invested in private market assets.

The key benefit of the reference portfolio is that it guards against the volatility of capital markets. At present, the allocations in NZ Super's reference portfolio – which is classified more broadly than the actual portfolio – are 70% global equities, 5% domestic equities, 5% global listed property and 20% fixed interest.

According to Mackenzie, of the fund's total commitments to unlisted mandates, the majority are domestic investments. This is mainly due to a large historical exposure to real estate assets in New Zealand. In terms of pure PE investment, however, only 25% is invested domestically while the remainder deployed overseas.

NZ Super's private equity program is now five years old, having made its earliest commitments

managers.”

In the last few years, NZ Super has been involved in several deals of note at home. In March 2010 it joined Infracore in the \$490 million joint acquisition of the downstream assets in New Zealand of Dutch petroleum giant Shell. It was responsible for one of the largest private equity investments of 2012, buying a 31.25% stake in New Zealand's Kaingaroa Forest from Harvard Management Company for \$2 billion. Canada-based Public Sector Pension Investment Board also participated in the transaction.

Access Asia

However, emerging Asia is becoming an increasingly significant part of NZ Super's private equity exposure. It currently has three relationships in emerging Asia – one generalist fund and two real estate funds, covering China and India, respectively.

These include China Infrastructure Partners, a \$426 million fund sponsored by BOC International and Temasek Holdings, and Red Fort India Real Estate Fund II, an India-focused property fund that reached a final close of \$500 million in early 2012. NZ Super also invested in KKR's first Asian fund in 2007.

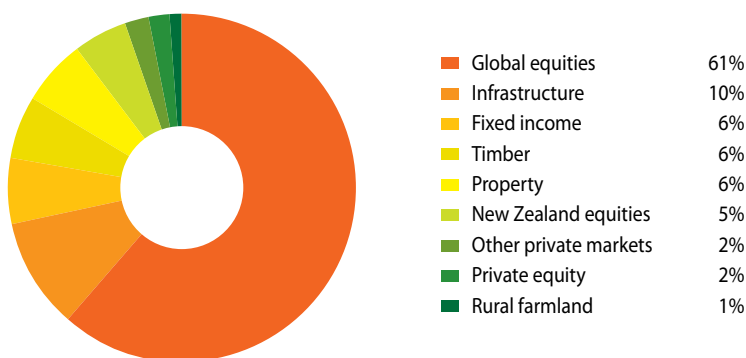
“We will increasingly use private equity managers where we don't have in house capabilities so I would expect more emphasis on managers for non-Australasian investment, but it depends on what opportunities come down our research pipeline,” Mackenzie says.

NZ Super has also begun to dip its toes in co-investment deals. The fund has completed one transaction in the domestic market and operates a co-investment vehicle in China with two counterparts. However, capacity is limited by the small team size and its relative isolation in New Zealand.

“[The domestic deal] was a great experience for the team but it was only NZ\$30 million in size so for the amount of work involved it probably wasn't of scale to be honest,” Mackenzie says.

Instead, she sees the key development in the next few years as the amount the group is prepared to commit to individual managers. Historically, NZ Super's average check size has been NZ\$25-30 million but in the future is will not deploy less than \$100 million with a single manager. ▀

New Zealand Superannuation Fund's asset allocation, June 2012



Source : New Zealand Superannuation Fund

investment opportunities,” explains Fiona Mackenzie, head of investments at NZ Super. “So it makes us a little different in that one year we might not be making any PE investments and another year we might make a lot.”

At the core of NZ Super's strategy is a reference portfolio, a shadow portfolio that provides a benchmark appropriate to the fund's long-term aims and associated risk profile. It

to HarbourVest International Private Equity Partners V and the Adams Street Partnership Fund Program.

“Fund-of-funds were our first and second investments and then we took on an advisor relationship in 2009,” says Mackenzie. “That is when started making investments into co-mingled funds and at that point we were looking to build of a diversified portfolio of private equity

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