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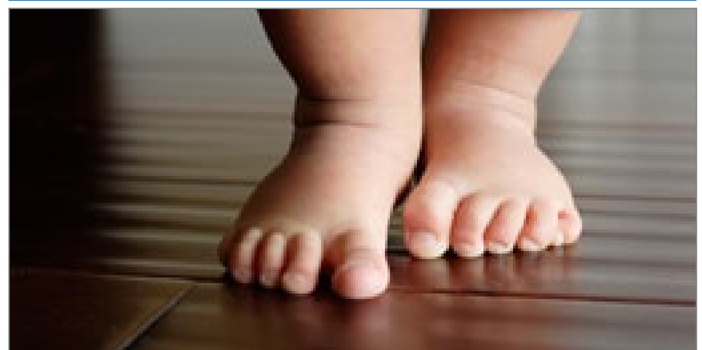

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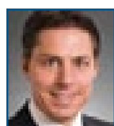

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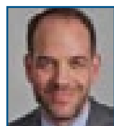

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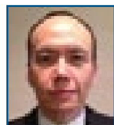

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Registration: **Pauline Chen** T: +852 3411 4936 E: Pauline@avcj.com
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Breaking down the buyout opportunity

MULTINATIONAL CORPORATIONS, WITH one eye on their precarious balance sheets, decide to cut their losses and offload divisions. Septuagenarian founders, keen to retire from the family business but with no obvious successor, agree that it's time to cash out. Entrepreneurs, who rose to prominence supported by strong economic tailwinds, conclude that it is harder to go solo in tougher commercial conditions.

These are the three oft-stated drivers of PE buyout deal flow in Asia. But is the hype about increased control deals in a region traditionally dominated by minority growth investments borne out by the reality?

According to AVCJ Research, announced buyout transactions came to $27.5 billion in 2012, surpassing 2010 by a couple of hundred million to become the most prolific year since 2007. Based on current progress, this figure probably won't be matched in 2013, but with $13.3 billion committed in the first seven months, it is unlikely to be a shabby year.

There are, however, a couple of caveats. First, large-cap deals tend to be limited to markets where leveraged financing is readily available: Australia and Japan, followed by South Korea and Singapore.

In 2007, when buyout investment peaked at $45.5 billion, Australia and Japan accounted for 54% of it. Australia has surpassed its 2007 figure only once since then – reaching $16 billion in 2010 – but in every other year the country has generated buyout transactions of at least $5.5 billion, good for one quarter to one third of the regional total.

With Japan not coming close to matching its $11.5 billion figure from 2007, the main reason for the region's strong performance in 2012 was China. The country saw $7.3 billion in buyout transactions, nearly three times its previous high and 28.5% of the Asian total. Focus Media was responsible for $3.7 billion of this and four more take-private deals for US-listed Chinese companies generated another $2 billion.

It is difficult to see how the momentum can be sustained. There deals are all structured through offshore holding companies, allowing leveraged finance to be used whereas for most China transactions it isn't an option. The surge of PE-backed take-privates that occurred in 2012 has now slowed to a trickle, with China buyouts in the first seven months of 2013 coming to $985 million.

Second, buyout deal flow is lumpy. Even in the more established buyout markets, 1-2 large deals really move the needle, and they aren't necessarily traditional corporate private equity.

In 2012, there were seven buyouts of $1 billion or more. Focus Media (The Carlyle Group, FountainVest Partners, CITIC Capital Partners, CDIB Capital and China Everbright), Jupiter Shop Channel (Bain Capital), Woonjin Coway (MBK Partners) and Akindo Sushiro (Permira) fall into the traditional category; Renesas Electronics (Innovation Network Corporation of Japan), Sydney Desalination Plant (Hastings Fund Management, Ontario Teachers' Pension Plan) and Kaingaroa Forest (New Zealand Superannuation Fund and PSP Investments) do not, even though they fit into the broader category of private capital.

In 2012, there were 41 buyouts totaling $12.9 billion in the $100 million to $1 billion range; below $100 million, 62 deals were completed for a total of $2.4 billion. If the aforementioned trends are indeed gathering pace then it is probably happening at the low end of the food chain. Heralding the arrival of a swathe of more diversified buyouts – by opportunity or geography – is premature.

Tim Burroughs
Managing Editor
Asian Venture Capital Journal

Managing Editor
Tim Burroughs (852) 3411 4909
Staff Writers
Andrew Woodman (852) 3411 4852
Mirzaan Jamwal (852) 3411 4821
Winnie Liu (852) 3411 4907

Creative Director
Dicky Tang
Designers
Catherine Chau, Edith Leung,
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Conference Coordinator
Fiona Keung, Jovial Chung

Publishing Director
Allen Lee

Managing Director
Jonathon Whiteley

Incisive Media
Unit 1401 Devon House, Taikoo Place
979 King's Road, Quarry Bay,
Hong Kong
T. (852) 3411-4900
F. (852) 3411-4999
E. info@avcj.com
URL. avcj.com

Beijing Representative Office
No.1-2-(2)-B-A554, 1st Building,
No.66 Nanshatan,
Chaoyang District, Beijing,
People's Republic of China
T. (86) 10 5869 6203
F. (86) 10 5869 6205
E. beijing@avcj.com

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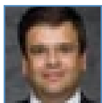
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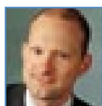
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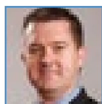
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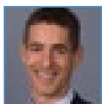
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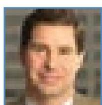
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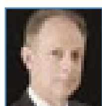
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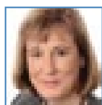
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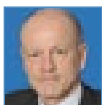
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NEWS

AUSTRALASIA

Hastings buys Phoenix Energy from Terra Firma

Australian infrastructure investor Hasting Funds Management has acquired 100% of Northern Irish gas distribution company Phoenix Natural Gas from Terra Firma. Financial details of the transaction were not disclosed.

NZ's Pan Pacific, Taiwan to set up $40m fund

Taiwan's state-run Institute for Information Industry (III) and New Zealand-based Pan Pacific Capital have formed a $40 million venture capital fund, with a view to promoting cross-border deals and expanding bilateral cooperation.

GREATER CHINA

China Tiantu Capital closes sixth RMB fund at $160m

Tiantu Capital has closed its sixth renminbi-denominated fund on RMB1 billion ($160 million). The vehicle will mainly invest in China's consumer sector. As of the end of last year, Tiantu had more than RMB5 billion under management across five funds. It has made 60 investments totaling around RMB2.4 billion.

VCs join gesture-based tech developer funding round

Shunwei Capital Partners and CTQuan joined Chinese mobile handset maker Xiaomi in a Series B funding round for Israel's Pebbles Interfaces worth $11 million. Robert Bosch Venture Capital, the VC arm of the Bosch Group and Giza Venture Capita led the round, with Sandisk also participating.

China pollution control business gets $20m round

Invesco WLR Private Equity and Keynote Ventures have led a $20 million Series C round funding for LP Amina, an US-based energy and environmental solutions provider. Existing investors Qiming Venture Partners and Hao Capital also participated.

Mandarin Capital exits valve component maker

Sino-European PE firm Mandarin Capital Partners has exited its 70% stake in Italian valves' components producer Gasket International to Hutchinson, a French thermoplastics company. The Girelli family that founded the business has also sold its 30% shareholding. Mandarin acquired Gasket in 2008 for about EUR24 million ($32 million) and supported the company's expansion into Asia

China's 58.com plans for $100m IPO in the US

Chinese venture capital-backed local classifieds website 58.com intends to raise at least $100 million through a US IPO later this year. If successful, it would become the second mainland China-based firm to go public in the US this year, and only the fourth to do so since the end of 2011.

China Merchants sells stake in NTong Technology

The direct investment arm of China Merchants Group plans to sell its entire 12.34% stake in NTong Technology to Shenzhen-listed Unisplendour Corporation (UNIS), for RMB86.36 million ($14.07 million). The proposed deal values the company at about RMB700 million.

GCS sees Dexia asset management deal collapse

GCS Capital's EUR380m ($503 million) bid to acquire the asset management arm of Dexia collapsed last week after the Franco-Belgian bank said the Hong Kong PE firm had been unable to pay for the deal. Dexia had warned GCS that the transaction faced collapse after the end-of-June completion deadline was missed.

NORTH ASIA

Jafco invests $10m in lunch box delivery start-up

Japanese VC firm Jafco Ventures has invested JPY1 billion ($10 million) in Star Festival, the start-up behind lunchbox delivery and catering site Gochikuru.com. To date, the company has partnered with 210 lunch box brands, serving more than 3.2 million customers.

Carlyle registers third Japan fund

The Carlyle Group has registered its third Japan buyout fund with the US Securities and Exchange Commission (SEC). Although initial reports put the target at $2 billion, sources told AVCJ in June that the GP was looking for around $1 billion. The filing for the fund, known as Carlyle Japan International Partners III, was made on Monday.

Advantage Partners exits Japan's Kazaka Securities

Japanese mid-market buyout firm Advantage Partners has sold its stake in Kazaka Securities to Osaka-based Naito Securities. The sale of the 100% stake in Kazaka Securities - a subsidiary of Kazaka Financial Group, with JPY300 billion ($3 billion) in client assets - will make Naito one of the largest medium-size brokerages in Japan.

Advantage reaches final close on $200m fund

Japanese mid-market buyout firm Advantage Partners has closed its latest fund, having reached the JPY20 billion ($200 million) hard cap after about five months in the market.

The bridge fund will have a two-year investment period, which means the firm is likely to start marketing its next vehicle in 12-18 months time, according to a source. The bridge fund was oversubscribed, attracting a mixture of domestic and overseas investors.

The firm's previous vehicle, Advantage Partners IV, launched in 2006 and reached a final close of JPY215 billion in 2007. The fund recorded a significant loss on Tokyo Star Bank. Advantage led a JPY252 billion (then $2.2 billion) acquisition in 2007 but struggled with the asset after the global financial crisis. Creditors assumed control of the bank in 2011.

Other Advantage portfolio companies have fared better. The firm has made four exits so far this year: Komeda Coffee was sold to MBK Partners for $482 million; MIT Corporate Advisory bought apparel company Credge; software developer 1st Holdings was sold to Orix Principal Investment for $272 million; and Tokyu Community picked up condominium management company United Communities.

Axa to exit Arkadin to Japan's NTT

Axa Private Equity has entered exclusive negotiations with Japan's NTT Communications Corporation to sell its stake in collaboration software as a service (SaaS) provider Arkadin. NTT is looking to acquire a 91.2% stake in the company while the management of Arkadin will re-invest alongside it. Axa took a 45% stake in Arkadin from its previous private equity sponsors, including Apax Partners, in July last year.

Baring completes Korea parcel delivery buyout

Baring Private Equity Asia has announced the acquisition of South Korean courier firm Logen. Details of the deal, said to be worth around KRW160 billion ($140 million), emerged last month prior to closing. The seller is Mirae Asset Private Equity.

ACA targets $100m for domestic IT fund

Japanese buyout firm Asian Capital Alliance (ACA) is targeting $100 million for a new fund focused on businesses in the domestic information and communications technology space. the fund expects a first close in September having already received verbal commitments. The majority of its LPs will be domestic investors.

INCJ invests $27m in Japan patent fund

Government-backed Innovation Network Corporation of Japan (INCJ) has invested JPY2.75 billion ($27.8 million) in a fund that will buy unused patents and license them to domestic start-ups. The vehicle, which launched earlier this month, is eventually looking to raise as much as JPY30 billion and will initially focus on patents in the consumer electronics space.

SOUTH ASIA

Lighthouse makes $60m first close on Fund II

Lighthouse Funds has reached a first close of approximately $60 million on its second India-focused fund. The GP is now targeting a final close of $125 million in the first quarter of 2014, but as a source who is familiar with situation told AVCJ, economic and political uncertainty loom large in an already challenging fundraising environment.

DBS abandons Bank Danamon takeover bid

Singapore's DBS Group has abandoned its $7.3 billion takeover bid for Indonesia's Bank Danamon after deciding the regulatory hurdles were insurmountable.

DBS won approval in May to buy a 40% interest in the bank for $2.75 billion, in accordance with the 40% cap on foreign ownership introduced last year. However, it wanted to acquire the 67.4% stake in Danamon owned by Temasek Holdings - also DBS' controlling shareholder - with a view to mounting a full takeover. The deadline for the bank to secure majority control was extended by two months in June but now the deal has been taken off the table.

DBS' stock rose 2.5% immediately after the cancellation was announced, perhaps reflecting investor concerns that it was willing to pay too much for Danamon. The offer valued the lender at 2.62x price-to-book value.

DBS CEO Piyush Gupta said it might take five years of organic expansion before the bank could match Danamon's $400 million in profit from the country. When DBS announced the bid 15 months ago, it said that 2011 revenue from South and Southeast Asia would have increased to 27% from 7% with Danamon.

Providence's Idea Cellular in $616m share sale

Idea Cellular, an Indian telecom provider backed by Providence Equity Partners, plans to issue up to INR37.5 billion ($616.1 million) in equity. Existing investor Axiata Group, the Malaysian telecom operator, will cover INR7.5 billion of the offering.

Founder of VC-backed ShopClues faces US charges

Sandeep Aggarwal, founder of VC-backed Indian e-commerce site ShopClues, has been arrested in the US in connection with the SAC Capital Advisors insider trading investigation. He is charged with passing confidential information to a trader concerning Microsoft's partnership with Yahoo in 2009. At the time, Aggarwal was an internet analyst at research firm Collins Stewart, covering Microsoft and Yahoo.

PE firms eye exit as Trimax IT Infras files for IPO

India's Trimax IT Infrastructure plans to go public, facilitating a partial exit for PE backers Aditya Birla Private Equity (ABPE), Zephyr Peacock India and BanyanTree Growth Capital. The company will issue 6 million new shares and sell 7 million existing shares. ABPE currently owns 9.50% of Trimax

GE Energy invests $42m in India hydro-electric project

GE Energy Financial Services India has committed INR2.5 billion ($42.5 million) to a hydro-power project in north-east India operated by Gati Infrastructure (GIL). The investment was made through a share subscription agreement, for an undisclosed stake.

KKR seeks investors to expand India NBFC

KKR is in talks with overseas investors to infuse capital into its non-banking financial company (NBFC) in India, KKR India Financial Services. The NBFC was launched in 2009 and has lent roughly INR80 billion ($1.3 billion) from KKR's balance sheet to 30 companies.

SOUTHEAST ASIA

Ex-World Bank president joins Temasek board

Former World Bank President Robert Zoellick has been appointed to the board of directors at Temasek Holdings as the Singapore state-owned investment firm looks to open its first US office. Zoellick will take up his new position from August 15.

SingTel Innov8 invests $10m in Fab.com

SingTel Innov8 has invested $10 million in online lifestyle store Fab.com as part of an ongoing Series D round of financing. It joins a list of strategic Asian backers as the company plans expansion in the region.

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

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The new normal

wInitiatives are in place to make private equity reporting faster, more detailed and completely standardized. Are the guidelines a good fit for the industry in Asia and what are GPs doing to meet them?

THE FUTURE OF PRIVATE EQUITY FUND performance reporting is as follows: Managers upload portfolio company data to a cloud-based platform where it is collated into a central database that offers a comprehensive picture of a fund's activities; the data flows automatically into a valuation mechanism that feeds into a dedicated application to be accessed by LPs as and when they required.

The process is seamless, rapid, detailed – and a world away from what many Asian GPs currently offer.

The finance team at a small to mid-cap private equity firm in the region might amount to a couple of people equipped with a $100 accounting software package and a pile of Excel spreadsheets. Data points are calculated, manually; a report is produced and circulated among LPs, either uploaded to a web portal or sent by email, hopefully within six weeks of the quarter ending; LPs extract the data, sometimes manually, and reconfigure it to their own format so like-for-like comparisons can be drawn with other portfolio GPs.

Among the more established firms, there is a gradual shift towards technology platforms that allow more automated and integrated portfolio management. But this doesn't mean communicating the results to LPs is any easier. Different firms use different formats – while the quality and quantity of information also varies – so LPs can't extract data at the push of a button.

"Standardization will come," says Tarek Chouman, managing director for Asia and the Middle East at eFront, a software solutions provider. "If LPs pressure GPs to report in a specific open format, it will be hard for the GPs to say no – either because a particular LP is important to them or because many LPs are asking for it. And if the GP can report in one format to all LPs, it might be just as happy."

Time for change?

The prevailing dynamic in fundraising – there is more demand for capital in Asia than LPs are willing to provide – suggests that this pressure, if applied, would be effective in many cases. There are also platforms available that offer the kind of uniform, vendor-agnostic channels that facilitate the transfer or more information more quickly.

While industry participants generally accept the inevitability of uniform reporting standards, and acknowledge the improved corporate governance and operating efficiencies that should accompany them, they remain cautious about the speed and extent of adoption.

"Most investments in China are minority deals and it is often a challenge to obtain the level of detail you get in a mature market like the US," says Stephen Tang, CFO at Lunar Capital, a mid-market China buyout firm. "We are gradually seeing improvements as younger, well-educated professional managers come up the ranks and appreciate the need for quality reporting. But it's not going to happen overnight."

> "I think the writing is on the wall that private equity at some point will start sharing data and let investors see what their investment in a particular fund is worth on a day-to-day basis"
>
> – Ray Haarstick

One LP adds that the beauty of private equity – and the better-than-public-market returns it delivers – in part lies in its opacity and the ability to uncover managers with qualities that might not be reflected in the quality of their reporting.

"PE started out as a cottage industry and in Asia at least it's still a cottage industry," he says. "We have massive amounts of information coming to us from all angles and among the smaller funds there is zero standardization. If the asset class is going to become more democratic, with individual investors putting in $5,000, then of course there needs to be more regulation but until then all we have are guidelines."

These guidelines fall into two camps. First, the International Private Equity and Venture Capital (IPEV) board was created in 2005 and charged with creating and promoting investment valuation guidelines for the industry that are compliant with international and US accounting standards.

Second, in 2009 the Institutional Limited Partners Association (ILPA) issued a set of principles to improve alignment of interest, governance and transparency in private equity. The idea was to go beyond accounting compliance and provide standardized guidelines for the preparation of financial statements. It duly released templates for GP-LP communication on capital calls, distributions and quarterly reporting.

From theory to practice

ILPA's next step is to release a data exchange template – in open source XML taxonomies so it is available to all – that can be used as a platform for information sharing.

The AltExchange Alliance, which was set up earlier this year by a group of LPs, GPs and service providers, has a similar objective but a slightly different way of achieving it. Whereas ILPA has set down guidelines, AltExchange allows GPs to choose what level of information they want to disclose in different categories. Its platform validates that files adhere to the agreed standard format and releases a validation certificate to the GP, who then distributes it to LPs. EFront is contracted to provide the validation platform.

"LP clients would say to us, 'We are very happy with the technology you are providing, but we don't receive data from GPs on a timely basis and to a level of detail that allows us to make the most of the technology,'" Chouman explains. "Data was therefore a blocking factor in our ability to sell analytical solutions on top of core portfolio management solutions so what we have tried to do is make communication as consistent and comprehensive as possible."

From an LP perspective, the desire for more detailed information on a timelier basis can be traced back to the global financial crisis.

Ray Haarstick, CEO of software solutions provider Relevant Equity Systems, recalls working with a listed investment firm that had a combination of direct real estate holdings and positions in GPs. It took six months for all the managers to disclose the extent of their write-downs and the firm's stock plunged from $55 per

tim.burroughs@incisivemedia.com

share to $8 per share during this period.

Private equity is expected to follow the path first trodden by hedge funds and mutual funds 20 years ago when databases were standardized to track performance, leading to the creation of benchmarking systems and rankings of the best managers.

Previous attempts at benchmarking date back to the public market equivalent (PME) measure of returns, which was devised in the 1990s as a hypothetical investment vehicle that mimicked private equity cash flows, but ultimately dismissed by many as unreliable. However, institutional investors that want to calculate the opportunity cost of committing $10 million to a GP versus putting the same sum into NASDAQ-listed equities, for example, will not be put off. They have tools to make these calculations, and they want data to feed into them.

"Right now private equity is reporting on a quarterly basis. Hedge funds used to be quarterly but now it's monthly and it will probably end up daily," Haarstick says. "I think the writing is on the wall that private equity at some point will start sharing data and let investors see what their investment in a particular fund is worth on a day-to-day basis. The big money wants more visibility."

Frequent engagement

Some global private equity firms, typically those familiar with reporting models in other areas of asset management, already have the ability to deliver information on a daily basis, although crystallizing it into a formal valuation is complicated because a senior partner must sign off on the document. Further down the food chain, GPs are under pressure to deliver their quarterly reports within a few weeks as opposed to the traditional 45 days after the quarter ends.

When asked how they feel about speeding up the reporting process, the array of responses given by Asian managers illustrates the difficulties in bringing the industry together under a common approach.

Lunar tries to report within 15 days of the end of quarter and claims that its disclosures largely conform to the ILPA guidelines. This is possible because the firm has fewer than 15 portfolio companies and is the majority shareholder in several of them, so obtaining financial information is relatively straightforward. Contrast that with Qiming Venture Partners, a China-focused VC firm with more than 70 portfolio companies. The quality and quantity of information provided may equal to Lunar but it takes a lot longer to compile.

"For VC firms with large portfolios, it would normally take up to one month to complete all the valuations and analysis, so reporting on a monthly basis would be difficult. For private equity firms with a smaller number of portfolio companies, it is easier," says Grace Lee, Qiming's CFO. "Also, the data we use to value investment is more subjective in nature compared to mutual funds and hedge funds. You really need time to do a good analysis."

The situation is further complicated by the blurred lines that exist between the different subsets of private equity in Asia. In the US the delineation between buyouts, venture capital and mezzanine are reasonably clear while certain China growth funds have been known to do everything from Series B rounds to cornerstone investments in IPOs.

Another frequent observation is that the ILPA guidelines are based on US investment models that don't necessarily suit Asian private equity. Buyouts dominate the industry in the US but of the $65.3 billion deployed in Asia last year, these transactions accounted for just 42%. Growth and PIPE deals contributed 27% and 22%, respectively. In China the split was even more balanced: 30% buyouts versus 33% growth and 31% PIPEs.

Lunar uses a KPI reporting template for its majority-held transactions that is similar to the ILPA standard. According to Derek Sulger, the firm's managing partner, when a similar template is applied to a China growth deal, it would be difficult to answer more than 5-10 of the 100 or so questions posed.

PIPE deals present another set of challenges. Hong Kong-listed companies are required to report every six months, with each report published no more than three months after the conclusion of the financial period. Any information that goes beyond what is available to public investors cannot be shared as it is

ILPA quarterly portfolio company reporting checklist

Standard schedule of investments

- Company name
- Security type (debt/equity)
- Number of shares
- Fund ownership percentage (fully diluted)
- Initial investment date
- Fund commitment
- Total invested
- Current cost
- Reported value
- Realized proceeds

Supplemental schedule of investments

- LP ownership percentage (fully diluted)
- Final exit date
- Valuation policy
- Period change in valuation
- Period change in cost
- Unrealized gains/losses and accrued interest
- Movement summary
- Current quarter investment multiple
- Prior quarter investment multiple
- Since inception IRR

Company profile

- Summary company data (name; initial investment date; industry; headquarters; company description; fund ownership percentage; investor group ownership percentage; enterprise valuation; securities held; ticker symbol; investor group members; management ownership percentage; board representation; board members; investment commitment; invested capital; reported value; realized proceeds; investment multiple; gross IRR)
- Investment background
- Initial investment thesis
- Exit expectations
- Recent events and key initiatives
- Company assessment
- Valuation methodology
- Risk assessment/update

Detailed company data

- Financial results (y/y % growth; LTM EBITDA; EBITDA margin; total enterprise value; TEV multiple; total leverage; total leverage multiple)
- Investment structure (units; total invested; reported value; realized proceeds)
- Capitalization (rate; maturity; at closing; at period end; covenant threshold; covenant headroom; total net debt; equity; enterprise valuation)

price-sensitive, so a GP investor must wait for the official disclosure – and then conduct its own analysis for the quarterly report to LPs. In these situations, even the 45-day reporting window might be missed.

A request too far?

The ILPA provisions on quarterly reporting recommend disclosure of a combination of GP-level and portfolio-level data packages. In addition to a summary letter offering an overview of performance and developments that could impact an investor's risk exposure, the GP should provide a balance sheet, information on operations and cash flow management, a capital account statement, and an investment schedule explaining portfolio valuations.

The supplemental reports should also include a snapshot of the operations and performance of each portfolio company: acquisition details, current financials, valuation methodology and expectations.

In the view of Relevant's Haarstick, ILPA is overreaching in some areas and asking for too much information. "They want to know who your portfolio company contacts are, how much money you put in, and the value created," he says. "By handing over this level of detail you risk being circumvented. Investors could go into those companies and do their own rounds."

There are situations in which LPs ask for large amounts of information. A large fund-of-funds operating primary, secondary and co-investment platforms will have multiple uses for portfolio company data and the ability to slice and dice it accordingly.

LGT Capital Partners, for example, has more than 40 people in its back office in Switzerland and Ireland devoted to disseminating information that comes from numerous sources and in various formats. The ultimate objective is that an investment professional in Hong Kong tasked with pricing a secondary deal can do a keyword search and identify the relevant data points. A large direct PE investor in Europe or the US may not have the same specialized resources.

"If there is a team of 3-6 covering the whole world for private equity and maybe infrastructure and real estate as well, it might be difficult for them to do what we are able to do," says Doug Coulter, a partner at LGT. "If we didn't have those 40 people we wouldn't be able to do it."

The reality is they aren't digging nearly as deep – a streamlined reporting system simply allows these small teams to conduct comparative analysis of GPs more easily. Haarstick has yet to see compliance with ILPA guidelines for quarterly reporting or capital and distributions notices appear in partnership agreements.

Similarly, most GPs *AVCJ* spoke to have yet to receive a litany of unreasonable data requests from their investors outside of the fundraising process. There is a demand for headline numbers that explain how an investment in a retailer is performing, but not a store-by-store breakdown. Sulger says Lunar has yet to see too much demand for portfolio data beyond what is currently disclosed. However, if the firm is going to the trouble of fulfilling specific requirements, he wants LP to respond proactively.

"We have a good relationship with our LPs and trust most to have this information because we feel they can add value," Sulger says. "We want to avoid providing it to LPs or outside parties purely interested out of morbid curiosity with limited value add. We give the information to people we trust will look at it, analyze it, understand it in the appropriate context and give valuable feedback."

Limited resources

The primary concern for most small to mid-cap GPs is not so what information they provide as how they can provide it. On one hand, the owners of portfolio companies are often unaccustomed to detailed reporting and have to be taught to collect the right information. On the other, the private equity firms themselves might struggle to implement the systems required to compile and communicate these data.

The likes of eFront, SunGard and Relevant are relatively new additions to a China private equity landscape that was – and to a certain extent still is – dominated by Microsoft Excel. It is not just a matter of software but also people and broader corporate culture.

"If you use this software you need dedicated people," says Qiming's Lee. "You can subscribe to the full model but if you are only using three elements then it's a waste of money. Most larger funds not only spend money on software but also invest in additional head count to utilize it. Smaller funds might have sophisticated models but the difficulty in doing this front-end to back-end seamless reporting is manpower."

In some cases, private equity firms have gone through painful year-long implementation processes only to find that they can't fully adapt to a new way of working.

CFOs tend to run the new system and Excel in parallel during implementation just in case something goes wrong and it is not unusual for this dual approach to remain in place. Managers speak positively of the speed and automation of these systems, whilst warning that it can work against you. Certain parameters are pre-programmed so that numbers can be swiftly translated into KPIs, but checking each step to identify potential errors is a protracted and frustrating process.

"If different sets of numbers come out the assumption is that Excel is right because the fund has been using it all along and you can trace back exactly what went in," says one GP. "That's a big concern for a CFO – you don't know whether you are right or the system is right."

Viewed in a positive light, these are nothing more than teething problems that will be addressed as the industry matures and private equity firms, from senior deal makers to junior analysts, buy into the need for more efficient reporting. This should occur naturally as businesses scale up, additional funds are raised, and there are a larger number of portfolio companies, at different stages of their respective investment cycles, to look after. Internal teams will be expanded or services will be outsourced – either way, it means an additional cost.

And this is essentially the cost of fundraising. Regardless of whether the movement is led by ILPA, AltExchange or another platform, the wheels are already in motion. The more in-demand GPs in Asia may be able to set their own terms on fund performance and portfolio reporting longer than most, and the extent to which LPs' dream of perfect harmonization is very much open to debate, but a manager's ability and willingness to disclose information is now among the criteria upon which he is judged.

To give an extreme example: If a GP is looking to raise Fund III and the senior executives are buying yachts and neglecting to invest in systems that allow them to communicate more effectively with investors, the likelihood of re-ups diminishes.

"Established platforms give more comfort to investors because they have the systems in place," says Mounir Guen, CEO of placement agent MVision. "Transparency has become a huge aspect of investor reviews and one that they use to assess whether you are institutional or not. The days when smaller firms had the flexibility of working with internally-generated reports are gone."

> **"Smaller funds might have sophisticated models but the difficulty in doing this front-end to back-end seamless reporting is manpower"** – Grace Lee

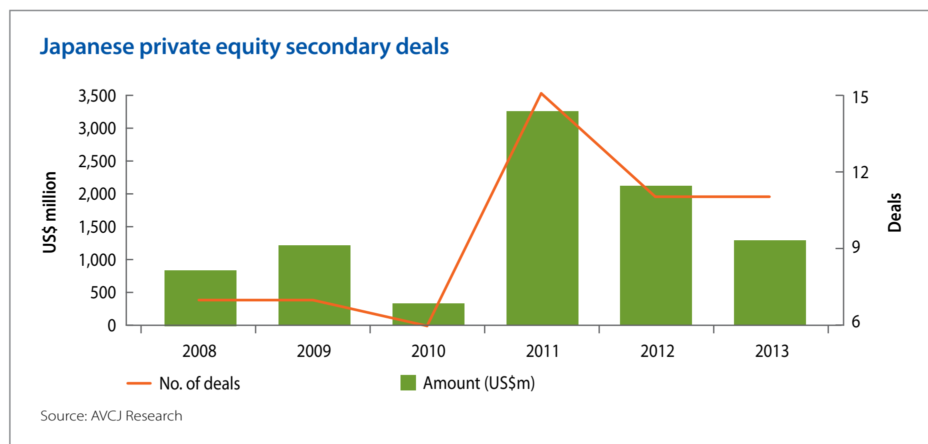
andrew.woodman@incisivemedia.com

Japan's secondaries surge

Secondary deals in Japan spiked in 2011 as buyouts from before the global financial crisis found an exit. With the country's economic prospects improving, industry participants expect the flow to continue

SECONDARIES HAVE NEVER ACCOUNTED for a significant proportion of exits in Japan – between 2007 and 2010 there were only 6-7 a year. In 2011, however, the number jumped to 15, followed by 11 in 2012. There have already been 11 so far this year worth a combined $1.2 billion – just over 20% of total PE equity exits.

The standout deal was Advantage Partners' sale of Komeda Coffee to MBK Partners for $482 million. The domestic GP achieved a 7x money multiple, but Josh Porter, managing director at Advantage, argues there are benefits at both ends. "LPs question the value of one GP buying from another because they assume the value has already been extracted and perhaps the buyer won't have the opportunity to create additional value but that hasn't been the case," he says.



Source: AVCJ Research

The surge in secondary deals from 2011 can be traced back to buyouts from the years leading up the global financial crisis. Investors want to exit, and with weak public markets and uncertainty among strategic players, secondaries are a welcome source of liquidity. Unison Capital has been on both sides of the table. Last year it bought auto industry supplier Asahi Tec from RHJ International and repair company Minit from CVC Capital Partners, then sold sushi chain Akindo Sushiro – which it backed in 2007 – to Permira.

More recently secondary deals in Japan have taken place against a different backdrop. The country has gone through a series of major economic reforms – introduced by Prime Minister Shinzo Abe – which have led to a devaluation of the yen and a consequent increase in investor appetite for Japanese assets. Secondary buyouts, previously so dominant, are only part of the story.

"I think that deal flow in the PE secondaries market is becoming stronger than ever before," says Moriyoshi Matsumoto, managing partner of secondaries specialist WM Partners, which spun-out from JAIC. "Japan has struggled to revitalize its economy in the last three years, so people thought it was too late to sell and too early to buy. Since the Abe administration came in more investors are looking to do deals."

WM Partners – one of just two pure secondaries platforms in Japan, alongside Ant Capital Partners – is targeting up to JPY10 billion ($102 million) for its debut fund. Matsumoto sees his opportunities in earlier stage deals where there has been a gap between seed and pre-IPO stage investments, creating an opportunity for GPs that can provide the capital and expertise needed to take a company to the next level.

While deal sizes are obviously smaller, early-stage secondaries accounted for a significant portion of deal flow last year. VC firms were involved in five of the 11 transactions.

Corporate venture funds were active participants. Yasuda Enterprise Development, SBI investment and Neostella Capital bought a minority stake in construction company Tama Home from Daiwa Corporate Investment and Mizuho Capital; Nissay Capital acquired a share in e-commerce site operator Dream Vision from the same group. In March, Future Investment – the investment arm of Future Architect – acquired sport products e-commerce company E-Sport from Global Brain, a 2005 vintage fund.

"We have seen more corporate venture capital funds being set up," says Joji Takeuchi, co-founder of PE advisory firm Brightrust Japan. "It is possible those funds could look to purchase portfolio companies from independent VC funds that were established in the early 2000s."

This phenomenon is not been limited to venture capital – a number of mid-cap PE funds are coming to the end of their lifespan, correlating with the rise in the number of Japan funds that reached a final close a decade earlier.

Shunsa Hayashi, managing director with Ant Capital – which covers traditional and direct secondaries in Japan and Greater China – sees this as a global phenomenon. "The secondaries market is picking up but there is still a limited number of players so we have opportunities, especially in the mid-cap space," he says.

Ant Capital is currently raising its fourth secondaries fund which launched early last year with a target of $150 million.

Browsing for buyouts

However, the balance of the market is still likely to favor regional and global buyout players. They are increasingly interested in Japan due to the improving macroeconomic environment and there is no shortage of willing sellers among the mid-market GPs with portfolios to exit.

In addition to the Akindo Sushiro and Komeda's Coffee transactions, CVC bought employment agency Prompt Holdings from Cerberus Capital Management last year, while this week China's CDH Investments and Belle International to acquire a stake in CLSA Capital Partners-owned apparel brand Baroque Japan.

There is no doubt the larger buyout players are interested. KKR, which recently announced a $6 billion final close on its second pan-Asian fund, has said it expects to become more active in the country. The Carlyle Group, meanwhile, is seeking around $1 billion for its third Japan fund.

"It should also be noted that there have been a good number of high-multiple exits in the past two years in Japan both by local funds and foreign funds," says Brightrust's Takeuchi. "Most investors' Asian allocation is so heavily concentrated on China and India that some sort of rebalancing would be appropriate for their portfolio risk management."

Clearlake backs Futuris to buck downturn

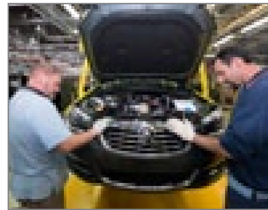
THE A$200 MILLION ($178 MILLION) STATE bailout for Australia's auto industry comes after years of decline in manufacturing. Industry production numbers are the lowest since 1957. Toyota and General Motors (GM) have scaled back production amid export pressure from a strong Australian dollar, reduced import tariffs and weaker demand for locally made large cars.

Ford Motor Company said it will stop making cars in Australia in 2016 as it is no longer viable to manufacture in the country.

Ford Australia sales account for about 25% of global sales for Futuris Automotive, the automotive components supplier Clearlake Capital Group bought from Elders last week. The company makes car seating and interior systems – including pedals, steering systems and interior trims – for Ford, GM, Tesla and Toyota, as well as for several Chinese carmakers.

But Futuris has managed to beat the downward trend. One reason for this is its drive into Asia. The company has manufacturing facilities in Thailand, China, Australia and the US, as well as design and engineering centers in the latter three countries. "We are one of the few companies that actually has all the intellectual property, advanced engineering and advanced manufacturing to be what is called a fully sequenced, just in time manufacturer," says Malcolm Jackman, CEO of Elders.

In the first half of 2013, automotive unit EBIT was A$5 million compared to A$5.4 million a year ago. Sales were up 3%, reflecting increased sales overseas offset by lower domestic vehicle build volumes.



Futuris: From Australia to Asia

Clearlake bought Futuris for A$69 million ($62 million), including debt, and will provide fresh capital to pursue growth opportunities overseas. The car parts business has little in common with the rest of Elders' agribusiness. "On this transaction, all the cash proceeds will be used to pay down corporate debt. The value was constructed on a cash-free, debt-free basis," Jackman explains.

Just as car manufacturers have been moving their facilities into China, India and Thailand, Futuris has been expanding its presence in the region. The company's headcount in Thailand – where it based close to a new Ford plant – grew to 700 in 2013, up from 200 the previous year. A second plant opened next door to cope with the business. There are also five plants in China, two in Australia and one in the USA.

"The Thailand and Australia facilities are predominantly supporting GM and Ford, and to a lesser extent Toyota. The US is around supporting Tesla," says Jackman. China is more of a case doing everything in country – primary design work is out of Australia, but the secondary design work is in China itself.

The opportunities and volumes in Asia are there, but the region does present challenges in pricing. A lot of the work done in China, for example, is for budget vehicles whereas what Futuris makes in the US is for high-end cars. Earlier this year the company announced it plans to launch in India through a joint venture.

Car Clubs enters the fast lane

BICYCLES ARE THE KINGS OF THE ROAD in Hangzhou. Following a program that was successfully introduced in Paris, the city in China's Zhejiang province has made a stock of about 66,500 bicycles available for hire. Journeys begin at one of 2,700 stations spread throughout the city – each no more than 1,000 feet apart – and end at another.

Car Clubs, a Hangzhou-based car rental operator, has a similar goal: to make its vehicles available anywhere and at anytime.

Car Clubs: anywhere, anytime

The two-year-old company last week received a Series A round of funding, worth several million renminbi, from local VC investor Incapital and Tobon VC, a government-managed fund. The capital will be put towards growing its number of operation stations to 200 and enlarge its fleet to 400 cars, up from 100 at present.

"The company is expected to raised several rounds of funding later to scale up its business. Once operations reach a critical mass, it will start establishing a brand name in the market," says Rongjun Liu, investment director at Incapital, which first backed Car Clubs last October.

Formerly known as Evnet, Car Clubs' fleet initially comprised electric cars but these were soon replaced by gas-powered vehicles. A customer makes a reservation online and collects his vehicle from any self-service station; rental fees are charged by the hour and settled automatically by scanning a membership card.

The minimum cost of renting a Car Club vehicle in rush hour is RMB50 – less than a one-hour taxi ride, although fewer miles are usually covered. Much like the bicycle rental system, Car Clubs is expected to help reduce traffic congestion and air pollution.

"The business strategy is in line with government policy to promote a green city," Liu says, "The local government has initiatives to provide subsidies for start-ups. Their investment is capped at 30% of a VC firm's commitment and the capital doesn't' have to be returned if the business is making losses. If it reports a profit, the government share can be bought back."

Tobon VC was launched in 2008 by Caikai Investment Group, which is owned by the Hangzhou provincial government. It has registered capital of RMB30 million.

Car Clubs will spend no more than RMB100,000 on each of its new vehicles, which means it won't match the Mercedes-Benzes and Audis offered by China Auto Rental, the country's largest car rental provider. China Auto Rental has also received PE backing and plans on expanding its 55,000-vehicle fleet to more than 100,000 by 2018. As of June, the company had nearly 600 service locations covering 66 cities and 52 airports.

Though keen to enter new cities, Car Clubs' ambitions are more modest. "I think the approach of China Auto Rental is too aggressive and the business expansion has been off the balance sheet," Liu says. "We will control Car Clubs budget for expanding in the early stages."

winnie.liu@incisivemedia.com

Safety first

Chinese insurers have been able to invest in domestic private equity for three years and in overseas private equity for 10 months. Investments are proceeding slowly, but infrastructure is being put in place

ONCE SHACKLED TO UNPREDICTABLE domestic investments, China's insurers now have license to venture overseas. As of late last year, they candabble in stocks, bonds, private equity, real estate and currency products in 45 countries and regions. It was the latest in a string of policy liberalizations by the China Insurance Regulatory Commission (CIRC). Private equity features strongly. Three years ago, insurers got the green light to participate in domestic PE as LPs. Last year, the CIRC raised the cap on their exposure to private equity funds and private companies to 10% of total assets, up from 5%.

Fast-track approvals have also been introduced for private equity fund commitments, with the average waiting time reduced from one year to a few months. Not that the insurers are inclined to move quickly.

> "We would like to be a GP, so we don't have to pay about 20% of the investment return to external managers in the form of fees" – Chinese insurer

"As an LP, we are freer than National Council for Social Security Fund, which is limited to invest onshore funds," says an executive in the investment management department of a Chinese insurer. "But we won't focus much on offshore investment even though the regulator allows us to. The preparation work will be more complicated – we aren't familiar with overseas markets."

Baby steps

China's insurance industry had total assets of RMB7.88 trillion ($1.29 trillion) as of June this year, which means up to RMB788 billion could theoretically be pumped into private equity and direct investments. To date, insurers have committed about RMB103.5 billion to local PE funds, of which only about RMB41.5 billion is with funds that have reached a close of some kind, according to AVCJ Research.

"We are working with several insurance companies, advising on their PE investment. More than half of them slowed down their pace in investments since last year," says Sun Dayi, managing director at Jade Investments.

However, it would be unfair to say insurers are losing their appetite for private equity. Rather, the slow pace of investment is the byproduct of an uncertain regulatory environment and a lack of familiarity with the asset class.

The CIRC opened the door in 2010, announcing the registered insurers could invest, either directly or indirectly, into domestic private equity firms "with a proven track record." China Life was the first to be granted a license to conduct investments in 2011, shortly followed by Ping An Insurance and Taikang Life Insurance.

Initial progress was slow due to the amount of red tape. Investments had to be approved on a case-by-case basis and insurers were only allowed to back managers with assets under management and net assets of at least RMB3 billion and RMB100 million, respectively, as well as three exits under their belt. Only a handful of leading GPs, such as Hony Capital and CITIC Private Equity, qualified.

China Life injected RMB2 billion into CITIC Private Equity's third renminbi fund last year, accounting for about 16% of the total corpus. That came after a RMB1.5 billion commitment to Hony's second local currency vehicle.

Even though Chinese insurers have experience sourcing deals and making direct investments in private companies – Ping An's direct investment team has been in operation for more than eight years – they are not are not allowed to sponsor or manage a private equity funds that raise capital from third-party investors.

"We would like to be a GP, so we don't have to pay about 20% of the investment return to external managers in the form of fees," says the insurance company executive. "More income will ultimately benefit for our business growth."

The CIRC doesn't see the situation in quite the same way; its priority is risk mitigation. "It's possible the regulator views acting as a GP to a private equity fund as a high-risk business given their lack of familiarity with this asset class and the importance of safety of insurance capital," says Ying Zhang, counsel at Fangda Partners.

In this context, the CIRC has informed insurers to appoint at least two third-party consultants, including one financial advisor and one legal advisor, who can review their fund due diligence and allocations to the asset class. Firms should also ensure the funds they invest in have an investment horizon of 10 years, as opposed to the 4-5 years favored by many local managers.

Team building

Insurers are actively consulting fund-of-funds managers regarding investments and evaluating GPs; however, few decisions have been made partly because they are still building up their professional investment teams domestically and internationally. This might involve creating a specialized PE group or broadening the remit of existing asset management teams.

"Insurance companies have experience investing in fixed income and equities overseas," says Jade Invest's Sun. "Who should make foreign PE investments remains to be defined, however. It takes time for management to figure out whether it should be the current private equity team or overseas team."

AVCJ understands that China Life set up an alternative investment team earlier this year, which is separate from its asset management department.

As for direct investment in private companies, the list of approved categories now includes energy and resources, property and casualty and auto insurance, as well as financial services. They are drawn towards larger-ticket deals that offer stable, infrastructure-style returns.

No insurer is anywhere near the 10% of total assets investment threshold, according to industry sources. There is a prevailing sense of caution, particularly given the difficulties China Investment Corporation ran into with its initial direct investments.

"Given the personnel personnel and sophistication required to go into the offshore alternative asset class, Chinese companies will take their time," says Fangda's Zhang. "However, the types of business and legal diligence questions we get from insurance LPs suggest they are becoming more sophisticated. They are learning fast and ramping up the infrastructure for offshore investments."

mirzaan.jamwal@incisivemedia.com

Soaring rocket

Rocket Internet, which has raised more than $1 billion in funding in the last year, is known for launching copycats of successful sites. Tito Costa, managing director for Southeast Asia, outlines a different strategy for the region

Q: Rocket claims to be the world's largest internet incubator. What is the secret sauce?

A: I have started 6-7 companies in 15 months, in Italy, Pakistan and Southeast Asia. It's about the people – you have the guidance of entrepreneurs who've done it for 10 years or more, so there is a well-defined method. We've gone from day one, when we take the investment decision, to live launch in 3-4 weeks. Rocket as a central entity develops the IT platform and in many cases it has already been developed, because we have launched verticals in several countries. We apply the same processes and key performance indicators that we've developed across the globe. Although we have to apply them in different regulatory environments and local situations, I would say the footprint, model and mindset is the same. We take on the market risk of acquiring enough customers at a reasonable cost and getting the customers to buy enough to make it profitable in the long run.

Q: In the past there have been quick turnarounds, such as selling auction site Alando.de to eBay in less than 100 days after launch. When you talk about the long run, what is the timeframe for returns?

A: Asia is a long term bet. It takes time to get to the scale you need in e-commerce. It took more than a decade to bring Amazon to profitability. Our European venture, Zalando, got to profitability in less than half that time and we are now seeing even faster developments for Rocket's second- and third-generation of e-commerce companies where we are applying knowledge acquired from all over the world. In the end what matters is building a valuable business.

Q: What is the strategy for Southeast Asia?

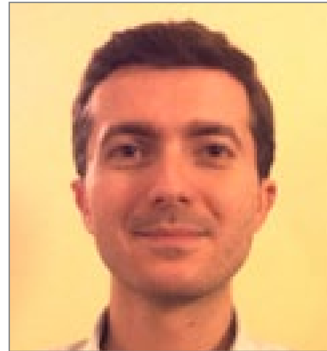
A: Our approach is to play the fragmentation in Southeast Asia, the different languages and cultures, to our advantage. We have decided to go for a localized structure in all of our ventures, from marketing to selection of merchandise. For Zalora [an online fashion retailer], we need to provide local brands and styles that are relevant. Indonesia and Malaysia are Muslim countries so we need to provide a Muslim collection, and then Vietnam and Philippines have different needs. We have to differentiate ourselves from Asos, which ships from London or from Amazon.

Q: Is the decision-making centralized?

A: We use a two-tier structure, with a regional team and managing directors that look over the regional software development, mobile development, customer relationship management, and on-site marketing. Then in each country there's a team running the daily business, the local marketing campaigns, operations and buying teams. We centralize what we can, but we are very locally-driven and this will be a key competitive advantage in the long term.

Q: How is Southeast Asia different from other emerging markets?

A: Across the region mobile is very relevant in terms of our traffic.



"If the growth and revenue hypothesis is not confirmed within 3-6 months then we pull out"

It already generates 25% of our revenue, which is pretty large compared to other markets that we've seen and it is set to grow faster as PCs are substituted by tablets and phones. We've launched a mobile-optimized website to meet that demand.

Q: Of the five ventures operating in Southeast Asia, which are the best performing?

A: Zalora and Lazada [another online retailer] are the two key investments in the region and they are doing well. Zalora has seen average month-on-month revenue growth of 15-20%, doubling every six months.

Q: Zalora has raised over $126 million in the 12 months since its launch, while Lazada has received around $236 million. Why have the ventures been able to raise capital so quickly?

A: Rocket's track record has helped the Asian ventures attract funding from existing and new investors. Our successes include Zalando in Europe, Brazil's Dafiti and Lamoda in Russia. Southeast Asia also has very strong macroeconomic fundamentals that have attracted foreign investment. It's a unique window of opportunity to enter the market, build the needed infrastructure and own the nascent e-commerce verticals, while building significant barriers to entry.

Q: Are local partnerships part of the strategy?

A: We have developed a number of local partnerships. We are working with banks on credit card discounts and cross-marketing in all of our countries. On the operations front, Zalora has partnered with the 7-Eleven retail chain in Singapore. Our customers can pick up orders there, and it now accounts for a significant portion of our deliveries. We are developing this as a pilot program in Singapore and looking into similar tie-ups in other countries as well.

Q: Why were office supply specialist OfficeFab and furniture venture Home24 shut down?

A: These are still active in other parts of the globe but they've been pulled from Southeast Asia. It's a long-term market penetration and domination kind of discussion. We go in with a certain hypothesis of growth and revenue. Sometimes you're not able to guess how the market will react. If the hypothesis is not confirmed within 3-6 months then we decide to pull out.

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