

EDITOR'S VIEWPOINT

Nominations open for 2013 AVCJ Asia Awards

Page 3

NEWS

Ascent Capital, AMP Capital, Anthem Asia, Carlyle, Hony, INCJ, JAFCO, JFDI.Asia, SIG Asia

Page 6

DEAL OF THE WEEK

Quadrant in Australian pet supplies buyout

Page 10

BVCF leads the fight against super bacteria

Page 10

FUNDS

China grocery tycoon seeds chain store fund

Page 11

PROFILE

How India's Everstone created NBFC IndoStar

Page 14

Perfectly conceived

Which incubator or accelerator model is best for birthing Asia start-ups? Page 8

FUNDS



L Capital aims larger

Big deals, mature markets on the agenda Page 11

FOCUS



Fount of knowledge

Patent funds harness Asian innovation Page 12

Real Assets Across Asia

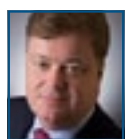
Private equity investment in infrastructure, energy and real estate

3 October 2013 • Hilton Singapore

GLOBAL PERSPECTIVE, LOCAL OPPORTUNITY avcjrealassets.com

Join us at the AVCJ Real Asset Forum:

- **Learn** how private equity is financing infrastructure in Asia
- **Explore** investment opportunities in infrastructure, energy and real estate
- **Meet** private equity leaders and institutional investors from across the globe
- **Hear** more than 20 of the most senior and experienced real asset investors, including:



Grant Kelley **KEYNOTE**
Co-head of Asia Pacific
APOLLO MANAGEMENT ASIA PACIFIC LTD



Neil Arora
Senior Managing Director
MACQUARIE CAPITAL



Kevin Lu
Regional Director, Asia Pacific, Multilateral
Investment Guarantee Agency (MIGA)
THE WORLD BANK



Vijay Pattabhiraman
Managing Director and CIO, Global
Real Assets - Asia Infrastructure
JP MORGAN ASSET MANAGEMENT



Wiebke Schloemer
Manager, Infrastructure and Natural
Resources, East Asia & Pacific Region
IFC



Andrew Yee
Managing Director and Global Head of
Infrastructure Principal Finance
STANDARD CHARTERED BANK

and many others...

For the latest programme and speaker line-up, please visit avcjrealassets.com

BOOK NOW

Registration: Pauline Chen T: +852 3411 4936 E: Pauline@avcj.com
Sponsorship: Darryl Mag T: +852 3411 4919 E: Darryl.Mag@incisivemedia.com

Co-Sponsors



Knowledge Partner

Gerson
Lehrman
Group

Have your say in the 2013 AVCJ Awards

CAN ANYONE STOP KKR? THAT IS THE

question being asked as we launch the 2013 AVCJ Private Equity & Venture Capital Awards, now in their 13th iteration.

The global buyout firm raised \$6 billion for its second pan-Asian fund, nearly twice as much as the next largest vehicle to complete fundraising during the last 12 months. Second place – by size – went to RRJ Capital II, which accumulated an impressive \$3.5 billion yet still fell short of the \$5 billion it was seeking. Many other GPs have also been forced to rein in their ambitions in a challenging fundraising environment.

All this makes for an interesting Fundraising of the Year category. At one end of the scale sits a big beast, which reached its target faster than immediate rivals – LPs were clearly convinced by KKR's investment thesis and track record, but at the same time the firm has sufficient resources to reach out to potential backers wherever they might be.

Success stories at the mid to small end of the scale stand out by virtue of their specialization. FountainVest Partners drew \$1.35 billion for its second China-focused fund – 40% larger than its predecessor – but the GP retains a reasonably concentrated sector focus and a "pure play" approach to private equity with no other strategies.

L Capital Asia's second regional fund is currently at a first close, but with the \$950 million hard cap already reached a final close is likely to come soon. As Sanjay Gujral, regional managing director at L Capital Asia, told *AVCJ* this week, it was not only the firm's themes – lifestyle and consumer plays in emerging Asia – that appealed to LPs, but also its discipline.

Carry on down the list of funds that reached a final close in the last year and it is more of the same.

Tata Opportunities Fund has a particular angle – leveraging the Tata Group brand – SSG Capital and Shoreline Capital are dedicated special situations players, and Vision Knight Capital is tech-focused. Even Southern Capital Group, which raised \$400 million for its third buyout fund, has honed its thesis. Previous

vehicles invested throughout Asia but the most recent fund is primarily seeking deals in Malaysia, Singapore and Indonesia.

These are only suggestions. We are looking to the Asian private equity and venture capital community to nominate candidates worthy of consideration – which they can do until September 30. For more details of the process and qualification criteria, please go to www.avcjforum.com/awards.

The categories are listed below. There is one addition for 2013, the Operational Value Add Award, which recognizes private equity-driven value creation. Internal discussions over whether to include an award of this kind stretch back a couple of years. Reservations as to how to judge entrants objectively and whether we should increase the number of awards at all (they are deliberately few in number) have been overcome.

Apart from that, it is largely business as usual. The AVCJ Editorial Board evaluates entries, submits long lists to a panel of industry judges who provide feedback, and then final short lists are posted online for the entire PE and VC community to vote on. The winners will be announced at an invitation-only gala dinner in Hong Kong on November 11.

We look forward to receiving your nominations.

2013 AWARDS CATEGORIES:

- Firm of the Year
- Private Equity Professional of the Year
- Venture Capital Professional of the Year
- Private Equity Deal of the Year
- Venture Capital Deal of the Year
- Private Equity Exit of the Year
- Fundraising of the Year
- Operational Value Add Award
- AVCJ Special Achievement Award

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,
Mansfield Hor, Tony Chow

Senior Research Manager
Helen Lee
Research Manager
Alfred Lam
Research Associates
Herbert Yum, Isas Chu,
Jason Chong, Kaho Mak

Circulation Manager
Sally Yip
Circulation Administrator
Prudence Lau

Manager, Delegate Sales
Pauline Chen

Senior Marketing Manager
Rebecca Yuen

Director, Business Development
Darryl Mag

Manager, Business Development
Anil Nathani, Samuel Lau

Sales Coordinator
Debbie Koo

Conference Managers
Jonathon Cohen, Sarah Doyle, Zachary Reff,
Conference Administrator
Amelie Poon
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 Nanshan,
Chaoyang District, Beijing,
People's Republic of China
T. (86) 10 5869 6203
F. (86) 10 5869 6205
E. beijing@avcj.com

The Publisher reserves all rights herein. Reproduction in whole or in part is permitted only with the written consent of AVCJ Group Limited.
ISSN 1817-1648 Copyright © 2013



26TH ANNUAL

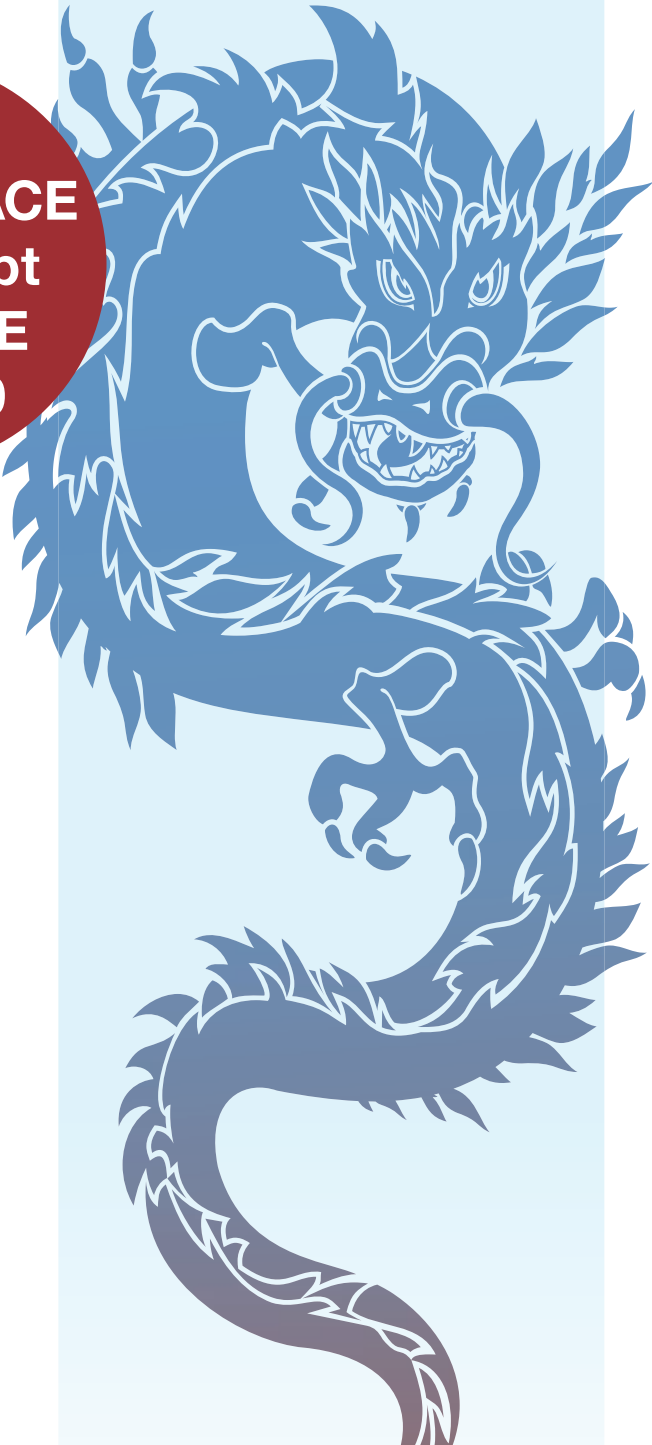


PRIVATE EQUITY & VENTURE FORUM

12-14 November 2013

Four Seasons Hotel, Hong Kong

**BOOK
YOUR PLACE
by 19 Sept
and SAVE
US\$300**



Keynote speakers



Steve Koltes, Co-Founder & Managing Partner
CVC CAPITAL PARTNERS



Dwight Poler, Managing Director
BAIN CAPITAL



Thomas H Lee, President
LEE EQUITY PARTNERS



Christopher Flowers, Founder
JC FLOWERS & CO



Plus global economist
Byron Wein, Vice Chairman
BLACKSTONE ADVISORY PARTNERS LP



Meet 1,000+
global PE
professionals



Network with
more than
250 LPs



Hear from 170+
industry leading
speakers

AVCJ Forum: Be at the heart of the debate.

REGISTER NOW

to assure your place at the largest and most influential gathering of top Asian focused private equity and venture capital industry professionals in the world today.



Contact us

Registration: **Pauline Chen**

T: +852 3411 4936

E: Pauline@avcj.com

avcjforum.com

AVCJ
ASIAN VENTURE CAPITAL JOURNAL
PRIVATE EQUITY & VENTURE FORUM



Register now at avcjforum.com

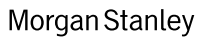
Lead sponsors



Asia series sponsor



Co-sponsors



Legal sponsors



Knowledge partner



VC summit legal sponsor



PE leaders' summit sponsors



Knowledge. Commitment. Success.



Awards sponsors



Exhibitors



Official broadcast partner



Communications partner



Contact us

Registration: **Darryl Mag**

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

avcjforum.com



GLOBAL

CI Funds Group targets \$150m for litigation fund

Specialist distressed debt and litigation investor Commercial Intelligence Funds Group (CI) is launching an Asia- and Africa-focused fund with a target of \$150 million. A first close is planned for the end of 2013. Alternatives Asia Africa Fund VII will primarily focus on financed claims in emerging markets, with a 20% allocation for claims outside Asia and Africa.

AUSTRALASIA

Lloyds sells loan portfolio to Bain credit affiliate

Bain Capital credit affiliate Sankaty Advisors has agreed to pay Lloyds Banking Group A\$371 million (\$335 million) for loans held by BOS International Australia. It is the latest in a series of divestments from the BOS loan portfolio after KKR and Allegro Funds picked up a portion towards the end of last year.

AMP Capital reaches first close on infra debt fund

AMP Capital has reached a first close of more than \$300 million on its latest infrastructure debt fund. The vehicle has a full target of around \$1 billion, roughly twice the size of its predecessor, which closed to new investors in June of last year.

Billabong posts \$777m loss, brand value drops to zero

Distressed Australian surfwear retailer Billabong International- which is currently negotiating a A\$325 million (\$290 million) refinancing deal with a consortium led by Altamont Capital Partners - has booked a net loss of A\$860 million, while cutting the value of its namesake brand to zero.

GREATER CHINA

Yixia.com completes \$25m Series B round

China mobile video app Yixia.com has completed a \$25 million Series B round of investment led by internet giant Sina Corporation. Existing backers Redpoint Ventures and Morningside Ventures also participated in the round.

Taiwan regulators stress commitment to PE

Taiwan's Minister of Economic Affairs Chia-juch Chang stressed that the government sees PE as an important contributor to local economic development, highlighting draft legislation that promises to ease the deal approvals process. However, PE investors said that further action is required before regulators can claim to offer an appropriate level of transparency.

The Ministry of Economic Affairs (MOEA) has formed a taskforce to coordinate between different government agencies with a view to



clarifying the criteria on which transactions are assessed. Also, an amendment to the Statute for Investment by Overseas Chinese and Foreign Nationals has been put before the Taiwan's Legislative Yuan that would allow certain deals to proceed without first receiving regulatory approval. "According to the Investment Commission, if the ceiling for post-investment reporting is set at \$1 million then 83% of all investment projects will only have to be reported after the fact," Chang told the AVCJ Taiwan Forum. Private equity investment in Taiwan reached just \$56.9 million in 2012, ranking 16th by PE deal value.

Jan-juy Lin, a commissioner with the Financial Supervisory Commission (FSC), echoed Chang's sentiments that Taiwan is very much open to PE investment - although he made the distinction between "long-term investors" and "short-term profit opportunities," alluding to the fact that the asset class has in the past been regarded with suspicion.

Carlyle, Cathay Capital, PingAn invest in Meinian

A consortium, comprising The Carlyle Group, Cathay Capital Private equity and China Ping An Insurance, has agreed to invest RMB300 million (\$49 million) in Meinian Onehealth Healthcare Group, the largest private provider of preventive healthcare check-up services in China.

Composition appoints Head of Asia Pacific

Real estate fund manager Composition Capital Partners has appointed Whye Choong Low as principal and new Head of Asia Pacific at its Hong Kong office. He will be in charge of both running the company's Asia Pacific operations and expanding its activities in the region.

China education site Fenbi.com to raise Series B round

Fenbi.com, a Beijing-based online education platform, is about to close its second round of VC funding. It is said that IDG Capital Partners and Matrix Partners China have joined the round, taking total capital raised to \$7 million.

Carlyle, Townsend commit to warehousing platform

The Carlyle Group and the US-based investment firm The Townsend Group will have agreed to invest \$200 million in logistics warehouses in China. The capital will be used to acquire an undisclosed stake in five warehouses owned by Shanghai Yupei Group and build an additional 12 properties in the next two years.

SIG Asia leads \$18m round for photo app Camera360

SIG Asia Investment (SAI), an affiliate of US financial group the Susquehanna International Group, has led a \$18 million Series B round of funding for Camera360, a photo-editing mobile app. Existing backers Matrix Partners China and Gobi Partners also participated.

NORTH ASIA

SMBC, IGPI invest \$1.3m in game design platform

SMBC Venture Capital and Industrial Growth Partners (IGPI) have invested JPY130 million (\$1.3 million) in Mugenup.com, a start-up that crowd-sources design talent to work on projects for game developers. Set up in 2011, the Tokyo-based firm provides a platform where developers can post design jobs to a pool of creators..

Rakuten leads Series B round for e-commerce app

Rakuten Group - Japan's largest e-commerce firm - has led a \$23 million financing round for the Silicon Valley-based start-up behind online

shopping app Slice. Russia Partners, a unit of New York PE firm Siguler Guff & Co, and NPD Group also joined the round along with existing investors DCM, Innovation Endeavors and Lightspeed Ventures.

JAFCO invests \$3m in Japan online laundry service

JAFCO Ventures has invested JPY300 million (\$3 million) in White Plus, the start-up behind Lenet, an online laundry delivery service. Established in 2009, the service allows users to request laundry services via the Lenet website. White Plus will use the funds to improve its service launch a beta version of its online crowd storage service Hiroe.

INCJ invests \$6m in Japan's UniZeo

The Innovation Network Corporation of Japan (INCJ) has invested JPY600 million (\$6 million) in UniZeo, a Japanese company which is focused new methods of producing synthetic zeolite. UniZeo was set up in April this year by Nippon Chemical Industrial to commercialize a patented low-cost method of producing synthetic zeolite.

SOUTH ASIA

Norwest, IFC-backed Snowman files for IPO

Snowman Logistics, an Indian cold chain services firm backed by Norwest Venture Partners and International Finance Corporation, has filed a draft red herring prospectus for its upcoming IPO. Snowman - a subsidiary of Indian port-based logistics operator Gateway Distripark - is looking to dilute a 25% stake, selling 42 million shares.

Ascent Capital invests \$3.7m in CARE Ratings

Ascent Capital will invest INR250 million (\$3.69 million) in Indian credit rating agency Credit Analysis and Research (CARE) According to a regulatory filing, Ascent India Fund III will buy 446,310 shares at INR560.15 apiece through a preferential issue of shares, amounting to an approximately 1.5% stake.

Morpheus Fund invests \$6m in TVC Skyshop

India's Morpheus Fund has invested INR420 million (\$6.17 million) for an 8% stake in direct-to-consumer retailing platform, TVC Skyshop. Founded in 2000, the retailer uses multiple

Simcere accepts \$490m Hony take-private bid

Chinese drug developer Simcere Pharmaceutical Group has agreed to a management buyout offer from a consortium led by its chairman and Hony Capital that values the company at approximately \$490 million. Simcere is now expected to de-list from the New York Stock Exchange, pending a shareholder vote.

According to a regulatory filing, Jinsheng Ren, Hony and the other buyers will pay \$9.66 per American Depository Share (ADS), which represents a 21.4% premium to Simcere's last closing price prior to the offer being announced on March 11. The initial bid was \$9.56 per share.

The consortium currently holds 77.6% of the total outstanding shares, so reaching the two



thirds majority support in the shareholder vote required for the deal to go through should be a formality. Ren controls about 39% of Simcere while Hony and its sponsor, Legend Holdings, between them have 17.7%. TrustBridge Partners and Fosun Industrial are among those that have agreed to roll over their stakes into the acquisition vehicle.

The transaction will be supported by \$85 million in debt financing provided by the New York and Nanjing branches of China Merchants Bank. According to AVCJ Research, Hony originally invested RMB200 million (then \$24 million) for a 30% interest in Jiangsu Simcere Pharmaceutical.

platforms such as print media, direct response television, the internet and catalogues to market a range of consumer goods,

Nalanda Capital invests in India's Info Edge

Nalanda Capital has invested more than INR268 million (\$3.9 million) in listed online classifieds company Info Edge India. The PE firm bought 1.7 million shares on the secondary market for around INR300 apiece.

Rabo, Proparco invest \$21m in Prabhat Dairy

Rabo Equity's India Agribusiness Fund has invested another INR800 million (\$12 million) in Prabhat Dairy, while French development finance institution Proparco has committed INR600 million to the company. Prabhat sells milk products directly to consumers and also to businesses as a food ingredients supplier.

SOUTHEAST ASIA

Anthem Asia makes first Myanmar investment

Anthem Asia, a new private equity firm based in Yangon, Myanmar, has closed its first deal in the country, investing around \$1 million in office rental firm Hintha Business Centers (HBC). The company runs serviced offices in the centre of Yangon - with 13 private offices available to rent on a weekly or monthly basis, starting at \$1800 a month.

Indonesia VCs, incubators form lobbying alliance

Eight Indonesian venture capital firms and incubators have come together to form a lobbying group known as the Alliance of Venture Capitals in Indonesia (AVCII). Members include CyberAgent Ventures, East Ventures, GEPI, Grupara, Ideosource, Jakarta Founders Institute, Merah Putih Incubator, and Mountain Indonesia.

Armstrong reaches \$130m third close on energy fund

Netherlands Development Finance Company FMO, the Swiss Investment Fund for Emerging Markets (SIFEM) and the IFC Catalyst Fund will invest about \$45 million to Armstrong Asset Management's Southeast Asia cleantech fund, bringing the total capital raised to \$130 million. A final close of \$150 million is expected by September.

JFDI.Asia launches latest accelerator program

Joyful Frog Digital Incubator (JFDI.Asia) - a Singapore-based accelerator - has launched its latest 100-day program with an intake of 10 new start-ups. The teams were chosen through an open competition attracting 321 applications. Modeled on the US accelerator Tech Stars, JFDI.Asia looks for teams ready to take their start-up from concept to early stage investment.

From acorns to oaks

As Asia's tech startup community flourishes, more incubators are setting up shop in the region in a bid to emulate Silicon Valley success – but what is the best way to do it?

TRADEGECKO BEGAN AS A CALCULATED

gamble. Three 20-something New Zealanders, Carl Thompson and brothers Cameron and Bradley Priest, moved to Singapore last year to develop a cloud-based inventory and sales management system for small- and medium-sized enterprises (SMEs) that is more sophisticated than Excel but cheaper than SAP.

The three entrepreneurs won a place on the 2012 intake of Singapore-based accelerator JFDI.Asia, receiving an initial investment of \$20,000 as well as assistance that led to the commercial launch of TradeGecko in October of the same year. Two months later, with around 200 trial users in 26 countries, the company raised a seed round of \$650,000 led by Wavemaker Labs. It is now targeting a Series A round of \$3-5 million.

The JFDI-Innov8 Bootcamp program – run by JFDI.Asia in conjunction with corporate VC unit SingTel Innov8 – offered intensive mentoring intended to turn a business plan into an investible business in the space of 100 days. For TradeGecko, the game changer was the support network that came as part of the package.

“There were plenty of programs and talks but that is not really where the value is; it is more about having advisors to give us a kick up the backside and keep us focused,” says Cameron Priest, the company’s CEO. “Having dropped everything and used our life savings, we had to make it work so that was most valuable thing for us.”

JFDI.Asia is just one of more than 100 incubators and accelerators now operating in Asia, primarily serving the internet and IT sector. According to AVCJ Research, seed and early-stage investments below \$1 million – the typical ticket size for seed investments following an incubation period – totaled just over \$62 million last year across 189 deals, more than the double the amount committed in 2010. This year looks set to match if not improve on that figure, with \$44 million invested so far across nearly 100 deals.

The emergence of incubators is part of a broader Asian growth story whereby millions of emerging markets consumers are getting online – and via mobile devices such as smart phones and tablets rather than PCs. Start-ups contribute to the ever-expanding ecosystem of niche products and services targeting this fast-growing

sector. At the helm of these businesses is a new generation of eager Asian entrepreneurs, full of energy but lacking direction.

Incubators and accelerators offer them capital and guidance, emulating the model established in Silicon Valley over the past decade but also adapting it to fit the unique demands of Asia’s start-up community. It is a matter of finding the formula that fits – so what has worked best so far?

Birth of the incubator

To understand how Asian incubators and accelerators are evolving one must appreciate how they came about in the first place, as well as the fundamental differences between the two.

concept. It is widely accepted that this strictly for-profit model was pioneered at Y Combinator in Silicon Valley in 2005, which was quickly followed by Tech Stars and others the following year. Like incubators, the form a seed accelerator takes can vary greatly from program to program, but there are some common themes.

The standard accelerator features an open application process for entrepreneurs; the purchase of an equity stake – typically less than 10% with an initial investment of \$35,000-50,000; a fixed incubation period – normally of around three to six months; and some form of mentoring. In many cases a co-working space is provided and at the end of the fixed period a

Asia seed and early stage investment (<US\$1m)



Source: AVCJ Research

The business incubator model predates Silicon Valley. The first one was set up in 1959 at the Batavia Industrial Center in New York, mainly as real estate play, providing start-ups with shared office space at a fee. It wasn’t until a couple of decades later that the concept of offering additional business advice and support was introduced. Under the traditional model, rents and client fees accounted for the majority of incubator revenues; few took equity stakes in companies.

Today around just under half of business incubators globally serve the technology sector. While many are commercial enterprises, a significant number are funded by regional or national governments or by other non-profit organizations.

Seed-stage accelerators are a more recent

demo day is held where “graduating” teams get to present their ideas to prospective investors.

The most important element of any program is the mentoring. Typically, mentors will come in the form of serial entrepreneurs and angel investors with relevant experience. The benefits of this are two-fold: entrepreneurs get access to expertise that might not otherwise be available to them, and they also get access to potential investors. For the mentors, it is a chance to see the team work together, which helps them decide whether they want to invest.

“Personally I like to get more involved,” says Vinnie Lauria, co-founder of seed-stage VC Golden Gate Ventures in Singapore, who regularly takes time out to visit and mentor at other incubators around Asia. “It is trade of time and resources and while some investors may not

see the value in it, I like to build up relationships and familiarity before demo day.”

However, the voluntary mentor-cum-investor system is not for everyone. Beijing-based early stage investor Innovation Works runs its own incubator with paid professionals who guide start-ups to seed-stage investment. Around two-thirds of Innovation Works’ 45-strong workforce comprises of operational professionals while the rest are responsible for the firm’s investments. There is a full in-house financing and accounting team, a legal team, a 10-person recruitment team and a group of designers who work around the various portfolio companies.

Chris Evdemon, a partner with Innovation Works, explains part of the reason for this is that many Chinese entrepreneurs come from an engineering- or product-focused background, rather than exhibiting the entrepreneurial credentials many incubators in the West are used to seeing.

“The teams we invest in are very good at what they do but may not have as much experience in the day-to-day functioning of a company,” he says. “In the first few months it is critical for them to get their initial product out in the market so they need to be a 100% focused on what they do best.”

This is only temporary, though. These functions are gradually transitioned to the start-up team once the business gains more traction.

All under one roof

With the degree of hand holding that takes place within incubator programs in Asia comes the need for a co-working space. While the incubator was founded on the concept of a co-working space, it is not universal among accelerators – indeed, Y Combinator is among those who don’t see it as necessary. The caveat is that Y Combinator is based in Silicon Valley, which is already like a giant incubator spread over two cities.

“It is the one place in world where you can wonder into a café and wave a term sheet around and say ‘Hey guys, I have been made an investment offer can someone give me some advice?’ and people will just offer it,” says Hugh Mason, co-founder of JFDI.Asia.

Deprived of this luxury, co-working spaces have become an essential component to many, if not all, Asian Incubators. JFDI.Asia, for example has gone as far as modeling the look and layout of its café to mimic those seen in the Valley.

“There is a lot of merit in housing together a few bright young energetic people all developing their own thing in the mobile internet sector,” agrees Evdemon.

“At the end of the day, in Beijing we do not have an ecosystem that is as mature, resourceful

and open as the Silicon Valley system.”

Another element that defines the difference between an incubator and accelerator is the time spent by companies within the program. The Tech Stars model, which has been widely adopted in Asia, dictates a three-month period – no more, no less. The idea is that the course of the acceleration is make-or-break period for the start-up; they either make a success of their company or force themselves to realize that it isn’t working.

Either way, says JFDI.Asia’s Mason, the outcome is good for all involved. “The problem with some incubators is that there is no fixed time limit. Teams come through the door and sit there for an undefined period and there is no urgency, whereas with an accelerator there is and that is incredibly healthy,” he says. “It forces people to focus and it limits the exposure of everybody.”

“The teams we invest in are very good at what they do but may not have as much experience in the day-to-day functioning of a business” – Chris Evdemon,

However, this does not paint the whole picture. While the benefits of fixed period are clear, not all investors are interested adopting this approach. Amit Anand is a co-founder and managing partner at Singapore-based Jungle Ventures, which runs its own incubator program. He is of the view that accelerators are ideal for teams that have already developed a product and identified their customer base, but still need to shape their business plan. In some cases, though, big ideas need more time to come to fruition.

“We try to work with the founder to incubate the big idea, help him with early-stage capital and give a runway to hatch these ideas into some sort of shape,” says Anand. “We end up investing more money in the end.”

In this sense, traditional incubation plays a more important role in situations where a complex idea requires long to meet its full potential. This means the incubator must put in more capital and it often comes from a larger affiliated venture capital fund.

Jungle Venture has a \$15 million fund – which reached a first close of \$10 million last October – that make seed stage investments of \$100,000 to \$1 million. Innovation Works, where the majority of companies are incubated for six to nine months, currently operates a much larger vehicle – its second – which reached a final close of \$275 million last October.

“By the end of this period the decision to make follow on investment is pretty easy in

comparison to getting know the product and the team for the first time because we have spent all these months working with them,” says Evdemon.

The finish line

Essentially, whatever form the incubation takes, everything boils down to the demo day, and what kind of deal a team can expect when they make it to the finish line. Needless to say, the valuation a company commands depends on the incubator or accelerator in more ways than one.

While it is true a longer incubation period can offer higher valuations down the line, one possible flipside is that accelerators with brand caché among investors might be able to ask for a premium. A company may even end up overvalued if a particular accelerator is able to create a buzz around its demo day and bring in a lot of investors wanting to cut checks.

“It is a mixed bag across the region,” says Jungle Ventures’ Anand. “Incubators that are starting to show success in follow-on funding are able to command higher valuations but I don’t think there is enough data to say whether different incubators are creating more value than others.”

Indeed, given the assortment of tailwinds and headwinds a company might face once it has emerged from incubation and is moving through institutional investment rounds, it might be impossible to identify a preeminent model. For the time being, most investors agree that there is no right or wrong solution; it is usually a matter of adjusting programs according to the particular circumstances and risk-appetite.

Furthermore, there appears to be little geographical differentiation in Asia: there is evidence of various models operating side-by-side in each country. As the ecosystem evolves, the expectation is that borders will become even less relevant – after all, most venture capital investors want to support companies with the potential to scale up across the region. Rather, the kinds of businesses being backed should come to the fore.

“I would like to see more incubators getting aligned to sectors, such as mobile internet, and becoming specialists,” says Anand. “I think there is a fair bit of hand holding to be done Asia and that can only happen when you are focusing on particular area rather than trying to be a generalist.”

DEAL OF THE WEEK

tim.burroughs@incisivemedia.com / winnie.liu@incisivemedia.com

Quadrant backs City Farmers' tech savvy

WITH A LONGSTANDING INTEREST IN

Australia's pet supplies industry, Quadrant Private Equity examined all the major independent players in search of a business suitable for rapid scaling up and expansion nationwide. In Perth-headquartered City Farmers, it found something unusual.

"The company has a sophisticated database-supported approach to management that we hadn't seen before at this scale," Justin Ryan, a director at Quadrant, told AVCJ. "That extends to electronic direct marketing, but also the analysis of data around the network in terms of pricing and stock management."

The GP was suitably impressed that last week it paid out A\$93 million (\$84 million) for a majority stake in City Farmers, which sells pet food, supplies and related products from a network of 31 large-format stores.

The technology that plays such an important role in the company's operations is the work of its CEO, Clayton Hollingsworth, previously CFO of Australian internet service provider iiNet. City Farmers was founded in the early 1990s and

Hollingsworth bought it five years ago – when there were about 10 stores – with backing from investors including Alan Green and Brian Singer, founders of Quiksilver and Rip Curl, respectively.

"Some very successful entrepreneurs backed this guy to build something from scratch, which he has done, and they have made some handsome returns," said Ryan. "We are in the business of backing talent."

One of the technology solutions City Farmers introduced came after a pricing strategy review found that prices were being set based on assumptions rather than scientific rationale.

A software platform enabled data analysis at item and store level. As a result, City Farmers narrowed the number of products that were known value items (KVIs), i.e. products that have a disproportionate impact on consumer price perception, from 400 to 89. This prompted a change in pricing strategy – so the right price was being offered at the right time to the right

customer – which in turn delivered an increase in gross profit.

For Quadrant, City Farmers was also attractive because of its industry fundamentals. Australia's pet specialty products industry, estimated to be worth A\$3 billion, is seen as a defensive consumer play but one that is also exhibiting strong growth, driven by a trend towards the "humanization" of pets. It is also highly fragmented.

While City Farmers isn't the largest operator in the space, Quadrant decided there was significant scope for expanding the company beyond its home market of Perth and into the country's northern and eastern states. City Farmers already has a

nascent presence in Queensland and Victoria.

"There are a lot of independents, but the model isn't about acquisitions; it is about creating a national network with better buying power and a better customer proposition. Mom-and-pop operators don't have the capacity to do that." ▀



City Farmers: Technology role

China's BVCF targets super bacteria

"LARGE PHARMACEUTICAL FIRMS AREN'T

putting a lot of resources into developing antibiotics nowadays because they can make more money producing drugs for chronic-related diseases, or cancer treatments," observes Zhi Yang, founder and managing partner of China life sciences-focused GP BVCF. "However, bacteria have grown resistant to most antibiotics."

Opportunities presented by the need for next-generation antibiotics that combat infections created by "super bacteria" that have developed a resistance to mainstream drugs prompted BVCF to lead a \$25 million Series B round of investment in MicuRx Pharmaceuticals. The US-based biopharmaceutical firm is developing MRX-I, an antibiotic that could treat infections caused by super bacteria. The round also includes existing backers Morningside Group and Devon Park Bioventures. The two VC firms committed \$12 million to MicuRx in 2007.



MicuRx: Battling bacteria

BVCF – previously known as BioVeda China – holds about one third of the company and two seats on its board. The investment comes from its latest \$200 million fund – BVCF III – which is scheduled to reach a final close in coming months. In June, International Financial Corp. (IFC) announced it would commit up to \$20 million to the fund, having previously invested in each of BVCF's previous vehicles.

The VC firm focuses on investments in life science and healthcare sector in China with an enterprise value of \$50-100 million. The first two funds are now fully invested.

MicuRx aims to capture both the benefits of US research expertise and high quality preclinical and development infrastructure in China. In addition to supporting R&D, the new capital will fund clinical trials in China and the US. In China, it will operate through a joint venture with Shanghai Mengke Pharmaceuticals and Shanghai Zhangjiang

Biomedical Industry Venture Capital.

"We hope the new drug can be recognized in every country, so we have to conduct clinical trials in several places," he says, adding that the new antibiotic is expected to launch within three years.

BVCF's team includes partners with an academic background and operational experience. It will provide MicuRx with broad contacts in the pharmaceutical industry in both China and the US, helping the firm build out its commercialization plans.

Yang says MicuRx's growth potential will improve as similar products are launched into the market by other pharma players. These include Pfizer's Zynox, which is used to treat serious infections caused by Gram-positive bacteria.

Ultimately, the VC firm expects to exit the company through an IPO. "An industry peer, TaiGen Biotechnology, launched an IPO in Taiwan recently and raised \$800 million," Yang says. "We see MicuRx achieving an even higher than that valuation because it produces a high-end, next-generation antibiotic." ▀

L Capital Asia II eyes bigger deals

LARGER DEALS, INCLUDING A FEW

buyouts, are likely to feature more prominently in L Capital Asia's second regional fund as the GP expands its attention to the more developed markets of Australia, Japan and South Korea, as well as bringing to bear the expertise of an expanded operations team.

L Capital Asia II reached a first close last week at the hard cap of \$950 million after less than six months in the market, already 50% larger than its 2009 vintage predecessor. The final close will include the GP contribution. The vehicle will follow the same strategy as

Fund I, backing 12-14 companies that qualify as aspirational, affordable and alternative mid-market brands. But ticket sizes will be bigger.

"Originally the geographical spread was predominantly Greater China and India, with Southeast Asia as an opportunistic play," Sanjay Gujral, L Capital Asia's regional managing director, told AVCJ. "But Southeast Asia has become



L Capital: Investments with style

our second focus area after Greater China and we have defocused on India in the near term, although we believe it will bounce back in the long term. We are also looking more at developed Asian markets like Australia, Japan and South Korea where there are companies we

can help find new growth in emerging Asia. While China and India are predominantly growth markets, in Southeast Asia and developed Asia there are more buyout opportunities."

There have been no deals in Japan and South Korea in Fund I, while there were two Australian assets. More than

40% of the corpus was deployed in Greater China, around 20% in India, 15% in Australia and the rest in Southeast Asia. So far, two companies have been exited.

On the operational side, L Capital Asia's in-house team has expanded to 9 people in the last 18 months, complementing an investment team of 15. The GP now has over 30 people in

total, three times more than when it was set up in 2009. "We now have deep bench strength in operations, which gives us greater confidence to look at buyout opportunities," Gujral adds.

The nature of L Capital Asia's operational value add is influenced by its sponsor LVMH which offers knowledge, networks and capabilities that can be brought into portfolio companies. The GP is also disciplined in where it seeks to do business. Deals tend to fall into one of four core areas: consumer products; beauty and wellness; lifestyle and food and beverage; and select retail and distribution assets. Media and entertainment and hospitality also feature on an opportunistic basis.

"If you look at the themes – lifestyle-consumer and emerging Asia – most investors globally would buy into that, so it clearly aided fundraising," Gujral adds. "But more importantly we have stuck to our knitting and delivered on the strategy."

LVMH remains a key LP, contributing around 10% of the corpus of both funds, but the majority of the capital in Fund II comes from global institutional investors. ▀

Grocery tycoon launches retail fund

AFTER SELLING HIS FAMILY BUSINESS,

Chinese hypermarket chain Home World Group, Yucun Du was on the lookout for a new project. Perhaps we shouldn't be surprised to learn that he set up a private equity firm.

China Telescope Investments was founded in Beijing last year and its strategy is rooted in Du's consumer sector experience. The Telescope Consumer Growth Fund I, which is co-managed by SAIF Partners and last week reached a first close of RMB300 million (\$49 million), targets retail and chain stores across catering, grocery, healthcare, pet supplies, and education.

"China's consumer market has strong growth potential because it still lags behind developed markets," Xiang Zhao, investment director at Telescope Investments, told AVCJ. "We differentiate ourselves from other private equity firms as we have rich experience in running one of the leading supermarket chain stores in China, enabling us to add value to retail operators."

He sees opening chain stores as the most efficient model to scale up an enterprise, citing Starbucks as the model to follow.

Sha Du, Home World Group's founder and also Yucun Du's father, contributed about half of the new fund's corpus. Du Senior was ranked as China's 14th richest man by Forbes magazine in 2005. Other LPs include high net worth individuals from Beijing and Tianjin, as well as Shenzhen-listed real estate developer YangGuang, which is majority-owned by GIC Private.

The fund, which will make investments in the RMB10-50 million range, is likely to raise a second round of investment within two years. "We will evaluate our first stage investment strategy and market response to our fund," Zhao says.

Before establishing Telescope, Yucun Du and his team made four venture investments, including Zhuhai Jinxun Electronic Technology, a community agriculture project created by Tsinghua University, Beijing media producer Kaxinmahua and kindergarten chain operator Ledudu Education. The latter may end up in the

fund because it falls within the investment remit.

Based in Tianjin, Home World ran more than 80 stores in 11 cities, mainly in China's northern regions. Du sold the Home Way unit to US-based home improvement retailer Home Depot in 2006. One year later, state-run conglomerate China Resources Group acquired Home World Group's

hypermarket chain in order to capitalize on the firm's northern China exposure.

"When we put different consumer businesses in a basket, it could mitigate risk as well," Zhao adds. The approach is based on an understanding that, although China's economy is weakening – in relative terms – with consumer

sentiment wavering, the falling tide will not ground all boats.

In pet food, for example, Zhao sees a defensive industry: people may choose to eat out less often based on perceptions of how far the household budget will stretch, but they are likely to continue to invest in the comfort of their pets. ▀



China Telescope: Retail play

Patent funds: Investing in Asia's innovators

Asia is now responsible for just over a third of all patent filings worldwide. Will independent patent funds, which have already won a niche following in the US, catch on over here?

SMART PHONES – OR, TO BE MORE

precise, the commercial value they generate – couldn't exist without patents covering the underlying intellectual property (IP). The iPhone, for example, includes 250,000 patented elements, ranging from circuit boards to the look and feel of the device.

A patent may be seen to award its owner a monopoly on an idea but in reality one license alone is never enough for any invention to be commercially exploited. No company can produce a television, camera or smart phone purely with patents to which it has exclusive rights. And collecting the requisite patents can be nigh on impossible: transactions are complex, expensive and, even when a patent is obtained, there is no guarantee of validity.

To overcome these hurdles and meet the demands of open innovation, a vast IP trading rights industry has emerged. Having barely existed a decade ago, it is now worth around \$200 billion and growing at annual clip of 25%. Latterly Asia has become a key player, now accounting for just over a third of all patent filings globally.

But it is not just the manufacturers looking to trade patents. So-called non-practicing entities (NPEs) – sometimes accused of being “patent trolls” – have long been using patents as a way to generate returns either through subscription-based licensing, retail licensing or litigation.

NPEs are increasingly acquiring patent portfolios through fund structures that generate returns for third-party investors. Patents are therefore an alternative asset class in their own right, but one with strong ties to venture capital because many of the IP rights being monetized have links to VC and PE. Knowledge of an idea's origins has intrinsic value in this business.

Gustav Aray was an investment manager with Intel Capital for 12 years prior setting up Rui Zhi Ventures, a Shanghai-based IP brokerage and advisory firm. “Back in the early 2000s Intel had made a series of investments and like everyone else some of them did not turn out as well as we hoped, but there was IP in these companies that could be used by competitors,” he explains.

Aray had helped Intel Capital establish its

own patent purchase organization, used to collect IP that could augment in its own portfolio. Today, many of Aray's clients include VC-backed companies, inventors or corporations holding patents that have either been superseded by other solutions and become redundant or are no longer part of their core business.

Intellectual approach

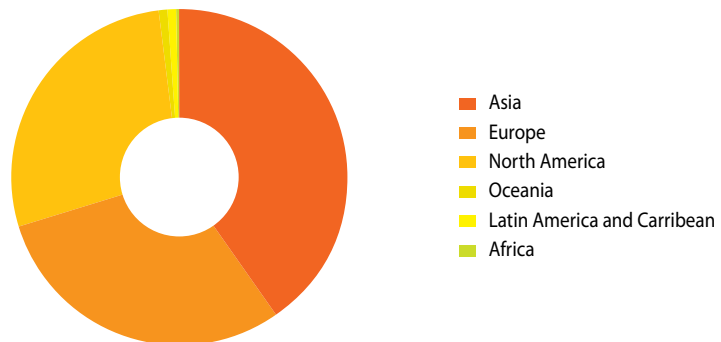
Among those eager to acquire these assets are NPEs like Intellectual Ventures, which was among the first firms to establish patent vehicles. It was founded in 2000 by former Microsoft CTO Nathan

active patent assets. The company claims this amounts to the world's largest patent portfolio held by a NPE.

Patent funds differ from their PE and VC counterparts in two key respects. Firstly, the lifespan is around 20 years, matching up with the typical term of a patent. Secondly, the way in which patent funds operate can vary markedly depending on how the patents are procured.

Intellectual Ventures identifies three main approaches. The firm executes its main buying strategy through its flagship Invention Investment fund platform. The first vehicle was

Patent applications by regional share, 2012 estimate



Source: World Intellectual Property Organisation

Myhrvold and Edward Jung, previously a software architect at Microsoft, who had originally set out to start a venture fund but decided against it.

“It wasn't just that they didn't want to be the 3000th venture fund out there, but in terms of gaining exposure to technology, the VC model is pretty risky – you are not only betting on the idea and the market timing, but also on the execution teams,” says Eric Nagel, vice president of investor relations with Intellectual Ventures in Singapore. “Patents, however, are essentially a call option on technology. What our founders did was create an invention capital market.”

Intellectual Ventures currently manages five global funds with around \$6 billion of capital under management and owns around 40,000

formed in 2003 with a corpus of \$2.2 billion dollars; the second reached \$2.8 billion; and a third is currently being raised, with a reported target of \$3 billion. Fundamentally, this strategy bears the greater similarity to PE – Intellectual Ventures takes a controlling interest in the patent or portfolio of patents with the intention of maximizing its value.

“The big difference is that we do an awful lot of investments, each of our funds had done over 1,000 deals,” says Nagel. “In 2012 alone we completed around 214 investments.”

The majority of deals – around 60% – are below \$1 million and most of the rest fall into the \$1-5 million bracket. However, the firm does execute a handful of large cap investments

in patent portfolios. One recent deal saw Intellectual Ventures lead a consortium of 12 companies, including Asian tech giants Huawei, HTC, Samsung and FujiFilm, to acquire the Kodak digital imaging patent portfolio for \$525 million.

The firm's two other strategies involve the Invention Science Fund (ISF), which launched in 2010 with a corpus of \$150 million, and the \$650 million Invention Development Fund (IDF). ISF has much in common with a seed round investor, inviting scientists and inventors to develop inventions from scratch at the firm's Washington laboratories for use in industries such as bio-tech, geo-engineering, and agriculture.

IDF, meanwhile, partners with around 400 universities and research institutions to work on inventions. With more than 10,000 invention disclosures since inception, the has seen around 450 patents granted to date.

Asian ideas

While Intellectual Ventures predominantly focuses on the US – where patents comprise 60% of its portfolio – Asia is gaining prominence. The region accounts for 20% of the firm's portfolio and the firm maintains a presence in Tokyo, Beijing, Seoul, Singapore and Bangalore.

Despite the size of the opportunity, there a few in any Asian firms operating a patent fund model of similar scale to Intellectual Ventures. However, it is not the only NPE in the market. Guy Proulx set up Transpacific IP in Singapore in 2004 after spending a number of years advising start-ups on IP issues as well as working with private equity investors and acquisition groups on technology and due diligence reviews.

"I think Asia is the right place to be with regards to IP," says Proulx, "Back when I started and I was buying Chinese patents a lot of people scoffed at what I was doing, but now they are out here trying to do it with me."

Transpacific began by using its own funds to build a portfolio of patents, selling them three years down the line. The company continues to acquire patents but has also expanded in to other areas such as patent portfolio management, transaction services and strategy consulting.

Patent acquisitions tend to be opportunistic and where large and valuable portfolios have been available Transpacific has brought in co-investors. In November last year it formed a consortium of high-tech Asian companies to buy the patent portfolio of Silicon Valley-based Phoenix Technologies – a portfolio company of LA-based private equity firm Marlin Equity Partners. The value of the deal was not disclosed but industry estimates put it at \$10-20 million.

Transpacific has yet to raise an IP fund but it remains a possibility. The issue is whether a

patent fund can provide the kinds of returns that would attract traditional LPs. Intelligent Ventures' backers primarily comprise those who have invested as part of a licensing agreement – usually leading technology companies like Apple, Microsoft and Google – as well as a number of US universities and a handful of venture capital firms.

Could the same be achieved with a dedicated Asia fund? Proulx admits that he has been considering such a move for some time but many Asian investors struggle to understand the asset class fully. He believes returns could be compelling with a decent fund realistically aiming for an IRR of 10-15%, although it would

Yoshii, the former Sanyo IP manager who now heads IP Bridge, tells AVCJ. "Many Japanese electronics companies are facing financial problems and some companies are shedding parts of their business – these include unused patents which could be acquired by overseas patent trolls."

The fear is not just the loss of IP but the fear that the patents can be bought cheap from distressed companies and then later used against Japanese companies in litigation.

Yoshii explains that historically, Japanese companies have only ever used patents to protect their own products. This runs in contrast

“Back when I started and I was buying Chinese patents a lot of people scoffed at what I was doing, but now they are out here trying to do it with me”

– Guy Proulx

be structured in a very different way to a normal PE fund.

"The challenge from the investment side is that intellectual property is a long-life asset," says Proulx. "The type of patent funds I have seen so far are not a good sale. I think the solution will be a hybrid or something like an evergreen fund where you can move investors in and out."

Beware the trolls

Most patent funds in Asia exist in the form of government-backed entities in places like Taiwan, South Korea and Japan. The Innovation Network Corporation of Japan (INCOJ), a partnership between the Japanese government and 19 major corporations, only recently set up its IP Bridge patent fund. It put in an initial JPY2.75 billion (\$27.8 million) but the corpus is expected to reach as much as JPY30 billion over time. Investors include Panasonic Corp. and Mitsui & Co.

The IP Bridge fund will purchase unused patents sitting in large technology companies with a view to licensing them to domestic start-ups. It is focusing on the consumer electronics space to begin with, and hopes to acquire 5,000 patents. Around half of the 1.35 million patents registered to Japanese businesses and individuals currently produce no revenue.

Like many of its Asian counterparts, IP Bridge is not just about generating returns. Essentially its aim is to protect Japanese companies from foreign NPE or patent trolls looking to exploit their unused patents.

"The government is concerned about the transfer of Japanese patents overseas," Shigeharu

to large US tech firms, which have long since been leveraged unutilized patents to make money – and thereby creating a far more developed US IP market populated by NPEs with resources to aggressively acquire patents assets in Asia and se them.

These concerns fears have led to similar vehicles being established elsewhere. In 2010, IP Cube Partners and Intellectual Discovery were set up by Korea's Intellectual Property Office and Ministry of Economics, respectively. Intellectual Discovery, the larger of the two, originally planned to raise \$500 million – \$200 million from the state and the rest from the private sector. However, this was subsequently scaled back to \$100 million after private investors failed to bite.

Efforts in Taiwan have also generated poor results. In 2011, the government created the Taiwan Medtech Fund (TMF). The fund was charged with raising 75% of its NT\$5 billion (\$167 million) target via the private sector, but plans were abandoned.

This raises the question of whether public-backed vehicles will really have a major role to play in the development of Asia's IP industry. The possibility still remains that the private sector will move into the patent fund space if more investors are won over by the idea and its promised returns.

"Over the last couple of years things has changed – real estate and private equity have not produced as strong returns as in the past, so there is an opportunity," says Transpacific's Proulx, "It really comes down to finding a way to do it that is compelling enough to the Asian investor. Once we do that we will see real movement." ▀

Book builder

While PE investors have been keen to capitalize on India's financial services industry, Everstone Capital took a unique approach to the sector – building an independent non-banking financial company

EVERSTONE CAPITAL FIRST NOTICED A

gap in India's \$750 billion credit market in 2010. Over the previous decade, global investment banks had set up their own non-banking financial companies (NBFCs) to serve large and mid-cap corporate but the global financial crisis forced a sharp reassessment of this and other strategies. Most banks retreated to focus on their home markets, scaling back the NBFCs or shuttering them entirely.

"There was a vacuum for a player to come in and create that type of business," says Dhanpal Jhaveri, partner and CEO at Everstone.

With the Indian economy growing at over 8% at the time, many companies were involved in big-ticket projects, especially infrastructure. Individual projects required investment of INR80 billion (\$1.2 billion), which was beyond local banks' capacity for rupee debt financing, so NBFCs were coming in with long-dated credit.

Private equity firms were drawn to the space by the consistent returns available in the space. While banks usually lend to real estate firms at interest rates of 13-14%, NBFCs charge 16-20%.

Once Everstone decided it wanted exposure, the question was how to get it. Jhaveri says there was little opportunity to buy into an existing NBFC without paying a significant premium to book value. Relying on the partners' experience in financial services – co-founders Sameer Sain and Atul Kapur both worked for Goldman Sachs – they decided to create an institution from scratch.

"Rather than paying a significant multiple to book, we could come in literally at book, build our own book, and given our experience, find the right management team to lead this business and build it over a period of 5-7 years into what would be one of the largest wholesale credit institutions in the country," Jhaveri explains.

Valuable partners

The start-up – named IndoStar Capital Finance (ICF) – aimed to work with corporates with net profit of INR2.5-5 billion that required funding for project and capital expenditure, long-term working capital, special situations and acquisition financing. It meant the loans had to be of a certain size – at least \$20-30 million. Bigger transactions were expected to help negotiate better structured deals.

Since the Reserve Bank of India (RBI) has set the single party exposure limit for NBFCs at 15% of owned funds and group exposure is capped at 25%, extending loans of that size required at least \$200 million (INR9 billion then) in capital. Everstone's Capital Partners II put around \$50 million into the venture, while LP co-investors contributed another \$50 million. But that that still left \$100 million unaccounted for.

Unlike traditional banks, there are no caps on foreign ownership of NBFCs so Everstone brought in Ashmore Group, a specialist emerging

"You cannot grow any meaningful credit financing business in India unless you have a degree of anchor lending coming in from the bankers"

– Vimal Bhandari

markets investor, and Goldman Sachs, with Baer Capital Partners in a smaller role.

"What's important for us is that the investors have a long duration of capital, at least 5-7 years, and an understanding of the business. We wanted to make sure the partners appreciated the risk as well as the potential returns it could offer, and had the balance sheet to write large checks to participate in this investment," Jhaveri says.

The role of the stakeholders extends beyond providing capital or introductions to other capital providers. As part of the company board, their representatives sit on the credit committee that has final authority in approving transactions. Management can only make recommendations.

The joint venture took almost a year to close and ICF's first capitalization was completed in March 2011. The following month Vimal Bhandari, country head of Aegon, joined as CEO and managing director. He had previously spent 17 years with IL&FS, building its various businesses in financial services.

While the investors provided strategic

oversight and direction, it was Bhandari and the two others on the management team – Sandeep Baid, then head of credit, and Sanjay Hinduja, head of origination and syndication – who built the company. One of Everstone's managing directors, Pankaj Thapar, was appointed CFO.

They charged headlong into developing the liability strategy, working to build relationships to raise money from the banking system, wholesale debt markets and money markets to supplement ICF's equity capital in lending activities. It is one of the biggest challenges building an NBFC in India since the RBI does not allow these institutions to take retail deposits.

"You cannot grow any meaningful credit financing business in India unless you have a degree of anchor lending coming in from the bankers," explains Bhandari. "To raise money from the capital or money markets is a lot more dependent on the empirical track record of the sponsors, the management team and also how the market perceives the company. Stronger qualitative issues need to be complemented by quantitative issues relating to the fundamental business model."

The process started with defining the asset composition – owing to the uncertain economic environment, a majority of ICF's loans would be senior secured credit, chiefly loans to operating companies, asset-backed loans, term loans and short-term facilities.

It also offers loans against shares and other tangible collateral. For example, last year ICF extended a six-year loan of INR1 billion to payment service provider Prizm Payment Services, which required capital to expand its automated teller machine (ATM) network. The structured financing involved an operating lease model for the ATM assets.

"We lend to those companies where we can grow with the company and do repeat transactions. It's one of the parameters we are very conscious of," says Bhandari.

ICF lends at a project level for commercial and residential real estate properties, often in the form of late-stage financing for the completion of developments that are already underway, which reduces execution and construction risks. The team felt the demand for housing and commercial office space will continue to rise and chose to work with developers in

designated micro-markets. It requires a high level of collateralization and a self-liquidity mechanism where loans can be repaid out of the sale of the underlying property.

Broadly 60-65% of the asset book is from infrastructure and operating company loans, 30% is set aside for real estate and the balance of 10% is for acquisition financing or promoter funding. "We have only three components so it is a much more predictable model from a risk and growth perspective for a lender to evaluate," Bhandari explains.

Getting rated

Next came the ratings process, where the agencies gave ICF the highest rating for its short-term paper and AA- for long-term loans. Abhinav Sharma, assistant general manager of CARE Ratings' financial sector team, says the rating is driven by leading global financial institutions that have promoted ICF, its experienced management, good risk management processes, comfortable capital adequacy and liquidity position.

These factors were part of the pitch Bhandari made to the multiple bankers they chased during the long, tedious process of evaluation, cross-examination and discussion that followed.

Conservative financial risk management practices adopted include setting leverage at a maximum of 25% of capital, even though NBFCs are allowed to operate at a 12% capital adequacy. Of ICF's net worth, 15% will always be maintained in liquid form, invested in bank deposits and near cash investments. It is also part of the company charter that there will not be any asset-liability mismatch on its book.

Furthermore, the ICF business model also seeks co-participation in some deals from other lenders – foreign institutional investors, mutual funds, other NBFCs or banks so that a part of the transaction can be sold through syndication. It increases the firm's ability to do larger deals, provide fees and benefit from yield differential, and Bhandari says, it helps "our credit standards be accepted by other people, which over a period of time makes the institutional positioning that much more robust."

Through this strategy ICF has established relationships with 12 banks, including ICICI, Axis, HDFC and numerous entities within the State Bank of India Group. The team was able to persuade bankers to start their relationship not with the easy current credit (CC) limit, but the more difficult one of giving a term loan of 54 months.

Within 12 months of formation ICF issued its first commercial paper in the money market and it has also started placing non-convertible debentures with mutual funds in the capital

Meeting a need: The NBFC opportunity

In 2011, the year Everstone Capital launched IndoStar Capital Finance, KKR and Baring Private Equity Partners were among the private equity firms that together invested \$200 million in six Indian non-banking financial companies (NBFCs). While investment in banks is capped at 5%, there is no such limit on NBFC ownership.

NBFCs broaden access to financial services and enhance diversification of the financial sector through credit solutions that are not offered by banks. They are engaged in everything from mortgages to vehicle and infrastructure financing and microfinance. Unlike banks, NBFCs are flexible in accepting collateral, and able to lend against shares pledged by promoters or against plots of land.

Most practitioners have niche expertise in retail or wholesale lending which gives them a competitive edge.

"For retail lending, flexible branch operations, origination and collection strengths in specific asset classes, geographies or borrower segments are an advantage," says Abhinav Sharma, an analyst at CARE Ratings agency. "For wholesale lending NBFCs, structuring and faster origination are strengths."

As of March 2012, the total number of NBFCs registered with Reserve Bank of India stood at 12,385 compared with 12,409 in 2011. While net owned funds of these institutions grew 25% to INR225 billion over the course of the 2012 financial year, the total size of all NBFCs assets in India is still only 10-12% that of the banking sector.

market. The company has cumulatively completed money market issuances of INR7.65 billion and long-term debenture issuances of INR2.65 billion.

Although the high interest rates for borrowing from banks have affected fund availability for NBFCs, within two years of operations ICF has originated and transacted 53 deals cumulatively worth more than INR43 billion. It now has an asset base of over INR22 billion, of which ICF has a net worth of INR10.2 billion and borrowings of INR11 billion. Income reached INR2.4 billion for the 2013 financial year, more than double the 2012 total, while net profit rose 69.3% to INR900.9 million.

"IndoStar had a return on total assets of 5.54% during the 2013 financial year, which indicates good profitability at its current low leverage. It is gradually building leverage and the return on net worth is expected to reach industry comparables over a period of time," says CARE's Sharma.

In the pipeline

Once ICF's asset base exceeds INR30 billion, which is expected to happen next year, the plan is to expand into new credit services. Bhandari says there is a significant opportunity for domestic and foreign investors who are interested in investing in the credit markets but do not have enough access to products that offer a secured return and better yields than bank deposits.

Asset management for this increasing number of wealthy families and institutions

who are looking to invest in credit by buying debentures is one business expansion option. ICF intends to set up an alternate investment fund for multi-sectoral investments in senior secured debt adjacent to the credit products on its balance sheet. The company already creates a large number of debentures which it sells down to co-participants and could give credit fund investors first refusal on this paper.

"We are trying to lever up our capability in the credit space and then at the same time get into non-funded income that can be grown into a fairly large asset management business. We will look at other opportunities in the credit market and may at some point want to see what we can do in small and medium enterprise financing. That segment has big potential," Bhandari adds.

The proposed new business would enable ICF to have a more predictable fee income and access to pools of capital. It could do larger deals in participation with the fund. Needless to say, a larger and diversified business makes for a much more attractive proposition when the investors come to exit. While an IPO would present ICF with a greater ability to tap the public markets for money, Jhaveri says Everstone is keeping its options open.

"It could be a combination of doing an IPO, selling to institutional investors or to combine with a large strategic local player or another foreign player who wants to enter India," he elaborates. ▀

Navigating a changing landscape

SAVE US\$390 if you register before **30 September**
Register now at avcjindia.com

Reasons to attend the AVCJ India Forum:



KEYNOTE

Ravi Venkatesan
Former Chairman
MICROSOFT INDIA



KEYNOTE

Ashishkumar Chauhan
Managing Director and
Chief Executive Officer
BOMBAY STOCK EXCHANGE

Exclusive keynote speeches from some of India's most respected and successful business leaders!

1 Network with 250 leading executives, including India's most successful and well-respected GPs

2 Meet more than 50 LPs including dozens of foreign investors looking to increase their allocations to India

3 Learn what successful funds have done to beat the odds and what others must do to prosper

4 Hear honest and thought-provoking discussion about where the industry is headed

5 Enjoy cocktails and canapés with India's top private equity minds, noted economists, global investors, and government officials who are driving policy

For the latest programme and speaker line-up, please visit avcjindia.com

Contact us

Registration: Pauline Chen
Sponsorship: Darryl Mag

T: +852 3411 4936
T: +852 3411 4919

E: Pauline@avcj.com
E: Darryl.Mag@incisivemedia.com

Asia Series Partner



Partners



Coller Capital



TATA OPPORTUNITIES FUND

Cocktail Reception Host



Knowledge Partners



GIBSON DUNN

SHEARMAN & STERLING

TRILEGAL