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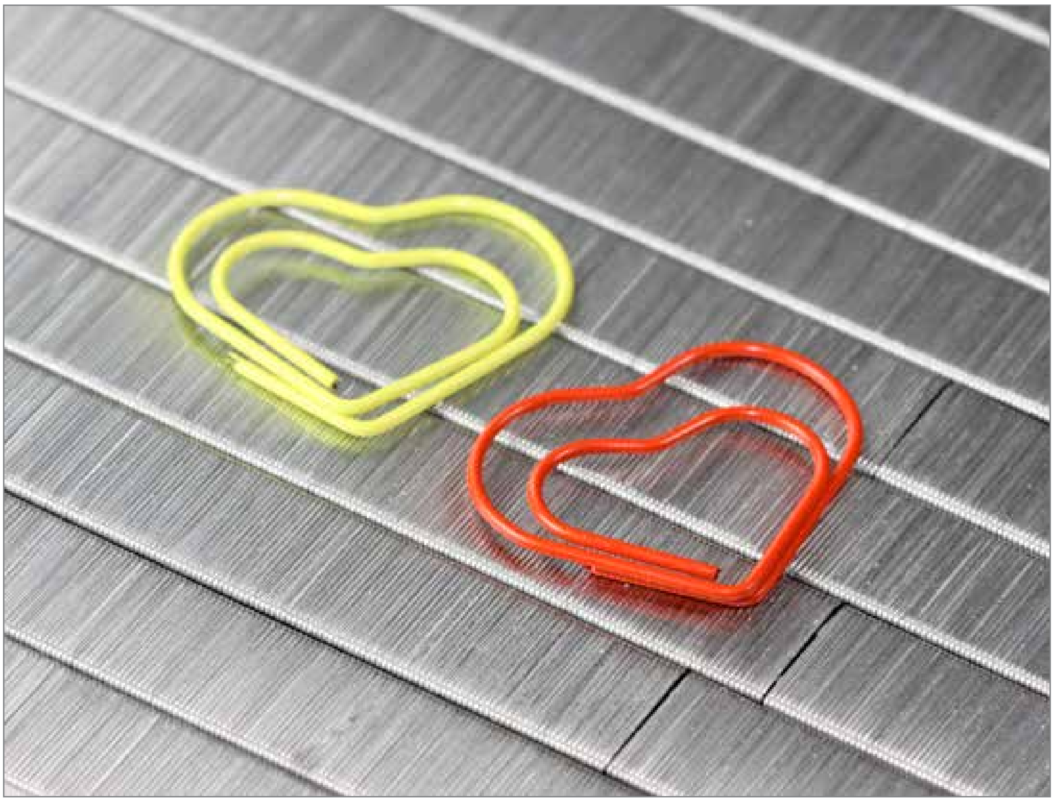

Stapled together

Happy outcomes are hard to engineer in GP secondary restructurings Page 8

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Sport fund hits a six

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EDITOR'S VIEWPOINT

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PE goes to the movies: Part II

AS THE MAN WHO HELPED LAUNCH THE careers of Bruce Lee and Jackie Chan, among others, film producer Raymond Chow can claim to have played a leading role in putting Hong Kong's martial arts movies on the international map.

When Citicorp Capital Asia (CCAL) teamed up with Chow's Golden Harvest to form a film financing fund in the 1990s, box office hits and box office takings were expected to follow. While the hits did indeed come – films backed by the Golden Harvest Film Fund included the 1997 release "The Soong Sisters," starring Maggie Cheung, Michelle Yeoh and Vivian Wu – the takings did not.

Karam Butalia, executive chairman of KV Asia Capital, who was at CCAL when the fund was set up, recalls "The Soong Sisters" just managing to break even once the production house and distributors took their cut.

"You have to understand the business and the finances are part of that. In this respect, the difference between success and failure is not that dissimilar from other industries," he said. "With 'The Soong Sisters' we were meeting people like Maggie Cheung and it's only later you think about how much money you've made. You are taken in by the females and the wining and dining."

It is a warning worth remembering now that private equity is basking in its latest foray into cinema. Hony Capital and TPG Capital's growth investment arm have partnered with two Hollywood producers to set up a film studio, which will invest more than $1 billion in productions over the next five years. The studio will put out 8-10 "star-driven, mid-budget films" each year, with Hony leveraging its China connections to deliver access to world's second-largest movie market by box office sales.

It is a familiar refrain, harking back not just to the CCAL fund but also to early 2012, when two China-focused film funds – Harvest Seven Stars Media Fund and China Mainstream Media – launched within a fortnight of one another. These funds would support local productions, potentially working with overseas studios.

The economic rationale of co-production joint ventures is clear. China only permits 20 foreign films to be show within its borders each year and overseas producers must work with accredited domestic distributors that keep all but around 25% of box office revenue.

"Transformers: Dark of the Moon," the third film in the sci-fi action franchise, generated ticket sales of $145.5 million in its first three weeks on release in China. Had it been a Sino-foreign co-production, the distribution restrictions on foreign films wouldn't have applied and the producers' cut would have been 40-45%. That represents a significant addition to their bottom line.

The problem – assuming producers can negotiate cultural differences and political limitations and deliver a film that appeals to audiences in China and overseas – is not so different from the one facing CCAL: transparency.

In the West, films are bonded, which gives investors a degree of security, and trusted intermediaries operate in the space between the cinemas and production companies. China lacks an established, uniform mechanism for collecting box office takings. There are also stories of fraud and difficulties remitting funds out of China due to the lack of an appropriate license or an unwillingness to pay taxes.

Given this background context, the comments made by Hony CEO John Zhao on the recent film studio investment are telling. He identified the benefits the PE firm could bring through its interests in local production and distribution company SMG Pictures and online TV provider PPTV.

While China's cinemas, and the way they are managed, is modernizing, and heavyweight distributors like SMG Pictures can help facilitate this development, PPTV is perhaps more interesting. Hony and Suning Commerce bought a majority stake in the business last year, clearly sensing that China's fractured media distribution model is becoming more digital, streamlined and ultimately profitable.

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NEWS

ASIA PACIFIC

Templeton closes fourth emerging markets fund

Franklin Templeton has reached a final close of more than $220 million on its latest emerging markets fund. The vehicle, which launched in March 2012 with a target of $300 million, has already made three investments. Templeton Strategic Emerging Marketing Fund IV primarily operates in China, India, Southeast Asia, Russia and Central and Eastern Europe.

Standard Chartered infra head to leave Asia

Andrew Yee, global head of infrastructure for Standard Chartered Bank's principal finance division, is leaving the firm. The decision is said to be mutual and amicable, with Yee set to depart in July after which he will relocate to Europe with his family.

Female representation in Asian PE drops in 2013

Asia-based private equity firms still have a higher proportion of women in high-level roles than their North American and European counterparts, although the average representation is down on 2012, according to a Preqin study. Females occupy an average of 11.8% of senior positions in Asian firms, down from 12.8% in March 2013. This compares to 9.7% in Europe, 11% in North America and 10% in the rest of the world.

Eaton hires Hamilton Lane exec for Asia distribution

Placement agent Eaton Partners has hired Jackson Chan, previously head of business development for Hamilton Lane in Asia. He will work on distribution of liquid and illiquid alternative assets offerings throughout the region and also assist in origination.

GREATER CHINA

Baring Asia, Hony agree Giant take-private

Chinese online game developer Giant Interactive has accepted a buyout offer from a consortium including Baring Private Equity Asia, Hony Capital and company management. It values the US-listed business at approximately $2.9 billion. The consortium, which already owns 49.3% of Giant, will finance the acquisition through a combination of rollover and fresh equity, as well as $850 million in debt.

Yunfeng seeks $1b for second China tech fund

Yunfeng Capital, a Chinese private equity firm established by Jack Ma and David Yu, founders of Alibaba Group and Target Media, respectively, is raising around $1 billion for its second fund. A first close of $600 million came last year and a final close will take place no later than June.

Yunfeng raised its debut fund in 2010, sourcing capital from around 20 well-known Chinese entrepreneurs - known as co-founders,

although they are passive investors. In early 2011, Yu said the firm had raised RMB10 billion ($1.5 billion) across two funds, one US dollar-denominated and the other renminbi-denominated, for investments in the tech, media and telecom (TMT), consumer and new energy spaces. It is unclear how much capital went into each fund – or, indeed, whether Yu included separate accounts in his total – but AVCJ understands the US dollar vehicle had a corpus of $307 million.

While Fund II, which launched in February of last year, follows a similar remit to that of its predecessor - Yunfeng identifies TMT, consumer and healthcare as its main areas of focus - the investor base has evolved. According to a source familiar with the situation, the first close includes a number of global institutional investors, including sovereign wealth funds, and there are a handful of $100 million commitments.

PE-backed Alibaba confirms US listing

Private equity-backed Chinese e-commerce giant Alibaba Group has decided to go public in the US, ending months of speculation. The company tried and failed to persuade Hong Kong regulators to approve its proposed shareholding structure.

Hao completes Pax exit for 4.7x return

Hao Capital has fully exited Chinese electronic payment systems provider Pax Technology, selling its remaining 7.6% stake in the Hong Kong-listed company for $44 million through a block trade. The investment has generated a gross multiple of 4.7x on an original investment of $30 million.

Alibaba to buy majority stake in ChinaVision

Alibaba Group has agreed to buy 60% of Hong Kong-listed ChinaVision Media Group - in which rival Tencent Holding and VC firm Sequoia Capital are current shareholders – for HK$6.24 billion ($804 million). Alibaba Investment will acquire 12.49 billion new shares of ChinaVision at HK$0.50 apiece, representing a discount of about 20.6% to its previous closing price.

Ceyuan leads $10m Series A for China bitcoin exchange

Ceyuan Ventures has led a $10 million Series A round of funding for OKCoin, which claims to be the China's largest bitcoin exchange by trading volume, with participation from Mandra Capital and existing backer VenturesLab. A number of Chinese angel investors also joined the round.

E-House forms JV with Yunfeng, Sequoia, Sina

E-House, a Chinese real estate service agency, has formed a property-oriented financial services joint venture with Sina Corporation, Sequoia Capital and Yunfeng Capital. The joint venture will provide asset-backed financial products for E-House's home buyers and Sina's online users, bridging individual borrowers and lenders.

Alibaba, CBC invest $20m in online travel platform

Alibaba Group and China Broadband Capital (CBC) have committed $20 million in Series B funding for outbound travel platform Byecity.com. The company differentiates itself from other travel platforms by offering online visa application services for outbound tourists.

Former Baidu COO David Zhu joins GGV Capital

David Zhu, former chief operating officer of Chinese internet giant Baidu, has joined GGV Capital as a partner. Zhu has more than 15 years

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NGP leads $10m round for food ordering business

Nokia Growth Partners (NGP) has led a $10 million Series B round of funding for Meican.com, a Chinese food ordering platform, with participation from KPCB China. Unity Ventures, KPCB and Zhenfund invested an undisclosed sum in the company two years ago.

E-House plans US listing for subsidiary Leju

E-House, a Chinese real estate service agency backed by several VC and internet strategic investors, is preparing a US IPO for its subsidiary Leju Holdings that could raise up to $200 million. China Renaissance Capital Investment, DLJ Real Estate Partners, Susquehanna Asia Investment and Farallon Capital committed a total of $25 million to parent company E-House in 2006.

NORTH ASIA

Jafco-backed EnBio raises $7.2m in Toyko IPO

EnBio, a Japanese soil decontamination business backed by Jafco, saw its stock open at JPY1311 – a 126% premium on the offering price – on its first day of trading. The company, which listed the Mothers section of the Tokyo Stock Exchange, raised JPY752 million ($7.2 million) from its IPO.

SOUTH ASIA

India Value Fund Advisors buys NBHC for $39m

India Value Fund Advisors has agreed to buy commodities and collateral management business National Bulk Handling Corporation (NBHC) from Financial Technologies India (FTIL) for INR2.42 billion ($39.5 million). The divestment is part of a broader restructuring plan introduced by FTIL, a financial markets services provider.

Kinnevik leads $90m round for India's Quikr

Swedish investor Investment AB Kinnevik has led a $90 million round of funding for Indian classifieds platform Quikr. Kinnevik contributed $39.3 million to the round with the balance coming from existing investors. Those investors include Matrix Partners, Nokia Growth Partners, Norwest Venture Partners, Omidyar Network, Warburg Pincus and e-commerce giant eBay.

Unison Capital targets $581m for Japan fund

Unison Capital is targeting JPY60 billion ($581 million) for its fourth Japan fund. The fund, which launched in early February, is scheduled for a first close by the summer. The vehicle is smaller than its predecessor – the JPY140 billion Unison Capital Partners III, raised in 2009 – which was scaled back by 25% in 2012 due to limited deal flow. The Fund III investment period ends in August.

"After careful planning and reviewing our past experiences we think the fund is a good size for our style of sourcing and value-add," Tatsuo Kawasaki, co-founder of Unison, told AVCJ. "Japan has a very deep corporate market where good

businesses change hands with relatively ease when compared with other Asian countries, but it still remains that the mega deals are harder to come by."

Kawasaki added that the fund will look to invest across numerous sectors, but with a particular focus on consumer-orientated businesses and upstream manufacturing. He sees these areas remaining competitive for Japan despite challenges posed by manufacturers elsewhere in the region.

Unison is also raising its debut Korea fund which it launched earlier this month. The fund is looking to raise KRW250 billion ($236 million).

PE-backed Manappuram acquires Jaypee NBFC

Manappuram Finance, a listed non-bank financial company (NBFC) backed by Baring Private Equity India and India Equity Partners among others, is to acquire Milestone Home Finance Company - a unit of Jaypee Hotels - for an undisclosed sum. Founded in 2010, Mumbai-based Milestone holds a license to provide home finance.

PE-backed Prime Focus to acquire Dax

India's Prime Focus Technologies (PFT), a unit of PE-backed movie effects and entertainment company Prime Focus, is to acquire DAX, a developer of a cloud-based workflow software-as-a-service (SaaS) for the media industry, for $9.1 million. PFT will make its investment through a series of performance-linked tranches over three years with cash flows from its North American operations supporting the payment.

IAN leads round for speech software firm Uniphore

Indian Angel Network (IAN) has led a round of investment for India's Uniphore Software Systems, a company that develops Indian language speech recognition software. YourNest Angel Fund and angel investor Ray Stata also took part in the round.

SOUTHEAST ASIA

L Capital buys control of luxury restaurant operator

L Capital Asia, the private equity firm backed by luxury goods conglomerate LVMH, has bought a 51% stake in Ku Dé Ta Group, a restaurant and club operator with interests in Singapore and Thailand. The company has secured venues in Hong Kong and Paris and is in discussions regarding locations in Dubai, Rome, Miami and Beijing. New York and Tokyo will follow.

Temasek tables $2.1b bid for full ownership of Olam

A consortium led by Singapore sovereign wealth fund Temasek Holdings has offered to pay $2.1 billion to take full ownership of agricultural commodity trading conglomerate Olam International. The consortium already owns a 52.5% stake in the firm. It is willing to pay S$2.23 per share, a 12% premium over the last traded price, valuing the company at $4.3 billion.

Gree, Transcosmos back Singapores's Luxola

Singapore-based online beauty store Luxola has raised $10 million in Series B funding from Japanese e-commerce services firm Transcosmos with existing backer Gree Ventures. Set up in 2011, Luxola claims to be the largest online beauty store in Southeast Asia by product selection with 105 brands.

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Shades of gray

Secondary restructuring opportunities are on the rise in Asia, but investors are wary of giving managers fresh primary capital on top. Deal flow is hard to source, even harder to execute, and highly bespoke

WITHIN A WEEK OF PUBLICATION, THE emails began to trickle in. "Saw your Ironbridge article the other day," one read. "Not sure if you're aware, but most of the LPs have kicked up a stink and the deal has been changed so they don't have to commit new money to the new fund."

This was a story in a state of flux, and according to sources familiar with the situation, it still is. Negotiating with existing and prospective LPs on a deal that will see a series of entries, exits and rollovers, was never an easy task. And on top of that, the GP is asking for more capital.

Australian GP Ironbridge Capital has not commented on its current fundraising efforts. The proposed scenario that emerged last autumn, relayed by investors and service providers, involved LPs in Funds I and II exiting their positions or rolling over into a new vehicle that will continue to manage the assets. Those that chose to participatewould also do a stapled secondary transaction, contributing capital to a blind pool that would make new investments.

Ironbridge apparently opted for a GP restructuring in order to leverage the secondary activity it was seeing in its funds and get more primary capital. However, a number of LPs objected to the notion of committing capital for new investments as a condition of participating in the rollover. It was duly removed; hence the emails suggesting AVCJ update its coverage to reflect subsequent developments.

The deal is now expected to be a secondary position only, with an anchor investor willing to cover the full $200 million available. This suggests a confidence in the GP that could give momentum to a future primary vehicle. Yet at the same time, it remains to be seen whether existing LPs hold their discomfort with the initial proposal against Ironbridge when it returns to market.

Tread carefully

Structuring a pure stapled secondary – where an investor takes an LP position in an existing fund, offering the GP who must approve the deal additional capital for a future fund as a sweetener – isa tricky balance of pricing, demand and opportunity. Unless the GP is a standout performer, LPs may well demand a number of sweeteners themselves.

"If we are a secondary investor leading the deal, we would work with the GP and advise them that in order to secure the approval of existing LPs they have to put a package together that gives the LPs a strong incentive to invest. Perhaps reducing their capital requirement is one way of doing it," says Jason Sambanju, managing director at Paul Capital. "Once you go down one path it raises all sorts of questions, which is why it is important to structure proposals properly."

While stapled secondaries and other fund restructurings are on the rise in Asia, it is not because the market is particularly conducive to them. The phenomenon is arguably more global in nature, driven by the maturing private equity industry, larger funds and more widespread LP bases, and regulatory change.

According to Cogent Partners, trading in traditional LP interests accounted for 77% of the $27.5 billion in global secondary market volume in 2013. Yet Dominik Woessner, a Shanghai-based director with Cogent, notes that GP-led transactions now account for around 25% of the firm's deal flow, up from 5-10% three years ago. The proportion of these transactions in Asia is also higher compared to the rest of the world because it is a shallow market with few investors selling traditional LP interests in funds.

This has a knock-on effect in terms of the allocation of on-the-ground resources. Most secondary specialists have staffed up in Asia in recent years and these people are expected to do more than conduct due diligence on Asian managers that crop up in global portfolio sales.

Their origination efforts must therefore be proactive. This might involve seeking out the GP with a fund that is nearing the end of its life and offering an exit route either for LPs in need of liquidity or for fund level assets the manager wants to sell in order to give LPs liquidity. There may be a successor vehicle, or there may not.

Restructuring opportunities can be fashioned from the debris, with or without the manager, but investors have to get their hands dirty. "You have guys on the ground telling everyone they are a global secondaries firm but they have to get some deals done," says Dean Collins, a partner at O'Melveny & Myers. "People have to be creative."

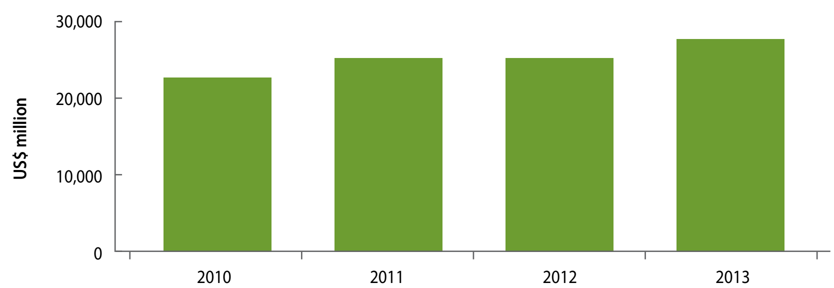
However, the highest profile stapled secondaries to emerge in Asia recently did not come from inexperienced managers or distressed situations.

An LP interest in a Morgan Stanley Private Equity Asia was picked up by AlpInvest Partners and LGT Capital Partners from Morgan Stanley and the two investors made a commitment to the GP's latest pan-regional fund, which is expected to close later this year. Headland Capital Partners is also heading back to market and AVCJ understands that a stake in an existing fund held by former parent HSBC is being offered to prospective investors in the new vehicle.

In both cases, the driving factor is banks needing to comply with the Volcker Rule restrictions.

"If you have an exceptional manager and an exceptional blind pool then a pure staple is possible," says one industry participant. "But it's not like anyone can go out there, sell the

Global secondary market volume



Source: Cogent Partners

portfolio and raise a new fund alongside. GPs try it but it is a challenge getting a pure staple for a blind pool of capital."

Tough negotiators

Ask most secondary investors to list their preferred deal structures and an LP stake in a fully funded, fully capitalized portfolio would be at the top; a stapled secondary would rank much lower.

In Asia as elsewhere investors have been more interested in entering funds and providing capital required to service existing portfolio companies rather than entering fresh blind pools. This may involve participating in additional funding rounds for growth companies that are not yet ready for IPO or, in the case of a control investment, supporting bolt-on acquisitions.

"Where the money is invested into the same vehicle and allocated to existing assets, two things happens," says Paul Capital's Sambanju. "First, you get cross-collateralization, with the GP accumulating carried interest on the basis of assets already in the fund. Second, you know the money is only going into those assets so there is no blind pool risk."

The documentation behind a stapled secondary can be as straightforward as a one-page term sheet, a transfer agreement between two investors on the existing fund and a subscription booklet for a new fund. Complications come in negotiating terms between the various parties.

These processes may ultimately be GP-led – the exception being when LPs move to oust the manager – but how the transaction came to market in the first place is significant.

Was it the result of extensive discussions with the LP advisory committee, which includes a few funds-of-funds that make primary and secondary commitments and are looking for deal flow in the latter? Or was it prompted by a speculative inquiry from an investor that is keeping tabs on secondaries market activity? Even the presence of an intermediary like Cogent may have a bearing on the outcome.

Once an investor becomes aware of a potential transaction, the first step involves understanding the assets, capital needs and deal pipeline. A proposal is put together and presented to LPs, usually a handful of key players. If there is agreement on general terms such as pricing, deeper due diligence follows. Issues including the legal ramifications of transferring assets and the rights of co-investors in particular deals come to the fore.

This detail goes into the definitive agreement, but battles are not easily won.

"Unlike a traditional secondary where there is a buyer and a seller and you look for a win-win situation, in these restructurings you add the third party, the GP, so you have to find a win-win-win situation," says Adam Howarth, managing director and co-head of PE secondaries at Partners Group. "It's all a negotiation and there are so many levers that need to be pulled to find a solution."

Pricing is an obvious sticking point: it has to be attractive enough for the seller to sell without making the deal economically unfeasible for the buyer. Various other clauses can be layered in to temper the economics. These might include the reset of carried interest and linking future payments to specific performance hurdles; the subordination of certain investors so that new entrants can get priority in terms of cash flows and distributions; and reductions in management fees or a larger GP commitment.

"Unlike a traditional secondary where there is a buyer and a seller and you look for a win-win situation, in these restructurings you add the GP, so you have to find a win-win-win situation" – Adam Howarth

The objective is to realign interests to reflect the changing dynamics of the fund and the relationships between the main actors. It comes down to who can push the envelope and how far.

While it is not unusual for secondary players to structure investments on an IRR-driven basis, O'Melveny & Myers' Collins says he is seeing these terms filter through to stapled primaries. There are, for example, triggers as to when management fees start and when draw downs can be made for the new fund, designed to achieve a combined return based on the projected performance of both vehicles.

"It is all about the secondary investor's rationale for doing the deal," Collins adds. "These might be global groups with traditional fund-of-funds businesses, but the new primary commitment comes from a secondary fund. A lot of it boils down to how a secondary purchaser sells the deal to its LPs."

Tailored solutions

The bespoke nature of deals in Asia may also be a function of the kinds of stapled secondaries that are available below the landmark transactions involving established managers.

Several industry participants reference friends-and-family deals whereby GPs offer access to a basket of earlier deal-by-deal investments to LPs that commit to their first institutional fund. These are not necessarily stapled secondaries because the existing assets may end up in the same structure as the primary capital.

The GP receives support to take its franchise to the next level and the groups or high net worth individuals who provided capital for transactions that now form the basis of the GP's track record get an exit route. However, Cogent's Woessner notes that raising a blind pool often comes at the expense of the price of the secondary and if the sellers want to maximize returns they probably wouldn't do it.

"An alternative would be to do the secondary transaction first," he says. "You create a first institutional, third-party fund, possibly including unfunded commitments for follow-on investments, in order to build up a track record with this new LP base. Then you go back to them, as well as other potential investors, after some time and raise a new, blind pool fund."

There is no formal staple binding GP and LP together, more an agreement to see how things go with the secondary and be open-minded about a subsequent primary. This approach might be preferable in less developed and volatile markets like India – the focus of much secondary structuring activity right now – where many managers have yet to convince LPs of their ability to create sustainable PE franchises.

"There are opportunities in Asia both to back well established managers or even less well-established managers that are trying to get a PE franchise off the ground," says Doug Coulter, a partner at LGT. "As long as it's the right structure and terms there will be LPs willing to underwrite a new franchise."

Almost regardless of country, there are GPs seeking to build these relationships in a compressed timeframe. In a challenging fundraising environment, the onus is on reaching a first close and one way of getting there is to offer a secondary LP exposure to existing assets while presenting a pipeline of new deals that would be funded using the new capital this investor provides. The staple remains but the risk and uncertainty of the blind pool might be reduced.

While such opportunities may be increasing, they must be treated with caution. "Fund restructurings or stapled transactions are generally large in terms of dollar volume," says Partners Group's Howarth. "It does move the needle in terms of deal flow, but in terms of opportunity each has to be evaluated on its own merits, on the assets and on the team side."

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Regulatory relief

The Korean government's recently announced M&A stimulation package includes a relaxation of restrictions on domestic private equity firms. But how much change are these reforms likely to bring?

THE AGREEMENT THAT SAW SOUTH Korean PE firm Hahn & Co. take a 76% stake in Hanjin Shipping's bulk carrier business for KRW400 billion ($380 million) was predicated on the ailing shipping conglomerate's need to shed assets and pay down debt. The sale is part of a restructuring through which Hanjin hopes to raise KRW1.5 trillion through divestments and source an additional KRW444 billion in loans.

It fits neatly into a broader trend in Korea where cash-strapped conglomerates, many still feeling the sting of the global financial crisis, have been forced to jettison assets. The way the deal was structured was also typical of the circuitous paths Korean GPs often need to take when looking to carve out these lucrative assets.

Hanjin's assets will be spun out into a new joint venture, with Hahn & Co. holding 76% to the shipping conglomerate's 24%. The PE firm paid KRW400 billion for its share while assuming around KRW1.4 trillion in debt.

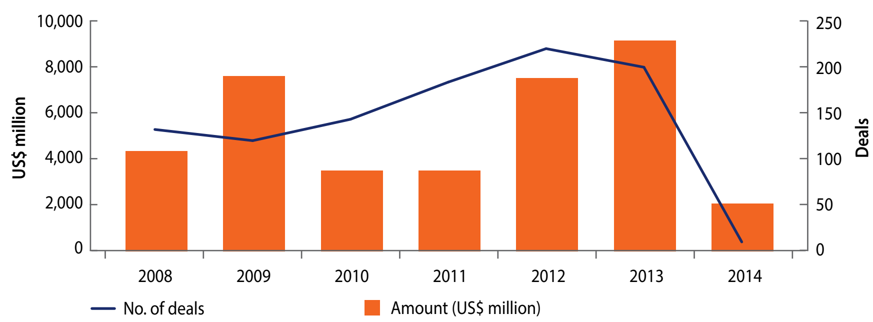
Were the GP a foreign vehicle this might not have been necessary. But as a locally-registered private equity fund (PEF) Hahn & Co. qualifies for a welcome capital gains tax exemption as well as some less welcome restrictions. These include being prevented from buying business units from Korean companies directly; the target must be a third-party entity.

It is hoped these limitations will be lifted as the country's Ministry of Strategy & Finance (MOSF) announced a set of regulatory changes to this month intended to makeeasier for PEFs and local companies to participate in M&A transactions. What remains to be seen is how exactly these reforms will take place.

The changes – revealed as part of a three-year "economic innovation strategy" focusing on regulatory reform across a number of financial services segments – are expected to come into force in the second half of this year. They are intended to help facilitate the sale of an estimated KRW10 trillion in assets held by struggling conglomerates.

"The government wants to have a more efficient M&A market in a broader sense but the immediate objective is to provide some solutions for distressed companies," explains Jong-Koo Park, an attorney with law firm Kim & Chang. "There have been previous amendments to the private equity laws over the years – for example, rules regarding GP registration – but this time the government is looking to help private equity carry out transactions more easily."

South Korea private equity investment



Source: AVCJ Research

M&A boost

The announcement comes against a backdrop of relatively strong deal flow. According to AVCJ Research, Korean buyouts reached $4.99 billion in 2013 across 27 disclosed transactions, the highest annual total on record. This pushed PE investment in the country to a high of $9.1 billion.

The largest recent deal was local GP MBK Partners' $1.67 billion acquisition of ING Life Insurance Korea, while there have been a number of others emanating from conglomerates under political and financial pressure to refocus on their core operations. MBK picked up water purifier business Woongjin Coway from the distressed Woongjin Group and Affinity Equity Partners bought digital music platform Loen Entertainment from SK Telecom.

However, it is the broader M&A market the government wants to see expand, with the MOSF wanting deal flow to grow from KRW40 trillion in 2013 to around KRW70 trillion by 2017. This involves encouraging PEFs which, according to Korea's Financial Supervisory Service, accounted for just 0.47% of GDP in 2012, compared to 0.72% in the US and 1.22% in the UK.

At the same time, the government reported that a total of 45 PEFs were established in the country last year, down from 60 in 2012.

Currently regulation of private equity in Korea is widely seen to be excessive and complex compared to more developed markets. It is one of relatively few jurisdictions, for example, in which GPs are required to register in order to qualify for local tax treatment.

The exact form the proposed changes will take is not yet known but the government has said regulations will be eased at the fund creation and investment, management and sale stages of the M&A cycle. In addition to making it easier for a Korea GPs to pick off attractive businesses from a parent company, the government will also streamline tax and financial support systems and rationalize the overall M&A procedure.

"For example, PEF's were previously required to hold a stake in a business for six months, but now they will be able to sell a portion of that stake so long as they can meet the minimum requirement of share ownership and management participation," says Kim & Chang's Park. "If the rule changes a GP will be able sell a portion of its stake as long as they maintain 10% ownership in the target company."

The reforms are not limited to facilitating carve-outs from distressed conglomerates but also seek to encourage corporate takeovers and investment in venture start-ups.

"The government's second objective is to support mid-sized companies. There have also been a number of initiatives around helping the overseas M&A of mid-sized companies," says Jay Kim, a managing director with Alvarez & Marsal.

Steps include enlarging the size of the Growth Ladder Fund, which was established by the government to help start-ups and their activities, to KRW3 trillion ($2.8 billion) from the current KRW1 trillion within three years. Meanwhile, tax benefits for M&A transactions carried out through share exchanges will increase and taxes levied on mergers of listed corporations will be reduced.

"The deregulation will open up more opportunities for venture companies for exit," adds Brian Koo of LB Investments. "And it will also give mid-size companies the chance to expand by buying domestic and foreign companies."

Overseas angle

But where does this leave overseas GPs who do not come under the purview of the legislation? The sizeable deals seen so far indicate that foreign investors will continue to have a big role to play in Korea's M&A market.

January saw the region's biggest ever PE exit when KKR and Affinity sold Oriental Brewery to Anheuser Busch InBev for $5.8 billion. And then this month The Carlyle Group acquired US-based Tyco's South Korean home security business for $1.93 billion. It is the largest-ever buyout in the country by a global private equity firm.

"The year started off with quite a bang because there have been a couple of huge deals coming out of Korea that have involved foreign PE funds," says Jaewoo Lee, a partner with Ropes & Gray in Hong Kong "Generally, public sentiment, media coverage and the government announcement all signal a positive environment for private equity."

The view is echoed by Kim & Chang's Park, who adds that any indication of the government liberalizing its stance on PE is good for both domestic and international funds as it shows that broader public opinion of private equity has improved when compared to a decade ago.

> **"The government wants to have a more efficient M&A market in a broader sense but the immediate objective is to provide some solutions for distressed companies"**
> – Jong-Koo Park

Another facet to this, however, is whether efforts to encourage greater involvement from Korean GPs in the M&A market might lead to global funds facing greater competition from domestic players. Indeed, many of the larger transactions in recent years have seen local firms bidding against their global counterparts. However, Ropes & Gray's Lee does not a see fundamental change.

"While I think in some ways this might foster more competition among PE funds going after the same targets, the broader picture is that many of the key players have been quite successful already, so I don't feel the changes proposed will affect the landscape greatly." he says.

Nevertheless, this promised progress must still be seen in the context of South Korea's track record for PE regulation.

Alvarez & Marsal's Kim observes that, given local PE regulation was much stricter 10 years ago, recent developments merely suggest a leveling of the playing field. "I think the general sentiment is that local PE funds are happy with the move but buyout funds would probably like more regulatory guidance and clarity on taxation and LBO issues," he says.

Equally, Kim & Chang's Park stresses that the tax issue is not thoroughly addressed in the announced package of liberalizations – although he is optimistic there may be movement in this area too. "We should wait and see what the government does," he says. "They may think about it."

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FidelisWorld takes the field with TechFront

THE INDIAN PREMIER LEAGUE (IPL) WILL literally enter new territory next month when the seventh season of the cricket tournament starts play in the United Arab Emirates – the first time the country has played host to such an event. The stadium chosen to host the first match is expected to be filled to capacity and those at the back unable to see the action close up will rely on the venue's illuminated television screens and scoreboards for a clear view.

This is the vital service that Technology Frontiers India (TechFront) has been providing to the IPL since 2009, and it is one of the reasons FidelisWorld Asset Management decided to buy a significant minority stake in the business for around $19.5 million this month. It is the Dubai-based GP's first investment.

Headquartered in Chennai, TechFront's business covers a broad range of arena management technology, comprising digital display systems and in-stadia lighting for sports events and concerts. It also develops smart phone applications for these events. The company previously received $10 million in funding from Avigo Capital in 2010.

According to Anand Krishnan, who helped set up FidelisWorld in 2011, TechFront distinguishes itself from competitors by integrating its display systems with fan applications.

"TechFront puts everything under one roof," Krishnan tells AVCJ. "It is all about trying to get the best of the sporting field to the fan, creating incremental revenue for rights holders, and a maximum return on investment for the sponsors, whether it is through digital systems, software or fan applications."

India's IPL: Game changer

The investment was made via FidelisWorld's FW Sports Investment Fund, which reached a first close of $100 million last October and has an overall target of $200 million. TechFront is one of many opportunities to arise from the emergence of professional sporting leagues in India. The 2007 debut of football's I-League was followed by the IPL in 2008 and more recently the Elite Football League of India.

"With the IPL and various private leagues emerging, incomes rising, increased leisure spending, and health consciousness emerging, I think the time is right to create an ecosystem for sports – there is a lot of value to be created," says Krishnan. "We are not interested in investing in sport teams and leagues that are dependent on sponsorship revenue; we are interested in the businesses that support the leagues, teams and consumers in this part of the world."

TechFront already gets more than 60% of its revenues from overseas markets in Asia and Europe. FidelisWorld plans to help the company further expand this global footprint.

"The company has a presence in Asia and Europe – in particular the UK – but it has not done much in South America, Africa, and the US. We have made forays in these regions with our connections so the next thing is to pull together a strategy," Kirshnan adds.

Kerogen enters PNG LNG space

SEVEN YEARS AFTER EXXONMOBIL BEGAN its feasibility study on commercializing gas resources in Papua New Guinea (PNG) through liquefied natural gas (LNG), the PNG LNG Project is poised to start delivering on its promise.

The oil and gas major announced last week that it has completed a 292-kilometer section of pipeline between the Southern Highlands and the coast. It is a key milestone for a project that is set to deliver its first LNG cargo in 2014.

The payoff on the $19 billion investment in the project's initial phase is the 9 trillion cubic feet of gas that will be sold over its lifetime. Long-term supply contracts have already been signed with several Asian energy companies.

ExxonMobil's efforts also underpin the investment thesis for other players seeking a portion of PNG's gas reserves. These include Kerogen Capital, a PE firm set up by former executives from J.P. Morgan's Asia energy and natural resources team who previously co-founded Indonesia's Ancora Capital. It recently announced a A$30 million ($27 million) investment in Twinza Oil which, among other assets, holds a 90% interest in a shallow water gas and condensate appraisal project in the country.

"PNG LNG projects are expected to produce some of the most attractive returns amongst new-build LNG projects globally. With PNG LNG starting gas sales in 2014, together with plans for further trains and new competing LNG projects, upstream gas resource aggregation is now an attractive opportunity" says Jason Cheng, co-founder and managing partner at Kerogen. "Recently, there have been a series of significant deals announced in PNG from majors, independents and junior oil and gas companies."

PNG for LNG: Popular location

Kerogen will take a 29% in Twinza, which is controlled by the Clough family, founders of Clough Engineering, an engineering, construction and support services provider for resource projects in Australia and PNG.

In addition to the PNG gas, Twinza's portfolio includes a 100% operating interest in a licence in a high potential oil and gas shale play in Queensland; and a 50% interest in two onshore exploration blocks in an extension of a gas-producing basin in north-central Thailand.

For Kerogen, though, the attraction is the management team as much as the assets it controls. "We invest in teams and platforms that have potential to grow and develop. The Twinza team has been operating in the region for decades and has a successful track record of discovering and commercializing assets in the region," says Cheng. "We see significant potential to further develop the portfolio together with the management team."

The investment is smaller than Kerogen's average check size – $100-150 million – but this reflects the current size of the Twinza platform, not its growth potential. Further commitments are expected from Kerogen and other investors as the individual projects ascend the development curve.

DCM bets bigger on China

DCM'S LATEST GLOBAL FUND IS SMALLER than its two predecessors because Silicon Valley-based general partners, Carl Amdahl and co-founder Dixon Doll, are stepping down. As a result, there will be fewer US investments, but China is expected to play a more significant role.

DCM Fund VII reached a final close of $330 million last week, $80 million more than the amount sought when the vehicle launched in July of last year. About $220 million of the corpus will be invested in Chinese start-ups. This compares to $150-$180 million in each of the two previous vehicles, which closed on $500 million and $400 million in 2005 and 2010.

"The China-based team, comprising two general partners and four senior investment professionals, is larger than the US team. We're also hiring two more junior investment team members," says Hurst Lin, a general partner at DCM China. "We have an additional $30 million to invest, which means two more deals. It's not a dramatic change."

Like its predecessors, the fund will focus on Series A and B rounds. Series A commitments are usually around $6 million, rising to $8-12 million for Series B and up to $20 million for Series C.

Lin says VC firms are facing more competition when seeking out deals in the telecom, media and technology (TMT) space from a combination of newcomers and newly active Chinese strategic investors. The risk is valuations might spiral out of control, but Lin plays it down. "I don't worry too much about strategic investors as they are more focused on later stagy types of deals," he explains. "We do more early-stage investments."

VIPshop: Home run for DCM

He adds that few strategics beyond Alibaba Group, Tencent Holdings and Baidu are willing to pay rich enough valuations to dissuade portfolio companies from pursuing IPOs.

However, DCM still needs to differentiate itself from others in the market. It does this by finding attractive niches within the mobile, digital media, e-commerce, and cloud computing landscape. The firm also puts a lot of emphasis on helping start-ups recruit management talent and optimize business performance.

Lin cites VIPshop as an example. The flash sales site went public in 2012 with a market capitalization of $600 million and DCM had a 20% stake. It is now worth $7.6 billion. "We thought its strategy of selling mass-market branded products, rather than luxury goods, would be an advantage," Lin says.

DCM also invested in 58.com, a classifieds marketplace that has more than tripled in value since its IPO last year. The firm was attracted by 58.com's strategy of hiring a sales team to teach Chinese shopkeepers how to advertise online. Competitors simply copied the Craigslist model, which offers no guidance to business owners.

The investment themes likely to dominate Fund VII are internet finance and online-to-offline businesses. Online gaming, once the sector's poster child, has lost its luster, Lin says.

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Cleaning China

When CITIC Capital Partners joined Audax Group in acquiring Elgin Equipment, its brief was to re-position the clean coal equipment business from low-growth America to high-growth China

COAL IS DESTINED TO REMAIN CHINA'S primary source of energy for decades. Sitting on 13% of the world's proven reserves of the mineral, the country consumes almost as much coal as the rest of the world combined, driven by its sheer volume of electricity generation, steel production and cement manufacturing.

The 3.7 billion tons of coal produced in 2012 fed power stations that accounted for 67% of the national electricity supply. New power stations continue to come online as China strives to meet the energy needs of an economy in the midst of industrialization and urbanization. Air pollution is the inevitable, and very visible, cost.

The problems, however, are about process just as much as volume. Once mined, coal in China typically goes unwashed, which means mud remains mixed in with the minerals. This mud cannot be burnt off fully on combustion so it is released into the air alongside the carbon particles, exacerbating the pollution effect.

The government is now paying attention and the 12th Five-Year Plan, a broad policy document covering 2011-2015, stipulates that most of China's coal must be washed. The specific target is to increase the wash rate from the present level of less than 40% to 70% by 2017.

To US-based Elgin Equipment, this policy position represents a huge market opportunity. The company produces coal processing equipment, including centrifuges used to wash soil and rock out of coal, and screeners that dry and group coals of different sizes. Elgin provides the tools through which coal can become cleaner and also generate more energy per ton.

The company is already a market leader in the US, accounting for three in four coal centrifuges and holding a 90% global share in its particular segment of the oil and gas drilling equipment industry. Elgin also generates steady revenue from replacement parts, services and maintenance.

Oil and gas drilling equipment represents the company's biggest revenue generator but there are high hopes for expansion in the clean coal space. This growth will not come in the US, which burns about 1 billion tons of coal per year compared to China's 4 billion tons.

Look east

"If we look at Elgin as a stand-alone US-based business, it's solid but not that fancy. It has steady cash flows with its leading market position, and new growth opportunities in the oil and gas market. But it's facing a very tough coal market in the US," notes Hanxi Zhao, managing director at CITIC Capital Partners. "However, if the company could build a meaningful business in China, then the overall dynamic for investing shifts. It becomes much more interesting."

This explains CITIC's rationale for buying Elgin in 2011, working in tandem with Boston-based private equity firm Audax Group. Audax sourced the deal and invited CITIC to participate, with a view to further penetrating the China market.

CITIC acquired more than 15% of the company through its third international fund. The three funds have made 28 investments in the US and Europe so far, including 14 platform deals.

"Our strategy is building company through add-on acquisitions as well as expanding globally," says Oliver Ewald, managing director of Audax. "We have known CITIC for many years and understood they can be a valuable partner for company that has significant growth potential in China."

Subsequent to the Elgin deal, the two private equity firms teamed up again in 2012 to buy Aavid Thermalloy, a US-based manufacturer of thermal management products that dissipate heat in electronic devices and prevent shutdown. China is earmarked as a growth market.

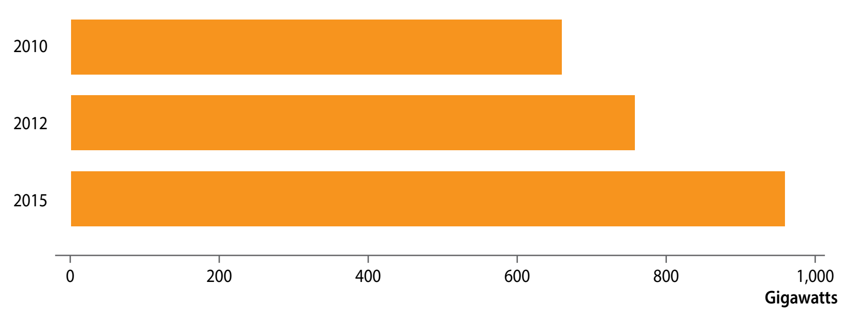
CITIC's minority stake in Elgin reflects the fact that the US remains the company's core customer base and Audax has deeper coverage and wider operational expertise in this geography. CITIC will drive improvements on the China side. Its initial contributions were to the pre-deal due diligence process and also helped identify China National Coal (CNC) Group as a joint venture partner.

"We saw the opportunity in coal, as well as oil and gas in China," Ewald adds. "China was still the minority piece for the whole group when we invested, but it will be an important piece for the growth of the business."

As part of the 12th Five-Year Plan, the Chinese government wants to consolidate the coal industry, creating a small group of large-scale national and regional players. The smaller miners, often beset by safety issues and lacking the capital to invest in equipment and technology, will be merged or shuttered. This is expected to create a smaller and more sophisticated customer base for Elgin.

> "The government has created a market for you, but it depends on whether you can grasp the opportunity or not"
> – Hanxi Zhao

12th Five-Year Plan target for coal power generation



Source: Central People's Government

Given the measures encouraging coal washing, Zhao estimates the domestic market for new centrifuges and screeners will be worth around $150 million. This doesn't include revenues from replacement parts and maintenance revenue, which normally account for 40% of the total.

"The government has set the mandate and we all know they will deliver what they say," she adds. "Essentially the government has created a market for you, but it depends on whether you can grasp the opportunity or not."

Initial frustrations

Elgin first attempted to ramp up its China operations in 2009, setting up a wholly foreign-owned enterprise (WFOE) and importing machinery products from the US for sale to local customers. However, expansion was hindered by a lack of market knowledge and distribution channels, as well as fierce competition from overseas coal washing equipment manufacturers.

The company's principal rivals for supply contracts for Chinese coal processing washing plants are US-based Schenck, Conn-Weld Industries and Birtley and Australia's FL Schmidt Ludowici, Tema Engineers and Aury. Local operators Zhong JI Wei Lin, Aury and Shandong Borun are also present in the market. The general consensus is that global brands are stronger in screeners while their local counterparts produce better centrifuges.

"We are a latecomer to the China market, so our marketing efforts will be critical to gain awareness with customers throughout China," says Manny Menendez, president of Elgin China.

Menendez modified the company's strategy and ditched the WFOE approach in favor of finding a local partner. The domestic coal sector is dominated by state-owned enterprises (SOEs) so Menendez had an obvious place to start. After searching a while, he settled on CNC Group, a coal miner and equipment manufacturer with $35-40 million in annual revenues. CITIC was brought in to help negotiate the joint venture.

"We normally don't like joint ventures because they bring their own problems," says Zhao. "But in this particular case, it makes total sense because the coal sector is government-driven and large SOEs are consolidating market. Elgin also faced a situation in which its competitors were already here, so we quickly decided that a joint venture with an SOE partner would be of help."

The joint venture also represented an unusual breakthrough because the SOE agreed to be the junior partner. CNC Group holds a 49% interest in China National Coal Elgin Mining Machinery, with Elgin owning the rest. The foreign player also has control of the board with five seats to CNC Group's four, while Menendez serves as chairman.

Zhao and Menendez link Elgin's success in securing a majority position in the joint venture to CNC Group's desire to enter the coal-processing business. Put simply, the SOE was willing sacrifice control in return for exposure to its partner's technology and expertise.

CNC Group not only operates a coal-mining business, but also manufactures underground mining equipment through its subsidiary, China National Coal Mining Equipment, which generates revenues of around $2 billion per year. Elgin is primarily involved in above-ground operations on the coal-processing side.

"We are complementary to each other. They are the leader in underground and we're the leader in above ground. We will be very strong force together. When we set up a factory, we can speak in the same language about the equipment. They already know it because they are involved in manufacturing," says Menendez.

Zhao pays tribute to the local management team's efforts in building relations with CNC Group. The CITIC contribution to this was less direct in that it was able to leverage the brand name of its ultimate parent, CITIC Group, one of China's leading industrial conglomerates.

"Our affiliation with CITIC Group helped a lot, especially when talking to an SOE," she explains. "You gain instant credibility with people."

Breaking ground

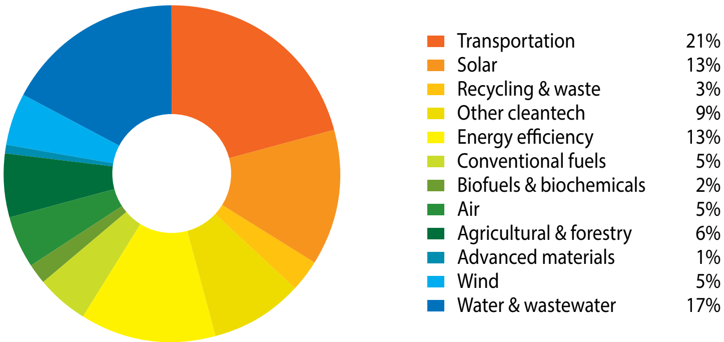
The joint venture launched at the end of last year and broke ground on a coal chemical factory in the Inner Mongolia city of Erdos. The facility produces centrifuges and screeners, relying on Elgin's intellectual property and systems expertise.

CNC Group is also National Coal Elgin Mining Machinery's biggest customer, using the joint venture as its main supplier of coal-washing equipment. Elgin's China operation is expected to generate initial sales of $20 million a year, moving into the multi-hundred millions once it ramps up production and wider sales and marketing efforts kick in.

"China is adding about one new coal processing washing plant per week, although we expect that velocity to slow down and the replacement of existing equipment at the more than 1,000 older plants to gain significant momentum," says Menendez. "Due to technology advances, especially in our centrifuge line, and pricing advantages, we feel a 10-20% market share is achievable in the next few years."

The joint venture is looking to hire about 80 staff, with CITIC taking the lead in recruitment efforts on the Elgin side. A general manager, controlling managers, sales and operations staff are all required. The private equity firm is also helping the joint venture with supply chain management, finding China suppliers to help accelerate localization of product sourcing, and identifying potential customers.

China VC and PE cleantech deals since 2012 by target industry



Source: Cleantech Group i3 Platform

Audax and CITIC's most likely exit route is a trade sale to strategic investors. Given oil and gas equipment remains Elgin's major business line the buyer would probably come from that industry. However, should the coal-washing equipment joint venture in China meet growth expectations, other parties may inquire after this asset in particular – either multinationals in the space keen to expand their China footprint or local strategics looking for technology.

Zhao welcomes the prospect of having multiple options, and the enhanced valuations this implies.

"We believe there is a decent chance that we will attract interest from Chinese strategic buyers because the company is a technology leader," she says. "At the end of the day, China is the largest coal market, and there is a need to burn the coal in a cleaner way."