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Southeast Asia’s e-commerce players need better logistics solutions

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Registration enquiries: Yeni Kittrell T: +852 3411 4836 E: Yeni.Kittrell@incisivemedia.com

Sponsorship enquiries: Anil Nathani T: +852 3411 4938 E: Anil.Nathani@incisivemedia.com
What now, Alibaba?

CHINESE ONLINE FURNITURE RETAILER

Meilele started out life as a store within Taobao, Alibaba Group’s C2C e-commerce platform in 2008. The company’s transactions ran through the Taobao platform, with online payment service Alipay collecting monies owed. Needless to say, the Alibaba ecosystem took its cut of the profits.

Having acquired a loyal following, Meilele departed Taobao and set up its own B2C platform. This was subsequently complemented by an offline presence, and now the company has close to 150 showrooms nationwide, allowing customers to sample the goods before they buy them as well as offering home design and renovation services.

Meilele has since been through two rounds of venture capital funding and issued a convertible bond. It is one of a host of vertical retail plays, often incorporating an online-to-offline (O2O) element that have attracted VC funding in recent years. They are seen as the key to securing a loyal customer base in China’s notoriously disloyal e-commerce universe and ultimately building sustainable brand value. Like Meilele, some of these vertical retail plays were born on Taobao but now they are essentially trying to take market share from it.

It would take a lot more than this to sink the Alibaba juggernaut, fresh from its $21.8 billion IPO, which is generally expected to claim the title of largest share offering ever when the allotment option kicks in. Alibaba is China’s leading e-commerce player with platforms covering B2B, B2C and C2C. Its three retail marketplaces – Taobao, Tmall and Juhuasuan – generated a combined gross merchandise value of RMB1.5 trillion ($248 billion) from 231 million active buyers and 8 million active sellers in 2013. Alibaba recorded a net profit of $1.99 billion in the second quarter this year, while it posted of $2.54 billion in revenue, up 46.3% year-on-year.

Alibaba is aware of these issues and acknowledges most of them in its IPO prospectus (admittedly, in a 43-page chapter that covers everything from unpredictable exchange rates to inscrutable regulators). The company highlighted the risks posed by failing to adapt to the rapidly evolving consumer behavior on mobile devices, the challenges it may face when entering new markets, and the fact that revenues would suffer if third-party buyers and sellers transacted their business directly rather than through an Alibaba e-commerce platform.

Referring to the emerging vertical online retailers that are posing a challenge to Taobao, one GP describes Alibaba as “an elephant with wolves all around it.” However, this elephant is still large enough to forge new paths for itself through the e-commerce jungle.

Alibaba was cash rich before the IPO but now it has even more capital-raising tools at its disposal. The company has already shown its willingness to make acquisitions in order to diversify its business. Alibaba, Baidu and Tencent Holdings represent the top-tier of Chinese internet companies, but they are all aware of the challenges it may face when entering new markets.

The sector has its incumbent giants, but it remains a mercurial creature.

Tim Burroughs
Managing Editor
Asian Venture Capital Journal
**AUSTRALASIA**

**Partners Group consortium seals PPP rail project**

A consortium featuring Partners Group has won the tender to operate Sydney’s North West Rail Link, one of Australia’s largest-ever public-private partnerships (PPP) ever seen in the country. Other consortium members include Hong Kong’s MTR Corporation, Australia’s Leighton Contractors, John Holland, UGL Rail Services and Plenary Group.

**SAI Global process ends with no full buyout offer**

SAI Global, the Australian risk management and standards compliance business that launched a sale process after receiving a $1 billion (1 billion) buyout offer from Pacific Equity Partners (PEP), has received no final bids for the entire company. A number of parties put forward proposals to acquire one or more of SAI’s underlying businesses. However, PEP did not submit a final offer.

**Lazard PE buys majority stake in Skybridge**

Lazard Australia Private Equity has acquired a majority interest in Skybridge, an Australian satellite broadband services provider, for an undisclosed sum. With an expanded balance sheet and additional management resources, the company will develop its existing satellite business and expand into new installation and contracting markets.

**Australian VC firm Square Peg plans global push**

Square Peg Capital, the Australia-based venture capital firm founded by the co-founder of job search site Seek is looking to expand overseas, with plans to invest up to $100 million a year in Israel and the US. Square Peg was founded in 2012 and has deployed around $50 million across 19 investments, most of them in Australia.

**GREATER CHINA**

**Carlyle, Yunfeng to exit GDC to Huayi Brothers**

The Carlyle Group and Yunfeng Capital are set to exit from GDC Technology as Huayi Brothers Media plans to acquire a controlling stake in the digital cinema equipment manufacturer. Movie studio Huayi currently owns 12% of the Hong Kong-headquartered business. Carlyle has 46.33% while Yunfeng holds 17.34%. Huayi plans to increase its holdings to 79% by means of share purchase in two stages.

**Anchorage fully exits Dick Smith with 4x return**

Anchorage Capital Partners has exited the remainder of its stake in Australian electronics retailer Dick Smith Holdings, generating a more than 4x return on its investment after a two-year holding period.

Having reduced its stake in Dick Smith from 98% to 20% through the company’s IPO in December 2013, Anchorage completed its exit on September 16, according to a regulatory filing. The private equity firm sold approximately 47.3 million shares at $2.22 apiece to raise $105 million ($94.4 million).

Anchorage’s total proceeds from the investment now stand at an estimated A$449.5 million, including A$344.5 million from the Dick Smith IPO, which valued the company at A$203.3 million. It bought Dick Smith from supermarket chain Woolworths in September 2012 for an initial A$20 million plus a share of any upside resulting from the private equity firm exiting the asset. Ahead of the IPO, Woolworths accepted a A$74 million payment in return for part of its rights to the float proceeds. The company received A$24 million through the IPO.

At the time of the acquisition, Dick Smith was experiencing declining profitability. Anchorage implemented a turnaround program that involved hiring new management talent, revising pricing and brand positioning, altering product sourcing processes and reducing costs, and introducing better training and incentives for staff. Net profit had slipped from A$13.2 million in 2012 to A$6.7 million in 2013, with EBITDA falling from A$32.6 million to A$23.4 million, and sales falling from A$1.37 billion to A$1.28 billion. In 2014, net profit rebounded to A$42.1 million, with EBITDA reaching A$74.4 million and sales coming to A$1.22 billion.

**GIC leads Series C for China car rental service Yongche**

Chinese car rental and taxi-booking site Yongche.com - which has a similar business model to Uber - has raised a Series C round of funding led by Singapore sovereign investor GIC Private. The size of the round was not disclosed but local media reported the amount as being above $100 million, with Chinese search operator Baidu also participating.

**China Haier VC, SAIF launch smart home fund**

Qingdao Haier Venture Capital (Haier VC), a corporate VC arm of Chinese white goods maker Qingdao Haier, has teamed up with SAIF Partners to form a RMB320 million ($32 million) smart home-focused VC fund. The two parties launched a joint venture, Qingdao Haier SAIF Investment (Haier SAIF), earlier this month. SAIF holds a 50% stake in the venture, while Haier VC owns 20%.

**Hong Kong Jockey Club in alternatives boost**

The Hong Kong Jockey Club has substantially increased its investments in alternative assets as part of efforts to diversify its holdings and achieve stronger returns. The sharpest increase was recorded in the club’s trust. Investments in alternatives by the trust’s capital fund jumped from HK$3.7 billion ($477 million) in 2013 to HK$5.3 billion in 2014.

**Tencent, Morningside commit $20m in travel site**

Tencent Holdings has led a $20 million Series B round of funding for Woqu.com, a Chinese outbound travel start-up, with participation from existing investor Morningside Technologies. The online platform was launched in April by Zhiwen Huang. It provides travel packages and car rental services for Chinese tourists visiting the US.

**Xiaomi Ventures backs health products maker**

Xiaomi Ventures, a corporate VC unit of Chinese mobile phone maker Xiaomi, has paid $25 million for a 20% stake in Healthlab, an offshore unit of healthcare electronics maker Andon Health. Shenzhen-listed Andon Health plans to restructure its overseas operation – including Hong Kong, US and France - under the Healthlab entity, with the parent company holding a 70% interest.
JD Capital offers student credit loans

China JD Capital, also known as Jielding Capital, has set up a new fund to provide individual loans for Chinese university students. The vehicle, Heima Investment, has registered capital of RMB50 million ($8 million) provided by the private equity firm, and hopes to raise at least RMB100 million from strategic investors.

NORTH ASIA

Altos reaches $60m close on South Korea fund

Silicon Valley-based VC firm Altos Ventures has reached a final close on its debut South Korea-focused fund at a hard cap of $60 million after eight months in the market. The investor response was slow to begin with, but picked up sufficiently that the fund broke through its original target of $30 million. It was then revised to $50 million with a hard cap of $60 million.

Korea’s SMBA to form VC fund with DFJ, Walden

Draper Fisher Jurvetson (DFJ) and Walden International have agreed to set up a $150 million venture capital fund with South Korea’s Small and Medium Business Administration (SMBA). DFJ and Walden will each put up $75 million and be responsible for managing the fund, at least 51% of which will be invested in Korean start-ups and small to medium-sized enterprises.

Learning platform Mana.bo raises $3m Series A round

Nissay Capital and Mitsubishi UFJ Capital have joined Japanese education firm Benesse in investing JPY330 million ($3 million) in online learning platform Mana.bo. Set up in April 2012, Mana.bo provides online tutor services in partnership with client companies in the education industry.

SOUTH ASIA

KKR agrees $164.2m financing for GMR Infra

KKR has agreed to invest INR10 billion ($164 million) in ailing Indian infrastructure conglomerate GMR Holdings (GMR), the parent of GMR Infrastructure (GIL), via a structured credit facility. The deal comes after GMR’s board agreed a INR1 billion rights issue in GMR Infrastructure. It is hoped the deal will allow the group to improve the net worth of GIL.

India’s Quikr gets $60m from Tiger Global

Tiger Global Management has led a $60 million round of funding for in Indian online classifieds platform Quikr. The deal comes just six months after Quikr raised $90 million in a round led by Sweden’s Investment AB Kinnevik. In total the start-up has had six funding rounds, raising an $200 million since it was set up in 2008.

IVFA picks 10% stake in Biocon research unit

India Vaue Fund Advisors (IVFA) has bought a 10% stake in Syngene International, the research unit of Indian bio-pharmaceuticals firm Biocon, for INR3.8 billion ($62 million). IVFA will acquire the shares from Biocon Research Limited (BRL), a wholly-owned subsidiary of Biocon. Once the transaction is complete Biocon and BRL will jointly hold an 85.5% stake in unit. The deals values Syngene at INR38 billion.

India’s Power2SME raises $7m Series C round

Power2SME, an Indian group buying start-up, has raised a INR420 million ($6.87 million) Series C round from existing investors Accel Partners, Kalaari Capital and Inventus Capital. Power2SME is a free platform that aggregates demand for raw materials from small- and medium-sized enterprises (SMEs), negotiates the best prices directly with suppliers and handles payments to them.

UK’s Amadeus Capital to open India office

Amadeus Capital Partners, the UK-based technology venture capital firm, will open an office in India as it looks to invest up to $10 million in local start-ups. The firm held a first close on its latest emerging markets-focused vehicle, Amadeus IV Digital Prosperity Fund, in July last year at $75 million. It is targeting a $150 million final close before the end of 2014.

SOUTHEAST ASIA

KKR completes Goodpack privatization

KKR has completed the $1.4 billion ($1.1 billion) acquisition of intermediate bulk container (IBC) manufacturer Goodpack. The company delisted from the Singapore Exchange on September 15. KKR will seek to accelerate Goodpack’s growth by penetrating new verticals and increasing sales in existing markets. Capstone, the private equity firm’s operations division, will also work with Goodpack to unlock greater value.
Web analytics

Southeast Asia is expected to see rapid growth in e-commerce over the next five years. But are there enough competent logistics providers to deliver the goods in a timely and cost-effective fashion?

ENSOGO, A THAILAND-BASED B2C
discount platform, was founded by serial entrepreneur Paul Svorakul in 2010. He expected to manage a few hundred transactions a month, so was astounded when 1,000 consumers put in orders within the first few days. Demand for Enso's special offers on dining, beauty treatments and other activities continued apace, with revenue doubling month-on-month.

Berlin-based VC investor Rebate Networks was suitably impressed and committed $2 million. Svorakul used the capital to introduce new regional platforms – Deallkoren in Indonesia and GoNabit in the Middle East. But as the company scaled up, logistics became a problem. "We were making $5 million in revenue a month from the discount deals business. Once we started shipping physical goods to customers, we looked for stronger local third-party logistics partners who could do cash-on-delivery," says Svorakul. "The biggest challenge we faced was finding logistics companies capable of handling B2C e-commerce fulfillment."

In 2011, US lifestyle online marketplace LivingSocial acquired Ensogo. Earlier this year, LivingSocial sold its Southeast Asia assets to Singapore-based iBuy Group. As part of a larger group, Ensogo’s has the resources to support growth. But the fundamental problem remains: Logistics providers in Southeast Asia, mainly focused on B2B business where goods are shipped in 5-7 days, are ill-suited to meeting the needs of e-commerce.

UBS estimates that only 32% of Southeast Asia’s 620 million population has internet access. As more people come online, online shopping will rise. B2C e-commerce is expected to grow at least five fold by 2020 to reach $35 billion. But who is going to deliver the parcels?

"More entrepreneurs are starting e-commerce service businesses to support small and medium-sized enterprises (SMEs) as they transform from traditional physical retailers into online platforms," says Alex Lin, head of Singapore Infocomm Investments, a VC arm of government-backed Infocomm Development Authority (IDA). "This will place even more stress on the already poor infrastructure."

According to AVCJ Research, venture capital investment in Southeast Asian e-commerce reached $746 million last year, a dramatic increase on the $170 million and $61 million committed in 2012 and 2011. While this could add to the logistics logjam, which in turn restricts e-commerce growth, there are also opportunities for investors looking to address the problem.

Last-mile challenge

The geography of Southeast Asia presents a particular challenge for the logistics sector. The likes of Indonesia and the Philippines – which are among the fastest-growing e-commerce markets – are archipelago nations. Getting from A to B is difficult when it means traveling across water. "Southeast Asia differs from China where logistics is more efficient because it is mainly on land," says Alfred Au Yeung, a freelance logistics consultant in Singapore, who has worked with several retailers on e-commerce initiatives. "Last-mile delivery services require road transportation."

Even on the roads there are problems. Express delivery crews are frequently caught up in serious traffic jams in the cities of Jakarta and Manila, which makes it difficult to schedule shipments within a certain timeframe. And then the fragmented nature of the industry means there are safety concerns. Credit cards are not widely used for online transactions in Southeast Asia and drivers have been known to flee with the money after being paid cash on delivery.

"Last-mile delivery is really difficult in Southeast Asia. Even in Singapore, there are all small van drivers and you never know when and where they will show up," says Vinnie Lauria, founding partner at Golden Gate Ventures. "They call you up and scream at you, saying you have to be there right now. Then they hang up."

Certain segments of e-commerce face further obstacles. Few logistics providers are able to deliver refrigerated products – or at least not without spoiling the goods – and this has promoted start-ups to build up their own warehouses and hire dedicated delivery staff. Golden Gate-backed online grocery player RedMart is one such company. The Singapore-based firm has built a 100,000-square-foot warehouse, bought 27 trucks and hired a staff of 200, ensuring fresh fruit can be delivered to customers on the same day or within 24 hours. Fashion is another area in which the importance of timely deliver has resulted in significant investments in self-owned logistics infrastructure. German-based Rocket Internet is a leading player in this space. Its two e-commerce sites zalora and Lazada, the largest Southeast Asia, have raised around $700 million in funding over the last two years. A large portion of this capital was earmarked for warehouses in different countries to handle last-mile delivery. Building local warehouses is important because it helps avoid additional delays arising from import restrictions. For example, it typically takes a long time to get approval from Indonesian customs to bring in goods, which directly impact the competitiveness of fast fashion e-commerce sites. However, Stefan Jung, partner at Monk's

ASEAN e-commerce market, 2013 estimates

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (million)</th>
<th>Number online (m)</th>
<th>% online</th>
<th>Social media users (m)</th>
<th>Retail sales (US$ billion)</th>
<th>E-commerce % of retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>244.8</td>
<td>75.9</td>
<td>31.0%</td>
<td>66</td>
<td>100.2</td>
<td>0.1%</td>
</tr>
<tr>
<td>Singapore</td>
<td>5.3</td>
<td>3.9</td>
<td>74.0%</td>
<td>36</td>
<td>29.6</td>
<td>1.0%</td>
</tr>
<tr>
<td>Philippines</td>
<td>97.7</td>
<td>33.6</td>
<td>34.4%</td>
<td>38</td>
<td>34.0</td>
<td>0.3%</td>
</tr>
<tr>
<td>Vietnam</td>
<td>88.8</td>
<td>31.0</td>
<td>35.0%</td>
<td>24</td>
<td>79.6</td>
<td>0.1%</td>
</tr>
<tr>
<td>Thailand</td>
<td>67.9</td>
<td>31.2</td>
<td>46.0%</td>
<td>27</td>
<td>94.4</td>
<td>0.2%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>29.5</td>
<td>18.5</td>
<td>62.6%</td>
<td>17</td>
<td>98.2</td>
<td>0.2%</td>
</tr>
<tr>
<td>Aggregate</td>
<td>534.0</td>
<td>194.2</td>
<td>36.4%</td>
<td>175.6</td>
<td>436.0</td>
<td>0.2%</td>
</tr>
<tr>
<td>China</td>
<td>1344.0</td>
<td>618.0</td>
<td>46.0%</td>
<td>610</td>
<td>381.2</td>
<td>8.0%</td>
</tr>
<tr>
<td>US</td>
<td>312.0</td>
<td>245.2</td>
<td>76.8%</td>
<td>213</td>
<td>3026.7</td>
<td>8.7%</td>
</tr>
</tbody>
</table>
Hill Ventures – and before that co-founder of Zalora and Lazada as Rocket Internet's managing director for Southeast Asia – sees more players trying to address the logistics shortcomings. This should benefit the entire e-commerce industry.

“I see a lot of start-ups working to solve logistics problems across Southeast Asia, not just the large players such as DHL and SingPost. ACommerce probably is the biggest start-up right now in the logistics space, but I also see 15-20 other start-ups trying to solve delivery problems. That’s exciting because they’re improving logistics – the situation is much better than three years ago,” he says.

Transformation plans

In response to the decline in traditional mail delivery, SingPost is diversifying its operations and targeting three growth areas: warehousing and delivery services, financial services and e-commerce. “We couldn’t sit by and wait for more international players like Amazon to enter Southeast Asia and build up significant operations. Instead, we’re building by ourselves, bringing more brands into the Asia Pacific region. We are creating the demand for services by ourselves,” says Marcelo Wesseler, senior vice president of e-commerce at SingPost.

Among SingPost’s initiatives is a program that helps over 600 retail brands – most of them fashion and electronics players like Adidas and Toshiba – launch websites in different Southeast Asian regions. It also integrates online technology, including online ordering and payment systems, and uses existing distribution centers to support warehousing and delivery. In the interests of efficiency, both Hong Kong and Singapore are now SingPost e-commerce hubs. For examples, packages supplied by Chinese merchants are consolidated in Hong Kong and then shipped to different markets.

“We chose to provide services for different brands because we can get a lot more in scale,” Wesseler explains. “Whether a customer buys a pair of Adidas shoes online in Malaysia, Indonesia or Thailand, everything is local experience, with local-language websites and local after-sale services. Consumers won’t know the shoes are shipped from Singapore or Hong Kong.”

Four months ago, Chinese e-commerce giant Alibaba Group paid $312.5 million ($249 million) for a 10.35% stake in SingPost and DHL to create an e-commerce platform. The company hopes to take advantage of the regional infrastructure.

There are also a number of emerging logistics start-ups devoted to serving the needs of e-commerce platforms. After selling Ensogo to LivingSocial, Srivarakul co-founded e-commerce focused investor Ardent Capital. Last year, Ardent’s Labs division launched aCommerce with a view helping e-commerce companies scale up with greater ease than Ensogo.

ACommerce provides end-to-end solutions in Indonesia, Thailand and Singapore. After one year in operation, it handles local fulfillment and delivery for clients such as L’Oreal, Lazada and Japan’s Rakuten. The company is now seeking partnership with large players like SingPost and DHL to do cross-border delivery for its clients.

“A lot of companies want to become a platform or marketplace, such as Alibaba’s TMall, Lazada and Rakuten. These players want to invest more in platforms, technology, marketing, and gain more online transaction fees from clients. They don’t want to invest in heavy assets like warehouse and fulfillment back-end services,” says Srivarakul.

However, aCommerce has ambitions that stretch beyond being a fulfillment and delivery services, which account for about 60% of its entire business. The company wants to provide technology platforms for e-commerce operators, building warehouse and transportation management systems that support local infrastructure.

Venture capital investors appear to have bought into this proposition. In June, aCommerce received a $10.7 million – the largest Series A round ever seen in Southeast Asia – led by Inspire Ventures. Other participants comprised a mixture of VC and strategic investors, including NTT DOCOMO Ventures, Sumitomo Corporation Equity Asia, Sinarmas Indonesia, Asia Pacific Digital, Cyberagent Ventures and JL Capital, as well as angel investors and key executive staff.

“We haven’t invested in any online retail websites. Rather, we have backed aCommerce, which can provide services to the whole playing field of online retailers,” says Tom Kim, managing partner at Inspire. “Thailand has over 20 websites and hundreds of independent online retailers in the fashion and beauty space who are competing aggressively with each other. Zalora may be on top but there are many others underneath. I don’t know who is going to win that war.”

Another Singapore-based e-commerce logistics player, Anchanto, has secured a few million dollars in VC funding. Vaibhav Dabhade, the firm’s co-founder and CEO, notes that technology is the main differentiator from other industry players. With a 25-strong team, Anchanto integrates its ordering system with the platforms of e-commerce clients. When consumers order goods online, the logistics provider receives the orders directly and handles delivery immediately.

Early movers

Although a few logistics start-ups are emerging, the amount of capital going into the sector is still small. It is just a tiny fraction of the $4.9 billion that private market investors – including a number of large private equity firms and leading institutional players – have deployed in warehousing and trucking and courier services in China in the last 18 months.

The size of the funding gap reflects the fact that China is a far larger online shopping market than Southeast Asia. E-commerce accounts for 0.2% of Southeast Asia’s $436 billion in total retail sales, according to UBS. This compares to 8% out of China’s $3.8 trillion retail market.

ACommerce’s Srivarakul says the main challenge for logistics businesses in the region is there aren’t enough e-commerce sites to fully realize potential of different verticals. It makes it difficult to optimize operations.

“It’s the chicken-or-egg story,” adds Golden Gate’s Lauria. “E-commerce operators here don’t have many choices in terms of delivery services. However, there won’t be many without stronger demand from the e-commerce side. You can’t have one without the other.” He sees Rocket Internet as a potentially valuable addition to the region. The company aggressively encourages consumers to buy online and this is the kind of demand driver required to stimulate the logistics side.

Lauria expects Southeast Asia to ultimately follow China’s lead, with 20% growth for both the e-commerce and logistics markets over the next few years. Inspire’s Kim raises the bar even higher, predicting that the e-commerce share of the region’s retail market will rise from 0.2% to 20% over the next 10 years.

He also emphasizes the importance of getting into the logistics game early. “We selected the most challenging part of that e-commerce value chain – the end-to-end component. Then we identified the smartest people to solve that problem, and that’s how we found aCommerce,” Kim says. “The great thing is there isn’t much competition in the end-to-end space right now.”

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Volkert Doeksen
Co-founder
ALPINVEST PARTNERS

D. Brooks Zug
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Registration enquiries:
Carolyn Law  T: +852 3411 4837
E: enquiry@avcj.com

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

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MANHEIM, THE WORLD’S LARGEST automobile auction provider, was a project more than 30 years in the making. The company facilitates sales of used cars worth $46 billion annually, dominating a US market that trades 40 million vehicles a year.

After its acquisition by Cox Enterprises in 1968, Manheim embarked on a series of roll-up acquisitions to give it the leading position it holds today. The Manheim ecosystem has also grown vertically to incorporate all kinds of financing, recovery, repair and information sharing components.

China’s used car market is experiencing this kind of evolution but in a highly condensed timeframe. As a result, Julian Cheng, managing director at Warburg Pincus, believes the country could end up with a behemoth even bigger than Manheim.

“With Manheim, Cox rolled up localized car auctions, parking lots if you will, over something like a 30-year period,” he says. “China is doing this where you have the internet and mobile internet. All these different businesses – which are in themselves worth billions – could end up in the same company. In developed markets, everything developed in different ways. In China it is starting at the same point.”

This was the rationale for Warburg Pincus participating alongside Tiger Global in a $260 million round of funding for Youxinpai, China’s leading used car auction platform. The company was founded in 2011 by executives from listed online auto advertising business BitAuto. It has previously received investment from Legend Capital, Bertelsmann Asia Investments (BAI), DCM and Tencent Collaboration Fund.

A total of 5.2 million second-hand autos were traded in China last year but the market is expected to grow more than fivefold. Markets of this scale cannot survive on informal trading systems alone. Dealers need to move large volumes of vehicles and platforms such as Manheim or Youxinpai are the way to do it. Youxinpai started out as an online-only offering but now operates a hybrid model with six offline centers that allow for sight inspections and the provision of other services.

Warburg Pincus was impressed by the company’s move into the offline space and by its efforts on mobile products. The new capital will be used to expand the physical network as well as for technology and service improvements.

Youxinpai, which differs from other online trading platforms by virtue of its size and focus on the wholesale trading market, is ultimately seen as a likely IPO candidate.

Cheng says Youxinpai’s scale and technology offering can be used to make car-trading more transparent, removing the inherent distrust that exists between buyer and seller. Perhaps just as significantly, these factors can also help Youxinpai consolidate its market position. “Excessive competition can be a problem in China, but this company has squashed the competition at an early stage,” Cheng adds.
Blackstone pins down China’s Xinrong

DRIVEN BY AN AGING POPULATION, increasing health awareness and a rising middle class, China’s medical device market is growing at a rapid pace. A recent report by the Hong Kong Medical and Healthcare Device Industries Association reveals that since 2000 sales of medical devices in the mainland have expanded by an annual average of more than 20%. Last year, the market was worth $34.5 billion.

VC and PE investors have long been aware of the opportunity, providing a much-needed source of capital to companies looking to grow their operations and the climb the value chain in an increasingly competitive domestic market. The Blackstone Group’s recent decision to take a significant stake in Xinrong Best Medical Instrument suggests there is still plenty of low-hanging fruit.

Set up in 2000, Xinrong claims to be the leading domestic manufacturer of orthopedic implants for trauma, spine, and joint applications. The company has a portfolio of products licensed under the China Food and Drug Administration (CFDA), which it sells to hospitals across the country through third-party distributors.

“We have been looking for a Chinese company in this sector for a while,” Yi Luo, a managing director with Blackstone in Shanghai, tells AVCJ. “There has already been quite a bit of M&A activity in the space, so we were looking for the remaining leading independent companies that we could help grow.”

The deal—which took just six months to close—is the first of its kind for Blackstone in China but still represents familiar territory; the GP previously led a consortium in the acquisition of US device manufacturer Biomet in 2007 and also bought orthopedic products specialist DJO in a $1.3 billion bolt-on deal the same year.

Xinrong’s story is a familiar one in China. The founders have built a strong business selling high-quality products through a solid network of distributors nationwide, but they lack the networks and capital needed to take it to the next level. “There have been a lot of early-stage opportunities in this space but increasingly we are seeing more mature companies that can use Blackstone’s help in terms of international market access, management transformation and governance improvement,” says Luo.

The PE firm’s first move will be to upgrade Xinrong’s management by bringing in a team of senior Chinese managers with international experience that the company might otherwise have struggled to recruit. Another area of focus will be the company’s sales and marketing strategy, with a view to boosting overseas sales.

Further growth will come from the Chinese orthopaedic implant market itself, which is projected to be worth $4.1 billion in 2020, up from $1.3 billion in 2013, according to Boston Consulting Group. “As demand for better healthcare grows in China, Xinrong is well placed to help meet those needs by providing low cost and high quality products,” says Luo.

Morningside bets on social network

“WE CURRENTLY HAVE A LARGE POSITION in Apple. We believe the company to be extremely undervalued. Spoke to Tim Cook today. More to come.” This 24-word Tweet, comprising just 111 characters, managed to push up Apple’s value by $12 billion in less than a minute.

It was posted last year by US investor Carl Icahn, who had announced the day before that he would start using the social network for public announcements. It was a watershed moment for the information, build their network, and connect for investors who are able to use it to share information, build their network, and connect with other investors,” says Fisher Zhang, a partner with existing investor Morningside Venture, which also took part in the latest round. “I don’t think there is company doing anything similar to it.”

This latest round brings the total raised by Snowball to about $53 million. It received a $10 million Series B round from Morningside and Sequoia Capital last year and before that a $20 million Series A round from Sequoia in 2011. The latest round of investment will be used to build a broker system that will eventually allow users to buy and sell stocks through Snowball’s website and apps. “It is still at very nascent stage but we are thinking about different monetization methodologies, including the public trading model,” says Zhang.

The first stage is creating a platform that can provide the information users need to conduct real-time research into the market—something they cannot get just by searching Google. The second stage will be building a transaction platform that allows investors to act on this information.

“Within an online community you are able to track and aggregate a lot of research, comments and actions produced members—and over time you will be able to see which members have good track records and who the most trusted sources of information are,” says Zhang. “That is the power of the social network.”
Stand and deliver

Competition is increasing in China’s online food delivery market as VC investors back start-ups looking to achieve scale ahead of expected consolidation. How asset-heavy should the business model be?

AS A BUSINESS MODEL, AN INDEPENDENT online food-ordering platform makes perfect sense. Restaurants can sell more food without adding seating capacity and staff or even investing in the infrastructure required to make the platform work. Consumers are presented with a one-shop-stop for a variety of cuisines that can be tracked en route to their door.

As a practical enterprise, launching an online food-ordering platform is a chicken-and-egg dilemma. A start-up service usually has no customers and no restaurant clients; it must pitch the latter and market to the former – no easy task in a market like China where the concept might not be well understood.

The three founders of Ele.me, which was set up in Shanghai approximately six years ago, focused on a target market of which they were a part: “They were still in school doing their masters degrees when we backed them,” recalls Allen Zhu, managing director at GSR Ventures, which provided a Series A round of funding in 2011. “The network was small – around Shanghai Jiaotong University – but we like the platform model and it has grown very fast.”

While Ele.me initially focused on the low-end catering market for students, JinShiSong went after corporate customers. The founders decided that restaurants would sign up if there was the potential of selling food by the office-load.

Fast forward several years and food-ordering platforms enjoy a prominent position in China’s online-to-offline (O2O) universe. According to internet consultancy iResearch, food will represent one of the largest vertical segments of the O2O market by 2015, with 300 million customers and a value in excess of RMB270 billion ($44 billion). The segment is now a regular recipient of venture capital funding and, in an increasingly competitive environment, the jury is out as to which enterprises will prevail.

The copycats

If China’s start-ups are want something to aim for, they need look no further than GrubHub in the US. Founded by two MBA students in Chicago in 2007, the company received its first VC funding in 2007. Last year it went public, raising $192 million.

GrubHub’s platform, which covers 30,000 restaurants, handled more than 135,000 orders in 2013 with gross food sales of $1.3 billion.

Revenue – a percentage of each order, paid by the restaurants – jumped from $82.3 million in 2012 to $137.1 million last year partly as a result of a merger with rival Seamless Holdings. Net income reached $6.7 million in 2013.

Michael Lewis’ inspiration when he co-founded JinShiSong in 2010 was Seamless rather than GrubHub. He used the service when working for J.P. Morgan in New York and, on moving to Beijing, found there was no equivalent. Sherpa’s started in Shanghai as early as 1999 and K.K. Rabbit followed in 2008. Both have since expanded to a couple of locations beyond Shanghai, including Beijing, but Lewis says he saw nothing with a nationwide mandate.

By the time Lewis departed JinShiSong in 2012 the company had broken even, been backed by ZhenFund, and was looking to expand into new cities. “We had a system based on the Android platform that allowed us to track orders and the locations of our drivers,” Lewis adds. “Now it is easy to find something online that does the same thing but this was early on so it was proprietary. Our rivals were very manual in their approach, relying on SMS and phone calls.”

JinShiSong now offers services in Shanghai, but like Sherpa’s and K.K. Rabbit, it is not on the brink of a nationwide rollout, nor can it claim a dominant position in its home market. There are several explanations for this. Sherpa’s, for example, is said to have remained at the high-end of the market, focusing on the expatriate community. And then all three companies differ from GrubHub in two respects: they charge the customer for delivery, not the restaurant; and they maintain their own delivery fleets. Both could be seen as obstacles to achieving scale.

There are practical reasons for keeping a fleet of drivers. Higher labor costs in the US mean such an indulgence is simply not economical, while China’s population density is significantly higher, allowing for greater operational efficiency. But due to the capital-intensive nature of the business, expanding into different geographies is expensive and sometimes complicated.

“Managing the people is the main challenge when scaling up,” says Ray Yang, managing director at Northern Light Venture Capital (NLVC), citing the experiences of portfolio company Daojia. “Costs go up and it’s hard to attract people willing to do the dirty work, the driving. It is not like hiring programmers out of university; you have to recruit and train people.”

The company received a Series A round from Morningside Technologies in 2010, the year it was founded. When NLVC participated in the Series B led by CDH Investments in 2011, Daojia had less than 20 delivery hubs in Beijing and one in Shanghai. It now claims one million users in eight cities, 3,000 restaurant partners and 1,000 delivery staff. Online retailer JD.com led a Series C round last year as well as a Series D last week. The capital will be spent on technology development, particularly on the mobile side, and expanding services to 20-30 cities by 2015.

Critics of the online-platform-plus-logistics-network model point to the costs involved and how these can eat into margins. “Restaurants are busy at lunchtime and dinnertime,” says Chuan Thor, managing director at Highland Capital Partners. “It doesn’t matter how big the logistics group is, sometimes you have too many customers and you cannot make all the deliveries yourself. But then if you have 1,000 logistics guys what do you have them do after lunch and before dinner?” It is also a difficult operation to replicate, which creates high barriers to entry.

Certainly, other companies in the space that have gained traction with venture capital tend to follow the asset-light GrubHub model. In addition to Ele.me, these include Etaoishi, a food ordering platform that launched in 2012 and received a Series A round led by Highland last November and a Series B led by Hosen Capital last week.

The company has partnerships with more than 20 local restaurant chains and wants to sign up a

“The internet is winner takes all. In pretty much every sub-sector it ends up with only 2-3 people”

– Allen Zhu
multiple of that number by the end of the year.

It is worth noting that Ele.me and Etaoshi’s target market differs somewhat from that of Daojia. While the latter is looking for restaurant customers that can’t or don’t want to take on the expense of complex in-house logistics operations, the other two companies often work with restaurant operators that are large enough to run their own deliveries.

They are also able to scale up at a much faster pace. When Sequoia Capital led Ele.me’s Series C round last November, the five-year-old company was handling about 100,000 orders a day and had 2 million registered users and 20,000 restaurant partners. However, Ele.me is still not taking a commission on each transaction – revenue comes from restaurants paying for prominent positions in search rankings – due to the amount of competition it faces.

**Defensive plays**

Further competition is inevitable almost regardless of business model. And the contrast between Daojia and Ele.me or Etaoshi is also reflected in the kind of strategic investors that have come on board to help head off rivals.

In JD.com, Daojia not only has a backer with its own platform and user base, but also one that is highly focused on logistics. JD said in its IPO prospectus that it would spend $1 billion on supply chain improvements over the next three years, citing “the underdevelopment of third-party fulfillment services in China in terms of both warehousing and logistics facilities and last-mile delivery services.” Ahead of the public listing it already had 24,400 delivery personnel.

Daojia exists within the “last-mile” space, transporting food short distances within urban areas under strict timeframes. NLVC’s Yang suggests that Daojia could actually help JD in this area in terms of providing quality services.

For Etaoshi and Ele.me, the onus is on aligning with groups that can expand their platform coverage. In May, Ele.me received $80 million from Dianping, a provider of restaurant reviews, online listings and Groupon-style discounts. They will share user and merchant data and integrate their food ordering services. The alliance with Dianping is also expected to bring more mid to high-end restaurants to Ele.me, whose client base still reflects the low-end, college student offering on which the business was built.

Etaoshi has yet to receive similar strategic investment but partnerships have been formed with search giant Baidu, antivirus software and browser provider Qihoo 360, Alibaba Group’s e-commerce platform Taobao and group buying site Meituan.

“These companies are very good at the online side but they aren’t as effective in terms of O2O,” says Highland’s Thor. “We are bringing the offline business online. All the information is real time – when a restaurant changes its prices all the channels are updated simultaneously.”

GrubHub has consolidated its position in the US through a string of horizontal acquisitions. In addition to Seamless, the company has picked up businesses that allowed it to address certain market niches, such as food-ordering from college campuses and professional sports venues. While it is feasible that one of China’s food-ordering platforms might build up sufficient momentum to go public, the argument is also made that some players – the pure-play platform providers in particular – would be most sustainable as part of larger companies with complementary business functions.

Zhu of GSR says it is too early to be drawn on the exit options for Ele.me and its rivals. But he does expect to see consolidation within the industry.

“When we first invested in Ele.me there were quite a few platforms and some have not survived because execution is so important,” Zhu says. “The internet is winner takes all. In pretty much every sub-sector it ends up with only 2-3 people.”

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Inside advantage

For the past 30 years Advantage Partners co-founder Richard Folsom has enjoyed a front-row seat on the inner workings Japan's corporate world – here he shares his insights.

WHEN RICHARD FOLSOM, CO-FOUNDER

and representative director of Advantage Partners, first passed through Japanese immigration control in 1980, his motivations extended far deeper than business. Folsom had been sent as a missionary by the Mormon Church – a role he volunteered for without knowing where he would be sent, or that the destination would have such a profound impact on his life and career.

"I didn't anticipate that I would be sent to Japan – in fact I had lived in Germany for a couple of years as a child and spoke a reasonable amount of German, so I thought they might send me there," recalls Folsom. "But I guess they figured if I could learn German, I could learn Japanese too – so it was destiny if you want to call it that."

Sent to the northernmost island of Hokkaido, Folsom had plenty of opportunity to immerse himself in Japan's language and culture. The experience impressed him so much that on returning to college two years later, he decided to add Japanese as a major to his economic studies. By the time Folsom graduated in 1984 his mind was set.

"When I graduated from college I started looking for a job that would bring me back to Japan," he says. "I didn't look for anything in the States – all I wanted was to come back to Japan."

Light bulb

It was Bain & Company that would be his ticket back. The consulting firm was in the process of populating its Tokyo office – which it had opened only two years earlier – and was in search of young Japanese-speaking Americans who were just coming out of college. Folsom fit the bill and by 1985 he was back in Japan.

Folsom would stay with Bain for five years – interrupted by a two-year stint at Wharton School of the University of Pennsylvania where he read his MBA. It was at Bain that Folsom met his eventual business partner and Advantage Partners co-founder, Taisuke Sasanuma.

"We were at Bain together from 1986 to 1988 and in that timeframe we got to know each other and work on a number of projects together, and that was when we began to discuss our future ambitions and plans for starting our own business," says Folsom.

It was during that period – the boom time of the mid to late 1980s - that Folsom and Sasanuma were first exposed to the concept of private equity through Bain Capital, a new investment firm set up by a group of former Bain & Company consultants in 1984. Folsom recalls how he and Sasanuma first got to meet the founders during a worldwide employee meeting. "I remember us sitting in one of those worldwide employee meetings combined with Bain Capital and listening to Mitt Romney and his partners present some of their most recent success cases," says Folsom. "Taisuke and I just looked at each other and this proverbial light bulb went off in our heads. We thought: 'This could be a great business if we could bring it to Japan.'"

Folsom and Sasanuma established Advantage in December 1992 but it was another five years before they launched their first fund. The reason for the delay was that two major pieces of legislation had prevented buyout funds from being formed. First, the Antitrust Law forbade financial investors from owning a majority stake in any business. Second, there were provisions stopping any funds from nominating members to the boards of portfolio companies.

However, with the bursting of Japan's economic bubble in 1991, Folsom and Sasanuma calculated that it would only be a matter of time before the rules changed and private equity would be made possible. In the meantime, the pair put PE on a back burner and sought out other opportunities.

In the early years, the pair started two businesses: a value-added tax (VAT) reclamation service for corporations looking to recoup taxes on various businesses expenses, primarily in the EU; and later an insurance brokerage and risk management business, which was sold to a larger US firm in 1998.

By 1997, the regulatory changes Folsom and Sasanuma were waiting for finally came through. Private equity buyouts were possible in Japan, and it was time for Advantage Partners to raise a fund. Folsom recalls the challenges that came with raising a first vehicle in a country where the concept of private equity was still alien. They were only able to gain momentum once the PE firm managed to get two of Japan's largest trading houses on their books – Marubeni and Mitsubishi Trading Corporation.

"Both of them had people in their team who had spent time in New York or London, had been involved in equity and debt finance in buyout deals, and had recently returned to Japan looking to see if the environment was ripe in Japan for this kind of business as well," says Folsom. "So they understood what we were talking about and it clicked with them immediately."

Small beginnings

With Marubeni and Mitsubishi on board, Advantage was able to raise more commitments from other Japanese institutions affiliated with the two trading houses. Fund I ended up with a corpus of JPY3 billion (around $30 million). "It was a small fund but I don't think anyone else was doing what we were doing at that time," recalls Folsom. "There were no investments or established deal flow in that period, so in the beginning we were just out there beating the bushes trying to generate deal opportunities."

Five deals came out of that first fund. One that stands out in Folsom's memory is Icreo – the re-branded food business carved out from the US pharmaceuticals firm American Home Products, later Wyeth, and since acquired by Pfizer. Its main product was a premium baby formula competing against products from three major domestic milk producers.

"It turned out to be a perfect small carve-out buyout transaction – we were able to do some
financial restructuring, help them in terms of marketing and product strategy, and grow the business over the three-year holding period to generate a 7x exit," says Folsom. "It was a real showpiece for the fund"

Over the ensuing years Advantage went from the strength to strength, raising around $80 million for Fund II and then $500 million for Fund III. Meanwhile, some highly publicized deals boosted the GP's profile – among them was beleaguered general merchandise store and supermarket chain Daiei in which Advantage bought a 23.4% stake with the government-backed Industrial Revitalization Corp. of Japan and Marubeni Corporation in 2005.

Hard times

However, the firm also took some hits. Everyone felt the impact of the global financial crisis and Advantage was no exception when it came to Tokyo Star Bank. The PE firm bought a majority stake in the lender via Fund IV – its largest vehicle at around $2 billion – for JPY170 billion in 2007 but struggled with the asset after the crisis. Eventually Tokyo Star was surrendered to creditors in 2011 after debts tied to the acquisition went unpaid. Advantage and its co-investors were left with a complete write-off.

"Having to write off Tokyo Star Bank was a real low point for us," says Folsom. "I think investors thought it might be the end of Advantage Partners as it was too big a loss to overcome – and perhaps we questioned ourselves – but we were determined. We felt what we were doing with our portfolio companies, and the way we were doing it, was still a successful model."

Arguably the PE firm’s saving grace was a handful of strong exits that came from the same fund as Tokyo Star; among them Folsom counts coffee shop chain Komeda, sold to MBK Partners last year, and condominium management company United Communities, exited to Tokyo Community around the same time.

"It was the strength of these home-run exits – bringing the fund above sea level and putting us on a trajectory for a reasonable return – that helped us regain the confidence of our LPs," says Folsom. "There were a lot of lessons learned from Tokyo Star. We can’t always predict major economic changes, and that was part of it, but certainly we learnt a lot about how we structure and price our investments and how conservative we are on certain projections.”

Things have since started to look up for Folsom, Advantage and Japan as a whole. It is now just over a year since the GP reached a $200m close on its bridge fund – the first since Fund IV – and the firm continues to make exits while taking advantage of a gradually improving macroeconomic situation to target new opportunities. Folsom remains cautious but optimistic.

"We have never had a tailwind in our 20 plus years in this market but maybe we are getting some of that today with Abenomics," says Folsom. "However, it remains to be seen’’

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“Taisuke and I just looked at each other and this proverbial light bulb went off in our heads. We thought: ‘This could be a great business if we could bring it to Japan’”

– Richard Folsom

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

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

**Speaking enquiries:**
Joy Qian
T: +852 3411 4866
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**Sponsorship enquiries**
Darryl Mag
T: +852 3411 4919
E: Darryl.Mag@incisivemedia.com

**Website:**
avcjtaiwann.com