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EDITOR'S VIEWPOINT

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The consumer counts

ONLINE USED CAR TRADING PLATFORMS in both India and China have received capital from private equity investors in the past week. The deals threw up a number of interesting industry statistics.

First, India, where trading platform Mahindra First Choice Wheels (MFCWL) raised $15 million from Valiant Capital Management, a San Francisco-based hedge fund. The country sees 3.2 million used cars traded each year, which means the second-hand market is already bigger than the market for new vehicles. It is expected to be nearly twice the size of the new car market within five years.

China is, as it stands, the polar opposite. There were six million used car transactions last year, with passenger vehicles accounting for 3.5 million of them. New car sales were much higher, coming in at 23.5 million units. The implication is that the second-hand market in China could be poised for extraordinary growth. Indeed, it is worth noting that two-and-a-half times more used cars than new cars are traded each year in the US.

The question for investors seeking exposure to this anticipated growth is where to enter. Substantial amounts of capital have been deployed in the industry, most of it targeting the business-to-business (B2B) space, i.e. wholesalers and dealerships trading used vehicles amongst themselves. But is this the best course of action?

The underlying thesis is strong: Private capital wants to be a force for disintermediation, taking advantage of information asymmetries and inefficient distribution channels. Through a combination of scale and technology – online trading platforms completed by offline centers at which buyers can literally kick the tires – the objective is to make trading less opaque, removing the inherent distrust that exists between buyer and seller.

B2B platforms certainly achieve scale but it remains to be seen whether this can translate into profit. Acting as an online intermediary between wholesalers brings with it limited bargaining power, while the battle for market share has seen rebates liberally distributed among dealerships in return for business. As a result, margins are thin.

Consumer-facing segments, on the other hand, offer more scope for value added services and higher margins. This involves facilitating sales of vehicles by consumers to used car wholesalers (C2B) or, more commonly for VC-invested businesses, operating a platform through which these wholesalers sell on the vehicles to a new batch of consumers (B2C).

In this context, the other significant investment last week in a used car trading platform – which saw KKR team up with search giant Baidu and US-based hedge fund sponsor Coatue to invest $170 million in Uxin – makes sense. Uxin is the prime mover in the B2B space through Youxinpai, competing against Cheyipai, another VC-backed group. It will use the new injection of capital to drive expansion into B2C services, having recently launched a platform dedicated to connecting auto retailers with used car buyers.

This doesn't necessarily signal a lack of confidence in B2B. For example, one key difference between the Chinese and US markets is the former has yet to see a critical mass of supply coming from car rental companies (fleets are still relatively young). However, this is gradually changing and it should have a positive impact on the B2B players' margins.

Rather, first of all, Uxin is looking to broaden its coverage of the used car industry with a view to extending its dominance. (When Waburg Pincus invested in the company last year comparisons were drawn with the emergence of Manheim as a leading player, albeit in a pre-digital age.) Second, there is a recognition that many of the most valuable online and mobile services are predicated on consumer engagement.

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NEWS

ASIA PACIFIC

TPG adds UTC executive to Asia operations team

TPG Capital has appointed Zubin Irani, previously of United Technologies Corporation (UTC), as a managing director within its Asia Pacific operations group. Irani, who is relocating from New Delhi to Singapore for his new role, will focus on building out the private equity firm's operations capability, and help implement performance improvement and talent management initiatives for portfolio companies.

AUSTRALASIA

Chile's Grupo Arcano to back Australian start-ups

Chilean private equity firm Grupo Arcano plans to invest up to $100 million over the next two years in Australian start-ups. It will focus on companies developing technology for healthcare, energy production, e-learning and agriculture.

VentureCrowd partners with Sydney Angels

Equity crowdfunding platform VentureCrowd has formed a partnership with angel investor group Sydney Angels in order to allow start-ups to tap new sources of capital. The tie-up means that Sydney Angels - which has made 35 deals since it was formed in 2008 - will refer its start-ups to the platform.

GREATER CHINA

Tiantu commits $32m in dining mobile app

Consumer-focused GP Tiantu Capital has invested RMB200 million ($32 million) in a Series A round of funding for Kaizhuo, a mobile app can be used to make restaurant bookings and payments. The new capital will be used to develop mobile payment technology and build relationships with more merchants.

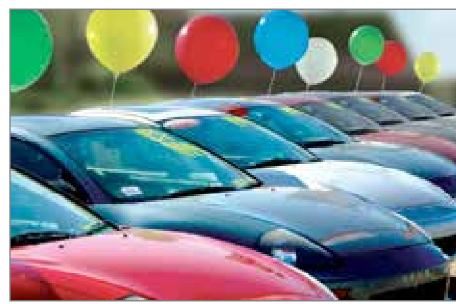
Alibaba backs Israeli venture fund

Alibaba Group has made an LP commitment to the latest fund being raised by Israel-based VC firm Jerusalem Venture Partners (JVP). It comes two months after the Chinese e-commerce giant made its first director investment in Israel. The commitment is said to be worth $15 million.

China used car platform gets $170m round

KKR has teamed up with search giant Baidu and US-based hedge fund sponsor Coatue to invest $170 million in Uxin, a Chinese online used car auction company best known for B2B platform Youxinpai.

The capital will be used to support Uxin's expansion in the B2C space, following the launch of Uxin Used Car, which connects auto retailers to used car buyers.



Founded in 2011 by executives from listed online auto advertising business BitAuto, Uxin is already a dominant B2B force through Youxinpai. It is China's largest used car auction site with a 47.8% market share by transaction volume in the first half of 2014, according to consultancy iResearch.

When Warburg Pincus and Tiger Global Management led a $260 million round for Uxin in September 2014, the online offering was complemented by six offline centers providing auctions and other services, and it had worked with about 15,000 car sellers. Now Uxin claims to employ over 1,000 specialists in 50 Chinese cities who inspect and certify the quality of used vehicles sold via its platforms. The company facilitates more than 150,000 transactions each year.

South Beauty founder's asset freeze upheld

A Hong Kong court has supported a move by CVC Capital Partners to freeze the assets of Lan Zhang, founder of China restaurant chain South Beauty, which was bought by the GP last year. CVC is said to have paid around $300 million for a majority stake in South Beauty, with Zhang remaining a shareholder and continuing to participate in strategic decisions. However, revenue has reportedly fallen dramatically since the acquisition.

Sailing makes partial exit from Israel-based Mobileye

Sailing Capital has raised $77.5 million by selling a portion of its shares in Mobileye, an Israel-based road accident avoidance technology developer that went public in the US in August last year. The GP sold about 1.9 million shares at $40 apiece, according to people familiar with the situation.

Hong Kong's Nest appoints ex-Intel executive

Hong Kong-based seed investor Nest has appointed Peter Dingle, formerly of Intel Corporation, to lead its newly-established Branded Accelerators program. Under the new initiative, Nest will customize accelerator programs for different multinational corporations.

Sequoia backs Noah's online financial platform

Sequoia Capital has invested in Shanghai Noah Yijie Financial Tech, an internet finance subsidiary owned by Noah Holdings. The investment will be used to strengthen the platform's offering in areas such as mutual funds, insurance and US dollar-denominated investment products.

Taiwan incubator raises $50m start-up fund

AppWorks, a Taiwanese incubator, has raised NT$1.5 billion ($50 million) for a new fund to support domestic internet start-ups. The vehicle, AppWorks Fund II, has received commitments from a number of Taiwanese corporations and financial institutions.

NORTH ASIA

INCJ invests in laser manufacturer Spectronix

The government-backed Innovation Network Corporation of Japan (INCJ) has agreed to invest up to JPY500 million ($4.2 million) in laser manufacturer Spectronix. The company will also receive additional undisclosed financing from funds managed by Daiwa Corporate Investment, Mitsubishi UFG Capital, and Senshu Ikeda Capital.

Japan's Rakuten to acquire VC-backed US eBook firm

Rakuten will pay $410 million to acquire US-based digital book marketplace OverDrive from Insight Venture Partners, a US private equity

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NEWS

firm. OverDrive's distribution platform, which includes over two million titles, along with streaming music and videos, will be integrated with Rakuten's global network, as will its ebook rental service.

Hahn & Co's Cowell e Holdings eyes $153m IPO

South Korea-focused GP Hahn & Co. is set for a partial exit from electronics manufacturer Cowell e Holdings as the company seeks to raise up to HK$1.19 billion ($153 million) through its Hong Kong IPO. The company – a major supplier of camera modules used in Apple devices – will sell 208 million shares at HK$4.00-5.75 apiece.

SOUTH ASIA

PE investors commit $96m to microfinance player

A consortium of private equity firms, including CX Partners, CDC Group, NewQuest Capital Partners and Bajaj Holdings, has invested NR6 billion ($96.2 million) in Indian microfinance institution (MFI) Ujjivan Financial Services.

IFC proposes $20m investment in NxtGen

The International Finance Corporation (IFC) is considering an investment of up to $20 million in Indian IT data center construction and management firm NxtGen Technology, in a deal that will involve both equity and debt. The funds will be used to expand the company's services and to complete an in-progress construction project.

Valiant backs used car trading platform

Indian used car trading platform Mahindra First Choice Wheels (MFCWL) has raised $15 million from Valiant Capital Management, a San Francisco-based hedge fund. It will take a minority stake in the business. MFCWL, which is controlled by the Mahindra Group, claims to be the country's leading multi-brand certified used car player

Trifecta secures RBL as anchor, raises target

Trifecta Capital, the venture debt firm set up former Canaan Partners Managing Director Rahul Khanna, has secured a INR500 million ($8 million) anchor investment from RBL Bank for its debut fund, and set a new target of INR4 billion. The vehicle was launched late last year with a target of INR3 billion. Registered as a Category II alternative investment fund (AIF), it is the first of its kind in India.

ChrysCapital invests in South Indian Bank

ChrysCapital Partners has paid INR527.8 million ($8.4 million) for a stake in listed lender South Indian Bank (SIB). The GP bought 20.5 million shares – or 1.5% – INR25.75 apiece, earlier this week in a bulk trade on the Bombay Stock Exchange (BSE) via its investment vehicle Lavender Investment. Also this week, Kotak Mahindra bought 28.5 million shares in the company, while India Capital Fund sold down 48.9 million shares.

VC-backed Snapdeal buys stake in logistics platform

Jasper Infotech, the VC-backed enterprise behind Indian online marketplace Snapdeal, has bought a 20% stake in QuickDel Logistics, operator of e-commerce logistics platform Gojavas. Snapdeal paid INR1.2 billion ($20 million) for the stake, valuing the business at INR6 billion.

Kedaara invests $32m in Indian packaging firm

Kedaara Capital has invested INR2 billion ($31.8 million) in India's Parkson Packaging – a maker of printing and laminated packaging cartons backed by ChrysCapital – for an undisclosed stake. It is not yet clear whether the investment represents an exit for ChrysCapital. The GP invested $25 million in the firm in 2006 for a 21% stake.

Bain to buy Japan Wind Development

Bain Capital Partners is set to acquire Japan Wind Development (JWD) - a leading Japanese wind farm developer - in a JPY9.7 billion ($80 million) take-private transaction.

Founded in 1999, JWD currently operates 18 wind farms across Japan and a further three in Germany. Bain - which expects to close the deal in early May - plans to grow the business further by focusing on operational improvements in existing wind farms and developing new facilities.

Alternative energy sources have been in high demand in Japan since the 2011 Great

East Japan Earthquake, which triggered the Fukushima Daiichi nuclear disaster, and the subsequent shutdown of the nation's nuclear reactors. In order to meet the country's increasing energy demands the Japanese government is subsidizing the development of green energy. Wind power currently accounts for 0.5% of the country's energy mix, but the government wants this to reach 5.1% by 2030 - up from the 1.7% target set prior to the earthquake. Subsidies have been provided through the FIT (feed-in tariff) system since 2012 and there is also a guarantee of fixed purchase price for electricity from renewable sources for the next 20 years.

SOUTHEAST ASIA

Ekuinas buys mobile payments firm, schools

Ekuinas, the Malaysian government-backed private equity investor, has acquired two companies – mobile payment platform Tranglo and private school chain Tenby Educare – for a total MYR124 million ($33.8 million). Ekuinas paid MYR54 million for 60% stake in Tranglo and MYR70 million for 70% stake in Tenby.

Creador commits $24m to Indonesia's Bank Index

Creador Capital has paid IDR290 billion ($24 million) for a 20% stake in Indonesian lender Bank Index Selindo. The new funding will raise Bank Index's core capital to IDR900 billion and lift its capital adequacy ratio to 22.2%. The lender hopes to provide credit card and internet banking services by next year.

Elixir Capital backs Indonesian recycling firm

US-based Elixir Capital has agreed to invest $4.5 million in Indonesian recycling company Bintang Makmur, through its ECM Straits Fund. Bintang Makmur will use the funds to create new recycling sites and hire more workers in Java and Bali.

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A ticking clock

All the talk of a swath of GP restructurings in Asia has yet to become reality. As India and China funds raised during the heady times inch closer to the 10-year mark, are we about to see a breakthrough?

FOUR TIMES IN THE LAST 20 OR SO YEARS, Mahon China has been called in after – as one investor puts it – LPs "pressed the nuclear button." Since the global financial crisis, the firm has specialized in restructuring and rehabilitating stalled or distressed assets in China. In certain situations it is the GP, not the assets, that are stressed, and investors in the fund resolve to bring in a new team to manage a portfolio.

The most recent case arose two years ago and concerned a GP that was suspected of misconduct. Mahon China advised the LPs as to whether they had leverage to replace the manager. They did, and the firm was duly appointed as the replacement GP. "Essentially what we do is step in when trust has broken down between the investors and the manager," says David Mahon, managing director and CIO of Mahon China.

Misconduct shatters this alignment of interest and limited partnership agreements (LPA) allow LPs to act upon it. In most cases, however, alignment gradually erodes over time as the GP fails to deliver on its promises. A fund might achieve "zombie" status when the manager is sitting on the assets purely for the fee income they generate, recognizing that a successor vehicle will not be raised. There is a reluctance to pursue exits because this reduces the assets under management and therefore the fees.

Removing the GP is a priority but LPs note that their powers can be limited. Situations are rarely as clear cut as the one outlined above and such drastic action requires the support of investors representing a comprehensive majority of the capital – in some cases up to 80%. Achieving consensus is difficult given each LP has its own objectives, priorities and competencies while the GP may actively resist change.

Mahon adds that LPs are sometimes reluctant to take action for fear of the questions that would be raised internally. "It is often better to replace the GP with people who are properly motivated, but it rarely happens because the LPs have to acknowledge that the GP is not performing," he says. "They don't want to admit that their decision to invest in the fund was flawed. This is the biggest barrier."

Kicking out the manager represents the sharp end of GP restructurings, yet several investors expect them to become a more common in Asia as frustration grows with GPs, notably in India and China, that have made minimal distributions. They are part of a much anticipated wave of restructurings in the region – so anticipated, in fact, that the phenomenon was being talked up two years ago.

While there are now hints of activity in India, it is premature to declare a panacea. The reality is that restructurings are tough to negotiate and really only work when every party involved believes it has something to gain.

"There was talk of a lot of restructurings globally but fewer deals than expected have actually closed," says Peter Kim, investment principal at Coller Capital. "These transactions are complex. In most deals there is a seller and a buyer, but in restructurings you have three parties: the seller or multiple sellers; the GP, which is very involved in the process; and the buyers, typically secondaries funds. You need a lot different interests to become aligned to make something happen."

> "If you come across a $50 million interest in a fund, you know that if the reserve price is met the full amount will transact. With a restructuring you can't be sure if you will get the uptake"
>
> – Adam Howarth

Death by numbers

Asia has followed the global norm in recent years with private equity fundraising dropping off as LPs seek to consolidate their GP relationships. More capital is going to a smaller number of players: funds reaching a final close in 2014 raised the third highest annual total on record, but the number of vehicles crossing the finishing the line was the lowest in more than a decade.

Look at India and China more closely and the picture becomes starker. Between 2006 and 2009, 112 India-focused vehicles achieved final closes, raising more than $19 billion. Over the five years that followed, $7.9 billion was raised by 71 funds. According to AVCJ Research, 90 private equity firms were responsible for the 112 final closes in 2006-2009 as some GPs raised multiple vehicles. Just 19 of these 90 managed final closes on successor vehicles between 2010 and 2014.

In China the phenomenon is similar, albeit less developed. The country's peak fundraising years were 2007-2011, when $41.7 billion went into 168 US dollar-denominated funds reaching a final close. (Renminbi vehicles have been excluded for the purposes of this analysis because they are still largely off limits to the leading secondary investors.) A total of 106 different GPs raised funds during this period, but only 37 of that number have completed a fundraise since then.

The classic GP restructuring would give these private equity firms more time to prove themselves. While some or all of the LPs want to their capital back, the management team still has faith in these assets and its ability to extract value from them. If it can identify some investors who think likewise, the portfolio can be acquired from the existing fund and housed in a new one with new LPs and different economics. The proceeds from the sale go to the LPs that wanted out.

However, these deals can come in all shapes and sizes, depending on the needs of the parties involved.

For example, the GP could simply amend the existing LPA to allow for the exit of existing investors and their replacement by new investors. This might be accompanied by stapled commitments to a new blind pool of capital. Alternatively, if the onus is on providing immediate liquidity, a slice could be carved out of the portfolio and placed into a new vehicle. The existing fund remains – it is run alongside the new vehicle, which may have a different investor

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base – and LPs have exposure to the remaining assets, but they also receive the sale proceeds as distributions.

If GP removal falls towards the acrimonious end of the spectrum then spin-outs are at the other end: management is highly incentivized to get a restructuring done because they get to set up their own platform, often buoyed by a pool of primary capital to make new investments.

"Where you have key people on the ground who are motivated to do a deal, that is when things get done. They will coordinate, convince and make things happen," says Brooke Zhou, executive director for Asia Pacific private equity at LGT Capital Partners. "When a GP is sitting on a fund and wondering whether it is able to raise another, the motivation factor is not as clear, considering the potential risks they face."

It is no coincidence this is where Asia has seen activity, from NewQuest Capital Partners in 2012 to Lightbox last year. Both spin-outs were helped by the previous LP bases being small and the LPs keen to get out – and not necessarily due to underperformance. NewQuest was originally the Asia PE team at Bank of America Merrill Lynch, which left the asset class due to changing regulations. Kleiner Perkins Caufeild & Byers (KPCB) and Sherpalo Ventures, the original backers of the Lightbox team, exited for strategic reasons.

Negotiating points

When dealing with a large group of LPs consensus is harder to find. Price is an obvious stumbling block. The seller doesn't want to be accused of offloading a position on the cheap while the buyer has certain return hurdles to meet. In the middle sits the GP, which may bridge the divide by giving up some of its own economics in order to secure a deal.

However, the negotiations go far deeper than this. If, for example, there is going to be a full restructuring and the selling entity will no longer exist, the buyers may be unhappy with the level of protection offered by the indemnities. A question mark over an audit of an individual portfolio company can therefore take on huge importance – if the buyer is not entirely comfortable with information presented this could derail any agreement or at least have a negative impact on price perception.

Jason Sambanju, head of Asia private equity secondaries at Deutsche Asset & Wealth Management, advocates care when engaging with LPs. "If you communicate too early you risk inertia; communicate too late and LPs might feel they are being forced into a corner," he says. "Managing the flow of information is very important."

This is arguably where what would have been Asia's highest-profile restructuring came up short. Australian GP Ironbridge Capital put forward a proposal whereby LPs in Funds I and II would exit their positions or roll over into a new vehicle holding the assets – and participate in a stapled secondary for a new vehicle. It was criticized by LPs, with some claiming that Ironbridge had no right to demand a primary commitment as a condition of rolling over.

The proposal was dropped and the transaction switched to a standard secondary sale as a number of investors took the opportunity to exit.

"There are so many factors that go into it and there is a lot of uncertainty," adds Adam Howarth, managing director and co-head of PE secondaries, Partners Group. "As a buyer you spend a lot of time and resources on negotiations without knowing the uptake. If you come across a $50 million interest in a fund, you know that if the reserve price is met the full amount will transact. With a restructuring you can't be sure if you will get the uptake."

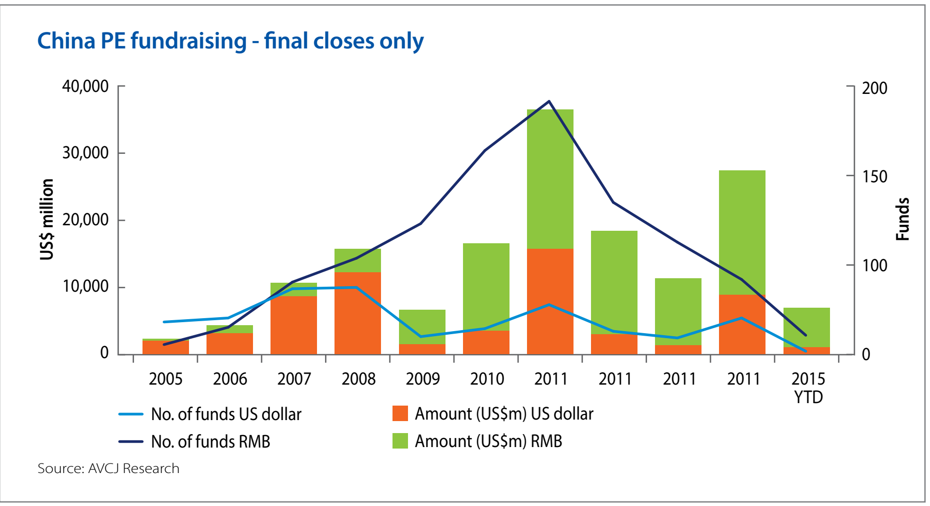
Alternative routes

There are also methods through which a GP can extend its life, or at least its options, aside from a full restructuring. A number of private equity firms in Asia are understood to be operating on a deal-by-deal basis. They want more time to prove themselves on their existing funds or they recognize that performance is poor, and so taking potential investments to LPs on a speculative basis is a means of restating or rebuilding the track record.

Another course of action is to explore smaller, one-off stapled secondary arrangements. While the original Ironbridge proposal saw a tender offer put to all LPs, other private equity firms are opting for a more low-key approach. If it becomes clear that a couple of LPs are not going to re-up, the GP can facilitate their exit – provided they can be convinced to sell – from the existing vehicle and bring in investors who buy the position and also commit to the new fund. There is no fund restructuring, but the GP takes a step towards guaranteeing its future.

"If they were to consider something bigger like a GP restructuring then they do need to think about the type of headline risk they face," LGT's

Source: AVCJ Research



Source: AVCJ Research

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Zhou adds. "With these smaller deals, you don't have to disclose it to all the LPs – unless they are legally obligated to do so such as a right of first refusal to their existing LPs – and definitely not to the entire market."

A further option is to secure exits on a portfolio or single-asset level, selling assets directly to a GP that assumes the management role. NewQuest's current remit is to acquire such assets, leveraging the team's past experience of managing and exiting businesses. However, Darren Massara, managing partner at the firm, notes that the model may ultimately extend to serving as a replacement or supplemental GP for a fund where some of the original LPs remain in place.

"Either the LPs completely trust the GP and feel this is the right group to shepherd these assets to monetization or they want to bring in someone else to help them," he says. "There could, in theory, be a situation where they bring in a NewQuest. We could sit alongside the GP and help find resolutions to the assets they still have in their portfolios."

Size matters?

This is driven by a long-term view that more restructuring opportunities will emerge in time, just as they have in the US and Europe. What remains to be seen is how deal size impacts the frequency with which these transactions occur and the nature of the groups that pursue them.

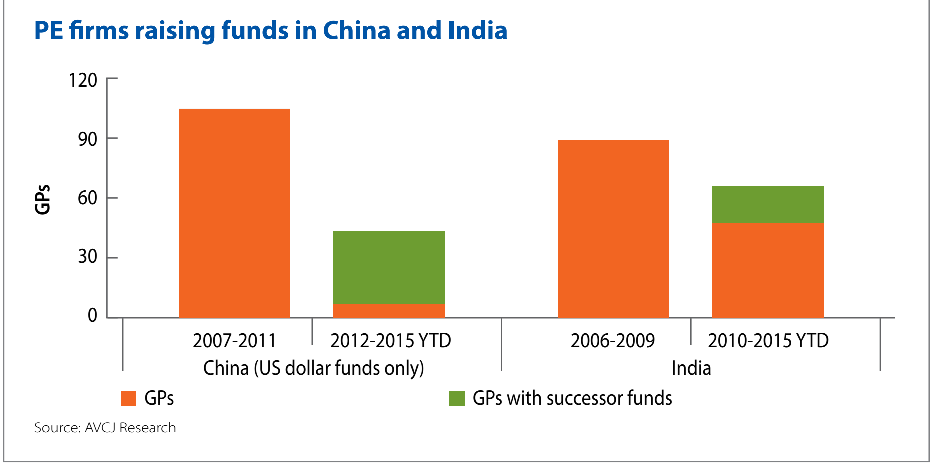
In November 2014, Intermediate Capital Group and Goldman Sachs led a $860 million restructuring of US-based private equity firm Diamond Castle's 2006 vintage fourth fund. A number of existing investors achieved liquidity while the Diamond Castle team will continue to manage the assets. The Ironbridge deal, had it been completed as a restructuring, might have been of comparable size but Diamond Castle is several times larger than Lightbox.

Given the uncertainty involved in restructurings, investors in the US and Europe typically want to deploy a reasonable amount of capital. It begs the question as to whether there is a sufficient number of attractive candidates in Asia.

"There is a high risk-return profile in these deals and they are not going to want to go through the brain damage if only a small amount of dollars will be put to work," says Philip Tsai, managing director with UBS' private funds group in New York. "The larger deals that have been done in the US and Europe have generally been with managers that were somewhat tracked and known by the secondary buyer community."

The counterpoint is that the $200-300 million mid-market China and India funds from the 2006-2008 vintages might be more pliable. While funds like Diamond Castle will have dozens of LPs, these smaller players might have only one dozen. It is difficult to generalize on LP breakdowns, but fund-of-funds were particularly active in early vintage country-focused vehicles in Asia. Bearing in mind fund-of-funds are reasonably activist and many have a presence in Asia, NewQuest's Massara contends that they are well-positioned to nudge GPs in the direction of restructurings.

"These deals will still be GP-led but they might be a little more LP-initiated than in the US and Europe," he says. "They can be the ones who say, 'This is what is happening in the US and Europe, it has worked for a few GPs. You guys might want to think about it.'"



The LP response to this is mixed. They see it as sound in theory but more complicated in practice. Potential conflicts of interest are a concern if the secondaries arm of a fund-of-funds approaches a GP in which the primaries team holds an interest. Beyond that, an LP can only suggest, not force a manager to take a particular course of action – at least in the absence of a misdemeanor or a no-fault divorce clause in the LPA.

> **"Some years there will be none, other years there will be three or four. We just haven't reached a tipping point yet"**
> - Jason Sambanju

Since setting up shop in Asia, several secondaries investors have run initiatives intended to educate the market on what restructurings and other secondary solutions can help GPs achieve. Pitching a concrete proposal to private equity firms, however, is a different matter. "We have approached a couple of GPs in China and India with ideas for restructuring," says one LP. "They aren't motivated enough. They are reluctant to do it because of the PR risk and they are unsure if it would be to their benefit."

Day of reckoning

It all comes back to the amount of pressure these GPs are under. There remain two well-represented constituencies in both India and China: the first remain convinced they can raise new funds, regardless of the feedback they might receive, and are therefore unwilling to consider a restructuring; the second accept their fate as zombie managers and see no upside in giving up the current trickle of fee income.

This status quo cannot last indefinitely. The realization that the capital-raising environment is challenging will sink in or funds will near the end of their 10-year lifespan and GPs will start asking for one-year extensions. It is then that the LPs leverage will really begin to tell and restructurings – alongside other secondary solutions – will appear on the agenda. Howarth of Partners Group says he is already seeing it, with some PE firms now exploring their options as a result of feedback from LPs.

Deutsche's Sambanju is similarly positive, noting that the momentum in India and predicting a "very interesting" next 36 months. However, he cautions that deal flow is likely to remain lumpy, simply because that is the nature of the business.

"Six months from now a $200 million fund restructuring might come out of the woodwork and everyone will say it's the beginning of a slew of deals," he says. "It won't work like that. Some years there will be none, other years there will be three or four. We just haven't reached a tipping point yet."

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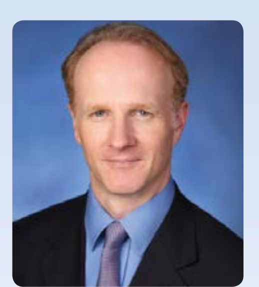

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Picking up speed

Internet-capable cars are a novelty now, but as they gain acceptance they could remake the way we drive. What are the most important factors for investors to watch down the road?

DRIVING A CAR MEANS PROCESSING VAST amounts of information – information about the state of the vehicle, road conditions, the weather, and other drivers. Right now that information is largely transmitted through a network of analog and mechanical sensors and processed by an organic computer: the human brain.

But various new technologies are challenging this century-old model. In the Tesla Model S, for example, an onboard computer collects data on the battery's charge capacity, transmits it over the internet to a remote center for analysis, and directs the driver to visit a service center without any command on his or her part. The connection goes the other way, too, with onboard navigation systems that automatically download maps as the driver moves between areas.

For Alibaba Group and SAIC Motors, this merging of internet and automobiles isn't a question of if, but when. The Chinese e-commerce giant and the car maker announced a RMB1 billion ($160 million) fund this month to invest in the development of connected cars. In addition, the two companies will launch a joint venture to build vehicles with Alibaba's hardware and software built in.

They are far from the only investors to see internet-enabled automobiles as the future. Intel Capital launched its $100 million connected car fund in 2012, and Nokia announced its own $100 million fund last year. However, as this is the first such fund launched by a Chinese firm, it is seen as confirmation that consumers in Asia are just as eager for the next era of driving as are those in the rest of the world.

Advantage Asia?

Jessica Archibald, managing director at Top Tier Capital Management, a US-based venture capital fund-of-funds, says she would not be surprised if VCs in Asia turned out to be more willing to invest in automobile-related projects than those in Western countries.

"If you think of a traditional venture capital investment in the US, it's either healthcare or it's software and hardware. It is rarely anything that deals with heavy manufacturing, like a car," Archibald says. She believes that investors in Asia, where VC is a younger field, may not face the same psychological barriers. By extension, they could see opportunities that their Western counterparts would be more likely to overlook.

On top of this, China is the largest and one of the fastest-growing car markets in the world, with nearly 20 million passenger vehicles sold last year. It is an irresistible draw for many Asian start-ups. "Most hardware firms in China, I think, when they first think about where they're going to attack the market, it would be in China first," says Jenny Lee, managing partner at GGV Capital, a Sino-US venture capital firm.

The maker of the finished car is not the only company that can profit from this growth. Contractors can sell their technology to manufacturers to be included in the finished product and earn money that way.

"If you can have three little sensors in every car that's being sold, that's a huge market," Archibald says.

In her view, those sensors represent the most likely path for near-term rewards. Though Tesla, Google and other car makers are trying to capture consumers' imaginations with promises of self-driving cars, those are long-term projects. However, manufacturers can begin adding technology to their products immediately.

The changes that will see the most immediate response are expected to be those that cater to consumers' growing demand for information. "There's a whole kind of phenomenon or migration going on where people want information now. They want a lot of information and they want it very quickly," Archibald adds.

Instant access

That demand has been building for decades, as consumers have been trained to expect information to be available instantly, in ever-growing quantities and contexts. Uninterrupted internet access became the standard first in businesses, then in homes. Finally, the creation of the smart phone made the internet a thumb-flick away. In some ways the car is the logical next step for internet access.

"The automobile represents the only device platform that today is largely unconnected," says Thilo Koslowski, vice president at technology consultancy Gartner. "For many consumers, such digital content is becoming an expression of their lifestyle, which they want to connect to throughout the day, including when driving a vehicle."

That expectation is no less in China, and in some ways the unique circumstances of the country present unique opportunities. For instance, the blocking of Google Maps creates an opening for local services to supply cars with the data that, in other countries, they could just download from Google.

> "The new automotive era of smart mobility will lead to significant changes that will … expand across multiple industries" – Thilo Koslowski

According to GGV's Lee, who says her firm is also considering opportunities in China's connected car sector, as developers become more familiar with the technology they will be able to stretch its applications further. In particular, businesses have potential to find very creative uses. For example, a rental car company could link a customer's car to his smart phone, allowing it to start automatically when approached and ensuring that nobody without the phone could operate it.

While Lee and Archibald caution against overexcitement about what is still evolutionary change, Gartner's Koslowski says investors need to be prepared for the long-term effects as each innovation gains acceptance.

"By 2020, there will be 150 million connected vehicles in the world," he says. "This new automotive era of smart mobility will lead to significant changes that will impact the fabric of the automotive industry and create new value and supply chains that expand across multiple industries."

The automobile and the smart phone both reshaped the world around them. Now the connected car stands to do the same thing. Investors will need to make sure they stay in the driver's seat.

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TA sees promise in YeePay's offline offering

CHINA'S THIRD-PARTY ONLINE PAYMENT market hit RMB8.08 trillion ($1.3 trillion) by gross merchandise volume (GMV) last year. Alipay, Alibaba Group's payment platform, is the dominant player with a 49.6% share, according to consultancy iResearch. Tencent Holdings' Tenpay ranked the second with 19.5%, followed by China UnionPay with 11.4%.

YeePay, with just 3.2%, has little chance of supplanting its rivals in the online space. As a result, the company has found itself a niche targeting offline merchants, which between them account for an estimated 20 times the GMV of the online market.

YeePay: Payment solutions

"While e-payment activity is growing from an already large base online, it's still has a rather low penetration offline," says Edward Sippel, TA Associates' managing director and co-head of Asia. "There aren't that many merchants using digital or mobile systems to process payments. Only 10% of small and medium-sized enterprises use payment technologies offline today. We think there are still a lot of opportunities in this space."

Last week, YeePay raised an undisclosed sum from TA and Hong Kong financial leasing business Far East Horizon. It is the company's fifth round of funding, following commitments by a range of VC investors.

YeePay differs from other third-party payment platforms in that it provides customized solutions for each offline merchant. Onrselling point is that it isn't Alipay. The market leader's core business is to facilitate payment for purchases made on TMall and Taobao. It is less likely to work with merchants that operate outside of the Alibaba universe, and certain merchants prefer to avoid Alipay if another Alibaba entity is in direct competition with them.

YeePay's appeal is therefore its independence. For instance, a commercial bank would prefer to have its own payment processing system because Yu'e Bao, Alibaba's money market fund platform, is luring customers away from traditional banks. It could opt for a customized service provided by YeePay. Online retailers JD.com and VIPshop are also customers.

YeePay's transaction volume last year came to $77 billion, up 100% on 2013. It specializes in certain verticals including airlines and travels, financial services, digital entertainment, fast-moving consumer goods and telecom. Driven by the government's promotion of non-cash payments and rising issuance of debit cards, more traditional stores are expected to install digital systems.

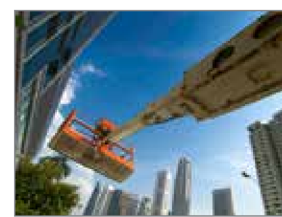
The partnership with TA and Far East Horizon could open the door to global collaborations and local penetration for YeePay. TA has backed online payment operators such as India-based BillDesk and BluePay Processing in the US, while Far East Horizon, which is part-owned by state-owned SinoChem Group, can offer important government relationships and local networks in China.

"It's a very powerful combination for YeePay because we both have very complementary strengths," Sippel says.

CDH bets on Aver Asia's diversity

SOUTHEAST ASIA-BASED EQUIPMENT leasing business Aver Asia Corporation has no revenues or supplier relationships in China there is no desire to expand into the country. Yet when the company required capital, it turned to CDH Investments, a long-standing Chinese GP that has started looking beyond its home market.

This is CDH's third investment in the region and Escamillo Lin, a director with the firm, sees reference points in previous transactions. "We are tapping into expertise we have developed from our investments in Indonesia and in China. Ever Asia is in the business of renting out equipment. It is not unlike Hertz, which rents out vehicles – and we have a car rental business in China called eHi – or Apexindo in Indonesia, which rents out drilling equipment to the oil and gas sector."


Aver Asia: Diversity play

The private equity firm has committed an undisclosed sum to Aver Asia, becoming the first external investor in the family-owned business, and it will support continued regional expansion. Headquartered in Singapore and with branch offices in Malaysia, Indonesia and Myanmar, the company has built up a 2,000-strong customer base across Southeast Asia.

Equipment rental worldwide is a fragmented industry – global leader United Rentals has a market capitalization of more than $8.5 billion yet an estimated market share of around 14% – although Lin is reluctant to cast Aver Asia in the role of regional consolidator. "As a PE fund we have the resources and ability to undertake all expansion possibilities, including inorganic expansion," he says.

Founded in 1999 by P.K. Ang, who remains CEO, Aver Asia has seen rapid growth. Annual revenue has increased from approximately S$20 million ($14.6 million) in 2008 to S$70-80 million in 2013, and it was projected to hit S$100 million last year. This has been underpinned by a conscious effort at diversification.

The company started out serving the shipping industry. When Singapore emerged as the leading offshore rig builder in the world, Aver Asia duly developed a customer base in the energy sector. Now electricity generator sets used to provide remote power, air compressors required for hydraulic tools, and aerial lifts represent that company's three largest product groups. But the full product range is broad, and so is the customer base.

Escamillo draws comparisons between Aver Asia and United Rentals, which also has broad sector coverage, and contrasts the business with Coates Hire, an Australia-based equipment provider that has a strong focus on the mining industry.

"We do have customers in the oil and gas segment – there are companies that operate offshore rigs sometimes and take our generators and lifts," says Escamillo. "But that same equipment could easily be used in shopping malls or by the organizers of Formula One. "They have tried to build a diverse portfolio that is not tied to a particular sector."

Vivo boosts fund for cross-border play

HEALTHCARE-FOCUSED VIVO CAPITAL HAS attracted increasing attention from LPs for its hybrid focus on the US and China. As testament to this, its latest fund – Vivo Capital Fund VIII – closed at $750 million after nine months in the market, with demand for positions well exceeding supply.

Fund VIII is twice the size of its predecessor, which was closed in 2012. While US-based LPs account for 50% of the corpus, Asian investors have contributed 35%. By comparison, US institutions were responsible for about 80% of the capital committed in the seventh fund, with the remaining 20% coming from Europe and Asia.

"The capital from Asia was very different from the US. The US has many different sources of institutional capital. In Asia a few years ago it was almost all family offices," says Frank Kung, the VC firm's managing partner.

"But there has been a ground shift. Asian investors are becoming more institutionalized and they're actively looking for opportunities outside of their own countries."

Vivo started out as an US-based venture fund in 1996. China investments started from Fund V, which was closed in 2005, with a 5% allocation to the country. By the next fund this had rise to 20% and then 40% in the seventh vehicle. For Fund VIII, Vivo expects a 50-50 split between the US and China.

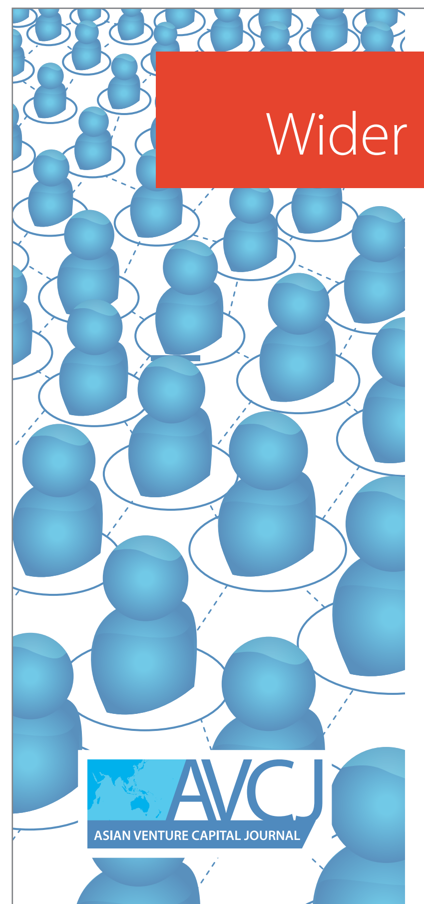
"The increase in the fund size doesn't mean that we'll do many deals – we plan a similar number of deals to Fund VII," says Kung. "We will continue to invite co-investors in each deal, but the number of co-investors will be fewer. We will increase our dollars committed in per transaction."

Vivo: Cross-border injection

The VC has expanded its team to handle the larger corpus. There were about 10 investment professionals when Vivo closed its seventh fund, but now it has 18 people in the US and China. After opening its first office in Shanghai in 2006, Vivo established a presence in Chengdu to manage renminbi-denominated investments. Two years ago, it hired Shan Fu, a former senior managing director with The Blackstone Group, to open a Beijing office.

Although Vivo focuses on technological synergies between China and the US, the firm's strategies for the two countries differ somewhat. In the US, Vivo targets late development stage pharmaceutical and medical devices developers – where there is a high probability of getting regulatory approval – in the private and public market spaces. In China, there is more of a growth capital approach.

"In China, everyone wants to put their money into healthcare, but we are able to convince the CEOs to choose us as a partner. In order to keep their growth engines moving forwards, they need to give up their existing pipelines because most of the products are generic." says Kung. "We are a value-add investor that brings new technology from the US for these Chinese firms."



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Tasting notes

For a long time the UK and Australia operations of US wine giant Constellation Brands had been a drain on the parent company. Nevertheless, CHAMP Private Equity saw the potential for a category leader

WHEN AUSTRALIAN WINES WERE FIRST introduced to the global market not everybody was keen. John Ratcliffe, CEO of Accolade, was an assistant buyer with UK liquor store chain Oddbins when – in 1984 – he tried to convince a leading figure in the local win industry that the antipodean tipple would be the next big thing.

"We tasted the samples I had brought from Australia, and I remember thinking that they tasted great. He simply said: 'My dear boy, these wines won't work at all; Australian wines will never work in this market because there is too much fruit,'" recalls Ratcliffe.

Needless to say, the prediction was wrong. Australian vintages – dubbed "sunshine in a bottle" – not only caught on in the UK and Europe, but found global appeal, democratizing the entire wine market. It is claimed that the fruitier, more palatable variety took what was the preserve of a niche consumer base and turned it into something that can be enjoyed by all. For the next 18 years the world's thirst for Australian wine was unquenchable. Export volumes grew from 8.9 million liters in 1984 to over 416 million liters by 2002, according to the wine economics research center at the University of Adelaide.

In 2003, US wine firm Constellation Brands thought it would reap the benefits of this rising demand by buying Australia's largest wine producer BRL Hardy – an asset which later would form the core of its UK and Australian operations – for A$1.85 billion (then $1.11 billion). However, the growth would not last.

"There was always going to be a correction," says Ratcliffe. "Even in the most exciting categories there is a correction, and for Australian wine that started in the early 2000s, which was pretty much when Constellation purchased the Australian asset."

By the time Constellation decided to exit its Australian and European assets, the business was in dire straits. In the last quarterly report before the sale, it was announced that revenue dropped 12% year-on-year to $235 million during the first nine months of the 2011 financial year. CHAMP Private Equity entered the bidding after being introduced to Constellation though one of its local affiliates in Australia.

"From the initial introduction it took us nearly 18 months to make the deal happen and the deal went through a variety of different constructs," explains John Haddock, CEO of CHAMP. "They spoke with a few interested parties but I think ultimately they chose to work with CHAMP because they realized we had the knowledge and local capabilities to make this work, and because it gave them a chance to retain a 20% stake in the business."

The PE firm eventually bought 80% of the business for $290 million – a fraction of the price Constellation paid for BRL Hardy – and renamed it Accolade Wines. At the time, most of the company's production and exports came out of Australia, with a handful of operations in the US and South Africa, while there were significant sales into the UK and mainland Europe. In addition to the Hardys brand, the portfolio included: South Africa's Kumala, Fish Hoek and Flagstone; a UK portfolio that featured Echo Falls and Stowells; and Australia's Banrock Station.

> "The downside of the wine industry being too fragmented is that with fragmentation comes complexity, and every multiple retailer the world over hates complexity because it adds cost" – John Ratcliffe

For CHAMP there was an opportunity to ride the recovery in demand for Australian wine and expand the company's portfolio. The ultimate objective was to turn it into a leader in the new world wine category with a focus offering popular mid-market vintages plus a handful premium product offerings. But the first step was to Accolade to move beyond its troubled past.

Lingering legacies

"Whenever you break off a chunk of a company it is easy for the new business to try and reflect the old company and its culture," says Ratcliffe. "So we had a company that was operated very much in a North American sort of model; it was a very hierarchical, it was very meeting-driven, and it just didn't move quickly enough."

Ratcliffe, who founded UK consultancy WineConsult in 2010 after holding senior posts at Oddbins and Canadian distillery Seagram, was initially brought in by CHAMP as an advisor at the due diligence stage. One of his first tasks was to streamline the hierarchical decision-making process that was not only slowing down operations and but also getting in the way of new business opportunities.

One early example was when Accolade had a one-off opportunity to sell a large parcel of wine to a major UK supermarket and it took three months for a sample to reach the client. Ratcliffe put this early glacial pace of development down to a crisis of confidence: Constellation had consistently blamed its Australian and UK division for group-wide underperformance, and this had impacted the mindset of management.

"When people have been in the crash position long enough they become quite risk averse, so what I had to do was not only hold hands but also make decision-making easier and speed things up," says Ratcliffe.

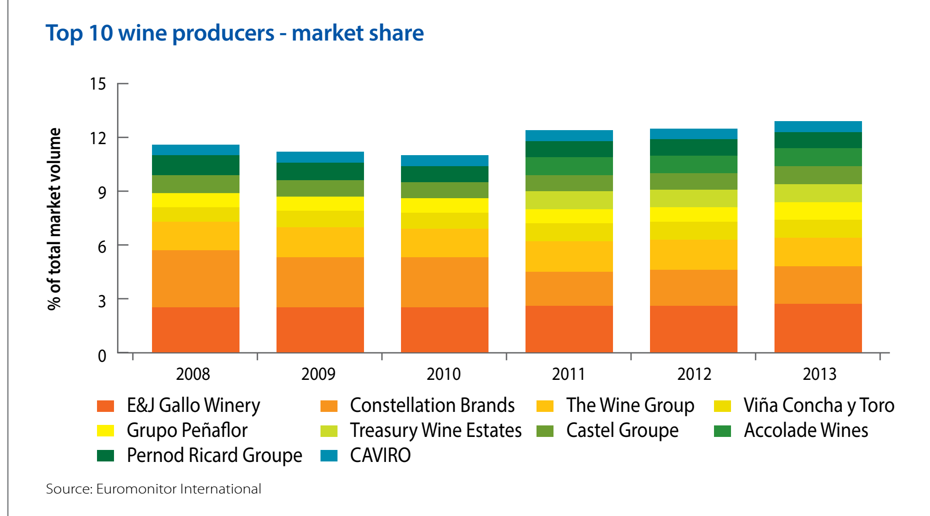
The next priority was to build out the portfolio. This acquisition spree was fueled by extra capital in the form of a $234 million facility provided by GE Capital, which came across as the ideal partner; it had previously provided financing for a similar investment – United Malt Holdings (UMH) – which CHAMP formed in 2006 after acquiring, alongside Castle Harlan, four North American malt producers. Accolade, like UMH, was a cross-border investment in a low margin industry, needing an asset-backed solution.

"The team originally looked at doing a more customary leveraged finance, cash-flow style facility for Accolade, but given the quality of receivables and liquidity of inventory, we were able to look at it slightly differently. In this case the asset-backed loan (ABL) solution worked very well," explains Nick Bennett, executive director and head of leveraged and sponsor finance with GE Capital.

The benefit of the asset-backed facility, which was provided in November of 2011, was greater flexibility because it involved fewer covenants and was particularly suited to the cyclical

nature of Accolade's business. For example, the Christmas peak periods would leave the business with a lot of receivables on its balance sheet towards the end of the year that would not get settled until January. With the ABL facility Accolade could unlock its balance sheet assets..

"We had a good experience with GE Capital with the asset-backed loan facility provided for our prior UMH investment – that also had some agricultural features to it – so we knew the financing product would work well," say's CHAMP's Haddock. "GE is a good provider of this type of financing product, and we secured a multi-geography, multi-currency, asset-backed loan in US, New Zealand, and Australian dollars, and UK pounds."



Source: Euromonitor International

The financing soon facilitated Accolade's first acquisition in January of 2012; the purchase of a majority stake in Chinese wine distribution business Shanghai CWC Wine Trading. Accolade already had distribution deals with the target company, and it would serve as a platform for expansion into the fast-growing China market.

Five months after that came a deeper incursion into the US market with the purchase of Californian brands Geyser Peak, Atlas Peak and XYZin, from Ascentia Wine Estates. Under the terms of the deal, Accolade agreed to lease Geyser Peak's winery and vineyard instead of buying them outright.

"We buy brands, we are not great believers in buying vineyards," explains Ratcliffe. "We sell the vineyards on and enter into long-term contracts; that gives us more flexibility, and of course it is better for our cash-flow."

A brand apart

While looking to expand into new markets, Accolade was also building up its existing brand equity on a global basis. In the early days of the investment the existing management was intent on new product development. Ratcliffe felt that this was to the detriment of existing brands – in particular Hardys – which could have benefited from more focus.

"Hardys was sitting there, an amazing brand, and they weren't putting much emphasis on it," he says. "So we changed all of that at the beginning of 2013, by deciding Hardys would be absolutely central to what we do."

This resolve was in turn backed up by an investment of $18 million in the Hardys brand over the next 18 months. From there, the company upgraded the packaging and websites across several brands, as well as securing a sponsorship deal to make Hardys the official wine of both the Australian and English cricket teams.

Meanwhile, Accolade continued to expand its portfolio, acquiring a number of wine brands from its New Zealand counterpart Mud House Wine Group. These included the flagship Mud House brand as well as the Waipara, Dusky Sounds, Haymaker and Skyleaf marques.

The aim is to make Accolade a one-stop shop for new world wines. "The downside of the wine industry being too fragmented is that with fragmentation comes complexity, and every multiple retailer the world over hates complexity because it adds cost," says Ratcliffe. "So if there is one trend globally at the moment, it is to take out cost and complexity; they want a range of products but they want one invoice, and we are able to do that."

On the other hand, as a result of expanding its wine portfolio and global footprint, Accolade has been obliged to invest heavily in its supply chain, which – according to the company – is currently responsible for shifting approximately 34 million cases of wine a year globally. One example of this is Accolade Park, a huge warehouse and distribution facility in the UK. Following an investment $20 million, the facility has opened a third production line, increasing output by 40%. Accolade Park, from which bottles of wine are shipped throughout the UK in large container bladders – has been instrumental in cost savings.

"One thing Constellation did brilliantly was that it saw the trend for offshore packing," says Ratcliffe. "Why would you import your glass from China and then fill it with wine from New Zealand and transport is all the way to the UK in glass?"

The company also has an outsourced bottling arrangement with Treasury Wine Estates whereby Accolade does the bottling for both companies in Europe, and Treasury provides the same services in Australia.

These changes in the brand portfolio and back-end infrastructure were matched by changes at the top of the management pile. For two years Accolade had been led by CEO Troy Christensen, who took up the role after serving just over four years as president of Constellation Australia and Europe. However, by March of 2013 he had left the business, and Accolade was in need of a new head. The choice was obvious – but it would be another six months before Ratcliffe could be convinced to leave his consultancy work to take the job.

"The more time we spent with the business the greater the opportunity he thought it had, and he was the logical candidate as he knew the business well," says Haddock. "So we coaxed him back into executive life to take over as CEO of this business."

Shortly after Ratcliffe's appointment, the company raised $300 million in a second round of financing from GE Capital. This funding was intended to consolidate and re-size the initial ABL facility, taking advantage of the earnings growth, and return capital to investors.

"We have returned 100% of our capital and we are still less than 2x geared," says Haddock. "Three years in it was an appropriate time to reset the capital structure, return some capital, and continue to allow the business to grow."

Meanwhile the acquisitions continue. Last month Accolade bolstered its core Australian portfolio with the purchase of Grant Burge Wines, an asset which includes the Grant Burge brand, Burge & Rathbone Fine Wine Merchants and the Krondorf Winery. It is unlikely to stop there, with Ratcliffe hinting there will be other investments in the coming months, as the company looks to fill the gaps in its new world wine portfolio; Haddock shares the same sentiment.

"One area in world where we have a more limited presence – and might look to do another acquisition – is South America, especially Chile or Argentina," he says.

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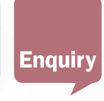

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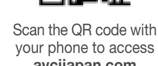

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