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DEAL OF THE WEEK



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28TH ANNUAL



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Two sides of a stock boom

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capital generated through share placements and sell-downs by PE investors is already at its third-highest quarterly level in two years. That's what happens when public markets go into overdrive.

In Hong Kong the Hang Seng Index has risen 11.2% since the start of the month on the back of a flood of Chinese capital entering the market. The gain stands at 18.5% since the start of 2015.

This is the context for the largest of the exits – Hony Capital selling the last of its shares in CSPC Pharmaceutical for HK\$9.78 billion (\$1.26 billion). Hony restructured the state-owned enterprise to lucrative effect, securing multiple partial exits. CSPC's stock started the month at HK\$6.55 and the PE firm was able to sell at a 4.4% discount to the previous close and still walk away with more than 4.4% had it sold at the end of March.

The Carlyle Group also made the most of Hong Kong's gains, exiting its remaining stake in Haier Electronics Group for HK\$3.29 billion. The price was up 15.7% on the March 31 close.

Other open market sales came in Australia – the ASX200 Index shot up in early February and remains at its highest level since before the global financial crisis – and, notably, India.

The BSE Sensex Index is at a record high and its ascent can be traced back to the general election last May, with a one-year gain of 23%. India investors were the most prolific, in terms of

number of exits, in the last quarter of 2014 and the first three months of this year. Despite some recent volatility, this momentum continues, with KKR raising approximately \$272 million through the sale of its entire stake in Bharti Infratel.

The flip side to this is reduced investment activity. So far April activity is not on a par with open market exits. A total of \$4.6 billion has been deployed across about 80 transactions. This compares to \$18.6 billion and over 500 deals for the first quarter in full, which represented a decline on the three months before that.

This is not for lack of effort. As one regional buyout manager puts it: "Everyone is busy working on deals but few are closing. Why is that? Prices are very high. After due diligence people find they can't take the price and the sellers won't reduce it – the stock market is going up and up so why would they?"

A second oft-cited reason is competition from strategic investors that have access to cheap financing and are increasingly acquisitive. In a lower growth environment there is one sure-fire way to achieve growth: buy it.

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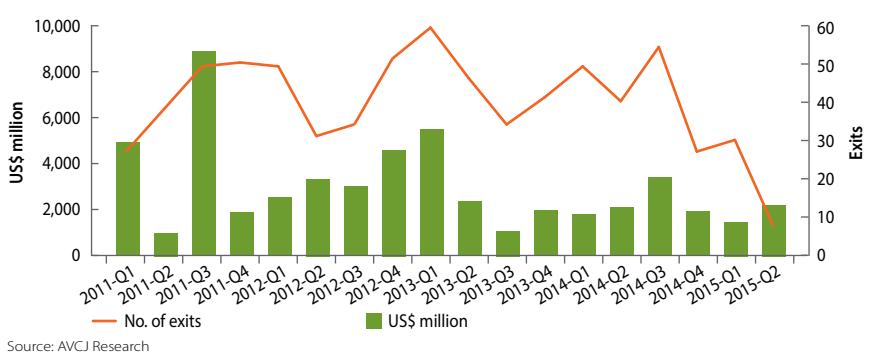
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Asia PE exits via open market sales



GLOBAL

NEA closes giant \$2.8b global VC fund

New Enterprise Associates (NEA) has reached a final close on its 15th global flagship fund at \$2.8 billion, and raised an additional \$350 for a new co-investment vehicle, NEA 15 Opportunity Fund. The fund – said to be the largest VC vehicle ever raised – brings NEA's total committed capital since inception to almost \$17 billion. It is also the firm's third vehicle to pass the \$2.5 billion mark.

ASIA PACIFIC

Asian LPs back Israel-based Viola's \$250m fund

At least six Asian investors are LPs in the latest fund being raised by Israel-based technology growth capital and buyout firm Viola Private Equity, which reached its targeted amount of \$250 million. Viola Private Equity II, which has a hard cap of \$300 million, received investments from institutional investors and family offices in the US, Asia, Europe and Israel. The Asian LPs are from Hong Kong and mainland China and primarily comprise large family offices.

AUSTRALASIA

Accel, Recruit Holdings back 99designs

Australia-founded online design marketplace 99designs has raised \$10 million in a Series B round led by Recruit Strategic Partners, with existing investor Accel Partners also participating. The new capital will be used for the company's expansion into Japan and other Asian countries.

GREATER CHINA

Hony in \$1.26b CSPC Pharma share sale

Hony Capital has sold HK\$9.78 billion (\$1.26 billion) worth of shares in CSPC Pharmaceutical to complete its exit from the Hong Kong-listed Chinese drug manufacturer. Three subsidiaries of Massive Top, the company through which Hony controlled CSPC, offloaded approximately 1.37 billion shares at HK\$7.15 apiece. This 23.16% stake is the entire interest held by the private equity firm's third fund.

Affinity to buy Nine's Australia events business

Affinity Equity Partners has agreed to buy Australia-based Nine Entertainment's live events and ticketing business for an enterprise valuation of A\$640 million (\$496 million).

The business, Nine Live, owns Ticketek, which is responsible for ticketing at nine of Australia's top 10 venues. It has more than 135 exclusive contracts with venues and promoters and Australia and New Zealand and issues more than



22 million tickets per year. Nine Live's other assets include the Allphones Arena in Sydney Olympic Park and a sports and entertainment touring and events business.

Nine Live posted revenue of A\$102.5 million for the first six months of the 2015 financial year, down 23.9% year-on-year, while EBITDA fell 10.2% to A\$36 million. The fall in revenue was primarily due to a smaller number of events during the period compared to 2014. Ticketek, which accounts for approximately 70% of total revenue, weakened slightly.

Following the sale, Nine Entertainment will retain a commercial relationship with Nine Live. It is divesting the asset in order to focus on its free-to-air television, digital and subscription streaming businesses. The company's flagship asset is Channel Nine, which is complemented by digital channels GO! and GEM.

DCM invests \$3m in China's Udesk

DCM has committed \$3 million in a Series A round of funding to Udesk, a China-based customer service outsourcing business. Founded in December 2013 by former employees of Tencent Holdings and other domestic internet companies, Udesk offers a traditional call center service combined with numerous digital functions such as email, microblogging and instant messaging. It represents another strand to China's growing internet-based enterprise services industry.

Credit card management app raises \$50m

U51.com, a VC-backed credit card management mobile app, has raised \$50 million from Shanghai-listed property developer Xinhua Zhongbao. The real estate firm, acting through its Hong Kong-based investment unit, is acquiring a 14.92% stake in the start-up. The app secured a \$50 million in a Series B round led by GGV Capital two months ago.

Carlyle raises \$424m via Haier sell-down

The Carlyle Group has fully exited Chinese home appliance maker Haier Electronics Group (HEG), raising HK\$3.29 billion (\$424 million) through a block trade. The private equity firm offloaded its remaining 140 million shares, or a 5.24% stake, at HK\$23.50 apiece. Carlyle bought \$194 million worth of convertible bonds and warrants in the company in August 2011, allowing it to acquire about 9% of the business.

Sungy receives management take-private offer

The chairman of Chinese app developer Sungy Mobile has submitted an offer to take the VC-backed company private less than 18 months after it went public on NASDAQ. Yuqiang Deng, Sungy's founder, chairman and CEO, and co-COO Zhi Zhu are willing to pay \$4.90 per share for all outstanding American Depository Shares (ADS). This values the company at approximately \$708 million.

CMC, FremantleMedia, SMG create TV JV

China Media Capital (CMC) has teamed up with London-headquartered TV producer FremantleMedia and Shanghai Media Group (SMG) to create a joint venture that will develop entertainment content for the China market. As part of the agreement, Fremantle will develop formats for SMG's Dragon TV and BesTV platforms. Fremantle will also handle worldwide distribution of the original contents developed by the joint venture.

TVM reaches \$50m first close on pharma fund

TVM Capital Life Science has reached a first close of \$50 million on its debut China fund, which will invest in Western companies with a view to obtaining licenses for development and commercialization in China. The new

vehicle, China BioPharma Capital I, has received a commitment from domestic drug maker Chongqing Lummy Pharmaceutical.

Legend Holdings files for Hong Kong IPO

Legend Holdings, sponsor of China-focused GPs Hony Capital and Legend Capital, has filed for a Hong Kong IPO. The firm is reportedly seeking to raise as much as \$3 billion. Legend Capital and Hony were set up in 2001 and 2003, largely at the instigation of Chuanzhi Liu, Legend's founder and president.

NORTH ASIA

Rakuten invests in VC-backed discount site Fanli

Japanese e-commerce firm Rakuten has bought a less than 10% stake in VC-backed Chinese discounts site Fanli in a Series C round of funding that values the business at about \$1 billion. Set up in 2006, Fanli claims to be China's largest online rebate and rebate-based flash sales company.

Dentsu launches \$42m corporate venture fund

Japanese advertising agency Dentsu has established a new corporate venture capital arm, Dentsu Ventures, and launched a new fund with a corpus of JPY5 billion (\$42 million). The fund will run for seven years and be global in its scope, targeting investments across the US, Europe and Asia.

KDDI buys majority stake in VC-backed Luxa

Japanese telecom giant KDDI has acquired a majority stake in VC-backed premium group-buying site Luxa. Luxa is similar to sites like Groupon, with the distinction being that it offers luxury goods catering to a higher income demographic. KDDI is an existing investor in the company, alongside Jafco and Global Brain.

SOUTH ASIA

Temasek invests \$151m in Glenmark Pharma

Singapore's Temasek Holdings has invested INR9.45 billion (\$151 million) in India's Glenmark Pharma via a preferential allotment of shares.

China's 58.com buys stake in VC-backed rival Ganji

US-listed Chinese classifieds site 58.com has agreed to buy a 43.2% stake in its domestic rival Ganji.com in a deal worth around \$1.61 billion. It is part of a broader consolidation in China's internet industry. Shareholders in Falcon View Technology, Ganji's parent company, will receive \$412.2 million in cash and 34 million newly issued shares in 58.com, valued at \$1.19 billion based on the most recent closing price. Shares in 58.com have climbed 30% in the past five trading days after it was reported that the two companies would merge.



The pricing of the deal suggests that Ganji is worth in the region of \$3.7 billion. Last year the company received \$200 million from The Carlyle Group and Tiger Global Management, while previous investors include BlueRun Ventures, Nokia Growth Partners, Capital Today, Sequoia Capital, CITIC Private Equity, Ontario Teachers' Pension Plan and Macquarie Group. It is unclear which groups are exiting.

In parallel to the investment, 58.com has also received additional funding from Tencent Holdings. The Chinese internet giant has agreed to buy \$400 million of newly issued shares at \$52 per American Depository Share, taking its stake in the company to 25.1%. Tencent paid \$736 million for 19.9% of 58.com in July 2014 and said the two companies would use each other as the preferred partner in local services and work together in building out online-to-offline services (O2O).

Temasek is subscribing to 10.8 million shares at INR875 apiece, giving it a 3.8% stake in the business. The investment will make Temasek the largest institutional investor in Glenmark; the promoters continue to hold a 46.45% stake.

Taxi-booking service Ola closes Series E at \$400m

Indian taxi-booking service Ola – operated by ANI Technologies – has closed its Series E round

of funding at \$400 million, valuing the company at \$2.4 billion. The round was led by DST Global. It emerged last week that Ola had raised \$315 million from DST, Tiger Global Management, Steadview Capital, Accel Partners and handful of smaller investors. Singapore's GIC Private and hedge fund Falcon Edge Capital have since been added to the investor roster.

Temasek completes acquisition of SVB India

Temasek Holdings has completed its acquisition of SVB India Finance for INR3 billion (\$48 million) and renamed the company. It will now be known as InnoVen Capital India. The completion of the deal, which was first announced in January, represents Temasek's entry into India's venture debt market and the first step in building a pan-Asian venture lending platform.

Tiger Global leads round for services marketplace

Indian local services marketplace LocalOye has raised a \$5 million Series A round of funding from Tiger Global Management and Lightspeed Venture Partners. Set up in 2013, Mumbai-based LocalOye is a mobile-only marketplace that uses a recommendation engine that matches users with local service providers including mechanics, fitness instructors, tutors, and event photographers.

SOUTHEAST ASIA

L Capital faces legal action over Jones the Grocer

L Capital Asia is being sued in Singapore's high court over its decision appoint administrators to gourmet food retailer Jones the Grocer by the company's former CEO John Manos. Sydney-headquartered Jones the Grocer went into voluntary administration in Australia last December, days after Manos stepped down as CEO. Manos, who owns a 37% stake in the business, is accusing majority shareholder L Capital of "oppressive conduct" in relation to administration proceedings.

Templeton backs Vietnam restaurant chain

Vietnamese restaurant operator Huy Vietnam has raised a \$15 million Series C round of funding led by Templeton Asset Management. Hong Kong-based Welkin Capital and Prosperous Alliance also took part in the round.

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Coming to America?

It has become increasingly costly for private equity firms to access borrower-friendly US financing for leveraged buyouts in Asia. The US markets are fickle and volatile, but Asian banks are also stepping up

BRADKEN IS FEELING THE FULL FORCE OF

the commodities downturn. The listed Australian company relies on the resources sector for more than 90% of its revenues, with one quarter tied to iron ore mining and processing activities. Having seen iron ore prices fall by half over the last 12 months, miners are scaling back exploration. This means less spending on crawler systems and other excavation equipment.

Last December, with Bradken's share price in the doldrums and its earnings showing little promise, the would-be buyers made their move.

Pacific Equity Partners (PEP) and Bain Capital first submitted a proposal in August that did not result in an offer. This time their A\$872 million (\$731 million) bid prompted Bradken to say it would open its books to all potential suitors. But it came to nothing. Unrest in the commodity and financing markets made it impossible to secure debt for the deal on acceptable terms.

Bradken is a classic cyclical business that would benefit from the borrower-friendly term loan B or high-yield bond financing often found in US leveraged buyouts. Unencumbered by maintenance covenants that could allow creditors to seize control in the event of a breach or obligations to make regular debt repayments, a PE buyer could focus on restructuring the company and riding out the cycle.

If there is a deal to be done on Bradken – another offer was rejected earlier in April – it would likely be financed by Australian banks as US investors shy away from mining services. Several banking sources argue that Bradken is not well understood outside of Australia and local lenders would be fairer in assessing its credit. But they would also insist on standard covenants and amortization; while not necessarily a deal breaker, sponsors used to US terms might rue the reduction in operational flexibility.

"The US market is an institutional market so there is a natural momentum to the money flows. Certain industries come in and out of favor," says Shannon Wolfers, a director at PEP, who declines to comment on Bradken or mining services specifically. "There are a lot of energy companies in the US that were funded through term loan B and when energy pricing started to fall the market effectively shut. The Australian market, being a bank market, is more stable."

This shift in sentiment is reflected in other deals in the space. While The Blackstone Group's acquisition of Orica Chemicals was financed out of the US, the loan had to be flexed to improve pricing for investors, as first reported by Debtwire. There has also been uncertainty over the debt structure being used to support Apollo Global Management's investment in Leighton Holdings' maintenance services business.

Declining demand

It is symptomatic of an environment in which US demand for high-yield exposure has weakened, making it harder for sponsors to get acquisition or refinancing packages for Asia-based companies on terms and at prices they can accept. With regional banks willing to lend on a more borrower-friendly basis than before, the question facing PE firms is how much of a premium would you pay for covenant lite?

billion for the most recent quarter. In the first quarter of 2014 it reached \$293 billion, much of it recapitalizations.

In addition to cyclical businesses, US term loan B and high-yield bonds are suited to situations in which cash is being directed at expansion, for example if a retailer wants to open many new stores. A "bullet" repayment on maturity or 1% amortization is kinder to the balance sheet. Covenants that are tested on an incurrence basis – i.e. they are triggered by a particular event – as opposed to maintenance tests carried out at regular intervals also offer greater freedom.

However, the reality is that few Asia-based companies are accepted by the US markets. Term loan B has featured in a spate of Australian deals – most of them refinancing or recapitalization events – since 2013 and also crept into a small number of transactions elsewhere in the region.

"If it's the right name, the right sponsor and the right country then the volume will almost certainly be there. Once you start un-ticking those boxes liquidity decreases"

– Lyndon Hsu

"On the demand side it is a very fickle and volatile market" says Rupert Manduke-Curtis, head of origination for non-Japan Asia at Mizuho Corporate Bank. "Whilst CLO [collateralized loan obligation] issuance in 2014 was the best year on record, estimated net demand for assets across CLOs and loan funds turned negative in December 2014 and the second lien market has all but disappeared in the first quarter of 2015."

He adds that, in terms of M&A, people are waiting to see when interest rates rise because that might trigger a technical outflow of money from the equity market, with a corresponding downwards adjustment in valuations.

Although CLO issuance rose year-on-year in the first three months of 2015, the total of \$23.9 billion represents the weakest quarter over the last 12 months. Meanwhile, mutual funds have seen net outflows in each of the last four quarters totalling \$37 billion. The volume of corporate leveraged buyouts in the US stood at \$126

Generally speaking, there must be a debt portion of at least \$300 million for a company with no less than \$100 million in EBITDA.

Good for Goodpack

KKR's \$1.4 billion (\$1.1 billion) privatization of Singapore-listed intermediate bulk container manufacturer Goodpack last year was the first time a PE firm used a term loan B to support an acquisition in Asia. This was because the deal met the criteria US investors might set out: a recognizable sponsor; an established, developed market client base; substantial US dollar revenues; and a jurisdiction that is seen as transparent, strong on anti-corruption, and with creditor-friendly legal frameworks.

"If you look at recent Asia-based issuers' attempts to tap US capital markets, the successful issuers all had trading counterparties that are well-known multinational corporates with a large US and/or global presence," says Lyndon Hsu,

COVER STORY

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head of leveraged and acquisition finance for Asia Pacific at HSBC. "The US capital markets can get comfortable with that kind of business."

Also in 2014, Blackstone financed its \$625 million privatization of Pactera Technology International through a \$275 million high-yield bond, only the second time such a structure had been used to support a leveraged buyout in Asia. It is instructive to compare the deal to a somewhat similar transaction that tried and failed to get US financing, the Baring Private Equity Asia-led take-private of Giant Interactive.

Both companies are Chinese, presenting a legal and enforcement risk, but they were also US-listed, which means there was a degree of

of leverage would have struggled. "If you went with 4.5x leverage in the US it wouldn't be underwritten and you would get a maximum 3x first lien at 500 basis points. The rest would need to be second lien, priced 350 basis points wider than the first lien," the source explains. "In Asia banks will still underwrite deals at 4x and 400-450 basis points for a single tranche structure, but you have covenants and amortization."

Another KKR investee, Singapore-headquartered disk drive manufacturer MMI, found itself in a similar position. Having completed a partial refinancing through a US high-yield bond in 2012, MMI sought a term loan B plus second lien – Debtwire put the total

done in the US term loan B market, including the first for cinema chain Hoyts Group. PEP went to the US because Australian banks were uncomfortable with dividend recaps for PE firms.

"After the global financial crisis, local banks had a real aversion to doing leveraged recaps," says Bryan Paisley, a partner at Baker & McKenzie. "It might be a business they knew well because they had been banking it for a number of years, so it's not as tricky as doing a new deal, but there was a degree of ideological resistance to the idea that the equity would get a return while the banks were increasing their exposure."

At the same time, quantitative easing (QE) in the US prompted a surge of money into the debt capital markets and the demand-supply imbalance meant there was less resistance on terms. According to Shannon Wolfers, a director at PEP, first lien debt was available out of the US at a margin of around 300 basis points compared to 400 basis points in Australia.

"Once you put currency swap costs on top of that it came back to being line ball from an interest cost perspective. Whenever we had looked at in the past the US was more expensive because of the costs of hedging the currency and the relevant spreads," Wolfers says. "That changed for a period, for certain companies, with QE in the US."

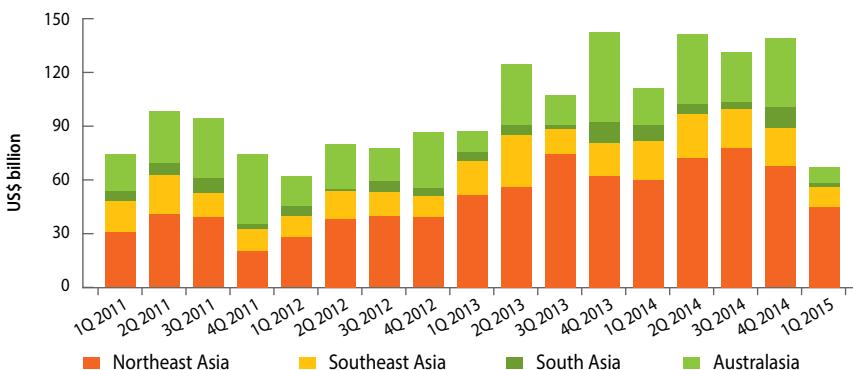
This disconnect could only be sustained for so long. While the US market has weakened, Australian banks responded to the competitive pressure by doing dividend recaps and offering better terms. Opinion is divided as to how much ground has really been given. On dividend recaps, Baker & McKenzie's Paisley observes that local banks are willing to accommodate a private equity undertaking but only for specific credits.

One Australian banker estimates that margins have narrowed by 25 basis points in the last six months, while mezzanine tranches – typically holdco PIK notes that sit outside the operating businesses against which senior debt is provided – are increasingly popular, allowing up to another turn of leverage. The counterpoint is that Australian banks are relatively conservative, largely sticking to 4-4.5x for senior debt for private equity buyouts and mezzanine financing is neither available in large quantum nor cheap.

David Brown, managing director at PEP, adds that the amount of leverage and nature of the covenants may vary between the US and Australian markets over time. Even so, the vast majority of the firm's deals have involved the Australian bank market and so high levels of leverage and covenant lite have never really been part of the business model.

Baker & McKenzie's Paisley notes that a number of global PE sponsors find local banks difficult to deal with and go to the US markets

Asia syndicated loan volumes, ex-Japan and Australasia



Source: Thomson Reuters LPC

transparency to their business models. However, while Pactera provides IT outsourcing services to multinationals, Giant's revenues are driven by online gamers within China. The former is easy for US investors to understand; the latter less so.

Timing was another factor that weighed in Goodpack's favor. "They hit the market when there were still massive inflows and the supply-demand imbalance was in favor of the borrower rather than the lender," says Mizuho's Manduke-Curtis. "That has changed now. People with cash to deploy are calling the shots even in a relatively asset starved market."

The \$520 million first lien and \$200 million second lien term loans for Goodpack had margins of 375 and 700 basis points over LIBOR. The entire package, which was fully underwritten, had a leverage multiple of approximately 6x – high for Asia but KKR acquired the company at a valuation of 11-12x EBITDA. A source familiar with the deal says it would still get done in the US today, despite weakening demand, although the overall margin might be 50-75 basis points wider than in August 2014 when the financing closed.

Fast forward to the end of 2014 and a lower quality business seeking a more modest amount

package at \$580 million, including a dividend recap, with leverage of 4.6-4.7x – but was caught by a widening in the margins. The deal needed to get done as soon as possible so the company went for an Asia-based bank package.

Shifts in Australia

Timing was also a consideration for PEP in refinancing New Zealand-based biscuits and snacks producer Griffin's Foods through the Australian banks rather than the US market. The PE firm ran a dual-track process and found that the amount of debt on offer was roughly the same but it was cheaper to do the deal locally.

A key factor was that Griffin's, a portfolio company since 2006, would likely soon be exited; indeed, the business was sold in July of last year. PEP could take some money off the table immediately or simply wait for the full exit, so picking the lowest-cost option was important. At the same time, covenants were less of a concern because a lot of debt had already been paid down and Griffin's was not overleveraged.

Over an approximately 18-month period from May 2013, PEP refinanced the debt held by eight of 10 portfolio companies. Three of these were

whenever possible. "I can see why a US sponsor, used to the terms and conditions in the US term loan B market, would be underwhelmed with what they would get in a syndicated loan deal in the local market," he says.

Local lenders

Those that are willing to engage find the most significant change is local lenders' willingness to provide larger amounts of debt than before. They are driven by ample capacity. It helps that Australia has seen a large number of exits over the past 18 months, bringing down the net size of the banks' leveraged loan books. At the same time, just like banks elsewhere in Asia, they want to compensate for deals lost to the US markets.

"The bank loan market is very liquid and when there exists a meaningful supply-side disequilibrium, banks become relatively more aggressive on lending terms, and therefore more effective in competing with the US markets, and importantly they reduce pricing," says Hsu of HSBC. "Presently, bank loan pricing is relatively cheap compared to where it and US markets pricing levels were 12-24 months ago."

In certain markets, there is enough local currency liquidity that deals are routinely covered by domestic banks. In Japan financing is available at leverage multiples of 7x and margins of 200

basis points; investors are happy to live with covenants at such pricing levels. According to David Irvine, a partner at Linklaters, Permira refinanced Arysta LifeScience out of the US because in this case covenant lite was deemed essential: the company has assets worldwide and is subject to currency fluctuations that could theoretically cause a drop in profitability and a breach of maintenance covenants.

Elsewhere, TPG Capital sought to refinance Chinese packaging company HCP Holdings through a high-yield bond but couldn't get it through. Debt was instead provided by banks in Taiwan, where the business is well known.

Taiwan lenders are increasingly active in deals throughout the region, offering highly competitive pricing and usually as part of a syndicate. They are said to have featured prominently in refinancing packages for MMI and for Hong Kong Broadband ahead of its IPO. There is also a willingness to cover smaller deals in their entirety, as was the case with a \$120 million facility for a take-private of Chinese hotel chain 7Days Group led by The Carlyle Group in 2013.

The capacity of Taiwan banks is limited and they are unlikely to step up for more than \$200 million of a \$1 billion deal. However, HSBC's Hsu believes there is sufficient liquidity among the Asian and international banks to accommodate a

\$2 billion buyout for an attractive company. "If it's the right name, the right sponsor and the right country then the volume will almost certainly be there. Once you start un-ticking those boxes liquidity decreases," he says.

Asked about the prospects for the volatile US term loan B and high-yield bond markets, industry participants unsurprisingly offer somewhat differing views. An executive with a global buyout firm who asked not to be named claims the US market is reopening for Asia-based companies and building up to another strong year, while there is also appetite for high-yield products in Europe.

Manduke-Curtis of Mizuho is more circumspect, suggesting there may be a feeding frenzy in CLO issuance ahead of regulatory changes that would hold back managers or arrangers. At present they contribute only a small portion of the fund's equity stake, which typically accounts for 10% of total value. From 2016 they would have to hold 5% of the entire CLO through maturity in equity or debt.

"There will likely be significant consolidation amongst fund managers and a reduction in total CLO issuance," he says. "And before that, once interest rate rises come through - whether it is June or September - a lot of money will likely move back into the bond market." ▶



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The madding crowd

With established Chinese companies, led by e-commerce giant JD.com, getting involved in equity crowdfunding, will these platforms gain traction as a financing channel for Chinese start-ups?

IN THE BATTLE BETWEEN CHINA'S

e-commerce giants to corner equity-based crowdfunding, JD.com appears to have stolen a march. JD Equity Crowdfunding launched at the end of last month, while a platform supported by Alibaba Group affiliate Ant Financial is said to be still in its preparatory stages.

The two companies already have reward-based systems, with JD Crowdfunding holding a 31.6% market share to Taobao Crowdfunding's 8.9%. Reward-based crowdfunding in China grew by 123.5% to reach RMB440 million (\$71 million) and it's expected to hit RMB15 billion this year, according to iResearch Consulting Group.

While the reward-based model sees investors receive small gifts in return for supporting projects, an equity-based system involves taking stakes in start-ups. It is a natural point of call for traditional venture capitalist firms seeking deals. With JD.com and Alibaba now focusing on the market, will these platforms become scalable mechanisms through which entrepreneurs can secure funding at seed and pre-A stages?

"Equity crowdfunding platforms are controversial in China. There are a bunch of these platforms operating at small scale and I think most of them are doomed to fail," says Harry Wang, a founding partner at early-stage VC firm Linear Ventures. "JD.com could be an exception as it might attract deals of higher quality. However, the best firms won't go to these types of platforms to raise money."

Regulatory uncertainty

Equity crowdfunding is a new to China but there are a few homegrown platforms. AngelCrunch was an early entrant, launching in 2011, and it has been joined by the likes of AngelClub and Dajiatou. Ping An Insurance has also registered a crowdfunding subsidiary.

They operate in gray area from a regulatory perspective. Raising capital from individuals for unqualified investment products could be seen as illegal fundraising. In 2013 online video distributor Media.V turned to Alibaba's C2C e-commerce site sell a 25% stake to the public after failing to win support from VC firms. A total of 1,194 investors committed RMB3.87 million, prompting an investigation by the Chinese Securities Regulatory Commission (CSRC).

Then last November Premier Li Keqiang

said the State Council would allow equity crowdfunding pilot programs. He emphasized that these platforms should be seen as a new financing channel for start-ups.

"I don't think the regulators will open equity crowdfunding for everyone, because it involves complex shareholding structures and post-investment portfolio management," says Raymond Wang, managing partner at Beijing-based law firm Anli Partners. "A limited numbers of qualified investors will be allowed to participate in these transactions, which aren't really in line with the concept of crowdfunding."

In December, the Securities Association

participate, as well as generating exits," says Don Jiang, a partner at Gobi.

Start-ups publicize their products through JD.com's retail channels, and VC players factor the market response into their investment decisions. When a start-up reaches its crowdfunding target, the individuals sign agreements mandating the lead investor to manage the deal. They then exit alongside the VC firm at the appropriate time.

In China, more angel investors want to put money into start-ups but it is usually difficult for them to source quality deals. They may also not have sufficient capital to invest in a clutch of start-ups consecutively.

"The best firms won't go to these types of platforms to raise money"

— Harry Wang

of China (SAC), an agency under the CSRC, published draft rules for equity crowdfunding. To qualify as an accredited investor, an individual must: invest at least RMB1 million in a single project; have net assets of RMB10 million; and have financial net assets of at least RMB3 million or an average annual income of RMB500,000 for the past three years. The total number of investors in a single project is capped at 200.

"These platforms are required to carry out background checks on investors. JD.com has been cautious to make sure investors meet certain standards, which will bring more public credibility," Wang adds.

To build up investor confidence, JD's Equity Crowdfunding has introduced a lead-and-follow mechanism. Institutional VC firms and angel funds will source deals – around 10 in each batch – and lead the investment rounds. Individual investors can participate alongside them.

Capital Today, ZhenFund, Sequoia Capital and Gobi Partners are among the VC firms to introduce deals. Gobi suggested two – snack food brand Jacky's Shrimp and an travel portal Directions Travel – and tried to raise RMB6.5 million. Each deal was over-subscribed.

"Crowdfunding will become an important component of the Chinese start-up community. However, only JD.com has come up with a solution in terms of motivating high net wealth individuals, start-ups and VC investors to

"Seed round valuations have risen to RMB2-5 million from below RMB1 million a few years ago. Crowdfunding allows people to invest smaller amounts across multiple deals and build portfolios – ideally with 20 start-ups," Jiang says.

Limited access

However, won't have access to a wide range of sectors. The VC firms will favor consumer goods-related businesses on the basis that non-professional investors are unlikely to fully understand more complicated, technology-focused companies, making it harder for those start-ups to get traction. Furthermore, not every founder would want to try crowdfunding if a traditional VC round is available.

To this end, VCs not directly involved in the platform are skeptical about its potential as a source of deals for them. Indeed, for the lead VC investors, the primary function might not be to raise capital as much as use the publicity to market their portfolio companies' products.

"Unlike online P2P lending and group-buying platforms, which can be standardized by selling products at certain prices, early-stage investments can't be standardized. It's a personal choice," says Linear's Wang. "Crowdfunding platforms to me could only serve as an information broker. Start-ups need investors to provide supports beyond capital. How can these platforms provide any additional help?" ▀

DEAL OF THE WEEK

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Ninebot's innovation keeps it rolling

CHINA'S LEGENDARY TRAFFIC JAMS ARE

a source of frustration to countless tourists and locals, not to mention a major cause of pollution. With studies putting the average speed of traffic in Beijing at 7.5 miles per hour, there is a clear opportunity for a company that can bring commuters relief.

Scooter maker Ninebot aims to fill that need. The company, which is best known for its two-wheeled, self-balancing personal transport vehicles for one person, recently raised an \$80 million Series A round from smart phone maker Xiaomi and VC firms Shunwei Capital Partners, WestSummit Capital, and Sequoia Capital.

Xiaomi and Shunwei – which share a co-founder – have been pursuing investments in the internet of things space and Ninebot is a good fit. "One of the core areas for us is smart devices, including any hardware that can be digitalized," says Cheng Tian, a partner at Shunwei.

Xiaomi specifically was drawn to the work that Ninebot had already put into making its vehicles internet-capable, and hopes to add the vehicles to its own ecosystem of smart devices.

Ninebot's designs inevitably invite comparison to the Segway Personal Transporter, made by the US-based company of the same name that Ninebot recently purchased. Segway's two-wheeled scooter was revolutionary at its introduction, and the name immediately took hold as a generic term for any similar product. Ninebot itself has been referred to as the "Chinese Segway."

WestSummit Managing Partner Raymond Yang believes that Ninebot's purchase could help Segway, which he feels never reached its potential. High prices and lack of innovation are some of the factors that have kept the brand from catching on among the consumers that should be its natural market. "They were great at invention 15 years ago, but then at a certain point, they stopped," Yang says.

Segway's own previous innovation was one of Ninebot's targets in the purchase. In a recent interview, Ninebot founder Wang Ye highlighted the acquisition of Segway's patents.



Ninebot: On a roll

These had been a source of tension between the companies, and Segway filed a patent infringement complaint against Ninebot last year.

In addition to the patents, Segway's presence in foreign markets represents another opportunity for Ninebot. Although Segway has not caught on among consumers, it has seen limited success in business and tourism settings, and enjoys name recognition that Ninebot has not yet achieved outside of China. Ninebot could make use of Segway's distribution channels, either by selling the two brands side-by-side or by rebranding its own vehicles under the Segway name.

Both Shunwei and WestSummit believe they have strengths that Ninebot can leverage: the former has intimate experience in the connected device market through its frequent collaboration with Xiaomi; and the latter offers support through its US presence. The goal is to help Segway and Ninebot finally reach their potential. ▀

Investors pay big for India grocery exposure

THE LAST YEAR HAS SEEN AN EXPLOSION

of interest in India's grocery delivery apps. Customers order food and other goods on their smart phones; the order goes to a buyer, who purchases the goods and then delivers them to the customer's home. The approach is suited to a country where mobile phones are the primary form of internet access.

Grofers was one of the early entrants in what is becoming a crowded market. The New Delhi-based company, which guarantees delivery from the customer's preferred vendor within 90 minutes, differs from rivals BigBasket and ZopNow in that it partners with local merchants rather than delivering from a central warehouse. That means its customers enjoy the convenience of shopping online, while still patronizing local vendors they trust.

"This is very important for things like produce, flowers and baked goods, where you know who in your local neighborhood has the fresh, quality

products that you are comfortable with," says Kshitij Torka, Grofers vice president of marketing. The appeal of buying local is a major reason why the company believes it can scale up from the three cities it serves now.

Grofers' expansion plans recently received a major boost with a \$35 million Series B round, just months after completing the \$10 million Series A. Most of the capital comes from two investors, Tiger Global Management and Sequoia Capital. Sequoia has been involved since the seed round in late 2014, while Tiger Global has participated since the Series A.

"Any time you want to bring in a new investor, it goes slower, because there's someone new coming on board. They need to do their own due diligence and other activities that have already been locked down by the current set of investors," Torka says. The company is happy enough with Tiger Global and Sequoia that it has yet to seek out new investors.



Grofers: Early entrant

Grofers' competitors are not far behind: BigBasket raised \$32.8 million in a Series B round last year, while ZopNow raised \$10 million the same week that Grofers announced its Series B. Both have also announced aggressive expansion plans, BigBasket from three cities to 10, and ZopNow from four cities to 15.

Additional competition comes from large-scale online retailers Amazon and Flipkart, both of which have announced similar hyper-local grocery ventures. Amazon's service opened in March, and Flipkart plans to launch its own later this year.

The entry of deep-pocketed new rivals is worrying to Grofers, and it is one reason the company decided to seek new funding so soon after the last round. Though management is reassured by the faith investors have shown in them, they know they will need to make bold moves to compete with their competitors' big budgets.

"We believe that there is a habit-forming nature with this," Torka says. "If we can get to the users first, then we can win the market." ▀

LPs remain loyal to Asia Alternatives

NEW YORK STATE COMMON RETIREMENT

Fund (NYSCRF) made its first direct China commitment in 2011, investing \$100 million in Hony Capital's fifth fund. Over the preceding years, the LP fashioned a more targeted Asia strategy, complementing its participation in pan-regional vehicles by entering fund-of-funds run by Asia Alternatives Management. It also set up separate accounts with the firm.

It was through Asia Alternatives that NYSCRF got its initial exposure to Hony. This familiarity likely made it easier for the pension fund to write a larger check and go direct.

There are other examples of LPs using Asia Alternatives as a stepping stone to deeper participation in private equity, but this doesn't necessarily mean they abandon the intermediated approach. NYSCRF is an investor in Asia Alternatives fourth fund-of-funds, which recently closed at \$1 billion, and has once again entered into a separate account.

"When we started Asia Alternatives, people warned us that LPs would just graduate and move beyond us," says Melissa Ma, co-founder

and managing director of the firm. "Certainly, some LPs have done that, and some have even opened offices in Asia, but I have been surprised at how few. Our re-up rate of 80% indicates to me that a lot of groups are taking longer to graduate – if ever."

If there is a graduation trend it is from fund-of-funds to separate accounts. When Asia Alternatives closed its third fund in 2012, there was \$908 million in the comingled vehicle and a further \$600 million in separate accounts. This time the separate account portion is \$800 million.

While restricted to larger LPs – Teachers' Retirement System of the State of Illinois' mandate is worth \$200 million – separate accounts are becoming more prevalent globally. Two thirds of respondents in a Preqin survey last year expected their activity from separate accounts to be equally significant or more significant than activity from co-mingled vehicles over the next 12 months.

There are approximately 150 LPs in Asia Alternatives' fourth fund, plus a handful of separate accounts, over which Asia Alternatives has discretion. When making investments, the firm is agnostic as to whether the capital comes from separate accounts or fund-of-funds. Similarly, there is a single fee structure, regardless of which vehicle an investor is in, although LPs making large commitments get steeper fee discounts.

Asked if LPs are becoming more aggressive on fees, Ma says that most new investors want to know how Asia Alternatives is going to deliver performance. The entire fund-of-funds industry has to justify why LPs should pay an extra layer of fees and it all comes down to performance.

"They can push on fees, but there is no amount of fee break that is going to be able to get you the type of returns you need to justify a fund-of-funds unless there is strong performance," Ma adds. ▀



Asia Alternatives: LP appeal

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Home advantage

It has been nearly a decade since Vani Kola, managing director of Kalaari Capital, went from being Silicon Valley entrepreneur to an India venture capitalist. The big move appears to have paid off

"I DIDN'T COME FROM A BUSINESS FAMILY,

so in the beginning I never thought of myself as a business person – I always thought of myself as a hardcore engineer," says Vani Kola, managing director and co-founder of Kalaari Capital. However, it wasn't long after arriving in the US that venture capital came onto the agenda.

Originally from Hyderabad, Kola enrolled at Arizona State University in 1985 on a master's program in electrical engineering. This was followed by a move to Silicon Valley where she held various engineering and technical management positions at IT group Consilium and later Control Data Corporation. By the mid-1990s Kola found herself working in the global epicenter of internet entrepreneurialism, and the mood was infectious.

"Everyone was trying to be an entrepreneur – your friends were doing it, your neighbors were doing it – so it really didn't seem so far-fetched for an engineer to quit her job and start a company," she says. "That is exactly what I did."

First foray

The idea for Kola's first venture came while she was working at Empros, a division of Control Data, where she was in charge of building a real-time software application for power generation management. Kola recalls that the culture of Silicon Valley was such that advice and mentorship for budding entrepreneurs was always close at hand.

Backed by VC investors, she set up RightWorks, a platform through which large companies could efficiently manage their global procurement. The thesis worked well and the business was sold in 2000, and Kola began her next venture. This was Certus Software, a software solutions provider specializing in financial compliance that grew to the point of serving over 70 clients globally. Securac Corp. bought it in 2005, after which Kola decided to return to India and move into venture capital.

"I like the world of start-ups but eventually I wanted to play a different role," she says. "I wanted to be on the sidelines rather than on the front line, and bring my knowledge and experience to help other entrepreneurs."

In 2006 Indo US Venture Partners – later to become Kalaari Capital – was formed. The first fund was NEA IndoUS Ventures, a vehicle

co-sponsored New Enterprise Associates, with a target of \$150 million. It ended up closing just shy of \$190 million.

"By then, I felt there was an inflection point in India – at least from perspective of venture capital and tech companies – so we set about raising a fund to invest in India's digital start-ups," says Kola. "When we first started the fund there



"The biggest challenges have been around making entrepreneurs understand the expectations of VC"

was a notion that maybe there would be a lot of cross-border investment where my knowledge working in the US could play a role."

The original idea was for IUVF to back early-stage start-ups that would have the opportunity to expand into the US. While this may have been the case with a handful of Indian start-ups, most of the growth was closer to home.

"I don't think it worked because we found that the best opportunities involved domestic companies leveraging India's consumption story," says Kola. "So we changed our name to reflect something that showed our roots in India and our commitment to the country."

Rebranded as Kalaari – after Kalaripayattu, an ancient Indian martial art – the firm launched its second fund as a completely independent entity.

Though smaller than its predecessor, the vehicle exceeded the \$150 million target and closed at \$162 million.

No plain sailing

Kalaari currently has 27 companies in its portfolio across both funds. They include e-commerce marketplace Snapdeal, online jewelry store Bluestone, and mobile app start-ups such as Haptik and Swipe. But the evolutionary path for India's VC industry has not been smooth.

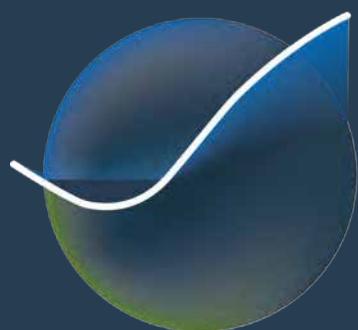
"The biggest challenges have been around making entrepreneurs understand the expectations of venture capital – the obligations and the value proposition – and the give-and-take of that," says Kola. "It can also be difficult to find quality entrepreneurs who can think very big. India has many companies that will have good outcomes, but you need to create large companies that can be category leaders."

Even with the right team, it has often proved hard to raise follow-on funding. However, that is changing and companies like Snapdeal – which most recently received \$627 million from SoftBank Corp. – are leading the way. This rapid growth among India's tech start-ups has also created more exit opportunities. A highlight for Kola was the sale of fashion e-commerce site Myntra, in which Kalaari first invested in 2007, to Snapdeal rival FlipKart for over \$300 million.

"The best part of nurturing a young company and team is having belief in the concept and then seeing that concept validated. Mukesh Bansal [founder of Myntra] had a very strong conviction that he could build Myntra at a time when there had never been an online apparel businesses in India," she says. "I was very proud that we were able to take that journey with him."

As India's technology space consolidates and those much-sought-after category leaders emerge, Kola expects Kalaari will continue to capitalize on its position as an early-stage investor. She adds that, despite challenges in the short-term, it has the potential to deliver consistent returns in the future.

"For the foreseeable future we will continue to pick strong entrepreneurs, and be the first ones to pick them," says Kola. "It is not a bubble, it is the beginning. Over the next decade we will see a number of new generation companies come, supported by investors like us." ▶



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