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ASIAN VENTURE CAPITAL JOURNAL

Asia's Private Equity News Source

avcj.com July 07 2015 Volume 28 Number 25

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EDITOR'S VIEWPOINT

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Best intentions

SHOULD CAFE COFFEE DAY, THE LARGEST player in India's chained café market, succeed in raising INR11.5 billion ($180 million) in its IPO, it would be the largest PE-backed offering on a domestic bourse in close to eight years.

None of the investors – KKR, New Silk Route Partners and Standard Chartered Private Equity – plan on selling any shares in the IPO; the proceeds have been earmarked for debt repayments, expansion and refurbishing the existing network. However, it represents a significant liquidity event in a market that has largely failed to live up to expectations in terms of PE exits.

India's strong public markets have proved a boon for private equity. Five PE-backed offerings have raised $326.8 between them on the Bombay Stock Exchange and the National Stock Exchange of India so far this year, according to AVCJ Research. This is still well short of the $2.2 billion raised through 22 IPOs in 2010, but it is already higher than any of the 12-month totals from the last three years.

Several other companies with PE sponsors have joined Coffee Day in submitting applications to the Securities and Exchange Board of India (SEBI) in the last couple of weeks, among them Matrix Cellular and RBL Bank.

This activity comes at a time when SEBI also appears to be acting – to a certain extent – on longstanding gripes from investors about bureaucratic obstacles holding back IPOs. Chief among these is the amount of time it takes to get approval for a listing, which can be as long as a year due to the level of scrutiny applied by the regulator to new candidates.

There are also concerns about the concept of the promoters and the lock-in of shares. SEBI requires that at least 20% of a promoter's post-issue capital be locked-up for three years. However, in the case of private equity-backed companies the promoter often doesn't hold as much as 20%, while the largest shareholder is typically a financial investor looking to exit.

What SEBI is now proposing is no panacea but it is certainly a step in the right direction. On general IPOs, there are plans to reduce the period between the offering and the listing from 12 days to six days, improve access to offerings for retail investors, and cut the costs involved in public issues of equity shares and convertibles. Follow-on offerings and rights issues can also be fast-tracked in certain cases.

More significantly, the regulator looks said to push ahead with a trading platform for technology start-ups. Companies will be subject to shorter lock-up periods and lower disclosure requirements, although limits will be imposed on the kinds of investors who can participate in this market and the size of individual ownership stakes.

Since 2004, India has seen more than 4,000 PE investments of varying types, yet only about 140 of these companies have listed on domestic stock exchanges. This compares to 8,000 deals in China and close to 900 IPOs in Shanghai, Shenzhen and Hong Kong. SEBI's reforms are not about to redress this balance, but they may convince more companies to list at home.

Tim Burroughs
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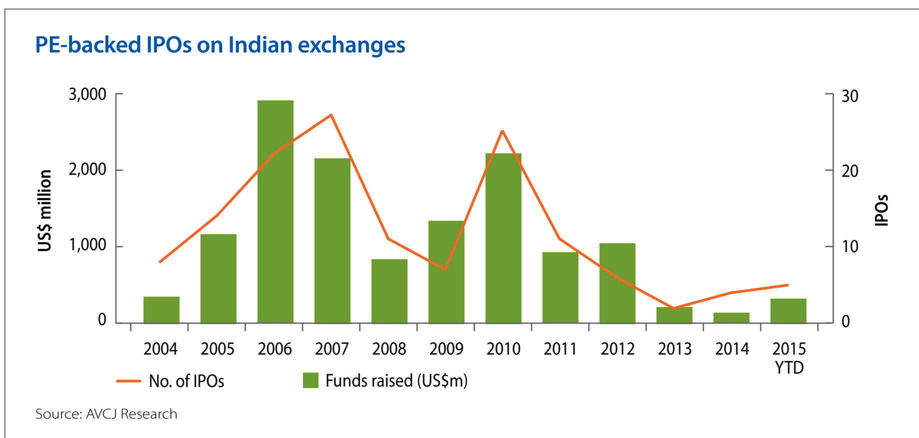

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NEWS

AUSTRALASIA

Novartis buys VC-backed drug developer Spinifex

Australian life sciences specialists Brandon Capital Partners and GBS Ventures will exit local drug developer Spinifex Pharmaceuticals after Novartis agreed to buy the business for $200 million in cash plus unspecified earn-outs. Other investors in Spinifex include global players Novo Ventures and Canaan Partners, as well as Uniseed Management and UniQues.

PE-owned GenesisCare to buy Cancer Partners UK

Australian cancer and cardiovascular treatment provider GenesisCare, which is owned by KKR, has bought cancer center manager Cancer Partners UK from its private equity backer, Apposite Capital. Cancer Partners operates one of the UK's largest networks of specialist outpatient cancer centers.

Ex-Telstra Super PE exec targets agribusiness

Robert Talevski, previously head of private markets portfolio manager at Telstra Super, has set up an investment firm that will source and execute deals in Australian agribusiness, taking advantage of strong cross-border demand for exposure to the space. Talevski's partner in the new venture - known as Asuro Group - is Summer Yan, who has worked on a number of food and agriculture investments.

GREATER CHINA

Cathay Capital launches Sino-French start-up fund

Cathay Capital Private Equity has launched a Sino-French Innovation Fund that is looking to invest in start-ups in France, China and the US. The fund, which has a target of EUR200-250 million ($222-277 million), has secured commitments from France-based Bpifrance and China Development Bank Capital.

Canada's Ivanhoe, CBRE in warehouse play

Ivanhoé Cambridge, a real estate investment arm of Canada's pension fund the Caisse de dépôt et placement du Québec (CDPQ), has partnered with CBRE Global Investment Partners to invest in Logos China Logistics Clubs, a Chinese warehouse developer and operator. The investment will allow Logos to make warehousing investments totaling up to $400 million.

Ascendent closes second China fund at $600m

Ascendent Capital Partners has reached a first and final close on its second China fund at the hard cap of $600 million. The vehicle has been in the market for around four months, following an official launch in March. LP demand at the first close was significantly larger than the GP's overall target of $500 million. However, the team decided against raising the hard cap.

Ascendent closed its debut fund at $365 million in 2012. Investments include pork producer WH Group, which went public in Hong Kong last year. Ascendent has now fully exited its position in the company. A second exit is expected later this month or next month with the sale of Nano Resources, a components manufacturer for high-speed trains. It is expected to deliver a 6x return.

The GP is also an investor in Dianping, a Chinese entertainment listings and group-buying platform that earlier this year completed a $850 million round of funding at a valuation of approximately $4 billion.

Ascendent brings what has been described as a merchant banking-style approach to private equity, providing companies with capital in conjunction with advice and solutions.

New Horizon, Addor back rural e-commerce play

New Horizon Capital and Addor Capital, a PE firm under Govtor Capital, have participated in a RMB500 million ($81 million) Series A round of financing for Huitongda, an online home appliance retailer that focuses on China's rural areas. Nanjing-based Huitongda was founded in 2010 by Jianguo Wang and Xiuxian Xu.

Carlyle growth fund to invest $115m in JIC Leasing

The Carlyle Group has agreed to commit $115 million from its growth fund to JIC Leasing, the equipment leasing subsidiary of China Jianyin Investment. The deal will see the private equity firm take an 18.5% stake in JIC.

Oriza, SF Express invest $80m in Wi-Fi operator

Oriza Holdings and SF Express, a Chinese logistics company, have led an $80 million Series A round of funding for 100MSH, a start-up that provides public Wi-Fi networks to commercial operators.

DST executive joins China's Xiaomi as CFO

Chinese smartphone maker Xiaomi has appointed Shou Zi Chew, formerly a partner at DST Global, as its chief financial officer. Singaporean national Chew joined DST in 2010, and helped the firm invest in Xiaomi in 2011.

Renren leads $50m round in online finance site

Chinese social networking site Renren has led a $50 million Series B round for Shenzhen Jinfuzi Network Technology, a Chinese online wealth management platform. Sequoia Capital also participated in the round.

VCs commit $100m to mobile office platform

IDG Capital Partners, DCM and Northern Light Venture Capital (NLVC) have participated in a $100 million Series D round of funding for Fxiaoke.com, a Chinese cloud-based mobile business management application.

IDG backs take-private bid for KongZhong

IDG Capital Partners and the chairman and CEO of online game developer KongZhong Corporation have submitted a take-private bid for the company. It values the business at approximately $388 million.

Liping Zhang chosen as Blackstone China chairman

Blackstone has appointed Liping Zhang as senior managing director and Greater China chairman. Zhang joins the company from Credit Suisse, where he served as co-CEO of Greater China and

vice chairman of global investment banking. He replaces Antony Leung, who stepped down in late 2013.

Qiming's William Hu becomes managing partner

China VC firm Qiming Venture Partners has promoted healthcare specialist William Hu to managing partner with immediate effect. Hu has been with the GP for nearly nine years and led investments in Tigermed, BBI Lifescience and Coland Pharma - all of which are now listed - as well as a range of still private start-ups.

NORTH ASIA

Korea's KIC targets 50% alternatives allocation

Korea Investment Corporation (KIC), which is expected to surpass $100 billion in assets this year, wants to increase its allocation to alternative assets to 50% from the current level of 8%. Hongchul Ahn, CEO of KIC, drew comparisons to the approaches taken by Yale University and other US endowments as well as pension funds such as a Canada Pension Plan Investment Board (CPPIB).

Recruit Holdings buys UK-based Quipper

Japan's Recruit Holdings has acquired UK education technology start-up Quipper for $40 million. The company has previously received over $10 million in VC funding from Globis Capital Partners, 500 Startups, Japanese education and publishing company Benesse, and VC firm Atomico.

SOUTH ASIA

TA invests in India's Atria, IVFA rolls over stake

TA Associates will join India Value Fund Advisors (IVFA) to buy about 95% of Indian broadband service provider Atria Convergence Technologies (ACT). IVFA's India Value Fund III, ACT's current majority shareholder, will exit most of its stake and roll it over into the firm's latest fund.

Amazon leads $60m round for India's BankBazaar

Amazon India has led a INR3.75 billion ($60 million) Series C round for Indian financial marketplace BankBazaar.com, with participation from Fidelity Growth Partners and Mousse Partners, along with existing investors Sequoia Capital and Walden International. BankBazaar connects customers to financial products provided by 23 leading Indian financial institutions and insurance firms.

Bain to sell FCI Asia for $1.28b

Bain Capital has agreed to sell FCI Asia, which manufacturers connectors used in electronics, data storage and telecommunications, to US-headquartered industry peer Amphenol for $1.28 billion.

Bain Capital Europe acquired FCI from Areva in 2005 at an enterprise valuation of EUR1.01 billion ($1.13 billion). The deal was supported by EUR695 million in debt.

At the time, the company was headquartered in France and was arguably best known for supplying interconnection systems to the motorized vehicles market. The private equity firm repositioned the business to focus on Asia as well as on higher-growth industry verticals. There were three divestments, including the motorized vehicles division, which went to Delphi for EUR765 million and the microconnectors division, which was sold to Astorg Partners for a reported EUR650 million.

FCI, now headquartered in Singapore and with around 7,400 employees worldwide, is expected to generate sales of $600 million in 2015 and an adjusted EBITDA margin of 20%. More than two thirds of the company's revenue in 2014 came from the data and communications sectors. Nearly two thirds came out of Asia Pacific.

SAIF, Accel commit $10m to services marketplace

SAIF Partners and Accel Partners have together invested $10 million in India services marketplace UrbanClap. The Gurgaon-based start-up uses its mobile platform to offer over 50 services across five main categories: home, health, events, lessons, and personal services.

VC-backed Housing.com fires controversial CEO

Rahul Yadav, the controversial CEO of VC-backed Indian property portal Housing.com, has been ousted from the company. In a statement, Housing.com said Yadav's conduct is not "befitting of a CEO and is detrimental to the company," citing his "behavior towards investors, ecosystem and the media."

Ratan Tata joins Jungle Ventures as special advisor

Ratan Tata – chairman emeritus of Tata Sons, holding company for India conglomerate Tata Group – has joined Singapore-based early-stage investor Jungle Ventures as a special advisor. He will spend time with the VC firm's portfolio companies, offering them mentorship. Tata has previously backed India taxi platform Ola.

SOUTHEAST ASIA

PENM in $120m first close on Vietnam fund

Vietnam-focused GP PENM Partners has reached a first close of $120 million on its fourth fund. The vehicle has a full target of approximately $180 million. PENM, which was previously known as BankInvest Private Equity, has $400 million under management across three existing funds.

NSI Ventures, F&H lead $8m round for Chope

NSI Ventures, the VC unit of Northstar Group, and consumer and technology sector-focused investor F&H Fund Management have led an $8 million round for Singapore online restaurant platform Chope. DSG Consumers Partners, Frontier Ventures, and existing investor Singapore Press Holdings (SPH) also participated in the round.

Ardent invests $2.2m in B2B portal Bizzy

Ardent Capital has committed $2.5 million to Bizzy, an Indonesian provider of business-to-business (B2B) e-commerce services. Bizzy manages a marketplace where clients can buy and sell a wide range of items, from office equipment to pantry supplies. Customers can also shop for office-related services.

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Slice and dice

A mainstay of private equity in the US and Europe, it is hoped that corporate carve-outs will play a larger role in Asia. Success rests on innovative deal-sourcing and careful management of multiple stakeholders

JONATHAN ZHU, A MANAGING DIRECTOR with Bain Capital, has been familiar with Chinese data networking equipment manufacturer H3C Technologies for more than a decade and spent much of this time trying to buy some of all of the business.

As a banker with Morgan Stanley, Zhu advised on the joint venture between US-based 3Com and China's Huawei Technologies that led to the creation of H3C in 2003. In 2006, working for Bain, he was involved in a joint bid with Huawei to buy 3Com's share of the JV. 3Com was willing to pay more and took full ownership of H3C. Twelve months after that, seeing that 3Com was trading a discount to the value of H3C, Bain tried to buy 3Com with Huawei as a minority investor, but US regulators nixed the deal.

By 2011, 3Com was a subsidiary of Hewlett-Packard (HP) and H3C had been allowed to expand its sales footprint beyond China. Focused on getting its data networking equipment into the hands of more customers, several ancillary businesses that had been seeded within China were no longer so important. HP decided to sell and Bain picked up a video surveillance business, now called Uniview Technologies.

"The first time we looked at H3C they didn't have this business. The second time, when we looked at 3Com, it was at such a nascent stage we didn't include it in our underwriting. But by 2011 it had become bigger – we were impressed by the progress they had made," Zhu says. "We knew it and we knew who was managing it. We were therefore the most aggressive and active in pursuing it."

Although HP has since divested control of H3C to Tsinghua Holdings – an investment unit of Tsinghua University – corporate carve-outs by PE are relatively rare in China. It is no coincidence that the other recent deal of significant size, CDH Investments' 2014 acquisition of Fujian Nanping Nanfu Battery also involved a multinational seller: Procter & Gamble (P&G), which had previously announced plans to offload more than half of its brands in a bid to boost profitability.

Chinese corporates, by contrast, are still in acquisition mode. No market in Asia has seen the upscale-downscale seesaw that dominated the US towards the end of the last century: conglomeration in the 1960s and 1970s followed by an unpicking of these behemoths in the 1980s and 1990s as investors decreed that performance would improve if management teams focused on a narrower set of goals.

Hope springs

There are, however, signs of movement. In some markets – China and Southeast Asia – this movement is barely visible; expectations of deal flow are based on the notion that companies will eventually retreat from industries in which they are less competitive. Japan and South Korea are in a different position, with conglomerates facing a combination of regulatory and financial pressure to divest non-core assets.

PE investors have high hopes for Japan in particular, citing the government's emphasis on corporate performance. The recently enacted corporate governance code promotes greater involvement of independent directors in decision making, while the new JPX-Nikkei Index 400 assesses candidates based on criteria such as return on equity (ROE) and transparent reporting, and proxy advisory firm ISS has recommended voting out directors of companies that fail to achieve an ROE of 5%.

"It is not a paradigm shift but it's a good trend," says Masamichi Yoshizawa, a partner with The Longreach Group, in reference to the corporate governance code. "Companies must engage more with outside shareholders and they can look to improve ROE through actions such as carve-outs to PE."

AVCJ Research has records of 375 buyouts in Asia – for which valuations were disclosed – worth $200 million since 2000. About 30% of these could be described as corporate carve-outs, and four in five of these involved businesses in Australia, Japan and South Korea.

The two largest were both announced within the last 12 months: the $6.3 billion acquisition of General Electric's Australia and New Zealand consumer finance business by KKR, Deutsche Bank and Varde Partners; and Hahn & Co's purchase of a majority stake in Korea-based Halle Visteon Climate Control from Visteon Corp for $2.5 billion.

Needless to say, in more developed markets divestments are a larger contributor to private equity deal flow. According to a survey released by EY earlier this year, 45% of corporate respondents had recently divested or placed a business on a watch list. Over half expect an increase in the number of strategic sellers over the next 12 months. The primary drivers are a unit's weak competitive position, an asset being deemed non-core, and concerns about shareholder activism.

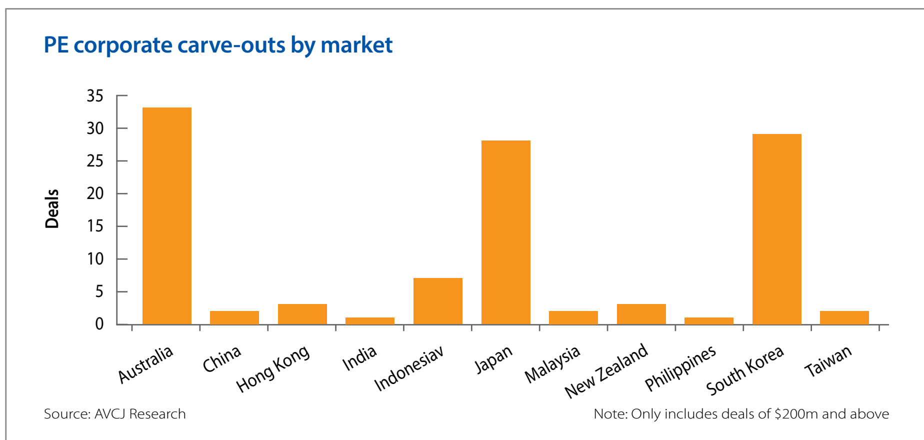
Even with a willing seller, carve-outs can present various complications. When Pacific Equity Partners (PEP) acquired Australia-based Peters Ice Cream from Nestle in 2012 (it has since sold the business to R&R of the UK), separating subsidiary from parent took 12 months. The private equity firm had to install new IT and reporting systems and find replacements for the management team members returning to Nestle. It also had to change the way in which the company was managed.

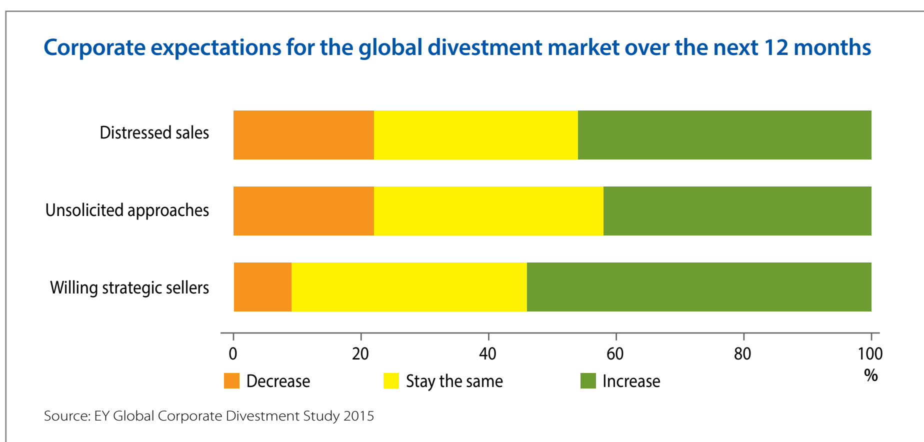
> "You can't create long-term value by taking low-hanging fruit. There has to be strategic upside"
>
> – Simon Pillar

"Operations, marketing, finance reporting went through a functional structure to different parts of the Nestle system. One of the first things we had to do was to create a structure for the business that meant everything reported up through the Peters CEO," says Simon Pillar, managing director at PEP. "It was a very positive thing. People came in on a Monday morning knowing exactly what they were doing, how much they'd sold last week, and how much money they were making."

Degrees of separation

Working with management to identify better ways in which to run a company – and providing





economic incentives for reaching agreed targets – is integral to the private equity carve-out. If the asset in question is an unloved Asia division of a multinational with disillusioned management, much can be achieved in this area. However, it depends on how and for how long the asset is considered by the parent to be non-core. This is well exemplified by two transactions involving Navis Capital Partners.

The first is Thai chicken producer Golden Foods Siam (GFS), which was a division of UK-based Grampian Country Foods until the parent was acquired by Dutch conglomerate VION Food Group in 2008. VION did not buy Grampian because it wanted exposure to Thailand, and in the wake of the global financial crisis, the parent was reluctant to invest in the business. Within a year it was sold to Navis.

The second is Linatex, a Malaysian rubber manufacturer owned by UK-listed Elementis. "It was a good company but had been non-core for a long time and the parent was milking it for cash," says Nick Bloy, managing partner at Navis. "Requests for investment in capital expenditure were only approved if it could be repaid in 12 months. The very definition of capex is that it takes longer than a year to repay. That sense of being squeezed to pay the corporate dividend is corrosive on a management team that has ambition."

Elementis eventually bowed to pressure from an activist shareholder and sold Linotex to Navis for $30.8 million in 2005. The private equity firm sold it five years later for $172.5 million.

In both cases, Navis found out from local management that a divestment could happen. It approached Elementis about Linotex and was invited to participate in an auction process for GFS on the basis of its previous experience in Thailand's poultry space with duck producer Bangkok Ranch.

Familiarity with the target business and management team can give a private equity firm the edge in a competitive process or even remove the need for an auction. For example, the CDH team had first backed Nanfu 15 years earlier, building up a majority ownership position before selling to Gillette, Duracell's parent, which was struggling to penetrate the Chinese market.

P&G subsequently bought Gillette but CDH stayed in touch with Nanfu's management. Thomas Lanyi, a director with the PE firm, told AVCJ last year that initial discussions with P&G were "pretty high level with us letting P&G dictate the direction." However, once the focus narrowed, CDH knew it could work with the Nanfu management. There was no competitive process and the PE firm paid close to $600 million for P&G's entire 78.8% stake in the business.

Personal connections were equally important in a second China carve-out by Bain, completed last year, also on a proprietary basis. The private equity firm had been looking at leasing businesses as part of deal-sourcing efforts within financial services and so was aware of Lionbridge. The team had previously created industrial equipment manufacturer Zoomlion's leasing division and then spun out as an independent, securing China CITIC Construction Corporation (CCCC) as a sponsor.

Recognizing that Lionbridge had nothing to do with any of its other operations, and reluctant to continue providing the guarantees required by banks as a condition of meeting the business' financial needs, CCCC decided to sell. A Bain executive heard about the planned divestment through a university classmate who knew the Lionbridge CEO. The combination of access to management and a prior understanding of the opportunity set in this space led to a deal.

Diplomacy first

It is vital that a prospective private equity buyer get comfortable with the management team of a non-core subsidiary, but careful diplomacy is required in terms of formal and informal approaches made to management and parent.

"You have to approach it with a fairly strict ethical framework," says Navis' Bloy. "You need to get to know management but you may also want information that the corporate parent would regard as confidential. If management team is very much in favor of a buyout they may not appreciate they are overstepping the mark in terms of what information they can share. This is more likely to get you disqualified from a process than present an advantage."

Indeed, many parent groups, particularly those that are listed, would be deeply unhappy to discover that a subsidiary has engaged in informal negotiations with private equity. They may fear being presented with a fait accompli when there is a broader duty to shareholders to conduct an objective, price discovery process, perhaps followed by a fully-fledged auction.

In situations that meet all fiduciary requirements and interaction takes place with the parent's blessing, management can still influence the process – perhaps just through body language during negotiations. The level of influence varies according to the corporate culture of the market.

"In the US there tends to be a key manager of the division or CEO of the company who has a lot of leeway to make the decision," says David Gross-Loh, a managing director with Bain. "In Japan it

is more consensus-oriented and you really have to communicate with and build your case with a large group of people. It's more of an informal process conducted one-on-one with the key people rather than going to the whole board and the board votes on it."

The center of gravity in Japan has shifted such that the parent, which five years ago might have offered a non-core subsidiary a choice between remaining under the corporate umbrella and improving profitability, being acquired by private equity or being acquired by a competitor, is no longer willing to continue providing support.

Even though the prospect of working with private equity and retaining a degree of independence might be preferable to absorption by a rival, Longreach's Yoshizawa says it is rare for a management teams to actively seek out private equity. Those that do are often frustrated at their parent group's reluctance to invest in overseas expansion, which for many companies is essential to preserving competitive advantage.

In this respect, the private equity offering must amount to more than just an escape route. While there may be clear cost savings or efficiencies a PE firm can easily realize post-acquisition, there has to be a strategic rationale for getting involved, not least because the management of the subsidiary or the legacy-wary parent insist on it.

Toolbox: Finding value in carve-outs

Kerry Foods did want to sell Pinnacle, or at least not at that particular time. The Ireland-based conglomerate had decided its Australasia-focused bakery business required a significant capital expenditure program and it wanted local management to focus on executing it. An auction would be a distraction; it could come later.

Nevertheless, Pacific Equity Partners (PEP) convinced Kerry to do business, agreeing a buyout of Pinnacle earlier this year. There was no auction. "We had to persuade them that we could assess the value of what was going to come out of the capex program, which was underway but had not yet started to deliver. And we persuaded them that our process would not be distracting for management," says Simon Pillar, managing director at PEP.

Kerry is relatively unusual in that it recognized Pinnacle was non-core but committed to the capex program with a view to realizing a higher valuation for the asset when the time came to divest. Stephen Lomas, Asia Pacific divestiture advisory services leader at EY, observes that all corporates should think about divestments as a way of raising capital for investments in other parts of their business. And in this respect, there is much they can learn from private equity.

"When a PE firm buys a business it is already planning to divest it at a profit – that is the business model," he says. "Corporates should look at what private equity does to enhance value. If they want to sell an asset in 2-3 years' time, isn't there something they can do now to get a better price later on?"

In addition to increasing revenue by investing in the non-core business – which some parent groups may struggle to justify – corporates can make operational improvements to reduce costs and also take working capital out of the business in order to boost the economic return on the sale. Further measures include optimizing legal and tax structures and treating divisions targeted for divestment as stand-alone entities.

"In these situations, what creates the opportunity to do something a bit more proprietary is a function of the complexity of the transaction," adds Pillar. "In the case of Griffin's Foods and Tegel [bought from Danone and Heinz, respectively], they were stand-alone businesses. This meant separation from the mother ship was relatively straightforward."

It is unclear to what extent corporates can replicate elements of the management buyout model that underpins many divestments: empowering a management team to make decisions and rewarding them for making the rights ones, based on a combination of efficient governance, performance-based incentives and accountability.

"Many big companies culturally do not have an entrepreneurial spirit. A spin-off unleashes it because you turn executives who are unloved in the corporate structure into shareholders and you can have a burst of alpha creation activity," says Nick Bloy, managing partner at Navis Capital Partners. "It is very hard within a corporate structure to say to a non-core business, 'We are empowering you to create some value, good luck guys.'"

"We've had situations where we have been able to reap quite significant procurement benefits very quickly and this has been surprising – for example, you would expect multinationals to be efficient in their purchasing," says PEP's Pillar. "But you can't create long-term value by taking low-hanging fruit. There has to be strategic upside."

The partnership approach

PEP went through this process in partnership with a corporate when it took a 50% stake in the Australasia hygiene products business of Sweden-headquartered SCA. The parent recognized the division required significant capex and wanted a partner to share the burden. PEP also provided local expertise and the business listed last year, allowing the PE firm to make a full exit.

This approach remains a rarity in Australasia, but elsewhere in the region – particularly if the seller is an Asia-based group – there is often an interest in retaining a minority stake in the divested asset. Situations vary, but in most cases the parent recognizes that a private equity investor can deliver growth that would not be achievable if driven in-house and wants to participate in the upside.

In China, HP held on to 20% of H3C. In Southeast Asia, when CVC Capital Partners bought a majority stake in Matahari Department Store, the asset was restructured as a joint venture between the PE firm and the seller, the Riady family-controlled Lippo Group. CVC's value proposition was that it could help professionalize Matahari and the Indonesia-based business has since gone public. It trades at four times the valuation at which CVC bought in and the PE firm has now sold down most of its stake.

Partnership was also a key factor in two Japan deals involving KKR and Bain, respectively. KKR bought a majority stake in Panasonic Healthcare in 2013, having convinced parent company Panasonic Corporation – which was to retain 20% of the business – that it could help drive growth through cross-border M&A. Last month the company agreed the bolt-on acquisition of Bayer's diabetes care business.

Bain, meanwhile, purchased of a 50% interest in Jupiter Shop Channel from Sumitomo Corp. in 2012 – a entirely bilateral deal that followed years of discussions with the Japanese corporate about a range of businesses.

"They had identified Jupiter Shop as a business they wanted to get off the balance sheet, but at the same time they wanted to grow it, particularly in the internet area. We showed them some work we'd done with retail and media companies in the US and they were impressed," Gross-Loh says. "This was more of a partnership decision on their part."

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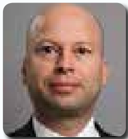

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The specialists

On the back of reforms and a rising consumer class, China's healthcare sector is expected to see huge growth. Sector specialists have emerged to capitalize on the opportunity. How can they differentiate themselves?

CHINA-FOCUSED LILLY ASIA VENTURES (LAV) tapped external capital sources for the first time when it spun out from global pharmaceutical firm Eli Lilly in 2011. However, the GP did not consider itself as a first-time fund.

Between 2008-2010, as a captive corporate VC arm, Lily Asia made investments worth $50 million. On becoming independent, the existing portfolio was packaged into Fund I, and then Eli Lilly was the sole LP in the $100 million second vehicle. Fund III closed in April at $300 million, with Eli Lilly once again participating at anchor LP alongside a mixture of sovereign wealth funds, fund-of-funds and family offices.

The new fund will invest $5-25 million in 20 growth-stage companies, with 75% of the corpus earmarked for drug development and the rest going into medical devices and diagnostics with a clinical angle. "Everything we touch has a heavy dose of scientific expertise behind it. In order to survive in that kind of deal sourcing environment, we should have a team that's fully specialized," says Judith Li, a partner at LAV. The firm has 10 investment professionals with healthcare industry backgrounds.

Traditionally, China healthcare investments have come from generalist funds, but as the private equity industry matures, at least five sector specialists have raised new pools of capital in the last two years. They include Sino-US plays Vivo Capital and OrbiMed Advisors, China life-science focused BVCF and first-time fund HightLight Capital. Ally Bridge is raising for the second fund, while newly-formed Aequus Asia Capital Partners is also seeking capital.

Industry participants expect this trend to continue as more GPs seek to differentiate in terms of team structure and investment thesis. Are LPs buying into their stories?

Being different

Steven Wang, a partner at CDH Venture, left the firm in last May and set up HighLight alongside Jason Zhao and John Zhu, previously healthcare specialists at SoftBank China Venture Capital and Greenwoods, respectively.

The firm closed two vehicles last September – a $200 million US dollar-denominated fund and RMB1 billion renminbi fund. Sequoia Capital is an LP in the offshore vehicle, alongside family offices and fund-of-funds. Chinese entrepreneurs and corporates contributed capital to the local currency vehicle. HighLight has already invested in 14 companies, stretching from mobile health technology to traditional drug manufacturers.

Although there are more healthcare-focused GPs in China, Wang says the number of high-quality teams is limited. While many managers have sector expertise and experience with international pharmaceutical firms, they may not be suited to operating independently, strategic planning, deal execution and team leadership.

"They are professional but not everyone is business savvy," says Wang. "In the healthcare investment world, you need talent and experiences. You come across many failures and stand out because of your personal strength. That's the same in the TMT [technology, media and telecom] sector. There are more GPs in TMT than in healthcare, but good deals still go to relatively few managers."

> "There are more GPs in TMT than in healthcare, but good deals still go to relatively few managers"
> – Steven Wang

Compared to TMT, healthcare businesses take longer to build and Chinese entrepreneurs are therefore picky about which PE firms to work with. Several GPs have developed cross-border investment theses in order to emphasize their value-add capabilities. Ally Bridge, for example, has a strong focus on overseas M&A and has built up 20-strong team, split between China and the US, all of whom have biotech experience.

"Some top companies in China come to me and say, 'We don't need you to help us in China, but how can you help us find cutting-edge technologies in the US?' That's a good question," says Frank Yu, founder of Ally Bridge. "The US is by far the dominant global player in life sciences. How can one really understand the sector without being familiar with the US market? But most funds in China do not have a remit to invest outside their home market."

Yu adds that founders come to Ally Bridge and they create deals together. Wuxi PharmaTech, a China-based provider of contract R&D services to the global life-science sector, for instance asked the GP to lead a consortium backing a $3.49 billion privatization of the company. Boyu Capital is also involved in the deal, which is likely to be the largest ever healthcare buyout in China.

Ally Bridge sees this as an example of how sector expertise can translate into opportunities of all sizes, from venture capital to buyouts. The firm plans on launching a hedge fund that will invest in every stage of the healthcare lifecycle.

However, HighLight's Wang argues only 10-20% of deals have a cross-border angle. "We can't overestimate our ability to find the cutting-edge technologies to feed the entrepreneurs. That's not our job. Those entrepreneurs work in the industry every day, so they can do it themselves. Our job is to find and support the bravest and most aggressive founder," he says.

Risk factors

On the pharmaceutical side, LAV also adopts an "in China, for China" strategy, investing in domestic drug developers that can bring mid-tier technology from develop markets into China. These investments have great market potentials and less technical risk.

"In the US, on adverage, of every 10 drugs being developed in clinical pipelines, nine will fail. In China the success rate is as high as five out of 10. The fundamental science has already been proven in developed countries, such as the US and Europe, so there is less risk. Within those five out of 10 possibilities, if you can find the right management teams to back, the success rate will rise dramatically," Li says.

Different investment strategy requires different skill-sets, and LPs are willing to provide capital to GPs that can demonstrate domain expertise and a relevant track record. The healthcare opportunity in China is undeniable, but managers have to show they can access it.

"You're seeing a lot of new GPs coming out to the market with a focus on healthcare. Some of them might not be able to survive in the long term if they fail to prove their capabilities with good performance," says Mingchen Xia, a Hong Kong-based principal in Hamilton Lane's fund investment team. "But from a broad perspective, the industry itself is sustainable."

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Carlyle targets e-commerce supply chain

AN ESTIMATED RMB12.3 TRILLION ($2 trillion) worth of goods were transacted online in China last year and gross merchandise value (GMV) will nearly double to RMB24.2 trillion over the next three years, according to consultancy iResearch. This has prompted huge demand for high-quality logistics infrastructure, particularly in the small items delivery and courier services segments, which play such an important roles in getting the goods to the customer.

Less-than-truckload (LTL) logistics operators provide road transportation for goods between 15 kilograms and three tons. In the low-weight segment between 15kg and 500kg, it is worth RMB400 billion. Growth may be strong but there should also be some consolidation – essential if China is to reduce logistics costs, which stand at 18% of GDP, compared to 8% in the US.

"The market is currently highly fragmented as mom-and-pop haul trucking companies amount for more than 90% of the market, representing significant consolidation potential," says Eric Zhang, managing director with The Carlyle Group's Asia buyout team.

Last week, the GP announced plans to invest $120 million in Shanghai ANE Logistics, which claims to be the largest LTL operator in China. The transaction, which will come from the $3.9 billion Carlyle Asia Partners IV, is expected to close in the next few months.

ANE Logisitcs: Supply solution

"ANE came across as one of the industry leaders that we would like to partner with as we were impressed by its strong management team and unique franchise model. When ANE kicked off its latest round of financing, it attracted strong interest from global and domestic private equity funds," Zhang adds.

Carlyle is the lead investor in the round, with Goldman Sachs and China Renaissance among the other participants. Last July, Warburg Pincus committed $50 million to the company, having invested an undisclosed sum earlier in the year. Prior to that, the business raised a $6.3 million Series A round from Sequoia Capital.

ANE has ramped up quickly over the last five years. Its national delivery network comprises 130 self-operated sorting centers, more than 4,000 contracted trucks and about 5,000 franchised pick-up-delivery stores. Logistics businesses tend to require large amounts of capital and a franchised model reduces the sums needed on a day-to-day basis. So, ANE is able to lower delivery fees and access a large customer base, while maintaining sustainable income from franchisees.

The new capital will be used to enhance the company's infrastructure and expand its network coverage in China. Carlyle will also leverage its experience in franchising and synergies with other portfolio companies.

"The company is led by an experienced senior management team with a combination of entrepreneurial drive, professionalism and strategic vision. We are confident that the company will emerge as one of the few most reputable entrepreneurial platforms in China's logistics space," says Zhang.

VCs dine on Korea's MangoPlate

NOTHING ILLUSTRATES SOUTH KOREA'S obsession with food better than a new foodie craze called Mukbang.

Mukbang – a portmanteau derived from the Korean words for eating and broadcasting – is essentially people making videos of themselves eating meals for others to watch online. The hobby, popular among young Koreans, is part of a broader trend that has helped drive massive growth in the restaurant industry. And it is one that MangoPlate, a restaurant review platform which recently won VC backing, is trying to tap.

"We found dining out is actually a pretty humongous market, worth $70-80 billion a year," explains Joon Oh, CEO and co-founder of MangoPlate. "It is a massive market and no one is really taking advantage of it."

This sense of an unexploited opportunity was no doubt shared by Qualcomm Ventures, SoftBank Ventures Korea, and Yahoo Japan's YJ Capital, which together agreed to invest $6.1 million in the company last week. James Kwon, a director at Qualcomm Ventures, says part of this growing obsession can be put down to increasing internationalization in the country.

"Every year about a half a million young people go abroad to study where they experience diverse food and culture. When they come back they look for that diversity in Korea," he says. "So search and discovery platforms like MangoPlate are becoming a very important part of this trend."

The platform started out as a labor of love when the four founders put together a spreadsheet of their favorite eateries. At the time the only source of restaurant reviews was Wingspoon, a platform offered by web portal giant Naver, and food blogs. The former was shut down – a result of government pressure on large conglomerates like Naver to trim their operations – and the latter were known for being little more than paid advertising.

MangoPlate: Good eating

"The list started out with 50 restaurants but we kept adding to it and more people got involved," says Oh. "By the time we got to 2,000 restaurants we said, 'Why don't we just create an app for it?'"

No longer a spreadsheet, the new platform allows users to provide reviews and photos of their restaurant visits, and also analyzes restaurant data, individual preferences and social networks in order to make better restaurant recommendations.

The company now claims to have around 40% of Korea's restaurants covered, and aims to double that to around 80% within the next year by focusing on customer acquisition, better features, and expanding coverage into new territory.

"Accumulating users and accumulating information on restaurants is the top priority for us," says Oh. "We now have very good coverage in Seoul, but our coverage outside of the capital – in cities like Busan – is not as good, so we will look to grow there."

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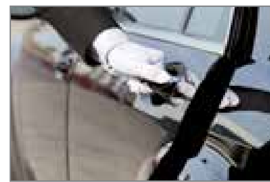
Ucar appeals to classy car bookers

CHINA'S ONLINE TAXI-BOOKING platforms have made huge strides, but the convenience they offer comes with an element of risk as well. Services like Didi Dache, Kuaidi Dache and Uber treat their drivers as contractors rather than employees, which limits the amount of vetting they can do.

This explains the move by certain industry participants into premium chauffeured car services, which address customers' safety concerns directly. The likes of Ucar, another ride-hailing app, employs its own drivers and rents its own cars rather than rely on crowd-sourcing drivers who provide their personal vehicles.

"They actually explicitly promise to the customers that they will guarantee drivers' background and qualifications, as well as vehicle conditions," says Emily Paau, director of investor relations at CAR Inc., the country's largest car hire firm. "They also track drivers' behavior and promise the customer to protect their privacy."

CAR has a longstanding relationship with Ucar; family members of CAR's chairman and CEO Charles Lu hold a majority of shares in the smaller company, and CAR agreed earlier this year to rent its high-end vehicles to Ucar, which now operates in 60 cities, through a co-branding arrangement. Now CAR has joined its investors Warburg Pincus and Legend Holdings to invest $250 million in Ucar's Series A round. The investment provided participants with a 20% stake, of which 10% will go to CAR.



Ucar: Driven to success

The arrangement provides the participants with a number of benefits; Ucar, which has been seeking to diversify its shareholding structure, will have a broader base of investors, while CAR can continue to pursue the synergy that it enjoys through its partnership with the smaller company. "They rent cars from us long-term, from three years to five years, and also they rent cars from us during the weekdays when our utilization rates are relatively low," says Paau.

For Warburg Pincus, which recently part-exited its stake in Hong Kong-listed CAR, the deal is an opportunity to remain connected to China's auto booking ecosystem. While the PE firm has been relatively hands-off at CAR, there is the potential for strategic support. For example, in the early days Legend offered its sponsorship to help CAR qualify for bank loans.

Other companies pursuing this business model include eHi Car Services, China's second-largest automotive rental service. It invested $25 million in Kuaidi Dache last year (the company has since announced a merger with Didi Dache) and has made its vehicles available through Kuaidi's platform. However, despite these inroads, Ucar believes its focus on the high-end segment gives it an advantage over more diversified competitors.

"Although there is some overlap of their business space, because of the difference in service quality, and also better drivers, we believe that Ucar's customers are more to high-end," says Paau.

Investors book trip with China's Tongcheng

CHINA'S TRAVEL INDUSTRY IS BOOMING but it is still heavily reliant on offline transactions. According to Derek Wang, an executive director with CITIC Capital, online penetration of the sector is just 12% – a tiny figure when set against 55% in the US and 35% in Japan.

On this basis, a company like Tongcheng Network Technology – which is behind travel website Ly.com and a leader in the online travel agencies (OTA) market – has arguably realized just a fraction of its true potential in China. This was the rationale behind CITIC's decision to join existing investors Wanda Group and Tencent Holdings in a RMB6 billion ($967 million) round of financing for the business.

CITIC had been eyeing investment in China's travel space for the past two years and OTAs emerged as one of the more attractive areas. "Deeper penetration, especially in sub-sectors such as tourist destination tickets and packaged tour products – both domestic and outbound – will grow rapidly," he explains. "OTAs are gaining market share from offline players with their national coverage, larger user base, higher efficiency and price advantage."

Set up in 2004, Suzhou-based Tongcheng provides online travel services including tickets for scenic attractions, hotel booking, domestic and international air tickets and cruises. It most recently received $200 million from Ctrip International, which became the second-largest shareholder after the management team, in April.

The company previously got RMB500 million from Tencent, Boyu Capital and Oriza Holdings, having raised an undisclosed sum from Tencent Collaboration Fund in May 2012. The company's first round came in early 2010 when Oriza – then called Suzhou Ventures – put in $2.9 million.

Tongcheng: A ticket to ride

Last year Tongcheng claimed it had served 30 million customers since inception; the company further says it is among the top three players in the industry, by gross merchandise value (GMV) and by number of customers served. CITIC came by the deal through its relationship with existing investors Tencent.

"This is our first investment in the OTA sector, and we have a few other targets in the pipeline in the general travel sectors, including tourist destinations and travel services," Wang adds.

One of Tongcheng's strengths is that it now has the kind of scale required to provide a wide spectrum of products outside of its core offering of travel tickets and local tour packages – something its smaller competitors struggle to do.

Wang also notes that while the company is still competing with other leading OTAs for market share and volume, the entry barrier is becoming higher.

"Tongcheng will use the proceeds for branding building, strengthening its system and providing the most wonderful user experience in its app design, product offering and service," he says. "The company will continue to strengthen its market position in all aspects of travel products, as the leading OTA in China."

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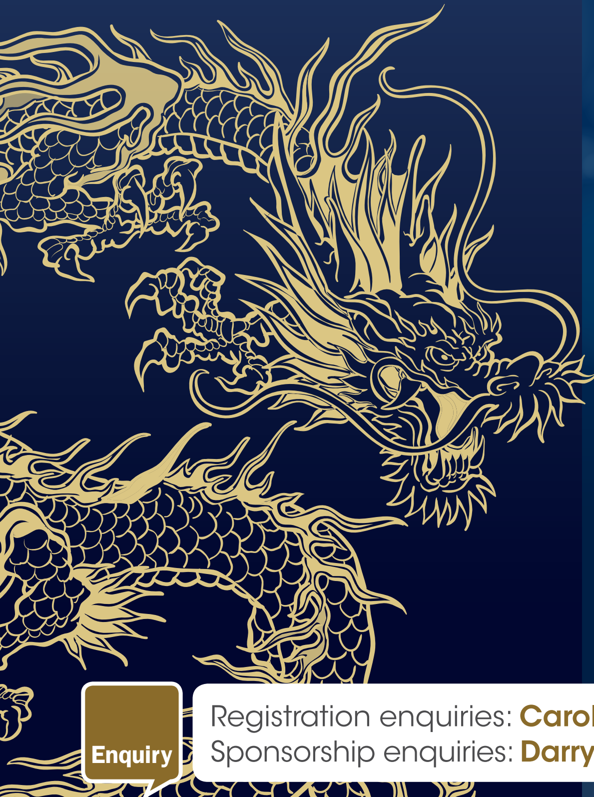

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The turnaround trade

Australia's Allegro Funds has been dealing in distress for 10 years – as advisor, replacement GP and now manager of its own fund. Founding partner Chester Moynihan explains how the firm's approach has evolved

Q: Your fund has explored a number of different business models. How has that history shaped your perspective on investing?

A: In the first stage of our history we were going into troubled companies and helping develop restructuring plans. Come 2008 we were actually tapped on the shoulder by the LPs to take over as a replacement GP of a distressed fund that was owned by ABN AMRO. We worked pretty much exclusively on that until the end of 2010. From then until 2013, we were accessing institutional capital for deal-by-deal investing and then in October of last year, we announced the first close of our fund, and we've done two deals out of that fund already.

I think what we've been able to demonstrate through those different phases is an ability, not only to operationally restructure and turn around underperforming businesses, but also to access that segment of the market, and deploy capital successfully into it.

Q: What sort of businesses do you consider to be good candidates for a turnaround?

A: Essentially, we target businesses that have a reason for being. They typically have a reasonably substantial revenue base, but have lost their way profitability-wise, and cash flow-wise. They are typically overleveraged, so they may be in the workout or bad bank section of a bank. In most cases the business has been operationally damaged. Good people have left, short-term decision making has prevailed, and the business is damaged.

Q: How do you structure your investments, and what size do you aim for?

A: Typically we would come in on an all equity basis. If we are partially debt funding something, it would be at a 1-1.5x, maybe 2x maximum level of debt. But the majority of our deals, and certainly the first two deals in our fund, have been on an all-equity basis, and the deal we're getting close to now will be on that basis as well. In terms of deal size, we've done a couple around the A$10-20 million mark, but from a fund balancing perspective, A$20-50 million is the sweet spot, particularly given that we've got a lot of parties, including our LPs, that are looking for co-investment.

Q: What strategy do you follow when you are trying to turn a company around, and how do you go about implementing that strategy?

A: What we're looking to do is to fix the balance sheet day one, but then to work intimately with the company to address whatever has gone wrong from an operational perspective. We call that our stabilization phase, and it would typically last 6-12 months. In every case we seek to partner with management, be that the incumbents or new people that we bring in. Once it's through stabilization, we're into the growth phase. At that point, we have an eye on exit.

Q: What is the most important factor in deciding that a particular company is not worth getting involved with?

A: The first judgment call is on what is fixable versus what is structurally impaired. We're looking for businesses in industries that will have a positive growth dynamic. There are some segments of mining services, for example, that have structural issues – no matter how cheap the assets are, we wouldn't go there. We're looking for businesses that we can restore to industry-level profitability, and that have a tail wind of industry dynamics behind them. A growth story is critical to achieving a successful exit. We find that it becomes a step too far to find a business that is challenged, or has issues, within an industry that has structural issues as well.

> "We target businesses that have a reason for being. They typically have a reasonably substantial revenue base, but have lost their way profitability-wise, and cash flow-wise"

Q: How did you apply these criteria in one of your recent deals?

A: I'll use I-Med [which runs a network of radiology clinics] as an example. It was in an industry displaying 8.5% growth, but was overleveraged with around A$1 billion of debt, and that led to all sorts of issues. We felt that fixing the debt structure and the business issues would put the company in a position where someone would want to buy it. And as was demonstrated when it was sold to EQT, having an industry tailwind is very helpful.

Q: How do you source deals?

A: There are broadly four buckets that our sourcing falls into. Traditional private equity is certainly one of them - these are usually failed sale processes. The second bucket is debt holders. This is where the debt is in commercial banks' workout areas, so they're looking to exit or find a solution for a problem loan, or it's a hedge fund that has bought into credit and wants to partner with someone that has on-the-ground resources and operational turnaround capability. The third bucket is the distress community. These would be the intermediaries, the lawyers, the insolvency practitioners, the accounting firms, the specialist restructuring advisors. And the final bucket is what we call proactive deal sourcing. That's just us running our ruler over industries, over companies, following up on industry intelligence.

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