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||| MVISION

Start-up central

HONG KONG IS THE FIFTH-EASIEST

place to do business globally, according to rankings released by the World Bank last year, behind Singapore, New Zealand, Denmark and South Korea. Though disappointing in terms of registering property and cross-border trade, the territory features in the top 10 in five of the World Bank's 10 categories: protecting minority investors, paying taxes, dealing with construction permits, getting electricity, and starting a business.

However, Hong Kong is not an easy place to be a technology start-up. In a ranking of global start-up ecosystems by research firm Compass, Hong Kong doesn't even make the top 20, although it has potential and is clearly trying to make up lost ground.

Compass examined five criteria through a combination of surveys, interviews and number-crunching: funding, talent, policy, market reach and start-up experience. Hong Kong falls short in the first three. In funding, there are gaps at the seed stage (Compass says there is a lack of angel investors) and the Series C and D stages (although this is largely a function of companies failing to achieve scale in their earlier institutional rounds). There is also a talent gap as graduates eschew the risk of start-ups for the certainty of employment with large corporations.

As for policy, Hong Kong ranks comparatively low but it has actively begun to incorporate innovation and entrepreneurship into municipal policy. The recent announcement of several initiatives intended to support the technology sector – including a HK\$2 billion (\$256 million) fund that will co-invest in start-ups alongside venture capital funds on a matching basis – is evidence of this progress.

Despite the low base, Compass found that Hong Kong was the fifth fastest-growing start-up ecosystem globally last year. In short, much of the general business infrastructure is already in place and so the territory is able to develop quickly as more sector-specific initiatives take hold. The study recommends targeting particular sub-sectors such as the internet of things and financial technology – leveraging Hong Kong's proximity to the hardware hub of Shenzhen and its strong financial services industry, respectively – and improving the availability of technical talent through progressive immigration policies.

There are two more suggestions: increase global know-how among entrepreneurs and develop an angel investor community. In terms of building know-how, there are steps the government can take in its role as industry catalyst. Co-working spaces, incubators and accelerators have proliferated in recent years and their health is vital to the sharing of ideas, experiences and best practices. Any initiatives that ensure technology is affordable and customers accessible are also vital, so a start-up can address a global market from day one, essential in a small geography like Hong Kong.

Singapore has made great strides in both these areas and it sits 10th in the Compass ranking, scoring particularly well for funding and start-up experience. The matching fund concept Hong Kong has announced is well-established in Singapore, with programs in place across multiple stages in order to provide the capital companies need to scale up their businesses. The value of country's ecosystem – calculated by combining start-up valuations at each funding round and at exit – are four times that of Hong Kong.

The angel investor community, however, is more difficult to develop through direct policy input. Rather, it represents the culmination of different policies as successful entrepreneurs come through the system and then invest in the next generation of start-ups. This in turn fills the talent gap as more young people are incentivized to build their own companies. There is certainly greater interest in the space than before, but the report's finding that the average age of founders in Hong Kong is lower than in Singapore or Silicon Valley is deceptive: it points to a lack of repeat entrepreneurs.

If Hong Kong can make life easier for start-ups then angel investors will emerge, but it takes time. In the meantime, positive vibes can go a long way, particularly in terms of shaking young people out of their career conservatism. Hong Kong needs to champion the success stories it is beginning to see.

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AUSTRALASIA

Greencross rebuffs TPG buyout offer

Australia-based pet services business Greencross has confirmed it received and rejected a buyout offer from TPG Capital worth around A\$720 million (\$507 million). The bid of A\$6.45 per share is close to the level at which Greencross was trading in mid-December before spiking in response to reports of PE interest. TPG acquired a 6.92% voting interest shortly before Christmas.

Future Fund trims private equity exposure

Australia's Future Fund has lowered its private equity allocation slightly and boosted its cash holdings, reflecting concerns over increased risk due to changes in lending and public policy across markets. The sovereign wealth fund had about 10.4% in the asset class as of December 2015, down from 10.8% as of June 2015, but still up on the 9.5% allocation at year-end 2014.

GREATER CHINA

PE investors complete Omnivision acquisition

Hua Capital Management, CITIC Capital and Goldstone Investment have completed their acquisition of US-listed chipmaker OmniVision Technologies in a deal worth \$1.9 billion. The consortium paid \$29.75 per share for all outstanding shares in the company.

Alibaba to sell stake in O2O services platform

Alibaba Group has confirmed it will exit Meituan, the China-based online-to-offline (O2O) services provider that merged with rival Dianping last year, to focus on its own platform. Koubei, a joint venture with Ant Financial, launched last year and focuses on food-related services.

Jinpan agrees Forebright-backed privatization

Jinpan International, a US-listed Chinese electric transformer manufacturer, has agreed a take-private deal with the company's chairman and Forebright Capital. It values the business at approximately \$98 million. The Forebright team spun out from China Everbright International in 2014.

Sequoia closes fifth India fund at \$920m

Sequoia Capital has closed its latest India fund – which has a minority allocation to Southeast Asia – at \$920 million, comprising an \$875 million institutional corpus and a GP commitment of \$45 million. The fundraising process was finalized in early January, according to a source familiar with the situation, with almost all the capital coming from existing investors. A regulatory filing for Sequoia Capital India V was made at the beginning of November last year.



The venture capital firm announced a final close of \$530 million on its fourth India fund as recently as May 2014. The vehicle had a remit for Southeast Asia as well. It targets the technology, consumer and healthcare sectors, with a focus on mobile, online payment, big data, software-as-a-service, cloud computing, enterprise software and medical and lifestyle opportunities.

The firm's first India fund, Sequoia Capital India Growth Fund I, raised \$400 million in 2006. According to AVCJ Research, two funds followed in 2007 – a second growth vehicle of \$725 million and an early-stage vehicle of \$300 million. There was an upheaval between Funds III and IV as a merger with WestBridge Capital didn't turn out as planned and the WestBridge founders restarted their own franchise in 2011.

Cloud storage firm Qiniu raises \$100m

Qiniu, a Chinese cloud storage service provider, has raised a \$100 million Series D round from China Broadband Capital (CBC), Telstra Ventures and Chinese mutual fund provider Harvest Global Investments. The company claimed to serve over 400,000 business users as of the end of last year.

China Merchants Bank to invest in Didi Kuaidi

China Merchants Bank (CMB) has agreed to invest in Chinese ride-hailing app Didi Kuaidi and to

create a strategic partnership with the company. The size of CMB's investment was not disclosed, but media reports have put it at \$200 million.

Hony to re-up in Jinjiang International

Hony Capital has agreed to invest an additional RMB599 million (\$91 million) hotel operator Shanghai Jinjiang International alongside other financial and strategic investors. The company is looking to raise RMB4.52 billion in total. Hony's stake will increase to 12.56%.

Hengyang Cattle set for reverse merger

Heilongjiang Hengyang Cattle Industry, a Chinese beef processor backed by CDH Investments among others, plans to list in Shenzhen through a backdoor listing. The largest shareholder in Shenzhen-listed Sundiro Holding will transfer its 11% stake to Hengyang Cattle in a deal worth RMB699 million (\$106 million).

Shanghai to compensate VCs for losses

The Shanghai government has proposed new measures to compensate early-stage investors for financial losses incurred by investing in local start-ups. The initiative only applies to onshore, renminbi-denominated investments. It will come into effect on February 1 and run for two years.

CMC to buy 30% of Hong Kong-listed Meike

CMC Holdings, an investment platform launched by CMC Capital Partners founder Ruigang Li, has agreed to buy 29.55% of Hong Kong-listed sportswear manufacturer Meike Holdings. Allan Yap, Meike's executive director and its largest shareholder, will sell his entire holding to CMC.

KTB, Jolly Innovation back CARsgen

KTB Ventures and Jolly Innovation Ventures led a \$30 million Series B round for Shanghai cancer therapy developer CARsgen Therapeutics. In the next year the company will complete the first stage of clinical studies for two drugs in China and preclinical testing for the same two in the US.

China healthcare platform raises \$20m

We Doctor Group, a Chinese online healthcare information portal formerly known as Guahao.



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com, has raised a further \$20 million from Shanghai-listed property developer Shandong Tyan Home. The company has previously received funding from the likes of Tencent Holdings, Hillhouse Capital and Goldman Sachs.

Everbright ReinFore backs Huasheng Finance

Everbright ReinFore, a private equity arm under China Everbright Group, has led a Series B round of funding for Huasheng Finance, a Chinese online lending platform. The deal is reportedly worth RMB100 million (\$15 million).

Life sciences player Adagene raises \$28m

Adagene, a China-based life sciences company focused on smart antibody technology, has raised a \$28 million Series B round led by GP Healthcare Capital, the medical-focused subsidiary of China's GP Capital. Existing backers Eight Roads Ventures China, F-Prime Capital, and WuXi Corporate Venture Fund also participated, along with new investor New World TMT.

NORTH ASIA

Corstone closes \$124m Korea fund

US-based private equity firm Corstone Capital has closed a South Korea-focused fund at KRW150 billion (\$124 million). LPs include the Korea Development Bank's Growth Ladder Fund and the Korean Teacher's Pension Fund, along with Corstone Capital.

Rakuten launches \$84m Japan venture fund

Rakuten Ventures, the corporate VC arm of Japanese e-commerce giant Rakuten, has launched a JPY10 billion (\$84 million) fund targeting start-ups in Japan. The fund will back companies with unique technologies and business models that offer potential for synergies with Rakuten Group's businesses.

Nissay commits \$1.7m to Japan's Onet team

Nissay Capital has invested \$1.7 million in Series A funding in Japanese workplace chat app Onet team. The company is looking to grow beyond its regional focus – 85% of customers are outside of Japan, with most residing in Southeast Asia – in 2016.

KKR nets over 2x on Masan Consumer exit

KKR has fully exited Vietnam's Masan Consumer Corp. (MCC), generating a more than 2x return on a \$359 million investment made across two tranches in 2011 and 2013. The private equity firm first paid \$159 million for a 10% stake in MCC and then committed a further \$200 million two years later. It ended up with an approximately 18% interest in the business, according to a source familiar with the situation.

KKR received one dividend payment from the business and made its exit over the course of three transactions, starting in July of last



year, when half the holding was sold back to the parent, Masan Group. The most recent transaction was related to the broader agreement between Masan Group and Thailand's Singha to create a combined food and beverage platform.

The first phase of funding in this partnership saw Singha pay \$50 million for a 33.3% interest in Masan Brewery and \$600 million for 14.3% of Masan Consumer Holdings, according to a disclosure. That \$600 million injection enabled Masan Consumer Holdings to purchase additional shares in MCC, taking its direct ownership of the company from 77.8% to 96.7%. This process facilitated the purchase of the remainder of KKR's stake. The size of the deal was not disclosed.

SOUTH ASIA

ADV commits \$45m to hospital chain

ADV Partners has invested \$45 million in Indian hospital chain Dr. Agarwal's Healthcare, providing an exit for existing backer Evolve Capital. Dr. Agarwal's will use the capital for the expansion of its publicly listed eye hospital chain, Dr. Agarwal's Eye Hospital, which currently has 45 facilities in India and 14 in Africa. The company plans to grow both in India and overseas.

Olympus, CX lead \$60m round for Nspira

Olympus Capital Asia Credit and CX Partners' India mezzanine fund have led a INR4 billion (\$59 million) round for Indian management service provider Nspira. Nspira will use the funds to grow into new regions and widen its sector focus.

SOUTHEAST ASIA

CVC, Lippo postpone plan to exit Link Net

CVC Capital Partners and the Lippo Group have suspended plans to sell their stake in Link Net, an Indonesian broadband and cable TV operator, due to economic volatility. Providence Equity Partners and Indosat were reportedly bidding, with sellers valuing Link Net at up to \$1.5 billion.

Kejora adds partner, targets \$100m fund

Indonesian venture capital firm Kejora Group has hired Eri Reksoprodjo, formerly of Saratoga Capital, as a partner as it looks to raise up to \$100 million for its first institutional fund. Reksoprodjo departed Saratoga in early 2015, having spent approximately three years with the firm.

Venturra leads \$12m round for KFit

Venturra Capital has led a \$12 million Series A round for Malaysia-based gym membership app KFit. Existing investors Sequoia Capital and 500 Startups also participated, along with newcomers SIG and Axiata Digital Innovation Fund.

Singapore's Eyeota raises \$7m Series A round

Global Brain, Infinity e.Ventures and Project A Ventures have committed \$7 million in Series A funding to Singapore adtech firm Eyeota. Eyeota will use the funds to enter new territories, grow its technology team and hire international staff.

Jungle Ventures adds to management team

Singapore-based Jungle Ventures, which is raising its second fund, has appointed Vaishali Cooper, previously of Komli Media, as CFO and ex-eBay executive James Li as head of finance. Menka Sajani, most recently with Google Southeast Asia after seven years with HQ Capital, has also joined as corporate development head.

Made to measure

Growing appetite for co-investment among foreign and local institutions in Asia has given rise to a wider variety of advisors offering customized solutions to those with limited in-house resources

THE COMBINED PRIVATE EQUITY

portfolios of the Oregon Public Employees' Retirement Fund and Washington State Investment Board are worth approximately \$32 billion. This comprises positions in more than 600 funds, although there is a high degree of crossover between the two portfolios. In Asia, for example, they both back Affinity Equity Partners, KKR and CDH Investments.

For the past decade, Fisher Lynch Capital has been tasked with combing through these manager relationships for co-investment opportunities on a global basis, easing the burden on limited in-house resources. Andy Hayes, private equity investment officer at Oregon State Treasury, has previously observed that the arrangement also brings clarity to his team's decision-making process: there is no danger of backing "a B-minus GP that could deliver a lot of co-investment."

Oregon and Washington each committed \$250 million to Fisher Lynch in 2005 and then put \$500 million apiece into a vehicle that started investing in 2011. They are the two biggest clients of the boutique investment firm.

Fisher Lynch to a certain extent owes its existence to Asia. Brett Fisher, the firm's co-founder, and Leon Kuan, one of his fellow managing directors, previously managed the North American private equity group for GIC Private. In addition to making LP commitments to funds, they took the Singapore sovereign wealth fund into 22 co-investments. Fisher Lynch was set up in 2003 to help US LPs get exposure to a strategy that, in the wrong hands, is as risky as it is lucrative.

Growth industry

Thirteen years on, co-investment is a priority for many LPs, even if relatively few are willing and able to act on opportunities, particularly when the target assets are far from home. But as foreign groups become increasingly comfortable with Asia and more local investors follow in the footsteps of GIC and build out PE programs, demand is growing. This has also given rise to advisors who offer highly customized services.

"We thought we could help institutions in three areas where they were struggling," says Michael Prahl, who set up Asia-IO Advisors last

year. "First, execution capabilities in co-investment, and resolving the tension between striving for active co-investment programs, which are expensive to set up, and having a cost-efficient program that is passive. Second, corollary to the co-investment program, access to Asian PE given how fragmented it becomes beyond the global brand names. Lastly, we wanted to provide these larger clients with something more customized than the traditional model."

Prahl, an adjunct professor with INSEAD's Global Private Equity Initiative and before that an investment professional at Apax Partners, joined his partner Denis Tse, formerly head of private investments in Asia for Lockheed Martin Investment Management, in founding Asia-IO. They have signed up several large clients and closed their first transaction in late 2015.

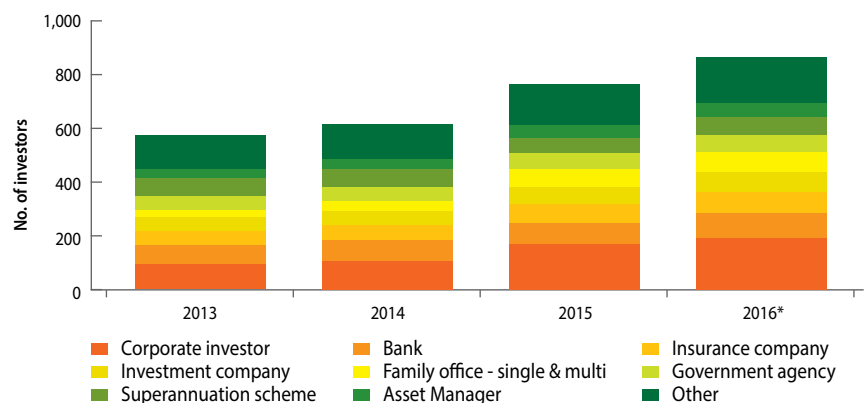
Asia-IO is not alone in offering customized

no plans to do this), then others that address co-investment as part of broader portfolio construction services have more in common with fund-of-funds providers that have for years offered customization through separately managed accounts (SMAs).

Countless other strategies are scattered around these, as advisors match up investment opportunities with LPs that have particular needs. "Three quarters of our pipeline is funds and one quarter is SMAs or structured companies," says Mounir Guen, CEO of MVision. "With structured companies, we could either find a solution for an investor and put together a partnership, or help a GP turbo-charge an outstanding portfolio company by finding long-term capital, so it doesn't have to be sold after 4-5 years."

These are solutions that exist outside of traditional fund structures, replacing or

Asia Pacific-based PE investors by type



Source: Preqin

* As of February 2016

co-investment solutions, but categorizing these different industry participants is challenging. They are defined not only by their willingness to provide flexibility, but also their desire to go against the grain, in whatever direction that may be.

For example, EXS Capital Group has operated as a fund-less sponsor for more than eight years, bringing co-investors into its deals through bespoke structures. If it sits closer to GPs working deal-by-deal basis as a stepping stone to launching a blind pool fund (EXS itself has

complementing them. However, for now they remain firmly in the minority. The bulk of capital entering the asset class enters blind pool funds that charge a 2% management fee and 20% carried interest, or some variation on that theme, depending on the popularity of the GP and the clout of the LP.

This is in part because most of the larger private equity investment programs follow a similar evolutionary path. It could take a year or so for an institution to enter the asset class as

consultants help to work out its objectives and how they can be achieved. Certain functions are handled directly and others are packaged into mandates for third-party providers. For example, primary commitments to managers in certain geographies or below a certain size are often outsourced. Secondaries and co-investment might also be placed in the hands of more experienced advisors.

The speed with which different areas of coverage are brought in house, if this happens at all, varies greatly – Canadian pension funds have been much more aggressive in accumulating internal expertise than their public sector counterparts in the US. But the route from fund-of-funds to direct primary commitments to co-investment to direct investment is well-trodden.

“Asia will develop in the same way as other parts of the world,” says Weichou Su, a partner at StepStone. “As the Chinese insurance companies go from five GP commitments a year to 20, it is easier to play the co-investment game. GPs give co-investment to the top 3-5 LPs that have been with them for a long time and are sizeable. If you are a Chinese insurance company you are not there yet, in terms of size, history or relationship. You have to build that before you can ask for co-investment.”

Finding a niche

Those with customized co-investment propositions by necessity exist at the margins, targeting institutions that for reasons of size, cost, flexibility or attitude are not getting what they want from standard offerings. While sovereign wealth funds and government-related entities are the largest Asia Pacific-based investors in private equity, Preqin has records of 867 groups within the region currently having exposure to PE – not necessarily exposure to co-investment – up from 575 three years ago. The biggest LP group is corporate investors, which number 100 more than the second-largest, banks.

Indeed, the Asia-IO model was initially based on working with large Western institutional investors – and it may still end up that way – but the current crop of clients are all Asian. These groups understand the region and are comfortable with direct exposure, but they may need help designing a program or pursuing opportunities outside their home markets across Asia or occasionally even on a global basis.

“They are not your typical large-scale institutional investors in private equity,” says Prael. “Some have emerging PE programs, some have corporate venture capital-style activities and occasionally they may make larger investments on a project-by-project basis. Yet, if you don’t have a structure set up, direct investing is a very complicated process.”

Asia-IO’s debut investment says a lot about the customization being sought. A fund managed by the firm bought a majority stake in Daiwa Associate, a Hong Kong-listed electronics manufacturer. The plan is to turn the business into a smart manufacturing systems specialist, serving as a platform for other acquisitions.

The Asia-IO fund raised capital from a number of LPs, but 75% was contributed by a clutch of companies with strategic interests in the IT sector, including Taiwan’s Foxconn Technology and Korea’s SK Holdings. The remaining 25% came from high net worth investors.

“Discretion makes the whole process more difficult to execute, so there are bigger advisors that might not want to give discretion on single co-investment decisions”

– Javad Movsourni

As such, this kind of approach doesn’t have to be a threat to traditional exposure. It allows investors to opt for additional coverage that addresses a particular strategic niche or fills a gap in execution capabilities. It is also cost-efficient because infrastructure is shared with a handful of other groups. LPs might want to avoid going it alone in these areas because it is unclear whether there will be enough deal flow to sustain the deployment of internal resources.

Erik Solberg, founder and CEO of EXS, divides the LP community into three broad categories: US and European institutions that have minimal capabilities in Asia, are unlikely to seek co-investments from portfolio GPs, and will never learn about his firm; groups, such as big family offices in Asia, that have no interest in entering blind pool funds, and may prefer direct exposure to deals through EXS or a similar model; and a broad swath of players, ranging from sovereign wealth funds to pension funds to fund-of-funds, that make commitments to funds and are looking for co-investment as well.

One of the reasons he gives for LPs choosing a customized approach rather than simply doubling down on deals sourced by portfolio GPs is access to a wider range of deal-flow. If, as StepStone’s Su also noted, big funds offer their best co-investments first to LPs that write the biggest checks or have the longest relationships with the manager, others miss out. In addition,

funds are often constrained by fairly narrow mandates, which may or may not remain applicable over time in highly volatile Asian markets. For instance, co-investments alongside a large pan-Asian manager would not offer the middle market exposure.

The co-investment vehicles offered by the likes of StepStone, HarbourVest Partners and Hamilton Lane are intended to address this dilemma. Furthermore, their solutions feature a degree of fee arbitrage: the 1/10 investors might pay is lower than the 2/20 for direct entry into a fund, even if the GP charges zero fees on co-investment. “We have so much exposure globally with hundreds of thousands of GPs and we can leverage those primary relationships to get more deal flow than any single group,” Su notes.

Selection criteria

So why go with a small platform instead of or in addition to a global player? It comes down to the level of customization required. While LPs able to get SMAs can to a large extent write their own ticket, the rest would typically commit to a co-mingled co-investment vehicle – paying fees on committed capital rather than just invested capital – and not everyone is comfortable with blind pool risk. Working with an advisor on a specific strategy can also result in differentiated deal-sourcing and offer a more intimate and educational investment experience.

“We think of ourselves as the outsourced investment office for our clients. We operate like direct investors yet we plug in much deeper to our clients’ preferences and decision processes and create very flexible, customised solutions. In effect we are constructing a portfolio of concentrated exposures that match their specific asset allocation agenda through a range of investment styles,” Asia-IO’s Prael says.

Choosing whether to invest and how to invest in a deal can be important to groups as they develop a familiarity with the asset class. For example, in 2013, EXS led an investment in a Vietnam-based real estate developer through a single project investment vehicle, charging fees and carry to investors only on invested capital, with strong transparency and close alignment. It is now working on another, larger round for the company, and while some investors are once again coming in through the fund, others are participating directly because they no longer needed third-party assistance. EXS receives no economics from these investors, but gets a placement fee from the investee company.

“Discretion makes the whole process more difficult to execute, so there are bigger advisors that might not want to give discretion on single co-investment decisions,” says Javad Movsourni, executive director in the private funds group at

UBS. "There is definitely a market for a strategy that offers greater flexibility but I don't see it exploding and growing bigger. I see more people being converted in terms of investing in funds. Maybe they get burned on one investment and appreciate a more diversified approach."

The broader question

This observation widens the debate to consider whether the current craving for co-investment is sustainable. Plenty of industry participants predict a scenario in which certain LPs – most likely those with limited resources to devote to due diligence – find their co-investments have underperformed, leaving the very large players to dominate the space. If there is truth to anecdotal reports of certain Asian LPs pushing into co-investment with a haste that belies their relative inexperience, the fallout could be severe.

"Some groups talk about it conceptually but it is very difficult to say whether they've done it successfully," says Niklas Amundsson, a partner at Monument Group. "There is a sense that some Asian institutions are skipping a few steps because they want to be like the Canadians. But the Canadians started out by investing in funds, then they did co-investment, and then they went direct. I think there will be a lot of secondary deal flow in Asia at some point."

If there is a reevaluation as to how LPs address co-investment, it isn't necessarily a bad thing for those offering customized solutions. Large investors may become increasingly open to creative structures as they develop their private equity programs. This points to more SMAs and a greater interest in ways to get direct exposure to deals.

Another potential development is variations on the typical fund structure, at least for managers that struggle to raise capital on their own terms. A first step might be funds with smaller core corpuses and larger guaranteed allocations for co-investment. UBS' Movsournov agrees this is a possibility, noting that LPs are already trying to codify co-investment rights, with legal undertakings to show co-investment opportunities to them before everyone else, up to a certain total capital commitment.

"If you are popular you can go for a 2/20 structure, but those outside the top quartile will come under pressure to offer something more bespoke, just like some GPs have come under pressure to give preferential terms to large LPs," he says. "If you go back 5-6 years, preferential terms on economics were not that common but now you see them all over the place."

For bespoke service providers adapting to this changing environment, the caveat is how far they

can evolve. First, it is difficult for these platforms to achieve scale and retain their high touch, high customization characteristics – as they grow in size they may become less differentiated from the global fund-of-funds. Another mode of expansion is to deepen relationships with a closely held set of clients, but the more vehicles a provider manages the more complicated the allocation procedures and the greater the risk of conflicts of interest.

Second, the temptation to raise committed capital – possibly offering less discretion to the investor – might be too great. There are various ways in which a flexible mandate can be secured, from pledge-style funds where the LP agrees to sponsor a team and commit to some of the deals the team generates to pure deal-by-deal arrangements. There are also different ways in which compensation can be agreed. But there is no substitute for having the capital in place to support a transaction from day one.

"How are you going to hang on to a deal without being able to promise you can close the transaction?" asks Sanjay Chakrabarty, a partner at Singapore-based Capital Square Partners, who has experienced working deal-by-deal. "That is the dichotomy you have to break through and the only way you can do it is by getting some committed capital. ▀"

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Smooth waters ahead?

India's government has made promising signals about its willingness to engage the venture capital community. GPs are optimistic, but reservations remain about the details

WHEN A VC FIRM SELLS A STAKE IN ONE

of its portfolio companies, it needs to know there is a reliable regulatory framework in place. However, Ash Lilani, co-founder and managing partner of India's Saama Capital, cannot count on that. At issue are the country's tax laws, which leave buyers confused as to whether any tax will have to be paid, and how it will impact the final transaction.

"90% of our deals get stuck at that point. We don't get stuck on price, we get stuck here," says Lilani. "If we can provide clarity on how tax treatment works for investments and exits, then it takes away a lot of the burden on investors."

Clarifying the capital gains burden is just one suggestion that India's venture capital

managers are generally optimistic, they also know that change will not happen overnight.

The report by SEBI's Alternative Investment Policy Advisory Committee (AIPAC) gives an indication of the shape that regulatory reforms could take. The panel's recommendations focused on promoting India's entrepreneurial environment by creating a more favorable atmosphere for GPs that fund the country's start-ups. AIPAC envisions this taking place primarily through streamlining the tax laws and unlocking domestic capital pools.

The tax recommendations include support for reforms to the capital gains tax that Saama's Lilani complained of. As AIPAC notes, the question of how to categorize profits from exits – as capital

with tax payable at the time of exercise – meaning that not only do employees exercising their options have to pay a higher rate than regular investors, but they also have to pay tax before they can actually sell the shares. If the share price declines before they are able to sell, employees could end up paying more in taxes than they receive in income. As a result, employees are inclined to devalue these incentive plans and employers are in turn unlikely to offer them.

"What it means is that in India, which is already such a cash-tight economy, people then value cash more, and now companies have to pay a lot more in cash," says Prashant Mehta, a partner at Lightbox Ventures. "And so we've seen that the cost base for an employee has gone up significantly."

Capital injection

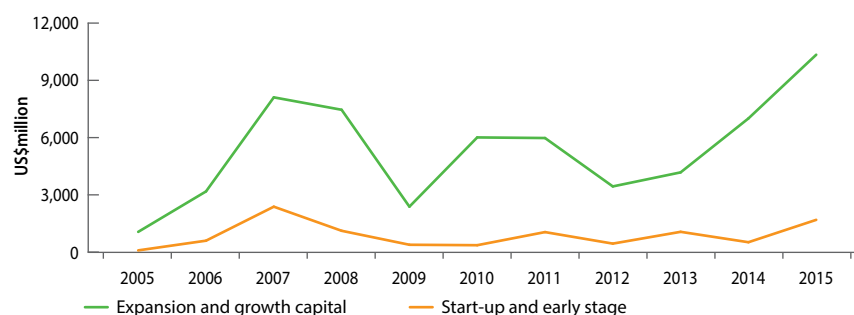
As AIPAC was unveiling its regulatory recommendations, the prime minister made his own contribution, announcing several measures aimed at encouraging the development of India's start-up economy. Proposals include reforms to the country's business environment to make things easier for start-up founders. However, the centerpiece of Modi's presentation was the announcement of a INR100 billion (\$1.4 billion) fund-of-funds for investments in micro, small, and medium-sized enterprises.

Despite the attention inevitably commanded by the announcement, industry players are divided on the government's ability to fit into India's venture capital ecosystem.

At heart of the skepticism is the fact that the government's priorities are not necessarily the same as those of other LPs; while most investors are fundamentally driven by the desire for returns on investments, the government's goal is to grow the economy and stimulate new areas of growth. GPs that take the government as an investor could therefore be pulled in two directions, to an extent.

On the other hand, Karthik Reddy, co-founder and managing partner of early-stage investor Blume Ventures, points out that the government is actually not a newcomer to the VC space. It has been contributing funding to GPs for years on an indirect basis, through institutions such as the Small Industries Development Bank of

VC funding in India



Source: AVCJ Research

community has for the government. Recent developments indicate that the government is beginning to listen. Prime Minister Narendra Modi led off the new year by announcing a new INR100 billion (\$1.5 billion) venture capital fund-of-funds; around the same time an advisory panel formed by the Securities and Exchange Board of India (SEBI) submitted a slew of recommendations intended to make it easier for VC and PE funds to do business in India.

Taxing issues

Progress is not guaranteed, despite the Modi administration's general support for venture capital and the country's start-up ecosystem. Much depends on the implementation of the proposed measures, and the ability of the government to follow through legislatively. While

gains or as business income – has been the subject of multiple contradictory judicial rulings. The effect is that buyers are never sure if the seller will be tied down by tax investigations in the middle of the sale.

"Buyers of our companies say, 'Wait a minute, we still have this risk. I agree with what you're saying, that's what the law says, but based on these recent cases, I'm not sure that you won't have to pay tax. So can you take 20% of what I'm giving you and put it in escrow or a withholding, to protect us in the event the government comes after you,'" Lilani explains.

AIPAC also suggests reforming the tax regulations relating to incentive programs such as stock options and employee stock ownership plans (ESOPs).

At the moment these are taxed as income,

India (SIDBI) rather than a fund-of-funds. As such, it knows how GPs operate, and is likely to take this into account when making its investment decisions rather than trying to enforce a change in priorities.

announcement; the government's fund-of-funds could provide them with much-needed support. However, several emphasize that the management style of the fund will be important. If it is run in a bureaucratic and cautious manner,

up's life – seen by many as possessing cosmetic value only since most start-ups do not make a profit in the first three years anyway.

Other measures have more support, including plans to make it easier both to start and to end a company. These are currently long and drawn-out processes, requiring large amounts of paperwork, which discourage potential entrepreneurs. While the government has an obligation to protect a company's employees, GPs feel that it should be possible to strike a balance and make the process less painful while still providing workers some protection, thereby encouraging more founders to take the plunge.

Overall, industry players see a lot to be hopeful for in the government's new measures. The emphasis is clearly on encouraging start-ups rather than the venture capital firms themselves, but the prime minister has also made it clear that he understands the importance of the VC industry to this goal. As for how many of the proposals will be implemented, GPs will have to wait and see.

"The government has made a great step forward," says Lightbox's Mehta. "Now the devil is in the details of how they're going to execute all these deals, and even more important, who are the people they're going to bring on board to execute them." ▀

"Buyers say, 'Wait a minute, we still have this risk. I agree with what you're saying, that's what the law says, but based on these recent cases, I'm not sure that you won't have to pay tax. So can you take 20% of what I'm giving you and put it in escrow to protect us in the event the government comes after you?'"

– Ash Lilani

"Effectively the GP is going to act in accordance with the interests of 75% of the LPs who are giving them money, not for the benefit of the 25% held by the government," Reddy says. "And if the government perceives a conflict of interest, they shouldn't approve the application."

Early-stage GPs – often overlooked as angel investors and late-stage funds grab most of the attention – also see an opportunity in the

eschewing the risks that come with early-stage investing, it may not be as effective as hoped.

Positive vibes

Though GPs are divided on the government's potential as an LP, all welcome the prospect of an improved business environment. Some of Modi's proposals on this score attracted criticism, such as a tax holiday for the first three years of a start-

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DEAL OF THE WEEK

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Apis bets on India ATM consolidation

THE ORIGINS OF APIS PARTNERS' \$25

million investment in Electronic Payments & Services (EPS), an India-based ATM provider, can be traced back to 2011 and another payments business, Network International.

When The Abraaj Group bought a stake in the Middle East-headquartered company, Udayan Goyal advised on the transaction and Matteo Stefanel was working for the PE firm. Over the next couple of years they tracked numerous possible acquisition targets for Network International. This took Goyal and Stefanel to India, among other places, where they conducted due diligence on the likes of SSS, Prism and Euronext.

The appeal of the industry in India - there are currently approximately 230,000 ATMs in the country, up from about 25,000 three years ago, and the government is targeting 550,000 in two years' time - was not forgotten. Four years on, having formed Apis Partners, an early-stage financial technology investor in Africa and South Asia, Goyal and Stefanel started looking for investments again.

"EPS was one of the younger companies and the people came from many of the companies we had conducted due diligence on before," says Goyal. "They got seed capital from Aavishkaar and when they got to the growth phase they reached out to us. There aren't many people in the world who have done as many ATM deals as we have, so we could contribute in three areas: product expansion, value chain expansion, and potentially geographical expansion."

Although EPS is looking at possibilities in Africa, domestic demand remains the primary growth driver. Recognizing the importance of ATMs in its financial inclusion strategy, the Indian authorities transferred responsibility for managing these systems from government agencies to third-party contractors. Private sector banks have largely followed suit, with contracts still put out for tender from either side every few months.

EPS has operations in 28 states and Goyal places it in the middle tier, comprising providers

with 7,500-15,000 ATMs. The company recently bought out its joint venture partner CISB to gain full control over 5,400 ATMs that are under long-term contracts with public sector banks.

The likes of SSS, Prism and Euronext sit in the first tier, with more than 15,000 ATMs apiece, while there are numerous smaller players with

fewer than 7,500 machines. Goyal believes there could be further acquisition opportunities at every level: from large companies that see ATMs as a non-core asset; from small and mid-size players that struggle because they lack scale.

"When we did the analysis of the sector we felt the combination of the quality of the contracts, team and operations at EPS meant the company could become the market consolidator and potentially a market leader," he adds. To this end, the capital Apis has committed to EPS - most of which will be used to support organic growth - could be followed by additional tranches should bolt-on acquisitions emerge. ▀



ATMs: On the rise in India

New name, same agribusiness strategy

THE PRIVATE EQUITY TEAM OF BLACK

River Asset Management were confident. They were always the best-performing division in the agriculture and commodities-focused firm - the alternative investment management branch of agribusiness giant Cargill - and the parent company knew it.

So when it was announced in September that Black River would separate from Cargill and split into three employee-owned firms, the PE team gave its enthusiastic assent. Now known as Proterra Investment Partners, with offices in Singapore, Shanghai, Mumbai and Tokyo, the firm is looking to build on the foundations it has already laid.

"On a day-to-day operating basis on the investment side, nothing has changed. Same people, same team, same investment strategy, same portfolio companies, same investors," says Tai Lin, managing director and head of Proterra in China. "On day one Proterra started with 49 people in six offices, and \$2.1 billion in AUM [assets under management]."

Despite emphasizing continuity, Proterra is

careful to emphasize its independence. Cargill remains an important LP, but it is by no means the only, or even the largest investor in Proterra's funds. The other investors include mostly university endowments and pension funds, mostly from the US and Europe.

As for the future, Proterra will continue to pursue the sector specialization that it began as part of Black River. Out of its \$2.1 billion AUM, nearly \$2 billion are concentrated in food and agriculture investments in Asia, Australia and other emerging markets, with meat, dairy and farming highly represented. The firm also operates a mining fund with a corpus of about \$165 million.

"Obviously coming out of Cargill it was natural that we would have this focus, and I'd say that's really what differentiates us," says Lin. "I don't think there are many other groups in the world, on the PE side, that operate on a pan-Asian, or even a global basis, and focus on food and agri."

Portfolio investments in Asia include China's

fifth-largest dairy farming company, AustAsia, and Indonesian dairy producer Greenfields, along with a banana plantation in Southeast Asia. It also owns agricultural land in Australia. Assets outside the region range from poultry in South Africa

to cropland in South America. Investments to date have fallen between \$15 million and \$125 million.

One significant planned strategic change is to offer more co-investment to the LP base. Proterra's future investments will also be weighted toward

control deals, enabling the firm to implement operational initiatives. For these the firm can draw on its established relationship with Cargill, which can provide assistance from both the supply and demand side.

"Now that we've done so many years of focusing on this industry and this area, we have a lot of cross-fertilization between our portfolio companies, or between their various operations and people we know," says Lin. ▀



Agri: Strategic focus

PE investors exit as Tsingda looks to local IPO

HAVING WORKED TOWARDS A US IPO,

Chinese online-to-offline (O2O) education service provider Tsingda eEdu Corporation registered to list on NASDAQ in 2011 but then stumbled amid market volatility. In the absence of capital from public investors, the company raised several rounds of offshore funding instead. OCBC's mezzanine capital unit was one of its backers.

"Initially, and until recently, we were of the opinion that an offshore IPO would be the best exit for us. However, the founder thought that the company might get a better valuation through an onshore IPO. As such, they had to dismantle the VIE [variable interest entity] structure and replace it with onshore funding. That provided an exit opportunity to us," says Daniel Kwan, head of MCU.

VIEs allow offshore investors to take equity stakes in companies that operate in sectors – including the internet and education – where foreign participation is restricted. Assets to which the offshore investors can have no direct exposure are held in a parallel entity owned by Chinese nationals. But companies cannot list domestically with these structures.

Tsingda's change of plan facilitated exits for Capvent and RRJ Capital as well as MCU. RRJ and MCU, which committed \$50 million and \$20 million in early to mid-2014, have generated returns of nearly 3x on their investments. Capvent put in \$5 million in 2012. The buyers of their shares were all onshore investors – including trust companies – that started expressing an interest in December 2014 when Tsingda withdrew its US IPO application.

Driven by a combination of urbanization and rising disposable incomes, China's education sector has become a popular target for private equity and venture capital investors.

Last year, the government announced an end to the three-decade-old one child policy, which is expected to have a long-term positive impact on the industry.

MCU identified Tsingda two years ago following top-down research of the industry. Founded in 2003, the company provides

supplementary educational courses and curricula for students from kindergarten through high school age. These are delivered across four online platforms – Babyangels.cn, Familybaby.cn, Xuexiba.com and Yi8edu.com. The online presence has since been supplemented by more than 3,000 offline teaching centers, most

of which operate as franchises, in response to demand from parents for children to experience a classroom environment.

"They have learning centers, but what is driving the company's growth and reach is its ability to package self-developed academic syllabuses on the online platform. They are

able to roll out these products and market them throughout the country," says Kwan.

At present, the online business accounts for about two thirds of Tsingda's RMB1 billion (\$152 million) in annual revenue. Students purchase pre-paid cards from offline centers and use them to access online courses. ▀



Online learning: Good to scale

SBCVC moves with the times in China

AS ITS NAME SUGGESTS, SOFTBANK CHINA

Venture Capital – otherwise known as SBCVC – has enjoyed a close affiliation with SoftBank Corporation despite being an independent fund manager since inception. While the Japanese telecom giant accounted for the bulk of the GP's \$100 million debut fund in 2000, over the ensuing years it has become one member of a more diversified LP base.

SBCVC has now closed its fifth fund at \$459 million – well above the initial target of \$400 million – after spending about 12 months in the market. US investors, including endowments and pension funds, make up the majority of the LP base, followed by Europe, Asia and Middle East. The International Financial Corporation (IFC) committed \$25 million to the vehicle.

The GP closed its previous fund in 2011 at \$386.7 million, while Fund III came in at \$320.4 million in 2008. Both represented a step up from the 2000 fund and its \$151.6 million successor, raised in 2006. However, the latter was accompanied by SBCVC Fund II-Annex, a \$43 million sidecar vehicle through which LPs could

co-invest in Fund II portfolio companies.

"SBCVC's investment team is very technology-centric. All of our senior partners have been entrepreneurs in the past. That's probably one of our biggest differentiating factors from other Chinese VC funds," says Kathy Chen, a partner and CFO at SBCVC. "Also, unlike some others, the majority of SBCVC's investments have not been in the consumer sector. Rather, the firm has focused on technology that leverages consumption growth."

Managing Partner Chauncey Shey was previously co-founder of UTStarcom, a broadband service provider that received early backing from SoftBank and went public in the US in 2000. Alan Song, also a managing partner, was a member of the same company's founding team. Meanwhile, Tim Liu, the third managing partner, set up Shanghai-listed high-tech company TongFang Corp.

SBCVC has backed over 100 Chinese companies across all stages of development,

from pre-Series A to pre-IPO. Over time, the GP's sector focus has shifted in line with the market opportunity in China. Early-stage technology, media and telecom (TMT) deals formed the bulk of Fund I – notably Alibaba Group – and by Fund II healthcare was introduced to the mix, followed by emerging technology sectors such as cleantech and new materials.

"With the newly-established fund, while

maintaining the existing focus and strategies, SBCVC is also looking at a lot of companies in the industrial 4.0 space, robotics, applied internet, and other technologies in the field of advanced industrial applications," says Chen.

The new fund will support around 40 companies looking to grow and gain access to international capital markets. Recent investments include social networking and video editing platform Acfun, online education platform Xuexibao and mobile healthcare service provider Shanghai KingYee. ▀



Robotics: Of interest to SBCVC

Volatile times

David Liu and Ming Lu, who head up KKR's private equity operations in Asia, discuss dislocation in China and its neighboring markets, engineering cross-border deal flow, and how GPs can differentiate themselves

David Liu and Ming Lu serve as co-heads of Asia private equity for KKR. They are jointly responsible for the overall strategy and implementation of KKR's Asia private equity funds.

Q: What does the volatility in China mean for private equity?

DL: From our perspective, this painful restructuring is better for China in the long term. The government needs to restructure the economy and address some of the excess capacity and overspending that has built up. This kind of market dislocation can create investment opportunities for long-term investors who are value-oriented and operationally focused. You have to focus on proprietary deal sourcing by leveraging deep industry knowledge; you have to be disciplined in your due diligence; and you need to be extremely operationally focused when working with portfolio companies. We have committed approximately \$1.5 billion in equity across all our platforms in China in 2014 and the first three quarters of 2015. That represents one of the most active two-year periods we've had in the country. We also took advantage of the market peaking earlier in the year and distributed across all platforms close to \$1.5 billion from China deals to LPs over the same time period.

Q: Is the recently announced distressed investment platform an example of targeting this dislocation?

DL: We set up that platform because we see interesting special situations-related opportunities in real estate and related sectors, and it is one of the many initiatives we are

pursuing. At the same time, dislocation potentially means more attractive valuations. When the public markets are not doing well, private equity becomes a more important source of capital to support growth. But more importantly, in some of the industries we've been focusing on – such as food safety, environmental services, healthcare, and education – the returns are not predicated on whether China's GDP growth is 7% or 5%. Those industries have stronger fundamental demand to support growth. The key is to find interesting sector themes, back strong management teams, and work closely with them to create value.

Q: What impact is the China slowdown having on other the investment environment in other Asian markets?

ML: China's structural slowdown has come at a time when there is excessive corporate leverage throughout many markets. We are going into a multi-year credit cycle that will involve significant deleveraging, particularly for the banking and corporate sectors. We are already seeing increased foreign exchange market volatility due to rising US dollar interest rates and increased pressure on the renminbi to depreciate and emerging market companies are trading at 7.5 P/E [price-to-earnings], which is a significant discount to developed markets. That is the major dislocation. The China slowdown is also part of an economic transformation from fixed-asset and investment-led growth to consumption and services-driven growth. This process will pose challenges to



“In the current environment, you really have to tidy up your operational set-up”

” – David Liu

a number of sectors in many markets – for example, the resource sector in Indonesia and Australia has been hit – but it also creates opportunities. There is a tourism boom in adjacent countries to China, while businesses that cater to Chinese demand for high-end goods and services are in great demand.

Q: Panasonic Healthcare and Haier – both KKR portfolio companies – have made cross-border acquisitions. Do you expect to see more of this?

ML: Panasonic Healthcare delivers on a number of investment themes for us. It is a carve-out of a very attractive business but a non-core subsidiary of Japanese corporate. It is also a global manufacturer of healthcare products. What the company needs is a global marketing organization to expand its

customer base, and they saw this synergistic opportunity to acquire Bayer's diabetes care business as a way to gain these capabilities. We helped them achieve that goal by leveraging our global network. We expect to see more of these situations in Asia. There are many corporations with non-core assets that have the opportunity to be spun out at some point.

DL: Haier as a national champion in China does not need our capital. They wanted to partner with us because of the relationship we have built with them and the strategic value we can bring beyond the capital we provide. Having a foreign long-term partner like us where we can bring our global network and local expertise to the table differentiates Haier from other local players. Cross-border acquisitions are not easy to execute anywhere in the world, but having a partner like us that brings global experience and expertise can increase the probability of success.

Q: How does the operational focus change when you are dealing with -companies that may not have experienced a slower growth environment?

DL: When strong economic growth was at your back you could focus on top-line growth and there was quite a lot of low-hanging fruit. In the current environment, management really has to sharpen up its operational discipline to drive differentiated performance. This means focusing on procurement cost reductions, and making supply chains and working capital management more efficient. Our China portfolio delivered

double-digit EBITDA growth well into 2015, with EBITDA growth meaningfully exceeding revenue growth. That comes from our operational initiatives.

Q: You have mentioned several sectors in which you see long-term opportunities in China. What about Asia as a whole?

ML: We try to take a thematic approach to identifying our priority industries, and determining how we can apply KKR's relevant experience across geographies to pivot toward the most attractive opportunities. Our key themes include food safety and agriculture, as we've seen problems in a number of countries across Asia in recent years. There's health care, which might address supply-demand imbalances in emerging markets or demographic changes in developed ones. Financial services is also interesting given the increasing sophistication of Asian financial markets,

and we see opportunities in environmental businesses to provide solutions to issues such as poor air, water and soil quality.

Q: Many financial services investments focus on internet-enabled disruption of established models. How does this factor into your assessment of the sector?

DL: The landscape is changing rapidly and e-commerce is making meaningful impacts. The internet is ultimately a business tool; it helps businesses enhance productivity, efficiency and scalability. When we evaluate any business, including an internet business, we focus on the same key issues such as long term business fundamentals and management capabilities. While short term evaluation matrix may vary, you have to understand the long-term business fundamentals, whether it is online or offline businesses. Over the long term, ultimately



Ming Lu

these companies all have to be profitable and generate attractive ROE (return on equity) to justify a sound investment.

Q: The acquisition of GE's Australia and New Zealand consumer finance business last year was KKR's largest-ever buyout in Asia. Will deals continue to grow in size?

ML: If you look over the last 10 years, deal size has been creeping up because economies and companies continue to

grow. We expect this trend to continue. But if you look at the distribution of deal size, it remains the same - the extremely larger deals represent a small portion of total deal flow.

Q: How is the overall Asia portfolio looking in terms of distributions?

DL: We distributed \$5 billion in PE in 2014 and through the first three quarters of 2015, with a large portion of that distributed in 2015. We have returned approximately 90% of our total invested capital in Asia - so we have significantly de-risked the portfolio - and we still have significant stakes in the ground for future upside. Trade sales have accounted for the larger portion of fully exited portfolios and we are definitely seeing more strategic interest in Asia. Given the public market volatility, strategic exits are going to be more and more prevalent, especially for control deals. ▀

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