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Teutonic again

TWICE IN THE SPACE OF A FEW WEEKS THE record for China's largest direct investment in Germany fell. There was private equity interest in both deals, first as buyer then as seller. While the numbers are unprecedented, the basic trend is not. Three years and two months ago, AVCJ ran an opinion piece under the headline "Teutonic ambitions." The first sentence: "Another week, another Chinese strategic acquisition of a German manufacturing asset."

Indeed, one of the nearly transactions back then became an actual transaction this time around. An unnamed Chinese buyer was reportedly in the running for plastics specialist KraussMaffei Group. Onex Corp. ended up buying the asset, but when KraussMaffei was put up for sale once again, China did not falter. China National Chemical Corporation (ChemChina), Guoxin International Investment Corp. and cross-border PE firm AGIC Capital agreed a EUR925 million ($1.01 billion) purchase.

The investment thesis is largely unchanged. KraussMaffei is a global leader in manufacturing machinery and systems used in the production and processing of plastics and rubber. There is a strong demand base for this in China, and by owning the technology behind it, local companies can continue to climb the industrial value chain.

The other deals from 2012 told a similar story – see, for example, Sany Heavy Industry's acquisition of concrete pump maker Putzmeister Holding and Weichai Power's EUR738 million investment in forklift truck manufacturer Kion. While CITIC Private Equity participated as a minority investor in the former transaction, the latter deal facilitated a partial exit for KKR and Goldman Sachs.

Fast forward to the present, and EQT Partners has performed the same maneuver, agreeing a full sale of German waste management company EEW Energy from Waste to Beijing Enterprises Holding (BEHL) for EUR1.44 billion. BEHL said that the acquisition represents an opportunity to introduce energy-from-waste technologies and management expertise to the China market.

There is a broader context to the recent activity. Last year, M&A involving Chinese companies reached a record $656 billion and this surge has carried over into 2016, with US and European assets at the top of the shopping list. Announced deals include ChemChina's $43 billion acquisition of Swiss chemicals group Syngenta; Haier Group's purchase of General Electric's appliance unit for $5.4 billion; and Dalian Wanda Group's $3.5 billion acquisition of film studio Legendary Entertainment.

Chinese companies are clearly looking at a wider range of industries than before. While the resources giants have understandably withdrawn, entertainment, consumer technology and food and beverage have come to the fore. Industrial technology – Syngenta's seeds or KraussMaffei's injection molding – is a consistent presence.

Both trends reflect changes in China's economy. On one hand, consumers are becoming more sophisticated; they are willing to pay a premium for quality goods and services. On the other, the traditional industrial sector is struggling; technology is a means by which companies can upgrade their product portfolios and achieve greater efficiency, hopefully addressing profit margin erosion in the process.

For those seeking technology, the Mittelstand – small and mid-size companies in Germany, Switzerland and Austria – remains a rich hunting ground. It is no coincidence that AGIC has launched a fund dedicated to Sino-German investments, or that middle market Chinese private equity firms are reaching out to their European counterparts with a view to sourcing partnership or secondary buyout opportunities.

While Chinese corporates have become more accustomed to international M&A, industrial Europe is a challenging environment, often characterized by tight family ownership. As such, there is every chance private equity firms will continue to feature in these deals: if not as sellers, then as the partners or co-investors that bridge cultural divides, address concerns about legacy pensions and intellectual property, and generally smooth the transition of European technology and expertise to China.

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NEWS

ASIA PACIFIC

Rocket raises $31.4m for property portal

Emerging markets property portal Lamudi has raised EUR29 million ($31.4 million) from its main backer, Germany's Rocket Internet, and other investors. The investment was made by Asia Pacific Internet Group (APACIG) – a joint venture between Rocket and Qatari telecom company Ooredoo – European VC firm Holtzbrinck Ventures, and Tengelmann Ventures.

AUSTRALASIA

TPG, Carlyle acquire stake in Greencross

TPG Capital and The Carlyle Group have jointly acquired 15.42% of Australia's Greencross, though a buyout offer for the listed pet service business was rejected. The firms offered A$6.75 per share for all equity they don't already own, valuing Greencross at A$770 million ($549 million).

Senate committee to probe Dick Smith demise

Australia's Senate Economics and References Committee will launch an inquiry into the collapse of listed domestic retailers following the demise of Dick Smith Electronics, previously owned by Anchorage Capital Partners. The committee will decide who to question, but one senator who called for an inquiry said he expected Anchorage to appear.

GREATER CHINA

Chinese consortium to buy Opera for $1.2b

A consortium featuring Qihoo 360 Technology is set to buy Norwegian web browser developer Opera Software for $1.2 billion. The purchaser is Golden Brick Silk Road (Shenzhen) Equity Investment Fund II, managed by Golden Brick Silk Road Investment, an affiliate of Hong Kong PE firm Golden Brick Capital. LPs include Qihoo and Beijing Kunlun Technology.

Apax sells stake in Tommy Hilfiger China JV

Apax Partners and other shareholders in Tommy Hilfiger Asia (TH Asia) have agreed to sell their remaining stake to Philips-Van Heusen Corp (PVH), owner of the Tommy Hilfiger parent, for about $172 million. PVH already has a 45% stake in TH Asia, a China-focused joint venture formed when Apax sold the parent to PVH in 2010.

Beijing Enterprises to buy Germany's EEW for $1.6b

Chinese state-owned conglomerate Beijing Enterprises Holding (BEHL) has agreed to buy EEW Energy from Waste, a German waste management company, from EQT Partners for EUR1.44 billion ($1.6 billion).It is said to be the largest direct investment by a Chinese company in Germany, topping the EUR925 million KraussMaffei deal struck last month between Onex Corp. and a consortium comprising China National Chemical Corporation, Guoxin International Investment Corp. and AGIC Capital.

EEW, active in Germany, Luxembourg and the Netherlands, employs over 1,000 people in 18 plants that convert waste into energy for electricity, heating and process steam for industries. Its installed waste capacity is 4.7 million tons and it has produced a total of 6 terrawatt hours of energy. Sales came to EUR539 million in 2014. BEHL said net profit was EUR15.1 million in 2014 and EUR65.6 million in 2015.

EQT Infrastructure II acquired a 51% stake in EEW from Eon in March 2013 for about EUR1 billion. Eon was selling off assets to reduce its debt load. It sold the remaining 49% to EQT in April 2015 in a group restructuring program. At the time, EEW reportedly had an enterprise value of around EUR1.3 billion.

CICC supports competing offer for Sinovac

China-based Sinovac Biotech, already the target of a take-private bid from its chairman and SAIF Partners, has received a competing offer from a consortium including China International Capital Corporation. Two Hong Kong PE firms, Heng Feng Investments and Fuerde Global Investment, are also involved, with Beijing Sinobioway Group.

BeiGene gains 18% on debut after $158m IPO

BeiGene, a Chinese cancer drug developer backed by Hillhouse Capital and CITIC Private Equity, closed up 18% on its first day of trading on NASDAQ after a $158.4 million IPO. The company sold 6.6 million shares at $24.00 apiece in its offering; it had planned to sell 5.5 million at $22.00-24.00. The stock opened at $28.97, peaked at $29.49, then settled back to $28.32.

China tightens private fund supervision

The Asset Management Association of China (AMAC), a self-regulatory organization for the PE industry, has tightened rules on domestic fund managers' registration to crack down on scams. Licenses for new private fund firms will be revoked if no products launch within six months of registration, while groups that have been registered for over one year will be excluded if they fail to introduce new products by May 1.

China's Kingsoft Cloud raises $60m

Kingsoft Cloud Group, a cloud computing unit owned by China's Kingsoft, has raised $60 million in a Series C round including existing backer IDG Capital Partners. The Hong Kong-listed parent will invest $31.1 million, while an entity named ChinaAMC Special Investment will commit $26.31 million. IDG will put in $2.59 million.

Warburg Pincus' China head to form own firm

David Li, managing director and head of China at Warburg Pincus, has left to start his own firm. Julian Cheng and Frank Wei will lead Warburg Pincus in China. Li was with the firm for 14 years.

Taiwan to allow listings by VC firms

Taiwan's Financial Supervisory Commission has issued guidelines for Taiwan-based vc firms to pursue onshore IPOs. Applicants must adhere to certain investment restrictions and meet a paid-in capital requirement for approval to list, along with criteria that apply to all public companies.

Haers buys Switzerland's SIGG from Riverside

Zhejiang Haers Vacuum Containers, a Chinese stainless vacuum container maker, will pay The Riverside Company CHF16.1 million ($16.6

million) in cash for Swiss bottle maker SIGG. Riverside acquired SIGG, which makes aluminum bottles sold in more than 40 countries, in 2003.

Prologis ups commitment to logistics venture

Prologis, a global real estate investment trust, has announced an increase of $882 million in equity commitment to the Prologis China Logistics Venture. Prologis committed $132 million; the rest came from HIP China Logistics Investments, a subsidiary of Abu Dhabi Investment Authority.

Black Soil postpones agriculture fundraise

Chang Sun, the former Asia managing director at Warburg Pincus who co-founded Chinese agriculture start-up Black Soil, has delayed plans to raise a $1 billion PE fund and will focus on individual deals. The decision was largely due to a lack of high quality agribusiness deals, plus a desire to build a track record in the sector.

Sequoia backs Dongpeng take-private

Hong Kong-listed ceramic tiles maker Dongpeng Holdings has received a take-private proposal from management and existing shareholder Sequoia Capital China. Sequoia and Xinming He, the company's chairman and CEO, offered HK$4.48 per share for all outstanding H-shares, a 31.76% premium to the previous close.

Bus service start-up raises $26m

Chinese mobile-enabled bus service provider Dada Bus has raised RMB173 million ($26 million) led by Shenzhen-listed construction materials maker Fujian Newchoice Pipe Technology. Domestic GP Shenzhen Weiyi Equity Investment and a government-backed fund managed by Technology Financial Group also took part.

NORTH ASIA

J-Star targets buyout of drugstore chain

J-Star has launched an offer for drugstore chain Aisei Pharmacy that values the JASDAQ-listed company around JPY12.7 billion ($112.5 million). Aisei, with over 300 stores, follows a mall-style approach, with several clinics in a single facility. The company had revenue of JPY55 billion and EBITDA of JPY3.6 billion in the 2015 financial year.

Partners Group, Kedaara to buy Au Housing

A joint venture between Kedaara Capital and Partners Group has agreed to buy Au Housing, the mortgage arm of Indian non-banking finance company (NBFC) Au Financiers. The deal, which still requires regulatory approval, is reportedly worth INR9.5 billion ($139 million).

The company will use the proceeds for its planned small finance bank. Au was one of 10 NBFCs to receive approval in principle to open a small finance bank from the Reserve Bank of India last year. The banks are meant to provide financial services to the country's unbanked population and bring them into the formal banking system.

Au still must dilute its level of foreign ownership to 49% in order to receive final approval; currently 62% is held by foreign investors, including Warburg Pincus, ChrysCapital and the International Finance Corporation (IFC). The firms have participated in several rounds for the company, including a $21 million investment in 2014 and a separate $25 million commitment by IFC the same year. Kedaara is also an investor in Au Financiers, having paid an undisclosed amount for a 10% stake in December 2014.

IMJ targets $53m for Japan venture fund

Singapore-based IMJ Investment Partners has raised JPY2 billion ($17.7 million) for a VC fund to back Japan start-ups. The full target is JPY6 billion. IMJ Investment Partners Japan Fund I is already investing, seeking mainly Series A rounds or later.

Japan Post Bank prepares for PE investment

Japan Post Bank plans to start making commitments to PE funds in the first half of 2016, according to Katsunori Sago, the bank's vice president in charge of asset management. Sago made the observation during an interview, stressing that the bank's drive to diversify will not be affected by recent declines in public markets.

KKR backs solar player's Japan expansion

KKR has acquired a majority stake in Gestamp Solar, a Spain-based developer and operator of solar plants looking to expand its business in Japan. The deal values the business at about $1 billion. Gestamp, which has been renamed X-Elio, has 50 megawatts of operational capacity in Japan, but expects installed capacity to reach as much as 600 MW by the end of 2017.

SOUTH ASIA

OTPP leads $200m round for Snapdeal

Ontario Teachers' Pension Plan (OTPP) has led a $200 million investment in Indian e-commerce giant Snapdeal. Other participants in the round included Singapore investment entity Brother Fortune Apparel and India-focused VC firm Iron Pillar. The valuation is said to be over $6.5 billion.

VC-backed Oyo Rooms acquires rival Zo Rooms

Oyo Rooms, an India-based budget hotel booking app backed by SoftBank Corp. and other VCs, has acquired rival Zo Rooms, which is backed by Tiger Global Management. The deal, structured as an all-stock swap, reportedly came after Zo Rooms failed to raise new funding.

Kalaari leads $4m round for RKSV Securities

Kalaari Capital has led an INR270 million ($4 million) Series A round for Mumbai online stock trading firm RKSV Securities. GVK Davix Technologies, an Indian contract research firm, also participated. The capital will be used to improve RKSV's technology and create new products.

SOUTHEAST ASIA

EDBI, TAL in $52m round for US-based Knewton

New York-based adaptive learning system developer Knewton has raised $52 million from a consortium of investors including EDBI – the corporate VC arm of Singapore's Economic Development Board – and Chinese education company TAL Education Group. The round was led by Belgium's Sofina and London-based Atomico Ventures.

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Direct exposure

Unwilling to take blind pool risks and keen to play a more active role in private equity, family offices are considering direct investment opportunities. Strategies and capabilities vary, as does the level of risk

THE COUGHLINS MADE THEIR MONEY in logistics, and more than a decade after divesting the core business, they continue to deploy capital in the sector. Coughlin Capital, a California-based family office led by three third-generation siblings, focuses almost exclusively on small to mid-size US companies in transportation, manufacturing and related services. It was a natural point of call for McNally Capital when seeking partners to invest in ITS Logistics.

McNally Capital, previously the investment arm of a single family office, describes itself as a merchant bank that sources direct investments for family offices and high net worth clients. It identified ITS, a third-party logistics provider, as a target and was ready to lead the deal, but wanted useful partners. Two families with national retail businesses – and therefore extensive warehousing and distribution operations – came in alongside Coughlin.

The investors bought a 60% stake in ITS at the beginning of last year with a view to creating an outsourced trucking services provider to companies that no longer want the cost or hassle of managing this function in house. ITS' three founders hold the remaining 40% and are still involved in management.

"They saw the value of staying on and leveraging the network we were able to bring," says Ward McNally, managing partner at McNally Capital. "The families not only help in overall operations – such as issues relating to truck drivers, logistics and fuel costs – but they also open up their rolodexes and make introductions to retailers and other companies that meet the profile of the kind of customer we are looking for."

ITS is an example of a well-conceived private equity co-investment: like-minded peers pooling capital and complementary expertise to fulfill a company's financial and strategic needs. This approach has become popular among US family offices that want to play a more active role in their investments. They might work with private equity firms, but they are also an alternative source of capital – one that is arguably more permanent and value-accretive.

At the same time, in the absence of the requisite skill sets, deals can end in catastrophe. Family offices as direct investors therefore also represent a risk, to target companies and to themselves. These dynamics place Asian groups at an interesting juncture. According to Preqin, more than 70 family offices based in the region are active in PE, a three-fold increase on 2013, but some groups' appetite for co-investment is at odds with their experience. Are they ready to be patient and professional capital?

"US family offices have evolved over a long period of time so they view direct investments as a way to generate better returns, and back businesses where they may have some knowledge," says David Kirby, founder of Kirby Capital Advisors, who works with a range of family offices. "Family offices in Asia tend to have less experience of PE and less awareness of the risk. This means they might move faster, but they are also more opportunistic."

> **Some entrepreneurial families believe their experience is superior to what private equity can deliver** – Mark Thornton

A clearer view

McNally Capital is one of a number of co-investment platforms to emerge in the US, combining established networks in the family office world with deal-sourcing and management services. Their remit is deliberately broad. "It is a function of the fact that once you've met one family you've only met one family," McNally explains. "They have different interests, human resources and financial capabilities, and they have different objectives and strategies when it comes to direct private equity."

The unifying element is a discomfort with blind pool funds. As one family office executive puts it: People made 30-35 fund commitments and built a diversified portfolio; but it was like an index fund of private equity – it delivered the mean, not the risk-return profile that you would expect given the illiquidity and the fees. This came to a head in the wake of the global financial crisis when liquidity concerns prompted many investors to review their alternatives allocations.

It is no coincidence that McNally Capital made the transition from single family office to its current role eight years ago. There has been a similar evolution in other markets, including the Middle East and Europe, and several groups now have resources on the ground in Asia.

Geneva-headquartered ACE & Company started as the direct investment arm of a single family office and began offering co-investment five years ago in response to inbound requests from other family offices. "We realized that the performance attribution of private equity fund allocations stemmed from 1-2 investments. We thought if we could better identify those opportunities, we could increase our return on co-investments," says Marc Syz, Asia-based managing director at ACE.

Two other factors also come into play, both of which hinge on underlying philosophy. First, there is a preference to be hands-on, particularly among the younger family offices where the core operating business from which their wealth derives has not yet been divested. Joining a group that employs a third-party manager to build a company might seem illogical when family members have a track record of doing this perfectly well on their own.

"Some entrepreneurial families believe their experience is superior to what private equity can deliver," says Mark Thornton, CIO of Metdist, a trading company owned by the Bagri family, which previously held a stake in the London Metals Exchange. "I have seen family offices dabble with private equity and get frustrated when they see investments underperforming. They say, 'Let's go back to building businesses ourselves rather than trusting others who we don't think can do as good a job as we can.'"

Second, families don't like paying fees and therefore balk at the notion of shelling out 2% per year based on capital under management plus 20% in post-deal carried interest. This is a very general statement because attitudes vary.

For example, one Asia-based executive with a European family office challenges the whole notion of co-investing in particular companies alongside a fund. He values portfolio diversification and backs a China manager to pick

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the 10 best local deals; choosing to double-down on two of these would negate the diversification effect and essentially involve second-guessing a team that is paid to be well-informed on China. The exception is when the family office can contribute something to a deal.

"If this is an investment that has an angle on the strategic side and we bring our own team and do our own due diligence, then that makes sense. If not, how do I know that this healthcare company in Chongqing will do better than this retail company in Beijing? These guys should know," the executive says. Even where there is a strategic rationale, this family office would not want to embark on a direct investment in China alone; it insists on partnering with third parties that have local resources.

Levels of comfort

In this sense, a family office's appetite for co-investment, and its willingness to pay others to provide leadership or guidance, is a function of comfort. While some North American groups are able to write checks of $200 million for direct deals, family offices in less developed markets are comparatively conservative – often expressing an interest in co-investment but ultimately reverting to fund commitments. Others only use third-party managers to get private equity exposure beyond their home geography or core industry.

The likes of McNally Capital and ACE exist in their current form because family groups want direct exposure to private equity but lack the in-house capabilities to source, execute and manage deals. While these groups have principal capital to invest alongside their clients and preserve an alignment of interest, they are also paid for their work. The same goes for Crescent Point and EXS Capital Group, two Asia-based firms that have operated for years on a deal-by-deal basis and regularly work with family offices.

"A lot of people go astray because they think that direct investment is easy. While the actual investing might be reasonably easy, monitoring and exit are a lot harder. A small portion of people's overall asset allocation goes into direct investments, but it takes up 80% of their time," says ACE's Syz.

ACE has a 35-strong network of professionals who work on deals globally. They look at around 1,000 opportunities each year, carry out due diligence on 50 of those, and invest in approximately 50% of companies that make it through to the diligence stage.

While the firm has people on the ground, every deal includes a specialist partner, typically a management team, another family office or a PE fund. Last year, it became the largest shareholder in financial products comparison site CompareAsiaGroup. The deal came about through a pre-existing relationship with Nova Founders Group – a financial technology investor set up by three former Rocket Internet executives and backed by Richard Li's Pacific Century Group – which seeded the business in 2014.

Syz distances his firm from those that target co-investment purely as a means of minimizing the private equity fee burden. ACE takes a similar approach to McNally, forming clubs of families that can contribute strategically to a company. It is willing to pay for access to the right deal, whether that involves supporting a fund-less sponsor or paying fees because others in a consortium are doing so.

Understanding how Asian family offices fit into this matrix is complicated by the fact that, like their Western brethren, they sit at different points on a broad spectrum. However, one recurrent theme flagged up by industry participants is relative youth: the family patriarch is still very much involved in both the core business and the management of his assets. Indeed, the line between the two may frequently blur. This has positive and negative connotations.

A family office investing in an industry in which it has extensive expertise and can offer synergies on the corporate side is a powerful proposition. As the ITS Logistics example illustrates, this is the kind of specialist local partner that many other family offices look for – and in Asia one sector features more prominently than others. "Everyone has a slightly different strategy, role and team composition, but the one thing all these families have in common is real estate. Since our specialty is doing PE-style deals into real estate operating platforms, we love that," says Eric Solberg, founder and CEO of EXS.

Regardless of the target industry, the presence of a family office with relevant strategic interests can also facilitate a path to exit. In certain cases, the family office – perhaps acting alongside other parties – seeds a company in expectation that the corporate unit will absorb the business once it is fully functioning.

The flip side is that a family office's motivations can be hard to gauge. Sanjay Chakrabarty, a partner at Singapore-based Capital Square Partners, who has worked with family offices on deals, recalls situations in which these groups have been obliged to drop out of transactions because they wanted to be the majority investor. It was no longer clear whether the agenda was financial or strategic.

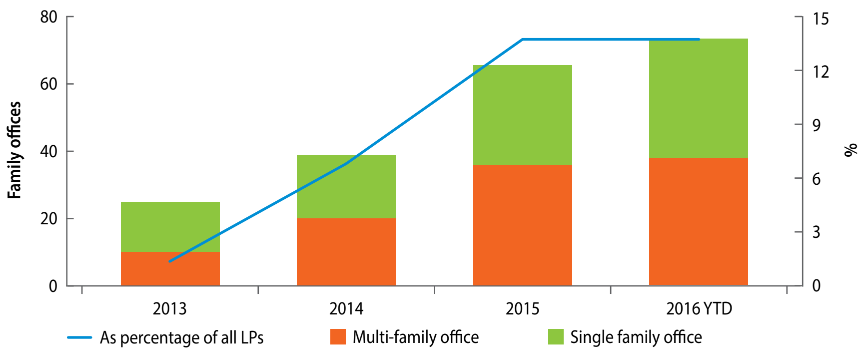
"As a financial investor I am not going to give majority control to anyone who has a strategic point of view; we would no longer be in alignment and I would be doing a disservice to my investors," he explains. "That is the paradox they have to break out of. On the one hand, family offices can and should invest in businesses they understand and in which they have expertise. But there is a creeping mentality to start thinking like a strategic investor and that conflict has to be managed."

Kirby of Kirby Capital notes that most family offices he deals with in the US are run entirely separately to the core business – different teams, different offices, maybe different cities. However, distance does not necessarily diminish an active patriarch's influence. He draws up the parameters within which the family office operates, even creating thresholds above which commitments require personal sign-off. In addition, the patriarch's children may be employed by the family office; some are highly suited to the job, and others less so.

These challenges are not unique to Asia, but they can be accentuated by the absence of institutional processes. It results in a decision-making system described as "not so much analytical and process-driven, but people-driven," or "more emotional." Breaking this habit is possible but it comes at a price.

"The approach is linked to what generation

Asia Pacific-based family office PE investors



Source: Preqin

the family office is in – they ultimately shift to capital preservation, as we can observe in Europe and North American, but when they are young they want to go direct," adds Michael Prahl, a fellow with INSEAD's Global Private Equity Initiative who now is a partner at Asia-IO Advisors, a co-investment platform for large institutional investors. "Making investments in areas they know, they already have assets there and are happy to double down. Going outside of the comfort zone, it is harder to evaluate opportunities. They have to invest in professionals and structures, which is expensive."

Metdist was willing to do exactly that. Thornton, who previously headed up 3i Group's Southeast Asia business and is still based in the region, was recruited to execute a control-oriented investment strategy. His small internal team is augmented by advisors who are brought in to assist with due diligence, assess management teams and assemble five-year development plans. While Thornton says the family places a high premium on finding teams that share its values, decisions are underpinned by private equity-style analysis.

"It wasn't until after I left 3i – having spent 16 years there – that I realized how important our internal processes were. When you go somewhere that doesn't have these processes you appreciate them for what they are," he adds.

Based on his experiences in the US, McNally of McNally Capital is convinced that the family office movement from fund commitments to direct operating company investments represents a systemic shift. Three years ago he wasn't so sure, but the steps taken to build out dedicated investment teams make for a convincing case. Five years hence, McNally expects club deals between families to account for a more meaningful portion of deal flow.

Plotting the future

It is an open question as to how quickly Asian family offices might follow suit. Although there are sophisticated groups in the region, they are few in number. EXS' Solberg believes there is still a struggle between applying local knowledge and connections and developing a professional approach. "The worst family offices hire second-rate PE guys, and they are just run-around guys for a very capricious and whimsical investment committee process," he says. "The best ones hire grade A professional teams and incentivize them as well as or better than PE firms."

Yet it is the pace of progress that is subject to debate, not progress itself. Several industry participants point to a development among Asian family offices that has already been seen elsewhere. It takes place gradually, crawling up and along two axes: the first measures the level of comfort with private equity, starting with fund investments and moving into direct exposure; the second tracks generational change and the introduction of professional management.

Henry Lee served as CIO of Hong Kong-based real estate and investment company Nan Fung Group, before launching his own fund under Hendale Asia. He respects families that don't assume they can seamlessly replicate business success in the investment world, but rather identify what can be accomplished in house and outsource other functions to third parties.

This is likely to happen with increasing regularity as more families recognize the importance of wealth preservation. Looking to create portfolios that are diversified rather than concentrated in particular industries, they find that time-intensive PE co-investment is best left to those with relevant expertise.

"Most Asian families have never thought of investments as a separate business because their operating businesses have done so well in a high growth economy," Lee says. "However, economies are slowing and operating rates of return are dropping with increasing risk. The primary way they can mitigate that risk is through investment diversification globally."

Early-stage icon

At $920 million, Sequoia Capital latest India fund is the largest ever VC vehicle raised in the country. How will the technology sector accommodate this quantum of capital?

NO ONE COULD ACCUSE SEQUOIA CAPITAL of holding back in India. Having closed its fourth fund at $530 million in April 2014, within 12 months the venture capital firm was adding a further $210 million to the corpus. Now, less than two years on, Fund VI spent almost no time at all in the market as it accumulated commitments of $920 million. It is the largest-ever vehicle raised by an India-focused VC firm.

To put the Sequoia fund in context, it accounts for almost all of the $1.03 billion raised by India-focused VC firms so far this year. It is also nearly half of the record $2.05 billion that went to 16 venture capital managers in 2015 as a whole. The previous year a total of $1.2 billion was committed to 10 funds.

And yet, since the fourth quarter last year, Asia's technology sector has cooled; investors have grown wary of pumping capital into established start-ups with high cash-burn and backing new entrants that seek unrealistic valuations. Sequoia's fundraising success for India suggests this market is able to resist torpor beginning to take hold elsewhere. Is it for real, or has Sequoia bitten off more than it can chew?

"Typical VC funds have an investment cycle of 3-4 years. If you break down a $300 million fund, you're talking about investing $75-100 million per year. For a $900 million fund, it goes up to $225-300 million. Are there sufficient opportunities in India to absorb that amount of capital? I absolutely think there are," says Aashish Bhinde, executive director with transaction advisory firm Avendus Capital.

Building a business

Sequoia started its India operation in 2006, raising $400 million for Sequoia Capital India Growth Fund I. 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.

Despite at one point splitting its venture and growth strategies across two funds, Sequoia has always been stage agnostic. For example, in 2006, the firm teamed up with KKR on the buyout of Flextronics International's India-based software development unit, while also participating in a seed round for news search engine platform Guruji.com.

This diversity extends to industries as well. Internet-enabled technology is Sequoia's sweet spot – particularly in the context of mobile, payments and software – but over the course of 100-plus investments across 10 years, it has also dipped into healthcare and various consumer-oriented opportunities. To some, it is evidence of a firm staying ahead of the curve.

"The combination of roots in Silicon Valley and successful past investments in India has enabled Sequoia's team to think a little ahead of the market. If you look at the whole e-commerce start-up space, many of the new local VC firms have been drawn towards the same sectors as Sequoia," one industry participant says.

Total VC investment in India reached a record $12 billion last year, up from $7.5 billion in 2014 and $5.2 billion in 2013. The principal actors, in dollar terms, were later-stage investors pouring capital into a relatively small number of businesses they see as long-term category leaders. The $500 million round e-commerce platform Snapdeal raised last year from the likes of SoftBank Corp, Foxconn Technology and Alibaba Group is a case in point.

The new high in venture capital fundraising came as Accel Partners, SAIF Partners, Kalaari Capital and Nexus Venture Partners all closed new funds, capitalizing on strong investor appetite for emerging markets internet exposure. However, so far only Nexus has raised a dedicated vehicle, or top-up fund, to support later-stage investments in existing portfolio companies.

Sequoia's preference appears to be making fresh and follow-on investments from a single vehicle, although it has created distinct teams for each strategy. The firm has 20 professionals looking at venture deals, and 15 focusing on the growth and expansion side.

Industry participants expect large follow-on rounds to remain a feature of the India venture capital space in 2016, not least due to the wave of consolidation that is enveloping the technology sector. Over the past two years, larger players such as Snapdeal, its e-commerce rival Flipkart, and ride-hailing app operator Ola have all become more acquisitive.

Sequoia benefited from this trend when one of its portfolio companies, online bill payment service Freecharge, was acquired by Snapdeal. The VC firm received a 3% stake in Snapdeal in return for its shares. More recently, Oyo Rooms – a budget hotel booking app backed by SoftBank and Sequoia, among others – acquired direct competitor Zo Rooms. The deal is said to have come about after Zo Rooms tried and failed to raise additional capital from its investors.

> "It won't be easy for private companies to raise capital, and valuations are going to be suppressed"
>
> – Aashish Bhinde

"There is a degree of nervousness about the market and that is likely to have a cascading effect on every company. It won't be easy for private companies to raise capital, and valuations are going to be suppressed. Mostly importantly, capital will become concentrated around few assets. All of this is likely to happen over the next 6-12 months," says Avendus's Bhinde.

Familiar signs

A similar phenomenon is expected in Southeast Asia. The current and previous Sequoia India funds have included a relatively small Southeast Asia allocation and the firm has completed nearly a dozen deals. These range from Indonesian e-commerce player Tokopedia to Malaysian online fitness platform Kfit.

"We have already seen a material change in valuations in the most recent funding rounds. There is a bifurcation between start-ups that have a clear path to a sustainable business model and start-ups that have solely focused on growth while neglecting fundamentals. As a result, there will be a flight to quality – and quality start-ups will benefit from the coming consolidation," says Stefan Jung, a managing partner at Venturra Capital, which co-invested with Sequoia in Kfit.

Partners Group brings in childcare expertise

WHEN AUSTRALIAN CHILDCARE PROVIDER Guardian Early Learning Group came up for sale in 2013, Partners Group lost out to Navis Capital Partners, which bought the asset from previous owner Wolseley Private Equity at a valuation of A$120 million ($110 million). But Partners Group's interest in Guardian didn't fade; in fact, the longer it watched, the more attractive Guardian became.

"The projection that management had provided at that point, they've beaten quite handsomely. And we've had a chance to keep in touch with them and to see the business evolve and grow, and to validate management's plan from those days," says Cyrus Driver, managing director and head of Asia private equity at Partners Group.

With a track record of backing childcare and education providers globally, the firm felt it was well-positioned to do business in Australia, where the structure of government support and regulation rewards established players and creates high barriers to entry for newcomers. Partners Group could be confident that its target for acquisition would have freedom to focus on offering high-quality services.

"As opposed to some markets in the world where anyone can open a childcare center, even with very poor standards, and then undercut those who are trying to provide genuine service, in Australia the rules of the game favor those who adhere to all the regulatory and quality requirements, and those who go above and beyond that," Driver says.


Childcare: Experience pays off

Having seen Guardian's capacity rise from 5,700 children per day in 2013 to more than 10,000, Partners Group was quick to enter the process when Navis put the company back up for sale. It bought a majority stake last month at a valuation of A$440 million.

The private equity firm now plans to bring its international childcare expertise to bear. Several new board members have been lined up, including a former executive from KinderCare who will advise on the development of new curriculum materials that will set Guardian apart from other centers. Partners Group will also support the company's physical growth plans. Construction of 10 new facilities was scheduled before the investment and now other greenfield projects will be accelerated.

The strategy for Guardian is part of a two-pronged approach. On one side, Partners Group looks for opportunities such as Guardian in sectors where it has global experience that can be leveraged. On the other, it seeks investments with a cross-border angle where it has an advantage over local competition. While Partners Group has made few investments in Australia so far, with growing maturity in the market it expects to build its presence there.

"We do see valuations improving in Australia," says Driver. "We see a more sober market from a seller's perspective, and therefore a healthier market for buyers. And we expect to grow our Australia portfolio quite substantially on the private equity side."

EQT leverages corporate compliance

THE GLOBAL TESTING, INSPECTION AND certification (TIC) market – ensuring everyone from sneaker manufacturers to nuclear power plant operators to rail service providers meets quality and safety standards – is dominated by a handful of companies. Three of them, Intertek, Bureau Veritas and SGS, together employ more than 180,000 people and generated revenue of around $13 billion in 2014.

Bureau Veritas describes TIC as a "vast and fragmented market" worth over EUR200 billion ($223 billion). Of this, 40% is available to outsourced providers. There is also plenty of untapped demand, with increased emphasis placed on sustainability and environmental, social and governance (ESG) issues.

While these headline numbers contributed to the thesis behind EQT Partners' investment in Hong Kong-based Elevate, the firm was equally focused on how it expected the TIC model to evolve. With around 350 people, Elevate is a fraction of Intertek, Bureau Veritas and SGS' size, but TIC auditing is just one part of its offering.

"The improvement consulting side of the business is significant," says Tai Wak Chung, managing director at EQT. "If you look at the traditional method of auditing, an inspector works through a list of issues that require verification. It is a check-list approach but it doesn't solve problems. Elevate sends in consultants to do that"


Consulting: Outside advice

Under this "audit-plus" approach, Elevate might find that high staff turnover is a drag on factory productivity. Research, much of it survey-based, is used to establish the root causes of employee dissatisfaction – apart from money, these may include unclean working environments, poor on-site amenities, or inadequate training – and a customized turnaround plan is drawn up.

Elevate's founders, who continue to run the business, wanted a partner to support expansion and EQT prevailed in a competitive process. It now holds a majority stake. The size of the investment was not disclosed, but it came from the EUR1.1 billion ($1.48 billion) EQT Mid Market fund, which writes equity checks of $40-100 million in Asia.

From its base in Hong Kong, Elevate has ready access to production facilities scattered across China and Southeast Asia. Most of the clients are multinationals in the US, and EQT will help with customer-sourcing in Europe through its existing industrial network. There are also plans to broaden Elevate's sector coverage. While apparel, consumer electronics and retail have been the traditional focus points, the TIC market is pivoting towards pharmaceuticals, automobiles and food.

Chung adds that product development is another area in which the company can progress. "One is a due diligence product, and as a PE firm we can certainly help with that," he says. "Then there is data and analytics, which is important in benchmarking across factories and geographies. Clients want to do quantitative assessment on a large scale."

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Back to the land

Chang Sun swapped his life as head of North Asia at Warburg Pincus to become a farmer in China. He sees substantial financial and social opportunities in modernizing a highly inefficient agriculture sector

THE SEEDS OF CHANG SUN'S CHINA agriculture business were planted several years ago when a friend shared some research that showed how far a small amount of investment could go. To take just one example, farmers use four times as much fertilizer as their US counterparts, have double the unit production costs for corn and one third the yield. If crop nutrients could be used in a more sensible way, these statistics could be turned on their head.

"The more I looked at it, the more excited I became. Then I decided to jump in with both feet, and invested in land transfer deals using my own money," Sun says. "My friend Fang Fenglei [founder of private equity firm Hopu Investment] heard about it and told me I was being idealistic. That may be true, but I want to make an impact."

Sun set up his new firm, Black Soil, last year after 20 years with Warburg Pincus. The transfer of land use rights is key to his productivity-oriented investment thesis: by contracting out these rights from multiple farmers, Black Soil can bring consolidation to a fragmented sector, introduce more automation, professionalize management, and pursue economies of scale.

These goals are ambitious as well as idealistic, and not all financial investors are convinced by the pitch. It represents a role reversal for Sun, who having helped Warburg Pincus become one of the first US-based private equity firms to gain a foothold in China, used to sit on the other side of the desk and decide whether entrepreneurs' ideas were worth backing.

"One should learn how to let go. People often have too much of a vested interest in what they are doing, and this makes them reluctant to leave their comfort zone," he observes. "My life has changed; it is difficult for me to get used to, but I have to accept it. Many successful entrepreneurs have gone on to become fund managers. I am going in the other direction, which is rare."

Unorthodox education

Sun was not born into a life of comfort. Born in the western province of Gansu, his father worked for a Zhejiang-based electric power company until falling victim to China's Cultural Revolution. Sun, still in primary school, moved to the countryside to stay with his nanny. Education was typical of the spirit of the times: children received lessons in crop cultivation and machine maintenance rather than academic subjects.

Sun became self-taught in unusual circumstances. After high school he signed up for a four-year term in the air force and during this time a friend bought him an English grammar book. Sun stayed up at night studying and listening to Voice of America while his fellow recruits slept.

When China resumed university entrance examinations in 1977, Sun was the only student from Zhejiang to win a place at Beijing Foreign Studies University. As a sophomore, he was accepted on to a United Nations program for Chinese-English translators, which involved a two-year postgraduate placement. By 1984 he was working at the UN headquarters in New York.

> "My life has changed; it is difficult for me to get used to, but I have to accept it. Many successful entrepreneurs have gone on to become fund managers. I am going in the other direction, which is rare"

However, life as a translator was unfulfilling. Sun resumed his private studies, focusing on mathematics and the sciences, and received a scholarship to enter a joint MA and MBA degree program at the Joseph Lauder Institute of International Management and the University of Pennsylvania's Wharton School of Business. On graduation, he was hired by Lepercq De Neuflize, a boutique asset management firm.

In the early 1990s, with several investment banks looking to expand in Greater China, Sun moved to Hong Kong to work for Goldman Sachs. He rose quickly, carried by a wave of state-owned enterprises seeking offshore listings. A year after working on the first H-share offering, by Tsingtao Brewery in 1993, he was put in touch with Charles R. Kaye by a head hunter.

Now co-CEO of Warburg Pincus, back then Kaye was a young managing partner tasked with opening the Hong Kong office. He invited Sun to establish the firm's China and North Asia operation, but Sun was reluctant. "Goldman at that time was almost a household name and had a great reputation. Nobody knew about Warburg Pincus; you had to build from the ground up. I had to explain to people that Warburg Pincus was nothing to do with UBS Warburg, because the names were similar," he recalls.

Seeing potential

Nevertheless, he saw potential for Warburg Pincus' minority investment style in China and accepted a job that paid half his Goldman Sachs salary. An early step was to come up with a Chinese name for the private equity firm – he settled on "Hua Ping," which bears some phonetic similarity to the English name. Local entrepreneurs' lack of familiarity with PE, and the absence of any intermediaries to assist with deal sourcing, posed more serious obstacles. As a result, Sun spent most of his time on the road.

"Today it takes about 20 minutes on the high-speed train from Shanghai to Nanjing. That's very different from 20 years ago. Back then, tractors, trucks and donkey carts filled the roads and there was no street lighting," he says. "It was so dangerous to travel in China that I actually asked the firm for extra life and disability insurance."

Warburg Pincus' Asian operation focused only on China and India, and Sun started with three fund managers – one from each country and another from the US. During the first seven years, about $250 million was deployed, initially in increments of $5-10 million. In the 13 years after that, $5 billion was invested and check sizes now routinely enter the $100-$150 million range. Warburg Pincus' Asian portfolio has grown to about 40% of total assets.

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Skilled at Chinese calligraphy and chess, four years ago Sun added Tai Chi to his leisure pursuits and practices the ancient marital art every morning. He believes these activities help him relate to company founders. "Everyone at Warburg Pincus is taught to respect entrepreneurs, who are successful in their own right. When they come to us for financing, they aren't begging for money so it's important to put ourselves in their shoes and think about what they need from us," Sun says.

Alongside this respect came keen-eyed scrutiny. He wanted entrepreneurs to display a long-term vision and passion for their business; the fund manager's duty was to temper this optimism with realism and ensure substantive execution plans were in place. These characteristics underpinned investments Sun led in AsiaInfo Technologies, Harbin Pharmaceutical Group and Gome Electrical Appliances.

Time for change

Nevertheless, he began to grow weary of the asset class, largely because the limited time horizon on private equity investments means there is little opportunity to guide a company through multiple stages of growth. "Many fund managers take themselves too seriously and feel too self-important. In reality most of the time we are just pushing paper and not creating anything concrete for society," he says.

By contrast, Black Soil's agriculture investments could involve protracted holding periods and deliver meaningful societal change. Taking advantage of reforms introduced in 2014 that allow farmers to lease out their land use rights, it wants to piece together small family-owned plots in the northern province of Heilongjiang and create large operations.

"As long as you have scale and accumulate enough land, you should be able to increase yield and reduce cost, which will lead to profitability. This is my thesis, and we will see in the next few years if it's correct or not, but I am putting my money where my mouth is," Sun says.

These efforts are supported by a specially-assembled team of agriculture experts. Among them are David Liu, previously China country manager for DuPont Pioneer where he focused on hybrid seeds that improve crop yields, and Xin Li, a former executive from Chinese agribusiness conglomerate COFCO. The initial plan was to raise a $1 billion private equity fund, but with LPs wary of backing a first-time fund in a relatively untapped area, Black Soil has decided to work on a deal-by-deal basis for the time being.

"I have done two deals instead of spending all my time raising a fund. Besides, even if I had $1 billion to deploy, could I find enough profitable opportunities in Chinese agriculture? Investors wanted me to show them "proof of concept". 'Have you done agriculture investing before? If not, how can you demonstrate that you will be successful in it?'" Sun says. "So I rolled up my sleeves and got my hands dirty – literally."

The first investment was for a majority stake in North 44, a rice company that has acquired the rights to cultivate 100,000 mu (66.7 million square meters) of land. In the second, Black Soil led a consortium that took a substantial interest – and assumed operational control – of a state-owned potato processor and distributor. These two projects are expected to generate about RMB1 billion ($152 million) in revenue by the end of 2016, with net profit reaching RMB150 million.

Sun wants to list them on the National Equities Exchange and Quotation (NEEQ), a local over-the-counter exchange also known as the New Third Board. Progress is being marshaled by a 20-strong operating team plus more than 100 staff working in the fields, while Sun flies up to Heilongjiang twice per quarter.

"To me, failure isn't an option – we have to succeed," he says. "If I can successfully guide these two companies to profitability, and take them public in China, then we can raise money from the public markets."