



**THE WINNERS**

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*Innovative Directions in Alternative Investing*

**\$2,660,000,000**

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# The 17th AVCJ Awards

## AS THE INDUSTRY'S PREMIER INFORMATION SOURCE, THE ASIAN

Venture Capital Journal tasks itself with highlighting the firms, professionals, investments, exits and fundraises that are a cut above the rest. We do this on a continuous basis through our editorial coverage and then on an annual basis through the AVCJ Private Equity & Venture Capital Awards.

The awards are a showcase for first-class innovation, ingenuity and performance. They are also unique in how they are distributed – relying primarily on nominations and votes cast by Asia's private equity and venture capital community, but with contributions from a select panel of industry judges as well as the AVCJ Editorial Board.

To mark the 30th anniversary of Asian Venture Capital Journal, the 17th iteration of the awards featured an additional element: recognition for the leading investment from each decade in which AVCJ has been active. It was an opportunity to reflect on how private equity has evolved in Asia and to identify some of the deals that have helped put the industry where it is today.

Apart from that, the categories and processes were unchanged. Nominations opened in August and names were put forward on behalf of third parties as well as directly. Individual firms were restricted to one submission per category. All submissions had to relate to fundraising, investment and exit activity over the 12-month period ended September 22, 2017.

The entries were evaluated by the AVCJ Editorial Board and a long list was created. The judges assessed the long list and had the opportunity – if they wished – to review original submission papers and propose alternative candidates. Their collective recommendations formed the basis of the final shortlists drawn up for each category.

Voting began on October 10 and closed on October 27. The entire private equity and venture capital community was able to participate in the vote, although they were asked to register – providing name, firm and contact details – so as to avoid vote packing. As in previous years, no more than 10 votes were accepted from the employees of a single firm.

The results were collated, assessed and final recommendations put forward. The PE and VC community has a 50% say in the outcome, with the judges and the AVCJ Editorial Board each accounting for 25%.

This assessment process did not apply in two categories: The Operational Value Add Award, which is presented at the discretion of the AVCJ Editorial Board with substantial input from a separate judging panel comprising industry professionals who work on the operations side; and the AVCJ Special Achievement Award, which is also presented at the discretion of the AVCJ Editorial Board, although external suggestions from the PE and VC community were considered.

As in previous years, we are indebted to our expert judges, who made the time to participate in the process. For 2017, they included representatives from:

- Adams Street Partners
- Allianz Capital Partners
- AlInvest Partners
- Asia Alternatives
- Capital Dynamics
- Commonfund
- Hamilton Lane
- HarbourVest Partners
- HQ Capital
- LGT Capital Partners
- Morgan Stanley Alternative Investment Partners
- Portfolio Advisors
- Standard Life Aberdeen
- StepStone

The judging panel for the Operational Value Add Award included:

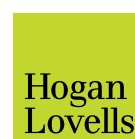
- AlixPartners
- Alvarez & Marsal
- AT Kearney
- Bain & Company
- EY
- KPMG
- PwC

The winners were announced at a gala dinner in Hong Kong on November 13, preceding the AVCJ Forum. Congratulations to those who took home prizes, and many thanks to everyone who participated.

We will preserve in our efforts to make the AVCJ Awards relevant, appealing and reflective of the work being done throughout the asset class in Asia. With this in mind, any feedback is much appreciated.

**Tim Burroughs**  
Managing Editor  
Asian Venture Capital Journal

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## ROLL OF HONOR

**Fundraising of the Year – Venture Capital:** LAV Biosciences Fund IV (Lilly Asia Ventures)

**Fundraising of the Year – Mid Cap:** Kedaara Capital Fund II (Kedaara Capital)

**Fundraising of the Year – Large Cap:** KKR Asian Fund III (KKR)

**Deal of the Year – Early Stage Technology:** Beijing SenseTime (CDH Investments/Dalian Wanda Group/IDG Capital)

**Deal of the Year – Late Stage Technology:** Ofo (Atomico/CITIC Private Equity/Coatue Management/Didi Chuxing/DST Global/Macrolink Group/Matrix Partners China)

**Deal of the Year – Mid Cap:** Press & Converting (VIG Partners)

**Deal of the Year – Large Cap:** Yingde Gases (PAG Asia Capital)

**Exit of the Year – IPO:** Au Small Finance Bank (ChrysCapital/IFC/Kedaara Capital/Warburg Pincus)

**Exit of the Year – Mid Cap:** Riraku (Advantage Partners)

**Exit of the Year – Large Cap:** Universal Studios Japan (Goldman Sachs/MBK Partners/Owl Creek Asset Management/PAG Asia Capital)

**Venture Capital Professional of the Year:** JP Gan & Nisa Leung (Qiming Venture Partners)

**Private Equity Professional of the Year:** Yichen Zhang (CITIC Capital)

**Operational Value Add:** Great Southern Rail (Allegro Funds)

**Firm of the Year:** KKR

### AVCJ 30th Anniversary Awards

**Investment of the 1980s:** Acer (H&Q Asia Pacific)

**Investment of the 1990s:** Korea First Bank (Newbridge Capital)

**Investment of the 2000s:** Oriental Brewery (Affinity Equity Partners/KKR)



“A deal that is 10% of your fund and comes back at 12x, returning more than your fund, gets a little bit of attention, so we are very pleased with how that worked out. Another thing we liked about this – and it is indicative of deals like Permira and Sushiro as well – is the growth in Japan. It’s a market people don’t expect a lot of growth in but sometimes it is there, and you get some great returns”

– Richard Folsom, Advantage Partners







“It started in 1986 when the Hong Kong government was going through one of those iterations of ‘How can we make Hong Kong a financial center?’ I was asked to chair a committee to do something about this. The decision of the committee was let’s create a private equity and venture capital center for the region, and that resulted in the founding of the Hong Kong Venture Capital Association and also the GEM market, which has taken on different shapes, and then the promotion of the whole industry. I am completely thrilled to see the way it has grown to today”

– Victor Fung



“We started off in a very small way five years ago to create a different type of fund. We focused on doing buyouts in India and actually having exits. I still remember our discussions with people – some of whom are in the room – and we said, ‘We don’t know what the world DPI means because we aren’t supposed to give money back in India.’ But we’ve been fortunate”

– Manish Kejriwal, Kedaara Capital



“Raising a \$9.3 billion fund is really not something you want to celebrate because it means more hard work and more pressure. But I’m glad we got this fundraising done and now we can focus on what we really need to be doing”

– Ming Lu, KKR

# Top of the pile

## FIRM OF THE YEAR & FUNDRAISING OF THE YEAR – LARGE CAP From raising the largest pan-regional fund ever seen in Asia to concluding Japan's biggest PE buyout, KKR has enjoyed an eventful 12 months

### “WE HAVE RECORDS OF HOW MANY TIMES

Henry Kravis flew to Japan to meet the chairmen and CEOs of different conglomerates, as well as other senior partners from around the world, not just those based in Asia,” says Ming Lu, head of Asia private equity at KKR. “They do this when there isn't an initial, specific target. It is about sharing our experience and showing companies how we can be operationally helpful.”

KKR's pursuit of a meaningful piece of corporate Japan has been protracted. By the end of 2012, seven years after establishing a presence in Asia, the firm had deployed \$5 billion in the region, but Japan only accounted for 6%. Since then, KKR has completed four corporate carve-outs in the country, with a fifth pending. Aggregate equity committed to Japan deals to date now stands at about \$2 billion, excluding co-investment.

It has become the firm's most active market in Asia, with two of those transactions closing within the last 12 months. They include the JPY498.3 billion (\$4.5 billion) acquisition of automotive components manufacturer Calsonic Kansei Corporation, a process that started with an agreement to buy Nissan's 41% holding in the company and ended with the completion of a tender offer for the entire business. It is the largest-ever private equity-sponsored transaction in Japan.

KKR announced 12 new investments between October 2016 and September 2017 – the qualification period for the AVCJ Awards – across China, Korea, India, Australia, and Vietnam, as well as Japan. There were also distributions from seven investments, including five full exits. Meanwhile, beyond the private equity world, the firm scaled its business across credit, real estate, infrastructure, and capital markets.

Yet the focal point for the period was KKR Asian Fund III, which closed in May at \$9.3 billion, breaking the firm's own record for the largest pool of capital ever raised for deployment across the region. KKR spent about six months in the market and ended up raising substantially more

than its \$7 billion target due to strong demand from LPs, many of whom had their allocations cut back.

### Big in Japan

This interest is based on track record and deal pipeline, and Japan is a prominent factor in both. There is a sense that the large-cap investment opportunity across the region is growing due to a combination of economic growth and structural change. Lu notes that when he started in private equity, buyouts were limited to Australia,

emotional and cultural barrier – they might say they know it's the right thing to do but it feels like selling your children. With the success of Panasonic Healthcare, I think they have seen that it can be beneficial.”

Panasonic Healthcare, KKR's second carve-out in Japan, has become its calling card. In 2013, the GP firm acquired Panasonic Healthcare for JPY165 billion, telling Panasonic – which retained a 20% stake – that it could drive expansion domestically and overseas. Since then the business has doubled in size, in part due to the purchase of

Bayer's diabetes care business. Last year, Mitsui & Co. invested at a valuation of JPY245.9 billion, enabling KKR to make a partial exit.

“We have exceeded many expectations with the company, and it is a reference point in every other meeting on the topic of carve-outs and our cross-border capabilities,” says Lu. “Japanese companies know we worked with all the stakeholders at Panasonic Healthcare to grow this business, and those stakeholders have now seen the value-add beyond capital that we bring and are advocates of our partnership model.”

PE firms have agreed five carve-outs from Japanese conglomerates in the past 12

months. Each was a competitive process and KKR prevailed in three. The acquisitions of Calsonic Kansei and power tools player Hitachi Koki have closed, while a deal has been struck with Hitachi over Hitachi Kokusai Electric but the tender offer to shareholders in the listed company has yet to be completed.

Even though these were auctions, KKR had reached out to the sellers long before any transactions became imminent. Suzuki recalls visiting Nissan with the deal team for preliminary discussions on potential carve-outs and then being drafted in once the due diligence began on Calsonic Kansei and the firm needed to draw up proposals for what it planned to do with the business. Given the company has 78 factories around the world, KKR emphasized its global network and sector expertise.



The KKR team receives the Firm of the Year award from Stephanie Keen of Hogan Lovells (second left)

Singapore, Hong Kong and to some extent Korea, but now emerging markets such as China and India can deliver sizeable deals.

But Japan looms large in almost every pan-regional investor's consciousness. Whether the shift is driven by governance reforms that prioritize return on equity (ROE) over scale, a recognition that being globally competitive means concentrating on core competencies, or an appreciation that private equity can be a good partner, conglomerates are more willing to sell to financial sponsors. While the gate hasn't fallen from its hinges, it is gradually opening, ending years of frustration.

“One part is that corporations are very reluctant to carve out subsidiaries in Japan,” says Sakae Suzuki, a managing director with KKR's Capstone operations team in Tokyo. “It's an

“They are keen to understand what kind of value-add we want to achieve and to see our track record. They may fear – at least this is my observation – that a PE firm will come in and dismantle the subsidiary, causing tremendous hardship for employees,” he says. “But we have shown that we really support the growth of businesses. We hope they see when KKR invests in a company, it tries to increase the value through growth rather than by cutting back on people and cost.”

While those concerns might be shared by all vendors, the methods of engagement vary.

A full takeover of the latter division is an eventual possibility, but preserving the LS Group relationship is paramount.

KKR is one of the few Asian buyout firms that can claim to have a true pan-regional presence. Fund III is being deployed by more than 60 investment professionals – supported by Capstone and KKR Capital Markets – based in offices in Beijing, Hong Kong, Mumbai, Seoul, Shanghai, Singapore, Sydney, and Tokyo. However, making each local team among the leading players in its market is not easy.

“Running a true pan-regional fund has its

my track record, franchise and relationships, then I won't be there five years from now. You have to think about it strategically.”

Preexisting relationships in Southeast Asia's business community have already paid off once this year in the form of Vietnam-based Masan Nutri-Science. KKR invested \$359 million in another Masan Group subsidiary, Masan Consumer Corp, between 2011 and 2013, exiting its position last year. This shared history helped the firm win a competitive process to invest \$150 million in Masan Nutri-Science, an animal feed supplier that is expanding into mid-stream agriculture. KKR also bought \$100 million worth of shares in Masan Group because it thought they were undervalued.

## “They are keen to understand what kind of value-add we want to achieve and to see our track record”

– Sakae Suzuki

For example, when working on the Panasonic Healthcare deal, Capstone had extensive discussions with the subsidiary's management as well as with Panasonic executives. During the Calsonic Kansei process, though, Suzuki didn't speak to management until after the deal was signed. Then it was a case of sitting down with as many people as possible.

Capstone distills its value-add strategies into a 100-day plan and a fast-start playbook. The latter lists immediate post-acquisition priorities, covering areas such as cost savings, revenue generation, research and development, and innovation cycles. Those initial meetings with management help the team develop ideas for what should go into these plans.

“The content of the fast-start playbook and the 100-day plan has a lot in common with deals in other countries,” Suzuki adds. “But then there are also mannerisms and considerations that are unique to Japanese management teams, so we have to customize our approach. We adjust and evolve our approach each time based on the situation.”

### Replicating the model

KKR is now in the process of taking its proven Japan template and applying it to Korea, where global private equity firms have long pursued carve-outs from the chaebols but to relatively little avail. An initial breakthrough came at the end of June with an agreement to invest in two divisions of LS Group subsidiary LS Mtron at a combined valuation of KRW1.1 trillion (\$940 million).

The GP will acquire 100% of LS Mtron's copper foil and laminate business and enter joint ownership – albeit with a 47% interest – of LS Automotive division. Automotive components sector research carried out for the Calsonic Kansei deal proved helpful in assessing LS Automotive.

challenges – it is challenging building a strong team in all markets and understanding the dynamics of those markets in real depth,” says Lu. “There are some pan-Asian platforms that are particularly active in one or two markets, which is an easier approach to establishing a team and a track record.”

A pan-regional strategy also requires a degree of flexibility. In late October, KKR paid around \$74 million for a 12.6% stake in Nippon Indosari Corpindo, a listed Indonesian bakery business. Regardless of the appeal of a proxy to rising consumer demand or the chance this might represent the first part of a multi-stage investment, mid-cap PIPE deals seem off-strategy for a \$9.3 billion fund. In fact, the transaction is an example of KKR thinking strategically about an emerging market.

Indonesia, like most Southeast Asian nations bar Singapore, cannot be relied upon to deliver a string of large buyouts, but pan-regional players hoping to develop the market still need to be there. Furthermore, Nippon Indosari Corpindo is backed by local conglomerate Salim Group, owner of a string of consumer businesses. It is the kind of partner with which PE firms want to become aligned.

“We have to be very flexible in each market. If we approach a market thinking we only want to do \$500 million deals, then we wouldn't end up doing anything in some places,” Lu explains. “But that doesn't mean five years from now it won't be different. And if I'm not there today building

### Pricing pressure

Whatever the strategy for deploying a \$9.3 billion fund, the lingering question – which was also asked of the firm's \$6 billion second Asian vehicle – is: How much is too much? With large amounts of capital entering the asset class globally, most of KKR's large-cap regional peers have raised or are raising substantially more capital than in the prior vintage.

A pan-Asian fund managed by a brand-name GP is the logical option for an institutional investor that must write large checks and wants reasonably broad exposure. It remains to be seen whether the small subset of firms that operate at the top end of the market are raising so much money that they will be unable to efficiently address the investment opportunity as it stands. The KKR view is that opportunity set – in

Japan and elsewhere – is growing fast enough to justify its fund size.

There are concerns about rising valuations, particularly in competitive processes and Lu shares them, noting that he sees plenty of deals in which the multiples are purely liquidity-driven rather than supported by the fundamentals. An investor will enter at a 20x price-to-earnings multiple in the expectation that they can enter at the same valuation in five years' time.

“A generation of investment professionals has grown up and never seen a high-interest rate environment, and that troubles me,” Lu adds. “There is no 20x P/E in my vocabulary. We underwrite based on long historical averages of P/E through cycles. If we can't justify a deal on that basis, we walk away. But even in the most expensive markets, you will find sectors that are good value.”



Ming Lu, KKR's Asia PE head



# Favorable diagnosis

**FUNDRAISING OF THE YEAR – VENTURE CAPITAL** Lilly Asia Ventures' rapid-fire \$450 million fundraise reflects increasing LP interest in the opportunities offered by the Chinese healthcare sector

## CHINA-FOCUSED LILLY ASIA VENTURES

(LAV) closed its fourth healthcare-focused fund – LAV Biosciences Fund IV – earlier this within two months of launch, hitting the hard cap of \$450 million. US institutional investors account for the

majority of the corpus, with the rest coming from Asia and the Middle East.

LAV was established in 2008 as a corporate VC arm of global pharmaceutical company Eli Lilly, focusing on life sciences investments in Asia. In

2011, it became independent. Fund III, which closed in April 2015 at \$300 million, received commitments from a mixture of sovereign wealth funds, fund-of-funds and family offices.

With a primary focus on pharmaceuticals, biotechnology and diagnostics, LAV invests in everything from greenfield projects to pre-IPO rounds. Most target companies are based in China, although the GP will consider US investments that are likely to have a significant impact on the Chinese market. The cross-border strategy also reflects the fact that healthcare is a global play, with the

convergence of technology from China and the US. Most biotech companies, for example, would nowadays opt to set up R&D centers in both countries as a means accessing advanced technology and distribution channels.

Since Fund III, LAV has pursued an incubation model whereby the GP launches new start-ups internally or backs entrepreneurs who join as venture partners. At present, there are five venture partners, two of whom have founded start-ups that have received funding from LAV. They include Veritas Genetics and Just Biotherapeutics China, both of which were co-founded by Jonathan Zhao, a venture partner who previously led Asia strategy for Amgen and Pfizer.

The larger corpus for Fund IV means LAV can deploy more capital in early and growth-stage deals. Recent investments from the fund include participation in a \$63 million round for US-based drug developer E-Scape Bio, which focuses on treatments for Alzheimer's disease. ■



Wendy Luo of Lilly Asia Ventures with HQ Capital's David Pierce

# Momentum play

**FUNDRAISING OF THE YEAR – MID CAP** Having proved an ability to return capital to LPs from its debut fund, Kedaara Capital took just three months to hit the hard cap on its second India vehicle

## WHEN KEDAARA CAPITAL INVESTED IN

automotive components manufacturer Bill Forge in 2015 it was planning for a longer holding period than 16 months. But last September, the India-focused firm had secured the first exit from its debut fund, with an approximately 50% IRR – thereby offering LPs a degree of reassurance that its strategy could work.

Kedaara closed Fund I in September 2013 with commitments of \$540 million, having spent around 18 months in the market. Fund II was raised in about one third of the time, reaching a first and final close in September 2017 at the institutional hard cap of \$750 million. Including the GP contribution, it has \$795 million to deploy.

The firm was established five years ago with three particular areas of focus: avoiding high entry valuations; doing control transactions and adding value to portfolio companies by leveraging the talents of operating partners; and concentrating from the outset on delivering successful exits.

"I remember discussions with many investors

– some of whom are in the room – and we said, 'The poor legacy of Indian private equity has historically given a negligible DPI [distributions to paid-in] to the LPs and we are determined to make sure we do it differently,' recalled Manish Kejriwal, a founding partner at Kedaara, speaking on the sidelines of the awards presentation dinner. "We have been fortunate indeed."

The Bill Forge exit came when Spain-headquartered CIE Automotive agreed to buy the company for INR13.1 billion (\$200 million). Kedaara received around INR3.15 billion in cash – more than the approximately INR3 billion it paid for a 46.88% interest in the business – plus shares in Mahindra CIE, the acquirer's India-listed subsidiary. The private equity firm has since added two more partial exits to its ledger, following IPOs by Au Small Finance Bank and Mahindra Logistics in 2017.

Six of the nine investments in Fund I are control deals. Clayton, Dubilier & Rice, a UK-based GP known for its operational approach to buyouts,

contributed to the latter, helping Kedaara define its approach operating partners. "This was very important in establishing how operating partners work with portfolio companies," said Kejriwal. "You don't necessarily want operating partners to be with the companies every day, making decisions for them. The role is more to help companies make their own decisions."

Kejriwal was formerly a partner with McKinsey & Company, based in New York and India, and helped set up the firm's private equity practice. He then spent seven years as India head at Temasek Holdings before launching Kedaara with General Atlantic alumni Sunish Sharma and Nishant Sharma.

Ontario Teachers' Pension Plan (OTPP) was the anchor investor in Fund I and it is performing the same role in Fund II. All the firm's other existing backers re-upped. New investors include Canadian pension fund Caisse de dépôt et placement du Québec (CDPQ) and insurance company Allianz. ■



# Deep thought

## DEAL OF THE YEAR – EARLY STAGE TECHNOLOGY A university spin-out focusing on technology commercialization, SenseTime has become popular among investors seeking artificial intelligence exposure

**XIAO'OU TANG, A PROFESSOR IN THE** department of information engineering at the Chinese University of Hong Kong (CUHK), is an expert in facial recognition technology. Over the course of more than 20 years, he guided hundreds of PhD students conducting research in computer vision and pattern recognition, but little progress was made in terms of commercialization. The technology just wasn't mature enough.

The turning point came in 2011. Since then, the development of deep learning – which involves using neural networks to feed data into a computer, which is then able to make decisions – has accelerated. And it has taken computer vision with it, is essentially enabling a range of computer vision applications, from face and image recognition to machine vision for self-driving cars.

Between 2011 and 2013, Tang and his students published more than 14 research papers on deep learning in computer vision – out of 29 papers in this field globally. As

a result, Tang recognized an opportunity to commercialize the technology to which he has devoted his career. He established SenseTime three years ago in Hong Kong Science Park, alongside two CUHK PhD students – Li Xu and Bing Xu – and Fan Yang, formerly a software development engineer at Microsoft.

"In China, there haven't been many start-ups formed by teams of professors and university students who want to commercialize their scientific research, although this is commonly seen in the US," says Bing Xu. "Most Chinese companies are focused on the innovation of business models, but I expect there will be more technology innovations in China, led by university spin-outs."

### Infrastructure build-out

IDG Capital visited the CUHK campus for due diligence in late 2014, and soon invested \$10 million in a Series A round. Within a year, SenseTime had expanded its four-strong founding team to include 30 scientists and

industry experts, most of whom are former students of Tang.

The commercialization process was expected to take two years or more and require huge upfront capital commitment to hire scientists and purchase equipment so the company could build internal computation capability. However, few Chinese VC firms foresaw the contribution computer vision and deep learning technology would make to the development of artificial intelligence (AI) software, an area that attracted a lot of investor attention in the past year.



Stuart Schonberger of CDH Investments

"In 2014-2015, we talked with many VC firms, but they only focused on our revenue. We were burning cash to recruit talent and build a proprietary deep learning platform at that time," recalls Xu. "We went through some tough times. On several occasions, we could hardly pay our employees." Tang sold his apartment and dipped into his savings to keep the business afloat as well as obtaining about RMB50 million in venture debt funding from Silicon Valley Bank.

SenseTime wants to build a proprietary deep learning platform – known as Parrots – that drives core AI technology, much like Google's TensorFlow. The company has already developed more than 5,000 different types of graphics processing units (GPU), a hardware that can accelerate the performance of deep learning. It hopes to help reduce R&D costs for AI technology developers in a variety of industries including medical imaging, high-performance computer chips and autonomous driving.

"We think the AI industry will achieve an explosive growth in the future. To achieve that you need to build a solid computing infrastructure to process a large amount of data. It's similar to the internet industry – first thing you need to have a comprehensive broadband network coverage," says Xu. "Our infrastructure coverage is probably more than four years ahead of that of other new players in the AI industry."

The victory of Google's DeepMind System, dubbed AlphaGo, over a human professional Go player without handicaps in October

2015 is regarded as a breakthrough for the AI industry. Since then, financial investors have shown greater interest in deep learning and AI technology. For SenseTime, AlphaGo's win represented a maturation of deep learning technology, and the company responded by looking for new funding to scale up its business.

### A start-up in demand

SenseTime received approximately \$10 million in a round led by StarVC, a VC firm established by several Chinese movie and entertainment personalities, in April of last year.

Although the company is not yet profitable, it supplies its AI chips and software solutions to the likes of China Mobile, Huawei, Xiaomi and JD.com. This was enough to convince CDH Investments of its commercialization potential. The PE firm led the first tranche of a Series B round worth \$120 million in December 2016, joined by Dalian Wanda Group, IDG and StarVC. A second tranche of \$290 million, led by Sailing Capital, closed six months later, valuing SenseTime at more than \$1 billion.

"Many investors were surprised that CDH, a private equity firm that has historically invested in traditional industries, would actually back a technology company that has not yet generated any profit. Given CDH's strong reputation, many other PE firms were confident enough to invest," says Xu.

Indeed, there were as many as 20 additional participants in the Series B round, including China Merchants Securities International, Morningside Venture Capital, China International Capital Corporation, Co-Store Capital, Advantech Capital, and China Renaissance.

SenseTime is now worth in excess of \$2 billion, having leveraged its investors' commercial and government relationships to accelerate growth. The company has more than 400 customers in China and overseas and last month announced a tie-up with Qualcomm Technologies to collaborate on AI and machine learning for mobile and internet-of-things (IoT) products.

"If we launched our business in the US, we would likely get acquired by large tech companies, like Google or Facebook, at an early stage of development," says Xu. "In China, however, large tech firms are not so keen on acquiring core technology companies. That's probably one of the reasons why we've become a major AI player in China." ■

# Start-up central

## VENTURE CAPITAL PROFESSIONALS OF THE YEAR J.P. Gan and Nisa Leung, managing partners at Qiming Venture Partners, discuss the latest trends they are seeing in China's consumer internet and healthcare spaces

**Q: Qiming has seen a number of IPOs in the last 12 months. What does that say about the broader exit environment for VC-backed companies in China?**

**GAN:** The onshore and offshore public markets, as well as M&A, have been good for Chinese tech companies. Traditionally, the Hong Kong Stock Exchange hasn't been that receptive to internet businesses but after Meitu [a photo and social networking app Meitu in which Qiming was the first investor] went public in late 2016, we've seen Zhong An Insurance and China Literature do IPOs. A few more companies are currently going through the application process, so we can say that Hong Kong is becoming an important exit venue for Chinese VC-backed companies. Meanwhile, the US market has been coming back, and on the domestic side, the regulatory approval process has got faster. Overall, I think it's the best I've ever seen in my career. Having said that, a few large tech companies, such as Meituan-Dianping and Didi Chuxing, will continue to raise capital from the private markets. I don't expect them to go for IPOs any time soon.

**LEUNG:** We've had four healthcare IPOs in 2017: Zai Lab on NASDAQ and three others on the A-share markets [one of which was a reverse merger]. In general, the healthcare companies we have invested in prefer to list domestically. Ultimately it depends on a company's fundraising structure and business model. Our three investees that went public in China were very profitable when they listed. Companies that have yet to become profitable will go to the US or Hong Kong.

**Q: How often your Qiming's consumer internet and healthcare teams look at deals together?**

**GAN:** We have about 30 investment professionals and they are allocated equally across healthcare, internet and consumer, and other core technology like big data, artificial intelligence (AI) and cleantech. We don't have a fixed ratio of how much of the fund should be deployed in each area. The consumer internet and healthcare teams have worked closely on several mobile healthcare investments like We Doctor and Miaoshou Doctor.

**LEUNG:** The ecosystems for healthcare – which is very diverse, comprising pharmaceuticals,

medical devices and diagnostics – and consumer internet are quite different. One interesting thing is that the BAT (Baidu, Alibaba Group and Tencent Holdings) are also entering the healthcare space in different ways. We have multiple co-investments with Alibaba and Tencent in digital healthcare. The convergence of sectors through technology



Nisa Leung of Qiming Venture Partners

is very interesting. The composition of our three main sectors gives us a unique angle. For example, when we identify a healthcare company that has deployed mobile internet or AI technology, we invite other teams to review the project and establish whether the technology is legitimate and vice versa.

**Q: Where do you see the most attractive investment opportunities right now?**

**GAN:** On the consumer internet side, there is a lot of discussion about "new retail." We have invested in an unmanned convenient store operator called BingoBox and then there are plenty of so-called new retail start-ups that put the vending machines in offices or public areas. At the end of the day, the business must make economic sense – it is more efficient to have the store or machine than a sales person – and involve disruptive technology. If you just use an app to open the vending machine's door, that's not high-tech at all. But if you use facial recognition or product recognition technology in stores, that's interesting.

**LEUNG:** New drug discovery is still very hot, and valuations have gone up a lot over the past two years. In some ways, healthcare

companies in China are more expensive than ones in the US now. Medical devices and diagnostics are also interesting. The mobile healthcare sector – start-ups using online platforms to connect doctors and patients – has gone through some volatility. Many well-funded companies found it difficult to raise follow-on rounds last year. But now Ping An Good Doctor is preparing an IPO in Hong Kong, so it's possible that other players will follow suit.

**Q: To what extent is healthcare becoming so hot that the valuations might surpass those of internet companies?**

**LEUNG:** TMT [technology, media and telecom] valuations are always ahead of healthcare because more money is entering the consumer internet space. But healthcare has been picking up. Given the exit prospects in the A-share and US markets, many healthcare-focused funds have been formed and the Chinese government is also pouring money into many tech areas. It's beneficial for our existing portfolio companies – we have one that have received 17 term sheets for its next funding round – but valuations are very high when backing new companies. Deciding whether or not to invest comes down to the quality of the management teams and the assets, and the R&D pipeline. Some healthcare-start-ups have pitched for early-stage rounds at valuations of \$300-500 million before they've even started clinical trials. As a value investor, we shy away from those deals.

**Q: What is the major difference that you see in entrepreneurship now compared to 10 years ago?**

**GAN:** The quality entrepreneurs is so much better. Ten years ago, it was difficult to find someone who had previously run a \$50 million-plus business or led more than 100 people. Good entrepreneurs came from multinationals or just the grassroots. Jack Ma, for example, worked in a completely different field to e-commerce. Now you have young and ambitious founders who have studied overseas and at domestic elite universities or who previously led thousands of employees at large technology companies. This batch of entrepreneurs is world-class in terms of technology development, business planning and execution.

**Q: How have the relationships evolved between Chinese start-ups and larger tech and healthcare companies?**

**GAN:** Although some of the new generation tech companies, such as online-to-offline local services platform Meituan-Dianping, have received backing from the BAT, the former is disrupting the latter. Just look at Baidu. In the

has been a mix. Some have worked and some haven't. Meanwhile, a number of home-grown Chinese companies that we have invested previously have become very big and they are partnering with new generation start-ups in a meaningful way. For example, our portfolio company TigerMed, a Shenzhen-listed contract research organization, has been

try my best. Many successful business stories have sad personal stories behind them. As a company grows, partnerships can break up and there might also be family issues, such as divorces. Sometimes I get involved in very difficult life decisions for the founders. That's part of my job, that's real value-add. But I'm not there to help them write press releases or review legal documents. They should hire people to do PR and legal.

**LEUNG:** Unlike most VC firms in China, all our senior partners have extensive operational backgrounds. When I sit on the boards, I work with our companies on acquisition targets, as well as partnerships with global pharmaceutical firms and large hospitals in the US and China. I think it's very hard to build a team to create that type of value-add because it is very personal. It's based on how we work alongside CEOs for a long time, brainstorming what types of partnerships we should develop. A lot of time these relationships are quite high level. We are deeply ingrained in our various sectors, but an HR person who understands the pharma industry may not understand financial technology, so it's kind of defeating the purpose of setting a dedicated team. The tough part is really about business strategy – which is the true value-add a professional VC should offer. ■

## “This batch of entrepreneurs is world-class in terms of technology development, business planning and execution”

– JP Gan

PC world, users would go to Baidu to search information, but in the mobile internet age, players like online news aggregator Toutiao push relevant information so users don't need to search by themselves. Toutiao is now generating billions of dollars in advertising revenue that might otherwise have gone to Baidu, so in many ways it is eating Baidu's market share. Meituan-Dianping is doing the same thing, developing technology that makes customized suggestions as to what people might want to eat or purchase.

**LEUNG:** When it comes to forming joint ventures between Chinese companies and international pharmaceutical companies, it

working with a handful of biotech companies globally. Its corporate venture arm also has been invested in companies both in China and the US, and we have co-invested in some of those deals as well.

**Q: Various large VC firms have set up dedicated teams to provide value-add services to start-ups, from human resources (HR) to public relations (PR). Would Qiming consider doing the same?**

**GAN:** Our time, industry resources and networks are valuable to entrepreneurs. If an entrepreneur comes to me and ask for help on business or even personal matters, I will

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# Hot wheels

## DEAL OF THE YEAR – LATE-STAGE TECHNOLOGY Ofo and Mobike dominate China's bike-sharing industry, having raised billions in funding. Investors in Ofo believe they are backing the more sustainable model

**BIKE-SHARING HAS EMERGED AS ONE OF** the hottest investment themes in China, with start-ups in the space attracting more than \$2.5 billion in funding over the past two years. It is estimated that nearly 40 companies offer bike-sharing services nationwide, but the industry is dominated by two behemoths, Mobike and Ofo. They account for a 95% market share as well as receiving most of the PE funding.

Ofo was launched on the campus of Peking University in 2015 as a student project. CEO Wei Dai and his four co-founders pooled their savings and borrowed cash wherever they could to provide the RMB150,000 (\$21,800) required to get the business off the ground. The company, which claims to be the world's first dock-less bike-sharing platform, now connects 6.5 million bikes with 100 million users in 150 cities across four countries. It is valued at more than \$2 billion.

"Ofo started on campus by college graduates who have pure motivations as to why they want to do the business. They thought through every problem that would confront the company in the early days, including the theft and misplacement of bikes. Ofo is the pioneer in bike-sharing and they will be successful," says Kelly Poon, a Greater China partner at Atomico.

The company has closed two funding rounds in the past 12 months. Atomico participated in the first, a \$450 million Series D round in March led by DST Global. CITIC Private Equity, ride-hailing platform Didi Chuxing, Matrix Partners China and Coatue Management also committed capital. Then in July Ofo raised \$700 million led by Alibaba Group. This is the largest round the bike-sharing industry has seen to date. Mobike – which sports orange bikes to Ofo's yellow – received \$600 million a month earlier from investors including Tencent Holdings.

### Capital game

Ofo and Mobike disrupted the traditional urban bike-sharing model by allowing users to park their machines anywhere, rather than in fixed docks. A deposit is required to join the platform and then users simply locate and unlock bikes through a mobile app. They pay RMB0.50-RMB1.00 for every 30 minutes spent on the bike. The cost is lower and the convenience level higher than public programs, resulting in a surge in popularity among students and commuters who are tired of inching their way through congested streets in cars.

"The explosive growth of bike-sharing in

China is because of business model innovation – users can pick up and park bikes anywhere at any time. It's much more convenient and very profitable," the 26-year-old Dai told AVCJ earlier this year.

Bike-sharing is fundamentally an asset leasing business run according to a simple unit economics model. "Ofo can control the cost of running the bicycles, and generate revenue from customer usage. If you can reach the right usage per bike, you will make money. But this depends on a set of assumptions that need to be rigorously studied and tested – the lifespan of a bike, usage frequency per bike, manufacturing and

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**"People expect that a merger would allow the companies to reduce spending on making new bikes and to generate more revenue"**

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– Yiran Liu

maintenance costs," Jingyang Wu, a managing director at CITIC Private Equity, said in April.

As such, in the early days, the key differentiator between Ofo and Mobike was cost per bike: RMB300 for the former versus RMB3,000 for the latter. Ofo minimized cost by using mechanical locks. A user scans the QR code on a bike and receives a password that is entered manually into the lock. Mobike users can unlock bikes by scanning the QR code and its machines have GPS tracking systems – but a bike had to be cycled at least one hour a day to charge up the battery that powers these high-tech functions.

According to Ofo investors, an Ofo bike returned the capital invested in it within 2-3 months compared to 2-3 years for Mobike. "Bike-sharing comes down to the volume of the bikes – a company should place as many as possible on the streets. It's different to the ride-hailing app model, which is about utilizing existing vehicles more efficiently through GPS. When the number of bikes reaches a critical mass, demand for using GPS systems will fall because users can find bikes easily on the street, says Poon.

Earlier this year, Mobike launched a lighter

version following complaints from users that the battery made the original model too heavy. The company has also introduced batteries with a 1-2 year lifespan and reduced manufacturing costs to RMB700 per bike. Meanwhile, Ofo added a GSM tracking system, which is slightly less accurate than GPS. Each Ofo bike now costs RMB500 to produce.

### Merger of equals

Capital is key to achieving critical mass in this bike-sharing war. While Ofo and Mobike have prospered, smaller players have been forced out. Bluegogo, a distant third in terms of market share but with 20 million registered users and 700,000 bikes at its peak, shut down a few weeks ago. The company received \$90 million from VCs including Black Hole Capital. Mingbike has also laid off most of its staff, with customers complaining that they can't get their RMB199 deposits back.

Ofo and Mobike are not profitable and the expectation is that they will ultimately merge. In doing so, they would follow a pattern set in other areas of China's internet economy where competition escalated to the point that capital raised from investors was fueling unsustainable battles for market share. This led to the formation of Didi Chuxing in ride-hailing, for example.

Some investors would welcome a similar outcome in bike-sharing. "People expect that a merger would allow the companies to reduce spending on making new bikes and to generate more revenue," says Yiran Liu, a partner at Vision Plus Capital, which backed Ofo's Series C round.

Ofo and Mobike hold about RMB6 billion in deposits collected from users, but they are not permitted to use this cash for other purposes. As such, they can only turn profitable once they hike the fees. The two companies are also going overseas, with a view to charging higher fees, particularly in more developed markets. Ofo has a year-end target of expansion into 20 countries, including Japan, France, Spain, Germany and the Philippines.

"Branding is very important for a Chinese company when it expands overseas. A few weeks ago, we helped set up a keynote speech for Ofo at a leading technology industry conference in London, with over 2,000 attendees. Those kind of activities can raise the company's brand awareness and help put a face to the company name, as the government and other industry players are just starting to get to know the name Ofo," Atomico's Poon says. ▀

# Beauty parade

## DEAL OF THE YEAR – MID CAP With Korean cosmetics brands trading at high valuations, VIG Partners thinks it got a bargain by moving upstream and buying a niche supplier to the skincare industry

### KOREA'S CROSS-BORDER CULTURAL

appeal – manifested in the form of music, TV dramas and beauty products that have drawn a substantial foreign consumer following, particularly in China – has created a natural opportunity for private equity firms. Indeed, Bain Capital Private Equity and Goldman Sachs have already seen this investment thesis pay off with the sale of cosmetics supplier Carver Korea to Unilever. While most GPs have gone after brands, VIG Partners approached the industry from a different angle.

"The cosmetics segment was somewhat of a dilemma for us," says Jason Shin, a managing partner at VIG. "While we liked the lifestyle and beauty industry a lot, the valuations of cosmetics brands were very high. Beauty and fashion is also fast-changing. Many brands have come and gone over the years, and we weren't sure the top players would remain the same for the next three to five years."

Furthermore, cosmetics brands have generally traded at EBITDA multiples of 15-20x, putting them beyond the reach of VIG's middle market fund, which typically targets companies with enterprise valuations of about \$300 million. Co-investment is always an option for larger deals, but the aforementioned concerns about valuations and brand sustainability meant the risk factor was too great.

As a result, VIG probed deeper into the industry supply chain for skincare products. It found that the facial mask segment was seeing significant growth on the back of the broader "Korean wave" phenomenon, and this was happening regardless of brand.

This led the private equity firm to acquire a 75% stake in domestic facial mask manufacturer Press & Converting (P&C) at an enterprise valuation of KRW146 million (\$127 million). It purchased a 33% holding from VC firm HES Capital Partners – which had invested KRW40 million in P&C early 2016 – and 40% from the founder, C.J. Son. Son remains CEO of the

company and holds the remaining 25% interest as the second-largest shareholder after VIG.

"We were negotiating the deal terms with the founder at the time when the THAAD [terminal high altitude area defense, a US anti-ballistic missile defense system] had become an issue between China and South Korea. We foresaw that Chinese tourists would shy away from Korean products, but it would be a short-term phenomenon. We took advantage of the situation and negotiated the price at a single-

digit EBITDA multiple," adds Shin.

### Sticky habits

Sheet masks comprise pre-cut fabrics soaked in serums that contain ingredients intended to treat dry skin and other related conditions. P&C entered the market in 2005 after Son recognized a growing opportunity in supplying sheet masks to manufacturers. The company has developed hundreds of sheet masks fabrics – including non-woven, cotton, and synthetic fiber – and

infuses them with a variety of ingredients and materials like charcoal, gold dust and bamboo. The different compositions number in the thousands.

There are approximately 5,000 facial mask brands in Korea. While beauty products conglomerates AmorePacific and LG Household & Healthcare manufacture their facial masks in house, most other skincare brands outsource production to third parties. P&C supplies sheets to more than 350 manufacturers – there are 500 in total in Korea – that account for 70% of the market.

The country's facial mask industry has grown fourfold over the past five years, from \$700 million in 2011 to \$2.7 billion in 2016. P&C's annual production capacity is about 1.8 billion sheets. The company has posted annual average revenue growth of about 60% over the last two years, with sales reaching KRW92 billion in 2016. Operating income for the year was KRW23.2 billion.

"The founder has managed to grow revenue by \$100 million per year. Once a company hits this level, it has to think about running the business like a big operation. The founder, who is only 46 years old, wants to pursue strategic expansion but he realized he can't take care of everything. Since we are a reputable mid-cap PE investor in Korea, he decided to sell a majority stake to us to help the company grow further," says Younggi Han, a director at VIG, who led the P&C transaction.

P&C's revenue is expected to decline around 15% in 2017 – with revenue for the entire industry set to drop 20% to \$2.2 billion – as result of falling Chinese demand. Chinese tourists account for about 50% of total inbound visitors to Korea, and they are among the biggest spenders on local cosmetics, but Beijing has imposed a ban on packaged tours to the country. This is the predicted result of tensions over THAAD. Once they abate, Han expects facial mask sales to resume their rapid growth, increasing at an annual average rate of 15% to reach \$4 billion by 2021.

### China expansion

VIG's immediate efforts post-acquisition focused on improving P&C's systems and processes by bringing a new management team, including a CFO and chief marketing officer. The next step is supporting expansion in China, where the facial mask market is almost three times the size of South Korea's. Revenue came to \$4.7 billion last year and it is projected to hit \$9 billion by 2021.

There are about 800 beauty products manufacturers in mainland China, with the top 10 players accounting for a more than 50% market share. P&C's market entry strategy is two-pronged: it will supply sheet masks to these leading manufacturers or work with Chinese skincare brands to develop products. In the longer term, the company plans to diversify into other product categories, supplying fabrics for the manufacture of diapers and wet tissues, among others.

"Given Korea's reputation for high-quality beauty products, we can team up with Korean manufacturers and approach Chinese brands directly about developing sheet masks that are specifically targeted at Chinese consumers. Chinese brands want to cooperate with us, because they can utilize Korean manufacturing and R&D capabilities through our network," adds Han. ■



Chulmin Lee of VIG Partners

# Fast mover

## DEAL OF THE YEAR – LARGE CAP PAG Asia Capital stole a march on the competition to secure a \$2.7 billion take-private of China's Yingde Gases, dealing with feuding shareholders and complex financing along the way

### YINGDE GASES IS MAINLAND CHINA'S

largest independent on-site industrial gas supplier with a more than 30% market share in 2016. It had 70 facilities in operation, most of them on the premises of metals and chemicals producers tied to long-term contracts. Revenue was up for the year at RMB8.4 billion (\$1.2 billion) but Yingde swung from a net profit to a net loss, largely as a result of rising impairment and finance costs. This was the fairly benign backdrop against which a painful shareholder battle broke out.

It started in November 2016, shortly after Yingde announced a private placement to China's OriginWater Technology that was intended to help service a growing debt load. The company's chairman and CEO and its COO – also founders and major shareholders – were removed, at a board meeting convened in their absence, due to unsatisfactory performance. Another shareholder took over as chairman while a representative of OriginWater became CEO.

This triggered four months of angst involving boardroom reshuffles, highly public disputes, and the cancellation of the share placement. As the situation deteriorated, dragging more senior and middle level management into the shareholder fight, international gas producer Air Products made an offer for Yingde. This coincided with the company taking out a high-interest bank loan to avoid defaulting on its existing debt and ratings agencies downgrading its bonds to deep junk status.

### Conviction play

Yingde mandated Morgan Stanley to run a sale process, but by then PAG Asia Capital had completed two months of due diligence with full support of management. It negotiated separately with the feuding major shareholders, winning irrevocable undertakings over 42% of the shares, secured bridge financing, made a general offer in early March and completed the deal within two months. The \$2.7 billion enterprise valuation equated to 5.4x EBITDA, about half the level of Yingde's global peers.

"The company was doing a share placement, so we were able to conduct due diligence. We got into the situation much sooner than everyone else, but if we hadn't known the industrial gases industry so well we wouldn't

have jumped up so quickly," says Weijian Shan, chairman and CEO of PAG.

Part of this was a historical familiarity with the industrial gases space in China. But the PAG team could also call upon more recent experience, albeit in the Korean market. A matter of weeks before PAG secured conditional undertakings from the Yingde shareholders, the sale process concluded for Daesung Industrial Gases, a supplier of general industrial and specialty gases.

A Goldman Sachs-led consortium bought the business in 2014 from Daesung Group, which was forced to divest assets in order to service its debts. MBK Partners acquired it from Goldman for



PAG Asia Capital's Tim Morrison (right) with Steven Tran of Hogan Lovells

a reported enterprise valuation of nearly KRW2 trillion (\$1.8 billion), which equated to an EBITDA multiple of 13x. Two Korean conglomerates, Hyosung Corporation and SK Group, both submitted bids while several private equity firms, including PAG, were also said to be in the running.

"That process was educational for us, our team learned a lot from it," Shan admits. He is curious why other private equity bidders, having done the work on Daesung, did not approach Yingde early on with more conviction, particularly given the acquisition multiple was much lower. He notes that one of PAG's advantages is it operates as a single team, rather than having different groups of people in each market that engage in inter-jurisdictional competition.

### End of the war

PAG found a way in because of the stalemate

at board level. Xiangti Zhao, the replacement chairman who owned 12.41% of Yingde, cast himself as the savior of a company that was on the verge of collapse due to mismanagement. Zhongguo Sun and Trevor Strutt, the ousted CEO and COO, who between them owned nearly 30% of Yingde, contested this version of events. Claiming that Zhao was acting in concert with OriginWater to seize control of the business, they opposed the placement.

As a result, Yingde was willing to engage with other prospective investors and PAG signed a non-disclosure agreement in late December 2016 enabling it to conduct due diligence. This involved visiting all the major sites of the company throughout the country and interviewing its key customers. At that point, there was no guarantee these efforts would result in a buyout.

Even after securing irrevocable undertakings from Zhao, Sun and Strutt – regulatory filings indicate the two sides could not agree how to proceed with a sale – there was no certainty because Yingde could still have accepted an offer that was at least 5% higher. However, PAG had right of first refusal, which effectively shut out the competition. On that basis, the GP put together \$1.5 billion in equity and bridge financing in time to launch a general offer for Yingde just as the auction process was beginning.

Within a month, investors representing more than 50% of the total shares had agreed to the tender, making the offer unconditional. Two weeks after that, the acceptance level reached 90%, ensuring PAG could proceed with a full privatization. It was the fastest ever take-private in the history of the Hong Kong Stock Exchange. "I tell the team to this day that we wasted two weeks for Chinese New Year, otherwise we would have done it even sooner and at an even lower valuation," says Shan.

One of PAG's first initiatives was to address Yingde's financial situation. Debt was refinanced, and borrowings had dropped below 50% of total assets by the end of June, with the debt-to-EBITDA ratio also improving. Meanwhile, balance sheet cash increased by nearly 100%. In addition, unproductive assets have been monetized, internal management systems strengthened, and new growth strategies introduced. Yingde posted year-on-year increases in revenue, EBITDA for the first six months of 2017. ▀

# Hitting the payoff

**EXIT OF THE YEAR – IPO** India's small finance bank reforms allowed Au Financiers to tackle an entirely new business opportunity, ultimately leading to a successful IPO for the company's private equity backers

## INDIA'S NON-BANKING FINANCE

companies (NBFCs) have proven a fertile market for private equity players in recent years, with both local and international GPs investing in the institutions to meet the growing demand for credit and financial services unmet by conventional banks.

Rajasthan-based Au Financiers, led by founder Sanjay Agarwal, had already attracted several rounds of funding by 2014. Its investors, including Warburg Pincus, the International Finance Corporation (IFC), ChrysCapital and Kedaara Capital, saw in the company a solid performer they could help mold into a market leader.

"Right from the beginning it was a business that had excellent systems and processes: whether you're talking about credit policies, underwriting processes, or collections processes, all of them were very good, especially for a firm of that size," says Gaurav Ahuja, a managing director at ChrysCapital, which bought a 10.5% stake in Au for \$24 million in 2013. "Also, they had built a very good business which was growing extremely fast, and at the same time it was maintaining a very strong return profile."

Au's PE backers had invested with the intention of helping the company identify growth opportunities, expand its team and improve its internal operations. However, a new government initiative would upend those plans and lead Au to completely remake itself.

## All change

That initiative was the small finance bank license, which the Reserve Bank of India (RBI) proposed as a means of attracting India's massive unbanked population into the financial system. The license would allow institutions to provide basic banking services, like accepting deposits and issuing credit cards, to low-income citizens overlooked by traditional banks.

NBFCs and microfinance institutions (MFIs), which were smaller and nimbler than banks – and most active in areas where the larger institutions wouldn't or couldn't operate – were particularly suitable candidates. Au was naturally attracted, but meeting the requirements for final approval required would be challenging.

For the company's PE backers, the idea

represented a major shift from where they had thought the company was headed. Nevertheless, they recognized that it could open up a whole new line of business for the company, and agreed to help create a plan of action. "It was basically all-hands-on-deck. Everybody went and did their work to find out what needed to be done, whether we felt we were capable of doing it, and whether it would create long-term shareholder value," says Ahuja. "Once we got our heads around it that's when we said it makes

enterprise (SME) lending and vehicle finance.

As Au made progress toward obtaining the license, its PE investors began to consider their next steps. The conversion to a small finance bank would give Au considerable public recognition that would be useful in launching an IPO.

## Good timing

Though some of Au's peers had also announced plans to go public, in this case the circumstances were somewhat different. The company didn't

need the offering to raise working capital – the sale of Au Housing had left it with more than enough. Instead, Au's IPO would comprise only shares held by its existing investors, which would all make a partial exit.

"We knew an IPO was the way forward, and the timing was right because the company was converting to a bank. The next step was to offer some of our shares into the IPO itself," explains Ahuja. "It wasn't one of those IPOs where any of the investors felt stretched and wanted to do the offering for the sake of getting liquidity – it was just

a natural part of the business."

The IPO in June saw Au's private equity investors sell 53 million shares at INR358 apiece, raising INR19.1 billion (\$297 million). Warburg Pincus sold 14.8 million of its 60 million shares, IFC sold 7.6 million of 30 million, ChrysCapital exited 11.3 million of its 22.5 million and Kedaara divested 10.8 million of 22 million shares.

As of early December, the company's market capitalization was INR195.8 billion, with the stock trading around INR685.80 per share. Revenue grew to INR13.9 billion for the year ended March 2017, up from INR10.2 billion the year before, while net profit rose from INR2.1 billion to INR8.2 billion.

For Au's backers the IPO and transition to the small finance bank are a vindication of the faith they placed in Agarwal and his management team. "They are excellent when it comes to execution. Once they knew what the requirements were to convert to a bank and get that approval, they had their work cut out for them," says Ahuja. "We worked collaboratively with them on some of those aspects, but I would say it is really Sanjay's execution abilities that allowed it to get where it is." ■



ChrysCapital and Kedaara Capital team members receive their award from Eric Wang of Alvarez & Marsal (left)

sense to apply for the license."

Au joined several other Indian NBFCs and MFIs – including several other PE-backed institutions – in applying for the first round of licenses in 2015 and was one of 10 institutions to receive in-principle approval that year. Meeting the regulatory requirements dominated the company through 2016, and the outcome of the process played a key role in Au's IPO earlier this year.

The first stage of converting to the new structure was to overhaul the company's internal systems to comply with the RBI's reporting standards. Au needed to improve its IT team and implement monthly management information sessions to improve its decision-making processes. In addition, the company had to meet the RBI's working capital requirements.

Au's investors provided assistance in these areas: ChrysCapital helped Au expand its IT team and develop procedures for meeting the reporting requirements, while Kedaara teamed up with Partners Group to acquire Au Housing, the company's housing finance arm. Divesting Au Housing was an effective way to raise capital for the small finance bank and also allow it to focus on its core sectors of small and medium-sized



# Comfort at scale

**EXIT OF THE YEAR – MID CAP** Over the course of four years, Advantage Partners doubled Japanese massage chain operator Riraku's store count and tripled EBITDA. A 12x money multiple on exit was its reward

## JAPAN'S UNEMPLOYMENT RATE HAS

held steady at 2.8% for most of 2017, a 23-year low, while the ratio of job openings to job applicants is at a 43-year high. Companies are rushing through initiatives to improve working conditions for existing staff, offering part-time positions to housewives, and making roles more attractive by converting them from temporary to permanent. For massage chain operator Riraku, this tightness in the labor market has been the biggest impediment to growth.

"In this tight labor environment, how do we attract the therapists we need at a cost level that makes sense to maintain our price points and deploy them in volume? That was the biggest limiting factor on store roll-outs," says Richard Folsom, co-founder and representative partner at Advantage Partners, which owned Riraku until September of this year. "At our peak, we were opening 110 new stores a year. Last year and this year we reduced it to 60-80 new stores, as we held back to allow the recruiting to catch up."

Nevertheless, the company's expansion over the last four years has been remarkable. Riraku has grown from 240 directly-owned outlets to 569 outlets as of the end of August

as a network previously restricted to Kansai, the western region including cities such as Osaka and Kyoto, has spread to cover the whole of Japan. Meanwhile, revenue has nearly doubled and EBITDA has tripled, surpassing JPY3 billion (\$26.5 million) this year.

## Expansion agenda

Advantage sold the business in September at a valuation of approximately \$300 million, securing a 12x money multiple and returning more than the entire corpus of its bridge fund, which closed at JPY20 billion in 2013. Unusually for deals that involve returns of this magnitude, the mode of exit was a buyback by one of the company's two founders. Riraku has established itself as the

largest player in Japan's massage chain industry by number of stores, and the growth is expected to continue.

"When we opened new stores we saw a lot of demand, but the question is can you find potential therapists, train them and match the therapists with customer needs. Riraku is one of the only players with the potential to keep on growing in this industry. The others are owner-operated and they don't have the infrastructure to handle complexity and scale," says Daisuke Murakami, a principal at Advantage. The GP believes the company could reach 1,000 stores over the next few years.

When Advantage was first alerted to Riraku through an intermediary, the company had only been operational for about two years. It tracked the business for 12 months and was impressed by the growth rate. The GP saw the same kind of potential for scale that it had managed to realize in other parts of the services sector through the introduction of professional systems and management.

It acquired a 75% stake in the business at a valuation of \$50 million, including debt, in October 2013, facilitating an exit for one of the three

founders. The other two, Yukihiro Takenouchi and Satoshi Koizumi, reinvested in the business – taking a combined 10% interest – and continued to serve as directors. Takenouchi led the buyout from Advantage.

Riraku's appeal was based in part on its market positioning. The company offers back and shoulder massages to the mass market. While most salon operators charge JPY6,000-10,000 (\$53-89) per hour, Riraku's price point is around JPY3,000. The company is also more efficient, with each outlet completing 1,000 massages every month, twice as many as its competitors. It has used the tagline: "Riraku, popular and affordable relaxation for salarymen, office ladies (OLs), and housewives."

"Riraku has made the service accessible to a regular buying base of customers who find it affordable and repeatable as part of their health regimen. For example, you get retirees who come in a 10 a.m. every Thursday," says Folsom. "We implemented systems that have come online in the last 18 months to collect more client information and allow more of an understanding of who is coming and how often."

## Service standards

Advantage used the same outside consultant it has used for other investments where the onus was on achieving scale. The strategy was based on a geographic and demographic modeling of the country to draw up a list of target cities, then identifying particular sites based on location, traffic and expected revenue.

"We put in place the infrastructure, including IT systems, and that helped us achieve bigger scale in a stable manner," says Murakami. "From 2017, following long discussions with management, we decided to enhance the quality of service for customers and therapists."

Initiatives on the customer side included a new style of treatment whereby clients lie on their sides rather than their backs, fully exposing the back and allowing a deeper massage of the back and shoulders. These treatments are delivered on higher quality mattresses – at an additional cost of JPY500 per session – that are more resilient and remain comfortable even for longer treatments.

Steps were taken to improve staff training so that these premium services are properly delivered. Novice therapists are now put through apprenticeships, lasting between three weeks and six months, alongside more experienced practitioners. Once established, they can attend regular seminars to review and upgrade their techniques. Therapists also participate in a ranking system, which means they can enjoy higher compensation based on customer feedback and length of working hours.

Riraku is one of six exits for Advantage over the last 12 months, with distributions amounting to nearly JPY100 billion across two funds. There haven't been any other founder buybacks, but the Riraku auction process still says a lot about broader exit trends in Japan's middle market. "Take the founder out of the equation and the next two highest bidders were financial sponsors," says Folsom. "We are seeing an increasing number of secondary deals in Japan." ■



**Richard Folsom of Advantage Partners with the Exit of the Year – Mid Cap award**

# AVCJ Private Equity & Venture Forum

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# Magic kingdom

**EXIT OF THE YEAR – LARGE CAP** Goldman Sachs, MBK Partners, Owl Creek Asset Management and PAG Asia Capital have profited handsomely from their efforts to bring more families to Universal Studios Japan

## HARRY POTTER CAME TO UNIVERSAL

Studios Japan (USJ) in 2014, but by then the amusement park operator's private equity owners and management team had already worked their magic. Attractions featuring domestic characters, such as Monkey D. Luffy from pirate cartoon One Piece and Shinji Ikari, the boy hero of science fiction anime series Neon Genesis, helped double EBITDA. The introduction of The Wizarding World of Harry Potter saw it double again.

These were part of a series of initiatives that brought about a fundamental shift in the USJ business model. Having spent eight years trying to emulate Six Flags by rolling out a big roller-coaster every summer, the company repositioned itself in the Disney mold, relying on the strength of intellectual property – attractions based on popular characters rather than thrills and spills – to establish a deeper emotional connection with visitors.

"USJ was a Hollywood-themed theme park and people in Japan went once but didn't come back," says Ken Kagasa, a partner and head of Japan at MBK Partners. "We decided to augment the target universe. We didn't just want to attract young people who enjoy the rides but also families and young females who were more likely to be repeat customers."

USJ generated revenue of \$1.5 billion last year, two-and-a-half times more than the 2009 figure, while EBITDA rose fourfold to \$600 million and visitor numbers doubled to 14.5 million. This reflected the resurgence of a consumer-oriented business that took a hit during the global financial crisis – but Comcast NBCUniversal was sufficiently impressed by the brand to buy it for JPY438 billion (\$3.9 billion).

The deal was structured across two tranches: Comcast acquired a 51% stake in September 2015 and 49% in March 2017. The second tranche valued USJ at JPY840 billion, including debt. MBK is said to have made an 8x return, having supported a privatization of the business at a valuation of JPY165 billion in 2009, working alongside Goldman Sachs, Owl Creek Asset Management and USJ CEO Glenn Gumpel. PAG Asia Capital joined the investor roster four years later, backing Gumpel in a \$250 million deal.

## A long association

Kagasa's involvement with USJ dates back to 2005 when he was part of the Goldman Sachs team that committed \$180 million to the

company. USJ was established in 1994 under license from NBCUniversal – which was acquired by Comcast in 2011 – and the theme park opened in 2001. NBCUniversal had an equity interest at the beginning but exited via an IPO in 2007 although the licensing agreement remained in place. By this point, USJ was stable; Gumpel had been hired in 2004 and stripped out a lot of inefficiencies to make the business profitable.



**MBK Partners' Mavis Chang with Eric Wang of Alvarez & Marsal**

"After Goldman invested in 2005 the company had been growing gradually, but then the global financial crisis happened and obviously attendance decreased," recalls Kagasa, who moved to MBK in 2008. "When MBK decided to invest it was a very tough situation and we needed to have a high level of conviction about the business, but I knew the management team well. Even though the economic situation was uncertain we believed that once it turned around the company would grow."

The private equity firm was also encouraged by USJ's highly defensible market position. It was the second-largest theme park in Asia and any new entrant would require a substantial amount of capital expenditure to compete. There was also a recognition that altering the business model to focus more on the emotional experience – elements of which had been envisioned by Gumpel but not fully implemented – could accelerate growth. However, not every stakeholder supported the change.

"Some people were against it. The original concept was that people would go there to enjoy a Universal Studios-related theme park. They were concerned it would dilute the brand image if on one side you had Hollywood content

and then Snoopy and Hello Kitty on the other. For serious movie fans, it might destroy the atmosphere and they wouldn't come back," Kagasa explains.

For the first couple of years EBITDA was stable as the modified brand image took time to sink in. It wasn't until the introduction of Universal Wonderland in 2012 – a 30,000 square-meter area with 30 different kinds of entertainment, including Hello Kitty Fashion Avenue, Sesame Street Fun World, and Snoopy Studios – that the investors saw a big jump in family attendance and were convinced the strategy was really working.

## Quality counts

The change in business model resulted in a reduction in capex because the company was no longer underwriting complex construction projects for new attractions. In this context, Harry Potter was an unusual bet – it required an investment of \$400 million, which amounted to a sizeable portion of USJ's revenue at the time. Kagasa describes it as a calculated risk, based on seeing the success of the brand at Universal Studios Florida and full market research to confirm its applicability to the Japanese market.

There was also a belief that they were investing in quality – a guiding principle during the holding period, which allowed USJ to increase ticket prices by 30% and eliminate discounts. For example, rather than drop prices during the winter and rainy seasons when attendance is generally lower, the company staged events targeted at diehard fans who would come along regardless of the weather. This was why One Piece and Neon Genesis took up residence in the park.

These efforts were tied together by a smarter approach to marketing from emphasizing the father-daughter relationship in TV commercials that aired at Christmas time or using promotions to cultivate local interest in Halloween. Kagasa identifies this as an area in which many Japanese consumer-oriented businesses could do more.

"In Japan, marketing is not considered a big value creation driver because the results are unforeseeable," he says. "A lot of companies are well known for the quality of their products but they are not good at marketing, thinking about the target market and getting the promotion right. We think we can continue adding value to Japan's retail industry by leveraging our experience with USJ." ■

# Back on track

**OPERATIONAL VALUE ADD** Allegro Funds secured a 25x return on Great Southern Rail by helping the formerly no-frills Australian transport company find a new life as a stylized high-end tourism attraction

## LUXURY SERVICES, CHERISHED CULTURAL

icons and companies with extremely longstanding staff are all areas where attention to perception has to be considered with the utmost delicacy. When Allegro Funds decided to rebuild Australia's Great Southern Rail (GSR), these factors combined into a layered set of opportunities and challenges.

Managing impressions internally meant careful consultation with staffers that, in some cases, had been with GSR for most of their lives, including one employee with 52 years of service. Meanwhile, the planned transition from straightforward passenger train to high-end tourism cruiser meant that there would be a range of new performance expectations from customers.

The first reputational challenge, however, involved the broader public reaction, especially since GSR specializes in traveling deep into the outback. The iconography around Australia's hinterland is almost untouchably sensitive cultural material, and if a new player is seen as disrupting that heritage, the backlash could be fierce.

Nevertheless, the arrival of budget airlines across the past couple of decades has made crisscrossing Australia by rail virtually obsolete. GSR tried to adapt, but its roots as a government dependent service did not translate into savvy commercial strategy. Allegro therefore began by helping to clarify the needed conceptual redirection.

"Over time, the number of people taking the train and the government subsidies reduced. To offset that, the business started to go down this luxury pathway, but it wasn't doing it properly because it was straddling two strategic positions," explains Adrian Loader, a managing director at Allegro. "A transportation business wants customers to get to the destination as fast as possible while a tourism business wants them to stop along the way and explore the environment. Those two models don't reconcile."

## Turnaround time

Allegro acquired GSR from UK-based Serco in May 2015 when the company's financials were faltering and attempts to attract strategic buyers drew minimal interest. Serco was undergoing a restructuring at the time, and Allegro was eager to meet the vendor's needs in order to secure the deal. As a result, compensation was understood to have included a substantial amount of

liabilities and a cash component of less than A\$5 million (\$3.8 million).

Three months later, GSR confirmed that the government was cutting off A\$9 million in annual fare concessions, increasing pressure on the imperative to evolve the business model. The services to be revamped included three routes: the Ghan between Adelaide and Darwin; the Indian Pacific between Sydney and Perth; and the Overland between Melbourne and Adelaide.

"We came up with a new strategy that was all about providing great experiences to people who want to see central Australia, which is difficult to navigate because of the lack of roads and people," says Loader. "The plan had nothing to do with the train. In fact, the train wasn't mentioned at all – it was very much a customer-focused transformation."

By early 2016, GSR had demonstrated that it could flourish without government funding and was charting significant earnings growth. It increased its revenue per return journey by 40%

Meanwhile, Allegro leveraged its tourism experience with Adelaide-based Discovery Parks, a company with 60 holiday park locations nationwide for which the GP claims to have dramatically reduced debt and increased EBITDA. Both investments made customer experience their primary performance metric by pursuing a net promoter score (NPS) strategy.

NPS calculations provide in a singular measure that is used to assess a project's commercial viability on a scale of 1 to 100. For example, a strong score in the hospitality industry would be in the mid-60s at most. Allegro aimed to be a world leader in this index with the launch of a new GSR itinerary, the Ghan Expedition, which went on to achieve an NPS of 86.

## Brand awareness

One of the main practical challenges was the fact that GSR under Serco had operated under a shared services model, with no in-house IT, finance function or human resources capacities.

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**"The plan had nothing to do with the train. In fact, the train wasn't mentioned at all – it was very much a customer-focused transformation"**

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– Adrian Loader

in 2016 to A\$827,000 and a further 15% in 2017 to A\$953,000. Late last year, Allegro exited the company to Quadrant Private Equity, generating a deal multiple of 25.1x and an IRR of 960%.

It was the first exit from Allegro's A\$180 million second fund. Marcus Darville, a managing partner at the Quadrant, said at the time that that GSR was well placed to benefit from a growing trend toward experiential travel by domestic and inbound leisure travelers.

Value-add efforts under Allegro included the implementation of a new enterprise resource planning system and the same train reservation system used by global competitors like Belmond, operator of the Orient Express. Additional improvements included the use of longer trains to reduce trip frequency and increase profitability. This coincided with a slashing of discounting programs, a retendering of legacy contracts, and a hike in the advertising budget to include media outlets such as Qantas Magazine, Lonely Planet and Prestige.

Executing a rebuild under the guidance of NPS indicators therefore meant bringing in fresh talent in a range of senior management positions. This included recruiting a new CFO and COO, as well as introducing operating partners such as Anouk Darling, a consultant at DNA-LAB Investing Strategic & Creative Capital.

"We knew we had to get the brand off people's bucket lists and on their to-do lists," says Darling, who has served on the boards of both GSR and Discovery Holiday Parks. "We had to create emotional engagement and unique experiences. Research shows that connecting with others and creating shareable moments is important. It's not about sitting on trains and seeing Australia, it's about sharing that journey and experiencing Australia."

Changes implemented under this philosophy included making the pricing of GSR tours all-inclusive. The idea is that passengers will respond more positively if they needn't worry about making additional payments for meals, drinks



and activities along the way.

Winning over customers emotionally was also a matter of style. Some A\$70 million has been spent on GSR fleet refurbishment in the past eight years, but under Allegro, sprucing up carriages became more of a wow-factor ploy. Most notably, these efforts included the unveiling of a “platinum club” lounge car, which was nominated this year for the Australian Interior Design Awards.

Architectural and consulting practice Woods Bagot was hired to add glamor to the interiors by echoing the aesthetics of the landscape along the track. Colors and materials were selected to match the mood and contours of Australian vistas, while adjustable lighting and window treatments aimed to maximize the functional flexibility of a limited space depending on the time of day.

Other detailing includes deep buttoned banquettes in earth-tone leathers, stone tabletops, brass fittings and upholstered seating. Sheer curtains are integrated into discrete ceiling light fixtures.

“There was a lot of focus on quality of experience because we knew that getting the details right would create a great customer experience and also create hero shots that potential customers want to see when they’re making up their minds,” says Loader. “We would have discussions about our vision and image ranging from the logo and ads right down to what type of wine glass we were going to have on the tables. The glasses have to have a good feel, but they can’t be too tall because the train rocks. That level of detail is important.”

Ultimately, one of the most critical design details proved to be as much about GSR team morale as impressing customers. On the occasion of a company Christmas party, staff enthusiastically received new uniforms designed by quintessentially Australian clothing outfitter RM Williams. GSR CEO Chris Tallent dramatically punctuated the event by emphasizing the importance of recognizing heritage during the transition.

“That was such a powerful moment, and it was from that time forward that people really embraced the changes inside the business,” says Loader. “That enabled the cultural transformation, and it was just wonderful to be involved in something like that.”

Darling also credits Tallent as a fervent and committed leader during the transition, addressing everything from the minutia of “branding expressions” to deeply integral cultural issues around staff engagement, training and consultation. During this process, the idea of

creating narratives around personal experiences emerged as an important component of pivoting the GSR team.

“When there are significant service expectations and more focus on guest experience measured through NPS, some staff opted out,” Darling says. “However, for the main, they approached the new direction with passion



Johan Krynauf of Allegro Funds with Alvarez & Marsal's Oliver Stratton

and vigor. The brand launch was their stories – about their lives on the train and connecting with guests.”

Sharing on a personal level also proved to be a major part of the customer experience thesis, especially in the context of repositioning hallowed touchstones of Australiana such as the Ghan and the Indian Pacific.

“[These brands] have equity and a meaning in the mind of the market,” Darling adds. “To change the timber of that meaning requires cut-through and compelling emotional engagement, and this is best done through storytelling –

separate lounge and a-la-carte dining facilities, en suite bathrooms, private transfers at the start and end of the journey, and a 24-hour concierge service.

Off-train excursions, including visits to historical sites, bonfires in the desert and stargazing, were likewise curated with a view to being simultaneously accessible and adventurous. “Dirty boots and fine wines” was the mantra. Allegro knew that combining comfort with memorable embellishments was the key to generating the needed buzz among Australia’s restless retirement set. This is because luxury rail is a bigger ticket item than most tourism businesses, putting more pressure on achieving perfection in service offerings.

“The reason the whole operational program succeeded was that people would experience the train journey and then go back and tell their friends about it,” says Loader. “If they give it a thumbs down, you know that 200 people will never do it. But if they give it a thumbs up, a few of their friends might do it.”

Demographics were also part of the value-add plan from a cultural point of view since marketing to older generations played into themes around interest in local history and cultural identity. Although Australia is an overwhelmingly urban nation, the mystique of the wide open spaces is a critical part of the collective id and by extension a primary demand driver for businesses like GSR.

Loader notes that his firm’s due diligence for the company revealed a substantial amount of free publicity in the form of radio chatter and general social interest in the products on offer.

## “It’s not about sitting on trains and seeing Australia, it’s about sharing that journey and experiencing Australia”

– Anouk Darling

neuroscience has proven it activates a different part of the brain. We currently live in a world where there is message overload. I refer to it as the inattention economy – the brain filters out unwanted communications.”

### Silver lining

From the beginning, this approach of immersive, interactive and narrative engagement was deliberately channeled at a more affluent customer base of over-55s. Fitting creature comforts were therefore introduced, including

From an operational value-add point of view, this scenario made Allegro’s work largely a matter of conjuring the right ambiance and giving an escapist public what it always wanted.

“Customer surveys for the business were actually quite positive even before we made our changes, and I think that’s because people wanted to believe in the train and the great Australian outback,” Loader says. “Capturing that feeling and making it the heart of the experience and marketing was really the key to the whole turnaround.”

# China firm, global agenda

**PE PROFESSIONAL OF THE YEAR** Yichen Zhang, CEO of CITIC Capital, discusses fundraising, working on outbound deals, the appeal of China divestments by foreign companies, and leading a multi-strategy firm

**Q: CITIC Capital hit the hard cap on the US dollar portion of its latest China fund after less than a year in the market. What does this say about LP demand for China private equity?**

**A:** It's different from before because demand is only strong for well-established firms with track records. For first-time funds, or for other large funds that have hit a rough patch in terms of performance, it's more difficult.

**Q: Are the renminbi and US dollar-denominated portions one fund or two separate funds?**

**A:** With our previous fund, by and large we managed to have the dollar and renminbi portions as parallel funds, investing in the same deals. The complication arose this year that quite a few of the deals we've done have been structured offshore. It is difficult for the renminbi fund to keep pace with the dollar fund because it cannot commit with the same degree of certainty given regulatory approval is involved. Overseas investors care about conflicts and we bend over backwards to try to appease them, and to a large extent we were able to do that in the last fund cycle. For the new fund, the dollar fund is close to 55% invested and the renminbi fund is 36% invested. Basically, it's no longer tenable to have them as parallel vehicles. Even if we have the intention of making them parallel down the road, we can't because the fund cycles are different.

**Q: For this fund you also combined the China and international teams. Why?**

**A:** As China becomes more integrated in the global economy, many China deals have an international angle and many international companies have a China angle. To fully utilize our sector expertise and international expertise it made sense to combine the teams. The international team works in an environment with very different dynamics

– almost every deal is an auction. They have close relationships with all the mid-market financial advisors in the US and Europe, and with many mid-market GPs. Combining that with the sector expertise of our China team has delivered some amazing results. When we bought CIBTvisas, a visa processing company, it didn't have any business in China. If our international team looked at it alone, it might have passed on it. But our China team includes a group that focuses on tourism, they liked the outbound business travel theme, and when they saw CIBTvisas, they immediately knew two Chinese companies that were perfect acquisition targets. The two teams are now working with it on those acquisitions.

**Q: Has your approach to working with partners on outbound deals changed?**

**A:** We are partnering with Chinese companies more on outbound deals – that is the case for Ansell Sexual Wellness and Axilone. For areas we are not familiar with, we work with other private equity firms. For example, Formel D was our first investment in Germany, so we decided to team up with 3i.

**Q: You worked with your parent company, CITIC Group, as well as The Carlyle Group on the McDonald's China and Hong Kong deal. Has this happened before?**

**A:** We hadn't worked with CITIC Group on a deal before, but we worked with Carlyle on Focus Media. McDonald's made it very clear from the beginning that it didn't want PE players – we had to bring in CITIC Group or there was no deal. One issue was that CITIC Group is such a large SOE [state-owned enterprise] and the McDonald's people wanted to know who they would be dealing with, so CITIC Group designated me to lead the deal.

**Q: What does the company need from new investors?**

**A:** The most fundamental issue is that decisions need to be made by people who are on the ground, not by someone who is sitting 10,000 miles away. Opening stores wasn't a bottom-up process – you would report your profit back to headquarters, a portion of global was allocated for capex, and then you would fight with the other countries over that capex pool. In many countries they probably didn't need

to open new stores, but in China you need to open a lot. However, under that system, the capex can't all go to China.

**Q: What does this mean for specific business development initiatives?**

**A:** The biggest growth driver right now is delivery – it increased by 81% in the first half of this year and the growth in major cities like Beijing and Shanghai is phenomenal. McDonald's headquarters in Chicago

was very impressed. You tell that to a guy in Chicago and he won't believe it. The next step is fostering stronger partnership with those delivery companies, Meituan-Dianping and Ele.me. Then there is digital marketing. McDonald's initially planned to create a single global app but I explained to the global CEO that the dynamics of the China market is very different from the rest of the world, it needs its own app and we need it faster. Close to 45% of McDonald's purchases are made using electronic payment – the biggest is WeChat Pay, then Alipay. With our relationship with Tencent, I hooked up the two teams and within six weeks, we had a customer loyalty program up and running. Now it serves four million users. We were in Chicago three weeks ago and McDonald's management said we were leading the world in this – and in digital marketing China does lead the world.

**Q: Are there similarities with Wall Street English?**

**A:** Yes. After Pearson took over the business it added another layer of management. If Wall Street English team in China wanted to launch



CITIC Capital's Yichen Zhang (right) with Tom Whelan of Hogan Lovells

**“Demand is only strong for well-established firms with track records”**

an app they would have to coordinate with seven vice-presidents at Pearson.

**Q: Why are we seeing more China divestments by foreign companies?**

**A:** The multinationals might say one reason is that the business environment has become unfriendly to foreign capital. I don't believe it. For a while, instead of national treatment, the multinationals were getting super-national treatment. Anywhere they went they would

stronger. In addition, multinationals used to get a China premium for their business on the public markets, but since 2014 it has become a discount. If that is the case and there are Chinese players willing to pay a good price, why not sell and book a gain?

**Q: What is the biggest advantage of being a multi-strategy firm in China?**

**A:** You can say there are synergies and all that, but ultimately the biggest advantage is that

dollar funding and the collateral is in China so from a secure lending perspective it's difficult. Second, you need to fundraise every couple of years, which is cumbersome. What we do is raise renminbi capital and syndicate the products out, so it's partially our own money, partially fund money, and a lot of co-investment.

**Q: Would you consider introducing other strategies?**

**A:** In addition to buyouts, we have real estate, mezzanine, and public markets. We had a venture capital division, but as a multi-strategy platform, the value of a strategy to the platform is its contribution to assets under management. Venture capital funds are never going to be that big – they are never going to get rich collecting fees – and so we might not be the platform to attract the best teams. We use our balance sheet money to take LP positions with a number of VC funds and build close working relationships with them, which means we can look at some of these companies early on. We have a team that focuses on One Belt One Road – we are onto our second fund for that – and there has been talk for many years about infrastructure plays in China. But it never works because local governments have cheap sources of funding and they are good at doing infrastructure. ▀

## “As China becomes more integrated in the global economy, many China deals have an international angle and many international companies have a China angle”

enjoy lower taxes than local companies and they negotiated good deals on land – local governments just wanted them there. A lot of those advantages have now gone, and they must compete on a level playing field. At the end of the day, multinationals believe they bring in best practice, which might be true, but you still need to adapt to local conditions and they often find this difficult. Domestic competition is also getting a lot

Chinese investors care about the brand of the firm more than the individual team. If you are multi-strategy you have a larger footprint, so they tend to hold you in higher regard.

**Q: There is a growing interest in credit strategies...**

**A:** We have a mezzanine business but it's not a fund – a fund structure isn't necessarily the right way to do it in China. First, it's mostly US

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# An investor at heart

**AVCJ SPECIAL ACHIEVEMENT** Victor Fung played a key role in the development of venture capital and private equity in Asia, and of AVCJ itself. He looks back at how the various pieces fell into place

**“VENTURE CAPITAL AND PRIVATE EQUITY** investing is very much part of my blood,” says Victor Fung. “If you ask me, it’s basically what I’ve been doing throughout my career.”

This is a bold statement, given Fung’s longevity and the variety of his activities. Best known to many in Hong Kong as a member of the family that controls logistics, trading and distribution conglomerate Fung Group, and its listed entity Li & Fung, Fung’s connections and experience have also spawned a multi-phase investment career, regional leadership of a financial institution, and all manner of often pro bono roles aimed at furthering Hong Kong’s economic development.

The venture capital chapter of his story began in the early 1980s with a confluence of events. Fung worked as a professor at Harvard Business School before returning to Hong Kong in 1976 to help run the family business. The family and private equity interests would later cross paths, but before that, Fung chaired a government-appointed committee tasked with figuring out how to remake Hong Kong as a financial center.

“The study concluded that we should transform Hong Kong into a fund management hub and think about how we could encourage venture capital establishment in Hong Kong,” recalls Fung. There were two concrete proposals: form an association that could promote the industry; and establish an exchange for brokering private stock sales, thereby enabling early-stage investors to sell to private equity players who would then guide start-ups to IPO.

As a result, Fung became the first chairman of what is now known as the Hong Kong Venture Capital & Private Equity Association (HKVCA). Meanwhile, steps were taken to establish the GEM board, although for various reasons, it did not turn out as Fung and his fellow committee members had envisaged.

Fung was also among the first backers of

the Asian Venture Capital Journal, which was founded the same year as the HKVCA. Lewis Rutherford of Inter-Asia Venture Management took the lead, with Fung, Ta-Lin Hsu of H&Q Asia Pacific, and Lip-Bu Tan of Walden International coming in as co-investors. “It all came together after this study,” he says, “These were what we thought were the ingredients necessary to create a fund management industry in Hong Kong.”

## Early mover

Three years earlier, while the study was still in process, Fung himself became one of those

ingredients. He was approached by Peter Brooke, founder of TA Associates and Advent International, about launching a venture capital fund to focus on technology transfer from the US to Asia. They spent more than a year on the road, eventually raising \$22 million. Among the first investments was a Taiwanese PC peripherals manufacturer called Multitech.

“I still remember one night I had dinner

with Stan Shih and he said, ‘Victor, I’ve got news for you. I would like to change the name of my company to Acer.’ I said, ‘You’ve got to be kidding. What’s wrong with Multitech?’” Fung recalls. Acer subsequently went public, securing an attractive return for the Hong Kong Venture Investment Trust (HKVIT).

With Christopher Leong in charge, HKVIT continued to make investments, eventually joining forces with NatSteel and DBS to form Transpac Capital in 1989. Meanwhile, Fung moved into private equity at the invitation of Prudential Financial, which wanted to build a merchant banking operation. Fung developed Prudential Asset Management Asia – which later spun out as PAMA Group – with Douglas Fergusson of Schroders, William Flanz of Chase Manhattan Bank, and Michael Kwee of AIA Group.

For the first three years, they invested \$500 million of Prudential’s balance sheet money, with a remit was to pursue buyout opportunities.

They were years ahead of their time. Indeed, the first buyout Prudential worked on in Asia – as an advisor rather than investor due to conflicts of interest – was Li & Fung as Victor and his brother William acquired the business from the family trust for \$60 million. “That was probably the first buyout anywhere in Asia,” Fung observes. “It was supported by senior debt as well as mezzanine and equity tranches.”

The PAMA team was also responsible for a significant breakthrough in Indonesia in the late 1980s, becoming the investor in a local venture capital company following a regulatory change that allowed foreigners to be majority owners of these entities. One of the first deals was an investment in United Tractors, a subsidiary of Astra International that held the local Caterpillar distribution license.

## Other interests

Fung left the family business – although he remained a shareholder – in 1986, with William assuming sole leadership. He served as CEO of Prudential’s Asia business for a decade, while continuing to participate in the PE industry, but scaled back his activities in the mid-1990s. Fung’s attentions turned to a broader role within the local business community, taking on posts such as chairman of the Hong Kong Trade Development Council and chairman of the territory’s Airport Authority.

Latterly, Fung has spent more time back in the family business, although mainly at the holding company level as group chairman of Fung Group. The main priority has been diversification, which has seen Fung Group acquire luxury brands in Europe, including Delvaux, the Belgian equivalent of Hermes, and build IDS Medical Systems, a medical equipment distributor in Southeast Asia.

Many of these investments have been led by Fung Capital, a private equity unit under the Fung family office. It has teams focusing on the technology space in the US and on brands in Europe and Asia – and it is largely through them that Fung retains his interest and involvement in PE investment. Contributing to the development of the industry in Hong Kong is one of his proudest achievements.

“I am very happy to see that Hong Kong today is the center for various types of fund management activity and I think there is a lot of opportunities to grow through the Greater Bay Area initiative in the Pearl River Delta and through the One Belt One Road initiative,” he says. ■



Victor Fung (right) with Brooks Zug of HarbourVest Partners

# AVCJ Private Equity & Venture Capital Award winners

## 2016

### Fundraising of the Year - Venture Capital:

GGV Capital VI, GGV Discovery I & GGV Capital VI Entrepreneurs Fund (GGV Capital)

**Fundraising of the Year - Mid Cap:** Quadrant Private Equity No.5 (Quadrant Private Equity)

**Fundraising of the Year - Large Cap:** PAG Asia II (PAG Asia Capital)

### Deal of the Year - Early Stage Technology:

Zai Lab (Advantech Capital /OrbiMed/Qiming Venture Partners/Sequoia Capital/TF Capital)

### Deal of the Year - Late Stage Technology:

Go-Jek (KKR/Warburg Pincus/Capital Group International/Farallon Capital)

**Deal of the Year - Mid Cap:** Wendy's Japan (The Longreach Group)

**Deal of the Year - Large Cap:** Golden Apple Education Group (PAG Asia Capital)

**Exit of the Year - IPO:** Focus Media (FountainVest Partners/The Carlyle Group/CITIC Capital/Primavera Capital/Fosun Group/China Everbright)

**Exit of the Year - Mid Cap:** Golden Foods Siam (Navis Capital Partners)

**Exit of the Year - Large Cap:** Loen Entertainment (Affinity Equity Partners)

**Venture Capital Professional of the Year:** Shailendra Singh (Sequoia Capital India)

**Private Equity Professional of the Year:** Frank Tang (FountainVest Partners)

**Operational Value Add:** China Hydroelectric (NewQuest Capital Partners)

**Firm of the Year:** Quadrant Private Equity

**AVCJ Special Achievement:** Kok-Yew Tang (Affinity Equity Partners)

Holdings/Tencent Holdings)

**Deal of the Year - Mid Cap:** SBI Life Living Corp (Advantage Partners)

**Deal of the Year - Large Cap:** Halle Visteon Climate Control Corp (Hahn & Company)

**Exit of the Year - IPO:** Hong Kong Broadband (CVC Capital Partners/AlpInvest Partners/GIC Private)

**Exit of the Year - Mid Cap:** Bushu Pharmaceuticals (Tokio Marine Capital)

**Exit of the Year - Large Cap:** Spotless Group (Pacific Equity Partners)

**VC Professional of the Year:** Neil Shen (Sequoia Capital)

**PE Professional of the Year:** Jean Eric Salata (Baring Private Equity Asia)

**Operational Value Add:** ECO Industrial Environmental Engineering (Navis Capital Partners)

**Firm of the Year:** Bain Capital

**AVCJ Special Achievement:** Ta-Lin Hsu (H&Q Asia Pacific)

**PE Professional of the Year:** David Liu & Julian J. Wolhardt (KKR)

**Operational Value Add:** Oriental Brewery (Affinity Equity Partners/KKR)

**Firm of the Year:** Affinity Equity Partners

**AVCJ Special Achievement:** Victor Chu (First Eastern Investment Group)

## 2013

**Fundraising of the Year:** KKR Asian Fund II (KKR)

**Private Equity Exit of the Year:** Matahari Department Store (CVC Capital Partners)

**Venture Capital Deal of the Year:** Tujia (CDH Investments/Qiming Venture Partners/GGV Capital/Lightspeed China/Ctrip/HomeAway)

**Private Equity Deal of the Year:** Panasonic Healthcare (KKR)

**Venture Capital Professional of the Year:** Richard Liu (Morningside Technologies)

**Private Equity Professional of the Year:** Michael B. Kim (MBK Partners)

**Operational Value-Add:** Yonghui Superstores (Headland Capital Partners)

**Firm of the Year:** KKR

**AVCJ Special Achievement:** Wu Shangzhi (CDH Investments)

## 2014

### Fundraising of the Year - Venture Capital:

Qiming Venture Partners IV (Qiming Venture Partners)

### Fundraising of the Year - Mid Cap:

Quadrant Private Equity No.4 (Quadrant Private Equity)

**Fundraising of the Year - Large Cap:** CVC Capital Partners Asia Pacific IV (CVC Capital Partners)

**Deal of the Year - Venture Capital:** Flipkart (Tiger Global/Naspers/GIC Private/Morgan Stanley Investment Management/DST Global/Accel Partners/Iconiq Capital/Sofina)

**Deal of the Year - Mid Cap:** IMAX China (FountainVest Partners/CMC Capital Partners)

**Deal of the Year - Large Cap:** Nanfu Battery (CDH Investments)

**Exit of the Year - IPO:** Alibaba Group (Silver Lake/China Investment Corporation/Yunfeng Capital/CITIC Capital/Boyu Capital/Nepoch Capital/Asia Alternatives/Pavilion Capital/Siguler Guff)

**Exit of the Year - Mid Cap:** United Cinemas (Advantage Partners)

**Exit of the Year - Large Cap:** Oriental Brewery (Affinity Equity Partners/KKR)

**VC Professional of the Year:** Jixun Foo (GGV Capital)

## 2012

**Fundraising of the Year:** PAG Asia I (PAG)

**Private Equity Exit of the Year:** King's Safetywear (Navis Capital Partners)

**Venture Capital Deal of the Year:** Xiaomi (IDG Capital Partners/Morningside Ventures / Qiming Venture Partners/Qualcomm Ventures/ Beijing ShunWei Venture Capital/DST Advisors/ Temasek Holdings)

**Private Equity Deal of the Year:** Tianhe Chemicals Group (Morgan Stanley Private Equity Asia)

**Venture Capital Professional of the Year:** Sanjeev Aggarwal (Helion Venture Partners)

**Private Equity Professional of the Year:** Roy Kuan (CVC Capital Partners)

**Firm of the Year:** Bain Capital

**AVCJ Special Achievement:** Lewis Rutherford (Inter-Asia Management)

## 2015

### Fundraising of the Year - Venture Capital:

Banyan Partners Fund II (Banyan Capital)

**Fundraising of the Year - Mid Cap:** Ascendent Capital Partners II (Ascendent Capital Partners)

**Fundraising of the Year - Large Cap:** Baring Asia Private Equity Fund VI (Baring Private Equity Asia)

### Deal of the Year - Early Stage Technology:

Ninebot (Sequoia Capital/Shunwei Capital Partners/WestSummit Capital/Xiaomi)

### Deal of the Year - Late Stage Technology:

Didi Kuaidi (Alibaba Group/Capital International/China Investment Corp/Coatue Management/Ping An Ventures/Temasek

## 2011

**Deal of the Year:** Hyva Holdings (Unitas Capital)  
**Firm of the Year:** Archer Capital  
**Fundraising of the Year:** Baring Asia Private Equity Fund V (Baring Private Equity Asia)  
**IPO of the Year:** Yonghui Superstores (Headland Capital Partners)  
**Trade Sale of the Year:** Beijing Leader & Harvest Technology (Affinity Equity Partners/Unitas Capital)  
**Private Equity Professional of the Year:** Peter Wiggs (Archer Capital)  
**Venture Capital Professional of the Year:** Sandeep Singhal (Nexus India)  
**Lifetime Achievement Award:** Philip Bilden, HarbourVest Partners

## 2010

**Venture Capital Professional of the Year:** Joe Zhou, Partner, KPCB  
**Venture Capital Firm of the Year:** Sequoia Capital India  
**Deal of the Year:** Sanyo Logistics  
**Trade Sale of the Year:** Parkway Holdings  
**IPO of the Year:** China Pacific Insurance  
**Fundraising of the Year:** CDH Fund IV (CDH Investments)  
**Private Equity Professional of the Year:** Weijian Shan, Group Chairman and CEO, PAG  
**Private Equity Firm of the Year:** TPG Capital  
**Lifetime Achievement award:** David Bonderman, Founding Partner, TPG Capital

## 2009

**Firm of the Year:** India Value fund Advisors  
**Buyout of the Year:** Oriental Brewery (Affinity Equity Partners/KKR)  
**Private Equity Professional of the Year:** Jean Eric Salata, Founding CEO, Baring Equity Asia  
**Venture Capital Professional of the Year:** Andrew Yan, Managing Director, Softbank Asia Infrastructure Fund  
**Exit of the Year:** Shenzhen Development Bank (TPG Capital)  
**Entrepreneur of the Year:** Gautam Adani, Adani Group  
**Fundraising of the Year:** MBK Partners II (MBK Partners)  
**Lifetime Achievement Award:** George Raffini  
**Publisher's Award:** Daniel Schwartz

## 2008

**Firm of the Year:** Affinity Equity Partners  
**Buyout of the year:** Magnum Corp (CVC Asia Pacific)  
**Private Equity Professional of the Year:** John Zhao, CEO, Hony Capital  
**Venture Capital Professional of the Year:** Sonny Wu, Managing Director, GSR Ventures  
**Exit of the Year:** Himart (Affinity Equity Partners)  
**Entrepreneur of the Year:** Tulsi Tanti, Chairman, Suzlon Energy  
**Fundraising of the Year:** Hony Capital Fund III (Hony Capital)  
**Lifetime Achievement Award:** William Ferris, Executive Chairman, Castle Harlan Australia Mezzanine Partners

## 2007

**Firm of the Year:** Advantage Partners  
**Buyout of the Year:** DCA Group (CVC Asia Pacific)  
**Professional of the Year:** Joe Bae, Partner, KKR  
**Exit of the Year:** Belle International Holdings (CDH Investments/Morgan Stanley Private Equity Asia)  
**Entrepreneur of the Year:** Ben Fan, President, Neo-Neon International  
**Fundraising of the Year:** Affinity Equity Partners

## 2006

**Entrepreneur of the Year:** Jason Jiang, Chairman, Focus Media  
**Buyout of the Year:** Brambles Industries (KKR)  
**Exit of the Year:** Suntech Power Co. Ltd (Actis/Dragontach Ventures/Goldman Sachs/Natixis Private Equity)  
**Private Equity Firm of the Year:** Pacific Equity Partners  
**Private Equity Professional of the Year:** Dan Carroll, Managing Partner, TPG Capital

## 2005

**Entrepreneur of the Year:** Jack Ma, Founder, Chairman and CEO, Alibaba  
**Buyout of the Year:** Himart (Affinity Equity Partners)  
**Exit of the Year:** Korea First Bank (Newbridge Capital)  
**Private Equity Firm of the Year:** Newbridge Capital  
**Private Equity Professional of the Year:** K.Y. Tang, Managing Director, Affinity Equity Partners

## 2004

**Entrepreneur of the Year:** Neil Shen, President/Founder, Ctrip.com  
**Buyout of the Year:** Hanaro Telecom (Newbridge Capital)  
**Exit of the Year:** Pacific Brands (CVC Asia Pacific/Catalyst Investment Partners)  
**Private Equity Firm of the Year:** JP Morgan Partners Asia  
**Private Equity Professional of the Year:** Maarten Ruijs, Managing Partner, CVC Asia Pacific

## 2003

**Entrepreneur of the Year:** Yibo Shao, Chairman, Eachnet  
**Buyout of the Year:** Yellow Pages Singapore (CVC Asia Pacific/JP Morgan Partners Asia)  
**Exit of the Year:** Vantec Corporation (3i/PPM Ventures)  
**Private Equity Firm of the Year:** CVC Asia Pacific  
**Private Equity Professional of the Year:** T.J. Huang, President, AsiaVest Partners, TCW/YFY

## 2002

**Entrepreneur of the Year:** Richard Chang, Chairman, SMIC  
**Buyout of the Year:** Haitai Confectionery (CVC Asia Pacific/JP Morgan Partners Asia/UBS Capital)  
**Exit of the Year:** Good Morning Securities (H&Q Asia Pacific/Lombard/GIC Private)  
**Private Equity Firm of the Year:** UBS Capital  
**Private Equity Professional of the Year:** Chan Sun, Director, Walburg Pincus  
**Special Achievement Award:** Inter-Asia Venture Management

## 2001

**Entrepreneur of the Year:** Narayana Murthy, Founder and CEO, Infosys Technologies  
**Private Equity Firm of the Year:** Telecom Venture Group  
**Private Equity Professional of the Year:** Lip-Bu Tan, Chairman, Walden International

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