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Smarter ventures

"The tulip bubble left nothing behind (except tulip bulbs), but the Internet will be a force for enduring change."

If you liked Katharine Campbell's writing when she was the private equity correspondent for the *Financial Times*, you'll be even more impressed after reading her recently published, *Smarter Ventures: A survivor's guide to venture capital through the new cycle*. The book not only provides a nostalgic journey down memory lane for those who lived the 1990's dotcom era, but a comprehensive overview of the venture capital process. While aimed at European readers, the book nicely records Silicon Valley's contribution to the venture model.

Campbell offers a "how to" approach to her subject, but ultimately touches upon the $64 question: Were the Valley guys that smart or just at the right place at the right time? And, if they were more than lucky, what are the implications for their European counterparts?

Written as guide for—and largely sympathetic to—the entrepreneur, she has successfully delved into the VC's mindset as well. Campbell sets the stage with an overview and history of venture capital over the decades; and, then turns her attention to the subject at hand, starting with a run down of funding sources from traditional venture to angels and corporate players.

Chapters on writing a business plan, organizing early meetings ("figuring out which buttons to press is an important part of the game"), and navigating due diligence are well-stocked with valuable insights. She counsels the entrepreneur to spend time researching who he or she asks for money: "It will save a *huge* amount of time if you get to the right people." On due diligence, she points out that "it's easier in the Valley where everyone knows everyone." In Europe, it's much harder, where the GPs must make "multicultural adjustments of all kinds."

The chapter on "Term Sheets" does yeoman's work in deciphering such arcane terms as "convertible participating preference shares," "full ratchet anti-dilution," and "pay to play" not to mention distinguishing between "drag along" and "tag along." The sections on exits and "down rounds" complete the cycle. Lists of references and useful websites are thoughtfully included at the end of many chapters.

If the book has any shortcomings, it's an apparent over reliance on certain sources for example, APAX's Sir Ronald Cohen or the Benchmark partners. But as the author suggests, venture capitalists "are not the most chatty souls," and several well-placed individuals chose to contribute anonymously.

At the top tier it is certainly more than luck.

Katharine Campbell

In a phone interview with *AVCJ*, Campbell observed: "The European VCs were doing things that worked in the States, but they came late. In the Valley, the eco-system was very well developed. "But at the top tier it is certainly more than luck. There is a mass of experience resident in those firms, and the value of the brand is just so important." In what she describes as the virtuous circle, "the best brand name VCs will get the best entrepreneurs, then open doors to the most powerful customers, further luring the best advisers and underwriters, which returns the most cash on the IPO—again reinforcing the VC's brand. Already having that reputation amongst entrepreneurs, the Valley firms were ready when the window opened."

"That virtuous circle isn't yet working in Europe," she notes, "because the links aren't there." There are many things that are different in Europe. For example, "large companies buying from small companies. In the US, virtually every large technology company has its roots in venture. So they understand it. That history just isn't there in Europe.

"European entrepreneurs don't speak venture capital. They don't do enough due diligence on their investors. The process of negotiation is incredibly uneven." "Acceptance of risk, acceptance of failure is not widespread."

But, it's getting better she says. There's "a gradual understanding of the process. On a much more macro level, it's a function of time."

***Smarter Ventures*, 319 pp, published by FT Prentice Hall (Great Britain 2003). Price £22.99. The best way to purchase a copy is to log onto: amazon.co.uk.** ❑

ASIA PACIFIC

HSBC's Fund 3 targets $500 million

With the investment climate in Asia turning for the better, HSBC is poised to take advantage. The HSBC Private Equity Fund 3 is targeting to raise at least $500 million. The fund had a closing in October at $212 million and is known to be in the last stages of another closing as *AVCJ* goes to press. George Raffini, Managing Director of HSBC Private Equity (Asia), the Investment Adviser to the fund, without confirming the exact figure, told *AVCJ*: "The fund is in the process of finalizing some LP commitments for the next closing which is expected to be at approximately $325 million." The fund will target middle market buyout and expansion capital opportunities, primarily in China, South Korea and Taiwan. In June 2003, the fund completed its first investment for $34 million in STX Shipbuilding, which had an IPO in South Korea on 27 October. *– V. G. K.*

INDIA

Keane Inc buys up Indian BPO Worldzen

Add one more to the BPO bandwagon in India: Amex-listed Keane Inc. The Boston-based infotech consultancy has bought a majority stake in BPO firm Worldzen, which provides back-office operations in insurance, financial services, collections and recovery and healthcare. Obviously, like other ITES providers, Keane is trying to bundle its IT applications outsourcing practice with Worldzen BPO business.

Financial details of the deal were not disclosed, but Keane will end up with 60% of the Worldzen, with the right to buy more of the company in due course. Earlier this year, the Carlyle Group had invested $4 million for an unspecified stake in Worldzen. Keane's purchase would affect part of Intel's ownership, but the extent of dilution was not revealed. Carlyle India's Vice President Kanwaljit Singh told *AVCJ*: "As part of the Keane investment, we had a partial exit. We have a non-disclosure agreement with them. But we continue to be engaged with Worldzen."

Part of Keane Inc's contribution, under the deal, were the assets of Keane Consulting Group. "Our BPO solution will leverage Keane Consulting Group's core competencies in business process design, process improvement and benchmark metrics, along with Worldzen's competency in BPO delivery," said Sandeep Bhargava, CEO of Worldzen.

Worldzen, headquartered in Illinois, has two BPO facilities near Delhi, in Noida and Gurgaon. Keane Inc's Indian subsidiary employs 1,000 people. *– V. G. K.*

INDONESIA

Bank Lippo contest scrubbed – for this year

Platinum Group Chairman Liu Chee-ming said he was stunned when the Indonesia Bank Restructuring Agency (IBRA) set a floor price of Rupiah 384/share on its 52% stake

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in Bank Lippo. When none of the three consortia, including Platinum-led Summit Investment, came within 35% of its limit, IBRA scrubbed the divestment exercise. Had bidders passed the threshold, they would have been entitled to re-bid. But none was even close – the highest price offered was in the Rupiah 340 range.

"We were never told there was a reserve price," Liu steamed. "At the end of the day, we can only follow what they officially announce they're looking for – which was price to book." That, of course, could only be settled on after due diligence, and Summit's due diligence raised concerns about the book. "If you want to sell in reference to the market price, we're not talking about price to book any more, are we?" Liu complained. Now it looks like the disposal will be held off till next year. Asked if his consortium would renew its bid for Bank Lippo then, Liu told *AVCJ*: "Let's look at the ground rules first – just watch and wait."

IBRA

Syafruddin Temenggun

Weeks before the bids went in, IBRA Chairman Syafruddin Temenggun had been strongly hinting that he was hoping for bids in the $200 million range – a hint one bidder dismissed as standard blather to get the bidders to aim high. Given the turn of events, it looks like Syafruddin wasn't kidding. The other consortia in the contest, were Swissasia Global, made up of Swissfirst Bank AG, Swissfirst Opportunities Anlagegesellschaft and VP Ventures Ltd – and Euro Capital Asia, which included Export and Industry Bank, a Philippine bank partially held by the Raidys who founded Bank Lippo, and Batavia Investment Management. Neither consortium could be reached.

Only two weeks before bids were due to be lodged, IBRA threatened to cancel the disposal if the consortia didn't strengthen their banking components and each scrambled to get banks to join their groups. Indonesia's banking sector has been full of surprises lately. On the heels of the Lippo cancellation came reports that authorities were investigating a suspected $141 million fraud at the government-controlled but publicly listed Bank Negara Indonesia (BNI) – the news coming just weeks after Indonesia was fingered as the world's sixth most corrupt country by Transparency International. Analysts who follow Indonesia's wobbly financial services industry are said to be concerned about reform plans unraveling. *– J. McC.*

AUSTRALIA

CVC buys hospitals, gets down to consolidate the business

Having bought the largest group of private hospitals in Australia, consortium leader CVC Asia Pacific has embarked on turning that business around. Last month, the consortium comprising CVC, Ironbridge Capital and the Singapore government's GIC Special Investments bought Mayne Group's 50 hospitals in Australia and three in Indonesia for A$813 million ($573 million).

Mayne sold its portfolio of hospitals after the company's asset integration plan – it has other businesses in pharmaceuticals and diagnostics – failed and led to profit downgrades by the company. Mayne Group CEO Stuart James put a brave face on the sale, calling it the "the most attractive proposition for the future Mayne." But the underlying reality was that the proceeds from the sale after transaction costs would be no more than its net asset value. Less than a week after selling off the hospitals, Mayne was searching for a buyer for its pharmacy outlets.

CVC ASIA PACIFIC

Andrew Cummins

CVC's Hong Kong-based Managing Director Andrew Cummins told *AVCJ*: "It is a huge and complex business, and turning it around would be our first task. That could take a couple of years. Only then can we think of an exit and possibly an exit through a stock market listing." He did not rule out a trade sale but thought that was not too likely, given the nature and the size of the hospital business.

Meanwhile, CVC is planning an IPO for its Pacific Brands clothing business sometime early next year. CVC and Catalyst Investment Management bought Pacific Brands from Pacific Dunlop in 2001 for $730 million when the parent company was struggling to boost profits and market share. Macquarie Bank and UBS are to lead manage the IPO, which is expected to fetch more A$1 billion. *– V. G. K.*

SOUTH KOREA

Policy worries about foreigners and Korea's telecoms

In light of AIG and Newbridge Capital just winning their battle for a combined 39.4% stake in Hanaro Telecom, it was all a bit confusing. Quoting a Ministry of Information and Communication source, one news agency reported last week that, "South Korea is moving ahead with revisions on foreign ownership rule in the telecom industry that allows a single foreign investor to buy more than a 15% stake in a local telecom company for investment purposes."

As it is, foreigners can take up to 49% stakes in Korean telecom firms right now. But the report went on to say that, under new rules, a foreign investor holding more than 15% of a local telecom would be restricted from exercising voting rights beyond 15%.

That would sure take some of the fun out of owning nearly 20% stakes in Hanaro Telecom, as AIG and Newbridge each do – so *AVCJ* wondered what they made of the news. B M Park, Partner at Newbridge Capital in Seoul, said, as far as he knew, the mooted 15% rule was "only a proposal submitted by a Congressman [Lee Jong-kul of the United New Party], not government policy." But, even if it came to more than that and new rules were implemented, there would be a 'grandfather' clause built into the legislation – at least, according to lawyers advising Newbridge. The grandfather device prevents retroactive application of new rules to done deals.

Grandfather clause or no, it would seem the issue goes beyond one lone Congressman. The report said the Ministry of Information and Communication was concerned that giants like SK Telecom and KT Corp not fall under foreign control. It also said the ministry would lobby for the government to assess foreign investors "on whether their investment could harm the public interest." But here's the part that might give the AIG-Newbridge consortium pause: "Kim Dong-soo, the Director-General of the ministry's telecom promotion bureau, said the government could order foreign investors to sell their stakes if they violated the new rules." And if they didn't do as they were told, the government could impose a fine of Won 100 million ($84,900) – a day!

– J. McC.

JAPAN

Daiei says no deal on restructuring help


Kunio Takagi

Would the Colony Capital deal come unstuck if Daiei agreed to receive support form the Industrial Revitalization Corp of Japan? Supermarket operator Daiei Inc, its shelves piled up with debts from its bleeding hotel and sports businesses, turned back an offer of help from the IRCJ. Media reports suggested that accepting help would have entailed ceding control of shares in the Fukuoka Daiei Hawks baseball team, and connected ticket sales – and Daiei's compensation for losses incurred by the team. Colony Capital outbid Ripplewood and Lehman Bros in the recent contest for Daiei's stadium and hotel interests.

Daiei, along with its major creditors, had approached the IRCJ to buy loans the company had going with 30-plus minor creditors. What effect, if any, IRCJ's conditions might have on the Colony Capital deal isn't known. *AVCJ's* calls to the investment firm were not returned. Before Colony Capital won the contest, Japan's *JiJi Press* reported: "Even after the winner is chosen, however, Daiei may need to make adjustments with IRCJ on a rehabilitation scheme for the Fukuoka businesses as the firm has sought IRCJ's assistance over the issue."

About 40 institutions have sunk cash into the two businesses, which together, have debts of ¥120 billion. All Daiei President Kunio Takagi would say is that the company would proceed with restructuring without the IRCJ's participation – leaving Daiei to keep working with UFJ Bank and its other major creditors.

Certainly, the market didn't take Daiei's no-deal news well. After Takagi announced IRCJ would not be part of the rebuilding effort, shares dropped 4.1% on the previous day's close – making for an overall 23% descent for the week, ending at ¥234. Shares in Japan's No. 3 retail group bounce around though: on the preceding Friday they rocketed up 35% after the chain announced impressive first half profits.

– J. McC. ❑

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ASIA PACIFIC

Granite Global and others make 4x in Oculex sale

It was just a year ago that Asian VC firms Granite Global Ventures, BioAsia Investments and Venture TDF participated in a $50 million round of financing for Oculex Pharmaceuticals.

Now, the Sunnyvale, Calif-based company has been sold for $230 million in cash to Allergan Inc., the makers of wrinkle treatment Botox, in a transaction handled by Credit Suisse First Boston. Granite Global reportedly made 4x on the deal. Also making out are the lead investors in the Oculex $50 million round: Perseus-Soro BioPharmaceutical Fund, which reportedly owned about 25% of Oculex, and Bay City Capital.

Oculex, a drug developer for eye diseases, had raised the funds for phase 2 clinical trials for the treatment of an age-related eyesight problem, macular edema. Granite Global Managing Director Joel Kellman said: "I am very excited; great exit [from a] great company." *– R. A. F.*

SINGAPORE

Baring investee Norelco merges up value chain

Singapore-based Norelco Centreline, 10% owned by Baring Private Equity, is acquiring UMS Semiconductor. The S$271 million deal, through a share swap dilutes Baring's share to something like 6%, according to Managing Partner Jean Eric Salata who told *AVCJ* that more acquisitions could well be on the cards for Norelco. Does this move things closer to exit? "Not really – this is really part of the value-building process," Salata said, confiding that UMS had been in his sights almost from the beginning.

Norelco makes semiconductor-making equipment for capital equipment king Applied Materials – it's the only AM-certified supplier in Asia – and hard disk-drive manufacturing kit for companies like Seagate, Maxtor and other big brands. Norelco's business, till UMS came along, was largely in disk-drive equipment, with a portion of activity devoted to the back-end chip-making equipment. Salata put the chip-drive mix at about 80:20. "Now they'll be much more equal."

All this comes at a good time – just as the semiconductor industry is pulling itself out of a very deep trough. Highly cyclical, semiconductor-making is a business that gets more expensive by the minute and is consolidating fast. Even giant chipmakers like IBM and Hitachi don't dare to develop next generation chips without risk-diluting alliances – yet the pressure to produce faster and more sophisticated chips that consolidate functions of many chips into single chips is unrelenting. The latest premium-priced chip can slip to commodity status in depressingly short order.

The merger, besides moving Norelco up to the premium end of capital equipment-making, creates the biggest company in its niche, Salata said. It also adds needed capacity, UMS having an excess of it, Norelco on the verge of running out of it. Salata said the company can make a giant 30-foot chamber (for growing crystals, for example) at its Fujian plant for 40% less than what it costs in Texas. *– J. McC.*

HONG KONG

Investor Asia downloads piece of Memorex

Investor AB's Investor Asia unit is putting down $39 million for a 35% stake in optical storage company Memorex Holdings, which owns 67% of Memorex International. It also has a three-year option on another 20% from vendor Hong Kong-listed Hanny Holdings. But with Napster back in business blasting music down the pipes, *AVCJ* asked Investor Asia CEO Winnie Fok where Memorex fit in the scheme of things. "People still go to retailers – and they still have to store it [if the download music or videos at home]." Indeed, one of the things that attracted her to Memorex was brilliant distribution – not to mention top management and a stellar track record that included steady profits.

Winnie Fok

Now the focus is on building market in Europe, where Investor Asia's parent company is well connected – and in Japan. "Japanese love American brands." Due diligence included commissioning Bain & Co to size up Memorex and its place in the industry. "The [primary customer] age group is between 20 and 35," Fok said. "This is not going to go away!" Customers may stay but technology certainly comes and goes – and that's just where Memorex seems to excel: "It doesn't have any baggage – when technology moves from CD to DVD to Flash, it moves too." *– J. McC.* ❑

CHINA

SMIC prepares for its IPO

Barely two years after installing machinery in its first wafer fabrication plant, SMIC – Semiconductor Manufacturing International Corp – has become Mainland China's largest chipmaker. Last week it scored another success by taking over Motorola's Tianjin fab.

SMIC's CEO Richard Chang announced that Motorola had agreed to swap its loss-making fab for a 10% stake in SMIC and a seat on the board of directors. Market sources told *AVCJ* that SMIC expects to file for a public listing this month, with a target IPO date of April 2004. Investment banks Credit Suisse First Boston and Deutsche Bank have been chosen as financial advisers for the IPO, which could raise $750 million.

Richard Chang Ranjan Chak

In September, to meet its expansion needs, SMIC raised $630 million through private placements with several major private equity funds – bringing the total capital raised by the firm to $1.5 billion.

Motorola invested $1 billion in its Tianjin fab in 2000 but it had been running at a mere 10% capacity. Last month the US-based parent decided to wind down its semiconductor operations to concentrate on its handset core business. As an industry analyst put it: "The deal suits both sides, Motorola gets rid of the loss-making fab and SMIC gets the fab it wants with hardly any cash spent."

SMIC's purchase was also a countermove to Taiwan Semiconductor Manufacturing Co (TSMC) which has committed to invest $10 billion in Shanghai over the next decade for the production of computer chips. *– V. G. K.*

ASIA PACIFIC

Oak fleshes out its India and China strategies

Having recently got seasoned techie and dealmaker Ranjan Chak on board, US-based Oak Investment Partners is firming up its Asian investment strategy. General Partner Fredric Harman and Venture Partner Chak have been touring India's technology centers and describing Oak's investment approach, which marks out India as a preferred destination for R&D and support services. Oak's concentration in China will centre mainly on semiconductors and telecom equipment. Harman stressed that Oak was one of the few VC companies to have its own dedicated technology partners, facilitating its tech investments.

Dwelling on the investment prospects, Chak told *AVCJ* that the current Oak fund amounts to $1.6 billion, some of which has been invested. "We could see ourselves investing up to 20% of the total fund in India, but we don't have a specific target or timeframe for that."

Last month Oak bought Canada-based Pivotal Corp for $44 million and merged it with Nasdaq-listed Talisma in which it already owned a major stake. Bangalore-based Talisma and Pivotal are both BPO firms handling customer relations management. *– V. G. K.*

CHINA

IFC adds Minsheng Bank to its growing China collection

When *AVCJ* touched base with the IFC in Beijing and Hong Kong, everyone seemed busy squiring around Managing Director VP Peter Woicke, who was variously on a plane somewhere between Beijing and points south in China. Our interest was sparked by news that the China Banking Regulatory Commission (CBRC) had cleared the way for the World Bank's investment company to take a 1.6% stake in Minsheng Banking Corp, China's first joint-stock bank. That project was said to be two years in the making.

IFC is steadily building up its Chinese bank holdings with little stakes here and there: so far it has invested in Nanjing City Commercial Bank, Bank of Shanghai, and Xian City Commercial Bank. What makes the Minsheng project interesting is the fact that the IFC is lending luster to the bank just ahead of its planned flotation aimed at raising $1 billion. Assuming the IPO goes ahead, it would be the first foray of a mainland bank in an offshore market. With Citibank, Deutsche Bank and Goldman Sachs handling the issue, Minsheng shares will be offered in New York and Hong Kong. The float is subject to the regulator's approval, but that is taken as a given.

中国民生银行
CHINA MINSHENG BANKING CORP., LTD

The IFC has said that part of its interest in collecting stakes is advancing the cause of better governance and financial services reform. It will be taking a seat on Minsheng's board, something other shareholders can hardly quarrel with ahead of a billion-dollar stock offering. *– J. McC.* ❑

Asian Private Equity: The Most Successful Long Term Global Asset Class?

Recently, a major U.S. institutional investor, attending a private equity conference in Shanghai expressed amazement regarding the wealth being created in Asia. He also wondered why, after investing in Asian private equity for over 10 years, he had not seen any of that wealth accrue to his own portfolio.

His experience is the cause of the well-recognized phenomenon at AVCJ conferences in which participants debate "What is Hot, and What is Not" and struggle to figure out the "Flavor of the Year" in terms of investment trend or country selection. However, investing in themes that change abruptly every few years may be problematic. A successful private equity program (investing in illiquid positions over a ten year fund life) needs to rely on more enduring success factors.

Institutional investors have been disappointed by the promises of high returns from investing in "The Pacific Century" (pre Asian Financial Crisis), "Buy Southeast Asia Cheap" (post Crisis) or "the Asian Internet and Telecommunications Wave". Most recently, the hot sector seems to be, "Buyouts in Japan." And who can blame institutional investors for periodically shifting their investment strategies since, on the surface, the old approaches appear not to have worked.

Asian Private Equity Has Performed

The truth, however, is that Asian private equity has been one of the largest creators of global wealth in history. For example, the 55 million-strong Overseas Chinese community started with virtually nothing after World War II, today controls an estimated $1.5 trillion in liquid assets and, according to the Economist, now comprises the fourth largest economy in the world.

How did Asian private capital create this wealth? One approach has been to focus on local industries such as real estate, banking, and consumer goods and exploit the growth of domestic markets as Asian exporters recycled their earnings into their local economies. A critical success factor for this approach has been local government and business connections. Not surprisingly, the winners have been local business groups and families rather than western institutional investors.

John-Paul Ho

The second approach has been to exploit the growth of Asia-Pacific as the world's manufacturing and services export powerhouse. This approach has been particularly successful since Asia's export growth rate from 1980-2002 has been 50% greater than its GDP growth (9.4% versus 6.1% for Asia ex-Japan).

At Crimson, we have, in our previous and current funds, executed a successful program for institutional investors that capitalizes on this export opportunity. For example, in our previous fund which invested from 1997-2000, we have generated a 52% gross IRR per annum across a portfolio of 24 realized companies (including write-offs), during a period in which the public markets that we benchmark our strategy against declined by 50%.

Buyouts versus Expansion Capital?

The ongoing debate about Buyouts versus Expansion Capital may not be productive. These are classifications regarding deal structures and not the key success factors in an Asian private equity program. We believe that deal mechanics are less important than selecting the investment strategy that best capitalizes on the fundamental drivers of wealth creation in Asia, and finding the right team to execute against the opportunity.

Although a variety of approaches and control mechanisms have been deployed, the track records of most of them have been uninspiring. Investing in early stage technology companies, for example, has proven difficult since there have been few Asia-led breakthroughs in product innovation. China and India's large domestic markets offer significant conceptual allure for growth investors, but the results have been disappointing due to poor legal and corporate governance, and fierce competition from multinational, local government and private sector competitors.

While there have been a few promising examples of buyouts in countries like Korea or Japan, the success of many of these seems primarily dependent upon government deregulation and macroeconomic factors within the specific country, both of which are outside the control of a private equity firm. In addition, the window of opportunity for restructuring plays may be limited, market timing is critical, and to consistently invest against this theme, a manager needs to repeatedly shift country focus and build new relationships. Finally, the public markets may offer a less expensive (i.e. reduced fees and no carried interest) alternative for betting on a country's turnaround, with better liquidity and risk management options.

Globalization and Exports

The proven approach to generating attractive private equity returns in Asia is to capitalize on the region's growth as the world's export powerhouse in manufacturing and services. One can achieve this goal either by buying out existing shareholders of an established company, or by providing expansion capital through a control syndicate of like-minded strategic and/or professional investors.

The key is not the "deal technique", but identifying those companies and teams with the best capabilities to take advantage of the changing global competitive landscape resulting from the relentless improvement of Asia's skilled workforces, manufacturing process knowledge, and service expertise. In addition, the private equity firm must add value by improving/growing operations and earn the "right" to control through the board of directors. The most effective firms leverage a team of partners who not only understand finance and strategy, but also have deep operational experience and a proven record of building similarly successful companies in the relevant countries.

At Crimson, we avoid family run businesses or industries dependent upon low cost, unskilled labor as their competitive edge. We focus on companies run by professional teams that have an enduring source of advantage such as unique manufacturing or service processes, high product complexity, or a defensible global distribution channel. Most of our portfolio companies also differentiate themselves through a cross-border operational footprint. These globally competitive, export oriented companies offer greater scale economies, reduce the risk of single country exposure, and are more suited to western institutional investment since they compete based on merit, not local relationships.

Globalization Delivers Returns

This investment approach in Asia has a successful long-term track record. At Crimson, for example, we backed Singapore-based Omni Industries, where we invested alongside a local business group and a professional management team from Hewlett Packard who had a strategy to transform a high quality plastic injection molding company into a full service provider of outsourced electronics manufacturing services. The team won customers such as Hewlett Packard, Compaq, and Philips. Omni was subsequently acquired by Celestica for approximately $800 million. Crimson generated a gross IRR of 358% per annum.

Crimson also co-invested with the Acer Group to acquire IBM's liquid crystal display business and move it offshore to Taiwan. This business was one of the first high volume LCD suppliers in Taiwan and secured clients such as IBM, Sony and Panasonic. The company went public and subsequently merged with AU Optronics, creating the world's third-largest LCD manufacturer with over $1 billion in revenues. Crimson generated a gross IRR of 168% per annum.

Crimson also acquired (with an investment syndicate) control of SPI and worked closely with a professional management team to transform the firm into the largest independent business process outsourcing company in Asia, via both organic growth and the acquisition of 5 companies in the US and Europe which it offshored to Asia. From 2000 to 2003, SPI grew revenues from $17 million to a forecasted $74 million and EBITDA from $2.4 million to a projected $23 million.

Restructuring versus Globalization

If there is a choice to be made, it seems it should be between whether to bet on the successful restructuring of the Japanese economy over the next few years, or invest in the continuation of the long standing growth of Asia as an export powerhouse.

With the globalization strategy, private equity firms have more control over the levers of success and are less dependent upon the timing of an economic cycle or the whims of regulatory bureaucracy. The globalization theme has been a proven and consistent wealth creator in Asia for over fifty years and the fundamental drivers remain intact for the foreseeable future.

The challenge for institutional investors is not determining whether a globalization approach will work (it already has), but evaluating which GP teams have the capabilities, experiences, and track records to execute successfully against this opportunity.

This perspective was written by John-Paul Ho and his partners at Crimson

BY JOEL MCCORMICK

Asia looks to continue its rebound

From India to Japan, the deal flow keeps picking up, even in China for those with a head for "LBOs with Chinese characteristics"

A year or so ago Simon Murray, Chairman of General Enterprise Management Services (GEMS), told the media there were still pots of gold to be found in Asia. This year the self-described opportunistic private equity investor is talking up bauxite in Eastern Russia – and silicon in China.

A year ago, Hong Kong was contemplating yet another year of deflation, unaware of the SARS horror about to devastate tourism, travel and deal flow. Today InvestHK Director-General Mike Rowse, the man tasked with convincing offshore companies to set up in Hong Kong, looks to full hotels and planes and a general rebound powered in part by the city's Closer Economic Partnership Agreement (CEPA) with China – a tariff-slashing compact that should see mainland companies flowing into the city, creating opportunities for investors.

In Shanghai, where business never really looked very down, Ming Chen, Managing Director of state-owned debt house SB Financial Guaranty, has watched a steady rise in LBO business, involving both state- and foreign-owned companies – even though leveraged buyouts still don't technically exist in China. Pushing deals past the RMB 1 billion mark for the first time this year, Chen now looks ahead to a busier 2004, using China's antiquated debt tools to structure more LBO-type deals – perhaps in alliance with some of the big private equity firms he's been talking with over the past several months.

Mike Rowse

SB Financial Guaranty, an arm of China's Department of Commerce, creates the means for mainland banks to put their piles of cash to work. "We're in the business of making RMB more efficient," Chen says. Devising hybrid structures – that still go by the book in their roundabout way – gets deals done faster than doing conventional Western-style LBOs, he explains. Since regulators have yet to formulate policy on LBOs as such, projects following that route must be approved on a case-by-case basis, a time-consuming exercise SB Guaranty neatly avoids.

After grim times, brighter prospects

At UBS Capital, Asia Pacific Director David Lai has watched buyout opportunities start to flow again in Korea after stalling in 2002 amid electoral uncertainties and an overheated economy that left vendors holding off for a better price. The government's clampdown on consumer credit and the subsequent slowdown – combined with the new administration's resolve to continue *chaebol* reform – got people thinking, he says. Maybe it was time, after all, to restructure and focus on core activities – and sell off non-core assets.

Buyouts are also picking up in Japan, he says, and in Singapore, though for less dire reasons. With deals starting to flow, what about fund-raising? Lai says that fund managers' success in building funds will depend on how well they make the risk-reward case for emerging markets. After the disastrous bumps and crashes of the last few years, he says many investors are opting for lower returns and less excitement, no matter how lucrative Asian prospects may appear.

Two difficult years

"The last two years have been pretty difficult for everybody," GEMS' Murray says, proceeding down a list starting with the run-up to the Iraq invasion and nuclear stand-offs in Asia and ending with the SARS horror. And before that, of course, came the tech and telecom collapse – in the latter case knocking off 3,000 out of a world population of 5,000 telcos. The sector shriveled in value by $4 trillion. "That's with a 'T'," he says, just in case there's any confusion. "From tulips to railways, we've never had a crash like that."

Given private equity's three essential parts – fund-raising, deal-flow and due diligence – everyone was bound to feel the impact somewhere. "Business depends on reputation, track record, the general environment and on how everyone is doing," Murray says. "If some people do badly, everyone is discredited."

Take a tour of the Simon Murray world of private equity and you're at once struck by both the ordinariness of his investment choices and the extraordinariness of his returns. To deal with the second point first, the first GEMS fund, Oriental and General I, raised $275 million of which $245 million has been invested. "In four and a half years," Murray chirps, "we've given back to investors $60 million in capital – and $110 million in profit." That made easier work of getting investors to plough money into O & G II, a second fund of $270 million.


David Lai

GEMS' gems

As for those ordinary choices, Murray likes steel, trees and semiconductors because – no surprise – China's appetite for steel, forest products and chips will be insatiable for eons. With Asia's auto industry set for explosive growth, and aluminum content in cars and trucks soaring, he likes bauxite. And though not yet invested there yet, he likes India because – like just about everyone else – he's noticed a giant middle class springing up, all 100 million of them hungering for cars, condos and the rest of the middle-class package. "We're invested where you'd expect us to be," he says.

But mix in credit cards in Korea (a volatile sector where GEMS holds shares in LG Card, and must keep holding them till prices yoyo back up), hotel investments in Thailand and other odds and ends, and the GEMS portfolio starts to look eclectic – even unfocused, to use the pejorative word. Except for the fact there's not an investment in the bunch where someone in the firm doesn't have an intimate knowledge of the industry. By that Murray means experience gained "at the coalface," not coming at a business from the outside as a banker.

Although others in the firm – all alums of JP Morgan, Morgan Stanley, Lazard and other blueblood houses – scout and nail down the deals, Murray himself fulfills that industry-experience requirement better than anyone. He spent years at conglomerate Jardine Matheson learning trading and engineering, which at Jardines covered everything from construction and industrial equipment to ports; he spent years working with tycoon Li Ka-shing, running Cheung Kong's Hutchison Whampoa, breaking new ground in telecoms, energy and ports. Then it was off to run Deutsche Bank's Asia operations out of Singapore for several years. With over 30 years as an old Asia hand under his belt, he started GEMS five years ago. "In 80% of deals [GEMS pursues], I've probably met the guy across the desk somewhere down the line."

Swashbuckling Tory

Murray says 1,100 prospects have come across his desk since the firm started. "Most of them are probably complete garbage," he says. But that still works out to combing through close to a prospect a day. Only a tiny few pass through the filter, for underneath the swashbuckling image – buffed and polished over the years by stories of his days in the fabled French Foreign Legion, of jogging, aged 60, across 150 of North African desert in blistering heat, or swinging from a chandelier to liven up a party – is a shrewd conservative.

"Europe is out of it," he thunders, blaming the EU's zero growth prospects on French and German socialists. Along with socialists, Murray doesn't much care for leveraging, or startups, and he rarely makes a move without allying with powerful friends. Recent case in point: GEMS took a stake in China's Grace Semiconductor, allying with Grace co-founder and friend Winston Wong, son of Wang Yung-ching, the founder of Formosa Plastics, the petrochemicals-based conglomerate. "Formosa Plastics," he says again, "that name mean anything to you?" (Grace, set to be the largest chip plant under one roof, oozes with pedigree on both sides of the Taiwan Strait – the other co-founder of Grace is Jiang Mianheng, son of former Chinese President Jiang Zemin.)

To thin out investment risk, GEMS' house rules stipulate that no more than 30% of a fund can be allocated to any one country, and no more than 20% can go to one industry. GEMS also does its deals – 90% of them, Murray says – off-market. "We're not competing with somebody else and paying more." The firm also shops for minority stakes "which makes us different from the buyout boys." Companies in Asia, he reasons, still tend to be family run, so taking them over is a non-starter. "That puts you at the coalface while they're on the golf course – and that's the wrong way round."

Considering the options, Asia looks good

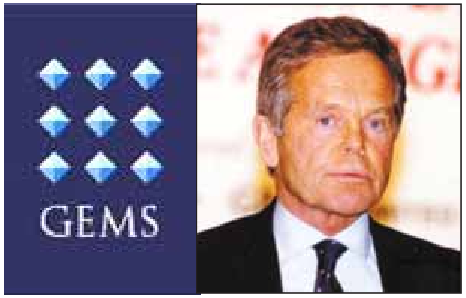
With Europe going nowhere and the US facing a $500 billion deficit and the dollar "going through the floorboards," Asia starts looking pretty good. "In Japan, we've probably seen the worst, Murray says. "Overall, Asia is much better than it was. Values are more realistic from a purchaser's point of view, so it's a good time to be an investor."

Keeping its opportunistic eyes peeled, GEMS is looking to get into something financial in India. "We like Thailand," he says and the auto sector from finance to materials. "Korea is tough but we like it." The general environment, despite Bush's Iraq project getting a bad press, has improved, he says. "The Indian-Pakistan border is being managed, North Korea is being managed; the China-Taiwan issue is being managed," he says.

String of exits

Murray didn't want to let the conversation drop without mentioning a few exits. Yozan Inc, a Japanese telecom offering wifi and internet telephony services, was at the top of his list. Over'98 and '99. GEMS invested $12 million and exited with $60 million via this year's IPO; GEMS exited China National Overseas Oil Corp (CNOOC) this year with shares at the HK$11.80 mark – after starting out at HK$4.50. Aside from the fact its shares are now 3.5 times the original price, Murray says NatSteel's dividends have already paid back much of GEMS' investment in a 20% stake of a buyout vehicle that allied GEMS with Standard Chartered Private Equity, Temasek and Ong Beng Seng's Excel Partners – and that only since last January. Plantation company Sino Forest has been looking good too, he says. Now readying for a listing on Hong Kong's stock exchange, its shares are trading in Toronto at three or four times their original price. All in all, Murray puts private equity's prospects going into 2004 at "fair to good."

While UBS Capital's David Lai sees deal flow continuing to pick up in the next six to nine months, he's especially pleased that financial sponsors and MBOs are gaining wider acceptance in Asia. Now taken as serious and viable alternatives by vendors, financial investors are finally taking their place alongside strategic players in the market. Helping that process are industry success stories like *3i*'s recent exit from logistics provider Vantec: *3i*, along with Prudential's PPM private equity arm, came into Japan to bring off Japan's first MBO in 2001, then restructured the company and exited, leaving a stronger player in a tough arena – all in 30 months. *3i*, had taken a combined 65% stake off Nissan Motor's hands for $128 million, and last August set another record, completing Japan's first secondary MBO, selling it to Mizuho Capital Partners.



Simon Murray

In China, always a few extra steps

If he's seeing momentum picking up in certain areas, Lai is as suspicious as ever of macro-economic trends in China – an opportunity best attacked indirectly though investments in non-Mainland Asian companies locating operations in China to pursue lower production costs and markets. In China, wealth is accumulating at the fastest pace in history, he readily agrees. "But as a financial investor, you have to ask yourself about [investment] infrastructure," he says. His concerns run from the dearth of reliable partners and managers to still not fully convertible RMB, not to mention the absence of legal machinery for resolving disputes and enforcing investors' rights. "Financial investors don't face the same pressures of realization and exit," he says. Which explains, he says, why strategic FDI is soaring, and private equity still only dribbles into China.

The other feature of China, so far as private equity is concerned, is that domestic banks are loaded with cash and starting to work with middleman guaranty companies like SB Guarantee to get in on deals done in local currency. They're also learning to get through regulatory hoops and hurdles that can mystify outsiders. SB Guarantee's interest is the high yield piece of the debt involved in these complex transactions: "Say you need to borrow more than the asset," Ming Chen explains. "Working with the banks, we combine a bridge loan with the transfer of debt to the purchasing company – and then add the higher yield debt."

China lacks the means for simultaneous transfers of assets and debt. "In Hong Kong or the States, you just sit down with a lawyer and do the transaction, but in China, it takes a few extra steps.

In time, Chen thinks, offshore private equity firms may see their way to leveraging their way into Chinese opportunities by doing LBOs with Chinese characteristics – just perhaps with SB Guaranty's help. Things change – after all, it was only 50 or 60 months ago that Japan cottoned on to the concept of the MBO. ❑

Silicon Valley smiles again on Asia

Western VCs begin to spot bright prospects in the region

After a lapse of a year or so, American and European venture capital firms doing business in Asia are warming up to the region. Several Silicon Valley-based private equity professionals *AVCJ* talked to are optimistic about the future. They say the IPO window is slowly opening, mergers and acquisitions are offering more liquidity, and investment prospects are good.

Some of them pointed to recent exits or turnarounds even in difficult markets such as China. These exits are going a long way toward addressing a common concern that it was difficult to earn a dime from Asian private equity investing. In another sign of their optimism, several of these firms are in a fund-raising mode.


Ta-lin Hsu

Emphasis on Greater China

While many of the Western VCs continue to pursue early-stage investments in Asia, H&Q Asia Pacific is going in a new direction, focusing on later-stage and larger-size deals in Greater China, Korea and Japan, according to Chairman Ta-lin Hsu. Like other firms, China is getting a lot of emphasis and specifically one mega-deal, Semiconductor Manufacturing Industrial Corp. (SMIC). Having raised some $1.5 billion from H&QAP and other venture firms, Goldman Sachs and Toshiba in 2000.

While the scale of this one project dominates most other deals in China, a lot of dealmaking is going on just below the radar. In the case of H&QAP, there are two recent investments in China – a $17 million investment in Data Systems, an IT back-up service for banks, and a significant follow-on investment in Array Networks, a web trafficking provider. In other signs of life, H&QAP has divested publicly held shares in two Thailand-based portfolio companies acquired through late-stage, restructuring transactions. The firm also made a good return recently by divesting shares it held in Japan's Access, a service provider to I-mode that H&Q AP took public on MOTHERS in 2001, Hsu said.

Asked what he sees on the horizon, Bob Ackerman, Managing Partner at Allegis Capital, cited the return of a selective IPO market for companies with four to five quarters of profitability and a pick-up in M&A activity driven by large technology companies looking to fill their product pipeline with attractively valued companies after they slashed R&D spending during the economic downturn. In Asia, he pointed to the rapid growth of US-domiciled startups led by successful Asian entrepreneurs with R&D centers primarily in China and India as one engine for steady, though not explosive, growth over the next few years.


Jean Salata

For Palo Alto-based Allegis Capital, Singapore, China and India are in the forefront for future investments, and in China its semiconductors and communications companies stand out. "You look to where the legal, financial and IP infrastructure is in place and where there is a good risk/reward ratio compared to pure US or European development efforts," Ackerman said. "As for industrial sectors, it really comes down to where the skills are globally competitive. Lower costs with non-competitive engineering or IP protection is no bargain."

Asia's tech advantage

Longer term, he added, as the Asian technology market grows along with globally competitive engineering resources and lower cost structures, Asia-based technology startup companies will have a compelling competitive advantage. "As the US has shown in technology, the combination of innovation with a strong, homogenous, domestic market and an entrepreneurial environment that supports capital formation (and predictable liquidity) with respect for the rights of investors is formidable," he stated.

To take advantage of some of these opportunities, he said Allegis Capital is raising a small side fund with strategic Asian players.

Jean Salata, Managing Partner at Baring Private Equity Partners, is downplaying any major changes in direction at the firm now that the group engineered an MBO from Dutch investment bank ING. Salata pointed to China, India, Taiwan, Hong Kong and Singapore for generating interesting opportunities and to outsourcing of BPO services to India as a long-term secular trend. Other strong areas are consumer financial services, outsourced manufacturing (portfolio company Norelco is one example), automotive and telecom equipment sectors in China (such as Comba, also in its portfolio).

Burning desire to succeed

Asked if China is the future, Salata responded: "We are very impressed by the quality of companies we are seeing in China today, both in terms of management capability and low-cost production capabilities. Increasingly, we are also seeing world-class product development and R&D capabilities. One of the most interesting aspects of China right now is the staggering growth in domestic demand. But the single most important reason to invest in Chinese companies is the burning desire to succeed that is a characteristic of so many Chinese entrepreneurs."


Lip-Bu Tan

But can a VC firm make money in China? Absolutely, he said, adding: "The notion that you can not make money in China is an unfortunate myth that plagues our industry." He ticked off two of the firm's recent money-making ventures in China – Netease, which listed on NASDAQ and now has a market cap of over US$2 billion and the recent sale of an SMS provider called Newpalm to Chinadotcom in a trade sale for a very good return.

Moving away from China, Salata noted that the firm is "more positive on the prospects in Asia than we have been in the last four years." He pointed to economic growth in most parts of the region coupled with improvements in corporate governance and a growing recognition of the role of private equity in helping companies grow and restructure.

At Walden International, Chairman Lip-Bu Tan said the firm is about halfway through investing its PacVen V, having earlier reduced the mega $1 billion fund to $750 million. Some 25 companies have been invested in, ranging from participating in the SMIC deal to wireless deals to telecom infrastructure startups.

With Tan spending so much of his time in China, *AVCJ* asked him if he thought Chinese deals were becoming overheated. His immediate response was "not for us." The reason he had such a quick comeback is that the firm prides itself on going where other companies haven't gone before. Such was the case with UpTech, a telecom company that Tan started earlier this year in China and then rounded up $50 million-plus funding from venture capitalists in Silicon Valley and Asia.

And there are exits too

Investing in deals is one thing, of course, and exiting them is another. But Walden has a story to tell there too. It plans to take Malaysian online recruitment company, Jobstreet.com, public next year, according to Kwee Bee Chok, Head of the Malaysian office. Walden also saw an exit from a China deal it had made back in 1994. That company, A-S China Plumbing Products, is a Shanghai-based subsidiary of American Standard that manufactures and distributes kitchen fixtures and plumbing fittings. K. O. Chia, Head of Walden's Hong Kong office, reports that A-S had an IPO in July 2003 on the HK GEM, with the first day closing price at HK1.92. In early October, the price was hovering at HK$1.5.

Even so, Walden must be glad to have shed this relic of the early days of investing and turn its focus on the future of Asian private equity.

Firms with Asians footprints

Crystal Ventures, too, has kept a steady pace in Asia. The firm has made four investments over the past year or so, all of them based in the US but most of them with a footprint in Asia. In April, Exavio, a San Jose-based video delivery company with operations in Beijing and Shanghai, raised $14 million from Crystal and three other VC firms.


Joseph Tseng

Crystal also invested in Buffalo-based Synacor, doling out (along with several other VC tech firms) $6.5 million in a third round for the company, which enables Internet access providers to offer basic and premium content subscription packages to customers in an easy-to-use manner. In July, the firm led a $7.4 million, Series D investment in Brisbane-based Informative, Inc., described as a provider of customer dialog marketing solutions. With the investment, Crystal Managing Director Joseph Tseng joined the board. In addition, the firm invested in San Francisco-based Astoria Software Inc., described as a provider of structured document management solutions. ❑

More money for Asia

Crystal's new fund has a trans-Pacific thrust

Crystal Ventures is launching its third private equity fund, CIVF III, with a greater focus on Asian investment. The US-based early-stage venture capital firm is in the beginning stages of raising the $450 million fund, and Co-founder Joseph Tzeng said that he expects to have a first close in the first quarter of 2004. He added that some 60-70% of the amount raised will be sourced from Asian investors, primarily in Hong Kong, Taiwan, Singapore and Mainland China. Crystal has $240 million under management, raised primarily from Asian LPs.

Veteran recruited to help

The new fund will increase its investment in Asia-based companies to 40%, with the remainder earmarked for North America and trans-Pacific firms. To help with the fund-raising, Crystal has recruited Henry Wong, an entrepreneur and investment veteran, as a Senior Partner. Crystal, founded in 1997 and headquartered in Cleveland, Ohio, has invested 25% of CIVF I and CIVF II on companies in Asia.

Tseng said the increased emphasis on Asian investments reflects the belief that the region has great potential and that globalization is driving a multi-national approach to venture capital investing. He added that CIVF III is generating interest from Asia-based institutional and private equity investors who share that belief.

"The venture capital industry is changing," said Tzeng. "The conventional approach of putting money in, passively advising portfolio companies from the sidelines, and then exiting through acquisition or a listing on NASDAQ is history. Today, with geography expanding to multi-regional and cross-border environments, small private companies are becoming cross-border operations – they are taking a multi-regional or global approach to conducting business if they want to succeed. NASDAQ is no longer the exit strategy of choice. Investors are nurturing their portfolio companies for global acquisition by multinational corporations, or even listings on a number of foreign exchanges. The venture capital industry cannot afford to focus on a US-centric market, and CIVF III will reflect this new reality."

Also differentiating the partners and professionals at Crystal from other investors are their skills and knowledge of Asian culture, governments and markets. The firm's partners offer portfolio companies a combination of strong operational abilities, traditional venture capital investing experience, and the ability to close deals – not just venture deals, but business development and sales deals. Crystal's partners have experience in running companies and managing their finances – from the early stages of development to later-stage acquisitions, buyouts, relaunches and IPOs. This experience enables them to approach all new deals with a mindset that is multicultural, multilingual and global.

Describing the firm's investment approach, Tseng referred to what he called the "three Rs" – companies that seek a cash infusion to recapitalize, reengineer or relaunch. While Tseng said that Crystal will continue to invest in early stage ventures, he noted that most companies requiring one of these three Rs will have revenues in the range of $5 million to $15 million.

Henry Wong

Wong, who along with his colleagues in Columbus, Ohio, Palo Alto, Taipei and Singapore scouts for investment prospects in Asia, brings more than two decades of experience creating and establishing successful companies that have included SS8 Networks, XaQti Corp (merged with Vitesse Semiconductor), CNet Technology, (multi-million-dollar public network hardware company), and Combinet (ISDN systems, sold to Cisco Systems for about $165 million). Wong also has advised or invested in Garage Technology Venture (a CALPERs startup fund), Authosis Semiconductor Fund, Woodside Fund, Gabriel Venture Partners, and Onset.

Tap into the China potential

"Greater China as a region is a technology market that has yet to be exploited, and those companies who share a global perspective on markets, expansion and development opportunities will succeed by tapping into its potential," said Wong.

Laying out his investment strategy, Tseng said that 10-15% of Fund III will be invested in early stage, next-generation, disruptive technology companies; 30-40% of the new fund will go toward companies that create enabling technologies based on existing infrastructure for specific solutions and applications. The remainder will focus on trans-Pacific companies that require restarting, reengineering or relaunching, and that are typically in the mid- to late-investment stage.

– R. A. F. ❑

Invisible hand, visible sentiment

Asia's investment climate improves after a wrenching transition

Classical economists, those disciples of Adam Smith, would tell you that the invisible hand of market mechanisms is the major economic determinant – no matter what governments wish or punters dream. Of course, prices and growth trends are influenced by wars, fear of wars and pestilences – we had a whiff of those in the past year – but markets absorb these shocks over time. And then the clouds clear, sentiment shifts for the better and investors move in.

That is the scenario being painted for Asian investment today. The traumas of the past year are over. "The private equity industry is going through a period of transition," says Steven Goodman, Partner at law firm Jones Day. And what are the signs of that transition? Goodman responds that funds are realigning their strategies by targeting new investment sectors, such as online gaming, The games sector, traditionally dominated by Japan, has been moving into South Korea and even China, he points out.

Steven Goodman

Secondly, players that haven't managed to tough it out have moved on and new players seeing new opportunities have moved in. "We are starting to see more fund-raising and fund-formation activity ... all evidence that the industry is in transition," Goodman elaborates.

In the opinion of Robert Woll, Partner at law firm Morrison & Foerster, the industry's transition for the better has progressed even further. "Business sentiment in general has improved since the summer of SARS; moreover, there have been investments as well exits through trade sales and even some IPOs on Hong Kong's GEM board, though the latter have not been that easy."

Robert Woll

Taking China as an example, Woll pointed out some of the deals, stressing that many were technology-related – a trend that is likely to grow. He offered a few examples over the last year, citing a string of Western and Asian venture funds investing in startups such as Baidu.com, Linktone, MeMeStar, Newpalm (China) IT and Venturepharm.

Also, there is a steady continuation of some trends set in motion earlier, Woll asserts. Intel Capital has been on the prowl, investing in a host of Asian IT-related ventures. Then there was the takeover of Motorola's $1 billion fab in Tianjin by SMIC is a strategic deal.

Then there is the example of International Finance Corp, a World Bank subsidiary that has kept investment momentum going in Asia. Ever perseverant, the IFC has been a noted strategic investor in Asia, which accounts for a quarter of its global program. Beginning the year with $3.5 billion invested in 200 Asian companies, the IFC will have added another $800 million by year-end.

However, although China receives the largest share of foreign direct investment among emerging markets, there are some glitches. "Financial investing is difficult in China as the system is still essentially inefficient. Whereas strategic investors are able to devote time and effort to work through these inefficiencies gradually, financial investors have limited time and must see actual returns," cautions Marcus Woo, the Taipei-based Partner at Jones Day.

But Woo too sees positive signs on the mainland: "The current leadership appears firmly committed to continued reform and growth of the economy. Financial investors will see change and eventually returns, but it will coincide with China's gradual reform process," he predicts.

Some reforms are seen in China's new venture capital and M&A rules, all helping to stimulate investment. New guidelines for VCs allow domestic funds to be managed together with foreign funds, for example, while new M&A rules provide a far clearer framework for domestic transactions.

Marcus Woo

Regulatory changes in Japan and South Korea have also been more investor-friendly. Between better regulations, and a stronger resolve to restructure their economies, Tokyo and Seoul are seeing accelerated M&A activity, says Jones Day lawyer John Kao. While foreign buyouts in these countries have so far mainly concentrated on financial services, telecom and some resort hotels and golf courses, "there will be a gradual movement towards bigger deals in other sectors such as manufacturing," Kao says. ❑

China is back, says Singapore's EDB chief

Singapore held its seventh annual TechVenture Conference last week as part of its inaugural "Global Entrepolis @ Singapore." The event was aimed at showcasing the island republic's "target to establish itself as a global entrepolis where entrepreneurs, innovators, and venture capitalists can interact and transact – a meeting place for the buyers and sellers of ideas, technology and innovation."

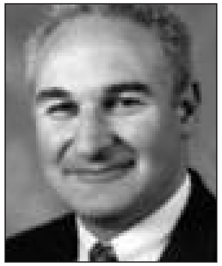
Teo Ming Kian, Chairman of the Singapore Economic Development Board (EDB), parent of the event's organizer, TIF Ventures, framed TechVenture's "Spinning Ventures into Capital Returns" theme in his opening remarks. Acknowledging that, "the last two years have been brutal for the VC industry," Teo believes that "the tide has turned," particularly in Asia.

In a brief retrospective, Teo asked why China's scientific advances from the Qin Dynasty (221 -205 BC) to Marco Polo (1300s) failed to spark the world's industrial revolution, and, instead, the Middle Kingdom fell far behind Europe.

"Many have pointed to Asian culture as inhibiting entrepreneurialism," he said. Teo cited author Joseph Needham's belief that China's bureaucratic system was at fault. Europe's feudalism was more conducive to a mercantilist society, which ultimately fostered modern capitalism. By contrast, Chinese society relegated the merchant to the bottom rung of the social ladder after the scholar, farmer and worker. And, without this human capital, there was little motivation to change.


Teo Ming Kian

Capitalism has returned to China, Teo said, citing the recent launch of Shenzhou 5 manned spacecraft as the country's statement to the world that "we are back." This spirit has not only been felt in China, but throughout the whole region," he added.


Ray Maxwell

Teo underscored EDB's commitment to fostering conditions for an "enterprise eco-system," evidenced in part by "Singapore's S$16 billion in venture funds managed by 150 venture capital firms from diverse origins."

Chairman Teo's remarks were followed by those of keynote speaker, Ray Maxwell, Managing Director, INVESCO Asset Management. After he provided an overview of the venture capital cycle, Maxwell was asked about his prognosis for exits, the lifeblood of venture's "virtuous cycle."

"Difficult," he responded. "The only companies that are going to be supported are those that are exceptionally well-funded, with large customer bases and strong cash flow. The great will win, the others will fail."

As he said earlier in this speech, the problem with the venture capital industry, is that you have a lot of people who can "talk the talk" but not many who can "walk the walk." – *D. M. S.*

IIs on returns, re-investing and disclosures

One of the more engaging panels at TechVenture was the one of institutional investors on the morning of October 29. Moderator Jean-Bernard Schmidt, Managing Partner of Soffinova Partners and the current EVCA Chairman, started with the question of "how predictable are private equity returns?" Not easily predictable seemed to be the answer, although Hamilton Lane Managing Director Wayne Harber said that in this environment his firm would be happy with returns in the high teens.

Responding to the same question, Christoph Rubeli, a Partner at Partners Group, suggested that good selection of different types of private equity partnerships is just as important as making some great picks. "Asset allocation is very important since private equity is a very cyclical industry," he said.

In another sharp question Schmidt asked the panelists about the number of their existing partnerships that they won't be reinvesting with. The answer from Harber was: 10-15% of their buyout funds ("mostly in the mid-market") portfolio, while 25% of their venture partnerships won't be seeing new commitments. As for Partners Group, Rubeli disclosed that it had a "watch list" of 12 from its portfolio of 150 partnerships, which it will probably not reinvest with.

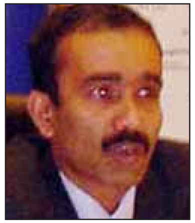
Yet another topic was the white-hot disclosures of fund performance and whether or not it should be extended to the portfolio company level. Bruno Raschle, CEO of fund of funds Group Adveq Management, said that if that were to happen, his firm may choose not to invest in such partnerships. He argued that superior performance is the reason institutions enter into an illiquid investment for 10 years and he would not want rivals to see any information that might give them a competitive edge. On his part, Hamilton Lane's Harber felt that it was probably alright to disclose on a fund level but definitely not on a portfolio company level. *– A. L.*

Hamilton Lane, Apex Ventures pick Singapore

Several major announcements were saved for the conference, including the setting up of the Singapore offices of a number of private equity firms. Hamilton Lane, the Philadelphia- and London-based private equity adviser and discretionary asset manager, announced its intention to use Singapore as the hub for its Asian operations.

London-based Managing Director Wayne Harber currently spearheads the firm's Asian investments. According to Harber, Hamilton Lane has been investing in Asia since 1995 with around 5% of its $26 billion private equity portfolio committed to Asian funds. "We are very bullish on the private equity industry and plan to $2-$6 billion per year, depending on the availability of opportunities."


Wayne Harber


Babu Ranganathan

Responding to *AVCJ* queries about his current preferences, he said that Hamilton Lane was looking hard at larger ($25 million or more per commitment) opportunities in South Korea, Japan, Taiwan and Singapore. He was also bullish on the Australian market citing the tax regulations as a positive sign.

Apex Venture Partners, an early stage venture capital firm managing $510 million, also opened an office headed by Director Lee Chuen Ting, who is charged with helping her Chicago-based employers tap opportunities for their portfolio companies in the region. General Partner Babu Ranganathan, who said that his firm currently focuses on software and applications as well as enterprise and network infrastructure, has increased the scope of its LPs from only US-based institutions to include Asian investors such as TIF Ventures.

Mao checks in: The conference also marked the appearance of former Sina.com CEO Daniel Mao who spoke about the need for companies to have strong governance to grow into higher margin activity. He also suggested investors focus on branding and companies with distribution and customers.

Mao also talked about the potential benefits of recruiting some of China's new generation of MNC-trained talent. But for those in the audience who wanted to know why Mao left Sina.com, moderator Joel Kellman – who lunched with Mao the day he quit – already heard his answer: "I am a turnaround guy, and the company's already turned around." *– A. L.* ❑

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