

Opalesque Asian Private Equity Roundtable

Opalesque Roundtable Sponsor:

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Editor's Note

With the completion of the Hong Kong–Zhuhai–Macau Bridge in late 2018, the Greater Bay area around Hong Kong and the South Chinese economy are starting to see dramatic changes in terms of ability to innovate and creating a circular economy that rings the bay. In a region that's already incredibly fertile and driven, capital, ideas, people – 130 million or as many as in the six most populated US states (CA, TX, FL, NY, PA, IL) – all kinds of things are now moving much more freely around.

88% of the next billion people to enter the middle class are going to be from Asia. The “G2C” region (Greater Greater China made up of China, Hong Kong, Taiwan, South Korea, Singapore, Malaysia, and Thailand) alone boasts a GDP of USD \$14 trillion (2017) and a population of 1.5 billion with one of the largest pools of young people on the globe..

While LPs look at Asia and say, “I should be there,” the numbers over the last three or four years are maybe telling them differently. Worse, some investors believe that reported private equity returns in Asia are largely illusionary as IRRs are based on unrealized valuations, and unless those unrealized valuations can be converted to cash, they don't really mean anything to the investor.

Buyout deal flow is thin as in general Asian entrepreneurs do not naturally sell control of good businesses. On the other hand, almost any of them will take new money in return for giving away a minority stake and some veto rights. Growth capital is therefore the predominant transaction type – however, if your growth capital deal doesn't go well, then you are in a very bad place. Therefore, instead of looking at IRRs or Total Value to Paid-In-Capital (TVPI) ratios, investors are advised to consider **Distributions to Paid-In-Capital (DPI)** ratios (page 10-11).

Still, taking a longer-term view, Asia should be right on the mark. Private equity investment in the Asia Pacific has grown from 5% of the global total in 2007 to a quarter of all investment in 2018 with \$833 billion now under management in the region. The Asian mid-market space is attractive and with the right network and origination (page 11, 19) Venture Capital as well. This Roundtable also discusses a process to invest in private equity assets in Asia but without the shortcomings of the conventional private equity model, the biggest of which is the lack of liquidity.

The Opalesque Asian Private Equity Roundtable, sponsored by [WTS Global](#), took place in Hong Kong with:

1. Anne-Marie Godfrey, [Partner, Akin Gump Straus Hauer & Feld](#)
2. Alexandre Casin, [CEO & Co-Founder, Poincaré Capital Management](#)
3. Brian Lau, [Managing Director, ShawKwei & Partners](#)
4. Professor Graham Leach, [Operating Partner, Hong Kong Emerging Technologies Venture Fund](#)
5. Hugh Dyus, [Partner, Navis Capital Partners](#)
6. Marc Lau, [Managing Partner, Axiom Asia Private Capital](#)
7. Robert Welzel, [Partner, WTS Global](#)

The group also discussed:

- **Manager selection** (page 9) **and origination make all the difference** (page 11, 19)
- How is the fading of private-public arbitrage opportunities affecting investors? (page 12)
- **Why are more European fund structures in the Asian market now?** (page 13). Why 25% of all the underlying exposure of Asian PE funds is in listed equities (page 15). Don't trust over-engineered transaction structures in Asia (page 25)
- **Opportunities with early stage VC managers in Asia** (page 13, 16-19). Is there a shakeout in the VC sector in China? (page 18). How to achieve a liquidation event from concept within a year (page 17)
- **Why exactly is the wealth creation from technology enabled business models so enormous in China?** How China is different from Silicon Valley (page 18-19, 21-22)
- Investing in G2C versus true frontier Asia (page 19-22). How Pinduoduo went from zero to 3rd largest e-commerce player in 3 years (page 21)

- How to deal with standards of governance in Asia (page 23)
- The human factor and where exactly artificial intelligence struggles (page 26-27).

Enjoy!

Matthias Knab
Knab@Opalesque.com

Participant Profiles



(LEFT TO RIGHT):

Marc Lau, Brian Lau, Matthias Knab, Alexandre Casin, Hugh Dyus
Anne-Marie Godfrey, Robert Welzel, Graham Leach

Introduction

Anne-Marie Godfrey

Akin Gump Strauss Hauer & Feld

My name is Anne-Marie Godfrey. I head up the investment funds practice at Akin Gump Strauss Hauer & Feld in Hong Kong. I have a team six lawyers here in the Hong Kong office working on hedge fund formation, private equity fund formation, retail funds work and all aspects of regulatory advice.

Robert Welzel

WTS Global

My name is Robert Welzel. I am a tax partner at WTS Global in Frankfurt with a consulting focus on international tax and regulatory issues. The company was formed in 2000 by former employees from the central tax department of Siemens and has since then developed rapidly. At present, our headcount in Germany is approximately 1,000, and the international tax network of WTS Global worldwide exceeds already 3,000 consultants.

WTS Global serves both major private equity houses and big institutional clients to manage cross-border tax reporting needs.

WTS Global deploys a bottom-up granularity methodology approach based on capturing and analyzing the economic data of the underlying target investments of the alternative funds provides for the realizability to adapt and facilitate the e.g. partnership, CFC-alike tax compliance reporting needs of any envisaged jurisdiction in a scalable and economically reasonable approach per investor. Applying a reasonable fee estimation reflecting the complexity of the specific alternative funds would bolster the economic scalability of any global fund marketing strategy especially in the institutional investor sphere.

The WTS Global service offering may be of interest for private equity houses intending to strengthen their international investor basis. Seamless cross-border tax and investor reporting should support the distribution of private equity and venture capital funds.

Graham Leach

Hong Kong Emerging Technologies
Venture Fund

My name is Graham Leach. I am a professor of Innovation and Entrepreneurship at the Hong Kong Polytechnic University where I also help to run the university incubator, and am the Blockchain Curriculum Lead. I used to work with a New York M&A boutique advisory company for about 10 years.

For quite some time now, I have noticed that when students graduate, they take their new ventures out into the market and don't have a natural place to go. It's a real problem, so I have decided to open an Emerging Technologies Venture Fund in Hong Kong because at the moment we don't have that kind of thing here – and I think we could use one, especially for very early stage emerging high tech companies and things like Blockchain, Internet of Things, big data, gaming, etc..

What I see happening is the emergence of the Greater Bay area around Hong Kong as a global force for high tech. Unfortunately, as I said, right now Hong Kong doesn't really have a place to support young entrepreneurs and start-up teams other than Science Park. I used to work there. I set up a big robotics prototyping facility there, so I know them quite well. Even in Science Park, where the "hardware" is fantastic and very high-profile – Science Park is Hong Kong's dedicated startup incubator – there seems to be a market failure with respect to funding that I'd like to try to fill.

I have been talking about the need for a Hong Kong Venture Fund to various people in the Hong Kong government and to the business community for a while now. At the moment, I'm gathering information, making friends, and looking for advice. I think the organization that I like to set up is going to be a blend of what you might call a traditional asset management company in Hong Kong, along with a very early stage investment platform that would integrate more progressive

and new ideas like blockchain into its design. Setting up something completely new allows me to aim for the ideal balance between an open and very flexible structure and yet something that's recognizable to traditional investors so they feel comfortable to invest in it.

Hugh Dyus
Navis Capital Partners

I have been in the Asian private equity industry for about two decades in a variety of different roles. I have been a GP where I was involved in sourcing, negotiating, structuring and managing deals of different types, including buyouts and minority stake deals. I have also been a LP, picking managers and funds, co-investing into direct deals and buying private equity fund secondaries. I have also raised funds for private equity in Asia.

Based on all that cumulative experience, I have developed an innovative approach whereby one can invest in private equity assets in Asia on a selective basis without the shortcomings of the conventional private equity model, the biggest of which is the lack of liquidity, which is deeply problematic in Asia. It is a hybrid strategy under the Navis Capital group called the Navis Jockey Fund.

Marc Lau
Axiom Asia Private Capital

My name is Marc Lau from Axiom Asia Private Capital. We are an independent fund management firm focused on private equity in Asia. We were founded in 2006 and have been investing in private equity on behalf of mainly US and European institutional investors who would like access to the Asian private equity markets. We currently manage over US\$5.2 billion across five private equity fund of funds and a co-investment fund. Before setting up Axiom, my partners and I used to work at one of the largest sovereign wealth funds based in Asia, namely the Government of Singapore Investment Corporation (GIC) where we were responsible for several billion in PE investments globally.

Brian Lau
Shawkwei Partners

I'm Brian Lau, Managing Director and Partner at Shawkwei Partners. We are a mid-market GP and one of the oldest independent GPs in the region. Based in Hong Kong we have offices in Singapore and Shanghai we focus on control investments across the region. We have also completed cross-continent deals between Europe and Asia. Our current fund is Asia Value Fund 2017, which follows five previous funds, and had its final close in September 2018 raising greater than USD \$800m.

Originally, we started in the late 90s as a minority partner doing growth investing. For the most part, this was the only available investment at that time. However, our two most recent funds moved to control stakes investing. This is for a couple of reasons. Firstly, these opportunities began to become available in 2008. Previously entrepreneurs were not of an age where they wanted to sell control stakes. Their businesses were growing, they often needed capital to finance a new factory, and had hopes to eventually IPO. But by around 2008 and 2009, and a lot of entrepreneurs were now in their 60's and their children did not want to go into the family business. These children were often educated overseas, became white collar professionals and/or had different interests, and foremost had no desire to join the family business. This opened up the opportunity for Shawkwei to provide succession planning and an exit for the founders.

The second reason for control is the ability to control the exit to maximize returns for our investors. In a minority situation, the exit priorities are dictated by the majority owner!

The strategy for Asia Value Fund 2017, similar to the previous control focused fund, to invest in good pan-Asian companies and bring them to the next level through further capital injections, investing in new professional management, technology and branding. We bring a global standard of governance to our companies and build them to become attractive acquisitions for strategic/industry buyers.

We invest across Asia in the developed markets of China, Hong Kong, Taiwan, South Korea, Singapore, Malaysia, and Thailand. *These countries collectively are known as the "G2C" region (Greater Greater China). The firm Asia Private Equity Research recently completed a study that*

showed the combined GDP of the G2C region was over USD \$14 trillion in 2017 and had a population of 1.5 billion. The G2C markets are home to one of the largest pools of young people on the globe (those under 35). This bloc has also seen a surge of foreign direct investment with over \$400 billion in recent years and will remain an embodiment of Asia's most vibrant and affluent economies. The pan-Asia nature of our fund vs. single country approach provides a geographic diversification and capitalizes on our strength of managing diverse and complex businesses and supply chains. We have also invested across continents where Asia has a strategic focus. For example, we have made German investments where the technology and HQ is in Germany, but much of the manufacturing or customer base is in Asia. This allows us to drive strategic value through our presence, experience, and expertise in the region.

ShawKwei invests in many different sectors and traditionally has had an industrial focus. Past investments have been in plastics injection molding and tool making, metal stamping, electronics manufacturing, oil & gas services, capital equipment manufacturing, maritime services, adhesive products, etc. These businesses are part of the traditional scope of Asian manufacturing with well established capabilities. These industrial and manufacturing sectors make up almost 35% of the GDP of the region and will remain a serious part of the economy which has higher growth rates than Europe and North America.

The investments we make tend to have more assets than a services business. We believe in clearly understanding a business based on its book value and being able to assess risk and growth opportunities.

I am extremely bullish about the investment returns for Asia Private Equity in our mid-market space. The number of opportunities continues to grow and is significantly higher than in the large-cap space where the deals are far fewer.

Alexandre Casin
Poincaré Capital Management

My name is Alex Casin. I am CEO and co-founder of Poincaré Capital Management. We are an investment firm involved in public and private equities focused on global investments with a focus on Asia. We look for opportunities around the globe, with a focus on Asia, and have the flexibility to work across the equity spectrum, from seed investments to buyouts and listed equities. The firm was launched two years ago, in partnership with H2O Asset Management, a USD 33 billion macro investing firm.

H2O Asset Management is an affiliate of Natixis Investment Managers, which is a one-trillion multi-boutiques asset management firm. My partner is Dr. Yang Lu, who was the former Equities division chief investment officer of SAFE, China State administrator of Foreign Exchange. Prior to joining SAFE in 2010, Dr. Lu spent over 10 years in California running two hedge funds after having begun his career in the academic sector in Switzerland, then later at Wharton.

My background is 20 years as an investment banker. So, with Poincaré Capital Management, we are involved in public and private investments. On the public side, we manage a global equities hedge fund and mandates for our clients. On the private side, we do investments across the various stages of the equity spectrum through SPV structures.

I'm also a founding partner of a holding company that makes acquisitions in the technology sector called **"You and Mr. Jones"**, which is the first brand-tech group in the world. We do both majority and minority investments with initial capital of 300 million dollars. We created this company as a holding company with an infinite life to seize the opportunity in the growth of digital marketing and, so far, You and Mr. Jones has done six majority acquisitions and 19 minority investments such as Pinterest, Niantic Labs, etc.

Our latest majority transaction was a UK-based global company called Oliver. In Asia, our companies have operations in Hong Kong, Singapore, Beijing, Shanghai, Taipei. The founder CEO of You and Mr. Jones is David Jones, the former CEO of Havas Group.

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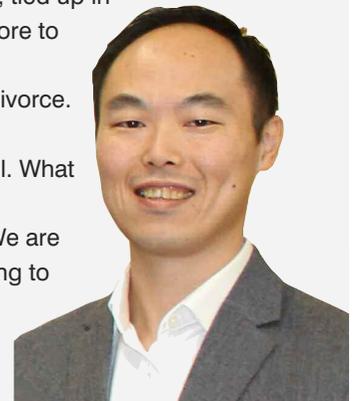
Matthias Knab

Some of you have already talked about the recent trends and development in private equity in Asia, for example, that control stakes have become increasingly available and therefore the range and attraction of Asian PE has really improved a lot. What other observations and trends do you want to share?

Marc Lau: Let me start by saying that **Asia isn't a place where one size necessarily fits all. You really have to look at it from both a country perspective as well as from a life cycle perspective.** For example, in markets like China and Vietnam, there are still a lot of very young entrepreneurs who need growth capital, or they may need venture capital in order to get new ideas off the ground.

On the other hand, in the more developed markets like Japan, Korea or Australia, there are entrepreneurs who are at a point where they are ready to retire. There's a lot of working capital, but also a lot of their own net worth, tied up in their businesses or in their company assets. Hence, developed markets lend themselves much more to buyout controls, succession-type deals. We see changes in ownership brought on by family circumstances, for example, the need to pay inheritance tax, or if the founder is going through a divorce.

Opportunities in each individual market though contribute to how we view the Asian market overall. What excites us most about investing in this region is the huge growth prospects for private equity. It is expected that 88% of the next billion people to enter the middle class are going to be from Asia. We are now starting to see how the consumer, healthcare and tech companies in our portfolios are catering to this new middle class.



Brian Lau: I agree with Marc's comments and would add that Asia's private equity is probably some 15, 20 years behind the US and maybe 10, 15 years behind Europe in terms of people's acceptance of private equity as an investment from an investee-company point of view. I think that 10 or 15 years ago, we haven't seen a lot of openness to private equity funds in the region.

Also, when you look at the broader eco-system of service sectors that support private equity, while in the US or in Europe you find a lot of lawyers, professionals, reorganization groups that can help you very well, this sphere is not as robust in Asia. I think that limitation also applies to a certain to the talent that you are looking to put into your private equity companies or your investee-companies.

From an LP perspective, another trend or development over the last two or three years is that there's more risk coming to Asia. And, digging a bit deeper here, you can find a couple of views relating to Asia. One is, of course, that in order to have a diversified portfolio, investors might think they should have a 10% or 15% allocation to Asia, and that because of the perceived risk, there is then also a belief that there should be higher returns. But in fact, if you look at the PE fund returns, the US has been hitting it out of the park for the last two or three years.

A second aspect relates to liquidity. People that invested in those in previous vintages of China and India funds haven't had the liquidity that they are looking for. So, also from that perspective, *LPs look at Asia say, "I should be there," but the numbers over the last*



three or four years are maybe telling them differently. However, if you take a longer-term view, Asia should be right on the mark, there are so many secular trends that represent opportunities with the population growth, GDP growth, and the general move to the middle class.

So from that perspective, Asian PE is going to be a very fruitful industry for the investor, both at the LP level and the GP level, and the surrounding service providers.

Our investments are pan-Asia and we avoid single country investments. This has allowed us to provide a high amount of liquidity and to return capital back to our investors. The dividends to paid in capital (“DPI”) from our most recent fund, 2012 vintage, is in the top 10% and we only have two portfolio investments remaining.

Marc Lau: Just adding to Brian's point about the returns – if you look at the long term median returns across US, Europe, and Asia, on a multiple level they are all roughly the same. One reason for this is that many of the same firms operate across these regions, meaning underwriting standards and competition are more or less standardized across the world particularly as PE becomes a more institutionalized asset class.

Where the difference does come in though, is in the spread of the top quartile. In the U.S and Europe, the spread between the 75th percentile and the very best return is narrower than it is in Asia. Take the '06 vintage as an example which is mostly fully realized. For this vintage in Asia, according to Cambridge Associates, the 5th percentile manager netted a 4.5x whereas the 75th percentile is roughly 2x, meaning a total spread in the top quartile of almost 2.5x. By contrast, the returns in the US and European markets had a smaller spread of about 0.6x-0.9x. What this shows is that the growth in Asia enables some managers to invest in deals that could really drive outperformance, thereby increasing the spread in the top quartile.

This is why manager selection is of the utmost importance. While statistics show there have been successful funds, as in every market, there are always funds where their investors have not had good experiences. This is normal. The reward for diligence and on the ground expertise is large. Most people are surprised that as a fund of funds, Axiom's 2006 fund has already returned more than 1.8x back to our investors net in cash, with more distributions to come before the end of the funds' life. This is despite charging “a second layer of fee and carry”.

A good partner on the ground can help you benefit from the underlying growth in Asia at a much lower level of risk because of the diversified nature of a fund of funds. An important point that is often missed is that the return per unit of risk for a fund of funds can be even more compelling than a direct investment in private equity if your FOF partner is picking top quartile funds.



Hugh Dyus: *Throughout my career, I've always taken a very strong interest in private equity returns and what they really mean. I actually think that reported private equity returns in Asia are largely illusionary. What I mean by that is that IRRs are based on unrealized valuations. And unless those unrealized valuations can be converted to cash, they don't really mean anything to the investor. Although, they are really helpful to raise your next fund if you are a GP.*

There is a very big structural challenge in the Asian private equity market. In general, the people who control businesses in Asia do not naturally sell control of good businesses. So, buyout deal flow is thin on the ground. On the other hand, almost any Asian entrepreneur will take new money in return for giving away a minority stake and some veto rights.

So, **growth capital is the predominant transaction type in Asia**, and because growth capital is a predominant transaction type, with the exception of a few disciplined players, like Shawkwei, most private equity managers do growth capital. And global buyout managers, when they set up their Asian funds, they are generally not pure buyout funds but hybrid funds, doing both control deals and growth capital deals. *The issue is that if you invest in a growth capital deal and it doesn't go well, then you are in a very bad place. You do not have the power to make changes as that power is held by the controlling shareholder. It is also very hard to persuade anyone else to buy you out, to step into your shoes into a minority stake and underperforming investment.*

Therefore, the ability to fully exit growth capital portfolios is deeply problematic for the Asian private equity industry, and that has always been that case. And so, when one looks at returns, one should not be looking at IRRs or Total Value to Paid-In-Capital (TVPI) ratios, but you should be looking at Distributions to Paid-In-Capital (DPI) ratios. *And whatever period of time you look at, Asian private equity compares poorly to US private equity or European private equity in DPI terms. And, if you look at the bottom quartile managers, then the numbers are exceptionally poor. DPI ratios of around 0.3x on mature funds for bottom quartile managers are common. This confirms that private equity managers cannot get out of bad growth capital deals. This is a big structural problem.*

This also means that the famous private equity “J” curve usually turns out to be an “S” curve for Asian growth capital managers. You have your good companies and can exit them and report your realized returns on those, but the tail of your portfolio is likely toxic and you may have to hold on to your “dogs” for ages until you finally write them down. As a manager, the best thing you can do for your investors and for yourself is to compound value in your winners and cut your losers, but you can't do that within conventional Asian private equity fund structures because you need to raise your next fund and to do that you need to show some distributions.

And so, to demonstrate distributions, you normally have to exit your winners, because those are the only ones you can exit, and you end up holding on to your losers. And so, I think the IRRs you see for Asian growth capital funds typically overstates the real returns which investors will get in the end, because IRRs compress towards the end of the life of those funds. And I note that many managers request fund life extensions because they cannot exit all their investments within the original agreed life of the fund. Further, the alignment of interests between LPs and the GP may break down as the GP tries to live off management fees on unrealized problematic investments that should have been written down or written off.

In terms of trends within the market, I'd like to point out the trend of ever larger sums of money being raised by managers, so larger and larger aggregate amounts of capital are being raised and deployed. While the macro environment in Asia is interesting and exciting, there is also a massive amount of competition for deals and a wall of money going into a market with relatively thin buyout deal flow.



Something like the \$100bn Softbank Vision fund is an unbelievable amount of money to deploy in what conceptually should be venture capital types of opportunity. This is another major challenge for the industry – how do you generate good returns when there is so much money being deployed by so many people and a cultural reluctance to sell control of good assets?

Brian Lau: I agree with Hugh, our investors highly care about DPI in the sense of, “Give me the highest DPI as quickly as possible.” That parameter is top of mind for them. IRR is helpful but there is no substitute for returning cash to your investors. That is our top focus at ShawKwei.

Getting back to funds into Asia, there is certainly a stratification of fund sizes with some tier one players raising \$8-\$9bn funds which are not control deals but sort of hybrid, co-invest, quasi-buyout deals. However, there are not a lot of these deals and they are highly competitive.

And so, if you have to deploy \$8bn and you have to write 18 \$500m checks, that's difficult. There are four or five of those large \$7bn+ funds, and there are less of them or none in the mid-market, which is why we like that space. We also have quite a few country funds that are adequately sized according to the economy of the respective country and the opportunity set there.

Our focus in the industrial sector and our long track record has led to many manufacturing owners and advisors approaching us directly. They know we invest in this space and know we have a game plan to improve the businesses we buy. Many founders seeking an exit often have as much interest in the future health of the business as they do the valuation.

We see many more opportunities to deploy cash in the mid-market space.



Alexandre Casin: We very much agree with the long-term vision for Asian economies, that that is why we established Poincaré in Hong Kong. We also look for businesses that do not have their headquarters in Asia, but benefit from the Asian growth opportunities, which enables us to buy Asian growth companies with Western corporate governance at a discount. Just to give you some listed large cap examples: Renault is listed in France but its valuation is derived from Asia. BMW is not really a German company – half of revenues come from one country, China. Likewise, Volkswagen is more a China going-concern with German corporate governance. These are companies which maybe headquartered in other jurisdictions, but effectively have their forward valuation anchored in Asia.



On the private side, we focus a lot of growth capital. *Where we do see a huge differentiation in PE is when it comes to the **origination**. In our ecosystem, we work closely with founders of technology companies like Biz Stone, co-founder of Twitter. If you are part of that entrepreneurial ecosystem, that helps originate the great opportunities. We tend to see the same funds operating in our focused sectors (brand technology, consumer digital, healthcare, services, media & entertainment). Having the first call from the founders of these companies when there is an opportunity creates some element of segmentation when it comes to origination.*

Hugh Dyus: I just want to elaborate on my point about growth capital. When I'm talking about growth capital, I am using the Asian definition, which is putting new money into a business for a minority stake behind somebody else who is a controlling shareholder. The term refers to the shareholding structure of the investee company, not to the growth profile of the investee company.

However good a manager is, when you invest in a portfolio of companies, some companies are not going to travel well. So, everyone has to deal with problematic investments. Interestingly, when you go back 15 years or so, growth capital funds in Asia actually generated very good returns for their investors. What was the reason for that? The reason is that they generated very high multiples of money on their winners, in the same way that venture capital works in the US. If you can generate high multiples of money on your winners, it doesn't matter if you have some companies that you can't get out of, because the overall result will still be good.

When you go back in history and examine Asian growth capital funds of 1999 to 2005 vintage, they would regularly make 6 - 9 times money on their winning deals. However, the problem now is that with the weight of capital chasing deals in the market, there is no longer a big discount between private and public market valuations. In China, you used to be able to invest in a private business at a single-digit price earnings multiple and you could IPO at say 25 times earnings. So, just on multiple arbitrage, you make 3 times, and on earnings growth, you could make another 2 or 3 times, which then enables you to generate a multiple of money of 6 - 9x on a winner.

Today, you generally cannot find significant discounts between private and public market valuations. Actually, after the big fall in the public markets because of the trade war between the US and China, it is probably the other way around. Lots of private companies who were planning to IPO have been doing private rounds instead as private funding is less dilutive for them. My point is that there is no significant private-public arbitrage opportunity generally available anymore, and therefore if you are going to make a high multiple of money, it has to come from the underlying growth of the business. And with a big wall of money looking for these high growth deals, entry valuations are very high. I think the growth capital model of investing in Asia is structurally flawed.

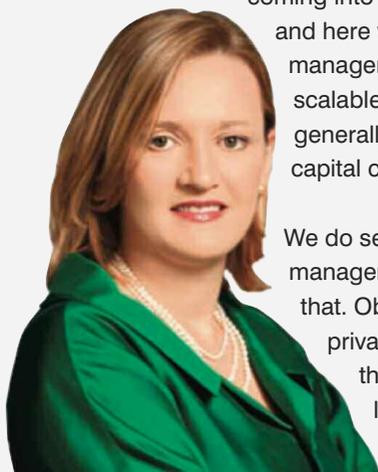


Matthias Knab

Anne-Marie, what do you see from your perspective?

Anne-Marie Godfrey: We see funds at their launch stage and we handle the closing. So, we get a sense of how much is coming into the fund and the overall industry. We deal with the managers obviously in setting up the funds, and here we see quite a large range of sophistication in the market. For example, we still have PRC managers who want to set up funds as segregated portfolio companies and have something that is scalable when the segregated portfolio structure is not really optimal for private equity fund and generally a limited partnership structure will work a lot better in terms of facilitating draw downs and capital calls, et cetera and also dealing with issues that the articles of association won't deal with.

We do see a trend of more private equity fund managers becoming active in Asia, even real estate managers coming onshore in Hong Kong and being licensed with the SFC. There are few drivers for that. Obviously, the Profit Tax Exemption Ordinance in 2015 extended the profits tax exemption to private equity-type investments. And even though when an investment manager is licensed and thus subject to the SFC's handbook, they are still subject to a lot less regulation than a more liquid fund, in terms of doing filings, the disclosure of interest filings, that kind of thing.



In terms of sectors where we see activities, obviously, health care in China has been a really big focus over the last couple of years. Of course, not all of these funds are going to succeed. At times I am reminded a bit of the pre-IPO funds that we were setting up four or five years ago, where a lot didn't IPO and managers had to find other exits. So, that's really what we're seeing in terms of fund structuring and where people are structuring them.

We are also seeing more European funds. For example, on a private equity fund that we are working on at the moment, we are doing an Irish **parallel structure** to admit European investors, and we are also about to start work on a Luxembourg structure as a parallel fund again for an Asian manager to admit predominantly Swiss investors.

So, we are seeing more European funds in the market and with changes that are coming down the tracks in Cayman like the requirement to have substance for a civil exempted management company, I think, people are starting to move away from the Cayman Islands as a fund domicile to Europe. You are also seeing Singapore having its own private equity fund structure. Hong Kong has just only the open-ended fund companies' regime where you could have illiquid assets, you just want to have a long lock up then as well. So, there are a lot of jurisdictions that have set up tax neutral vehicles that do effectively the same thing as a Cayman Island's fund, but with an additional layer of regulation.

Matthias Knab

Anne-Marie, what would be from your perspective a piece of advice for investors looking at Asian private equity?

Anne-Marie Godfrey:

I think due diligence is extremely important. We do quite a bit of investor work for a large investor in Asia and the Middle East. We do the legal due diligence and negotiate side letters and work alongside consultants, and here I get the sense, even from the questions that I received from the consultants, that an enormous amount of due diligence being done. So, any serious investor investing in Asia is going to do a lot of due diligence, which adds time and a cost element to the investment investors should be aware of.

Hugh Dyus: For someone looking to get exposure to Asian private equity in a conventional way, my own view is that they should focus on specific niche segments of the market.

One would be buyout managers who are disciplined in sticking to control investments. The other one would be **early stage VC managers**. Those to me are the most attractive segments of the market, which are not polluted by the risks of growth capital we talked about earlier.

I would not do pure growth capital managers or the managers with hybrid strategies and a lot of growth capital in their portfolios. And then there are also more innovative approaches than just signing up to a conventional private equity fund.



Marc Lau: Hugh, just to clarify, when you talked about the challenges around growth capital in Asia, I assume the market you have in mind is China, am I right?

Hugh Dyus: Actually, China and India are very clearly the two markets which are predominantly growth capital markets. North Asia and Southeast Asia are hybrid markets.

Marc Lau: I do believe that one's view of the world is often colored by personal experience. Perhaps I was fortunate to have started my career in institutions that figured out how to navigate Asia successfully from the mid-90s with positive experiences across Growth Capital, Venture, and Buyout. Singapore's two sovereign wealth funds GIC and Temasek, have both invested larger and larger amounts in fast-growing companies in China, India and the rest of Asia, and have benefitted from that exposure. Temasek is by definition a minority investor in most of its deals and has the bulk of its portfolio in Asia. Their 40-year net track record is in the high teens. Our experience at Axiom has also been positive in cash on cash terms.

Going back to my original comment, each market in Asia is very different, and so you have to tailor your approach in each country to the realities of that economy and the private equity market of that country. Where are the opportunities? Where are the gaps? Where is the supply and demand of capital?



Countries like China where firms have historically made money, attract greater competition. You have to be nimble enough to switch your approach to these markets as well, whether that is taking a contrarian approach in certain vintage years or putting more money into sectors or geographies that are overlooked. We also need to monitor the macro factors, like disruption and technology, how are those changing the way people consume or do their business?

My advice to investors is this: **being on the ground is paramount.** Anyone that wants to invest in an emerging market like Asia has to be close to the developments on the macroeconomy, the supply/demand of capital, as well as regulations, as Anne-Marie has pointed out.

Alexandre Casin: I think Asia is ready to take on the innovative structures and to reduce this agency problem and addressing management fee issues or the non-distribution of cash – I think **special purpose vehicles** are a very good way forward, and we invest specifically through that. So, we believe a special purpose vehicle, single investment opportunities, are really a very efficient tool for LPs. It means better corporate governance, it is very transparent, but it means as well more work for LPs.

Robert Welzel: In addition to legal structuring and regulation, tax aspects are also relevant for investors and managers. The awareness and ability to provide transparent tax information is growing and recognized as an important feature to attract institutional investors.

Nevertheless, investors investing in Asian private equity are sometimes still lacking the information to establish a reasonable valid tax compliance. What is the inherent risk of noncompliance with tax reporting? For example, a German investor, lacking sufficient transparent tax data from the fund manager in respect to the underlying target investments and in case that the

performance is negative, this investor might even face the risk of a substance taxation. The potential risk that in case of economic nonperformance the capital contribution might be exposed to a tax risk will distract potential investors. An enhanced tax compliance taking care of these tax risk features will first mitigate such risks and secondly help to attract more European investors to invest in Asia private equity.

The mentioned alternative of listed private equity provides for some relief in respect of the addressed tax risk features as well.



Matthias Knab

Hugh, it's time to let the genie out of the bottle, how does the solution you talked about work, how does it address the structural challenges around investing in growth capital PE in Asia?

Hugh Dyus: In my career, I established Macquarie's Asian private equity fund of funds business. The best thing I did at Macquarie for my clients was to become a very active investor in the private equity fund secondaries market. I did that in the aftermath of the bankruptcy of Lehman Brothers. At that time, there was a lot of distress in the market and there were very few buyers of positions in funds in Asia. So, that was a good time to be an investor in Asian private equity fund secondaries. But over time, with low interest rates globally, there was less and less financial distress and many new buyers came into the market. The market opportunity in Asian private equity fund secondaries has become less attractive.

*However, because of the unusual characteristics of Asian private equity, one of the things I realized is if you invest in a portfolio of Asian private equity funds, you get much more listed equity than you think. And so, I took a detailed look and researched the portfolios of Asian private equity funds, and I found about **25% of all the underlying exposure that you get through Asian private equity funds is in listed equities.** And that arises in two main ways:*

Firstly, a private equity firm invests in a business when it is private and that business subsequently lists. In Asia, an IPO is normally a primary issue of new capital. It's not an exit event for the private equity firm, which may remain an investor in the listed business for several years after IPO.

Secondly, Asian private equity managers often invest in listed companies from the outset. That type of transaction typically happens when a manager is researching a private opportunity, they do their competitive due diligence and find a stronger company that happens to be listed. And so, they invest in a listed company from day one. Based on the research I did, *about 20% of all private equity deals in Asia are PIPE deals, namely Private Investment in Public Equity.*



This means that you get a lot of listed companies within Asian private equity funds. What we do is invest on a highly selective basis in companies from the listed portion of private equity funds through the listed markets. *We invest exclusively in private equity and venture capital backed listed companies in Asia. All these companies are portfolio companies within a private equity or venture capital fund, but they are all listed.* And we simply buy existing shares through the listed markets, effectively co-investing behind reputable private equity and venture capital managers on a selective basis at a time and price that suits us.

Essentially, I am using the same principles I used in the private equity fund secondary market, namely to only invest if the assets are of high quality and are available at a discounted price.

Applying those same principles to the public market, I look at the universe of private equity backed listed companies, and I try to identify high quality companies which for some reason are trading at low valuations. Low valuations are achievable where companies are not fully understood or appreciated by the market or where there is a known concern that the market is overly anxious about. Such concerns might be macro, sectoral or company specific concerns. That is the essence of the strategy we pursue. It is a way to get private equity exposure in Asia, but without a close-ended structure and without illiquidity risk as every underlying portfolio company of ours is already listed.

People often misunderstand what we do as “listed private equity” because they think of listed holding companies with a lot of private investments underneath. Those types of investment vehicle are very hard to understand and accordingly generally end up trading at discounts to net asset value. What we are doing is very different. We have a Cayman Island structure which is private, but open to investors, and every underlying investment is liquid and marked to market daily.

Matthias Knab

Let's turn to venture capital now. At a family office conference in Singapore, I saw a very interesting study from a Chinese university on the top 20 Chinese family offices. One slide compared the ten richest Chinese billionaires of 2018 versus 2007 and the industry or source of their wealth. While in 2007, seven out of the top ten made their fortune in real estate, and one each in photovoltaic, paper and retail household appliances, in 2018 seven were from different technology sectors. The country has now 476 billionaires, second only to the US, and the wealth creation, particularly from the technology side, is unprecedented.

Graham, I am curious to hear more from you regarding entrepreneurship and opportunities for venture capital?

Graham Leach: About four years ago, My University was approached by the Hong Kong government, sort of behind the scenes and quietly, to give them some input on what sort of emergent policy would be good for Hong Kong with the finalization of the **Hong Kong–Zhuhai–Macau Bridge**. Interestingly, about the same time, a fellow Professor in the Architecture stream had asked me almost the same exact question: “*How is the completion of that bridge going to change the dynamics of the South Chinese economy?*”

I worked with one our Associate Deans on this question for about six months, and we came to the conclusion that, with the completion of that bridge, the South Chinese economy would dramatically change in terms of its ability to Innovate.

Our angle on this was that it would create a circular economy that ringed the bay, from what used to be a chain economy. With the bridge closing the Greater Bay, all of a sudden, capital, ideas, people, all kinds of things could move much more freely around in a circular-type economy, and quite a large one – there are 130 million people in the Greater Bay area and billions of dollars moving around in there.

We called our idea the Innovation Roundabout, somewhat like the traffic pattern, and showed how it allowed resources to move around and around much more quickly than before. And indeed, we are now starting to see that happening, ideas are starting to bloom within the Greater Bay Area



now. The Greater Bay was very difficult to do business in before, without a bridge closing that final gap over the water. Now, things can really move, so the bridge is not only an architectural feat, it has also unleashed a lot of positive impact and economic momentum.

We talked about the wall of money in private equity, and, of course, here I am on the other side of the spectrum with these little **Angel and early stage deals**. On the venture side, the denominations are tiny compared to what you guys would normally be talking about. In this world, a \$10m deal would be a massive deal in my space. Typically, the teams I work with are just beyond seed investment, or maybe just past the Angel investor stage. They are usually looking for something between \$2m and \$10m, so it might not be even worth it for you to be looking at those deals considering the echelon of capital some of the people here are playing in. There is also the issue that there are hundreds or maybe thousands of these kinds of deals to sort through, so the issue for me isn't lack of deal flow – there are so many, you can't stay on top of it.

And, of course, qualifying them is very hard, because they are so early stage. It's hard to figure out which ones are together and going to make it, but the multiples are not 3X - the multiples in my space are 50X, 90X, 200X – massive multiples.

But there are lots of problems. A lot of the companies that I'm talking to don't even have an office. Their project might just be a bunch of people distributed around the world firing up a project, and then, all of a sudden, they get funded. Very often these days, the funding comes from a crypto millionaire who made money on Bitcoin or some other coin, and they just plug in a quarter of a million dollars worth of value to diversify their risk, or just get into something promising and exciting. The next thing you know, the project is up and running, it has a Minimum Viable Product and it is attracting even more money from prospective investors and even customers.

*I've seen a classic pattern emerge over and over in this space from the funding end: An initial quarter million dollars, then \$2m to \$5m dollars, or \$5m to \$10m dollars and the next thing you know they are starting to plan for their Security Token Offering, or STO – and they are doing all of this within a year or two. They develop significant funding and **achieve a liquidation event sometimes within a year** from concept to what we would normally call an exit.*

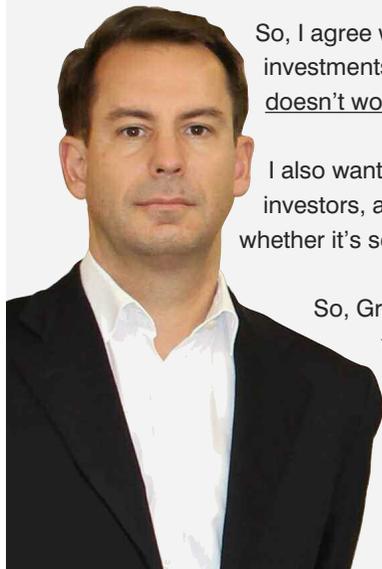
Yesterday we had a Blockchain conference here in Hong Kong, and there was a very interesting comment from a company which was talking about using Blockchain to kind of equip funds with the kind of liquidity I am seeing in the Blockchain world, and give the Limited Partners the ability to get in and get out of positions more easily by tokenizing participation in the fund itself.

This is great for LPs who want to get out, but there's still a fundamental structural problem with the whole VC concept. It's like you said Hugh, there's no way you can get out of a deal if it's a bad deal, because everyone wants out at the same time, which kills the ability to exit. So you end up dragging bad deals around like an anchor for a long time, or end up taking a bath on them and writing off the capital to get the numbers working again. The nice thing about VC-style returns is that you can theoretically payout because you are making enough multiples on your winners. But, the bad side is the bundling of dogs with stars. You have to have a fairly broad portfolio, because I think the ratio is like **19 dogs for one star...**

So, as a start-up guy – I have been doing this for 20 years and just came back from Canada, and I was just recently all over the US, in Dubai and in Malta – what I am telling you is the South China areas are incredibly fertile and driven. The deal flow is massive, though if you don't speak Chinese somewhat hard to access. And some countries are simply more active than others; Singapore, for example, is also an amazing jurisdiction for Innovation in terms of patents and capital allocation. What I am aiming to do with my Venture Fund is basically copy the results of Temasek, which is an incredible organization in terms of its returns and ability to capture and drive Innovation.

The region and particularly China are producing a just colossal amount of Innovation, but there is also that difficulty getting your hands on money for Innovation, because there is a certain amount of cultural risk avoidance, and property speculation here has rendered spectacular returns on a very low-risk basis. So I feel there is an opportunity for Venture here, because Venture is currently a somewhat neglected area of the local economy.

Alexandre Casin: I'll share what we are experiencing in VC through You and Mr. Jones. One investment is Niantic Labs, which is best known for developing the augmented reality mobile games Ingress, Pokémon Go, and the upcoming Harry Potter: Wizards Unite. High returns come from initial selection and participation to all rounds.



So, I agree with Graham, it happens in the region and in this environment. Looking through the lens of our investments, we found that, in our case, 20% of the portfolio really makes outstanding returns, 20% doesn't work and the rest is okay, but this is sufficient to generate a 30% IRR.

I also want to come back to how this space is organized. In the US you have great VC and private equity investors, and then there are also hybrid types like us with a strong industry knowledge. We are agnostic whether it's seeding, VC or whether it's late stage.

So, Graham, one way to go about this challenge of getting access to capital is to find out these new type of specialists which you can find even within the more established firms which operate sector verticals of different types of risk capital and that can allocate with a more flexible approach.

Talking about trends, I also do see more international funds coming here.

Hugh Dyus: There is no doubt that the wealth creation from technology enabled business models has been enormous in China, and I want to share some thoughts about why this has been so successful. Firstly, there is the large scale and the relatively homogenous nature of the Chinese market. Secondly, in areas where you don't have any existing or legacy infrastructure, then the latest technology can be easily adopted with less resistance, allowing one to leapfrog stages of development. Thirdly, the cost of a smart phone is so cheap in China that smart phone ownership is widespread. These factors have helped facilitate massive wealth creation in China from technology enabled businesses.

I did comment earlier that one of the spaces I thought was attractive was early stage VC. Of course, there are many different stages of VC. In some, there is too much money for too few deals and in others, there is too little money for too many deals.

I think that at the moment, there is a shakeout in the VC sector in China. The amount of capital that has flowed into the industry because of historic successes has dramatically increased over the last few years. Whenever you have a market which attracts increasingly large amounts of money, then valuations go up dramatically. However, the amount of new money now available for the industry has started to dry up. As a result, many businesses are starting to tighten their budgets, there are rounds of layoffs, and people are now much concerned about their burn rates.

One of the things that has always impressed and scared me at the same time is the willingness of PRC entrepreneurs to burn a huge amount of money over a long period of time. In some cases when you look at it over the long run, you'll say, "Wow! That was brilliant because you have created something with a large user base that couldn't otherwise have been created," and in other cases, it's just a bottomless pit. So, how do you predict in advance which is the bottomless pit of wasted money and which is the kind of business model that becomes the next Tencent or the next Alibaba, that is very hard to say. But definitely, right now in Chinese VC backed companies, there's a lot of belt-tightening going on because fresh capital has become scarcer than it used to be.



Brian Lau: If I were an investor and I had to do VC in Asia, I would focus on mobile internet based ventures in the Shenzhen area and Beijing area. The ecosystem of the mobile deployment that is used in the new economy – the online world is so prevalent in China – is incredible.

I have colleagues who are very successful VC investors with large funds, and they don't want their fund to be too large like a multi-billion fund, so they have capped it, and demand for their funds is incredibly high.

We all know that there are some good investment opportunities out there, but how do you source the really good ones? So I asked him how he is sourcing and finding his deals? He has made some very well-known investments in the past, and so what

he told me was, *"Once you are in this ecosystem with CEOs and entrepreneurs, they just hang out with each other. They talk to each other and they refer."* All his deals are through referrals from CEOs of his portfolio companies which range from seed money, venture, capital and ownership stakes. He says the amount of deals he is seeing even from a pure referral perspective is just incredible. He does none of it in Hong Kong, it's all in Beijing and Shenzhen.

I mentioned to him that it's like Silicon Valley and he goes, *"Yes and no. It's yes in terms of the dynamism, the volume, but no because it's not the US, it's China and that China has its own VC mobile dynamic and players, and ecosystem. So, if I'm an investor, I'll look for a good manager in the VC space and if you can get into their fund, I think this is a space where the good get better by participating."*



Graham Leach: I've got a friend in Hong Kong who runs an Asian frontier fund, so he focuses on Vietnam, Cambodia and places like that; really emerging markets.

I am wondering to hear your perspective on those emerging markets where you may have regime risks, the infrastructure is sometimes really not all that well developed, the legal and banking systems can be lacking and sometimes dominated by ruling families that can make your life hard if you don't play the game according to their rules. I am wondering about your views?



Brian Lau: We don't do invest in these markets as we think that for a Myanmar, Vietnam or a Thailand investment, a local manager would probably be to a certain extent more successful than us. We focus on Pan Asia deals which means it doesn't matter where it's headquartered, but its revenue, manufacturing or presence cuts across the supply chain of Asia, so this generally tends to be clustered around a number of manufacturing sectors. Taiwan, the Taipei area and the southern part of Taiwan, Tianjin, Shanghai, Suzhou, Zhengzhou a little bit, Guangdong area, Singapore, Johor, Penang and a bit of Thailand.

Looking at the markets you have mentioned, I think there is country risk and pricing risk. Maybe Korea was a great place to invest 10 years ago from a country perspective, but I think it's very expensive now. We felt that to invest in a country only, even Japan or Korea, we needed to be there, but we are not Japanese nor Korean.

So we stick to Pan Asia serving multinational customers, but with an element of growing



domestic market, and that cuts across many different industries, so there is also enough diversification. I wouldn't know how you handle the country risk if you were truly investing in Myanmar or Cambodia. There's political risk, your fund can basically get shut down. As a GP, that's a high risk. Now, if I were going into a fund of funds, that's a model that addresses those risks, but we have specifically focused on Pan Asia investment.

Marc Lau: One angle to Graham's question can be found in capital allocation. We cannot avoid risk in this business, but generally, you would allocate more dollars to things you believe display a more attractive risk and fewer dollars to the ones that are more "risky". For countries where the exit markets are not so proven and whose capital markets are still in much earlier stages of development, you are probably better off doing something like what Hugh is doing, investing in attractive companies that have already gone public.

Investors have typically a hierarchy of opportunities they can attack, and there are many different opportunities in Asia, but you would always prioritize on an individual basis the capital that you deploy across those opportunities.



Hugh Dyus: The most important thing when you invest is assessing the magnitude and probability of upside potential versus the magnitude and probability of downside risk and that depends more on the underlying granular opportunity and less on whether one country is better to invest in than another.

I personally would never invest in a single country frontier market fund, particularly through a private equity fund structure because I think it is extraordinarily risky, and you don't have to take that risk. You can get more upside for less risk somewhere else.

Alexandre Casin: We mentioned that there are huge opportunities in the digital consumer space, and these are global opportunities. Digital plus consumer, that's where it is, and from that perspective, it's irrelevant where the Intellectual Property originates. Digital plus consumer is global. In order to solve this issue of local opportunities, just look for scalable business models with knowledge and fantastic human capital, and a business model with global scaling characteristics.

Anne-Marie Godfrey: The frontier markets carry their own set of risks, we mentioned some, but there are also anti-money laundering risks in terms of who you are doing business with, corruption issues – from my perspective as a lawyer, it just seems like there's no end to the legal risk involved in investing in a single country frontier jurisdiction.

Marc Lau: As I've said before, let's not forget that markets change over time. It wasn't too long ago that China was considered a frontier market. If you had avoided that frontier market at that point, then you would have lost a lot of very good returns that came out in the early 2000s, across a whole range of businesses.

Many of the large global PE firms such as Newbridge, Carlyle, and so forth, came to Asia as early as the late 90s and made a lot of money investing in financial services in China. At that time, the markets and the exit path also weren't clear. In fact, the domestic "A" and "B" shares in China had yet to be restructured and were not tradeable offshore. So, markets change with time, and at some point, you have to make a call on when you think that market is going to be deep enough.



One statistic that surprises many of our US and European LPs is the sheer concentration of people in China's cities. A medium-size city in China has 1 million people, and there is something like 270 or 280 cities where the population is more than 1 million people. This is a large reason why venture does so well in China. Ideas can gain traction extremely quickly and you don't have to go very far before you actually have proof of concept and scalability.

Alexandre Casin: We can illustrate Marc's point about the size and speed of China with one live example. We invested in a seed round in July 2018 in a company in China. The pre-A round took place 5 months later at 4x, and preparing the A round at substantial premium. The underlying business has done very well in the period and has great prospects.

The Europeans are usually surprised by such things, but when the addressable market is very simple, and if you are addressing a need in the right way, then the roll-up opportunity is massive. As we discussed, you can test locally, and once you get it right, then the opportunity set is massive and it can go very fast.



Marc Lau: I think Alex made a very good point, China has scale and ambitious entrepreneurs. I disagree, however, with the characterization of China as a homogenous market.

A case in point is e-commerce. A few years ago, PE-backed companies that did well in e-commerce, were the likes of Alibaba or JD.com, catering to the richer, 1st and 2nd-tier city customers that consume bigger ticket items.

But in recent years, there have been more and more platforms that cater to the growing spending power of people who live in 3rd and 4th-tier cities. *Pinduoduo (PDD) is a good example of a firm that targets these consumers. The company went from zero three years ago to become the third largest e-commerce player in China. They did this by selling larger quantities of cheaper goods on its platform rather than having fewer expensive items. This is quite astonishing considering it took JD almost 19 years and Alibaba 20 years, to accomplish the same feat.*



My point is, even in big competitive markets like China, where there is a lot of venture capital money, a lot of growth capital, and an increasing amount of buyout-focused capital, there will always be opportunities. Smart investors just have to look in the right places to pinpoint the areas which are underserved.

Graham Leach: I have to ask for forgiveness as my question regarding country funds was actually a bit of a trick question, and I actually agree with you that a country-based fund seems a little old fashioned of an idea now considering that we have got ubiquitous global communication systems penetrating just about every country in the world.

Tomorrow morning at 10:30, I will be teaching a globalization course and the message that I'm projecting to my graduate students is this: Once you open a business in a digital economy, you are, by default, a global business and somewhat location-less, which today is one of your competitive advantages. I'll give you a quick example. Something like 2.3 million people play games on their phones now. So, if you have a hit game from Finland like Angry Birds or from Vietnam like Flappy Bird, you can have a million users in a month, all paying you in what amounts to instant liquidity.

My invitation to all aspiring teams and entrepreneurs is to come to Hong Kong to incubate at the Science Park and then find a Chinese partner to roll out that idea within China once they have proven it in Hong Kong. Of course, you cannot roll out digitally only, so there is a certain element of localization no matter which country you go to. And then you have a global company – but if you really want to hit a home run, you will always need a certain amount of local content. You need to be able to resonate with the local identity, whatever that local identity happens to be. It could be a messaging question, it could be the name, it could be the color choice, but right down at the ground level, you need somebody who's pretty in touch with that local community to start your roll-out. That's why partnering makes so much sense to me.

So, there is this very interesting mix with the abstract idea of a location-less company and scale-free opportunity, but when it comes down to the nuts and balls, you have to be local as well and deal with the tax regime or the legal regime.



Hugh Dyus: Allow me to come back to the point why all of us here are pointing to China and the massive opportunity for startup companies in its digital economy. We mentioned the homogeneity of the country, and, as we all know, there are also major differences between different parts of China. A key question is how easy it is to expand a proven business model from one part of the country to other regions.

In China, if you have a business concept that is proven to be successful say in Shanghai, the probability you can roll that out nationally to other big cities is actually very high. By contrast, the cultural and linguistic barriers across different parts of India are higher. So, if you have a proven business model that works in the South of India and you try to roll that out across the whole of India, the likelihood that you will fail is quite high. This ability to scale up very fast in China is something that helps explain the more explosive rates of wealth creation you find there.

Let me add another observation regarding rates of wealth creation globally which I think is quite important. I took a close look at the Forbes list of billionaires, the number of new billionaires and the combined wealth of the billionaires across the different regions – North America, Europe and Asia. There is no doubt at all that wealth creation in Asia is extraordinarily rapid.



*In Asia, the number of new billionaires is growing at a faster rate than other parts of the world and their combined wealth is growing at a faster rate as well. But, if you invest in listed equity markets in Asia, your long term returns from investing in listed equity markets in Asia have lagged GDP growth. At the same time, these billionaires are getting wealthier much faster than GDP growth. If you think about that, this is a puzzle. Why are the controlling shareholders of listed companies accumulating wealth at a much faster rate than investors buying shares in the region's stock markets? This points to another issue and structural challenge of investing in Asia, **that standards of governance in Asia are poor** compared to North America or Europe. Or in other words, the people who control listed*

businesses in Asia are better at making money for themselves than for their public shareholders.

The ways they do that can be very subtle. Related company transactions are of course one way of transferring wealth, but it can happen in many other ways, such as the timing of an IPO, when they buy shares back and when and on what terms they inject a business into the listed entity.

I think that anyone looking at investing in the listed markets in Asia needs to be very conscious of this issue and should develop an approach to try to invest in companies and behind people where you as a public market shareholder are likely to get a fair share of the wealth that is created. I can tell you that if you objectively look at the quality of some listed businesses and at their valuations, there are some very strong businesses generating very strong cash flows with very cheap valuations. But that can be completely rational, because the market or the informed investor knows that the entrepreneur behind that group is not going to give you a fair deal.

Matthias Knab

This is a good point and also an argument for active asset management as opposed to just using passive vehicles when looking to invest in Asia.

Marc Lau:

Right, we have to thank Hugh for his strategy because he only invests in listed companies that are owned by private equity funds, which means by definition, that **private equity is a good governance factor for investments** that he is making and from that perspective a positive influence on the market.

Hugh Dyus:

You are right, Marc, *I actually see the private equity player in the companies we invest in as a policeman whose job is to keep the controlling shareholder honest. I don't think that they are always successful, but I think where you have more policemen, you have less crime.*

Marc Lau: Graham made a good point about the need to **localize your business**, even if it's global. You can see a simple example just by comparing Ctrip versus Trip.com (both owned by Ctrip). They both have the exact same backend, but if you compare the front pages, they are completely different, because they target entirely different markets. In China, webpages tend to be busier and much more complicated with lots of information, something Western audiences are not used to.

Country differences are huge in Asia, and that's why local knowledge is important. Sometimes even within a country – see Hugh's point about India – there can be fundamental differences. This is one of the reasons why we have such a large investment team that speak all the major languages in the region.

From that perspective, local knowledge on how the systems work and also who to do business with as opposed to who not to do business in terms of governance is extremely important. From that perspective, there is immense value in a country-focused fund or in a local player.



I often come across investors that demand a risk premium just for investing in Asia. We shouldn't lose sight of the fact that corporate governance is an issue globally, not a uniquely "Asia problem". The options backdating scandal that happened a number of years ago was a very widespread abuse in the US impacting the New York Stock Exchange and NASDAQ. So I would say that there are corporate governance issues and pitfalls in every market.

Also in taking companies private, you can face regulatory risk, hidden risk, and liabilities. If you want to make money in that market, you have to make sure that you have the best advisers who understand the local landscape, in order to avoid the pitfalls.

I actually believe that most of the money made in private equity is done by avoiding losses. There is undeniable growth in Asia, and so that rising tide will float the boat, what you need to do is to stay away from the zeros and the losing trades.

Brian Lau: Over the last six years, we have privatized three companies from the Singapore stock exchange. The founders owned 40% of the company and this made it difficult for them to exit. We were able to privatize these at 60% of book value. We ended up buying very good companies by looking closely at the value opportunities across the entire company. Sometimes it was a key technology, other times it was several key customer relationships, and often it was analyzing the value presented on the balance sheet and their own inefficient use of cash.



After privatizing we brought a lot of additional governance to these portfolio companies so that they are run at international standards. This includes the management governance, the management professionalism, internal audit, and remuneration. We improve these companies to a point where a multinational can come in and feel very comfortable in acquiring the business.

Hugh Dyus: When we talk about public and private markets, allow me to add that I think the proposition that the public markets are efficient is a laughable proposition.

I'm amazed when academics talk about it, particularly in Asia. Just over the course of one month, stock prices can fall by 50% or double and to say both prices are right at each point in time, to me, that's laughable. The fundamental value of companies does not change so quickly in the absence of surprising fresh information.

Alexandre Casin: I have a question on the LP structures. Have you seen a trend with preferred shares, various slices of funding, hybrid capital? Is that a sophistication that you have seen in Asian transactions?

Brian Lau: We don't see a lot of sophistication when it comes to capital allocation or the types of shares. Generally, the privatizations we have done or seen involve a block of shares where you can get enough to take a majority, and then do a general offer, or in some cases get an exemption, but generally do a general offer at 20% to 30% premium, yet still at quite a discount to that book value. The privatizations we have seen, not just our own but with other PE players as well, have not required the use or availability of that sort of specialty class of shares or hybrid ways of doing things.

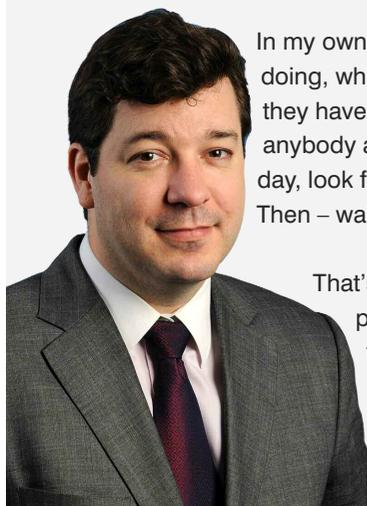
Hugh Dyus: *I have a view that over-engineered transaction structures don't work so well in Asia. You just need to get some very basic things right – the ethics of the entrepreneur, the alignment of interests between the parties, is it a quality business, the valuation.*

When you over-engineer it, the extra bells and whistles you are putting in give you an extra sense of protection that may be illusory. Growth capital managers have added a whole range of things which they believe give them downside protection – investments structured as debt convertible into equity and theoretically repayable if not converted; put options promising minimum rates of return and guarantees from the founder that they will stand behind various promises – all sorts of fancy structures. Those structures definitely help to get a deal approved by the investment committee, but when the investment goes wrong and you try to exercise your rights and get your money back, you often find they do not work in practice. Fancy documentation cannot save a bad deal.



Graham Leach: Hugh, I agree with your assessment in terms of the market efficiently pricing assets. In one of the classes that I teach, we talk about **homo economicus**, which is supposed to be some sort of theoretical Spock-like creature who can price anything instantly and reflect the price of that normally.

And a lot of academics tend to think that this creature, which basically emanated from the writings of John Stuart Mill back in the 19th century, exists somewhere. This is directly opposed to the ideas of Benjamin Graham, who in the post-war period suggested that in reality there is “**Mr. Market**”, a hysterical manic depressive person who overreacts to everything. At the sign of any bad signal, he sells everything he owns, including his house. On any good signal, he buys everything in sight, on credit if he has to.



In my own personal investment strategy, I think I am maybe mirroring what some of you here might be doing, which is to look for underpriced but fundamentally good, sound companies, with the caveat that they have to be well-governed. That has been a very successful personal strategy for me. I don't think anybody at the table is going to argue with it: Find a good company, run by good people, it's had a bad day, look for crazy Mr. Market people who are dumping it and buy at whatever discount you can negotiate. Then – wait a while and the cream will naturally rise to the top once again, and then you can exit.

That's been very successful for me for the listed markets, however, we also know that the venture properties that I am looking at don't have a trading history, and often they are more of a theoretical company than a real company. And so, the criteria I use in this context is somewhat different – what I am looking for in those companies is a great idea that's not constrained by physical means, run by a good team.

Hugh Dyus: I would agree with you and Benjamin Graham that indeed many Chinese retail investors are hysterical, manic depressives who invest with borrowed money. When the market falls, many of them have to meet margin calls and that can result in irrationally selling down very high-quality businesses to surprisingly cheap prices.

Matthias Knab

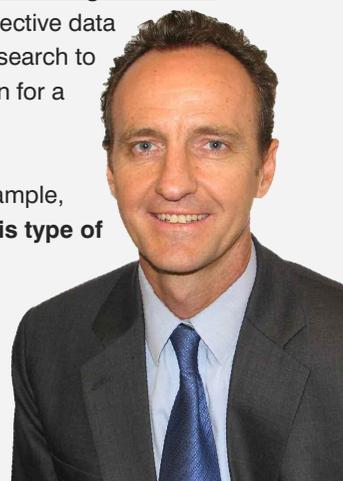
Final question: In your own research and investment process, how much of that is technology supported, and how has the use of technology changed over the past couple of years?

Hugh Dyus: We monitor a universe of stocks which is large. We do use artificial intelligence or a quant program to monitor all relevant information in real time. Share prices are changing all the time, the fundamentals of companies are normally updated quarterly or maybe semi-annually. Our program monitors all the companies in our universe based on quality of company factors, valuation factors, quality of the underlying private equity sponsor and other factors like that.

For us, technology is hugely helpful, but we don't let the technology make any decisions. Many wealth managers in China use robo-advisors which they are selling to their clients, and the programs actually make the buying and selling decisions. We, on the other hand, use technology to shine a spotlight on those companies which on the basis of objective data and ratios are high quality companies available at attractive valuations. And then we do deeper research to try and confirm that it is indeed a high quality business and that it is not available at a low valuation for a good reason.

We can very often find a good reason why something is cheap and then we drop the idea. For example, the controlling shareholder may not be trustworthy. **Artificial intelligence struggles to assess this type of thing.**

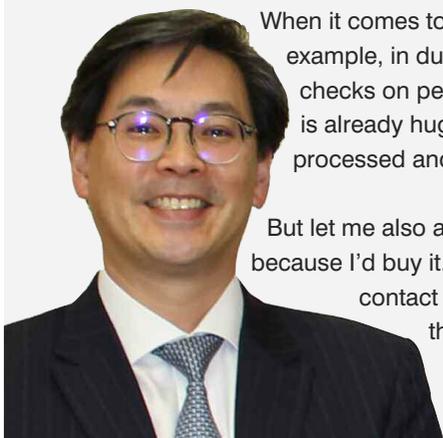
We also use technology-based algorithms in our trading based on our objectives. So, technology is an important part of our business and I think will increasingly become so in the investment business.



Brian Lau: I had mentioned that all our deals come through either introductions or referrals, also from service providers such as accountants, lawyers, or from the owners and entrepreneurs as people know us as an investor in certain types of company.

When it comes to technology, the ways we complete a deal, technology is very highly involved. For example, in due diligence, there's a social media element when we use investigators to do background checks on people or when we gather information on competitors. And while the available information is already huge and keeps growing, at the same time, the speed at which this information can be processed and robustly analyzed across many toolsets is impressive.

But let me also add that there isn't one silver bullet. I wish there was a deal sourcing silver bullet app because I'd buy it. And, let me also add that in our space, the relationship-driven deal sourcing and the contact or rapport with an owner that wants to sell to you remains a key part, and by supporting the other important aspects of our business, technology helps our firm in a significant way.



Alexandre Casin: We look at the convergence of digital technology and the consumer, which to us is a very large opportunity. So, technology is fully embedded in everything that we do. We use more technological tools to assess, quantify, evaluate and benchmark.

When we look at future opportunities on the investment side, we are looking for companies that are great because we believe they leverage technology. We should do the same thing ourselves in order to be successful: understand, invest in and use a lot of technology.



Graham Leach: Of course, while technology is fundamental for companies and what we do, we also have to keep looking at the other side of things: Where and how humans are driving these organizations.

We have to pick the right people to drive the idea forward and into growth. You can't just do that on the numbers because people can game the numbers, and the numbers sometimes don't capture everything you need to base your investment decision on. There's always the Human Factor to take into account, regardless of whatever investment you ultimately make. It's people who make a company – or break it.





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Links

Opalesque.TV video which got 104 views over 2016 Christmas:

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