

T&I ASIA

CHINA SPECIAL REPORT : Beijing



Participants from the Left: David Lam, W.I. Harper; Steve Cowan, 57 Stars; Simon Eckersley, Hao Capital; Ming Yeh, SVB Capital; Bill Li, Walden International; Annabelle Long, Bertelsmann; Vincent Huang, Pantheon; Eric Mason, Church Pension Fund; Rocky Lee, Cadwalader, Wickersham & Taft; Cheng Wang, Guardian Life.

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December, 2010

Capital Raised:
USD89,250,000

IPO Share Price:
USD17.00/Share


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SemiLEDs Corp.

INITIAL PUBLIC OFFERING
NASDAQ: LEDS

Underwriters:
BofA Merrill Lynch, Barclays Capital
Inc., and Jefferies & Compay, Inc.

A WI HARPER INVESTMENT

WI HARPER GROUP

SAN FRANCISCO | TAIPEI | BEIJING

April, 2011

Capital Raised:
USD195,000,000

IPO Share Price:
USD15.00/Share


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21Vianet Group, Inc.

INITIAL PUBLIC OFFERING
NASDAQ: VNET

Underwriters:
Morgan Stanley & Co. International
plc, Barclays Capital Inc., and J.P.
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A WI HARPER INVESTMENT

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April, 2011

Capital Raised:
CNY950,000,000

IPO Share Price:
CNY38.00/Share

EDAN

Edan Instruments, Inc.

INITIAL PUBLIC OFFERING
SHENZHEN STOCK EXCHANGE:
300206.SZ

Underwriters:
Ping An Securities Company Ltd.

A WI HARPER INVESTMENT

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T&I China Special Report. Beijing. Session 1 of 3.**VINCENT HUANG, PANTHEON CAPITAL:**

I'm Vincent Huang from Pantheon. We're a global fund of funds, and the fund of funds of longest standing here in Asia. We've been investing in Asia for almost 20 years and have had an office in HK since 1992. I joined Pantheon 7 years ago and been responsible for the emerging parts of Asia, primarily China and India. Most of what we do here is investing in private equity funds. We're seeing a lot of the fly-in investors, probably the same number as in the 2007 to 2008 peak period. Meanwhile, there is an emergence of new RMB investors. I think that for the



GPs who are competing in the market, you probably see this first hand. The valuations for deals have been bid up by a lot of the new RMB funds and that is the biggest change from three or four years ago.

CHENG WANG, GUARDIAN LIFE:

I'm Cheng Wang with Guardian Life, based in New York. We invest from the insurance company's balance sheet capital. We look at investing in China from an historical perspective and from the returns point of view, all you have to do is to return 2X to your LPs and you've made it into the all time top quartile of funds in China. Relatively speaking, you must have a premium structure, because you need a premium over the returns of the fixed income indices. From there, what is a premium and what should be the premium will always be an issue for discussion because LPs always



have an option for investing in public securities and so we have to find ways to compensate for the illiquidity of private securities. That said, and in this environment, people are still expecting a compound rate of return of 15% or more, from the PE fund side.

ERIC MASON, CHURCH PENSION FUND:

I'm Eric Mason with the Church Pension Plan which is a defined benefit plan whose ultimate clients are retired priests and lay workers of the Episcopal Church. I work for

an investment management team within the pension fund managing global assets of about 9 billion dollars. We've been investing in Asia since early 2000 and in alternatives since 2004. Across Asia we have a portfolio of over 20 managers, mostly in PE and private real estate. We're now looking at hedge funds and public markets in Asia. We cover all asset classes from Hong Kong in coordination with the team in New York City. Last year we had one of the best years for distributions from our private equity portfolio. What's interesting about that and what validated the Church Pension Fund's point of view, is that a significant portion came from Asia with a high level specifically from our China investments. We've always taken a long term view for investing in Asia and we've been pleasantly surprised to begin to get liquidity events from Asia. We've begun seeing solid, albeit largely unrealized returns from Asia. While 2010 liquidity may have been the result of a backlog of investments, I think that we're going to see a good first half of this year as well. I first came to Beijing to study and teach in 1990, and where I spent three years, before attending graduate school. My professional career was with JP Morgan and Carlyle Group in Asia focused on PE and debt markets before joining the Church Pension Fund. I want to comment a bit on Cheng's point about the liquidity premium in Asia, which I think was interesting, because we're looking across all the major asset classes of PE, private real estate, hedge funds and public equity. As a result we need to benchmark against the relative risk-return in all these options. I have to be a bit careful since I'm learning a lot about the evolving nature of hedge funds and public market managers here particularly post 2008. However, as a general rule there is probably less liquidity in these markets than in developed markets. We are seeing a range of structures that are almost hybrid between traditional public funds and PE. For example, even managers in public markets are often looking for longer lock up periods and even though these are public investments, the actual levels of liquidity in domestic public markets in China and India can be quite low especially for smaller caps. In China, there is added complexity of with regard to the regulatory friction in getting money in and out. So while I absolutely agree that you've got to be compensated for the illiquidity of private



equity, it's interesting to note that you almost have to compensate for the illiquidity of public equities in Asia as well (laughter).

GUARDIAN LIFE: Which is why I was unwilling to put a label on the premium side. (more laughter).

CHURCH PENSION FUND: Likewise we're careful in how we break out our return expectations because I think that many of us as investors, at least to some extent, have to be considered as one pool of capital.



DAVID LAM, WI HARPER: As the first GP to speak today, I hope that I'm not merely repeating history here. I'm David Lam. WI Harper is one of the earliest venture capital and private equity franchises in greater China. We've been investing in China for over 15 years and we're currently investing from our 7th fund. With respect to the question asked by the moderator about outbound investment from

China, our firm has always had a focus on cross border investments, though initially this was more between the US and Taiwan with a strategic presence in Beijing. Over the years, we've been building out our presence here in Beijing. Today, Beijing has more than half of our investment team, while we have strategic teams in Taiwan and the US. With respect to China outbound investments and the interest of Chinese firms to invest in the US, I think that it's clear that the US continues to be [the] place for innovation, especially in the sectors that we cover: healthcare, clean-tech and tech. Today, the types of investments that we see are very attractive are, first, investments that are US technology companies that have China as their potential end market or who have substantial staff there, where we can work to bring them out to China. Second, on the flip side there are companies that we invest in here in mainland China that are looking to expand internationally. Because we have roots outside of the mainland, in Taiwan and the US, [we feel] that Taiwan can be a great gateway to Asia and the US to other parts of the Western World. We've found opportunities to partner with companies in China that are selling into global markets that can leverage our resources. Stepping back for a moment, one thing that I wanted to comment on is Vincent's remarks about valuations

creeping up, and that is absolutely the case. You can see this with the public markets heating up in China. At the end of the day, for a firm like us, our capital is the most expensive capital out there. All of us here today, for the most part, are investing from US dollar denominated funds. Why do I say that we're the most expensive? Because if I'm a profitable company, with cash on the balance sheet and I need money, I can borrow it from my local bank. I can also work with an RMB denominated fund where capital is put to work much faster, and in some cases, though not in all, the deal terms are a lot less cumbersome and valuations may be more attractive. But when we, or some of our peers approach [deals in China], our capital takes the longest, because we have to register our capital with the Chinese government. We learned that with one of our first investments from WI Harper Fund VII, that the registration process can take on a life of its own and take a long time. So our capital moves slower and our valuations are more aggressive because we are financial investors. When entrepreneurs are looking at the time [and process], including registering the capital and due diligence, they really see foreign capital as being more expensive. We really have to stand out as investors, not just relative to our peers, but relative to all of the ways that entrepreneurs can raise money today, and that is by adding value. This puts pressure on this industry and GPs like us to insure that we can add value to our companies, because if we don't then we're only competing based on price and that's not going to work.



STEVEN COWAN, 57 STARS: We too are a global PE fund of funds, investing outside of the US and Western Europe, which means that the market traditionally describes us as an emerging markets private equity fund of funds. We have four offices around the world, and, recently, we changed the firm's name from PCGI. Formerly, we had Pacific Corporate Group as a shareholder and we bought them out last year. The firm has been in business for six years, but prior to that most of our senior team worked at the Overseas Private Investment Corporation, so we've been investing in emerging market private equity funds, including in Asia, for collectively around 100 years or so.

SIMON ECKERSLEY, HAO CAPITAL: We're not known very well, though we've been around for five years. We manage two funds. A first fund of about \$100 million which is fully invested and which has so far paid back 75% of the capital we drew down so this fund should be fully paid back by the end of this year. Our second fund of just over \$400 million is 65% invested with the first exit for the fund occurring through an IPO at the end of last year in Hong Kong. We're considering raising our next fund at some point later this year or early next year. We manage growth capital funds, purely China focused and our LPs are primarily



from the US and Europe, a mixture of individuals and institutions. Our recent IPO was Pax Technology, the largest point of sales machine producer in China, with a 35% market share, which IPO'ed on the Hong Kong Stock Exchange; it's an investment from Fund I and Fund II.

T&I: Your sense of Hong Kong exits this year?

SIMON ECKERSLEY, HAO CAPITAL: In terms of IPOs it doesn't necessarily matter how well a company's doing. The success of an IPO is a function of how well the public markets are doing, what the reception is, whether enthusiasm is there by investors and how they're feeling about the public markets. At moment, things are not necessarily overly positive in public markets. There was an element of forced-feeding at the end of the Q4 last year which is causing some regurgitation, so we need to wait for a bit more stability.



T&I: Vincent comment on the role that hedge funds may play in terms competition for investments in China?

PANTHEON: We don't invest in hedge funds like some of our peers do, however, I have friends working in the hedge fund industry, who were very active in '07 to '08. At one point many hedge funds were setting up private equity arms that were competitors for our GPs, same as the prop desks at investment banks. But in the two to three years since then a lot of hedge funds ran into liquidity problems and

therefore they had to retrench, cut back on a lot of their investments, selling their positions. We saw a lot of those teams dissolved or moving along to do something else. There is now another wave of them coming back, setting up hedge fund operations in Hong Kong or China. I personally believe that they're more realistic now, looking for short term returns on liquid investments, rather than long term lockups in PE investments of 4 to 6 years so they represent a different type of investment style compared to before. If you combine this phenomena with the fact that there are RMB funds looking for short term flips, that's why pre-IPO valuations are being driven up. And this is why we believe the least interesting segment in PE for is in late stage, pre-IPO investments; because the efficiency between public and private markets is very high now. So in our case, we're either going to move into either earlier stage or more specialized investments to gain above average returns.



MING YEH, SVB CAPITAL:

I'm Ming Yeh with SVB Capital which is the venture capital arm of Silicon Valley Bank headquartered in California. SVB Capital has about \$1.4 billion to invest globally and we came into Asia around 2000, mostly through investing US dollars into different PE funds. In late 2009 we set up two RMB funds, together with the Yangpu district of Shanghai, which was one of the first RMB fund of fund vehicles here in China and that vehicle has invested in five funds. Our focus is on two sides; one, we have well established relationships here in China through our US dollar practice, so we leverage that. A lot of the US dollar GPs that we work with are considering raising RMB funds, so that's an obvious leverage point. The other leverage point is that Silicon Valley Banks' model is to provide financial services to early stage companies and there we have a wide reaching network, with earlier stage local, RMB domestic GPs. But for our portfolio we want to build out RMB relationships with both early stage and more established later stage GPs from the US.

GUARDIAN LIFE: You provide VC lending to local GPs?

SVB CAPITAL: We currently do not have an RMB banking license, so if you're a US dollar GP, yes, we can still offer all of our offshore dollar products and services. But if you're

an RMB GP and you need RMB credit line, at this point we can't do this, but we filed for joint venture domestic banking status at the end of the year 2010, together with the Shanghai Pudong Development Bank, and hopefully once that license is granted then we're able to provide all of our products and services to our RMB GPs as we do for our US dollar GPs.

CHURCH PENSION FUND: The RMB funds that you invest in, are those typically RMB funds that are managed by dollar GPs who have a parallel structure or are they pure local RMB funds, or a combination?

SVB CAPITAL: Of the existing five funds that we have invested in, three are what I would call US dollar GP teams that manage both RMB funds and US dollar funds; they're names that we all know. Two of them are local GP teams that do not have US dollar funds, they're pure RMB GPs.

CHURCH PENSION FUND: And of those who are pure RMB funds are you seeing any of them that are now turning around and wanting to raise dollar funds?

SVB CAPITAL: Yes, definitely.

CHURCH PENSION FUND: That is one of the common themes we hear about among the LP community in Asia.

SVB CAPITAL: I think so. I think that this market has demands for both currencies and it means that the dollar funds want RMB and the RMB funds wants dollars. And if they can raise both why not? At the end of the day, entrepreneurs like to pick and choose, so a lot of GPs feel that in order to stay competitive they need to have both. I see a lot of the RMB funds wanting to raise dollar funds. But the RMB GPs have not broken into the institutional realm of the investment market place of the US dollar fund of funds.

HAO CAPITAL: Have RMB GPs have broken into the RMB institutional market, or is that still nascent as well?

SVB CAPITAL: I think that they're just at the beginning of doing this. I know of a couple of RMB funds that have successfully raised capital from institutionalized offshore LPs, but it's a very small subset.

PANTHEON CAPITAL: What do you see as differences for terms and agreement between RMB and dollar funds?

SVB CAPITAL: Ah, the terms for RMB funds are lousy (laughter from room).

CHURCH PENSION FUND: For whom?

SVB CAPITAL: It really depends, so if we were really were talking about an RMB fund being raised by US dollar GPs, then the terms for the RMB funds tend to be more similar [to their US dollar fund terms], more like what we here at this table are used to seeing. But in general, RMB funds tend to have shorter investment periods, shorter term life and profit distribution is slightly different. But we're really trying to tell the marketplace that we're looking at investing in RMB funds from a completely institution-alized, professionally managed viewpoint. At the end of the day, we're here to make money, so the terms have to make sense for us to invest. Even if you're an RMB manager and there are different market terms for RMB funds.



T&I: What specifically is "lousy" for the terms?

SVB CAPITAL: Deal by deal carry is one. Shorter life for funds is another. I've seen funds with investment periods, from one to two years, with a total fund life of five years, which we think is very short, for the complete liquidation of a fund.

HAO CAPITAL: Doesn't that make sense if you consider what Vincent just said?

SVB CAPITAL: It does mean a lot of pre-IPOs.

PANTHEON: Right, if you can't get into pre-IPOs you shouldn't be raising funds.

HAO CAPITAL: That was what I was going to say. This isn't PE in the way that it's understood in the West. But that doesn't mean that it doesn't make sense for China or that it hasn't made sense over the last year or two.

SVB CAPITAL: Right. But I don't want to send the message that those are our typical market terms. They are not. They're merely examples that I have seen among the funds that we have looked at seriously and in which we have decided to invest, I would say that the terms are pretty similar to what our peers here today expect.

T&I: Do you see a proliferation of RMB Fund of Funds, similar to dollar fund of funds?

SVB CAPITAL: I think everybody should come in and raise RMB fund of funds. Selfishly from my perspective, I think that the market still needs a lot of education so the more institutional LPs that come into this market the better it will educate the market and bring the whole legal eco-system up to par. So more institutional LPs in this market helps our business; it would be better if we had more peers in the marketplace. I think the structure of dual currencies will continue for a while and that dollar GPs will look for RMB and RMB funds will look for dollars, so that the only question is whether your business model validates that for you; and if it does then I think it makes sense for people to start having dual denominated fund of funds as well.

PANTHEON: I think the difference between China and the rest of the world is that there is a lot of long term capital in mature markets such as pension funds or endowments which are perfectly suited for PE. And because a lot of pension funds have limited resources to invest into PE, even though they may be based in the US, and only invest in the US, they still need help from FOFs. But in China, there is a real lack of long term institutional money and that is why a lot of the local fund of funds, have to target private individuals as their LPs which causes their short term mentality; because private individuals have much shorter time horizons for their investments. So fund of funds are definitely one of the products that are needed in the market. However, unfortunately other than the few like Silicon Valley Capital, which have RMB, most of the fund of funds people that launched their products that I know of are private wealth management people that are selling their products as a channel of moving capital and charging fees, rather than for investing capital professionally.

T&I: Let's ask CWT to review what they see in terms?

ROCKY LEE, CADWALADER, WICKERSHAM & TAFT: I'm Rocky Lee, the Asia managing partner of Cadwalader in both our Hong Kong and Beijing offices. I handle a lot of the PE work here in China for the firm, in addition to working with growth capital investing, corporate securities and fund formation matters. I am interested in all of your comments here today. The RMB fund market hasn't been proven over substantial time. I think last year, when we met last for this same discussion, it did feel like RMB funds were a novelty concept with a high degree of uncertainty; today, I see bigger, better, more institutionalized RMB funds

coming into the market. Recently, for example, Chinese insurance companies have been given permission to raise and invest RMB funds as LPs and that's a significant development, because Chinese insurers will take a longer-term view and they'll hire investment professionals. To date, I see insurance companies with western-styled professionals seeking a longer-term investment time horizon. They're not merely looking at short-term investments in Pre-IPO deals, but classical PE, VC and growth capital investments. I think that we'll continue to see in China, this mixed bag of sophisticated and unsophisticated RMB funds. You'll see diversity, some with short term horizons of three years; you'll see wealthy entrepreneurs, who have made money somehow, who have decided to become angel investors or whom will create funds. And when they create funds, the funds will range from 100 million to 500 million RMB; not really a fund by a Western definition, but because the securities regulations are sufficiently flexible here one can set up an investment fund with roughly \$15 million, which by Western standards, would not even be sufficient for an anchor investment for those of us sitting here today, but in China it's good enough to establish a fund. We're also seeing the development of several interesting trends, in which we observe a divergence, a clear distinction between unsophisticated and sophisticated RMB funds, where the sophisticated funds will not accept terms less than the standard of 2% management fee and 20% carry, whereas the unsophisticated funds, will accept whatever terms the RMB LPs are willing to give, because they're desperate to raise capital; they want to put money to work; they want to prove that they're worthy GPs. This is giving us almost two separate classes of RMB funds, we try to avoid the less sophisticated, but they are in the market. We're also seeing a number of SOEs beginning to hire investment professionals within their organizations, to help them become either legitimate LP investors or GP managers. Back in 2010 I would have been negotiating with some Deputy level administrator within an SOE, who was looking to do something grand for the organization, as an SOE set up a fund. But today, I'm negotiating with an ex-banker, who is now working for these SOEs, who is looking at how to create a business unit that will manage the SOE's money.



GUARDIAN LIFE: Balance sheet or pension fund money?

CWT: Balance sheet money, but the time horizon is reasonable for putting it to work and the terms are reasonable and rational. The biggest conflict within the SOE organizations is deciding how these professionals are compensated, because their peers within the SOEs are making 5,000 to 10,000 Yuan per month, despite being very senior in their organizations, while the GP professionals are making 100 times that amount. The professionals working for the SOEs as GP, or whom are brought in to co-manage these fund, want carry; what is happening is that we're negotiating the SOE team's economics with the parent SOE, to attempt to figure out how this will not cause conflict with the more international aspects of the GPs operations. It's a very interesting discussion because you have to align the PRC team interests with the SOE's interests, but at the same time, motivating the GP and insuring that the PRC GP team is not being over-compensated against their SOE peers.

T&I: Let's switch topics for a moment, and introduce the other participants in today's discussion.

ANNABELLE LONG, BERTELSMANN: Good morning. I



manage the China business for Bertelsmann, a privately-owned media conglomerate based in Europe, whose operations include firms such as RTL, Random House, G&J, Arvato and BMG, a joint venture between us and KKR. I sit on the board of BMG. We have over 3,000 employees in China, so we have been going pretty deep into China, where we have been present for 16

years. Historically Bertelsmann has been pretty M&A driven, making more than one billion dollars in acquisitions on yearly basis. So for us, the China market is no longer a conceptual, emerging opportunity, but a concrete strategic growth driver and therefore a capital allocation priority. In 2008 we sat up an in-house PE investment fund in China, starting with \$100 million dollar to test the waters and we're now stepping up the commitment to invest around \$100 million per year, via both direct growth stage investments and also fund of fund investments, mostly in earlier stage venture funds, including some of you here in the room. We have an operations background at Bertelsmann, so our investment focus should be relevant

and ideally synergetic to our current core business. We look into mainly three areas including media, in general and very broadly defined, in education; and in business process outsourcing, be it content, services, tech-nology, or distribution channel. We try to identify future growth direction for a media giant in this fastest growing economy, starting from stepping stone minority participations, in the hope to build our portfolio in China and broaden the business scope for the group.

BILL LI, WALDEN INTERNATIONAL: I'm Bill Li a

Managing Director for Walden International, one of the early VC investors in China, investing here since 1994. Today we manage investments across four different funds, with assets under management of about \$2 billion. We have some small RMB funds as well. We invest mainly in TMT sectors, but also more recently in new and emerging sectors. We've been quite consistent in our investments in China for the past few years, and last year, which was a good year, we had five IPOs [of portfolio firms in China and we're looking for even more this year.



T&I: How does this last year and five IPOs compare with the previous best year for capital market exits?

WALDEN: I think we'd have to go back to 2000 to find a year that was as good; but last year was not quite as good as that. The first IPO we had was Auto Navi and the capital markets were just waking up, as we were putting that deal out, but still we were able to get a reasonable valuation. But in terms of foreign IPOs there were a lot of good IPOs last year, so that trend has been good and while there are those who say that this is a singular sign of a bubble at least from our point of view this opening of capital markets for exits from China is something that we've been waiting for, over a long period of time.

T&I: Let's begin a 2nd round of topics now and given that WI Harper has just closed its latest fund I'm going to ask David to give us all the benefit of the many concerns that you heard from LPs as you've been on the road.

WI HARPER: Let me address that by looking back a bit at the last year, as we've been in the market for the entire year. Our LP base is pretty broad. We have LPs from the Middle East, from Europe, from the US, and from Taiwan. In the last year, I've literally had the opportunity to travel around the world and visit with our current and prospective investors. The first answer that I have to the question about LP concerns with China, differs depending upon the part of the world in which one talks with LPs. In the Middle East I heard huge concerns about VC, in general, as an asset class. There was a clear level of skepticism about VC, regardless of the region that really hit home. At the same time, I found a lot of interest in China. Some of



our investors from the Middle East have been with us for quite a long period and are exposed to China, but outside of that group there was less experience in the region. As a result, I was often asked some basic questions about China as compared to other regions I visited. My impression was that there was genuine interest but also a steep learning curve among many of

the investors we talked with. In Europe there was a lot of interest in China and also for VC. At the same time, a lot of investors were, given the economic situation in Europe during last summer, very conservative about deploying their own capital into ten year, closed end funds in the VC and PE industry. In the US, we actually found one investor whose clients were taking in returns from PE – as we heard here today, saying that 2010 was a great year for distributions – and not returning that to their primary capital corpus but who were instead, returning that capital to their portfolios that suffered more than most during the last year. Overall, I think it's fair to say that there is a keen interest in China but everybody has their own issues with regard to whether this is the right time to be investing in GPs in China.

T&I: WI Harper has also been putting a lot of effort into Innovation Works?

WI HARPER: At least six months, because it was entirely a start-up, so there were round-trip capital issues. In the case of Innovation Works, what we've done is to set up the first institutionally backed seed fund in China, Innovation Works Development Fund, which we're co-managing with

the team at Innovation Works. As for the fund raising process for Innovation Works Development Fund, the path was really to go to strategic investors first. We approached a number of strategic investors in Taiwan that were very interested, that knew Kaifu Lee and were interested in the concept of an incubator. That success led to some institutions coming in, which led to other strategic investors coming in and now there are also several high net worth investors who have participated.

T&I: The process of getting money in, permits, permissions, fund transfers?

WI HARPER: Aside from the funding delay, putting together the incubator went very quickly. The fund side went very slowly. It was complicated by our Taiwan and China connection with quite complex investment dynamics that slowed things further and presented several hurdles that Chris Evdemon and I had to climb, in getting our Taiwanese investors into the Innovation Works Development Fund.

T&I: Rocky there are new regulations from the NDRC about registering funds being brought into China?

CWT: Those regulations have always been there, it was merely the first time that they announced the requirements for registrations. We've all known about these requirements; there was really nothing new. The issue is that if you're an RMB fund, you need to comply with NDRC registration and the majority of RMB funds do not have an NDRC registration, which means that technically they're in non-compliance. And there are lots of those. In addition there is no enforcement of the rules, so that when we look at a lot of funds, on behalf of foreign LPs and I represent a lot of LPs from the US and elsewhere, we always look to this, to make sure that the RMB fund does have their NDRC approval and there is both a nationwide and a provincial, NDRC approval requirement, depending upon the fund and the RMB fund's scope. It's a judgment call by the LP. There are certain RMB funds, that are very well known in the market, that do not have this NDRC approval right now, and I don't expect them to get this.

T&I: Simon I've asked you to comment on whether you see RMB funds in competition with you for deals.

HAO CAPITAL: Of course they're competition; the only question to ask is why one would expect anything different? This is a great market, a fantastic economy, that's growing strongly. There are exciting sectors, great

new businesses emerging from the pack. There are so many reasons to invest in China, so it makes complete sense that domestic investors would want a piece of this as well, so competition is entirely to be expected, however, I think that if we consider what the RMB funds are, at the moment, how they're constituted, then as Rocky and Vincent were saying, some funds are more like a collection of wealthy entrepreneurs, or high net worth individuals, who have cobbled together 30 to 50 million dollars equivalent, or you may be seeing funds that if you really look closely at the composition of the investment committee, you find that they have a government veto there. That somewhere underlying these funds, what you have is government money, by another name and the investment objectives of funds like that may be very different from what we do, which is simply to provide the best returns to our LPs. The government, if they're acting as an LP, has different objectives. In terms of real competition, neither of those kinds of funds are really

competition for the US dollar funds. What is competition are the RMB arms of some of the dollar funds, but again, that's to be entirely expected, it's an incredibly attractive market, why would it be different? And I think that there is likely to be more competition as time goes on, but the big change that will go on in China and which will ultimately change the competitive landscape is the

increased sophistication of the local LPs. I think that is the thing most lacking in China today. People like CIC aside—which has grown from a few people to an incredibly sophisticated organization, that does considerable due diligence and is like a sophisticated foreign LP within the context of private equity of China today – I don't think that this is the case. Currently fund terms are very different from terms that Western endowment funds or pension funds are used to seeing in PE markets elsewhere around the world. Short fund life, immediate drawdown of 100% of capital on day one, these types of things; it's very different from what sophisticated Western LPs are used to seeing. I think that will change and CIC for example, is a benchmark for LPs here to look at. But this is a number of years away.

SVB CAPITAL: My perspective on this is that there is definitely competition between dollar GPs and RMB GPs, but fundamentally the deals that they see and markets that

they compete in are different. I see dollar GPs, the deal profile for these funds are different from the RMB deal profiles. So fundamentally there's a bifurcation. Yes competition exists but competition is good and there is a clear bifurcation between RMB funds, dollar funds, and dollar funds with RMB. And saying that causes me to ask about something else, about the state of RMB funds today. While we talk a lot about how the terms are not the same, from a Western view, the terms are lousy, things like a deal by deal carry. At the same time, I want to point out what the RMB funds market is becoming, there are funds and they are playing in the same space as all of us here today and in the space that those of us from the West are used to and there are some funds doing this that are rather sophisticated. There are funds getting institutional LP support here in China from the National Social Security Fund, for example, which has funded several RMB funds; so while the sophistication of the potential LP base is lacking the skills of the dollar side, they're on that path.

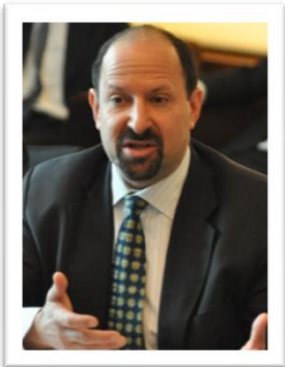
CHURCH PENSION FUND: Let me ask this of the GPs here today and perhaps from the fund of funds as well. What are you seeing in terms of the demands from the actual entrepreneurs? While it is interesting to discuss all day what we as LP/GPs want in terms and relationships, this market will in the long term be driven by what the entrepreneurs are going to demand. So I ask you, what are the key criteria entrepreneurs are using to determine if they want RMB or US dollar investments? How are entrepreneurs saying they go about selecting RMB funds over dollar funds?

SVB CAPITAL: Exactly. Back to my point about there being a natural bifurcation, driven by deal expectations, by the nature of your business; If you're an internet gaming company, you want to be offshore, you're going to go for US dollar GPs, you're not going to go for RMB. If you're a coal mine and you're owned by some SOE and you have



regulations governing what you can do, or that are needed for your business, then you're going to list onshore, then yes, you're going to go to these RMB funds. These are the two sides of the spectrum of what we are seeing today. And then there are the in-betweens.

57 STARS: And that is a critical point which is that the choice between RMB and dollar funds is a spectrum and there are extremes, but there is a heck of a lot of competition in the middle of that spectrum. From the LP's perspective, it's not merely competition that we are concerned about with respect to actual transactions and pricing as a result of that competition, but also very critically, the GP's time and attention. If, in fact, you have, say, three-fifths of your portfolio in GPs who manage pools of capital in both currencies, if they are deploying the RMB



with much greater velocity, which sometimes they are, then they have to return it with greater velocity, which in some instances they may, then naturally there is going to be quite a bit of time and attention that must be paid to that RMB portfolio, and from our perspective, we have to think about what does that mean, in terms of what they're going to do, or what they're not going to

do, with respect to their dollar portfolio. From our perspective, not being solely a China focused fund— though I will say that a very large part of our portfolio is in China and it will continue to be – we have to ask, what is this ultimately going to mean in terms of our return expectations with respect to dollar funds in China, absent being a Qualified Foreign Limited Partner (QFLP).

SVB CAPITAL: And even being a QFLP doesn't mean that you've solved the problem. But what you're saying is true, the conflicts which arise when the dollar fund and the RMB fund are the same team, in reality exists, but this is something that is not going to go away, so we're going to have to get our hands around this.

57 STARS: But in the first generation of these combined funds among the GPs that is exactly what we're seeing. The GPs are saying to their LPs: we have to get our arms around it, we have to work together, we're all in this together, we're partners, so trust us, because you just can't have rules where the deal flow is unknown. So, you just

have to trust us. Needless to say, that is working better in some instances than in others (laughter).

T&I: Rocky, will you define QFLP for us?

CWT: The Qualified Foreign Limited Partner status or QFLP originated in Shanghai as a pilot program, as did the QFGP program. In this case, the government said, let's give certain LPs a pre-qualified status; arguably they'll be big name brands, well established, lots of AUM, fantastic track records. China will allow them to come into China to invest, to help foster local domestic RMB investing and to help RMB funds become more mature with their guidance. The idea being that the qualifications are pretty high hurdles. All of this becomes very important in light of the fact that there are two kinds of RMB funds, at present: domestically sourced RMB and foreign sourced RMB. There is now clearer guidance from regulators that 5% is the hurdle, the point at which if an LP accepts dollars, they are classified as a foreign RMB fund. The issue of converting dollars to RMB is a foreign exchange issue, but once your converted dollars are in China you may be an RMB fund. But once the foreign source of funds passes 5% of an RMB fund, then that fund is a foreign RMB fund and all its investments are subject to MOFCOM review and the MOFCOM Catalogue. This has implications for exits, for A share IPOs, though IPO regulations haven't caught up to this, nor have MOFCOM approved A share listing that included foreign RMB investments.



PANTHEON: The concept is relatively new so to date the limited partner association for China is still observing. For example, one of Pantheon's GPs is one of the first three funds to be "qualified" by the Shanghai government and meanwhile we, Pantheon are in the process of being qualified ourselves. This is a two step process. First you have to be accepted by the government as a GP under a set of qualifications. Then on top of that the LPs for that GP have to meet the government's qualifications. Then after that they may, or may not, grant you the QFLP status, in which case you can convert your commitment to your GP into RMB, however, as Rocky says, that is just the conversion, it doesn't resolve the different treatment of

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foreign sources of capital, which is the ultimate problem for the USD funds.

CHURCH PENSION FUND: So even QFLPs contaminate domestic RMB funds?

PANTHEON: Yes, exactly.

CWT: If the RMB fund is at less than 5% foreign currency participation, when you talk to MOFCOM they hold a different view. MOFCOM takes the view that foreign sourced RMB makes the PRC RMB fund “foreign” for the purpose of the MOFCOM Catalogue.

WI HARPER: And hence the gray areas for the issue that Steve raised about domestic preferences, which could be important for strategic issues such as the ability to IPO on domestic exchanges or tactical items such as the reimbursements for portfolio companies.

SVB CAPITAL: This applies to Shanghai alone?

CWT: This is a point we’ve yet to determine, whether MOFCOM restrictions apply only to Shanghai, because Shanghai has its own set of rules, or is this part of a national movement, to apply the same standards elsewhere so that the question is what does the entrepreneur do? If he wants to list on the Shanghai Stock Exchange, he wants that to be a smooth process, he does not want to have “tainted” RMB to come into a his company as consideration. That upsets the process of his IPO; that’s how entrepreneurs are looking at this. So the RMB denominated fund, needs to tell its potential portfolio company that its RMB is not foreign sourced, or does not pass the foreign sourced threshold if this Shanghai Pilot rule becomes the “law” so that an investment doesn’t introduce additional complexities for the entrepreneur. In due course we’ll have clarity this, but for now 5% is the magic number and different regulators have different views, but the conversation with the central government in Beijing indicates that 5% might be a number that they’re happy with. However, even 5% presents a bifurcation of the Catalog review. I assume everyone that the MOFCOM Catalog incorporates the concept of limiting investments in specific industries and there is a splitting up of industries in which foreign investment is absolutely prohibited or limited due to security concerns, which in turn, impacted the reasons for the recent changes in M&A rules. Today there are three sets of rules providing guidance for M&A, which most fund lawyers don’t like to talk about; these are not new regulations and they have existed for some time, and

are not something new that has appeared as a result of the furor over CFIUS in the US declaring that Huawei would not be allowed to make a US acquisition due to security concerns. In fact there has been clarification within the last five months with regard to state secret requirements and clarification with regard to what sectors present security concerns and what areas are strictly off limits either through direct or indirect foreign investments through nominees. So today there are clear guidelines as to what areas dollar sourced RMB may or may not invest in.

T&I: What about RMB managers who want to raise dollar funds, investing outside of China?

CHURCH PENSION FUND: Right. That is the opposite side of the coin. In the past discussion focused on USD funds raising new RMB funds. We need to spend some more time with this, if we want to stay a bit ahead the trends. Our goal clearly is to deal with the best managers who have insights into trends and who can generate the best returns. And at present we’re limited to investing only in dollars, so we should be asking today whether this should only be with traditional foreign teams with offshore dollar funds or is it possible that there are good opportunities with locally home grown RMB fund management teams, that have moved offshore and are raising dollars. This presents questions on the opposite side of funds onshore raising dollars to convert to RMB.

PANTHEON: Interesting point. I just had a conversation with a lawyer representing those RMB funds who are trying to raise dollar funds. Despite their reputation of funds and being among the top five local funds in the market, they’ve failed in raising even \$100 million. At the beginning of their efforts they thought that they could raise this money fairly easily, because their returns have been great. They’ve had single investments earning ten to twenty times invested capital, their fund has returned ten times capital, and they’ve been visited by so many US dollar LPs, they felt like if they only took \$2 million apiece from all their visitors who showed interest, they would easily raise \$100 million. In the end what they discovered is that most of the Western LPs are not comfortable with the grass root approach by local GPs despite these GPs being leaders in the RMB fund market. That’s an interesting outcome; I would have thought that LPs would be returns driven and as long as GPs are showing good returns, they should be able to raise money, but that’s not the case.

T&I: Who invests with RMB?

SVB CAPITAL:

New Margin has RMB.

HAO CAPITAL:

We're strictly dollars.

WI HARPER:

We're strictly dollars.



CHURCH PENSION FUND: A lot of this discussion will depend upon the investment stage you're investing in. If you're very early stage tech driven, as you say Ming, those companies are very naturally going to go towards US dollar funds with the natural exits in the US, so we're very comfortable in that regard. The question is whether there is unique value added by home grown managers,

who have to date managed small RMB funds and whether these domestic GPs who are raising dollars will be successful. Of course, this may not take place this year or even next year, but it's going to happen gradually so we're trying to develop these relationships to see who is going to emerge as the new leaders in next five years.

CWT: I see a lot of this too. Domestic GPs come to me to ask how and if they can do this. What I observe is that the LPs want funds to have a star manager, or a strong personality. At the same time, entrepreneurs are looking at these dollar funds asking who is the person at these funds who can help take their firm to the next level. And most recently I've seen something that I've never seen before; entrepreneurs aren't necessarily chasing the highest valuation term sheet. Historically, it's always been, whoever gives the highest valuation, that's who entrepreneurs go with. That's not the case this year when entrepreneurs are saying "I want this partner or MD to be the person who is leading my company to a public exit; the fund or the valuation are not the most important factor anymore. So Key-man has become more important than ever. But among the RMB funds wanting to raise dollars, there is usually not that key man or personality, and I think that a lot of LPs, when they're taking calls from these domestic GPs wanting to raise dollars, are raising this objection: that there is no star. Great, it's a big name fund, but who is the person leading?"

GUARDIAN LIFE: That's always a problem for successful GPs wanting to raise capital. You almost have to have someone who carries a charisma about themselves, so that no matter what the internal factors for a particular GP that person is key to the fund raising.

CWT: I've never seen this phenomenon to the extent that we see it today. For the last decade the most important thing was valuations. In fact, we'd see firms losing out on investments over as little as a \$2 million valuation, or for \$5 million better valuation.

GUARDIAN LIFE: We've been meeting with some of these funds such as those that you describe, who have good RMB track records, but their teams have had a little difficulty, explaining their strategy, describing their secret sauce and then when we don't see a clear leader, you leave these meetings with more uncertainty about them, then you had before the meeting. And that makes it hard to make a call about investing in RMB funds.



T&I: WOFEs. We've been predicting the end of the WOFE in China for years now.

CWT: Oh, they're going to be here forever. (laughter) JVs too. While the RMB remains a restricted currency and even when the RMB achieves a free float, there are going to be restrictions, so WOFE structures will continue to be viable. And at present there really isn't a reason for China's government to open up the currency flood gates.

T&I: Annabelle, will you introduce a discussion on sectors beginning with education.

BERTELSMANN: This trend of investing in education companies in China is not a new one. My recent observations are that there is market consolidation. The market is so fragmented and inefficient that despite the huge demand, that the intensified competition creates chaos. Strategy and execution on M&A will be crucial qualities to look at when evaluating a company. Many may have underestimated the players who 'put the dog's breakfast' together. To quickly achieve scale and coverage is at least as important as inventing sophisticated products. Firms who are niche vertical leaders, offering a single, interesting, even if it's a cutting edge application, but who

lack capacity to grow inorganically, may see less interest from investors. There are firms now taking the lead to consolidate and integrate some of these vertical sectors and building national coverage, with delegated resources and run by seasoned professionals from outside the education circle. I think they will be the next generation leaders in the space. As for media, I think the fundamental consumption of content remains strong but monetization needs to be further improved.



However, media companies also come to realize their value via multiple revenue sources. The recent e-commerce momentum certainly benefited media property owners. I see some of them also are inspired to think about more direct participation in commerce, to further leverage their influence on consumer behavior and

move further along the value chain, than only earning ads dollars. The entry barrier held by the traditional retailers has been crashed by the internet, but it's hard to imagine media companies who are most effective in understanding and acquiring customers also predicting merchandise strategy and promoting products.

T&I: And thus avoiding the ever increasing regulation of electronic publishing in China?

BERTELSMANN: Well, to the extent that one can avoid such regulation.

WALDEN: We've been active investors in several sectors of tech over the years, but I think that e-commerce is currently the hot sector. It went through really explosive growth over the last year and I foresee a wave of IPOs coming in the market and valuations for investments are getting very high, even including very early stage deals, which is probably a sign that a bubble is developing, especially in terms of valuations for e-commerce offerings. But there are some fundamentals within e-commerce, one of these being the receptivity by China's population to online purchasing as well as the improvements to the infrastructure of the sector, such as online payments through banks and the fact that the current purchasing generation who have grown up with the internet, have been educated to its use through things like instant messaging, so they're becoming used to buying things through the internet. The other thing driving this is that

retail prices have gone up so much in the traditional retail channel that people can't afford to sell products in the traditional ways. And logistics have become a big problem, so that for example, buyers can't see the latest fashion in retail stores. At the same time there is a big increase in urbanization, to about 400 million people who have moved to the cities and they're having an impact, creating a leap in the size of big brand merchandising. All of these things are fundamental to the up and coming companies. And as people become more and more used to buying things over the internet, I see changes in behavior and then secondary changes that those things cause. Almost every week now you can see express deliveries to the office of our own staff and when I talk with them they say that they're buying more stuff online that they used to buy in traditional retail channels. It's become something like a fantasy, about what happens when they can't get something delivered; they get a really bad feeling. It's quite a phenomenon and I definitely see this increasing; just as you see GroupOn coming to China, and you see a lot of advertising for these firms everywhere. As a result we'll see a wave of e-commerce offerings in public markets and while it's going to take public markets time to digest all these IPOs, in the long term there are good fundamentals for e-commerce in China, so I see it going through this wave and progressing through a couple of generations after which we'll begin to see a lot of new things coming up.



T&I: Ming, can you comment on any perspective you have with regard to tech investing for China?

SVB CAPITAL: I don't know that there are any special perspectives from us as an LP, but going back to observing the differences between investments by RMB and dollar funds I think that China as a market is still very much driven by the consumer sector and a lot of the exits that come from China are from the consumer side. And while I do see that evolving, the current exits reflecting the current marketplace, I do foresee a move into tech and again, that will help strengthen the bifurcation among and between dollar and RMB funds as dollar funds are focused on tech, core tech and technology exits and RMB funds are driven by consumer trends and RMB exits.

T&I: Observations on onshore versus offshore exits?

SVB CAPITAL: I don't have numbers on this, but I do think that the number of onshore exits, has outpaced the offshore exits.

GUARDIAN LIFE: Of the 32 public exits last year, 19 were from China or Hong Kong-based companies.

SVB CAPITAL: Right and I don't know how many of the exits domestically, are PE-VC backed for A share, Hong Kong and Shenzhen exchanges but I suspect that there were more onshore exits than offshore.

T&I: What have the LPs here realized from distributions?



57 STARS: To date distributions from IPOs are overwhelmingly from off-shore markets compared to onshore exits. There are a lot more onshore exits occurring and there is a lot more talk about them, than there are returns from them in our PE portfolios to date, but domestic exits are unquestionably gaining momentum; there's no doubt about that. And we expect such

exits to be an increasing part of our portfolio returns. From a broader perspective, the overwhelming majority of value we see in private equity portfolios in China is unrealized. So, while yes, there are some distributions, there is still a lot of stuff out there that is unrealized that has the potential to be of tremendous value; it's still early days [for returns] from China.

PANTHEON: And most domestic IPOs are done by domestic GPs; they're not particularly raising funds from dollar investors. The first overseas investor that took their company to exit on the Chinext market, was Warburg Pincus in a medical devices company called Lepu. For us, there was a CDH investment from our portfolio, a soybean machine company got listed in A share market, that was only three years ago. It's going to be a while before we see any massive distributions coming from exits in domestic markets, but it's happening.

WI HARPER: Just one comment, on Ming's mention of the distinction between consumer and technology and areas where Bill at Walden has been active such as the semiconductor space. One sector that we've been very

excited about is the LED sector. It's a market that is just coming to the fore, for consumer lighting. We made an investment in a US-domiciled company which has most of its team in Taiwan and went public on the Nasdaq based on the growth story for its products in China where they are involved in a JV in China to build their LED lighting products. This is where we see technology meeting the consumer market. Since we know and have extensive contacts with the LED industry in Taiwan, we've keyed in on this particular sector. E-commerce is another example, but we see markets like materials and lighting and the in clean-tech sector having exciting opportunities.

HAO CAPITAL: One sector we like is healthcare. And specifically medical equipment. We like TCM and Pharma, where there are very interesting companies coming up. The consumer side is a great area of focus, but this is where we see valuations really starting to move up and we're seeing a number of Pre-IPOs or PIPE type deals that we stay away from, because we don't have to look back very far to see what happened to the last Pre-IPO cycle, though it was largely an offshore Pre-IPO cycle. We're going to have to wait to see what is going to happen this time. As you just said Steve, there is a lot of unrealized NAV in portfolios in China, and at the end of the day, it is all about giving money back to our LPs, so we're going to have to wait and see what happens to liquidity, particularly for some of these smaller companies; liquidity is always the key in terms of whether you can exit or not.

T&I: Bringing us to how one goes about valuing and benchmarking returns, which Cheng will address.

GUARDIAN LIFE: Right. Earlier, I mentioned something derived from the asset allocation perspective, about how we decide to put money into private equity and where target allocations should be; and even from within different sub-asset classes, where we consider several factors. I think that we need to look to post-investment valuations as active portfolio managers, and to carefully consider how we monitor our portfolio's performance, for both realized and unrealized returns, to allow us to make decisions about whether to re-up with GPs or whether we should be selling our positions early on in the secondary market. In some cases that's the direction we're going.

CHURCH PENSION FUND: Cheng, let me interrupt you in order to ask and to seek input from everyone around the table, if we look at the landscape of investing in PE in China, where value is derived. It seems that that there is at least some arbitrage between private valuations and public

valuations, especially in the very early stage of VC. Keeping in mind that I just came back from two weeks in India where there seems to be no arbitrage (loud laughter, and comments. someone says there is a “negative arbitrage”). So maybe I’m wrong in asking this, but even among the late stage or SOE buyouts, for very different reasons there is also an ability to enter investments at somewhat reasonable values to generate distinct returns. So the question is what about the traditional growth capital? I am not saying that that the growth space can’t [perform] but I’m just wondering if that isn’t the most crowded part of the PE investment market in both China and India. So I am asking whether others here see valuations expanding and returns contracting in terms of the competition. Obviously this is a very broad brush question, but generally we see some value at early stage, and we see value at late stage, but the middle seems challenging.



PANTHEON: I think that valuation arbitrage still exists if you use a foreign market as a benchmark for your entry and a domestic market for your exit (laughter) and that’s the problem. Traditional PE players like us always bench-mark the long term cyclicity adjusted price to the earnings ratio.

HAO CAPITAL: There is an arbitrage if you believe that China’s valuations will remain where they are. In a lot of these onshore pre-IPO type deals, valuations are half where the public markets are trading. But these entry costs are priced exactly where the offshore markets are priced, so that there is no arbitrage.

CHURCH PENSION FUND: You’re talking about mid-sized growth capital deals? That’s my whole point.

HAO CAPITAL: Right. I agree. So you have to believe that these 30, 40, 50 multiples will remain in order to make these kinds of transactions attractive but these are very much pre-IPO type of deals. There seems to be huge amounts of interest in these types of transactions so I think that if you’re looking for arbitrage, you need to step away from that and not join the crowd.

CHURCH PENSION FUND: Okay. And just to be clear, I’m not talking about paying a 20 times earnings valuation for an investment and then hoping the local capital markets

take you out at 60 times earnings valuation post an exit event. I’m talking about offshore USD funds, typically looking at offshore market take outs in early stage tech deals, paying a reasonable multiple, but focused on execution in growing the company and then gaining some arbitrage expansion, i.e., some multiple expansion, as a model is proven through organic growth. I’m not talking about talking about investing in the local markets, and hoping for a 50 to 60 times valuations or something of that kind, that is what is typically associated with the local RMB funds’ strategy.

PANTHEON: But you’re competing with managers in that space, even if you’re a dollar fund, targeting an overseas listing, you’re competing with RMB funds for the same deal flow.

CHURCH PENSION FUND: Not necessarily. We are told that the RMB fund managers and their LPs are not comfortable with the lack of profits and longer term gestation of traditional early stage investing.

HAO CAPITAL: One of the issues that you raise and this goes back to something that Ming was saying, about a lot of the deals that are attractive to local investors, not being attractive to dollar investors. If you are in what is effectively an auction process, where people are bidding up valuations, these aren’t necessarily the type of transactions that you want to be in. Also, in terms of a bifurcation, there are some transactions and some entrepreneurs, who are not looking for domestic money and they’re happy to take a lower valuation, from perhaps a more sophisticated investor because they can see some of the benefits, not just from having dollars coming in, but also the type of longer term view that typically the dollar funds will have, where we’re there for three to five years in a relationship, with a lot more brought to the table



WI HARPER: I would validate what you’ve said about venture capital and earlier stage investments Eric, which in China, may mean that we’re investing in a company that has revenues, may be profitable, and where you’re pricing off a P/E multiple. I think a lot of this boils down to the public markets. For us, it’s a lot easier to have a conversation with an entrepreneur who has bootstrapped

his or her company, where we're looking to invest at, say, a sub-ten P/E where they will mark themselves up quite substantially in their first institutional round, versus a company that is further along that is comparable to public comps where you're trying to talk someone down from an 80x P/E public valuation. My guess is that as you see that the public market correcting, you're going to see private equity market valuations come down.

GUARDIAN LIFE: Back on the topic of return expectations, once a program is up and from the active portfolio managers point of view; a lot of that is not driven by realization, at least for us, an insurance company, it's regulation driven and liability driven, in that we have to maintain a certain balance between realized returns and unrealized returns. And while it's good to have a realized return, then you have a re-investment risk and while if you have unrealized returns that are on your balance sheet, there is a risk based capital charge. Annabelle, as a captive program, how do you view this consideration as part of your ongoing decision making process.



BERTELSMANN: You're right, we're a captive investment group, investing from our balance sheet and that means that we have a longer term perspective on our investments, than a

typical PE or venture fund, especially given that we are attempting to build our operating presence on the ground in China, so I totally agree that we are thinking more along the lines of strategic investments, so I really have to consider these long term liabilities on my balance sheet.

PANTHEON: Going back to the earlier comments on sector focus, I can't help but think that the ones discussed are the most populated sectors for investment in China by all of the funds here and so therefore probably represent the best growth opportunities, but they're fully priced sectors as well, at least in our view. So let me ask the GPs here, where do people see value in this market? And where are the sectors you think, well, you're probably not going to tell us (laughter) you are willing to consider investing in that are less populated sectors?

HAO CAPITAL: I think that is what we're doing. We think that some industrial sectors are interesting, because a lot of the growth funds in particular, are not looking there. Okay, these aren't the obvious IPO candidates of today, but

that also means that they don't get so much interest. I'll say healthcare too, and there are lots of different areas within that one sector, some of which we think present great value. At the same time I agree with your sentiment in general about certain sectors being fully priced.

T&I: Each of you please give us your one year forecast.

PANTHEON: I think that for fund of funds, the fund raising market will continue to be very challenging, so that is a key concern that we have. We're not terribly worried about returns that will be coming out of China, in fact, we fell pretty comfortable, that the macro environment is still working out quite well. And to our surprise, India has become much more challenging than we already thought it was. There are good GPs there, but the returns are not going to be as good as we originally anticipated so we have to adjust our expectations there and investing will continue to be very challenging. So going forward, we're going to have to look very hard at how we generate superior returns from investing in Asia. The hot money flowing into Asia in the last twelve to eighteen months has driven up valuations across Asia and that means that returns will be diminished, going forward.

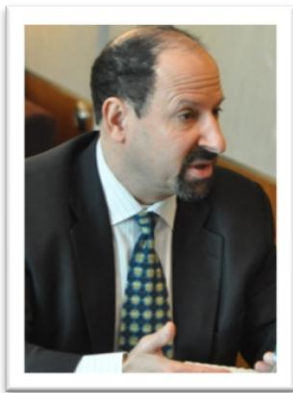
BERTELSMANN: There's no particular concern for us, but it's an interesting time to observe and to be sensitive to regulation changes which we may have thought were challenging to our investments before, and which will be changing again by mid-year this year. We need to take these into consideration as we plot our remaining investments for the year. My personal feeling is that if you want to do something in the internet, media driven space, then you need to be quick about it, because the window may close for foreign investments. I think the government is trying to figure out how they want to implement media policies and they might want to tighten control on content, especially in social media which can spread information at light speed. Pay attention to Twitter and mini-blogs on Sina, which will be asked to regulate the activities on their platform, to get a sense for the government's thinking.



GUARDIAN LIFE: I'm going to take a totally opposite view for the coming year. My view has always been that some bubble will burst for China investing and as a native Chinese, despite my coming back

only once or twice a year, every time I come back, people are rushing into something that's not building something for the long term, but because of this feeling that they have to be into this something now, for today. And that is simply not right. So we're going to see the real estate bubble burst, or the consumer stop spending, or at least stop spending at the rate they have been for the last three to five years, and that will cause people's business model to crash.

57 STARS: I think our perspective is much closer to Cheng's than to a wildly positive outlook, which is not to say that we necessarily think that there is a bubble. We are cautious with respect to the macro environment. We think there are risks and we're also concerned about the relative lack of the institutional depth of many of the GPs, particularly compared to other parts of the world where we invest. In connection with that, there is a great deal of – as



one always has in a very active investment environment – a tremendous amount of dynamism. By that I mean that if I listen to Rocky for five minutes and ask myself: "what are the rules going to be tomorrow?" my answer is: "I have almost no idea." You can easily, as we have done, spend thousands of dollars working with lawyers making sure that you understand the regulatory

environment, but our efforts in that regard haven't given me clarity on what's going to happen in two weeks, much less two years from today. We have some general indications, but we continue to have to spend a lot of money on this. And simultaneously, the conversations that we've had here today, about pricing pressure and competition with RMB funds are very significant. They present concerns and I don't think these concerns are going to abate anytime soon. This is part of the trend of investing here in China and it's going to continue. It's unlikely that the environment will become quite as efficient as India is today, in the short term, though clearly we've seen significant evolution in just the last three to four years, not to mention the last five to seven. So this pricing pressure is very significant, and it's going to require that GPs increasingly have a competitive advantage and an ability to add genuine value somehow or other to their portfolios, which is going to be another challenge for a number of GPs because of their lack of institutional depth. There are a few

with great experience as investors here in China, who have built very impressive organizations and who have that depth that we seek. But, in a more than \$5 or \$6 trillion dollar economy, it might be expected that a community of GPs has developed that has greater depth than we see in China today. The dynamism that I mentioned involves not just the regulatory environment, but also change within GPs. Everybody recognizes that there is quite a bit of fluidity in some of the management teams among GPs in the region.

CHURCH PENSION FUND: When I first joined the Church Pension Fund, I had concerns, like a lot of professionals who have been living out here over the last twenty years, that our institutions had only a vague notion about Asia or worse that we had largely romanticized what Asia offers. The Church Pension Fund was not in that category at all. We have been thinking carefully about building a portfolio over the long term. In the first year when I joined the fund,



we presented this long term perspective to the Board. In order to protect and grow our Fund with the view of providing for our future retirees, we asked the Board to think about what the world will look like in the middle of retirement for someone who joins the priesthood today. In other words, we need to think in terms of decades and when we project ahead it's obviously going to be much different than it is from today and Asia will be an important element of the future's production and growth. So for the Church Pension Fund the question is not about what is going to happen in the next 12 months as your question asks; for us this is the wrong focus. We're thinking about the next 20 to 30 years. It's up to our managers to insure they're not investing at over-inflated valuations, that they're being disciplined in their investments. That's what we're asking of our managers; that they help us over the next 20 years get exposure to this market, it's not a matter of whether there are bubbles today or tomorrow. In fact, we think bubbles can be a positive. We hope that managers generally sell into cyclical bubbles and buy when they deflate. For example, we just invested in a PE fund looking at the second and third tier city residential middle market income housing in China. Although almost every headline screams about a bubble in the real estate market in China, the fact is, this is the time to invest. We already see a fall in land

prices and because you're starting to see the contraction of liquidity there are more interesting opportunities. My responsibility is to insure that 20 years from now we're best able to service our pension obligations for our fund and if we're not taking a long term view about that, we're failing our pension holders.

WI HARPER: My prediction is really about the investment approach that we're taking and that Steve was alluding to as well. Keeping in mind that we are a boutique and specialty investment firm, one of the challenges of having too much capital in the VC and PE industry is that it's hard to source great deals. I think that if you're very focused, that presents opportunities. Entrepreneurs want people who can add value; we've heard that from many people here; if you have domain expertise and you're very focused, you will be able to add value and that will lead to getting deals at the best price possible. In terms of concerns, I think that coming from the US – I'm based in the US but spend a fair amount of my time here in Beijing – one of my concerns is that we could have a slowdown in the Chinese economy, as well as the US economy, in the second half of the year. I hope that won't



happen. I see the Dow at 12,000 and the Chinese markets are doing well, but I think that if both were to be hit at the same time, we could have a bit of trouble.

HAO CAPITAL: Our concerns are some specific ones, because we're going to be out fund-raising again, (laughter) so to some extent that depends upon the LP world. In terms of there being a bubble, I'm not certain whether it's

better that the bubble bursts, or continues to inflate, in terms of a fund-raising perspective.

WALDEN: From our point of view, we're holding a lot of portfolio companies and have been for a while, so we're concerned about how long it's going to take to make a lot of exits. If the capital markets remain open then we'll try and bring these companies to market. At the same time, we have to be really focused on identifying new companies, that aren't affected by high valuations, but which have really good fundamentals, that we can build in the long term. Those are our two challenges.

CWT: I think that the big challenge lies within the economy; labor prices are rising quickly, real estate costs are going up quickly, so my guess is that if something bad happens and you're in the right vintage year, then you're in a tough position. (nervous laughter). Hey, I'm the lawyer, you pay me to worry about these things.

SVB CAPITAL: Silicon Valley Bank is in China, which is a focus and a big market for us. Our goal over the next twelve months is to get our banking license for China. And I'm here to cultivate our RMB investment environment; my charter for the next year, is to work with emerging RMB GPs and to help populate the RMB ecosystem.



END OF THE FIRST SESSION.

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HAO Capital is an independent private equity firm founded in 2005. We are focused on providing growth equity to private Chinese companies. Currently, we manage over US\$500 million in assets across two funds. Our team comprises 15 professionals with extensive private equity and operating experience. We have offices in Beijing and Hong Kong.

Contact: info@haocapital.net
www.haocapital.net