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PREQIN MARKETS IN FOCUS: PRIVATE EQUITY & VENTURE CAPITAL IN GREATER CHINA'S INNOVATION ECONOMY

preqin

Contents

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Data Pack

The data behind all of the charts featured in this report is available to download for free. Ready-made charts are also included that can be used for presentations, marketing materials and company reports.

To download the data pack, please visit: www.preqin.com/PEGC19

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CEO's Foreword

I am proud to present Preqin's report on Greater China's private equity & venture capital (PEVC) industry, where we explore the rise of Greater China as a global innovator. Enduring an economic slowdown and trade tensions with the US, the region has faced many challenges of late. It has therefore been necessary to switch up the game plan, and move from an export-dependent economy to a nation powered by domestic innovation.

What is PEVC's role in this transition? The drive for self-sufficiency has brought a surge in domestic entrepreneurial activity, thus creating abundant opportunities for PEVC funding. And we have seen some notable developments over the years. Greater China clocked nearly $600bn in assets under management (AUM) as of December 2018, at a year-on-year growth rate of 36%. This means Greater China's contribution[1] to Asia-Pacific-focused AUM is the largest of any sub-region.

Even with these outstanding figures, industry growth is at its most sluggish in five years. PEVC is not unaffected by the economic and political instability, and signs of a slowdown have begun to appear. As of July 2019, deal-making activity within the space has dipped by more than one-third[3] in comparison to the same seven-month period in 2018. While 2019 fundraising looks upbeat compared with the previous year, it is still a decline of over 50% from the 2016 record of $135bn.

As Greater China turns its focus to driving domestic consumption, this report dives deeper into six key sectors integral to the domestic PEVC market: healthcare, consumer discretionary, information technology, artificial intelligence, e-commerce and fintech. Each of these sectors has evolved tremendously in recent years, and plays a vital part in building Greater China's status as an innovation economy.

Mark O'Hare
CEO, Preqin

The continual growth of the PEVC industry has to be supported by a healthy ecosystem of fund managers and investors. **Preqin Pro** tracks over 4,600 fund managers and 740 investors that have raised or invested in Greater China-focused PEVC funds. Unsurprisingly, there is significant home bias, especially in the fund manager space: over 90% of these managers are based in China. Nevertheless, the investor landscape is more encouraging with a diversified base hailing from China (42%), US (34%) and other regions (14%).

Preqin is thrilled to be at the heart of the exciting developments in Greater China PEVC. We are thankful to have built our networks in Asia-Pacific over the years, and would like to extend our gratitude to the industry-leaders that have contributed their insights to this report: BPEA, CDH Investment, HKVCA, LPACN, Manulife-Sinochem, MAPECT, Oriza FoF, Prospect Avenue Capital, The Dietrich Foundation and Value Partners.

Preqin is committed to providing the best data and information to support our customers – investors, fund managers, advisors and service providers – in making the best investment decisions. We will continue to invest heavily in our data, insights and tools for the alternative assets professionals in Greater China.

[1] Greater China accounts for 61% of Asia-Pacific-focused AUM, Preqin Pro.
[2] Figure as of July 2019.
[3] As of July 2019, the number of private equity-backed buyout deals and VC deals in Greater China has dropped by 30% and 48% respectively.

Robust Opportunity as Beijing Races towards Technology and Innovation

The transitioning Chinese economy has opened up huge new avenues for investment in domestic PEVC

At a glance, Greater China's staggering $600bn[1] in PEVC AUM, up 36% from the previous year, suggests an industry transitioning impressively. Yet, this latest rate of year-on-year growth is the slowest since 2014.

The comparatively laggard pace parallels China's economic performance – its 6.2% GDP expansion in Q2 2019 was the most sluggish in 27 years[2]. Fundraising and closing deals are getting harder in the face of looming headwinds such as an economic slowdown, high debt and nagging trade tensions with the US. The number of Greater China-focused PEVC funds closed and VC deals completed in 2019 up to the end of July plummeted 59% and 48% respectively compared with the same period last year.

After two decades of rapid economic growth fuelled by debt and foreign direct investments, the central government is spearheading a switch from an export-driven economy to domestic consumption. Traditional manufacturing is making way for innovation and technology. In tandem with this transition, we see that the sources of capital driving the PEVC industry in Greater China are changing.

The decade since 2008 marked the turning-point. Fundraising became dominated by RMB-denominated vehicles backed by domestic players such as banks, local governments and corporate investors. However, a tightening domestic credit environment has prompted fund managers to look elsewhere for fresh capital, resulting in the rise of USD funds last year which has continued into 2019[3].

Despite the trade war rhetoric, US-based institutions including pension funds, endowment plans and foundations are among the most active investors in Greater China, comprising over a full third (34%) of the PEVC investor base – second only to China-based LPs. Our LP roundtable on page 28 invites prominent domestic and international players to share their insights on a range of topics including the differences between RMB and USD fund managers, how asset allocation decisions are crafted, and the due diligence process in GP selection.

China is advancing rapidly as a global innovator, moving up three spots since last year to 14th this year in the Global Innovation Index.[4] Global tech leaders have singled out Beijing, Hong Kong, Shanghai and Shenzhen as China's tech innovation hubs over the next four years, according to KPMG.[5]

Advancing certain sectors is central to Beijing's plans (mapped out in its 'Made in China 2025' strategy) to transform China into a world leader in innovation. Preqin surveyed LPs globally in August on their investment appetite, preferences and return expectations when investing in Greater China. Like elsewhere, investors cited healthcare, IT and new-economy industries such as artificial intelligence (AI), e-commerce and fintech as the standout sectors for opportunity.

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[1] *Figure as of December 2018.*

[2] *National Bureau of Statistics of China*

[3] *Aggregate capital raised by RMB-denominated funds as of July 2019 includes the $28bn (RMB 200bn) final close of state-backed China Integrated Circuit Industry Investment Fund II.*

[4] *https://www.globalinnovationindex.org/gii-2019-report*

[5] *https://assets.kpmg/content/dam/kpmg/sk/pdf/2018/tech-hubs-forging-new-paths.pdf*

A transitioning Chinese economy is good news for the PEVC market

For innovation to thrive in these sectors, government and corporate roles, as well as the inflow of private capital, are crucial and interlinked. In 2017, the Chinese Government released the 'New Generation Artificial Intelligence Development Plan,' which outlined China's ambitions to build an RMB 1tn domestic AI industry and lead the world in AI by 2030. The Ministry of Science and Technology has since recruited 15 national AI champions including iconic firms like Baidu, Alibaba, Tencent (also known as BAT), iFlyTek and SenseTime to head the development of next-generation technologies. They are expected to host open innovation platforms in their respective fields, ranging from autonomous driving, smart city, voice and facial intelligence to computer vision for medical diagnosis. In concert with this, the aggregate value of AI VC deals leapt 27-fold within five years, amounting to $8.1bn in 2018.

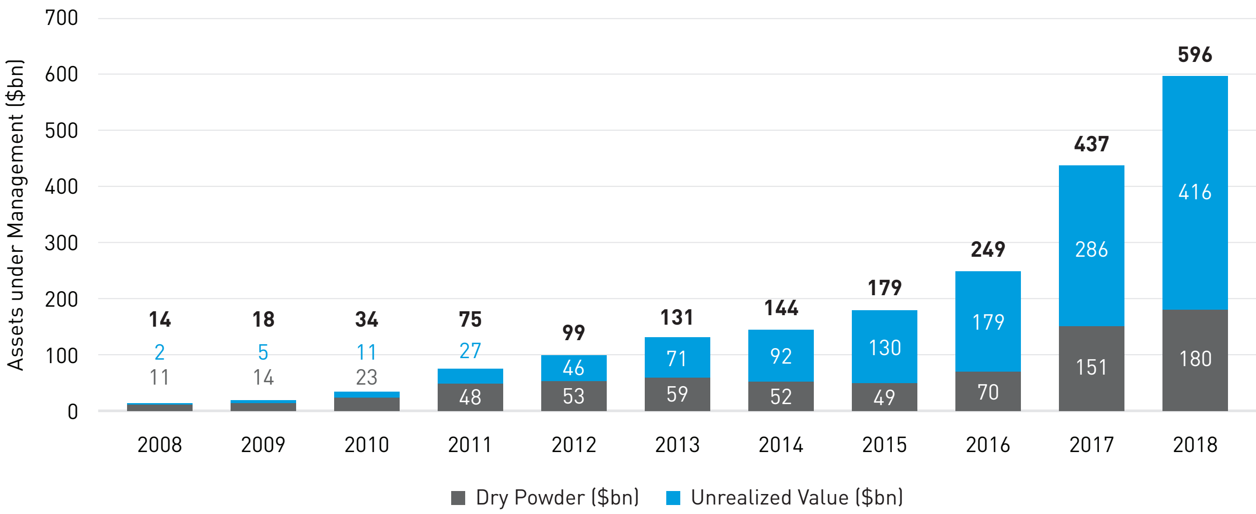
The launch of Shanghai's Science and Technology Innovation Board (dubbed the STAR Market) in July 2019 marked another step in the right direction for China's economic transition by introducing a new capital-raising channel for domestic tech companies still in pre-profit stage. The move comes after the Hong Kong Stock Exchange announced new rules to allow listings of pre-revenue tech firms on the main board. In 2019 as of the end of July, 96 VC exits were completed in Greater China, up 25% in comparison to the same period in 2018.

A transitioning Chinese economy is good news for the PEVC market. While fundraising and crafting deals remain challenging in the near term, fund managers and institutional investors can expect a rainbow of fresh investment and exit opportunities over the long term as China constructs its new economic pillars in technology and innovation.

Overview of Greater China

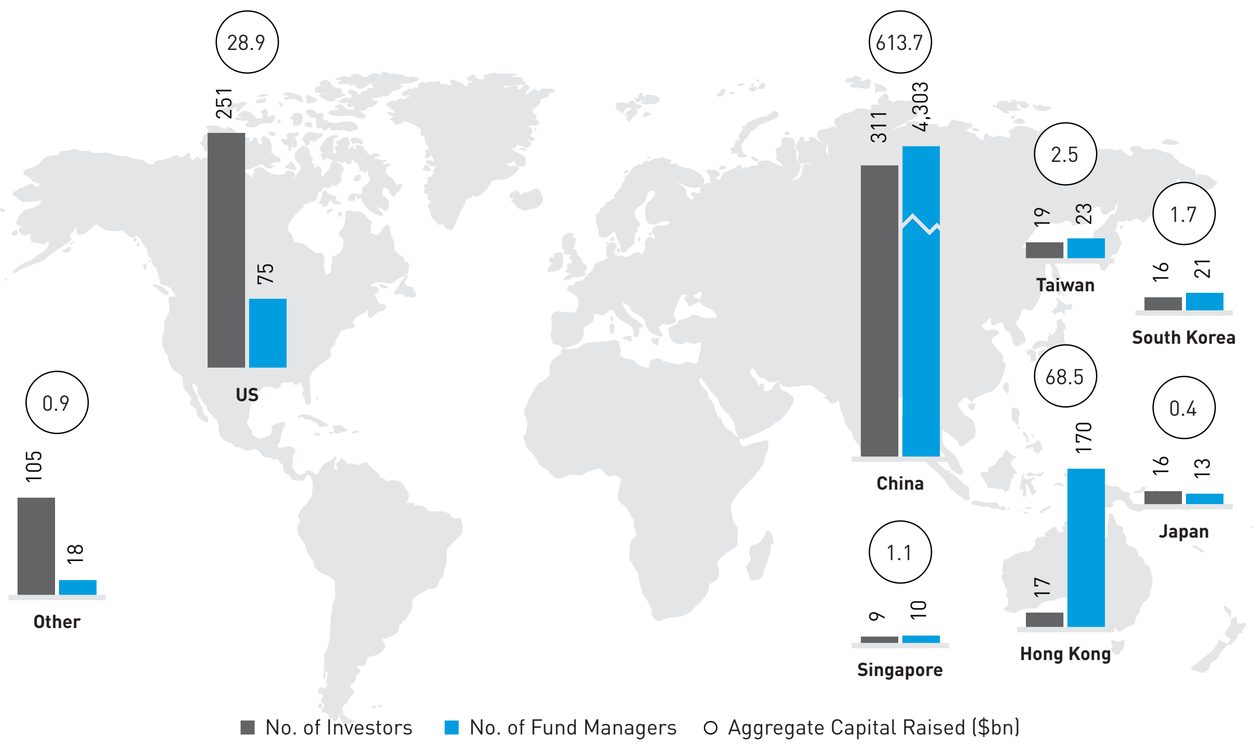
Year-on-year AUM growth rate is at its slowest since 2014

Fig. 1: Greater China-Focused Private Equity & Venture Capital Assets under Management, 2008 - 2018



Source: Preqin Pro

Fig. 2: Fund Managers and Institutional Investors Active in Greater China-Focused Private Equity & Venture Capital by Location

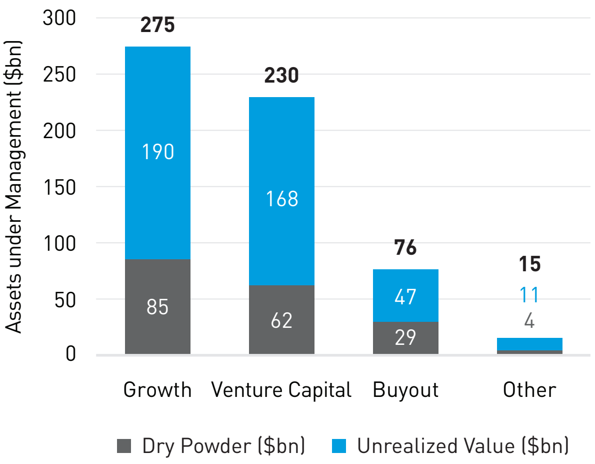


Source: Preqin Pro

AUM, Performance and Fundraising

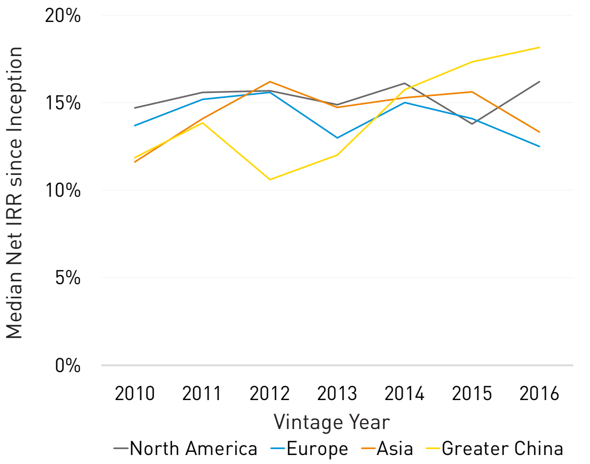
Fundraising has surpassed 2018, and the rise in USD funds continues

Fig. 3: Greater China-Focused Private Equity & Venture Capital Assets under Management by Fund Type



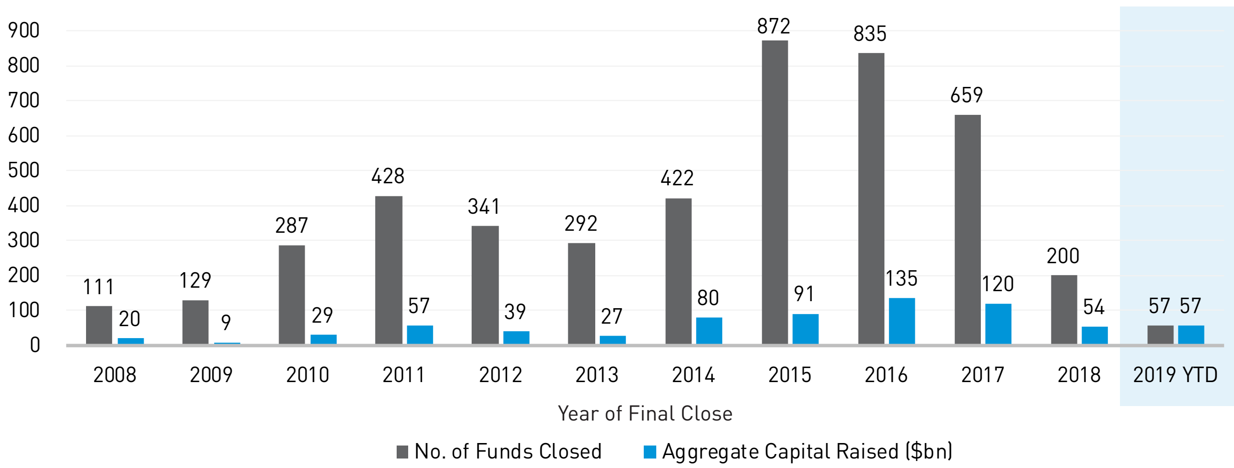
Source: Preqin Pro. Data as of December 2018

Fig. 4: Private Equity & Venture Capital - Median Net IRRs by Primary Geographic Focus and Vintage Year



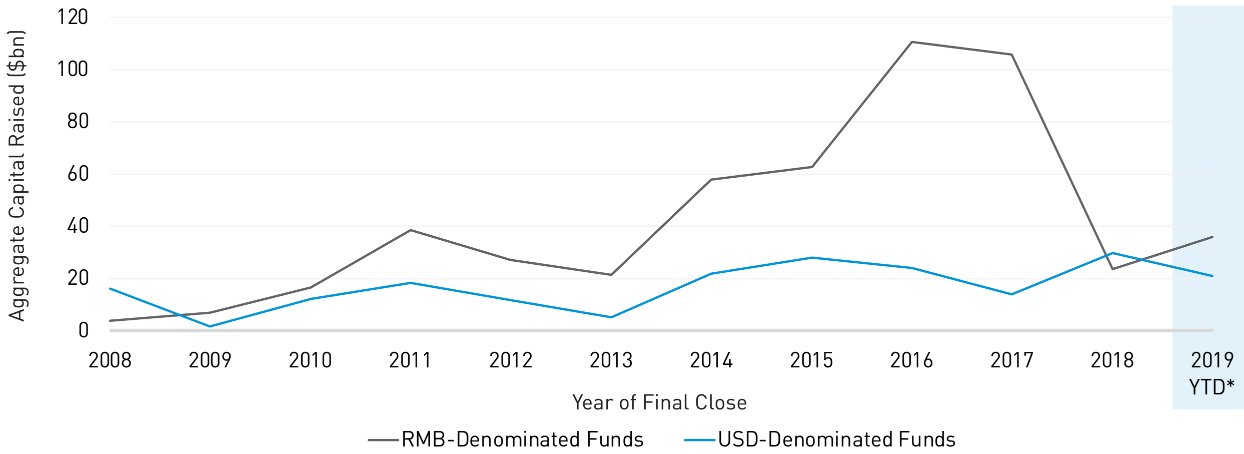
Source: Preqin Pro. Most Up-to-Date Data

Fig. 5: Annual Greater China-Focused Private Equity & Venture Capital Fundraising, 2008 - 2019 YTD



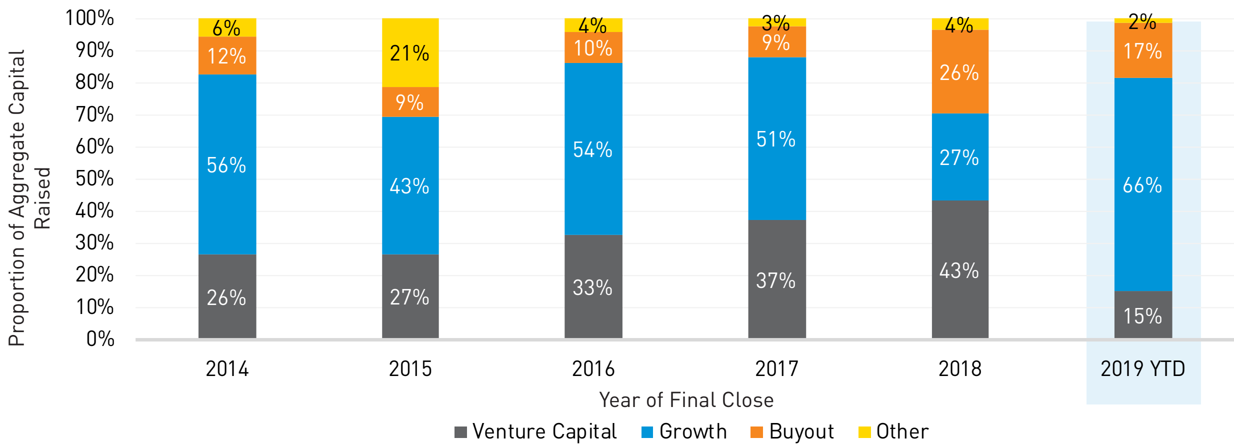
Source: Preqin Pro. Data as of July 2019

Fig. 6: Aggregate Capital Raised by Greater China-Focused Private Equity & Venture Capital Funds: RMB- vs. USD-Denominated Funds, 2008 - 2019 YTD*



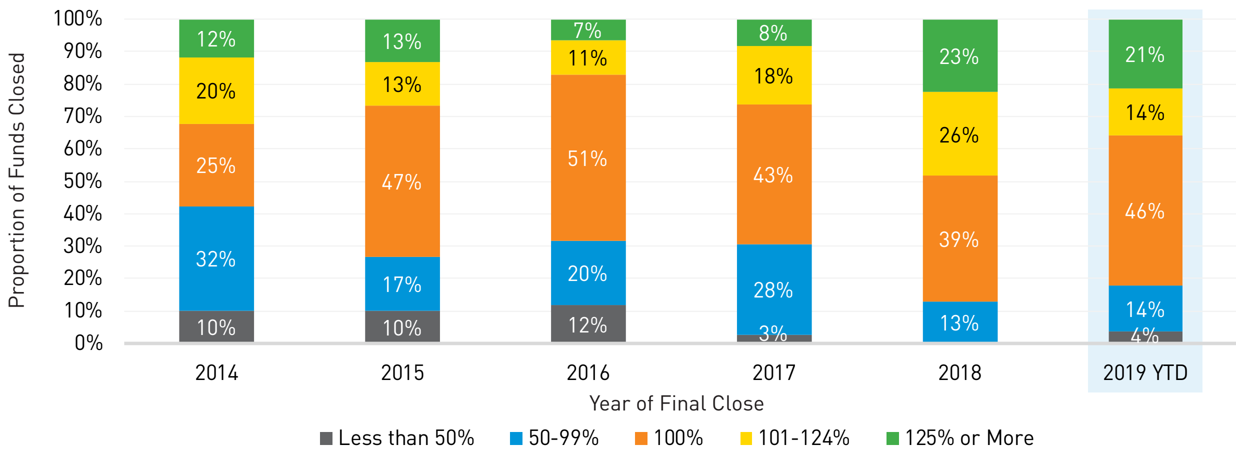
Source: Preqin Pro. Data as of July 2019

Fig. 7: Aggregate Capital Raised by Greater China-Focused Private Equity & Venture Capital Funds by Fund Type, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 8: Greater China-Focused Private Equity & Venture Capital Funds Closed by Proportion of Target Size Achieved, 2014 - 2019 YTD



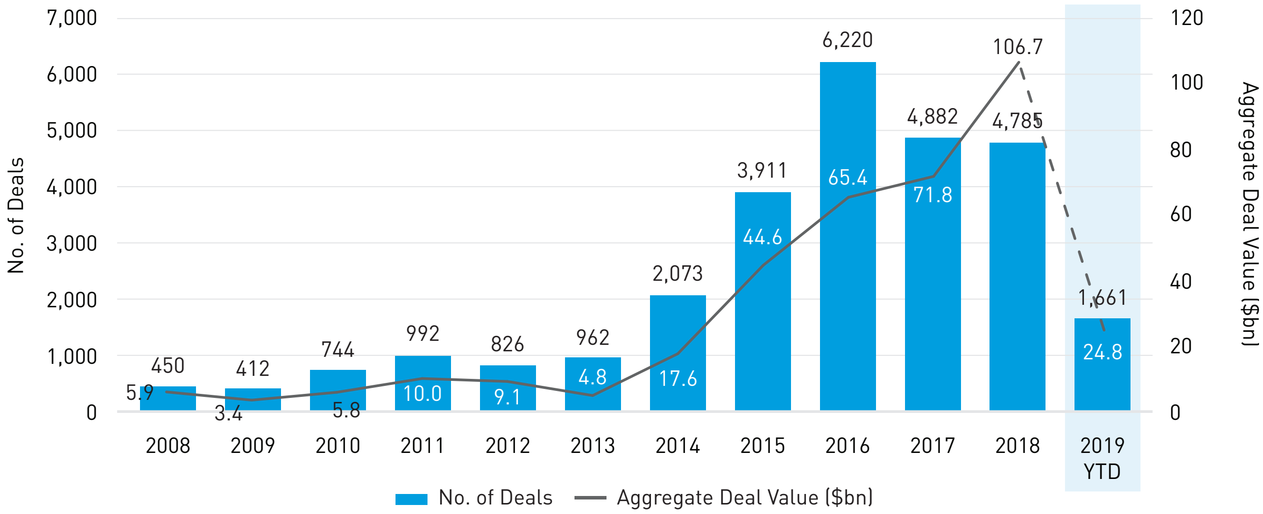
Source: Preqin Pro. Data as of July 2019

**State-backed China Integrated Circuit Industry Investment Fund II held a final close on RMB 200bn in July 2019.*

Deals and Exits

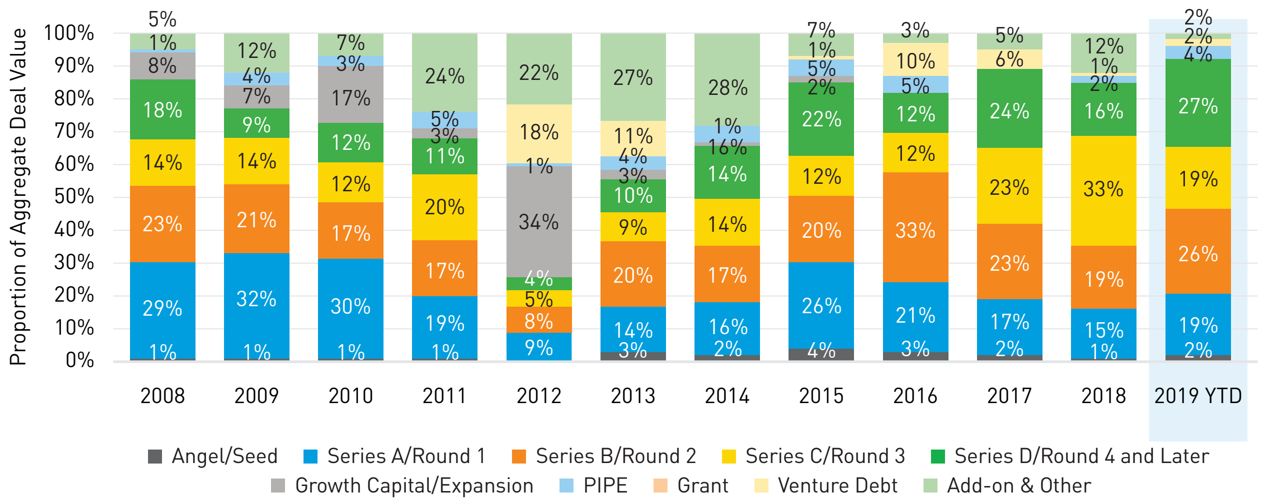
Deal-making activity within PEVC has dipped by more than one-third since 2018

Fig. 9: Venture Capital Deals* in Greater China, 2008 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

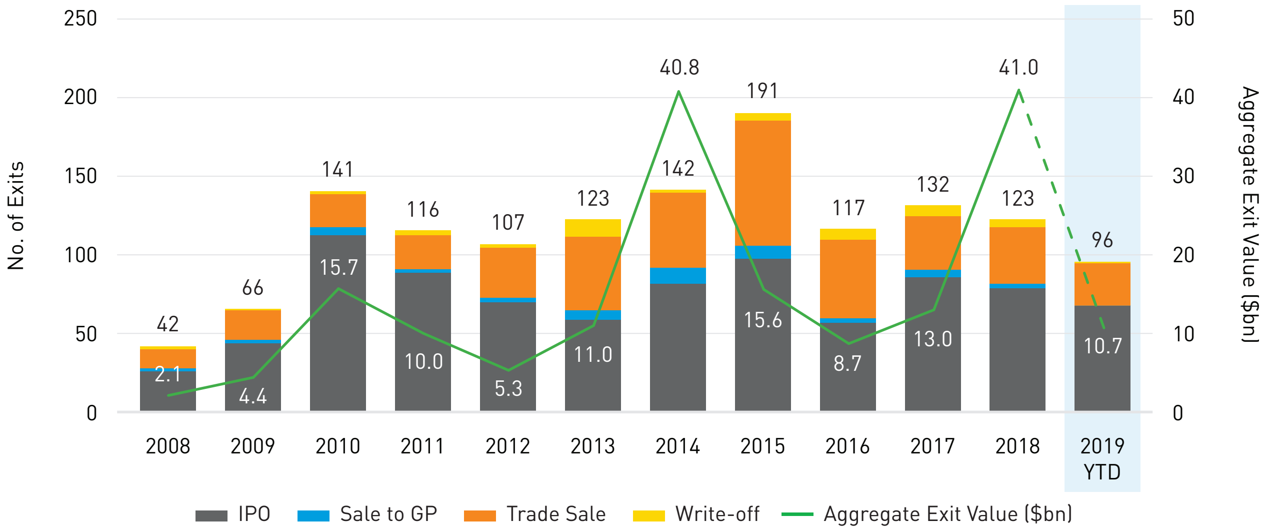
Fig. 10: Aggregate Value of Venture Capital Deals in Greater China by Stage, 2008 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

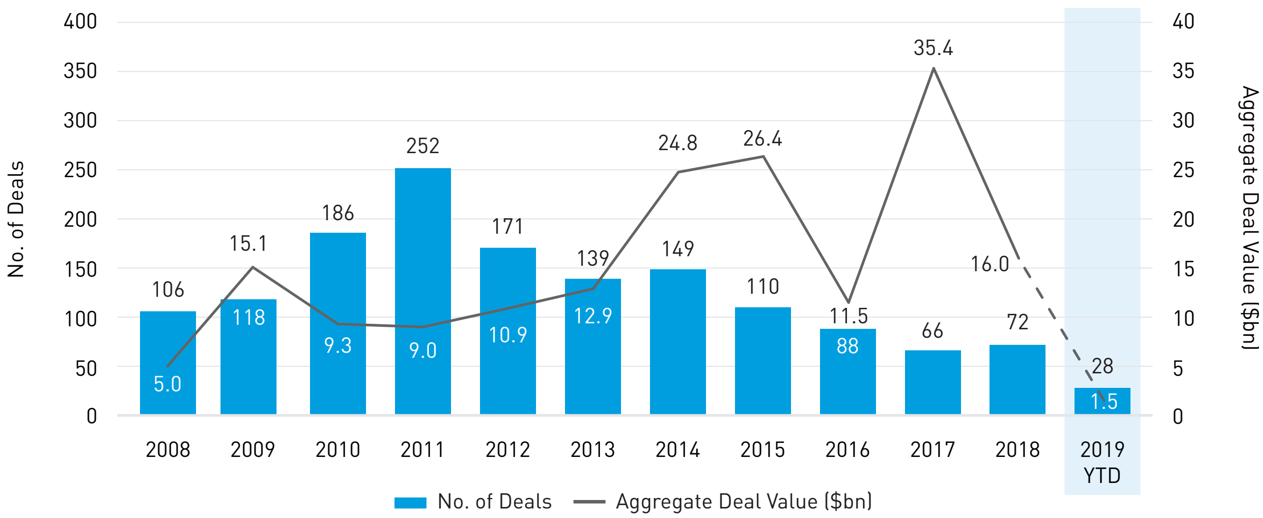
*Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.

Fig. 11: Venture Capital Exits in Greater China by Type, 2008 - 2019 YTD



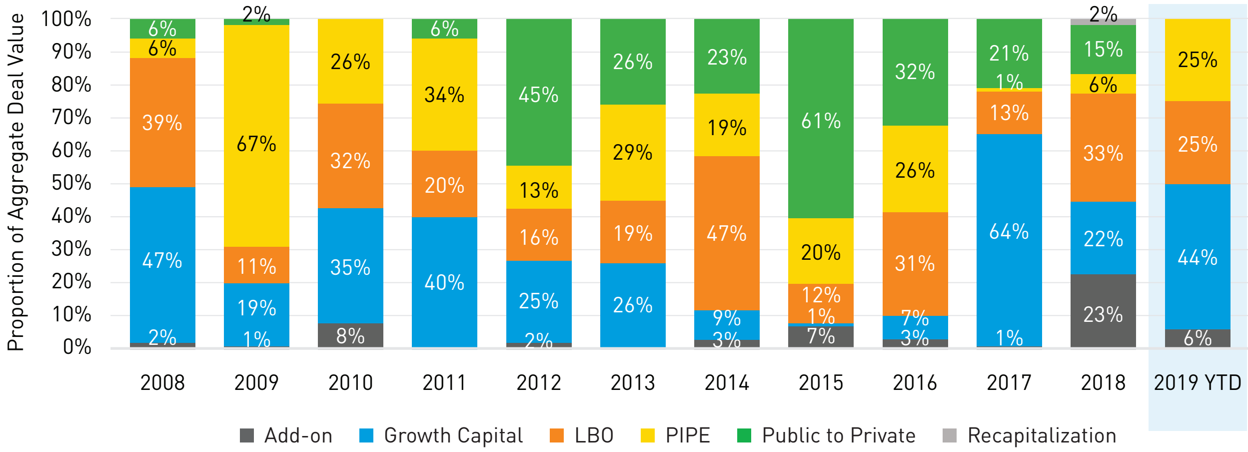
Source: Preqin Pro. Data as of July 2019

Fig. 12: Private Equity-Backed Buyout Deals in Greater China, 2008 - 2019 YTD



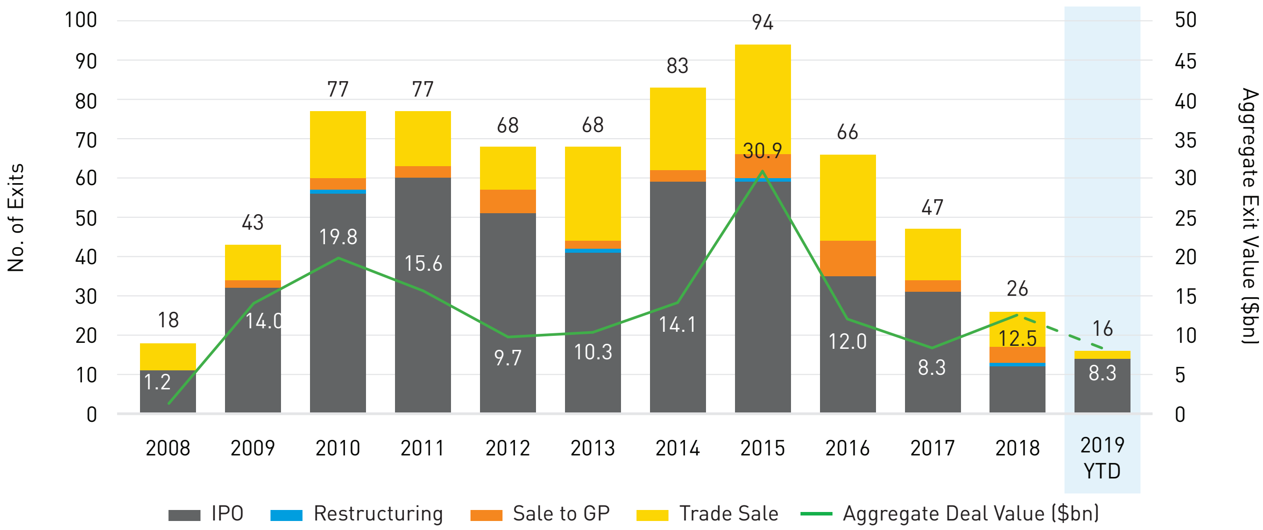
Source: Preqin Pro. Data as of July 2019

Fig. 13: Aggregate Value of Private Equity-Backed Buyout Deals in Greater China by Type, 2008 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 14: Private Equity-Backed Buyout Exits in Greater China by Type, 2008 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

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League Tables and Market Benchmarks

Fig. 15: Largest Greater China-Based Fund Managers by Total Capital Raised for Venture Capital Funds in the Last 10 Years

Rank	Firm	Headquarters	Total Venture Capital Raised in Last 10 Years ($bn)	Total Estimated Venture Capital Dry Powder ($bn)
1	YF Capital	Shanghai	5.8	1.3
2	Legend Capital	Beijing	5.6	1.5
3	IDG Capital	Beijing	4.6	0.5
4	Baidu Capital	Beijing	4.5	2.5
5	Qiming Venture Partners	Shanghai	3.8	1.4
6	Matrix Partners China	Beijing	3.1	1.1
7	Sinovation Ventures	Beijing	3.0	1.2
8	Shunwei Capital Partners	Beijing	2.8	0.5
9	Morningside Venture Capital	Shanghai	2.5	1.1
10	Shenzhen Capital Group	Shenzhen	2.2	0.6

Source: Preqin Pro

Fig. 16: Largest Greater China-Based Fund Managers by Total Capital Raised for Growth & Buyout Funds in the Last 10 Years

Rank	Firm	Headquarters	Total Growth & Buyout Capital Raised in Last 10 Years ($bn)	Total Estimated Growth & Buyout Dry Powder ($bn)
1	Hillhouse Capital Group	Beijing	16.9	8.9
2	PAG Asia Capital	Hong Kong	12.1	4.8
3	Baring Private Equity Asia	Hong Kong	10.9	0.4
4	RRJ Capital	Hong Kong	10.3	0.7
5	CITIC PE Funds Management	Beijing	10.1	2.7
6	Affinity Equity Partners	Hong Kong	9.8	4.6
7	CDH Investments	Beijing	9.0	0.2
8	Boyu Capital	Hong Kong	8.2	4.1
9	China Merchants Capital	Shenzhen	7.8	3.1
10	Hony Capital	Beijing	6.6	0.1

Source: Preqin Pro

Fig. 17: Top Performing Greater China-Focused Venture Capital Funds (Vintages 2006-2016)

Fund	Firm	Vintage	Fund Size (mn)	Fund Type	Net IRR (%)	Date Reported
Joy Capital I	Joy Capital	2015	200 USD	Early Stage	89.5	31-Dec-18
Ventech China III	Ventech China	2015	225 USD	Early Stage	67.0	30-Sep-18
Internet Founders Fund I	Eminence Ventures	2016	8.5 USD	Venture Capital (General)	59.0	30-Jun-19
Langsheng Investment Fund II	Langsheng Investment	2013	150 RMB	Venture Capital (General)	43.5	30-Jun-19
Ventech China II	Ventech China	2011	85 USD	Early Stage	33.0	30-Sep-18

Source: Preqin Pro

Fig. 18: Top Performing Greater China-Focused Growth & Buyout Funds (Vintages 2006-2016)

Fund	Firm	Vintage	Fund Size (mn)	Fund Type	Net IRR (%)	Date Reported
Peregrine Greater China Capital Appreciation Fund	Bull Capital Partners	2008	185 USD	Growth	47.8	31-Mar-19
Shanghai Guanyou Healthcare Buyout Fund I	Shanghai Guanyou Investment	2014	308 RMB	Buyout	45.9	30-Jun-19
C-Bridge Healthcare Fund II	CBC Group	2016	400 USD	Growth	30.6	31-Mar-19
Orchid Asia V	Orchid Asia Group	2011	650 USD	Growth	27.4	31-Dec-18
CPE China Fund	CITIC Private Equity Funds Management	2010	990 USD	Growth	26.9	31-Mar-19

Source: Preqin Pro

Fig. 19: Greater China-Focused Private Equity & Venture Capital Funds to Watch (Vintages 2017-2019)

Fund	Firm	Vintage	Fund Size (mn)	Fund Type	Net Multiple (X)	Date Reported
Eminence Ventures RMB I	Eminence Ventures	2017	100 RMB	Venture Capital (General)	1.92	30-Jun-19
Joy Capital II	Joy Capital	2017	300 USD	Early Stage	1.42	31-Dec-18
Vision Plus Capital Fund II USD	Vision Plus Capital	2018	250 USD	Early Stage	1.32	31-Dec-18
China Creation Ventures USD I	China Creation Ventures	2017	200 USD	Early Stage	1.30	30-Jun-19
Vickers Venture RMB Fund	Vickers Venture Partners	2017	232RMB	Venture Capital (General)	1.28	31-Mar-19

Source: Preqin Pro

Fig. 20: Private Equity & Venture Capital Benchmarks: Asia vs. Greater China

	Net IRR (%) Quartiles											
	Asia						Greater China					
Vintage	No. of Funds	Max	Q1	Median	Q3	Min	No. of Funds	Max	Q1	Median	Q3	Min
2010	23	70.0	24.6	11.6	3.1	-53.0	8	26.9	18.0	11.9	8.2	3.3
2011	40	65.4	20.1	14.1	8.7	-17.5	12	33.0	23.7	13.9	8.4	-16.6
2012	32	283.0	25.5	16.2	10.8	-0.8	5	18.0	16.3	10.6	9.0	3.5
2013	42	65.0	21.5	14.8	9.2	-2.4	7	43.5	17.7	12.0	10.0	8.0
2014	32	62.6	31.1	15.3	12.1	-10.6	11	45.9	22.5	15.8	9.0	-10.6
2015	35	79.5	22.6	15.6	10.8	2.9	10	89.5	41.4	17.4	14.0	10.7
2016	42	70.0	26.2	13.3	8.5	-23.7	17	92.0	51.9	18.2	13.8	2.4

	Multiple (X) Quartiles											
	Asia						Greater China					
Vintage	No. of Funds	Max	Q1	Median	Q3	Min	No. of Funds	Max	Q1	Median	Q3	Min
2010	23	51.70	3.02	1.76	1.28	0.80	8	3.23	2.29	1.77	1.43	1.11
2011	40	4.20	2.18	1.69	1.47	0.37	12	2.71	2.17	1.80	1.43	0.39
2012	32	5.05	2.27	1.61	1.41	0.53	5	2.24	2.06	1.48	1.39	1.14
2013	42	6.40	1.70	1.46	1.25	0.62	7	3.51	1.86	1.40	1.37	1.35
2014	32	4.18	1.65	1.34	1.21	0.29	11	2.56	1.72	1.46	1.34	0.79
2015	35	3.64	1.67	1.34	1.23	0.97	10	3.68	2.28	1.61	1.34	1.21
2016	42	5.08	1.30	1.20	1.09	0.83	17	4.50	1.58	1.32	1.22	1.04

Source: Preqin Pro. Most Up-to-Date Data

Fig. 21: Most Active Venture Capital Firms in Greater China in 2018

Rank	Firm	No. of Deals	Aggregate Deal Value ($bn)	Notable Investments
1	Sequoia Capital	117	268	Ant Financial, Pinduoduo, Manbang
2	ZhenFund	110	10	Xiaohongshu, Xiaoqule, Club Factory
3	IDG Capital	109	70	Ping An Medical and Healthcare Management, Chehaoduo, Ping An Good Doctor
4	Matrix Partners China	91	31	Lixiang Auto, Xiaopeng Motors, Yuanfudao
5	K2VC	65	7	MyDreamPlus Technology, Yunding Technology, Xiangwushuo
6	Shunwei Capital Partners	58	16	17Zuoye, Qutoutiao, Meicai
7	Gaorong Capital	54	5	Danke Gongyu, Tianrang Intelligence, Coffee Box
8	Legend Capital	52	16	Kemei Biotechnology, Luckin Coffee, Innovent Biologics
9	Qiming Venture Partners	51	14	Tuhu, Wacai, BingoBox
10	Shenzhen Capital Group	42	15	SenseTime, Pagoda, Roadstar.ai
	Northern Light Venture Capital	42	4	Zelgen, 91xinshang, Maihaoche
	Fortune Capital	42	4	QK365, Meiwei Dental, Shangqiao56

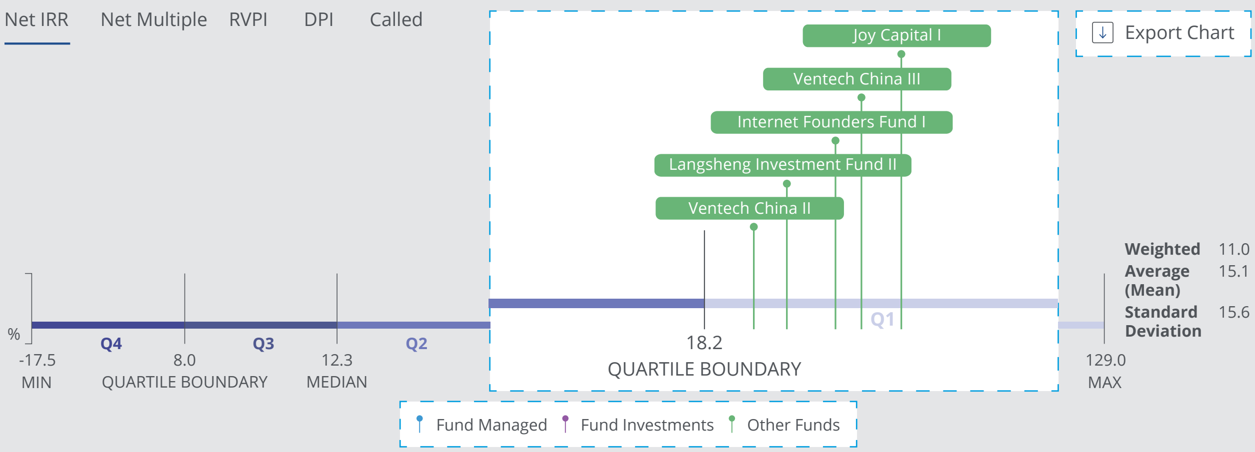
Source: Preqin Pro

Fig. 22: Largest Unicorns in China

Portfolio Company	Post-Money Valuation ($bn)	Total No. of Funding Rounds	Primary Industry	Vertical(s)	Latest Investment Date	Sample Investor(s) in Latest Funding Round
Ant Financial	150	6	Financial Services	Fintech	Jun-18	China Pacific Life Insurance
ByteDance	75	7	Media	Mobile Apps, Social Media	Oct-18	KKR, Primavera Capital, SoftBank
Didi Chuxing	56	26	Transportation Services	Mobile Apps	Jul-19	Toyota Motor Corporation
Lufax	39.4	3	Financial Services	Fintech	Dec-18	Primavera Capital, Qatar Investment Authority, All-Stars Investment, SBI Holdings, JP Morgan, Macquarie Group, UBS, UOB, Goldman Sachs, LionRock Capital, Hedosophia, Hermitage Capital
JD Finance	20	3	Financial Services	Fintech	Jul-18	CITIC Capital, CICC Capital, China Securities, Bank of China Group Investment

Source: Preqin Pro

New: Personalized Benchmarks



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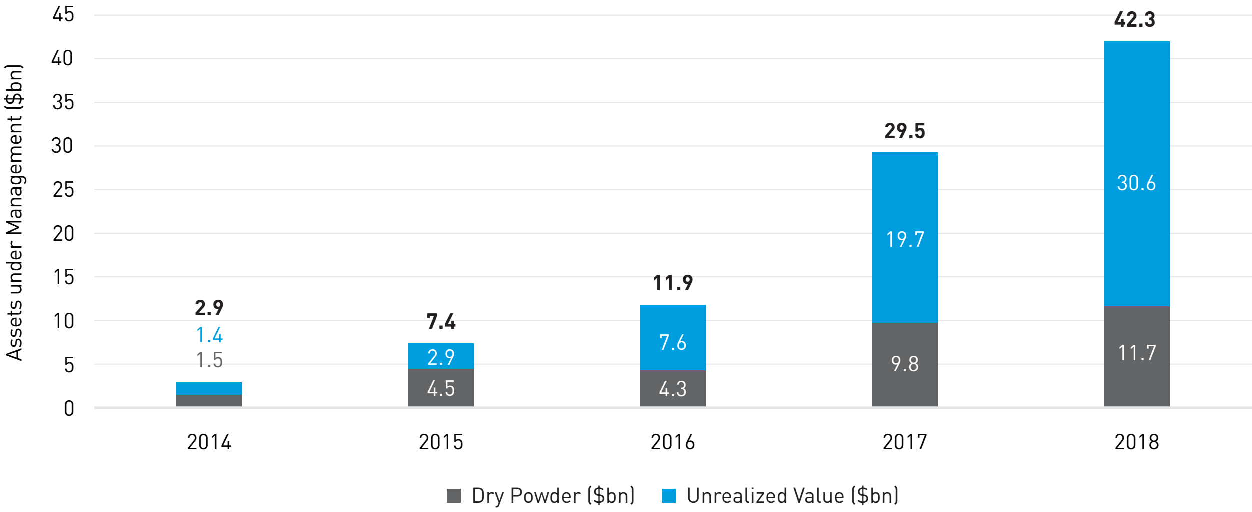
Industry Overview

Healthcare

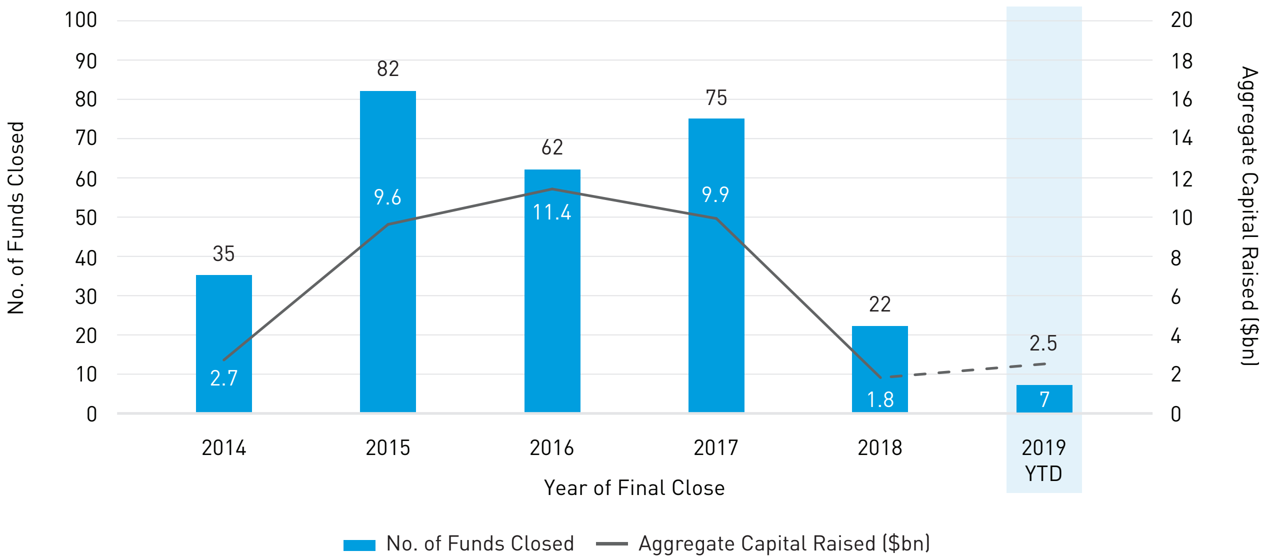
Healthcare remains evergreen with steady AUM growth year on year

Fig. 23: Greater China Healthcare-Focused Private Equity & Venture Capital Assets under Management, 2014 - 2018



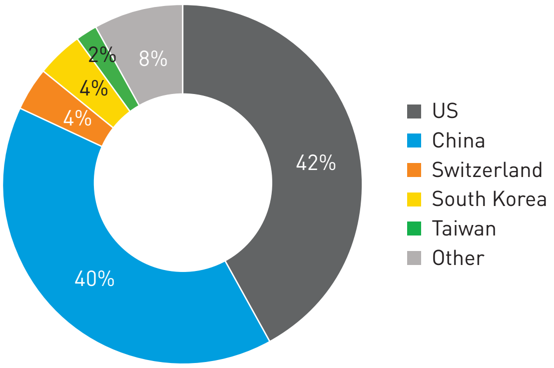
Source: Preqin Pro

Fig. 24: Annual Greater China Healthcare-Focused Private Equity & Venture Capital Fundraising, 2014 - 2019 YTD



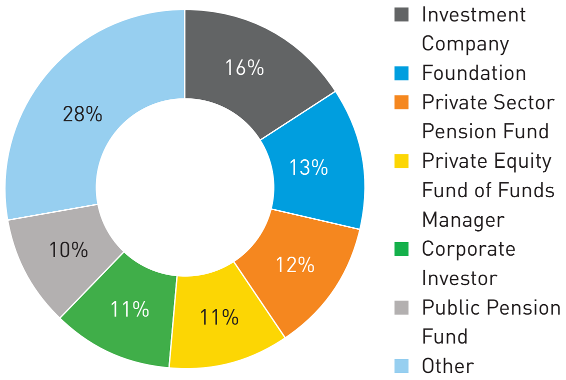
Source: Preqin Pro. Data as of July 2019

Fig. 25: Private Equity & Venture Capital Investors Active in Greater China Healthcare-Focused Funds by Location



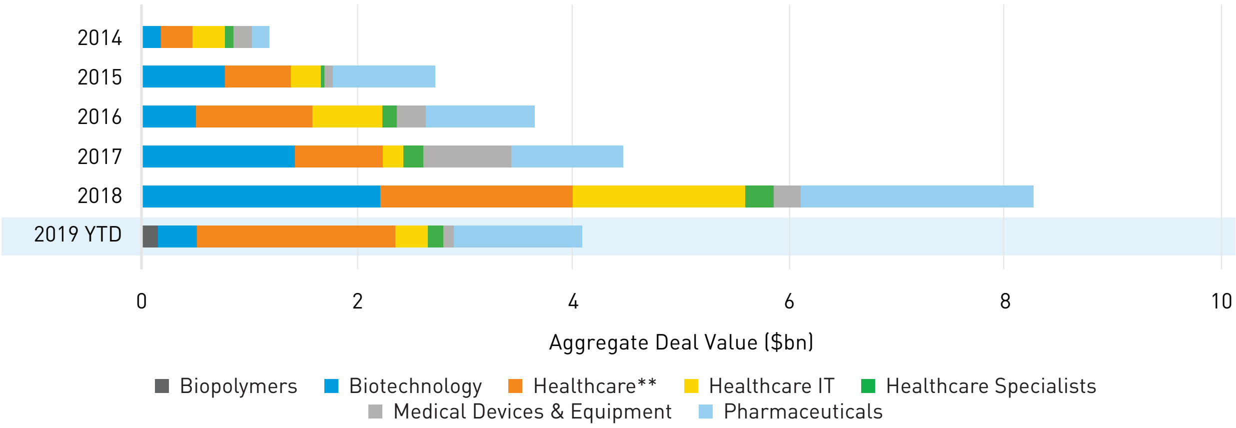
Source: Preqin Pro

Fig. 26: Private Equity & Venture Capital Investors Active in Greater China Healthcare-Focused Funds by Type



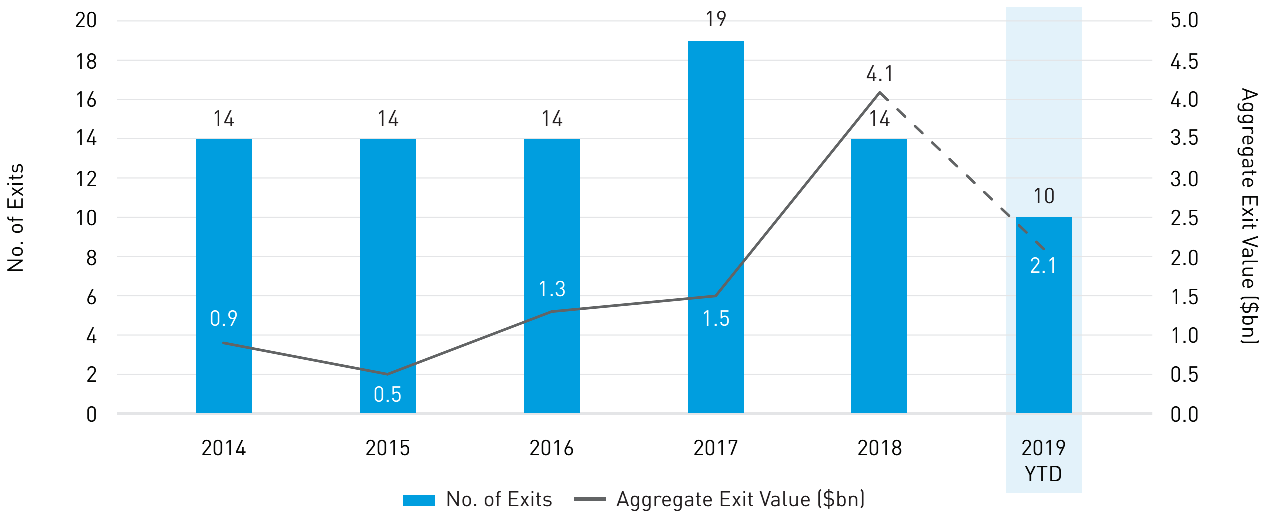
Source: Preqin Pro

Fig. 27: Aggregate Value of Healthcare Venture Capital Deals* in Greater China by Primary Industry, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 28: Healthcare Venture Capital Exits in Greater China, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

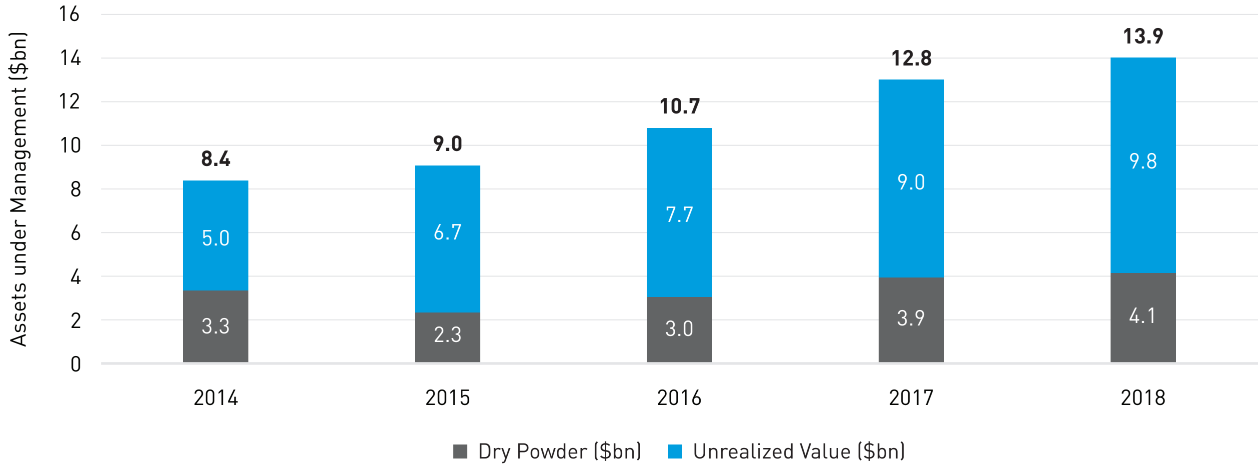
*Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.
**Healthcare refers to aesthetic medicine, alternative medicine, clinics/outpatient services, diagnostic, medical & imaging laboratories, emergency services, epidemiology, home healthcare, nursing homes & assisted living and hospitals.

Industry Overview

Consumer Discretionary

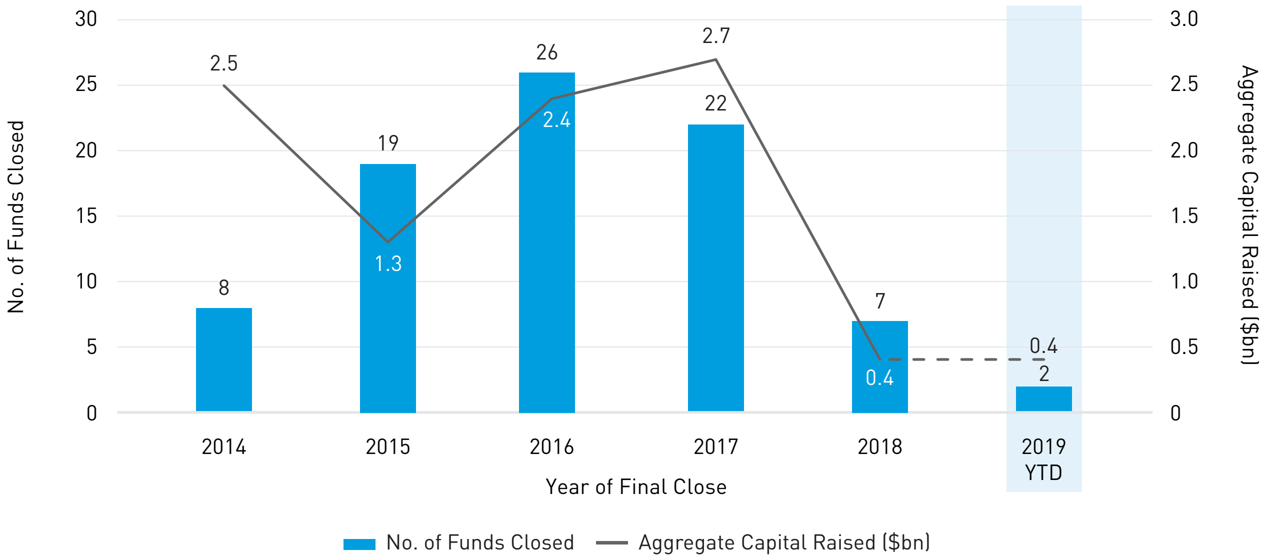
One of the most sought-after industries in PEVC, Greater China AUM is increasing year on year

Fig. 29: Greater China Consumer Discretionary-Focused Private Equity & Venture Capital Assets under Management, 2014 - 2018



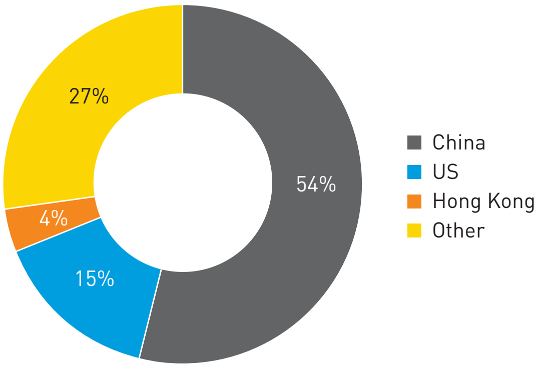
Source: Preqin Pro

Fig. 30: Annual Greater China Consumer Discretionary-Focused Private Equity & Venture Capital Fundraising, 2014 - 2019 YTD



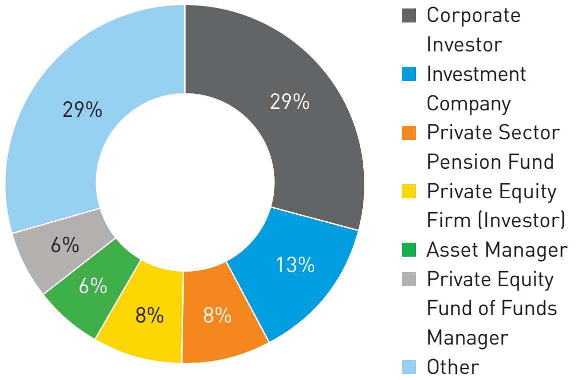
Source: Preqin Pro. Data as of July 2019

Fig. 31: Private Equity & Venture Capital Investors Active in Greater China Consumer Discretionary-Focused Funds by Location



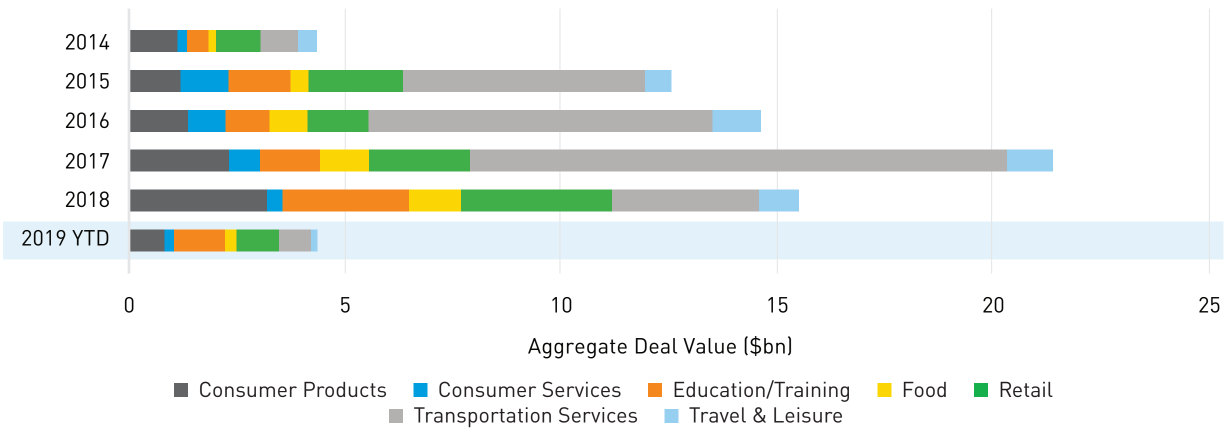
Source: Preqin Pro

Fig. 32: Private Equity & Venture Capital Investors Active in Greater China Consumer Discretionary-Focused Funds by Type



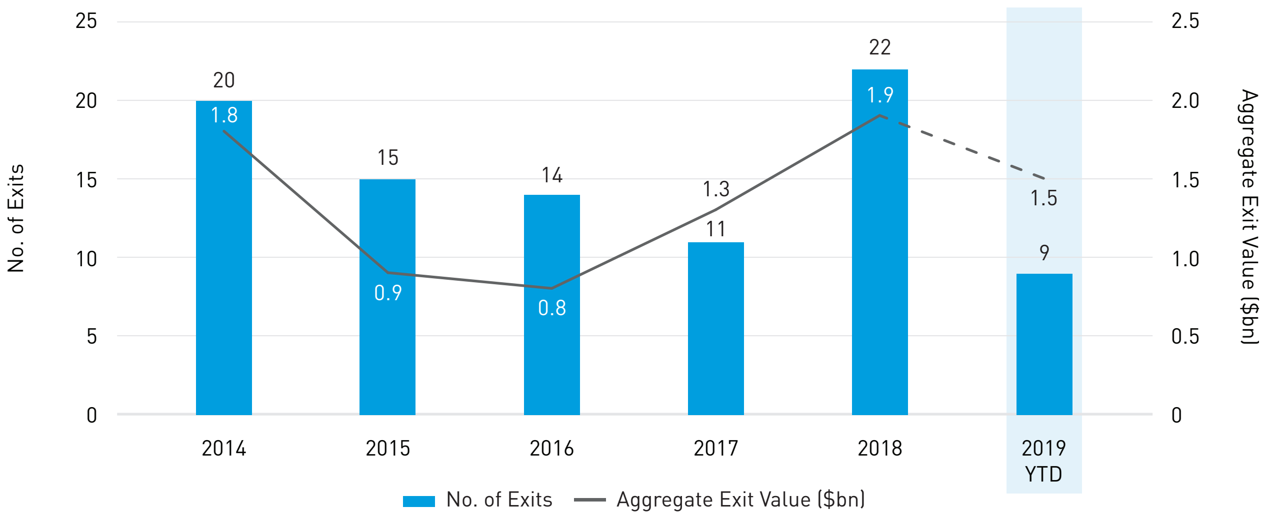
Source: Preqin Pro

Fig. 33: Aggregate Value of Consumer Discretionary Venture Capital Deals* in Greater China by Primary Industry, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 34: Consumer Discretionary Venture Capital Exits in Greater China, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

*Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.

Demand for Private Universities in China Is Set to Soar

The rise of China's innovation economy means it needs even more workers with tech skills

Michael J. Mills
Managing Director, Alternative Products, Value Partners

China's higher education sector is attracting more investment than ever before. With the rise of China's middle class, and the growing affluence of Chinese families[1], student demand for higher education qualifications is increasing fast. As a result, since 2017, the Chinese Government has sought to encourage more private investment in higher education.

This presents private equity (PE) with an exciting new opportunity. We see great potential for PE to offer private, for-profit educational services centred on technical and vocational skills. These skills are expected to become increasingly essential as China continues to spend more on research and development (R&D) and on its innovation economy. Below, we examine the key drivers behind China's growing appetite for private higher education facilities.

The Need for More Universities

In its 13th Five-Year Plan, the Ministry of Education (MOE) set a target that at least 50%[2] of high-school students should enter college by 2020. This means that by next year, about 750,000 additional students will be looking to enrol in higher education. By 2030, the government is aiming to raise that target to 60%.[3] In order to achieve the 2020 target, approximately 75 new universities[4] will be required.

In 2017, there were about two million[5] high-school or *gaokao* graduates seeking college admission who were unable to attend because of a lack of university places.

To cope with soaring demand for higher education, some regions are adjusting their policies to allow more students to apply. For example, Guangdong will increase its student quota by 80,000[6] within the next three years, while Sichuan has extended its application deadline so that students have more time to submit their requests.

The Critical Role of Private Universities

As China transitions towards an innovation economy underpinned by higher-value-chain products and services, it requires an increasingly skilled workforce. Given how fast technology is changing, educational institutions will need to be versatile and agile to equip students with the right technical skills, and we believe that private universities are in the best position to do so.

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[1] *National Bureau of Statistics, March 2019*
[2] *Ministry of Education, July 2018*
[3] *China Association of Higher Education*
[4] *We assume that one university can cater to 10k students. If we estimate that the total population of potential university students is 15m, then 5%*15m = 750k, meaning 75 universities are required.*
[5] *Wind Data*
[6] *Guangdong Province Department of Education, May 2019*

Value Partners

Value Partners is one of Asia's largest independent asset management firms offering a diversified asset management portfolio for institutional and individual clients globally. Established in 1993 and headquartered in Hong Kong, it operates offices globally including in Beijing, Shanghai, Shenzhen, Singapore, Kuala Lumpur, London and Boston. Value Partners was the first and only asset management firm listed on the Main Board of the Hong Kong Stock Exchange after it went public in 2007.

Michael J. Mills, Managing Director of Alternative Products, leads the development, distribution and Investor Relations functions of alternative investment products including private debt, private equity, real estate and hedge funds.

That is why we welcome the government's recent liberalization of the education sector. The Private Education Promotion Law's draft implementation rules demonstrate support for private enterprises and foreign investment in the sector. Education is capital intensive, and the ability to grow tuition fees is key to spur investments. Statistics show that China's average tuition fees are massively underpriced compared to those of South Korea and North America. While annual fees in China averaged $1,700[7] in 2017/2018, South Korea charged 5x more ($6,643) – and in the US, fees set students back by a whopping $21,000 plus change.

This highlights the huge potential for revenue growth in China's higher education sector. According to estimates from UBS[8], revenues in the sector are expected to rise by 8-10% annually between 2020 and 2025.

PE's Value-Add to the Higher Education Sector

To capture growth in this sector, we identified a value-creation process that eventually improves private schools. Firstly, PE firms can help schools to see the importance of offering quality curriculums and optimizing their program offerings. There has to be a focus on enhancing job prospects for their students. Schools could offer highly sought-after programs such as Computer Science and Finance, and actively seek out internships for their students to gain practical experience. This will then result in increased enrolment rates and the ability to charge higher tuition for a more holistic education. More tuition revenue translates into higher profits for investors in the education sector. This improvement in profitability provides the schools with room for expansion and the capacity to develop more niche curriculums such as robotics and engineering.

Currently, China is one of the world's biggest exporters of students seeking overseas education. By expanding local higher education options, the private sector can tap into this demand. PE can play a key role in this expansion by helping to create bilateral arrangements with international institutions, or by setting up twinning arrangements. Such initiatives would also attract international students to China. Furthermore, with the launch of China's multibillion-dollar Belt and Road Initiative – a global fiscal stimulus package – we expect even more international students to look to China for their university education.

For PE firms with the expertise to put capital to work locally and scale their investments, China's higher education market is especially attractive.

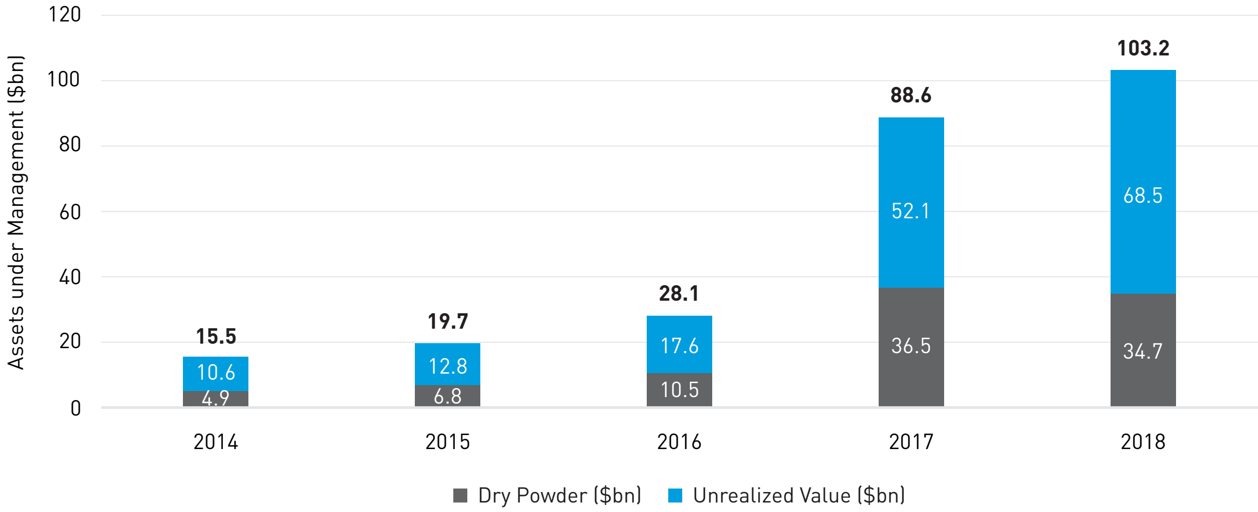
[7] *Education at a Glance 2017: OECD Indicators, Ministry of Education of South Korea*
[8] *UBS Securities Research, January 2019*

Industry Overview

Information Technology

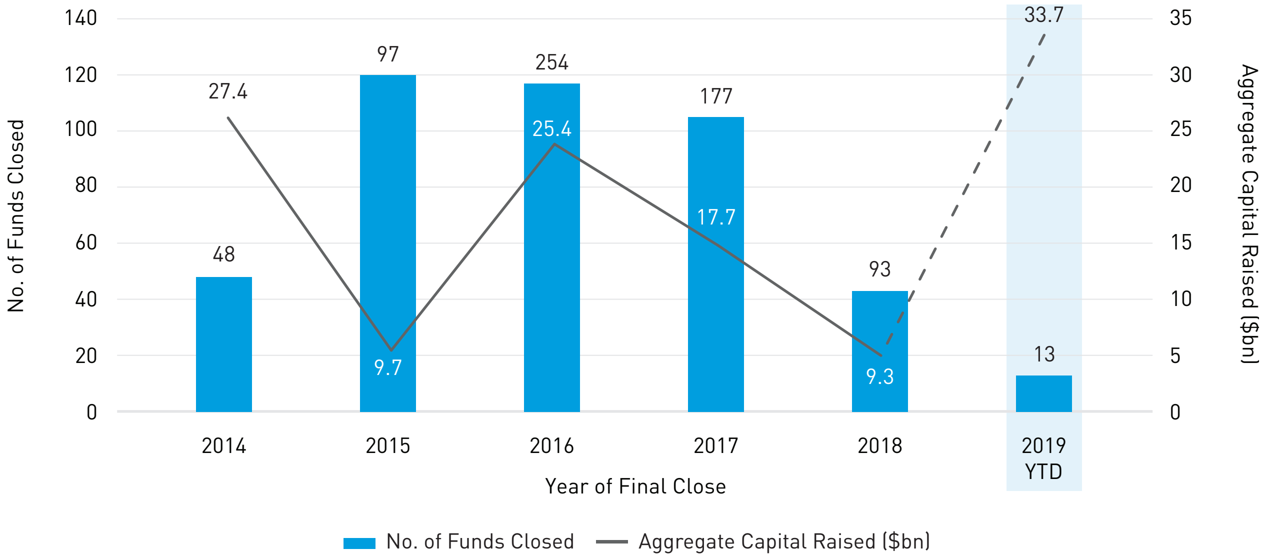
Significant development opportunities are expected as AUM passes the $100bn mark

Fig. 35: Greater China Information Technology-Focused Private Equity & Venture Capital Assets under Management, 2014 - 2018



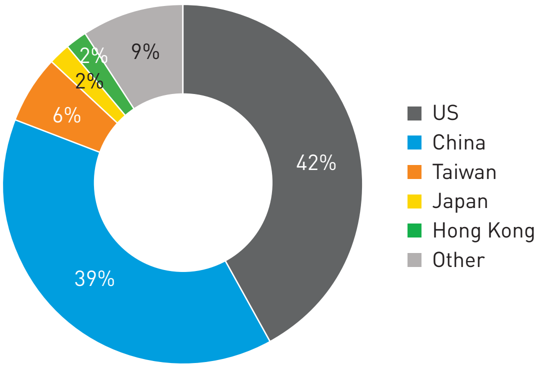
Source: Preqin Pro

Fig. 36: Annual Greater China Information Technology-Focused Private Equity & Venture Capital Fundraising, 2014 - 2019 YTD



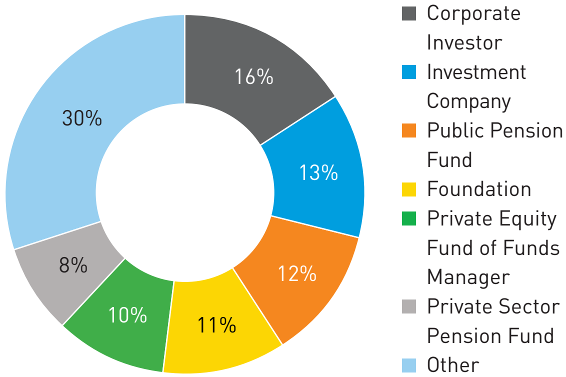
Source: Preqin Pro. Data as of July 2019

Fig. 37: Private Equity & Venture Capital Investors Active in Greater China Information Technology-Focused Funds by Location



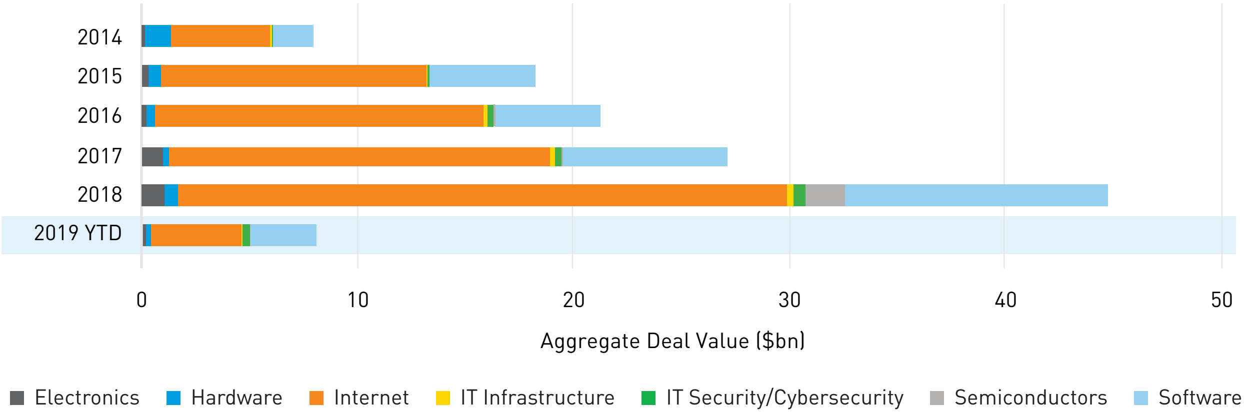
Source: Preqin Pro

Fig. 38: Private Equity & Venture Capital Investors Active in Greater China Information Technology-Focused Funds by Type



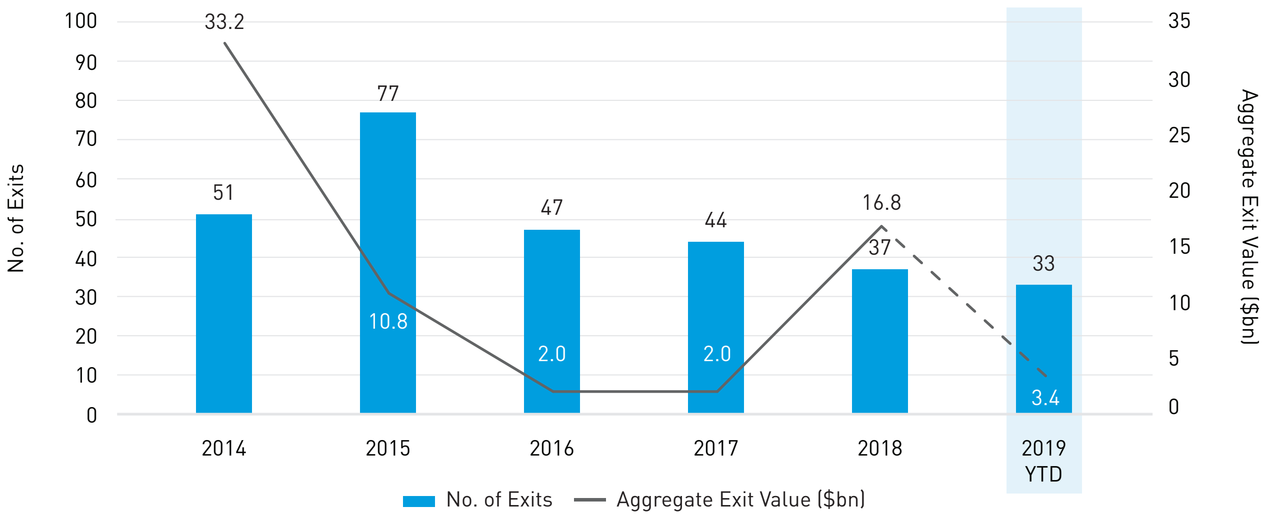
Source: Preqin Pro

Fig. 39: Aggregate Value of Information Technology Venture Capital Deals* in Greater China by Primary Industry, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 40: Information Technology Venture Capital Exits in Greater China, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

*Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.

Understanding China's Complex Regulatory System Is Vital for PEVC Investors

Personal connections or 'guanxi' isn't enough – PEVC investors targeting China's internet businesses also need to know how its regulatory agencies function

China has an extensive and complex regulatory framework. Start-ups and small businesses operating in China's fast-growing internet sector need to be able to navigate this system. Many of these businesses have yet to familiarize themselves with the agencies regulating them, and often they look to their private equity or venture capital (PEVC) backers to bolster this competency.

That's why it's vital that PEVC investors possess the necessary 'guanxi' or personal relationships with regulatory agencies. However, personal relationships alone aren't enough. PEVC investors also need to have a deep understanding of China's regulatory system. This means having a strong grasp of the historical evolution of the relevant regulatory agencies, along with up-to-date knowledge of key personnel changes.

These are essential elements for PEVC investors to build a track record of success. PEVC investment teams must be able to show that they have the experience and the contacts to help their investee companies resolve potential conflicts with regulators before they escalate. The first step is knowing the roles and responsibilities of the many government institutions operating in this space.

Ming Liao
Founding and Managing Partner, Prospect Avenue Capital

Compliance Failures Can Have Serious Consequences

The Cyberspace Administration of China (CAC)[1] is one of the leading internet regulators in China. The CAC works with several ministries and agencies that are responsible for routine supervision of internet businesses, including the People's Bank of China, the State Administration of Foreign Exchange (SAFE)[2], the China Securities Regulatory Commission (CSRC)[3], the China Banking and Insurance Regulatory Commission (CBIRC)[4], the Ministry of Industry and Information Technology (MIIT)[5], the State Administration for Market Regulation (SAMR)[6] and the Ministry of Public Security (MPS)[7].

We have noticed that government tolerance of the illegal collection and usage of consumer information through mobile apps is gradually wearing thin.

1 http://www.cac.gov.cn/
2 http://www.safe.gov.cn/en/
3 http://www.csrc.gov.cn/pub/csrc_en/
4 http://www.cbirc.gov.cn/web2019/english/index.html
5 http://www.miit.gov.cn/
6 http://www.samr.gov.cn/
7 http://www.mps.gov.cn/

According to publicly available information, in January 2019, the CAC, together with the MIIT, MPS and SAMR, announced a joint decision to crack down on the illegal collection of personal information. Shortly after the announcement, Personal Information Protection Taskforce on Apps was established by the National Information Security Standardization Technical Committee[8], China Consumers Association[9], Internet Society of China[10] and CAC to be responsible for supervising the collection of mobile app information.

In November 2019, the MIIT announced a special remediation act to protect app users, focusing on the illegal collection and usage of consumers' information as well as unreasonable demands on user limits, which affected numerous apps and app stores. More than 140 apps were reviewed and 20 of them were summoned to meet regulators.

There are also cross-agency groups like China's Internet Financial Risk Specialist Rectification Work Leadership Team, which was established in October 2016 and is led by the central bank. Members of the Team include the CSRC, the CBIRC, the MIIT and the SAMR. The Team's supervision spans online credit platforms (including peer-to-peer lending and cash loans), online payments, online fund sales, online asset managers, internet brokerages, online insurance brokerages, and digital currency and exchange.

Failure to understand and comply with China's internet regulations can have serious consequences. Two recent cases highlight the importance of knowing how to work with regulators to ensure compliance. The first occurred in late 2018, when local public security bureaus working with the MPS arrested the founders of five big data companies for violations involving the disclosure of Chinese citizens' private information. The second occurred in August 2019, when SAFE notified two cross-border payment companies that they had failed to comply with existing regulations. SAFE ordered banks and other payment companies to stop cooperating with these companies, essentially putting a stop to their business.

How PEVC Investors Can Help

Educating investee companies about the importance of regulation and connecting them with specific agencies to deepen mutual understanding is critical. PEVC investors must also encourage investee companies to provide these agencies with regular updates about how their business is progressing. These updates can help to eliminate regulatory concerns.

In emergency situations, PEVC investors must be able to take quick action. This may involve contacting the head of the specific department responsible for regulating an investee company in order to facilitate communication, explain the situation, clear up any misunderstandings and avoid potential business suspensions.

Tech companies across the globe are facing increasing scrutiny from governments, and in China heavier regulation is on the horizon. By leveraging decades of experience working with various Chinese regulatory authorities, and our extensive capital markets expertise, PAC is able to help investee companies to identify and avoid potential regulatory pitfalls with foresight. Learning this proactive approach to regulation gives our investee companies a competitive edge, and adds value for our limited partners.

*PAC goes on to explore why investors should be wary of high valuations in the internet space in Greater China. Stay tuned for the article on **Preqin Insights**.*

Prospect Avenue Capital

We are a $500mn growth capital fund focusing on China's technology, media & telecoms (TMT) sector. Established in February 2018, PAC has deployed nearly $200mn, including five mid- to late-stage investments. Except one US IPO in 2019, PAC expects two more IPO listings in 2020.

PAC's founding partner Ming Liao is a Princeton graduate and Morgan Stanley-trained former investment banker. He earned his BA in Economics in China and his Master in Public Affairs in Economics at the Woodrow Wilson School of Public and International Affairs at Princeton University. Apart from Morgan Stanley, he held senior executive roles at Carlyle Group and UBS AG.

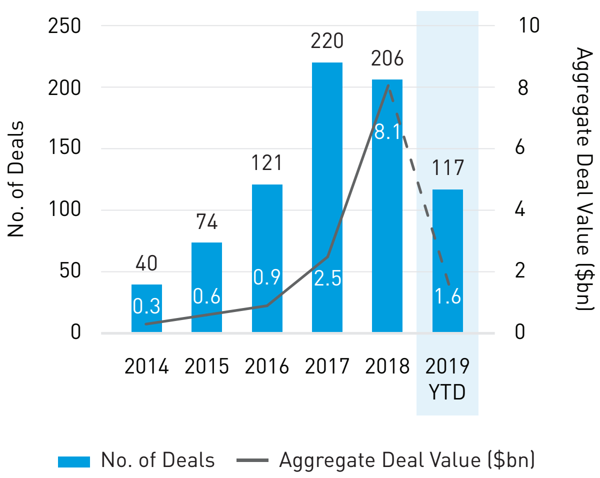
8 *https://www.tc260.org.cn/*
9 *http://www.cca.cn/En/Index.html*
10 *http://www.isc.org.cn/english/*

Industry Overview

Artificial Intelligence, E-Commerce and Fintech

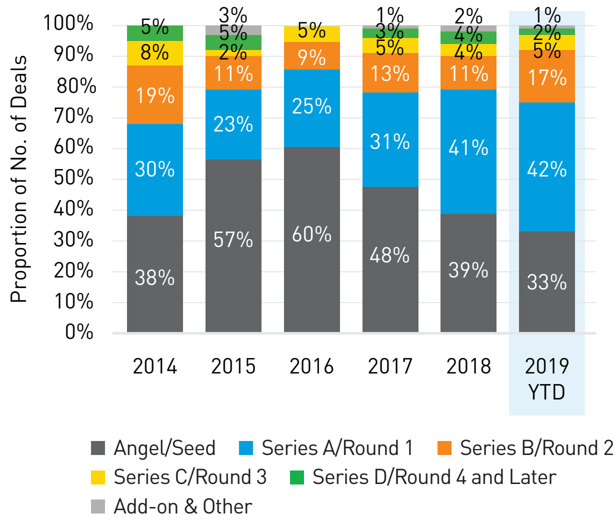
Artificial intelligence, e-commerce and fintech are the core developments of the new economy

Fig. 41: Artificial Intelligence Venture Capital Deals* in Greater China, 2014 - 2019 YTD



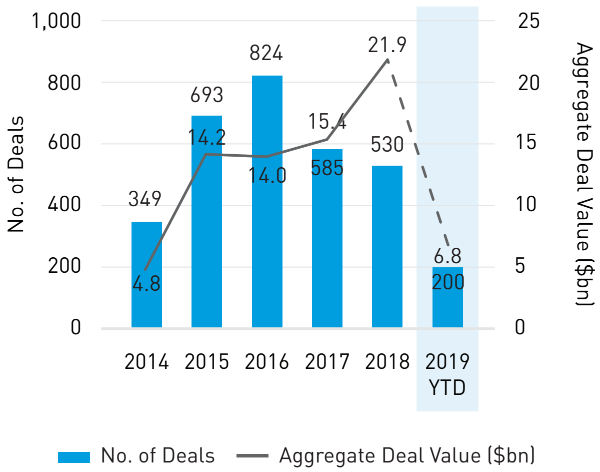
Source: Preqin Pro. Data as of July 2019

Fig. 42: Artificial Intelligence Venture Capital Deals in Greater China by Stage, 2014 - 2019 YTD



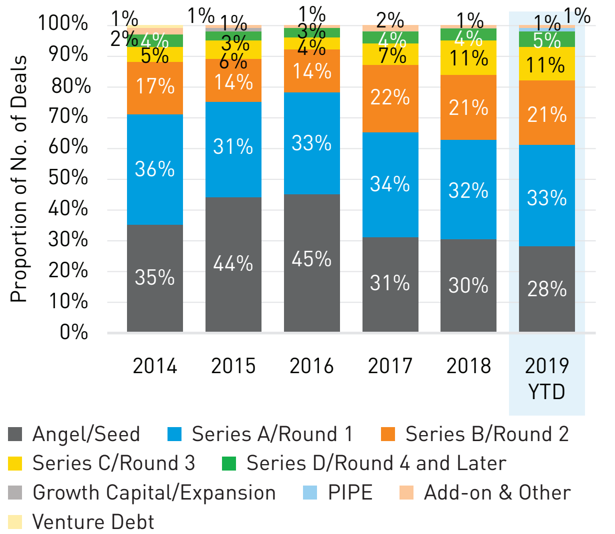
Source: Preqin Pro. Data as of July 2019

Fig. 43: E-Commerce Venture Capital Deals* in Greater China, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

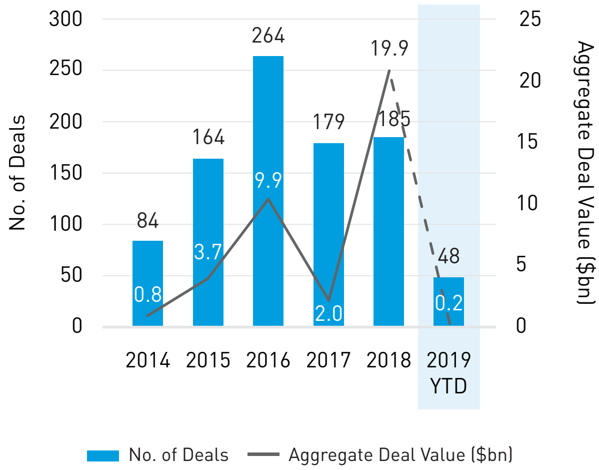
Fig. 44: E-Commerce Venture Capital Deals in Greater China by Stage, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

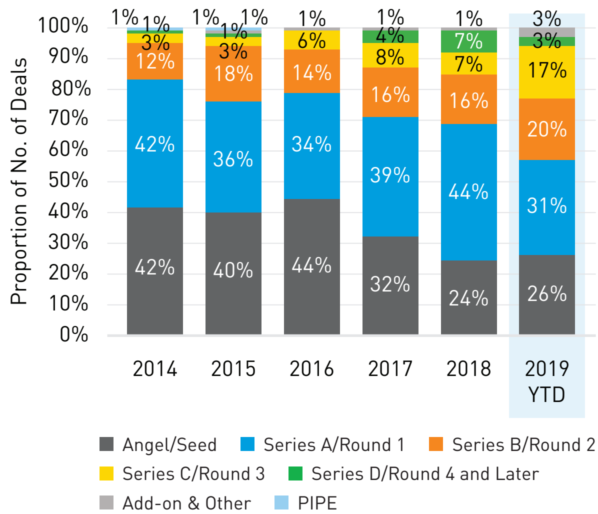
**Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.*

Fig. 45: Fintech Venture Capital Deals* in Greater China, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

Fig. 46: Fintech Venture Capital Deals in Greater China by Stage, 2014 - 2019 YTD



Source: Preqin Pro. Data as of July 2019

**Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.*

Roundtable: 12 Questions, Three Strategies

The private investment climate in Greater China is in a state of flux arising from political, policy, business and economic developments

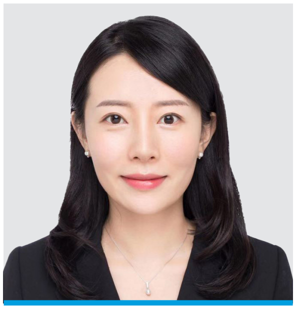
Working together with CDH Investment's Executive Director **Yu Ren**, Preqin posed 12 questions to our panelists on the current state of play in Greater China PEVC. Oriza FoF's **Timothy Wang**, The Dietrich Foundation's **Edward J. Grefenstette** and Manulife-Sinochem Life Insurance's **Ellen Hong** offer their insights into how the PEVC climate in Greater China may evolve, and a sense of the opportunities in store.

Yu Ren

Executive Director, CDH Investment

Edward J. Grefenstette

CEO and CIO, The Dietrich Foundation



Ellen Hong

Head of Private Equity, Manulife-Sinochem Life Insurance

Timothy Wang

Senior Partner, Oriza FoF

Has your investment strategy been affected by the challenges this year, which include the US-China trade tensions and China's lowest GDP growth in 27 years?

Ellen Hong: As an onshore, joint-venture insurance company, our long-term strategy is to steadily increase our allocation to alternative assets, and our current PE portfolio accounts for only a small portion of total onshore RMB investable assets in China. Given the current uncertainty, we will be more selective when considering GPs, and will target the top Chinese GPs with track records of sustained outperformance.

Timothy Wang: Due to the long-term nature of fund of funds investments, we generally do not adjust our fund of funds investment strategy. However, we have considered the long-term impact of China-US relations and will continue to monitor the associated investment opportunities and risks.

Edward J. Grefenstette: We have always pursued Chinese funds oriented towards domestic consumption, domestically developed innovation and domestic healthcare. So, our portfolio hasn't suffered directly from the recent export-related volatility. Naturally, things overall have slowed down and uncertainty about the future has increased. Thoughtful investors are likely recalibrating their assumptions to determine whether the risk/return profile of Chinese PEVC remains attractive. At this point, we believe elite Chinese GPs can still generate compelling returns.

Among investors surveyed globally by Preqin in August 2019, almost three-quarters were actively looking for or considering new investments in Greater China-focused PE funds over the coming year. Why is the Greater China opportunity so unique?

Timothy Wang: China continues to climb the ranks of innovation, it has obtained a world-leading position in digital economy, and urbanization has increased the nation's market size. The Chinese market has unique charms with its sizeable population, independent circular economy, stable national political environment and the feasibility of 5G application.

Edward J. Grefenstette: A common culture and work ethic, a willingness to adopt new technology as well as a large population have so far provided an unprecedented VC opportunity for new businesses to scale quickly. In an era where the cost of starting a business is declining and entrepreneurialism is taking off, Asian VC (and China in particular) has produced outsized returns for many investors. Of course, China presents unique risks too. China's rate of change is faster than anywhere else. Investing with a long-term horizon requires a special sort of patience as sentiments fluctuate rapidly.

Ellen Hong: China-focused PE funds are special in three ways. First, the same GP manages RMB- and USD-dominated funds with contrasting sets of LP bases. Depending on a firm's exit options and legal framework, the GP will choose to deploy either USD or RMB funds; and, in some cases for USD/RMB cross-fund investments, this may raise potential conflict-of-interest issues.

Second, unlike mature markets, China offers no clear delineation between VC and growth equity funds. In recent years, we have observed an upward trend in late-round financing valuations, which has forced PE managers to adapt their strategies and focus on opportunities in early-stage companies in high-growth sectors, especially in technology, media & telecommunications (TMT) and healthcare. The emergence of a number of large internet companies in China has also transformed the VC investment ecosystem. Finally, a trend has emerged in the past five years, where sector-focused GPs create spin-offs from large and established platforms.

What challenges do you face when allocating to Greater China-focused funds?

Timothy Wang: China's policies change relatively quickly. This hinders the ability of investors to determine where policies will lead and to identify signs of change. Investors must understand the general political and economic trends before investing in China. Also, China does not provide a comprehensive or stable exit strategy, which remains a key investment challenge.

Edward J. Grefenstette: PE investing is always and everywhere a relationship business. Without an office in China, our biggest challenge is spending an adequate amount of time face-to-face with our partners. Finding and keeping exceptional PEVC partners is hard, personal work, anywhere. It takes time to understand how people think and develop conviction on their judgement and character. Once achieved, maintaining that conviction over time is no easy task, either, especially as successor funds often get much larger and (unfortunately) the alignment of interests between the GP and LP can quickly deteriorate. In this sense, the challenges we see in China are not unique in nature – just harder to overcome.

What obstacles do overseas investors face, and how important is a domestic presence when allocating to Greater China?

Edward J. Grefenstette: A threshold challenge for most overseas investors is getting their investment committees comfortable with investing in a blind pool in Greater China, where the PEVC ecosystem has distinct features. Because PE is a people business, developing conviction is difficult without substantial resources and networks on the ground. As a result, I think it is prudent for some overseas LPs to partner with thoughtful funds of funds to supplement their due diligence efforts.

Preqin data shows that USD-denominated Greater China-focused funds raised $6bn more than RMB funds last year. What are the short- and long-term implications for international LPs? What differing criteria should be used in fund allocations in USD and RMB?

Ellen Hong: After the introduction of China's new regulations on asset management in 2018, fundraising for RMB funds dropped significantly in 2018 from the previous year. Bank funds are restricted from investing in RMB PE funds; previously, they were an important source of capital for domestic RMB PE funds and RMB funds of funds. Although fundraising will suffer in the short term, this dip will benefit the RMB PE industry's long-term outlook. With the drop in dry powder, valuations in the primary market will drop to a more reasonable and acceptable level. Both resources and capital will gradually flow to the leading institutions and the market's high-quality deals. The LP base for USD funds is more stable and institutional than for RMB funds, and is less impacted by onshore regulations – USD funds are usually more institutionalized than RMB funds.

Timothy Wang: We believe that this trend will continue for some time. The supply of RMB capital will remain limited until the situation is clarified. USD investment in China has always been relatively stable. As this period coincides with an exit wave, there is a relatively high amount of investment funds available. The gap between USD and RMB funds has shrunk in certain sectors such as TMT. Investments in certain sensitive sectors remain mostly RMB investments.

What common mistakes do GPs make when meeting with prospective LPs? Are there any unique misunderstandings between homegrown Chinese GPs and international LPs?

Timothy Wang: When fund managers and investors meet, they often pay excessive attention to past record and resources, and fail to provide adequate explanation for the current fund strategies, differences in the strategies, and the compatibility of the strategies with the team.

Ellen Hong: Onshore RMB fund GPs present a variety of challenges for international LPs: generally, they are less institutionalized, and lack transparency on the funds' information as well as past performance data. Often, they also have the same investment team managing different RMB funds over the same period, creating possible conflicts of interest.

Edward J. Grefenstette: Persistently exceptional GPs are rare, but we believe most of the elite ones possess a high degree of self-awareness: they know what they do well, and what they don't. If a GP exhibits very little humility and cannot persuasively articulate the 'lessons learned,' then a quick pass is usually easy. We joke that the two types of GPs that lose lots of money are those that know nothing, and those that know everything. I would recommend that GPs come fully prepared to talk honestly and to be specific about the potential pitfalls of executing their strategy and the mitigation thereof. Culturally, it can be difficult for some Chinese managers to get comfortable with that approach.

Is there a sector play in your asset allocation decisions in Greater China?

Timothy Wang: Yes. In China, sector-focused funds are more pronounced in VC than in PE. The rise of new technologies, the funding oversupply and an overcrowded market have scattered development efforts. It is thus essential to form an industrial chain focused on integrating upstream and downstream professionals, which will facilitate resource coordination and sharing. The contraction of the financing market may shrink or even eliminate teams, a trend that may have legs if the squeeze on funding persists.

Ellen Hong: Yes. We currently have a healthcare-focused fund in our PE portfolio; the size of the healthcare market is expected to continue to boom with increasing per capita income, and an ageing population. Healthcare is a defensive sector and presents investment opportunities, especially for long-term insurance capital. Our current portfolio shows an under-allocation for the bio-pharm sector, even with the growing demand and growth potential for innovation drugs in the Chinese market. Pharma investments, mainly innovation drugs, have a long investment cycle and require deep industry insights and technical expertise. Sector-specific funds are better equipped with the right talent, a knowledgeable investment committee and the resources to identify the investment opportunity, make informed investment decisions and optimize the risk-adjusted return.

Edward J. Grefenstette: Our investment program targets specific sectors within Greater China. Our sector selection methodology largely rests on relatively predictable trends, such as the continued growth and evolution of consumption patterns, healthcare reform/expansion, increasing innovations in technology, and emerging enterprise developments. While the fear of missing out is strong in China, we've been careful to avoid chasing the new 'hot sectors' that appear every year or so – those sectors come and go, but the broader trends have remained intact.

Preqin data shows that information technology (IT)-focused funds have raised the most capital (23%) over the past five years among PEVC funds targeting Greater China. What are the difficulties investors encounter when evaluating new-economy businesses?

Ellen Hong: It is hard to evaluate growth sustainability due to the lack of visibility in profitability, the high burn rate, the cost of testing a business model, high customer acquisition costs and the inconsistencies of valuation assessments between primary and public markets. We have observed a clear upward trend in valuations for new-economy companies due to increased capital supply in the primary market, despite the fading enthusiasm from primary and public investors caused by the poor public market performance of recently listed new-economy companies.

Timothy Wang: Mobile network applications have grown rapidly in the past five years and this sector will soon enter the second half of the development cycle, which focuses on improving efficiency and lowering costs. Competition in the existing market will impose higher requirements for team management. Therefore, it will take time for investors to adequately adjust and evaluate the system for industries in the new economy.

Edward J. Grefenstette: Within IT, we think investors must be mindful of pricing and adoption. B2B has emerged as an area of strong interest for many VC managers and, consequently, deal pricing has risen. It is clear that Chinese businesses will invest more in technology to remain competitive as labour costs have risen and improved efficiency is now an imperative. But the rate of adoption is an open question. Whether Chinese businesses significantly redirect capital (historically earmarked for expansion) towards SaaS/IT solutions to improve efficiencies remains to be seen.

Surveyed investors prefer healthcare to sectors such as fintech, consumer discretionary and e-commerce. What are the difficulties of evaluating healthcare-related investments in Greater China?

Edward J. Grefenstette: The healthcare sector in China holds many challenges for investors. Many LPs are allocating capital to this sector hoping for alpha, anchored in the belief that the beta associated with rising healthcare consumption is guaranteed. Early results look promising, but fund sizes have grown to the point that making decisions based on historical returns is risky. Firms deploying larger and larger funds will be forced to modify their existing investment strategies, often with little experience in doing so at scale. As the saying goes, past results might not be indicative of future performance.

Ellen Hong: Healthcare investments are increasingly competitive and fresh capital focused on this sector has spiked valuations. Valuation methodologies for early-stage pharma companies are different from those in other sectors. Second, there is regulatory risk: changes in healthcare regulation such as price cuts on drugs/devices will exert downward pressure on Chinese healthcare companies. Third, healthcare investment, especially early-stage investments, has a higher risk profile. Drug discovery is a long-term pursuit with a higher chance of failure, and requires continuous capital injection.

How has regulation facilitated investment in PEVC and alternatives in general? Are there rules or policies regulators should implement to further expand the scope of PEVC investment?

Ellen Hong: The China Banking and Insurance Regulatory Commission (CBIRC) introduced two favourable policies recently. In October last year, it publicly solicited opinions on the Measures for the Administration of Private Equity Investment in Insurance Funds, and the main content of the revision was to remove the industry restrictions on PE investment of insurance capital through the "negative list and positive guidance" mechanism to encourage the insurance funds to support the economy. Second, the CBIRC simplified the registration procedure for PE investment plans, improved the efficiency of PE investment plans and insurance PE funds, and supported insurance companies to increase their allocations to PE.

Has the ageing population and 'pension crisis' in China affected your PEVC investment strategy, scope or risk management?

Ellen Hong: The restart of National Social Security Fund's (NSSF) internal PE program has animated the social security fund in the market – its average commitment to a single PEVC fund is RMB 2-4bn. The NSSF has become the largest and most important LP and funding source for top RMB funds. Unlike the US pension system, state-level guidance funds and local government vehicles play an important role in the LP base for RMB PEVC funds in China. But most local government guidance funds are not very market oriented, with registration requirements for GPs and a mandatory requirement for a minimum percentage of capital to be invested in companies within the local jurisdiction.

Unrealized value and dry powder of Greater China-focused PEVC funds hit record levels of $416bn and $180bn respectively as of December last year, Preqin data shows. What are the solutions to deploy the remaining assets in maturing funds?

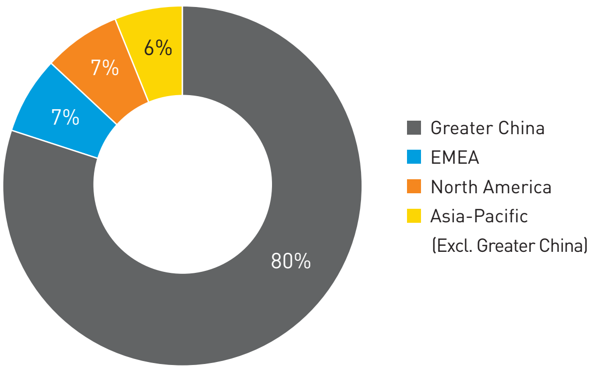
Timothy Wang: China has a relatively small primary market which remains in the preliminary phase of expansion. However, it has an immense secondary equity market which provides vast numbers of investment targets for second-hand transactions. Secondaries funds will have development opportunities in China. In addition, we expect the M&A market in China to mature and this will enrich exit channels.

Investor Survey

Fifty-four percent of surveyed LPs plan to make new investments in Greater China

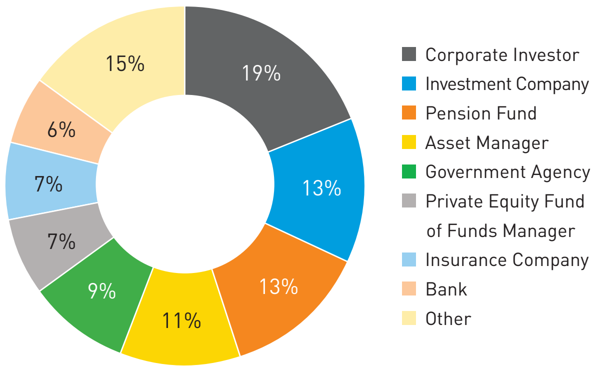
In August 2019, Preqin surveyed over 50 global investors to understand their investment intentions, allocation targets and expected returns over the next 12 months. We would like to extend our gratitude to Limited Partners Association of China (LPACN) for assisting with the survey.

Fig. 47: Respondents by Investor Location



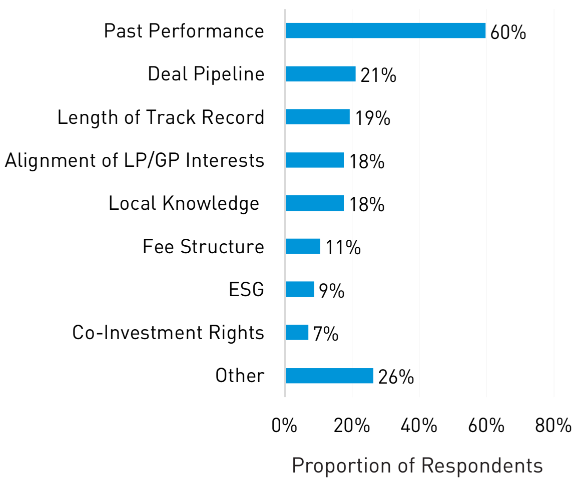
Source: Preqin Investor Interviews, August 2019

Fig. 48: Respondents by Investor Type



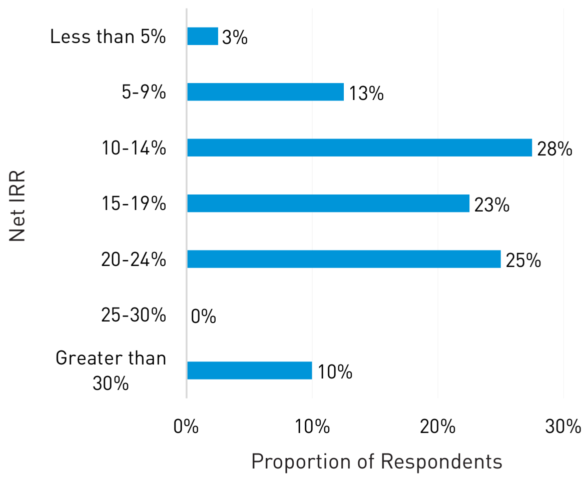
Source: Preqin Investor Interviews, August 2019

Fig. 49: Key Factors Investors Consider when Selecting a Private Equity & Venture Capital Fund Manager



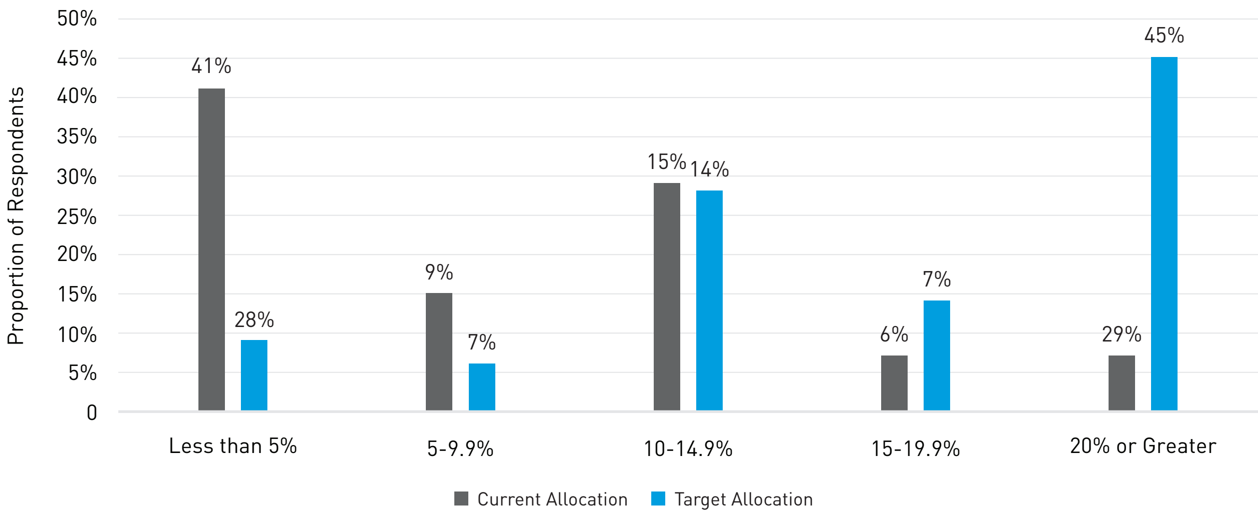
Source: Preqin Investor Interviews, August 2019

Fig. 50: Investor Return Expectations when Investing in Greater China-Focused Private Equity & Venture Capital Funds



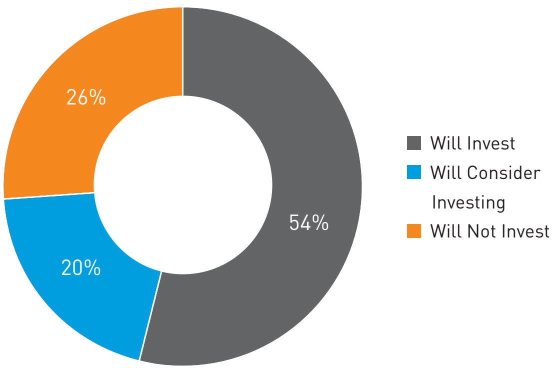
Source: Preqin Investor Interviews, August 2019

Fig. 51: Investors' Current and Target Allocations to Private Equity & Venture Capital (As a % of AUM)



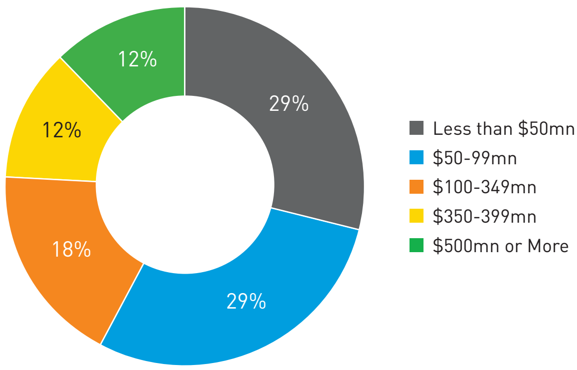
Source: Preqin Investor Interviews, August 2019. Excludes Fund of Funds Managers.

Fig. 52: Investors Planning to Make New Commitments to Greater China-Focused Private Equity & Venture Capital Funds in the Next 12 Months



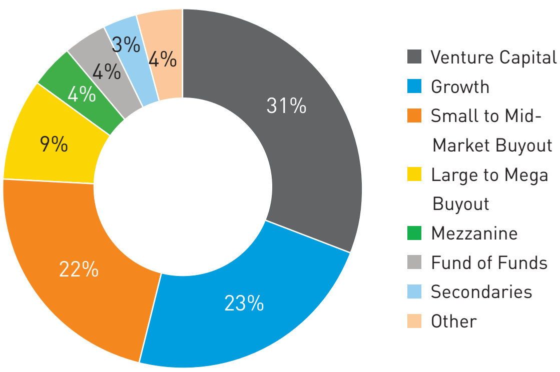
Source: Preqin Investor Interviews, August 2019

Fig. 53: Amount of Fresh Capital Investors Plan to Invest in Greater China-Focused Private Equity & Venture Capital Funds in the Next 12 Months



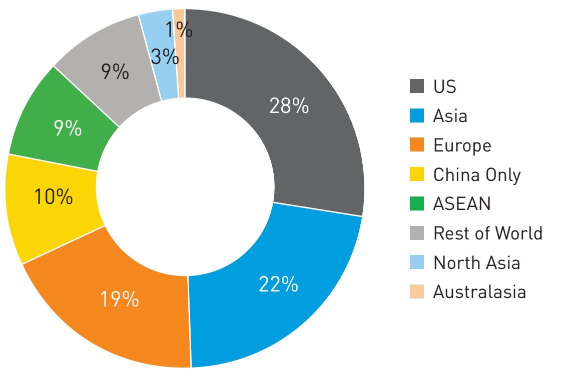
Source: Preqin Investor Interviews, August 2019

Fig. 54: Private Equity & Venture Capital Fund Types Targeted by Investors for Their Greater China Exposure in the Next 12 Months



Source: Preqin Investor Interviews, August 2019

Fig. 55: Regions Targeted by Investors in the Next 12 Months Outside of Greater China



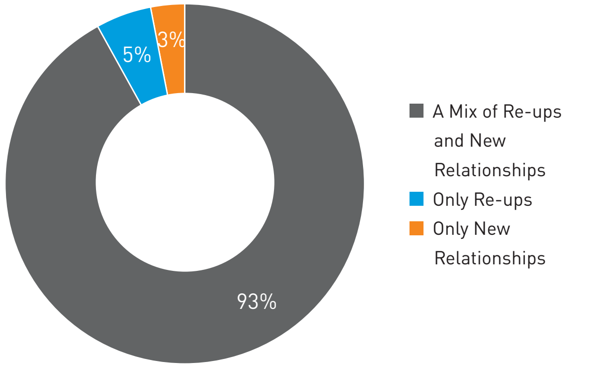
Source: Preqin Investor Interviews, August 2019

Fig. 56: Top Five Industries Presenting the Best Opportunities in Greater China Private Equity & Venture Capital in the Next 12 Months According to Investors

Rank	Industry
1	Healthcare
2	Information Technology
3	Fintech, Artificial Intelligence, E-Commerce
4	Consumer Discretionary
5	Media & Telecoms

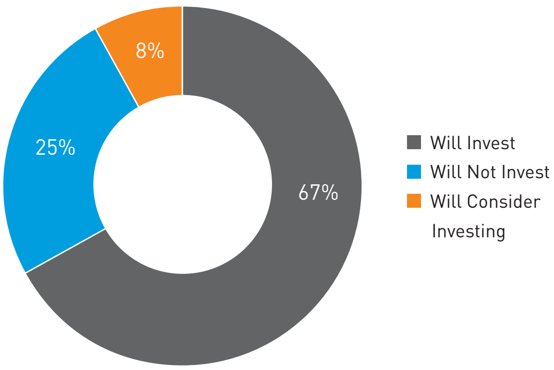
Source: Preqin Investor Interviews, August 2019

Fig. 57: Investors' Plans to Form New GP Relationships in the Next 12 Months



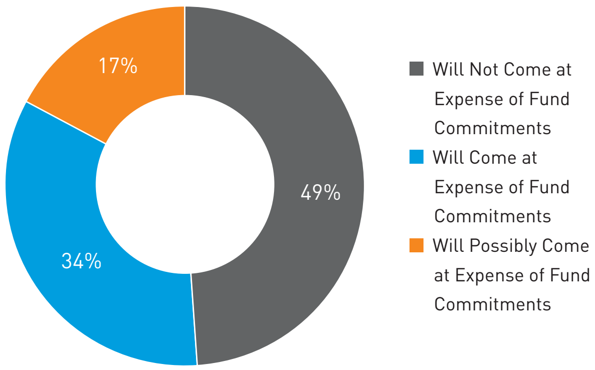
Source: Preqin Investor Interviews, August 2019

Fig. 58: Investors' Plans to Invest in Direct Private Equity in the Next 12 Months



Source: Preqin Investor Interviews, August 2019

Fig. 59: Investors Investing in Direct Private Equity at the Expense of Fund Commitments in the Next 12 Months



Source: Preqin Investor Interviews, August 2019

Limited Partners Association of China

Initiated in September 2008 by leading limited partners (LPs) in Asia, The Limited Partners Association of China (LPACN) aims to become the most credible non-profit platform of interaction for institutional investors in private equity from China and abroad. Since the foundation of LPACN, about 100 representatives of leading LP institutions from all around the world have become members. The combined capital under management of LPACN members is in excess of $1,000bn.

Challenges and Opportunities in Greater China Private Equity

Industry associations Beijing Private Equity Association (BPEA), Taiwan Mergers & Acquisitions and Private Equity Council (MAPECT) and Hong Kong Venture Capital Association (HKVCA) discuss the outlook for the PEVC industry in Greater China.

Guo Wei, BPEA: Ushering in a New Era for China's PEVC Industry

Guo Wei

Secretary General,
Beijing Private Equity Association

Regulatory Changes

Preqin: The launch of the SSE STAR Market, seen by some as China's boldest capital market reform, raises interesting questions. Does this signify a new era of regulatory changes, or a more relaxed exit environment? And how will GPs and LPs react?

Wei Guo: Seven months was all it took for China to launch the SSE STAR Market this June – a rare feat for Beijing's capital market development which ushered in a new era for capital market reform. The market's most important innovation was the launch of a pilot project, the Registration System. The China Securities Regulatory Commission (CSRC) aims to incubate a capital market system whereby the heart of the Registration System is information disclosure; this is expected to create meaningful capital market reforms.

The SSE STAR Market aims to support hard-technology enterprises with core technologies which will greatly encourage PEVC investment. Investment sources will be more inclined to technology-driven enterprises. Simultaneously, the SSE STAR Market will have also improved the ecosystem of VC investment, forcing institutions to improve their investment ability, return to value investment and promote the virtuous circle of the primary market.

The SSE STAR Market has broadened the heavily IPO-dependent exit channel of funds. This includes unshackling the rigid constraints on corporate profitability requirements to make them more company friendly than the former listing requirements.

Market Conditions

Preqin: Our data shows signs of overcrowding in the Chinese market. As of July 2019, the total number of PEVC funds in market exceeds the number of funds closed so far this year (907 vs. 78). Funds are also taking longer to close, as shown by the increase in average time spent on the road. How do you foresee industry players reacting to this?

Wei Guo: Since 2018, the fundraising cycle has become noticeably longer. We think the top institutions with good performance track records can still compete and even raise more funds within a typical fundraising cycle. Although the number of funds closed has decreased this year, the average fund size has increased, with the cycle for small- and medium-sized participants taking longer to complete. So, fund managers should adopt a more measured pace in fundraising.

Valuations

Preqin: What are the funding challenges that Chinese start-ups face? Preqin Pro shows the unrealized value and dry powder of Greater China-focused PEVC funds hit record levels of $416bn and $180bn respectively as of December 2018. This may indicate an environment of high valuations. Is a market correction looming, and how?

Wei Guo: High market valuations over the past few years were spurred by the rapid development of the PE investment industry. The continuous influx of funds in market spiked the valuations of the invested enterprises, even inverting prices in the primary and secondary markets. The high valuations are the result of fierce competition in the equity investment market. Lower exit returns will force the adjustment of corporate valuations and then the market will return to a more normalized state.

Beijing Private Equity Association (BPEA)

BPEA is a non-profit social group, which was established by the equity investment fund industry in a voluntary joint initiative on June 20, 2008. With the tenet of "standardization, marketization and internationalization," BPEA focuses on providing independent and professional information consultation, investment consulting and fundraising services for all parties in the PE investment industry in China, through professional training, research consulting, conference services, GP-LP matchmaking and other services which will help the industry to flourish.

Guo Wei is Secretary General of BPEA. She has served as the head of member department, the director of the secretariat, and the deputy secretary general of BPEA.

Cy Huang, MAPECT: PEVC on the Cusp of Good Times in Taiwan

Taiwan's PEVC market traditionally receives little attention compared to others in the Greater China region, with a comparatively lower amount of investments and number of deals. According to Preqin data, however, aggregate deal value in Taiwan reached $2.0bn in 2018, an unprecedented high over the past 10 years. Our observations in recent years too, reveal that Taiwan is poised for a golden era of PEVC, and for several reasons.

Firstly, many first-generation chiefs of Taiwanese enterprises are retiring, spurring succession issues. Secondly, the restructuring of the global supply chain offers Taiwanese companies a window of opportunity to go global, which has created the need to attract foreign strategic partners. Thirdly, Taiwanese companies in China are remitting funds which so far this year have totalled $20bn[1], resulting in new PE firms and family offices springing up in Taiwan. Fourthly, there has been a substantial relaxation of regulations, with regulatory authorities' attitudes towards PE shifting from negative to positive.

The change in attitude has created a more investor-friendly climate. For instance, local fund management firms have been allowed to establish and raise PE funds, and the limit for alternative assets investment for insurers increased from 2% to 3%[2]. The government recently announced a tax deduction benefit for Taiwanese funds repatriated from China if the money is used for direct and PE investment.

The harvest of these encouraging policies, coupled with the US-China trade imbroglio, has attracted foreign PE firms to Taiwanese funds, firming the conclusion that Taiwan is set to become a key Asian market for private investors.

Cy Huang

Founding Chairman, Taiwan Mergers & Acquisitions and Private Equity Council

Taiwan Mergers & Acquisitions and Private Equity Council (MAPECT)

Established in 2009, MAPECT aims to assist in developing a more welcoming mergers & acquisition (M&A) and PE investment environment in Taiwan; act as a communication bridge with the private sector, the Taiwanese Government and financial institutions abroad; advocate the concept of M&A and PE investment; propose policies annually to the relevant authorities; and organize exchanges between Taiwanese and international bodies.

MAPECT's founding chairman Cy Huang has logged over 30 years in investment banking during which time he has led many transactions in the Greater China area, including IPOs, secondary offerings, private placements and M&A.

[1] *https://www.moea.gov.tw/Mns/populace/news/News.aspx?kind=1&menu_id=40&news_id=86798*

[2] *https://www.ib.gov.tw/ch/home.jsp?id=34&parentpath=0&mcustomize=news_view.jsp&dataserno=201811060007&aplistdn=ou=news,ou=multisite,ou=chinese,ou=ap_root,o=fsc,c=tw&dtable=News*

Denis Tse, HKVCA: Chances of Private Investment Slowdown Not Unrealistic

Hong Kong's PEVC market witnessed a total announced transaction value of $1.66bn for the first nine months of this year and $3.69bn in 2018, with VC deals representing 46%[3] of the transaction value.

Given Hong Kong's mature economy, succession-driven buyouts were rare, the last being Permira's takeover of Topcast Aviation. Deal recycling or secondary buyouts are surfacing as well, as reflected in Affinity's acquisition of Trimco, and CITIC Capital and FountainVest's purchase of Loscam, in the past 18 months. Interestingly, instances of corporate jettisoning of Hong Kong-headquartered operations by multinationals and even local groups seem to be trending as a function of change, either proactive or forced, in their strategic priorities. Some examples: the spin-outs of Li & Fung's logistics division (invested by Temasek), Euromoney's global intelligence division (to CITIC Capital) and TDK's optical module business (to an Everbright-Asia-IO consortium). With international trade dynamics shifting, we expect a more vibrant environment in Greater China, including Hong Kong, for private equity-backed corporate carve-outs.

As for VC, a fresh crop of star companies headquartered in Hong Kong have emerged with significant ($50mn+) backing from world-class investors, including SandboxVR (virtual reality entertainment centres), AirWallex (cross-border payment), AutoX (autonomous driving software), Freightos (freight forwarding marketplace) and KaiOS (enhanced feature-phone operating system). Many are not native bred but leverage on Hong Kong's locational East-West nexus as an operating hub for roll-outs regionally or globally. Advantaging Hong Kong's geographical edge offers a glimpse of potential new Hong Kong-based star VC companies.

On the other hand, with the technology market becoming more discerning globally and the significant rescinding of liquidity from China, it's now harder to obtain early-stage funding in Hong Kong's nascent VC market. Thus far, less than $4mn of the Hong Kong Government's ambitious Innovation & Technology Venture Fund co-investment program, which has HKD 2bn ($256mn) earmarked for six GPs, has been deployed to date since its launch in July last year. And several Hong Kong unicorns may fall victim in a sub-$1bn down round within the next two or three quarters if they stick to their business plans, and follow in the unenviable footsteps of Tink Labs which is set to be the first to fail.

Denis Tse

Research Committee Chairman, Hong Kong Venture Capital Association

Hong Kong Venture Capital Association (HKVCA)

HKVCA is a veteran trade association established in Hong Kong in 1987. Of its 450 members, 280 are Hong Kong-based PE managers who represent the full spectrum of the industry from VC through growth capital and growth buyouts to institutional fund investors, funds of funds and secondary investors. The association represents small teams investing in start-ups as well as eight of the 10 largest global PE firms.

Denis Tse is Asia-IO Holding's founding managing partner and chairs HKVCA's research committee. Before which he headed the Asian private investment arm for corporate pension manager Lockheed Martin Investment Management Company. While there, he was named "40 under 40" by Chief Investment Officer magazine.

The current, protracted civilian unrest in Hong Kong, compounded by the US-China trade dispute, affects investment and exit sentiment. Temasek has stalled the sale of its stake in major Hong Kong drugstore chain AS Watson, owing to retail sector repercussions. Moreover, it is no longer unheard of to learn of boardrooms in manufacturing and technology firms with significant Hong Kong operations being asked by Chinese investors to divert investments from Hong Kong. To be sure, the reasons include capital needs for increased localization in, or diversification from, China depending on the clients these respective firms wish to placate, as national and security-related considerations begin to impact cross-border business. Apart from intriguing valuation dislocation opportunities, we expect PEVC investments to slow down in Hong Kong in the coming year.

[3] *HKVCA*

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