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Asia Pacific
An Evolving VC Market

Thematic Report by
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Global Venture Capital Investors

Betting Big on Asia-Pacific

Asia-Pacific has emerged as a sweet spot for Venture Capital (VC) investors attracted by the region's growth prospects.

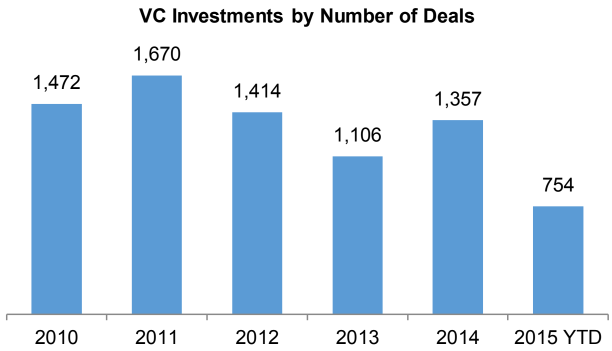
China and India, two key economies in the region, have grown at a substantial rate over the past decade and are fast becoming a hotbed for global venture capital investments.

While lack of transparency, regulatory framework, infrastructure, and poor governance continue to act as impediments in the short-term, long-term investment and growth prospects look robust as Asian governments continue to focus on favorable policy reforms and good governance.

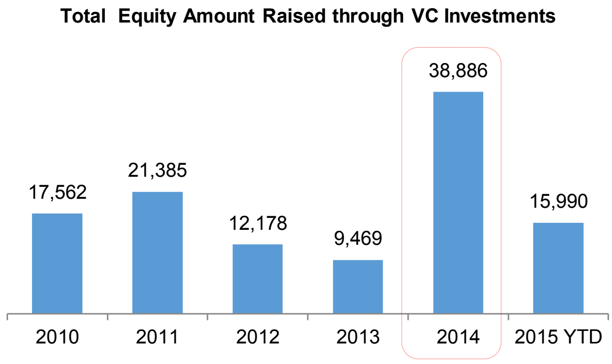
The Rise and Rise of Asia-Pacific VC Opportunities

Venture capitalism, an investment method well established in Western economies, is gaining traction in Asia-Pacific. The rise of technology-driven ideas may lead to the development of a new hotbed for venture capital investments in the region. The start-up ecosystem in the emerging economies of Asia-Pacific is still at a nascent stage, but is rapidly evolving. Technology-driven start-ups such as Telison, BOE Technology Group, tap4fun from China, and Edureka from India have been featured in the list of Deloitte's top 10 fastest growing tech firms. Considering the talent base and growth potential, several global venture capital firms are seeking opportunities to invest in Asia-Pacific's start-up ecosystem. During 2010–15, nearly 7,773 companies raised funds via VC investors in Asia-Pacific. Moreover, the region witnessed nine big ticket deals in 2014 raising over USD19.7bn, up 9 times from USD1.9bn in 2013. This trend has continued in 2015, and since the turn of the year the region captured USD15.9bn (a total of 754 investments) in venture capital funding till date.

Asia- Pacific VC investment deals



Asia- Pacific VC investments by Value (in USD'mn)



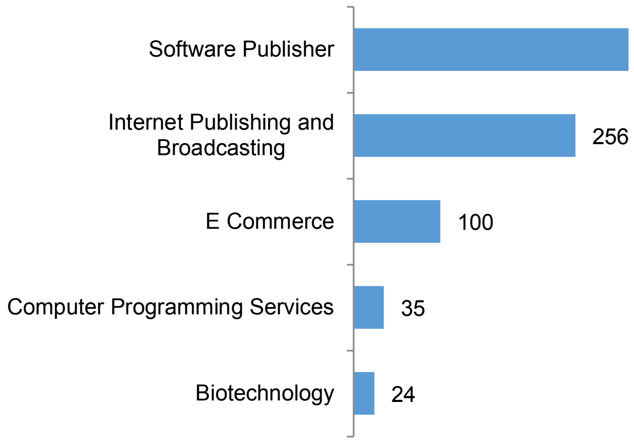
Source: Thomson One Banker

Despite the tremendous growth potential, total VC investments in Asia-Pacific have been lower than the Western economies due to the lack of investor confidence in emerging markets. However, VC investments in the region continue to grow; in 2014, Asia-Pacific emerged as one of the major investment destinations, with investments worth over USD38bn in start-ups. Currently, large global financiers, such as Blackstone and Morgan Stanley, are showing keen interest to invest in Asia-Pacific's technology-driven start-ups.

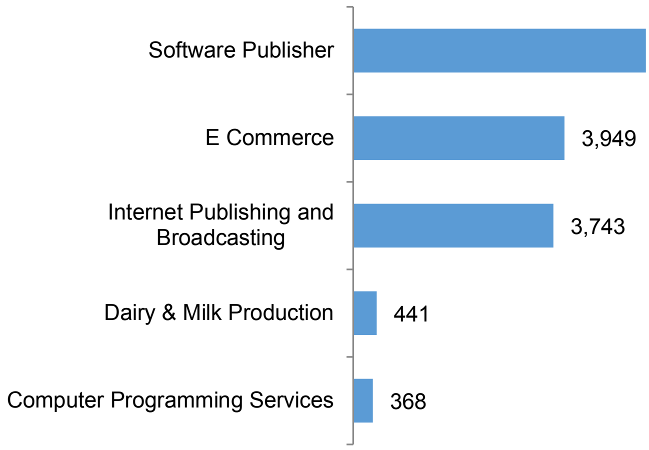
Investment in Tech Start-ups and E-commerce Remain in Vogue

Of the 1,357 VC deals carried out during 2014 in Asia-Pacific, nearly 27% were in software-driven technologies developed by enthusiastic start-ups to fill the gap in local markets. In addition, Asia-Pacific's e-commerce sector also gathered momentum and raised about USD3.9bn through 100 deals (or average equity amount of around USD46mn per company) in 2014.

Top Five Sectors by Number of VC Deals (2014)



Top Five Sectors by VC Investment Volume (USD'mn)

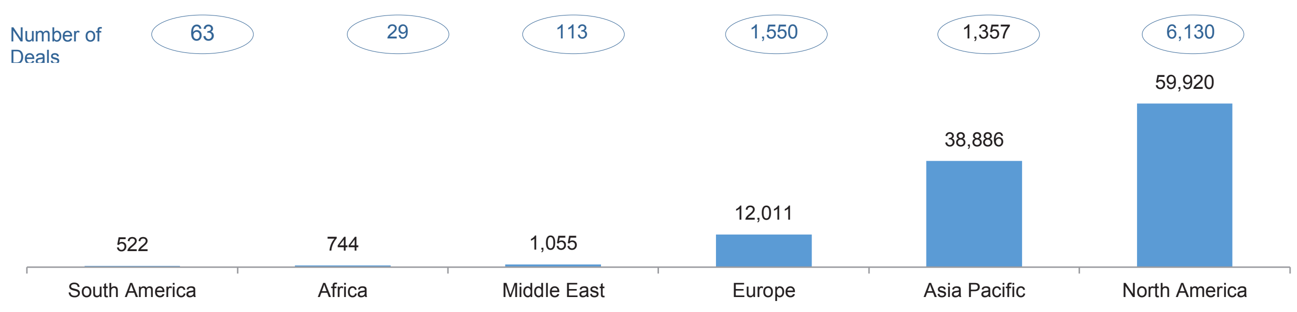


Source: Thomson One Banker

Emerging Markets are Fast Closing the Gap with Global VC Strongholds: India, China to Lead the Way

While, the global economies are expected to grow at a sluggish rate, emerging economies in Asia-Pacific are projected to expand at a substantially higher rate, supported by favorable demographics (higher proportion of young and earning population), rising disposable income, rapid rate of urbanization and increasing need for infrastructural facilities, presenting a unique opportunity for investors. Despite growing popularity among global VC funds, Asia-Pacific still lags behind the US and European market in terms of number of deals. The start-ups in the developed markets, such as the US, continue to attract the attention of VC investors. However, the trend appears to be shifting away from Silicon Valley towards Asia Pacific, where the software publishing, e-commerce and Internet publishing & broadcasting, and web search portal segments are gaining traction. In 2014, the amount of capital raised in the US increased nearly 56% to USD57.1bn through 5,541 deals compared with USD36.6bn raised in 2013. On the other hand, the amount of capital invested across the Asia-Pacific region jumped about 311% year-on-year to USD38.9bn in 2014. The software publishing, e-commerce, Internet publishing & broadcasting, and web search portal segments in Asia-Pacific raised USD13.3bn through 720 deals in 2014, up ~4 times from USD2.8bn in 2013.

Geographic Breakdown of VC Investments in 2014 (USD'mn)



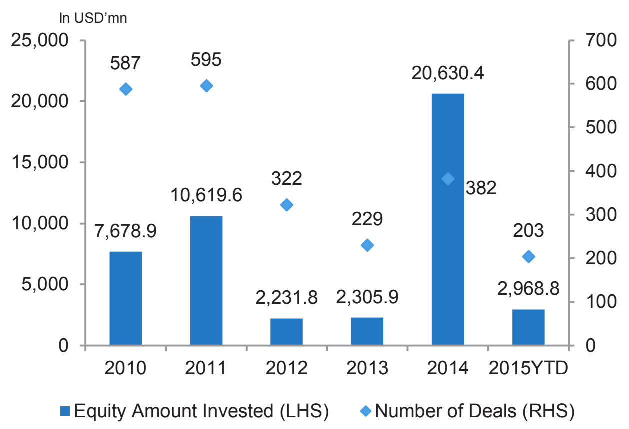
Source: Thomson One Banker

With continually increasing investment activity, Asia-Pacific has already overtaken Europe in terms of deal value and is expected to further narrow the gap with North America over the medium term.

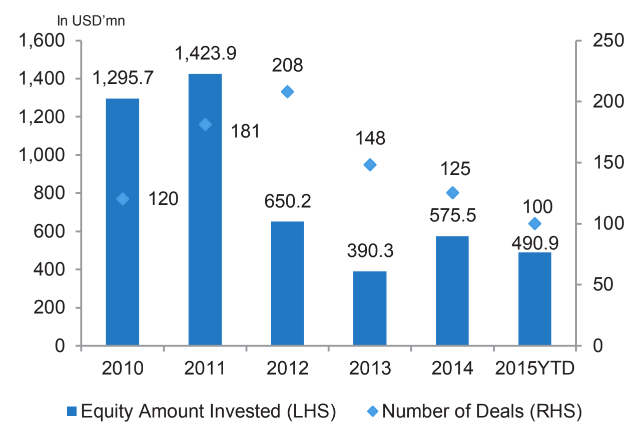
Betting Big on India and China

The availability of seed, angel, and venture capital funding remains the key factor in the development of a successful start-up ecosystem. In developed countries, particularly the US, VC investors have played an important role in nurturing companies that offer new and innovative services. Compared to the developed economies, the VC industry in India and China is still at a nascent stage; however, with a well-developed education system and technological advancements, entrepreneurship is being promoted and rewarded with increasing investor interest in these countries. In 2014, 507 start-ups with innovative technologies and service offerings raised their first round of capital from VC investors.

Initial Funding Scenario in China



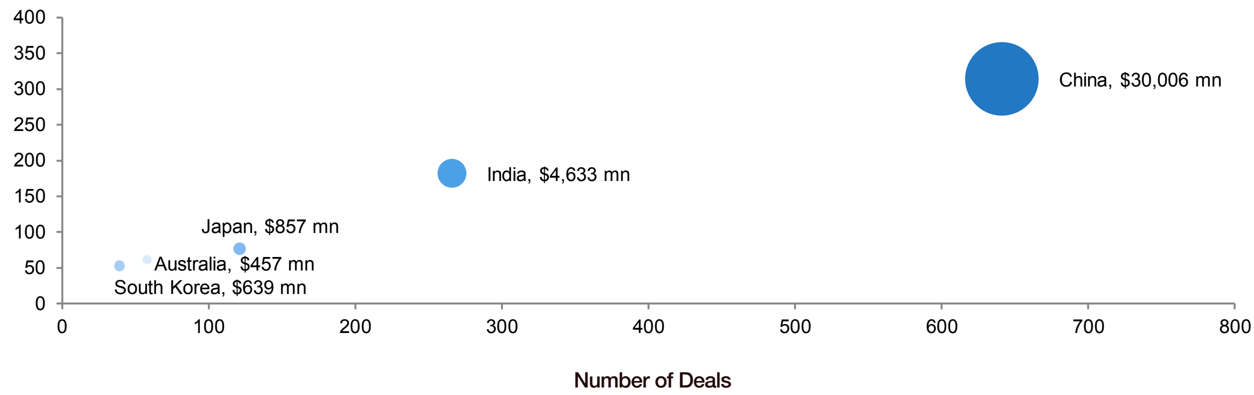
Initial Funding Scenario in India



Source: Thomson One Banker

In recent years, venture investment returns have somewhat dried down in the Western countries. Big ticket investors are on the lookout for options that can ensure higher returns than underperforming equity markets. China and India, which were largely unaffected by the global economic downturn and have continued to register a good GDP growth rate over the past few years, are becoming major hotbed for venture capital investments. In 2014, the start-ups operating in these two rising economies of the east have managed to have jointly raised USD34.6bn. Historically, China has led India in attracting investors; however, with China's economy showing signs of subdued growth in recent years, investors might turn their attention toward India in the long run.

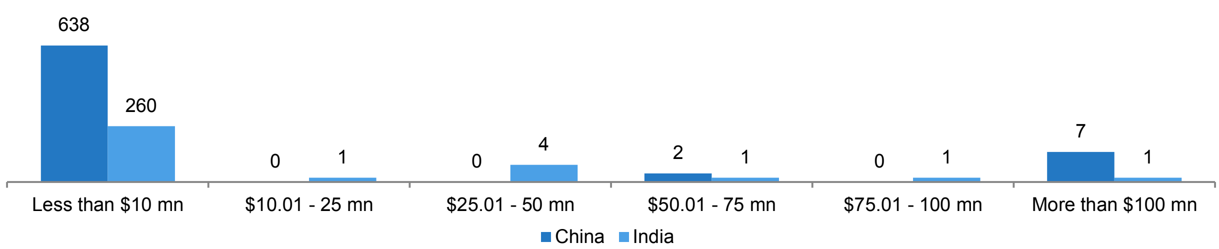
Venture Capital Landscape in Asia-Pacific in 2014 - India and China come out as clear winners



Source: Thomson One Banker; Note: Bubble Size represents aggregate equity invested in the country

Chinese and Indian start-ups are not only raising funds from regional investors but also attracting Silicon Valley's big spenders. Both these countries witnessed eight deals in the start-up ecosystem in excess of USD100mn totaling USD19.7 bn.

Number of Venture Capital Deals by Deal Size in 2014



Source: Thomson One Banker

Major VC Investments in China and India

Country	Company Name	Industry	Equity Invested (USD'mn)	Investors
China	Sinopec Marketing	Petroleum and Petroleum Products	17,457.9	Shanghai Fosun VC Management and CICC Qianhai Development Fund
China	Xiaomi Technology	Software Publisher	1,100.0	Digital Sky Technologies and Yunfeng Fund II
India	Flipkart Online Services	E-commerce	1,000.0	Accel Partners, GIC Special Investments, Morgan Stanley Alternative Investment Partners, and Tiger Global Management
China	ZhongAn Online P&C Insurance	Insurance	931.1	SAIF Partners
China	TCL Corp	AV Equipment Manufacturing	913.3	Tianjin Chengbai Equity Investment Partner and other undisclosed funds

Source: Thomson One Banker

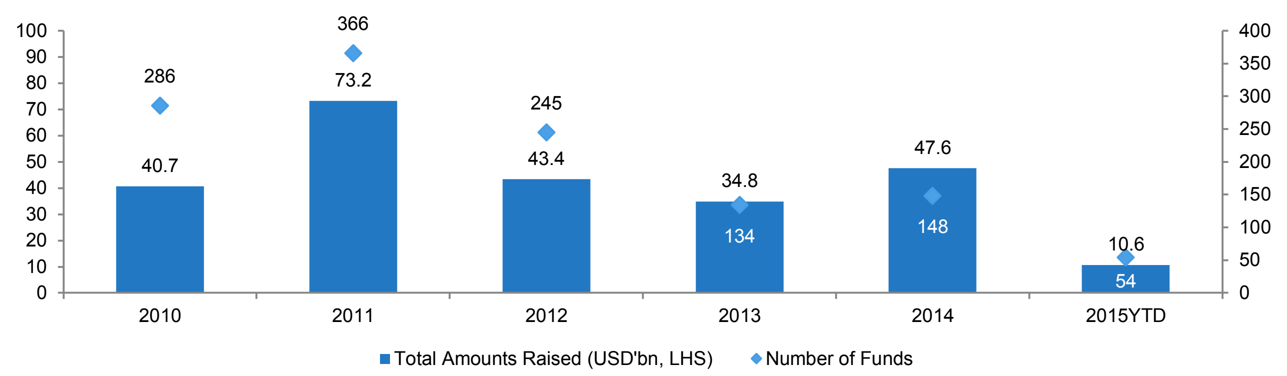
Emerging Trends Shaping Up the Industry

Several factors are attracting investor in Asia-Pacific. Although China and India are perennial favorites due to their strong economic growth rates, investors are also looking to invest in other countries such as Singapore, Malaysia, and Indonesia. With increasing number of investors entering the region, rising fund activity and inflated valuations are two key trends that are likely to define the future of venture capital industry in Asia-Pacific.

Rising Asia Focused Venture Funds

The Venture Capital industry has witnessed strong fund raising growth in recent years, with nearly USD47.6bn being raised by 148 Asia-focused VC funds in 2014. Furthermore, in 2015, 54 Asia-focused funds have raised USD10.6bn until date. The primary investment focus of these funds was on technology driven startups, however consumer sector has also attracted some interest from investors.

The Emergence of Asia Focused Venture Funds



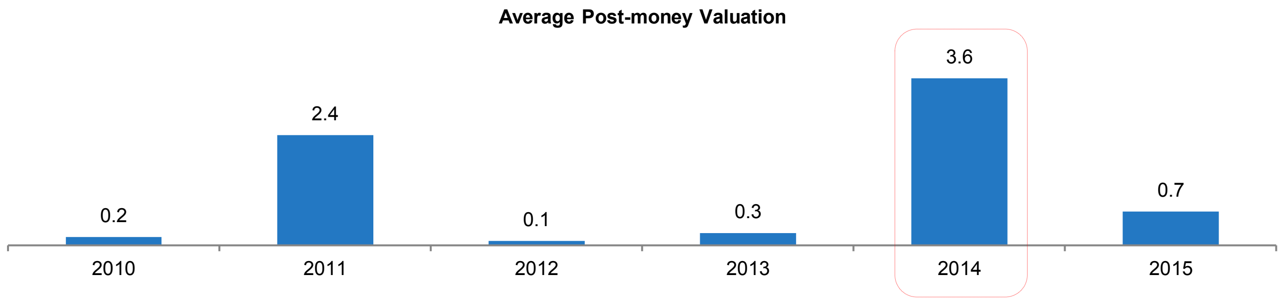
Source: Thomson One Banker

As global investors plan to capitalize on Asia-Pacific's growth story, domestic investors are also coming up with Angel funds and helping companies in the seed rounds. In India and China particularly, 302 domestic funds raised USD10.7bn in 2014.

Soaring Valuations

Over the past few years, economic reforms in Asia-Pacific have enabled the consumer class to grow, increasing the number of Smartphone users and improving Internet penetration. Asia-Pacific is currently considered the hub of technological innovations. Tech start-ups in the region are attracting huge VC investments. In 2014, 11 start-ups in China raised Venture Investments at an aggregate post-money valuation of USD46.8 bn, while five companies in India raised venture investment at a post-money valuation of USD10.6bn. This soaring valuation of start-ups in the region indicates that the venture investors are investing in the companies with a long term view and are filling in the coffers to create technology giants in the region.

Rising Valuations of Start-ups in Asia-Pacific (USD'bn)



Source: Thomson One Banker; Note: Only deals where post-money valuation was disclosed were considered

In an attempt to gain a share of Asia-Pacific's growing technological ecosystem, VC firms are investing at multiples significantly higher than their peers in the US and Europe. For instance, Flipkart, India's largest e-commerce company was valued at around USD11bn after its latest round of funding. This valuation amount is more than three times its gross merchandise volume (GMV) of over USD3bn. In contrast, e-commerce veteran eBay trades at roughly equal to its GMV.

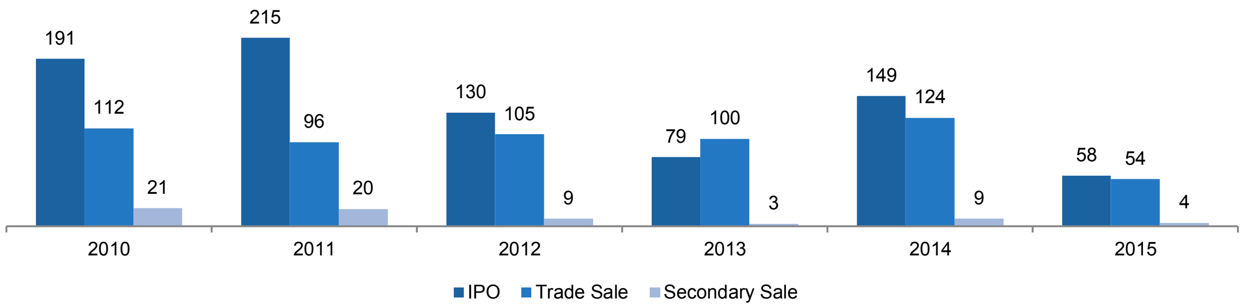
Over the past one year, post-money valuation in the initial funding rounds has soared up in the region. Several companies in India and China, such as Flipkart (which raised USD1bn in recent round of funding) and Xiaomi (which raised USD1.1bn in recent round of funding), were valued well above USD1bn at post-money valuations in their first few rounds of funding. Although high valuations at an early stage are helping to develop the start-up ecosystem in Asia-Pacific and encouraging entrepreneurs, late-stage investors are being cautious about the rising valuations of companies.

Key Concerns Weigh Heavy On Attractive Opportunities in Asia-Pacific

The success and failure of a VC investment is determined by the value a VC firm is able to generate from its portfolio company at the time of exit. An exit strategy is a vital part of the VC cycle and plays a crucial role in assessing the VC investment's performance. An investor can consider various routes at the time of exit, with trade sale (acquisition by a strategic or financial buyer) and IPO being the two most popular options among VC investors.

Globally, an IPO has been the most preferred exit route, with companies raising USD83.2bn in 2014. In the past, the IPO option has provided huge gains to VC investors in Asia-Pacific; however, with soaring valuations at initial stages, the IPO route appears to be a distant option.

Number of VC Exits by Type in Asia-Pacific



Source: Thomson One Banker

In 2014, Asia-Pacific witnessed 149 VC-backed IPOs that raised a median amount of USD15.5bn. In addition, M&A is not a viable exit option for VC investors, with the region witnessing 124 deals worth USD14.6bn, substantially lower than 541 deals raising USD58.8bn for VC investors in the US.

Governance and Infrastructure Issues Persist

Although Asia-Pacific has been one of the key destinations for international investors, several VC investments have underperformed. Venture capitalists face numerous challenges in the form of weak regulatory systems, poor infrastructure, and cultural differences, which makes it difficult for the investors to monitor their investments in the region.

Despite the presence of abundant talent across the region, the start-up ecosystem is still evolving. Recently, many countries in the region introduced start-up friendly norms and have started promoting first-generation entrepreneurs, but the basic infrastructure is still not appropriate for new and upcoming technologies and service providers. As Asia-Pacific prepares for the next level of technology boom, the start-up ecosystem would require strong support from government authorities.

The Way Forward

Spreading from India to Japan and China to Australia, Asia-Pacific is a diverse market. Although the region is collectively underdeveloped, it presents a wide range of opportunities for investors with a long-term horizon. VC investments have gathered pace in recent years, and considering the technology boom in the region, these investments are expected to further rise in the near term.

Historically, VC investments in Asia-Pacific have been largely profitable and have generated reasonable returns for their investors. The average time to exit is low compared with other major geographies. However, rising valuations may be a cause of concern for late-stage investors. Nonetheless, with portfolio companies largely catering to the underserved consumer base in Asia-Pacific, robust returns are expected over the long run.

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