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State-owned Enterprises Become Major Investors of RMB PE Funds

>>P2

Hot News

P9 Meituan.com Scores US$50M in Series B Financing Round
P9 Tencent Invests HK$900M in Kingsoft to Be the Largest Shareholder
P9 GSR Ventures Closes Its Fourth Fund at US$350M
P7 TrustBridge Partners Invests Millions USD in Golimi's Series A Financing
P10 Alibaba Joins in Meituan's US$50M Series B Financingt
P10 Sequoia Capital Announces Investment in Innovation Works
P10 Shengjingshanhe Receives RMB127.5M Investment, to Try IPO Again
P11 CMIA Capital Launches US$200M Fund for China & Southeast Asia
P11 Partners Group Signs MOU with Pudong New Area for First RMB Fund
P11 Yao Ming Participates in RMB80.00M Financing Closed by Xijie.com
P12 Lenovo Completes Acquisition of NEC, Holding 51% Stake in the JV

Meituan.com Scores US$50M in Series B Financing Round

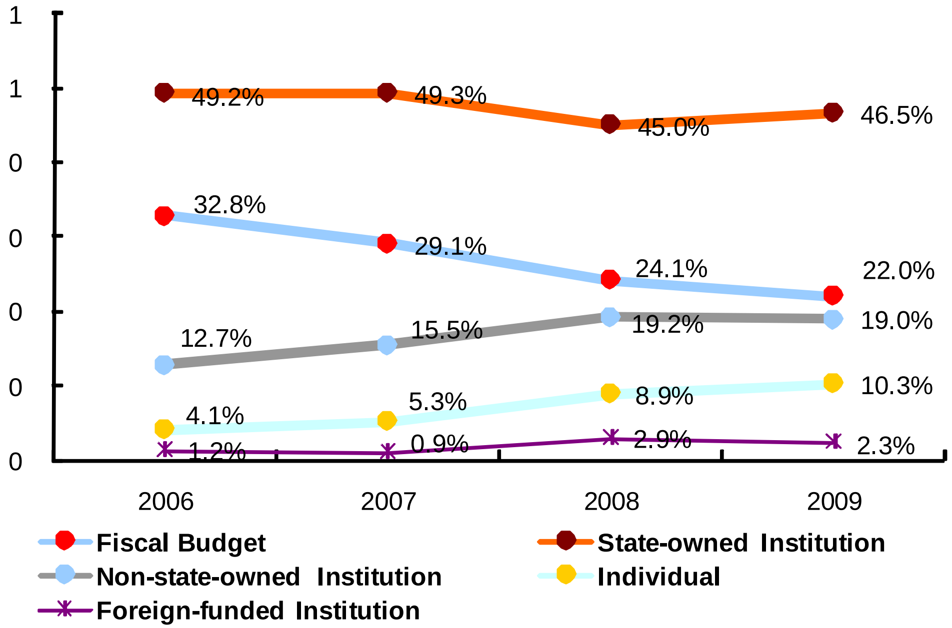
>>P9

State-owned Enterprises Become Major Investors of RMB PE Funds

Written By Yonge Qian , Analyst with Zero2IPO Research Center

The RMB fundraising boom moved on in 2010. Among the funds that has completed fundraising and the newly-established ones that has not fulfilled fundraising, RMB funds accounted for more than 80%. In the era featured by the rapid expansion of RMB funds, we draw the following conclusion after comparison with the mature markets in Europe and America: The major limited partners of domestic private equity (PE) funds are not public pension funds but state-owned enterprises. In a field of investment that is highly marketized, such a high degree of participation by state-owned enterprises, we have to say, is another typical feature of China.

Figure 1 Year-on-year Comparison of Paid-in Capital of LPs of Venture Capital Funds in 2006-2009



Source: Zero2IPO Research Center

State-owned Enterprises Become Major RMB LPs at Home

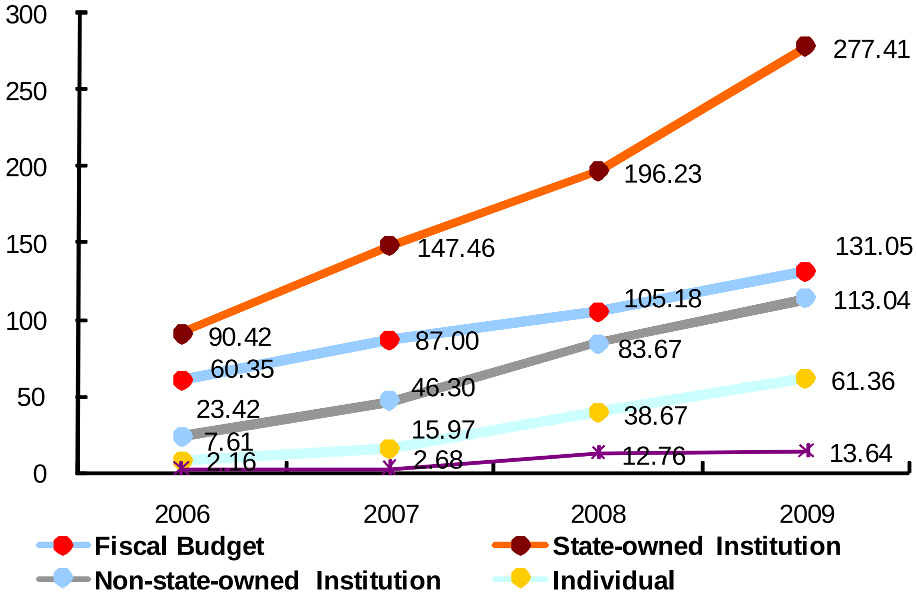
The compliance of equity investment with China's policy orientation serves as the fundamental reason behind the vigorous participation of state-owned enterprises in equity investments. During the 12th Five Year Plan period, equity investment will play a big role in pushing forward the joint reorganization, resources integration and industrial upgrading by state-owned enterprises.

According to the Report on the Development of China's Venture Capital Industry 2010 jointly released by the National Development and Reform Commission (NDRC) and the Venture Capital Committee of Investment Association of China, a total of 483 VC firms were filed at the NDRC in 2006-2009; State-owned firms accounted for the biggest share in terms of LP paid-in capital, nearly 50%, and the value involved showed a notable growing trend.

Meanwhile, data from Zero2IPO Research Center also confirmed the said phenomena, i.e. more than half of the new funds that completed fundraising or at least fulfilled round A fundraising in 2010 saw the participation of state-owned enterprises. Moreover, the value raised with the participation of state-owned enterprises represented 69% of the total.

In terms of geographical distribution, state-owned enterprises showed distinctive features too. According to the statistics concerning 382 LPs by the China Venture Capital Association, Jiangsu, Zhejiang, Beijing, Shanghai and Shenzhen become the clustering places for RMB LPs, with the number of LPs accounting for 70% of the national total. The majority of LPs in all the regions are all state-owned enterprises and fund of funds, except for Jiangsu, Zhejiang and Shenzhen,

Figure 2 Year-on-year Comparison of Paid-in Capital of LPs of Venture Capital Funds in 2006-2009 (Unit: RMB100M)



Source: Zero2IPO Research Center

where the bulk of LPs are private enterprises.

State-owned Enterprises Boast Abundant Capital That Facilitates Their Participation in Equity Investments

The abundant capital of state-owned enterprises lays a sound foundation for their participation of equity investments. During the 11th Five Year Plan period, state-owned enterprises enjoyed significantly improved overall capability, comprehensive quality and economic benefits. From 2005 to 2009, the assets of state-owned enterprises nationwide expanded from RMB25.40 trillion to RMb53.50 trillion, an annual growth of 20.5% on average; The sales revenue increased from RMB14.20 trillion to RMB24.20 trillion, an annual growth of 14.3% on average; Post-tax net profit that belonged to parent companies surged from RMB498.22B to RMB872.60B, an annual growth of 13.5% on average; The tax paid rose from RMB1.20 trillion to RMB2.30 trillion, an annual growth of 17.7% on average.

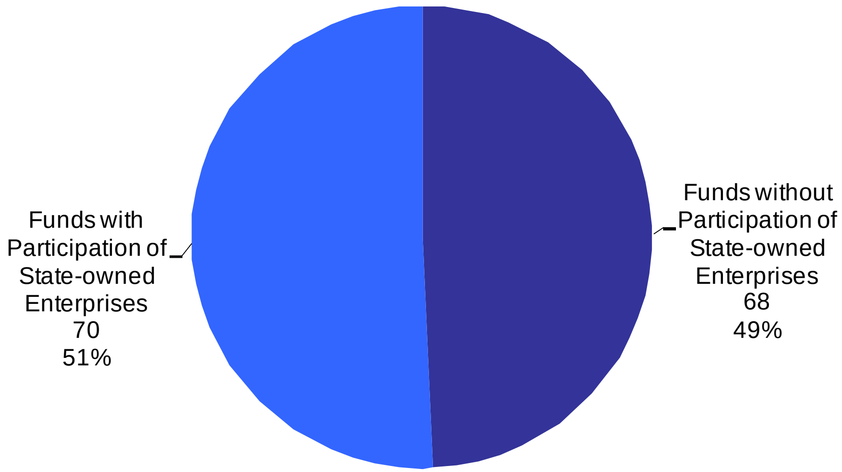
Because of owing abundant capital, state-owned enterprises have become major investors or initiators of big-sized RMB funds. For example, China Aerospace Science and Technology Corporation that reported a total asset of RMB182.60B in early 2010 made Aerospace Investment Holding Limited the investment subject and launched the aerospace industrial fund together with Beijing Yizhuang International Investment Development Co., Ltd., State-owned Capital Operation & Management Center of Haidian District, CITIC Group and Beijing Aerospace Industrial Fund Management Co., Ltd. The fund has a size of RMB20.00B with the first phase totaling RMB3.00B, which is expected to mainly invest in the fields related to aerospace products, technological application and service sectors.

In the same year, China South Industries Group Corporation that reported RMB236.00B operating revenue gained from core business in 2010 made South Industry Assets Management Co., Ltd. as the investment subject to set up Southern Capital Equity Investment Fund. With a size of RMB3.00B, the fund mainly focuses on the projects both inside and outside the Group and in the industrial chain that have strong profitability and huge development potentials, as well as the ones of private placement by the listed companies under the Group or excellent firms under the Group that independently seeking for IPOs.

State-owned Enterprises Participate in Equity Investments Mainly for Further Developing Their Core Business

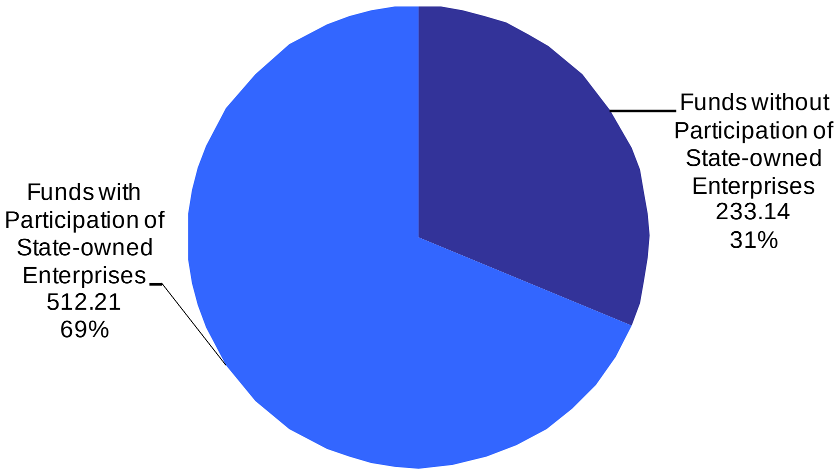
Governments have always had very tough regulation over the investment activities carried out by state-owned enterprises. The Interim Measures for the Supervision and Administration of the Investments by Central Enterprises released by the State-owned Assets Supervision and Administration Commission of the State Council as early as 2006 clearly specified the following provisions regarding the

Figure 3 Comparison of Equity Investment Funds with Participation of Establishment by State-owned Enterprises in 2010 (By No. of Funds)



Source: Zero2IPO Research Center

Figure 4 Comparison of Equity Investment Funds with Participation of Establishment by State-owned Enterprises in 2010 (By Investment Amt., RMB100M)



Source: Zero2IPO Research Center

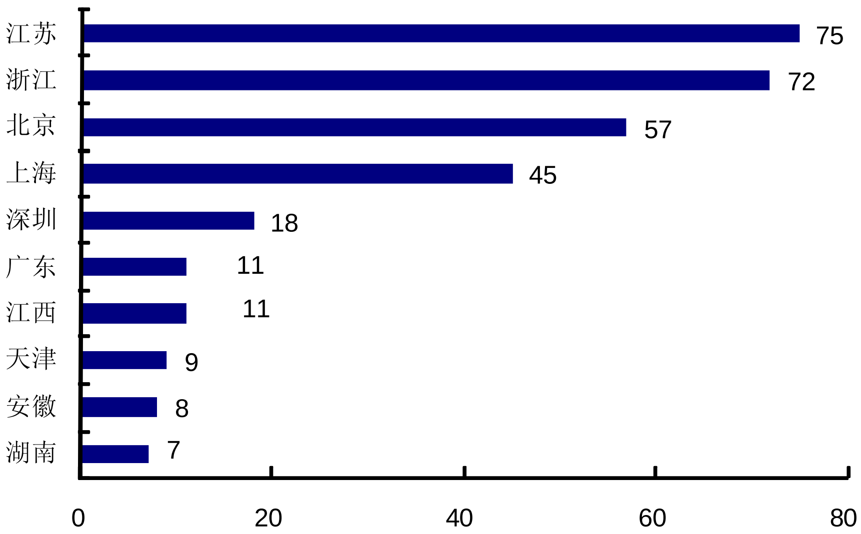
principles that state-owned enterprises shall follow when making equity investments: i) Compliance with national development plans and industrial policies; ii) Compliance with enterprise layout and restructuring directions; iii) Compliance with enterprises development strategies and plans; iv) Prominence of main businesses that helps improve core competence; v) Investments in non-core business shall comply with enterprise restructuring and reform directions and not affect the development of core business. Therefore, it can be seen that state-owned enterprises participate in equity investments mainly for better developing their core business.

In addition, other purposes include: i) In response to state policies, pushing for regional economic development on behalf of government institutions; ii) Integrating resources inside enterprises and linking with the capital market to enhance operational efficiency; iii) Cooperating with other enterprises, expanding resources and integrating resources of various sides to establish interest communities.

The state-owned enterprises that involve in equity investments generally break down into two types: i) State-owned enterprises with certain amount of capital that intend to widen their fundraising channels through setting up funds. They typically consider they have abundant project resources and are more familiar with the industry, so they independently launch PE funds. There are a big number of such state-owned enterprises in current market; ii) State-owned enterprises with sufficient capital. In general, they are monopolistic enterprises with leaders of charming characters, and are willing to promote the sustainable development of enterprises by trying fresh ways of capital operation.

For example, COFCO launched the first agricultural industrial fund in early 2011 with a full size of RMB6.00B, the first phase of which has a size of RMB2.00B. Relying on the advantages of COFCO in agricultural food field, the fund mainly invests in agricultural product manufacturing, processing and food enterprises. COFCO runs the agricultural industrial fund in line with its own development strategies and plans, and the benefits mainly include: i) Helping COFCO establish the operational mode based on the full industrial chain, broadening its resources of capital through the platform of the equity investment fund to ease the great pressure on the liability ratio; ii) Holding a stake in the enterprises that hope to introduce financial investors through the industrial fund to achieve the goals of synergy operation; iii) Enriching the formerly single mode of debt investment to alleviate the financing demand of a big number of enterprises in the industrial chain and thus intensify the control over them.

Figure 5 Top Ten Regions with the Most Local LPs in 2010

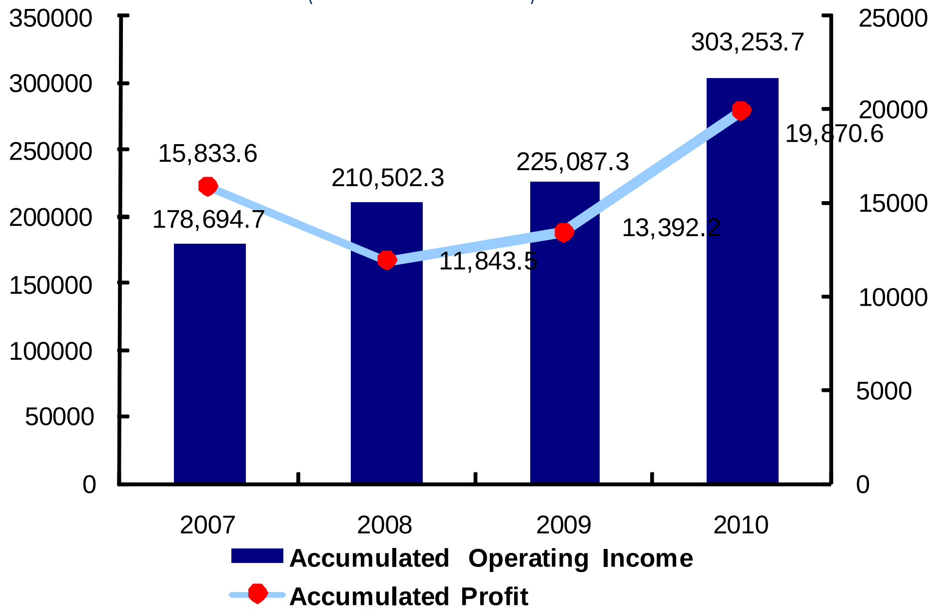


Source: Zero2IPO Research Center

The Ways of Participating in Equity Investments by State-owned Enterprises Change with the Time

As the equity investment industry develops, the ways of participation in the equity investments by state-owned enterprises keep adjusting. At present, the state-owned enterprises mostly choose to set up PE funds because they have rich industrial resources and sufficient capital and are not willing to give up their direct control over the funds. Meanwhile, the state-owned enterprises can also solve a chain of problems, such as backward internal incentive mechanisms and decision-making mechanisms, lack of professional talents and few sources of fundraising, by launching PE funds.

Figure 6 Year-on-year Comparison of Operational Income of State-owned and State-holding Enterprises in 2007-2010 (Unit: RMB100M)



Source: Zero2IPO Research Center

After years of exploration, some state-owned enterprises begin to try different ways of participation. Shanghai Dazhong Public Utilities Group, for example, shifted from investing in PE funds to launching PE fund. Since 2000, Dazhong Public Utilities, relying on the employees and resources of its investment & development department, has successively invested in a number of PE funds and their management companies like Shenzhen Capital Group Co., Ltd., Hangxin and Xingye. In

2010, it set up Shanghai Dazhong Private Equity Investment Co., Ltd. with a registered capital of RMB500.00M in a bid to involve in the preliminary project screening process, change follow-up investment into joint investment, integrate resources from multiple platforms and thus forge its own VC brand.

Contrary to Dazhong Public Utilities, CAS Holdings, parent company of Legend Holdings Ltd., is a typical example that shifted from direct equity investment to investment in PE funds. The participation of equity investment by CAS Holdings can be traced back to 1997; Based on the development strategies of the CAS, CAS Holdings withdrew from a number of enterprises that included CNC and China Sciences Group from 2006 to 2009 by reducing state's stake in listed companies. Because investing PE funds is safer than launching PE funds, involves no setup of internal investment teams, which facilitates operation and complies with the mission of the CAS in pushing for industrial development and supporting scientific & technological enterprises. Therefore, CAS Holdings began to invest in PE funds in a vigorous manner in 2009, and almost half of its cash assets are invested in this field.

State-owned Enterprises Face Redundant Investment Decision-making Processes

State-owned enterprises have more complex investment decision-making processes that consume a longer period of time, compared with private enterprises. In general, before any equity investment is made by the state-owned enterprises, feasible study reports shall be provided by relevant responsible departments and then submitted to GM office meetings for review; if necessary, the state-owned enterprises will retain the third party institutions to assess the projects and issue assessment reports, which will be submitted by GM office to the boards of directors for approval. In addition, the Interim Measures for the Supervision and Administration of the Investments by Central Enterprises also specify that state-owned enterprises shall formulate annual investment plans based on their development strategies and plans, and submit the annual investment plans to the State-owned Assets Supervision and Administration Commission of the State Council within a specified period of time.

Complex decision-making processes bring inconveniences to state-owned enterprises when equity investments are carried out. For example, China Development Bank set up the first state-level fund of funds, CDB-SVG FOF, through its wholly-owned subsidiary CDB Capital. The fund has a full size of RMB60.00B (RMB15.00B for the first phase) and mainly invests in RMB PE funds on China market. Delightfully, the fund is well received by many state-owned enterprises, including insurance institutions. And China Life and China Reinsurance both promised to invest in the FOF. However, the investment by China Life and China Reinsurance in the FOF requires the approval from the CIRC, because of the huge amounts involved. This prolongs the period from the launch of the FOF to the actual arrival of the funds and brings inconveniences to the preliminary investments by the FOF. ■

Table 1 Analysis on Reasons behind Investments by New Funds in 2010

Fund Name	Region	Fund Type	Capital Type	Fundraising Amt. (Unit: RMBM)	LP	Investment Field	Investment Reason
CCBI Chengtou Environmental Protection Fund	Shanghai	Growth fund	Joint venture	1,800.00	CCBI, Shanghai Chengtou Corporation	Environmental protection	Industrial investment

Source: Zero2IPO Research Center

Table 1 Analysis on Reasons behind Investments by New Funds in 2010

Fund Name	Region	Fund Type	Capital Type	Fundraising Amt. (Unit: RMBM)	LP	Investment Field	Investment Reason
Aerospace Industrial Fund	Beijing	Growth fund	Local	3,030.30	Aerospace Investment Holding Limited, Beijing Yizhuang International Investment Development Co., Ltd., State-owned Assets Operation & Management Center of Haidian District, CITIC Group, Aerospace Industrial Fund Management Co., Ltd.	Aviation products, aviation technology application, aviation services industries and other related fields	Industrial investment
Internet of Things Fund	Shanghai	VC fund	Local	300	Shanghai Institute of Microsystem and Information Technology, Shanghai Shangchuang Xinwei Investment Management Co., Ltd., State-owned Assets Operation Co., Ltd. of Jiading District, Jiading Industrial Zone Development Co., Ltd.	The Internet of things	Industrial investment
China Merchants Yinke Venture	Shenzhen	VC fund	Local	510	China Merchants Technology, Yinke Venture Capital, a fund guided by the municipal government of Chengdu	Projects in Chengdu and Sichuan and invested fields, such as Broad IT, new materials, energy saving and environmental protection, modern services and agriculture, etc.	Promoting regional economic development
Zhongshan Kechuang Fund	Zhongshan	VC fund	Local	100	Dazhong Public Utilities, Zhongshan Municipal Government	Innovative high-tech and high-growth SMEs in Zhongshan	Promoting regional economic development
Hefei GTJA Venture Ca pital Investment Co., Ltd.	Hefei	VC fund	Local	200	Hefei Construction Investment and Holding Co., Ltd., Shenzhen GTJA Investment Group Co., Ltd.	Seed-stage, growth-stage and late-stage start-ups in Hefei	Promoting regional economic development
Hony Capital RMB Fund II	Beijing	Growth fund	Local	7,300.00	Social Security Fund, CAS Holdings, Legend Holdings, BOCGI, CCB Investment	Two major topics amid China's consumption upgrading and urbanization	Seeking for new earning points/assets accretion

Source: Zero2IPO Research Center

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Fund Name	Region	Fund Type	Capital Type	Fundraising Amt. （Unit: RMBM）	LP	Investment Field	Investment Reason
Carlyle Beijing RMB Fund	Beijing	Growth fund	Joint venture	2,400.00	Beijing State-owned Capital Operation & Management Center, Beijing Private Equity Investment & Development Fund	Equity investments in large and medium-sized high-growth enterprises	Seeking for new earning points/assets accretion
SME VC Fund of Jiangsu Govtor Capital Group, Lianyungang Sub-fund	Lianyungang	VC fund	Local	50	Jiangsu Govtor Capital Group, Golden Ocean Investment Group	Investments in energy saving, new materials, electronic information, biology, medical technology, modern services, modern agriculture, equipment manufacturing and transformation of traditional industry by high-tech technology, etc.	Seeking for new earning points/assets accretion
Xiangjiang Industrial Investment	Changsha	Growth fund	Local	2,500.00	Hunan Xiangtou Holdings Group Co., Ltd., China Merchants Securities	Investments in equipment manufacturing, nonferrous metallurgy, high-tech technology, finance, culture, modern agriculture as well as enhancement of strategic investments in low-carbon economy, high-tech technology and emerging industries	Seeking for new earning points/assets accretion
Southern Capital					China South Industries Group Corporation, South Industry Assets	High-tech projects in finance, broad IT, advanced manufacturing, environmental	Seeking for new