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How Far Is China's Mobile Internet from the O2O Era?

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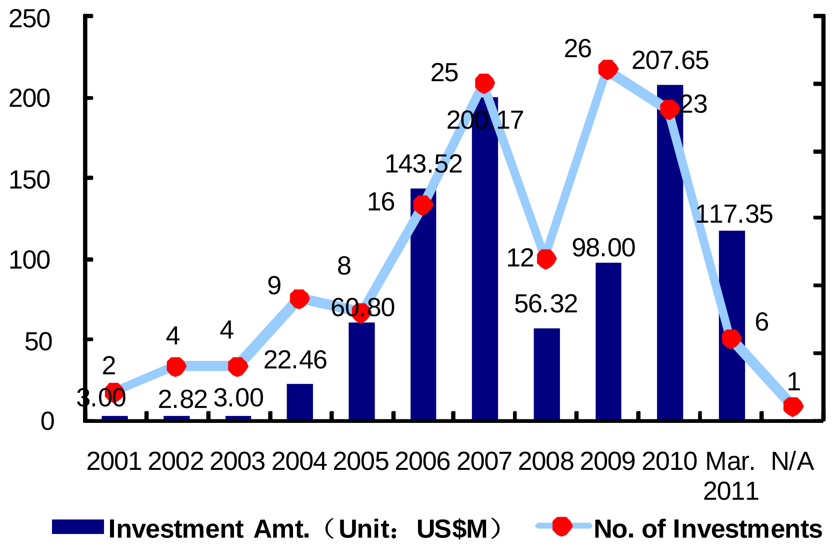
How Far Is China's Mobile Internet from the O2O Era?

Written By Zhang Yanan, Analyst with Zero2IPO Research Center

The tide of e-commerce is coming to the fore and becoming ever burgeoning, regardless of the distance we are from e-commerce, we can still feel and experience the hustle and bustle of the investments in China's e-commerce market. Judging from the development of China's e-commerce market, from B2B to C2C, and from B2C to O2O, enterprises that hold high the banner of e-commerce have won the favor of the capital market. Whether this frenzy will expand into the mobile internet sector? Will the capital providers take the lead in this market?

Figure 1 Comparison of Investments in Chinese Mobile Internet Market in 2001 - Q1 2011



Source: Zero2IPO Research Center

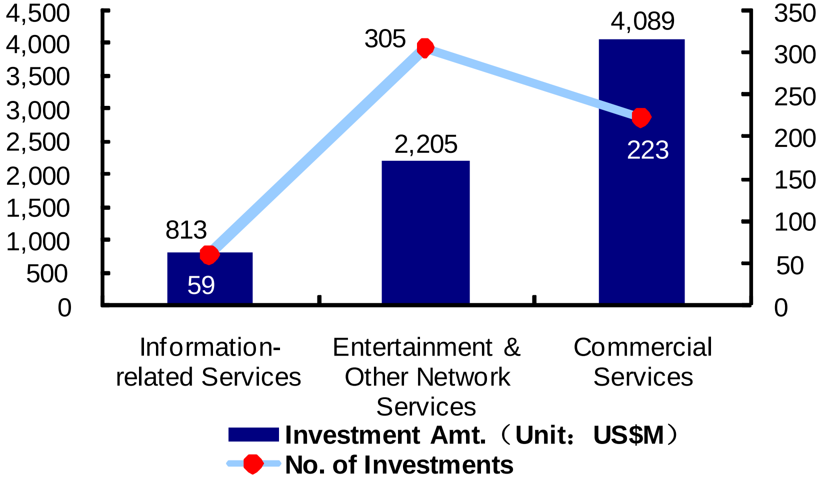
The last ten years witnessed the development of China's mobile internet amidst twists and turns; investment direction depends on industry development

China Mobile released the "Monternet" in Nov. 2011, lifting up the curtain over China's mobile internet era, which has experienced development amid twists and turns in the past decade due to its long-term restrictions by Internet environment and policies. China's mobile Internet has entered into a new era, from a totally enclosed era dominated by telecom operators with SMS and MMS as core business to Free WAP era formed by some SP "breaking the prison", as well as then into an open great Mobile Internet era featured by the competitions amongst various stakeholders, including telecom operators, terminal manufacturers, Internet content providers, service providers and system providers.

The investments in China's Mobile Internet are closely associated with the development of industrial environment. Between 2001 and 2003, i.e. the basic business era with SMS and MMS at the core, the enclosed environment offered rather limited opportunities for capital to enter the market partially due to the underdeveloped capital environment in China. Between 2004 and 2007, China's mobile Internet embraced the first round of fast development. This could be attributed to three aspects: first, the mobile Internet has transformed into a semi-enclosed environment, in where numerous small and medium-sized mobile Internet firms, especially manufacturers of client software of mobile phone, experienced rapid development, offering many opportunities for capital influx; second, the improvement of the Internet environment, due to China Mobile's update from 2.5G network to 2.75G network and China Unicom's release of 2.5GGPRS business, has provided a relatively smooth channel for applications; third, Internet and terminal manufacturers quickened the speed of penetration in the mobile Internet market and facilitated the formation and development of the mobile Internet business through the transferring of Internet business. With the arrival of open mobile Internet era, China's mobile Internet embraced the second round of investment boom in 2010 driven by the dual factors of capital and industry. To begin with, when it comes to capital, private equity fund and industrial capital which provide investments for mobile Internet have developed on a fast track, such as the investment fund established by SNDA targeting at mobile Internet, LE fund by LENOVO and Innovation Works Fund; second, leading Internet businesses updated their departments related to mobile Internet as a way to facilitate and accelerate the investments in mobile Internet.

Besides, Zero2IPO Research Center projects, based on the investments in China's mobile Internet in Q1'11, investments in this sector are expected to hit a historical high in the year 2011.

Figure 2 Classification of Investments in Chinese Mobile Internet Industry in 2001 - Q1 2011



Source: Zero2IPO Research Center

As for sub-industry breakdown, mobile game has been sought after in the capital market in more than a decade, with clear-cut business mode and the demand of mobile Internet entertainment era. Despite of the persistent investments in the mobile game market, the presence of many Internet game giants, and even the engagement of film and media organizations, such as Hybrid Brother and Borui Communication, will make the competitions in mobile game market much more intense in the pan-entertainment era. As China's Mobile Internet continues to develop, capital will seek for new investment opportunities against intense competition risks, and it's more likely to appear in the mobile e-commerce industry.

China's e-commerce investments show a clear priority and O2O group purchase stimulates the enthusiasm of capital

With regard to investments in China's Internet sector, the first round of investments mainly went to information-oriented companies while the second round focused more on entertainment-driven application, and the third round is featured by the investments in commercial application enterprises. Preliminary statistics from Zero2IPO Research Center show that between 2001 and March 2011, the disclosed cases of investments in commercial application sector (mainly including e-commerce, payment, advertisement agent and network marketing service, etc.) registered 223 with a total investment value of US$4.089B involved, far higher than that in the other two sectors.

(Notes: 1. Entertainment and other network services include online game, online community, online video, online education and online recruiting, among others; 2, commercial services cover e-commerce, payment, advertisement agent and network marketing service)

There is a clear trend that Internet investments have tilted towards e-commerce sector, especially the investments in 2010. The year 2010 witnessed the flourishing e-commerce B2C investments with 56 cases disclosed in this sector. Among which, 40 investment cases garnered US$714M in total or US$17.85M on average, far more higher than those of other market segments. Judging from e-commerce B2C investments in the previous year, we can say that group purchase industry, the pioneer of O2O, witnessed frequent investments. The incomplete figures of Zero2IPO Research Center demonstrate that from the beginning of 2010 to now, China's group purchase sector has recorded 17 investment cases. In particular, Lashou.com secured over RMB100M investment in mid-April 2011, attracting a great deal of attention and bringing China's O2O sector in the spotlight.

The path of investment in China's Internet is traceable which may be followed suit by Mobile Internet

It's generally believed among industry insiders that the certain differences between China's mobile Internet and Internet mean mobile Internet needs to explore a unique development path. However, the commercial essence of the above-mentioned two is similar to some degree, which makes the development path of the "two networks" traceable. In this connection, it is projected that the next investment boom in China's mobile Internet will happen in commercial fields. However, the distinctive features of commercial applications in mobile Internet sector, such as the portable feature of mobile terminal, uniqueness of users' identity and traceable character of users' location, will catalyze the development of mobile e-commerce O2O.

In a word, it will take a while for China's mobile Internet to enter into commercial application era from entertainment application era. Capital needs more courage to take on risks while it waits and sees and takes visionary actions. That being said, after user education and cultivation by O2O businesses, such as Groupon and dianping.com, the development of e-commerce O2O of China's Mobile Internet will be much faster than that of the Internet. Meanwhile, businesses of this sector emerge one after another. Do capital gear up for them?

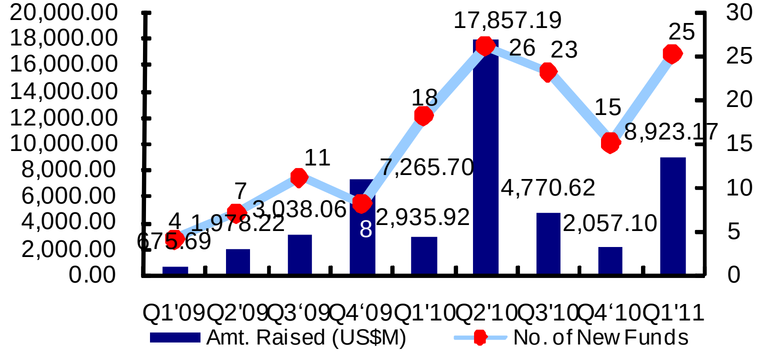
Date	Investor	Investee	Investment Amt. (US$ M)	Currency	Investment Round
2010.04	Private Investors	Groupon.cn	2.93	RMB	A
2010.04.23	Taishan Investment	Lashou.com	N/A	N/A	A
2010.05	LPAI	Ayatuan.com	1.93	RMB	A
2010.05	Zheshang Venture Investment	Kutuan.com	1.46	RMB	A
2010.06.05	GSR Ventures	Lashou.com	N/A	N/A	B
2010.06	Mitsui Ventures	Ftuan.com	N/A	N/A	C
2010.06.09	Vigor Ventures	Kutuan.com	1.17	RMB	B
2010.08	Sequoia Capital	Meituan.com	10	USD	A
2010.09.14	N/A	Tg123.com	1	USD	A
2010.09.19	KPCB	Manzuo.com	N/A	N/A	A
2010.11	IDG	Didatuan.com	N/A	N/A	A
2010.12	Private Investors	Groupon.cn	30.06	RMB	B
2010.12.02	Tenaya Capital, NVP, GSR Ventures	Lashou.com	50	USD	B
2011.02.24	Private Investors	24quan.com	N/A	N/A	A
2011.02.28	Tencent Collaboration Fund, Yunfeng Fund	Gaopeng.com	N/A	N/A	A
2011.03.14	Sequoia Capital	Jumei.com (original tuanmei.com)	10	USD	A
2011.04.11	Milestone Capital, GSR Ventures and others	Lashou.com	110	USD	C

China's PE Market Raised US$8.92B in Q1'11 with Active Real Estate Funds and Dominating Domestic Exits

Zero2IPO Research Center

In accordance with the data released recently by Zero2IPO Research Center, a leading VC/PE research institution in the Greater China region, China's PE market witnessed persistent improvement of fundraising activity in Q1'11. A total of 25 PE funds available for investments in Chinese mainland, including a number of new funds launched by foreign institutions, had accomplished their fundraising with an aggregate amount of US$8.92B. However, unlike the enthusiastic fundraising, PE investment had slowed its pace by completing 75 deals, with a total investment amount of US$1.97B. Specifically, the machinery manufacturing and Internet industries took the lead with eight deals respectively in terms of the number of deals, while the highlighted bio/healthcare and clean-tech industries in 2010 came second with seven deals this quarter. In reference to exit, after a marked improvement in Q4'10, this quarter staged a sharp reduction in the number of exits, as 29 PE funds exited from 23 investees, including 28 IPO exits and one M&A exit.

Figure 1 Quarter-on-quarter Comparison on Fundraising of PE Funds in Q1'09-Q1'11

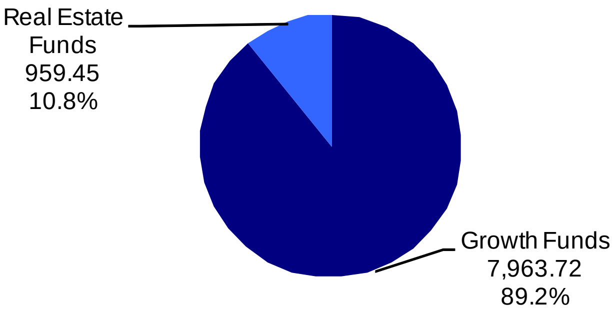


Source: Zero2IPO Research Center

25 Funds Raise US$8.92B, a Marked Increase on both Y-o-Y and Q-o-Q Basis

As the statistics of Zero2IPO Research Center suggested, a total 25 new funds were closed in Q1'11, up 66.7% quarter-on-quarter and 38.9% year-on-year; the fundraising amount surged to US$8.92B, 4.33 and 3.04 times respectively of that in the previous quarter and year, thanks to a number of large PE funds initiated by KKR, Baring Private Equity Asia, Primavera Capital, launched by Fred Hu, former Chairman of Greater China at Goldman Sachs Group, and other foreign institutions. From the perspective of institution type of closed funds, among these 25 new funds, 18 were raised by domestic institutions and the other seven ones were launched by foreign firms. In addition to the fund closed, there were 19 new funds initiated, 15 ones of which disclosed a total of target fundraising amount of US$14.90B. Obviously, China's PE market continued the fundraising momentum of the previous year in 2011.

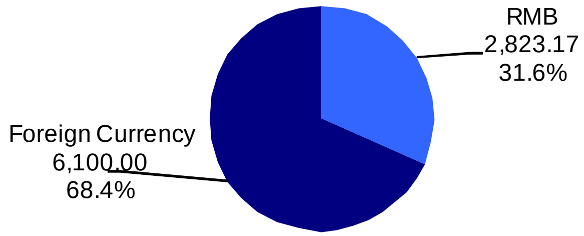
Figure 2 Distribution of New PE Funds in Q1'11 by Fund Type (By Amt. Raised, US$M)



Source: Zero2IPO Research Center

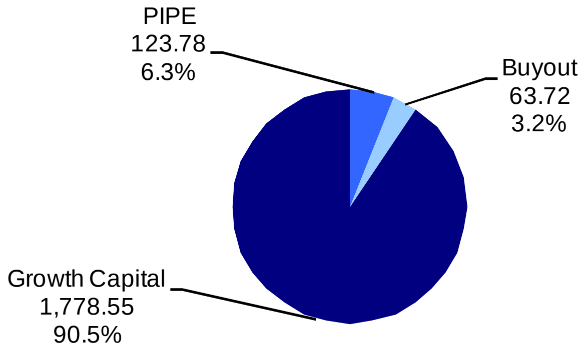
In terms of the fund type, among the 25 funds closed in Q1'11, there were 20 growth funds and five real estate funds, which raised US$7.96B and US$959.45M respectively. Compared with the situation in the previous year when domestic institutions led the fundraising of real estate funds, Q1'11 closed five real estate funds, three of which were managed by foreign institutions with an average fundraising amount of US$239.00M, significantly outperform-

Figure 3 Distribution of New PE Funds in Q1'11 by Currency (By Amt. Raised, US$M)



Source: Zero2IPO Research Center

Figure 5 Distribution of PE Investments in Q1'11 by Investment Strategy (By Investment Amt., US$M)



Source: Zero2IPO Research Center

ing the US$122.00M of domestic real estate funds. Zero2IPO Research Center observed that real estate funds had picked up activity in fundraising since 2010, when a total of ten funds raised US $1.86B, and most of funds were raised by small-sized institutions with relatively lower amount, except Star Capital Investment Fund, Gaw Capital, and other large funds. The year 2011 witnessed further improved fundraising of real estate funds, which mainly involved professional property enterprises, with gradually increased fund scale. Furthermore, due to the tightened monetary policies and shrunken bank credits, real estate funds showed increasingly great importance in the financing of real estate corporations. Therefore, real estate PE funds would embrace a surge in fundraising and investments in 2011, Zero2IPO Research Center estimated.

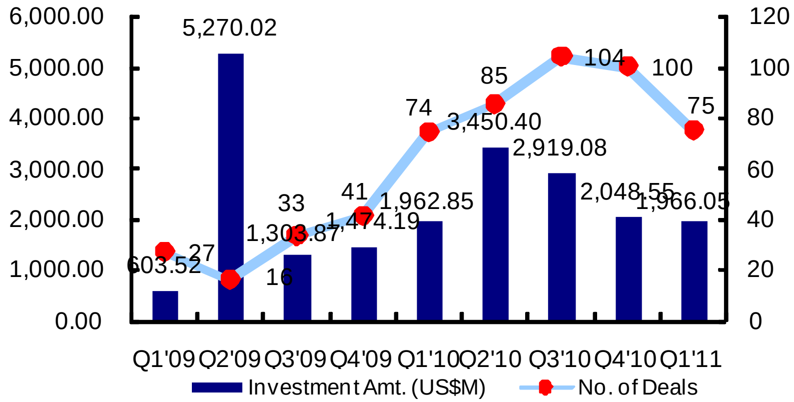
In terms of the currency of new funds, RMB funds took an overwhelming lead in the number of funds in Q1'11 with 18 funds closed, which were generally small-sized, except Shanghai Prosperity Fund and Guangdong SME Direct Equity Investment Fund. Foreign funds had accelerated their fundraising this quarter by closing seven funds totally, which exceeded a half of the number in the whole 2010. Due to a number of closed large-sized foreign-currency funds such as KKR China Growth Fund, Baring Private Equity Asia V and Primavera Capital I, foreign-currency funds outstripped RMB funds in the fundraising amount, accounting for 68.4% of the total. Furthermore, Zero2IPO Research Center noted that two foreign institutions raised two RMB funds successfully, which mainly focused on the real estate industry.

PE Investments Shrink in Both Number of Deals and Amount; PIPE Investments See Sharp Fall in Average Investment Amount

Unlike the enthusiastic investments in China's PE market in 2010, the year 2011 witnessed an obvious downturn in PE market, completing a total of 75 investment deals in Q1'11, among which 63 deals disclosed an aggregate investment amount of US$1.97B, slight growth of 1.4% and 0.2% year-on-year respectively in terms of number of investment deals and amount, but dropping by 25.0% and 4.0% quarter-on-quarter. According to Zero2IPO Research Center, the downturn in number of investment deals and amount was partly due to the influence of the New Year's Day and the Spring Festival, and the acceleration of fundraising in Q1'11 is expected to boost the investments and set new highs both in the number of investment deals and amount in the full 2011.

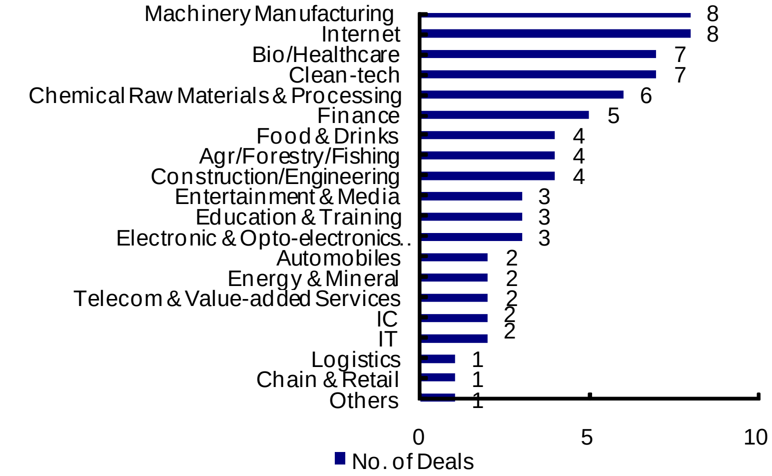
The investment strategy of these deals completed in Q1'11 was simple, as the growth capital took

Figure 4 Quarter-on-quarter Comparison on Investments of PE Funds in Q1'09-Q1'11



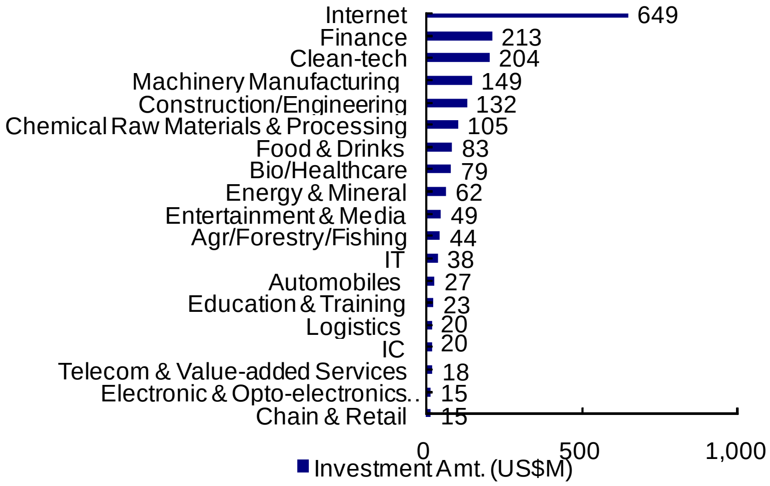
Source: Zero2IPO Research Center

Figure 6 Industry Breakdown of PE Investments in Q1'11 (By No. of Deals)



Source: Zero2IPO Research Center

Figure 7 Industry Breakdown of PE Investments in Q1'11 (By Investment Amt., US$M)

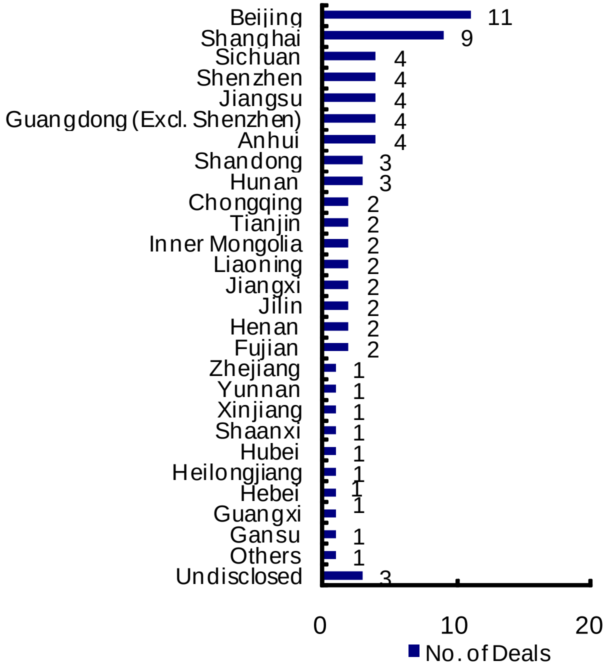


Source: Zero2IPO Research Center

the lead with 67 deals, PIPE and buyout investments closed just seven and one deals respectively. In reference to the investment scale, the investment deals of growth capital and buyout in Q1'11 witnessed slight improvement in average investment amount from the previous year, while PIPE investments had small amount generally with a relatively sharp reduction in the average investment scale from US$115.00M in 2010.

From the perspective of industry breakdown, 75 investment deals closed in Q1'11 were scattered in 20 grade-1 industries. To be specific, machinery manufacturing and Internet industries topped the list by securing eight deals each, followed by the bio/healthcare and clean-tech with seven deals respectively, which were favored by investors in 2010. It is worth noting that education and training industry was better received by PE investors in Q1'11 by completing three deals or US$22.80M investment than 2010 when only one investment deals was closed. In reference to the investment amount, Internet industry held a good lead over the finance industry in the second place, thanks to 360buy securing US$500.00M from DST, a Russian investment group.

Figure 8 Geographic Distribution of PE Investments in Q1'11 (By No. of Deals)

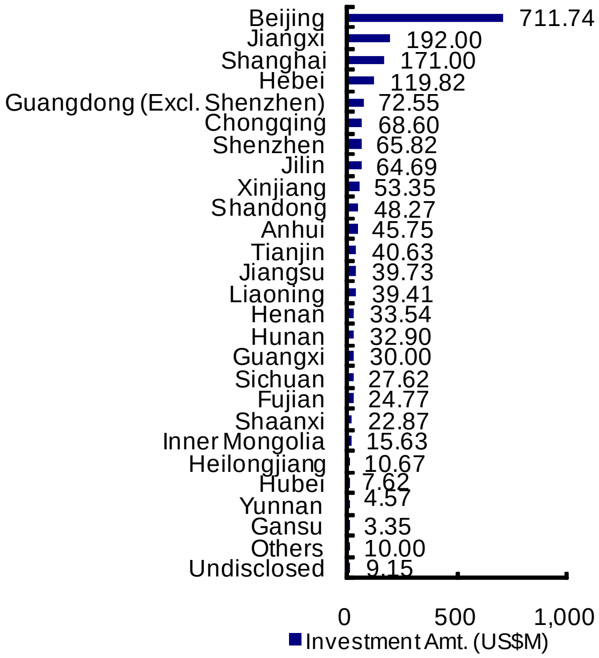


Source: Zero2IPO Research Center

Beijing Maintains the Lead; Anhui-based Enterprises Better Received

In reference to geographic distribution, 75 investment deals were distributed in 27 provinces and cities, among which Beijing and Shanghai topped the list with 11 and nine deals respectively. It is worth noting that Anhui closed a total of four deals, a considerable improvement in the ranking, breaking the quarterly record in number of deals. In terms of investment amount, Bei-

Figure 9 Geographic Distribution of PE Investments in Q1'11 (By Investment Amt., US$M)



Source: Zero2IPO Research Center

jing maintained the lead, especially due to the large investment in 360buy, substantially outperforming other areas. In addition, despite inactivity in investments and few large-scale investments, Jiangxi and Hebei witnessed great improvement in ranking.

Domestic Exits Dominate the

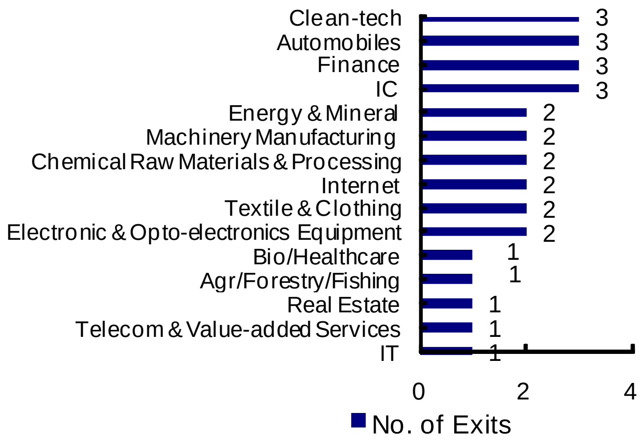
In regard to the exits, after a surge of investment deals in Q4'10, this quarter saw a sharp reduction, with 29 PE funds exiting from 23 investees, up 64.7% year-on-year, but plunging 69.2% on a quarter-on-quarter basis. The 29 exits include 28 IPO exits and one deal via M&A.

As for industry breakdown, the 29 exits involved 15 industries, among which clean-tech, automobiles, finance, and IC industries took the lead with three exits each, and the finance and IC industries outstripped their level in the previous year. In addition, the textile & clothing industry also had outstanding performance in Q1'11, as Baofeng Modern International Holdings Co., Ltd. and Zuoan Fashion Limited were listed on HKMB and NYSE respectively with a PE exit each, breaking the embarrassing "zero exit" of the industry in 2010.

The strong rise of China-based investment institutions in recent years had gradually changed the dominating prospect of overseas markets. In Q1'11, the domestic markets had grown into the major arena of PE exits. Specifically, ChiNext outperformed other markets by completing 13 exits involving 10 listed companies, fol-

seas peers in the return of investment, for instance Sinovel Wind Group Co., Ltd. went public on Shanghai Stock Exchange and yielded the return on book value of 180.00 times for New Horizon Capital, which was the IPO exits with the highest return this quarter. ■

Figure 10 Industry Breakdown of PE Exits in Q1'11 (By No. of Exits)



Source: Zero2IPO Research Center

Figure 11 Market Breakdown of IPO-backed Exits in Q1'11 (By No. of Exits)