# Spotlight Asia

## Kroll Quarterly M&A Newsletter

April/May 2018

**We are pleased to present the latest edition of Spotlight Asia, Kroll's quarterly M&A newsletter, produced in association with Mergermarket.**

### Contents include:

- An overview of PE and VC technology investments in India and Southeast Asia
- Analyses of activity and trends in ecommerce, fintech, healthcare and AI
- Observations on foreign interest and competition from corporate investors
- An interview with Reshmi Khurana and Cem Ozturk, Managing Directors at Kroll, on recognizing and mitigating risks before investing in emerging or disruptive technologies

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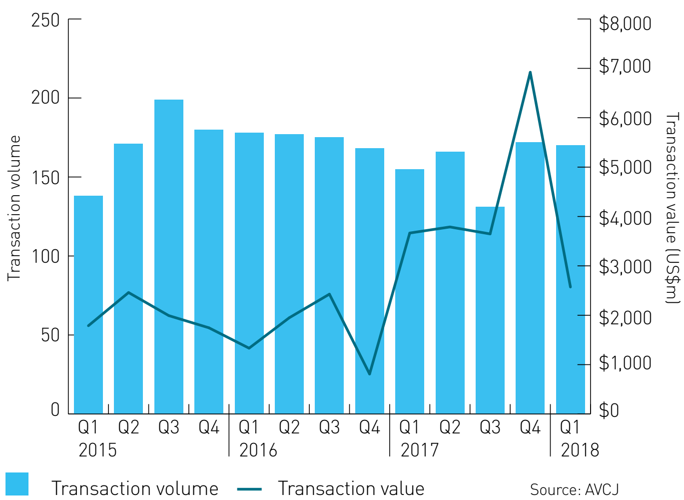
## Staying ahead of change: Investing in disruptive tech in India and Southeast Asia

As private investors pursue technology opportunities in emerging markets, India and Southeast Asia continue to capture investments. Private equity (PE) and venture capital (VC) investors announced 170 technology transactions worth US$2.6bn in the first quarter of 2018, reflecting a sustained momentum from the 172 transactions in Q4 2017 in terms of deal volume. Throughout 2017, India and Southeast Asia received US$18bn in technology deals[1], up from only US$6.5bn in 2016, in testament to the attractiveness of these high-growth markets for investors looking to capitalize on the fast-evolving tech sector.

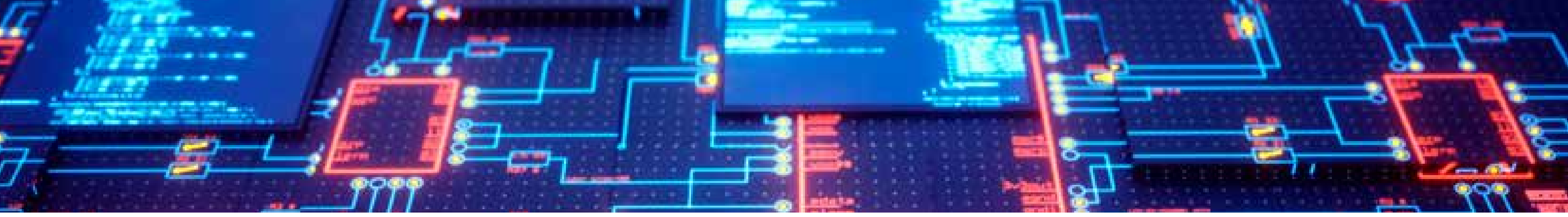
Since 2015, India has seen the majority of total PE and VC tech activity in the Indian and Southeast Asian markets, accounting for 56% of deal value and 71% of volume. As the next biggest market, Singapore accounted for 33% of deal value and 10% of volume, while Indonesia (7% of deal value and 7% of volume) was also on investors' radar screens.

**PE and VC tech transactions in India and Southeast Asia 2015–Q1 2018***



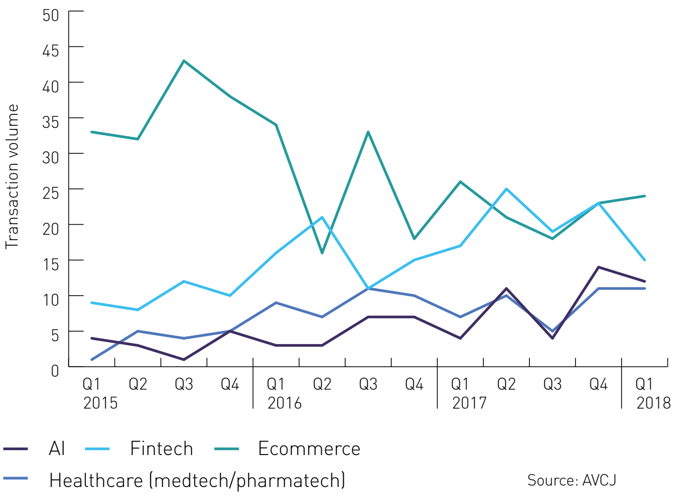

*Southeast Asia includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

[1] In this newsletter, technology deals or transactions refer to PE or VC transactions with either "computer related" or "information technology" as their investee primary industry, based on data generated from the Asian Venture Capital Journal (AVCJ).



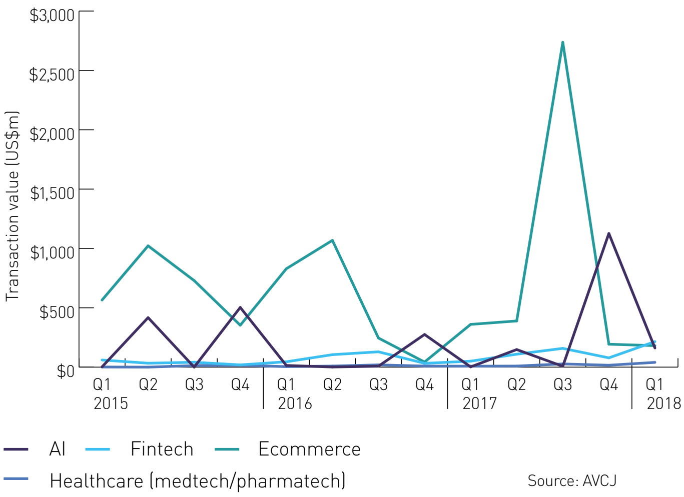


**PE and VC tech transaction volumes in India and Southeast Asia**




Source: AVCJ

**PE and VC tech transaction values in India and Southeast Asia**




Source: AVCJ

In 2018, PE and VC funds continue to study how technology will reshape some of the core growth sectors in these countries, such as financial services, education, healthcare, and retail. As industries pursue digital transformation and grapple with technology-related disruptions, investors will see new investment opportunities in the next few years. Ecommerce, fintech, technology in healthcare (medtech and pharmatech), and artificial intelligence (AI) stand out for their advances in technology and their cross-sector applications.

## Ecommerce

With a vast combined population, a mass-market shift towards smartphone usage and an upwardly-mobile middle class, India and Southeast Asia have become crucibles for ecommerce advancement, aided by infrastructure improvement and the widespread digitization of payment systems. Ecommerce posted 88 transactions worth US$3.7bn in 2017, and has accounted for 16% of PE and VC tech investment volume and 25% of value in India and Southeast Asia since 2015.

**India was the top investee country**, receiving 72% of PE and VC ecommerce buys in India and Southeast Asia since 2015. Exemplifying investor interest in India's flourishing ecommerce market, India-based e-marketplace Flipkart raised US$2.5bn from Softbank in 2017.

In **second place was Indonesia** with 12% of PE and VC ecommerce investment volume and 3% of value since 2015. In 2017, Indonesia-based ecommerce start-up Sale Stock raised US$27m. Singapore contributed to 5% of volume and 2% of value, with online fashion marketplace Zilingo raising US$17m from Sequoia Capital India and Burda Principal Investments. Such ecommerce plays have been staged against demographic shifts in Southeast Asia, home to the world's fastest-growing internet population of approximately 260 million—with projections to reach 480 million by 2020—based on research by Temasek and Google.

Opportunities are unfolding in Malaysia and Vietnam as well, where thriving consumer markets offer the promise of higher risk-adjusted returns. In Malaysia, ecommerce portal iPrice raised US$4m in Series A funding in 2016, while in Vietnam, consumer goods e-platform Leflair raised US$1m in pre-Series A investment in 2017. Investor interest has also been spreading to allied sectors. In Thailand, ecommerce enabler and e-distributer aCommerce closed a US$65m Series B round in 2017.

## Fintech

Fintech investments have been rising over the past three years, signaling potential that hype is becoming reality. In 2017, 84 deals worth US$395m were announced, a 33% increase in volume and 27% in value from 2016. More than half of the transactions since 2015 have been channeled into India (58%), followed by Singapore (17%) and Indonesia (9%).

India's fintech appeal lies in the sheer size of its unbanked population, paired with its reputation as a strong regional technology hub. To succeed in the longer run, however, the country needs to catch up in regulatory support. In 2017, India-based digital lending platform Capital Float raised US$45m in its Series C funding round.

Meanwhile, the Monetary Authority of Singapore has set up a US$21m grant to drive fintech development, especially in AI and data analytics. In 2017, Singapore-based online personal finance comparison portal Moneysmart raised US$10m. In frontier and emerging Southeast Asia, relatively low digitization levels are leaving room for growth. In 2017, Indonesia-based online consumer lending service UangTeman raised US$12m in a Series A funding round.

A fundamental investment consideration is whether a fintech company can withstand the test of emerging and evolving guidelines and restrictions aimed at regulating this sector, as lawmakers attempt to reconcile growth imperatives with the need for guidelines and laws necessary to protect this sector.

# *Foresight and adaptability: Mitigating disruptive tech risks in India and Southeast Asia*


**Kroll Managing Directors, Reshmi Khurana and Cem Ozturk, reveal how private investors can minimize tech risk in India and Southeast Asia.**

**What are the key recent developments in PE and VC tech investment activity in India and Southeast Asia?**
**Reshmi:** As traditional banks continue to face pressure from non-performing loans in India, and increasingly in Southeast Asia, tech companies seeking capital have been turning to private investors. Meanwhile, governments in these geographies have been providing fertile ground for digitization and tech investment through policy initiatives, by incubating tech funds with traditional banks or by initiating e-governance projects to digitize government services, attracting investment in ancillary industries like enterprise solutions. As a result, globally, traditional tech investors, e.g. Tiger Capital or Softbank, have almost doubled down on investments in the region, catalyzing the rise of locally grown tech unicorns.

**What sector-specific risks are investors likely to encounter when making tech investments in India and Southeast Asia?**
**Reshmi:** *Regulatory risk.* The number one risk is regulatory risk, aside from shared market and financial risks, especially when tech crosses into highly regulated sectors like financial services, insurance, and even media. Businesses cannot predict regulation because regulators cannot predict how businesses will evolve. To some degree, all new technology is inherently disruptive to established business models or processes. Out of necessity, this often translates into regulatory action that is more reactive than proactive as the effects and consequences of a particular technology become known over time. We often see regulators later imposing controls around licensing or pricing to protect consumers and local businesses. Investors come to Kroll to help them understand how regulators, customers, competitors, and other stakeholders are likely to think about a certain sector, company, or business model as it evolves. Recently, an investor considering investing in a tech-based micro-lending company in the Philippines asked Kroll how the local regulator might view the start-up, its lending rates, and business model, especially as it scales up.

*Promoter risk.* The primary founders of traditional businesses, common targets of PE, tend to be from established business families that are diversifying. In tech, however, founders are often first-generation entrepreneurs. Many may have great business ideas and built innovative companies, but they don't have a vast track record that can be easily assessed. We help investors understand the background of such founders and analyze how they might be expected to behave post-investment, providing insight into fundamental considerations such as whether the investee has the ability and commitment to scale up and manage the business and to maintain the governance standards that the investor expects.

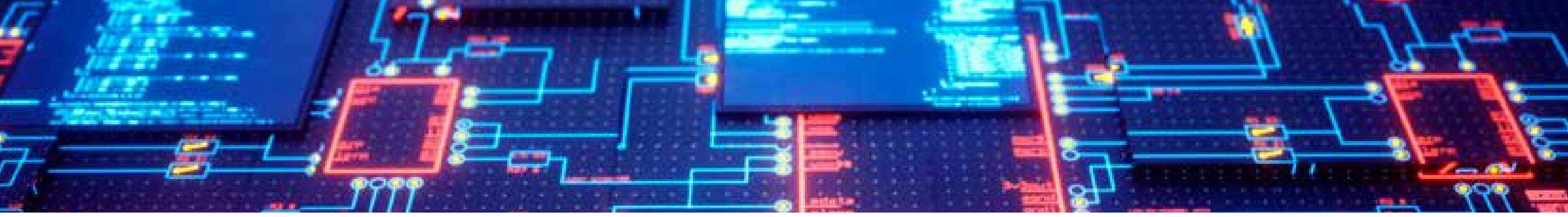
**Cem:** *Stakeholder risk.* Fast-developing industries tend to be disruptive for existing stakeholders, such as established competitors, which can result in backlash, especially when such stakeholders have robust political and regulatory influence. In India and the Philippines, local taxi companies have reacted negatively to some ride-hailing companies, pushing for them to be regulated. To forestall and sidestep adverse repercussions, investors need assistance in discovering how a potential tech investment may end up affecting business models, customers, employees, contractors, distributers, and suppliers. In this respect, tech investors frequently engage our services to conduct benchmarking studies.

**How does political risk affect PE and VC investors?**
**Cem:** While many economies in the region, such as India, Indonesia, and Vietnam, are seeing more political stability than they ever have, an element of political risk remains. In Malaysia, there is the possibility of a regime change with the upcoming elections, and the Philippines and Indonesia may also see changes in their governments in the near future. A key factor to watch is whether aspiring political forces are running on platforms of economic nationalism, and then whether certain disruptive technologies are being framed as emblems of foreign influence, especially among the stakeholder groups described above. In Southeast Asia, Indonesia may be the best example of this type of trend.

Policy change can still be ad hoc in some of these countries, leading to political uncertainty and risk surrounding changes that may affect tech companies. India, for instance, is on the path of tech liberalization, but may be prone to sudden policy shifts, as with its currency ban or alcohol prohibition. Overall, governments are committed to liberalization and job creation, but each government can still make policy decisions that disrupt certain sectors.

**What is the value of investigative due diligence in uncovering often overlooked issues in the region?**
**Reshmi:** India and some Southeast Asian markets are different from more developed or regulated markets in the maturity of their corporate governance environment. In day-to-day operations, businesses tend to get pushed into practices that have a direct impact on the reporting of financial results, or which expose them to fraud and corruption risk in Western terms. There is often a sense that something unseen is going on in the background, disconnected to what gets recorded in the books, casting a shadow over the integrity and transparency of financial statements.

To mitigate their risk exposures, PE and VC investors come to Kroll for our expertise in conducting investigative research to help them understand the financial health and business practices of a potential investment and their target markets which, however challenging, are too large to ignore. To be able to factor in these risks and maximize an investment opportunity and its returns, investors have to make both qualitative and quantitative assessments, identifying influencers and uncovering their relationships with regulators and governments. Investors need to be better prepared with the understanding of all the dynamics involved in operating in this region to ensure that they make investments with a certain level of confidence. Our advice is not to be swayed by the competitive pressures of too many investors chasing too few deals and to take your time, so you can be well-prepared to make a winning investment.



# *Staying ahead of change: Investing in disruptive tech in India and Southeast Asia*

## Healthcare (medtech/pharmatech)

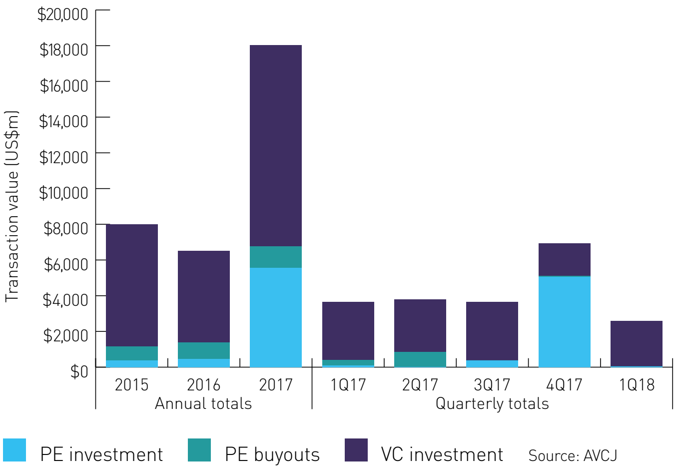
Tech in the healthcare industry (medtech/pharmatech) bears tremendous upsides, even though only US$59m was invested via 33 deals in 2017. In the face of aging populations, rapid urbanization, and rising disposable incomes, demand is exploding for access to quality healthcare at affordable costs. This has given rise to pockets of potential where technological applications can make a difference with preventive care and earlier diagnoses, less invasive treatment, as well as the decentralization of care.

India saw 95% of healthcare transaction volume since 2015, with the remaining 5% going towards Singapore and frontier Vietnam. In 2018, India's government announced regulatory developments including the notification of the Medical Devices Rules, a risk-based classification of medical devices. In an illustration of VC interest in the sub-sector, India-based CureFit raised US$3.2m from Trifecta Capital Advisors and Prathithi Investment Trust in April 2017. In Singapore, Homage, an online matching platform for home healthcare services, raised US$1.2m from 500 Startups, Golden Gate Ventures and SeedPlus in March 2017.

## Artificial intelligence

AI promises enormous potential by dint of its wide-ranging cross-sector applications, contributing to 4% of PE and VC technology transactions in India and Southeast Asia since 2015. In India (96% of AI investment volume), ride-hailing company Ola raised US$1.1bn to invest in AI from investors led by Tencent and Softbank. In 2017, Malaysia Debt Ventures launched its third fund to invest up to US$1bn in emerging technologies, including AI, over the next 20 years.

**PE and VC tech activity in India and Southeast Asia by investment type**



Source: AVCJ

From a legal and regulatory standpoint, the sub-sector may face headwinds, given far-reaching legal and ethical questions surrounding data privacy and security, liability for decisions made by AI, as well as the ownership of intellectual property created by AI. More questions are arising in the wake of the fatal accident involving a self-driving Uber car in the state of Arizona in the US in March this year.

## Capital interest: Foreign funds and corporate trends

While local funds have been the dominant players in these markets (Indian investors were involved in 40% of investment instances[2] with those from Southeast Asia in 20% since 2015), foreign investors have been making inroads. US investors took part in 25% of investment instances, followed by Japanese (5%) and European (4%) funds. While generally aware of the regions' lack of cross-jurisdictional congruence, foreign investors have been seeking an early mover advantage, and few are going at it alone, choosing instead to partner either with other overseas investors, or with local investors for their expertise. Since 2015, fewer than a fourth of transactions involving overseas funds had a single foreign investor.

Competition from strategic corporate buyers has also become more pronounced. Looking to stay ahead of competitors via accelerated growth and diversification by investing in technology and innovation, some have established their own VC arms, like Softbank, Google, Alibaba and Cisco. Others are partnering with financial investors to share risk exposures and gain access to wider capital pools. In 2017, Alibaba partnered with SAIF Partners in a US$200m funding round for Paytm, marking the former's formal entry into India's ecommerce market.

## Conclusion: An evolving ecosystem

With technology in India and Southeast Asia witnessing a PE and VC investment boom in 2017, it is evident that investors recognize the region's immense potential. As investors look to enter the game early, VC funding has focused on start-ups. As more and more local companies in the region demonstrate the sustained performance and market reach required to secure larger mid- or growth-stage funding, PE investments in the tech sector may also begin to look up in 2018 and beyond. In the next 12-24 months, both regions may see steadier international interest and buyouts as more investable targets start to reach the size and growth stage that render them ripe for the picking.

[2] In this newsletter, "investment instances" refer to every instance or occurrence in which an investor is involved in a transaction. A transaction with five investors, for example, would have five investment instances.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