DEAL #1: FACIAL RECOGNITION UNICORN SENSETIME SCORED A BILLION-DOLLAR INVESTMENT FROM ALIBABA

DEAL #2: TINK LABS, WHICH DEVELOPERS SMARTPHONES FOR HOTEL GUESTS, IS VALUED AT ABOUT US$1.5B

VC fundraising hits US$2.28b in 2018

Artificial intelligence accounted for a significant amount of VC activity in 2018, led by the headline-grabbing US$1.2b investment in SenseTime the largest VC and technology transaction last year.

The number of venture capital (VC), and technology deals in Hong Kong remained the same in 2018 at 42 deals in total, but their combined value jumped 81%, powered by what analysts noted as a "breakout" class of homegrown startups, primarily in the technology space, that are attracting the lion's share of funding. VC and technology investments in Hong Kong hit US$2.287b in 2018 from US$1.262b in 2017, according to data from the Hong Kong Venture Capital and Private Equity Association (HKVCA).

Of the VC and technology transactions in 2018, the biggest by far was the US$1.2b investment in facial-recognition technology company SenseTime by high-profile institutional investors including Alibaba Investment, Temasek, Hopu Capital, Silver Lake and Tiger Global.

The second-largest deal was the US$300m investment in Tink Labs by an undisclosed group of investment funds and strategic investors in a deal that values the Hong Kong-based developer of smartphones for hotel room guests at about US$1.5b. Online logistics platform GoGoVan attracted US$250m from InnoVision Capital, Hongrun Capital and the Russia-China Investment Fund, among other investors, in what marked as the third-biggest VC and technology transaction in 2018.

The technology, media and telecom sector accounted for a dominant 89% of all VC and technology deals by volume in 2018, according to HKVCA, with the healthcare, consumer & retail and business services splitting the remainder at 6%, 3% and 2%, respectively. The technology sector will continue to to draw in VC funds looking to compete for higher-quality targets in 2019, according to analysts.

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"You are starting to see a very interesting development in the emergence of breakout companies coming out of HK. I would say these are still isolated incidents; they haven't created a cluster effect yet. But I think quite soon in other entrepreneurial clusters you will start to see some breakout examples," said **Denis Tse,** chair, research committee of HKVCA and founding managing partner of private equity manager Asia-IO Holdings

Aside from SenseTime, Tse reckoned another notable deal involved travel tech platform Klook, which attracted US$200m in funding in August 2018. The company plans to use the financing to expand in the U.S. and Europe. There is also buzz surrounding virtual reality startup Sandbox VR, which in late January 2019 raised a US$68m Series A investment round led by US-based VC firm Andreessen Horowitz -- a "very rare" occurrence as the latter does not usually invest in a Hong Kong-based company, according to Tse.

"AI is going to be one of the key focus areas in the HK market going forward," said **Alyssa Aaron**, director of investments at Nest Ventures. "In the wake of the Chinese government's ambition to be a world leader in AI by 2030, investors are pouring billions into AI startups similar to SenseTime."

However, she noted that whilst there is a clear trend around investment in AI -- the government has even launched the HKAI Lab to further support growth in this space -- it remains to be seen what some of these startups can practically deliver.

Flight to quality

The larger investment rounds and heightened market uncertainty, especially in late 2018, have pushed investors, including VC funds, to place a higher premium on quality when evaluating potential targets, analysts noted.

"The overall backdrop is that there is a flight towards quality because as you can see in the public market, investors are getting more discerning about company growth potential. They are really looking at an individual company's capability and quality, rather than just a generalized approach that you have seen in the past two years," said Tse.

"I think it's a positive trend for companies that are delivering quality and are really thinking about creating innovative products and services. It's a good recalibrating juncture," he added.

Many Hong Kong startups were either not prepared or lacked the desired scale by Mainland Chinese investors, noted **Lap Man**, co-founder and managing partner of Beyond Ventures, a HK-based VC fund established by VC fund eGarden Ventures in partnership with local serial entrepreneurs.

"What we have observed in HK is that many startups are not ready at all, or they have only a written proposal on hand, and they have not started the business yet," said Man. "Though there is so much money floating around, it is not easy for startups to seek financial backing especially from mainland Chinese capital which has a much higher requirement on the business scale of the startups."

SenseTime's emergence as the market leader in facial recognition has made it more difficult for smaller AI-focused firms to gain a foothold, according to KPMG's latest quarterly Venture Pulse report, although it expects growth to likely be driven by other areas of AI and a bevy of corporates looking to embed such technologies within their own applications. "However, with the focus of investors primarily on late-stage deals, it will likely be difficult for AI-focused startups to attract funding without strong use cases," the report said.

Large corporates in Hong Kong have shown increased interest in exploring digital transformation, Aaron said, citing how 85% of firms boosted their digital investment in 2018, whilst 93% said they were planning to increase such investment over the next two years. She also noted that many corporates have begun setting up a dedicated ventures arm in order to facilitate innovation, including the electricity supply company CLP Group.

"We are expecting to see more startup-corporate partnerships and corporate venture investments in 2019 and in the future," said Aaron.

Amongst sectors, there should also be continued


Denis Tse


Alyssa Aaron


Lap Man

interest in the fintech space in 2019, according to Man. "Startups are not only changing how banks operate, but they reinvent other financial areas that have been left untouched for decades." For example, financial services and technology startup Oriente raised US$105m in an initial funding round in November 2018 which it said it would use to level up its technology and product development, as well as fuel its growth into new Southeast Asian markets.

Man reckoned the government's rollout of virtual banking licenses, the first set of which could potentially be granted as early as the first quarter of 2019, will further change how individuals and businesses reshape the delivery of financial services.

Aaron also saw a positive uptrend for fintech in 2018, and she foresees the sector continuing to be dominant moving forward, factoring in the government's planned US$63.9m allocation to boost financial services in the city, including fintech, over the next five years.

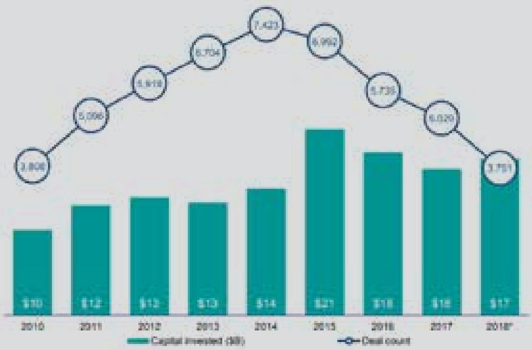
However, Man maintained that opportunities for VC funds can come from any sector. "We do not see particular sectors dominating the deals. We have examined more than 200 deals annually and the successful deals come from a wide range of sectors. For Beyond Ventures, we invest in startups with unique technological innovation and/or self-sustained and creative business model."

With the economy becoming more uncertain, Tse said there will likely be "some crunching" on valuation on VC fundraising, although it remains to be seen whether that will lead to a withdrawal of VC activity by less experienced players that were attracted to the sector. "Good managers continue to be strong in fundraising but you can see that the less proven managers would have a hard time raising capital."

Family office rush

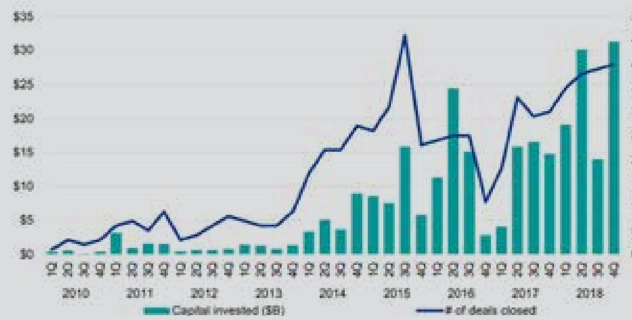
Despite the prevailing uncertainty, many Hong Kong-based family offices are either setting up their own fund or are partnering with VC funds to co-invest in potential startups, noted Man. For example, Union Capital, a family office and institutional investor focused in Western Asia and Africa, entered the HK market in late 2018 and

Global first-time venture financings of companies 2010-2018



Source:KPMG

Global unicorn funding rounds 2010-Q4 2018



Source: KPMG

is looking to work with local partners to spot opportunities.

Peter Stein, managing director of the HK Private Wealth Management Association, told CityWireAsia in October 2018 that close to half of the $1t assets managed by the domestic private wealth industry stems from corporate and institutional professional investors. "We believe much of this figure is made up of family offices in various forms, from single family offices to family offices embedded within family businesses," he was quoted as saying.

In order to boost the city's attractiveness to family offices, the PWMA has recommended tax-related incentives such as expanding asset coverage of offshore funds exemptions and revamping trust taxation, among others. The association has argued that such changes would enable HK to match some of the tax perks that have made Singapore a favored destination among family offices.

Matthew Tai, whose father built a fortune in real estate and is the CEO of JM Enigma Capital Group, has placed roughly 15% of his family office's US$70m capital in technology investments, up from zero percent two years ago, according to Bloomberg News. "My family's traditional business was about development of land," Tai was quoted as saying in the Bloomberg News report. "But that's history. The new world is the cyber world."

The family office trend is partly driven by a recent surge of newly minted millionaire and billionaire startup cofounders following a surge in IPOs last year. The number of IPOs in the Hong Kong Stock Exchange reached a new record in 2018, capping off a very positive year for exits in the region, according to KPMG's latest quarterly Venture Pulse report.

The advisory firm said the acceleration in HK IPO activity, which saw a strong surge in the third quarter, was also enabled by changes to listing rules for technology companies with dual-class share structures and for biotech companies earlier in 2018. The trend could be sustained as KPMG assessed that sentiment remains favourable for future listings in HK despite some caution about private valuations potentially being higher than those within the public markets.

"You don't see an immediate impact on the local venture community, but in terms of creating avenues for IPOs, I think it has become more interesting for venture-backed companies," said Tse.

SINGAPORE VIEW

Singapore startups hauled US$7.5b

Startups in Singapore continued to account for the lion's share of regional funding after raising US$7.5b in 2018 across 189 deals, according to a report from e27. The average deal size in Singapore was US$29m with fintech reigning supreme as the most popular vertical for deals (21) although the enterprise solutions segment is fast catching up with 20 deals on its belt. E-commerce, healthtech and big data rounded out the top five with 12-14 deals each.

In terms of average deal size, the automotive segment raised the highest average round at over US$1.3b in 2018 driven almost entirely by ride-hailing app Grab who remains undaunted in its bid for superapp status. The ICT segment raised over US$300m and Entertainment crossed the US$200m mark. E-commerce averaged over US$15m whilst the Aerospace sector raised an average of US$50m. Roughly 75% of all funding deals in Southeast Asia went through Singapore with a significant chunk of the money going to only three companies: Grab, Lazada and Sea Group which all trace their roots to Singapore.

Despite the burgeoning VC funding landscape, some startups are turning to alternative funding routes for their funding needs. Singapore-based startup Delegate sought to raise US$1m for its pre-series A round to improve the capabilities of its event platform through a family office, a trend seen to flourish in Singapore this year.

Through the capital injection of an undisclosed Singapore-based family office and the participation of an angel investor, Delegate managed to raise enough money for its plans to expand into the US and Australia and enhance its SaaS offering. "We weren't willing to raise more than we required so family offices were the ideal investment vehicle for us. The flexibility in their investment mandates was a definite advantage for us," said Jacqueline Ye, co-founder of Delegate.

What used to be the exclusive domain of VCs is no more as family offices have been slowly but actively expanding into the thriving tech startup landscape, particularly in the early-stage scene, as part of their long-term wealth generation ploys, observed **Justin Hall,** partner at Golden Gate Ventures. The private equity (direct and fund investing) asset class currently accounts for a 22% share of the average family office portfolio, up 3.8 percentage points from 2017, according to a report from UBS and Campden, which noted how nearly 80% of these investments either met or exceeded their performance expectations.

Startup funding based on vertical in 2018

Source: e27