# Foundation backs Bright's renminbi-to US dollar restructuring

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**In leading a USD 82m cross-currency restructuring of a consumer-tech portfolio managed by China's Bright Capital, Foundation Private Equity opted for a structure that is unusual yet prioritises alignment**

Born in the 1980s, Xiaofeng Wu and Alice Luo are a younger generation spin-out from one of China's oldest venture capital firms, NewMargin Ventures. The consumer-oriented investment thesis of their firm, Bright Capital, is rooted in an appreciation of the nuances of generation Z.

"We focus on new consumption, but it's wider than retail – it's the new lifestyle of the younger generations in mainstream society," said Wu, who led NewMargin's Shenzhen office prior to establishing Bright Capital with Luo in 2015.

The firm has raised two funds and one annexe vehicle to date, all renminbi-denominated, with commitments of less than USD 100m. The portfolio features around 30 early-stage bets across consumer-retail, technology-enabled services, and entertainment. Three are being used to launch Bright Capital in the US dollar fund space through a cross-currency secondary restructuring.

“Everything we invest in is technology-driven. For example, we invested in an offline retailer that has become a unicorn, but it’s actually a big data company, with artificial intelligence algorithms driving the middle and back-end operations,” Luo added.

“Another characteristic of our investments is they involve micro-innovations at the business model level, whether that’s in the supply chain, the middle and back office, or front-end sales and product design. Overall, it gives consumers a new experience, a new way of life.”

The offline retailer is KK Group, which operates an online marketplace supported by hundreds of brick-and-mortar stores that essentially function as experience centres. It has raised more than USD 600m across multiple funding rounds, most recently a USD 300m round in July 2021 led by JD.com.

Other portfolio companies include flower delivery platform Flower Plus, cake brand Happy Cakes, fresh produce-focused software-as-a-service provider Zhimadi, cross-border e-commerce player YKS Group, podcasting platform Ximalaya, and game developers Dream of Dragon and Langrensha.

**Two sleeves**

The USD 82m restructuring – the companies involved have not been named, although one is said to have filed for a Hong Kong IPO – is being led by Foundation Private Equity. Half a dozen other investors participated in the syndicate, among them three fund-of-funds that vetted Bright Capital as prospective primary commitment as well as a secondary.

“We’ve seen other people do continuation funds but then they can’t raise new primary capital because all the participants in the continuation fund were secondary investors,” said Jeremy Foo, a partner at Foundation. “When we approached Bright, we guaranteed that we would put together a syndicate with members that do primaries first and also look at secondary deals.”

However, the transaction is unusual in that is neither a pure secondary nor a primary stapled to a secondary as an anchor commitment to a new fund. Rather, Foundation and its syndicate partners are investors in a primary sleeve and the manager’s ability to take compensation out of that vehicle is tied to the performance of the secondary fund.

“We wanted to make sure the outcomes of the primary and secondary portions were linked, so the interests of the manager are extremely closely aligned to our own,” Foo explained.

Creating a single pool of capital that accommodates existing assets and offers dry powder for new deals was dismissed because it presents vintage conflict issues. A selection of typically long-dated VC investments would be sitting alongside older positions that the secondary investors want to see exited within four years.

Even with Foundation entering at a discount to net asset value (NAV), Bright Capital’s renminbi fund LPs will profit handsomely – and immediately. There is no risk of delayed IPO or a drop in the share price prior to the lock-up period ending, Foo noted. The sale of two assets from Fund I brings the distributions to paid-in (DPI) above 3x; the third comes from Fund II, which has a DPI of nearly 1x.

Wu added that he was reluctant to exit good assets because of fund life constraints: “It takes a long time for a good company to become a large company. US dollar funds have longer investment cycles. This will allow us to support companies from the early stage all the way through.”

**Getting comfortable**

Investors in China’s technology sector received a somewhat brutal reminder of their risk exposure with the onset of a regulatory barrage last year. This included an additional layer of approvals for overseas listings by companies that collect significant amounts of consumer data. Negotiations between Bright Capital and Foundation – in process at that time – were slowed.

“We had to figure out what it meant in terms of liquidity for the three companies. We got comfortable enough that they could list in Hong Kong instead and that any difference in valuation between Hong Kong and the US would not be material in the underwriting outcome,” Foo said.

Foundation was also encouraged by the quality of the GP. This applies not only to strategy and the depth of consumer insight that informs Bright Capital’s investment thesis, but also to a willingness and ability to display the institutional practices expected in the US dollar fund space. While renminbi secondary opportunities are plentiful, Foo noted that finding good managers is difficult.

“There must be proper corporate governance – cross-fund investments being put through an advisory committee, calling capital in a responsible manner when investments are actually being made,” he said. “There are a lot of renminbi funds that invest in businesses run by related parties, for example. You spend time on the portfolio and realise that nothing makes sense at all.”