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ASIAN BUSINESS NEWS



Kewei Yang

U.S. Venture Capital Floods 'Chinese Garages'

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BEIJING -- When Kewei Yang set up the Chinese office of his high-tech company, Analogix Semiconductor Inc., he squeezed about a dozen employees into a cramped high-rise apartment here. One of Mr. Yang's venture-capital backers called it "the Chinese garage" -- the Asian equivalent of the Silicon Valley home workshops that spawned big companies such as Hewlett-Packard

Co.

There are a lot of busy Chinese garages these days. Unlike the low-tech factory floors churning out cheap TV sets and T-shirts, companies such as Analogix are developing innovative products that are luring cash from foreign venture capitalists.

Early-stage investors are plowing money into China, and often posting permanent staff here, despite concerns about political instability, tight controls on capital and a dearth of local management talent. U.S. financiers say huge domestic demand for high-tech gadgets and sophisticated technical gear in China is hard to ignore, particularly when it spawns genuine local innovation in fields such as telecommunications and semiconductor design -- not just "me too" technologies riffing off Western products.

"A lot of people just view China as offshore, cheap labor, [but] it's not true," says Mr. Yang, whose chip-design company scooped up \$10 million in funding from three U.S. firms: Woodside Fund, DCM-Doll Capital Management and IDG Technology Venture Investment. The company just closed a second funding round with the U.S.'s Globespan Capital Partners.

Analogix is based in California but now houses most of its staff, including Mr. Yang, in a gleaming new Beijing office tower, mainly to be closer to customers. And though the company's financial backers are American, Analogix's office culture has a decidedly Chinese flavor: Every day at 3 p.m., employees stand up next to their desks for calisthenics. They jump and stretch in tune with militaristic music piped over the office



sound system before returning to their jobs creating high-speed computer chips, most of which are sold to telecom-equipment providers.

The total number of U.S. venture-capital deals in China in 2004 soared to the highest level in 10 years, according to the Arlington, Va.-based National Venture Capital Association. The 43 Chinese deals dwarfed the 24 investments made by U.S. venture capitalists last year in India, a country better known for its high-tech prowess.

Although the \$557 million that U.S. venture firms invested in China last year was less than the \$725 million invested in 2003, total

venture-capital investment in China last year -- including non-U.S. firms tracked by Beijing-based research concern Zero2IPO Ltd. -- hit \$1.27 billion, up 28% from 2003. Indeed, Doll Capital Management co-founder David Chao, at a venture-capital conference in Beijing this month, raised the possibility of a "bubble" in the market, particularly for mid- to late-stage investments in China.

Doll Capital has an investment partnership with China's Legend Capital; just last week, Silicon Valley's Accel Partners and International Data Group announced a new, \$250 million growth fund to invest in China. So far, few venture investors think the Chinese government's decision to slightly revalue its currency, the yuan, will crimp foreign interest in the market, though the revaluation will make Chinese investments slightly more expensive for U.S. firms investing with dollars.

Earning a decent return on all these new investments can be tricky, however. There has been a slowdown this year in the market for Chinese initial public offerings of stock, meaning it can be tougher for venture capitalists to profitably sell out of their investments. And while some venture-backed Chinese companies already have engineered successful IPOs, the euphoria doesn't always last: American depository shares of last year's blockbuster, the \$1.8 billion listing of Shanghai-based Semiconductor Manufacturing International Corp. on the New York Stock Exchange, have plummeted nearly 40% from their initial offering price.

"A lot more people will lose money in China than make money," says Andy Yan, the Hong Kong-based managing partner of SAIF Partners, which manages the \$400 million, China-focused Softbank Asia Infrastructure Fund. SAIF just raised a second \$640 million fund also concentrated on mainland Chinese companies.

Many Western venture capitalists still struggle with language and cultural barriers. Most business in China is still based on personal relationships, and Silicon Valley

types sometimes aren't comfortable eating with Chinese entrepreneurs in "shabby" restaurants and singing the obligatory karaoke songs after dinner, says Mr. Yan, who is originally from the mainland.

But the chance of hitting it big remains a strong lure for foreign funds. One of the biggest winners for Mr. Yan's fund has been **Shanda Interactive Entertainment Ltd.**, which pioneered a new, profitable business model for selling computer games over the Internet in China.

Other venture-funded companies have exploited the huge Chinese mobile-phone market, now the largest in the world, and the Chinese appetite for downloading services such as ringtones and horoscopes to their handsets. Many companies receive business incentives from the government, such as tax and rent breaks, because Beijing is intent on building its own, domestic high-tech sector.

The government also can be a problem for venture investors, however. Some investments are being put on hold until new rules requiring approvals and registrations for the offshore transfer of assets by Chinese residents are clarified, for example.

But Duane Kuang, who oversees Chinese investments for Intel Capital, the venture arm of chip giant **Intel Corp.**, says the rules are likely just "another idiosyncrasy of investing in China" and not a long-term barrier to investment. Intel -- which has seen hundreds of semiconductor-design firms spring up in China recently to serve the exploding local demand for chips -- last month announced a \$200 million fund to invest in Chinese technology companies.

So far, Intel has found many Chinese chip-design companies making products "that are innovative, but still addressing a relatively low-end market," Mr. Kuang says. But "in the years to come, we believe these companies will move upmarket...and we're confident that a number of these companies will have real business interactions with Intel," he says.

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