Institute for Capital Market Research Malaysia

Malaysian VC Ecosystem:
Facilitating the expansion of the venture debt industry

Why this research matters

- As Malaysia aspires to become a high-income nation, it is important to cultivate a culture which promotes entrepreneurship and innovation into the society. Innovation and entrepreneurship drives productivity, efficiency and creates quality and more highly skilled employment of “knowledge workers”. The mutual relationship between economic growth and innovation brings increasing returns to the economy and this is where the venture capital (VC) and private equity (PE) funding plays a pivotal role

- In line with this, ICMR’s report on “Catalysing the growth of the venture capital industry” mapped out the current state of play in Malaysia’s venture capital industry, identified the challenges facing the industry and formulated possible solutions to further catalyse the growth of the industry.

- The research report blended the findings of secondary research sources with independent dialogues with a host of public and private venture capitalists, accelerators, family offices, private equity players and the Securities Commission Malaysia (SC) to better gauge how the industry anticipate the way venture capital may unfold in Malaysia.

- The report outlines development strategies that will transform the competitive dynamics of Malaysia’s venture capital industry. The strategies aim to

  - ❖ Expand the role of the capital market in financing new ventures and small-to-medium sized entities,
  - ❖ Widening ownership of assets through further liberalisation of VC industry, as well as
  - ❖ Adopting a more centralised and integrated form of cooperation between the Government and private sector

Why this research matters (cont'd)

- To achieve these strategies, key recommendations were designed to be considered by the policy-makers in a holistic manner, with an understanding of the interconnected elements of each recommendation and how its works in an integrated ecosystem
- The recommendations include:
    - Restructuring and privatisation of some existing public venture capital,
    - Centralised government agency to provide an equity pool for grants, seed investments & matching funds,
    - Establishment of a Funds-of-Fund model,
    - Creation of a single platform for market access,
    - Facilitate expansion of venture debt sector,
    - Review existing pre-conditions for tax incentives,
    - Create a one-stop centre which acts as an information gateway for Malaysia's VC ecosystem,
    - An inter-ministerial council with a participatory approach

Why this research matters (cont'd)

- To complement the VC industry, it is critical to ensure that debt financing is sufficiently available in the ecosystem and are able to meet the different criteria across the entire VC value chain
  - Venture debt allow start-ups to enjoy enhanced capital efficiency through reduced dilution and accelerated growth at a lower cost to the business
  - VD in some jurisdictions complement venture equity financing, and fills a space not well served by banks. In situation where VC money is not easily available, venture debt helps lengthen runway and allows businesses to have more time to experiment with strategies
  - VD may also complement and reduce government's loan financing schemes burden via private sector participation

- In line with this, ICMR delved into studying the venture debt market in more detail. This presentation is divided in the following sections:
  - Overview of global private debt industry
  - Overview of global venture debt industry
  - State of play for Malaysia venture debt industry

Global Private Debt Industry

A brief overview

Overview of the global private debt industry

- Credit extended to companies/projects bilaterally & originate by non-FIs lenders

- Large & diverse Private Debt (PD) ecosystem — Asset managers, private equity firms, business development companies & hedge funds
  - ***E.g. Hercules, Cerberus, Hamilton Lane, Trifecta Capital, Innoven Capital***

- Types of Private Debt:
  - Direct lending (senior secured loans)
  - Mezzanine (convertible debt-equity loans)
  - Distressed
  - Special situations
  - Venture debt (loans with equity-kicker)

- Increasing use of direct lending & venture debt to supply funding to mid-market borrowers:
  1. **Growth capital.** Term-loan used to augment equity round, finance M&A activity & OPEX
  2. **Accounts receivable financing.** Revenue-generating companies to borrow against their accounts receivable (e.g. MRR credit facility)
  3. **Equipment financing.** Typically structured as lease or purchase of equipment (e.g. network infrastructure, manufacturing, R&D, etc.)

Booming of global private debt industry and poised to hit US$1 trillion AUM

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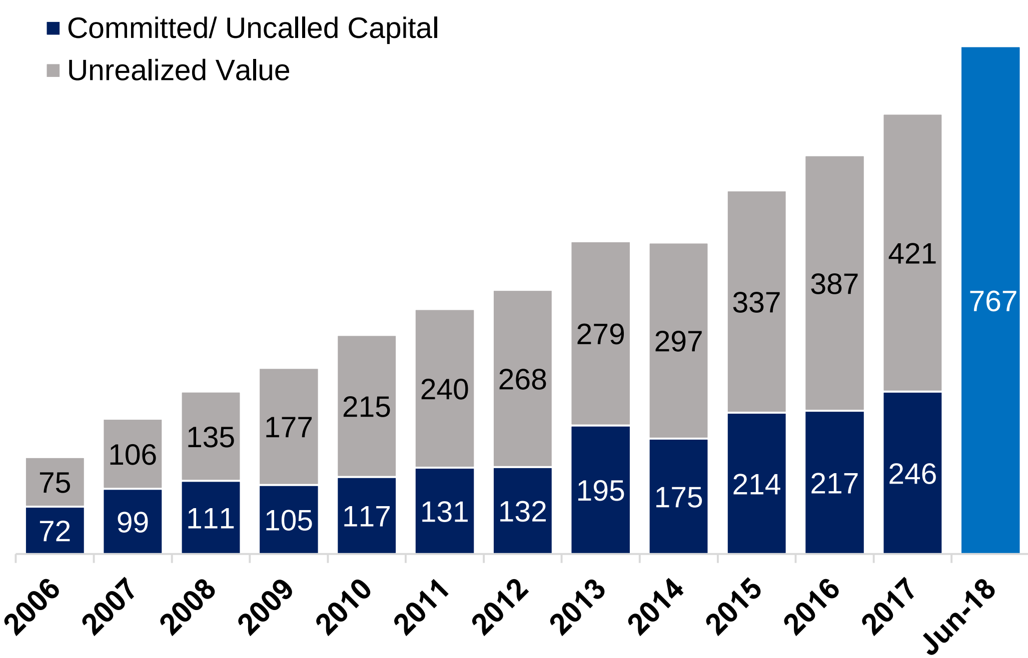
Private Debt Assets under Management, 2006 – 2018
US$ billion

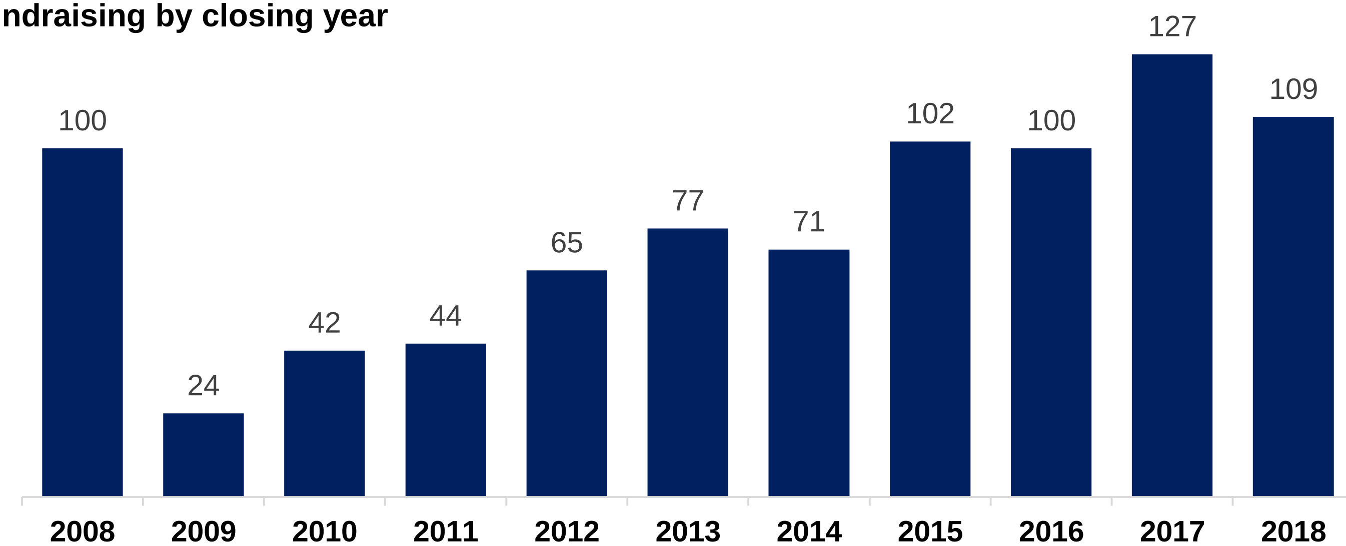


- **Capital Available for Investment:** Private debt industry currently has $769 billion in committed capital
- Industry grew 5x in size since 2006, when AUM stood at $147 billion
- Breakdown of AUM as at 2017:
  - a) Distressed debt (35%)
  - b) Direct lending (27.9%)
  - c) Mezzanine (22.9%)
  - d) Special situation (12.5%)
  - e) Venture debt (1.7%)
- **Uncalled capital (dry powder)** reach $246 billion as at end 2017
- Dry powder grew 11.8% between 2006-2017, and over 13.4% compared to 2017
- Expected to reach US$1 trillion AUM

Source: *Preqin Global Private Debt Report March 2018*

Global private debt fundraising has exceeded $100 billion for the past four years

Global private debt fundraising by closing year
$ billion



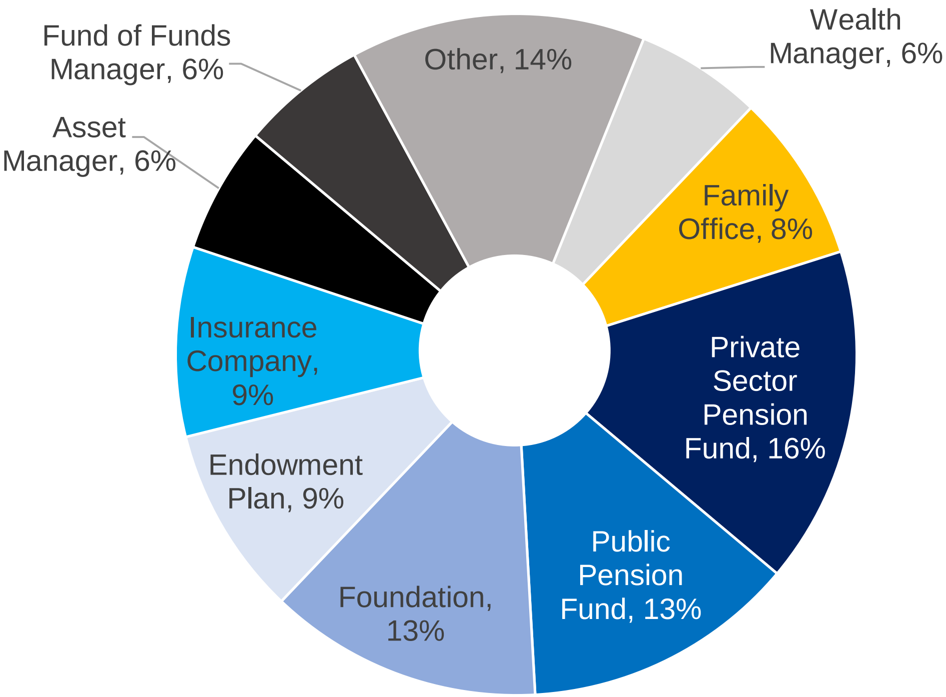
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Private debt funds (#)	97	59	79	86	107	152	138	171	157	161	139
Average fund size ($ million)	1,029	410	528	510	606	505	517	598	634	791	781

- Private debt fundraising softened in 2018 (-15% versus 2017), but long-term growth trend remains intact
- PD fundraising GAGR (2013-18) grown 8.9% outpaced PE (7.8%) & closed-end real estate (4.4%) on the back of sustained low interest rates and a long economic expansion

Source: *Private markets come of age: McKinsey Global Private Markets Review 2019*

Significant growth in investors base for the private debt space

Make-up of Investors in Private Debt by Type, 2017
Percentage (%)

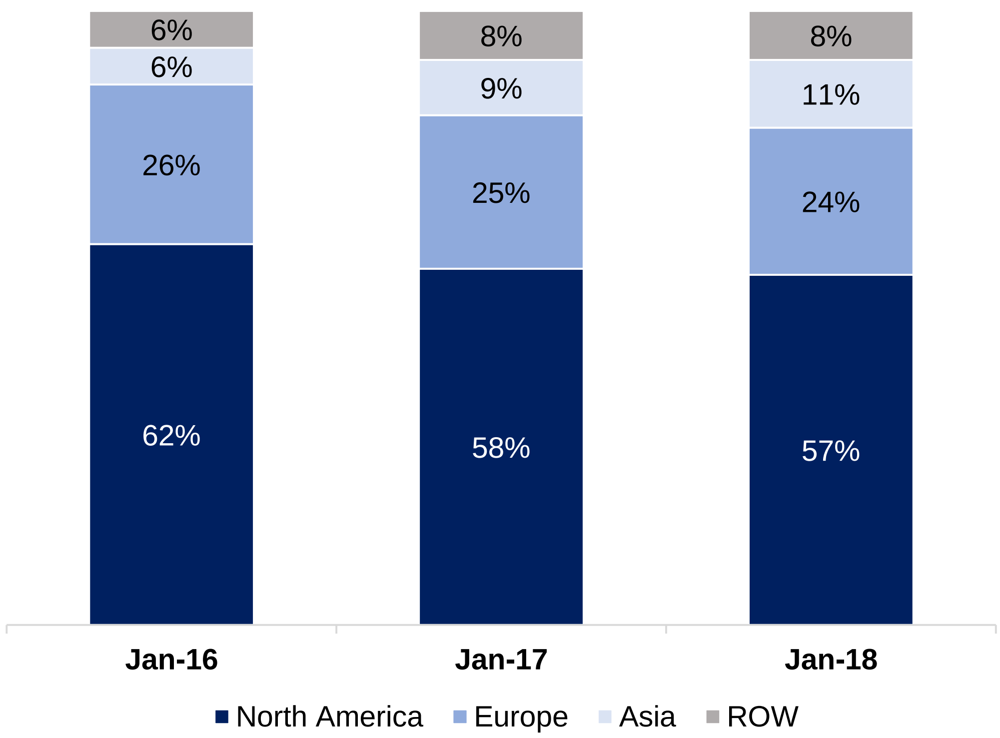


- Institutional investors continue to outnumber wealth/asset managers
- Private sector pension funds (16%), public pension funds (13%) and foundations (13%) are the most prominent investor types in private credit space
- Public debt markets are not deep in many parts of the world. As access to bank loans and high-yield issuance diminishes, private debt investors step in to fill the void

Source: *Institute for Private Capital; Performance of Private Credit Funds: A First Look.*
PitchBook, Welcome to the private debt show white paper.
Preqin Global Private Debt Report March 2018.

Evolution of the global private debt industry between 2016 - 2018

Make-up of Investors in Private Debt by Location, 2016-2018
Percentage (%)

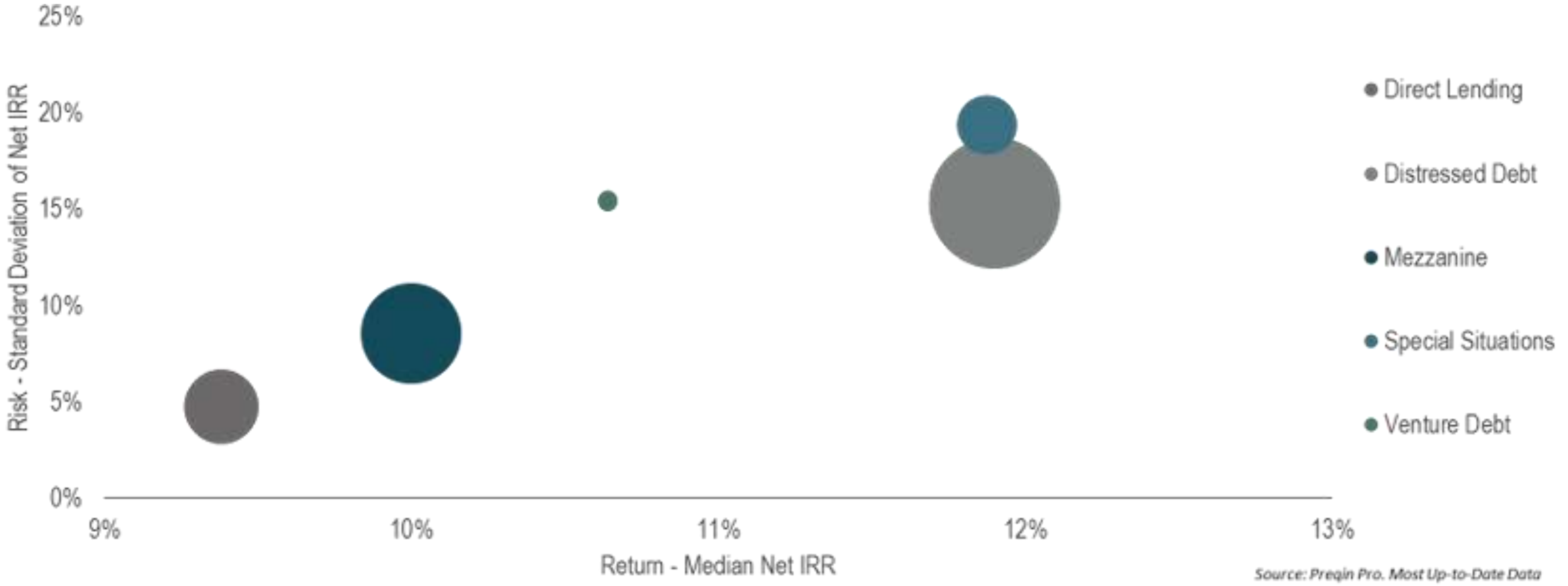


- Over 3,100 institutional investors (Jan 2018) actively investing in private debt opportunities:
  - +700 investors since Jan 2017
  - +1,200 investors since Jan 2016
- Strong concentration of investors in North America (57%) and Europe (24%)
- Increase in Asia-based investors:
  - South Korea (+36%)
  - China (+52%)
  - India (+110%)
- Global fund managers seeking alternative investments due to low interest rate environment & lack of SME funding

Source: *Preqin Global Private Debt Report March 2018*

Strong Risk-Adjusted Returns Across Private Debt Strategies

Private Debt: Risk/Return by Fund Type (All Vintages)
Percentage (%)



Source: *Preqin 5th Annual Private Debt London 2019 Conference (March 2019)*

Global Venture Debt Industry

Debt financing for high-growth start-ups & SMEs

Brief overview of the global venture debt

- **Venture debt** is generally deployed by way of senior, secured non-convertible debenture, and accompanied by equity options

- General characteristics of venture debt:

  a) Have raised equity financing rounds from venture capital

  b) High-growth businesses to acquire working capital without giving away equity during in-between funding rounds

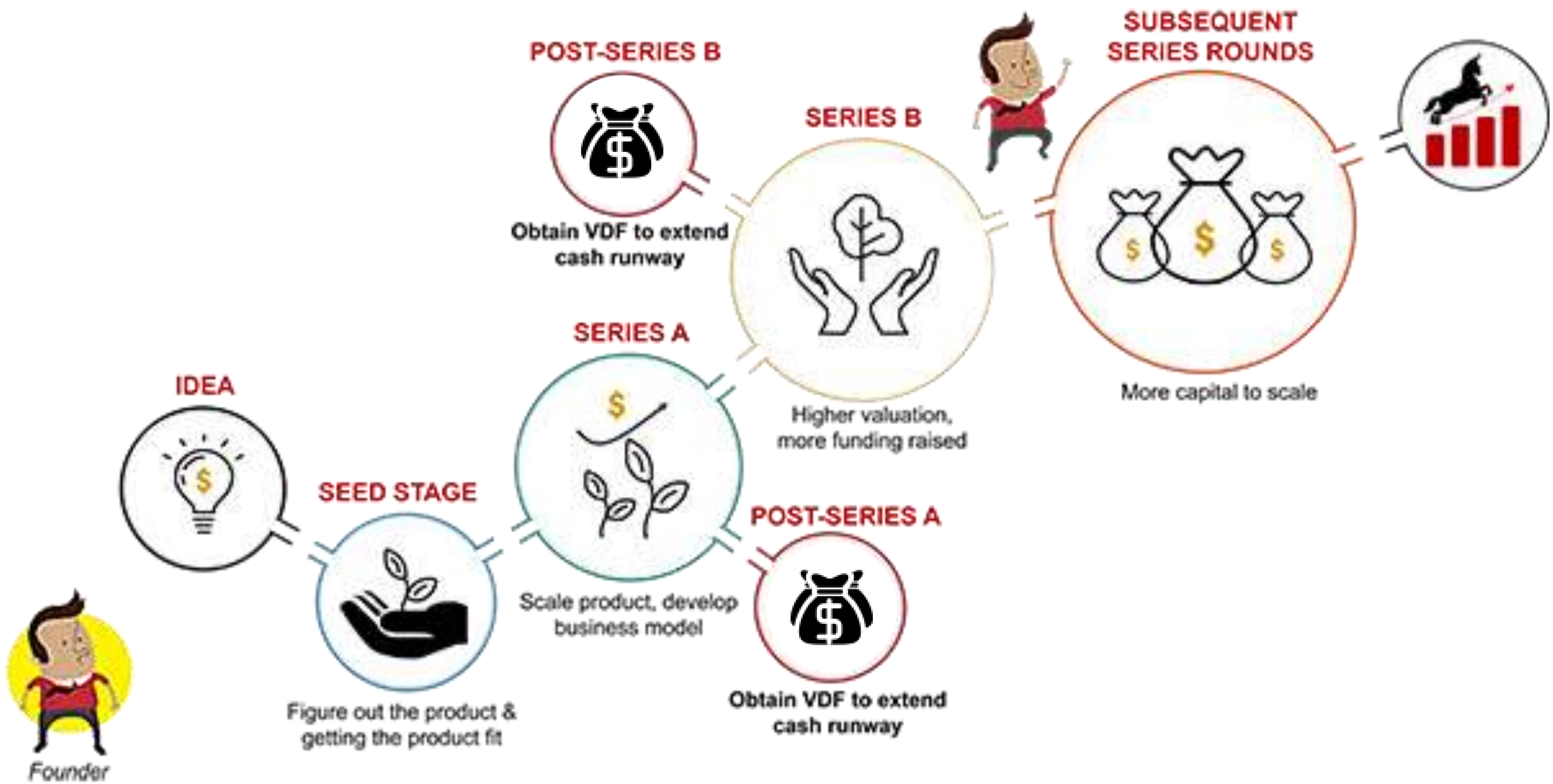
  c) Periodic income distribution along with equity kicker (e.g. warrant)

  d) Interest – Typically floating rate

Examples of venture debt participants globally

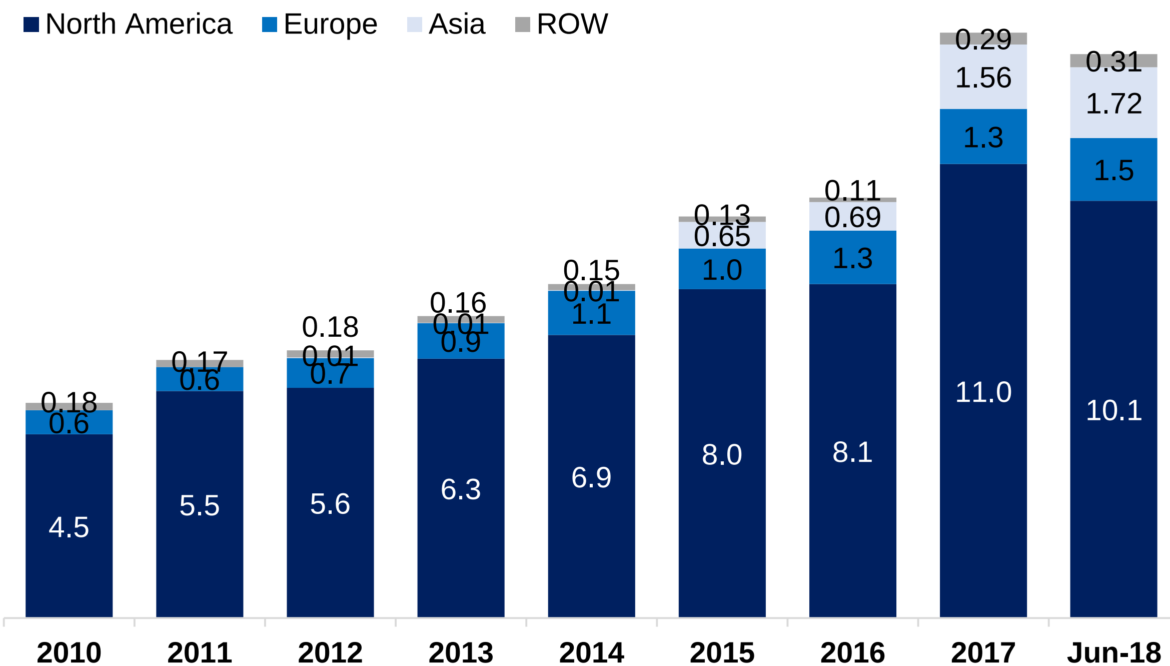
Financial institutions	Venture debt funds	Micro-funding marketplace
Barclays, Silicon Valley Bank, Square 1 Bank, DBS Bank	Hercules Capital, Horizon Technology, TriplePoint Ventures, Innoven Capital & Trifecta Capital	OnDeck, Lending Club, Funding Circle, Prosper, SoFi, Zopa, Kabbage, Credit Karma..

Difference between venture debt and other forms of credit



Overview of the global venture debt industry assets under management…

Global venture debt assets under management
US$ billion



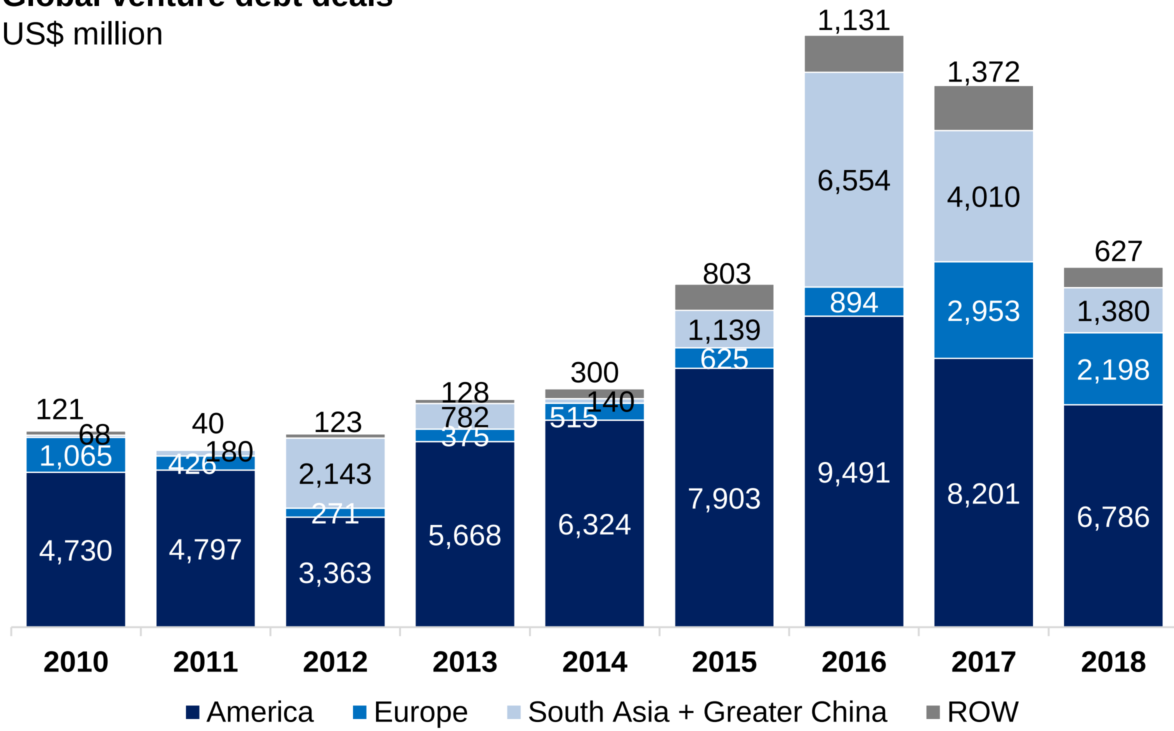
CAGR (2010-2017)	
ROW	+7.2%
Asia	+180.0%
Europe	+12.6%
North America	+13.8%

- North America continues to dominate the global venture debt space, representing 73.4% of total venture debt AUM, followed by Asia (12.6%), Europe (11.1%), and Rest of the World (2.9%)
- Asia achieved highest growth annually (180%), followed by North America (13.8%), Europe (12.6%) and ROW (7.2%)

Source: *Preqin database*

South Asia & Greater China achieving highest growth in venture debt deals

Global venture debt deals
US$ million



CAGR (2010-2018)

America	+4.6%
Europe	+9.5%
South Asia + Greater China	+45.8%
ROW	+22.8%

- 2018 global VD deals concentrated on America (61%), followed by Europe (20%), South Asia (13%) & ROW (5.7%)
- South Asia/Greater China recorded highest growth of 45.8% from 2010-2018
- Growth in South Asia driven by Greater China (151%) vis-à-vis South Asia (25%) from 2010-2018

Source: *Preqin database*

Various structures utilised in the global private credit space to facilitate lending to SMEs

- Venture debt as a form of credit solution for growth-stage ventures to finance operation expenditures
- Encourage development of many types of capital providers to ensure availability of funds to match risk/return profile of investors

	Venture Debt	Private Credit Fund
Country	India, Singapore & ROW	North America
Business vehicle	DFIs or Alternative investment fund structure	Business Development Companies (Close-ended investment vehicle)
Mandate	Generally to finance early-stage or venture companies	Finance middle-market companies (e.g. mezzanine funds, distressed funds, direct lending funds & other strategies)
Managerial assistance to borrower	May or may not involve in management & operations	Significant involvement in management & operations
Market size	US$13.6 billion (June 2018)*	US$33.8 billion AUM**
Examples of providers	Silicon Valley Bank, Barclays & Innoven capital, Trifecta Capital Advisors & etc.	Hercules Capital, Horizon Technology, TriplePoint Ventures, Hamilton Lane & etc.

Source: **Preqin database, BDCinvestor.com*
***Estimate based on 44 BDCs listed on US Exchanges (exclude unlisted BDCs).*

Venture debt gaining significant traction in Asia

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Singapore (Venture debt development progress)

- DBS launched (2015) “in-house venture debt” for tech start-ups, partnering Vertex Venture, Monk’s Hill Ventures & Golden Gate Ventures. Must raised $1 million (Series A), 1 year operation & commercially viable business model.
- Temasek & UOB bought SVB India for $48 million (2015) & rebrands it as InnoVen Capital
- Enterprise Singapore launched Venture Debt Programme (2015). Enterprise Singapore shares 50% of the risk of loan defaults with Participating Financial Institutions (PFIs).
  - Interest rates, repayment structures, collateral/warrant structures determined by the PFIs
  - Ticket size S$5 million & warrants will be required
  - Companies registered & operate in Singapore (30% local shareholding) & group annual sales of up to S$100 million

India (Venture debt development progress)

- 1st credit SME programme by Citibank India (2005). Venture Capitals (IvyCap Ventures Advisors & Unicorn India Ventures) subsequently diversified to launch venture debt funds
- SEBI extend perimeter of regulation to unregulated funds via AIF (2012)
- Liberalisation to allow insurers invest in Category I & II Alternative Investment Funds by IRDA (2017)
- Market reach $1.2 billion debt finance in 2018 (represents 8.8% of total $13.7 billion start-ups investments)

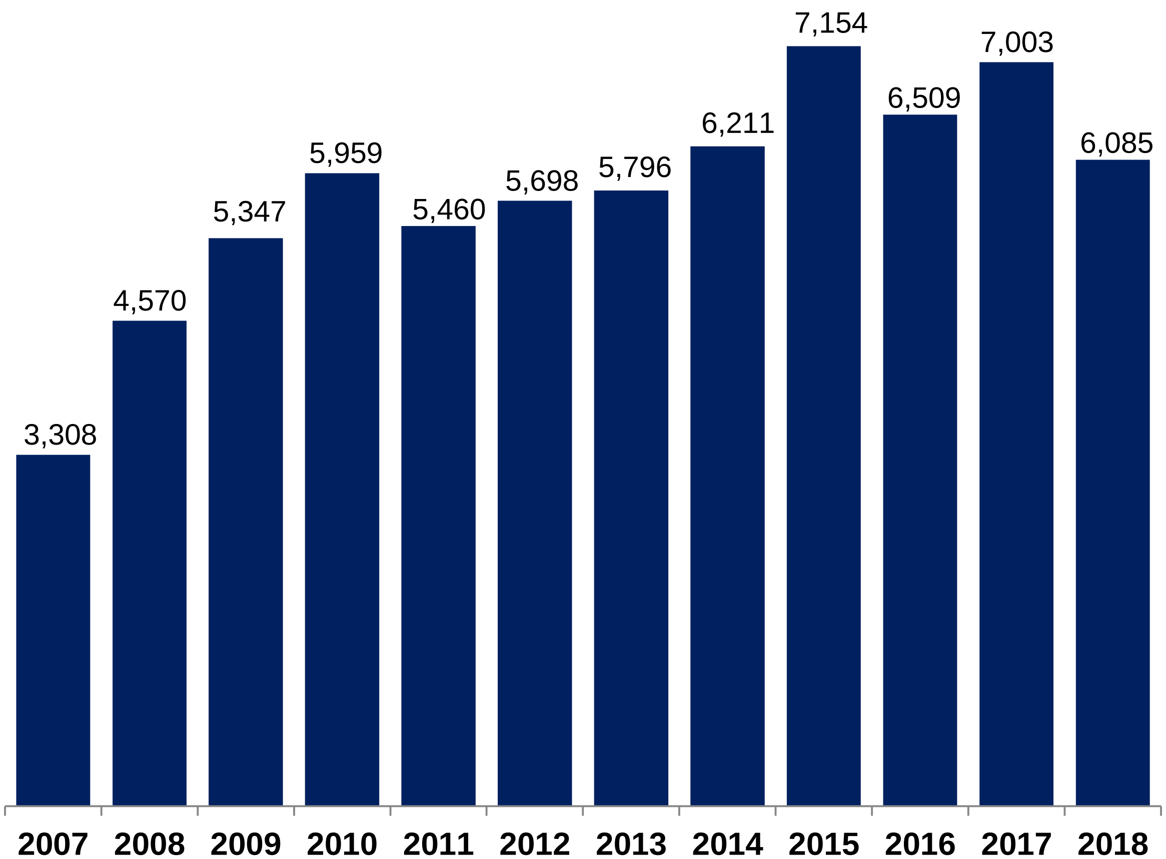
Source: *SEBI, Economictimes India, Enterprise Singapore, e27.co, straitstimes.com,*

Malaysia Venture Capital Ecosystem

State of play

VC industry experienced growth over the last decade

Malaysia VC industry AUM
RM million



- Amount of committed funds under management has grown at 6% CAGR to RM6 billion
- Malaysian government successfully set up the preconditions phase for the development of local venture capital industry driven by a desire to support innovation to move the country toward a high-income nation
- In light of the current evolution within the global VC ecosystem, the role of venture capital in financing high growth ventures and SMEs has to be re-assessed

Note: *Funds committed based on funds outsourced to VCC/VCMC and does not include funds invested directly*
Source: *Securities Commission Malaysia*

Public VCs established to fill the funding gap; over the years funding intensified…

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mavcap
investing in tomorrow

- Nurture infant ICT companies & current fund size over RM1 billion
- Funded by Government via loan & equity structure
- Investments – **Direct & Outsource Partners Programme** with foreign players & local players

MODAL PERDANA

- Specialize in E&E sector & current fund size over RM322.5 million
- Funding structure: Loans and RCPS
- Investments – **Direct**

Cradle
Creating. Leading. Startups.

- Incorporated with a mandate to seed fund potential & high-calibre tech start-ups through its Cradle Investment Programme. Has helped **fund over 700 Malaysian tech start-ups**
- Role expanded from grant provider to investor through the establishment of **Cradle Seed Ventures in 2015** and following its portfolio expansion to equity investment **(DEQ800)** in 2017

MyCreative Ventures

- Launched to spur Malaysia's creative industry & current fund size over RM200 million allocated
- Further expansion to establish private equity fund
- Funding structure: Loans & equity

… established various alternative fund raising vehicles to complement the VC industry

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MDV

- Malaysia Debt Ventures established to provide flexible/innovative loan & Shariah financing facilities to develop high-impact and technology-driven sectors
- MDV's mandate expanded to include ICT, Biotechnology and Green Technology
- RM11.26 billion disbursed to 711 approved companies via creation of 814 credit lines

Suruhanjaya Sekuriti
Securities Commission
Malaysia

- Equity crowdfunding & peer-to-peer lending introduced to democratize financing and complement the VC industry
- As at end June 2018, there are 7 ECF and 6 P2P players. Total funds raised across ECF and P2P was RM70 million with over 4,000 investors. 651 deals were successful and 150 MSMEs were able to raise funding

BURSA MALAYSIA

- LEAP market established as an alternative market for SMEs & companies to raise funds through a single platform
- Feeder market for potential SME seeking listing on ACE/MAIN market

Maturity of Malaysia VC ecosystem reflected in the breath of players

Examples of Malaysia's financiers at various business cycle

Business Lifecycle	Start-ups & Micro-Enterprises	Development Stage	Growth	Listed / Mature
Target Companies' Attributes	• Start-ups • Ideas on paper	• Small scale commercial operations • Low / negative profits • Investment size < RM30 million, between RM1 million to RM15 million	• Growth and expansion stage companies • Investment size between RM30 million to RM300 million	• Large companies with established market positions, often with multiple subsidiaries/ core businesses • Investment size - RM500 million
Existing Institutions / Programmes	Examples of existing institutions and programmes include:		Examples of Institutions include:	Examples of institutions include:
	Grants e.g.: • Cradle Investment Programme • SME Corp • CRDF • BiotechCorp Equity & Loan: • PUNB • Modal Perdana • A-Bio • AIM • Tekun	Equity & Debt: • MAVCAP • MTDC • PNS • PUNB • SME Corp [facilitator] • MARA • MDV • SME Bank • Pelaburan Mara Berhad	• Creador • Navis Capital • Ekuinas • CMS Opus • Maybank Private Equity	• Khazanah • 1MDB • PNB • LTAT • EPF • LTH • Other Unit Trusts Long term holding

Source: Ekuinas

Debt financing a compliment to equity financing for SMEs and entrepreneurs

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Fund providers

- Ministries & agencies

Grants

Players

- Private VCs/ Accelerators/ Alternative platforms
- ***Venture debt***

Capital

Debt

Regulators

- Securities Commission
- Bank Negara Malaysia

Policy

New ventures /SMEs

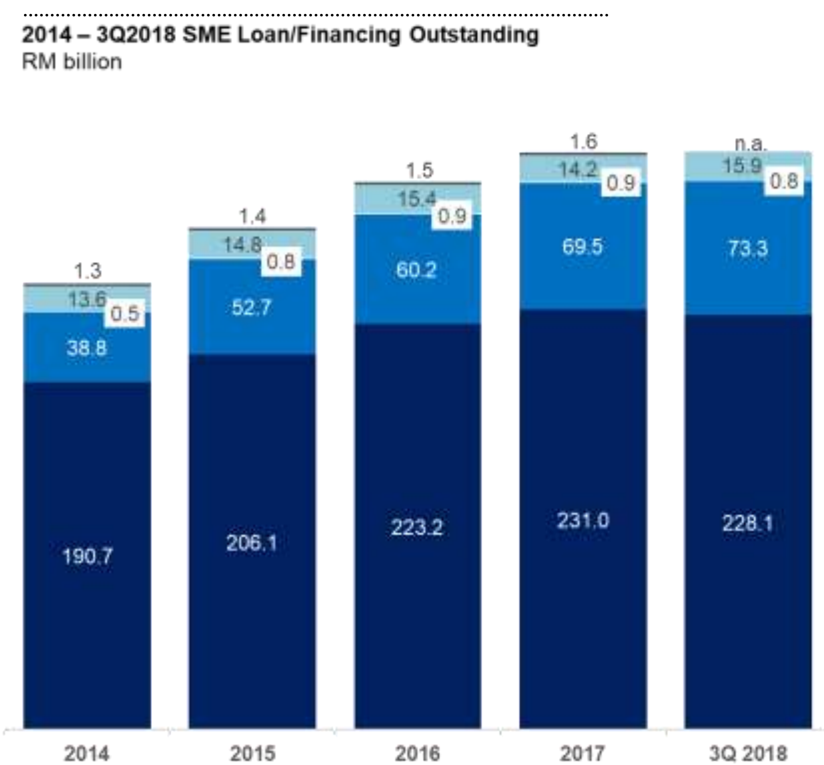
Opportunities for private debt development:

- High number SMEs/ mid-market companies (907,065) in Malaysia
  - *Too small to approach bond market or insignificant for FIs*
- Need to be more than just pure lenders
  - ***e.g.*** *look at entire business & growth prospects rather than just credit history*
- Greater financial engineering to enable pursue expansion business plans

Source: *SME Corporation Annual Report 2017/2018*

Opportunities to further expand debt financing as in-between rounds of financing for entrepreneurs

- SME banking loan outstanding grew 30% to RM318.1b (3Q18) vs. RM244.9b (2014).
- Stricter bank regulations & increased compliance costs shifted risk culture of banks
- RM21 billion credit financing gap for SMEs to be filled by alternative financing (e.g. crowdfunding, peer-to-peer lending, factoring and leasing)*
- Southeast Asia's internet economy estimated to exceed $200 billion by 2025



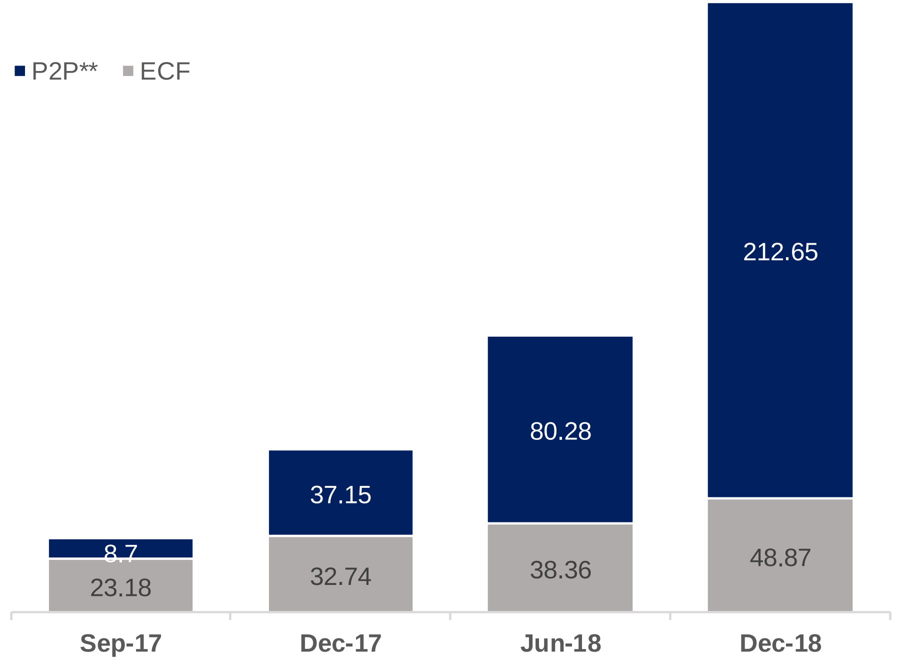
Note: *MDV's statistic measured based on gross financing portfolio and latest annual report 2017*

Source: *Malaysia Debt Ventures Annual Report*
Bank Negara Malaysia
Businessinsider.sg
**BNM Financial Stability & Payment Systems Report 2016*

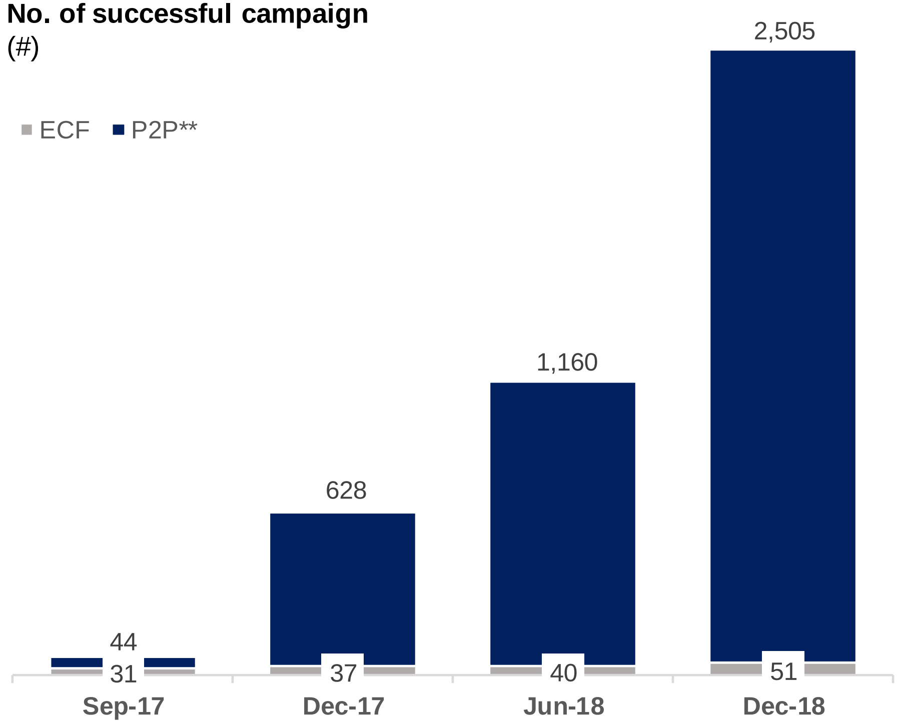
Growth in P2P investments in Malaysia signals the potential room for venture debt financing

- **Sept 2017 – Dec 2018.** Amount raised by ECF grew to RM48.8 million (110%) compared to P2P growth of 2,344% amounting to RM212.7 million
- **Sept 2017 – Dec 2018.** Successful ECF campaigns grew marginally (65%) from 31 to 51 campaigns, while P2P grew 5,593% from 44 to 2,505 campaigns
- P2P operators form strategic partnerships with FIs & financing companies for liquidity

Total amount successfully raised
RM million



No. of successful campaign
(#)



Source: *Securities Commission Malaysia Annual Report 2018*
Note: *All statistics are cumulative since inception*
***Successful campaigns for P2P includes repeated issuance for a single SME*

Need to facilitate expansion of venture debt sector

- Essential to nurture the Malaysian venture debt fund industry through a structured regulatory framework & broaden emerging ventures/SMEs credit financing options:

- Venture debt experiences in some prominent jurisdictions:

  - **North America —** Close-ended Business Development Companies (listed & unlisted) registered as investment advisers with US SEC

  - **India —** Majority in “Trust” and registered as category-II Alternative Investment Fund (SEBI)

  - **Singapore —** Registered with MAS as licensed VC fund management company (e.g. Genesis Alternative Ventures)

<u>Moving forward:</u>

- Need to expand scope of Malaysia VC regulations to facilitate expansion of venture debt sector

- Public sector to drive risk-sharing schemes via Venture Debt Pilot Programme to draw private debt funds providers

- Provide framework for listing of close-ended venture debt funds

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THANK YOU