# Getting the right IPOs

Several impending Mainboard IPOs may help deflect criticism that SGX faces a drought. But the exchange's real challenge — and opportunity — is in small caps and start-ups that have been garnering hefty valuations in the private market.

| BY JOAN NG |

Online reservations provider Chope started out in 2011 with nine restaurants in its stable. Today, the company supports reservations for over 700 restaurants across Singapore, Hong Kong, Shanghai, Beijing and Bangkok. By at least one estimate, the company is now more richly valued than San Francisco-based rival OpenTable on a per-dollar-of-revenue basis. It sounds like a prime candidate for a listing on the Singapore Exchange's Catalist board for fast-growing companies. Except, CEO Arrif Ziaudeen is not interested.

"Public investors want consistent or immediate financial returns," Ziaudeen says. "The start-up world is a risky one, where companies may need to use large amounts [of capital] without profit or even monetisation to win market share." He has turned instead to angel investors, venture capital funds and strategic investors for money. Chope managed to raise $11 million in Series C funding last year, which *Tech in Asia* estimates gives the company a market value of US$20 million ($27.4 million) to US$30 million, or 14 to 19 times expected revenue. OpenTable was acquired by **Priceline Group** in 2014 for 11.5 times expected revenue.

Ziaudeen says his investors have a longer-term interest in the company and may even have some knowledge that will help Chope grow. And although he thinks Chope might be in a position to IPO in about five years, a listing is not among his primary goals. "The current preference is not to, unless there's a pressing need for liquidity that the private market cannot support. The key consideration is agility: to pivot, to respond, to take risks."

Start-ups such as Chope are mushrooming rapidly across Southeast Asia and raising funds to grow. Other hotly valued home-grown names include online shopping portal Reebonz, online grocer RedMart and online gaming platform Garena. Unfortunately for SGX, many of these start-ups share Ziaudeen's sentiments about going public. According to a recent report by Golden Gate Ventures, an early-stage venture capital firm in Southeast Asia, there have been just 11 technology IPOs in the region since 2005. Southeast Asian start-ups seem to prefer exits through M&As instead, with 127 acquisitions taking place in the same period.

Vincent Lauria, managing partner at Golden Gate Ventures, says valuations may be one reason for the lack of IPOs. "A trade sale will often result in larger financial returns than going public, especially if the acquirer has a strong strategic interest in the region," he says in the report.

Things could change though. "Like China a decade ago, Southeast Asia is now an emerging market on the brink of something big," the report continues. Five of the 10 member countries of the Association of Southeast Asian Nations are among the top 25 countries globally in terms of GDP growth. The Asean Economic Community had a nominal GDP of US$2.4 trillion in 2013, placing it seventh overall in the world. Given current growth patterns, the AEC is predicted to rise to the fourth spot by 2050.

Now, even as the AEC creates a more cohesive economic environment for start-ups, China's economic growth is slowing. More foreign companies and investors are therefore looking towards Southeast Asia. As the region's markets become larger and more mature, the number of high-value start-ups will rise. "Private equity firms are increasingly making smaller early-stage investments in Southeast Asia start-ups instead of writing larger growth-stage cheques — a sure sign that they expect to make Uber- or **Facebook**-like returns on such deals," the report says. "It seems possible that Southeast Asia could be on the cusp of a China-like explosion of IPO exits."

SGX, still viewed as Southeast Asia's premier exchange, has a unique opportunity to build a position in this space. It already has a dedicated board for fast-growing companies — Catalist — which is gaining a following. But it has to move fast, and deal with several issues. Chiefly, it has to develop a pool of investors while convincing companies a listing is worth the effort.

## Attracting companies

Banks and other capital market firms have been quick to recognise the opportunity that the start-up boom affords, and have been offering these companies a range of funding options. **United Overseas Bank**, for instance, is collaborating with a global equity crowdfunding platform called OurCrowd to offer start-ups and small and medium-sized enterprises (SMEs) funding. It also has a joint venture with Temasek Holdings to provide venture debt financing to start-ups in China, India and Southeast Asia. Among the local start-ups that have signed venture debt financing deals with UOB is Reebonz, an online luxury goods marketplace. "Venture debt provides less dilution to founders and gives the debt holder variable upside from warrants issued, so it's a win-win [situation], says Samuel Lim, CEO of Reebonz.

UOB is still pursuing IPOs, of course. "At UOB, we have been seeing a growing trend of SMEs in Singapore looking to tap the equity capital markets for funds. This means SMEs will continue to account for the majority of IPOs on the SGX. To support SMEs with their public listings, we work closely with the relationship managers serving the financing needs of this client segment," says Khong Choun Mun, managing director of equity capital markets at UOB Group.

But Khong recognises there is some room for improvement when it comes to attracting

listings. "We believe more has to be done by both the public and private sectors to enhance continuously Singapore's appeal as a listing destination. These efforts include attracting high-quality and large-sized offerings to raise SGX's standing, bringing back retail investors' interest in IPOs to improve market liquidity, setting up SME-focused funds to invest in such listed companies and reducing the costs of maintaining listings."

Indeed, the cost of listing is a common complaint among smaller companies. Unlike the Mainboard, Catalist does not have a profitability requirement for listing. Instead, companies must engage a sponsor that vets them and helps ensure they comply with listing requirements. These sponsors charge fees for their services, which some companies say add up to more than the cost of a listing on the Mainboard.

However, the Catalist sponsors say the system makes it possible for small companies to list. "Mainboard-listed companies tend to be able to afford to have their own departments looking at governance and the regulatory regime," says J Jayaprakash, CEO of RHT Holdings, adding that continuing sponsor fees are not comparable with Mainboard listing fees. "For a smaller-cap company, they don't need an in-house [department], so that is why it's outsourced."

## Finding investors

Another grouse is valuation. Lim says that while an IPO remains an option for Reebonz, Singapore is not "optimal" for Internet companies such as his because of "valuation and investor breadth and depth".

Part of the problem is a lack of interest, particularly from institutional investors. In its report, Golden Gate Ventures says: "Institutional investors that are looking for growth investments on the exchange don't have experience dealing with technology start-ups and may have difficulty understanding their business models and growth trajectories. These factors combine to make IPOs less attractive for start-ups even as [exchanges] like Catalist make inroads."

This observation might seem odd, given the large investments being made in these companies in the private market. According to the *Asian Venture Capital Journal*, roughly six in every 10 deals announced last year were in early- or growth-stage technology plays. These investments are responsible for more than one quarter of all private equity capital deployed in Asia. In 2014, the share was 18%. That was about twice the 2013 figure. Private equity deals topped US$100 billion for the first time last year.

Venture capital funds are also becoming larger. GGV Capital, which has financed companies such as ride-hailing app Grab and e-commerce powerhouse **Alibaba Group Holding**, last year raised US$457 million for its GGV Capital Select fund. This top-up fund was for portfolio companies that have become so large and valuable they no longer fall within the remit of existing funds. Portfolio companies, while staying private for longer, are finding ready capital for expansion. In Singapore, meanwhile, fundraising is at its highest level in four years.

Says one local investment banker: "I would really like to know, why is there investment interest in these start-ups but not in Catalist-listed SMEs?"

The fact is that many investors think of listed small caps and unlisted ones as two separate asset classes and allocate their dollars accordingly. Kenneth Yeo, managing director and head of investment services and product solutions at HSBC Private Bank, says his clients typically think of listed equities as a single asset class. Within this universe, their focus tends to be on blue-chip names. This is particularly so in the current period of market volatility. "If things are already volatile for these blue-chip names, there will be even higher volatility on small-cap names. Our clients, typically... do not look much into [small caps] actually."

However, Yeo says he is beginning to see demand among the private bank's clients for diversification through private equity investments. "A lot of our private clients are getting more sophisticated today." He says HSBC clients tend to buy into private equity funds run by well-known institutions such as Blackstone. While these funds require long holding periods and carry significant risks, they are broadly diversified. For a typical client with a moderate risk appetite, HSBC advises an allocation of 4% into private equity.

"While equities can **return** on a single-stock basis a very high **return**, there's volatility when you pick the wrong name. The idea is you can be shorter-term in playing stocks; you can also have core holdings in your portfolio in stocks, and then private equity can be a less-liquid complement to hopefully help diversify the risk in your portfolio," Yeo adds. "We never come across a comparison between a small-cap stock and a private equity fund. The comparison is between the liquidity profile of a private equity fund and a mutual fund, whether equity or fixed income."

Another issue that investors in the small-cap space face is liquidity. Terence Wong, CEO of hedge fund Azure Capital and a long-time watcher of local small caps, says this segment tends to go through boom and bust periods. "There will suddenly be a lot of interest, which could be driven by specific catalysts. But after awhile, it fizzles. The institutions that buy in tend to have trouble liquidating their investment," says Wong, who was formerly head of research at RHB Research Institute Singapore and was responsible for the initiation of a "Billion & Below" model portfolio for the house.

Nevertheless, Wong says there are small caps that have proven to eventually be very good investments. These tend to be companies with a good investment story that gets recognised — whether in the media or by analysts. "The people running the company must be open to telling the story," he says, adding that on this front, many local small caps tend to fall short. Companies that follow this story with solid execution will tend to see their valuations and liquidity improve. They will be able to issue more shares and their market capitalisations will rise, thus promoting a virtuous cycle.

Wong adds that he continues to invest in the small-cap space as he sees "a lot of value in the market". At the same time, he helps point his portfolio companies in the right direction as to "how their liquidity can be improved".

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## Starting small

Mohamed Nasser Ismail, SGX's head of equity capital markets for SMEs, says he has been hearing all these grouses for some time. "But we would like to present a different perspective of the value of a listing," he says. "I would be very clear that a listing is not for everyone. It has to be motivated by the right intentions, and the right growth plans and strategies."

A company that goes through the listing process goes through a transformation, Nasser says. "[This transformation] will prepare it for a more complex operation, a wider operation as it scales up quickly. These are things that matter in order to have an enduring enterprise and a sustainable business. These things will enable a company to prepare itself for its next stage of growth. But it's not really appreciated by entrepreneurs yet. They have to see and understand that capital is just one side of the equation."

To educate companies about the advantages of listing, SGX has been actively engaging start-ups and SMEs here. It participates in conferences such as the Tech in Asia Conference, Echelon and InnovFest. "We are well plugged in to the digital eco-system," says Nasser. "We are always at Blk71 speaking with the entrepreneurs on the ground." Blk71 is a start-up co-working space on Ayer Rajah Crescent.

Nasser also challenges the notion that local investors do not understand digital companies. "We do have a small but thriving sector of digital companies that are doing very well and command very good valuations. [They attract] very good interest with high liquidity, with an average price-to-earnings multiple of 33 times," he says. Catalist-listed companies in fact have higher turnover velocity than their Mainboard counterparts. "But perhaps it is not as well known as it should be. And that's what we've been doing — trying to get that message out."

While there may not be too many SMEs such as Chope and Reebonz listed on SGX today, Nasser thinks it is only a matter of time before the listings come. "As Singapore becomes a smart nation and a knowledge-based economy, the Singapore Exchange will always reflect what the wider economy is like. The companies we are developing today, some of them will naturally flow into our capital markets. As the wider eco-system becomes more familiar with this space, it is only natural that these companies will tap the capital markets to fuel their growth. It's an inevitability and you will see some very exciting and very promising digital companies coming into our landscape."

## Global game

SGX is not the only board trying to lure SMEs though. A World Federation of Exchanges report on SME exchanges highlights an increasing focus among global exchanges on the SME space. In the US, an IPO Task Force in 2011 found a "precipitous decline of the US IPO market — driven by a paucity of emerging growth companies going public". The result was an IPO "on-ramp" provision giving companies five years from the date of their IPOs to scale up to full regulatory compliance.

Meanwhile, many exchanges have set up boards targeted at SMEs. In addition to the **London Stock Exchange Group**'s well-known AIM board and **Hong Kong Exchanges and Clearing**'s Growth Enterprise Market, some other relatively successful boards include the Bombay Stock Exchange SME market, the Korea Exchange Kosdaq market, the Shenzhen Stock Exchange ChiNext market and the Euronext's EnterNext.

The fierce competition has sometimes made SGX seem like it is running behind. **ASX**, for instance, has had particular success with digital start-ups. According to Golden Gate Ventures, five of the 11 tech IPOs in the Asean market over the last 15 years have chosen to list in Australia. "ASX is unique in offering smaller growth companies a main board listing on a globally recognised exchange," says James Posnett, manager of listings business development at ASX, in the report. Even so, ASX is reportedly taking another look at its admission rules. Proposed changes could make it harder for early-stage tech companies with limited revenue to list.

Nasser says SGX's game plan will be to focus on quality listings. "Some start-ups, they would like to go to the public markets to raise funds before they are ready to do so. We are interested in getting good quality companies, not just any company. And we want them to go grow up right. We want them to get good advice and we think that's in abundance in Singapore," he says.

RHT's Jayaprakash agrees it is more important for SGX to secure quality rather than quantity. "At the end of the day, when you go out into the region, [the Singapore name inspires] trust. That is the badge SGX is able to provide companies," he says. When RHT goes on roadshows overseas to drum up capital markets business, he adds, many foreign companies show interest in a listing here.

Still, venture capitalists often say the start-up game is all about patience. It looks like SGX as well as investors lamenting the dearth of IPOs of exciting, fast-growing companies might well have to be patient too. E