SVCA Singapore Venture Capital & Private Equity Association
#07-02A Far East Finance Building 14 Robinson Road Singapore 048545 * Tel:(65) 6224 7001 * Fax (65) 6224 6772 * UEN No. S92SS0118E

Discussion with MAS on COVID-19

MAS Questions:

a) how the industry, and your members, are coping with the situation; and

SVCA response

Fund level:

- As required by recent MOM and MAS advisories, virtually all PE/VC fund managers have implemented work-from-home or rotating teams with limited impact on operations.
- LPs are asking fund managers what they have done at the manager/fund level and what they are doing at the portfolio level in response to COVID-19.
- While some large and well established fund managers have raised new capital during Q1, we are hearing that for smaller and mid-sized fund managers fundraising has ground almost to a halt as LP investors (i) adopt a wait-and-see attitude, and (ii) are looking to preserve their own capital.
- There is also potential risk of the so called “denominator effect” whereby allocations to private investments suddenly exceed portfolio allocations thresholds of large institutional investors due to overall decline in portfolio values as public market valuations fall dramatically. This may impact (on a temporary or medium-term basis) new commitments or in a worst-case scenario lead to defaults on already committed capital.
- Investment in new portfolio companies has slowed substantially as (i) deals that were already in the pipeline need to be reconsidered given the dramatic changes in the macro environment, and (ii) sourcing and performing diligence on new opportunities has become very difficult due in part to travel restrictions, and (iii) fund managers look to preserve cash so they are in a position to provide support to their existing portfolio companies.
- There have been reports of some investors invoking force-majeure clauses to walk away from uncompleted deals in the region. An example being BGH and OTPP cancelling their bid to acquire Abano Healthcare.
- Fund manager’s ability to support investments that were made out of earlier fund’s will be limited due to (i) lack of unused capital available in such prior funds, and (ii) substantial conflicts that arise with using current fund’s capital to support prior fund’s investments. We understand that some fund managers have already started consulting with LP Advisory Committees on these issues and that some may seek LPAC approval/waiver of cross-fund conflicts.
- Exits from existing portfolio companies are on hold as (i) public markets are largely closed, (ii) strategic/corporate buyers have backed off to focus on their own existing businesses, and (iii) secondary buyers (i.e. other PE firms) are also waiting to see how things develop and generally preserving cash. For funds that are still early in their (typically 10 year) term this may not be terribly problematic as they have time to ride out the storm, but older vintage funds may be pressured to sell at much reduced valuations or hold assets well beyond their stated 10 year term.
- While long term impact on funds is not yet clear, it is expected that IRRs will likely be reduced due to delays in exits.
- Portfolio valuations will almost surely take a hit at the end of Q1 and H1 which will likely have a negative impact on management fees for some funds. This may lead effected fund managers to look to reduce costs, potentially via headcount reductions.
- Some funds employ leverage either to bridge capital calls or as a strategy (for example in buyouts). If LPs fail to honour capital calls, funds could end up defaulting on their bridge loans. The rapid decline in valuations of, and cashflows from, portfolio companies could lead to breaches of leverage

covenants at both fund and portfolio company levels. If these facilities are large enough they may pose some systemic risk.

- Fund managers who have commitments from family offices or individuals are at a heightened risk for capital call defaults. Many VCs in Singapore have such commitments.
- Some concern that as countries look to protect their domestic economies, they may erect additional barriers to foreign investment. We are optimistic that within ASEAN various treaties should protect investments and fund-flows, in particular those that move through Singapore.
- One potentially positive (although probably rare) outcome would be for funds that have sufficient capital available to make follow-on investments in existing portfolio companies at substantially reduced valuations.

Portfolio company level:

- Most portfolio companies have implemented measures to protect the health and safety of their employees and customers.
- Portfolio companies in the information technology and services sectors have started implementing work-from-home and other BCP measures. These workplace measures appear to be working OK but productivity is being negatively impacted.
- Manufacturing companies and those in the travel, entertainment and food services industries are getting hit hard as (i) it is not possible to manufacture-from-home, (ii) almost all travel and live entertainment has ceased, and (iii) the uptick in food-take-away/delivery is not sufficient to offset the fixed operating costs of food service businesses that have seen a massive decline in dine-in customers. In addition, we do not expect commercial landlords to be as accommodating as the Singapore government in situations of tenant stress.
- Some portfolio companies, in particular those offering on-line health services, on-line learning and food delivery, are seeing significant upticks in their business, but they too are facing supply-chain and fulfilment challenges.
- Portfolio companies with significant debt are at hight risk and will likely need lenders to show flexibility in order to avoid defaults.
- Start-ups in Southeast Asia have historically enjoyed a higher cadence of fund raising (i.e. lower amounts but more often) versus their global peers. While this has been good from a dilution perspective, it has left many of these companies with insufficient capital/runway to weather the COVID crisis.
- Start-up valuations in Southeast Asia over the past few years have, in many cases, been relatively high (vs. public markets). For start-ups that have insufficient capital/runway, raising equity rounds now, if available at all, will almost surely mean substantially reduced valuations and very high dilution for the early investors and entrepreneurs.
- Many start-ups have received funding over the past few years from corporate investors (there has been a growing cohort of “Corporate Venture Capital” in Asia). We expect that the uncertainty and negative business impacts of the COVID-19 pandemic will lead many of these corporate investors to put new investments on hold as they refocus on their core businesses.

b) areas that MAS can provide support or assistance to the industry.

<u>**SVCA response**</u>: The Singapore government’s support for the economy through Budget 2020 and the Resilience Budget will go a long way to relieving the economic pain being caused by the COVID-19 pandemic. We note in particular that the support is focused on keeping SMEs afloat and preserving jobs, both of which are critically important to the overall health of the local economy. That said, we are of the view that some of the mechanisms that are being used to achieve this may not be impactful for the PE/VC fund industry and, in particular for the early-stage/start-up ecosystem.

#07-02A Far East Finance Building 14 Robinson Road Singapore 048545 * Tel:(65) 6224 7001 * Fax (65) 6224 6772 * UEN No. S92SS0118E

As we have discussed before, many of the PE/VC managers based in Singapore make most of their investments in portfolio companies outside of Singapore. Regional governments have indicated that they will respond to the COVID-19 crisis with support for their economies, but this is unlikely to be as broad or effective as what Singapore is doing for local companies. Many Singapore based managers will thus see substantial value deterioration in their regional portfolios. This will lead to lower fees being received by the managers and reduced likelihood of earning carry/performance fees. All of which may lead to managers to reduce their operating costs in Singapore.

With respect to the support measures in the Resilience Budget, we would note:

(1) The deferment of income tax payments, while helpful, will (i) not be very meaningful for most small to mid-size PE/VC fund managers who tend to have very little profit from their operations, and (ii) be almost irrelevant for most of the current cohort of early-stage/start-up companies in Singapore which are still in the high growth but money-losing stage of development.

(2) The wage support provided by the Enhanced Jobs Support Scheme will be a benefit to all businesses in Singapore, but due to the wage ceiling and the local employee requirement, it may not be that impactful for fund managers and early-stage/start-up companies. While the wage ceiling under the Resilience Budget is more favourable and is above the nationwide average, it remains well below what most employees of fund managers get paid, as well as meaningfully below what most "tech" employees get paid in the start-up environment. In addition, both fund managers and start-ups tend to have a lot of non-local employees – fund managers needing them for regional networking capabilities and start-ups leveraging regional pockets of technology expertise.

(3) Most fund managers and start-ups are not based in government-owned/managed non-residential facilities (other than Block 71), and thus will not benefit from rental waivers.

(4) Most fund managers and start-ups rent their office space and thus may be unlikely to see the benefits of the enhanced property tax rebates for non-residential properties (the landlords seem likely to benefit most). The government might consider strongly encouraging (or requiring) landlords to pass-through all (or a substantial portion) of the real estate tax relief to their tenants.

(5) Fund managers rarely avail themselves of credit facilities (for working capital) and start-ups usually do not qualify (even with risk sharing) thus we do not expect the enhanced financing support made available in the Resilience Budget to have an impact on fund managers or early-stage companies in Singapore.

Suggestions from our members for how MAS (or the Singapore government more broadly) might specifically help the fund management industry at this time:

(1) Further enhancement of the wage support scheme targeted specifically at fund managers. This could take the form of raising the wage ceiling and perhaps expanding the categories of employees who qualify for such support. If that is not possible then perhaps an alternative scheme could be implemented whereby MAS lends funds to fund managers to support their operations/employment with such loans to be forgiven if the fund manager maintains its current level of headcount for a minimum period (say six months).

#07-02A Far East Finance Building 14 Robinson Road Singapore 048545 * Tel:(65) 6224 7001 * Fax (65) 6224 6772 * UEN No. S92SS0118E

(2) More flexibility from MoM on EP renewals. While we recognize that preserving jobs for Singaporeans is at the top of the government's agenda, we would suggest that the last thing that the fund management industry needs now among all the other external stresses is additional disruption from having to recruit new talent if EPs are not renewed.

(3) MAS (or another government agency) could provide direct support for the growth capital and the start-up ecosystem through one or more of:

(i) interest-free "venture loans", perhaps with attached warrants that would allow the government to participate in the gains for those companies that survive this crisis and go on to future success;

(ii) matching/co-investing (at subsidised rates) in portfolio companies that receive rescue funding from PE/VC funds (like what was done in the Technology Incubator Scheme, or the fixed return co-investment structures that ESVF implemented);

(iii) outright grants to start-up companies that are working on innovation or productivity enhancement that will be accretive to the Singapore economy in the medium to long run (if they survive).

c) MAS table:

SVCA response: most of these questions seem more relevant to hedge and/or credit funds rather than PE/VC, but see responses below.

S/N	Topic	Points for discussion	SVCA Comments
1	**Market conditions**	▪ **Feedback on members' funds** ▪ **What are PEVC managers most concerned about with respect to current market conditions?**	In addition to the matters highlighted in our responses to MAS question a) above, we would note: Global central bank action has been substantial, and markets appear to have stabilized somewhat, but we expect greater than normal volatility to continue. In particular given the many macro uncertainties we expect borrowers to face an uphill battle with lenders (in terms of new credit and amending existing facilities) for some time. We have noted a slowdown in M&A and private debt markets. Short term market volatility may be less damaging to PE/VC funds (as compared to hedge/credit fund) given PE/VC fund's extended lifecycles, but the industry will still suffer meaningful negative effects.

#07-02A Far East Finance Building 14 Robinson Road Singapore 048545 * Tel:(65) 6224 7001 * Fax (65) 6224 6772 * UEN No. S92SS0118E

2	**Operational resilience**	▪ **Feedback on the implementation of measures in the advisories disseminated over the last few weeks.** ▪ **Does adhering to the advisories pose specific impediments or problems for fund managers in the course of their daily business?**	While we understand there was some initial uncertainty in the PE/VC industry as to the full intent of the recent advisories, we believe that the industry has not found the MAS advisories difficult to adhere to in practice.
3	**Regulatory requirements**	▪ **Feedback on regulatory requirements that members may have difficulty complying with or could be relieved from under current conditions, e.g. borrowing and leverage limits for funds.**	An extension of filing deadlines (as has been rolled out in other context and countries) would be welcome as fund managers may need more time to gather and compile information from teams working remotely. MAS being flexible with respect to fund managers who temporarily fall below capital adequacy requirements would be supportive given funding and liquidity issues currently faced by some managers. As we have highlighted before, we remain of the view that PE managers (and the fund management industry in general) would benefit from a regulatory approach that is similar to that available for the VC managers and that such an approach would not materially increase the risk in the industry.
4	**Other assistance or support that can be rendered by MAS**	▪ **Feedback on other possible areas that MAS can provide support or assistance to the industry.**	Please see above responses to MAS question b).