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FIRSTNEWS VOL 07, MAY 2021

EQUITIESFIRST™ Progressive Capital

FINANCING DISPARITY BETWEEN OWNERS OF SMALL CAPS VS LARGE CAPS

BACKGROUND

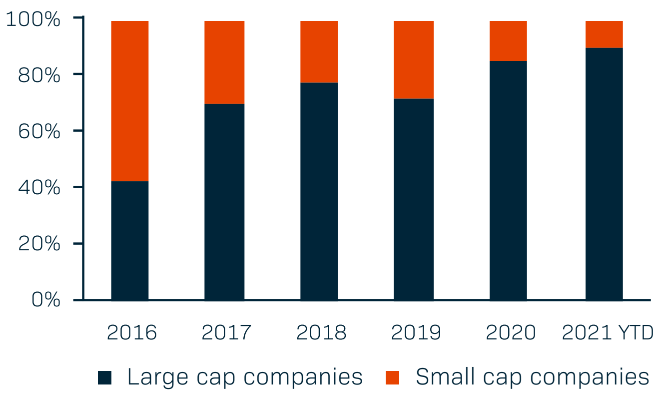
- We have seen a spike in fundraising activities in 2020 and 2021 YTD across both equity and debt capital markets in Asia as corporates strive to survive through COVID-19.
- Nonetheless, this was driven largely by the large cap companies (>US$ 1bn market capitalization) while small cap companies struggled to access capital.
- We analyzed the fundraising activities in Asia (using Hong Kong / China, Singapore, Thailand, South Korea as proxies for the region). We made the following observations:
  - **While the total capital raised through new IPOs in Asia increased 25% YoY in 2020, this declined 35% YoY for small cap companies.**
  - **While the total capital raised through the issuance of new bonds in Asia increased >100% YoY in 2020, this declined 11% for small cap companies.**

KEY TAKEAWAYS

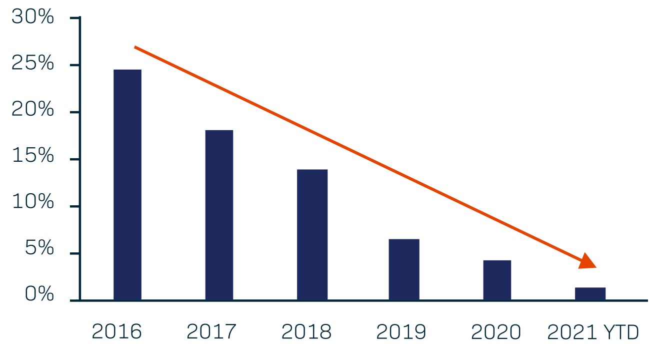
- The key reasons for the lack of investor appetite for Asia small cap companies include 1) their share price underperformance vs large cap companies in the last 4 consecutive years, despite the higher beta/share price volatility; 2) the lack of analyst coverage; and 3) increasing default risk for new bond issuance.
- While small cap companies are struggling to raise capital, **EquitiesFirst** can assist the **substantial shareholders** of these firms to access financing through share-backed lending. Given the non-purpose feature of the loan, the substantial shareholder has the flexibility to lend the capital back to the company.
- While small cap companies may not qualify for margin lending from private banks, they may qualify for a loan from **EquitiesFirst** given its lower minimum market cap and liquidity requirement. **EquitiesFirst** is able to provide competitive financing which is both non-recourse and non-purpose.

Large cap companies are taking an increasingly high market share in terms of capital raised across equity capital markets (IPO and share placement) and debt capital markets (new bond issuance):

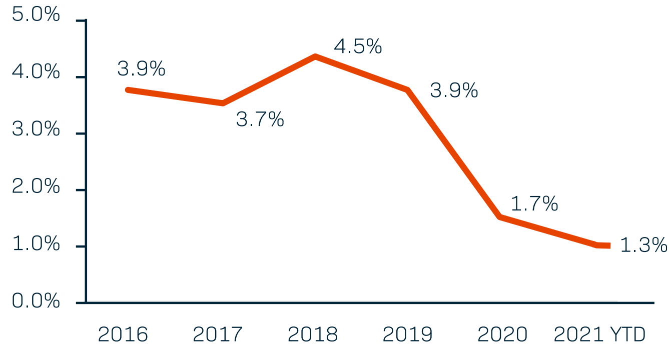
MARKET SHARE BREAKDOWN OF NEW INITIAL PUBLIC OFFERINGS (BY CAPITAL RAISED)



MARKET SHARE OF SMALL CAP COMPANIES IN ADDITIONAL SHARE OFFERINGS (BY CAPITAL RAISED)



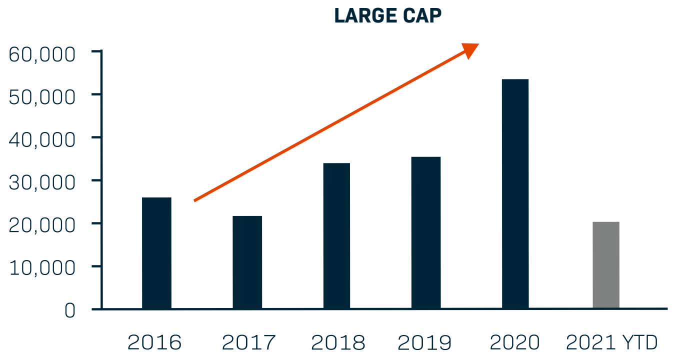
MARKET SHARE OF SMALL CAP COMPANIES IN NEW BOND ISSUANCES (BY CAPITAL RAISED)

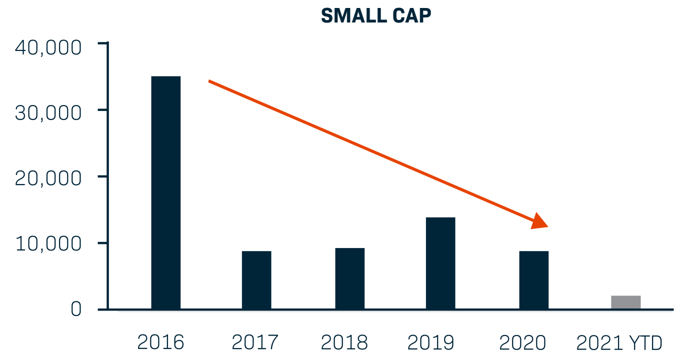


Source: Bloomberg

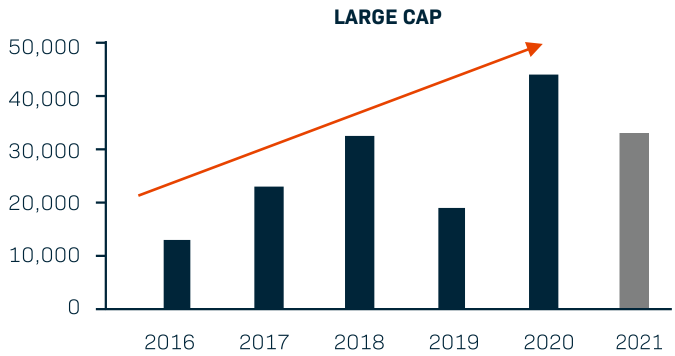
We have seen a spike in fundraising activities in 2020 and 2021 YTD across both equity and debt capital markets in Asia as corporates navigate the economic impact of COVID-19. Nonetheless, this uptick was driven purely by large cap companies (>US$ 1bn market capitalization) while small cap companies struggled to raise capital. While large cap companies are gaining traction in raising capital through IPOs, additional share offerings and new bond issuances, it has been the polar opposite scenario for small cap companies.

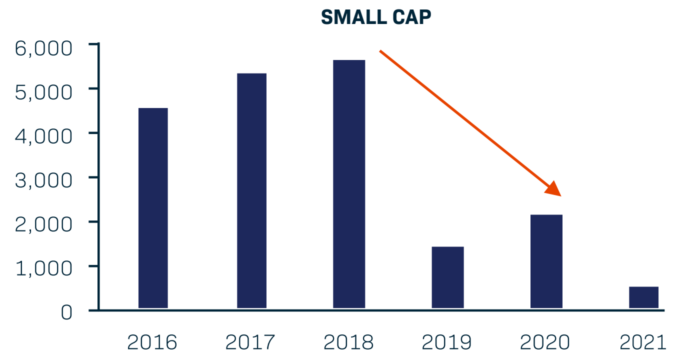
Capital raised through new IPOs (USD mn)



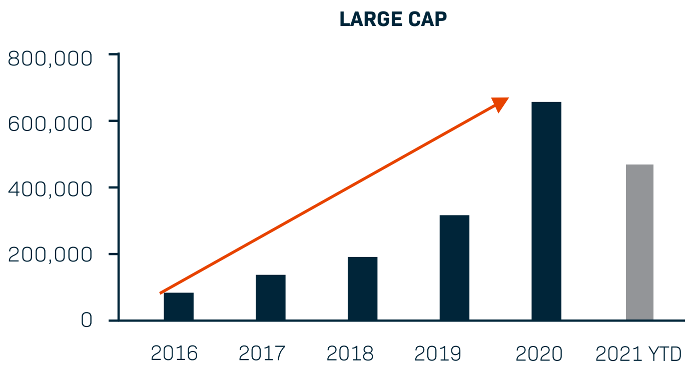


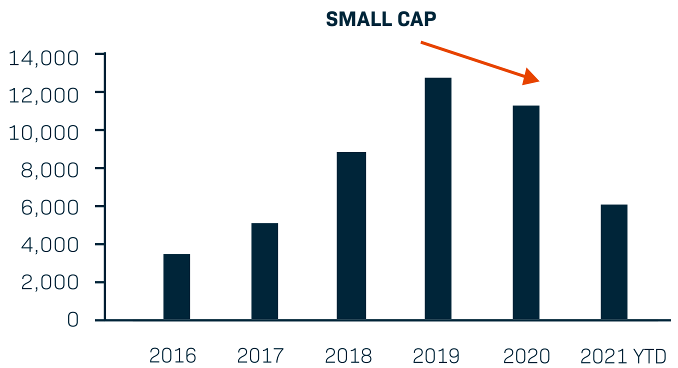
Capital raised through additional share offerings (USD mn)





Capital raised through new bond issuance (USD mn)





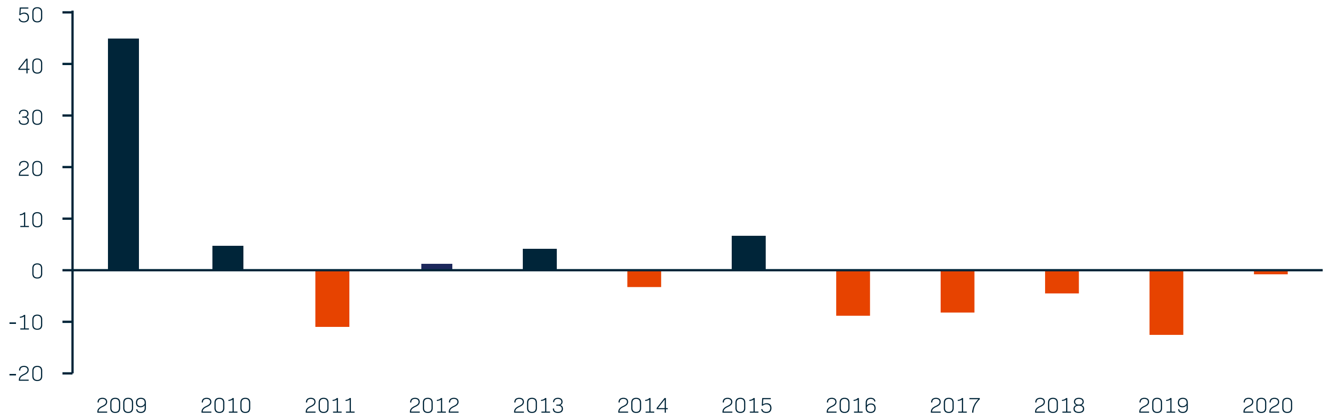
Source: Bloomberg

The key reasons for the lack of investor appetite for Asia small cap companies include:

1 THE MISMATCH BETWEEN HIGHER RISK AND HIGHER RETURN

Small cap companies have higher share price volatility than large cap companies (62% vs 46% on 90 days share price volatility). In theory, investors would need a higher expected return to compensate for the higher risk. However, there has been a mismatch. Despite the higher risk, Asia small caps have underperformed large caps in the last 4 consecutive years (proxy from MSCI Asia ex Japan indices).

SHARE PRICE OUTPERFORMANCE/UNDERPERFORMANCE OF ASIA EX JAPAN SMALL CAPS VS LARGE CAPS



2 LACK OF ANALYST COVERAGE AND MARKET COMMUNICATION

Large cap companies in Asia (using the Hong Kong / China, Singapore, Thailand and South Korean markets as a proxy) have research coverage from 12.6 analysts, on average. In contrast, small cap companies in Asia only have 0.5 analysts covering them on average. In addition to the lack of analyst coverage, small cap companies typically do not have a dedicated investor relations team. Management teams take on a greater role in investor communications, but also rely on outsourced PR agencies.

3 INCREASING BOND DEFAULT RISK ACROSS THE REGION

In the past 2 years, there were 6 bonds issued by small cap companies which defaulted. The total value of these defaulted bonds is US$ 1.1bn, with coupons in the 6.5% to 10.0% range. In comparison, none of the bonds issued by large cap companies have defaulted in the last 5 years.

LIST OF BONDS ISSUED BY SMALL CAP COMPANIES WHICH HAVE DEFAULTED IN THE LAST 5 YEARS

#	Issuer Name	Ticker	Default Date	Coupon	Amount Outstanding (USD)
1	Asia Capital Group PCL	ACAPTB	6/18/2020	6.50	2,357,979
2	Hilong Holding Ltd	HILOHO	6/22/2020	7.25	165,114,000
3	Century Sunshine Group Holdings Ltd	CENSUN	7/3/2020	7.00	73,640,647
4	Hilong Holding Ltd	HILOHO	10/16/2020	8.25	200,000,000
5	GCL New Energy Holdings Ltd	GCLNE	1/30/2021	7.10	500,000,000
6	Carnival Group International Holdings Ltd	CARINT	3/22/2021	10.00	180,000,000

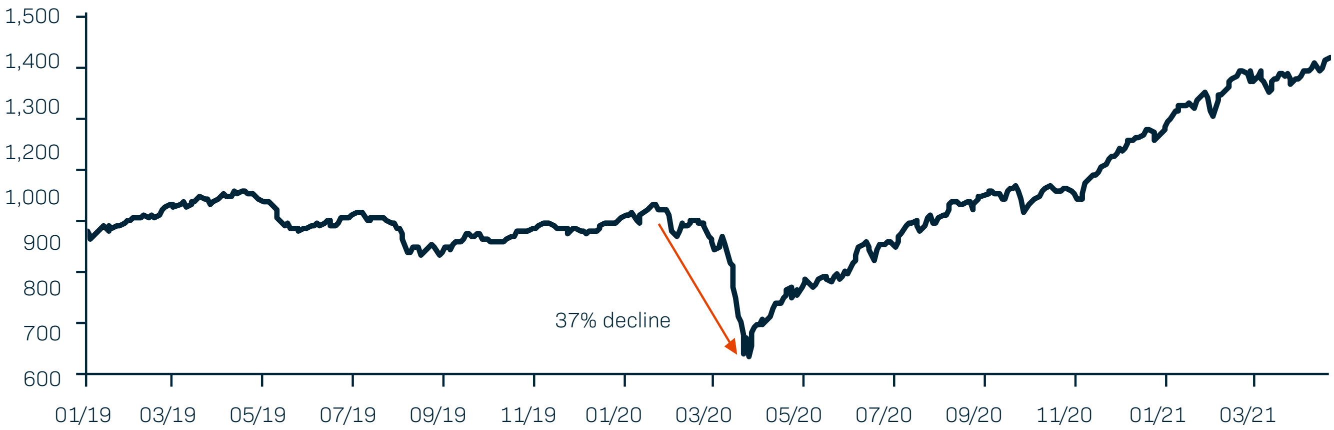
Source: Bloomberg

While small cap companies may not qualify for margin lending from private banks, they may qualify for a loan from **EquitiesFirst** despite lower market cap and liquidity. We can transact with substantial shareholders of small market cap companies, while still providing competitive commercial terms. Because **EquitiesFirst** financing is non-purpose, the shareholder is free to use this facility as a source of working capital or as a refinancing facility for their operating company. This can be a vital solution for the financing shortfall in the small cap space. Furthermore, the **EquitiesFirst** model is inherently medium term and more accommodating to share price volatility.

MARGIN CALL ADVANTAGE

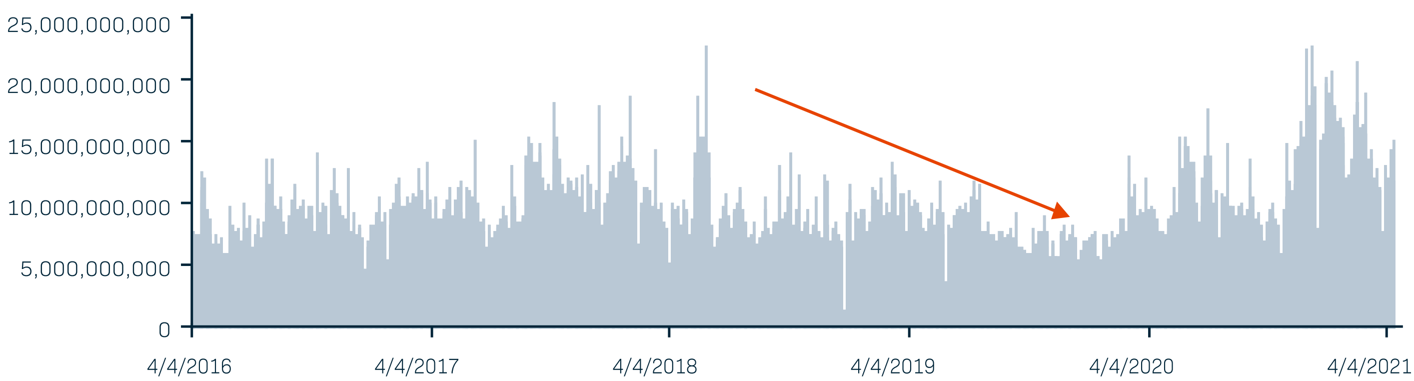
In early 2020, when the market was factoring-in the impact of COVID-19, the MSCI Asia ex Japan Index dropped by 37%. Shares pledged to a traditional bank would have been subject to margin calls. **EquitiesFirst's** margin call threshold is calculated as 80% of the loan LTV. In other words, assuming an LTV of 65%, the margin call threshold would not be breached until a decline of more than 48%. Even the market correction in 2020 would not have triggered such an event for small caps, on average.

MSCI ASIA EX JAPAN SMALL CAP INDEX SHARE PRICE PERFORMANCE



There are also times which the trading volume of small cap companies have declined, especially when investor sentiment is cautious or uncertain. Asia small caps have been subject to such liquidity fluctuations (proxy from MSCI Index), such as in 2019 and early 2020. A decline in trading volume is a common margin call trigger for typical share-backed lending by banks. These lenders have the right to adjust their margin call thresholds and requirements at will and take into account volume, volatility, and portfolio composition as well as price. In comparison, **EquitiesFirst** has fixed and transparent margin call terms which track only the change in market price.

VOLUME OF ASIA EX JAPAN SMALL CAP INDEX



Source: Bloomberg

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