PRIVATE EQUITY COMES OF AGE

ALL STORIES BY **ELAINE BOEY**

Private equity (PE) has graduated from being a little-known asset class on the fringes of the investment world to the mainstream. This alternative asset class allows high-net-worth individuals to invest in high-potential private companies via a PE fund.

In exchange for a fee, the PE firm (known as the general partner or GP) uses its strategic, operational and financial expertise to create value for the investee company and eventually exits at a premium to its acquisition cost. This is when returns are generated for the investors, known as limited partners (LPs).

The PE industry in developed markets has benefited from low interest rates, economic growth and unprecedented investor interest, mainly due to the strong returns generated. A 2017 white paper by independent retirement planning company Voya found that the asset class outperformed the S&P 500 from 1996 to 2016.

PE has attracted institutional investors from around the world, including some of the largest asset managers in Malaysia such as the Employees Provident Fund, Permodalan Nasional Bhd and Kumpulan Wang Persaraan (Diperbadankan). As a result, the global PE industry's dry powder (available investment capital) hit a record US$2 trillion at the end of last year.

The value of PE deals globally has increased every year since 2014, although the number of individual transactions has been curtailed on the back of rising valuations. Meanwhile, global PE net asset value surged 18% last year. According to the McKinsey Global Private Markets Review 2019 report, global private net asset value has grown 7.5 times — twice as fast as public market capitalisation — in this century. Southeast Asia's contribution to global PE and venture capital (PEVC) assets under management (AUM) is modest but growing quickly. According to Preqin — the leading provider of financial data and information on the alternative assets market — the region made up less than 1% of the US$3.6 trillion in global AUM at the end of last year. Between 2017 and 2018, Asean's PEVC AUM rose 8.6% to US$28 billion from US$26 billion.

Malaysia participates in the global PE industry through a small number of local firms and, in particular, Ekuiti Nasional Bhd (better known as Ekuinas), the only government-owned PE firm in the country.

This special report, done in conjunction with the *Malaysian Private Equity Forum 2019*, the growth, nature and outlook of the local PE industry is discussed while local LPs describe the long-term trends and opportunities. The report offers critical insights into these trends as well as highlights the importance of this alternative asset class to investors and the opportunities in the local industry. It also serves as a guide to the role played by PE in Malaysian companies facing challenges in their industries and the external environment as well as those looking to grow into future market leaders. E

A quiet performer in a challenging industry

Ekuinas proves its worth as an active investor in Malaysian companies

Ekuiti Nasional Bhd (Ekuinas) was established 10 years ago to promote equitable and sustainable bumiputera economic participation by finding and developing the next generation of leading Malaysian companies.

Back then, it was an untested business concept and many were unsure whether the team entrusted with the task would have the tenacity and capability to find deals, create value for their investments and eventually exit them.

Over the years though, Ekuinas has displayed its ability to not only find, invest and enhance the business of high-growth Malaysian companies but also exit from its investments and generate returns. For example, the Ekuinas Direct (Tranche II) Fund — which was fully deployed and currently being crystallised — made a gross internal rate of return of 14% in 2018, surpassing the firm's internal benchmark of 12%. This is an especially commendable performance when compared with local equities, which declined 5.9% (as registered by the benchmark FBM KLCI) during this period.

Ekuinas stands out as a private equity (PE) fund with two objectives — to generate strong returns for stakeholders and to create positive change in society. To deliver on its social objectives, the firm seeks to increase bumiputera equity ownership in its portfolio companies, grow the number of bumiputera talent across industries, distribute its gains to the wider bumiputera community and directly impact the bumiputera community through its corporate social responsibility (CSR) programme, Iltizam.

Ekuinas' reputation as a credible PE player in the region was cemented last year when it was recognised as one of the top three firms in the "Best PE Firm in Southeast Asia" category in the prestigious PE International Awards 2018.

Here, CEO Syed Yasir Arafat Syed Abd Kadir talks to *The Edge* about Ekuinas' 10-year journey, the challenges it has faced and how it has managed to deliver on its mandate.

***The Edge:* Ekuinas celebrates its 10th anniversary this year and during this time, you have managed to prove that a government-owned PE firm with social and commercial objectives does work. What has the journey been like?**

Syed Yasir Arafat: Ekuinas' business model started as a concept and there were many scepticism initially as no one was really sure whether a PE firm with a Malaysia-focused mandate would be viable. Just a decade ago, PE was a nascent industry and there was an overwhelming number of views that deal flows were limited and potentially unsustainable. Furthermore, it was extremely difficult to find people with PE experience. So, we had to learn from the ground up. It was a challenging period, but we managed to demonstrate that we could sustain deal flow and play an important role in value creation and ultimately exit our investments and generate returns.

Tell us about your financial performance and some of the more notable achievements.

PATRICK GOH/THE EDGE

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> ***Syed Yasir Arafat***

First, we have made a return on our investments as seen in the performance of our funds. We have also proved to critics that we are true PE investors, not just an asset allocation firm, and able to create long-term business value for our portfolio companies.

With 10 years of experience, we have been through the entire PE cycle from deal sourcing to value creation and exits, all taking place at the same time. Only a small number of local PE firms have experienced this end-to-end process.

When Ekuinas started operations, the PE industry consisted of a small number of sporadic deals. No one had any idea if it was possible to find sufficient and suitable high-growth local companies to invest in. But we managed to invest in 23 companies across different industries, and have already exited from 10 of them.

The ability to exit is very important for any investor. Ekuinas operates entirely as a commercial entity. This means all our exits were done at the highest commercial value in the free and open market, and without prejudice.

Having said that, if we sold to a private buyer, we ensured that the new owner would be able to support the continued growth of our portfolio companies.

We have been able to exit from our investments in multiple ways, from going public to private sale, having restructured the companies. It shows the vibrancy of the local PE market and speaks of our experience in crystallising returns.

I believe Ekuinas has played a role in the development of the local PE industry. Now, there are more players, much more interest and consequently more deals and more exits. If you look at the number of PE transactions in the market, it is clear that it is no longer a nascent industry.

The global PE industry has done extremely well in the past five years. During this time, this alternative asset class had attracted unprecedented amounts of capital and outperformed the more traditional asset classes. How would you describe Malaysia's PE industry now?

For the longest time, many people — companies and entrepreneurs — had very little idea about PE and what we could bring to the table as their partners. This has changed over the years. Now, founders or the senior management of companies are aware about PE and are able to talk about the valuation of their businesses and the kind of partners they are looking for. In Malaysia, PE is especially relevant to mid-market companies.

There is a lot more capital flowing towards PE around the world and this is driving up the valuations of companies and heightening competition. Some have described this as 'more money chasing fewer deals' and we can see this taking place in the country.

I believe these are signs of a robust industry that is successfully serving the needs of institutional investors, which are looking for higher returns and portfolio diversification. Clearly, PE is increasingly important as an investment option and as a source of funding.

What are some of the critical factors behind Ekuinas' success?

Organisationally, from day one, we were set up in line with the best practices of global PE firms.

We have a separate LP and GP structure although Ekuinas is owned by a foundation established by the government. We set up our funds according to vintage years, as opposed to co-mingling our investments, as this facilitates the benchmarking of each fund's performance. Furthermore, our board members are highly regarded professionals in their respective fields. Usually, there is a minimum representation from the government on our board. None of our board members has vested interest [in our portfolio companies]. So, it is truly an independent board, notwithstanding our parentage.

Although we have social objectives, it has always been clear that our commercial objectives have to prevail to ensure that our operations are sustainable and we avoid the trap of turning into a disbursement agency. We have been committed to the highest level of transparency since the beginning and are among the few government investment institutions that publish an annual report. We announce all our investments and divestments to the public, and this is over and beyond the general practice in the industry. When we closed our maiden fund, we appointed the Centre of Asia Private Equity Research (CAPER) to undertake a benchmarking exercise to compare our performance against those of our peers in the region.

We have a robust decision-making and investment evaluation process because we wanted to have a proper set-up for our PE activities from the get-go. We invested in talent, systems and capacity building to ensure that we had the necessary ingredients to become a successful PE firm. Our talents are from different backgrounds, including investment banking, consulting and audit firms. We also have former entrepreneurs working with us.

We ensure that our employees are deeply involved in our transactions and portfolio companies. This is especially important as more than 90% of our deals are buyouts and Ekuinas is an active shareholder. Over the years, we have continued to invest in our capabilities. We also intensely engage with the management teams of our portfolio companies to ensure that shared visions are executed. In 2015, we built a portfolio management and monitoring team to intensify our value-creation initiatives.

How do you tie your social objectives with your commercial objectives?

The returns from our investments are channelled to benefit the wider bumiputera community through our gains distribution. Similar to what we did in 2014 where we distributed RM200 million to Yayasan Pelaburan Bumiputera.

On top of that, we also reach out to the deserving bumiputera communities through our corporate social initiatives. These initiatives are carried out through our CSR programme called ILTIZAM.

ILTIZAM consists of three pillars: entrepreneurship, education and community. The beneficiaries of each pillar are carefully selected and we seek to make the most meaningful impact for the recipients as well as the broader society.

Describe the value-enhancing activities in one of your investments. Perhaps an example of how technology was used to create value with the advent of the Fourth Industrial Revolution (Industry 4.0)?

We invested in bumiputera sporting goods retailer Al-Ikhsan in 2016. This was our first investment in the retail sports equipment segment and we saw tremendous opportunity to optimise its supply chain and ensure that its retail partners received the right goods in a timely manner. By working together, we identified an optimisation algorithm to improve the movement of goods in terms of the number of items and retail locations. We also matched supply with demand, minimised human interaction and leveraged existing systems in the company.

And the results?

We tested the new system in a pilot project on about 20% of Al-Ikhsan's inventory. The results were impressive as the company made an additional RM8 million in top-line growth within seven months. The system also generated processing efficiency — what was previously done in a week with three employees is now performed in three hours by one person. We are working to roll out the system for all of Al-Ikhsan's inventory and look forward to harnessing the full potential of systems and technologies to benefit Ekuinas and all our portfolio companies in this digital age.

How big is the team at Ekuinas? Are you looking to grow the firm?

We currently have about 24 employees in our investment team. We are relatively lean, but that is the nature of PE firms. This way, the senior PE investing team members are always directly involved in the deals. It is easier for our portfolio companies and prospective ones to talk to us. They do not have to deal with cumbersome organisational hierarchy.

What are some of the challenges you have faced over the years?

There have been many. One challenge was creating an understanding that our results, although reported yearly, are not based on our performance or actions taken within a single year. As with any other PE funds, our returns are based on deliberate efforts over time to build a diversified fund portfolio consisting of robust companies that are able to sustain, and even thrive, in an everchanging, challenging and volatile environment.

Furthermore, our value creation initiatives are designed to build a long-term sustainable business. But our portfolio companies, our investments, report their financial performance on a yearly basis and that is subject to the overall macroeconomic environment during that period. Clearly, it is inaccurate to draw any definite conclusions on their viability. Our peers typically do not report on their performance on an annual basis.

We talked about more dry powder, more competition and fewer deals in the global PE industry. Is this seen in the region and does it pose a challenge for Ekuinas?

Clearly, more foreign PE firms coming to Malaysia for deals heightens competition. But it is good for the industry, although valuations are going up and deal multiples are now higher than before. This means more value-creation activities are needed to make a good return on investment.

What we need to do in such an environment is sharpen our due diligence to ensure that we are paying the right price for an investment. We also leverage our insights and experience in the Malaysian market as well as our local connections. This should enable us to identify potential acquisitions in advance of our competitors. At the same time, we also have to prepare for an increasingly challenging economic period.

Can you tell us a bit about your personal growth as CEO of Ekuinas?

I have been with Ekuinas since the beginning and started as the managing partner of investments. I have seen the company grow throughout an entire economic cycle consisting of both good and challenging times. Frankly, it has been a tough journey but a fulfilling one as I — and the rest of the team at Ekuinas — am always learning and improving.

The initial team and I had to learn from the get-go and we worked extremely hard to prove an unproven business concept [a government-owned PE fund with commercial and social objectives]. It is also important to note that the board of Ekuinas has been instrumental in its growth and success. They were very supportive when I took the helm four years ago and have provided invaluable advice, guidance and insights over the years. E